Hoping that something turns up: The Chancellor’s Autumn Statement

Economic commentary

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18 November 2022

Key points

- Jeremy Hunt’s Autumn Statement brought few surprises, with measures in the short term to support the economy as it weathers a recession, but curbs on public spending from 2025. Many unpopular aspects of the package have therefore been left to the next government.

- The OBR anticipates that the government will need to borrow around £300 billion more over five years than it envisaged as recently as March, with the cost of servicing the national debt peaking at £120 billion in the current fiscal year. The ratio of debt to GDP will continue to rise in coming years and isn’t expected to start falling until 2027/28.

- The retention of universal energy price support for households until March 2024, albeit at a higher level, will help to keep a lid on inflation during 2023. HSBC expects inflation to fall to 5.2% at the end of 2023, but we also anticipate that it will still be above the 2% target a year later. With the Bank of England having assumed in its latest forecasts that universal support would be retained, the stance of the Autumn Statement will have no meaningful impact on the outlook for Bank Rate, which HSBC still expects will peak at 3.75% in February 2023.

- The statement appears to have preserved the recent calm in financial markets. Yet the path ahead is daunting, with households set to see the past eight years of improvement in living standards wiped out during the coming recession. The government is no doubt hoping that something will turn up, so that some of the measures in this statement can be reversed at a later date.

“Rolling the pitch” is a phrase that’s become popular of late among political commentators. It’s used to describe the process of softening people up for bad news, so that when the moment of truth arrives it’s not quite such a big shock, and indeed may even bring relief that things weren’t even worse. With Jeremy Hunt’s Autumn Statement delayed by more than two weeks from its initial scheduling at Halloween, there’s been a lot of pitch-rolling, as well as a fair amount of ‘kite-flying’, the process where ideas are floated in the press to see how much apoplexy they arouse among backbenchers and the party faithful in the country. So, when it came to the big day, there wasn’t much in Mr. Hunt’s statement that came as a surprise. Nonetheless, the contrast between the tone of this statement and that delivered by Kwasi Kwarteng on 23 September couldn’t have been more stark, with Mr. Kwarteng’s “going for growth” replaced by Mr. Hunt battening down the hatches to weather an economic storm.

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The first thing to get to grips with is the dramatic change in the economic landscape since the outbreak of the war in Ukraine. When Rishi Sunak delivered his Spring Statement in March, it was already clear that the war would have a significant impact on the UK's economic and fiscal prospects. It had also become obvious that the spike in inflation would last rather longer than had been hoped. But with gas prices rising to almost unimaginable levels during the summer and the economy slipping into recession from the third quarter, the difference between then and now is stark; and that's before the effects of September's disastrous "mini Budget" are factored in.

Back in March, the Office for Budget Responsibility (OBR) expected the economy to grow by a modest 1.5% in 2023, accelerating to 2.3% the following year. Now, it's expected to contract by 1.4% during 2023. The downturn is slated to last for five quarters, with output shrinking by 2.1%. Although a recovery is projected to get under way from the final quarter of next year, full-year GDP growth in 2024 is now forecast at a more modest 1.3%. The OBR thinks that inflation will peak at around its current level in the final months of this year, but will still average 7.4% during 2023. This compares with March's forecast that it would average just 4.1%. Thereafter, it's predicted to fall sharply, and indeed to go into negative territory for a while during the middle of the decade. This makes possible a strong revival in real incomes, such that the pace of economic growth is then projected to average 2.5% (precisely what Liz Truss and Kwasi Kwarteng were aiming for) from 2025 to 2027. But with the immediate outlook for inflation so much worse than the OBR was expecting in March, the forecast for the yield on government bonds, which is an important determinant of the cost of servicing the national debt, has been raised by around 2.25 percentage points across the forecast horizon.

Such big changes in the outlook for key variables are enough to drive a coach and horses through any set of fiscal forecasts. So, not only has the headroom from March turned into a 'black hole', but also Mr. Hunt felt obliged to come up with a plan that conformed to the letter of the OBR's assessment. The after-shock of September's "mini Budget" is that the government has had to consider measures that would have been off the table had that statement never been made.

