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Responsibility

Economic and fiscal outlook

November 2011

Robert Chote
Chairman

Coverage and process

- Five year forecasts for the economy and public finances, plus assessment of progress against targets
- Independent Budget Responsibility Committee responsible for assumptions, judgements and conclusions
- No political or official pressure to change them
- BRC helped by OBR staff and drawing upon expertise in many Whitehall departments and other bodies

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Overview

- Growth in 2011 weaker than expected thanks to inflation squeeze
- GDP to grow by 0.9% in 2011 and 0.7% in 2012
- Medium term growth prospects also weaker
- Economy expected to be 3½% smaller by 2016 than thought in March
- Weaker growth means more borrowing – and structural not cyclical
- Without additional action, fiscal targets likely to be missed
- Government announces extra spending cuts in 2015-16 and 2016-17
- Targets back on course to be hit, but with smaller margin than March

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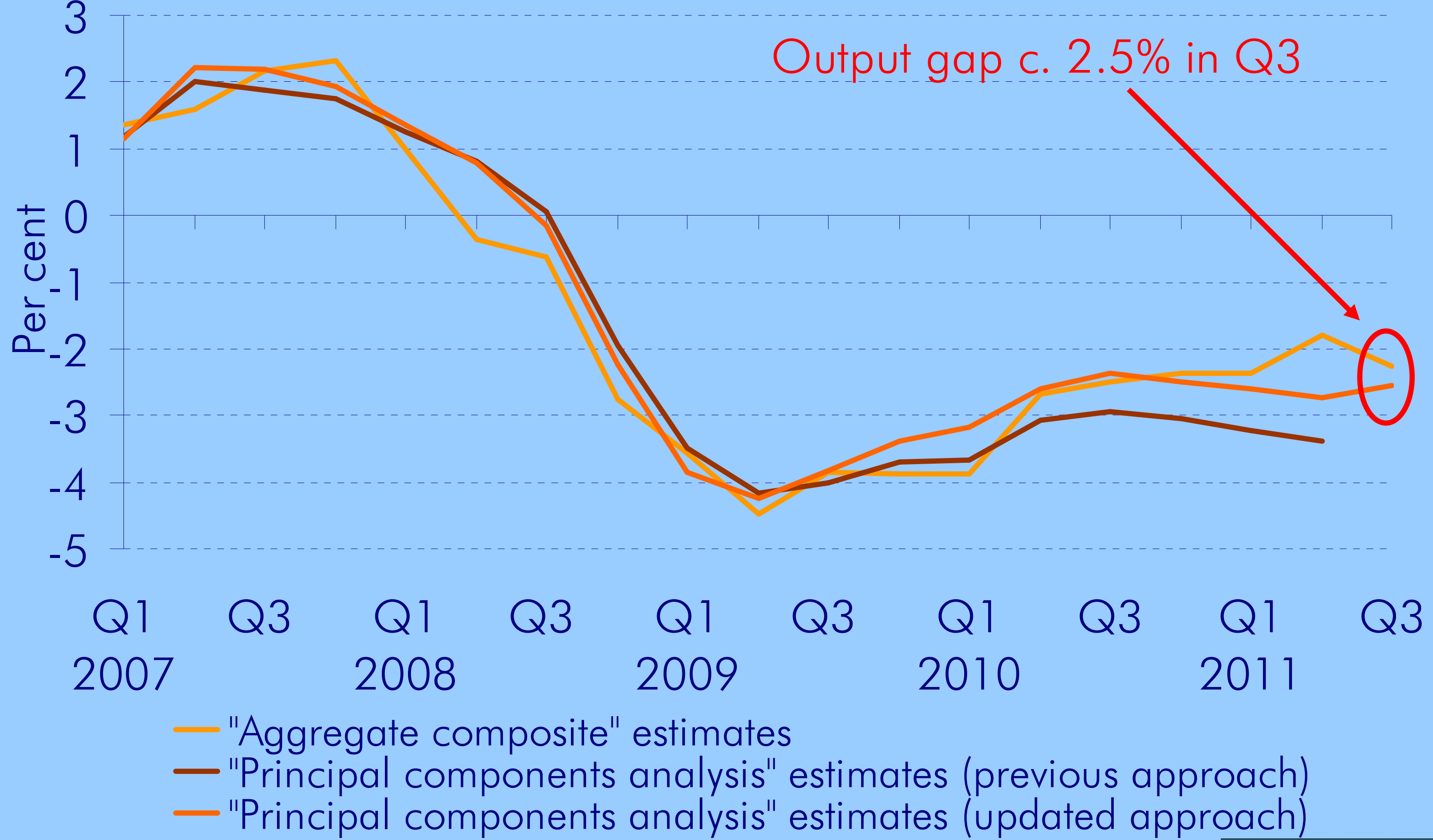
How much spare capacity?



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Weak growth in potential output

- Output gap smaller in Q3 than at end-2010 and than expected in March
- Would have been much wider if potential output had been growing as strongly as we assumed at Budget time
- Productive potential appears to have grown 1% a year since recession
- Weak productivity growth rather than higher structural unemployment

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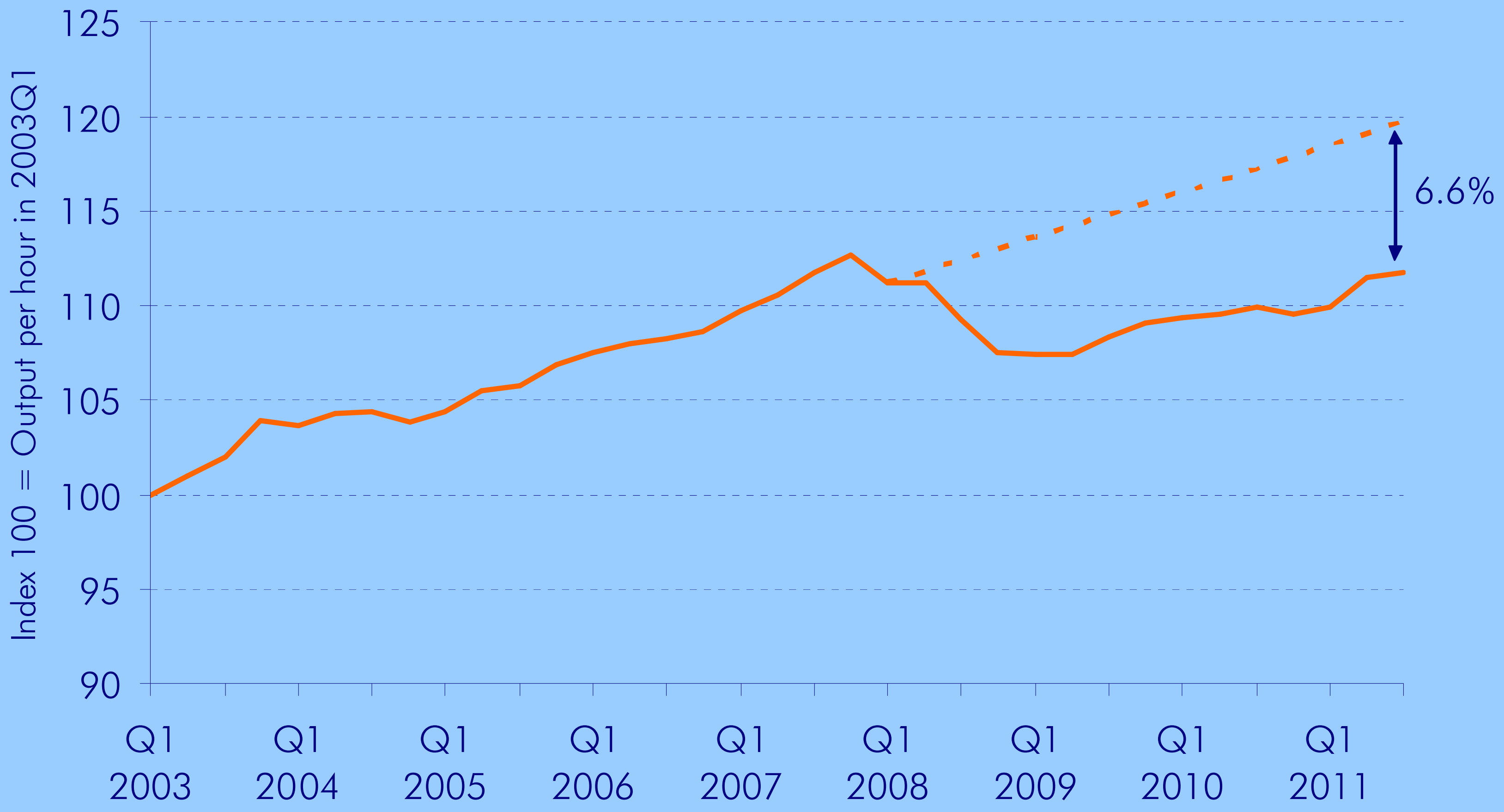
Output per hour stays below pre-crisis trend



