

## "TIS BUT A SCRATCH"

Theresa May's Brexit deal has once again gone down in defeat. It is high time for investors to start thinking the unthinkable.

When will they ever learn? Over the past 48 hours, we have been inundated by comments from our colleagues in financial markets opining on British politics. The tone followed a familiar trajectory, mirrored in the pound's exchange rate against the dollar. First, there was despair, as the reality sank in that Theresa May's withdrawal agreement might face another humiliating defeat. Next, there was hope, triggered by Monday's late night "news" that a new spin had been found to make the dreaded backstop<sup>1</sup> arrangement more acceptable to the Brexiteers. Within a few hours, alas, it became clear there was even less to the latest backstop tweaks than met the eye, as Geoffrey Cox, the UK's attorney-general acknowledged.<sup>2</sup> And at the end of Tuesday, markets reacted to another stunning government defeat as a bit of a non-event. Somehow, the consensus still appears to think, it will all get sorted out in the end without causing too much damage.

### BREXIT REALITIES AND MYTHS

To us, all this has long looked dangerously complacent. As we noted back in January, "the clock is ticking. And, with every day that passes, the UK is moving closer to a chaotic, no-deal Brexit."<sup>3</sup> Since then, both Theresa May and Jeremy Corbyn seem to have lost control of their respective parties. The prospect of a no-deal Brexit by accident remains very real.

We hasten to add that a chaotic, no-deal Brexit need not happen by anyone's design. As we wrote in November 2018, "only an admittedly sizeable minority was ever in favor of swiftly severing relations with the European Union (EU) altogether, by leaving without a deal. Polling, both before and after the 2016 referendum, has been pretty unambiguous on that. A larger group, of about half of voters has

been broadly in favor of the status quo, perhaps on slightly amended terms notably on the movement of people." Since then, public opinion has, if anything, moved further in favor of remaining – with a lead of five to seven per cent in polling averages in recent months.<sup>4</sup>

Both a no-deal Brexit and Theresa May's deal are quite unpopular among ordinary voters.<sup>5</sup> The same, as we saw again this week, is true among Member of Parliament (MPs). It remains far less clear, alas, which of the eventual alternative outcomes the House of Commons might be able to actually agree on. This starts with a misreading of the Brexit referendum result, and what sort of mandate, if any, it carried. Based on the data, others have argued that "Brexit is not the will of the British people – it never has been".<sup>6</sup> We would not quite go that far. As with any election or referendum, there is always a large number of contributors. In the case of Brexit, we have previously argued that the rise of China and a backlash in the UK's regions left behind by globalization appears to have played an outsized role.<sup>7</sup>

Such a reading hints at policy dilemmas well beyond the question of any "deal" or "no deal." It is also important to keep in mind that in the UK, a backlash in the UK's regions left behind by globalization would not have been enough to secure a majority for leaving. What was also needed was asymmetric turn-out. To simplify (but only a little), Leave supporters had campaigned for decades to make their voice heard, win or lose. By contrast, it seems pretty clear that many "Remain" sympathizers simply could not believe the UK would really leave the EU – and sat out the referendum as a result. Such beliefs in "Remain" winning were unwarranted by the polling data<sup>8</sup>, but widely shared in much of the media, among financial market participants and betting markets.<sup>9</sup> Add demographic shifts (with younger, "pro-Remain"

<sup>1</sup> The deal intends to avoid border checks for Northern Ireland, if the UK and EU fail to agree the terms of a future relationship.

<sup>2</sup> <https://www.ft.com/content/c336e788-44b6-11e9-a965-23d669740bfb>

<sup>3</sup> <https://go.dws.com/beware-of-brexiteer-complacency>

<sup>4</sup> See, e.g.: <https://pollofpolls.eu/GB/23/post-brexiteer-eu-membership-polls>

<sup>5</sup> For a useful overview of the demographic split, see: <https://www.economist.com/graphic-detail/2019/02/23/british-voters-are-unimpressed-by-theresa-mays-brexiteer-deal>

<sup>6</sup> <https://blogs.lse.ac.uk/brexit/2016/10/24/brexit-is-not-the-will-of-the-british-people-it-never-has-been/>

<sup>7</sup> [https://go.dws.com/cio-special\\_free-trade-under-attack](https://go.dws.com/cio-special_free-trade-under-attack)

<sup>8</sup> <https://go.dws.com/european-elections-2017>

<sup>9</sup> Interestingly, betting markets were a little quicker, by about an hour or so, than foreign exchange traders to update their flawed beliefs. See: <https://www.cam.ac.uk/research/news/gamblers-predicted-brexiteer-before-financial-traders-study-finds>

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cohorts reaching voting age), and it is no wonder that Brexit supporters should be so adamantly opposed to a second referendum of any sort.

Based on developments of the past week, or so, it seems pretty clear that there are more than enough MPs ready to block a second referendum, Theresa May's deal and a chaotic no-deal Brexit. The difference between the former two and the last option is that a chaotic no-deal Brexit is the default option, if the UK and its European partners fail to act. An extension to article 50 could avoid this – but it has become increasingly questionable in recent weeks on what terms the European Union might agree to any such request. Keep in mind that any extension will require unanimous approval by all 27 remaining member states.

It was just such an impasse that we had in mind, back in November, when we warned: "Faced with legalistic, intransigent and increasingly impatient European partners, British brinkmanship paired with political chaos still risks delivering an outcome only relatively few voters ever wanted."<sup>10</sup> Can this still be avoided? Of course! It has long been clear that across all major parties, there would be a majority for a much softer Brexit deal, ideally one that includes access to the single market in services, as well as goods. Unfortunately, it would be hard to steer matters in that direction, even if the UK had a less dysfunctional parliament momentarily.

Which brings us back to the latest historic defeat of Theresa May's withdrawal agreement. At 391 votes against versus 242 votes in favor it looks pretty bad by any measure – except for the even larger defeat back in January. For now, though, Ms. May appears determined to stagger on. All in all, events in Westminster seem to validate comparisons dating back to the summer of 2017, after Theresa May lost her snap general election. Since then, commentators have frequently compared her with the Black Knight from the movie "Monty Python and the Holy Grail."<sup>11</sup> "Tis but a scratch!" the Black Knight says, as he loses his sword-wielding arm. "It's just a flesh wound." the Black Knight responds to the loss of his second arm, before being reduced to a mere stump and declaring: "All right, we'll call it a draw."

It remains debatable who the "Black Knight" will turn out to be in the Westminster drama. It may well turn out to be the Brexiteers, feeling invincible and having overreached. While changing course towards a softer Brexit may no longer prove to be a feasible option in the time available, there remains one more alternative that is becoming increasingly more probable. If no other options are feasible, the House of Commons might yet decide on a straightforward revocation of article 50 – a scenario we wrote about back in December.<sup>12</sup> Doing so without triggering public discontent would take much more political skill than either Ms. May or any of her various opponents have demonstrated in recent months. In the meantime, we believe it takes a lot of bravery – or perhaps, willful blindness in the face of unyielding parliamentary arithmetic – to ignore the risks of a no-deal Brexit. Are we in a minority in thinking so? You bet. But then, the consensus has been wrong on Brexit all along!

<sup>10</sup> <https://go.dws.com/westminster-in-turmoil>

<sup>11</sup> <https://www.mirror.co.uk/news/uk-news/theresa-holy-grail-prime-minister-10689806>

<sup>12</sup> <https://go.dws.com/brexit-leadership-challenge>

## GLOSSARY

### Brexit

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

### 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.

### Pound sterling (GBP)

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

### 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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