

Special Coverage:

Labour wins a majority in the UK election

Key takeaways

- ◆ Labour achieved a majority win in the UK election, putting them just shy of the 1997 landslide and short of some of the forecasts. With a majority of the scale, they should be able to drive through policies with little opposition.
- ◆ Markets have been more driven by the improvement in economic fundamentals. We have revised our 2024 GDP growth forecast higher to 0.9%, which is 0.2% above the consensus. Further falls in inflation during this quarter should open the door for the BoE to cut rates, providing further support to households.
- ◆ We moved UK equities to overweight in June because we expect that the improving economic outlook and better investor sentiment would unlock the value in a cheap equity market. Recent fund flows show that investors are drawn to the UK's cheap valuations and attractive dividends. With Labour signing up to the Conservative's fiscal rule of reducing the UK government debt-to-GDP level within a five-year period means that the gilts market reaction is likely to be subdued. We remain overweight on UK gilts.



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What happened?

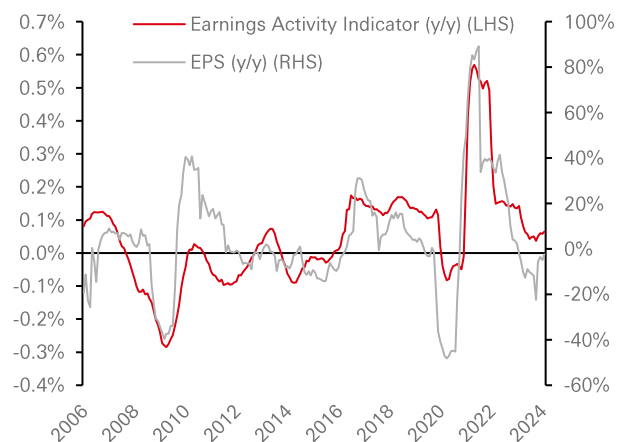
- Labour won the UK election with a majority. At the time of writing, they have won 412 seats in Parliament – just 6 short of Tony Blair's 1997 landslide victory. Keir Starmer will head to the King today to be confirmed as the new Prime Minister.
- The Conservatives are on course for their worst-ever result, currently with 121 seats with only two left to declare, but there's enough daylight between them and the Liberal Democrats to be the formal Opposition, with the Liberal Democrats on 71 seats—trumping pre-election expectations.
- The voters punished some of the household names within the Conservative party, such as former PM Liz Truss and Defence Secretary Grant Shapps. It was an especially poor night for the Scottish National Party (SNP), currently at a loss of 37 seats, with a few candidates yet to declare, leaving just a handful of MPs (members of Parliament). The Reform Party has won four seats and managed to even eat into Labour constituencies too.
- The instant reaction from GBP was very sanguine. It then drifted higher through the night but the move only amounted to just over 0.2% of strengthening. This is no surprise as the market was already poised for a Labour win, given the universal landslide predicted by the polls. When the equity markets opened, housebuilders climbed almost 2%, reflecting Labour's commitment to build 1.5 million houses over the next five years. The FTSE 250 also rallied, surpassing gains of 2%, as investors forecasted on Labour's manifesto pledge to "kickstart economic growth" by channeling growth through a £7.3bn National Wealth Fund with a "target of attracting three pounds of private investment for every one pound of public investment".
- For passing legislation, large majorities make the Government's life easier. Labour has also committed to reform the House of Lords but, in the meantime, can add more seats to prevent legislation from being thrown back to the House of Commons.

- While the UK's overall tax burden is at the lower end within the G7, it has had the steepest rise from the pre-pandemic days. Consequently, it was a key campaign battleground. Labour's approach was to commit to not increasing the key taxation rates, keeping the corporate tax rate at 25%. This combination of fiscal and tax constraints means that a Labour government hasn't been seen by the market to represent a game-changing shift, and the impact on markets has been uneventful.
- In addition to the planning reform, other bigger campaign policies include the £8.3bn of "capitalisation" for The Great British Energy, the windfall tax on oil and gas companies, the "genuine living wage", to name a few. The market will also focus on how Labour approaches its industrial strategy. Moreover, how the relationship evolves with the EU could influence the path of GBP. Therefore, for the first few weeks and months in power, there is room for a little more volatility in GBP and some sectors, such as Energy, with the probability for greater divergence across the potential winners and losers.
- Labour is also aiming for a pro-growth policy. Should a more meaningful change in industrial strategy be seen to boost growth, it would typically boost more domestically oriented stocks. The broader picture, however, is of relative stability when compared to the French election.

Investment implications

- We've recently upgraded our GDP growth forecast for the UK to 0.9%, which is 0.2% ahead of the consensus. While this comes with some upward revision in our CPI forecast, we still see it falling to 1.4% in the second quarter before rising to 2.2%. This opens the door for the BoE to cut rates in August.
- Our upgrade to growth is partly because of the strong start to the year but also due to resilient real wage growth, which has largely absorbed increases in mortgage rates, some resilience to the housing market and, as a product of these, improving consumer confidence. We expect higher growth will lead to better earnings, with our earnings activity indicator picking up.
- We also upgraded UK equities to overweight in June and highlighted that international investors had taken note of the improved outlook, with a visible increase in investment in UK equities. Valuations are cheap compared to the US and the rest of the world, as well as their historical levels.
- Our overweight on gilts remains. With Labour signing up to the Conservative's fiscal rule of falling the UK government debt-to-GDP level within a five-year period means that the gilts market reaction is likely to be subdued. Markets have taken the resilience of the UK economy to higher rates and extrapolated forward to a future where the interest rates cycle oscillates around 3.5%. The risks to rates are skewed to the downside, in our view. This opens up a clear opportunity to put cash to work in gilts, locking in these higher rates, especially now that yields trade at attractive levels.
- In June, we shifted to a neutral view on GBP from negative earlier. This relative improvement helps importers' purchasing power, including households and smaller-cap or domestically focused companies.

UK earnings are set to pick up



Source: Bloomberg, HSBC Global Private Banking and Wealth, as at 5 July 2024. Past performance is not a reliable indicator of future performance.

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