PICTET WEALTH MANAGEMENT

UK Autumn Budget: "Invest, invest, invest"

A new fiscal regime for the UK

31 OCTOBER 2024, CIO OFFICE & MACRO RESEARCH

AUTHORS
SEBASTIEN GORGONI
sgorgoni@pictet.com
MICHAEL HART
mihart@pictet.com

FLASH NOTE

SUMMARY

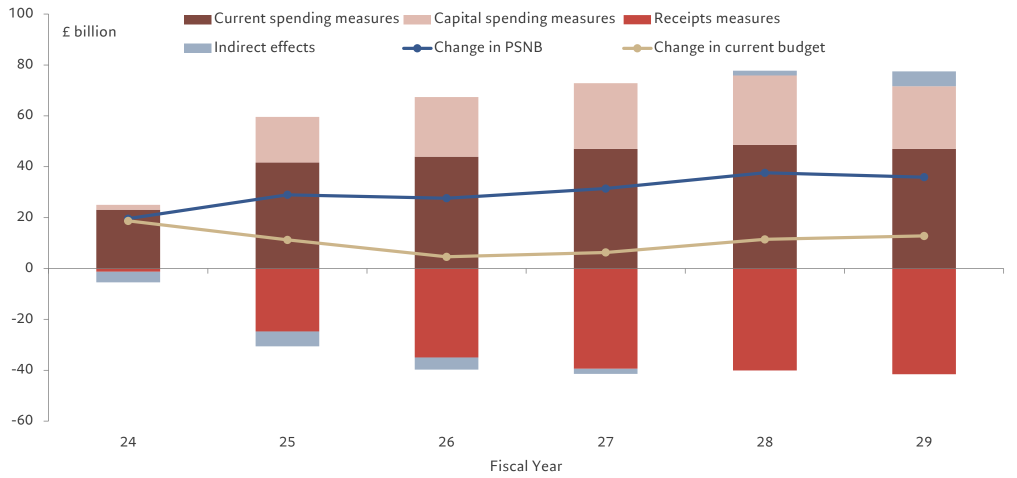
- In her 2024 Autumn Budget, Chancellor Reeves revealed significant changes to UK fiscal policy, including a boost in spending, taxes and borrowing, aimed at "fixing the foundations" of the country.
- Total spending is expected to rise by approximately £70 billion, with two-thirds allocated to day-to-day expenditures. The tax increases, amounting to approximately £40 billion, will primarily come from a rise in employer National Insurance Contributions and capital gains taxes.
- The budget introduced a new fiscal framework with the goal of balancing the current budget deficit by 2029-30, potentially achieving this as early as 2027-28. Additionally, it aims to reduce the debt-to-GDP ratio by 2029-30. An alternate debt measure, compared to the 2024 Spring Budget, has been adopted, allowing for greater borrowing capacity for capital spending.
- The front-loaded fiscal loosening is expected to boost GDP in 2025-26 due to increased demand, posing an upside risk to inflation and potentially challenging the Bank of England's rate-cutting cycle. However, fiscal tightening is expected to prevail in the medium-term. In combination with higher gilt yields and a potential boost for growth, this leaves sterling poised for further gains once post-budget volatility abates.

A "NO RETURN TO AUSTERITY"

On October 30th, the UK Chancellor of the Exchequer, Rachel Reeves, unveiled her highly anticipated Autumn Budget, marking a significant shift in the nation's fiscal policy. The announcements of substantial tax hikes, coupled with a notable increase in spending and borrowing, aim to address the country's economic challenges, stimulate growth, and invest in critical infrastructure. Reeves' strategy reflects a bold commitment to fiscal responsibility with the need for more public investment, setting the stage for a transformative period in the UK's economic landscape.

The budget unveiled a series of tax hikes totalling £41.5 billion to help address the projected rise in spending, which is expected to increase by £71.6 billion in 2029-30. This increase includes £21.6 billion allocated for capital spending and £48.8 billion for day-to-day spending. A significant portion of this surge is attributed to the £22 billion fiscal shortfall announced during the summer, as well as the need to finance underfunded public services following a one-year spending review. To boost tax revenues, the budget includes a 1.2 percentage point increase in employer National Insurance Contributions (NIC), bringing the rate to 15%. Additionally, changes to inheritance taxes and a rise in capital gains taxes—from 10% to 18% for lower rates and from 20% to 24% for higher rates—were announced. The budget also confirmed the tax policy decisions made during the elections, including the abolition of non-dom status.

