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Preparing the pitch

Autumn Statement 2023 preview

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Summary

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The economy has been more resilient than expected this year – but is now slowing

- The Office for Budget Responsibility is likely to mark up growth this year from -0.2% to around 0.6%
- Business surveys and financial market indicators suggest the UK is now entering recessionary territory

Higher wages and inflation are driving up tax revenues

- Inflation and wage growth have been much higher than expected, boosting tax revenues by nearly £15bn so far this year

Stronger tax revenues will last and be only partially offset by higher debt interest bills:

- A permanently larger economy in cash terms leaves tax receipts permanently up by around £40bn
- Interest rates are over 1 percentage point higher than OBR expected in March, adding £16bn to debt interest costs in 2027-28

This will make it look like the Chancellor has more fiscal wiggle room…

- Borrowing forecast could improve by around £16bn in 2027-28
- Debt could come in materially lower by around 6 percentage points of GDP
- The Chancellor would have increased headroom against his goal of debt falling (£13bn, up from £6.5bn)

…but this is an illusion. It assumes inflation pushes up tax revenues but not spending on public services

- Spending power of public services is currently falling as rising wage bills bite (pay promises already total £15bn)
- Unprotected departments' spending power is set to be cut by 16% between 2022-23 and 2027-28, up from 11% at March Budget

The Chancellor also faces a big decision on the uprating of benefits:

- Freezing working-age benefits next April would save the Treasury up to £4.2bn, but push an additional 400,000 children into poverty
- Even if uprating goes ahead, the poorest half of the population are likely to see disposable incomes fall around 1% next year

Expect wider announcements focused on boosting growth including to pension-fund regulation and planning reform (to boost electricity grid capacity)

Economic news points to a stronger past, but a weaker future

UK's post-pandemic recovery revised up, into line with G7 pack

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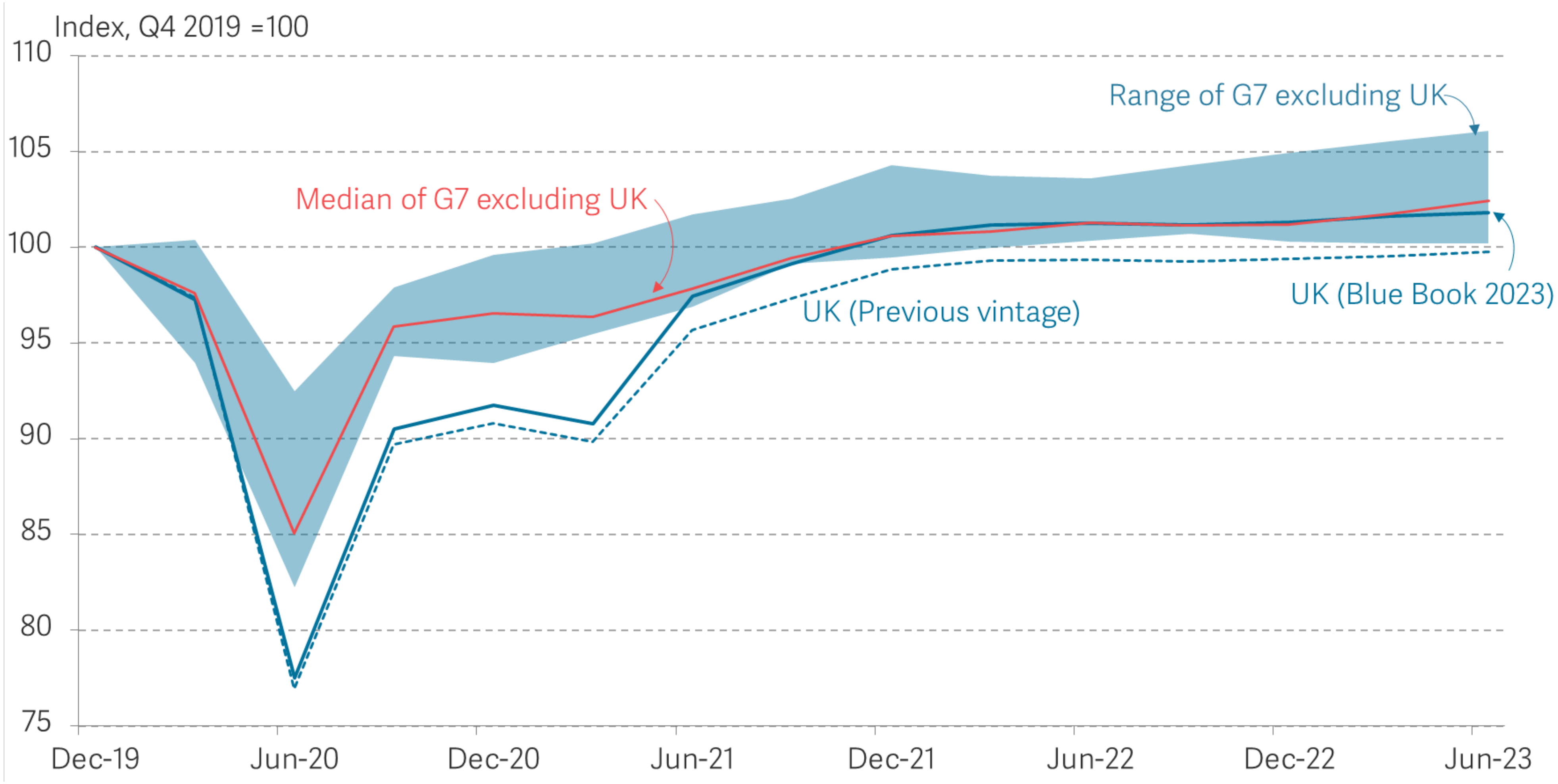
Quarterly real GDP: G7 countries



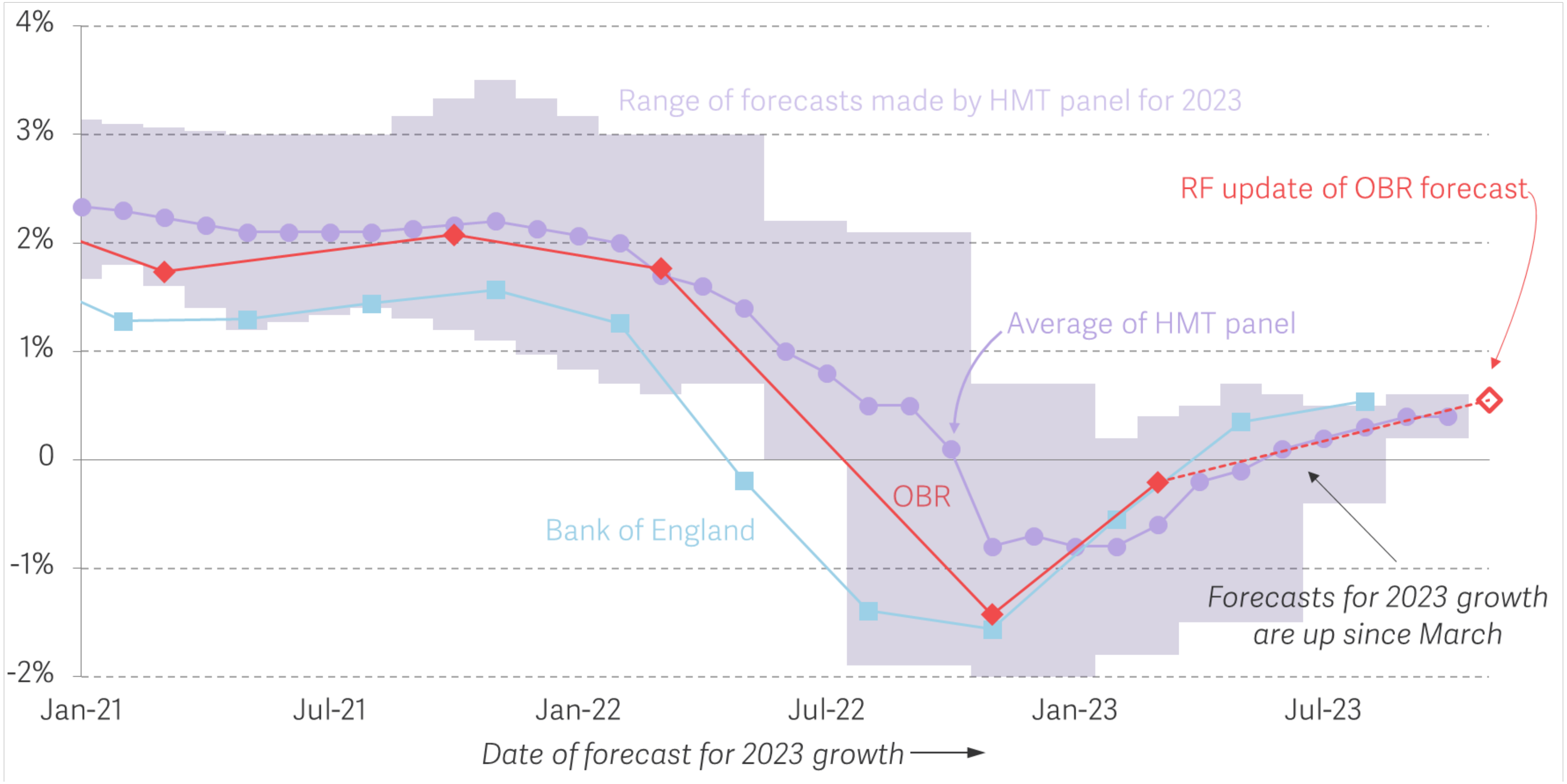
Source RF analysis of ONS, National Accounts; and OECD, Quarterly GDP.

ONS has decided the UK's recovery in 2021 was much stronger than previously thought, such that the level of GDP at that point is now 0.6% above the pre-pandemic peak, rather than 1.2% below

GDP revisions are good news, but also old news when it comes to the public finances. Tax receipts related to that higher GDP are already in and accounted for in the OBR's previous forecasts

The economy has also been more resilient than feared this year...

Forecasts for real GDP growth in 2023, by date of forecast: UK



We expect the OBR to revise up its growth forecast for this year

In March, OBR expected the economy to shrink by 0.2% in 2023. We expect it to project growth of around 0.6%

Source: RF analysis of HM Treasury, Forecasts for the UK economy, various; Bank of England, Monetary Policy Report, various; and OBR, Economic and Fiscal Outlook, various.

…with employment higher-than-expected in March

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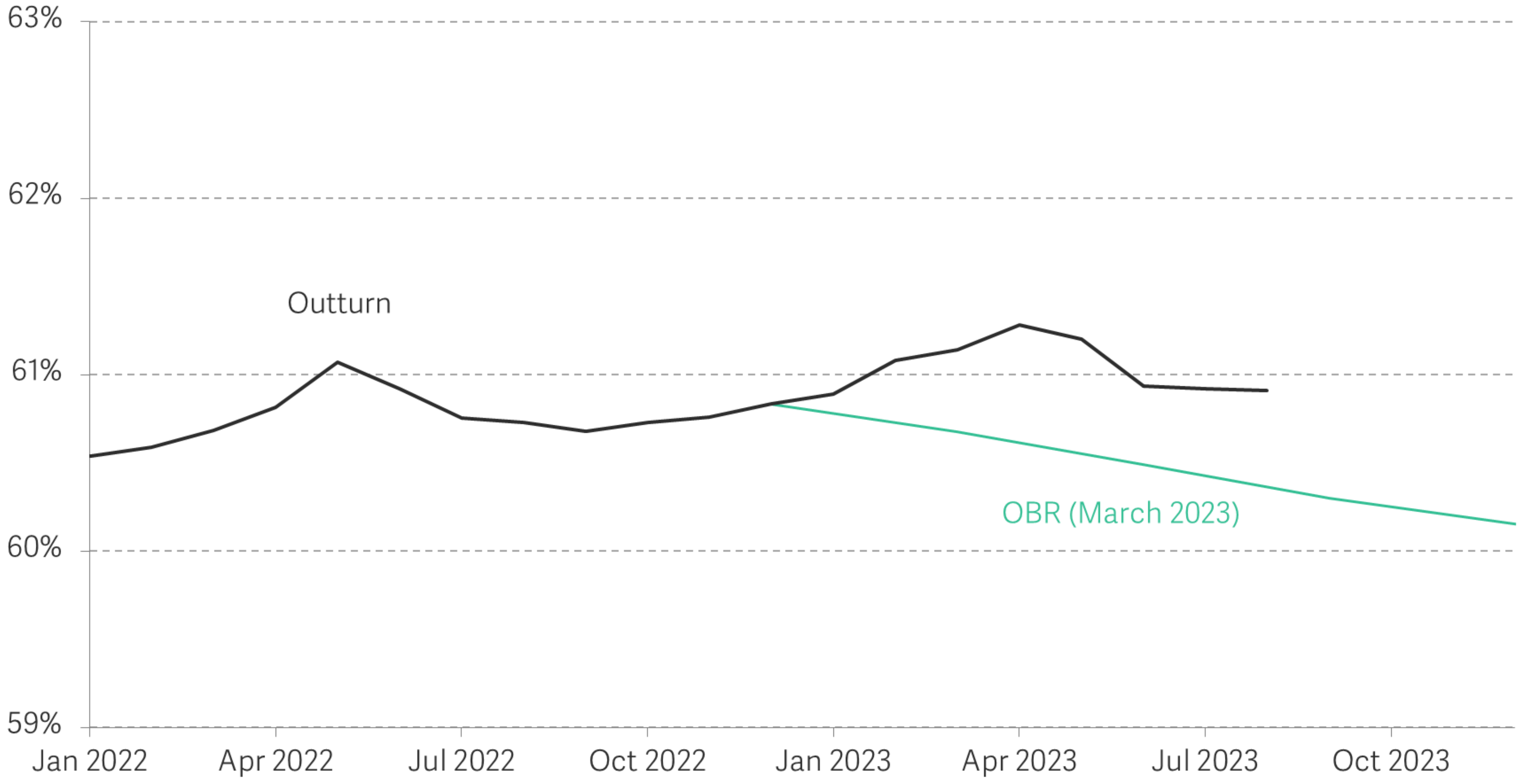
16+ employment rate, outturn and OBR forecast: UK



A more resilient economy means employment being 0.4ppts higher than in the OBR's March forecast…

