

Office for
**Budget
Responsibility**

Economic and fiscal outlook

5 December 2012

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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 23 November**
- **No pressure to change any conclusions**

Overview

- **Economic outlook**

- **Weaker outlook for real and nominal GDP growth**
- **Policy measures provide small boost over next two years**
- **Majority of growth downgrade cyclical not structural**

- **Fiscal outlook**

- **Comparisons complicated by special factors (e.g. APF)**
- **Weaker economy weakens revenues**
- **Little change in outlook for spending**
- **Budget deficit shrinks less quickly than in March**
- **On course to hit fiscal mandate, now in 2017-18**
- **But debt unlikely to be falling in 2015-16**

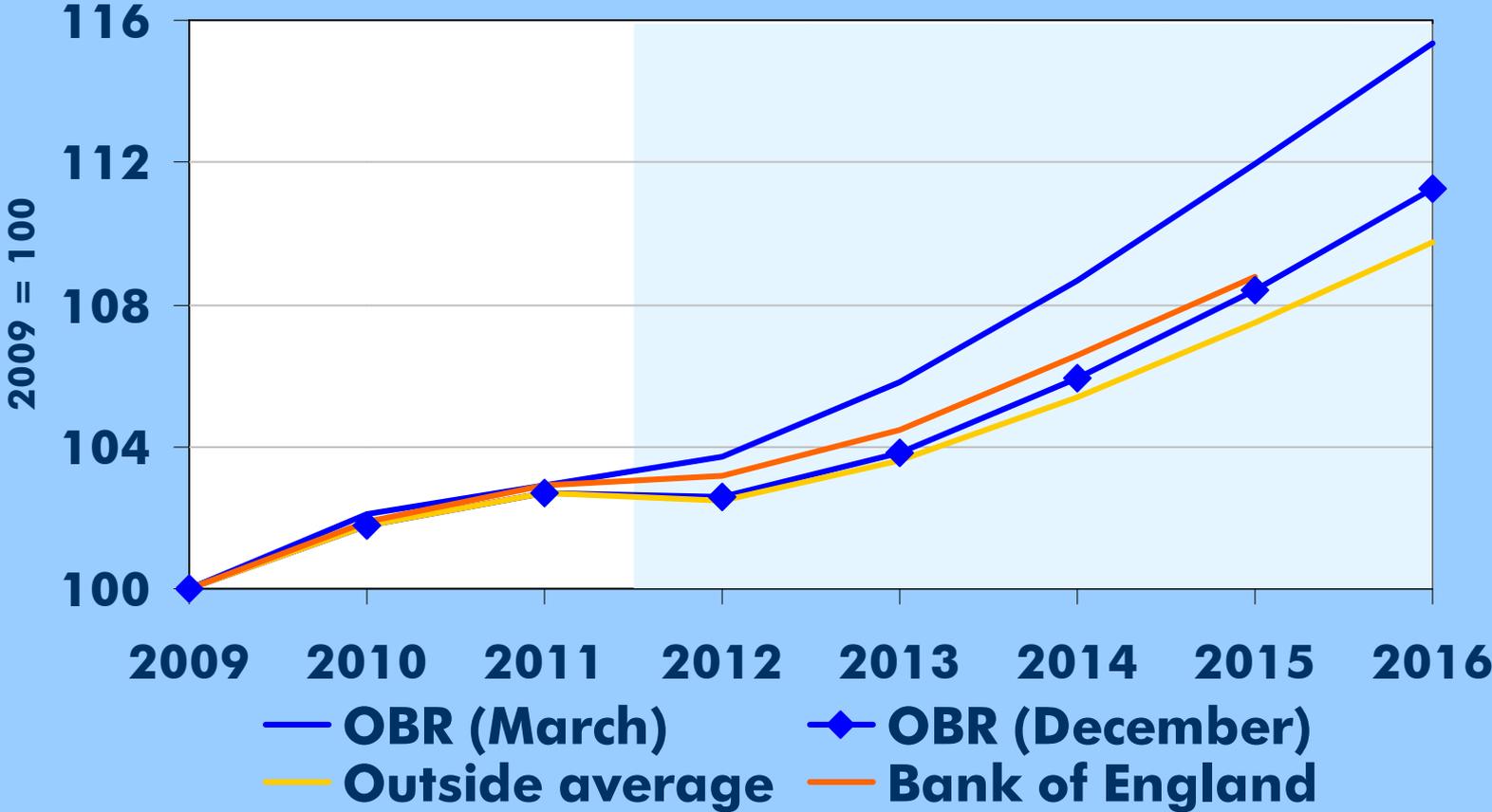
GDP growth per quarter



GDP growth

% growth p.a.	March EFO	December EFO	Change
2012	0.8	-0.1	-0.9
2013	2.0	1.2	-0.8
2014	2.7	2.0	-0.7
2015	3.0	2.3	-0.7
2016	3.0	2.7	-0.4
2017	-	2.8	-

Level of GDP since the trough



Household consumption

% growth p.a.	2012	2013	2014	2015	2016
New forecast	0.5	0.9	1.6	1.8	2.4
<i>Change from March</i>	<i>0.0</i>	<i>-0.5</i>	<i>-0.8</i>	<i>-1.2</i>	<i>-0.6</i>

