



**R&R Weekly Column**  
**By Brunello Rosa**



## UK Chancellor's Growth Plan Is An Economic Gamble

Last week was an eventful one. On Wednesday, the [US Federal Reserve increased its policy target range](#) by additional 75bps, to 3-3.25%. On Thursday, the [Bank of England increased its policy rate](#) by 50bps to 2.25% in order to tackle rampant inflation. And on Sunday [general elections were held in Italy](#). Russian President Vladimir Putin meanwhile announced the partial mobilisation of Russians of fighting age, which most commentators interpreted as an escalation of the war.

While these events were taking place, on Friday the new UK Chancellor of the Exchequer, Kwasi Kwarteng [announced its Growth Plan for the UK](#), which, according to its proponents, represents the “biggest package of tax cuts in generations.” The fiscal package, which is larger than a regular budget, will be comprised the following measures:

*For households*, a) the basic rate of income tax will be cut to 19% in April 2023, one year earlier than planned; b) the 45% additional rate of income tax will be abolished; and c) there will be changes made to the Stamp Duty regime for homebuyers, with 200,000 people expected not to pay the tax altogether each year. This comes a day after the government announced that the Health and Social Care Levy (HSCL) of 1.25%, due to be introduced from April 2023, will not be implemented, and that the 1.25% increase in National Insurance contributions (NICs) rates that was introduced in April 2022 will end on 6 November 2022.

*For companies* there are planned tax cuts as well, in particular: a) the cancellation of the planned increase to the Corporation Tax (CT) main rate from 19% to 25%, with changes made to the dividend tax rate; b) the cancellation of the planned increase in the rate of Diverted Profits Tax from 25% to 31%, and the planned reduction in the Corporate Tax surcharge rate for banking companies, both of which are expected to take effect from 1 April 2023; and c) the introduction of new investment zones around the UK where enhanced tax reliefs will be offered for Stamp Duty Land Tax (SDLT), Enhanced Capital Allowances, Structures and Buildings Allowance and Employer National Insurance contributions.

The government expects these tax cuts to increase the UK's growth potential from 1.75% to 2.5%, and to increase productivity and wages over time. Considering as well the measures that were introduced in previous weeks, in particular the Energy Price Guarantee that was made in response to the large increases in gas prices that are being experienced by households and companies, how credible are these promises?

The Bank of England, [in its latest statement](#), said that it will assess the overall impact of these measures on growth and inflation, and their implications for monetary policy, in the November 2022 Monetary Policy Report. In its preliminary assessment the BoE announced that by increasing disposable income the energy price cap may induce stronger spending, which could be inflationary.

Therein lies the real risk, which we discussed in previous analysis. Monetary policy and fiscal policy are not working in the same direction anymore. To the contrary: fiscal easing to support economic activity tends to be inflationary, whereas monetary tightening to combat inflation tends to be recessionary. The monetary-fiscal coordination that worked so well during the pandemic is now a distant memory. And the biggest problem is that an optimal policy mix does not even exist.

The UK government does not seem to have understood this point. It has introduced a massive plan of tax cuts as it was operating in isolation, without considering the potential inflationary impact, at the same time as the BoE is trying to tame inflation with higher rates and QT. Moreover, these tax cuts imply much larger borrowing, which may also result in higher long-term rates, which in turn tend to depress economic activity.

[Markets have been fast to provide their response](#), with the GBP sinking versus the USD to one of its lowest points on record. Voters in the UK seem to have expressed their view as well, [with polls](#) showing a solid Labour lead (42% versus 33%, with LibDems, SNP and Greens – all potential allies of Labour – polling at 20% collectively). Liz Truss should learn from Margaret Thatcher, whom she considers to be her role model. Thatcher did increase taxes, including the hated VAT, before cutting taxes. And her government collapsed on [the proposed introduction of the poll tax, intended to finance local governments](#).

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🔗 [A New Reliance? A Proposed Gas Pipeline And The Complicated Picture Of European Energy Security](#), by London Politica, 14 September 2022



Looking Ahead

**The Week Ahead: QoQ GDP To Shrink In US And UK; Inflation To Accelerate In EZ; EZ Unemployment To Rise; Core PCE To Rise In US**  
**In the US**, in Q2, GDP is expected to shrink by -0.6% q-o-q (p: -1.6%). In August, core PCE is likely to rise by 4.7% y-o-y (p: 4.6%). September's consumer sentiment is seen increasing to 59.5 (p: 58.2).

**In the EZ**, in August, the unemployment rate is expected to stay unchanged at 6.6%. In August, as flash estimates show: i) headline inflation is seen rising to 9.6% y-o-y (p: 9.1%); and ii) core inflation is likely to surge to 4.7% y-o-y (p: 4.3%). In September, economic sentiment is likely to decrease to 95 (p: 97.6) and consumer confidence is expected to deteriorate further to -28.8 (p: -25).

