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The UK general election: what will a Labour landslide mean for investors?

6 July 2024

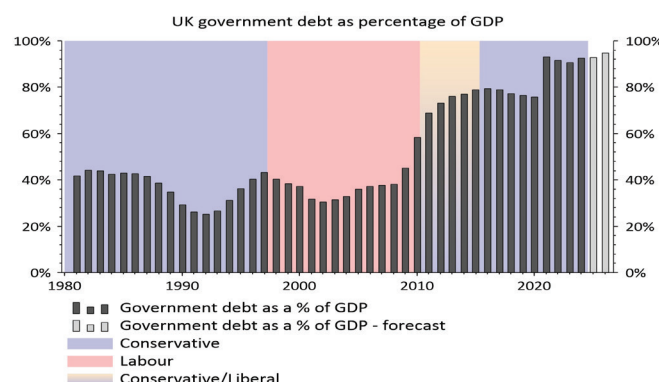
Labour has won a landslide victory in the general election and will form the next government with a huge majority. With the count now over, Labour has won 412 seats out of 650 seats while the Conservatives have won 121 seats. By contrast, when parliament was dissolved on 30 May, the Conservatives held 345 seats, Labour 206, the Scottish Nationalists 43 and Reform 1. Now the results are all in, the question for investors is what a Labour government will mean for the UK economy and investors in UK assets.

Labour's election manifesto outlined relatively modest tax and spending plans, with £8 billion of additional tax revenue raised principally through increased taxation of people living in the UK with non-domiciled status, a clampdown on tax avoidance, the imposition of VAT on private school fees and a windfall tax on big energy companies. Labour's Green Prosperity Plan aims to provide clean power by 2030 and create the Great British Energy Company, a state-owned investor in clean power projects.

Rachel Reeves, the incoming chancellor, said the election would be fought on the economy and affirmed the party's commitment to economic stability. In September 2022, Kwasi Kwarteng, the chancellor under Liz Truss, the then prime minister, unveiled a package of unfunded government spending in a mini-budget. He had previously asked the Office for Budget Responsibility (OBR), which was set up in 2010 with a mandate to provide independent analysis of the public finances, not to comment on the impact of these measures on the economy. Fears that the mini-budget would lead to higher government borrowing led to sharp falls for UK government bonds (gilts) and sterling and a crisis for pension funds investing in gilts. The Bank of England intervened in bond markets to calm investors' nerves and Kwarteng and ultimately Truss were forced to resign.

Aiming to distance Labour from accusations of fiscal profligacy, Reeves has announced a new "fiscal lock",

promising the OBR would publish forecasts to accompany all major decisions on tax and spending. In her 2024 Mais lecture, she said a Labour government would ensure that "day-to-day costs are met by revenues and that debt must be falling as a share of the economy by the fifth year of the forecast, creating the space to respond to future crises". The chart below shows the impact of the 2007-09 great financial crisis under Labour and the Covid-19 lockdowns under the Conservatives on the nation's finances. The need to respond to future national emergencies would appear to have drowned out any discernible relationship between political party and public sector borrowing.



Source: LSEG Datastream

UK debt as a percentage of gross domestic product (GDP) is currently 100% and the OBR fears it may move higher because of the impact of higher numbers of the long-term sick following the pandemic, an increase in state pension payments as baby boomers retire and high government spending to meet the net zero emissions target by 2050. In its July 2023 fiscal risks and sustainability report, the OBR said that although UK debt as a percentage of GDP had been higher in the past, the UK was now more exposed to a sudden rise in inflation and interest rates. There are three reasons. The average maturity of government debt has fallen to two years following quantitative easing; the UK has one of the highest proportions of inflation-linked debt to conventional debt; and the proportion of gilts owned overseas has risen, leaving UK public finances more vulnerable to changes in sentiment among foreign investors.

