AUTUMN STATEMENT FIXED INCOME REACTION

Given the intense anticipation for the Autumn Statement please find below our market update and a summary of the macro impact.

POST AUTUMN STATEMENT MARKET UPDATE

- The fiscal consolidation package, alongside Hunt's reiteration of his support for the Bank of England further reduces the risk premia priced into the Gilt market sparked by the Truss/Kwarteng mini-budget panic selloff.
- On balance, we do not expect the announcements to have much of an impact on Gilts from here, given the rally beforehand. The mini-budget yield sell-off has been reversed in the face of a more stable fiscal outlook, whilst the terminal bank rate market pricing of 4.6% is now holding steady and well below the peaks seen a few weeks back. If anything, this is likely to be a touch too high given the weakness in the UK economy.
- The announced tightening measures are fairly back-loaded and, at the margin, this is positive for growth with the tightening impulse in the short term perhaps less than expected. However, the increase of the effective energy price cap by £500 will further squeeze consumers next year.
- The OBR's (Office for Budget Responsibility) inflation and growth outlook perhaps looks a touch optimistic and leaves room for a downside surprise to growth in 2024 and a potential breach of the 3% borrowing/GDP target with only a ~0.3% headroom here on current growth forecasts.
- Our overall positive view on GBP denominated credits remains intact, where a risk premium is still built into UK spreads. We do not foresee the increased energy and utility levies as having significant credit impact on UK names given the strength in earnings and balance sheet improvement in recent years.
- Our duration strategy is retained. There isn't sufficient news to trigger a move further up the interest rate curve. Clearly, we will be closely monitoring the BoE's response and incoming data to review our duration strategy.

STATEMENT OVERVIEW

In his speech on the 17th of November, the UK Chancellor laid out plans to help deal with the cost-of-living crisis and further stabilise the UK's fiscal position.

Jeremy Hunt announced two new fiscal rules:

01 Debt-to-GDP must fall by the fifth year of a rolling five-year period.

02 Public sector borrowing must be below 3% of GDP over the same period.

To help achieve these goals, a £55bn consolidation package was announced with the majority of the total coming from spending cuts (£30bn) and the balance from tax increases (£25bn).

Some of the main measures are noted below:

TAX MEASURES

- Additional rate (45 pence) income tax threshold reduced from £150k to £125k.
- Windfall taxes: levy increased to 35% from 25% for energy companies from January 2023-March 2028, and a new temporary levy of 45% on electricity generators from January 2023. In combination these measures are expected to raise £14bn next year.
- Freezing of personal tax thresholds until April 2028: personal allowance, higher rate, National Insurance and Inheritance Tax.
- Cutting of the dividend allowance and Annual Exempt Amount for Capital Gains Tax to £500 and £3,000 respectively, by April 2024.
- Freezing Employers' NIC (National Insurance Contribution) threshold until April 2028 (but retaining the £5k Employment Allowance).
- Removal of the road tax exemption for EV's.

PUBLIC SPENDING MEASURES

- Maintaining the defence budget at least 2% of GDP in line with the NATO commitment.
- Overseas aid will likely remain around 0.5% of GDP – under the 0.7% target until the fiscal situation allows.
- Freezing the capital budget for infrastructure in cash terms from 2025-2028.
- Increase schools spending by £2.3bn p.a.
- NHS budget increased by £3.3bn in each of the next two years.
- Extending the Energy Price Guarantee for a further 123 months from April 2023 at a higher level of £3,000 for the average household.
- Maintaining the triple lock on state pensions.

OBR FORECASTS

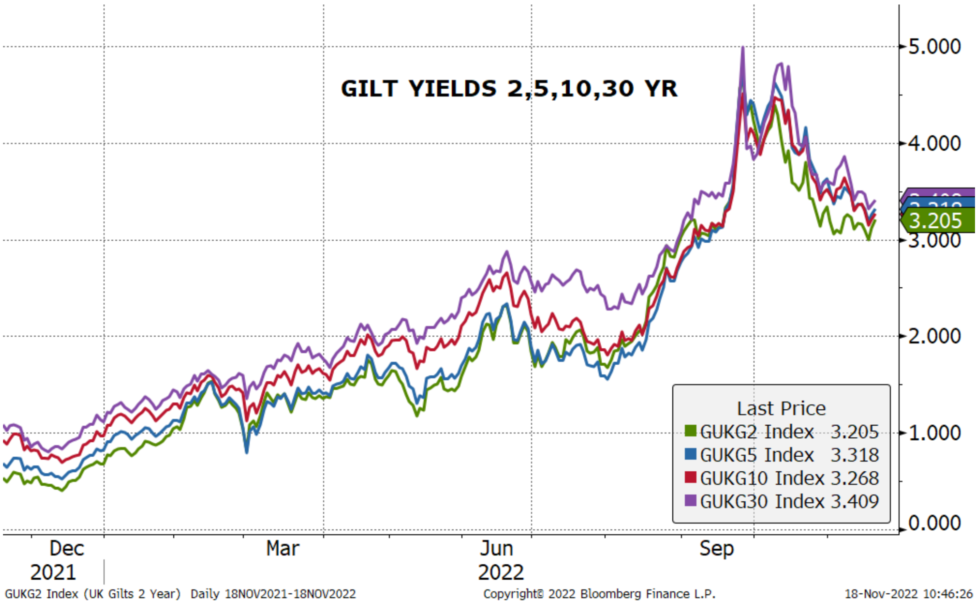
Yesterday the Office for Budget Responsibility also announced its Economic and Fiscal Outlook for the UK. The salient forecasts are as follows:

