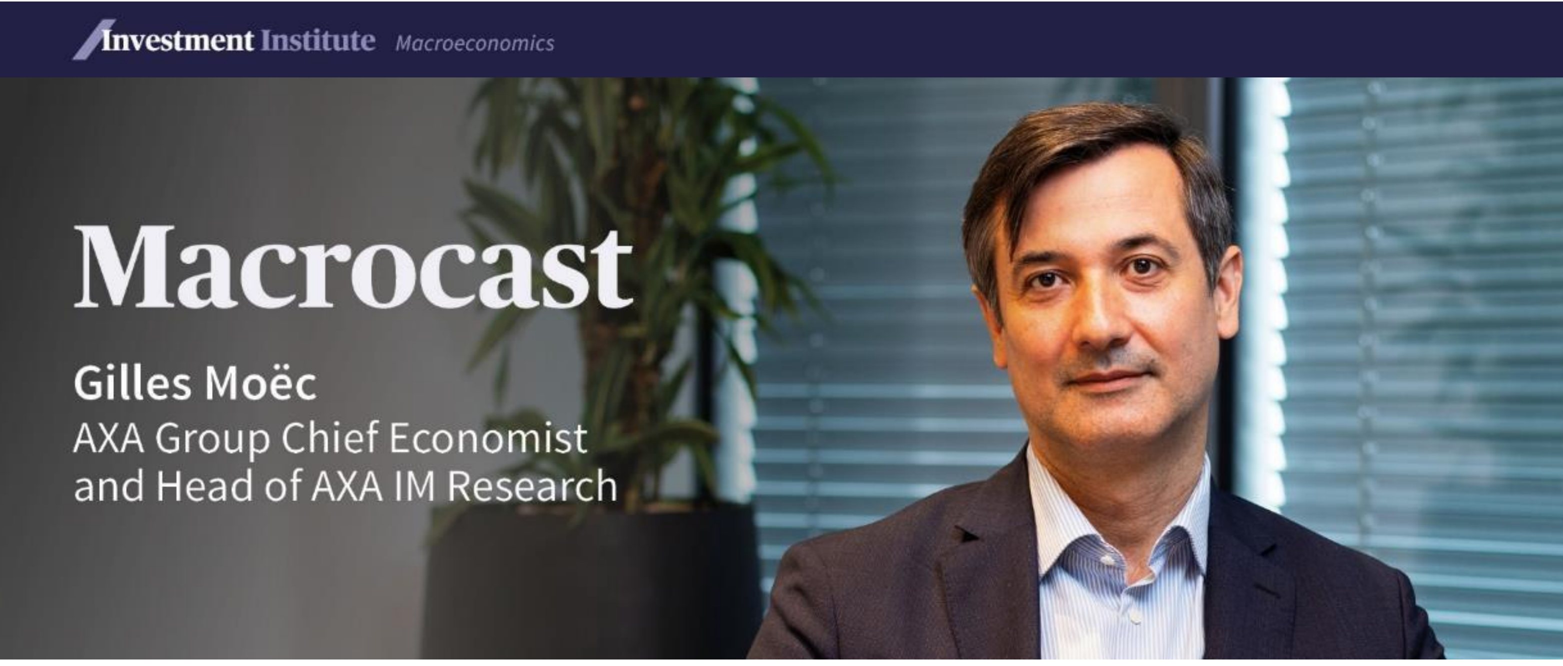
245 – 4 November 2024



Holding One's Breath

- We review the state of play ahead of the US vote and explore the main policy issues
- We take a look at the UK budget from last week

Poll aggregators suggest that the US presidential race is very tight, but the change in dynamics – Harris' national lead has been shrinking slowly since mid-October, and Trump is now seen in the lead in 5 out of 7 swing states, albeit with tiny margins – combined with the memory of the polls' understatement of voting intentions for the Republican candidate in 2016 and 2020 has pushed the market into pricing quite clearly a Trump victory. Collectively, investors seem to agree with the notion that a Trump 2.0 administration would come with more inflation and a higher deficit – we concur. This results in a rise in US long-term yields and an upward revision in the market's expected trajectory for the Fed even in the absence of new significant macro data.

We explore once again the main macro policy issues at stake here (regulation, immigration, trade, fiscal policy, and the possible erosion of the Fed's independence), with the help of a remarkable, quantified paper by the Peterson Institute which tackles three out these five issues. The paper largely confirms our view that, taken in isolation, a 10% hike in US tariffs would be manageable by the rest of the world, especially if monetary policy is allowed to play its stabilisation role, adopting a more hawkish stance in the US and a more dovish one elsewhere. However, we disagree with the mostly benign assessment of the impact of a 60% tariff hike on imports from China on third countries. We do not think that in such configuration we could count on a relative stability of the yuan. The temptation of depreciating the currency aggressively would become very difficult to resist in Beijing, with significant knock-on effects on Europe. We also highlight the importance of the contagion effects from a dominant US bond market in case of additional fiscal drift. This calls for even more readiness to act, if need be, by the ECB.

