

# Five Brexit Myths

*On a dramatic day for UK, European, and the global financial markets, Eoin Fahy, Chief Economist, takes a look at the Brexit issue and in particular at five 'Myths', that have arisen about what happens next.*



**Myth 1: As the UK is now set to leave the European Union, governments will now move quickly to introduce border controls on trade between the UK and the EU.**

**Reality:** The UK's vote to leave the EU is the start – not the end - of the exit process. It is likely that it will be late 2018, at the earliest, before the UK could legally exit, and it could in fact be considerably later than that. The exit mechanism in European law states that once the UK formally informs the EU of its intention to leave, under the terms of Article 50 of the European Treaty, a two-year period of negotiations begins, at the end of which the UK would legally leave. This period could only be extended by unanimous agreement of all 28 countries involved. However, there have been some suggestions that the UK might opt not to invoke this particular article of the Treaty, as it puts inconvenient time limits and restrictions on the exit process. Instead it may start a more informal set of negotiations to facilitate the exit.

Either way, however, it is very clear that barriers to trade between the UK and the EU will not be in place in the immediate future.

**Myth 2: The European Union is falling apart.**

**Reality:** The Brexit vote is a real blow to the EU, but it cannot be said to be “falling apart”. The fact that one country has voted to leave should be seen in the context of the growth (not decline) of the number of countries in the EU in recent years. Prior to 1973, there were only six countries in the EU. That grew to 12 in 1986, 15 in 1995, 25 in 2004, 27 in 2007 and 28 in 2013. The departure of one country, even the UK which is the third-largest member with about 13% of the EU population, does not mean that the union is falling apart. This is perhaps especially the case for the UK, which has always been seen as somewhat “semi-detached” from the EU, with much less enthusiasm for the EU at official and general public level than in most other EU member states.

To be fair, while it's wrong to say that the EU is falling apart, it is not impossible to make the case that the UK's departure could (note could, not will) lead to further departures over the next few years. The EU is unpopular in some countries such as Denmark, and the Dutch electorate recently voted against an EU agreement with Ukraine in a sign, perhaps, of its disaffection with the EU. In Greece, to date the electorate appear to continue to favour EU membership notwithstanding the extreme difficulties there, but further austerity measures and social unrest could change that picture. And there is always the possibility that the UK will lead to populist parties in other countries organising similar referenda, potentially with similar results. But this does seem unlikely at this stage, and certainly not a “done deal”.

**Myth 3: Brexit will inevitably lead to a recession in the UK, and probably in Europe as well.**

**Reality:** There can be little doubt that Brexit is negative for the UK economy, as has already been stated by a myriad of independent institutions and economists, inside and outside the UK. But we need to be careful not to confuse “slow growth” with “recession”. A recession is a possibility; there is no doubt about that, particularly if the UK's exit is badly handled. A scenario where negotiations failed to achieve an agreement to allow reasonably tariff-free access to each other's markets could lead to a recession if it had a very negative effect on trade.

But it's much more likely that the negative impact would be felt over several years, keeping growth to a much lower level than would otherwise have been the case, and could well push up the unemployment rate, perhaps.

Turning to the impact on the rest of Europe, the negative impact on trade, and business confidence, is most unlikely – in its own right – to be big enough to cause a recession. While trade with the UK is important, the UK is just not important enough to cause a recession for a trading bloc as large as the eurozone.

That said, a recession in Europe is nonetheless possible (though not probable) as a result of a different channel, i.e. a repeat of the European sovereign debt crisis. One conceivable scenario is that investors become concerned that other countries will leave the EU and it will eventually break up completely. In that scenario, weaker countries could no longer expect financial support from wealthy countries like Germany, or from the European Central Bank, and so in an extreme case they might be forced to default on their debts.

Bond yields for peripheral, high-debt countries like Portugal, Greece, Spain and Italy would soar, and the damage to business confidence, combined with an inevitable credit crunch, would cause a sharp recession in Europe.

This scenario is unlikely and certainly not our base forecast, however.

#### **Myth 4: The result of the referendum means that the issue is now closed. The electorate has spoken and the UK will certainly now leave the EU.**

**Reality:** While it is certainly very likely that the UK will leave, it is not a certainty. As mentioned above, it will probably be at least two years before the UK could legally leave the EU, which gives plenty of time for UK and European politicians to reach an agreement on revised terms for UK membership of the EU, allowing a second referendum to be held, this time – potentially - resulting in a vote to Remain in the EU. We should not forget that a substantial majority of the members of the UK Parliament are in favour of remaining in the EU – approximately half of the ruling Conservative Party, as well as the considerable majority of the various opposition parties.

That said, a reversal of the decision would not be easy to achieve. Outgoing Prime Minister David Cameron has explicitly said that another referendum is not a possibility, and he or any other politician trying to overturn the referendum result could be seen to be defying the vote of the people, so they would need to be able to argue that circumstances have changed so much that a second vote is necessary. This is possible, but unlikely.

#### **Myth 5: Protest parties now dominate European politics.**

**Reality:** It is easy to look at the UK electorate's vote to leave the EU, combined with the strong showing of many other protest/populist parties across Europe, and conclude that these protest parties are about to take power in Europe. But the facts say otherwise. In the most recent general or Presidential elections, most of these parties obtained support ranging from about 15% to 25%. In Spain, Podemos took 21% of the vote in its most recent general election, while the Five Star movement in Italy got 26%, Syriza in Greece reached 35%, Sinn Fein in Ireland took 14%, the National Front in France took 18%, and the UK Independence Party (UKIP) took 13%. The exception is Greece, where Syriza took about 35% of the votes (but due to an unusual voting system, came very close to forming a majority government). These vote shares show a high level of support, certainly, but far below majority status.

The bottom line: populist/protest parties are now an important political bloc in many European countries, but they certainly do not dominate parliaments and they seem unlikely to take power anywhere other than Greece.

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