HM Treasury

AUTUMN STATEMENT 2016

alinea knowledge

The Autumn Statement:
What's in it for construction?

November 2016

Autumn Statement 2016 | Headlines

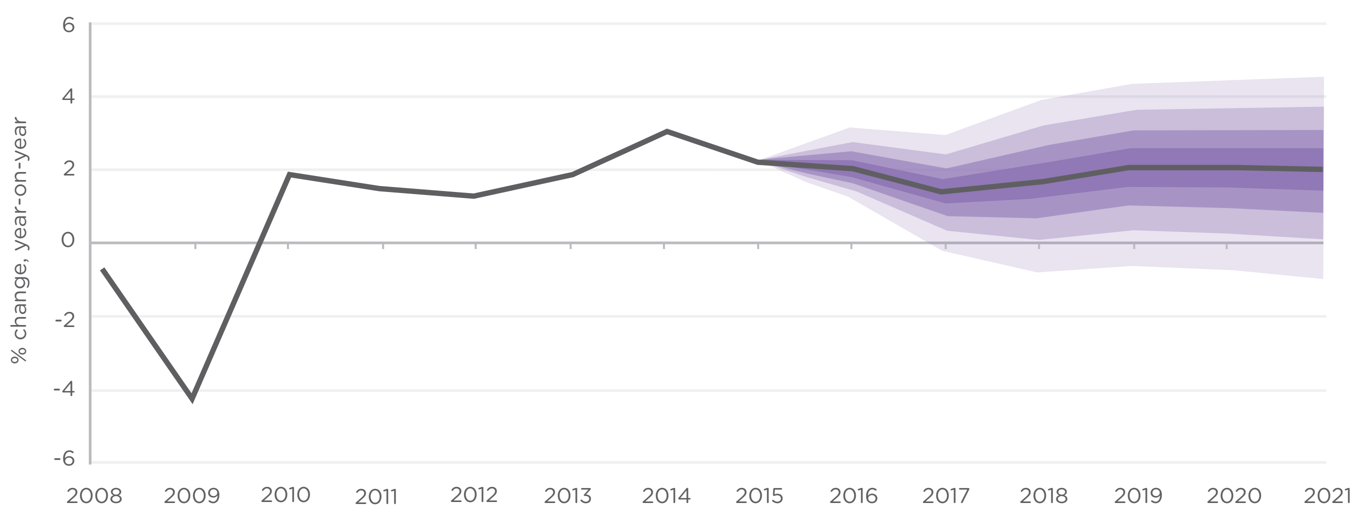
- The UK is the fastest growing major economy this year, but will be overtaken next year.
- We will be borrowing £122bn more to 2020 than previously assumed – of which £58.7bn is a direct result of the UK's departure from the EU.
- There is no information on the plan for Brexit, other than £0.5bn being set aside for Civil Service preparations.
- A national investment fund will receive £23bn over the next five years, to tackle the country's poor productivity levels. It covers infrastructure projects ranging from housing and roads to R&D and telecoms.
- £7bn of the £23bn is unallocated, to be invested from 2020 onwards.
- Funds allocated to housing include £2.3bn for 100,000 new homes in areas of 'high demand', plus £1.4bn for an extra 40,000 affordable homes.
- Key for construction will be the government delivering on these pledges, as recent history shows that 'investment' does not always become 'spending'.
- There was no mention of the construction skills crisis, which could affect many of the newly announced schemes.
- Unchecked public spending will be part funded by some reduced tax benefits, such as salary sacrifice and pension draw-downs restrictions – backed by a crackdown on tax evasion and avoidance.
- The UK's debt position will peak at nearly £2trn, or 90% of GDP, a peacetime high.

"It's been a difficult year for forecasters, and a good one for lovers of surprises. The Autumn Statement had a few, not least the OBR predictions of the cost of Brexit. Given the enduring prevailing uncertainty around Brexit it is perhaps to be expected that their forecasts come with a health warning, yet an apparent 50% margin of error is alarming."

