

AY 2025-26

Department of Political
Economy

Daniele Girardi

Managing the UK economy

Fiscal and monetary policy since 1945

Week 10 – 2020-25: Covid, Brexit, and the return of inflation

Final essay (1/2)

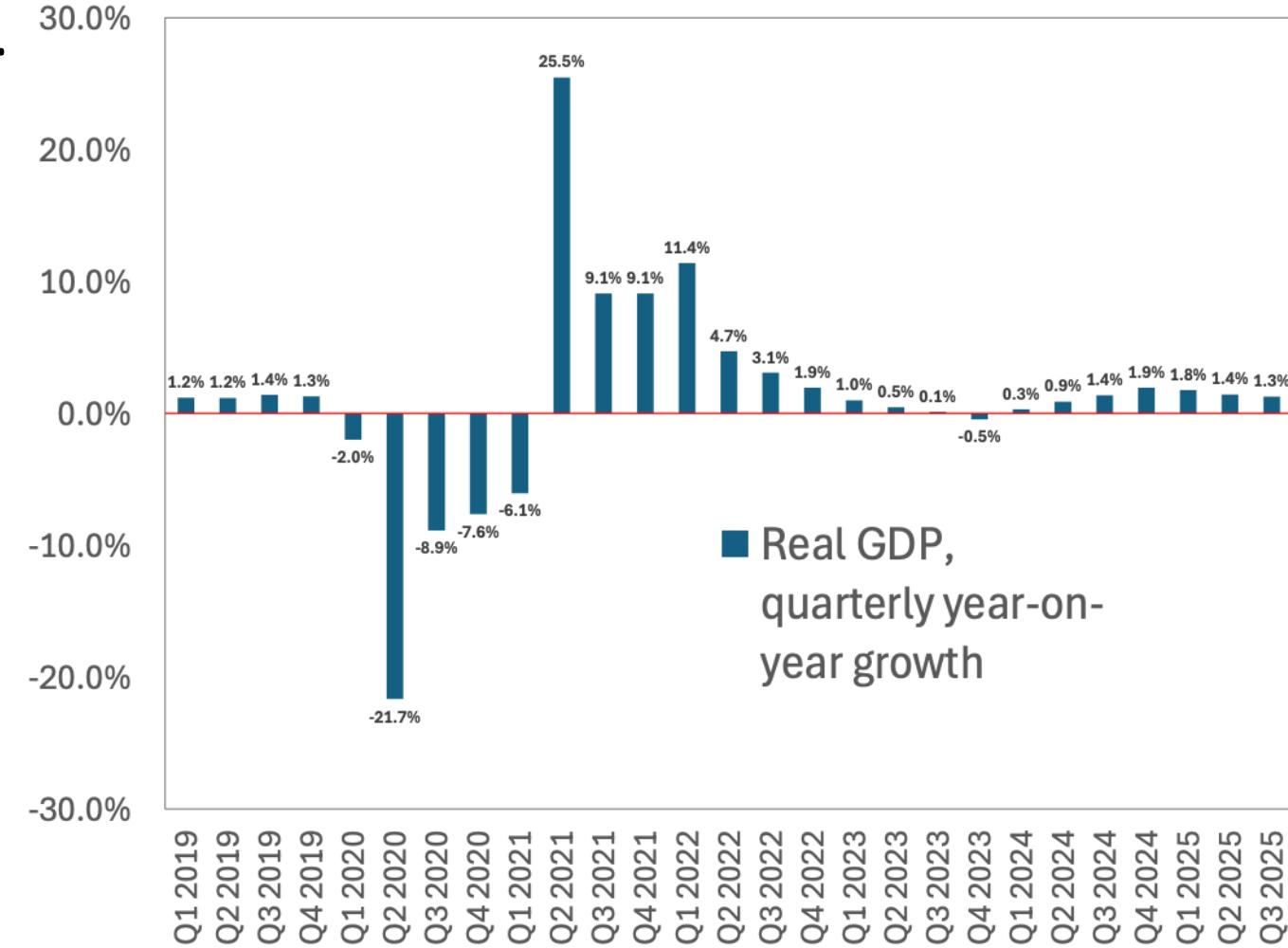
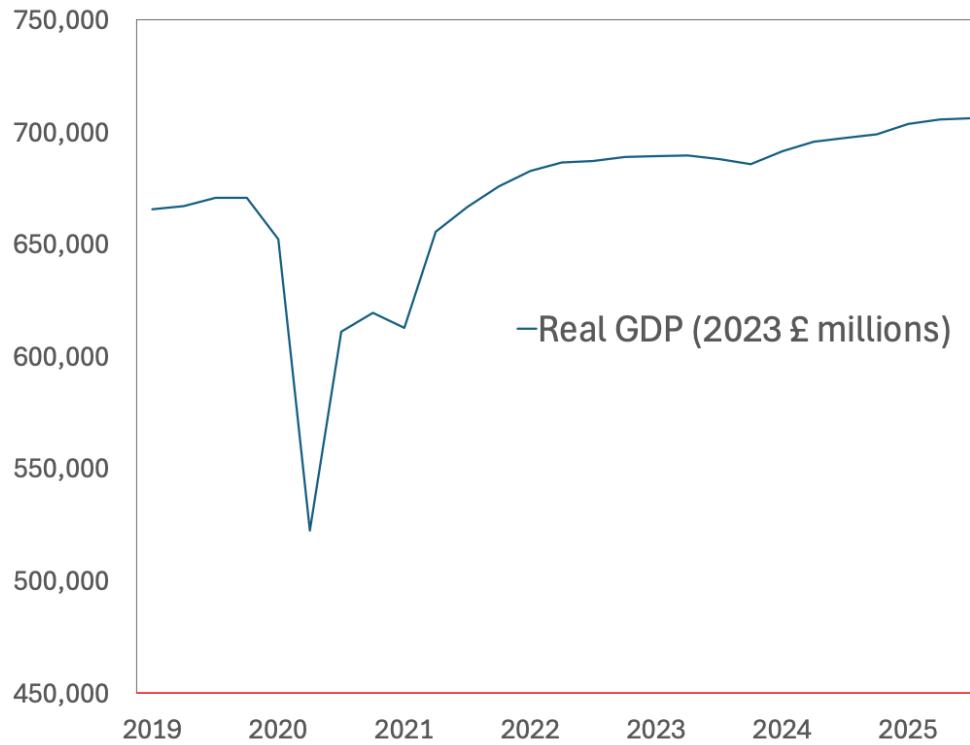
- Deadlines:
 - **December 15** for confirming the topic with me
 - **January 15 at 3pm** for delivering the essay (submission link on Keats)
- Make sure you are familiar with the DPE [Word Count policy](#).
- Clearly structure your essay in sections.
- Make the following very clear in the introduction:
 1. What is the question(s) you are addressing
 - (can be one question or a *small* number of questions)
 2. Why is it important
 3. How your essay will help answer the question(s)
 4. What are the main points your essay will make in answer to the question(s)

Final essay (2/2)