Yet for all the welter of announcements, the approach taken at this Autumn Statement was a fairly simple one. The bulk of the cost of supporting households and businesses with their energy costs will be met largely from windfall levies on oil and gas producers and generators of renewable electricity. Meanwhile, the damage done to the public finances by the worsening economic situation, higher inflation and the government's increased borrowing cost, will be met by applying restraint to public expenditure, both day-to-day and capital spending, from April 2024.

The changing economic backdrop:
OBR forecasts, November 2022 vs previous forecasts

		2021	2022	2023	2024	2025	2026	2027
GDP growth	October 2021	6.5	6.0	2.1	1.3	1.6	1.7	
	March 2022	7.5	3.8	1.8	2.1	1.8	1.7	
	November 2022	**7.5**	**4.2**	**-1.4**	**1.3**	**2.6**	**2.7**	**2.2**
CPI inflation	October 2021	2.3	4.0	2.6	2.1	2.0	2.0	
	March 2022	2.6	7.4	4.0	1.5	1.9	2.0	
	November 2022	**2.6**	**9.1**	**7.4**	**0.6**	**-0.8**	**0.2**	**1.7**

Source: OBR, *Economic and Fiscal Outlook*

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One of the few surprises in Mr. Hunt's statement is that the Energy Price Guarantee (EPG), which caps gas and electricity prices paid by households, will be kept in place after April next year. At present, the capped price for electricity of around 34p per kilowatt hour and around 10p per kilowatt hour equivalent for gas, means that the typical domestic customer is paying around £2,500 a year. This will be increased to £3,000 from next April, and will apply for 12 months. Current energy prices would have meant typical users paying about £3,700 a year had the EPG been ended, so the preservation of the cap, albeit at a higher price, will mean that inflation rates will be significantly lower after April than would otherwise have been the case. Those in receipt of Universal Credit, the state pension, and disability benefits will benefit from annual cost of living payments of £900, £300, and £150 respectively.

At prevailing energy prices, the cost of supporting households with their energy bills until April is reckoned to amount to £24.8 billion, while the cost of supporting businesses over the same period will cost £18.4 billion. Raising the capped price for a typical user to £3,000 means that the cost of support for the 2023/24 fiscal year will fall to £12.8 billion. An announcement will be made about targeted help for businesses early in the New Year. Taking into account the other energy relief measures, the total cost is expected to come to £69 billion during this and the next financial year, similar to the cost of the furlough scheme during the pandemic.

With this long-awaited statement now out of the way, perhaps the biggest challenge for Mr Sunak's administration will be to try to find ways to get energy prices down, and in particular to weaken the link between gas and electricity prices. Quite apart from anything else, the OBR's fiscal arithmetic assumes that the cost of energy price support measures will be negligible from April 2024. Taken together, the levy on oil and gas producers, initially set at 25% but now raised to 35%, and extended to April 2028, along with the new levy of 45% on electricity generated from renewable sources (including nuclear and biomass), is projected to bring in nearly £56 billion.

Delaying the pain

Mr. Hunt was at pains to point out the various ways in which the government will help to nurse the economy through the period of recession that began in the third quarter. One of the worst aspects of the present downturn is the steep fall in the spending power of households, with real disposable incomes expected to fall by around 7% during 2022 and 2023. This is not only the biggest fall since the Second World War, but wipes out all the gains made in the preceding eight years. Among the measures targeted at sustaining incomes, especially for those on lower incomes, is the increase in the National Living Wage by 9.7% from next April, the up-rating of the state pension in line with September's CPI inflation rate of 10.1% as per the Triple Lock mechanism, a similar up-rating of many social security benefits, and the capping of rent increases in the public sector to 7% next year.

The measures announced in this Autumn Statement in fact represent a very small fiscal giveaway of £2 billion in the 2023/24 fiscal year. But thereafter the screw is tightened sharply, with the consolidation over the period from the present fiscal year out to 2027/28 forecast to amount to £130 billion. Of this, £55 billion has been shunted into the final year. In other words, most of the pain is being deferred until after the next general election. Although the government could delay the vote until January 2025, if the polls aren't looking too dreadful it would probably want to go to the country in May or June of 2024.

