MARKET UPDATE

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The budget nobody wanted to deliver

When Jeremy Hunt moved to the dispatch box this week his predecessor had both cursed and blessed his budget.

The curse of course was the contribution made to an enormous fiscal hole which could only be filled by meating out pain across the country. The blessing? Rarely have expectations for good news been so low. If Hunt was able to pull even the most ragged and dejected rabbit from the hat it would be greeted with joyous rapture. Some bedraggled creatures did emerge such as more money for the NHS.

Yet overall, Hunt was forced to propose a £55 billion package of tax rises and spending cuts aiming to fix the country's public finances and restore its economic credibility.

In a clear reversal from his predecessor the tax plans were focused on wealthier people bearing much of the burden but accompanied by real pressure on those on benefits at a time of ultra-low unemployment.

The announced tax changes came as expected, with main measures including cutting the threshold for the top rate of income tax of 45% to £125,000 and freezing of allowances and thresholds for income tax, national insurance, and inheritance tax for a further two years.

The budget aims to slash the dividend allowance to £1,000 from £2,000 next year, and then to £500 in April 2024.

Pensions and benefits will increase in line with inflation and there will be additional payments on top to the poorest next year to help with the cost of living.

From April, the Energy Price Guarantee will run for another 12 months at £3,000 a year for the average household up from £2,500.

Corporation tax will rise to 25% from 19% from April. The oil and gas sector will face an expanded windfall tax of 35%, up from 25%. The Chancellor also announced a new 45% tax on low-carbon electricity generators, which would be temporary. The two taxes together would raise £14 billion next year.

The Chancellor offered a sour outlook for growth, saying that the economy will shrink by 1.4% in 2023, compared with a forecast for growth of 1.8% published in March.

None of this is good news of course and there can be little doubt that there is pain to come.

However, every action, as the law goes, has an equal and opposite reaction. The benefit of taking this pain should be felt in lower inflation. As inflation comes down, the Bank of England is able to raise interest rates by less. This starts to ease the pain being felt in the real economy. Ultimately as inflation falls, the Chancellor may well find he has more scope to help households than is implied by this budget.

Yet for the moment he knows he must hold his nerve and wait for the pain to pass.

As investors, this budget comes as conditions generally improve. Bonds have stopped falling in price as the market begins to believe it has the measure of how far interest rates will need to rise. Added to this, the rate of US inflation has begun to slow markedly. If US inflation is falling this will drive falling inflation around the world. These factors have created a better environment to invest and can be welcomed alongside the higher expected returns implied by today's bond and share prices.

Whilst the economic pain may still be felt, we can take comfort that the stock market has already taken much of its pain and hope for a recovery.

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