



Countdown to Brexit: Will the UK Leave on Halloween?

New Prime Minister Boris Johnson faces tough battle with Parliament.

July 2019

New UK Prime Minister Boris Johnson has vowed to deliver Brexit by the October 31 deadline, “do or die.” This will not be easy given that Johnson faces the exact same impasse that led to the downfall of Theresa May: The UK Parliament has rejected the withdrawal agreement that May struck with the European Union (EU), the EU has stated firmly that it will not renegotiate that agreement, and the majority of members of Parliament (MPs) remain opposed to the UK leaving the EU without a deal being agreed upon.

In the fifth 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?

Theoretically, there remain four possible scenarios, though (as we will explain later) only two of them are realistic.

1. The UK government fails to get a deal approved by Parliament, and the UK exits the EU on October 31 without arrangements in place and with no transition period to enable business and people to prepare. UK trade with the EU is immediately governed by World Trade Organization rules.



Quentin Fitzsimmons
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2. A further extension to Article 50 is granted, most likely pushing the deadline into 2020. This is only likely to occur if there is a specific reason to delay—for example, to allow time for a general election and/or a new referendum.
3. Against the odds, Prime Minister Johnson wins some concessions from the EU, and Parliament passes an amended form of the withdrawal agreement.
4. Circumstances arise that persuade the UK government to revoke Article 50, suspending Brexit indefinitely.

What Has Changed Since Our Last Update?

Having failed three times to get the withdrawal agreement she brokered with the EU through Parliament, Theresa May resigned as leader of the ruling Conservative Party on May 24.

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This triggered an election for the new leader of the party, and the winner of the election would also automatically become the new prime minister of the UK. After several rounds of voting, Conservative MPs eventually chose Boris Johnson and Jeremy Hunt as the two candidates to go forward to the final vote of around 160,000 Conservative Party members. Boris Johnson was announced as the winner of this election on July 23.

During his campaign, Boris Johnson insisted that he could use the threat of a no deal to win an improved Brexit deal for the UK from the EU. This seems unlikely to occur given the EU's repeated insistence that it will not renegotiate the withdrawal agreement—a position reaffirmed by new European Commission President Ursula von der Leyen.

If a new deal cannot be agreed upon, Prime Minister Johnson has vowed to take the UK out of the EU without a deal on October 31. However, he is likely to face considerable opposition on this from Parliament, where most MPs—including a significant number of Conservative MPs—oppose a no-deal exit. There are a number of ways in which MPs could try to prevent a no-deal Brexit, including amending existing legislation, holding a vote of no confidence in the government, or putting pressure on the government by expressing “the will of Parliament” against a no deal.

Media reports have suggested that Prime Minister Johnson may seek to prevent MPs from blocking a no deal by taking the controversial step of suspending Parliament in the runup to October 31. In response, Parliament immediately approved legislation that would appear to prevent the prime minister from doing this. Further battles within Parliament between the various factions can be expected right up to October 31.

Although four potential outcomes remain, I believe only two remain a realistic possibility: leaving without a deal on

October 31 or a further extension to Article 50. I do not believe there is any chance of the EU agreeing to a new Brexit deal that is subsequently voted through Parliament. It is possible that events elsewhere in the world become so pressing that Parliament votes to revoke Article 50, suspending Brexit indefinitely—but this is very unlikely. Given Prime Minister Johnson's previous comments, I believe the most likely outcome is now a no-deal Brexit, with the second most likely outcome an extension to Article 50 to allow time for a general election and/or new referendum.

What Are Your Current expectations of the Various Possible Outcomes?

Leave without a deal on October 31	65%
A further extension to Article 50	30%
Parliament approves amended withdrawal agreement	0%
A revocation of Article 50	5%

What Are The Current Prospects For Financial Assets?

Fixed income

Boris Johnson's comments during the leadership campaign have raised expectations of the UK leaving the EU without a deal on October 31, leading to widespread jitters in the markets. At the same time, there is a growing sense that UK economic fundamentals—along with those of most of the rest of the world—are deteriorating, increasing expectations of a Bank of England rate cut by the end of 2019. Combined, these developments have sent investors piling into safe haven assets, causing UK sovereign bonds to rally sharply in recent weeks.

The period of uncertainty is likely to continue over the next few months as the Brexit deadline looms, extending the rally in UK gilts. If the UK leaves without a deal on October 31 and there is clear

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immediate disruption to the supply of goods, the resulting panic could push yields sharply lower. However, if there is less disruption than anticipated, yields may rise sharply.

Equities

UK stock markets have delivered healthy returns so far this year, although they have lagged other major markets in relative terms. Growing expectations of central bank rate cuts and hopes of a positive outcome from U.S.-China trade talks have supported stocks in recent months, although this has been offset by deepening fears over the health of the global economy. As uncertainty persists ahead of the October 31 deadline, UK stocks are likely to remain muted relative to other markets. Last week, the UK's Office for Budget Responsibility predicted that a no-deal Brexit would cause a recession and a 5% stock market decline.

Currencies

Sterling plunged to a multiyear low last week after both Boris Johnson and Jeremy Hunt appeared to harden their stances on Brexit in the final days of their leadership campaigns. Johnson's claim that the Irish backstop must be ditched, a move that has already been emphatically rejected by Brussels, exacerbated fears of a disorderly exit

and sent sterling tumbling. The currency is likely to remain under severe pressure over the next few months as Brexit approaches. However, if Parliament appears to be gaining ground in its attempt to block a no-deal exit, possibly leading to an extension to Article 50, a rally in sterling may occur.

What We're Watching Next

All eyes will be on Prime Minister Boris Johnson in his first few weeks in office to see whether he sticks to his hitherto hardline stance on Brexit or adopts a softer approach. It is not easy to predict which way this will go: While Johnson communicates very well, it is invariably difficult to know what he really means. In either case, I believe it is almost certain that Johnson will not be able to secure an improved Brexit deal from the EU, so any significant developments over the next few months are likely to occur in the UK Parliament. MPs opposed to a no-deal Brexit have already begun trying to block Prime Minister Johnson from taking the UK out of the EU on October 31, which is likely to result in ever-more ingenious counter-tactics from Johnson's government. This parliamentary guerilla war will intensify as October 31 approaches, raising the possibility of a general election before the deadline is reached.

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