Wednesday 15 March 2023

UK Budget 2023: A walk on the supply side

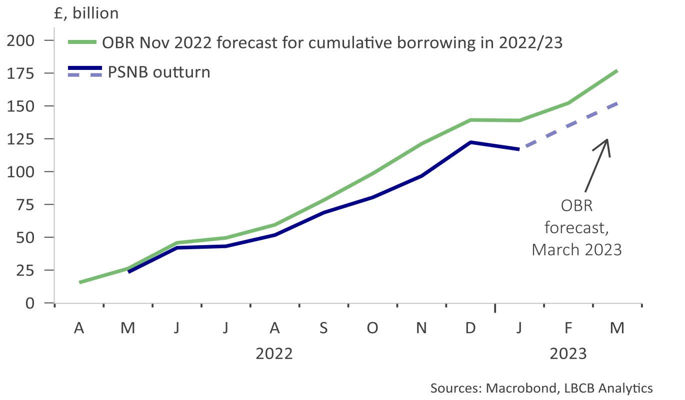
The UK Chancellor, Jeremy Hunt, delivered the first Budget of the Sunak premiership, supported by a more positive fiscal backdrop than at the time of the last fiscal event in November. However, with the UK's economic outlook facing multiple challenges, the Chancellor still faced a tricky task in managing all the demands placed in front of him.

Lower near-term borrowing provides room to spend

Relative to the Autumn Statement the UK Chancellor, Jeremy Hunt, went into the latest fiscal event with much better news on the near-term fiscal outlook behind him. In the current fiscal year, government borrowing outturns have been noticeably lower, which meant that up until January the government had borrowed a cumulative £30.6bn less (on a like-for like basis after taking account of accounting differences for student loans), than the Office for Budget Responsibility (OBR) had expected in its last forecast update in November. This improvement in the finances was largely a reflection of a stronger-than-expected economic performance. Additionally, declines in wholesale energy prices have helped lower the fiscal cost of the government's Energy Price Guarantee (EPG) scheme, while lower debt interest spending – due to lower government bond yields and reduced expectations for Bank Rate – also played their part in driving lower-than-expected borrowing in the current fiscal year. As a result, the OBR cut its borrowing forecast from £177bn to £152bn.

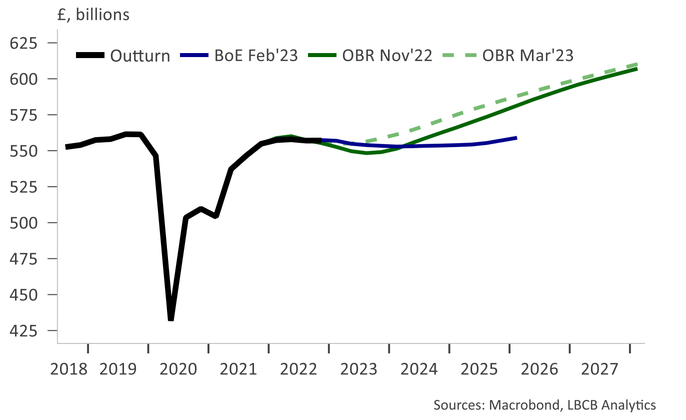
The undershoot in borrowing in the current fiscal year, meant that the Chancellor had some wiggle room to announce several spending measures in the coming fiscal year, targeted towards those policy areas seen as priorities for the government, including helping households with the rising cost of living.

Chart 1: Lower borrowing in 2022/23 left the Chancellor with room to spend



Sources: Macrobond, LBCB Analytics

Chart 2: OBR continues to forecast strong GDP growth

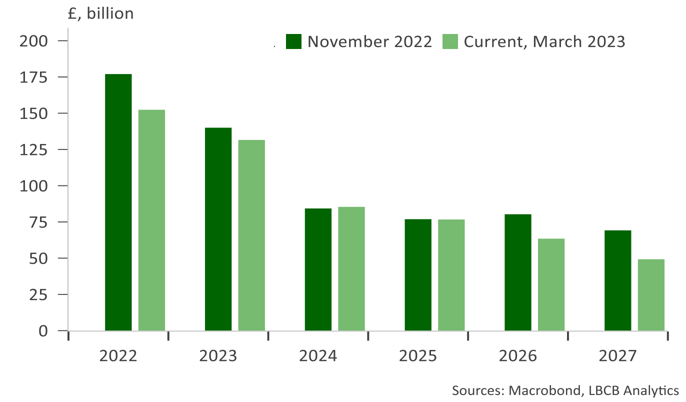


Sources: Macrobond, LBCB Analytics

Notably, the Chancellor confirmed that the EPG would be kept at £2,500pa, rather than being raised to £3,000pa in April, in keeping with media reports in the run-up to the Budget, and the Treasury's announcement earlier in the day. This was followed up by confirmation that plans to raise the rate of fuel duty on petrol and diesel from April, had also been scrapped. The fuel duty 'escalator', which was designed to increase the levy every year, was frozen once again, while the 5p/litre discount that was introduced in the wake of Russia's invasion of Ukraine, was also extended for another year.

