Equity Research;
2022 mini Budget

COLLINS SARRI STATHAM
INVESTMENTS

Research Report

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Key Risks to Price Target

Not applicable

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A New York Times article yesterday by Eshe Nelson remarked that the UK was "in the midst of vast change, with a new government and new monarch" – and the Bank of England was struggling to keep interest rates at levels commensurate with an inflation problem.

Today the new Chancellor Kwasi Kwarteng announced a 'mini-Budget' that contained significant unfunded £45bn worth of tax cuts alongside £65bn energy subsidies and promises to take a 'pro-growth', 'new era approach'.

The Chancellor's measures amount to a reversal of the Johnson government's attempts to partially fund the endless NHS spending increases with tax rises. The 'new era approach' essentially amounts to a spending plan that will be added onto the government's debt pile significantly swelling the UK debt load well beyond current levels of 95% GDP (January 2022). There is a £12bn corporation tax cut, a £17bn National Insurance tax cut, a £5bn basic income tax cut and a £2bn cut via the abolition of the additional 45p tax rate.

Furthermore, in the present context, one of significant geopolitical problems and war, the UK government is experimenting with major policy changes at a stressful time. Even the normally reserved, Martin Lewis, Money Saving Expert has described the mini Budget as 'staggering' in terms of boosting spending and borrowing at the same time.

The main Budget changes are as follows:-

Income tax

- Cut in basic rate of income tax to 19% from April 2023
- Government estimates 31 million people getting £170 a year more

  This move is positive in terms of providing a broad stimulus.

- Currently, people in England, Wales and Northern Ireland pay 20% on any annual earning between £12,571 to £50,270.
- 45% higher rate of income tax abolished
- One single higher rate of income tax of 40% from April next year

  The total removal of the higher rate is controversial. It will reduce the tax yield from the wealthy – and is pure form Reagan taxpayer funded 'trickle down economics' that studies have shown do not in fact stimulate lower *incomes. The primary effect is to increase wealth gap imbalances and increase budget deficits.*

National Insurance

- Reverse recent rise in National Insurance (NI) from 6 November
- Workers and employers have paid an extra 1.25p in the pound since April
- New Health and Social Care Levy to pay for the NHS will not be introduced

Corporation tax

- Cancel rise in corporation tax which was due to increase from 19% to 25% in April 2023

  The aim appears designed to undercut EU and other low tax domiciles, as well as free up cash for corporate expansion. In reality it will boost shareholder returns as a first order effect.

Benefits

- Rules around universal credit tightened, by reducing benefits if people don't fulfil job search commitments
- Around 120,000 more people on Universal Credit to be asked to take steps to seek more work, or face having their benefits reduced
- Jobseekers over 50 to be given extra time with work coaches to help them return to job market

Stamp duty

- Cut to stamp duty which is paid when people buy a property in England and Northern Ireland
- No stamp duty on first £250,000 and for first time buyers that rises to £425,000 - comes into operation today

  (Previously the exempt level was £125,000).

- 200,000 more people will be taken out of paying stamp duty altogether, government claims

  The stamp duty move will stimulate at lower price levels and help first time buyers and ancillary services, such as contractors, furniture, removals, storage, legal & administrative, mortgage finance.

Energy

- Freeze on energy bills, which the government claims will reduce inflation by 5 percentage points
- Total cost for the energy package expected to be around £60bn for the six months from October

The price freeze will provide certainty however at an exorbitant £60bn cost for just 6 months – a cost similar to the 2020 furlough program worth £69bn.

Bankers' bonuses

- Rules which limit bankers' bonuses scrapped
- Package of regulatory reforms to be set out later in the autumn

This reverses 2008 linked financial reforms aimed at de-risking banking – I am not sure of the rationale for this.

Shopping

- VAT-free shopping for overseas visitors
- Planned increases in the duties on beer, for cider, for wine, and for spirits cancelled

Infrastructure and investment zones

- Government discussing setting up investment zones with 38 local areas in England
- Tax cuts and liberalised planning rules to be offered to release land for housing and commercial use
- Investment zones offered measures such as no business rates and stamp duty waived
- New legislation to cut planning rules, get rid of EU regulations and environmental assessments in an effort to speed up building.

This sounds positive but 'green belt' restrictions and council use regulations are there to maintain green spaces and balance competing interests. Cutting planning rules and environmental assessments (straight from the Donald Trump wish list!) entails derailing local interests and environmental considerations for another shopping centre or block of flats.

Conclusion

The negative across the board reaction to today's 'mini' Budget is the sharpest response I can recall to any UK Budget. UK blue chips are off c. 2% responding also to the ongoing global sell-off. Gilts are down by c. 3%-6%.

Markets have reacted negatively because the UK government has employed inflationary measures (tax cuts, spending commitments), injecting cash at a time of rampant inflation. This will prolong an inflationary spiral that is only around 9 months old and complicate the Bank of England's efforts to get back to 2%. The economic illiteracy being employed is concerning. There is a total lack of effort to provide forward visibility on the package's economic impact.

The Bank of England Governor explained yesterday the "UK is already in a recession" confirming stagflationary conditions hence some stimulus is justifiable today, however what has been provided is excessive in fiscal terms.

The one day upwards shift in gilt yields, one of the sharpest in market history, suggests a lack of confidence in the gilt market's ability to absorb the new primary issuance (gilt issues) plus secondary sales (The Bank will sell c. £80bn over Q4 'quantitative tightening') without much higher yields.

Gilt Yields

NAME	COUPON	PRICE	YIELD	1 DAY	1 MONTH	1 YEAR	TIME (EDT)
GTGBP2Y:GOV **UK Gilt 2 Year Yield**	1.00	95.57	3.91%	+46	+121	+353	7:49 AM
GTGBP5Y:GOV **UK Gilt 5 Year Yield**	1.25	87.57	4.11%	+56	+158	+349	7:49 AM
GTGBP10Y:GOV **UK Gilt 10 Year Yield**	4.25	103.66	3.79%	+30	+122	+289	7:49 AM
GTGBP30Y:GOV **UK Gilt 30 Year Yield**	1.25	53.22	3.99%	+22	+110	+278	7:49 AM

Source: www.bloomberg.com

According to Bloomberg data market expectations have shifted to the view that UK base rates will now hit 5.25% by August 2023 which will lead to significant upwards pressure on mortgages and could exacerbate recessionary conditions by worsening consumer cashflow.

The drop in sterling to $1.1050 is noteworthy. This loss of confidence in sterling assets raises the risk of a collapse in sterling's external value possibly to US$ parity – something only briefly experienced in 1985…which is also inflationary.

Whilst we remain hopeful that the market repricing will be swift, the reality of the 'mini-Budget' leaves questions unanswered. Will the UK government be able to fund spending on this scale, and if so, for how long? How far will UK interest rates have to rise to prevent a sterling collapse? Can the Bank of England remain independent if it responds, and rapidly moves up base rates? The new Truss government is well aware of significant concerns over the credibility of its spending approach not just from the civil service, but also across the political spectrum and at the Bank of England yet charged off regardless. At what point will monetary countermeasures have to be brought in?

2022 has brought many surprises and it is appropriate to remain very vigilant in these conditions.

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