BREXITINCT horror pushes UK to the brink!

The Brexit vote by the British Parliament rejected Theresa May's Brexit deal by a majority of 230 votes. A no confidence vote is to be held later today which May's Government is expected to ward off with the support of the DUP. The consensus view is that the deal might be defeated or eventuated which has added to near-term volatility.

However, the likelihood of the bear-case occurring, is less than 20% probability. This includes a "no-deal" scenario (most MPs will not tolerate a no-deal Brexit), in which UK will leave the European Union on 29 March 2019 under World Trade Organisation trade rules. In a "bull-case" scenario, the UK could reject BREXIT entirely but that outcome is equally unlikely! The muddle through scenario is to postpone the Brexit date beyond 29 March 2019. If the EU agrees, the "Norway option", or a second referendum, or a left leaning Labour Party winning the no-confidence debate will create further uncertainty, as given the near equal divide across the UK populace between Remainers or Leavers will NOT break the logjam and will solve little or nothing.

The base-case (>50% probability) hopefully, is that an exit agreement will eventually be signed off closer to the deadline but before the end of March 2019. Should the base case eventuate, a GBP rally appears probable, which should benefit SA corporates with exposure to UK earnings, as well as the SA dual-listed stocks. Analysts highlight the outlook for SA stocks with UK exposure in 2019, and their buy preference is for Investec, Quilter, Discovery, Equites, TFG and Altron.

Despite BREXIT's paradigm-changing set of circumstances, employment in the UK is at near record levels and wage growth is proving to be quite healthy. During fiscal 2018, third quarter GDP grew the most in two years, driven by exports (on the back of a weaker pound) and household spending. However, Business spending decreased the most since the pre-2008 crisis, as Brexit uncertainty continues to suppress prospects for robust growth. We remain positive on the undervalued GBP vs USD; target Dollar/Sterling at 1.35/£ and 1.40/£.

EU is potentially heading for a "technical recession" led by an economic slowdown in Germany. Even if a "technical" recession is avoided, this is of limited comfort. The bigger picture is that having slowed sharply last year, Germany's economy is likely to remain weak this year. This slowdown in Germany, coupled with the rejection of the current deal, is even more significant given that the trade links between the UK and Germany are extensive.

The European Central Bank's forecasts for GDP suggest a 1.7% print in 2020 & 2021. This is based on the forecast of an improvement in exports by as much as 100bps over the coming two years. Considering that EU growth has been driven primarily by exports, we expect that the slowdown in Chinese demand, overlaid with the trade war-driven skittishness of purchasing managers across the world, has rendered these estimates optimistic.

On the positive side, unemployment continues to improve, along with a gradual uptick in wage growth in the EU. Political risk and a divergence of the underlying data between core and peripheral Europe, continue to weigh on sentiment and spending. We remain neutral on the EUR vs USD and CHF. Dollar/Euro to end 2019 and 2020 at 1.10/€ and 1.15/€, respectively.

Hopefully this economic background and the rejection by a 230 majority of British Parliamentarians of the current deal will serve as a wakeup call to the EU negotiators to relook the current deal and the Irish “backstop” clause which is clearly the “Lobster Pot” trap which needs to be excised. A further concern for markets is the looming EU elections which compounds uncertainty if the scenario to postpone the Brexit date beyond 29 March 2019 becomes a reality.

Mark Huxter, January 2019