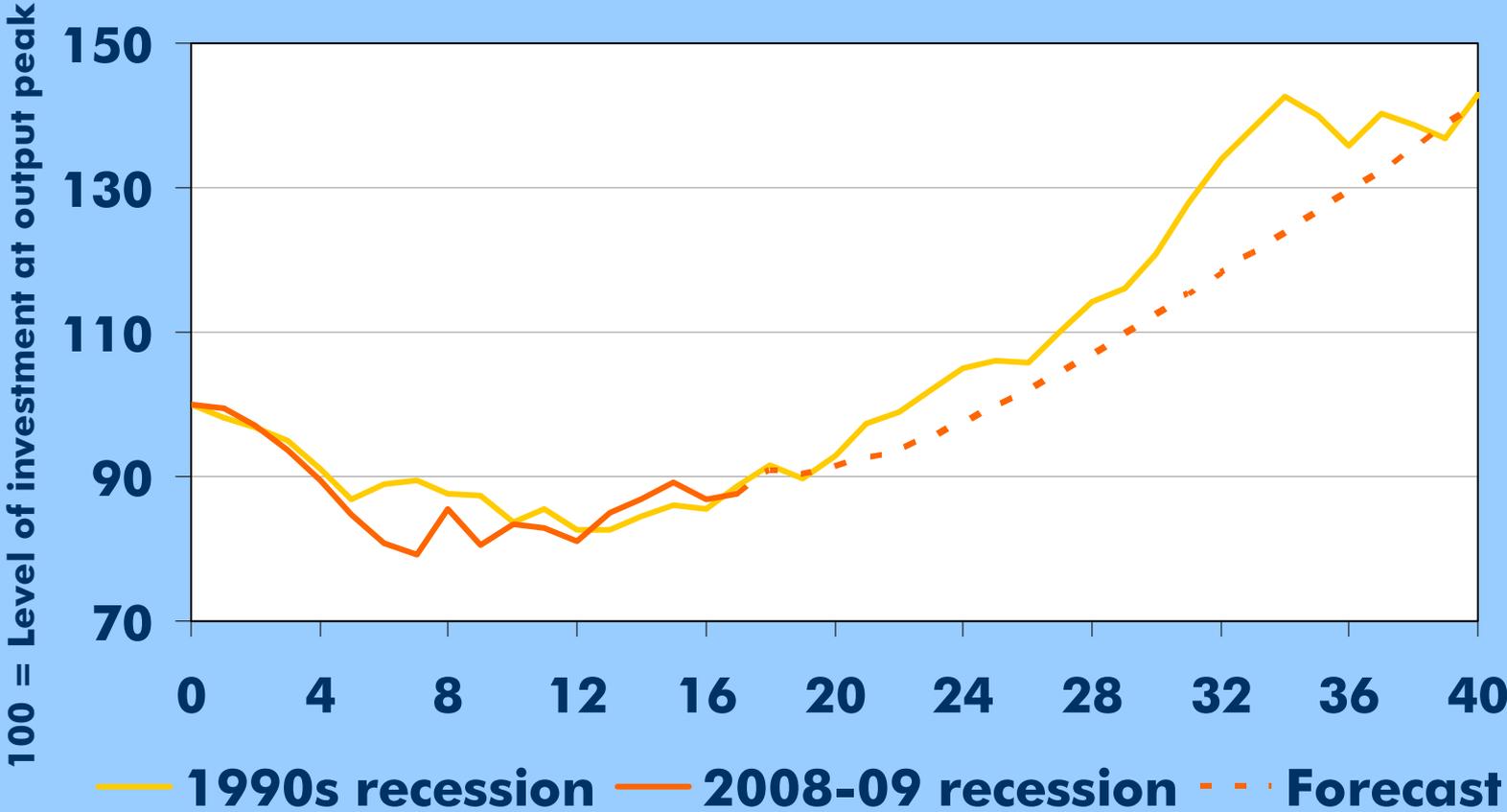
- **Consumption growth revised down since March**
- **Weak productivity slows pick-up in nominal earnings**
- **Upward revision to inflation squeezes real incomes**

Business investment

% growth p.a.	2012	2013	2014	2015	2016
New forecast	3.8	4.9	8.1	10.2	10.1
<i>Change from March</i>	<i>+3.1</i>	<i>-1.5</i>	<i>-0.7</i>	<i>-0.1</i>	<i>+0.1</i>

- **Slower growth expected over forecast horizon**
- **Eurozone troubles hit demand and credit conditions**
- **Outlook for domestic demand weaker**
- **But starting position much stronger**

Business investment: now & 90s



- **Business investment now 7% up since the recession ended, not 1% down as in March**

Other components of demand

- **Net trade**

- **Unexpectedly big drag on growth this year**
- **Contribution still positive, but revised down since March**
- **Export markets weaker, plus loss of share**

- **Government consumption**

- **Revised up since March, as output assumed to be less affected by cuts in nominal spending**

Labour market and inflation

- **Labour market**

- **Employment stronger than expected, despite double dip**
- **Expect modest rise in unemployment through next year**
- **Government employment projected to fall by about 900k from Q1 2011 to 2018 – excluding FE reclassification**

