

## 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



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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.

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## 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.

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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.

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