Group Economics

Ulster Bank

UK Budget 2014

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Budget 2014 – Osborne's Penultimate Budget

Today's Budget represented George Osborne's ninth *'fiscal event'* since he became Chancellor and he has two more to go *(Autumn Budget Statement 2014 & Budget 2015)* before the next General Election. *'Security / secure'* were the watch words and appeared 8 times in the speech with *'delivering security for the people of this country'* the Chancellor's vision and long-term plan.

As expected, the economic growth forecasts were upgraded significantly and represented the biggest inter-budget revision in 30 years. In March 2013, the Office for Budget Responsibility (OBR) expected GDP growth of just 0.6% in 2013. The outturn came in at three times that figure at 1.8%. The UK economy is now expected to accelerate to 2.7% this year, up from 1.8% last March and 2.4% in December's Autumn Budget Statement. Next year the economy is set to grow at 2.3%, which was in line with Budget 2013's forecast and slightly above December's (2.2%).

The stronger the UK's economic recovery, the better for Northern Ireland as this automatically translates to a more robust recovery in Northern Ireland too. We expect economic growth of 1.5%-2.0% this year up from an estimated 1.0% growth rate for 2013. This too represents an upgrade on our own Northern Ireland growth forecasts made last March.

A stronger UK economic recovery is good news for the public finances too. As the Chancellor noted *"there can be no economic security if there is no control of the public finances"*. However, whilst the public finances are improving, it is from a horrendous state. Claims that the *'deficit is falling'* should be treated with some caution as it means that the annual deficit's share of GDP is falling but until this turns into a surplus *(or positive)* the overall stock of debt will continue to rise.

In 2009/10 the annual deficit *(or net borrowing)* was 11% of GDP. This is set to fall from 6.6% this year to 5.5% in 2014/15. This still remains one of the largest deficits anywhere in the developed world. Furthermore, the UK's fiscal difficulties are structural as opposed to cyclical. This means that economic growth on its own will not reduce the deficit. Hence the need for an ongoing fiscal adjustment *(public expenditure cuts and tax / benefit changes*). It will take until 2018/19 before the deficit is eliminated entirely or 2017/18 when adjustment for the economic cycle is made.

As a result, the UK's overall stock of national debt is set to rise to 2018/19 and will push through the £1.5 trillion mark in the preceding year. Also baked into the plan are public expenditure cuts and public sector pay restraint until at least 2018/19. Much of the detail surrounding these cuts has been kicked into the long grass and beyond the next year's General Election. The Chancellor's speech noted that *"continuing with pay restraint in the public sector – an essential part of maintaining sound finances and economic stability"*. It is also noted in Budget 2014 that *"in the civil service, the government is making good progress towards removing progression pay by 2015/16. Proposals have now been agreed with departments covering 50% of the civil service workforce previously identified with progression pay."* It is unclear what these agreed proposals are and their implications for Northern Ireland's public sector.

In addition, a welfare cap *(which excludes the state pension and unemployment benefits)* is also to be applied from 2015/16 to 2018/19. Whilst this is set to rise by forecast inflation, it will act as a drag on the UK economy, and Northern Ireland in particular, for the rest of the decade and beyond. Furthermore, the next Parliament will be an era of interest rate rises and public expenditure cuts. This is something we haven't yet experienced.

Against this backdrop, most of the myriad of the measures announced today are relatively minor, though many are not unwelcome.

Savers & pensioners

Savers and pensioners are the biggest gainers from today's announcement with the pension's announcements highly significant. The new ISA, or *'NISA'*, will have a new £15,000 tax free threshold and the government is abolishing the restriction that only half can be saved in cash. Savers on low incomes will benefit from the abolition of the 10p tax rate up to a higher threshold of £5,000. The threshold was previously £2,880.

The Chancellor has also lifted the cap on investments in Premium Bonds for the first time since 2003. From June this year, the cap on investments will rise from £30,000 to £40,000. In 2015/16 the investment limit will rise again to £50,000.

A raft of measures designed to give pensioners more flexibility in purchasing an annuity and a flexible drawdown of income. Pensioners will no longer be obliged to purchase an annuity and in time, could take their entire pension savings as a lump sum. Moreover, pension income released will be taxed at the normal marginal rate of tax as opposed to the 55% rate that currently applies.

Allowances & Thresholds

A centre-piece of recent budgets has been raising the personal income tax allowance. The income tax personal allowance threshold will be raised from £10,000 in 2014/15 to £10,500 in 2015/16. This will take more low income earners out of income tax altogether.

