

# Europe Strategy Bulletin

November 18, 2022

## UK: taxpayers to be hit hard in 2023/24, perhaps capping the need for BoE rate hikes

Guillaume Menuet, Head – EMEA Investment Strategy & Economics | +44 207 500 0452 | [guillaume.menuet@citi.com](mailto:guillaume.menuet@citi.com)

Judiyah Amirthanathar, EMEA Investment Strategy | +44 207 508 7335 | [judiyah.amirthanathar@citi.com](mailto:judiyah.amirthanathar@citi.com)

### BUDGET SUMMARY:

- **UK government set to raise £55bn by 2024 through tax increases and spending cuts.**
- **The package helps to lower inflation at the margin and potentially reduces rate hikes by the Bank of England by 1Q-23.**
- **Autumn statement winners: households set to receive extended energy support, lower income households set to see rise in line of credit and pensioners see pension income rise.**
- **Autumn statement losers: all taxpayers, investors, and energy companies.**
- **Market reaction: muted as markets had priced in most of the proposed announcements.**
- **CGW Investments - Strategy view: remain neutral UK equities and underweight government bonds**

### Autumn Budget

The autumn statement delivered by Chancellor Hunt will hurt all taxpayers, with the government looking for additional revenues to fill the fiscal hole. This is about broadening the tax base, spreading the pain far and wide. £55bn of tax increases and spending cuts will materialise in 2024 and after the next election in late 2025.

Public spending will also decline in real terms since outlays are expected to increase by only 1% in nominal terms.

Much of the fiscal tightening exercise is backloaded, with the freeze in thresholds happening from April next year and continuing into the following year, by which time the government hopes that the economy will be recovering enough to improve the conservative party's chances for the next parliamentary elections to be held before January 2025.

If the package helps to lower inflation by lowering demand and stabilising government debt, it will at the margin reduce the amount of interest rate hikes that the Bank of England (BoE) will likely need to deliver in the final few months of 2022 and the start of 2023.

Markets have barely reacted to the news, suggesting that there were very few surprises and the effort to rebuild credibility continues, allowing investors to focus on long-term fundamentals of the UK economy and the prospect of a credible path towards debt sustainability.

## OBR forecasts: recession on its ways, with inflation set to decline with a lag

The Office for Budget Responsibility (OBR) forecasts that the UK recession will last just over a year from 3Q-22, with a peak to trough fall in GDP of 2%. The OBR expects UK GDP to recover to its pre-pandemic level in 4Q-24. It forecasts that after real GDP growth of 4.2% in 2022, there will be a decline of 1.4% in 2023, followed by a gain of 1.3% in 2024. Citi Global Wealth Investments forecasts GDP growth of 4.3% in 2022, -1.0% in 2023 and +1.0% in 2024. The OBR anticipates that CPI inflation will average 9.1% in 2022, 7.4% in 2023 and 0.6% in 2024, with the annual inflation rate set to turn negative in 1H-24.

The fiscal tightening to be delivered by the UK government and the monetary policy tightening currently implemented by the BoE are expected to result in a two-year record fall of 7% in household disposable income (cancelling out the gains of the previous eight years) with a much lower trajectory for inflation in 2023, on its way below zero in the middle of the decade.

For public finances, the stock of debt as a percentage of GDP is expected to fall within five years, instead of the previous three-year target. A new fiscal rule was also introduced, requiring that the budget deficit would have to be reduced to below 3% of GDP per year within five years.

## Autumn statement winners:

1. **All households:** as the energy support package will be extended beyond April, with a new energy cap of £3,000 (estimated on energy usage for the average household), £500 higher than the current one.
2. **Lower income households** and those receiving universal and/or child credits are being shielded since their benefits are being increased in line with inflation. This was a must for the government to protect the most vulnerable in society at a time when the cost-of-living crisis is affecting households that spend a disproportionate amount of their income on essentials and frequently purchased items, which have recently substantially increased in price. The national minimum wage will also increase by 9.7% to £10.42 per hour from April 2023.
3. **Pensioners:** Chancellor Hunt confirmed that the state pension will rise to £10,600 in line with inflation, reinstating the triple lock in April 2023 essentially protecting them from any cost-of-living increases.

## Autumn statement losers:

- 1) **All taxpayers:** since the Treasury is freezing all tax thresholds until 2028. With inflation set to increase markedly in 2022 and 2023, many more households will become liable to pay tax, not only at the basic rate of 20% (from £12,570), but also at the 40% rate (from £50,271) and of course at the marginal rate of 45% (threshold lowered from £150,000 to £125,000), with the latter expected to bring up 250,000 taxpayers into the highest bracket.
- 2) **Investors:** as the capital gains tax (20%) threshold will be lowered from £12,000 to £6,000 from April 2023 and to be halved to £3,000 by April 2024. There will also be a cut in the dividend tax threshold from £2,000 to £1,000 in April 2023, to be halved to £500 in April 2024.
- 3) **Energy companies:** the additional levy on oil and gas companies will be raised from 25% to 35% on January 1 and extended for 2 years until the end of March 2028. The windfall tax will also be extended to electricity generators with a level of 45% being applied to revenues deemed "extraordinary".

## Market impact

Sterling weakened a little against both the euro and the dollar to 1.1420 and 1.1810 respectively on Thursday. The UK gilt market rallied by around 2 basis point (bp) on the news of a significant increase in tax revenues, with the 2-year yield up 8bp to 3.07%, while the 10-year yield was up 1bp to 3.16%. UK equities were largely unaffected, down 0.5% on the day.

