

Office for  
**Budget  
Responsibility**

# **Forecast evaluation report 2013**

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Chairman**

**9 October 2013**

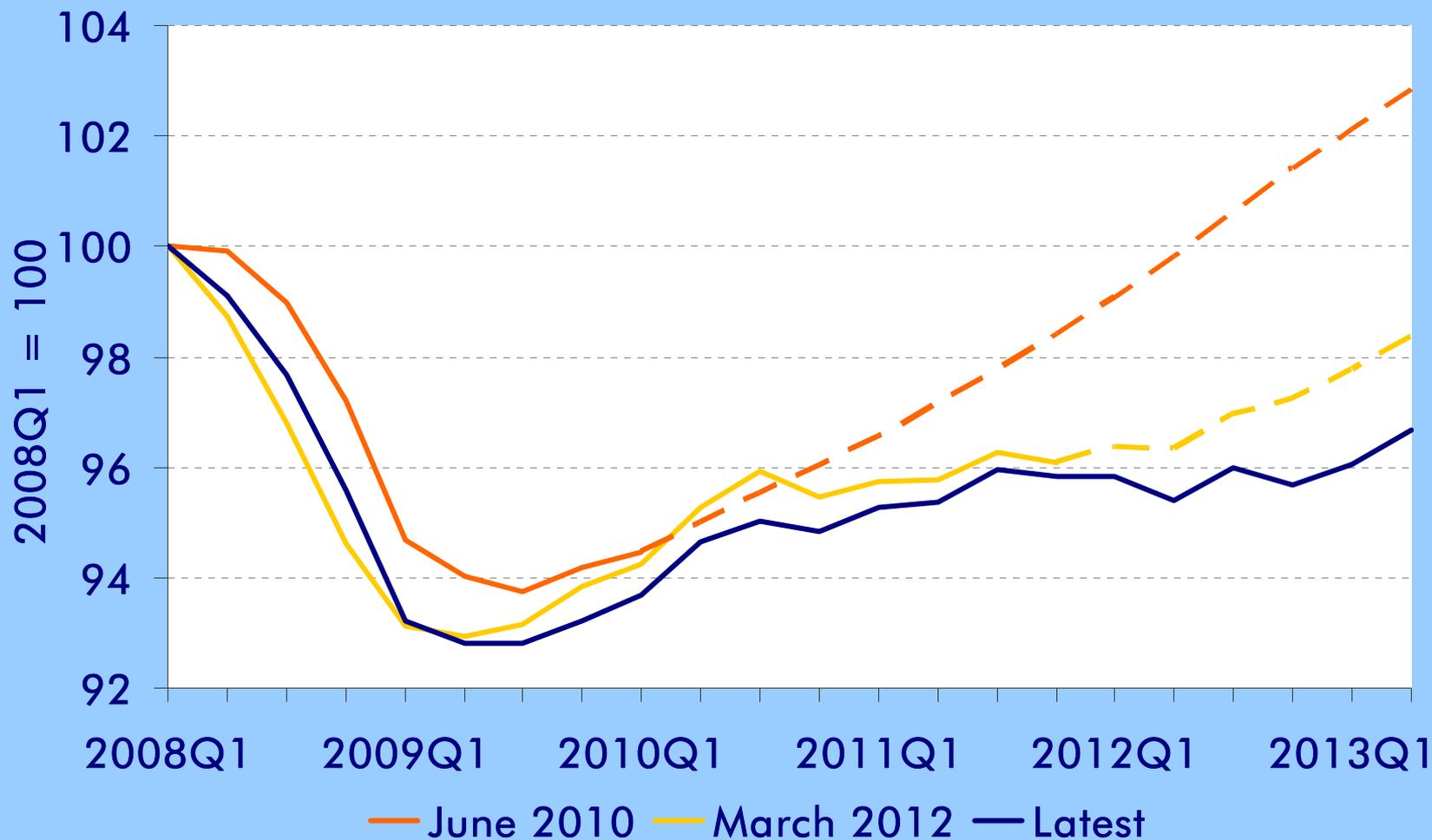
# **The aim of this report**

- **We publish 2 medium-term forecasts a year**
- **In which we emphasise and quantify uncertainty**
- **In this report we evaluate forecasts against outturns**
  - Focus on June 2010 and March 2012 forecasts
- **Why? Accountability, transparency and learning**

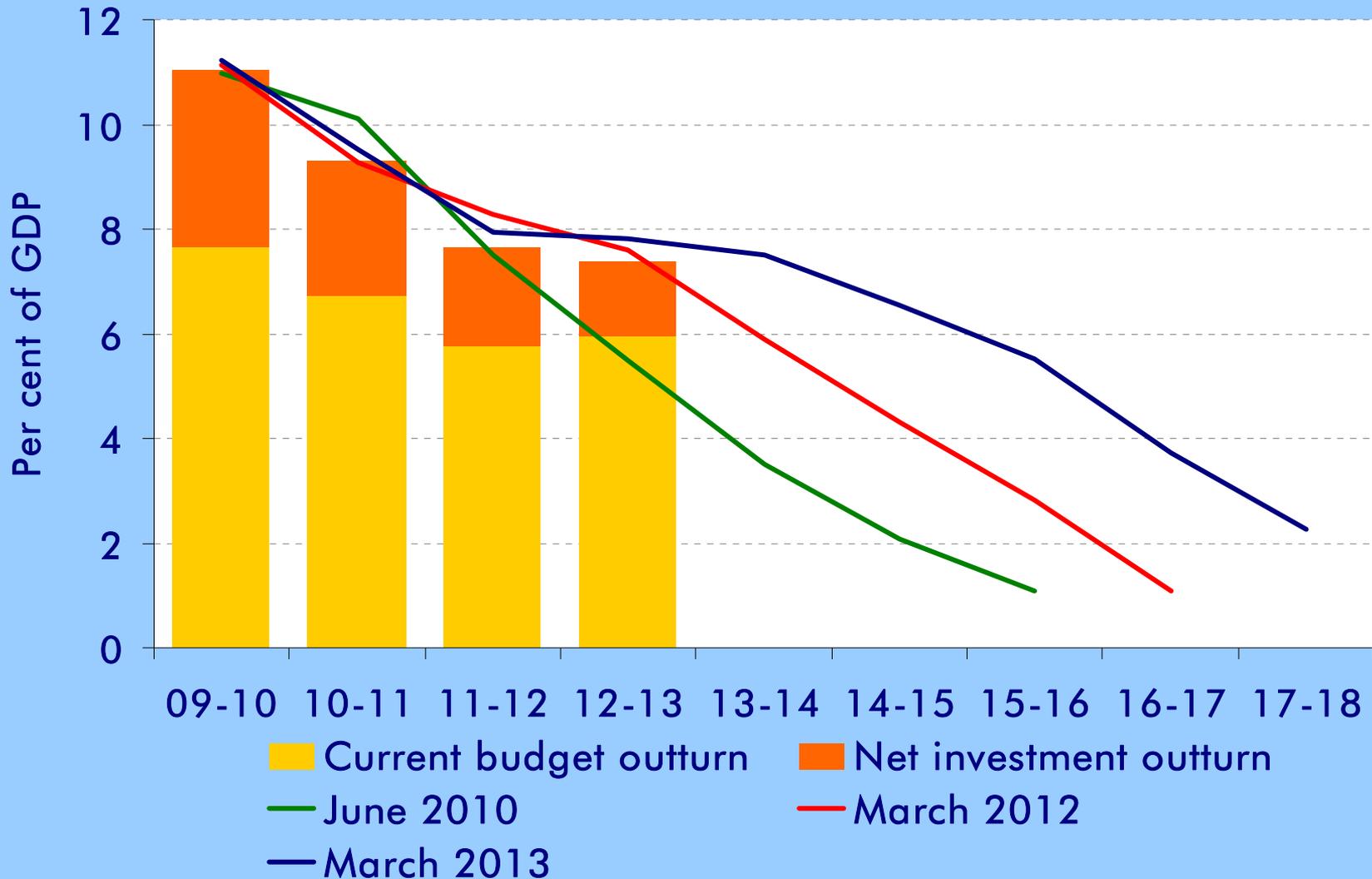
# What do we want to explain?