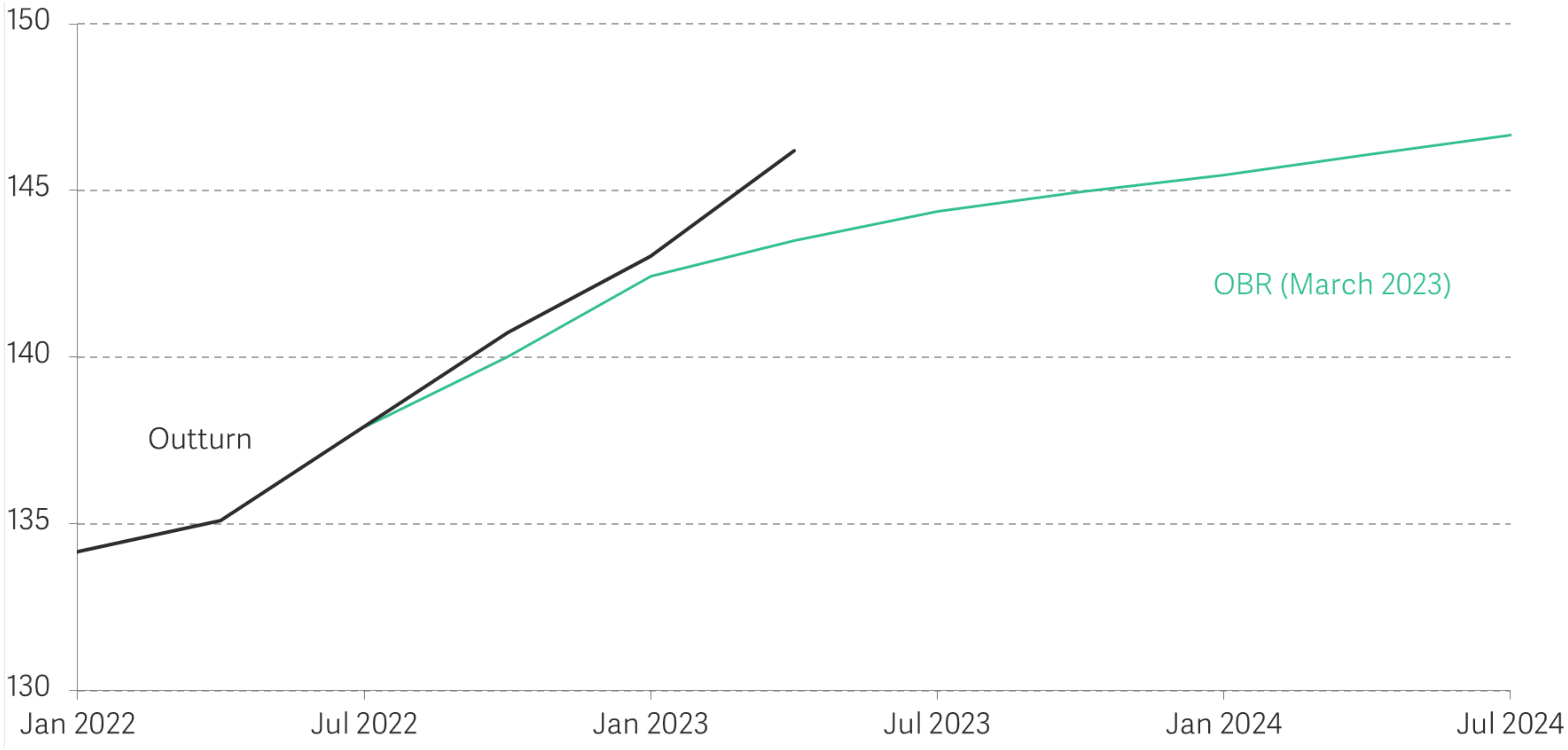
…and inactivity being 0.6 ppts lower

Note: there is greater uncertainty than normal about employment data: the Labour Force Survey (LFS), our main source of labour market data, is [inconsistent]() with other sources

Notes: The outturn data points for May-Jul 2023 and Jun-Aug 2023 use the adjusted series the ONS published in October 2023.
Source: RF analysis of ONS, Labour market statistics; ONS, Adjusted employment, unemployment, and economic inactivity; OBR, Economic and Fiscal Outlook, March 2023.

Wages are coming in stronger than expected…

Average earnings index (Q1 2008 = 100), outturn and OBR forecast: UK



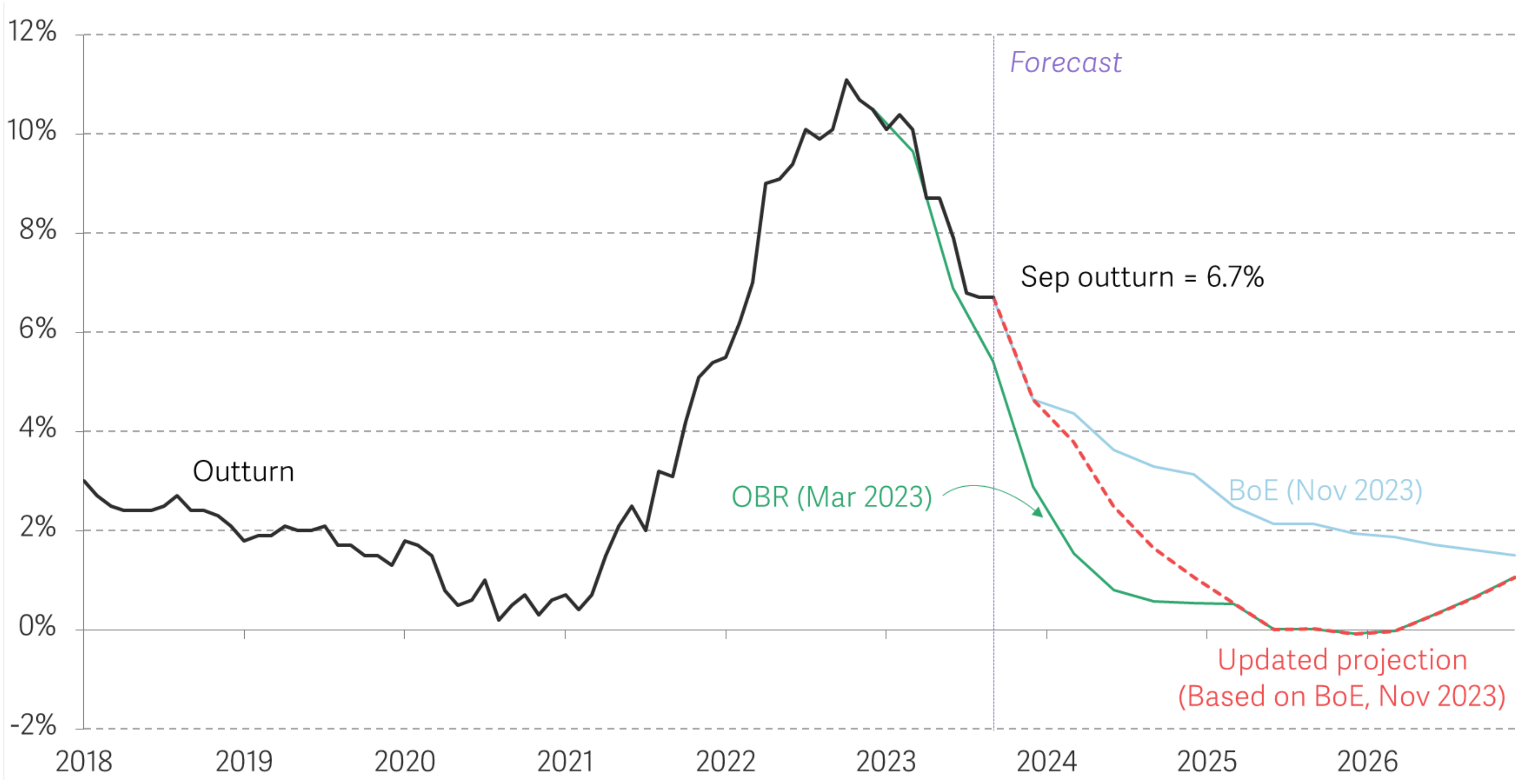
Wages grew by 8.2% in the year to Q2 2023, compared to the OBR's March forecast of 6.2%

The Chancellor has already announced that the NLW will rise to 'over £11' but we estimate the final rate will be around £11.46 when it is confirmed at the Autumn Statement

Source: RF analysis of OBR, Economic and Fiscal Outlook, March 2023; ONS, Quarterly National Accounts.

...and so are prices. Inflation falls are slower than expected

CPI inflation, outturns and Bank of England and OBR forecasts: UK



Source: RF analysis of ONS, Consumer price inflation; Bank of England, Monetary Policy Report, various; OBR, Economic and Fiscal Outlook, March 2023.

The OBR had expected inflation to fall back more sharply than it has to date

This could leave the OBR revising up the price level in end-2025 by around 3% cent

Partly as a result, interest rates are up

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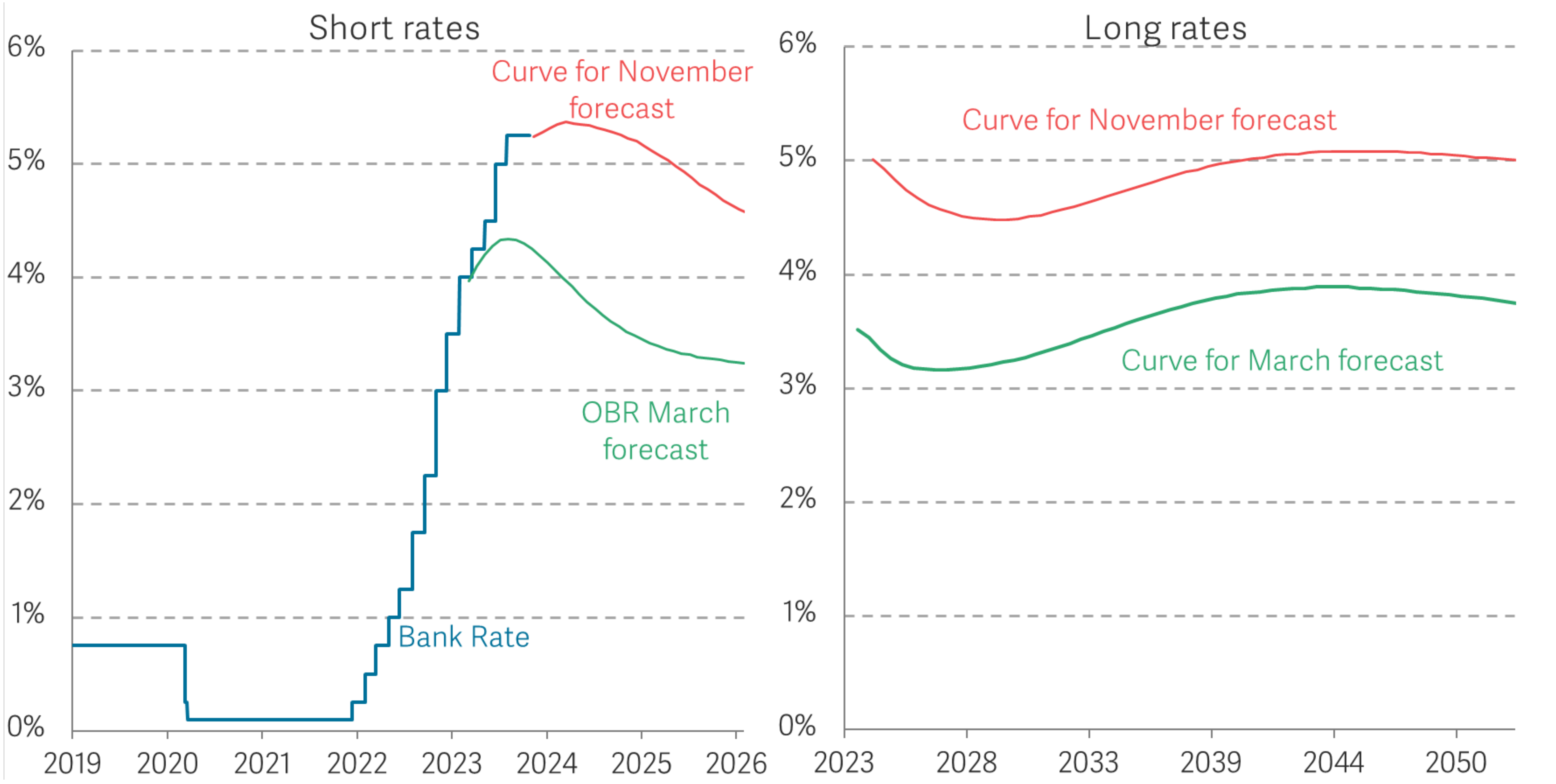
Bank Rate and overnight index swap forward curves (left panel) and gilt spot curve (right panel): UK



In March, policy rates were expected to peak at 4.25%...

...but higher inflation has meant the BoE has raised them to 5.25%

This has also fed through to around 1ppt higher long rates, which are key for government borrowing costs

Notes: The short rate curve is taken from the overnight index swap curve; long rates is the gilt spot curve.
Source: RF analysis of Bank of England, Official Bank Rate History Data from 1694 & Yield Curves.

Higher interest rates have slowed the economy and the labour market has turned

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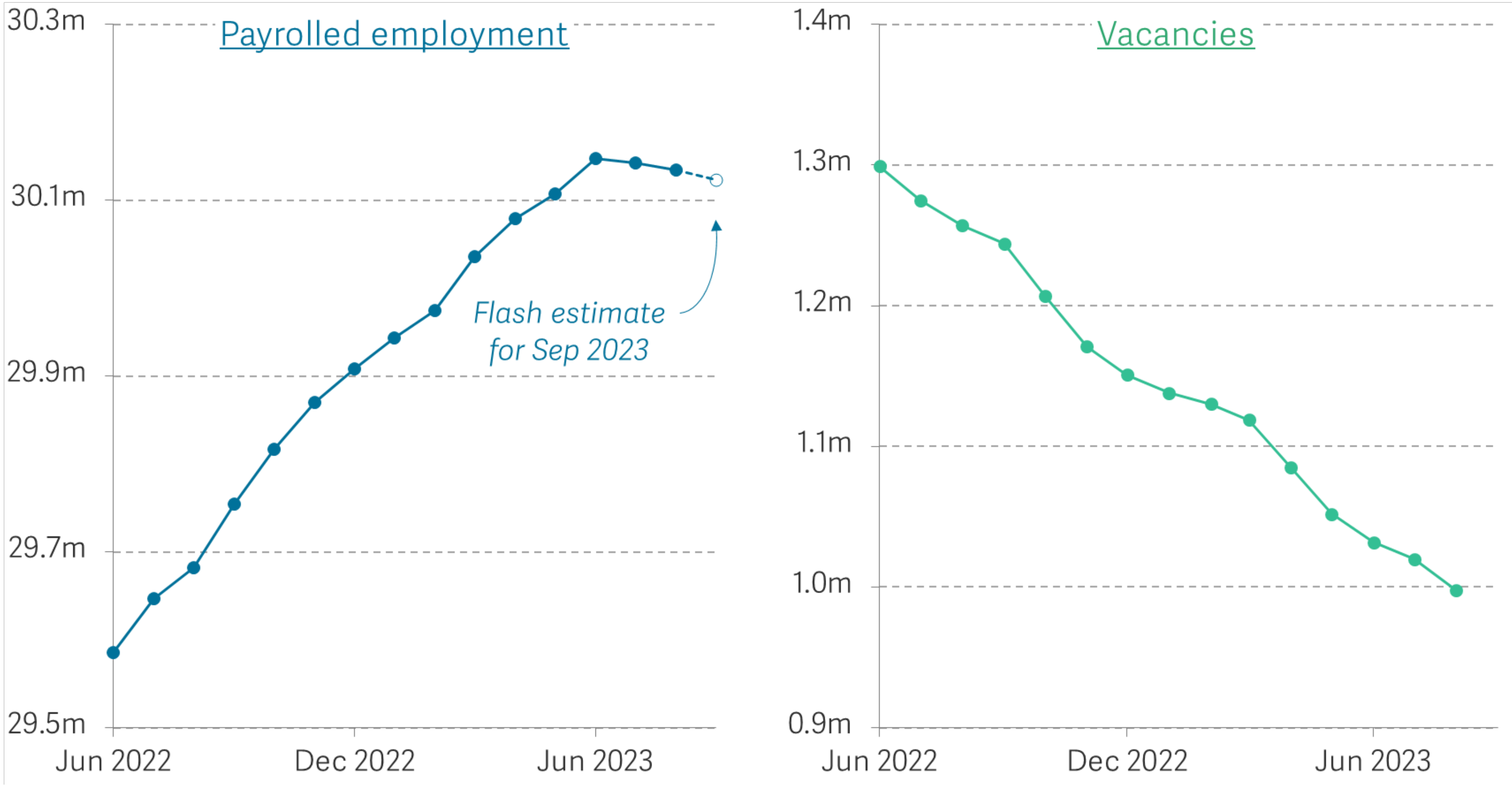
Number of paid employees (left-hand panel) and number of vacancies (right-hand panel): UK



