Economics

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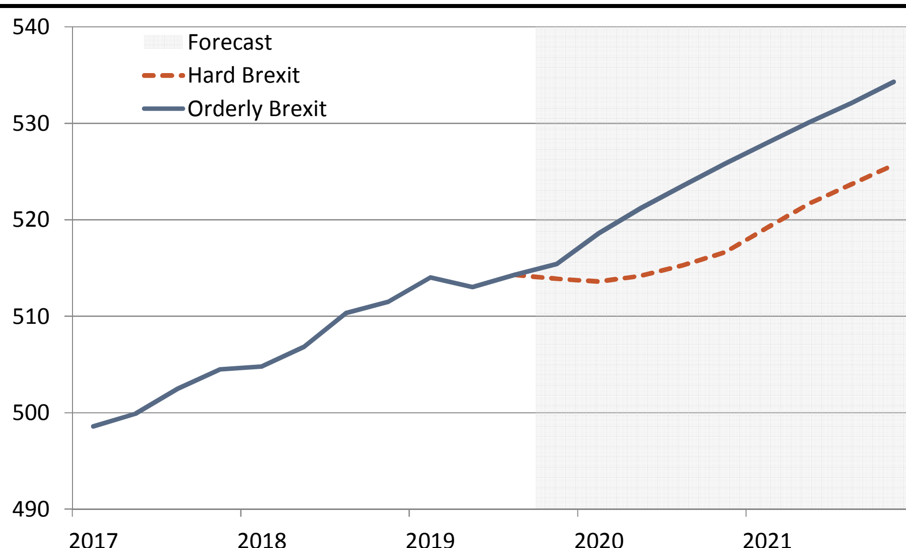
The big Brexit mess: economic scenarios

- **Who will blink?** UK Prime Minister Boris Johnson is playing a game of chicken with the EU and moderate Conservatives. He aims to renegotiate the Brexit Withdrawal Agreement that Parliament has three times rejected by threatening to leave the EU with no deal on 31 October. He bets that the EU will seek a compromise at the final hour. But he has just a one-seat working majority in the House of Commons. The EU may be inclined to stick to its guns and refuse to soften, in the hope that moderates in UK parliament will block a hard Brexit.
- **Serious risk of an accident:** A lot has to go right for the moderates to stop a hard Brexit. Nothing has to change for a hard Brexit to happen – that is the default at the end of October. While all Brexit outcomes remain possible, the risk of an accident looms large. We see a 70% chance of chaos on 31 October – hard Brexit (30%) or further extension (40%) – with just a 30% chance of an orderly Brexit by then.

In this note we consider the economic outlook in three potential scenarios: orderly Brexit on 31 October, hard Brexit on 31 October and a further Brexit delay.

- **Orderly Brexit = economic upswing:** Driven by a pick-up in consumer spending and a rebound in business investment, we would expect real GDP growth to accelerate from 1.1% in 2019 to 1.6% in 2020 and to 1.7% in 2021.
- **Hard Brexit = near-term slump:** Amid serious supply-side disruptions for trade, migration and investment with the EU, and rising inflation from a likely drop in sterling that would dampen real spending, we project that the real GDP growth would slow to 0.2% in 2020 from 1.1% in 2019, before rebounding to 1.5% in 2021. Could a hard Brexit tip the UK into recession? Yes. However, that risk is partly mitigated by the preparations for such an outcome by the UK government and firms that export to the EU.
- **Further Brexit delay = below-trend growth:** With resilient consumption growth offset by subdued investment and volatile stockpiling and trade, we would expect growth of 1.1% in 2019 and 2020. By 2021, we would expect some resolution – at which point one of the other scenarios would become relevant.

Chart 1: Real GDP outlook – hard Brexit versus orderly Brexit



Quarterly data. Real GDP in 2016 pounds sterling. Source: Berenberg

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Kallum Pickering
Senior Economist
+44 20 3465 2672
kallum.pickering@berenberg.com

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The big Brexit mess

Brexit already hurts. Since the EU referendum in June 2016, UK real UK GDP growth has slowed to an average of 1.5% annualised, from 2.4% annualised in the three years to Q2 2016. Domestic-oriented equities have underperformed (Chart 2). Trade-weighted sterling remains 20% below the pre-referendum peak (Chart 3). The recent fall in the exchange rate since Johnson became PM reflects increased market anxieties about the hard Brexit threat.

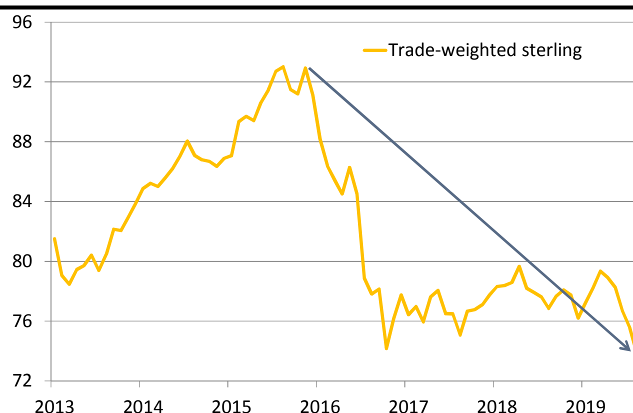
All Brexit outcomes remain possible (hard Brexit, further extension and no Brexit). In our view, however, the risk of no deal (hard Brexit) on October 31 or afterwards increased when Johnson became PM. We currently put the risk at 40% (30ppt on October 31 and 10ppt thereafter). Looking ahead, a lot will depend on: a) whether the UK and EU manage to forge a compromise to avoid a hard Brexit on 31 October; and b) how long Johnson can survive with just a one-seat working majority in the House of Commons.

In such uncertain times, providing an economic base case is tricky. In this note we describe: a) the key political issues and provide b) economic projections based on three potential Brexit outcomes.

Chart 2: FTSE versus UK domestic company performance

Daily data. Source: Eikon from Refinitiv, MSCI and BoE August 2019 Inflation Report

Chart 3: Trade-weighted sterling (Jan-05=100)



Monthly data. Source: Bank of England, Berenberg estimates. August data estimated based on a 2.3% decline from July average.

Political outlook – cutting through the noise

Taking Johnson's words at face value: a) he wants the UK and EU to strike a deal that avoids a hard Brexit; b) he does not want an election before Brexit is sorted; but c) he will take the UK out of the EU "no ifs no buts" on 31 October – ie hard Brexit – if a) is not achieved.

The best-case scenario for the UK and EU economic and financial market outlook would be if Johnson managed to pull off a) and b) while avoiding c). That is easier said than done. First, the EU remains steadfast that it will not renegotiate the Withdrawal Agreement (WA) – the Brexit agreement drawn up the EU and the ex-PM Theresa May and her team. And second, moderates in UK parliament say they are ready to bring down the government if Johnson goes for c).

That Johnson wants to renegotiate the WA the UK parliament has three times rejected is not completely unreasonable. However, Johnson's bombastic "do or die" attitude to leaving the EU on 31 October in addition to his claim that he will not renegotiate until the EU drops the contentious "Irish backstop" from the WA has not gone down well in European capitals.

