

Office for
**Budget
Responsibility**

Economic and fiscal outlook

18 March 2015

**Robert Chote
Chairman**

Coverage and process

- Five year forecasts, plus assessment of targets
- Independent BRC responsible for conclusions
- Helped by OBR staff and other officials
- Final pre-measures forecast on 6 March
- Met with the Chancellor on 9 March
- Policy assumptions signed off by 'quad'

Overview

- **Since our last forecast**
 - Further sharp fall in oil price
 - Further rise in net inward migration
 - Lower market interest rates
 - Downward revisions to GDP outturns
 - Another disappointing quarter for productivity growth
 - Weaker global outlook
- **Modest net effect on GDP forecast and budget deficit**
- **Budget policy decisions**
 - Giveaways/takeaways largely offset on scorecard
 - Slightly tighter squeeze on total spending to 2018-19
 - But 2019-20 cut in spending/GDP dropped
 - More asset sales next year to get debt/GDP falling earlier

Recent economic developments

- GDP growth revised down from 5.1% to 4.5% 13Q1 to 14Q3
- GDP growth weaker than expected at 0.5% in 14Q4
- Employment near forecast in Q4, but hours worked stronger
- So hourly productivity fell – again weaker than expected
- Net inward migration 298k in year to September 2014
- Base rate expectations down from 2.2% to 1.7% in 20Q1
- Medium term oil price assumption down 17% since December

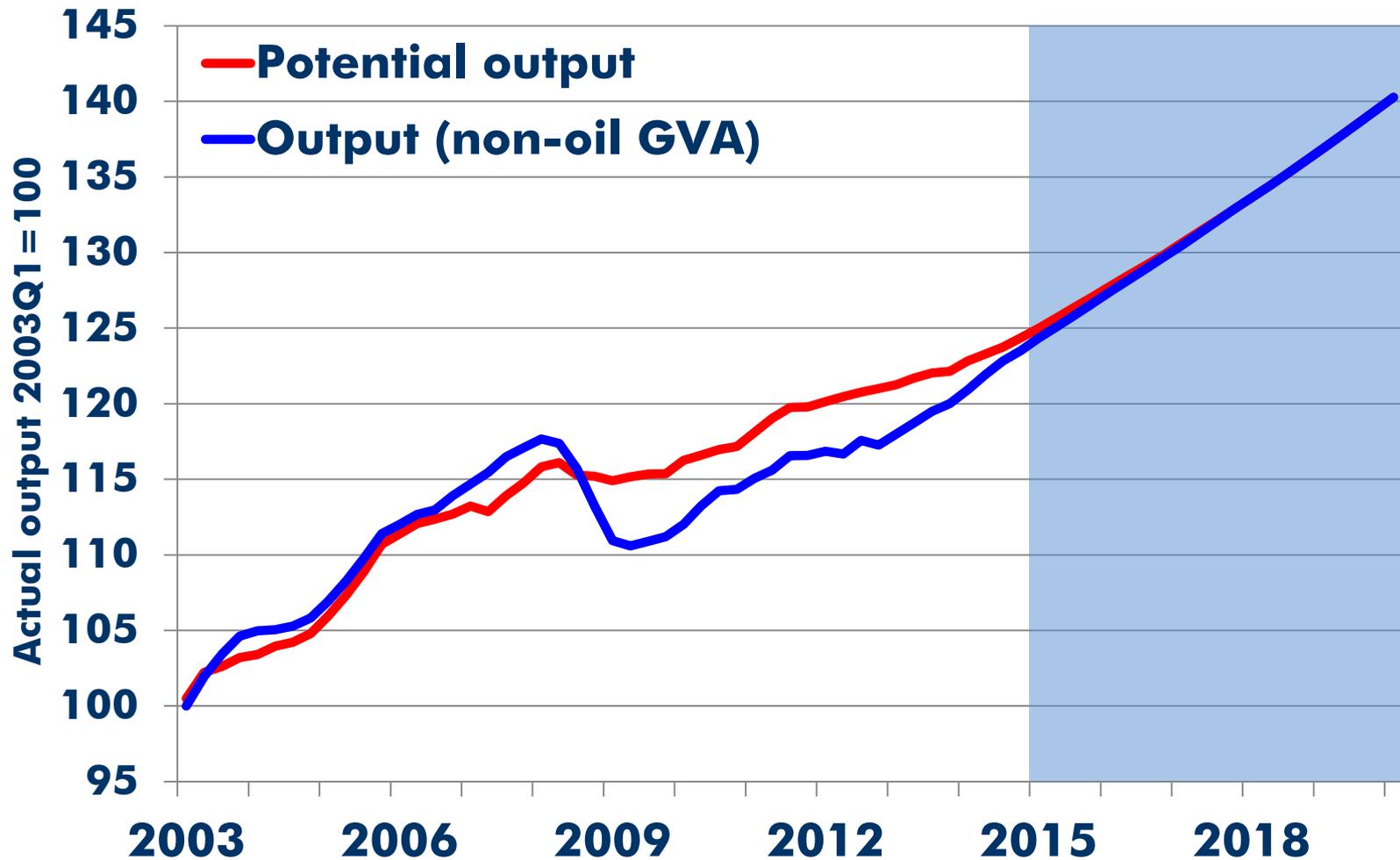
Real GDP growth

| % growth p.a. | December EFO | March EFO | Change (to unrounded data) |
|--------------------------|-------------------------|----------------------|---------------------------------------|
| 2014 | 3.0 | 2.6 | -0.5 |
| 2015 | 2.4 | 2.5 | +0.1 |
| 2016 | 2.2 | 2.3 | +0.2 |
| 2017 | 2.4 | 2.3 | -0.1 |
| 2018 | 2.3 | 2.3 | - |
| 2019 | 2.3 | 2.4 | +0.0 |