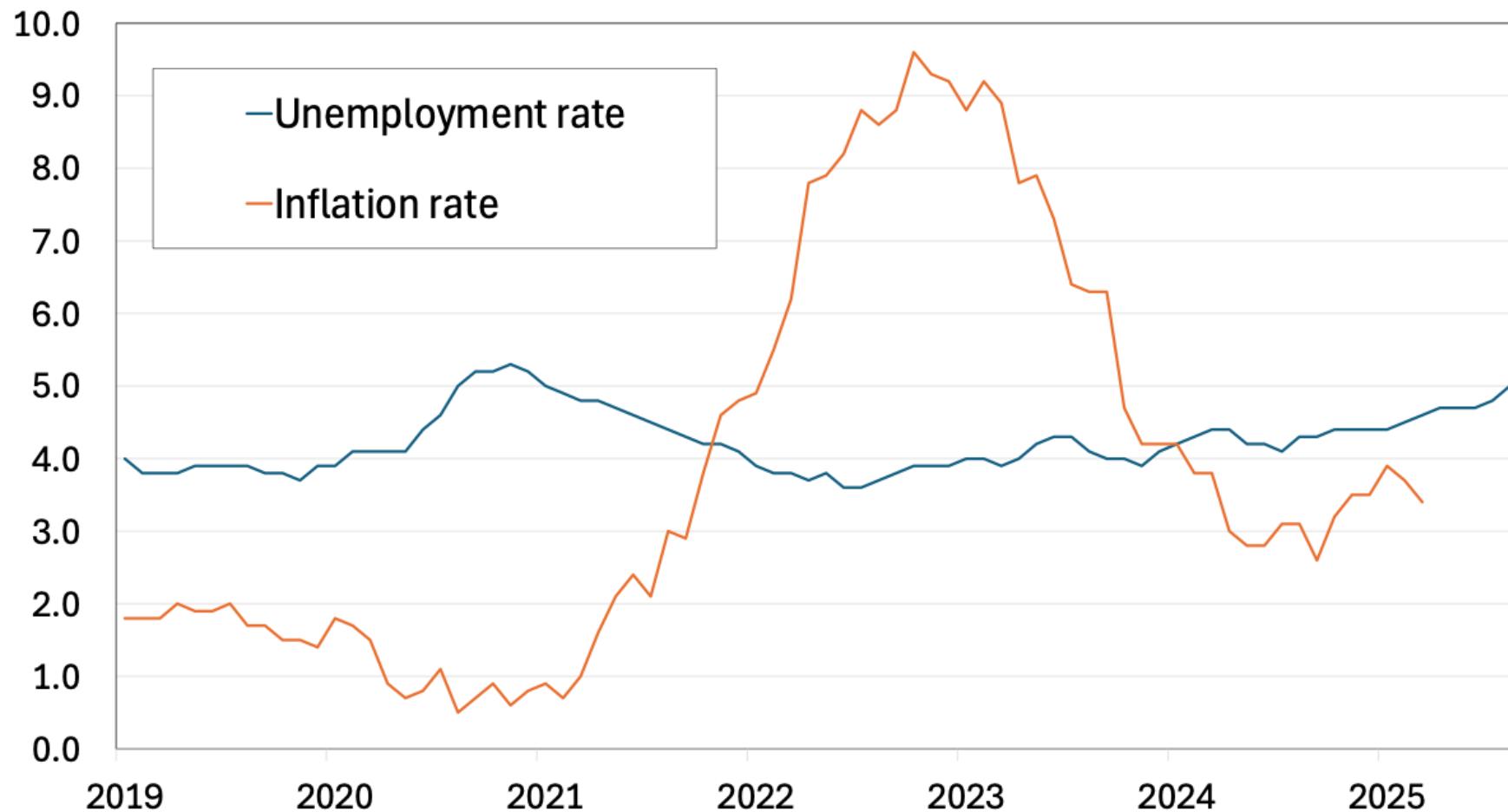
- Question(s) you set to address can be simple, like for example: “*what did X consist of?*” or “*what was the motivation behind X?*” or “*what were the main features of X?*” or “*what were the advantages and drawbacks of X?*”.
- Make sure to provide a clear summary description *in your own words* of the event/topic/policy, before developing your analysis/argument.
- Provide sources backing your statements whenever needed.
- Stick to authoritative/serious sources.
- Don’t just provide a scattered patchwork of quotes reporting what other people said about your topic: you need to create *your own organized* narrative.
- **Don’t let AI write your essay:** (a) It will do a terrible job; (b) I will spot it, and will have to report it. Read the “Generative AI guidance” on our Keats page.

2020-2025: Overview

- Covid recession was massive, but quick recovery after reopening.
- Underlying growth rate remains low.

