

**Market opinion:**

**UK Economy-Security or  
Risk Ahead?**

**Why the markets want stable  
Coalition government:**



The Liberal Democrats have demonstrated over the last five years that they can provide the leadership to deliver the stable government necessary for the economy to flourish, with the UK becoming the fastest growing western economy in 2014.

As we look forward to the policies of the next government it is clear however that both Labour and the Conservatives want to deviate from the strong economic management of the last five years of coalition government. This is borne out by the volatility seen in the sterling and gilt markets over the last 3 months as investor concern grows that a new government will mark a departure from the stable coalition of the last 5 years.

The Conservatives want to lurch to the right, cutting £50bn more than the Liberal Democrats and departing from the balanced approach to deficit reduction that Christine Lagarde commended just last week. The threat of a 'Blukip' Coalition and the Conservative's commitment to holding a de-stabilising referendum on EU membership by 2017 is widely acknowledged in the financial markets to be bad for British business and investment.

In contrast Labour want to lurch to the left by borrowing £70bn more than the Liberal Democrats and threatening the UK's current strong fiscal credibility by refusing to name a date for when they will balance the structural current budget. In doing so they threaten the jobs-rich economic recovery that the Liberal Democrats have overseen in Coalition.

The financial markets in the UK have expressed their displeasure with both Conservative and Labour plans for the UK economy over the next parliament, whether due to Tory plans for an EU referendum, Labour's reckless borrowing, or the threat posed by the SNP.

This document contains evidence from the UK's investment banks, ratings agencies and economists who have all publically stated their concern over Labour and Conservative economic plans.

As a recent report released by AXA wealth management said **"we think markets would react most positively to policies that were closer to the political centre ground"**.

That is why it is so important for the UK economy, that whether it is David Cameron or Ed Miliband who is Prime Minister that the Liberal Democrats are in government to anchor Britain in the centre ground and build a stronger economy and a fairer society, providing opportunity for everyone.

**Danny Alexander**

Published and Promoted by Tim Gordon on behalf of the Liberal Democrats, both at 8-10 Great George Street, Westminster SW1P 3AE

# The threat of departure from stable coalition government...

## 1. Is causing volatility in sterling and gilt (UK government debt) markets

"Last week saw a raft of warnings from analysts at major banks on risks to sterling, with worries over heavier spending and taxes, and regulation of the financial sector by a potential centre-left Labour government top of the list. Risks that Britain will leave the European Union if the ruling Conservatives win are also a worry."

Reuters<sup>i</sup>, 2<sup>nd</sup> March 2015

"You're seeing the first signs that some political risk has been priced into sterling" [as on an interest rate differential basis, sterling should be trading higher]

HSBC<sup>ii</sup>, 30<sup>th</sup> March 2015

"A couple of things suggest the market is starting to get concerned about UK political risk, volatility in dollar-sterling options expiring in 3 months' time is at a 4-year high, and has been steadily rising as we move into UK election season"

Kathleen Brooks, Forex.com<sup>iii</sup>, 2<sup>nd</sup> April 2015

"The data [from gilt auctions] suggests some kind of buyers' strike," ... "This is entirely consistent with the idea that non-resident [investors] may wish to reduce gilt holdings in the face of a very uncertain election"

Nomura<sup>iv</sup>, 9<sup>th</sup> April 2015

"[The UK government 25 year bonds] saw its bid-to-cover ratio — a measure of demand — fall to 1.4. That fell from 1.9 at a previous sale in August [2014]"

Financial Times<sup>v</sup>, 16<sup>th</sup> April 2015

"we see cheapening in 10yr Gilts on asset swap ... incorporates both the fiscal risk premia as well as the political uncertainty"

RBC capital markets<sup>vi</sup>, 5<sup>th</sup> March 2015

"British government is about to become much less stable and predictable ... The extent to which this unsettles financial markets remains to be seen, but the risks feel under-priced"

RBS<sup>vii</sup>, 1<sup>st</sup> April 2015

"Investors seem to have learnt from their experience with the Scottish Referendum back in September, where political risk was largely ignored, ... this time around the market has been acutely aware of political risk."