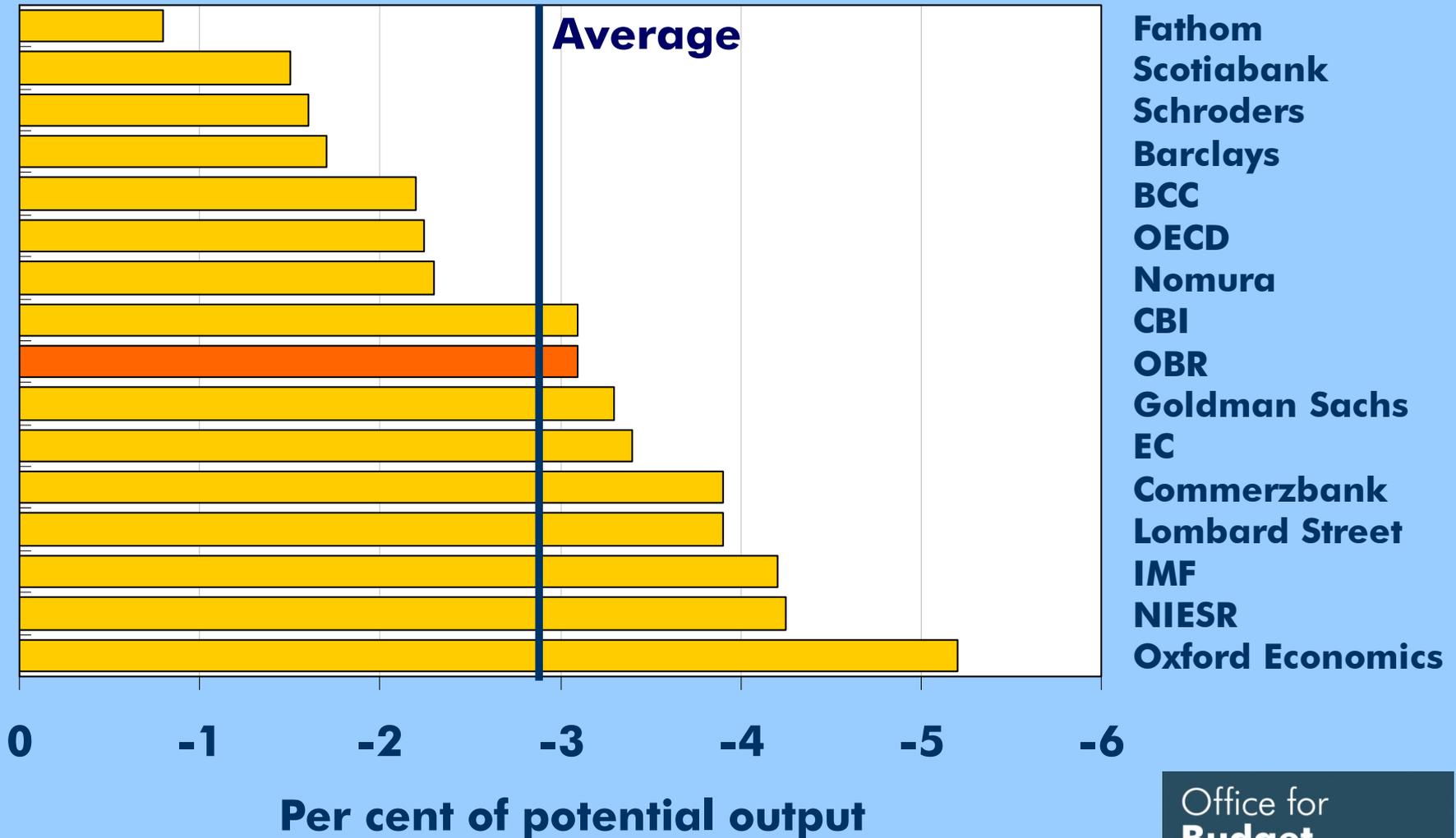
- **Inflation**

- **Inflation revised up for 2013 and 2014 since March**
- **Thanks to tuition fees, energy and food**
- **GDP deflator growth revised down in medium term**

Potential output I

- **Business surveys and earnings growth suggest that spare capacity shrank during the double dip**
- **This would imply a significant fall in Total Factor Productivity – the efficiency with which inputs are combined to make a unit of output**
- **Falling TFP seems less plausible now than during the crisis, so we assume TFP was flat**
- **So output 3.1% below potential in 2012**

