Hymans Robertson Investment Services (HRIS)

Labour's first Budget

September 2024

- The UK Budget is not normally significant enough to move global asset prices. Any impact on UK assets is likely to be limited to sterling, gilts, and potentially certain UK equity sectors and/or UK centric businesses.
- Some taxes are expected to rise, but it's thought the Government's major revenue sources should be protected. It's noticeable that the Chancellor's recent tone is signalling that the budget could be less restrictive than was maybe first thought, with suggestions that some of the money from tax hikes will be used to boost investment spending.
- HRIS portfolios are globally diversified, which should help dampen any volatility associated with the Budget.

Labour's much awaited first Budget is now just a matter of weeks away[1]. Much of the speculation in the build-up has related to potential tax changes that the Chancellor may announce. In this note, we're not making any comments relating to tax advice (we'll leave that to the tax specialists) and instead we've set out some comments relating to potential investment-related themes.

Budget expected to be an insignificant event in a global context

First of all, it should be noted that, in the context of global assets, the UK budget is typically a relatively insignificant event and it's therefore expected to have limited-to-no impact on international asset prices. Indeed, even its impact on UK assets is likely to be mostly limited to gilts (UK government bonds), certain UK equity sectors that are affected by specific policies (the global nature of the firms on the FTSE 100 means this will mostly be limited to smaller, UK-focused businesses) and potentially sterling.

Any impact on gilts and sterling will be driven by what the Budget's overall impact is on the outlook for government borrowing. A significant net increase in borrowing, caused by either lower taxes and/or increased spending may have a detrimental impact on gilt prices and sterling's relative strength. It should be remembered though that this is in the context of what investors already expect. Since coming into 11 Downing Street, Rachel Reeves has been highlighting the challenging position surrounding public finances - given this, much will already be priced into markets. It's also worth noting that HRIS portfolios are globally diversified (by asset class, style, and currency) which should help dampen any volatility, should there be any significant short-term market moves on the back of the Budget.

Tax increases likely but not likely to cause market volatility in isolation

The consensus is that there are likely to be some tax increases. Given the constraints that the Chancellor has put on raising any of the major sources of tax revenue like income tax and VAT, the main potential sources of additional tax revenue are thought to include capital gains tax (CGT), inheritance tax (IHT) and pensions tax relief. There are concerns that a change in CGT and pension tax relief may lead to a notable trading of assets around the time of the Budget, which could contribute to increase market volatility. We think volatility driven purely by the Budget is unlikely for a number of reasons, including as outlined above, the implications of the UK Budget tend to be small in a global context and investments are held in many forms e.g. pensions and maybe not caught from any tax-related announcements.

[1] The Budget is on 30 October. The Chancellor's speech is expected to start around 12.30 and last for about an hour.

Government borrowing to increase but scope exists for boosts to investment

Government officials are considering a range of options to loosen constraints on investment imposed by the existing fiscal rules, which require debt to fall as a share of GDP in five years' time. The Chancellor wants the Treasury to better recognise the benefits of investment, rather than primarily the costs. As part of this, officials are examining alternative measures of the government balance sheet that reflect the assets created via investment, not just the liabilities.

However, the government will need to be cautious about how much borrowing capacity it uses for investment given the need for it to maintain the confidence of financial markets. Miscommunication, or the perception that the government is borrowing to fund day-to-day spending pose a risk to both sterling and gilts. The government is also heavily constrained by its other main fiscal rule, which required it to balance the budget when investment is stripped out.

Summary

Outside of potentially careless statements, fiscal events such as the Budget generally have a low impact on asset prices (with the possible exception of gilts and sterling). Some taxes are expected to rise, but this will probably limit, not eliminate, any increase to government borrowing. The Chancellor may try to generate more fiscal headroom which has the potential to be well received by the market if suitably justified and evidenced.

.

Jack Richards
Investment Manager