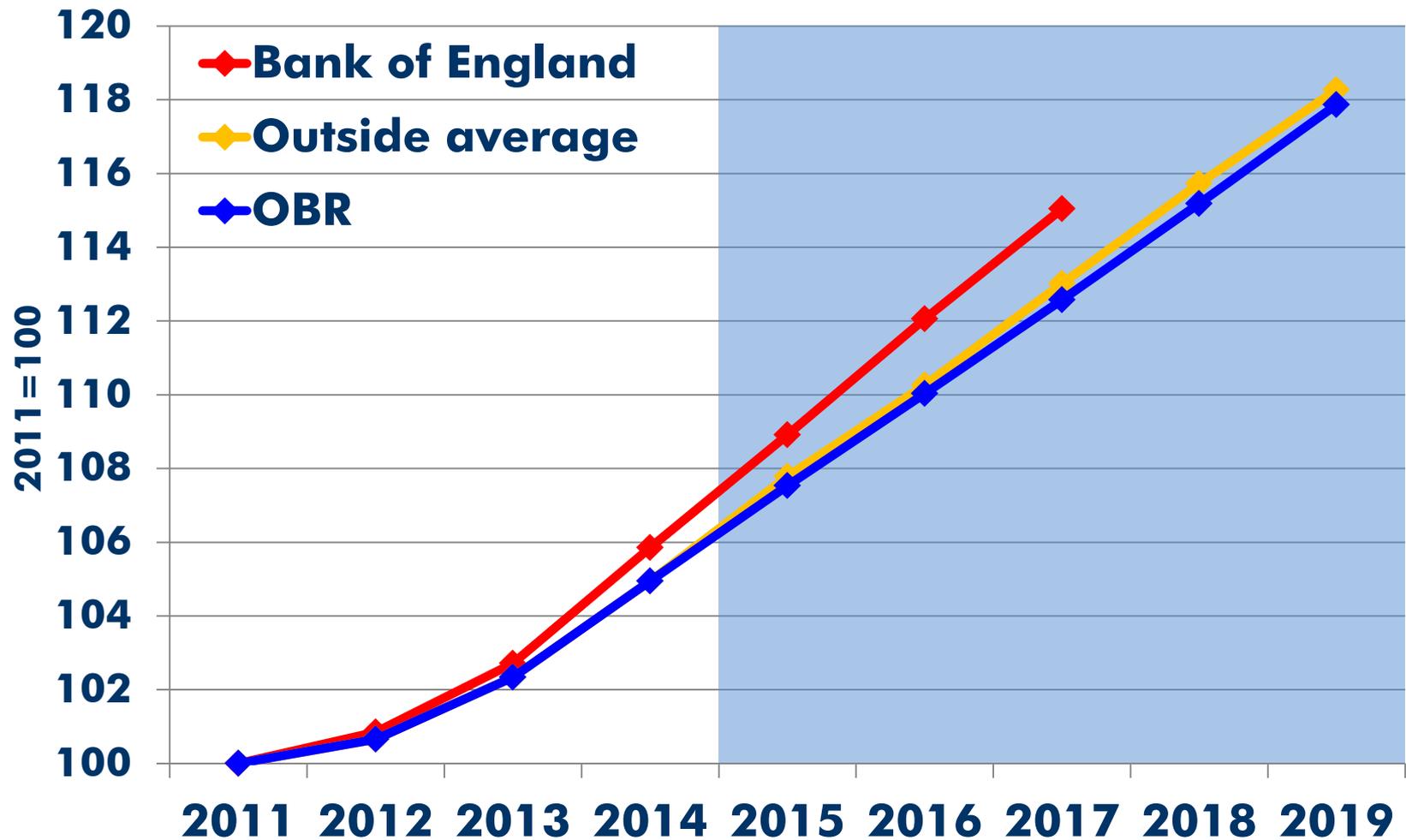
Cumulative growth 14Q3 to 20Q1

- **Potential non-oil output growth +0.6pppts**
 - +0.6pppts from greater net inward migration
 - + $\frac{1}{4}$ pppts from lower oil price via higher investment
 - - $\frac{1}{4}$ pppts from recent weak productivity
- **Actual non-oil output growth also +0.6pppts**
 - Revised up from 13.6% to 14.2%
- **But oil production falls 20 per cent**
- **So growth in GDP revised +0.4pppts**
 - From 13.3% to 13.7%

