

# Beyond Boris

**British stress with the EU will endure far beyond Boris Johnson's tenure.**

By Vaibhav Tandon



British Prime Minister Boris Johnson is a man of action. He seems to be in perpetual motion, and doesn't mind if photographers are in tow. On the policy front, he has also been a man in a hurry: he concluded an agreement to implement Brexit in six months, something his predecessors had been unable to do over the prior three and a half years.

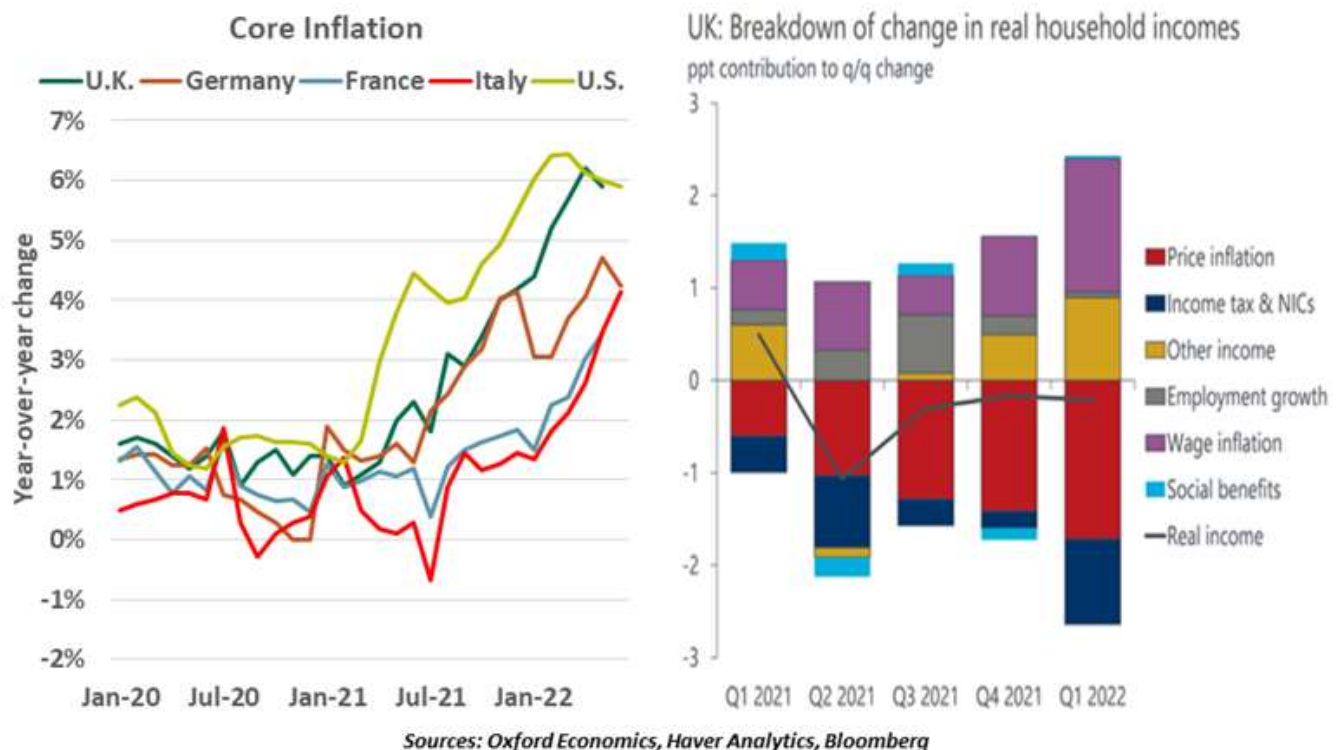
Unfortunately, his actions during the pandemic (hosting a cocktail party while his country was in lockdown) were a leading cause of the loss of confidence that proved his undoing. Last week, Johnson quit amid a deepening political crisis and rising odds of recession. A leadership derby is underway, with an outcome expected by early September. But Johnson's impact on the British economy is likely to continue long after that.

The U.K. appears to have avoided the doomsday predictions that some forwarded when the decision to leave the European Union (EU) was taken. The number of jobs and institutions in the finance sector shifting to Europe has turned out to be far smaller than initially expected. London remains the continent's most attractive destination for financial services investment.

