



Kallum Pickering, Senior Economist | Kallum.pickering@berenberg.com | +44 20 3465 2672

MAYDAY MAYDAY – UK ELECTION

Berenberg Macro Flash

At 6:50 am, according to BBC seat predictions, the next parliament looks as such: Conservatives 318 seats, Labour 261 seats, SNP 35 seats, LibDems 13 seats, DUP 10 seats. The parliament has 650 seats with 326 seats needed to win majority.

Hung parliament = political shock: The UK gets weak and wobbly government at the worst possible time, that is, when it has to re-negotiate its position in Europe and the world. The Brexit clock is ticking. After triggering Article 50 (the EU divorce process) back in March, Theresa May undertook the gamble of a general election to further increase her majority, and lost badly. Until parliament gets its act together the UK will be in no position to start serious Brexit talks on 19 June. After the UK wasted the first three months of the two-year divorce period, why should the EU agree to extend the deadline?

Forget about Brexit for a moment: With more seats won for Labour under far-left leader Jeremy Corbyn than in 2015 and 2010, yesterday's vote potentially represents a serious lurch to the left from an economic policy viewpoint. Don't forget, the Conservatives also campaigned on a moderately interventionist platform too. This could put the legacy of Thatcher's pro-growth reforms at risk. If such policies were followed they could compound the damage that Brexit does to UK trend growth (1.5% in case of a hard Brexit, from 2.2% pre-Brexit). This outcome could further add to the risk that service companies may choose to shift some operations from the UK to the EU27 or the US over time.

Will the UK change its mind on Brexit? Maybe but not very likely. With typically around two-thirds of MPs in the House of Commons being pro-EU, the hung parliament introduces a small but not negligible probability of a second referendum. Now that the risks of exit, and the challenges in securing a good deal with the EU are clear, could the UK change its mind on Brexit? Maybe, Labour gains appear to be in areas that voted "remain" in the Brexit referendum.

Can May continue? Theresa May is either out (most likely) or seriously weakened. The result is a major embarrassment for May who called the election just a few weeks ago on the back of a commanding 20+ poll lead. After an unsuccessful election campaign that has managed to both weaken her personal credibility and make far-left Labour leader Corbyn relevant again, May is badly damaged. She will probably be seen as who squandered her party's lead against a virtually unelectable opponent.

Coalition government: In 2010 the Conservatives and the Liberal Democrats shook hands as coalition partners just five days after the election result. But 2017 is not 2010. In 2010 the economy was suffering the aftermath of the financial crisis. The financial crisis, in the end, turned out to be a uniting problem. This time is different. Brexit is a divisive issue. All key parties have been at each others' throats over Brexit. The chance of a consensus forming on key issues, such as migration control, looks slim, but not impossible. The early speculation is that the Conservatives and the pro-Brexit DUP (Democratic Union Party – N. Ireland) could enter a coalition. But with 329 seats between them, the working majority would be very slim. No doubt there will be speculation of another Conservative-Lib Dem government. But the Lib Dems want another referendum on Europe. That would be a tough sell for the Eurosceptics in the Conservative Party.

Near-term economic and market impact: We do not expect a major impact on short-term UK demand growth. Household demand will probably not be affected much. However, amid the added uncertainty, business could



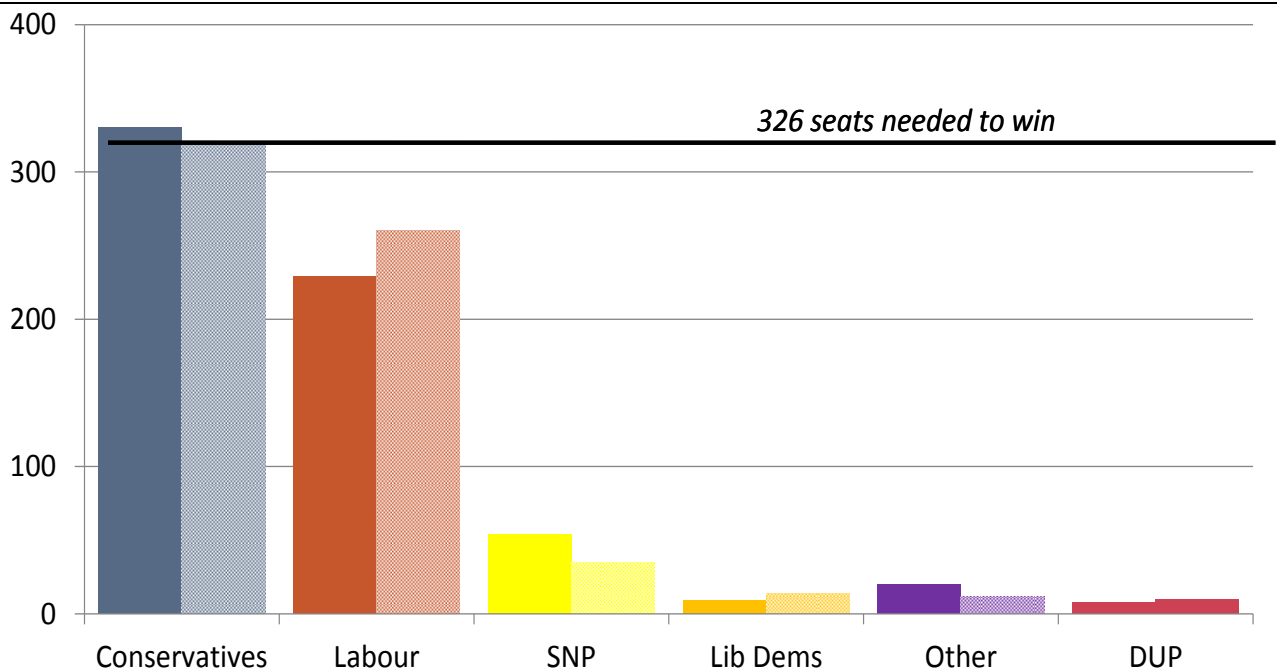
MACRO NEWS

tread more carefully than before when deciding on investment and hiring. The result is negative for UK asset markets, but not dramatically so. It is modestly negative for the sterling exchange rate but we do not expect a large impact beyond an initial knee-jerk reaction. This is not a repeat of the Brexit vote on June 23. Instead, the political uncertainty coming from the result is partly compensated by the small chance that Brexit may not happen and by the hope that UK may opt for a less hard Brexit.

The Scottish question: The probability of Scottish independence has receded for two reasons: 1) the SNP is weakened, the vote will be perceived as a rejection of Scottish independence in Westminster; 2) the Conservatives are weaker, which makes it easier for Scots to stay with a less Tory England and the potential of a softer Brexit.

Another example for populists elsewhere: Two major political upsets in 2016, Brexit vote and Trump, both are now making negative headlines. The sorry fate of the Brexiters and the Conservatives is likely to strengthen pro-EU sentiment on the continent a little further.

Final seat projections (shaded bars) versus seat distribution at the end of the 2015-17 parliament (solid bars)



Source: UK Parliament, BBC



BERENBERG

PARTNERSHIP SINCE 1590

MACRO NEWS

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact capitalmarkets@berenberg.de.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com