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 the 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.

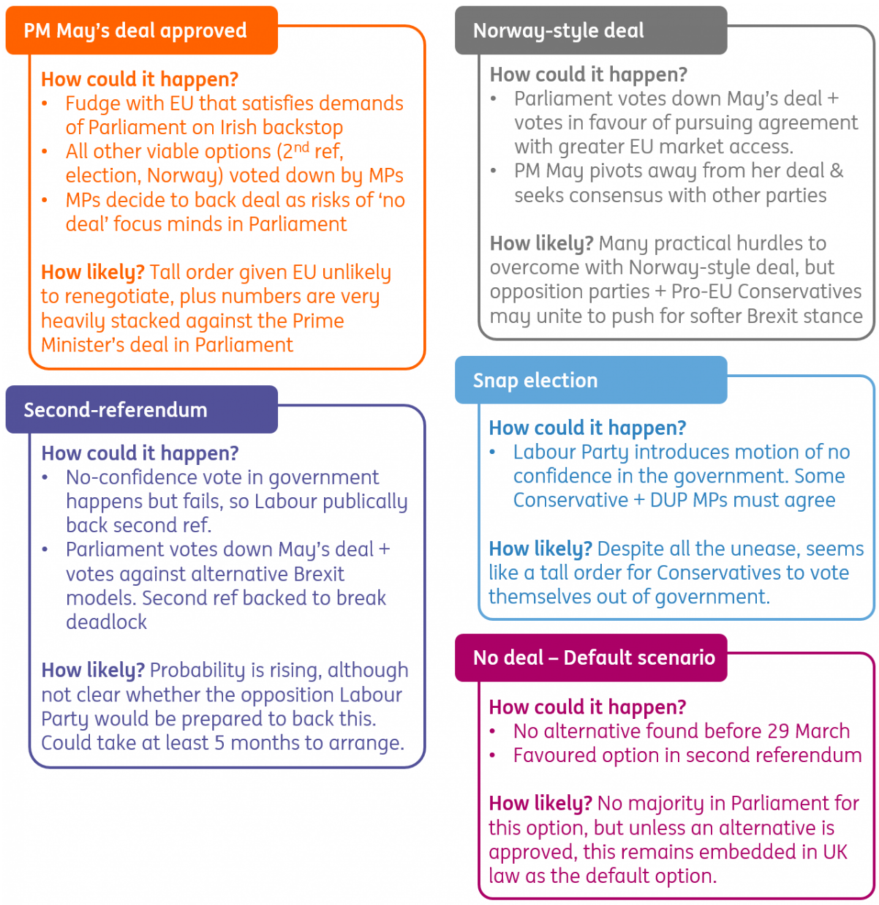
Assuming there isn't a snap election, MPs will still likely get a say on what happens next. The government will have to inform Parliament of its next steps within 21 days of losing the vote, and this plan could be amended by lawmakers. It's probably at this point that we'll find out whether there is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



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.

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