

March 2025 *Economic and fiscal outlook*

Transcript of Presentation by:

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1. Introduction

- Thanks, Laura. Good afternoon, everyone.
- I'll start by taking you through our latest forecast for the economy.
- And then turn to what it, and the policies announced since the Autumn Budget, imply for the public finances.
- I'll end with a discussion of the key sources of risk around what is a particularly uncertain outlook for both the UK and global economy at the moment.

2. Interest rates

- Both the global and domestic backdrop for this Spring Statement are more challenging than at the time of our previous forecast back in October.
- This has been most apparent in global debt markets where, as you can see on the left, yields on government bonds have risen across many advanced economies since the autumn.
- Here in the UK, yields on 10-year gilts had risen by around $\frac{1}{2}$ a percentage point since our last forecast to around $4\frac{1}{2}$ per cent when we took a print of financial market expectations for this forecast.
- And market participants now expect both Bank Rate and gilt yields to be higher over the next five years, as you can see from the chart on the right.

3. Energy prices and inflation

- A second element of this more challenging environment is a rebound in energy prices and inflation.

- On the back of a colder-than-expected winter, European wholesale gas prices are now expected to start rising again to a peak of around 130 pence a therm this year, over 30 per cent higher than assumed in our October forecast.
- The resulting increase in the Ofgem price cap, alongside higher prices for food and other regulated utilities, are collectively expected to push monthly CPI inflation up from 3 per cent in January to 3.8 per cent in the middle of this year.
- But we expect inflation to fall back to target from 2026 onwards as gas prices decline, and greater spare capacity in the economy helps to reduce domestic inflationary pressures.

4. Real GDP growth

- A third element of this more challenging context has been the UK's disappointing GDP performance in recent months.
- After what looked like strong growth in the first half of last year, UK domestic output stagnated over the second half of 2024, coming in around 0.2 percentage points below our forecast for the year as a whole.
- And historical revisions to ONS data suggested that more of the relatively meagre output growth we have seen since the pandemic has come from exceptionally strong growth in the size of the workforce and less had come from growth in output per hour worked.
- Indeed, the latest ONS data imply that labour productivity actually fell by around 1 per cent over the course of last year.
- In addition to these developments in outturn data, forward-looking indicators of business and consumer confidence also trended down in recent months.
- Reflecting this lack of recent momentum and waning domestic confidence, alongside rises in interest rate expectations and gas prices, we have halved our forecast for real GDP growth this year from 2 to 1 per cent.
- We then expect output growth to gather pace to average $1\frac{3}{4}$ per cent over the remainder of the forecast as interest rates and gas prices fall, the household saving rate falls back toward its historical average, and slack in the economy is taken up.
- But this still leaves overall growth in output between 2023 and 2029 around $\frac{1}{2}$ a percentage point lower than we forecast back in October and the level of trend productivity over 1 per cent lower by the end of the forecast.

5. Pre-measures change in borrowing since October

- Let me now turn to what these and other economic developments imply for the public finances relative to our October forecast, before accounting for the effects of policy:
 - A shortfall in **tax receipts**, especially in corporation and self-assessed taxes (shown in the yellow bars), adds £6 billion to borrowing this year, but only £2 billion by 2029-30 as higher nominal earnings growth boosts income tax and NICs receipts.
 - Higher gilt yields and inflation push up **debt interest** costs across the forecast and by £10 billion in the final year (as shown in the blue bars).
 - And (as shown in the grey bars) forecast changes increase **other spending** by £4 billion next year, mainly reflecting higher capital spending by local authorities and public corporations, but only add £1 billion to borrowing in the fifth year.
- Taken together, and before accounting for the impact of policy decisions, these changes to our **underlying fiscal forecast** add around £13 billion to borrowing in 2029-30 (as shown by the white diamonds).

6. Spring Statement policy package

- Against this weaker pre-measures fiscal outlook, the Government has announced a series of policies since our October forecast.
- In December, we had the final details of the Government's reforms to the residential planning system.
 - While these don't have any direct spending or tax implications, we do expect them to deliver a significant increase in the rate of housebuilding which has positive knock-on effects for our estimates of GDP and government revenues from housing and other taxes.
 - Specifically, we estimate that the Government's planning reforms will deliver an additional 170,000 houses and take total net additions to the UK housing stock to around 1.3 million over the next five years.
 - We expect this to provide a temporary boost to demand, via increased residential investment, and a permanent boost to the level of potential output of around 0.2 per cent by 2029. This is the result of a boost to the productivity of residential construction and the increased flow of housing services, which continue to rise beyond the forecast horizon.

