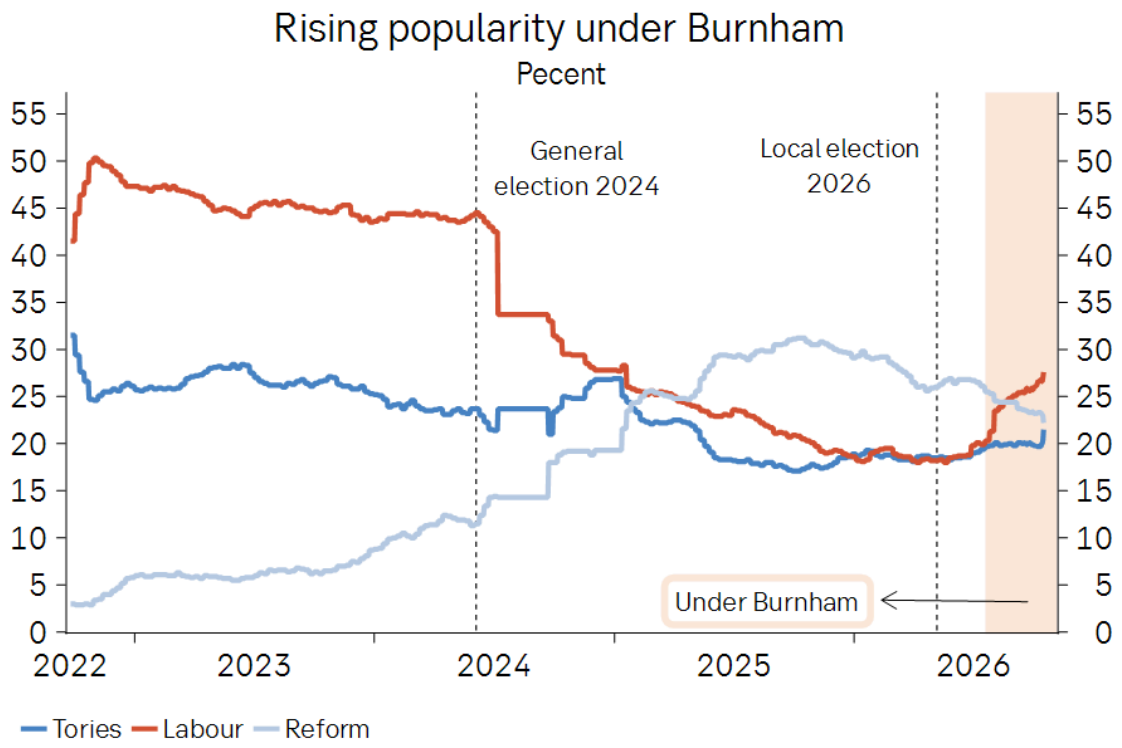
26 October 2026

Upcoming Budget - Kicking the can down the road

Prime Minister Andy Burnham has ambitious plans to reshape the UK economy, and markets have been bracing for a potentially significant Budget on 28 October. However, with gilt yields elevated and markets on alert, alongside signs of an economic recovery, we expect a relatively modest Budget, primarily focused on supporting households and laying the groundwork for future reforms. The more difficult spending decisions will likely be postponed until 2027. With markets already pricing in a cautious Budget, the scope for a positive surprise appears limited, while an unexpectedly expansionary package could push gilt yields higher and sterling lower.

Cautious start but ambitious long-term agenda. The Burnham government has so far introduced relatively modest measures aimed at supporting households and addressing everyday concerns. Whether this reflects a genuine focus on voters' needs or simply limited fiscal headroom is for the reader to decide. Nevertheless, the strategy appears to have helped Labour recover in the polls, regaining its position as the largest party ahead of Reform UK.

