



Brexit

- The vote on the Brexit agreement negotiated with the EU was crushingly defeated in the House of Commons. Still, a chaotic Brexit is not the most likely outcome, something that the positive reaction of the British pound already indicates. Nothing can be ruled out in the current uncertain environment, and that includes accommodation on the part of the EU. Signs are pointing to an extension of the deadline for Britain's exit beyond March 29. Prime Minister May is likely to seek an agreement that will bring all parties on board. Should she then succeed in bringing about a soft Brexit, the British pound should appreciate noticeably.
- The British pound and the Japanese yen appreciated noticeably. Gains also predominated among the emerging market currencies.
- Helaba Currency Forecasts

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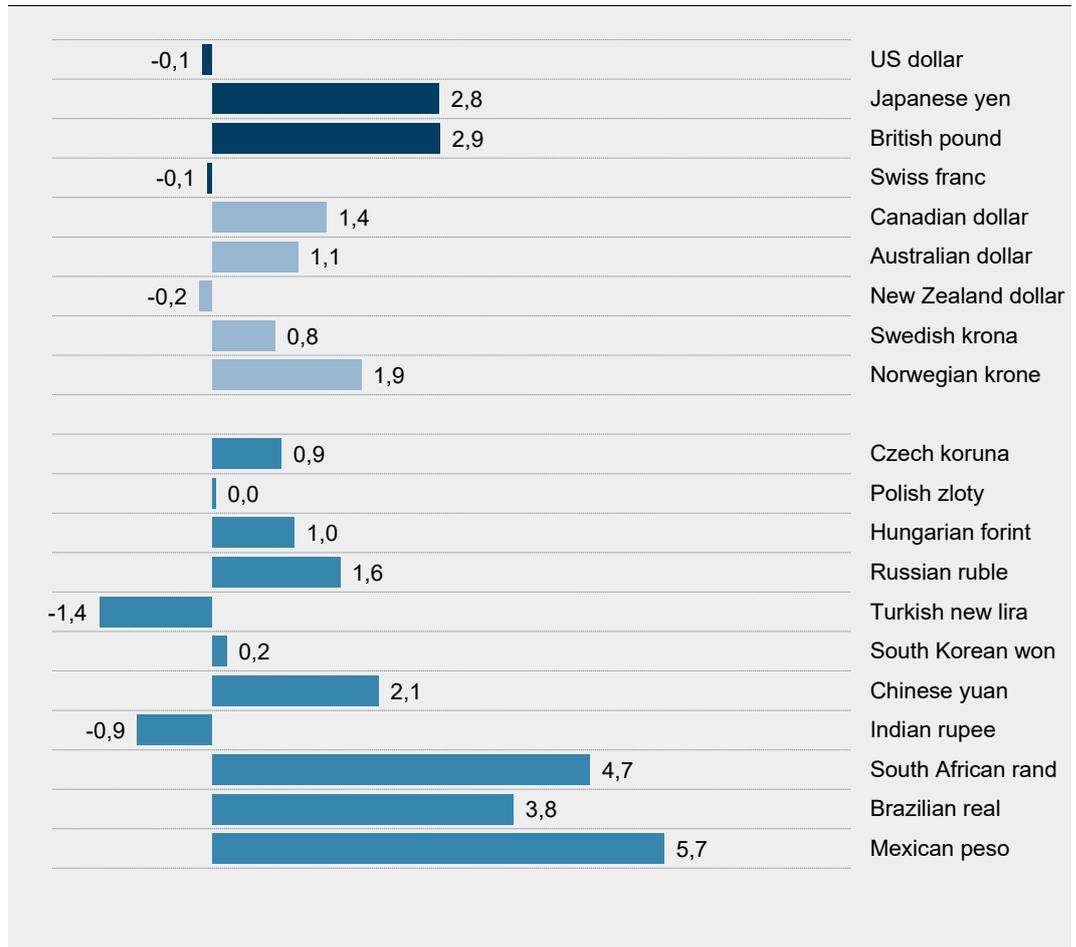
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Performance on a month-over-month basis

% vs. euro compared to the previous month (from 12/19/18 to 01/17/19)



■ Core currencies ■ Rest of G10 ■ Currencies of emerging markets

Sources: Bloomberg, Helaba Research

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GBP: Plan B!?

