UK Budget 2024: Growth Ambitions Meet Rising Gilt Yields and Cautious Market Reactions

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Executive Summary

Chancellor Rachel Reeves' 2024 budget has struck a delicate balance between stimulating growth and maintaining fiscal credibility. While the expansionary measures initially reassured markets, new borrowing projections triggered a sharp rise in 10-year gilt yields, hitting a one-year high of 4.47%. The Bank of England may now reconsider its pace of rate cuts, with the potential for higher inflation keeping financial markets cautious about the longer-term impact.

What Happened: Strategic Expansion within Tight Fiscal Limits

The first labour budget in years, presented by Chancellor Rachel Reeves, marked a return to expansionary fiscal policy, aiming to boost growth through investment in public services and infrastructure. The budget included £40 billion in new annual tax revenue and an added £140 billion in public borrowing over five years to fund a £72 billion spending increase, with approximately one-third earmarked for critical infrastructure projects. However, forecasts for medium-term growth remain cautious, suggesting that sustained economic gains may be limited even with increased investment.

Initial Market Impact: Calm Turned to Caution as Gilt Yields Surged

Initially, markets responded positively to the budget's structured, predictable nature. Ten-year gilt yields dropped by 10 basis points during the speech. However, as details of increased borrowing requirements became clear, market sentiment shifted sharply. The yield on 10-year gilts rose by 20 basis points to reach 4.47%, the highest level in a year, reflecting market concerns over inflation and the sheer scale of new debt issuance. Notably, the Debt Management Office adjusted its issuance target to £297 billion, an increase of £19 billion from earlier forecasts, which heightened investor vigilance.

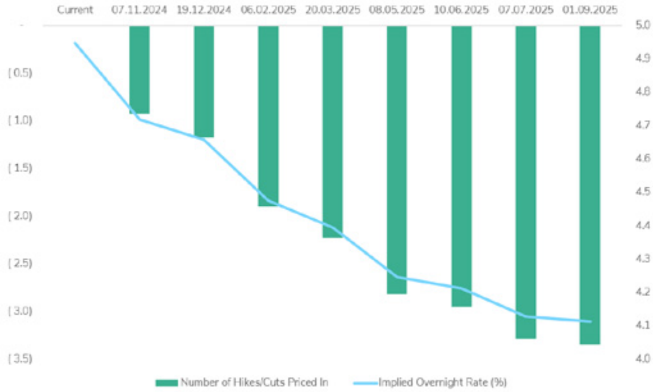
Chart 1: 10-year Gilt yield hits its highest level in a year!

Source: Bloomberg

Long-Term Outlook: Rising Mortgage Rates and Slower Rate Cuts in Focus

The long-term outlook highlights both growth ambitions and inflationary risks. The budget's fiscal stance is expected to keep borrowing elevated, exerting upward pressure on mortgage rates. For instance, the five-year UK yield reached 4.35%, prompting lenders to raise fixed mortgage rates by up to 0.15%. This increase in borrowing costs may dampen consumer spending, creating a drag on economic growth. Additionally, analysts anticipate that the Bank of England may decelerate its rate-cutting cycle in response to inflation risks, potentially reducing the total rate cuts by 25 to 50 basis points over the next few years.

Chart 2: Market Expectations for BoE Rate Path: Limited to Only 3 Cuts in the Coming Year!



Source: Bloomberg

Conclusion: A Growth Agenda with Mixed Economic Signals

While the budget prioritises investment in national renewal, the surge in gilt yields reflects market skepticism over sustained growth, despite additional spending. Higher taxes on employers, a broadened capital gains tax, and adjustments to inheritance tax are expected to increase revenue, but they may also reduce hiring and impact private investment. As inflation risks linger, the Bank of England's response to these fiscal measures will be critical in stabilising both the UK economy and financial markets. In essence, Reeves' budget successfully avoids immediate market disruptions but leaves open questions about the potential long-term effects of sustained high borrowing and inflation pressures. Expect the Bank of England to tread carefully in the coming months.

For further information

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