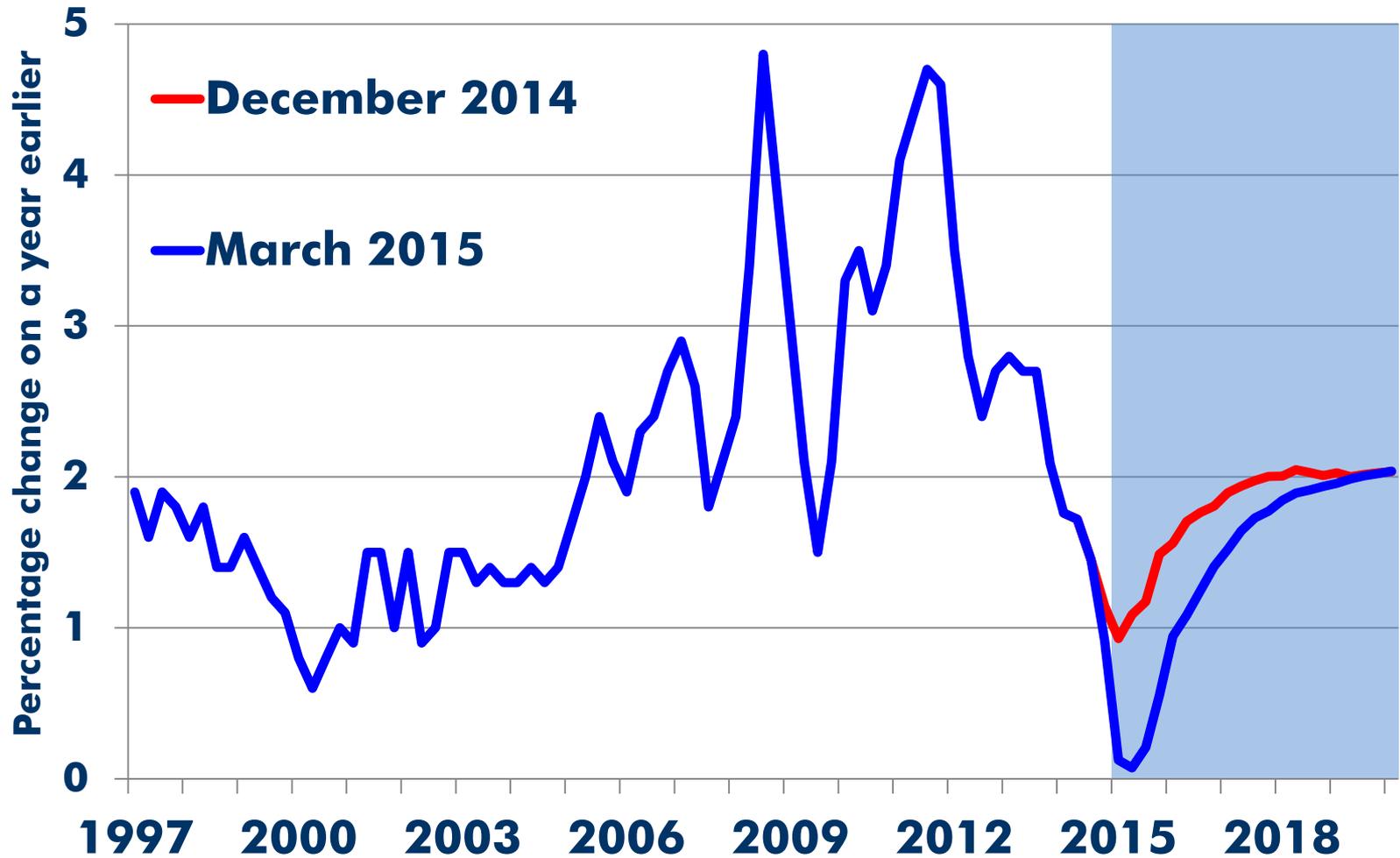
Actual and potential output



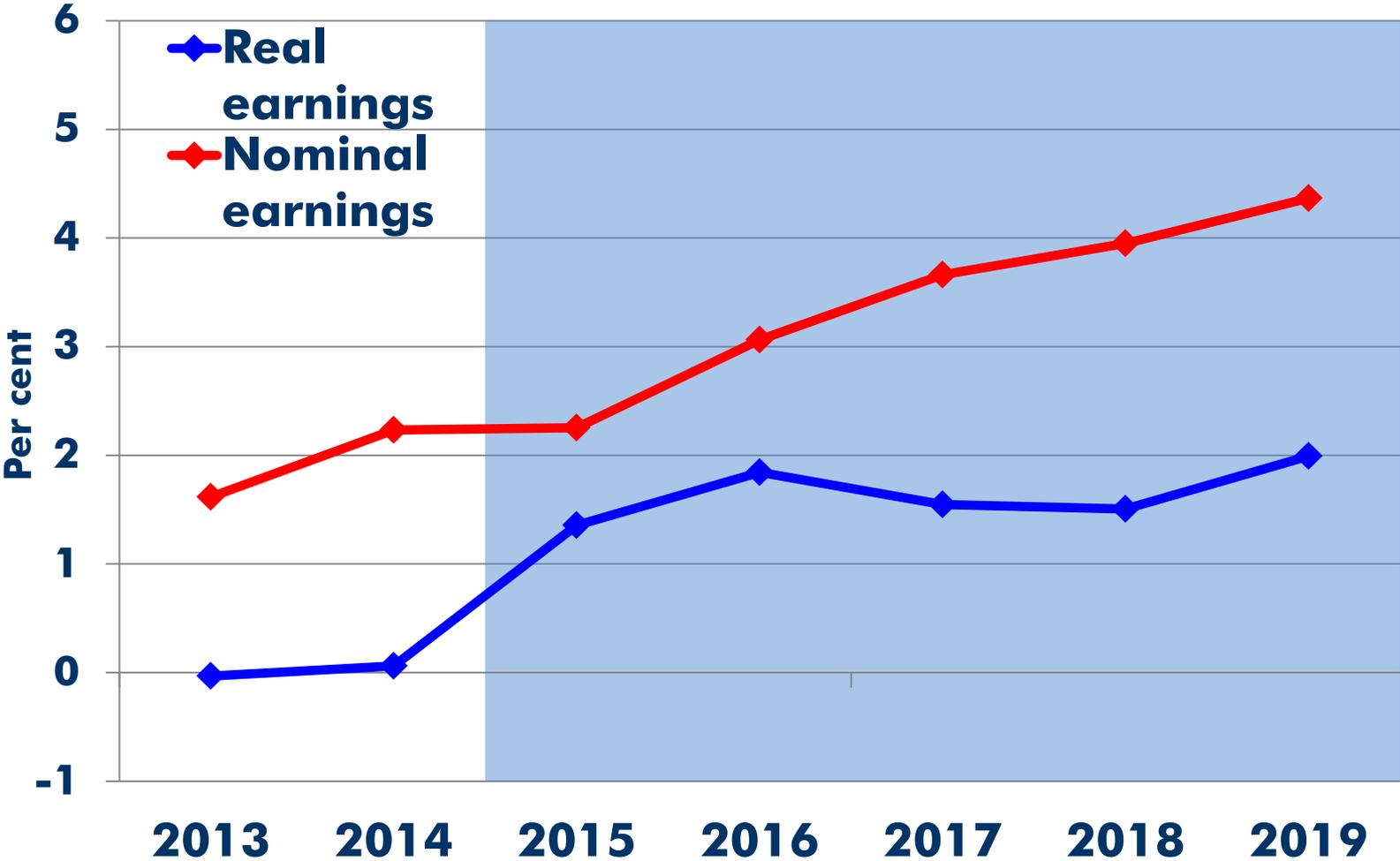
Level of GDP



CPI inflation



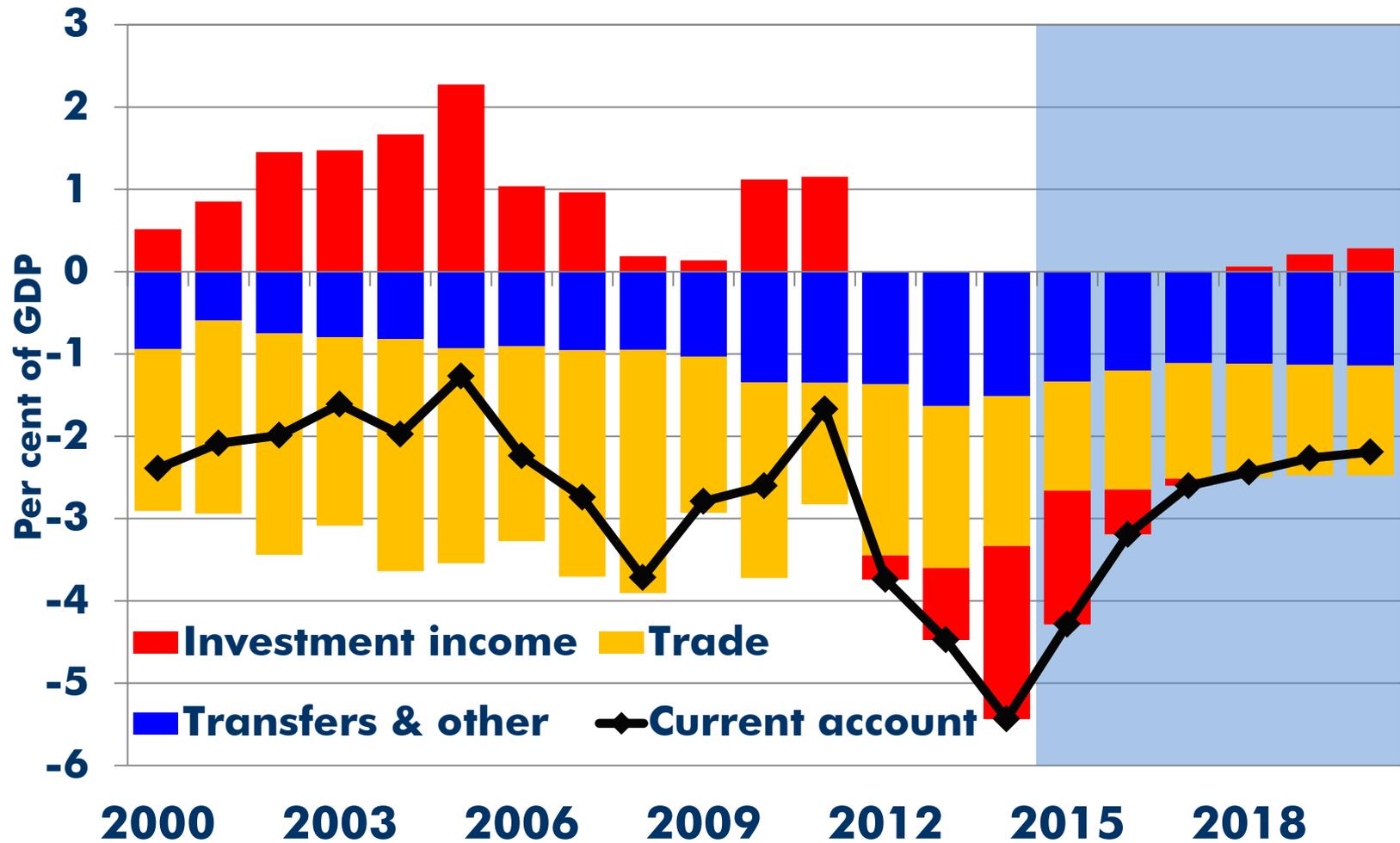
Earnings growth



Sectoral developments

- **Composition of GDP growth**
 - Stronger consumption in near term as lower oil price boosts real incomes
 - Weaker business (especially North Sea) and residential investment
- **Housing market**
 - Weaker house price growth near term
 - But stronger later
 - Weaker transactions though forecast
- **Smaller rise in household debt**