Mr. Praline: I wish to complain about this parrot what I purchased not half an hour ago from this very boutique.
 Owner: Oh yes, the, uh, the Norwegian Blue...What's,uh...What's wrong with it?
 Mr. Praline: I'll tell you what's wrong with it, my lad. 'E's dead, that's what's wrong with it!
 Owner: No, no, 'e's uh,...he's resting.
 Mr. Praline: Look, matey, I know a dead parrot when I see one, and I'm looking at one right now."

From Monty Python's "Dead Parrot" sketch

The EU withdrawal agreement negotiated by the British government was rejected in the House of Commons by a vote of 432 to 202. This is said to have been the greatest defeat a prime minister has ever suffered in Parliament. A defeat was widely expected. However, the vote was so lopsided that even minor improvements with the help of the EU will hardly turn the tide. The deal is probably as dead as the parrot in the Monty Python sketch – even if not everyone sees it that way.

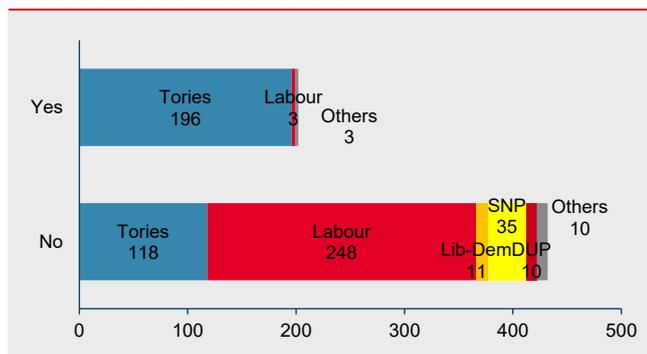
Brexit deal failed, so did vote of no confidence

Still, Prime Minister May remains in office. She survived the vote of no confidence of the opposition in the House of Commons. A voluntary resignation is also out of the question. In doing so, she is clearly showing more toughness than some of the so-called political heavyweights in her Conservative Party, who fled in the face of lesser opposition. New elections are therefore off the table for the time being. But what comes next? If nothing happens by then, the United Kingdom will leave the EU on 29 March 2019 in a disorderly fashion.

Right now, anything seems possible: a "no deal" Brexit, a second referendum, a new deal, a Plan B, a postponement of Britain's departure. The various interest groups are able to find a majority against any solution. None of these possibilities has a realistic chance of getting sufficient support at the moment. Everyone is pushing the deadline until just before the abyss at the end of March and waiting for the other to blink first. The Brexit is thus turning into a "game of chicken". In the James Dean movie "Rebel Without a Cause," that game had a deadly end, however.

May loses Brexit vote by a margin of 230

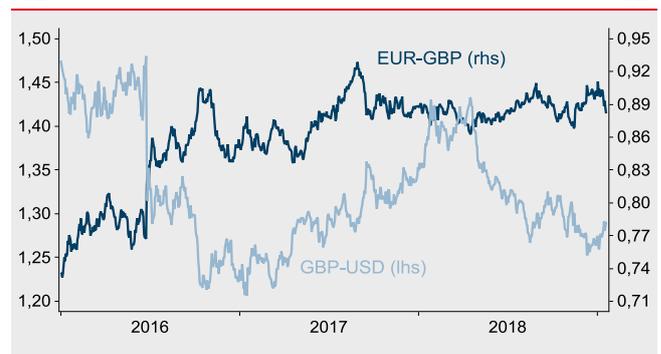
Number of votes in the House of Commons



Sources: BBC, Helaba Research

Pound defies the Brexit chaos

USD GBP



Sources: Macrobond, Helaba Research

"No Deal" scenario undesirable

A clear majority in Parliament wants to prevent a "no deal" Brexit. Only a hard core of Conservative supporters of Brexit prefer that solution. Although parliament is making it more difficult for the government to prepare for it, at least there has been no decision as of yet that would definitely prevent it from doing so. In such a scenario, a customs border would be created between the UK and the EU. The WTO tariffs that would then kick in would be in the single-digit percentage range for many products – with noticeably higher levies on some agricultural goods. The main problem, however, would be customs clearance. It is assumed that the British are not adequately prepared in terms of personnel and spatial capacities and are unlikely to achieve this in the remaining two months. The same probably applies to the EU side. Kilometre-long truck lines would be programmed, the transport of goods would be delayed and supply chains would be endangered.