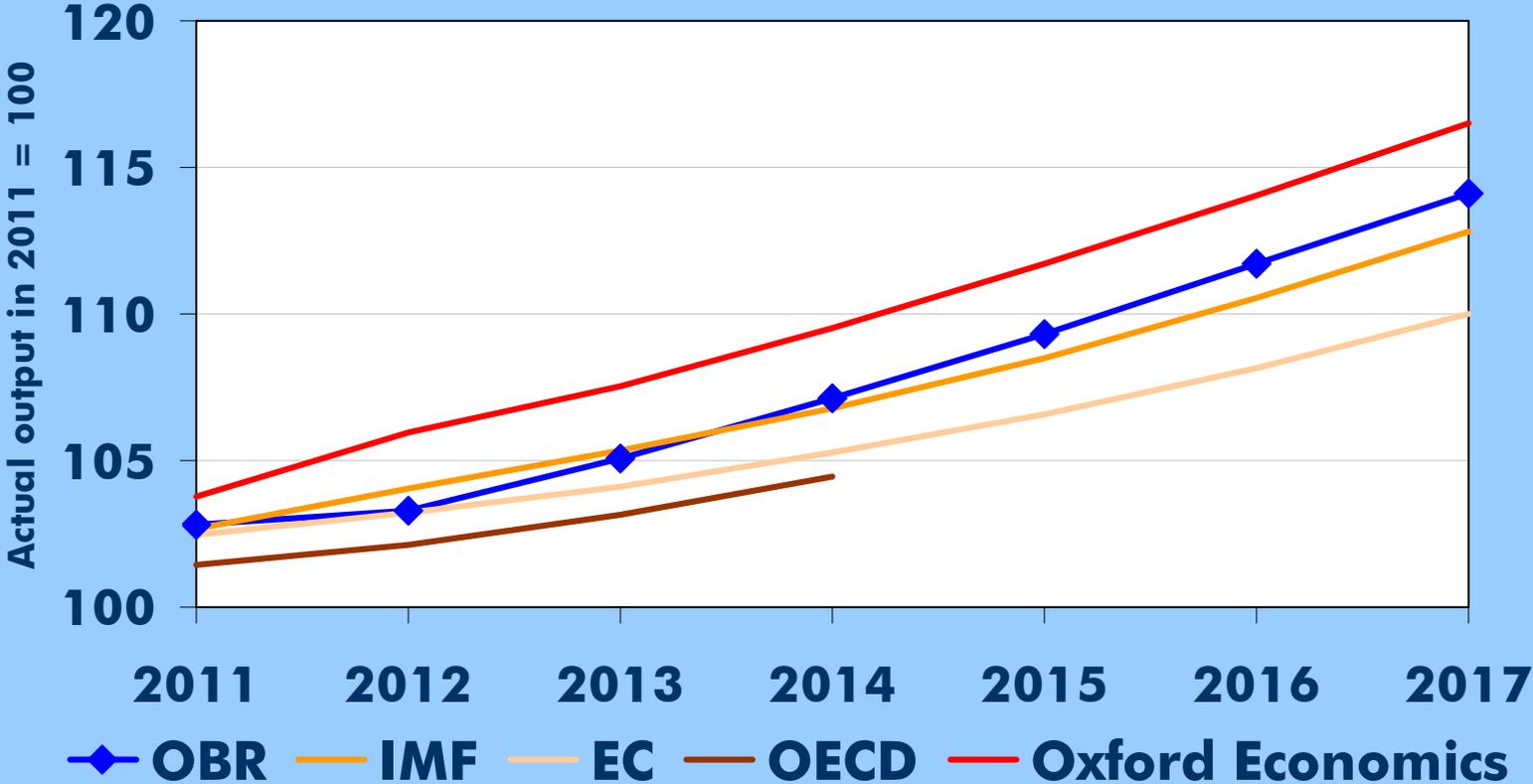
Output gap in 2012



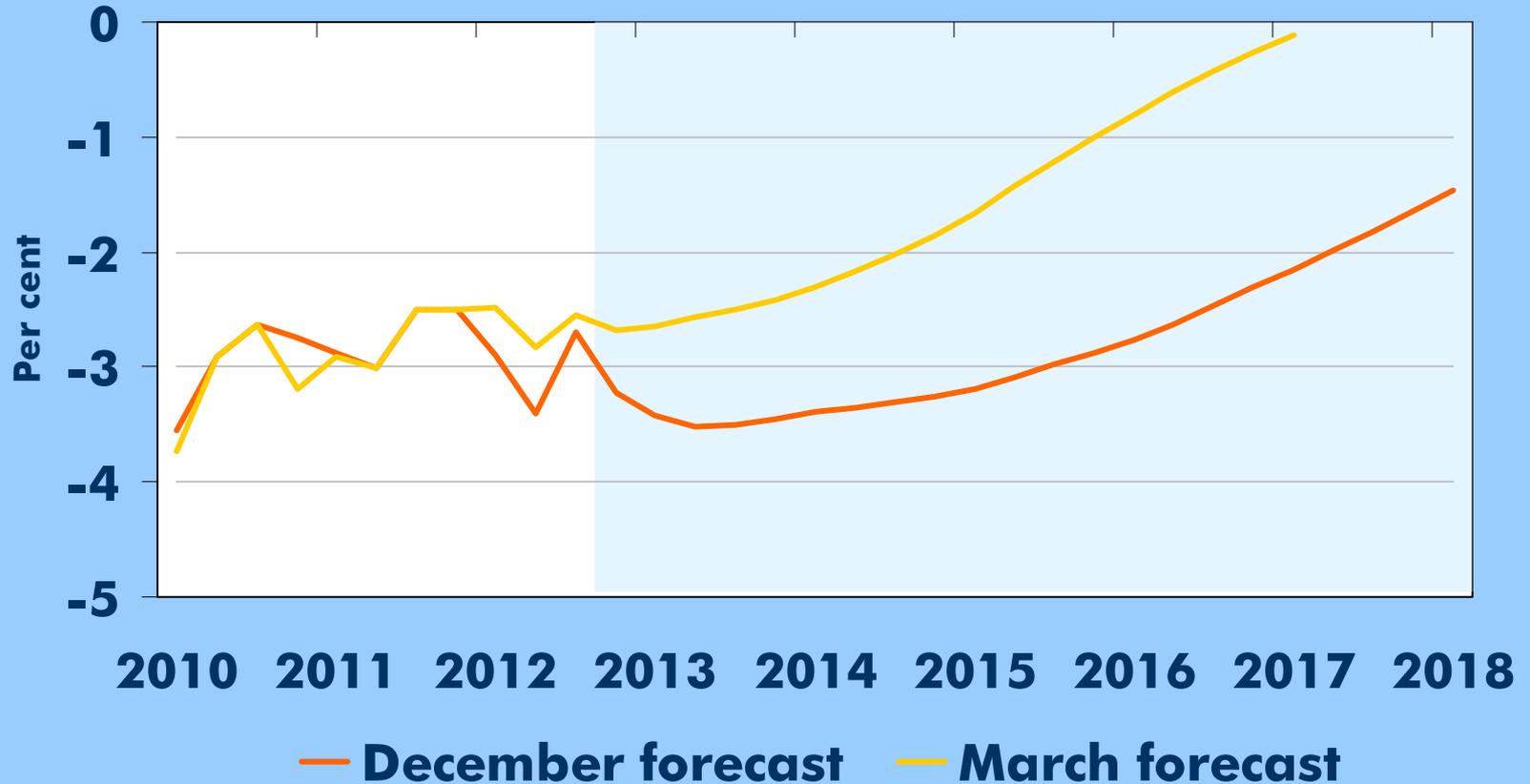
Potential output II

- **We assume that potential GDP growth takes longer to recover to its long-term trend**
- **Given current output gap and future growth estimates, potential GDP ends up 1.3% lower in 2016 than we thought in March**

Potential output forecasts



Output gap forecast



The public finances

- **This time comparisons complicated by:**
 - **Royal Mail pension fund transfer**
 - **Reclassification of Bradford & Bingley and NRAM into central government**
 - **Government's decision to transfer Asset Purchase Facility (APF) balances to the Treasury**

Royal Mail pension transfer

- **Government took Royal Mail's historic pension deficit – plus associated pension fund assets – onto public sector balance sheet in April**
- **Impact (also included in March forecast):**
 - **£28bn one-off cut in PSNB in 2012-13**
 - **£23bn cut in net debt from 2013-14 as assets sold**
 - **£1.3-1.5bn increase in annual pension spending**

