

Managing the UK economy

Fiscal and monetary policy since 1945

Week 10 – 2020-24: Covid, Brexit, and the return of inflation

AY 2024-25

Department of Political
Economy

Daniele Girardi

Final essay (1/2)

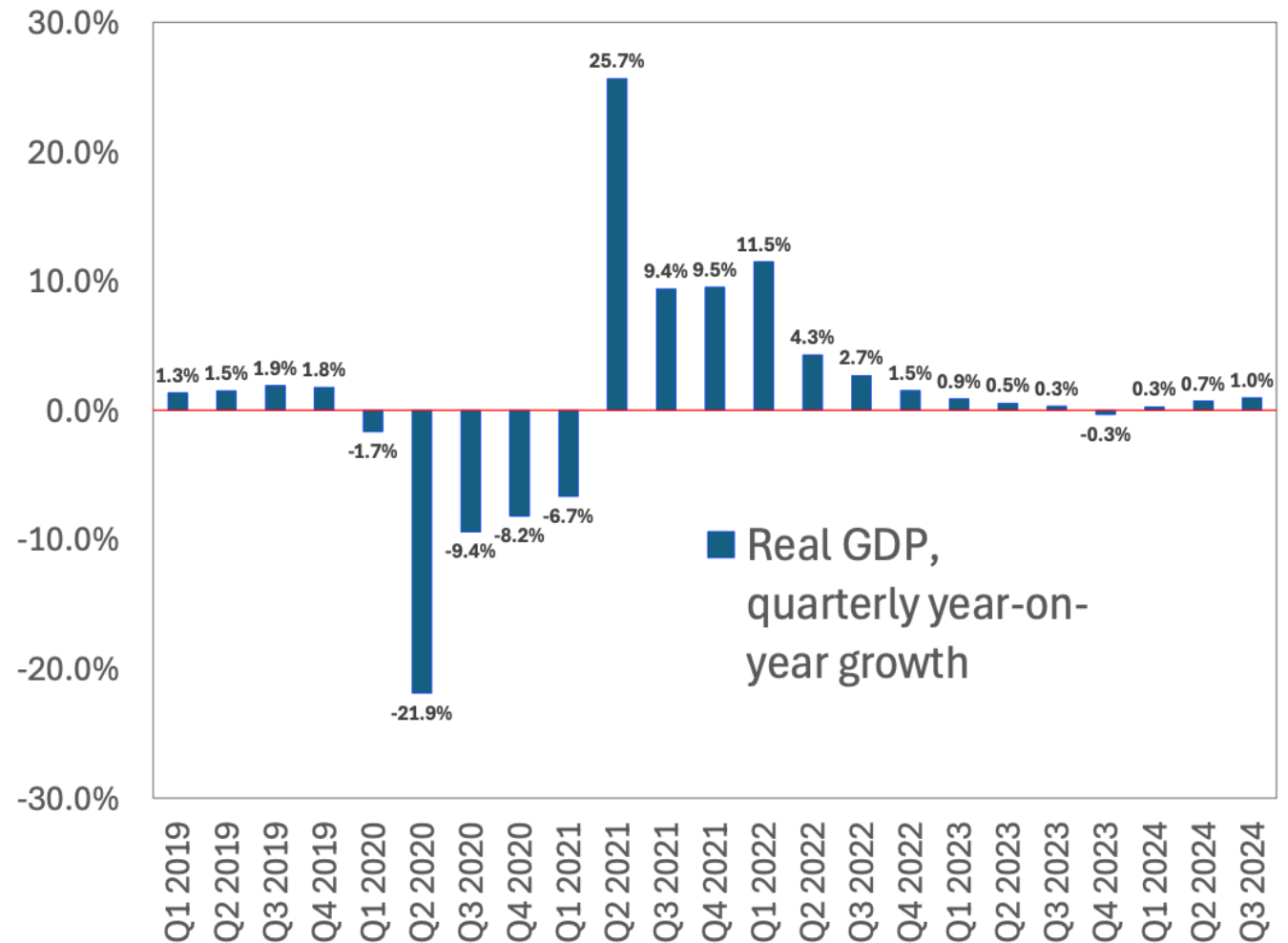
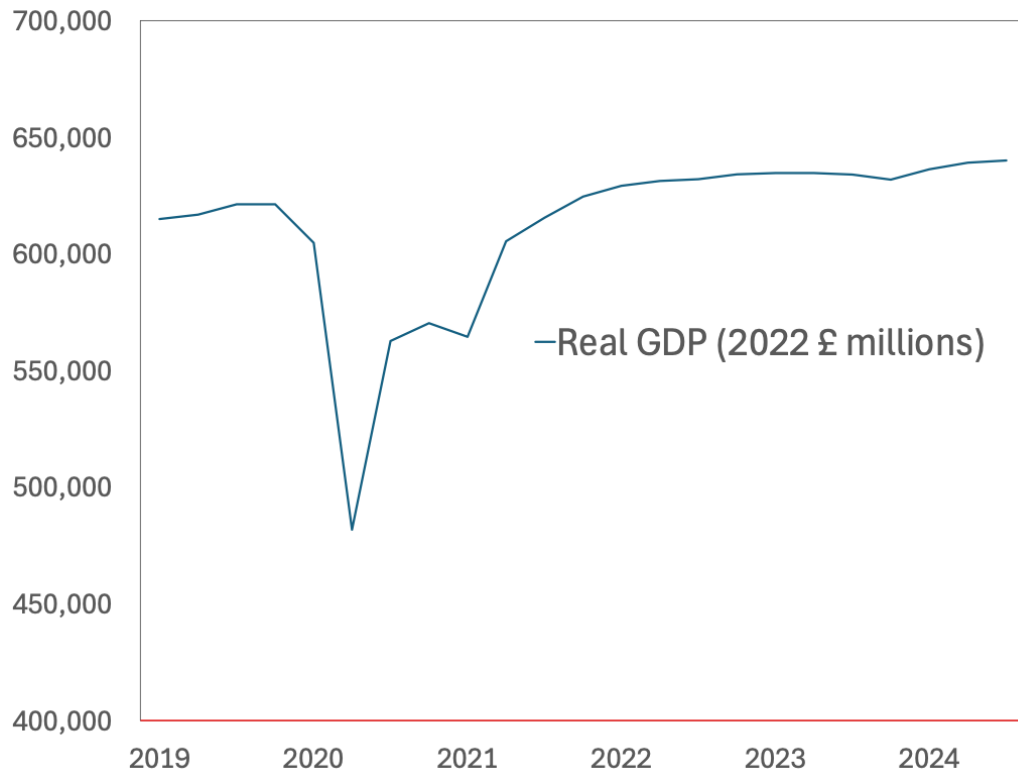
- Deadlines:
 - **December 9** for confirming the topic with me
 - **January 10 at 3pm** for delivering the essay (submission link on Keats)
- Make sure you are familiar with the DPE [Word Count policy](#).
- Make the following very clear in the introduction:
 1. What is the question(s) you are addressing
 - (can be one question or a small number of questions)
 2. Why is it important
 3. How your essay will help answer the question
 4. What are the main points your essay will make in answer to the question

