Having pointed to a landslide Conservative victory just a few weeks ago, opinion polls have narrowed dramatically and suggest that Jeremy Corbyn could possibly become the UK’s next prime minister. Nonetheless, the UK’s first past the post system (rather than proportional representation) makes translating these ratings into parliamentary seats incredibly difficult. Most election experts still think the Conservatives will win a majority, but the markets’ biggest fear will be a hung parliament, which will create huge uncertainty for the Brexit process. With only 21 months left before the UK leaves the EU the outcome of the election will have huge ramifications for the economy and markets.

What could happen under different election outcomes...

Theresa May victory – size matters

Theresa May has suggested a larger parliamentary majority will boost Britain’s chances of winning a good deal in Brexit negotiations. It won’t make any difference to the EU’s demands of a substantial divorce payment, nor its stance of making sure that they win the best deal possible for their own constituents.

However, a large Conservative majority may help dilute the influence of hard line Brexiteers within the parliamentary party. This could allow May to compromise more during Brexit negotiations, thereby moving away from “hard Brexit”. An interview in the Financial Times suggested she is starting to shift her position, talking more about a 2-3 year transition period and the need to consult business.

Anything much below a 40 seat majority would likely be seen as a failure and could leave her vulnerable and dependent on the hardline Brexit supporting MPs.

Conservative Party. However, a change of strategy at this point and if the parties are not united could lead to an unclear negotiating position. This would make winning a good Brexit deal for the UK more challenging.

There are other broader implications resulting from a minority Labour government. A Scottish independence referendum could come sooner, increasing political risk, and the proposed nationalisation of certain industries would increase national debt.

There are also the issues of higher taxes, more spending, larger deficits, higher inflation and the likelihood of higher bond yields. None of these is a market friendly outcome.

What if May loses?

Last week’s YouGov poll suggested the possibility of a hung parliament whereby the Conservatives fall short of attaining an overall majority. Given talk of a “progressive alliance” between Labour, the Lib Dems, Greens and the regional nationalist parties it would be difficult for the Conservatives to win a confidence vote. Instead, Labour would likely try to form a minority government, getting support from other parties on an issue by issue basis. Nonetheless, this would take time to arrange and eat into valuable Brexit negotiation time.

This outcome could potentially yield a “softer” Brexit, something closer to EEA membership enjoyed by Norway, given all in the alliance want to retain the membership benefits of the single market and are less preoccupied with migration than the

Current state of play shows GBP trading neutral... meaning an election surprise could see a big move

More neutral positioning means greater two-way risks to GBP

Cable showing no real signs of a general election bias

1.30 = GBP/USD short-term fair value

Cable isn’t trading at much of a discount or premium relative to recent episodes of political uncertainty
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