State of Play

5 March 2021

Our Investment Specialist, Simon Durling, shares his thoughts on the Budget 2021 in our latest update.

On 3 March 2021, as the UK approached the successful delivery of 21 million first vaccine injections, Chancellor of the Exchequer Rishi Sunak held up the famous red box on the steps of 11 Downing Street before delivering his Budget 2021 statement in the House of Commons. It is difficult to think of a time in recent history where the enormity of the decisions facing the Chancellor have been more challenging. In this week's State of Play I summarise the key aspects of the Chancellor's announcements and how investment markets might interpret these decisions.

Revised economic forecasts and borrowing predictions

According to the UK Government's independent forecaster, the Office for Budget Responsibility (OBR), the UK economy will grow by 4% this year, 7.3% next year and return to its pre-pandemic size in mid-2022 - six months sooner than previously forecast. The Chancellor said that the total cost of the UK Government's COVID-19 support package was more than £350bn after announcing a further £65bn extension, indeed public borrowing for this financial year alone (2020/21) will be the largest since the world wars. The revised outlook for unemployment was also much better than first feared. Although 700,000 have lost their jobs since the crisis began, the peak of unemployment is expected to be 6.5% (vs. last year's prediction of 11.9%), providing clear evidence, according to the OBR, that the furlough scheme has been successful at protecting jobs.

Financial support continues

After nearly 12 months of various lockdowns, restrictions and curbs on economic activity, one of the least surprising parts of the Budget 2021 related to financial support packages. The furlough scheme, which was implemented in March last year and pays 80% of a person's wages, aims to maintain the link between employer and employee, and supported nearly nine million people at its peak in spring of last year. As expected the furlough scheme is to be extended, but in a slight surprise this will be until September 2021, long after the restrictions are due to be lifted in full on 21 June 2021. Employers will be asked to contribute 10% in July and 20% in August and September.

The support for self-employed people will continue and be extended to September 2021 via a fourth grant, covering February to April, of up to 80% of average three month trading profits with a maximum of £7,500 and a fifth grant, of a lower amount, which will cover May to September. In addition, a further 600,000 newly self-employed people who have submitted their tax return for 2019/20 will be eligible for grants as the support is widened.

The £20 weekly uplift in Universal Credit, worth £1,000 a year, is to be extended for another six months to end in September 2021, alongside Working Tax Credit claimants who will get a £500 one-off payment. In addition, the minimum living wage will increase to £8.91 from April.

Repaying the rising debt burden

One of the themes of the Chancellor's statement was outlining the approach to bringing the UK Government's finances under control once we emerge from the pandemic and return to somewhere near normal over the next few months. The vast amounts of borrowing to support the country during the crisis will need to be addressed at some point in the future but the big questions remain of when, how much and who will contribute.

The first part of addressing the future debt pile was an increase in corporation tax on company profits which will increase from the current 19% to 25%, but will be delayed for two years until April 2023 to allow companies to invest and recover after a traumatic 12 months. To assist smaller companies, those with profits of less than £50,000, their rate will be kept at 19% and the tax being tapered above this amount, with only firms earning £250,000 or above paying the full 25% rate. Businesses will also be able to carry back trading losses of up to £2m for one year to three years.

Although there will be no changes to rates of income tax, national insurance or value added tax (VAT), by freezing the personal income tax allowance at £12,570 and the higher rate threshold at £50,270 from April 2021 to 2026, the UK Government will raise additional tax revenue as future wage rises will start to increase the tax taken as these thresholds remain the same. The inheritance tax (IHT) and capital gains tax (CGT) thresholds were also frozen till 2026. A freeze on IHT and CGT rates may impact only a small number this year, but with the rates being frozen until 2026 it is expected that a significant number of people may be impacted in real terms as the years go on. In another move to recover revenue, the UK Government froze the pensions lifetime allowance (LTA), capping the amount that individuals can pay into a private pension before incurring tax charges. The LTA was set at £1,073,100 for 2020/21 and will be frozen until 2025/26. Normally, it rises according to inflation and data released by the UK Government during the Budget showed the freeze will net the Treasury £990m by 2025/26. Fuel duty remains frozen, for the eleventh year in a row. Alcohol duty was frozen for the second year in a row, saving drinkers an estimated £1.7bn.

The housing market

As expected the stamp duty land tax holiday will be extended to 30 June 2021, with a transitional nil rate band of £250,000 then applying until 30 September 2021. In addition, the Chancellor announced UK Government mortgage guarantees to lenders that support buyers who can only afford a 5% deposit and revealed a number of large banks have already signed up to the deals which will be available from next month. The mortgage guarantee scheme will be available for homes worth up to £600,000 for both first-time buyers and existing homeowners. The Chancellor said: 'Owning a home is a dream for millions across the UK and we want to help as many people as possible. Saving up for a big deposit can often be difficult, and the pandemic has meant there are fewer low deposit mortgages available'.

