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Cross-Asset- and Strategy-Research

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Postcard from London

Is Britain the new Italy? Debt and political instability are on the rise

I vividly remember the years I spent living and working in London in the 2000s. The British rather enjoyed looking down on us “Europeans.” The UK economy was growing faster, and Britain could boast sound public finances and stable politics. This rather charming superiority complex helped prepare the ground for the Brexit vote. That voters, in the fevered atmosphere of 2016, were not really answering the question put to them but simply wanted to give the government a kick in the shins is merely a tragic side note. On the day after the referendum, “[What is the EU?](#)” was one of the most frequently googled questions in Britain. Small wonder that the mood has since turned and that a majority of Britons now regard leaving as a mistake (fig. 1). Economically, too, the maneuver went badly wrong, just as most economists had expected. Britain’s economy is now estimated to be [6% to 8% smaller than it would have been without Brexit](#).

The party system is fraying

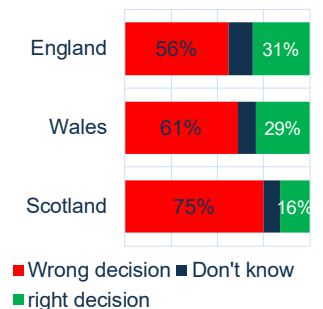
It is therefore all the more surprising that Nigel Farage, the ring-leader of the Brexiteers, has been leading the [polls](#) for more than a year with his Reform UK party, formerly the UK Independence Party. The two traditional parties of government, the Conservatives and Labour, are languishing at around 18% each. On the left, the Green Party is gaining ground; compared with Germany’s Greens, the UK’s green outfit is markedly more radical. To Farage’s right – yes, that is possible – the [Restore Britain](#) party is taking shape, campaigning for the return of the death penalty and the mass deportation of foreigners.

Britain had long been regarded as a haven of political stability, a place where reforms could be implemented with relative ease.



Perhaps another option?

Fig. 1: Was Brexit the right or wrong decision (June 2026)



Source: [YouGov](#), LBBW Research

Now Britain's voters, too, seem gripped by a desire for some vague kind of change, almost regardless of where it leads.

That is producing an ever-faster churn in government. Since the referendum, Britain has had six prime ministers. A seventh will follow shortly: on Monday Prime Minister Keir Starmer bowed to mounting pressure and resigned. Bizarrely, it was Donald Trump via a TruthSocial post who announced Starmer stepping down (not without declaring him a loser), a day before Sir Keir made his announcement. This merry-go-round of prime ministers is beginning to look rather Italian – though that is unfair to Italy, where politics is currently unusually stable.

Andy Burnham at the gates

At the last general election, the Labour Party won an overwhelming majority of 174 seats. Even so, after dramatic losses in local elections in May, it is now busy tearing itself apart. Starmer's poll ratings had recently been very poor, though still better than those of German Chancellor Friedrich Merz. His decision to appoint Peter Mandelson, a confidant of Jeffrey Epstein, as ambassador to Washington triggered a major scandal. This fits a trend that has been under way for more than five years: whoever governs, the public rejects both the government and its leader. Many Labour MPs began to fear for their political careers and pressed Starmer to step aside.

Now Andy Burnham enters the stage from the left. Until now, the "King of the North" had been mayor of Manchester and last week won a [deliberately engineered by-election](#) for a seat in the House of Commons. His ambition is no secret: he wants to be prime minister himself. And his chances of moving into 10 Downing Street soon look excellent.

Will markets welcome the likely change at the top and the end of the political limbo? That remains to be seen. Burnham is seen as more left-wing and has called for an end to "40 years of neoliberalism" in Britain. Public finances have gone off the rails and increasingly resemble Italy's (see fig. 2). It is doubtful that Burnham will prove any better than the centrist Starmer at bringing them under control. After Burnham's by-election victory was announced, yields on 10-year government bonds promptly jumped by ten basis points.

This is not yet a Liz Truss moment – the sort of market revolt that forced the luckless Conservative prime minister to resign in October 2022 after just 49 days. After she unveiled her plan for sweeping debt-funded tax cuts, yields on 30-year UK government bonds rose from 3.5% to more than 5%. But a parliamentary majority is only a necessary condition for a free hand in economic policy, not a sufficient one. As the legendary U.S. political adviser James Carville put it: "I used to think that if there was reincarnation, I wanted to come back as the president or the pope or as a .400 baseball hitter. But now I would like to come back as the bond market. You can intimidate everybody."

The party system in flux

Political stability has had its day

Keir Starmer throws in the towel

Fig. 2: Government budget balance and debt (% of GDP)



Source: IMF, LBBW Research

The investors' reaction is what matters

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