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THE SUNDAY TIMES

@dsmitheconomics

Under new management

The economic and housing outlook under Labour

Four questions

- How bad, or good, was the new government’s economic inheritance?
- What will be in the October 30 budget?
- How fast and how far will interest rates fall?
- What might all this mean for you?

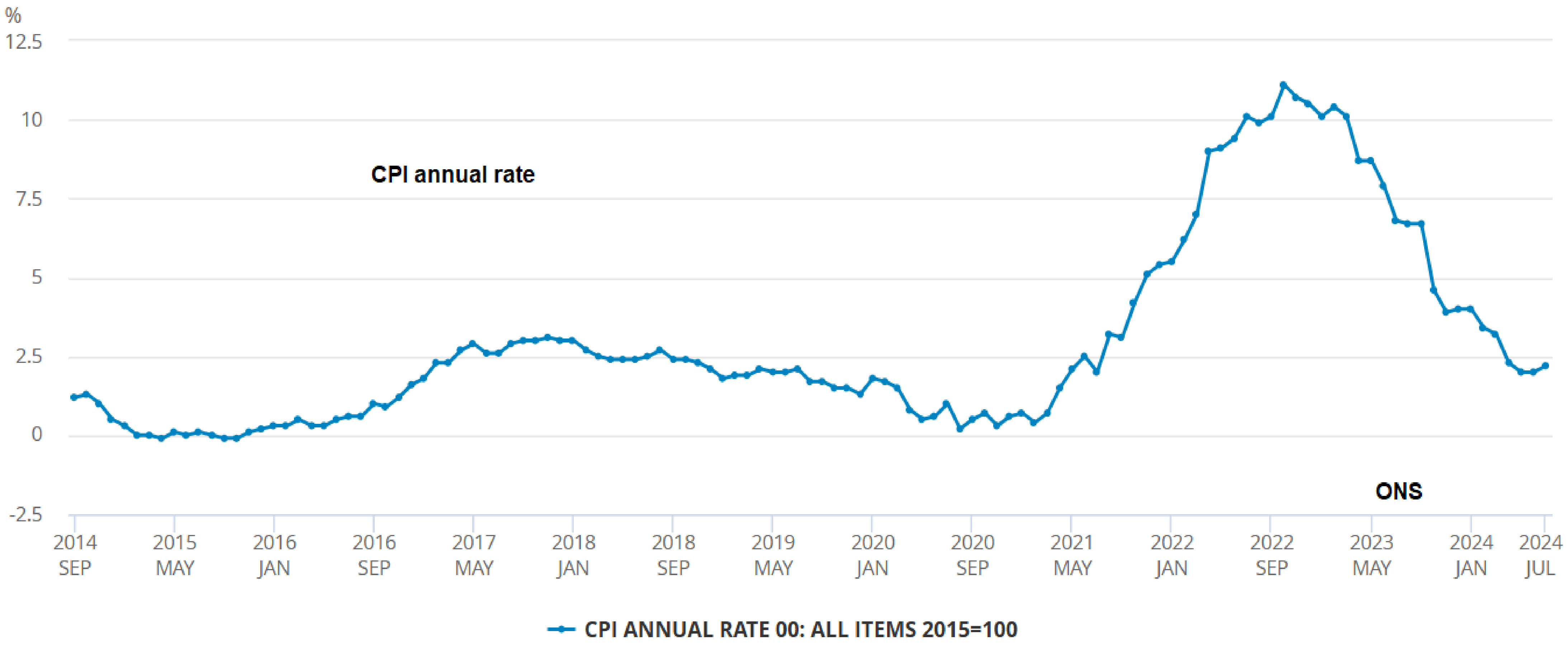
The economy’s had a run of shocks

- The global financial crisis.
- Brexit & the Trump trade wars
- The pandemic.
- The Russian invasion of Ukraine

Like the Four Horsemen of the Apocalypse

But growth has made a minor comeback

And inflation has got over its surge



The problem is fiscal (1)