Johnson's wish to drop the backstop is viewed as so unreasonable by the EU that European leaders believe that his top priority is to win new elections soon. Containing the Brexit damage comes second. While taking his opening gambit somewhat seriously, they partly think he is just running an elaborate PR exercise to shift public perceptions in the UK in his favour in case of a snap election.

The Eurosceptic wing of the Conservative Party criticised ex-PM May for taking a too-soft approach in Brexit negotiations with the EU. May tried and failed several times to renegotiate the backstop. Johnson often states that he is playing hard ball because he believes that the EU will seek a compromise at the last moment to prevent a hard Brexit.

We do not expect the EU to yield to Johnson's demand to completely drop the backstop. Johnson probably knows this. Instead, we think that Johnson hopes to create enough space between the EU's current position and his own that a compromise could be struck somewhere in the middle.

If, for example, Johnson could secure a time limit to the backstop, most Conservatives with the help of Labour MPs who represent pro-Brexit constituencies, would likely pass the WA. As the critical backstop issue uniquely affects the Republic of Ireland, Irish PM (Taoiseach) Leo Varadkar largely determines the EU27 position. If the Republic of Ireland accepted changes to the backstop then the rest of the EU would go along with that.

How the debate in Dublin develops in the coming months will therefore be critical for the outcome of Brexit. Varadkar remains unyielding for now. In a telephone call on 19 August Varadkar told Johnson that the WA cannot be re-opened.

The EU's overriding priority is the cohesion of the 27. While the EU would prefer an orderly Brexit and remain on good terms with its close neighbour, it needs to safeguard the integrity of its Common Market. It is ready to accept the economic consequences of a hard Brexit in order to preserve that. In contrast to the logic often portrayed in the British press, Berlin or other EU capitals are unlikely to exert significant pressure on Dublin over the backstop.

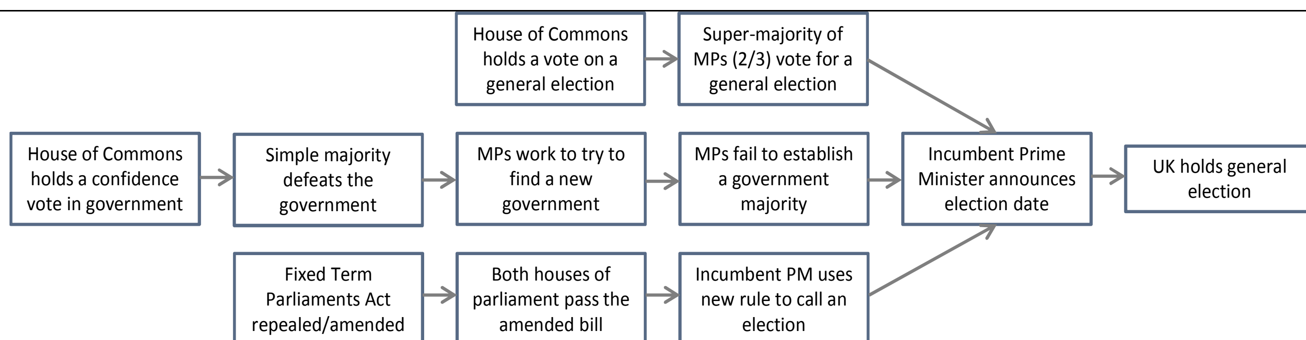
For Johnson to have any chance of renegotiating the WA he must therefore make his own position more credible. The only way to do this would be by demonstrating to the EU that he either has the backing of parliament or could retain power after a snap election. As it stands, Varadkar probably doubts the credibility of Johnson's framing of the situation as "renegotiate the WA or it is a no-deal Brexit". Varadkar is likely betting that if he holds steady and refuses to compromise with Johnson, moderates in UK parliament will block a hard Brexit anyway.

Parliament is set to return from its summer recess on 3 September. Johnson has just a one-seat working majority. Even in normal times he would struggle to pass any major new laws. Senior Conservative MPs – working with MPs from opposition parties – have long warned Johnson that they will do whatever it takes to stop a hard Brexit. The four MPs to watch – all Conservatives – are Dominic Grieve, Sir Oliver Letwin, Philip Hammond and Rory Stewart.

As an initial tactic, Conservative moderates will probably try to find some parliamentary trick or device to force the PM to ask for a further extension. They managed this with May. Failing that, they could vote with the opposition in a no confidence vote in the government.

The Fixed Term Parliaments Act sets out what would happen if the government lost a confidence vote (Chart 4). An election would not automatically be triggered. Before that, MPs would have two weeks to try to find a new working majority to govern.

Chart 4: Fixed Term Parliaments Act



Source: UK Parliament

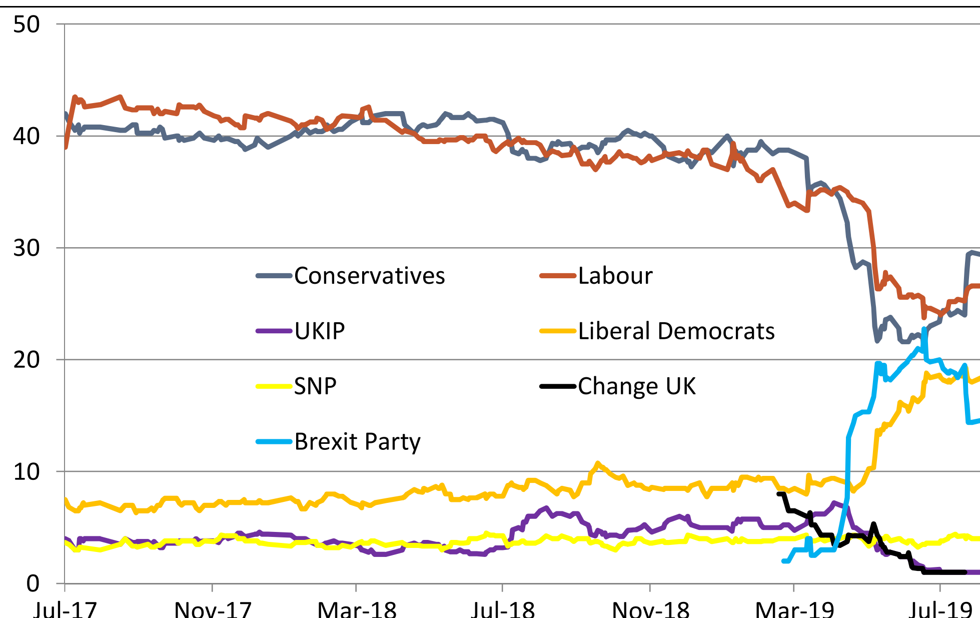
Moderates in parliament who want to block a hard Brexit could try to form a cross-party coalition once they have brought down Johnson. However, it is not clear who would lead this group as caretaker PM. Potential options include: 1) senior Conservative MP Kenneth Clarke or senior Labour MP Harriet Harman; or 2) Labour leader Jeremy Corbyn.

