UK Autumn Statement, November 22nd 2023 from around 12:30GMT/07:30EST

TL/DR:

- Chancellor Hunt is unlikely to meaningfully alter fiscal policy and keep his limited powder dry for the pre-election Spring Budget.
- While wage-driven tax receipts and lower than forecast borrowing provide notable fiscal space, this is all but eroded by a higher debt funding burden.
- OBR is likely to judge that the fiscal charter's points have been attained, particularly as the 5yr reference period rolls out to FY28/29.
- Gilt remit is expected to be circa. GBP 15bln lower for FY23/24 Y/Y at around GBP 223bln.

Overall:

- Chancellor Hunt is unlikely to make any meaningful alterations to fiscal policy as it remains around 12-months until a UK election is likely to occur (the latest possible date is January 2025) and he will want to keep his limited powder dry. As such, any pre-election adjustments could be seen in a Mar'24 Budget or theoretically as late as the Autumn 2024 statement if the election occurs in early-2025. On the March update, Morgan Stanley expects in the region of GBP 15bln fiscal easing to occur around this period which will be focused on tax reductions aimed primarily at higher-income individuals e.g. abolishing inheritance tax (projected by the IFS to cost the Treasury GBP 7bln/year if scrapped).
- Specifically, the Gilt remit for FY23/24 is likely to be around GBP 15bln lower Y/Y at just over GBP 220bln.
- While the UK finds itself with a marked amount of additional fiscal room from lower than forecast borrowing and wage-driven tax receipts, this has been all but eroded by elevated debt servicing costs due to the BoE's tightening cycle.
- As always, the statement will be accompanied by OBR forecasts which are likely to be adjusted negatively in the near-term given the OBR's March growth projections appear slightly too optimistic. Nonetheless, the institute is likely to judge that Hunt's statement adheres to the fiscal charter, particularly as this update sees the 5yr reference point rollout to the next fiscal period.

Gilts:

- For FY23/24, Morgan Stanley expects a cut in projected Gilt issuance given more favourable than anticipated tax receipts, though any fiscal headroom will likely be depleted by elevated debt-servicing charges.
- Gross Gilt Issuance exp. GBP 222.8bln (March'23 241bln; Sept'22 for FY22/23 169.5bln)
- Gross Financing Requirement exp. 267.3bln (March'23 255bln)
- Net T-bill exp. 5.0bln (March'23 5bln; Sept'22 for FY22/23 22.3bln)
- *Expectations via HSBC; contingent on BoE QT continuing at a 50bln/year pace until APF holdings are down to 500bln*
- Additionally, in July Hunt flagged that they were looking into reforms around pensions to support UK growth, primarily through a new investment vehicle where pension funds would be able to co-invest in firms overseen by the British Business Bank. Note, HSBC cautions that any reforms could affect both defined benefit and defined contribution schemes, which is potentially notable for the Gilt market as defined benefit pensions are a key component of demand and any siphoning of the interest away could further undermine institutional appetite. A potential outcome which is of heighted concern given supply is expected to remain elevated for numerous years ahead.

Weekend Press Reports:

- As usual, the pre-statement weekend has seen a flurry or press reports around the upcoming fiscal event. The most pertinent of which is that Chancellor Hunt has reportedly delayed the widely-touted plan to cut inheritance tax until 2024 (i.e. the March budget/pre-election manifesto) in favour of a reduction to income tax. PM Sunak has previously pledged to lower the 20% basic rate to 16% by the end of the next parliament; as such, the FT citing a Tory insider reports that Hunt has been looking at a 1pp cut to this. A cut which, if announced, could be in place by April 2024 and thus benefiting voters ahead of the upcoming election (date TBA) and costing the Treasury circa. GBP 6bln.