Steve Watts, alinea consulting

- The OBR figures paint a gloomy picture (though less pessimistic than the Bank of England) because they are based on some cheerless Brexit-induced assumptions, in the absence of any details from the government. They also seem over-precise, especially given its suggested 50% margin of error!
- However, its forecast of a dip in economic growth is followed by a rebound in GDP, suggesting that the pain of Brexit will be short-term.
- Construction will be one of the industries hit by some cost increases, such as insurance premium tax and the National Living Wage.
- Estate agents are a clear and immediate loser, with shares falling on the news of a ban on letting agents fees to tenants.
- From next year, there will be an Autumn Budget and a shorter update on the economy in a Spring Statement.

UK real GDP growth fan chart



Source: ONS, OBR

Autumn Statement 2016 | Basis

Basis of OBR scenarios

The Office for Budget Responsibility (OBR) is clear in its analysis for the Autumn Statement that it has "no privileged knowledge on Brexit". The OBR is required, by law, to produce forecasts based on current Government policy, so approached Government to provide "a formal statement of...policy as regards its desired trade regime and system of migration control as a basis for projections". It was merely sent pre-existing public statements, leaving it to make several assumptions:

- the UK leaves the EU in April 2019
- the negotiation of new trading arrangements with the EU and others slows the pace of import and export growth for the next 10 years
- the UK adopts a tighter migration regime than currently in place (although not strict enough to bring it to the desired 'tens of thousands').

The OBR has assumed that Brexit would lead to "lower trade flows, lower investment and lower net inward migration....hence lower output" although no mass shedding of jobs or a collapse in consumer spending. These assumptions mean that the degree of uncertainty surrounding the forecast is much higher than usual (it has been suggested that some figures have a margin of 50% around them).

The OBR also tried to find out whether the basis of the Nissan deal would have any contingent liabilities but the Treasury declined to answer.

UK Budget Regimes

Philip Hammond made his first Autumn Statement his last, by saying, "no other major economy makes hundreds of tax changes twice a year". From next year the UK will have its main Budget reading in autumn, announcing tax changes in good time for the start of the new tax year, and a Spring Statement will respond to OBR forecasts but no major fiscal event. This will allow for greater scrutiny of measures ahead of their implementation and avoids "making significant changes twice a year just for the sake of it".

Fiscal rules

The Chancellor dropped George Osborne's targeted surplus in 2020 but installed three new rules of his own:

1) Borrowing to be 2% of GDP by the end of parliament.
2) Public sector net debt will be falling by the end of parliament.
3) Welfare spending to remain within a government set, and OBR monitored, cap.

"The economy has not slowed as sharply as some forecasters feared in the wake of the referendum vote to leave the European Union. But it has slowed. And the outlook is weaker than at the time of the Budget."

Robert Chote, Chairman of the OBR

Autumn Statement 2016 | The economics

Economic background

The first fiscal speech from the new Chancellor of Theresa May's relatively new cabinet was seen as a modest give-away as the economic outlook weakens following the vote to leave the European Union five months ago.

Unlike last year's Autumn Statement, which had a clear message that the "long term economic plan is working", Philip Hammond appeared cautious of risks but still optimistic about the future of the UK.

The Chancellor reported on an economy that has "bounced back from the depths of a recession" and that the IMF has forecast will grow at the fastest rate of any advanced major economy this year. Employment is at a record high and the unemployment rate is at its lowest for 11 years.

However, a closer look at the data shows that there are significant headwinds in the coming year, and the OBR forecasts have been reported as all 'doom and gloom'.

According to the OBR, the UK's growth will be 2.1% this year but will fall to 1.4% in 2017 before increasing in 2018 and 2019 to 1.7% and 2.1% respectively.

The deficit

Hammond abandoned George Osborne's plan to eradicate the budget deficit by 2020, and instead announced that lower tax receipts and extra borrowing would push the deficit to £21.9bn. Over the course of the next five years, net public sector borrowing will total £216.3bn which is £122.2bn higher than expected in the Budget in March. Debt will peak at 90.2% of GDP in 2017-2018; by comparison, public debt between 1994-2010 averaged just below 40%.