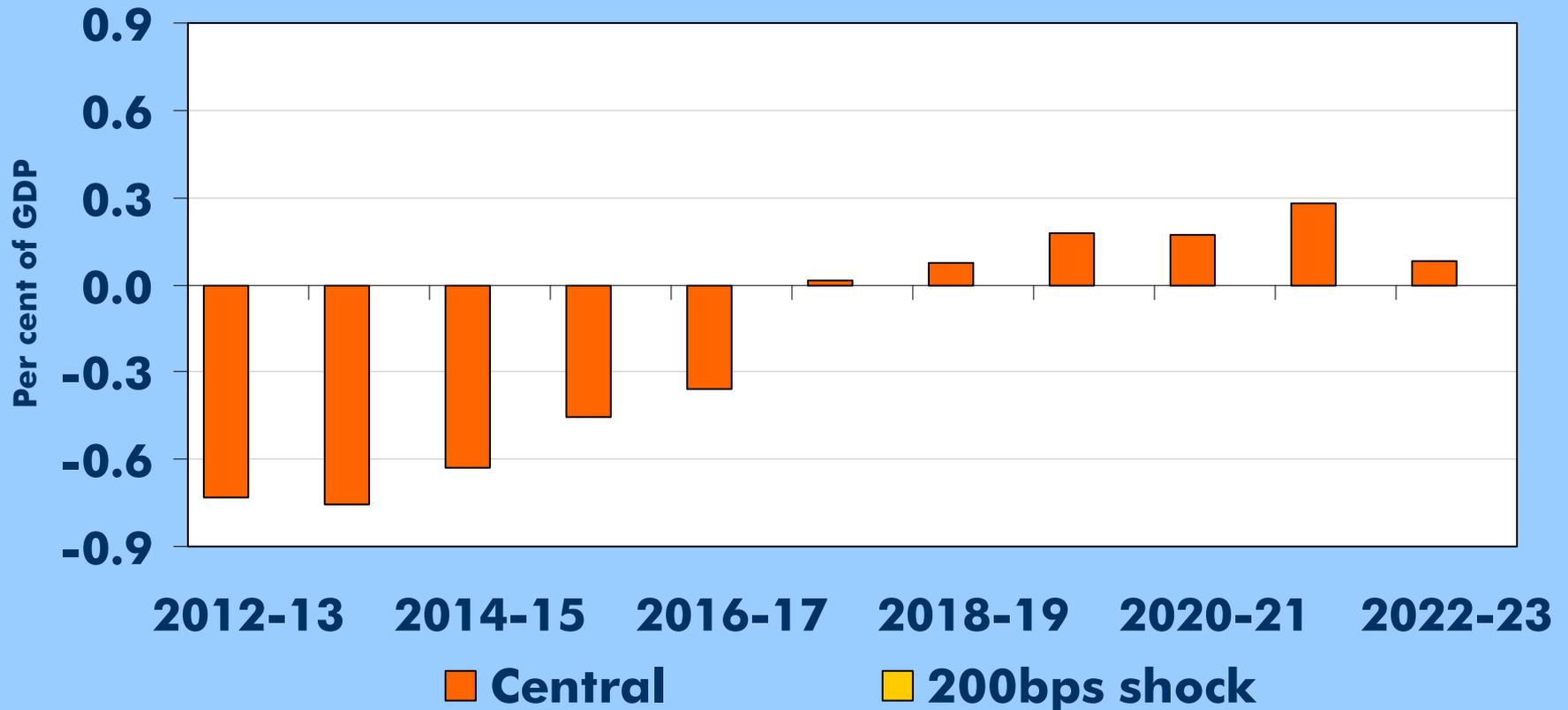
B&B/NRAM reclassification

- **ONS has decided that Bradford & Bingley and Northern Rock Asset Management are part of central government**
- **This results in small improvements in PSNB and the current budget balance in each year of the forecast (£1.6bn max)**
- **But also increases net debt by 4.3 per cent of GDP (£68bn) this year falling to 1.7% of GDP (£34bn) in 2017-18 as mortgage books run down**

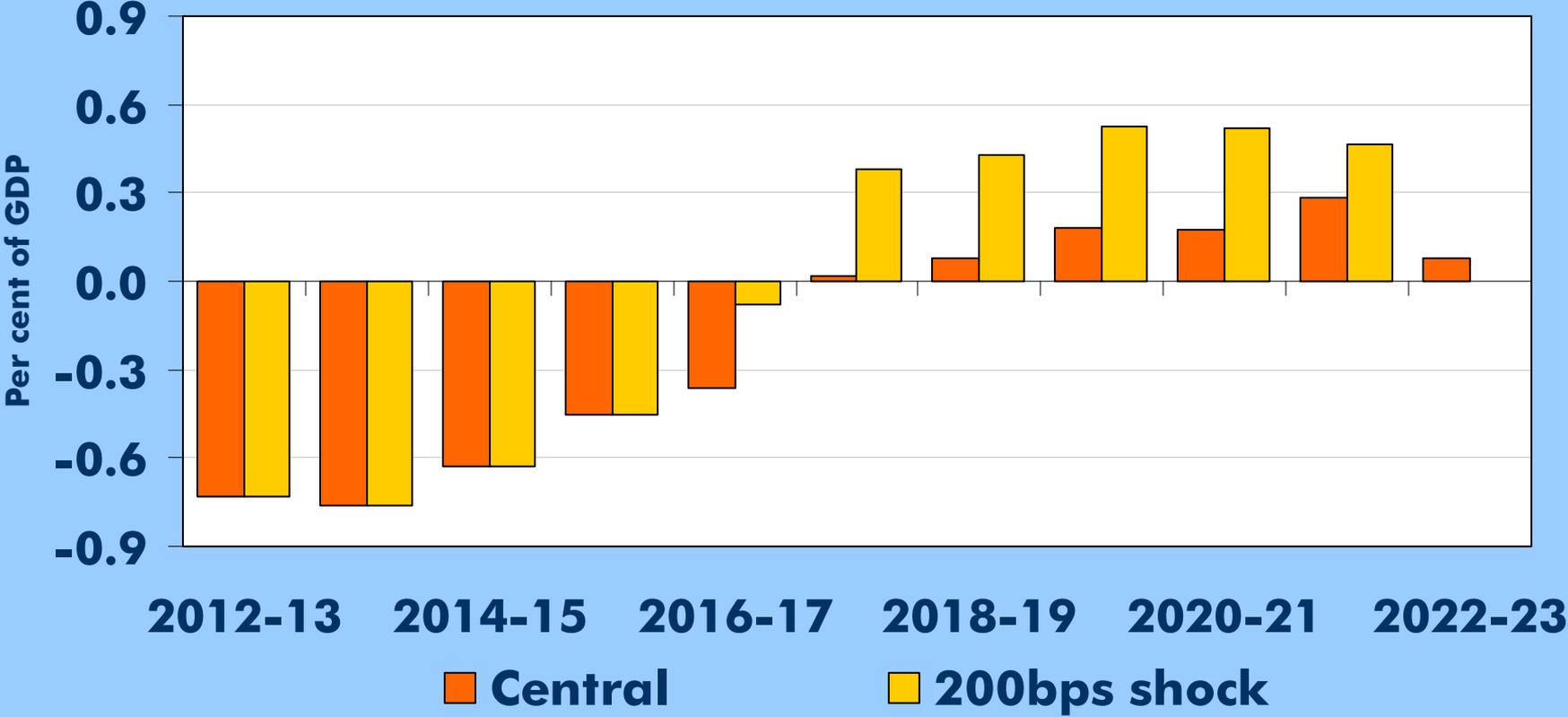
Asset Purchase Facility (APF)

- **Government has decided to transfer surpluses and deficits in the APF to the Treasury on an ongoing basis**
- **We have to predict how ONS will choose to treat this**
- **We assume it will unwind QE between 2016 and 2022**
- **Reduces net borrowing and net debt in the near term as coupon payments flow to the Treasury**
- **But increases it as monetary policy tightens and QE unwound as flows decline and losses crystallise**
- **Net profit/loss depends on gilt movements**