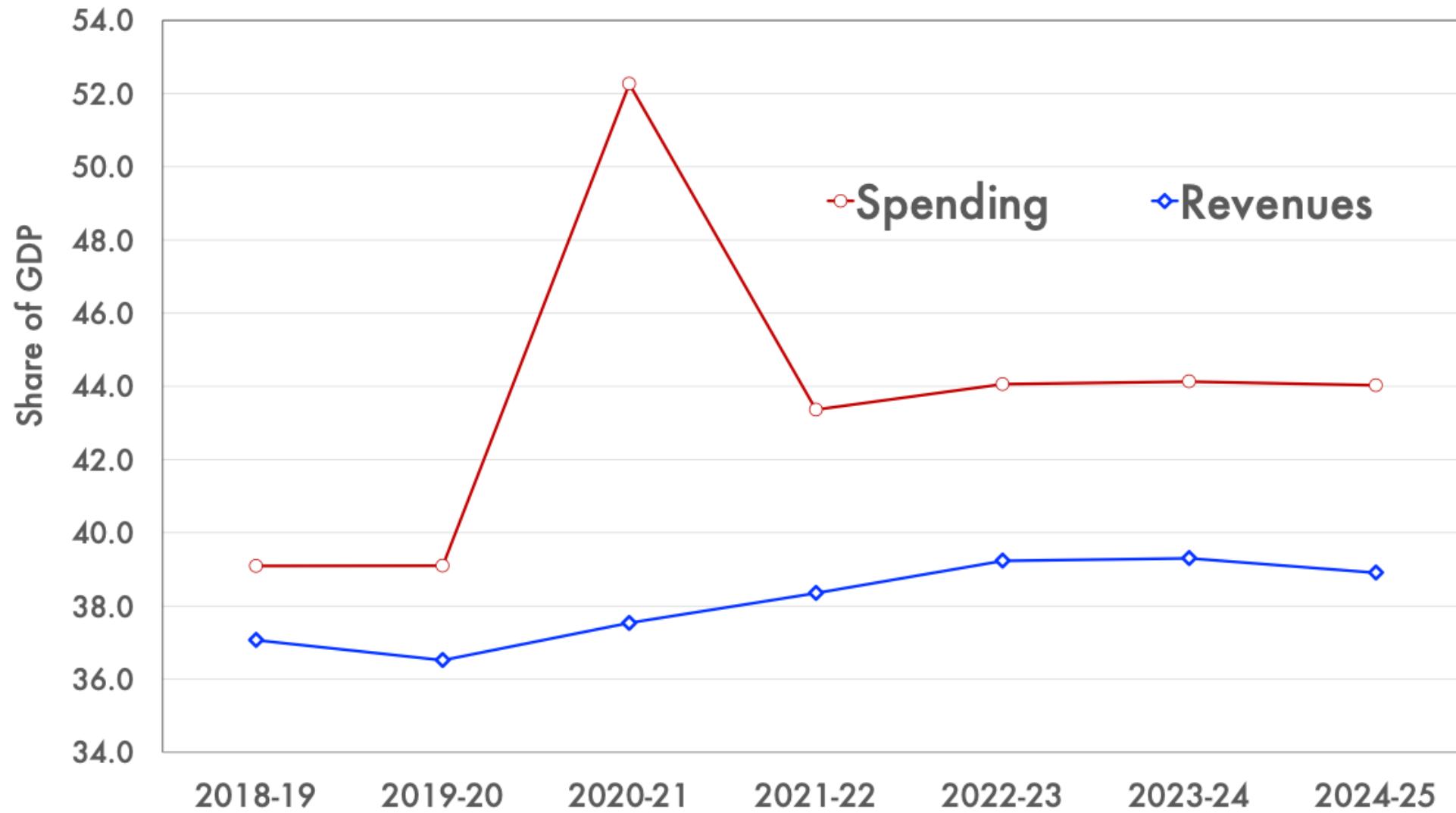


2020-2025: Overview



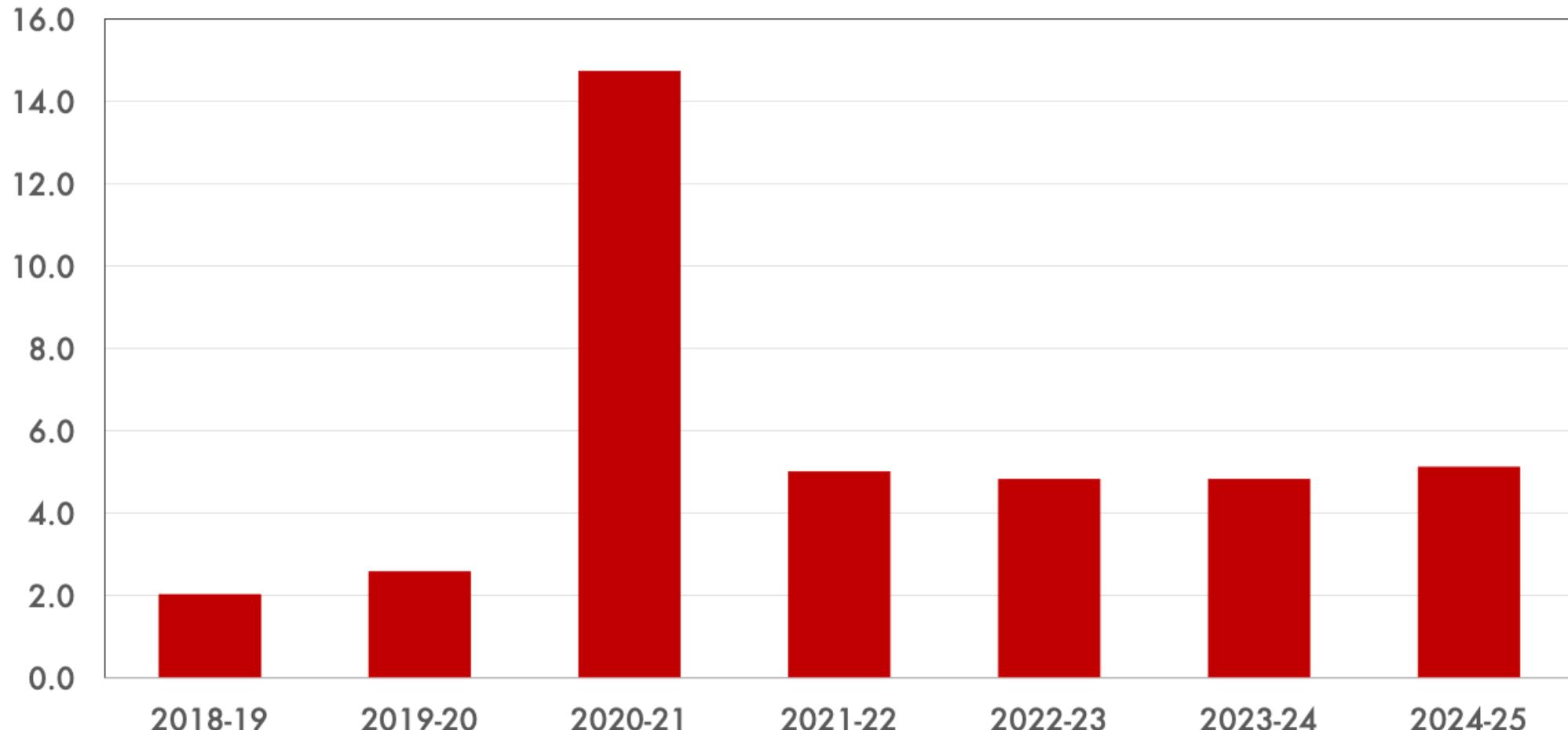
- Increase in unemployment during Covid was very limited due to massive government subsidies.
- Inflation spiked in 2022-23, then slowly went down.