But, contrary to the Brexiteers' promises, the divorce hasn't ushered in a new era of prosperity. British real growth has lagged that of the EU. According to the Centre for European Reform, the U.K. economy is already 5% smaller than it would have been had it stayed in the bloc.

Business uncertainty has been weighing on investments. A recent [survey](#) revealed that 45% of Britons (up from 30% in June 2021) think that leaving the EU. has made their daily life worse.

The Office for Budget Responsibility estimates that British workers will be 4% less productive due to Brexit.



Those in the "leave" camp trumpeted the freedom to reestablish trade relationships and regulatory frameworks as primary benefits. In effect, however, the U.K.'s exit has erected more barriers to commerce, and British exports have lagged well behind those of other advanced economies.

The U.K. no longer enjoys unchecked access to the EU's large customs territory, which stretches from Turkey to the Atlantic and covers nearly half a billion consumers. The divorce has created barriers to cross-border mobility, causing disruptions in supply chains. Trade relations between the two sides now involve more paperwork and checks, making British exports less competitive.

According to the [London School of Economics](#), trade relationships between U.K. exporters and EU importers fell by almost one third since January 2021, owing to red tape. British businesses incurred £4.5 billion in duties on European goods entering the country in the 12 months to January 2022, an increase of 64% over the previous year.

### **The British government's actions are once again stoking fears of a trade war with the EU.**

A lot of work remains to be done to achieve the flexibility of international commerce that the U.K. enjoyed under EU negotiated agreements. The government has signed only three new trade deals since leaving the bloc. Negotiations with the U.S. on a trade arrangement began two years ago and have failed to make much progress. As a result, U.K. goods exports are down 14% since early 2020 compared to a global average of an 8% increase over the same time period.

The Northern Ireland protocol was central to the trade agreement between the U.K. and the EU. It attempted to solve the thorny problem of trade with Ireland, an EU country which shares a 500-kilometer land border with Britain. But almost from the moment the ink had dried, Boris Johnson sought to renegotiate.

Of late, the British government has pressed to remove the internal customs border. This has stoked fears of a trade war which would add to inflation and derail growth. In a worst-case scenario, the E.U. could retaliate by revoking parts of the Brexit agreement, including the zero-tariff arrangements, or move to suspend that agreement in its entirety. A more pragmatic approach to the issue from the next prime minister is unlikely. Cutting taxes and easing regulations as proposed by most candidates would further inflame tensions with the EU.

/ UK business investment / Continuation of 2010-2015 trend



### **Goods Exports**



Sources: Bloomberg, FT, CPB Trade Monitor

Brexit was the most important issue for U.K. residents when they returned Boris Johnson to power in December 2019. That is not the case anymore. The economy has emerged as the major concern for many since the onset of the pandemic and Russia's invasion of Ukraine.

### **Inflation is much worse in Britain than it is in the rest of Europe.**

Johnson's successor must deal with a cost-of-living crisis while avoiding a recession. The combination of soaring energy prices, supply chain bottlenecks and a weaker currency has pushed inflation to a four-decade high, drawing parallels with the Great Inflation of the 1970s. Britain's household saving ratio has fallen below pre-pandemic levels. Real incomes have declined for four successive quarters, and could fall to new lows. The rising cost of living has not only eaten into spending power, but also support for the government.

The pandemic and Russia's invasion have been common inflationary forces across the globe, but Brexit differentiates the U.K. from its peers on this front. It has the highest inflation among major advanced economies, including the EU, despite the bloc facing bigger supply shocks from the war. It's hard to isolate the impact of Brexit from other disruptive forces, but a [study](#) by the London School of Economics suggests that trade barriers have contributed to a 6% increase in U.K. food prices.

Reduced immigration amid curbs on low-skilled foreign workers has created enduring labor shortages, contributing to higher wage inflation in Britain. Wages have been growing faster in the U.K. than in countries like Germany and France, even though all three countries followed similar policies to support their labor markets during the pandemic. British core inflation has been diverging from the eurozone's since mid-2021, well before the war started.

There is not much the U.K. government could have done to contain the spillovers from the pandemic and the Ukraine war. But Boris Johnson's fingerprints are all over the mess that continues to be Brexit. Perpetuating the stress with the EU will give the British economy a bad case of long Boris.

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