

GOOD-BYE BREXIT?

Market may remain nervous, but the actual risks of a hard, chaotic Brexit, have fallen sharply.

For many months, we have been warning of the risks of a hard, chaotic no-deal Brexit. In an alternative universe, we might well have been proven right. March 29, the long-looming Brexit day envisioned under Article 50, came and went. On that day, the House of Commons once again voted down the withdrawal agreement by a still sizeable 344 to 286 votes. Theresa May offered to resign and increasingly looked like Prime Minister in name only. Under the original schedule, a no-deal Brexit could easily have happened that day, with all the potential fall-out for the economy and financial markets well beyond the United Kingdom.

Such risks are likely to continue to loom large in coming days. April 12, the deadline for the extension granted by remaining European Union (EU) member states is fast approaching. As that realization sinks in, market complacency on Brexit might well be replaced by nervousness, perhaps even panic. After all, Members of Parliament (MPs) have been unable to coalesce around a workable solution for the last two years. Who could still have confidence in them doing so now that the Brexit drama is already in overtime?

Well, it might be contrarian, but events of the last week have actually boosted our confidence in a reasonably quick and satisfactory resolution to the current impasse. Partly, that is because of the oddly-timed offer of Theresa May to resign as Prime Minister. She made it conditional on MPs passing her withdrawal agreement. Any remaining scrap of authority she had at the start of the week was shredded by the end of it.

At the end of the debate of her withdrawal agreement, Ms. May was reduced to pleading with Labour MPs. Any successor of hers as Prime Minister, she argued, would still be subject to the same merciless arithmetic in the current House of Commons. The implication was that whatever future relationship a post Brexit UK will negotiate with EU would take into account Labour preferences for a softer Brexit. On that, Ms. May is, for once, likely to be proven spot on. If only she had given such reassurances five, two or even one month ago! Matters might well have turned out very differently for her deal – and her premiership.

To us, the key events of the past week were the two votes in which MPs finally decided to wrest control of the parlia-

mentary time-table from the government. That means MPs are now likely to have the necessary parliamentary tools (as well as the latent power) to stop a no-deal Brexit, or indeed a hard Brexit of any sort. (In Westminster and elsewhere, parliamentary rebellions against a weak executive have a tendency to grow, rather than shrink.) Meanwhile, the first round of indicative votes suggest that Brexiteer MPs lack the numbers to block most of the alternative options to a no-deal Brexit. That includes even any last minute decision to revoke Article 50. The next round of indicative votes is scheduled for today.

Might Ms. May instead decide to call a snap general election? Under the Fixed-Term Parliament Act, this is no longer as easy as it once was. In any case, such a move would appear unwise. Tory MP have long dreaded the prospect of another campaign under May's leadership, given how dismal she proved on the stump in 2017. Party donors appear just as frustrated; the conservative party reportedly faces a cash crunch, which could make fighting another expensive election very hard. However, Ms. May has made a habit of making risky decisions that might appear foolish to anyone not in her inner circle of trusted advisors.

IMPLICATIONS

We think that the likelihood of the UK remaining in the EU for the foreseeable future has gone up sharply. This could most obviously happen if the UK asks for a further, long extension to hold another referendum and commits to participate in elections to the European Parliament, perhaps on the same day as a snap general election. Our current take on available polling data and other indicators of popular sentiment in the UK make us very doubtful that new elections would produce a more Eurosceptic House of Commons. Having presided over the current impasse, the Tories would probably be blamed by Leave and Remain voters alike for the current mess. The Eurosceptic vote could well splinter. Parties such as the UK Independence Party (UKIP) risk costing the Tories plenty of marginal seats under the UK's first-past-the-post system (without necessarily winning any seats in Westminster themselves).

As for the European Parliament, proportional representation would obviously provide an opening for both pro- and anti-

¹ <https://blogs.lse.ac.uk/brexit/2019/03/26/we-can-and-should-revoke-article-50-heres-how-to-do-it/>

² <https://www.ft.com/content/8e553444-4fe6-11e9-b401-8d9ef1626294>

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European forces with no or little presence in the House of Commons. Still, Eurosceptic parties, however broadly defined, would probably struggle to hold on, let alone significantly improve upon their results in 2014. As a reminder, UKIP already came in on top with 27% of the vote, beating Labour at 25% and the Tories at 23%.³ Turnout would likely be far higher this time around. It might prove a lot easier to mobilize pro-, rather than anti-European voters. Trying to explain to Leavers why they should even vote in elections for a parliament they no longer want to be part of, looks challenging. Voter mobilization would also be key in the event of a second referendum. We would prefer more data, not to mention clarity about the questions on the ballot, before speculating on the likely outcome.

Alternatively, the withdrawal agreement might yet be passed sufficiently quickly to avoid participating in elections to the European Parliament. The Tories, in particular, might want to avoid such a test of their electoral strength. Local elections in England and Northern Ireland are already scheduled to be held on May 2, 2019. This too may help incentivize sufficient numbers of Tories, Labour and the Democratic Unionists of Northern Ireland to reach a Brexit compromise quickly. The numbers in the Commons might prove tricky, however, with many MPs in other, smaller parties still holding out for a second referendum. If such a quick Brexit does take place, it is likely to be a far softer version than what Ms. May has been aiming for (and than many in her party may find acceptable). Last Wednesday's indicative votes suggests that the path of least parliamentary resistance would probably start, though not necessarily end with a customs union.

And a no-deal Brexit? We have long argued that such an outcome could all too easily happen by accident, rather than by design. That remains possible, but a lot less likely than it was even a week ago. Part of our concern has always been that far too many of the relevant decision makers in Westminster and elsewhere appeared reluctant to carefully think through the seemingly unthinkable plan accordingly. Having stared into the abyss on Brexit day, that is changing quickly. We believe Ms. May's loss of authority should reduce the potential for further unforced errors.⁴

So, to sum it all up, we believe events of the past week have made a no-deal Brexit in the immediate future much less likely than we would have feared a month ago. If Brexit does take place, it is likely to be a lot softer and maybe a lot slower too. And there are now plenty of paths towards the UK remaining an EU member. The situation clearly remains very fluid. But at least for financial markets, Brexit day could have gone a lot worse.

³ <http://www.europarl.europa.eu/elections2014-results/en/country-results-uk-2014.html>

⁴ In forecasting key decisions of Ms May, we have increasingly been guided by "The Logic Of Failure" a classic study by the psychologist Dietrich Dörner on "recognizing and avoiding error in complex situations."

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.

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.

UK Independence Party (UKIP)

The **UK Independence Party (UKIP)** is a right-wing political party in the United Kingdom long in favour of ending the country's membership of the European Union.

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