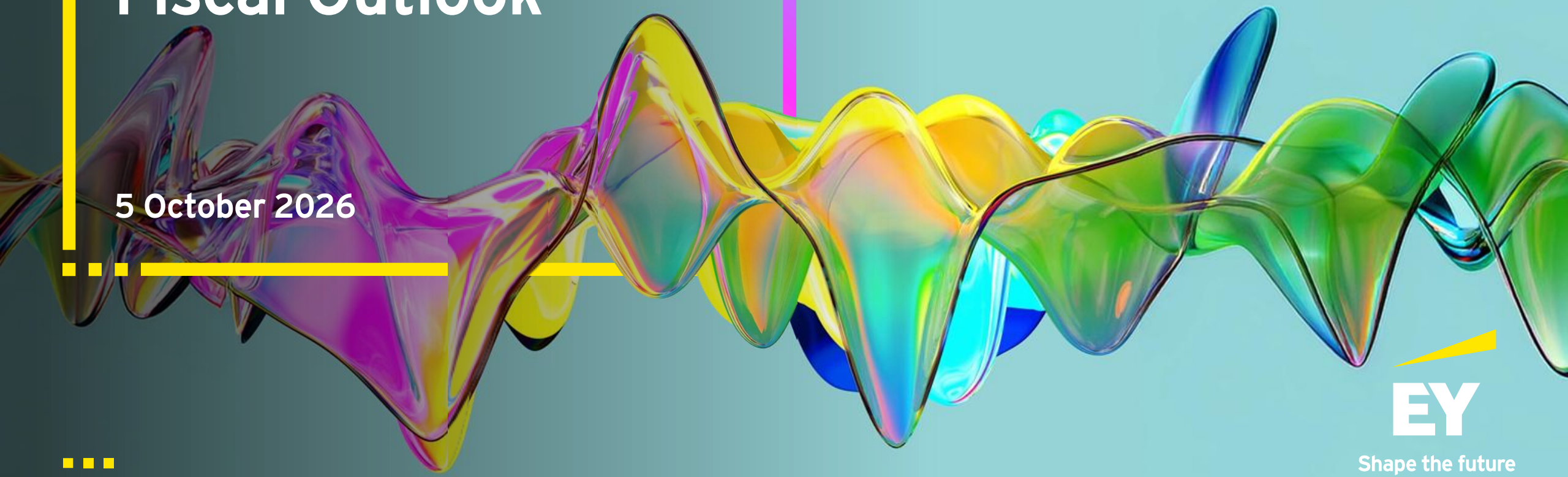
EY UK Pre-Budget Fiscal Outlook

5 October 2026



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Introduction

Peter Arnold
EY UK Chief Economist

The Autumn Budget is always a significant event in the political and economic calendar, but never more so than this year, with another new Prime Minister/Chancellor combination – the tenth in ten years – at the helm.

The Prime Minister Andy Burnham came into power in the summer with a weight of expectation and, with his Chancellor John Healey, will be seeking to find the secret to rebooting the UK's economic health, a challenge that has illuded many of their predecessors, while operating under the same fiscal constraints.

The economic and fiscal context is challenging. While growth in the UK economy has held up well so far this year, it is expected to slow in the second half of the year, as the impact of higher energy prices feed through the economy. Gilt yields have hit their highest levels this century, adding to debt service costs. Taxes are already forecast to reach record highs as a share of GDP. And many of the potential revenue raisers are either ruled out by manifesto pledges or are politically challenging to deliver.

The Chancellor will inherit fiscal headroom that, according to the OBR in March, stood at £23.6bn in March this year – still historically quite a thin margin against annual tax and spend figures of c£1 trillion a year.

However, the impact of the latest energy shock and rising bond Yields will have eaten into the headroom – taking it down to c£11bn based on our most recent forecast, And it could be even more challenging; in our adverse scenario where we see a continuation of the conflict in the Middle East plus further escalation – this could fall into negative territory forcing some action.

Given the level of uncertainty, we expect that the Chancellor will seek to reassure financial markets and voters by looking to maintain headroom, and hopefully holding back some fiscal firepower for later in the Parliament. That does imply at least some moderate spending cuts and/or tax increases just to stand still.

Further, a number of announcements in the early weeks of his term, aimed at alleviating cost of living pressures, can be expected to be formalised as policy measures scored at this Budget.

Beyond that, some of the Prime Minister's more ambitious policy objectives may be put on hold for now, to allow more time to work through the various fiscal levers that are available to fund them. What these are, and how they could be paid for, are also explored in this report.

5 October 2026

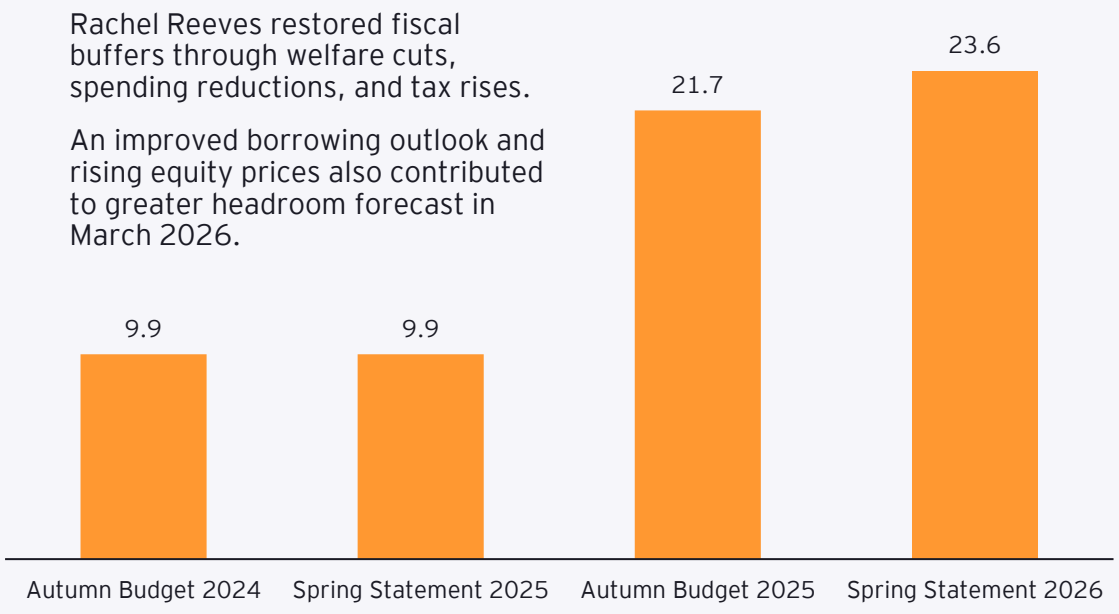
fiscal context

In March, the OBR forecast that the Chancellor had c.£24bn headroom against fiscal targets, an improvement on previous Budgets, but still a small margin for error