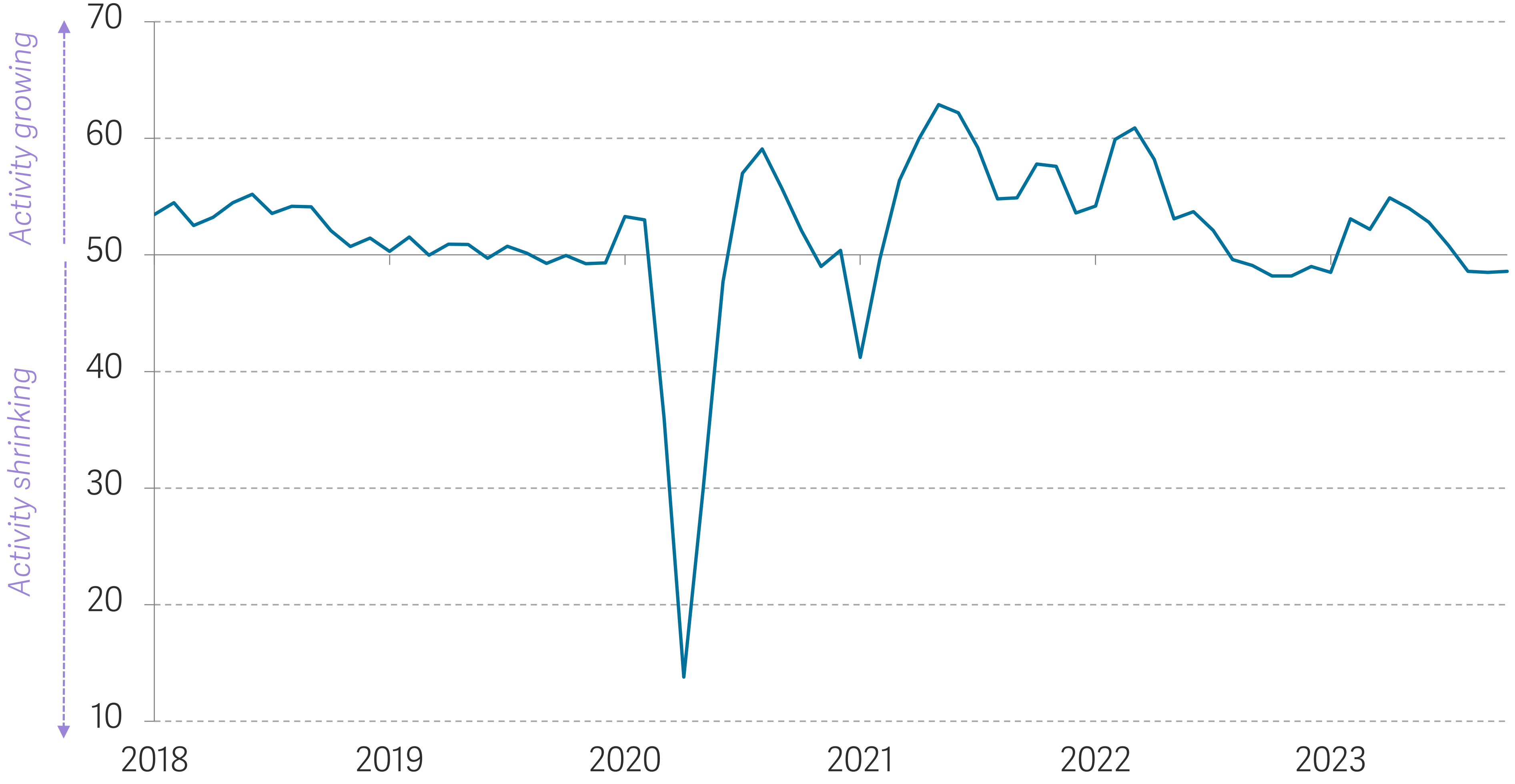
There are signs that the labour market has turned: payrolled employment has stopped rising and vacancies are continuing to fall back from their post-pandemic peak

But given data issues, there's uncertainty about how quickly that's happening

Notes: Both series are seasonally adjusted. Latest datapoint is September 2023 for the payrolled employment series and August 2023 for the vacancies series. The September 2023 payrolled employment figure is a flash estimate and likely to be revised when more data becomes available.
Source: ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted; ONS, Vacancies and unemployment.

Real-time growth indicators are in recessionary territory…

Composite Purchasing Managers Index (50 = no change on previous month): UK



UK Purchasing Managers Index is consistent with GDP falling by 0.2% in both September and October

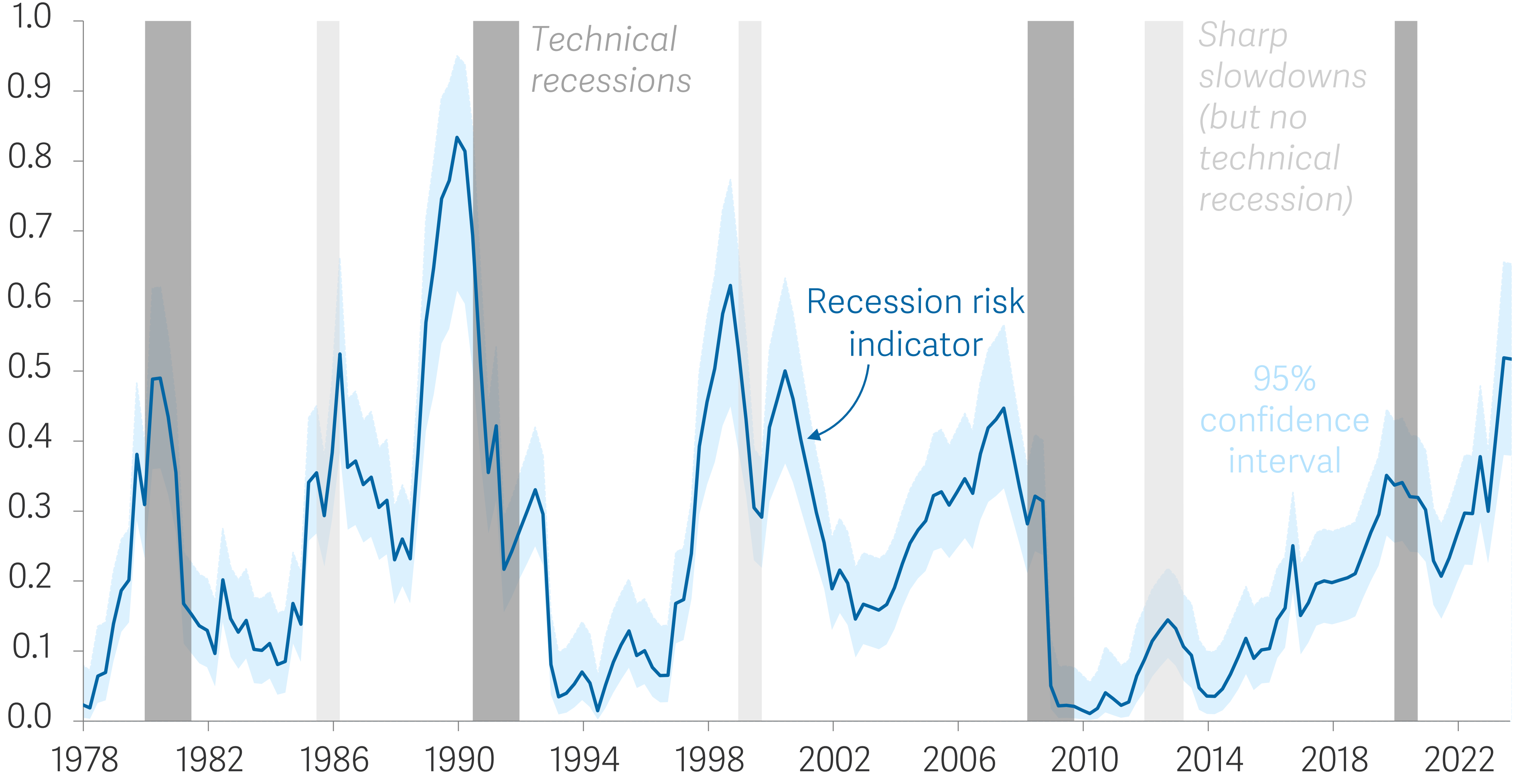
This suggests the UK economy is stagnating or is in recessionary territory

GDP growth will likely be revised up for 2023, but down for 2024

Source: IHS Markit / CIPS

…and a financial market recession risk indicator is high

Estimated probability of recession within three years, based on the slope of government yield curve: UK



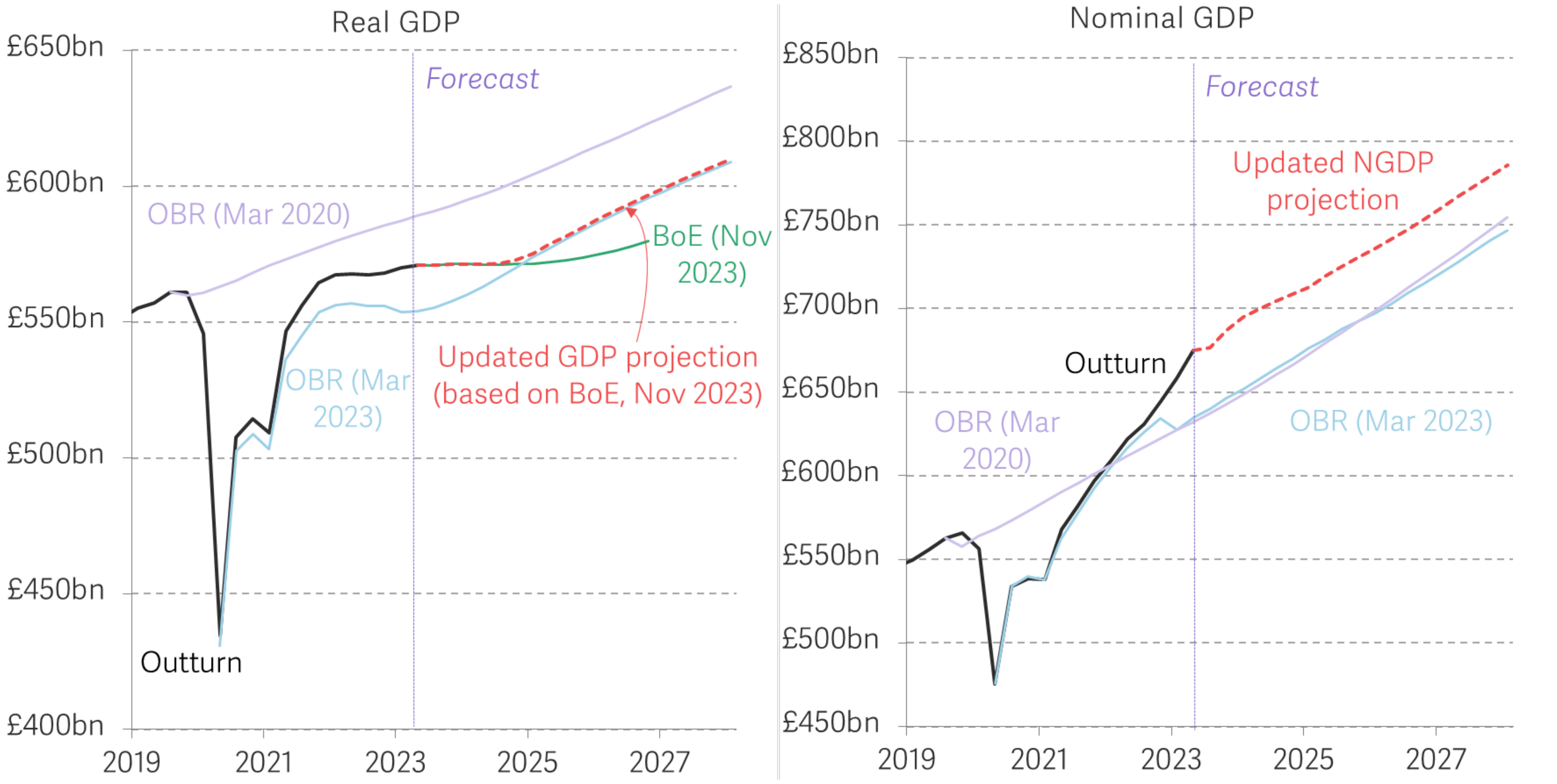
The term structure of interest rates has historically been a warning indicator of recessions…

…and that warning indicator is currently higher than before the financial crisis

Notes: Technical recessions are defined as at least two successive quarters of negative growth; slowdowns are defined as a sharp slowdown in quarterly growth to below 0.1 per cent outside of a recession (more than a year and a half away from the start or end of a recession). Predicted recession probability taken from a simple univariate probit model of the probability of a recession in the following three years, driven by the slope of the yield curve between two and five years ahead.
Source: RF analysis of ONS, National Accounts; Bank of England, Yield Curve Data.

The result: a bigger economy in nominal, but not necessarily real, terms

Real GDP (left panel) and nominal GDP (right panel), outturns and Bank of England and OBR forecasts: UK



Despite a stronger 2023, OBR is likely to mark down real GDP growth in 2024 and 2025, leaving the size of the real economy largely unchanged

But nominal GDP –key for tax revenues – will remain significantly higher on the back of stronger wage growth and inflation

Notes: All measures are rebased and re-referenced to 2019.
Source: RF analysis of ONS, National Accounts; Bank of England, Monetary Policy Report, various; OBR, Economic and Fiscal Outlook, November 2022.

