

UK Parliament votes on revised Brexit deal

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Brexit deal agreed, but will it pass in a House of Commons vote?

Boris Johnson has finally secured a deal with European leaders over the UK's exit from the European Union, but the Brexit saga is far from over.

Optimism that a revised deal could be imminent has triggered a sharp upward move in sterling in the past week. The UK currency experienced its largest two-day rally since June 2016 on Thursday and Friday of last week, extending its gains for the past seven days to approximately 5% yesterday (Figure 1).

Figure 1: GBP/USD & GBP/EUR (09/10/19 - 17/10/19)



The main changes to the new deal concern the Northern Irish 'backstop', which has been scrapped. In return, the UK would accept an internal customs border across the Irish Sea. This amounts to a significant concession from Boris Johnson from Theresa May's position that no such border could be contemplated.

Despite the early levels of optimism surrounding news of a deal, a crucial stumbling block to a smooth and orderly Brexit remains. The renegotiated deal now requires approval within the House of Commons. This is something that Theresa May failed to secure on three separate occasions earlier in the year. MPs will now return to parliament on Saturday in order to first debate on the changes to the withdrawal agreement and then vote on the revised deal.

At the most recent vote in March, May's withdrawal text was rejected by a 58 vote margin. As things stand, we think that Johnson's revised deal has a better chance of passing, but our expectations are that it will still fall short. Following the removal of 21 Tory whips in September, the Conservative Party have lost their majority within the Commons. The Tories coalition partner, the DUP, have sounded less optimistic over the deal, stating that they would be 'unable' to vote for the new proposals. The key to Johnson's success now looks likely to rest on how many Labour rebels he can convince to back his deal. This appears to be a pretty high hurdle given that the Labour Party is now officially rallying behind the idea of holding a fresh referendum.

Following tomorrow's vote, we think that three outcomes to Brexit are now possible:

- 1) **The revised Brexit agreement passes in the House of Commons vote, the UK leaves the European Union on 31st October** - Under such a scenario, the UK would enter into the transition period and the 'no deal' Brexit debate would finally be put to bed. We would expect a sharp rally in the pound against every other currency, with the 1.35 to the dollar mark the first target.
- 2) **The House of Commons vote does not pass, Brexit is extended** - Should the new withdrawal agreement not pass tomorrow, Boris Johnson is still required by law (due to the Benn Act) to ask for a three-month extension to the Brexit deadline to 31st January.

There remains the question as to whether or not the EU would actually accept this request, particularly after Juncker seemingly ruled out the possibility on Thursday. EU leaders have, however, voiced a more conciliatory stance since then. We expect the request to be granted given that it is likely that Juncker's comments were more a ploy to encourage MPs to vote in favour of the deal rather than anything else.

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Under such a scenario, Boris Johnson would no doubt call a general election in the hopes of garnering a majority that would support his deal. Another hung parliament followed by coalition discussions would likely ensue. According to the latest bookmaker odds, the Tories have an implied 75% chance of winning the election and a 40% chance of achieving a majority.

- 3) **The UK leaves the EU on 31st October with no deal in place** - Should the House of Commons vote not pass and the EU reject the UK's request to extend the Brexit deadline, the default remains for the UK to leave the EU without a deal in place at the end of the month. As mentioned above, we think that this is unlikely, although the possibility should not be ruled out. A massive sell-off in GBP would follow, possibly in excess of 10% from current elevated levels.

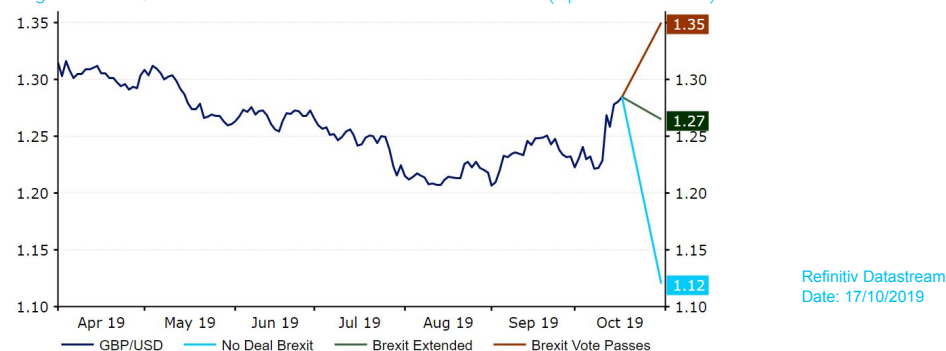
We outline below the aforementioned three scenarios, the probability we would assign to each and the potential market reaction in sterling for each outcome.