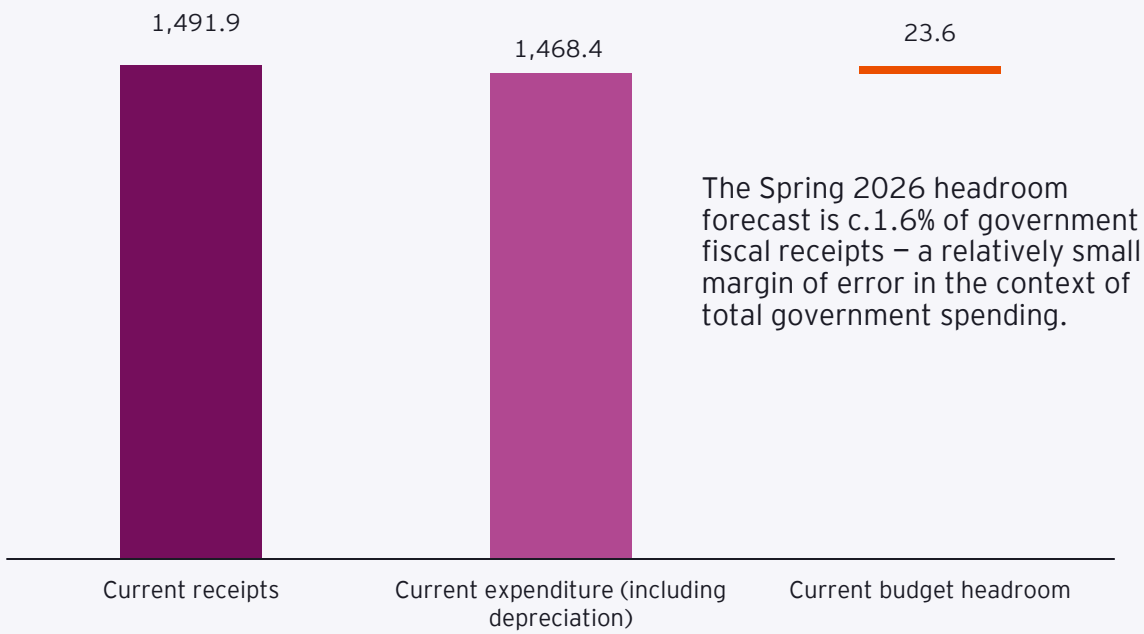
Headroom forecasts
£bn

Rachel Reeves restored fiscal buffers through welfare cuts, spending reductions, and tax rises.

An improved borrowing outlook and rising equity prices also contributed to greater headroom forecast in March 2026.



Net borrowing, OBR forecast (2029 – 2030)
£b



The Spring 2026 headroom forecast is c.1.6% of government fiscal receipts – a relatively small margin of error in the context of total government spending.

The fiscal stability rule set constraints for the Government, including additional spending to be funded through higher revenues, spending reductions or existing headroom, while weaker growth or higher borrowing costs could reduce the forecast buffer.

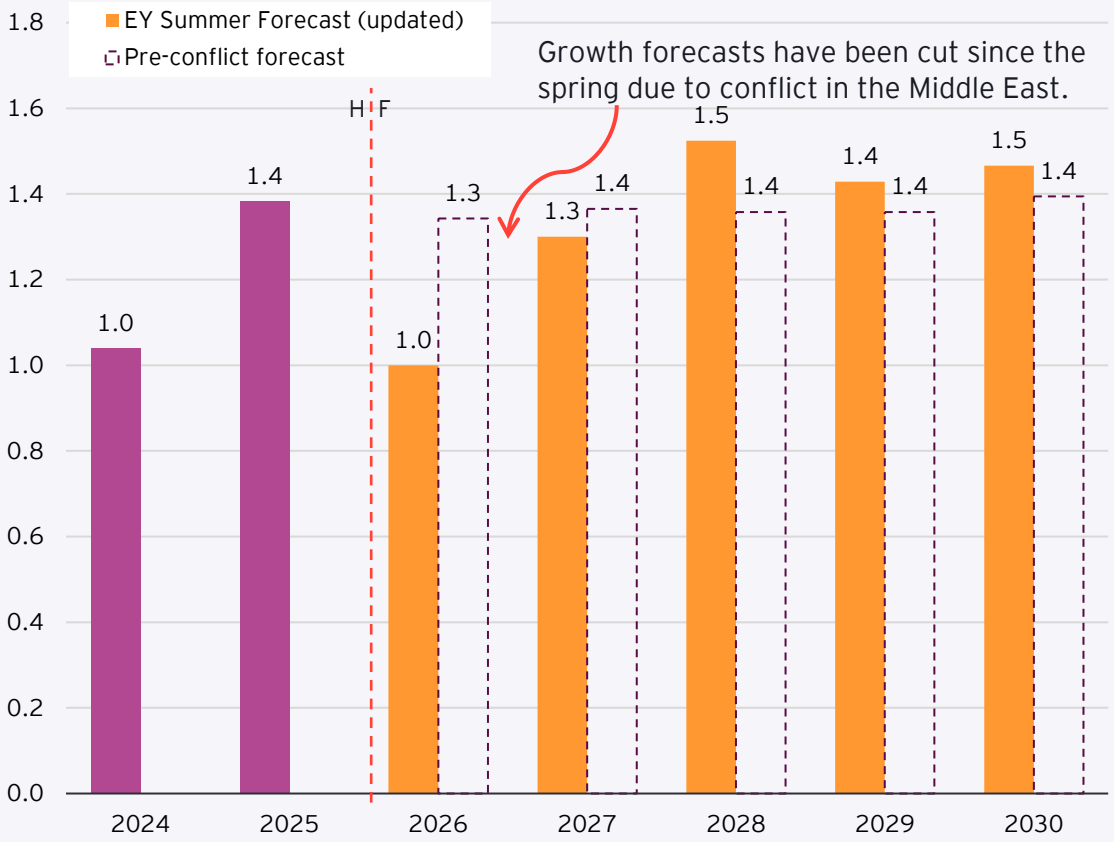
The Prime Minister and the Chancellor have committed to retain the inherited fiscal framework.

