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# UK General Election

## The need-to-knows ahead of 4 July

- After 14 years of Conservative rule, polls and prediction markets indicate a Labour majority government led by Keir Starmer as the most likely outcome in the next general election due on 4 July.
- Despite the challenges of overturning more than 100 constituencies, the struggles faced by the Tories and the SNP make a Labour victory most likely.
- We expect the market impact to be limited given the limited fiscal headroom and the ghost of the 2022 “mini”-Budget still enforcing fiscal responsibility.

After 14 years of Conservative party rule, a Labour majority government led by Keir Starmer is at present the most likely outcome after the general election according to both polls and prediction markets (chart 1 and 2). To secure the outright majority, Labour will need to overturn 123 constituencies. This follows the worst post-war defeat for the Labour party in 2019. By comparison, only 59 seats were required in the 1997 election, which secured a landslide Labour win (chart 3). However, with the headwinds that have faced both the Tories and the Scottish National Party (SNP) the past years, a Labour victory is in the cards.

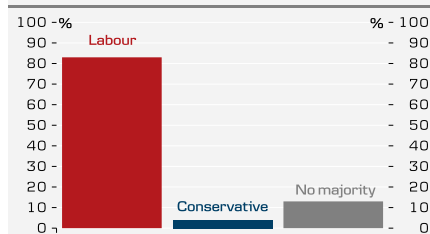
Regardless of the election outcome, fiscal policy is likely to remain constrained in light of the large public debt and in the absence of a noteworthy improvement in the structural outlook (e.g. productivity growth, see chart 4). In March, the UK fiscal watchdog the OBR, estimated that the fiscal headroom is historically slender at GBP 8.9bn against the objective of lowering the debt-to-GDP ratio over the rolling five-year forecast horizon. This has led both parties to campaign on the notion of fiscal responsibility. Likewise, Labour has watered down policies such as the GBP 28bn a year green investment pledge following questions on funding. While the respective election manifestos have not been presented yet, we aim to outline key policies and respective differences below.

### Key policies: spending, taxes, EU, Brexit and the BoE

**Spending and taxes.** With the tax-burden set to rise to the highest level post-war according to the OBR, neither party has unsurprisingly been eager to outline plans to increase taxes. On balance, we expect Labour to prove more inclined to fund increased spending via tax raises (e.g. removing the tax break for private schools and targeting taxes on wealth). Additionally, Labour is set to have more focus on industrial policy, labour market reforms and decentralisation aimed at boosting supply as highlighted by Starmer. As outlined by chancellor Hunt, a Conservative government would likely prioritise continued cuts to National Insurance contributions (NIC) with an eventual ambition to scrap it altogether. Conversely, Labour party is likely not to deliver further cuts to NIC with its ties to pension funding. More details on Labour policy is presented in Box A below.

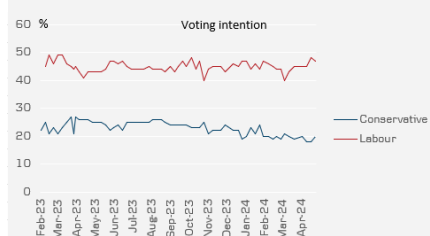
**EU and Brexit.** While a Brexit reversal is highly unlikely under the rule of either party, we expect a more cooperative stance toward the EU under a Labour government.

Chart 1. Prediction markets point to outright Labour majority ...



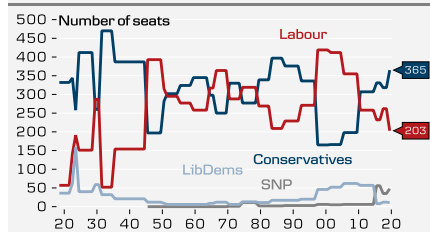
Source: Betfair, Macrobond Financial.

Chart 2. ... and so do the polls



Source: YouGov

Chart 3. Historical election results



Source: ONS, Macrobond Financial

Analyst, UK Research  
Kirstine Kundby-Nielsen  
+45 45 14 15 29  
kigrn@danskebank.dk

A smoother implementation of post-Brexit regulation would initially be positive for the UK economy and UK assets, boosting growth and improve the supply side. However, we highlight the risk of the political process falling short of expectations leaving the lasting impact more muted, which has also been the case previously.

