High inflation, debt and political fault lines: Rishi Sunak faces a challenging few months ahead

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RishiSunak/Twitter

Rishi Sunak, Britain's first prime minister with Indian roots, faces arduous economic and political challenges.

When Sunak was Chancellor of the Exchequer from February 2020 to July, the United Kingdom provided economic assistance to households and businesses to shield them from the impact of the Covid-19 pandemic.

As *The New York Times* notes, inflation was low and the Bank of England was buying government debt while keeping the overall costs of borrowing low so that Sunak had a free hand to increase fiscal spending. Now, the situation is quite different.

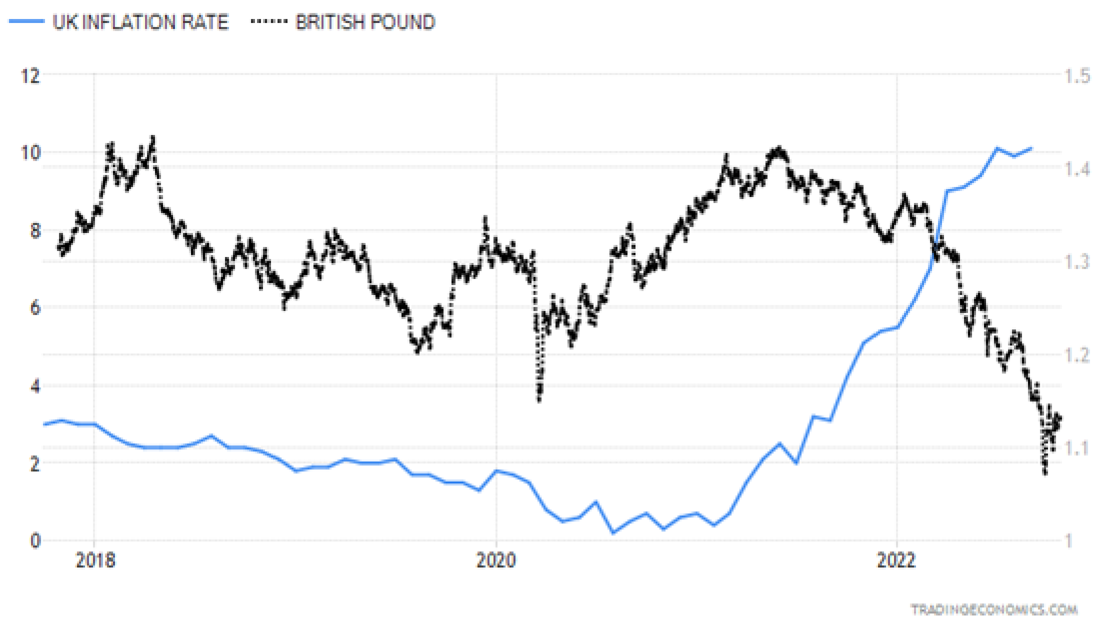
The British pound is depreciating rapidly, weakening its purchasing power and driving up inflation.

Credit: Trading Economics.

There are external factors and the effects of "poly-crises" contributing to price rises in Britain, triggered by a strong dollar, the effects of the Russia-Ukraine war and the supply-side shocks of the pandemic. Britain has systemic, internal challenges as well.

According to *Trading Economics*, the United Kingdom's annual inflation rate rose to 10.1% in September from 9.9% in August, returning to the 40-year high hit in July and crossing market expectations of a 10% rate.

"The largest contribution to the increase was from food (14.8% vs 13.4% in August), namely oils and fats and dairy products," says the *Trading Economics* report. The report states that consumer costs for housing and utilities increased as well – 20.2% from 20% – due to a surge in the cost of electricity, gas, and home fuels.