Taxes

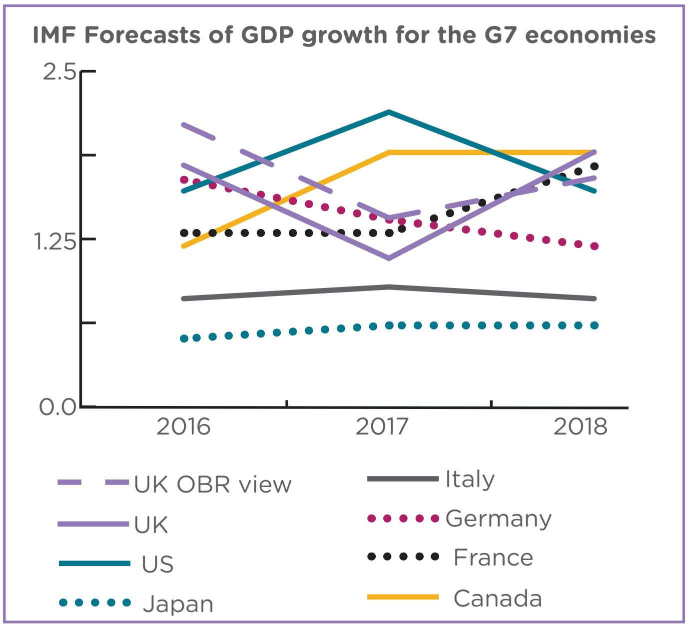
The tax-free personal allowance will rise to £11,500 with the intention to increase it further to £12,500 over the course of parliament. The higher rate will rise to £50,000. From 2020, the personal allowance will rise automatically during the 2020s in line with inflation. The National Living Wage will increase from its current £7.20 to £7.50 in April.

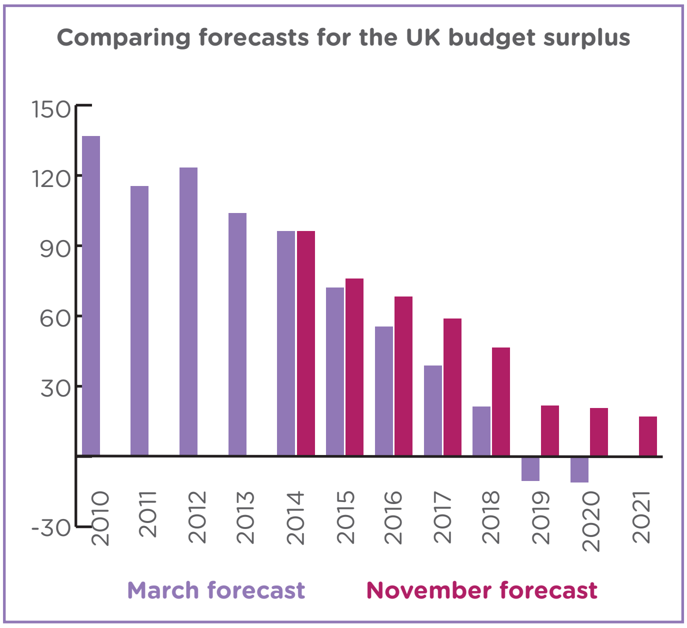
Corporation tax will fall to 17%, the lowest in the G20 but not the 15% that Theresa May had previously suggested. Only time will tell whether the US President Elect, Donald Trump, follows his Trump Plan to lower business tax rates from 35% to 15%.

The Insurance Premium Tax (IPT) was introduced in 1994 at a rate of 2.5% and in June will rise from its current 10% up to 12%. This is the third increase in IPT in the last 18 months.

Fuel duty increases have been frozen for the seventh successive year, saving the average van driver £350 a year.

