

Office for
**Budget
Responsibility**

July 2021 Fiscal risks report

The live event will begin at 11.00

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Responsibility**

July 2021 Fiscal risks report

Richard Hughes
Chairman

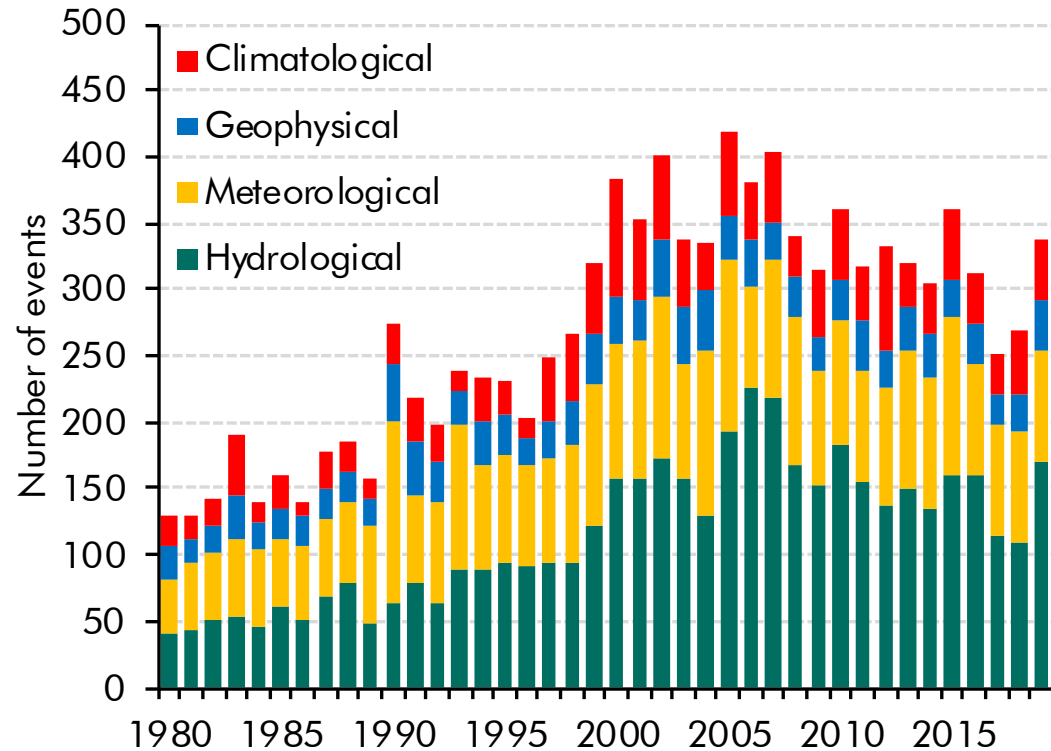
London
6 July 2021

Background on the Fiscal risks report

- **OBR tasked with producing biennial *Fiscal risks report (FRR)* in 2015**
- **2017 & 2019 FRRs took an 'encyclopaedic' approach to cataloguing 97 risks**
- **2020 saw crystallisation of biggest fiscal risk in peacetime**
- **2021 FRR shifts the focus to three potentially catastrophic risks**
 - Coronavirus pandemic (Chapter 2)
 - Climate change (Chapter 3)
 - Cost of public debt (Chapter 4)
 - Update on 97 other risks (Chapter 5)
- **Thanks OBR staff, HMT, Bank of England, Departments, & Think Tanks**

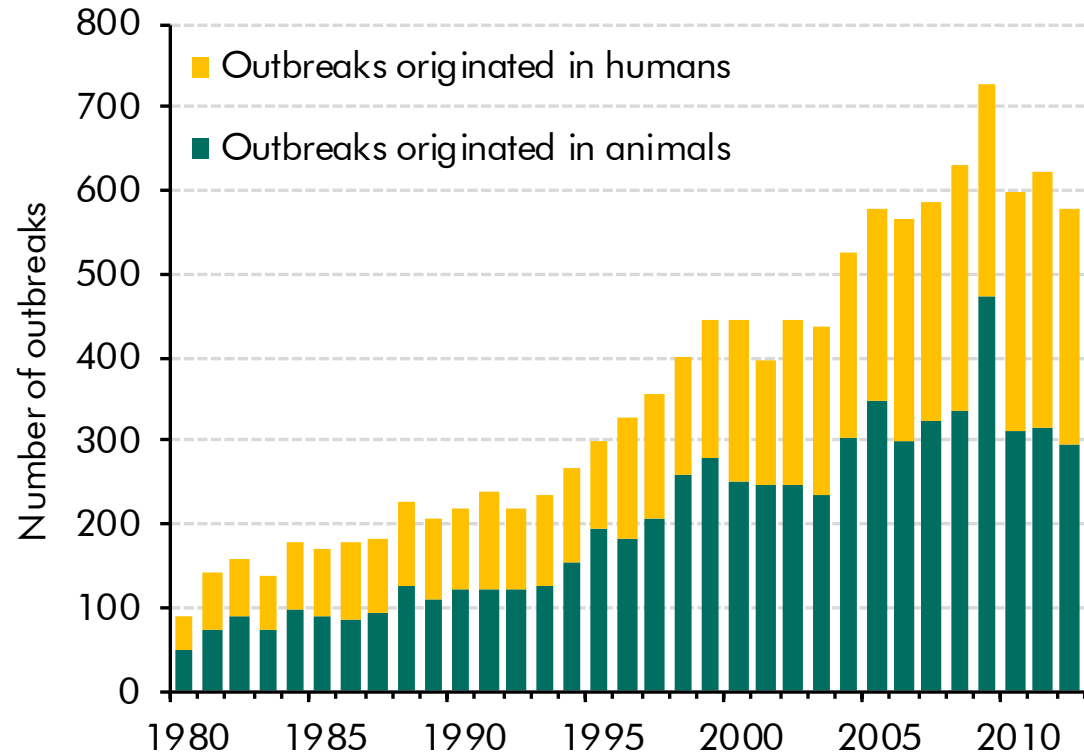
Is the world becoming a riskier place?

Natural disasters



Source: The Emergency Events Database

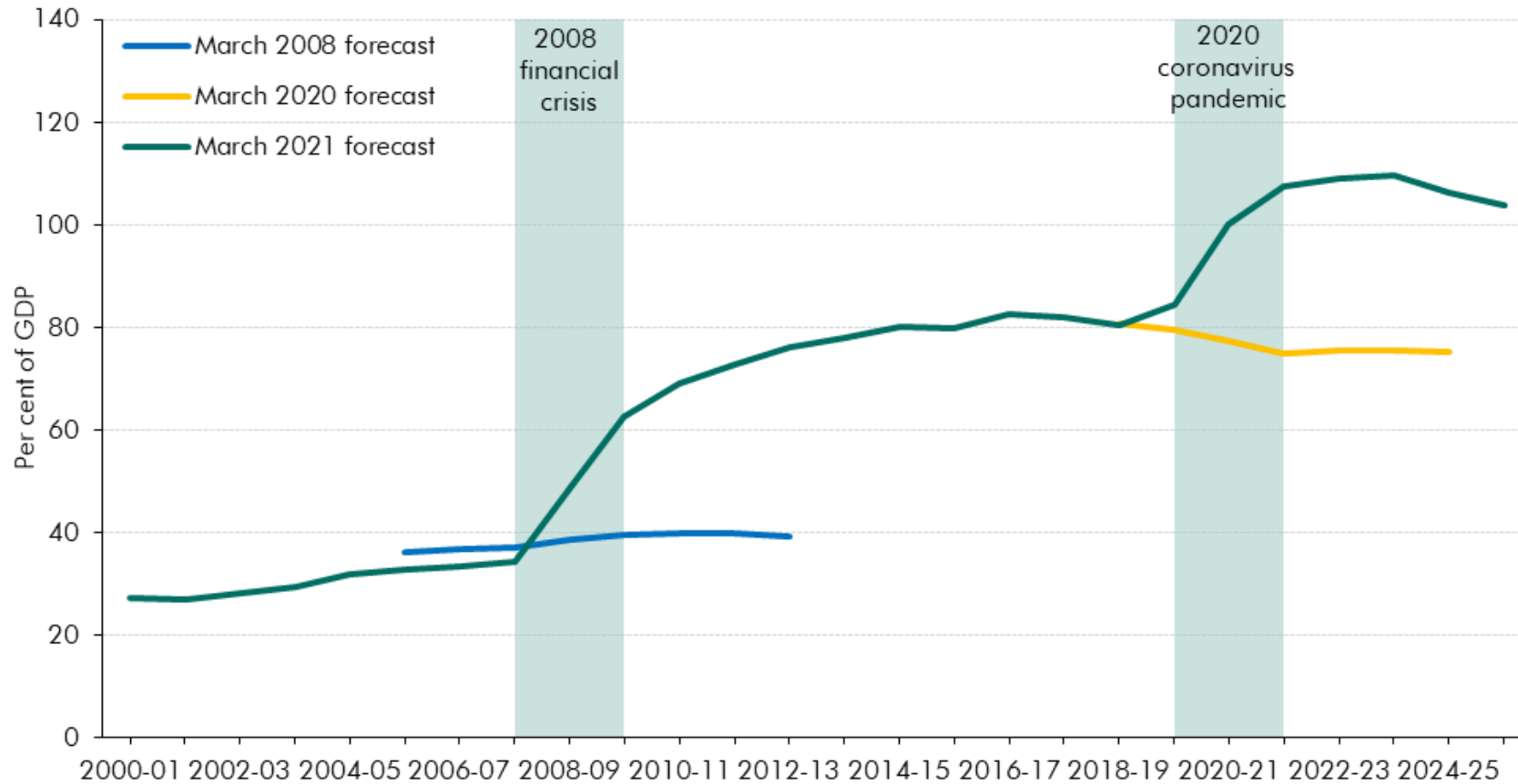
Infectious disease outbreaks



Source: KF Smith et al. (2014)

Are governments more exposed to risks?

