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Economic and fiscal outlook

20 March 2013

Robert Chote
Chairman

EFO coverage and process

- Five year forecasts, plus assessment of targets
- Independent BRC responsible for conclusions
- Helped by OBR staff and other officials
- Met with the Chancellor on 28 February
- Forecast closed except measures on 7 March
- No pressure to change any conclusions

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Overview

- **Economic outlook**
  - Real GDP revised up in 2012 but down in 2013 and 2014
  - Whole economy inflation and nominal GDP revised down
  - CPI inflation revised up and unemployment revised down
  - Economy 3½% below full capacity in 2013

- **Fiscal outlook**
  - Sharp fall in headline deficit this year, but flattered
  - Underlying deficit £120bn last year, this year and next year
  - Medium term: receipts lower, spending little changed
  - 2012-13: receipts lower, offset by departmental squeeze
  - Mandate likely to be met, supplementary target missed

GDP growth

% growth p.a.	December EFO	March EFO	*Change*
2012	–0.1	0.2	*+0.3*
2013	1.2	0.6	*–0.6*
2014	2.0	1.8	*–0.3*
2015	2.3	2.3	-
2016	2.7	2.7	-
2017	2.8	2.8	-

In 2017-18 real GDP 0.6% lower and nominal GDP 2.6% lower than in December EFO

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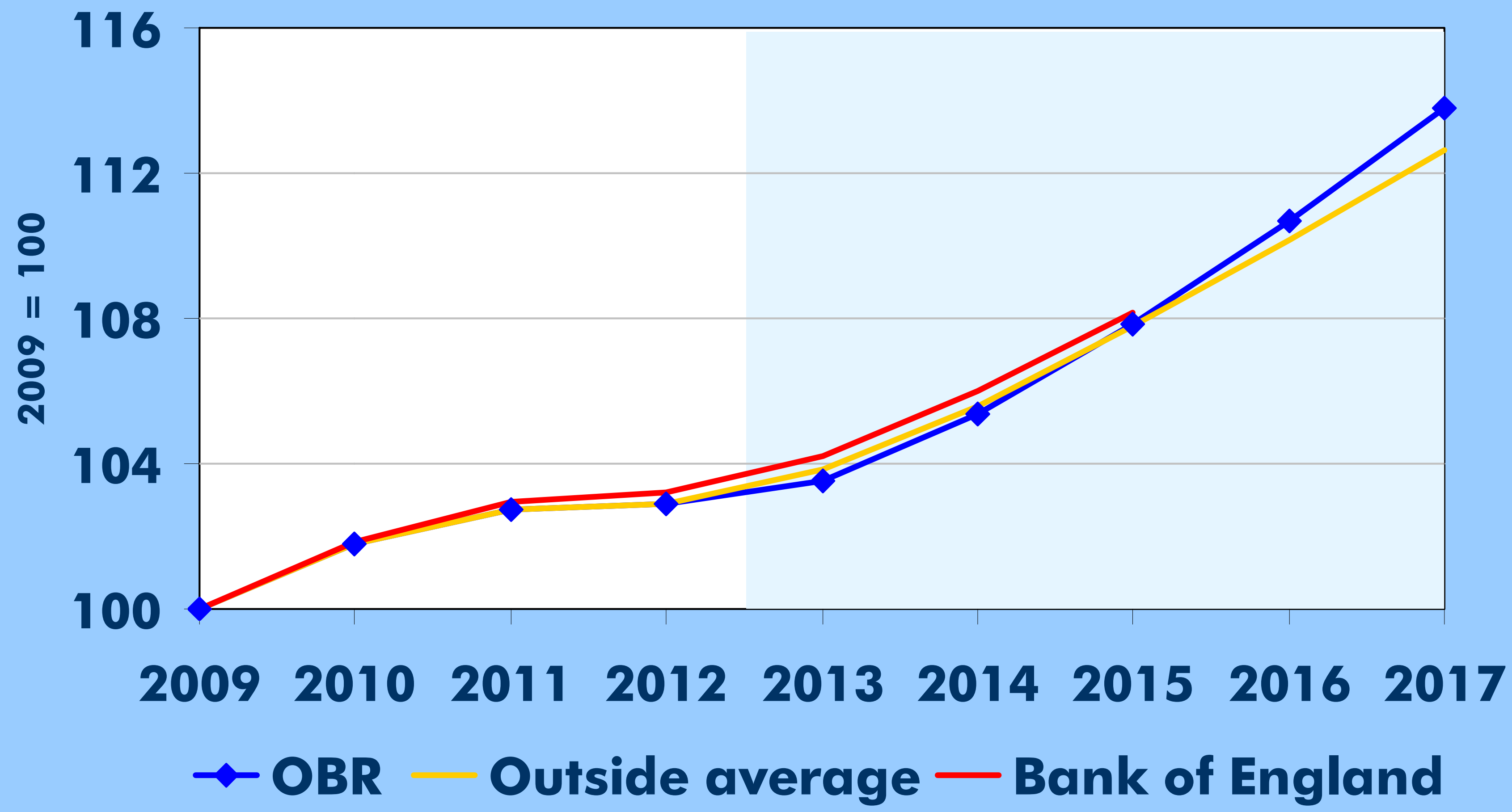
Level of GDP since the trough



