For professional clients only
September 2019
Research & Strategy Insights

UK reaction: UK government loses control of Brexit

Brexit developments

David Page,
Head of Macroeconomic (interim)
Research – Core Investment

Key points

- Parliament appears to have assumed control for this next phase of the Brexit process.
- Having passed a key vote on Tuesday, Parliament yesterday voted to pass a bill to require an extension of Article 50, rather than a no deal Brexit on 31 October.
- Prime Minister Johnson immediately tabled a measure to hold an election on 15 October, but this did not get the required backing.
- We consider an election in the UK over the coming months as now close to an inevitability, but there is more uncertainty over its timing.
- Our central view continues to envisage an extension of Article 50 to deliver a UK election, most likely in November.
- UK financial markets have been volatile in the light of political uncertainty and this looks set to continue over the coming months. Fading risks of a 31 October no deal Brexit are likely to support sterling and weigh on government bonds.

Last night saw a series of votes that appeared to sketch out the shape of the next phase of the Brexit process. On Tuesday night, Parliament voted by a majority of 27 to seize control of the Parliamentary timetable. Last night saw the fulfilment of this gambit as Parliament voted 327-299 to approve a bill designed to require the government to seek an extension to Article 50 rather than deliver a no deal Brexit on 31 October. The bill states that if no new deal with the EU is secured by 19 October the government should seek an extension to Article 50 from 31 October to 31 January. The bill is prescriptive in how government should write to the EU, retains Parliamentary authority over accepting any alternative date suggested by the EU and provides opportunity to introduce fresh legislation further into the process. However, having passed the Commons, the bill now ascends to the Lords, where its passage is not guaranteed. In an attempt to use up the time before the government prorogues Parliament next week, opponents of the bill in the Lords have tabled 100 amendments, which will each have to be debated and voted upon. Despite passing the commons, the bill could still flounder in the Lords on procedural blocks. Nevertheless, despite this risk, **the government's actions suggest that it believe there is a good chance of the bill coming into law and constraining their ability to deliver Brexit by 31 October**, "do or die" and it is our central expectation.

The government reacted to the apparent unwinding of its Brexit plans by immediately **tabling a measure to hold a general election on 15 October**, fulfilling Prime Minister Johnson's threat from earlier in the week. Such an election would present the Prime Minister with a chance to change the Parliamentary arithmetic, to attend the 17 October EU Summit with fresh domestic support, to overturn any new constraining legislation and resume his plan for an exit on 31 October. This measure achieved a majority in the Commons of 298-56. However, with mass abstentions the vote **did not deliver the two-thirds majority (434 votes) required by the Fixed Term Parliament Act to deliver an early election** at this point. **In the short-term, this appears to leave the government's Brexit plans grounded – legislation looks set to force an extension if no deal is reached and Parliament for now is constraining the government returning to the polls.**

However, the UK government has had a working majority of just one since August and is now in a minority since Prime Minister Johnson expelled 21 Tory MPs that rebelled on Tuesday night. **Such Parliamentary arithmetic makes the prospect of an imminent general election almost an inevitability**. The question remains around the timing. The Liberal Democrats and some independent MPs have suggested that their priority is to avoid a no deal Brexit on 31 October. As such, they have said that they will not back an early election until the UK has secured an extension of Article 50. The Labour position is, as ever, more nuanced. It has stated that it would not support an election until legislation to avoid a no deal is introduced. However, Labour is said to be considering tabling a "vote of no confidence" in the government next week after legislation is passed. This would be subtly different from accepting the governments suggestion of an early election. It would see the current government dissolve with more ignominy than on its own terms (the difference from resigning and being sacked). It would provide an opportunity for a National Unity government to be formed in the following 14-day period, although we think this would be unlikely if legislation to avert no deal had been passed. Most importantly the process would take longer – with the 14-day period between the first and second vote. This would make it **impossible to hold an election before 19 October, the date the government would be required to seek extension of Article 50 from the EU**. To our minds, there are both electoral advantages to the opposition parties in seeing Prime Minister Johnson having to extend Article 50 as well as obvious benefits for the broader economy. As such, **we consider the most likely outcome an extension of Article 50 to allow for a general election in November**. However, as the twists and turns of the last few days suggest, this can change quickly and there is still a risk of a pre-31 October vote.

A number of uncertainties remain over such an outlook. First, as stated the Lords may successfully delay current legislation to avert a no deal – something we will see over the coming days. Second, in an aside to yesterday's voting an amendment appeared to "accidentally" pass on a procedural error. The amendment, tabled by Labour MP Stephen Kinnock, appears to commit the government to using the period of an extension to attempt to pass the final version of the Withdrawal Agreement that previous Prime Minister May agreed after cross-party talks – a vote that was never taken as May's authority quickly crumbled. This amendment may come to nothing in the heat of a general election and still containing the controversial Irish back-stop agreement. However, with more extreme options of no deal and second referendum increasingly gaining momentum, many in Parliament may grasp the opportunity of another chance to compromise their way out of the current impasse. Finally, we must remember that it is the EU that has to *unanimously* agree to extend Article 50, if the UK asks it. An EU diplomat said yesterday "If the UK parliament were to ask for an extension to prevent a no-deal outcome, it would be hard to see how the EU27 could refuse that" and many in the EU have suggested that an extension to allow for further democratic process would be viewed favourably. However, there are obvious inherent risks when considering the incentives of 27 individual countries.

Following developments of the last week, we stick with our central expectation that the UK is most likely to seek an extension of Article 50 to hold a general election most likely in November. Despite legislation discussing a 3-month extension, we think that with a fresh election suggesting the risk of a second referendum, which could not also be held within 3-months, the EU is likely to offer only a longer extension to allow for the possibility of a longer process and avoid excessive uncertainty on EU business. **We consider an extension likely until at least mid-2020**. Beyond that the future of Brexit looks set to be determined by the UK public, first in an election and depending on that outcome, possibly in a second referendum. Both outcomes look difficult to call with any certainty and this further elevation of Brexit uncertainty looks set to continue to weigh on UK economic outlook. **We forecast UK GDP growth at just 1.1% for 2019 and 1.0% for 2020.**

F**inancial markets have been affected by the fast-moving political events of the past week**. Most dramatically gilt yields plummeted from 0.55% last week before announcements of proroguing Parliament to as low as 0.35% on Tuesday. Risks of a receding no deal Brexit have helped yields rise back to 0.49%. Sterling has also been increasingly volatile, dropping below $1.20 against the US dollar – its lowest levels since the 1980s (barring a more recent flash crash episode). Sterling has currently risen by over 2% from these lows and currently trades above $1.20. It has also recovered from the extreme lows against the euro to trade just above £0.90 – although the euro has seen its own volatility with political uncertainty also a feature in the Euro area in recent weeks. **We continue to envisage the fading risk of a no deal 31 October as something that would boost the currency and lift UK yields. However, with political uncertainty set to remain elevated for most of the remainder of this year, sterling asset volatility is likely to remain equally elevated**.

Our Research is available on line:

AXA Investment Managers SA
Tour Majunga – La Défense 9 – 6 place de la Pyramide 92800 Puteaux – France
Registred with the Nanterre Trade and Companies Register under number 393 051 826