

Economic and fiscal outlook

November 2010

Robert Chote

Scope of the document

- Economic forecasts to 2015–16
- Public finance forecasts to 2015–16
- Assessment of progress towards the Government's medium-term fiscal objectives
- Preliminary view of long-term fiscal sustainability

Uncertainty and the forecast

- Significant uncertainty around all economic and fiscal forecasts
- Our central forecasts are median forecasts: so we think they are equally likely to be too high as too low
- Illustrate uncertainty based on past forecast performance
- Sensitivity and scenario analysis used to test vulnerability of Government targets to divergence from central forecast

Process and independence

- Independent Budget Responsibility Committee responsible for assumptions, judgements and conclusions
- Supported by our full-time OBR staff
- Drawing on data and analysis from HMRC, HMT, DWP etc
- Draft forecast presented to Chancellor on 18 November
- No political pressure to change any conclusions

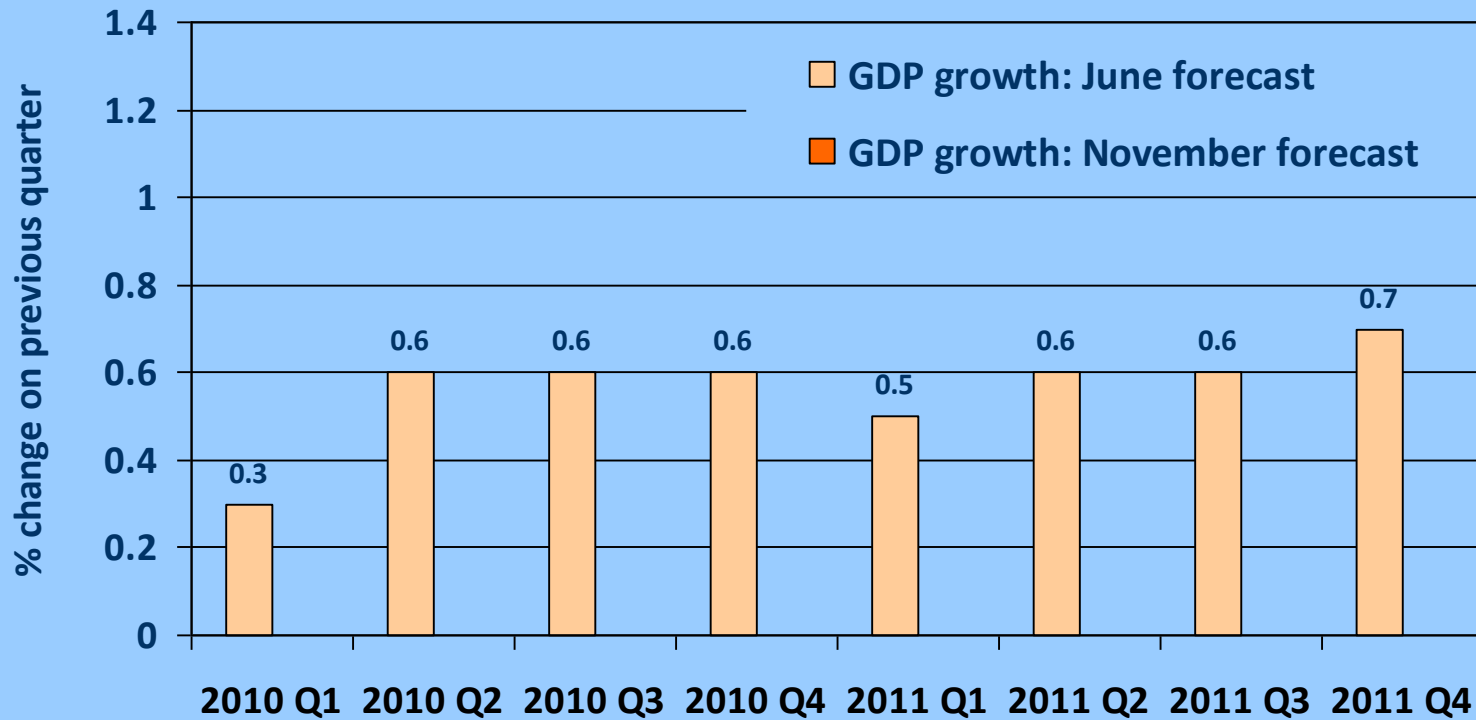
Key points: economic outlook

- Economy has been growing more strongly than expected
- Partly a timing effect and partly underlying momentum
- GDP in 2011: level revised up, growth revised down
- Steady recovery continues thereafter, but slower GDP growth than after previous three recessions
- Employment to increase despite public sector job cuts

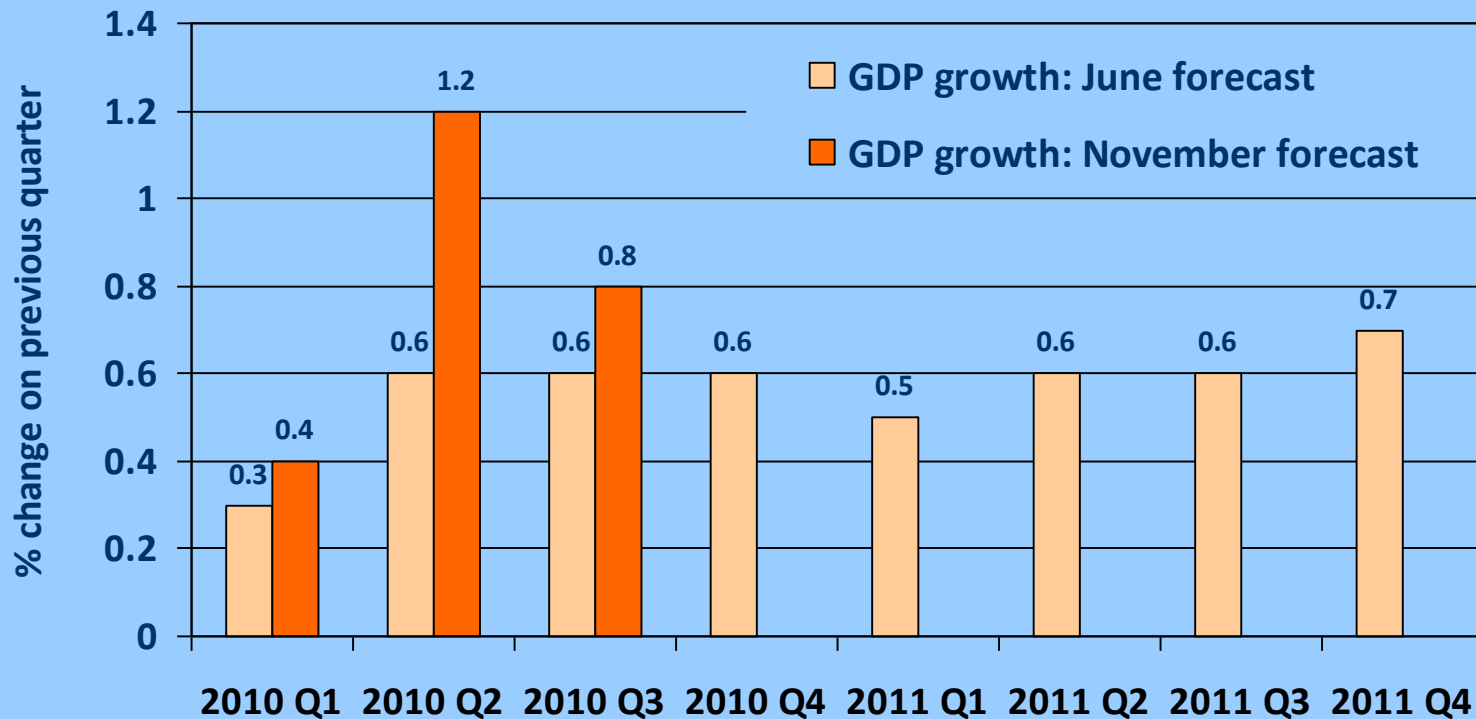
Key points: fiscal outlook

- Revenues and spending both revised down since June
- Little change in borrowing and debt forecasts since June
- Government to meet targets, with slightly more headroom than in June
- Biggest economic risk to targets: overestimate of potential GDP
- Also risks around revenues and spending for given state of the economy
- Longer-term spending pressures from ageing, but not unique to the UK