HSBC<sup>viii</sup>, 14<sup>th</sup> April 2015

# A Labour victory would...

## 1. Reduce UK economic growth by up to 0.6pp costing the UK economy over £10bn

"A Labour government, particularly if supported by the Scottish Nationalists, seems likely to pursue "populist" policies which will entrench the structural problems of the UK and its slow trend growth"

Andrew Smithers, Smithers & Co<sup>ix</sup>, 1<sup>st</sup> January 2015

"A left wing coalition around Labour, would, in our view ... embark on structural changes which could in the medium run reduce the appeal of the UK as a business location and trigger, ultimately, a deterioration in potential GDP growth,"

Bank of America Merrill Lynch<sup>x</sup>, 13<sup>th</sup> February 2015

"Nevertheless, in our bear case scenario, where a minority [Labour] government is dependent on non-traditional parties [SNP] to pass key votes, we see GDP growth slowing to 2.1%Y in 2015, primarily due to uncertainty leading to weaker private sector investment"

Morgan Stanley<sup>xi</sup>, 12<sup>th</sup> April 2015

"Labour's lack of coherent policies (e.g., on the deficit) combined with "bashing the rich" rhetoric is deeply disquieting and can only damage our economic competitiveness"

Ruth Lea, Arbuthnot Securities<sup>xii</sup>, 1<sup>st</sup> January 2015

"Although I don't think that Conservative policies are quite right, I think that insofar as we know what Labour policies are they are even more mistaken."

Mark Wickens, Economist, York University<sup>xiii</sup>, 1<sup>st</sup> January 2015

"Investors are concerned that a Labour government might be unable to deal with Britain's deficit and will slow economic growth, especially if it has to make a deal with the Scottish Nationalist Party."

International Finance Magazine<sup>xiv</sup>, 17<sup>th</sup> April 2015

"...should Labour be returned to power, we face the possibility of Ed Balls potentially becoming Chancellor despite a questionable past track record of presiding over a previous collapse in the UK's finances"

Allianz Global Investors<sup>xv</sup>, April 2015

**Note:** Morgan Stanley estimated that a Labour-SNP coalition could cause UK economic growth to fall to 2.1% from 2.7% in 2015

## **2. Increase interest rates by up to 0.7pp - costing the average household an extra £800 a year in mortgage interest payments**

"One consequence [of a labour led government] could be higher short- and longer-term interest rates"

Deutsche Bank<sup>xvi</sup>, 13<sup>th</sup> April 2015

"[A Labour-led government would make] the Bank Of England more inclined to increase base rates faster than the market currently anticipates"

UBS<sup>xvii</sup>, 8<sup>th</sup> April 2015

"[A Labour government could] result in a rise in inflation expectations and bring forward the timing of interest rate hikes"

Blackrock<sup>xviii</sup>, 8<sup>th</sup> April 2015

"Looser fiscal policy would we think trigger uncertainty about the government's policy framework, and earlier and faster rate normalisation by the MPC"

Morgan Stanley<sup>xix</sup>, 12<sup>th</sup> April 2015

"A likely fiscal relaxation under Labour-led combinations would likely lift short-term activity but see interest rates rise more quickly"

AXA Wealth Management<sup>xx</sup>, 1<sup>st</sup> April 2015

"a Labour-led government is likely to pursue a much looser fiscal policy ... In such an event, we think that the pace of monetary tightening would be faster.

Credit Suisse<sup>xxi</sup>, 2<sup>nd</sup> April 2015

"A Labour victory would, however, be likely to induce some capital flight ..... a lower exchange rate and possibly require a higher Bank Rate for a given inflation target than would be the case otherwise"

David B Smith, Chair of the Shadow MPC<sup>xxii</sup>, September 2014

### **Notes:**

Credit Suisse believe that a Labour-led government would result in the Bank of England base rate being 0.5% higher by the end of 2016

NIESR believe that a Labour-led government would result in the Bank of England base rate being 0.7% higher by 2019

### 3. Negatively affect markets, and cause government borrowing costs (gilt yields) to rise

"The business community may be sceptical that a Labour-led government would deliver market-friendly policies at the micro level in the face of adverse shocks. By contrast, the existing coalition has established some market credibility as a consequence of the stabilisation it has achieved in the UK economy since 2010."

Goldman Sachs<sup>xxiii</sup>, 20<sup>th</sup> April 2015

"Of the potential Labour-led government combinations, financial markets would likely respond more favourably to a Labour/LibDem coalition"

Goldman Sachs<sup>xxiv</sup>, 20<sup>th</sup> April 2015

"The main financial challenge for the new government will be cutting the budget deficit and any backtracking on the pace of this reduction by a Labour government would likely lead to a temporary sell-off in gilts and steepen the yield curve."

Blackrock<sup>xxv</sup>, 8<sup>th</sup> April 2015

"Concerns over budgetary discipline, if left unchecked, could lead to a rise in Gilt yields."

Goldman Sachs<sup>xxvi</sup>, 20<sup>th</sup> April 2015

"A Labour government could see the pound weaken and financial stocks fall in London trading as a result of the City's dim view of Labour and its economic credentials" ... "We could see additional price volatility in UK gilts, with the City seeking safe haven investments should Labour win, at least in the short term, as they digest the consequences for the UK economy."

