PRESS NOTICE 5 December 2013

Economic and fiscal outlook - December 2013

Budget forecast to be back in balance by 2018-19

We have revised up our short-term growth forecast and revised borrowing down by a cumulative £73 billion, with the budget back in balance by 2018-19. The improvements are cyclical rather than structural. The Government is on track to meet its fiscal mandate, but not its supplementary debt target.

The UK economy has picked up more strongly in 2013 than we expected in our March forecast. Private consumption and housing investment have surprised on the upside, while business investment and net trade have continued to disappoint. Short-term indicators suggest that this momentum has been maintained into the final quarter of the year, leading us to revise up our forecast for GDP growth in 2013 as a whole from 0.6 per cent to 1.4 per cent. We judge the positive growth surprise to have been cyclical, reducing the amount of spare capacity in the economy, rather than indicating stronger underlying growth potential.

We do not expect the quarterly growth rates seen during 2013 to be sustained in 2014. While consumer confidence, credit conditions and the housing market have improved, productivity and real earnings growth have remained weak. Ultimately, productivity-driven growth in real earnings is necessary to sustain the recovery. So we expect quarterly GDP growth to slow into 2014, and then to strengthen gradually as productivity picks up. The outlook for productivity growth is the key uncertainty confronting all UK forecasters.

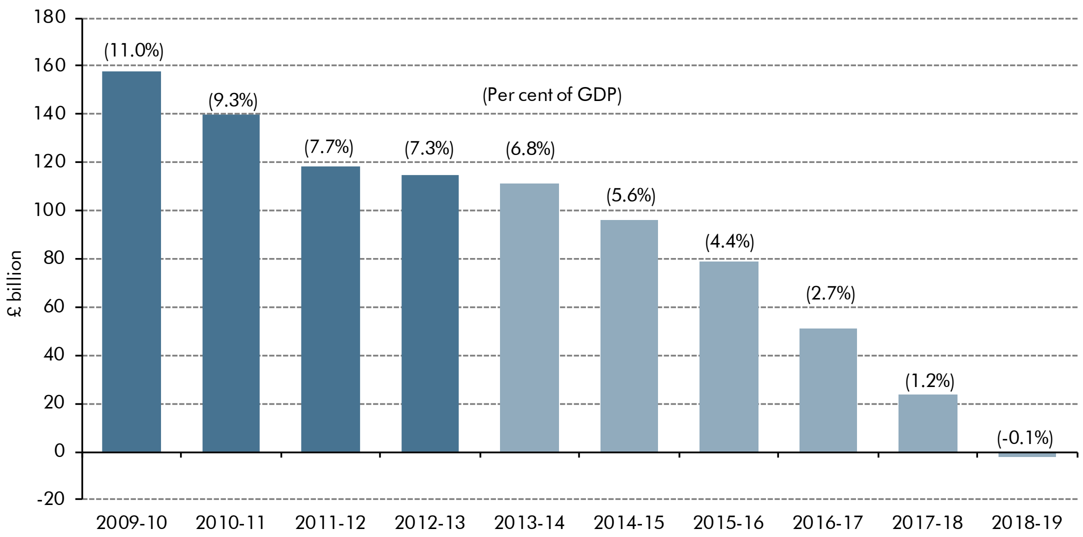
Public sector net borrowing (PSNB) – the gap between what the Government spends and raises in revenue – is forecast to be £111.2 billion this year (measured on an underlying basis, excluding transfers related to the Royal Mail Pension Plan and quantitative easing). This is £8.6 billion lower than our March forecast and £3.8 billion lower than in 2012-13.

We have revised our receipts forecast for this year up by £3.4 billion (excluding the effects of borrowing-neutral changes that raise both receipts and spending). VAT, onshore corporation tax and stamp duty are all expected to out-perform our March forecast. We have revised spending down by £5.2 billion on the same basis. This largely reflects the fact that we expect central government departments to underspend the Treasury limits they faced in March by £7 billion, rather than the £3.5 billion we forecast at the time. The Treasury has cut the central reserve against those limits by £2 billion in the Autumn Statement, presenting that portion of the underspend as a policy measure.

The downward revisions to our borrowing forecasts increase over time, reaching £19.3 billion in 2017-18, giving a cumulative downward revision of £73.1 billion between 2013-14 and 2017-18. Mirroring our judgement that the upward revision to our economic growth forecast since March is cyclical rather than structural, the downward revisions to our borrowing forecasts reduce the overall budget deficit but not the structural budget deficit.