- Inflation: CPI (Consumer Price Index) is set to peak at 11.1% in the current quarter, 9.1% this calendar year, before falling to 7.4% in 2023 and falling again to just 0.6% in 2024.
- Growth: GDP growth of +4.2% this year but falling -1.4% in 2023 and then rising in 2024 by +1.3% (this is higher than the Bank's forecast of a further -0.9% fall in 2024 due to the OBR's softer inflation outlook and higher personal savings reduction expectation).
- Unemployment: OBR forecast the unemployment rate to peak at 4.9% in 3Q24 with up from a short-term expectation of the rate falling from 3.6% today to 3.5% in the next data print.
- UK borrowing: the net effect of higher interest rates, energy-shock-driven reduction in receipts and inflation-driven rise in welfare, the Energy Price Guarantee offset by the measures announced yesterday is to increase UK borrowing versus the March OBR forecast by £77.9bn in the current fiscal year and by £89.8bn in 2023-24.
- OBR forecast a rising deficit (from £133bn or 5.7% of GDP in FY21-22) to 7.1% of GDP or £177 billion in the current fiscal year; 5.5% of GDP or £140 billion in FY23-24; then by 2027-28, it falls to 2.4% of GDP or £69 billion.
- Tax burden: rises to 37.1%; the highest level since WWII.
- Debt: rises sharply from 84.3% of GDP to 97.6% in 2025-26 before a modest fall in the following two years. The OBR expects the government's target to have falling debt-to-GDP in five years' time to be achieved.

MARKET REACTION

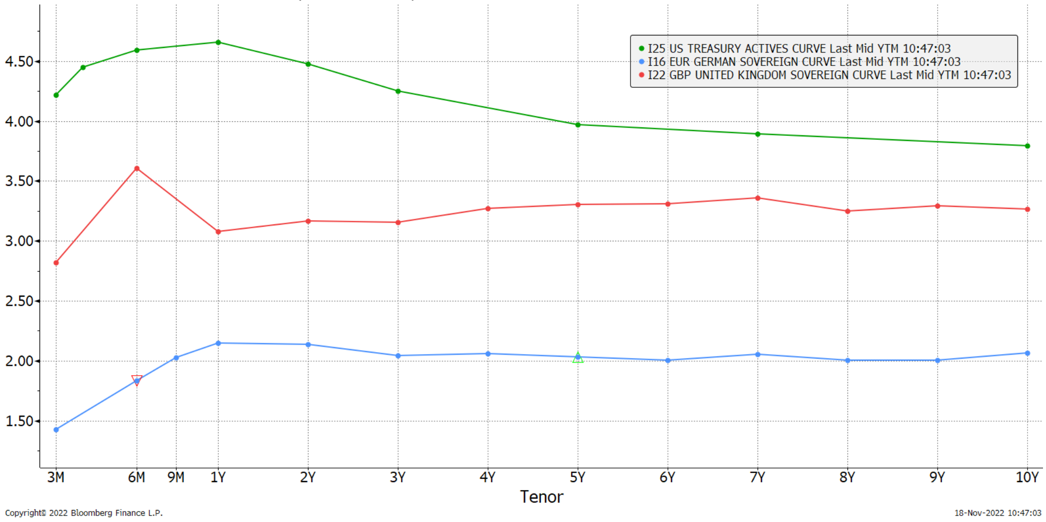
Little reaction yesterday with GBP/USD paring initial losses to close the day -0.4% at 1.1864 and 10yr Gilt yields 0.05% wider on the day at 3.20%.

REVERSAL OF THE MINI-BUDGET YIELD SPIKE



Source: Bloomberg

FLAT YIELD GILT CURVE (RED LINE)



Source: Bloomberg