

**HENRY COOK**  
*Senior Europe Economist*

Economic Research Office

T: +44 (0)20 7577 1591  
E: henry.cook@uk.mufg.jp

**MUFG BANK, LTD.**  
A member of MUFG, a global financial group

## An end to the political chaos?

25 October 2022

The appointment of Rishi Sunak as the UK's new prime minister has been met with a positive market reaction as a line is drawn under the ill-fated 'Trussonomics' experiment. After a turbulent period for the UK we now expect a period of relative calm. For Sunak, the challenge will be to restore fiscal discipline amid dwindling public support and a faltering UK economy.

### The new PM seeks to restore credibility

Liz Truss became the shortest-serving prime minister in UK history following her resignation after just 44 days in office. Her successor, Rishi Sunak, has been chosen in rapid time. Candidates needed to reach 100 nominations from Conservative MPs (there are 357). It became clear that Sunak's main rivals (Boris Johnson and Penny Mordaunt) could not muster enough support and both dropped out of the race. This meant that Sunak was selected as Conservative leader without the scheduled vote of party members to separate the two leading candidates.

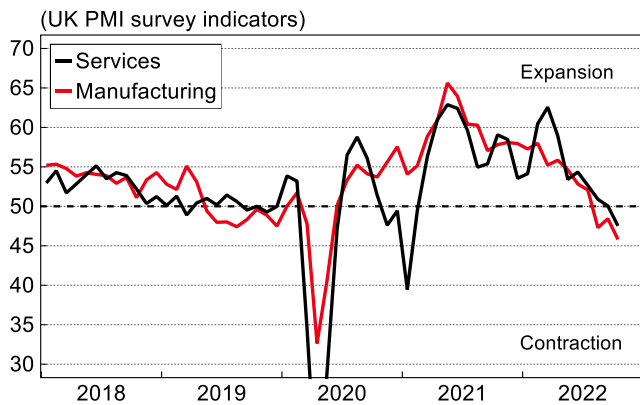
There should now be a period of relative stability after the turmoil of Truss. Sunak, previously UK chancellor, ran against Truss in the previous leadership election on a platform of fiscal discipline. His warnings that her plans were a 'fairy tale' and would drive up interest rates were vindicated (see [here](#)), and so he comes into his new role with credibility. The market reaction to the announcement he will be the new PM was clearly positive. He is pragmatic and can be seen as a safe pair of hands who will not pursue radical policies. Sunak supported Brexit but seems less likely to be needlessly antagonistic towards UK allies (in a way some of his predecessors may have been), which should reduce the chances of future bust-ups with the EU.

### Political challenges will remain

While the change of prime minister is good news for UK financial stability, it is unlikely to be entirely plain sailing. Sunak has inherited an economy slipping into recession (Chart 1) and a deeply-divided Conservative Party. He has to immediately make significant tax and spend decisions (see below) and there may be internal opposition to some policies. The fact that Sunak achieved the support of a strong majority of the parliamentary party combined with the brevity of his predecessor's term in office means that he should be safe from leadership challenges for a while. However, there is a risk of an early election (the next is due to be held by January 2025) should he struggle to find support for his economic policies in parliament.

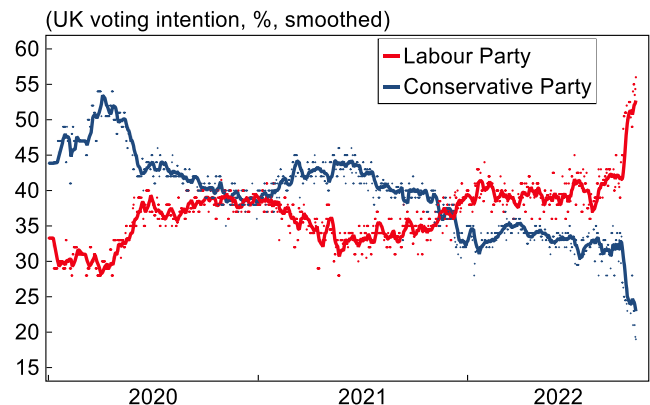
Sunak's profile increased sharply during the pandemic as he introduced the furlough scheme and subsidies for restaurant meals, but his electoral appeal with the wider public has not been tested. Nonetheless, we expect he will enjoy something of a honeymoon period in the polls. Frankly, it's hard to see how the figures can get much worse for the Conservatives. But it will be a big ask to overtake Labour's lead (Chart 2) as cost of living pressures mount. Households will increasingly feel the pain from more expensive mortgage payments as fixed term deals expire. Rates would have increased regardless as central banks tighten policy, but this will be indelibly linked in the minds of many to policy choices made by Conservative governments.