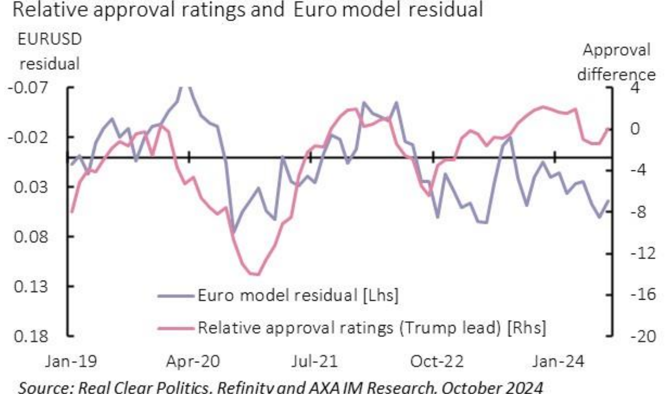
While the US elections leaves of course little bandwidth, we also explore the UK budget unveiled last week. The market reaction was measured, but we feel a chance to build a mutually beneficial trade-off between fiscal and monetary policy has been missed there.

The State of play ahead of the US elections

We do not think the release of the employment report for October last Friday changes the overall picture of the US economy. Job creation stalled, but the strike at Boeing combined with the hurricane in the South-East makes it very difficult to tell the signal from the noise. Crucially, the unemployment rate did not rise (it stayed at 4.1%), as labour supply was probably hit as hard as employment by the same exceptional factors, but at least this is in line with the message from the new unemployment benefits claims, which have hit their lowest point in 5 months last week. The downward revision by 112K of the job numbers over the previous two months is particularly interesting in our view, since it cannot have been polluted by the recent noise. To give a sense of perspective, in the previous version of the September payroll, job creation stood at +1.3% annualised over 3 months. The new version has it at 1.0%. This is in line with the message from the usual sources of labour market tension, such as job openings, which point to a gradual, but certainly not dramatic, cooling of the US labour market.

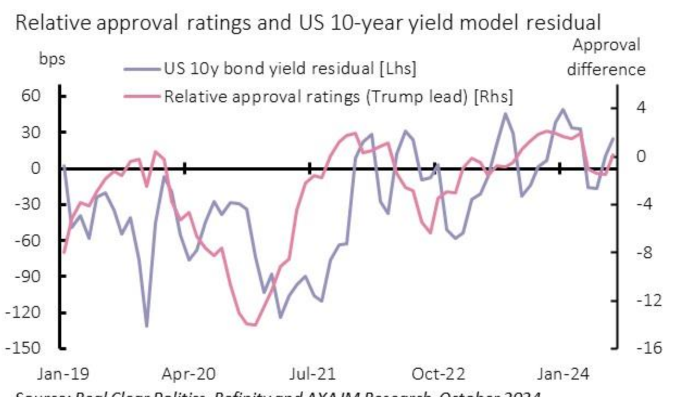
After a series of stronger-than-expected data releases in the first half of October which had triggered a shift in the markets' expected Fed trajectory, with a disappearance of "jumbo" 50bp cuts and a higher terminal rate, a debate had emerged on whether the central bank would be able to cut at all in November. Although it was noisy, the October employment report, when taken together with the job openings and unemployment claims, should help the Federal Open Market Committee (FOMC) deliver a 25bp cut this week. After that, when the FOMC meets again in December, they will have another employment report coming with, hopefully, much more signal than noise. **If, as we expect, the overall "labour market cooling" message prevails, we think the Federal Reserve (Fed) will cut again (by 25bps). Beyond that, however, we think the overall stance of monetary policy will be very dependent on who wins the elections this week.**

Exhibit 1 – Polls and 10-year yields



Source: Real Clear Politics, Refinitiv and AXA IM Research, October 2024

Exhibit 2 – Polls and FX



Source: Real Clear Politics, Refinitiv and AXA IM Research, October 2024

For about three weeks, the market has been clearly expecting that Donald Trump will be the next president of the United States. The surest signal in our view lies in the behaviour of 10-year yields in the second half of October. Indeed, that they rose significantly – jointly with the forwards contracts on the Fed's future moves – in the first 17 days of the month could be easily explained the dataflow alone, with higher-than-expected prints for the September employment report, consumer price inflation and retail sales. Yet, 10-year yields rose by another 20bps in the following two weeks although no significant data surprises came in – until the October employment report. However, this move coincided with the beginning of a steady erosion of Kamala Harris' lead in the national polls. Indeed, after reaching a peak at 3.7% on 23 August just after the Democratic Convention (we use here the *538* weighted average of polls), her lead stayed within a tight range of 2.5-3.0% throughout September. It fell below 2% for the first time on 20 October, and continued to shrink slowly, to reach 1% on 3 November. We will come back in details to the economic content of the platforms in the next section, but the market has been routinely endorsing the points made by many economists – including your truly – that the US would face more inflation and a higher public deficit if Donald Trump wins, which should push long-term interest rates higher. When we look at the prediction errors of our fundamental model for the US 10-year yield,