**BoE.** We expect neither government to interfere with either the inflation target nor the BoE’s independence. Last month, former Labour PM Gordon Brown proposed reverse tiering on BoE reserves, which has sparked concern as to whether a Labour government would use this to fund spending. Reverse tiering would reduce the interest paid on deposits placed at the central bank. Conversely, chancellor Hunt has noted that he is “not considering” the proposal, since it could impact the competitiveness of British banks.

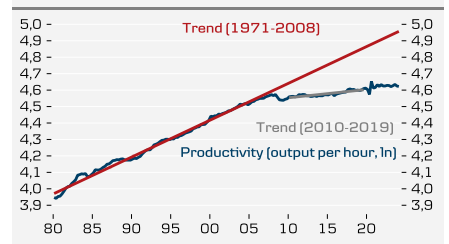
**We expect limited market impact**

Overall, we expect the market impact of the UK general election on 4 July to be fairly muted with both parties firmly campaigning on the notion of delivering economic stability and the fiscal policy likely to remain constrained. In the regard, we deem the likelihood of another fiscal event akin to the “mini”-budget as unlikely. With the “mini”-budget still fresh in mind, this will also limit the possibility of the Labour party turning to unfunded spending, which historically has worried markets and triggered a subsequent rise in Gilt yields. However, closer ties to the EU, policies aimed at boosting growth and the supply side of the economy, less policy uncertainty are on balance GBP positive although we do not want to overstate the impact. For UK assets, we believe the cyclical backdrop, the global investment environment alongside the policy action from the BoE to prove more important for UK assets.

Given the UK’s large current account deficit the GBP has historically been very sensitive to political uncertainty. However, this time around a Labour victory remains a clear base case for both markets and political pundits, which limits the potential for an uncertainty induced setback to GBP.

We do not believe the timing of the election will interfere with the BoE delivering the first 25bp cut in August. Alongside the recent topside surprise to inflation, the timing of the election further reduces the chance of an earlier move in June given the pre-election black-out period, limiting the BoE’s communication on policy action.

**Chart 4. Poor productivity growth hinders UK growth prospects**



Source: ONS, Macrobond Financial

**Box 1. Labour policy: The “First Steps”**

1. Deliver economic stability with tough spending rules, so we can grow our economy and keep taxes, inflation and mortgages as low as possible.
2. Cut NHS waiting times with 40,000 more evening and weekend appointments each week, paid for by cracking down on tax avoidance and non-doms.
3. Launch a new Border Security Command with hundreds of new specialist investigators and counter-terror powers to smash criminal gangs and strengthen our borders.
4. Set up Great British Energy, a publicly-owned clean power company, to cut bills for good and boost energy security, paid for by a windfall tax on oil and gas giants.
5. Crack down on antisocial behaviour, with more neighbourhood police paid for by ending wasteful contracts, tough new penalties for offenders, and a new network of youth hubs.
6. Recruit 6,500 new teachers in key subjects to set children up for life, work and the future, paid for by ending tax breaks for private schools

Source: Labour

**Box 2. UK election system**

**First past the post.** Each of the 650 constituencies elects one Member of Parliament (MP) by the so-called ‘first past the post’ system, where the candidate with most votes (not necessarily the majority of the votes) takes the seat (‘winner takes all’). This election system benefits the big parties and explains why the Conservative Party and the Labour Party have taken turns leading the government. Recently however, this has increasingly resulted in hung parliaments (i.e. no party with an absolute majority by itself) following the 2010 and 2017 elections.

**Tactical voting.** The ‘winner takes all’ system also means there is a higher degree of tactical voting, as there is a high risk of a wasted vote. This explains why the Scottish National Party (SNP) has many MPs, while its share of the national vote is small. It also explains why it is difficult to translate national voting intentions into number of seats.

**Majority.** To win the outright majority, 326 seats are needed but in practice the number is a slightly lower, as historically Sinn Fein (the Irish Republican Party) MPs have not taken their seats. The Speaker is also considered neutral.

**Fixed-term elections.** The Fixed Term Parliament Act of 2011 introduced fixed-term elections with an election every fifth year with two exceptions: 1) the House of Commons dissolves itself by a two-thirds majority, or 2) the government loses a no-confidence vote, and no new government is formed within two weeks.

**Polling stations.** Polling stations are open from 08:00 CET to 23:00 CET with exit polls released after polling stations close. We usually know the election results early in the morning of the following day.

*Source: UK parliament*

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