

Brexit Monitor

The real test is the vote in the House of Commons

According to media reports, PM Theresa May and the EU have reached a (technical) agreement on the UK's withdrawal from the EU. The market responded accordingly by strengthening the GBP and EUR/GBP fell to 0.866 but later recovered back above 0.87. We had not expected PM Theresa May would be able to pull it off this week given she has been under heavy fire from all sides of British politics, so this is a positive development. **We still do not know the exact content of the deal but, according to media reports, the backstop will be UK-wide although Northern Ireland has to stay aligned with most EU single-market rules.**

The UK Cabinet will meet today at 15:00 CET to discuss the draft text and whether it can support it or not. Also, the EU ambassadors meet with the EU's chief negotiator Michel Barnier to have a look at the text. **While we think it is smooth sailing for the EU to agree on the text, it is more difficult to say how the UK Cabinet will react.** Many ministers have been very clear that they cannot say yes to a withdrawal agreement where the UK is not able to leave the EU customs union unilaterally (see *The Guardian* for a full list of which ministers may resign over the deal). They fear such an arrangement would leave the UK inside the customs union forever, making them unable to make free trade deals with other countries. Media reports suggest that the deal includes a review/exit mechanism but not the details of how it looks. It will also be interesting to see whether the deal includes an option to extend the transition period beyond 31 December 2020, an idea which was floated last month. We also do not know at this point whether the deal includes a 'backstop to the backstop' (EU's demand), which, however, seems likely if the UK is, in one way or another, to leave the UK-wide backstop. As we mentioned in our latest *Brexit monitor*, this is also the impression one gets from the letter PM Theresa May sent last week to DUP leader Foster.

If both the UK Cabinet and the EU say yes to the deal, the EU will most likely call for an extraordinary Brexit summit later this month (25 November has been suggested), where the EU leaders will give their approval. However, as we argued in the previous monitor, **we think the real test was not whether PM Theresa May could sign a deal with the EU, but whether it can pass the UK House of Commons.** We have to listen closely to statements from different political parties (and not least different wings of the parties) and top politicians. Leading Brexiteer Boris Johnson has already said he will vote against the deal, as he argues it will make the UK a vassel state, see *Daily Mail*. Jacob Regg-Moss has done the same. Brexit hardliners voting against the deal are probably at least 25 persons but could easily be more. In a *letter (Twitter)*, the DUP's leader Arlene Foster has stated the deal will weaken the Union and is not in the national interest.

The fact that we do not know the responses from the UK Cabinet, EU leaders and not least whether a majority in the House of Commons can support the deal explains why the GBP strengthening was only to a limited extent. This also means that the renewed Brexit optimism may fade again in the very near term, sending EUR/GBP higher. GBP is likely set to stay volatile.

Key dates

Today (14 November): UK Cabinet meets to discuss Brexit deal at 3pm. Will the Cabinet support the deal?

25 November: Extraordinary EU summit on Brexit. Deal to be signed (assuming Cabinet says yes)

10 December: Possible date before House of Commons vote on Brexit agreement

13-14 December: EU summit

20 December to 7 January: House of Commons recess due to Christmas

Key questions

What does the backstop look like?
Can the UK leave the Customs Union unilaterally?

Can Theresa May's Cabinet support the deal?

Will EU politicians/leaders support the deal?

Will the deal survive a vote in the House of Commons? Can PM Theresa May persuade the Labour MPs to vote in favour of the deal?

What about the political declaration on the future relationship?

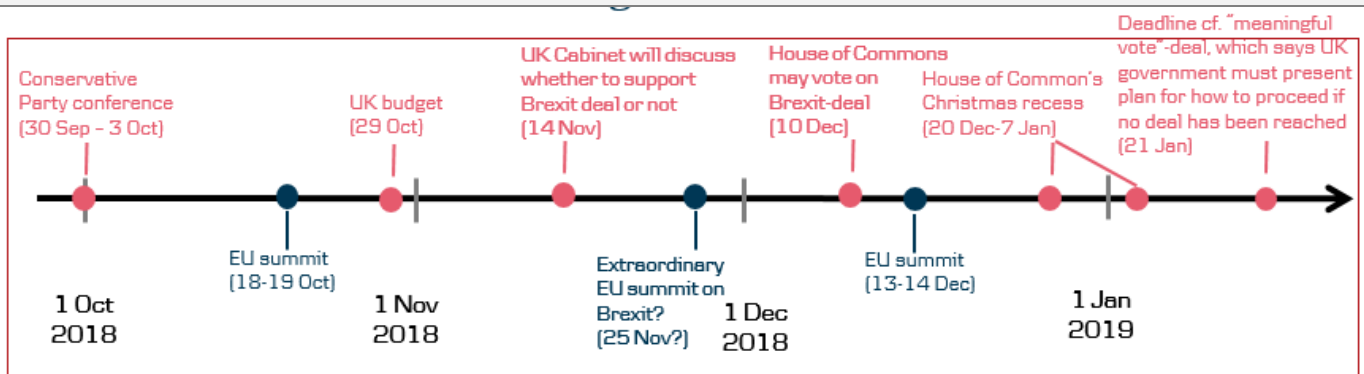
Senior Analyst
Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.dk