using inflation, growth, deficit and Fed policy as inputs, they correlate nicely with the gyrations in the presidential polls. The same holds for the dollar exchange rate against the euro (see Exhibit 1 and 2).

A Trump victory would defeat the old Clinton/Carville mantra "it's the economy stupid". The picture US citizens should have when voting is of a still robust economy, cooling down enough to kill inflation – a major confidence breaker in the last two years – and allow the Fed to cut interest rates at a fairly fast clip. On this basis, Kamala Harris, as the "continuity candidate", should normally do well. The recent deterioration in her lead however suggests this is not enough, or that it may have come too late. A few months ago, we exhumed in Macrocast oldish academic works which suggest that voters make up their mind about the state of the economy well in advance of the vote. A common view is that Biden was trailing in the polls essentially because of his age, not because of his management of the economy, and Harris' surge when she secured the nomination initially seemed to confirm that view. It may well be, however, that a generic displeasure with the Democratic policies' impact – or lack thereof, in particular on inflation – is now catching up with Kamala Harris, who has not distanced herself visibly from Biden's approach.

A key factor in the market's shift was the lead reversals in most swing states. Given how entrenched and polarized political positions are now in the US, the level of uncertainty on the outcome is very low in 43 states – plus the federal district. This suggests that Kamala Harris should be able to count, as a basis, on 226 votes in the electoral college, against 219 for Donald Trump. They need 270 to win. A month ago, based on the state polls, Harris had a lead in 5 of the 7 swing states, enough to win. In the latest series of polls aggregated by 538, Trump is now in the lead in 5 states, Harris only 2 (Michigan and Wisconsin). On this basis, Trump would be the next President of the United States, securing 287 seats. The leads are however still well within the margin of error. For instance, Trump's lead stands at only 0.4% in Pennsylvania, which alone brings 19 votes in the electoral college. If Trump loses Pennsylvania, he could still win, but then he would need to carry all the other swing states including Wisconsin, where he has not been in the lead since Harris was nominated.

The battle is thus far from being lost for Kamala Harris. 538's model gives Trump only a 53% probability of winning. Harris' campaign's finances are in a much better shape than Trump's, and this could be decisive in the last days of the race when "relative mobilisation" of voters is key. But **we suspect that the market's leaning to a Trump victory is also fuelled by a lingering doubt on the polls' reliability.** The 538 weighted average gave Biden a lead of 8.4% over Trump on 3 November 2020. He eventually won the popular vote by a margin of only 4 points. It may be that polls have become better at detecting hidden Trump supporters in 4 years, but from this point of view, Harris' national lead looks even more precarious. Of course, if the polls are right, in any case it remains a very tight race which means that the results could be known quite late, a potential source of market volatility in the days ahead.

A final note on electoral predictions: the polls are painting a much clearer picture of the Senate race. 538 has a probability of 90% for a Republican majority in the upper house. By contrast, it sees a probability of only 52% of a Republican majority in the House. This matters a lot since it focuses attention, in the candidates' platforms, on what they could achieve with executive orders rather than through legislation.

Five macroeconomic issues

A popular view – to which we partly subscribe – is that the old "Washington consensus" of the 1990s truly died with the emergence of Donald Trump and Joe Biden. Commitment to free trade and fiscal prudence disappeared on both sides of the spectrum. There are still differences of degrees across the two parties on these items – we will come back to them – but **there is an area where the old ideological fence is still high: regulation**.

Donald Trump was elected in 2016 on a "1-in/2-out" platform, i.e. promising to remove two regulations for each new one under his administration. This materialised in an executive order very early in his presidency (30 January 2017). Arithmetically, he delivered. As expected, he dismantled much of the US federal environmental regulatory framework

(nearly 100 regulations in this field, according to the New Times count), and there is little doubt he would continue in this vein should he win (see below). But there is another area which we think is of interest: healthcare.

