UK Watch

Autumn Statement preview: limited room

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United Kingdom

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Higher debt interest offsets stronger tax take

New forecasts in next week's Autumn Statement will in our view show higher debt interest costs offsetting stronger tax receipts to leave the Chancellor with limited headroom against his fiscal rules. That said, maintaining tight public spending plans for longer should give the Chancellor the £10bn a year he needs to make full investment expensing permanent.

Higher borrowing

Overall we expect borrowing of £121bn in 2023/24, down from £132bn forecast in the Budget, reflecting tax receipts boosted by higher than expected inflation. After that we expect higher debt interest payments and weaker growth to boost borrowing. We look for total borrowing of £526bn between 2023/24 and 2028/29, compared to £442bn in the Budget. In these figures we assume the Chancellor pencils in another year of tight public spending plans in the fifth year of the forecast to generate £16bn of pre-measures headroom. We assume that extra headroom is spent on making full investment expensing permanent.

We expect a £13bn drop in 2023/24 financing need

The Debt Management Office (DMO) will update the Gilt Remit following the Chancellor's Autumn Statement on 22 November. We would expect the 2023/24 Net Financing Requirement (NFR) to remain broadly unchanged – we project £230bn, a £13bn drop relative to the DMO's April projection. We expect Gilt sales to be cut by £8bn and net T-bill sales to be reduced by £5bn. Our estimates suggest the NFR will rise again in fiscal year 2024/25. We assume the DMO will raise £245bn by selling Gilts, a £15bn increase relative to our updated projection for the current fiscal year, and £5bn via net T-bill sales. We do not expect big swings in Gilt issuance across the "buckets" in either of the fiscal events and do not expect 2024/25 Gilt supply from the DMO and BoE combined to rise materially above this year's total. But it will remain very high.

Refer to important disclosures on page 5 to 7.
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Higher debt interest offsets higher tax receipts

Exhibit 1 shows our forecasts for next week's Autumn Statement public borrowing update. We expect borrowing in 2023/24 to be cut £11bn to £121bn, reflecting stronger than expected tax receipts. Those stronger tax receipts have results from higher-than-expected inflation and should carry over to future years, cutting borrowing.

Stronger tax receipts should be offset by two factors, however. First, higher debt interest costs and welfare payments will boost spending while the deterioration in the near-term growth outlook since the Budget should also weigh. We see almost no possibility that the Chancellor will raise fuel duty as planned next year, which we reflect in our figures. That may not be reflected in next week's official fiscal forecasts however, with the Chancellor perhaps waiting until the Budget to cancel the fuel Duty rise.

We assume pencilling in another year of weak public spending growth in the final year of the fiscal forecast will deliver enough headroom to allow the Chancellor to make permanent full investment expensing. Full expensing was introduced in the Budget in March this year, but was only scheduled to run for three years so as to not fall foul of the Chancellor's fiscal rules, which are based on borrowing and debt in the fifth year of the forecast. Overall we expect about £6bn headroom against those fiscal rules in 2028/29.

We suspect the Chancellor will target further spending restraint in time for the Budget to generate further headroom to cut personal taxes before the election.

Exhibit 1: Higher debt interest offsets higher tax receipts
BofAf public sector borrowing

	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
OBR forecast	152	132	85	77	64	49	
Changes							
Debt interest	0	14	30	29	22	25	21
Undershoot/growth outlook	0	-25	-15	-15	-15	-15	-15
Freeze fuel duty	0	0	5	5	5	5	5
Extend full expensing	0	0	0	0	0	10	10
Public sector borrowing	152	121	105	95	75	74	56
% GDP	6.1	4.7	3.9	3.5	2.7	2.5	1.8
Public sector net debt ex BoE, % GDP	88.9	91.7	93.7	95.6	96.6	97.1	96.9

Source: BofA Global Research, Office for Budget Responsibility

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A small drop in Gilt sales this fiscal year

