A Volatile Summer Ahead for UK

- Fallout from EU parliamentary elections remains to be seen
- A Conservative Party leadership contest is very likely this summer
- A general election remains a significant risk

With UK politics returning to the fore as a driving force for GBP, it’s worth looking at the current state of play as the EU parliamentary elections approach.

The EU parliamentary elections

- Elections to the European Parliament are scheduled to take place on May 23 in the United Kingdom
- The most recent polling shows the Conservative Party finding it hard to make it even into third place against the Liberal Democrats, with both the Labour Party and the newly-formed Brexit Party seeing greater support, while the Greens are not that far behind in the very latest poll published.

PM Theresa May’s position

- The prospective defeat in the EU elections, coupled with the major losses seen during the local elections earlier this month, has seen the 1922 Committee of backbench Conservative MPs finally pressure Prime Minister Theresa May to set a timetable for her departure.
- The trigger for what happens next will be a vote on the withdrawal agreement bill during
the week starting June 3. The PM has said that if the bill were to pass then she has already said that she will resign. If she loses then reports indicate that she will announce her resignation anyway.

Will the withdrawal bill pass?

• From very early on there had been suggestions that the cross-party talks between the government and Labour Party leadership were unlikely to produce a deal but were, rather, “about providing political cover for both sides”.

• On the morning after the news broke about the PM’s future, Labour leader Jeremy Corbyn announced that the talks had "gone as far as they can". He also said: “However, I should reiterate that, without significant changes, we will continue to oppose the government’s deal as we do not believe it safeguards jobs, living standards and manufacturing industry in Britain.”

• Current expectations are that the bill will not pass when it comes to the vote.

The Conservative Party leadership contest

• The current debate is when the leadership contest must be completed by, with some arguing that it should have concluded before the party conference starting on September 29, while others insist that it should take place as soon as possible.

• A number of senior Conservative are expected to enter the race, including Boris Johnson and Sajid Javid.

A general election?

• Downing Street has reportedly told Conservative MPs that if the withdrawal deal is rejected once again then the UK “will have to choose between a no-deal exit that could risk the unity of the UK, a second EU referendum or an early general election”.

• Ahead of the cross-party talks on finding a common approach to Brexit, the Labour leader Jeremy Corbyn said: "We hold in reserve the right to bring a motion of no-confidence in the government if the government proves it’s incapable of commanding a majority in the House of Commons: time will tell on that”.

How can a general election be triggered in the UK?

• The Fixed-term Parliaments Act of 2011 created a five-year period between general elections. Early elections can therefore only be held in specified circumstances. The first of these is that a motion for an early general election is agreed by at least two-thirds of the whole House or without division (as occurred in 2017). The second is if a motion of no confidence is passed (by a simple majority) in the present government and no alternative government is confirmed by the Commons within 14 days.

• In the last confidence motion brought against the government in mid-January the government won by 325 to 306.

What’s the current situation in Parliament?
• There are 650 elected MPs in the House of Commons. One seat (Peterborough) is currently vacant. The seven Sinn Fein MPs do not take their seats in Parliament and therefore do not vote. The Speaker along with his three deputies (one Conservative and two Labour) by tradition do not vote either).

• There are now 312 active lawmakers on the Conservative benches. In addition there are 10 members of the DUP which supports the government by a confidence and supply agreement.

• The 11 members of the Change UK Party might, at present, vote with the government in a confidence motion. Whether this might change should the Conservative Party change leader and stance towards Brexit, remains to be seen.

• Active Labour lawmakers, combined with MPs from the Scottish National Party, Plaid Cymru, Green Party, Liberal Democrats and the remainder of the independent MPs, number 305.

• A by-election will be held in Peterborough on June 6.

• Based upon these numbers, it would therefore likely take 15 rebel Conservative MPs at most to vote against the government to bring it down. At present there is no indication that a sufficient number would be prepared to do this.

• It is unclear how this picture might change heading into the summer, given the multiple possible events that could shift parliamentary alliances (including the outcome of the EU parliamentary elections, the Conservative leadership contest and the shape of any new approach to Brexit that might emerge).

What is also unknown is the impact a significant result for the newly-formed Brexit Party in the EU parliamentary elections might potentially have.

How might the UK vote in a general election?

• Twelve major opinion polls have been published since the UK local elections in early May. (Opinium, Opinium, YouGov/The Times, ComRes/Brexit Express, Kantar Public, ComRes, Hanbury Strategy, Ipsos MORI, YouGov/The Times, Opinium/The Observer, YouGov and Survation).

• In nine of the polls Labour was between two and nine percentage points ahead of the Conservative Party. The three other polls showed the two parties tied. However, both the newly formed Brexit Party and the Liberal Democrats have been trending higher in recent weeks.

• In both the 2015 election and the 2016 referendum, political betting proved a less than accurate indicator of the outcome.

How do the two most senior Labour politicians describe their politics?

• Labour leader Jeremy Corbyn describes himself as a socialist or democratic socialist. When he was asked in 2015 if he regarded himself as a Marxist he said: “That’s an
interesting question. I haven’t thought about that for a long time. I haven’t really read as much of Marx as I should have done.”

• Shadow Chancellor John McDonnell has spoken in favor of Marxism on a number of occasions. He has also been questioned directly on whether he sees himself as possibly the first Marxist chancellor of the UK.

• Mr. McDonnell has said that his plan is for Labour to establish a Public Ownership Unit to develop legal and financial plans to bring private industries into the state sector, and set out a timetable for action. Further details of the plans for nationalization have emerged in recent days.

• Mr. Corbyn has spoken in favour of “quantitative easing for people”.

The current Labour leadership and markets

• Speaking at a fringe event at the Labour Party conference in 2017, Shadow Chancellor John McDonnell said that a future Labour administration would not be "traditional" and "people want to know we’re ready, and they want to know we’ve got a response to anything that could happen".

He argued that the party must "scenario-plan" for all kinds of potential challenges, "bringing the relevant expertise together at every level to talk through what happens if there is such and such a reaction".

He noted specifically: "What if there is a run on GBP? What happens if there is this concept of capital flight? I don't think there will be, but you never know.” Leader Jeremy Corbyn subsequently endorsed the plan noting: “John is right to look at all these scenarios because if we're going to move into government we need to know what we're going to do”.

And GBP?
• Some sense of the potential impact that the shifting tectonic plates in UK politics may have can be gauged from the fact that GBP has just suffered its worst week in at least six months against the USD, despite the fact that most of what happened in the UK was less than surprising.

• In the run-up to the referendum in 2016 it was possible to see a premium being built into GBP/USD implied volatility to reflect specific date risk from the start of the year. At present there is little to suggest significant amounts of stress in the system with both three-month and six-month ATMF implied volatility at the lower end of their ranges for the past few years.

It’s also noticeable that while there is a positive slope to the premium curve, it is not particularly steep at present (the gap between three-month is around 78 bps, roughly where it was at the start of 2016.)
• Since 1971 there have been 112 months that have registered a 10% or greater y/y decline in GBP against the USD, 55 months that have seen a 10% or greater decline compared to six months earlier and 14 months that saw a 10% or greater decline when compared to three months earlier.

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