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BREXBACK? PROBABLY NOT

Berenberg Macro Flash

Political turmoil in the UK, some soul-searching in the EU-27, a major but largely orderly re-pricing of financial assets, a plunge in Sterling, rating downgrades for the UK: so far, the impact of the UK vote to leave the EU is playing out like many observers including us had predicted in our “what if” risk scenarios ahead of the vote. So far, we see only one modest surprise: in its political confusion, the UK is further weakening its economy and its bargaining position by delaying the start of divorce negotiations, apparently waiting until at least early September to install a new prime minister to get the ball rolling.

Unsurprisingly, the victorious Brexiteers have not come up with a coherent idea of what comes next. Instead, and also as expected, they may soon have to explain to the UK public that the promises on which they won the vote, including those of saving money and avoiding any economic damage, could be impossible to keep.

In some quarters, a discussion along the lines “maybe we didn’t quite mean it” seems to be unfolding. Some observers have even suggested that the UK may not actually leave the EU. That may or may not include holding a second referendum, perhaps after securing “better” terms from the EU in new talks. Could the UK exit from the Brexit, could it “brex back” into staying in the EU? To answer that, we can use a slightly updated version of what we wrote before when we explained that “out is out”, to again borrow a phrase from German finance minister Schaeuble.

COULD A BORIS DO A TSIPRAS?

Technically speaking, the 23 June referendum was merely advisory. It does not bind parliament and has no legal consequences for the EU as such. If the UK does not file for divorce by invoking Article 50 of the EU treaty, it will just stay in the EU as if nothing has happened. However, I find it difficult to believe that Cameron’s successor would want to do and could get away with doing a Tsipras. Last July, the Greek prime minister simply ignored the result of a referendum he had called (and won), signing a tough new agreement with Greece’s official creditors instead. We dare not imagine the turmoil in the Conservative Party if a new prime minister does not implement the referendum result. Many UK voters registered their anger at the “establishment” with their vote for Brexit. If they get the impression that the “establishment” is ignoring their vote, the anger could only get worse. If London fails to follow up on the referendum result, the UKIP populists could get a big boost in major parts of England at the expense of the Conservatives and Labour alike.

THE EU-27 WILL NOT OFFER BETTER TERMS

In addition, much of the UK discussion seems to ignore the views held on the continent. Some Brexiteers, including Boris Johnson, have occasionally toyed with the idea of using a “leave” vote to launch new negotiations with the EU on better terms to stay in. For the EU-27 countries, that would be unacceptable. They already offered the best terms they could back in February. Going along with a UK suggestion to now negotiate substantially better terms for the UK would set the worst possible incentive for other member countries. That would invite the would-be copycats. As much as, for instance, Germany values the UK as a member of the EU, it now has to safeguard the overall cohesion of the EU-27 even more. Only if the UK relents, which looks highly unlikely but not impossible if the country falls into the recession that Boris Johnson promised would never happen, may the EU settle on keeping the UK on roughly the terms it offered in February, save a few diplomatically worded clauses here and there. With the Brexit vote, priorities for the EU-



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27 have shifted. Keeping the UK in is no longer the major ambition. Instead, the EU-27 will judge everything they discuss with the UK through a new prism: does it help to secure the cohesion of the EU-27 or not?

COMMON MARKET WITHOUT FREE MOVEMENT OF LABOUR?

Suggestions that the UK could restrict the free movement of labour but remain a full member of the common market otherwise, either with a new deal in the EU or in a post-Brexit arrangement, ignore one big point: the free movement of labour is one of the four fundamental principles of the common market. Clamping down on welfare tourism along the lines that Cameron secured in the reform deal which UK voters have now rejected is possible. But to get the EU-27 including its eastern European members and Spain ratify a deal that restricts the free movement of labour while granting the UK all other freedoms of the common market seems highly implausible, to put it mildly. As German chancellor Merkel told the German parliament this morning, there will be “no cherry picking”. Instead, he who leaves the family cannot expect to ditch the duties but retain the privileges. There will be a “noticeable difference” between a country that is in and a country that is out.

The UK debate often overlooks that the Brexit vote and the refusal of the UK to start the divorce proceedings soon are eliciting a counter-reaction in some EU-27 members. Contemplating additional concessions to a UK that is seen more and more as somewhat unpredictable and unreliable would not come easy for many EU-27 members.

In the political turmoil into which the UK has thrown itself, nothing can be ruled out. I would be absolutely delighted if the UK could still avoid the folly of Brexit. But that seems to be a slim chance rather than a real possibility at the moment. Somewhat less far-fetched but still not quite probable may be that, once the UK and the EU have settled the terms of divorce in a couple of years, UK voters may then reject these rather unfavourable terms and choose to stay in the EU instead. But again, that does not look likely either. Out probably means out.

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