- The Spring Statement also includes changes in the level and composition of departmental spending, which leaves it slightly higher by 2029-30. Within this:
 - Capital spending is increased across the forecast and by £4 billion in 2029-30. This mainly reflects the Government's announcement in February that it would increase defence spending from 2.3 to 2.5 per cent of GDP in 2027-28.
 - The capital-heavy increase in defence spending is funded by more current-heavy cuts in overseas aid from 0.5 to 0.3 per cent of GNI.
 - Other changes increase current spending for new policy commitments, including a new 'transformation fund' in the near term and a medium-term increase to funding for DWP employment support programmes announced last week.
 - But, in the final year of the forecast, these are offset by an unspecified reduction in the overall current spending envelope which leaves it £4 billion lower in 2029-30.
- Finally, in last week's *Green Paper*, the Government announced a package of welfare reforms which are estimated to reduce spending by £5 billion in 2029-30. These savings arise mainly from:
 - Tightening the gateway for personal independence payments, which reduces PIP awards for around 800,000 claimants.
 - Further savings come from reducing the generosity of health-related universal credit for 3 million families, with the savings focused on new claimants after April 2026, whose health element is halved.
 - These reductions are partially offset by an increase in the 'standard allowance' for all 7 million families on universal credit, and the decision to reverse the 2023 reforms that tightened the work capability assessment.

7. Overall change in borrowing since October

- Looking at how these policy measures compare against the deterioration in the underlying fiscal outlook since October:
 - The policy package outlined on the previous slide results in a **net reduction in spending** of £4 billion by the final year of the forecast (shown in dark green)...
 - ...to which the Chancellor adds a small number of **tax increases** (shown in light green), which reduce borrowing by a further £2 billion by the end of the forecast.

- And these policy changes, together with their indirect effects on the economy, leave **borrowing** around £4 billion higher in 2029-30 than we forecast back in October (as shown by the black diamonds).
- But because some of the spending changes, notably the defence increases and overseas aid cuts, swap lower current spending for higher capital spending, they return the **current balance**, the Chancellor's fiscal target, to exactly where it was in the final year of our October forecast (as shown by the white circles on this chart).

8. Public sector net borrowing

- Looking at what both forecast and policy changes do to the overall path of government borrowing...
- ...the net effect of these policies was to offset most of the deterioration in the underlying fiscal position since October.
- Borrowing is now forecast to fall from 4.8 per cent of GDP this year to 2.1 per cent of GDP by 2029-30.
- But it's still around £8 billion higher on average over the next five years than we forecast in the autumn.

9. Public sector net debt

- Debt is broadly flat at around 96 per cent of GDP over the forecast.
- But it's around £30 billion higher by the end of the decade than we forecast back in October due to the additional borrowing over the next few years.

10. Current balance target

- Looking at what all of this means for the specific aggregates targeted by the Chancellor in the fiscal rules she set back in the autumn...
- ...as you can see from the lines and the blocks on these charts, underlying forecast changes tipped the current balance rule from a £10 billion surplus to a £4 billion deficit in the target year of 2029-30.
- But the policy measures included in this Spring Statement and their indirect effects on the economy were enough to regain all of that lost headroom.

- And restore the current budget back to a surplus of £10 billion by the end of the decade.

11. Net financial liabilities target

- Turning to the Chancellor's target to get net financial liabilities falling as a share of GDP...
- ...this objective was on track to be met by £5 billion even before taking account of policy measures.
- And the measures included in this Spring Statement return that headroom to £15 billion – also broadly the same as the Chancellor had back in October.

12. Headroom against fiscal rules

- £10 billion of headroom against the Government's main fiscal rule may sound like a lot of money, but, as you can see from this chart:
 - It's a third of the average margin of around £30 billion set aside by all Chancellors against their respective fiscal rules since 2010.
 - It's the third-smallest such margin any Chancellor has had against their rules over that period.
 - And it's the same margin that this Chancellor left in her October Budget – which was eliminated by the increase in interest rates and other, relatively small, forecast changes over the course of just the last few months.

13. Risks to the outlook

- This illustrates that the headroom that the Chancellor has maintained against her fiscal targets is a tiny fraction of risks to the outlook over the next five years.
- This Spring Statement does make some progress in addressing three key risks we have highlighted in previous fiscal risks reports:
 - First, it funds an increase in defence spending from 2.3 to 2.5 per cent of GDP by the middle of this Parliament. Although it also creates a new, more expensive, and as yet unfunded, commitment to increase spending further to 3 per cent of GDP in the next Parliament.

- Second, the *Pathways to Work Green Paper* begins to address the rising cost of health-related benefits. But there are significant uncertainties around the costings of the welfare measures included in this forecast. And many of the broader policy ambitions in the *Green Paper* are yet to be clearly specified.
- Third, this Spring Statement breaks a historical pattern of asymmetric policy responses to forecast changes – in which windfalls were generally spent but shortfalls were not fully made up.
 - In this Statement, on our central forecast, all of the £14 billion deterioration in the current balance was recovered by the final year.
 - And the Chancellor's headroom was restored to the £10 billion she had in the autumn.
- But the array of potential claims on that small amount of headroom is large and varied.
- And I would like to close by exploring three of those:
 - uncertainty around the UK's recent productivity performance;
 - continued volatility in interest rates across advanced economies;
 - and escalating global trade restrictions.

