

Global Perspective

from the Investment Advisory Group

Trussonomics to lead the British pound to parity with the U.S. dollar

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Executive summary

Mary Elizabeth (Liz) Truss became the U.K.'s third female Prime Minister (PM) after Margaret Thatcher and Theresa May. With the country facing down a potential economic crisis, her prescribed policies pose their own risks. She **supports low-tax, high-growth fiscal policies** that could lead to **higher deficits and currency depreciation** if growth objectives do not materialize. Truss also mentioned plans to change the Bank of England's inflation mandate during her campaign. Her economic policies are eerily similar to the former Japanese Prime Minister, Shinzo Abe's, economic plan dubbed "Abenomics". As it happened to the Japanese yen during the "Abenomics" period, we expect the British pound to lose significant value during the "**Trussonomics**" period.

What happened

The U.K.'s 2019 election was a historic moment as Boris Johnson's Conservative Party managed to win a landslide Parliamentary election that empowered Johnson to shape U.K. policy. This strong mandate by U.K.'s political standards did not last long, as scandals over parties in Downing Street during the Covid lockdowns and economic hardships due to soaring inflation eroded his popularity. The scandal that broke the camel's back was Johnson's appointment of Chris Pincher as deputy chief whip despite serious allegations against him of inappropriate behavior. This **led to Boris Johnson's resignation**, and the search for a new leader for the Conservative Party and PM.

After two months of internal horse trading, U.K.'s Conservative Party elected its leader, Liz Truss, and appointed her as the Prime Minister. She was a Secretary of State for Foreign, Commonwealth and Development Affairs in Boris Johnson's cabinet. Truss is a staunch **supporter of free trade and known as a pro-market-friendly politician**; more importantly, in the 2016 Brexit referendum, she supported the remaining camp, but later, she switched her views on Brexit the year after the referendum.

"We will come out stronger," said Boris Johnson in his farewell speech, which we believe will be **far from reality**. In the U.K., every time a new leader gets elected within a party without a general election, the political party weakens due to splits in the leadership selection process. It is hard to believe that this time would be any different.

In her acceptance speech, Truss vowed to deliver a bold plan to **cut taxes, grow the economy, tackle the energy crisis**, and deliver progress on the National Health Service without going into specifics.

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Our take

43% of the Conservative Party did not want her to become their new leader

It took six rounds of voting to elect Liz Truss as the new leader of the Conservative Party. In the fifth round, Rishi Sunak, gathered 24 more votes than Truss, but she moved to the last round by beating third-place winner Penny Mordaunt by only eight votes. In the sixth and final round, Truss managed to gather 57% of the votes beating Rishi Sunak, winner of the previous five rounds. The election process has **divided the Conservative Party**. This division could become more visible when Truss tackles policy initiatives like reducing taxes to businesses or providing stimulus to lower income groups for their energy consumption. She **appointed loyalist** Members of Parliament (MP) to her Cabinet, further aggravating the internal divide.

Freezing energy bills is needed, but it is highly inflationary

According to leaked reports, she is working on **plans to freeze energy bills** until the next general election in 2024. U.K.'s low-income households desperately need support from the government, with energy bills rising relentlessly. Still, any price cap on energy **could promote more energy use**. The cost of capping prices could lift inflation to even higher levels, with consumers chasing other goods and services with their available disposable incomes.

Changing Bank of England's mandate could be disastrous for the British pound

During her campaign, Truss suggested that she would **investigate the Bank of England's inflation mandate**. A low-tax, high-growth fiscal policy doesn't work well with restrictive monetary policies; it would be counterproductive. A key element of Abe's economic policy in Japan was loose monetary policy coupled with expansionary fiscal policy, much like Truss is proposing. At the end, that delivered a weak Japanese Yen with not much change in actual economic growth rates. Similarly, we expect "Trussonomics" to have little meaningful economic impact. To make matters worse, unlike Abe's Japan a decade ago, the **U.K.'s current annual inflation is at double digits**, and the monetary policy rate is at 1.75%, already very loose. The British pound will continue to slide if the Bank of England's inflation mandate is neutered.

British pound at levels not seen since the 1980s – may trade at parity before the 2024 election

Liz Truss becomes the third female PM after Margaret Thatcher and Theresa May. Margaret Thatcher was the PM when the British pound was last this low. Truss' expansionary fiscal policies could push the **British pound to below parity before the next general election**. Recent political uncertainty has not been helpful to the pound, but more importantly, the currency is facing structural headwinds that are hard to ignore. The U.K.'s **productivity is one of the lowest in Europe**, and Brexit exacerbated the bottlenecks on border checks and the availability of skilled workers. The energy relief package could cost over £100b, or close to 3% of the UK's GDP.

U.S. dollar per British pound



Data Source: Truist IAG, Bloomberg

Could this lead to an early election?

Keir Starmer, the opposition Labour Party leader, is opportunistically calling for fresh elections while the Conservative Party is in crisis mode. An early election could be disastrous for the Conservative Party. Fortunately, the party still commands a significant majority in Parliament, and it could give Truss a chance to govern until the end of the full term.

Bottom line

Only 50 M.P.'s voted for Truss during the first round of leadership election, and it took six rounds of the elimination process to make her the leader of the Conservative Party and the leader of the U.K. This **political divide will prevent her from achieving her grandiose plans**. British assets, including the British pound, are cheap by historical standards and could get even cheaper. The **pound will likely reach parity** before the next general election if she can cap energy prices, lower taxes, and change the Bank of England's inflation mandate. We continue to recommend an underweight position in overseas equities, especially in Europe.

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