Rachel Reeves' fiscal rules committed the Government to a) covering day-to-day expenditure with tax revenues by 2029-30 **(Stability Rule),** and b) public sector net financial liabilities (PSNFL) falling as a % of GDP **(Investment Rule)**

Source: OBR

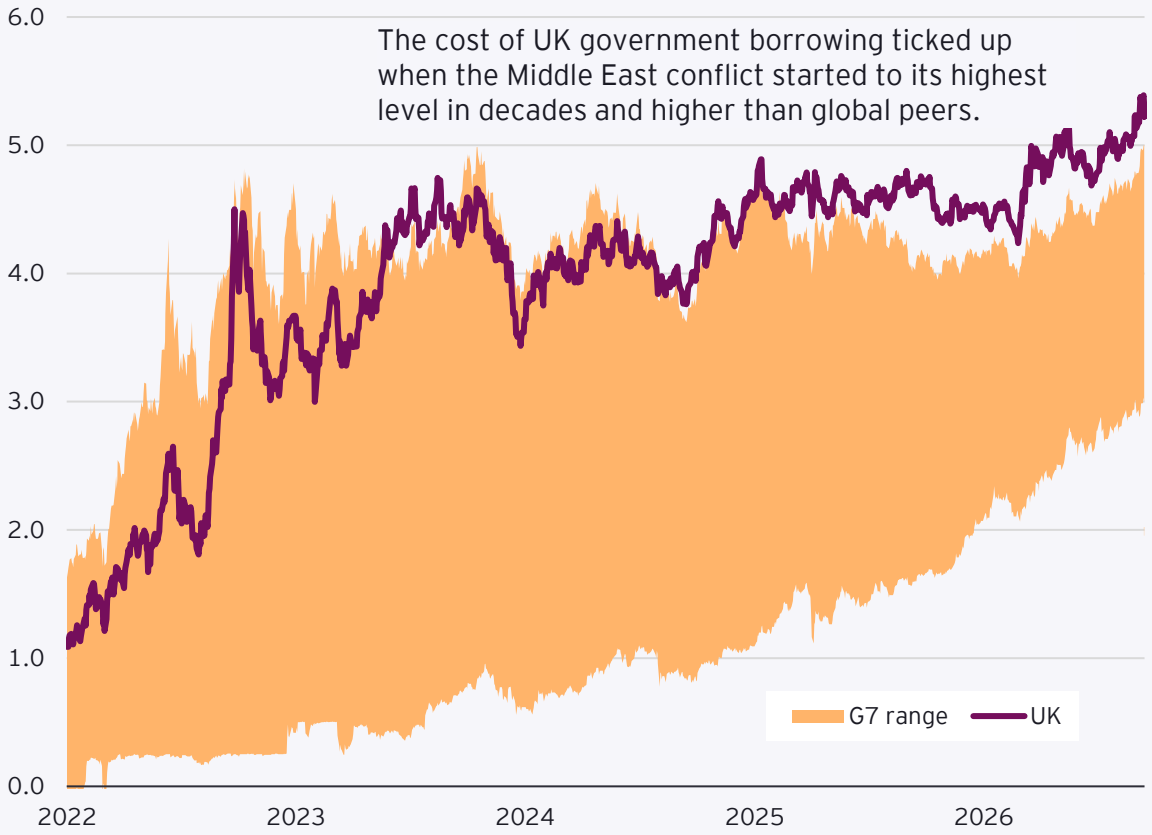
Since then, the Middle East conflict has driven up inflation and acted as a headwind to growth, while bond yields have risen sharply

GDP real growth rate forecast
year-on-year rate, %, 2024 – 2030



Source: ONS, EY Summer Outlook

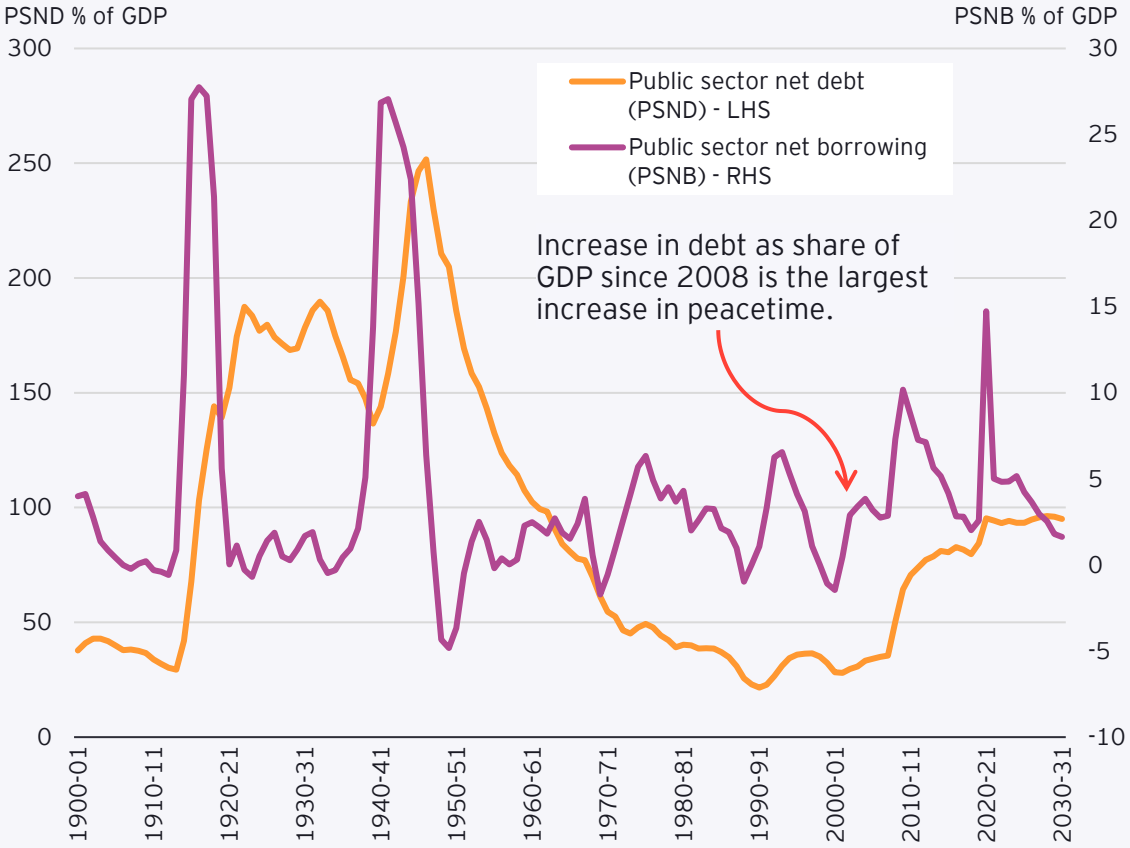
UK 10-year gilt yields vs G7 range
January 2022 to September 2026, %



