Group Economics

Ulster Bank

Budget 2015 - Election acts as a speed camera on the pace of austerity

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Summary

This Budget more than any of the Osborne Budgets that went before it had one eye on the election. Previous Budgets focused on protecting the older generation, and again we saw this today with the confirmation of more pension flexibility for those people with annuities. However the younger so-called 'jilted generation' also featured on two key fronts - first of all, with employers national insurance contributions waived for under 21s and an additional waiver for employers hiring young apprentices next year; and secondly with the Help to Buy ISA, through which first time buyers will receive a bonus of up to £3,000 for saving for a deposit. While this is welcome and will undoubtedly be attractive to many first time buyers, in Northern Ireland it is perhaps less economically significant than in the South East of England, as the issue with the local housing market is that there are too many potential home movers in negative equity or with not enough equity to move.

As in previous Budgets, the Chancellor has continued his theme of raising the personal allowance. Given that Northern Ireland has lower average incomes than the rest of the UK, an increasing number of individuals locally will be taken out of income tax altogether.

Over the next 24 hours, the media headlines around the Budget are likely to focus on populist measures like the beer duty reduction and the Help to Buy ISA. However, attention will quickly return to the public finances. While these are improving, as the Chancellor highlighted today, the challenges of reducing our debt burden and cutting public expenditure remain. Indeed, there are an additional £12 billion in welfare spending cuts included in the Budget, which will bring further financial and political challenges for Northern Ireland in particular.

While the pace of austerity appears to have eased relative to the Autumn Statement back in December, people should be under no illusion – the UK faces a second Parliament of fiscal pain. Such a scenario was flagged five years ago by the Institute for Fiscal Studies (IFS). Day-to-day public spending is facing cuts in 2016/17 and 2017/18 that are more than twice what has been experienced on average over the last 5-years. Effectively, the 2015 General Election has acted as a speed camera for the pace of austerity, and after May the austerity accelerator will have a heavy right foot on it again. It is likely that the most unpalatable medicine will be delivered at the start of the fixed 5-year Parliament.

Regardless of who wins the next election, a second 'Emergency Budget' is expected in June. Public spending growth is not expected to return until 2019-20. We also will face a Spending Review in the autumn. It is noted that in the first so called Parliament of pain, record low interest rates and a weak currency provided much needed tailwinds to the economy. Looking ahead into the second Parliament of pain, the public expenditure cuts for day-to-day spending will be deeper than experienced to date and the sterling / euro exchange rate is now a headwind not a tailwind. Furthermore, it would be overly optimistic to assume that interest rates will remain on hold for another 5 years as has been the case for the last 6 years. Austerity may be easing and economic growth remains robust. Enjoy that combination while it lasts.

Budget 2015

Economic Outlook - The Chancellor's speech was littered with references to the strong state of the UK economy relative to what he inherited almost five years ago. Last year the economy grew faster than any major economy and there are currently more people employed than ever before. George Osborne also set the lofty goal *"to become the most prosperous major economy in the world"*. The latest forecasts from the Office for Budget Responsibility (OBR) revealed a marginal upward revision for growth this year, to 2.5% from 2.4% due to higher government spending. This is below the current consensus of 2.7%. Growth in 2016 has also been raised to 2.3% from 2.2% which is again below the 2.5% consensus amongst independent forecasters. Thereafter, growth is expected to be around 2.3% through to 2019 – which is similar to the outlook back in December. Northern Ireland's economic growth rates are expected to lag the UK by up to 1 percentage point in 2015 & 2016.

Sterling strength an economic headwind - A more subdued global outlook will adversely affect exports and this will be compounded by the sterling's strength within the Eurozone market. This will act as a significant headwind for Northern Ireland firms that share a land-border with the Eurozone – the Republic of Ireland. Over the last five years, sterling weakness vis-à-vis the euro has acted as a tailwind for the UK and NI economic recoveries. Looking ahead, however, it will act as a headwind. The table below highlights that sterling is stronger against the euro today than at time since the Chancellor has delivered one of his eleven fiscal events. The good news is that sterling is relatively weak against the dollar. As a result, those UK /NI firms exporting into the US are price competitive. However, as the euro has hit a 12-year low against the dollar, Eurozone exporters have n exchange rate tailwind on their backs too.

