Office for
Budget
Responsibility

PRESS NOTICE

21 March 2012

Economic and fiscal outlook - March 2012

Neutral Budget leaves Government on course to hit fiscal targets

The 'takeaways' and 'giveaways' in the March 2012 Budget broadly balance out over the five years of our latest forecast, leaving the Government on course to meet its two fiscal targets with much the same margin for error as in November.

Our overall assessment of the outlook and risks for the UK economy is broadly unchanged from our November *Economic and fiscal outlook (EFO)*. We still expect the economy to avoid a technical recession with positive growth in the first quarter of 2012, although another fall cannot be ruled out given the volatility of quarterly output estimates. We forecast that GDP will grow by 0.8 per cent this year, the same rate as in 2011. This is an upward revision of 0.1 percentage points relative to our November forecast, reflecting our judgement that the economy carried a little more momentum into the new year than previously anticipated.

Our medium-term growth forecast is very similar to November. We forecast growth of 2.0 per cent in 2013 (revised down from 2.1 per cent in November), picking up to 2.7 per cent in 2014 and 3.0 per cent in the final two years of the forecast. We still assume that potential output will take until 2014 to return to its long-term average growth rate of around 2.3 per cent a year, as the financial sector and credit conditions take time to normalise. The key risks that we identify to our forecast are the situation in the euro area and a further spike in oil prices.

Public sector net borrowing (PSNB) is forecast to total £126 billion or 8.3 per cent of GDP this year, £1.1 billion less than we forecast in November. We expect the public sector to spend £6.2 billion less than we forecast in November, but we also expect tax revenues to be £5.1 billion lower than we forecast – primarily due to a £3.6 billion shortfall in self assessment receipts.

PSNB is then forecast to decline to £21 billion or 1.1 per cent of GDP in 2016-17. The overall decline in PSNB is little changed from our November forecast, with borrowing expected to be just £2.5 billion lower in 2016-17 than we thought in the autumn. Public sector net debt (PSND) is expected to rise from 67.3 per cent of GDP this year to a peak of 76.3 per cent in 2014-15, falling thereafter.

The fall in PSNB in 2012-13 is much larger than in our November forecast due to the Government's decision to transfer the Royal Mail's historic pension deficit, plus a share of its pension fund's assets, into the public sector. This will lead to a one-off reduction in PSNB of £28 billion (or 1.8 per cent of GDP) in 2012-13, and will reduce PSND by around £23 billion from 2012-13 onwards as pension fund assets are transferred and sold.

The short-term impact of the Royal Mail transfer appears very favourable for the public finances. But the long-term impact is likely to be negative, as the £37.5 billion estimated present value of the transferred liabilities (the future payments to pensioners) exceeds the £28 billion value of the transferred assets.

Our public finance forecasts incorporate the expected impact of the tax and spending measures announced in the Budget. The impact of these measures on borrowing is broadly neutral across the forecast period, with net 'giveaways' and 'takeaways' no larger than £2 billion in any year. The impact of measures in the final year of the forecast is to reduce borrowing by £1.1 billion.

The Chancellor's decision to cut the 50 per cent additional rate of income tax to 45 per cent has an estimated direct cost to the Exchequer of £0.1 billion in 2013-14, excluding the impact of 'reverse forestalling' as people shift taxable income from 2012-13 into 2013-14 to take advantage of the lower rate. The figure is small because the additional rate is now assumed to be close to its revenue-maximising level.

Analysis of recent tax returns by HMRC suggests that people have taken greater steps to reduce their taxable income in response to the 50 per cent rate than the original costings assumed. We and the Government now assume that the behavioural response is broadly in line with previous estimates made for the Institute for Fiscal Studies' Mirrlees Review, although huge uncertainty surrounds all such estimates. One consequence is that we now assume that the 50 per cent rate would have raised about £2 billion less in 2012-13 than the original costing suggested, after taking account of forestalling. Our baseline forecasts now reflect this shortfall.

The Government's fiscal mandate requires it to balance the cyclically-adjusted current budget (CACB) at the end of a rolling, five-year period, now 2016-17. The supplementary target requires public sector net debt to fall as a share of GDP between 2014-15 and 2015-16. Including Budget policy measures, our central forecast suggests that the Government has a greater than 50 per cent probability of meeting both these targets. The CACB is expected to be in surplus by £9 billion or 0.5 per cent of GDP in 2016-17, while PSND is expected to fall by 0.3 per cent of GDP in 2015-16. These margins for error are essentially unchanged since the November forecast and are little affected by the Budget measures.

There is huge uncertainty around all public finance projections, especially over this time horizon. We stress-test the Government's chances of achieving the targets using sensitivity and scenario analysis. A significant risk to achieving the mandate is that potential output turns out to be lower at the end of the forecast than we currently assume.

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 document which are published by the OBR today are available on our website at: www.budgetresponsibility.independent.gov.uk

3. The OBR has also published forecasts of some Scottish taxes today in line with our forthcoming responsibilities within the Scotland Bill. For the first time, the OBR is providing forecasts for Scottish income tax, landfill tax, stamp duty land tax and aggregates levy receipts, in advance of the devolution of some elements of these taxes to the Scottish Government.

4. The OBR has also announced today that the next *Fiscal sustainability report* will be published on 12 July 2012.

5. Where possible the OBR will release supplementary information on the *Economic and fiscal outlook* at midday on 26 March, in response to requests received by noon on 22 March. We will release a list of the information to be published at noon on 23 March. Subsequently, we will continue with our standard policy of releasing supplementary information monthly on the day of the HMT/ONS Public Sector Finances release.

6. Questions about the *Economic and fiscal outlook* should be sent to OBRpress@obr.gsi.gov.uk or directed to:

For questions on the *EFO* – Tom Josephs on 020 7271 2408 or 07733 034066, or

For questions on today's press conference – Mark Dembowicz on 020 7271 2442 or 07912 523 979