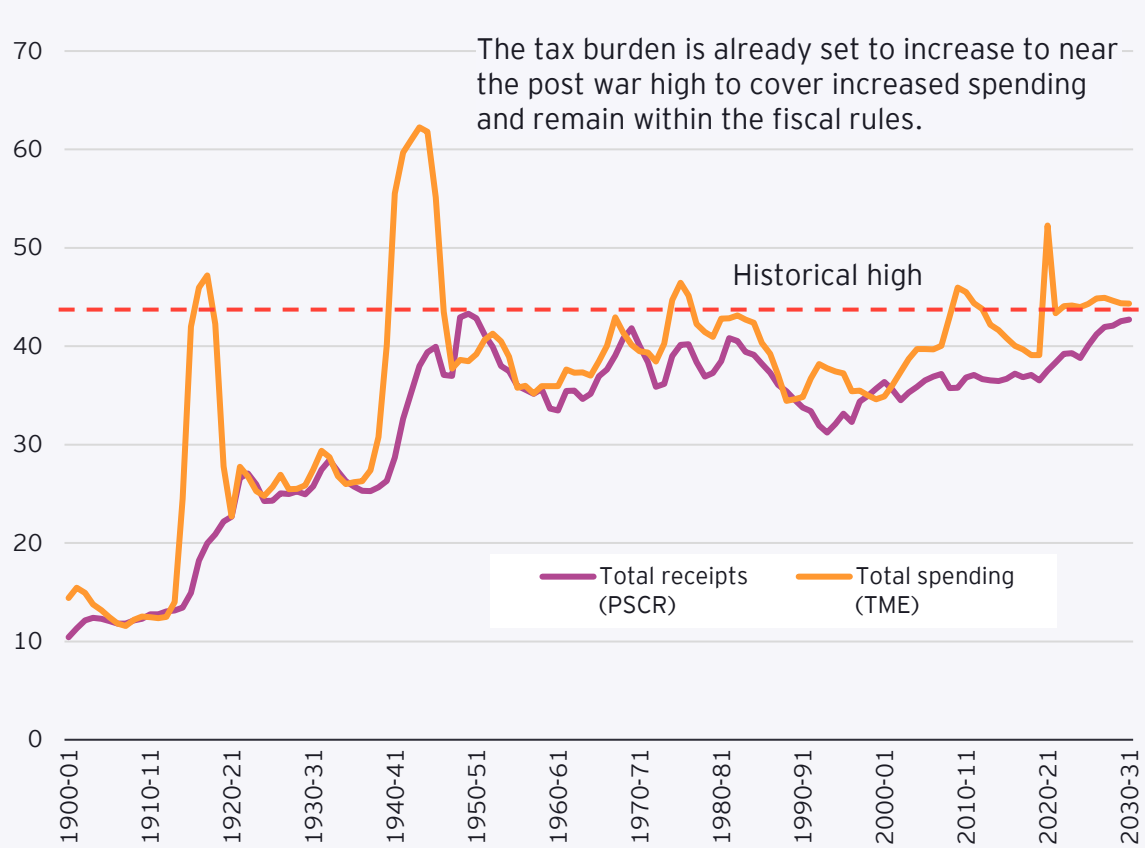
Source: LSEG

The Prime Minister is also operating under the same constraints as his predecessor – taxes are historically high, and government debt has tripled as a share of GDP

Public sector net debt and deficit, OBR forecast
% of GDP, 1900/01 to 2030/31



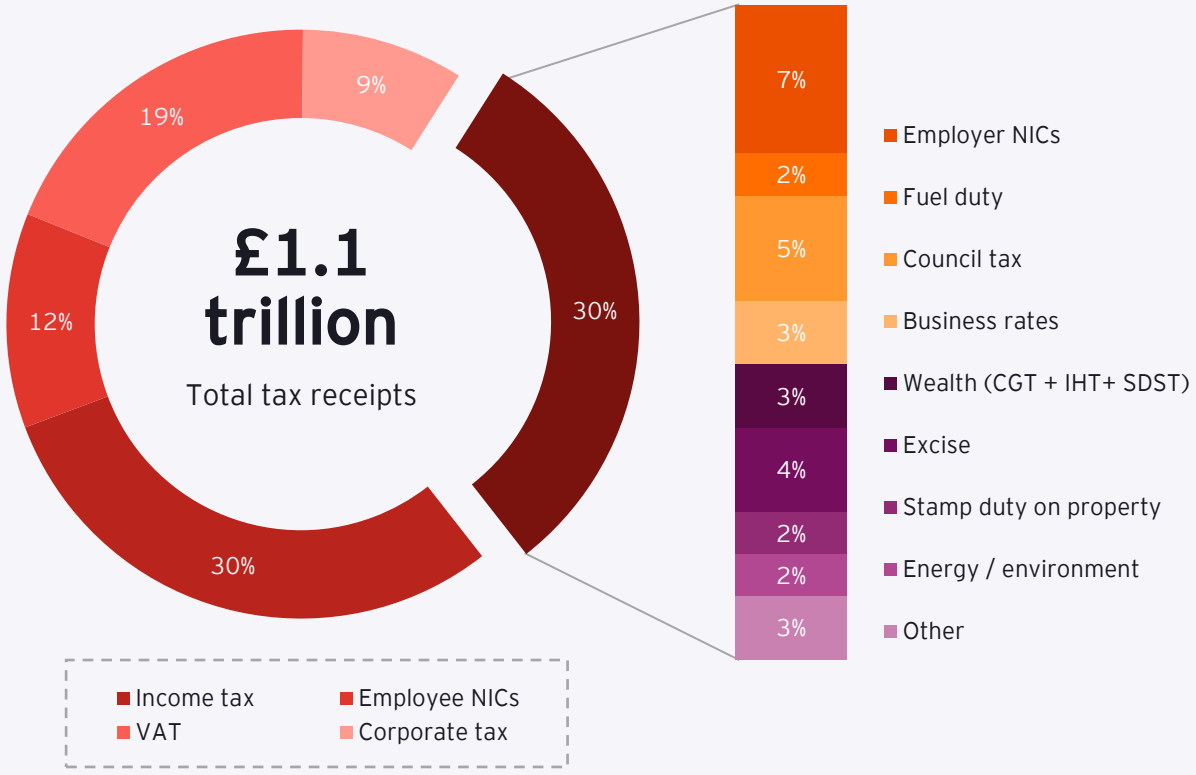
Total tax receipts and expenditure, OBR forecast
% of GDP, 1900/01 to 2030/31



Source: OBR

Labour's manifesto pledges rule out rate rises for taxes that generate around 70% of total revenue, leaving relatively few options for revenue uplift

Breakdown of tax receipts
2025 - 2026



70% receipts locked by manifesto pledges

The Labour manifesto pledged no increases in the rates of income tax, employee NICs, corporation tax or VAT – together these account for £772 billion, of the total £1.1 trillion of tax revenue in 2025-26.

Of the 30% that remain, more than half would be difficult to increase:

- Employer NICs increased in the Autumn Budget 2024, widely regarded as a "tax on jobs".
- Fuel duty is planned to increase every year in line with RPI, but that planned increase is usually cancelled.
- Council tax funds local authority spending, not central government.
- Business rates are likely too politically sensitive due to impact on high street business.

