

Economic and fiscal outlook - December 2012

Government borrowing revised higher as weaker economy hits revenues

The OBR has revised up its forecasts for public sector borrowing over the next five years, as a weaker outlook for the economy reduces tax revenues. As a result the Government no longer seems likely to achieve its target of reducing public sector net debt in 2015-16

The economy has performed less strongly this year than we expected at the time of our last forecast in March, primarily reflecting the weakness of net exports. Looking forward, the recovery still lacks momentum. We now expect a small fall in GDP in the fourth quarter of this year, followed by a gradual pick-up next year. GDP is forecast to fall by 0.1 per cent in 2012 and then to grow by 1.2 per cent in 2013.

We are more pessimistic about the economy's medium term growth prospects than we were in March. We expect weak productivity to constrain nominal earnings growth for longer, with a slower fall in inflation delaying the pick-up in real incomes. The outlook for the world economy and UK exports has deteriorated and we expect the difficulties of the euro area to depress confidence and put upward pressure on bank funding costs for longer. Investment is likely to be restrained by poor credit conditions and uncertainty about demand.

Our central forecast is for the economy to grow by 2 per cent in 2014, 2.3 per cent in 2015, 2.7 per cent in 2016 and 2.8 per cent in 2017. This would leave real GDP 3.2 per cent lower in 2016 than we forecast in March. But most of this downward revision is assumed to be cyclical – and therefore eventually reversible – rather than structural and permanent. We have revised down our forecasts for nominal GDP slightly more than our forecasts for real GDP, as we expect whole economy inflation to be lower in the medium term than we assumed in March.

Public sector net borrowing (PSNB) is forecast at £108 billion or 6.9 per cent of GDP this year, excluding the transfer of the Royal Mail's historic pension deficit and associated assets into the public sector. This is £11 billion less than we forecast in March, primarily reflecting the decision to transfer balances from the Bank of England's Asset Purchase Facility (APF) to the Exchequer. Other receipts are likely to be weaker than we expected, although we assume that the Government will raise an extra £3.5 billion from the 4G spectrum auction (which will score as negative capital spending). We assume that central and local government will once again significantly underspend against their budgets.

PSNB is then forecast to decline to £31 billion or 1.6 per cent of GDP by 2017-18, a smaller and slower improvement than in March – mainly because the weaker outlook for the economy will reduce expected tax receipts. Receipts are expected to remain broadly flat at around 38 per cent of GDP over the forecast, with spending falling from 43.1 per cent this year to 39.5 per cent in 2017-18.

Our forecast includes the impact of the policy measures announced in the Autumn Statement. Auctioning spectrum reduces borrowing this year, with 'giveaways' and 'takeaways' broadly offsetting each other through to 2016-17. Cuts in non-investment spending then extend into 2017-18 for the first time, reducing borrowing by a little over 1 per cent of GDP in that year. As regards the economy, we expect the Autumn Statement measures to deliver a small boost to growth over the next two years, partially reversed thereafter.

The decision to transfer surpluses and deficits generated by the APF to the Treasury means they will be reflected in the public finances on an ongoing basis. This will reduce PSNB and public sector net debt (PSND) through to 2016-17, given our assumptions for the future of quantitative easing (QE) and the way the ONS might treat these flows. But as monetary policy tightens and QE is unwound, PSNB will be higher thereafter and the reduction in PSND partially unwound. We estimate that QE will eventually result in a relatively small net reduction in the level of PSND.

We now expect PSND to peak at 79.9 per cent of GDP in 2015-16, compared to a peak of 76.3 per cent of GDP in 2014-15 in our March forecast. PSND is pushed higher as a share of GDP by weaker nominal GDP growth, higher net borrowing, and the reclassification of Bradford and Bingley plc and Northern Rock (Asset Management) into central government. These upward pressures are partially offset by the impact of the APF transfers and our forecast that the Debt Management Office will continue to sell gilts at a premium to nominal value.

The Government now appears more likely than not to miss its 'supplementary target', which requires PSND to fall as a share of GDP between 2014-15 and 2015-16. We now predict that PSND will rise by 1 per cent of GDP in 2015-16, falling by 0.8 per cent a year later. In the absence of the reclassifications and APF transfers, we estimate that PSND would be stable as a share of GDP between 2015-16 and 2016-17, and then fall in 2017-18.

The Government's 'fiscal mandate' requires it to balance the cyclically-adjusted current budget (CACB) at the end of a rolling five-year period, now 2017-18. Our central forecast shows the CACB in surplus by 0.9 per cent of GDP in 2017-18, implying that the Government is more likely than not to meet the mandate. This is a result of the additional year of cuts in non-investment spending. The CACB is also expected to be in surplus by 0.4 per cent of GDP in 2016-17, although this largely reflects the bank reclassifications and APF transfers.

There is huge uncertainty around all public finance projections, especially over this time horizon. We stress test the Government's chances of achieving its targets using sensitivity and scenario analysis. A key risk is that potential output turns out to be lower at the end of the forecast than we currently assume.