Both options could face opposition. Corbyn and his close allies may reject option 1) while moderate Conservatives could reject option 2). If either bid were successful, we would expect parliament to request a further extension from the EU before calling a snap election shortly thereafter.

In light of the election risk, Johnson has been de facto campaigning for re-election since becoming PM on 23 July 2019. This "campaign" has two main thrusts: 1) play hard ball with the EU (for the reasons discussed above); and 2) to set out his economic plans – deregulation plus fiscal stimulus (see UK fiscal stimulus ahead? Consequences and risks).

So far, Johnson has enjoyed some success. Support for the Conservatives has risen by c10ppt to c31% since he became PM. As Chart 5 shows, nearly all the recent rise in support for the Conservative Party has come at the expense of the Brexit Party. Whether the "Boris bounce" continues in the coming months is an open question. However, it could be a necessary step for Johnson to build enough credibility to have any real chance of getting the EU to budge on the backstop.

Chart 5: Conservatives rebounding since Boris Johnson became PM



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.

Based on current opinion polls, the Conservatives would fall short of a working majority in snap elections. However, if moderate MPs look to hold a confidence vote, Johnson could still move first and call a snap election. That would give him more control over the timetable. As a best guess, he would probably call an election for early November – perhaps even 1 November (the day after Brexit). Why? Parliament is automatically dissolved 25 working days before a general election, and is generally prorogued a few days before that. This would drastically shorten the timeframe for moderate MPs to block a hard Brexit.

What if the Conservatives lost a snap election following a hard Brexit on October 31? Probably, parliament would try to put an end to a hard Brexit fast. However, that may not be easy. First, the legal position of the UK with respect to the EU and its institutions would have changed absolutely. The UK would be a "third country" and the Article 50 process upon which the Brexit negotiations have been based would no longer apply.

It not clear whether it would be possible: a) for the UK to re-enter EU on old terms – de facto retroactively agreeing a new extension (that would need unanimous support among the 27 to take back a UK that is seen across many EU capitals as a nuisance); or b) to state before 31 October that the UK would have the right to retroactively revoke its Article 50 declaration post-Brexit so that it could return into EU without the 27 having to agree to it. The politics suggest that the EU27 are unlikely to take back the UK on old terms as if nothing had happened. Of course, a lot would depend on the make-up of UK parliament in such a scenario. But as a majority of Labour, Liberal Democrat, SNP, independents and Green MPs seem to be in favour of a second referendum, that would be a likely outcome.

Johnson's is pursuing a high-risk strategy. If he fails, he would go down in history as the PM with the shortest tenure ever. Currently, that title goes to George Canning, a Tory PM who lasted just 119 days in 1827. For Johnson, it really seems to be "do" or "die". If he cannot do the

former, the latter is preferable than being seen as a complete fool by acquiescing to the EU or to Conservative wets by asking for a Brexit extension.

The outlook is complicated. We set out – based on the points we make above – our probabilities of the possible Brexit outcomes in Chart 6. We continue to see: a 35% likelihood that parliament eventually passes the WA (30ppt before 31 October, 5ppt after); a 40% risk of a hard Brexit (30ppt on 31 October, 10ppt after); and a 25% chance that the UK remains in the EU – most likely following a snap election that ends with a pro-EU coalition government and second referendum.

Chart 6: Probabilities of potential Brexit outcomes

Outcome/By	*Before 31 Oct*	*After 31 Oct*	**Total**
Hard Brexit	30ppt	10ppt	**40%**
Orderly Brexit	30ppt	5ppt	**35%**
Remain	0ppt	25ppt	**25%**

WA = Withdrawal Agreement. Source: Berenberg

Uncertain macro – possible scenarios

Due to the uncertain political outlook, the range within which the economic outlook could fall is higher than usual. **Please note: our base case – which we include in forecasts at a glance – remains conditioned on an orderly Brexit on 31 October.** But that outcome is far from certain, though (30% probability).

In this section we consider the economic outlook in other potential scenarios. Our forecasts are summarised in Table 1.

Table 1: Summary of forecasts

% yoy	**2020**	**2021**	**Long-run potential**
Orderly Brexit	1.6	1.7	1.7-1.8
Hard Brexit	0.2	1.5	1.4-1.5
No resolution	1.1	-	-

Source: Berenberg

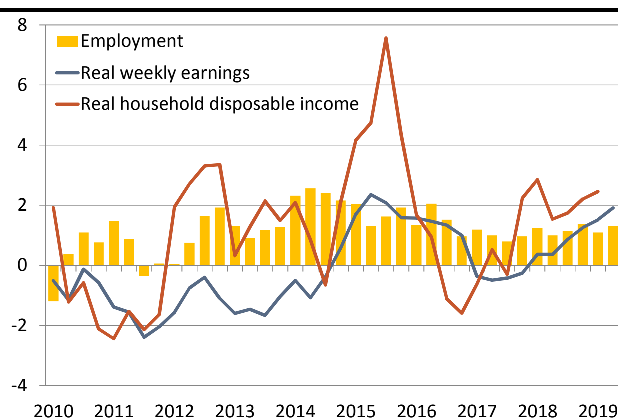
Orderly Brexit

In an orderly Brexit on 31 October, we would expect real GDP growth to accelerate from 1.1% in 2019 to 1.6% in 2020 and to 1.7% in 2021. The key points are as follows.

- After sagging badly for the past three years, rising business confidence should lift investment growth from 0.1% yoy in 2019 to 2.3% in 2020 and to 3.4% in 2021. Despite picking up momentum, we would expect investment to remain well below three-year average up to the Brexit vote of 4.8% yoy.
- Solid UK household fundamentals should continue to support real domestic demand and spending. Real wages increased by 2.0% yoy in June and have picked up solidly during the past two years from the low of -0.5% yoy in November 2017 – Chart 7. Near-record high vacancies and the lowest unemployment rate since the early 1970s point to further gains ahead. Expect household consumption growth to pick up from 1.7% yoy in 2019 to 2.2% in 2020 and 2.1% in 2021.
- The initial temporary inflation shock following the Brexit vote has had persisting effects. Inflation expectations have risen sharply since the Brexit vote – Chart 8 – even as the annual rate of growth in the consumer price index has returned to the BoE's target of 2%. We forecast inflation of 2.1% in 2020 and 2020, with risks tilted to the upside due to potential for tax cuts and higher public spending.
- To contain the inflation risks from further wage rises and a modest pick up in unit labour costs, the BoE will need to take action to bring inflation expectations back to 2%. The BoE would likely keep the bank rate unchanged at 0.75% in H2 2019 before hiking rates twice in 2020 and once in 2021, by 0.25bp each time. That would take the bank rate to 1.5% by the end of 2020. In our view, this call is consistent with the BoE guidance