Non-cash benefits which allow employees and employers to pay less tax and national insurance are being scaled back. However salary sacrifice schemes for pensions, childcare and cycle-to-work will still be included in the scheme. From April next year, company cars (unless they are ultra-low emissions vehicles), car parking near your workplace and gym memberships will lose their tax perks.





Autumn Statement 2016 | What does it mean for construction?

National Productivity Investment Fund

For construction, the headline announcement was a £23.67bn National Productivity Investment Fund (NPIF). This will look for improvements in four main areas considered critical for improving productivity: housing, transport, digital communications and research & development.

This fund is allocated as below, with only £16.7bn of the headline figure appearing within this parliament.

This extra funding is added to other pledges in recent Budgets which have seen the announcements of increasingly large sums of money. Whilst greater investment in improving the state of the nation's infrastructure will no doubt be welcomed by many construction firms, it is hoped that a greater emphasis will be placed on the strategy for delivering these schemes.

National productivity investment fund (£m)

		2017-18	2018-19	2019-20	2020-21	2020-21
Housing £8.16bn	Accelerated housing	285	635	665	380	
	Affordable housing	1,120	1,125	880	340	
	Housing infrastructure fund	60	300	945	1,425	
Infrastructure £3.02bn	Roads and local transport	365	500	430	650	
	Next generation vehicles	75	100	110	115	
	Digital railway enhancements	30	55	165	285	
	Cambridge-Milton Keynes-Oxford corridor	5	135	0	0	
Digital Communications £0.74bn	Fibre and 5G investment	25	150	275	290	
Research and Development £4.75bn	Research and development funding	425	820	1,500	2,000	
Unallocated £7.0bn						7,000
Annual total		£2.39bn	£3.82bn	£4.97bn	£5.49bn	£7.00bn

Autumn Statement 2016 | What does it mean for construction?

"The chancellor's commitment to double annual capital spending on housing by 2020 demonstrates that he understands that house building and economic growth are intrinsically linked. For every £1 invested in construction, £2.84 is generated in the wider economy and therefore the best way to protect ourselves from an economic wobble as we leave the EU is to invest in our built environment."

Sarah McMonagle, Federation of Master Builders' director of external affairs

Housing

In addition to the 140,000 homes which the NPIF aims to 'unlock', the Chancellor had a few other headlines for the housing market.

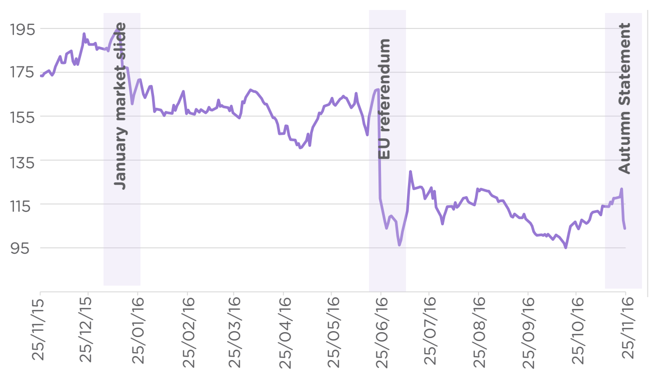
As part of the government's ongoing devolution, the Greater London Authority has been apportioned a £3.15bn fund for the delivery of 90,000 new affordable housing starts by 2020-21. This fund sits outside the NPIF budget.

Right to Buy has been extended, allowing over 3,000 tenants to buy their home, under the scheme which gives council tenants the option to buy their home at a substantial discount. The scheme has been significantly criticised as sold-off homes are not replaced, therefore reducing the stock of council homes.

As rumoured before the reading of the Autumn Statement, lettings agent fees are to be banned "as soon as possible". Since last year, lettings and managing agents have been legally obliged to clearly advertise their fees but this has not helped to regulate the market. According to Shelter, the average upfront costs to UK renters using a letting agency are usually more than £1,000, and in London this figure is often over £2,000.

Before the measure was formally announced, agents' share prices were falling. Foxtons and Countrywide saw their shares fall 10% and 5% respectively.

The effect on estate agent shares (example)



Source: Foxtons shareprice

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