



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



### UK Prime Minister Debacle Shows That Market Discipline Still Bites

Last week, the drama surrounding the British government came to a sudden conclusion. After [sacking her finance minister Kwasi Kwarteng](#) in an extreme attempt to save her job, Prime Minister [Liz Truss had to give in and hand her resignation in](#) as head of the Conservative party, less than two months after winning its leadership contest. As with Boris Johnson before her, she will remain as Prime Minister until a successor is found, ideally by the end of this week.

The hope by the conservative leaders is that, if there are multiple candidates vying to replace Truss, one of the last two remaining candidates will withdraw from the race in order to avoid the choice being left to the base membership of the party, which would imply a longer process. At one point it seemed that Boris Johnson would enter the race in an attempt at staging an unexpected comeback, just a few months after leaving his position as Tory leader, [but then he withdrew from the competition](#). At this stage, Rishi Sunak is the frontrunner of the competition.

What led to this sudden conclusion? First, [Liz Truss replaced Kwasi Kwarteng with Jeremy Hunt](#), who is perceived to be a much safer pair of hands than Kwarteng was. From that position, Hunt performed a U-turn on the fiscal policies introduced by Truss and Kwarteng in the so-called mini-budget presented earlier in October, which we labelled as an “economic gamble.” Instead of promising GBP 45bn of unfunded tax cuts, [Hunt presented a plan of GBP 41bn of spending cuts](#). With these moves, Hunt appeared to be the de-facto Prime Minister, overshadowing Truss and her flagship economic program.

Second, Truss’s attempts at manoeuvring within the UK political scene proved to be totally ineffective vis-à-vis the market reaction to her economic plans. The market continued to be sceptical of her plans, and of what may have been presented in the actual budget. As a result, the GBP continued to be under the cosh, reaching almost parity with the USD. Long-term rates also continued to face upward pressure, especially after the Bank of England stopped its emergency bond-purchases program.

The third factor behind the conclusion of these political events was the conflict between price stability and financial stability that caught fiscal policy in the middle (even if fiscal policy ended up being the trigger for the financial stability episode). In the UK, like in any other major country, central banks are focused on fighting rampant post-pandemic inflation by increasing rates frequently and in large step. By doing so, they risk triggering financial stability episodes in a fragile system, as the [Financial Instability Hypothesis by Hyman Minsky would suggest](#). In this case, the episode was triggered by reckless fiscal plans that led to an increase in interest rates in the leveraged system of pension funds performing LDIs. When these funds received margin calls to cover their derivatives position, they had to sell the most liquid assets, i.e. gilts, to get the cash they needed, thus triggering a further increase in rates, until the BoE stepped in to save the day.

The clear lesson of this entire saga is that market discipline still works, and that even those countries that pride themselves of being financially advanced, such as the UK, are subject to it. This is good news, because the market will induce governments to adopt sounder fiscal policies, at a time when they may be the only source of support to dwindling economic activity, which is at risk of soon entering a recession.

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Looking Ahead

**The Week Ahead: US QoQ GDP To Rise; PMIs To Fall In DMs; EZ Economic Sentiment To Decline; CBs To Remain Hawkish**

**In the US**, Q3, GDP is seen advancing by 2.1% q-o-q (*p*: -0.6%). In October, manufacturing and services PMIs are expected to decline to 51 (*p*: 52) and 49.2 (*p*: 49.3) respectively.

**In the EZ**, in October, manufacturing and services PMIs are expected to decline to 47.8 (*p*: 48.4) and 48.2 (*p*: 48.8) respectively. Composite PMI is likely to fall to 47.5 (*p*: 48.1). October's economic sentiment is likely to fall to 92.5 (*p*: 93.7), whereas consumer confidence is expected to recover slightly to -27.6 (*p*: -28.8).

**Also in the EZ**, ECB is expected to raise its main policy rate by 75bps: *i*) interest rate on the 'main refinancing operations' to 2.0%; *ii*) interest rate on the 'marginal lending facility' to 2.25%; and *iii*) 'deposit facility' to 1.5%.

**In the UK**, in October, manufacturing and services PMIs are expected to decline to 48.0 (*p*: 48.4) and 49 (*p*: 50) respectively. Composite PMI is likely to fall to 48.1 (*p*: 49.1).

