

FLASH UPDATE

Brexit – a meaningful vote indeed



As was widely expected, Theresa May's government suffered a heavy defeat in the 'meaningful vote' on the Withdrawal Agreement (WA) negotiated with the European Union. Given the scale of the defeat – over two-thirds of Members of Parliament (MPs) voted against – a no-confidence vote has been called for this evening. What does the future hold? Is Brexit still on the cards?

It is important to bear in mind that there is little common ground between the groups who voted the WA down. Some – such as eurosceptic Conservative Party members – opposed the bill because it does not deliver a clear-cut break with the European Union. Others opposed it because they would prefer a much softer version of Brexit, or indeed no Brexit at all. On closer scrutiny, it emerges that the only point on which a clear majority exists in the Commons is rejection of a disorderly, 'no-deal' Brexit. So what are the options?

Snap election? Today's no-confidence vote is likely to be won by the government. The Conservative Party has little appetite for a snap election which could be forced if the vote were lost. And the Democratic Unionist Party allies have already declared support for Mrs May. Hence, we view this as a rather remote prospect.

Another referendum? A long-cherished ambition of many Remainers, a new referendum would be unlikely to resolve the divisions in Parliament and the country. According to the whatUKthinks.org poll of polls, the margin in favour of Remain is the same today as it was just before the June 2016 vote. We believe that this would be the last option, to be tried only if MPs prove unable to forge common ground.

Delay Brexit Day? This looks increasingly likely, given the imminence of the March 29 deadline. Press reports over the week-end suggested that the other European Union members (EU-27) would be willing to accept a short delay until after the European Parliament elections, perhaps to July. However, this would also require the Commons to amend or repeal previous legislation which fixed March 29 as Brexit Day. In addition, this legislation could be worded so as to reduce the risk of a 'no-deal' Brexit, as desired by a majority of MPs.

All data taken from Bloomberg and Macrobond (11/01/2019).

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CA014/JAN/2019

Parliament takes control ? Last week, several amendments to yesterday's vote were authorised by the Speaker of Parliament, who controls parliamentary procedures in the Commons. Mrs May's statements after her defeat yesterday evening also indicated a willingness to work with MPs, across party boundaries, to find a way forward. If sufficient common ground is found, this would garner support for a delay to Brexit Day. However, changes to the WA – which covers exit – and to the accompanying Political Declaration – which covers the future relationship – would need approval from the EU-27. This might prove difficult unless majority support for the texts in the Commons looks forthcoming.

In this hypothesis, MPs would be faced with two main options.

1. If « no-deal » Brexit were to become less likely, it is possible that eurosceptic Conservatives could end up supporting May's WA, given that the alternative – Customs Union (CU) membership or perhaps even a European Free Trade Area-style deal – would be even more unpalatable.
2. A « softer » version of Brexit – such as CU membership – would involve close alignment with the EU and prevent the UK negotiating its own free trade deals. This would be anathema to eurosceptics and would be viewed as a betrayal of the referendum result.

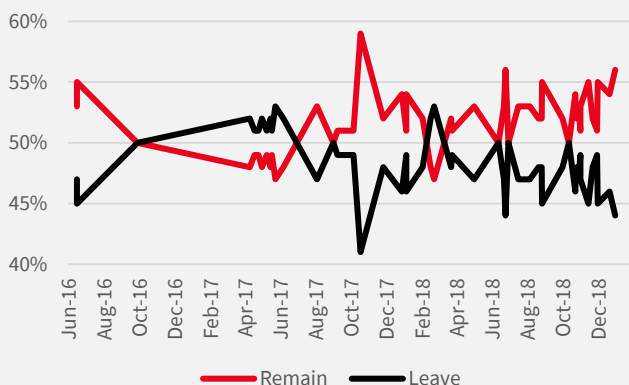
If we are right in thinking that the way forward will involve compromise with MPs across party lines, Mrs May will be forced towards a solution that reflects majority preference in parliament. At present, it appears that many more MPs are in favour of 'soft' Brexit than oppose it. These include the vast majority of Labour MPs, the Scottish Nationalists, Liberal Democrats and a sizeable minority of Conservatives. Working with this group might prove difficult for May as it involves rubbing out the 'red lines' which she has drawn. However, she may well find that there is little alternative to a pivot towards « soft » Brexit.

Bottom line.

- Sterling remains a barometer of market sentiment about Brexit. Ahead of the vote, it fell against the dollar before regaining ground in the aftermath. With the odds of hard Brexit receding, investors breathed a sigh of relief. Currency volatility is set to remain high as long as uncertainty about the final Brexit outcome remains elevated.
- In light of continuing uncertainty, the Bank of England will refrain from hiking rates. UK inflation is receding (2.1% in December) whereas GDP growth is moderate but steady. This should help keep long-term Gilt yields in check.
- Should a deal be reached, business and household confidence should rebound. In the event, mid-caps and UK domestic stocks could outperform large caps and exporters in the short term. The former are more sensitive to consumer spending and the service sector whereas the latter generate around 70% of their revenues abroad – stronger sterling weighs on overseas profits.
- However, domestic stocks could have difficulty in sustaining their outperformance: 1/ the UK economy remains sluggish and 2/ the improvements in global and Chinese growth and higher oil prices we expect in coming months should favour large caps.
- From an asset allocation perspective, we maintain a neutral stance on UK equities and Gilts and a defensive stance on UK corporate bonds.

No change in two years

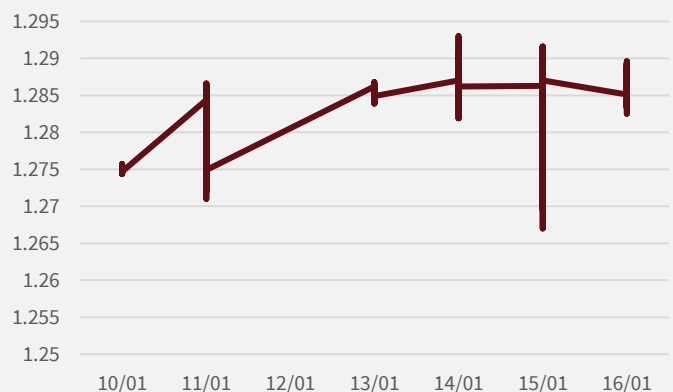
Polls for another referendum on Brexit



Sources: SGPB, Whatukthinks.org, data as of 14/01/2019

Sterling bounced after the meaningful vote defeat

GBP USD intraday rate



Sources: SGPB, Bloomberg, data as of 16/01/2019

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