Tortoise QuickTake
Credit Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

I'm Graham Allen, Senior Portfolio Manager with this week's credit podcast. The resignation of Boris Johnson as the UK Home Secretary once again casts a long shadow over the final BREXIT agreement. Despite the uncertainty, the Friday March 29, 2019 date for the UK's exit from the European Union draws ever closer. Although on the face of it, the alarm bells are ringing for Prime Minister Theresa May's future, the reality is, the lack of any deal in the form of an orderly exit is also another blow for the EU itself, coming hard upon the election of the anti-Euro Italian government. The cabinet resignations add to the list of uncertainties for the political hierarchy in Europe, following increasing doubt over the future of Germany's Chancellor Merkel.

For now, the political uncertainty in Europe has not significantly affected the economic recovery or the investment markets in Europe. This may not last, as the anti-EU trend will likely continue to be reflected in elections across the continent going forward. Whatever the final BREXIT agreement is, it will be viewed as a possible blueprint for other countries to leave the EU. It is for this reason Brussels is taking a hardline stance, as it is not in the EU's interest to see any kind of tidy workable exit strategy end up in place. This put Theresa May in the difficult position of having little room to negotiate, much less find any middle ground, between the EU and the hardline BREXIT members of her cabinet. Looking back, this made the cabinet resignations of Johnson and Davis inevitable. It is also worth remembering that Theresa May voted for the UK to 'remain' within the EU, always raising questions of her commitment to a positive outcome for the UK.

So how is this likely to play out?

Despite running a sizeable trade surplus with the UK, the EU stance is unlikely to soften for the reasons mentioned earlier, which may now lead to a hard BREXIT outcome in March 2019. In addition, a hard BREXIT would mean that UK payments to the EU could terminate on day one, leaving a large hole in the overall EU budget. So a hard BREXIT doesn't just mean pain for the UK. The latest cabinet departures now make this more likely given the intransigence of the EU. A change of leadership in the Conservative Party is now quite possible, as Boris Johnson's departure could embolden the anti-EU backbenchers to mount a leadership challenge to Theresa May. To counter this, May could elect a firmly anti-EU replacement, which has now happened with the appointment of Dominic Raab.

But politics aside, BREXIT will happen, with speculation by the EU President that BREXIT could now disappear being wishful thinking. The resignations will simply re-harden the battle lines within the UK political establishment that were becoming blurred with the current trajectory of negotiations. At this juncture, the most likely outcome will favor a hard BREXIT, as any kind of middle ground is contrary to the core fundamentals of both sides. For the European Union to work there must be a free flow of labor within the union, adherence to the Stability pact, and in the end, acceptance toward a more united European fiscal policy and shift of budgetary power to Brussels. This flies in the face of BREXIT's raison d'etre. Surprisingly, within some powerful elements on the European side such as German business leaders, there is a preference for a hard BREXIT that is workable, versus a muddled compromise. At least then all parties know where they stand. In that instance the UK's trade policy will be governed by WTO rules, and it will govern its own borders.

A hard BREXIT will almost certainly cause some disruption and pain for the UK in the short term. Some businesses will migrate to Europe and the future of UK citizens living in Europe could be in doubt (and vice versa). Ultimately, however, the UK will be far better off outside of the Union in the long-term according to the 'Leave' campaign.

If this turns out to be the case and the UK thrives, the irony is that it will have been the EU's hard line negotiating position that provided the blueprint and incentive for other countries to leave down the road.

Whatever happens now, May's soft BREXIT is back to square one and time is running out.

That's it for today. We'll speak to you again in our next credit podcast.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.

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