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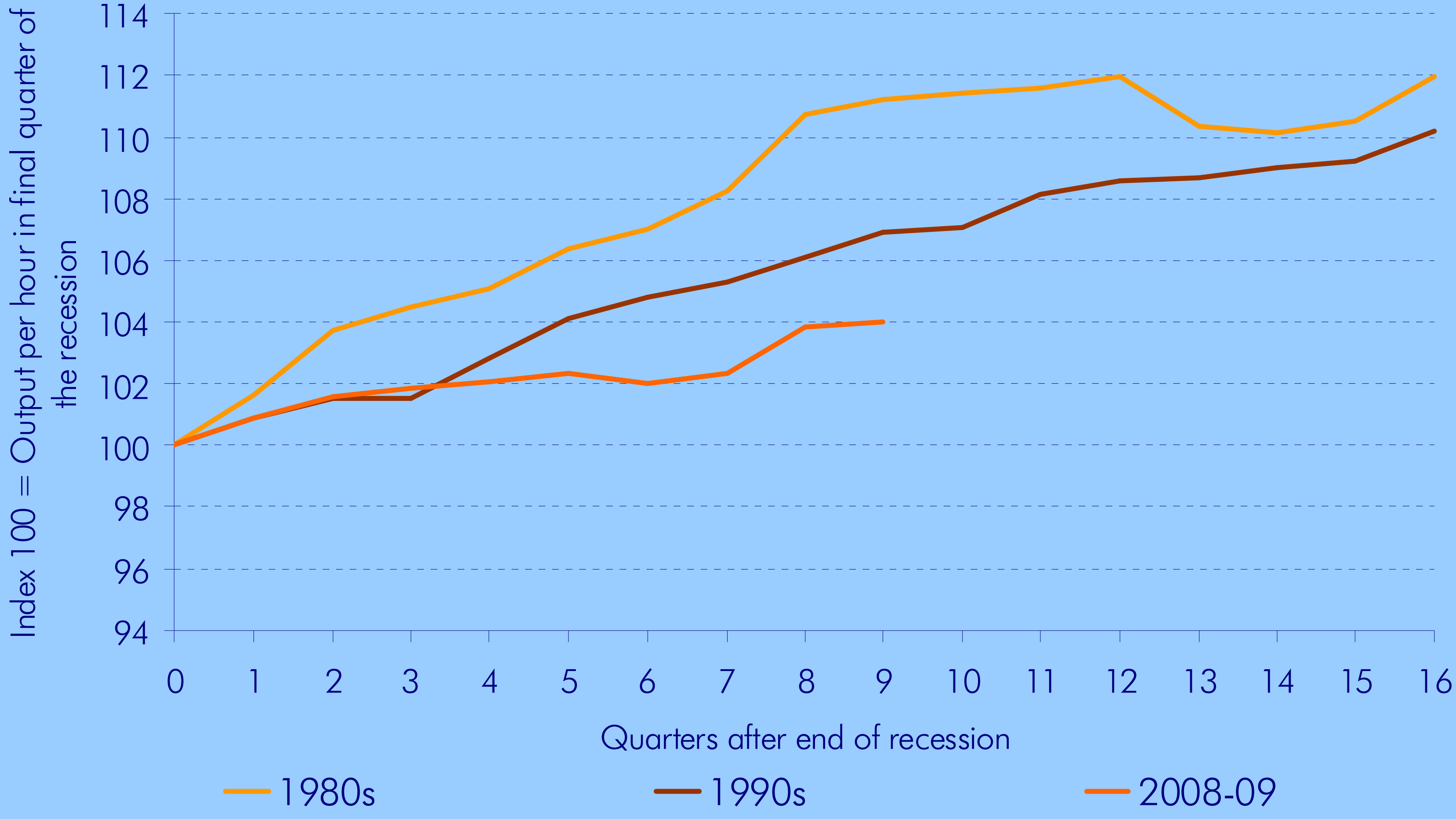
Productivity grows less than in past recoveries



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Potential output revised down

- Hard to fully explain weak productivity growth
- May be that financial sector problems are preventing firms from reallocating capital to more productive activities
- Now seems sensible to assume gradual rise in potential output growth rather than ‘snap back’ to long run average
- Potential output now expected to be 3½% lower in 2016 than expected in March

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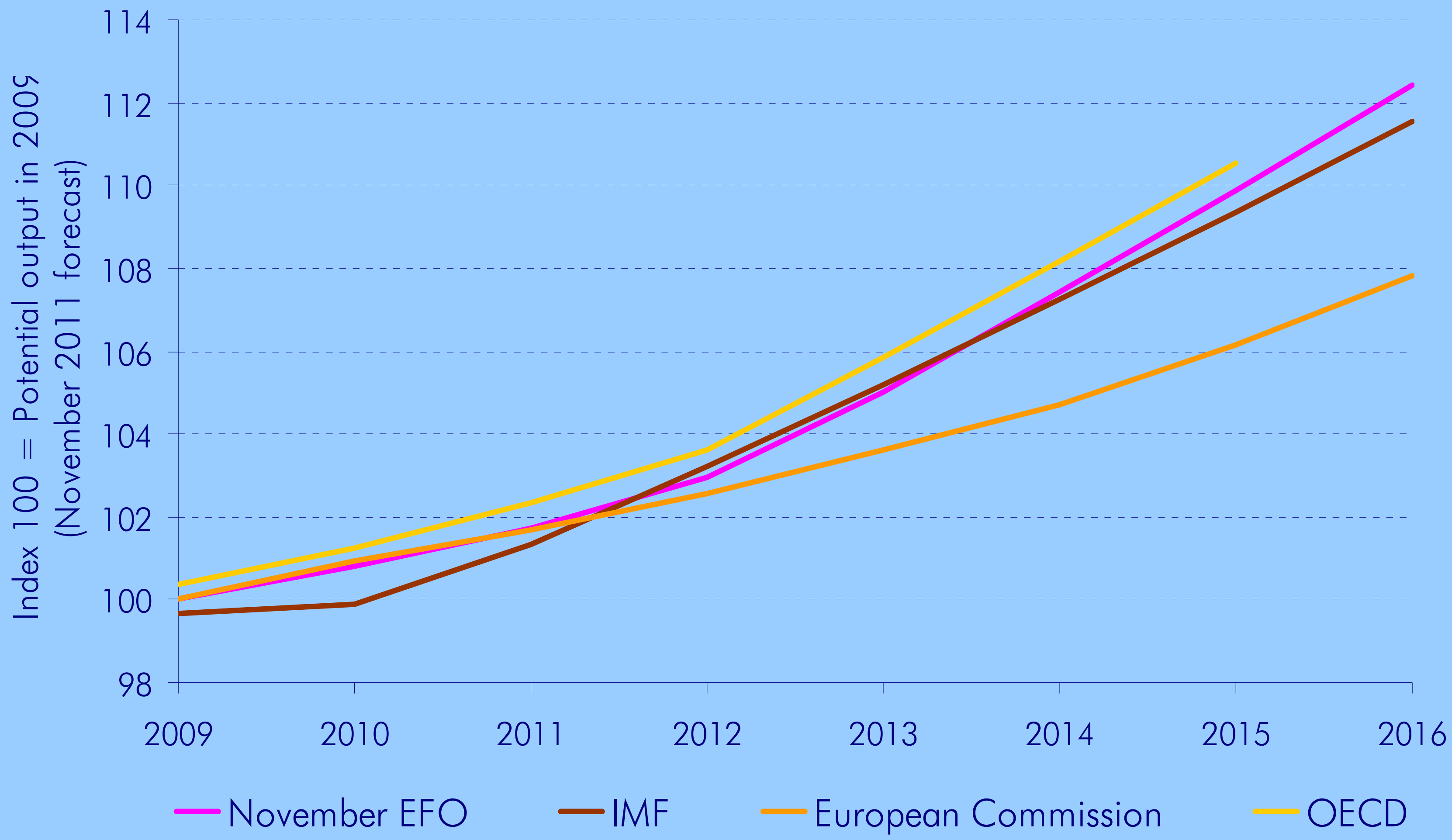
Potential output: comparing forecasts



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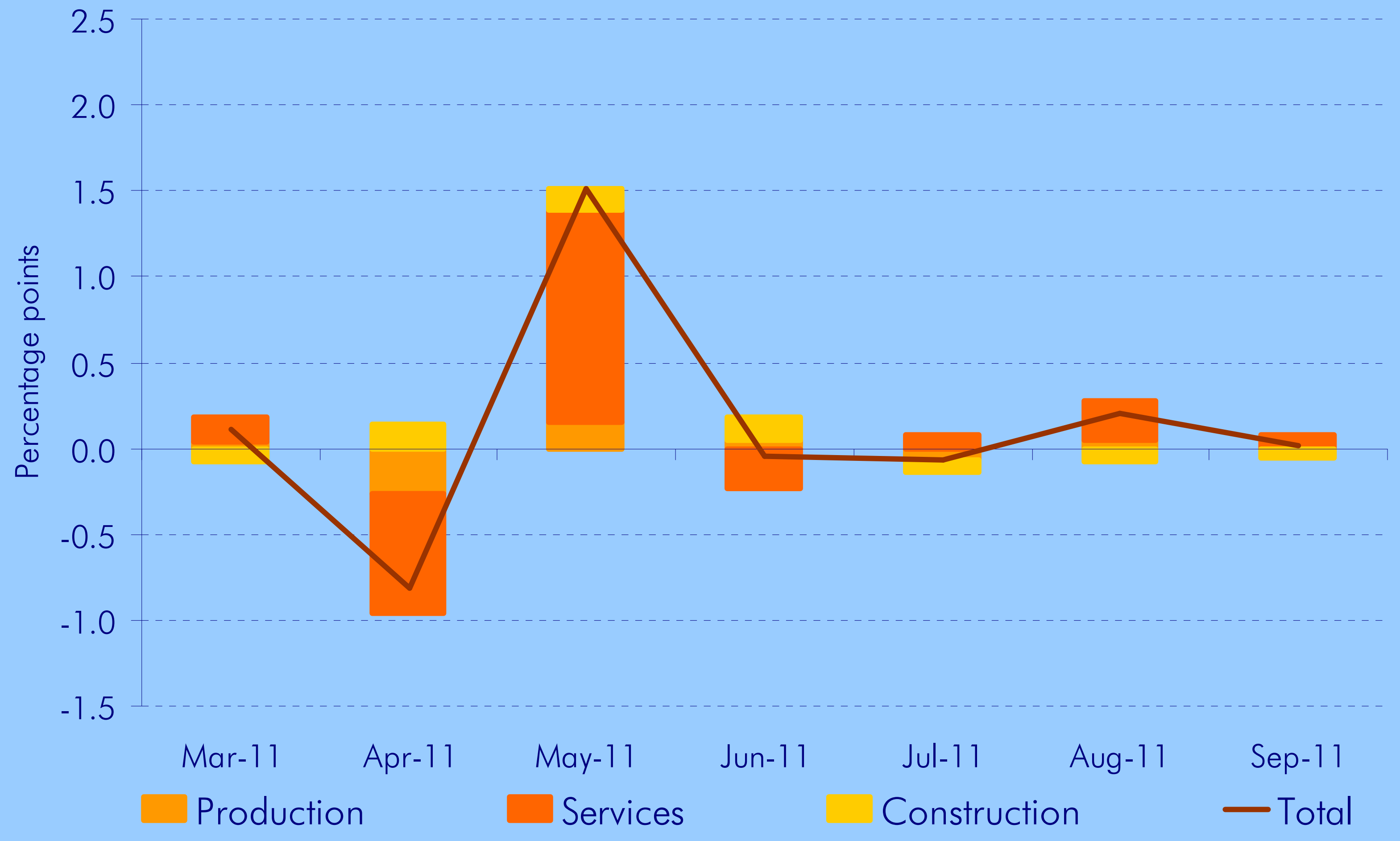
Monthly GDP growth since the Budget