Chart 1: impact of measures on public sector net debt PSNB and current deficit (OBR projections – Autumn Budget 2024)

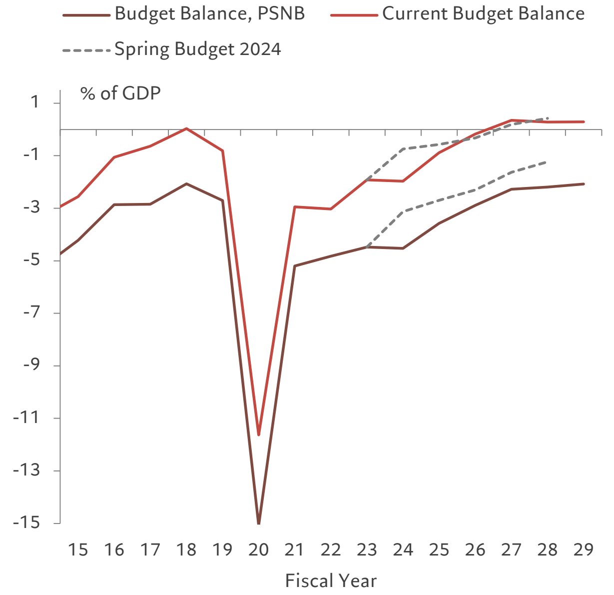


Source: Pictet Wealth Management, OBR, as of 30.10.2024

The fiscal framework saw significant revisions in this budget as Rachel Reeves introduced new fiscal targets. The first objective is to achieve a balanced current budget deficit by 2029-30 and then maintain this balance on a three-year rolling basis. Projections from the Office for Budget Responsibility (OBR) suggest that this target could be achieved as early as 2027-28. Additionally, the second goal is to ensure that the debt-to-GDP ratio declines in the final year of the forecast, followed by sustaining this balance on a three-year rolling basis. Unlike the previous government, which used public sector net debt (PSND) excluding the Bank of England's balance sheet as its debt measure—thereby limiting additional borrowing—the new government has adopted public sector net financial liabilities (PSNFL) as its metric. This change provides greater flexibility for borrowing as it accounts for illiquid public sector assets. Overall, the decisions outlined by Chancellor Reeves indicate a substantial fiscal loosening in 2024-25 relative to the 2024 Spring Budget, followed by a notable acceleration in fiscal tightening in the subsequent years.

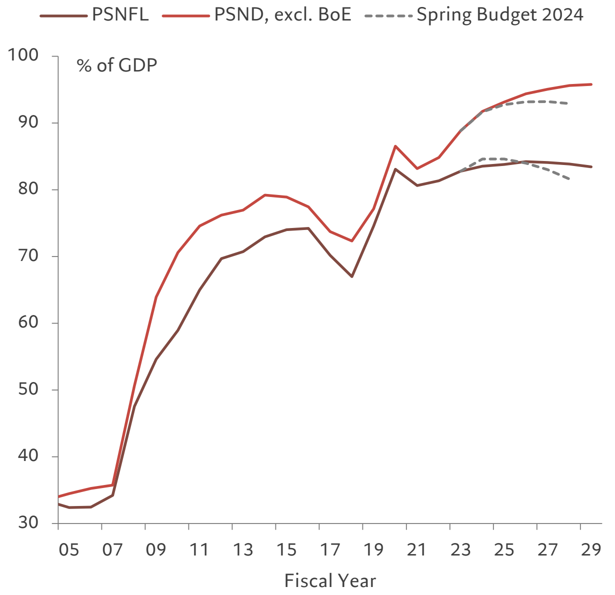
For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

Chart 2: budget balance (OBR projections – Autumn Budget 2024)



Source: Pictet Wealth Management, OBR, as of 30.10.2024

Chart 3: government balance sheet measures (OBR projections – Autumn Budget 2024)