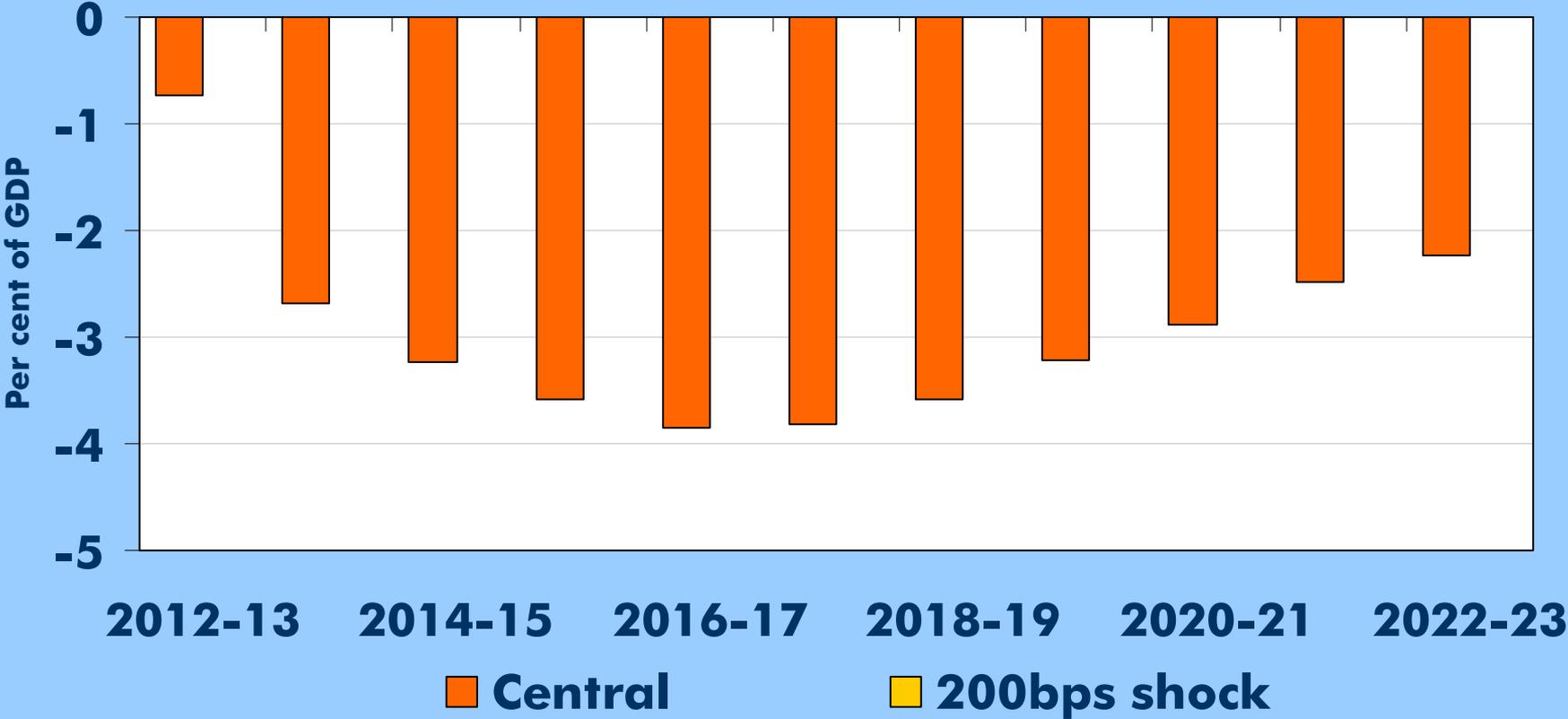
Impact of APF on net borrowing



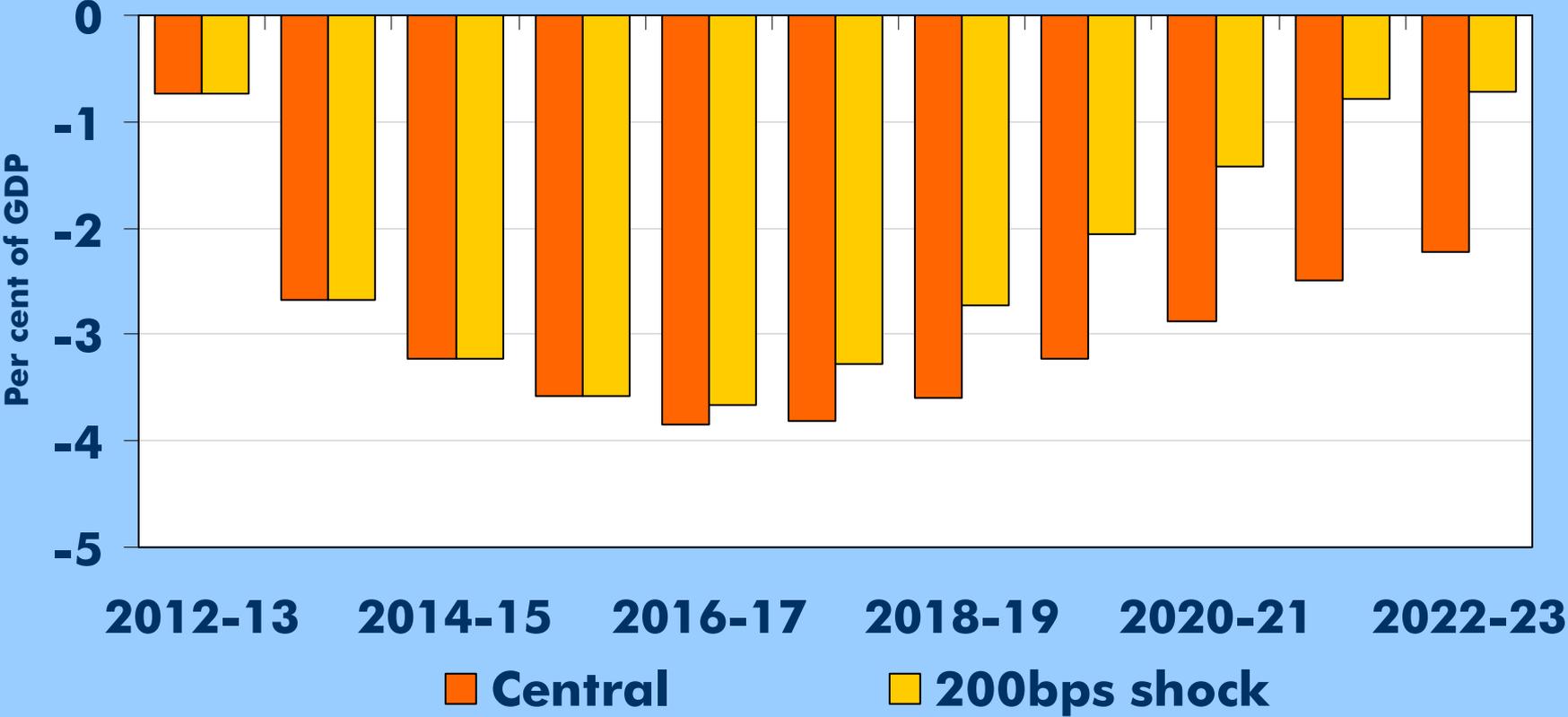
Impact of APF on net borrowing



Impact of APF on net debt



Impact of APF on net debt



Net borrowing in 2012-13

PSNB ex Royal Mail	Cash	% GDP
March forecast	£120bn	7.6
Lower receipts forecast	+£10.4bn	
Lower spending forecast	-£6.1bn	
Spectrum proceeds	-£3.5bn	
Other AS measures	-£0.5bn	
APF	-£11.5bn	
B&B / NRAM	-£0.4bn	
December forecast	£108.5bn	6.9