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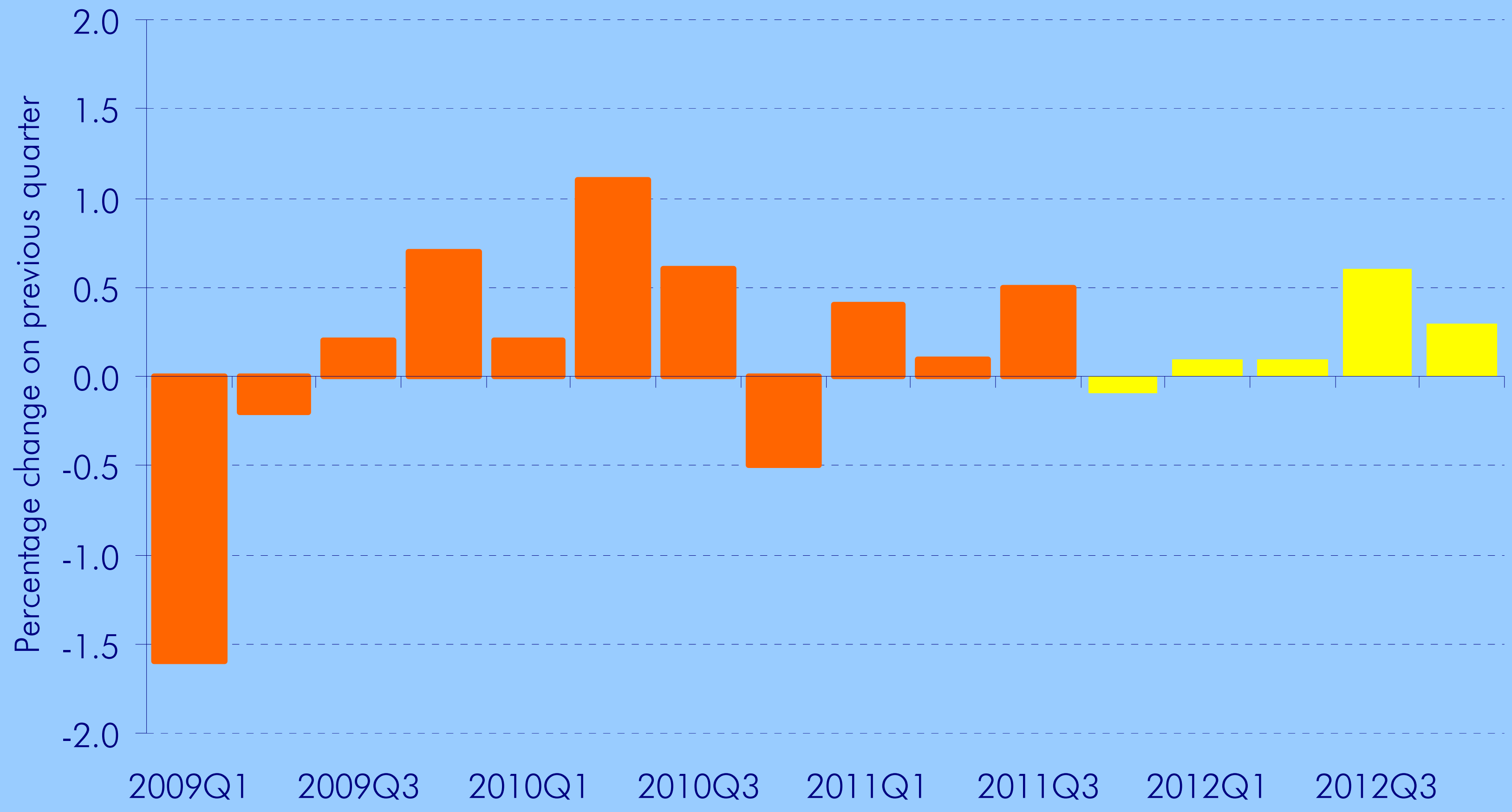
Quarterly GDP growth in the short term



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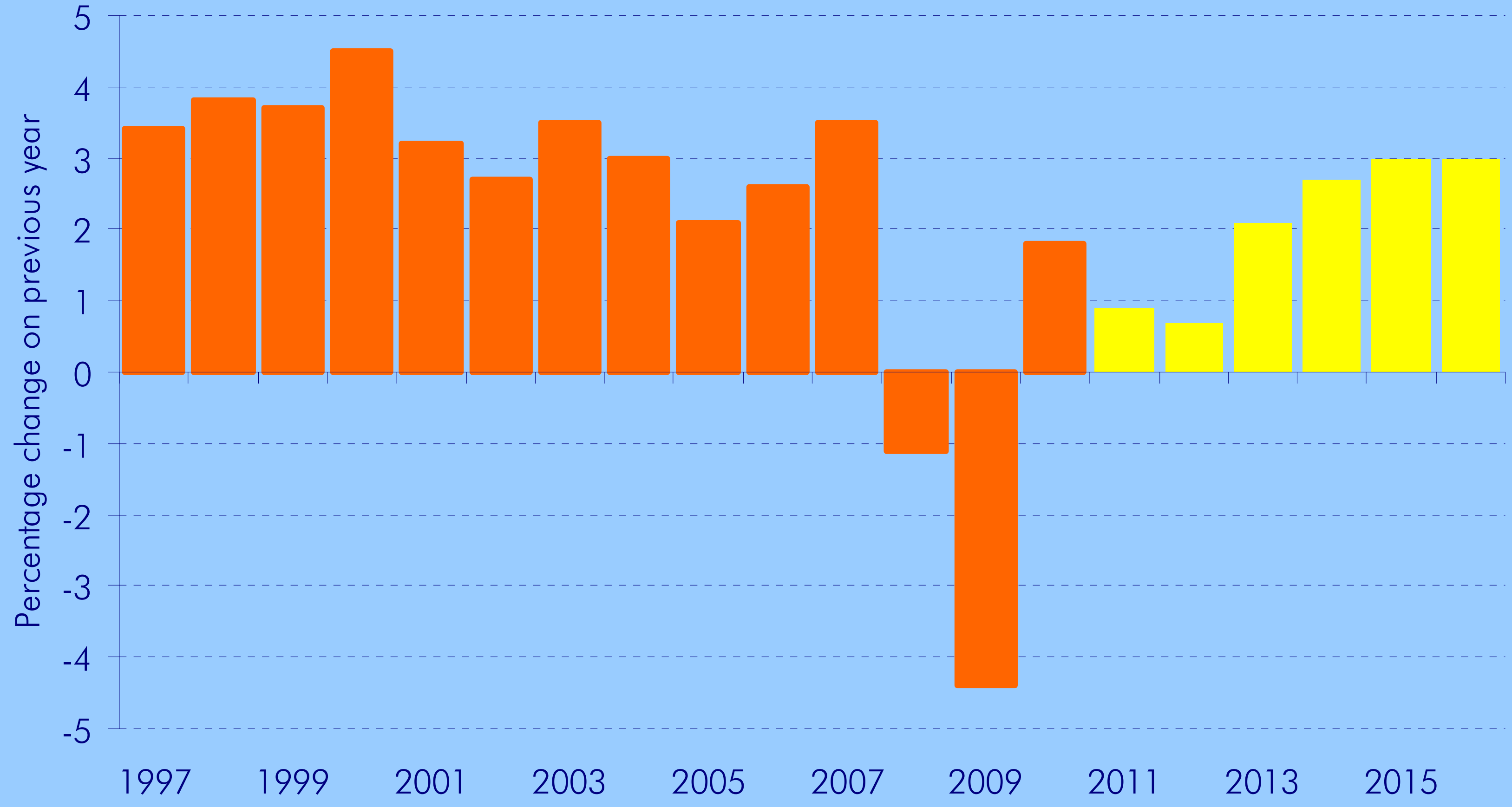
Annual GDP growth in the medium term



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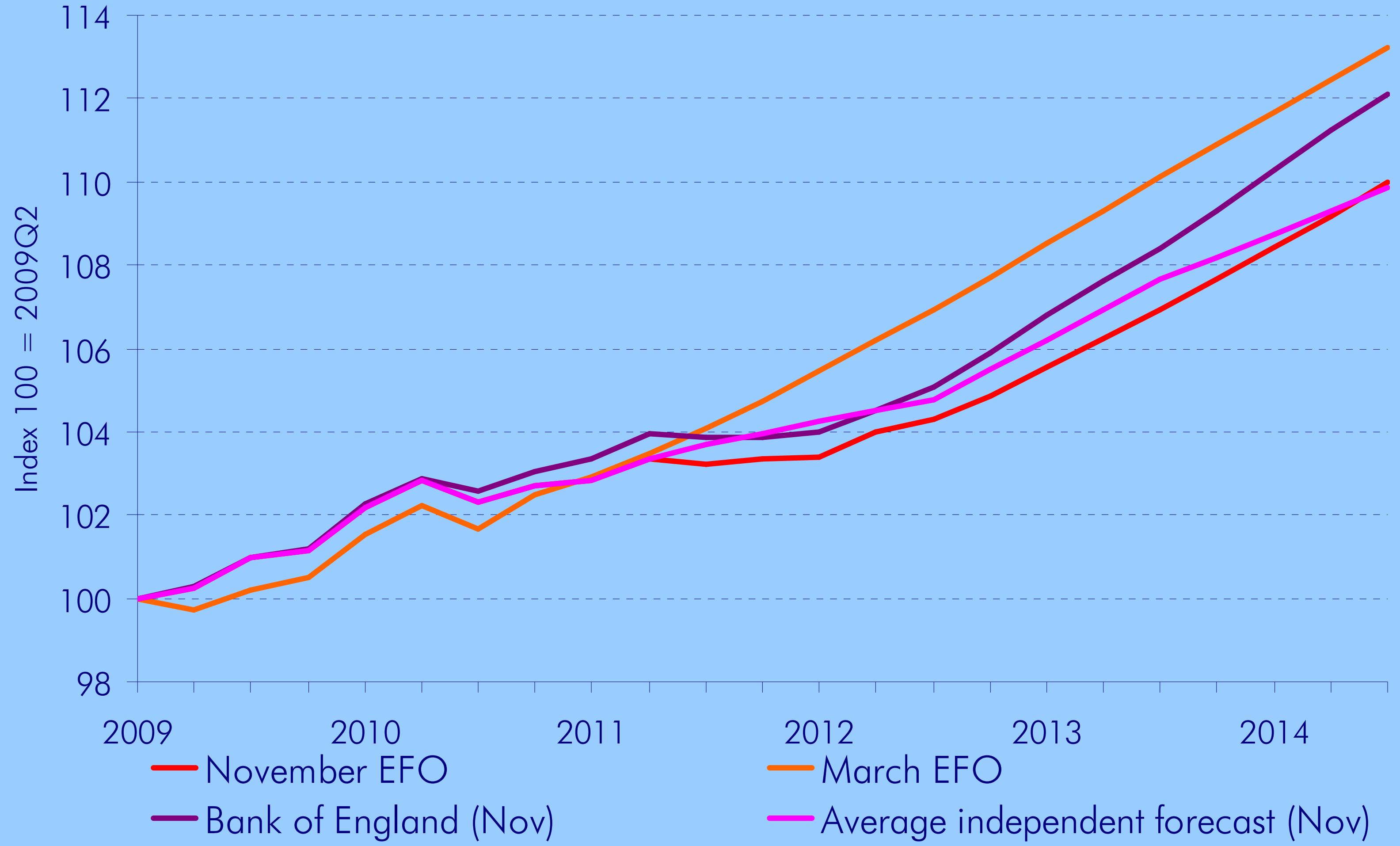
Level of GDP: forecast comparison