Final essay (2/2)

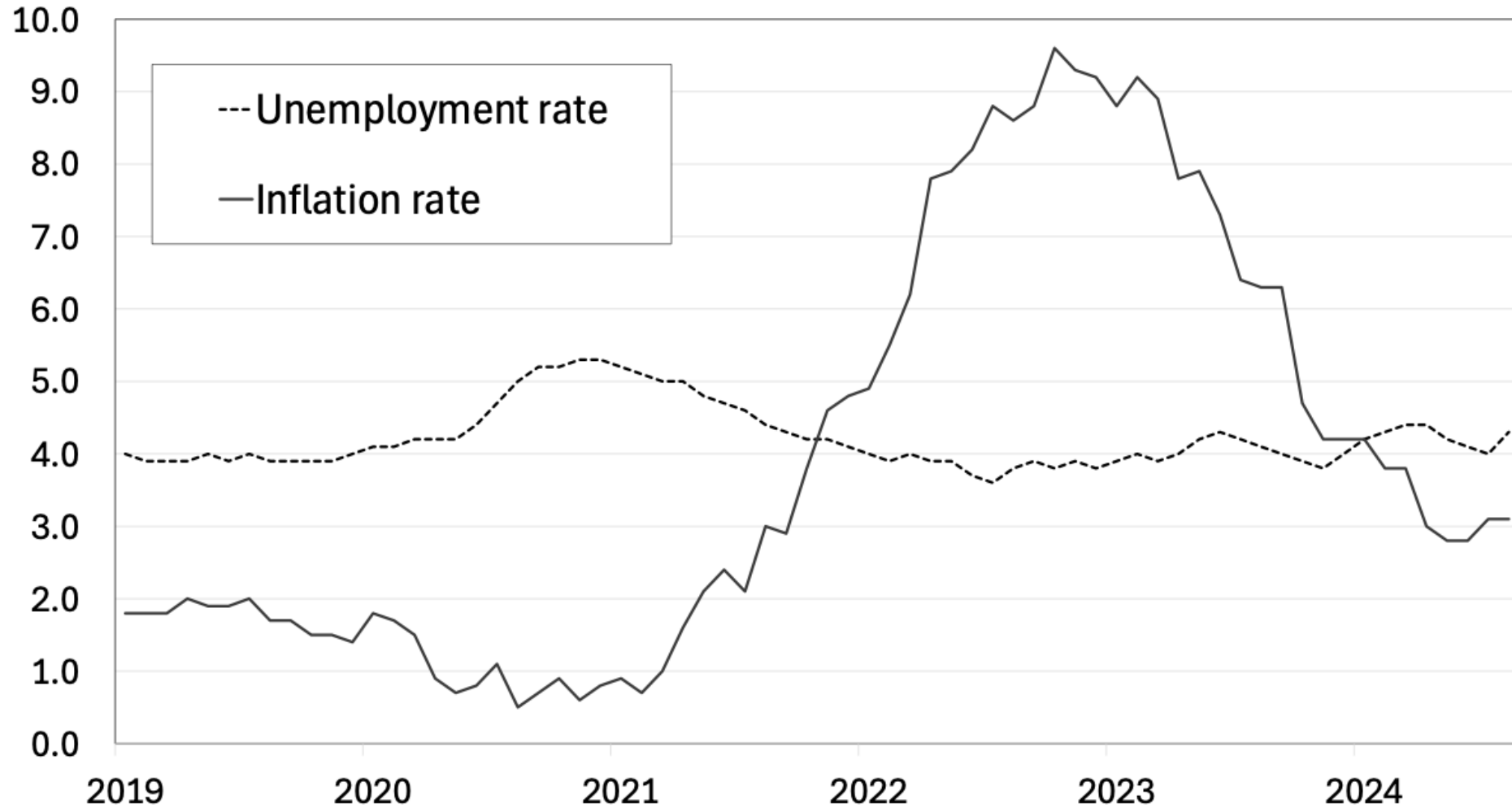
- Question(s) you set to address can be simple, like for example:
“what did X consist of?” or *“what was the motivation behind X?”* or *“what were the main features of X?”* or *“what were the advantages and drawbacks of X?”*.
- Make sure to provide a clear summary description *in your own words* of the 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 ChatGPT write your essay:** It will do a terrible job, and I will also very likely spot it.

