RATHBONES

BORROWING RISES AHEAD OF UK SPRING FORECAST

REVIEW OF THE WEEK
24 MARCH 2025

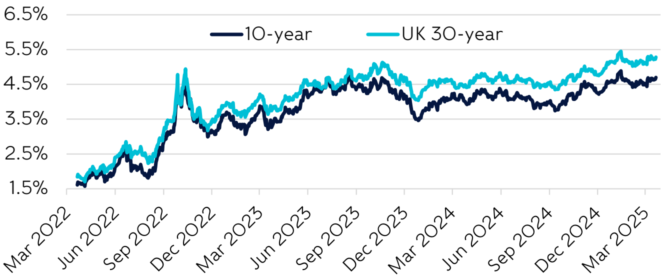
THE GOVERNMENT IS POISED TO CUT PUBLIC SPENDING. WILL ITS SPRING FORECAST ALSO TINKER WITH TAXES AND BORROWING? IF SO, UK GOVERNMENT BONDS COULD BEAR THE BRUNT.

UK government bond yields have crept higher over the past few weeks in anticipation of the Spring Forecast that's set for Wednesday. The government's fiscal watchdog, the Office for Budget Responsibility (OBR), will give its assessment of the nation's finances to Parliament around lunchtime. Its estimates of current tax receipts and public spending will lay out whether the government is likely to keep to its legally mandated fiscal promises to rein in borrowing and government spending by 2029-30.

Depending on those estimates, Chancellor Rachel Reeves may be forced to make changes to the Budget she set out back in October. **We've set out the situation here**, and will be updating you further on the day. While it's possible that Reeves could increase taxes further, scuttlebutt leaked ahead of time seems to suggest that she is focused on cutting government spending to try to balance the books.

Official statistics show that the deficit between government spending and tax receipts in February was £10.7 billion; back in October the OBR thought that would be just £6.5bn. The bigger shortfall was driven by much-lower economic growth than anticipated, but also by higher-than-expected government spending. Bond investors are assuming even greater amounts of borrowing will be required, with the prices of 10-year and 30-year UK government bonds dropping recently. That means their yields have risen, increasing the government's borrowing costs further. This is a sensitive area for the government as it has the potential to create a feedback loop: higher borrowing costs squeeze the public finances, requiring more debt, which sends yields higher again. The government has levers it can pull here, for instance by skewing the types of bonds it issues and the length of their maturities.

UK GOVERNMENT BOND YIELDS CREEP HIGHER



Source: FactSet; data 3 years to 21 Mar 2025

One way of alleviating that pressure would be if the Bank of England (BoE) continues cutting its benchmark overnight interest rate. While this rate has less effect on longer-term government bond yields, which are determined by the market, it can reduce shorter-term borrowing rates. That would encourage people to reduce savings (because of the lower returns on cash) in favour of spending or investment. Typically, that gives a boost to bond and stock prices (as long as the economy isn't in recession).

On Thursday, the BoE left its benchmark overnight interest rate at 4.5%, as expected. While a cut is possible at its next meeting in May, most expect the rate to remain where it is until the summer at least. Inflation is still around 3% – it's forecast to fall by 0.1 of a percentage point to 2.9% when February's measure is released on Wednesday morning. Erratic US tariff policies are injecting uncertainty into the global market, leading everyone from households and businesspeople to politicians and central bankers to wait and see before making big decisions.

US moderates, but not yet worrisome

On the other side of the Atlantic, the US Federal Reserve (Fed) left its overnight interest rate unchanged as well, at the range 4.25%-4.50%. The central bank also cut this year's US growth forecast to 1.7%, down from the 2.1% it had expected at the start of the year. It also raised its estimate of its favoured inflation measure, Core PCE inflation (which omits volatile food and energy prices). Rather than 2.5%, the Fed now believes it will be 2.8%, further from its target of 2%.

Fed Chair Jay Powell said that uncertainty over the tariff increases were “a good part” of the reason for these tweaks. He also noted that the central bank wasn’t in a hurry to make changes to its interest rate until the uncertainty lifted. Along with price stability, the Fed’s other mandate is targeting maximum employment. At 4.1%, unemployment is higher than it tended to be during the red-hot post-pandemic period, but it’s still very low relative to history. Arguably, the Fed has done a good job in recent years. It avoided a recession and has kept inflation relatively contained. This has left it with the space to wait and see.

As for stocks, they have calmed down **after the recent sell-off**. Looking back, 2024 was a bumper year for global stock returns, following an even better year in 2023. After strong runs, for markets to continue to forge higher, you really need to see sustained growth in profits into the next year and beyond, otherwise there’s a risk that prices fall back in disappointment. The latest slump doesn’t appear to be driven by disintegrating profits, but rather because of loud and unclear trade policy emanating from the White House. Financial data feed Factset reports that analysts think average first-quarter US earnings will be 7% higher than a year earlier. While that’s lower than the 11.6% expected at the outset of the year, it seems a conservative moderation rather than a sign of imminent collapse. There is, of course, a chance that profits do turn and start to deteriorate significantly. We will be watching the coming earnings season closely.

While politics can affect markets in the short term (the last few weeks is a case in point), **predicting them is often a fool’s errand**. Today, especially in America, this is truer than ever! Rather, it makes sense to focus on what you can control: looking for ‘quality’ investments that are smooth operators, not overloaded with debt and which have strong records of increasing their profits year after year. These companies tend to be more expensive than the average and they don’t necessarily deliver you gains every year. But we believe they are the best path to preserving and growing wealth over years and decades.

*If you have any questions or comments, or if there’s anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We’d love to hear from you.*