Autumn Budget 2024

Key points and market reaction

FOR FINANCIAL ADVISERS AND THEIR RETAIL CLIENTS

Introduction

Chancellor Rachel Reeves announced the UK autumn budget 2024 yesterday, introducing several key changes that will impact investments, wealth, savings, pensions and taxes. The chancellor has incorporated a £40bn tax increase as a central component of her strategy to address the nation's financial and public service challenges, with the end goal of driving economic growth. This plan will primarily impact businesses and affluent individuals, with Reeves frequently emphasising her support for "working people". Let's explore some of the key changes in this budget and how the markets have reacted.

Investments and savings

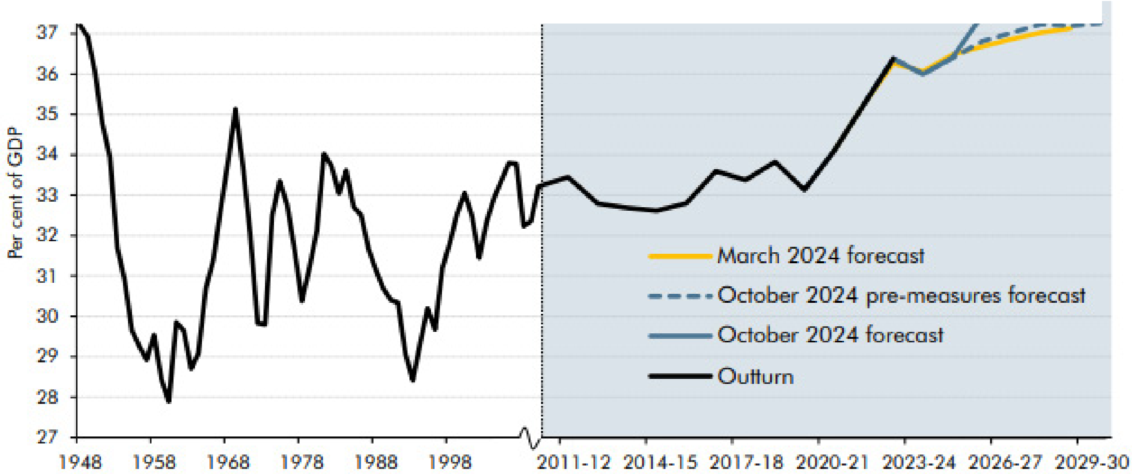
One of the most notable changes is the inclusion of family wealth held in pensions within the scope of inheritance tax from 2027. Beneficiaries may also have to pay income tax on the pension proceeds even after inheritance tax has been deducted if the pensioner dies after they turn 75. This move could fundamentally shift how the wealthy approach retirement planning with pensions currently being an optimal method to mitigating one's tax bill when passing wealth through generations. It could promote more spending of the pension before death and, for example, areas like the property market could see a boost if investors opt to invest in real estate instead.

Capital gains tax also saw an increase in a move that was widely anticipated, however, the increase was smaller than expected. The lower rate of capital gains tax will increase from 10% to 18%, while the higher rate has moved from 20% to 24%. Some predictions suggested the rates could have been increased to align with the income tax brackets.

Property

Landlords will face additional tax burdens as the stamp duty surcharge for second homes will increase by 2 percentage points to 5%. While this change will again attract a bigger tax revenue from those wealthy enough to afford a second home, it is expected to hurt renters as landlords may pass on the additional costs. This could be negative for the economy with renters already seeing much of their wages being spent on rent, leaving them less to spend in the economy and ultimately contributing towards growth.

Chart 1 - UK taxes as a share of GDP



Source: Office for National Statistics and Office for Budget Responsibility, October 2024

Wealth taxes

The budget also targets the wealthy with several measures. Non-dom tax status will be scrapped from April next year, removing the concept of domicile from the tax system and cracking down on the use of overseas trusts to shield assets from UK inheritance tax. This change is expected to raise £12.7bn over the next five years, however, with a weaker tax advantage it may discourage internationals from residing in the UK. A mass exodus of people with non-dom status from the UK would likely lower the total figure raised through the removal of this tax break.

Additionally, private equity fund managers will see their carried interest relief reformed, with the tax rate increasing to 32% from April 2025 and potentially rising further from April 2026.

Businesses, employers and employees

The budget also includes measures that will impact businesses and employers. The National Insurance rate that employers pay will increase by 1.2 percentage points from 13.8% to 15%, and the threshold at which employers pay NI on employees' salaries will be reduced from £9,100 to £5,000. These changes are expected to raise £25bn for the Treasury. The increased cost to businesses could end up being passed on to employees in the form of reduced pay packets.