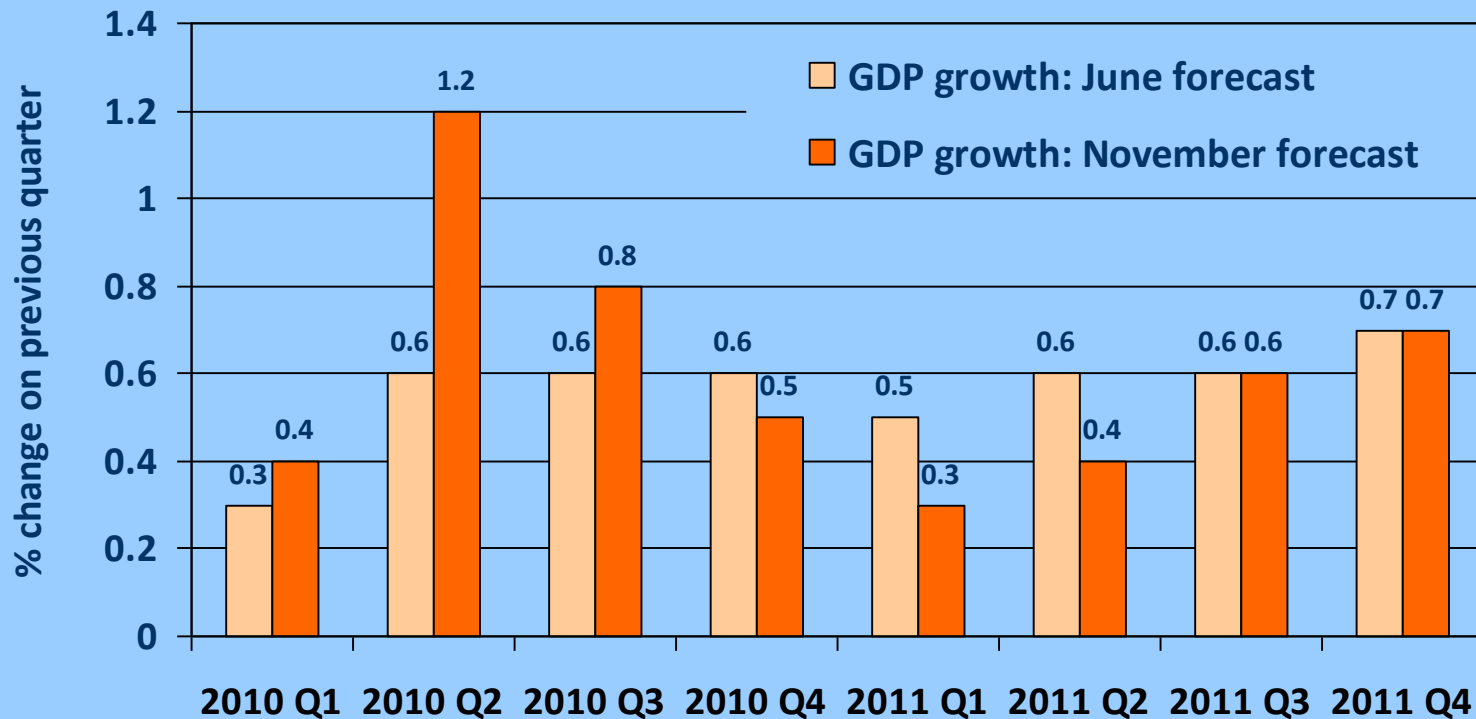
Short-term GDP growth



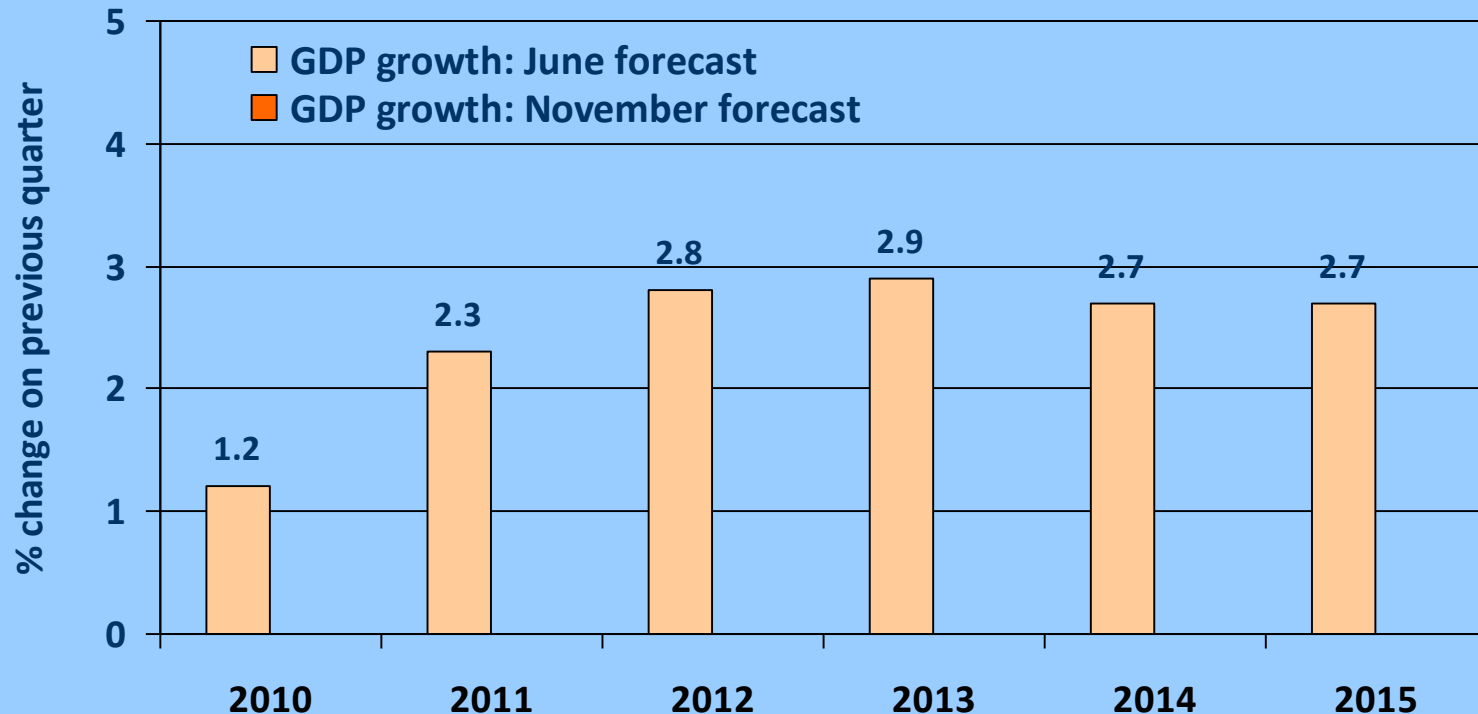
Short-term GDP growth



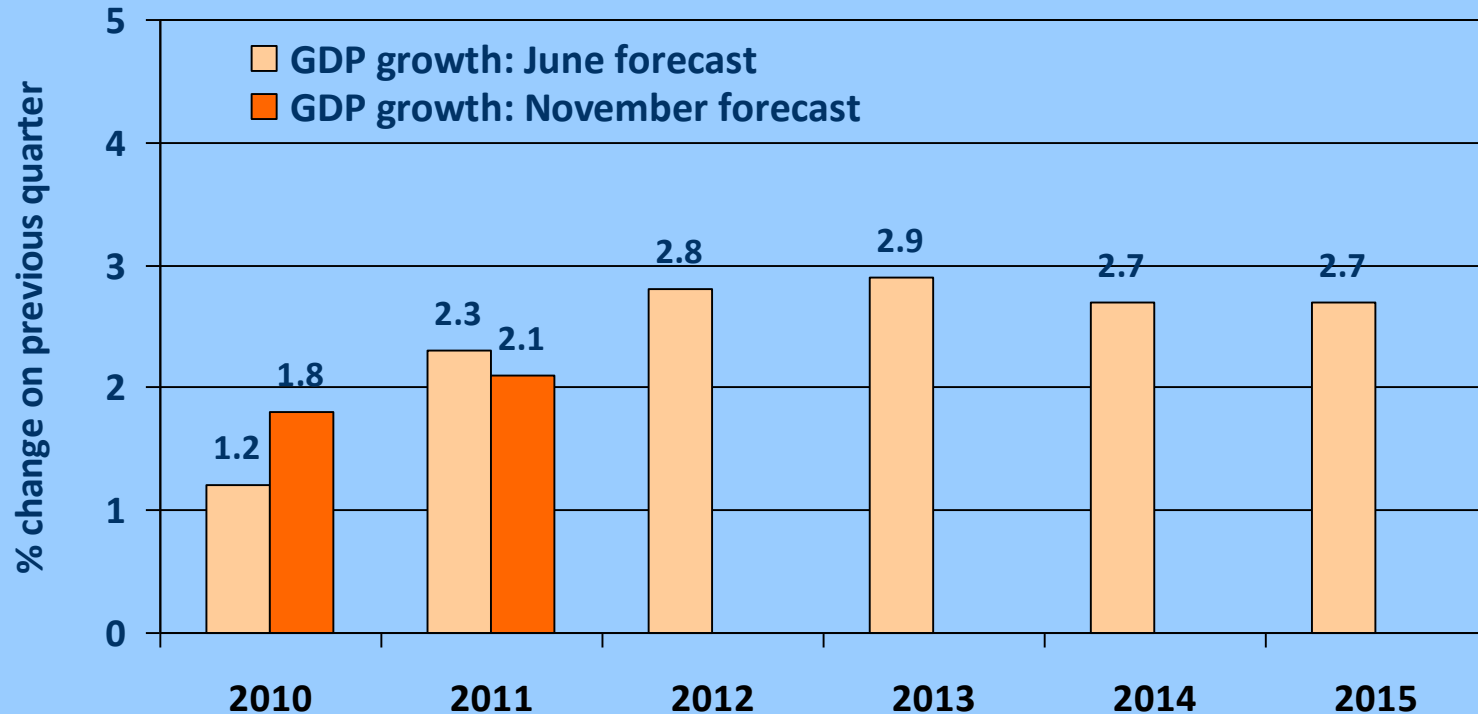
Short-term GDP growth



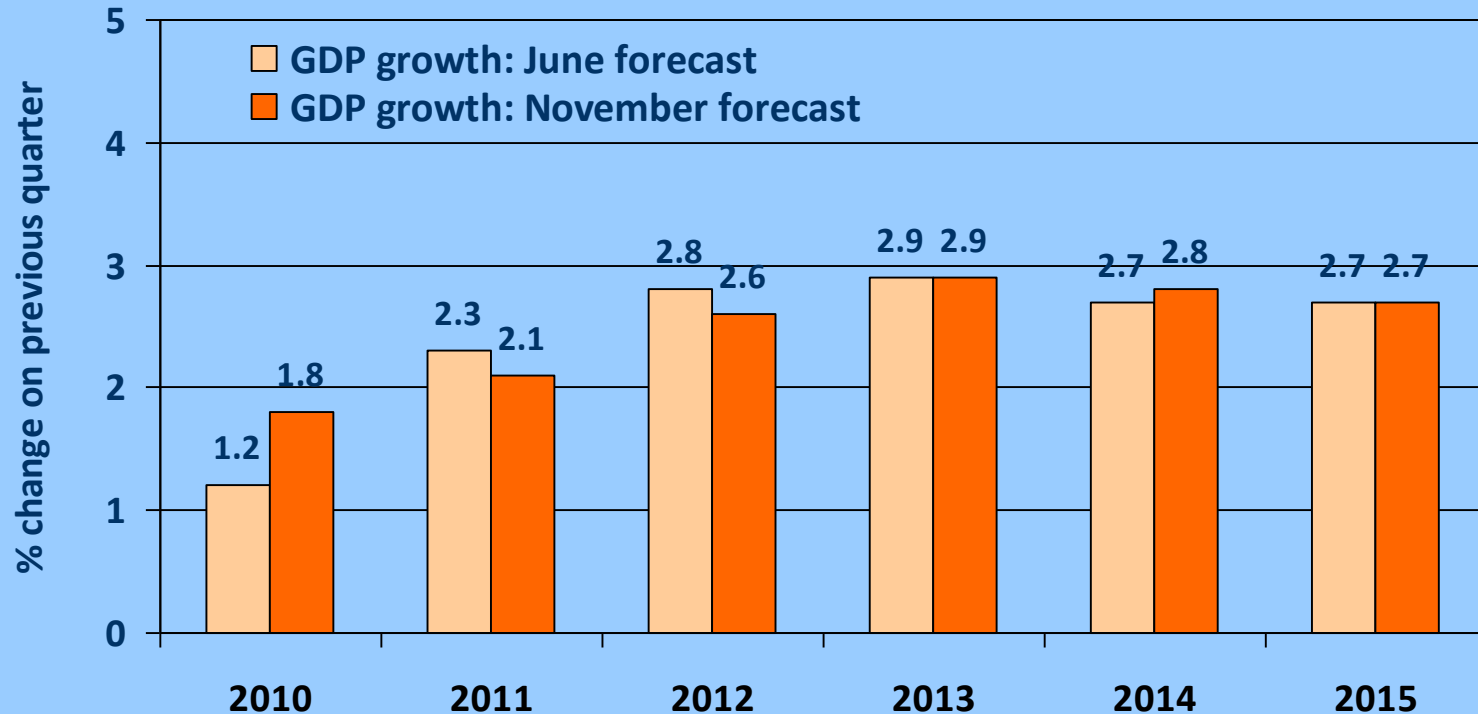
Medium-term GDP growth



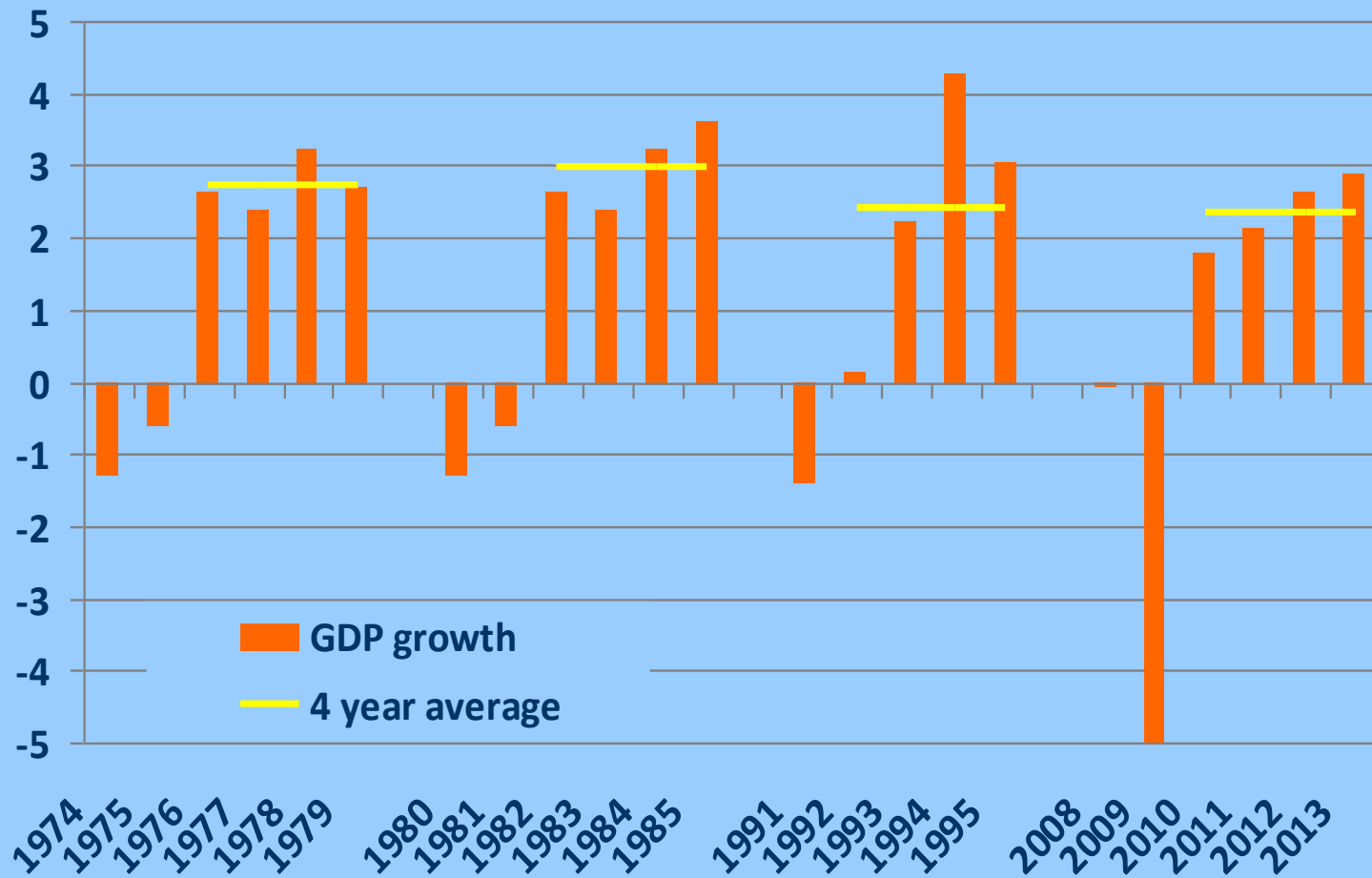
Medium-term GDP growth



Medium-term GDP growth



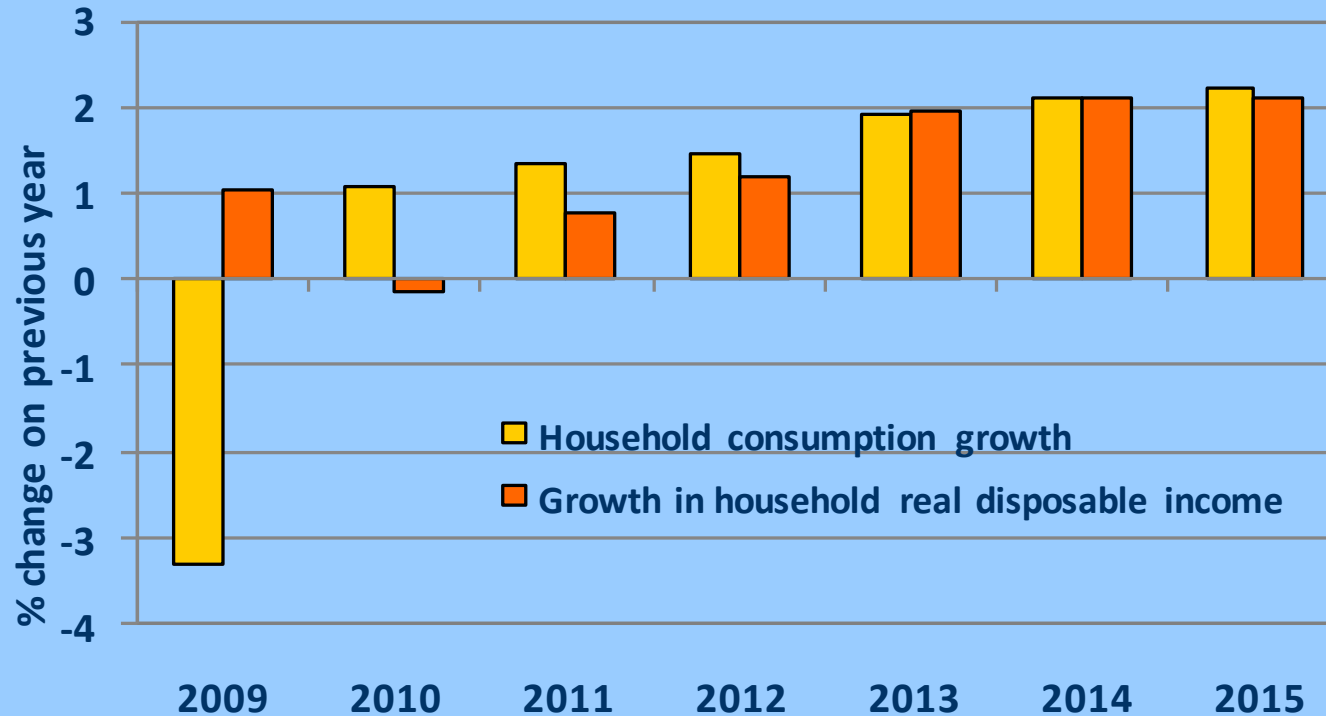
Recovery from past recessions



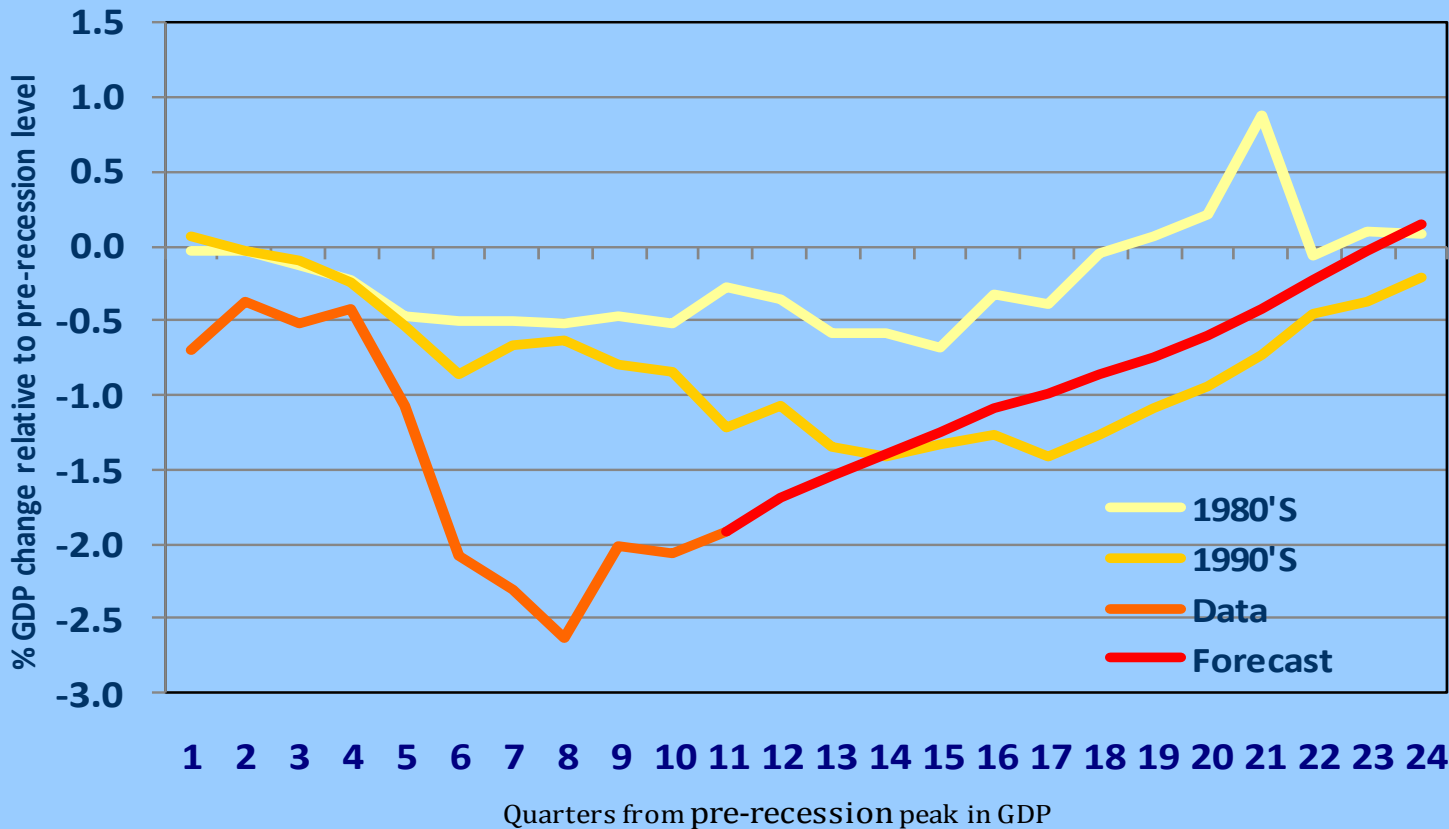
Composition of growth: demand

Expenditure components of GDP at constant market prices							
Percentage change on a year earlier	2009	2010	2011	2012	2013	2014	2015
Household consumption ¹	-3.3	1.1	1.3	1.5	1.9	2.1	2.2
Business investment	-18.8	1.3	8.6	8.4	10.2	9.8	7.6
General government consumption	1.0	1.8	-0.4	-1.3	-1.8	-2.4	-1.7
General government investment	14.2	1.0	-15.3	-9.7	-5.9	-1.5	2.6
Net trade ²	0.7	-0.9	0.7	0.9	0.7	0.6	0.5
<p><i>1 Includes households and non-profit institutions serving households..</i></p> <p><i>2 Contribution to GDP growth, percentage points..</i></p>							

