

Hammond's UK budget balancing-act

Less fiscal headroom and political pressure mean that Chancellor Hammond could struggle to make big changes at this week's budget



As UK budgets go, this week's will be a particularly tricky one for Chancellor Phillip Hammond. Faced with an economy which is still struggling and mounting political pressure, he is unlikely to be able to announce any major changes this time.

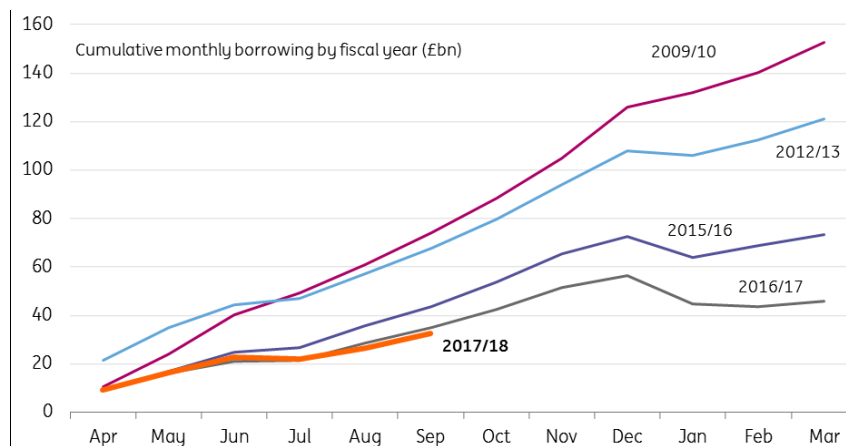
The Chancellor's first constraint comes from his own budget rules that were introduced last year, requiring the UK budget deficit to be below 2% of GDP by 2020-21. According to the Office for Budget Responsibility's March forecasts, the Chancellor had effectively left himself £26 billion of headroom to navigate any turbulence over the next few years. That number will get a small boost from better finances this year, but there also look set to be a series of sizable downgrades that will limit the Chancellor's wiggle room further out. The largest change is likely to come from a big downgrade in the OBR's productivity forecasts, which will lower estimates of tax revenue (partly via lower wage growth).

There will be some additional measures aimed at shoring up the government's political standing. Reports suggesting support for housing construction is likely to be a major focus, and there may also be some increases in public sector pay. But changes are likely to be fairly marginal in nature and will have to be carefully crafted to ensure that they pass through the House of Commons, given the government's narrow majority.

So what does this all mean for the economy and markets? Well, in absence of any big policy changes, UK growth is likely to remain fairly sluggish for the next few quarters. Whilst the consumer squeeze has arguably passed its peak, wages are still rising more slowly than prices and households continue to take a cautious approach to discretionary spending

For markets, internal Conservative Party politics are likely to continue to be a major focus. There have been several press reports over recent months that Philip Hammond's job may be vulnerable, particularly following his advocacy of a softer Brexit over the summer. A gaffe from the Chancellor this weekend (he claimed in an interview that there are 'no unemployed people' in the UK) has not helped him. Given Hammond has a reputation amongst investors as a "safe pair of hands", any signs that the Chancellor could be replaced would likely add an extra layer of market uncertainty.

The UK deficit has been falling in recent years



Source: Macrobond

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