2020-2024: Overview

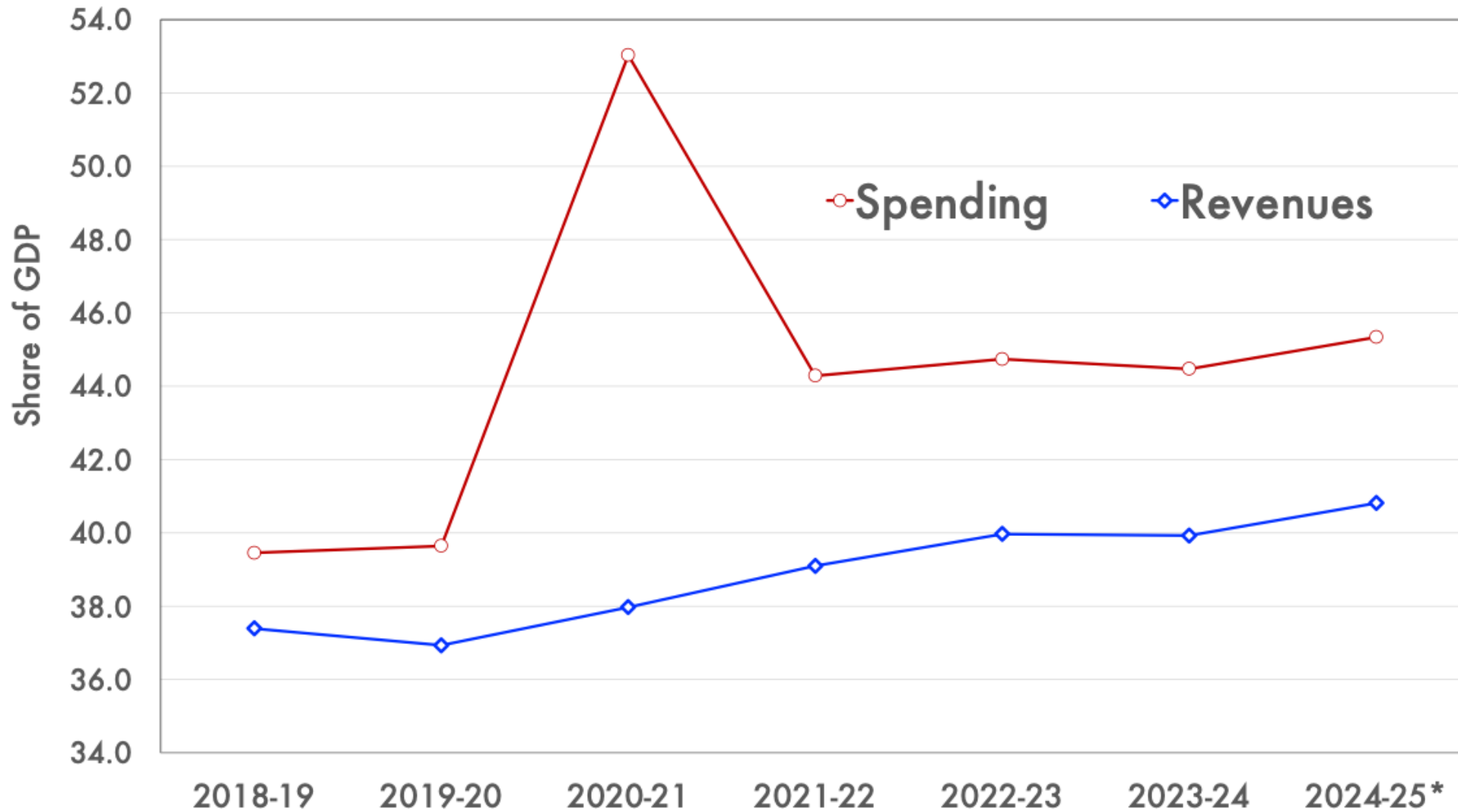
- Covid recession was massive, but quick recovery after reopening.
- Underlying growth rate remains low.