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Higher inflation will drive up tax revenues, only partially offset by higher debt interest

It may look like the Chancellor has more fiscal wiggle room…

Higher nominal GDP has already boosted tax revenues this year

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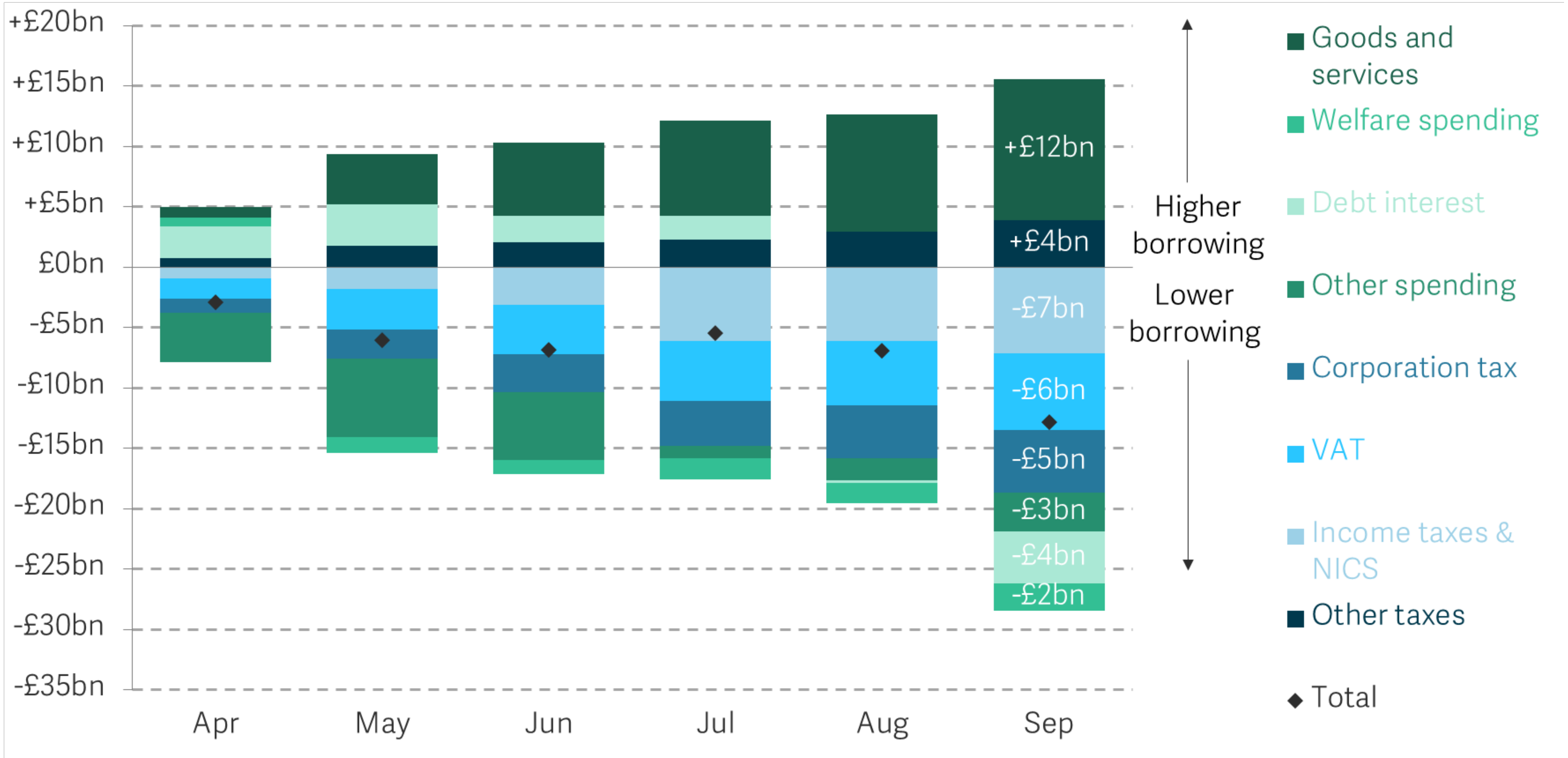
Central government net borrowing, difference from OBR forecast for the year to date: April – September 2023



Higher inflation than expected has left tax receipts (in blue) around **£15 billion higher** than expected over the first six months of this year

We expect tax receipts to remain higher in the medium term, reflecting a bigger economy in nominal terms

Source: RF analysis of ONS, OBR

Higher rates mean higher government debt interest costs

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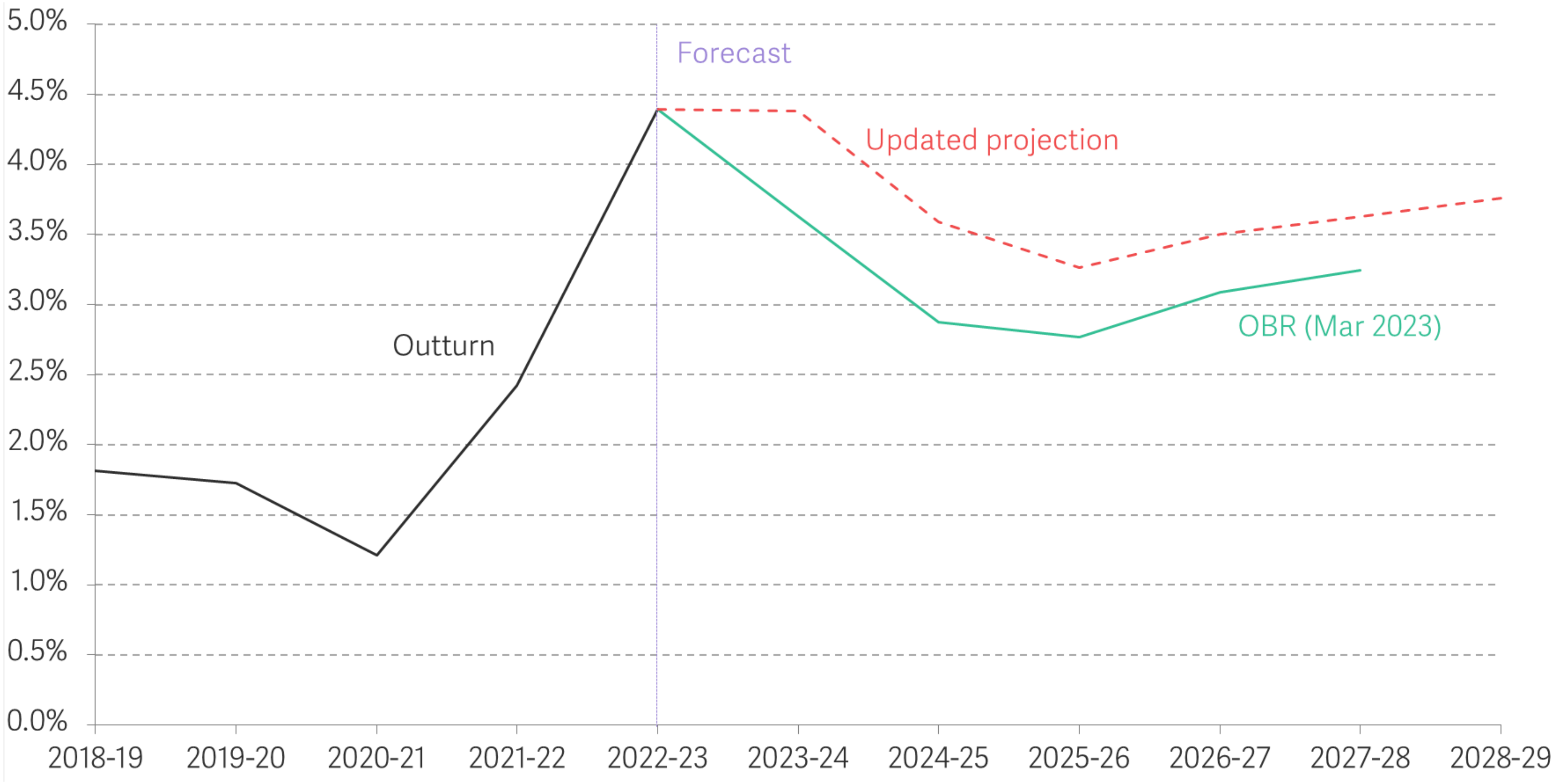
Central government debt interest (net of APF) as a proportion of GDP, outturn and forecast



Adjusting to the latest market expectations for interest rates would mean annual debt-interest costs are £16bn higher than forecast in March by 2027-28

Note: The NGDP denominator used for the OBR's March 2023 forecast is adjusted to reflect ONS Blue Book revisions.
Source: RF analysis of OBR.

The fiscal forecasts are likely to improve with higher tax revenues outweighing higher debt interest costs

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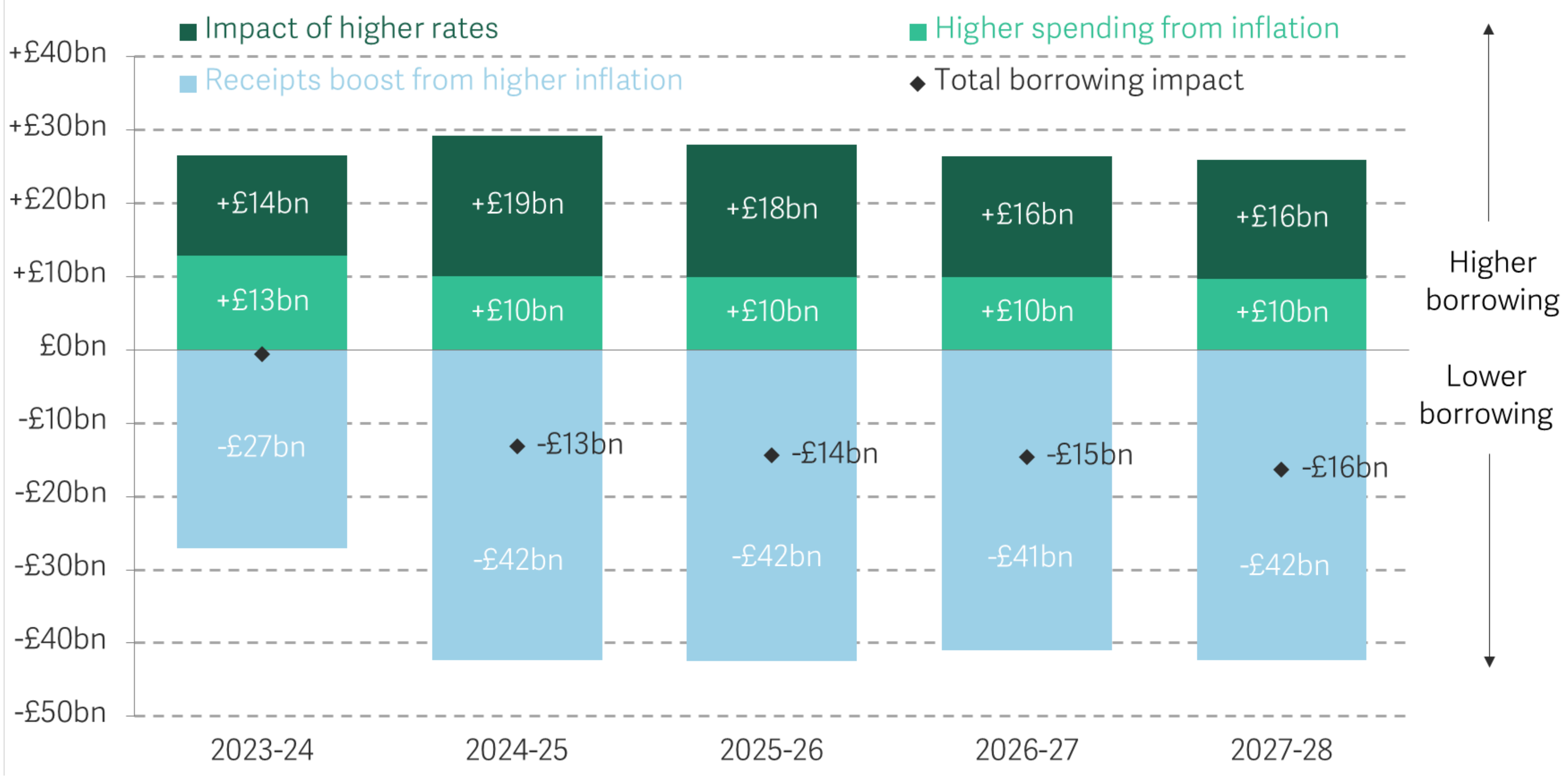
Impact of revised forecast on public sector borrowing, £ billion: 2023-24 to 2027-28



Inflation increases welfare spending and debt interest but increases tax revenues

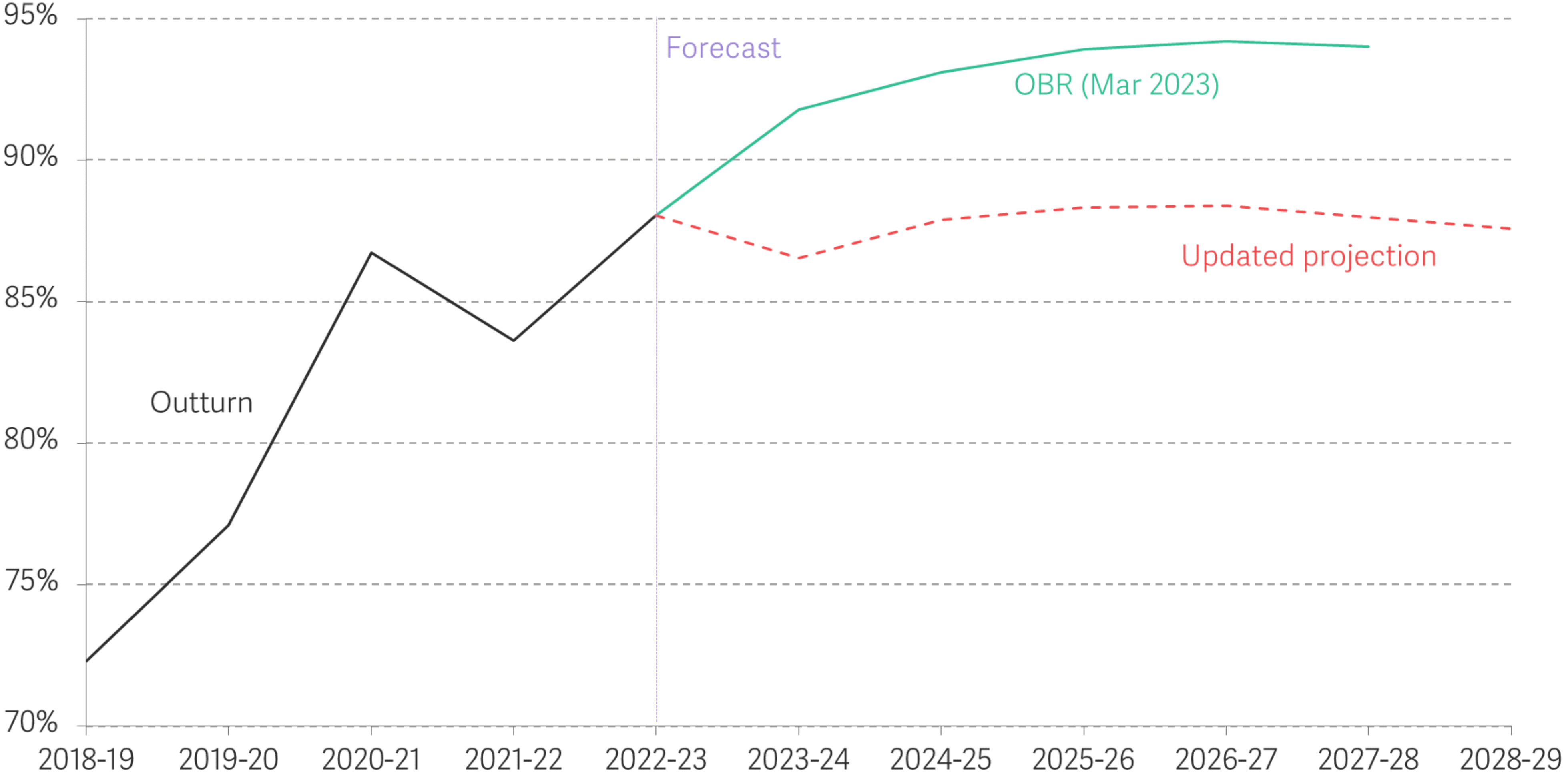
A larger economy in cash terms leaves tax receipts up by around £40bn

Based on this, a plausible central case is that borrowing is around **£16bn** lower than the OBR's March forecast by 2027-28

Source: RF analysis of OBR.

