

## Brexit: Four thoughts after Westminster's wild Wednesday

A UK election now looks inevitable - the only question now is 'when'. However, the chances of a 'no deal' Brexit on 31 October appear to have receded, but there are still ways it could happen, and given the outcome of an election looks deeply uncertain, despite the Conservatives' lead in the polls, the rebound in sterling is unlikely to have legs



British Prime Minister Boris Johnson gesturing to Labour party leader Jeremy Corbyn during a session in the House of Commons

Source: Shutterstock

UK lawmakers achieved a major breakthrough last night in their bid to avert a 'no-deal' exit on 31 October.

The House of Commons passed a bill, that once law, would oblige the prime minister to ask for a further Brexit delay, if he fails to get MPs to sign up to a Brexit deal by 19 October. The bill is now with the House of Lords, and despite initial signals that the government would do all it could to block it, looks set to pass by Monday.

The upshot is that a general election now looks highly likely, and the chances of a 'no deal'

exit on October 31 appear to be slowly receding. Here are four thoughts on these latest developments.

## 1 A general election now a question of 'when' rather than 'if'

Two-thirds of MPs are required to give consent to a general election, and last night, Mr Johnson's Conservative party failed to secure that majority.

But just because an election wasn't called last night, it doesn't mean one isn't imminent. The Labour party has signalled that if the bill passes and gains royal assent, which helps insure against a 'no deal' exit, they would give their consent to Britain heading to the polls.

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The question is 'when' – and it appears Labour is really in the driving seat here. Initial signals from the opposition party's leader Jeremy Corbyn suggested he was open to the government's proposal for an election on 15 October.

But at a meeting of Labour MPs yesterday, almost all were **reportedly** in favour of an election after October 31. The logic is that by then, Mr Johnson will most likely have been forced to ask for an Article 50 extension, meaning he will have failed in his "do or die" pledge to take the UK out of the EU by October 31. While the Conservative election campaign will almost certainly seek to frame this as parliament attempting to block Brexit, Labour appear to be calculating that it could leave Johnson more exposed to the Brexit party at the polls.

Whether it's before, or after, October 31, in our view, Britain is now almost certainly heading to the polls.

## 2 'No deal' chances are slowly receding, but it could still happen

Assuming the bill, designed to initiate a further Brexit delay, becomes law, then this is a big step closer to averting 'no deal' on 31 October. However, it is too early to conclude that the risk has faded entirely.

First, if an election occurs on 15 October, and the Conservatives retain power, then in principle, there is nothing stopping them reversing this law that requires them to ask for another Article 50 extension. That said, there would be a remarkably short amount of time between the results of the election – presumably on 16 October – and the deadline to ask for the extension on 19 October.

Can new MPs be sworn in, a new speaker of the House of Commons be elected - and if the Conservatives don't achieve a majority - a new confidence and supply agreement with the Democratic Unionist party formed? That's all before considering the time needed to pass a new

law itself.

Secondly, even if a 'no deal' exit is averted in October, it could still happen at a future point in time. If the Conservatives are able to secure a majority at an election, then their 'Plan' A' may still be to try and push a deal (even if only lightly-revised) through parliament. But if this fails, then the government may well press ahead and try to leave the EU without a deal.

Finally, if the prime minister is forced to ask for an Article 50 extension in October, a further Brexit delay relies upon the EU saying 'yes'. Brussels has previously signalled that it would be willing to allow a further delay for a so-called diplomatic event, be that an election or referendum. But without a firm justification, there could be more resistance to another extension than there was back in April. France, in particular, has signalled it is reluctant to grant further time. However assuming Ireland remains open to granting a further extension, it seems unlikely that the EU as a whole would disagree – particularly given that the EU is keen to avoid being perceived as the party to blame if 'no deal' happens.

However nothing is guaranteed – and at the very least, the EU may prefer to keep an extension fairly short (perhaps around three months) to keep the pressure on the UK to make a decision.

### 3 An election would be impossible to call, despite Conservative's lead in the polls

If an election does end up taking place, based on headline polls alone, Mr Johnson's prospects look good. His party is polling around 33% based on a range of recent polls. And while this is a step down in vote when compared to the previous election, Labour has slipped further – the opposition party currently sits at just 25%.

Under the UK's first-past-the-post system, these polling numbers very crudely translate into a majority. Electoral calculus – a website that maps polling data onto the FPTP system, predicts Mr Johnson could win 350 seats, well over the 320 he needs for a working majority in parliament.

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In reality though, it is unlikely to be this straight-forward and this election will be virtually impossible to call. As [we noted earlier in the week](#), the Conservatives will come under pressure from the Scottish National Party, as well as the Liberal Democrats in certain areas of Southern England.

