

Parliament rejects Prime Minister's motion

Theresa May does not have parliamentary confidence in her approach to securing Brexit. This is the second blow to the Prime Minister's authority in a month. The previous setback for May was on the 15th January when 68% of present MPs voted against her Withdrawal Agreement, mostly citing the Irish backstop question as a dealbreaker.

Having conveyed their support for May's plan to seek amendments concerning the backstop on the 29th January, MPs were set today to reiterate their support for the Prime Minister's strategy of getting more from Brussels, before going for another "meaningful vote" on her Brexit deal in Parliament. However, this time, 54% of present MPs did not deem her approach to Brexit satisfactory, thus further weakening her position.

May's European Debacle:

As the Prime Minister was defeated at home in mid-January, her decision was to pressure the EU to tweak the Withdrawal Agreement it agreed with her back in November, particularly to ensure that there would not be any hard border between Northern Ireland and the rest of the United Kingdom after Brexit. This, in spite of clear statements from European officials, that they would not renegotiate the deal unless London accepted closer alignment with EU regulations to secure a close trading relationship with the 27 member states.

Since then, no apparent progress has been achieved on May's side. European leaders remain adamant not to offer Britain a better deal without something in return. For Brussels, the ball is in London's court and the question of what type of Brexit should happen is solely at the hands of British MPs. Nonetheless, the European Commission argued against a no-deal Brexit and raised the stakes of such a scenario by preventing member countries from engaging with British ministers to put in place health and benefits arrangements to UK nationals in EU countries. This means that in the case of a no-deal Brexit, British nationals on the mainland will not be covered by national health systems anymore.

May's Failed Political Gamble:

Since her mid-January defeat, May has basically sought to run down the clock of Brexit, by seeking to pressure her own recalcitrant allies into voting for whatever Brexit deal she would come up with in the next few weeks. To apply such pressure, May has had to change her strategy. Acknowledging that she could not see her deal passed in Parliament without support from the opposition party Labour, Prime

Minister May adopted a conciliatory approach toward the Left and stopped seeing Brexit as a decision to be taken solely by the Parliament's majority.

By exploiting Labour's internal divisions, the party being divided similar to Conservatives between Europhiles and Eurosceptics, Prime Minister May had hoped to draw Labour Eurosceptics closer to her position. One of such Eurosceptics is Labour leader Jeremy Corbyn, who has previously called the EU an "empire" and a "bankers' Europe". Thought to have changed his views with the 24th September Liverpool meeting, where Labour seemed to come closer to supporting a second Brexit referendum, Jeremy Corbyn has since then showed he has not changed his mind over the 23rd June 2016 referendum results.

Indeed, Corbyn has time and again shown his potential support for May's Brexit deal. On the 7th February, he sent her a letter with 5 conditions she would need to uphold in order to have Labour votes on her side. Additionally, Corbyn has shielded insubordinate Labour MPs from being sacked because they did not vote within the party's line, thus preventing Labour from being able to block a no-deal departure or delay Brexit. Already, these actions in addition to Corbyn's willingness to support May's Brexit deal, have raised the likelihood of dozens of resignations from anti-Brexit Labour members.

To ensure the support of Labour Eurosceptics for her deal, May pushed forward promises to strengthen workers' rights, in particular policies such as a "regression lock" syncing workers' protections with European standards. Other figures from the Left, such as Len McCluskey, leader of the largest Union in Britain called Unite, were in talks with the Prime Minister to support her deal in exchange of future labour reforms. Of course, Theresa May was unlikely to go too far on Labour's side. As aforementioned, her conciliatory approach was another way to pressure her own Brexiters to support her deal for fear of ending with a deal and government policies in anathema to Conservative values. Corbyn's conditions have already been rejected by the Prime Minister, who refuses to accept a full customs union with Brussels, something that would solve the Irish backstop but curtail Britain's trading autonomy.

However, instead of earning the support of Eurosceptic Labour MPs, May has further alienated Europhile MPs and angered hard-Brexiters who have abstained from supporting her motion on the 14th February.

