

UK Watch

Autumn Budget: Uncertainty Builds

Uncertainty on the Autumn Budget rises

Budget uncertainty rose after the Chancellor dropped plans to raise income tax. Markets had viewed income tax rise as a predictable way to raise revenues. Now it looks like small tax rises and freezing thresholds are likely to feature in the Budget. Assuming this backdrop emerges, this raises questions on what the tax rises will be, how frontloaded they are and predictability of tax revenues. Having said that, we expect the Chancellor to meet fiscal rules, raise the headroom and deliver half of the consolidation via frontloaded tax rises, which should reduce market concerns. But our conviction on the size of frontloaded tax rises is now lower.

Chancellor still likely needs £27-32bn of consolidation

We think the Chancellor still likely needs to do £27-32bn (0.9%-1.1% of GDP) in tax rises/spending cuts in the Budget to fill the fiscal gap and raise the headroom. This is slightly lower than before. We think the Chancellor is likely to implement the majority of £27-32bn (0.9%-1.1% of GDP) of consolidation via non-inflationary tax rises, out of which £13-18bn are likely to be frontloaded (0.4%-0.6% of GDP).

Reduced clarity on near term impact

0.4-0.6% of GDP of non-inflationary frontloaded tax rises could weigh on 2026 growth/inflation by ~15bps and increase risks of an additional cut on top of our forecast of two more cuts. But at the margin, relative to the scenario where income tax rise was part of the package, there is now greater uncertainty on the size of frontloaded small taxes, near-term growth/inflation impact and scope for the BoE to cut rates much more than expected. If consolidation is more gradual, then we would expect the impact to be minimal.

Rates: Curb your enthusiasm

key implications for the rates market are (1) heightened uncertainty over the credibility and feasibility of the government's fiscal consolidation plans; (2) uncertainty over improved OBR economic forecasts raising the possibility that further revisions will be required in the not-so-distant future; and (3) reduced clarity on the likely magnitude of adverse growth and inflation effects. Our Gilt Remit forecasts remain unchanged: we expect the £2bn increase in Gross Financing Requirement to be covered by an increase in net T-bill sales. We lightened up our existing trade ideas last week in nominals. In inflation, the "smorgasbord" approach concerns over expensive homes tax effect on RPI.

FX: Kite Flying

For all the noise around Friday's announcement, GBP ended the day higher and crucially, idiosyncratic risk premium fell. What does this tell us? Whilst details of the Budget matter, there are two important pillars which are anchoring the market: commitment to fiscal rule and increasing the headroom. If GBP risk premium is any guide, then we think that the mood music has improved. Nonetheless in our view this is not the moment to be brave. The case for hedging foreign currency risk for GBP functional investors is strong. But fading GBP weakness until the release valve of event risk has passed is cautioned against.

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Uncertainty on the Autumn Budget rises

The uncertainty on the Autumn Budget has increased. After preparing the ground for raising income tax (with a potential NICs offset) for many days, the Chancellor is looking to drop those plans and focus on small taxes instead to raise the required revenues. In reality, the Treasury is likely to have had several options on the table depending on the OBR outcome. A better-than-expected OBR forecast along with the income tax plan perhaps not raising as much money as expected were likely behind the decision to drop the plan to raise income tax. It however could also be driven by the need to avoid challenging internal politics on breaking the manifesto promises.

Markets viewed the income tax plan as a predictable way to raise tax revenues, along with showing the political willingness to take tough decisions to undertake consolidation. Now it looks like a series of small taxes and freezing income tax thresholds are likely to feature as main revenues raising measures. Even plans to lower tax thresholds is looking less probable to us.

This opens up questions on what these tax rises will be, how frontloaded they are as well as ambiguity on the deliverability and predictability of tax revenues. It also raises risks of non-linear effects if tax rises affect too many sectors. At the same time, uncertainty over improved OBR economic forecasts raises risks of future revisions. Overall market concerns on the UK's fiscal position have increased.

Having said that, and crucially for markets, we still expect the Chancellor to meet the fiscal rules, raise her headroom and deliver about half of the consolidation via frontloaded tax rises, which should reduce concerns. But our conviction on the size of frontloaded tax rises is now lower.

