In Touch technical update

UK Spring Budget 2024

The Chancellor has published the Spring Budget for 2024, with the further cut to National Insurance grabbing the headlines, whilst attempting to emphasise that the UK economy had reached a turning point. However, in what could be the current government's last fiscal event before a general election, the OBR's forecasts continue to make grim reading, despite some minor upward revisions to growth.

Why bring you this note?

The Chancellor has published the UK's Spring Budget for 2024.

At a glance…

- The Chancellor delivered the Spring Budget against a backdrop of a looming general election. Conservatives will be watching to see whether today's announcements will change the picture in the opinion polls.
- Cutting personal taxes at the top of his agenda, with an eye-catching 2% cut to National Insurance contributions, following on from the 2% cut in the Autumn Statement.
- However, this was paid for by tax rises elsewhere, continued fiscal drag and cuts to departmental spending.
- The overall tax burden is still set to rise by 4% over the 5-year forecast horizon to near post-war highs.
- The OBR revised up growth forecasts but partly due to an increase in the expected population, but also due to lower inflation. Meanwhile real disposable incomes are expected to recover their pre-pandemic peak 2-years earlier than forecast in November. This would still leave the UK trailing many countries in the G7 in terms of trends in living standards, however.
- Inflation forecasts were revised down this year and next, partly due to faster-than-expected falls in energy prices.
- Government debt is expected to continue rising each year, except in the fifth of the 5-year forecast horizon, while deficits are set to fall to the lowest level since 2001.
- In terms of pensions, the government confirmed it is progressing several pensions-specific developments.

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A Budget with an eye on the general election

The Chancellor delivered a highly political speech for his second Spring Budget today with more than half an eye on the upcoming general election. In the context of a large lead for the Labour party in the opinion polls, Jeremy Hunt has been under pressure to announce a headline grabbing tax cut. But higher interest rates and a lower-than-expected growth rate have combined to reduce his wriggle room for such an announcement – the fiscal headroom was announced to be £8.9bn, which is significantly less than the £13bn that was available at the time of the Autumn Statement. To resolve this conundrum, Mr. Hunt has decided to raise taxes elsewhere and to continue to limit departmental spending. Conservative politicians will be watching closely in the days ahead to see whether today's Budget will make a dent in the Labour party's poll lead.

Virtually all of the major measures announced today were leaked in the past few days, including:

- A further 2% point cut to National Insurance from 10% to 8%.
- A rise in taxes on non-economy flights, a new tax on vapes and the scrapping of the existing "non-dom" tax breaks for wealthy individuals whose permanent home is overseas.
- An extension to the windfall tax on the oil and gas sector.
- A "British ISA", allowing tax-free investments of up to £5000 per year in UK firms. This is on top of current ISA limits.
- Changes in the thresholds for child benefit.

Overall, today's announcements were relatively light on so-called supply side measures, intended to improve the productivity of business and to increase the labour force. The key measures to mention were the changes to child benefit thresholds and some tax relief for the performing arts. In contrast, partly in order to pay for the headline-grabbing National Insurance contribution cut, the Chancellor announced a wide scale programme of public sector efficiency improvements, including introducing the use of artificial intelligence in healthcare and the digitisation of several services.

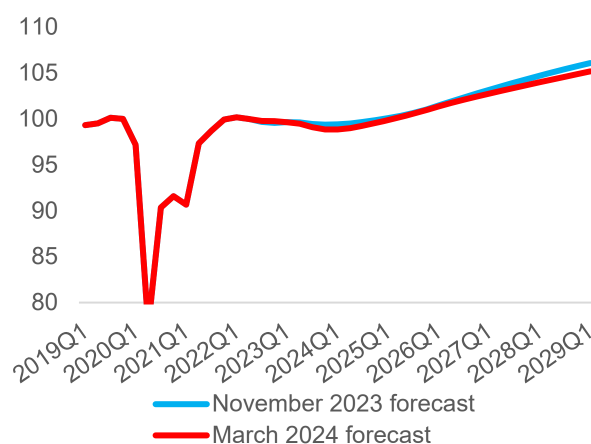
Meanwhile, although the Chancellor would like to highlight today's cut to personal taxation, this needs to be seen in the context of an ongoing freeze to income tax thresholds and other taxation measures, which still results in the overall tax burden of the economy rising by a substantial 4% points over the 5-year forecast horizon to near post-war highs of 37.1% - only slightly less than forecast in November.

Upward revisions to growth forecasts but the trend remains moderate

The Office for Budget Responsibility's (OBR's) previous forecasts last Autumn contained sharp downward revisions to the growth forecasts. In contrast, today's update has revealed some offsetting upward revisions to those growth numbers. GDP growth is expected to be 0.8% this year, while the largest upward revision is seen in 2025, with a 0.5%-point increase to 1.9%, as inflation has eased back. Nonetheless, growth is only set to peak at 2.2% in 2026, before falling back and the overall picture remains of a UK economy that is struggling to grow strongly.

It is also noteworthy that one major reason cited by the OBR for the improved growth forecasts is an upward revision to population growth, partly through higher immigration. The result of this is that output per person (or GDP per capita) is now forecast to grow more slowly than the already quite moderate rates published in November.

