Cebr's Immediate Reaction

LEADING ECONOMIC ANALYSIS, FORECASTS AND DATA

Autumn Budget Briefing, October 2024

Bigger state, lower growth, but a boost for long-term investment

The first-ever female Chancellor has delivered her first Budget, one full of both tricks and treats. The state will now be much larger than it was due to be. Still, the government avoided spooking markets by setting out tax plans that would stabilise public finances despite announced giveaways and investment increases.

The scale of tax increases clearly hurts growth. The OBR cut its medium-term growth forecast compared to the March Budget. However, given its agreement with the Treasury that the forecast would have been 'materially different' with better spending information when putting that forecast together, these numbers are no longer comparable.

Nonetheless, annual growth of around 1.5% in five years would be a bad outcome. It is below Cebr's current forecast and below the already low growth rates seen before the pandemic. The OBR is known for being consistently overly pessimistic, but it is no surprise that the £40 billion raised in extra public revenues has had a big impact on the economic outlook.

The biggest revenue raiser was the change in employers' national insurance contributions (NICs), which the government expects to raise £25 billion per year by the end of parliament. This more than offsets the total revenue lost from employee NICs cuts in the past two fiscal events. While the overall impact is to shift the tax burden from employees to employers, it is likely that at least a large portion of this is passed on, either in lower wages, or more likely given the tight labour market, in higher prices.

An important detail here is the extra relief offered to small businesses, as our two regular small business trackers, in partnership with FSB and Sage, both show that small business employment growth continues to underperform compared to official data. However, these reliefs only support the very smallest of businesses and should be extended further.

Rachel Reeves provided a positive surprise by not extending the 'fiscal drag', contrary to pre-Budget speculation. The fiscal drag gradually increases people's personal tax burdens as inflation rises, so while this might not grab headlines in the same way as a rate cut, especially as it doesn't come in for another few years, it will eventually make a massive difference.

Beyond this, the impact of the Budget on a household's day-to-day spending will be mixed. The fuel duty freeze will help, as 2023 Cebr research found a 5p increase would lower GDP by around 1% and UK jobs by around 31,000.

Cuts to draught duties are sorely needed by a pub industry suffering from the ongoing cost-of-living crisis. Still, airlines have not yet fully recovered from the pandemic despite a strong summer, so the increase in air duties seems short-sighted. Further increases in duties on soft drinks and tobacco seem draconian and based on judgements around the consumption of these products, rather than the economics of the public expenditure impacts.

What we don’t know is how successful government will be in improving public sector productivity. The 2% productivity improvement target for the public sector is positive and would help to mitigate some of the necessity of higher taxes, but it does not go anywhere near far enough given the 20% decline in productivity seen since the pandemic alone.

It also remains to be seen how international investors react to changes in Capital Gains Tax and loss of non-dom status. While Rachel Reeves mentioned that the new rates would remain the lowest across the G7, this doesn’t make it any less unwise to make the UK even less competitive for inward investment than it already is. Treasury will be hoping that they have struck the right balance between revenue gain and behavioural change, but on the face of it, the scope of these increases looks risky.

Overall, today’s Budget does go some way to deliver on Labour’s manifesto pledge for change: it wasn’t all hocus pocus. However, it remains to be seen if the full impact of the higher tax and higher investment strategy will be insidious or if they are successful in conjuring higher growth.

- **Christopher Breen, Head of Economic Insight**

Key policies

National Insurance Contributions (NICs)

- The Government has introduced adjustments to employers' national insurance contributions (NICs), positioning these changes as a significant revenue generator in today's Budget. The policy includes a 1.2 percentage point increase in the employer NICs rate and a reduction in the secondary threshold, the level at which employers begin to make contributions on each employee's pay, from £9,100 to £5,000 per year.
- Cebr analysis projects that these measures will generate £22.9 billion by the 2029/30 financial year. This captures the anticipated direct behavioural responses, including increased incorporations and mini umbrella company incentives. This projection is lower than the OBR's forecast of £25.7 billion for the same period, partially due to Cebr's lower near-term inflation estimates. Lower inflation would exert downward pressure on nominal wage growth, moderating some of the fiscal impact from today's announcement of a freeze in the employer NICs thresholds.
- Combined with the recent employee NICs rate reductions introduced in prior fiscal events, which Cebr expects to increase Treasury revenue by £22.2 billion by 2029/30, the adjustments signal a shift in the relative tax burden from employees to employers.
- Smaller businesses, which could feel a disproportionate impact, may find relief in the Budget's increase in the employment allowance from £5,000 to £10,500, along with the removal of the employment allowance threshold. This enables all eligible employers to claim the allowance, regardless of liability size.
- However, both Cebr's and the OBR's revenue estimates are static and do not account for indirect behavioural adjustments by businesses. As employers anticipate higher NICs on employee wages, many are likely to manage these additional costs by moderating wage growth and reducing hiring.
- This response could potentially reduce labour demand, influencing the jobs market outlook over the longer term. The OBR has incorporated assumptions regarding these indirect behavioural responses, with such responses expected to reduce the policy's revenue yield by approximately a third over the forecast period. While the full extent of these responses remains to be seen, it is likely that the actual fiscal impact will deviate significantly from initial static estimates.

