23 October 2019

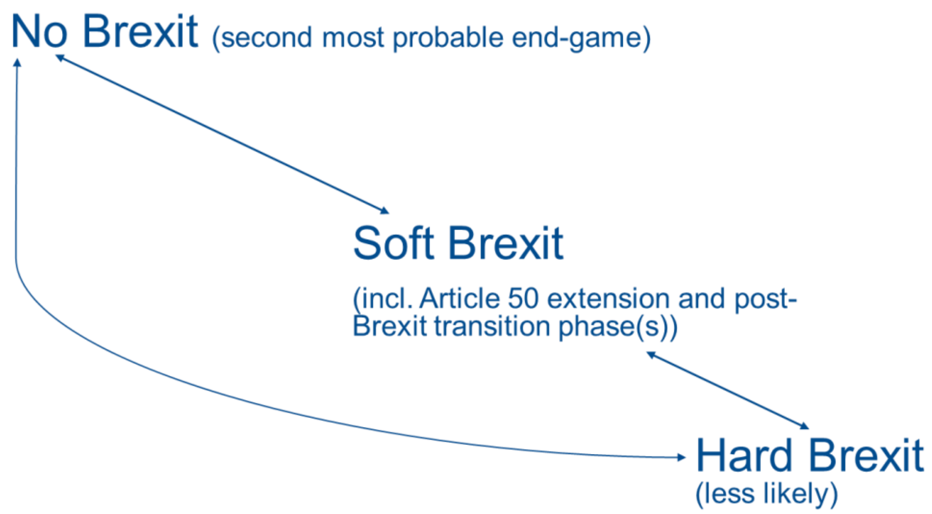
Brexit deconstructed: state of play, UK impact in five charts

As British Prime Minister Boris Johnson fights to push his Brexit deal through Parliament, the UK remains mired in uncertainty about if, when and how it exits the EU. This has exacted a price on the economy and the credit rating outlook. We look at the critical issues in five charts.

Chart #1: Everything changes, yet everything stays the same…

Our view has remained unchanged that a soft Brexit is the most likely end-game after the 2016 referendum despite Britain's seesaw politics in the past year. A hard Brexit – including the no-deal form of it – remains unlikely. However, the government's 31 October timetable to achieve an orderly exit has been ambitious – and Scope has expected a third extension of the UK's membership of the EU beyond 31 October.

Figure 1: Core Brexit Scenarios



Source: Scope Ratings (2017). 'Uncertainties around Brexit challenge UK credit outlook'.

#2: Prime Minister Johnson has attained a tentative parliamentary majority for his Brexit deal

The Brexit arrangement agreed with Brussels on 17 October hinges on a Northern Ireland-only customs arrangement, which keeps Northern Ireland in the UK customs territory but applies EU tariff, regulatory and VAT rates/rules in Northern Ireland. On 22 October, Prime Minister Johnson gained a 329-299 majority for his deal in the UK Parliament (circled on **Figure 2, next page**), the first time Parliament had approved any Brexit deal 'in principle'. However, Parliament voted down by 322-308 his plan to exit by *31 October*. While the deal carried a parliamentary majority *at this stage*, potential amendments and stall tactics from opposition groups present significant challenges to leaving with the deal in its current form – which may require early elections to resolve.

