BREXIT, PURSUED BY A BEAR

With apologies to William Shakespeare ('A Winter's Tale').

Last year, after an ill-advised referendum, the UK voted to leave the European Union of which it had been a member since 1973. The surprise result was driven by widespread concerns over immigration and national security - the two are closely linked these days - as well as a sense of unease that the UK was slowly being suffocated by EU red tape with little benefit for the wider population. A minority may have understood the technical implications of a 'leave' vote, but the majority voted with their heart, as is often the case with national plebiscites.

by Russell Collister,
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The public debate preceding the vote barely touched upon the detailed and complex areas now concerning those negotiating an exit from trade agreements spanning 40 years of history. This is not surprising. It was far easier for the likes of foreign secretary Boris Johnson to boast that the underfunded National Health Service would receive an extra £350m a week by exiting the EU (a claim subsequently discredited) than to explain the intricacies of cross-border trade tariffs with the likes of Belgium and Spain.

The 'leave' vote really reflected dissatisfaction with the long years of austerity which followed the 2008 global financial crisis, rather than the intimate workings of the EU, although the two were inevitably linked by Brexit campaigners and parts of the British media. For swathes of UK public sector workers, wages had been frozen in real terms for nearly a decade (and are still falling) whilst immigration had been steadily rising. Discontent was ripe for exploitation.

Throughout all of this, the ruling Conservative Party was consistently behind the curve of public opinion. The entirely avoidable 2017 general election wiped out the workable majority which Theresa May's government had enjoyed and led to a controversial alliance with the Northern Ireland Democratic Unionist Party, consummated with taxpayers' money. As a backdrop for complex negotiations with the EU, it was about as bad as it could get.

If the political situation was unstable, then the economic position was almost worse. The immediate consequence of Brexit was a sharp devaluation of the value of sterling, in particular against the Dollar and (ironically), the Euro. Whilst the London stock market rallied (an estimated 71% of revenues from FTSE100 companies is generated outside of the UK), inflation has started to creep up and touched 3%, the highest on record in more than 5 years.

GDP growth in the UK has also weakened. Since the start of 2017, the headline figure has been trending lower and is forecast to increase by a below average 1.5% in 2017 (compared to 2% in the Eurozone and 2.2% in the US).

Although it may not yet feel like it, most of the UK electorate will be poorer in real terms since Brexit, even with the cap on public sector wage increases finally removed this week (behind the curve again). Net migration from the UK has also accelerated as EU nationals depart, uncertain of their rights in post-Brexit Britain.

By early 2019 the implementation of Article 50, which started the formal exit process, will have run its course and Britain will have left the EU. There are still many, many unanswered questions as to what this post-Brexit wilderness will look like, but here are some scenarios (hard to soft).

1. **No deal.** Although there have been anecdotal tales of businesses relocating to the likes of Frankfurt and Dublin, the City remains a hugely attractive financial centre. Certainly, the Chinese have been voting with their wallets and snapping up landmark assets at prices discounted by sterling's collapse. The legal framework of the UK makes it a prime destination for overseas capital, not just in London but in many other major UK cities too. No deal would, however, jeopardise this status and lead to trade tariffs, travel restrictions and probably another sterling crisis. International equities traded in London would not be especially affected, but the short-term prognosis for the UK would be complex and negative.

2. **Partial Trade Deal.** Probably favoured only by Donald Trump (one of the few heads of state to openly praise Brexit), this is the protectionist option whereby trade agreements would be torn up and re-negotiated case by case via the World Trade Organisation. Hundreds, if not thousands of such agreements exist and so whilst in theory it may work, in practice it would be a disaster. International business (with the UK) would slow and the trade deficit would soar. A compromise deal ('the Canadian option') with the EU to maintain free-trade in certain goods might be possible but any deal would exclude the services sector, such as banking, which represents nearly 80% of the UK market. It may also exclude agriculture. Two-thirds of the UK's food is exported to the EU whilst 90% of seasonal workers in the sector come from (eastern) Europe.

3. **Full Trade Deal.** This would include goods and services but would be a pointless option for hard line Brexiteers as it would require the UK to re-negotiate trade with the EU going forward but without the influence it currently enjoys. Going a stage further, the establishment of a new Customs Union may allow Britain to negotiate its own new trade deals within the EU (but not, presumably, with the US or China where it would remain bound by EU rules). A 'softer' Brexit of this nature would be resisted by the 'hard Brexit' protagonists in the UK Government (who presumably don't have to do the hard lifting of trade negotiations themselves). Both deals may, however, include passporting rights to allow UK companies to sell services into the EU and vice versa. It would be a fudge, but far better than options 1 or 2.

Option 3 at least suggests that there is a glimmer of light at the end of the Eurotunnel. There are, of course, many other scenarios which will become apparent as the March 2019 deadline approaches. The best part of a thousand trade agreements, negotiated over many decades cannot be unwound in a matter of months and, although European politicians may not say so in public, the UK market is vital to many areas of Europe's economy which makes the whole laborious process even more ludicrous.

Probably the best that can be hoped for is a formal 'future framework' which will set out a vision from both sides of the debate and then negotiate the detail in the years ahead. This would, at least, create minimum disruption for businesses whose leaders, as ever, will be some way ahead of politicians in determining an equitable way forward.

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