Currencies

	Euro / Sterling Pence	Sterling / Euro €	Sterling / Dollar $
Start of 'Credit Crunch' *(9th August 2007)*	67.6	1.48	2.02
Budget 2010 *(22nd June 2010)*	82.8	1.21	1.48
Comprehensive Spending Review *(20th October 2010)*	88.1	1.14	1.58
Budget 2011 *(23rd March 2011)*	86.8	1.15	1.62
Autumn Statement 2011 *(29th November 2011)*	85.4	1.17	1.56
Budget 2012 *(21st March 2012)*	83.3	1.20	1.59
Autumn Statement 2012 *(5th December 2012)*	81.2	1.23	1.61
Budget 2013 *(20th March 2013)*	85.3	1.17	1.51
Autumn Statement 2013 *(5th December 2013)*	83.7	1.20	1.63
Budget 2014 *(19th March 2014)*	83.7	1.20	1.65
Autumn Statement 2014 *(3rd December 2014)*	79.0	1.27	1.57
Budget 2015 *(18th March 2015)*	72.5	1.38	1.49

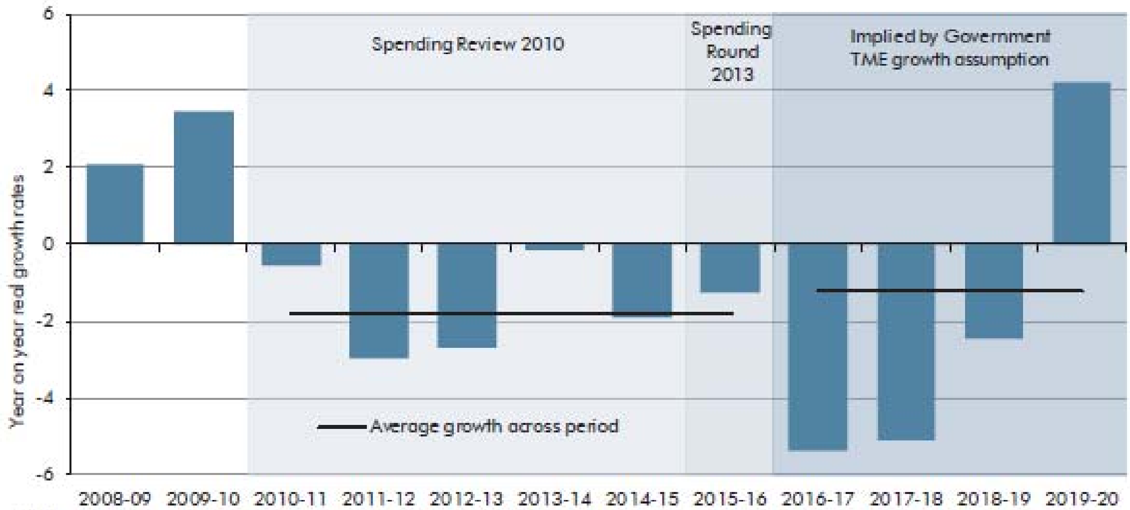
Source: Bloomberg

£114bn of borrowing required over the next 2 years - The Chancellor's overall tone on the strength of the UK economy oozed positivity. Listening to the speech alone and ignoring the mass of accompanying documents, you would be forgiven for forgetting that the UK still faces some huge fiscal challenges. While there is some improvement relative to December's Autumn Statement. The UK's medium term fiscal outlook is still pretty dire. Public sector borrowing is falling. Nevertheless, the government still has to borrow £75bn for 2015/16 alone followed by £39bn in the next fiscal year. The latter is more than the annual economic output (GVA) of the Northern Ireland economy. A surplus does not materialise until 2018/19 (+£5.2bn). Meanwhile the deficit expressed as a share of GDP falls from 5% in 2014/15 to 4% in 2015/16 and only falls below the EU Stability & Growth Pact threshold of 3% in 2016/17.

