# Immediate Insight: UK Budget

23 March 2011

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## Budget acts to maintain market confidence

Chancellor George Osborne today delivered the UK Government's second Budget since coming into power. There were few surprises and financial markets registered little reaction. There was more focus on the minutes from the last meeting of the Monetary Policy Committee (MPC), which were released earlier in the day. These indicated that a rate rise in May is unlikely. In response, the market pushed back its rate-hike expectations to late summer / early autumn.

The key points from the Budget were:

- 2011 growth forecast downgraded from 2.1% to 1.7%; 2012 forecast also down from 2.6% to 2.5%.
- Borrowing forecast at £146 billion this year, £2.5 billion lower than anticipated.
- Planned inflation rise in fuel duty due in April to be delayed until 2012.

Following the Chancellor's Budget statement, the Debt Management Office (DMO) released a statement announcing it will issue £169 billion of gilts during the 2011/12 fiscal year (see table below), with increased index-linked issuance and reduced medium-dated issuance. This total was slightly higher than the market was expecting (by around £6 billion). Gilt sales between 2012/2013 and 2015/2016 periods are also projected to be higher, by some £67 billion in total. However, the numbers still show that the overall, longer term pattern is for lower gilt sales over time, and this is what the market chose to focus on.

| Split by maturity and type | £bn | % |
|---|---|---|
| **Short-dated conventional** | 58.0 | 34.3 |
| **Medium-dated conventional** | 34.9 | 20.7 |
| **Long-dated conventional** | 37.7 | 22.3 |
| **Index-linked** | 38.4 | 22.7 |
| Total | 169.0 | 100 |

## Insight's view

**Government bonds:**
Our view for the gilt market remains unchanged. Government bond markets have been marginally stronger today, but mainly due to the MPC minutes showing a slight push back in rate hike expectations and ongoing EU debt concerns. We do believe that rates will move higher later this year, and that this will continue to be felt primarily by rises in short-dated bond yields as the yield curve flattens. Once rates do start to rise, the market will swiftly move to price in more rate hikes than is currently priced in. As a result, we are managing the duration (interest rate risk) and yield curve exposures in our portfolios on an opportunistic basis. This includes diversifying into non-UK markets and corporate bonds when attractively priced, tactical opportunities present themselves.

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**Sterling:**
Sterling is weaker today but this is largely due to the MPC minutes which were released this morning and showed that there was no change to the number of members voting for a rate rise. The budget itself has relatively little impact on the value of the UK currency; external factors such as the balance of trade deficit and interest rate expectations are far more significant. Although sterling has the potential to benefit in the short term from a positive global inventory cycle, we remain cautious on the longer term outlook given the indebted nature of the UK government and consumers alike.

**Equities:**
While the government has relatively little room for manoeuvre given the poor state of UK finances, this budget marked a small positive step for UK equities on the whole. Policies are largely pro-growth in nature, although the absolute changes are small. The proposals for a relaxation of some housing planning rules are positive and should encourage a supply-led response to help ease high price levels in the housing market. However, the proposal to provide loans for a limited number of first-time buyers is less positive, and shows that not all the lessons of the financial crisis have been learnt.