Meanwhile the higher rate (40%) income tax band threshold will be raised from £41,450 to £41,865 from next month and to £42,285 next year. It is noted that the number of higher rate income tax payers in Northern Ireland has increased by 50% since 2009/10 *(from 48,000 to 72,000).* Fiscal drag has captured an increasing number of individuals into this higher tax bracket. In 2007/08, 8.1% of all taxpayer's were paying the 40% rate this fell to 6.4% in 2009/10. However, by 2013/14 this has jumped to 10%.

Budget 2014 confirms that the Tax-Free Childcare costs cap will be increased to £10,000 per year for each child under the age of 12 years of age. Households with two working parents will be able to claim up to £2,000 (20%) of childcare costs from autumn 2015.

Business Friendly Measures

There were a raft of measures for business to promote exports and innovation. These included:

- Doubling the amount of lending available for UK exporters, through UK Export Finance's (UKEF) direct lending programme. The scheme will now have £3bn and will lower the associated interest rates.
- A doubling of the annual investment allowance to £500k, 100% tax free allowance for those firms, investing in qualifying plant & machinery.
- Raising the R&D tax credit for loss making SMEs from 11% to 14.5% from April 2014.
- Northern Ireland will also get its first Enterprise Zone, a pilot in Coleraine. The pilot is on a site adjacent to the University of Ulster Coleraine Campus where 5NINES, a leading global data centre development and consulting firm, have announced plans for a £20 million investment. The Enterprise Zone status will allow 100% first year enhanced capital allowance on eligible plant and machinery. Unlike the Annual Investment Allowance (AIA) this is not capped at £500,000. This announcement is an endorsement of Northern Ireland's world class telecommunications infrastructure and 5NINES will utilise Project Kelvin, which is the direct telecommunications link between Northern Ireland and North America. According to the Finance and Enterprise Ministers "Data centres are a strategically important piece of telecommunications infrastructure and the Executive was keen to demonstrate its support for the proposal in an innovative way".
- The Seed Enterprise Investment Scheme (SEIS) and the capital gains tax 50% reinvestment relief has been made permanent.
- The Social Investment Tax Relief for social enterprises will have 30% income tax relief. This matches the relief in the Enterprise Investment Scheme (EIS) and the Venture Capital Trusts (VCT).

With regard to energy costs, a £7billion package was announced to cut energy bills for manufacturers, with benefits for families and other businesses too. It is not clear the extent to which this will benefit Northern Ireland, if at all, with Northern Ireland not mentioned. This is concerning, given that Northern Ireland has some of the highest energy costs in Europe, particularly for large manufacturers.

Housing Market

The Help to Buy equity loan scheme in the UK *(which applies to new builds only)* is to be extended until March 2020. Meanwhile the Help to Buy mortgage guarantee scheme, which supports high loan to value mortgages, will continue until December 2016.

In an effort to boost housing supply, the government is creating a £500 million Builders Finance Fund. This will provide loans to developers to unlock 15,000 housing units stalled due to difficulty in accessing finance. Such a scheme would have relevance if it was to apply to Northern Ireland given that difficulties in this area are more acute than elsewhere in the UK. By way of context, Northern Ireland's proportionate share *(as a % of GDP)* of such a fund would equate to £11.5 million.

A 15% Stamp Duty Land Tax will be applied to properties acquired by corporate envelopes. The Budget announces two bands for Annual Tax on Enveloped Dwellings (ATED). The 15% charge will apply on properties worth £500,000 to £1 million from April 2016 with the £1 million to £2 million properties coming into scope in April 2015. An ATED capital gains tax related charge of 15% will also apply to properties over £500,000 from 20 March 2014.

Other Duties

As usual, there was much in the Budget with regard to the so-called 'Sin taxes'. This includes a rise in cigarette duty of 2% above inflation, with the escalator extended for the rest of the next Parliament. With Northern Ireland households spending 100% more than the UK average on cigarettes, this will not be popular with many, unlike the scrapping of the escalator for alcohol duties and the 1p cut in beer duty.

Conclusion

Overall, despite 56 separate measures, and a number of giveaways *(ranging from theatre tax relief to £200m for pothole repairs)*, this was as fiscally neutral a Budget as you could get, costing a net £130 million over five years. With all Budgets, the devil will be in the detail. Fiscal anoraks wading into the Office for Budget Responsibility's 200 page Economic and Fiscal Outlook, which accompanied the relatively light 121 page Budget 2014 document, will notice that there are additional cuts in public expenditure and public sector pensions as yet not specified. Therefore we still have several years of fiscal pain still to come. What form this will take is yet to be determined. However, the squeeze will not just be confined to the fiscal sphere. The monetary policy squeeze, no matter how mild, is expected to begin next year. Fiscal austerity and rising interest rates is something we haven't experienced yet. However, it is something we will have to get used to.

Richard Ramsey,
19th March 2014

Calls may be recorded.