# Despite large rise in taxes, Budget still boosts economy

As the Budget loosens fiscal policy relative to previous plans, it is consistent with GDP growth perhaps being a bit stronger and interest rates perhaps not falling quite as fast. The muted initial reaction suggests the financial markets have given the Budget the thumbs up.

The large £41.5bn (1.2% of GDP) rise in taxes by 2029/30 will gain most of the attention, with a lot of the heavy lifting due to the 1.2% rise in national insurance tax for employers (raising £25bn by 2029/30). But the tax rises are more than offset by a £47bn (1.4% of GDP) rise in current (day-to-day) spending by 2029/30 and a £24.6bn (0.7% of GDP) rise in public investment, with the latter being more than funded by a £32.5bn (1.0% of GDP) rise in public borrowing. (These numbers are on the OBR's costings.) The result is that the Budget loosens fiscal policy relative to the previous government's plans.

To be clear, fiscal policy is still being tightened over the next five years. It's just that it will be tightened by less than the previous government planned in the Budget back in March. For example, over the five years to 2028/29, fiscal policy will be tightened by £68bn (2.4% of GDP) compared to the plans for £86bn (2.9% of GDP) of tightening in the March Budget. That's a net loosening in this Budget of £18bn (0.5% of GDP). (Changes in the cyclically adjusted primary balance are used as a barometer of the stance of fiscal policy.)

The result is that the Budget may mean that GDP growth is somewhat stronger over the coming years than the 1.5% forecasted. That may mean the Bank of England cuts interest rates from 5.00% now, to our forecast of 3.00%, a bit slower than by early 2026.

The response in the financial markets has been fairly muted, with both 10-year gilt yields and the pound nudging up a bit. This is despite the switch to targeting the Public Sector Net Financial Liabilities (PSNFL) measure of debt allowing the big rises in borrowing and public investment. But the Chancellor tightened her self-imposed rules in other ways and it seems the markets are satisfied with her fiscal credentials.

Looking ahead, it might not be long before there is more pressure to raise day-to-day spending further. On the current budget rule, there is a buffer of only £9.9bn (0.3% of GDP). So, if the economy performs as the OBR expects, or worse, any further rise in spending will need to be paid for by more tax hikes. The Chancellor will be hoping that the rises on public investment will mean the economy grows faster than the OBR expects, which would mean spending could be increased without more tax hikes.

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