SUMMER STATEMENT : RISHI SUNAK KEEPS SPENDING

9th July 2020

Rishi Sunak, Chancellor of the Exchequer, yesterday unveiled a further £30bn of government expenditure to support economic activity in the face of the ongoing coronavirus pandemic. The government has now committed £189bn to Covid support measures since March, yet Sunak suggested additional support may still be required.

In addition to confirming previously released support for the construction industry, yesterday's announcement included four key measures:

- A payment of £1,000 per furloughed employee that is brought back to work and retained until January 2021;
- A "kick-starter" initiative designed to encourage the creation of jobs for workers aged between 16 and 25;
- The elimination of stamp duty on house purchases under £500,000 until the end of March 2021;
- A reduction in VAT for the hospitality and entertainment industries and an innovative government funded discount to encourage people to visit newly re-opened restaurants.

From an economic perspective, there is much to like in the Chancellor's plans. The focus on the creation and preservation of jobs is welcome at a time when the labour market faces its greatest challenge in decades. As 'entry level' jobs are highly concentrated in the hospitality and construction industries, efforts to support these areas appears sensible. And, while the bonus for rehiring furloughed workers may only delay a wave of redundancies, it is possible that the economic recovery may be sufficiently advanced by January to ensure these jobs are permanent.

Against these positives, a number of challenges are identifiable. There is little the government can do to discern between furloughed workers rehired because of the £1,000 bonus and those that would have been rehired without it: a portion of the bonus scheme is therefore likely to be a gift from the government to the corporate sector. It is also unclear whether the prospect of £1,000 in January is sufficient to convince companies to accept the cashflow implications of rehiring workers in the interim.

Finally, if workers are rehired on the minimum terms required to qualify for the £1,000 bonus, their income may not support the levels of consumption necessary to return the economy to 'normal'. Meanwhile, the incentive of a discount may be immaterial if consumers are avoiding restaurants because of health – rather than financial – concerns.

Though £30bn of spending is significant, it is likely to be merely a stopgap measure. Indeed, the Chancellor acknowledged that, having seen 18 years' worth of economic growth reversed in just two months, the government has not "done everything [it has] done so far just to step back now and say 'job done'". It is likely that further stimulus will be required by the time Sunak presents the Autumn budget.

WHAT DOES IT MEAN FOR INVESTORS?

The initial market reaction to the Chancellor's statement was muted. As measured by the FTSE All Share index, UK stocks drifted somewhat lower, while government bond yields and sterling exchange rates were little changed. This reaction – or lack of reaction – to a stimulus package that at most other times would be considered sizeable lends weight to the idea that more support is yet to come.

In short, in and of itself, yesterday's announcement means little to investors. However, in the context of Sunak's pledge that the government will continue to help the economy "rebuild", it can be seen as a marker of the future direction of travel, which almost certainly will be of consequence for investors.

It seems likely the government will continue to spend freely. This will require the issuance of debt which, all else being equal, ought to put upward pressure on government bond yields (which move inversely to prices). However, the Bank of England's ongoing quantitative easing programme (in which the bank buys up government debt) should counteract this pressure. Success in supporting employment should feed relatively directly into success in supporting the economic recovery. In turn, this would be expected to be positive for domestic UK share prices, and for the value of the pound.

In other words, after several years of lacklustre returns, there are grounds for cautious optimism among investors in the UK stock market.

The Graphene model portfolios all contain healthy allocations to the UK stock market, attained through actively managed funds seeking the best investment opportunities available. We believe the portfolios are well-placed to evolve with and benefit from the measures being taken to support the UK economy.

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