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Household consumption

Contribution to GDP growth (ppt)	2012	2013	2014	2015	2016	2017
New forecast	**0.6**	**0.3**	**0.8**	**1.1**	**1.5**	**1.8**
Change from December	*+0.3*	*–0.2*	*–0.2*	*-0.1*	-	-

- **Consumption growth slightly slower than in December**
- **Weak productivity slows pick-up in nominal earnings**
- **Upward revision to inflation squeezes real incomes**

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Business investment

Contribution to GDP growth (ppt)	2012	2013	2014	2015	2016	2017
New forecast	**0.4**	**0.2**	**0.5**	**0.8**	**0.8**	**0.9**
Change from December	*+0.1*	*–0.3*	*–0.2*	*–0.2*	*–0.2*	*–0.1*

- **Starting level of business investment revised higher**
- **Future growth rates revised lower**
- **Weaker recovery expected than in 1990s**

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Net exports

Contribution to GDP growth (ppt)	2012	2013	2014	2015	2016	2017
New forecast	**–0.8**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Change from December	*–0.1*	*–0.1*	-	-	-	-

- **Weak net exports were the biggest drag on growth in 2012**
- **Export markets weaker looking forward**
- **Forecast assumes ongoing loss of market share**

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Government consumption and investment

Contribution to GDP growth (ppt)	2012	2013	2014	2015	2016	2017
New forecast	**0.6**	**0.2**	**–0.1**	**–0.1**	**–0.3**	**–0.4**
Change from December	*+0.3*	*+0.4*	*+0.2*	*+0.3*	*+0.3*	*+0.2*

- **Government spending still positive for growth this year**
- **Nominal spending cuts not showing up much in output**

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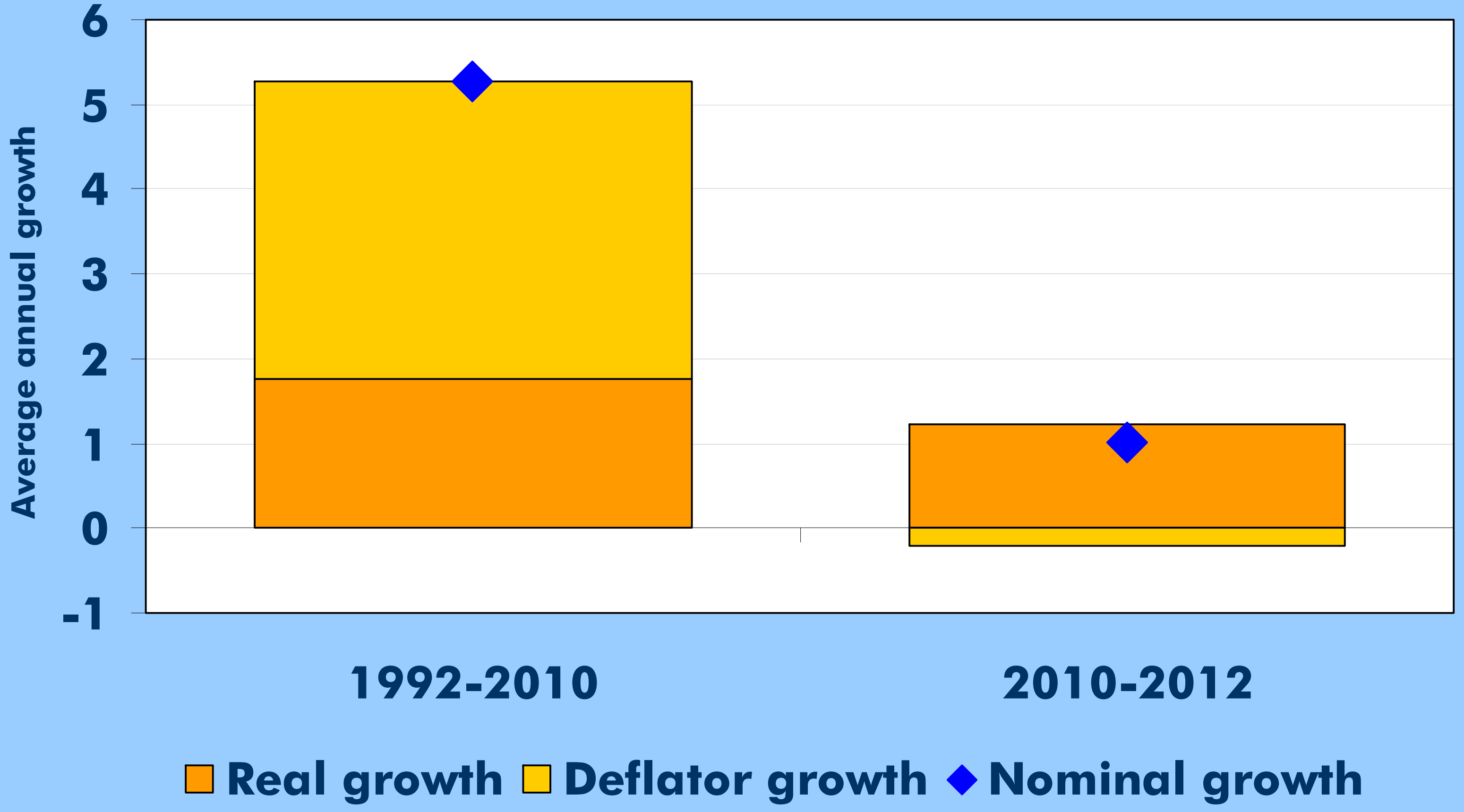
Government consumption and investment