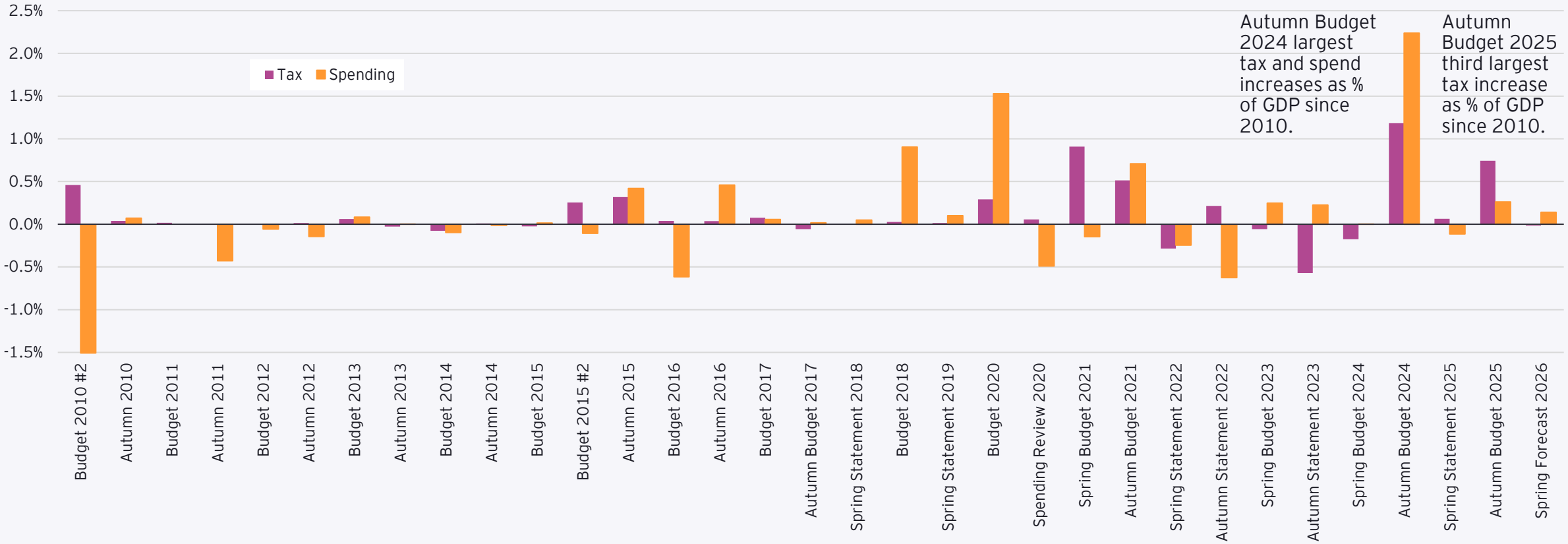
This leaves only 13% of tax revenue, both, not covered by the manifesto, and more viable to increase – therefore likely to remain at the centre of policy speculation.

Source: OBR

The last two budgets were ‘big’ fiscal events – with c£90bn of extra spending, £70bn in tax increases, and over £30bn of extra borrowing

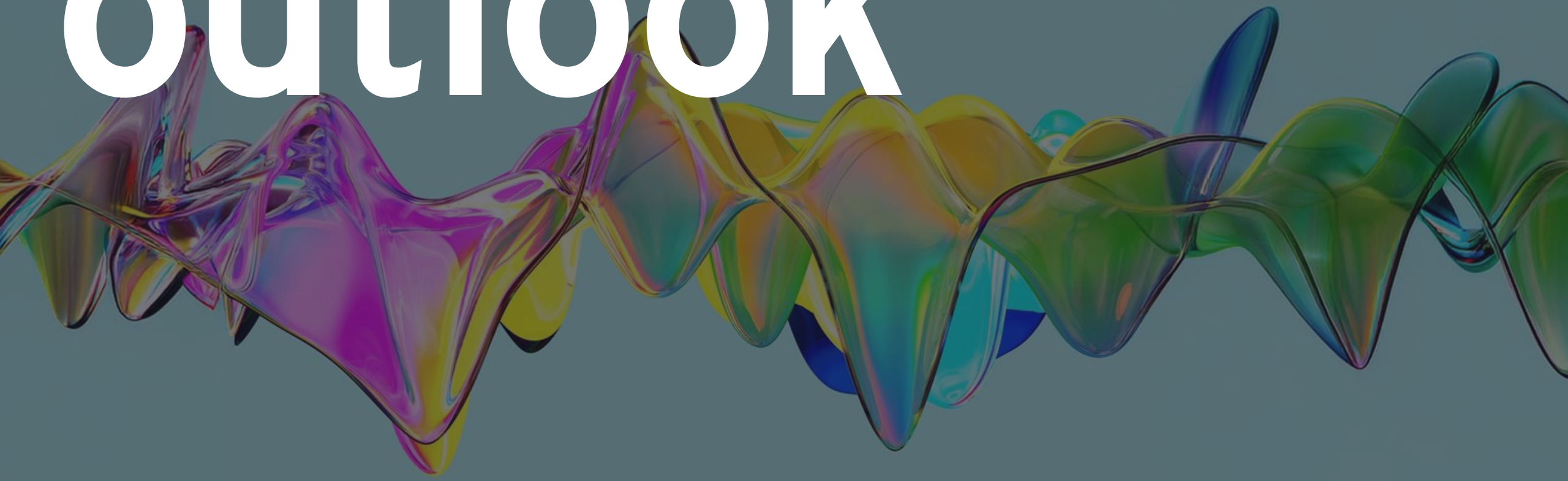
Tax and spend policy changes as % of GDP – impact in fifth year of fiscal projections

Policy measures as % GDP, fiscal events 2010 - 2026



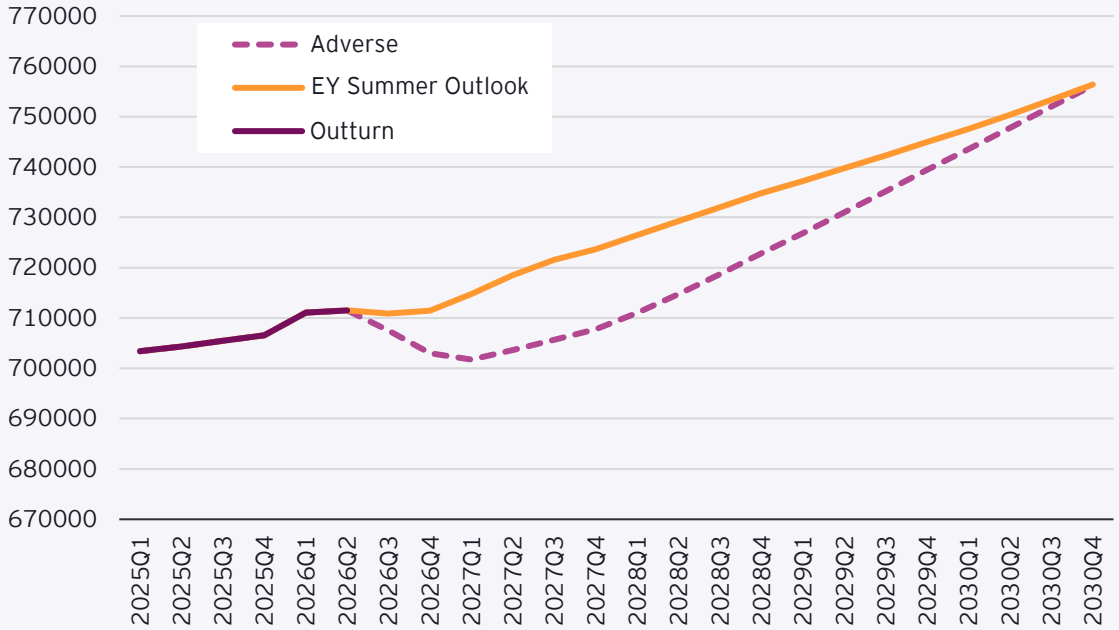
Source: OBR Policy Measures Database, as % of GDP

