

Prospects

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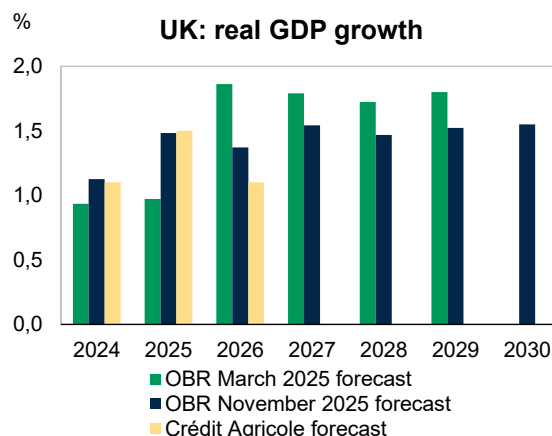
UNITED KINGDOM – Autumn Budget 2025, grasshopper or ant?

The Chancellor of the Exchequer, Rachel Reeves, presented her [2025 Autumn Budget](#) to Parliament on Wednesday 26 November, which had been eagerly awaited by the markets. In line with expectations, this Budget provides for **a further significant increase in taxes and duties of GBP26bn over the next five years**, following a GBP32bn increase announced in the October 2024 Budget. The Autumn Budget also includes **a GBP9bn increase in public spending by 2029-30**.

The main challenge for the Chancellor was to reassure investors by confirming that she would not deviate from her main budgetary rule (the current budget must be in balance in 2029-30) and that her room for maneuver would be sufficiently increased to ensure improved resilience of the fiscal metrics in case of negative surprises on growth or shocks on interest rates. Judging by the market reaction at the close of trading on 26 November, the Chancellor appears to have achieved her goal: *gilt* yields fell slightly and sterling appreciated in the wake of the budget announcement. Indeed, **the Office for Budget Responsibility (OBR) estimates that the headroom against the current budget has more than doubled**, which is a pleasant surprise: **the margin is estimated at GBP21.7bn, compared with GBP9.9bn in March**, and is close to the historical average of previous chancellors' margins for maneuver (GBP29bn).

The economic context is particularly complex: growth is slowing, inflation and interest rates have soared since March, unemployment is rising and household and business confidence has weakened. The OBR has taken note of these unfavorable developments in its *Economic and Fiscal Outlook*, revising down its growth forecast for 2026 (to 1.4% from 1.9% forecast in March). **Except for 2025 (growth revised upwards to 1.5%), annual growth forecasts have been revised downwards for the next five years, with average growth of 1.5% per year compared to 1.8% previously, due to downward revisions in productivity growth forecasts of 0.3 percentage points (pp) on average per year.**

As a result, the Chancellor has had to deal with a budgetary situation that has deteriorated since March. However, the extent of this deterioration remains limited compared to initial fears: **contrary to expectations, the significant Budget “black hole” anticipated by many observers does not appear in the OBR's estimates.** Significant upward revisions to inflation forecasts (to 3.5% in 2025 and 2.5% in 2026, 0.2 and 0.4 pp above the March forecasts respectively) and to wage growth (0.9 and 1 pp higher than the March forecasts for 2025 and 2026 respectively, to 5.2% in 2025 and 3.3% in 2026 for average weekly earnings) have offset the negative effects of productivity forecasts on tax revenues. The deterioration in the current budget deficit before accounting for Budget policies the measures announced in the budget is estimated at only GBP6bn in 2029-30. The OBR estimates that the budget rule on the current deficit was met before the new Budget policies were considered, with a current surplus of around GBP4bn in 2029-30. **The OBR's forecasts were therefore good news for the Chancellor, confirming compliance with her main fiscal rule, even before accounting for Budget policies.**

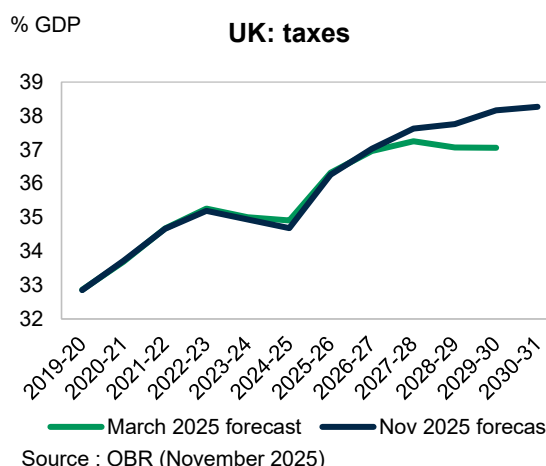


But that is where the good news ends. One unexpected factor was the increase in planned spending by local authorities, with the OBR anticipating rapid growth in budgets for special educational needs and disabilities (costing GBP8 bn by 2029–30). Additionally, **the government faces an underlying and structural deterioration in welfare spending (which the OBR has also revised upwards by GBP8bn by 2029-30).** This summer, the government's U-turn on part of its plan to cut disability benefits and winter heating allowances illustrates the difficulty it faces in reforming this type of expenditure. The Chancellor has decided to accommodate the rise in welfare spending by a further substantial increase in taxation and, chiefly, by borrowing more in the near term. **She even announced an unexpected, yet welcome, relaxation measure: the removal of the two-child limit on Universal Credit from April 2026** to combat child poverty (at a cost of GBP3bn per year). This measure is expected to lift 450,000 children out of poverty by 2029-30.

