Are we in danger of failing the economy yet again as politics turn messy?

Vicky Pryce

Reshuffles, firings, the re-emergence of David (now Lord) Cameron as foreign secretary , the Rwanda mess and whether to vote or not to vote for a ceasefire in Gaza have all taken the spotlight away from what is surely a crucial time in the UK political calendar. The Autumn Statement is due next week, the first serious economic event in what is now a pre-election period of probably no more than 12 months. And we know that in most cases, except perhaps around the Brexit decisions and the subsequent troubled period that followed, it is 'the economy, stupid 'as far as voters are concerned.

At least in advance of the event on the 22nd we have had some good news. The annual rate of inflation came down sharply, as anticipated, to 4.6% for October from 6.4% in September, mainly reflecting the fall in energy costs and a slowdown in food price inflation. Input costs and factory gate prices actually fell, year on year. That surely means that the markets' expectations of a gradual drop in UK interest rates starting somewhere in the spring may well prove right. Other countries are seeing similar reactions, with the US seeing a drop in inflation to 3.2% in October, the lowest since March 2021i.

The Eurozone has just had the earlier flash average inflation estimate for the region confirmed at 2.9% for October and must be going through the process of rethinking its own tough monetary stance given likely growth of just 0.6% growth this year, reflecting to a considerable extent the impact on firms and households of tighter credit conditions. The economy will need some boosting and monetary relaxation will probably be the way to achieve that if it is to achieve the 1.3% bounce the EU is now forecasting for 2024 and 1.7% in 2025, particularly as the fiscal largesse of 'Bidenomics' is not likely to be replicated elsewhereii. Indeed the German government has just been told by its constitutional court that the €60b or so saved from its pandemic spending cannot be recycled into the next year for green and growth projectsiii. This seems to fly in the face of what Germany needs right now after what has been made clear has been a long period of underinvestment in infrastructure and over-dependence on fossil fuel imports from Russia.

But at least with the first pledge to halve inflation from the 10.1% at the turn of the year now achieved, a month early as the Chancellor, Jeremy Hunt, is happy to be reminding us, the focus must surely switch to growth. Despite an 0.2% pick up in GDP in September, the quarter overall saw no growth due to the large 0.5% drop in August.

The flatlining in the quarter was in fact felt across all sectors of the economy- and worryingly it also included a 4.2% drop in business investment, reversing a previous upward trend, now the 'super-deduction' capital allowances arrangement ,in operation for the past two years following Covid, has come to an endiv, replaced by a 3 year, full expensing regime for investing in plant and machinery. And the data for the overall economy looks worrying. Insolvencies in Q2 and Q3 were at their highest levels since mid 2009v, manufacturing and services PMIs fell again in October, and so did business and consumer confidence.

Next week's Autumn Statement, almost certainly the last one before the next elections, should therefore be the event that attempts to reverse the doom and gloom which is descending on households and businesses faced with high interest rates and increased taxation. But the Chancellor will want to err on the side of caution to give himself some more room for manoeuvre in the March budget for maximum effect before a possible election some six months later. But pressures are mounting to be more adventurous now as there may indeed be more room for manoeuvre thanoriginally thought. Lower unemployment rates than expected and regular pay rising by some 7.7% in the three months to September over a year earlier viare resulting in higher than forecast income tax receipts, added to by the 'fiscal drag' of frozen personal allowances. In fact, the Institute for Fiscal Studies estimates that by 20278-28 the fiscal drag will add some £52b a year of extra revenue for the Exchequervii. Inflation has also boosted VAT receipts.

Of course, there are increases in the government's costs too on the other side of the balance sheet including higher debt servicing and question marks still remain about the exact scale of the expected rise in pensions under the triple lock and in overall benefits from next Aprilviii.

But government spending has been kept under reasonable control as we saw with the refusal of the Treasury to grant the extra £1b that the NHS had requested for this year to cover for the cost of the doctors' and other health workers' strikes and cover winter pressures despite a possible fiscal headroom of £13b to £15b. ix The cancellation of the second leg of HS2 could also allow some more spending leeway or at least give the Treasury room to argue that its fiscal rules can still be met despite some extra largesse. Nevertheless, caution will still be the main theme this time round. So, expect the principal focus to be on measures to support business after heavy lobbying from business bodiesx. But the question remains about whether any impact will be fast enough for the government to be able to get some credit for a pickup in the economy before the next elections. If not, then more desperate measures, including some tax cuts, will surely come in March.

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