Figure 2: Ebury's Brexit Outcome Forecasts

Outcome	Bookmaker Probability	Ebury Probability	GBP/USD	GBP/EUR	EUR/USD
Brexit vote passes	~30%	25%	1.35	1.20	1.13
Brexit extended	~70%	60%	1.27	1.13	1.12
No deal Brexit	~14%	15%	1.10-1.14	1.01-1.04	1.09

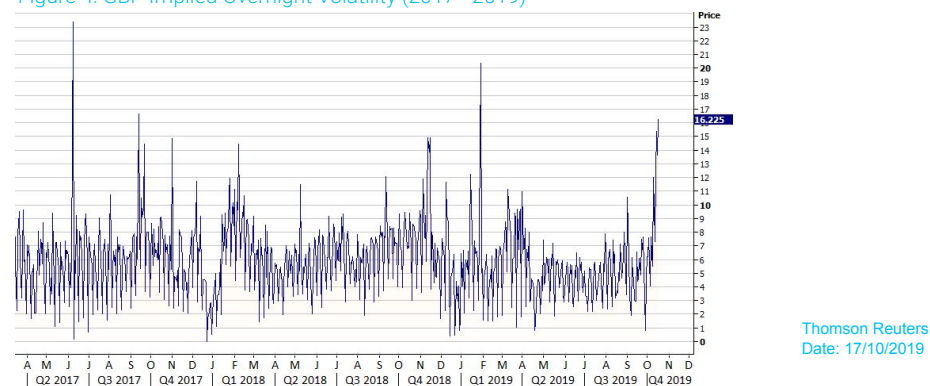
*all forecasts conducted by Ebury's analysts

Figure 3: GBP/USD Short-term Brexit Reaction Forecasts (April '19 - Oct '19)



Unsurprisingly, volatility in the pound has been sky-high in the lead up to Saturday's crucial vote. The measure of overnight volatility in GBP (an indicator of the cost to insure against one-way moves in the pound) reached its highest level since June 2017 at one stage on Thursday, albeit this measure has since fallen slightly at the time of writing (Figure 4).

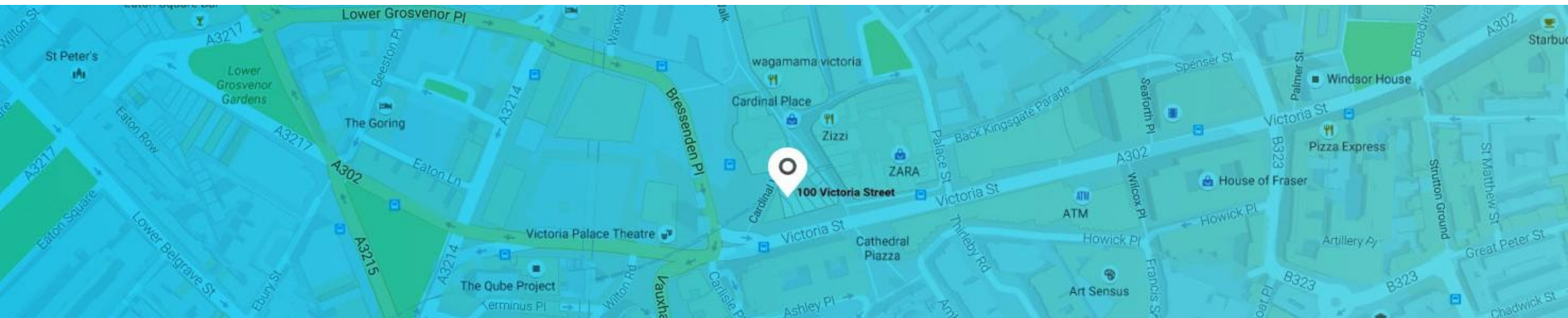
Figure 4: GBP Implied Overnight Volatility (2017 - 2019)



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We expect Friday trading to be more of the same, with moves in the pound likely to remain violent and unpredictable as investors establish positions and put in place trading strategies ahead of the weekend's vote. FX markets are, of course, closed during the weekend, so a frantic Asian trading session starting Sunday night (Monday morning in Asia) is to be expected.

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