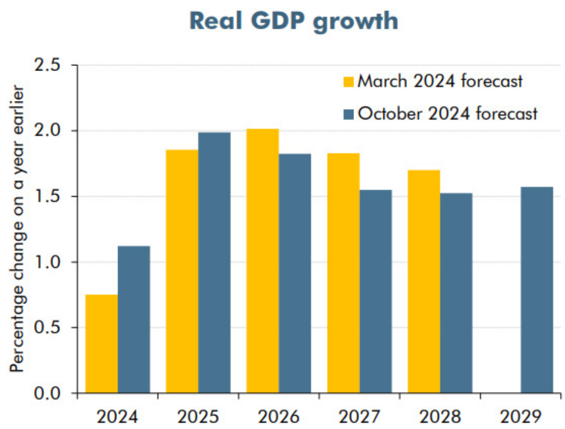
For individuals, the budget includes both positive and negative changes. The national minimum wage will increase by 6.7% to £12.21 an hour from April 2025, benefiting minimum wage workers. State pensioners will see a 4% increase in the state pension, with the weekly benefit reaching £230.30 for the full new flat-rate state pension. However, income tax thresholds will remain frozen until 2028, meaning more pensioners will be taxed on their income from 2027.

Public services

The budget earmarks substantial spending increases across various sectors. The core schools budget is set to expand by £2.3bn next year, supplemented by an additional £300m for further education and a tripling of investment in breakfast clubs. Special educational needs funding will grow by 6% or £1bn from this year. The defence budget is scheduled to rise by £2.9bn next year. Local government is allocated £1.3bn in extra grant funding for essential services, which includes £600m more for social care and £230m to combat homelessness and rough sleeping.

The NHS will benefit from a comprehensive 10-year plan, starting with a £22bn increase in the day-to-day budget and £3.1bn in capital spending over the next two years. This includes £1bn to address a backlog of repairs and upgrades across the NHS estate, £1.5bn for new hospital beds, diagnostic equipment, and surgical hubs. These measures aim to fulfil Labour's pledge of 18-week maximum waiting times and deliver 40,000 additional hospital appointments per week.

Chart 2 - Forecast for UK GDP growth



Source: Office for Budget Responsibility, 2024

Impact on financial markets

After initially responding positively, the market sentiment flipped to show uncertainty towards the chancellors plans which involved more additional borrowing than they were anticipated. The total increase to borrowing stands at £28bn a year over the next five years. Such significant levels of borrowing can concern markets for a number of reasons:

- Increasing government spending is known as expansionary fiscal policy. This can stimulate economic growth, but in doing so can also cause an increase in inflation due to the increase levels of economic activity.

- With inflation still an issue in the UK, the possibility of inflation lasting for longer may lead to some thinking interest rates may not fall as quickly.

- Governments sell gilts to raise money to spend on such projects. A greater supply of gilts can weigh on their price as you would expect to see with any other good.

- As the supply of gilts increases, the yields, or interest rates, demanded by borrowers tends to increase and this drives up the cost of borrowing.

The immediate aftermath of the budget has seen the 10-year gilt yield rise 0.2% to 4.43%, indicating concern about the planned increase in spending but also the possibility of higher inflation as a result of the national insurance changes. As gilt yields rise, gilt values fall.

The reaction in the UK equity market has been mixed. The FTSE 100, which is comprised of the 100 biggest UK companies, has fallen 2.5% since the announcement yesterday. Housebuilder, in particular, have fallen as higher interest rates would keep mortgage rates higher and deter some purchases. The FTSE 250 is also down. The outcome of the budget appears to have muddied the UK outlook to a degree and failed to achieve the boost to growth Reeves was targeting.

However, the FTSE AIM (alternative investment market) index jumped nearly 4% following the budget. The market had been falling in recent weeks due to fears that inheritance tax relief for investments held for more than two years would be scrapped. In the end, the budget revealed relief will be capped at 50% and this helped AIM stocks to rally.

Conclusion

In summary, the 2024 budget has elicited a varied response from the markets, reflecting the complex interplay of fiscal policy, inflation concerns and investor sentiment. While the planned increase in government borrowing aims to stimulate economic growth, it also raises questions about the potential long-term impacts on inflation and interest rates.

As the markets continue to digest the implications of the budget, it remains to be seen whether the intended economic boost will materialise or if further adjustments will be necessary to ensure a balanced and sustainable growth trajectory.