Current account balance



The public finances

- Receipts lower across most of the forecast
- Spending lower across most of the forecast
- Modest falls in borrowing in most years, but...
- Cut in spending/GDP in 19-20 dropped
 - Public service squeeze less severe
 - Smaller surplus in that year
- Additional asset sales in 15-16
 - Allows debt/GDP to fall a year earlier

Public sector net borrowing

| £ billion | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---------------------------|-------------|-------------|-------------|-------------|-------------|--------------|
| December | 91.3 | 75.9 | 40.9 | 14.5 | -4.0 | -23.1 |
| Forecast changes: | | | | | | |
| Receipts | -1.1 | +3.3 | +4.9 | +5.8 | +4.0 | -1.9 |
| Spending (old rule) | 0.0 | -3.3 | -4.4 | -5.4 | -4.1 | -2.8 |
| Policy changes: | | | | | | |
| Scorecard measures | 0.0 | -0.7 | 0.0 | -0.2 | +0.9 | +0.6 |
| Spending assumption | | | -1.9 | -1.9 | -2.0 | +20.2 |
| March | 90.2 | 75.3 | 39.4 | 12.8 | -5.2 | -7.0 |
| <i>Memo: total change</i> | <i>-1.1</i> | <i>-0.7</i> | <i>-1.5</i> | <i>-1.8</i> | <i>-1.2</i> | <i>+16.1</i> |

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Selected scorecard policy measures

| £ million | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|------------------------------|------------|-----------|------------|-------------|-------------|
| Big 'takeaways' | | | | | |
| Bank levy increase | 685 | 925 | 925 | 920 | 920 |
| Pensions: lifetime allowance | 60 | 300 | 420 | 550 | 590 |
| Annuities: secondary market | 0 | 535 | 540 | -130 | -120 |
| Big 'giveaways' | | | | | |
| Personal allowance increase | 0 | -960 | -1,480 | -1,585 | -1,680 |
| Savings allowance | -15 | -1,030 | -565 | -640 | -765 |
| Help to Buy: ISA | -45 | -230 | -415 | -640 | -835 |
| Oil and gas package | -250 | -395 | -305 | -285 | -85 |
| Total scorecard | 745 | 45 | 230 | -885 | -570 |

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Coalition spending assumption

For 2016-17 and 2017-18: TME should fall in real terms at the same rate as over the 2010-11 to 2014-15 period covered by Spending Review 2010. For 2010-11, the relevant measure of TME should exclude underspending against plans and the in-year spending reductions announced in the June 2010 Budget, include an estimate of the retrospective effect of our decision to anticipate the future ONS revisions to the measurement of depreciation for Network Rail and the life-length of roads, but not include the retrospective effect of our decision to anticipate the future ONS reclassification of UK subscriptions to multilateral development banks. For 2014-15, the measure of TME should exclude our measure of DEL shortfalls, include our changes to the depreciation forecast that anticipate ONS revisions mentioned above, exclude the changes to our forecast for the ONS's reclassification of UK subscriptions to multilateral development banks, exclude the net effect of the historical adjustment to the UK's GNI-based contribution to the EU, and also exclude the expected adjustment in respect of its VAT contributions to the EU in December 2014. This fall in real terms should then be applied to our pre-measures forecast of TME in 2015-16, which should also exclude our forecast for DEL underspending, exclude the reclassification of UK subscriptions to multilateral development banks, exclude the additional rebate in respect of the historical adjustment to the UK's GNI-based contribution to the EU, exclude the adjustments included in our latest forecast that would accrue in December 2015 in respect of UK GNI and VAT-based contributions to the EU in 2014-15, but include the adjustment included in our latest forecast for the expected revisions to the UK's 2015-16 GNI contributions when these are revised in May 2015. The effects of previous budget measures are also taken into account, to ensure that they have the same effect on future years as they did in each previous fiscal event. Within TME, PSGI should be held flat in real terms from a level in 2015-16 that includes our allowance for shortfall and includes the reclassification of UK subscriptions to multilateral development banks;

For 2018-19: TME should be held flat in real terms, and within TME, PSGI should grow in line with nominal GDP. The results should be calculated to ensure that previous budget measures have the same effect as announced in the relevant fiscal event; and

For 2019-20: both TME and PSGI within TME should be grown in line with nominal GDP. Again, the results should be calculated to ensure that previous budget measures have the same effect as announced in the relevant fiscal event.

Total public spending

| £ billion | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| December | 737.1 | 746.2 | 746.7 | 751.3 | 765.3 | 779.9 |
| Debt interest | -2.3 | -6.7 | -7.0 | -7.5 | -8.5 | -9.0 |
| Welfare | -0.5 | -1.4 | -3.0 | -3.9 | -4.9 | -5.6 |
| Other | +1.0 | +2.7 | -1.4 | -0.2 | 0.0 | +1.2 |
| Classification changes | +2.1 | +2.2 | +2.2 | +2.2 | +2.3 | +2.3 |
| RDEL plans | -0.3 | -0.4 | - | - | - | - |
| Implied RDEL | - | - | +2.7 | +2.0 | +5.0 | +28.5 |
| March | 737.1 | 742.6 | 740.3 | 743.9 | 759.2 | 797.3 |
| <i>Memo: total change</i> | <i>0.0</i> | <i>-3.6</i> | <i>-6.4</i> | <i>-7.3</i> | <i>-6.1</i> | <i>+17.4</i> |