City Index<sup>xxvii</sup>, 24<sup>th</sup> February 2015

# A Conservative government that risked Brexit would...

## 1. Reduce economic growth and threaten UK credit rating

"In macro terms, an EU referendum under a Tory-led majority would likely have an adverse impact. ... We think markets would react most positively to policies that were closer to the political centre ground."

AXA Wealth Management<sup>xxviii</sup>, 1<sup>st</sup> April 2015

"What might Brexit mean? Again, the outcome is highly uncertain but some possible results could include: a reduction in UK GDP thanks to lower exports to the EU; less direct investment in Britain (most of it comes from Europe); a downgrade in the UK's credit rating..."

Fidelity Investments<sup>xxix</sup>, 13<sup>th</sup> February 2015

"A Conservative-led majority government would raise Brexit risk... [and] We believe that Brexit (if it happens) would be highly damaging for the UK economy"

Citigroup<sup>xxx</sup>, 21<sup>st</sup> April 2015

"We believe that if the UK were to leave the EU, this would weaken the UK's economic prospects, and be a negative factor for the [national credit] rating."

Standard & Poors<sup>xxxi</sup>, 13<sup>th</sup> June 2014

## 2. Threaten UK trade, jobs, and business investment

"the Conservatives' commitment to hold a referendum on EU membership by 2017 and the increased risk of exit would likely be negative for investment spending and UK assets."

Goldman Sachs<sup>xxxii</sup>, 20<sup>th</sup> April 2015

"In particular, the promise of an EU referendum by 2017 ... could have negative consequences for both investment and sterling."

Deutsche Bank<sup>xxxiii</sup>, 13<sup>th</sup> April 2015

"Even if the UK were to vote to stay in the EU, pre-referendum uncertainties probably would cast a shadow over jobs and investment in the UK in the run-up to such a vote"

Citigroup<sup>xxxiv</sup>, 21<sup>st</sup> April 2015

"The Conservative Party in the UK has promised a referendum on EU membership if it is elected; the prospect of this may at the margin crimp international investment in the UK economy."

Barclays<sup>xxxv</sup>, January 2015

"As the EU accounts for around 50 per cent of the UK's goods and 36 per cent of its services exports, a withdrawal from the EU could have negative implications for trade and investment, both ahead of the event and following it."

Moody's<sup>xxxvi</sup>, 9<sup>th</sup> April 2015

"a Conservative-led administration could lead the UK out of the EU, particularly if it has to work with UKIP, and that is a prospect that frightens many investors and businesses."

International Finance Magazine<sup>xxxvii</sup>, 17<sup>th</sup> April 2015

"The Conservative's Achilles heel on the economy is the potential for activity – in investment, in particular – to be postponed because of uncertainty until after an EU referendum in 2017."

RBC Capital Markets<sup>xxxviii</sup>, 5<sup>th</sup> March 2015

### **3. Negatively affect markets, and cause government borrowing costs (gilt yields) to rise**

"...the Tories' pledge to hold a referendum on EU membership ... would be more likely to send the [gilt] yield surging than tumbling"

Capital Economics<sup>xxxix</sup>, 10<sup>th</sup> April 2015

"There will be uncertainty about the composition of the government, or about potential referendums, which might invite some increase in the 'term premium', raising Gilt yields"

Investec Wealth Management<sup>xl</sup>, January 2015

"At that point, [Britain leaving the EU] that would lead to huge turbulence and perhaps the phrase 'the greatest turbulence since the second world war' might be appropriate"

Sir Andrew Cahn, Nomura<sup>xli</sup>, 7<sup>th</sup> April 2015



# However a Liberal Democrat coalition would...

**1. Bring a favourable market reaction - to a party with a record of economic stability, a commitment to the UK's membership of the European Union, and a manifesto that delivers both a fairer society and a stronger economy**

"We think markets would react most positively to policies that were closer to the political centre ground."

AXA Wealth Management<sup>xlii</sup>, 1<sup>st</sup> April 2015

"the existing coalition has established some market credibility as a consequence of the stabilisation it has achieved in the UK economy since 2010."

Goldman Sachs<sup>xliii</sup>, 20<sup>th</sup> April 2015

"The political outcomes that worry the market the most would be outright victories. A Labour victory would bring market worries about a fiscal deficit to the fore, despite Labour's best efforts to allay such concerns. An outright Conservative victory would bring an EU 'in-out' referendum."

HSBC<sup>xliv</sup>, 14<sup>th</sup> April 2015

"In terms of other policy, we see risks to the business environment, whether from a Conservative-led government, which would hold a Brexit referendum in 2017, or from the more interventionist policies of a Labour-led government."

