

BEWARE OF BREXIT COMPLACENCY

While yesterday's vote changed little, the risks of Britain crashing out of the EU remain very real

MAY SUFFERS HEAVY DEFEAT – AS WIDELY EXPECTED

Not so long ago, there were heated debates in the House of Commons on whether Members of Parliament (MPs) were going to have any meaningful say in Brexit. Well, the day of the "meaningful vote" on Theresa May's withdrawal agreement has come – and gone. And, in our judgment, little, if anything, has actually been achieved.

The scale of May's defeat was bigger than expected – it is pretty stunning that in the end, only 202 voted in favor and 432 against the motion. Market reactions were fairly muted. That's partly because many think the events of the past few weeks have made a chaotic, no-deal Brexit (also referred to as "hard Brexit") less likely. And as usual, we wouldn't put too much emphasis on short-term reactions on yet another step in the Brexit saga.

May seemed unsurprised by the defeat and immediately offered the House a confidence vote on the government on Wednesday, which opposition leader Corbyn swiftly accepted. Furthermore, she declared that the government would put forward a new motion on Monday January 21 potentially including amendments from opposition parties, which she promised to include in the decision-making process to a bigger extent.

NO FRESH CLARITY – EVERYTHING REMAINS POSSIBLE

All this basically means little fresh clarity has emerged. Instead, there is more of the same that has been so characteristic of the entire Brexit process so far – kicking the can further down the road. It was telling that May explicitly made clear that it was not the government's intention to simply run down the clock till March 29, the day the exit arrives. While we believe she will win the confidence vote, we are not sure what kind of strategy she will present to the House on Monday. Like most market observers, we continue to hope that a hard, chaotic Brexit can be avoided. Perhaps, a slightly amended version of the withdrawal bill might yet get parlia-

mentary approval. However, we see little leeway or desire on the part of the European Union (EU) to make significant changes, especially to the hotly disputed Northern Ireland backstop arrangement. How and when the whole saga might end remains anyone's guess – though we would stress that it is too early to rule out various softer versions of Brexit just yet.

However, as yesterday's vote offered little progress and clarity, we want to use this update to highlight the remaining risks in this Brexit process. We want to remind readers how many unexpected turns this process has already taken, and that betting on MP's putting national interest before party or personal interest rests on a weak foundation judged by their recent behavior. After all, Brexit started as a result of party-political gambles going wrong; why should it not end this way?

TAIL RISK OF "HARD BREXIT" HAS RATHER INCREASED

In fact, the reason for which we believe the risks of Britain crashing out of the EU have, if anything, gone up are pretty straightforward. Yes, it is true that a majority of MPs do not want such an outcome. That has become increasingly clear in recent weeks. And yes, the prime minister has made it clear, again and again, that she has no appetite for such an outcome either. (But just as a reminder of how unpredictable this process remains and how erratic political behavior remains, think of Theresa May's often repeated mantra: "No deal is better than a bad deal."¹)

The trouble is that in politics as in life, accidents can and do happen. Many of the alternatives to the May withdrawal deal are just as unappealing. The May deal has finally demonstrated what should have been obvious all along. A Brexit of any sort is going to involve some painful trade-offs.

A clean break with the EU would be destabilizing to the British economy, at least in the short to medium term. It would deprive the United Kingdom of easy access to many of its biggest markets, especially in services. A "soft Brexit"² of

¹<https://www.theguardian.com/politics/video/2018/sep/21/brexit-no-deal-is-better-than-a-bad-deal-says-theresa-may-video>

²A so-called "soft Brexit" encompasses any deal that involves the UK retaining membership in the European Single Market as well as at least some free movement of people.

any kind, by contrast, means still having to abide by many EU rules as well as probably still contributing to the budget, without having a say in how these are set. Parliament might now try to find majorities for various alternative arrangements. But there is little reason to suppose that any of these will stand up better to parliamentary scrutiny than the May deal.

Meanwhile, the clock is ticking. And, with every day that passes, the UK is moving closer to a chaotic, no-deal Brexit. The events of recent weeks make that more likely in three important ways.

- _ First, Parliament last week tied the government's hands in preparing for no deal. "Remain" MPs from all major parties voted to limit the government's tax-varying powers in the event of a no-deal Brexit. Their intent has been to force the government to avoid such an outcome. Alas, however well-intended, this means the UK will probably be even less prepared than it might have been.
- _ Second, all the parliamentary maneuvering has further eroded May's authority. It is now an open question as to how much she could actually achieve – whatever her wishes. Hopes for her to help resolve the confusions her decisions have helped to create look increasingly misguided. In particular, her role in securing any compromise proposal for a "soft Brexit" would now probably have to be quite marginal. Markets should also start to acknowledge that while May may have been good in keeping her job so far, she might be less good at fulfilling it.
- _ Third, and perhaps most crucially, the Labour leadership continues its delicate balancing act of opposing May's deal but failing to actually endorse any credible alternative. In purely party political terms, that seems shrewd

enough. Labour's party members and activists are mostly in the "Remain" camp. But many of the voters it would need to win the next general election backed "Leave" in the 2016 Referendum. A second referendum, no matter how exactly the question is phrased, would split the party and could damage its electoral prospects.

That, at least, appears to be how Jeremy Corbyn sees matters. He views pressing for a general election as his main priority, followed by new negotiations with the EU and, perhaps, eventually, a second referendum. That is in line with a resolution passed at the last Labour Party conference. But sticking to this line for as long as he can means parliamentary arithmetic makes a resolution of any sort extremely hard before "Brexit day" on March 29.

From a purely party-political perspective, moreover, this is actually quite a tempting outcome for Labour. The closer Brexit day, the better, perhaps, the chance of winning over some Tory defectors or Ulster Unionists to bring down the government. This would provide an excuse to ask for an extension of Article 50. Such an extension requires the unanimous consent of all 27 other EU members, but we believe this to be a hurdle that can be overcome. And theoretically, as a means to avert a "hard Brexit" at the very last minute, Article 50 could be revoked – this would, however, cause uproar amongst the Brexit voters.

CONCLUSION

We conclude this update in a similar way to most of our other Brexit pieces: up until March 29 – and maybe beyond – investors should expect plenty of Brexit-related, unnerving headlines. Even if not all these headlines will necessarily be that meaningful.

GLOSSARY

Article 50 of the Lisbon Treaty

Article 50 of the Lisbon Treaty governs the withdrawal of a member state from the European Union.

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**, also referred to as "Tories", is a center-right political party in the United Kingdom.

European Union (EU)

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

House of Commons

The **House of Commons** is the lower chamber of the United Kingdom's parliament.

Labour Party

The **Labour Party** is a center-left political party and one of the three biggest parties in the United Kingdom.

U.K.'s EU Referendum

U.K.'s EU referendum held on June 23, 2016 in which the citizens of UK voted for an exit of the UK from the EU, with a majority of 52%.

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