Weekly Update

C0 | EXTERNAL PUBLICATION

The UK's Fiscal Exercise


Alan Mudie
Head of investment Strategy
(41) 22 819 0255
alan.mudie@socgen.com


Xavier Denis
Global strategist
(33)1 5637 9817
xavier.denis@socgen.com


Antonio Bertone
Global strategist
(33)1 42 13 24 06
antonio.bertone@socgen.com


Sophie Fournier
Global strategist
(33)1 42 14 59 36
sophie.fournier@socgen.com


Paul Beecham
Editor in chief
(33) 1 56 37 39 61
paul.beecham@socgen.com

Whereas the budget process in Washington seems to last most of the year, in London it is condensed into two quite short speeches by the Chancellor of the Exchequer – the annual Budget in March and the Autumn Statement in November. This week, Chancellor Hammond delivered his semi-annual set piece. It provided some detailed insights into the outlook for the UK economy.

Much of the background is provided by the Office for Budget Responsibility (OBR), which was set up by George Osborne in 2010 to provide an objective framework of projections and reports, independent from any government influence. The OBR's new forecasts suggest a worsening outlook for the UK economy and its finances.

As shown in the left-hand chart below, the forecasts for real GDP growth have been revised down for this year and for the next four years – in aggregate, this represents a potential loss of output amounting to 2.2% of UK GDP. In its report, the OBR underlines that this downgrade is due in large part to lower population and productivity growth. It explains its expectations for the adult population with reference to less inward migration and slightly higher mortality rates, and those for productivity in light of lower domestic business investment and foreign direct investment.

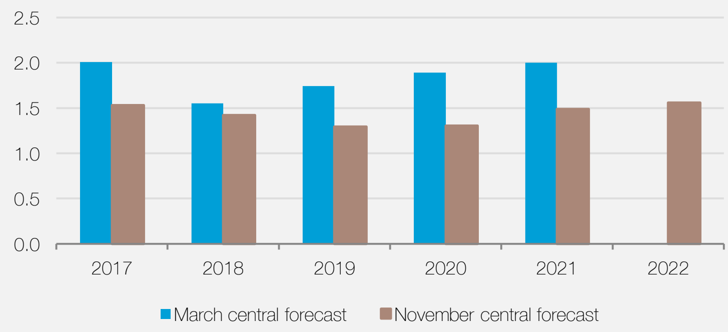
The OBR's forecasts for borrowing are shown in the right-hand chart. The short-term outlook looks better than in March, thanks in part to better-than-expected monthly tax revenues and spending. However, it is also flattered by recent relaxation of government control over housing associations – this means that up to £5bn of borrowing has been reclassified as private rather than public. Beyond 2018-2019, the outlook for public borrowing worsens vis-à-vis the previous forecasts. In effect, Hammond has used some of the headroom he had against the pledge to keep the deficit below 2% of GDP in 2020-2021 in order to boost borrowing in coming years.

The increase in borrowing is designed to achieve a number of aims. First, the Chancellor plans a raft of measures to support house-building – increasing planned spending by £15bn – in order to increase the number of new homes to 300'000 per annum by 2025 versus 217'000 last year. Second, Hammond has set an additional £3bn aside to finance preparation for Brexit. Also, he boosted the size of the national productivity investment fund by £8bn and said it would last a year longer than initially planned.

In summary, this budget exercise keeps the UK's public finances in line with most of the government's fiscal targets. However, it also paints a picture of an economy which looks set to underperform growth in the eurozone over coming years. We continue to expect weakness in the currency and to see better opportunities for equity investment elsewhere (see *Tightening Our Focus*).

