



Countdown to Brexit—Three Weeks To Go

Prime Minister's withdrawal deal could still find support.

March 2019

The UK is scheduled to leave the EU on March 29. Although this is less than a month away, a range of possible outcomes remain possible—although clarity has emerged in certain areas since last week.

In the second of a weekly series of updates, Quentin Fitzsimmons, fixed income portfolio manager and T. Rowe Price's resident Brexit specialist, provides an overview of the current state of play.

What Are the Current Scenarios?

The four primary scenarios are:

1. Parliament agrees a modified version of the deal that the UK government has agreed with the EU and the UK leaves the bloc on March 29.
2. The UK government fails to get a deal approved by Parliament and the UK exits the EU on March 29 without arrangements in place and with no transition period to enable business and people to prepare. UK trade with the EU would immediately be governed by World Trade Organization rules.
3. The EU agrees to extend Article 50, the legislation that sets March 29 as the legally binding exit date from the EU, to give the UK government



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more time to get a deal approved by Parliament. This could potentially involve the UK electorate voting on the deal in a second referendum.

4. Prime Minister Theresa May decides to call a snap election in a bid to increase the ruling Conservative Party's majority and make it easier to push a deal through. An extension to Article 50 would be necessary in the event of a snap election being called.

What Has Changed Over the Past Week?

In another remarkable week in UK politics, the prospects for Prime Minister May's previously dead-in-the-water withdrawal agreement have revived. This is driven by a view that the European Research Group (the ERG—the Conservative Party's most ardent Brexiteers) and the Democratic Unionist Party (DUP) may now support the deal.

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The potential shift stems from the DUP's and ERG's desire to ensure that the UK leaves the EU on time on March 29. They are seeking to nullify subsequent parliamentary votes on amendments designed to affirm that the UK leaves the EU with a deal and requests for an extension to Article 50.

Earlier in the week, Prime Minister May promised that members of Parliament (MPs) will get the chance to reject a no-deal exit and force a "limited" delay to Brexit if her deal is not approved by Parliament.

Meanwhile, the opposition Labour Party also backed a second referendum on Brexit after its own alternative Brexit plan was rejected by Parliament. Labour will likely try to secure a second referendum as soon as Prime Minister May brings her Brexit deal back to Parliament, expected to be on March 12.

Based On Events Over the Past Week, What Are Market Expectations About the Likelihood of the Various Outcomes?

Leave with May's deal and letter of comfort on Irish backstop	50%
No-deal exit on March 29	15%
Extension to Article 50	25%
Snap election	10%

Source: T. Rowe Price; as of February 21, 2019.

What Are the Current Prospects for Financial Assets Given the Most Likely Outcome Above, In Your View?

Fixed income: UK bond markets will likely remain dependent on the country's economic path, which is unlikely to be strong in the near term under any Brexit

outcome. Even with a deal, a hard Brexit would hit credit markets, but in our view that would also create opportunities to buy corporate bonds whose valuations have fallen too far in relation to their fundamental quality.

Equities: The UK equity market has already de-rated. In theory, UK equities look attractive on many international comparisons. An acceptance of Prime Minister May's deal would potentially unlock value in the market, which has been braced for the possibility of a disorderly Brexit without a deal.

Currencies: Sterling has been buoyed by the prospects of a deal as it would eliminate the potential cliff-edge Brexit. However, the prime minister's potential deal is not an ideal economic solution. As sterling remains the shock absorber for the UK economy, it could still potentially weaken. How much weaker would depend on how quickly confidence in the economy is restored. We believe the UK economy might recover more quickly than expected, meaning that any weakness in sterling, and UK assets more generally, could be short-lived.

What We're Watching Next

Parliament will get a vote on Prime Minister May's deal by March 12. Negotiations with the EU will continue until then, but it seems unlikely that any major concessions to the existing deal will be offered. If May's deal is rejected again, MPs will vote on March 13 on whether they support a "no deal" Brexit. If Parliament votes against Prime Minister May's Brexit deal and leaving without a deal, MPs will vote on March 14 on whether the UK should seek a "short, limited extension to Article 50."

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