Countdown to Brexit—A Few Days (or Possibly a Year) to Go

Will the UK be given a short or long extension—or none at all?

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The UK is scheduled to leave the European Union (EU) this Friday. Whether it does or not depends on the outcome of this week's EU summit. The UK has asked for a further delay to Brexit to June 30, but EU President Donald Tusk is reported to favor a longer, "flexible" extension of up to a year, with the option of cutting it short if Parliament approves a deal. For any extension to be granted, all EU leaders must agree to it—and this is not a guaranteed outcome.

In the fourth of a 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 Potential Scenarios?

We have previously outlined four potential Brexit scenarios:

1. After numerous attempts, Parliament finally approves a modified version of the deal that the UK government has agreed to with the EU and the UK leaves the bloc on those terms. However, given the strength of the opposition to the deal within Parliament, the chances of this happening appear to be negligible.

2. The UK government fails to get a deal approved by Parliament and the UK exits the EU on April 12 without arrangements in place and with no transition period to enable businesses and people to prepare. UK trade with the EU would immediately be governed by World Trade Organization rules.

3. The UK seeks—and is granted—a longer extension to Article 50.

4. Prime Minister Theresa May decides to call a snap election in an attempt to increase the ruling Conservative Party's majority and make it easier to push a deal through.

What Has Changed Since Our Last Update?

Prime Minister May promised the Conservative Party that she will resign her post if Parliament approves the Withdrawal Agreement she agreed to with the EU. However, the Democratic Unionist Party, upon which the Conservatives depend for a parliamentary majority, remained resolute in its opposition to the deal, as did 34 of May's own MPs, and the deal was

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rejected by Parliament for a third time. As such, the deal is as good as dead.

Parliament sought to take control of the Brexit process through a number of "indicative votes" to determine whether any outcome can command a majority in the House of Commons. However, despite two rounds of votes, MPs failed to form a majority behind any option. A cross-party group of MPs then forced through an emergency bill to instruct May to seek an extension from the EU, which passed by a majority of just one—312 to 311.

After failing to agree upon a way forward with her own Cabinet, Prime Minister May then asked opposition Labour Party leader Jeremy Corbyn to sit down for talks designed to agree upon a Brexit deal that they could jointly put to the House of Commons. These talks are ongoing.

Finally, as media reports suggested that EU President Tusk will propose a lengthy, "flexible" extension to Article 50, Prime Minister May wrote to him asking for a shorter delay to June 30. There is no guarantee that EU leaders will approve either extension at this week's summit, but of the two proposals, Tusk's is more likely to be ratified.

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	0%	↓
No-deal exit on April 12	10%	↓
Extension to Article 50	90%	↑
Snap election	0%	–

Source: T. Rowe Price; as of April 8, 2019.

What Are the Current Prospects for Financial Assets?

Fixed Income: UK gilts rallied in March amid concerns over a no-deal Brexit but have since given back some of those gains as the prospect of a "cliff-edge" scenario has diminished. A period of uncertainty is now likely to follow as the markets weigh the likelihood of a softer Brexit against the prospect of a long-term arrangement that is nonetheless worse than being in the EU. Adding to this uncertainty is the possibility that Labour leader Corbyn comes out of the current negotiations with his popularity enhanced, increasing his chances of becoming prime minister.

Equities: Stock markets are now having to price the reduction in the risk of a disorderly Brexit against the probability that permanent membership of a customs union with the EU would not improve the attractiveness of the UK economy over the medium to longer term. This will likely keep UK stocks muted for the time being.

Currencies: Sterling has been stuck in neutral, showing little inclination to react strongly to any recent developments, almost certainly for the same reason that gilts have been subdued—i.e., relief at the diminishing prospect of a no-deal Brexit is giving way to pessimism over what may come next. While a rally of sorts cannot be ruled out if an extension to Article 50 is agreed to by the EU, these negative sentiments are likely to keep it in check.

What We're Watching Next

All eyes will be on this week's EU summit in Brussels, where the leaders of other countries in the bloc will decide on whether to grant the UK a further Brexit extension. Of the two extensions currently being discussed—Prime Minister May's June 30 extension and EU President Tusk's longer, flexible extension—the latter seems more likely to be approved. However, there is clearly concern among some members that a delay to Brexit will provide an unnecessary distraction, meaning it remains possible that no extension is given and the UK crashes out of the EU this Friday. If that occurs, expect a very high degree of market turbulence to follow.

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