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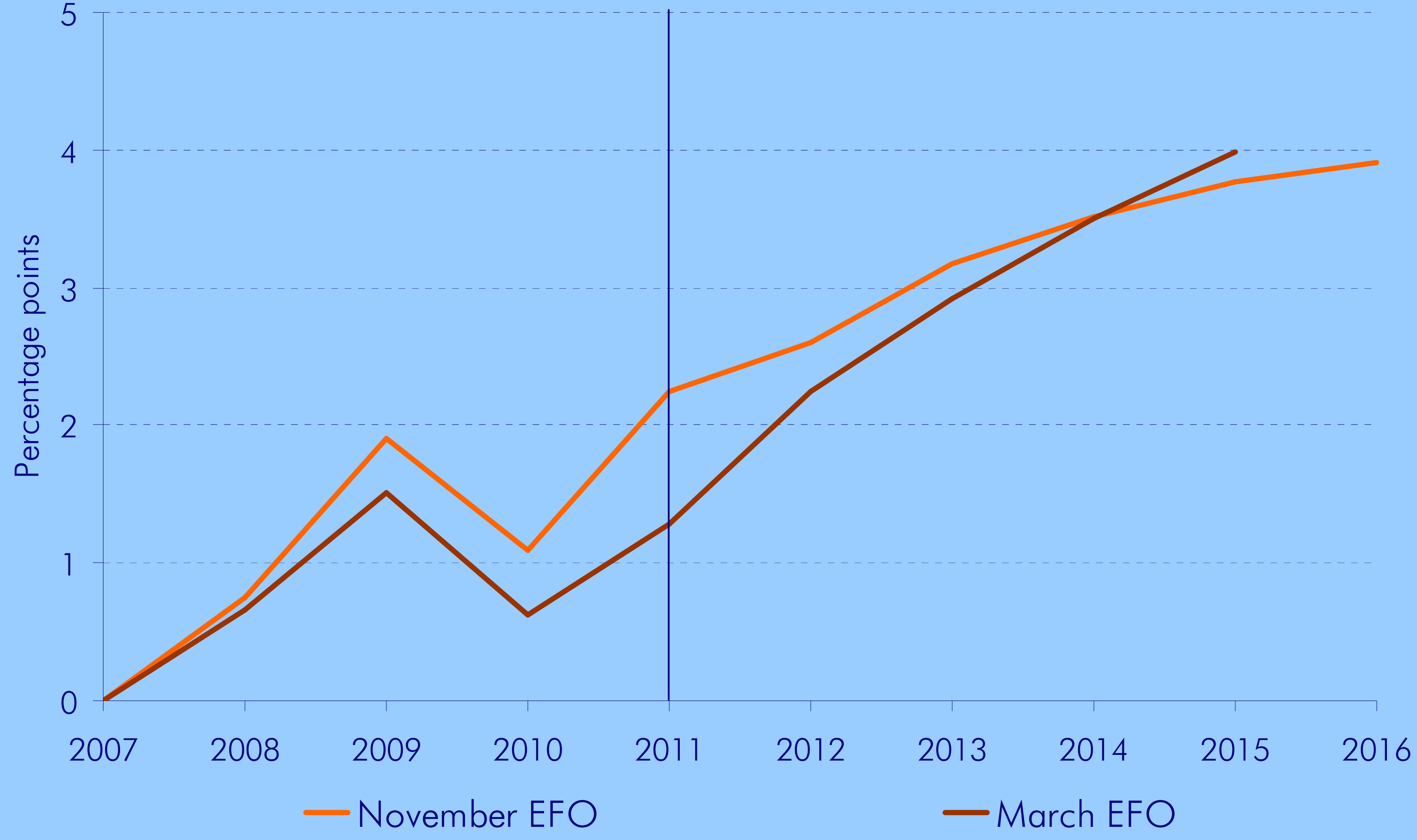
Net trade contribution to GDP growth



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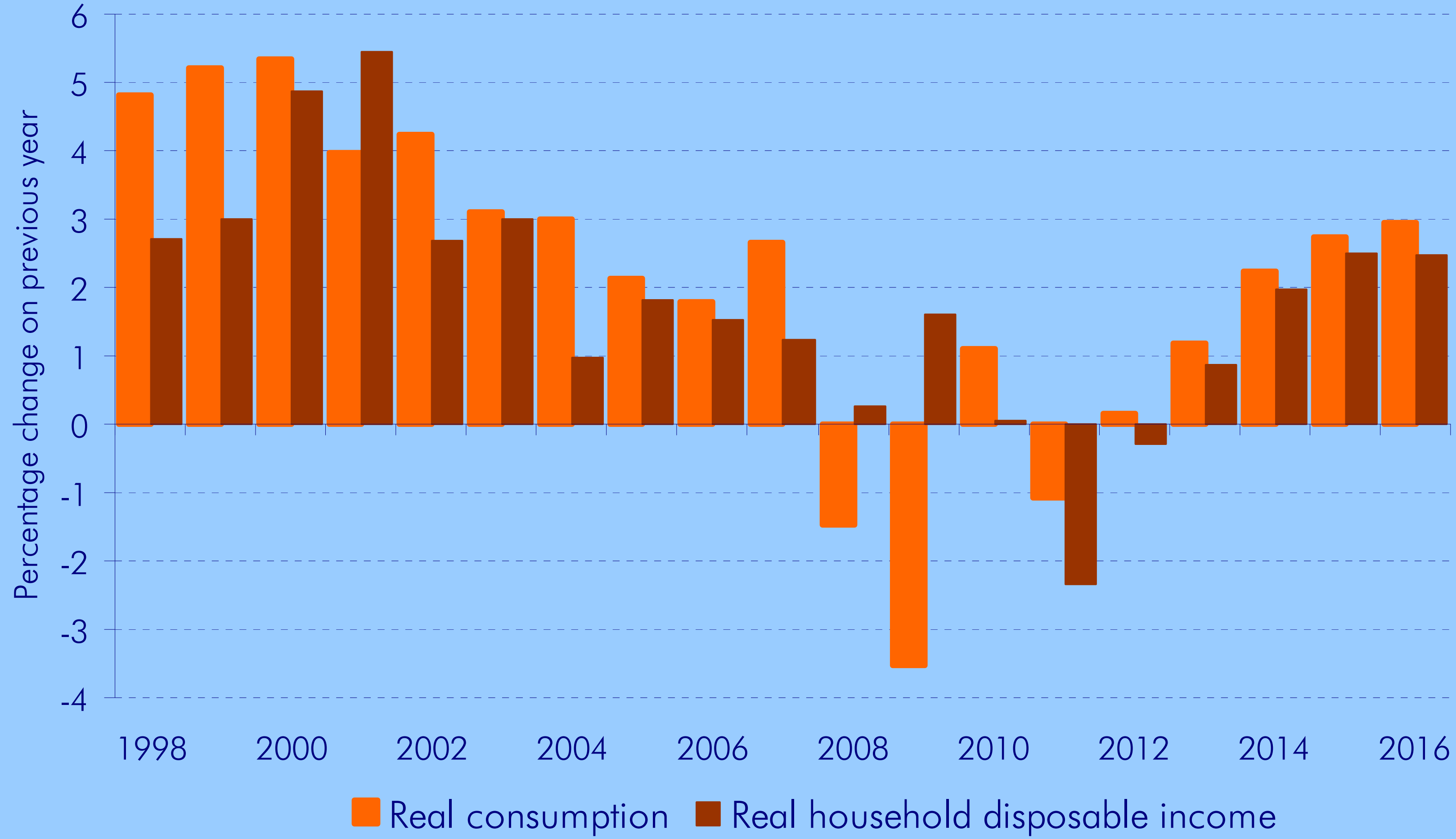
Household incomes and consumption



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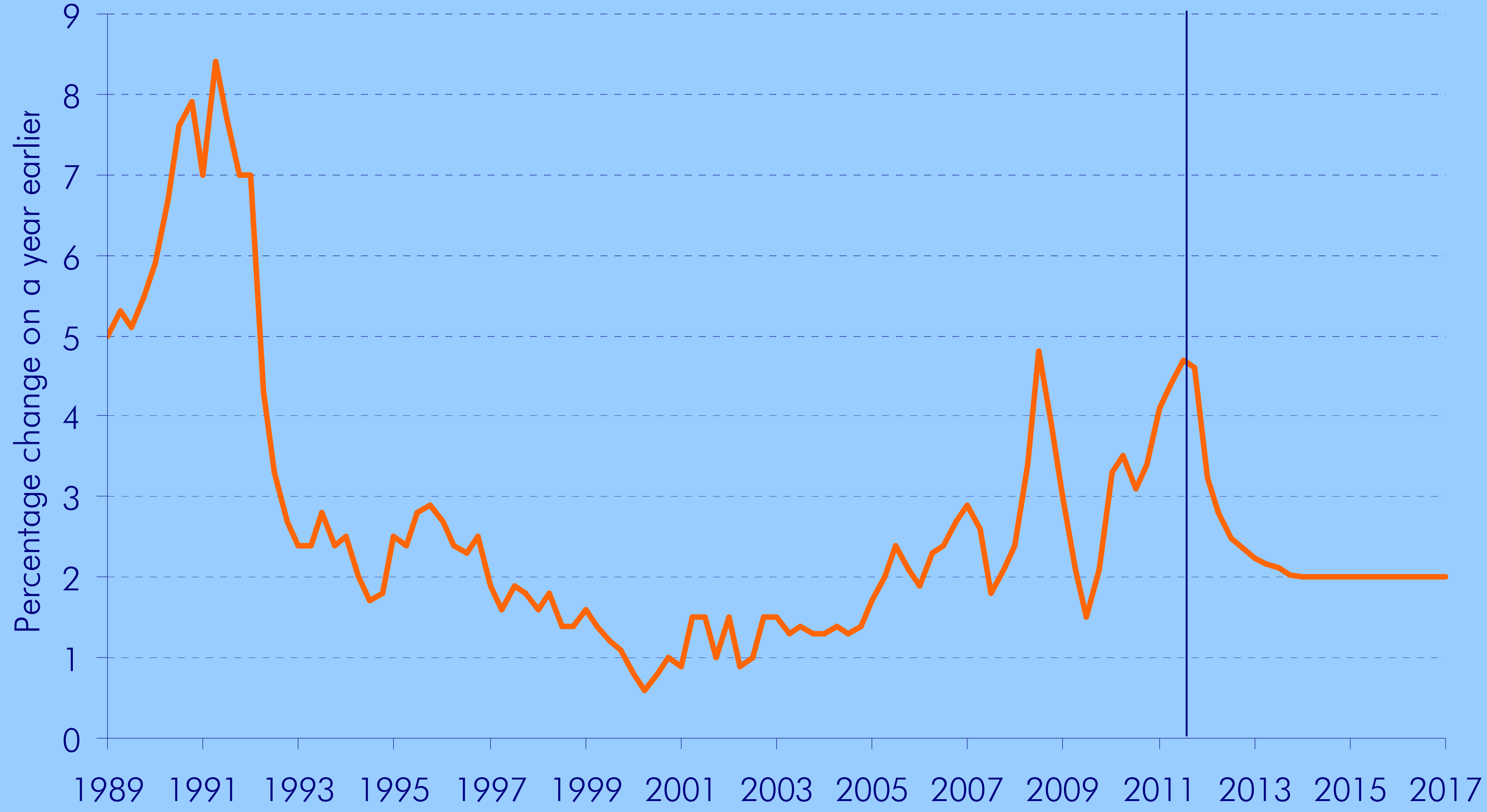
CPI inflation to fall next year



