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SUPREME COURT BACKS PARLIAMENTARY VOTE - HARD BREXIT RISK FALLS

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Supreme Court ruling nudges the Brexit pendulum slightly towards a softer Brexit. Since a majority of MPs are pro-EU, anything that raises the influence of parliament on the Brexit process boosts the prospects of a less hard exit from the EU. Today's 8-3 vote by the 11 Supreme Court judges, backing the High Court ruling that parliament must take a vote on triggering Article 50, is a positive for the long-term UK economic outlook. By damaging trade, migration and investment with the EU, its biggest market, Brexit will reduce the UK's long run potential growth rate to 1.8% pa from its current rate of 2.2% in our base case. Today's judgement tilts the risk to our long-term outlook a little to the upside. The Supreme Court also ruled that government will not need the assent of the devolved parliaments of Scotland, Wales and N. Ireland before triggering Article 50.

Three key takeaways from today's ruling: (1) Both the House of Commons and the House of Lords will need to pass a bill before triggering Article 50. May does not have a party majority in the House of Lords and she doesn't have a Brexit majority in the House of Commons. While MPs voted overwhelmingly in favour of sticking to May's self-imposed March deadline to trigger Article 50, MPs will likely nudge government toward a softer Brexit – one that prioritises EU Single Market access over migration controls – to get the bill over the line. (2) That assent in the mostly pro-EU devolved national parliaments is not necessary further removes the risk of delays to the March deadline. (3) Markets would benefit from the additional detail about May's strategy – in particular, her plans for controlling migration. Better understanding of the government's plans for controlling migration is critical to judge the extent to which the EU would offer the UK preferential access to its markets – thereby aiding markets' analysis of the long-term costs of Brexit.

Remember, parliament gets a second say before Brexit: In a speech last week, May announced that she would ask parliament to vote on the final Brexit deal before the UK leaves the EU. But there is a serious question of how valid such a vote would be. Unfortunately for the UK, the two-year deadline and Article 50 process is designed to give the much bigger EU more leverage than the exiting country. Once the UK triggers Article 50 (likely in March) the two-year countdown begins. If the UK doesn't agree to the terms of the post-Brexit deal and likely transitional arrangements then it may suffer a cliff-edge Brexit and find itself trading with the EU on WTO terms. That would be the worst outcome for the economy.

The sterling factor: In our base case, the UK remains the fastest growing major economy in Europe. And with the short-term risks to growth tilted to the upside, that trade-weighted sterling is down 15% since last year seems somewhat excessive. But sterling is clearly heavily influenced by markets' negative sentiment towards Brexit. Despite the good news today, which may prompt a short rally in sterling, the risk of clashes early on in the negotiations between the UK and the EU remains high. And with the Fed set to hike the funds rate three times this year, risks to the sterling outlook are tilted to the downside. That cable (GBPUSD) could drop below 1.20 by the middle of the year still seems likely.

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