This leaves debt lower than forecast and the Chancellor with slightly more fiscal headroom

Public sector net debt ex. Bank of England as a proportion of GDP, outturn and forecast



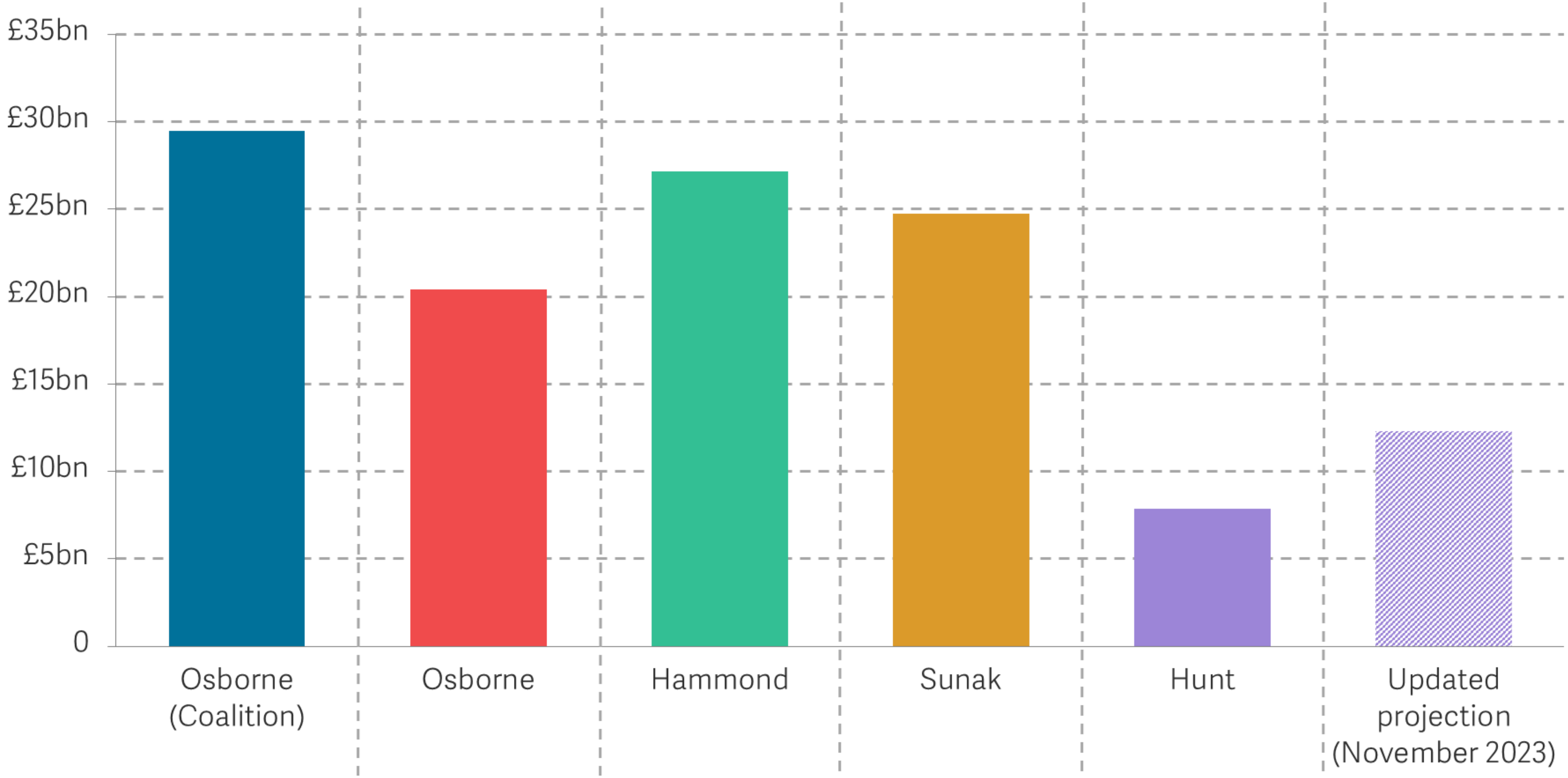
In our central case, headroom in 2027-28 would be **£13bn** (+£6.5bn compared to March)

…and around £13bn for 2028-29 assuming the same trends continue into the final year of the forecast

Note: The NGDP denominator used for the OBR's March 2023 forecast is here adjusted to reflect ONS Blue Book revisions.
Source: RF analysis of OBR.

Headroom is up but remains low by historical standards

Average forecast headroom against their respective fiscal rules by Chancellor, and projected November 2023 forecast headroom



£13bn of headroom would still be small by historical standards

Average headroom against fiscal rules since 2010 has been around **£25bn**

Notes: Average headrooms relate to the following past fiscal targets: 'Osborne (Coalition)' fiscal targets relate to balancing the cyclically-adjusted current deficit in three years; 'Osborne' relates to balancing public sector net borrowing in five years (original rule required this to be met in 2019-20, and then in each subsequent year); 'Hammond' relates to cyclically adjusted public sector net borrowing being less than 2 per cent of GDP in three years (rule referred to a fixed target year while it was in place, so comparison uses the average time left to reach the rule over the term it applied); 'Sunak' relates to public sector net debt (excluding the Bank of England) falling as a proportion of GDP in three years. Projected headroom is here presented as a percentage of GDP, multiplied by March 2023 NGDP in 2027-28 for comparability with the historical figures.
Source: OBR, Economic and Fiscal Outlook, various.

…but this extra fiscal headroom is an illusion.

It assumes higher inflation increases taxes but does not drive up public service spending

Inflation, wages and tax revenues are up. But we're pretending public service spending will not follow

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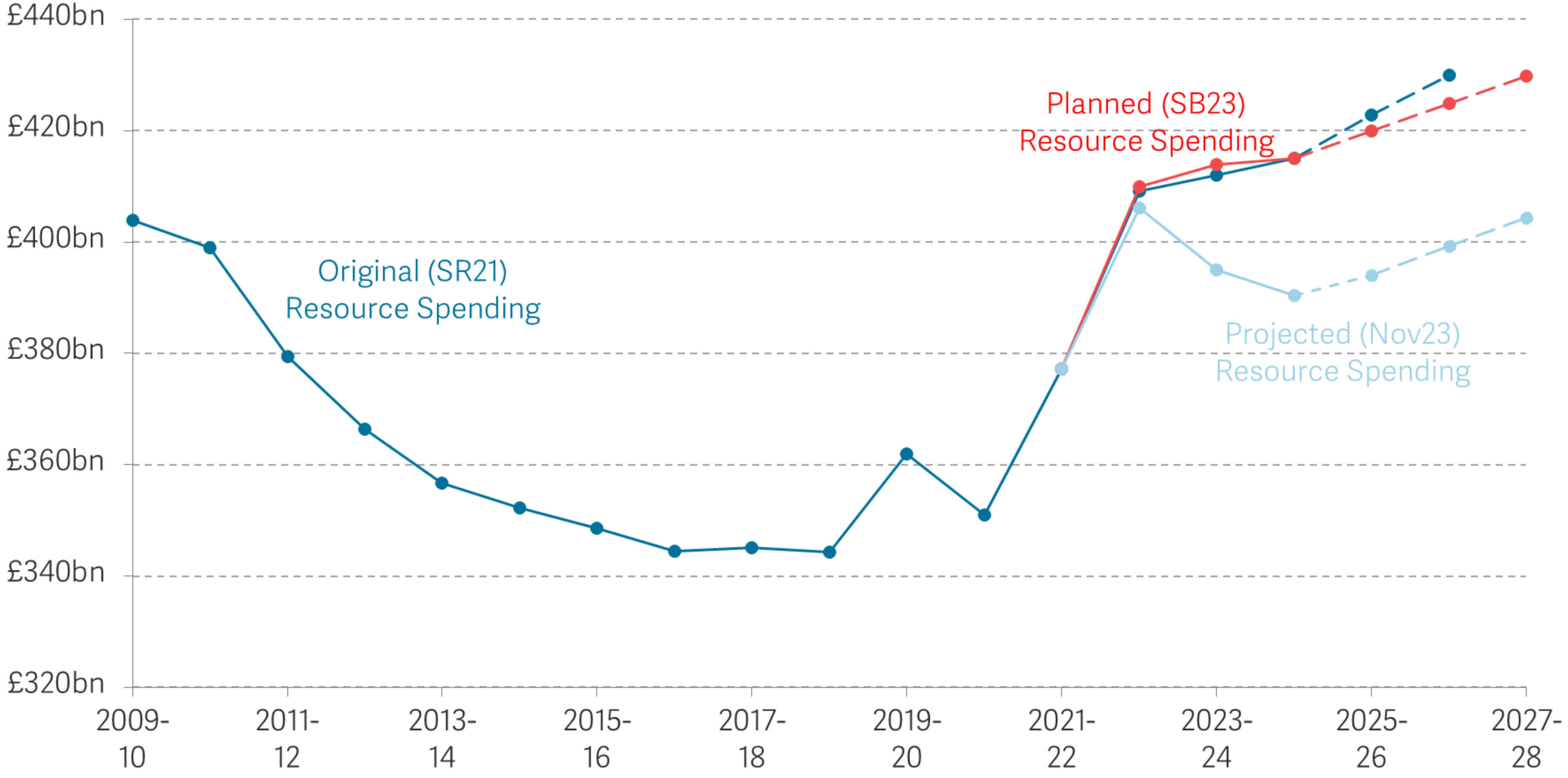
Real RDEL excluding depreciation outturn and plans: UK



Economy-wide (GDP deflator) prices set to rise by 14% between 2022-23 and 2027-28, compared with only 8% in the OBR's March forecast

RDEL budgets for 2023-24 are already **£19bn** lower in real terms than SR21 projections

Notes: Original (SR21) RDELx is deflated using the OBR GDP deflator forecast March 2022, RDELx SB23 is deflated using the OBR GDP deflator forecast of March 2023, RDELx Nov23 is deflated using Bank of England GDP deflator forecast of November 2023. All values are in 21-22 cash figures.
Source: RF analysis of Bank of England, Monetary Policy Report; HM Treasury, Budget and Spending Review documents, various; OBR, Economic and Fiscal Outlook, various.

Pressure on public spending from a rising wage bill is large, and currently being ignored

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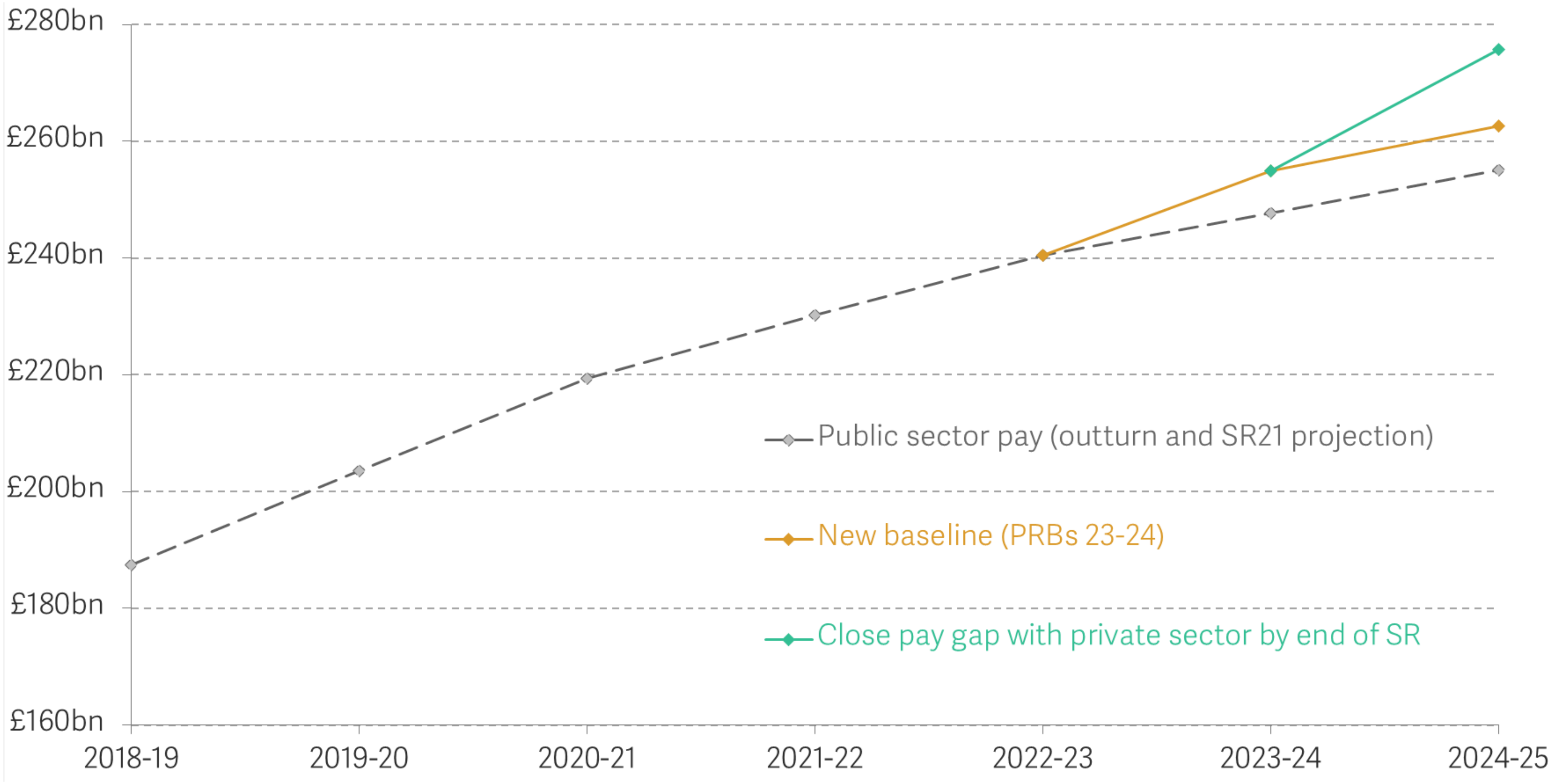
Nominal public sector spending on staff costs: outturn and forecast



