

# United Kingdom

## Brexit update

As we approach 31 October 2019, the latest deadline for the British exit from the European Union (Brexit), who can say where the UK is heading? Probably not the Prime Minister himself, Boris Johnson, who lost his majority in the House of Commons in an attempt to suspend discussions and fuelled scepticism among his European partners by presenting a take it or leave it ‘compromise’ on the Irish backstop that is hardly applicable nor acceptable. This would leave the Brexit end-point with no deal, although this has been prohibited by a law, or the more likely, but by no means guaranteed, outcome of a new extension accompanied by an early general election.

It is now more than three years since the UK voted in a referendum to leave the European Union (EU). And yet, no one knows the direction in which the country is heading. A withdrawal agreement is on the table, but this has been rejected on three occasions by the House of Commons, so it would be quite some feat to get it ratified by 31 October 2019 (the next deadline). In a last attempt to find support at Westminster, Prime Minister Boris Johnson proposed to remove the “backstop” for Northern Ireland that was intended to prevent the return of hard border with the Republic of Ireland, while maintaining the integrity of the single market.

But his offer to the twenty-seven other EU member states (the 27) is unlikely to find favour either for its form (it has been presented as a ‘take it or leave it’ offer) or for its contents. Thin on detail, legally and operationally questionable, Boris Johnson’s alternative to the backstop suggests that the two Irelands could remain in a common regulatory zone, whilst belonging to two different customs unions (British and European) and that all this could be achieved without re-introducing border checks. At the time of writing, the European Parliament and the President of the Council, Donald Tusk, have given these proposals a pretty frosty reception.

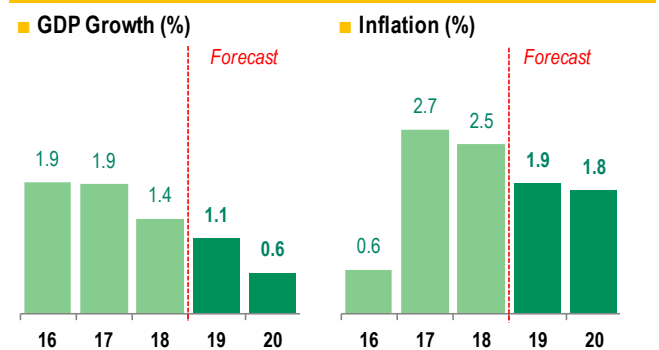
In the unlikely case Boris Johnson reaches a new deal with the 27, he would have the greatest difficulty in ratifying it, having lost his majority in a House of Commons he tried to suspend<sup>1</sup>. This would leave the end-point either as a ‘no deal’, although this has been prohibited by a recent change in the law, or the more likely, but by no means guaranteed, outcome of a new delay accompanied by an early general election.

### Deal or no deal...

Whilst negotiating a withdrawal agreement (WA), the 27 have been actively preparing for the possibility of a no-deal exit. To do so, the Council and Parliament have adopted a series of contingency measures covering areas as varied as fisheries, data transfers, citizens’ rights, transports, chemicals or medicines. Most of the proposed solutions are temporary and subject to reciprocity from the UK (see Box 3); the European Commission has also indicated that they will in no way replace the EU’s rules and preferences, which will cease to apply to the UK on its departure date. The aim is to soften, as far as possible, the impacts of no deal, which nearly all economic actors – with UK businesses topping the list – believe to be both negative and inevitable.

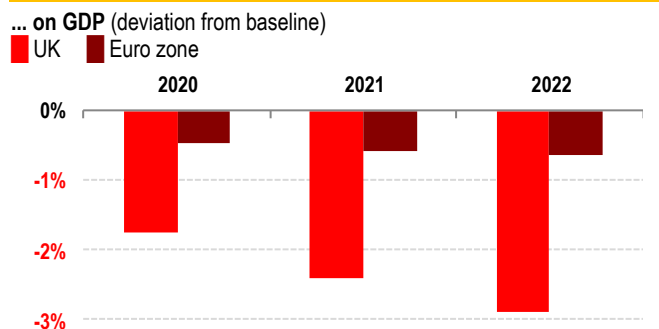
<sup>1</sup> The suspension was overturned by the Supreme Court on 24 September 2019.

### 1- Growth and inflation

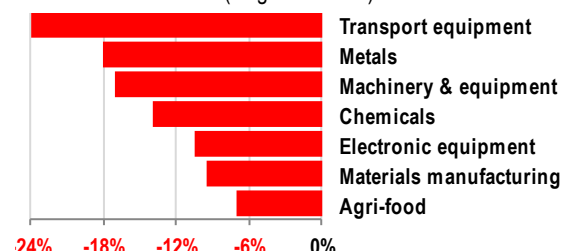


Source: National statistics, BNP Paribas

### 2- The economic cost of a no-deal Brexit...



... on production in certain sectors of UK economy  
Deviation from baseline (long-term effect)



Source: OECD

In a study published recently<sup>2</sup>, the Organisation for Economic Cooperation and Development put the loss in UK’s production following a no-deal at nearly 3 points of GDP by 2022. The National

<sup>2</sup> See OECD (2019), Interim Economic Outlook, September.



