RATHBONES

Autumn 2025 Budget

By Oliver Jones
Head of Asset Allocation

26 November 2025

What does the Budget mean for the economy?

Rachel Reeves avoided spooking the bond market with her Budget, but we think the Chancellor could have done more to boost long-term economic growth. And although she's built a bigger margin for error, Reeves could find herself looking for more tax increases in a year's time.

Quick take

- This year's Budget was another missed opportunity to boost investment and growth.
- Increased 'fiscal headroom' left bond markets calm, but future tax increases can't be ruled out.
- Increased taxation of pensions will discourage investment; tweaks to business taxation will also fail to boost it.

A sticking-plaster budget

The package of tax increases announced today has, overall, been received calmly by the government bond market with the Chancellor sensibly building some additional 'headroom' against her key fiscal rule. This number is the margin for error built into the Treasury's tax and spending plans, in case tax receipts are lower than expected or spending is higher.

But beyond that, this Budget is yet another missed opportunity to address the structural causes of the UK's tough fiscal situation by prioritising economic growth and investment.

The changes to pension salary sacrifice rules, which continue a trend under this government towards tougher tax treatment of pensions, were particularly disappointing in that regard. They will work against the government's broader agenda to drive more investment from pension funds into productive assets in the UK.

Headroom rebuilt, but risks remain

The tightening of fiscal policy announced by the Chancellor today increased the fiscal headroom to £22bn, compared to just under £10bn after the last fiscal statement. That is a welcome and necessary change, with the previous decision to maintain only a wafer-thin margin generating months of damaging and avoidable pre-Budget speculation about which tax taxes would rise. The UK compares favourably to some other advanced economies, including the US and France, in having a serious plan to reduce its budget deficit. We discussed this in the September issue of our *Investment Insights* magazine.

Rachel Reeves was helped by the new forecasts from the Office for Budget Responsibility, the fiscal watchdog, which were downgraded by far less than feared. That meant she could rebuild her headroom without explicitly breaking her party's manifesto tax pledge not to raise taxes for "working people". She could also find the money to keep Labour MPs on side by scrapping the two-child benefit cap.

The Chancellor may not be out of the woods, though.

£22bn is still less than the average headroom Chancellors have historically maintained against their fiscal rules, in an era of heightened economic volatility.

And she has repeated the old trick of announcing tightening measures which are heavily 'backdated' – far out in the future – and so will not make any difference in the short term. That includes the decision to keep income tax thresholds frozen for three more years, which was the largest single revenue-raiser. Backdated measures are inherently less credible, because there is more time for them to be overtaken by events. In the next three fiscal years, the measures announced today increase spending by *more* than taxation. It is only towards the end of the forecast that tax changes in this Budget, especially the freezing of income tax thresholds, bite.

And the fiscal watchdog judges that the probability of the government meeting its budget rule is only 59%, and its debt rule just 52%, illustrating just how little margin for error the Chancellor is still working with. With all of that in mind, it is still easily possible that Rachel Reeves finds herself looking for more tax increases again in a year's time. Longer-dated government bond yields, which are particularly sensitive to perceptions about the fiscal outlook, are likely to remain volatile against a global backdrop of high government borrowing.

The Budget also contained some measures which will temporarily bear down on inflation. Most notably, the Treasury covered some of the Renewables Obligation in energy bills – an extra charge to pay for development of renewables. These measures could shave about 0.4 of a percentage point off the headline rate (currently 3.6%) in 2026-27, relative to a world where the Chancellor did nothing. But some of that impact is expected to reverse over the following couple of years, so again the longer-term picture has not fundamentally changed.

Structural issues still unaddressed

Taking a step back, there was very little in this Budget to address some of the key structural causes of the UK's tough fiscal situation. We are thinking especially of the long-term weakness of investment and the ways that the tax system hampers growth. We highlighted both these issues in our pre-Budget *Building Prosperity* report. Some measures, especially the decision to impose national insurance on salary sacrifice pension contributions above £2,000 from 2029, are actively counterproductive.

As we illustrated in that report, there is a logical inconsistency in the government's current approach to pensions.

On the one hand, the reforms in its Pension Schemes Bill are rightly premised on the idea that the pension system has a vital role to play in supporting productive investment. More than half of small businesses that say they haven't invested enough in the past three years cite a reason related to a lack of external financing, something the pension system is especially well-equipped to provide. And the government wants to drive more pension assets into productive assets in the UK.

On the other hand, the changes announced today continue the trend towards tougher tax treatment of pensions, following the decision in the previous Budget that they will fall into the inheritance tax net from 2027. There is plenty of evidence that people respond to changes in the tax treatment of pensions when deciding how much to contribute. Changes like the ones announced today disincentivise contributions, limiting the pool of capital available to flow to where it is needed most for economic growth.

The Chancellor's tweaks to business taxation were also disappointing. Before the Budget we called for the expansion of full expensing (which allows firms to deduct investments from their profits before paying tax) to all forms of business investment. This would have provided a stronger incentive for firms to invest, and removed the arbitrary preferential treatment given to plant and machinery investment (which can already be fully expensed).

But there was no sign of that at all. Instead, the Chancellor effectively made changes in the opposite direction, raising revenue by reducing the generosity of capital allowances in net terms (via a reduction in the writing down allowance, only partly offset by a new first-year lease allowance).

Finally, changes to business rates also failed to move the dial for investment significantly. Reduced rates for smaller retail, hospitality, and leisure properties, alongside higher rates for larger, high-value properties, shift the burden of the tax away from the high street and towards the likes of supermarkets and warehouses. And a temporary relief package will reduce pressures on some firms affected by revaluations. But the broader problem with the system, that it disincentivises investment in upgrading premises (as doing so increases the rental value used to calculate the tax), was not addressed.

'Mansion tax' highlights risks to bricks and mortar
We've highlighted before that property taxes are an attractive option for politicians trying to raise revenue from wealthy individuals, because they are particularly hard to avoid (since property is arguably the least mobile form of wealth). A case in point is the new 'mansion tax', or High Value Council Tax Surcharge, imposed on owners of houses valued above £2mn. As we argued in our *Don't Bet the House* report, this long-running ratcheting up of property taxation is a reason why bricks and mortar is no longer the reliable route to building wealth that it was for a generation from the 1980s to the mid-2010s.

The new mansion tax should at least be less economically damaging than some of the other options mooted before the Budget, especially the broad tax on wealth proposed by some Labour MPs or the alternative of charging capital gains tax on more expensive primary residences. But we are disappointed not to see any progress towards reducing the damage caused by other property taxes, and specifically stamp duty. By penalising moving, stamp duty makes it harder for workers to find suitable, affordable housing close to the jobs they are best suited for, making it one of the most economically damaging taxes. We estimate that removing it could contribute to 300,000 additional home transactions a year.

Additional information

If you no longer wish to receive this publication, please call 020 7399 0000 or speak to your regular Rathbones contact.

Call:

For contact details of your nearest office please visit

www.rathbones.com/about-us/our-offices

Visit:

rathbones.com

Email:

enquiries@rathbones.com

For specialist ethical, sustainable and impact investment services:

Greenbank

0117 930 3000

enquiries@greenbankinvestments.com

greenbankinvestments.com

For offshore investment management services:

Rathbones Investment Management International

01534 740 500

rathboneimi.com

@rathbonesgroup

Rathbones Group Plc

@RathbonesPlc

RATHBONES