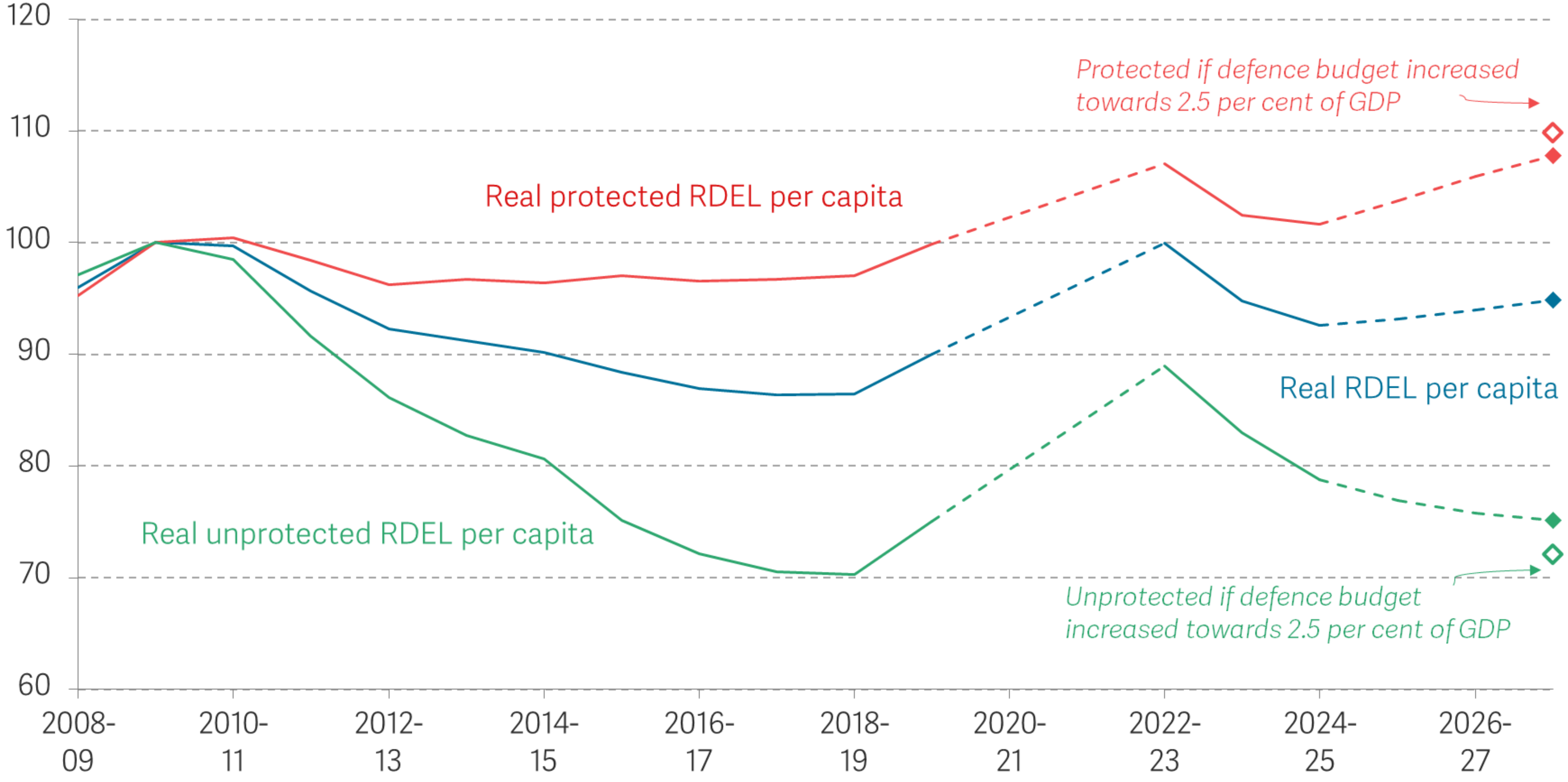
Spending Review 2021 is completely out-of-date on public sector pay

Government needs to spend an extra **£15bn** to meet pay promises (yellow line) with a further **£13bn** (green line) to close pay growth gap with the private sector by 2024-25

Source: RF analysis of HM Treasury, Public Spending Statistics, Budget and Spending Review documents, various; ONS, Average Weekly Earnings.

Scale of cuts pencilled in are undeliverable – a fiscal fiction

Indices of real (government expenditure deflator-adjusted) per-capita resource departmental expenditure limits (2009-10=100), all departments, 'unprotected' departments and 'protected' departments



Unprotected departments' spending power is set to be cut by **16%** between 2022-23 and 2027-28, even larger than the 11% at the time of the March Budget

Spending cuts are similar in pace to those overseen by George Osborne in the early 2010s

Notes: Deflated using the Bank of England forecast for the GDP deflator to 2022-23 cash terms. Protected budgets include health, education, defence and foreign, commonwealth and development office.
Source: RF analysis of Bank of England, Monetary Policy Report; OBR, Economic and Fiscal Outlook, various; HM Treasury, Budget and Spending Review documents, various.

There is less scope for public sector productivity rises riding to the rescue than previously thought

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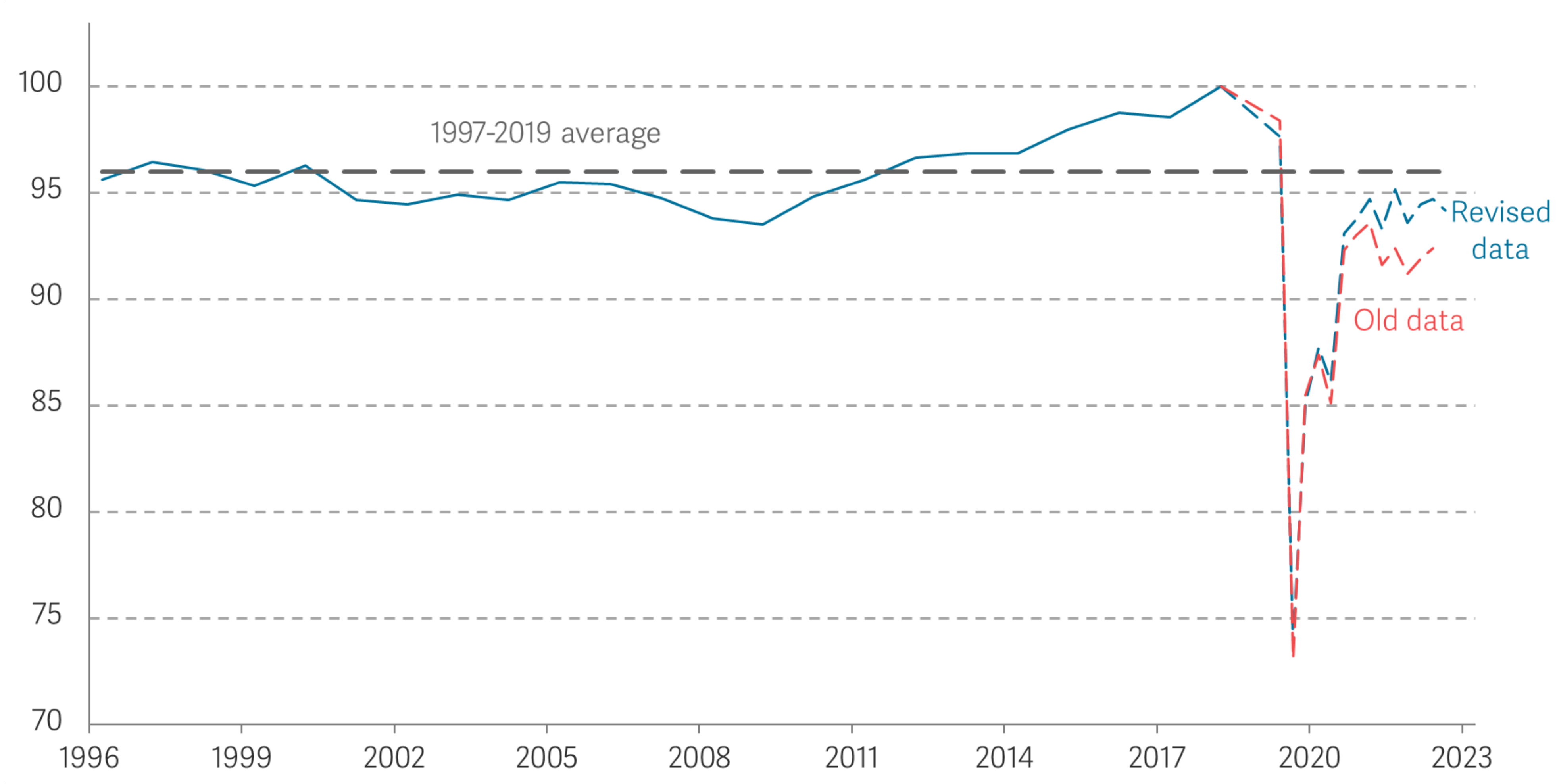
Public services productivity (2019=100): UK



Old data suggested massive scope to increase public sector productivity to ease spending pressure

But, on the latest data, a return to the 1997-2019 trend would only be the equivalent of a around **£3bn** more for unprotected departments

Source: RF analysis of ONS, Public Services Productivity.

The tax forecast contains some fiction too

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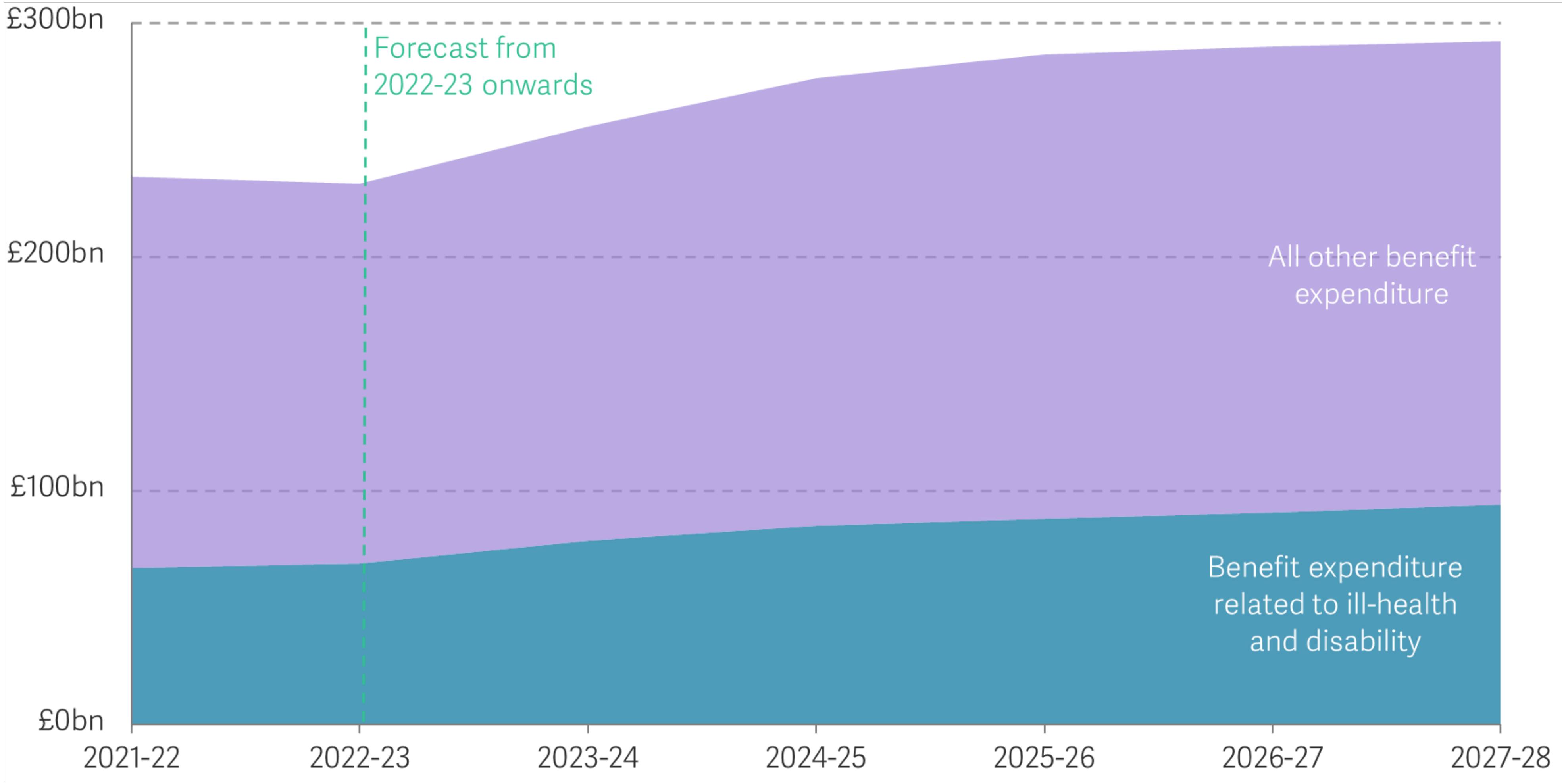
- If Fuel Duty doesn't rise by 5p next March, plus RPI each year, that would cost £4bn in 2027-28
  - The Government may be tempted to temporarily extend the 5p discount again, avoiding this pre-election tax rise but – on paper – not permanently increasing borrowing
- Corporation Tax full expensing will currently end in 2026, but the Government would like to make this permanent at a cost of £9bn per year (which would decline over time)
- The Stamp Duty threshold is due to halve in March 2025; cancelling this would cost £1.6bn per year
- Business rate cuts were announced in 2020, 2021 and 2022. In 2024, rates are due to rise by 6.7% and temporary support will expire

Benefit cuts are coming – but there's a key decision about how big they are

The Government is worried about the rising welfare bill, particularly increasing ill-health and disability

Total welfare spending, outturn and forecast, in 2023-24 prices: UK



Benefit expenditure related to ill-health and disability is set to be 40% higher in real terms in 2027-28 than in 2021-22

Source: RF analysis of DWP, Benefit expenditure and caseload tables 2023.

