‘No deal’ Brexit has been avoided but uncertainty is likely to persist

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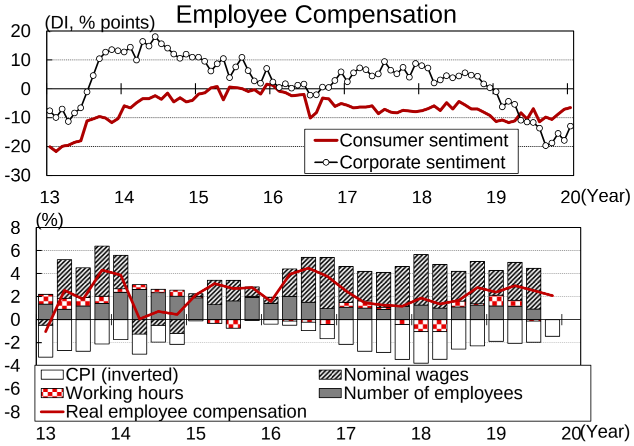
UK GDP growth slowed to 0.0% QoQ in Q4 2019, due mainly to Brexit-related uncertainty. Private consumption, still supported by healthy employment and income conditions, grew by a mere 0.1% QoQ, and government consumption continued to expand at 2.1% QoQ. However, stagnant negotiations with the EU resulted in heightened concern over a 'no deal Brexit', and capital expenditure fell by 1.0% QoQ as businesses adopted a 'wait-and-see' approach to investment.

Following a decisive Conservative victory in the December 2019 general election, the UK left the EU on 31 January 2020. The 'transition period' now lasts until 31 December 2020, during which time the UK will effectively remain a member of the EU customs union and single market. Since the start of this year, monthly economic data have demonstrated signs of improving corporate sentiment (Chart 1, 2), due in part to the avoidance of a worst case 'no deal' scenario. The US and China also reached the initial stages of a trade agreement, which helped to allay concerns of a global slowdown.

Negotiations on the future relationship between the UK and the EU are likely to be difficult, and with the new threat from the coronavirus, future uncertainty looks unlikely to clear for some time. There is little prospect of UK and EU concluding all aspects of the negotiations in the time left (less than 9 months), and the UK is strongly opposed to extending the transition period. There are also stark differences in the negotiating positions of the two sides. The UK favours a 'Canada style' deal, which would allow a large degree of trade liberalisation whilst limiting regulatory alignment with the EU. The EU on the other hand has emphasised that adherence to ‘level playing field’ provisions is a pre-requisite to any free trade agreement (FTA). Based on Boris Johnson's past negotiating tactics, large parliamentary majority, and desire to preserve the union, we believe that some kind of extension remains likely. In the absence of a formal extension, it is likely that mitigating measures such as a partial deal would be used to alleviate the ill effects of ending the transition period without an FTA.

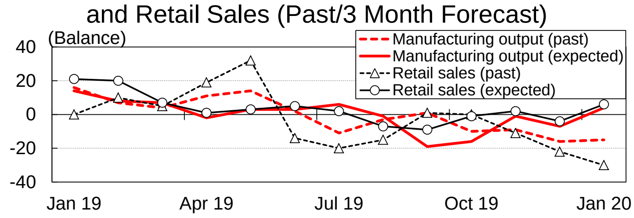
Concern over the possibility that the UK could reach the end of the transition period without a deal is likely to continue to drag on corporate sentiment (Chart 3). On the economic impact of the coronavirus, mitigating factors include 1) the UK economy is primarily service-based, and 2) exports to China make up just 0.9% of exports as a proportion of nominal GDP. However, given that the UK is already dealing with the inherent uncertainty of Brexit, we must be mindful that the spread of the coronavirus has the potential to delay any recovery in corporate sentiment, and we as have seen Eurozone, we may see coronavirus-induced disruption to supply chains.

Chart 1: UK Corporate and Consumer Sentiment, Employee Compensation



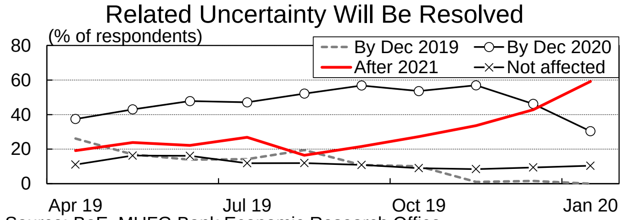
Source: ONS, BoE, MUFG Bank Economic Research Office

Chart 2: CBI Business Survey, Manufacturing Output and Retail Sales (Past/3 Month Forecast)



Source: UK CBI, MUFG Bank Economic Research Office

Chart 3: UK Business Expections of When Brexit Related Uncertainty Will Be Resolved



Source: BoE, MUFG Bank Economic Research Office

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