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Labour market and inflation

- **Labour market**
  - Employment revised up and unemployment down
  - Weaker outlook for productivity and nominal earnings
  - Real earnings growth also hit by higher inflation
- **Inflation**
  - CPI inflation revised up to reflect data, oil and lower £
  - GDP deflator revised down because of data and lower government deflator growth

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Potential output I

- Business surveys suggest that spare capacity shrank again in Q4 and over 2012
- Implies significant fall in efficiency with which inputs are combined to make a unit of output
- Does not seem plausible, so assume TFP flat
- Leaves output 2.7% below potential in 2012 and 3.6% below potential in 2013
- In middle of outside forecast range

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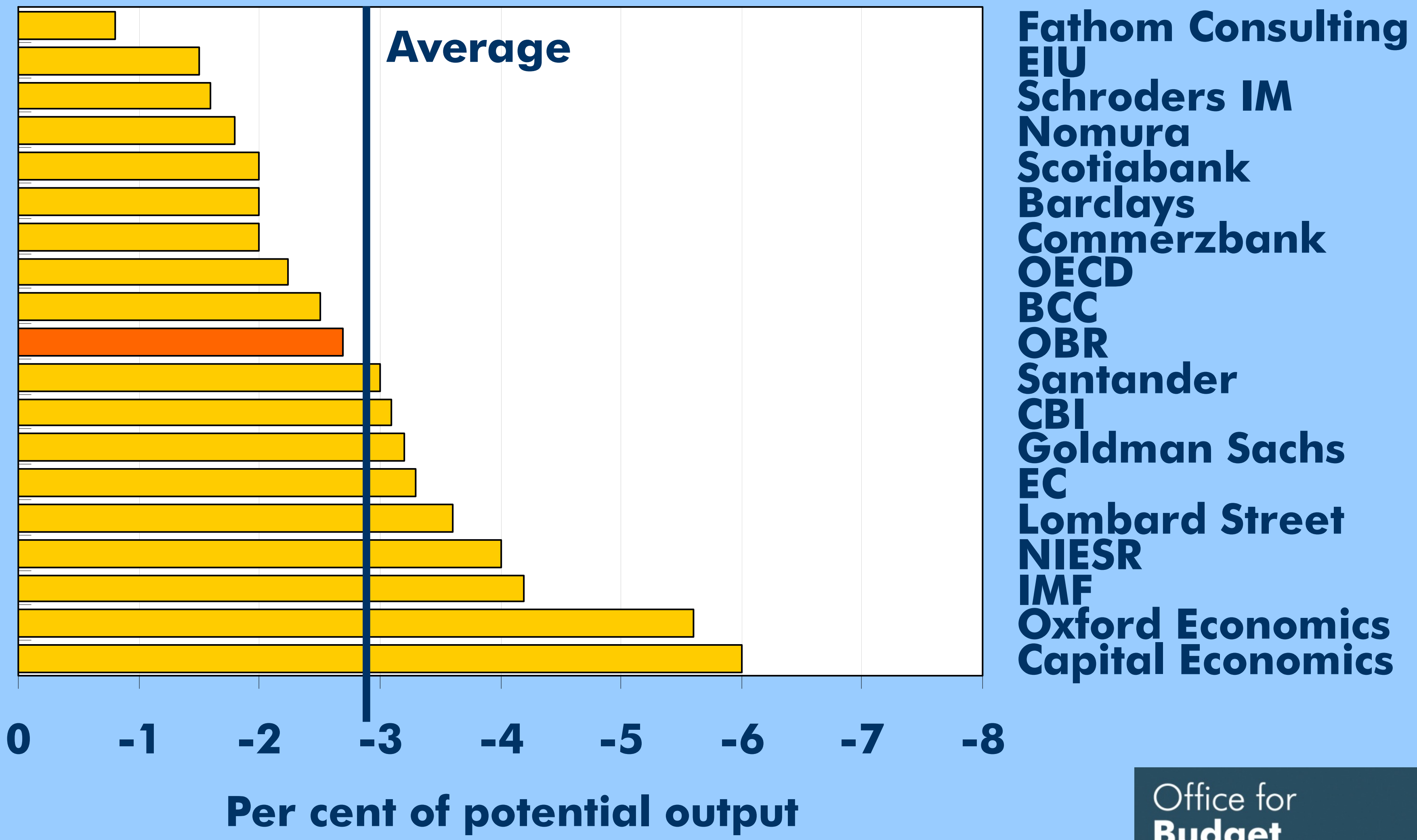
Output gap in 2012