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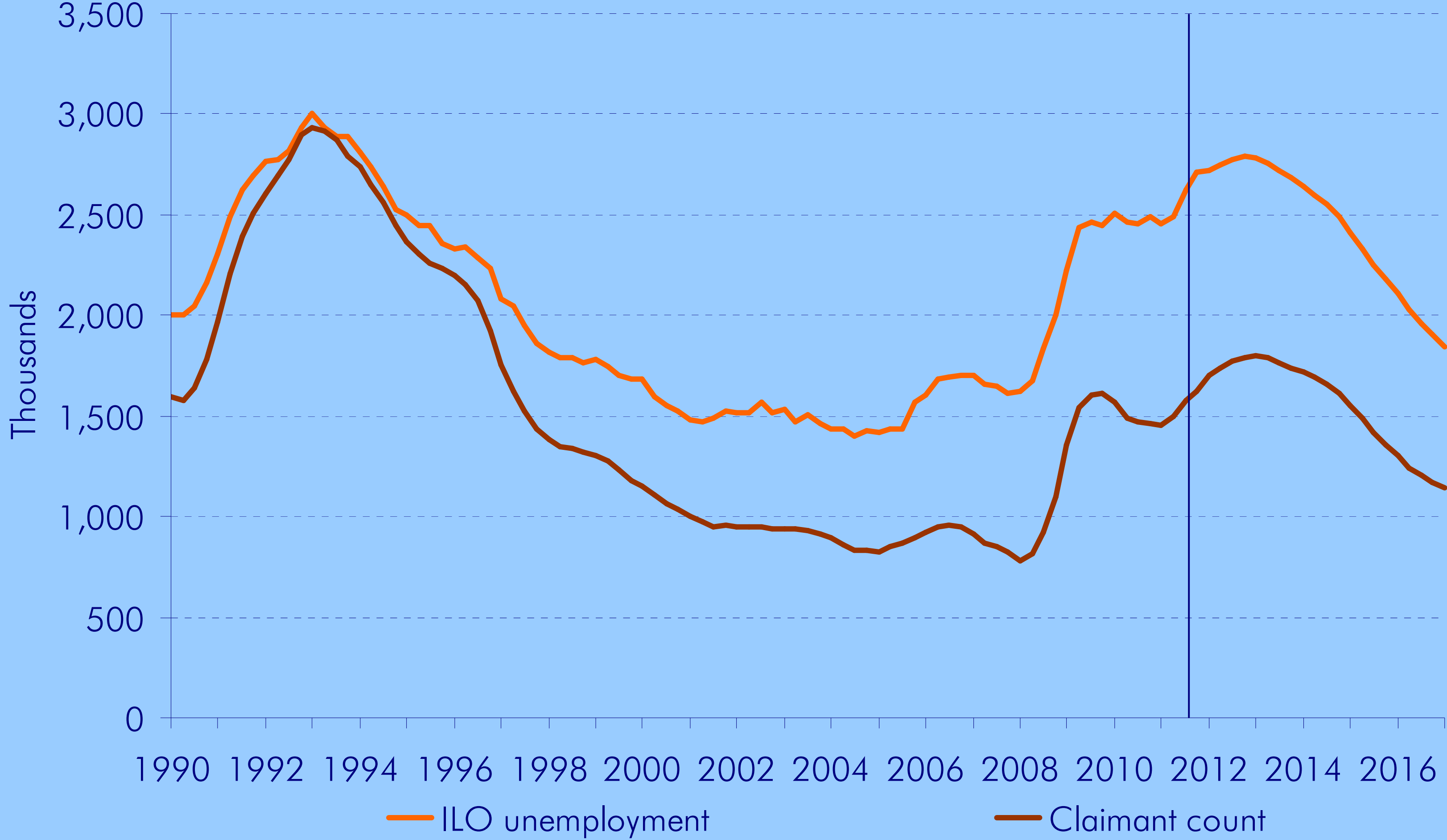
Unemployment to rise into next year



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Effects of Autumn Statement measures

- Spending cuts in 2015-16 and 2016-17
  - Cut direct contribution to GDP growth from government consumption
  - Assumed offset by looser monetary policy at that horizon

- Credit easing
  - No effect assumed in this forecast
  - Potential to boost investment and growth, but hard to judge effectiveness until we have more details eg of contracts requiring pass-through

- Delayed fuel duty increases
  - Inflation forecast revised down modestly

- New build indemnity scheme
  - Modest increase in forecast for housing transactions

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Potential risks from the euro area

- Central forecast assumes that euro area 'struggles through'
- More disorderly outcome a significant downside risk
- Could affect UK through a number of channels
  - Weaker trade
  - Tighter credit
  - Government borrowing costs
  - Financial system impairment
- Cannot quantify downside risk in a meaningful way, given the range of potential outcomes

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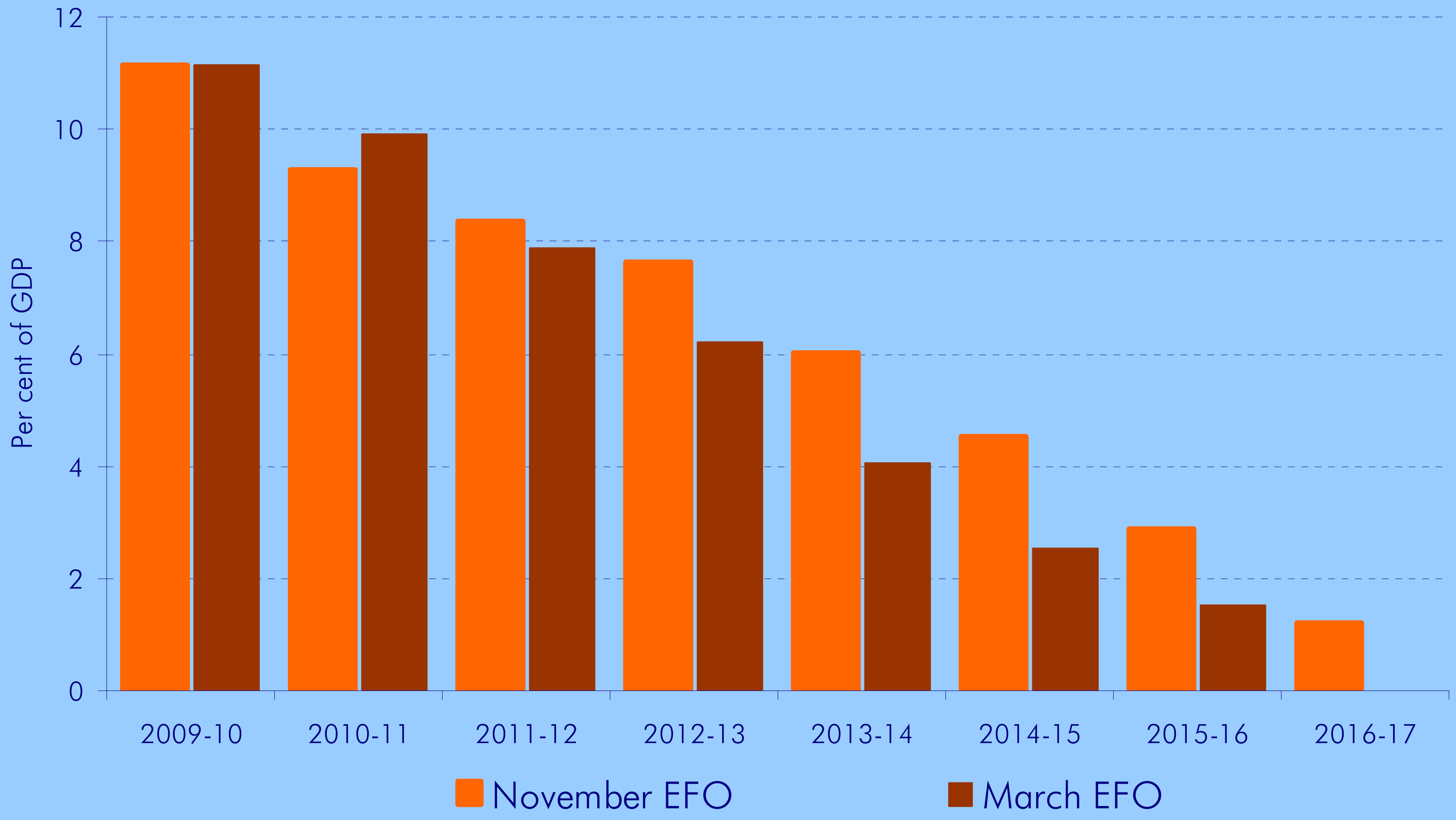
Headline deficit to shrink, but more slowly



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Revenues lower and spending higher

- Revenue and spending impact roughly equal in 2015-16

- On the revenue side:
  - Lower wages and salaries, consumer spending and profits
  - Lower oil prices, share prices and interest rates
  - Sharp fall in financial sector corporation tax payments

- On the spending side
  - Departmental spending is mostly fixed in cash terms
  - Higher CPI inflation and claimant count unemployment
  - Offset by lower debt interest costs and spending cuts