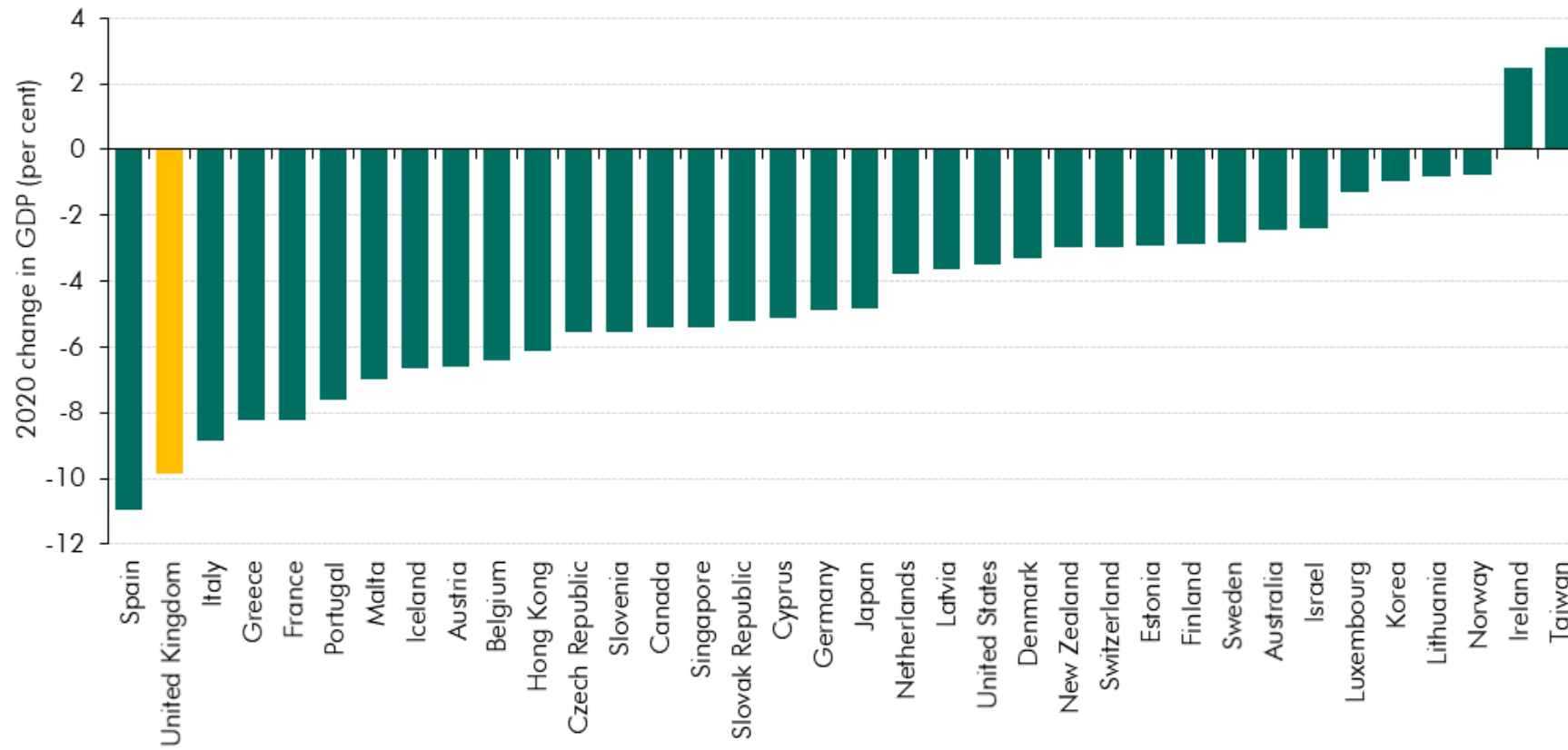
Public sector net debt



Source: ONS, OBR

Coronavirus economic impact

Change in real GDP in 2020 in advanced economies

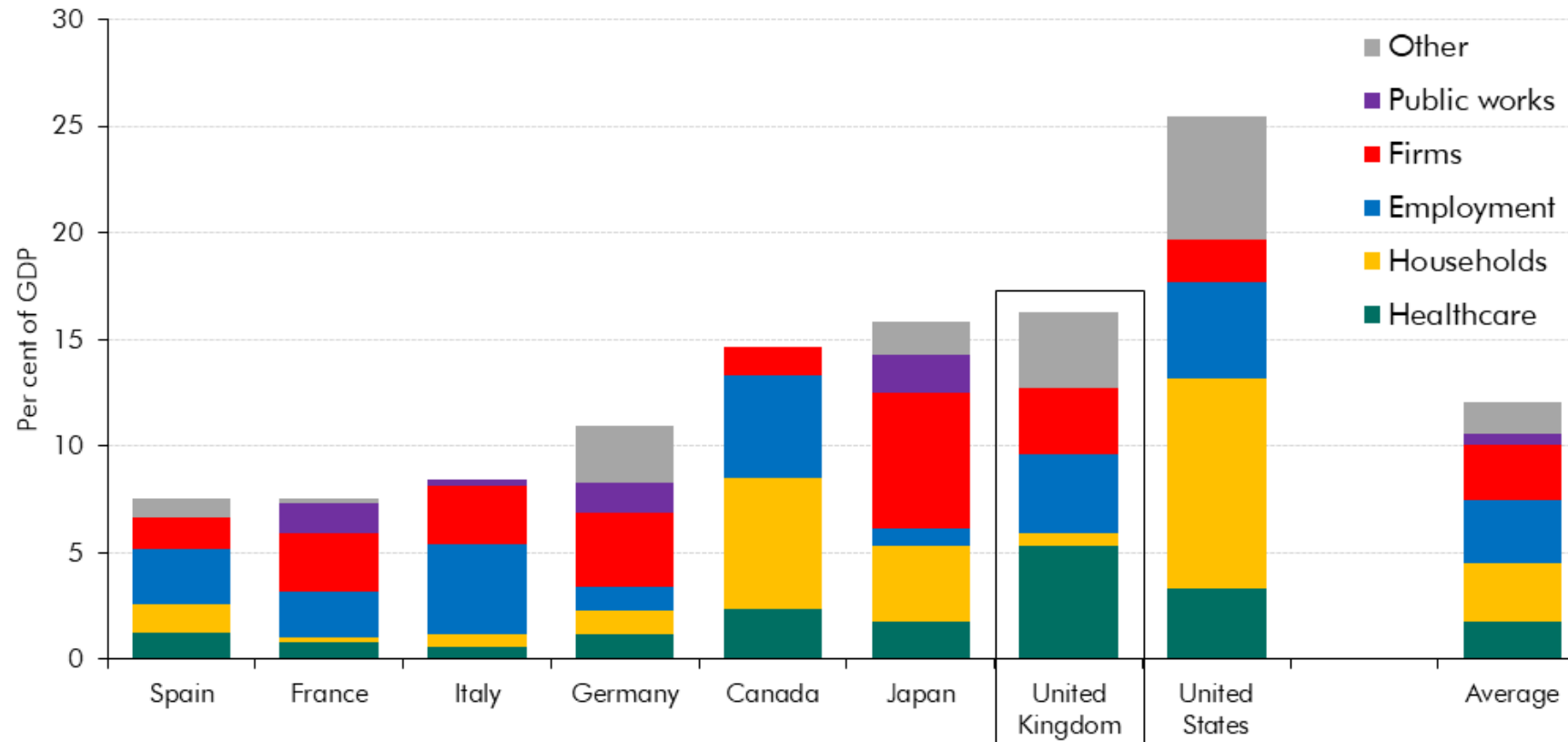


Note: Based on IMF definition of advanced economies.

Source: IMF, ONS

Coronavirus fiscal rescue packages

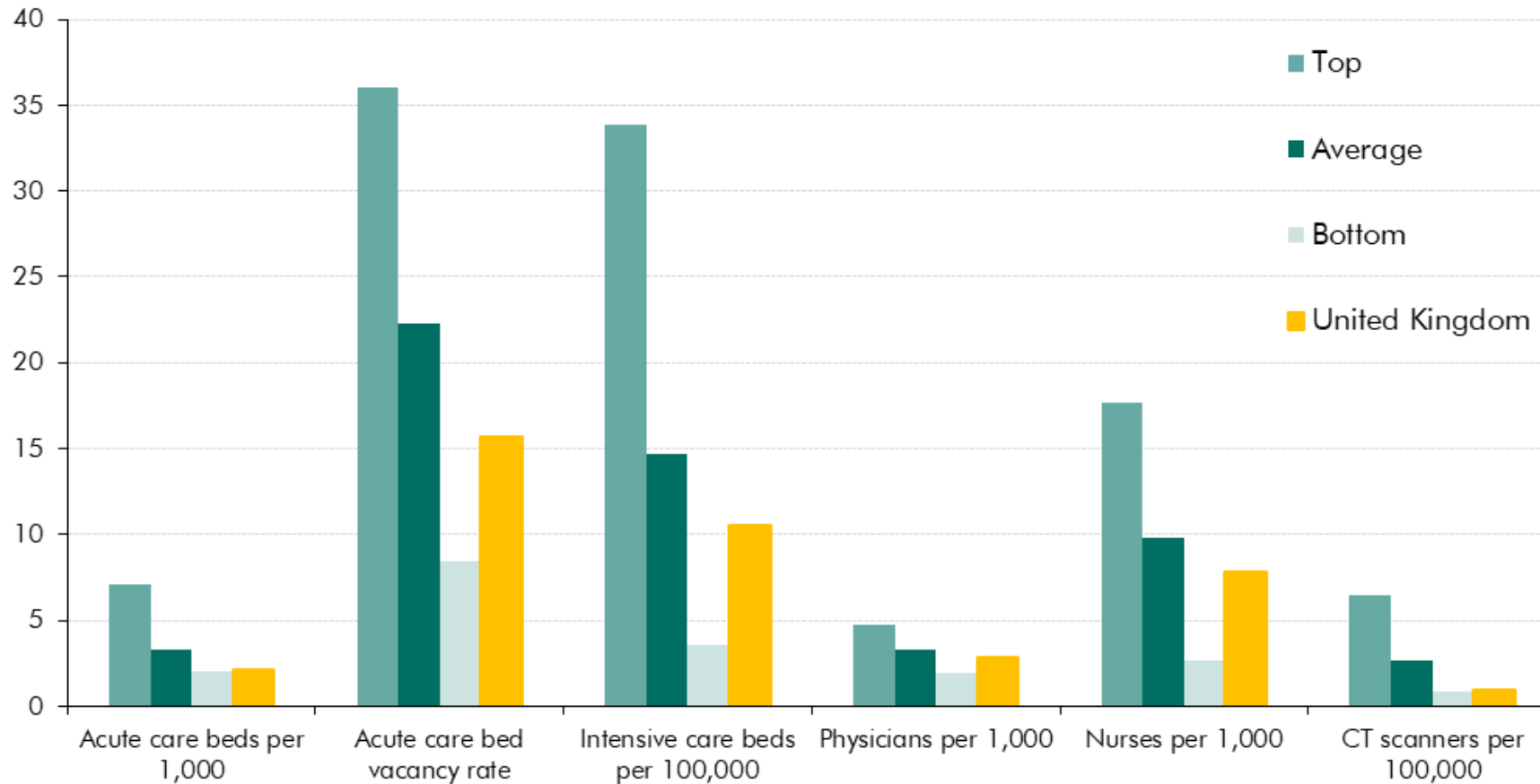
Fiscal support by recipient for selected advanced economies



