The Election Budget:

Spring Budget 2024 preview

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Summary:

The outlook for the economy is likely to be little changed

- Growth has surprised to the downside as the economy has slipped into recession
- Inflation has also been weaker than expected, driving lower interest-rate expectations
- But in future years faster population growth will push the other way

Lower rates and a bigger population provide around £10bn more fiscal headroom

Expectations are for personal tax cuts:

- Fuel duty rises will be scrapped and cuts to personal taxes are expected
- 1p off the basic rate of Income Tax costs £7bn but cutting tax rates while freezing the personal allowance is a transfer from low to high earners – those earning under £38,000 will lose out

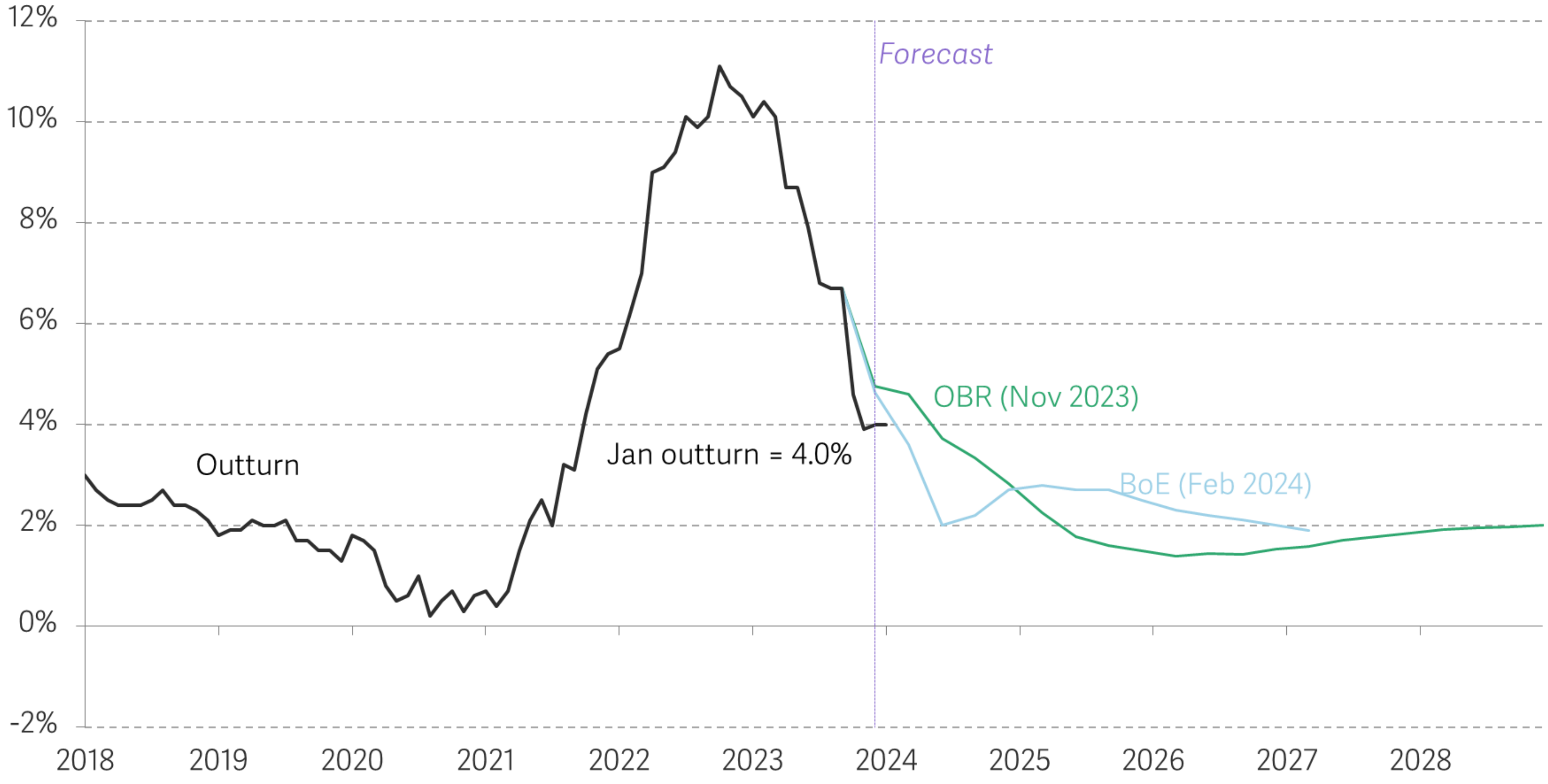
Britain is being offered a 'tax-raising sandwich', not tax cuts:

- Tax rises of around £20 billion were introduced in 2023-24, including freezing personal tax thresholds and increasing Corporation Tax
- Highly unusually the Government has also pre-announced post-election tax rises of £17 billion
- Past electoral experience and undeliverable spending plans mean further rises could be to come
- Public finances forecasts based on 'fiscal fiction' of delivering 17 per cent cuts to real, per-capita spending in unprotected departments by 2028-29

Inflation has fallen faster and growth been weaker than expected

Inflation is falling faster than expected…

Outturn and forecasts for CPI inflation from the OBR and Bank of England: UK



Source: OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report, November 2023; ONS, Consumer Price Inflation.

Inflation was about 1ppt weaker than expected in January

The Bank of England has raised its medium-term inflation forecast given domestic price pressures

In the longer-term, faster population growth will provide a small boost to GDP…

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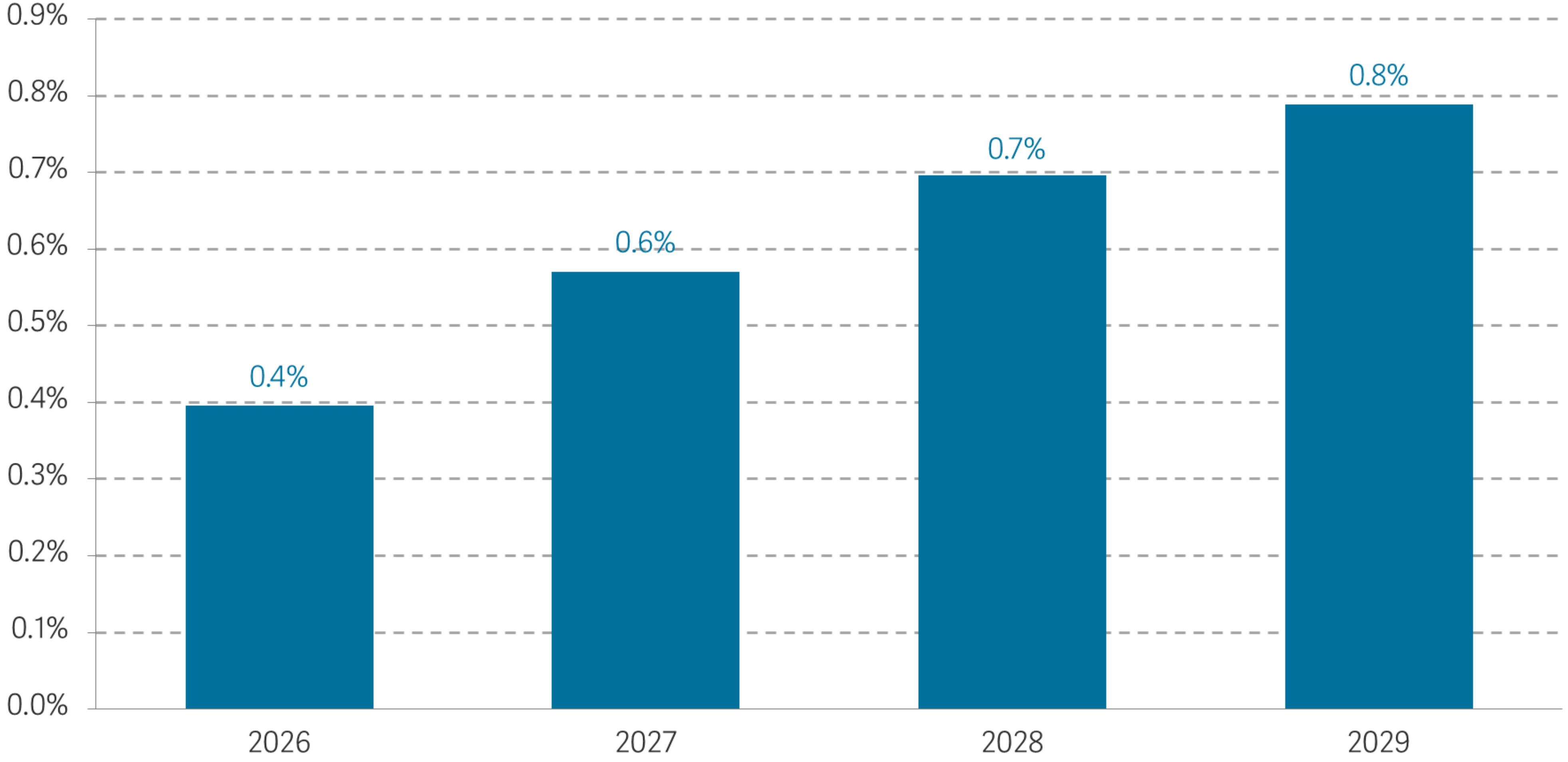
Illustrative impact of 2021-based population projections on potential GDP: UK

