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The Weekly Round-up

Friday 24 November 2023

In his latest weekly round-up, Guy Foster, our Chief Strategist, gives his take on the autumn statement's key announcements and the potential impact on UK monetary policy.

This was a relatively quiet week with Thanksgiving holidays in the US meaning either the closure of or reduced activity in some of the biggest markets in the world.

In the UK, chancellor Jeremy Hunt delivered the autumn statement, which proved to be something of an anticlimax. Here are a few of the macroeconomic factors which either affected or were affected by the autumn statement.

Higher inflation meant that UK tax receipts had been bigger than forecast. When inflation is high, revenue from payrolls and spending tends to rise faster than government expenditure. This is particularly the case due to the freezing of tax allowances and thresholds since April 2021. As such, the backdrop to this week's autumn statement was one in which more people were drawn into higher tax brackets, causing an increase in the amount of tax they are paying as a share of their real incomes. The extra revenue was partially spent on a surprisingly large two-percentage-point cut to the rate of employee National Insurance (NI). Reducing this tax is good news for consumers and generally good news for the economy. All employees will benefit from the cut to NI, but most would benefit more from raising thresholds in line with inflation. However, in isolation this move is stimulative and the fact that it was surprisingly large has some macroeconomic implications.

Impact on monetary policy

Earlier in the week, Andrew Bailey, the governor of the Bank of England, had been at pains to stress that inflation remained a challenge. He stressed the risks posed by higher commodity prices, particularly food prices, and how these could be subject to shocks stemming from geopolitical events. These shocks

would filter through to higher domestic inflation if the labour market remains strong and so the governor warned against assuming that interest rates will come down.

At the start of this week, markets were assuming three potential interest rate cuts during 2024. After the NI giveaway, there are between one and two cuts expected. Bond yields rose as well because the chancellor's plans mean more borrowing than had been expected. Over the week, UK bonds were marked underperformers.

Tax giveaways may have been motivated by a forthcoming election, which must take place by January 2025, but they will be well justified if the UK economy weakens over the coming year. This week's purchasing managers' indices (PMIs) implied that the services sector had gone from contraction in October back to expansion during November, while the manufacturing sector contraction slowed down. These individual data points would suggest the economy is strengthening over the very short term. They are not enough to signal a new trend, but should be considered encouraging. However, they also raise the prospect that the kind of price shocks the governor was warning about could mean higher wage demands and consumer prices if the labour market remains very tight.

Signs of inflation?

The PMIs for the UK and eurozone called out "stubbornly high" input costs (for the UK) and "astonishingly high and even accelerating input costs" (for the eurozone). Some of that commentary seems a little hyperbolic, but after a run of declines in the index of services sector companies charging higher output costs, it is noticeable that these indices rose in November for the UK, France, Germany and broader eurozone.

A caveat that should be included here is that when writing a summary of the weekly market and economic news, I can either only mention things that support our current view, or mention everything and risk being unclear. For the last two weeks, we commented on how the data has supported the idea of an economic slowdown, and that remains the case, but UK economic policy is a touch more stimulative and a few economic data points have hinted at inflation creeping back. Taking these things in sum, it seems more likely than not that the UK economy continues to slow and that price pressures gradually ebb.

Boosting investment

The other measure included within the autumn statement was the full expensing of capital investment. This creates a powerful incentive for businesses. The impact of investment spending is twofold. It creates near-term demand, and longer-term supply. So while the Bank of England may not appreciate the short-term boost to demand (which would be inflationary), it will appreciate any ensuing increase in productive capacity (which would be disinflationary).

The short-term boost to demand is unlikely to be huge as full expensing of capital investment was in place on a temporary basis over the last year anyway. Prior to that, an even more generous “super deduction” was available for two years following the outbreak of the pandemic. A lot of investment will have been brought forward to benefit from these temporary measures. The change taking place this week was that deduction being made permanent.

The big picture

The outlook for capital investment around the world is very important from an investment perspective. However, government investment incentives are a small part of the factors determining the willingness of firms to invest.

Several factors make it seem likely that firms will invest more in the future. The need to harness the power of artificial intelligence will be a big driver of investment. There may also be a lot of investment associated with the migration of manufacturing facilities back toward their home markets (so called re-shoring) or other measures to reduce instability in supply chains. There will also be a lot of investment required for countries to reduce carbon emissions. For many countries, significant investment is likely also required in defence. After a prolonged period of relative geopolitical calm, military operations seem to be on the rise. Europe, in particular, has been enjoying a peace dividend for much of the time since the fall of the Berlin Wall.

So while the autumn statement may have garnered a lot of headlines, its impact overall is relatively minimal given the larger factors at play.

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