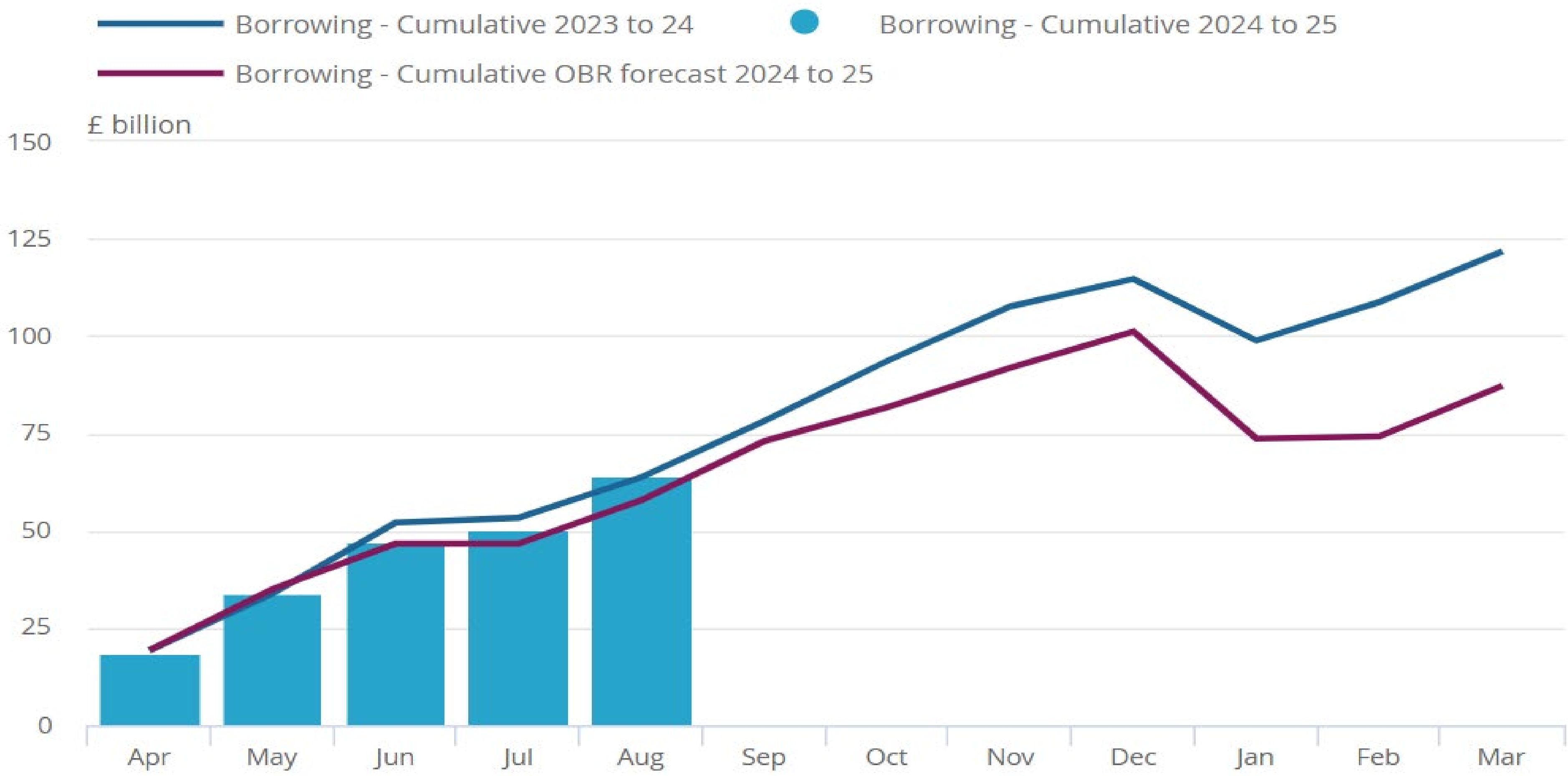
“Mr Speaker, the government published its plans for day-to-day departmental spending at the Spring Budget in March. But when I arrived at the Treasury on the very first day I was alerted by officials that this was not how much the previous government expected to spend this year.

Not even close. In fact, the total pressure on these budgets across a range of areas was an additional £35bn. Once you account for the slippage in budgets you usually see over a year and the reserve of £9bn to deal with genuinely unexpected events it means, Mr Speaker, that I have inherited a projected overspend of £22bn.

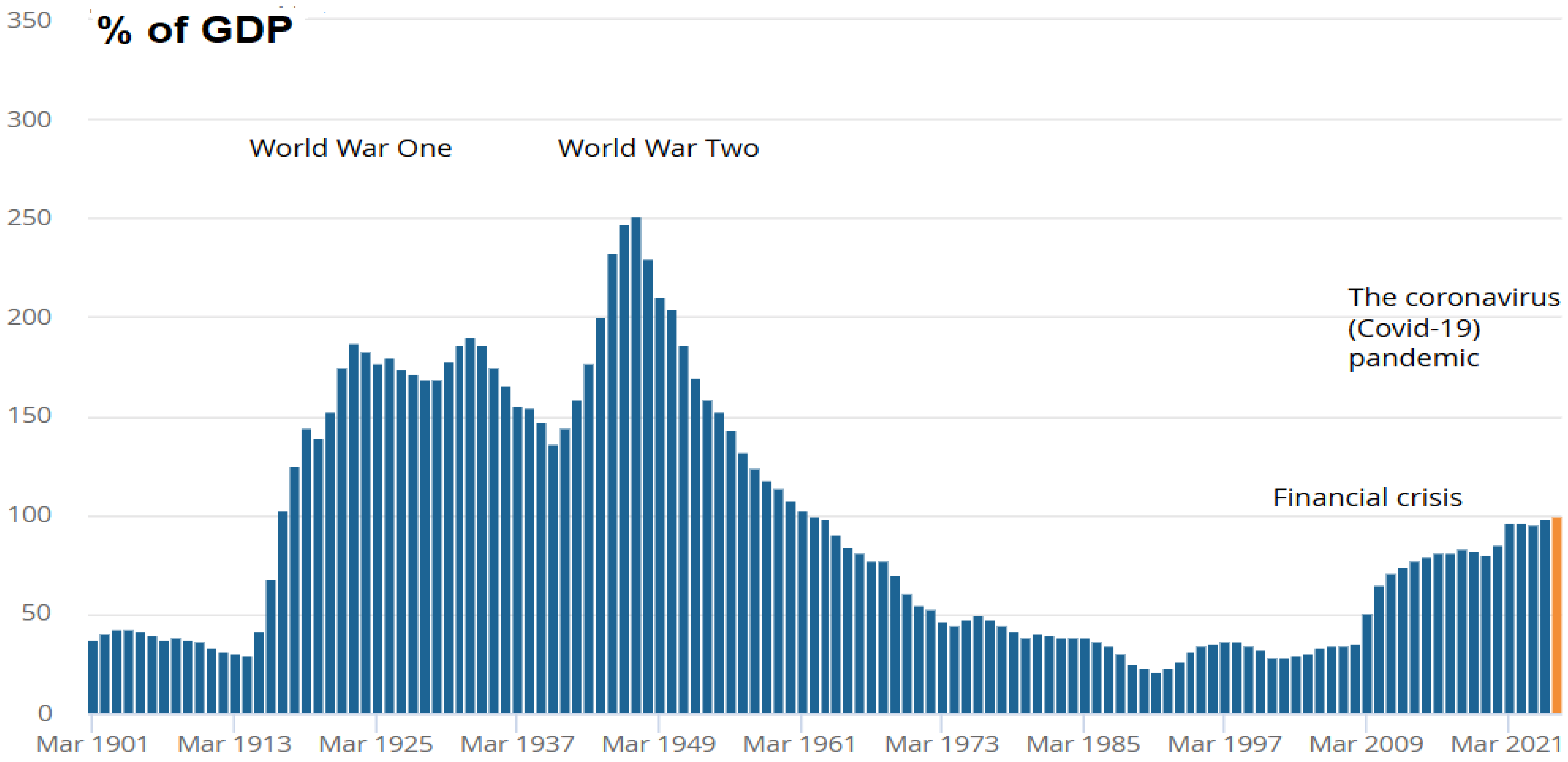
A £22bn hole in the public finances now – not in the future. If left unaddressed it would have meant a 25% increase in the government’s financing needs this year, pushing gilt issuance further into record highs outside of the pandemic.”