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All this means investors are unlikely to tolerate significantly higher levels of government borrowing without demanding higher returns, leading to falls in gilt prices. As has been well-flagged, Labour is, therefore, likely to raise taxes to fund additional spending, with reduced tax relief on pension contributions and higher inheritance and capital gains taxes amongst the more likely candidates.

UK bonds may, however, make gains despite the high level of government borrowing, which may restrict Labour's ability to invest in measures to stimulate economic growth. If Reeves can honour her promise of fiscal prudence, investors may buy gilts on the grounds that inflation is stabilising at or around the Bank of England's 2% target, meaning that interest rate cuts will be on the horizon.

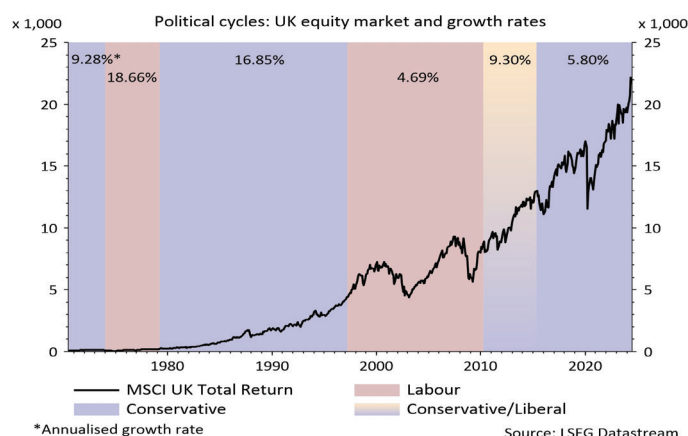
UK stocks may also make gains because they are lowly-valued relative to many other equity markets. This has not gone unnoticed recently, leading to a number of corporate and private equity takeover approaches at share prices far higher than those prevailing in the market. The economy has returned to growth after the shallow recession it entered in the second half of 2023. The UK savings rate of 10.5% compared to 3.9% in the US suggests that consumers have the capacity to spend more should their confidence levels rise. Labour's victory will remove the policy uncertainty engendered by the election and corporate executives may be more inclined to invest for the longer term.

The chart and table opposite show that Labour governments have not typically spelled lower returns for stockmarket investors than Tory governments.

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Equity returns: No 10 winners and losers

Prime minister	Term	Annualised return Conservative	Annualised return Labour	Percentage change Conservative	Percentage change Labour
Edward Heath	19/06/1970-04/03/1974	9.30%		39.02%	
Harold Wilson	04/03/1974-05/04/1976		11.38%		25.29%
James Callaghan	05/04/1976-04/05/1979		23.85%		93.41%
Margaret Thatcher	04/05/1979-28/11/1990	16.81%		503.41%	
John Major	28/11/1990-02/05/1997	16.91%		173.04%	
Tony Blair	02/05/1997-27/06/2007		7.04%		99.41%
Gordon Brown	27/06/2007-11/05/2010		-3.34%		-4.87%
David Cameron (Coalition)	11/05/2010-08/05/2015	9.30%		55.95%	
David Cameron	08/05/2015-13/07/2016	0.73%		0.86%	
Theresa May	13/07/2016-24/07/2019	8.02%		26.34%	
Boris Johnson	24/07/2019-06/09/2022	3.00%		9.65%	
Liz Truss	06/09/2022-25/10/2022	-24.14%		-3.74%	
Rishi Sunak	25/10/2022-04/07/2024	13.22%		23.35%	

MSCI UK Total Return Index annualised growth rate and percentage change during premiership

Source: LSEG Datastream

With a majority of this size, it is possible a more radical policy agenda could emerge over the coming months and the Brompton investment team will watch closely to determine what impact such a shift could have on UK assets. Globally diversified, multi-asset portfolios give investors exposure to high-conviction investment themes and reduce dependence on domestic assets. The team remains positive on the prospects for markets overall because falling inflation and interest rates are supportive for global equities and bonds.