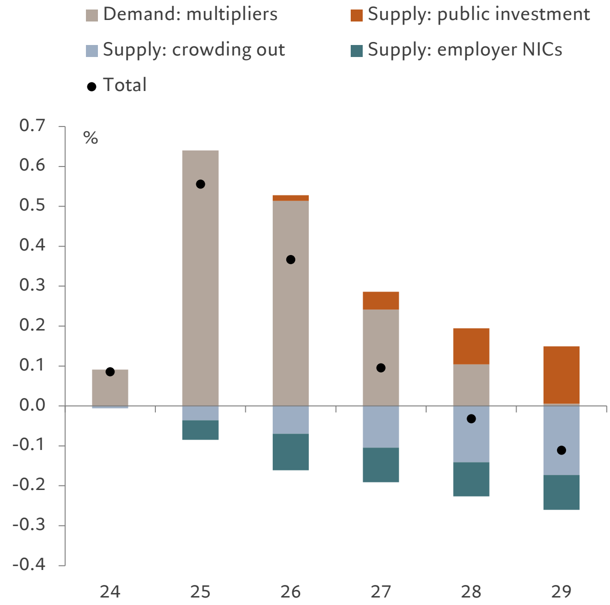
Source: Pictet Wealth Management, OBR, as of 30.10.2024

MACROECONOMIC IMPLICATIONS

By effectively front-loading fiscal loosening, the OBR anticipates that the impact on demand will boost real GDP by 0.6% in 2025-26, presenting an upside risk to growth. However, this demand effect is likely to diminish in subsequent years due to higher interest rates, as projected by the OBR. Additionally, the rise in employer National Insurance Contributions (NICs) could negatively impact growth by reducing labour supply and demand, as well as work incentives. Public investments, which typically have long implementation lags, are expected to take time before contributing positively to growth. Overall, this budget may also pose an upside risk to our medium-term inflation forecast due to potential demand pressures as the output gap is expected to be higher than in the previous Spring Budget, before converging to zero. While we remain confident that the BoE could cut its policy rate by 25 basis points in both November and December, bringing the rate to 4.5% by year-end, this budget may challenge the BoE's rate-cutting cycle in the medium term.

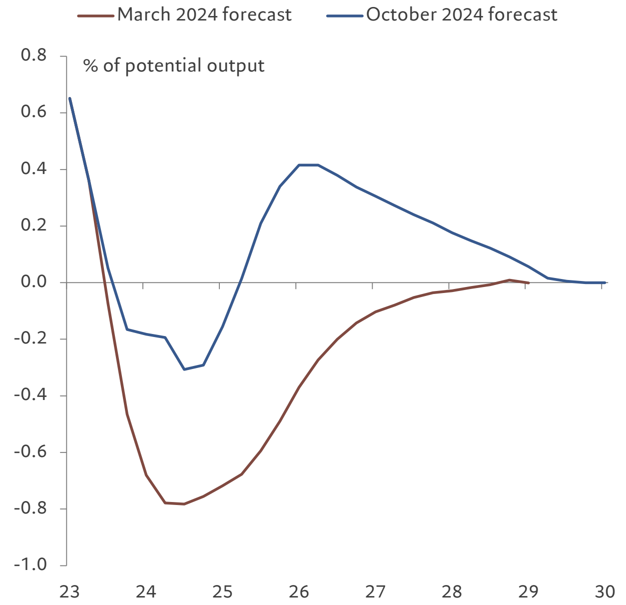
Notwithstanding the short-term boost to growth, inflation and the increase in net borrowing, fiscal policy is expected to remain on a tightening trajectory as the budget deficit is projected to decline over the medium term. This budget effectively marks a departure from a decade of significant austerity by front-loading fiscal loosening, although fiscal consolidation is expected to prevail in the subsequent years.

Chart 4: policy impacts on real GDP (OBR projections – Autumn Budget 2024)



Source: Pictet Wealth Management, OBR, as of 30.10.2024

Chart 5: output gap (OBR projections – Autumn Budget 2024)



Source: Pictet Wealth Management, OBR, as of 30.10.2024

MARKET IMPLICATIONS

Despite a steady drip feed of information ahead of the budget release, the eventual announcement caused discomfort in markets. Expectations for the BoE's easing cycle continued to be reined in and now price in only 90bps worth of cuts by September 2025, a significant shift from the over 130 bps priced in two weeks earlier. Similarly, the increased borrowing requirement and fears of steady fiscal expansion have boosted both 10year and 30year gilt yields by some 20bps on the day, lifting them to their highest level in almost a year (itself a 20-year high).