Chancellor still likely needs to do £27-32bn of consolidation

In our Budget preview [UK Viewpoint: Autumn Budget Preview 11 November 2025 \(see note\)](#), we wrote that the Chancellor potentially needs to do consolidation of £30-35bn to fill the fiscal hole of £22.5bn, provide £2.5bn of giveaways as well as raise the headroom by £5-10bn (from current £10bn to £15-20bn). Reports suggest that fiscal hole is now closer to £20bn due to better forecasts from the OBR. Potentially the offset from wage growth is a bit higher than we expected. Moreover, the OBR has announced that forecast window for gilt yields it is using is 10 days as of 21 Oct., a week later than we expected, which captures some of the gilt rally and reduces the hit to headroom from higher gilt yields by £1.5bn to £2.5bn.

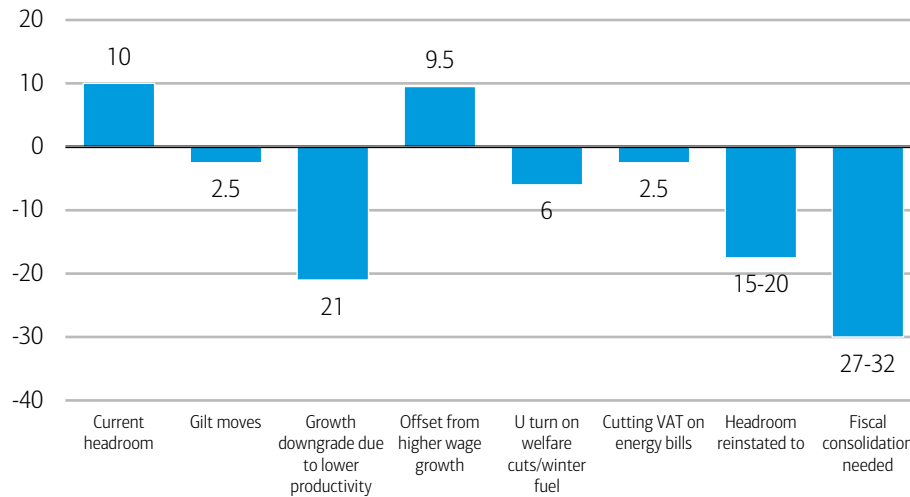
But our understanding is that the £20bn of fiscal hole doesn't include new policy decisions such as the £2.5bn needed to lower VAT on energy bills or lifting of two child benefit cap (lifting of two child benefit cap could potentially be paid for by proposals to replace jobseeker's allowance and employment & support allowance with a single new 'unemployment insurance (UI) benefit).

Overall, we think the Chancellor still likely needs to do £27-32bn (0.9%-1.1% of GDP) of tax rises/spending cuts in the upcoming Budget to fill the fiscal hole, provide giveaways and raise the headroom (Exhibit 1). This is slightly lower than before. Nonetheless this still represents a substantial amount that the Chancellor needs to raise in the upcoming Budget, and questions remain on how the Chancellor will fill this fiscal hole. This estimate remains uncertain, and risks are two sided.



Exhibit 1: We think the Chancellor still likely needs to do £27-32bn (0.9%-1.1% of GDP) of tax rises/spending cuts in the upcoming Budget to fill the fiscal hole and raise the headroom

Sources of fiscal hole



Source: OBR, BofA Global Research

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Consolidation likely to now rely on threshold freezes, smaller taxes and some backloaded spending cuts

We think the Chancellor is likely to undergo majority of £27-32bn (0.9%-1.1% of GDP) of fiscal consolidation via non-inflationary tax rises, out of which £13-18bn are expected to be frontloaded (0.4%-0.6% of GDP).

The consolidation is now likely to rely on frontloaded smaller taxes, backloaded threshold freezes and some backloaded spending cuts.

