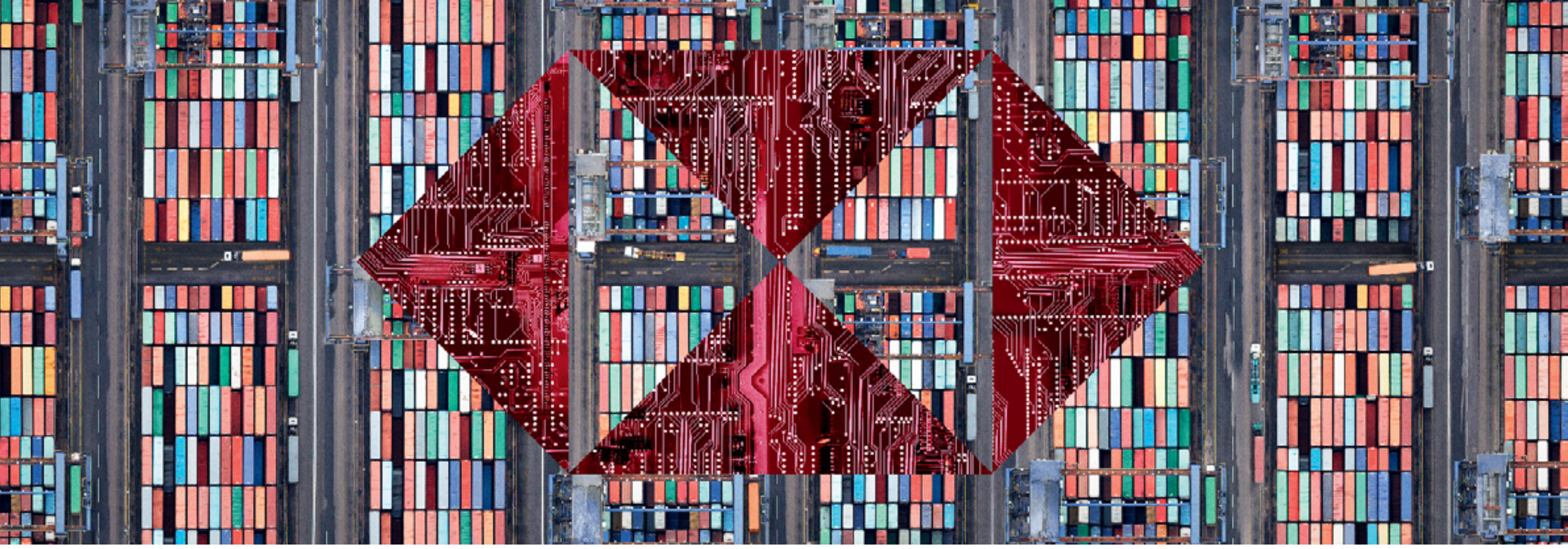

Brexit Commons Vote Update

Get the latest news on Brexit developments as Mark Berrisford-Smith, Head of Economics for HSBC UK Commercial Banking, gives his update on the Commons vote, what the next steps are and what it could mean for businesses across Europe.

Recorded on Thursday 17th January 2019.

Plain text = interviewer, Ed Simmonds
Bold text = interviewee, Mark Berrisford-Smith

Hello and welcome to the HSBC Business podcast. I'm Ed Simmonds and I've been looking after our preparations for Brexit, as a bank.

This week saw a critical juncture in the Brexit process as Parliament voted on the Prime Minister's draft withdrawal agreement. The 'no' vote might not have come as a great surprise for many of us, but what will it mean for the process? And, more importantly for the business community?

We're here with HSBC UK Commercial Banking's Head of Economics, Mark Berrisford-Smith, to give some clarity on what the vote means, and what the next steps will be.

Mark, thanks for joining us –

Thank you.

It feels like a long time since you last spoke to us, following the EU Summit in October. So before we look at the result itself, it's now been two months since the government reached an agreement with the EU, how has business fared during this long period of uncertainty?

00:57

Well, it would be fair to say, that many businesses are confused, and exasperated, and – certainly, if you like at the statements that have come out from the likes of the CBI and the British Chambers of Commerce – there is an increasing sense of frustration and exasperation that the process is proving so difficult, and that we're now so close to the wire.

