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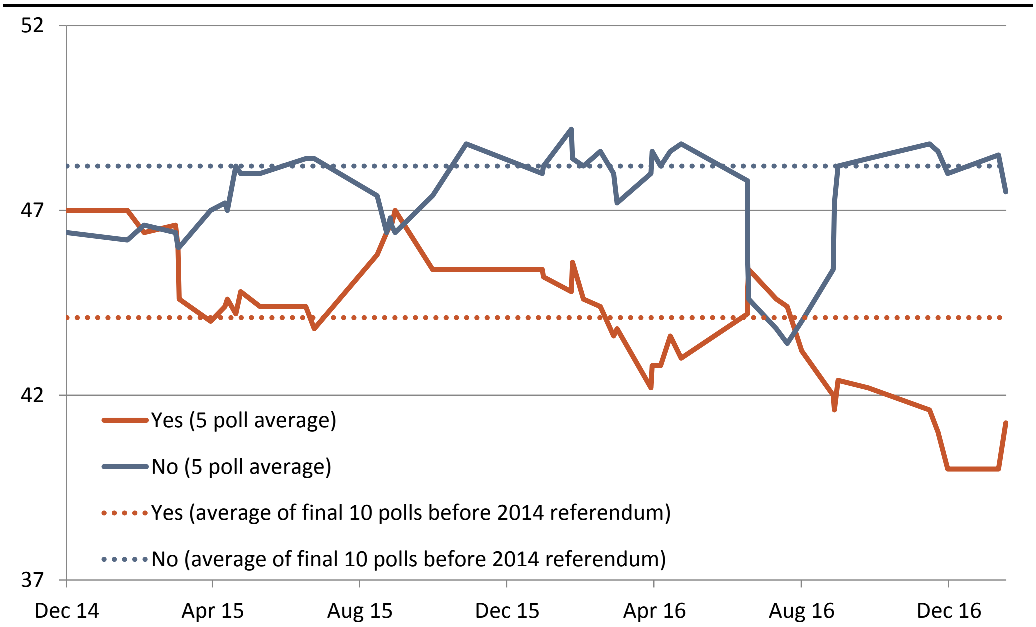
UK UPDATE: SCOTTISH INDEPENDENCE, ARTICLE 50, SOLID NEAR-TERM OUTLOOK

Berenberg Macro Flash

Support for Scottish independence has fallen since the Brexit vote: Could Scotland leave the UK in order to stay in the EU upon Brexit? According to some media reports, PM Theresa May is readying for a possible second Scottish independence referendum. But the only really relevant issue when it comes down to a potential second referendum on Scottish independence is whether the Scottish people would in fact go against the result of the first referendum held in September 2014 and vote 'yes' to independence. Looking at opinion polls since the first referendum, support to remain in the UK has held broadly stable at 48% - the same level of poll support before the 2014 referendum that ended with 55.3% of Scottish people voting to remain in the UK. Meanwhile, support for Scottish independence has fallen by around 5 points since 2014. At the current level of c42% in opinion polls, support for independence is c2 points below the 44% support shown in the pre-2014 referendum polls (support for 'yes' in the 2014 referendum was 44.7%). Despite SNP (Scottish National Party) leader Nicola Sturgeon's post-Brexit posturing for another referendum, would the SNP leader really push for a second referendum anytime soon with no clear suggestion of a victory? That seems highly improbable. A second 'no' vote would put the question to rest for at least a generation. Our hunch is that by signalling the desire to hold another referendum, the SNP probably knows it can secure enough votes to retain its solid majority of Scottish seats at the 2020 UK general election and likely secure another win at the 2021 Scottish Parliament election.

Opinion polling for Scottish independence



Question: Should Scotland be an independent country? Result from 18 Sept 2014 referendum: 44.7% = yes, 55.3% = no. Source: Various, Berenberg calculations.

House of Lords unlikely to succeed in getting major amendments to the Article 50 bill: After the prime minister easily won approval – without any amendments - from the House of Commons (lower house) to trigger Brexit by invoking Article 50 of the EU treaties, it seems unlikely that the unelected House of Lords (upper house) will introduce any significant changes to the bill that will enable the government to kick-off Brexit negotiations with the EU27. While May's Conservative Party has a majority in the lower house, they do not have a majority in the upper house. This provides a theoretical basis for changes to the bill. Both houses must agree on the bill before it is passed. A process known as 'ping pong' where a bill moves back and forth between the two houses can go on indefinitely. While potential amendments by the Lords such as guaranteeing rights of EU citizens in the UK and giving parliament a veto on the final deal could be positive from an economic point of view, the risk of a strong political backlash for the unelected upper house from such a move would likely be too severe for it to gain enough support. Our base case remains that prime minister May will likely have a law passed in time for her self-appointed end-of-March deadline to trigger Article 50.

Feb PMI data likely strong after solid ESI readings: After growing at above-trend pace in the second half of 2016 the UK economy has carried significant momentum into 2017. PMI data for February is likely signal strong growth in the services (exp. 54) and manufacturing (exp. 55) sectors driven by solid domestic demand and the cyclical upturn in global demand. The much smaller construction sector is likely to have expanded at a more meagre pace according to the PMI (exp. 52) as Brexit uncertainty is dampening demand for long-lived investments and as firms struggle with labour shortages. Following the 12% depreciation in trade-weighted sterling since the Brexit vote, firms across all sectors will likely report sharp rises in input costs. The European Commission ESI data for February – comparable to PMI data – showed a strong improvement across all sectors with the headline (composite) index reaching its highest level since December 2015. Soft data indicate that real GDP is currently expanding at or a little above its quarterly trend rate of 0.5%. The continued strong performance of the UK since the Brexit vote supports our above-consensus calls for the next two years: We forecast real GDP growth in 2017 and 2018 of 2.0% and 1.7%, respectively. Our forecasts exceed Bloomberg consensus (28 February 2017) of 1.5% in 2017 and 1.3% in 2018. For more information please see 'UK outlook resilient: first rate hike in 2018'.

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