Rachel Reeves, July 24, 2024

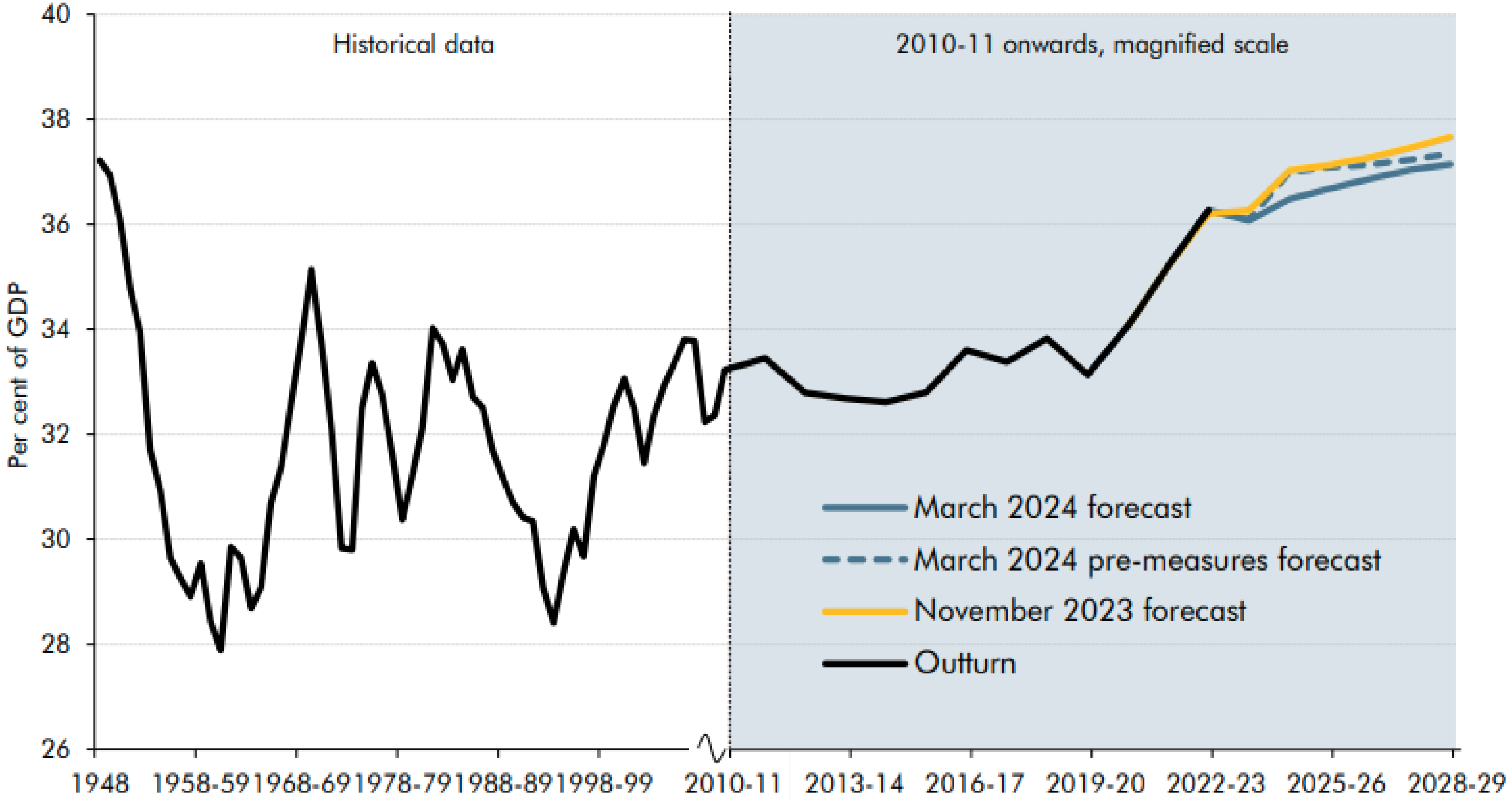
The problem is fiscal (2)



Debt is now 100% of GDP



With the tax burden already the highest since the 1940s



Source: ONS, OBR

October 30 budget will be painful – not my words

What might be in the budget?

- No increases in the main rates of income tax, employees' NI, corporation tax or VAT.
- But Reeves will want to raise £15-20 billion in extra tax in order to put realistic spending plans in place.
- Those with the "broadest shoulders" will face the biggest burden.
- There will also be more public borrowing, despite the tough rhetoric.