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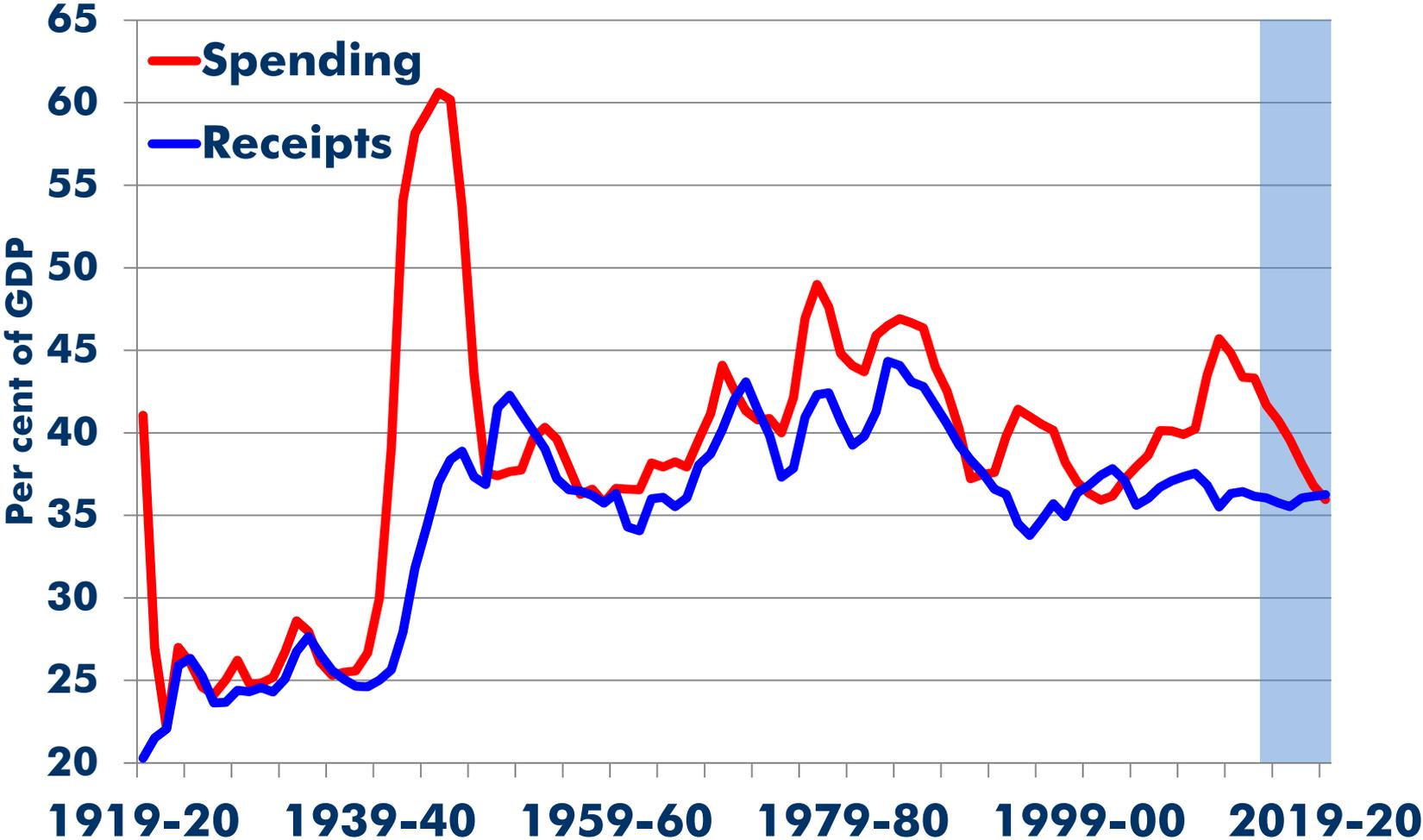
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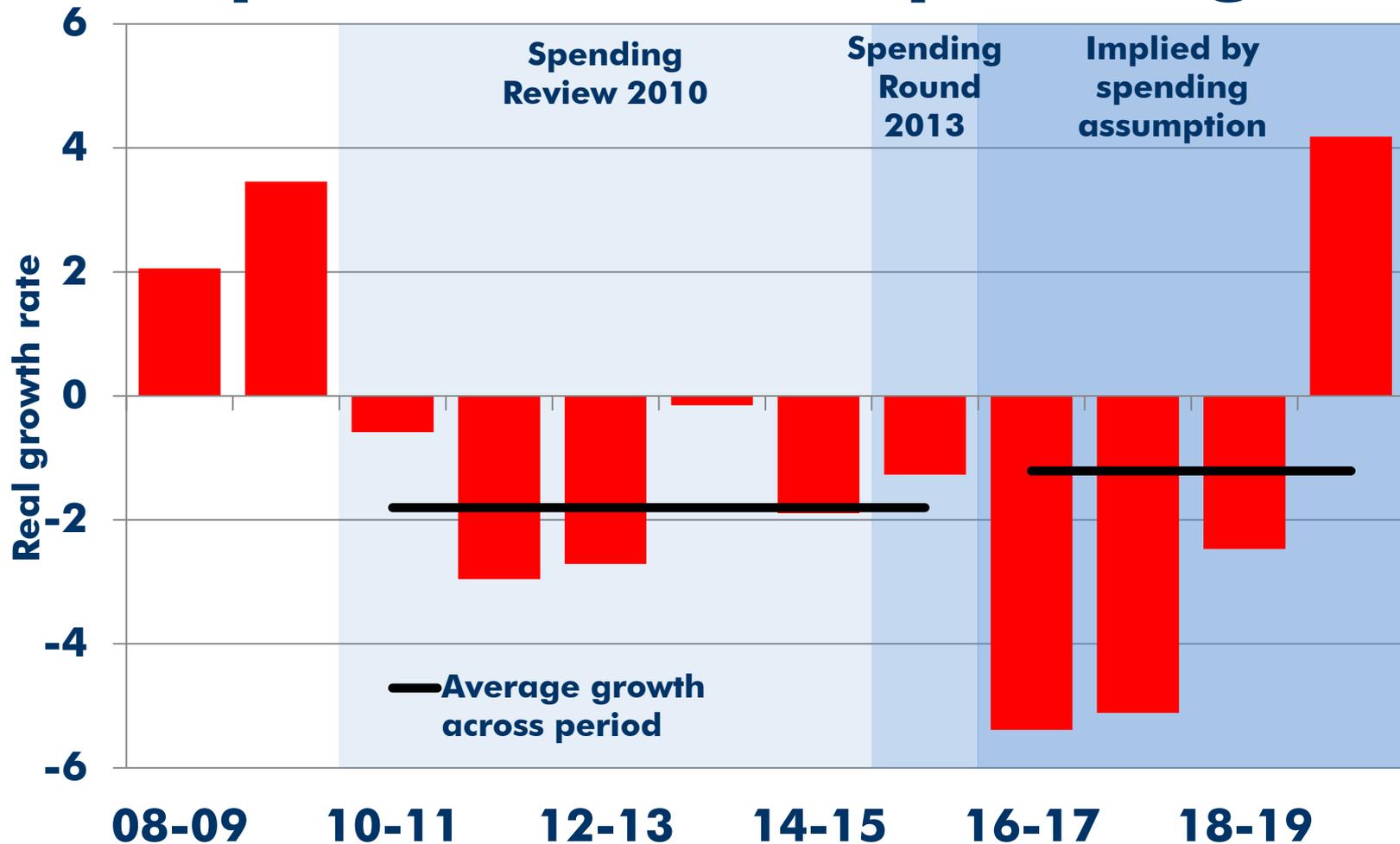
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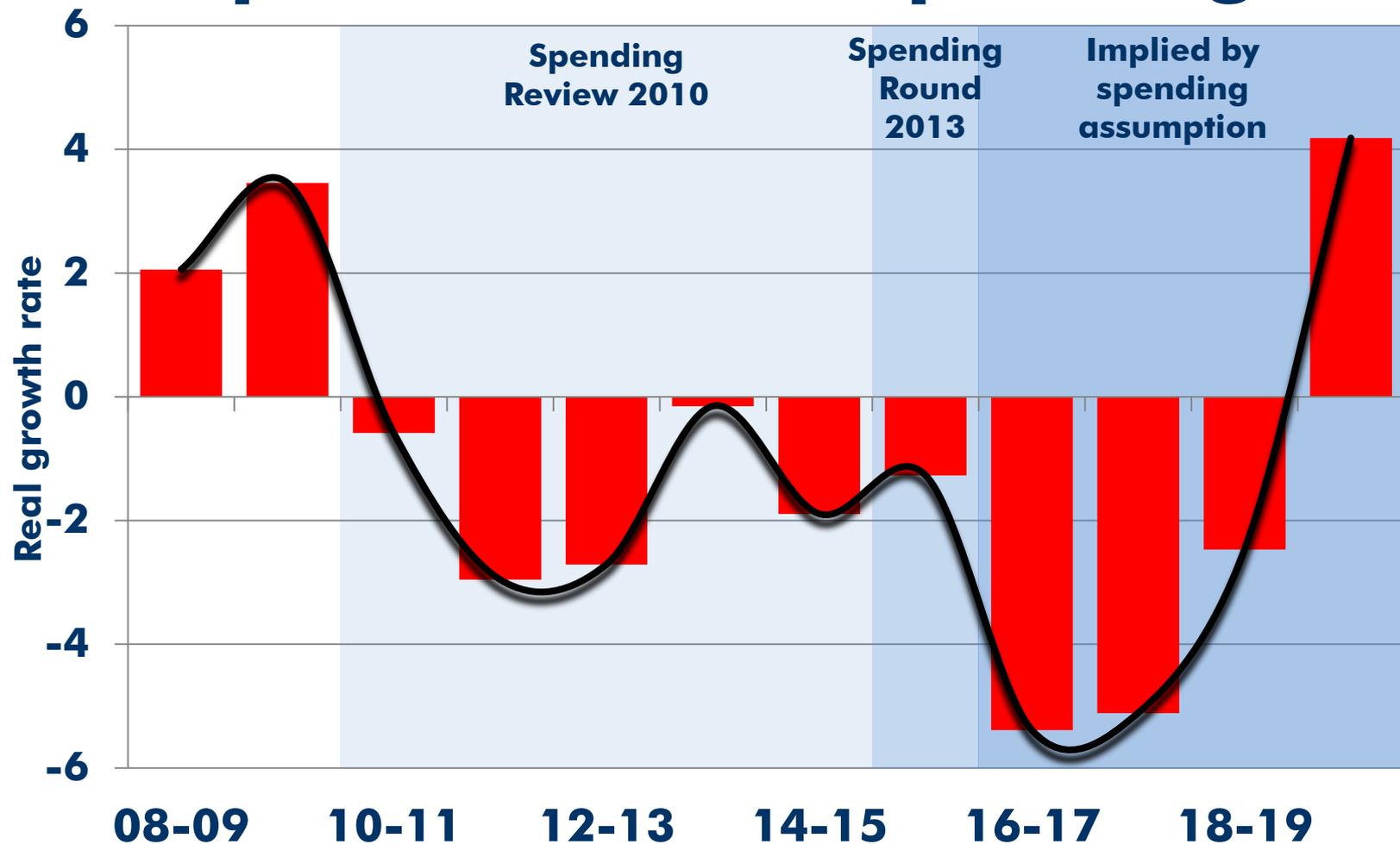
Receipts and spending



