

Brexit Monitor

“See you in October”

Key takeaways

- The EU has granted an extension to 31 October and some EU leaders already appear open to the possibility of a further extension if needed.
- Near term, we monitor the response in the UK. The Conservative backbenchers want to get rid of Theresa May.
- Look out for local elections on 2 May and European elections on 23 May. Mood for snap election is low.
- No signs of imminent breakthrough in cross-party talks.
- We expect EUR/GBP will remain in the 0.85-0.87 range for now. Markets likely to focus on other things than Brexit now.
- Extension not only for the better from an economic perspective.

And now back to the UK...

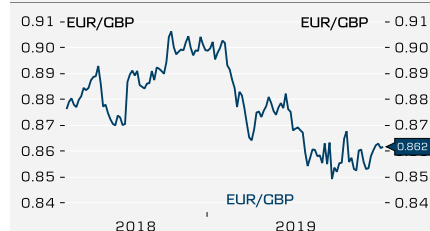
After a very long meeting last night, EU leaders decided to grant the UK a "medium" extension to 31 October (including taking stock in June). While a majority of the EU leaders wanted a long extension of 9-12 months, French President Macron played hard ball and argued for a much shorter extension. The extension is conditional on no reopening of the withdrawal agreement, participation in European elections and "sincere cooperation". The UK government has accepted the offer, meaning that the new Brexit day is now officially 31 October and the agreement does not need approval in the House of Commons (EU law is above British law). After the EU summit, German Chancellor Merkel sounded open to the possibility of a further extension.

Now, we will monitor the British politicians' reaction. While Conservative Party rules say there cannot be another no confidence vote in May's party leadership until December, the leaders of the Conservative backbenchers (the so-called 1922 committee) decided yesterday they will try to persuade May to quit soon. A bad local election on 2 May or bad European elections on 23 May may be what is needed to force Theresa May out. The problem is, however, that there is no obvious successor and a leadership contest may take up a lot of energy and time. May has no intention of stepping down.

It is difficult to predict what is going to happen but as it seems unlikely that the House of Commons will back Theresa May's deal and a breakthrough in the cross-party talks does not seem imminent, it may end up being the case that the EU leaders will have to decide once again in October. Right now, it is our base case but much can happen from here to October, see game tree on page 3.

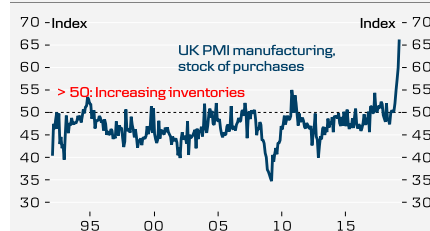
The mood for a snap election is low but cannot be ruled out. While the Prime Minister previously had this nuclear option, the fixed term act means a snap election can only be called if Parliament dissolves itself by a two-thirds majority or the government loses a no confidence vote (and no new government is formed within 14 days). Otherwise, the next election is in 2022. Polls show Labour and Conservatives are neck-and-neck and the Conservatives risk both losing power to Labour and the whole Brexit process (with a higher probability of Brexit being reversed under a Labour government).

EUR/GBP has traded in the range of 0.85-0.87 since late-February



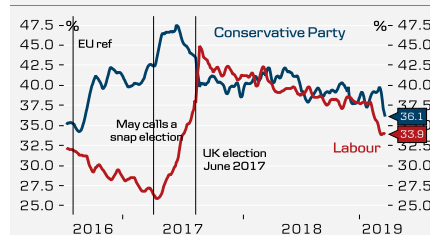
Source: Bloomberg, Macrobond Financial

UK manufacturers are stockpiling due to Brexit fears



Source: IHS Markit, Macrobond Financial

Conservatives and Labour are neck-and-neck



Source: British elects, Macrobond Financial

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

May's deal, permanent customs union or second EU referendum

With respect to the Brexit end-game, we think there are three options from here: May's deal as it is (if the DUP and Brexiteers get so afraid of the extension that they eventually back the deal), May's deal including a permanent customs union (if cross-party talks with Labour succeed, with the risk of splitting the parties) or a second EU referendum (a small majority is now in favour of remaining in the EU, although it is only very slim and uncertainty is high).

