

# MAY'S POSITION IN QUESTION?

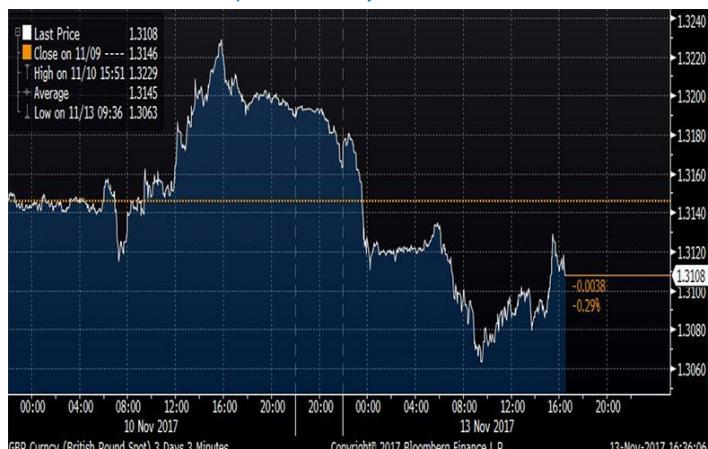
In recent weeks, the United Kingdom's Prime Minister, Theresa May, has faced increasing pressure within the media on her authority and position. Two prominent cabinet ministers from May's government have been forced to resign and there continues to be an aura of scandal surrounding her administration.

Sir Michael Fallon (Defence Secretary) resigned amid allegations about his personal behaviour and Priti Patel, (International Development Secretary) resigned because of controversy surrounding her unauthorised meetings with Israeli officials earlier in the year. These resignations are coupled with Boris Johnson's position as Foreign Secretary being brought to question over his handling of Nazanin Zaghari-Ratcliffe, who is currently being held in Iran, and his rumoured memo that he sent to May outlining how to pursue Brexit negotiations. Similarly, her First Secretary of State, Damian Green is also under investigation by the cabinet office over behavioural allegations.

Because of this, it has been felt domestically (and perhaps even more internationally) that May is losing control of her cabinet, government and the Party. This apparent weakened support has raised suspicions as to whether as leader of the Party she can deliver a Brexit outcome that delivers a scenario that protects both jobs and growth within the economy. Especially at such a crucial time for the UK when the country is reaching the point of advanced Brexit negotiations, it is imperative that we see the once promised "Strong and Stable Leadership", because it seems within six months it has been forgotten.

Sterling had risen on Friday, 10 November, after the European Commission's Chief Brexit negotiator Michel Barnier and the UK's Brexit Secretary David Davies left open the chance of a transition deal being implemented by the 14th of December. As markets opened the following Monday, Sterling fell to its lowest level in a week, as political developments in the UK casted a shadow over May's position, ending down 0.85% vs. the USD and 0.77% against the EUR. We view this as a knee-jerk reaction commonly seen when a slightly more sensational headline hits the market and in particular triggers automated Fund selling. Towards the end of the trading day, Sterling did start to recover.

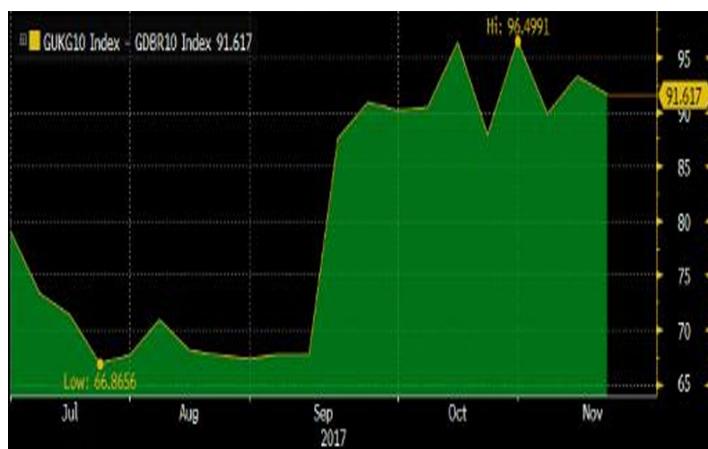
**Chart 1 – GBP/USD Spot Currency**



Source: Bloomberg, 13 November 2017

UK Bonds have recently also underperformed. Differentials between German Bunds and British 10-year bond yields have widened to over 90 basis points in Bunds favour, compared to less than 70 basis points early September.

**Chart 2 – UK Gilt 10 Year v German Bund 10 Year**



Source: Bloomberg, 13 November 2017

The catalyst for the latest fall in Sterling came from an article published in The Sunday Times on 12 November. It reported that as many as 40 Conservative Party MPs agreed to sign a letter of no confidence against May, which might trigger a leadership challenge (eight short of the number needed to do this). A leadership challenge would take place within the Conservative Party, similar to how ultimately May was elected after David Cameron's departure in 2016.

The question we should ask at this point is whether May should be preparing for a leadership contest or is this threat simply speculation/journalism like we have heard already before inside her Conservative Party? Perhaps elements of both are correct. It is certainly evident that May's political position is currently weak, yet we argue her position is still safe in the short to medium term.