2020-2024: Overview

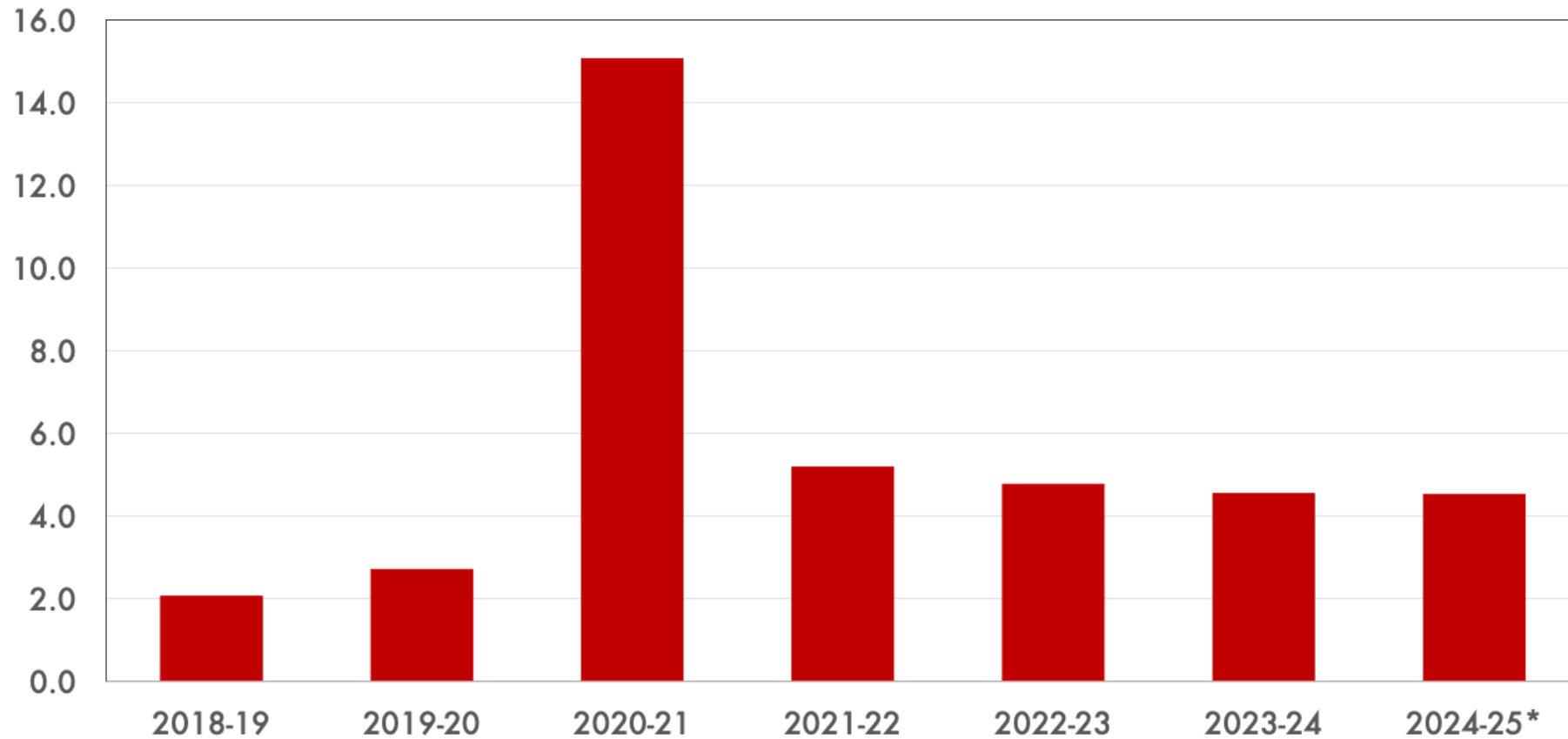


2020-2024: Overview

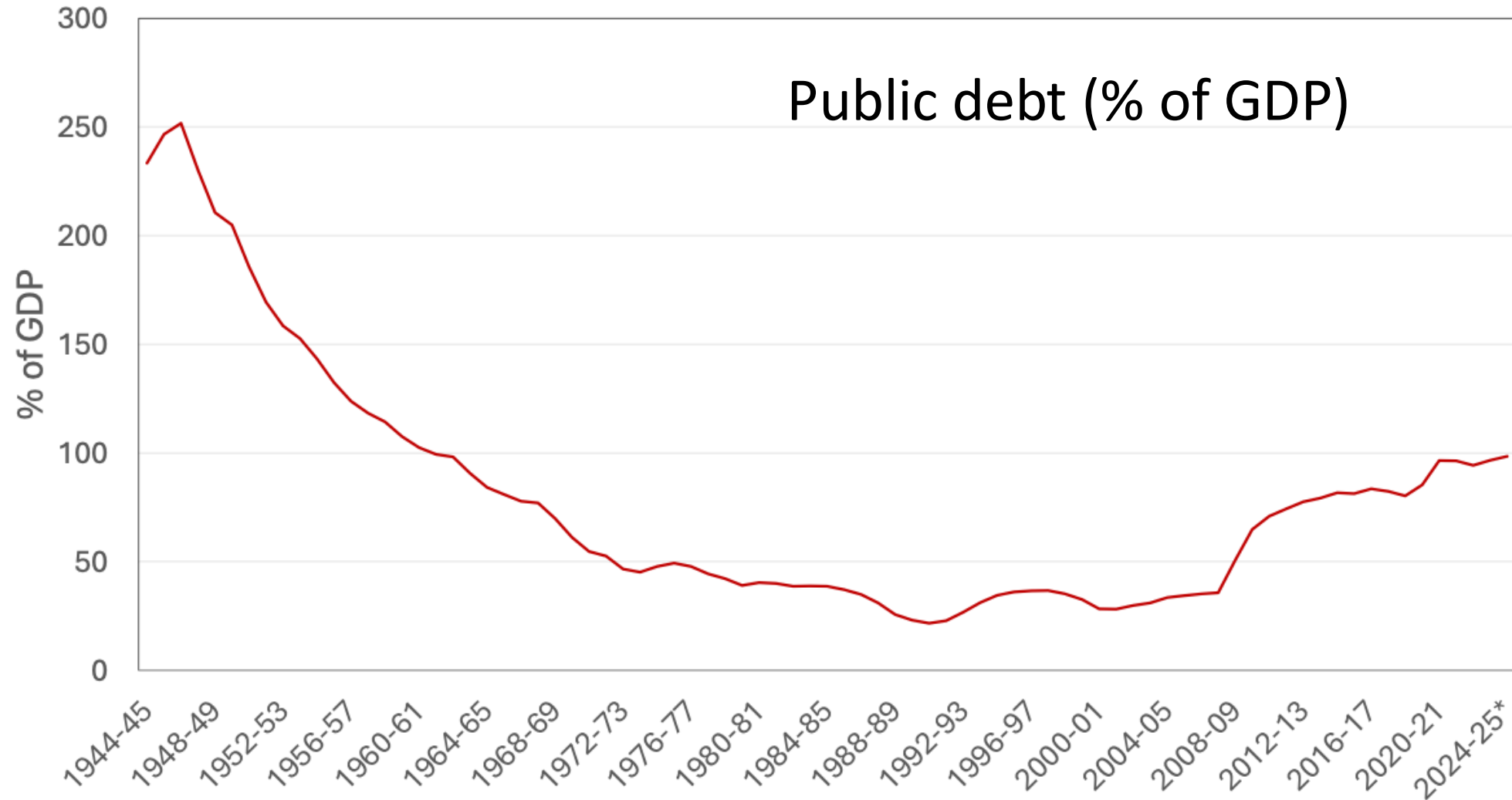


2020-2024: Overview

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



2020-2024: Overview