British bookmakers are already offering bets on which food items would have to be rationed first by the government. There would also be considerable legal uncertainty. For example, licenses for importing medicines and chemicals into the EU would be lacking. Air rights would be in doubt.

In principle, the difficulties of a disordered Brexit can be solved over time. With appropriate cooperation between the United Kingdom and the EU, some problems could be defused with transitional solutions. Customs personnel can be increased and truck parking spaces created. Nevertheless, this would put a heavy strain on the British economy, at least temporarily.

Extending the deadline
of the Brexit

If a "no deal" scenario is to be prevented, there must be another solution. A postponement of the EU withdrawal would give the British time for alternatives or at least for a less disorderly Brexit. A request by the British government to extend the deadline is becoming increasingly likely. The decision about that would be made by the European Council, unanimously. The EU would probably not be obstructionist, even if the British lacked good excuses such as new elections or a new referendum. However, the risk remains that individual countries would block such a move. Another problem is the length of a deadline extension in connection with the elections to the European Parliament from 23 to 26 May. The aim is to avoid the participation of the departing British. But by the beginning of July at the latest, when the parliament is constituted, Britain must have left the EU. Otherwise the parliament would not be legal. That leaves a postponement of the Brexit by two to three months, since later dates would make British participation in the election unavoidable. We believe that such an extension is likely. In theory, the date of withdrawal could even be postponed indefinitely, until the British have forgotten about their decision to leave in their search for an exit. In practice, neither the British nor the EU will have any interest in such a scenario.

Should the British want a new referendum, the EU would hardly be able to refuse to extend the deadline. However, as it would take four to five months to prepare another referendum, such a decision would have to be taken quickly. Uncertainty attaches already to the format of a referendum: would it be a vote between May's unloved deal and the UK staying in the EU? Or a vote between a "no deal" Brexit and staying in the EU? Or as in the 2016 referendum, a vote only to "Remain" or "Leave"? The format of the question alone would have considerable influence on the outcome. According to surveys, the position of remaining in the EU seems to have a slight lead – as it did before the last referendum. In any case, the outcome would be quite uncertain. Even a victory for a "no-deal" Brexit over remaining could not be ruled out.

New referendum
not likely

Without the government there will be no second referendum – even if Parliament were to vote for it. May rejects this, and a large majority of Conservative deputies have a similar view. If in a second referendum a majority votes for remaining in the EU, this could split the party. Most Conservative voters opted for the Brexit and would likely feel betrayed. The British party system could become unstable. Even after a second referendum, the Brexit issue would certainly not be off the table. In any case, it would be questionable how the EU and Britain would deal with each other after the UK cancelled the Brexit. From the EU's point of view, too, the continued presence of an unreliable partner like the United Kingdom would be less than ideal. In spite of a discussion that may flare up, there will probably be no new referendum.

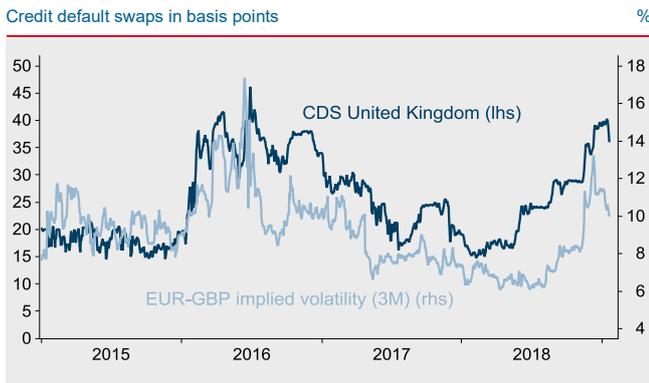
Following a recent parliamentary decision, Theresa May has to present a Plan B to the House of Commons on 21 January. However, it is doubtful whether she will have a workable plan by then. May is now approaching the other parties. However, Corbyn, the leader of the opposition Labour Party, is not yet ready to talk. Theoretically, a rather soft Brexit should find a multi-party majority in parliament, even if a substantial part of May's faction – at least a third – would vote against her. But that was already the case with the Brexit deal vote. May's political survival in office would be doubtful. However, since the end of her term in office is looming anyway, May does not have much to lose. The cooperation by Labour is questionable. In terms of substance, a rather soft Brexit might not be a major hurdle in the Brexit-critical group. However, party tactical behaviour could prevent a concession. Moreover, many in the Labour Party even prefer remaining in the EU to a soft Brexit. But party leader Corbyn sees it differently. Nevertheless, cooperation does not seem unrealistic in the face of the "no deal" abyss.

