Economics Weekly

29 March 2010

A Budget that did no harm?

Government borrowing in the years ahead has been revised down...

Overview

It is sometimes said that the first rule for Budgets should be: 'do no harm'. Judging by the reaction of financial markets immediately after the 2010 Budget this maxim seems to have been observed, with fairly little movement in bonds, equities, cash or the currency. However, it is far too soon to say whether this was a good Budget or not in the medium term, as this depends very much on how economic and financial events unfold relative to the assumptions in the Budget. What we do know is that, relative to the Pre-Budget Report (PBR) in 2009, there are few new announcements in the Budget at the macro level.

...but remains too high and more detail about how the reduction in debt is to be achieved is necessary...

Although there were some headline-grabbing spending increases (help for small businesses and for first-time buyers), most were paid for by tax rises (some hidden, like the freezing of allowances) and in total were relatively small, amounting to some £2.5bn for businesses. Hence, the alarming increase in the Budget deficit as a result of the global recession and financial crisis remains starkly apparent in the projections for the years ahead. Government borrowing is expected to be smaller in 2009/10 than announced in last year's PBR due to better revenues (from VAT and corporation tax), at a revised £167bn versus £178bn. The Budget deficit of 11.8% of gdp in 2009/10 is halved in 2013/14, to 5.2% of gdp (£89bn) on Treasury figures. However, if optimistic growth assumptions are not met, the deficit will likely be significantly higher.

...otherwise there is a risk of a very negative financial market reaction at some point in the future

Net borrowing and the impact of financial interventions on net debt

Estimate (£bn)	09-10	10-11	11-12
Net borrowing	166.5	163	131
Net debt exc. financial interventions	913.1	1081	1216
Net debt inc. financial interventions	776.6	952	1095

Fiscal arithmetic

The UK's fiscal arithmetic makes for unpleasant reading, even after a reduction of £11bn this year, £13bn next year and a cumulative £100bn less than projected in the 2009 PBR. Over the period to 2014/15, when the deficit is expected to have fallen back to 4% of gdp, borrowing is expected to have totalled £734bn. This will roughly double the net debt to gdp ratio from its level prior to the recession, to 75% of gdp in 2014/15. With £39bn of spending cuts and tax rises already announced, the reduction in the deficit to £89bn in 2013/14 is courtesy of fast growth in gdp, officially projected at 3.25% next year, and 3.5% in future years.

Economic outlook

The Treasury's GDP projection for 2010 was left unchanged in today's Budget at a midpoint of 1.25%. Although this is above our own forecast of 0.7%, it is in line with the consensus. Where, however, the Treasury departs company from both ourselves and the consensus is in its optimistic forecasts for growth in 2011 and

Chart a: Deficit to remain large as spending runs ahead of revenue

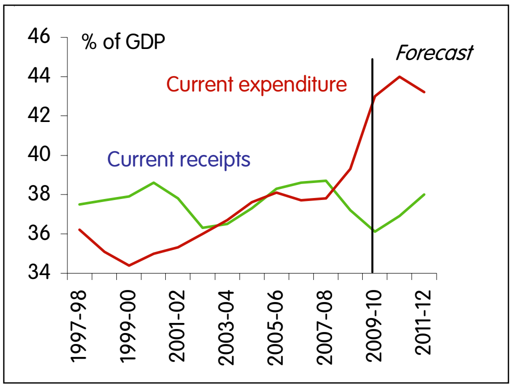
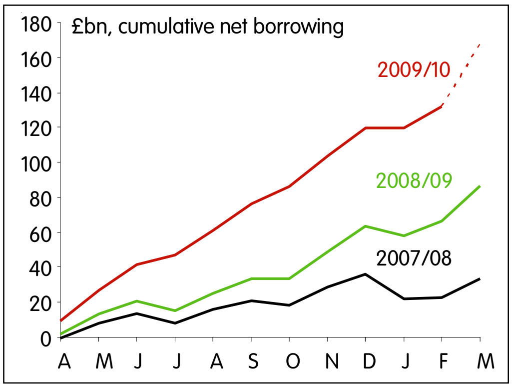


