

19 July 2019

Brexit: reduced chance of a sensible outcome

Probabilities of potential Brexit outcomes

Outcome/By	Before 31 Oct	After 31 Oct	Total
Hard Brexit	30ppt	10ppt	40%
Pass WA	30ppt	5ppt	35%
Remain	0ppt	25ppt	25%

WA = Withdrawal Agreement. Source: Berenberg

- Scary times:** As the last few Conservative Party members cast their votes to decide the party's next leader and new UK Prime Minister (PM) – result on 23 July – candidates Boris Johnson and Jeremy Hunt are hardening on Brexit. Both declared on Monday that neither would accept the contentious Irish backstop as part of a Withdrawal Agreement (WA), even in the unlikely case the EU agreed to a time limit or unilateral exit mechanism. At face value, this reduces the probability of an eventual deal.
- Genuine hardening or negotiation tactic?** In politics, a lot that is said on the campaign trail stays there. Johnson, the big favourite to win, has a reputation for changing his rhetoric to suit the audience and his positions on a whim. It is possible that he is trying to create space for a compromise by demanding the impossible in order to get Irish PM Leo Varadkar to accept a half-way deal, ie a time limit on the backstop. As a Remainer in the 2016 referendum, Hunt has to match Johnson like-for-like on Brexit otherwise he risks looking soft to the eurosceptic Conservative Party voter base.
- Hard Brexit risks mounting:** Two additional developments suggest that the hard Brexit risk has gone up. First, Johnson has picked eurosceptic Daniel Moylan as his top Brexit advisor. By surrounding himself with hardliners, Johnson could find himself boxed into a hard Brexit with little room for manoeuvre. Second, with Labour sliding in the polls – lowering the chance of success in snap elections – up to 10 MPs in Brexit constituencies are ready to back a hard Brexit according to MP Emma Lewell-Buck.
- Moderates strike back:** Moderates in the House of Commons seem to be reacting to the increased threat of a hard Brexit by backing measures that seek to prevent such an outcome. Yesterday a majority (315 to 274) of MPs (including senior Conservatives) backed a proposal that will require parliament to sit for several days in September and October to debate Northern Irish affairs. This makes it harder than before for a pro-Brexit PM to bypass parliament by temporarily suspending it in order to force through a hard Brexit. Separately, a handful of Conservatives continue to threaten the nuclear option of bringing down the government if it looks like the UK is heading for a hard Brexit.
- Increase risk of a further delay:** Recent developments set the stage for a showdown between a hard-Brexit PM and a moderate-majority parliament in autumn that could end in a further Brexit delay (40% chance). Probably, the EU would only agree to an extension in case of serious political developments such as to provide time for a snap election and/or a second referendum. We have thus split up our updated probabilities to reflect what could happen either on or after 31 October (see table).
- Falling probability of a compromise:** We lower the likelihood that parliament eventually passes the WA or some revised version of it from 40% to 35% (30ppt before 31 October, 5ppt after) – within that, we see a 20ppt chance the EU compromises on a time limit to the backstop.
- Tail-risks rise:** We raise the risk of an eventual hard Brexit to 40% from 35% (30ppt before 31 October, 10ppt after). Furthermore, we still see a 25% chance that the UK remains in the EU – most likely following a snap election that ends with a pro-EU coalition government and second referendum. However, in these uncertain times, we note that there is a high probability that the outlook could change again once the new PM enters No. 10.

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