Besides the support from moderate Conservatives, PM Theresa May probably needs support from Labour MPs to pass the deal. The question is whether she can persuade enough of them? Every vote counts and the best strategy is probably what PM Theresa May has already tried to do: telling the hard Brexiteers that by not voting in favour of the deal it may very well end up that Brexit never happens at all and telling the remainers and soft Brexiteers that the alternative is the bad 'no deal' Brexit scenario. The Conservative Chief Whip has said he is "confident" there will be a majority in the House of Commons. Most political analysts are having a hard time seeing the deal getting through the House of Commons at the moment, but let's see in the next couple of weeks whether momentum may shift. **The date for the vote in the House of Commons has been suggested to be 10 December, assuming the Cabinet gives its approval.**

When we get more clarification that there is support for the deal – and again, most importantly whether it has support in the House of Commons – the GBP should appreciate more. We forecast EUR/GBP in 0.84 in 3M. For more, see *Corporate Hedger: Strong November could turn to cold December for GBP*, 13 November.

Another interesting thing to look out for is the political declaration on the future relationship, which we have not heard much about due to the discussions on the backstop. How concrete and precise is it? Or are the details limited? Or have they not really started discussing the future framework? **The more vague and weak the political declaration is, the more difficult it will be to sell the Brexit deal to the lawmakers.** The problem is that while the withdrawal agreement will be hundreds of pages, the political declaration will probably be very short. The negotiations will continue during the transition period running from 30 March 2019 to 31 December 2020. If no permanent agreement is found, the backstop proposal will come into force. The problem is that two years is not a long time to negotiate despite that the UK and the EU would start from a different starting point than other negotiations, as everything is already aligned to begin with.

Brexit timetable - Brexit-clock is ticking



Source: Danske Bank

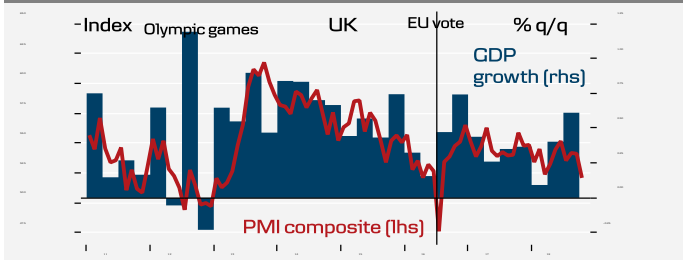
Macro charts

Zero GDP growth in August and September



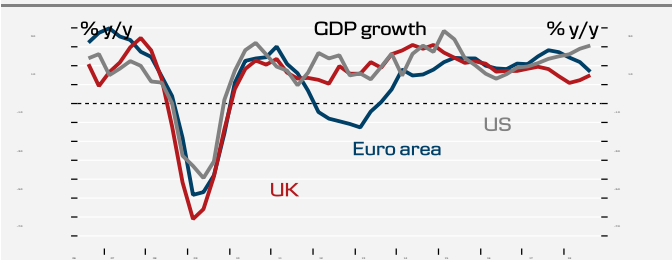
Source: ONS, Macrobond Financial

PMI composite suggests growth had a weak start to Q4



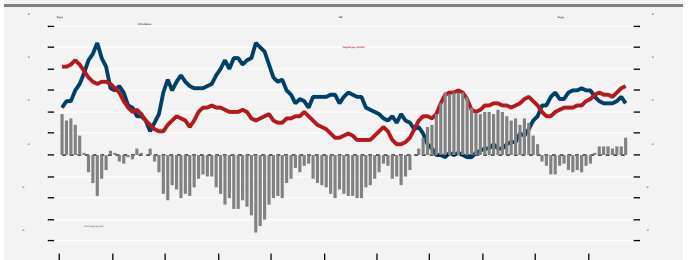
Source: ONS, Markit Economics, Macrobond Financial