- **Relative to June 2010 forecast**
  - Real GDP growth has been much weaker than expected
  - Yet budget deficit narrowed as forecast in 10-11 and 11-12
  - But then narrowed much less than forecast in 12-13
- **Relative to March 2012 forecast**
  - Growth again weaker than we expected from early 2012
  - But deficit smaller than expected in 12-13

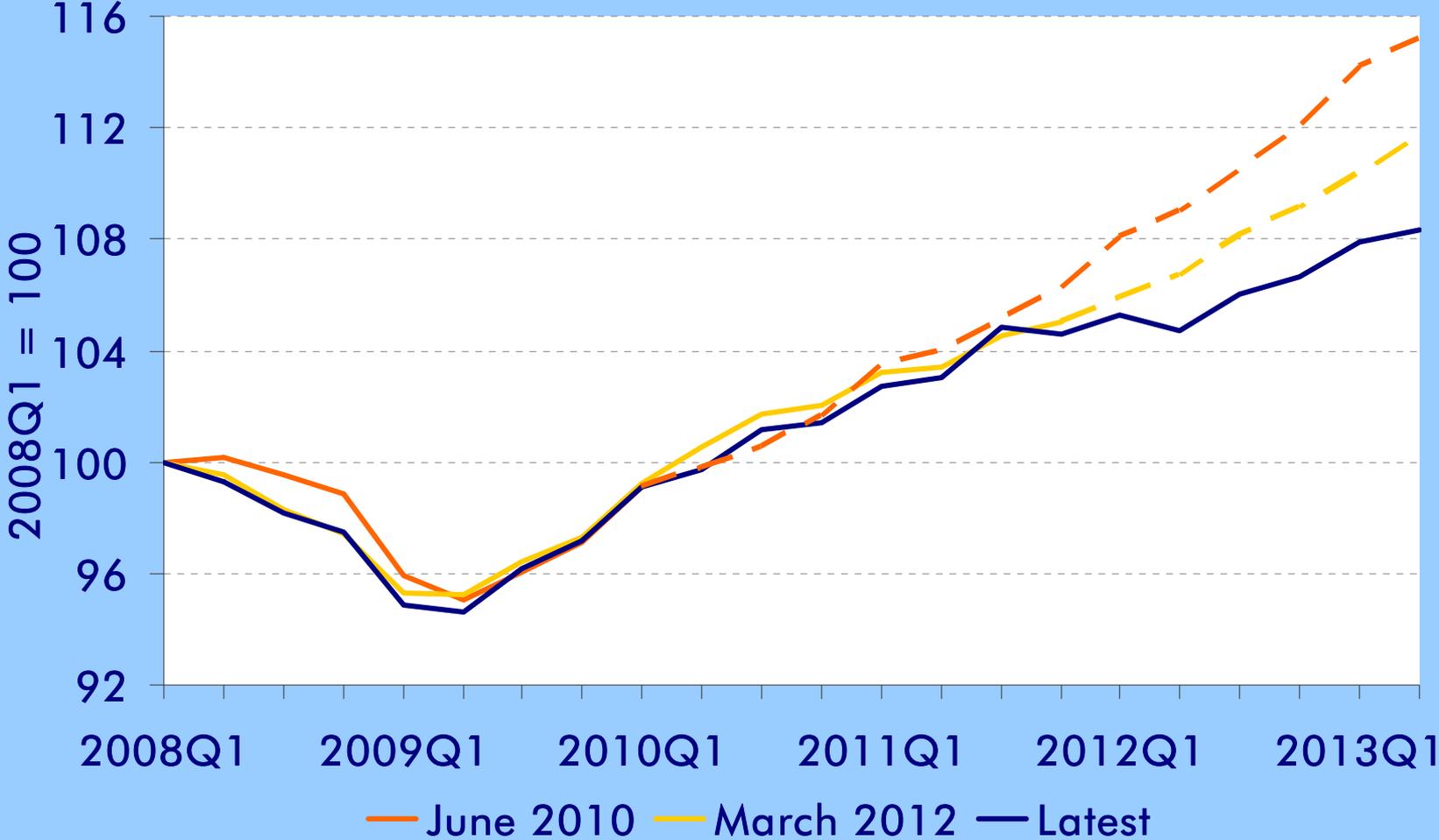
# Real GDP forecasts and outturns



# Net borrowing forecasts and outturns

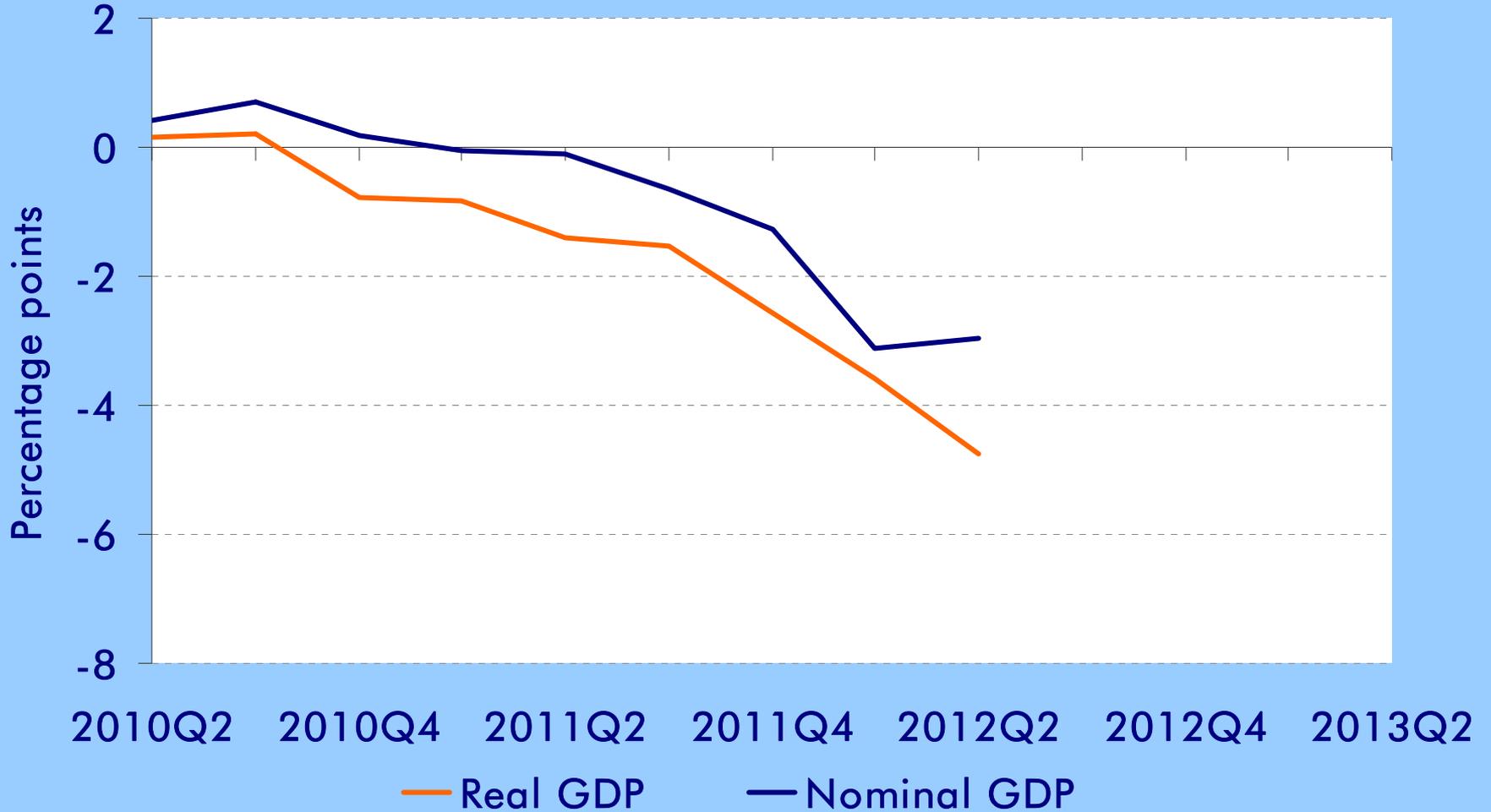


# Nominal GDP forecasts and outturns



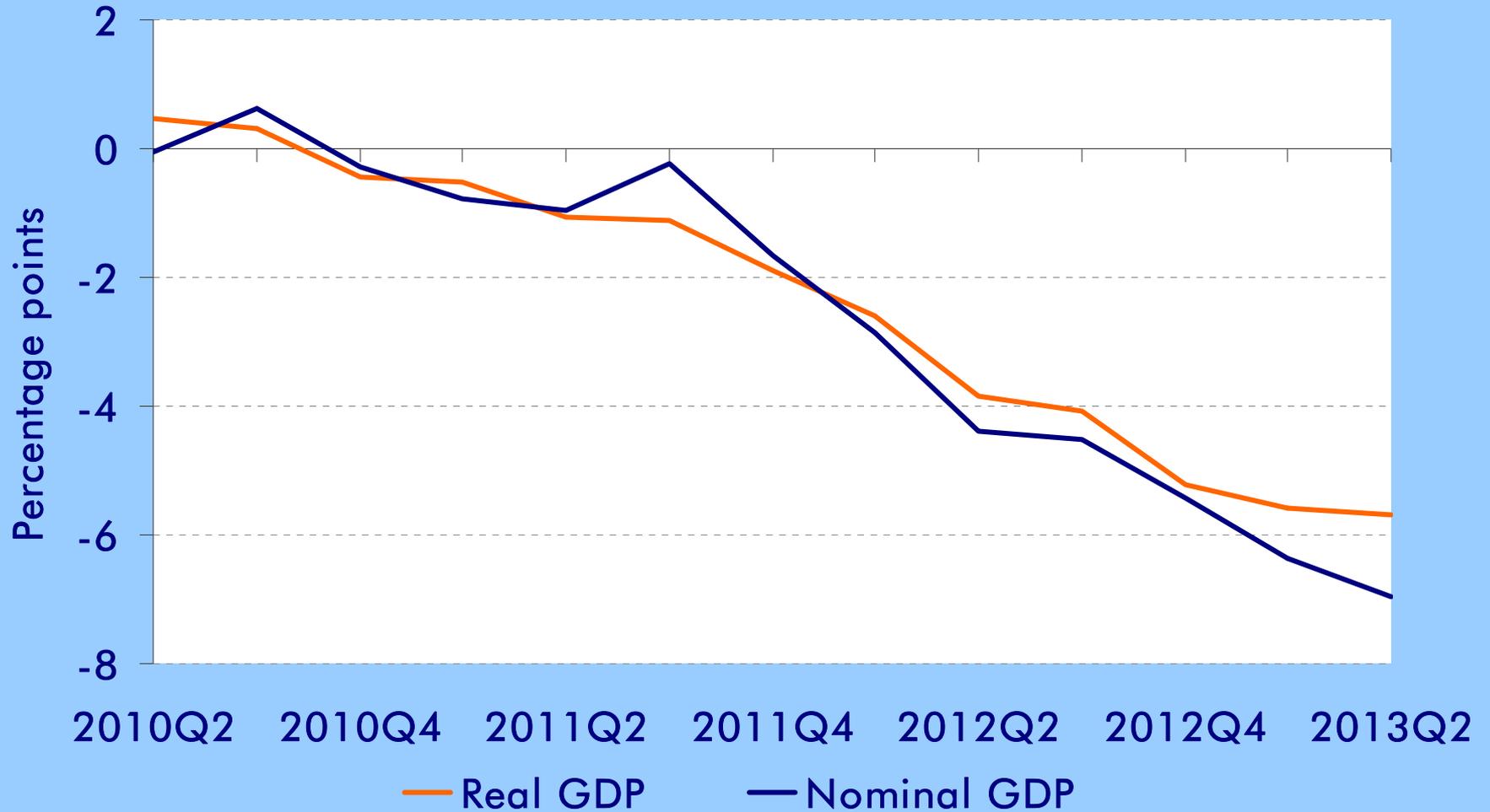
# Nominal and real GDP errors

Last year's data



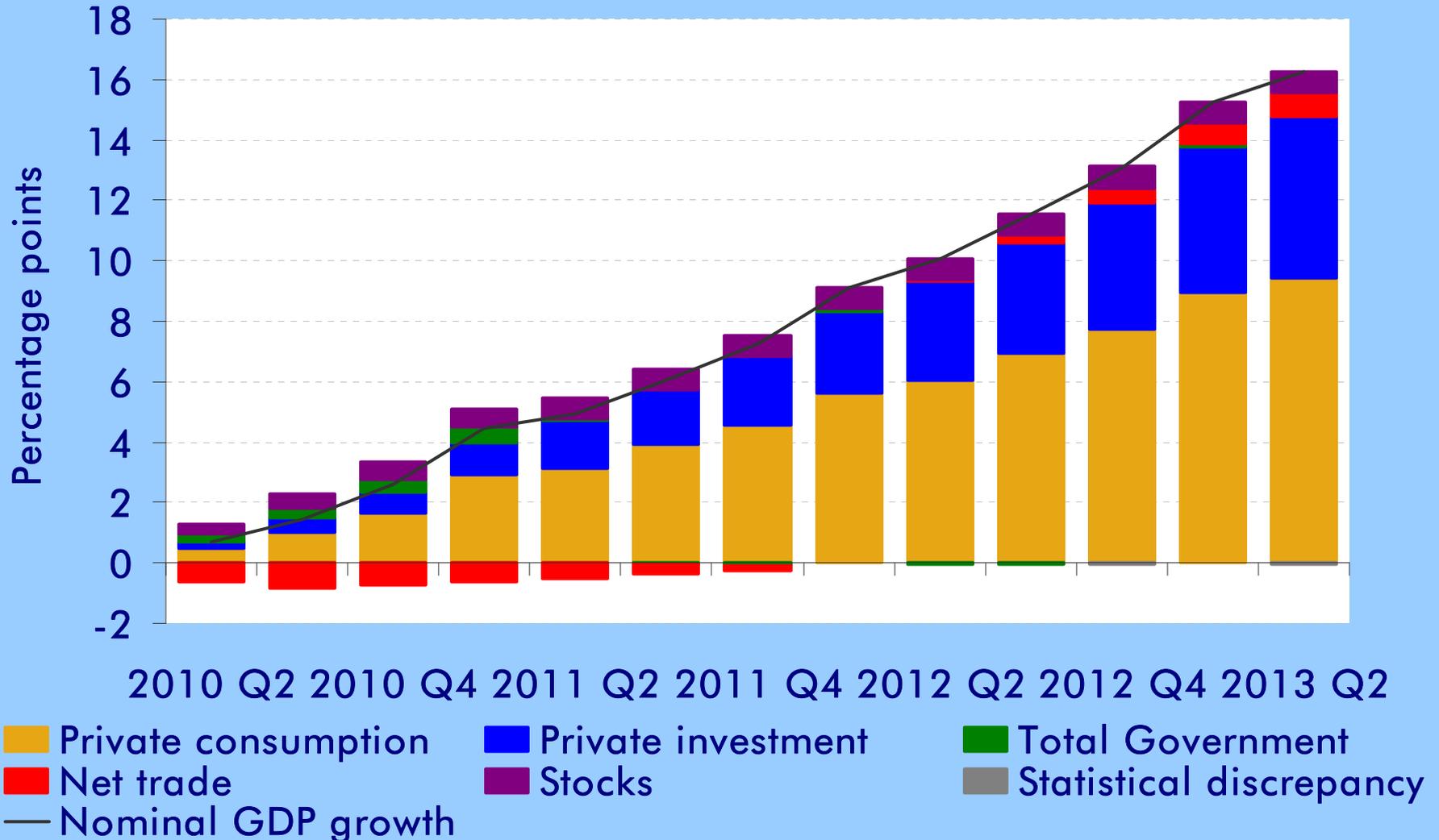
# Nominal and real GDP errors

Latest data



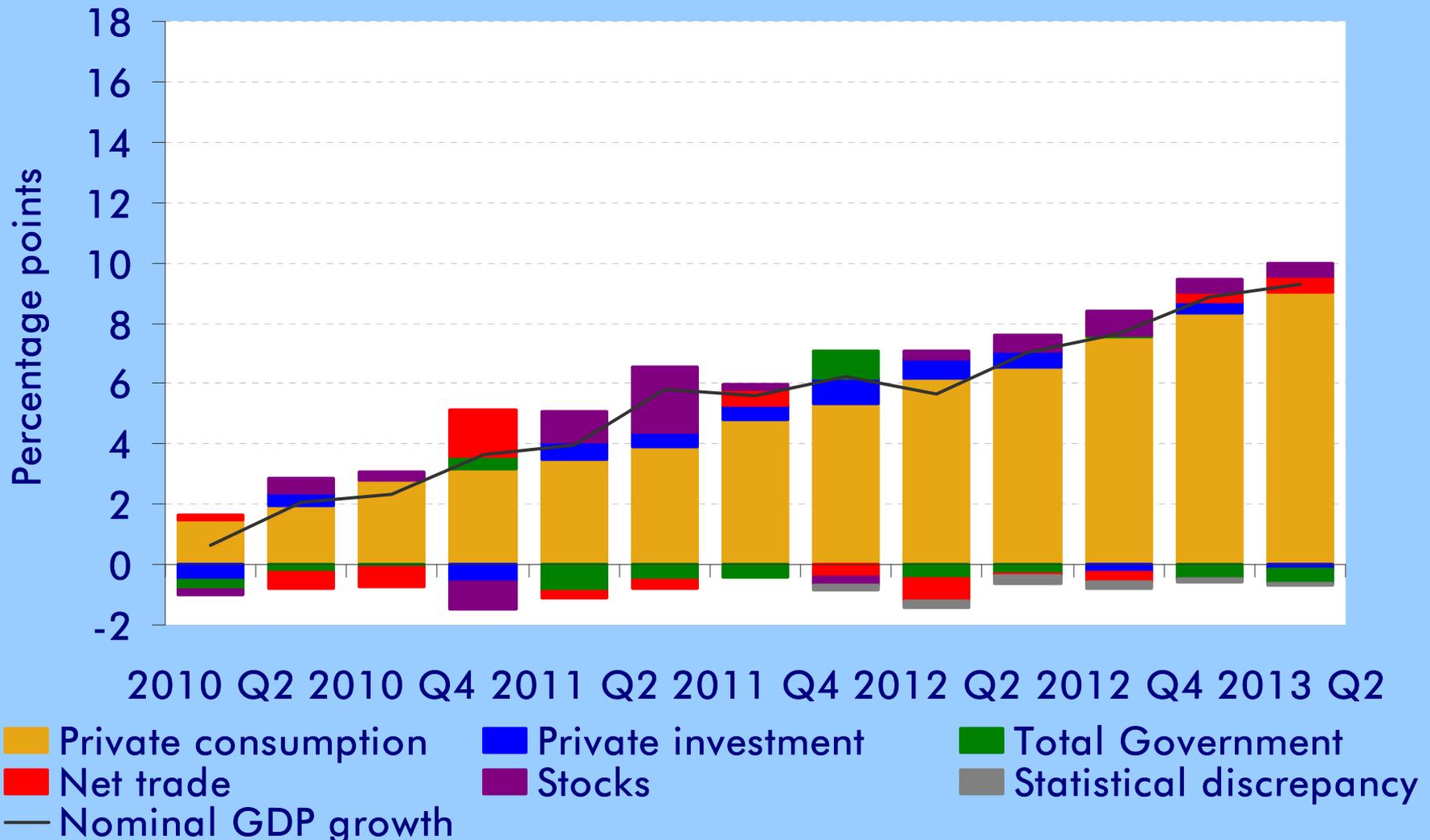
# Nominal GDP growth: spending

## June 10 forecast



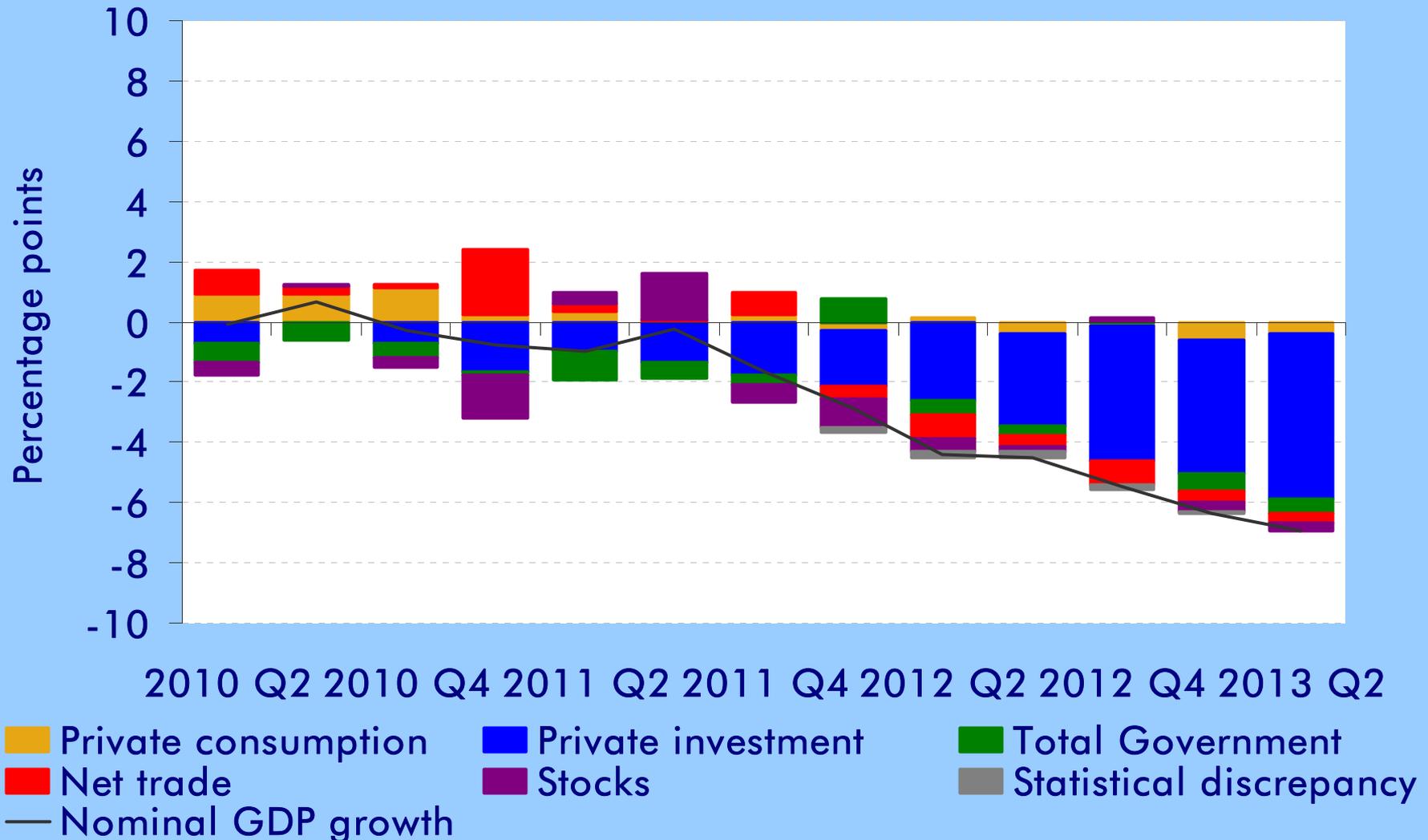
# Nominal GDP growth: spending

## Latest ONS outturn



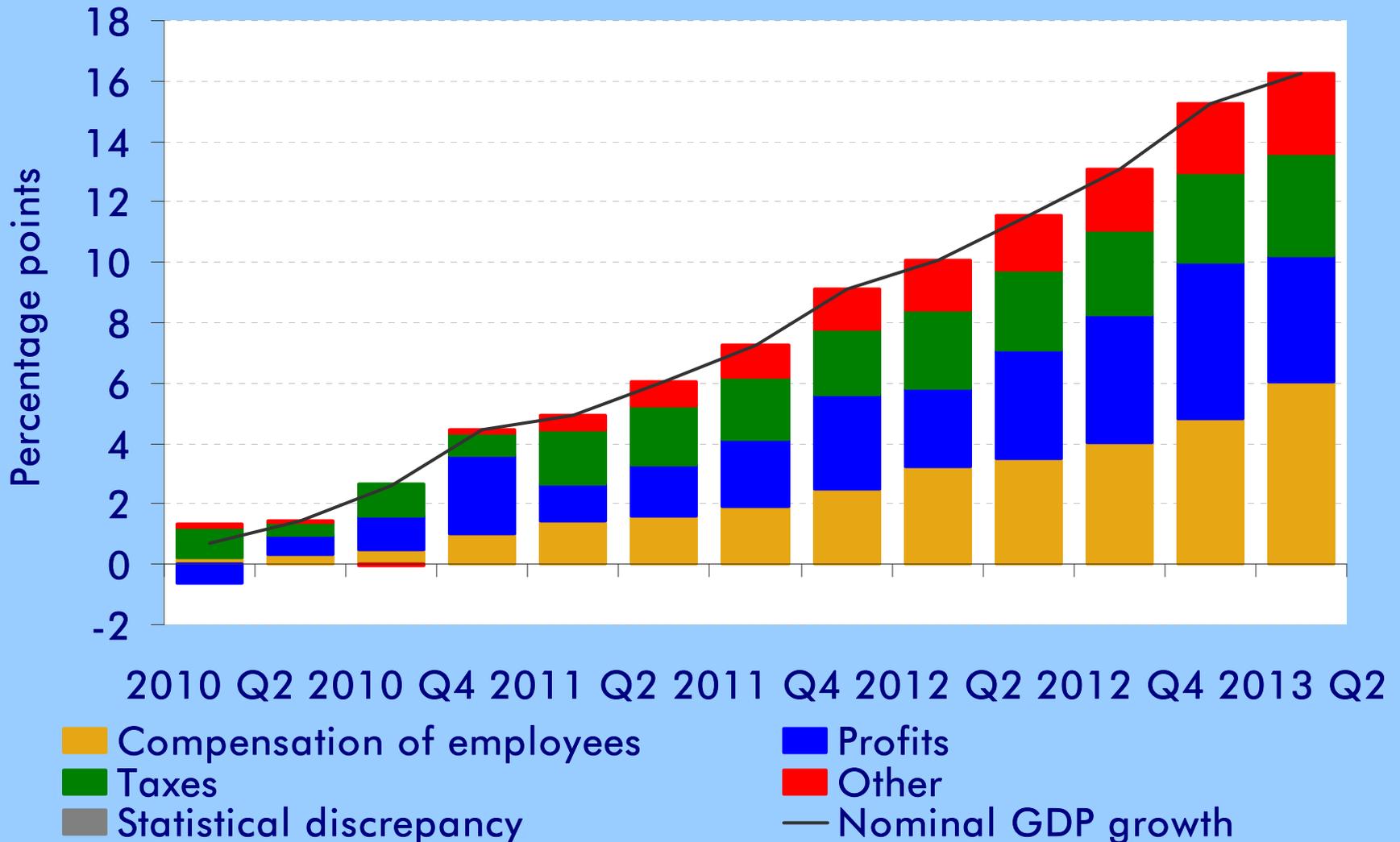
# Nominal GDP growth: spending

## Forecast error



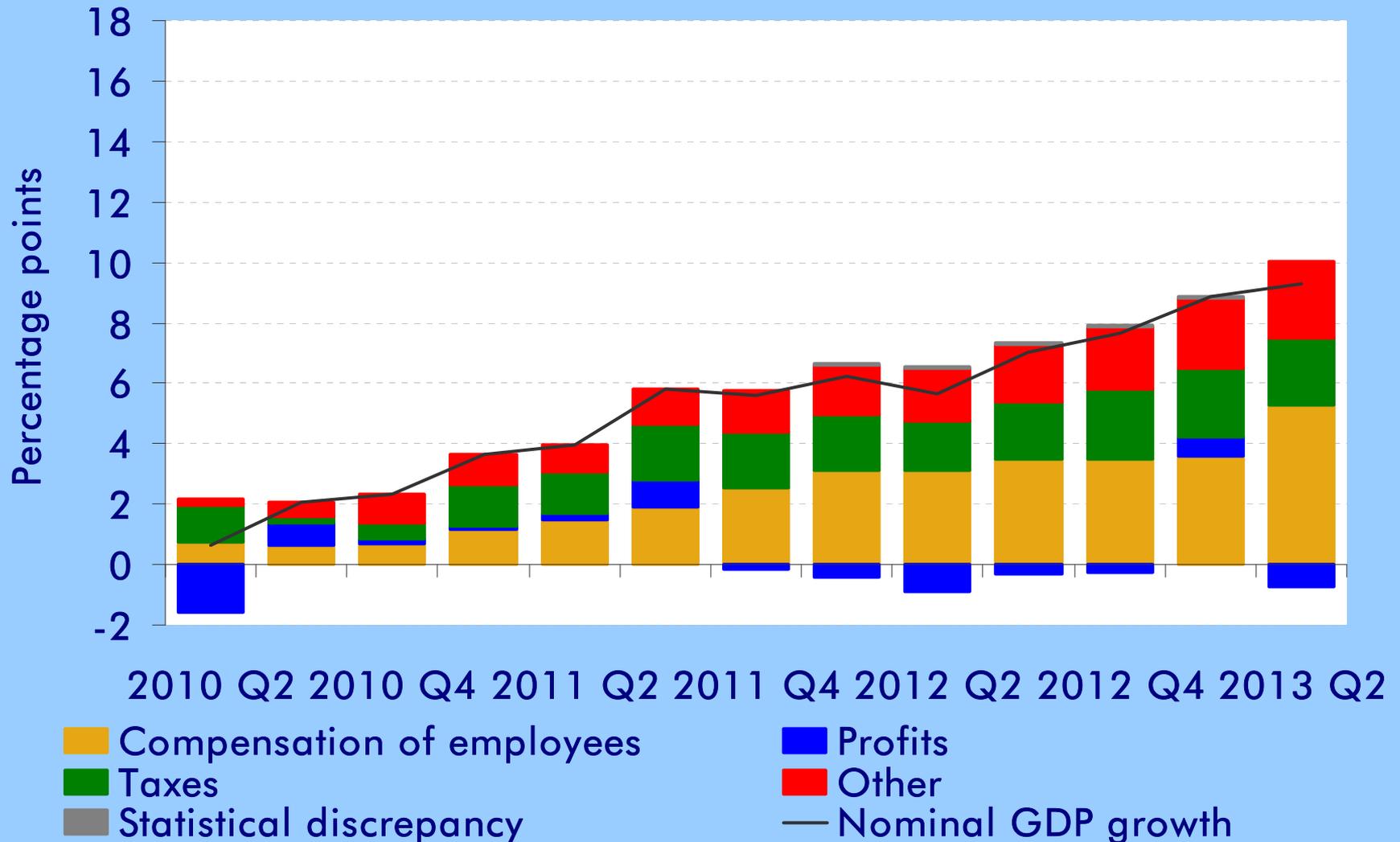
# Nominal GDP growth: income

June 10 forecast



