United Kingdom

Brexit update

Brexit has been behind thirty-seven resignations from the government responsible for managing the process, the latest being that of Prime Minister Theresa May herself. Having failed three times to get the Withdrawal Agreement through Parliament, she had little choice but to ask for an extension of the Article 50 period and then in the end to resign. The two candidates to take her place are the current Foreign Secretary, Jeremy Hunt, and his predecessor, Boris Johnson. Whilst Mr Johnson claims he can negotiate a changed deal and trigger Brexit from 31 October 2019 (the latest deadline), Mr Hunt plans to seek more time in order to renegotiate to allow for an orderly exit.

The relative strength of the UK economy in the first quarter of 2019 (with GDP growing by an annualised 2%) should not be allowed to mask the true situation. First, the rebound was driven by an intense phase of inventory building in preparation for a Brexit that did not in the end take place, and ran counter to the picture painted by surveys of business leaders, which were more gloomy. The fundamental trends are not good. Foreign direct investment flows have reversed to a position of net outflows; the trade deficit has widened; and the pound has not recovered (Figure 1). Meanwhile, flows of immigrants from the European Union (EU) have dried up (with less than 60,000 net arrivals in 2018, equal to the low point of 2009), which is hitting the real estate sector. Whether it is the former Foreign Secretary, Boris Johnson, or his successor, Jeremy Hunt, who succeeds Theresa May, the future Prime Minister will inherit an economy under pressure; moreover, they will have very little time to act, given the current Brexit departure date of 31 October 2019.

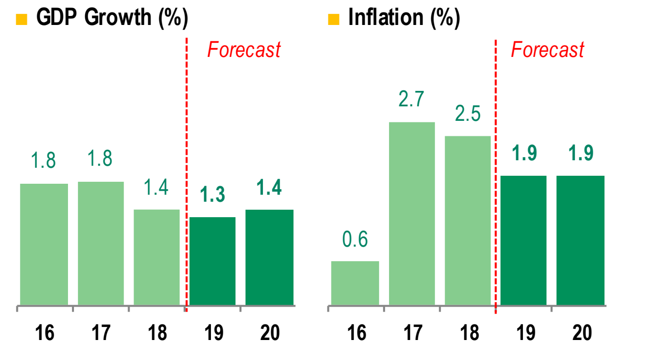
Replace the Prime Minister, but to what end?

Having declared after the Brexit referendum that the UK could have its cake and eat it when it came to the Single Market, candidate Johnson will have his work cut out to persuade the twenty-seven EU heads of state or government (the 27) to offer his country better terms for its departure.

His chances of success are close to zero. When they accepted an extension of the Article 50 period to 31 October 2019, the 27 were clear that the Withdrawal Agreement they had reached with Mrs May in November 2018 would not be renegotiated. One key issue is the "Irish backstop"[1] which is a stumbling block for some in the UK but seen by Europe as a guarantee of the integrity of the Single Market. Although there is some (limited) room for rewriting the Political Declaration (which is not legally binding, but sets the direction of travel for post-Brexit negotiations), the incoming Prime Minister should not count on being able to put anything other than the current withdrawal agreement before the House of Commons.

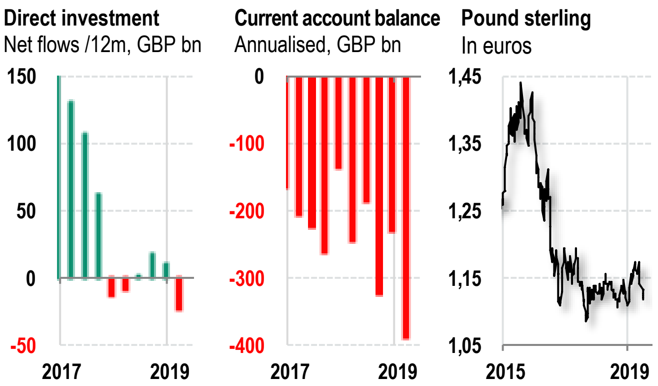
However, with the Withdrawal Agreement having already been rejected three times, any ratification before 31 October looks highly unlikely, especially given that current parliamentary arithmetic casts

1- Growth and inflation



Source: National statistics, BNP Paribas

2- Slippery slopes



Source: ONS, Refinitiv

Northern Ireland's Democratic Unionist Party as the referees, preventing any compromise.

The more clear-sighted Jeremy Hunt recognises that the UK is not currently in a position to enact the terms of the divorce agreement with the EU. He has argued for a further delay to Brexit, which, if his candidacy is successful, will not take place until 2020. In response, Boris Johnson has promised that the UK will leave the EU by midnight on 31 October, even if there is no deal in place.