Chart b: Borrowing is expected to reach £167bn in the current financial year



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2010 calendar of central bank meetings

European ECB (1.00%) 8 April, 6 May, 10 June, 8 July
US FOMC (0-0.25%)
28 April, 23 June, 10 August, 21 September
UK MPC (0.50%)
8 April, 6 May, 10 June, 6 July

Rolling calendar of UK data releases and events

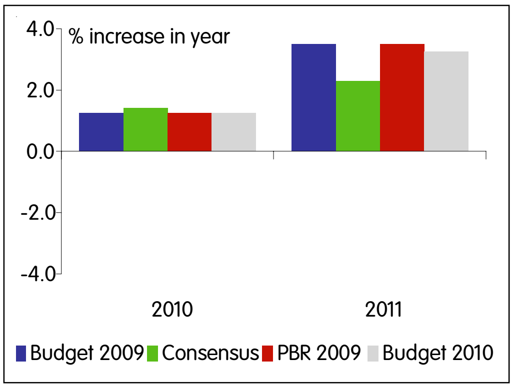
Mortgage approvals (29/03)
Q4 GDP (final) (30/03)
Q4 current account (30/03)
GfK consumer conf (31/03)
PMI manufacturing (01/04)
PMI services (07/04)

Rolling calendar of US data releases and events

Core PCE deflator (29/03)
Consumer conf. (30/03)
Factory orders (31/03)
Non-farm payrolls (02/04)
FOMC minutes (06/04)
Trade balance (13/04)

* All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg , and Thomson Datastream

Chart c: Official projections of UK GDP growth in 2011 ahead of independent view



thereafter. The Chancellor is clearly relying on a broad and deep economic expansion over the coming years. The combination of a cyclical recovery, an upbeat view on the prospects for trend growth and the lower starting point for borrowing enabled the Chancellor to project a further improvement in the public sector finances. It remains to be seen whether such optimism is justified, but we doubt it.

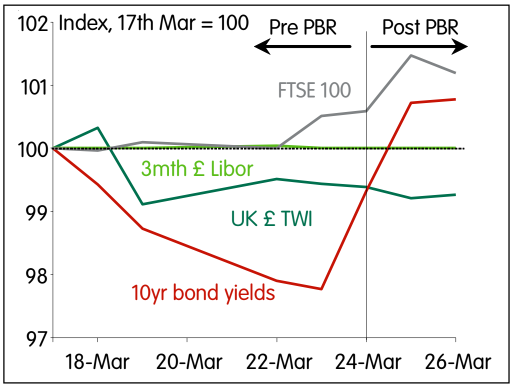
Company and market impact

The centerpiece of the Budget was a package of £2.5bn to support small businesses, including a temporary rise in the level of small business rate relief and a doubling of the Annual Investment Allowance to £100,000 and entrepreneurs' relief to the first £2m of gains. Other measures included new bank lending commitments to homebuyers and businesses of £105bn, including £67bn from Lloyds Banking Group, as well as the establishment of UK Finance for Growth and a Green Investment Bank.

Financial market reaction

Despite the perception that financial market reaction to the Budget has been universally negative, the data do not entirely bear this view out. Looking at chart d shows that the FTSE-100 has risen in every session since then, after languishing in the week running up to the Budget. This seems odd, though it could be that

Chart d: Market perceptions of UK Budget seem to be mixed



the Budget at least ended the uncertainty about what was going to be in it. 10-year bond yields are higher, even though borrowing for the full year was cut by £11bn to £167bn. Perhaps this rise in yields reflects the lack of detail about where the £39bn of measures to take the deficit down to £89bn by 2013/14 was coming from. (The budget deficit is projected to fall by £78bn from this year to £89bn in four years. Of that fall, the Budget showed that £19bn was coming from tax rises and £20bn from spending cuts but did not show where the other £39bn was coming from. It is this that could have pushed up gilt yields).

