Time for Tax: The UK Autumn Budget

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The UK has seen a shift of power since the 2023 spring budget, with a large-scale swing from a Conservative majority to a Labour landslide - a surprising election, not by winner but by magnitude of victory. The Conservative party lost the public's trust, stemming from malfeasances as far back as 2020. If it was simply a gameshow the burn rate of Conservative prime ministers would be comical, but unfortunately, it was a very real state of affairs, deteriorating public opinion of the party's ability to lead. The tenure of Rishi Sunak, however, did calm the waters to some extent. Although by this point, the Conservative ship had already sailed.

Labour has encountered mixed commentary over their first 100 days in power, with some suggesting not enough progress has been made. Nevertheless, the Autumn budget came as an opportunity for the Labour party to set the tone moving forward, actioning their plan to rebuild public services and stabilise public finances, for the first time in 14 years. This was presented by Rachel Reeves who served as shadow chancellor of the exchequer since 2021, quite the preparation for the task at hand.

To tackle this mammoth of a budget let's break it down into where this money is being generated from and where it's being spent!

Money Generated

This is the largest tax raising budget since 1993, which is impressive considering the labour manifesto promised to not change income tax, National Insurance (NI) or VAT for workers. It is entirely logical that higher levels of taxation are part of any potential solution to improve public services in the UK, but is this the right way? On this promise, the manifesto was fulfilled to the letter by only raising NI specifically for employers from 13.8% to 15%. This change is predicted to generate £25bn a year by the end of the forecast period.

Nonetheless, the Office for Budget Responsibility's (OBR) calculation claims that ¾ of this tax increase will be passed on to the employees over the coming years. Some have seen this as a broken promise in the spirit of their manifesto, with workers indirectly facing higher prices and lower wage growth as a result. With that being said, money was put directly into pockets through an increase in national wages by 6.7% for over 21s with an intention to phase 18-21 and 21+ minimum wages into a single adult rate over time. This maintains minimum wage growth above the rate of inflation, which is positive support for young workers. There was also talk of raising the personal tax-free allowance in 28/29, though this is years down the line.

In terms of the capital gains tax (CGT), inheritance tax and stamp duty front, there were few surprises. The CGT increase, was potentially below anticipated; weeks earlier, Labour leader Keir Starmer had indicated that speculation about CGT rates matching income tax rates was "wide of the mark," which dampened expectations before the announcement. On the inheritance tax side, it has been expanded to include pensions and farms. This could have strong negative impacts on agriculture, particularly when combined with a freeze applied to the farming budget which is a cut in real terms. The Country Land and Business Association (CLA) has stated that this could impact 70,000 UK Farms, with the potential to disrupt food security of home grown produce. On the housing front, first time buyers have seen the higher stamp duty threshold remain until April 2025, at which point it is expected to be reduced from £425,000 down to £300,000. For people buying second homes there will be an increase up to 5% for additional stamp duty on the second property.

In a clear statement of the broadest shoulders bearing the burden, Labour delivered increased tax implications on non-dom citizens (a UK resident who lives outside the UK for tax purposes) and private school fees. The Labour plans will see the current non-dom regime scrapped in April 2025 with a move to the new residence-based regime. According to HMRC, the number of non-dom claimants was 74,000 in 2022-23, which should generate around £2.7bn a year by 28-29. The hotly anticipated VAT levy for private school fees will take effect from January 2025 along with the removal of business rate relief. On a positive note for consumers, the freeze on fuel duty has been maintained keeping further pressure off inflation. Air travel on the other hand is not being frozen with passenger duty on economy short haul flights increasing by £2, while private jets will also see an additional 50% air passenger duty.

There was an expected rise in tobacco duty and a new tax on vaping liquid. Cigarettes have been progressively taxed more over time in an attempt to reduce usage and in turn hopefully reduce the burden on the NHS through the negative health implications. Along the same line, alcohol tax will rise in line with the retail price index, however a cut of 1.7% will be applied to draught beer. So, with the average cost of a pint in the UK being £5.17 this tax cut means buying 517 pints gets you one free!

Finally, Labour tweaked the rules around borrowing to track a wider, looser 'investment rule', which involves borrowing, for the purpose of eventually reducing total debt. In short, this change to the rules allows the government to borrow more to invest in services.

This was the most important element of the budget for the Gilt market, which interpreted this change as an indication that bond issuance in the UK was going to rise at the same time as the inflationary impacts of the budget. This means interest rates are not going to come down as quickly as previously hoped. UK Gilts fell over 1% following the announcement, which whilst not ideal, could have been a lot worse. See Kwasi Kwarteng.

Money Spent

Spending was announced on compensation schemes for the victims of the infected blood scandal (£11.8bn) and the UK Post Office Horizon IT scandal (£1.8bn).

The NHS, a hotly discussed point in the July election, has received a much needed £22.6bn increase in allowance for day-to-day spending accompanied by an increase of £3.1bn for infrastructure investment. These proposals are to take effect by the end of 2025 but will be preceded by multiple cash injections to try and stimulate short-term improvements.

With the introduction of the previously mentioned investment rule, Reeves has stated the only way to drive economic growth is to 'invest, invest, invest'. The Governments Research and Development (R&D) will reach £20.4bn in 2025-26, with emphasis on technology, medical science and engineering. There will be investments of £2bn in the form of support for electric vehicles, £1bn in the aerospace industry as well as £500m in life sciences.

The Department for Education will be receiving 6.7bn of investment, a real terms increase of 19%. There will be increases across the public education sector, with increases in school budget for teachers (£2.3bn), school maintenance (£300m), funding for special educational needs (£1bn) and higher education (£300m). There will be a further £1.4bn to help renovate and improve 500 schools most in need of support. A portion of this will come from the VAT levy on private schools.

The Labour government is also targeting investment of £5bn in 2025/26 for housing, with £500m set aside specifically for affordable housing. With intentions to hire 100s of new planning officers, to help accelerate development, increase supply and bring the cost of new homes down for first time buyers.

Based on the initial report created by OBR, the forecasted impact of the budget appears to slightly increase inflation expectation in the next 3 years, settling in with the estimates from the previous budget in around 2027/28. This has reduced UK estimates for interest rate cuts by the end of 2024 which exacerbated the selloff in UK Gilts.

This budget saw a clear shift towards public sector investment and growth with fewer incentives for investing in the private sector. The end result is expected to be similar in terms of GDP growth. However, there is more of a focus now on growing the UK public sector services, which is a step towards leveling the playing field of quality of access between private and public services.

The UK bond market predictably didn't react too positively to the increased borrowing, but importantly it hasn't fallen through the floor, which is a clear and positive distinction between this budget and that of Liz Truss's disastrous attempt. The budget, if executed well with borrowing remaining prudent, could produce a drastic improvement in the public services available in the UK.

In terms of TAM's market outlook, the UK post-budget remains a market with robust growth prospects and increased levels of investment with interest rates coming in the quarters ahead. This should be good for confidence and performance in both UK stocks and bonds in which we see value in from here. As the focus now shifts to the US election and the rising geopolitical risks, we will continue to monitor the market and, where appropriate, react to changes in the narrative globally.

If you would like to speak with us about anything in this note, or to discuss our discretionary investment management services in general, please get in touch with our UK business development manager David Terry today.

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