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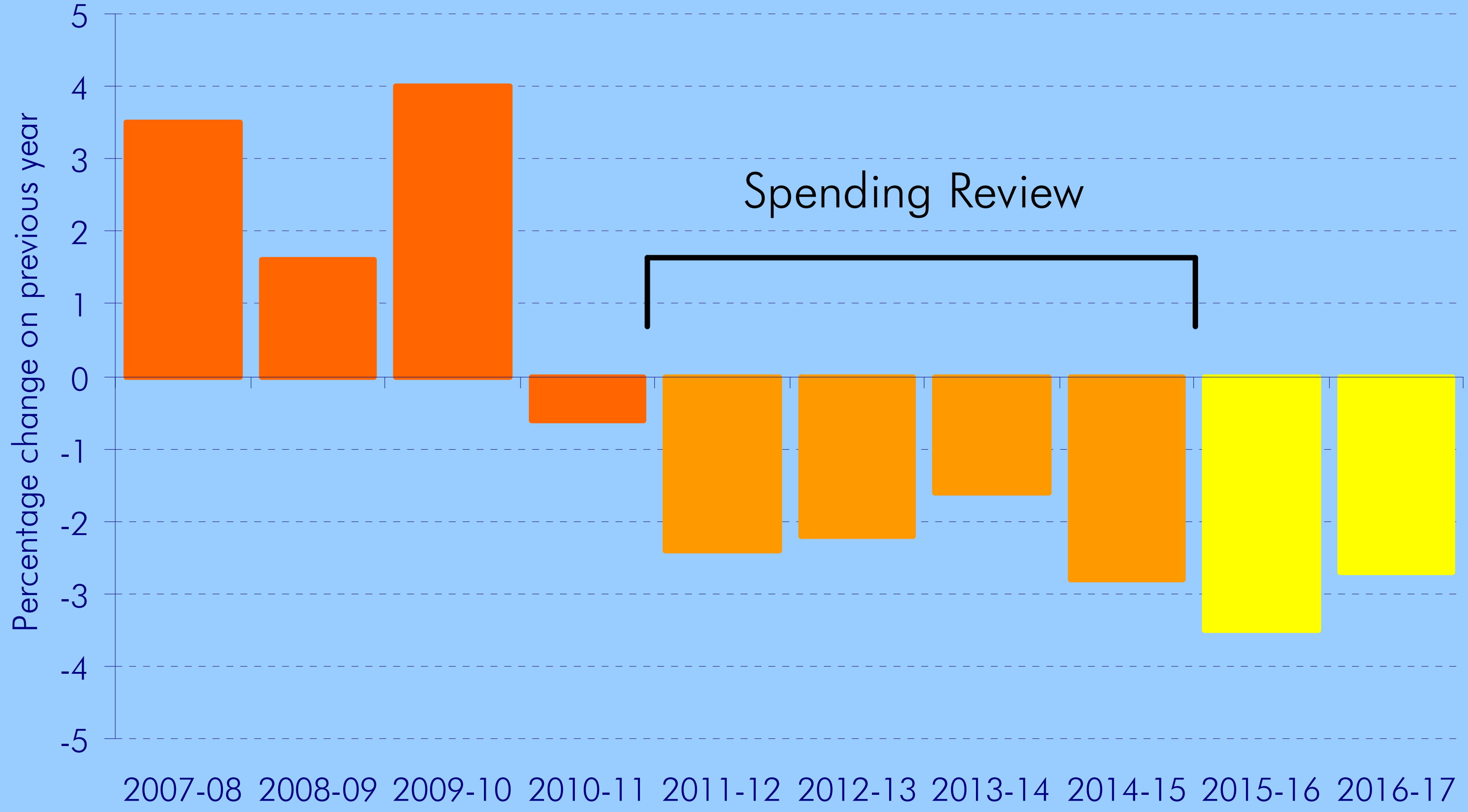
Bigger squeeze on public services spending



Annual real change in implied PSCE in RDEL
(non-investment spending on public services and admin)

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Student loans put upward pressure on debt

- Average loan per student now estimated at £7,000, up from £6,800 in March
- Lower earnings forecast reduces expected repayments
- Government pays out more and gets less back during the forecast period, putting modest upward pressure on debt

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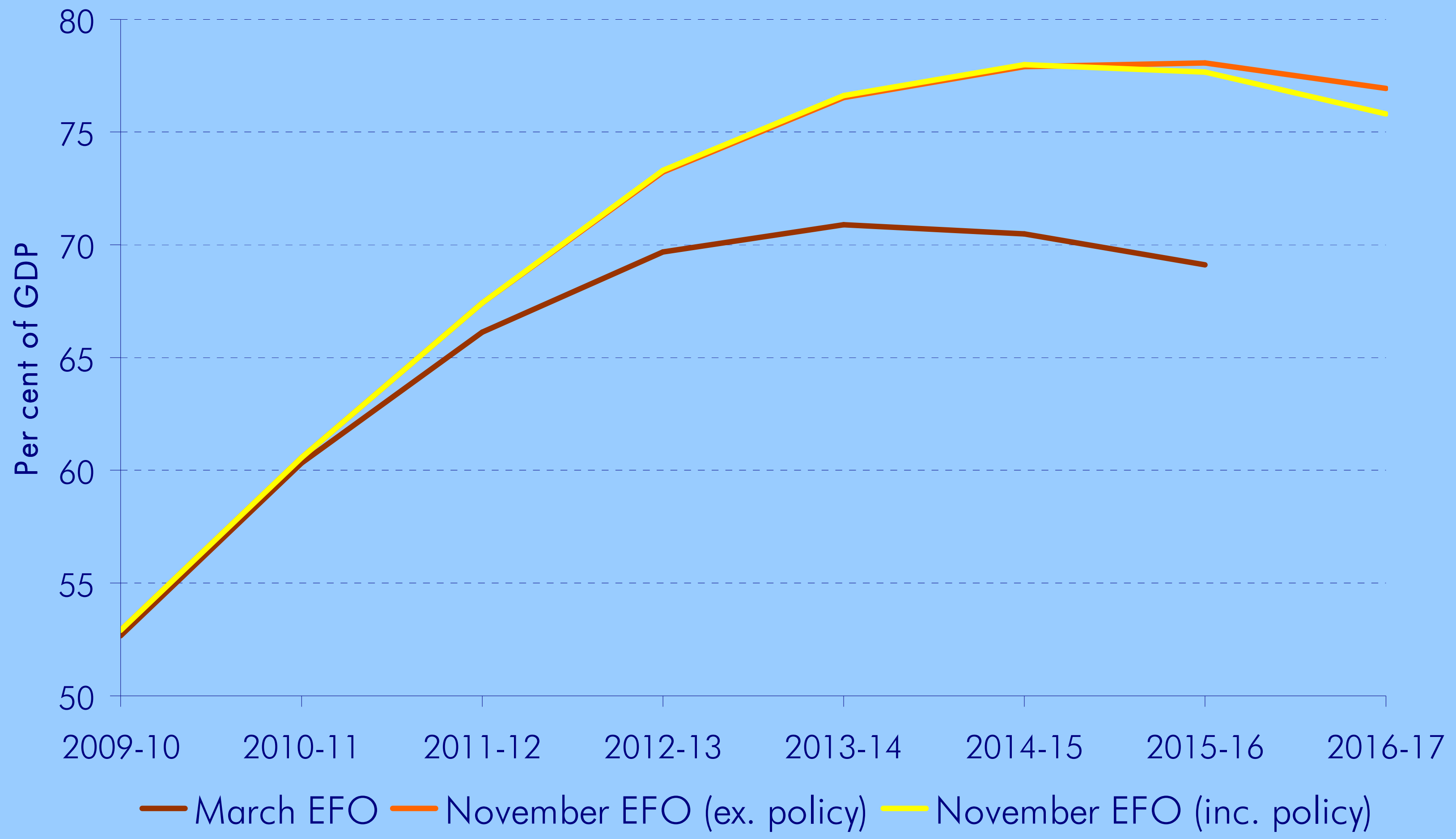
Debt peak higher than in March



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General government employment

- March forecast suggested 400,000 fall in GGE from 2011Q1 to 2016 Q1
- Bigger implied public services cuts raise estimate to 710,000 by 2017 Q1
- Greater uncertainty thanks to decision to recycle savings from pay restraint in schools and NHS

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Policy fiscal risks

- The Government plans to take the Royal Mail's historic pension deficit into the public sector, but this requires state aid approval.
  - Impact would look strongly beneficial in the short term, but would likely be negative in the longer term
- The UK and Switzerland signed an anti tax evasion deal in August, but it has to be ratified by the Swiss parliament and may require a referendum.
  - Ministers and HMRC have publicly stated that the agreement should yield £4 to 7 billion.
  - We currently judge that the yield from the agreement is likely to be towards the lower end of the range

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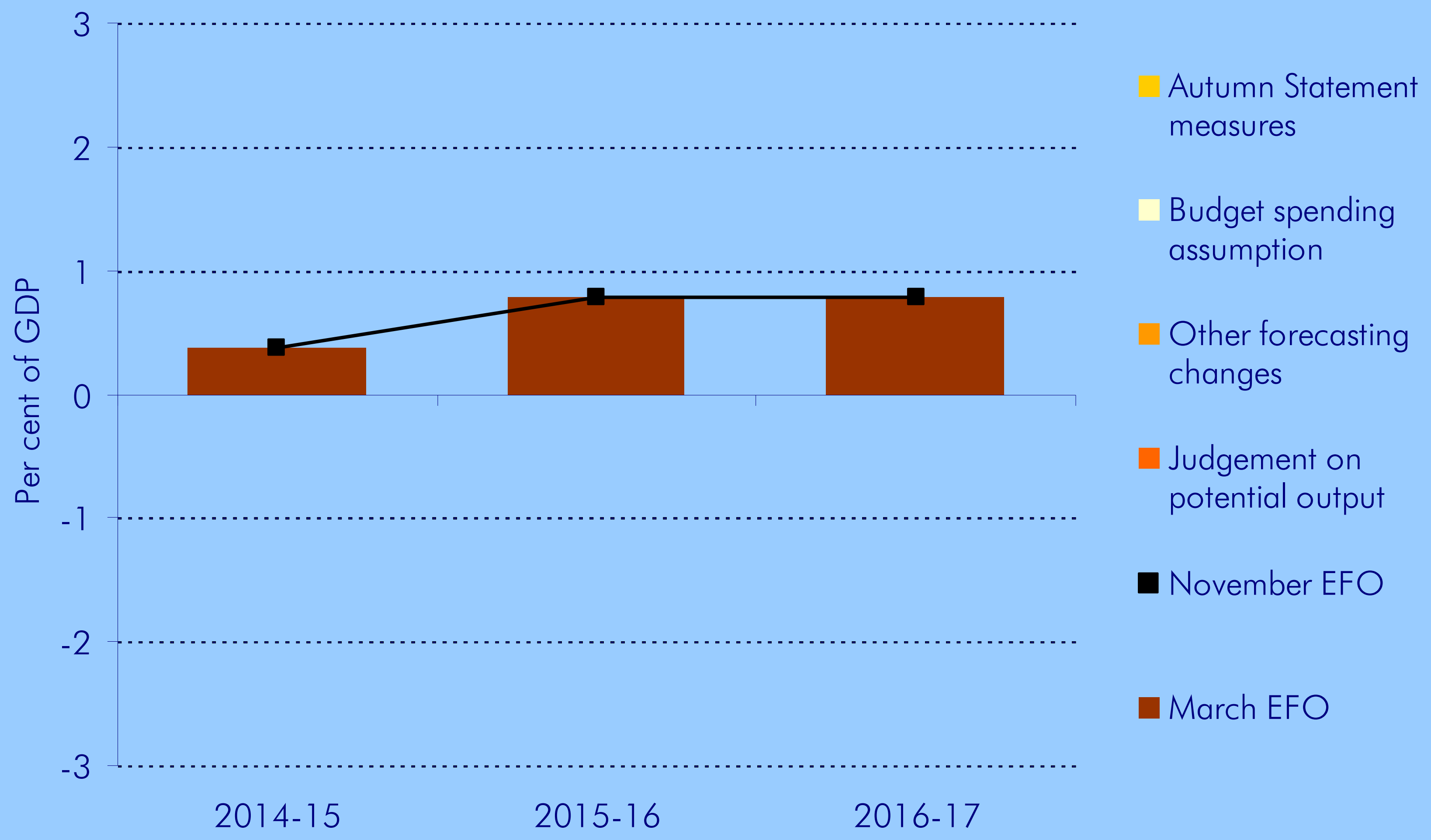
Meeting the mandate?