May Stabbed in the Back:

On Thursday evening, the European Research Group (ERG) led by Tory Jacob Rees-Mogg voiced their dissatisfaction with May's domestic political tactics and her endorsement of MPs' decision to rule out a no-deal option. Clearly, Thursday's vote was an exercise in positioning and the ERG MPs did not think twice before showing May that they did not appreciate her overtures to Labour and her putting pressure on them to rule out a no-deal Brexit.

Conservative Andrea Leadsom, the current Minister of State at the Department of Energy and Climate Change as well as an ERG member, has lately said that the government was "absolutely" determined to keep a no-deal option on the table, thus further showing the intra-party cracks within the Conservative Party. Overall, it is 67 Tories who have decided to let down their Prime Minister by abstaining from Thursday's vote.

As a result of this, pro-May and anti-May deal Tories have butted heads, with Alistair Burt the Minister of State for International Development and the MENA region, contradicting former Brexit Secretary David Davis by saying that there will not be a no-deal Brexit. The intensification of intra-party disputes within Conservatives raises the possibility of further cabinet defections. Conservative Dominic Grieve, MP for Beaconsfield, announced that 6 ministers could leave May's cabinet if no extension to the Brexit deadline was delivered. This not only shows how politically divisive the issue of Brexit has become, as it also shows that whatever the end result will be, political disruption is to be expected. Not only wreaking havoc on May's cabinet, a no-deal cabinet could also exacerbate calls from Sinn Fein and the Scottish National Party to exit the United Kingdom and remain in the EU as independent nations.

What Solutions Now?

Before yesterday's vote, May's position was slightly improved as a result of several developments. First, the Democratic Unionist Party Leader Arlene Foster had suggested she would be more flexible in dealing with the issue of the Irish Backstop. Second, the European Commission Secretary-General floated the idea, shared by May, that a legally binding text external to the Withdrawal Agreement would be provided, thus allowing MPs to vote for the agreement whilst being assured that the backstop would not be permanent. This legal text, also known as a "joint interpretative instrument" has for long been favoured by Number 10.

With Thursday's Tory revolt however, Theresa May does not seem to be in the same position. In fact, her defeat has weakened her position toward European negotiators and furthered weakened her ability to cut a better deal from Brussels. A sizeable portion of her party seems to prefer a no-deal option and the adoption of "alternative arrangements" that could neutralise the negative effects of a hard border between Northern Ireland and Great Britain. Such arrangements mostly rely on technology and would allow goods to pass any border without vehicles being individually checked. Albeit an attractive option, the Prime Minister has time and again said that such a technology was not available at the moment.

Out of options, May now seems ready to relinquish her claims to renegotiate the backstop. Brexit Secretary Stephen Barclay is believed to have told Michel Barnier, the EU's top Brexit negotiator, that the Britain was not pursuing a reopening to the Withdrawal Agreement anymore. This would mean that the key to any solution remains in London, unless EU officials decide to reward May for her new position by offering other amendments to the Withdrawal Agreement. Nonetheless, any tacit understanding between May and EU officials would probably be criticised by those exhorting a hard Brexit.

May is not believed to offer an alternative strategy until the end of this month. It now seems that due to the ERG's stand Thursday, a no-deal Brexit remains well on the table. Since Brexiters are not likely to budge, May's strategy of running down the clock to get her deal accepted at the eleventh hour is doomed to fail. The Prime Minister is more likely to face two eventual scenarios: a no-deal Brexit or an extension of the Brexit deadline.

Extending D-Day:

MPs have sought to put in place amendments to rule out a no-deal Brexit by calling for an extension of Article 50 if no deal was backed by Parliament. However, such amendments have failed. On Thursday, an amendment calling for Parliament control over Brexit after the 27th February was defeated by 16 votes. This vote down followed the defeat of the Cooper-Boles amendment which was rejected by 23 votes for calling to extend Article 50 if no deal was passed by Parliament after 13th March. The slight margins of defeat show that extending Article 50 remains an option for Britain, and that it is likely that such an option could get better chances of acceptance the closer MPs get to the 29th March.

