UK Economic Update

AIB Economic Research Unit

30th October 2024

UK Autumn Budget

Tax & spend package, but can it boost growth?

Today's UK budget is the first of the new Labour Government, and has been eagerly anticipated in recent weeks. While many of the measures were leaked in advance, markets were well prepared for the fiscal event. Overall, this is a tax and spend budget with two key aims: 1) boosting long term infrastructure spending and 2) raising enough revenues up front to pay for increases in health & education spending, while assuaging markets of the Government's fiscal credibility.

The public finances remain in a fragile state, despite the £40bn of tax hikes announced. The Office for Budget Responsibility (OBR) projects a persistent budget deficit in the near term, but the Government's target to close the "day-to-day" deficit (ex capital spending) will met by the end of the parliament. The revised national debt target, a more complex measure of the Government's national balance sheet, is also projected to be falling by the end of the parliament, but the overall picture is that tough choices have been made to achieve this by limiting spending increases in many departments to pay for the boost to infrastructure, health and education. In the short run, this tax raising budget is unlikely to boost GDP growth too much in the coming years, but the focus on capacity-enhancing infrastructure is to be welcomed, and should bear fruit in the long term.

Key Points - UK Autumn Budget

Budget 2025 is set against brighter growth outlook	Budget 2025 is set against an improved economic backdrop so far this year. GDP growth has accelerated following the mild recession in 2023. Nonetheless, the October PMI data pointed to a modest increase in UK private sector output, but the rate of expansion slowed for the second month running. Survey respondents cited the impact of delayed decision-making among clients and heightened economic uncertainty ahead of the Budget.
The new Government had limited its options on tax and spend	The Chancellor had also pre-committed to not raising incomes taxes, workers national insurance (NI), or VAT ahead the Budget, with these revenues making up the vast majority of total taxes. However, in the event, she did decide to raise NI on employer contributions (£23.8bn), the single-biggest tax raising measure announced.
A substantial tax raising package falling on businesses and asset	Alongside the Employer NI hike, other measures included a rise in capital gains tax and other smaller measures, which total £40bn, one of the largest tax-raising packages ever announced by a Chancellor.
Change to fiscal rules enables increased borrowing to fund infrastructure	Aside from the tax hikes, there are also significant increases in expenditure, focused on infrastructure and health spending. A change to the Chancellor's debt rule enables her to borrowing to invest in infrastructure, while tax hikes enable current spending increases elsewhere.
But tight spending ceiling for many departments outside of infrastructure, and little discernible growth boost	However, while some areas have seen significant spending increases, many departments will only see modest increases. Therefore, alongside the up front tax hikes, this budget is unlikely to boost GDP growth too much in the coming years. The OBR forecasts confirms this, estimating that the Budget measures will add only modestly to GDP. Nevertheless, the focus on capacity-enhancing infrastructure is to be welcomed, and should bear fruit in the long term.

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Upturn in growth and looser fiscal rules gives chancellor room to invest

- **The UK economy gathered some momentum in the first half of the year,** with GDP rising by 0.7% in Q1 and by 0.6% in Q2. The underlying breakdown for Q2 showed household consumption rose by 0.2% in the quarter, contributing 0.1 percentage points (p.p.) to growth. Meanwhile, gross fixed capital formation added a hefty 2.4 p.p. to the total, owing to increases in fixed investment, and a sharp rise in inventories. Government expenditure boosted output by a further 0.3 p.p. Net trade clipped 2.2 p.p. from GDP. Today's OBR forecasts show GDP rising by 1.1% in 2024, 2% in 2025, and 1.8% in 2025

UK ECONOMIC & FISCAL FORECASTS

(%)	2024(f)	2025(f)	2026(f)	2027(f)
GDP	**1.1**	**2.0**	**1.8**	**1.5**
Household Cons	0.4	1.7	1.9	1.7
Inflation	2.5	2.6	2.3	2.1
Unemp Rate	4.3	4.1	4.0	4.1
Fiscal (% of GDP)	**25/26**	**26/27**	**27/28**	**28/29**
Borrowing (PSNB)	3.6	2.9	2.3	2.2
Current Budget Bal.	0.9	0.2	-0.3	-0.3
Public Sector NFLs	83.8	84.2	84.1	83.9

Sources: *OBR, UK Treasury, October 2024*

- **Lead indicators suggest global growth remains positive.** Meantime, the UK October PMI data pointed to a modest increase in UK private sector output, but the rate of expansion slowed for the second month running. Survey respondents cited the impact of delayed decision-making among clients and heightened economic uncertainty ahead of the Budget.

- **The headline Budget measures were a substantial £40bn tax-raising package and a sharp rise in infrastructure spending,** underpinned by a change in the fiscal rules, notably the introduction of a new "Net Financial Debt" rule which provide significantly more borrowing headroom for the Chancellor to invest in infrastructure. **Markets should be assuaged by the fact that she is not planning to use all of this headroom, with current spending pledges funded by tax rises**.

- **In terms of the tax package**, the headline measure was a rise in Employer's NI contribution to 15% from 13.8%, albeit this hike was softened by rises in thresholds to exclude some SMEs from the hikes. Other hikes included an increase in capital gains (CGT) and inheritance taxes. The lower rate of CGT will rise from 10% to 18%, and the higher rate from 20% to 24%. Alongside other smaller measures, the tax package totals £40bn, one of the largest tax-raising packages ever announced by a Chancellor.

- Meanwhile, **spending increases are focused on a substantial increase in infrastructure spending, funded by higher borrowing.** Overall, higher capital spending in this Budget raises real government investment by 15% from 2025 to 2029, leaving it broadly stable at 3.4% of GDP over the forecast period**.**

- On the current expenditure side, the focus was firmly on increases in both health and education. However, the overall growth in public spending, including capital spending rising by only 1.7% in real terms, implying tough choices have been made in many other departments.

Tax and spend budget, but growth forecasts not yet boosted in the medium term.

- **Overall, this is very much a "tax and spend" budget,** which aligns with the priorities of the new Government to invest, to enhance infrastructure, health and education provision. The OBR estimate the tax burden will rise further from 36.4% of GDP this year to a record high of 38.2% in 2029-30, 5.1% of GDP higher than before the pandemic.

- **The OBR estimates that the policy measures could boost GDP somewhat, particularly the mechanical impact of extra Government spending on investment and public services.** However, the fiscal watchdog has actually revised lower its long term or trend GDP forecasts compared to March by c.0.5 percentage points to 1.5%, on the back of expectations for weaker productivity growth and population gains. As yet, the OBR is not giving the Government credit for its infrastructure and growth agenda, but this may change in the coming years, if the Government can start to deliver on its promises.