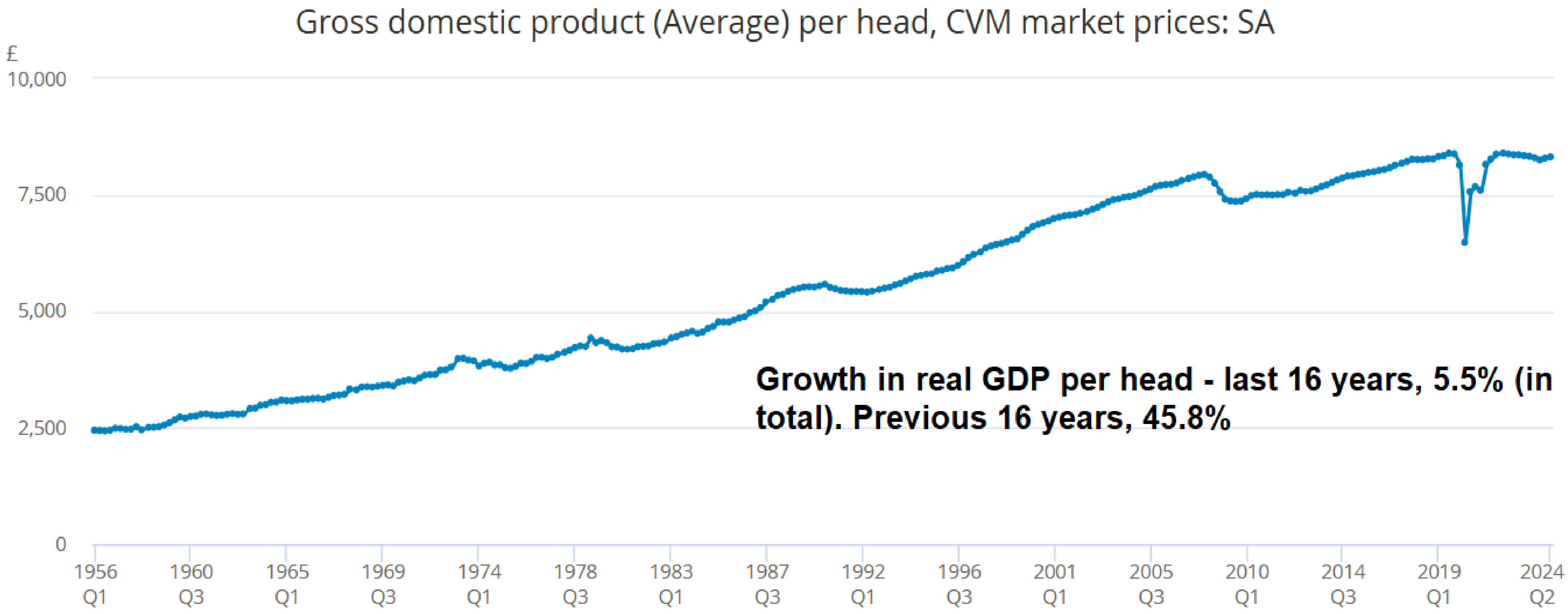
Some of the other possibilities

- **Capital Gains Tax (CGT)** changes -beyond the manifesto commitment to raise taxes on carried interest - would ideally involve significant reform. Employees face a top tax rate of 47% and dividends are taxed at up to 39.35% but the top CGT rate for shares is 20%, with relief potentially lowering that to 10%, and there are ways to pay zero tax. This combination – creating both winners and losers – would raise around £8 billion per year.

- **Inheritance Tax** could raise more revenue if its reliefs and exemptions were reviewed. Pension pots should be brought within scope, and business and agricultural relief ended – or much more restricted. Owning AIM-listed shares should no longer be sufficient justification for not applying Inheritance Tax. These changes could raise up to £2 billion. Going further, the Government could end the complicated residence nil- rate band, which was introduced in 2017 and provides an extra tax-free allowance if a main residence is left to a direct descendant, raising a further £2 billion.

- There are many options for reforming **pension tax reliefs**, but one of the simplest options is to levy employer NI on employers' pension contributions. Up to £12 billion could be raised by ending this tax break that favours employer pension contributions over worker contributions. Of this, £3 billion would then ideally be used to give full employee NI relief on employee pension contributions, which would particularly benefit basic-rate taxpayers. This combination – raising up to £9 billion – would level the playing field between employer and employee pension contributions. **Resolution Foundation, 'Tax and Reform', September 2024.**

