UK election: Conservative win sharpens Brexit focus

The Conservative Party’s general election win may spell certainty for Brexit but it also raises questions over how the government will meet its pre-election public spending promises. Managers from BNY Mellon Investment Management firms consider the likely market impacts of the Conservative majority.

The Conservative Party majority in the UK election, consolidating Boris Johnson’s position as British Prime Minister, spells some certainty for the Brexit question and looks set to boost market confidence, at least in the short-term, according to BNY Mellon Investment Management commentators.

Mellon chief economist and macro strategist, Vincent Reinhart, says: “A Conservative Party general election win represents victories for Boris Johnson, proponents of exiting the EU and much maligned-pollsters. The latter correctly predicted the Conservative win, giving financial markets a head start in pricing in the consequences.

“Important and contentious details to be filled in Johnson’s Brexit deal subsequently include bilateral trade deals to replace those covered by the EU ones, especially with the EU. Even with these issues obscuring the outlook, investors are likely to be more receptive to risk taking and to look more favourably at the exchange value of the pound. Investor confidence should be also buoyed by the certainty an assertive Labour government is not in place to reregulate all and nationalize some industries.”

Beyond Brexit and a potential boost in market confidence, however, the election win will also drive new focus on Conservative manifesto spending commitments, as the party pledged a £3bn increase in day-to-day spending.

Spending pledges

With markets digesting the latest news, Newton’s fixed income manager, Howard Cunningham, expects renewed volatility and uncertainty ahead, as he believes question marks remain over both the Brexit negotiations – beyond the much debated withdrawal deal - and wider government spending commitments.

"Under the Conservative plans, current spending and tax revenues are each about £3bn higher than previous budget forecasts with most of the extra tax take coming from canceling a planned further cut in Corporation Tax rates from the next fiscal year,” he says.

“The problem with their approach is that by ruling out any increases in the three main personal taxes (Income Tax, National Insurance and VAT) they have closed off one financing avenue if greater public spending is needed eg. by the UK National Health Service, or if pursuit of a clean break with the EU at the end of 2020 leads to further economic weakness. Extra borrowing would therefore be required to plug the gap.”

“Officials will keep the policy rate on hold until some of the dust settles on the net effect of exit on the balance of aggregate demand and supply. For the former, the lack of clarity about the outlook impedes investment. As for the latter, disruptions in supply chains raise costs and cut output.”

Mellon infrastructure manager, Jim Lydotes, says he believes the election results could prove positive for the UK infrastructure market, given concerns a Labour government might have nationalized some utilities.

“Given where valuations sit today, we do think that the market has (rightly) coalesced around the belief that these assets will not be nationalized, and thus we would not expect an outsized move from traditional water and energy assets with a Conservative Party win,” he adds.

The UK’s departure from the European Union (EU) looks set to be the most pressing issue facing the Johnson administration. During the run up to the election, the Prime Minister underlined his determination to take the UK out of the EU by January 31 in order to ‘Get Brexit done’. Before the election Johnson had promised to bring his previously agreed Brexit deal back to Parliament before Christmas in a bid to leave the EU by the end of January.
Definitions
Gilts – UK government debt
Period of austerity – A period of time when a government is trying to reduce its public spending
Fiscal spending – Spending by a government
Hung parliament – a term used in legislatures under the Westminster system in the UK to describe a situation in which no particular party or pre-existing coalition has an absolute majority of members of parliament.
VAT – Value added tax, a sales tax on goods and services in the UK

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