Source: IMF, OBR

Health system capacity in OECD countries

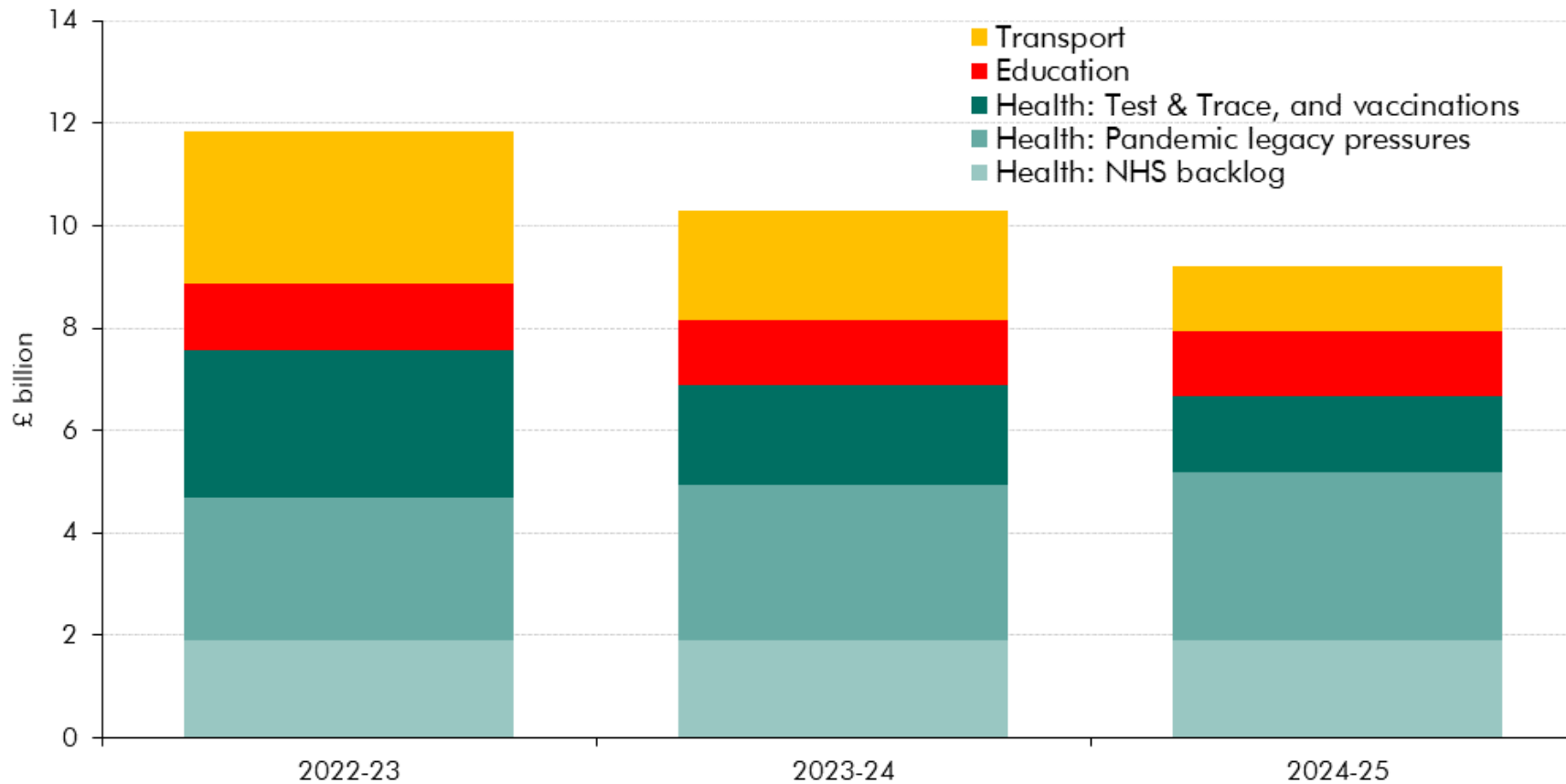
Indicators of health system capacity in OECD countries



Source: OECD, OBR

Coronavirus legacy spending pressures

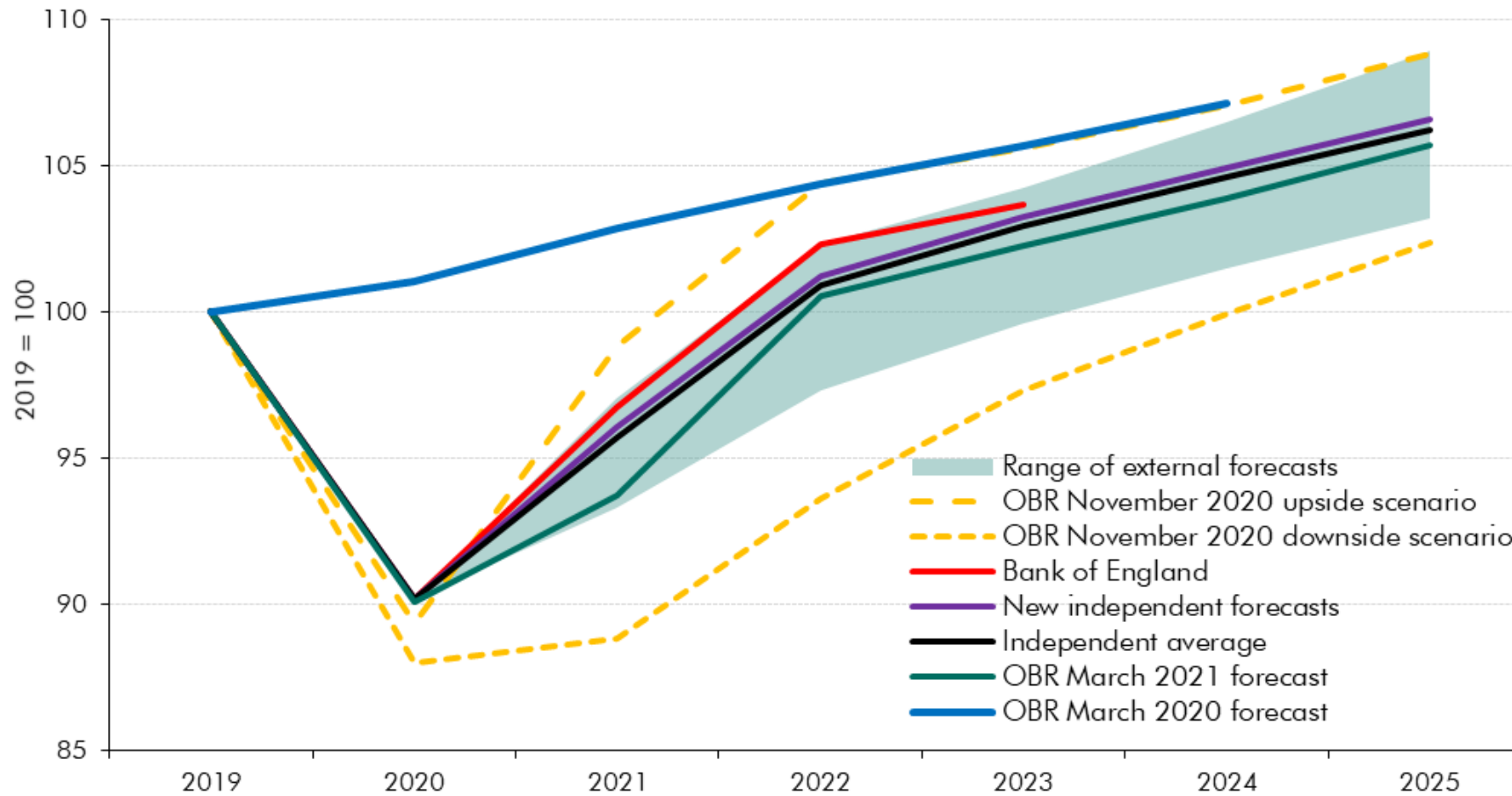
Pandemic-related pressures on departmental resource spending