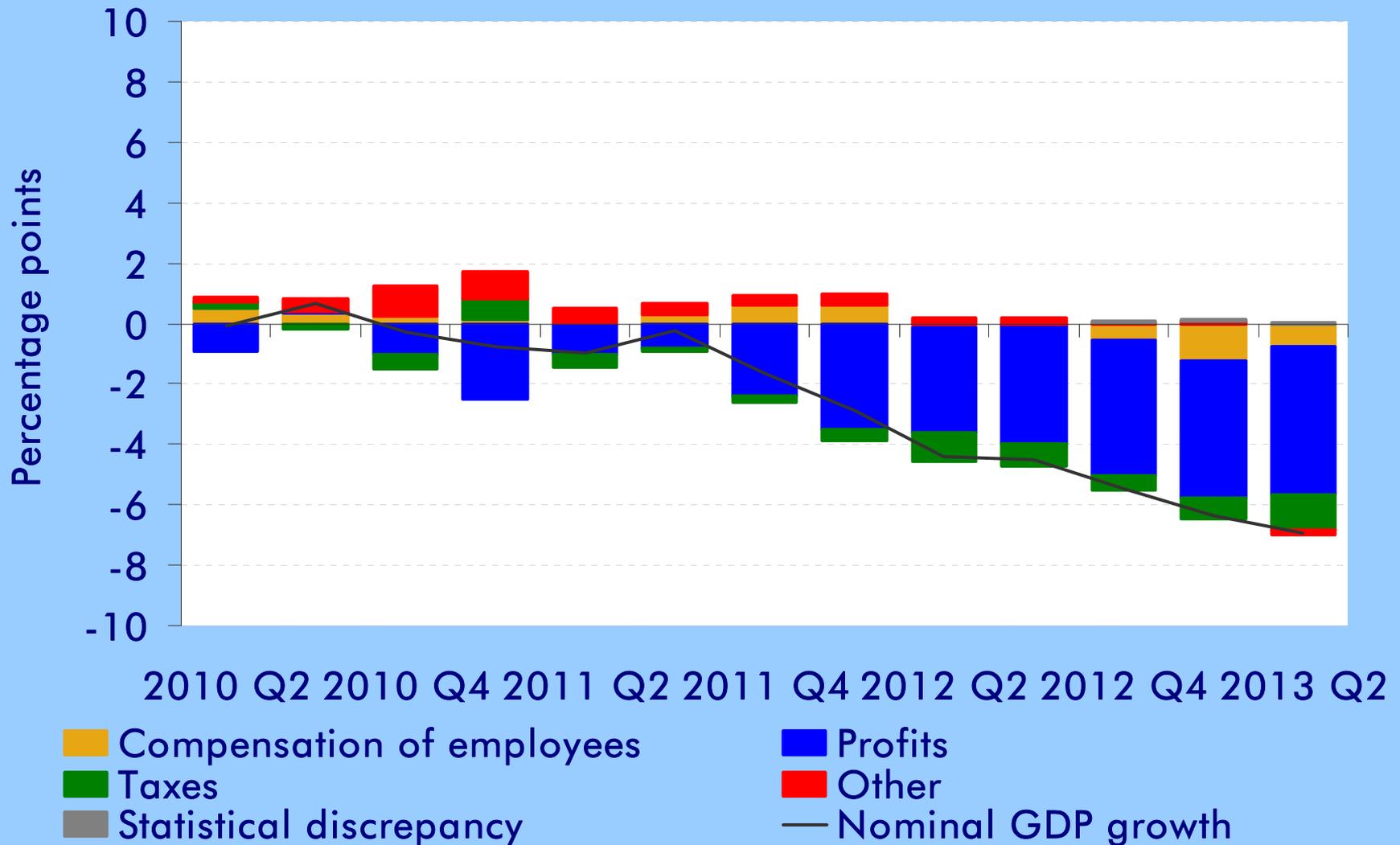
# Nominal GDP growth: income

## Latest outturn



# Nominal GDP growth: income

## June 10 forecast errors



# Why no deficit overshoot in 11-12?

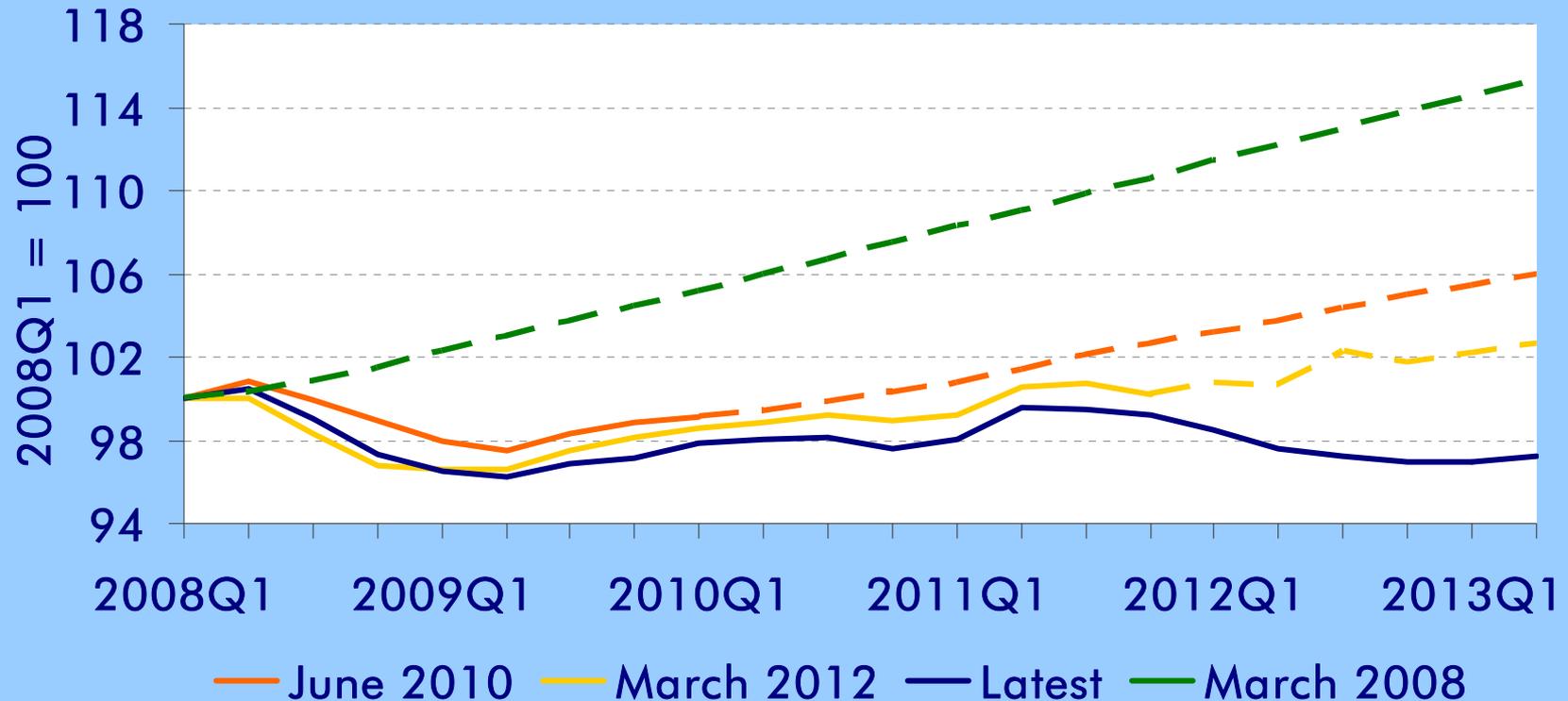
- **PSNB £118.5bn, barely above forecast of £115.6bn**
- **Error in nominal GDP growth forecast concentrated in those areas that are taxed relatively lightly**
  - Private investment rather than private consumption
  - Profits rather than labour income
- **Receipts were still £8bn weaker than forecast, but partly for reasons that had little to do with GDP**
  - Impact of 50p forestalling on income tax receipts
  - Use of past losses to reduce corporation tax liabilities
- **But this was partly offset by central government underspends and local authorities adding to reserves**

# So what went wrong in 2012-13?

June 2010 PSNB error	2010-11	2011-12	2012-13
<b>% GDP</b>	<b>-0.8</b>	<b>+0.1</b>	<b>+1.9</b>
<b>£ billion</b>	<b>-9</b>	<b>+3</b>	<b>+27</b>

- **Much bigger nominal GDP shortfall than in previous two years**
- **Labour income fell short of forecast despite employment holding up**