Business investment

To encourage businesses to invest now the Chancellor has introduced a 'super deduction' where firms will be able deduct qualifying investment costs from their tax bills, reducing their taxable profits by 130% from the investment made for the next two years. Also trading losses can temporarily be carried back for three years to boost business balance sheets and encourage business investment. The measures put in place last year to incentivise businesses to take on apprentices will rise to £3,000 with £126m allocated for traineeships.

The business rates holiday has been extended to the end of June 2021, at the same rate of 100%. For the nine months that follow the rate will be 66%, up to £2m per business, but with a lower cap for businesses that have been able to stay open. The temporary VAT cut for the hospitality and tourism industry down to 5% has been extended until the end of September 2021. It will rise to 12.5% for the six months after that before expiring on 31 March 2022.

In a scheme called 'Help to Grow' 130,000 small and medium-sized businesses will be helped back on to their feet after the crisis with £520m to help them access management training, technology advice and discounted software to improve productivity.

A £5bn grant scheme will help pubs, restaurants, shops and other businesses in England that have been hit hardest by the pandemic. Non-essential retailers, who are able to reopen from April, will be eligible for 'restart grants' of £6,000 per premises, and those outlets in the hospitality, leisure and personal care sectors, which will reopen later based on the reopening roadmap laid down by the Prime Minister, will be eligible for up to £18,000.

Budget - a look back through the history books

The Budget is one of the oldest political events in the calendar and can be traced back hundreds of years. It is the device by which money is formally raised for UK Government spending. The first Exchequer budget was prepared in 1284 which showed that the Crown was spending far more than it could possibly bring in, hence the rapid introduction of taxation to cover the shortfall. The first official 'Budget' was delivered by Sir Robert Walpole in 1733.

Proposals contained within the Budget have to be authorised by Parliament in the form of the subsequent Finance Bill before they can come into force. But following the Provisional Collection of Taxes Act 1968 some changes in duties, for example vehicle excise duty, can take effect immediately from the Chancellor's announcement. Indirect taxes, such as VAT, are permanent, whereas direct taxes, like income tax, are annual and have to be renewed by Parliament each year.

The green revolution

The Chancellor unveiled a number of policies designed to give a boost to green technology and infrastructure including the introduction of the UK's first green savings Bond, which will be available through the National Savings & Investment (NS&I) scheme allowing retail investors to invest in the UK Government's green agenda. In addition, the UK Government will establish a UK infrastructure bank based in Leeds backed with £22bn in debt and guarantees to undertake projects in clean energy, transport, digital, water and waste with the aim of funding £40bn worth of public and private projects.

Freeports

The Chancellor announced eight freeports will be established in England where economic zones benefit from simpler planning rules, funding for transport links, cheaper customs and other tax breaks. The areas initially chosen to become freeports are East Midlands Airport, Felixstowe and Harwich, Humber, Liverpool City Region, Plymouth, Solent, Thames, and Teeside.

Retail

The limit for the amount you can spend using a contactless payment will rise to £100 later in the year. The lockdowns have accelerated a move away from cash with shoppers being encouraged to use contactless payments to help measures in suppressing infections. The limit was raised from £30 to £45 in April last year after which contactless payments have grown rapidly and represent about 40% of all card transactions today.

Market update and reaction

The immediate market reaction to the Budget 2021 statement was broadly positive with markets in the UK up slightly on the trading day and sterling rose slightly against both the dollar and the euro. Bond yields rose as markets turned their attention to calculating or 'guesstimating' what the potential stimulus and support packages could mean for an increase in prices once lockdown reopening is in full swing. As I explained last week, if inflation surprises the market then the repricing of all asset classes could prompt a sell-off to adjust for the new reality.

Regardless of the steps and measures introduced by the Chancellor within the Budget, the prospects for investors in the short-term remain uncertain as it is unclear how the economy will react as the vaccine programme reaches a wider demographic between now and the end of July, when the UK Government has targeted that every adult in the UK will have been offered a first vaccination dose. The factors affecting market momentum will be a combination of economic recovery, how many more people lose their jobs, how consumers react once restrictions are lifted and how businesses approach the stimulus measures announced last year, and in this Budget in particular. Inflation data will dominate valuations along with the global pandemic and fiscal stimulus implemented, especially in the US. What is clear is the financial decisions taken by the Chancellor and other governments around the world will shape market reaction and investor outcomes for the foreseeable future.

Find out more

Read our latest market updates or investment insights on our website: **www.santanderassetmanagement.co.uk**.

Note: Data as at 3 March 2021.

Important Information