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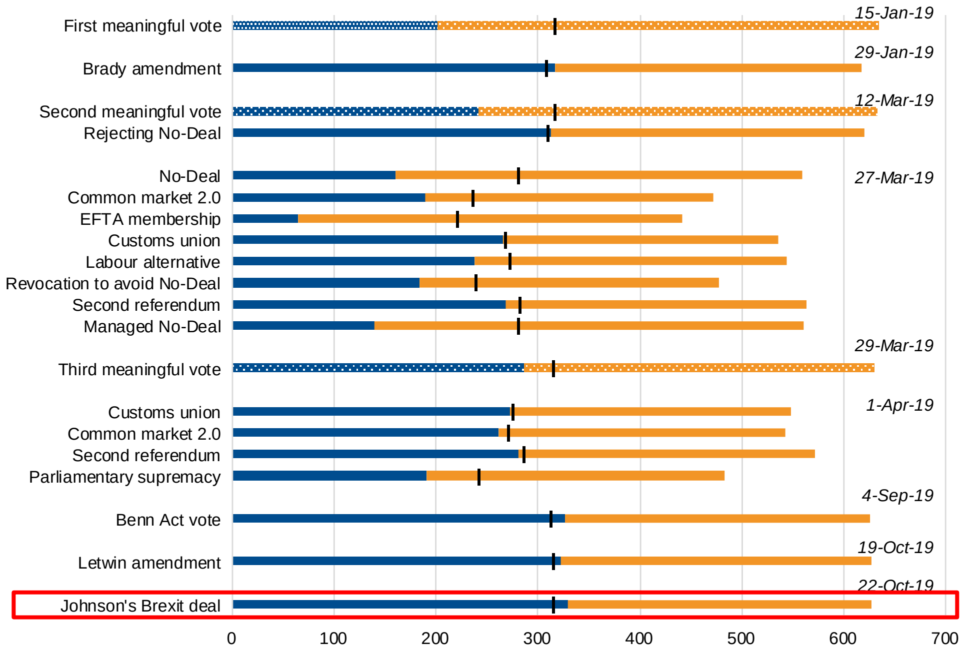
Figure 2: House of Commons votes on alternative Brexit options

(Yes votes in blue; No in orange; hash marks denote votes needed for a majority – depending on the number of abstainers)

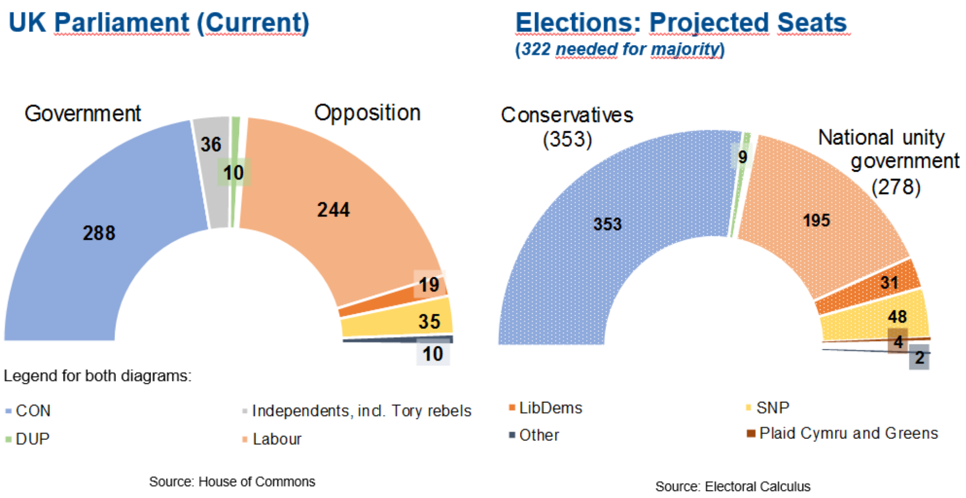


Source: UK House of Commons, Scope Ratings GmbH

#3: Attention turns to the electoral calculus in the UK…

Early general elections are on the radar, with the key question being whether the UK will have exited the EU before then. If Prime Minister Johnson gets Brexit done before elections, he could benefit from having delivered on the referendum, potentially securing a clear majority for his Conservative Party in elections. Conversely, if Tories are unable to compel Parliament to ratify the deal absent significant alterations or if parliamentary tactics and/or deal amendments frustrate exit plans, elections could, alternatively, be needed to resolve the impasse. Under Johnson's premiership, the Conservative Party's polling numbers have improved, with an outright seat majority within sight (**Figure 3 on the next page**, right-hand side). Two scenarios seem most likely after hypothetical elections: i) a stronger Tory government that facilitates a soft Brexit (if an exit from the EU had not already been achieved) or, alternatively, ii) a 'national unity government' of parties that favour a second referendum – the most direct route to stopping Brexit. Another hung parliament also cannot be ruled out.