Sterling had strengthened against the euro in the run-up of the budget release but sold off on the announcement. By contrast, GBPUSD had weakened going into the announcement – mostly as a result of idiosyncratic dollar strengthening – and fell before rebounding, leaving altogether little impact.

The further outlook after this hurdle has been cleared will hinge on how the outlook for rates unfolds. Markets view the BoE as less likely to ease aggressively than just weeks earlier. Despite a pledge to massively increase spending, Chancellor Reeves managed to avoid the tumultuous market reaction that plagued Lizz Truss's government. But gilt yields could still drift higher as increased borrowing meets the market. At the same time, the potential boost to growth should be pound-positive. As such, we regard Sterling as being poised for further gains once post-budget volatility abates.

For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.

Glossary of risks: Available on this link or QR Code: pictet.com/macroeconomic-risks

Glossary of terms: Available on this link or QR Code: pictet.com/glossary-of-terms

Index and data provider disclaimers: Any index data referenced herein remains the property of the Data providers. Data providers Disclaimers are available on this link or QR Code: pictet.com/3rd-party-data-providers

Legal disclaimer:

This marketing communication (hereinafter the "Document") may only be read and/or used by its addressee. It is not intended for and must neither be provided to nor used by persons that are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations. It does not constitute advice, an offer, an invitation to offer or solicitation to buy, sell or subscribe to any securities, commodities, derivatives, or other financial instruments (collectively referred to as "Investment(s)") or to enter into any legal relations or agreement, nor does it constitute an advice or recommendation with respect to any Investment(s). The Instrument(s) mentioned in this Document might not be registered with or approved by the relevant regulatory authority. Public distribution may therefore not be permitted, and private placements may be restricted to specific types of investors. Detailed selling restrictions of the relevant Investment(s) may apply and need to be considered. This Document does not set forth a personal recommendation tailored to the needs, knowledge and experience, sustainability preferences, if any, objectives, and financial situation of any individual or company. This Document and/or the Investment(s) mentioned herein might not be suitable for the addressee and should not be considered as a suitability report as the bank has not received all the necessary information on the addressee to complete its suitability assessment that covers the addressee's knowledge and experience, tolerance to risk, sustainability preferences, if any, investment needs and the addressee's ability to absorb financial risk. The bank may have issued or distributed other reports or documents that are inconsistent with and reach different conclusion from, and may act inconsistently with, the information and/or opinions presented in this Document, and the bank may have material interests that conflict with the interests of the addressee of this Document. Investor should seek independent financial advice regarding the appropriateness of investing in any Investment(s) or adopting any strategies discussed in this Document. Should the investor decide to proceed with any transaction in relation to an Investment(s) referred to herein, this will be their sole responsibility, and the suitability /appropriateness of the transaction and other specific financial risks as well as any legal, regulatory, credit, tax and accounting consequences should be assessed by an expert. Furthermore, the bank makes no representations and gives no advice concerning the appropriate accounting treatment or possible tax consequences of any Investment(s). The information, tools and material presented in this Document are provided for information purposes only and were obtained in good faith from sources believed to be reliable. Such information may change without notice. The bank cannot be held liable for any fluctuation of the price of the securities. Prices, values, or returns of any Investment(s) mentioned in this Document are based on the bank's customary sources of financial data. The bank is under no obligation to update the information contained in this Document and no representation or warranty, express or implied, is made as to its accuracy or completeness. Accordingly, the bank accepts no liability for loss arising from the use of or reliance on this Document presented for information purposes only. The market value of Investment(s) may fall or rise without notice, on the basis of economic, financial or political changes, the remaining term to maturity, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some Investment(s) may not be readily realisable as the relevant market may be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the return of the respective Investment(s) mentioned in this Document. The political and economic situation in emerging countries is significantly less stable than in industrialised countries and related Investment(s) are exposed to higher risks and volatility. Forecasts and past performance are not reliable indicators or guarantees of future results. No representation or warranty expressed or implied in this Document is made by the bank regarding future performances. Accordingly, the investor must be willing and able to assume all risks and may receive back less than originally invested. Any performance shown does not take into account commissions and costs (which negatively impact the performance). The investor must only make investment decisions when they fully understand the relevant Investment(s) and the involved risks. In particular, the relevant Investment(s) documentation (such as the issuance program, final terms, prospectus, simplified prospectus, private placement memorandum and key (investor) information document) must be read. Structured products are complex financial products and involve a high degree of risk. The value of structured products depends not only on the performance of the underlying asset(s), but also on the credit rating of the issuer. Furthermore, the investor is exposed to the risk of default of the issuer/guarantor. If this Document contains a link to Investment(s) documentation including a Swiss Key Information Document or a Key Information Document of a Package Retail and Insurance-based Investment Products ("KIDs"), please note that the respective Investment(s) documentation may change without notice. In order to access the most recent version of the respective KID/other Investment(s) document, the investor must click on the link immediately before confirming to the bank their decision to invest. If the investor has not been provided with a link to access the relevant document, or if they are in any doubt as to what the latest version of the respective KID/other Investment(s) document is, or where it can be found, they can ask their usual bank contact. If the bank is not the manufacturer of the Investment(s), the KID/other documents is/are provided by a third party (the "Third Party Document"). The Third-Party Document is obtained from sources believed to be reliable. The bank does not make any guaranty or warranty as to the correctness and accuracy of the data contained in the Third-Party Document. The bank may not be held liable for an investment decision or other transaction made based on reliance on, or use of, the data contained in the Third-Party Document. Should the investor subscribe to the Investment(s) marketed herein, they acknowledges that they have (i) received, in good time, read and understood any relevant documentation linked to the Investment(s), including, as the case may be, the respective KID/other documents; (ii) taken note of the Investment(s) restrictions; and (iii) met the applicable subjective and objective eligibility conditions to invest in the Investment(s). The bank may, if necessary, rely on these acknowledgements and receive the investor's orders, to transmit them to another professional, to execute them and sign, on the investor's behalf, any documents or certificates needed to subscribe to the Investment(s), according to the relevant clauses of the investor's mandate as well as the General Conditions or Terms and Conditions of the bank. Further, by subscribing to the Investment(s), the investor agrees to indemnify and hold harmless the bank for any and all claims, losses and damages they may incur in connection with their Investment(s). Any form of reproduction, copying, disclosure, modification and/or publication of this Document in any form or by any means whatsoever is not permitted without the prior written consent of the bank and no liability whatsoever will be incurred by the bank. The addressee of this Document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information provided in this Document.