A no deal Brexit seems unlikely, as both the UK and EU have blinked, in our view, but of course we cannot rule it out completely. The idea of a soft Brexit (single market or single market and customs union) seems dead after the indicative votes held in the House of Commons.

EUR/GBP to stay in the 0.85-0.87 range near term

EUR/GBP was little changed after the EU leaders decided to grant the UK a medium-long extension to October and, for now, **we think the cross will continue to trade in the 0.85-0.87 range.**

In case of a no deal Brexit, we still expect EUR/GBP to move towards parity. We still expect EUR/GBP to move down to 0.83 if the Withdrawal Agreement passes.

Without the extension to October and with no imminent breakthrough, markets are likely to start focusing on other things than Brexit.

Extension prolongs period with high uncertainty

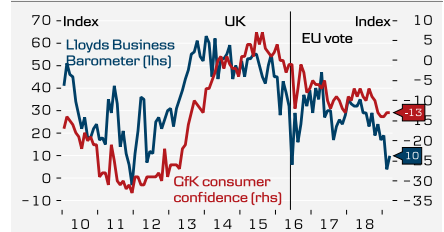
From an economic perspective, a long extension means we avoid a disastrous no deal Brexit tomorrow. However, **the extension is not only for the better**, as the period with high uncertainty for companies is prolonged, which would continue to have damaging effects on the economy. There is much evidence that companies have stockpiled due to no deal Brexit fears. Business investments in the UK fell in all four quarters last year, as companies have postponed or cancelled investment projects. Note also that EU27 companies are referring to Brexit uncertainties as a negative factor in e.g. businesses surveys.

EUR/GBP forecasts

Brexit scenarios	EUR/GBP forecast
Near-term	0.85-0.87
Brexit-deal passes	0.83
Snap election	0.87-0.90
"No deal" Brexit	Towards 1.00
Second referendum	0.82-0.86
- (Brexit is reversed)	Break below 0.80 (0.76-0.80 range)