Overall stock of public sector net debt to breach £1.5 trillion this year - The public sector net debt to GDP ratio, which is the overall stock of debt *(or the sum of all the deficits)* expressed as a share of national income peaks at 80.4% in 2014/15 and starts to fall slowly to 71.6% by 2019/20. However, this still remains very high. Furthermore, looking at the overall stock of public sector net debt, this is set to breach the £1.5 trillion mark later this year and £1.6 trillion by 2017/18. This is perhaps not quite "The Comeback Country" the Chancellor was referring to in his speech.

Two Parliaments of fiscal pain - While the pace of austerity appears to have eased relative to the Autumn Statement back in December, people should be under no illusion – the UK faces a second Parliament of fiscal pain. By extension, so does Northern Ireland. Effectively, the 2015 General Election has acted as a speed camera for the pace of austerity, and after May the austerity accelerator will have a heavy right foot on it again. This is illustrated by looking at the chart below which highlights the real growth rates of RDEL *(Resource Departmental Expenditure Limit)*. Resource DEL expenditure is day-to-day spending and is mostly staffing costs. Therefore it is determined by employee numbers and rates of pay.

Chart 4.7: Year-on-year real growth in resource DEL



Note: RDEL series excludes major historical switches with AME as well as switches with AME in forecast years. Details are available in the supplementary fiscal tables on our website.
Source: OBR

Day-to-day spending faces deeper cuts than experienced to date - During the period 2010/11 to 2014/15 Resource DEL experienced an annual average real terms reduction of 2.4%. Incidentally, this compared favourably with an average annual decline of 5.7% for CDEL *(Capital DEL which includes infrastructure spending).* The pace of austerity is set to ease for both RDEL and CDEL in the 2015/16 financial year due to start next month with RDEL and CDEL set to fall by 1.4% and 1.8% respectively in real terms. However, the pace of austerity moves up a gear for the RDEL with real terms cuts of 5.8% in 2016/17 and 5.4% in 2017/18. ***These are more than twice the scale of the average per annum cuts experienced over the last five years.*** The RDEL falls by 2.6% in 2018/19 which again is more than the average cut experienced over the last five years. The good news is there is a 4.3% real terms rise pencilled in for 2019/20. Furthermore, capital expenditure, which bore the brunt of the spending cuts over the last five years is flat in 2016/17 and experiences real terms growth of 1.3% in 2017/18, 5.9% in 2018/19 and 4.3% in 2019/20.

Prepare for Emergency Budget II - The cuts highlighted above will feed through to Northern Ireland's Block Grant through the Barnett Formula *(incidentally Northern Ireland received £11m from its Barnett consequentials in today's Budget).* These figures are indicative and are not set in stone. They will be determined by the next government which will undertake the next Spending Review in the autumn. Before then, an 'Emergency Budget' is expected to take place after the General Election most likely in June. The scale of the public expenditure cuts could be reduced if taxes and / or borrowing are raised instead. It is worth remembering that the last Emergency Budget in June 2010 contained the biggest tax rise of this Parliament – the hike in the VAT rate from 17.5% to 20%. It is noted that there has been considerably lobbying for a cut in the VAT rate for the hospitality and tourism industry, as in the Republic of Ireland. However, it is considered that any movement in the VAT rate post the General Election is likely to be up not down.

Civil Service to abolish progression pay - The public expenditure cuts highlighted above will involve job losses and pay restraint. Budget 2015 confirms that proposals have been agreed with all departments to abolish progression pay across the Civil Service. While it remains to be seen what these proposals are this move is highly significant.

More welfare spending cuts to come - Welfare spending sits outside of the DEL expenditure highlighted above and makes up the bulk of Annually Managed Expenditure, or AME. Since 2010 welfare spending has been reduced by £21bn. A further £12bn of welfare spending cuts is included in Budget 2015. These will bring further financial and political challenges for Northern Ireland in particular. It should be noted that overall levels of welfare spending continue to rise out to 2019/20. The cuts referred to are simply limiting the rate of increase.

