New UK prime minister sharpens Brexit focus

As Boris Johnson prepares to take over as UK prime minister, Newton fixed income portfolio manager Howard Cunningham considers the likely impacts on gilt and sterling markets and future Brexit negotiations.

Boris Johnson has been elected as the new leader of the UK Conservative Party, beating rival Jeremy Hunt by 92,153 votes to 46,656 votes, and will now replace Theresa May as prime minister of the UK.

The UK’s departure from the European Union (EU) looks set to be the most pressing issue facing the new prime minister. During the leadership contest Johnson underlined his determination to take the UK out of the EU by October 31. He has consistently supported a UK withdrawal from the EU and campaigned strongly for Brexit during the 2016 referendum.

With markets digesting the latest news, Newton’s Howard Cunningham, expects some renewed volatility and uncertainty ahead, as question marks remain over the Brexit terms and negotiations.

“I don’t expect massive market moves after this result because Johnson was the clear favourite and this outcome was largely priced in. However, in our view, some increased volatility in sterling and gilt markets could persist if wider uncertainty over Brexit continues,” he said.

“Johnson’s stated commitment to leaving the EU by October 31 could have a slightly weakening bias for sterling unless he makes some more conciliatory comments on negotiating with the EU, which, at this stage, doesn’t seem likely. The new prime minister faces some difficult choices. While not leaving the EU on October 31, or at all, could be politically damaging for him, a no deal Brexit could also be very economically damaging to the UK.”

Likely impact

Cunningham added: “Looking ahead, we may see more market volatility if the EU refuses to renegotiate the existing UK withdrawal agreement. From a currency perspective, there is scope for sterling to weaken further, though it has already weakened considerably in recent weeks. It is also possible it could match some of the lows it hit just after the EU referendum in 2016 if there is no sign of movement from either side in any further withdrawal negotiations.”

Despite this outlook, Cunningham believes a recent fall in gilt yields owes less to ongoing Brexit moves than wider national and global economic trends. “Gilt yields have dropped in the last few months, in line with a drop in US Treasuries and Bund yields have also dropped significantly over the same period. While Brexit may play a small factor in gilt yield falls, particularly the prospect of a ‘hard’ or no deal Brexit, the key drivers of this trend are economics, slower global growth, lower inflation and more accommodative monetary policy by central banks.”
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