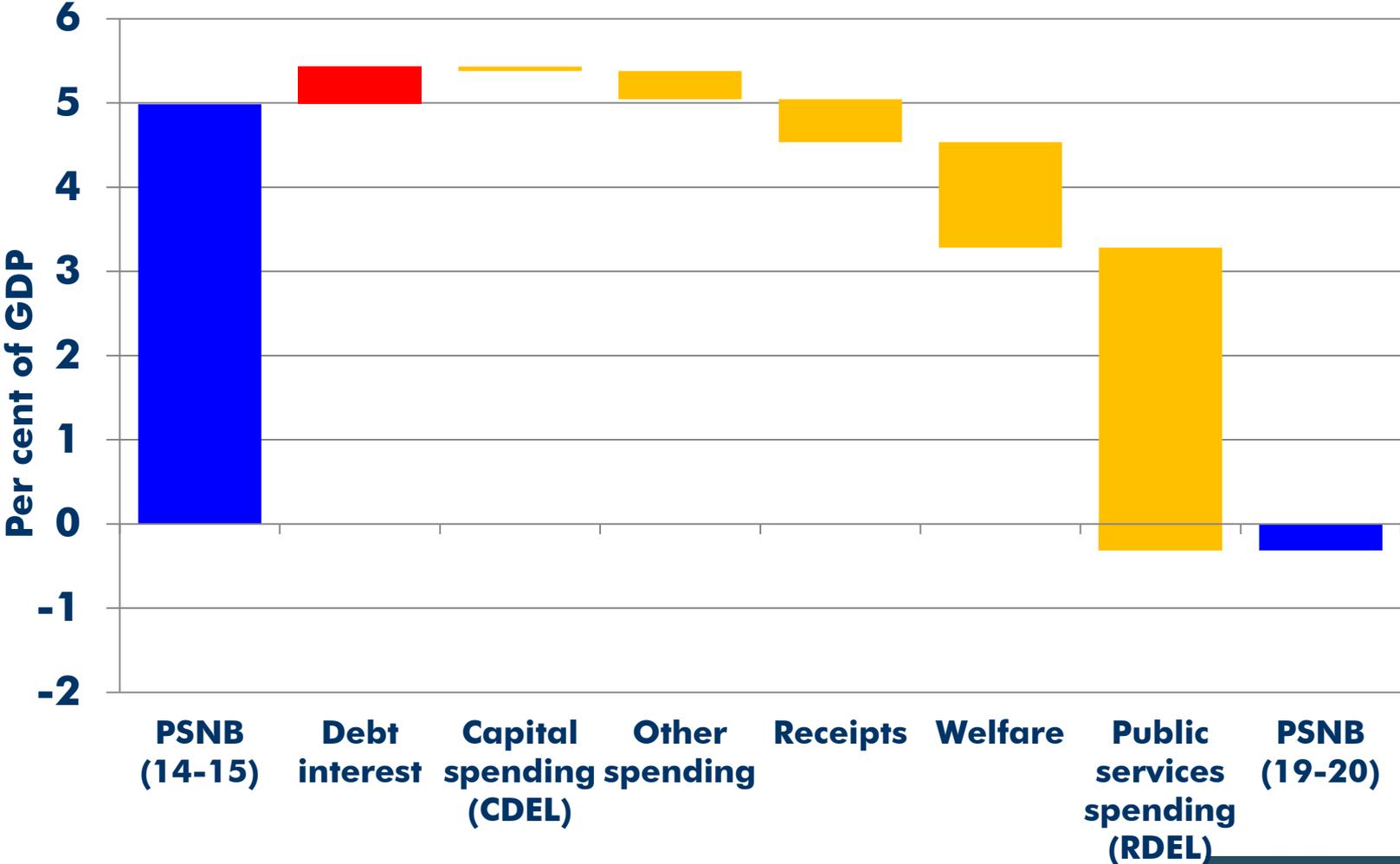
Real public services spending



Real public services spending



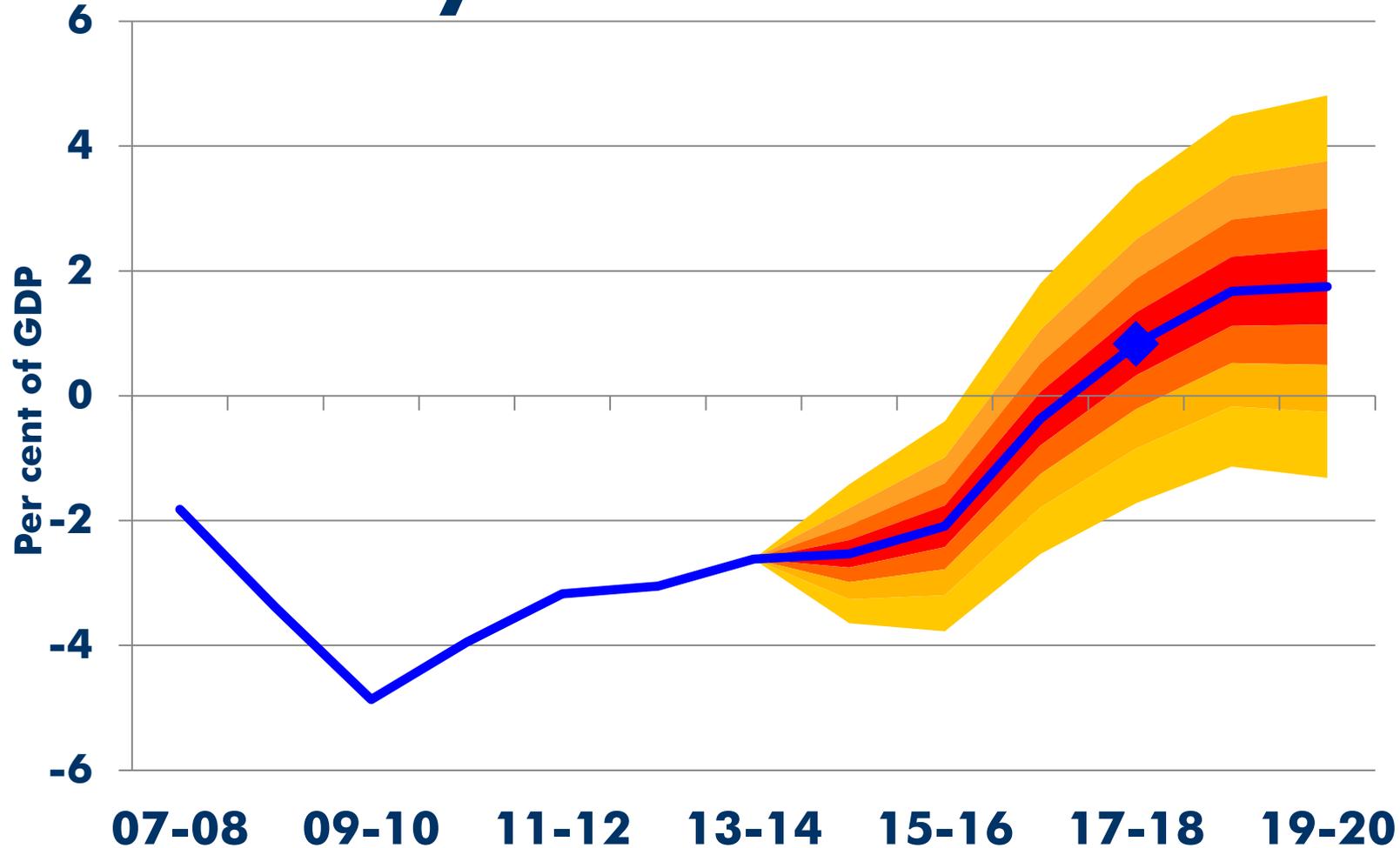
How PSNB returns to balance



The fiscal mandate

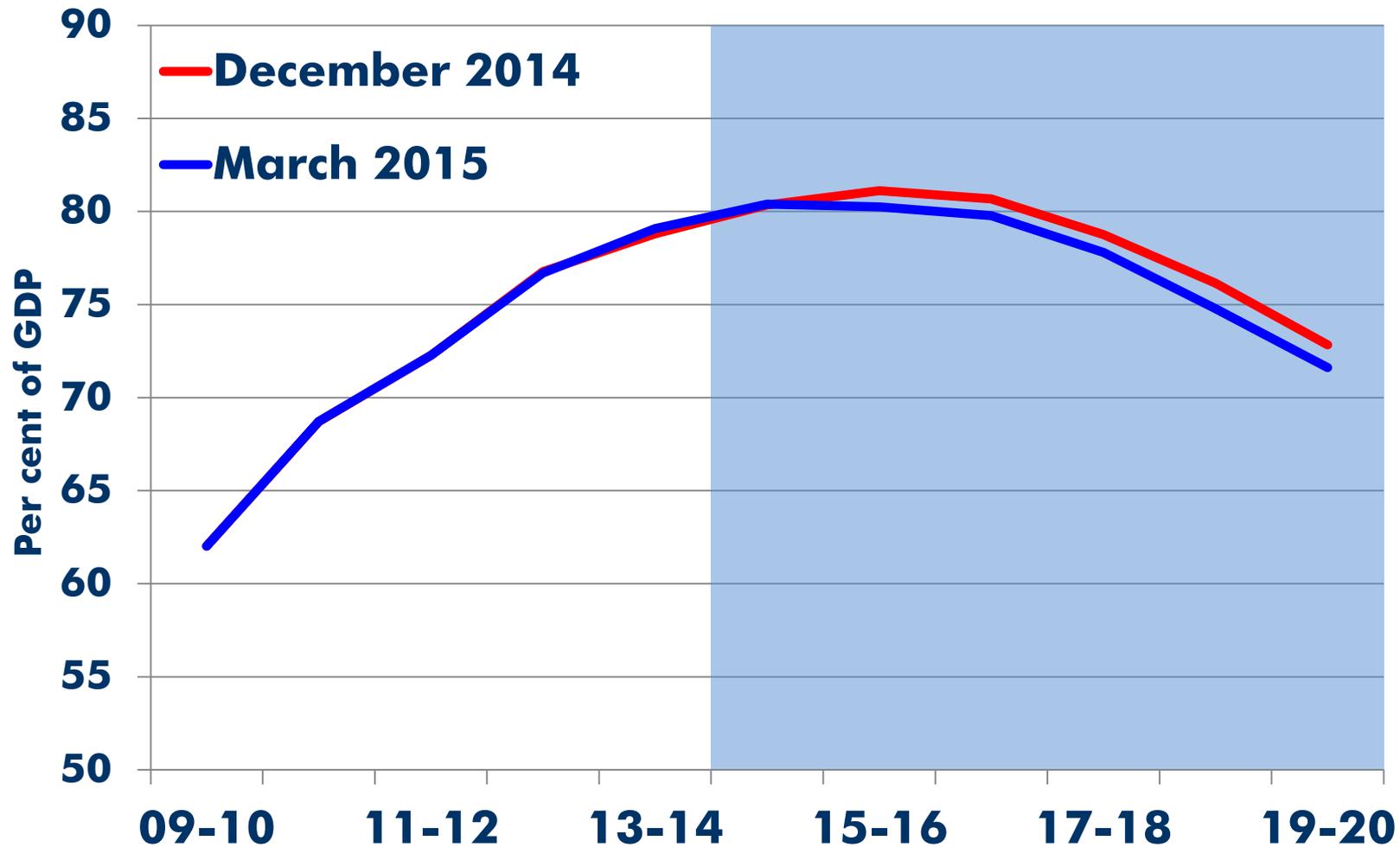
| Cyclically adjusted current budget balance as % of GDP | 2017-18 (new) | 2019-20 (old) |
|-------------------------------------------------------------------|--------------------------|--------------------------|
| December | +0.7 | +2.3 |
| Underlying receipts | 0.0 | 0.0 |
| Underlying spending | +0.1 | +0.4 |
| Scorecard measures | 0.0 | 0.0 |
| New post 2015-16 spending assumption | +0.1 | -0.9 |
| March | +0.8 | +1.7 |