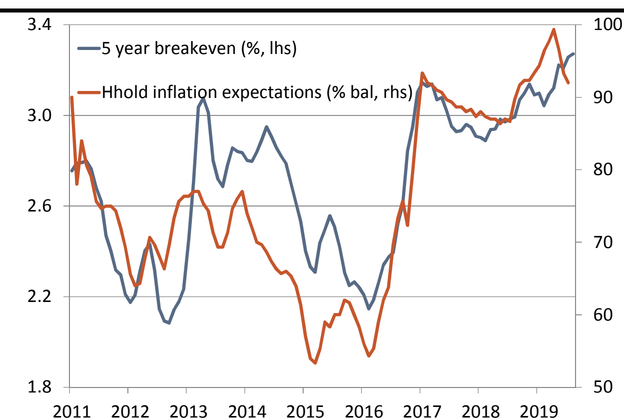
from the most recent Inflation Report in August that *"assuming a smooth Brexit and some recovery in global growth... the committee judges that increases in interest rates, at a gradual pace and to a limited extent, would be appropriate to return inflation sustainably to the 2% target".*

Chart 7: Yoy % change in employment, real wages and real incomes



Quarterly data. Source: ONS

Chart 8: Elevated inflation expectations



Monthly data. Source: Bloomberg, GfK. Data show three-month moving average. Household expectations show balance of respondents expecting consumer prices to rise versus fall over the next 12 months. August data as of 19/08/19

- A better-than-expected rebound in confidence following an orderly Brexit plus the prospect of a fiscal stimulus suggests that the risks to the medium-term outlook in an orderly Brexit would be tilted to the upside. See Table 2 for a full breakdown.

Table 2: UK economic forecasts if an orderly Brexit happens on 31 October

		2018	2019	2020	2021	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
GDP	% y/y	**1.4**	**1.1**	**1.6**	**1.7**	1.8	1.2	0.8	0.8	0.9	1.6	1.8	2.0	1.8	1.7	1.6	1.6
	% q/q					0.5	-0.2	0.2	0.2	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4
	%q/q ann.					2.0	-0.8	1.0	0.9	2.5	2.0	1.8	1.8	1.7	1.6	1.5	1.7
Private Consumption	% y/y	**1.7**	**1.7**	**2.2**	**2.1**	1.7	1.7	1.6	1.8	1.8	2.0	2.3	2.5	2.3	2.1	2.0	1.8
	% q/q					0.6	0.5	0.3	0.4	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.5
Government Consumption	% y/y	**0.4**	**2.3**	**0.7**	**0.4**	1.6	2.7	3.0	1.9	1.2	0.7	0.5	0.4	0.4	0.4	0.4	0.4
	% q/q					0.8	0.7	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Investment	% y/y	**0.2**	**0.1**	**2.3**	**3.4**	0.9	0.5	-1.1	0.2	0.0	2.0	3.5	3.9	3.6	3.4	3.4	3.2
	% q/q					1.2	-1.0	-0.7	0.7	1.0	1.0	0.8	1.0	0.8	0.8	0.8	0.8
Final Domestic Demand [1]	% y/y	**1.2**	**1.5**	**1.9**	**2.0**	1.5	1.7	1.4	1.5	1.4	1.8	2.2	2.4	2.2	2.0	1.9	1.8
	% q/q					0.7	0.3	0.1	0.4	0.6	0.6	0.5	0.6	0.4	0.4	0.4	0.4
Net Exports [1]	% y/y	**-0.2**	**-0.8**	**0.3**	**-0.4**	-3.4	0.4	-0.8	0.4	2.7	-0.7	0.2	-0.9	-0.5	-0.4	-0.4	-0.4
	% q/q					-2.9	3.3	-1.1	1.1	-0.5	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Stockbuilding [1]	% y/y	**0.4**	**-0.3**	**-1.0**	**-0.6**	1.5	-0.9	0.0	-1.6	-1.4	0.5	-0.7	0.5	0.0	0.1	0.0	0.2
	% q/q					0.3	-1.9	1.2	-1.3	0.5	0.0	0.1	-0.1	0.1	0.0	0.0	0.1
Current Account Balance	GBP bn	**-81.6**	**-102.9**	**-105.6**	**-91.2**	-30.0	-21.1	-26.3	-25.5	-27.8	-26.9	-26.0	-25.1	-24.2	-23.3	-22.4	-21.5
	% of GDP	**-3.9**	**-4.7**	**-4.7**	**-4.0**	-5.6	-3.9	-4.8	-4.6	-4.9	-4.8	-4.6	-4.4	-4.2	-4.1	-3.9	-3.7
Industrial Production [2]	% y/y	**0.8**	**-0.3**	**1.5**	**1.5**	-0.7	-0.5	-0.7	0.6	1.0	1.8	1.7	1.6	1.5	1.5	1.4	1.4
	% q/q					0.1	-0.4	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment Rate [2]	%	**4.1**	**3.9**	**3.8**	**3.6**	3.9	3.9	3.9	3.8	3.8	3.8	3.7	3.7	3.7	3.7	3.6	3.6
CPI [2]	% y/y	**2.5**	**2.0**	**2.1**	**2.1**	1.9	2.0	2.0	2.0	2.0	2.1	2.2	2.2	2.1	2.1	2.0	2.0
General Govt. Balance [3]	% of GDP	**-1.6**	**-1.6**	**-1.2**	**-1.0**												
General Govt Debt [3]	% of GDP	**87.3**	**86.3**	**85.3**	**84.6**												
BoE Bank Rate [4]		**0.75**	**0.75**	**1.25**	**1.50**	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.50

[1] Contribution to GDP growth [2] Period averages [3] Maastricht basis [4] End period

Source: Berenberg

Hard Brexit

No one really knows for sure how much a hard Brexit (ie no deal, no transition) would hurt the UK economy in the short run. The shock would be more complicated than a normal cyclical downturn. Typical economic shocks entail a temporary dip in demand. A hard Brexit would be a significant shock to the supply side of the UK economy coming from a sudden jump in barriers to trade, among other things, with the EU, the UK's biggest market.

On 27 June 2018, the House of Commons Treasury Committee requested that the BoE publish analysis of how Brexit would impact the bank's ability to meet its objectives for financial and monetary stability. This included "worst-case scenario" analysis of a hard Brexit in which the BoE estimated a potential hit of c10% of GDP by the end of 2023. In March 2019 BoE Governor Mark Carney noted that preparations for a hard Brexit meant that the likely impact would be much lower than that. More recently, leaked government documents under the moniker "Operation Yellowhammer" predict significant economic disruption in the event of a no deal – especially at borders for flows of goods and people.

Could a hard Brexit tip the UK into recession? Yes. However, that risk is partly mitigated by the contingency planning for such an outcome by the UK government and firms that export to the EU. Probably, a hard Brexit would cause a sharp initial drop in economic activity that goes along with the initial panic and further depreciation of sterling that gradually fades as the government and public overcome initial adjustment challenges.

We project that the real GDP growth would slow to 0.2% in 2020 from 1.1% in 2019, before rebounding to 1.5% in 2021. See Table 3 for a full breakdown. The key points are as follows.