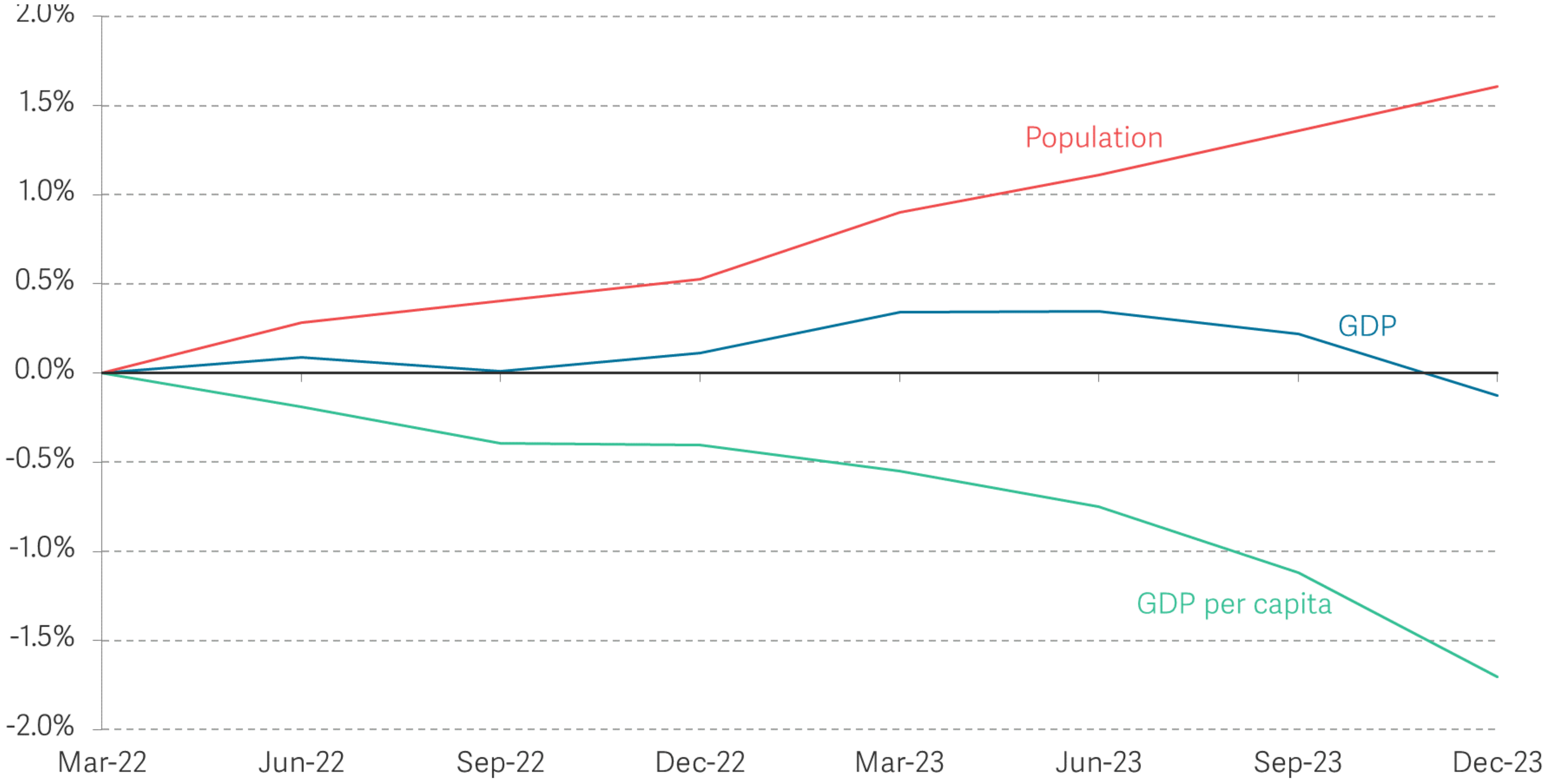


The ONS has raised its projection for longer-term net migration flows from 245k to 315k – mechanically this could boost potential output by nearly 1 per cent

Source: OBR, Economic and fiscal outlook - November 2023; ONS, National population projections: 2021-based interim.

…but in the near term we have fallen into recession

Growth in GDP, population and GDP per capita since Q1 2022: UK



Source: ONS, National Accounts.

GDP has surprised to the downside in the second half of 2023, unexpectedly falling into recession

Faster population growth means GDP per capita looks even worse – falling for an unprecedented 7 quarters in a row

The cash size of the economy is likely to be slightly larger than in November

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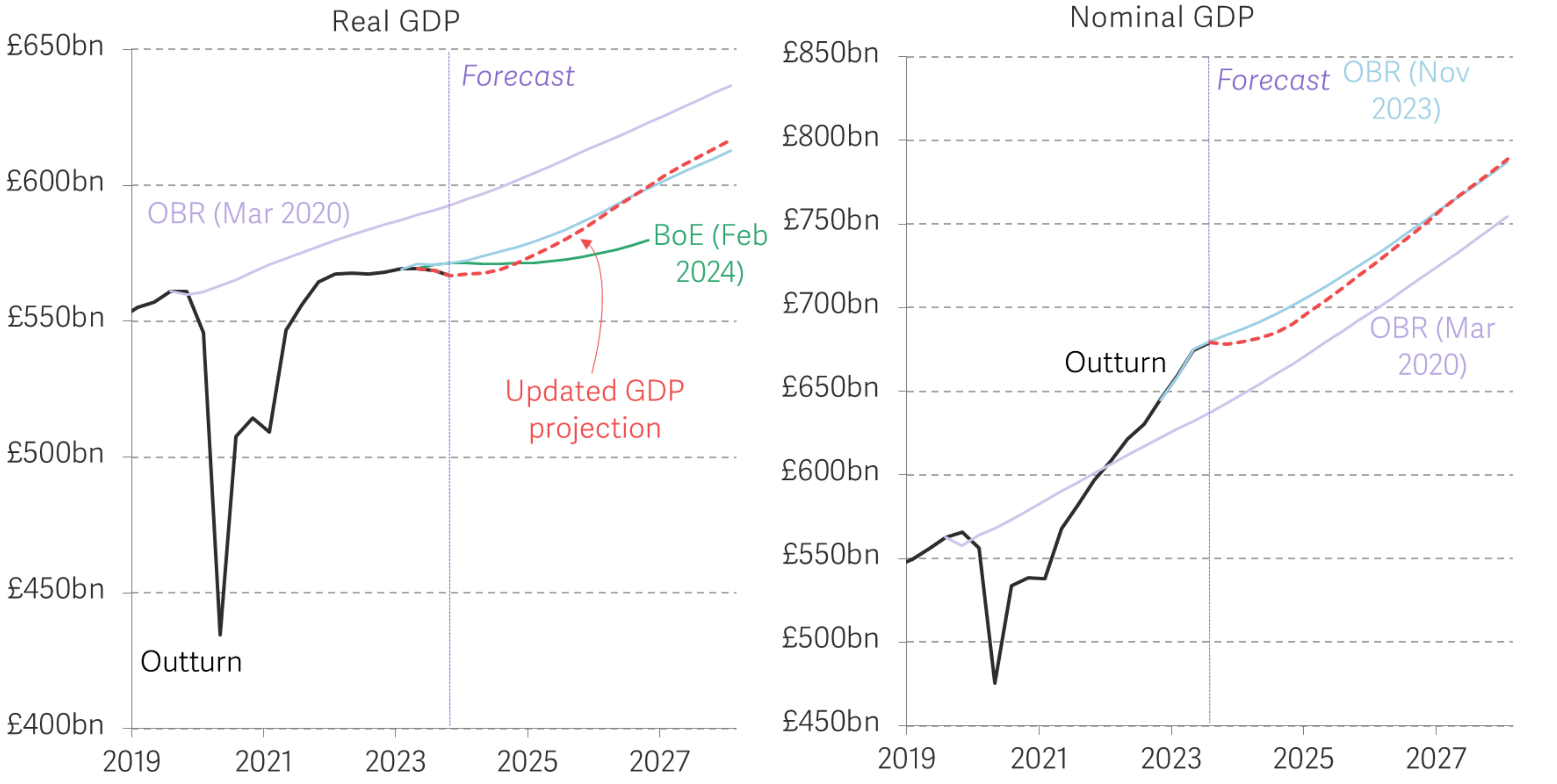
Real GDP (left panel) and nominal GDP (right panel), outturns and Bank of England and OBR forecasts: UK



Beyond the near term weakness, the larger population means that, OBR may mark up real GDP

This could outweigh the impact of a slightly lower price level, leaving cash size of the economy is slightly larger than in November

Notes: All real 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, various.