So the key question will be whether the Conservatives can make-up ground in Labour-held areas that voted to leave at the 2016 referendum. The economy will be a key battleground here – polling has shown that, while many Conservative and Labour leave voters share similar views on things like crime and immigration, they differ heavily on issues such as nationalisation and public spending.

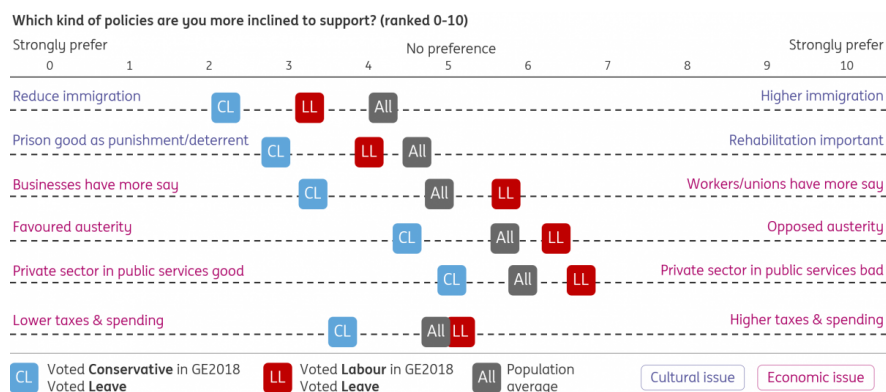
Mr Johnson’s messaging on ‘no deal’ will also be key. A survey by *Deltapoll* last week suggested only 28% of the public think a ‘no deal’ is the best option - even if a majority of his own party’s voters do. If he campaigns hard on ‘no deal’, he risks amplifying losses of moderate voters. Take a nuanced line on ‘no deal’ though, and he will be more vulnerable to the Brexit party in these key battleground constituencies.

In short, the outcome of the election would be highly uncertain – and it may boil down to how successfully the Labour party manage to re-frame the election in domestic policy terms, as opposed to down Brexit lines.

Don’t forget the former-PM Theresa May lost around four Labour seats for every one she gained, despite a huge lead in the polls at the start of the campaign.

[Read why an election poses risks for both the Conservative and Labour party](#)

## Key challenge for Johnson will be to convince 'Labour leavers' on the economy



Source: Lord Ashcroft poll, April 2019

Voters asked to rank their preference between two statements on a scale of 0-10

### 4 Sterling's rebound won't have legs

The outlook for the pound will largely depend on who wins a general election, if one does indeed happen - and based on headline polls alone, Mr Johnson’s prospects look good.

We don’t expect the current GBP rebound to have legs. So far, Sterling has benefited from the mix of the success MPs have had in legislating against 'no-deal' Brexit and the stretched short GBP positioning. But with early elections looming, we expect the pound to soon re-start its weakening trend, given election uncertainty and the non-negligible risk of a 'no-deal' Brexit if the Conservative party win a parliamentary majority under prime minister Boris Johnson.

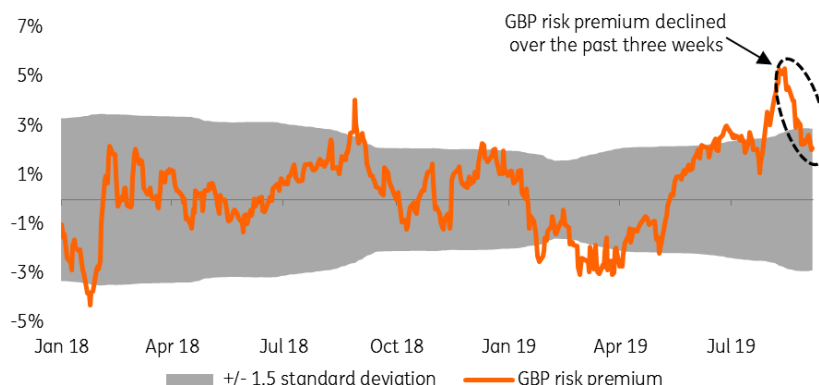
Recall the GBP price action earlier in the year. The pound initially strengthened on hopes of an Article 50 extension (as is happening now) but eventually depreciated meaningfully as UK politics became even more fragmented and the risk of a no-deal Brexit increased. We expect a similar roadmap this time around and target EUR/GBP 0.95 and GBP/USD 1.17 in the coming months, with the date of the early election (before or after the October deadline) determining the timing of GBP depreciation. Nonetheless, the end game is the same – weaker sterling for the remainder of the

year.

As we discussed in our [sterling risk premium tracker](#), there is still more scope for risk premium to be built into GBP. After the GBP strength this week, we estimate that around 2% of short-term risk premia is priced into GBP at this point vs 5% in August as shown in the figure below suggesting more downside to GBP once election uncertainty kicks in.

## GBP risk premium

The estimate of EUR/GBP risk premium. A residual between EUR/GBP short-term financial fair value and the spot.



Source: ING

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