Office for
Budget Responsibility

PRESS NOTICE

3 December 2014

Economic and fiscal outlook – December 2014

Budget deficit higher this year, but back to balance by 2018-19

Despite stronger growth, we have revised up our estimate of the budget deficit this year. But the budget is still forecast to be back in balance by 2018-19. The Government is on track to meet its fiscal mandate and the welfare cap, but not its supplementary debt target.

In headline terms, the UK economy has outperformed our March forecast, with GDP expected to grow by 3.0 per cent this year and unemployment already down to 6.0 per cent. But wage and productivity growth have once again disappointed, while national income and spending have outperformed most in those areas that yield least tax revenue.

For these and other reasons, this year has seen a sharp fall in the amount of tax raised for every pound of measured economic activity. As a result, despite strong economic growth, the budget deficit is expected to fall by only £6.3 billion this year to £91.3 billion, around half the decline we expected in March. That would be the second smallest year-on-year reduction since its peak in 2009-10, despite this being the strongest year for GDP growth.

GDP has increased more strongly this year than we expected in March, which has led us to increase our forecasts for growth in calendar years 2014 and 2015. But we still expect the quarterly pace of growth to slow into next year – and somewhat more so than in March – as consumer spending moves more into line with income growth. We have also revised down our forecasts for global GDP and trade growth. With unemployment falling more rapidly than we expected, we judge that there is less spare capacity in the economy than we forecast in March and therefore less scope for above-trend growth in the future as this spare capacity is used up. As a result, we have modestly revised down our forecasts for GDP growth in the later years of the forecast to between 2 and 2½ per cent a year, in line with the average of outside forecasts.

We have also revised our inflation forecast down significantly, due to lower-than-expected outturns in recent data and the effects of lower oil and food prices. We now expect CPI inflation to remain below the Bank of England’s 2 per cent target until 2017. Meaningful real wage growth is expected to resume in 2015, although the measure of real earnings in our forecast does not return to its pre-crisis level within the next five years. But that outcome is reliant on the most important uncertainty in our (and most people's) economy forecast: the timing and strength of the long-awaited return to sustained productivity growth.

Public sector net borrowing is expected to fall by 0.6 per cent of GDP this year, reaching 5.0 per cent – half the peak it reached in 2009-10. Looking further ahead, we expect the deficit to fall each year and – as in March – to reach a small surplus by 2018-19. Comparisons with our March forecast are complicated by methodological changes to the National Accounts that were implemented by the Office for National Statistics – and by other statistical agencies across Europe – over the summer. But on our best estimate of a like-for-like basis, borrowing is expected to be higher in the initial years of the forecast and slightly lower from 2016-17 than we thought in March. This reflects relatively large and broadly offsetting changes in the expected path of receipts and spending. In particular:

- receipts have been revised down by £7.8 billion in 2014-15, rising to £25.3 billion by 2018-19. Lower wage growth has reduced our income tax forecast and a variety of factors have reduced expected receipts from VAT and excise duties. Relative to GDP, tax receipts are expected to recover to their 2013-14 level towards the end of the forecast. This relies on an improvement in productivity boosting earnings growth and income tax receipts, although the Budget 2013 decision to abolish contracting out from National Insurance contributions will also raise the tax-to-GDP ratio significantly in 2016-17; and

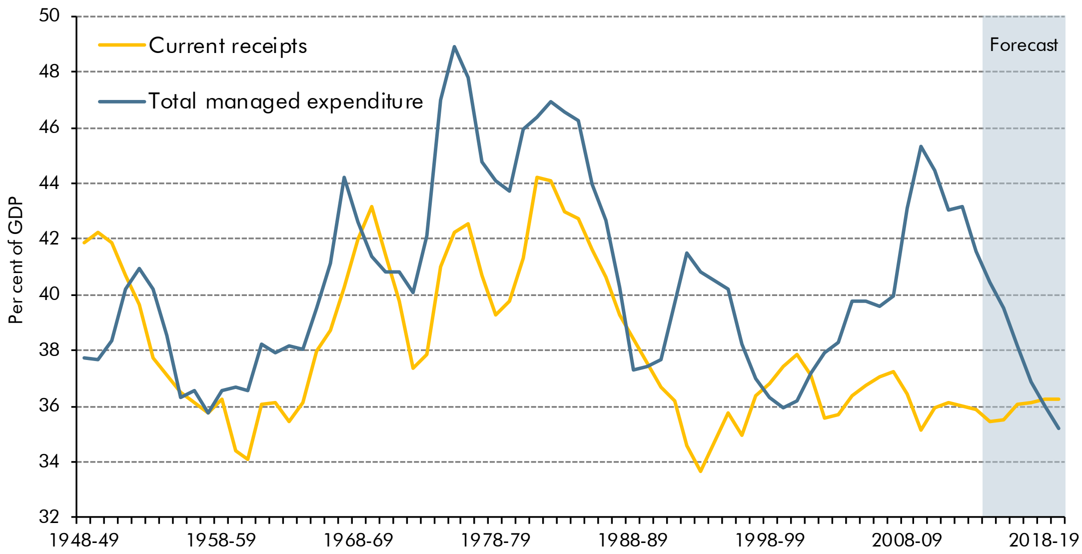
- public spending has been revised down by £2.0 billion in 2014-15 and by £7.7 billion in 2015-16, the final years for which the Government has set detailed spending plans. By 2018-19, the downward revision reaches £23.5 billion. This largely reflects lower debt interest payments, due to the fall in market interest rates since March. But the Government has also tightened the implied squeeze on departmental spending on public services from 2016-17 to the end of the forecast and of the next Parliament.