Fiscal headroom is likely to increase modestly

In-year public finances are running below OBR forecasts

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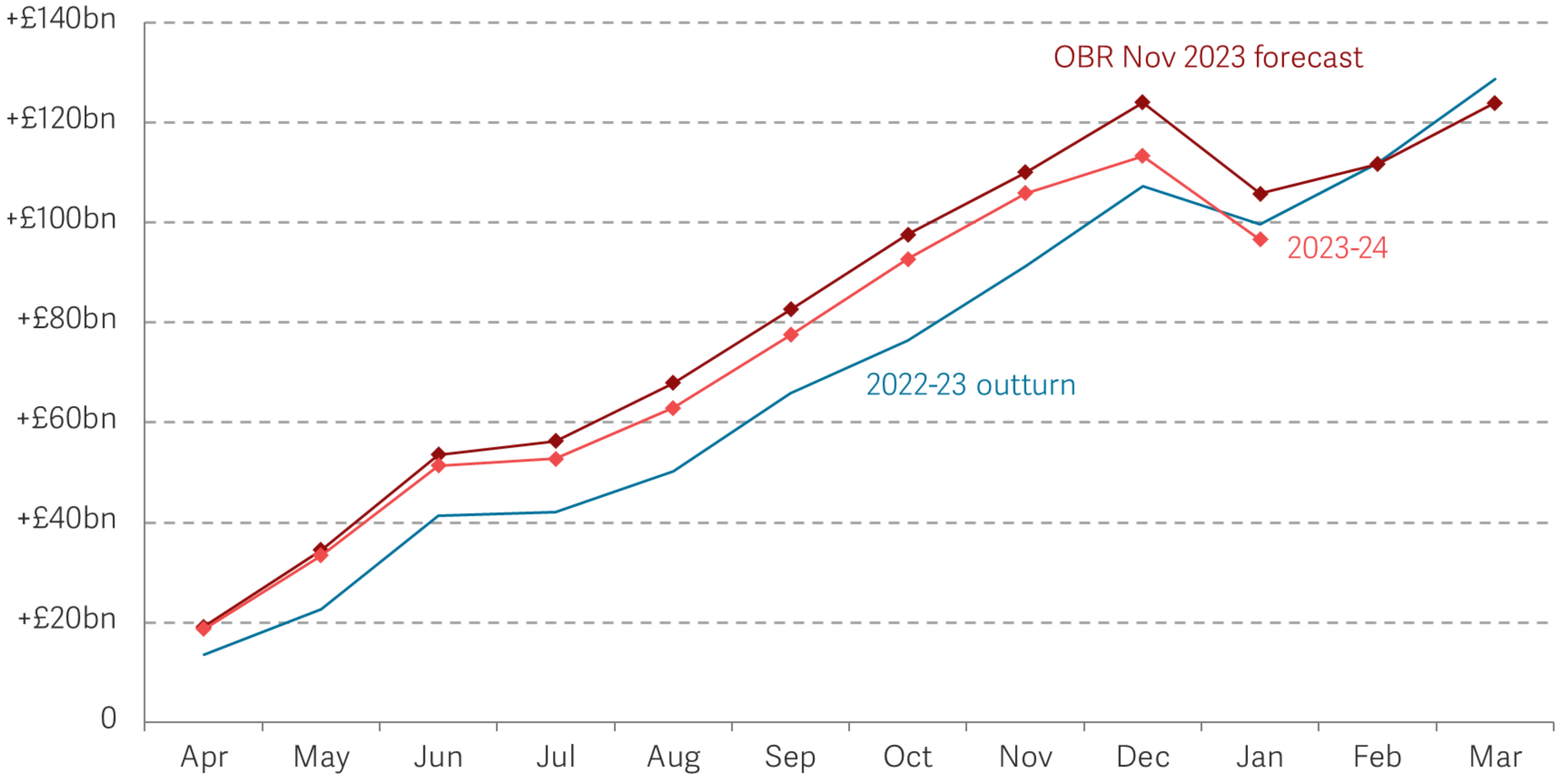
Public sector net borrowing, difference from OBR forecast for the year to date: April - January 2024



Central government receipts in the year to December were just £2.5 billion below the OBR's forecast in November...

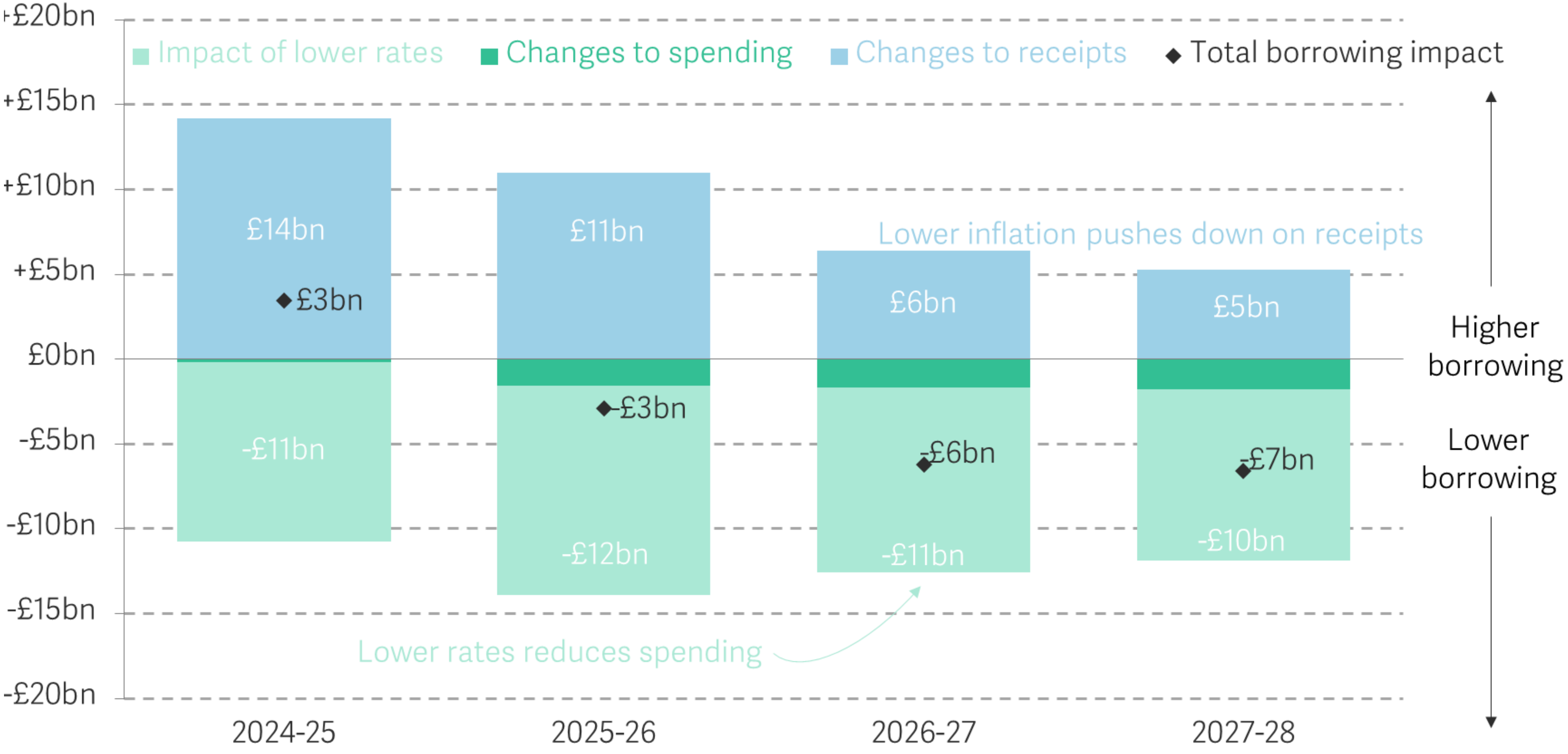
...with spending around £8.0 billion lower

So borrowing is now over £9 billion below expectations at the Autumn Statement (including some lower than expected local government borrowing)

Source: RF analysis of ONS, OBR.

Lower rates is the main driver of lower borrowing

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



Lower short-term rates (and to a lesser extent longer-term rates) reduce spending by around £10 billion by the end of the forecast…

…meanwhile lower inflation (partially offset by faster population growth) reduces tax receipts

Source: RF analysis of OBR.

