RATHBONES

THE CHANCELLOR'S GOODWILL HUNTING

REVIEW OF THE WEEK
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THE GOVERNMENT HAS MORE CASH TO WORK WITH AFTER BETTER-THAN-EXPECTED GDP GROWTH AND HIGHER TAX RECEIPTS. HOW WILL THE EXTRA MONEY BE USED?

The government approaches this week's Autumn Statement with more money than expected yet less popularity than it would have hoped.

Just over a year ago, then-Prime Minister Liz Truss and her Chancellor Kwasi Kwarteng approached this fiscal set piece with radical plans to slash taxes in a nation where 32% of the public planned to vote Conservative. After a whirlwind month, the tax cuts were ditched – along with Truss and Kwarteng – but not before the pound plummeted to its lowest-ever level against the dollar, bond yields rocketed and the Bank of England intervened to save some defined benefit (final salary) pension funds from going bust.

Another outcome of the palaver was the appointment of Chancellor Jeremy Hunt. **Hunt moved quickly to calm markets and restore credibility to No.11 Downing Street** . Cuts to income tax rates were shelved, the threshold for the 45p upper rate of tax was reduced by roughly £25,000 to £125,140 and the rest frozen till 2028, and the support payments for energy bills were diluted to save money. A large increase in the rate of corporation tax, from 19% to 25% (except for businesses making less than £50,000 in profits), was reinstated. Government budgets were squeezed. All very sober stuff – calming whispers in the ear of that great stallion, the bond market.

Yet it's pretty miserable for voters. For a couple of months, they're thankful for prudence rescuing the nation from the brink. But thereafter they get tired of the grind. Average pre-tax pay is 8.4% higher over the past year, according to the Office for National Statistics (ONS); over three years it's fully 20% higher. That should be happy days, except everything's more expensive – the CPI shopping basket of typical household goods and services costs 21% more over the same period. And CPI doesn't include the largest bill that most people pay: the roof over your head. Many homeowners are rolling off pre-pandemic-era mortgage deals and having to refinance at rates several times higher. The Bank of England estimates that the average monthly mortgage payment of a semi-detached house mortgaged for 25 years with a 25% deposit has roughly doubled over the past three years. **This has driven record increases in rents.** The official figures report an increase of 10% nationwide over the past three years, yet data from letting agents put the figure at between 10% and 12% for the year to August alone. Talking to renters and a glance in property agents' windows suggests the private market information is likely closer to the truth.

Unfortunately, the increases in wages are pre-tax, while the increase in housing and other costs must be paid after the taxman has taken his cut. This makes the squeeze on households greater than you would initially think looking at the numbers. With the thresholds frozen – and the top one reduced – more people are pushed into paying higher rates than they are used to. And they are paying more tax on pounds that buy much less than they once did.

But the flipside, of course, is more money flowing into the government's coffers. The combination of high inflation and high nominal GDP growth, allied with the frozen tax thresholds, has helped the government finances greatly. Headline economic growth is reported in real terms, i.e. with the effect of inflation stripped away. This real GDP growth was better than forecast but still miserly over the first six months of the fiscal year. However, taxes are paid in nominal terms – before you adjust for inflation. The amount of spending and earnings in the UK (which then gets taxed) is higher than it was six months ago and it's dramatically more than it was three years ago!

The independent watchdog of the public finances, the Office for Budget Responsibility, confirms as much. In the first six months of the government's fiscal year ending 5 April 2024, the government needed to issue a fifth less debt to plug the gap between spending and tax receipts. This was despite paying 6% more than forecast for the day-to-day costs of running public services, a big driver of which was agreeing higher salaries for workers. Roughly 3% more tax flowed in than previously expected, with upside surprises across the board from income tax and national insurance through to VAT and corporation tax.

So despite cheerier public finances, government approval ratings have dipped to roughly 23%, according to Politico. With the government struggling to curry favour with voters, pressure is rising on Chancellor Hunt to use this unexpected cash in Wednesday's Autumn Statement.

How to Use it

This has set the rumour mill spinning. Plenty of ideas have been floated, from a new ISA that encourages people to invest in smaller UK stocks, to income tax cuts and reductions in inheritance tax. We will have to wait and see exactly what the Chancellor decides to do – watch out for our round-up of the Autumn Statement and what it means for you and nation's finances on Thursday. Yet Hunt can't get too carried away. With borrowing costs running high, with economic growth sputtering, he shouldn't overestimate what he can throw around. Added to that, any reduction in taxes will likely add fuel to inflation, which, while falling, is still more than double its 2% target.

Investment in the UK has been very poor for many, many years. And especially bad since Brexit. Excepting a few high-profile factories you see in the news, businesses on the whole simply aren't putting money into new enterprises here in Britain. Since July 2016, UK business investment has grown by just 4% in inflation-adjusted terms, compared to an average rate of 20% across the US, Canada, Germany, France and Italy. The Resolution Foundation argues that the UK's average investment of 2.5% of GDP is well below the 3.7% of industrialised peers.

Unfortunately, the UK government, like many others, missed a golden opportunity to borrow at near-zero-percent rates to improve roads, rail networks, ports, digital infrastructure and homes. With government borrowing rates now between 4% and 5%, the uplift to economic activity to be delivered from each pound invested must be higher. However, we think there are many areas where that would be true.

While the government will be pressured to cut taxes to put more money in people's pockets ahead of a general election, we hope that as much thought is given to a programme of public investment and encouraging businesses to pump their money into Britain. Because that's the proven way to ensure the whole nation is wealthier in the years to come, rather than simply the next six months.

If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We'd love to hear from you.