As part of a package of measures aimed at reducing the cost-of-living, the Chancellor announced: a 4.1% increase in *the national living* wage in April 2026, from GBP12.21 to GBP12.71, and an 8.5% increase for employees aged 18 to 20; a reduction in household energy bills of around GBP150 on average per household from April 2026; an extension of the 5 pence reduction in fuel duty until the end of August 2026; and a one-year freeze on regulated rail fares and prescription charges.

To finance these discretionary expenditures, the Chancellor has managed to put together a significant program of tax and duty increases, while leaving her main tax rates unchanged (*National Insurance Contributions* or *NIC* rates, VAT and income tax rates). **By far the most significant tax measure is the three-year extension (from 2028 to 2031) of the income tax freeze**, which is expected to raise GBP8bn in 2029-30 and GBP13bn in 2030-31. As the Chancellor acknowledged, this clearly represents a tax increase for workers. In fact, a typical employee will pay an additional GBP220 in 2030-31 because of this measure. A direct 1 pp increase in the income tax rate would have been fairer as it would have penalized lower income earners less.

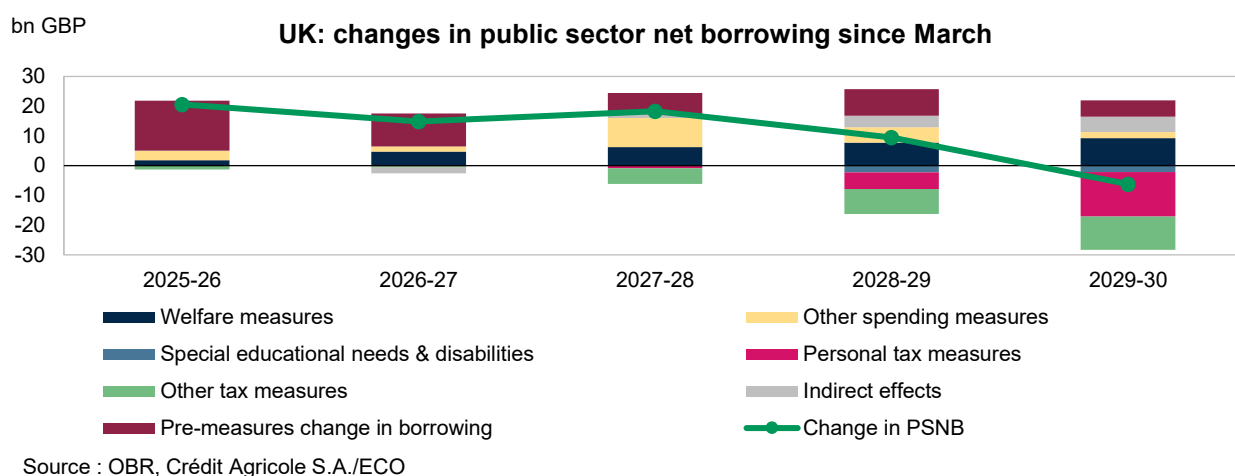
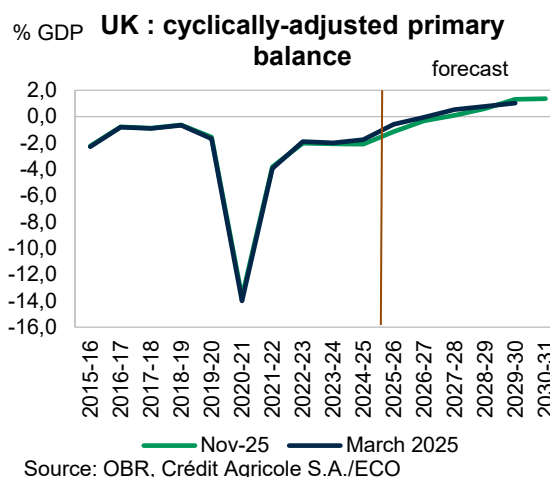
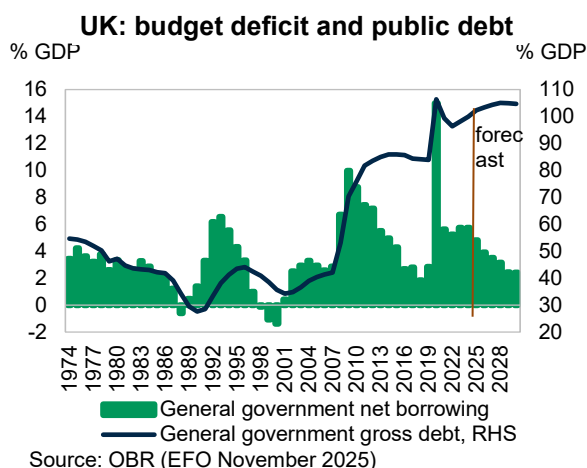
The second most significant measure in terms of tax revenue is the introduction from April 2029 of both employer and employee National Insurance on salary-sacrificed pension contributions above £2,000 per year. Finally, **the government is introducing a host of tax levies targeting high-income earners**, including a council tax charge on properties worth more than £2 million, starting in April 2028, an increase in income tax rates on dividends and on property and savings income, a tax on electric cars, etc. In addition to these measures, there will be an increase in gambling taxes, a tourist tax on overnight stays in England, a broadening of the scope of the sugar tax from 2028 to include other soft beverages, etc.



