PREVIEW: UK Spring Budget due Wednesday, 15th March at 12:30GMT/08:30EDT

OVERVIEW: March's Spring Budget is unlikely to spur a significant market reaction, as despite the more favourable economic backdrop, the medium-term forecasts are likely to be less favourable. As such, Chancellor Hunt has limited fiscal space to announce any blockbuster measures. Particularly as he will want to keep some powder dry for the 2024 /2025 election cycle. Nonetheless, the Chancellor is likely to abandon the fuel duty and energy price guarantee increase alongside announcing a public-sector pay increase, though the magnitude of this is uncertain. From the DMO, Morgan Stanley expects the Gross Financing Requirement to be GBP 265bln for FY23/24 vs the illustrative GBP 305bln from November's forecasts; resulting in GBP 242.5bln of Gilt issuance.

ECONOMIC BACKDROP: In the roughly four months since Chancellor Hunt's Autumn Statement, where the Chancellor unveiled a multitude of tax and spending announcements in a bid to shore up the nation's finances and bolster market participants' confidence in the UK following Kwarteng/Truss' brief time in charge, the economic backdrop has changed significantly. Most pertinently, energy prices have fallen significantly (though remain elevated historically) and borrowing data has been more favourable than the OBR expected. With public sector net borrowing (PSNB ex) in January showing a GBP 5.4bln surplus, down markedly YY but well above the OBR's 0.4bln forecast surplus. However, this is caveated by the highest on-record January self-assessed income tax receipts; reminder, January tends to have higher accrued receipts vs other months, which the ONS highlights "often leading to a public sector net surplus.".

Additionally, CPI/PPI and BoE rate expectations have both seen a shift lower. On the BoE, this has been compounded by a dovish shift in global Central Bank pricing in wake of the Silicon Valley Bank collapse and concern over potential contagion. Though, it is worth making the point that the BoE was seemingly nearing the concluding phase of its hiking cycle anyway.

FISCAL TARGETS: In short, desks expect the Chancellor to meet his fiscal targets with reference to the fifth year of the OBR's forecasts, i.e. 2027/28. While the Chancellor achieving the borrowing target appears to be fairly certain, the wiggle room around the underlying debt rule is less favourable. Whether or not the targets are attained is very much dependent on the OBR's GDP view.

As a reminder, the UK fiscal charter has three main targets for the Chancellor: debt as a % of GDP to be falling by the fifth year of the OBR's forecast (referring to PSND ex-BoE); borrowing to not exceed 3% of GDP by the fifth year; certain welfare spending must be within a predetermined cap.

OBR FORECASTS: The OBR is expected to announce a significant downward revision to their 2022/23 borrowing forecast from the GBP 177bln announced in November to around GBP 140bln, according to Pantheon Macroeconomics given the better-than-expected start to the year. A view that will be further lowered by around GBP 15bln for 2023/24 given expected growth upgrades and favourable energy pricing.

In short, the near-term growth view is expected to be upgraded given the more favourable economic backdrop while medium-term projections are likely to be unfavourable, with ING highlighting that the November view was too favourable. Specifically, the OBR's Real GDP Forecasts (% YY) under Capital Economics' central estimate is -0.6% (prev. -1.4%) for 2023, 1.2% (prev. 1.3) in 2024, 2.5% (prev. 2.6%) in 2025, 1.8% (prev. 2.7%) in 2026 and 1.4% in 2027 (prev. 2.2%). Forecasts which, according to CapEco, imply the Chancellor will attain his fiscal targets (as outlined above), though the room for error around the debt rule is just GBP 3bln when the expected fuel duty freeze is accounted for.

On inflation, Goldman Sachs says the extension of the household energy bills cap will cause inflation to drop to 1.8% by end-2023 moving below the BoE's 2.0% target. Such a move would be a substantial fall from the current +10% pace and a substantial revision lower from Goldman's recent 3.6% projection. More broadly, the key inflation forecast is the 2025 projection which in November the OBR had at -0.8% and could see a marked revision higher.

POSSIBLE MEASURES: Given the limited short-term fiscal space likely available to the Chancellor and the prospect of an unfavourable medium-term outlook the Budget isn't expected to contain anything too blockbuster, with the Chancellor likely to keep some powder dry for the 2024/25 election cycle.

Nonetheless, Hunt will almost certainly scrap the flagged fuel duty increase to 23% increase to the Energy Price Guarantee (EPG) from GBP 2.5k to GBP 3k, measures which come at a fiscal cost of around GBP 8bln. Additionally, given recent strike action and inflation, a public sector pay rise; the magnitude of this will be closely watched given BoE concerns over a wage-price spiral and as current budgets allow for a roughly 3.5% increase; with Deutsche Bank positing that a 5% increase would cost around GBP 4bln.

Other potential measures include a defence spending increase of around GBP 10bln for 24-months and tax relief on investment spending, as well as reversing the corporation tax rate increase and alterations to the capital allowance. Albeit, the latter two measures are generally judged to be less likely and could be used as pre-election sweeteners by the Chancellor.

DMO REMIT (GBP): For FY23/24 Morgan Stanley estimates gross financing requirements of 265bln, resulting in 242.5 bln worth of gilt issuance. The breakdown would be 109.2bln, 50.9bln, 58.2bln and 24.3bln of short, medium, long and I /L respectively. The bank highlights that such issuance would be unusual in terms of magnitude and proportions but is in-fitting with high issuance habits.

In November, the DMO's gross gilt issuance for 2022/23 was 169.5bln (exp. 185bln) and the breakdown was 66.5bln, 43.2bln, 39.8bln and 17bln of short, medium, long and I/L respectively. The illustrative gross financing requirement for FY23/24 at this point was 305bln.

MARKET IMPACT: Given near-term fiscal policy is likely to be subject to relatively small changes, due to unfavourable medium-term OBR projections and the need to keep some fiscal space heading into the election cycle, Capital Economics believes the market reaction should be "relatively muted". And, by extension, the debt market will be reassured by the Chancellor adhering to his fiscal targets.