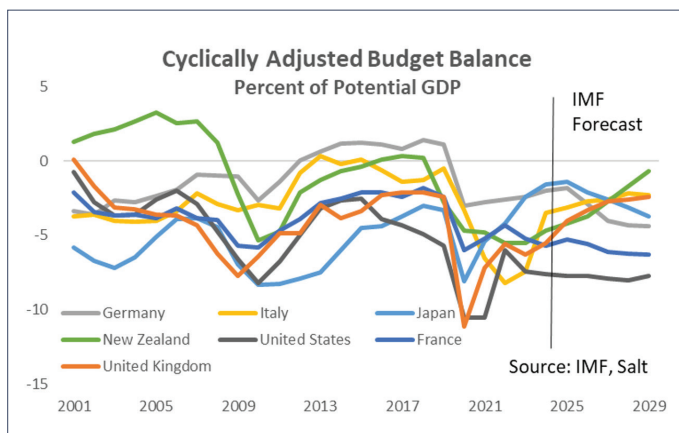


# SALT INSIGHT

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24 November 2025

## Is the UK heading for a “Rachel Reeves Moment”?

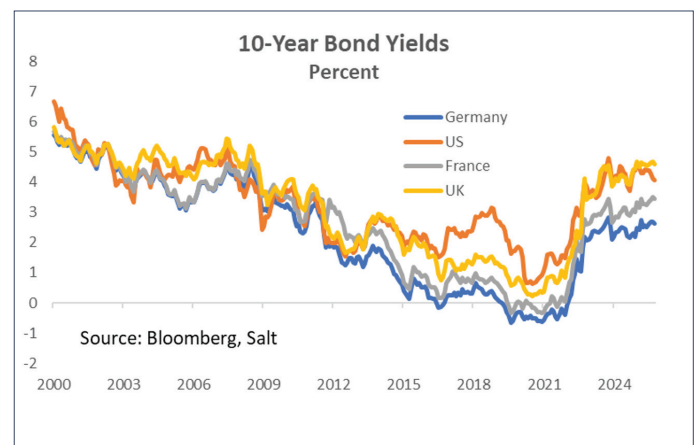
Five years ago, as we were building the new suite of Salt global and diversified funds, we went through an exercise of determining the key structural challenges our new funds would need to navigate in the years ahead. Fiscal sustainability and the tough trade-offs that would need to be made by all developed market governments was high on the list. Covid, and the inability of various governments around the world to rein in massive structural deficits has brought those challenges forward. In 2025 it's fascinating, while also admittedly unsettling for markets, to observe the fraught politics of fiscal consolidation playing out in real time.



Focus this year has been firmly on the United States and the implications of President Trump's One Big Beautiful Bill Act. And don't forget France where no less than four Prime Minister's (counting Sebastien Lecornu twice, which I think is only fair!) over a little more than a year have been offered up as the 2025 political version of sacrificial lambs to try and pass a Budget through the French legislature.

More recent focus has been on the UK, where this week Chancellor Rachel Reeves will bring down a Budget in a challenging set of circumstances that seeks to avoid her and Prime Minister Sir Keir Starmer's own potential Liz Truss/Kwasi Kwarteng Moment, where the so-called bond market vigilantes brought the Truss premiership to an abrupt end.

Much of the recent rise in long-dated developed-market bond yields reflects a reassessment of fiscal sustainability. Investors are increasingly pricing a structural risk premium into sovereign curves as deficits prove stickier, ageing populations raise entitlement costs, and political constraints limit credible consolidation plans.



Nowhere is this clearer than in the UK, where the combination of weak potential growth, high debt-servicing costs, and repeated fiscal surprises has left gilt markets hypersensitive to any sign that medium-term debt

dynamics are deteriorating. The lesson of the past two years is that bond investors no longer give governments the benefit of the doubt.

This week's fiscal event will be Reeves' first true test of whether she can translate narrative into numbers, and whether the government's promise of "stability and renewal" can survive collision with Britain's stubborn fiscal arithmetic. The challenge is immense - the market expects credibility, voters expect investment, and the Treasury expects realism. As the saying goes, reconciling all three in a single Budget is a circle even Euclid would have trouble squaring!!

The pressure has intensified in the lead-up to the announcement. Updated welfare projections have disrupted the original plan, with rising disability-related spending and higher caseloads blowing out costs at exactly the wrong moment.

Welfare is also the point where economics meets internal party politics. While the Treasury sees this as one of the few areas where meaningful savings might be found, parts of the Labour movement view any tightening as incompatible with the party's social-justice mandate. The resulting frictions have narrowed Reeves's room for manoeuvre even further. At the same time, officials warn that meaningful fiscal consolidation cannot be achieved by efficiencies alone.

On the revenue side, Reeves has openly accepted that tax increases are unavoidable, but the pre-Budget adjustments suggest the scale may be larger – and the mix less tidy – than initially hoped. Efficiency would suggest broad base-widening and the removal of distortionary reliefs, but political incentives tend to favour stealth with small freezes, tweaks and thresholds that raise material sums without generating banner headlines. The result is likely to be a Budget built on incrementalism rather than sweeping reform, even if the latter might do more for long-term growth.

Adding to the complexity is the OBR's recent advice that the UK's productivity outlook has deteriorated further. A lower trend growth rate tightens the fiscal corset: it reduces medium-term revenue projections, lifts the debt-to-GDP ratio mechanically, and shrinks the room available for discretionary policy. For a chancellor trying to chart a path back to fiscal sustainability, weaker productivity is not just an economic disappointment – it is a constraint that raises the political cost of every decision she makes this week.

The Bank of England will be watching closely. A Budget that leans heavily on tax rises and expenditure restraint could, at the margin, reduce demand and give the MPC slightly more comfort about cutting rates in 2026. Conversely, significant near-term spending or measures that lift household cashflow would complicate the Bank's job, potentially pushing it towards a more cautious stance on easing. Either way, fiscal policy is about to become a more prominent variable in the BoE's reaction function.

So, Reeves arrives at this week's Budget grappling with the classic triad: maintain fiscal credibility, support growth, and preserve political capital. The OBR has just made the numbers harder, welfare dynamics have made them messier, and tax politics has made them touchier. If she can land this Budget without rattling markets or alienating voters, it will be a notable achievement. The vigilantes are watching.

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