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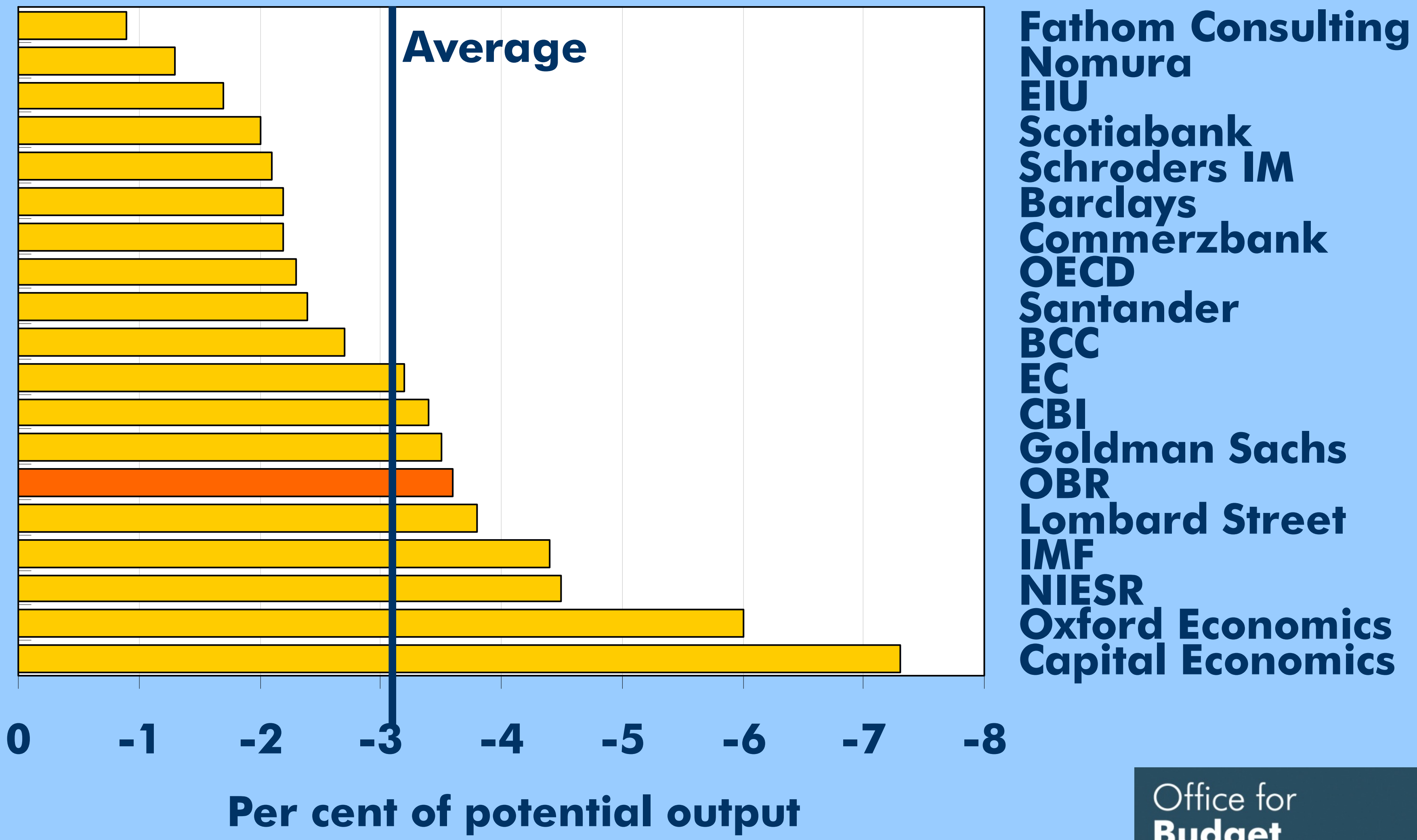
Output gap in 2013



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Potential output II

- We assume that potential GDP growth takes time to recover to its long-term trend
- But still spare capacity at the end of the forecast
- By 2017 potential output 14.6% below pre-crisis trend and actual GDP 2.3% below that
- Our potential GDP forecasts within wide range