- Additionally, Hunt in interviews to Sky News and the BBC said he wanted to outline a path to reducing the taxation burden and that everything is on the table. However, the Chancellor made clear that there won't be any reductions which could spur inflation pressures, in the context of the government attaining its goal of halving the rate of inflation before end-2023.
- More broadly, the weekend press has focused heavily on the Chancellor having more fiscal space than expected, with reports ranging anywhere between GBP 13bln-25bln, which on face value is a substantial increase from the estimated GBP 6.5bln headroom available in March. Fiscal space will be essentially halved by any one of the frequently touted measures, such as freezing the increase in fuel duty or altering/removing inheritance tax (though, above reporting reduces the odds of this), even before the impact of things like the Triple Lock level or reference inflation period for uprating benefits are considered. As such, while the headline space is more encouraging, the Chancellor's fiscal breathing room remains limited and his ability to take measures constrained by potential inflationary ramifications.

Other weekend reports, in brief:

- Expected to signal that the government will be looking to repeal EU legislation and replace it with new City rules, a process which would include a review of contactless payments. (Sky News)
- Those living close to new electricity infrastructure to be offered as much as GBP 10k off their bills over 10-years. (FT)
- ISA reform map to create a portal enabling payments into multiple accounts, changing rules on fractional shares. Though, these measures reportedly mean that broader alterations such as a UK equities allowance have been pushed into 2024. (FT)
- Businesses have urged for further changes to tax incentive schemes to be delayed, amid a rise in fraudulent claims; currently, there is a 100% tax relief on capital spending, which reports have suggested could be made permanent. (Times)

Fiscal Consolidation/March'23 Recap:

- The current fiscal charter, announced Autumn'22 by Hunt to restore confidence and bring in fiscal consolidation, has a number of points, but the most notable and relevant targets are for government debt as a % of GDP to be falling by the fifth year of the OBR's forecast; with reference to PSND (ex-BoE). Borrowing to not exceed 3% of GDP by the fifth year. And finally for the welfare cap to be pre-determined and within the Treasury's announced margin.
- The most recent full economic assessment from the OBR came alongside the Chancellor's March Spring Budget, at which point the Office judged that the measures and economic outlook leave "debt falling by only the narrowest of margins in five years' time.", with the five-year reference period being 2027-28. Additionally, the 3% borrowing target should be adhered to by "modest margins"; however, the Welfare Cap is scheduled to be exceeded by over GBP 4bln. Full assessment available here.

Economic Backdrop:

- Most pertinently for the Chancellor, PSNB ex-public sector banks for H1 printed at GBP 81.7bln, while this is GBP 15.3bln higher Y/Y it is almost GBP 20bln shy of the OBR's GBP 101.5bln forecast from the March budget. A release which gives Hunt some wiggle room and allows for public sector wage adjustments to be accounted for without affecting broader plans. Additionally, strong inflation-driven wage growth has led to further theoretical fiscal room for the Government, with Morgan Stanley estimating that FY23 income tax receipts will be some GBP 24bln above the OBR's March forecast.
- However, elevated debt-servicing costs due to higher interest rates limit how much of the fiscal space the Chancellor can actually utilise. Reminder, alongside the March update the OBR forecast the BoE Bank Rate peaking at 4.25%, a rate which has subsequently and seemingly reached a terminal 5.25%. On this, Rabobank reminds that Hunt has intimated the additional interest rate burden could cost the Treasury GBP 20-30bln/year extra – essentially eroding the aforementioned fiscal breathing room.
- Additionally, softer than expected (vs. OBR projections) recent GDP prints are likely to limit how much additional borrowing Hunt will be willing to stomach, given the debt to GDP charter requirement, though the extended reference point to 2028-29 provides some leeway; i.e. Q3 Prelim. GDP printed at 0.0% Q/Q vs the OBR's forecast for 0.2% and a return to growth, thereafter the OBR forecast Q4'23 and Q1'24 Q/Q prints of 0.4% and 0.5% respectively, which are likely somewhat optimistic and as such subject to downward revision.
- In terms of the borrowing target, Pantheon believes that the OBR is likely to revise up the 2024/25 and 2025/26 views by around GBP 15bln for each period and as such take the borrowing figure as a % of GDP to above 3.0%. Albeit, given the mandate only applies to the five year ahead reference period (FY28/29) Hunt should be able to portray his plans in such a way that it brings the figure well under the cap and in-line with the charter.

