

## **GIAM Macro & Market Research – Market Commentary**

### **UK flirting with the abyss**

- **Yesterday evening, UK PM Theresa May lost the second meaningful vote on the EU-UK withdrawal agreement again by a wide margin. Today, we expect the British Parliament to reject a no-deal Brexit, followed by a vote to extend the Brexit date tomorrow.**
- **Compared to the situation after the first meaningful vote, further negotiations with the EU look unlikely to bring any break-through. Thus, a solution will rather depend on the British Parliament.**
- **According to press reports, hard Brexiteers openly prefer a no-deal exit. Thus, the Conservative party plus its coalition partner DUP look unlikely to get the deal passed on their own. Bipartisan action has proven difficult so far, but is still a distinct possibility.**
- **The situation has become very fluid again. Among alternative solutions (second referendum, fresh elections, softer Brexit, revocation of Article 50) a new referendum might be the “easiest-to-reach” bipartisan compromise.**
- **The EU is increasingly demanding a viable reason to delay Brexit (which needs a unanimous approval), implicitly also forcing the UK to explore fresh routes for a deal to pass.**
- **Yesterday’s decision has increased the likelihood of both extremes, a crash Brexit and no Brexit. An accidental outcome cannot be excluded, but we still consider a benign outcome as more likely than not.**

Dear Colleagues,

Yesterday evening, the British Parliament rejected the EU-UK withdrawal agreement for a second time by a large margin, although the 149 dissenting votes were less damaging than the 230 negative ballots in the first round. After the decision, PM Theresa May confirmed her previous promises regarding the next steps. Today, there will be a motion, asking MPs if they would agree with a no-deal Brexit. If rejected, as is widely expected, there will be another motion to extend Article 50 tomorrow, which we also anticipate to pass.

However, as PM May stressed after the parliamentary decision, a vote against a crash Brexit is not enough to prevent such an outcome. Ultimately, what is needed is a withdrawal agreement to pass. The route to resort to another round of negotiations with the EU looks rather unpromising. After the last-minute (although small) concessions Juncker made to May on Monday night, the EU responded with frustration to the UK Parliament decision, saying it had done what was possible and Juncker excluded a “third chance”. Although these statements might not be fully credible, there seems to be a EU consensus that the bloc will not jeopardize the integrity of the Common Market, just to please some hard Brexiteers.

Thus, any solution will rather depend on the British Parliament. The Conservative party plus its coalition partner seem unlikely to get the deal passed on their own. Jacob Rees-Mogg, the leader of the hard Brexiteers from the European Research Group (ERG), told reporters that he assumed the next step to be a no-deal Brexit. At the same time, Tory MP Nick Boles warned the ERG that centrist Tories would “do whatever it takes to frustrate you”.

In fact, there is some prospect that the rift within the Conservative Party (and to a lesser extent also within Labour) could result in new parliamentary majorities. Bipartisan action would be needed to get the deal passed. However, recent experience shows the hurdle for this to happen is rather high. To get Labour aboard, some elements of their plan would need to be included, most likely the customs union as it would solve the backstop problem to a large extent. But PM May has handled the Brexit so far along party lines, failing to build bridges across parties. MPs may take action into their own hands gains probability the closer a no-deal Brexit gets.

Accordingly, the situation has become again very fluid with a broad range of possible outcomes. This could include PM May’s resignation or Labour bringing forward a second no-confidence vote. However, the easiest bipartisan action could be to resort to the electorate by means of a second referendum. Clearly, PM May would prefer the referendum to vote on her deal only. In Parliament the hard Brexiteers would vote against a referendum, while Labour would clearly prefer the electorate to decide on the Brexit altogether. Next in line could be fresh elections. According to latest opinion polls, the conservative Party is again in the lead, so that Labour ultimately may agree to a referendum rather than snap elections. Latest news suggests that – apart from the Corbyn plan and a second referendum – a Norway-style membership in the EEA have been proposed. This option would include contributions to the EU budget and adherence to the EU four economic freedoms (including free movement of labour, a central point for the UK to exit.). Lastly, the UK could also withdraw from Article 50 altogether (as mentioned by May), but this also would need parliamentary approval.

On the other side of the Channel, the EU is increasingly demanding a viable reason to delay Brexit (which needs a unanimous decision). The EU voiced mistrusts regarding PM May’s ability to organize a majority for any withdrawal agreement. Implicitly, it is also forcing the UK to explore fresh routes for the deal to pass. Chief EU negotiator Barnier stressed the need of the EU preparing for a no-deal. However, in the end we expect the EU to agree to a delay, not least to deflect the blame for an UK crash exit. The time horizon for a delay is still rather uncertain with the EU parliamentary elections from May 23-26 a major point of concern. The EU is very reluctant to allow fresh British EU-lawmakers a vote on its president and budget, only to drop out a few months later. Time constraints are increasingly likely to become binding. Organizing a referendum within this short time frame until end of May would be very challenging but might still be feasible, provided a bipartisan agreement on the referendum question can be reached shortly. By contrast, to set up fresh elections within broadly two and a half month will in our view be daring. Hence, among the various options and given the time constraints we think that a referendum may have a slightly higher chance to break the deadlock.

In sum, yesterday’s decision has increased the likelihood of both extreme outcomes, a crash Brexit and a no Brexit. We still consider a benign outcome as more likely than not. Nevertheless, an accidental outcome cannot be excluded. The British Pound lost 0.5% vs,

USD but almost 1% against the euro, whereas the FTSE100 did not show a significant reaction to yesterday's events.

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