**CHART 1: UK SLIPPING TOWARDS RECESSION**



Source: IHS Markit, MUFG Bank Economic Research Office

**CHART 2: LABOUR HAVE OPENED A LARGE LEAD**



Source: Europe Elects, MUFG Bank Economic Research Office

Prediction markets are currently suggesting that Labour have a 62% probability of winning the most seats at the next UK general election. Our takeaway from the recent party conference was that Labour would take a more moderate approach to fiscal policy in power, at least initially, than may have been the case in the past. The Truss experience also will serve as a strong deterrent against big spending pledges. However, the fact that a change in government within two years is plausible may weigh on areas such as business investment, which has seen anaemic growth for some time, given the prospect of significant regulatory shifts.

#### **A tough balance between spending cuts and tax increases**

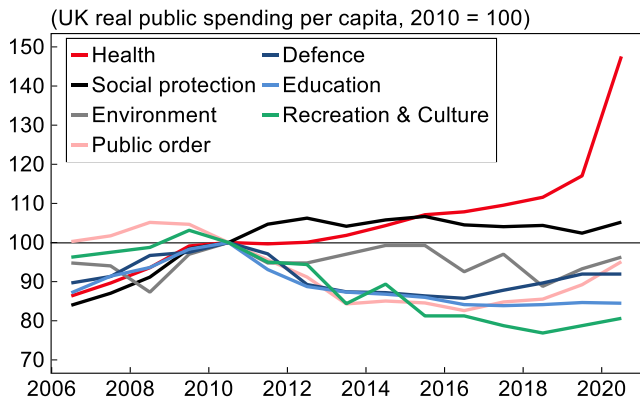
During his period as chancellor (February 2020 – July 2022), Sunak did not introduce any notable cuts to government expenditure. As well as the pressures of the pandemic, that was probably due to reluctance from Boris Johnson to make unpopular decisions. Sunak was then criticised from within his own party for putting the UK on course to have a historically high tax-to-GDP ratio of 36% as he sought to balance the books. Despite this, Sunak's natural instinct is probably to cut taxes when possible. But, he will be wary of the inflationary effect of doing so and conscious of the immediate need to put the UK on a sustainable fiscal footing after the market reaction to 'Trussonomics'.

With the next election looming, and the Conservatives trailing in the polls, it will again be tempting to kick politically painful decisions on spending down the road. There are few obvious targets for cuts after post-GFC austerity (Chart 3), and any reductions in capital spending or services should be considered alongside the UK's longstanding issues with productivity growth.

In the absence of swingeing spending cuts, we think it will be hard to bring down the tax-to-GDP ratio (Chart 4) in the medium term. One of the few measures announced by Truss that was not reversed by new Chancellor Jeremy Hunt (see [here](#)) was the cancellation of the 1.25pp increase in National Insurance contributions. This increase was actually introduced by Sunak when chancellor to help support health and social care funding, and so he may be keen to see it go ahead. Another option will be to introduce 'stealth' tax increases – the freezing of income tax thresholds despite high inflation – to increase government revenues.