It looks certain a cut to incapacity benefits will be confirmed

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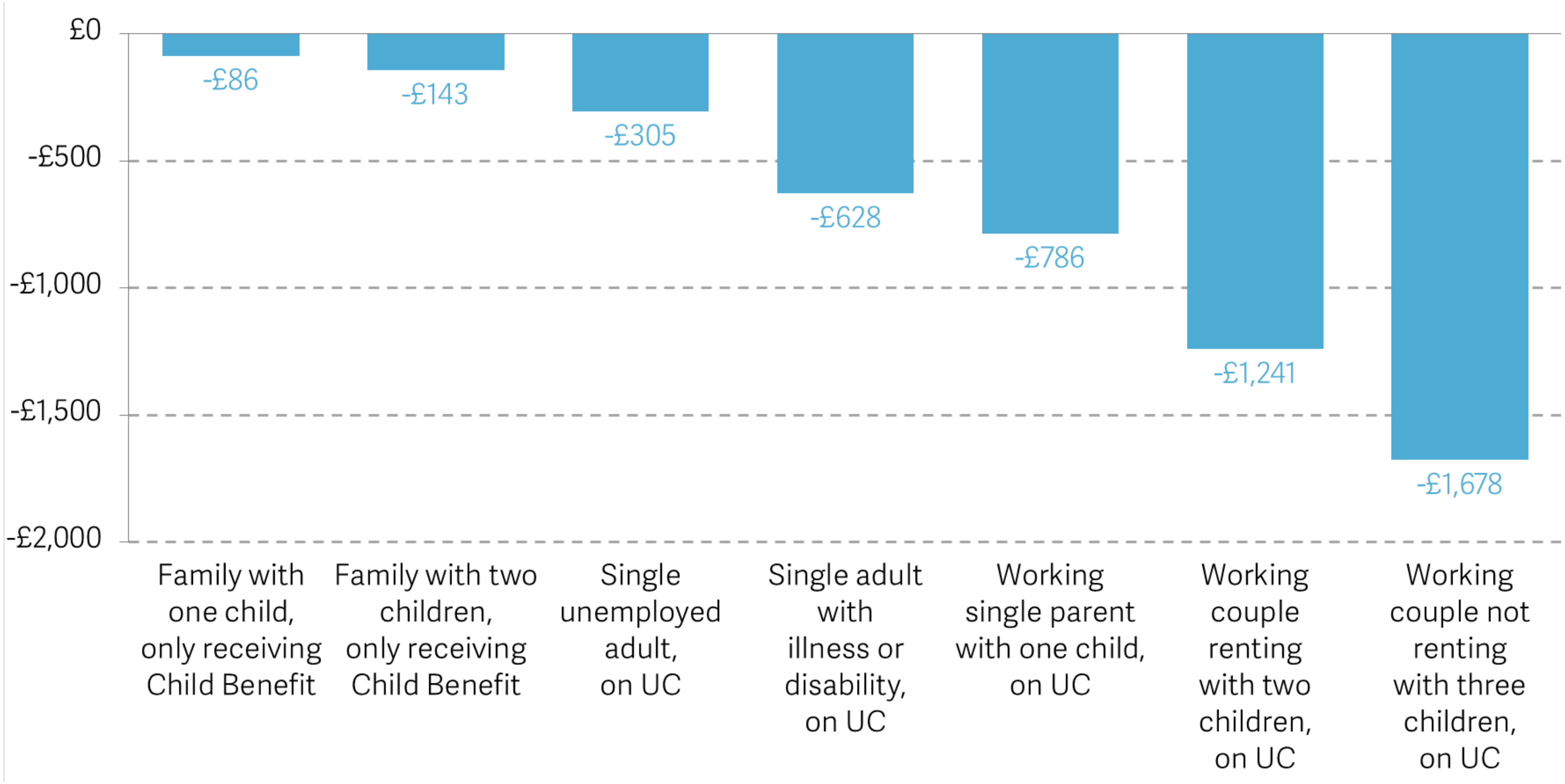
- The Government is consulting on changes to the Work Capability Assessment (WCA), with the conclusions expected to be announced by the Chancellor
- Exact details of the reforms, and how much they might save, remains unclear
- But Government is clearly looking to raise the bar for receiving the extra health-related component of UC, and to tighten conditionality for those receiving it
- Almost 2.8 million adults are at risk of losing support, three-quarters of whom are from the lower half of the income distribution
- This should gradually reduce welfare spending but will not be implemented until 2025 at the earliest
- In the longer-term, the Government has said it wants to scrap the WCA, but has given no details. In any case, this cannot happen until the end of the decade

It's not yet clear whether the Chancellor will allow working-age benefits to rise in line with inflation

Example losses to real annual income from freezing rather than uprating benefits in line with September CPI: UK, 2024-25



The Government has not confirmed whether it will uprate benefits in line with inflation in April…

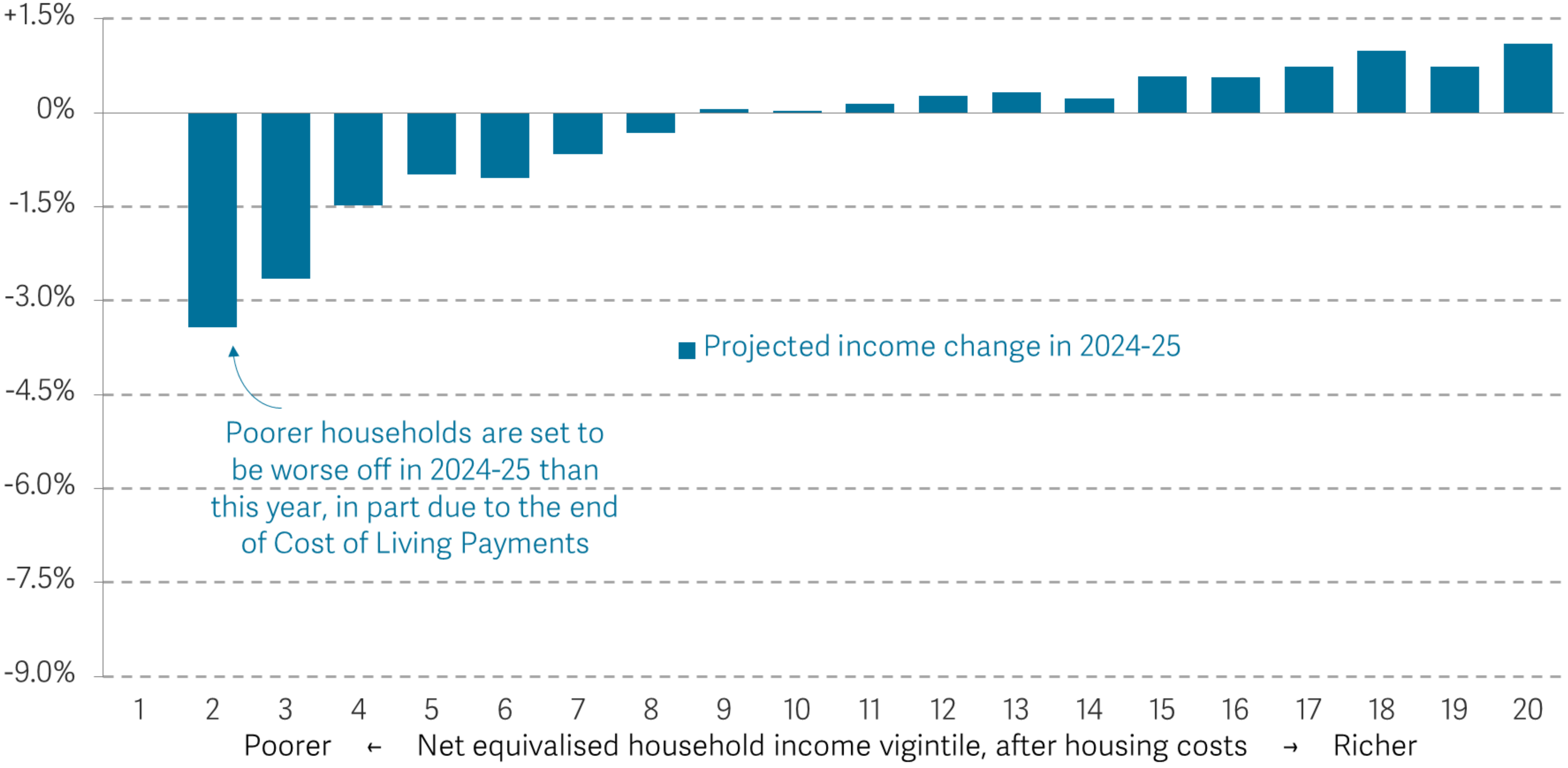
…following normal practice would mean a 6.7% increase in cash benefit levels

The Treasury would save up to £4.2bn from not uprating benefits

Notes: Assumes all 'unprotected' working-age benefits are frozen at 2023-24 nominal levels rather than uprated by 6.7 per cent. 'Unprotected benefits' are: Universal Credit (excluding housing element); contributory JSA and ESA; tax credits; non-contributory JSA and ESA; income support; bereavement benefits; Statutory Maternity and Paternity Pay; and Maternity Allowance. Single parent with one child in work is assumed to be renting, working at least 20 hours a week earning NLW, and have a child born after 6th April 2017. Working couple with two children is assumed to be renting, working at least 20 hours a week earning NLW, and have two children born after 6th April 2017. Working couple with three children is assumed to be renting, working at least 20 hours a week earning NLW are to have three children born before 6th April 2017. Source: RF analysis of DWP, HBAI using the IPPR Tax-Benefit Model.

Even if full uprating goes ahead, low-income households are set to see income falls as the Cost of Living payments stop

Real change in average equivalised non-pensioner household disposable income, after housing costs, by income vigintile: UK, 2024-25



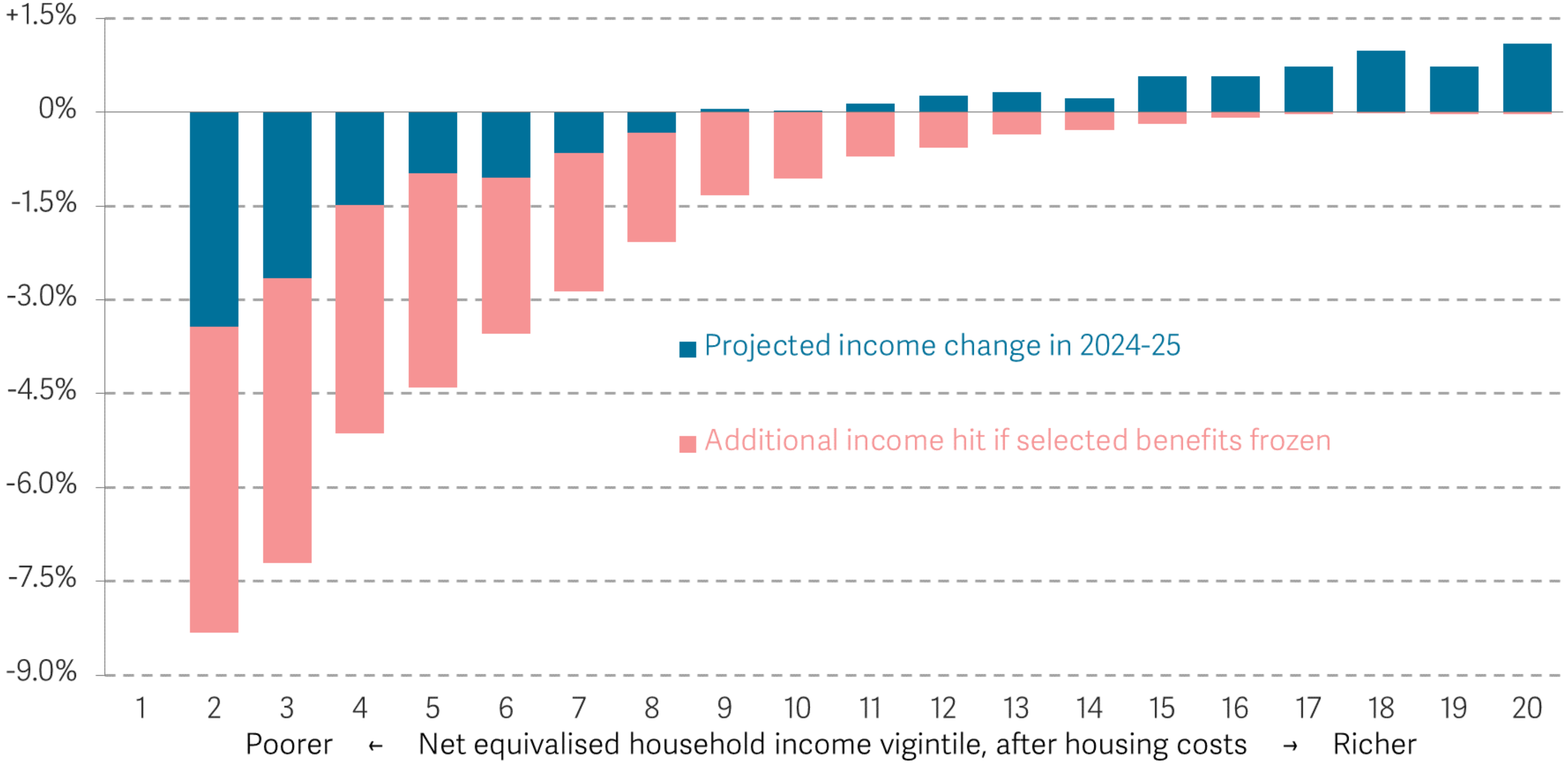
The outlook for the lower half of the non-pensioner population is already a difficult one, with income projected to fall by 1% in 2024-25

This implies an extra 300,000 people are projected to fall into absolute poverty

Notes: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
Source: RF analysis of DWP, Households Below Average Income using the IPPR Tax-Benefit Model.; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

Failing to uprate benefits would mean a far deeper squeeze

Real change in average equivalised non-pensioner household disposable income, after housing costs, by income vigintile: UK, 2024-25



Not uprating benefits in line with inflation would reduce the incomes of nine million households by an average of £470 per year

And push an additional 400,000 children into absolute poverty

Notes: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group. Based on 6.9% uprating value. See L Judge & L Murphy, Rates of change, Resolution Foundation, October 2023 for more details.
Source: RF analysis of DWP, Households Below Average Income using the IPPR Tax-Benefit Model.; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

Nearly 1/3 of households face higher energy bills this winter than last

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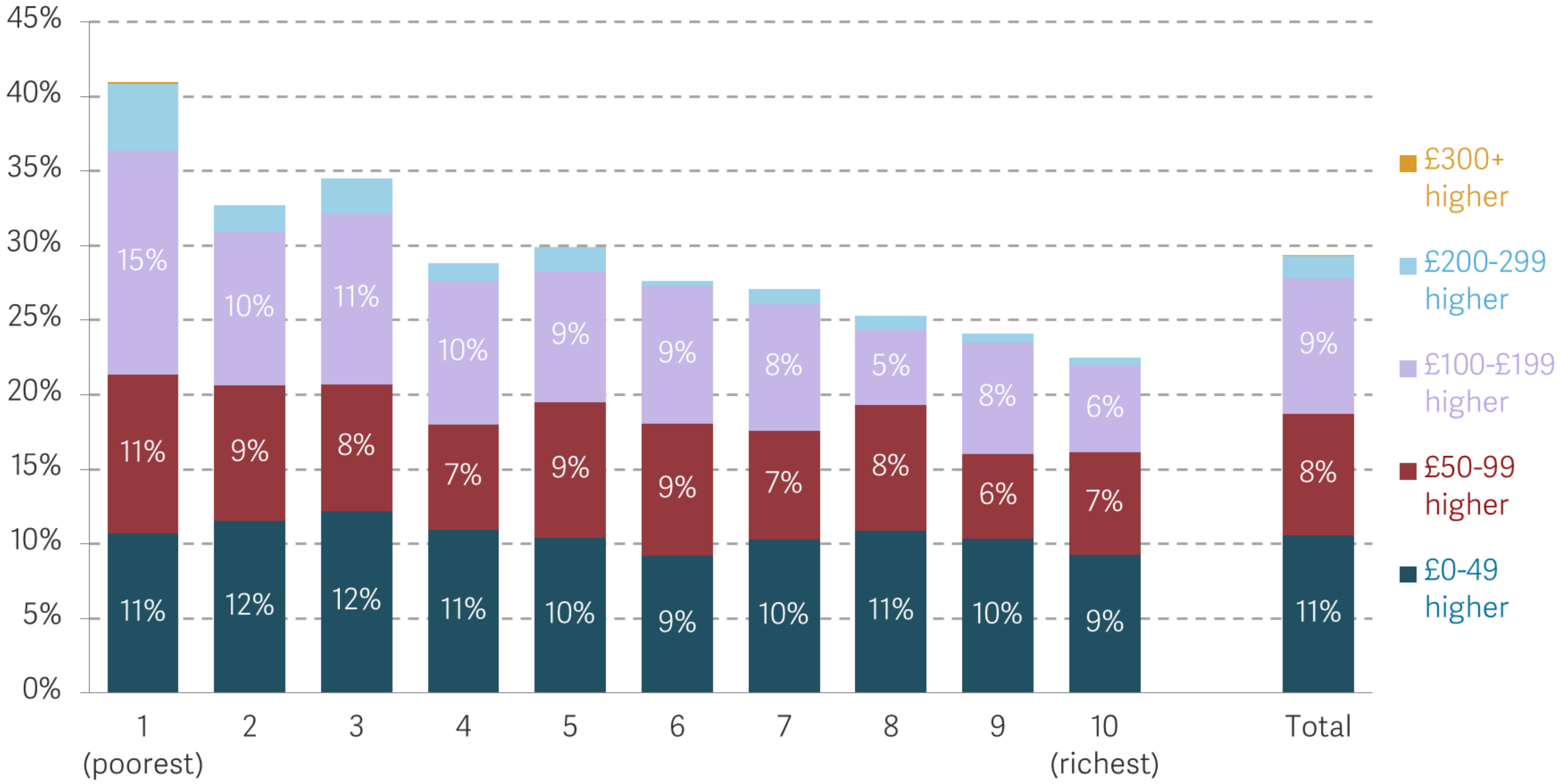
Share of households in each equivalised after housing costs income decile with higher expected energy bills in winter 2023-24 than in winter 2022-23, England



Reductions in energy bill support mean many households will face higher energy bills despite falls in the cost of energy

11% of families face energy bills rising by more than £100 this winter (20% for the poorest households)

Notes: Chart shows dual fuel households. English Housing Survey data on energy spending is disaggregated into unit prices and standing charges, and uprated in line with prices set through the Default Tariff Cap since October 2021. Update of figure from E Fry & J Marshall, Gotta get through this, Resolution Foundation, August 2023 using Cornwall Insight Q1 2024 price cap forecasts released 2 November 2023. Source: RF analysis of DLUHC English Housing Survey, Ofgem Default Tariff Cap, UCL Smart Energy Research Laboratory, Cornwall Insight, Department for Energy Security and Net Zero data.

