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Elston Insights

UK Elections: outlook for Gilts and Sterling

- UK elections have no impact on global equity markets
- UK economic outlook impacts UK mid- and small-caps
- Change of Government could impact outlook for Gilts and Sterling

Polls are pointing to a clear Labour victory on 4th July 2024. Ironically even if the pre-election inflation prints get to 2%, a 1992 Tory comeback based on an improving economic outlook seems unlikely.

UK elections have no impact on global equity markets, as the UK represents such a small part of overall global equity markets. Any potential improvement in the UK economy that could lead to lower interest rates could be positive for UK mid- and small-caps.

Markets prefer certainty and competence. The recent Conservative era has not been characterised with either of those characteristics. Ironically, whilst a strong Labour win could spell higher taxes for high earners, from a market perspective, it could be potentially supportive to UK Gilts valuations (lower risk means lower yield means higher capital values), and to Sterling relative to the Dollar.

A clear Labour win would:

1. Reduce political instability risk that has been associated with endless Tory leadership contests since Brexit.

The Shadow Chancellor of the Exchequer, Rachel Reeves, has pledged to stick to government's fiscal discipline and is making all the right noises to reassure the Gilts market that a repeat of the September 2022 mini-budget fiasco would not be repeated and will take into account the OBR forecasts into consideration when shaping fiscal policy.

2. Be a fresh start. Conservatives are still struggling to regain credibility since the Truss budget.

The Labour government could show better fiscal discipline at the start of the term which may help bring inflation under control faster than the current pace and give the BoE confidence to embark on an interest rate cutting cycle which would eventually prop up the economy. Rate cuts could drive flows back to Gilts as most investors have been severely burned with the heavy sell off in 2022.

3. Could be marginally positive for sterling (but not if BoE cuts are sooner and deeper than the US Fed.

A stable UK government could drive capital flows into the country leading to marginal appreciation of Pound Sterling against the Dollar but if inflation remains sticky in the US and the Fed does not cut interest rates, Sterling could remain range bound relative to the US Dollar.

Bottom line

Lower UK political risk premium plus falling BOE rates are supportive for the UK bond market which is why it makes sense to be extending duration and locking in 4%+ yields in long term Gilts.

Henry Cobbe, CFA

Head of Research, Elston Consulting

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