# Why the UK's Halloween budget isn't yet scaring investors

From creaking public services to ageing infrastructure, there are growing calls on the UK's public purse. Potential changes to the fiscal rules on 30 October will buy the Treasury time and space to lift investment. Major tax rises have been ruled out, but we doubt these can be avoided indefinitely


We're expecting more tricks than treats at 11 Downing Street in this year's Autumn Budget

## Labour has little choice but to boost day-to-day spending

The Labour government has made no secret of the fact that it's not impressed with its economic inheritance. Some of this gloom is undoubtedly overstated; the UK economy grew by almost 1.5% over the first half of the year, after all. But that doesn't change the fact that there's next to no money available to play with in the existing budget.

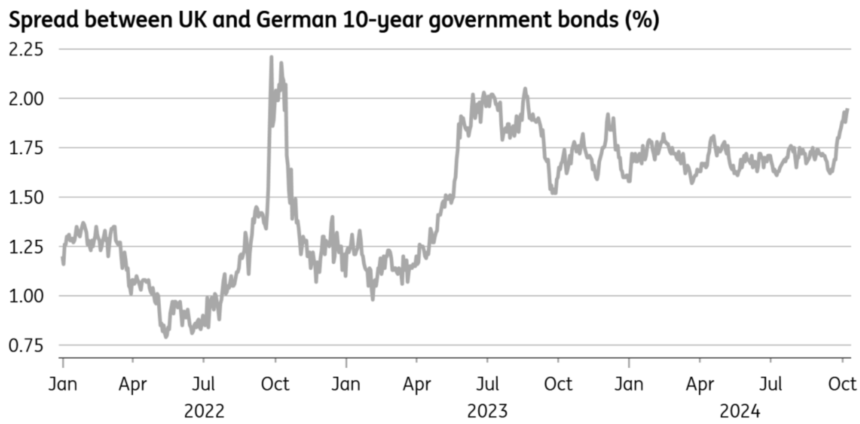
Remember the UK's finances are guided by fiscal rules that are overseen by the Office for Budget Responsibility. And as of March, the Treasury only met those rules with a very modest "headroom" of just £9bn – less than half a percent of GDP.

Despite that, Labour has little choice but to increase day-to-day spending. Public services are creaking and spending plans dating back to 2021 were never properly adjusted for inflation. Roughly £20bn/year is needed to avoid unrealistically sharp real-terms cuts across several government departments.

Without revisiting major tax hikes, Labour will struggle to bridge the gap. The Treasury is looking at a swathe of changes to minor taxes and allowances, but these often raise negligible amounts of cash. A planned change to one of the fiscal rules, which will require the government to balance the current budget over five years, will increase the available headroom only fractionally.

Surprises are possible, but it seems we're likely to see only modest increases in tax that fund equally modest increases in day-to-day spending. But on investment, things look more interesting.

## UK-German spreads have increased, though not because of budget concerns




Source: Macrobond

## Increased public investment looks likely

Under existing plans, capital spending is set to fall from 2.5% of GDP last year to 1.7% in five years' time.

To turn that around, the Treasury is reportedly considering a further re-engineering of the fiscal rules that would potentially unlock in excess of £50bn/year by the end of the decade for investment, equivalent to 2% of GDP. Those are big numbers which, if realised, would presumably be financed by a significant increase in borrowing.

So far, investors don't appear particularly concerned. Yes, we've seen a spike in the UK-German bond spread. And the spread between UK gilts and the equivalent swap rate has widened out too. But the former is down to a global central bank repricing, and the latter is due to quantitative tightening. Fiscal concerns don't seem to be feeding into markets just yet.

That could of course change; France has shown that markets aren't immune to fiscal challenges. In the UK, memories of the 2022 budget debacle are still etched into the country's political memory. We therefore suspect the government will be reluctant to endorse a plan that dramatically increases borrowing.

The government might create the space for large investments, but that doesn't mean it has to use all or even most of it. And where it does, we suspect the Treasury will go to great lengths to demonstrate that it's selecting the investment projects with the biggest potential to boost economic activity.

None of this changes the fact that there will be ever-growing calls on the public purse over the coming years. Fiscal rule changes buy the government time – but we doubt tough decisions on tax rises can be avoided forever.

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