

# 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.

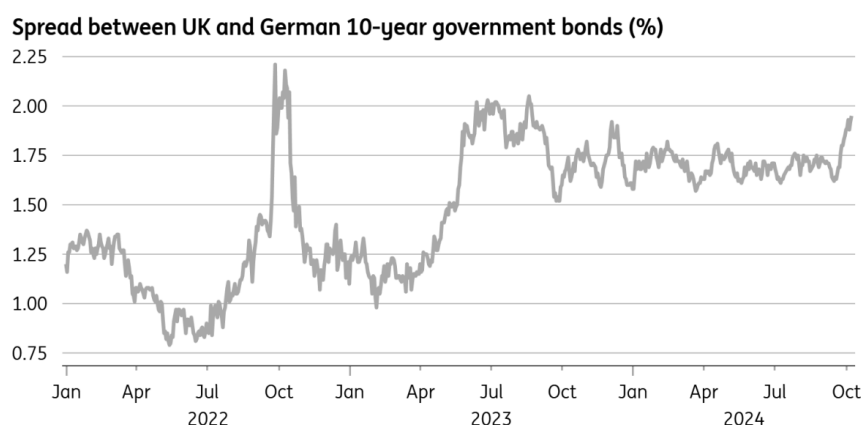
Despite that, Labour has little choice but to increase day-to-day spending. Public services are creaking and spending plans dating back to 2021 were never properly adjusted for inflation. Roughly £20bn/year is needed to avoid unrealistically sharp real-terms cuts across several

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.

## 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 [www.ing.com](http://www.ing.com).