pre-budget outlook

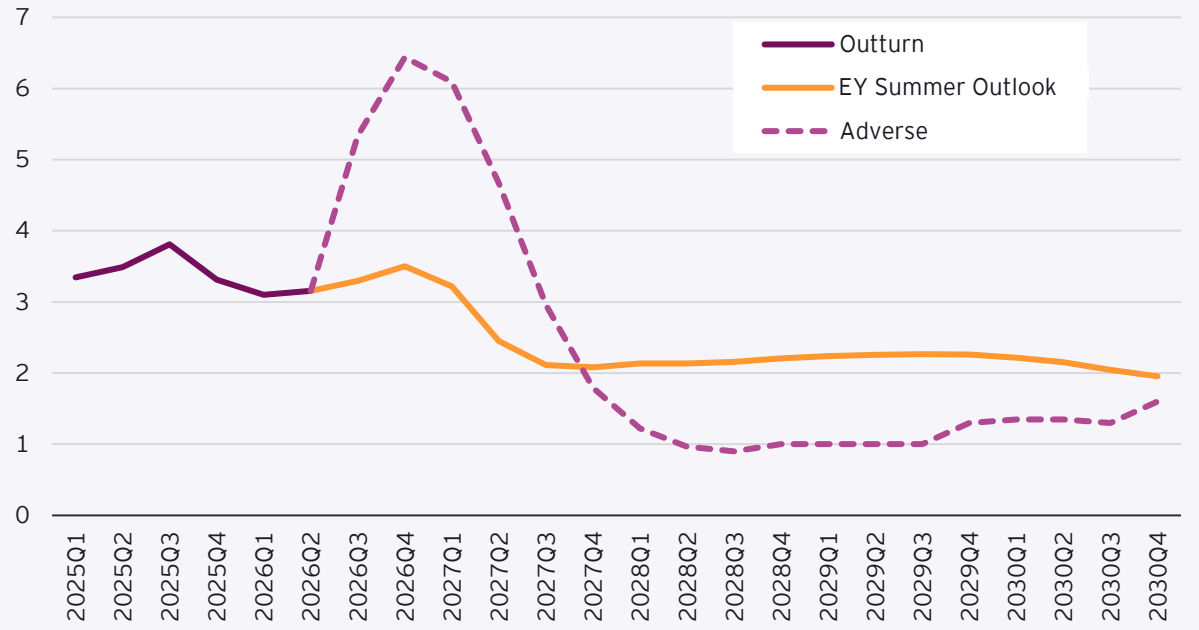


Headroom depends critically on growth forecasts – our summer forecast sees growth slow in 2026 before returning to trend in 2027, but the outlook is threatened by further escalation in the Middle East

UK GDP level scenarios, quarterly real £mn
2025 - 2030



UK inflation scenarios, 12-month rate %
2025 - 2030



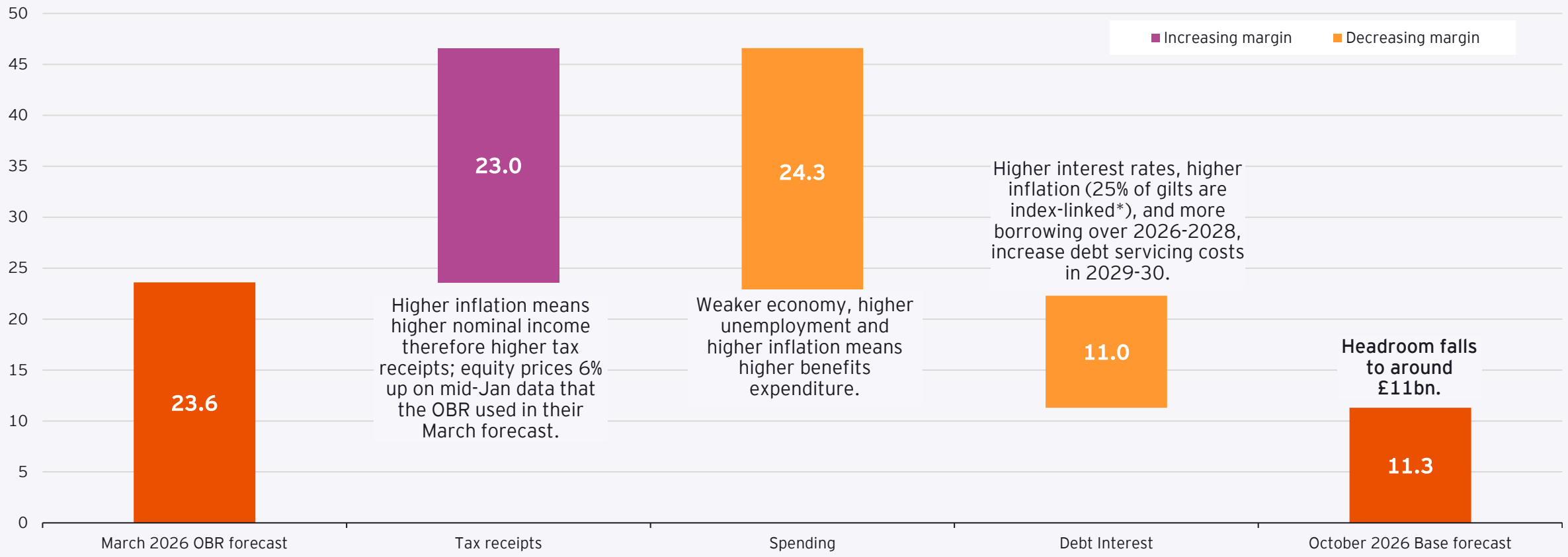
Despite activity softening, underlying economic momentum held up relatively well in Q2 2026, helped by lower-than-expected inflation and falling global energy prices during the period of ceasefire in the Middle East. This resilience has supported the outlook this year, pushing our growth forecast up to 1.0% from 0.8% and reducing the expected peak of inflation from around 4% to just over 3.5% by the end of 2026.

The risks to the central EY Summer Outlook are firmly skewed to the downside. Further escalation in the Middle East threatens to unwind the recent falls in energy prices. In the adverse scenario, UK inflation could hit 6% by the end of 2026, driving the UK economy into a recession in the second half of 2026 and early 2027.