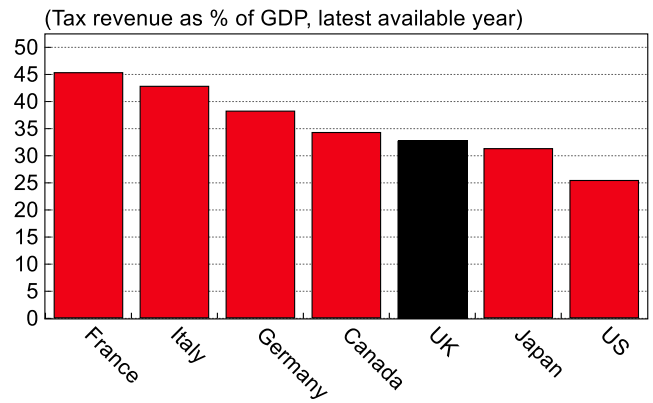
Sunak's fiscal priorities should be revealed next week. As it stands, a medium-term fiscal plan announcement is scheduled for 31 October, and this is to be accompanied by new OBR forecasts. The market reaction is likely to be minimal – a stark contrast to the fallout from the Truss 'mini' Budget.

**CHART 3: THERE ARE FEW OBVIOUS TARGETS FOR SPENDING CUTS**



Source: UK Treasury, MUFG Bank Economic Research Office

**CHART 4: UK TAX-TO-GDP IS STILL LOW BY EUROPEAN STANDARDS**



Source: OECD, MUFG Bank Economic Research Office

## CERTIFICATION

The author(s) mentioned on the cover of this report hereby certify(ies) (or, where multiple authors are responsible, individually certify with respect to each security that the author covers in this report) that the views expressed in this report accurately reflect their personal views about the subject company(ies) and its (their) securities, and also certify(ies) that they have not been, are not, and will not be receiving direct or indirect compensation in exchange for expressing any specific recommendation(s) or view(s) in this report.

## DISCLAIMERS

This report has been prepared by the Global Markets Research, US Rates and Credit Strategy desks within MUFG Bank, Ltd. ("MUBK") and MUFG Securities EMEA plc ("MUS(EMEA)") and may be distributed to you either by MUBK, MUS(EMEA) or by another subsidiary of the Mitsubishi UFJ Financial Group ("MUFG").

### Legal entities and branches

The securities related businesses within MUFG (together referred to in this presentation as "MUFG Securities") are: (1) MUFG SECURITIES EMEA PLC ("MUS(EMEA)") which is authorised in the United Kingdom by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority ("FCA") and the PRA (FS Registration Number 124512). MUS(EMEA) has a branch office that is registered at Level 3, East Wing, The Gate, Dubai International Financial Centre, PO Box 506894, Dubai, UAE ("Dubai Branch"). The Dubai Branch is authorised to operate in the Dubai International Financial Centre ("DIFC") as a Non-DIFC Entity (Commercial License Number CL1656) and is regulated by the Dubai Financial Services Authority (Reference Number F002623); (2) MUFG Securities (Europe) N.V. ("MUS(EU)") which is authorized and regulated in the Netherlands by the Dutch Authority for the Financial Markets (AFM) and also regulated by De Nederlandsche Bank (DNB). MUS(EU) Paris Branch is regulated in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and the Autorité des marchés financiers (AMF); (3) MUFG SECURITIES AMERICAS INC. ("MUSA") which is registered in the United States with the Securities and Exchange Commission ("SEC") and regulated by the Financial Industry Regulatory Authority ("FINRA") (SEC# 8-43026; CRD# 19685); (4) MUFG SECURITIES (CANADA), LTD. ("MUS(CAN)") is an investment dealers registered in Canada with the Ontario Securities Commission ("OSC") and in each province and territory of Canada, a member of the Investment Industry Regulatory Organization of Canada ("IIROC"), and a member of the Canadian Investor Protection Fund ("CIPF"). Customers' accounts are protected by CIPF within the specified limits; (5) MUFG SECURITIES ASIA LIMITED ("MUS(ASIA)") which is incorporated in Hong Kong, licensed under the Hong Kong Securities and Futures Ordinance and regulated by the Hong Kong Securities and Futures Commission (Central Entity Number AAA889). MUS(ASIA) is registered as a foreign company under the Corporations Act 2001 of Australia ARBN No. 169 329 453; and (6) MUFG Securities Asia (Singapore) Limited ("MUS(ASP)") which is licensed as an approved merchant bank by the Monetary Authority of Singapore. In respect of the financial services provided to wholesale clients in Australia, MUS(ASIA), MUS(EMEA), MUS(USA) and MUS(ASP) are each exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 of Australia under the Australian Securities and Investments Commission Class Order Exemption CO 03/1099, CO 03/1103, CO 03/1100, and CO 03/1102, respectively. Each of MUS(ASIA), MUS(EMEA), MUSA, MUS(CAN), and MUS(ASP) are regulated under the laws of Hong Kong, the United Kingdom, the United States, Canada and Singapore respectively, which differ from Australian laws.

