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What's to follow on from a Labour victory?

The results are in. Following a convincing Labour win, the UK has voted for a change in government, electing Sir Keir Starmer as the new UK Prime Minister.

Despite the seismic political earthquake, financial markets barely registered a tremor. Indeed, in the weeks leading up to yesterday's general election, investors have been looking everywhere but UK politics. Investors have arguably been responding to a relatively more optimistic investment picture: a constructive mix of improving economic growth, moderating underlying inflation, and the start of interest rate cuts from the Bank of England later this year. This has kept the FTSE 100 UK equity index close to record highs in recent weeks.

Three reasons why markets are relaxed about a labour victory:

Far from being indifferent, the market's seemingly passive response to the incoming new government demonstrates its rationality. Instead of a sudden rush of political apathy, we see three economic factors at play:

First, the market's understanding of political risks is evident.

For some time now, the newly minted Labour government had held a commanding lead over the Conservatives in this week's general election polls. With such an established poll majority, markets have judged that Labour will not need to entertain market-unfriendly economic policies to win extra votes. Perhaps learning lessons from the disastrous, short-lived Liz Truss premiership in the autumn of 2022, Labour are not expected to want, nor need, to risk lurching into radical economic choices, which has arguably hamstrung them in the past.

Second, the market has had time to adjust to a change in leadership.

Given such a long-running lead in the polls before the election announcement, markets have had ample time to prepare. Markets have been reassured regarding the Labour Party's commitment to financial stewardship of the economy. Central to calming market concerns is the commitment made earlier this year by the incoming Chancellor Rachel Reeves. She agreed to maintain the importance of the main fiscal rule – a self-imposed rule where government debt as a percentage of gross domestic product (GDP) must be falling by the fifth year of the official forecast period.

Thirdly, irrespective of Labour's ambitions, there is limited fiscal headroom.

The inescapable reality is that there is limited room for manoeuvre. Fiscal headroom refers to the scope available for tax cuts or higher spending and these constraints are assessed by the Office for Budget Responsibility. And they are harder to meet when economic growth looks weak. The incoming government's ability to move the aggregate fiscal dial and unsettle fixed income markets, is very restricted, which could ironically be seen as a positive. In the near term, the market's reaction to the election outcome was always expected to be minimal, whichever political party had won this week.

It's all about the economy

A so-called Labour 'supermajority' might normally raise concerns around 'tax and spend'. However, so far, it looks like the new government's actions will be centred around growing the size of the UK economic pie, rather than making bigger cuts from it. As much as Brexit will allow, investors expect to see a closer alignment with Europe, reducing trade frictions while also fulfilling its promise to encourage business investment more broadly. This growth-orientated approach will require, among other things, some political stability and long-term thinking, both of which have arguably been absent in recent years.

All in all, investors appear to be quite happy to move on from the theatre of Westminster – it seems there are more important things in financial markets than UK politics.

What happens next for you and your wealth?

Throughout the campaign, the Labour Party manifesto promised not to increase taxes for working people, which is likely to leave a gap in their spending commitments.

What revenue-raising measures are on the cards?

As Chancellor, there are many levers that Reeves can pull, but speculation has been rising that inheritance and capital gains taxes will be a target. And let's not forget about pensions, as political parties like to tinker with this area.

One area already pledged is to add tax to private school fees. For many people, school fees are by far their biggest outgoing, and any increase will be a cause for concern.

On a more niche level, there is debate on whether Labour will change the non-dom tax regime and the beneficial tax treatment for executives working in the private equity industry carried interest.

In the coming weeks and months, we will carefully watch changes that could affect your financial goals while hoping that fears over drastic changes to the wealth landscape will be a storm in a teacup.

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