- **Asset markets and interest rates had been expected to normalise**
- **Weak income tax receipts from the self-employed**
- **North Sea receipts hit by further production fall**
- **Benefit spending pushed up by 5.2% September 2011 CPI**
- **Cash spending below forecast but not spending as % of GDP**

# Gloomier view of potential in Nov 11



- **Productivity weaker than forecast in June 10**
- **In Autumn 11 we assumed hit would be bigger and longer**
- **Cut potential GDP by 3.5% at end of the forecast horizon**

# Our March 2012 forecast

- **Weaker GDP forecast than June 10 reflected**
  - Weak underlying productivity growth
  - Slow progress improving credit conditions
  - Impact of euro-zone difficulties
  - Failure of asset markets to normalise
- **Deficit forecast for 2012-13 revised up £30bn from June 2010 to £120bn**

# Our March 2012 forecast

	Growth since 2011 Q4		Net borrowing 2012-13
	Real GDP	Nominal GDP	
<b>March 2012</b>	<b>2.4%</b>	<b>6.4%</b>	<b>£119.9bn</b>
<b>Latest outturn</b>	<b>0.9%</b>	<b>3.5%</b>	<b>£115.7bn</b>

- **New economy forecasts still too strong**
  - Investment again failed to pick up
  - Euro-area conditions worsened further
- **But yet deficit came in £4bn below forecast**

# Why the £4bn undershoot?

- **Receipts undershot by £5bn**
  - Lower North Sea production
  - But nominal GDP composition favourable
- **More than offset by £9bn spending undershoot**
  - Local authorities added to reserves again
  - Central government departments under-spent Budget 12 plans by £18.5bn, partly to keep deficit forecast falling
  - Departmental limit raised from £364bn in June 10 to £369bn after SR10. Ended up spending £351bn

# Explaining weak real growth to 2012Q2

Contributions to real GDP growth from 2010Q1 to 2012Q2	June 2010 forecast	Last year's data	Latest data
<b>Private consumption</b>	<b>+2.0</b>	<b>0</b>	
<b>Private investment</b>	<b>+2.5</b>	<b>+0.7</b>	
<b>Net trade</b>	<b>+1.9</b>	<b>+0.2</b>	
<b>Total government</b>	<b>-1.5</b>	<b>-0.7</b>	
<b>Stockbuilding</b>	<b>+0.8</b>	<b>+0.5</b>	
<b>Total GDP</b>	<b>+5.7</b>	<b>+0.9</b>	

- **Last year error evenly split between consumption, investment and net trade, offset by government**