Source: EY calculations in the NiGEM model

Our base case forecast suggests that headroom has reduced – from £23.6bn to c.£11bn – as a result of higher bond yields and a weaker economy

October 2026 Budget: current balance target (central case)
£bn, current budget in 2029 - 2030

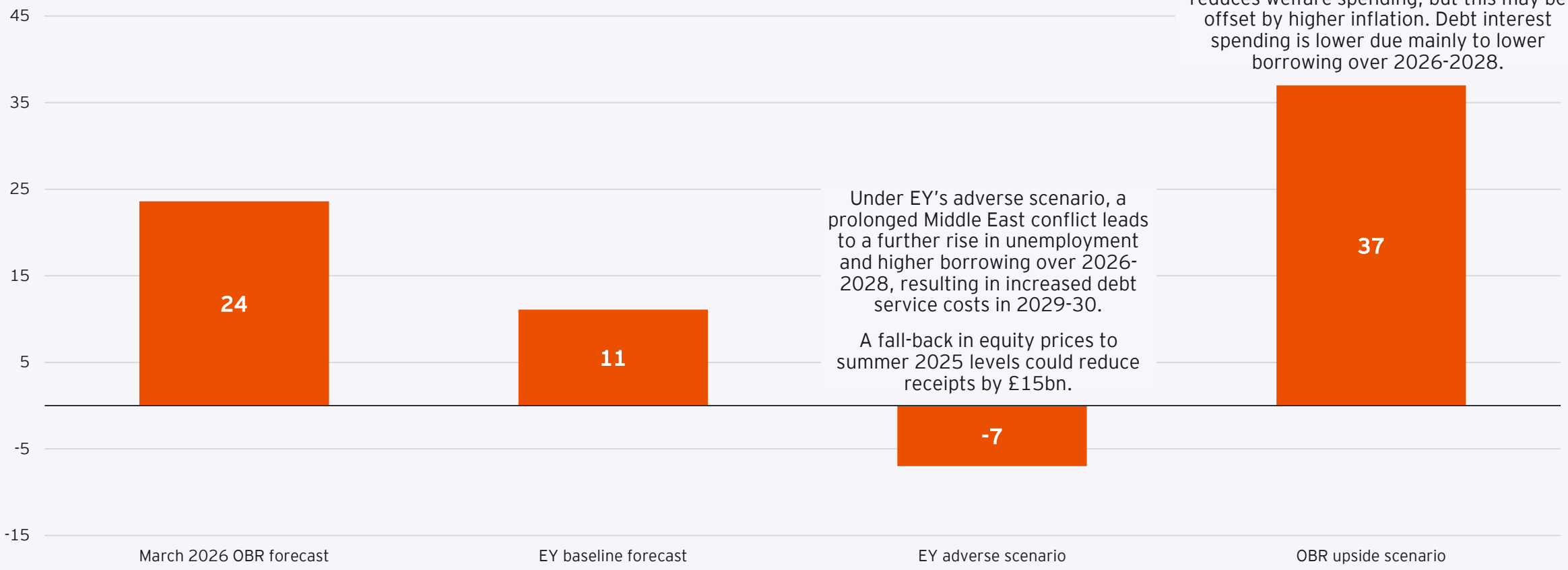


Source: NiGEM; EY calculations in OBR fiscal ready reckoner, using EY summer forecast and market interest rates

*Debt Management Office

An adverse scenario such as a protracted Middle East conflict could lead to missing the fiscal rule, whereas stronger growth could provide headroom for more ambitious policy options

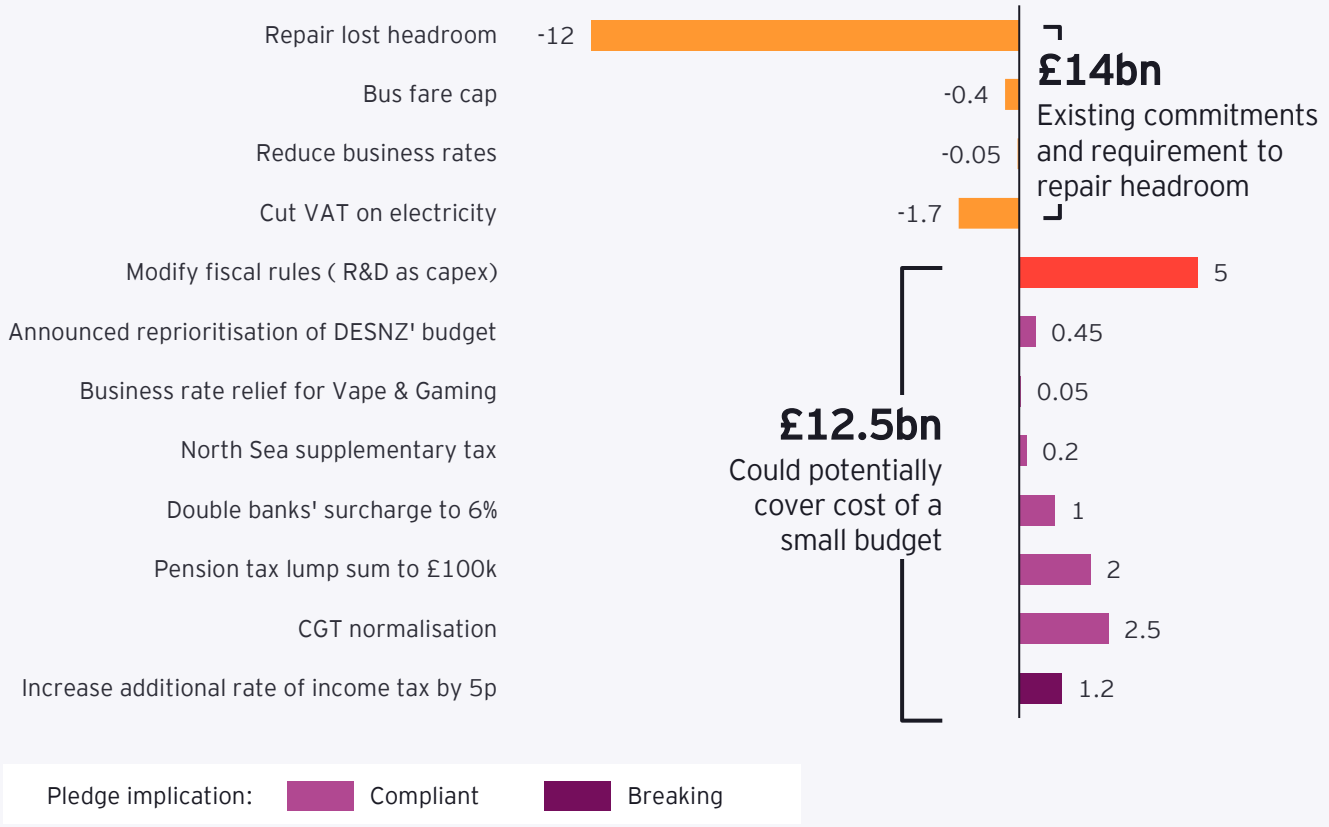
Current balance under alternative economic scenarios
£bn, current budget in 2029 – 2030



Source: NiGEM; EY calculations using OBR fiscal ready reckoner and OBR fiscal sensitivity analysis

The level of ambition will determine the size of spending, and a ‘small’ Budget can be funded largely with targeted revenue-raising choices

'Small Budget' spend items and potential revenue-raising
£bn



Given a volatile economic environment, we expect that the Chancellor will want to at least repair fiscal headroom, costing ~£12bn.