Stronger receipts explain the majority of the downward revision to borrowing, with higher profits supporting onshore corporation tax receipts and a stronger property market lifting stamp duty and other capital tax receipts. Our medium-term forecasts for public spending are little changed since March, with a number of factors broadly offsetting each other. In 2018-19, we expect the underlying balance to move into surplus for the first time in 18 years. But the headline balance will still be in modest deficit, as we expect the Treasury to have to find money to transfer to the Bank of England's Asset Purchase Facility.

Chart A: Public sector net borrowing excluding the Royal Mail and Asset Purchase Facility transfers



Source: ONS, OBR

The tax and spending measures that the Treasury has included in its Autumn Statement policy decisions table have little cumulative impact on borrowing over the forecast, with the £2 billion cut in departmental spending limits and special reserve this year offsetting a £1.4 billion cumulative net tax cut through to 2018-19 and a £0.6 billion cumulative increase in spending in 2014-15 and 2015-16, the last two years for which detailed departmental spending plans have been set.

But there are specific decisions on departmental spending identified in the Autumn Statement policy table that, if continued after 2015-16, would require extra spending between 2016-17 and 2018-19. For example, the extension of free school meals costs £755 million in 2015-16 while removing the cap on student numbers rises to a cost of

£785 million by 2018-19. This spending would reduce the amount available for departments to spend on other things when plans for those years are set out in future spending reviews. The cost of the net tax cuts in the policy table will also continue to accumulate beyond 2018-19.

The Government's 'fiscal mandate' requires it to balance the cyclically-adjusted current budget (CACB) – the amount the Government borrows to finance non-investment spending, adjusted for the state of the economy – five years ahead. In March, we forecast that the CACB would be in surplus by 0.8 per cent of GDP in the then target year of 2017-18. We now expect a slightly smaller surplus of 0.7 per cent of GDP in that year. Thanks to a rise in the average tax rate on national income, and the Government's decision to continue cutting public services spending as a share of GDP, we forecast a bigger surplus of 1.6 per cent of GDP in the new target year of 2018-19, implying significant headroom against the fiscal mandate.

The Government's supplementary target is for public sector net debt (PSND) to be falling as a share of GDP in 2015-16. But, as in our December 2012 and March 2013 forecasts, we expect PSND still to be rising in that year. We expect PSND to peak at 80.0 per cent of GDP in 2015-16, to fall by a statistically and fiscally insignificant margin in 2016-17, and then to fall more rapidly to 75.9 per cent of GDP by 2018-19. This implies that, relative to the size of the economy, debt will peak at more than double its pre-crisis level.

Needless to say, there is huge uncertainty around all public finance projections, which increases over longer time horizons. 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 over the coming five years than we currently assume. More of the deficit would then be structural and would remain after the economy recovers.

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: http://budgetresponsibility.org.uk/
3. The OBR will release supplementary information on the *Economic and fiscal outlook* on 20 December, the day of the HMT/ONS *Public Sector Finances* release, in response to requests received by 17 December. We will release a list of any information to be published at 9.30am on 19 December.
4. Questions about the *Economic and fiscal outlook* should be sent to OBRpress@obr.gsi.gov.uk.

Table A: Overview of OBR December 2013 economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast[1]					
	2012	2013	2014	2015	2016	2017	2018
Output at constant market prices							
Gross domestic product (GDP)	0.1	1.4	2.4	2.2	2.6	2.7	2.7
GDP level (2012=100)	100.0	101.4	103.9	106.2	108.9	111.8	114.8
Output gap (per cent of potential output)	-2.6	-2.3	-1.8	-1.6	-1.2	-0.7	-0.2
Expenditure components of GDP at constant market prices							
Household consumption[2]	1.2	1.9	1.9	1.7	2.4	2.8	2.8
Business investment	2.6	-5.5	5.1	8.6	8.7	8.9	7.9
General government consumption	1.7	0.7	0.4	-0.5	-1.0	-1.8	-1.1
General government investment	4.6	-6.9	7.3	1.2	2.1	0.5	-1.1
Net trade[3]	-0.7	-0.2	0.0	0.1	0.0	0.0	-0.1
Inflation							
CPI	2.8	2.6	2.3	2.1	2.0	2.0	2.0
Labour market							
Employment (millions)	29.5	29.9	30.2	30.4	30.7	30.9	31.2
Average earnings[4]	2.0	1.5	2.6	3.3	3.5	3.7	3.8
ILO unemployment (% rate)	7.9	7.6	7.1	7.0	6.6	6.1	5.6
Claimant count (millions)	1.59	1.43	1.27	1.23	1.18	1.13	1.10
	Changes since March forecast						
Output at constant market prices							
Gross domestic product (GDP)	0.0	0.8	0.6	-0.1	-0.1	-0.1	
GDP level (2012=100)[5]	0.0	0.8	1.4	1.3	1.2	1.1	
Output gap (per cent of potential output)	0.1	1.2	1.9	1.8	1.7	1.6	
Expenditure components of GDP at constant market prices							
Household consumption[2]	0.2	1.5	0.7	0.0	0.0	0.0	
Business investment	-2.3	-7.4	-1.0	0.0	0.1	0.3	
General government consumption	-0.9	0.3	1.1	-0.1	0.0	0.0	
General government investment	1.9	-9.5	2.4	-0.7	3.6	1.7	
Net trade[3]	0.1	-0.3	-0.1	-0.1	-0.1	-0.1	
Inflation							
CPI	0.0	-0.2	-0.1	0.0	0.0	0.0	
Labour market							
Employment (millions)	0.0	0.1	0.3	0.3	0.4	0.4	
Average earnings[4]	0.0	0.0	-0.2	-0.4	-0.4	-0.3	
ILO unemployment (% rate)	0.0	-0.3	-0.9	-0.9	-0.9	-0.8	
Claimant count (millions)	0.00	-0.15	-0.36	-0.35	-0.30	-0.24	

