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INVESTMENT MANAGEMENT

Thought
for the weekend

Emergency budget

The emergency budget provided few surprises with gilt yields largely unchanged and sterling modestly stronger, indicating international investors' continued support for the new coalition government's plans to take an axe to government spending. Now comes the hard part: executing the plan.

The key features of the emergency budget are outlined below. It was, as expected, a blend of public spending cuts and tax rises in the ratio of about four to one. The idea is that large universal tax rises simply reduce spending across all sectors of the economy but that public spending cuts can be targeted and much can be deferred. Furthermore the private sector will often step in to satisfy a need, for example a new motorway or rail link can be built and financed by the private sector and some social spending picked up by charities. The expectation is that as government steps back so jobs will be created in the private sector.

The strategy was very successful in Canada during the nineties but the jury is still out on how it will work here. Canada reduced its deficit against a backdrop of runaway global growth, falling interest rates and rising global financial liquidity. We do not have that luxury, indeed we are one of many developed countries attempting the same trick at the same time. If we all cut government spending aggressively what will happened to global growth? And how will the plans set out in the budget work in the real world, particularly when the unexpected yet inevitable external shock hits us?

Financial markets may have given the budget a cautious thumbs up but the hardest part has only just begun.

Key points

Personal taxation
- Personal allowances increased by £1,000 to £7,475 from 6 April 2011. Only basic rate tax payers will benefit.
- Review and possible repeal of pension rules due to be introduced on 6 April 2011
- Possible reduction in annual pension contribution allowance from £255,000 to between £30,000 and £45,000
- Furnished holiday lettings rules to be retained subject to a review in the summer
- Review of taxation rules for non-domiciled individuals

Capital gains, ISAs and inheritance tax
- Annual CGT exemption maintained at £10,100
- CGT allowance increased to 28% from 23 June 2010 for higher and additional rate tax payers and for trusts and personal representatives
- Entrepreneurs' CGT relief raised to £5m at 10%
- ISA allowance unchanged at £10,200
- Inheritance Tax threshold frozen at £325,000

Indirect taxation
- VAT increased to 20% from 4 January 2011
- Insurance premium tax from 5% to 6%

Bank tax
- Banks to pay a £2bn levy (additional international sanctions still to be agreed)

Business tax
- Corporation tax to fall from 28% to 24% over 4 years
- NIC concession for new businesses outside the south-east
- Capital allowances reduced

The economy
- Deficit to be cut from 12% to 1.1% of GDP by 2015-16
- Growth forecast reduced to 1.2% this year rising to 2.3% next year and 2.8% thereafter
- Inflation target maintained at 2%

The public sector
- Unprotected government departments to see budgets cut by 25% over 4 years
- Public sector pay frozen for two years
- Pensions review process underway

Welfare and benefits
- Welfare to be cut
- Housing relief to be capped
- Benefits to be updated in line with consumer price index rather than retail price index from next year
- Child benefits frozen for three years
- Child Trust Fund scheme to end

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Thought for the weekend is an occasional research publication intended to draw readers' attention to topics and issues of general interest to investors.

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