UK Finance

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Monthly Economic Review

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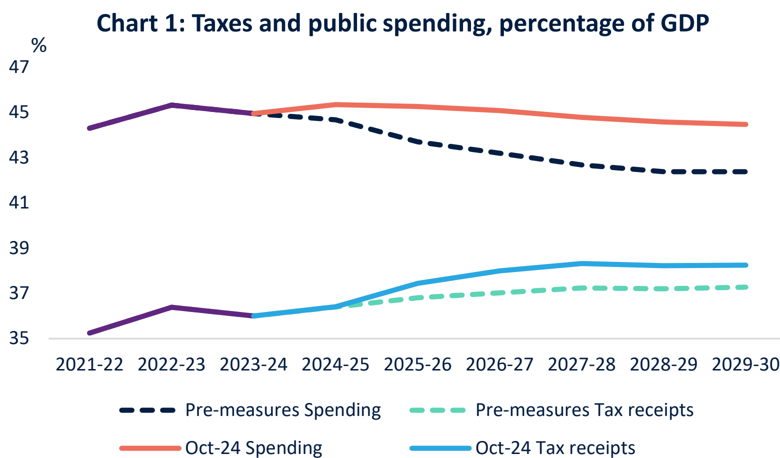
This month the main focus is the detail of the much-anticipated Budget statement and the update economic and fiscal forecasts from the OBR. We also look at some of the encouraging news on inflation ahead of the next interest rate decision.

Budget and OBR forecast

There was significant speculation ahead of this much-anticipated Budget and no shortage of commentary, analysis, praise and criticism in the days that followed. Our briefing will draw out some of the key implications for the public finances and economic outlook from the statement.

Chart 1: Taxes and public spending, percentage of GDP



Source: OBR

Ahead of her speech, the Chancellor had already set out some key challenges for the new government in balancing the books (much of which

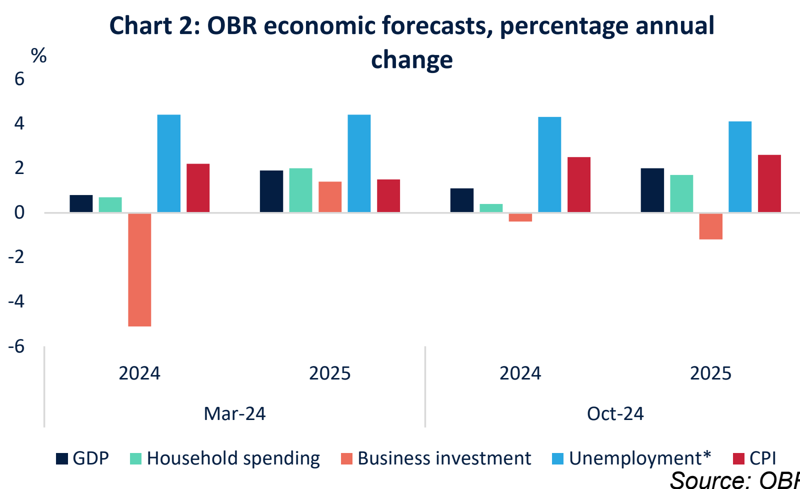
was evident ahead of the election) – previous fiscal forecasts had assumed post-election cuts to most departmental budgets and the incoming government had identified a number of areas of in-year overspend and unfunded policy commitments (including two large compensation schemes). AKA the 'black hole'. Tax rises were expected. And that's what we got (**chart 1**).

To put the public finances on a 'stable footing', the Chancellor brought forward tax increases amounting to just over £40 billion per year by the end of the forecast period (2029/30). The bulk of the revenue raising was from an increase in employer national insurance contributions (NICs), including a cut to the level at which employers start paying NICs. There was an offsetting increase to the employment allowance aimed at minimising the impact on the smallest employers.

Changes to the capital gains tax regime, including for non-doms, and the application of VAT to private school fees account for most of the rest of revenue raised. Against expectations, there were no changes to fuel duty and the freeze on personal tax thresholds will not be extended.

