

21 October 2019

Still on course for orderly Brexit soon; hard Brexit risk down

What is at stake? Potential UK real GDP growth per year in different Brexit scenarios

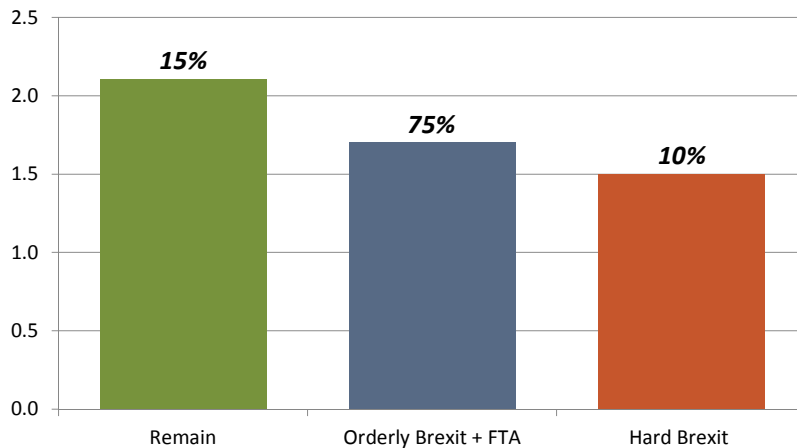


Chart shows % change yoy. FTA – zero quota and tariff free trade agreement covering goods and some non-financial services. Probability attached to outcome shown above bars. Source: Berenberg

- The Brexit mess takes another turn:** UK Prime Minister Boris Johnson suffered another setback on “super Saturday” when the UK parliament delayed the meaningful vote on his new Brexit deal. Johnson even had to ask the EU for another Brexit delay, which he did in a decidedly odd way. However, the outcome is no reason to sell UK assets or sterling, in our view. Johnson still plans to pass the necessary UK domestic legislation to implement the Brexit deal and to hold the decisive vote on his Brexit deal in parliament this week, with a first vote as early as today.
- Two reasons why the chance of an orderly Brexit has increased:** 1) Johnson has already succeeded where his predecessor Theresa May failed. The Eurosceptic wing of his party is now backing a deal for an orderly Brexit. With 322 to 306, the Saturday vote was already close. 2) This vote closed the last legal loophole that might have led to a hard Brexit on 31 October. Some of those rebel Conservatives, independents and pro-Brexit Labour members of parliament who did not vote for Johnson on Saturday because they do not trust him may now be ready to support the new Brexit deal. Their priority is to rule out a hard Brexit, not to prevent an orderly Brexit. As a result, Johnson probably now has the numbers to pass his deal. We thus raise the chance of an orderly Brexit from 35% to 75%, with a 60% probability that the UK parliament will accept the new Brexit deal before 31 October.
- Hard Brexit risk down:** We see a 40% risk that the UK parliament will not ratify Johnson’s Brexit deal before 31 October. This could lead to a longer Brexit extension with snap elections and/or a new referendum. Even in the case of new elections, the risk of a hard Brexit would now be small. As the whole of the Conservative Party is now firmly behind Johnson’s deal, no major party in parliament now wants or threatens to go for a hard Brexit. In case of a snap election, Johnson would likely campaign and win a majority with his new deal, rather than on a hard Brexit ticket as seemed possible before. Centre and centre-right moderate voters could support the Conservatives without fearing it would lead to a hard Brexit. This is the key result of Johnson’s deal with the EU last week. We thus reduce the risk of a hard Brexit from 35% to 10%. The residual risk could come into play if a) a surprise surge in support for Nigel Farage’s Brexit Party before or in an election were to force Johnson to disavow his own deal; or b) if the UK and EU fail to strike a deal on their future economic relations by the end of the transition period.
- Probability of no Brexit down:** The one route to a reversal of Brexit – the “rebel alliance” of MPs who wanted to stop a hard Brexit unites to back a second referendum – is partly closed off now that most Conservative rebels are ready to vote for Johnson’s deal. Furthermore, in a second referendum, Johnson’s deal would probably stand a better chance of beating “remain” than May’s old deal or a hard Brexit. We cut the probability of no Brexit to 15% from 30%.
- EU reaction – keep calm and carry on:** The EU27 wants to avoid a hard Brexit, and, as its second priority, end the Brexit mess as fast as possible. In response to Johnson’s “unsigned” extension request, the EU will probably wait until shortly before 31 October to see whether the UK still passes the deal. If so, the EU would likely grant a short technical extension if required to complete ratification proceedings in the UK and EU parliaments. Otherwise, the EU may grant a brief extension with a deadline for the UK to propose a clear way forward before the EU may decide whether it should offer a long extension to accommodate new UK elections and/or a new UK referendum.

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