Office for
Budget
Responsibility

PRESS NOTICE

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OBR revises up public sector borrowing forecast

The independent Office for Budget Responsibility has revised up its forecasts for public sector net borrowing by around £10 billion a year in the medium term, mainly reflecting the impact of higher inflation and a weaker outlook for economic growth.

The OBR's latest forecasts are published in its March 2011 *Economic and fiscal outlook.* This sets out projections for the economy and for the public finances through to 2015-16, incorporating the impact of measures announced in Budget 2011.

Despite the increase in expected borrowing, the OBR believes that the Government remains on course to achieve its two medium-term fiscal targets – and with much the same margin for error as it had after the June 2010 Budget.

The OBR has endorsed all but one of the Government's Budget policy costings: the short life assets regime costing was provided with too little information and after the deadline for adequate scrutiny. We will re-examine it after the Budget and adjust our next forecast if necessary. We were also informed of the corporation tax main rate cut and the additional 1p cut in fuel duty after the deadline for incorporation in the economic forecast, but we do not believe that they would have had a material effect. Our fiscal forecast does however include the direct costs of these measures for the public finances.

Key conclusions from the *Outlook* include:

The outlook for the economy

- Our central forecast is for the economy to grow by 1.7 per cent in 2011, down from the 2.1 per cent we forecast in the last *Outlook* in November. Higher-than-expected inflation is expected to squeeze household incomes and weaken consumer spending growth. Recent data also suggest that the economy had less momentum coming into 2011 than appeared likely in November.

- Weaker economic growth this year and next increases the amount of spare capacity in the economy and creates scope for slightly higher growth in 2014 and 2015. But we do not expect all the ground lost to be made up: our forecast for the level of GDP in 2015-16 is 0.7 per cent lower than in November. Higher oil prices explain about a quarter of this downward revision.

- Policy measures announced in the Budget could, in time, increase the productive potential of the economy. But the effects are uncertain, they would likely appear with a lag, and they will depend on how the policies are implemented. Given this, the existence of potential offsetting risks, and the uncertainty that lies around the underlying estimate, we do not believe that there is sufficient evidence yet to justify raising our trend growth assumptions from November.

- LFS unemployment is forecast to rise from 8.0 to 8.3 per cent of the labour force by the second quarter, before falling to 6.4 per cent by 2015. Over the next five years we expect market sector employment to rise by 1.3 million, partly offset by a roughly 400,000 fall in general government employment.

- Higher global energy and food prices are likely to keep CPI inflation between 4 and 5 per cent for most of 2011, higher than we forecast in November. But as recent price rises fall out of the annual inflation rate, and as spare capacity continues to bear down on inflationary pressures, it should fall back towards its target level of 2 per cent.

The outlook for the public finances

- Public sector net borrowing is expected to come in at £145.9 billion (or 9.9 per cent of GDP) in 2010-11. This is £2.6 billion less than we forecast in November, largely reflecting lower spending. We do not expect revenues to be as strong in the remainder of the year as some external analysts, reflecting February outturns and the fact that income tax receipts this time last year were probably boosted by forestalling ahead of the introduction of the 50p tax rate.

- Public sector net borrowing is then expected to fall from £122 billion (7.9 per cent of GDP) in 2011-12 to £29 billion (1.5 per cent) by 2015-16, with cuts in spending on public services and administration making the largest contribution.

- Total public spending is expected to be higher in the medium term than forecast in November, with revenues broadly flat. By 2015-16 spending is expected to be £10.9 billion higher than forecast in November, with net borrowing £11 billion (or 0.6 per cent of GDP) higher.

- The upward revision to spending primarily reflects the impact of higher near-term inflation, which pushes up social security and debt interest bills. There are offsetting factors within our broadly unchanged revenue forecast. Weaker economic activity pushes down income tax and NIC receipts, while Budget measures also reduce corporation tax and fuel duty receipts. Conversely, higher oil prices, market interest rates and inflation increase North Sea revenues, interest receipts and business rates receipts respectively.

- The measures announced in Budget 2011 have very little direct effect on the outlook for the public finances. 'Giveaways' and 'takeaways' broadly balance in each year of the forecast, with a net fiscal tightening (i.e. a reduction in net borrowing arising from the measures) of just £0.3 billion in 2015-16.

- Our forecasts for cyclically-adjusted net borrowing have been revised up less sharply than our forecasts for headline borrowing. This is because we believe that there will be more spare capacity in the economy in the medium term than we expected in November, so much of the headline change is cyclical.

Performance against the Government's fiscal targets

- The Government has a medium-term fiscal mandate (to balance the cyclically-adjusted current budget by the end of a rolling, five year period) and a supplementary target (to see public sector net debt falling in 2015-16).

- Taking into account the measures announced in Budget 2011, our central forecast suggests that the Government has a greater than 50 per cent probability of meeting both these targets under current policy. Compared to the June 2010 Budget, it has the same margin for error against the mandate and slightly less against the supplementary target.

- If our forecasts are as accurate as past Budget and Pre-Budget Report forecasts, there is a roughly 70 per cent chance of the Government meeting the mandate under current policies.

- The greatest threat to the achievement of the mandate is if there is less spare capacity in the economy than we estimate, and therefore less scope for growth to help erode the deficit. If the economy is running 1.5 per cent or less below full capacity – rather than the 3 per cent we currently believe – then the mandate would be on course to be missed.

- If higher inflation was to be reflected in wage settlements, and then to remain persistently higher than in our central forecast, this would probably increase rather than reduce the Government's chances of meeting the mandate by boosting revenues. But on unchanged policies the cash plans set out in the Spending Review would then imply a much tighter real squeeze on public services spending.

NOTES TO EDITORS

1. The Office for Budget Responsibility is the UK's independent fiscal watchdog – responsible for producing forecasts for the economy and the public finances and reporting on long-term fiscal sustainability.
2. The *Outlook* is available here: http://budgetresponsibility.independent.gov.uk/
3. We will release supplementary information on the *Economic and fiscal outlook* at 2pm on 28 March, in response to requests received by 12pm on 25 March. We will release a list of the information to be published at 2pm on 25 March. Subsequently we will continue with our standard policy of releasing supplementary information monthly on the day of the 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 Tom Youldon in the press office on 020 7271 2435.