

## Limited room for tax changes as UK chancellor gets set to unveil Autumn Statement

The UK chancellor can look forward to a little extra wiggle room when it comes to meeting his fiscal goals, as the impact of higher inflation on tax revenues offsets the effect of higher debt interest spending. But the margin for error is still tight and doesn't offer much space to make major policy changes this month



Chancellor Jeremy Hunt will present his Autumn Statement to the House of Commons on 22 November

### The chancellor is poised to get extra wiggle room

UK Chancellor Jeremy Hunt is likely to be gifted with a rare bit of good news as he gears up for his Autumn Statement on 22 November. Not only has borrowing come in £20bn lower than forecast so far this fiscal year, but new projections from the Office for Budget Responsibility (OBR) are likely to show that he has a little more wiggle room to play with, whilst still meeting his main fiscal goal of lowering debt as a share of GDP within five years.

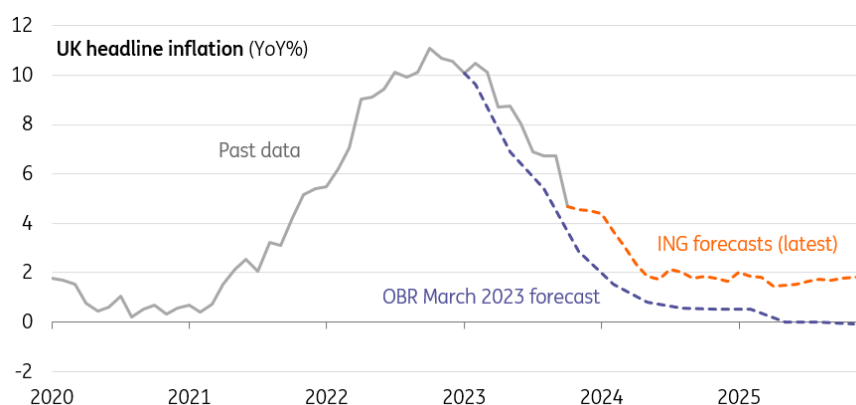
It's true that markets expect Bank Rate to be roughly one percentage point higher than when the

OBR last produced forecasts in March, which is likely to push up the forecast for debt interest (net) by roughly £18bn in 2027/8 by our estimates. But that has, of course, gone hand in hand with higher inflation.

That translates into higher nominal spending on things like welfare, though the government is reportedly looking to temper that increase by uprating welfare benefits by October's (lower) inflation reading, rather than using September's (higher) reading as is more typical. But higher inflation also means more money coming in for the Treasury, and that's what's likely to dominate the new OBR projections.

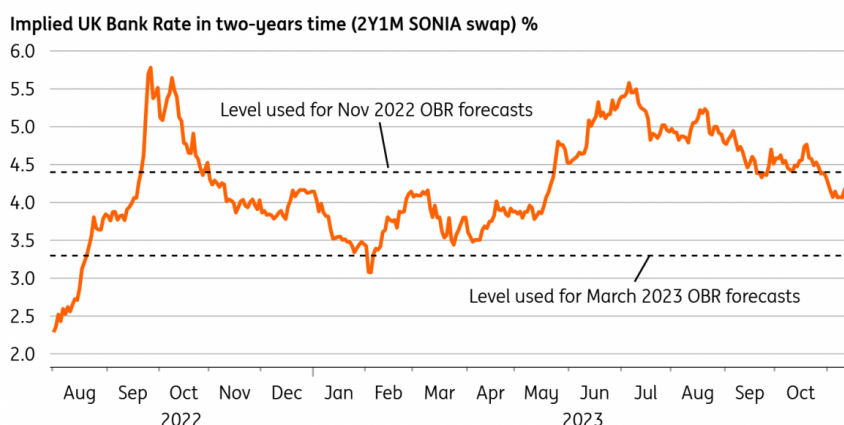
When we wrap all of that together and plug our own inflation/wage forecasts into the OBR's "ready reckoner" model, those extra revenues outweigh the negative impact of higher interest rates and inflation on spending.

