Sunak outlines prudent budget, reserving firepower for 2024 election

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Despite calls for the Government to offset the cost of living crisis with further measures to support households against rising energy and fuel costs, the spring budget today outlined a more prudent plan for government spending as the Treasury opted to reserve the fiscal headroom in the wake of a substantial growth downgrade.

The message from financial markets in response to the budget was clear: fiscal policy won't lift the UK's growth profile sufficiently enough to clear the path for the Bank of England to aggressively tighten monetary policy. The pound continues to lead losses in the G10 against the dollar, front-end Gilt yields sit over 12bps lower on the day, while short-term interest rate markets are still not convinced that the Bank Rate will sit above 2% this year. In response to the cost of living crisis, Chancellor Rishi Sunak today announced three immediate measures to support the £9bn plan already in place to limit the impact of rising gas and electricity bills. Firstly, the government has decided to cut the fuel duty by 5p per litre, with the measure set to stay in place until March 2023. This is expected to reduce tax revenue by around £5bn and help offset rising fuel prices that aren't subject to government caps. The measures come after February's CPI data, which was released this morning, showed a 2.3% MoM increase in liquid fuels, vehicle fuels and lubricants. Secondly, the government will reduce the VAT on green energy products from 5% to 0%, while also bringing wind and water turbines back into scope for the more favourable tax rates. The Chancellor outlined that this will see a tax saving of around £1000 for all eligible households, with a £300 saving in energy costs. Finally, the government has decided to double the household support fund by £500m to £1bn. This is money allocated to local authorities to support the most in need members of the community.

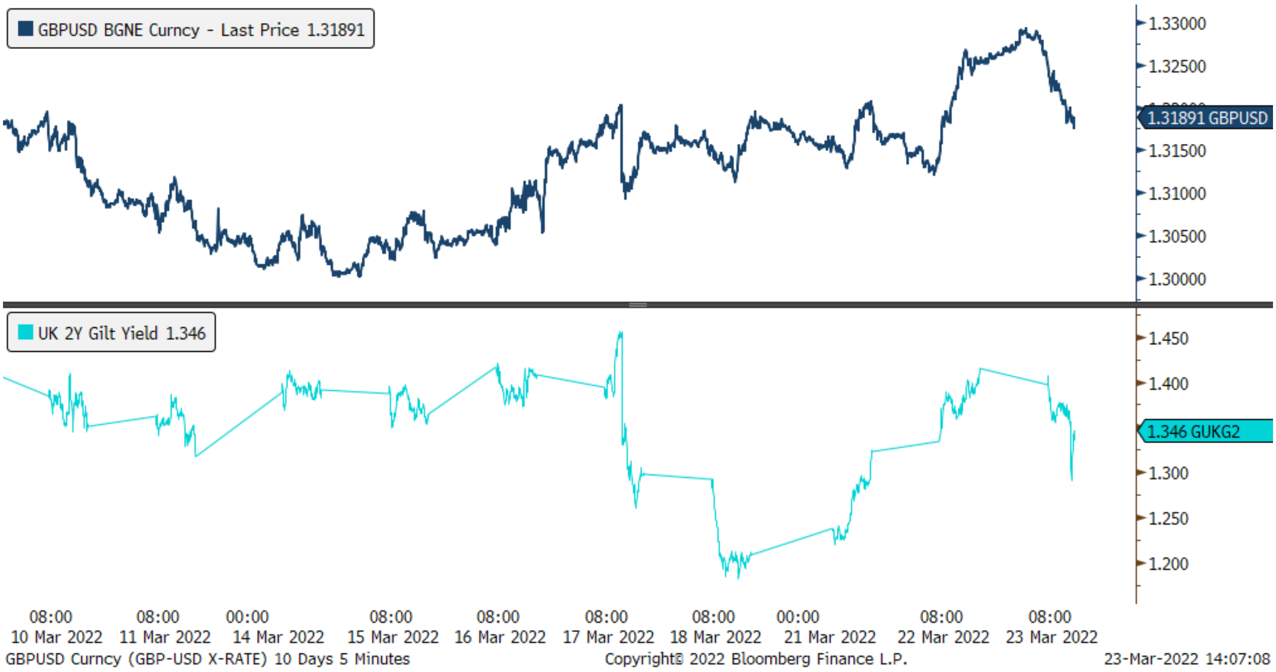
> *Overall, however, the initial government response fell short of more substantive growth supportive measures. Expectations of which included increased military spending in response to Russia's invasion of Ukraine, a delay in the National Insurance tax hike, further funding to reduce the energy burden for households, and an upwards revision to tax thresholds in response to rising nominal wages. Instead, given the Office for Budget Responsibility's projections of growth, the government opted for a more prudent stance, sweetening the pill with promises of tax adjustments for both businesses and households further down the line.*

Chancellor Sunak found himself with around £20bn of fiscal headroom relative to his 3-year target heading into the spring budget, owing to a £37bn windfall in tax receipts that is only partly offset by other spending measures and interest payments. Today's announcements suggest only £10bn of the freed up finances will be spent on new tax cuts, with the rest allocated to reducing the sovereign's debt burden. Those tax cuts include not only the measures outlined in the immediate three responses but also include an increase in the tax-free threshold for national insurance contributions to £12,500 in July " described as a £6bn tax cut " and a £5bn tax cut in the form of a reduction in the lowest income tax band from 20% to 19% in April 2024 should the UK economic profile remain on track with its current projections.

> *Despite the pledged tax cuts, it must be noted that the measures announced today are minimal and suggest that the government is reserving firepower for use ahead of the election in 2024.*

The more prudent spending measures announced today saw the debt management office (DMO) announce a remit to issue £124.7bn in Gilts in the fiscal year 2022/23. This sits at the very bottom of the range that analysts have forecasted and largely explains the rise in Gilt prices, which due to the inverse relationship is weighing on yields. As things stand, we don't expect fiscal policy to be supportive of the pound. Instead, GBP bulls will have to rely on the UK consumer to prop up expectations of BoE policy tightening, in terms of both supporting UK economic activity and also raising inflation expectations, at a time when the OBR expects households' real disposable incomes to drop by 2% in 2022-23.

GBP finds no support from the spring budget while front-end Gilt yields plummet



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