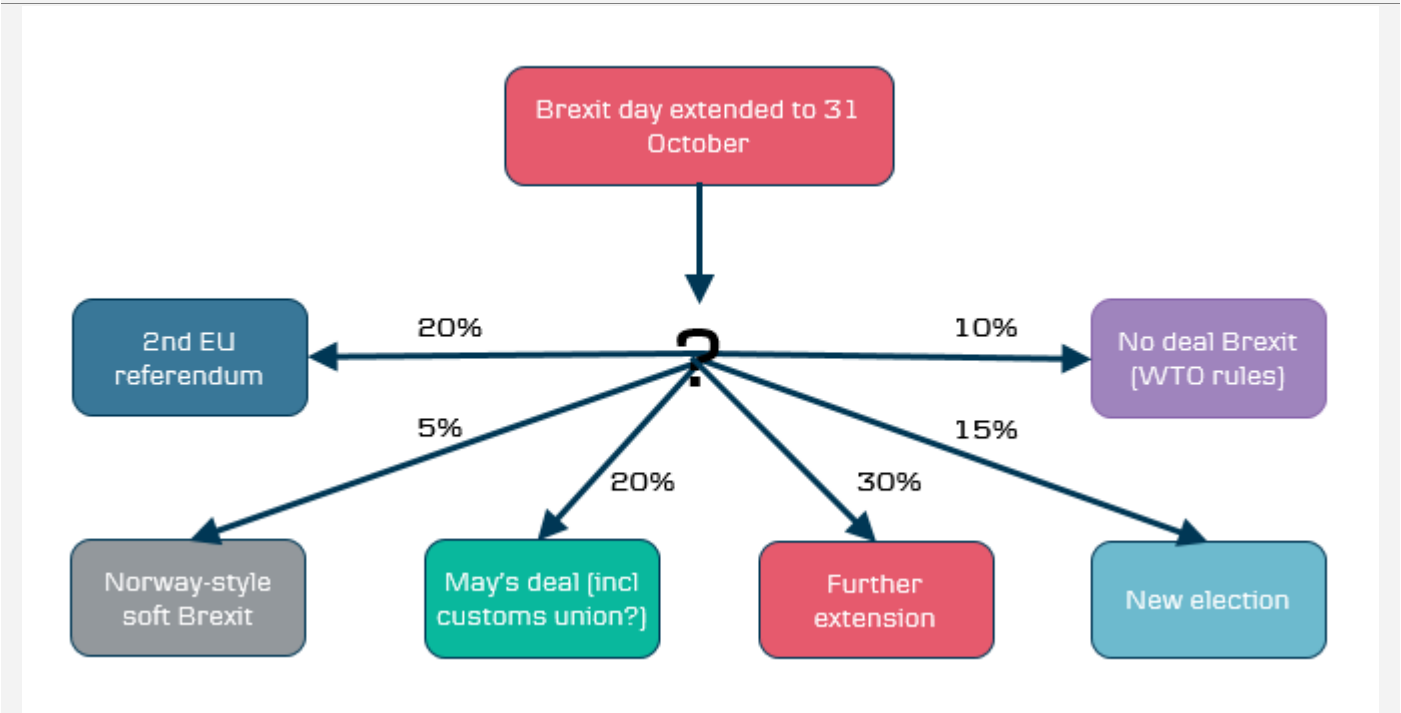
Source: Danske Bank

Business confidence has fallen due to Brexit concerns



Source: GfK, Lloyds Bank, Macrobond Financial

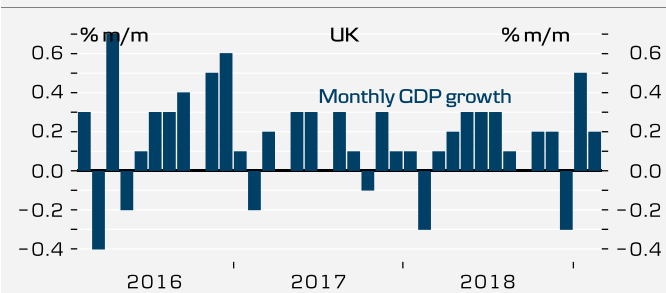
Brexit scenarios



Source: Danske Bank

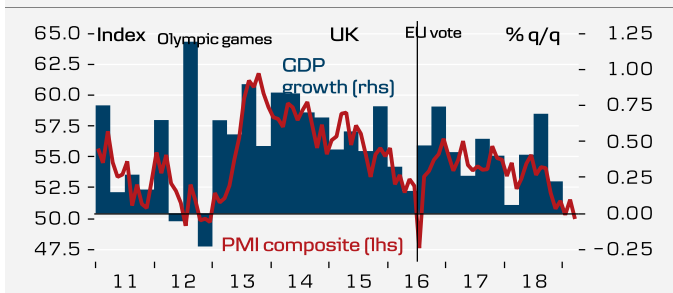
Macro charts

GDP growth in Q1 has been higher than anticipated



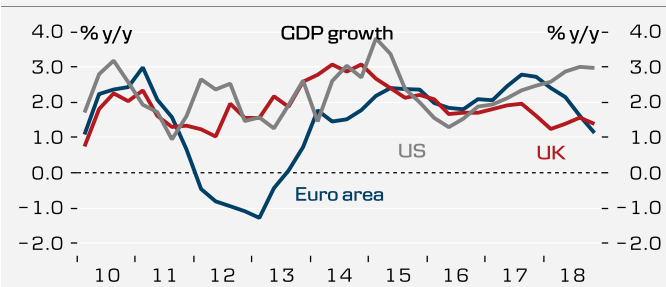
Source: ONS, Macrobond Financial

PMIs are subdued and suggest weak growth



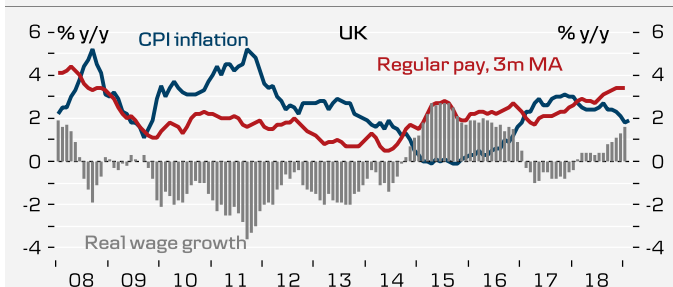