The weakness of her position is in large part due to the result of June's General election. The nature of her government, with a small working majority (with the current agreement with the 10 members of the Democratic Unionist Party (DUP)), is very different to ones formed with 100+ majorities of Margaret Thatcher and Tony Blair. And as such her position is always going to be questioned and any small question/story maybe given more attention than in previous administrations.

Further analysis of the UK's June election can be seen in the below article:

<https://en.nikkoam.com/articles/2017/06/june-gamble-doesnt-pay-off-for-may>

While the eight MPs needed to trigger a leadership challenge might seem small at first, it is not necessarily new. Over a month ago a similar story was suggested by, Grant Shapps (a current Conservative MP and former Conservative Party Chairman in Cameron's government) stated he had 35 Tory MPs willing to back a vote of no confidence in May, which didn't eventually result in much of a market event.

To put in context, there are currently 317 Conservative MPs sitting in the House of Commons; therefore, if a leadership challenge were to take place, due to the numbers currently needed to see a successful challenge and oust May as leader means the event is still very unlikely. It is worth noting also that what is being threatened within this band of MPs should not be confused with a motion of no confidence against May's government by the House of Commons last seen in 1979 with the fall of James Callaghan's Labour government. Today either members of the government and/or the DUP would have to vote against the government in a vote of no confidence, which we would argue is extremely unlikely.

What is also crucial in terms of May likely staying in power (in the near term at least) is that it is widely accepted that the Conservative Party do not want a leadership battle that could divide the Party and publicly display potential disruptive forces to a wider audience. Additionally, another election would undoubtedly prove to be very unpopular among the electorate, with the general consensus being that the UK public is politically exhausted after a number of divisive elections/referendums being fought in recent years.

The current rhetoric of the opposition Labour Party, has been to 'accuse' May of lacking the support within her Party to deliver the Brexit transition period that she has proposed. Leading figures of the Party are confident that Jeremy Corbyn (Leader) will be Prime Minister within a year. It is also evident that since June's election, Labour has been manoeuvring and are certainly on "election watch", being prepared if there is an imminent election.

As stated earlier, it cannot be denied that May is in a weak position. There is certainly a possibility of May's government of breaking up (albeit small). There are comparisons with her government's stability to John Major's administration in the early 1990's. It also had a small majority and was yet able to survive a number of embarrassments such as Black Wednesday.

However, one key difference to both administrations is the Leader of the opposition. In the form of Tony Blair, Major had a powerful enemy across the benches who was more centrist and had much greater appeal as the Leader of the opposition, than Jeremy Corbyn (to the wider public as a whole). The market itself would fear a Corbyn government much more than a change in Conservative led government. Even if an early election were to be held, the result would be hard to call. With Labour (despite the apparent weak position of May's government) in the polls just marginally ahead of the Conservative Party, approval ratings between May and Corbyn as Prime Minister are still actually in the favour of May.

What does the current turmoil mean in terms of the continuing Brexit negotiations? From the perspective of the European Commission, there is some understanding/sympathy of the difficulty in the situation that May currently faces. However, it is quite clear that from a European perspective there is no intention to lessen their position in their terms of negotiations of a deal based on May's support domestically. Michael Barnier, has consistently called for agreement from both sides on three things before talks can advance in December.

1. Citizens' Rights
2. The Financial Settlement (Brexit Divorce Bill)
3. The border between Ireland and Northern Ireland

For the Conservatives, the three elements listed above are not necessarily a cause for problem within her own Party in terms of agreement. However, the cost of the financial settlement is especially touchy among pro-Brexit backbenchers. Barnier is not seeking a fixed amount that needs to be met, but rather a commitment by the UK to meet its obligations that it signed up to when it had been a member.

May's position will very likely be determined by the outcome of the Brexit negotiations, as will be her legacy. If it is felt among Conservatives that foreign leaders are starting to view her as weak and that this will bring a failure to get an adequate deal, there will be further momentum within the Party for her to leave. This renewed pressure on May's government when Brexit negotiations are reaching an advanced stage is certainly not ideal. However, we are not at this stage and we were also recently told that Parliament will be given a take-it or leave-it vote on the final Brexit deal before the UK leaves the EU.

In terms of the wider UK economy as a whole, other than weaker Sterling, recent macroeconomic data has been somewhat encouraging. Industrial production has been strong (and above consensus), including manufacturing production, and the country enjoys record low unemployment. PMIs (manufacturing, services and composite) have also been strong and above expectations. Therefore despite a weaker political environment, the economy is still holding up. There

has not been the economic downturn that was predicted by commentators before the Brexit referendum.

In conclusion, we think it is unlikely that May will lose her position certainly in the near term. Certain events, especially the election in June, have created a situation that makes her position weaker and make it more difficult for her to govern. Due to the nature of her administration and the unique time we are living in, there is an increased spotlight that perhaps prior Prime Ministers have not had. However, it is very unlikely for her to be replaced within her own Party. This is because there is a lack of an heir-apparent, and the Conservative Party would be extremely reluctant to even slightly increase the risk of another election, especially with the rising popularity of a Corbyn led Labour Party. In the meantime, the focus of the government should be on the important Brexit negotiations and in the interests of the country over the Party, which is why we would ascertain her position is fragile, but safe.

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