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After Brexit: the UK's uncertain future as a new asset class for international investors

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The immediate verdict of financial markets on the UK's decision to leave the EU was damning: sterling fell sharply, investors fled some real estate funds thereby threatening their solvency, and British banks took a hit on the stock market. Moreover, the UK government lost its triple-A rating in bond markets.

The economic uncertainty was magnified by the political risk the leaders of the Brexit campaign, Boris Johnson and Michael Gove, created by entering into a selfish bout of in-fighting. This revealed to those outside the UK a lack of a vision and planning.

Johnson appeared to panic after the unexpected success of the leave campaign, announcing in a newspaper article that Brexit did not mean cutting all ties with the EU economically and politically. Gove then betrayed Johnson, accusing him for not possessing the necessary qualities to lead the Conservative party and the country in a future outside the EU.

The leader of the opposition, Jeremy Corbyn, also came under strong attack from the majority of his own shadow cabinet and the parliamentary Labour party, who publicly voiced their misgivings about his style of leadership. On top of this English drama, a probable Scottish tragedy in the form of a second Scottish referendum to leave the UK was mentioned by Nicola Sturgeon, the Scottish first minister. Of course, the UK has historically strong political institutions, traditions and elites, collectively driven by common sense to avoid political drama and to achieve stability in domestic and international affairs. Nevertheless, the formidable challenge of navigating uncharted waters after the referendum result has caused an unexpected degree of turmoil.

Against such a background, when assessing asset classes, the UK faces relegation to the league of sizeable emerging economies, joining the likes of Brazil, Turkey and South Korea. Such economies regularly experience runs on their currencies due to a mixture of macroeconomic fragilities. These can include high levels of sovereign debt, high current account deficits, weak under-capitalised banks, and political infighting. Post-Brexit, the UK exhibits and will continue to exhibit all of these weaknesses in the near to medium term.

There will also be new problems. For example, there is already anecdotal evidence of food processing and fruit farming businesses suffering labour shortages because immigrants from East Europe are returning home. The French prime minister has already announced tax breaks and other support to lure bankers from London to Paris. Therefore, building a solid post-Brexit economic future for Britain on the weak foundations of structural economic problems and new political uncertainties is going to be extremely difficult.

That said, international investors, especially the hedge funds which thrive on volatility, will still see opportunities in sterling, UK stocks and bonds, and real estate. Since the demise of the BRICs and emerging economies from the second half of 2013, when the US Federal Reserve announced tapering of quantitative easing, international investors have been short of new asset classes to speculate on. In the past, we have seen dotcom companies, Asian “tigers”, BRICs and commodity plays filling that role. If the UK is to avoid relegation to the league of emerging economies, it must make itself a brand-new asset class in terms of international finance.

The country clearly has advantages to sell. These include the size of its existing economy, the reliability of its legal and other institutions, and well operated financial markets. Since the 2008 financial crisis, Switzerland, Norway, Denmark and Sweden have found new roles for themselves in line with the quantitative easing polices of the US, Japan and the eurozone. None of these countries, though, can offer what the UK can. In that sense, Britain could easily join the Nordic countries to form a new asset class.

Upcoming elections in countries like France and Holland might also give momentum to this new asset class of the “Saxon-Viking” economies. Speculators may even be betting on the financial consequences of “Frenchxit” and “Dutchxit”, which would give things an extra push.

Britain’s leave campaigners were fighting to take back control from Brussels. However, people can now see the impossibility of having full control over economic and international affairs. The governor of the Bank of England, Mark Carney, has announced that the anticipated financial risks are crystallising. There is going to be much more to it than renegotiating trade relations with the EU. But if the UK can become a new asset class in the global economy, that gives the best chance of staying afloat in turbulent financial markets.

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