Fast Comment UK

UK Chancellor's "fiscal event"

- Taxes have been cut dramatically in a bid to get the UK economy moving
- The Government is taking a less guiding role in economic management
- Negative market reaction: Gilt yields and interest rate expectations up, sterling down

Tax cuts coming through fast

The new Chancellor Kwasi Kwarteng presented a "fiscal event" today. This is not a Budget, but set out a number of immediate changes to the tax code that are aimed at getting the economy growing once again.

National Insurance (which is essentially income tax by a slightly more palatable name), which rose by 1.25% for individuals in the Spring, has now been reversed. This reversal will come into effect from November. The government has also cancelled the Health and Social Care levy - whether this means that the Government will be backing away from the promise to pay for long term care remains to be seen.

The planned rise in Corporation tax, from 19% to 25%, which had been set to take effect this autumn, is now cancelled.
The basic rate of income tax is now due to fall from 20% to 19% in April 2023.

The top rate of income tax is to be lowered from 45% to 40% from April 2023. The top rate of tax had been raised in the dying days of the last Labour government and the incoming coalition government felt that politically they could only lower this to 45%. This has now been lowered to 40%, the level the Treasury had for some twenty years said was the point of revenue maximisation. The actual rate paid is slightly higher, as 2% of NI remains uncapped.

Stamp Duty on property is to have its nil rate band increased from £125k to £250, and first-time buyers will not pay until a home costs more than £425k (from £300k). Our view has been that the UK property market is set to slow over the coming year as the house prices to value ratio was at an all-time high and affordability, as measured by mortgage cost as a percent of income, had been rising alongside interest rates. Lowering transaction costs will be welcomed by buyers, judging by the impact of similar moves during the Covid Pandemic. However, lower transactions costs will not in and of themselves be sufficient to put the housing market on a more sustainable path. That will need planning reform, which itself tends to be contentious.

A new direction on economic management

Broader thoughts: UK governments of both left, right, and coalition, had for the past twenty years been of the view that they could direct the economy through nudges and incentives. The tax code was an important element of this and as such tax reductions were often tied to investment or other behaviours. This is at least partly being reversed by the Truss Government. There is clearly a desire to get the economy moving, and at the same time show that this Government is new and fresh. The judgement is that the Truss administration has very little time to make its mark, hence the dramatic changes outlined today. The bigger question is whether tax cuts to higher earners are going to have a rapid enough impact on the economy to offset the immediate costs.

There have been concerns about the affordability of these measures - the Government has set out that these measures will cost -£19bn in 2022-23, and this rises to £45bn in 2026-27. Gilt yields and interest rate expectations have been rising rapidly in response to the Chancellor's statement. Sterling, already down and below its long-term Purchasing Power Parity valuations, is seeing further falls.
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Interestingly, the Government has also set out what it expects the energy package to cost - estimates from some analysts have been as high as £150bn, although such estimates assume peak energy prices would continue for a prolonged period and that that consumers would not lower demand in the face of high costs. The Government's own estimate as to the cost is some £31bn

for households and £29bn for businesses in 2022-23. There is of course a good deal of uncertainty around these numbers due to energy prices themselves being so volatile.

The Chancellor is still set to give a full budget in November of this year, and this will be accompanied by the Office for Budget Responsibility giving a full breakdown of the expected costs and impacts of the government decisions.

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