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Brexit Update: Game over?

Economic Comment
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- **Theresa May has said she will resign on 7 June, after her last attempt to save the EU-UK deal failed to garner sufficient support last week.**
- **Her departure makes way for a Tory leadership contest that is likely to put a Brexit hardliner in the PM function; As of now, Boris Johnson is regarded as the most likely winner, but several candidates have indicated they will run in the race.**
- **The new PM is likely to try to renegotiate the EU-UK deal in order to change the Irish Backstop, but the EU is expected to stand its ground.**
- **If the UK government opts for a hard Brexit as a result, it will face firm opposition from the British Parliament.**
- **Such a conflict is likely to eventually lead to an early general election, a process that will need to be accommodated by a third extension of article 50 by the EU.**
- **All in all, we see a delay of Brexit to 2020 as the most likely outcome, but the odds of a Hard Brexit on 31 October are uncomfortably high.**
- **A second referendum could play an important role in the electoral campaign and open the door for the UK to remain in the EU in 2020.**
- **The already elevated degree of uncertainty around Brexit may rise further in the coming months and will continue to weigh on the British economy.**

The end of May

The British Prime Minister Theresa May announced on Friday 24 May she will resign from her function on June 7. The final blow to her premiership was her speech a few days earlier; a speech in which she announced her proposal for revamping the EU-UK deal and bringing it forward for a vote in Parliament as part of the Withdrawal Agreement Bill (WAB) at the beginning of June. After Tory-Labour Brexit talks collapsed on Friday 17 May, the PM's WAB proposal represented a final attempt to appease the opposition by incorporating various Labour demands such as a customs union with the EU, a confirmatory referendum on the deal, alignment of the UK with the EU on environmental and workers' rights etc. These proposals were not enshrined in the WAB, but gave parliament the final say on their adoption. PM May's proposal also gave MPs the lead on many other Brexit decisions such as the implementation of the Irish Backstop and the government's mandate in negotiations with the EU on the future relationship.

The proposal infuriated Tory MPs and hence backfired. Leader of the Commons Andrea Leadsom resigned and, more importantly, the 1922 Committee of Conservatives in Parliament threatened to change party rules and allow for a vote of confidence in their leader at the beginning of June. To avoid being ousted by her own party

the PM announced her departure plans. Theresa May will serve as caretaker PM until the Conservative Party elects another leader, a process which is likely to be completed before the end of July. The National Conservative Convention on 15 June will now probably serve as a campaign platform for the Tory leadership contest.

The hurricane after the storm

The departure of the PM makes way for a leadership challenge within the Conservative Party. Various Tory politicians have already been jockeying for position in recent weeks and eight of them have already announced their candidature: former Foreign Secretary Boris Johnson, former Brexit Secretary Dominic Raab, Environment Secretary Michael Gove, former Secretary for Work and Pensions Esther McVey, former House of Commons leader Andrea Leadsom, Secretary for Work and Social care Matt Hancock, Foreign Secretary Jeremy Hunt and International Development Secretary Rory Stewart. The list is expected to expand to around 15 candidates in total. Following a selection by the 313 Conservatives in parliament a shortlist will be subject to a vote by 100,000 Conservative activists. The expectation is that the winner will adopt a tougher stance on Brexit, and Boris Johnson is the favourite in the race so far. Several candidates have already indicated they will opt for a hard Brexit if they cannot improve the current agreement through negotiations with the EU and their tone has only hardened after the success of the Brexit Party in the EP elections. Since PM May's resignation does not change the parliamentary arithmetic, the firm opposition of the British Parliament to a no-deal Brexit is likely to cause a flare-up in tensions between the government and Parliament.

Not the end of Brexit

The resignation of the PM leaves Brexit unresolved and the UK not only as divided over the matter as in 2016, but also more remote from a compromise than ever. The division in the UK was once again highlighted by the outcome of the European Parliament (EP) elections held on 23 May in the UK. The polls were won by the Brexit party with 32% of the votes, while pro-EU Liberal Democrats came in second with 20% of the votes. Anti-Brexit parties together garnered 40% of the votes and that gives them a margin of only 5% above pro-Brexit parties. Both larger parties, Labour and Conservative, were punished by the UK population for their unclear position on Brexit as they have tried to appease both the Leave and Remain voters. The results reveal not only the division on Brexit among the British population, but also the lack of support for a compromise. This is likely to embolden politicians on both sides of the Brexit spectrum and if anything reduces the chances of an orderly Brexit moving forward.