On the spending side, additional spending, reaching over £70 billion by the end of the forecast period, was announced – split roughly two-thirds departmental spending and one-third capital spending. This will provide departments with budgets for this financial year and next and set the broad spending envelope for the 2025 spending review. As **chart 1** illustrates this sets quite a difference path for taxes and spending as a percentage of GDP compared with that assumed before the package was announced.

Additionally, one of the more widely trailed measures in budget was a change to the fiscal rules. The new rules will deliver a current budget balance and for net financial liabilities to be falling, both initially in five years. This created some additional 'fiscal space' and supported a planned increase in capital spending. All in all the measures amounted to fiscal loosening of some £37 billion per year over the next parliament. The gilt market reacted with a bit of a wobble once the scale of fiscal loosening became evident, but nothing on the scale of that seen two years ago.



Source: OBR

A few final thoughts on the growth implications (**chart 2**). Key forecasts for growth and the labour market were little changed compared with March. GDP growth is expected to be a little stronger this year and next, before falling back to around 1.5 per cent

per annum in the second half of the forecast period. CPI will be higher, notably next year as the OBR expects some pass through from higher NICs into consumer prices and the additional demand generated by fiscal loosening. Those NICs rises also feed into weaker real income growth – particularly in the later years of the forecast. And consequently, household spending growth will also be a tad weaker than previously expected. There were also downward revisions to business investment from squeezed profitability and a higher cost of capital. However, the OBR does note longer term benefits to the growth outlook from higher public investment.

Collectively the budget arguably focused more on shoring up public services than headline growth. While consumer (and business) confidence looked shaky ahead of the statement, the potential impact on businesses may take a little time to process, and households will not feel materially better off in the near term. There is a clearer commitment to longer term public investment, which has long been a weak point for the UK, but there remains a job to do on longer term structural reforms that could support improvements in productivity and growth.

A modern industrial strategy

In addition to the tax and spending measures announced in the Budget, outlined above, the government published a further strand of its economic policy earlier in October – a consultation on a new industrial strategy. *Invest 2035: the UK's modern industrial strategy* is billed as a central strand of the government's growth mission. In short, the approach is to focus, over a ten-year horizon, on '*tackling barriers to growth in our highest potential growth-driving sectors and places, creating the right conditions for increased investment.'*

Government focus on industrial strategy as a framing for pro-growth policies that can give businesses visibility of priorities and the confidence to make longer-term investments in the UK is not new. The previous coalition and Conservative governments brought forward their own industrial strategies. And some of what is contained in this consultation document will be familiar: highlighting UK strengths, such as a high-quality research base, skilled workforce, robust institutions and global interconnectedness. In addition, the longstanding problems the strategy is aiming to address – low investment, poor productivity, and weak diffusion of new technologies and ideas.

The strategy proposes a focus on stimulating investment and activity in sectors with the highest growth potential. These cut across both production and services, including financial services, and those industries that will underpin the drive to net zero and support broader security concerns. The consultation is seeking input into the targeted and cross-cutting policies where government can act to remove or reduce barriers to

business growth, including, skills, innovation, infrastructure, regulation, and international partnerships.

As this isn't the first outing of industrial strategy – will it be different this time? It's obviously too soon to say, but there do appear to have been some lessons taken from previous iterations.

A few positive early reflections – it's consultative – not just on the policy detail, but on where sector efforts should be targeted. Moreover, the net has been cast wide for sectors that have high growth potential. It's doesn't sit with a single department, rather is pitched as a joined Business Department and Treasury strategy, this is important to avoid tussles on spending policies and tax, which has previously been out of scope. The consultation commits to a monitoring and evaluation framework, which will be vital to track what's working. A finally, it acknowledges the risks from policy churn and aims to embed to strategy over the next decade.