To respond to the growing healthcare burden in an ageing society, Democrats typically respond by extending collective protection. Harris is a case in point. Before running in the primaries in 2020, she had championed the "Medicare for all" initiative with the left of her party which would have delivered a public universal healthcare cover in the US (she has moved away from this since then). **Donald Trump failed to deliver on his promise to dismantle Obamacare, but interestingly he focused on price mechanisms to reduce the cost of healthcare in the US**. For instance, he took an executive order which sought to apply the "most favoured nation" principle to the price of drugs in the US (forcing pharmaceutical companies to set the price of a drug in the US at the lowest level seen in any other developed country). Most of his initiatives failed to have an impact, often because they were bogged down in subsequent litigation, or because his decision to allow Medicare to import (cheaper) drugs from Canada collided with Ottawa's reluctance to face a "raid" on its own supplies, but there Trump followed a Republican tradition to fight established rents – even if in this particular case, Republican lawmakers did not support him. We will come back to this point on other issues. While **Donald Trump largely controls the Republican electoral machine – sometimes to the party's detriment when he imposes congressional candidates with narrow appeal – he does not have full control of the Republican caucus in Congress.**

In the current race, Donald Trump's deregulation enthusiasm has focused on oil and gas – in continuity with his first term, and any limit to drilling on the US territory set by Joe Biden would probably disappear – but new themes have appeared. Crypto-currency – although he had called, as recently as in 2021, for 'high regulation on bitcoin" – is now very much in Donald Trump's deregulation focus, as well as the liberalisation of cannabis (the latter point is now consensual across the political spectrum in the US).

While another deregulation effort could boost US supply, such effect could be offset, and even more than offset, by Trump's promised crackdown on immigration. He pledged a massive deportation effort. The idea that the US would be about to trigger mass deportations of illegal immigrants using security forces (including the military) may seem surreal, but there is a historical precedent: in 1954, under the Eisenhower presidency, the US government proceeded to the deportation of 1.3mn Mexican immigrants, which would be the equivalent of more than 2.8 million today given the population growth. Keeping – as is our remit – to the macro-financial ramifications of such decision, we can use a remarkable paper by the Peterson Institute (see link here) which is making the rounds in the economic profession to gauge the potential effect of such a decision. According to the Pew Centre, a very respectable source, there are in c.8mn illegal immigrants in the US workforce, 5% of the total. Replicating the 1.3mn deportations of 1954 would reduce available labour by 0.8% and would naturally significantly raise the price of labour, and the Peterson Institute reckons this could lift inflation by 0.35% in 2025, while reducing GDP by 0.2%. The additional detrimental effect on growth would rise in 2026 (-0.7% cumulatively relative to baseline).

We note that Donald Trump is talking not just of replicating the 1954 episode, but also of deporting *all* illegal immigrants. The Pew Centre – a very respectable source – estimates there are 8.3mn illegal immigrants in the US workforce, 5% of the total. Now, we would expect significant resistance from the Republican party on such a plan given the depth of the damage it would inflict to the US economy. **The Peterson's quantification in this case is indeed quite daunting: the shock would be large enough to trigger a complete stagnation of US GDP all the way to 2028**. True, Donald Trump would likely operate via an executive order, i.e. without the need for Congressional support, but the Republican caucus could retaliate by blocking some of his platform's items which need to be legislated. Even the "limited version" of deportation would be politically sensitive. Indeed, the illegal workforce is particularly large in agriculture. While the overall impact on Consumer Price Index (CPI) could seem to be limited, food prices would spike significantly. Consumer – and voters' – confidence is usually particularly sensitive to food prices shocks (it is a high-frequency purchase item). Still, if Donald Trump in any case cannot count on a Republican majority in the House, he would have little incentive to dilute his platform since his chances to make deals with Congress would be low anyway. Maybe paradoxically, a House controlled by the Democrats could make him more, not less extreme.

If however the threat of massive economic disruption operates, there could be "middle ways" to placate the Republican base's need to see "something done" about immigration while limiting the damage to the economy. JD Vance is promoting a legislative initiative under which cash transfers from the US to countries of mass emigration would be taxed. This tax would then be offset upon filling a tax return. The result would be neutral for legal immigrants and penalizing for illegals.