Table A: Overview of OBR December 2012 economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn 2011	2012	2013	Forecast ¹ 2014 2015 2016 2017			
Output at constant market prices							
Gross domestic product (GDP)	0.9	-0.1	1.2	2.0	2.3	2.7	2.8
GDP Level (2011 = 100)	100.0	99.9	101.1	103.2	105.6	108.4	111.4
Output gap (per cent of potential output)	-2.7	-3.1	-3.5	-3.3	-3.0	-2.5	-1.9
Expenditure components of GDP at constant market prices							
Household consumption ²	-0.9	0.5	0.9	1.6	1.8	2.4	2.9
Business investment	2.9	3.8	4.9	8.1	10.2	10.1	9.5
General government consumption	0.2	2.4	-0.7	-1.4	-1.2	-2.1	-3.0
General government investment	-20.4	-9.2	-2.5	4.8	-3.0	-2.6	0.7
Net trade ³	1.2	-0.6	0.3	0.2	0.2	0.2	0.1
Inflation							
CPI	4.5	2.8	2.5	2.2	2.0	2.0	2.0
Labour market							
Employment (millions)	29.2	29.5	29.6	29.7	29.9	30.2	30.4
Average earnings ⁴	2.2	2.7	2.2	2.8	3.7	4.0	4.0
ILO unemployment (% rate)	8.1	8.0	8.2	8.2	8.0	7.6	7.1
Claimant count (millions)	1.53	1.59	1.66	1.69	1.63	1.53	1.43
Changes since March forecast							
Output at constant market prices							
Gross domestic product (GDP)	0.1	-0.9	-0.8	-0.7	-0.7	-0.4	
GDP Level (2011 = 100)	0.0	-0.9	-1.7	-2.4	-3.2	-3.7	
Output gap (per cent of potential output)	0.0	-0.4	-0.9	-1.2	-1.7	-2.0	
Expenditure components of GDP at constant market prices							
Household consumption ²	0.0	0.0	-0.5	-0.8	-1.2	-0.6	
Business investment	2.7	3.1	-1.5	-0.7	-0.1	0.0	
General government consumption	-0.1	1.8	0.4	0.7	1.6	0.5	
General government investment	-7.3	-4.2	1.1	4.7	-3.3	-1.2	
Net trade ³	0.0	-1.1	-0.2	-0.2	-0.1	0.0	
Inflation							
CPI	0.0	0.0	0.6	0.2	0.0	0.0	
Labour market							
Employment (millions)	0.0	0.4	0.4	0.3	0.2	0.2	
Average earnings ⁴	1.0	0.1	-0.9	-1.6	-0.7	-0.6	
ILO unemployment (% rate)	0.0	-0.7	-0.4	0.2	0.8	1.3	
Claimant count (thousands)	2	-62	22	166	275	340	

¹ The forecast is consistent with the second estimate of GDP data for the third quarter of 2012, released by the Office for National Statistics on 27th November 2012.

² Includes households and non-profit institutions serving households.

³ Contribution to GDP growth, percentage points.

⁴ Wages and salaries divided by employees.

Table B: Overview of OBR December 2012 fiscal forecast

	Per cent of GDP						
	Outturn			Forecast			
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Public sector net borrowing	7.9	5.1	6.1	5.2	4.2	2.6	1.6
Cyclically-adjusted net borrowing	6.0	3.0	3.8	2.9	2.0	0.9	0.3
Surplus on current budget	-6.2	-5.7	-4.6	-3.7	-2.9	-1.4	-0.4
Fiscal mandate and supplementary target							
Cyclically-adjusted surplus on current budget	-4.3	-3.6	-2.2	-1.4	-0.8	0.4	0.9
Public sector net debt ¹	66.4	74.7	76.8	79.0	79.9	79.2	77.3
Changes since March forecast							
Public sector net borrowing	-0.3	-0.7	0.2	0.9	1.3	1.6	-
Cyclically-adjusted net borrowing	-0.4	-1.0	-0.4	0.0	0.1	0.2	-
Surplus on current budget	0.3	0.4	-0.1	-0.7	-1.2	-1.5	-
Cyclically-adjusted surplus on current budget	0.3	0.6	0.5	0.2	-0.1	-0.1	-
Public sector net debt ¹	-0.9	2.8	1.8	2.6	3.9	4.9	-
Memo: PSNB excluding Royal Mail transfer	7.9	6.9	6.1	5.2	4.2	2.6	1.6

¹ Debt at end March; GDP centred on end March.

Table C: Public sector net borrowing: changes since previous forecast

	£ billion					
	Outturn		Forecast			
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
March forecast	126.0	91.9	98	75	52	21
December forecast	121.4	80.5	99	88	73	49
Change	-4.6	-11.4	1.8	12.9	21.3	27.9
<i>of which:</i>						
Forecast changes	-4.6	4.4	13.6	23.0	29.1	36.0
Policy measures	0.0	-4.0	0.9	0.9	0.9	-0.3
APF transfers	0.0	-11.5	-12.3	-10.6	-8.0	-6.6
B&B/NRAM classification	-	-0.4	-0.5	-0.4	-0.8	-1.1
Memo: March EFO PSNB ex Royal Mail	126.0	119.9	97.5	75.0	52.0	21.1
Memo: PSNB excluding Royal Mail	121.4	108.5	99.3	87.9	73.3	49.0
Memo: PSNB ex Royal Mail and APF	121.4	119.9	111.6	98.6	81.2	55.6
Memo: PSNB ex RM, B&B, NRAM and APF	-	120.3	112.1	99.0	82.0	56.7

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, judging progress towards 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: www.budgetresponsibility.independent.gov.uk
3. Where possible the OBR will release supplementary information on the *Economic and fiscal outlook* at 9.30am on 11 December, in response to requests received

by noon on 7 December. We will release a list of the information to be published at 9.30 am on 10 December. Subsequently, we will continue with our standard policy of releasing supplementary information monthly on the day of the HMT/ONS Public Sector Finances release.

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

For questions on the *Economic and fiscal outlook* – Tom Josephs on 020 7271 2408 or 07733 034066, or

For questions on today's press conference – Mark Dembowicz on 020 7271 2442 or 07827 914326