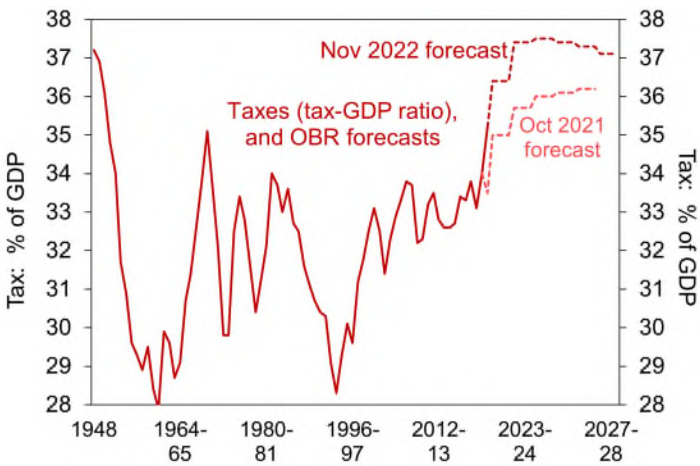
As was widely trailed in the run-up to the statement, the burden of closing the gap in the government's finances fell harder on public spending than on additional taxation. It's not so much that public spending is going to be cut, although the settlements for some departments will be painful enough and there was no definitive commitment at this stage to increase spending on defence to above 2% of GDP. Taken as a whole, public spending on day-to-day services will still increase in real terms, but only by 1% a year after April 2025. What this will mean for individual departments won't be spelt out until the next Spending Review, which will be due at some point in 2024. The biggest burden will fall on capital expenditure, where spending will be frozen in nominal, or cash, terms from 2025, which will amount to a sizeable cut in real terms during subsequent years.

On the tax front, the Chancellor extended the freezing of most personal tax thresholds by another two years until April 2028. This means that growth of incomes and inflation will drag more people into paying taxes or paying them at a higher rate. Not all thresholds were frozen, with some being cut, most notably the threshold at which tax is paid on dividends, which will fall to just £500 a year from 2024 from its present level of £2,000, and the starting point for paying Capital Gains Tax, which will be cut to just £3,000 in 2024 from the present £12,300. As was strongly signaled, the 45% Income Tax rate levied on higher earners, which Kwasi Kwarteng abolished, is not only being retained, but the threshold will be lowered from £150,000 to £125,141. It will therefore kick in at that point in the income spectrum after people have lost all of their personal allowance of £12,570.

It's noteworthy that the Chancellor, having reversed most of the measures announced by Kwasi Kwarteng eight weeks ago, didn't feel able to back-track on the cut in National Insurance Contributions, from 13.5% to 12.25%, which takes effect this month, nor did he reinstate the Health and Social Care Levy, with additional funding for provision of social care coming from general taxation. In any case, the personal taxation measures, unpopular as they will be in many quarters, don't raise a lot of money in the bigger scheme of things, with the increased take for the Exchequer being a modest £13 billion over the forecasting period out to 2027/28.

When it comes to taxation of businesses, quite apart from the fact that the increase in Corporation Tax for larger firms will still go ahead next year, the biggest contributor to the Treasury's coffers will be the freezing of the upper limit on National Insurance Contributions for employers. This measure alone is reckoned by the OBR to bring in an additional £25 billion over the next five years. On top of that, the government's commitment to implement Pillar 2 of the rules on taxation of multinationals, as per the OECD's multilateral initiative, from the start of 2024 will bring in a further £8 billion. Also of note, was the lack of any mention about the so-called "super deduction", which will lapse, as scheduled, in April next year.

A rising tax burden



Source: OBR, *Economic and Fiscal Outlook*

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New rules

Given the deterioration in the state of the public finances, there was no realistic prospect of meeting the fiscal rules previously set out by Rishi Sunak, without imposing a spell of harsh austerity. Instead, the Chancellor has set out two new rules relating to the burden of debt in relation to GDP and the public sector's annual borrowing. The ratio of net public sector debt (excluding the Bank of England) to GDP must now be falling by the fifth year of the forecasting period, whereas previously this was to have been achieved in the third year. Unsurprisingly, the measures announced by Mr. Hunt ensure that this is indeed the case, albeit that the debt burden is still forecast to amount to 97.3% of GDP in 2027/28. In the meantime, it will continue to climb from an anticipated 89.9% of GDP this year, for the next three fiscal years.