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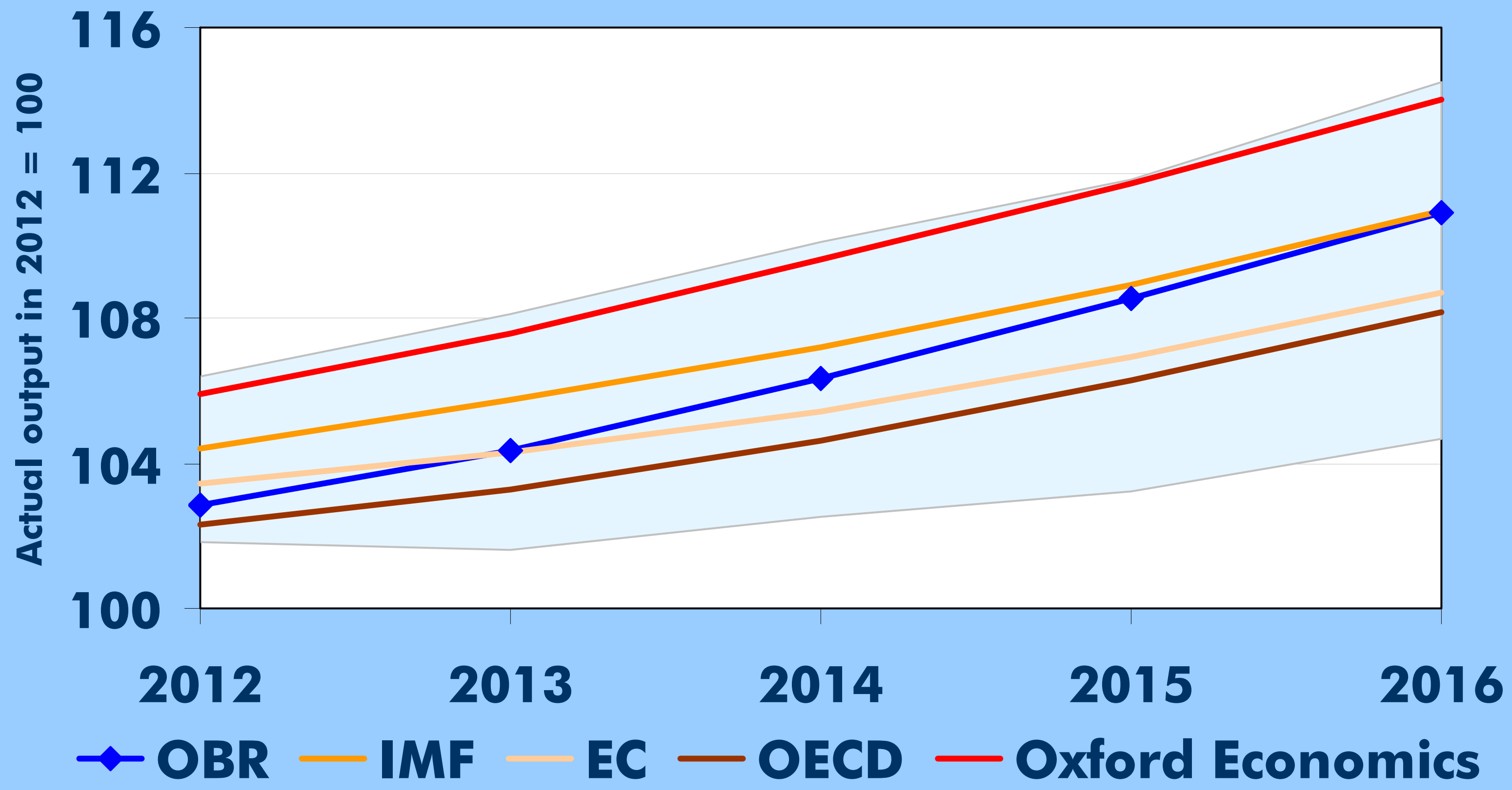
Potential output forecasts



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The public finances

- Once again comparisons complicated by:
  - Government's decision to transfer Royal Mail pension fund assets to public sector
  - Government's decision to transfer balances in Bank of England's Asset Purchase Facility (APF) to the Treasury
  - Statistical classification decisions
- Focus here on Public Sector Net Borrowing excluding Royal Mail and APF transfers

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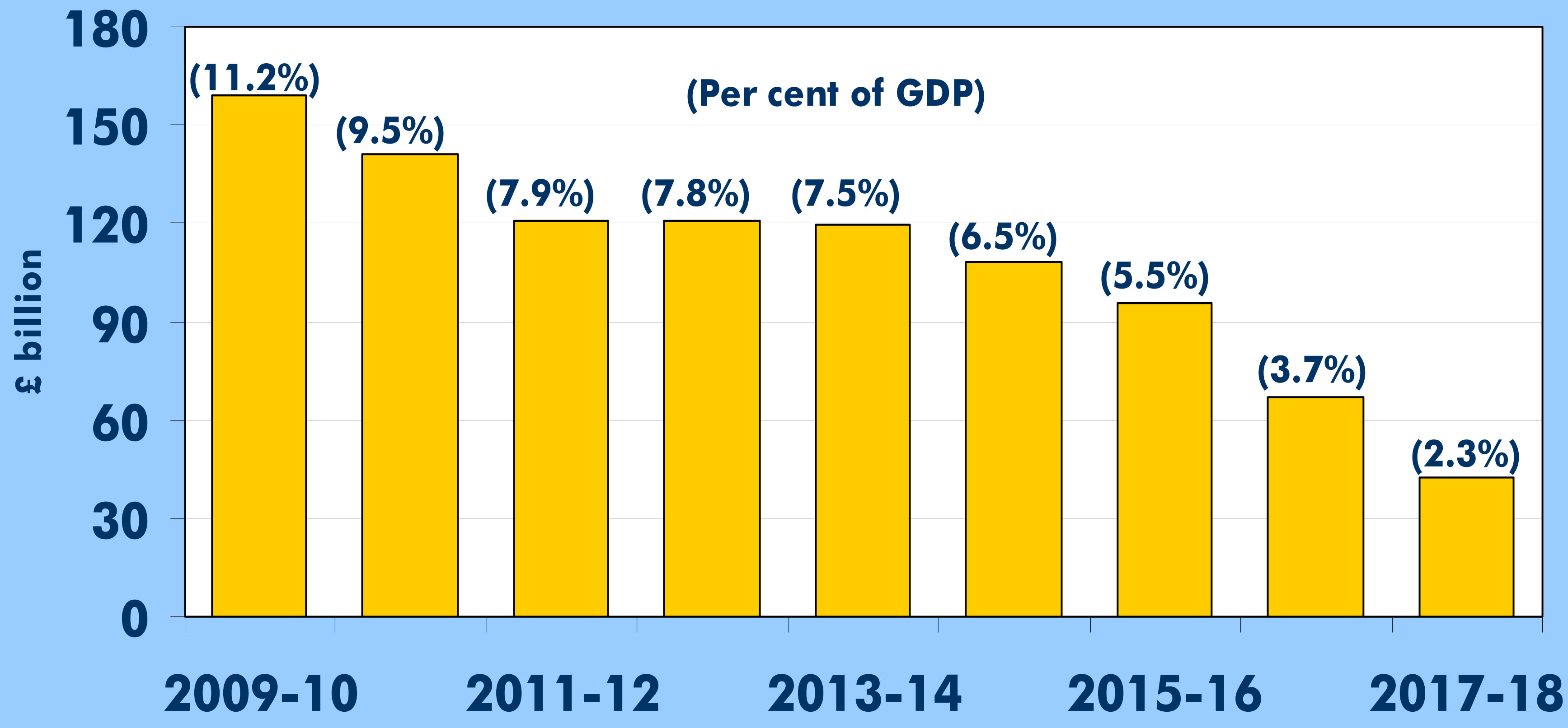
Public sector net borrowing