A quick list of the regulatory and tariff complications of a 'no deal Brexit' is enough to show that such an option, even if some emergency measures were put in place (continuity of payment and settlement business, temporary extensions of licences, etc.) would

[1] The Withdrawal Agreement states that once the UK has left the EU, and in order to avoid the reintroduction of a physical border between Northern Ireland and the Republic of Ireland, a safety net, or 'backstop' will apply to Northern Ireland. Under the Agreement and until the 'future relationship' is settled, Northern Ireland will remain in a temporary customs union with the EU and will have full alignment of standards (legal, technical, environmental, etc.).

have the harshest economic impact for the UK (box 4). According to recent estimates from NIESR[2] it would result in a cumulative loss of 5 points of GDP by 2021. On the political front, it would also be difficult to get a no deal outcome through, for two reasons.

First, because it is far from certain that this approach is supported by a majority of the British people. Granted, at the European elections of 23 May, a good third of voters opted for the extremist Brexit Party or UK Independence Party (UKIP), both vehemently opposed to the EU and in favour of a clean break from it. However, the various pro-European parties (Liberal Democrats, Greens, Change UK, Scottish National Party) received more votes (6.7 million in all, or 40% of the total). Punished for their indecisiveness, the Labour and Conservative parties garnered less than a quarter of the votes and were the big losers in this election (figure 3). The European elections therefore revealed a fragmented political landscape, but also delivered an important message: in the UK supporters of a hard, or 'no deal' Brexit are many, but they are nevertheless a minority.

Secondly, the House of Commons signalled, in an indicative vote on 14 March, that it would oppose a no deal Brexit under all circumstances. Any Prime Minister seeking to push things to the wire would therefore run the risk of finding himself in a minority after a no-confidence vote. He would still have the ultimate option of proroguing parliament beyond midnight on 31 October, claiming that it would be necessary to do so to allow negotiations with EU partners up until the last minute[3]. This would lead to a 'hard Brexit' by default, but create such political turmoil that the question of its validity and the possibility of an early general election would immediately arise.

An early election?

If in the end the House of Commons is unable or unwilling to ratify the Withdrawal Agreement but is also opposed to a no deal exit, its replacement would seem to be the only chance of moving out of the impasse. The question is thus not if but when and under what circumstances an early general election would take place. If the 31 October deadline seems too close, the 27 would in all likelihood agree to a further delay on the grounds that a general election in the UK could change the situation in a way that would allow an orderly withdrawal or even resubmit the question of Brexit to the British people.

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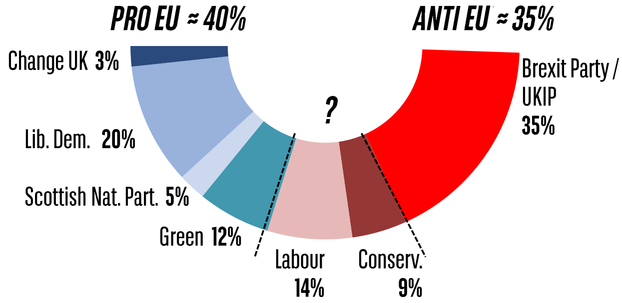
3- A fragmented landscape

Results of the European elections on 23 May (% of votes cast)



Source: Press

4- A (non-exhaustive) **list of the regulatory and tariff consequences of 'no deal'**

Without a transitional period […] trade relations with the UK will be governed by general WTO rules, without application of preferences as of the date of withdrawal. This means in particular that:

*-**Customs formalities will apply**, declarations will have to be lodged and customs authorities may require guarantees for potential or existing customs debts.*

*-**Customs duties will apply** to goods entering the EU from the United Kingdom, without preferences.*

*-**Prohibitions or restrictions may also apply** to some goods entering the EU from the United Kingdom, which means that import or export licences might be required.*

-Import and export licences issued by the United Kingdom will no longer be valid in the EU.

*-**Authorised Economic Operator** (AEO) **authorisations issued by the United Kingdom will no longer be valid in the EU**.*

*-Member States will **charge VAT at importation** of goods entering the EU from the United Kingdom.*

*-**Rules for the declaration and payment of VAT** […] and for cross-border VAT refunds will change.*

*-**Movements of goods to the United Kingdom** will require an export declaration. Movement of excise goods to the UK may also require an electronic administrative document (eAD).*

Etc.

Source: European Commission, How to prepare for Brexit, Customs guide for businesses (extracts)

[2] National Institute of Economic and Social Research (2019) "Modelling the Short- and Long-run impact of Brexit" NiGEM Observation n°14, 31 May.

[3] See the opinion expressed by former Conservative MP Nick Boles on the Guardian website, May 29.