

GBP—Light At the End of the Tunnel ?

Yesterday's extra-ordinary events in the UK House of Parliament saw PM May's government defeated in three consecutive votes. The defeats reflected the weak position the government finds itself in now, without the assured support of the minority DUP and with Conservative MPs willing to vote against their own party. The outcome of yesterday's developments does, however, brighten longer run prospects for the GBP somewhat because there now appears to be a realistic chance that parliament could decide that there is an alternative to the unpalatable choices that May's Brexit negotiations have left the country facing.

PM May suffered a series of quite humiliating defeats in the House of Commons yesterday—the first full day of debate on her Brexit plan—which underlined her weakened position, undermined her authority even further and left her government in the unique position of being found in contempt of parliament (regarding its failure to publish the full legal advice given to the government on her Brexit deal).

It was the third vote that is perhaps most consequential for the GBP, however. By an overwhelming majority, MPs voted in favour of an amendment (proposed by one of May's own, Conservative party MPs) which would give parliament more of a say in what happens if—as is widely expected—May's Brexit plan is rejected in next week's parliamentary vote.

Until now, May has been so determined to deliver on her Brexit vision that the only choices offered to the country were 1) the Withdrawal Agreement based on her negotiations with Brussels or 2) a "no deal" Brexit. Yesterday's amendment *might* mean that, for the first time in this process, there are alternatives to those unpalatable choices.

One of the vexing issues of this debate has been the lack of realistic alternatives to government policy despite some difficult truths. Government and Bank of England assessments published last week indicated the UK economy would be relatively (versus the status quo) worse off economically under all Brexit scenarios. It is apparent that the sort of Brexit that was promised by Leave campaigners in 2016 is not the sort of Brexit that can be realistically achieved. And it appears that there is a majority of MPs who—for various reasons—will not support May's deal. Now, however, there is the real prospect of a "less worse" outcome, we think—although just what that is remains hard to determine.

At the very least, we think parliamentary rejection of May's Brexit plan could lead to a softer Brexit (although this is also one argument to suggest that "hard Brexit" MPs who had previously rejected May's deal as too soft might now rally behind her plan). As the "road map" Reuters has drawn up (top right) shows, there is a significant risk to PM May herself in the event of a heavy defeat in next Tuesday's vote (she might either resign or face a no-confidence motion). And we ascribe a fairly low probability to the notion that the EU would be willing to renegotiate (significantly more favourable Brexit terms) in the event of defeat.

That suggests to us that while there may be a heightened degree of short-term uncertainty around the political implications of rejection (i.e. May's future and perhaps speculation of a general election even), the more likely Brexit scenarios now tilt towards either :- 1) a softer Brexit (we think the EU would be more amenable to a "do-over" on talks that keeps the UK closer to the EU. 2) Brexit delayed indefinitely or Article 50 cancelled outright. 3) A new referendum. Or 4) A whole new policy under a new government.

Uncertainties remain. The political backdrop will remain messy. Labour continues to flag in the polls—despite May's handling of the Brexit talks—which rather suggests that Labour leader Corbyn will not necessarily want to force an election. Tory

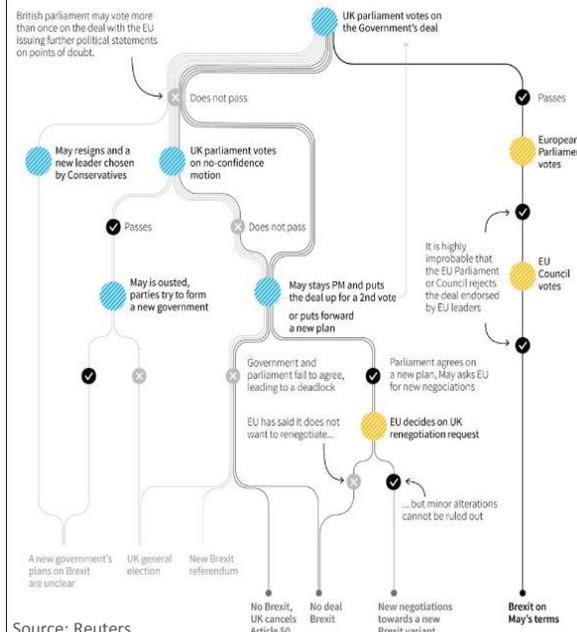
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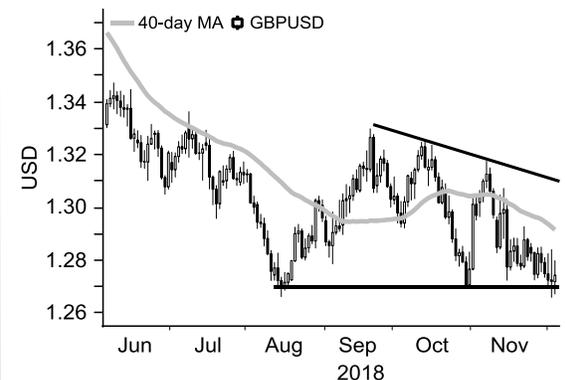
Brexit deal maze

British parliament votes on December 11 on the deal Prime Minister Theresa May struck with the European Union. Here are some of the possible scenarios for the deal:



Source; Reuters

GBPUSD Rebounds from Key Support



Source: Macrobond, Scotiabank FICC Strategy

infighting in the event of a leadership battle is liable to be spectacular but the party might be able to settle on a compromise interim leader to try and move the party towards a consensus. But the real consequence of this week's developments is that MPs now at least have a real choice about the future and the electorate will perhaps expect them to vote with their conscience and the national interest in mind.

The odds of a soft Brexit or no Brexit at all remain hard to quantify but have definitely improved, in our opinion, over the last 24 hours. If that is indeed the case, we think the GBP may be at—or at least close to—a low. Cable rallied in response to the developments yesterday and, for a third time since August, bargain hunters have been active in and around the 1.27 area. It is starting to look—tentatively—as if the pound has seen the worst.

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