- A depreciation in sterling, perhaps by up to a further 10%, would push up import prices and the headline inflation rate above 3% in 2020. The squeeze to real incomes would weigh on real domestic spending, just as after the Brexit vote in 2016 – Charts 9 and 10. Tariff and non-tariff barriers would raise the costs of UK-EU trade and create supply bottlenecks on goods that had previously flowed across the UK-EU border without such frictions – this could add to inflationary pressures in the short run.

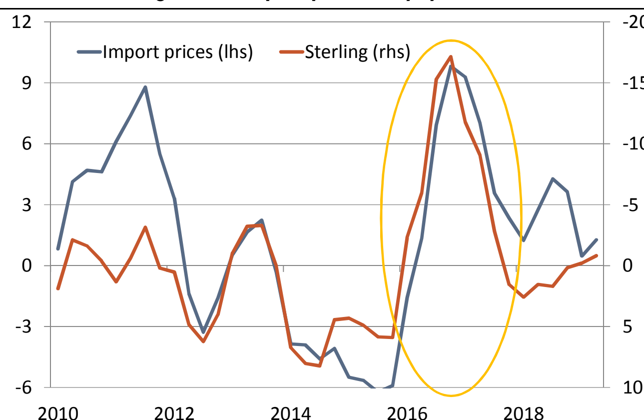
- We project that consumption growth would slow from 1.6% in 2019 to 0.7% in 2020 before rising to 1.4% in 2021. To help buffer the hit to real incomes and, in turn, real spending, households would likely reduce their already low savings rate – 4.4% in Q1 2019 – and increase borrowing temporarily. Risks to consumption would be tilted to the downside pending any rise in unemployment that could further weaken consumer sentiment.

- Lower business confidence would weigh on firms' demand for labour and investment. Business investment has stagnated since the Brexit vote. A no-deal Brexit would risk more pronounced investment weakness. Unemployment could rise if firms rationalise their production amid fears of lowered sales prospects. Producers that rely on just-in-time deliveries of inputs from the EU market would be hurt the most. After declining by 0.5% in 2019 we would project a further drop in investment of 3.0% in 2020 before a rebound of 3.0% in 2021. Expect unemployment to rise to 4.3% in 2020 with risks tilted to the upside.

- The loss of the EU financial services passport that allows UK-based firms to export some types of financial products to the EU market would weigh on the UK's financial sector. Amid the heightened risk of recession, credit and lending standards in the real economy could tighten modestly. We would expect the BoE to try to offset this by loosening monetary policy, though.

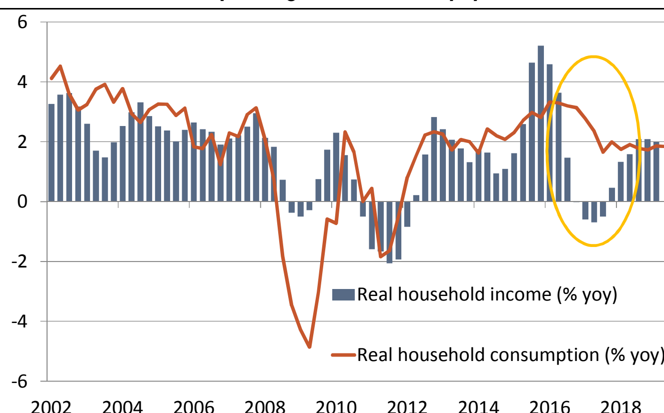
- Expect the BoE to broadly repeat the steps it took after the Brexit vote. First, provide markets with emergency liquidity to facilitate smooth re-pricing of risks and the new outlook in sterling markets. Second, send a strong signal that it would stimulate the economy in case of a major downturn in demand. The BoE would likely buy more government and corporate bonds through its quantitative easing programme, lower the bank rate (from 0.75% to 0.25% at the November 2019 Inflation Report), and open special credit lines at the central bank to encourage commercial lenders to fully pass on the rate cut and stimulus. On the back of an eventual economic rebound following the initial shock, the BoE would likely start to gradually lift rates towards the end of 2020.

Chart 9: Sterling versus import prices (% yoy)



Monthly. Source: Bank of England, ONS. Sterling = broad trade-weighted sterling. Headline inflation = consumer price index

Chart 10: Household spending and income (% yoy)



Quarterly data. Source: ONS

- The fiscal response to a hard Brexit remains a wildcard. Johnson has hinted at cuts to VAT tax, income tax and/national insurance to lift real incomes. Such measures could partly offset the rise in import price inflation. Direct spending on public works could also provide a boost to short-term domestic demand. However, even if a VAT cut could offset the rise in import prices – implying a net-zero effect on headline inflation – the UK would still suffer the supply-side shock from disruptions at the border for trade, workers and investment. This would still have real economic effects.

- A hard Brexit plus a large fiscal stimulus could turn the UK's long-run debt sustainability into an urgent issue. The OBR's most recent forecasts suggest that the UK's long-run fiscal outlook is currently unsustainable. Based on current tax-and-spending projections, the public sector primary balance is forecast to worsen from -0.5% of GDP in 2023, to -8% of GDP by the 2060s as debt as a percentage of GDP rises above 250%. The expected explosion in borrowing is mainly the result of a likely sharp rise in healthcare costs and other spending linked to the UK's ageing population. With a major short-term stimulus to offset the costs of a hard Brexit the UK could soon find itself in deep fiscal waters.