National Living Wage

- Following through on Labour's pledge, the Chancellor announced increases to the National Living Wage (NLW) to support lower-income households. Key changes to NLW rates are as follows:
  - The rate for those aged 18-20 will be increased by 16.3%, bringing the minimum to £10.00 per hour.
  - The rate for those aged 21 and over will be increased by 6.7%, taking the minimum to £12.20.
  - Apprentices will receive the largest relative increase, amounting to an 18.0% uplift, taking their minimum hourly wage to £7.55.
- These increases will support the spending power of lower income households and younger workers, who have yet to recover from the ongoing impacts of the cost-of-living crisis. According to Cebr's Income Tracker work, spending power for households in the second income quintile fell short of its pre-crisis peak by 71.9% in September. Meanwhile, those in the lowest quintile are experiencing negative

spending power, indicating insufficient income for essential expenses.

- Households in these income brackets are likely to be the beneficiaries of the NLW increase, which is expected to help alleviate some of these financial pressures.
- However, similarly to the changes to NICs, the NLW increases will raise labour costs for employers. This could lead businesses to pass higher costs on to customers through price increases, fuelling inflationary pressures.
- These additional costs may also encourage firms to soften their labour inputs, be that through reducing existing headcount or restricting hiring. This will potentially impact jobs growth and unemployment.

Personal allowance (PA) and higher rate threshold (HRT) freeze

- Contrary to prior budget speculation, the Chancellor announced that the current freeze in the PA and HRT will not be extended beyond 2027/28. Extending the freeze would have generated an estimated £7.3 billion in additional tax revenue, by gradually increasing the number of individuals entering higher tax bands.
- The ongoing freeze is still projected to yield substantial tax receipts, with our forecasted revenue slightly lower than the OBR's due to differences in short-term inflation forecasts. By the freeze's conclusion in 2027/28, total additional tax receipts are anticipated to reach £35.4 billion.

Capital Gains Tax

- The rate of Capital Gains Tax (CGT) will increase from 10% to 18% for basic rate taxpayers and from 20% to 24% for higher rate taxpayers. These changes bring the rates on most assets into line with the rates on residential property, which were maintained at 18% and 24%.
- Other rates were also changed, including that paid on carried interest, for gains accruing to trustees, and on Business Asset Disposal Relief.
- The increases in the rates of CGT will impact the supply side of the economy, by discouraging saving and investment and ultimately hampering growth. Increasing the rate paid on BADR may also discourage the labour supply of private business owners.
- However, the alignment of rates across asset classes will reduce the distortions in capital allocation by treating these neutrally.
- The OBR estimates 60% of the static yield for main CGT is lost because of behavioural changes. In its forecast, the OBR assumed some forestalling of CGT due to anticipation of rate increases before the Budget. It also assumed that migration is not a key factor affecting the main CGT revenue forecasts, as the UK's headline CGT rate remains in line with most other advanced economies.
- In the short term, Cebr forecasts that the changes to CGT alone will reduce annual GDP growth by 0.1 percentage points, from 1.3% to 1.2% in 2025.
- Cebr estimates that economic losses associated with this policy will accumulate over time. We estimate that the annual shortfall in GDP relative to an unchanged CGT landscape will be 0.3% by 2030, rising to 1.4% by 2043.