We expect a £13bn drop in 2023/24 financing need in Autumn Statement

The Debt Management Office (DMO) will update the Gilt Remit following the Chancellor's Autumn Statement on 22 November. The revised Net Financing Requirement (NFR) projection for fiscal year 2023/24 will likely balance the impact from better-than-expected public borrowing against larger Asset Purchase Facility (APF) losses and a larger index-linked Gilt redemption value. Another wild card will be whether September's large National Savings and Investment (NS&I) inflow can be sustained in the months ahead. On balance, we would expect the 2023/24 NFR to remain broadly unchanged – we project £230bn, a £13bn drop relative to the DMO's April projection (Exhibit 2). We expect Gilt sales to be cut by £8bn and net T-bill sales to be reduced by £5bn. We would expect any larger reduction in NFR, were it to occur, to be implemented largely through changes in planned net T-bill sales to achieve smoother Gilt issuance into fiscal year 2024/25. This would not be unprecedented – for example, the DMO reduced net T-bill sales by £25bn in its October 2021 revision.

We expect Gilt sales to gain pace again in 2024/25

Our estimates suggest the NFR will rise again in fiscal year 2024/25. We assume the DMO will raise £245bn by selling Gilts, a £15bn increase relative to our updated projection for the current fiscal year, and £5bn via net T-bill sales. The DMO could smooth Gilt issuance between 2023/24 and 2024/25 further by aiming for higher net T-bill sales next year, which would not be unprecedented either – the September 2022 Remit update projected £40.2bn net T-bill sales. In our view, growing the T-bill market would also help temper the duration being delivered with a significant quantum to sell, appeal to the preferences of the overseas investors and encourage banks to return to the market.

Exhibit 2: UK DMO Remit for fiscal years 2023/24 and 2024/25 including BofA projections, £bn
We expect 2023/24 planned Gilt sales to be cut by £13bn and net T-bill sales by £5bn

	UK DMO financing Remit arithmetic (£bn)	FY 2023/24 (DMO - Apr'23)		FY 2023/24 (BofA - Nov'23)		FY 2024/25 (BofA - Nov'23)	
	CGNCR	160		157		121	
	Redemptions	117		117		140	
	Adj. from prev. FY	-25		-25		0	
	Gross Financing Req. (GFR)	252		250		261	
Less:							
	NS&I	8		18		10	
	Other financing	2		2		1	
	Net Financing Req. (NFR)	243		230		250	
To be financed through:							
	Gilt sales, through:	238		230		245	
	Short conventional	*85*	*36%*	*85*	*37%*	*95*	*39%*
	Medium conventional	*65*	*27%*	*65*	*28%*	*65*	*27%*
	Long conventional	*50*	*21%*	*50*	*22%*	*50*	*20%*
	Index-linked	*26*	*11%*	*26*	*11%*	*25*	*10%*
	Unallocated	*12*	*5%*	*4*	*2%*	*10*	*4%*
	Net T-bill sales	5		0		5	
	Total financing	243		230		250	
	DMO net cash position	2		2		2	

Source: Debt Management Office, BofA Global Research

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Broadly unchanged "buckets" enough to support short-end liquidity

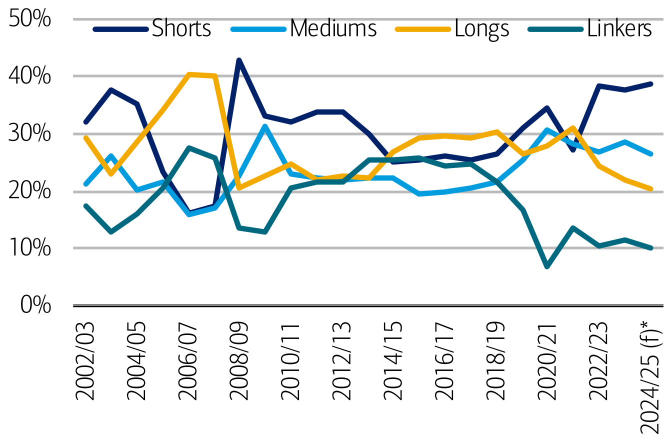
We do not expect big swings in Gilt issuance across the "buckets" in either of the fiscal events (Exhibit 3). Skewing Gilt sales quite a lot shorter and/or growing the T-bill market both make a lot of sense to us, for reasons outlined above. But keeping the share of short-dated Gilts stable near 40% will be a good way to gently support liquidity at the front-end in current market conditions. Liquidity seems to have improved since the start of the year (short-dated Gilts trading much cheaper relative to Sonia; and the Bank of England's (BoE) Asset Purchase Facility (APF) lending of Gilts to the DMO's Standing Repo Facility (SRF) has gone down since late 2022– Exhibit 4). Yet, short-dated Gilt richness remains, signalling that scarcity remains an issue. Compare that with T-bill auctions, which are now clearing some 5-8bp cheap to Sonia (Exhibit 5).