MUFG Bank Ltd ("MUBK"), is a limited liability stock company incorporated in Japan and registered in the Tokyo Legal Affairs Bureau (company no. 0100-01-008846). MUBK's head office is at 7-1 Marunouchi 2-Chome, Chiyoda-Ku, Tokyo 100-8388, Japan. MUBK's London branch is at Ropemaker Place, 25 Ropemaker Street, London EC2Y 9AN, and is registered as a UK establishment in the UK register of companies (registered no. BR002013). The principal office of MUBK's Canada branch (MUFG Bank, Ltd., Canada Branch) is located at 200 Bay Street, Suite 1800, Toronto, Ontario, M5J 2J1, Canada. MUFG Bank's Canada branch is an authorized foreign bank branch permitted to carry on business in Canada pursuant to the Bank Act (Canada); Deposits with MUFG Bank Canada are not insured by the Canada Deposit Insurance Corporation. MUBK is authorised and regulated by the Japanese Financial Services Agency. MUBK's London branch is authorised by the UK Prudential Regulation Authority ("PRA") and regulated by the UK Financial Conduct Authority ("FCA") with limited regulation by the PRA.

### General disclosures

This report is for information purposes only and should not be construed as investment research as defined by MIFID 2 or a solicitation of any offer to buy or sell any security, commodity, futures contract or related derivative (hereafter "instrument") or to participate in any trading strategy. This report does not constitute a personal recommendation and does not take into account the individual financial circumstances, needs or objectives of the recipients. Recipients should therefore seek their own financial, legal, tax or other advice before deciding to invest in any of the instruments mentioned in this report.

Certain information contained in this report has been obtained or derived from third party sources and such information is believed to be correct and reliable but has not been independently verified. MUFG does not make any guarantee, representation, warranty or undertaking, express or implied, as to the fairness, accuracy, reliability, completeness, adequacy or appropriateness of any information or comments contained in this report. Furthermore the information may not be current due to, among other things, changes in the financial markets or economic environment. MUFG has no obligation to update any such information contained in this report.

The information contained in this report may contain forward-looking information ("FLI"). FLI is information regarding possible events, conditions, or results of operations that is based on assumptions about future economic conditions and courses of action and may be presented as either a forecast or a projection. This report is not intended to forecast or predict future events. Past performance is not a guarantee or indication of future results. Upon receipt of this report, each recipient acknowledges and agrees that any FLI included herein should not be considered material. Recipients should consult their own legal and financial advisers for additional information. Any prices provided herein (other than those identified as being historical) are indicative only and do not represent firm quotes as to either price or size.

This report is proprietary to MUFG and may not be quoted, circulated or otherwise referred to without our prior written consent. Notwithstanding this, MUFG shall not be liable in any manner whatsoever for any consequences or loss (including but not limited to any direct, indirect or consequential loss, loss of profits and damages) arising from any reliance on or usage of this report and accepts no legal responsibility to any investor who directly or indirectly receives this material.

### Country and region specific disclosures

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or is located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to any law, regulation or rule. Each entity and branch within MUFG is subject to distinct regulatory requirements and certain products and services discussed in this document may not be available in all jurisdictions or to all client types.

In this regard, please note the following in relation to the jurisdictions in which MUFG has a local presence:

- United Kingdom / European Economic Area (EEA): This report is intended for distribution to a "professional client" or "eligible counterparty" as those terms are defined in the rules of the FCA and PRA. In other EEA countries, this report is intended only for persons regarded as professional investors (or equivalent) in their home jurisdiction.

