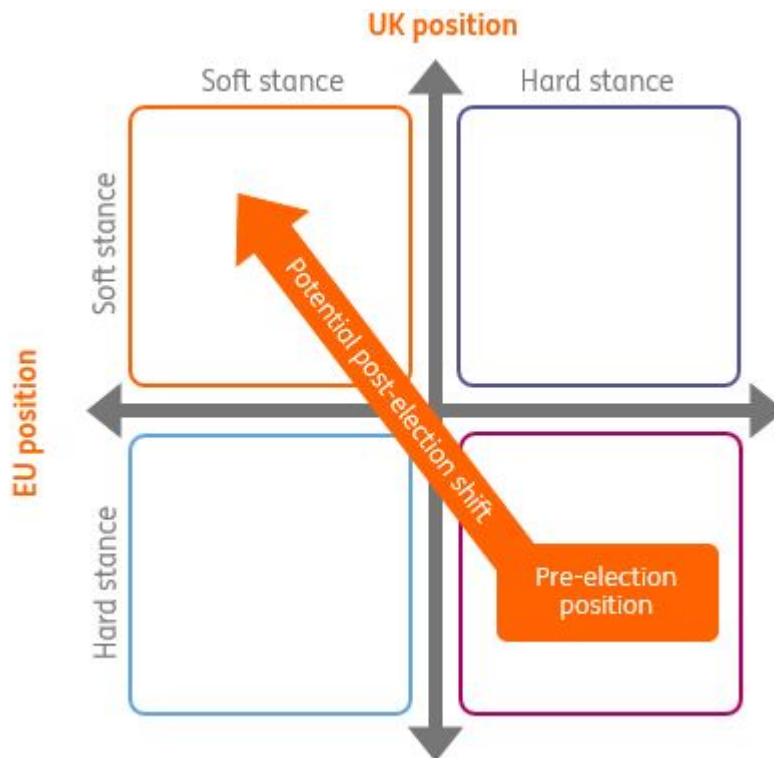


How the UK election could alter Brexit strategies

A softer Brexit now looks likely after the UK election. But it's not quite that simple...





Starting position: Stalemate

This is arguably where we were before the election. The UK government had been taking a tough stance on migration and the divorce bill. Meanwhile, Europe was refusing to back down on free movement of people and had doubled its initial estimate of the potential “divorce bill”.

Under pressure: Initial UK position softens

With UKIP support having collapsed at this election, there is the opportunity to pull back from the hard stance on the EU. Theresa May has been weakened and needs to gather support from both wings of her party. The DUP will also want to ensure an open border with Ireland, which will limit the scope for hard Brexit.

An opposition that is decidedly less hostile towards Europe also means the Conservatives don’t have to compete on a harder Brexit. Indeed, the government may have to consider a softer stance to secure parliamentary passage of the Brexit legislation.

EU lead negotiator Barnier has opened with a conciliatory approach, saying negotiations should only start when the UK is ready. “Let’s put our minds together on striking a deal”, he said on the morning after the election.

Defections destabilise fragile government

To get here, it might initially take signs of a softer Brexit stance from the Conservative government. This could frustrate the harder-line Brexit supporters in the Conservative party, and could potentially see threats of defections to a resurgent UKIP. This in turn could see the Conservative’s fragile majority erode to zero, raising the possibility of an immediate election. Awkward timing of such a move during the negotiations would spell trouble.

Toxic politics return

Even if the UK softens its stance, the potential for Italian elections to result in an anti-EU government could see the EU respond by showing that leaving the EU is incredibly painful. This could see the EU pulling back from negotiations, risking the clock ticking down and the UK leaving the EU without a deal in place in an effort to deter Italy from following the UK down this path.

EU politicians might also calculate that a hard line could lead the UK to reconsider its position, or destabilise the minority Conservative government in such a way as to trigger another election.

This new election would then be fought on the issue of an unattractive hard Brexit option. This could lead some parties to campaign on the basis of a softer Brexit or on the offer of a second referendum. Both options would be more desirable for the rest of the EU.

What now for Brexit?

Theresa May called the election anticipating a landslide victory, but the Conservatives failed to win a majority and are reliant on Northern Ireland's DUP for support to continue in government. Having adopted a tough line on Brexit, this election outcome could re-open her party's wounds regarding Europe and May will need to work hard to unite it. With the UKIP threat eliminated (for now) and all opposition parties keener on a "softer" Brexit, there is scope for a shift in her stance.

The seemingly conciliatory tone struck by the EU leaders (Michel Barnier today commented that negotiations will start only when the UK is ready) also seems to reduce the odds of a "hard" Brexit. Nonetheless, there are lots of risks to this assessment, with a narrow majority leaving the government vulnerable to by-election defeats and defections. There is already a question over how long Theresa May could last as PM, but there will be plenty more twists and turns before Brexit is concluded, including the possibility of a new election.

Authors

James Knightley

Chief International Economist

james.knightley@ing.com

James Smith

Developed Markets Economist

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose

possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.