Table 3: UK economic forecasts if a no-deal Brexit happens on 31 October

		2018	2019	2020	2021	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
GDP	% y/y	**1.4**	**1.1**	**0.2**	**1.5**	1.8	1.2	0.8	0.5	-0.1	0.2	0.2	0.5	1.1	1.5	1.6	1.8
	% q/q					0.5	-0.2	0.2	-0.1	-0.1	0.1	0.2	0.3	0.5	0.5	0.4	0.4
	%q/q ann.					2.0	-0.8	1.0	-0.3	-0.2	0.5	0.8	1.1	2.0	1.9	1.5	1.5
Private Consumption	% y/y	**1.7**	**1.6**	**0.7**	**1.4**	1.7	1.7	1.6	1.4	0.9	0.6	0.5	0.8	1.1	1.3	1.5	1.6
	% q/q					0.6	0.5	0.3	0.0	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.4
Government Consumption	% y/y	**0.4**	**2.5**	**2.6**	**1.5**	1.6	2.7	3.0	2.5	2.5	2.7	2.8	2.4	2.0	1.6	1.4	1.0
	% q/q					0.8	0.7	0.3	0.8	0.8	0.8	0.4	0.4	0.4	0.4	0.2	0.0
Investment	% y/y	**0.2**	**-0.5**	**-3.0**	**3.0**	0.9	0.5	-1.1	-2.4	-4.6	-4.1	-3.0	-0.3	1.7	3.2	3.5	3.6
	% q/q					1.2	-1.0	-0.7	-2.0	-1.0	-0.5	0.5	0.7	1.0	1.0	0.8	0.8
Final Domestic Demand [1]	% y/y	**1.2**	**1.4**	**0.4**	**1.7**	1.5	1.7	1.4	0.9	0.3	0.2	0.4	0.9	1.4	1.7	1.8	1.8
	% q/q					0.7	0.3	0.1	-0.2	0.1	0.2	0.3	0.4	0.5	0.5	0.4	0.4
Net Exports [1]	% y/y	**-0.2**	**-0.8**	**0.5**	**-0.3**	-3.4	0.4	-0.8	0.7	2.9	-0.5	0.5	-0.9	-0.3	-0.3	-0.2	-0.3
	% q/q					-2.9	3.3	-1.1	1.4	-0.6	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Stockbuilding [1]	% y/y	**0.4**	**-0.3**	**-1.0**	**-0.6**	1.5	-0.9	0.0	-1.6	-1.4	0.5	-0.7	0.5	0.0	0.1	0.0	0.2
	% q/q					0.3	-1.9	1.2	-1.3	0.5	0.0	0.1	-0.1	0.1	0.0	0.0	0.1
Current Account Balance	GBP bn	**-81.6**	**-101.2**	**-98.2**	**-83.8**	-30.0	-21.1	-26.3	-23.8	-25.9	-25.0	-24.1	-23.2	-22.3	-21.4	-20.5	-19.6
	% of GDP	**-3.9**	**-4.6**	**-4.3**	**-3.6**	-5.6	-3.9	-4.8	-4.3	-4.6	-4.4	-4.3	-4.1	-3.9	-3.7	-3.5	-3.4
Industrial Production [2]	% y/y	**0.8**	**-0.4**	**-0.9**	**1.2**	-0.7	-0.5	-0.7	0.1	-0.8	-0.9	-1.0	-0.6	0.6	1.5	1.4	1.4
	% q/q					0.1	-0.4	0.5	0.0	-0.9	-0.5	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment Rate [2]	%	**4.1**	**4.0**	**4.2**	**4.2**	3.9	3.9	4.0	4.1	4.2	4.3	4.3	4.3	4.2	4.2	4.2	4.2
CPI [2]	% y/y	**2.5**	**2.1**	**3.3**	**2.5**	1.9	2.0	2.0	2.3	3.1	3.6	3.4	3.3	3.0	2.7	2.4	2.2
General Govt. Balance [3]	% of GDP	**-1.6**	**-1.6**	**-2.4**	**-2.2**												
General Govt Debt [3]	% of GDP	**87.3**	**86.3**	**85.8**	**85.9**												
BoE Bank Rate [4]		**0.75**	**0.75**	**0.50**	**0.75**	0.75	0.75	0.75	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75

[1] Contribution to GDP growth [2] Period averages [3] Maastricht basis [4] End period

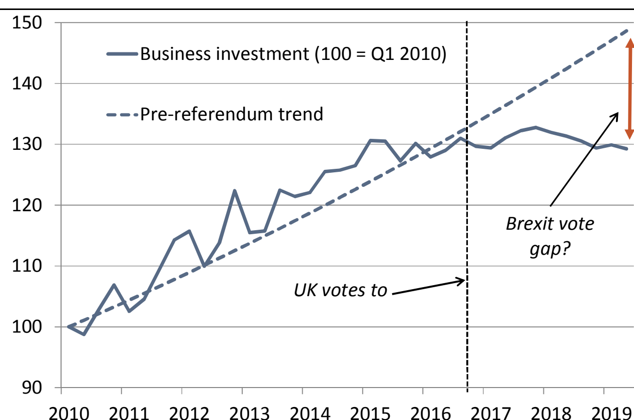
Source: Berenberg

Further extension and prolonged uncertainty

In our view, a further Brexit extension would most likely prolong the current ongoing sub-trend growth momentum. **We would project growth of 1.1% in 2019 and 2020.** That is well below long-run growth potential, even in a hard Brexit (1.5%). What exactly could happen in a further extension is anyone's guess. Chances are that, however, by 2021 there would be some resolution. Hence, we only forecast out to 2020 in this scenario. If and when Brexit is resolved the economy would likely shift towards one of the other scenarios we mention in the note. The key points are as follows.

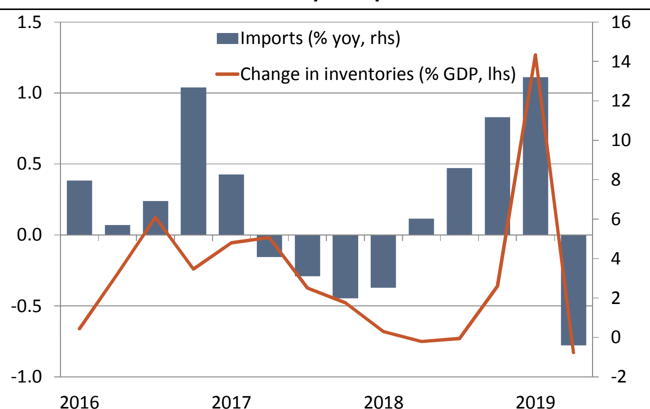
- **Resilient consumption growth:** While spending on big-ticket consumer durables and housing (including repairs and maintenance) will likely remain weak due to the effects of uncertainty, continued real wage gains and mostly healthy household finances should underpin solid day-to-day spending and thus stable real consumption growth. Household spending growth has only slowed modestly since the Brexit vote. Having averaged 2.4% yoy in the three years to the referendum, consumption has slowed to a 2.0% yoy average since Q2 2016 – with a 2.1% annualised averaged in H1 2019. Real wages are rising solidly while confidence and households' reported financial situation remains strong. Expect households to continue to weather the noisy politics.
- **Continued stagnant investment:** The Brexit-uncertainty effect during the past three years is most pronounced in business spending. While hiring remains solid, as Chart 11 shows, real business investment has stagnated since the Brexit vote. We estimate that, if the pre-referendum trend had continued over the past three years, business investment would have been 13% higher than estimated in Q2 2019. Due to the UK's flexible labour market laws, firms can easily cut staff in case of a drop in demand. This partly explains the weak investment trend. Firms have expanded their productive capacity via hiring (low risk) while holding back investment (high risk).
- **Volatile trade and stockpiling:** These components of GDP will likely continue to be heavily influenced by firms shifting expectations about the outcome of Brexit. As Chart 12 shows, these two components of output have been volatile so far in 2019. Ahead of a possible hard Brexit on 28 March 2019, firms imported more than normal and built up stocks. Then, in Q2 2019, these trends reversed after the Brexit date was set back to 31 October 2019. A further extension will prolong such volatility.
- A further extension would put the BoE in a tricky position. We would expect the BoE to continue to guide markets towards further rate hikes, and probably look to hike rates at a pace of one per year, compared to two or more in an orderly Brexit.

