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Reaction to today's Budget Announcement

Sam Hill, Fixed Income fund manager, comments:

Darling's day started off badly with confirmation of further deterioration in the public finances for the fiscal year just ended. With revenues continuing to head south quickly in March, the Chancellor had to head to the House of Commons to tell us all the financing requirement for 2009-2010 is £240bn - beyond the upper end of the range expected by markets.

In the midst of this ongoing cyclical deterioration in the budget it is difficult for anyone to put too much faith in the forecasts that have been released today because of the speed of the correction in the economy. So the uncertainty hasn't really been dealt with - it is now focused on the credibility of the economic growth forecasts that are being used to determine the recovery in tax revenues. If there is any slippage in the economy's performance versus HM Treasury very optimistic forecasts the likelihood is Darling will find himself making another downgrade to the public finances in the pre-budget report in November. The risk is that the government has been incentivised to forecast overly-optimistic economic growth because, in terms of repairing the fiscal hole, it leaves less pressure on tax hikes at this stage in the electoral cycle.

There may be more bad news to come on the deficit, but alongside today's average earnings data releases there is a very important opposing force to support the Gilt market. For the month of February the year on year decline in average earnings, including bonuses, across the whole economy was 2.1%. If the labour force continues to settle for these muted pay deals then the disinflationary forces in the economy are material. This leaves the valuation of long-term Gilts looking attractive - yielding as they do comfortably over 4%.

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*US\$73bn, €52bn. Source: Threadneedle, as at 31.12.2008.

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