2020-2025: Overview

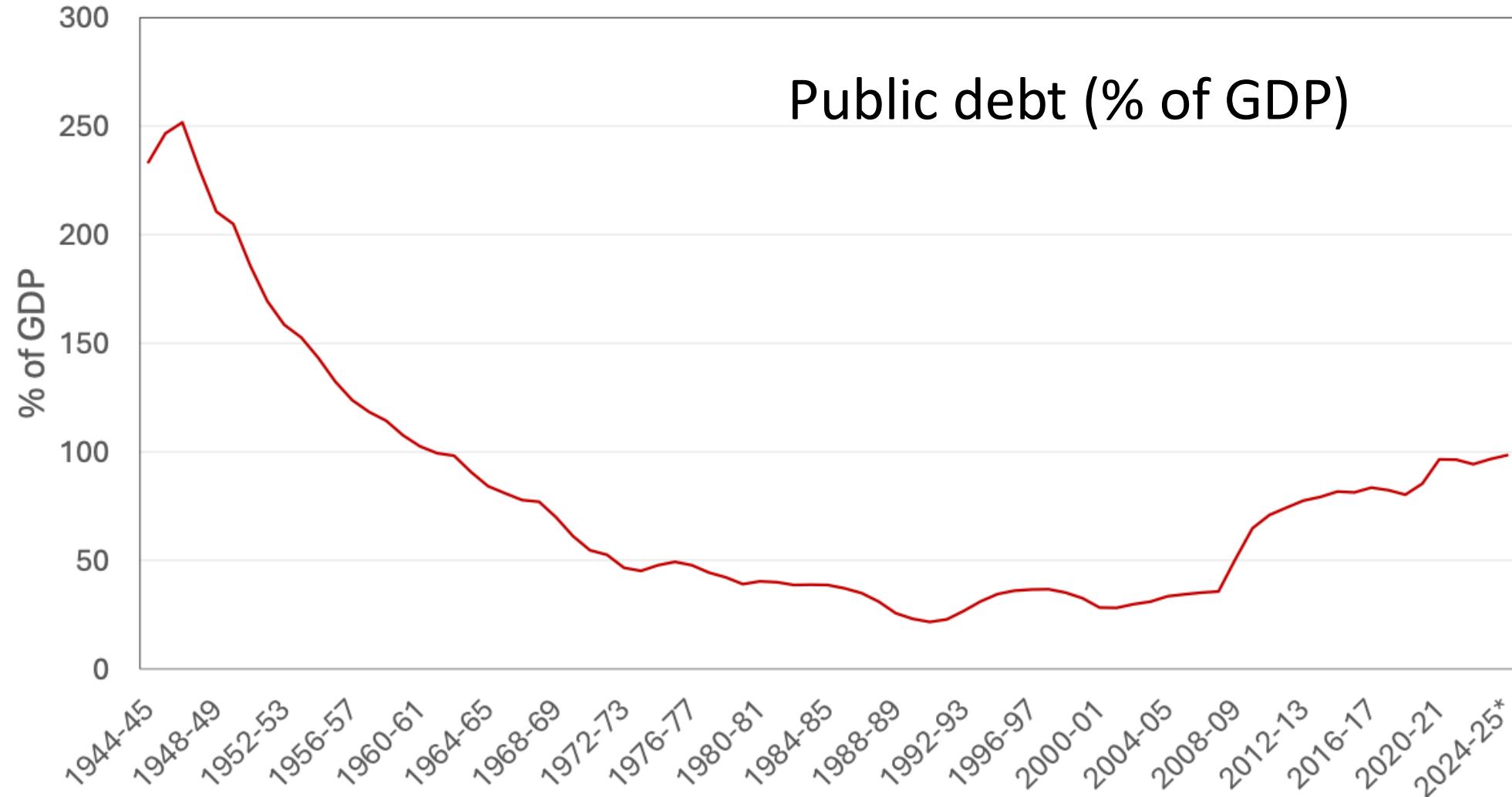


2020-2025: Overview

- Huge deficit during Covid, then settles on a level higher than pre-Covid.



2020-2025: Overview



2020-2025: Overview

- 2020-21: Strong fiscal & monetary response to Covid crisis.
- A new trend towards bigger government (even besides the Covid response).
- Post-Covid inflation ends the era of loose monetary policy.
- 2024-25: Labour's increase in investment & taxation, and new fiscal rules.



Macroeconomic policy in 2020-22



- July 2019- Sep 2022: Johnson government
 - Sunak Chancellor (after brief Javid parenthesis)
- Johnson explicitly rejects austerity & embraces increased government spending.
- Mar 2020 budget increases spending & borrowing
 - First Covid measures but also structural increases in departmental funding.
- Then the Covid crisis upends all plans and fiscal rules.

Policy reaction to the 2020-21 Covid crisis

- Furlough scheme
 - Mar 2020 to Sep 2021.
 - Covering up to 80% of wages.
 - Preserved worker-firm links.
 - Coronavirus Job Retention Scheme (CJRS) + Self Employment Income Support Scheme (SEISS)
 - 1.3m employers used CJRS, covering 11.7m jobs.
 - £70 bn (CJRS) + £21 bn (SEISS)
- Other subsidies to firms
 - Temporary tax breaks & deferrals.
 - A series of grant & loans schemes.
- Temporary increase in welfare benefits (UC)
- Additional funding for NHS & other public services.
- BoE: New large round of Quantitative Easing.

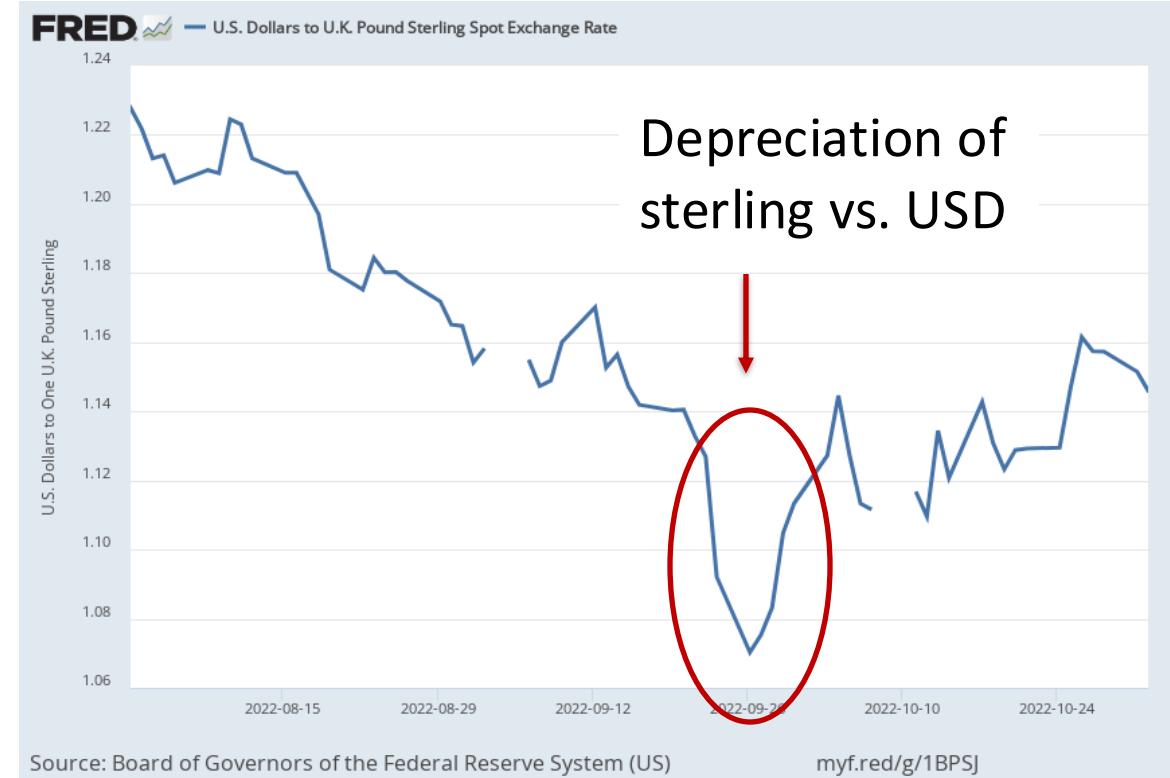


The Sep 2022 Truss-Kwarteng mini-budget (& mini-crisis)

- Sep 2022: Truss PM, Kwarteng Chancellor
- Not officially a budget, but a government statement outlining fiscal plans.
- Biggest tax cut since 1972 Barber boom.
 - Eliminate the 45% additional rate
 - Reversed all the previously planned tax rises
 - On top of just announced Energy Price guarantee
 - Entirely deficit-financed
- A shocking sudden reversal of policy, injecting large stimulus amid high inflation.
- Highly regressive
- Came without any OBR costing/forecasts

