

An unexpected budget for savers

By Tom Stevenson, 23 June 2010

After all the pre-budget fears, savers and investors fared better than they might have expected in George Osborne's first outing

Having been so comprehensively softened up for a tough "austerity" budget, it could have been a lot worse. If you are one of the UK's six million public sector workers, or on benefits, you might beg to differ. But a saver or investor, working in the private sector, will feel like they've escaped the worst of the Chancellor's "unavoidable" clampdown.



George Osborne has walked a tightrope between a catastrophe in the public finances and a double dip recession. Most people would probably agree that he has done it with some skill, especially when you think he was also trying to keep opposite wings of the Tories and Lib Dems happy at the same time. It was an unenviable task.

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If you are looking at a two year pay freeze, a review of your final salary pension scheme, a 25% cut in the budget of the department that employs you or a reduction in your housing, disability or child tax credit benefit, you won't look very kindly on the spending and welfare squeeze imposed by this Emergency Budget.

Indeed the big question mark over the measures is whether they will kill the patient while he's still on the operating table. Renewed slump cannot be discounted given the scale of the cuts and there are plenty of economists who will question the plausibility of the Office of Budget Responsibility's economic forecasts for the next few years. After a slow down this year and next they factor in a pretty punchy recovery thereafter.

The VAT hike (albeit only bringing the UK in line with most of our European peers) will contribute to a slow-down in activity. It also threatens to keep inflation higher than the Bank of England would like, although the danger of falling prices looks every bit as real given the scale of the fiscal squeeze in the months ahead. I still expect interest rates to stay lower for longer.

In the context of a cash-strapped, revenue-hungry Government, savers and investors might have thought they would be an easy target. But the Chancellor, to his credit, seems to have listened to the representations of many on his backbenches, some newspapers like the Telegraph and indeed Fidelity, which kicked off a campaign against the threat of a damaging hike to capital gains tax.

The most pleasing aspect of the CGT measures was the fact that a proposed reduction of the annual tax-free allowance (a Lib Dem manifesto pledge) was kicked into the long grass. This is very good news for the many retired people who use the £10,100 allowance to draw down some of their savings to supplement their pension.

The increase in the flat 18% CGT rate for higher-rate taxpayers to 28% is not exactly welcome but it is a lot better than the 40-50% tax that we had been primed to expect. For many investors who pay only basic rate tax on their income the rate is pegged at 18%. And while indexation or taper relief would have rewarded those who held their investments for several years, no-one would have welcomed the extra complexity.

Our preferred solution would have been a clearer distinction between short-term speculators and longer-term investors, with those holding onto their assets for a year or more only attracting tax at the basic rate, but the new arrangements are an acceptable compromise. All credit to those who joined our campaign to fight for fairer CGT.

One further aspect of the CGT changes was well thought through. The immediate imposition of the tax avoided an unseemly rush to the exit by buy to let property owners which would undoubtedly have ensued had there been a window of a few months before the new rate kicked in. A wobbly housing market would have taken that sort of over-supply extremely badly.

The key message from the CGT changes is that all the courses of action which made sense last week will continue to make even more sense next week and beyond. Maximising your use of the generous ISA allowance looks doubly prudent today. No further income tax and no CGT ever is a pretty attractive incentive.

Pensions were the unexpected beneficiary of the Chancellor's recognition that saving matters. The previous government had put in place an almost wholly unworkable system of reducing tax relief on pension contributions for higher earners. With the Lib Dems champing at the bit to get rid of higher rate tax relief altogether, the prognosis was not good as the Chancellor got to his feet.

Great news then that the Government seems once again to have listened to representations from the pensions industry and understood that the policy goal of reducing the share of tax relief enjoyed by higher rate tax-payers (and saving money) can be better achieved by imposing a cap on pension contributions.

The numbers being talked about by the Government (£30,000 - £45,000) will be more than enough for most pension savers and if a use-it-or-lose-it annual allowance encourages people to start saving earlier, so much the better.

I also particularly like the sound of an Office for Tax Simplification. Complexity is the enemy of prudent financial planning so keep it simple is a rallying cry I'm all in favour of. Good news too that the compulsory annuitisation of pension pots at the age of 75 is destined for the history books.

Pensions are a viable long-term savings vehicle again so now the fight is about ensuring that the pensions landscape remains simple and stable. We'll certainly be pushing for that in the months and years ahead.

At the macro-economic level, the Chancellor has taken a very brave gamble. I think it is the right one, and the markets seem generally to agree with me. Only time will tell. For savers and investors, however, this is that most unusual Budget – one that's longer on bouquets than brickbats.

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