newsquawk

PREVIEW: UK Budget presentation from 12:30GMT/08:30EDT

OVERVIEW

Labour Chancellor Reeves will in her debut budget announce extensive fiscal measures to plug the “black hole” she inherited from the Conservative government, reporting has the hole at around GBP 22bln but Reeves herself says the situation is worse owing to unfunded pressure on finances. To do this, Reeves’ budget will have a new “golden rule” as its cornerstone, a rule which says that day-to-day spending must be balanced by tax revenue, designed to reassure the market and prevent a Truss-era reaction to unfunded spending. Alongside this, Reeves will change the debt measure which underpins the rule that debt as a share of GDP must be falling between the fourth and fifth years of the horizon. Reeves will reportedly change it from PSND ex-BoE to PSNFL, a broader measure which potentially frees up as much as GBP 50bln of headroom. While this room is available, it remains to be seen how much of it Reeves will tap the market for in order to ensure no adverse reaction in the Gilt market and as anything she borrows has to be spent on investment (given the new “golden rule”), something which is notoriously difficult to successfully deploy in the UK. For Gilts and Sterling, the reaction depends on exactly how much Reeves taps the market for and how expansionary the market judges the overall budget to be; Morgan Stanley expects the issuance remit to increase by 8bln from 278bln to 285bln for the 2024/25 FY. For the BoE, the argument is two-way with the budget likely to be net-expansionary and thus, all things equal, drive tighter conditions; however, the uncertainty around any investment decisions and the policy lag in the benefits being felt mean the immediate course of rate decisions might not change much. Note, unless otherwise stated all figures in the document are in GBP.

FISCAL BACKDROP

Chancellor Reeves inherited a 22bln “black hole” from the prior Conservative government, a hole which is primarily formed of a 9.5bln public sector wage agreement in addition to necessary spending increases to update department budgets to reflect inflation and population growth since they were last adjusted in 2021. Reeves herself has said the fiscal situation is now worse than this owing to multiple sources of unfunded pressure on finances e.g. energy upside seen following the Russian invasion of Ukraine and heightened supply chain costs. Interestingly, the OBR has announced it will be releasing its costings of the last budget and review into it on Wednesday, a release which should provide some insight into the 22bln figure.

As a reminder, the last budget was presented in March by Chancellor Hunt under the Sunak-led Conservative government. A budget which was assessed by the OBR to be consistent with 2024 Real GDP growth of 0.8% (0.7% Nov.'23 update) and left the government with fiscal headroom of 0.3% of GDP or 8.9bln, a margin the OBR described as being “historically modest”. The March assessment described the medium-term outlook as challenging given a growing population and rising inactivity levels, an outlook the Labour party intends to change via its ongoing Growth Mission Board.

ECONOMIC PICTURE

PSNB came in shy of market consensus at 16.61bln for September (exp. 17.5bln), while the debt-to-GDP ratio stood at 98.5% and is 4pps higher Y/Y; however, it is 0.5pp shy of the OBR’s March forecast for September while August’s measure has been revised down to 98.8% from 100% owing to a subsequent GDP revision. Note, the PSNB and PSNB ex-banks figures are now the same, owing to no institutions currently being classified as public sector banks.

Recent data has been encouraging for the government, with inflation continuing to moderate and coming in cooler than the BoE forecast for the headline and all-important services Y/Y measure in September; a release which increases the likelihood of continued near-term BoE easing and thus will reduce the interest burden on borrowing. Recently, the IMF upgraded its view of UK GDP from 1.1% to 1.5% vs the 0.8% 2024 Real GDP growth assessment the OBR provided in March, with the IMF forecasting growth of 1.5% for 2025.

Reeves will be hoping the budget is sufficient to deliver annual growth of around the 2.5% mark by the end of the forecast horizon, something the OBR forecasts will be keenly sought for. However, Investec makes the point that the policy lag from investment spending might lead the OBR to instead verbally acknowledge that trend growth could increase outside of the forecast horizon. A point which would likely support Gilts.

FISCAL RULES

Reeves has reportedly made clear to the Labour Cabinet that the primary fiscal rule for the budget will be her so-called “golden rule”, which says that day-to-day spending is balanced with tax revenues; hence, the expected focus on tax generation in the budget. A rule which is designed to provide market reassurance and safeguard against any potential Truss-style meltdown from unfunded spending measures.