Duties

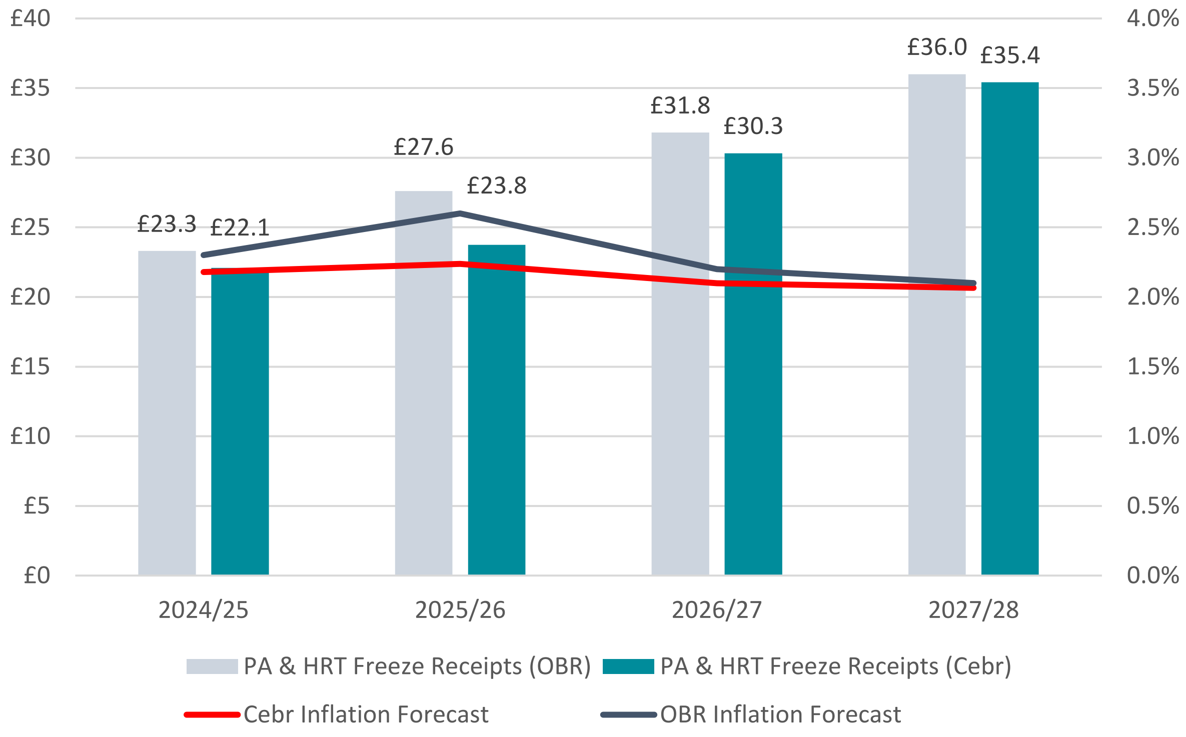
- The 5p cut to fuel duty, first implemented in March 2022, was surprisingly extended. The Chancellor committed to keeping fuel duty at its current level of 52.95p per litre until March 2026.
- Fuel duty has not been increased since 2011. As of October 2024, the real terms value has fallen by an estimated 39.5% over this period. The shortfall is expected

to reach 41.0% by the end of the newly committed freeze period.

- Previous Cebr work has considered the adverse economic consequences that could result from a hike to fuel duty. The continued freeze is largely seen as pro-growth in the near term, supporting real-terms spending power and consumption in other areas of the economy.
- There were several changes to alcohol duties. It was confirmed that alcohol duty on non-draught products will be uprated by RPI inflation from February. However, duties on draught products will be cut by 1.7%.
- This is expected to support pubs and bars, brewers, and the wider hospitality sector. Previous Cebr work has highlighted the economic activity that could be generated by cuts to this tax, including additional jobs and receipts from other taxes.
- The Government committed to maintaining the tobacco duty escalator, which increases this tax by inflation on the Retail Price Index, plus a further two percentage points, each year.
- The Government confirmed that a duty on vaping liquid would be implemented from October 2026. To maintain the financial incentive to vape rather than smoke, it was also announced that a one-off tobacco duty rise over and above the escalator would be implemented.

