UK fiscal headroom: Goodbye, Hello.

The Chancellor of the Exchequer announced a series of spending cuts, hoping to tame down markets concerns about the UK fiscal position. The government has restored its fiscal headroom but only by a small margin, leaving the government vulnerable to any change in growth forecasts. While the market reaction was muted at first, Gilts yields have since then increased, focusing on the needs for additional fiscal retrenchment later this year – with possibly some tax hikes this time round.

Fiscal headroom vanished. In her first budget as a UK Chancellor of the Exchequer last Autumn, Rachel Reeves announced an increase in public investment as well as higher employer's social contributions. It allowed the government not only to meet its self-imposed fiscal rule but also to show a fiscal headroom (a buffer against any adverse developments). However, this headroom was very limited (£9.9bn or 0.3% of GDP) and rapidly eroded as growth was revised down and on the back of higher bond yields. This forced the Chancellor to announce new measures, this time focused mostly on spending cuts:

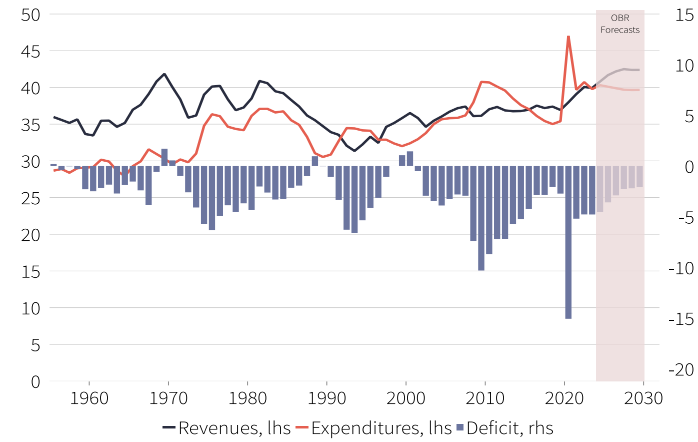
- Welfare cuts worth around £4.5bn. Since Covid, the number of people claiming disability or incapacity benefits surged, from 2.8mlns in 2019 to about 4mlns in 2024, of which almost two-third are neither working nor looking for a job. As a result, working-age health-related benefits represented 1.7% of GDP in 2024, an increase of £12bn or 0.4pp compared with 2019. Against this backdrop, the government decided to tighten the eligibility conditions to the disability benefits as well as to cut the universal benefits for new entrants.
- Across-the-board departmental spending cuts, worth around £3.5bn. With defence spending set to be increased to 2.5% of GDP and the NHS shielded from any cuts, unprotected departments representing around a quarter of all primary spending will disproportionally bear the brunt of the adjustment.
- Tax avoidance measures worth around £2bn.

History to repeat itself again? This allowed the government in succeeding to restore the lost fiscal headroom, but only back to its projected level at the time of the Autumn Statement (just under £10bn or 0.3% of GDP). As a result, history may repeat itself. Should growth disappoint again (or bond yields rise further), the Chancellor may find herself in the exact same situation in six months when presenting the Autumn Statement. Yet, given the large global uncertainty, further downward revisions to growth are a distinct possibility. The Chancellor is thus at a clear risk next autumn of having either to breach the fiscal rules (leading to a much more adverse bond market reaction) or to renege on the government electoral promise not to hike taxes.

The BoE to remain cautious. The Bank of England (BoE) has only cut interest rates by 75bp in one year vs. 100bp for the Fed and 150bp for the ECB. This is mostly due to a still tight labour market and sticky services inflation. As they are relatively modest and will not be implemented before FY2026, the new fiscal measures are unlikely to change the BoE's short-term stance.

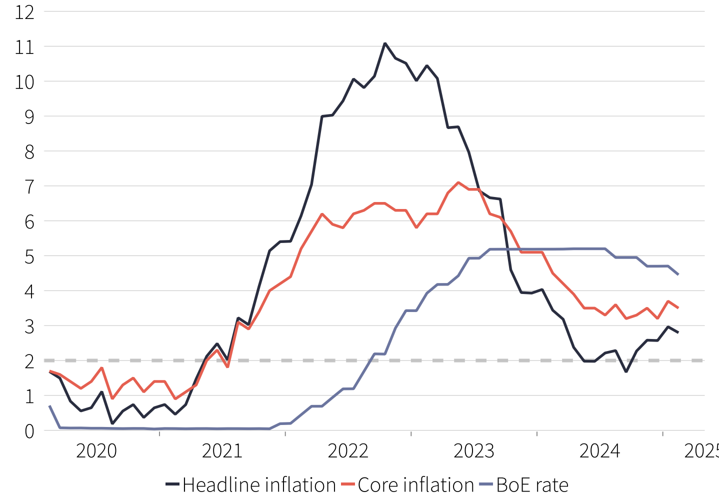
The BoE will instead continue to focus on short-term inflation and labour market developments. Regarding the former, the February inflation print was positive (with a modest drop to 2.8% year-over-year). Regarding the latter, the impeding increase in employers' national insurance contribution may lead to additional labour market easing. This should allow the BoE to continue cutting interest rates by up to 3 times in 2025.

UK PUBLIC FINANCES METRICS
% of GDP, forecast by Office for Budget Responsibility



Sources: Société Générale Investment Solutions, Macrobond, OBR 2029

BOE KEY RATE VS. INFLATION RATE (year-over-year)



Sources: Société Générale Investment Solutions, Macrobond, ONS 02/2025

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SOCIETE GENERALE
Private Banking

OUR MACRO COMMENTS

Events of the week

The United States is expanding the trade war to the auto sector

The U.S. government has announced a 25% increase in tariffs on all imports of automobiles and some automobiles parts from April 3. These new tariffs are in addition to the customs duties already imposed to autos imports.