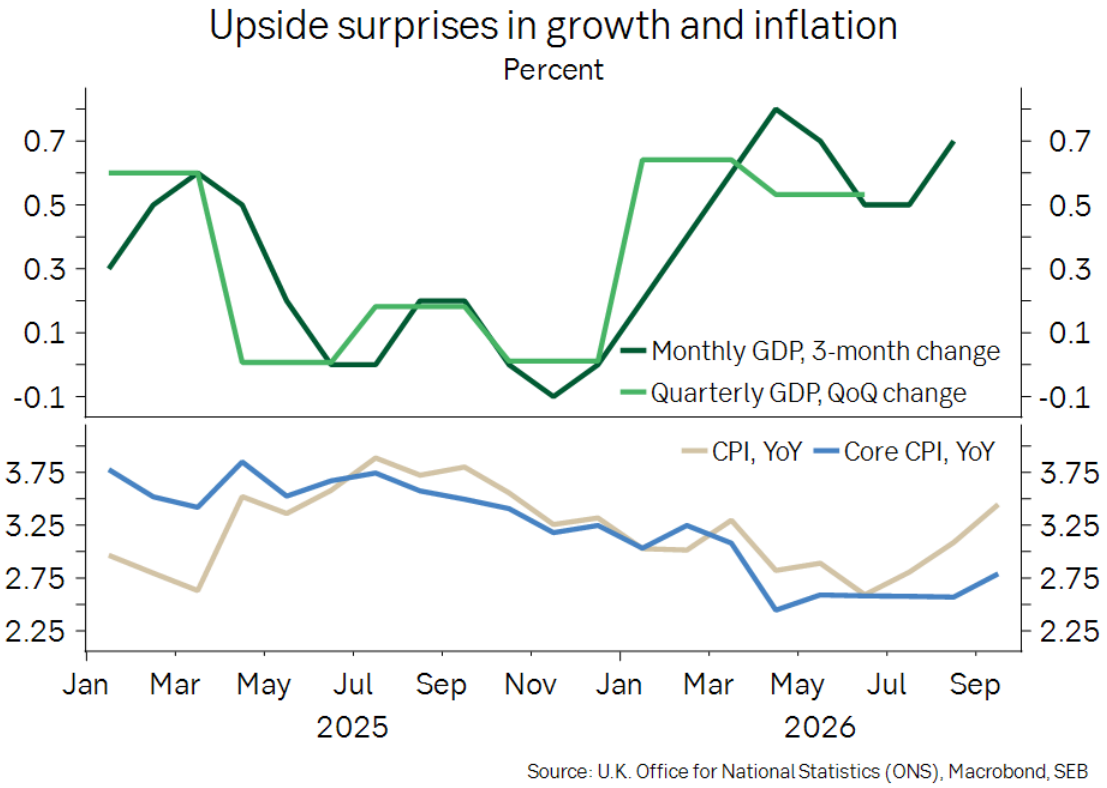


Source: PolitPro, Macrobond, SEB

However, the government's longer-term ambitions are considerably greater. The Manchesterism strategy emphasizes greater public control over essential infrastructure and services, increased housing construction, stronger regional economies, a greater focus on vocational training and youth unemployment, as well as higher defence spending and closer cooperation with the EU. The spending ambitions far exceed what even generous fiscal assumptions could accommodate.

Political constraints make the fiscal arithmetic harder. Burnham and Healey have pledged to retain the previous government's fiscal rules, requiring the current budget to be in surplus and public sector net financial liabilities (PSNFL) to fall as a share of GDP by 2029/30. The government has also promised not to raise the main taxes on working households, including income tax, VAT and National Insurance, which together account for 54% of total tax revenues. These commitments significantly constrain Healey's room for long-term reforms.

Resilient growth, but inflation risks are rising. The UK economy has remained surprisingly resilient, reducing the immediate need for fiscal stimulus. GDP grew by 0.6% quarter-on-quarter in Q1 and 0.5% in Q2, while growth remained solid over the summer. Business investment has increased, partly supported by higher spending on infrastructure and technology. Household consumption has also benefited from improving real incomes, and with the saving ratio still elevated at 8.8%, there is scope for a further recovery.