Growth is the big challenge



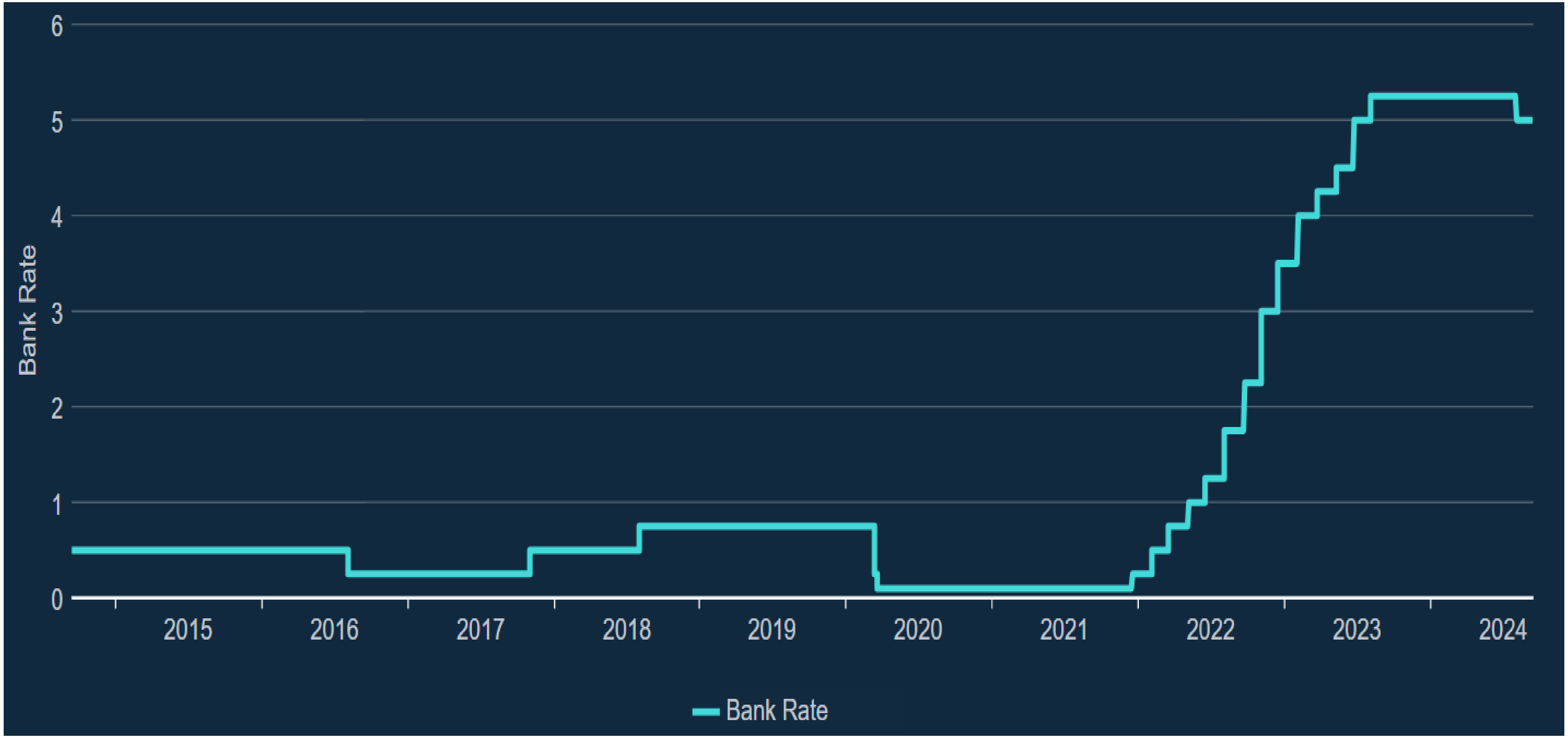
It’s a long way to the top of the G7 growth league

Cumulative GDP growth since Q4 2019 (the eve of the pandemic)

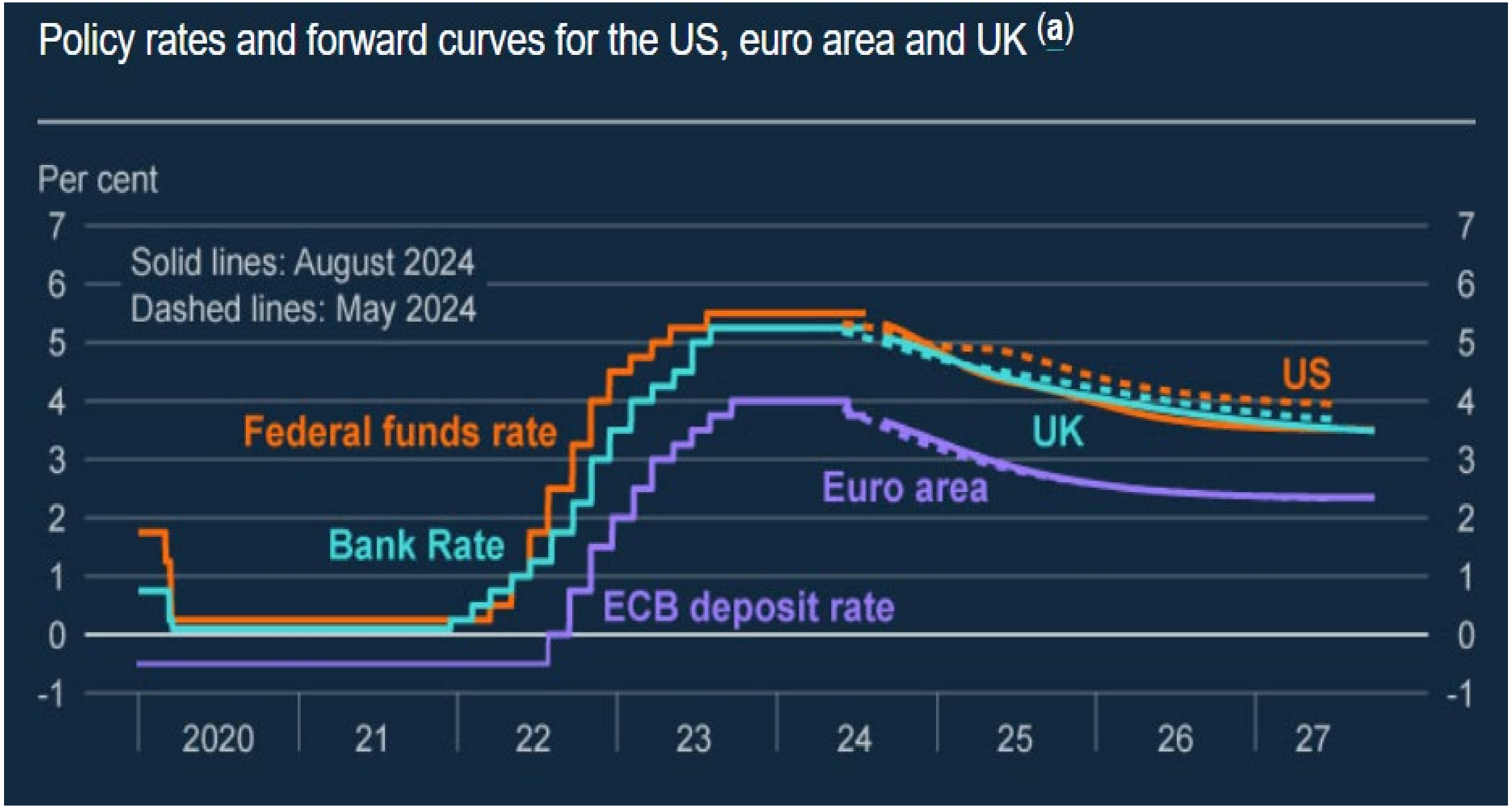
- UK: 2.3%
- Japan 3.1%
- France 3.8%
- Italy 4.7%
- Canada 5.4%
- America 9.4%
- Though Germany, just 0.2%