14. Productivity risks

- One of the single greatest risks to the fiscal outlook arises out of the difficulty in interpreting what the most recent combination of population, employment, and GDP data implies for the future productivity of the UK economy.
- Our central forecast assumes that:
 - The fall in recorded output per hour worked that the UK has seemingly experienced over the last two years represents a mix of permanent structural weakness, temporary cyclical factors, and measurement challenges.
 - And underlying productivity growth picks up from 0.3 per cent this year to 1¼ per cent by the end of the decade, around halfway between its pre- and post-financial crisis averages.

- But this still leaves the level of productivity at the forecast horizon over 1 per cent lower than in October.
- In the *EFO*, we also consider a downside scenario in which:
 - This very poor recent underlying productivity growth persists further into the future and remains at just 0.3 per cent per year over the remainder of the forecast.
 - In this scenario, the current budget would end the decade in deficit by around 1.4 per cent of GDP and the Chancellor would miss her fiscal target by £48 billion.
- We also consider the implications of an upside scenario in which:
 - *All* of the currently observed weakness in productivity is cyclical and output per hour returns to the same *level* we forecast back in October by the end of the decade.
 - In this scenario, the current budget would be in surplus by around 1 per cent of GDP, and the Chancellor would overachieve her fiscal rule by around £33 billion.

15. Interest rate risks

- A second key source of risk to the fiscal outlook is continued volatility in global interest rates.
- Since early October, daily 10-year gilt yields have varied by a full percentage point between 3.9 per cent and 4.9 per cent.
- And, as shown in yellow on these two charts, it would only take a 0.6 percentage point increase in market expectations for gilt yields and Bank Rate...
- ...to tip the current balance from a £10 billion surplus back into deficit in 2029-30, the target year for the Chancellor's fiscal rules.
- And with UK gilt rates being highly sensitive to developments in global bond markets...
- ...and continued uncertainty about the direction of fiscal policy in both the US and the eurozone.
-even more extreme scenarios for interest rates would be plausible.

16. Global trade policy risks

- A final source of risk to our forecast is the outlook for global trade policy.
- Our central forecast for the global economy is based on the IMF's January *World Economic Outlook*, which did not include any effects from the higher tariffs introduced by the new Trump Administration in the US, or the retaliatory tariffs imposed by other countries.
- However, we do explore the implications of an escalating trade war between the US and its trading partners for the UK's economic and fiscal prospects.
- The object of these trade scenarios is not to try to estimate the precise impact of what continues to be a rapidly changing trade policy landscape.
- Rather it is to illustrate the potential orders of magnitude associated with different levels of escalation in global trade policy restrictions.
- In a first scenario, shown in yellow, we look at the implications of the US imposing a 20 percentage point increase in tariffs on all goods imported from Mexico, Canada, and China with all three of these countries retaliating in kind.
 - In this scenario, the lasting effects on the UK's output and public finances are limited.
 - Though we do face some near-term reduction in GDP as a result of higher uncertainty and reduced demand for our exports from other countries directly affected by the tariffs.
- In a second scenario, shown in green, we look at the implications of the US extending its 20 percentage point tariff increase to all goods imports, including those from the UK, Europe, and the rest of the world. This would take the effective US tariff rate to around 25 per cent. But, in this scenario, we assume that the rest of the world does not retaliate.
 - In this case, the UK experiences a larger and more lasting loss of output, peaking at just over ½ a per cent in 2026-27.
 - And the corresponding loss of tax revenue and increase in inflation-linked spending virtually eliminates the headroom against the Chancellor's current balance target by 2029-30.

- The third and final scenario, shown in purple, illustrates the consequences of the UK and the rest of the world retaliating by levying their own 20 percentage point increase in tariffs on all goods imported from the US.
 - In this scenario, the UK experiences a larger loss of output which peaks at around 1 per cent in 2026-27.
 - And while the Exchequer gains around £9 billion a year in additional tariff revenue, this is more than offset by the loss in revenue from other taxes on domestic income, consumption, and profits.
 - And the net result is that the Chancellor's fiscal headroom is also almost wiped out by the fifth year of the forecast.

17. Summary

- In summary, since the Chancellor presented her first Budget in the autumn, the economic outlook has become both:
 - more challenging – with output stagnating, bond yields rising, business and consumer confidence falling, and energy prices rising over the past six months;
 - and less certain – with big questions about the UK's recent productivity performance, European security arrangements, and global trade policies.
- Against this more difficult backdrop, and before taking account of Spring Statement policies, the forecast we presented to the Chancellor:
 - halved the rate of GDP growth this year from 2 to 1 per cent and left the level of productivity lower in the medium term;
 - and showed the current budget in deficit by around £4 billion at the end of the decade.
- In the run-up to this Spring Statement, the Government announced:
 - reforms to the residential planning system;
 - cuts to welfare and departmental current spending;
 - and an array of smaller tax measures.

- These and other changes were just enough to restore the headroom against the Chancellor's main fiscal rule to the £10 billion surplus she had back in the autumn.
- But this is still the third-lowest margin any Chancellor has had against their fiscal rules, and risks to the outlook for UK productivity, interest rates, and global tariff policies could all reduce it to back to zero over the next five years.