

Market Bulletin

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Brexit: A week of high drama and minimum progress

This week the House of Commons demonstrated that a clear majority of Members of Parliament (MPs) are not willing to leave the EU without a deal. Our view has always been that we would at some point end with a relatively soft Brexit. The bedrock of this view has been that there is only a small majority (roughly 100 in a 650 seat Parliament¹) truly comfortable with 'no deal'.

Where we went wrong was an assessment that the 'midnight hour' in negotiations was March 29. In fact, the European Parliament elections are serving as the definitive deadline. Below we outline likely next steps and risks.

Third time lucky?

The prime minister will put the deal to a vote for a third time next week, most likely on Tuesday. If it passes, the Prime Minister will request a short extension to Article 50 to complete the legislative process (the extension would be to June 30, just before the new European Parliament sits on July 2, following the elections on May 23-26).

The likelihood of the deal passing will rise considerably if the UK's Attorney General can provide assurances to Parliament (or more specifically the DUP and Conservative Eurosceptic backbench) that the UK cannot be 'trapped' in the backstop against its will.

The EU may provide the prime minister with assistance by further altering the concessions they made in Salzburg on the eve of the last vote. This may be the specific wording, or the placing of those words.

But there have also been reports that the Attorney General is considering another article within the Vienna Convention on Law of International Treaties, which may also provide a legal basis for a unilateral revocation of the backstop.



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¹ Roughly the number of Conservative MPs that voted against the Prime Minister in the Conservative Party leadership confidence vote.

Note this number is smaller than the number that wanted to keep no deal on the table in this week's vote. In our view this is merely because a number of MPs felt that removing the possibility at this stage removed the prime minister's leverage in the final stages of negotiations.

Good news in bad news clothing

If there is no legally binding change to the backstop then the prime minister's deal may well be defeated for a third time. This might seem like bad news with the clock ticking. In fact this could be the turning point for a significant step forward for two reasons.

First, it is likely to lead to an agreement from both the UK and EU that a long extension is required. This would replace the current deal, which constitutes a legally binding withdrawal agreement and non-legally binding ambition for a free trade agreement (FTA), and return to the principle that 'nothing is agreed until everything is agreed'.

Given the UK would not have committed to its financial settlement (the bill), it would increase the EU's incentives to move more swiftly towards the final FTA. The downside for the UK would be that it would have to make ongoing EU budget payments and participate in the European Parliament elections.²

Second, the Prime Minister will have to acknowledge that the only majority in the house is for a Brexit based on a customs union in goods at a minimum. This is softer than the current Brexit on the table.

In conclusion, while it is easy to get lost in the headlines and political drama, as investors we can focus on the fact that there is no majority for no deal and there is a majority for a soft Brexit. Whilst there will likely still be considerable volatility along the way, the end result is highly likely to be a close economic partnership between the UK and EU. For investors with longer horizons, the markets most affected by this near-term drama might offer some opportunities.

² It is possible that this period would also entail a general election in the UK. As polls currently stand it seems the Conservatives would increase their number of seats, which may make passing any legislation easier - including Brexit legislation. Prime Minister May has already stated that she will not lead the Party for the next election, so this does lead to some uncertainty, however it is unlikely to lead to an increase in the number of Eurosceptic MPs and so the Parliamentary arithmetic for a hard vs soft Brexit remains unchanged.

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