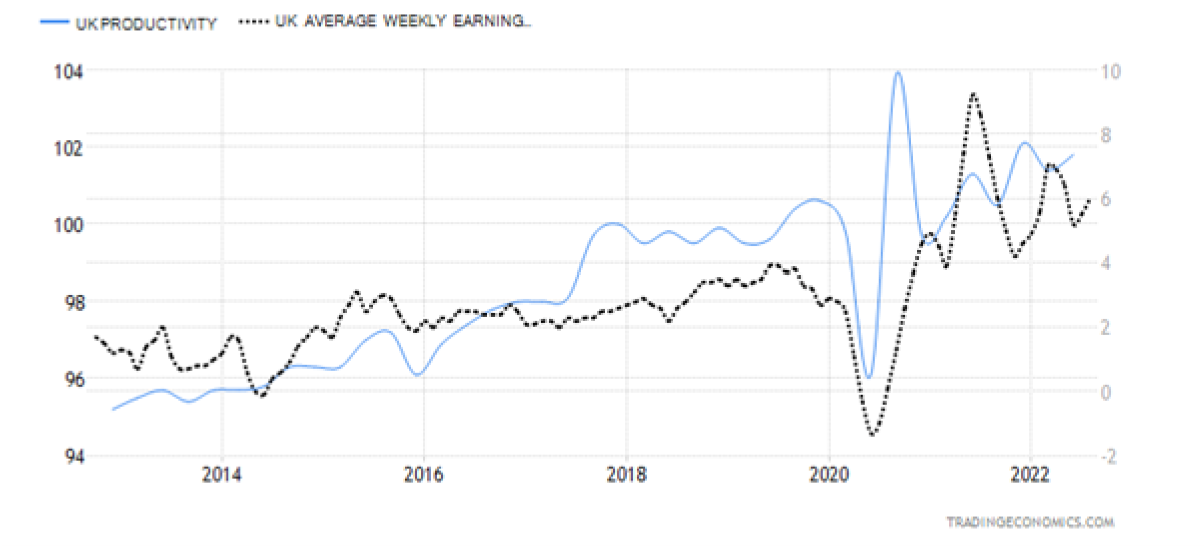


Credit: Trading Economics.

On job creation, the employment rate (as seen above) has been marginally rising, which is good, given the sharp rise in unemployment rates seen in the United Kingdom during the pandemic years 2020 and 2021. But wage growth, when measured in terms of average weekly earnings, has remained volatile, which increases uncertainty, putting pressure on household budgets and debt/borrowing levels at times of soaring inflation.

Credit: Trading Economics.

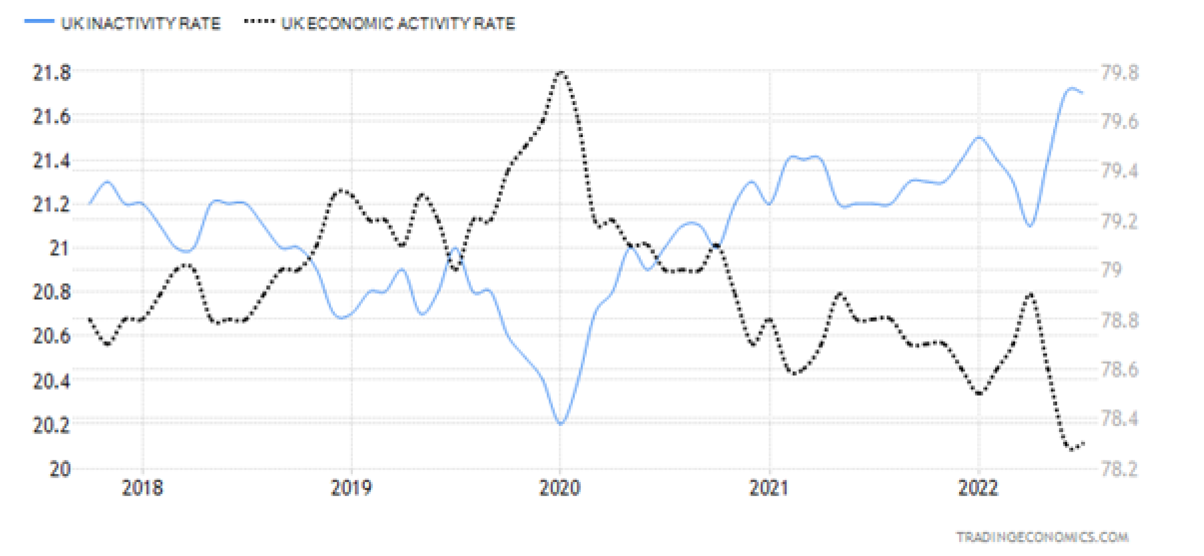
Trends in labour productivity have lost sync with wage growth levels. It reflects a systemic concern in the United Kingdom's nature of job creation in the post-pandemic Brexit context. This is especially true for working classes based outside London where despite the heightened productivity of workers, average wage growth has not risen to the same level.



