Comment w/c 8th July

Looking on the bright side

"You don't tell deliberate lies, but sometimes you have to be evasive."

Margaret Thatcher

In less than three weeks, the waiting game will be over and we'll have a new prime minister in place, together with a complete overhaul of the ministerial line-up. Provided he passes the inevitable vote of confidence (Labour has a three-line whip in place for 23/24 July), the intention will be to despatch the Brexit issue without a further extension, and move on from this three-year hiatus.

One of the most prominent commentators on the UK economy in the event of 'no deal' is Roger Bootle of **Capital Economics** , and last Tuesday he and his team gave a strongly upbeat forecast of our prospects.

So this week we look at the bright side of what could happen over the months - and years – ahead, and offer a vision of how the United Kingdom could be strong enough within a couple of years to help resolve the impending Eurozone crisis, notwithstanding Brexit.

The polls point strongly to a Johnson victory, and all the indications are that his team is well-organised and prepared to take power before the summer recess. Both Boris Johnson and Jeremy Hunt have made substantial pledges of fiscal largesse, but most commentators seem to regard these as electoral bribes rather than the reality of preparing to counterbalance a post-Brexit shock to the economy.

Capital Economics' cyclically-adjusted Budget deficit shows that there is significant headroom available for fiscal expansion, as a result of the sustained programme of austerity. In the event of 'no-deal', they expect fiscal policy to be loosened swiftly and substantially, by least 0.5% of GDP. They also expect interest rates to be cut to 0.25%, and a re-start to quantitative easing.

Meanwhile, they point out that there has been good progress with Brexit preparations:

- Most risks to the stability of UK financial services have been mitigated (comment from the Bank of England);
- Deals are in place for aviation, haulage, passenger transport, and the rights of EU citizens in the UK; and
- 90% of businesses have implemented some form of contingency plans.

So far as import tariffs are concerned, the Department for International Trade have indicated that the average goods import tariff will be c. 2.2% in the event of 'no deal', significantly lower than the general WTO 4% level.

As a result, Capital Economics predict GDP rebounding sharply following an initial dip, in the event of 'no deal'; but their central forecast sees GDP staying positive even in the immediate aftermath. Meanwhile, by the end of 2021, they see no significant difference in GDP prospects between the three potential Brexit outcomes - 'deal' on 31 October, repeated delays, or 'no deal' on 31 October - and average earnings are expected to continue to outpace CPI.

The biggest difference they predict between those three potential outcomes is in interest rates, which by end 2021 they forecast at 1.5% in the event of a deal, and 0.5% in the event of 'no deal'.

All this means that Boris Johnson's team is right to take a robust line to the EU negotiations, and parliament should not stand the way of resolving Brexit by 31 October, even if it means 'no deal'. My own preference is that the United Kingdom should invite Leo Varadkar and Arlene Foster to find a mutually acceptable resolution to the Irish border issue by the end of August, so that both the EU and UK can confirm their approval in good time before the October deadline. If Arlene Foster cannot secure an outcome to the DUP's satisfaction, the default would be 'no deal'.

After the Capital Economics presentation was completed, I asked Roger how soon he thought it would be before the Eurozone breaks up. That's a much more difficult thing to forecast: if the Italians push it to the wire, it could be in the next couple of years – however, if the can continues to be kicked down the road, it could be 5-10 years away.

Whenever it is, London and the United Kingdom will stand ready to help European economies back to their feet. New currencies will require formation, and financial markets will need to support that transition. That's when the United Kingdom will demonstrate that we really are a good friend to our European neighbours.

So, looking on the bright side, there is a potentially good outcome to all of this. The one question not addressed above is political turmoil, and there's plenty of scope for that: but, of course, if Brexit is concluded by the end of this year, why will we need a Brexit Party? What we will need is a Prime Minister who can welcome Nigel Farage and his team well before the next UK election takes place: and Boris is well-placed to do that.

Gavin Oldham OBE

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