In addition, Reeves looks set to stick to reducing debt as a share of the economy by the fifth year of the forecast; however, it remains to be seen what measure of debt she will select. Currently, PSND ex-BoE is utilised, which CapEco estimates will be assessed by the OBR as providing 20bln of headroom (vs 8.9bln in March), when rolled into the 2029/30 period (the binding year for October’s budget) this increases to around 25bln (vs 14bln in March). However, Reeves could switch this to PSND, PSNFL or PSNW; Public Sector Net Debt (36bln of headroom), Public Sector Net Financial Liabilities (73bn), or Public Sector Net Worth (78bln), via CapEco.

From these figures, it is worth noting that the “golden rule” uses up around 25bln of headroom when looking at it from a borrowing perspective (as day-to-day spending must be balanced by tax revenue, not borrowing). As such, the amount Reeves can increase borrowing while adhering to the two fiscal rules is a spread of 11-53bln, dependent on which measure she utilises; given the “golden rule”, this funding would be exclusively for investment purposes.

As a reminder, a switch to PSND has drawn extensive media focus as the measure accounts for the BoE’s QT-related losses and thus is higher than PSND ex-BoE in the current period and therefore is expected to fall at a relatively faster rate in the 4th-5th year reference period, equating to higher headroom. Most recently, the Guardian has reported citing sources that the Chancellor will be selecting the PSNFL measure, a figure which provides more headroom than PSND (reporting around this pressured Gilts at the time) though not as much as the widest PSNW measure would.

Note, some reports have intimated that Reeves could be looking to generate over 35bln from tax increases, a figure which could have a variety of implications on the above calculus and subsequent theoretical borrowing levels, depending on whether the money is entirely spent on day-to-day spending or used for some degree of investment.

Copyright © {{ copyright-year }} Newsquawk Voice Limited. All rights reserved.
Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.
newsquawk.com · +44 20 3582 2778 · info@newsquawk.com

BORROWING IMPLICATIONS

Assuming Reeves changes the debt measure used for the existing rule, then the headline headroom figure itself is not necessarily a significant hurdle. The issue potentially comes from the marketplace, with Reeves having the unenviable challenge of convincing foreign bondholders (who represent a significant proportion of DMO auction demand) to effectively fund domestic UK investment via their bond activity. As of 2023, foreign agents held 25% of UK debt, "well above the advanced economy average of 18%" writes the OBR. Furthermore, as the GDP-related benefits of any investment will take at least a handful of years to realise, the debt ratio will rise in the short term, and potentially more permanently if the investment is not handled correctly (hence why Starmer has formed a Growth Mission Board, which Reeves chairs). Additionally, such investment could be regarded as inflationary and in-turn form a higher yield environment which would lift borrowing costs for the government; a point which forms the basis of the argument that the budget could lead to tighter monetary policy.

Morgan Stanley expects the gilt issuance remit to increase by 8bln from 278bln to 285bln for the 2024/25 FY. For 2025/26, this is seen increasing by 21.6bln to 277.8bln and thereafter by around 20bln/year until 2028/29. In terms of the impact, MS highlights that while the market should be able to absorb this "relatively smoothly", they do not foresee any significant improvement to the demand-supply balance which they described as challenging. **The Reuters survey of UK Primary Dealers has the 2024/25 issuance target being raised to 295bln from 277.7bln.**

BOE IMPLICATIONS

For the BoE, the implications are mixed. On one hand, the potential for better economic prospects from the net-expansionary statement could lead to tighter monetary policy, though this is subject to much uncertainty depending on how the funding is utilised and then how successful the resulting infrastructure developments are. However, the likes of ING do not think the budget will be a gamechanger for the BoE given the mentioned uncertainty around the impact of the stimulus in the near/medium term, as such they believe the budget "shouldn't massively change the course of BoE interest rate cuts" and look for the Bank Rate to settle at 3.25% by the end of summer 2025.

GILTS

UK auctions in recent weeks have experienced uncharacteristically poor performance. Results which have potentially been impaired by anticipation of the upcoming fiscal update and concern that Reeves could outline a significant borrowing remit to fund planned investment. A point highlighted by Citi's Nabarro who remarked that they have seen a "material reduction in demand from international real money". Ultimately, any Gilt reaction may be determined by how robust Reeves' approach to her new fiscal rules are (i.e. which measure of debt she picks, and whether she adheres to the "golden rule" from the first FY period or not) and, until this is known, Panmure's French makes the case for staying out of Gilts.