Uncertainty and the mandate



Implies 65% chance of success

Public sector net debt



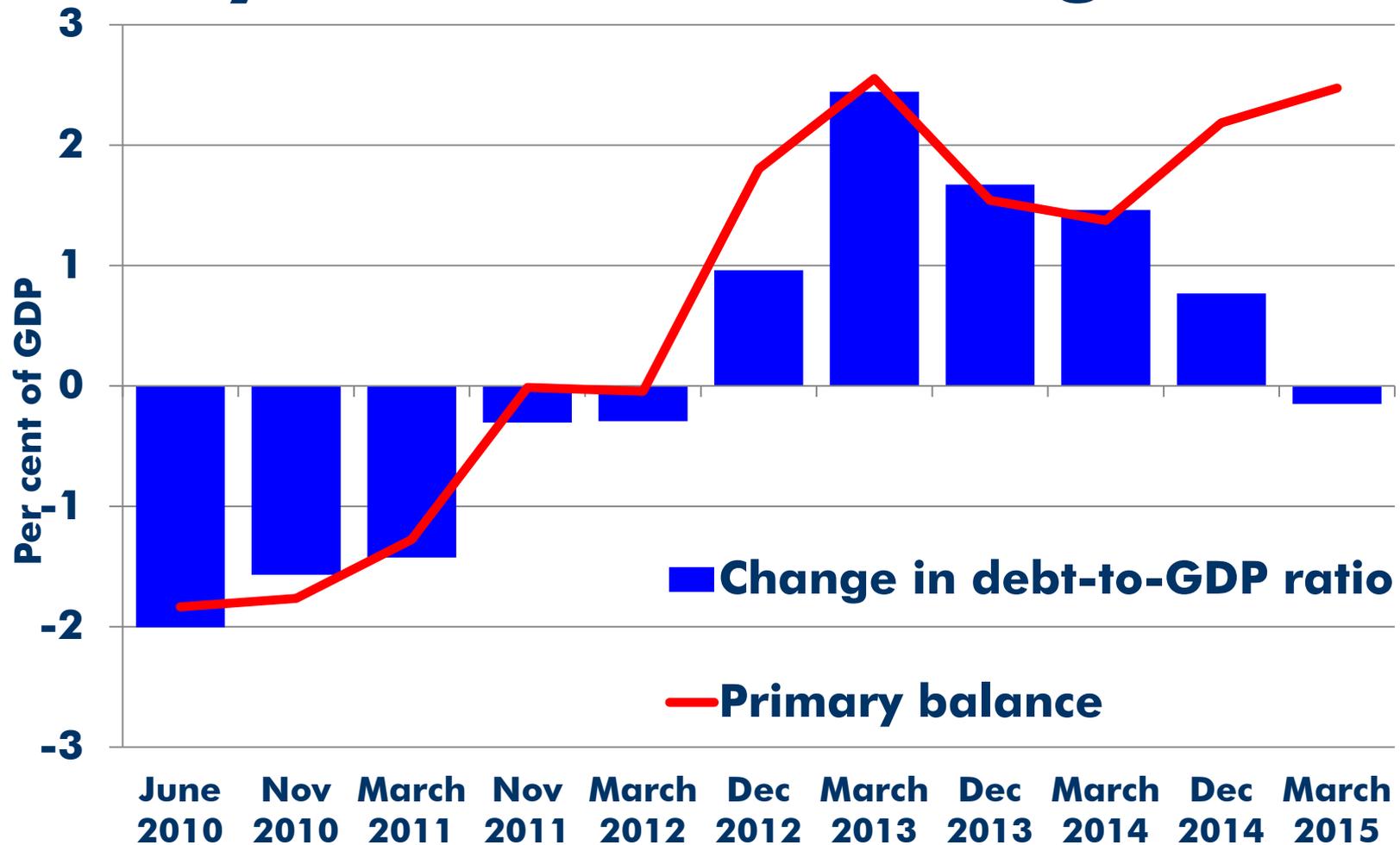
Change in net debt on previous year

| % of GDP | 2015-16 (old) | 2016-17 (new) |
|-------------------------|--------------------------|--------------------------|
| December | +0.8 | -0.5 |
| Nominal GDP revisions | -0.1 | +0.2 |
| UKAR/Lloyds asset sales | -1.0 | +0.1 |
| Other | +0.3 | -0.3 |
| March | -0.2 | -0.5 |

Asset sales details

- **£11 billion of UKAR assets in 2015-16 (new)**
- **£9 billion of Lloyds shares in 2015-16 (mostly new; on top of £1 billion this year)**
- **£12 billion of student loans over 5 years (AS13 announcement, now more costly)**
- **£0.8 billion for Eurostar (recent announcement)**

Primary balance and change in debt



Summary: public finance goals

- **Debt/GDP falling in 2015-16**
 - Lloyds and NRAM asset sales
- **Achieve new mandate with decent margin**
 - Keep big public services squeeze in 16-17 and 17-18
- **Deficit lower up to 18-19 than December**
 - Tighter total spending squeeze to 18-19
- **Avoid spending/GDP falling to post-war low**
 - Spending/GDP cut dropped in 19-20
- **Result: public services rollercoaster**