Source: OBR

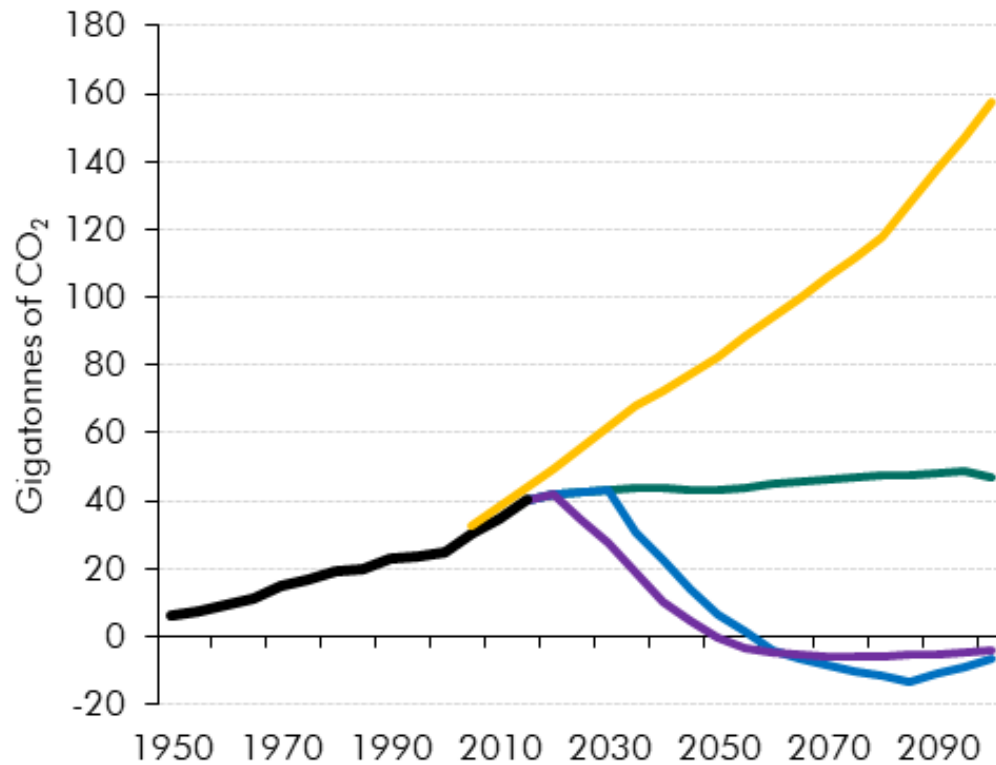
Coronavirus economic legacy

Comparison of GDP forecasts

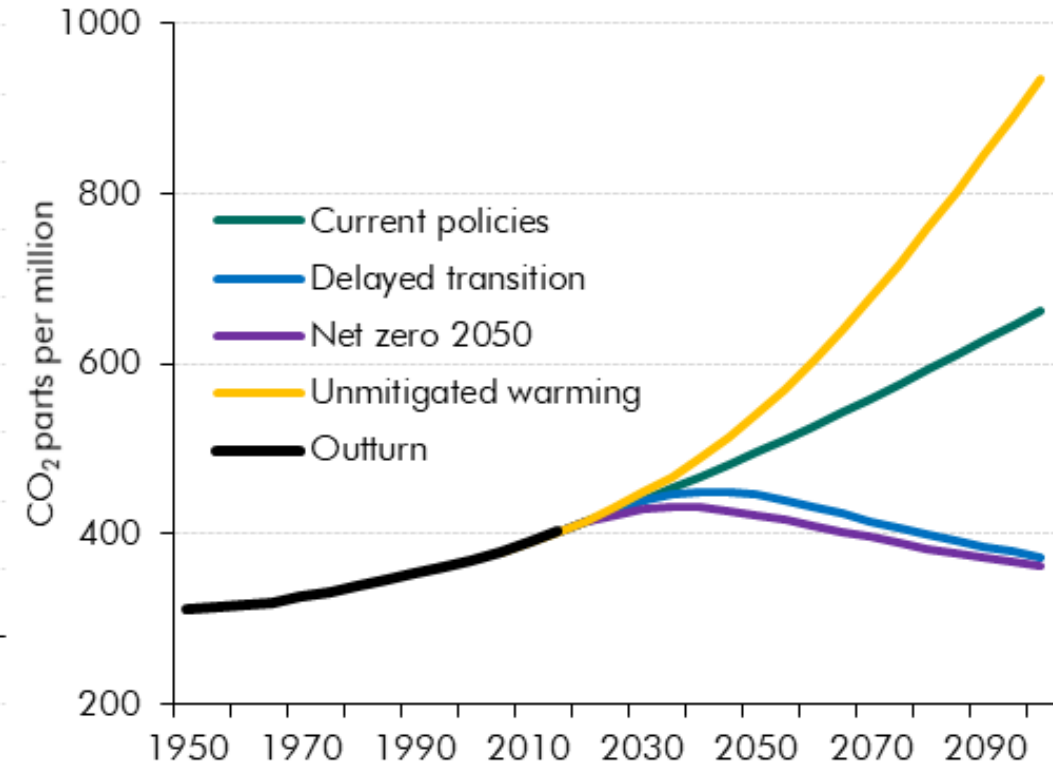


Global CO₂ emissions and temperatures

Global carbon dioxide emissions



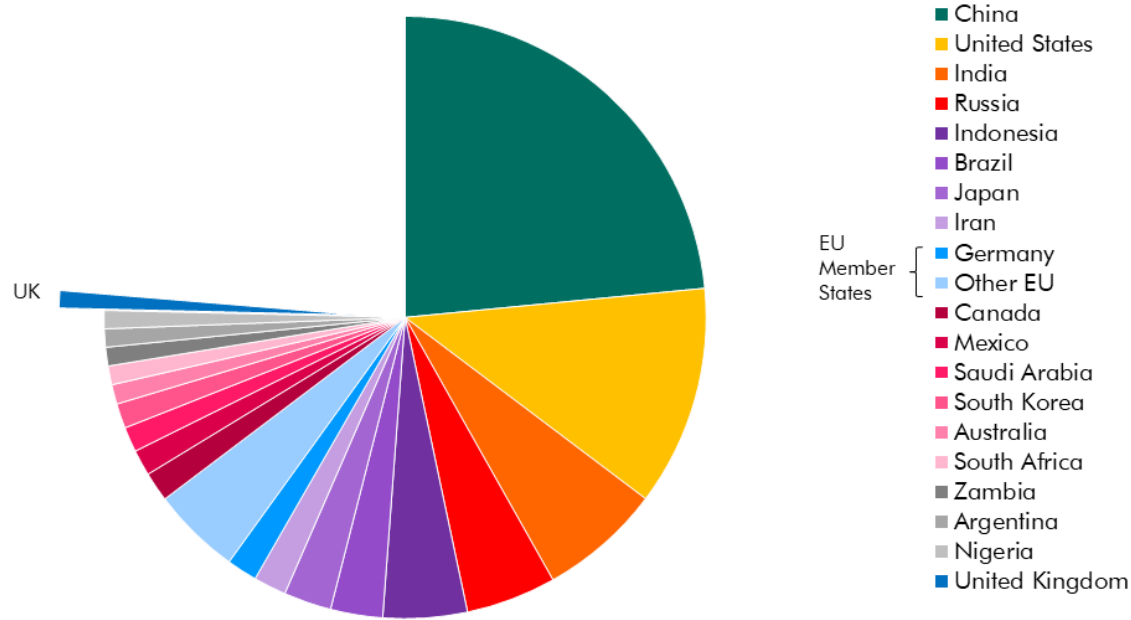
Atmospheric concentrations of CO₂



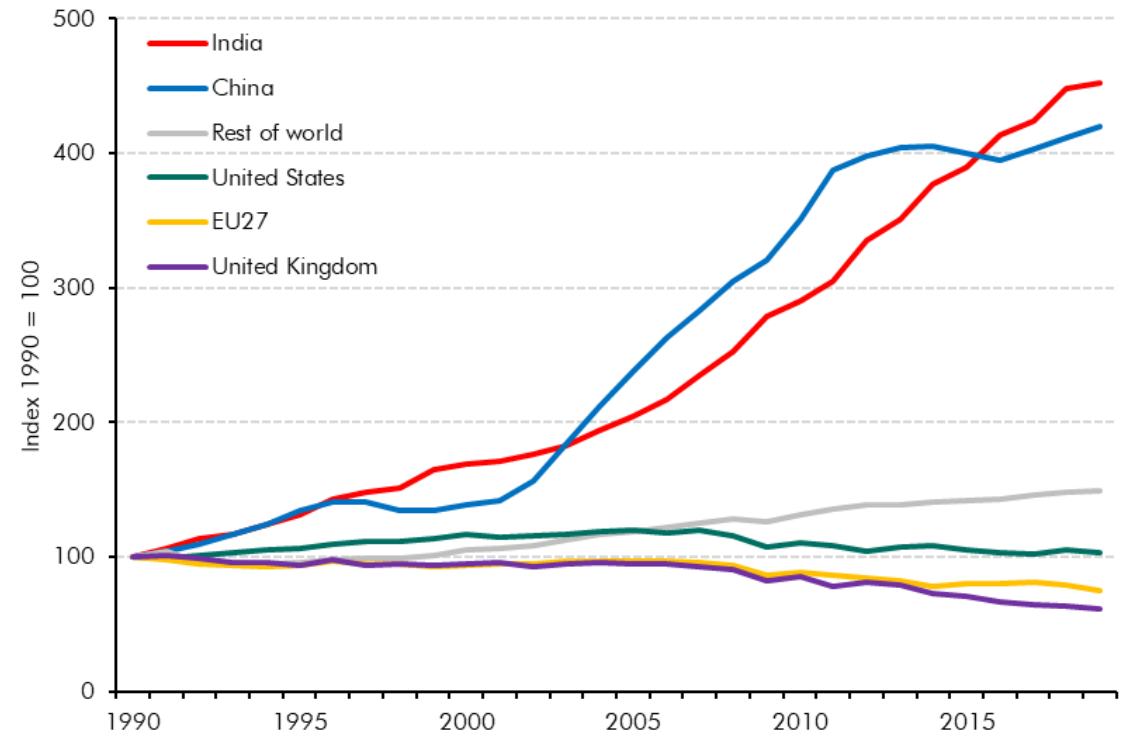
Source: Our World in Data, NGFS Climate Scenarios Database, GCAM model, International Institute for Applied Systems Analysis RCP database, Joint Global Change Research Institute GCAM database, and OBR calculations.