Commitments aimed at improving cost of living have already been announced.

Targeted revenue measures could repair headroom without increasing manifesto-protected taxes (except additional rate for high earners).

The Budget may therefore prioritise targeted measures now and defer larger tax decisions. This would:

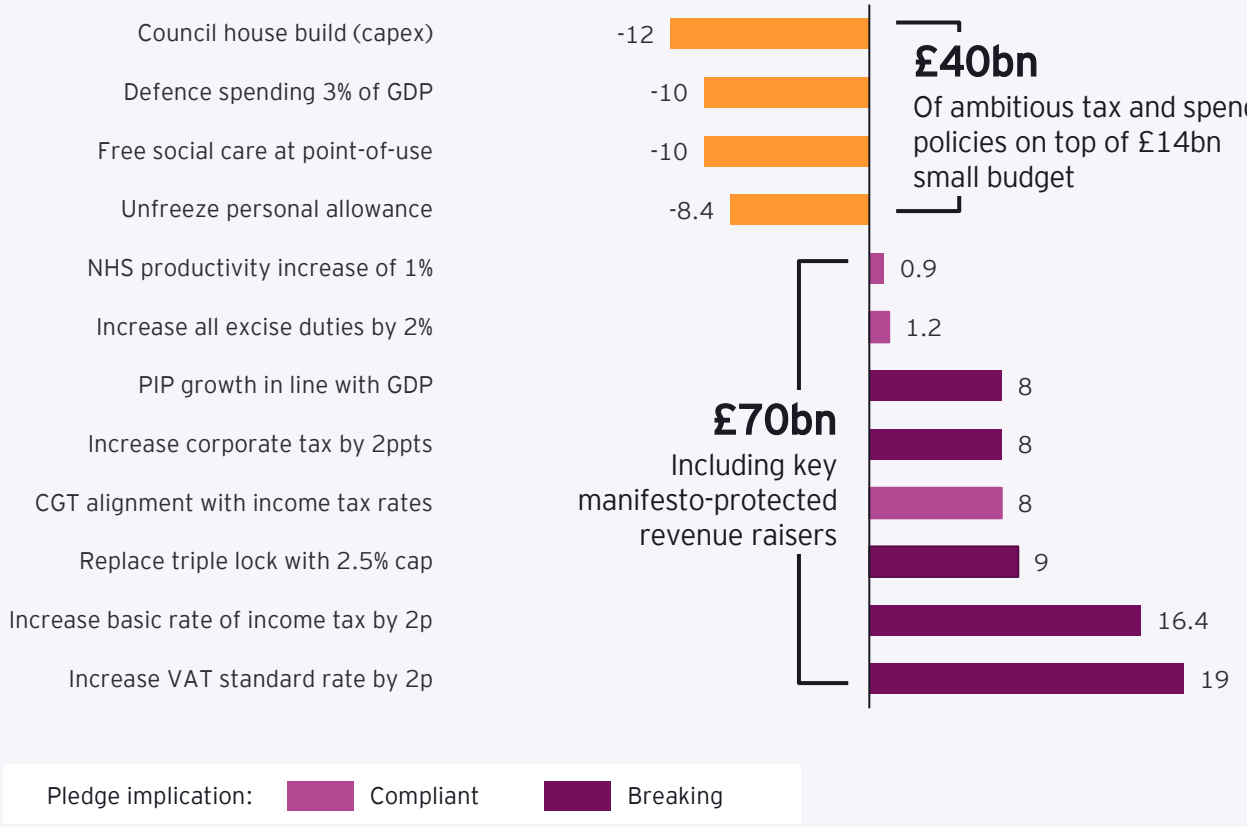
- Limit the immediate impact on households and businesses while economic conditions are uncertain.
- Preserve manifesto commitments against the main rates of income tax, NICs, VAT, and corporation tax.
- Defer tax rises in lockstep with implementation of major spending commitments.

Costings are illustrative impacts, some are pre-behaviour

Source: EY analysis, Gov.UK press notices, ONS (R&D expenditure data), IFS, OBR, HMRC tax ready reckoner.

Funding a ‘large’ Budget will require broad tax rises, including from some manifesto-protected policies like corporation, income, and value-added taxes

‘Large’ Budget additional spend items and potential revenue-raising
£bn



In addition to the ‘small’ Budget proposals, a more ambitious budget could add another £40bn of fiscal cost options. Of this, £8bn is a tax cut (unfreezing the personal allowance) and £32bn relate to public spending.

Of the spending increase, £12bn would be likely to be capex, and £20bn count against the current budget rule, which would need to be balanced by spending cuts and tax rises elsewhere.

We expect the Budget may signal a path towards these aims, without formally announcing them and funding their full cost immediately. This would:

- Limit immediate pressure on fiscal targets while growth, inflation, and borrowing costs remain uncertain.
- Preserve significant announcements for later in the Parliament.

Costings are illustrative impacts, some are pre-behaviour

Source: EY analysis, Health Foundation, IFS, NHS England Consolidated Accounts (staff costs data), DWP (Benefit & Expenditure Caseload data), Resolution Foundation, HMRC tax ready reckoner.

Rebuilding fiscal headroom will depend increasingly on stronger economic growth as spending pressures rise and the largest tax bases remain constrained

Limited room for manoeuvre

Since March, fiscal headroom may have tightened to c. £11bn. In addition, the Government is facing c. £43bn of increased ambitions; however, with 70% of receipts tied to manifesto-protected taxes, options for raising revenue are limited.

Targeted measures over major reform

The Budget will likely focus on moderate spending measures and targeted revenue raisers. More ambitious commitments on defence, social care or tax reductions may be signalled rather than fully funded, with larger decisions deferred until conditions improve.

Speculation set to intensify

With income tax, NICs, VAT and corporation tax largely off the table, attention is likely to shift to a small pool of viable levers. Wealth taxes, capital gains, duties and sector-specific levies are therefore likely to remain at the centre of policy speculation.

Growth remains the swing factor

Growth remains the single biggest factor in the fiscal outlook. Alongside fiscal measures, we can expect to see more detail on devolution and the 'Manchester model' of growth, measures to reduce energy costs, ongoing reform to the pension system to unlocking capital, plans for investment and adoption of AI, and on skills or training targeted at NEETs and so on.

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