Chart 11: Business investment since the Brexit vote



Quarterly data. Source: ONS, Berenberg

Chart 12: Brexit-related volatility in imports and inventories



Quarterly data. Source: ONS

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Contacts

BERENBERG
PARTNERSHIP SINCE 1590

JOH. BERENBERG, GOSSLER & CO. KG

Internet www.berenberg.com

E-mail: firstname.lastname@berenberg.com

EQUITY RESEARCH

GENERAL MID CAP

MID CAP - DACH

Carl-Oscar Bredengen +44 20 3753 3160
Marta Bruska +44 20 3753 3187
Charlotte Friedrichs +44 20 3753 3077
Gustav Froberg +44 20 3465 2655
James Letten +44 20 3753 3176
Alexander O'Donoghue +44 20 3207 7804
Gerhard Orgonas +44 20 3465 2635
Benjamin Pfannes-Varrow +44 20 3465 2620

MID CAP - EU core

Beatrice Allen +44 20 3465 2662
Fraser Donlon +44 20 3465 2674
Remi Grenu +44 20 3207 7806
Christoph Greulich +44 20 3753 3119
Andreas Markou +44 20 3753 3022
Anna Patrice +44 20 3207 7863
Trion Reid +44 20 3753 3113
Jan Richard +44 20 3753 3029

MID CAP - UK

Calum Battersby +44 20 3753 3118
Joseph Bloomfield +44 20 3753 3248
Robert Chantry +44 20 3207 7861
Sam Cullen +44 20 3753 3183
Ned Hammond +44 20 3753 3017
Tom Horne +44 20 3207 7913
Edward James +44 20 3207 7811
Kieran Lee +44 20 3465 2736
Lush Mahendrarajah +44 20 3207 7896
Benjamin May +44 20 3465 2667
Alex Medhurst +44 20 3753 3047
Anthony Plom +44 20 3207 7908
Eoghan Reid +44 20 3753 3055
Owen Shirley +44 20 3465 2731
Donald Tait +44 20 3753 3031
Sean Thapar +44 20 3465 2657

THEMATIC RESEARCH

Steven Bowen +44 20 3753 3057
Julia Schrameier +44 20 3753 3172

BUSINESS SERVICES, LEISURE & TRANSPORT

BUSINESS SERVICES

Tom Burlton +44 20 3207 7852

LEISURE

Jack Cummings +44 20 3753 3161
Stuart Gordon +44 20 3207 7858
Annabel Hay-Jahans +44 20 3465 2720

TRANSPORT & LOGISTICS

William Fitzalan Howard +44 20 3465 2640
Joel Spungin +44 20 3207 7867
Adrian Yanoshik +44 20 3753 3073

CONSUMER

BEVERAGES

Javier Gonzalez Lastra +44 20 3465 2719
Matt Reid +44 20 3753 3075

FOOD MANUFACTURING AND HPC

Ebba Bjorklid +44 20 3753 3247
Fulvio Cazzol +44 20 3207 7840
James Targett +44 20 3207 7873

FOOD RETAIL

Thomas Davies +44 20 3753 3104

GENERAL RETAIL

Michael Benedict +44 20 3753 3175
Oliver Anderson +44 20 3753 3173
Graham Renwick +44 20 3207 7851
Michelle Wilson +44 20 3465 2663

LUXURY GOODS

Lauren Molyneux +44 20 3207 7892

ENERGY

OIL & GAS

Baha Bassatne +44 20 3753 3158
John Gleeson +44 20 3465 2716
Ilkin Karimli +44 20 3465 2684
Edward Pizzey +44 20 3753 3185
Henry Tarr +44 20 3207 7827

ENERGY (cont'd)

UTILITIES

Zaim Beekawa +44 20 3207 7855
Oliver Brown +44 20 3207 7922
Andrew Fisher +44 20 3207 7937
Lawson Steele +44 20 3207 7887

FINANCIALS

BANKS

Adam Barrass +44 20 3207 7923
Frederick Brennan +44 20 3753 3171
Michael Christodoulou +44 20 3207 7920
Andrew Lowe +44 20 3465 2743
Eoin Mullany +44 20 3207 7854
Peter Richardson +44 20 3465 2681

DIVERSIFIED FINANCIALS

Panos Ellinas +44 20 3753 3149
Chris Turner +44 20 3753 3019

INSURANCE

Iain Pearce +44 20 3465 2665

REAL ESTATE

Kai Klose +44 20 3207 7888

HEALTHCARE

Scott Bardo +44 20 3207 7869
Klara Fernandes +44 20 3465 2718
Michael Healy +44 20 3753 3201
Tom Jones +44 20 3207 7877
Michael Ruzic-Gauthier +44 20 3753 3128

INDUSTRIALS

AEROSPACE & DEFENCE

Andrew Gollan +44 20 3207 7891
Ross Law +44 20 3465 2692
George McWhirter +44 20 3753 3163

AUTOMOTIVES

Cristian Dirpes +44 20 3465 2721
Asad Farid +44 20 3207 7932

INDUSTRIALS (cont'd)

CAPITAL GOODS

Jonathan Coubrough +44 20 3465 2699
Philippe Lorrain +44 20 3207 7823

MATERIALS

CHEMICALS

Sebastian Bray +44 20 3753 3011
Xian Deng +44 20 3753 3014
Anthony Manning +44 20 3753 3092
Rikin Patel +44 20 3753 3080

METALS & MINING

Richard Hatch +44 20 3753 3070
Laurent Kimman +44 20 3465 2675
Michael Stoner +44 20 3465 2643

TMT

TECHNOLOGY

Tammy Qiu +44 20 3465 2673
Tej Sthankiya +44 20 3753 3099
Lou Ann Yong +44 20 3753 3159

MEDIA

Robert Berg +44 20 3465 2680
Keisi Hysa +44 20 3207 7817
Laura Janssens +44 20 3465 2639
Sarah Simon +44 20 3207 7830

TELECOMMUNICATIONS

David Burns +44 20 3753 3059
Usman Ghazi +44 20 3207 7824
Laura Janssens +44 20 3465 2639
Abhilash Mohapatra +44 20 3465 2644
Carl Murdock-Smith +44 20 3207 7918

ECONOMICS

Florian Hense +44 20 3207 7859
Kallum Pickering +44 20 3465 2672
Holger Schmieding +44 20 3207 7889

EQUITY SALES

SPECIALIST SALES

AEROSPACE & DEFENCE & CAPITAL GOODS

Cara Luciano +44 20 3753 3146

AUTOS & TECHNOLOGY

Edward Wales +44 20 3207 7815

BANKS & DIVERSIFIED FINANCIALS

Eleni Papoula +44 20 3465 2741

BUSINESS SERVICES, LEISURE & TRANSPORT

Rebecca Langley +44 20 3207 7930

CONSUMER DISCRETIONARY

Pauline Chevalier +44 20 3753 3209

CONSUMER STAPLES

Ramnique Sroa +44 20 3753 3064

HEALTHCARE

David Hogg +44 20 3465 2628

MEDIA & TELECOMS

Jonathan Smith +44 20 3207 7842

METALS & MINING, OIL & GAS AND UTILITIES

Jason Turner +44 20 3753 3063

THEMATICS

Chris Armstrong +44 20 3207 7809

SALES

BENELUX

Miel Bakker +44 20 3207 7808
Bram van Hijfte +44 20 3753 3000

FRANCE

Alexandre Chevassus +33 1 5844 9512
Dalila Farigoule +33 1 5844 9510
Kevin Nor +33 1 5844 9505
Guillaume Viret +331 5844 9507