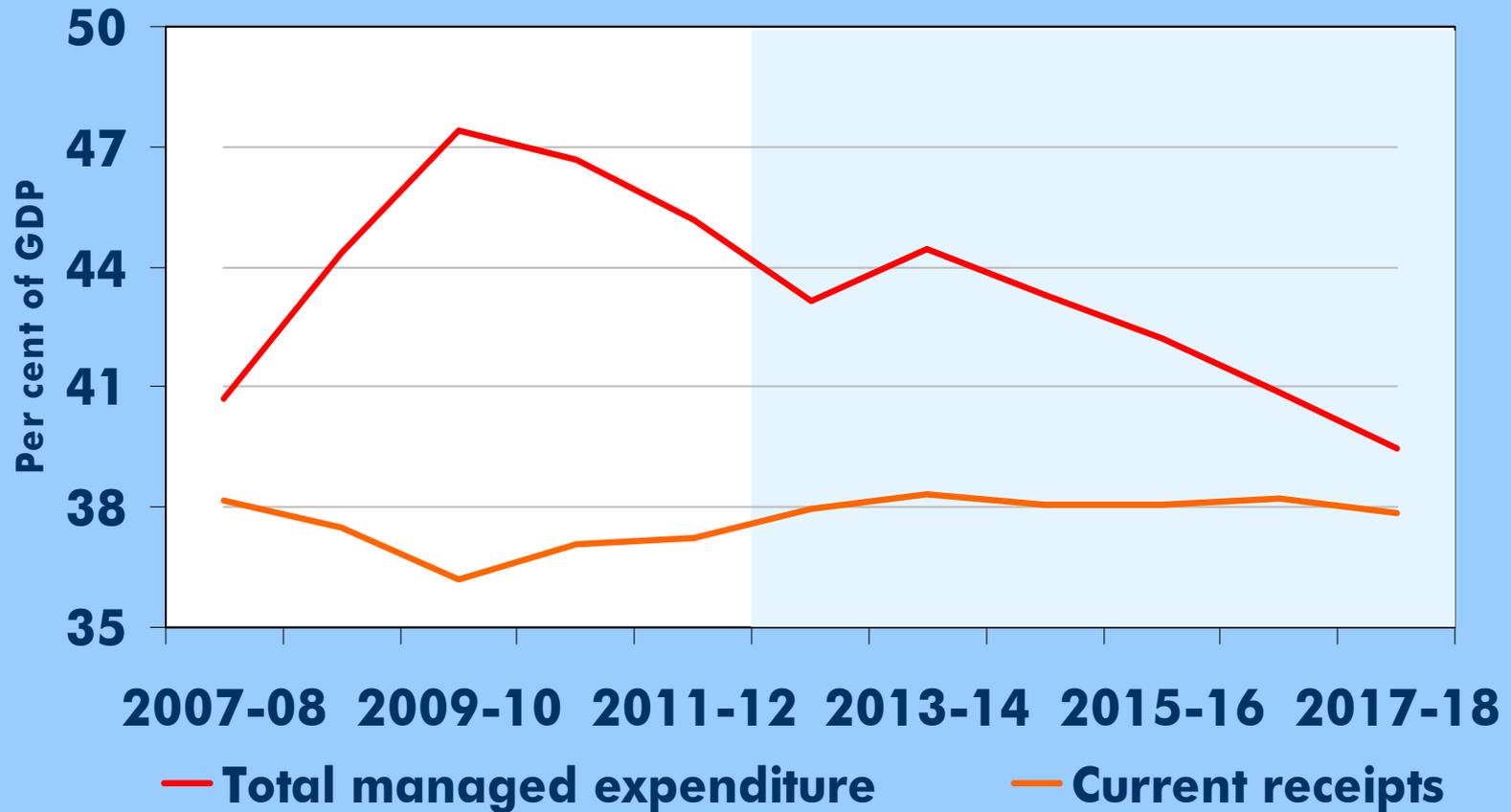
Public sector net borrowing

% of GDP

Excluding RM	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March	7.6	5.9	4.3	2.8	1.1	
December	6.9	6.1	5.2	4.2	2.6	1.6
<i>Change</i>	<i>-0.7</i>	<i>+0.2</i>	<i>+0.9</i>	<i>+1.3</i>	<i>+1.6</i>	

Excluding RM, APF, B&B/NRAM	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March	7.6	5.9	4.3	2.8	1.1	
December	7.7	6.9	5.9	4.7	3.1	1.7
<i>Change</i>	<i>+0.1</i>	<i>+1.0</i>	<i>+1.5</i>	<i>+1.8</i>	<i>+2.0</i>	

Receipts and spending



Receipts and spending

- **Receipts down £29.1bn and spending down £1.2bn in 2016-17 compared to March**
- **Receipts**
 - **Most taxes lower as result of weaker economy**
 - **Partly offset by APF and B&B/NRAM**
- **Spending**
 - **Lower inflation and interest rates reduce spending**
 - **Higher unemployment and higher borrowing increase spending**