• United States of America: This report, when distributed by MUSA, is intended for Institutional Investors ("Institutional Accounts" as defined by FINRA Rule 4512(c)). When distributed by a non-US affiliate of MUSA, this report is intended for distribution solely to "major U.S. institutional investors" or "U.S. institutional investors" pursuant to Rule 15a-6 under the U.S. Securities Exchange Act of 1934, as amended. Securities referenced in this report may have been underwritten by MUSA and/or its affiliates. Nothing in this report should be considered an offer or solicitation of an offer to buy or sell securities or any other financial product or a commitment of any kind with respect to any transaction.

IRS Circular 230 Disclosure: MUFG Securities does not provide tax advice. Accordingly, any discussion of U.S. tax matters included herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone not affiliated with MUSA of any of the matters addressed herein or for the purpose of avoiding U.S. tax-related penalties.

• Hong Kong: This report is only intended for distribution to a "professional investor" as that term is defined in the Securities and Futures Ordinance and should not be passed onto any other person.

• Singapore: This report is only intended for distribution to an "institutional investor", "accredited investor" or "expert investor" as those terms are defined under regulation 2 of the Financial Advisers Regulation. It is solely for the use of such investors and shall not be distributed, forwarded, passed on or disseminated to any other person. Investors should note that, as a result of exemptions that apply when this report is distributed to "accredited investors" and "expert investors", MUSS is exempt from complying with certain requirements under the Financial Advisers Act, including section 25 of the Financial Advisers Act (which requires a financial adviser to disclose all material information on certain investment products), section 27 (which requires a financial adviser to have a reasonable basis for making recommendations on investments) and section 36 (which requires a financial adviser to disclose any interests that it holds in securities that it recommends).

• Canada: When distributed in Canada by MUS(EMEA) or MUSA. MUS(EMEA) operates under an International Dealer Exemption from registration with the securities regulators in Alberta, British Columbia, Manitoba, Ontario and Québec. MUSA operates under an International Dealer Exemption from registration with the securities regulators in all Canadian Provinces and Territories. When distributed by MUS(EMEA) or MUSA, this report is only intended for a "permitted client" as that term is defined under the National Instrument 31-103 in Canada and is not intended for re-distribution to any other person. When distributed by MUS(CAN), this report is only intended for an "institutional client" as that term is defined under the IIROC dealer member rules and is not intended for re-distribution to any other person. The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, or solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Under no circumstance is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. • Japan: This Note, when distributed by MUFG Securities affiliates located outside of Japan, is intended for distribution in accordance with Article 58-2 of the Financial Instruments Exchange Act 1948 ("FIEA") i) to a "Financial Instruments Business Operator" engaged in "Securities-Related Business" as defined in the FIEA or ii) to the government, the Bank of Japan, a qualified financial institution defined in Article 209 of the Cabinet Office Ordinance Concerning Financial Instruments Business, Etc., or an Investment Manager.

When distributed by Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. ("MUMSS"), this Note is intended for distribution to a "Professional Investor (tokutei-toushika)" as defined in the FIEA.

• United Arab Emirates: This report is only intended for distribution to a "Professional Client" or "Market Counterparty" as those terms are defined under the rules of the Dubai Financial Services Authority and only a person meeting the criteria for these terms should act upon this report.

• Australia: This Note is only intended for distribution to persons in Australia who are sophisticated or professional investors for the purposes of section 708 of the Corporations Act of Australia, and are wholesale clients for the purposes of section 761G of the Corporations Act of Australia. This Note is not intended to be distributed or passed on, directly or indirectly, to any other class of persons in Australia.

Other jurisdictions:

MUFG Securities also relies on local registrations or regulatory exemptions in order to undertake certain securities business in other countries. In Thailand, MUS(EMEA) has a derivatives dealer registration with the Securities and Exchange Commission, Thailand. In Canada, MUS(EMEA) and MUSA each operate under an international dealer exemption registered with the securities regulators. MUS(EMEA) operates under the exemption in Alberta, Quebec, Ontario, British Columbia and Manitoba. MUSA operates under the exemption in all Canadian Provinces and Territories.