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Investment Institute *Macroeconomics*

UK Spring Statement: Modest measures, immodest growth outlook

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Key points

- The Chancellor's fiscal statement today required changes to her spending plans to stay within her fiscal forecasts
- Yet those changes were relatively small with spending seeing the largest adjustments through welfare spending
- Yet these small changes were only by virtue of still upbeat OBR economic forecasts. Forecasts were cut to 1% for this year, but growth is expected to bounce to 1.9% in 2026 and remain around 1.75% for the rest of the forecast horizon
- These forecasts remaining optimistic in the context of significant economic uncertainty. Our own forecasts are lower with risks skewed to the downside
- Despite the growth optimism, borrowing forecasts were still revised higher by £50bn over the horizon and gilt issuance is projected up £40bn next year alone

Summary

Chancellor Reeves delivered her first Budget in October as one to underpin growth. Today's Spring Statement was billed as an uneventful fiscal update and while Reeves delivered her statement in a combative style, there were in fact relatively few material announcements in keeping with her hopes.

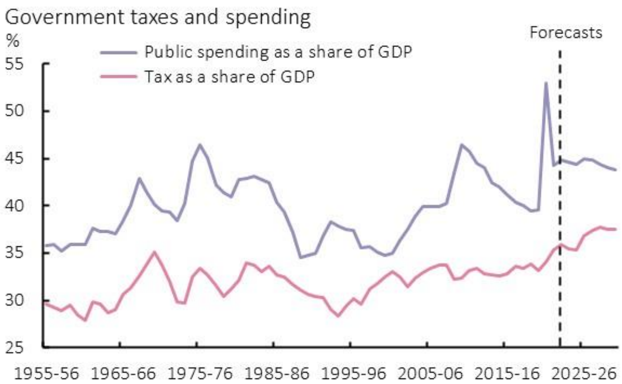
A weaker near-term growth outlook and a widening of gilt yields contributed to the Office for Budget Responsibility (OBR) downgrading its initial finances projections by around £10bn per annum over the forecast horizon, including a downgrade to the public borrowing (PSNB) forecast for this year of £10bn and next by £12bn. However, a weaker growth forecast for 2025 was mitigated by firmer forecasts for future years, which minimised the impact on the finances over the medium term.

This meant that Chancellor Reeves needed to make (relatively) minor adjustments to the overall scope of the finances to stay within her fiscal targets. These were broadly covered by the welfare spending cuts trailed before today's fiscal event, but also included some other fine-tuning, including increasing efficiencies across government – particularly in tax collection – while swapping some expenditure to investment categories (not captured in the Chancellor's Stability Rule). The OBR assessed that the Chancellor would meet her fiscal rules – although her margin for doing so was still slim at 0.3% of GDP and the OBR's probability assessment of meeting her rules was only 54%. In the context of heightened global uncertainty, there is no material margin for slippage.

Moreover, these forecasts are fundamentally underpinned by the OBR's still rosy growth forecasts. Slippage this year (the OBR reduced its forecast to 1% from 2% in October) has simply seen them anticipate a faster catch-up in future years. We have our doubts. We forecast growth of 1.4% in 2026 – in line with the Bank of England – but again 0.5 percentage point (ppt) below the OBR forecast. In future years, growth that persists around 1.75% is underpinned by an expectation of a rebound in productivity growth. Yet we are cautious of this given the protracted weakness in UK business investment in recent years.

Given the small margin for error, today's Spring Statement is unlikely to prove the last word on efforts to restrain the public finances. With the Chancellor's new fiscal rules not being cyclically-adjusted, they are highly susceptible to growth forecast changes that we anticipate – albeit that relatively high OBR's Bank Rate and gilt yield outlooks could improve the outlook somewhat.

Exhibit 1: The size of the state is rising



Source : Office for Budget Responsibility and AXA IM Research, March 2025

More broadly, welfare spending cuts have been likened to Osborne's austerity budget(s). They are far from that and real total spending is set to continue to rise by on average 1.5% over the coming five years. Indeed, this now sees public spending rising to 45% of GDP in 2027-28 – its joint highest outside of recessions since 1950 (Exhibit 1). The shortfall in revenues to meet this – and the consequent continued increase in gilt issuance – has put a strain on markets. Even while today's adjustments meet the Chancellor's fiscal rules, public sector net borrowing is forecast to rise by a further £50bn and gilt issuance is forecast to rise by nearly £40bn this year alone. Gilts yields have visibly underperformed international peers in recent months (although were stable on the day).