# Explaining weak real growth to 2012Q2

Contributions to real GDP growth from 2010Q1 to 2012Q2	June 2010 forecast	Last year's data	Latest data
<b>Private consumption</b>	<b>+2.0</b>	0	<b>+1.2</b>
<b>Private investment</b>	<b>+2.5</b>	+0.7	<b>+0.3</b>
<b>Net trade</b>	<b>+1.9</b>	+0.2	<b>+0.3</b>
<b>Total government</b>	<b>-1.5</b>	-0.7	<b>+0.2</b>
<b>Stockbuilding</b>	<b>+0.8</b>	+0.5	<b>0</b>
<b>Total GDP</b>	<b>+5.7</b>	+0.9	<b>+1.8</b>

- **Growth estimate doubled**
- **Composition looks very different**

# Explaining weak real growth to 2013Q2

Contributions to real GDP growth from 2010Q1 to 2013Q2	June 2010 forecast	Latest data	Error
<b>Private consumption</b>	<b>+3.4</b>	<b>+2.2</b>	<b>-1.2</b>
<b>Private investment</b>	<b>+4.2</b>	<b>-0.4</b>	<b>-4.5</b>
<b>Net trade</b>	<b>+2.6</b>	<b>+0.7</b>	<b>-1.9</b>
<b>Total government</b>	<b>-2.1</b>	<b>+0.2</b>	<b>+2.3</b>
<b>Stockbuilding</b>	<b>+0.8</b>	<b>+0.5</b>	<b>-0.3</b>
<b>Total GDP</b>	<b>+8.9</b>	<b>+3.2</b>	<b>-5.7</b>

- **Much clearer ranking of errors**
- **1st, investment. 2nd, net trade. 3rd, consumption**