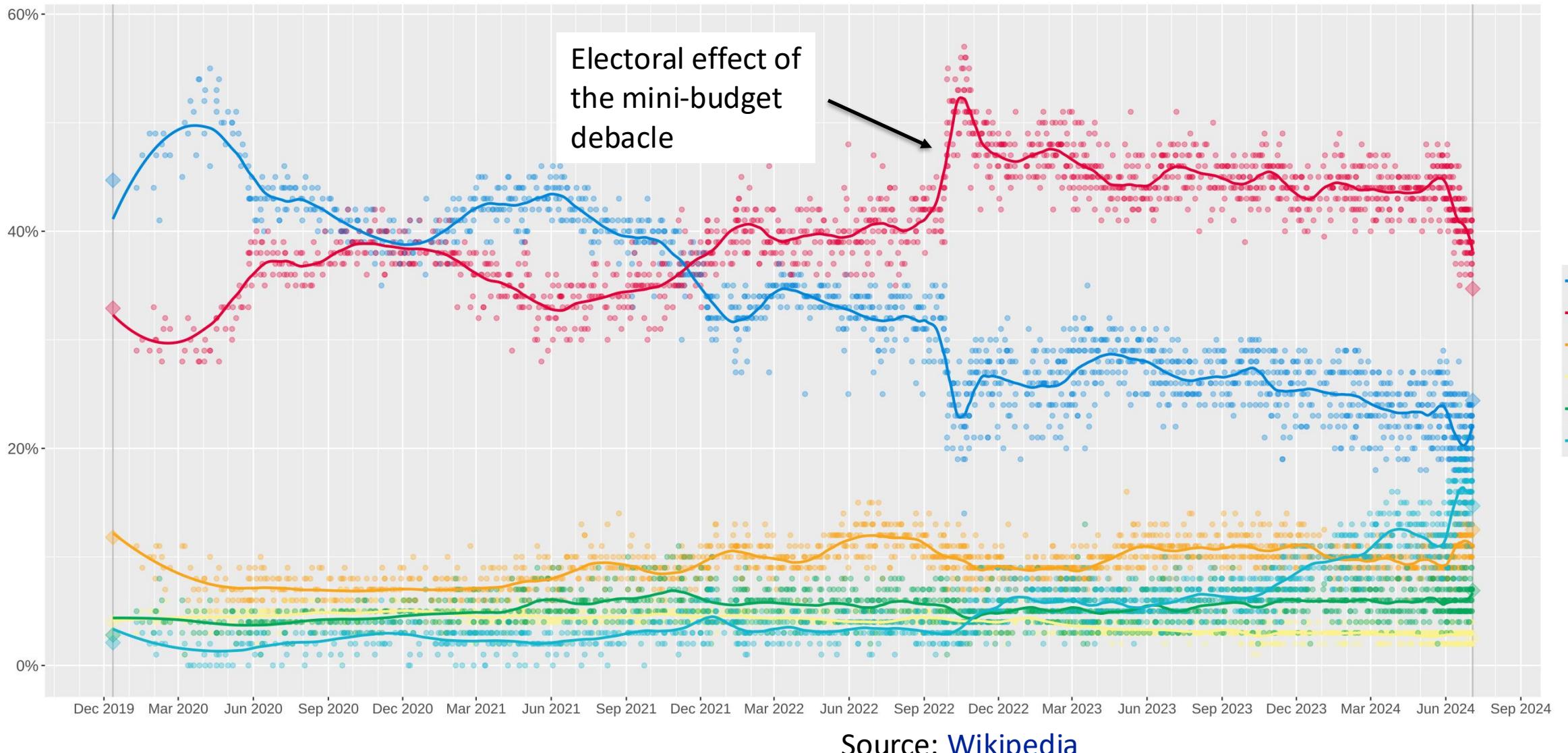


Financial reaction to Sep 2022 mini-budget



- BoE emergency intervention to stabilise Gilts market
- Higher expected inflation can explain higher Gilts rates, but not £ depreciation
- Increase in risk premium on UK assets due to perceived unpredictability/incompetence

The Sep 2022 Truss-Kwarteng mini-budget

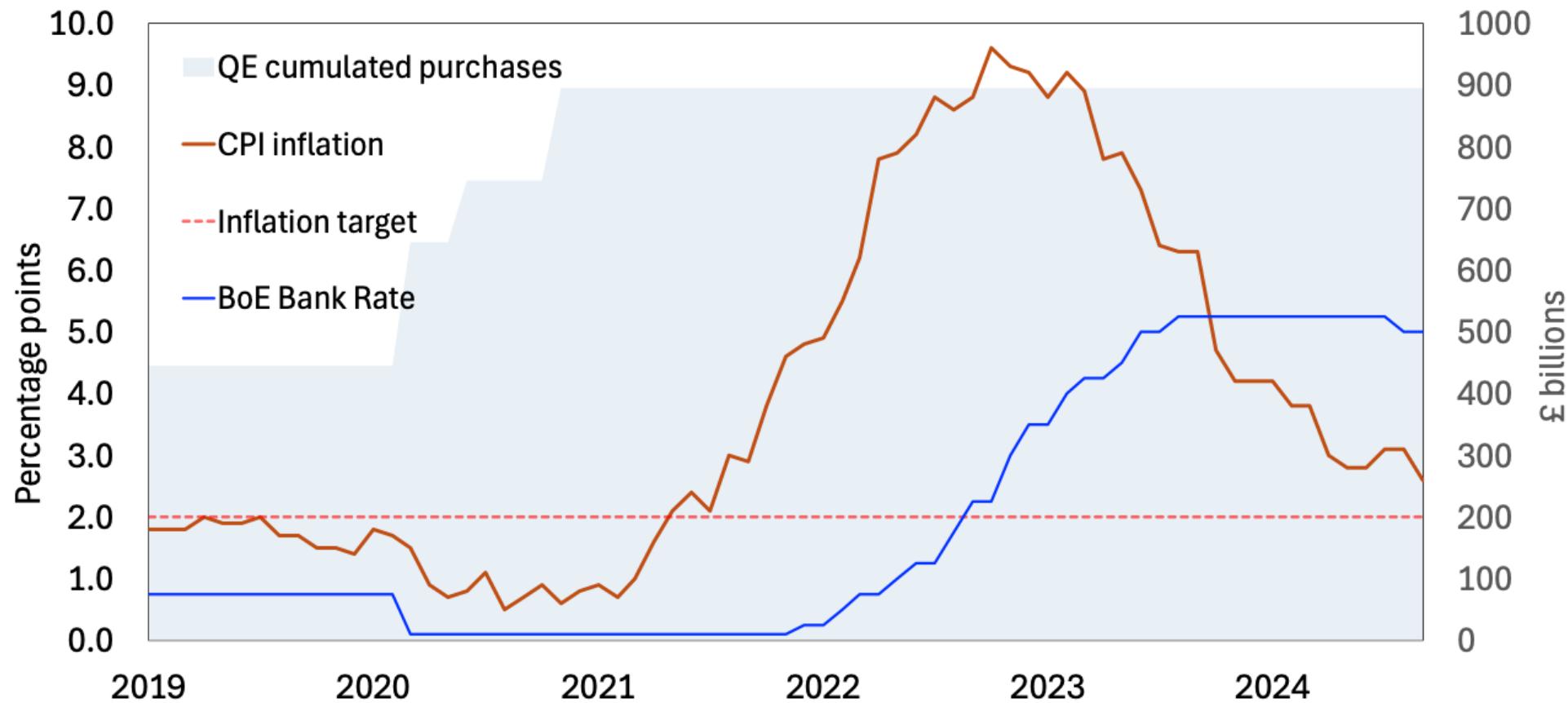


2022-24: Sunak-Hunt

- Truss government does not survive the mini-budget mini-crisis.
- Oct 2022- July 2024: Sunak PM, Hunt Chancellor.
- Two budgets (+ two autumn statements).
- Scrap Truss-Kwarteng mini-budget plans.
- Sunak-Hunt plan to stabilize public finances:
 - Extend the freeze of income tax & NIC thresholds until 2028 (a large tax increase in real terms)
 - Budgeted spending cuts starting in 2025
- Spring 2024 cut in NIC.



