

The United Kingdom and Brexit: Economic Uncertainty Plus Political Instability

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Summary: Complete report available upon request.

Key takeaways

- The UK economy has looked healthy and real estate values have held up, but **underlying weaknesses are beginning to show through**. Inflation, currency depreciation, and a lack of real wage growth present serious threats to the economy. Brexit uncertainty and a steady drumbeat of corporate reductions and departures are likely to undermine sentiment.
- **Theresa May's premiership is in serious trouble** after losing her majority in an ill-advised off-cycle election; cabinet ministers are jockeying for position and cabinet unity is weak while the opposition has gained strength.
- An uneasy consensus that Brexit is now inevitable has taken hold, but **May's weakness has undermined confidence in the government's Brexit strategy** and clouded the UK's outlook—making reliable predictions about the transition process, timing, and outcome very difficult.
- The Europeans are exasperated with London but they are not looking to punish the UK. Nevertheless, **the EU's firm and united stance is reinforcing a hard Brexit scenario**. The costs to the EU are much more diffuse and therefore politically easier to manage.
- **A hard Brexit, preceded by some stop-gap "soft" transitional regime, remains the most likely outcome (50% probability)**. A no-deal, "crash out" scenario is a 15% probability. In any event, Brexit should be viewed as a tortuous 10–20-year process that businesses and investors will have to deal with.

Issues to watch, questions to ask

- **The fate of May and Brexit implications.** With much of her party, her cabinet, and the country expecting her eventual resignation, what will policy be on Brexit by the end of negotiations? Brexit represents the most significant realignment of UK policy in decades but London has no good options and it lacks the leadership for finessing it.
- **The strength of sterling.** A continued decline in the value of sterling could lead it below parity with the euro. This would exacerbate pressures on household budgets, importers, and those reliant upon inputs from abroad. Where will the currency be at the end of 2018?
- **The future of London.** Many multinationals are formulating plans to shift resources and people away from London, and contingency plans are being put in place as well. At the same time, technology and business evolution are driving rapid changes in London's business and employment profile. While it's too early to draw conclusions, it's time to start thinking about major changes rendering one the world's most important economic hubs. ■