The Telegraph

Hammond's fiscal blunder almost guarantees a hard-landing

AMBROSE EVANS-PRITCHARD

23 NOVEMBER 2016 • 6:18PM

3 Comments

The UK Treasury has imposed its super-cautious view on the Chancellor, but caution holds its own dangers

Philip Hammond has succumbed to the fatal caution of the Treasury. A rare chance has been wasted.

Britain must now face the full storm of the Brexit downturn next year and the year after without any precautionary buffer worth the name. A hard landing is all but guaranteed.

If the Chancellor had wished to launch a barrage of investment on the country's rickety infrastructure and do something to lift productivity from the bottom ranks of the OECD league, there could scarcely have been a better global climate. All the stars are aligned.

The whole world is shifting on its economic axis. The era of fiscal austerity is over. The US, Japan, and even the eurozone, are all are switching to net stimulus, painfully aware that zero rates and quantitative easing have run their useful course.

Donald Trump wants an infrastructure blitz of $550bn over five years, buttressed by even bigger tax cuts than Ronald Reagan's 'supply-side revolution' of the early 1980s.

Fiscal largesse has become the new global orthodoxy. The International Monetary Fund has converted. The bond vigilantes have been tamed. Vast sums of excess capital are sitting on the sidelines, searching for homes in infrastructure projects that pay for themselves. Yet the Chancellor has opted for caution.

There is nothing wrong with his list of targeted spending: £220m on 'pinch points' for congested roads, £450m for digital signalling on the railways, £750m on 5G mobile networks. They are admirable. But they do not make a dent on Britain's infrastructure deficit or come close to offsetting the slump in private investment that is all too likely once the traumatic process of EU extrication gets underway.

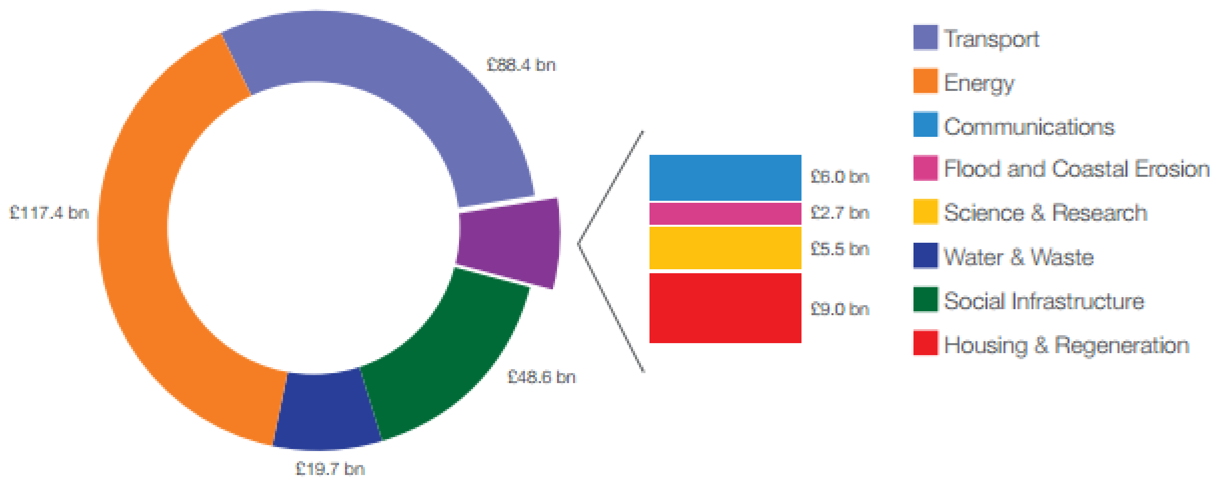
Morning rush hour traffic along the M25

Mr Hammond describes Britain's productivity failings as "shocking". "We lag the US and Germany by some 30 percentage points. But we also lag France by over 20 and Italy by eight. Which means that in the real world, it takes a German worker four days to make what we make in five," he said.

Quite so, but his National Productivity Investment Fund of £4.8bn a year is thin gruel in a £2 trillion economy and still leaves public investment trailing average OECD levels by roughly 1pc of GDP. For all the rhetoric, it will actually fall in real terms.

The Treasury itself says in its 'National Infrastructure Delivery Plan 2016-2021' that the country needs to spend half a trillion pounds to plug the gap over the next five years, identifying 600 projects ranging from smart power, to fast broadband, flood defences, roads, sewers, and such exotica as beamless light and semi-conductor catapults.

Chart ES.1 Infrastructure investment, by sector, spend from 2016-17 to 2020-21



Source: Infrastructure & Projects Authority, Major Infrastructure Tracking Unit

Britain needs half a trillion pounds of infrastructure spending over the next five years CREDIT: TREASURY

Nor does the Autumn Statement move the needle on macro-economic policy. Mr Hammond has preserved the essential austerity thrust of the Osborne era. It will take the Government slightly longer to achieve a budget surplus but the direction is the same.

Citigroup says the UK is still pursuing the most draconian fiscal squeeze in the OECD bloc, though there is headroom written into the plan if the Chancellor needs to loosen later. The deficit will be cut from 3.5pc of GDP to 1pc over the space of three years

“They have missed an opportunity,” said Nobel economist Christopher Pissarides from the London School of Economics.

“Britain desperately needs more infrastructure spending. Productivity has stalled completely and now we have the added uncertainty of Brexit. Extra spending of 1pc of GDP a year is perfectly affordable, and I think they should be doing it right now. The most important objective is that we don’t sink back into recession,” he said.

