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BREXIT: CROSS PARTY TALKS STILL AT AN IMPASSE

Berenberg Macro Flash

Still no progress: The UK's Brexit debacle has quietened of late, with the newsflow mostly focused on the ongoing cross-party talks to break the impasse. All options remain on the table in the UK, including no Brexit, a hard Brexit and even another extension beyond October. The slow recent developments have not led us to change our key calls: hard Brexit (20%); May's deal (5%); customs-union model (45%); Norway-plus model (10%); and no Brexit (20%).

May-Corbyn talks still ongoing, but no sign of a breakthrough yet

Technical talks between Prime Minister Theresa May's and Labour leader Jeremy Corbyn's teams continue. They want to find an option for the future UK-EU relationship that both party leaders can back and that parliament could support. The mostly likely outcome, if indeed the talks succeed, would be for the leaders to propose that the UK remained in the EU customs union with close regulatory alignment with the EU in goods. May would then ask parliament to vote on the withdrawal agreement (WA).

Parliament will have to pass the WA for any May-Corbyn plan to take effect. Whether parliament will do so is the most market-relevant issue for now. Passing the WA would remove the risk of a hard Brexit entirely, ensure that the Irish border remained open in all circumstances, and guarantee that the UK would remain in the single market during any transitional period that would last until at least the end of 2020.

But the talks are difficult. There are major sticking points. Even if May and Corbyn could bring such a proposal to parliament, it is not guaranteed to pass – probably yes, but not certain. The hardline Eurosceptic wing of the Conservative Party rails against the idea of keeping the UK in the EU customs union. On the other side of the political aisle, pro-EU Labour MPs continue to push their party towards backing a second referendum.

Aside from the politics, there are practical issues. Corbyn wants assurances that any agreement would be protected from a future hardline Brexit prime minister. This is a pressing issue given the growing pressure on May to resign as Conservative leader and prime minister. Labour worries that a Boris Johnson or the like would renege on the agreement if they ever became prime minister. In addition, May apparently wants to set the arrangement as a temporary solution, until the general election in 2022, to allow major parties to then campaign on whatever their preferred outcome for UK-EU trade is. May wants to contain the risk of a revolt by Tory hardliners. We doubt, however, that Labour or Brussels would go for such a plan, which is so clearly designed, first and foremost, to keep peace within the Conservatives. As a compromise, the EU might agree to a permanent agreement that included a clause to renegotiate after a long time.



Is there a plan B?

If the cross-party talks break down, May will probably try her luck in parliament by holding a series of indicative votes on the various options for future trade with the EU. So far, though, parliament has managed to muster a majority only against a hard Brexit but not for any of the potential options for the future UK-EU partnership. May has set a bad example. By trying and failing time and again to pass her own version of the Brexit deal (WA plus plans for a UK-EU free trade agreement), she has de facto kept alive all possible options.

MPs believe that, if they hold out long enough, their own preferred option for the future partnership will eventually come around. For indicative votes to clarify the situation, May would need to reduce the options, or at least establish a mechanism that definitively removes the options that MPs have rejected. If MPs face a limited number of options against the threat of a hard Brexit as the alternative, they would probably support one of the compromises eventually.

Plan C?

If none of the above works, the options would be a second referendum or a hard Brexit at the end of October when the current extension ends. The chance of the EU further indulging the UK by agreeing to another extension remains an unlikely, but not impossible, option – especially in the case of a second EU referendum. Both the Conservatives and Labour have an incentive to avoid any of these outcomes. Public support for Brexit and Remain is roughly split between the traditional Labour and Conservative voters. The current Brexit impasse is hurting both parties, while a hard Brexit or a reversal of Brexit would likely reduce their support at the next election at the expense of the new parties emerging at the fringes of British politics.

Our base case remains that parliament will eventually back one of the softer options for UK-EU trade – probably the customs-union model – and then pass the WA shortly thereafter. Because of the drubbing the Conservatives are likely to get at the European elections on 23-26 May, May hopes to settle Brexit before European MPs are due to take their seats on 2 July. This will be possible only if the current talks with Labour succeed. Plans B and C would run well into the summer.

Economic outlook

On the back of a breakthrough in Q2, the UK economy would likely rebound nicely in the second half of 2019, driven by stronger investment, consumption and confidence, with sustained gains in 2020. [We forecast GDP growth of 1.5% in 2019 and 2.1% in 2020.](#) UK equities – which have already rallied since the start of the year – probably have further to go still if Brexit is resolved and a hard Brexit is avoided. If there is no resolution soon – and, thus, prolonged uncertainty and the risk of a hard Brexit continues into H2 – economic momentum will remain subdued and markets will continue to fret about the hard Brexit risk.



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