2020-2024: 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.
- Labour's Oct 2024 budget 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.

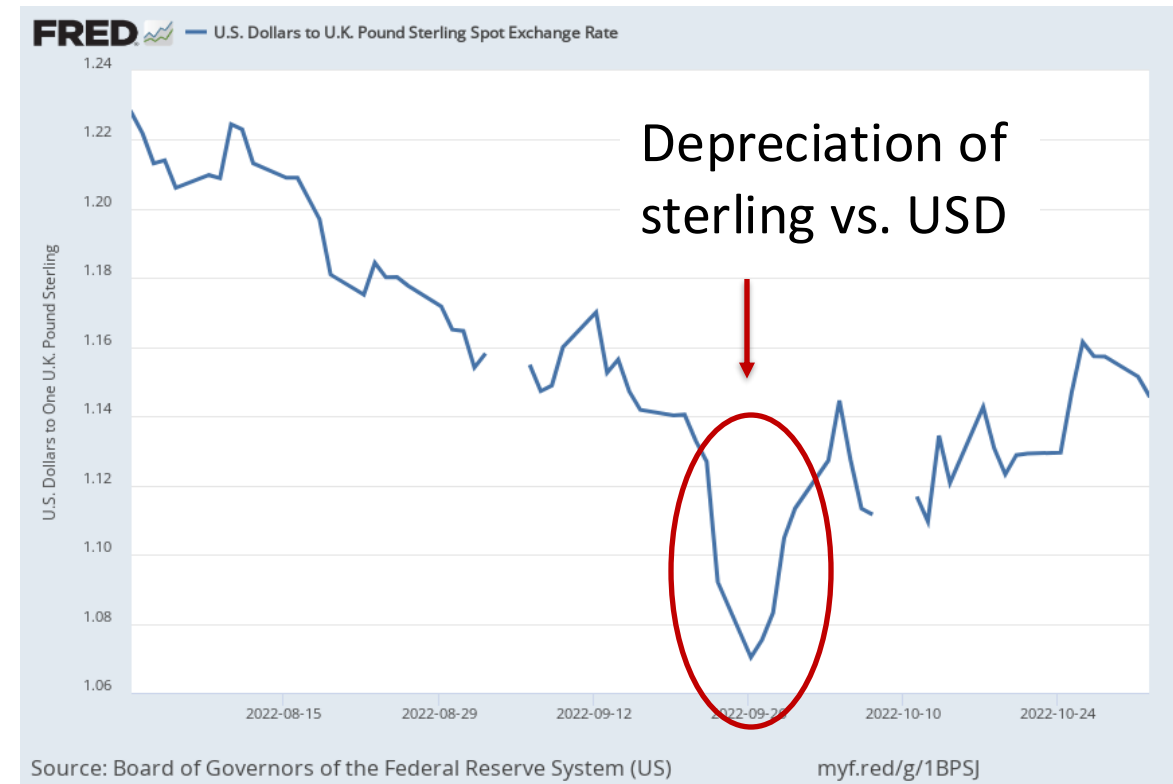
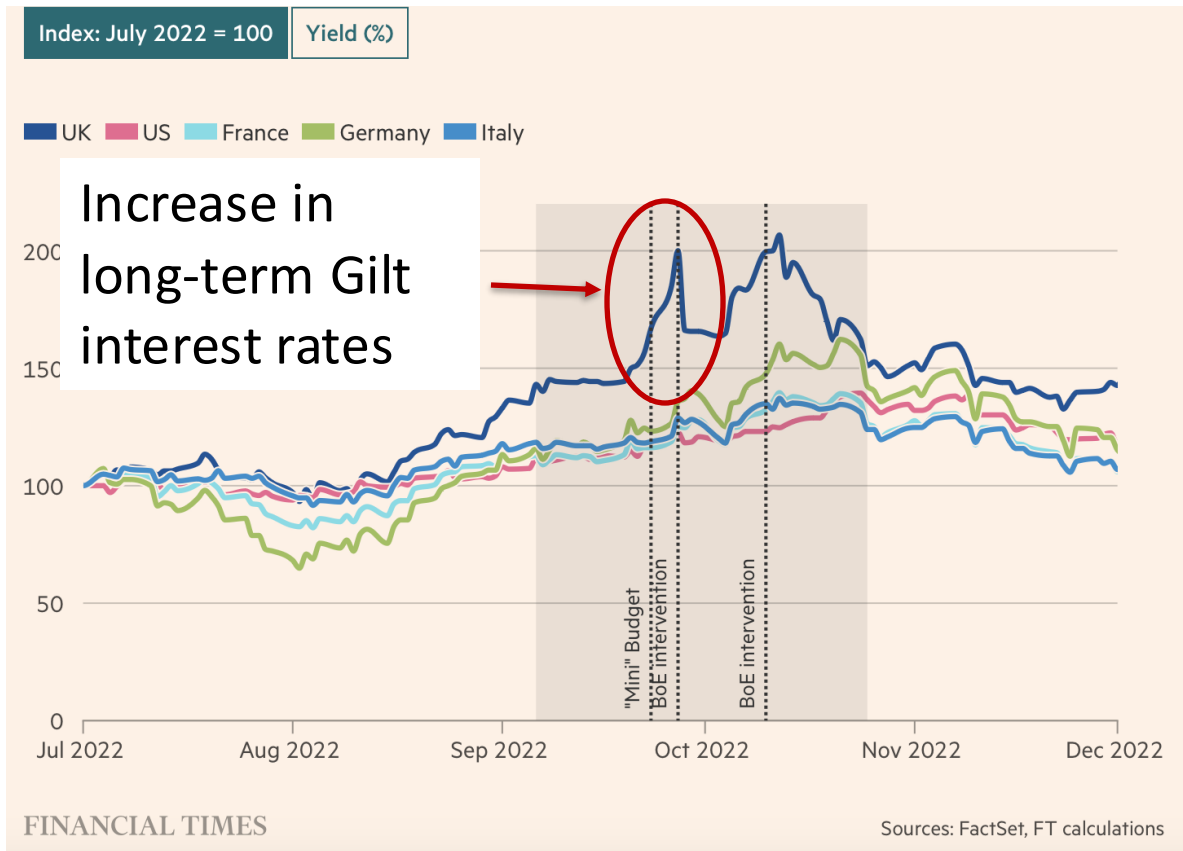


