

With "victories" like this...

Theresa May has survived a leadership challenge. For markets, alas, this changes very little.

When it comes to amateur dramatics, the Westminster parliament is hard to beat. As a day of political drama, December 12 was exceptional. Markets, however, mostly treated the day as a non-event. The pound pounced up and down a little, ending the day roughly where it had been Tuesday afternoon. And in terms of market reactions, that was pretty much it. Which is understandable enough, if you think through what actually happened and what it might mean for Brexit.

With "victories" like this...

In normal times, yesterday's events would have been a stunning and most probably fatal rebuke for any prime minister. Theresa May "won" a vote of confidence by 200 to 117 votes among her conservative-parliamentary-party colleagues. In order to do so, she had to pretty much promise that she will not lead her party into the next election. That deprives her of patronage, a major source of power in the British context. It effectively turns Theresa May into a lame duck – and a gravely wounded one at that.

Among Theresa May's "supporters" were plenty of members of her own cabinet lukewarm, and at times openly skeptical on the terms of the withdrawal agreement from the European Union (EU). The deal has painstakingly been negotiated between the UK and its European partners over 18 months. It has taken only a few weeks, to fall apart under parliamentary scrutiny. Passing anything close to the current deal in parliament always looked hard. In the light of recent events, it is now open to question whether its final version will even be endorsed by the full cabinet. That will depend on May's ability to secure further concessions, notable on the backstop arrangement to avoid border checks for Northern Ireland. However, Britain's European partners have already signaled quite unambiguously they are unwilling to move much.

Silver linings

During prime ministers question time on Wednesday, veteran Tory MP Ken Clarke rhetorically asked: "Can the Prime Minister think of anything more unhelpful, irrelevant and irresponsible than for the Conservative Party to embark on weeks of a Conservative leadership election?" Actually, there might have been: waiting a few more weeks before pulling this sort of stunt. The vote helpfully clarified the size of the Tory contingent adamantly determined to bring about a hard, or as they might prefer a clean Brexit. Such a cliff-edge Brexit, come March 29, would, in our view, be economically ruinous. However, political disasters can happen – and it still might, if "British brinkmanship paired with

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political chaos" were to run up against "legalistic, intransigent and increasingly impatient European partners", as we previously put it.¹

This worst-case scenario may have become somewhat less likely. At 117, the number of Tory-rebels group is large enough to continue stirring up plenty of turmoil, but too small to dictate government policy any longer. Theresa May cannot be challenged as Tory leader for the next twelve months. She could, of course, face a vote of confidence in the House of Commons at any time. Take those two facts together, and she will probably continue to avoid a no-deal, cliff-edge Brexit at all costs.

In her response to Mr. Clarke, May pointed to the January 21 deadline for parliament to vote on her deal and claimed that because of the tight timeline: "The new leader - were a new leader to come in - one of the first things they would have to do would be to either extend Article 50 or rescind Article 50, and that would mean either delaying or stopping Brexit."²

It would be ironic, though no longer totally unthinkable, if May ended up doing either of those things herself to stave off disaster. According to a recent ruling by the European Court of Justice (ECJ), Britain has the unilateral right to reverse its Brexit decision, by revoking its Article 50 letter. By contrast, extending the deadline would require the agreement of all other member states. Of course, neither of those options currently ranks highly among Theresa May's potential choices. In coming weeks, her priority is likely to be to seek whatever further concessions she can get from Britain's European partners. If that proves insufficient to regain support within her own party, as now seems likely, she will reach out to the opposition. Various alternative deals, modelled on the arrangements the EU has with other countries such as Canada, Switzerland and Norway will all be mooted. So will a second referendum. None of these possible alternative solutions, however, is likely to be readily available by March 29. Trade deals are complicated matters and tend to require lengthy negotiations, even if you use an existing framework, similar to Norway's. Referenda too require some preparation. And in the meantime, markets might have little reason to panic, but no reason to stop worrying about Brexit either.

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¹CIO Flash: Westminster in turmoil as of 11/16/18: <https://download.dws.com/download?elib-assetguid=0622c1ba6e224c0e91ee42d71ad63613>
²<https://www.pressreader.com/uk/the-herald/20181213/281663961099526>

Glossary

Brexit

Brexit is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

Conservative Party

The **Conservative party** is a center-right political party in the United Kingdom.

European Court of Justice (ECJ)

European Court of Justice (ECJ) the highest court in the European Union in matters of European Union law.

European Union (EU)

The **European Union (EU)** is a political and economic union of 28 member states located primarily in Europe.

Pound sterling (GBP)

The **pound sterling (GBP)**, or simply the pound, is the official currency of the United Kingdom and its territories.

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