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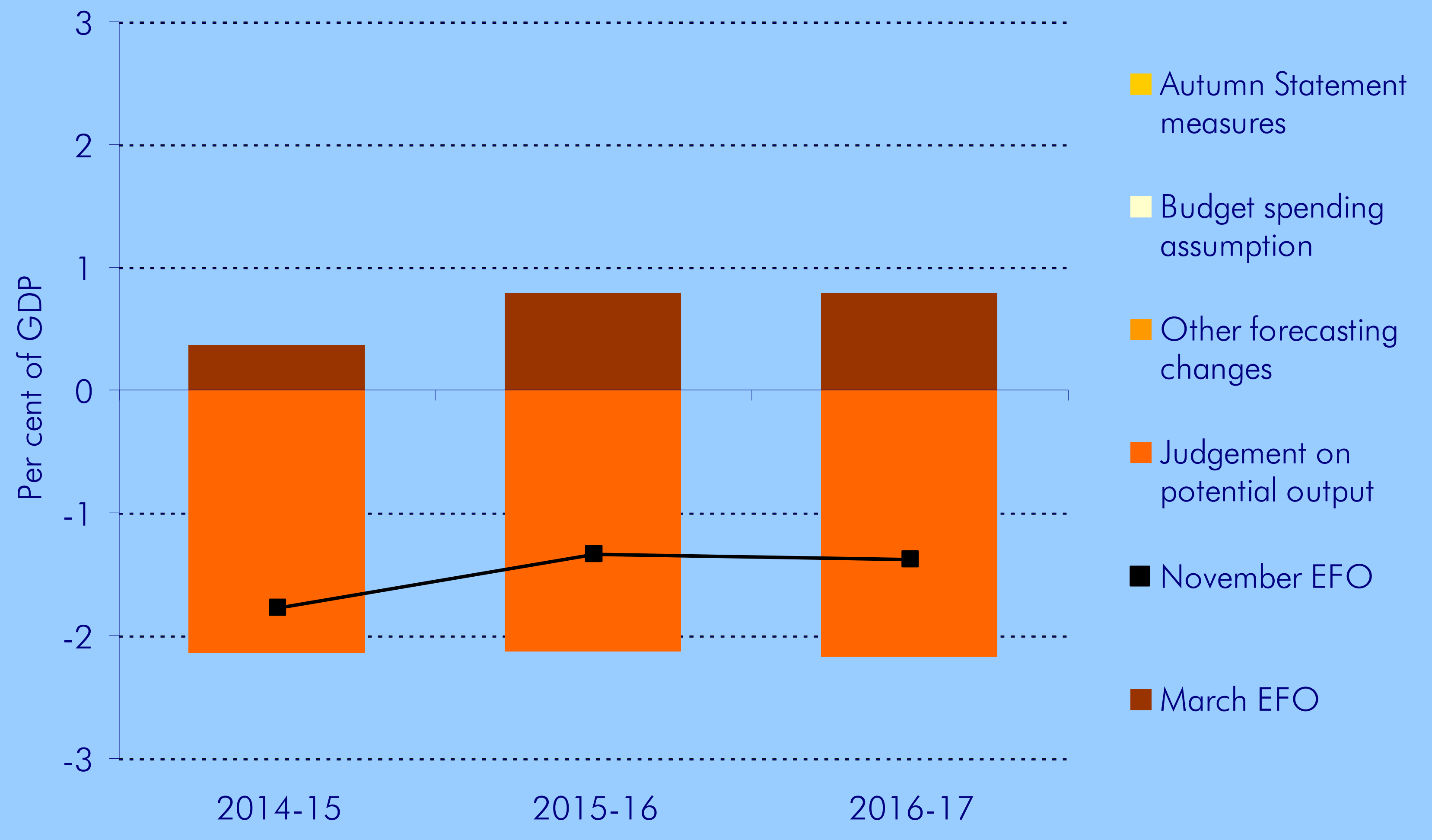
Meeting the mandate?



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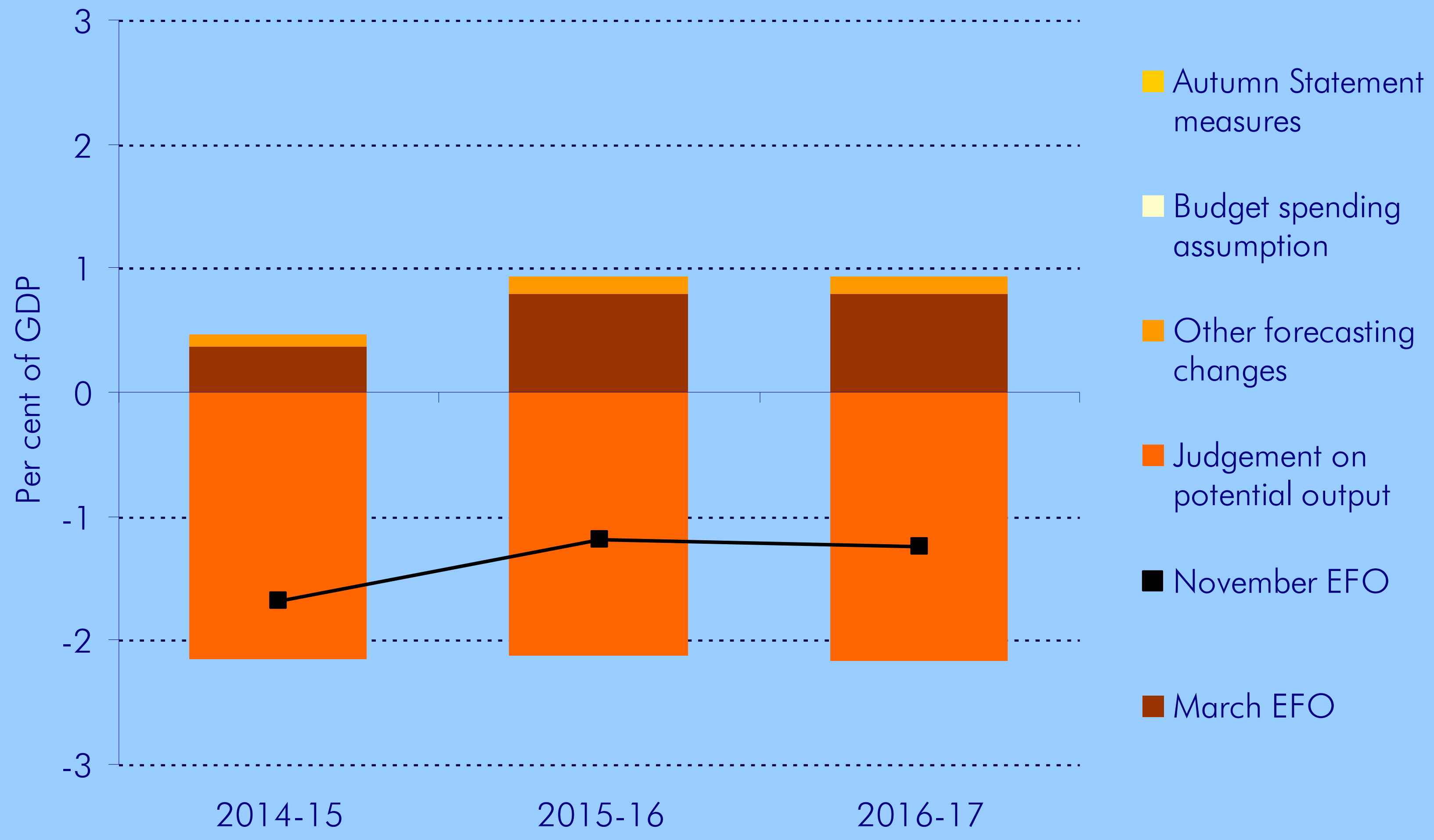

