



Countdown to Brexit: Will a Christmas Election Deliver Clarity?

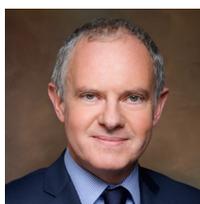
November 2019

December's poll could lead to a quick exit—or a lengthy delay

The UK's general election on December 12 may finally bring some long-awaited clarity over Brexit—or it may deliver an extended period of uncertainty and confusion. The poll will almost certainly be regarded as an unofficial vote on Brexit by most of the UK electorate, despite the likely attempts from the various parties to promote policies in other areas, such as the economy and public services. As such, tactical voting—where voters support a candidate other than their first choice in order to prevent an undesirable outcome—is likely to play a bigger-than-usual role in determining the result. This makes the election highly unpredictable.

As things stand, the UK is set to leave the European Union (EU) on January 31, 2020—and this will very likely occur if Prime Minister Boris Johnson's Conservative Party gains an overall majority in the election. If there is another hung Parliament or the Labour Party wins the election, a further delay to Brexit—probably including a second referendum—is more likely. It is not inconceivable that the UK could still be a member of the EU this time next year.

In the seventh 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



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and discusses what he believes are the most likely outcomes.

What Are the Potential Scenarios?

There are three main potential outcomes at this stage.

1. The Conservative Party gains an overall (though likely modest) majority. It then either pushes Boris Johnson's existing Brexit deal through Parliament or seeks to use its strengthened position to negotiate a better deal with the EU, underpinned by the renewed threat of leaving without a deal. Either way, the UK leaves the EU on January 31.
2. The Labour Party either wins the election outright (unlikely) or is the largest party in a coalition government with the Liberal Democrats, Scottish National Party, Plaid Cymru, and Green Party (more likely). Jeremy Corbyn becomes prime minister and seeks to negotiate

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a “better” (read “softer”) Brexit deal with the EU. A referendum is then held on that deal (or Boris Johnson’s previous deal if the EU is unwilling to negotiate a new one), which will require an extension to Brexit until mid-2020 at least.

3. The Conservative Party fails to gain an overall majority but forms a coalition government with the Northern Irish Democratic Unionist Party (in other words, a continuation of the status quo). The opposition parties force through a second Benn Bill, forcing the government to seek a further Brexit extension from the EU beyond January 31. As a general election has been held and has failed to bring clarity, the only option left will be for the government to hold another referendum, most likely giving people a choice of Boris Johnson’s deal, no deal, or remaining in the EU.

What Has Changed Since Our Last Update?

On October 17, it emerged that Prime Minister Boris Johnson had struck a revised Brexit withdrawal agreement with the EU. The deal took many by surprise, coming less than three weeks before the UK was due to leave the EU. Johnson had previously been hit by a Supreme Court ruling that his proroguing, or suspension, of Parliament was illegal, and had also expelled 21 Members of Parliament (MPs) from his own party after they rebelled against the government in a bid to prevent a no-deal Brexit.

Johnson’s deal with the EU replaced the so-called “Irish backstop” of May’s deal with an arrangement that would take the entire UK, including Northern Ireland, out of the EU customs union. However, the arrangement would avoid a hard border on the island of Ireland by keeping Northern Ireland aligned with the EU customs union in practice.

On October 26, Parliament voted in favor of the withdrawal agreement bill progressing, something that Johnson’s predecessor Theresa May failed to achieve with her withdrawal agreement. However, MPs also voted against the prime minister’s plan to fast-track the bill in order to meet the Brexit deadline, which prompted Johnson to “pause” the legislation’s progress through Parliament.

Without Parliament’s approval for a deal, Johnson was compelled by law to ask the EU for a Brexit extension, despite previously stating that he would rather be “dead in a ditch” than do this. On October 28, three days before the deadline, the EU agreed to extend the Brexit deadline to January 31. Later that same day, Johnson tried to force a general election under the Fixed-term Parliaments Act but failed to gain the required two-thirds majority in Parliament for it to pass.

On October 29, MPs finally backed Boris Johnson’s request for a general election on December 12 in order to break the Brexit deadlock. Parliament will be dissolved on November 6 to enable the parties to begin their campaigns.

Based on Events Over the Past Few Weeks, What Is Your Current Estimate of the Various Possible Outcomes?

A Conservative majority, leading to Brexit on January 31	50%
A Labour government or Labour-led coalition, leading to a Brexit delay and a second referendum	30%
A Conservative-led coalition with the Democratic Unionist Party (DUP), most likely leading to a Brexit delay and a second referendum	20%

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What Would Be the Implications For Financial Markets of the Three Potential Outcomes of the Election?

A Conservative Majority Government

A Conservative majority government would be free to press ahead with its spending plans, which would likely boost hopes for the UK economy and steepen the gilt yield curve. However, this optimism may be moderated by renewed fears of a hard Brexit, which would weigh on sterling. The removal of any prospect of a left-wing government raising taxes and seeking to nationalize key industries would boost stocks, particularly in the utilities, financials, and real estate sectors.

A Labour Majority Government or Labour-Led Coalition

A Jeremy Corbyn-led government would be expected to pursue aggressively loose fiscal policies to fund ambitious spending projects, forcing the Bank of England to raise rates to combat inflation. Anticipation of this would likely lead to a sell-off in gilts, sending yields higher, although this may be tempered to some degree by relief that a no-deal Brexit is off the table. Concern over the long-term sustainability of a Corbyn government's fiscal plans would very likely keep sterling in check for an extended period, while the prospect of nationalization would cause considerable dislocation in stock markets, particularly in utilities and financials.

A Conservative-Led Coalition

Another Conservative minority government would leave markets subdued amid continued uncertainty. Relief that Jeremy Corbyn is not going to be prime minister and that a no-deal Brexit remains unlikely will bring some relief to markets, although this will be offset by fears that the Brexit impasse could drag on for months longer. Fears over the prospects for the UK economy are likely to keep UK sovereign bonds anchored, while sterling will be kept in check. Although UK shares will remain cheap, a sustained rally is unlikely until there is clarity on Brexit, which may not occur for some time.

What We're Watching Next

Given the unpredictability of this election, the potential for opinion poll swings between now and December 12 is high. The fact that more than 50 current MPs are standing down, combined with the likelihood of widespread tactical voting, raises the possibility of surprise outcomes in some constituencies. Unpopular policy announcements, embarrassing personal revelations and poor media appearances from senior party figures have the potential to move the polls significantly. We will be closely watching all of these developments throughout November and early December as we seek to build a clearer picture of the likely outcome—and therefore the consequences for Brexit.

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