As a result of the better-than-expected economic momentum and the impact of the measures aimed at supporting spending in the near term, the UK is now expected to avoid falling into a 'technical recession' (defined as at least two consecutive quarters of declining output) this year, though the UK economy is still expected to contract by 0.2% in 2023 albeit by less than the 1.0%

Chart 3: Borrowing projections revised lower over the forecast horizon



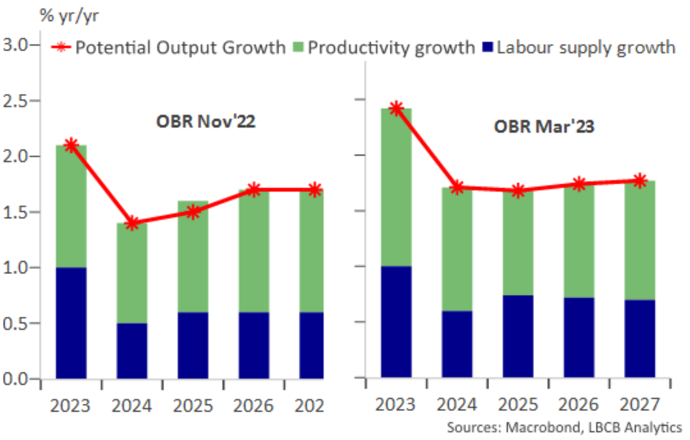
Sources: Macrobond, LBCB Analytics

fall expected back in November. These developments are also expected to help the economy by aiding a swifter moderation in inflation. Indeed, by the end of the year, the OBR expected the annual rate of CPI inflation to be below 3% from its current level of 10.1%.

Supply-side improvements to play a key role

However, as these factors are temporary in nature, and not expected to boost demand over the longer term, the greater focus of today's Budget was on how the economy was expected to grow in coming years, particularly how much was driven by government borrowing. Relative to its November projections. The OBR now expect cumulative borrowing over the next five fiscal years (2023/24 – 2027/28) to be around £407bn, some £43bn less than it previously envisaged. Against a backdrop of a surge in the cost of living, the Chancellor focused on improving the supply side of the economy, most notably, inducing labour participation and business investment. As a result, the economy is now expected to be 8.2% above its pre-pandemic size (from Q4 2019) by the end of 2027, versus 7.7% in the November projections.

Chart 4: Labour supply growth forecast to play a greater role over the five-year horizon



In a bid to incentivise business investment, and support an improvement in productivity, the Chancellor announced a temporary 100 per cent capital allowance scheme for all qualifying investment spending over the next three fiscal years. With the Chancellor confirming that the increase in corporation tax, from 19% to 25%, would go ahead, this was seen as helping to provide some offset.

Greater emphasis on labour supply

There was also a focus on doing more to improve the supply of labour in the UK. The starting point, was an acknowledgment that labour force participation fell sharply in the wake of the pandemic, leaving the total size of the UK labour force around 520,000 people smaller than it would otherwise be (see Chart 5). By far the biggest impact has come from the rise in 'inactivity' from ill health – with the latest labour market figures showing that over 2.5 million were reported as being inactive due to long-term illness. Here, the Chancellor announced a Health and Disability White Paper that set out plans to reform the welfare system.

Elsewhere, efforts to keep older workers in work for longer and to return to work were reflected in changes to pensions where the annual allowance for tax-relief on pension contributions was raised from £40,000 to £60,000, while the lifetime allowance charge would also be abolished. Measures to help with childcare costs were also announced to help parents return to work. Working parents of children up to 3 years old in England would be able to access up to 30 hours of free childcare per week starting from April 2024. However, overall, at an aggregate level, the net impact of these measures seems to result in only a marginal improvement in the supply side of the economy (see Chart 6) relative to the OBR's prior projections.

Chart 5: Measures aimed at improving labour force participation welcomed

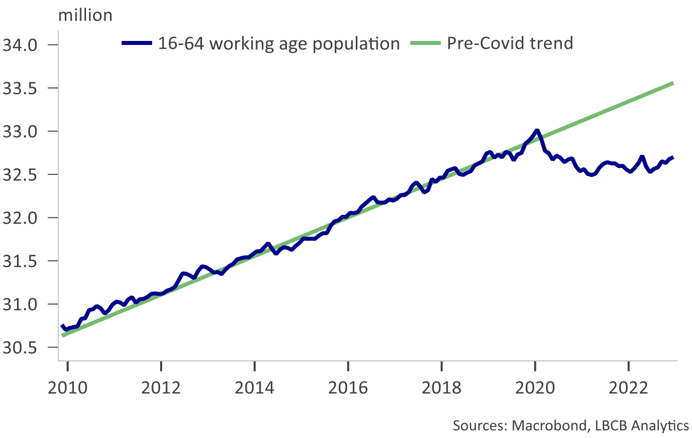
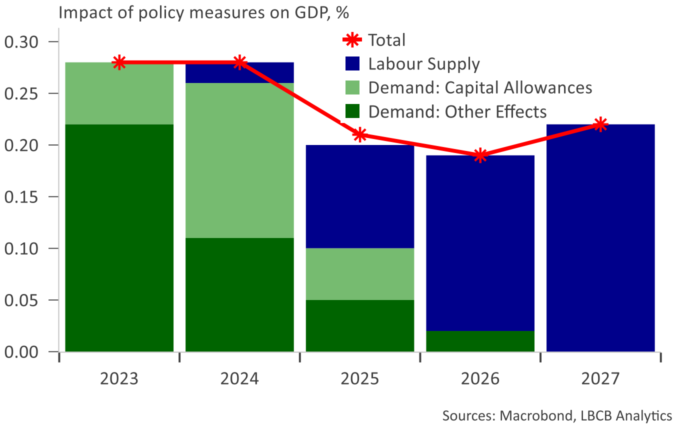


Chart 6: Supply-side improvements to play a bigger role further out



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