Inflation & the end of monetary stimulus



- 2022 switch to **Quantitative Tightening**.
- Might have contributed to rising Gilt yields.
- QT plans revisited (slowed down) in Sep 2025.

2024-25: Labour's new fiscal rules

- Ninth change of fiscal rules since 2008.
- New measure of public debt to be targeted
 - 1997-2022: “Public sector net debt” (PSND)
 - 2022-24: “*Public sector net debt excluding BoE*”
 - Now: “*Public sector net financial liabilities*”
- Rule 1: The return of the Golden Rule
 - *Current* budget must be forecasted to balance in the medium-term.
 - Previous (Hunt’s) rule was overall deficit < 3% over medium term.
- Rule 2: Debt stabilization
 - Debt must be (forecasted to be) falling in the medium term.
- A shortened rolling horizon for meeting the targets
 - 3 years instead of 5 (gradual transition: fully in place by 2026-27)
 - Meant to curb the phenomenon of fictitious tax increases and spending cuts from year +3 to +5, often observed in recent past.



The Oct 2024 & Nov 2025 Labour budgets

- Increase in spending & taxation relative to the previous (Conservative) plans.
- Prevented steep decline in public investment entailed by the previous plans for 2024-30.
 - Education & NHS investment main ‘winners’.
- Substantial increase in taxation to support the increase in planned spending
 - Mostly progressive.
- Damage control, but is there a long-term vision?



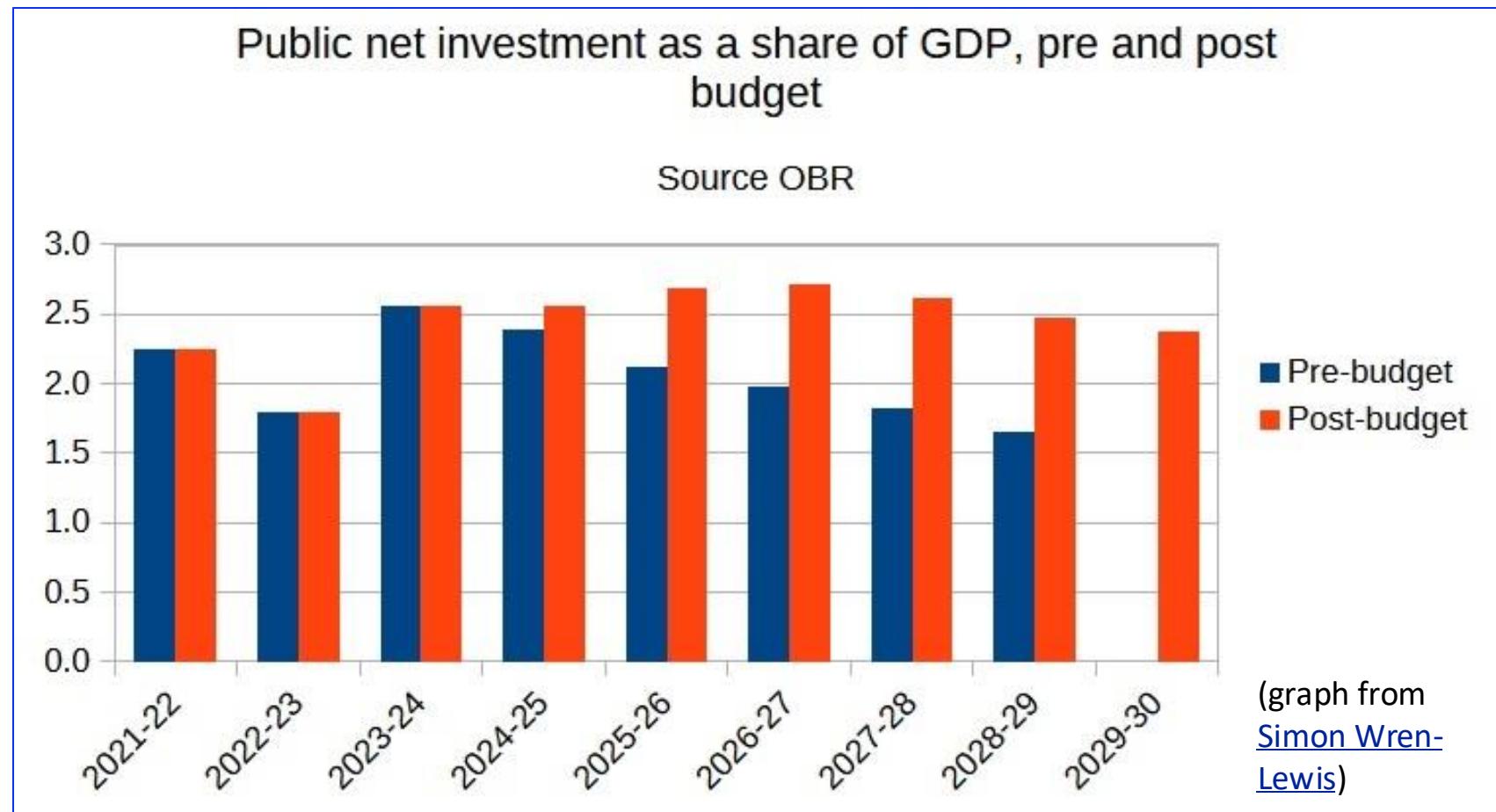
The Oct 2024 & Nov 2025 Labour budgets

- **Oct 2024:** Increase in spending (relative to plans) roughly half financed by tax increases, half by borrowing
 - → a modest *fiscal expansion*
 - Tax increases: ~40bn by 2028 [~ 1% of GDP]
 - Increase in employer NI + others
 - Reversed previously planned spending cuts
- **Nov 2025 :** further tax increases (~26bn), only partly offset by slightly increased spending
 - → a modest *fiscal consolidation*
 - “Backloaded” tax increases only kick in in 2029
 - Extension of tax thresholds freeze to 2029-31 + others
 - Partly to offset worsened forecasts, but mostly to increases buffer against fiscal rules to £22 bn (“headroom”).



