State of Play

Budget special

31 October 2024

Nearly four months after taking office, the Labour government unveiled its debut budget yesterday. Anticipating a significant change in direction, markets were braced for a major fiscal shake-up after years of a Conservative government. This week's State of Play looks at the key topics from the Budget, the reaction of financial markets and our thoughts going forward.

Key announcements

The Budget raises taxes by £40bn.

Taxes

- No rise in employee national insurance.
- National Insurance (NI) contributions for employers (not employees) will increase by 1.2% to 15% from April 2025.
- The point at which employers start paying NI will fall from £9,100 a year to £5,000 a year. This will raise £25bn per year.
- The lower rate of Capital Gains Tax (CGT) on the sale of assets will increase from 10% to 18%. The higher rate will go from 20% to 24%. CGT on the sale of residential property will remain unchanged.
- Tax thresholds will rise, meaning the point at which people pay higher taxes will be increased. These tax bands had been frozen, but this freeze will end in 2028, and the bands will increase at the rate of inflation.
- The freeze on Inheritance Tax (IHT) will continue for a further two years until 2030. This means the first £325,000 can be inherited tax-free, rising to £500,000 if the estate is passed to direct descendants, and £1m if it's passed to a surviving spouse or civil partner.

Wages

- The minimum wage for people 21 and over will rise by 6.7% to £12.21 an hour. This is the equivalent of £1,400 a year for a full-time worker. Workers aged 18 to 20 will see their minimum wage increase by 16.3% to £10 an hour.

Business

- Businesses will get an increase in employment allowance, which will mean 65,000 employers won't pay any NI at all next year with the allowance growing from £5,000 to £10,500. This will mean more than a million businesses will pay the same or less than they did previously.

NHS

- The day-to-day NHS budget will increase by £22.bn.
- This will support 40,000 extra hospital appointments and procedures every week and will include £1.5bn for new hospital beds.

Fuel duty

- Fuel duty will be frozen this year and next, with the existing 5p cut maintained.

Alcohol and tobacco

- A cut to draft alcohol duty of 1.7%, and the tax on tobacco will rise at the rate of inflation plus an additional 2%. There will also be an extra 10% on rolling tobacco.
- There will be a new flat rate duty on all vaping liquid from October 2025.

Education

- VAT will be introduced on private school fees from January 2025 and business rates relief for private schools will be removed from April 2025.

Economy

- Public finances will be in surplus, rather than in deficit, by the 2027-2028 financial year. The government claims this means reaching stability two years earlier than planned.
- The Office for Budget Responsibility (OBR) predicts UK GDP growth to be 1.1% in 2024, 2.0% in 2025, 1.85% in 2026, 1.5% in 2027, 1.5% in 2028, 1.6% in 2029.
- The OBR expects public sector net borrowing to be £105.6bn in 2025-26, £88.5bn in 2026-27, £72.2bn in 2027-28, £71.9bn in 2028-29 and £70.6bn in 2029-30.

Market reaction

Apart from the famous ‘Mini-budget’, these announcements are usually met with a minor market reaction. With most of the prior speculation being unfounded, the same can be said for market reaction to Labour's debut Budget.

10-year gilt yields moved higher as the Chancellor outlined plans to ‘invest, invest, invest’ and sterling strengthened against the dollar after the announcement. The FTSE 250 index moved higher as the Budget unfolded. The FTSE AIM 100 (sometimes known as the junior market) is not an index that investors tend to follow closely but the anticipated change to IHT relief was softer than expected. Investors had feared that the Chancellor would scrap IHT relief on certain types of AIM shares, but in the end the rate of relief was halved. Disaster was avoided for the junior market as a full abolishment of the tax relief could have triggered a widespread sell-off. The AIM index jumped 4%.[1]

Our thoughts

The Budget failed to live up to some of the worst speculation and scaremongering ever seen. There were no meaningful changes to direct taxation, which means most people are no worse off unless they pay capital gains tax (and only 400,000 do each year) or inheritance tax (which is paid by 4% of estates). There were some sighs of relief by those who were worried about employee NI, ISAs, gifting and fuel duty. Much of the prior speculation centred around tax rises in these areas and they were left untouched.

However, there is no such thing as a victimless tax, and the hike in Employer National Insurance bills will partly be reflected in lower wage rises and less hiring.

The OBR's forecasts for inflation and economic growth incorporating the new Budget policies is slightly less appealing. They forecast that the Budget will push up inflation and because of this increase over time, interest rates are likely to stay higher for longer which will lead to a knock-on effect on growth.

The 'Non-dom' regime is being ended. No forecaster can predict how many of those previously not domiciled in the UK for tax purposes will leave, and how many will stay.

What next?

Given the assumptions for the path of economic growth and the limited headroom left to meet fiscal targets if receipts undershoot or spending overshoots, there is a real possibility that the Chancellor will have to raise taxes again. The first-choice ought to be to reverse the previous government's cuts to employee NI, worth £20bn. Targeting those who pay higher rates of income tax might appeal, but the income tax system is already very progressive: the top 1% of earners pay over 20% of the tax.

The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions and risk comfort. If you already have a plan in place or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing here.

Note: Data as at 31 October 2024

[1]AJ Bell, 31 October 2024