ECO FLASH

June 2019

Six questions about Brexit

after the European elections of 23 May 2019

Jean-Luc PROUTAT

- What do the results of the European elections tell us?
- Does Prime Minister May's resignation change things?
- Can the Withdrawal Agreement still be saved?
- Is there still a risk of a no-deal Brexit?
- Are we heading towards early elections?
- How is the UK economy holding up?

In the referendum of 23 June 2016, 51.9% of UK citizens voted for Brexit, i.e. for the UK to leave the European Union (EU). On 29 March 2017, Prime Minister May triggered article 50 of the EU Treaty, which officially started the withdrawal procedure that was to be completed by midnight on 29 March 2019. By May 2019, Brexit still had not occurred. Against all expectations, UK voters were called to participate in the European elections, after which Theresa May announced her resignation. With five months to go before the new deadline, which was moved back to 31 October 2019 (the official end date of the Junker Commission's mandate), we examine six questions pertaining to Brexit.

What do the European elections tell us?

The main takeaways are the polarisation of opinion on Brexit and the paradoxically high voter participation rate for an election that was not supposed to have occurred. In the UK, a good third of voters expressed support for the two extreme eurosceptic parties, the Brexit Party and UKIP, which are seeking a radical break with the EU. On the opposite end of the spectrum, however, the pro-European parties (Liberal Democrats, Greens, Change UK, SNP) received more votes (6.7 million altogether, or 40% of the vote). Sanctioned for their indecision, the Labour and Conservative parties received less than 1 in 4 votes and were the election's big losers

Polarisation

UK, results of the 23 May 2019 European election

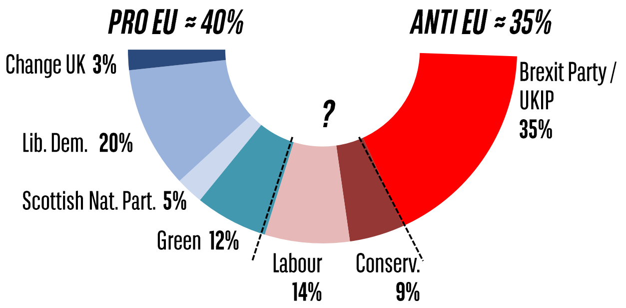

Chart 1 Source: Press

(chart 1). The results of the European elections show the fragmentation of the political landscape, but they also send an important message: there might be strong support for a no-deal Brexit in the UK, but it is still in the minority.

Does Prime Minister May's resignation change things?

Above all, her resignation risks extending the period of inaction, whereas the deadline for Brexit is still set at 31 October 2019. After her resignation on 7 June, Mrs. May will continue to handle ongoing business until the Conservative party finds a new leader. Through a series of votes, the 313 Tory MPs must first select two of the thirteen (!) candidates (as at 3 June). The final choice will then be made by the Conservative party's 125,000 members. The elected candidate becomes Prime Minister after being appointed by the Queen, which is normally a formality. The procedure could last until 20 July, and then it's the summer holidays, which means the new prime minister will have very little time to act.

Eco FLASH

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

Can the Withdrawal Agreement still be saved?

The 27 heads of EU State and government have clearly stated that they would not reopen negotiations on the Withdrawal Agreement concluded with the UK on 28 November 2018. One of the big issues is the Northern Ireland backstop[1], which is the main sticking point for the UK side, but which the Europeans see as a guarantee of the integrity of the single market. The House of Commons still has the possibility of ratifying the Withdrawal Agreement, up to the 31 October deadline. But having already rejected it on three occasions, there is little chance that it would change its mind, especially under current configuration where the Irish Democratic Unionist Party (DUP) plays a pivotal power-sharing role that prevents any compromise. The only way to work towards a negotiated solution would undoubtedly require a new House of Commons, which implies holding early elections.

Is there still a risk of a no-deal Brexit?