A further deterioration in the finances by the end of the year as growth undershoots OBR forecasts again is our central view. And a material deterioration is a risk in an increasingly uncertain global economy. The Autumn Budget is thus likely to have to juggle further deterioration. Here, if the Chancellor persists with spending plans, she is likely to have to consider broader tax increases – with a real risk that the breadth required ends up in a manifesto breach. However, with public spending already projected to account for close to half of UK GDP, keeping bond yields higher and playing some part in keeping inflation elevated and Bank Rate cuts more cautious, there is a risk that private sector recovery continues to remain moribund. The Chancellor may have to consider a broader strategy review in the Autumn Budget.

OBR still too punchy on economy

As we expected, the OBR slashed its 2025 growth forecast in half to 1.0% – broadly in line with our expectations, 0.9% – from 2.0% in October. The watchdog explained that around one-third of the downgrade was the result of "structural weakness", with trend growth considered 0.5ppt lower in 2025 than it was in October, after the OBR revised up its population estimates to a greater extent than its real GDP forecasts. The other two-thirds reflected several temporary factors, including a hit to demand from higher borrowing costs and uncertainty and supply constraints from elevated gas prices. Looking ahead, the OBR's bullish potential growth forecasts, alongside looser monetary policy and lower gas prices, drive real GDP growth to 1.9% in 2026 and then to an average of 1.75% across the remainder of the forecast horizon.

The OBR's medium-term growth forecasts look too upbeat to us, however. The OBR expects trend productivity growth to rise to 1.25% in 2029 – broadly in line with its 2000-to-19 average – driven by capital deepening – which adds 0.2ppt to average annual trend productivity growth – and total factor productivity growth – which contributes 0.8ppt on average. Policy changes, including the planning reforms, are expected to boost the level of trend productivity by 0.2% in 2029.

Yet we struggle to see where much of this catch up will come from. Labour supply growth looks set to be modest going forward, as immigration drops back, health issues persist, and an aging population weighs on hours worked. In addition, low levels of business investment over the past few years suggests that productivity growth is set to remain in the doldrums. At the same time, households' spending probably will likely stay sluggish, even as Bank Rate continues to ease, given moderate scarring following the dual shocks of the pandemic and inflation. The saving ratio looks set to remain elevated over the forecast horizon, though it should continue to drop from current highs. The OBR's forecast for real incomes growth for this year also looks high to us; we see real household disposable income (RHDI) around 1% in 2025, as wage growth drops back, and inflation edges higher. On balance, we expect growth to rise to 1.4% in 2026 and think potential growth hovers more around 1.5%. Note that if productivity growth remains weak at around 0.3%, the OBR state that the headroom would pretty much be wiped out.

We also consider that risks to our growth forecasts lie to the downside, given the level of global uncertainty. Indeed, if global growth slows materially on the back of persistent trade policy uncertainty or because tariffs end up larger than expected, this would have a material impact on the UK growth rate, via weaker exports and domestic demand. Note too that the fiscal stance was already in contractionary territory over the first two years of the forecast horizon coming out of the October Budget and is now even tighter, following Reeves' spending cuts, which will act as a further headwind to growth particularly over the coming financial year.

A key potential tailwind however, could come from a faster and sharper pace of interest rate cuts than the path underpinning the watchdog's March forecasts. While the OBR revised up its Consumer Price Index (CPI) inflation projections for this year by 0.6ppt and now expects the headline rate to rise from 2.5% in 2024, to 3.2% in 2025, like us, it doesn't appear to think the UK has an inherent inflation problem. The upward revisions reflect higher energy prices, food prices and a larger-than-anticipated increase in water bills. Further ahead it drops back to 2.1% in 2026 and remains around the 2% target, as growing labour market slack causes pay growth to slow materially. Given the material move back to target over the medium term, we think the Bank of England will cut rates faster and by more than the assumptions underpinning the OBR's forecast, to 3.75% by year and to 3.5% end-26. Gilt yields are also forecast to remain at elevated levels and there may also be scope for some easing here. However, these are unlikely to be enough to get growth along the path the OBR expects.

Measures focus on welfare spending cuts

The Chancellor focussed largely on amendments to government spending in the Spring Statement, measures that contributed to reducing borrowing by £4.0bn by 29/30. First, she gave more detail around the welfare changes that had been largely briefed to the press beforehand, including changes to incapacity and disability benefits which lowered borrowing by £6.4bn. These reforms were partly offset by an increase in the generosity of universal credit for all claimants, boosting borrowing by £1.9bn.

Departmental spending changes, meanwhile, will push up total spending by £2.2bn per year on average over the forecast horizon, but the increase largely reflects an increase in capital spending. Indeed, capital departmental spending rises from around £0.4bn on average over the first two years of the forecast horizon to £4.4bn by FY29/30, as defence spending is shifted from the day-to-day budget into the capital budget. Resource departmental spending, by contrast, averages just over £1bn in the first three years of the forecast period, but cuts are then pencilled in over the back-end of the forecast window, reducing spending by £4.4bn by FY29/30. Tax changes, meanwhile, were minimal and focussed mostly on compliance measures (See Appendix 1 for a table of measures).