Recent weakness in Gilts, both on the market and via DMO outings, may not entirely be a function of fiscal uncertainty. As inflation has (despite printing cooler than expected in September) been relatively sticky with growth also robust (particularly when compared to the likes of Germany), factors which would weigh on Gilts and bolster yields irrespective of the upcoming budget. As such, both Barclays and HSBC have remarked in recent weeks that Gilts look cheap while Amundi has highlighted shorter-dated Gilts as offering the best value.

REVENUE RAISING MEASURES

Using Citi scenario analysis, IFS outlined that to spur economic growth, all department spending would need to rise by at least the level of national income, which would require 17bln of additional spending in the 2028-29 period. A level which would be in addition to 9bln of specific revenue-raising measures from the manifesto, equating to a 25bln level of tax rises. However, Reeves spoke with the New Statesmen thereafter and intimated that this figure is insufficient as it does not account for various sources of unfunded pressures. Thereafter, the Telegraph has reported that of an expected revenue raise of 40bln, 35bln will be via tax increases which could make the budget the largest ever tax-generating fiscal statement. Most recently, the likes of the Daily Mail has reported the final figure could be above 40bln and "could even hit 50bln" according to insiders cited.

For equities broadly, Goldman Sachs writes that changes which discourage investment are seen as having a relatively marginal impact on UK equity, as domestic capital is "often not allocated to UK equity in any case". Elsewhere, the desk notes that a rise in employer NI contributions would impact domestic stocks and small caps. A generally higher tax burden could hit growth and have a negative impact on demand and by association UK firms.

Measure	Detail	Revenue Raised	Impact
National Insurance	Employers contribution is expected to be raised from the current 13.8% rate on earnings above 175/week; FT reports a 2pp increase is possible. Additionally, the threshold from which payments begin is expected to be cut, via BBC.	**A 1pp increase to the rate raises ~8.5bln.**	**Wages and/or staff levels could be cut** as firms look to combat the increased employer cost. Increased costs for domestic firms and small caps.
Capital Gains	PM Starmer has pushed back on speculation of a 40% higher rate (currently 24%). Nonetheless, the measure is expected to increase. One suggestion is an increase to the rate but a return to indexation (i.e. taxing post-inflation) to offset some impact.	Resolution Foundation has suggested changes **could raise 7.5bln**, depending on the breakdown.	**Concerns around capital flight, reduction in investment, share ownership, business activity & more** - as such, the IFS has called for extensive reform of the system. **Gilts** potentially sensitive after reports in The Times that retail investors are "piling" into Gilts ahead of a potential increase to capital gains tax on shares.
Non-dom	Last gov't made significant changes, Labour has since pledged to tighten rules further and will remove the ability for overseas income to be sheltered from Inheritance Tax via trusts.	Unclear; depends on the alteration, timeframe and behavioural implications.	Concern around capital flight and impact on business investment, of particular focus given Labour's focus around driving investment & growth.
Income Tax	Manifesto committed to no increase. However, FT reports that the freeze on thresholds will continue beyond 2028.	**Threshold freeze could generate around 7bln.**	
VAT	Manifesto committed to no increase; nothing concrete has been reported which deviates from this.	A 1pp change to the reduced and standard rates generates around **0.5bln and 8.5bln** respectively	Change would be a surprise, potentially impacting spending activity and by association **retailers** in the UK.

Copyright © {{ copyright-year }} Newsquawk Voice Limited. All rights reserved.
Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.
newsquawk.com · +44 20 3582 2778 · info@newsquawk.com