Politically and economically, a hard Brexit -- in which the UK leaves the EU with no deal – would be the most costly outcome. According to a recent NIESR estimate[2], a no-deal Brexit would trigger a cumulative 5-point loss of GDP by 2021. As we have already pointed out, both the European elections and survey results show that a majority of the British do not favour a no-deal Brexit (chart 2). Moreover, in an indicative vote on 14 March, the House of Commons has already expressed it would oppose *no deal* under any circumstances. Although this reduces the risks, it does not rule out the possibility of a hard Brexit. First, UK law does not oblige a government that is determined to go ahead with Brexit to reach an agreement with the EU. Second, even if the new prime minister were to lose a no-confidence vote in the House of Commons, he or she could still extend the parliamentary session through the deadline of 31 October, on the grounds that it must continue to negotiate with the EU partners. In this case, a no-deal Brexit would occur by default (see Boles, 2019[3]).

Are we heading towards early elections?

Considering that the House of Commons is unable to ratify the Withdrawal Agreement but also opposes a no-deal Brexit, the only chance of breaking the deadlock would seem to be early elections. It is not really a question of whether early elections will be held, but when, and under what conditions. The 31 October deadline seems to be too close, but the EU-27 would probably agree to push it back again on grounds that a general election in the UK might change the situation, enabling gradual progress towards a smooth exit, or it might even call into question Brexit. In any case, the next prime minister would have to agree with this plan (he alone has the power to call for another delay), which is far from certain. Of the 13 candidates to lead the party, five have already said that they were prepared to trigger a no-deal Brexit on 31 October, including the two frontrunners, Boris Johnson and Dominic Raab, the former foreign secretary and Brexit secretary, respectively.

Shadow of a doubt

UK opinion on Brexit (balance)

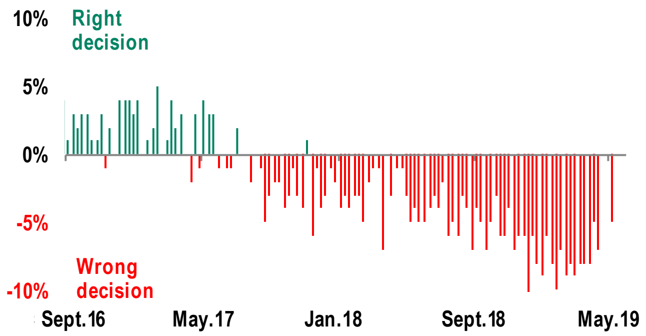

Chart 2 Source: NatCent

A bit less attractive

Direct investment (cumulative net flows over 12 months, GBP bn)

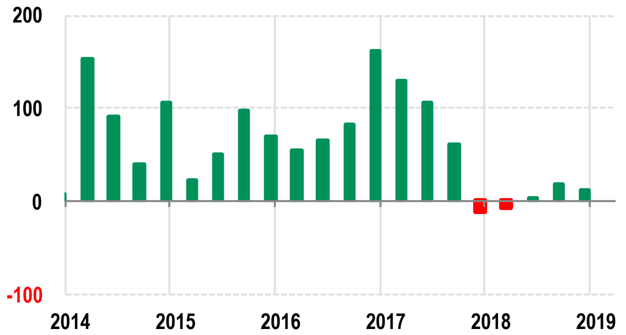

Chart 3 Source: Office for National Statistics

How is the UK economy holding up?

The UK economy rebounded in first-quarter 2019, with GDP up 2% on annual basis, fuelled by intensive stockpiling in preparation for Brexit. Yet this upturn runs against business surveys, which are more pessimistic, and should not entertain any illusions. Underlying trends are not good. When article 50 was triggered two years ago (in March 2017) officially starting the UK's withdrawal from the EU, foreign direct investment flows have started to reverse: net inflows, which averaged GBP 56 bn a year between 2012 and 2016, gave way to net outflows of GBP 1 bn a year since 2017 (see chart 3). Immigrant flows from the EU have dwindled as well (fewer than 60,000 net arrivals in 2018, in line with the low point of 2009), which is straining the housing sector.