A Republican administration would not only try to limit inflows of people into the US. It would also try to stem inflows of goods. We have already commented at length in Macrocast on Donald Trump's trade platform. We can there as well use the Peterson Institute's quantification as a guide: if overall tariffs were to rise by 10 percentage points "across the board", inflation would react immediately, with a 0.6% jump relative to baseline. US GDP would predictably react a bit more slowly but still fall by 0.36% relative to baseline by 2026. Note however that the impact on other countries' GDP would often be smaller. Germany for instance, although it is one of the most export-reliant countries in the Euro area, would lose only 0.1% of GDP relative to baseline. Predictably, the shock would be larger however in the countries which are totally integrated in the US value chain. Canada would lose 0.4% of GDP by 2027, and Mexico would see the gap from baseline widen until a peak to 0.6% by 2032. In our own analysis of Trump's "trade war 2.0", we allowed for some specific treatment of these two countries. True, the free-trade agreement they signed with the US does not automatically protect them against tariffs, but the disruptions it would bring to the operations of many US-based businesses would be significant (more than USD3bn of trade crosses the Canadian border every day). In a plausible scenario, Donald Trump would use the threat of tariffs within United States-Mexico-Canada Agreement (USMCA) to extract concessions from Canada and Mexico when the treaty's renegotiation comes due in 2026, for instance requesting they align on the US in their attitude towards China. The Peterson Institute, probably for simplicity reasons, only provided estimates for a blanket 10% tariff hike covering all countries.

Yet, with this caveat, **the Peterson's results would confirm our long-held view that, despite the importance of US demand, the rest of the world could manage a 10% hike on the tariffs levied on the products they export to the US, especially if monetary policy is allowed to play its expected stabilisation role**. The Fed would react by adjusting its rate trajectory upward, while the rest of the world would take the opposite stance. In the Peterson's estimates, the dollar would appreciate by 5% vis-à-vis all other currencies. In the current configuration, with inflation converging to target, we fail to see what would prevent the European Central Bank (ECB) to accelerate the ongoing removal of its restrictive stance. Incidentally, an interest side-result of the Peterson's quantification is that **it would be in the interest of other countries NOT to retaliate to US higher tariffs.** Indeed, to the losses experienced by exporters we would need to add the loss to consumers from higher customs duties. While we acknowledge this may be politically difficult to sustain for third countries, this is a traditional result of trade theories.

Where we have a major disagreement with the Peterson's estimates it is on the ramifications of a 60% tariff hike on Chinese products alone. Indeed, while the impact on Chinese GDP does not surprise us (nearly 1% by 2026), we were quite surprised by the absence of second-round effects on many third countries. For instance, the German economy would be virtually unaffected in 2025 before *gaining* against the baseline from 2026 onward. The Peterson's model seems to operate mainly via production re-allocation: the loss of productive capacities in China – as its producers would be de facto excluded from the US market – would gradually shift to third countries. But an essential ingredient in the Peterson's model seems to be the unmovable anchoring of China's monetary policy on the Fed's to avoid any significant depreciation in its currency. They have only a 10% depreciation of the Renminbi in this scenario. We do not think this would hold in a 60% tariff configuration. Already faced with a too soft domestic demand, Beijing would probably react by trying to offset the decline of its exports to the US by boosting its efforts on third markets, in emerging countries and in Europe. Allowing for a more significant depreciation of the Renminbi would be a natural way to achieve this. Mature exporters to China, Europe in the first place, would have to deal with both a contraction in Chinese demand and an exacerbation of China's competitive push on exports it deems strategic.

The Peterson adds to its list of policy issues **the possibility that a Republican administration would erode the independence of the Fed.** The effect in their calibration is dramatic. Drawing on estimates that, in developing countries, central bank's independence reduced inflation by between 1 and 6 percentage points, the authors posited that the Fed's target would move up by 2 percentage points (to 4% then). This would ultimately deteriorate the US real economy via the usual risk premium channel, so that by 2028 US GDP would be 1.2% below baseline, after an initial boost in 2025. There again, we are surprised by the ramifications for the rest of the world in the Peterson's narrative: China and Europe would experience an *improvement* in their growth trajectory relative to baseline. We find this hard to believe when the world's largest economy would be in the midst of a stagflation crisis.

A key element here is the interest rate channel. Indeed, in the Peterson's model, investment outflows from the US (reflected in higher market interest rates) as a result of the shift in the Fed's preferences trigger investment inflows in other countries, lowering real long-term interest rates over there. This in our view ignores the always problematic fact that **irrespective of US fundamentals, the US bond market remains dominant and "sets the tone" for interest rates at the global level**. True, one could argue that precisely, disposing of the Fed's independence – in a world where most other big players would remain orthodox – could be the "nail in the coffin" of such dominance, but we have plenty of historical precedents – see the 1970s – where the Fed was far from being the best pupil in the monetarist class, but the US bond market still dominated.

