Election fever – Labour's (not so unexpected) majority

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– Market impact muted with outcome already priced in
– UK fiscal outlook will remain challenging
– Further clarity still required over Labour's policy on pensions

The results of the UK general election yesterday will have come as little surprise to anyone, with public opinion polls having accurately predicted a Labour majority government after 14 years of Conservative rule. Whilst Labour are not expected to make wholesale changes to policy in the short-term (surprises may still come over the longer-term), they face an uphill struggle to achieve their domestic policy aims given the budgetary tightrope they are going to need to walk.

Impact on financial markets

Elections are a well-known risk factor for markets, just recently we saw volatility in French equity markets following Macron's surprise announcement of Parliamentary elections and the subsequent vote. Whilst the Prime Minister's decision to call an election in the UK was equally surprising given the state of polling, the eventual result has long been priced in by markets. As such today's result has not had an discernable impact on markets. UK equity markets have not dramatically fallen, UK government bonds haven't sold off sharply (did anyone else fear Trussonomics 2.0?) and Sterling has remained steady vs the US dollar and other major currencies.

That there has been no immediate reaction in markets to the result does not mean that a strong Labour victory will not impact markets over the coming Parliament. The UK still faces multiple headwinds, with a large deficit and stagnant productivity, particularly in the public sector, both of which will need to be resolved and a pathway found to generate sustained GDP growth if living standard are to rise.

There may also be sectoral stories in play as well. Labour's manifesto pledge to build 1.5m houses over the five-year parliament term, with targets being made mandatory, could provide a boost for the UK housing sector in particular. Conversely, if Labour renationalises key public sectors including water and rail services that could have a negative impact for these UK equity sectors.

Impact on fiscal outlook

Rachel Reeves, the incoming Chancellor of the Exchequer, has committed to adhering to the UK fiscal rules, as Labour look to portray themselves as a party which can maintain fiscal responsibility. However, they will face significant challenges trying to kick-start a UK economy which has been grappling with sluggish growth in recent years, attributed to a decline in productivity growth, with the lasting effects of Brexit and COVID (amongst others) still impacting on the UK economy.

Reducing the high government debt to GDP ratio (currently near 100%) and creating fiscal headroom (given the current fiscal deficit) will remain a priority for the incoming Labour government, and may prove particularly challenging given they have ruled out making any immediate changes to income tax, national insurance or corporation tax. Labour will likely require out-of-the-box thinking to stimulate productivity growth, with expectations that they may look to increase additional taxes elsewhere – may capital gains tax be at risk?

What does a Labour government mean for pensions?

Labour's adoption of the 'Ming vase' strategy has resulted in their policy for pensions remaining rather vague. Their manifesto primarily includes a commitment to conducting a wider pensions review upon being elected. We summarise some of the key changes (or lack of changes) below:

- **Defined Benefit Schemes** – Labour remain broadly committed to prior initiatives (consolidation etc) although this is likely to be better understood over the long-term. Labour's manifesto states that they will "Act to increase investment from pension funds in UK markets", however it remains unclear in what form this will take place. Will this be forced upon schemes or only gently encouraged?

- **Tax –** Labour has proposed no changes to the recently removed lifetime allowance (LTA) tax, having shelved previous plans to re-introduce LTA. However, other tax changes remain possible – tax free lump sums, inheritance tax on pensions and/or tax deferral benefits for higher rate tax payers may be at risk of policy change.

- **Other savings** – Labour have pledged commitment to the "triple lock", promising not to raise taxes on the "big three" income tax, national insurance or VAT for five years if the party wins the general election. However, they would not match the Conservatives pledge on the "triple lock plus" which promised to raise the tax-free pension allowance in line with the state pension. While a host of other changes may still come, we think it is more likely that these will take place over the longer-term given the various complexities that need to be considered when adjusting the pensions system and lower hanging fruit existing elsewhere..

Global market volatility to remain

Surprises in future policy from Labour or manifesto U-turns will likely result in increased uncertainty and market volatility. Furthermore, any unexpected future tax hikes may trigger mini-market events. Given the UK fiscal outlook all of these are possible, particularly later in the cycle; as a result we anticipate increase volatility over the coming few years.
It is worth remembering the UK is a small part of the global financial system. Of more relevance to global financial markets are this year's US elections (and the many other global elections this year) . These we expect to increase market volatility far more than the result of the UK election. In the US, opinion polls expect the election to be closely contested which will further increase uncertainty over future US policy. Either outcome will likely impact on global markets – given the increasing polarisation of views between the two parties. This coupled with the current heightened global geo-political tensions means that global market volatility is likely to remain over the remainder of the year.

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