



Kallum Pickering, Senior UK Economist | Kallum.pickering@berenberg.com | +44 203 465 2672

BREXIT UPDATE: FINALLY, WHITE SMOKE - UK ECONOMY SHOULD IMPROVE NEXT YEAR

Berenberg Macro Flash

Early this morning EU President Jean-Claude Juncker announced that the EU Commission has recommended that 'sufficient progress' had been made on the three key elements of the Brexit divorce talks; citizens rights, the Irish border, and the Brexit bill. This followed discussion well into the early hours of this morning and came after a long week of heavy negotiations around the key sticking point, the contentious Irish border question which has now been settled. Remember, it was the dispute between the Conservatives, their ally the Northern Irish DUP, and Dublin, on the initial wording of the agreement on the Irish border that scuppered the Monday breakthrough.

While the leaders of the EU27 will still need to endorse the deal to allow discussions to move forward onto the transitional and trade talks, it is likely that the 27 member states will follow the recommendation of the EU Commission. EU council president Donald Tusk will speak later today and is likely to set the agenda for the 14 December summit – he is likely to signal that post-Brexit trade talks can begin shortly.

WHAT HAPPENS NEXT?

With sufficient progress made in the divorce negotiations the UK and the EU will move onto trade and transitional talks at the upcoming 14 December EU Summit. The progress today supports our above-consensus near-term growth calls for the UK of 1.8% in 2018 and 1.9% in 2019 (Bloomberg consensus 8 Dec – 1.4% in 2018 and 1.6% in 2019). Now that firms and households will likely expect that a soft Brexit has become more likely, the global upturn can now begin to rub off on the UK more next year. Higher business and household confidence from the lower risk of a hard Brexit should underpin stronger gains in long-lived consumption and investment.

Our Brexit base case therefore remains unchanged. We expect the UK to accept by late 2018 a transition deal (possibly similar to the Norway deal minus some financial market privileges) for 2 or 3 years (80% probability). Since it will be difficult to change such an arrangement very much over time, major parts of this arrangement could solidify into the final terms for post-Brexit trade between the UK and the EU. In this base case, Brexit could reduce trend growth to 1.8% from the pre-Brexit rate of 2.2%. The key risk remains that the UK will or opt for a hard Brexit with few follow-up arrangements for privileged access to the EU27 market (20% risk). In a hard Brexit, UK trend growth could fall to 1.5%.



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Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com