Source: ONS, Markit Economics, Macrobond Financial

GDP growth is stuck at around 1.0-1.5% compared to 2-3% previously



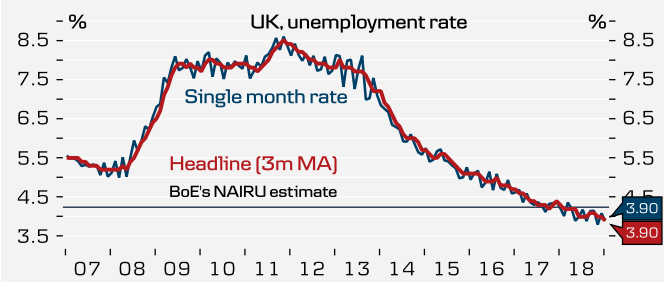
Source: ONS, Eurostat, BEA, Macrobond Financial, Danske Bank calculations

Real wage growth has turned positive again



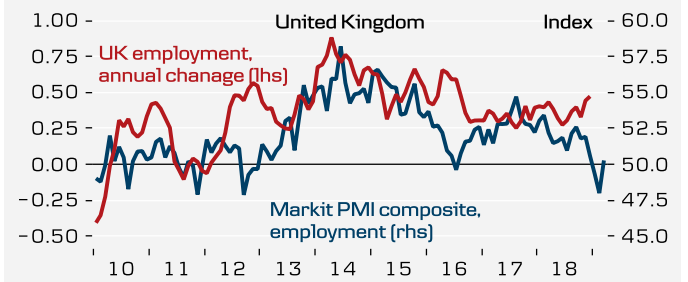
Source: ONS, Macrobond Financial, Danske Bank

Unemployment rate is low



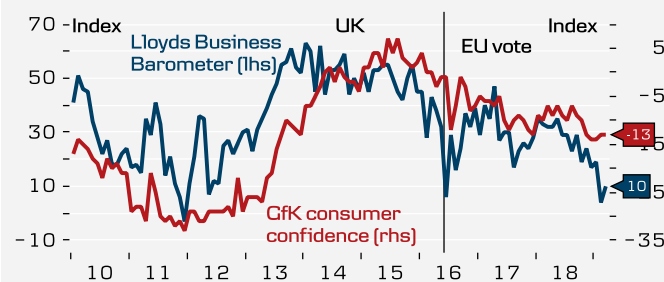
Source: ONS, Bank of England, Macrobond Financial