The combination of deteriorating economic forecasts increased budgetary expenditure and higher taxation is leading to upward revisions in the ratios of public expenditure-to-GDP and tax revenue-to-GDP over the next five years. According to OBR estimates, **total managed expenditure will account for around 44% of GDP by 2030, 5 pp more than before the pandemic and 1 pp more than in the March forecast. Tax revenue is expected to reach 38,3% of GDP in 2030-31.**

However, the timing of the tax increases is unfavorable for public finances. Most of the tax measures will take effect in later years of this parliament, from 2027-28 onwards. The increases in expenditure, on the other hand, will have an immediate effect. **This will result in a deterioration in the budget deficit over the next four years** (a reduction is only expected at the very end of the period, in 2029-30). Public sector net borrowing (PSNB) is revised upwards by 0.5 pp in 2025-26 to 4.5% of GDP (after 5.1% in 2024-25, revised upwards by 0.4 pp), by 0.4 pp to 3.5% in 2026-27 and by 0.5 pp to 3% in 2027-28. Public sector net debt (PSND) is expected to exceed GBP3tn in 2026-27 (95.3% of GDP) and peak in 2028-29 at 97% of GDP.¹ **General government gross debt is projected at 101.4% in 2025, 103.1% in 2026 and reach a peak at 105% in 2029.**

¹ Measure used for international comparison and in particular by the European Commission for the budgetary rules of EU countries. Narrower than the PSND, it only considers the debt of local and central government and not the debt of the wider public sector. Unlike the PSND, it does not deduct liquid financial assets.



✓ **Our opinion** – This is not the major fiscal consolidation budget that was anticipated, quite the contrary. The government has chosen to spend more over the entire forecast period and only increase taxes significantly towards the end of the legislative term. Indeed, public sector current expenditure has been revised upwards: +0.5 pp (as a percentage of GDP), +0.6 pp and +0.7 pp for 2025-26, 2026-27 and 2027-28 respectively. At the same time, the tax burden (as a percentage of GDP) is virtually unchanged over the next two years: -0.1 pp for 2025-26, +0.1 pp in 2026-27, before being revised upwards by +0.4 pp for 2027-28 and 0.7 pp for 2028-29. In addition, capital investment is also revised upwards by 0.2 pp per year between 2027-28 and 2029-30.

This translates into a slight fiscal stimulus to domestic demand of around 0.15 pp per year in 2026-27 and 2027-28 in our growth forecasts. But let us not be mistaken: the fiscal impulse remains restrictive, it will just be less so than expected last March. The cyclically adjusted primary deficit (i.e. excluding debt costs) has been revised upwards for the next four years and its return to balance has been postponed to 2027-28, one year later than forecast in March. Both the total budget deficit and public debt have been revised upwards (except for the very last year of the legislative term).

The government has chosen to play the role of the grasshopper rather than the ant, spending more to maintain social benefits, reduce poverty and ease the cost of living for families. The cost will be borne by workers, savers and businesses (through higher National Insurance contributions). The markets are surprisingly lenient, probably satisfied by the doubling of the 'headroom' compared to the fiscal mandate. But this is partly due to forecasts of strong tax revenues, which are themselves linked to less sharp downward revisions to productivity growth forecasts than feared and, above all, to upward revisions in inflation and wage growth forecasts. **However, these forecasts remain subject to downside risks. It is quite likely that tax revenues will continue to disappoint, as was the case over the last year.** Many of the revenue-raising measures presented in the budget are considered "uncertain" by the OBR.

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Crédit Agricole S.A. — Group Economic Research

12 place des États-Unis – 92127 Montrouge Cedex

Publication manager: Isabelle Job-Bazille

Chief Editor: Armelle Sarda

Information centre: Elisabeth Serreau – **Statistics:** Datalab ECO

Editor: Sophie Gaubert

Contact: publication.eco@credit-agricole-sa.fr

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