UK contribution to global CO₂ emissions

UK share of global CO₂ emissions in 2016



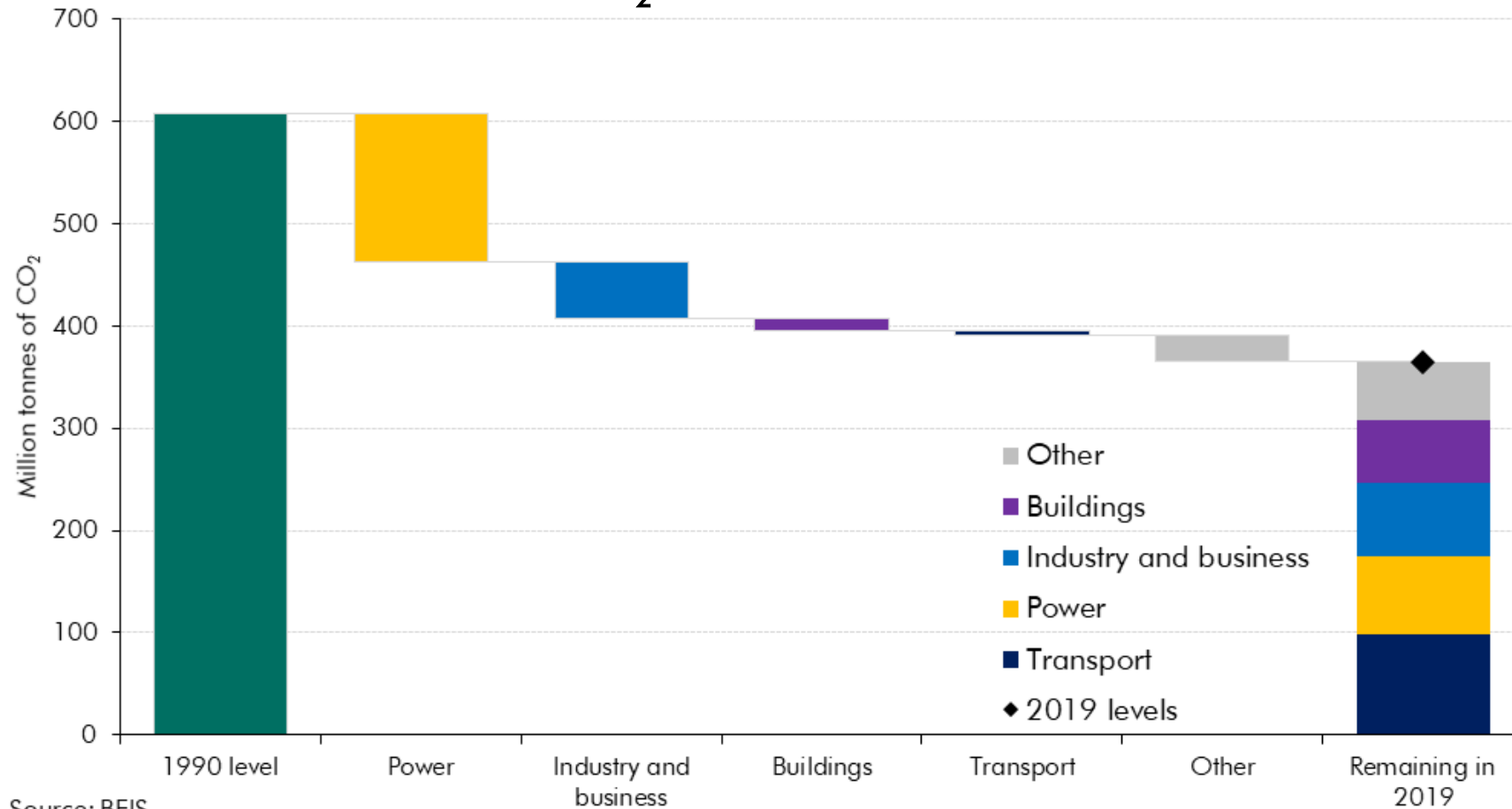
CO₂ emissions relative to 1990



Source: Our World in Data

Contributions to cutting UK CO₂ emissions

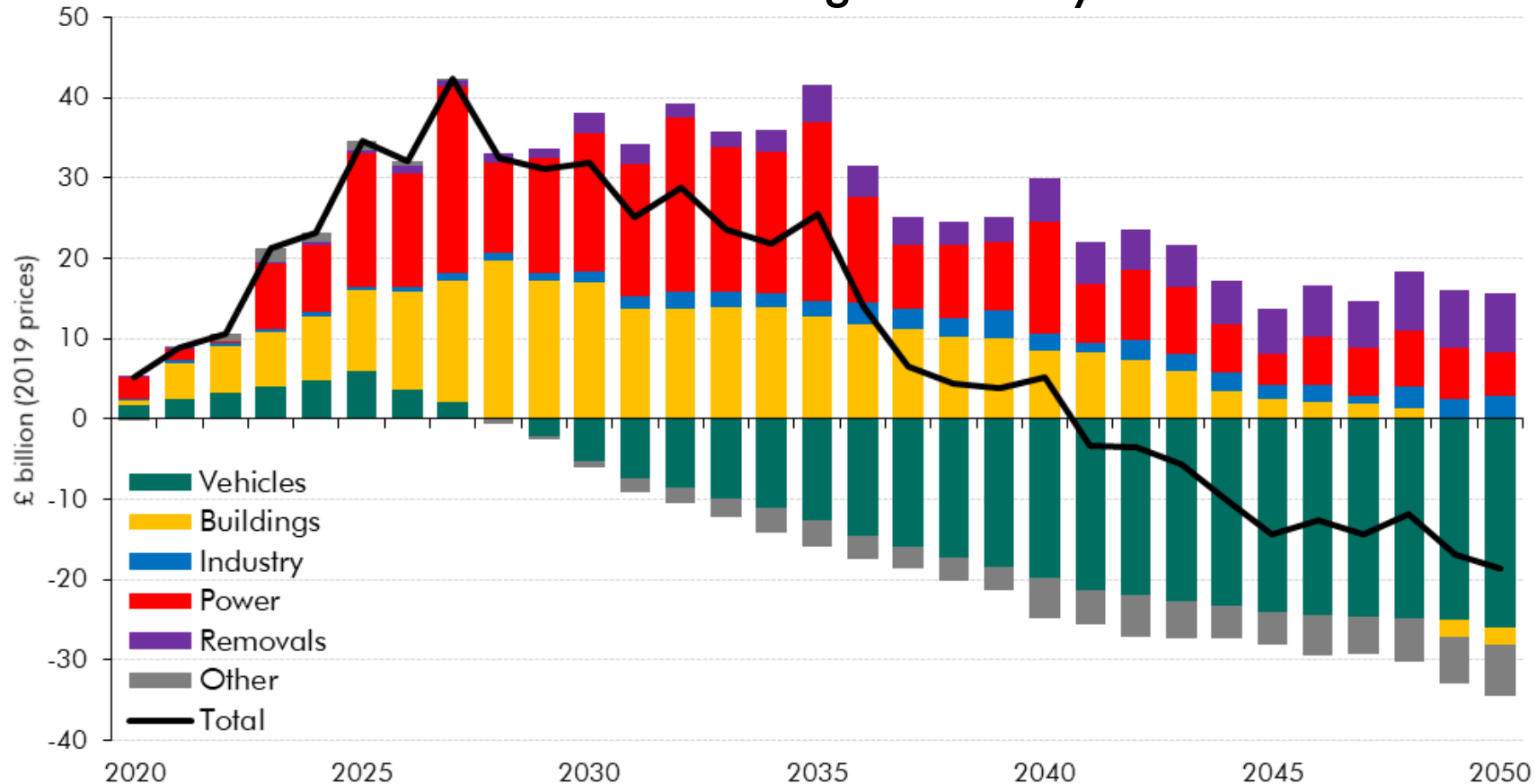
Reduction in UK CO₂ emissions between 1990 and 2019



Source: BEIS

Whole economy cost of reaching net zero

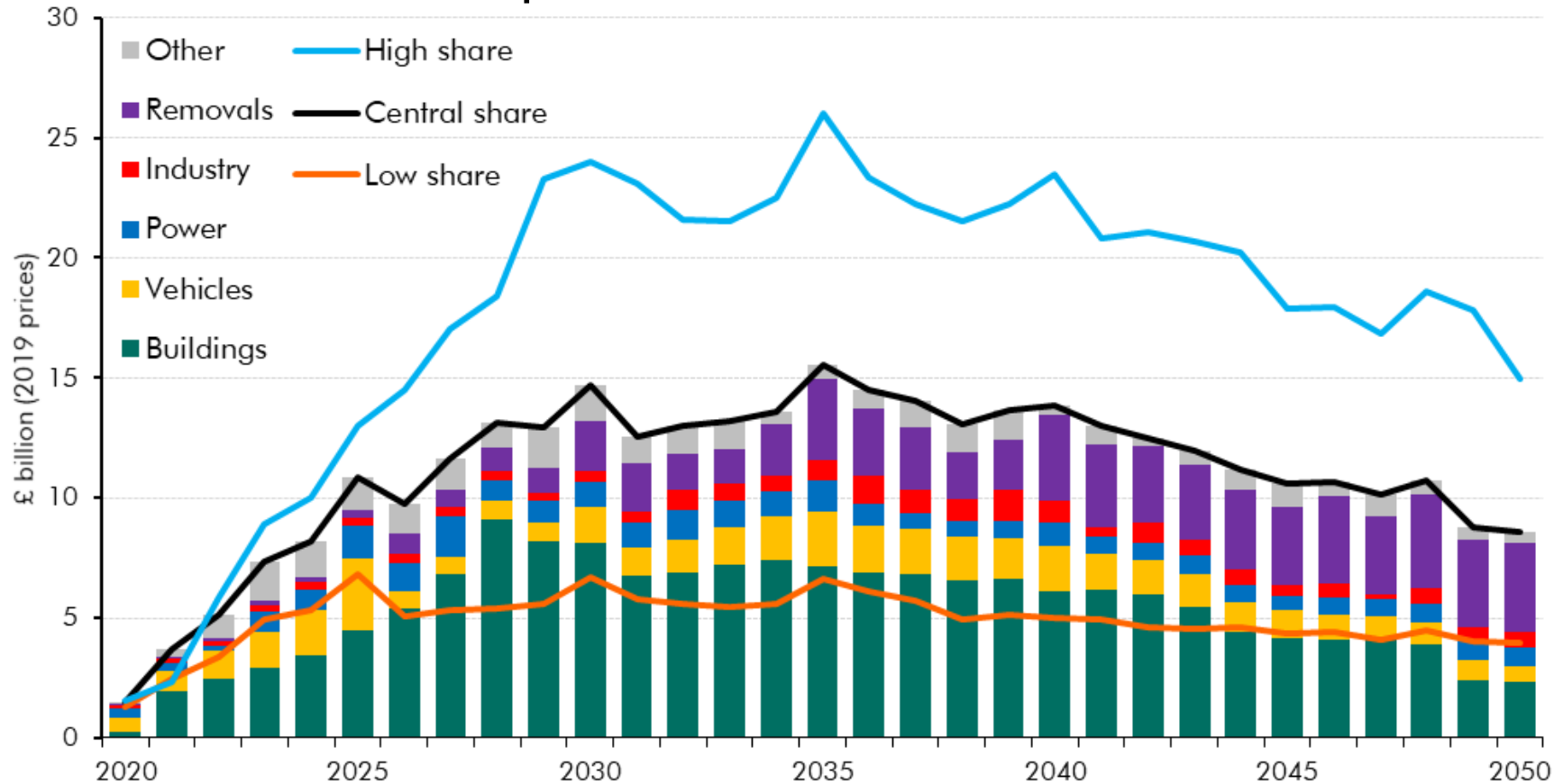
Net cost of reaching net zero by sector



Source: CCC balanced net zero pathway

Fiscal costs of reaching net zero

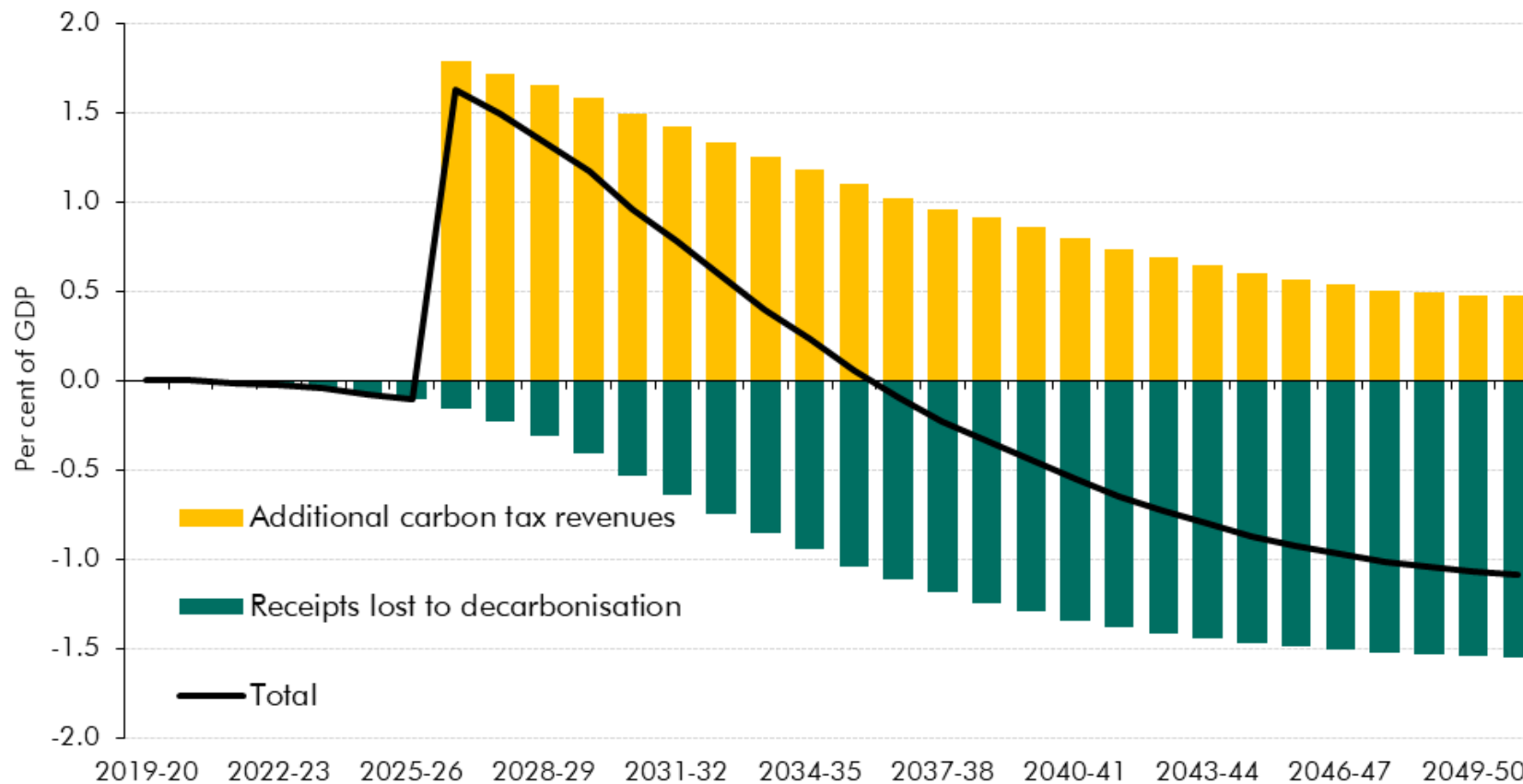
Costs to the public sector of the transition to net zero



