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## **ECONOMIC IMPLICATIONS OF MAY'S SPEECH: CRUCIAL DETAILS STILL UNKNOWN**

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#### **On the economy, we learned nothing new**

Besides offering a roundup of May and her Conservative government's broad ambitions for Brexit, most of which had been leaked or announced much earlier, we learned nothing new today that adds any colour to our economic outlook for Brexit. Critical details on the government's intended future rules for migration, or its ambitions for the length and nature of a transitional agreement for Brexit, are still missing. Such details are crucial in order to better estimate the level of access the UK will get to the EU market – think single market-migration trade-off – and the long terms consequences of Brexit.

#### **On the process, we learned a little more**

May announced that she would ask parliament to vote on the final Brexit deal before the UK leaves the EU, but there is a serious question of how valid such a vote would be. Unfortunately for the UK, the two year deadline and Article 50 process is designed to give to much bigger EU much leverage than the exiting country. Once the UK triggers Article 50 (likely in March) the two-year stopwatch begins to tick. If the UK doesn't agree to the terms of the post-Brexit deal and likely transitional arrangements then it may suffer a cliff-edge Brexit and find itself trading with the EU on WTO terms. That would be the worst outcome for the economy.

#### **Messy negotiations highly likely**

Emboldened by the stronger performance of the UK economy since the June 23 referendum, May announced that 'no deal is better than a bad deal' and that the UK would respond in kind with competitive tax cuts to support UK the economy if the EU looked to offer the UK a bad deal for future trade. May's tough opening gambit was to be expected following the heavy criticism of the then Prime Minister David Cameron's attempt at a new EU settlement for the UK before the referendum by his backbenchers.

In summary, May announced her that the broad elements of her Brexit strategy were as follows; full control over UK laws, an exit from the Single Market and Customs Union, full control over EU migration, major reductions in the UK's net contribution to the EU and a free trade-deal to maximise the UK's access to the Single Market. EU27 leaders will see these criteria as contradicting the four principles of the single market. As May has stated on several occasions that she will prioritise regaining control of the UK's borders and laws over access to the single market, and we do not expect the EU to compromise its principles, the UK is set to face significant economic consequences from Brexit.

#### **May's speech did not alter our base case by much**

While there are profound uncertainties, we currently expect the UK and EU27 to agree a deal in which the UK maintains a good level of access to the EU's goods markets and limited access to the less developed services markets. Crucially, we expect the UK to lose its EU financial services passport. This follows from the UK raising some modest barriers to migration from the EU. By lowering growth in trade, investment and migration with the UK's biggest market (EU) we expect our Brexit base case to reduce UK potential growth to 1.8% per year from its pre-referendum rate of 2.2%. May's fighting talk somewhat raises the risk of a harder Brexit than our base case assumes, risks to long-term growth are thus tilted to the downside. The accumulated costs of Brexit could add up badly over time.



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