UK's Autumn 2022 Budget: A Comment

UK's budget is a bet that inflation is transitory and is designed in keeping Tories in power

Moustafa Chatzouz

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The Sunak-Hunt Budget

Today is Budget Day, and besides my congratulations to my ex-colleagues for their hard work in the background, I have a few quick reactions.

Today's Budget was an off-the-shelf, "play it safe" budget from Sunak. It was nothing too negative, but also nothing too positive. The budget balanced political and economic risks in the short run, reduced debt (mostly after the planned elections in two years), and made sure it met the OBR's forecasts on paper rather than in reality.

Unfortunately, there was minimal support for long-term growth and potential output. This has a deflationary impact over time, which makes it easier for people to get cheaper mortgages. To be fair, no political party has a serious structural reform agenda.

The distributional implications of the budget will be subject to debate. According to the OBR, inflation has wiped out eight years of real wage growth for most households in the UK in just two years. After the budget, most vulnerable people will still see their real wages falling.

The overall fiscal stance is mostly tuned to the expected peak in inflation, pushing back actual austerity after the elections. In general, it's not easy to tackle inflation through fiscal policy, but blind austerity is also not the answer. I will try to come back with a more detailed post in due time. The key point is that fiscal policy is much more likely to have a higher impact on output than reduce inflation via aggregate demand. Letting the Bank of England lead the fight against inflation and doing the minimum by not adding fuel to the fire makes sense. The budget delivers such ideas.

Hunt also mentioned that inflation is mostly driven by global factors. Although this is correct, I think it rather exposes the government with a very late and a poor implantation of a price cap policy. Why is price capping an optimal response to rising inflation due to global factors? Besides the obvious protection it provides to households, energy price caps are equivalent to closing the borders to a widespread global virus. Price caps effectively convert a supply-side problem to a demand problem and increase the relative importance of domestic to global factors. Together, this implies that national governments and central banks can have greater control over inflation and thus contribute to a less uncertain outlook.

Price caps were introduced quite late and with no clear plan on what to do next. They seemed to be conditioned on market expectations. It's important to remember that when governments in the past have had to manage similar inflation problems, inflation jumped once the price caps were lifted. Keeping inflation on a durable and, more importantly, a more certain falling path required price caps to be imposed much sooner with a clearer plan, ideally linked to the overall risks in the global and domestic economy, rather than accepting the wishful thinking in the markets.