

Research @ Citi Podcast Markets Edition: “King of the North” — Market Implications of Andy Burnham

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Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Beata Manthey (0:06)

Welcome to Research @ Citi Markets Edition, where we break down global macro in 10 minutes. I'm your host, Beata Manthey, Head of European Equity Strategy at Citi.

The UK political landscape has been reshaped. Following the prime minister's resignation earlier today, Andy Burnham's by-election win positions him as a clear front-runner to lead the country. The implications are far-reaching, touching everything from the stability of the transition to the direction of the economy, rates, FX, and of course equities.

To help us unpack this, I'm joined today by my colleague May Rostom, our Chief UK Economist, to walk us through the political and economic scenarios. Welcome, May.

May Rostom (0:49)

Happy to be here.

Beata Manthey (0:50)

So, May, let's start with the timeline. The prime minister has resigned. What happens now and how quickly can we expect Mr. Burnham to take the reins?

May Rostom (1:01)

Officially, the only thing we know is the Labour nomination window will be open between July 9th and the 16th. Now that Wes Streeting has come out publicly in support of Andy Burnham, if nobody else puts themselves forward, we can wrap this up perhaps by mid- to late summer, as long as nobody else challenges Andy Burnham for the premiership. Of course, all of this is moving very quickly, so things can change. So we'll have to see from here.

The good news, however, is that Sir Keir Starmer has said he will remain as prime minister until the selection process is complete. And for the Labour Party, this means an orderly handover, which ensures the strongest chance of their success.

Beata Manthey (1:44)

And his by-election victory was the catalyst for this. The result itself was quite striking.

May Rostom (1:50)

It was. And this was a big victory. Andy Burnham won the by-election last week in a constituency that only weeks prior was won decisively by Reform in the local elections. He captured 55% of the vote. That's a 10-point increase to the 45% vote share that Labour won in the 2024 general election.

And while Burnham's personal popularity in Manchester was a factor, it does look like tactical voting also had a part to play. The UK's first-past-the-post system makes multi-party politics really hard, but voters from other parties seemingly lent their support to keep the Reform Party out. So, we had the Conservatives, the Greens, the Lib Dems — all of them together captured just over 3% of the vote combined.

And this type of strategic voting behavior is a dynamic we're starting to see more of as the UK shifts to bloc voting. And the left-wing bloc currently seems more consolidated and popular than the splintering right-wing bloc.

Beata Manthey (2:55)

So a summer transition seems likely. What does this mean for the economy? And what do we actually know about what a Burnham premiership would look like from a policy perspective?

May Rostom (3:06)

Yeah, that's a key question, Beata. On policy, we're really none the wiser. We have no firm policy platform from a Burnham or would-be Burnham government, and he will be faced with hard choices, which will come to the fore fairly quickly. It's important to note that the chancellor pick is perhaps the cabinet pick that matters most, so we're going to have to watch for that.

Mr. Burnham has given some clues, however. So in an interview last week with The Times, he said he would consider cutting welfare to fund defense. We also know he cares about public infrastructure and transport, as one example. So while we really don't know exactly what he's going to be spending on, something akin to perhaps improving train transport in the north of England, perhaps especially in areas where HS2 — which is the UK's high-speed rail — was cancelled, might be one area. But again, this yet remains to be seen.

More broadly speaking, he's indicated that he's in favor of nationalizing utilities such as water. But how one can do that in a short window before the next election is perhaps something that's easier said than done.

Beyond that, he's promised to adhere to the existing Labour manifesto and fiscal rules, which gives him the same constraints that the previous prime minister had.

Beata Manthey (4:27)

But he has made comments about borrowing, which have made markets nervous previously.

May Rostom (4:33)

He has, but the markets have responded fairly calmly today, and perhaps because we now have more certainty than we've had in the last few months. Importantly, Richard Hughes, formerly Head of the OBR, is informally advising him. This is an encouraging indication he will likely adhere to the fiscal rules. We think he will be able to lean on the Treasury's second fiscal rule, which targets public-sector net financial liabilities, or the PSNFL. This is an investment fiscal rule that Rachel Reeves, the current chancellor, introduced, and this is so that the government

can offset borrowing against public-sector investment. Without getting into too much detail, we think that Mr. Hughes is uniquely positioned to advise on making that accounting work.

Ultimately, and for an Andy Burnham premiership, he would inherit a precarious fiscal situation with easy few tools, and the market's appetite for additional UK debt is still limited. So that's a summary of the economic backdrop.

But let me circle back to you, Beata. What are the market implications of all this? Is this already priced in?

Beata Manthey (5:40)

Thanks, May. So when it comes to political implications for equity markets, what matters the most as a transmission mechanism are: number one, rates; number two, FX. And over the medium term, the most likely scenario is a weaker pound and slightly higher rates.

So from a rates perspective, as you've outlined, the direction of travel seems to be towards slightly higher borrowing. And even if it is framed as good borrowing for investment, the market will remain focused on this increase in supply. Our rate-strategy team warns that this political uncertainty and fiscal outlook could weigh on gilts.

This prospect of higher gilt yields has meaningful implications for UK equities and from our strategy perspective creates some clear potential winners and losers.

Firstly, on the index level, the more domestically focused FTSE 250 tends to be more sensitive to rising rates. So we would expect it to underperform the more internationally oriented FTSE 100 in a rising yield environment. And this is also compounded by the fact that FTSE 250 earnings forecasts have been downgraded year-to-date, while FTSE 100 has seen earnings revised higher. So we continue from here to favor FTSE 100 over FTSE 250.

Secondly, looking at sectors, higher yields are a classic headwind for rate-sensitive areas like real estate and utilities. Conversely, sectors like financials and energy tend to benefit in relative terms.

Finally, it's very important to highlight that from a standpoint of parts of the market negatively exposed to higher rates, it has already underperformed significantly this year. So some level of political risk premium has remained embedded in the market. But if rates move higher, you could see some more downside there. So potentially not all priced in yet.

So that is a very short summary of the market implications. And of course, there is a lot more to unpack. But for today, our time is up.

Many thanks, May, for your insights today.

May Rostom (7:52)

My pleasure.

Beata Manthey (7:53)

Thank you for joining us today. This episode was recorded on June 22, and I'm your host, Beata Manthey. Our next Research @ Citi Markets Edition will be hosted by Dirk Willer, Citi's Global Head of Macro Strategy and Asset Allocation. Thanks for tuning in. Goodbye for now.

Disclaimer (8:12)

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