

UK budget: Three main takeaways for markets

The combined actions of the Bank of England and the UK Treasury will go some way to insulate firms against cashflow constraints over the coming weeks and months. This should help the pound's short-term prospects, but the ongoing uncertainty around UK-EU trade talks is still likely to prove to be a drag on the currency later this year



Source: Shutterstock

There's little doubt that today marks a big sea change in UK fiscal policy. The government has unveiled a £30bn stimulus package, with pledges to significantly increase both current and capital spending over the next five years.

But the details matter, and for markets, there were really three key questions going into the budget.

1

How far does the budget go in tackling Covid-19 impact? (Pretty far)

This is probably the most pressing issue, and the concerns are primarily focussed on firms' cashflows, particularly those in travel, hospitality and leisure industries who may suffer from lower demand and staffing disruptions.

The [targeted actions from the Bank of England announced earlier in the day](#) go some way to helping this, by encouraging banks to continue extending credit lines to affected firms. But ultimately the Bank's measures can only incentivise the banks to increase lending, and fiscal policy is arguably better placed to offer more precise options to help mitigate cash flow issues.

On this, the Chancellor, Rishi Sunak has announced a fairly sizeable £12bn package, which is perhaps more than most had expected. Probably the most important element of this is a state-guarantee scheme for small businesses, to ensure affected firms retain access to their day-to-day financing needs. The government has also taken the fairly large step of removing business rates for various companies, meaning these firms won't be taxed on the premises they occupy.

Ultimately the Bank's measures can only incentivise the banks to increase lending, and fiscal policy is arguably better placed to offer more precise options to help mitigate cash flow issues

There are also tweaks surrounding statutory sick pay, an amount that firms are required to pay workers for time off. The government will reduce the burden on small firms by taking on the cost of sick-pay for up to two weeks of a worker's illness. However, one often-cited criticism surrounding UK sick pay more generally is that it is lower than those in other European countries - around 20% of average weekly earnings - potentially leaving individuals more exposed relative to some other developed countries.

2 Have the fiscal rules changed amid all this extra spending? (A: Not yet...)

In effect, the answer is "yes". The formal forecasts still assume some wriggle-room under the manifesto pledge to balance current spending by 2022/23, but those projections don't include these new policy measures nor arguably the full effect the virus will have on GDP.

The Treasury has therefore been able to avoid making formal changes to the fiscal rules on this occasion, but the Chancellor has said they will be reviewed, making future changes likely. However in reality markets are unlikely to be fazed by any prospect of reduced fiscal discipline, given how low borrowing costs are and given the economic circumstances.

3 How quickly will public investment rise? (A: It depends)

Finally, markets were on the lookout for signs of the government's public investment plans. We know from the election manifesto that the government was planning to raise the level of investment to 3% of GDP, from a little over 2% currently. The budget contains the first concrete

signs of this, although the details are yet to be thrashed out.

These moves will be growth positive, although as always, it often takes longer than planned for higher capital spending to feed through - there are only so many 'shovel ready' projects available.

One of the key constraints will be labour. Staff shortages tend to be more prevalent in the construction industry, given the tight jobs market and amplified perhaps by reduced levels of net migration from the EU.

We also know that a large chunk of money will be spent on research and development over the next few years, although again the devil will be in the detail. To boost productivity, this will need to be channelled into applied research - development within specific industries to help more targeted innovation, something that is often easier said than done.

All of this means it could be a few years before that 3% level of public investment is reached.

GBP: Coordinated stimulus helps sterling's short-term prospects

With both the Bank of England and the UK government delivering targeted stimulus in a coordinated fashion, GBP finds itself in a rather unique position within G10 FX space, where authorities are pulling in the same direction. This is why the GBP response to the unexpected 50 basis points rate cut (under a normal scenario a clear negative for the currency) was fairly muted today and GBP is in fact up both against EUR and USD.

In our view, the GBP downside vs EUR should be limited for now due to two mitigating factors: (1) general sterling factor: the UK government and central bank targeted measures are a partial mitigating factor for downside risks to the UK economy; and (2) a EUR/GBP near-term specific factor - the surprise rate cut today will raise expectations for more meaningful ECB easing tomorrow, thus limiting near-term EUR/GBP upside.

While the proactive measures by the central bank and the UK government are a short term positive for GBP, one shouldn't get carried away given the upcoming UK-EU trade negotiations (which we see as a negative) are likely to weigh on the GBP around the middle of the year.

Author

James Smith

Developed Markets Economist

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an

investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.