On each of the policy items, we have tried to balance the message from the campaign with an assessment of what could be realistically implemented. Eroding the Fed's independence is not straightforward. True, Donald Trump could fire Jay Powell from his role as *President* of the Federal Reserve board, but he could not remove him as *member* of the board, and the FOMC is not obliged to appoint the President of the Fed as its chairman, which means that removing Jay Powell from monetary policy setting is not fully within the grasp of the US President, until the end of his term in 2026. Changing the status of the Fed, to make it more amenable to suggestions from the administration, would take thorny discussions with legislators. This would not fly in the absence of a Republican majority in the House. Even if the Republicans win, it is likely that the risk premium on US yields would start rising the minute such a project would be transmitted to Congress. This could act as a warning to enough Republican lawmakers to stop it in its track. Independence rarely dies in one neat swoop. It erodes over time and is usually detected by the results of policymakers' choices rather than by their intentions. The choice of a more amenable chairman in 2026 could start the process, but we do not think it is necessarily the most pressing matter on the agenda.

There is however one area which has not been covered by the Peterson Institute which could become a key market driver: fiscal policy. The numbers there are quite well-known. Prolonging 2025 the tax cuts Donald Trump delivered in 2017 would raise the federal deficit by 1% of GDP every year for the next decade, as per the Congressional Budget Office. To this, one should add new proposals from the Republican candidate, such as reducing the corporate tax rate from 21% to 15% - the latter being less discussed than the popular deduction on Treasury Inflation Protected Securities (TIPS), now also supported by Kamala Harris, which would probably add less than 0.1% of GDP to the deficit, even in its most extensive version. Donald Trump also advocates eliminating tax on social security benefits (state pensions for our European readers), which are currently partly subject to tax (from 50% to 85%). According to the Penn-Wharton Budget Model, this would bring the overall cost of the Republican platform to c. USD600-700bn a year over the next decade, i.e. c.2% of GDP, or 1.5% when taking on board the "dynamic effects" (aka positive effect on growth). This would add to the pressure on the supply of US Treasuries. This is another area through which the "market interest rate channel" could be a key source of contagion from US politics to the rest of the world.

True, **there is still a segment of the Republican caucus in Congress which might sufficiently concerned about the public debt trajectory of the US to pull the brakes on at least some of the President's tax projects**. This is incidentally where the tariff issue re-emerges. Indeed, the hikes in customs duties, on top of being presented as an instrument of economic rebalancing for the US and a tool to impair China's economic expansion, is increasingly marketed as a simple way to plug the US gaping fiscal deficit. In some conservative circles, this would be a return to the origins of the US

financial covenant – tariffs stood for most of the federal government resources until the Civil War (against only 4% at a recent peak in 2019). The argument should not be batted away (even if this would be a terribly socially regressive way to raise government income, since it would ultimately bear on consumers, with the poorest – with a high import content of their spending – paying the brunt). **If the only thing offsetting tax cuts is higher inflation – which ultimately is the result of higher tariffs – then interest rates are still likely to rise.**

All these lengthy developments lead to the same policy recommendation for Europe if Donald Trump wins: remove monetary restriction faster. This may be made necessary by a further deterioration in the European real economy in reaction to US tariffs (in particular via second round effects of a 60% tariff on China), to allow a faster depreciation in the euro, or to offset the overall tightening in financial conditions which could be the result of some contagion from the US to European yields.

We have focused on the Republican platform so far since it is the most disruptive one. **Kamala Harris as the continuity candidate has been mostly seen by the market as a "business as usual" proposition**, for instance focusing on curtailing China's access to key technologies, following on Biden's approach, rather than on blanket tariffs. There would however be changes from the current policy stance. She would be forced to act on immigration as well, even if it would probably take a very different form, given how sensitive the issue has become in the US – including for many Democrats. She is advocating technical changes to the asylum assessment process which would make it more restrictive and less prone to litigation. On fiscal policy, she would usher in some additional federal spending, such as extending the Child Tax Credit (CTC) and other tax credits for those at the bottom of the income ladder. According to the Penn-Wharton Budget Model, roughly half of this extra expenditure would be covered by a rise in the corporate tax rate from 21% to 28%. This would bring the net additional cost to the deficit to some USD 100-120bn annually over the next decade, i.e. around 0.4-0.5% of GDP.

The difference in magnitude with Trump's platform is of course huge, and a victory by Harris would probably send US rates on a very different trajectory, but fundamentally, what remains problematic in the US is that none of the main candidates is offering solutions to the underlying deterioration in the US fiscal position. The Congressional Budget Office (CBO)'s "no policy change" as US public debt hitting 116% of GDP in 2034, up from 99% in 2024. The key choice still consists in either accepting to bring tax to a level commensurate with the trends in welfare spending in an ageing society or reforming the social support framework. None of the two parties is currently ready, or willing, to tackle this. Since the US economy continues to do well, and with the Fed starting to cut rates, there is some time to address these issues, but not an eternity.