The interest rate dog barked a lot

But Bank Rate has come down a notch



Official rates everywhere have further to fall



But we won’t go back to near zero rates

“Don't expect we're going back to zero because zero was the product of huge global shocks,” Andrew Bailey, August 2024.

(Narrator: Shocks could easily happen again)

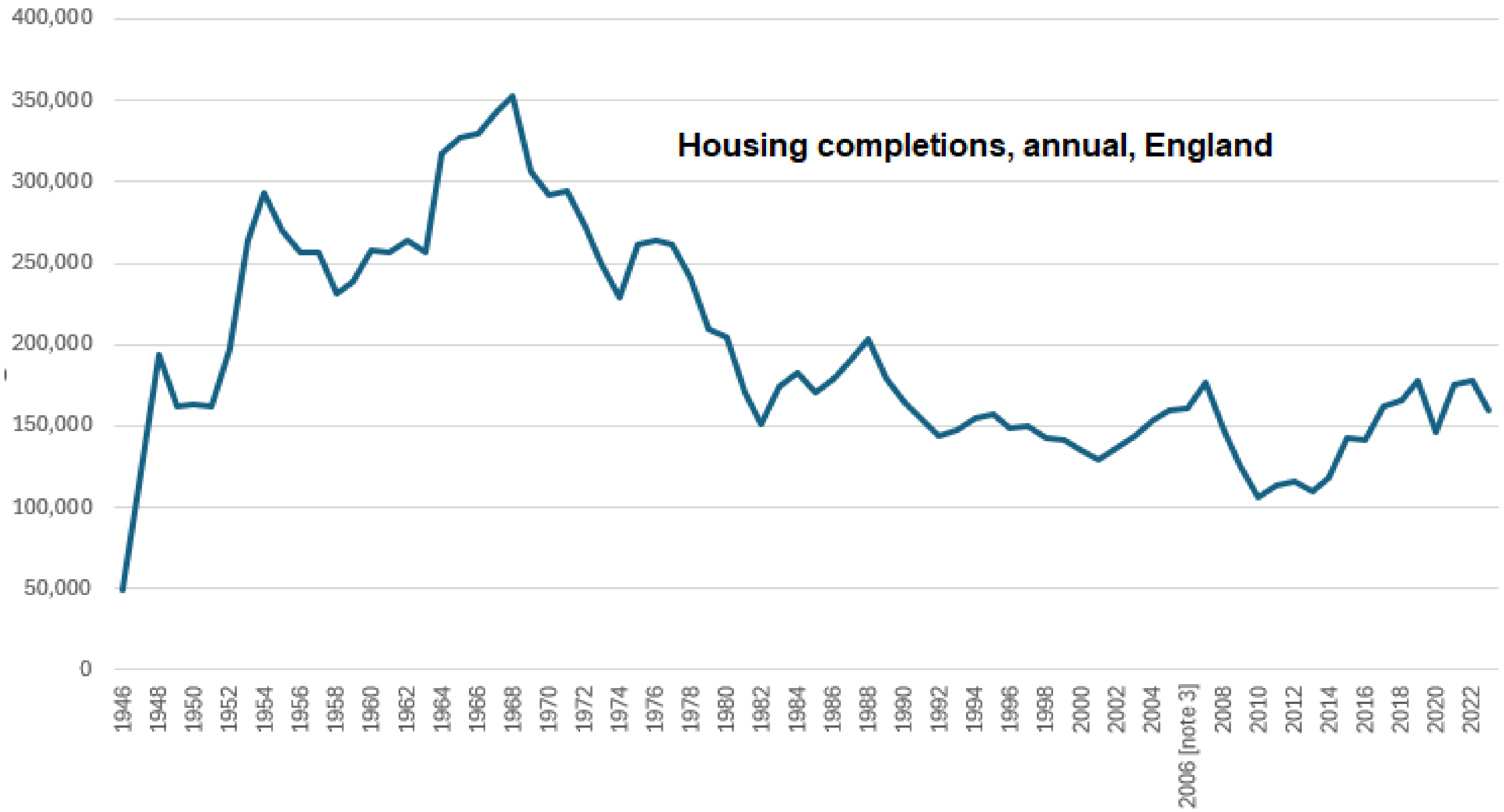
What we learned from the September 19 minutes

- **Only one vote for a cut from arch-dove Swati Dhingra**
- **The MPC is still worried about service-sector inflation, currently 5.6%**
- **But it thinks inflation will be 2.5% at the end of the year, from 2.75% previously.**
- **And it thinks pay trends are going its way.**

