BUDGET *commentary*

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Reaction to Rachel Reeves' second budget

A "bucket budget" that doesn't hold water

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Summary

As anticipated, the Chancellor has delivered a raft of measures to increase tax from a variety of different sources with an aim to generate £26bn in extra revenue by 2030. The negative impact on consumption and investment may well compromise this budget's efficacy. Markets have been calm but storm clouds could gather in the future.

Lifting taxes by the handle - key changes

Winston Churchill once quipped, "for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle." The futility of relying on taxation to drive growth is well understood. Higher taxes risk dampening consumer spending, discouraging investment, and ultimately slowing the economy. In other words, it undermines the very revenues the Treasury seeks to protect.

Yet Chancellor Rachel Reeves appears to have set this wisdom aside, pressing ahead with a smorgasbord of smaller taxes outside the big three of Income Tax, National Insurance, and VAT in today's budget. Some of the key tax changes include:

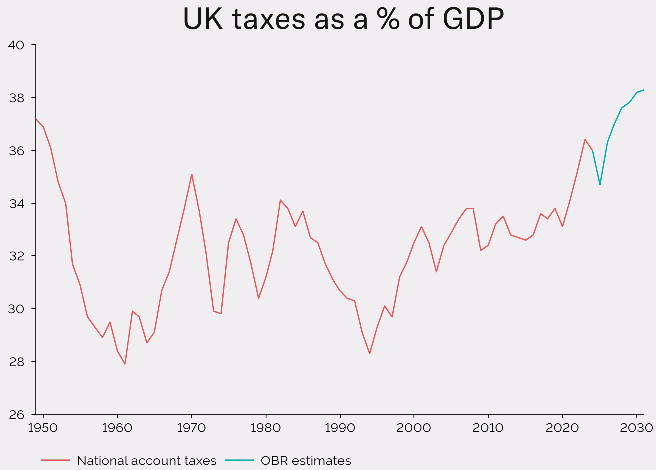
Key Tax changes	Estimated revenue by 2029-30
Income tax & National Insurance threshold freeze	£8bn
NIC on salary sacrifice pensions	£4.7bn
Collect select tax payments via PAYE instead of SA	£2.7bn
Improved tax compliance, enforcement & collection	£2.3bn
Higher taxes on dividends, property and savings (2%)	£2.1bn
Corporation tax: reduce write down allowance (18%→14%)	£1.5bn
New mileage based Electric Vehicle tax (Apr 2028)	£1.4bn
New Online Gambling tax	£1.1bn
CGT relief cut on employee ownership trusts (100%→50%)	£0.9bn
Inheritance tax allowance freeze extension	£0.8bn
High Value properties (>£2mn) council tax surcharge	£0.4bn

> "Given that the tax burden in the economy is already set to exceed levels last seen more than 70 years ago, higher taxes are likely to dampen economic growth"

The rationale behind today's tax changes is to uphold the Chancellor's self-imposed fiscal rules aimed at enhancing the government's credibility and lowering borrowing costs in the gilt market. The problem is that this approach may have unintended consequences both economically and politically.

Economic impact from the budget

Given that the tax burden in the economy is already set to exceed levels last seen more than 70 years ago, higher taxes are likely to dampen economic growth.



Source: LSEG Datastream/Evelyn Partners. Data as at 26/11/2025

That could well worsen debt sustainability over time. The UK's reliance on five-year fiscal projections compounds the risk. These forecasts are built on assumptions about future economic conditions that are inherently uncertain and often inaccurate. They cannot account for shocks, like geopolitical events or technological disruptions, making them a poor foundation for policy. With weak productivity, high debt servicing costs and uncertainty in the residential market already weighing on the economy, further tax hikes risk making the situation worse.

Moreover, the Chancellor's approach of a patchwork of smaller tax rises may well underdeliver on revenue since they entail high degrees of uncertainty. That's because these measures have narrow bases and involve targeting multiple groups. This risks broad dissatisfaction and potential rollbacks, undermining fiscal credibility. Furthermore, freezing personal income tax thresholds for two more years could be politically fragile with a general election in 2029, making a reversal possible in investors' eyes.

Political implications

The budget could also trigger political instability. Backbench Labour MPs are already voicing concern over tax hikes that disproportionately affect working households. Freezing the personal income tax allowance will likely be viewed by the public as a tax by stealth, as more working people will ultimately pay more tax. Dissent by Labour backbenchers could escalate, raising the risk of a leadership challenge or even a change in Chancellor, injecting further uncertainty into fiscal policy.

For the gilt market, this matters. Foreign investors currently hold around a third of UK government debt, and any signs of political fragmentation or fiscal backtracking could undermine confidence, leading to higher borrowing costs.

Impact on gilts

Since the first quarter of this year the UK has held the unenviable position of having the highest borrowing costs amongst all G7 nations, with the sustainability of government debt being cited as a driver for higher longer term bond yields. Today's £26bn in tax raising measures in 2029-30 align with pre-budget expectations for £20–30bn of fiscal tightening.[1] However given the breadth of policy action across a range of smaller revenue generating measures and the potential for unintended responses from business and households who feel targeted and aim to mitigate these tax rises, bond (debt) markets may not feel sufficiently put at ease.

Longer term (7-10 years) UK gilt yields may well remain elevated with the risk of continued political uncertainty and policy U-turns.

Shorter term (1-5 years) UK gilt yields screen attractively given the UK's economic backdrop of subdued growth (not helped by higher taxes) and gradually declining rate of inflation, markets are anticipating further interest rate cuts from the current level of 4%. This should, all else being equal, act to support shorter dated UK bonds.

Impact on equities

The impact of the budget on UK equities is likely to be limited because the London-listed equities derive around three quarters of their revenues from overseas, particularly concentrated in the larger cap stocks. Smaller listed companies tend to be more domestically focused, so they are slightly more sensitive to the tax and spending measures laid out today.

One way the budget will affect equity returns is via exchange rates. If budget announcements are perceived to affect UK growth negatively, sterling is likely to weaken relative to other currencies. For most investors, who hold equities in their portfolios on an unhedged basis, the value of holdings denominated in foreign currencies will increase. In addition, those UK companies whose earnings are generated overseas also stand to benefit from a lower sterling exchange rate against major currencies, as those profits will be worth more.

Summary

In short, in trying to plug holes in the public finances, Reeves may end up drilling new ones—creating a "bucket budget" that simply doesn't hold water. Like Churchill's analogy, it's an exercise in futility: a fiscal plan that promises stability but risks leaking credibility, growth, and political cohesion.

Source

[1] Office for Budget Responsibility, November 2025

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