Distributor: Banque Pictet & Cie SA, route des Acacias 60, 1211 Geneva 73, Switzerland, is established in Switzerland and licensed under Swiss law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA)**,** Laupenstrasse 27, 3003 Berne, Switzerland. The information contained in this Document is not the result of independent financial analysis and does therefore not qualify as financial research within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research. The investor must read the brochure "Risk Involved in Trading Financial Instruments" of the Swiss Bankers Association. Structured products do not qualify as collective investment schemes within the meaning of the Swiss Federal Act on Collective Investment Schemes (CISA) and are therefore not subject to the regulations of the CISA or the supervision of the FINMA.

Distributor: Bank Pictet & Cie (Europe) AG, is a credit institution incorporated under German law with registered office at Neue Mainzer Str. 2-4, 60311 Frankfurt am Main, Germany, authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) (German Federal Financial Supervisory Authority).
Bank Pictet & Cie (Europe) AG, succursale de Luxembourg, is authorised and regulated by the BaFin and is subject to limited regulation by the Luxembourg Financial Authority, Commission de Surveillance du Secteur Financier (CSSF);
Bank Pictet & Cie (Europe) AG, succursale de Paris, is authorised and regulated by the BaFin and is subject to limited regulation by the ACPR (Autorité de Contrôle Prudentiel et de Résolution) and the AMF (Autorité des Marchés Financiers);
Bank Pictet & Cie (Europe) AG, succursale italiana, is authorised and regulated by the BaFin and is subject to limited regulation by the Consob (Commissione Nazionale per le Società e la Borsa);
Bank Pictet & Cie (Europe) AG, sucursal en España, is authorised and regulated by the BaFin and is subject to limited regulation by the Bank of Spain and CNMV (Comisión Nacional del Mercado de Valores);

Bank Pictet & Cie (Europe) AG, succursale de Monaco, is authorised and regulated by the BaFin and is subject to limited regulation by the Commission for the CCAF (Control of Financial Activities). This Document sets forth neither an investment advice under MiFID, nor the results of investment research within the meaning of MiFID. The investor must only take investment(s) decisions when they fully understand the relevant Investment(s) and the involved risks. Therefore, the investor must read the brochure "General description of risks pertaining to financial instruments".