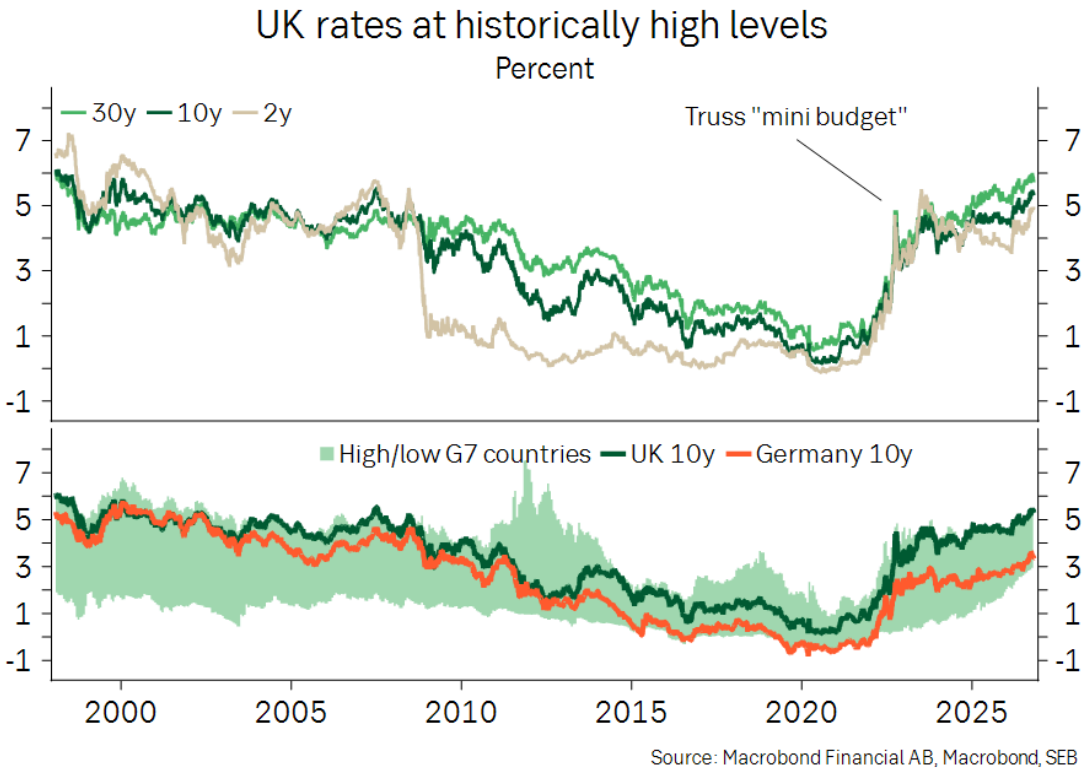


Source: U.K. Office for National Statistics (ONS), Macrobond, SEB

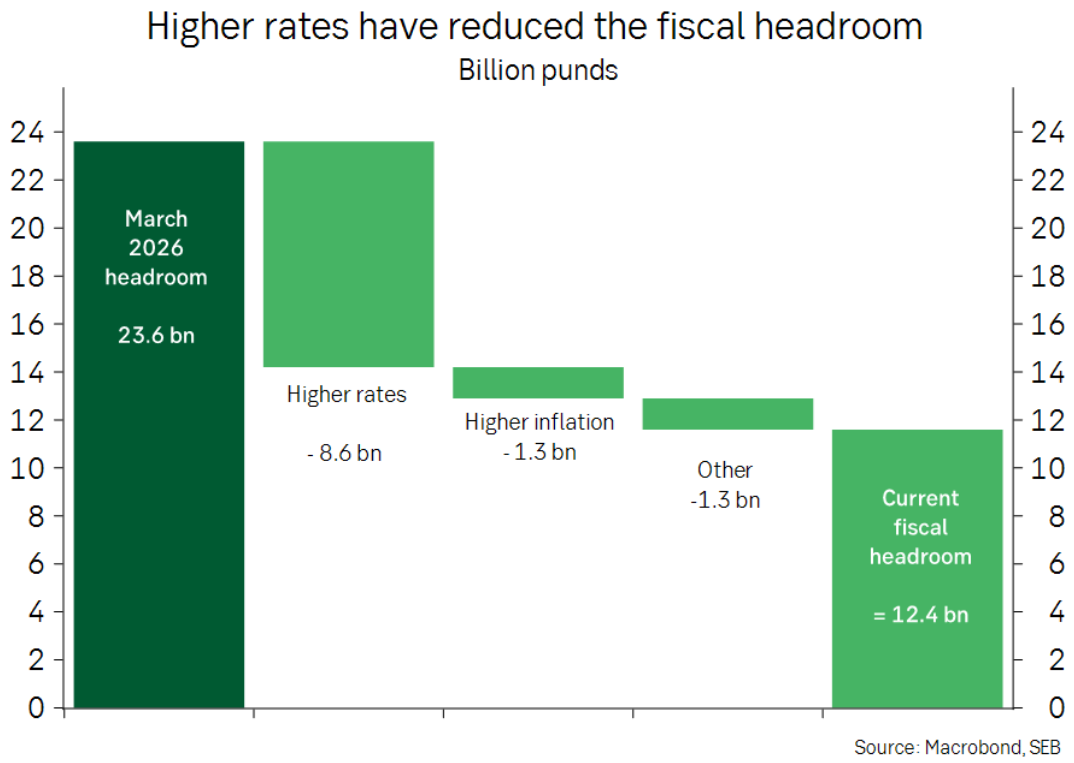
However, renewed inflationary pressures complicate the outlook. Headline inflation accelerated to 3.5% in September, while core inflation rose to 2.8% and services inflation to 3.7%. Higher energy prices, driven by the Middle East conflict, are eroding households' purchasing power, while rising producer prices suggest inflationary pressures in the pipeline. With inflation moving further above the BoE's target, we expect additional monetary tightening. Meanwhile, falling vacancies and weak payroll employment signal a soft labour market and with consumer confidence plunging in October, the risk of a faltering recovery is substantial.

Elevated yields reduce fiscal headroom. The 10-year gilt yield reached around 5.5% in early October, its highest level since 2007, while the 30-year yield briefly exceeded 6%. Although yields have since

declined somewhat, borrowing costs remain elevated. With public sector net debt at 94% of GDP, substantial refinancing needs ahead and a relatively large share of inflation-linked debt, the UK particularly exposed. The recent global bond sell-off shows that investors are increasingly scrutinizing countries with weak public finances and are quick to demand higher risk premia. So far, France has been at the centre of attention, but market attention could quickly shift to the UK if the Budget raises concerns about fiscal credibility.



In March, the OBR projected fiscal headroom of £23.6bn against the current-budget rule and £27.1bn against the PSNFL investment rule. More recent estimates suggest that headroom against the current-budget rule could narrow to around £10–15bn, leaving the government with a relatively small buffer against further shocks.



What does this mean for the Budget? The government's political ambitions and constraints, alongside the economic and financial backdrop, point towards a cautious Budget. Healey needs to demonstrate that the government is delivering on its promises and supporting the economic recovery while preserving market confidence and ensuring compliance with the fiscal rules.