The UK's fiscal gamble

While the eyes of the world are fixated on the US, there is little bandwidth this week to discuss other geographies, but we still think that some comments on last week's UK budget are warranted. Since the new British government had been, since even before the election, promising only "blood, sweat and tears" on fiscal issues, hinting at some tax hikes, even though the most visible ones – VAT, income tax and corporate tax rates – had been sanctuarised, we were bracing ourselves for a fairly hawkish budget. What little additional public spending would be made possible by tax hikes would be directed to investment programmes, lifting potential growth instead of adding to the pressure of demand on fragile British supply. This sentiment was fuelled by reports on unease within some members of the cabinet around the overall fiscal plans. As we wrote two weeks ago, **we thought it made sense for the UK government to start its tenure with a tough budget**. Politically, they could still blame the Tory legacy for it, and economically, they could expect a faster pace of rate cuts by the Bank of England which would take on board the effect of the fiscal tightening on aggregate demand and inflation.

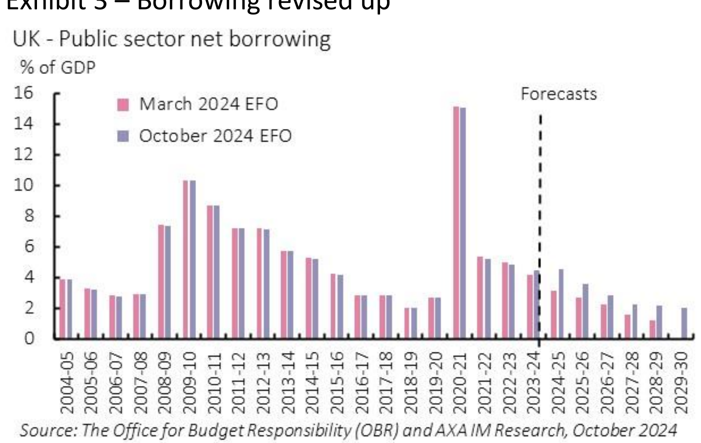
We were wrong. The tax hikes duly came, but spending rose even more. The Office for Budget Responsibility (OBR) outlined a £25bn increase in spending this year and an average of £69.5bn in each of the following five years,

equivalent to a 2.2% of GDP increase per year. Tax revenues, meanwhile, are forecast to increase by around £36.2bn a year, equivalent to 1.1% of GDP. That makes for a chunky fiscal push. Most of the additional spending (70%) is going to "day to day spending", most notably in education and healthcare. There is little doubt that the sorry state of the National Health Service called for additional resources – and this should now be complemented by structural reforms, as promised by the Health Secretary – but this type of expenditure has only a slow and indirect effect on potential growth. True, the dramatic rise in the number of working age British residents who cannot work for health reasons may down the line be curbed by a better healthcare system, but it may take years to materialise. In a similar vein, a better education system will eventually lift productivity, but the lag can be substantial.

Ultimately, the Chancellor opted for a fairly traditional centre-left budget, with a focus on improving public service provision, but **the impact on growth is likelier to be felt more in the short term (the knee-jerk reaction to the injection of fresh government cash) than in the long-term (the product of stronger collective infrastructure and better incentives)**. While the "big taxes" were indeed left unchanged, there is one aspect on the income side which could even prove detrimental to growth in the medium-term: the choice to hit the National Insurance Contribution paid by employers by 1.2%, combined with a reduction in the threshold below which they are exempt. This is by far the biggest income contributor in the government's plan, with a gain of c.1% of GDP for the state's coffers. Raising labour costs when the Pay As You Earn (PAYE) data suggests the UK may have just started to destroy jobs is not ideal. This is all the more problematic that the Chancellor at the same time endorsed the recommendation of the Low Pay Commission and mandated an increase in the National Living Wage by 6.7%. While we still expect the Bank of England to continue removing restriction, there is no reason for the Monetary Policy Committee (MPC) to accelerate the pace after the budget announcements.

The announcements are consistent with an upward revision in the government's net borrowing (see Exhibit 3). At first glance, it is not forecasted to differ much from the levels seen well into the austerity phase of the 2010s but note however that the Bank of England is now running its holdings of gilts down, which will result in a "net" borrowing closer to 9% of GDP next year, close to the levels seen in during the Great Financial Crisis. The market reaction was measured though. 10-year yields spiked by 15bps since the announcements, only 8bps more than the German 10-year. The UK is not back in a "Liz Truss" moment, but we feel that a better fiscal/monetary trade-off could have been achieved.