The Sep 2022 Truss-Kwarteng mini-budget (& mini-crisis)

- 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

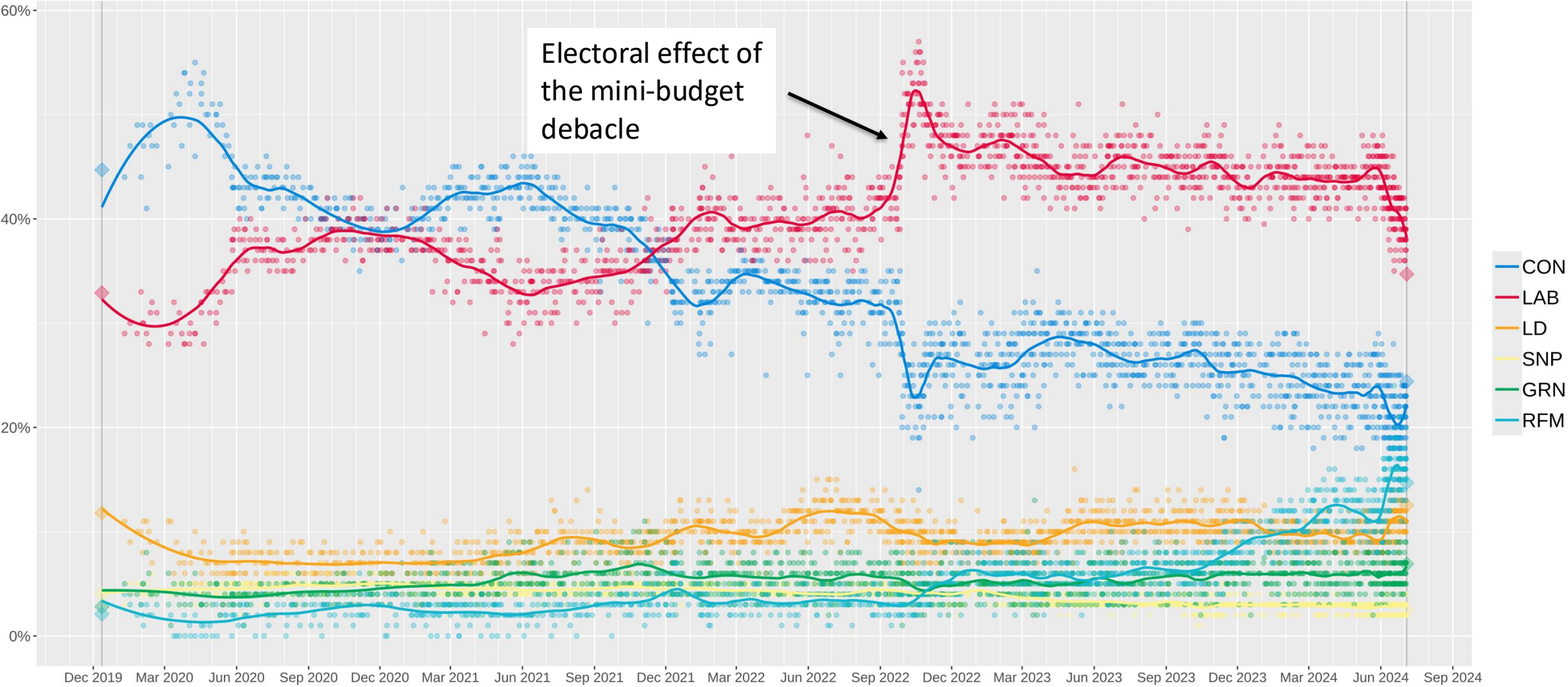


Financial reaction to Sep 2022 mini-budget



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

The Sep 2022 Truss-Kwarteng mini-budget



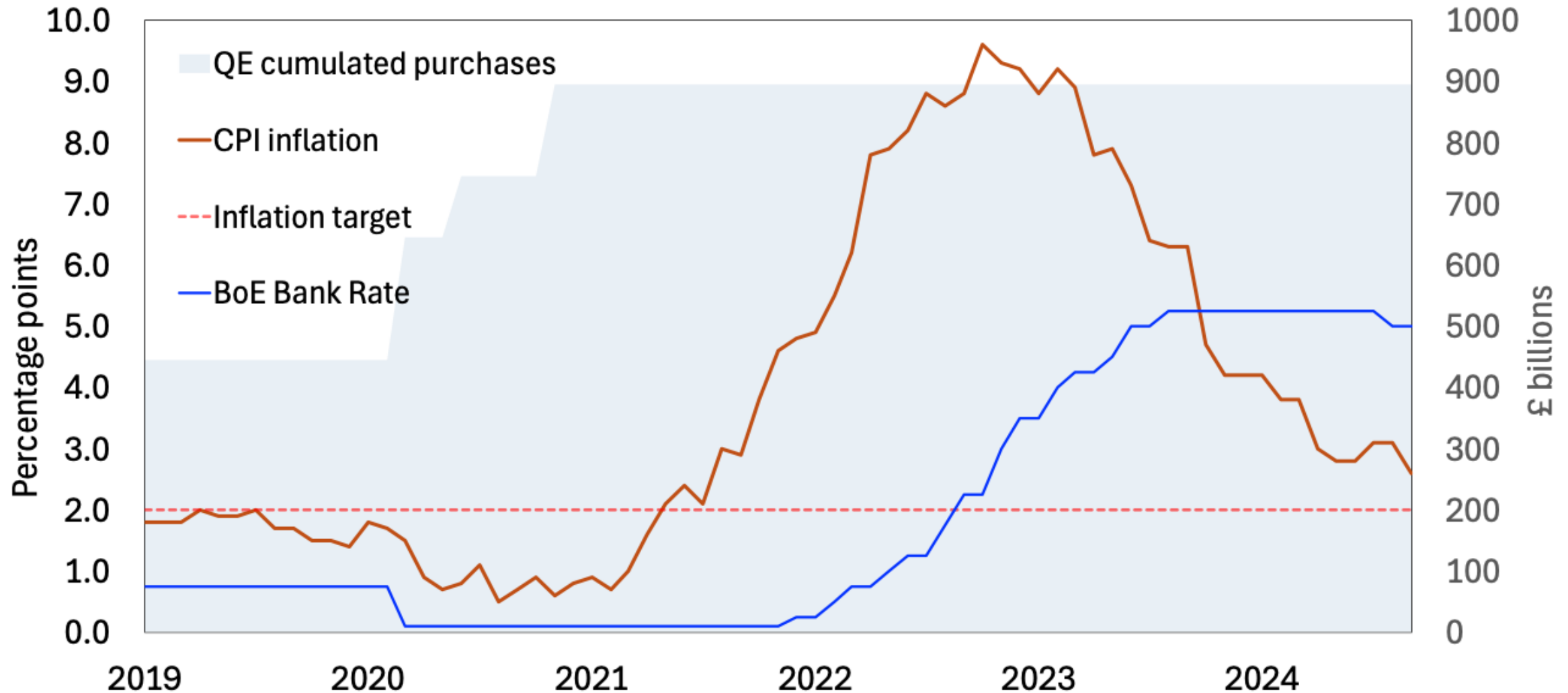
Source: [Wikipedia](#)

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



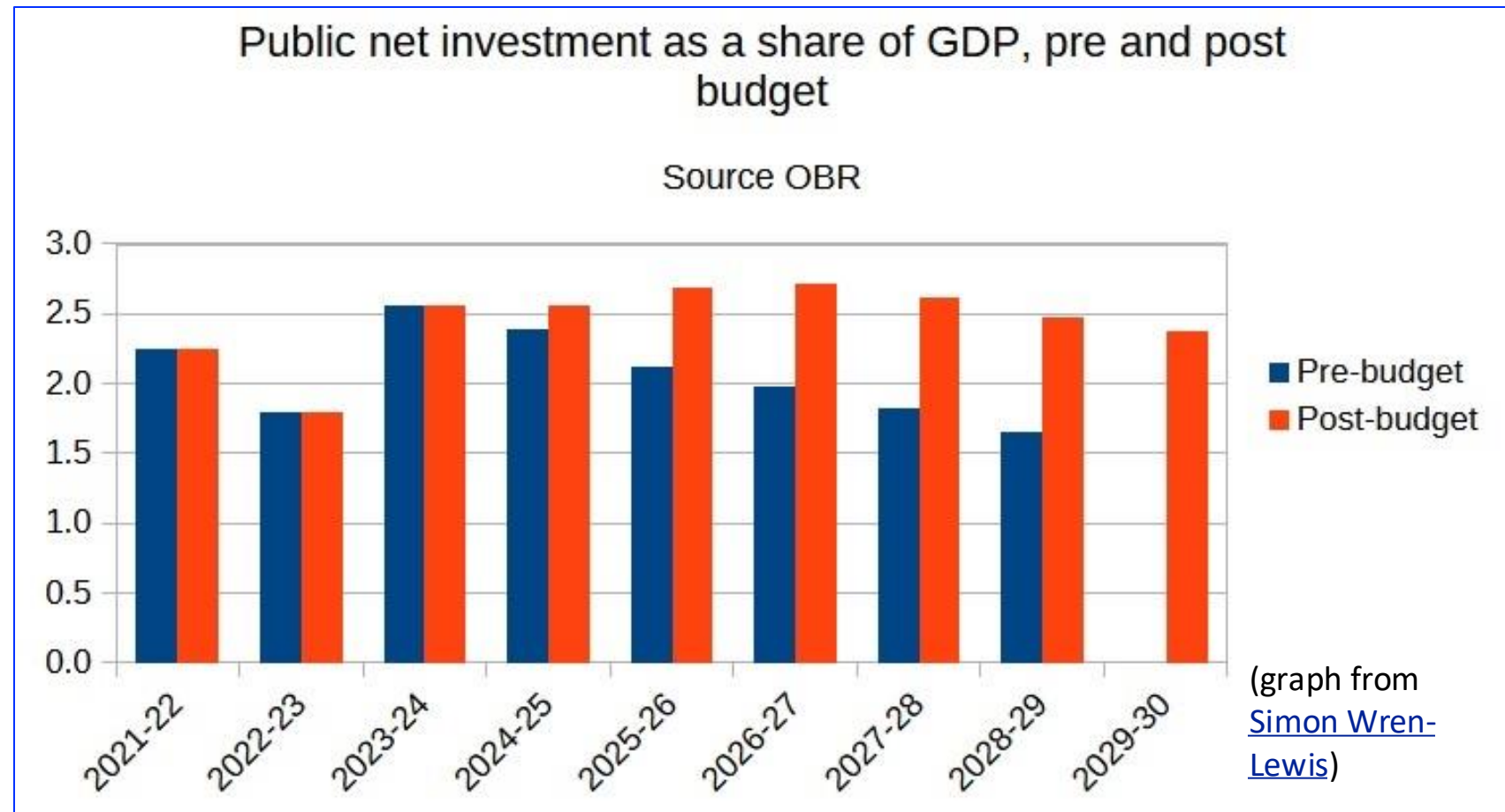
Oct 2024 budget: Labour's new fiscal rules

- 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 over 2020-24.