Financial Sector & Other Asset Sales – Budget 2015 included a number of proposals to raise much needed revenue from asset sales. These included: plans to sell £9bn of Lloyds shares over the next year; the UK government will also undertake a major sale of its Northern Rock and Bradford & Bingley plc assets; HM Treasury also signed a deal this month to sell its entire holding in Eurostar International Limited for £757m.

Devolution – Budget 2015 placed significant emphasis on devolution and region specific initiatives such as developing a Northern Powerhouse. These included: further powers *(linked to planning and skills*) for the Mayor of London; a new devolution deal for West Yorkshire Combined Authority *(includes new powers over skills, business support & transport)* and a new Enterprise Zone in Plymouth on the naval dockyard. For Northern Ireland, the Chancellor emphasised the importance of the implementation of the Stormont House Agreement and urged Northern Ireland's leaders to ensure that happens. Corporation Tax powers would be commenced in 2017 if the Executive demonstrates its finances are on a sustainable footing. Implementing the outstanding welfare reforms are inextricably linked to this.

Income Tax

Personal allowance - The personal income tax allowance has been raised from £6,475 in April 2010 to £10,600 from April 2015. Further increases to £10,800 in 2016/17 and £11,000 by 2017/18 were announced today. The Marriage Allowance will also rise in line with the personal allowance. Since 2010 the Government will have lifted 103,000 people in Northern Ireland out of income tax altogether by 2017/18, and 698,000 people will see an average real terms gain of £561. Meanwhile the higher-rate income tax threshold *(40% rate)* will rise in line with the personal allowance increase. The 40% tax rate kicks in at £42,700 in 2016/17 and £43,000 in 2017/18. This represents the first above-inflation increase in the higher-rate threshold in seven years. A typical higher-rate taxpayer will have a cash gain of £848 by 2017/18.

Agriculture – From April 2016 farmers will be able to average their profits over 5 years *(previously 2 years)* for income tax purposes. This will benefit Northern Ireland more than most UK regions given that agriculture accounts for a greater share of the economy than in other regions.

No more tax returns - Budget 2015 announced that digital tax accounts will be introduced over the next Parliament. This will do away with the need for annual tax returns with small businesses and individuals able to see and manage their tax affairs online instead.

Business Taxes

Banking Levy – The government will increase the Bank Levy from 0.156% to 0.21% of banks' liabilities from 1 April 2015. This represents the biggest rise in the bank levy since it was introduced in 2011 and the rate has now been raised eight times from an initial 0.075%. In addition, the banking sector will no longer be able to offset the cost of compensating customers for issues such as mis-selling payment protection insurance (PPI).

VAT removed for public sector contracts - Delivering public services for less is one of the key challenges facing the UK economy. Budget 2015 revealed that the coalition has removed VAT charges for private sector bidders on public sector contracts and therefore levels the playing field. Up until now the in-house option had the advantage of having no VAT cost included. This was a significant cost advantage vis-à-vis private sector providers. As a result of today's change, which had been lobbied for by the Business Services Association *(includes BT, Serco, G4S, Sodexo)*, government outsourcing is expected to increase. Northern Ireland will benefit from this change too.

North Sea Oil tax cuts – The future viability / profitability of the North Sea oil industry has suffered from the huge drop in the oil price since mid-2014. However, the oil industry will benefit from £1.3bn of tax cuts. The supplementary charge on oil and gas companies will be cut from 30% to 20% and backdated to 1 January 2015. Meanwhile the petroleum revenue tax rate on older oil fields has been reduced from 50% to 35%. These measures, alongside a new Investment Allowance, should encourage investment. It should be noted that local firm Harland & Wolff has benefited from a number of contracts in the North Sea oil industry.

Employers' National Insurance Contributions – The Chancellor announced that National Insurance Contributions would be abolished for those businesses employing individuals under 21 years of age. Meanwhile this exemption will be extended to young apprentices from April 2016. Youth unemployment *(18-24yrs)* is a particular problem in Northern Ireland. The current youth unemployment rate of 19.5% compares unfavourably with 14.3% for the UK.

