

PROPONOMICS

MAY 2019

NEVERENDUM – WHERE NEXT ON BREXIT?

The Brexit debate is now deadlocked and polarised. The odds are increasing that the issue will go back to the electorate.

Headlines

The Brexit debate is deadlocked in Parliament, and a change of Prime Minister may make little difference.

The likelihood of a second referendum is growing, but this will take time to organise.

Recent economic data suggest firms are starting to tune out the Brexit politics, and are moving forward with investment plans.

Theresa May's attempt to build a Brexit solution on the middle ground between the warring factions in Parliament has ended with her resignation, and MPs have so far refused to endorse any of the other options available. We are now in what Canadians, during the Quebec independence debate, called 'Neverendum' – where the politicians can neither solve nor walk away from a problem.

Some of those running to be the next Prime Minister claim they can end the deadlock, by threatening to go down the hard Brexit route unless the EU offers changes to the Withdrawal Agreement. Two contenders, Boris Johnson and Dominic Raab, say they would take the UK out the EU on the 31st October, deal or no deal. Yet, pundits question whether this approach will work. The EU has flatly refused to renegotiate.

The Chancellor of the Exchequer, Philip Hammond, has pointed out that the majority in Parliament are opposed to no deal, and a Prime Minister who ignores the legislature will not last long. In March,

400 MPs voted against a hard Brexit, with just 160 in favour. The Foreign Secretary, Jeremy Hunt, told the BBC that a no deal Brexit would be political "suicide". Speaker Alan Bercow described the idea of the House of Commons being by-passed as "simply unimaginable". All this makes threats to leave with no deal sound like a bluff.

No compromise

Some hard Brexit supporters hope that the balance in Parliament could be changed by a General Election. However, this option looks risky for the Conservatives and Labour. The European Parliament elections saw 40% of UK voters back pro-Remain parties, like the Liberal Democrats, and 35% favour parties calling for no deal. The Conservatives and Labour, the advocates of a Brexit compromise, slumped to a combined 24% of the vote. To this backdrop, calling a General Election will not appeal greatly to many Conservative or Labour MPs in Westminster.



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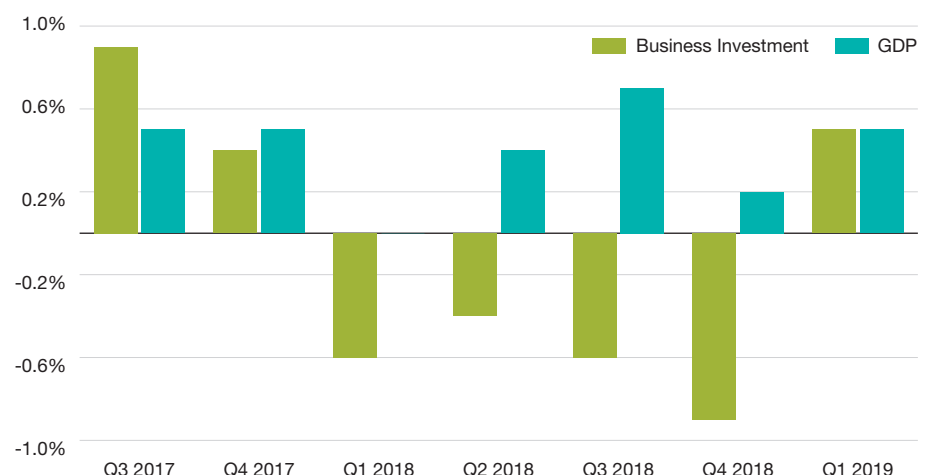
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FIGURE 1

Quarter-on-quarter growth for UK GDP and Business Investment



Source: ONS

So the current situation appears to be:

- **No deal** – requires a confrontation with Parliament, sparking a constitutional crisis, so looks unlikely. It could though happen by going back to the people for a second referendum.
- **General Election** – high risk due to the unpredictability of the electorate, and the unpopularity of Labour and the Conservatives.
- **A new deal** – the EU has shown no willingness to reopen negotiations, and probably views threats of a no deal as a bluff.

Therefore a second referendum appears the most likely way to break the deadlock, but this option requires more time. Firstly, time will be needed to persuade leave supporters of the need to have another referendum by explaining that Parliament is unlikely to sanction either the Withdrawal Agreement or a no deal, so achieving either requires going over MPs heads to the electorate. Second, the referendum itself will take time to arrange – one estimate suggested a minimum of 22 weeks. All this suggests we are heading towards another extension of the Article 50 notice.

The economy

This beckons the question, how is the economy coping with the uncertainty, given it is set to continue? The answer is better than one would have expected. GDP growth in Q1 2019 was 0.5% quarter-on-quarter, which is better than the 0.2% recorded in Q4 2018 and ahead of a consensus forecast of 0.4%.

This was partly due to firms stockpiling, as for much of Q1 a hard Brexit was feared, but there were other factors, and these bode well for the outlook. Business investment rebounded in Q1, after a long period of contraction. Previously, firms had delayed investment while awaiting clarity on Brexit. However, in Q1 they decided that continuing to delay was no longer an option, and there was a sharp rise in spending on IT equipment and machinery.

This is significant for two reasons. Firstly, more spending on technology will deliver productivity gains. Second, this is consistent with what happened in Canada during its Neverendum period. Eventually, firms gave up waiting for the politicians to stop arguing, and pushed on into the political headwinds. That nearly 100,000 net new jobs were created in Q1 in the UK supports this view of firms pressing on regardless.

Yes, there are examples where Brexit is having a direct negative impact, such as the car industry’s problems, but these are exceptions rather than the norm. For most of the economy, Brexit is not preventing significant growth.

On the consumer side, we see a similar story, with retail sales volume rising by 1.8% in the three months to April, up from a 0.7% in January. This is well above the 10 year average of 0.5%.

A few weeks ago, veteran US investor, Warren Buffett, said he would invest in the UK irrespective of whether Brexit happened. There is a growing view in business that Brexit is something of a distraction, and one that is becoming less of a reason to delay an investment. The Brexit uncertainty looks set to continue, but the UK economy is tuning out the political noise and expanding.

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COMMERCIAL RESEARCH

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