Source: CCC balanced net zero pathway, OBR

Fiscal opportunities on the way to net zero

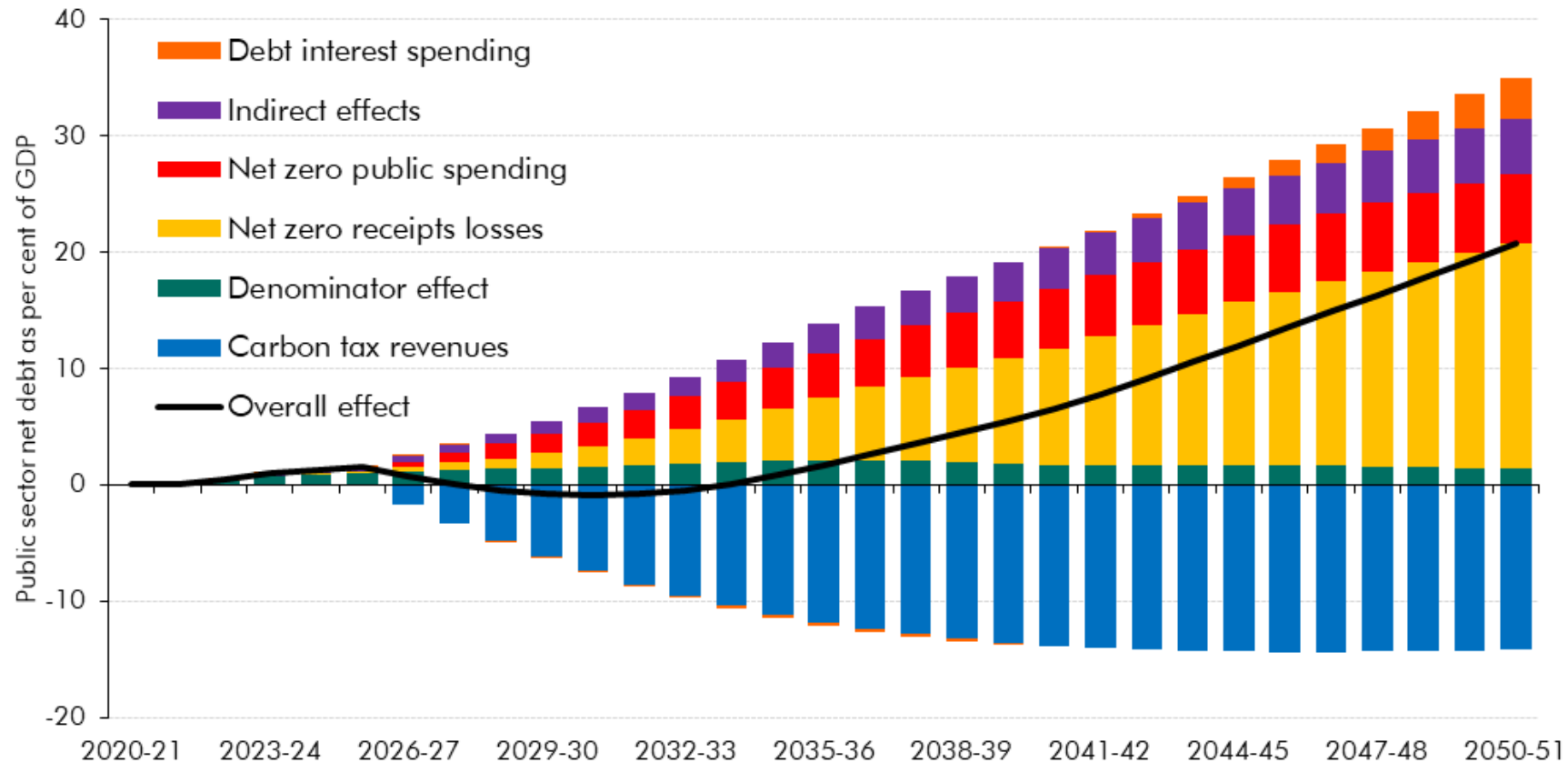
Net revenue gains/losses from decarbonisation



Source: OBR

Net debt impact of reaching net zero

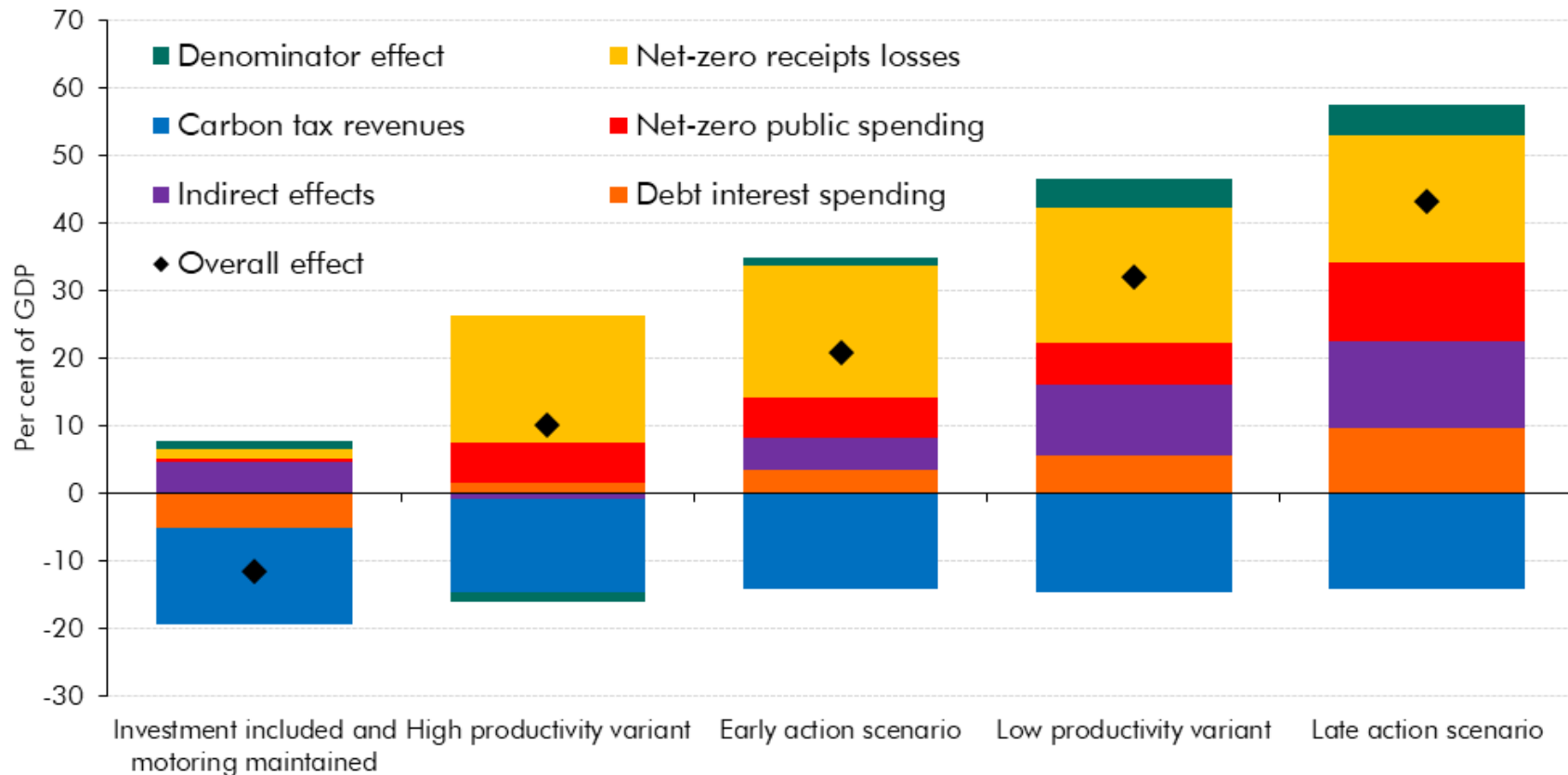
Early action scenario: difference in PSND from baseline



Source: OBR

Alternative fiscal scenarios toward net zero

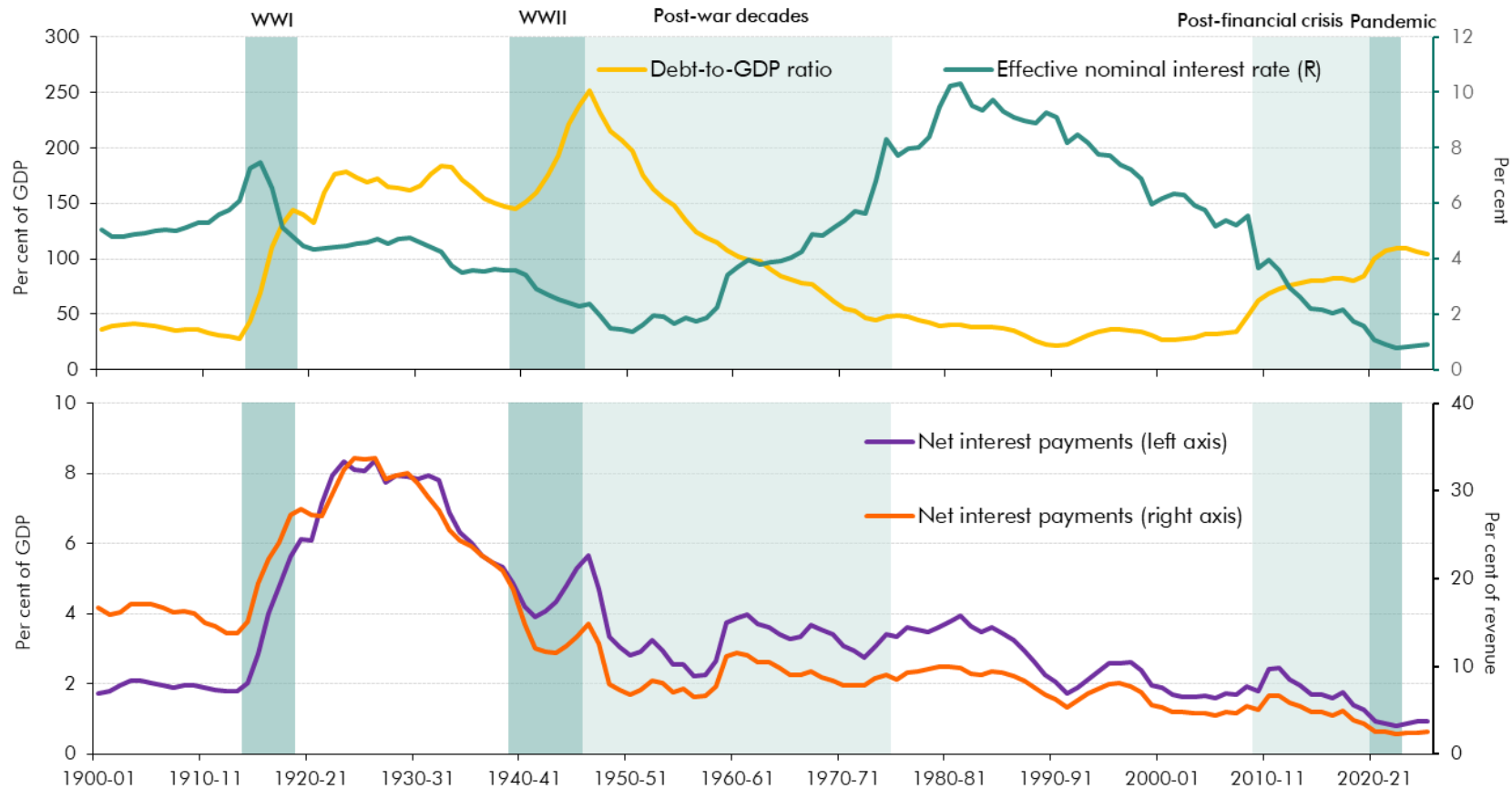
Differences from baseline PSND under various scenarios