Figure 3: UK parliamentary composition



Seat distributions exclude seats allotted to Sinn Féin (which abstains from taking up its seats in Parliament) and the one seat assigned to the House Speaker.

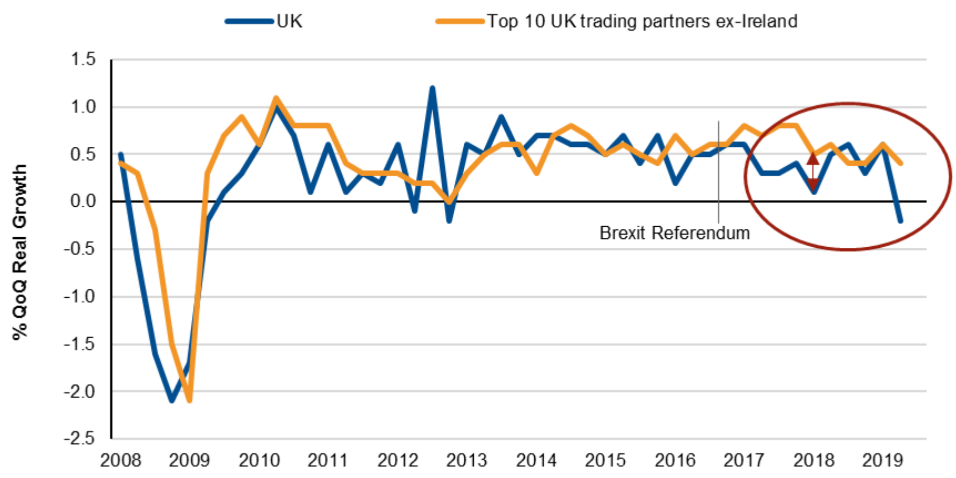
*CON = Conservative Party; DUP = Democratic Unionist Party; LibDems = Liberal Democrats; SNP = Scottish National Party

Source: House of Commons, Electoral Calculus

#4: The impact of Brexit uncertainty on the UK has already been far from negligible, first in economic terms…

Even before Brexit takes place, the UK economy has underperformed those of its largest trading partners by well over 1% of GDP cumulatively since the June 2016 referendum (**Figure 4**). The current account deficit has also widened to 5% of GDP in the year to Q2 2019, from 3.5% in 2017. Still, sterling's status as one of the world's most important reserve currencies remains intact, judging by little change in the share of the world's allocated reserves held in the pound, guaranteeing the UK economy's resilience to external shocks.

Figure 4: UK economy versus top 10 trading partners ex-Ireland, %QoQ GDP growth



Source: Haver Analytics, Scope Ratings GmbH calculations

#5: … and with regards to the outlook on public finances.

We have a long-term sovereign rating for the UK of AA, with a Negative Outlook. Consistent with our view that a no-deal exit has been and remains unlikely, the Negative Outlook has reflected instead an expectation that Brexit talks may simply last a very long time and well beyond the two years offered under Article 50. This prolonged timetable brings with it uncertainty that impairs business sentiment and economic growth. The UK government's economic programme has moreover already shown signs of fiscal loosening alongside postponements of difficult structural reforms, a trend likely to persist as Brexit still dominates the domestic agenda. Even were the UK to leave the EU (in name only) in the period after 1 November, the UK and EU would face prolonged and difficult talks over a new long-term trading agreement.

Figure 5: Scope's UK credit rating compared with other rating agencies

Credit rating agency	UK long-term rating
Scope Ratings	AA/Negative
Moody's	Aa2/Stable
S&P	AA/Negative
Fitch	AA (Rating Watch Negative)
DBRS	AAA/Stable

Source: Bloomberg, Scope Ratings GmbH

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