This leaves debt lower than in November and the Chancellor with slightly more headroom

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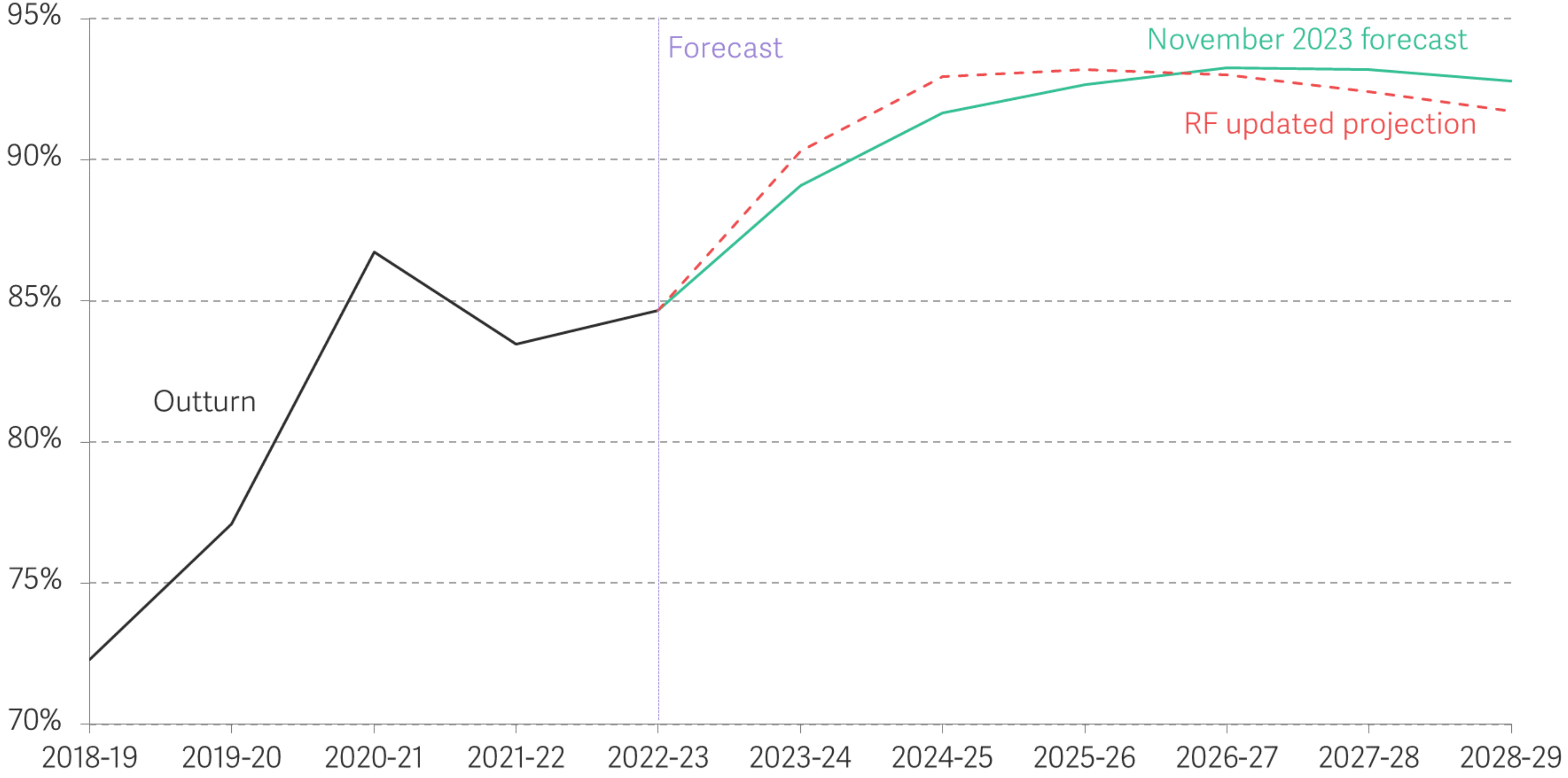
Public sector net debt ex. Bank of England as a proportion of GDP, outturn and forecast

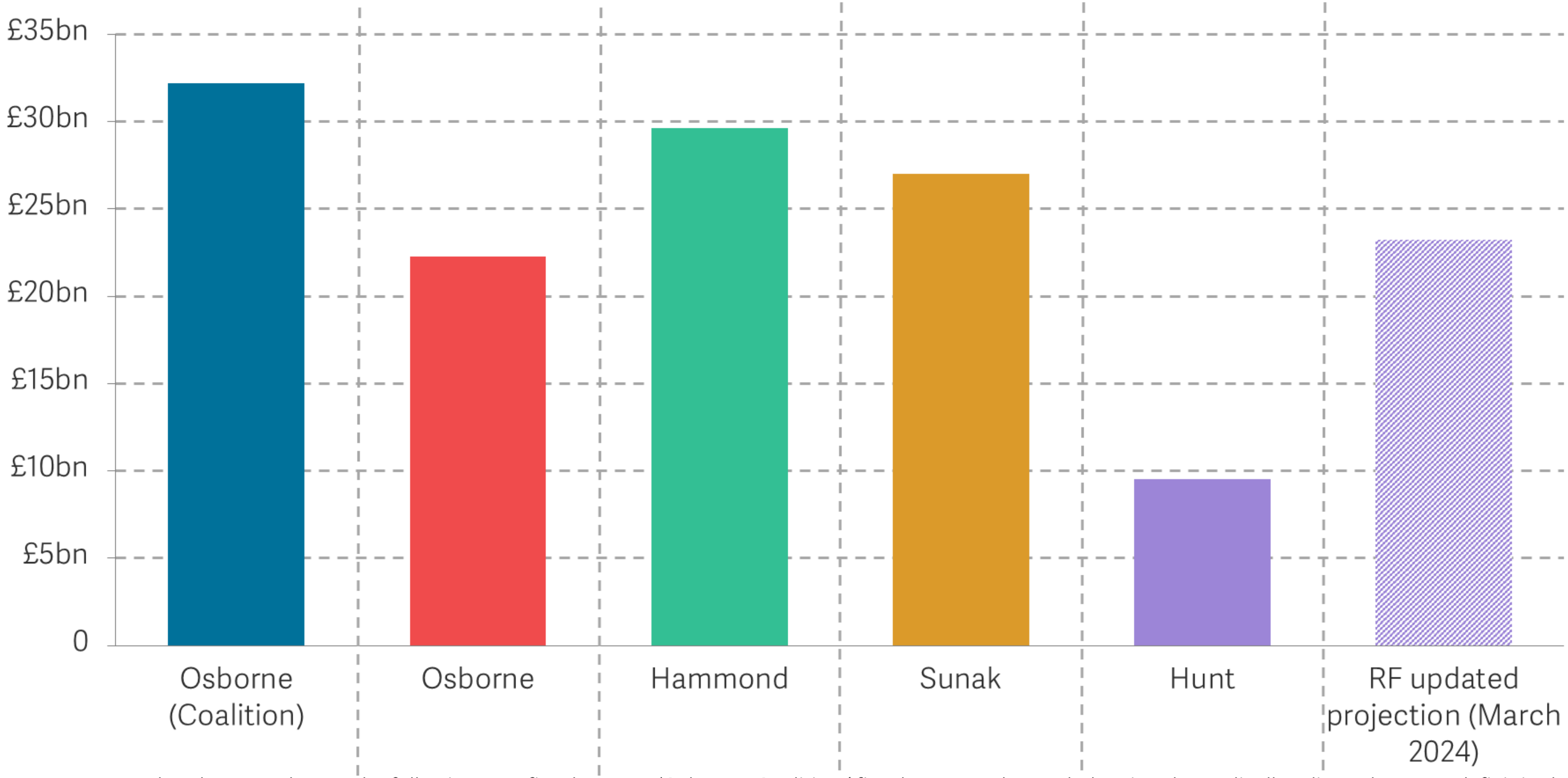


In our central case, headroom in 2028-29 would be £23 billion (+£10 billion compared to March)

Note: The nominal GDP denominator used for the OBR's November 2023 forecast is adjusted here to reflect ONS revisions.
Source: RF analysis of OBR.

Before policy, headroom may be slightly below historical norms

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



This is somewhat less than the average headroom against fiscal rules since 2010 (£27 billion)

Headroom would be much higher on a total PSND target (nearly £40 billion) which was discussed by TSC

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 November 2023 NGDP in 2028-29 for comparability with the historical figures.
Source: OBR, Economic and Fiscal Outlook, various.

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So tax cuts are coming

Speculation has focused on personal tax cuts

- During the Tory leadership campaign: Rishi Sunak promised to cut the basic rate of tax by 4p (from 20p to 16p)
- In January: “When I say that I want to keep cutting taxes, that’s what we’re going to deliver.”
- The Chancellor in February: “The direction of travel we want to go in is to lighten the tax burden“
- So expectations have been steered towards cancelling the rise in Fuel Duty and cuts to personal tax rates