- 1) **Limited backloaded department spending cuts raise £5bn:** The government can potentially lower the real growth in department spending in 2029-30 from 1% to 0.5%, which can raise ~£5bn.
- 2) **Backloaded threshold freezes can raise £9bn:** The extension of the freeze on income tax and National Insurance thresholds beyond 2028 is a backloaded tax and can raise ~£9bn.
- 3) **Potentially frontloaded small taxes of £13-18bn (0.4-0.6% of GDP)**

We think the rest of consolidation via smaller taxes is likely to be frontloaded. But our conviction on the size of frontloaded small taxes is now lower and the move to drop plans to raise income tax increases the risk that the Chancellor relies more on backloaded small tax rises. Plans to lower tax thresholds is also looking less probable to us.

Small taxes under consideration and looking increasingly possible include a rise in gambling taxes, raising council tax on higher value properties, targeting pensions savings via reducing tax benefits from salary sacrifice pension schemes, road tax on electric cars and taxing dividends. It also looks like the Chancellor is looking to freeze personal savings allowance for an additional year. The most likely option for property looks to be to raise council tax on the most expensive properties, either in the form of new bands or by increasing existing rates. Doubling council tax rates on properties in the highest two bands could raise £4.2 billion. There are also suggestions that the Chancellor could apply a new £600mn surcharge on 300,000 of the most valuable properties across the top three council tax bands.

Extending NI to limited liability partnerships, exit charge (20% capital gains tax on sale of business assets for those leaving the UK), bank surcharge or cutting tax free pensions lumpsum allowance are looking less likely.

Exhibit 2: Possible tax rises that could be considered in the Autumn: Consolidation likely to now rely on threshold freezes, smaller taxes and some backloaded spending cuts

Possible tax rises and estimated amounts that could be raised

Smaller tax rises that don't break the manifesto commitments	Estimated amt raised
Extending the freeze on income tax and NI thresholds beyond 2028 (backloaded)	-£9bn
Rise in gambling levies	-£3bn
Reducing tax benefits from salary sacrifice pensions schemes- employee contributions of more than £2,000 a year subject to NI	£2bn
Council tax reform	£5bn
Raising basic income tax rate on dividends	£1.5-2bn
Road tax on electric cars	-£2bn
Freezing personal savings allowance	£6bn
Extend National Insurance to rental income	-£2bn
Abolishing residence nil-rate band for property inheritance	£2bn
Scrapping inheritance tax relief on Aim-listed shares	£100mn-£1bn
Abolishing dividend allowance	£325mn
Removing capital gains exemption on primary residences above £1.5mn	Uncertain
Inheritance tax rules- cap total amount that can be gifted over a lifetime without incurring inheritance tax or extending seven year period	Uncertain
Review of ISA limit- Overall ISA limit could be cut or curtailed for cash ISAs.	Uncertain
Taxes looking less likely	
Extending employer NI to limited liability partnerships	£2bn
Exit charge	£2bn
Higher bank surcharge, raising bank corporation surcharge from 3% to 8%	-£2bn
Reducing 25% tax free lump sum that retirees can withdraw after 55	-£2bn if tax free lumpsum reduced to £100K
Applying 30% flat rate to income tax relief on all pension contributions	-£2.7bn
Reinstating pensions lifetime allowance	-£800mn
Replacing stamp duty with potential tax on sales of homes worth more than £500K or an annual proportional property tax on homes over £500K	Uncertain

Source: BofA Global Research

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Reduced clarity on near term impact

We estimate that £13-18bn (0.4%-0.6% of GDP) of non-inflationary frontloaded tax rises can weigh on growth by ~15bps in 2026 via reduced household spending power. Relative to the scenario where income tax rise was a part of the package, there is now greater uncertainty on the near-term growth impact. The impact on growth could be smaller, if taxes are geared towards consumers with a lower marginal propensity to consume or higher if there are non-linear effects from raising small taxes on many sectors. Moreover, as we mentioned above, uncertainty on the size of frontloaded tax rises also adds ambiguity on the near-term growth impact.

We also think inflation could be 15bps lower in 2026 if the Chancellor goes ahead with the proposal to cut 5p VAT on energy bills. There are also proposals being discussed to link rail fares to CPI instead of RPI which could very marginally lower inflation (by 0.5bps).