Autumn Statement 2014 policy measures reduce borrowing by £0.2 billion a year on average between 2014-15 and 2019-20. The giveaways – including the reform of stamp duty land tax and raising the income tax personal allowance – broadly offset the takeaways – particularly from banks (including Financial Conduct Authority fines this year, related to foreign exchange trading) and multinational companies. Additional funding for the NHS from the 2015-16 reserve has also been reflected in our forecast. The largest single-year effect of a Government decision comes via its new assumption for total spending in 2019-20, although this does not appear in the Treasury's table of policy decisions. This implies another cut in current spending by central government departments in that year equivalent to £14.5 billion (compared to holding spending flat as a share of potential GDP).

On the Government's latest plans and medium-term assumptions, we are now in the fifth year of what is projected to be a 10-year fiscal consolidation. Relative to GDP, the budget deficit has been halved to date, thanks primarily to lower departmental spending (both current and capital) and lower welfare spending. The tax-to-GDP ratio his risen little since 2009-10. Looking forward, the Government's policy assumption for total spending implies that the burden of the remaining consolidation would fall overwhelmingly on the day-to-day running costs of the public services – and more so after this Autumn Statement. Between 2009-10 and 2019-20, spending on public services, administration and grants by central government is projected to fall from 21.2 per cent to 12.6 per cent of GDP and from £5,650 to £3,880 per head in 2014-15 prices. Around 40 per cent of these cuts would have been delivered during this Parliament, with around 60 per cent to come during the next.

Total public spending is projected to fall to 35.2 per cent of GDP in 2019-20, taking it below the previous post-war lows reached in 1957-58 and 1999-00 to what would probably be its lowest level in 80 years. Receipts are projected to end the forecast broadly in line with their average share of GDP over the past 20 years.

Chart A: Total public spending and receipts



Source: ONS, OBR

On our central forecast, the Coalition Government is on track to meet its fiscal mandate – to borrow only what it needs to pay for investment, adjusting for the state of the economy, at the end of the five-year forecast – with £50.6 billion to spare. It remains on course to miss its supplementary target, to have net debt falling as a share of GDP in 2015-16.

In our first formal assessment, we judge that the Government is on course to keep spending on social security and tax credits (excluding the state pension and those benefits that vary most with the state of the economy) within the permitted margins of the 'welfare cap' it set in the Budget.

Parliament requires that our forecasts reflect the current policies of the current Government, but those policies could change. The two member parties of the Coalition have already said that they would follow different policies if either was to govern alone after the election. The Conservatives have said they would look to cut welfare spending by more, so that they could cut public services by less. And the Liberal Democrats have said that they would be willing to borrow more to finance capital spending that would increase growth, and also to increase taxes on the relatively well-off. Labour has said that it would "*balance the books and deliver a surplus on the current budget and falling national debt in the next Parliament. How fast we can go will depend on the state of the economy and the public finances we inherit.*"

Notes

1. The Office for Budget Responsibility is the UK's independent fiscal watchdog – responsible for producing forecasts for the economy and the public finances, assessing progress against the Government's fiscal targets, and reporting on long-term fiscal sustainability.

2. All of the documents published by the OBR today are available on our website at: http://budgetresponsibility.org.uk/

3. The OBR will release supplementary information on the *Economic and fiscal outlook* on 26 March in response to requests received by 23 March. We will release a list of any information to be published at 9.30am on 25 March.

