



Countdown to Brexit: The Battle Intensifies

The UK is in the grip of a constitutional crisis.

September 2019

Prime Minister Boris Johnson is engaged in a fierce battle with the UK Parliament as the October 31 Brexit deadline approaches. The UK Supreme Court's ruling that Mr. Johnson's prorogation of Parliament was unlawful was the latest in a series of setbacks for the prime minister, who has suffered a number of parliamentary defeats since he took office. The most important of those was Parliament's approval of a bill that gives Mr. Johnson until October 19 to either pass a Brexit deal in Parliament or persuade lawmakers to approve a no-deal Brexit. When that deadline passes, Mr. Johnson will be compelled to ask the European Union (EU) for a Brexit extension to January 31, 2020—something that he has said that he would rather be “dead in a ditch” than do. A major battle between Mr. Johnson and Parliament, where the government no longer has a majority, lies ahead.

In the sixth 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?

Four theoretical scenarios remain, of which three are realistically possible.



Quentin Fitzsimmons
Fixed Income Portfolio Manager

1. The UK could leave 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 will be compelled to move to World Trade Organization rules.
2. A further extension to Article 50 is requested and granted, pushing the deadline to January 31, 2020, or an alternative date proposed by the EU.
3. Mr. Johnson wins some last-minute concessions from the EU on the Irish backstop and Parliament passes an amended form of the Withdrawal Agreement.
4. The UK government revokes Article 50, suspending Brexit indefinitely.

What Has Changed Since Our Last Update?

Boris Johnson began his term as UK prime minister with a promise to deliver

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Brexit by the October 31 “do or die.” In his early days in office, he insisted that this could be achieved with a bold, much-improved Brexit deal agreed with the EU and approved by the UK Parliament.

However, Mr. Johnson’s negotiations with the EU have not gone well, and the only deal on the table is the same one that the previous Prime Minister Theresa May failed to get members of Parliament (MPs) to approve—and ultimately paid for it with her job.

In late August, Mr. Johnson controversially decided to prorogue, or suspend, Parliament from mid-September until October 14 (although Parliament would ordinarily be in recess for much of this period anyway to allow for the annual party conferences to take place). Parliament responded to the prorogation by passing a new bill setting an October 19 deadline for Mr. Johnson to either get a Brexit deal approved by Parliament or to persuade MPs to vote for a no-deal Brexit. In the event that he cannot achieve either, the bill says that Johnson must ask the EU for a Brexit extension to January 31, 2020. The bill was passed with the help of 21 Conservative MPs—all of whom Johnson immediately purged from the party, obliterating his wafer-thin majority in Parliament.

Mr. Johnson then tried—twice—to force a snap election with the aim of boosting his majority with new MPs more aligned to his hard-Brexit views. However, he was thwarted on both occasions when the opposition parties, sensing a trap, refused to agree to play along. If an extension to Article 50 is granted, it is likely that the opposition parties will try to force a general election. For the time being at least, Mr. Johnson remains in office with no majority and apparently unable to fulfill his commitment to leaving the EU on October 31.

On September 24, the Supreme Court ruled that Mr. Johnson’s prorogation of Parliament was “unlawful, void, and of no effect”—meaning that Parliament is no longer suspended. More importantly, the judgment makes it very difficult for Mr. Johnson to prorogue Parliament again—a tactic that he may well have employed had the Supreme Court ruled the other way.

If the October 19 deadline passes without a deal being agreed upon, MPs agreeing to a no-deal Brexit, or a new election being called, Johnson faces being forced to ask the EU for a delay to Brexit. However, he has insisted in the strongest possible terms that he does not want to do this. It is possible that when the time comes, he will back down and ask for the extension, most likely while complaining loudly to the public that his hands are tied by Parliament. Alternatively, he could resign, although those closest to him insist that this is very unlikely. Other possibilities include Johnson simply refusing to ask the EU for an extension, which would mean breaking the law (which he has said he will not do) or fulfilling his obligation to ask the EU for an extension but doing so in such a way that makes it likely that the EU will refuse it.

Four potential outcomes remain, three of which are realistically possible: the UK leaves without a deal on October 31, there is a further extension to Article 50, or Parliament approves a modified version of the Withdrawal Agreement. Overall, I think the probability of the UK leaving the EU without a deal on October 31 is now around 55%. I believe there is around a 35% chance of an extension to Article 50 and a small, but not insignificant, chance of an amended version of Theresa May’s Withdrawal Agreement being approved.

“Sterling could come under renewed pressure if the markets once again believe that a no-deal Brexit is the most likely outcome.”

In the event that an extension to Article 50 is granted, I believe the probability of a no deal exit by the new deadline will be 65%, with a 35% chance of an amended version of the Withdrawal Agreement being agreed. However, these may change in the event of a general election or a second referendum.

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

Leave without a deal on October 31	55%
A further extension to Article 50	35%
Parliament approves a modified Withdrawal Agreement	10%
The Government revokes Article 50	0%

What Are the Current Prospects for Financial Assets?

Fixed Income

The looming prospect of Brexit continues to cause widespread jitters in markets. At the same time, there is a growing sense that the Bank of England will cut interest rates by the end of 2019 in response to deteriorating UK fundamentals, fears of a global recession, and a disorderly UK exit from the EU. Combined, these developments have sent investors piling into “safe-haven” assets, leading to an extended rally in UK sovereign bonds.

The rally is likely continue over the next few months ahead of the deadline. If the UK leaves without a deal on October 31 and there is clear immediate disruption to the supply of goods, the resulting panic could push yields sharply lower. However, the Bank of England has recently revised down its estimate of the impact of a no-deal Brexit, suggesting it will be less severe than previously thought. If there is less disruption than anticipated, yields may rally after Brexit, although this is likely to be short-lived.

Equities

UK stock markets are pricing in a significant amount of political risk—British shares are now as cheap as they were more than two decades ago. Hopes for central bank rate cuts and a positive outcome from U.S.-China trade talks have offered some support, but 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, and this will likely continue in the period immediately after a no-deal Brexit.

Currencies

Sterling has been boosted in recent weeks as the markets have reacted positively to Parliament’s approval of the bill aimed at preventing a no-deal Brexit, then the Supreme Court’s ruling against Mr. Johnson. However, the currency could come under renewed pressure over the next few weeks if the markets once again begin to believe—as I do—that a no-deal Brexit is the most likely outcome. If Brexit does occur on October 31, sterling is likely to remain muted for some time as the markets assesses the immediate impact of the UK’s exit from the EU.

What We’re Watching Next

The Supreme Court’s ruling that Mr. Johnson’s prorogation of Parliament was unlawful is important because it makes it very difficult for him to deploy the same tactic again. Now, all eyes will be on Parliament over the coming days and weeks to see what further steps lawmakers will seek to take to prevent a no-deal Brexit. As things stand, Mr. Johnson has until October 19 to either agree a new Brexit deal with the EU or persuade MPs to back a no-deal Brexit, neither of which look remotely likely to occur. The big question is how Johnson will respond if, as seems likely, he is compelled by law to ask the EU for a Brexit extension to January 31 next year. The last few weeks before the October 31 deadline could see considerable market upheaval.

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