Morgan Stanley<sup>xlv</sup>, 12<sup>th</sup> April 2015

"We have argued previously that either a Labour-led government or a Conservative-led government poses policy risks for the UK economy and markets."

Citigroup<sup>xlvi</sup>, 21<sup>st</sup> April 2015

"Of the potential Labour-led government combinations, financial markets would likely respond more favourably to a Labour/LibDem coalition"

Goldman Sachs<sup>xlvii</sup>, 20<sup>th</sup> April 2015

"Although I don't think that Conservative policies are quite right, I think that insofar as we know what Labour policies are they are even more mistaken."

Mark Wickens, Economist, York University<sup>xlviii</sup>, 1<sup>st</sup> January 2015

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- <sup>i</sup> <http://reut.rs/1K2lh1L>
- <sup>ii</sup> <http://yhoo.it/1Dyzzlb>
- <sup>iii</sup> <http://reut.rs/1DclOT1>
- <sup>iv</sup> <http://bit.ly/1Ng8GgM>
- <sup>v</sup> <http://on.ft.com/1cZKdfy>
- <sup>vi</sup> RBC Capital Markets, "UK General Election Guide: Too close to call", 05/03/2015
- <sup>vii</sup> RBS, "UK Economy", 01/04/2015
- <sup>viii</sup> <http://bit.ly/1CZCcFh>
- <sup>ix</sup> <http://on.ft.com/1GaKoOt>
- <sup>x</sup> <http://bit.ly/1Q9yXfR>
- <sup>xi</sup> <http://mgstn.ly/1GarJm7>
- <sup>xii</sup> <http://on.ft.com/1GaKoOt>
- <sup>xiii</sup> <http://on.ft.com/1GaKoOt>
- <sup>xiv</sup> <http://bit.ly/1D7jC6q>
- <sup>xv</sup> <http://bit.ly/1Eki6Ui>
- <sup>xvi</sup> <http://bit.ly/1aKtV8o>
- <sup>xvii</sup> <http://bit.ly/1Q9EZwY>
- <sup>xviii</sup> <http://bit.ly/1O7Hql8>
- <sup>xix</sup> <http://mgstn.ly/1GarJm7>
- <sup>xx</sup> <http://bit.ly/1HnIOdH>
- <sup>xxi</sup> <http://bit.ly/1yK568b>
- <sup>xxii</sup> <http://bit.ly/1HnJL5T>
- <sup>xxiii</sup> Goldman Sachs, Portfolio Strategy Research, "UK election special", 20/04/2015
- <sup>xxiv</sup> Goldman Sachs, Portfolio Strategy Research, "UK election special", 20/04/2015
- <sup>xxv</sup> <http://bit.ly/1O7Hql8>
- <sup>xxvi</sup> Goldman Sachs, Portfolio Strategy Research, "UK election special", 20/04/2015
- <sup>xxvii</sup> <http://bit.ly/1DdaVHK>
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- <sup>xxix</sup> <http://bit.ly/1O7TtyK>
- <sup>xxx</sup> Citigroup, Global Political Insights, 21/04/2014
- <sup>xxxi</sup> <http://reut.rs/1H89SPw>
- <sup>xxxii</sup> Goldman Sachs, Portfolio Strategy Research, "UK election special", 20/04/2015
- <sup>xxxiii</sup> <http://bit.ly/1aKtV8o>
- <sup>xxxiv</sup> Citigroup, Global Political Insights, 21/04/2014
- <sup>xxxv</sup> <http://bit.ly/1cQxNq7>
- <sup>xxxvi</sup> <http://bit.ly/1OyuiQZ>
- <sup>xxxvii</sup> <http://bit.ly/1D7jC6q>
- <sup>xxxviii</sup> RBC Capital Markets, "UK General Election Guide: Too close to call", 05/03/2015
- <sup>xxxix</sup> Capital Economics, Global Markets Update, "How will Gilts fare following the UK election?" 10/04/2015
- <sup>xl</sup> <http://bit.ly/1IC7kGU>
- <sup>xli</sup> <http://bit.ly/1Gm2orS>
- <sup>xlii</sup> <http://bit.ly/1HnIOdH>
- <sup>xliiii</sup> Goldman Sachs, Portfolio Strategy Research, "UK election special", 20/04/2015
- <sup>xliiv</sup> <http://bit.ly/1CZCcFh>
- <sup>xliv</sup> <http://mgstn.ly/1GarJm7>
- <sup>xlvi</sup> <http://mgstn.ly/1GarJm7>
- <sup>xlvii</sup> Goldman Sachs, Portfolio Strategy Research, "UK election special", 20/04/2015
- <sup>xlviii</sup> <http://on.ft.com/1GaKoOt>

