

[REDACTED]

From: DICKINSON Roy (ECFIN)
Sent: 12 April 2016 09:32
To: [REDACTED]
Subject: RE: Eurasia Group Note - UNITED KINGDOM - BREXIT risk rising

Well, I was always worried about the effect of accidents: and there have been more accidents this month than I could ever have imagined: Brussels attacks, the steel crisis, the Panama papers, and still the migrant crisis.

Yet the remain lead in the polls is still fairly consistent. So I'm still pretty optimistic.

From: [REDACTED]
Sent: Monday, April 11, 2016 7:22 PM
To: [REDACTED]
Subject: FW: Eurasia Group Note - UNITED KINGDOM - BREXIT risk rising

FYI

José

From: [REDACTED]
Sent: Monday, April 11, 2016 2:05 PM
To: [REDACTED]
Subject: Eurasia Group Note - UNITED KINGDOM - BREXIT risk rising

All:

Please see latest piece attached. Comments welcome.

[REDACTED]

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From: [REDACTED]
Sent: Monday, April 11, 2016 6:16 AM
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Subject: Eurasia Group Note - UNITED KINGDOM - BREXIT risk rising

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EUROPE

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11 April 2016 06:13 EDT

UNITED KINGDOM - Government Stability

Short-term trajectory: **NEUTRAL**

Long-term trajectory: **NEGATIVE**

BREXIT risk rising

- We are increasing our probability of BREXIT from 30% to 40%.
- Momentum currently favours the "leave" campaign, as the Panama revelations are likely to aggravate other underlying Eurosceptic trends in British public opinion.
- Voters' risk aversion and the economic uncertainty associated with leaving the EU will still give the edge to the "remain" campaign, but this is becoming a closer call.

We are increasing our probability of BREXIT from 30 to 40%. This is driven by three factors: 1) opinion polls and the underlying trends in British public opinion they represent; 2) the fallout from Panama for British Prime Minister David Cameron; and 3) the increasing risks of a "bad context" in Europe at the time of the vote, especially regards the EU's refugee crisis.

Opinion polls

The opinion poll data we are analyzing with Ipsos now suggest BREXIT risk is higher than 30%. According to these polls, the remain campaign had a large lead (8 percentage points) until mid-February. For multiple reasons, primarily related to the weakness of Cameron's renegotiation, that lead has now disappeared. While British public opinion is now essentially tied, some of the underlying trends indicate momentum is currently in favor of leave.

For example, Tory voters have been more or less evenly split over BREXIT. But over the last month, the evidence suggests they are slowly leaning more towards leave. This will probably continue, as Tory voters get ambiguous messages from their party which is split, with 140 out of 330 MPs currently supporting exit. Cameron will therefore have to mobilize Labour and Liberal Democrat voters to increase his chances of winning the referendum (remain averages 65% for both groups). But his ability to do this, and prevent Tory voters sliding towards BREXIT will be hurt by the Panama revelations.

Next, British voters polled so far agree the economy is a bigger issue than immigration (or security) when considering how to vote on 23 June. This is important, as even Eurosceptics are more likely to vote to remain if they believe BREXIT will hurt them economically. However those polled so far are currently divided on the economic impact of BREXIT, with most people (~60%) unsure or thinking it makes no difference. If Cameron's team is not able to win the economic argument – something they have been heavily focused on over the last eight weeks – they are unlikely to win the vote.

Finally, turnout and undecideds will be two key drivers of the referendum outcome. But as of now, voting enthusiasm currently lies with leave: those who are more likely to vote are more likely to lean towards leaving the EU (58%) than remaining a member (42%). So if turnout is low, it's more likely leave voters will be the ones showing up. Moreover, 8-14% of Britons are currently undecided on the referendum and as of now, it's unclear how they will ultimately vote. Some polls show them split; others show them leaning slightly towards remain. The demographic profile of undecided voters is also equally muddled.

The fallout from Panama

The Panama scandal is proving a disaster for Cameron, who, as the effective face of the remain campaign, does not want to be anywhere near this story. But Cameron's face has been leading multiple newspapers for much of last week and this weekend. This will likely continue this week. The scandal has associated Cameron personally with the politically toxic use of offshore tax havens used by the global elite; it has called into question the sincerity and effectiveness of his own promises to close off-shore tax loopholes and it has highlighted the privilege of his own background which – while never hidden – has never hampered Cameron in creating his “we're all in this together” political narrative as Prime Minister.

Although Cameron has personally done nothing wrong, his failure to fully disclose his links to his father's off-shore trust Blairmore and his rather specific denials have not killed the story. Cameron has now issued five separate statements on the matter, including most recently, his tax returns.

But even this has not stopped the news flow. This is primarily because Panama has helped re-energise Labour and its struggling leader Jeremy Corbyn. In fact, this is the first big issue Corbyn has looked even remotely surefooted on, and he is adeptly using this opportunity to redraw traditional political battle lines at Westminster.