Gilt supply from the DMO and BoE combined will stay elevated

We do not expect 2024/25 Gilt supply from the DMO and BoE combined to rise materially above this year's total. But it will remain very high (Exhibit 6). This is one reason behind our bearish stance on Gilts relative to forwards and on cross-market basis. We prefer to express it against ACGBs rather than outright.

Exhibit 3: Breakdown of Gilt sales at outturn and BofA estimates, £bn

We expect the share of short-dated Gilts to remain close to 40%



Source: Debt Management Office, BofA Global Research

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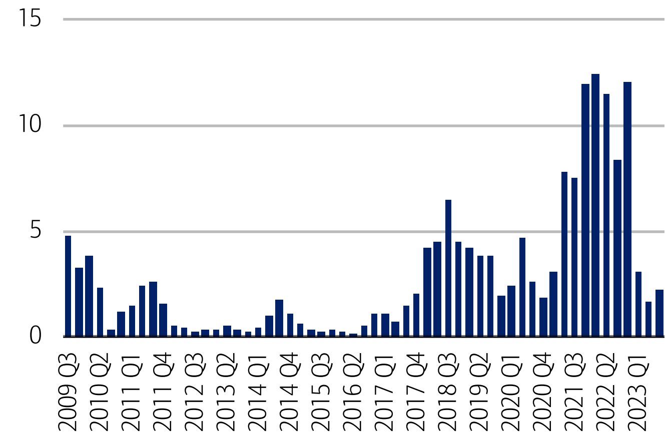
Exhibit 4: Average daily value of Gilts lent by the APF to the DMO, £bn

Down in the first three quarters of 2023



Source: Bank of England, BofA Global Research

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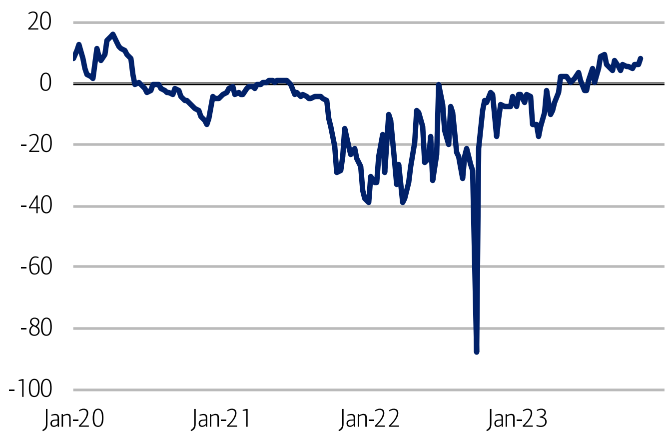
Exhibit 5: 6m T-bill spread to Sonia at auctions, bp

T-bills auctions are now clearing as much as 8bp cheap to Sonia



Source: Bloomberg, BofA Global Research

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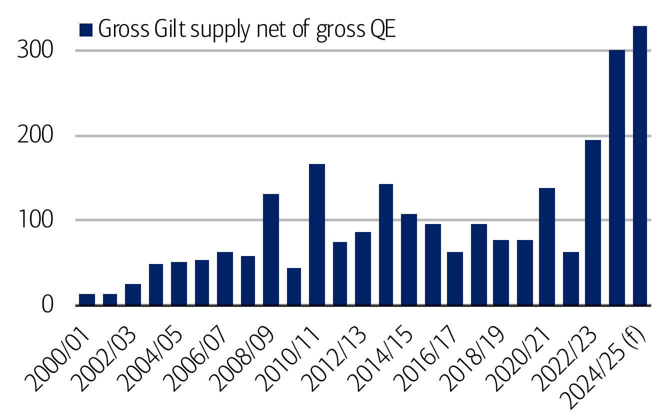
Exhibit 6: Gross Gilt supply net of gross QE, £bn

Gilt supply from the DMO and BoE combined will remain elevated



Source: Bank of England, Debt Management Office, BofA Global Research

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