29th February 2024

Market Update – The Market Response to a UK Recession, and What to Expect from the Budget

A History of Recession

The UK economy is now officially in a recession, having experienced two consecutive quarters of negative economic growth (-0.1% for Q3 2023 and -0.3% for Q4). To give some context it may be useful to consider the two previous recessions of the last 20 years. During the Global Financial Crisis (GFC) of 2008 and 2009 the economy had quarterly losses of -0.5% in Q2 2008, then -1.5%, -2.1%, -2% before -0.3% in Q2 2009 (source: ONS). The 2008 recession occurred amid the backdrop of banking failures and concern around the viability of the global financial system, which therefore led to large losses in markets over a sustained period. A shorter, but much sharper recession occurred in the first half of 2020 with -2.7% and -20.3% quarterly figures experienced, with Covid lockdown and the uncertainty of the pandemic the cause. Markets fell heavily too during this recession, but recovered quickly as a huge level of fiscal and monetary stimulus bolstered investors' confidence, as did the developments of successful covid vaccines.

Short and Shallow

The recession we are now in is a result of the damaging impacts high inflation and high interest rates have had on the ability of consumers to keep spending and maintaining financial commitments, otherwise known as the cost-of-living crisis. Inflation has already fallen by a large amount from its peak of 11.1% to the current 4% and is expected to fall towards the 2% target level over the coming months. With inflation fading as a problem, economic conditions will become less challenging. In the Bank of England's February projection, they forecast that the economy would grow by 0.25% this year, and by 0.75% in 2025, hardly a buoyant situation, but also not terrible. The UK is currently in a mild recession, but it is widely expected to be one which is both short and shallow in nature, with improvement very possible over the coming months.

Market Movements

Investment markets have been unsettled over the past two years, with losses in 2022 and much of 2023 as concerns mounted that inflation would stay high indefinitely and therefore interest rates would have to keep increasing. Since late October 2023, however, there have been improved conditions for markets as investors' attention moved towards the falling inflation figures and how this would allow interest rates to be reduced. Assuming interest rates do come down later this year, then, in Future Money's opinion, there are likely to be broadly positive conditions for markets.

Political Cost of Recession

Amongst investors, this is being talked about as merely a 'technical' recession, rather than one in which major disruption is expected. Within political circles, however, the label of recession must surely hang like a millstone around the necks of Jeremy Hunt and Rishi Sunak, with their opponents taking it as an easy opportunity to criticise their leadership as we approach a general election.

The Budget

Next Wednesday Mr Hunt will attempt to wrest control of the narrative during the delivery of the Budget. This will likely be his last big opportunity to influence the business landscape and shape public opinion before the election, which is expected later this year.

Head Room is Tight

The Chancellor had been hoping for space in the budget which would allow him to reduce the tax burden without cutting spending, but with government borrowing costs having risen over recent months there is now thought to be less 'fiscal headroom' than previously expected. This limits the Chancellor's options, but with the Conservative party far behind Labour in the polls, with many other attempts to boost support exhausted, and, as discussed, with the UK now officially in recession, it is likely that the government will promise as many giveaways as they can in the hope that a sugar rush of tax cuts boosts the economy and therefore their chances of re-election.

Minor Tax Cuts

Investors will be watching the Budget with interest and any tax cuts or supportive fiscal policies are likely to be well received, particularly by UK equities. A caveat to this would be if Jeremy Hunt's announcements were deemed unfunded and reckless, in which case markets could show their disapproval in a similar style to the turbulence which followed Kwasi Kwarteng's disastrous mini-budget during Liz Truss' time in 10 Downing St. Should this happen then UK gilts and the British pound would likely suffer the most. While a possibility, this seems an unlikely outcome given the more orthodox and market aware style of Jeremy Hunt and Rishi Sunak. More likely are minor cuts to personal taxes, which will be funded either through additional tax rises elsewhere, or with promises of reduced spending further down the line (after the election, importantly).

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Future Money Ltd

James Watson House · Montgomery Way · Rosehill · Carlisle · CA1 2UU

0203 4570 387

www.futuremoney.co.uk