Measure	Detail	Revenue Raised	Impact
Fuel Duty	The current 5p cut is expected to end from 2025. Additionally, the duty is expected to increase annually with inflation equating to a ~7p total rise.	**Raising around 4.2bln**.	Retailers, businesses and consumers would all be sensitive to a change.
Winter Fuel	Already confirmed that payments will be axed for all pensioners except those on credit.	**~1bln**	Measure has been subject to significant political pushback.
Inheritance Tax	Reportedly been considering multiple alterations to the headline tax (40% on assets above 325k) and the numerous reliefs/exemptions that are associated with it.	Given the complexity of the tax, it is hard to speculate how much would be raised; but a 1pp raises 80mln and a 5k reduction to the exemption threshold around 50mln.	**FTSE AIM** stocks held for two years are currently exempt, an exemption which could be removed.
Pensions	Tax-free lump sum amount expected to be reduced from 268k to 100k. Reports have also suggested a flat rate of pension relief.	**Limiting the up-front relief to the basic rate of income tax would generate around 15bln**, via IFS.	
Business Rates	Bloomberg has reported a change to the business rate system first to cut charges levied on shop/hospitality owners. Secondly, to alter the system where tax is based on the value of a firm's physical presence, an alteration which would raise more from large-cap e-commerce firms i.e. **Amazon (AMZN)**.	**Spur small businesses and possibly listed retail names**, depending on the extent of the first measure. Second point could influence the activity of large-cap foreign firms, potentially impacting investment etc.	
Energy Levy	Windfall tax on the profits of oil and gas firms is expected to increase once again, to 38% from 35% as of November and is seen as likely to remain in place until 2030. Also set to confirm the end of licensing for new oil and gas fields.	Levy, as it stands, **raised 3.6bln in the 2023/24 period**.	**BP (BP/ LN)** & **Shell (SHEL LN)** have both paid significant amounts under the levy. Further increases could change their business/investment activity.
Air Passenger Duty	Expected to increase though details are sparse on exactly how. Duty varies significantly based on distance and travel class.	Some reports have suggested it **could raise 4.5bln**.	Likes of **easyJet (EZJ LN), Ryanair (RYA ID)** and **IAG (IAG LN)** among those who could be affected.
Vaping	Considering increasing the e-cigarette levy & an additional increase to tobacco duty. Disposable vapes banned in 2025 (confirmed).	Tobacco duty currently raises 10mln based on packs of 20.	**BATS (BATS LN)** & **Imperial Brands (IMB LN)** from the UK and **Altria (MO)**, **Phillip Morris (PM)** etc from elsewhere.
Alcohol	Changes to make it easier for pubs to serve independent local beer, Guardian reports that “some form of consultation with the industry” could be announced.	**Diageo (DGE LN)**, **Fevertree (FEVR LN)** and other names potentially in focus.	

SPENDING CUTS

Around 5bln worth of spending cuts are expected across the various government departments. Measures which have sparked outrage from members of the Cabinet, namely Deputy Rayner (also serves as Housing Secretary), Justice Secretary Mahmood and Transport Secretary Haigh; focus of the complaint is on the planned spending reductions which are reportedly as much as 20% per department for the next FY. The Times reports that one of those members described the touted cuts as “absolutely huge” and “totally self-defeating”.

For Rayner at least, as Housing Secretary, her pushback appears to have borne fruit with reports via the Times suggesting that her department will be provided with around GBP 1bln for an 18-month period. Allowing for the doubling of the rate of council house construction, seen as a key component of the 1.5mln home target.

INFRASTRUCTURE SPENDING

Rayner’s houses aside, other spending points are expected to focus on energy and transportation. For energy, the budgets for GB Energy, the Labour-created public energy firm, and the UK Wealth Fund (replacing the UKIB). Further, initiatives to provide insulations to households will be framed as a longer-term investment to reduce energy bills and keep inflation in check. Energy aside, but within commodities, details around the flagged 3bln investment for steel will be sought. In terms of transportation, the main focus is HS2. On this, the government has recently launched a spending review to overhaul the scheme in light of reports that the total cost is still being underestimated by 10bln. As the review has only just begun it is likely premature for there to be an update in the budget, but we remain attentive nonetheless. Elsewhere, in the week prior to the budget, Downing Street briefed that five additional Freeports were to be constructed; however, officials have since said that new sites will not be unveiled in the budget. Unsteady, Reeves will outline the “next steps”, according to the FT. Finally, the NHS will undoubtedly receive support measures, though any such measure(s) is expected to be contingent on reform.

Copyright © 2024 Newsquawk Voice Limited. All rights reserved.

Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.

newsquawk.com · +44 20 3582 2778 · info@newsquawk.com

Copyright © {{ copyright-year }} Newsquawk Voice Limited. All rights reserved.

Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.

newsquawk.com · +44 20 3582 2778 · info@newsquawk.com