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BREXIT: CAN BORIS SELL IT?

Berenberg Macro Flash

Close to a deal – but with one big snag

UK and EU negotiators have reportedly agreed key elements of a revised deal for an orderly Brexit. However, they have not finalised the deal yet. The biggest hurdle does not seem to lie in technical details that still need to be resolved. Instead, the newsflow suggests that the Northern Irish DUP (Democratic Unionist Party) is objecting to some key elements of the potential deal, namely the way in which Northern Ireland would be de facto kept in the EU customs union and the precise mechanics of how Northern Ireland could approve and potentially exit this arrangement (four years after the end of the envisaged transition period).

The Republic of Ireland, whose priority is to keep the border open, is reluctant to grant the DUP a de facto veto over the customs arrangements. Unless UK Prime Minister Boris Johnson can convince the DUP to back the deal he seems to be ready to strike with the EU, the planned vote on the deal in UK parliament on Saturday would be futile. Without the support of the 10 DUP MPs, Johnson would probably fall short of a majority for a deal.

Is there a path to an orderly Brexit soon?

Yes, if Johnson can bring the DUP on board. However, as the EU summit is starting this afternoon, it may soon be too late to draw up the full legal text of a new deal in time for EU leaders to approve it by the end of the summit on Friday. But if Johnson can get the DUP on board over the next 24 hours and if negotiators then formally agree on key aspects of a deal, EU leaders could probably sign off a political declaration that outlines the key elements of what had been agreed. If so, Johnson could take that to parliament on Saturday and ask MPs to vote on it. While approval by parliament of an outline deal without full legal details would only be symbolic at that stage, it would provide Johnson with a legitimate case for asking EU leaders for a short extension rather than the much longer one (of at least until 31 January 2019) implied by the UK's 'Benn Act'. With luck, a full legal text may still be ready by Friday if the DUP softens its position soon.

The Benn Act states that the UK PM must ask the EU for an extension to 31 January if parliament has not passed a deal or backed a hard Brexit by 19 October i.e. this Saturday. Theoretically, if parliament symbolically backed the outline of deal, negotiators in Brussels could then settle remaining legal and technical details thereafter. That may require just a short 'technical' extension beyond the 31 October planned Brexit date of probably no more than a couple of weeks. If so, Johnson could then bring the legal text of the deal back to parliament to vote on it again in early November.

Johnson has learned May's lesson

Johnson's predecessor Theresa May never managed to convince enough MPs from the Eurosceptic wing of her party and the DUP to back her deal. On three occasions parliament rejected it. But Johnson has better credentials for the task than May. Johnson presents himself as a staunch Brexiteer whereas May backed "remain" in the 2016 referendum. More importantly, he seems to have learned a key lesson. Instead of formally signing up to all details of a deal with the EU and then trying to bring parliament on board thereafter (as May did), Johnson is keeping key stakeholders in the loop throughout the current talks. Herein lies the crux of the current problem. One key



stakeholder (the DUP) still seems unwilling to back the current terms. However, Johnson's approach also means that, if he signs off a deal in the coming hours/days, his chances of getting it through parliament would be much higher than May's.

To get a deal through parliament, Johnson would need support from all remaining Conservatives and the 21 that were evicted from the Conservative parliamentary party some weeks ago when they defied the party line over the Benn Act. This is probably doable. As long as a hard Brexit is off the table, moderate Conservatives should be inclined to back a deal. After all, it would dramatically boost their chances in an upcoming election. For the 21 rebels, Johnson would likely offer to bring them back into the parliamentary party in exchange for backing the deal – most would accept that. If Johnson is lucky, he may even get a few MPs from the Labour Party on board, especially those that sit in pro-Brexit northern constituencies who fear they could lose their seat to Brexit Party candidates if an election takes place before Brexit is sorted.

What if a deal can be struck that is then passed by the UK parliament? The resulting orderly Brexit would:

- be the least bad political outcome for both the UK and the EU27,
- remove the risk of a disruptive no deal hard Brexit,
- significantly reduce the risk that left-wing Labour leader Jeremy Corbyn could ever become UK prime minister (PM),
- raise the probability that current PM Boris Johnson would win potential snap elections,
- boost UK GDP growth to an annualised rate of close to 2% instead of the current sub-1% as a rebound in pent-up business investment and some additional consumer spending would more than offset some a downscaling of inventories,
- let UK trend growth settle around 1.7% instead of less than 1.4% in case of a hard Brexit (and c2.1% pre-Brexit).
- reduce the risk that the Eurozone could fall into stagnation in the next few quarters,
- give the UK a chance to start a political healing process as it would strengthen the political centre,
- come as a major political relief for the EU27 which wants to keep the UK as a close friend but is not keen to either have a hard Brexit or retain a divided and potentially unreliable UK as a full EU member in the EU budget and reform discussions to come.

What if talks collapse or the UK parliament rejects the potential deal?

We do not see much risk of a hard Brexit at the end of the month. Instead, we would expect the UK and EU to agree to an extension during which the UK would hold an election and/or a second EU referendum. The hard Brexit risk is now mostly a function of Johnson winning a majority of seats in the House of Commons in snap elections and then going for a hard Brexit if he cannot get a deal through parliament. In a second referendum on EU membership, the probability distribution of outcomes would tilt towards “remain” with a significant probability of a soft Brexit instead. A lot would depend on the question on the ballot, however. Upon setting the question, the pro-EU parties in Westminster – who would likely be in control at that point - would probably try to keep “hard Brexit” off the ballot paper and instead offer a choice between the WA and remain. Of course, a public backlash may change that.



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