If the Budget has some frontloaded non-inflationary tax rises as we expect, it can increase risks of an additional Bank rate cut on top of our forecast of two more cuts in Feb/ April 2026 and put downside risks to our terminal rate forecast of 3.5%. Moreover, risks of an earlier rate cut in December have increased. But this would depend on underlying disinflation progress and size of frontloaded- tax rises. At the margin, not raising income tax and uncertainty on the size of frontloaded small taxes raises questions on the near-term disinflationary impact of the Budget and the scope of the BoE to cut rates much more than expected. If the consolidation is more gradual, then the impact on near term growth/inflation/BoE profile is expected to be minimal.



Markets: Rates & FX

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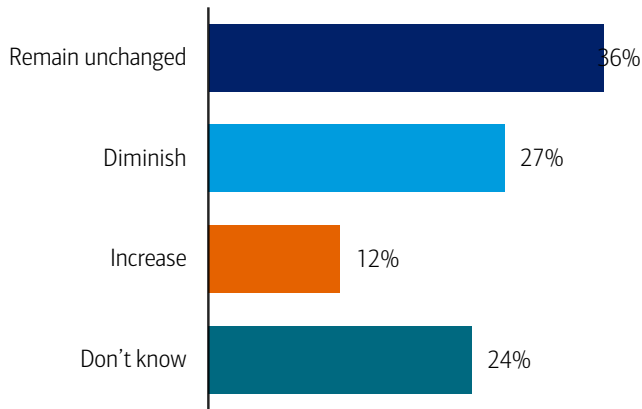
Rates: Curb your enthusiasm

The Gilt market exuberance that had characterized price action over the past month came to an abrupt halt last week following reports that the Chancellor would not be going ahead with an income tax increase that she had seemed to be preparing the ground for. This apparent policy backtrack, later reports suggested, was enabled by better-than-expected fiscal shortfall projections from the OBR and reflected internal pressure to uphold manifesto commitments. It now appears likely that an array of smaller tax rises, including a prolonging of the income tax threshold freeze, will be deployed instead. In our view, the key implications for the rates market are:

- (1) heightened uncertainty over the credibility and feasibility of the government’s fiscal consolidation plans (even before the reported shift away from the income tax remedy, our latest [14 November FX and Rates Sentiment Survey](#), conducted 7-12 November, showed that nearly half of respondents expected unchanged or increased fiscal concerns after the Budget, despite more bullish exposure in rates: Exhibit 3 and Exhibit 4);
- (2) uncertainty over improved OBR economic forecasts raising the possibility that further revisions will be required in the not-so-distant future;
- (3) reduced clarity on the likely magnitude of adverse growth and inflation effects.

Exhibit 3: Following the Budget announcement on 26 November, how do you anticipate UK fiscal concerns to evolve?

Nearly 50% expected increased/unchanged fiscal concerns post-Budget

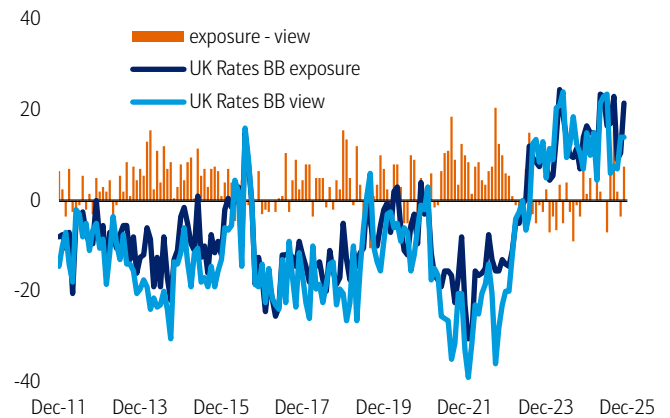


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 4: UK duration exposure and view, 2011 to 2025 YTD

Survey respondents added to their longs amid more bullish sentiment



Source: BofA Global Research FX and Rates Sentiment Survey

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Our Gilt Remit forecasts remain unchanged, reflecting our expectation that the government will adhere to fiscal rules and rely on tax increases and spending cuts to address the fiscal hole, deliver giveaways, and rebuild the fiscal headroom. We estimate the Gross Financing Requirement to amount to £324.5bn for the current fiscal year, an increase of £2.0bn relative to April's Remit, to be financed via net T-bill issuance for debt management purposes.