But, in reality, the impact on the economy, as a whole, of this period of heightened uncertainty since November, has not been that great. The economy is still growing. We had some GDP figures for the month of November, which showed the UK economy growing by 0.2% in that month. Now, monthly GDP numbers are a new-fangled innovation from the Office of National Statistics, and I personally am a little bit sniffy about them. But it's fair to say that if they've reported 0.2% growth in a month and – even if they subsequently revise the numbers – they are not likely to revise them to negative. So it does seem there was still growth in the economy in November, even at the point that we reached the Brexit denouement, and the government was concluding its deal. It was also at the point where it was also becoming fairly obvious that it wasn't going to get support in parliament.

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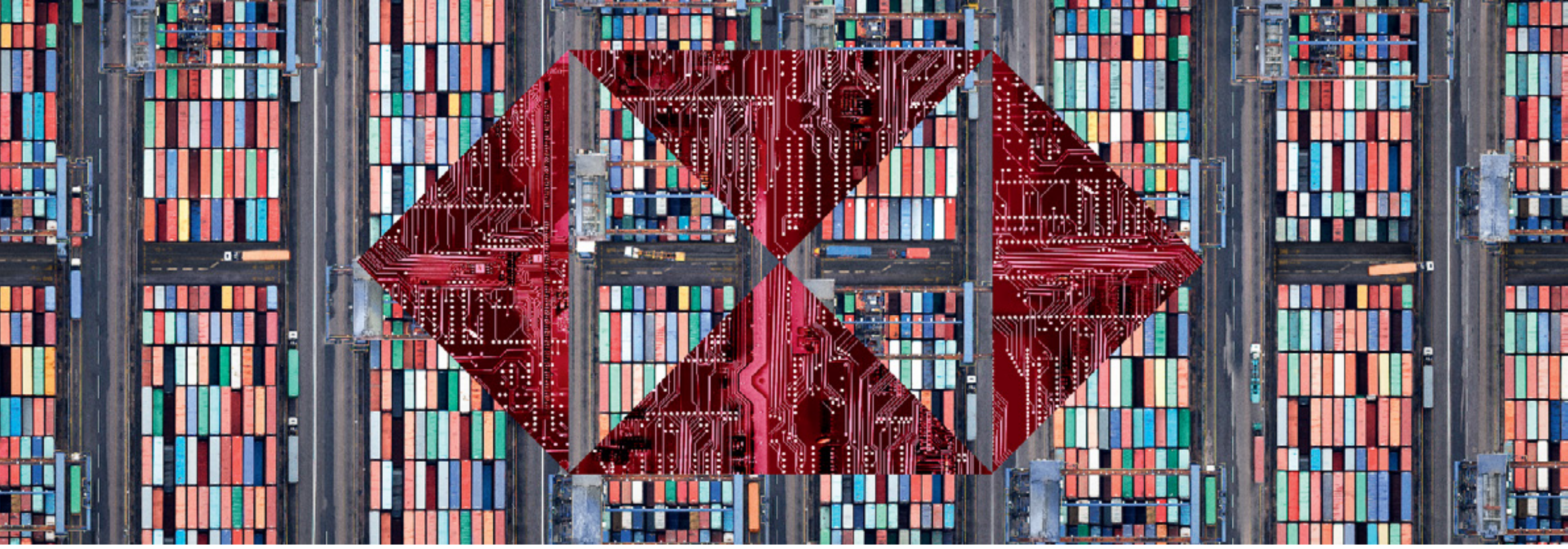


Since November, we've had more surveys of consumer sentiment, and of business sentiment. Now, the consumer surveys have shown that ordinary people are clearly worried by Brexit, and what it might mean for their futures. But it hasn't so far had a huge impact on their spending. The retail sales figures for November were actually quite strong, suggesting that we're getting into the swing of all this Black Friday stuff that came to us from America. And as for December, we don't yet have any hard numbers but the trading statements from the retailers suggest that while it wasn't too good for some, it was ok for others – and certainly that it wasn't a disaster.

