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Mini-budget delivers big tax cuts… and big inflation concerns.

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- The UK government announced an expansionary fiscal policy including a reversal of the National Insurance Contribution beginning in November 2022 and a cut to personal income tax effective April 2023.
- UK Gilt yields jumped 0.45% across the curve, as shown by Bloomberg. Markets now price in excess of an expected 1% Bank of England base rate increase in November 2022, a further 3% by March 2023. The pound tumbled against the U.S. dollar.
- SEI's global portfolios have been cautiously positioned in terms of developed market duration, including underweighting gilts. UK portfolios have been neutral duration, selecting issues in the middle of the gilt curve and holding elevated levels of gilts. Managers see opportunities with additional widening of credit spreads.

Chancellor of the Exchequer Kwasi Kwarteng released the Conservative Party's Growth Plan on 23 September 2022, announcing several expansionary fiscal policies. Of note the government plans to:

- Reverse the 1.25% National Insurance contribution increase from November 2022 and cancel the Health and Social Care Levy.
- Cancel next year's planned rise in the Corporation Tax to 25%, keeping it at 19%.
- Double the threshold from which Stamp Duty Land Tax (SDLT) must be paid as of 23 September, moving it to £250,000 for all home purchases. The threshold at which first-time buyers begin to pay SDLT will increase from £300,000 to £425,000, and the maximum value of a property on which first-time buyers' relief can be claimed will also increase from £500,000 to £625,000.
- Abolish the additional rate of income tax as of April 2023 (currently set at 45% for earnings over £150,000).
- Decrease the basic rate tax by 1% to 19% beginning April 2023, a year earlier than previously planned.
- Reverse the 1.25% increase in dividend tax rates applying UK-wide from 6 April 2023. The ordinary and upper rates of dividend tax will be reduced to 2021-22 levels of 7.5% and 32.5%, respectively.
- Create "investment zones" with a reduction in planning restrictions for land use.
- Through the Prudential Regulation Authority, remove the current cap to bankers' bonuses currently set at 100% of fixed pay (or 200% with shareholder approval).

These announcements come in addition to the previously announced Energy Price Guarantee, capping the average household energy bill at £2,500 per year for a period of two years from October 2022 and the six-month Energy Bill Relief Scheme for businesses and other non-domestic energy users.

Market impact

Two-year gilt yields jumped from 3.45% to as high as 3.90% on the news, as shown by Bloomberg, in a clear sign that markets views the plan as inflationary. In the wake of the massive tax cuts, expectations have risen that the Bank of England (BoE) will need to follow up on its 22 September 0.50% interest rate hike with even larger moves in order to meet its inflation mandate. Market pricing projects the BoE base rate at 5.8% in March 2023, a 3.4% increase from where it sits today. Expectations have now moved for a November base rate increase in excess of 1%.

Gilt yields jumped across the curve with the Debt Management Office reporting an upward revision in their Net Financing Requirement (NFR) in 2022-23, from £161.7 billion in April 2022 to £234.1 billion in September 2022. Gilt yields peak around the four-year point, flattening before inverting beyond the 25-year rate.

Sterling has had a troubled year against the U.S. dollar, down from 1.35 in January 2022 to 1.07 in late September. Market onlookers have begun to speculate that it may reach parity, a scenario once viewed as implausible.

Portfolio positioning

UK portfolios have been positioned neutral to benchmark interest rate duration. In UK Core we have been overweight the belly, underweight the longer-end of the curve and subtly underweight the front end.

In UK Credit we have held an off-benchmark exposure to Gilts, currently sized at about 8.5% with a view that spreads may see further weakness. The Gilt position is one side of a barbell construction, with BBB holdings of preferred issues on the other side to bring the Fund yield to maturity equal to that of the benchmark.

Global portfolios, which take greater active currency risk than UK portfolios, have moved to a marginal overweight to GBP since June 2022 from being positioned flat to underweight previously. We have been underweight developed market duration, including Gilts throughout the year. We remain positioned for higher G7 government yields with the exception of U.S. Treasurys where we have neutralised our underweight.

We believe that tumultuous times present opportunities for actively managed portfolios. The managers we work with anticipate that additional widening of credit spreads will present security selection opportunities.

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