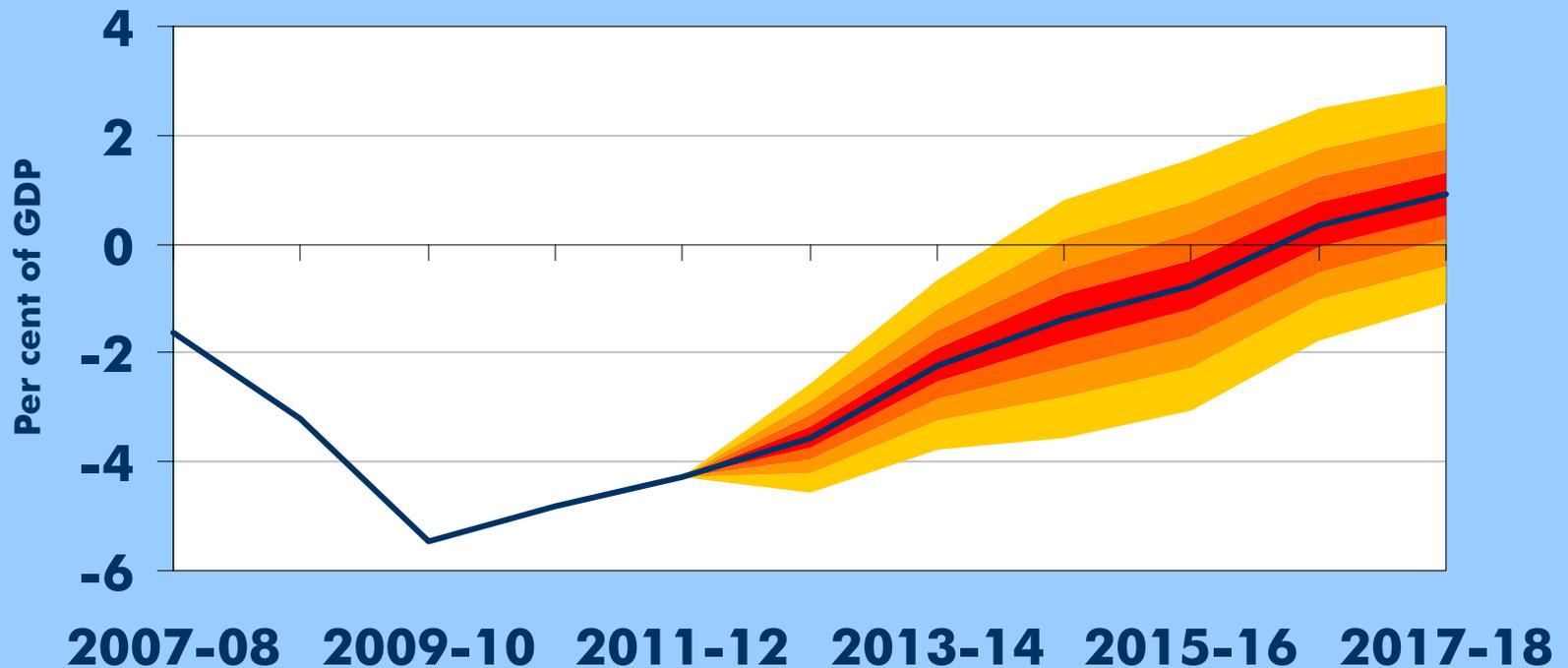
Impact of AS policy measures

- **Little fiscal impact in 2016-17 relative to March**
- **Extending non-investment spending cuts to 2017-18 reduces PSNB by 1.1% of GDP relative to flat as % of GDP**
- **Small boost to GDP growth in 2013 and 2014 (mostly capital spending), then partially reversed**
- **Fuel duty slightly reduces inflation next year**
- **Some boost to housing transactions**

The fiscal mandate

CACB as % of GDP	2016-17	2017-18
March	+0.5	+0.5
Judgement on potential output	-0.9	-0.9
Other forecasting changes	+0.3	+0.3
B&B / NRAM	+0.1	+0.1
APF	+0.4	-
Extending non-investment spending cuts to 17-18	-	+1.1
December	+0.4	+0.9

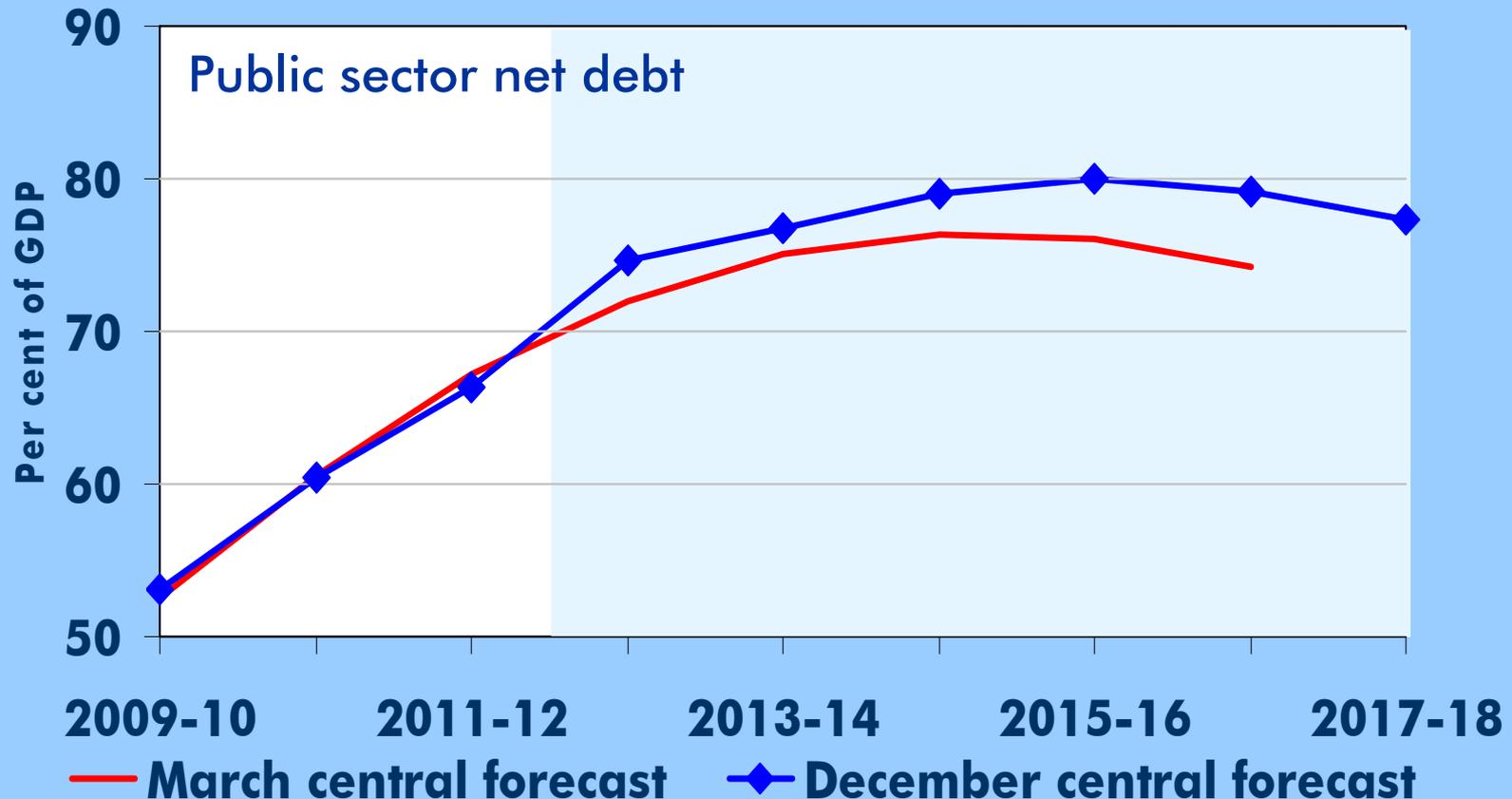
Uncertainty and the mandate



— December central forecast

- **Implies 70% chance of success**

The supplementary target



Change in net debt on previous year

% of GDP	2015-16	2016-17
March	-0.3	-1.8
Lower nominal GDP	+0.8	+0.3
Higher borrowing	+1.6	+1.8
APF	-0.3	-0.3
B&B/NRAM	-0.5	-0.5
Other (inc issuing gilts at premium)	-0.3	-0.3
December	+1.0	-0.8