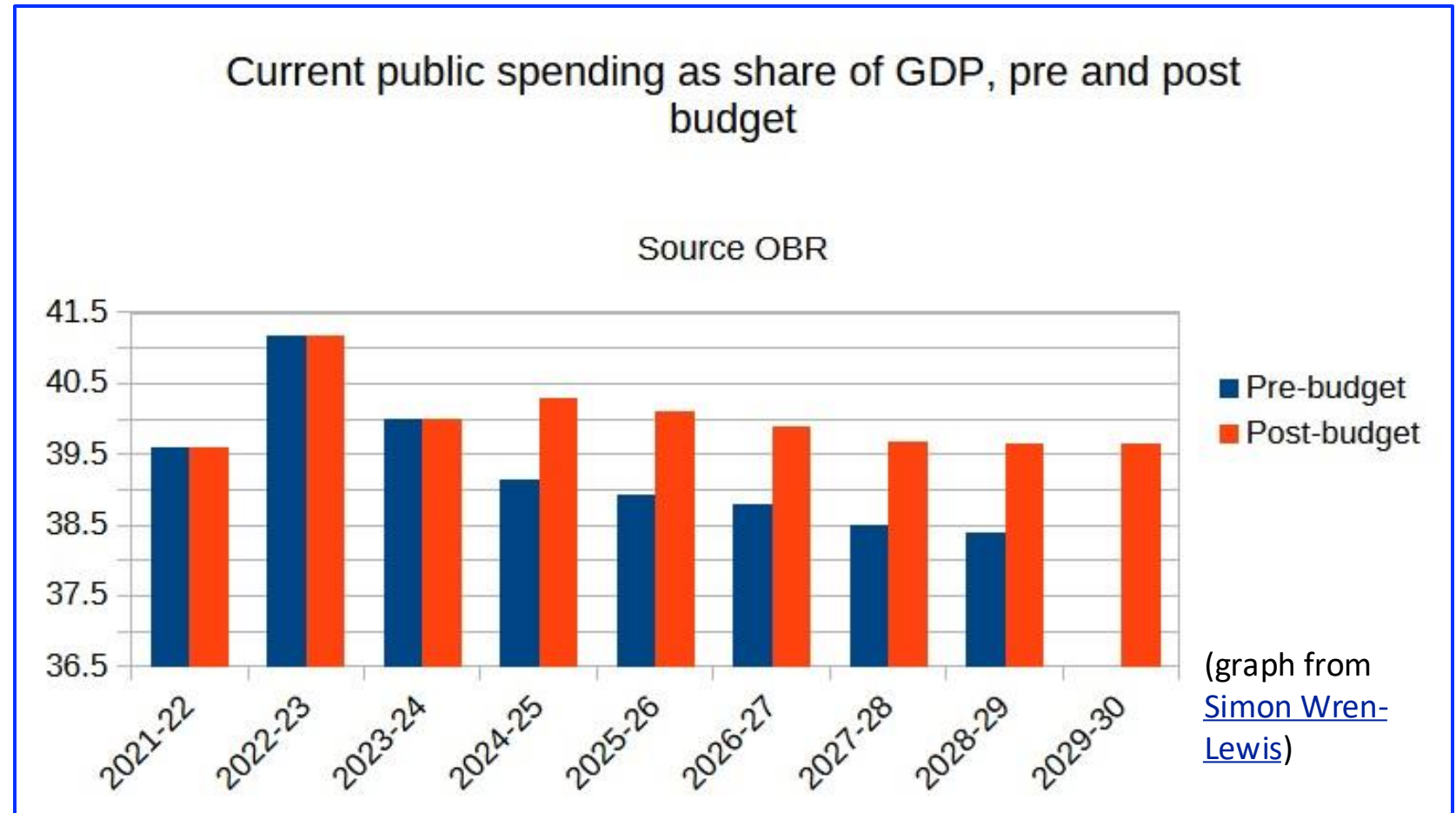
The Oct 2024 budget

- Main highlight & aim: more public investment relative to previous plans (which entailed a sharp decline between 2024 and 2008).
- Mainly education and NHS.



The Oct 2024 budget

- Also more current spending relative to previous plans (which again entailed a sharp decline).

