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Special Coverage: UK investors face another fiscal waiting game

Key takeaways

- The UK's new Prime Minister, Andy Burnham, has prioritised measures to ease cost-of-living pressures, including proposals to remove VAT on household electricity bills, while outlining a broader growth agenda centred on public investment.
- Markets remain focused on fiscal credibility, with gilt yields rising on concerns over higher borrowing. The FTSE 100 has remained relatively resilient, supported by its defensive and energy-heavy composition amid ongoing geopolitical tensions in the Middle East.
- We remain neutral and selective on UK equities, as modest domestic growth, still-above-target inflation, and uncertainty over the new leadership's policies leave limited near-term catalysts for a more positive outlook. The broadly stable rates backdrop for UK gilts, with the Bank of England expected to hold through 2026, is offset by fiscal credibility concerns and the prospect of higher borrowing. We will wait for greater clarity on the fiscal path before adjusting our neutral positioning for UK gilts.

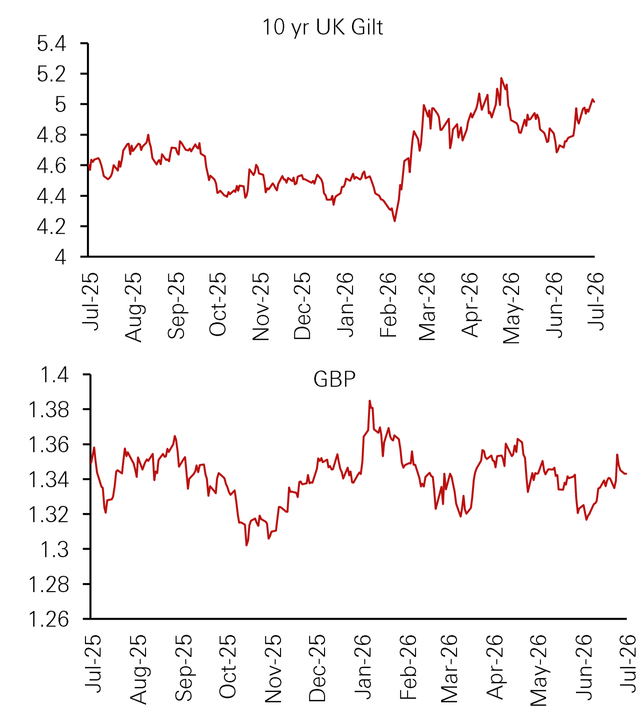
Jonathan Sparks
Chief Investment Officer for the UK, HSBC Private Bank and Premier Wealth

Abhinav Pandey
Investment Strategist, HSBC Private Bank and Premier Wealth

What happened?

- The UK has entered a new political chapter with Andy Burnham becoming Prime Minister. Burnham has pledged a "new economic model" centred on tackling the cost of living, decentralising decision-making and delivering greater investment in public services.
- Financial markets, however, have been quick to focus on the implications for fiscal policy rather than the political transition itself. While these objectives are aimed at supporting long-term growth, investors are looking for reassurance that they can be achieved without undermining the UK's fiscal credibility.
- Markets were concerned by Burnham's comments that the government would seek "flexibility" within its borrowing and spending rules. Investors interpreted this as a signal that fiscal policy could become more expansionary, pushing gilt yields higher across the curve, with 30-year yields reaching their highest level in almost two months. The GBP also weakened as investors demanded a higher premium for holding UK government debt. The reaction reflects how sensitive markets remain to fiscal policy following the 2022 gilt market turmoil.

Gilt yields rose while GBP weakened following the announcement



Source: Bloomberg, HSBC Private Bank and Premier Wealth as of 21 July 2026. Past performance is not a reliable indicator of future performance.

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- The government's first policy announcement was the removal of the 5% VAT rate on household electricity bills from October, a measure expected to save households around £45 per year. Funded by cancelling the previously announced Digital ID programme, the policy is estimated to reduce headline inflation by around 0.1%, while providing modest support to consumer spending. Lower electricity costs should also support the UK's longer-term electrification and green transition objectives by reducing the cost of energy consumption.
- One area worth highlighting is the evolution of the UK's debt profile. Compared with a decade ago, the government now relies relatively more on shorter-dated gilt issuance and less on ultra-long maturities. While this has helped lower borrowing costs during periods of falling interest rates, it also means a larger proportion of debt needs to be refinanced more frequently, making government financing costs more sensitive to changes in market yields. With gilt yields already elevated, maintaining investor confidence in the fiscal framework will therefore be critical.

Investment implications

- For now, much will depend on the government's Autumn Budget, where markets will be looking for greater clarity on spending priorities, borrowing plans and how the new administration intends to balance its growth ambitions with fiscal discipline. Until then, gilts and the GBP are likely to remain sensitive to any signals around fiscal policy and borrowing. We remain neutral on UK gilts.
- The FTSE 100 is relatively well positioned in the current environment. Its meaningful exposure to energy and defensive sectors has helped cushion performance amid heightened geopolitical tensions in the Middle East, providing greater resilience than more domestically focused equity markets. However, given limited catalysts to turn more positive, we remain neutral on UK equities. Looking ahead, if our base case materialises and a severe escalation involving Iran is avoided, we expect the Bank of England to keep the Bank Rate unchanged rather than tighten them further.
- A combination of stable policy rates, easing geopolitical risk and moderating inflation should gradually reduce upward pressure on gilt yields, helping restore confidence in the UK's fiscal outlook. Lower borrowing costs could provide the new government with greater flexibility to pursue its investment and public service agenda while also creating a more supportive backdrop for UK financial assets, particularly domestically exposed companies that stand to benefit from improving consumer confidence and lower financing costs.

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