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Brexit Takes Off

March 2017

Theresa May has formally notified the European Union of Britain's intention to leave

Sunday's papers could not have been more divided. 'This week the UK will throw into jeopardy 60 years of unparalleled European peace, security and prosperity' warned the *Observer*. While a triumphalist *Sunday Express* declared, 'EU laws head for the dustbin from next week.'

Whatever your view, the fact is that yesterday, Prime Minister Theresa May formally triggered Article 50 of the Lisbon Treaty, beginning two years of negotiations that could – in theory – see the United Kingdom leave the European Union on Friday, March 29th 2019.

There will undoubtedly be many, many twists and turns over the next two years: as countless people have written, we're now embarking on the most complicated divorce in history. But for now, let's take a look at what is likely to happen – both in the UK and in Europe – what the impact may be on the UK economy, and what shape the negotiations with Europe are likely to take.

What is the formal process of leaving the EU?

On Wednesday, Theresa May sent a letter to the EU, giving formal notification of Britain's intention to leave, and triggering the two year negotiation period. She described the letter as, "one of the most important documents in our government's recent history" – to most observers, a significant understatement. One commentator on the BBC – taking a rather longer view – compared it to the excommunication of Elizabeth I by Pope Pius V in 1570, which presumably removed England from the free market of the 16th Century…

The EU will respond to the letter within 48 hours – but it is unlikely that serious negotiations will begin until May. Easter is in little more than two weeks and the 28-nation bloc has already said that it wants time to prepare.

In theory, the two year negotiation period *can* be extended – although this will require the agreement of all the 27 remaining members of the EU. At this stage, there seems to be a desire on all sides to complete the negotiations within the two year time-frame.

Could UK politics de-rail Brexit?

Currently, the next UK General Election – under the Fixed Term Parliament Act – is due to be held in May 2020. There have been suggestions that Theresa May might use the Brexit negotiations as a chance to seek her own mandate and go to the country while the opposition parties are at such a low ebb. Last week's *Sunday Express* even went so far as to name a date for this snap election: Thursday May 4th. Other commentators have suggested May 2018 as a likely date. But Theresa May is nothing if not cautious: expect her to see how the negotiations are progressing before any hint of a General Election appears on her agenda.

And then there's Scotland. No-one can fail to have heard the calls for a second Scottish referendum on independence. Nicola Sturgeon has demanded the referendum: Theresa May has – for now – rejected those demands. Interestingly, as the *Spectator* recently pointed out, had Scotland become independent two years ago, it would now be bankrupt. Oil revenues are now 99% lower than those estimated in the SNP's manifesto: to quote the *Spectator*, "America has mastered fracking now and doesn't need to import so much oil, pushing the price down from $110 a barrel to $45."

The Scottish government currently spends £127 for every £100 it raises in tax – a ratio unequalled anywhere else in the developed world. It can do that because the extra money comes from England. A consensus view is that the demands for Scottish independence will continue to be made – and they will continue to be rejected. If there is to be a second referendum on Scottish independence then it is likely to be after Brexit, not before it. But yes, over the next two years there will be – to quote Shakespeare's *Macbeth* – a great deal of 'sound and fury' coming from north of the border.

Could elections in Europe affect Brexit?

2017 had the potential to be a pivotal year for Europe, with elections in Holland, France and Germany. We already know the result of the poll in Holland: the People's Party, led by Prime Minister Mark Rutte, remained the largest party with 33 seats, ahead of the far-right Freedom Party which gained 20 seats. The result was greeted with sighs of relief through European corridors of power and attention now turns to the French Presidential elections, where the first round of voting is due at the end of April.

At the time of writing, independent – but very much establishment – candidate, Emmanuel Macron and Marine le Pen, leader of the Front National, are running roughly neck and neck at around 25-26% of the vote. However, it is widely expected that the second round of voting – almost certain to be a run-off between the two – will see Macron win comfortably.

So two down, one to go, and while Angela Merkel will undoubtedly be under pressure in September's poll as she seeks her fourth term as German Chancellor, most experts expect her to be re-elected – and to remain the de facto leader of Europe.