Jean-Luc PROUTAT
jean-luc.proutat@bnpparibas.com

[1] Under the Withdrawal Agreement, to avoid the reintroduction of a physical border between the two Irelands once the UK exits the European Union, a safety net or backstop would be applied to Northern Ireland. Northern Ireland would temporarily maintain a customs union with the EU as well as the complete alignment of legal, technical and environmental standards, as long as necessary for the completion of a framework agreement on future relations.

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

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

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com
ADVANCED ECONOMIES AND STATISTICS		
Jean-Luc Proutat Head – United States, United Kingdom	+33 1 58 16 73 32	jeanluc.proutat@bnpparibas.com
Hélène Baudchon France – Labour markets	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Louis Boisset European Central Bank watch, Euro area global view, Japan	+33 1 57 43 02 91	louis.boisset@bnpparibas.com
Frédérique Cerisier Euro area (European gouvernance and public finances), Spain, Portugal	+33 1 43 16 95 52	frederique.cerisier@bnpparibas.com
Catherine Stephan Nordic countries – World trade – Education, health, social conditions	+33 1 55 77 71 89	catherine.stephan@bnpparibas.com
Raymond Van Der Putten Germany, Netherlands, Austria, Switzerland – Energy, climate – Long-term projections	+33 1 42 98 53 99	raymond.vanderputten@bnpparibas.com
Tarik Rharrab Statistics	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com
BANKING ECONOMICS		
Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Laure Baquero	+ 33 1 43 16 95 50	laure.baquero@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+ 33 1 40 14 30 77	thomas.humblot@bnpparibas.com
EMERGING ECONOMIES AND COUNTRY RISK		
François Faure Head	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, other North Asian countries, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Sylvain Bellefontaine Turkey, Ukraine, Central European countries	+33 1 42 98 26 77	sylvain.bellefontaine@bnpparibas.com
Sara Confalonieri Africa (Portuguese & English-speaking countries)	+33 1 42 98 43 86	sara.confalonieri@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, Kazakhstan, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
CONTACT MEDIA		
Michel Bernardini	+33 1 42 98 05 71	michel.bernardini@bnpparibas.com

OUR PUBLICATIONS

CONJONCTURE

Structural or in news flow, two issues analysed in depth

EMERGING

Analyses and forecasts for a selection of emerging economies

PERSPECTIVES

Analyses and forecasts for the main countries, emerging or developed

ECOFLASH

Data releases, major economic events. Our detailed views…

ECOWEEK

Weekly economic news and much more…

ECOTV

In this monthly web TV, our economists make sense of economic news

ECOTV WEEK

What is the main event this week? The answer is in your two minutes of economy

The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. This report does not constitute an offer or solicitation to buy or sell any securities or other investment. It does not constitute investment advice, nor financial research or analysis. Information and opinions contained in the report are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient; they are subject to change without notice and not intended to provide the sole basis of any evaluation of the instruments discussed herein. Any reference to past performance should not be taken as an indication of future performance. To the fullest extent permitted by law, no BNP Paribas group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report. BNP Paribas SA and its affiliates (collectively "BNP Paribas") may make a market in, or may, as principal or agent, buy or sell securities of any issuer or person mentioned in this report or derivatives thereon. BNP Paribas may have a financial interest in any issuer or person mentioned in this report, including a long or short position in their securities and/or options, futures or other derivative instruments based thereon. Prices, yields and other similar information included in this report are included for information purposes. Numerous factors will affect market pricing and there is no certainty that transactions could be executed at these prices. BNP Paribas, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any person mentioned in this report. BNP Paribas may, from time to time, solicit, perform or have performed investment banking, underwriting or other services (including acting as adviser, manager, underwriter or lender) within the last 12 months for any person referred to in this report. BNP Paribas may be a party to an agreement with any person relating to the production of this report. BNP Paribas, may to the extent permitted by law, have acted upon or used the information contained herein, or the research or analysis on which it was based, before its publication. BNP Paribas may receive or intend to seek compensation for investment banking services in the next three months from or in relation to any person mentioned in this report. Any person mentioned in this report may have been provided with sections of this report prior to its publication in order to verify its factual accuracy.

