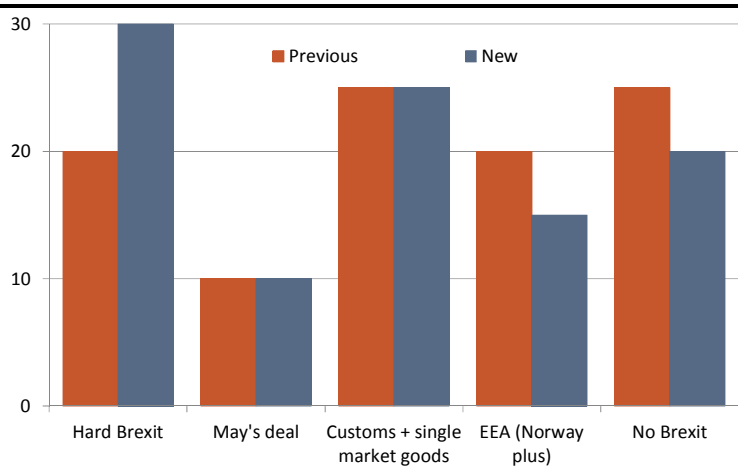


29 January 2019

## Brexit update: parliament flops, hard Brexit risk rises

Potential Brexit outcomes and probabilities (%)



Source: Berenberg

- A major opportunity missed:** Although the clock is ticking, the UK parliament last night failed to move the UK away from the hard-Brexit abyss. None of the key initiatives put forward by pro-EU MPs that would have provided parliament an opportunity stop a hard Brexit and steer the UK towards a softer Brexit outcome or second referendum secured a majority backing. Parliament is badly divided over Brexit. The current political paralysis raises the tail-risk that the UK could crash out of the EU without a deal.
- Risk of a hard Brexit – by accident – has risen sharply:** Although there is a majority in parliament against a hard Brexit – as last night’s symbolic vote on such an outcome demonstrated – that alone is not enough to prevent such an outcome. A hard Brexit is the default option unless a deal or delay is secured before Brexit day on 29 March 2019. With only 58 days left until the UK is due to leave the EU, we raise the risk of a no-deal from 20% to 30%, and lower the probabilities of “Norway plus – soft Brexit” and “no Brexit” – see chart.
- Back to the backstop:** On 15 January, the UK parliament voted down Prime Minister Theresa May’s Brexit deal by an historic margin. For different reasons, both Brexiteers and Remainers in the Conservative Party, in addition to the Northern Irish DUP and the vast majority of opposition MPs, voted against the prime minister’s deal. In a surprise outcome last night, parliament backed a plan to renegotiate the contentious “Irish backstop”.
- Watch Dublin:** On the contentious issue of the backstop guarantee against a hard border in Ireland, the EU is unlikely to relent, in our view. The EU may offer further re-assurances that it does not want to use the backstop. But it would only drop the backstop if the Republic of Ireland were to say that a hard Brexit would be worse than a Brexit deal without a backstop. So far, we see no sign that Dublin, and hence the EU, will blink in what seems to be descending into a game of chicken between the UK and the EU. As a result, parliament is likely to vote down May’s deal again when it comes to the second vote – possibly on or around 14 February.
- Peak uncertainty:** The UK is at serious risk of committing an extraordinary act of economic and political self-harm. With luck, the sheer acuteness of the situation will focus parliamentarians’ minds in the coming weeks. After failing yesterday to grasp a golden opportunity to steer Brexit, we expect the majority of MPs that favour close ties with the EU to have another crack at the whip when it comes to the second vote on May’s deal. That will provide another opportunity for parliament to influence the outcome of Brexit. Still, as yesterday’s votes showed, this could prove to be a reach too far.
- Extension to Article 50 likely:** In any “deal” outcome, the UK will probably need an extension to Article 50 – by a few weeks – to provide the necessary time to ratify the Withdrawal Agreement and future partnership, whatever the details of it may be. In case the UK decided to go for a second referendum, or even a general election, then probably an extension lasting several months would be needed. In any of these scenarios, we would expect the EU to agree to the necessary extension, including any accommodations needed for the May European elections. In our view, however, the EU is unlikely to agree to a lengthy extension for the purpose of simply giving the UK parliament more time to make up its mind. To avoid a hard Brexit, UK parliament must act – quickly!

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