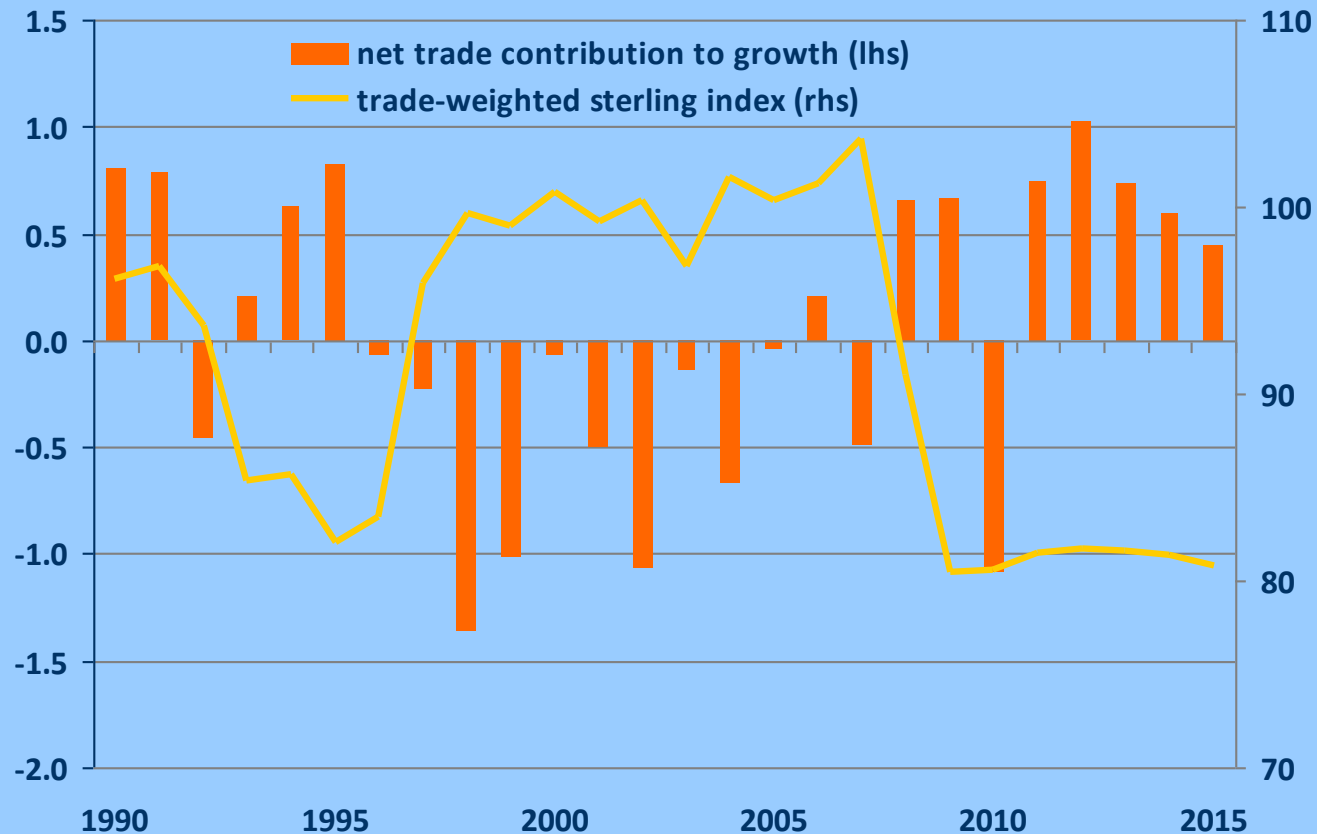
Consumer spending and incomes



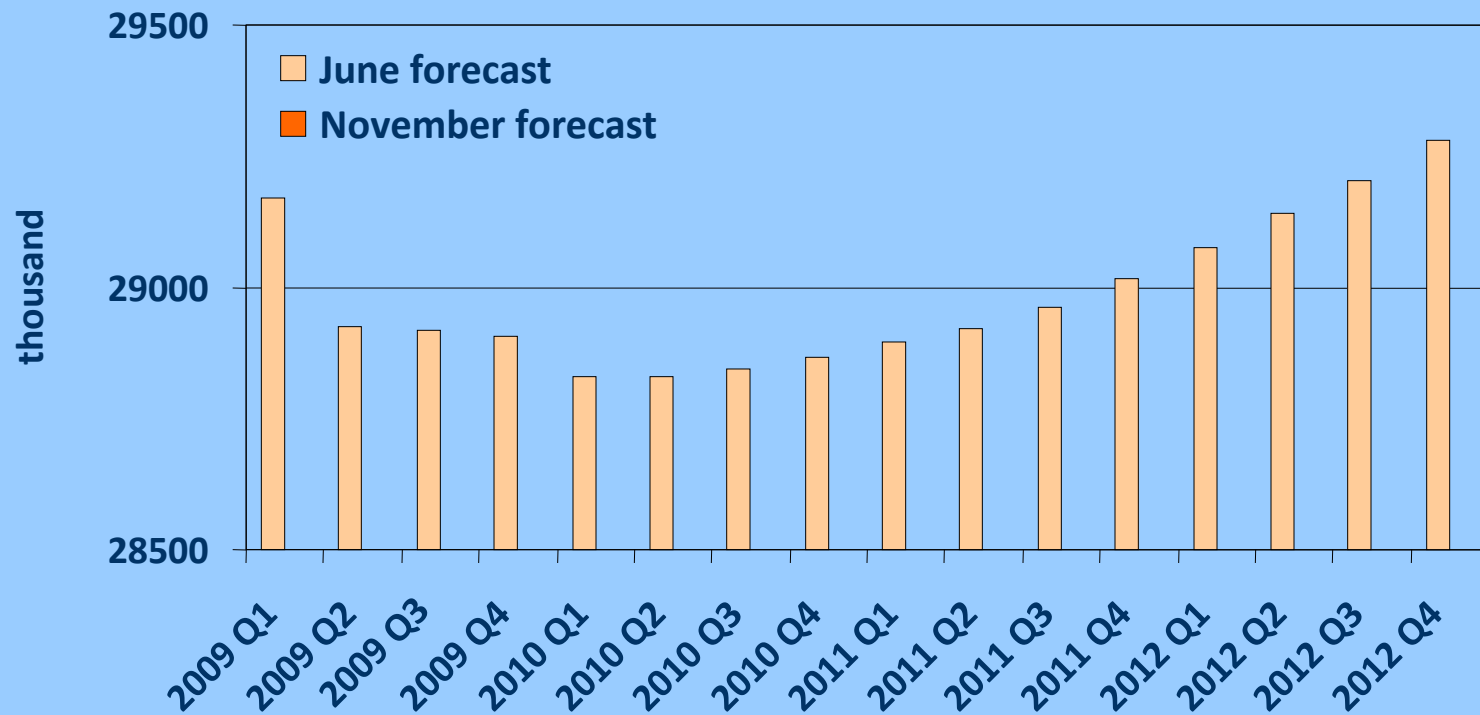
Business investment as share of GDP



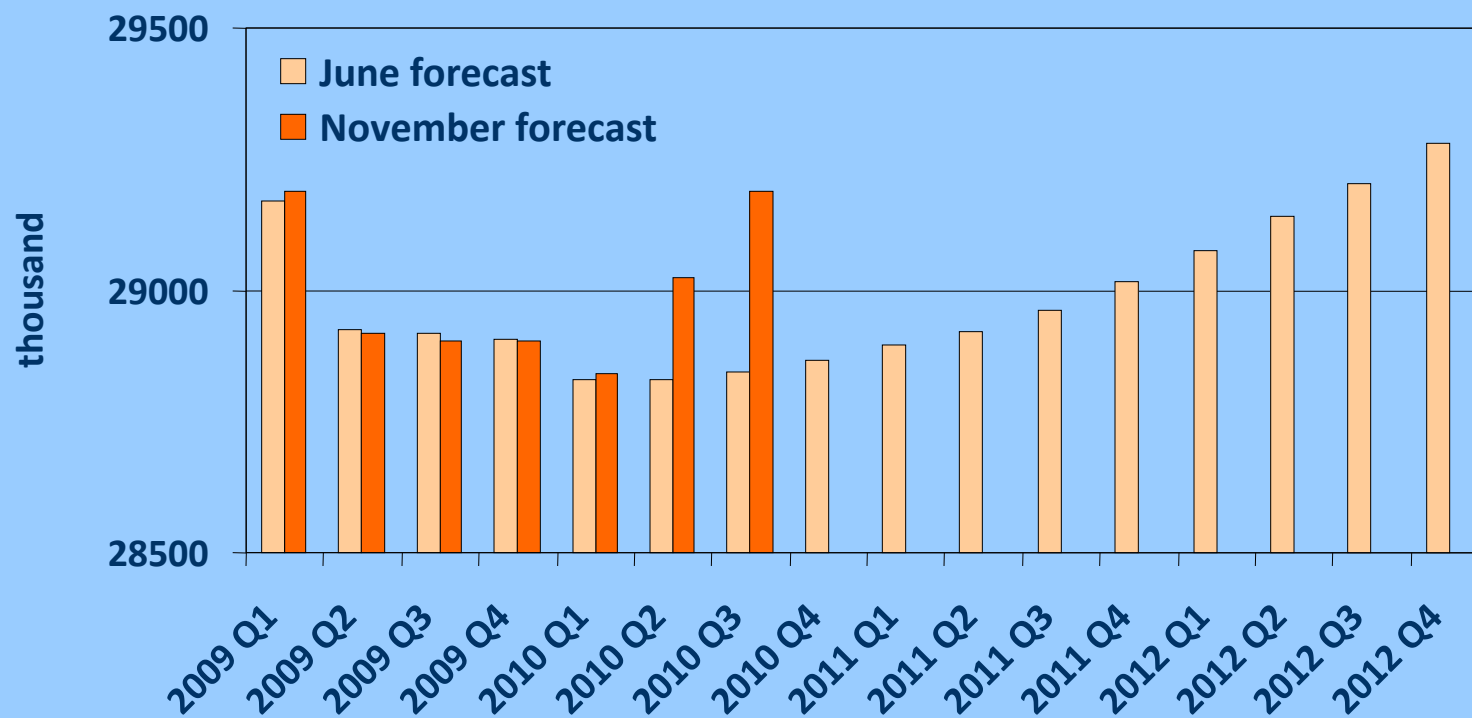
Net trade contribution and sterling



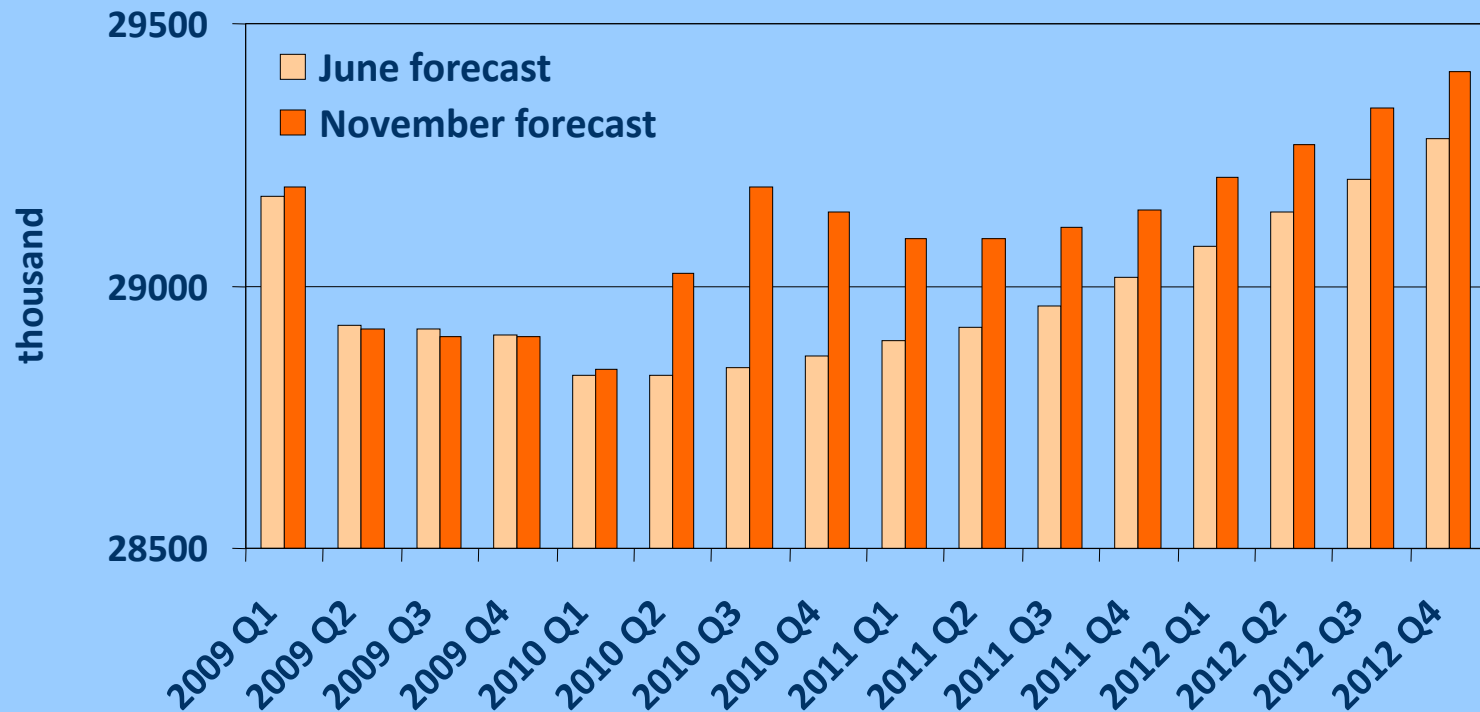
LFS employment



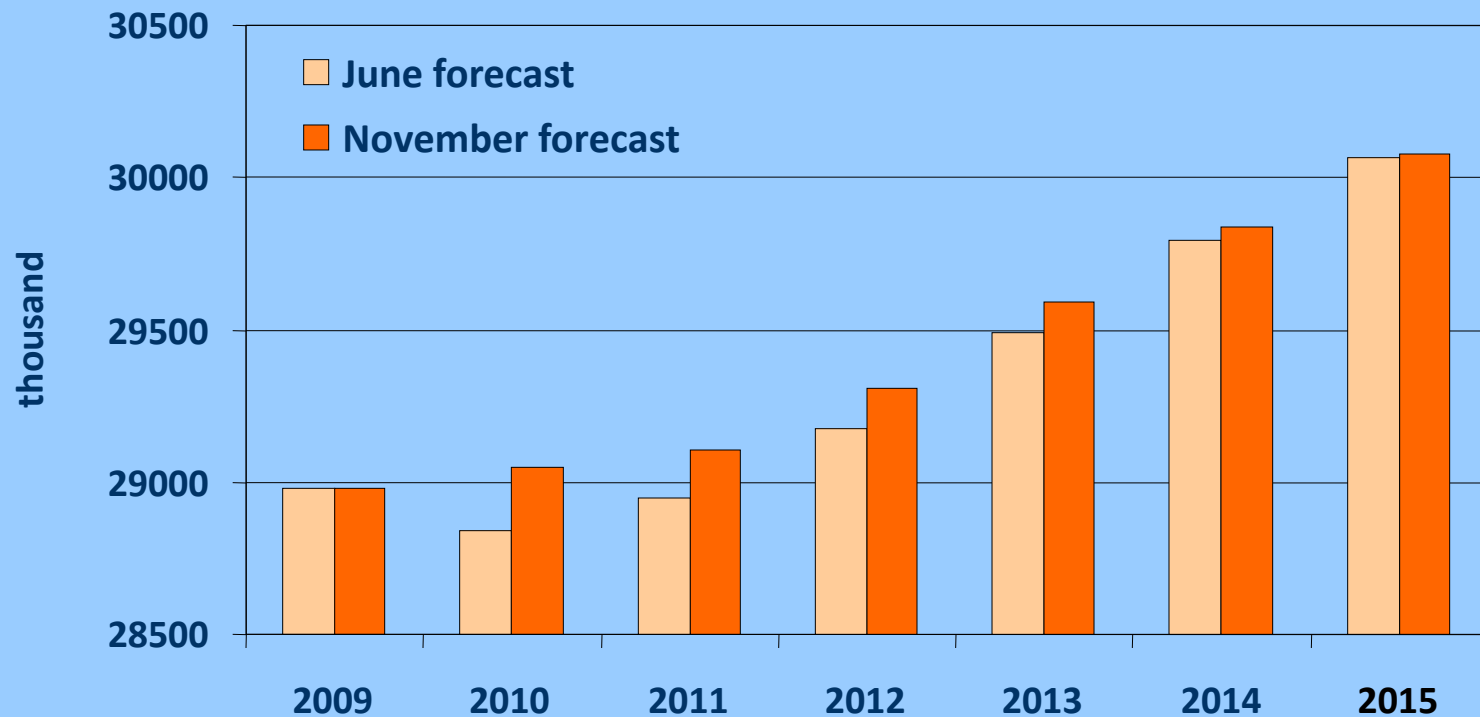
LFS employment



LFS employment



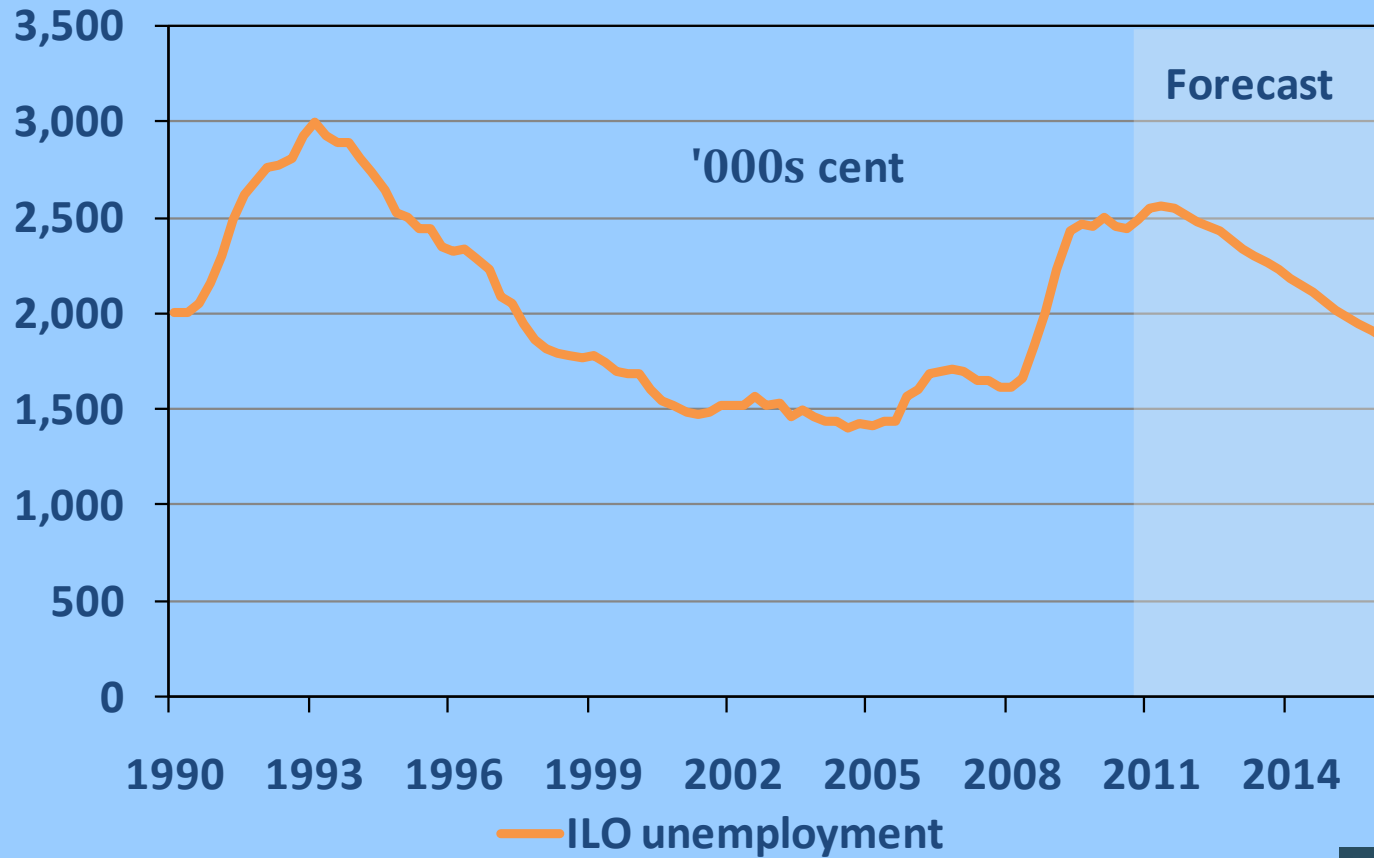
LFS employment



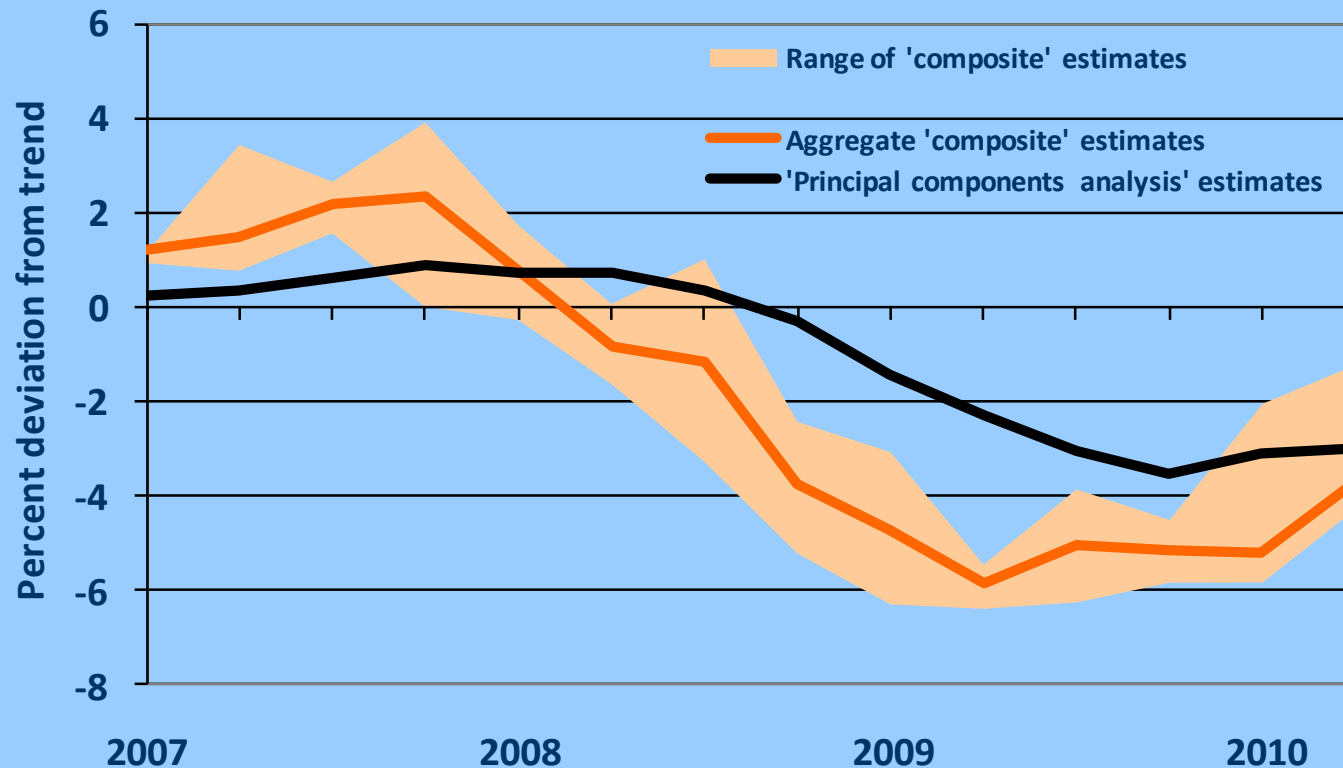
General government employment

- Interim OBR predicted 490,000 fall between 2010-11 and 2014-15
- Broader and simpler methodology would have cut that to 460,000
- Spending Review substituted welfare cuts for cuts in public services spending: pool of money to pay for GGE in 2014-15 is now 2.5% higher
- So new forecast of fall in GGE to 2014–15 is 330,000
- But Government also plans real freeze in total public spending in 2015–16
- This implies further 80,000 fall in 2015-16 without further welfare cuts