BNP Paribas is incorporated in France with limited liability. Registered Office 16 Boulevard des Italiens, 75009 Paris. This report was produced by a BNP Paribas group company. This report is for the use of intended recipients and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of BNP Paribas. By accepting this document you agree to be bound by the foregoing limitations.

Certain countries within the European Economic Area:

This report has been approved for publication in the United Kingdom by BNP Paribas London Branch. BNP Paribas London Branch is authorised and supervised by the Autorité de Contrôle Prudentiel and authorised and subject to limited regulation by the Financial Services Authority. Details of the extent of our authorisation and regulation by the Financial Services Authority are available from us on request.

This report has been approved for publication in France by BNP Paribas SA. BNP Paribas SA is incorporated in France with Limited Liability and is authorised by the Autorité de Contrôle Prudentiel (ACP) and regulated by the Autorité des Marchés Financiers (AMF). Its head office is 16, boulevard des Italiens 75009 Paris, France.

This report is being distributed in Germany either by BNP Paribas London Branch or by BNP Paribas Niederlassung Frankfurt am Main, a branch of BNP Paribas S.A. whose head office is in Paris, France. BNP Paribas S.A. – Niederlassung Frankfurt am Main, Europa Allee 12, 60327 Frankfurt is authorised and supervised by the Autorité de Contrôle Prudentiel and it is authorised and subject to limited regulation by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

United States: This report is being distributed to US persons by BNP Paribas Securities Corp., or by a subsidiary or affiliate of BNP Paribas that is not registered as a US broker-dealer. BNP Paribas Securities Corp., a subsidiary of BNP Paribas, is a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority and other principal exchanges. BNP Paribas Securities Corp. accepts responsibility for the content of a report prepared by another non-U.S. affiliate only when distributed to U.S. persons by BNP Paribas Securities Corp.

Japan: This report is being distributed in Japan by BNP Paribas Securities (Japan) Limited or by a subsidiary or affiliate of BNP Paribas not registered as a financial instruments firm in Japan, to certain financial institutions defined by article 17-3, item 1 of the Financial Instruments and Exchange Law Enforcement Order. BNP Paribas Securities (Japan) Limited is a financial instruments firm registered according to the Financial Instruments and Exchange Law of Japan and a member of the Japan Securities Dealers Association and the Financial Futures Association of Japan. BNP Paribas Securities (Japan) Limited accepts responsibility for the content of a report prepared by another non-Japan affiliate only when distributed to Japanese based firms by BNP Paribas Securities (Japan) Limited. Some of the foreign securities stated on this report are not disclosed according to the Financial Instruments and Exchange Law of Japan.

Hong Kong: This report is being distributed in Hong Kong by BNP Paribas Hong Kong Branch, a branch of BNP Paribas whose head office is in Paris, France. BNP Paribas Hong Kong Branch is registered as a Licensed Bank under the Banking Ordinance and regulated by the Hong Kong Monetary Authority. BNP Paribas Hong Kong Branch is also a Registered Institution regulated by the Securities and Futures Commission for the conduct of Regulated Activity Types 1, 4 and 6 under the Securities and Futures Ordinance.
Some or all the information reported in this document may already have been published on
https://globalmarkets.bnpparibas.com

© BNP Paribas (2015). All rights reserved.

YOU WANT TO RECEIVE OUR PUBLICATIONS?

SUBSCRIBE ON OUR WEBSITE
http://economic-research.bnpparibas.com

AND

FOLLOW US ON LINKEDIN
https://www.linkedin.com/showcase/bnp--paribas-economic-research/
OR TWITTER
https://twitter.com/EtudesEco_BNPP

© BNP Paribas (2015). All rights reserved.

Prepared by Economic Research – BNP PARIBAS
Registered Office: 16 boulevard des Italiens – 75009 PARIS
Tel: +33 (0) 1.42.98.12.34 – www.group.bnpparibas.com
Publisher: Jean Lemierre. Editor: William De Vijlder

BNP PARIBAS

The bank for a changing world