Economist's Weekly Market View

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UK Chancellor avoids a "Truss moment"

The market reaction to last week's UK Autumn Budget, suggests investor appetite has been tested by the scale of spending planned by the Chancellor in the next few years. However, this was far from a "Liz Truss moment" which led to a plunge in gilts and sterling in Autumn 2022. The headline Budget measures were a major £40bn tax-raising package and a sharp increase in infrastructure spending, underpinned by a change in the fiscal rules which provide significantly more borrowing headroom for the Chancellor to invest. In particular, the borrowing requirement expanded substantially, with an additional c.£140bn in debt issuance planned over and above the Spring Budget in March during the lifetime of this parliament.

On the week, UK gilt yields are c.20-30 basis points (bps) higher across the curve, well in excess of moves in other G7 countries. Sterling has also weakened somewhat since the Budget statement, but the overall moves are modest in comparison to the "mini budget" debacle in 2022. Thus, the Chancellor appears to have just about assuaged markets and pulled off a substantial up front fiscal expansion, by tying herself to more binding timelines on her fiscal rules in the medium term. However, as with recent budgets, the plans for later years have come under scrutiny, with the fiscal watchdog, the Office for Budget Responsibility, and the Institute for Fiscal Studies calling into question both the Government's forecasted yield from the tax hikes and the credibility of tighter spending ceilings from 2027 onwards.

Overall, higher capital spending in this Budget raises real government investment by 15% from 2025 to 2029, and this, in particular, has boosted the near term GDP forecasts from the OBR. However, boosting capital investment to this extent in an economy operating close to full capacity will be challenging, so the main upfront positive impact of the Budget will be the rise in current spending – largely from higher public sector wages and a boost to health and education funding, alongside the dampening effects of higher taxes falling on employers and asset-based transactions.

With these offsetting impacts from the Budget well understood in advance, the outlook for the Bank of England is unlikely to change too considerably when it holds its key meeting (25bp cut expected) this coming Thursday. With the US Fed meeting (25bp cut expected) taking place the same day, on the back of the US Presidential election on Tuesday, this could be a volatile week for financial markets.

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