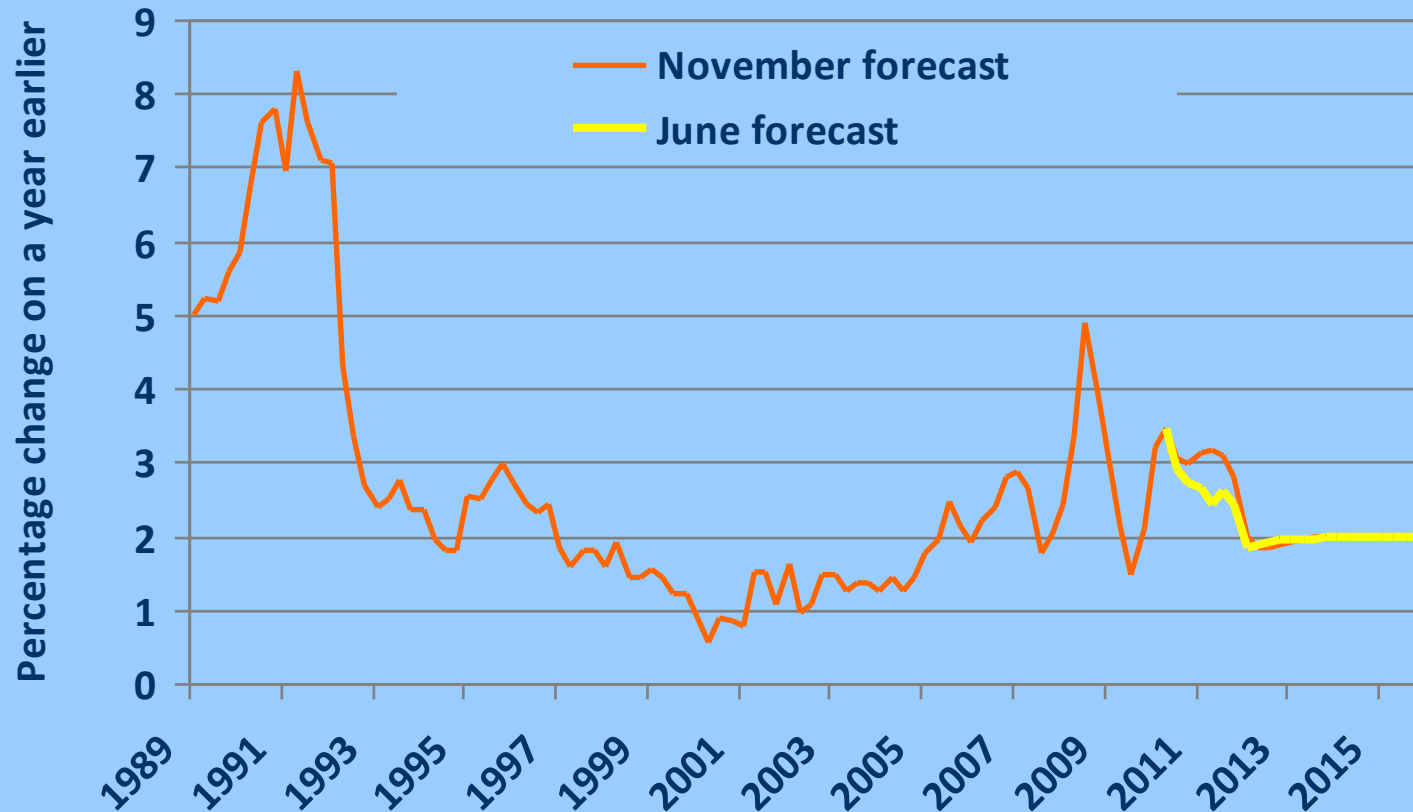
ILO unemployment



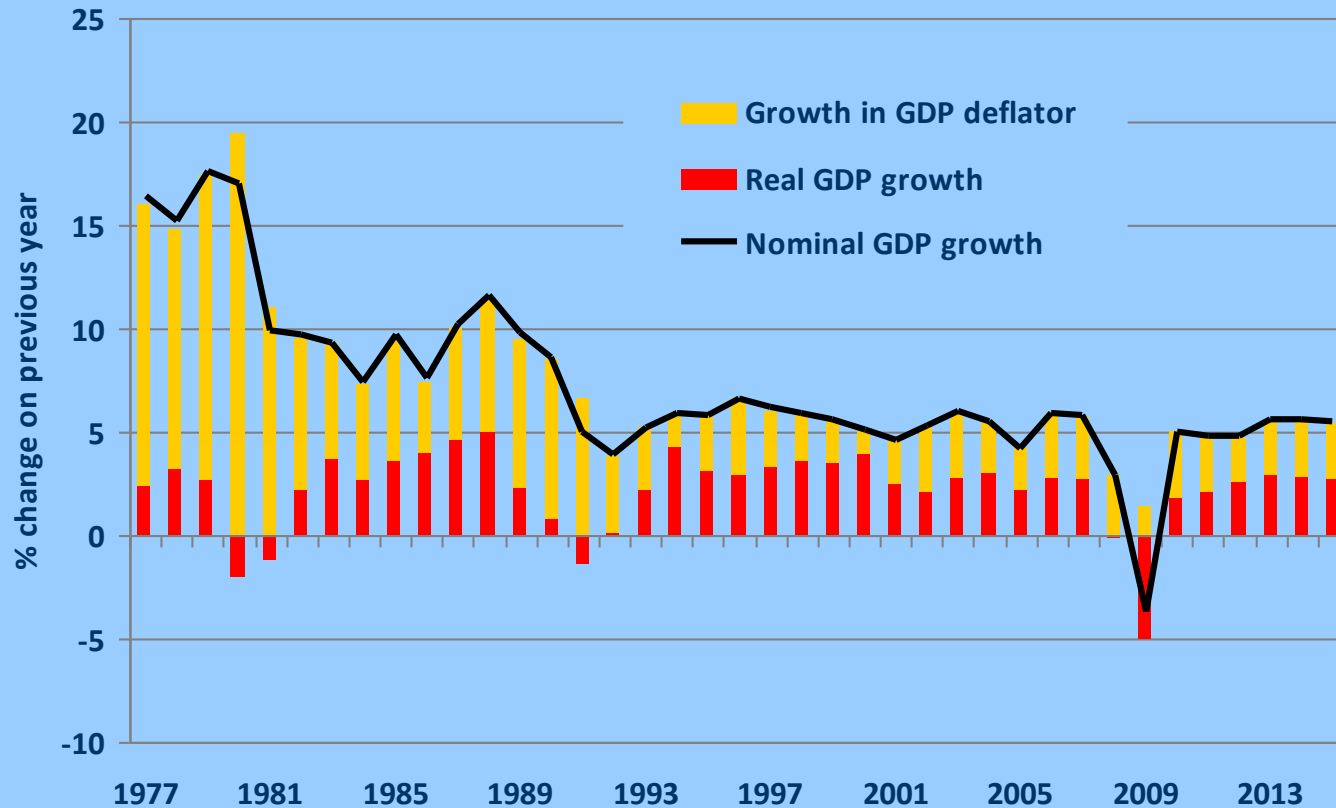
How big is the 'output gap'?