GDP growth forecasts has been revised down for the five coming years

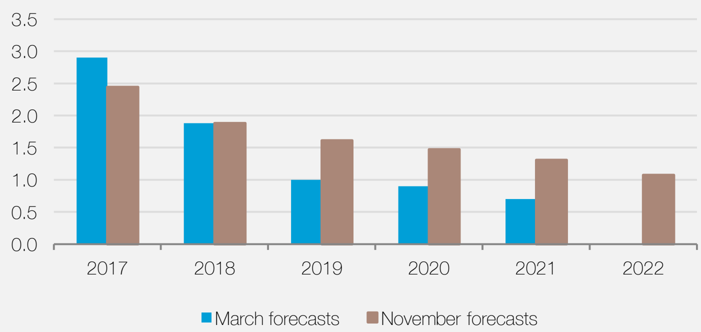
UK real GDP growth forecasts (2017 to 2022)



Sources: Societe Generale Private Banking, OBR (data as of November 2017)

Beyond 2018-2019, public borrowing worsens vis-à-vis previous forecasts

UK public sector net borrowing forecasts (2017 to 2022)



Sources: Societe Generale Private Banking, OBR (data as of November 2017)

This week and next

EUROZONE

- The PMI confidence index rose from 55.7 to 56.7 in September, beating expectations (55.6).
- The ZEW survey's "Expectations" component rose from 29.3 to 31.7 in September, pointing to stronger activity.
- The consumer price index edged up from -0.5% to 0.3% MoM in August but remained stable at 1.5% on a year-on-year basis over the same period.

Next week's key events	Per.	Prev.	Cons.
27 Sep M3 Money Supply (YoY)	Aug	4,5%	--
28 Sep Consumer confidence	Sep	-1,2	--

UNITED KINGDOM

- In August, retail sales surged from 1.3% to 2.4% YoY, while expectations were for 1.1%. This is quite encouraging in a country where consumption is such a big driver.

Next week's key events	Per.	Prev.	Cons.
28 Sep Nationwide house Px (MoM)	Sep	-0,1%	--

UNITED STATES

- Industrial production slipped from 0.2% to -0.9% MoM in August partly because of the hurricane Harvey.
- Building permits increased from -4.1% to 5.7% in August.
- The leading index edged up from 0.3% to 0.4% in August, suggesting solid activity ahead.
- The Philadelphia Fed business confidence index crept up from 18.9 to 23.8 in September.

Next week's key events		Per.	Prev.	Cons.
26 Sep	New home sales (MoM)	Aug	-9,4%	5,1%
27 Sep	Pending home sales (MoM)	Aug	-0,8 %	-0,5%

ASIA & EMERGING COUNTRIES

- In Japan, exports increased more than expected, rising from 13.4% to 18.4% in August. This was the fastest pace since November 2013. Imports increased by 15.2% in August but exports were ever stronger, pushing the Japanese trade balance further in surplus (113.6 billion yen).
- In Taiwan, industrial production grew 3.25% YoY in August, above the 1.85% surveyed.

Next week's key events		Per.	Prev.	Cons.
27 Sep	Japan: Small business confidence	Sep	49	--
27 Sep	China: Industrial Profits (YoY)	Aug	16.5%	--

Sources: Datastream, Bloomberg, 24 November 2017, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 6-month targets

CURRENCIES & COMMODITIES

	Thursday close	6mth target
EUR/USD	1.19	1.20
GBP/USD	1.33	1.28
USD/RUB	58.4	60
AUD/USD	0.76	0.72
EUR/CHF	1.16	1.18
USD/CNY	6.58	7.1
USD/CAD	1.27	1.37
USD/JPY	111	118
Brent	$63.4	$55
Gold	$1291	$1225

We maintain our 6-month targets this week.

Forecast figures are not a reliable indicator of future performance

Question time

Past performance should not been seen as a guarantee of future returns.

%

CURRENCIES
What is your view on EUR/USD?

24 November 2017

We remain constructive on the euro and slightly bearish dollar at 6 and 12 months.

Stronger global growth and receding or low inflation in many countries should encourage investors to build long carry positions on high-yielding currencies.

Also, dollar supports (a Fed rate hike in December, elusive hopes of a tax reform) already seemed to be priced in. With moderate long-term inflation expectations and recent disappointment on the wage front (US hourly earnings decreased from 2.8% to 2.4% YoY in October), we see no reason for US rate hike expectations to be revised up.

Interest rate differentials have been less of a driver for currency moves these last twelve months. Relative valuation, macro momentum, and risk sentiment have taken over during the recent period.