In nominal rates, we lightened up our existing trade ideas last week on the back of 30y Gilts trading at the rich end of the recent trading range against Sonia (for more, see Rates – UK section of Global Rates Weekly, 14 November). Our expected Gilt Remit outcome should not take the market by surprise, but we expect our remaining long-end curve flattening view to be supported by the absence of long-end supply until the year-end, with December coupon payments potentially providing some additional support (Exhibit 6). Risk to our view is that the market focuses on increased funding needs for future years and/or that long positions are unwound into the risk event (Exhibit 5).

RPI and the expensive homes tax

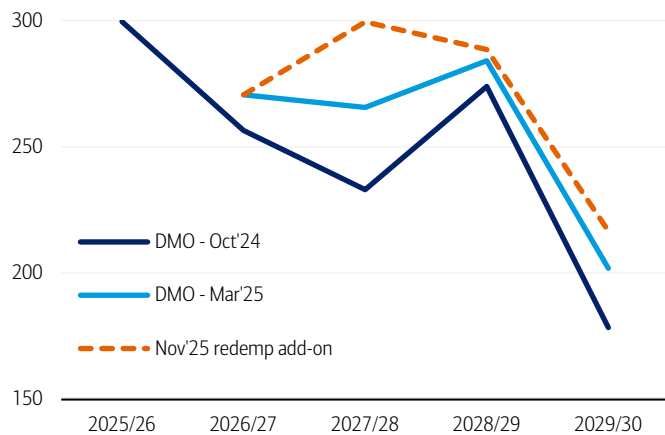
On inflation, the Chancellor has repeatedly expressed a desire to avoid fiscal repair measures that add to inflation and, if anything, introduce measures that curb inflation (if only temporarily). However, in the move away from raising income tax rates towards a “smorgasbord” approach of several smaller elements, there is one suggested policy that concerns us in this regard.

One thing that appears to be being considered again is an increase in tax on expensive homes. This could be problematic for RPI, although it would not be a meaningful issue for CPI. What would matter for RPI (and CPIH) is whether or not this would count as a general increase in council tax, lifting RPI. Council tax raised about £45bn last year, so raising the £4bn suggested in the press could be equivalent to almost 10% on the council tax bill (or 0.4% on RPI).

This is further complicated by the fact that (in principle) RPI's sampling universe excludes the very top income earners. To the extent that these high earners are also the owners of the expensive homes, then their council tax increases should, in theory, be excluded from RPI. But it is hard to see how this exclusion might be achieved in practice.

Exhibit 5: DMO IGFR & BofA projected Gilt redemption top-up, £bn

UKT 4% 2028 reopenings since March adding £28bn to 2027/28

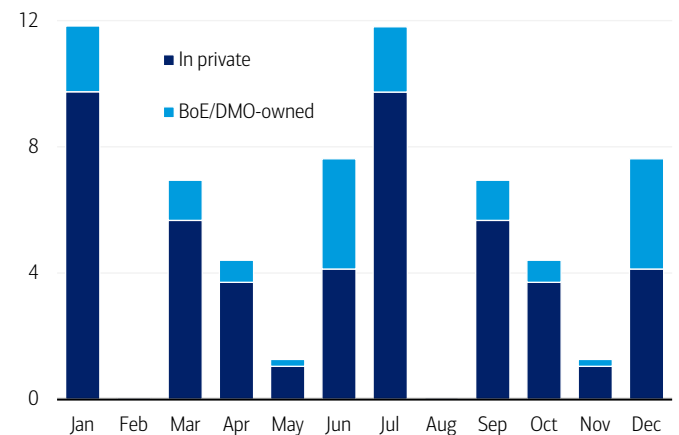


Source: Debt Management Office, BofA Global Research

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Exhibit 6: Gilt coupon payments, £bn

December coupon payments to potentially provide some support for Gilts



Source: Bloomberg, BofA Global Research

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FX: Kite Flying

Despite all the noise around last week’s headlines, GBP ended higher on the day and more significantly, GBP risk premium eased lower. The latter is our key metric for how the market perceives the risks associated around the Budget. Moreover, normalized measures of skew (3mth risk reversals in EUR/GBP) (Exhibit 7) have eased lower from elevated levels. Whilst this provides some relief to GBP, we still caution that the crosscurrents of news flow, and particularly how this is supported by some sections of media could impact GBP.