03:11

As for the business surveys, particularly the purchasing managers index surveys, that are very closely watched by financial markets, they continue to show the economy growing, albeit very sluggishly. They haven't turned negative. And indeed within those surveys there is evidence that firms are stocking up, as they make contingency plans for a no-deal Brexit. That in itself is actually beneficial to the economy, because of course it increases activity. So I think when the dust settles, and we finally get the GDP numbers for the fourth quarter of 2018 and the first quarter of 2019, I'd still expect them to show very sluggish growth. Okay it might be 0.2%, it might be 0.1%, but it will still be growth.

04:01

So, some positive elements there. So, moving onto the result from Tuesday's vote, parliament rejected the draft withdrawal agreement. What does this mean? And what options does the government now have?

04:15

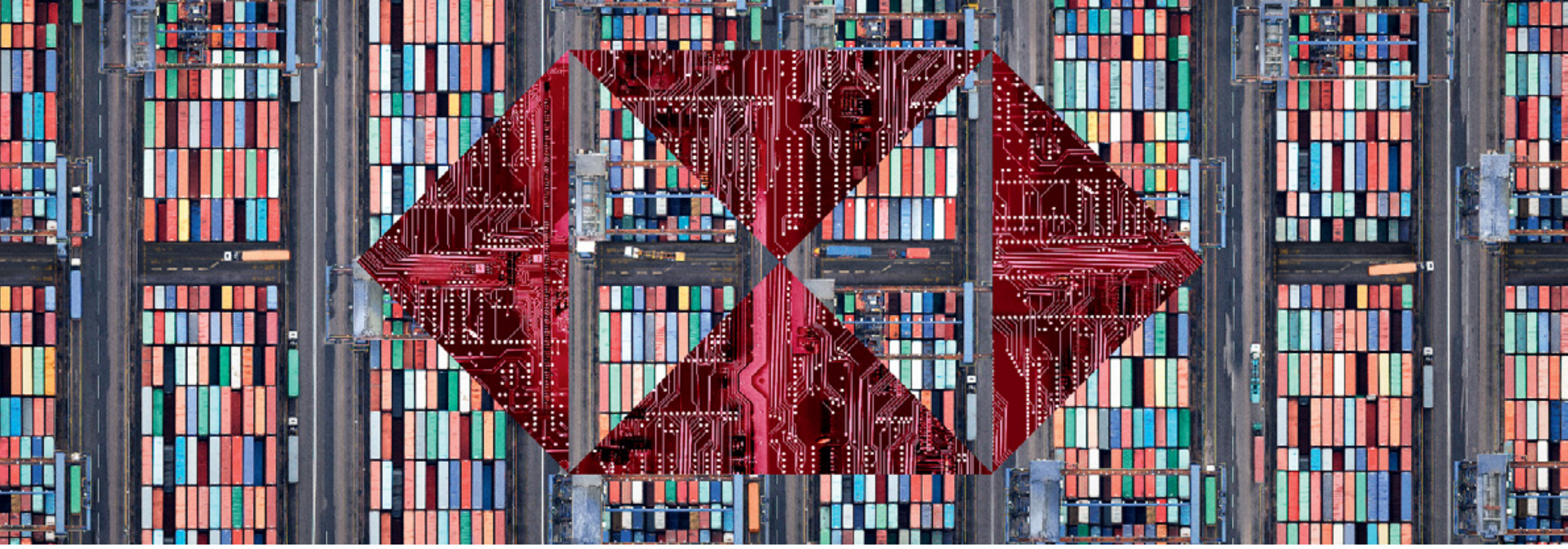
I think what it really means is that we've now got a lot of the clag out of the way. Over the past month, we've had a leadership election for the Conservative Party. Subsequent to the Meaningful Vote on Tuesday, we've had motion of confidence put down by Labour, which the government saw off. We've then had a decisive outcome to the Meaningful Vote. Now, had this gone down by 20, 30, 40, 50, 60, something like that, the size of the defeat tweaking this isn't going to get it over the line. We're going to have to do something quite different.