GDP growth still slower than in the rest of the world



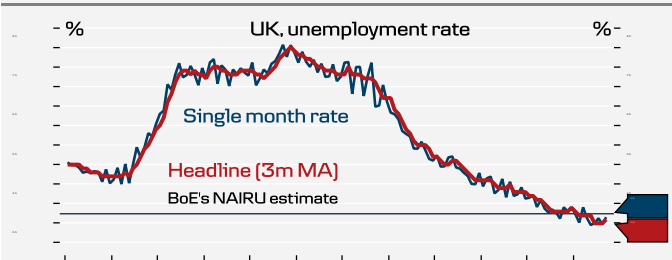
Source: ONS, Eurostat, BEA, Danske Bank calculations, Macrobond Financial

Real wage growth still subdued



Source: ONS, Danske Bank, Macrobond Financial

Unemployment rate ticked higher to 4.1% in September



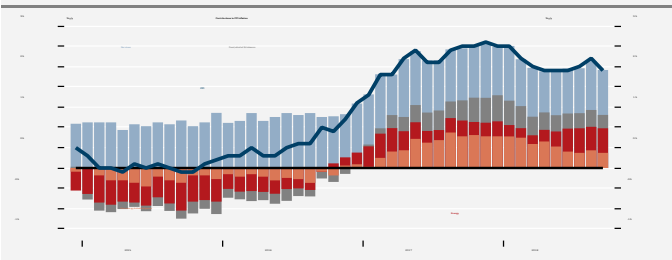
Source: ONS, Bank of England, Macrobond Financial

Probably still some slack left in the labour market



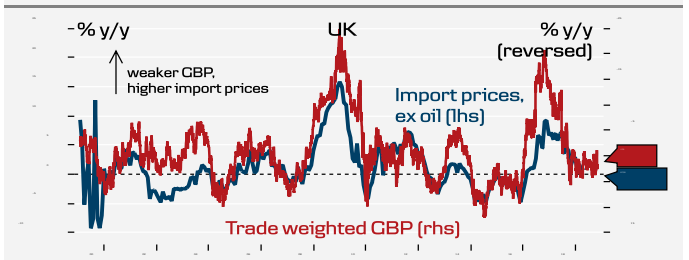
Source: ONS, Macrobond Financial

CPI inflation is set to move down gradually...



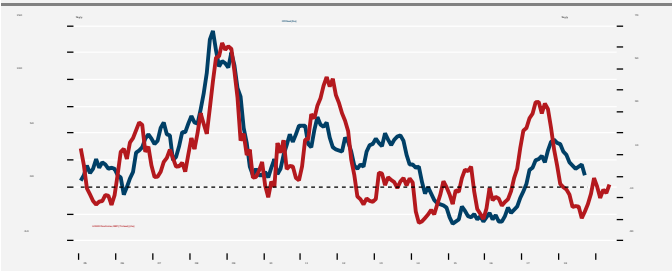
Source: ONS, Danske Bank, Macrobond Financial

...as import price inflation has peaked



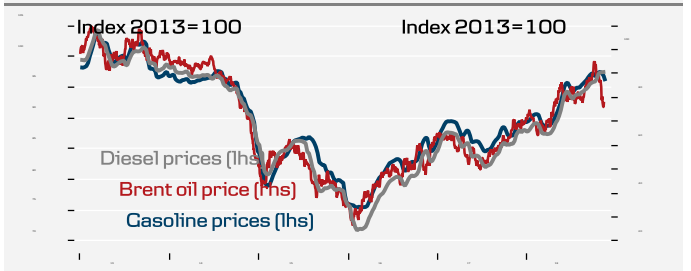
Source: ONS, Bank of England, Macrobond Financial

Food price inflation has peaked



Source: ONS, Bloomberg, Macrobond Financial

Oil price increases since the bottom in 2016 have also driven headline inflation higher



Source: Bloomberg, UK government, Macrobond Financial

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Mikael Olai Milhøj, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issues covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research report has been prepared by Danske Bank (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided herein.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/A, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Report completed: 13 November 2018, 23:03 CEST

Report first disseminated: 14 November 2018, 06:30 CEST