Three month Libor rates remained unchanged, likely reflecting market perceptions that the Budget did not alter the timing of the next move in UK official short term interest rates. On a trade-weighted basis, the pound continued to weaken, and the Budget appeared to have played little direct part in that trend. It can be observed from the chart that the pound was weakening prior to the Budget announcement and stayed low after it. From a short-term market perspective, the Chancellor seems to have succeed in the maxim, 'do little harm'. In the medium term, the jury is decidedly out on whether this was the right Budget to deliver at this time.

Trevor Williams, Chief Economist, Corporate Markets

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Weekly economic data preview

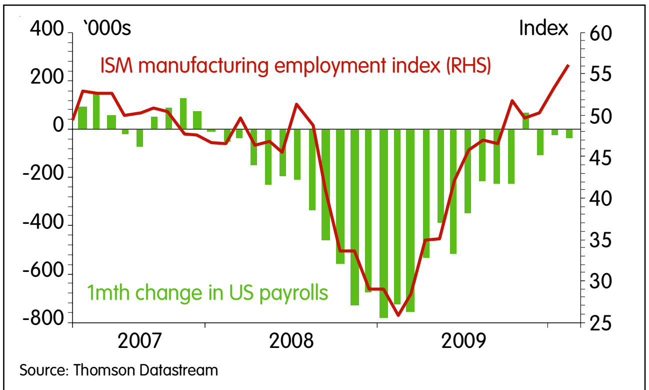
29 March 2010

Good Friday for US payrolls?

- All eyes will be on this week's key release, the March US Employment Report. The report is expected to deliver the first sizeable increase in US payrolls since November 2007. After declining by 36k last month, partly due to bad weather, payrolls are forecast to have recovered by around 200k in March. Over recent weeks, leading indicators of the US labour market have continued to improve. The employment component of the latest manufacturing ISM, for example, is currently at its highest since November 2005. Against a firmer employment backdrop, the unemployment rate is forecast to drop from 9.7% to 9.5%. This week's numbers could mark a clear turning point for the US labour market although, given the challenges still facing the US economy, it is likely to be some time before payrolls are posting sustained monthly gains of 200k plus. Given its importance, a strong payroll could prompt a significant market reaction, especially as the closure of markets in Europe for the Good Friday holiday is likely to mean liquidity conditions are thin. Apart from the labour market data, this week's US calendar also includes the latest Chicago PMI and ISM manufacturing surveys. We expect both reports to build on the gains in recent months. US consumer confidence, personal income and spending, and house price data are also due.
- As we approach the end of the first quarter, the statistical noise surrounding many of the recent data releases continues to cloud the underlying view of the UK economy. Last week's retail sales figures were a case in point. Although retail sales jumped by 2.1% in February, the impact of the increase was substantially tempered by a marked downward revision to the January outturn, as the extreme weather conditions that month played havoc with the data. It is not only the retail sales report that has been volatile: the recent industrial production, labour market, PMI and CPI reports have also been sending mixed messages. The market should get a better sense of the economy's underlying strength from the forthcoming March data. This week sees the first of the key March releases, namely the manufacturing PMI. In recent months this survey has posted a strong recovery, underpinned by the fall in the pound, rising global trade and a slower pace of destocking. The results of our latest in-house Business Barometer, however, suggest that the pace of improvement was not sustained over the past month. As a result, we look for the manufacturing index to drop back to 56.0, from 56.6 in February. Another important UK release this week will be the final Q4 GDP report. Although less timely than the PMI, the survey will contain more detail about the forces shaping growth in the latter months of 2009, including the household saving ratio. Accompanying the GDP report, the Q4 current account figures will be watched for an indication of whether the UK's imbalances are improving. We expect little change. Also this week, the latest UK consumer credit, mortgage lending and approvals figures are due along with the BoE's Credit Conditions Survey for Q1.
- For now, the focus in the eurozone remains less on the economic data and more on the fiscal travails of Greece and some of the other peripheral EMU members. The support package agreed by eurozone leaders last week represents a positive step forward, providing the euro exchange rate with some much needed solace, at least for now. The prospect of any sustained improvement in the euro's fortunes, however, could well be tested if, as expected, this week's US data surprise on the strong side. Although unlikely to be major market movers, the eurozone economic calendar is fairly busy this week. Amongst the more important releases, the latest CPI and employment figures are due in Germany, while later in the week, the EU-16 flash CPI and European Commission's confidence surveys are published. We expect the overall tone of this week's eurozone economic releases to be slightly firmer, consistent with a slow economic recovery.

