Insights, Tacit Thought | Weekly Investment Insights

Whatever your politics, the budget in the UK this week matters.

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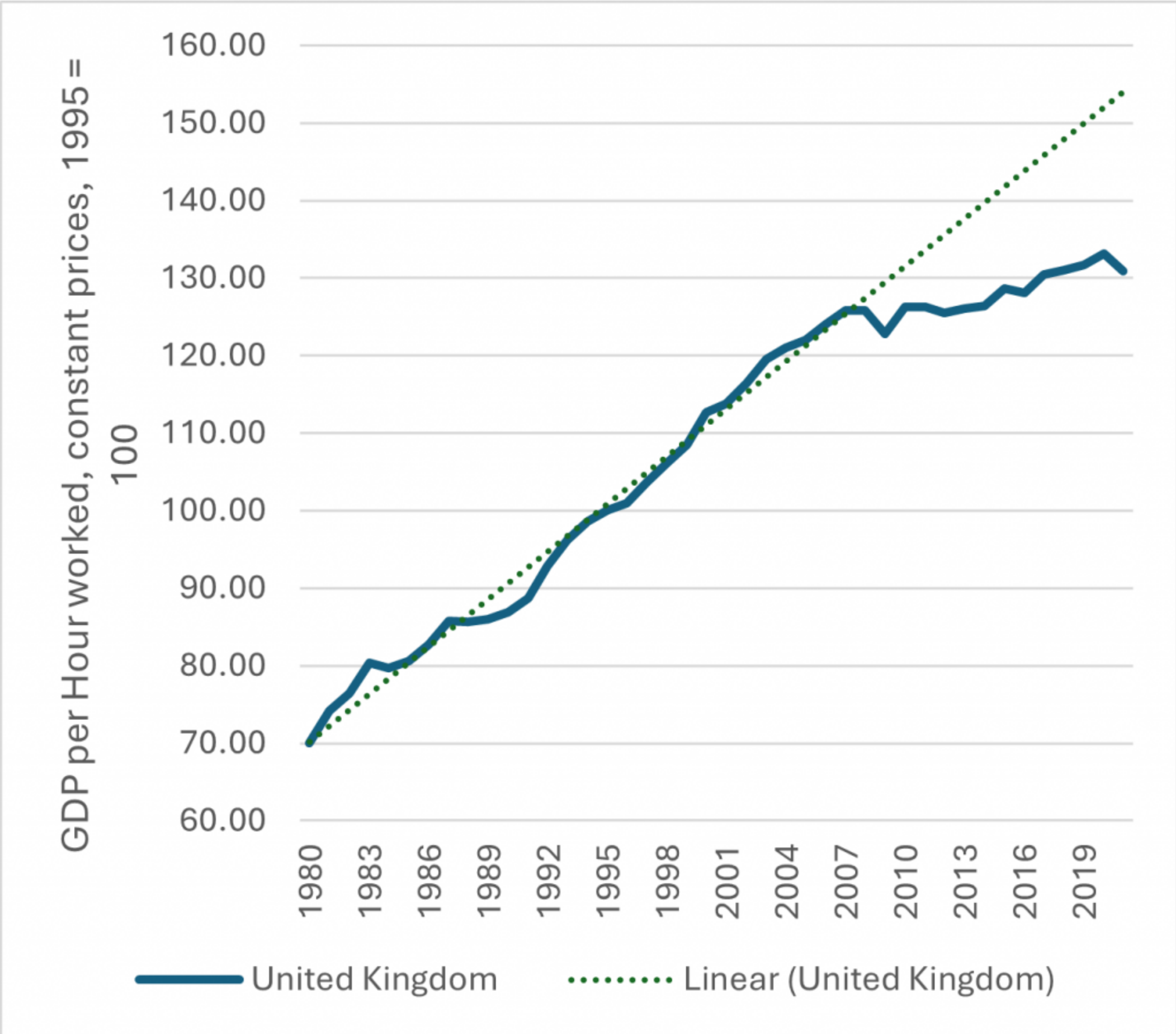
As investors, our primary focus is on what the chancellor Rachel reeves is trying to achieve and most importantly whether she can deliver on the plan.

Firstly some context. The UK economy, as shown in the chart below, has grown at a very slow rate over the past decade. This is well below the historic trend and if we account for population growth, GDP per capita, the chart would look even worse.



Source: Tacit Investment Management, October 2024.

An aging population alongside this poor growth has led to higher taxes. These taxes could be lower, but at the expense of a major structural change to the welfare state be it through lower benefits spend or an overhaul of how the NHS is funded in future.

The budget this week aimed to deal with day to day issues by raising taxes further with the hope that this extra spend will solve some of the immediate political issues that the Labour government has inherited. At the same time, the Chancellor committed to borrowing more to invest with the aim of improving the UK growth rate as well as improving productivity. If these two work, the trajectory of the growth line in the above chart would increase, illustrating improved growth. This would then result in lower debt ratios and hopefully lower taxes by the end of this parliament.

If the government does not achieve its objective, the UK population will be saddled with higher debts and a higher annual tax burden. In the modern world, voters have shown very little patience, and it is unlikely this will change for the current government. Therefore, the new administration needs to establish its credibility quickly making this budget unusually important. It will be interesting to see how market reactions in UK gilts and equities develop. The investment angle for those in the UK is actually quite straightforward. Firstly, if the government succeeds in its aims over the next few years, UK assets should perform well relative to their European peers as there has been a higher risk premium attached to them over the past few years. If they do not, our hunch is that it is not bond yields that will rise materially as they did during Liz Truss's tenure as taxes have been increased materially but a falling Pound will likely do most of the heavy lifting. At present, our portfolios remain skewed away from the UK and we do not see any reason to revisit this in the short term following the events of this week.

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