Bank Pictet & Cie (Europe) AG, London Branch ("Pictet London Branch") Pictet London Branch is a branch of Bank Pictet & Cie (Europe) AG. Bank Pictet & Cie (Europe) AG is a credit institution incorporated in Germany and registered with the German Commercial Register, under HRB no. 131080. Its registered office is at Neue Mainzer Str. 2-4, 60311 Frankfurt am Main, Germany. Bank Pictet & Cie (Europe) AG is authorised and regulated by the BaFin. Pictet London Branch is registered as a UK establishment with Companies House (establishment no. BR016925) and its UK registered office address is Stratton House, 6th Floor, 5 Stratton Street, London W1J 8LA. Authorised by the Prudential Regulation Authority (PRA) and subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the PRA. Details about the extent of the regulation by the PRA are available from Pictet London Branch on request. This Document sets forth neither a personal recommendation tailored to the needs, objectives and financial situation of any individual or company (investment advice as defined in the Financial Conduct Authority's Handbook of rules and guidance (the "FCA Handbook")), nor the results of investment research within the meaning of the FCA Handbook.

Distributor: Pictet Bank & Trust Limited is licensed and regulated by the Central Bank of The Bahamas and the Securities Commission of The Bahamas. Its registered office is at Building 1, Bayside Executive Park, West Bay Street & Blake Road, Nassau, New Providence, The Bahamas. The investor must only take investment decisions when they fully understand the relevant Investment(s) and the involved risks.

Distributor: Banque Pictet & Cie SA Singapore Branch ("BPSA SG Branch") in Singapore: Banque Pictet & Cie SA is a limited liability company incorporated in Switzerland. Banque Pictet & Cie SA Singapore Branch is registered in Singapore with UEN: T24FC0020C. This Document is not directed to, or intended for distribution, publication to or use by, persons that are not accredited investors, expert investors or institutional investors as defined in section 4A of the Securities and Futures Act 2001 of Singapore ("SFA") or any person or entity that is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject BPSA SG Branch and any of its affiliates or related corporations to any prospectus or registration requirements. BPSA SG Branch is a wholesale bank branch regulated by the Monetary Authority of Singapore ("MAS") under the Banking Act 1970 of Singapore, an exempt financial adviser under the Financial Advisers Act 2001 of Singapore and an exempt capital markets licence holder under the SFA. Please contact BPSA SG Branch in Singapore in respect of any matters arising from, or in connection with this Document.

Distributor: Banque Pictet & Cie SA, Hong Kong Branch ("Pictet HK Branch") in Hong Kong: This Document is not directed to, or intended for distribution, publication to or use by, persons that are not "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO"). If the addressee does not want Pictet HK Branch to use their personal information for marketing purposes, they can request Pictet HK Branch to stop doing so without incurring any charge to the addressee. To make this request, please contact the Data Protection Officer by email at asia-data-protection@pictet.com or by post to the address of Pictet HK Branch provided below. In distributing an Investment(s) as an agent for a third-party service provider, Pictet HK Branch distributes the Investment(s) for the third-party service provider and the Investment(s) is an Investment(s) of the third-party service provider but not Pictet HK Branch. In respect of an eligible dispute (as defined in the Terms of Reference for the Financial Dispute Resolution Centre in relation to the Financial Dispute Resolution Scheme) arising between Pictet HK Branch and the addressee out of the selling process or processing of the related transaction, Pictet HK Branch is required to enter into a Financial Dispute Resolution Scheme process with the addressee; however, any dispute over the contractual terms of the Investment(s) should be resolved directly between the third-party service provider and the addressee. Pictet HK Branch is a branch of Banque Pictet & Cie SA, a limited liability company incorporated in Switzerland. It is an authorised institution within the meaning of the Banking Ordinance and a registered institution (CE no.: BMG891) under the SFO carrying on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities. The registered address of Pictet HK Branch is 9/F., Chater House, 8 Connaught Road Central, Hong Kong.

Warning: The content of this Document has not been reviewed by any regulatory authority in Hong Kong. Investors are advised to exercise caution in relation to the Investment(s). If the investor is in any doubt about any of the contents of this Document, they should obtain independent professional advice.

For information about personal data protection, please refer to the Pictet Group's Privacy Notice available at https//www.pictet.com/privacynotice.