The Budget will no doubt include a cut to Fuel Duty

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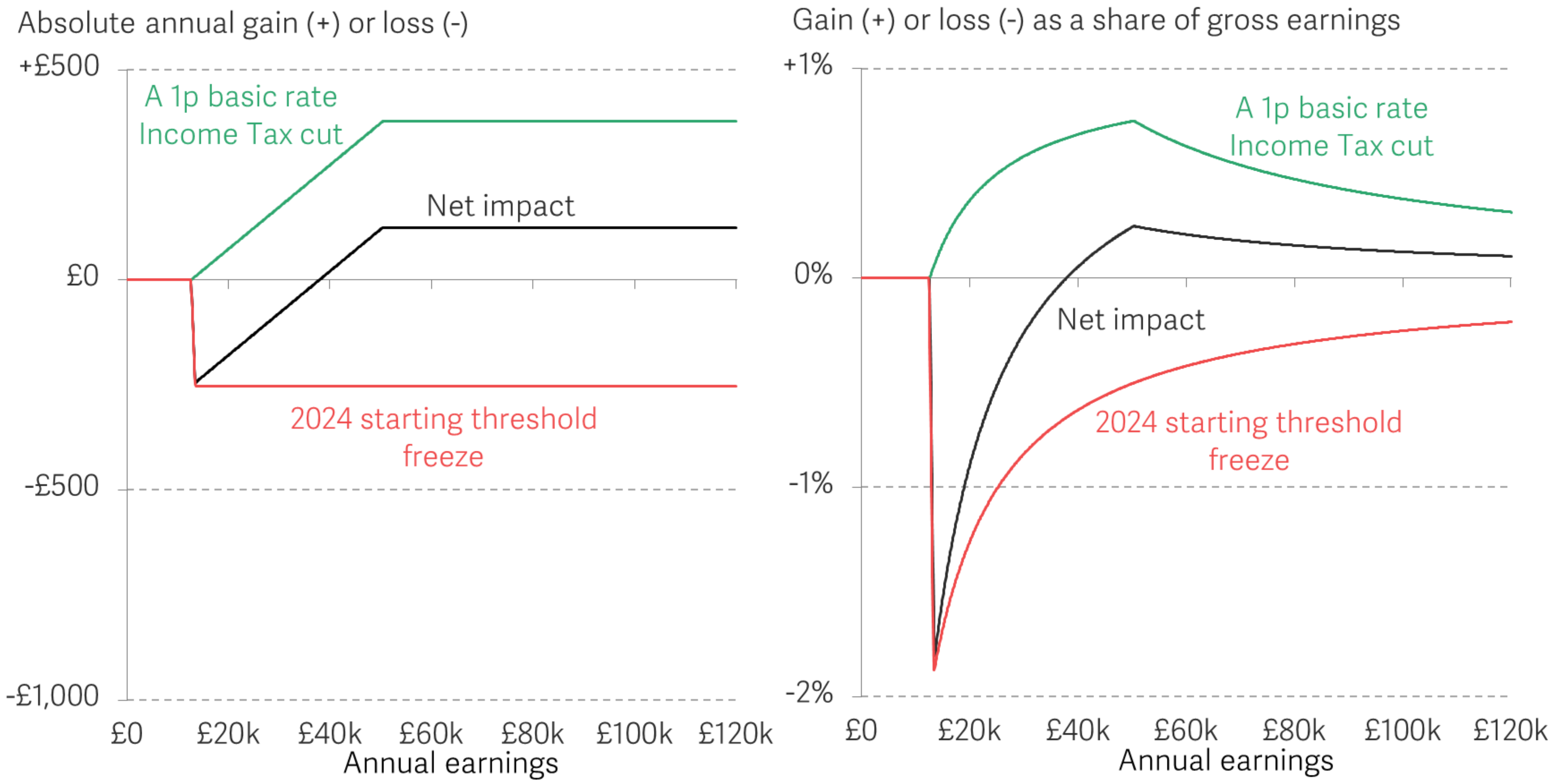
- We have an early March Budget so the 5p rise in Fuel Duty planned for 23 March can be scrapped
- Cancelling this 5p rise would cost around £2 billion a year
- Likely to be delayed by 1 year again, until after the general election
- Cancelling this year's separate RPI increase would cost roughly £1 billion a year

Options for cutting personal taxes

	Basic rate Income Tax cuts	Main rate worker NICs cuts	Cancel 2024 personal allowance freeze
Cost in 2027-28	£7 billion for 1p	£5 billion for 1p	£7 billion (raising allowance from £12,570 to £13,410)
Beneficiaries	All taxpayers	All workers (ideally only employees)	All taxpayers except those above £125,140
Geography	May not happen in Scotland nor potentially Wales	UK-wide	UK-wide (slightly different implications in Scotland)
Benefit for employee at £20k	£74	£74	£252
Benefit for employee at £50k	£374	£374	£252
Notes	Any cut in the basic rate of Income Tax would, we think, take it to its lowest since 1915-16	Lowering (only) the employee rate from a planned 10% to 8% would align it with the new self-employed rate	

1p cut in the basic rate of Income Tax while freezing the allowance is a transfer from low to high earners

Impact on employees of selected tax policies in 2024-25: UK exc. Scotland



A focus on cutting rates while also freezing the allowance is a giveaway to higher earners (as illustrated by 1p cut shown here)

Those below £38,000 would be better off with normal uprating than a 1p basic rate cut

For comparison, the median employee job pays £28,000

Notes: Freeze is relative to the £12,570 Income Tax and National Insurance threshold rising in line with 6.7 per cent inflation. Does not include the impact of Universal Credit means-testing.
Source: RF analysis.

Cutting the basic rate of Income Tax would be more regressive than many other tax options

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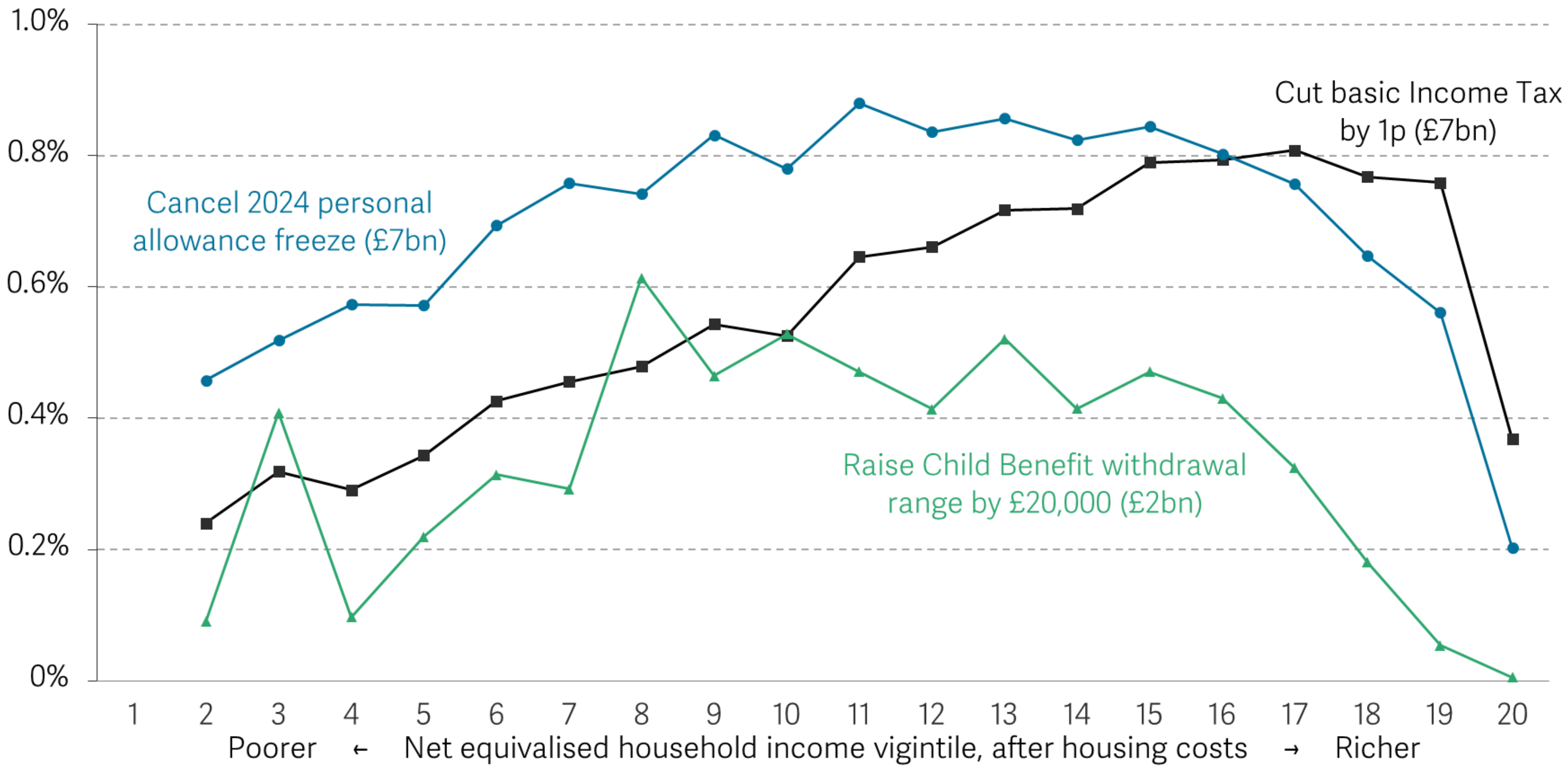
Impact of tax cuts on household disposable incomes after housing costs in 2027-28: UK