04:52

Ok, so what does this mean for our businesses across Europe? How can they – or should they – react to this news?

04:59

I'm afraid to say that nothing that's happened in the last few days provides any more certainty about what the final outcome will be. Some of the clag, if you like to call it, has been got out of the way, I mean parliaments had it's say and come to decisive opinion, Theresa May suffered a challenge to her leadership, we've had a motion of no confidence in the government. That, if you like, clears the decks for other things to happen. But at this point there is still no certainty on what the outcome is going to be and you still cannot say at this point that we've reduced the risks of a no deal hard exit. It's still a perfectly possible outcome. We will hope that the politicians can avoid it, but there's absolutely no guarantee. So firms are planning for a hard exit for the UK and if they've been doing work to mitigate against that then they need to continue to do so. Because one of the things that potentially happens in a no deal Brexit is that the goods they import from the UK could be subject to tariffs and obviously the most basic advice is to understand what those tariffs are, whether they are large, whether they are small, most of them are actually quite small, a lot of them are under 5%. That may matter, it may not matter, but at least know what they are, know what impact it has and ultimately make choices about whether you can still continue to use those UK suppliers. Equally be aware that



goods sent into the UK are also likely to be subject to tariffs. Now the UK might take unilateral action to mitigate those tariffs, that would be possible, but as far as we know at the moment, at the point of exit from the EU, the UK will have the same tariffs on goods as the EU currently does.

Thanks Mark. So, still really a need for businesses to look at all eventualities and to continue planning in detail. What do you think the result will mean for the UK economy?

06:33

Given that businesses are facing this gnawing uncertainty and given what it's going on in the global economy, the UK has actually proved itself quite resilient. Now, if we can get this over the line, and if we have an orderly exit – whether its on 29 March or some date shortly thereafter – then I'm reasonably optimistic about the coming year for the UK economy. And I'm optimistic on a couple of accounts, actually.

Firstly, if you can remove the uncertainty about how Brexit is going to work and when it will happen, then a lot of businesses – particularly big ones – will start to think about investing again. We've had three quarters in which business investment spending has fallen. Now that is rare. It usually only happens the country is in recession. The economy is not in recession and the fact it has happened simply reflects uncertainty on the parts of businesses.

07:38

Second, we had Philip Hammond's budget at the end of October. It's committed to a fiscal loosening - £103 billion over five years. I know most of it is going on health, but it does seem like the government is back in the game. The major issue that has been impacting on consumers over the last couple of years is now dissipating. So, you go back to the start of 2017, consumers have been retrenching because earnings growth has been keeping pace with inflation. People had been earning a little bit more, but that has bought them a little bit less. That's now finished. The inflation rate is – the last one for December, 2.1%, the last earnings growth numbers we have, 3.3%. So inflation has ebbed, earnings growth has accelerated a bit because the labour market is tight, and that means up and down the country living standards of ordinary people will be starting to rise again. And that means they will be inclined to spend money if we can remove those Brexit uncertainties.

So, if we can get an orderly resolution to this, then I think the economy could grow more quickly than it did last year. We'll be looking at growth this year of about 1.6% versus 1.3% for last year. If, on the other hand, it really does end up being a no deal, in that scenario, it's not the disruption of ports. That would certainly be important in the first couple of months, and I'd hazard a guess that the GDP figures for the second quarter of next year would not look good at all. They would probably be negative. But actually the bigger issue and the longer term issue is not the disruption, it's what would happen to the currency. This is what drove consumers to retrench over the past couple of years. Its' the fact the currency fell in the wake of the referendum result. And that put up the prices of everything we import, that delivered inflation, inflation ran ahead of earnings, and consumers retrenched. Now if sterling falls again in the wake of a no deal exit, then the same train of events would start up again. We'd get higher import prices, we'd get more inflation, consumers would start to feel squeezed again, and would start to retrench. And that's what puts the economy into recession in this scenario, not the disruption. So, if it does come to a hard, no deal exit, watch the currency.

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Very good, thanks Mark. So, a lot still to look out for. I like though your thoughts on optimism and resilience. So it's been good to speak to you Mark, thank you, and I think that's all we have time for.

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