

28th June 2024

UK Election: changes ahead

- Labour likely to win the election
- Tax rises inevitable with either party
- No impact on global equities, marginal positive for Sterling

Top Line

Labour are likely to win the UK General Election on 4th July 2024, possibly by a landslide. Whoever wins, taxes are on the rise to repair the country's post-covid finances. The UK elections have no impact on global equities, but a clear majority for Labour could be marginally positive for Sterling.

UK 2024 Election outlook

The Economists' median estimate is 380 seats for Labour (with a range of 298-487), and 185 seats for the Conservatives (with a range of 82 to 263). 326 seats are required for a majority.

The move from a Conservative majority of 80 to a landslide win for Labour within 5 years would be a change of historic proportions reflecting voter dissatisfaction.

The Conservative's record in Government may be remembered for seemingly endless leadership changes, factional infighting and the chaos of the Truss budget that destabilised the Gilts market.

Polling data shows not only the Labour's wide lead over the Conservatives, but also a drop in support for both main parties in favour of fringe parties, such as Reform, which is attracting disgruntled voters from the Conservatives and less so from Labour.

From a regional perspective, Labour's return to Scotland's Central Belt will mark an end to the SNP's monopoly, the Red Wall will likely turn back red again, the Lib Dems could pick up Conservative seats in the south-west and London could lose the support of previously safe commuter-belt seats. It's likely to be a bruising defeat for the Conservatives which will require a long period of reflection.

Top of voters' minds, according to surveys are firstly the economy, secondly health and the NHS, and thirdly immigration and asylum. These are the main battlegrounds on which each party will attempt to convince voters they are best placed to fix.

UK economic outlook

On the economy, following the Truss budget, the Conservatives damaged their reputation for economic competence despite the subsequent stabilisation by Hunt & Sunak. What is the outlook for the key macro factors?

Looking at the three macro factors, growth is now the focus.

Growth: Real GDP has recovered and the UK has now exited a technical recession, but it is stagnating at +0.1% for 2023, +0.4% for 2024. Real GDP per person, meanwhile, is declining.

Inflation: Inflation rate is moderating, and has finally hit the 2% target rate: but there are risks of “bumpiness” around the target rate, or even a reacceleration. The 2% target could become more of a “floor”, than a “ceiling”, in our view.

Interest Rates: The Bank of England left policy rates on hold at 5.25% and markets are expecting the first rate cut of 25bp could come in September, so long inflation data continues to show a moderation. Once inflation looks contained, policymakers may continue to cut interest rates towards a 3% “neutral” over the next 2 years. Falling policy rates means lower yields on money market funds, but are supportive for longer-duration bonds and risk assets more generally.

Public and personal finances

Whoever wins the election, taxes will have to rise to restore the country’s finances following the ramp up in Government debt to fight the Covid crisis.

Based on current policies, the Office of Budget Responsibility (OBR) expects the tax burden (as % of GDP) to rise to a post-WW2 high of 37.7% in 2027-28, and public sector net borrowing to continue to rise from post-Covid high of 88.8%.

Living standards (as measured by real disposable incomes) should start to recover following largest drop since 1950s in 2022-23. The end of energy shock and recent cuts to national insurance should help.

Labour's tax policy

Labour’s leadership has pledged not to change the tax rate of the “big 4” taxes (income tax, national insurance, VAT, and corporation tax). But anything else could be in scope.

VAT on private school fees, capital gains tax partial or full harmonisation with income tax rates, a revision of council tax bands, a tax on second homes: there is no shortage of ways that can be explored to raise the broader tax take.

A focus on growth

The only solution to the UK’s economic malaise is to return the country to growth. So this election is also (or should be) a vote for which party can deliver best on economic growth.

It’s no coincidence that Labour mentions Growth 47 times in their manifesto, compared to Conservatives 18. The Labour manifesto positions the party as firmly centrist, and supportive of

business, stability, and investment. It's a long way from the Corbyn era and is in a way old "New Labour". Whether that proves to be true or not, we shall see. The Conservative manifesto is also focused on Growth, and it also focuses significantly on tax and the need to cut taxes for the self-employed, and for businesses to support growth. In both cases, the detail matters. And for Labour if they win, delivery matters more.

What does this mean for portfolios?

Markets like certainty, and the political volatility in the UK since Cameron's announcement of the Brexit referendum in January 2013 has been damaging – particularly for Sterling. More recently, UK mid-cap and small-cap equities have suffered from a slowing economy and rising interest rates.

A landslide win for a centrist-looking Labour party brings a certain amount of stability, and the likelihood of at least two electoral terms (10 years) to implement policy measures. On the margin, this prospect of stability, is marginally positive for Sterling. This, and the expectation of falling rate cuts, is supportive for Sterling denominated bonds.

The exiting from a recession, potential for improved economic growth and falling interest rates is also positive for UK mid-cap and small-cap equities.

The election will have no material impact on the FTSE 100 which is predominantly multi-national companies with 80% revenues earned overseas. Any material strength in Sterling could even act as a slight dampener on FTSE 100 performance, because of this translation effect.

The UK election will have no impact on global equity markets, as the UK is such a small part of the global equity universe.

Bottom line

Whilst political change can be expected in the UK, this will not make a material impact on a broadly diversified portfolio.

Henry Cobbe, CFA

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