**The Quarter Ahead: Truss Resigned; China's Communist Party Congress In Beijing; Giorgia Meloni As PM Formed Government**

**Liz Truss Resigned as UK Prime Minister.** Truss' finance minister Kwasi Kwarteng announced an economic plan so-called 'mini-budget', which began a turbulent period for the UK bond market and sent financial markets into a tailspin. Most of the policies were reversed by the second Chancellor Jeremy Hunt. Rishi Sunak and Penny Mordaunt entered the PM race. Boris Johnson was also expected to be running for PM, before he withdrew his candidacy, whereas Chancellor Hunt ruled out a leadership bid for himself.

**China's Communist Party Congress ended in Beijing.** China announced its new central committee would include many allies of President Xi Jinping, that in turn determined the core leadership – the Politburo and the Politburo Standing Committee on Sunday. Four of the current seven members of the Politburo Standing Committee were not on the list.

**Giorgia Meloni was sworn in as Italy's Prime Minister.** Her government will include Matteo Salvini's Lega and Silvio Berlusconi's Forza Italia. Giancarlo Giorgetti of the Lega party was named as economy minister and foreign ministry went to Antonio Tajani from Forza Italia. Nine ministries were given to politicians from the Brothers of Italy and five each to the Lega and Forza Italia. Technocrats were given a further five cabinet posts.

Last Week's Review

**Real Economy: EZ And UK Core Inflation Rose; UK Retail Sales Shrank; Consumer Confidence Recovered Slightly In EZ And UK**

**In the US**, in September, IP rose by 5.3% y-o-y (*p*: 3.9%) and 0.4% m-o-m (*p*: -0.1%).

**In the EZ**, in September, headline inflation declined slightly to 9.9% y-o-y (*c*: 10.0%; *p*: 9.1%), whereas core inflation increased to 4.8% y-o-y as expected (*p*: 4.3%). Monthly inflation is surged by 1.2% (*c*: 1.2%; *p*: 0.6%). October's consumer recovered slightly to -27.6 (*c*: -30; *p*: -28.8). Also in October, ZEW economic sentiment index rose slightly to -59.7 (*c*: -61.2; *p*: -60.7)

**In the UK**, in September, headline and core inflation rose to 10.1% y-o-y (*c*: 10.0%; *p*: 9.9%) and 6.5% y-o-y (*c*: 6.4%; *p*: 6.3%). Monthly inflation rose by 0.5% (*c*: 0.4%; *p*: 0.5%). Also in September, retail sales shrank by -6.9% y-o-y (*c*: -5.0%; *p*: -5.4%) and -1.4% m-o-m (*c*: -0.5%; *p*: -1.7%). October's confidence recovered slightly to -47 (*c*: -52; *p*: -49).

**Financial Markets: Stocks Were Up And 10Y Yields Rose; Dollar Is Down, Whereas Oil and Gold Prices Are Up**

**Market Drivers:** Investors reacted positively to earnings reports, as a result, stock indices registered gains. In Europe, investors were optimistic as Truss resigned and her fiscal policies were scrapped. Also, in Europe, yields rose ahead of the hawkish decision from ECB.

**Global Equities:** Increased w-o-w (MSCI ACWI, +3.2%, to 569.93). The US S&P 500 index increased (+4.7% w-o-w, to 3,752.75). In the EZ, share prices were up (Eurostoxx 50, +2.8% w-o-w, to 3,476.62). In EMs, equity prices rose (MSCI EMs, +0.2%, to 865.04). Volatility rose to 29.7 (VIX S&P 500, 52w avg.: 25.5; 10y avg.: 18.2).

**Fixed Income:** w-o-w, the 10-year US treasury yields rose (+20 bps to 4.22%). The 2-year US Treasury yields fell (-1 bps to 4.48%). The German 10-year bund yield also rose (+5 bps to 2.42%).

**FX:** w-o-w, the US Dollar Index was down (DXY, -1.2%, to 111.82; EUR/USD -0.2%, to 0.97). In EMs, currencies fell (MSCI EM Currency Index, -0.4% w-o-w, to 1,578.21).

**Commodities:** w-o-w, oil prices rose (Brent, +2.1% to 93.6 USD/b). Gold prices increased w-o-w (+0.8% to 1,662.50 USD/Oz).



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## 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



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