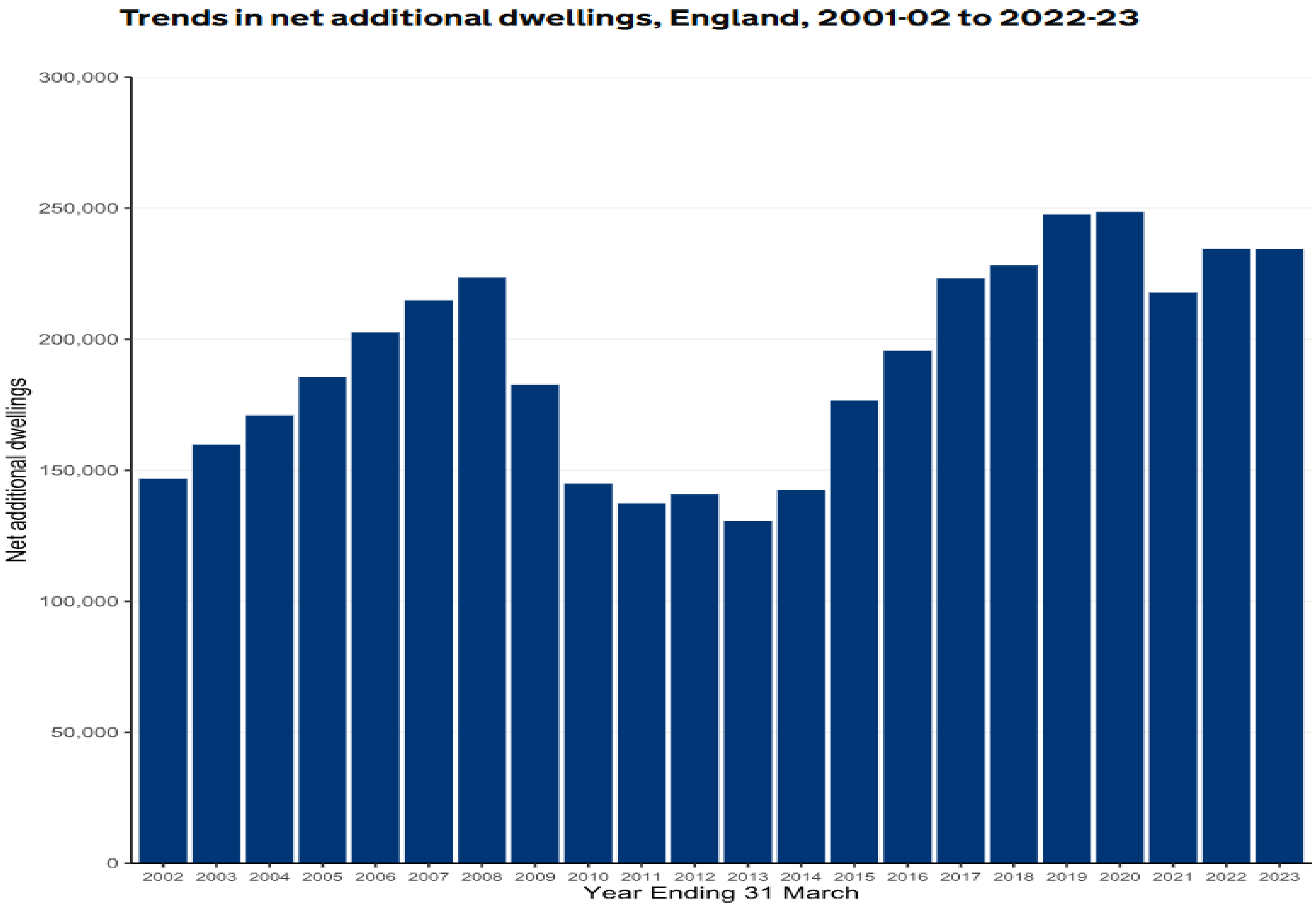
What might all this mean for you?

Labour wants many more new houses

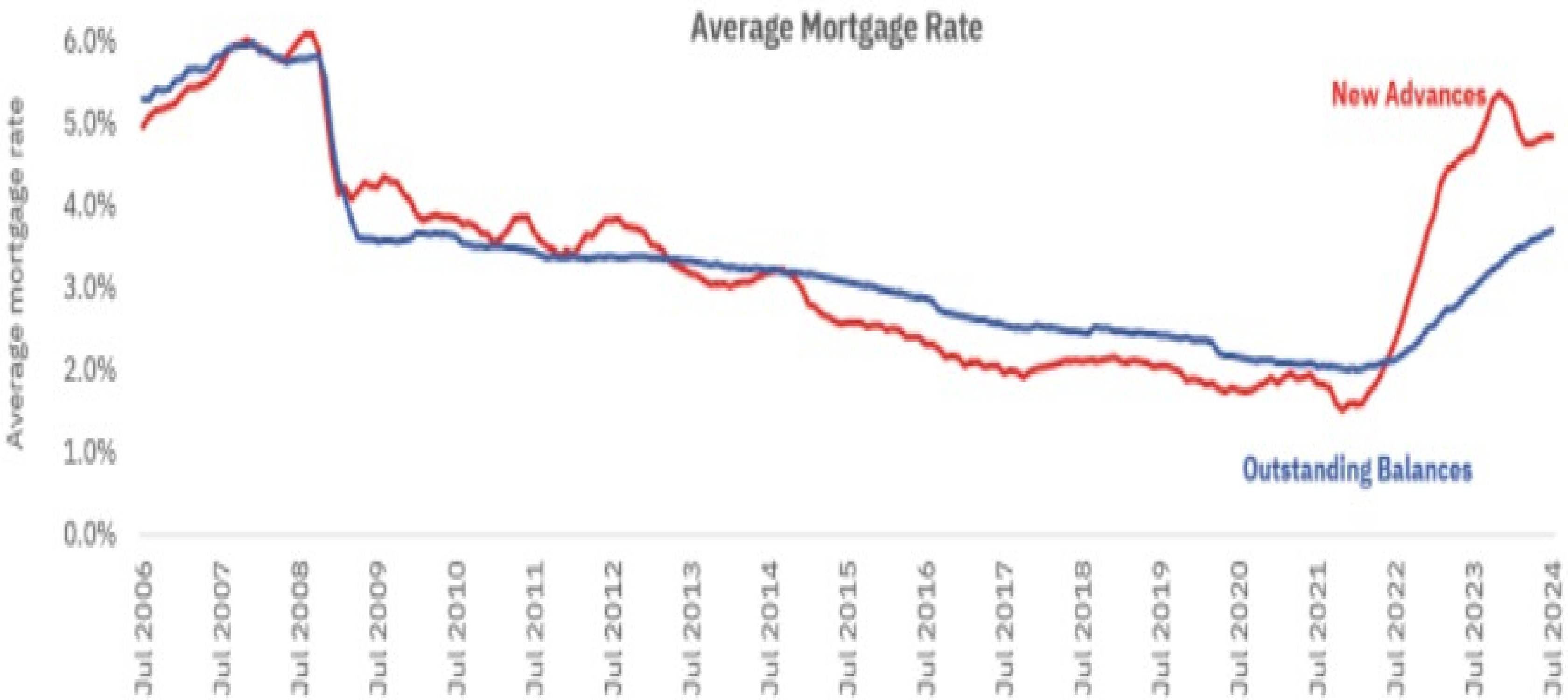
But it's a long time since we built 300,000 a year