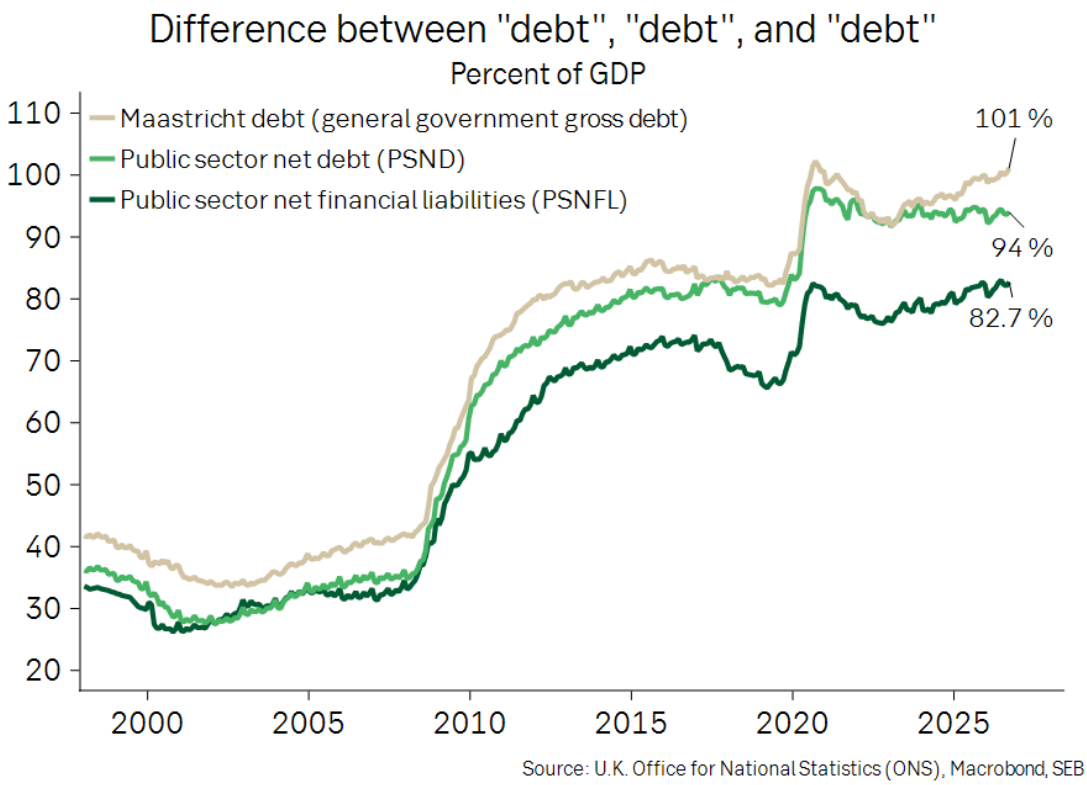
Household and small business support is therefore likely to be the main spending priority, potentially amounting to £4bn. With higher energy prices having eroded the benefits of earlier measures, further assistance with energy bills is likely. Relief for small businesses is also expected, potentially through an increase in the business rates relief threshold. Temporary support measures that expire before 2029/30 would have limited direct impact on fiscal headroom in the target year, although they would still increase near-term borrowing.

For the more structural themes, the Budget will need to address the remaining £4.7bn funding gap over four years in the Defence Investment Plan. It will also provide further details on previously announced regional devolution and investment reforms, including changes allowing related local projects to be assessed together and a lower social discount rate, which increases the present value of long-term investment benefits. More ambitious reforms, including regional income tax sharing, social care and the longer-term increase in defence spending, will largely be left for the 2027 Spending Review.

