WEEKLY ANALYSIS

M. Alain Freymond—Partner & CIO

A "MINI-BUDGET" THAT SOWS CHAOS IN THE UNITED KINGDOM

New government already discredited. Massive rate rise. Risk of bankruptcy of UK pension funds. Fall of the pound.180 degree turn in monetary policy. Stability of real estate prices. Limited shock to equities.

Key points

- The new British government announces a "mini-budget" that causes chaos
- UK economy still in overdrive in Q3?
- Leading indicators still indecisive
- Slight drop in tension in the labor market
- Household confidence falls to historic lows
- Prices could continue to rise by up to +13%
- The BoE intervenes massively in the emergency with a £65 billion support plan
- British bond market goes up in flames
- The "mini-budget" ends the pound
- First signs of house price decline
- Limited shock for UK equities

The new British government announces a "mini-budget that causes chaos

The new British government has sprung a surprise by announcing a mini-budget based on a number of measures that have caused widespread concern in the financial markets and pushed the pound down. The strategy presented is based heavily on lower taxes, further deregulation, a freeze on the energy bill, and the introduction of a new tax system in an effort to revive the country's stalled growth and control runaway inflation. The government of the new Prime Minister, Liz Truss, has proposed a historic tax cut, which has led to fears that the British public finances will spiral out of control. Economists have estimated the cost of this tax package at several hundred billion pounds, which has led to a sharp rise in the yields of the British Treasury. While inflation is over 10%, freezing the energy bill at 2,500 pounds for an average household might seem like a good social measure, at least that is how the new finance minister presented it, arguing that the new government is close to the people in these difficult times.

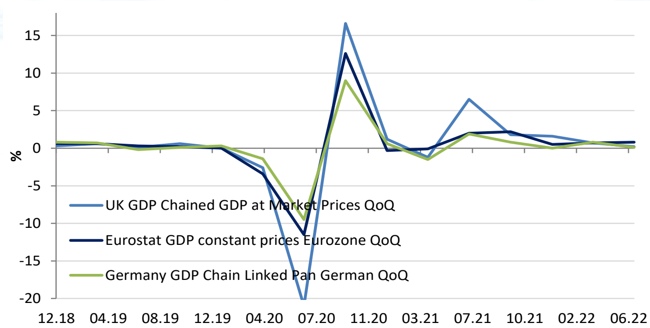
This measure alone would cost 60 billion over six months. As for tax cuts, these are mainly reductions in social security contributions, taxes on real estate transactions and the maximum income tax rate, which are supposed to boost the economy. The experts believe that these are the biggest tax cuts in 50 years, without even proposing to rebalance public accounts.

The lifting of the ban on hydraulic fracturing and the abandonment of the initially planned increase in corporate taxes are other important measures in the announced tax package. After several days of panic and chaos, the government has partially reversed some of the elements of its tax package in an attempt to ease tensions and reduce the uncertainties that had caused the pound to plunge and interest rates to rise sharply, notably by removing the reduction from 45% to 40% of the maximum tax threshold for high earners. However, the main thrust of the plan has been maintained and the overall consequences for public finances remain worrying.

UK economy still in overdrive in Q3?

The latest revision of the British economy's growth figures finally show that GDP grew by +0.2% instead of the -0.1% contraction initially announced. Over a 12-month period, the measurement gap is more important since GDP would have grown by +4.4% compared to +2.9% according to the first estimates.

Quarterly GDP growth - United Kingdom



Sources: Bloomberg, BBGI Group SA