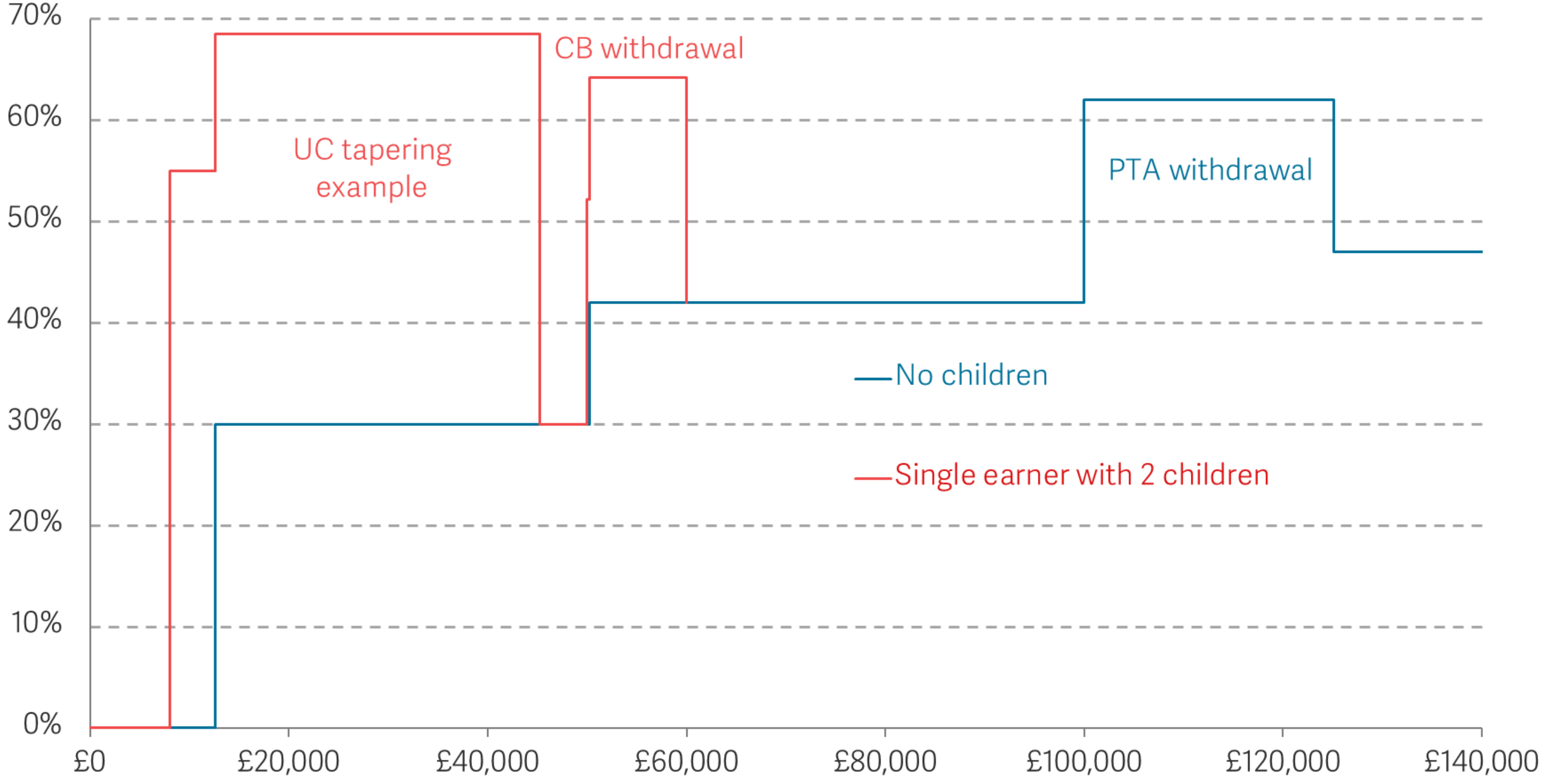
80% of the cost of a basic rate Income Tax cut would go to the top half of the population, raising inequality

Raising the Child Benefit withdrawal range is more progressive (by household income) than one might expect

Notes: Personal allowance policy assumes that the starting point for personal National Insurance remains aligned with the Income Tax allowance.
Source: RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model.

Removing Child Benefit withdrawal improves work incentives

Marginal rates for employees in 2024-25: UK exc. Scotland



Abolishing Child Benefit withdrawal entirely would cost around £4 billion

Raising the income range from £50k-£60k to £70k-£80k (thereby affecting fewer people) would cost around £2 billion

Notes: Does not include student loan repayments or employer National Insurance. Universal Credit schedule assumes no housing costs.
Source: RF analysis.

Britain is getting a tax-raising sandwich, not cuts

Budget cuts sandwiched between rises that have happened and those which are planned

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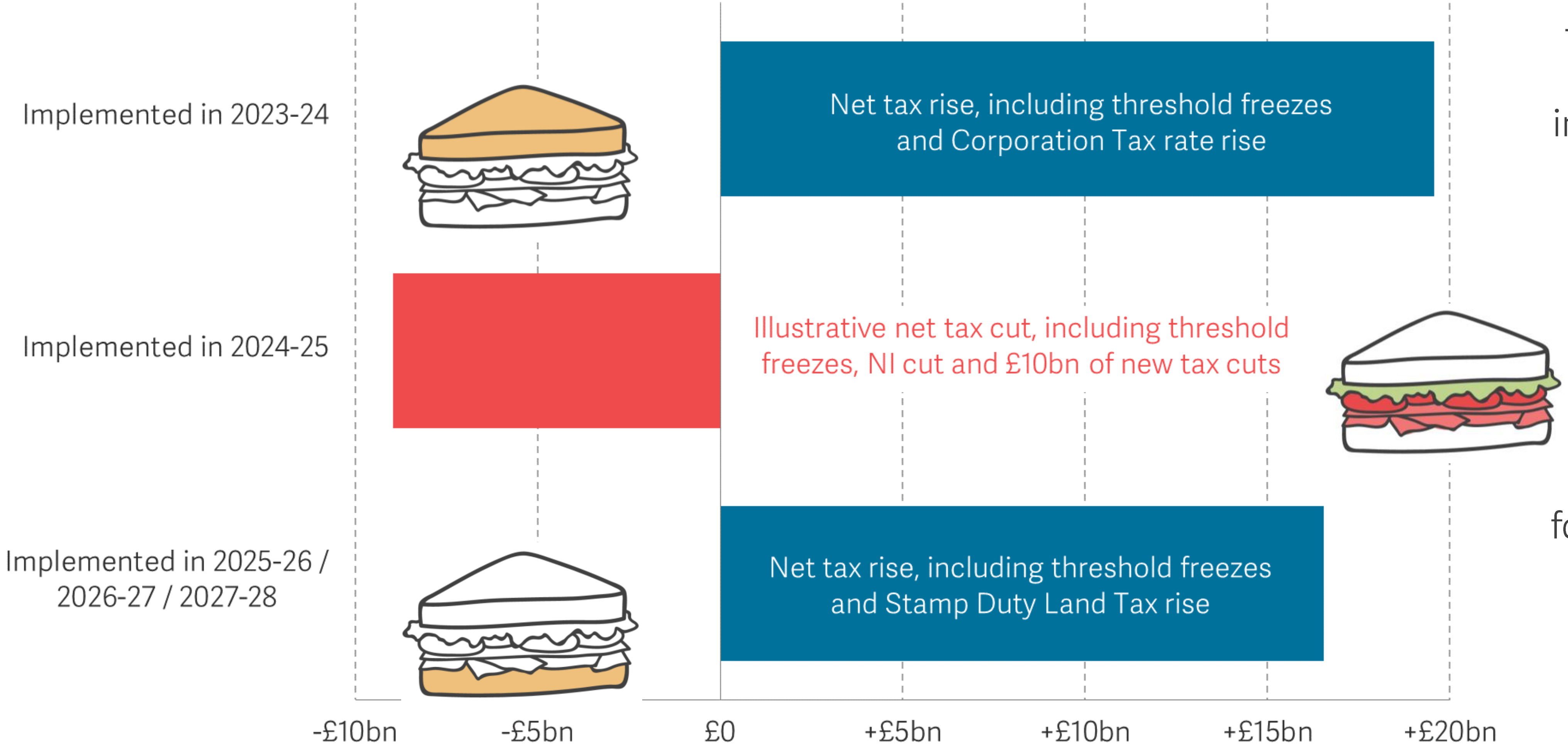
1. Tax rises that have already taken effect: mainly threshold freezes and Corporation Tax

2. Tax cuts coming at the Budget

3. Tax rises to come, including further threshold freezes and Stamp Duty

Tax cuts in 2024 will be sandwiched between major tax rises

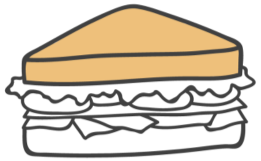
Net impact of major tax measures in 2027-28, by year of implementation: UK



Tax rises of around £20 billion were introduced in 2023-24

...and highly unusually, £17 billion of tax rises for next parliament, have been announced

Notes: Tax changes include: Income Tax and National Insurance threshold freezes and cuts, reductions in Capital Gains and Dividend Tax allowances, Corporation Tax rate rises and full expensing, pension tax allowance changes, a Business Rates freeze, Fuel Duty freezes, National Insurance rate cuts (which fully take effect in April 2024), a planned Stamp Duty rise, the extension of VED to electric car drivers, and a 5p Fuel Duty rise (which we assume will be delayed until after the election). Minor tax changes and anti-avoidance measures have been excluded.
Source: RF analysis.