By geography, the main countries impacted by this measure are Mexico, whose country supplies 36% of the cars and spare parts that the United States imports, Canada (13%), Japan (13%), South Korea (12%) and Germany (9%).

However, American, Japanese and German companies are also indirectly affected by this measure via their car production in Mexico

This is likely raise US inflation in the coming months, which should lead the Fed to maintain a cautious bias.

Euro area: the recovery in credit continues.

Bank credit data for February show that the recovery continues in the context of the ECB's interest rate cut cycle. Credit to the private sector increased by 1.2% year-on-year in February, with a positive contribution from credit to households and businesses.

In France, however, the recovery in credit is more muted. Growth in household credit remains sluggish, with mortgage lending still in contraction year-on-year. Corporate lending was however more dynamic, with growth of 2.1% year-on-year in February and a strong contribution from long-term credit.

EVENTS OVER THE NEXT FEW MONTHS

- **2 April: Planned effective date of US tariffs against EU products**
- **17 April: ECB monetary policy meeting**
- **7 May: Fed monetary policy meeting**
- **8 May: BoE monetary policy meeting**

KEY EVENTS NEXT WEEK

Monday		
	China	PMI business survey (March)
	Germany	Inflation (March)
Tuesday		
	United States	ISM manufacturing survey (March)
		JOLTS (February)
	Euro area	Inflation (March)
		Unemployment rate (February)
Wednesday		
	United States	Durable goods orders (February)
Thursday		
	United States	Trade balance (February)
		ISM services survey (March)
Friday		
	United States	Employment report (March)
	France	Industrial production (February)
	Germany	Factory orders (February)

MARKET PERFORMANCES

Interbank rates

%	26/03/2025	28/02/2025	27/12/2024	01/01/2024	28/03/2024
US SOFR	4.334	4.35	4.55	5.34	5.32
Euro area €ster	2.417	2.66	2.92	3.88	3.90
UK SONIA	4.457	4.46	4.70	5.19	5.19
Switzerland SARON	0.199	0.43	0.46	1.70	1.46
Japan TONAR	0.477	0.48	0.23	-0.04	0.08

10Y Government rates

%	27/03/2025	28/02/2025	27/12/2024	01/01/2024	28/03/2024
US Treasuries	4.38	4.24	4.62	3.88	4.20
France OAT	3.47	3.12	3.19	2.55	2.82
Germany Bund	2.77	2.38	2.38	2.02	2.29
Italy BTP	3.82	3.47	3.53	3.70	3.70
Spain Bonos	3.40	3.07	3.07	2.98	3.15
Switzerland	0.65	0.40	0.29	0.66	0.64
UK Gilts	4.79	4.51	4.61	3.60	3.92
Japan JGB	1.56	1.38	1.08	0.62	0.74

Credit

%	27/03/2025	28/02/2025	27/12/2024	01/01/2024	28/03/2024
United States IG	5.24	5.08	5.37	5.06	5.30
United States HY	7.63	7.15	7.50	7.59	7.66
Europe IG	3.56	3.32	3.47	3.72	3.84
Europe HY	5.89	5.40	5.72	6.80	6.57
Emerging FX	6.27	6.12	6.41	6.77	6.76

Equity indices

27/03/2025 vs	-1w	-1m	-3m	01/01/2024	-1y
World	0.22	-2.553	-0.699	19.14	10.03
United States	0.43	-4.424	-3.685	19.72	10.05
Euro area	-0.63	-0.375	10.896	20.85	10.57
France	-0.61	-1.205	9.376	9.52	1.79
Germany	-1.02	0.436	13.544	31.64	21.90
United Kingdom	0.33	-0.961	6.972	15.91	12.03
Japan	0.40	4.761	0.900	21.43	3.31
Emerging	0.03	2.744	4.047	18.12	13.65
China USD	-0.42	4.109	16.896	39.39	42.61
India USD	0.71	9.841	-5.030	8.75	4.85
Latin America USD	0.28	7.738	16.212	-14.70	-10.78

Foreign exchange rates

	27/03/2025	28/02/2025	27/12/2024	01/01/2024	28/03/2024
EUR/USD	1.08	1.04	1.04	1.11	1.08
GBP/USD	1.30	1.26	1.26	1.27	1.26
EUR/CHF	0.95	0.94	0.94	0.93	0.97
USD/JPY	150.97	150.67	157.60	141.03	151.33
USD/CNY	7.26	7.28	7.30	7.08	7.23

Commodity prices

	27/03/2025	28/02/2025	27/12/2024	01/01/2024	28/03/2024
Brent, USD/BL	73	73	73	77	87
Copper, USD/Metric ton	9,787	9,364	8,843	8,476	8,729
Gold, USD/Troy oz	3,057	2,858	2,621	2,063	2,231
Silver, USD/Troy oz	34	31	30	24	25
Palladium, USD/Troy oz	977	918	919	1,136	1,017
Platinium, USD/Troy oz	976	943	925	1,000	907

Source : Bloomberg on 28 March 2025, 1W = 1 week change, 3M = 3 month change, 12M = 12 mont change, YTD = year to date change, Equities; total return in local currency . Government bonds = 10 year returns. Figures are rounded..

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