

## ECONOMIC UPDATE

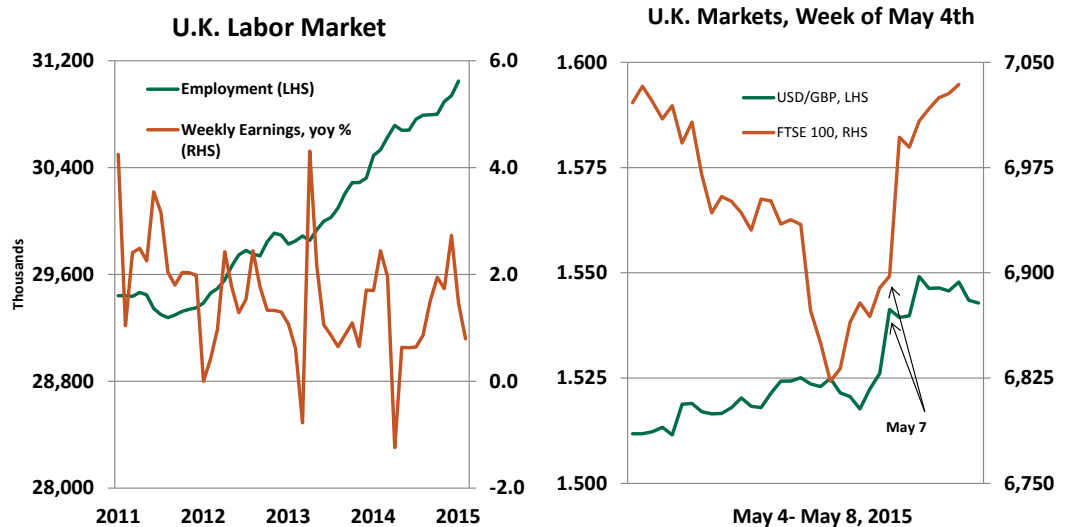
May 8, 2015

- **The U.K. Election Surprises Everyone**

The pollsters got it wrong. Well, not completely – they were right in their prediction that the Scottish National Party (SNP) would sweep to victory in Scotland and the Liberal Democrat vote would collapse. But on the main issue of whether any party would win a majority, they were off the mark.

The Conservatives (Tories) have an outright majority with 331 out of 650 seats; they held 302 seats after the 2010 election. The Labour party holds 232 seats after losing 26 positions. The SNP won 56 out of a possible 59 seats in Scotland, a resounding victory compared with the previous election's lone seat. The Liberal Democrats captured only 8 of the 57 seats they held previously.

The unexpected decisiveness of the outcome will be positive for market and business conditions. The prospect of extended efforts to build coalitions, a hung parliament or more balloting before the end of the year has been a considerable source of uncertainty. As the results became clear, the sterling appreciated by 1.5% against the dollar and more than 2% against the euro. The FTSE 100 is up 2%, with banks and utility companies posting gains on the prospect of a more business friendly environment under the Tories.



Source: Haver Analytics, Thomson Reuters Datastream


David Cameron now faces the challenge of making good on his pre-election promises, some of which he may have expected to be watered down in a coalition. A significant test will be whether he can reduce the deficit and deliver a surplus by 2018/19 without increasing VAT, income tax or National Insurance. Achieving this target will be a challenge as the 2014 budget deficit stands at £102 billion or 5.7% of gross domestic product.

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Indeed, Cameron wants to cut income tax for low earners by raising the minimum threshold. In addition, he has promised to extend the “Right-to-Buy” scheme for social housing tenants, build more affordable housing, and devolve fiscal powers to Scotland and other areas.

In the job market, three million more apprenticeships have been pledged. However job creation has not been an issue in the United Kingdom, partly due to a jump in self-employment. Wage growth, on the other hand, has been sluggish and this, along with productivity, is what needs to be addressed for the economy to really kick into gear.

Further down the line, the spectacular rise of the SNP raises the question of whether a second Scottish independence referendum may be on the table. Nicola Sturgeon has stated this is not a priority; however it has always been a fundamental party policy. This may once again become a source of speculation in the years ahead.

Regarding Europe, a referendum on European Union (EU) membership is now likely by 2017. Cameron has promised to renegotiate the U.K.’s position within the EU before going to a vote, but the uncertainty leading up to such a vote will breed concern and volatility in the markets.

Will the United Kingdom remain united? And will it choose to continue its economic alliance with the rest of the continent? These are key questions not just for Britain, but for the rest of the world. Whatever happens next, this election will certainly prove to be as important as it was billed to be, but perhaps not for the reasons originally thought.

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