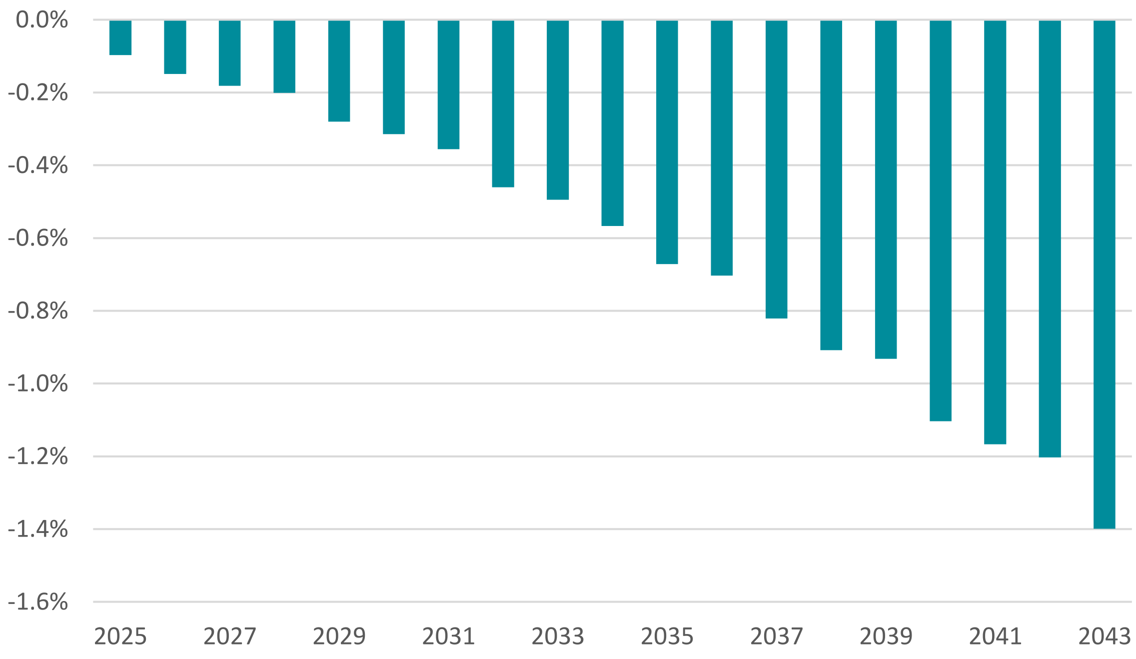
Key charts

Figure 1 – Estimates for additional tax receipts due to PA & HRT freeze (£ billion, LHS) and estimates for financial year inflation (RHS)



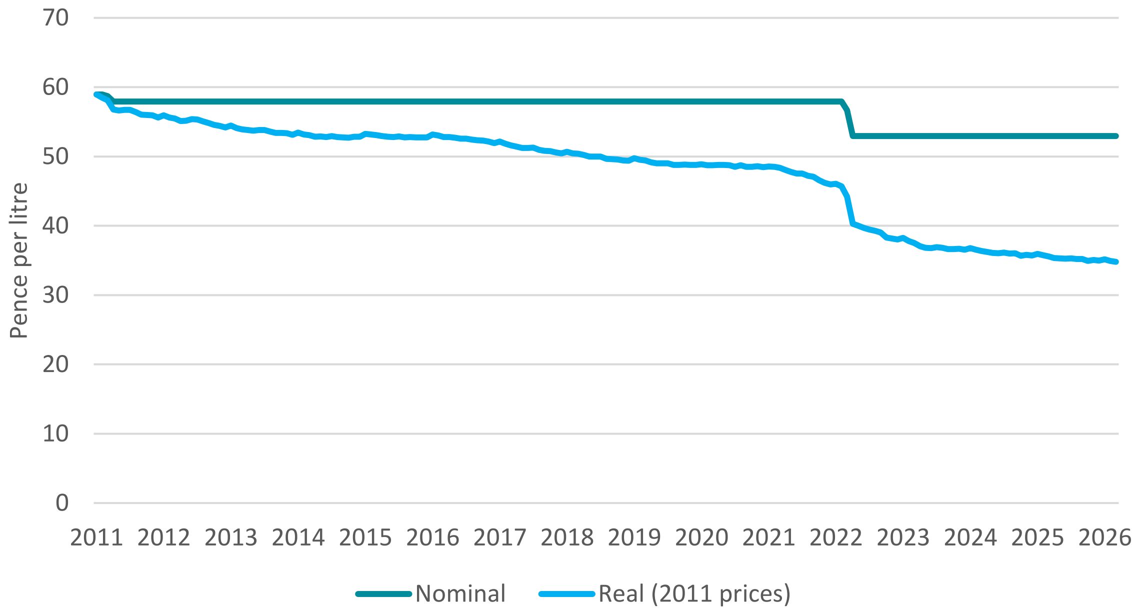
Source: OBR, Cebr analysis

Figure 2 – Expected shortfall in GDP due to CGT change, relative to unchanged CGT landscape



Source: Cebr analysis

Figure 3 – Fuel duty value, nominal and real



Source: Department for Energy Security and Net Zero, Cebr analysis

Contact

Nina Skero
Chief Executive
nskero@cebr.com
020 7324 2876

Christopher Breen
Head of Economic Insight
cbreen@cebr.com
020 7324 2866

Sam Miley
Managing Economist and Forecasting Lead
smiley@cebr.com
020 7324 2874