Tax rises have already happened

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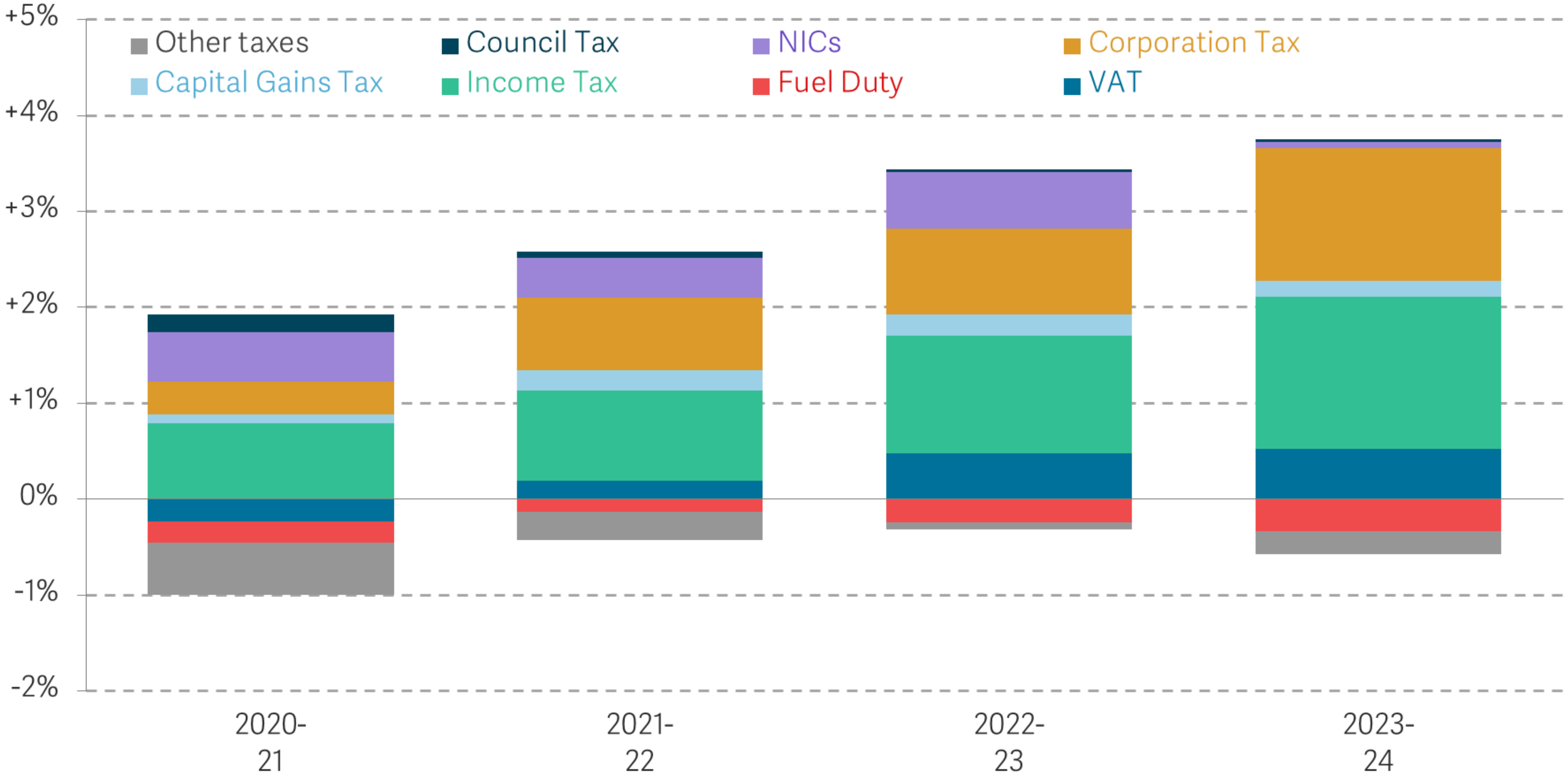
Changes in tax revenue as a share of GDP relative to 2019-20: UK



Tax threshold freezes are contributing to increased Income Tax revenue

Despite the introduction of full expensing, the OBR estimates the effective (onshore) Corporation Tax rate will rise from 11% in 2019-20 to 18% in 2024-25

Notes: Other taxes include: Stamp Duty Land Tax; Tobacco, Alcohol, Vehicle Excise and Air Passenger Duties; Environmental and Energy Profit Levies; Inheritance Tax; and other public sector taxes and receipts.
Source: RF analysis of OBR, Economic and Fiscal Outlook, November 2023.

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More tax rises are coming after the election

Reason for tax rises (1): rises already announced

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General election

January 2025

March 2025 – Temporary 5p Fuel Duty cut may expire (if delayed by 1 year)

April 2025 – Temporary Stamp Duty threshold rise will expire; Tax threshold freeze; VED introduced for electric cars

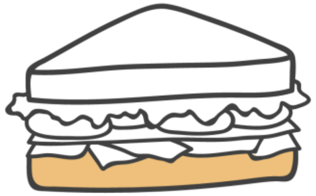
April 2026 – Tax threshold freeze

April 2027 – Tax threshold freeze

January 2028

Unusual to go into an election with tax rises already scheduled for the next parliament but this Government have a number pencilled in

Council Tax also set to rise by around 5% per year putting us on track for first sustained rise since early 2000s



Reason for tax rises (2): that's what happens after elections

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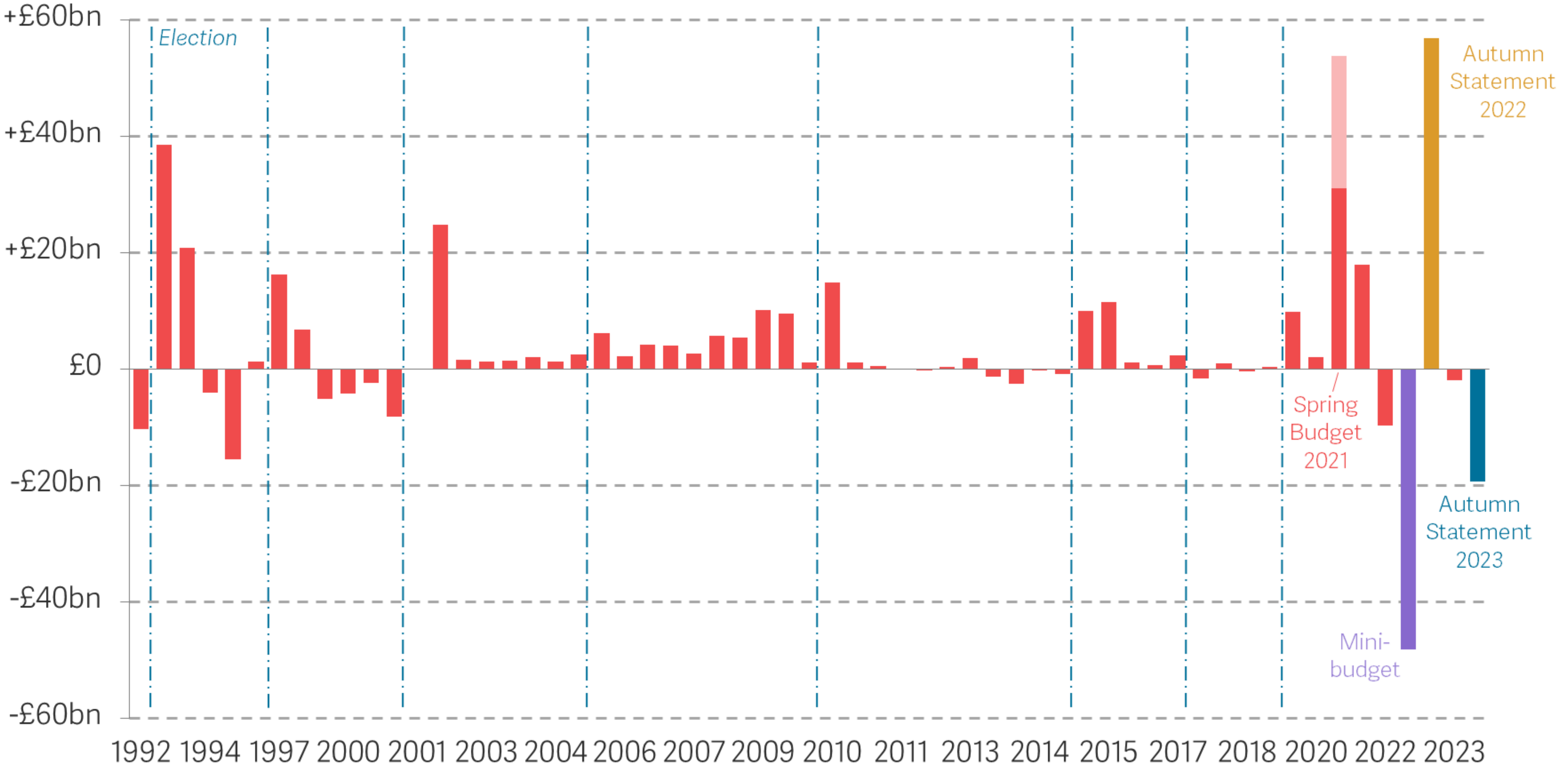
Net long-term annual impact of tax policy announcements at each fiscal event since 1992: UK