Credit: Trading Economics.

Another trend is the rise in the levels of economic inactivity amongst the British working class since the pandemic. The United Kingdom's Office for National Statistics defines economic inactivity as: "People not in employment who have not been seeking work within the last four weeks and/or are unable to start work within the next two weeks."

Trends below of the economic inactivity rate and economic activity rate – measured via the labour force participation rate – present a troubling picture of Britain's current labour market orientation. More of the working class, post-2020 has been observed to be "inactive" as against those entering the workforce.

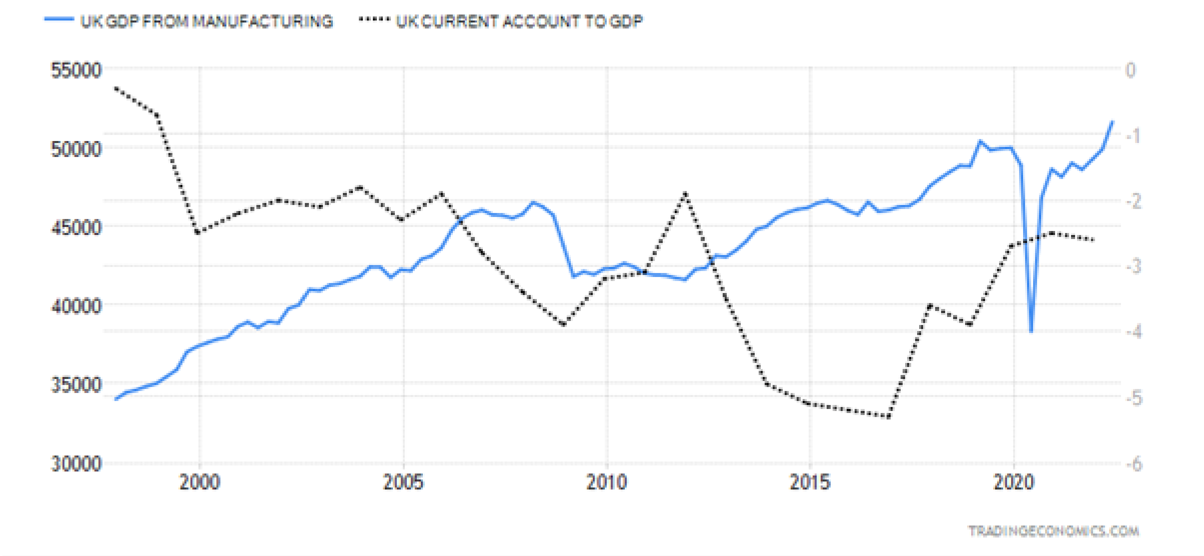


Credit: Trading Economics.

Negative business sentiment

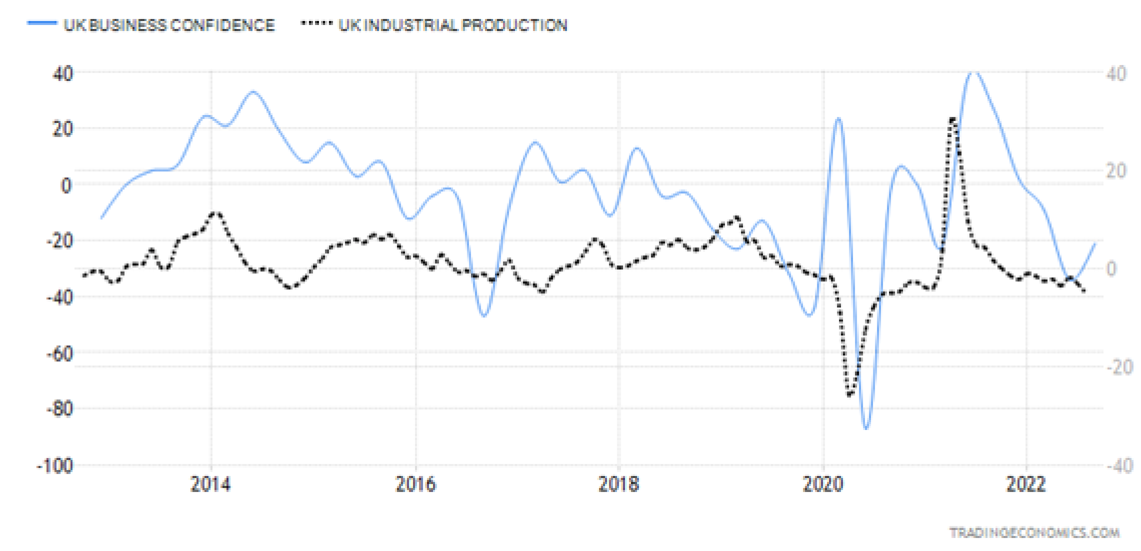
Going by the numbers from the last few decades, Britain's reputation as a strong trading nation and its manufacturing sector-led growth image appears to be a myth. Business sentiment and industrial production levels have remained low, reported *Trading Economics*.

