

UK: Breaking the Brexit deadlock

The UK economy is beginning to stall as Prime Minister Theresa May prepares to hold a crunch vote on her deal in mid-January. This looks set to be rejected by MPs, potentially opening the door to either a second referendum or a push towards the 'Norway option'. Nobody truly knows what option will prevail, but some form of Brexit delay is becoming more likely



Theresa May leaves
Downing Street,
December 17th

'No deal' remains the default Brexit scenario - unless MPs can unite around an alternative

As the new year begins, it's worth reminding ourselves that as things stand, the default legal position is that the UK will leave the EU on 29 March without a deal, unless Parliament can unite around a particular alternative course of action. Nobody truly knows which (if any) particular option may ultimately command a majority amongst MPs, but there are a few main scenarios.

First off, there's the deal that the Prime Minister agreed with Brussels back in November and the fact remains that Theresa May faces a steep, uphill battle to get it approved by Parliament. A crucial vote on the agreement – which was dramatically postponed in mid-December – will take place on 14 January, and right now, it looks set to be rejected, potentially by a heavy margin.

Turning the tide will be tough – if not impossible – particularly given that the EU has made it clear it is not prepared to renegotiate. Back in December, Theresa May had hoped to win legal assurances that the contentious Irish backstop would never be needed, but the EU has made it clear this would render the agreement an invalid insurance policy against a hard border in Northern Ireland.

If the deal is voted down, MPs are likely to get a say on next steps

So what next if Parliament votes down the deal? Well, talk of a no-confidence vote in the government is likely to rise once again, although so far the Labour Party has been reluctant to go down this path. However if a confidence vote were to happen and get enough support among MPs (which still seems like a tall order, given that some Conservative/DUP MPs would need to back it), then an election would be triggered within 14 days- if an alternative government cannot be confirmed by lawmakers.

Assuming there isn't a snap election, MPs will still likely get a say on what happens next. The government will have to inform Parliament of its next steps within 21 days of losing the vote, and this plan could be amended by lawmakers. It's probably at this point that we'll find out whether there is a majority for a new Brexit direction.

Of all the possible options, a second referendum, or a push towards something resembling the so-called Norway-option, seem most likely to command a majority.

Of course, both still face challenges. In the case of a second referendum, there is no consensus on what question would be on the ballot paper, neither have the polls shifted enough to suggest the verdict would be decisively different today versus the 2016 vote.

In the case of the EEA-style deal, the EU is reportedly wary that the UK could struggle to permanently accept being a rule-taker in key areas (e.g. finance). It's also likely that the Irish backstop would still be kept in place, given that the EEA has a one-year exit clause, raising concern in Brussels that it could be used as a way to ultimately reach a harder Brexit and risk border frictions within Ireland. It would also require the government to drop perhaps it's reddest of red lines – no freedom of movement.

How the different Brexit options could materialise

PM May's deal approved

How could it happen?

- Fudge with EU that satisfies demands of Parliament on Irish backstop
- All other viable options (2nd ref, election, Norway) voted down by MPs
- MPs decide to back deal as risks of 'no deal' focus minds in Parliament

How likely? Tall order given EU unlikely to renegotiate, plus numbers are very heavily stacked against the Prime Minister's deal in Parliament

Norway-style deal

How could it happen?

- Parliament votes down May's deal + votes in favour of pursuing agreement with greater EU market access.
- PM May pivots away from her deal & seeks consensus with other parties

How likely? Many practical hurdles to overcome with Norway-style deal, but opposition parties + Pro-EU Conservatives may unite to push for softer Brexit stance

Second-referendum

How could it happen?

- No-confidence vote in government happens but fails, so Labour publically back second ref.
- Parliament votes down May's deal + votes against alternative Brexit models. Second ref backed to break deadlock

How likely? Probability is rising, although not clear whether the opposition Labour Party would be prepared to back this. Could take at least 5 months to arrange.

Snap election

How could it happen?

- Labour Party introduces motion of no confidence in the government. Some Conservative + DUP MPs must agree

How likely? Despite all the unease, seems like a tall order for Conservatives to vote themselves out of government.

No deal – Default scenario

How could it happen?

- No alternative found before 29 March
- Favoured option in second referendum

How likely? No majority in Parliament for this option, but unless an alternative is approved, this remains embedded in UK law as the default option.

Source: ING

A Brexit delay looks more likely - although this isn't challenge-free either

No one knows which way MPs will go, but what ties all of these options together is a lack of time. Our understanding is that a second referendum could take upwards of five months to arrange, allowing time for legislation to pass, the question to be consulted upon and a regulated campaign period. A softer Brexit option would take time to renegotiate, while a general election would take a minimum of five weeks – and if a new government came in, presumably extra time to reshape the existing deal.

This is important because Parliamentary rules mean that new legislation (such as the EU Withdrawal Act) need to be laid 21 sitting days before coming into effect – which in other words, means the deal needs to be approved by Parliament by 26 February.

Put simply, the chances of some form of Brexit delay are rising. An extension to the Article 50 period seems the most likely way of doing this, and assuming the rationale for doing so was for the UK to change course in some way, or hold a fresh vote, then it is unlikely EU member states would object.

The chances of some form of Brexit delay are rising

That said, this approach isn't without its challenges either. The main hurdle is the EU Parliamentary elections, which would need to take place before new MEPs gather for the first time on 2 July and potentially putting a time limit on a possible Article 50 extension. Some have suggested this could be navigated by temporarily giving the MEP roles to MPs from the House of Commons, although it's not clear whether this would be legally permissible. The more drastic alternative to an extension would be to revoke Article 50 altogether, although it's very hard to see the government or Parliament opting to do this without the public's consent.

The economy is beginning to suffer

Whatever happens, it's clear the economy is entering a tumultuous phase. [Growth slowed through the final quarter of 2018](#) and we expect the economy to continue to struggle. While the Bank of England appears keen to continue tightening policy when it can, the odds of a rate hike before the summer are fading and the prospect of a Brexit delay (thus prolonging the uncertainty for firms and consumers) would likely rule out another rate hike until much later in 2019.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.