Exhibit 3 – Borrowing revised up



Source: The Office for Budget Responsibility (OBR) and AXA IM Research, October 2024

Country/Region	What we focused on last week	What we will focus on in next weeks
US	• Payrolls (Oct) slowed to 12k, unemp stayed at 4.1% and earnings rose to 4.5% (3m-ann). But Oct's figures distorted by storm. • JOLTS survey (Sep) vacancies fell to 7.4m vs 7.9m • GDP (Q3, p) 2.8% (saar), above our 2.6% est, underpinned by strong consumer • Conf Bd confidence (Oct) stronger than expected • PCE inflation (Sep) fell to 2.1% (43m low), core 2.7%	• US election. Results could be a day later, but legal risks could extend. Polls remain on a knife-edge, but Trump momentum grown lately • FOMC meeting. Expect 0.25% cut to FFR. No forecast updates. Powell to provide press conf. • ISM services index (Oct) hit 19m high of 54.9 in Sept, moving in line with PMI • Trade (Sep) deficit widening after goods (prel)
Euro Area	• EMU GDP growth came at +0.4%qoq, above expectations. Excluding one off from Olympics and excluding Irish volatile data, we believe current growth momentum is lower, closer to +0.3% • EC surveys (Oct) edged down, impacted by industrial sector while services were slightly better • EMU inflation came at 2%yoy above expectations, core at 2.7% flat from September	• Industrial output in France, Germany and Italy (Sep) • Final PMI (Oct) • EMU retail sales (Sep)
UK	• BoE cons. credit (Sep) came in weaker at £1.2bn, compared to £1.4bn in Aug. Mortgage approvals rose to 66.7K, back to 2015-to-19 levels • Chancellor Reeves delivered a fiscal easing equivalent to 0.6% of GDP over next 3 years at her inaugural Budget. Tax hikes of £40bn and an additional £140bn of borrowing	• BRC Retail Sales (Oct) look for signs households pared back spending in run up to the budget • Final PMIs (Oct) unlikely to change materially from flash estimate. Cons. PMI to remain above 50 • BoE set to cut Bank Rate to 4.75%. Will probably revise up its growth and inflation forecasts slightly • RICS survey (Oct) to show further improvement
Japan	• Cons conf (Oct) dropped to 36.2, from 36.9 in Sep. • IP (Sep) rose 1.4%mom. Retail sales, however, down by 2.3%mom • LDP lost its majority. 30 days to form government • BoJ maintained policy rate at 0.25%	• Final PMIs (Oct) unlikely to change materially from flash estimates • Wage data (Sep) look for signs that wage dynamics are improving • HH spending (Sep) look for signs HH are spending any additional cash from rising real incomes
China	• Industrial profit (Jan-Sept) dropped by 3.5%yoy, reverted the gain in Jan-Aug of +0.5%yoy • NBS mfg PMI (Oct) up to 50.1 from 49.8 in Sept • NBS non-mfg PMI (Oct) up to 50.2 (Sept: 50.0)	• 1 Nov: Caixin mfg PMI for October • 5 Nov: Caixin services PMI for October • 7 Nov: Imports and exports for October
Emerging Markets	• Q3 GDP: Mexico (1%qoq), Hungary (-0.7%qoq), Czech Republic (0.3%qoq), Hong Kong (1.5%yoy), Taiwan (4.0%yoy) • IP (Sep): Korea (-1%yoy), Thailand (-3.5%yoy)	• CB: Malaysia (3%), Czech Republic (4.25%) and Poland (5.75%) on hold, Brazil 50bps hike to 11.25% • CPI (Sep): Taiwan, Thailand, Korea, Philippines, Mexico • Q3 GDP: Philippines, Indonesia

Upcoming events		
	US:	Mon: Factory orders (Sep); Tue: Balance of trade (Sep), Exports (Sep), Imports (Sep), Composite PMI (Oct), Services PMI (Oct), ISM services PMI (Oct), Presidential election; Thu: Initial jobless claims (Nov/02), Nonfarm productivity (Q3, p), Unit labour costs (Q3, p), Fed interest rate decision; Fri: Michigan consumer sentiment (Nov, p)
	Euro Area:	Mon: Sp, It, Fr, Ge, Ez Mfg PMI (Oct); Tue: Fr IP (Sep), Sp unemp (Oct); Wed: Ge factory orders (Sep), Sp, It, Fr, Ge, Ez Services PMI (Oct); Thu: Ge Balance of trade (Sep), Ge Exports (Sep), Ge IP (Sep), Ez retail sales (Sep); Fri: Fr balance of trade (Sep), It IP (Sep), It Retail sales (Sep)
	UK:	Mon: Retail sales (Oct); Tue: Services PMI (Oct); Wed: Construction PMI (Oct); Thu: Halifax house price index (Oct), BoE Interest rate decision
	Japan:	Wed: Services PMI (Oct); Fri: Reuters Tanken Index (Nov)
	China:	Tue: Caixin services PMI (Oct); Thu: Balance of trade (Oct), Imports (Oct), Exports (Oct); Sat: Inflation (Oct), PPI (Oct)

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