Excluding Royal Mail and APF transfers



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Net borrowing in 2012-13

	PSNB ex Royal Mail and APF
December forecast	**£119.9bn**
Lower underlying receipts forecast (mostly income tax and North Sea)	+£5.1bn
4G auction receipts lower than expected	+£1.2bn
Lower underlying spending forecast (partly lower inflation and unemployment)	–£1.9bn
Squeeze on central government departmental spending	–£3.4bn
March forecast	**£120.9bn**

Central government spending

- £11bn underspend versus July 2012 PESA plans
- £5bn underspend in Supplementary Estimates – final plans – including £4bn Budget Exchange
- February forecasts showed further £5bn reduction against Supplementary Estimates
- We expect another small underspend on top
- Spending limits cut in 2013-14 and 2014-15
- One result: greater transparency

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Public sector net borrowing

Excluding RM and APF	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
December	**120**	**112**	**99**	**81**	**56**	**31**
Receipts forecast	+5	+9	+9	+12	+13	+14
Spending forecast	–1	-	–1	-	-	–1
Budget measures	-	–1	+2	+3	–2	–1
2012-13 spending	–3	1	1	-	-	-
March	**121**	**120**	**108**	**96**	**67**	**43**
Memo: change	*+1*	*+8*	*+10*	*+14*	*+11*	*+12*

Impact of Budget policy measures

- Neutral budget over full five years
- Small giveaways/takeaways in individual years
- Plus £3bn current to capital switch in next SR
- Doesn't affect level of GDP by 2017-18
- Small near-term reduction in inflation
- Support for housing transactions

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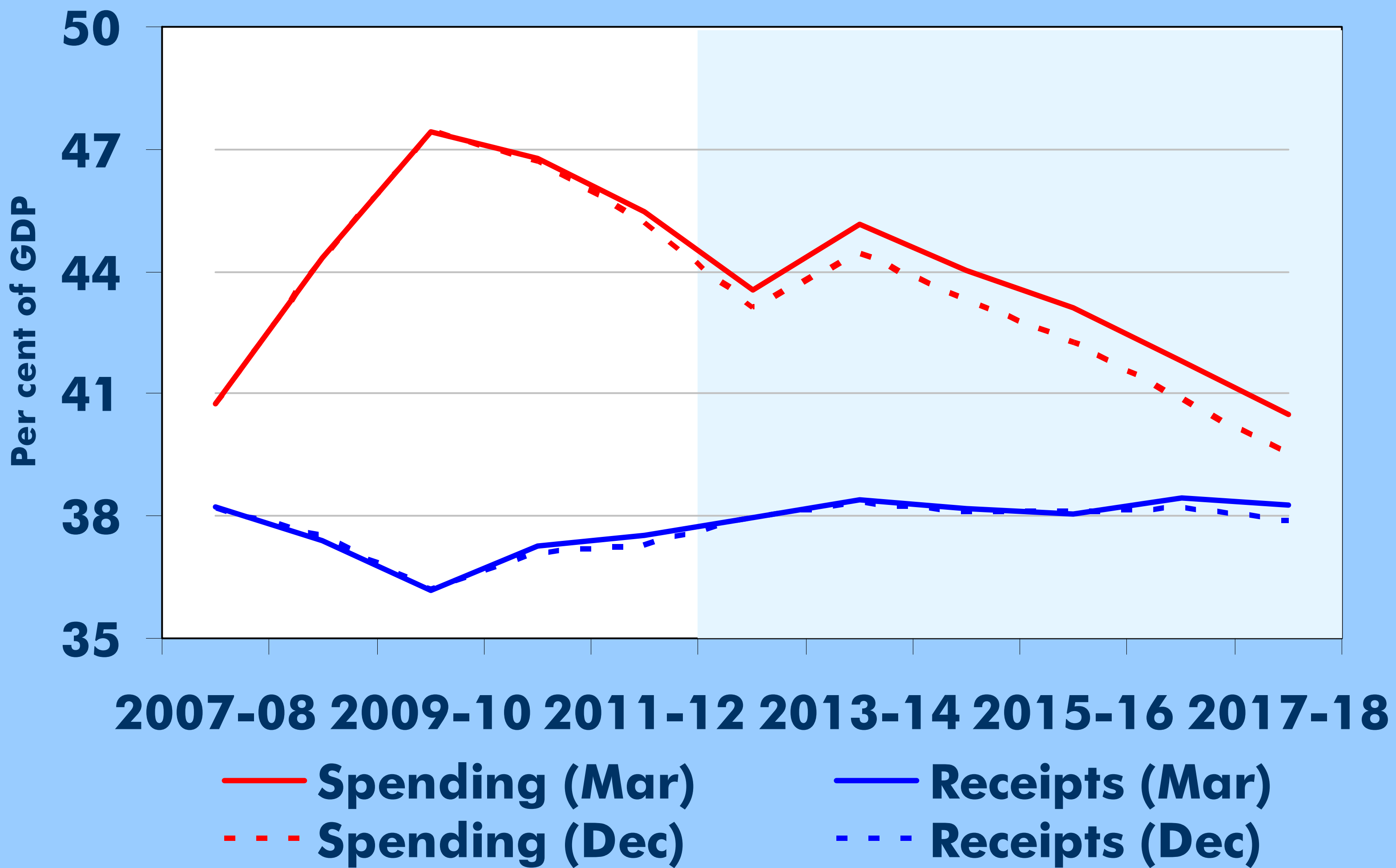
Receipts and spending