The second rule is that the amount borrowed annually by the government must be at less than 3% of GDP, also in the fifth year of the forecasts. This is a departure from previous frameworks, which focused instead on current, or day-to-day, spending. The OBR now believes that the deficit for the current fiscal year will come in at an eye-watering £177 billion, as against the £99.3 billion it had forecast in March. From next year onwards, however, the shortfall is due to fall as a percentage of GDP, coming down from 7.1% in 2022/23 to a more comfortable 2.4% in 2027/28.

Needless to say, the figures for the cost of servicing the national debt are genuinely eye-popping. The OBR expects the government to spend £120.4 billion on interest payments in the current year, representing around 11% of its revenues. Interest payments are therefore the biggest component of government expenditure, after the Department for Health and Social Care.

Doing what was needed

This was the seventh "fiscal event" of 2022, delivered by the fourth Chancellor of the Exchequer to hold the post this year. But given the difficult circumstances, made worse by September's "mini Budget", it is clearly the most important, setting the economic and political direction of Rishi Sunak's administration for the next two years, and for longer if the Conservatives manage to win the next general election. The muted response from financial markets suggests that Jeremy Hunt's statement has landed as well as could be expected, although some backbench Conservative MPs will be deeply unhappy about the change of direction.

Higher interest rates push up debt servicing costs:
OBR forecasts, November 2022 vs previous forecasts

		2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Market gilt rates (%)	October 2021	0.8	0.9	0.9	1.0	1.1	1.2	
	March 2022	0.9	1.4	1.4	1.5	1.5	1.6	
	November 2022	**1.0**	**3.0**	**3.7**	**3.7**	**3.7**	**3.7**	**3.7**
Net debt interest (£ bn)	October 2021	36.0	33.7	28.8	27.7	28.8	29.5	
	March 2022	49.3	72.4	37.0	36.8	37.5	37.6	
	November 2022	**49.1**	**108.8**	**87.8**	**63.7**	**64.1**	**85.2**	**88.8**

Source: OBR, *Economic and Fiscal Outlook*

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Above all, what Mr. Hunt's statement delivered was a set of policy measures which stabilize the fiscal situation in line with the OBR's latest thinking. In other words, he has made sure that the sums add up, albeit that much of the pain will fall on the next government, of whatever colour, to deliver, and quite possibly take the blame for.

Those of a skeptical disposition may well question whether the next government will really have the stomach to deliver the hard part of the plans outlined in the Autumn Statement. The Government is no doubt hoping that, having done enough in this Autumn Statement to keep the markets onside, at some point a favourable turn of events will allow it to reverse some of the more painful measures. As we've found out, the OBR's forecasting is extremely fluid over a five-year time horizon, so that under propitious circumstances future forecasts could offer the government of the day more headroom.

Yet it's highly unlikely that the forecasts can be rolled back to where they were in March. An end to the war in Ukraine would calm the fraught geopolitical situation and would no doubt lead to a further easing of commodity prices. But it seems highly unlikely that Europe (including the UK) will ever again buy gas from Russia in anything like the volumes that were shipped before the invasion of Ukraine. Prices for gas, and also for oil, will therefore very likely remain at elevated levels for the foreseeable future, irrespective of what happens in Ukraine. More to the point, the outlook for inflation and interest rates isn't likely to alter materially in a favourable direction. Indeed, if the Bank of England fails to tame inflation with the interest rate increases that are expected to deliver during the next few months, then Bank Rate and bond yields might not peak where the OBR thinks they will, requiring a further adverse adjustment to its forecasts.

As things stand, Jeremy Hunt's statement will make little difference to the immediate outlook for interest rates. With the Government and the Bank of England now moving in the same direction, HSBC still expects the present tightening cycle to come to an end in February 2023 with Bank Rate then being left at 3.75% for an extended period. The big question is whether that will be enough to tame inflation, or whether a bitter second bite of the cherry will be needed, perhaps in about a year's time.

Issued by HSBC UK Bank plc

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