- Elsewhere, one of the main hallmarks of the Sunak premiership has been a commitment to halving inflation by end-2023, a goal that was achieved by the October inflation release printing at 4.6% Y/Y, down from the circa. 10.7% Y/Y level headline CPI was running at when Sunak made the pledge. Sunak attaining this pledge will likely become a key component of the pending re-election campaign. But, in terms of the Autumn Statement, some Ministers implied that tax reductions could be announced if is was clear that the pledge to halve inflation before end-2023 was attained.

Potential Measures for Autumn/Spring

- **Tax Cuts:** Hunt has made it clear that we should not expect tax reductions at this stage. However, Cabinet Minister Jenrick in a BBC interview intimated that cuts were possible if the government had attained its target of getting inflation to circa. 5% by end-2023. Logically, any inflation-contingent cuts would not be announced until early-2024 given data lags, with the March update a potential occasion for such a reduction. As is usually the case, Hunt may well retain the long in place temporary 5p cut to fuel duty to generate a “win” for households. However, the IFS points out that keeping the cut and not increasing the rate in-line with inflation could cost the Treasury as much as GBP 6bln by 2027-28 (the pre-statement fiscal target reference year).
- **Inheritance Tax:** Towards the end of September, The Times published an article stating that PM Sunak was working on plans to cut the inheritance tax, a move that is reportedly to be framed as an “aspirational offer to voters” ahead of the next election. Currently, inheritance tax is applied at a 40% rate on estates in excess of GBP 325k alongside an additional allowance for children, meaning GBP 1mln can be passed from parents to children before the levy applies. Note, some of the sources cited suggest that the plan to reduce the 40% levy is more likely in March; a view echoed by Morgan Stanley & others. On the reports around a reform, the IFS has calculated that removing the levy entirely would cost the Treasury circa. GBP 7bln/year with almost half of the benefit going to estates over GBP 2mln in size.
- **Pensions:** The main point of contention here is the triple lock, which ensures state pensions increase by the highest of average earnings growth, CPI inflation, or 2.5%. In April, state pensions increased by 10.1% given the 10.1% reference inflation figure. For the next fiscal year, if the lock is adhered to then pensioners will receive an 8.5% increase equating to GBP 901 and lifting the yearly total to GBP 11.5k. As has been the case recently, there are questions about the affordability and sustainability of adhering to the lock when the inflation reference rate is as high as it is. As a reminder, during COVID the government technically broke the lock when it opted to use CPI rather than the higher average earnings figure. In September, the Guardian reported that the Chancellor was looking at using wage data (7.8%) instead of CPI (8.5%) for the lock, which would save the Treasury around GBP 1bln.
- **Wages/Benefits:** At the Tory party conference, Hunt confirmed that the national living wage would increase to at least GBP 11/hr from April (current 10.42/hr); however, there is some speculation that the increase could be dropped/adjusted to save funds. For reference, the Low Pay Commission (which advises the government) is yet to announce its FY23/24 recommendation. Additionally, Hunt flagged that there would be a review into the benefits system and its fairness, such as preventing those who frequently break the system's rules from making new benefit claims for a set period of time.
- **ISAs:** Some reports have suggested that the Chancellor could sweeten the terms of LISAs (Lifetime ISAs) for first home purchases and increase the maximum house value that it can be used on from the current GBP 450k cap. Additionally, the likes of Hargreaves Lansdown are calling on the Chancellor to trim the early access penalty to 20% from 25% and allow contributions up until age 55 from the current 50.
- **Housing:** The UK’s National Housing Federation has, among other points, called on the Chancellor to announce a new 10yr I/L rent settlement, commit to new burdens funding for housing associations and reopen the Energy Bill Support Scheme Alternative Funding. Click here for the full submission. Elsewhere, Stamp Duty terms could see a slight tweak via a new green rebate for homeowners who improve their household's energy efficiency within a set period of time.