

questions, when answers were vital

sterling still rests on nitro-glycerine – but who now holds the fuse?

The British election has delivered a plethora of questions when the imperative national (and market) need was for answers. This inconclusive out-turn has crippled the decision-making process *at the precise moment when decisive action is vital.*

Throughout the last week – as the general election in the debt-stretched UK drew closer, and as the travails of Greece underlined the perils of fiscal instability – politicians and commentators of all hues assured the public that ‘Britain is nothing like Greece’.

This, on the morning after the election, is true in one grim respect at least – because, **while Greece has a resolute government, determined to tackle the deficit, the UK does not.** The British election has delivered a plethora of questions when the country’s (and the markets’) imperative need was for answers.

To recap – and based on the information available at the time of writing – the Conservatives are thought to have received about 36% of the vote, earning an estimated 307 seats in Parliament. Labour is expected to return about 261 seats from 29% of the vote, and the Liberal Democrats perhaps 54 seats from 23%. No single party has earned the 326 seats needed for a parliamentary majority and, for that matter, it does not, at this point, appear that this number can be achieved, either, by re-running the ill-starred Labour-Liberal alliances of the past.

If the electoral arithmetic is opaque, the fiscal arithmetic is starkly clear. In 2010, Britain is likely to run one of the biggest deficits in the developed world, public spending is more than 50% higher than it was less than a decade ago, and **the UK’s debt ratings are surely now heading for review.** In a recent report¹, we explained the risk of a ‘perfect storm’ for the UK economy, and this electoral out-turn has brought the storm-front very, very much closer.

Questions, questions

The obvious – but by no means the only, or even the most important – question posed by this inconclusive electoral result is, of course, the issue of who will form the next government. The media are full of speculation on this point, so our comments here can be brief.

Mr Brown will, we think, try at all costs to cling on to an office to which he was never directly elected in the first place. He will attempt to offer inducements to Liberal Democrat leader Nick Clegg, though both will be aware that further votes – perhaps from the Scots or Welsh nationalists – could still be needed if a majority is to be created. Mr Clegg, for whom the next few months are likely to be particularly hazardous, will also listen to overtures from David Cameron’s Conservatives.

Other questions are, we think, rather more interesting. The most important such question, of course, is what the markets will make of all this. But let’s address some of the other issues first, because answers to these questions will materially influence market perceptions.

Next, then, is this the full-time or the half-time score? We believe that **a second election, within months of this one, is far more likely than not.** This in turn means – as we outlined in an earlier Note² – that Britain will, in some very important respects, be re-running the 1970s.

¹ Tullett Prebon Strategy Insights, Issue Four, *Britain at the Crossroads – the Case for Fundamental Change*, April 2010

² Tullett Prebon Strategy Notes, Issue Four, *Back to the Seventies?*, 5th May 2010

We called attention to the 1974 parallel immediately before the election because we believe that the mid-1970s – the period between the hung parliament of 1974 and the IMF bail-out of 1976 – present a chilling parallel for the current outlook. Then, as now, Britain was living far beyond its fiscal means; then, as now, the global (and local) economic outlook was precarious; and then, as now, the British electoral process inflicted indecision **at the very moment when decisive action was imperative.**

Another question concerns the distribution of votes. This is a vexed issue. Though faring badly in England, Labour's vote proved more resilient in Wales, and actually *increased* in Scotland. Thus far, and in contrast to strong nationalist sentiment in Wales and Scotland, there has been no groundswell of specifically *English* nationalism, but the soil may now be markedly more fertile for such a development. An English proto-nationalist movement could, after all, argue that, on top of a tax and spending equation which has long appeared to discriminate against England, English taxpayers have also – at the behest of a Scots prime minister and a Scots chancellor – bailed out both the Royal Bank of Scotland and HBOS (Halifax-Bank of Scotland).

Geographic inequality is surely overshadowed by electoral inefficiency. That Labour – with an apparent 29% of the popular vote – should win about five times as many seats as the Liberal Democrats (with about 23%) seems bizarre. Questions also need to be asked about a postal voting system whose probity has been called into question, and about a ballot process which seems to have left large numbers of people unable to cast their votes at all.

Clarity – unfortunately

So how will – or should – markets react? Adversely, we believe. **A downgrading of the UK's credit ratings is now appreciably more likely than it was yesterday.**

If many critical issues remain vexed after this election, one fact is starkly and worryingly clear. It is that **the British political system has produced indecision at the very moment when a decisive outcome was most imperatively required.**

Historically (and logically), the life-spans of hung parliaments tend to be brief, so politicians are likely to remain on a campaign footing, and will be most unwilling to participate in fiscal decisions which, while nationally imperative, are bound to be electorally unpopular. The political watchwords, for the next few months at least, are likely to remain those of Benjamin Disraeli, who famously ordered a colleague to 'damn your principles! – stick to your party!'

No political party will be pleased with the outcome of this election. Labour, after all, lost the election. The Conservatives failed to supplant an unpopular government at the depths of an economic crisis. And the Liberal Democrats, perhaps squeezed by the two-party arithmetic of the British political system, failed to turn apparent pre-election popularity into votes.

But the biggest loser, we feel, is likely to be the UK's economic standing. Respected investor Bill Gross recently said that Britain's government bonds – and, by implication, sterling as well – were 'resting on a bed of nitro-glycerine'.

This remains true – with the added complication that **we no longer even know who is holding the fuse.**

Dr Tim Morgan

GLOBAL HEAD OF RESEARCH

Tullett Prebon Group Ltd | 155 Bishopsgate, London EC2M 3TQ | Tel: +44 (0)20 7200 7000 | Fax: +44 (0)20 7200 7176 | www.tullettprebon.com

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