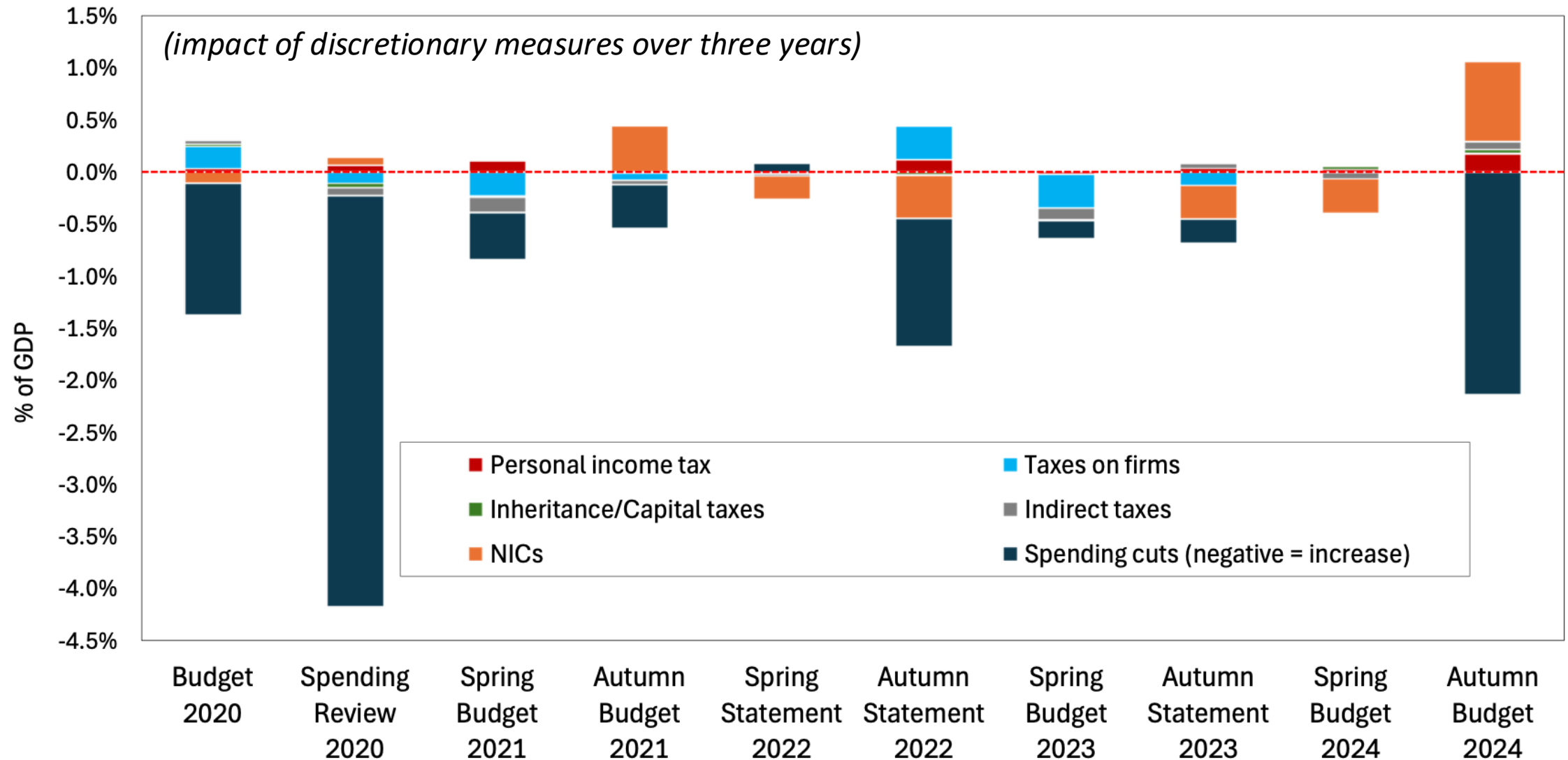


The Oct 2024 budget

- Increase in spending roughly half financed by tax increases, half by borrowing.
- Tax increases: ~40bn by 2028 [$\sim 1\%$ of GDP]
 - Employer NIC (25 bn)
 - Rate 13.8 \rightarrow 15%
 - Allowance threshold 9,100 to 5,000
 - Abolition of non-dom tax regime (9 bn)
 - Capital gains tax increase (2.5 bn)
 - Lower rate 10 \rightarrow 18%
 - Higher rate 20% \rightarrow 24%
 - Rest comes from higher taxes on private schools, energy company and private equity, and crackdown on tax avoidance.



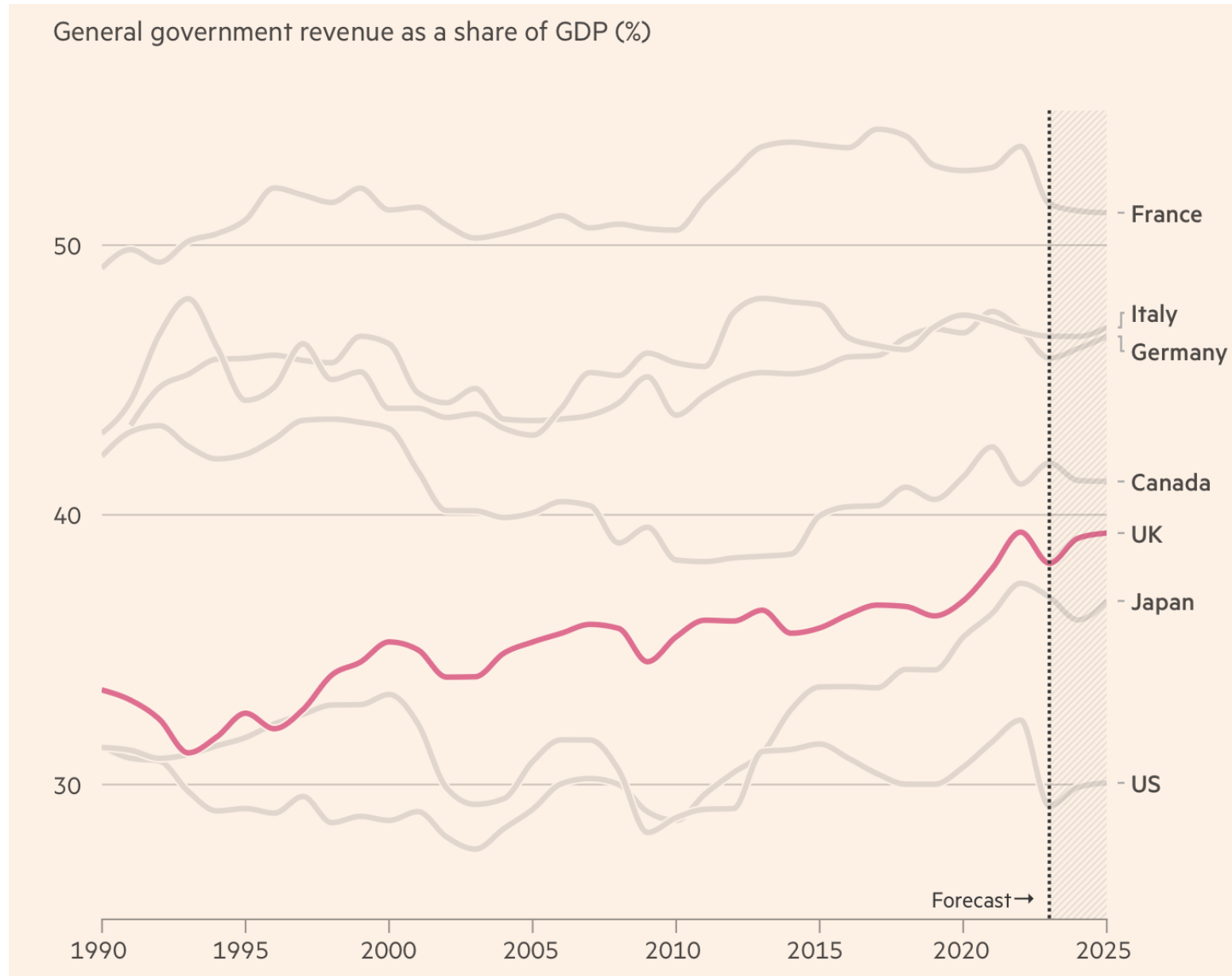
Fiscal policy in 2020-2024 in a graph



A 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