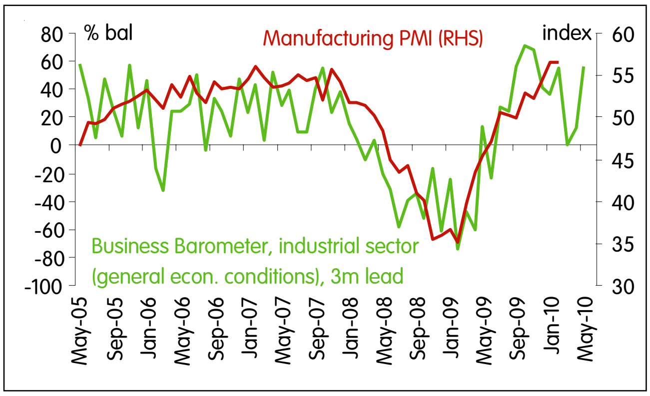
Adam Chester, Senior UK Macroeconomist

Chart 1: US ISM manufacturing employment index points to payroll gain in March



Source: Thomson Datastream

Chart 2: Our in-house Business Barometer suggests the UK manufacturing PMI dropped this month



29 March - 2 April

Country	Time	Event	Actual	Consensus	Forecast	Previous
Mon 29						
UK	29-31	Nationwide house prices (Mar)		0.2% (8.2%)	n/a	-1.0% (9.2%)
GE		CPI - EU harmonised (Mar) P		0.3% (0.9%)	0.3% (0.9%)	0.4% (0.5%)
UK	09:30	Net consumer credit (Feb)		0.4B	0.4B	0.5B
UK	09:30	Net lending sec. on dwellings (Feb)		1.4B	1.3B	1.5B
UK	09:30	M4 money supply (Feb) F		n/a	0.2% (3.6%)	0.2% (3.6%)
EC	10:00	Business climate indicator (Mar)		-0.82	-0.80	-0.98
EC	10:00	Industrial confidence (Mar)		-11	-12	-13
EC	10:00	Consumer confidence (Mar) F		-17	-16	-17
EC	10:00	Economic confidence (Mar)		97.1	96.5	95.9
EC	10:00	Services confidence (Mar)		2	1	1
US	13:30	Personal income (Feb)		0.1%	0.2%	0.1%
US	13:30	Personal spending (Feb)		0.3%	0.3%	0.5%
US	13:30	PCE deflator (Feb)		1.8%	1.8%	2.1%
US	13:30	Core PCE deflator (Feb)		0.1% (1.3%)	0.1% (1.3%	0.0% (1.4%)
Tue 30						
JN	00:30	Overall household spending (Feb)		(1.5%)	(1.5%)	(1.7%)
JN	00:30	Jobless rate (Feb)		4.9%	4.9%	4.9%
JN	00:50	Industrial production (Feb) P		-0.5% (31.7%)	-0.5% (31.7%)	2.7% (18.5%)
GE	07:00	Import prices (Feb)		0.4% (2.1%)	0.4% (2.1%)	1.7% (1.4%)
FR	07:45	GDP (Q4) F		0.6% (-0.3%)	0.6% (-0.3%)	0.6% (-0.3%)
UK	09:30	GDP (Q4) F		0.3% (-3.3%)	0.3% (-3.3%)	0.3% (-3.3%)
UK	09:30	Current account (Q4)		-5.0B	-4.5B	-4.7B
CA	13:30	Industrial product price index (Feb)		0.0%	0.1%	0.3%
CA	13:30	Raw materials price index (Feb)		-1.0%	0.0%	3.3%
US	14:00	S&P/CS Composite-20 (Jan)		-0.6%	-0.1%	-3.1%
US	15:00	Consumer confidence (Mar)		50.0	51.0	46.0
Wed 31						
UK	00:01	GfK consumer confidence (Mar)		-13	-14	-14
AU	01:30	Retail sales (Feb)		0.3%	0.2%	1.2%
FR	07:45	Producer prices (Feb)		0.1% (1.1%)	0.0% (1.0%)	0.7% (0.4%)