Source: OBR

Government debt and interest costs

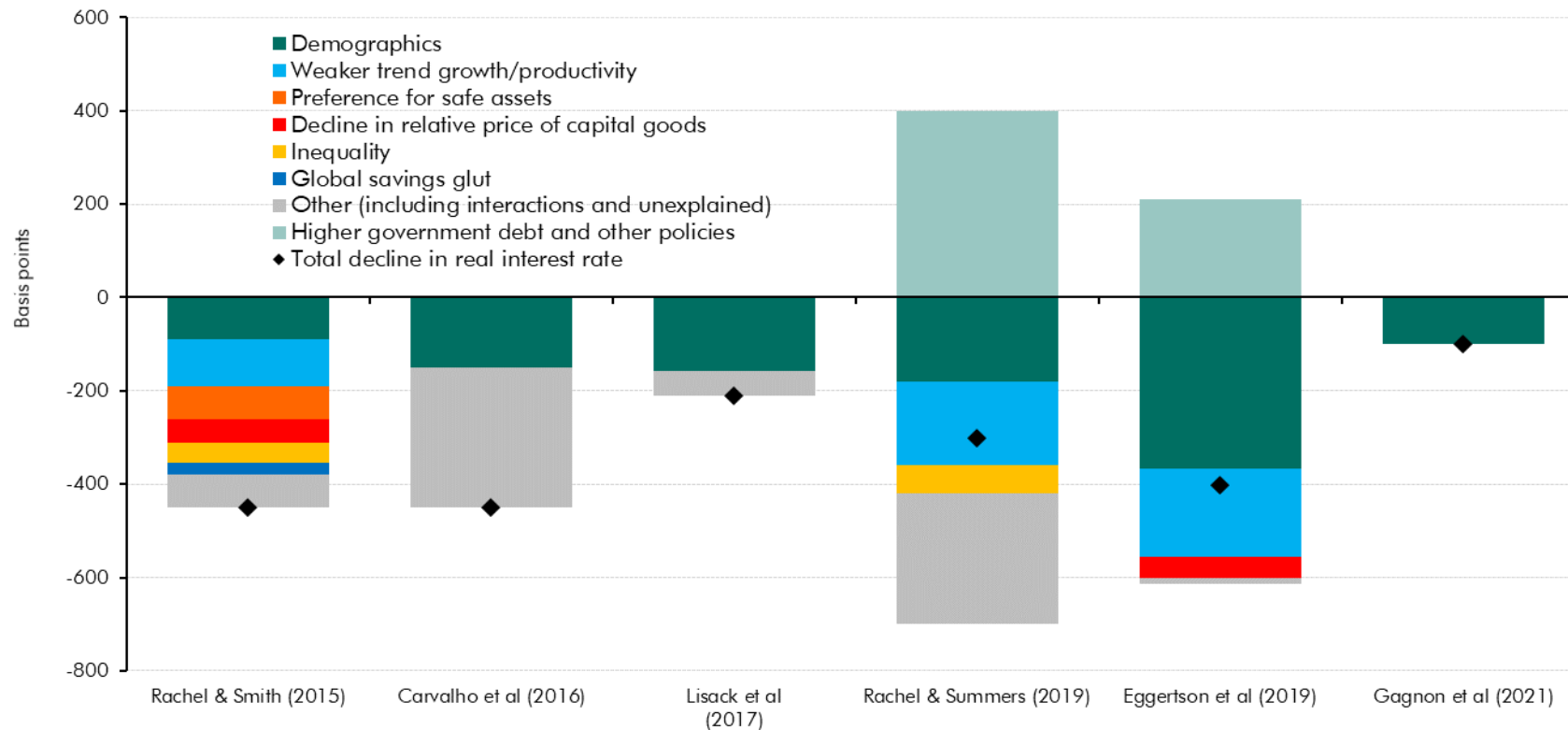
Debt/GDP & Interest payments/GDP



Source: Bank of England, ONS, OBR

Accounting for lower interest rates

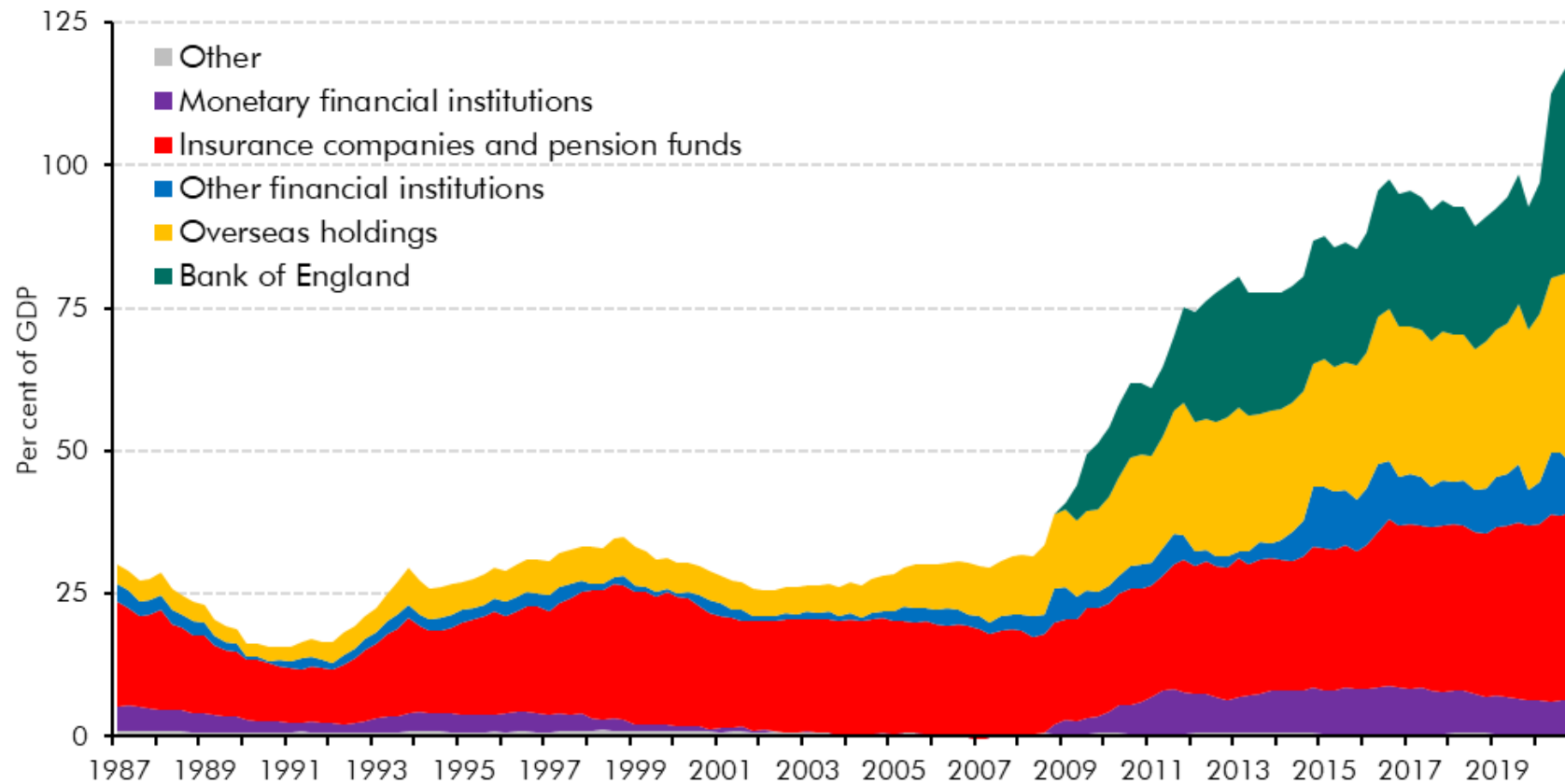
Contributions to the fall in global real interest rates



Source: Rachel, L., and Smith, T., *Secular drivers of the global real interest rate*, Bank of England Working Paper, 2015; Carvalho, C., Ferrero, A., and Nechio, F., *Demographics and real interest rates: Inspecting the mechanism*, Federal Reserve Bank of San Francisco Working Paper, 2016; Lisack, N., Sajedi, R., and Thwaites, G., *Demographic trends and the real interest rate*, Bank of England Working Paper, 2017; Rachel, L., and Summers, L., *On falling neutral real rates, fiscal policy, and the risk of secular stagnation*, Brookings Papers on Economic Activity, 2019; Eggertsson, G., Mehrotra, N., and Robbins, J., *A model of secular stagnation: Theory and quantitative evaluation*, American Economic Journal: Macroeconomics, 2019; Gagnon, E., Johannsen, B., and Lopez-Salido, D., *Understanding the new normal: The role of demographics*, IMF Economic Review, 2021.