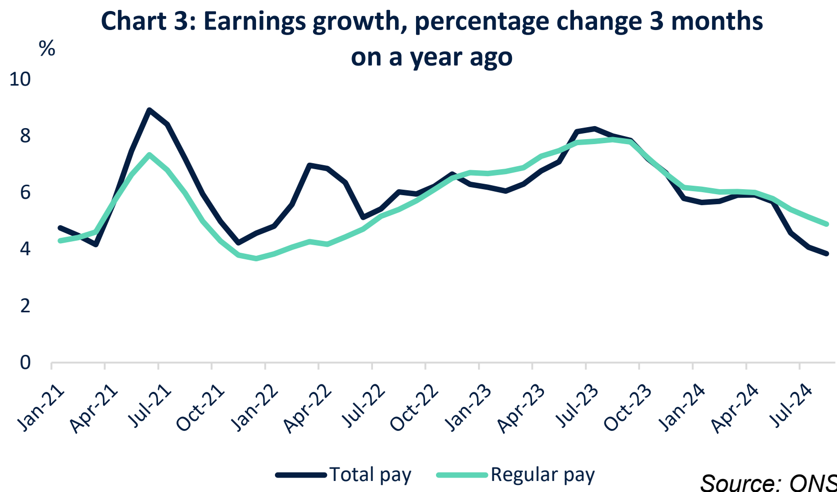
UK Finance will be submitting a detailed response to the consultation.

Earnings growth continues to moderate

There was encouraging news on the fight against inflation in recent months. The September CPI print came in at a lower-than-expected 1.7 per cent, meaning headline inflation has averaged just above the Bank of England's two per cent target over the past six months. Pushing CPI lower in September was a fall in transport costs, principally air fares and motor fuels. However, the former of these drivers is somewhat volatile. There was, however, a rise in food price inflation – the first increase since March 2023.

While attending an Institute of International Finance gathering in Washington Andrew Bailey, Governor of the Bank of England, noted that inflation has fallen "faster than we expected" but "we've got a very unbalanced mix of inflation components and services inflation remains higher than is consistent with the target." Services inflation has continued to drift lower over the course of this year, with September's figure the lowest since April 2022 and a little below where the Bank of England thought it would be by the end of this year, but at 4.9 per cent it is, nevertheless, proving stickier than Monetary Policy Committee (MPC) members would like.

Continued moderation in wage growth, which is more closely linked to services rather than goods inflation could help. **Chart 3** shows the slowdown in total (including bonuses) and regular pay growth over the past 18 months, to 3.8 per cent and 4.9 per cent respectively. The more rapid fall in total pay growth is a result of one-off bonuses for NHS and other civil service workers paid out in June – August 2023.



Elsewhere in the labour market data, there are further signs of loosening with the number of vacancies still falling quarter-on-quarter, and business surveys also point to slowing recruitment, which should sustain a slowdown in services inflation in the months ahead. Though there may be some impact from the recently announced 6.7 per cent rise in the minimum wage from next April (and significantly greater planned rises in the rate for younger employees and apprentices).

With inflation seemingly now heading in the right direction, the MPC is widely expected to cut Bank Rate when it meets again in November, with economists predicting another quarter point reduction. The Committee will also have the benefit of an updated forecast, which will also reflect last month's Budget decisions. In the short term, we know that CPI will rise with the increase in October's energy price cap. The National Institute of Economic and Social Research (NIESR) expects this to add around 0.5 percentage points in October, with CPI ending the year around 2.5 per cent. Given that, and with a range of other risks to the outlook, it is reasonable to assume that a majority of MPC members won't be in a hurry to cut again in December.

For the love of tariffs

One of the features of the post-pandemic period has been disruptions to supply chains. As the global economy re-opened after the pandemic, supply chains were put under stress as businesses started trading again and consumption patterns returned to normal. Before supply chains could function normally, there were additional strains from geopolitical conflict – first Russia's invasion of Ukraine, and more recently, Middle East tensions. And add to this the increasing risk of disruption from weather-related events. This contributed to soaring inflation and presented significant challenges for a

number of industry sectors. In the UK, these were overlaid with changing trading arrangements with the EU, post-Brexit.