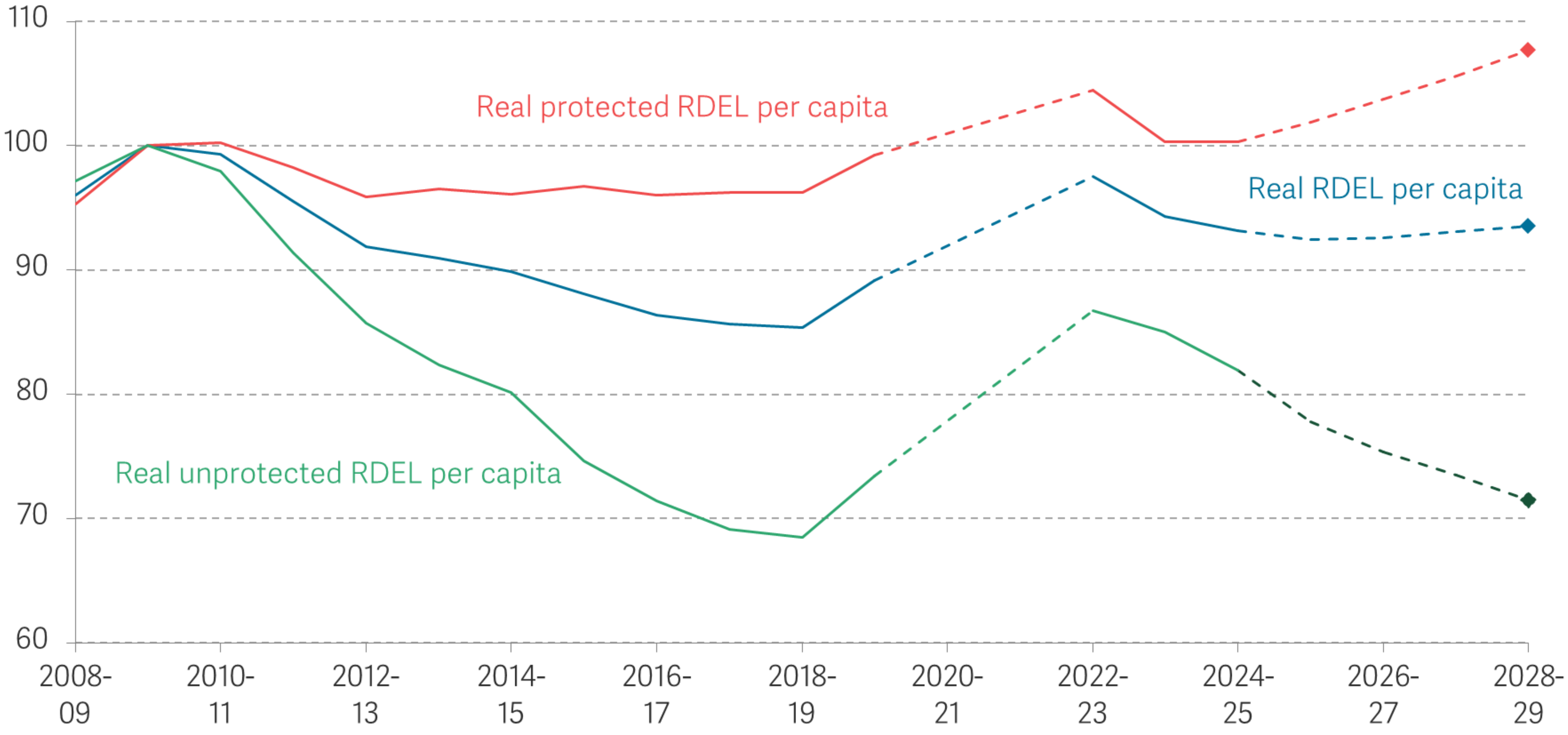
Budget 1992, the day before the election was called, created a 20% tax rate. But 1993's two Budgets raised taxes by £60 billion

1995/1996 Budgets cut the basic rate from 25% to 23% and raised the personal allowance. But Budget 1997 raised taxes by £16 billion

Notes: Impacts in 2028-29, with past values uprated in line with nominal GDP. Based on forecasts from the time of each fiscal event (actual impacts on tax revenue may have differed), but the unexpected extra revenue from freezing Income Tax thresholds is estimated in the pink Spring Budget 2021 column. Autumn Statement 2022 includes mini-budget reversals and scrapping of 19 per cent rate of Income Tax.
Source: RF analysis of OBR, Policy measures database; HM Treasury, The Growth Plan 2022; HM Treasury, Autumn Statement 2022 Policy Decisions.

Reason for tax rises (3): spending plans are undeliverable

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

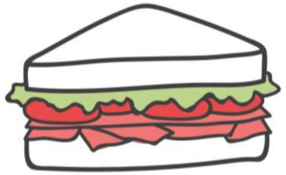


Unprotected departments are set to see their per capita day-to-day budgets fall by 18% - deeper than expected thanks to population growth

Further cutting RDEL growth from 1 to 0.75% would mean cuts of a fifth

It would take around £30 billion to return unprotected departments to 2022-23 levels of real, per capita spending

Notes: Deflated using the OBR 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 OBR, Economic and Fiscal Outlook, November 2023/ various.; HM Treasury, November/ various and PESA tables.



Clear that the Government would like to cut Income Tax or National Insurance rates

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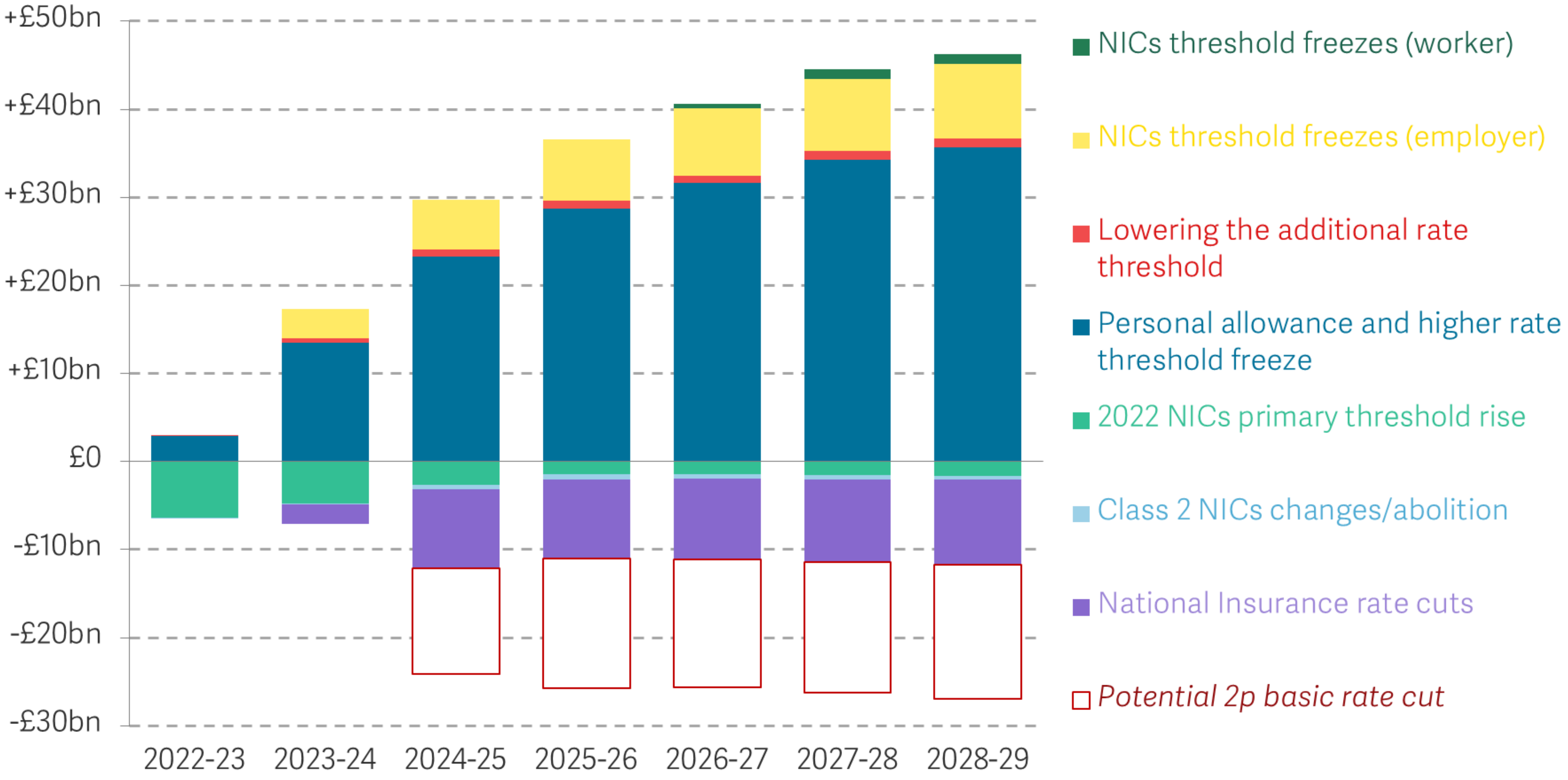
Projected impact in each year of personal tax policy changes made since 2021: UK



Even after a large Income Tax cut, personal taxes would be going up

Notes: Changes in the inflation forecast for 2024 through 2026 may change the projected impact of threshold freezes.
Source: RF analysis based on figures from OBR, Economic and fiscal outlook, November 2023; HMRC, Direct effects of illustrative tax changes, January 2024; HMT, Autumn Statement 2023, November 2023.

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