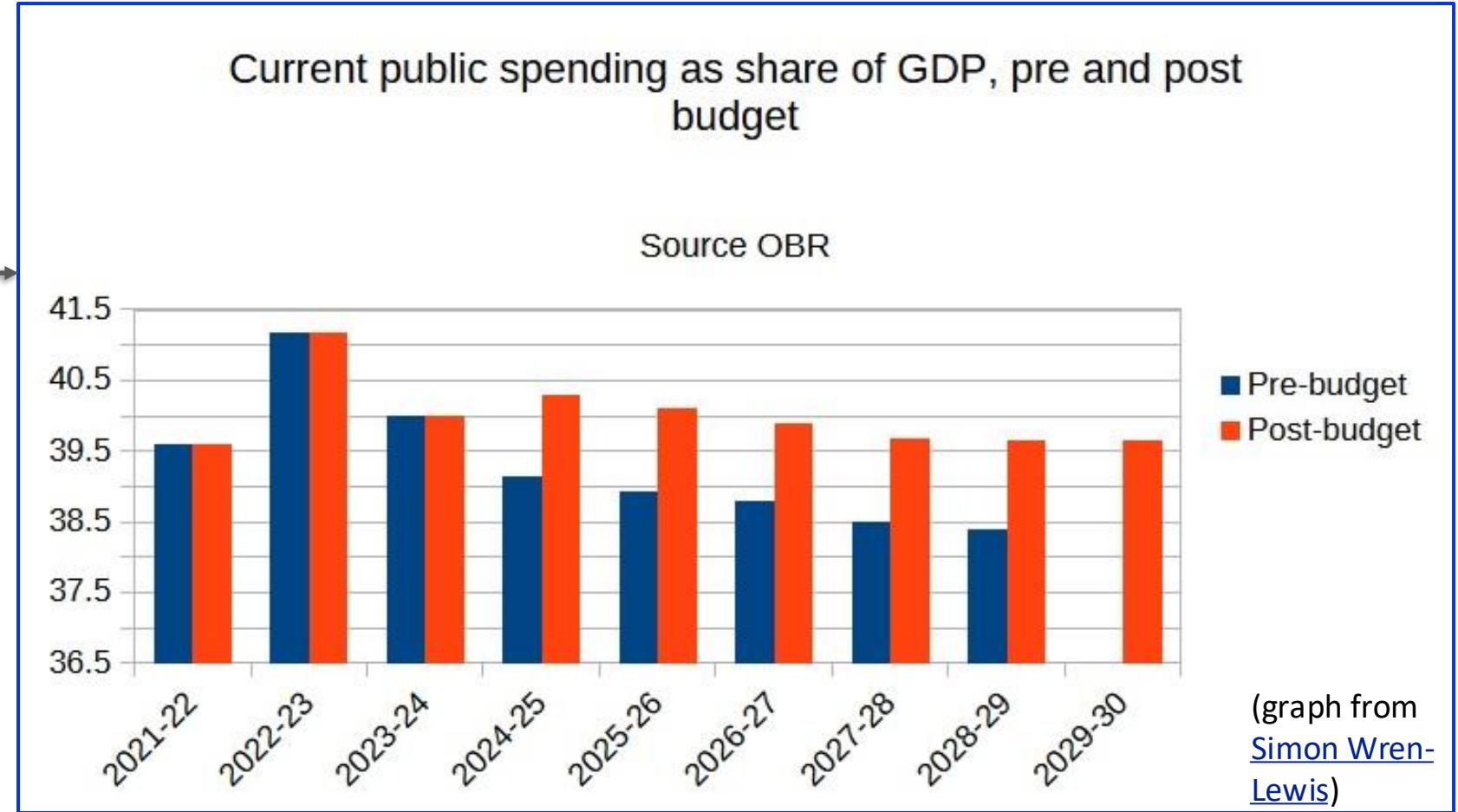
The Oct 2024 & Nov 2025 Labour budgets

Effect of Oct
2024 budget
on public
investment
forecasts



The Oct 2024 & Nov 2025 Labour budgets

Effect of Oct
2024 budget
on **current**
spending
forecasts

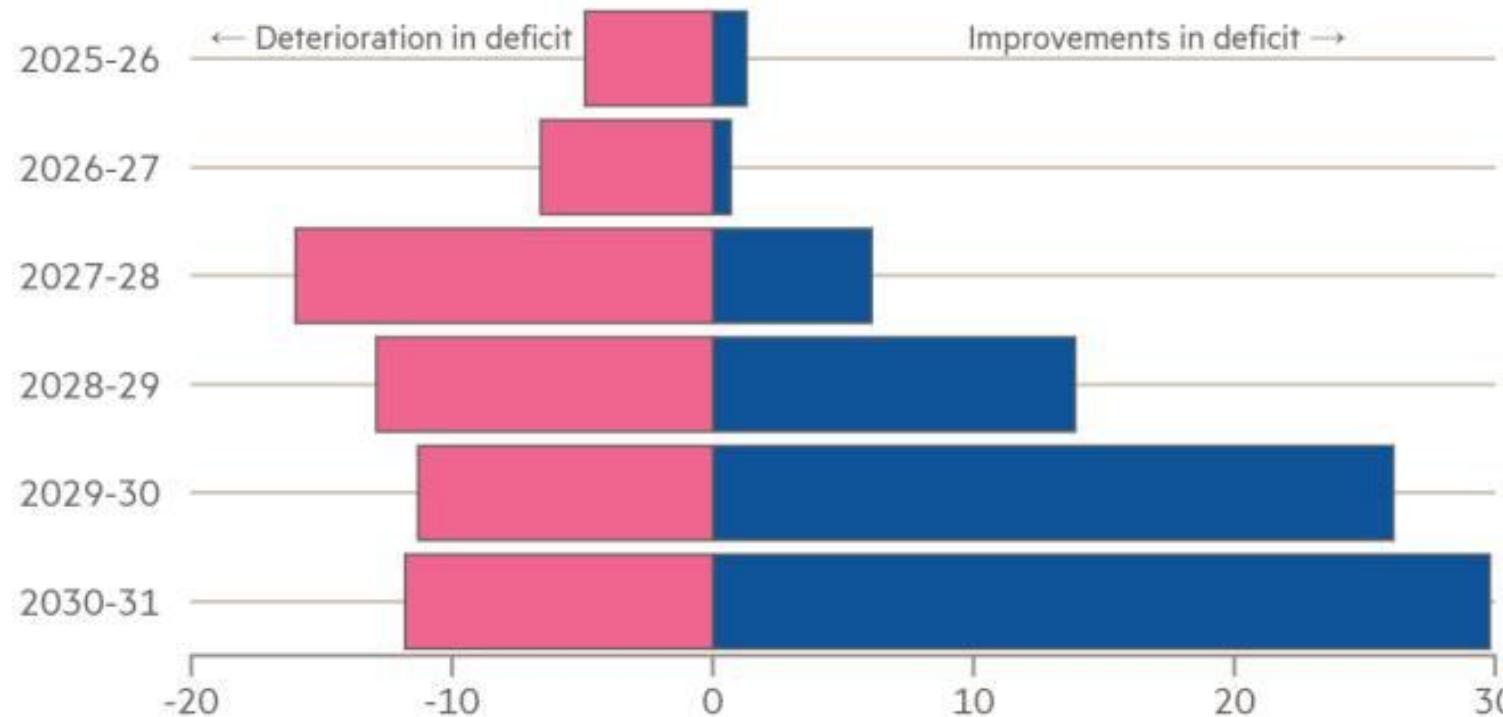


The Nov 2025 budget

A tax-and-spend Budget produces fiscal tightening, but only after 2028

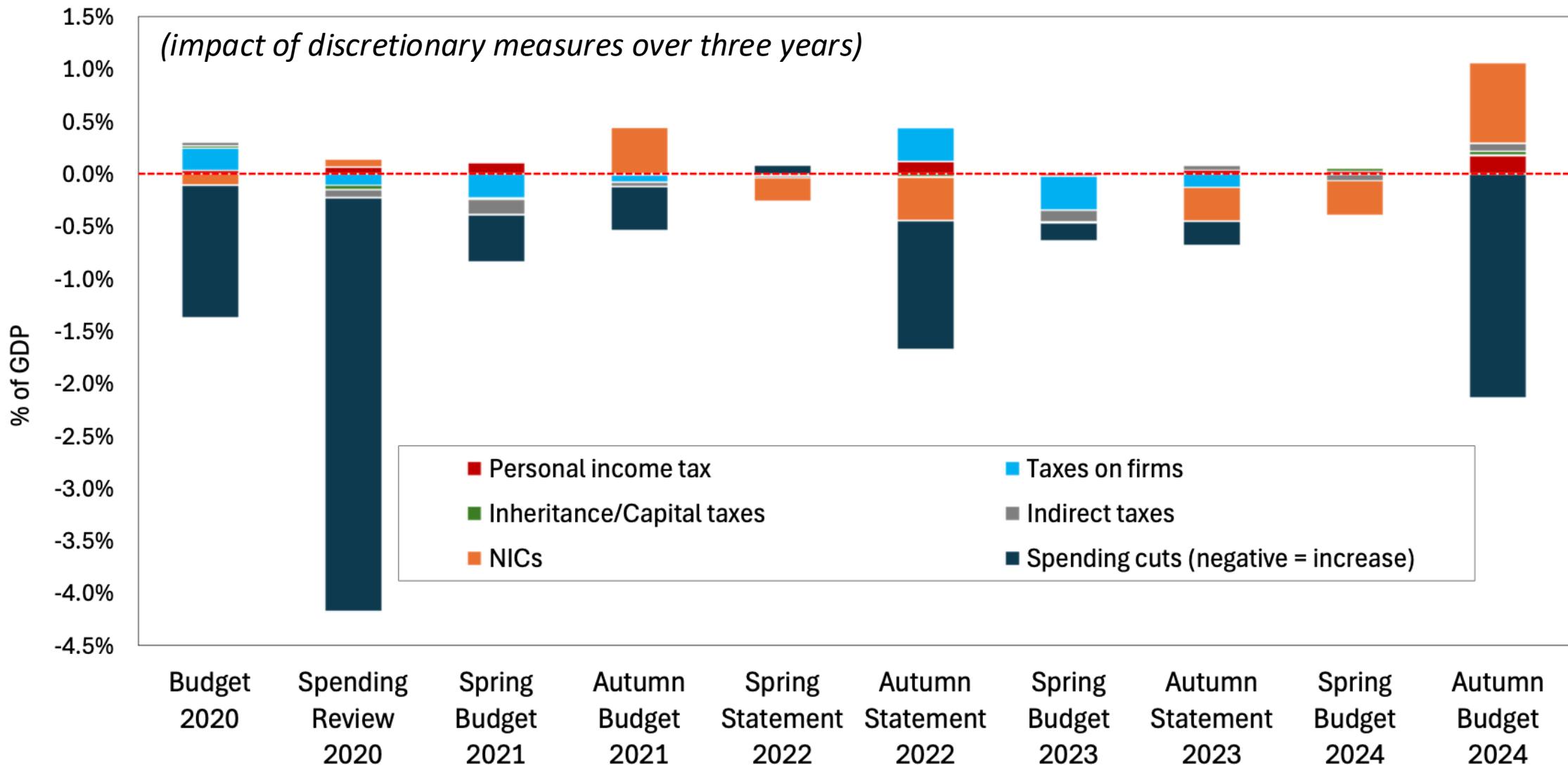
Impact on public borrowing of new measures introduced (£bn)