The SNP's amendment to revoke Article 50, thus annulling Brexit was also voted down on Thursday. MPs brought several amendments to enable either MPs or the people to decide which option they would prefer, instead of voting for a yes-or-no position. However, it seems that the binary choice of no-deal or deadline extension remains the most likely scenario. Yesterday, MP Soubry and Umunna partially succeeded in pushing the government to release information on the negative consequences of a no-deal Brexit, thus potentially increasing the likelihood that the public will support an extension of the deadline. Olly Robbins, a UK Brexit negotiator, is believed to have said that the EU is likely to extend the deadline. Indeed, it remains in Brussels' interest for the UK not to crash out without a deal.

What are the various versions of a Brexit deal?

A no-deal Brexit would put the UK at the bottom of the list of trading nations by forcing the country to base most of its trade on the World Trade Organisation rulebook (something that no nation does), as long as it does not secure more bilateral trade agreements. Currently, the UK has managed to sign 5 of these agreements in 2019, with rather minor trade partners such as Chile, the Eastern and Southern Africa organisation and the Faroe Islands. Recently, the UK signed more significant deals preserving trading arrangements with Switzerland and the US, both representing £32 billion and £12.8 billion in annual bilateral trade respectively.

If a Brexit deal is passed before the 29th March, Britain will have two years to decide its future trading relation with the EU. This relation is likely to be influenced by current trading relations the EU holds with countries within the European Economic Area (Norway, Lichtenstein and Iceland), the European Free Trade Agreement (EEA + Switzerland) or the Canadian-European Trade Agreement (CETA). Each of these trading agreements hold pros and cons that are likely to anger Europhiles as much as Eurosceptics in Britain.

For the Norway model, the UK would stay in the single market and therefore relinquish its control over EU immigration, a key demand of Brexiters. In addition to not solving the Irish backstop problem as Britain would be kept away from the EU's customs union, Britain would still be required to pay a sizeable sum to Brussels, much lower than the current annual fare of £9 billion. Therefore, a Norway + model has been pushed forward by some Labour MPs as an alternative. By including the UK in the customs union, such a model would nearly keep all benefits of being an EU member without actually being one. This would certainly be rejected by EU countries and EFTA countries as they would not like the UK to have its cake and eat it at the same time. Additionally, Brexiters would reject being in the

exact position as they were in whilst being an EU member, this time with the only change that London would have no say in EU lawmaking.

The Switzerland model would allow London to cherry-pick EU regulations it wants, but it would still entail a lack of control over EU immigration and a small fare to be paid to Brussels. Again, both the EU and Brexiters are likely to reject such a model. Remains the CETA model, which would allow the UK to trade in most goods without paying charges to Brussels. London would regain control over EU immigration and legal autonomy. This model is the most likely to gain overall support, especially amongst Brexiters. However, it does not solve the issue of the backstop and it could potentially take years before a full version is negotiated.

The Economic Impact of Brexit:

The government's decision to release information highlighting the cost of a no-deal Brexit is likely to influence the public's opinion against such an option. According to the Bank of England, Brexit has already cost £80 billion since the 2016 vote, or more than four times more than the EU membership fare usually demanded of the UK. Overall, this means that the UK has already lost 2% of its GDP due to its decision to leave the EU. Business investment was down by 3.7% in 2018, a steep drop for a country not encountering any economic or financial crisis.

Additionally, the UK's economic growth has slowed as the growth rate for Q4 2018 was only 0.2%, against 0.6% for Q3. Annual growth for last year was the lowest since the aftermath of the global financial crisis, with 1.4% growth. This low rate reflects the weakened business confidence and the steep production cuts in car and steel manufacturing as well as construction. Growth is expected to be even lower in 2019, with 1.2% instead of the expected 1.7% growth rate. In fact, according to the Bank of England, the risk of a recession has increased from 6% to around 20% for 2019.

Mark Carney has warned that the British economy was not ready for a no-deal Brexit. In the case of such a scenario, there are fears that the UK will struggle to defend its industry from trade dumping and unfair subsidies that could lead its market to be flooded with cheap goods from countries like China, Russia and Brazil. Moreover, firms such as Airbus, Mondelez and Nissan have said that their supply lines were at risk in the case of a no-deal Brexit and that they were expecting to incur costs and depleted earnings. Businesses are frustrated with the government's inability to offer clear advice on Brexit and its implications.