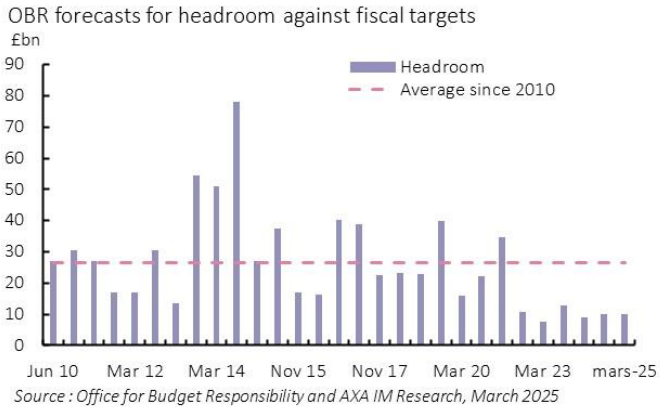
Fiscal targets met, but borrowing rises

Despite a deterioration in the public finances reflecting a weakening in the near-term economic outlook and a rise in gilt yields, the overall impact was mitigated by the OBR's confidence that the economy will bounce back. This meant that the Chancellor only had to engage in modest remedial action to put the finances back on track today. Most direct spending cuts, for instance, were the pre-announced welfare spending reforms with several other relatively minor tweaks.

The deterioration in the economic forecasts alone resulted in a worsening in the finances by around £12bn per annum over the forecast horizon. Tax receipts based on underlying forecast differences were forecast £5.9bn lower in 2024-25 and around £2-3bn lower over the forecast horizon. Spending was seen higher by £9.6bn in 2025-26 and then between £7-9bn higher in the next three years, before rising to £11.4bn in 2029-30. The rise in spending was compounded by a deterioration in debt interest payments that were forecast to rise to £111.2bn in 2025-26 (up £5.5bn) to £131.6bn in 2029-30 (£9.4bn higher). For 2025-26, higher-than-expected Retail Price Index (RPI) inflation forecasts accounted for most of the impact, although this effect is expected to modestly reverse in future years as inflation falls back to target. However, the OBR's conditioning path for Bank Rate was 0.25ppt higher over most of the forecast horizon, adding on around £1.5bn, while higher gilt rates is expected to add up to £4.8bn to debt interest by the end of the forecast horizon.

This meant the government had to take corrective action to continue to meet its fiscal rules. Direct spending measures were broadly accounted for by welfare spending cuts, rising to £4.8bn by 2029-30, with pretty much all of this coming from disability benefit changes. Changes to incapacity benefits expected to be more than offset by changes to the Universal Credit standard allowance. However, we note two points of caution about other changes. First, the government is once again banking on more efficient tax collection to raise more from its previous tax changes, these gains are hoped to rise to £1bn by 2029-30. We also note that departmental spending sees a reasonably large switch (c £4bn) from current spending to investment spending in the final year of the forecast. This is largely accounted for by reduced overseas development aid to defence investment spending. However, this has a very favourable impact on the presentation of the finances: it maintains total spending commitments, while reducing current spending. In other words, the government cuts spending that counts towards the government's day-to-day fiscal target and is adding to investment spending, that doesn't. We had warned that with the new fiscal rules focused on a current budget metric, it was open to classifying more and more spending as investment as opposed to day-to-day. It has taken the government five months of the new targets to start to use this transfer.

Exhibit 2: Chancellor persists with small contingency



Taking a step back, based on these measures, the OBR assessed that the government would meet its fiscal rules. Indeed, the forecast suggest that the Stability Rule (balancing the current budget by 2029-30) would be achieved with a 54% chance and the Investment Rule (Net Financial Liabilities falling as a proportion of debt by 2029-30) with a 51% chance. The Chancellor restored the forecast surplus on the current budget to £9.9bn (0.3%) in 2029-30, as before. Although this surplus is in excess of strictly meeting the rule, it is worth highlighting that this buffer is a contingency so that any variations in the economic and fiscal forecasts do not immediately result in the need for changes to fiscal policy. As Exhibit 2 illustrates, the Chancellor's 0.3% of GDP buffer is very small by historical standards – only Chancellor Hunt's pre-election Budgets have seen a lower contingency allocated. Given the elevated uncertainty in the current economic environment, this makes it highly likely that the Chancellor will have to make future fiscal changes to keep the finances on track.

More broadly, public sector borrowing is now forecast to be nearly £50bn higher than last October – £8bn per annum on average, despite the current account budget surplus being maintained. The government's net financial liabilities forecast is also now £33bn higher than forecast in October, albeit that as a proportion of GDP it is lower at 82.7% from 83.4%, this reflecting the forecast higher level of nominal growth at this point.

