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BREXIT UPDATE: WHAT WILL BORIS DO?

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The outlook for Brexit remains highly uncertain. Boris Johnson looks set to win the Conservative Party leadership race and become the next UK Prime Minister (PM). Of course, no one can actually say for sure what will do. However, our (tentative) base case remains that Johnson will persuade parliament to pass the Brexit agreement that Theresa May had negotiated with the EU - although in a slightly modified version. We put a 40% probability on this outcome. The risks around this call are large. We see a 35% risk of a hard Brexit and a 25% probability of no Brexit at all in the end. While a further Brexit delay is not impossible, it seems highly unlikely that Johnson will want to do so.

Setting out the base case

Johnson probably will be named the leader of the Conservative Party on or around 23 July. He will be sworn in as PM shortly thereafter. In 2016, Theresa May was invited by the Queen to form a government just two days after winning the Conservative leadership race. Parliament is due to begin its summer break on 25 July, returning on 3 September. While the new PM could shorten or even end the recess, that remains unlikely. Instead, we expect him to head to Brussels to try to renegotiate the Brexit withdrawal agreement (WA) and political declaration on future trade.

Johnson has said that he wants a Canada-style free trade agreement between the UK-EU. This should not require any significant or contentious change to the political declaration on future trade. Changing the terms of the WA will be much more difficult. Johnson wants the Irish backstop to be time-limited. This puts the spotlight on Irish Taoiseach Leo Varadkar. If Johnson can convince Varadkar that his choice is between a hard border in Ireland following a hard Brexit, or a five-year time limit on the Irish backstop, he may blink. [We see no evidence yet that this could happen.](#) But in the unlikely case that Varadkar were to agree to a time limit for the Irish backstop at the last minute, the other 26 EU countries would go along with that.

We look for Johnson to present his tweaked version of May's deal to MPs shortly in Autumn, once MPs have returned from the summer break. If parliament passes the WA, the UK will leave the EU on 31 October and enter the transitional phase where it remains in the single market and customs union at least until the end of 2020. If parliament rejects the WA, then Johnson may try to take – as he pledges – the hard Brexit route. This will not be easy. It could end with the Conservatives losing power and/or Brexit being reversed. Our tentative bet is that the Conservative Party – including the Eurosceptic wing – will see their interests best served by accepting the WA and claiming whatever renegotiation Johnson achieves as a major win.

Unlike May, Johnson probably has the pro-Brexit credentials to convince the Eurosceptic wing of his party that he would see to it that the UK does not stay in the EU customs union after the transition period. They could thus find the WA easier to swallow than under May. Johnson may also need to promise that mainland UK would match Northern Irish regulations on goods – as part of the Irish backstop – in order to keep the Conservatives' parliamentary partners, the DUP, on board with such a plan.

Our base case rests on two key arguments:

- 1) **Johnson is a self-serving pragmatist:** Despite the bluster and bravado about Brexit, his record as London mayor is telling. He is not an ideologue. On key issues his instinct is to take the option that boosts his own popularity. He is also an effective campaigner and salesman. Assuming that his main objective would be to remain in No. 10 Downing Street – as long as possible, Johnson will probably view the issues of the day – Brexit, the economy and so on – as devices to achieve this end. As it stands, polling suggests the Conservative Party would suffer badly in a snap election. Latest polling puts the Conservatives at around 24% support, versus 40% at the start of the year and