[1] The forecast is consistent with the second estimate of GDP data for the third quarter of 2013, released by the Office for National Statistics on 27 November 2013.

[2] Includes households and non-profit institutions serving households.

[3] Contribution to GDP growth, percentage points.

[4] Wages and salaries divided by employees.

[5] Per cent change since March.

Table B: Overview of OBR December 2013 fiscal forecast

	Per cent of GDP						
	Outturn	Forecast					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Underlying fiscal aggregates							
Public sector net borrowing[1]	7.3	6.8	5.6	4.4	2.7	1.2	-0.1
Cyclically-adjusted net borrowing[1]	5.5	5.2	4.3	3.3	1.9	0.7	-0.3
Surplus on current budget[1]	-5.9	-5.3	-4.0	-2.9	-1.2	0.2	1.4
Headline fiscal aggregates							
Public sector net borrowing	5.1	6.0	4.9	4.0	2.6	1.3	0.1
Cyclically-adjusted net borrowing	3.3	4.4	3.6	2.9	1.7	0.8	-0.1
Surplus on current budget	-5.5	-4.5	-3.3	-2.5	-1.1	0.2	1.4
Fiscal mandate and supplementary target							
Cyclically-adjusted surplus on current budget	-3.6	-2.9	-2.0	-1.4	-0.2	0.7	1.6
Public sector net debt	73.9	75.5	78.3	80.0	79.9	78.4	75.9
	Changes since March forecast						
Public sector net borrowing[1]	-0.5	-0.7	-0.9	-1.1	-1.0	-1.1	
Cyclically-adjusted net borrowing[1]	-0.4	0.1	0.3	0.1	0.2	0.0	
Surplus on current budget[1]	0.5	0.7	0.9	1.1	1.1	1.1	
Cyclically-adjusted surplus on current budget	0.4	-0.1	-0.3	-0.2	-0.3	-0.1	
Public sector net debt	-2.0	-3.6	-4.3	-5.1	-5.7	-6.4	

[1] Excluding Royal Mail and APF transfers.

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

	£ billion						
	Outturn	Forecast					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Public sector net borrowing[1]							
March forecast	120.9	119.8	108.4	95.5	67.0	42.7	
December forecast	115.0	111.2	96.0	78.7	51.1	23.4	-2.2
Change	**-5.9**	**-8.6**	**-12.4**	**-16.8**	**-15.9**	**-19.3**	
of which:							
Pre-measures forecasts							
of which:							
Receipts[1,2]	-4.3	-3.4	-9.6	-13.2	-14.5	-14.6	
DEL spending[3]	-0.5	-1.8	0.0	-1.3	0.3	-4.0	
AME spending[1,2,3]	-1.1	-1.4	-2.9	-2.4	-2.1	-1.3	
Measures in the Treasury's policy decision table	0.0	-2.0	0.1	0.1	0.4	0.6	

[1] Excluding Royal Mail and APF transfers.

[2] Excluding fiscally neutral switches, which include changes in the proportion of tax credits treated as negative tax, Renewables Obligation and the treatment of artistic originals in public corporations' gross operating surplus and capital expenditure.

[3] DEL and AME have been adjusted to remove the effects of the OSCAR classification changes on DEL, which are largely offset in AME, explained in Box 4.4.