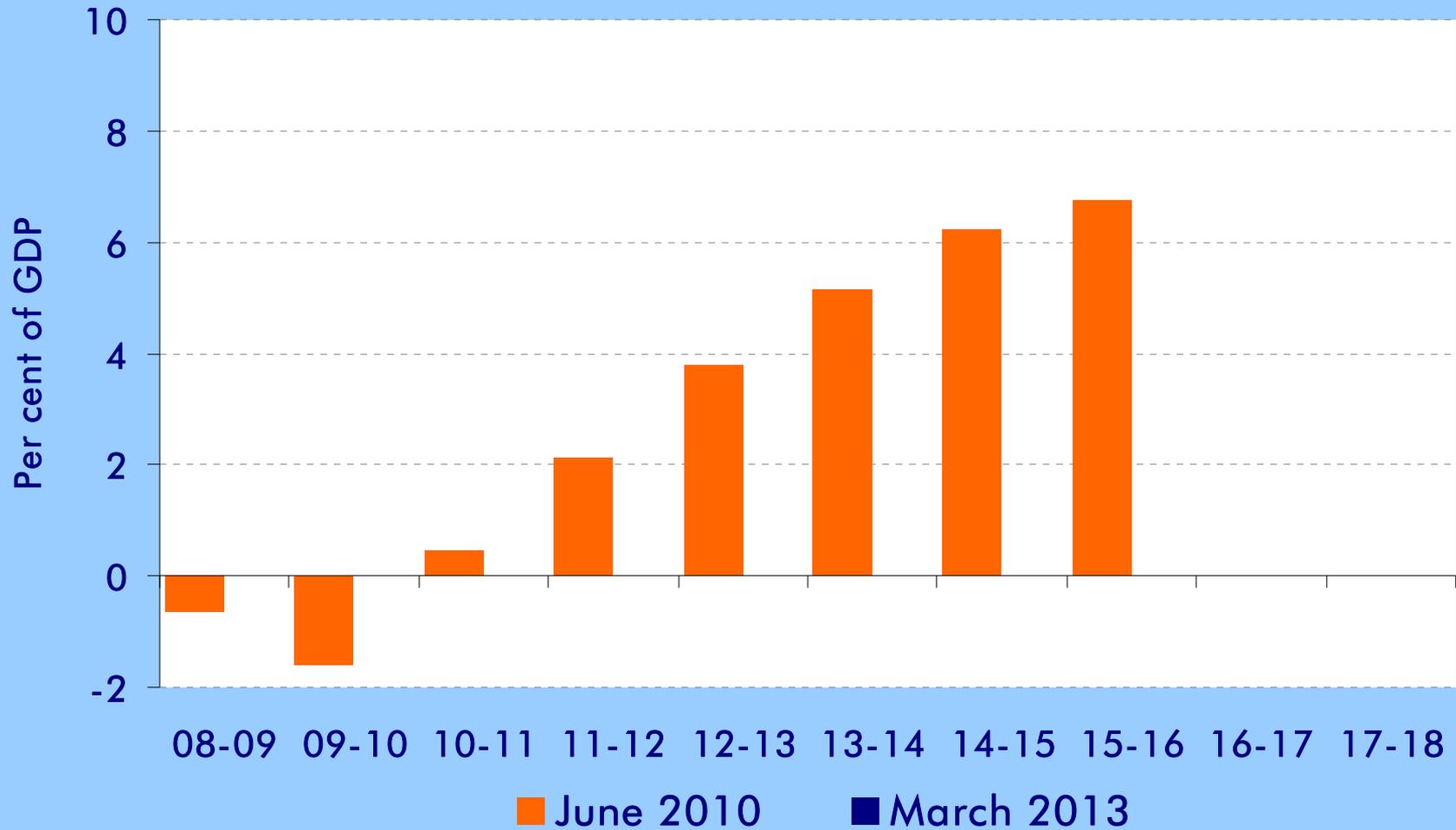
# Private investment

- **Some concern that deflator revisions have made real investment growth look weaker**
  - But investment weak in nominal terms too
- **So why was investment so weak vs forecast?**
  - Unexpected and persistent weakness of profits – linked to persistent weakness of productivity – may have led firms to revise down expected future profitability
  - Weak profits imply less internal finance, while those seeking external finance face tough credit conditions
  - Prolonged demand uncertainty may deter projects expensive to reverse. Labour more flexible.

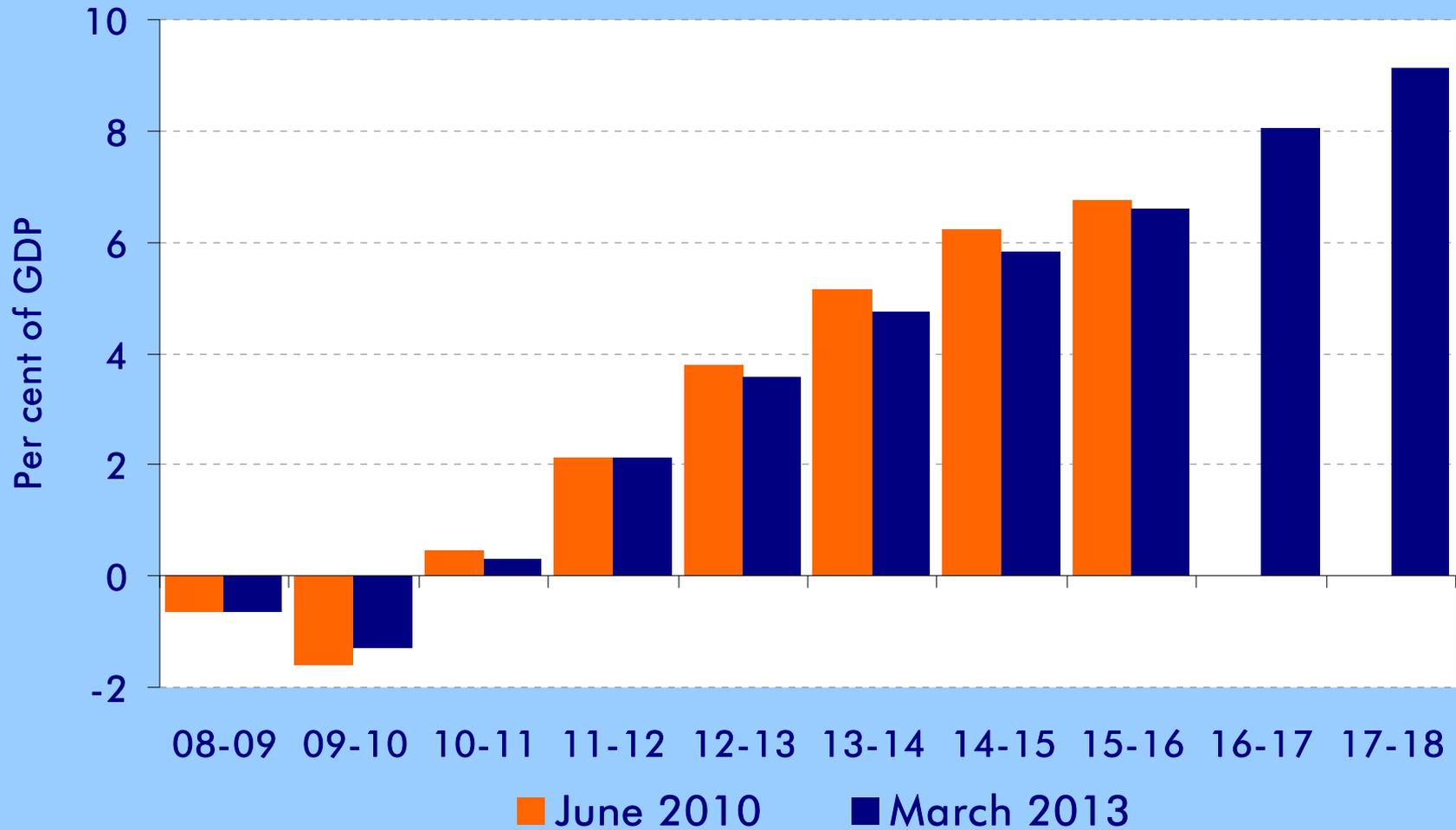
# Impact of policy

- **Monetary policy looser than we assumed it would be in June 2010 – rates, QE, FLS**
- **Fiscal policy tightening eased slightly through to 12-13, but longer consolidation**
- **We said last year**
  - We assumed fiscal consolidation would lower real GDP
  - Larger-than-expected 'multiplier' possible, but not the most obvious reason for GDP errors given composition
- **Take same view this year**

