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BREXIT: ONE STEP FORWARD, ONE STEP BACK

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SIT TIGHT FOR NOW
The new twist in the Brexit tale does not change our key calls for the final outcome: We still see a 75% chance of an orderly Brexit eventually, with a 15% probability the UK remains in the EU and a 10% risk of a hard Brexit. However, Brexit will now most likely be delayed beyond Halloween. Uncertainty will weigh on the economy for longer.

What happened? Last night UK Prime Minister Boris Johnson won support for his Brexit deal 'in principle' (329 for: 299 against). He has managed what his predecessor Theresa May could not - to get the House of Commons to at least begin the process of legislating for an orderly Brexit. That is progress, of a sort. But some thirty minutes later, the Commons voted against the government's proposed accelerated timetable that would have enabled a Halloween Brexit - as currently planned (308 for: 322 against). Reacting to the defeat, Johnson announced that his legislation would be put on pause until the EU responds to the UK's pending request for a further Brexit delay until 31 January 2020 (see below). Before the key votes, Johnson has said that he would push for an election if MPs rejected his proposed legislative timetable.

One of two things will happen next
1) The PM tries again in the coming days to get MPs to back an accelerated timetable for his legislation. He may hope that the Brexit weary opposition MPs in pro-Brexit constituencies will help him get his deal through parliament soon. The alternative for them is an election in which they could be unseated by Brexit Party or Conservative Party candidates. 19 Labour MPs backed Johnson on the first vote last. The UK could still leave by early or mid-November after a short "technical" extension.

2) The PM pulls his Brexit legislation and pushes on for an election. The House of Commons has twice rejected Johnson's calls for an election. It may do it a third time. Johnson would require a two-thirds Commons majority vote for an election. If he can not manage that, he may be forced to call a vote of confidence in his own government. This route requires a simple majority to get to an election. But there are several steps. If the government loses a confidence vote, MPs will get two weeks to try and form a new government. As the Lib Dems and Conservative rebels have said they will not back Labour leader Jeremy Corbyn, even as an interim PM, the chance of a new government emerging from that two week period is very low, in our view. Once the 14 days are up, the confidence vote is repeated. If the government loses again then elections are triggered. Roughly six weeks are needed to hold elections in the UK. With a Brexit deal in his hand, Johnson would likely do well in a snap election. An orderly Brexit at the end of January 2020 would therefore be the most likely outcome of a snap election, in our view.

THE EU ANGLE: BREXIT EXTENSION OR FLEXTENSION
Once again, Brexit limbo in the UK puts the EU into a position that it does not relish. If the UK now suspends the ratification of Boris Johnson's Brexit deal, the EU decision whether to grant a short or long Brexit extension could be a key factor shaping political events in the UK: a short extension of two to four weeks would merely give the UK time to – probably - ratify the current deal, a long extension of 3-6 months could pave the way for new elections and/or a new referendum in the UK.

The EU wants to avoid a hard Brexit, end the Brexit uncertainty as fast as possible, and - if possible - lend some support to those in the UK who want to maintain close ties with the EU. The EU has accepted Johnson's unsigned letter as a genuine request for another Brexit extension. The EU's first response, namely to wait and see whether the UK may still pass the Brexit deal in time for an orderly Brexit on 31 October, no longer seems to be an option.

Exasperated by the twists and turns of the Brexit saga and keen to get over with it, many in the EU would like to force the UK to finally make up its mind fast. The economic damage caused by uncertainty strengthens the case for no more than a short extension. However, those in the UK who want to stay close to the EU are by and large also the ones who want a long extension.

The easiest for the EU would be to simply grant the extension to 31 January 2020, as the UK has requested. However, EU leaders may also take their cue from the first extensions in March and April: it could make sense for the EU to first give the UK a short extension of two to four weeks to potentially ratify the deal. If this has not happened by a certain deadline, Brexit would automatically be extended again, possibly for six months or at least until 31 January 2020, as the UK has requested. Any extension could be made flexible by allowing the UK to leave the EU earlier if and when the UK has finally made up its mind.

Of course, opinions about a potential extension differ within the EU, as they did in March and April. France reportedly wants to grant at most a brief technical extension, Germany and most EU diplomats seem to favour a longer time horizon. EU Council President Donald Tusk is reportedly proposing that the EU should accept the UK request for an extension. He is reportedly in favour of a flexible extension until 31 January. This seems to be the most likely outcome. Tusk's consultations with EU leaders are starting in earnest today.

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