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The fiscal mandate

CACB as % of GDP	2016-17	2017-18
December	**+0.4**	**+0.9**
Judgement on potential output	–0.2	–0.2
APF transfers	-	+0.1
Budget measures	+0.3	+0.2
Other forecasting changes	–0.3	–0.3
March	**+0.1**	**+0.8**

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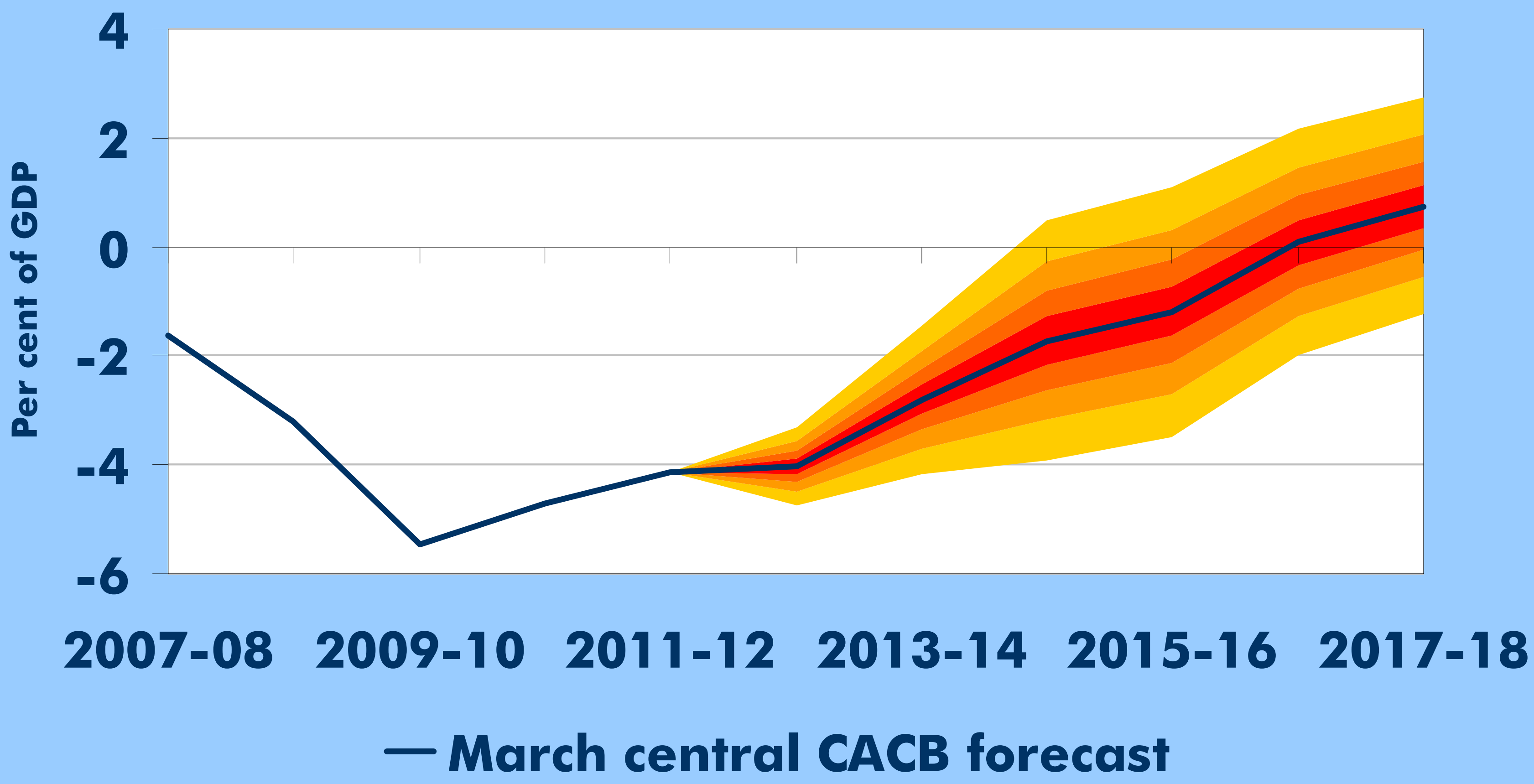
Uncertainty and the mandate