Tax increases Spending increases



- ‘Backloaded’ pattern
- But remember this is relative to the pre-existing plans.
- The overall forecast is still for stable public investment and declining current spending (as % of GDP).

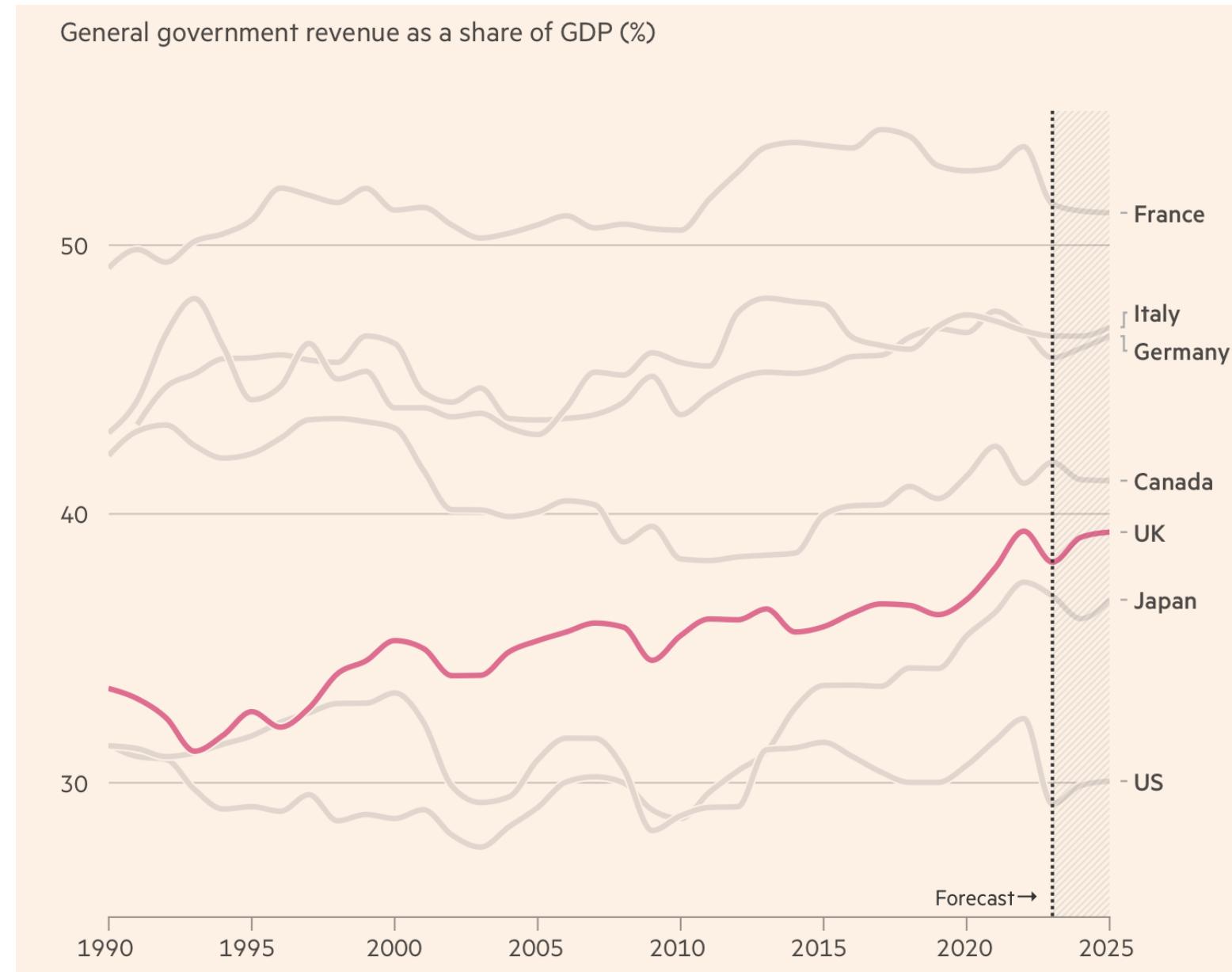
Fiscal policy in 2020-2025 in a graph



The big question for UK public finance

Will the size of government in the UK converge to European levels anytime soon?

(graph from [Financial Times](#) based on IMF data)





Thank you for your attention