4. Questions about the *Economic and fiscal outlook* should be sent to OBRpress@obr.gsi.gov.uk.

Table A: Overview of OBR December 2014 economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2013	2014	2015	2016	2017	2018	2019
Output at constant market prices							
Gross domestic product (GDP)	1.7	3.0	2.4	2.2	2.4	2.3	2.3
GDP levels (2013=100)	100.0	103.0	105.5	107.8	110.4	112.9	115.5
Output gap	-2.2	-1.0	-0.5	-0.5	-0.2	-0.1	0.0
Expenditure components of GDP							
Household consumption	1.6	2.3	2.8	2.2	2.4	2.3	2.4
General government consumption	0.7	1.1	-0.4	-0.8	-0.9	-0.3	0.0
Business investment	4.8	7.7	8.4	6.3	6.3	6.3	6.3
General government investment	-7.3	2.1	3.3	1.6	2.2	1.6	2.3
Net trade[1]	0.0	-0.2	-0.5	-0.1	-0.1	-0.1	-0.2
Inflation							
CPI	2.6	1.5	1.2	1.7	2.0	2.0	2.0
Labour market							
Employment (millions)	30.0	30.7	31.2	31.4	31.5	31.6	31.7
Average earnings	1.8	1.8	2.0	3.1	3.9	3.9	3.8
LFS unemployment (% rate)	7.6	6.2	5.4	5.2	5.3	5.3	5.3
Claimant count (millions)	1.42	1.04	0.84	0.83	0.84	0.85	0.86
	Changes since March forecast						
Output at constant market prices							
Gross domestic product (GDP)	0.0	0.3	0.1	-0.4	-0.2	-0.1	-
GDP levels (2013=100)	0.0	0.3	0.3	0.0	-0.3	-0.4	-
Output gap	0.0	0.4	0.6	0.3	0.1	-0.1	-
Expenditure components of GDP							-
Household consumption	-0.7	0.2	1.0	-0.3	-0.2	0.0	-
General government consumption	-0.2	-0.1	0.1	0.5	0.9	0.6	-
Business investment	6.0	-0.2	-0.8	-1.7	-2.4	-1.3	-
General government investment	-0.9	-8.6	2.3	-0.6	1.3	2.1	-
Net trade	-0.1	0.0	-0.6	-0.1	-0.1	-0.1	-
Inflation							-
CPI	0.0	-0.3	-0.8	-0.3	0.0	0.0	-
Labour market							-
Employment (millions)	0.1	0.4	0.5	0.5	0.3	0.2	-
Average earnings	0.3	-0.7	-1.2	-0.5	0.1	0.1	-
LFS unemployment (% rate)	0.0	-0.6	-1.2	-0.9	-0.4	0.0	-
Claimant count (millions)	0.00	-0.16	-0.29	-0.23	-0.14	-0.09	-

[1] Contribution to GDP growth.

Table B: Public sector net borrowing: change since March forecast

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
March 2014 underlying PSNB (ESA95)	**107.8**	**95.5**	**75.2**	**44.5**	**16.5**	**-4.8**	
APF effect	12.2	11.6	6.9	2.9	-1.3	-3.7	
March 2014 headline PSNB (ESA95)	**95.6**	**83.9**	**68.3**	**41.5**	**17.8**	**-1.1**	
Changes due to implementation of ESA10 and the ONS PSF review							
Total	**3.6**	**2.5**	**0.0**	**-0.1**	**-2.0**	**-2.5**	
Of which:							
Receipts	-0.9	-4.7	-9.8	-13.9	-15.9	-16.8	
AME spending	*4.5*	*7.3*	*9.8*	*13.8*	*13.9*	*14.2*	
March 2014 headline PSNB (ESA10)	99.3	86.4	68.3	41.5	15.8	-3.7	
Forecast changes and consequences for implied government spending							
Forecast changes since March 2014	**-1.7**	**5.8**	**6.6**	**-0.1**	**0.8**	**1.8**	
Of which:							
Receipts forecast	-1.6	7.8	14.3	18.9	22.7	25.3	
Spending forecast	-0.1	-2.0	-7.7	-19.0	-21.9	-23.5	
Of which:							
AME	*-2.5*	*-1.3*	*-9.3*	*-11.9*	*-15.9*	*-19.2*	
DEL plans	*2.4*	*-0.7*	*1.6*				
Changes to implied total DEL from applying Budget 2014 spending policy assumptions post 2015-16				*-7.1*	*-6.0*	*-4.3*	
December 2014 before effects of Government decisions	**97.5**	**92.1**	**74.9**	**41.3**	**16.6**	**-1.9**	**-6.5**
Changes due to Government decisions							
Autumn Statement policy measures	0.0	-0.9	1.0	-0.1	-0.4	-0.5	-0.4
Effect of applying new Autumn Statement spending policy assumptions post 2015-16[1]				-0.4	-1.6	-1.7	-16.2
December 2014 headline PSNB (ESA10)	97.5	91.3	75.9	40.9	14.5	-4.0	-23.1
Change since March on a like-for-like basis	**-1.7**	**4.9**	**7.7**	**-0.6**	**-1.3**	**-0.3**	
Memo: December 2014 implied on ESA95	*101.2*	*93.8*	*76.0*	*40.8*	*12.6*	*-6.6*	

[1]The additional tightening in 2019-20 of £14.5 billion is relative to a baseline that assumes current spending by departments would otherwise have remained constant as a share of potential GDP.