- **Implies 70% chance of success**

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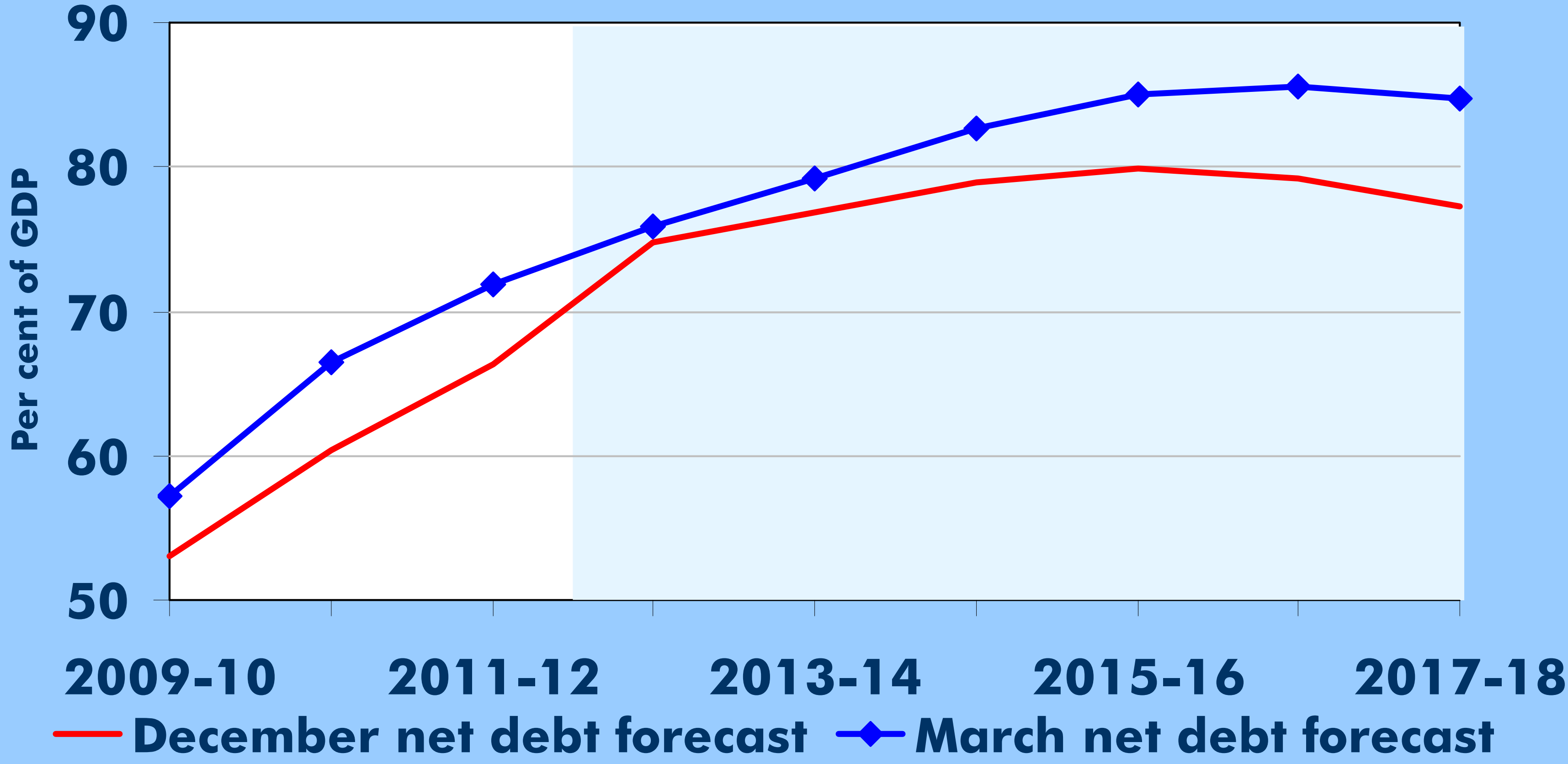
Public sector net debt



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Change in net debt on previous year

% of GDP	**2015-16**	**2016-17**
December	**+1.0**	**–0.8**
Nominal GDP revised down	+0.2	+0.2
Higher net borrowing	+0.8	+0.5
Gilt issuance premia and other	+0.5	+0.5
March	**+2.4**	**+0.5**

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