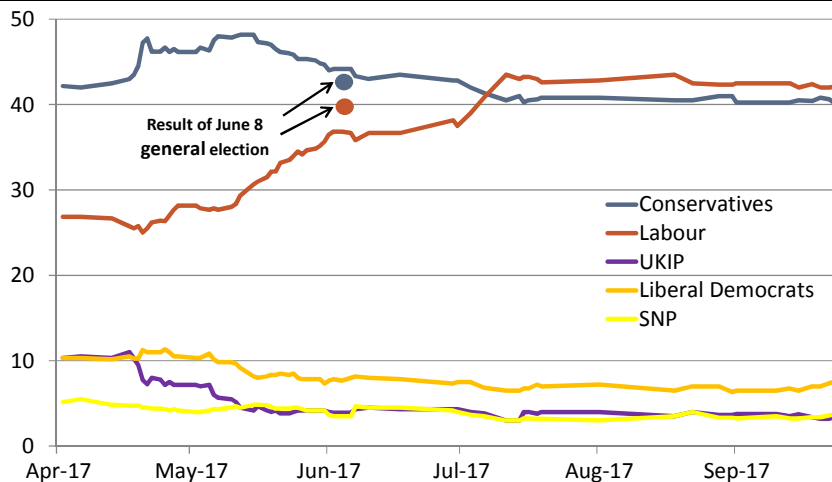


6 October 2017

UK politics: what next?

Labour are a whisker ahead in the polls after May's botched snap election in June 2017



UK opinion poll. Source: National polls. Three-poll moving average. 8 June 2017 election results: Conservatives (42.4%), Labour (40.0%), Liberal Democrats (7.3%), SNP (3.1%) and UKIP (1.8%).

- **A slow-motion tailspin:** Ever since the then-prime minister David Cameron announced in 2013 that the UK would hold a vote on EU membership, British politics has taken a turn for the worse. Even before the UK voted for Brexit in June 2016, the governing centre-right Conservatives were divided over the issue. Prime Minister Theresa May is badly damaged after losing her party's slim majority in snap elections in June 2017. And, after her disappointing performance at the Conservative conference earlier this week, the media is at fever pitch over speculation that May could soon resign.
- **The threat from the left:** Labour is currently headed by far-left Jeremy Corbyn, whose socialist economic policies would risk taking the UK partly back to the 1970s. With Labour marginally ahead according to the latest opinion polls – see chart – the fear of Corbyn at Number 10 is the glue that binds the governing Conservative-Democratic Unionist Party of Northern Ireland (DUP) piecemeal alliance together. We see four potential scenarios for the future.
- **Scenario one – May resigns, Conservatives hold on until 2022 (35%):** Unable to keep control over her party, May resigns. Her party elects a new leader who holds the office of Prime Minister until the next scheduled elections in 2022. If May signs off on the EU's demands for the Brexit bill and citizens rights before resigning, her successor could have a free run at trade talks with the EU – potentially opening the door to a favourable deal. But if May was replaced by a hard-line Brexiteer, the risk of a hard Brexit – no UK-EU trade deal – could rise materially.
- **Scenario two – May holds on to 2022 (35%):** May holds out after concluding that a divisive leadership election could break up her party or the fragile alliance with the DUP. The Brexit route followed so far, of the UK gradually conceding to the EU's demands, would continue. But infighting between moderate Tories and Brexiteers could prevent the UK-EU talks moving forward, thereby raising the risk of the UK facing a cliff-edge Brexit in March 2019.
- **Scenario three – snap elections, Conservatives win (10%):** May resigns and, unable to govern effectively, the government calls snap elections. Much like our base case, the outlook for Brexit depends on who ends up in Number 10.
- **Scenario four – snap elections, Labour wins, possibly in a coalition (20%):** Labour leader Corbyn comes from the far-left fringes of British politics that has traditionally viewed the EU as some sort of capitalist conspiracy. But since his party base holds more-favourable views towards Europe than the Conservatives, Labour would probably seek to soften Brexit in the end. That said, misguided economic policies under Corbyn would create risks to the long run growth that could exceed the potential upside coming from the more-limited negative impact of Brexit.
- **All of the UK's major economic risks are political:** Inside the EU, the UK can sustain annual real GDP growth of 2.2%. If the UK and the EU can strike a post-Brexit trade deal covering goods and non-financial services (our base case), trend growth could fall to a still-decent 1.8% per year. In case of a hard Brexit, however, to which we assign a 30% collective risk from the above scenarios, trend growth could fall to 1.5%. Whichever destination UK politics finds itself at in the coming years will determine the fate of Brexit. Rarely has the future of the UK seemed so uncertain.

Economics

Chart of the week



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