The report notes that according to the Business Optimism Index, published by the Confederation of British Industry's Industrial Trends Survey, optimism improved to -21 in the third quarter of 2022 from -34 during the previous three-month period.



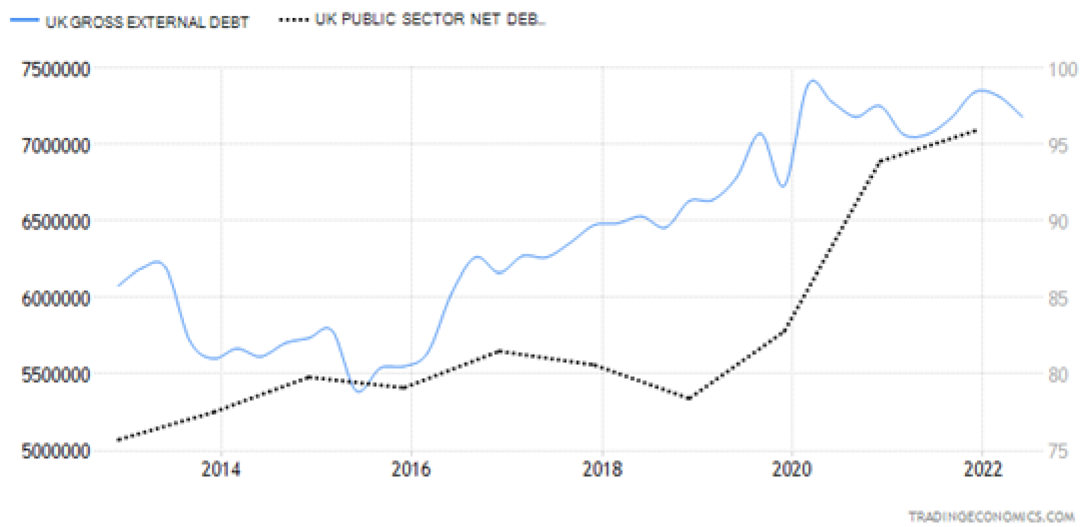
Credit: Trading Economics.

Manufacturing too remained low, says the report. "Growth in manufacturing output and orders eased in the quarter to July, slowing to more typical rates of expansion following a period of exceptionally strong growth over the previous year," said *Trading Economics*. "Average costs and prices continued to rise sharply, although growth eased from recent highs."



Credit: Trading Economics.