GE	08:55	Unemployment change (000s) (Mar)		8K	10K	7K
GE	08:55	Unemployment rate (s.a) (Mar)		8.2%	8.3%	8.2%
EC	10:00	Euro zone unemployment rate (Feb)		10.0%	10.0%	9.9%
EC	10:00	CPI estimate (Mar)		1.1%	1.0%	0.9%
US	13:15	ADP employment change (Mar)		40K	50K	-20K
CA	13:30	Monthly GDP estimate (Jan)		0.5%	0.4%	0.6%
US	14:45	Chicago PMI (Mar)		61.0	62.0	62.6
US	15:00	Factory orders (Feb)		0.5%	0.5%	1.7%
Thur 1						
AU	01:30	Trade balance (Feb)		-1340M	-1000M	-1176M
GE	07:00	Retail sales (Feb)		0.0% (-0.4%)	0.0% (-0.4%)	-0.5% (-3.4%)
FR	08:50	PMI manufacturing (Mar) F		56.3	56.3	56.3
GE	08:55	PMI manufacturing (Mar) F		59.6	59.6	59.6
EC	09:00	PMI manufacturing (Mar) F		54.3	54.3	54.3
UK	09:30	PMI manufacturing (Mar)		56.8	56.1	56.6

29 March - 2 April

Country	Time	Event	Actual	Consensus	Forecast	Previous
US	13:30	Initial jobless claims (Mar-27)		439K	430K	442K
US	15:00	ISM manufacturing (Mar)		57.0	57.5	56.5
US	15:00	Construction spending (Feb)		-1.0%	-1.0%	-0.6%
Fri 2						
US	13:30	Non-farm payrolls (Mar)		187K	200K	-36K
US	13:30	Average hourly earnings (Mar)		0.2% (1.9%)	0.1% (1.8%)	0.1% (1.9%)
US	13:30	Unemployment rate (Mar)		9.7%	9.5%	9.7%

Key events of the week

Mon 29th	EC	ECB member Orphanides speaks in Surrey (17:45)
	UK	BoE member Dale chairs Panel discussion at conference in Surrey (17:45)
Tue 30th	UK	BoE member Haldane speaks in Hong Kong (17:45)
Wed 31st	US	Fed member Fisher speaks in Tucson (01:15), Fed member Lockhart speaks in Connecticut (17:30), US Fed member Duke speaks in Arizona (17:30)
	EC	ECB member Bini Smaghi speaks in Italy (18:30)
Thu 1st	EC	France to auction €8.5bn of bonds (10:00)
	UK	Bank of England releases its quarterly Credit Conditions Survey (09:30)
	US	Fed member Bullard speaks at St. Louis Fed (21:00), Fed member Dudley speaks in Virginia (22:00)
Fri 2nd		Good Friday

Source: Bloomberg
NB: Data in brackets denote YoY. Market consensus estimates are taken the preceding Friday.