In it's latest forecast update for the global economy, the International Monetary Fund (IMF) notes while advanced economies have shown some resilience in the face of these challenges, disruptions may not end there. In its latest World Economic Outlook report the IMF notes the risks from '*significant shifts in trade policy*', not least as many countries have experienced a change of government this year and models a number of potential scenarios for the global economy.

In one of these scenarios the IMF looks at the impact of a global increase in tariffs as a result of escalating trade tensions. The imposition of tariffs by the US, eurozone and China would affect around a quarter of global goods trade. In addition, greater trade policy uncertainty might also be expected to lower investment, particularly in capital intensive sectors, such as manufacturing. The impact on world GDP and growth in major economies is illustrated in **chart 4**. Given the already muted outlook for growth in the near-term, this is a hit to output the global economy (including the UK and EU) can ill afford.

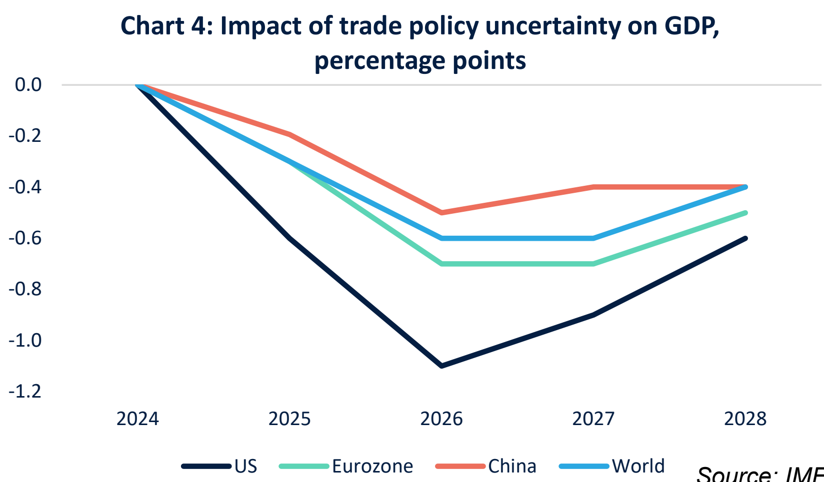


Chart 4: Impact of trade policy uncertainty on GDP, percentage points

Source: IMF

The IMF also notes some policy action that could offset some of the consequences of a ratcheting up of trade tensions – such as higher public investment in the EU, improved productivity, and, in the US, a temporary renewal of some 2017 Tax Cuts and Jobs Act provisions. With the US election seemingly on a knife edge and the two candidates offering very different (if slightly thin) solutions to US growth and fiscal challenges, the outcome could have a material bearing on growth prospects beyond its borders. We'll no doubt return to this once the ballots have been counted in future briefings.

ICYMI and coming up…

Last month we published the Half year Fraud report, which showed over £570m was lost to unauthorised and APP fraud in the first six months of 2024. Read the analysis and get the full breakdown by fraud type here.

Also new last month was the release of our latest buy-to-Let dashboard – find it with all our data releases.

In the month ahead we'll be releasing Q3 Arrears and Possessions data (7 November) and our Later Life mortgage lending dashboard (28 November).

Key indicators

Indicator	Period	Value	Change	2024 Forecast*
GDP	Q2 2024	0.5%	↓	1.0%
CPI inflation	Sep 2024	1.7%	↓	2.5%*
Unemployment rate	Aug 2024	4.0%	↓	4.3%*
Average earnings	Aug 2024	3.8%	↓	4.6%
Brent crude	Sep 2024	$74.20	↓	-
$ Exchange rate	Oct 2024	$1.30	↓	-
Bank Rate	Oct 2024	5.0%	↔	4.7%*

Source: ONS, HM Treasury, Bank of England, EIA

*Q4 2024