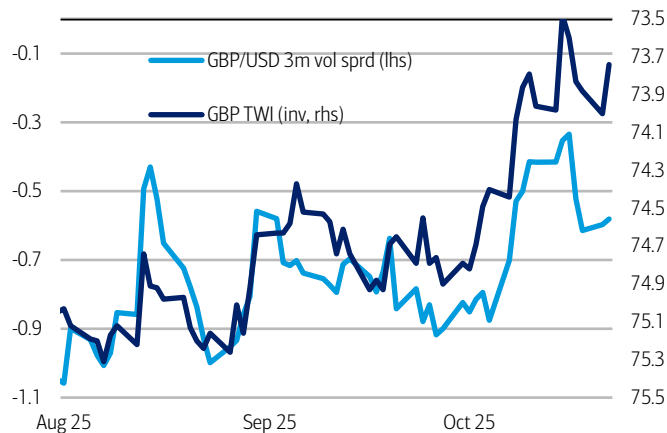
The perils of reacting to every single news headline has been a common feature of trading GBP ever since Brexit and sensitivity to Budget headlines has risen exponentially since September 2022. We think it is important to understand what matters for GBP. This was clearly shown when the Government clarified media headlines of a change in emphasis on fiscal consolidation. We believe there are two things that matter: whether the government will stick to its Fiscal Rule (Yes) & whether it will raise the headroom (Yes).

Details matter, of course, but markets have been aware for some time that the Treasury has several options on the table. We view the various announcements as essentially a kite-flying exercise to gauge market reaction to various measures. This is obviously sub-optimal and until the measures are announced. However, it is fair to say that expectations management has not been a success. As we discuss above, the mood music has improved, and GBP has recalibrated to yields (Exhibit 8). We think this is crucial: we think the attrition from lower yields may be coming to an end as BoE pricing gravitates towards a 3.25% terminal rate.

In conclusion, we think uncertainty ahead of the Fiscal event remains high and should keep volatility and inventory for the Budget Day entrenched. For GBP functional investors. EUR/GBP 1yr forward all-in rates remain at attractive levels as does carry despite the recalibration in front-end rates. However, until the release valve of the passing of the event risk we doubt that GBP will find a sense of relief providing the two anchors of Fiscal Rule and headroom are adhered to.

Exhibit 7: GBP/USD 3mth risk premium

Risk premium has eased lower despite crosscurrents of new

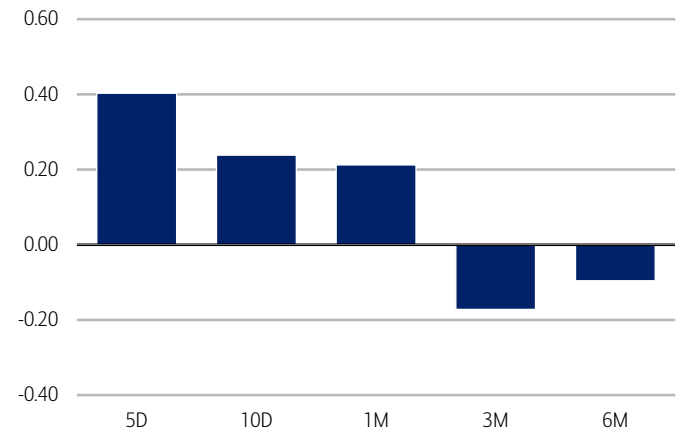


Source: BofA Global Research, Bloomberg

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Exhibit 8: GBP TWI correlation vs US 10yr

Correlation to rates has been rising.



Source: BofA Global Research, Bloomberg

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