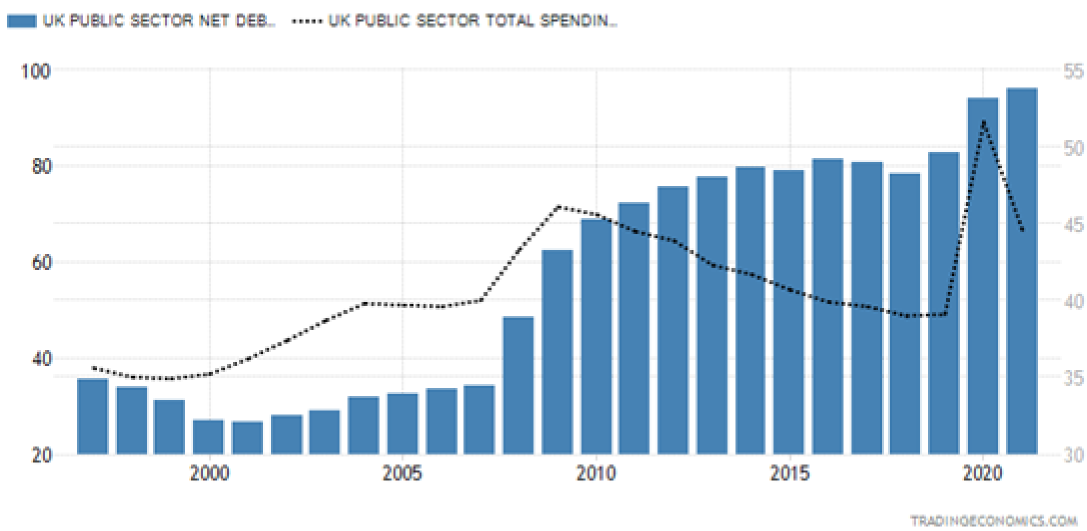
The current account to gross domestic product, or GDP, ratio has been in deficit for most of the last few decades, worsening post 2020. On manufacturing-led GDP growth, Britain is far behind most other industrially developed nations. Brexit and the United Kingdom's divorce with the European Union has not helped either. The UK's debt too has been rising over the last five-six years.



Credit: Trading Economics.

On aggregate debt, the Sunak administration will need to get its fiscal priorities right. As Chancellor of the Exchequer, Sunak may have had the flexibility for fiscal spending, but rising external and government debt levels will put more pressure on him – and the exchequer – to cut back on spending or raise taxes. Either of these moves will be seen as "anti-people" interventions. The move to drastically reduce corporate taxes had drawn immense criticism and eventually led to the exit of Liz Truss as prime minister in 45 days.

The current trend reflects a drop in government spending to GDP levels, something that was initiated by Sunak's predecessors, particularly the Boris Johnson administration, though the public sector debt to GDP ratio has persistently stayed high. In 2021, the United Kingdom'sgovernment debt was 95.9% of the country's GDP. According to Investopedia, debt-to-GDP ratio indicates a country's ability to repay its debt.



Credit: Trading Economics.

What is immediately needed, under Sunak's leadership, is a stable medium-to-long term fiscal consolidation path that gets all members of the Conservative Party on board, which will not be easy. The current government must then be able to pass this plan in

Parliament and then stick to it to reduce fiscal deficit while maintaining essential government spending, bringing down overall borrowing levels in the long term.

A divided kingdom

The UK, in its internal geographical alliance under the Crown-Parliament constitutional monarchy, has not been this divided in the past few decades.

From Wales to Scotland to Northern Ireland, there has been a rising resentment against England's ill-timed political decision making – from the time of Brexit – and the economic policy response to multiple crises. More than three prime ministers have come and left office in less than four years of the Conservative Party's rule.

Following the death of Queen Elizabeth II in September, it is difficult to ignore the possibilities of a Scottish referendum for independence being realised (or put to vote) under a Sunak administration. If that were to happen, there is little certainty about the path Northern Ireland might take thereafter.

Sunak faces an immense public perception battle as well. He has faced immense criticism over his wealth and his image as a Goldman Sachs-elitist. Sunak is perceived as a young politician with little to no grassroots experience of the UK's working classes. Significantly, he has not been elected to power either.

More trouble is looming as well. Sunak's new administration will have to deal with a railway unions' strike in November over pay and job security dispute, reported Reuters. Teaching and administrative university staff have also announced a strike over pay and workload, according to the BBC. Employees of the National Health Service, postal and telecom departments have also warned of strikes over pay hikes.

Sunak, as a prime minister who may have to seek another term for his new administration in a short time, will have to structurally reorient economic and political policy focus.

His administration will have to address the concerns of low-income working class groups outside London without losing touch with the economic challenges that the government and the nation face. Sunak will also have to address the fault lines within the Conservative Party, whose members have found it difficult to work with the policies of their own leader.

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