**In the UK**, in Q2, the economy is seen contracting by -0.1% q-o-q (p: 0.8%). Also in Q2, GDP is expected to advance 2.9% y-o-y (p: 8.7%).

**The Quarter Ahead: UK's Chancellor Unveiled Growth Plan; Putin Declared Partial Mobilization; Protests In Iran; Elections In Italy**  
**UK Chancellor Kwarteng announced a new Growth Plan.** According to the plan, i) the planned corporate tax rise to 25% is cancelled, keeping at 19%; ii) basic rate of income tax is cut to 19% in April 2023; iii) 45% higher rate of income tax is abolished; iv) there will be a single higher rate of income tax of 40%. The government estimates the tax cuts will total £45 billion by 2026-27. As a result, the pound fell to a 37-year low against the dollar and FTSE 100 decreased to its lowest level since March.

**Putin declared partial military mobilization to bolster his forces in Ukraine.** This move led to protests across the country and the cost of flights departing from Moscow surged. According to the Defense Ministry, 300,000 reservists would be summoned to active duty. In the meantime, Kremlin-engineered referendums on whether to become part of Russia has started. G7 leaders say those votes breach international law and have no legitimacy.

**The series of protests and civil unrest were sparked by the death of Iranian woman Mahsa Amini in police custody.** The 22-year old Mahsa Amini was apprehended in Tehran for not wearing her hijab properly. Dozens of protesters have reportedly been killed. Iranian Government also blocked internet access.

**Italian Elections** were held on Sunday and the centre-right coalition is expected to win with a comfortable majority.

Last Week's Review

**Real Economy: PMIs Rose In US, Whereas Fell In EZ; Consumer Confidence Remained Low In UK And EZ; CBs Remained Hawkish**

**In the US**, in September, manufacturing PMI increased to 51.8 (c: 51.1 p: 51.5), and services PMI rose too to 49.2 (c: 45; p: 43.7). As a result, the Composite PMI increased as well to 49.3 (p: 44.6).

**In the EZ**, in September, the manufacturing and services PMI fell to 48.5 (c: 48.7; p: 49.6) and 48.9 (c: 49.0; p: 49.8) respectively. As a result, composite PMI also decreased to 48.2 (p: 48.9) as expected. In September, flash estimate of consumer confidence deteriorated to -28.8 (c: -25.8; p: -25.0).

**In the UK**, in September, manufacturing PMI increased to 48.5 (c: 47.5; p: 47.3), while services PMI fell to 49.2 (c: 50; p: 50.9). Consequently, Composite PMI decreased to 48.4 (c: 49.0; p: 49.6). In September, consumer confidence shrank to -49 (c: -42; p: -44).

**Also in the DMs**, the Bank of England increased its Bank Rate by 50bps to 2.25% and the Federal Reserve increased its Fed funds target range by 75 bps to 3.0% - 3.25%.

**Financial Markets: Stocks Were Down And Yields Rose; Dollar Is Up; Oil and Gold Prices Are Down**

**Market Drivers:** Investors absorbed the hawkish Fed messages. As a result, stocks stumbled and bond yields moved sharply higher.

**Global Equities:** Decreased w-o-w (MSCI ACWI, -3.0%, to 579.55). The US S&P 500 index fell (-4.7% w-o-w, to 3,693.23). In the EZ, share prices were down (Eurostoxx 50, -4.3% w-o-w, to 3,348.60). In EMs, equity prices decreased (MSCI EMs, -2.3%, to 922.61). Volatility rose significantly to 30.5 (VIX S&P 500, 52w avg.: 24.5; 10y avg.: 18.2).

**Fixed Income:** w-o-w, 10-year US treasury yields rose (+23 bps to 3.69%). The 2-year US Treasury yields rose as well (+33 bps to 4.20%). The German 10-year bund yield rose (+26 bps to 2.03%).

**FX:** w-o-w, the US Dollar Index was up (DXY, +3.0%, to 112.82; EUR/USD -3.2%, to 0.97). In EMs, currencies fell (MSCI EM Currency Index, -0.8% w-o-w, to 1,603.49).

**Commodities:** w-o-w, oil prices fell (Brent, -5.1% to 86.65 USD/b). Gold prices decreased w-o-w (-1.9% to 1,651.70 USD/Oz).



@RosaRoubini



Rosa & Roubini



Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to [info@rosa-roubini-associates.com](mailto:info@rosa-roubini-associates.com)

[www.rosa-roubini-associates.com](http://www.rosa-roubini-associates.com)

118 Pall Mall, London SW1Y 5ED

Nato Balavazde contributed to this Viewsletter

The picture in the front page comes from [this website](https://www.rosa-roubini-associates.com)



## Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year