



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

BREXIT: FOCUS ON THE SIGNALS, NOT THE NOISE

Berenberg Macro Flash

As the tense Brexit negotiations come to a head, the high-pressured environment makes for even noisier politics than usual. In conversations with clients, we have noticed a change in focus on Brexit discussions in the past few weeks. Amid the quick-fire deal making in Brussels and London, technical details and rumours about the state of play seem to be in focus more than before. While certain details are crucial (such as the nature of the 'backstop' agreement for Northern Ireland), we ought not to lose sight of the big picture.

On this basis, three points are worth keeping in mind:

1. **The bulk of the deal is agreed:** PM May, her Brexit secretary Dominic Raab, and lead EU negotiator have all said in recent days, in one way or another that the deal is pretty much done. PM May claimed yesterday in parliament that '95% of the deal is done'. Reading between the lines, UK and EU technocrats seem to have more or less agreed the key principles of the withdrawal agreement. At home, May has already paid a significant price for softening her stance during the Brexit negotiations. Amid threats of a leadership challenge, she cannot be seen as taking a soft approach with the EU at the final stage of the talks. She may indeed hope that, by pushing the negotiations to the line, last minute concessions from the EU are possible. This is unlikely. The EU27 has already agreed its position and is unlikely to shift much at this stage. The remaining talks are now mostly about altering the language of the deal here and there, as the British say 'constructive ambiguity', and adjusting the terms at the margin – while keeping the key principles the same - in order to produce a deal that PM May thinks has the best chance of: a) passing in parliament; and b) not causing her government and party to completely unravel.
2. **PM May still seems safe for now:** Despite widespread reporting in UK press that the Conservative Party is just a couple of signatures short of the 48 needed to trigger a vote of no confidence in Prime Minister Theresa May, she still has a good chance of remaining Tory leader and PM until at least the Brexit deal is agreed at the UK-EU level and passed through the respective parliaments, and probably, some time into the transitional period which is set to begin in April 2019. May's spokesperson announced yesterday that she would not face the Conservative Party's 1922 Committee - to make her case for remaining leader – tomorrow as was widely speculated at the weekend. With no obvious challenger that can carry a majority among Conservative MPs, and probably, with not enough MPs to bring her down in a vote of no confidence (there are 315 Conservative MPs in the House of Commons), May is probably safe for now. Since whoever replaced May would face the same challenges as her, any moderate that could carry a majority within the Tory ranks probably does not really want the top job just yet.
3. **Our base case is still a deal by year-end:** PM May's willingness to cross so-called 'red-lines' throughout the negotiations highlights the key point – her threat that 'no-deal is better than a bad one' is not credible. As long as May is in No. 10, she will likely do all



BERENBERG
PARTNERSHIP SINCE 1590

MACRO NEWS

she can to strike a deal and avoid a hard-Brexit. However, the risk that May missteps – either by pushing the limits of her own MPs too far and losing her job, or presenting a deal that cannot pass in parliament – is significant. We see a 60% chance that May will strike a deal with the EU (probably by December) before trying to unite as much of her party as possible around her deal and passing it via a vote in parliament shortly thereafter. With some cross-party support, we would expect PM May to get such a deal through parliament. Most Conservative MPs along with some moderates from the Liberal Democrats, the Labour Party and the other smaller parties, would back any sensible deal that avoids a hard Brexit and keeps the Irish border open. However, the tail risks around this outlook are large (20% chance of a hard Brexit, 10% chance of a soft Brexit, and 10% chance of no Brexit)

Economic impact of a Brexit deal: If the UK and EU strike a deal and avoid a hard-Brexit, further improving household fundamentals will add to domestic demand growth in 2019 and beyond, while falling uncertainty will add to business confidence and investment spending. On this basis, we expect real GDP growth to accelerate from around 1.3% in 2018 to 1.7% in 2019 and 2020 and the BoE to step up the pace of rate hikes to two per year (versus one hike each in 2017 and 2018). Based on recent wage and inflation trends the risks to our forecasts are skewed to the upside.

For our recent analysis on Brexit please see:

[Brexit talks hit a wall – what happens now?](#)

[Brexit: Breakthrough ahead?](#)

[Brexit: Entering the hot phase](#)

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact capitalmarkets@berenberg.de.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3753 3001
www.berenberg.com
carsten.hesse@berenberg.com