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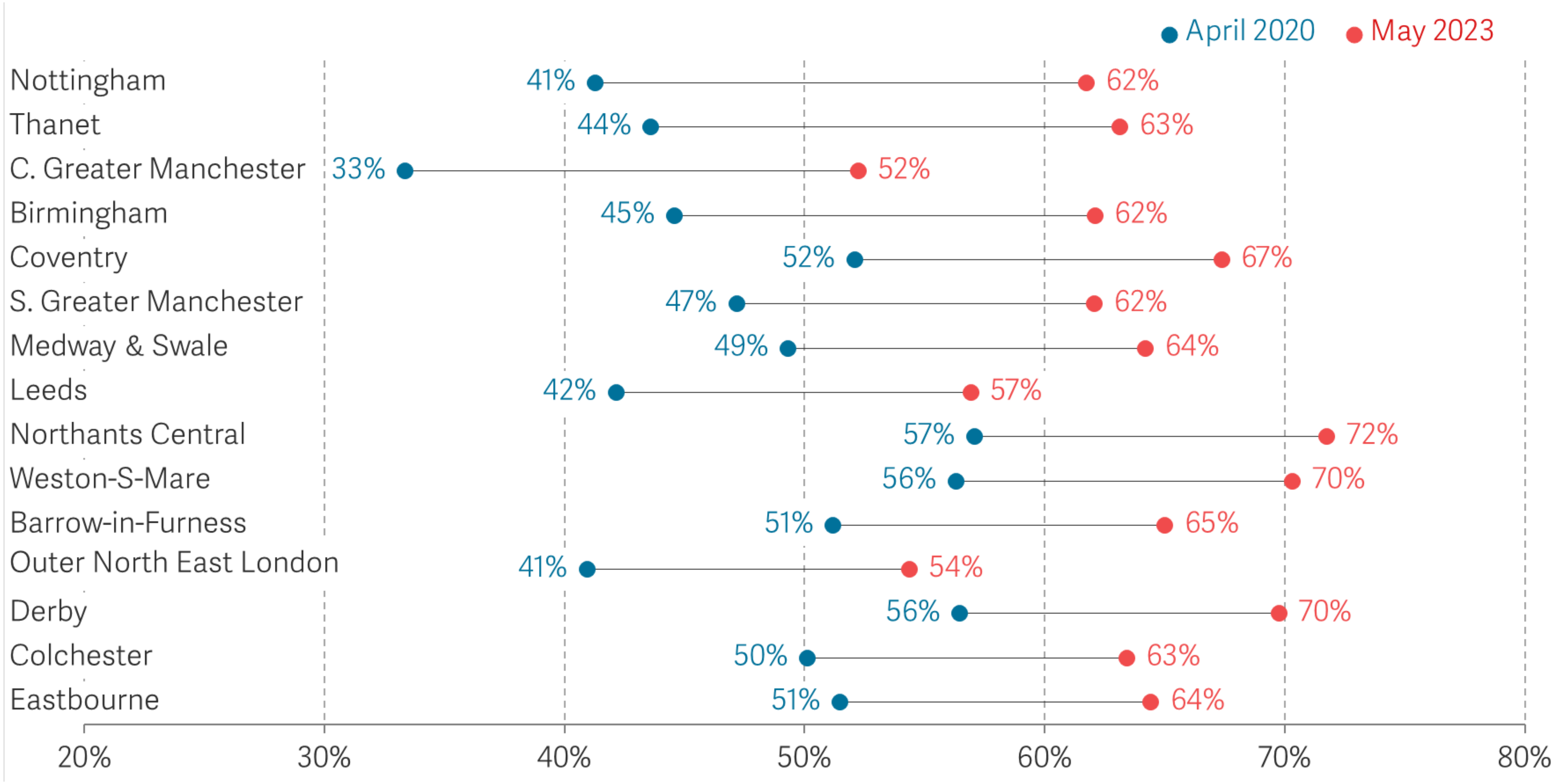
Meanwhile, Local Housing Allowance freezes continue to bite

Proportion of households on Universal Credit claiming LHA whose housing costs are not covered in full: top fifteen BRMAs by percentage point increase, April 2020 to May 2023,



Some local areas have seen a 20 percentage point increase in the proportion of households whose housing costs are not fully covered by their housing support

Source: RF analysis of DWP, Households Below Average Income.

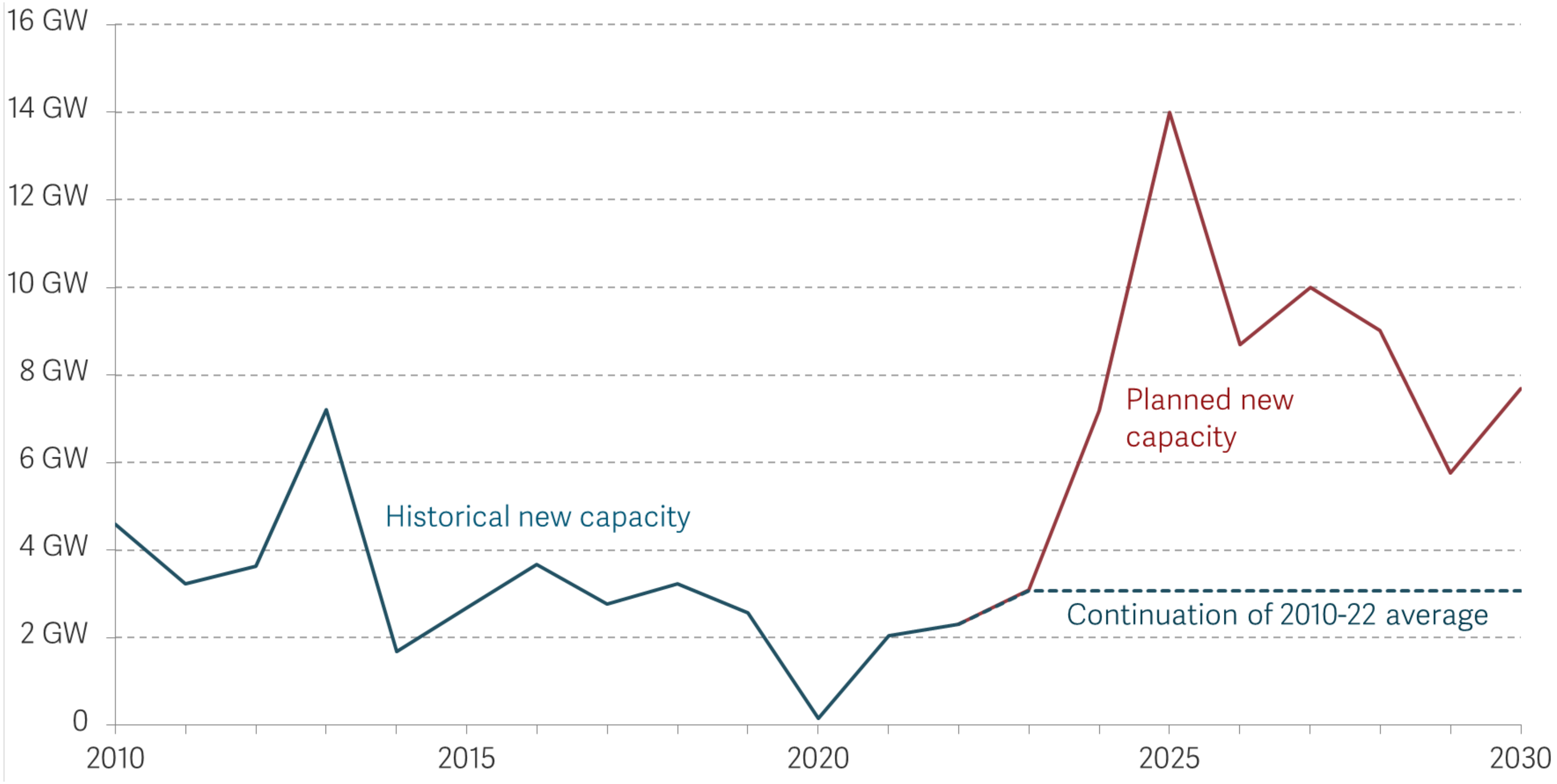
Expect wider policy announcements to be focused on growth

Investment-boosting reform of pension funds is likely

- Pension funds hold most of UK financial wealth. But DB funds have moved away from holding UK equities, and DC schemes are fragmented
- The Chancellor's 'Mansion House Reforms' aimed to remedy this by:
  - Consulting on consolidating local government pensions and increasing the share invested in private equity
  - Plans to legislate for 'superfunds' to consolidate small DB schemes
  - Calling for evidence on an expanded role for the Pension Protection Fund, which currently insures DB schemes and administers schemes of failed sponsors
- Watch for response to consultations and more detailed plans to boost business investment

Easing energy planning bottlenecks is also expected

Historical new electricity generation capacity and planned new generation and storage capacity, by commission date, GB



Reform is needed to ensure a planned surge in new electricity generation can be connected to the grid

The next 5 years will see as much capacity added as the total from 2010-22

Planning reform key to building individual projects and requisite network upgrades

Notes: Planned capacity includes thermal and renewable generation, storage and interconnection. Non de-rated capacities shown.
Source: RF analysis of DESNZ and BEIS data.

Decisions are also needed to put renewable energy progress back on track

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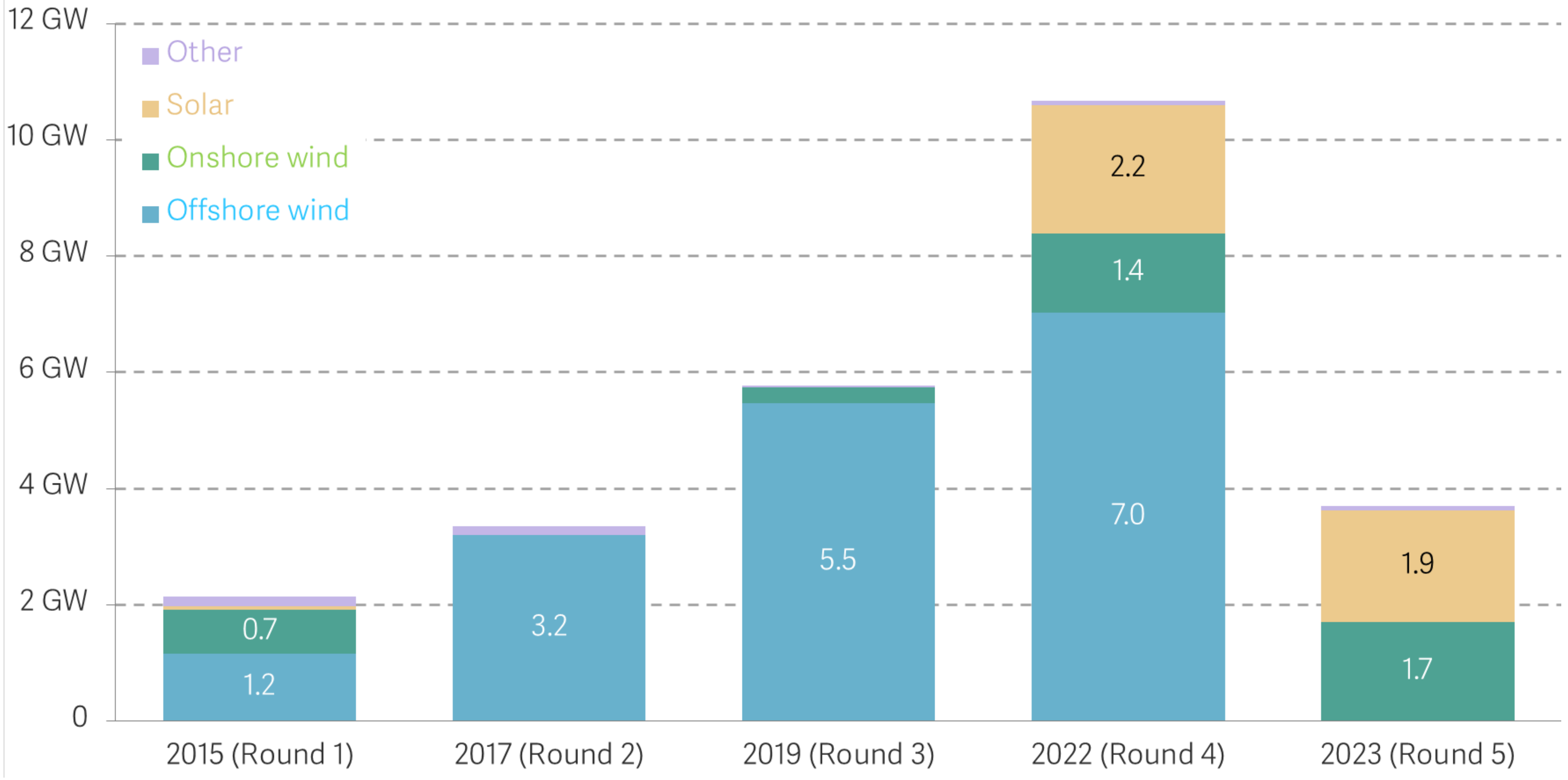
Renewable energy generation capacity awarded contracts in the UK Government's Contract for Difference auctions, by technology type and auction round, GB



Failure to procure any offshore wind in 2023 has put the Government's renewable energy targets under pressure

Parameters for the 2024 auction will need to balance a price that attracts investment, but does not push up energy bills

Notes: Other = tidal stream, biomass and energy from waste. Remote island wind is classed as onshore wind and floating offshore wind as offshore wind.
Source: RF analysis of DECC, BEIS and DESNZ CfD allocation round 1-5 results.

Resolution Foundation

Preparing the pitch

Autumn Statement 2023 preview

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