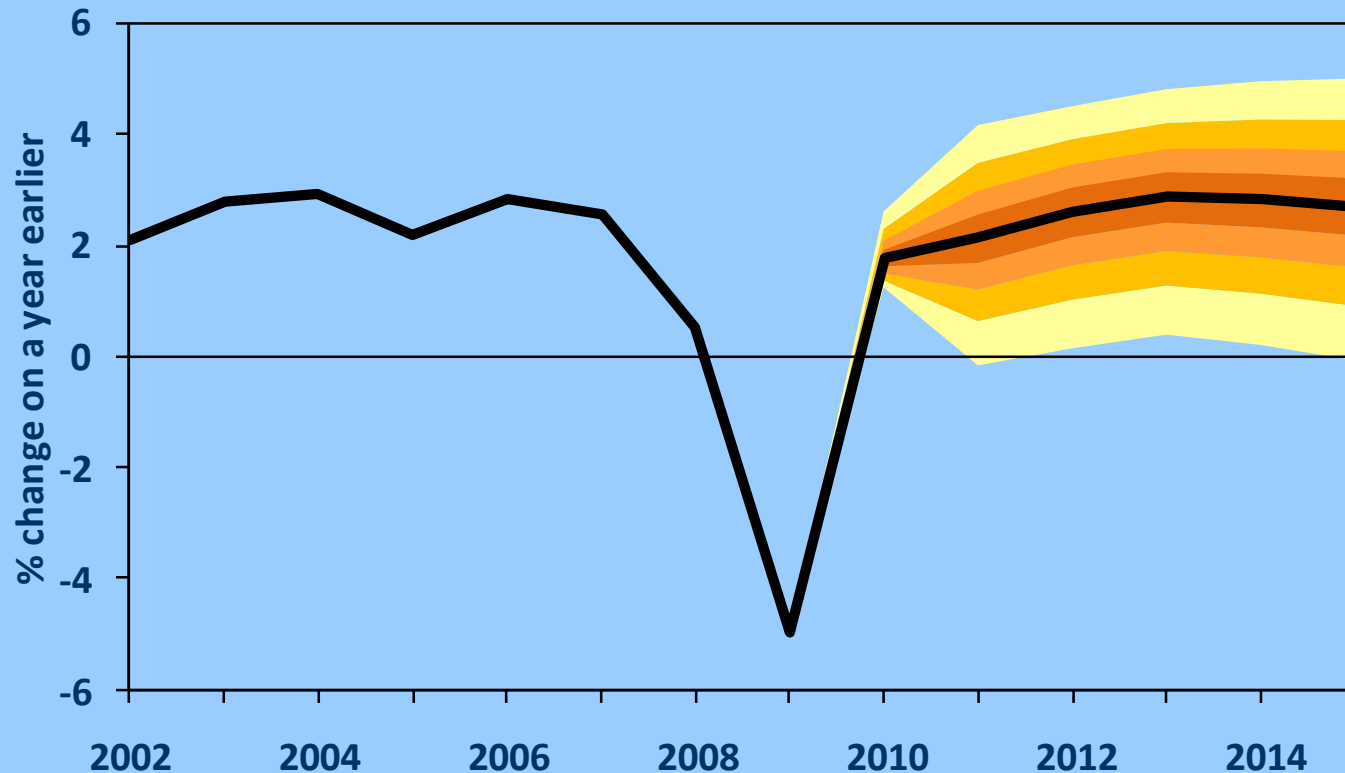
CPI inflation outturn and forecast



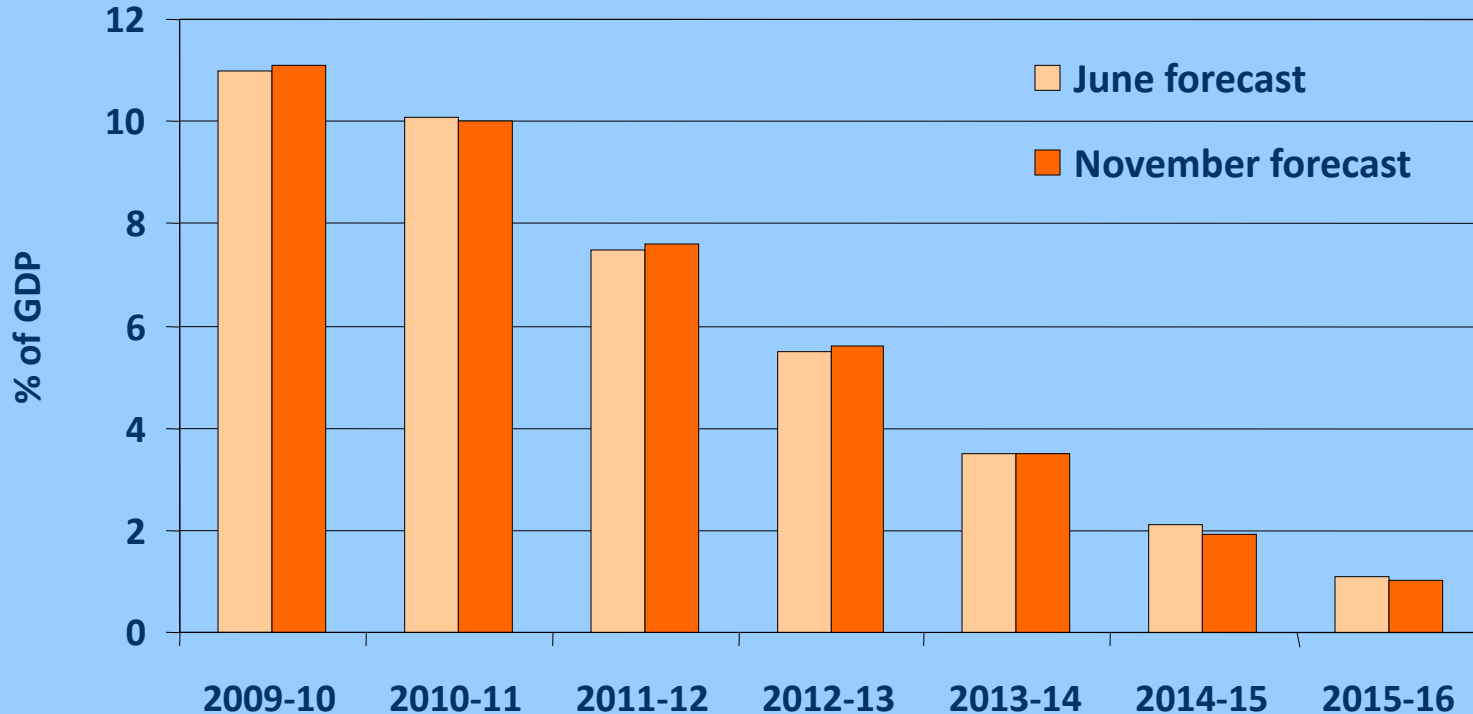
Growth in nominal GDP



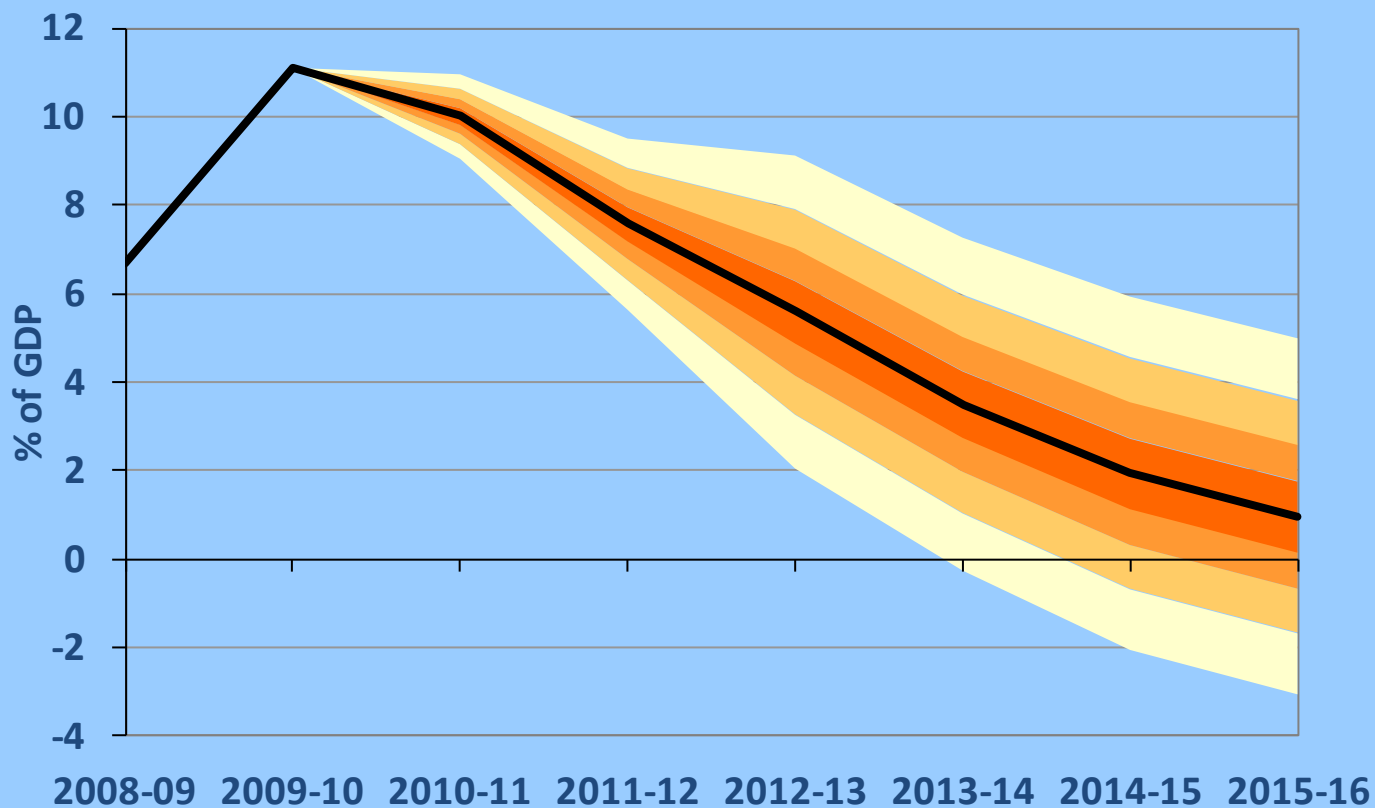
GDP growth probability distribution



Public sector net borrowing



PSNB fan chart



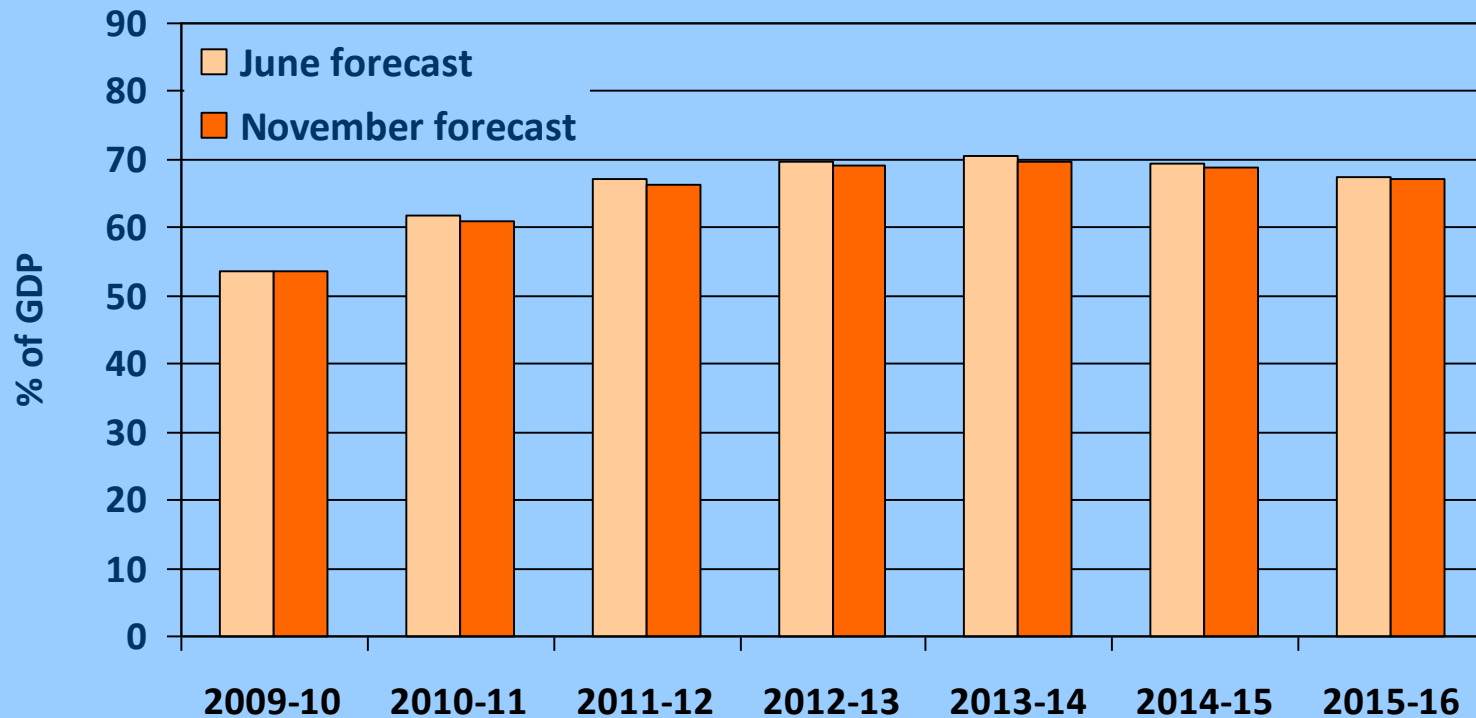
Change to revenue forecasts since June

£ billion	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Total	+2.0	+2.0	−1.6	−2.7	−2.1	−2.4
Of which:						
Value added tax	+1.5	+3.2	+3.7	+4.3	+4.9	+5.7
Corporation tax	+0.2	−1.2	−3.0	−3.8	−4.3	−5.3
Stamp duty land tax	+0.2	−0.8	−1.4	−1.9	−2.0	−2.0
<i>Memo: policy measures</i>		<i>+0.1</i>	<i>+0.2</i>	<i>+0.7</i>	<i>+0.7</i>	<i>+0.8</i>

Change to spending forecasts since June

£ billion	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Total	+1.4	+3.8	+0.3	-2.6	-4.5	-4.6
<i>Of which:</i>						
<i>Public services (DEL)</i>	-0.8	+1.6	+5.2	+9.9	+12.0	+14.7
<i>Accounting adjustments</i>	+2.0	+2.9	-1.4	-3.6	-4.1	-4.6
<i>Social security</i>	0.0	+0.3	-1.2	-4.3	-5.4	-6.3
<i>Debt interest</i>	-0.6	-2.5	-3.7	-4.3	-4.1	-3.4
<i>Public sector pensions</i>	+0.3	0.0	-0.4	-2.1	-3.0	-3.4
Memo: policy measures	0.0	+1.0	+0.1	-1.0	-0.8	+1.4

Public sector net debt



The Government's fiscal objectives

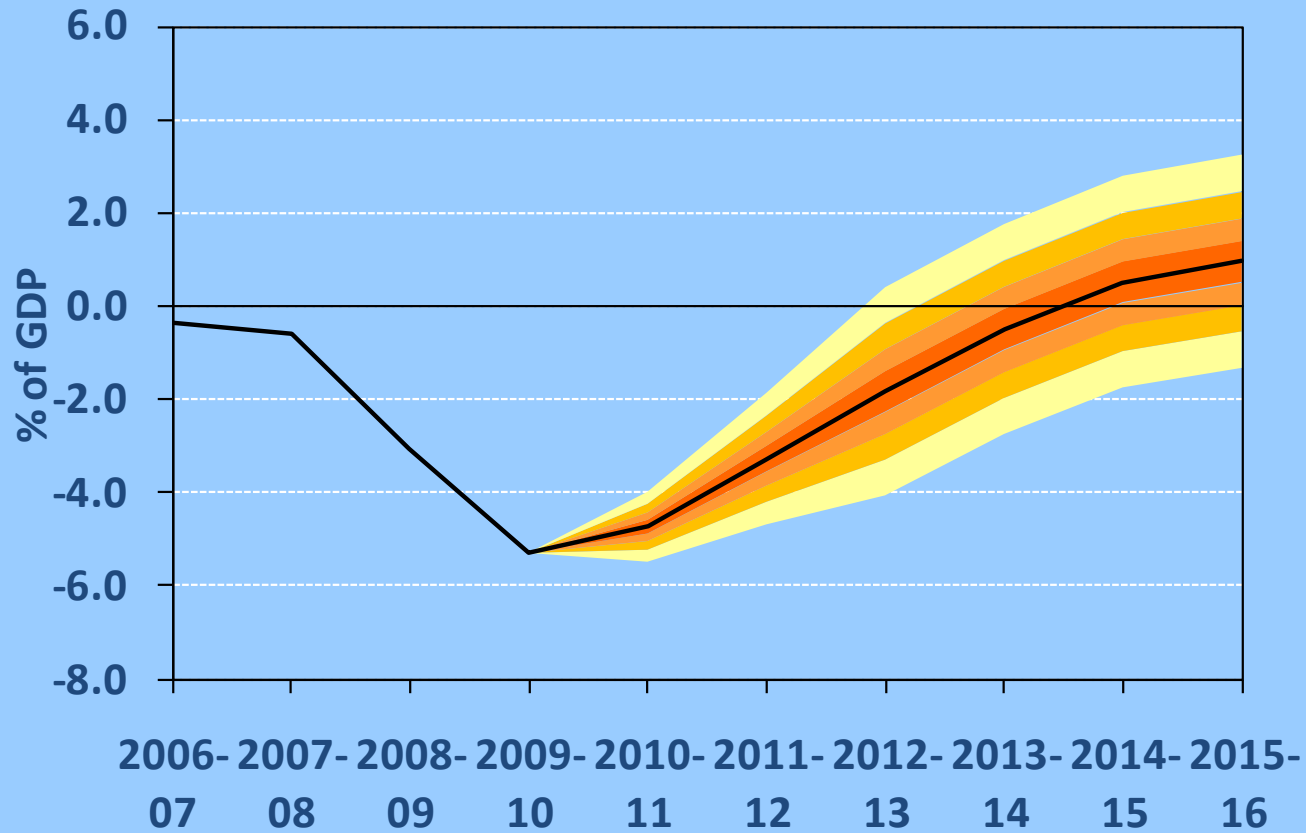
- The fiscal mandate:
 - cyclically-adjusted current budget in balance by the end of the forecasting horizon (l.e. 2015-16 for this forecast)
- Supplementary target:
 - To have public sector net debt falling in 2015–16
- OBR tasked with judging whether the Government has a better than 50% chance of achieving them

Progress against Government targets

% GDP		2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Cyclically adjusted current budget balance	November	-4.7	-3.3	-1.8	-0.5	+0.5	+0.9
	June	-4.8	-3.2	-1.9	-0.7	+0.3	+0.8
Public sector net debt	November	60.8	66.3	69.1	69.7	68.8	67.2
	June	61.9	67.2	69.8	70.3	69.4	67.4

