GILTS TUMBLE AS KWARTENG'S MINI-BUDGET USHERS IN VAST ADDITIONAL BORROWING

This week we saw Liz Truss go back to the future as she dusted off Margaret Thatcher's policy solutions to try and fix the UK economy. Truss and chancellor Kwasi Kwarteng have opted for huge tax cuts as their method of jolting the UK into growth and these policies come straight from Thatcher's playbook. However, the UK is no longer a high-tax economy with a very rigid labour market. Had Thatcher been in power today, would she have applied her 1980s' policies to an economy that looks very different and faces a host of different problems?

Markets reacted badly to the chancellor's announcements as gilts sold off sharply on the prospect of the huge increase in government borrowing needed to pay for the tax cuts. Equities have also fallen on the back of a drop in services and manufacturing output and depressed consumer confidence. Truss and Kwarteng are gambling that their tax cuts are strong enough to power the UK's flux capacitor and generate sufficient future economic growth to cover their short-term cost. So far the time machine has managed to push sterling back to levels last seen in the early 80s.

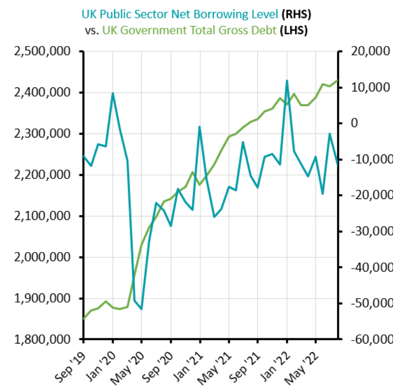
THE MARKETS THIS WEEK

FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
-1.07%	-2.98%	-1.50%	-2.17%	-4.31%	+0.25%	+0.35%	-2.43%	+1.74%	-0.84%	-1.50%

UK: KWARTENG'S TAX CUTS SENDS SHOCK WAVES THROUGH MARKETS

The value of UK government bonds tumbled after chancellor Kwasi Kwarteng delivered his mini-Budget to the House of Commons. Kwarteng unveiled a much wider package of tax cuts than expected, with the abolition of the 45p additional rate of income tax, a 1p cut to the basic rate of tax and cuts to stamp duty to add to the widely expected scrapping of the corporation tax rise and the reversal of the increase to NI.

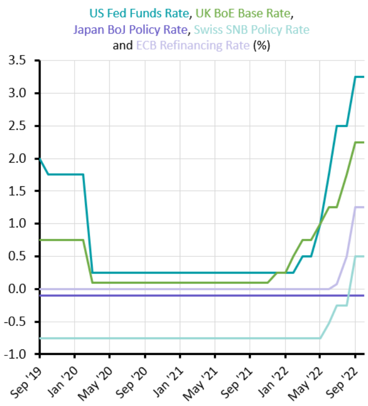
The reforms will see a sharp drop in government tax receipts and the Treasury has confirmed it plans to raise an additional £72bn this year to pay for the reforms. With gilts already under pressure due to rising interest rates and the need to finance the energy price cap, markets reacted badly to the huge increase in government borrowing and gilts of all durations sold off heavily. Short-dated gilts are back to levels last seen before the financial crisis while the yield on 10-year gilts rose above the equivalent on US 10-year Treasuries. The pound also dropped sharply as it fell below $1.11 – a level last seen in 1983.



RATES: CENTRAL BANKS TAKE CONCERTED ACTION TO TACKLE INFLATION

The US Federal Reserve hiked rates by 0.75% for the third month in a row, cut its estimate for growth for this year and forecast that rates will hit 4.4% by the end of the year before peaking at 4.6% in 2023. The Bank of England increased the base rate by 0.5% while four other banks also raised rates. Sweden's Riksbank raised rates by 1% and the Swiss National Bank hiked rates by 0.75% to lift the Swiss rate out of negative territory for the first time in seven years. The South African Reserve Bank and the Norwegian Central Bank also raised rates in the global fight against inflation.

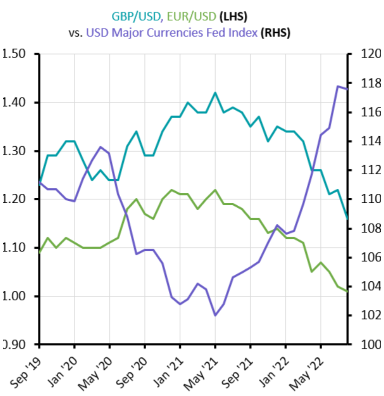
The scale of the Riksbank hike contributed to a big sell-off in government bonds early in the week. Most developed government bonds continued to slide after the US rate decision and global equities sold off as investors anticipate recession after US Fed chairman Jerome Powell said rates are going to be raised high enough and for long enough to cause some pain to the economy, including increasing unemployment.



CURRENCIES: RISING DOLLAR CAUSES PROBLEMS AROUND THE WORLD

The US Federal Reserve's rate hike and Russia's partial mobilisation caused the dollar to appreciate sharply. The US Dollar Index is now at its highest in 20 years having risen by almost 1% on Wednesday. This is putting huge pressure on other currencies. The pound fell to under $1.11, while the euro was trading around $0.98 – having dropped to parity only a month ago. Weakness against the dollar is not confined to western economies. This week the Bank of Japan intervened in the currency markets for the first time since 1998 to try and prop up the depreciating currency as the yen has fallen around 20% this year. The Chinese yuan has fallen to $7 and is hitting a level that saw the Chinese government accused of currency manipulation only three years ago.

The strength of the dollar is causing considerable problems for economies outside the US as net-importers risk importing higher inflation and demand for dollars contributes to tighter monetary conditions and increases the risk of a global recession.



Data Sourced from FE Analytics and FactSet