

**Alex Fusté**

Chief Global Economist

Andbank

[alex.fuste@andbank.com](mailto:alex.fuste@andbank.com)

[@AlexfusteAlex](https://twitter.com/AlexfusteAlex)



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## United Kingdom. Political Scenario. Outlook for the Sterling

Prime Minister Boris Johnson is to announce a 1.8 billion pound cash injection for Britain's public health system and has also committed to putting money into policing, education and regional infrastructure projects. My question is: How will this be funded? After years of austerity, Johnson said he is willing to funnel more money into public services using the previous government's so-called "fiscal headroom", which had been earmarked to support the economy through a no-deal scenario. Does this mean that we are already in No-deal scenario? No. By ushering in a spending spree on health, education and policing, Johnson is signaling that he has entered in a campaign for an eventual election process. In fact, many of my colleagues in London already describe this as evidence that the government is on an election footing for later this year.

The trigger for early election could be a motion of no-confidence. Indeed, it is highly likely that the Labour Party will bring a motion of no confidence to the government in September, arguing that it does so to prevent a No-deal Brexit. In our view, Johnson could lose this no-confidence vote as parliamentary forces arrayed against a no-deal Brexit are more united and Johnson's majority is even smaller now than May's one. It needs only two dissident Tories to vote down Johnson's government, and at least three Tory MP's have publicly stated that they are willing to bring down the government to avert a no-deal Brexit. A political analyst in the UK I talked to yesterday suggested that Johnson will lose this motion of no confidence, being forced to call elections. The idea that Johnson could suspend Parliament to prevent a vote of no confidence is a delusion. It would be the first time since 1625, when King Charles I dissolved UK's Parliament and many in the country were outraged by what they regarded as the King's non-parliamentary use of medieval laws to raise money and define his own religious rules. I am absolutely convinced that Boris Johnson will try to avoid (at all costs) being compared to the infamous King Charles I.

**Outlook for the Sterling:** There is a wide range of possibilities regarding to Brexit (and thus, for the sterling), but to know what these possibilities are you must first know what the extreme scenarios are: 1) A No Deal Brexit would see the sterling fall close to

parity with the USD. 2) A revoking of article 50 exit process would see the sterling to rally to US\$1.50. The rest of possibilities necessarily fall within these two extremes. What follows is the description of (in our view) the two most likely scenarios.

**Scenario I (Probability 45%):** Johnson manages to find a way to avoid a no-deal Brexit by just asking for some cosmetic changes to May's Plan. The change could be a time limit on the backstop, and the Parliament would pass this "enhanced" plan because the hardliners, who just wanted to oust Theresa May, will now do whatever is necessary to get Brexit done and maximize Johnson's chances of winning a snap general election. In the other hand, the "centrist" Tories have already given up and prefer any kind of negotiated Brexit to a no-deal Brexit. Not to mention that the EU leaders also want the Brexit saga finished. I assign a high probability to this scenario since a time limit on the backstop (that guarantees an open border between the two Irelands) matters to Dublin, which could also "guide" other EU leaders in the direction of an agreement. In this scenario, the Sterling would rally to USD1.50.

A likely scenario is one in which Johnson manages to achieve some cosmetic changes to the withdrawal agreement, and the UK's parliament passes the plan

**Scenario II (Probability 35%):** The EU offers no concessions and Johnson vows for a No-deal Brexit, spurring a no confidence vote which the government loses, leading to general election (and the Brexit waiting again). The Sterling trades around USD1.20-USD1.30 until the election result becomes clear, though it is highly likely that the election results in a hung parliament (what would keep the Brexit in the freezer). The pound should recover some of the lost ground in the mid-term..

**Other scenarios account for a joint probability of 20%,** and range from a Hard Brexit (the sterling would fall to US\$ 1), to a UK's leaving with an interim agreement with the EU that maintains current trading relationship until a final agreement is reached. In fact, under the WTO's GATT rules, both parts must agree to extend trading rules. The sterling would rally to US\$ 1.3 in this second scenario..

Very little is to be resolved in the next 4-8 weeks, and the lack of information will probably weight on the sterling, specially if we consider that the government's strategy relies on amplifying the possibility of a No-deal Brexit. A rally in the sterling will only start when compelling evidence that supports scenario 1 occurs.