

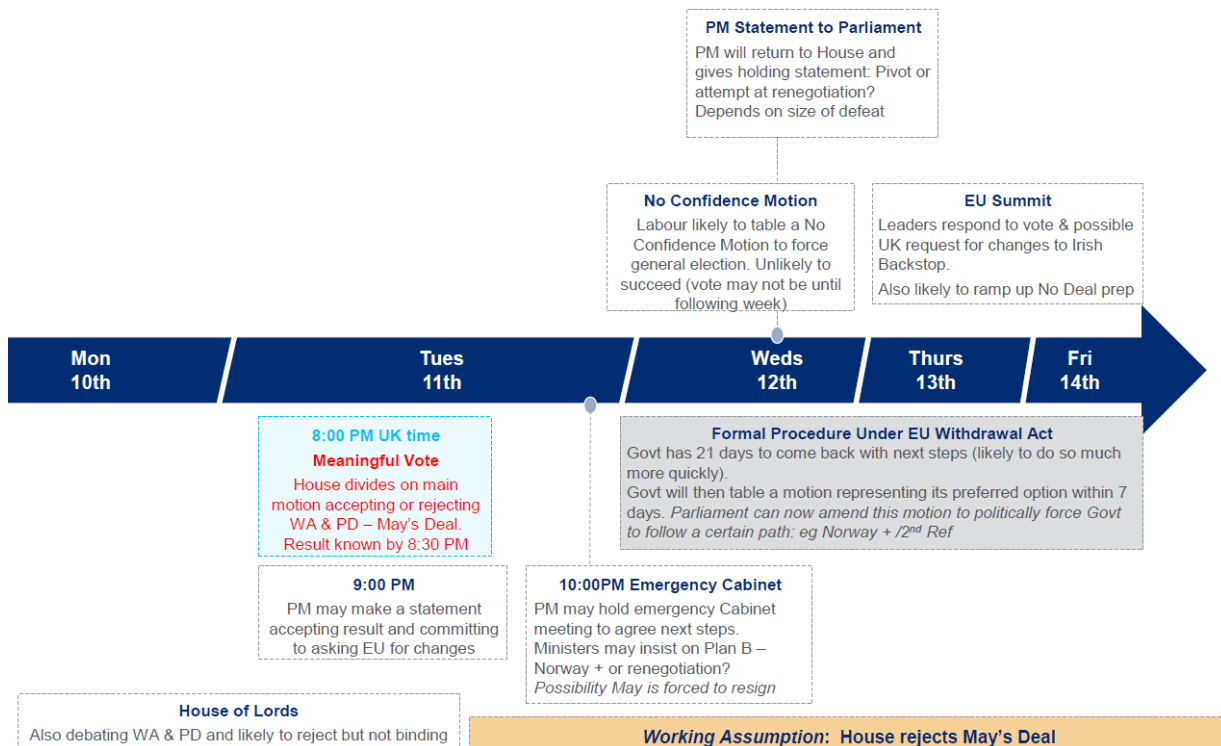
10 DECEMBER 2018

Countdown to the Brexit Vote

The UK's proposed exit from the EU is now at its most critical stage. The two sides have agreement on a 585 page Withdrawal document as well as on a document describing future trading relations. On 11th December the UK's House of Commons votes to ratify both documents of the deal.

- If the deal is ratified then the EU summit on 13th and 14th December is likely to be followed by EU27 ratification (which needs 20 out of the 27 member states ratifying, representing at least 65% of the EU27 population). If this happened then the UK would leave the EU on the proposed terms on 29th March 2019. However if parliament votes against the deal then the possibility of agreeing a deal before 29th March 2019 falls and in addition the possibility of a UK constitutional crisis rises.
- The critical swing MP voters are waverers from the opposition Labour party, who might vote in favour only if they have high confidence that their vote will count towards a win. However, it seems likely that PM May will not have the momentum to attract enough Labour waverers. This is because she probably won't have further certainty from the EU before the vote that the Irish backstop would be unlikely to be needed. So she is likely to lose the vote. The vital question would then be the size of the defeat.

Figure 1: Brexit Vote Timeline



Source: Citi Private Bank. As of 3 December 2018.

Possible best outcome after a narrow Commons defeat

- Defeat by a narrow margin could be enough for PM May to avoid a Conservative party leadership challenge, and if she mobilizes support quickly around an adjusted UK position then she could request an EU renegotiation. The EU could reject this request, but Citi analysts think that would be unlikely as they would lose what they have negotiated. These include the guaranteed rights of EU citizens in the UK and the £39 billion UK divorce payment. In addition within the EU27 there is some support for the deal, for example from the Benelux countries. Were the EU to accept a renegotiation, its most likely that they would be disinclined to renegotiate the (legally binding) Withdrawal document, however they might be more flexible with the (non legally binding) future trade arrangement.

Impact of “No Deal” scenario

- The Government estimates that if the UK crashed out the EU on 29th March 2019 without a deal, then the impact on the economy could be between 7.7% and 9.3% over the next 15 years, with the range dependent on how far net EU immigration was reduced. The Bank of England has warned that the UK would enter a worse recession than in 2009, with unemployment rising to 7.5% and house prices falling by nearly one-third. While this seems highly uncertain, the UK has only very recently started preparing for a No Deal scenario. Whatever the actual impact there would be significant disruption and uncertainty in the UK at least in the short term.
- While No Deal is not Citi's base case, there are several political scenarios that could potentially lead to No Deal, all starting with a large House of Commons defeat for PM May on 11th December. PM May could then face the choice of either resigning on a no-confidence motion or calling a general election (which would need a least a two-third majority in the House of Commons), or she could face a Conservative leadership contest. With any of these scenarios the resulting political turmoil could raise the further prospect of a second referendum. A second referendum might need EU agreement on an Article 50 extension. Regarding a possible referendum question there seems to be some support for three choices (Yes to the current deal, No to the current deal, Remain).

Market Implications

- Even on a best-case political outcome over the next few weeks, there will be tough EU negotiations during the transition period regarding future trade, and details of this could be particularly important.
- Citi analysts expect high volatility near term, especially in Sterling, which recently reached a 3-year high in volatility at 13.3%. Citi analysts believe that UK equities have short-term vulnerability, and it's too early to position for the long-term.

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