Per capita GDP growth is set to grow more slowly than forecast in November
(Real GDP per person, Q4 2019 = 100)

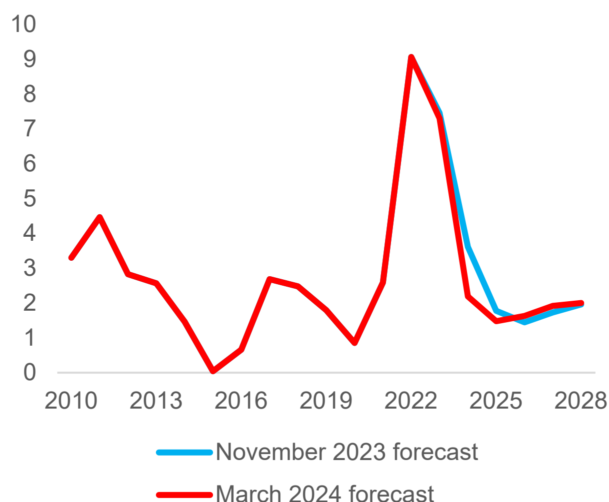


Source: OBR

Nonetheless, the OBR also now believes that living standards are likely to recover a little faster than previously forecast, with real disposable incomes expected to recover its pre-pandemic peak by 2025-26, which is two years earlier than forecast in November. The underlying reasons for this include the further reduction to National Insurance (giving a boost of 0.5%) and the quicker than expected fall in energy prices. Of course, this follows the largest drop in living standards since the statistics began in 1950 last year and a recovery to the pre-pandemic peak would still leave the UK trailing some of its G7 peers.

Meanwhile, the inflation forecasts have been revised lower, especially this year and next, which are then counteracted somewhat by small upward revisions in later years. This is a reversal from the upward revisions we saw in the November set of forecasts. Overall, with inflation expected to fall to 2.2% in 2024 and 1.5% next year, the OBR believes that the Bank of England's inflation target will be met. The OBR also assumes in its forecasts that monetary policy will be cut in line with current market expectations – this may not turn out to be the case if we are correct that inflation remains a little stickier than these latest forecasts.

Inflation revised lower in the next two years (CPI inflation, year-on-year %)



Source: OBR

Government debt continues to rise, only falling slightly at the end of the 5-year forecast horizon

The measures announced today have not fundamentally changed the government's debt prospects, with public sector net debt rising from 88.8% of GDP to 93.2% by 2027-28, before falling back slightly to 92.9%, thus meeting one of the Chancellor's key fiscal rules – that debt as a percentage of GDP should be falling by the end of the 5-year forecast horizon.

Meanwhile, the deficit is still expected to fall sharply throughout the forecast horizon, from 4.2% of GDP in this fiscal year, all the way down to 1.2% in 2028-29. This would be the lowest annual borrowing rate since 2001. However, these forecasts are based on sharp cuts to departmental spending – a 1% of GDP reduction in departmental spending is forecast over the next 5 years. Will the Labour party stick to these spending cut plans, should they win the upcoming general election? Alternatively, will they decide to raise taxes at a time when the overall tax take is set to rise to a near post-war high and government debt is approaching 100% of GDP? Budgets are often a political event as much as a fiscal event but the edge in today's announcements cannot be escaped.

In terms of debt issuance, total Gilt issuance was revised higher by the Debt Management Office. The DMO's Net Financing Requirement was reported as £265bn versus the previous estimate of £258bn. This is compared with a financing requirement for the previous fiscal year of £232.3bn.

Market reaction and our Medium-Term View

At the time of writing (3pm), the markets have moved relatively little in response to today's Budget, probably because so much of its contents was leaked beforehand, not leaving much to surprise. 10-year and 2-year Gilt yields are down by 3bps and 4bps respectively on the day, likely due to the downward revision to the inflation forecasts. Meanwhile, the FTSE 100 index is up 0.6% on the day, while sterling is little moved versus the US dollar and the euro. The biggest boost initially occurred in the domestically-focused FTSE 250, probably following the announcement of a new "British ISA".

In terms of our Medium-Term Views, today's Statement and the accompanying OBR forecasts continue to paint a difficult picture of current and future growth. The current technical recession may be short-lived in our view but any recovery is also likely to be shallow – the UK economy's challenges continue to be weak productivity growth, low business and infrastructure investments, a large inactive

population and the need to improve vocational training. When it comes to inflation, we believe that price measures are likely to remain uncomfortably high for the Bank of England, meaning interest rates may not be cut by as much as markets expect. We have maintained a moderately positive view on Gilts, emphasising the longer duration segments of the yield curve, but we have moved to a neutral view on investment grade bonds as spreads have narrowed substantially. In terms of equities, we moved to neutral across the developed markets, including the UK, late last year and we maintain that view.

Pension announcements

The anticipated Value for Money framework for DC schemes will highlight schemes that focus on short-term costs savings at the expense of long-term investment outcomes. Proposals will require schemes to compare their performance, costs and other metrics against those of at least two schemes managing over £10 billion in assets. The FCA and TPR will be given powers to close schemes to new employer entrants and, where necessary, wind up a scheme. The FCA will consult on this framework in the spring.

Requirements will be introduced for DC pension funds to publicly disclose the breakdown of their asset allocations, including UK equities.

The government confirmed that it remains committed to exploring a lifetime provider model for DC pension schemes in the long-term.

The winners of the Long-Term Investment for Technology and Science (LIFTS) competition, intended to generate over a billion pounds of investment into UK science and technology companies, were also announced.

Local Government Pension Scheme

The Chancellor announced that requirements will also be introduced for Local Government Pension Scheme funds to publicly disclose the breakdown of their asset allocations, including UK equities, on an annual basis. These requirements are expected by the end of the month as part of the new Annual Report guidance. The Chancellor also stated that the government will review what further action is needed if this reporting does not demonstrate that UK equity allocations are increasing.

There are also various announcements for how productivity can be improved in the public sector, including a requirement for local authorities to produce plans by July 2024 setting out how they will *improve service performance, utilise data and technology, and reduce wasteful spend*. The Chancellor also announced additional funding for children's social care and that Government will *work with the LGPS to consider the role they might play in unlocking investment in new children's homes*.

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