European elections are therefore unlikely to significantly impact the Brexit negotiations. Despite Marine le Pen appearing to be a supporter of Brexit, a victory in the French Presidential elections could well complicate the negotiations further: the euro would undoubtedly fall sharply in value (as the pound did after Brexit) and there would be a more inward-looking, nationalist France to contend with.

What are the early issues likely to be?

One of the most contentious issues – certainly the one which will generate the most headlines – will be the question of whether Britain should pay an 'exit penalty' to the EU. There have been suggestions that the EU will be looking for £50bn: inevitably, Britain will push for a substantially lower figure, with some commentators seeing no reason why we should pay anything at all.

There will almost certainly also need to be a transitional deal to cover the period between Britain leaving the EU and agreeing to a new, long-term trade deal with Europe, which could take up to five years to finalise.

But it is now nine months since Britain voted to leave the EU: inevitably there will have been informal talks with the EU during that time and there are suggestions that a series of early deals might be announced after Article 50 is triggered. Informal talks are clearly at odds with the EU's official line, but there is optimism in Whitehall that Germany – behind the scenes at least – wants to work constructively.

Examples of early deals being considered might include deals over migrants, and defence arrangements in Eastern Europe. Clearly 'reciprocity' will be the word: for example, Britain may be given early permission to negotiate trade deals with non-EU countries in return for some olive branch to Berlin and Brussels, perhaps over migrants' rights – something Theresa May has said that she wants to address early on.

What does all this mean for the UK economy and for trade?

Any mention of Philip Hammond’s first – and possibly last – Budget speech is now overshadowed by the back-peddling on the recent Class 4 national insurance budget announcement. However, it’s important to note that he opened the speech with positive news on the economy, with both the Office for Budget Responsibility and the Bank of England increasing their growth forecast for this year to 2% as, “the UK economy continued to confound the doubters with robust growth.”

The manufacturing sector, in particular, has benefitted from the fall in sterling since the vote to leave the EU – but clearly what’s good news for manufacturing may not be good news for food prices, with the latest inflation figures showing a rise to 2.3% in February.

If – as we have suggested above – one of the early ‘wins’ will be the freedom to negotiate deals with non-EU countries then Britain is going to find Donald Trump a willing listener. With his bid to repeal Obamacare having been withdrawn last week for lack of support, the new President badly needs some positive headlines. You would also expect our trade negotiators to be booking flights to India and China fairly quickly.

What about companies? How have they reacted to the decision to leave the EU? Prior to the Referendum, there were plenty of dire warnings of large companies exiting en masse to Europe. So far this hasn’t happened: in February, Apple boss Tim Cook met the Prime Minister and told her he thought the UK would do “just fine” outside the EU. Amazon announced plans to create 5,000 more jobs in the UK and Boeing gave a significant boost to the economy of South Yorkshire, announcing plans to open its first European commercial factory just outside Sheffield.

The FTSE has continued to hit record highs, and unemployment has recently fallen to its lowest level since 1975. But these are very early days: no one should draw any firm conclusions from the events of a few months. Yes, some companies will remain in – or be attracted to – the UK because of the looser regulation and lower tax it may offer outside the EU. No doubt other companies will move in the opposite direction, deciding that they want to retain access to the single market under the present rules.

Conclusions

Theresa May swept into 10 Downing Street famously declaring that, “Brexit means Brexit.” She has now started the formal process and the overwhelming odds are that Brexit will happen. What shape it takes – whether, for example, it will be the very hard Brexit demanded by the Tory right – will take some time to determine. There will be plenty of claims and counter-claims and we are in for two years of uncertainty – and that’s before the UK economy deals with any problems caused by the rest of the world. Brexit is not the only game in town: there remains the continuing possibility of a slowdown in China, and the uncertainties over the economic policies of the new administration in Washington.

Whatever happens, you may have questions about how the developments over the next two years will impact on your savings and investments: rest assured that we will never be more than a phone call or an email away.

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