Customs union
as Plan B?

What could a Plan B look like? Prime Minister May has two red lines. She wants to be able to restrict the free movement of workers and conclude international trade agreements after leaving the EU. The former is not possible with further participation in the EU single market, the latter not within the framework of a customs union. She has to cross at least one of the lines. There will be little support for further unrestricted freedom of movement for workers among supporters of Brexit. Although the British did have an empire, realistically, as a small country in an increasingly protectionist international environment, the British have little to gain. A customs union would therefore not be such a big restriction. While Britain would then have to follow the EU's rules of the game in foreign trade, it is hard to imagine a withdrawal agreement in which the British would have access to the EU market and still have an equal say in product standards. Free trade is not important to the Labour opposition anyway. A customs union would largely solve the problem of the Ireland-Northern Ireland border. In a failed agreement, the whole of Great Britain would remain in the customs union anyway within the framework of the "backstop" clause. The EU could hardly oppose this. There would certainly be requirements from Brussels that go beyond a customs union, but these do not seem insurmountable.

A customs union plus something more would be a Plan B, which could then find a multi-party majority in Parliament and the approval of the EU. For this, however, Prime Minister May and the opposition would have to do something out of character. The prerequisite for a Plan B is probably an extension of the deadline on the part of the EU. The alternatives do not look more realistic. While the danger of a disorderly EU withdrawal has grown after the recent chaos days in London, it is not the most likely scenario. We therefore continue to expect Britain to leave the EU in an orderly fashion, but presumably somewhat later than planned.

Easing concerns in the financial markets



Sources: Macrobond, Helaba Research

Pound sterling undervalued



Sources: Macrobond, Helaba Research

Pound sterling with
chances – and high risks

Not only did the currency market react to recent events in a relaxed manner, it is also becoming more optimistic. The pound sterling appreciated against the Euro and the US Dollar. The euro-pound exchange rate slipped below 0.88 to a two-month low. The implied volatility of exchange rates fell, investors see less need for hedging. If an agreement with the EU and in the British Parliament becomes apparent, the pound will continue to appreciate. The euro-pound exchange rate should fall to 0.85 and later to 0.80. After all, the British currency as a whole is undervalued. The pound-dollar exchange rate could even climb from just under 1.30 to 1.50. The appreciation potential is there, but so are the risks. For now, the Brexit drama is likely to head into overtime.

Helaba Currency Forecasts

	Performance			Forecast horizon at end ...			
	year to date	1 month	current*	Q1/2019	Q2/2019	Q3/2019	Q4/2019
vs. Euro	(vs. Euro, %)						
US dollar	0,7	-0,1	1,14	1,15	1,20	1,20	1,25
Japanese yen	1,1	2,8	124	125	128	128	132
British pound	2,5	2,9	0,88	0,85	0,85	0,80	0,80
Swiss franc	-0,6	-0,1	1,13	1,15	1,15	1,20	1,20
Canadian dollar	3,4	1,4	1,51	1,48	1,52	1,52	1,58
Australian dollar	2,7	1,1	1,58	1,55	1,60	1,58	1,58
Swedish krona	-1,2	0,8	10,27	9,90	9,80	9,60	9,50
Norwegian krone	1,7	1,9	9,74	9,30	9,10	8,90	8,80
Chinese yuan	1,9	2,1	7,72	8,05	8,28	8,28	8,50
vs. US-Dollar	(vs. USD, %)						
Japanese yen	0,4	2,9	109	109	107	107	106
Swiss franc	-1,2	0,0	0,99	1,00	0,96	1,00	0,96
Canadian dollar	2,7	1,5	1,33	1,29	1,27	1,27	1,26
Swedish krona	-1,8	0,9	9,02	8,61	8,17	8,00	7,60
Norwegian krone	1,1	2,0	8,55	8,09	7,58	7,42	7,04
Chinese yuan	1,5	1,7	6,78	7,00	6,90	6,90	6,80
US-Dollar vs. ...	(vs. USD, %)						
British pound	1,8	3,0	1,30	1,35	1,41	1,50	1,56
Australian dollar	2,0	1,2	0,72	0,74	0,75	0,76	0,79

*17.01.2019

Sources: Bloomberg, Helaba Research ■