## Citi Global Wealth Investments – Strategy Views

**BoE rates likely to peak in early 2023:** This fiscal tightening exercise will not change the outlook for the UK economy much in our view. The disinflationary impact of the package might at the margin reduce the need for the BoE to hike rates aggressively, but the short-term focus will likely remain on combating inflation and rebuilding its credibility by hiking interest rates to around 4.25% by March 2023.

**Political fallout:** It is probably too early to say how the package has been received by the majority of conservative MPs and whether it can be passed in parliament as presented, with unpopular capital expenditure projects such as the high-speed rail HS2 maintained. Real term cuts to government expenditure might exacerbate the already elevated social tensions in the public sector amid widespread threats of strike actions.

**Risks broadly balanced:** Challenges remain for 2023 and beyond, with elevated uncertainty and geopolitical risks. But in the event of a quicker resolution of the war in Ukraine, it would be likely that global commodity prices would decline, and that risk appetite would increase. This combination would likely rekindle investor appetite for cheap European assets, including European currencies such as sterling.

**UK equities:** The fiscal stimulus announced by the Chancellor will lead to a deterioration for domestic UK equities, due to lower domestic demand and cost saving incentives taken by UK households. As the UK battles through a recession the sterling should remain range pound, which should be supportive for the UK large cap equity market, given that most of UK firms generate a large part of their revenue (over 70%) overseas. However, not all UK equity markets will benefit as mid and small cap market generate most of their revenue domestically ([EMEA Strategy Monthly | Winter is coming...no place to hide in Europe?](#)).

The OCIS Global Investment Committee (GIC) have placed emphasis on being invested in global quality large-cap equity markets and this is the same case for the UK equity market. Currently, the GIC is currently neutral on UK equities, favouring large cap over mid and small cap equities.

**UK fixed income:** In our view, higher gilt yields are quite attractive for both domestic and foreign investors. We believe a hike of 50bp by the BoE on 15 December is likely, followed by another 50bp hike in February and a final hike of 25bp in 1Q-23, bringing the terminal rate to 4.25%. With yields at historically attractive levels and a potential recession around the corner for the UK economy (we forecast that real GDP growth will fall by 1% in 2023) local investors could start to position for a lower yield environment ([EMEA Strategy Monthly | Challenges are coming thick and fast as winter approaches](#)) However, on a global asset allocation level the GIC remain underweight European government bonds.

---

---



INVESTMENT PRODUCTS: NOT FDIC INSURED · NOT CDIC INSURED · NOT GOVERNMENT INSURED  
· NO BANK GUARANTEE · MAY LOSE VALUE

**This email contains promotional materials. If you do not wish to receive any further promotional emails from Citi Private Bank, please email [donotspam@citi.com](mailto:donotspam@citi.com) with “UNSUBSCRIBE” in the subject line. Email is not a secure environment; therefore, do not use email to communicate any information that is confidential such as your account number or social security number.**

This Communication is prepared by Citi Global Wealth Investments (“CGWI”) which is comprised of the Investments and Capital Markets capabilities of Citi Private Bank, Citi Personal Wealth Management and International Personal Bank U.S.

Citi Private Bank and Citi Personal Wealth Management are businesses of Citigroup Inc. (“Citigroup”), which provides its clients access to a broad array of products and services available through bank and non-bank affiliates of Citigroup. Not all products and services are provided by all affiliates or are available at all locations. In the U.S., investment products and services are provided by Citigroup Global Markets Inc. (“CGMI”), member FINRA and SIPC, and Citi Private Advisory, LLC (“CPA”), member FINRA and SIPC and Citi Global Alternatives, LLC (“CGA”). CGMI accounts are carried by Pershing LLC, member FINRA, NYSE, SIPC. CPA acts as distributor of certain alternative investment products to clients of Citi Private Bank. Insurance is offered by Citi Personal Wealth Management through Citigroup Life Agency LLC (“CLA”). In California, CLA does business as Citigroup Life Insurance Agency, LLC (license number 0G56746). CGMI, CPA, CGA and Citibank, N.A. are affiliated companies under the common control of Citigroup.

Outside the U.S., investment products and services are provided by other Citigroup affiliates. Investment Management services (including portfolio management) are available through CGMI, CGA, Citibank, N.A. and other affiliated advisory businesses. These Citigroup affiliates, including CGA, will be compensated for the respective investment management, advisory, administrative, distribution and placement services they may provide.

[Read additional important information](#)

**Past performance is not indicative of future results. Real results may vary.**

**\*\*Citi and its employees are not in the business of providing, and do not provide, tax or legal advice to any taxpayer outside Citi. Any statement in this Communication regarding tax matters is not intended or written to be used, and cannot be used or relied upon, by any taxpayer for the purpose of avoiding tax penalties. Any such taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.**

MBS are also sensitive to interest rate changes which can negatively impact the market value of the security. During times of heightened volatility, MBS can experience greater levels of illiquidity and larger price movements.

Important information, including information relating to risk considerations can be found in the link above.

Views, opinions and estimates expressed herein may differ from the opinions expressed by other Citi businesses or affiliates, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice, and are subject to change without notice based on market and other conditions. Citi is under no duty to update this presentation and accepts no liability for any loss (whether direct, indirect or consequential) that may arise from any use of the information contained in or derived from this presentation.

© 2022 Citigroup Inc. All Rights Reserved. Citi, Citi and Arc Design and other marks used herein are service marks of Citigroup Inc. or its affiliates, used and registered throughout the world.

[www.citiprivatebank.com](http://www.citiprivatebank.com)