The Panama scandal increases the probability of BREXIT in two major ways.

First, polls show Cameron is the most important politician for the remain campaign. And for a long time, the voting public has seen Cameron as a qualitatively different Tory, distinct from, say, Chancellor George Osborne or Home Secretary Theresa May, with more of an every-man persona. Panama has the potential to diminish that differential, pin Cameron with an elitist tag and undermine the credibility of his own moderate and persuasive voice. Indeed, Cameron's job approval scores have been dropping since December and these approvals will most likely take another hit as soon as polls have had a chance to catch up with public opinion. This will make Cameron less effective; in a worst case scenario, it could strengthen the leave campaign's argument that the European Union is an elitist construct that has lost touch with ordinary voters.

Second, Cameron and the remain camp actively need the Labour Party to put aside party-political divisions and help mobilize progressive and younger voters who are both more likely to vote Labour and be supportive of the UK remaining in the EU. But the more wounded Cameron appears, the harder it will be for Labour activists to “hit the doorsteps” in support of delivering the clear-cut remain vote on which Cameron’s political future now plainly hangs. If the 23 June referendum becomes a referendum on Cameron and the Conservative government – more likely the longer this story plays out – Labour activists will find it very difficult (and are unlikely) to campaign to save a Tory leader.

Bad context, security and the EU’s refugee crisis

Lastly, the EU’s refugee crisis, though unlikely to escalate to the degree it did last year, has not been resolved. The EU’s recent agreement with Turkey hangs on the Union’s willingness to deliver visa liberalization for Turkish nationals by June, something the EU is unlikely to do (see: Eurasia Group Note – [EU/TURKEY - Still negative on the deal](#)). As this becomes clearer in early May, it will send negative signals to Turkey and make it harder for Turkish Prime Minister Ahmet Davutoglu to remain co-operative with Europe.

Refugee flows into Greece will likely increase, as they will in Italy too, as smugglers divert refugees through Libya (see our forthcoming note on this issue shortly). This will at a minimum increase tensions between Southern and Northern Europe: the South will push for the adoption of new asylum rules, but the political necessity for core Europe to engage will have diminished given refugee numbers to their countries has fallen drastically since the closing of the Balkans Route. There is a direct implication for Cameron, as the UK has been able to deport around 12,000 asylum seekers to the EU under the bloc’s old rules; this is unlikely to be the case under the new system.

Combined with the increased threat of terrorism in the UK and Europe, as foreign fighters return from Syria and Iraq, and the fact the EU will struggle to forge a credible common security policy, context will remain a problem for Cameron. This is especially as the leave campaign has and will prove somewhat effective at conflating the issues of refugees, security and terrorism as they attempt to speak to their voters concerns of immigration, autonomy and nationalism.

But no BREXIT is still our basecase

Following Cameron’s EU negotiation we kept our BREXIT probability at 30%, believing there was a fair chance that the remain camp would be able to leverage macro factors in its favor with middle-ground voters to overcome the deal’s negative reception in the UK media and the Eurosceptic wing of the Tory party.

Despite the recent swing in the polls, we remain of the view that the macro factors ultimately point to a vote for the UK to remain in the EU. Historical data on referendums point to a strong inertia factor, where voters opt for the status quo. And while the economic stability arguments for remain have failed to gain traction at present, they are likely to regain force if the result remains in the balance come polling day, bolstered by the fear-factor of further falls in Sterling and stock market volatility that would encourage floating voters to opt to stay with what they know. Those factors are also likely to boost the intensity of discussion around the June 23 poll, which in turn is likely to further boost turnout in favor of remain.

However time is short and this has been a bruising six weeks for the Cameron government – a poorly handled annual budget, a crisis over steel in which the government looked behind the curve and now the Panama scandal – which have all prevented the remain campaign from shaking off negative sentiment over the EU deal.

It is that current negative direction of travel, reflected in tightening polls, a negative European outlook noted above and the deteriorating political environment in Westminster – that causes us to raise our call on the chances of BREXIT to 40%.

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Explanation of Political Trajectories (ie, "Trajectories")

Eurasia Group's (EG) Political Trajectories are indicators of the net impact of political factors on the macro business environment in a country over specific timeframes. For each country, two Trajectories are provided, a short-term (6 months) and a long term assessment (24 months). Trajectories are assigned by Eurasia Group's country analysts through a structured qualitative process. Each Trajectory represents a net assessment, indicating how political changes in a country impact the macro business environment, defined as the economic and investment climate in the country. Once initiated, Trajectories are updated both periodically and as events warrant. Trajectories may be suspended from time to time if there is no active analyst opinion or analyst coverage, but the opinion or coverage is expected to resume. Trajectories can be:

Positive: Political factors in the country are anticipated to have a positive impact on the macro business environment

Neutral: Political factors in the country are anticipated to have a neutral or negligible impact on the macro business environment

Negative: Political factors in the country are anticipated to have a negative impact on the macro business environment

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