On the currency level, whilst Germany's potential recession and expectations of a ruling out of no-deal Brexit appreciated the Sterling, the new development caused the currency to drop and stand at 1.14156 euros today. With lacklustre growth in sight, expectations for the Bank of England to usher rate hikes are decreasing. Indeed, it would be ill-advised for the central bank to make lending more expensive at a time of low growth. Accordingly, investors should not expect the pound to regain its former levels as it was previously expected. Indeed, the pound was believed to gain a value upwards \$1.40 and 1.16 euros at the end of the year. However, this depends on the removal of uncertainty, which would only happen if Prime Minister May passes her deal in Parliament or if a no-deal Brexit is implemented once and for all.

With growth slowing and the interest rate unlikely to raise above its current rate of 0.75%, inflation is said to fall below targets. Another concern surrounding a no-deal Brexit is what will happen to key sectors to the British economy, such as the financial industry. In fact, in the case of a no-deal, Britain might lose its equivalence with EU regulations and therefore lose access to such markets. For financiers, that would mean that EU institutions would not grant them equivalent status, and they would therefore incur higher transaction costs.

Uncertainty Remains the Prime Risk for Business:

Yet, in spite of all the negative impact a no-deal Brexit could have on firms and the overall economy, the prime risk to businesses is uncertainty rather than the costs incurred by a no-deal. In fact, businesses have invested a lot on contingency plans to face such a scenario. A deadline extension to Brexit would waste such investments and therefore be more cumbersome than a no-deal Brexit. This is why big businesses are calling upon the government to either make a clean slate by accepting a no-deal Brexit by the 29th March, or secure a significant deadline extension from Brussels so as to guarantee that for the next deadline, Britain would leave with a deal.

If Britain extends the deadline by less than 6 months, the likelihood of May passing her Withdrawal Agreement in Parliament will remain scant, and a no-deal Brexit might only be postponed, but this time requiring businesses to adopt new contingency plans with new timelines and resources. In fact, what the British government should be reminded of is that it is their perpetual squabbling that keeps businessmen and businesswomen awake at night, not the likelihood of a no-deal. If Prime Minister May fails to get rid of uncertainty, British growth is likely to be 1.5 percentage point lower than what it should be for the next three years. However, if the government manages to pass a deal early enough,

or accept a no-deal, or even secure a year-long deadline extension, then higher growth could be reached as such scenarios would lower uncertainty for businesses. Brexit would then bring its expected dividend and higher growth could lead to higher interest rates and inflation, in line with the global economy.

Our publications do not offer investment advice and nothing in them should be construed as investment advice. Our publications provide information and education for investors who can make their investment decisions without advice.

Sources:

City AM, 10 February 2019, Alexandra Rogers, "Theresa May promises MPs another Brexit vote by end of February if no deal is agreed with EU"

FT, 7 February 2019, "Bank of England pulls back on multiple rate rise plans"

FT, 5 February 2019, George Parker and Laura Hughes, "DUP hints at flexibility over Irish backstop Brexit solution"

FT, 7 February 2019, George Parker, "What next for Theresa May's Brexit deal?"

FT, 5 February 2019, "Theresa May sticks to keeping backstop in Brexit deal"

FT, 11 February 2019, Philip Stafford, "The unanswered Brexit questions for traders"

FT, 14 February 2019, Alex Barker and Peter Campbell, "EU businesses urge clean break from UK or long Brexit delay"

FT, 14 February 2019, Henry Mance, "Theresa May suffers new Commons defeat on Brexit plan B"

FT, 14 February 2019, Henry Mance, "May braced for parliamentary defeat on new Brexit plan"

FXStreet, 7 February 2019, Flavio Tosti, "EUR/GBP Technical Analysis: Euro takes a dive against Pound on BoE Super Thursday"

The Telegraph, 10 February 2019, Edward Malnick, "Brussels refusing to guarantee healthcare for expats under no-deal Brexit"

The Guardian, 14 February 2019, "Brexit has cost British economy £80 billion- Bank of England"

The Guardian, 14 February 2019, "Theresa May defeated on Brexit again as ERG Tories abstain"

Sky News, 10 February 2019, Audrey Allegretti, "'Emergency zone': Brexit vote may happen just

weeks before March exit date”

Image © Shutterstock