
Weekly Market Flash

Theresa May and the Turkeys

November 21, 2018

It's not Thanksgiving week over in London, but British prime minister Theresa May is likely in a mood to give thanks anyway. The object of May's thankfulness would be the spectacle of hardline Eurosceptics in her own Tory party, led by the decidedly odd duo of Boris Johnson and Jacob Rees-Mogg, doing their best impression of a rafter of turkeys cluelessly scampering this way and that in a ham-fisted effort to unseat the PM and torpedo the much-unloved Brexit deal she is trying to sell to Parliament.

A Comedy of Errors

The tragi-comical mess that is Brexit has percolated in and out of the news since the referendum nearly two and a half years ago produced the shocking (at the time, not so much any more) decision to quit the EU. With the Article 50 deadline of March 2019 looming, the recent headlines have been decidedly unkind to just about anyone involved with the negotiation process, most of all from the UK side. Concerns about the potential global impact of a no-deal crash-out from the EU have joined other festering concerns – about tech stocks, interest rates, China and others – to keep market sentiment on the side of risk-off. As we write this, the S&P 500 is hovering just at the technical correction threshold of a 10 percent decline from its last high (reached on September 20). If the May government collapses in the coming weeks, which is not a zero-probability event, then confidence may be shaken further still.

Under the frothy headlines, though, there is at least a case to make that the worst outcome will be avoided. Amid all else going on in the world right now, we think it is worth one's time to understand where things currently stand on Brexit and why they might not be quite as dire as they seem – why, in other words, Theresa May might truly be in a thankful mood.

The Artlessness of the Deal

Exceedingly few kind words, to be sure, have been penned about the deal currently up for approval. A “rotten prawn” opined British journalist Quentin Letts in a recent [Washington Post opinion](#) piece (the piece is also notable for likening PM May to an “Atlantic mollusk” in a way that was actually meant as a compliment). The deal keeps the UK in a threadbare customs union with the EU that at once displeases Remainers (stuck in limbo is worse than being part of the EU) and Leavers (stuck in limbo is worse than the clean break that was voted for in 2016). It gives discretion to Brussels over future decisions about the very contentious and seemingly intractable issue of the Northern Ireland border. In the minds of not a few observers it is nothing short of a transfer of decision-making power on a great many issues from the British Parliament to the European Commission.

The Worst Option, Except for All the Others

Rotten prawn though it may be, the May deal has gained some important sources of support including Bank of England head Mark Carney, leaders in the UK business community and establishment media organs such as the Financial Times and Economist. The common theme being that, as bad as this deal may be, it is infinitely preferable to an abrupt ejection from the EU next March with no Plan B. The real-world implications of a hard, no-deal Brexit have not, in any meaningful way, been manifestly evident to date. The pound sterling today is just 15 percent weaker versus the US dollar than it was right before the

Brexit vote happened. The FTSE 100 stock index has gained about 10 percent since June 2016 – much less than the S&P 500, say, but still positive. Headline macroeconomic numbers from jobs to inflation and GDP have also held up reasonably well – again, not going gangbusters but neither going into recession.

A hard Brexit, many believe, would be the end of these relative good times and the beginning of something much worse. The Bank of England plans to back up its support for the May deal next week with a more detailed assessment of the economic consequences of an abrupt Brexit crash-out. Paramount in the minds of those supporting the deal is the transition period it provides – anywhere from two to four years – after Article 50 kicks in next March for both sides to work out a detailed agreement for trade and economic cooperation. Wait, you say, wasn't that what they were supposed to be doing for the last two years? Fair point – but an "extended transition period" is actually what the EU does best – it kicks the can down the road to be fixed at some future date. Meanwhile, businesses and investors at least have the assurance of continuity for a measurable period of time.

Vox Populi, Redux?

There is a certain cunning logic to that kick-the-can trick in the EU playbook: things can change, maybe to the extent that a final decision on Brexit will never be made. Currently there is quite a bit of chatter in Britain about a so-called "People's Vote" (good marketing!) that would effectively revisit the entire premise of Brexit. Voters in this scenario would have three options: choose the May deal currently on the table, choose a hard Brexit along the lines of what Johnson, Rees-Mogg and the rest of the Tory turkeys claim to want (the details of which are, to be charitable, foggy), or choose...to stay in the EU. While the notion of a second referendum has been bandied about since the immediate aftermath of the first one, this People's Vote idea seems to have quite a bit of cross-over support from erstwhile Leavers and Remainers. According to at least one recent poll on the topic, the cohort preferring to remain in the EU was 54 percent. Recall that in the original vote 48 percent supported Remain, 52 percent were for Leave.

So could the whole unseemly mess just go away, like a bad dream that finally dissipates with morning's light? That would not necessarily be the way to bet, nor would it solve the very real, very partisan divide among Britons about their place in Europe and the world at large. Sadly, we are too far down the road of populism and blinkered, tribal nation-first thinking in too many parts of the world for that toothpaste to go back into the tube. But there are three possible, practical alternatives in front of the UK today. Of the three, one would very likely deliver a great deal of economic pain within a very short period of time. Either of the other two would be far more palatable – and could helpfully reassure global markets that the world's humans have not yet completely gone off their rockers.

We wish all of you and your families a very happy Thanksgiving.

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