Gilt issuance increased for 2025-26

The deterioration in the public finances – as recorded by the increased borrowing requirement – has also increased the outlook for gilt issuance. For 2024-25, the central government net cash requirement (CGNCR) was revised higher again to £172.6bn, up £7.5bn to its highest since 2021-22. This was financed by an increase in National Savings accounting for £0.8bn of this, with the Debt Management Office (DMO) absorbing the remaining £6.7bn borrowing overshoot by running down its short-term assets with gilt auctions finalised for this year. Gilt sales totalled £297bn for the year as a whole.

The DMO will, however, unwind this borrowing overshoot in the next financial year, adding £6.7bn to the overall requirement. Yet this change is somewhat dwarfed by today's £30bn upward revision to CGNCR in 2025-26 to £142.7bn. With redemptions also modestly higher than foreseen in October (at £168bn) total financing needs were seen materially higher than in October. Indeed, with other financing only increasing marginally (£1.7bn extra from National Savings, £1.8bn from other financing) total borrowing needs to have jumped by £38bn and gilt sales are now seen at £299bn, compared to a previous expectation of falling £35bn from this year's total to £261bn.

Although issuance was higher than expected in October, the maturity split was broadly in line with market expectations. At this stage it is difficult to assess whether the DMO will fund this higher borrowing need in broadly the same manner as historically. The DMO has allocated a relatively small amount of issuance to long-gilts (15-years+). However, the DMO has left £27.5bn of that unallocated. If all of that were skewed to long issuance, this would restore the proportion to 22%, similar to recent years, with total long duration, including index-linked issuance, to 33%. However, the DMO retains the flexibility to allocate this over the course of the year.

Finally, we note that the absolute level of gilt issuance remains high. Net gilt issuance (after allowing for Bank of England APF maturities) reached 9% of GDP in 2024-25 – a record since the Bank of England began quantitative easing. It is forecast to fall in 2025-26 to 7.7% of GDP in 2025-26 – the fall, despite slightly higher outright gilt sales, reflecting in part the relatively higher level of redemptions. This fall is forecast to continue over coming years, current projections suggest net issuance should fall to below 5.5% in 2026-27 and 2027-28 and to 5% by 2028-29. However, like the broader projections of the public finances, these are also at risk of deterioration from here.

Mild market reaction

Today's market reaction was as buoyant as it was ever going to be. Having opened lower on better-than-expected inflation data, the 10-year gilt yield was initially volatile during the Chancellor's Statement, rising to a high of 4.77% before immediately dropping to a low below 4.70%. It settled at around 4.73%, down 4 basis points (bps) on the day. 2-year yields, meanwhile, rose to 4.30% as the Chancellor spoke, but have closed at 4.27%, 3bps down on the day. The pound is also modestly lower at around €1.1950 to the euro, compared to €1.1995, at the start of the day and is down at $1.2884 to the US dollar, from $1.2943. Markets are pencilling in around a 50% chance of a cut in May and just over an 80% chance of two cuts by year end.

Appendix 1

Spring statement policy decisions (£ million)	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Growth						
Capital Investment	0	0	-770	-3540	-4065	-4615
o/w Net capital spending change ex defence and ODA	0	0	0	-1320	-1475	-1855
Other	0	-95	-200	-225	-225	0
Public Services						
Current spending	0	0	1365	1785	2985	6100
o/w: Net resource spending change ex defence and ODA	0	0	-1030	-495	525	3470
Transformation fund	0	-250	-2000	-1000	0	0
Employment support	0	0	-200	-300	-400	-1000
Other	0	-100	-285	-370	-495	-505
Welfare						
Personal Independence Payment (PIP)	0	0	220	1845	3520	4715
Work Capability Assessment	0	0	-180	-630	-975	-1290
Universal Credit	0	0	-65	390	805	1120
Welfare Fraud and Error	0	110	165	240	250	240
Tax						
Tax Debt Collection	70	275	585	585	615	715
Other	0	5	65	125	205	340
Other pre-announced and technical measures						
Building Safety Levy	0	0	0	55	245	345
Support for Local Governments	-1215	-915	420	420	170	55
RDEL	740	0	0	0	0	0
CDEL	-390	0	0	0	0	0
Other	-15	-80	-5	40	5	25
Total impact of policy decisions	**-810**	**-1050**	**-890**	**-585**	**2645**	**6260**
Total spending impact of policy decisions	**-865**	**-2035**	**-2300**	**-2180**	**760**	**4030**
Total tax & fees impact of policy decisions	**50**	**985**	**1410**	**1595**	**1885**	**2230**

Note: Positive numbers show savings and negative numbers show costs
Source: HM Treasury, AXA IM Research, March 2025

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Our Research is available online: www.axa-im.com/investment-institute

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**All figures, as at end of December 2024*

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