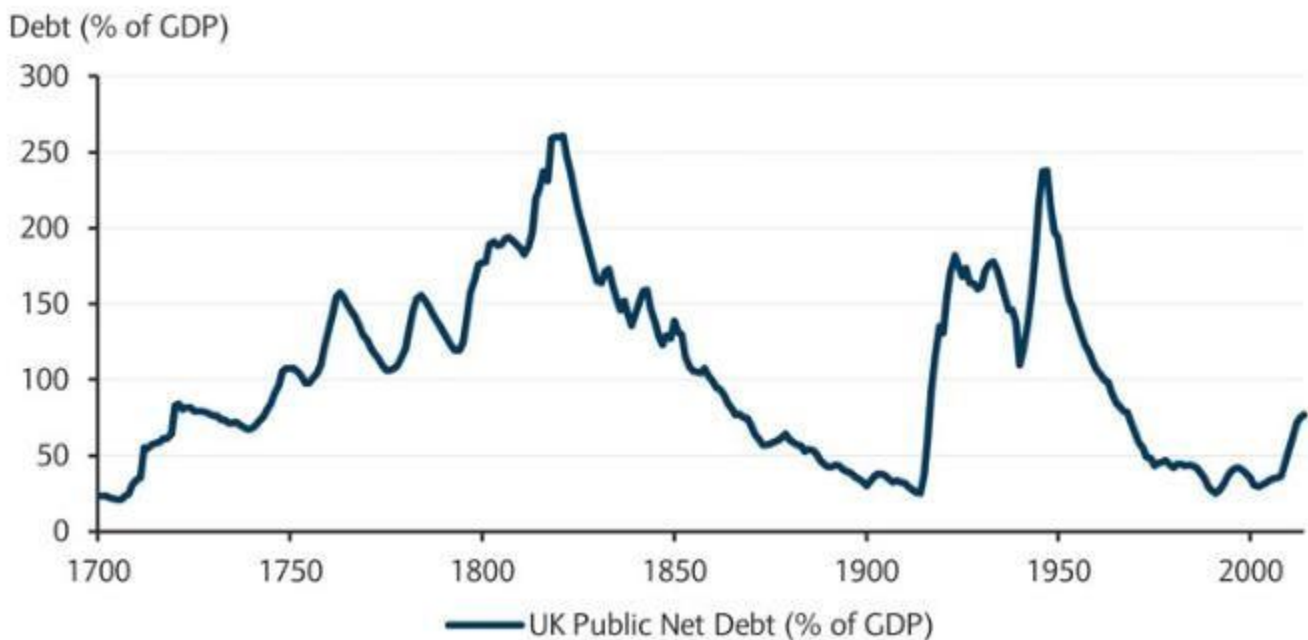
David Owen from the US bank Jefferies said fear of the bond markets is badly misplaced. “Brexit amounts to a supply shock and for that you need capital spending. Britain can borrow at phenomenally low rates and we think stimulus of 1-2pc of GDP over two to three years would not be crazy,” he said.

“The whole narrative has changed in the global macro-community. It is not like the dark old days when people were worried about Greece. Right now the markets welcome targeted spending,” he said.

The Treasury might claim otherwise. Yields on 10-year Gilts jumped eleven basis points to 1.48pc after Mr Hammond revealed how far public finances have deteriorated.

But context is everything. Yields on equivalent US Treasuries have jumped by even more over recent weeks as the ‘reflation trade’ gathers pace, and have reached 2.4pc.

Figure 2: A historical perspective on UK debt



Source: Barclays, HM Treasury, B.R. Mitchell, "British Historical Statistics," as of 01 Aug 2014.

Britain's debt is high at 90pc of GDP but it has been much higher in the past CREDIT:BARCLAYS

Data from the Bank of England shows that foreigners snapped up a net £13.3bn of Gilts in September, the highest in almost a year. That may have changed after the 'hard Brexit' flap at the Tory party conference but there is no sign yet of a Gilts strike.

Central banks, sovereign wealth funds, and Asian pension funds are still rotating into British debt automatically whenever sterling falls to keep their weightings level.

John Maynard Keynes railed against the 'Treasury View' for most of the inter-war years. He predicted that the Puritan drive to achieve a balanced budget in the 1920s would merely shrink the nominal base of the economy through deflation, pushing up debt ratios even faster. That is exactly what happened.

Mr Hammond has inherited a budget deficit heading towards a post-war peak of 90.2pc of GDP in 2017-2018. He has to pick among poisons. Dangers abound whatever he does.

Yet the greater risk over the next two years is that a 'sudden stop' in private investment will tip the economy into recession, setting off a self-feeding downward slide.

That would push the budget deficit back towards double digits in short order and the Chancellor really would have something to worry about. Alea iacta est.

Autumn Statement | Key points

- No further welfare savings measures
- Increase in Personal Allowance to £12,500 by the end of the parliament, and the Higher Rate Threshold to £50,000 by 2020-21
- Increase in National Living Wage from £7.20 to £7.50 in April 2017
- Ban on letting agents charging fees to renters "as soon as possible"

- New three-year NS&I Investment Bond available from spring 2017
- Fuel duty frozen for a seventh year
- New national productivity investment fund of £23bn to be spent on innovation and infrastructure
- £1bn to invest in full-fibre broadband and trialling 5G networks
- £2.3bn Housing Infrastructure Fund for infrastructure for up to 100,000 new homes in high-demand areas
- Continued support for Help to Buy loan scheme and Help to Buy ISA
- Corporation Tax to fall to 17%
- Salary sacrifice schemes to be subject to the same tax as cash income from April 2017 (pensions, childcare and cycle-to-work schemes exempted)
- Autumn statement abolished. Instead, the UK will hold annual budgets in Autumn from 2017 and hold Spring fiscal statements

---