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THERESA, BORIS AND THE BREXIT MESS: THE EU ANGLE

Berenberg Macro Flash

Six months after the EU27 and the UK ended their negotiations on the Brexit deal, the UK has not moved any closer towards resolving Brexit. The UK is still not tackling the hard question head on: does it want to leave on the terms available, does it instead want to exit its major market without any deal about future relations, or does it want to stay after having learned more about the costs of Brexit? As both Conservatives and Labour play their internal games, Theresa May now follows Margaret Thatcher and David Cameron as the third UK prime minister brought down by the division among UK Conservatives over Europe. Does the end of May change the picture for the EU27? Not very much.

The Brexit deal has two separate parts, the detailed **Withdrawal Agreement** and the short **political declaration on future relations**. The EU27 have emphasised repeatedly that they will not renegotiate the Withdrawal Agreement. While some UK Brexiteers claim that, with their better negotiating skills, they could have extracted concessions from the EU27 that May could not, I see no reason for that. Why would the EU suddenly ditch the solidarity within the club and override Ireland's insistence on the "backstop" guarantee against a hard border in Ireland?

The new UK prime minister will face almost exactly the same position from the big EU27 as May did in her futile attempts to soften them up. For two reasons, the position of the EU27 may even be hardening slightly over time:

- 1) The political turmoil in the UK strengthens the incentive for the EU27 to do whatever they can to safeguard their internal coherence rather than straining it by granting the UK concessions that some member countries object to.
- 2) The fear of a no-deal hard Brexit is fading somewhat on the continent. The longer this tail risk has already been discussed and prepared for, the less of a shock it would be if it were to happen.

If the new UK prime minister is lucky, she or he will have a choice of four options as the Brexit deadline of 31 October approaches: 1) pass the Withdrawal Agreement for an orderly Brexit, 2) leave without a deal, 3) revoke Brexit, or 4) sign up to a multi-year extension until well after the next scheduled UK general election. If he or she is unlucky, the EU27 will not even offer the last option of a new extension. There is very little appetite within the EU to let the Brexit issue fester for longer.

Half a year ago, most EU members would probably have preferred that the UK stays in the EU, with only some (France) not sure about it. After half a year of political theatre in the UK, it may well be that, by now, many EU countries would be too afraid of a deeply divided UK disrupting the EU to really want it to stay. Instead, many on the continent may now see an orderly "velvet" Brexit as the least bad among the realistic outcomes.



COULD BORIS DO WHAT THERESA COULD NOT?

The leading contender to succeed Theresa May, Boris Johnson, is seen on the continent as a talented self-promoter with a limited grasp of the European facts and little ideological baggage. After all, he reportedly made up his mind whether or not to back Brexit only on the evening he had to publish a newspaper column about his choice. While he did not endear himself to his continental colleagues during his stint as foreign minister, his flexibility could turn into an advantage. If and when he has achieved his ambition to move in 10 Downing Street, he may have an interest to limit the Brexit damage to the UK. With his credibility as a Brexiteer, he may even achieve what May, for lack of that credibility, did not. We would not rule out that Boris may convince more of his Conservative colleagues in parliament to pass the Withdrawal Agreement as the basis for talks about UK-EU future relations. Johnson might even do a deal with Labour. After all, if he is in office, Labour would not need to insist on a “**Boris lock**”, that is on an elusive safeguard against the risk that a May successor may not abide by a deal she might have struck with Labour leader Jeremy Corbyn. From the EU27 angle, a genuine hardline Brexiteer without the flexibility ascribed to Boris Johnson could be a worse outcome.

Unlike the Withdrawal Agreement, the political declaration on future relations largely reflects the red lines (“no customs union, stop to free movement of labour,...”) which May herself had drawn. As before, the EU remains ready to adjust the declaration on future relations if the UK drops some of its red lines. If May had agreed a permanent customs union deal with Labour, the EU would have gone along with it. If a new UK prime minister wants to distance her- or himself from May’s deal by moving closer to a customs union or even a Norway-style arrangement, that would be fine for the EU.

NO DEAL? THINK TWICE

Of course, the UK could choose to leave the EU without a deal. We see a [25% probability for that](#). The immediate economic disruption would probably be limited, for the EU27 even more so than for the UK. Planes would still fly, lorries would still roll, medicines would still be delivered and financial regulators would see to it that existing derivatives contracts would not blow up. In practice, the transition to general border controls and the ensuing damage to cross-Channel supply chains would probably be gradual.

Nonetheless, the option of a no-deal hard Brexit may not be fully available to the UK in the sense that some Brexiteers seem to believe. Whatever the outcome of the Brexit saga, the UK and the EU27 will remain close neighbours and partners who will need each other regularly to settle all sorts of bilateral issues. Given the relative size of their economies, the EU27 will usually have more economic leverage than the UK, be it in their bilateral dealings or in their negotiations with third parties.

After a no-deal Brexit, the EU27 would present the UK with the demand to first pay its dues as specified in the Withdrawal Agreement at every instance at which the UK and the much bigger EU27 would have a need to negotiate in the future. Other trading partners may draw their own conclusions if the UK does not honour its commitments to the EU. And the more the UK deviates



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from EU regulations, the less access it could have to the EU27 market. In other words, even in case of a hard Brexit, the UK would probably end up having to accept most of the Withdrawal Agreement. The exception might be the Irish backstop. From the EU27 angle, a hard border in Ireland would be a very sad outcome, even though the consequences for all of Ireland would be more directly felt in the UK than in much of the EU27.

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