Composition of UK gilt investors

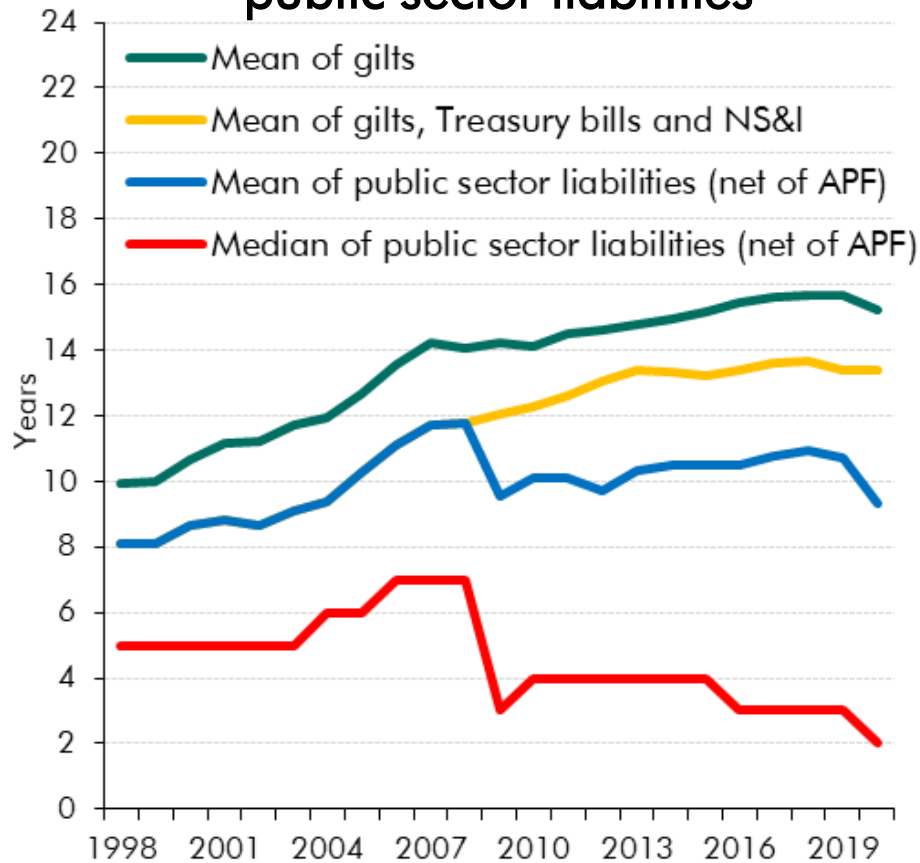
Holdings of UK government bonds



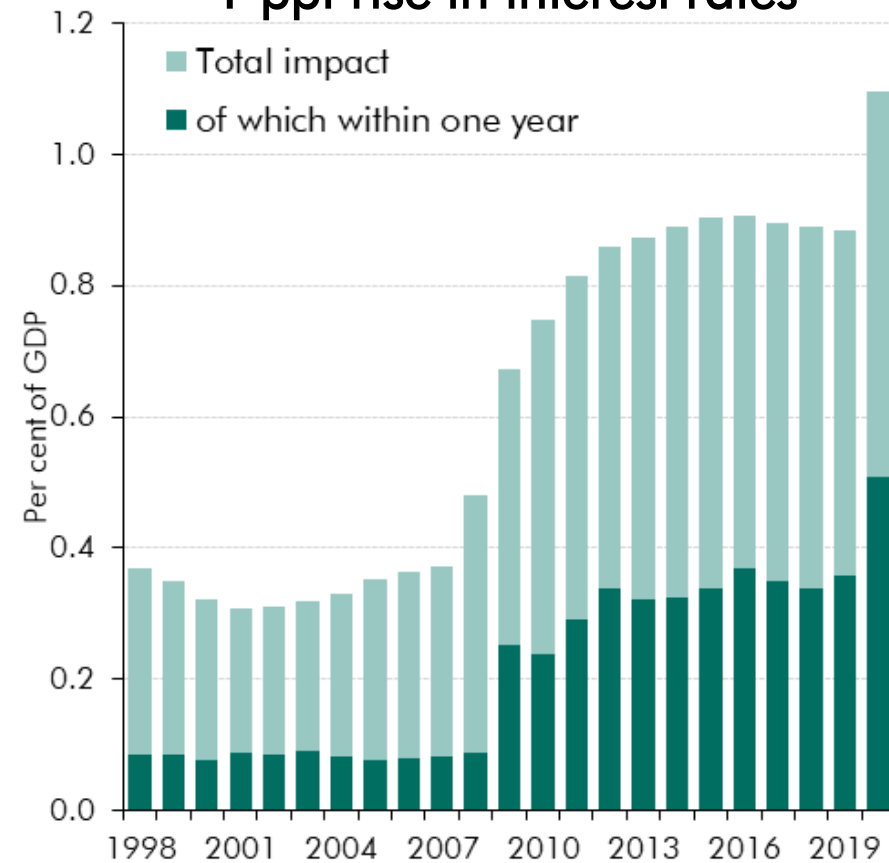
Source: DMO, ONS

Sensitivity to interest rate changes

Effective maturity of public sector liabilities

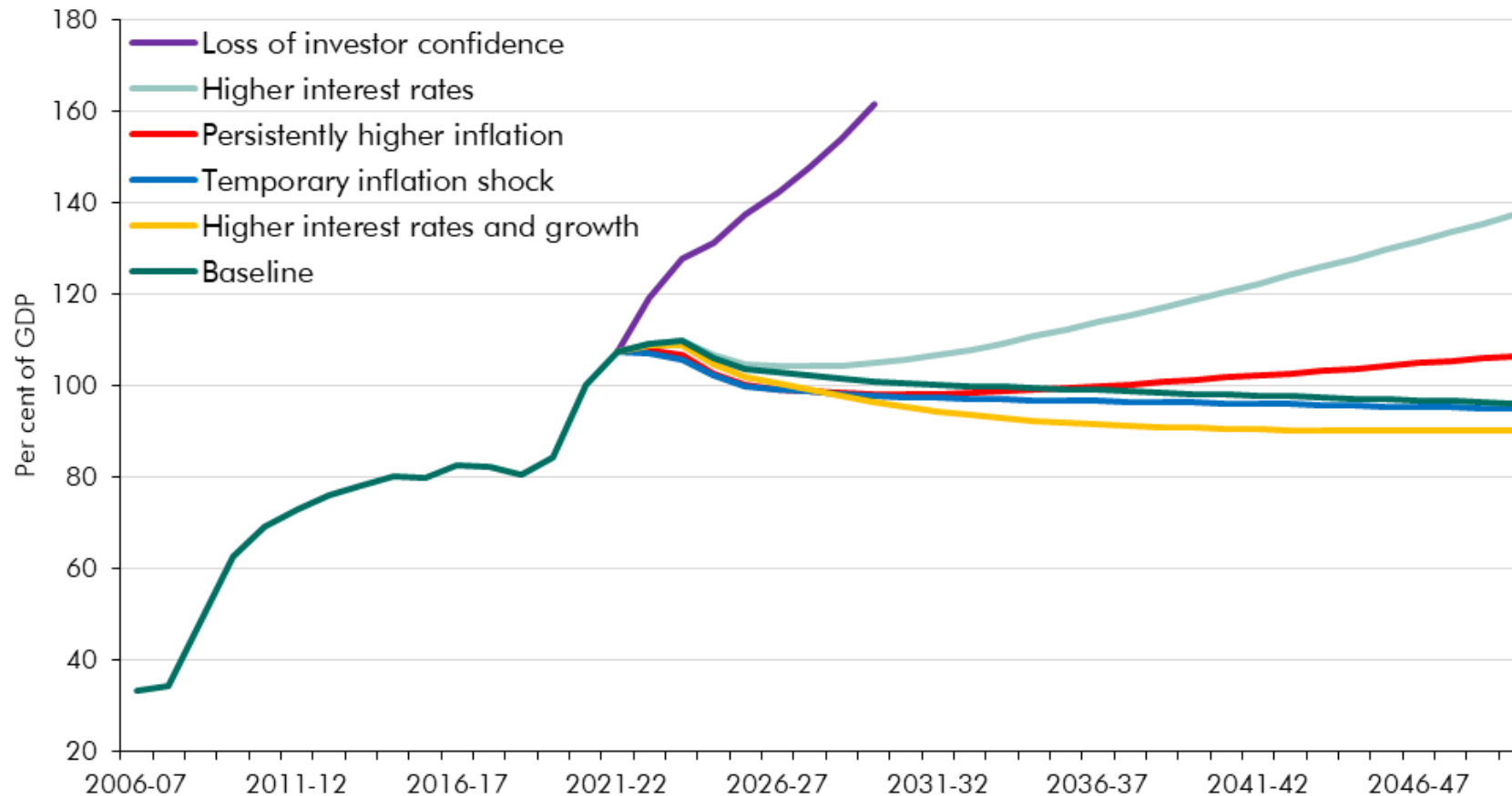


Rise in interest payments from a 1 ppt rise in interest rates



Scenarios for the cost of public debt

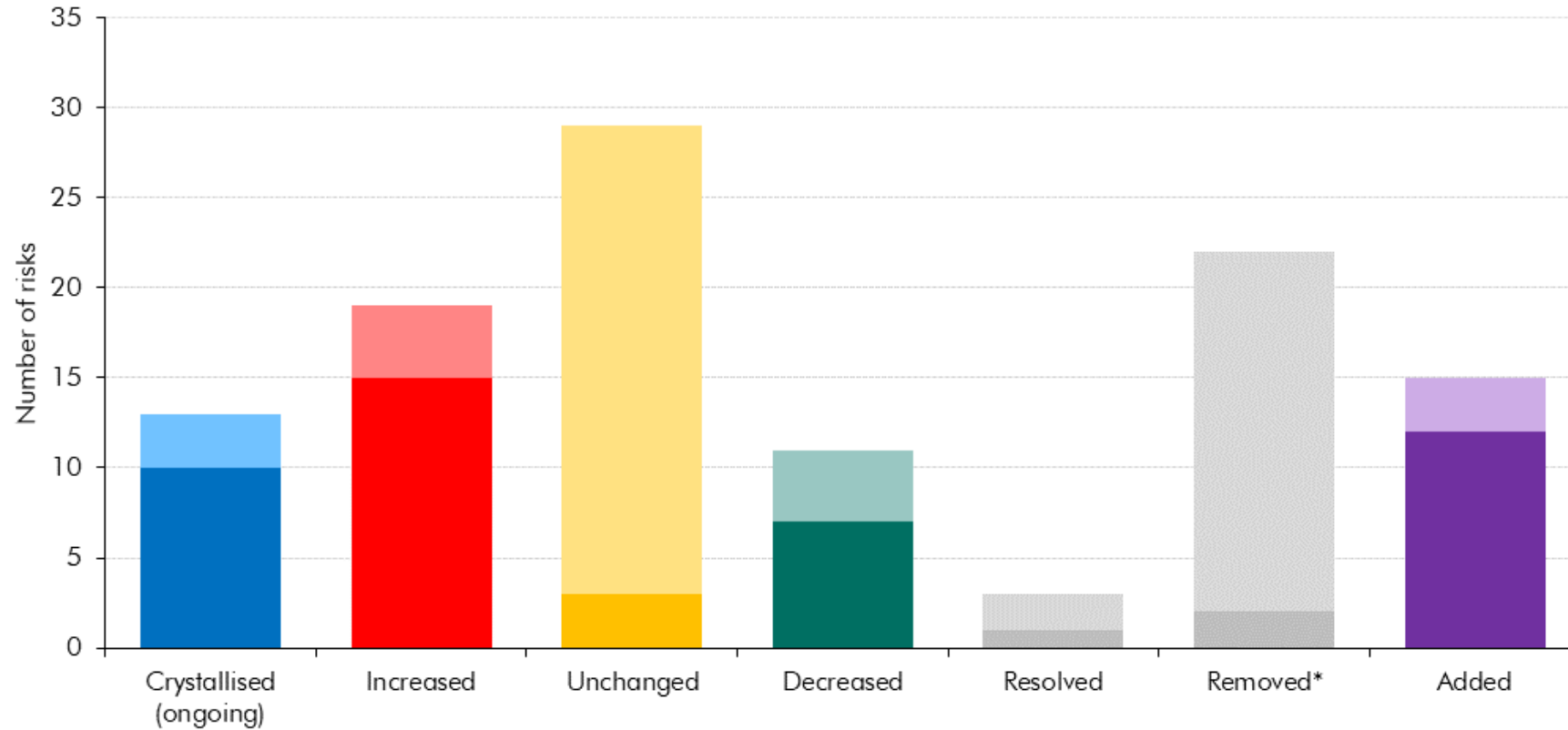
Public sector net debt (% of GDP)



Source: ONS, OBR

Update on other fiscal risks

Changes to the 97 risks identified in the 2019 Fiscal risks report



Note: Darker shaded portions show the number of risks within each category that have been affected to some extent by the pandemic.
Source: OBR

Lessons for dealing with catastrophic risks

- **Catastrophic risks are real and may have become more frequent**
- **While it is difficult to predict when catastrophic risks will materialise, it is possible to anticipate their effects**
- **There are advantages in preventing or halting a process that involves rapidly escalating costs early**
- **When investing in risk prevention, governments have a tendency to ‘fight the last war’**
- **In the absence of perfect foresight, fiscal space may be the single most valuable risk management tool**