PMIs signal employment growth is slowing down



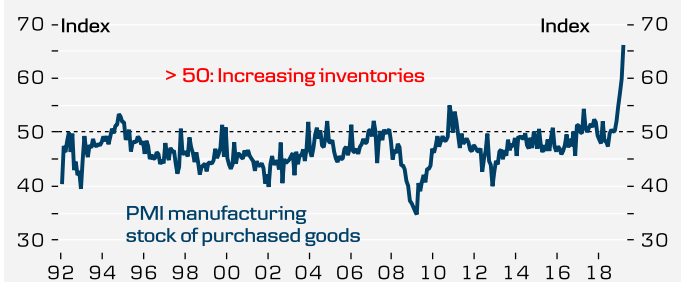
Source: ONS, Macrobond Financial

Business confidence hit by Brexit fears



Source: Lloyd, GfK, Macrobond Financial

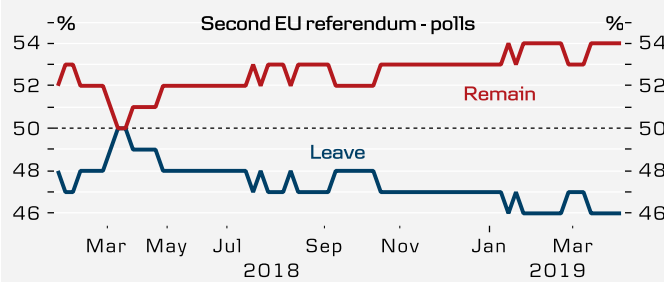
Companies are stockpiling as part of Brexit preparations



Source: IHS Markit, Macrobond Financial

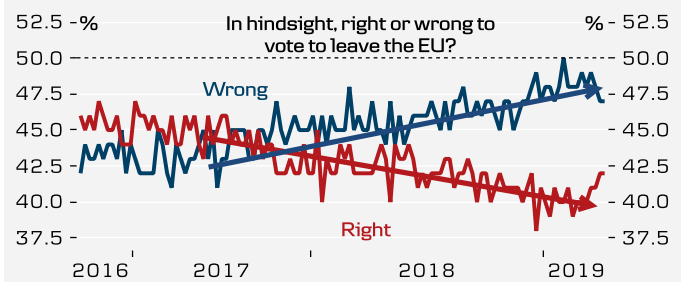
Brexit charts

Small majority now wants to remain in the EU, but still close



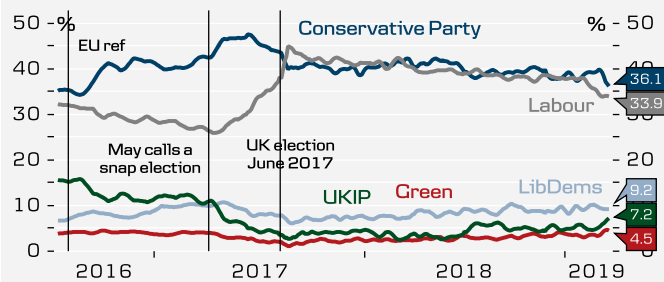
Source: NatCen Social Research, Macrobond Financial

More people think it was wrong to vote to leave the EU



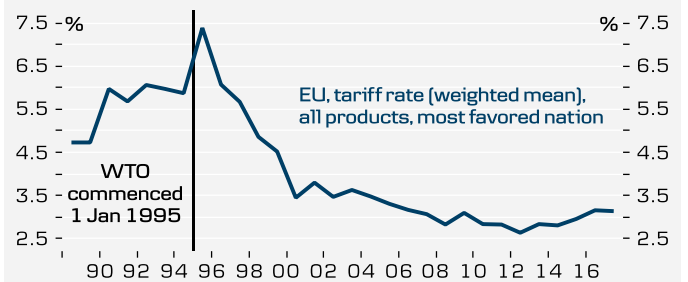
Source: NatCen Social Research, Macrobond Financial

No mood for general elections at this point...



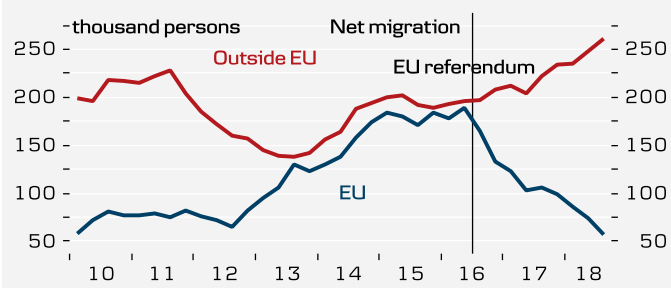
Source: Britain Elects, Macrobond Financial

Tariff rates have declined since WTO came into force



Source: WTO, Macrobond Financial

Net migration from the EU to the UK has declined since the EU referendum



Source: ONS, 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 issuers 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: 11 April 2019, 09:17 CEST

Report first disseminated: 11 April 2019, 10:15 CEST