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PRESS RELEASE **03 DECEMBER 2014**

Hermes Group Chief Economist Neil Williams Reacts to the Autumn Statement: Fiscal Slippage

From a gilts market perspective, the Chancellor was probably right to resist playing 'Santa' today, and with the coffers light keep his fiscal powder dry. Growth may be better, but there's still some hard work to do on deficit and debt reduction.

This is admittedly a warmer Autumn Statement than the Chancellor expected a year ago. With the UK's 'sugar rush' continuing, conventional gilts and equities should welcome the upgrade to growth projections, and the fact that Osborne is trying still to keep budget consolidation ahead of fiscally 'expensive' give-aways. The only slightly smaller, £1.3bn drop in gilts issuance plan will though disappoint some.

But, there's clear slippage, and the fiscal screw will have to stay tight if Osborne is to whittle down the underlying budget deficit and return it to the black in 2018/19. GDP revisions have helped, but better growth should have squeezed the headline deficits by far more than they have. This suggests the shortfall in income-tax receipts and external headwinds will be used to dent his claim that 'Plan A' is working.

So, let's not get too carried away. First, the deficit is still high. Even including special items like the transfer of the Royal Mail Pension Plan and QE profits, the hoped-for 5%-of-GDP deficit for 2014/15 will still be the G7's widest after Japan.

Second, while the headline deficit falls on better growth, the structural, less growth-sensitive part of the deficit will fall by less, begging further reform and consolidation.

And, as a result, the net-debt-to-GDP ratio will not even peak, at a higher-than-planned 81%, until 2015/16. This is disappointing given real GDP is now 4% up on its pre-crisis peak. This 81% ratio is roughly twice Japan's was when it limped into a 'lost decade' in the mid 1990s.

This means a blend of more fiscal consolidation – whether skewed toward spending cuts or tax hikes - and ways to protect recovery will still be needed, whoever wins the general election next May.

Meantime, softer CPI inflation, an unfixed euro-zone, and geopolitical risk elsewhere stress the importance of keeping a loose monetary stance. The BoE is thus likely to defer any Bank rate hike till real wages – the recovery's missing piece – pick up, which looks off the radar till late summer 2015.

-ENDS-

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Notes to Editors:

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