Other Reliefs – A raft of tax reliefs announced today included: an increase in the rate of film tax relief to 25% from 1 April 2015. This will benefit Northern Ireland's evolving film industry which has seen the likes of Game of Thrones produced on these shores. An orchestra tax relief of 25% of qualifying expenditure is set to come in on 1 April 2016. There were also additional tax credits for the video games industry and the government will consult on a tax relief for local newspapers.

Savings & Pensions

A new Personal Savings Allowance will be created from April 2016, exempting the first £1,000 of savings income from any tax for basic taxpayers and the first £500 for higher income taxpayers. This will save up to £200 off an annual tax bill. As so many people no longer pay tax on their savings, the automatic 20% income tax deduction by banks and building societies on non-ISA savings will cease from April next year. New flexibilities are also introduced into ISAs enabling in-year withdrawals and repayments.

Help to Buy ISA - only a couple of days ago the Chancellor said there would be no gimmicks or giveaways. However, today's Help to Buy ISA ticked both boxes. First-time buyers will receive a bonus of up to £3,000 for savings of £12,000 for a deposit. This applies to houses up to £250,000 outside of London and £450,000 within London. While this is welcome and will undoubtedly be attractive to many first time buyers, in Northern

Ireland it is perhaps less economically significant than in the South East of England, as the issue with the local housing market is that there are too many potential home movers in negative equity or with not enough equity to move.

Selling annuities - New flexibilities were also introduced for those pensioners with annuities. From April 2016, those individuals already receiving income from an annuity will be able to sell that income to a third party. The proceeds of the sale could be taken as a lump sum or drawn down over a number of years.

Lifetime Pension Allowance – Budget 2015 announced that from April 2016 the lifetime allowance for pension contributions *(that receive tax relief)* will be reduced from £1.25m to £1m. This will affect only the wealthiest individuals.

Duties

There was no change with Tobacco Duty which is set to increase by 2% above RPI inflation. RPI is currently running at 1.1% y/y. The alcoholic drinks industry received a welcome boost with the duty on beer and spirits cut. George Osborne cut a penny off the pint of beer *(to take effect on 23 March 2015)* for the third year in a row and cut 2% off the duty on Scotch whisky and other spirits. This is only the fourth time in a century that this has happened. The duty on low strength cider was cut (by 2%) for the first time since 2002 while wine duty was frozen. The planned Fuel Duty increase due to take place in September has been scrapped. By the end of 2015/16 fuel duty will have been frozen for 5 years, resulting in the longest duty freeze in 20 years. It is noted that petrol prices are at their lowest level since George Osborne began delivering his first fiscal event in June 2010.

UK Petrol & Diesel Prices

(Note Northern Ireland prices are the highest of all UK regions)

	Petrol *(pence per litre)*	**Petrol** *(£ per 60 litre tank)*	**Diesel** *(pence per litre)*	**Diesel** *(£ per 60 litre tank)*
Start of 'Credit Crunch' *(9th August 2007)*	96.2	57.7	96.7	58.1
Budget 2010 *(22nd June 2010)*	117.8	70.7	120.4	72.2
Comprehensive Spending Review *(20th October 2010)*	117.3	70.4	120.6	72.4
Budget 2011 *(23rd March 2011)*	133.1	79.9	139.5	83.7
Autumn Statement 2011 *(29th November 2011)*	133.2	80.0	141.1	84.7
Budget 2012 *(21st March 2012)*	139.0	83.4	146.2	87.7
Autumn Statement 2012 *(5th December 2012)*	133.1	79.8	140.9	84.5
Budget 2013 March *(20th March 2013)*	137.6	82.5	144.8	86.9
Autumn Statement 2013 *(5th December 2013)*	130.3	78.2	137.9	82.7
Budget 2014 March *(19th March 2014)*	128.6	77.3	136.3	81.8
Autumn Statement 2014 *(3rd December 2013)*	121.2	72.7	126.1	75.7
Budget 2015 *(18th March 2015)*	111.0*	66.6	118.3*	71.0

Source: ONS & Ulster Bank Calculations, based on weekly prices as of 16th March 2015

Richard Ramsey
18th March 2015