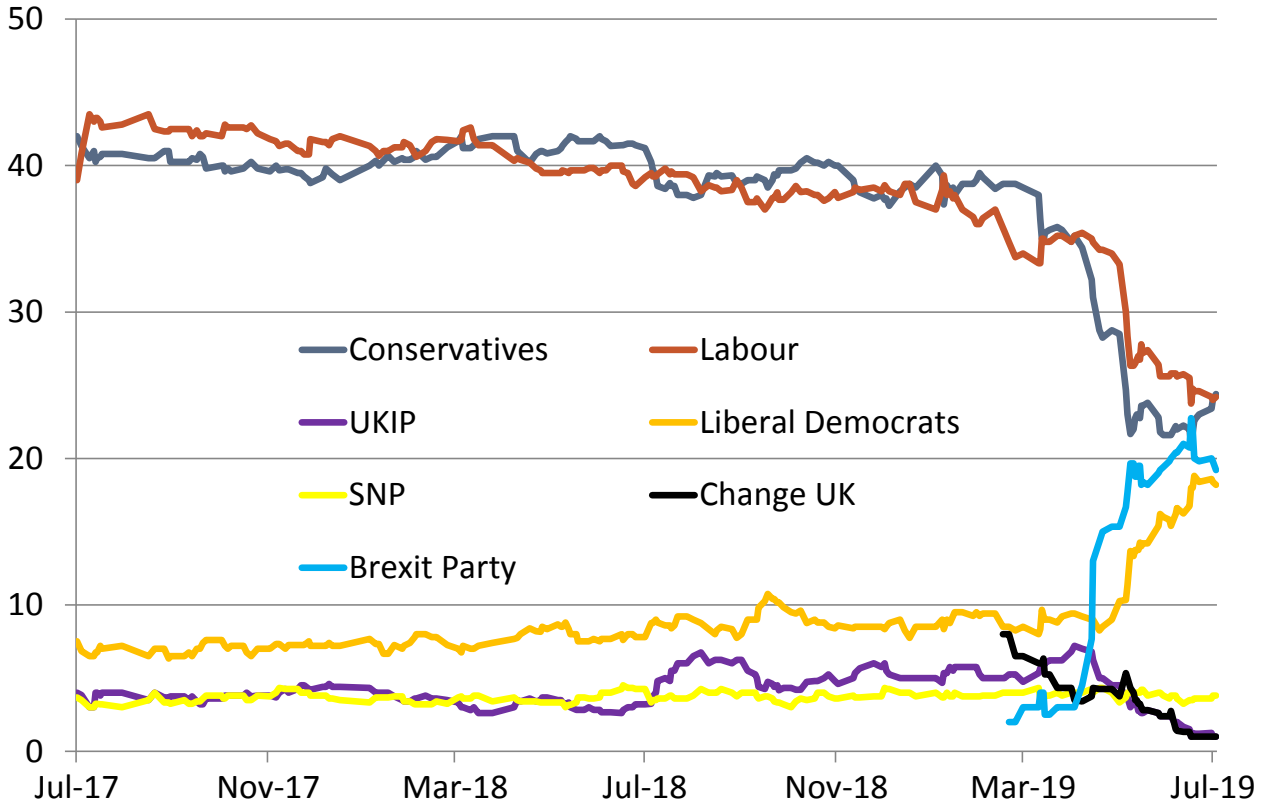
down from 42.4% of the total votes in the June 2017 general election. Johnson would have his work cut out to lift the Conservatives' standing heading into the 2022 election. His best bet would thus be to deliver Brexit and ensure the economy builds a head of steam in the coming years. If Johnson goes for a hard Brexit, these objectives become mutually exclusive as a hard Brexit would weaken the economy. But if Johnson can deliver Brexit and avoid a no-deal, [a fiscal stimulus could set the economy on a strong run](#) into the election.

- 2) **Political logic and reality constrains the realistic options:** If Johnson decides to head for a hard Brexit, it is not clear that he could deliver it and keep his government intact. The Conservative Party, along with its parliamentary partners the DUP, have just a three-seat majority in the House of Commons. It would take just a handful of moderate Conservatives to fell the government. The outcome of the snap election that could follow would be highly uncertain. Latest polling points to a hung parliament with support divided between the Conservatives, Labour, the Liberal Democrats and the Brexit Party (Chart 1). The risk that the Conservatives would lose power, and thus control of the Brexit process, would be significant. The outcome of a second referendum would be similarly uncertain. The only option that can deliver Brexit and enhance the probability that the Conservatives remain in power is to pass the WA.

The Johnson disclaimer: His lack of attention to detail and cavalier-style leave him prone to miscalculated gambles. Just as we argue that Johnson may be just the trick that could get the WA through parliament and keep the government together, that same trick could end up with him going for a hard Brexit while still keeping the government together. Moderates and Brexiteers alike seem to be projecting their Brexit hopes on Johnson. Brexiteers hope he will take a hard line with the EU that could result in a hard Brexit unless the EU yields to his demands. Moderates argue that, deep down, he is a soft Brexiteer who, like May, would initially talk a hard game, but in the end stop short of a hard Brexit. It is quite possible that Johnson himself has not quite decided yet what his best strategy is.



Chart 1: Conservatives and Labour fall behind while the Brexit Party and Lib Dems benefit from the Brexit mess



UK opinion polls for national elections. Three-poll moving average. 8 June 2017 election results: Conservatives (42.4%), Labour (40.0%) LD (7.3%), SNP (3.1%) and UKIP (1.8%). SNP: Some data points include Plaid Cymru. Source: National polls.