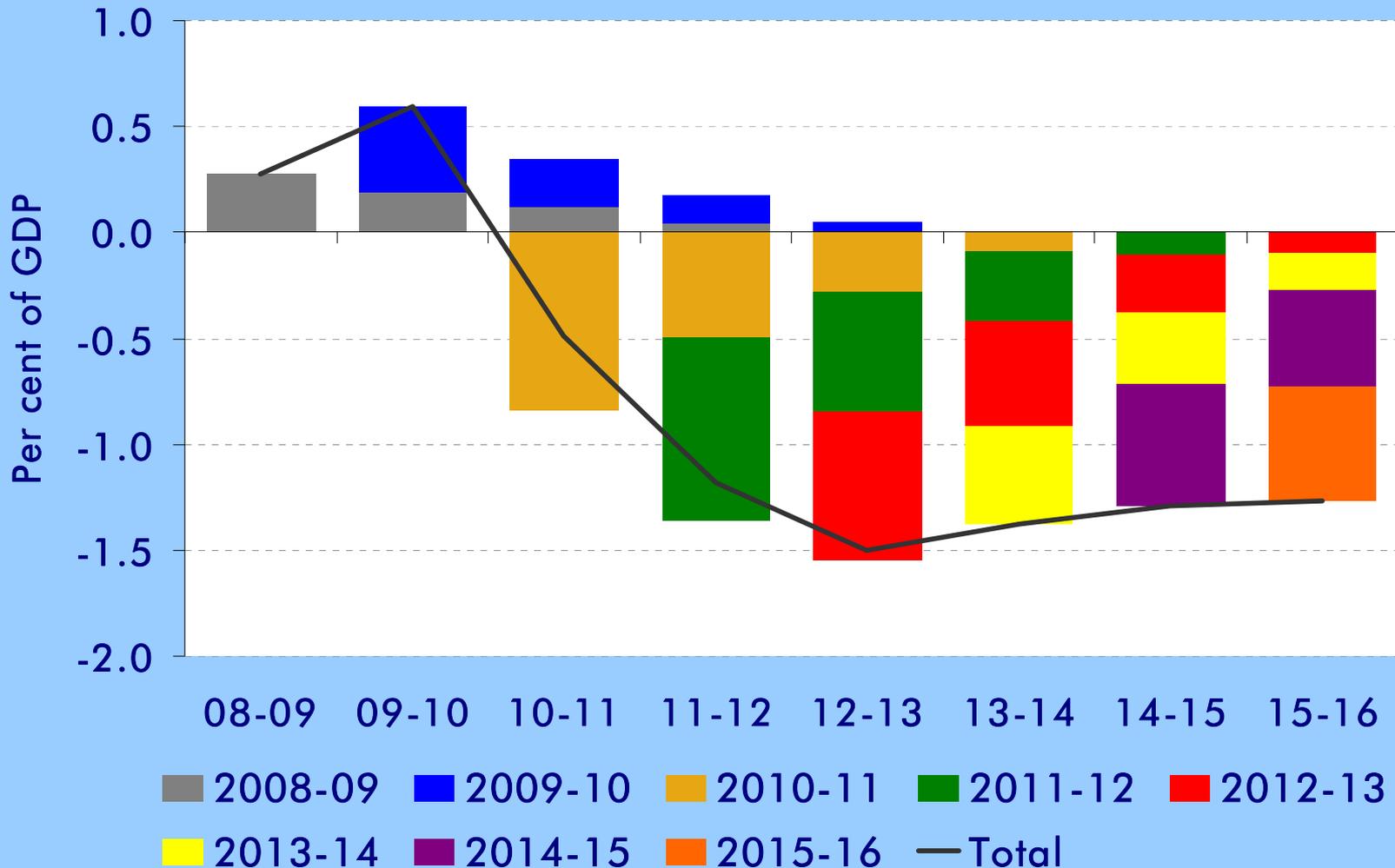
# Fiscal tightening: Budget 2008 baseline



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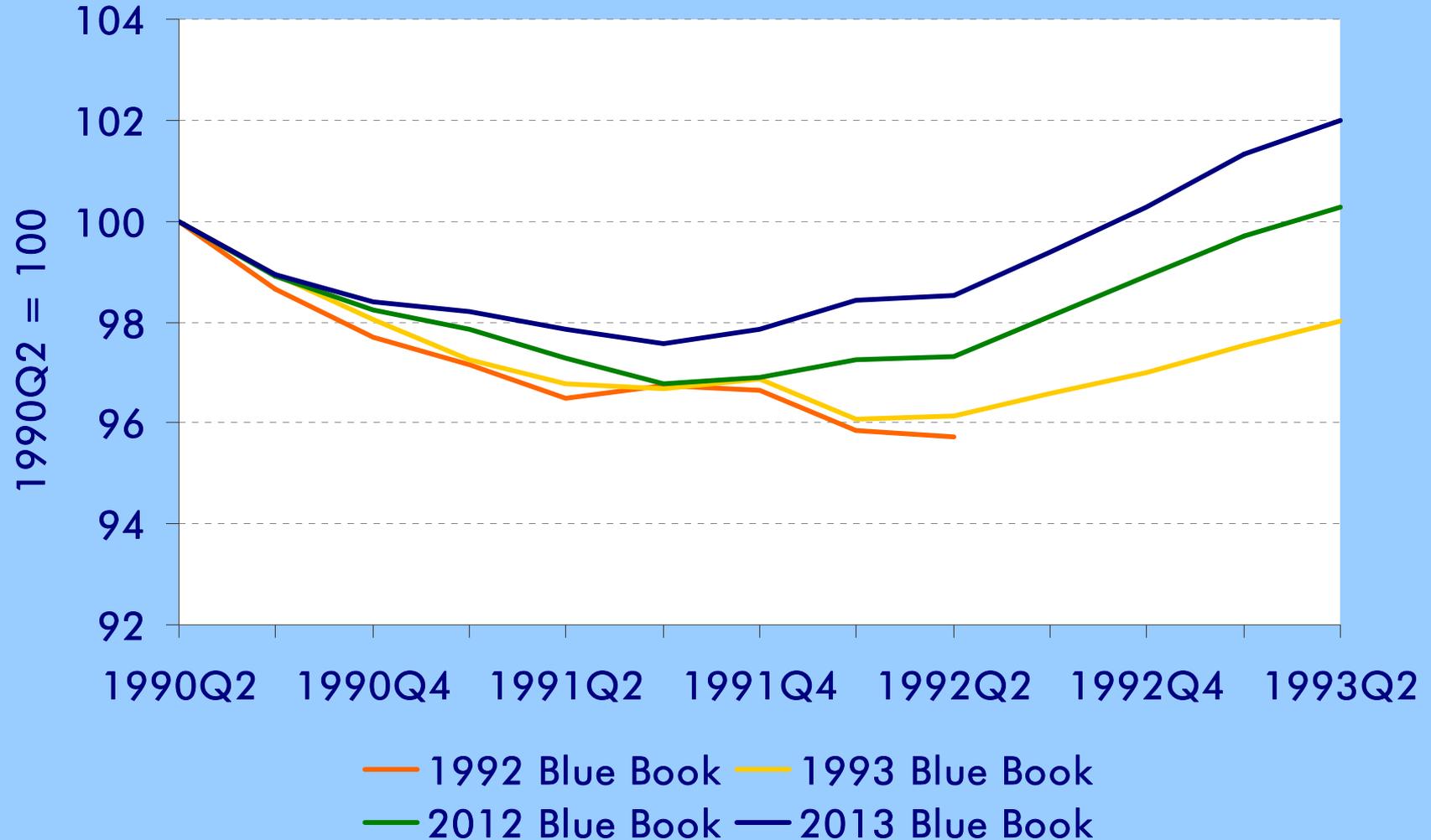
# Fiscal tightening: impact on GDP



# GDP growth errors

	Per cent		
	Calendar years ahead		
	In-year	One	Two
June 2010	0.5	-1.2	-2.7
November 2010	-0.1	-1.0	-2.5
March 2011	-0.6	-2.4	
November 2011	0.2	-0.6	
March 2012	-0.7		
December 2012	0.2		

# GDP revisions: a warning from history



# Net borrowing errors

	Per cent of GDP			
	Fiscal years ahead			
	In-year	One	Two	Three
June 2010 <sup>1</sup>	0.0	-0.8	0.2	1.9
November 2010	-0.7	0.1	1.8	
March 2011	-0.6	-0.2	1.2	
November 2011	-0.7	-0.2		
March 2012	-0.6	-0.2		
December 2012	-0.3			
March 2013	-0.4			

<sup>1</sup> For comparability with other forecasts, 'in-year' is assumed to be 2009-10.

# Receipts errors

	Per cent of GDP			
	Fiscal years ahead			
	In-year	One	Two	Three
June 2010 <sup>1</sup>	-0.6	-0.3	-0.8	-1.1
November 2010	-0.2	-0.6	-0.8	
March 2011	-0.3	-0.9	-0.8	
November 2011	-0.6	-0.4		
March 2012	-0.3	-0.2		
December 2012	0.1			
March 2013	-0.2			

<sup>1</sup> For comparability with other forecasts, 'in-year' is assumed to be 2009-10.

# Spending errors

	Per cent of GDP			
	Fiscal years ahead			
	In-year	One	Two	Three
June 2010 <sup>1</sup>	-0.5	-1.1	-0.6	0.8
November 2010	-0.9	-0.5	1.0	
March 2011	-0.9	-1.1	0.4	
November 2011	-1.3	-0.6		
March 2012	-0.9	-0.5		
December 2012	-0.2			
March 2013	-0.7			

<sup>1</sup> For comparability with other forecasts, 'in-year' is assumed to be 2009-10.

# Conclusions

- **Real GDP growth over-estimated until recently**
- **But public finances driven more by**
  - Behaviour of nominal GDP and its components
  - North Sea production and expenditure
  - Specific tax issues: corporate losses and forestalling
  - Central government and local authority spending
- **Forecast errors more often than not smaller than in pre-OBR period, but beware revisions**