- Both targets more likely than not to be met

Structural current budget fan chart



Structural current budget in 2015-16

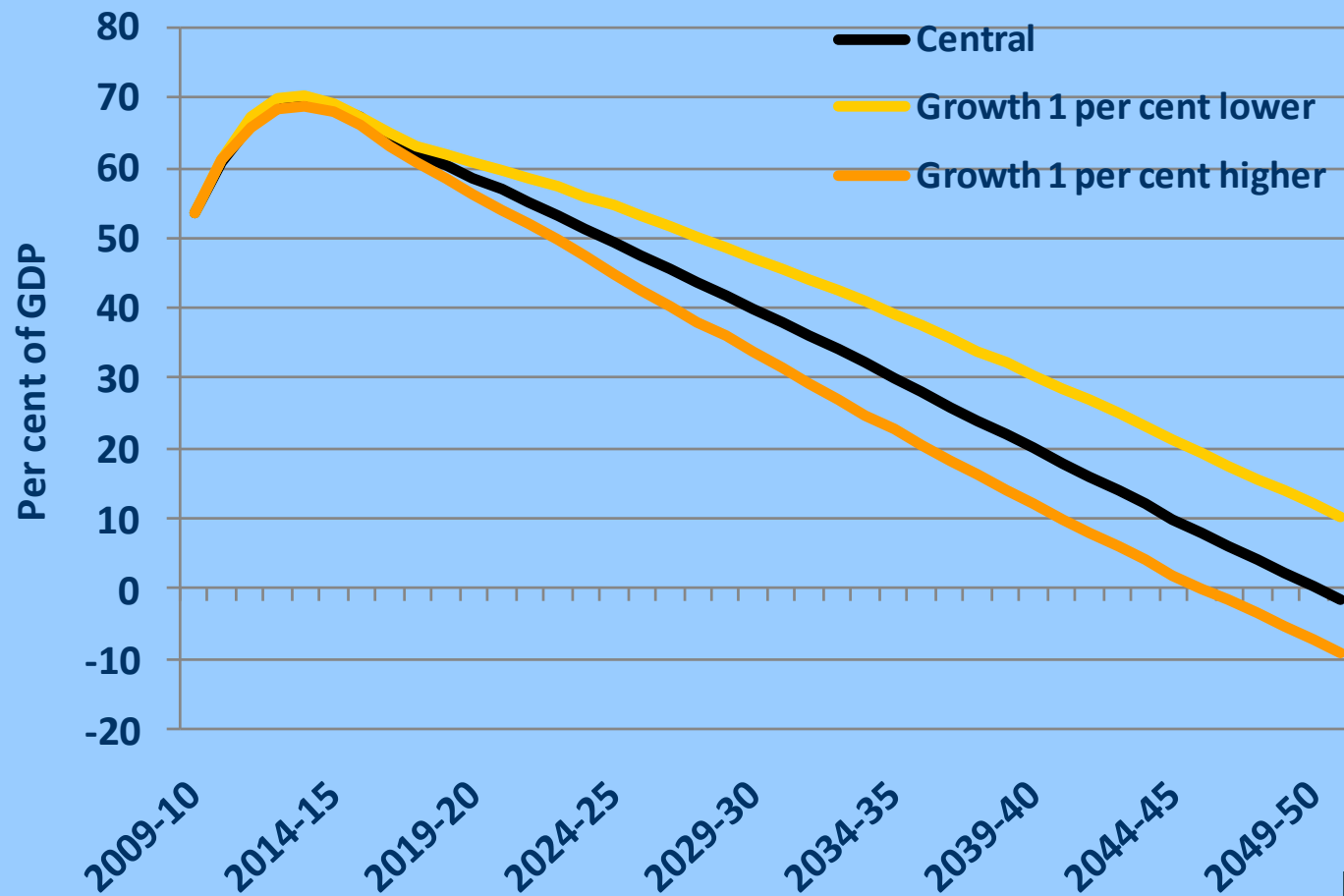
	Output Gap Closes					
Output gap in Q2 2010		2012-13	2014-15	2016-17	2018-19	2020-21
	-1.25	-0.5	-0.5	-0.5	-0.5	-0.5
	-2.25	0.2	0.2	0.2	0.2	0.2
	-3.25	0.9	0.9	0.9	0.9	0.9
	-4.25	1.7	1.7	1.7	1.7	1.6
	-5.25	2.4	2.4	2.4	2.4	2.4

Per cent of GDP	r-50	r	r+50	r+100	r+150
Cyclically-adjusted current budget balance in 2015-16	1.1	0.9	0.8	0.6	0.5

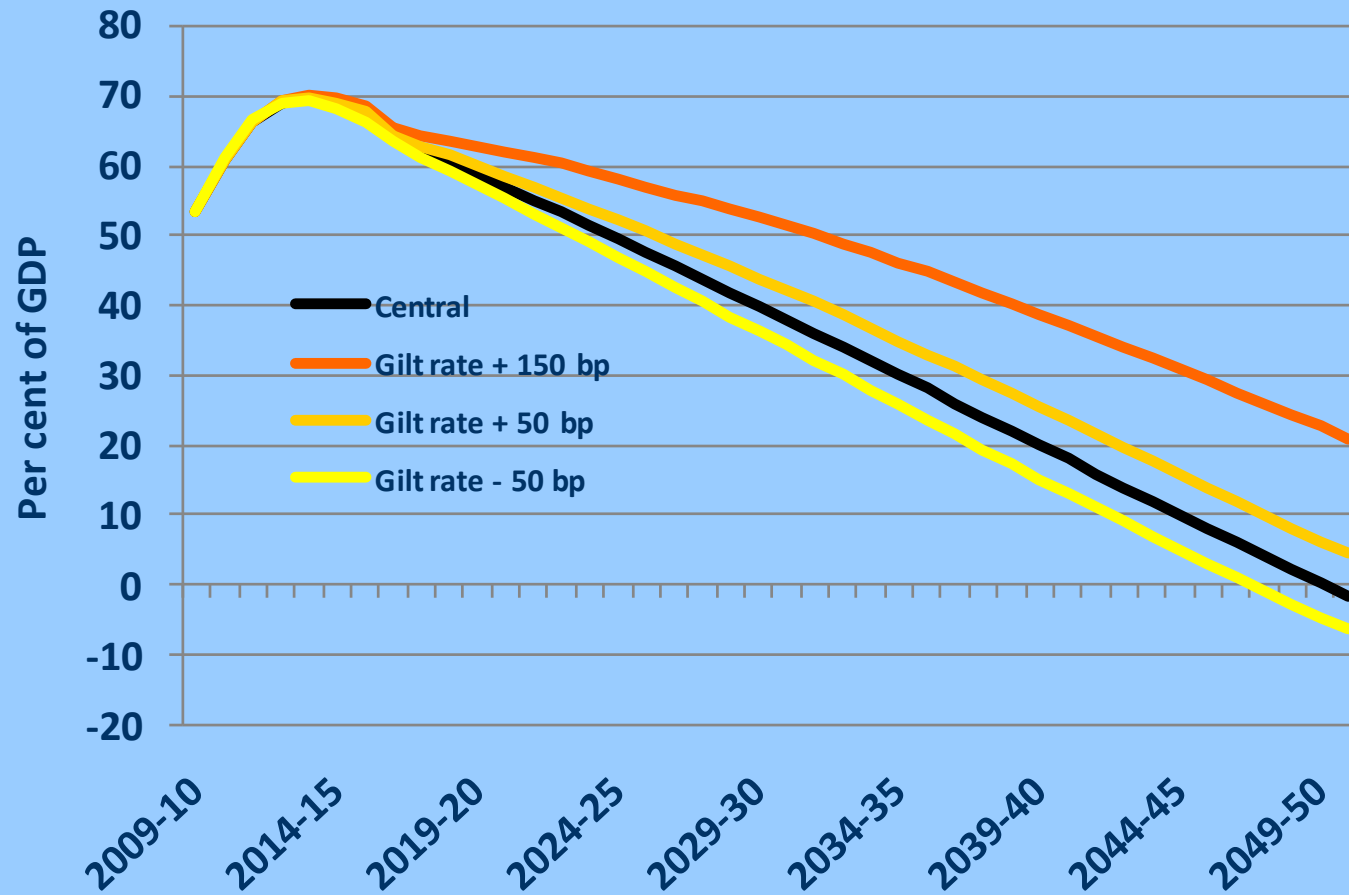
Scenario analysis

- Delayed rebalancing
 - Same GDP growth rates, but more consumption and less contribution from net trade
 - Chances of meeting mandate improve as consumption 'revenue rich', but this effect would reverse
- Persistent weak demand
 - Growth lower than in central forecast, pulling down potential
 - Chances of meeting mandate reduced, as loss of potential increases structural component of deficit

Public sector net debt



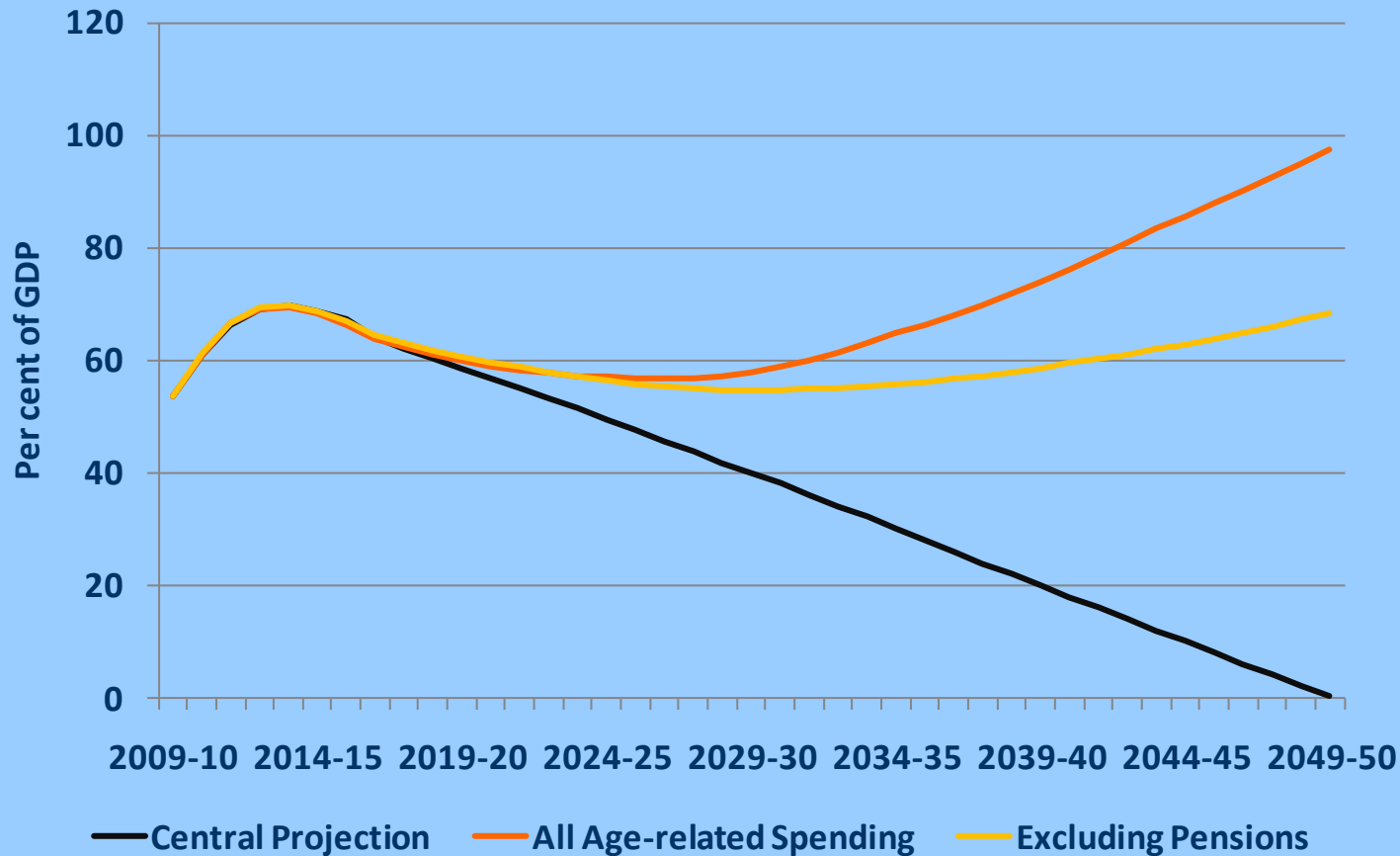
Public sector net debt



Age-related spending

Per cent of GDP	2009-10	2019-20	2029-30	2039-40	2049-50
Health	8.0	8.5	9.4	10.2	10.6
Long-term care	1.2	1.4	1.7	2.0	2.2
Education	6.0	5.9	5.9	5.8	5.7
Pensions	5.5	5.3	6.1	6.8	6.8
Public service pensions	1.8	1.9	2.0	1.9	1.8
Total	22.5	23.1	25.1	26.6	27.1

Public sector net debt



Conclusion

- Our central forecast suggests that the Government's planned fiscal consolidation more likely than not to be consistent with meeting medium-term fiscal targets and sustaining (relatively weak) economic recovery
- But considerable uncertainty around central forecast, as around all economic and fiscal forecasts