SCANDINAVIA

Marco Weiss +49 40 3506 0719

UK

Thomas Baker +44 20 3753 3062
James Burt +44 20 3207 7807
Fabian De Smet +44 20 3207 7810
Marta De-Sousa Fialho +44 20 3753 3098
Katie Jackson +44 20 3753 3041
Robert Floyd +44 20 3753 3018
David Franklin +44 20 3465 2747
Sean Heath +44 20 3465 2742
Stuart Holt +44 20 3465 2646
James Hunt +44 20 3753 3007
James McRae +44 20 3753 3036

UK (cont'd)

David Mortlock +44 20 3207 7850
Bhavin Patel +44 20 3207 7926
Kushal Patel +44 20 3753 3038
Richard Payman +44 20 3207 7825
Christopher Pyle +44 20 3753 3076
Adam Robertson +44 20 3753 3095
Mark Sheridan +44 20 3207 7802
George Smibert +44 20 3207 7911
Sam Stannah +44 20 3753 3157
Paul Walker +44 20 3465 2632

GERMANY

Simone Arnheiter +49 69 91 30 90 740
Nina Buechs +49 69 91 30 90 735
André Grosskurth +49 69 91 30 90 734

SWITZERLAND, AUSTRIA & ITALY

Duncan Downes +41 22 317 1062
Andrea Ferrari +41 44 283 2020
Gianni Lavigna +41 44 283 2038
Jamie Nettleton +41 44 283 2026
Yeannie Rath +41 44 283 2029

COO Office

Greg Swallow +44 20 3207 7833

CRM

Megan Connelly +44 20 3753 3244
Laura Cooper +44 20 3753 3065
Beau Dibbs +44 20 3753 3048
Jessica Jarmyn +44 20 3465 2696
Madeleine Lockwood +44 20 3753 3110
Vikram Nayar +44 20 3465 2737
Fenella Neill +44 20 3207 7868

CORPORATE ACCESS

Lindsay Arnold +44 20 3207 7821
Sally Fitzpatrick +44 20 3207 7826
Maz Gentile +44 20 3465 2668
Robyn Gowers +44 20 3753 3109
Dipti Jethwani +44 20 3207 7936
Ross Mackay +44 20 3207 7866
Stella Siggins +44 20 3465 2630
Lucy Stevens +44 20 3753 3068
Abbie Stewart +44 20 3753 3054

EVENTS

Miranda Bridges +44 20 3753 3008
Charlotte David +44 20 3207 7832
Suzy Khan +44 20 3207 7915
Natalie Meech +44 20 3207 7831
Eleanor Metcalfe +44 20 3207 7834
Sarah Weyman +44 20 3207 7801

SALES TRADING

LONDON

Charles Beddow +44 20 3465 2691
Mike Berry +44 20 3465 2755
Joseph Chappell +44 20 3207 7885
Stewart Cook +44 20 3465 2752
Mark Edwards +44 20 3753 3004
Tom Floyd +44 20 3753 3136
Tristan Hedley +44 20 3753 3006
Peter King +44 20 3753 3139
Simon Messman +44 20 3465 2754

LONDON (cont'd)

AJ Pulleyn +44 20 3465 2756
Paul Somers +44 20 3465 2753
Frans Van Wakeren +44 20 3753 3079

PARIS

Vincent Klein +33 1 58 44 95 09

EQUITY TRADING

HAMBURG

David Hohn +49 40 350 60 761
Lukas Niehoff +49 40 350 60 798
Lennart Pleus +49 40 350 60 596
Marvin Schweden +49 40 350 60 576
Philipp Wiechmann +49 40 350 60 346
Christoffer Winter +49 40 350 60 559

LONDON

Christopher Brown +44 20 3753 3085
Edward Burlison-Rush +44 20 3753 3005

LONDON (cont'd)

Jack Clayton +44 20 3753 3166
Will Kain +44 20 3753 3167
Chris McKeand +44 20 3207 7938
Ross Tobias +44 20 3753 3137
Robert Towers +44 20 3753 3262

ELECTRONIC TRADING

Jonas Doehler +44 40 3506 0391
Matthias Führer +49 40 3506 0597
Sven Kramer +49 40 3506 0347

Contacts

BERENBERG
PARTNERSHIP SINCE 1590

BERENBERG CAPITAL MARKETS LLC Member FINRA & SIPC

Internet www.berenberg-us.com E-mail: firstname.lastname@berenberg-us.com

EQUITY RESEARCH

CONSTRUCTION
Robert Muir +1 646 949 9028
Daniel Wang +1 646 949 9025

GENERAL MID CAP - US
Samuel England +1 646 949 9035
Alex Maroccia +1 646 949 9033
Brett Knoblauch +1 646 949 9032

FOOD MANUFACTURING
Donald McLee +1 646 949 9026

HEALTHCARE

BIOTECH/THERAPEUTICS
Shanshan Xu +1 646 949 9023

MED. TECH/SERVICES
Ravi Misra +1 646 949 9028

SPECIALTY PHARMA/BIOTECH
Patrick R. Trucchio +1 646 949 9027

CAPITAL GOODS
Andrew Buscaglia +1 646 949 9040

INDUSTRIAL MATERIALS
Paretosh Misra +1 646 949 9031

REAL ESTATE
Nate Crossett +1 646 949 9030
Connor Siversky +1 646 949 9037

SOFTWARE & IT SERVICES
Gal Munda +1 646 949 9021
Joshua Tilton +1 646 949 9036

TECHNOLOGY HARDWARE
Andrew DeGasperi +1 646 949 9044

ECONOMICS

Mickey Levy +1 646 949 9099
Roiana Reid +1 646 949 9098

EQUITY SALES

SALES
David Alonso +1 312 210 9933
Albert Aguiar +1 646 949 9218
Jason Cantrell +1 415 802 2523
Daniel Claeys +1 646 949 3144
Nate Emerton +1 617 292 82 11
Kelleigh Faldi +1 617 292 8288
Ted Franchetti +1 646 949 9231
Rich Harb +1 617 292 8228
Zubin Hubner +1 646 949 9202
Jessica London +1 646 949 9203
Anthony Masucci +1 646 949 9217
Ryan McDonnell +1 646 949 9214
Emily Mouret +1 415 802 2525
Peter Nichols +1 646 949 9201
Kieran O'Sullivan +1 617 292 8292
Rodrigo Ortigao +1 646 949 9205

CRM
Alexandra Angove +1 646 949 9211
Sammy Chea +1 646 949 9241

CORPORATE ACCESS
Adriane Klein +1 617 292 8202
Olivia Lee +1 646 949 9207

EVENTS
Meridian Della Penna +1 646 949 9208
Laura Hawes +1 646 949 9209

SALES TRADING

Ronald Cestra +1 646 949 9104
Mark Corcoran +1 646 949 9105
Michael Haughey +1 646 949 9106
Christopher Kanian +1 646 949 9103
Lars Schwartau +1 646 949 9101
Donato Tierno +1 646 949 9109