

PRESS RELEASE



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Brexit: A blind date is better than a bad breakup

- **The cost of uncertainty regarding Brexit could be as much as -0.1pp of GDP growth per quarter between now and making a deal**
- **Euler Hermes still expect a 'Blind Brexit' (70% likelihood): a last-minute deal with the EU where both sides agree on a Free Trade Agreement with very close ties**
- **In a 'No deal' scenario (25% likelihood), the UK will exit the EU under the WTO conditions: 4% to 5% of mutual import tariffs, with heavy consequences on both sides**

On July 26th, the EU rejected the Brexit deal proposed by the UK (the Chequers plan). In response to the rejection of this proposal, the EU proposed two solutions: (i) a Norway type of agreement or (ii) a Comprehensive Economic and Trade Agreement (CETA) type of agreement – with EU membership for Northern Ireland. For the moment, the UK rejected both proposals. Importantly, we cannot exclude the risk of early elections before March 2019.

In light of recent events, Euler Hermes publishes today a new study analysing the likelihood of a 'no deal'.

The cost of uncertainty

Given the lack of unity in British Brexit policies, we increased the likelihood of a 'no deal' to 25%.

This higher uncertainty already bears financial costs, notably on the pound sterling: we calculate that the GBP/EUR would reach a low of 1.06–1.09 at the peak of tensions in November–December. This would mean a -3% depreciation per month on average until a deal is made.

It could also cut UK GDP growth by as much as -0.1pp per quarter over the next two quarters while pushing companies to reinforce their contingency stocking in an environment of low domestic demand. Thus, **we revised our GDP growth forecast by -0.1pp in 2018 and 2019 to 1.3% and 1.2% respectively.**

The more this uncertainty shock persists, the more it damages the economy, as it can result in negative wealth effects through tighter financial conditions, a weaker consumer demand, and fragile business profitability.

Last minute deal: A blind date between the UK and Europe?

Our central scenario (70% probability) continues to be a last-minute agreement by January 2019 which would ratify the 21-month transition period. An agreement is likely to give temporary relief to financial markets, especially to the pound. We estimate the pound to euro exchange to rebound to 1.14 by April 2019.

However, the political declaration on the future Trade Relationship Agreement with the EU is likely to lack very concrete details. It will hence look more like a 'Blind Brexit', as a formal trade agreement would not be published until the end of the transition period, planned for December 2020.

According to Euler Hermes, the most probable scenario would be an 'Extensive FTA' similar to Norway following the transition period. This scenario would avoid Ireland's dislocation and allow Conservatives to keep their majority in the Parliament.

A 'No Deal' would be a case of bad breakup for businesses

Should the EU and the UK not be able to find an agreement by March 29th 2019, in the absence of an extension of the Article 50, the UK would exit the EU under the WTO conditions. According to our estimate, **there is a 25% probability for this scenario.**

We would expect the pound to depreciate by 20%. Two extra minutes of additional controls at the border (in addition to the current two minutes) would translate into 32 km or 5 hours of queues, which would more than triple the existing ones. WTO conditions would translate into 4% to 5% of mutual import tariffs. Moreover, as all trade agreements need approval from all States that signed the deal, a transition phase will be necessary.

Over and above these bureaucratic hurdles, damage will be caused by the fact that extremely interconnected supply chains with the EU countries will become obsolete. This would lead to massive investment stops and production relocations over time. Financial services would also be heavily impacted.

Overall, we would expect UK GDP growth to fall by -1% in 2019 in this 'no deal' scenario.

On the other side, top EU losers in exports of goods would include Germany (~EUR8bn), the Netherlands (~EUR4bn), France (~EUR3bn) and Belgium (~EUR3bn).

"We believe a blind date is way better than a bad breakup, as January 2019 is the minimum must-have time to allow ratification by the UK Parliament and the EU. We are also convinced that the Norway example is the best one for such an agreement, even if the UK would need to copy or replicate all of the 40 FTAs with the approximately 70 countries that the EU currently has these FTAs in place with" explains **Ludovic Subran, Chief Economist at Euler Hermes.**

Discover the full study here

About Euler Hermes

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