In the current context, the dollar looks slightly expensive and the euro moderately cheap.

Market performance

Past performance should not been seen as a guarantee of future returns.

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-36 bp	0 bp	→	0 bp	-3 bp	-1 bp
3mth Euribor (EUR)	-33 bp	0 bp	→	0 bp	-1 bp	-2 bp
3mth Libor (USD)	146 bp	3 bp	↑	14 bp	46 bp	53 bp
3mth Libor (GBP)	52 bp	0 bp	→	24 bp	16 bp	12 bp
10-year US Treasury bond	232 bp	-5 bp	↓	15 bp	-12 bp	-3 bp
10-year German bond	35 bp	-3 bp	↓	4 bp	24 bp	15 bp
10-year French bond	55 bp	-5 bp	↓	-13 bp	-14 bp	-25 bp
10-year UK bond	129 bp	-5 bp	↓	19 bp	5 bp	-18 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.1%	→	0.7 %	2.7 %	3.4 %
BAML EURO Corp HY	0.2%	↑	1.5 %	6.8 %	9.0 %
BAML GBP Corp IG	0.5%	↑	-0.8 %	4.0 %	7.0 %
BAML US IG	0.5%	↑	0.7 %	6.0 %	6.8 %
BAML US HY	0.4%	↑	1.4 %	7.0 %	9.4 %
JPM Global EM Sov. Plus	0.7%	↑	1.0 %	10.8 %	12.1 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.19	0.7 %	↑	0.4 %	12.7 %	12.2%
EUR/CHF	1.16	-0.6 %	↓	2.1 %	8.6 %	8.4%
GBP/USD	1.33	0.9 %	↑	4.0 %	7.9 %	7.0%
USD/JPY	111	-1.6 %	↓	2.0 %	-4.9 %	-1.2%
USD/BRL	3.22	-1.6 %	↓	2.6 %	-1.0 %	-5.1%
USD/CNY	6.58	-0.7 %	↓	-1.1 %	-5.2 %	-4.9%
USD/RUB	58.4	-2.1 %	↓	-1.0 %	-4.6 %	-9.2%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.1 %	↑	-0.8 %	1.6 %	1.7 %
United Kingdom (3-7yr)	0.2 %	↑	-0.9 %	0.1 %	1.0 %
Germany (3-7yr)	-0.1 %	↓	-0.1 %	-0.6 %	0.0 %
Japan (3-7yr)	0.1 %	↑	0.2 %	0.1 %	0.2 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	502	1.1 %	↑	6.4 %	21.7 %	24.7 %
Eurostoxx 50	3 572	0.2 %	↑	4.2 %	12.0 %	21.7 %
DAX	13 009	-0.3 %	↓	6.9 %	13.3 %	22.0 %
CAC 40	5 380	0.8 %	↑	5.4 %	13.9 %	22.6 %
S&P 500	2 597	0.5 %	↑	6.8 %	18.1 %	20.2 %
FTSE 100	7 417	0.5 %	↑	1.2 %	7.9 %	13.2 %
SMI	9 316	1.8 %	↑	4.1 %	17.1 %	24.1 %
Topix	1 777	0.9 %	↑	12.0 %	19.3 %	25.4 %
IBOV Brazil	74 487	2.7 %	↑	5.7 %	23.7 %	20.2 %
MICEX Russia *	2 149	0.8 %	↑	9.7 %	-3.8 %	3.0 %
MSCI EM	1 152	2.4 %	↑	7.5 %	36.6 %	38.2 %
SENSEX 30 India	33 588	1.5 %	↑	6.7 %	27.8 %	30.6 %
Hang Seng (H-K)	29 708	2.4 %	↑	9.4 %	40.3 %	36.1 %
Shanghaï Composite	3 352	-1.4 %	↓	2.0 %	8.0 %	3.4 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$63	2.5 %	↑	21.0 %	11.8 %	29.6 %
Gold	$1 291	0.8 %	↑	0.1 %	11.5 %	8.7 %
Silver	$17.1	0.3 %	↑	0.7 %	6.8 %	4.7 %

Source: Datastream, on 23 November 2017 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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