### Inflation has come in higher than the OBR forecast in March...



Source: Macrobond, OBR, ING

### ...but interest rates are expected to be higher too



Source: Macrobond, ING calculations

### "Headroom" is higher, but still limited

Our rough estimates suggest the chancellor will be landed with roughly £15bn in "headroom" against his fiscal targets, which is an increase from the £6.5bn available back in March. That figure

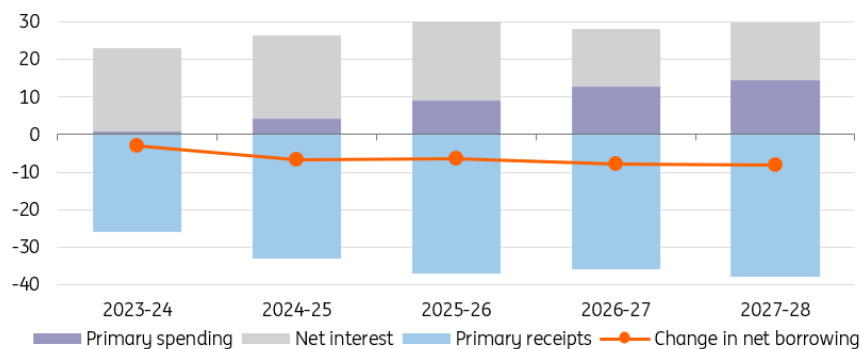
is based on market rate expectations, and we reckon that figure would rise by a further £6-7bn if we're right that the Bank of England cuts Bank Rate more aggressively than markets expect over the next couple of years.

Whichever way you cut it though, that's still not a huge margin to play with. Hunt's predecessors, particularly those in post before Covid, typically built in larger headroom than the £15bn likely to be available to the Treasury next week. It means he doesn't have much to play with ahead of an anticipated election next year, which we're assuming comes in October 2024 (though formally it can happen at any point before the end of January 2025).

That's even more true when you consider that some of the budgetary assumptions underpinning the forecasts described above look unrealistic. Hunt managed to win back markets this time last year with an Autumn Statement that combined some near-term stimulus with longer-term austerity, via an even mix of tighter tax and spending policies. Those included a 15% cut to public sector net investment in nominal terms annually by 2027/28 - or put another way, it goes from 2.9% of GDP to 2% over that same time frame.

## Higher revenues from inflation trump debt interest increases, according to OBR model

Possible changes to OBR net borrowing forecast, assuming ING forecasts for inflation, interest rates etc



Source: OBR, ING forecasts

Estimates use March 2023 OBR "ready reckoner" model, and we've adjusted it using our latest inflation and wage forecasts. Most other variables are unchanged, for simplicity, so estimates shouldn't be taken as precise

## Medium-term spending plans look challenging

One particular challenge with this is that it appears inconsistent with the government's net zero commitments. The pathway that the government has committed to will almost certainly require heavier public investment than we've seen so far (particularly in buildings). The opposition Labour Party has pledged to increase investment in this area, and the [Institute for Fiscal Studies](#) reckons this would limit the fall in net investment to 2.5% of GDP by 2027/8.

The OBR's forecasts are also based on government plans to limit day-to-day spending in government departments, such that in real terms, per capita expenditure will fall over the next couple of years. The scale of those real-terms cuts will be more aggressive in departments where budgets are not protected, and these could be challenging to achieve in practice.

Finally, the plans for later this decade also assume that some of the government's flagship tax

policies are only temporary. That includes the government's capital allowances, which allow firms to offset certain investments against their tax bill, and are slated to end after three years. Extending that looks inevitable, and would likely cost £9-10bn/year, eating up more than half of the chancellor's already tight "headroom". The OBR's forecasts also assume that a 5p/litre cut to fuel duty is phased out, and that this is uprated by inflation in future years – something that hasn't happened since 2011 despite repeated plans to the contrary.

## Modest tax cuts possible, but it wouldn't move the needle much for the BoE

Does all of this rule out a sizable cut to, for example, income tax ahead of the next election? Hunt shelved plans to cut the basic rate of income tax from 20% to 19% this time last year, with a saving of £6bn/year later this decade. It's possible that these plans will be reheated in the spring ahead of the forthcoming election, and it's likely that the chancellor will have the fiscal space to do so. But that's likely to be as far as the government can go without making even deeper planned cuts elsewhere later this decade.

None of this would likely move the needle for the Bank of England. A tax cut of that magnitude, if it comes, is unlikely to make a decisive difference to next year's growth outlook. More importantly, we think by the spring it will have become more evident that inflationary pressures are cooling, and by summer we think both services inflation and wage growth will be back to the 4% area. While still too high for the BoE's liking, we think that would be sufficient to unlock rate cuts by August.

### Author

#### James Smith

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and

which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.