Institute of Economic and Social Research (NIESR) puts the figure at 5 points. This is only an average. Given the UK's role in European value chains, the losses would be particularly severe in several highly integrated sectors, like automotive and aerospace (Chart 2).

Whilst not negligible, the shock would be more bearable for the euro zone (a 0.6 pp loss in GDP after three year, five-times less than in the UK). Clearly, the picture would be very mixed from one country to the next, with Ireland, for instance, seeing an impact on growth eight times greater than that in Spain<sup>3</sup>. As a result, the support measures already include provisions to redirect EU resources (such as from the European Maritime and Fisheries Fund for example) towards the worst-affected sectors and regions.

A no-deal Brexit represents a leap into the unknown and no one can claim to be able to predict its exact consequences. Econometric analysis therefore plays only an indicative role. One of its merits, though, is that it shows that the process will end poorly for pretty much everyone; there will be no winners, only different types of loser. In the run-up to 31 October reason rather than desire is likely to push UK and EU leaders to agree a fresh extension (the third) prior to finally separating... or not. The UK could well hold an early general election, and at the moment the polls are showing a lead for Boris Johnson's Conservative Party.

#### ■ ... the damage is done

Whatever the final outcome, the Brexit saga has already caused significant damage to the UK economy, which will be hard to repair. The transfers to continental Europe of the European Banking Authority, the European Medicines Agency, the security centre for the Galileo GPS system, or simply the subsidiaries and headquarters of groups seeking to secure access to the single market are all probably one-way moves. For the first time since the financial crisis of 2008, the UK's balance of payments has shown a chronic net outflow of foreign direct investment.

Economic conditions in the UK are deteriorating. Business surveys remained weak throughout the summer and GDP contracted in the second quarter. At 49.3 in September, the Purchasing Managers Index is at its lowest for ten years, apart from its brief collapse in July 2016 after the Leave victory in the referendum.

Jean-Luc Proutat

[jean-luc.proutat@bnpparibas.com](mailto:jean-luc.proutat@bnpparibas.com)

### 3- Some examples of contingency measures adopted by the EU in the event of a no-deal Brexit

#### Citizens

*On the withdrawal date, UK citizens will be considered as citizens of a non-member third country, without preferential treatment, implying enhanced border controls, passport and visa requirements and residence permits to travel and work in the EU, the withdrawal of mutual recognition of professional qualifications and of the automatic portability of social security rights, etc.*

*On condition of reciprocity, the contingency measures aim to guarantee UK citizens and their families resident in the EU prior to the withdrawal date the right to remain legally for a transitional period (12 months in France) during which time they can apply for permanent residence; they also seek to guarantee social rights acquired in the UK prior to the date of withdrawal, as well as equality of treatment in access to health care and the assimilation and aggregation of pension rights, etc.*

#### Customs

*On the withdrawal date, customs formalities and duties would apply immediately (declarations, VAT payments, possible guarantee requirements, etc.). Prohibitions or restrictions might apply. Import and export licences would be required, whilst Authorised Economic Operator (AEO) certifications granted by the UK would no longer be valid in the EU.*

*The contingency measures seek, as much as possible, to prevent blockages at borders and/or disruption to supplies: increased border post resources (both human and infrastructure), the temporary, conditional extension of the validity of checks and approvals for marketability carried out by the UK for certain products (medicines, veterinary products, etc.). In addition, nearly one hundred 'preparatory notices' have been issued to businesses to help guide them through the administrative and regulatory processes, adapt contracts, relocate facilities, restructure sites and so forth.*

#### Air travel

*On the withdrawal date, EU rules governing air travel services within the EU will no longer apply to the UK, resulting in the UK's loss of access rights for flights to EU destinations and for all flights (internal or international) operated within the EU or between the EU and a third country.*

*On condition of reciprocity the contingency measures aim to ensure basic air connectivity (maintaining services between the UK and the 27) for a short period of time, until 30 March 2020. After that date, carriers based in the UK will have to conform to EU requirements, notably in terms of ownership and control, in order to operate within the EU.*

Source: European Commission

<sup>3</sup> See Insee (2019), *Assessing the impact of Brexit on the economic activity of the UK's closest partners: the trade channel*, Conjoncture in France, March 2019.

