Brexit a go after clear Conservative win

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The ruling UK Conservative Party won a large outright majority in Thursday's election, giving Prime Minister Boris Johnson a stable government and mandate to deliver Brexit in January. The pound and domestic-focused UK equities should benefit from greater political certainty after four years of wrangling over leaving the European Union, with bond yields climbing on a brighter growth outlook and expected fiscal stimulus, in our view.

We see the UK entering a period of relative political stability for the first time in a decade. Johnson has political authority and flexibility but faces another difficult Brexit deadline: to negotiate a trade deal with the EU by the end of 2020 when the current Withdrawal Agreement expires. This is a tight timeframe that Johnson has said he sees no reason to extend, with end-2020 serving as another cliff edge leading to a disorderly exit on WTO terms if no deal is in place. We see this as a risk but not our main scenario. Negotiating a trade deal will be difficult and could take many months to play out. Uncertainty could spill over into the second half of next year. Yet if more time is needed to strike a deal, we expect Johnson to find a way of extending the deadline – at least for ratification. A larger parliamentary majority will likely give him a freer hand to negotiate with the EU and make some concessions without materially changing what will be a relatively hard Brexit – leaving the single market and customs union. That should benefit UK goods more than services. The result in Scotland will be a source of tension and up pressure for an independence referendum, but we don't expect this government to grant one.

UK assets should receive a boost, having become a widespread underweight among global investors. We expect to see flows back into UK equity and credit now that some of the Brexit uncertainty has been removed. Domestic-focused UK sectors – such as construction, consumer discretionary, financials, real estate and healthcare – should outperform international counterparts.

The Conservative Party is promising materially higher fiscal spending. We see upward pressure on gilt yields due to shifts in expectations on monetary policy, concerns on fiscal stimulus and an improved growth outlook. While the pound has mostly priced in a Conservative victory, the UK currency could add to its gains on positive economic developments and a broader steadying of trade tensions. A stronger pound could also drag on large UK-listed companies – such as energy companies – with predominantly U.S. dollar revenues, as well as pull breakeven inflation rates lower in the near term.

Medium term, fiscal stimulus will likely help the UK economy recover along with any global pickup. Yet we don't see a return to pre-Brexit growth levels for an economy that has experienced persistently weak growth and higher inflation since the 2016 referendum. The Bank of England (BOE) is likely to keep policy rates on hold, with the government due to nominate a successor to BOE Governor Mark Carney early in 2020. Johnson now has a mandate to implement policies that go beyond the party's cautious manifesto, potentially looking at sizable investment in the National Health Service and infrastructure across the UK. He may remold Conservative Party policy to reflect a broader set of voters, including those from former Labour Party strongholds, with an eye on re-election in five years.

Key views

Prime Minister Boris Johnson can push ahead with Brexit but faces a difficult end-2020 deadline to negotiate a trade deal with the EU. We expect an extension.

We see the pound and domestic-focused UK equities benefiting from greater political certainty, and bond yields rising on a brighter growth outlook.

The UK economy should recover thanks to greater political stability and fiscal stimulus – yet we don't see a return to pre-Brexit growth levels.

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Views from our strategists and portfolio teams

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