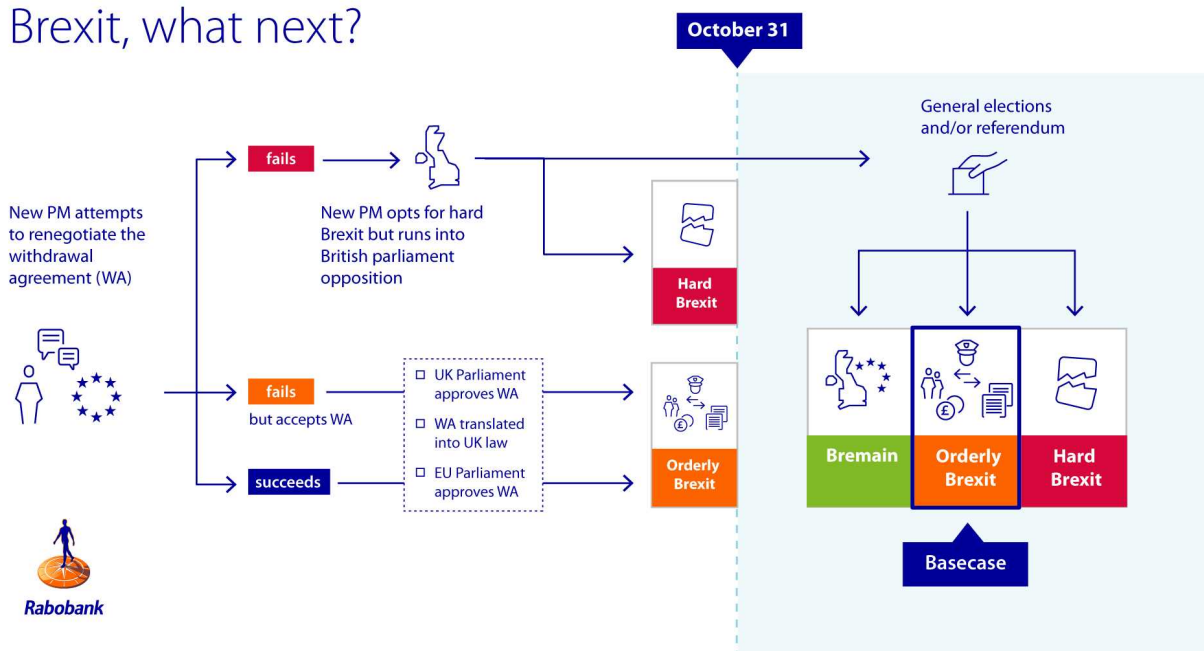
Another extension most likely

The Tory leadership contest is likely to place a hardliner at the lead of the UK this summer and that increases the odds of a hard Brexit on 31 October 2019. This will not be the main goal of the new leader, who will first attempt to renegotiate the Irish Backstop part of the withdrawal agreement with the EU. This process will face a serious time and resources constraint as the EU will be absorbed with many other processes and decisions in the aftermath of the European Elections, while the British Parliament will only gather for one month after the summer recess which starts on 20 July. The attempt to alter the Withdrawal Agreement is likely to fall on deaf ears in Brussels and push the new PM towards a hard Brexit. However, the firm opposition of the British MPs to such an outcome will likely lead to a conflict with the government and eventually trigger an early election, as some Tory MP's might vote against a government pursuing a hard Brexit in a vote of confidence. Such political developments in the UK will need to be accommodated by a further extension of article 50 by the EU at the 17-18 October Summit. This is an outcome that various leaders on the continent have already admitted cannot be excluded. Given all the above we see a further extension of Brexit into 2020 as the most likely outcome, though we note that the odds of a hard Brexit at this date also remain uncomfortably high. An orderly Brexit at the end of October - which [used to be our base case](#) - now seems a remote outcome.

Brexit beyond 2019

If the third extension materializes, we still see three possible outcomes in 2020, namely Breain, Orderly Brexit and hard Brexit. However, the odds of either of these outcomes materializing have changed. An orderly Brexit remains the most pragmatic and likely outcome. But given the polarization in the UK the odds of a Breain or a hard Brexit are almost as high. While Theresa May is out of the Brexit process, her EU-UK deal is not entirely dead. If the UK decides to pursue an orderly Brexit post- elections, the Withdrawal Agreement will still form the base for such an outcome. Namely, there will still be an Irish border to prevent from emerging and the current Irish Backstop construction still looks like the maximum the EU can stretch to accommodate UK sovereignty without compromising its own institutions. The political declaration will remain open for negotiation, as it has been in the past. A shift towards a softer Brexit will depend on the UK's willingness to also accept the obligations that come with it. An early election could also open the door for the UK to eventually stay in the EU, if the pledge of a referendum is back in play during the electoral campaign. Keep in mind, however, that a victory for Remain should not be taken for granted and the results of the EP elections are illustrative in that sense. The already elevated degree of Brexit uncertainty observed in the past years is poised to reach new highs in the coming months on the back of even more political turmoil and an even more fragmented Brexit outcome landscape. And that, in turn, will [continue to weigh on the British economy](#).

Brexit, what next?



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