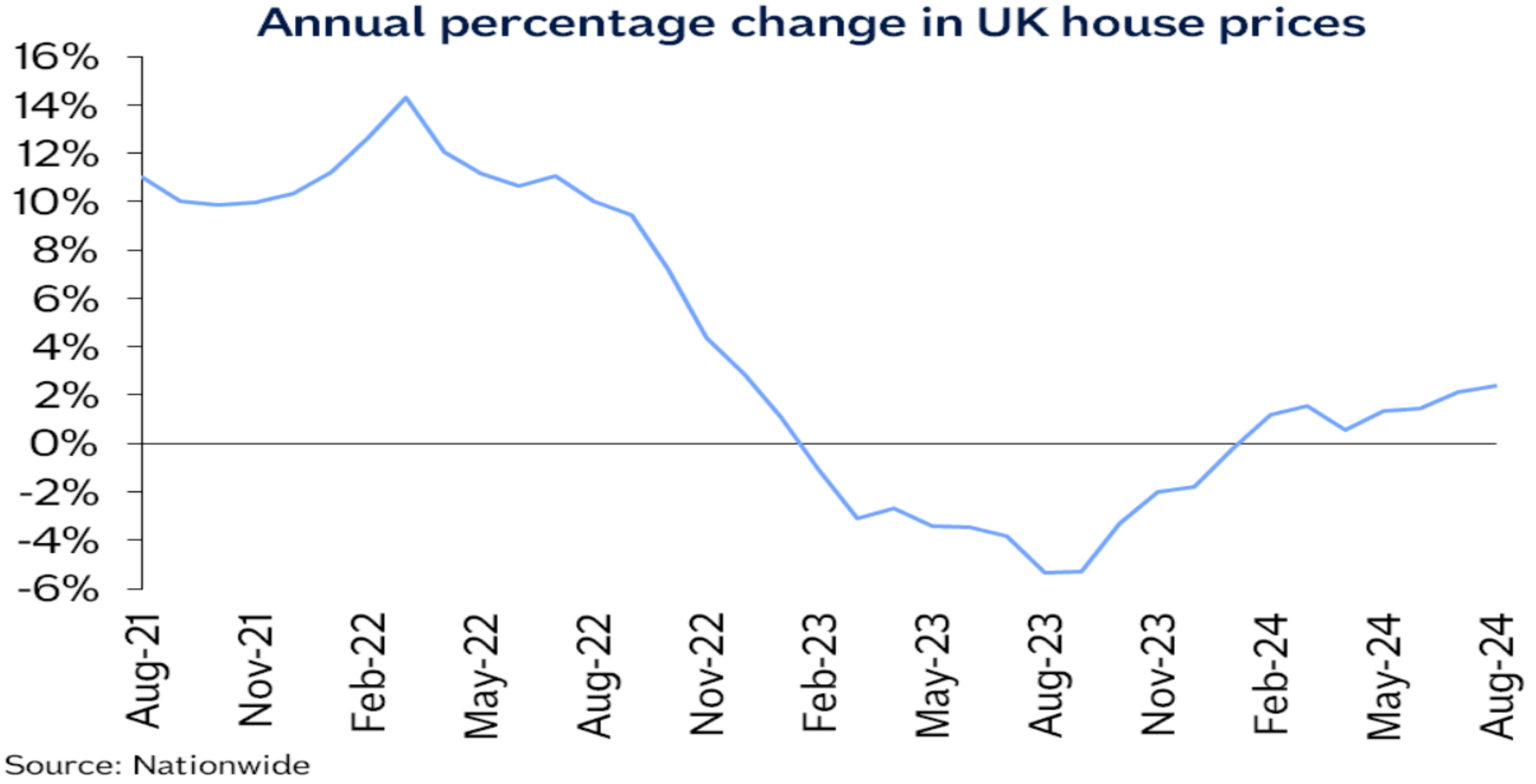
Though another measure gets you a bit closer



Mortgage rates are edging lower



Helping house prices



Which have done much better than feared

September 2022:

UK house prices may fall 20% amid mortgage 'carnage', warn experts

Is the UK about to see 'biggest ever' house price crash?

This is a big uncertainty

So plenty to think about

Let’s hope for not too many more black swans

And in the meantime, keep counting those skips