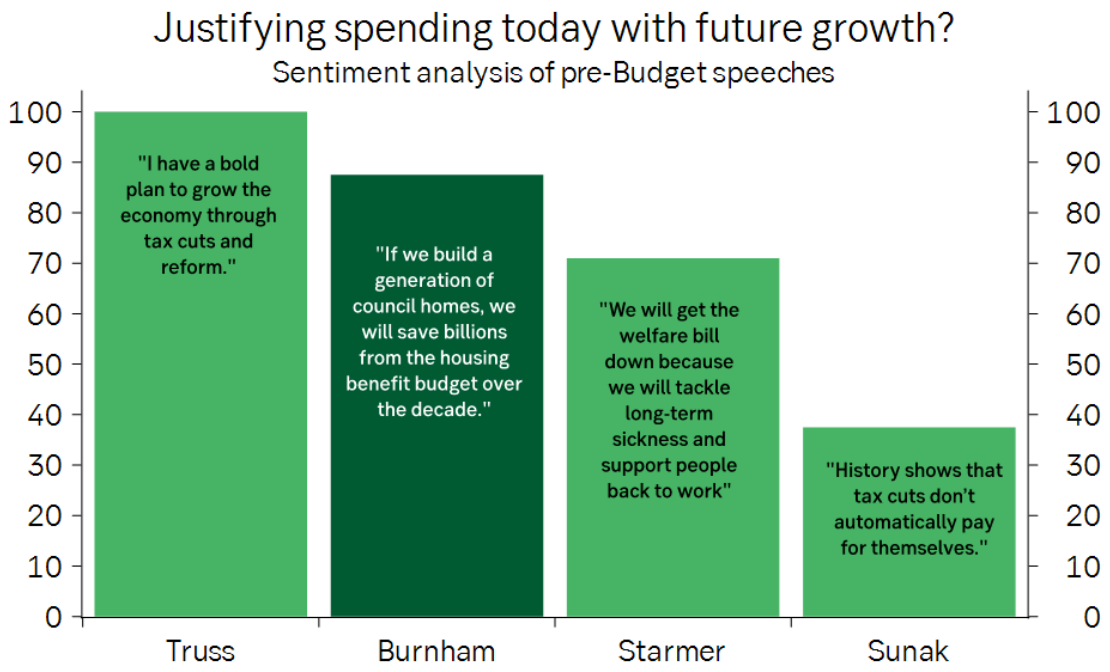
With constraints on the revenue side, Healey will need to rely on smaller tax changes to finance spending. An increase in the bank corporation tax surcharge has emerged as a leading possibility, potentially raising around £2bn annually. Changes to property taxes and selected tax reliefs could also be considered. However, reports suggest the Chancellor has ruled out higher capital gains tax rates, reflecting concerns about private investment and the economic recovery.

Risks and potential market reactions. Our base case is a relatively cautious Budget that preserves around £10–15bn of fiscal headroom, and maintains a credible fiscal trajectory. This should have limited implications for gilt yields or sterling, as well as for the economy. A larger buffer could provide some support for gilts by reducing fiscal uncertainty.

A potential risk is excessive use of public financial institutions (PuFins) to expand investment without breaching the fiscal rules. Under the PSNFL framework, borrowing to finance loans or equity investments can be offset by the financial assets acquired, leaving the headline debt measure largely unchanged. However, that still requires additional gilt issuance and entails financial risks, particularly if the assets fail to deliver the expected returns.



Another concern is reliance on optimistic assumptions about future growth or tax revenues to justify spending commitments. Comparing earlier prime ministers' pre-Budget speeches with Burnham's communication suggests that he places considerable emphasis on these dynamic effects, which often fail to materialise to the extent anticipated. The reduction in the discount rate, which increases the present value of future benefits, illustrates how these views could influence policy. Markets will therefore scrutinise whether the government relies on credible OBR forecasts or uncertain future growth effects to justify additional spending.



Source: Macrobond, Claude, SEB

*The scores are based on a qualitative assessment of pre -Budget speeches using LLM. The score measur es the intensivity of language indicating reliance on future growth and increased future revenue to justify upfront spendi ng or tax cuts. The speaches are normalized so that the pre -budget speaches of Liz Truss = 100.

Similarly, postponing major commitments, including higher defence expenditure and social care reform, without explaining how they will eventually be financed, could undermine confidence even if the fiscal rules are formally met.

A negative surprise would likely lead to higher long-dated gilt yields and a weaker pound. The 10- to 30-year segment is particularly sensitive to fiscal risk premia, although reduced issuance at the long end could partly cushion supply pressures. With bond markets already on alert, the reaction could be amplified by broader concerns about government finances. A deterioration in confidence would widen UK government bond spreads against German Bunds and US Treasuries.

Ultimately, a cautious Budget may help preserve market confidence in the near term but postponing major spending decisions until 2027 risks creating a more difficult fiscal challenge further down the road.

Read more on related topics:

Manchesterism (SEB Research)

3 cases for Burnham's premiership (SEB Research)

Sterling (SEB Research)

Economic outlook (SEB Research)

Malte Meuller
Advisor to the Chief Economist
malte.meuller@seb.se
+46707392266