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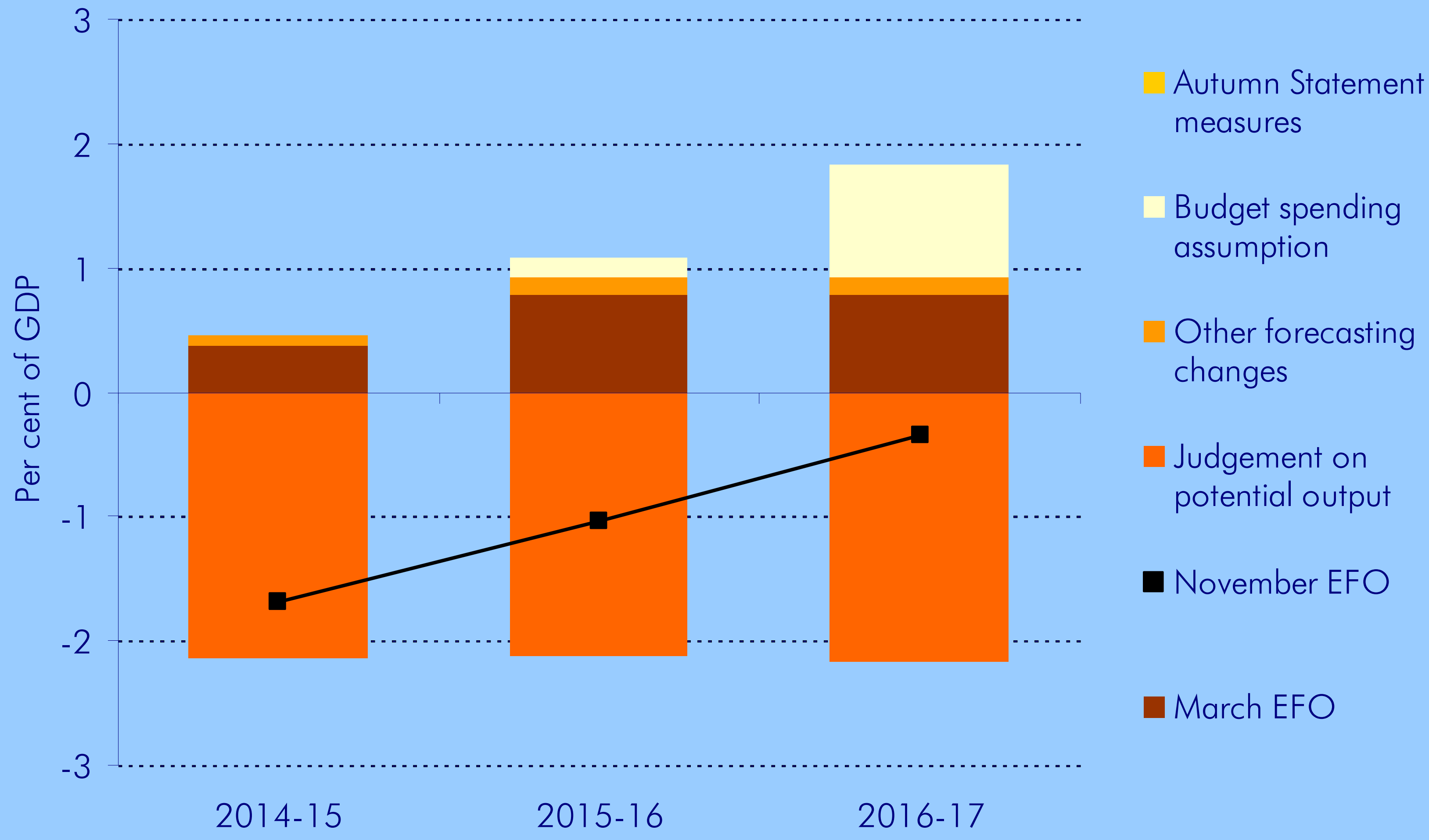

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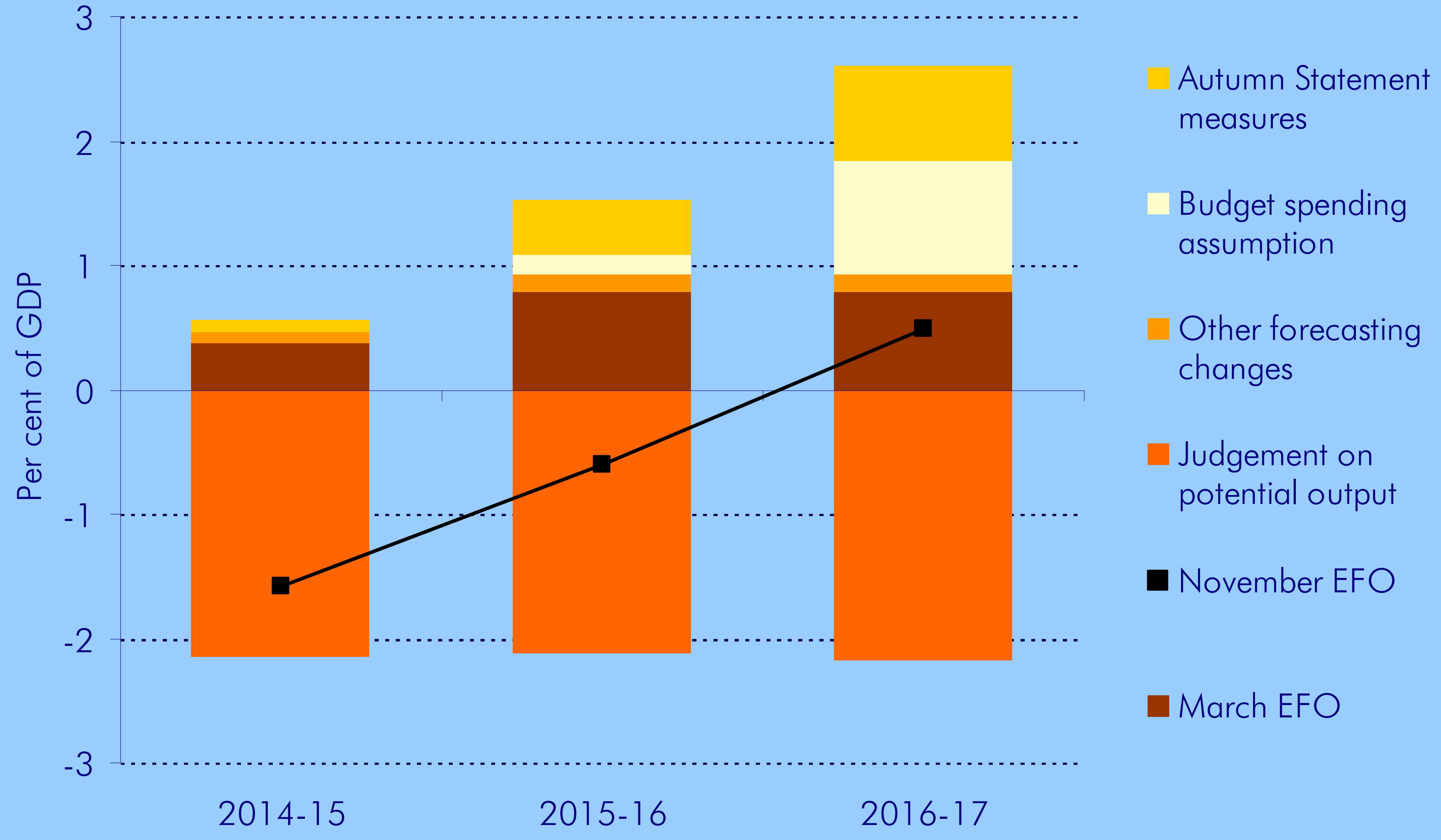
Meeting the mandate?



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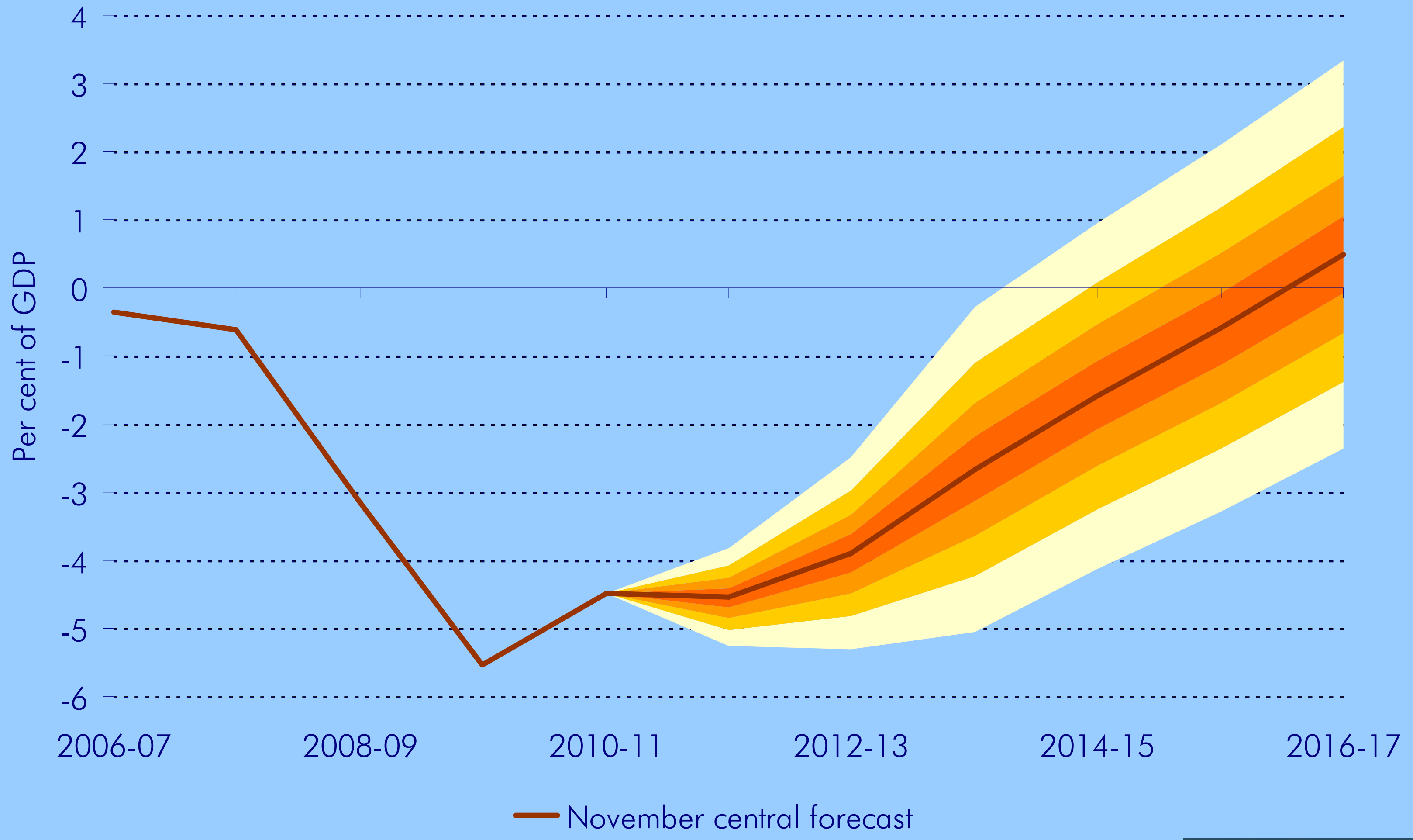
Chances of meeting the mandate



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The supplementary target

- To have debt falling as a share of GDP in 2015-16
- March forecast: fall of 1.4% of GDP
- November forecast: fall of 0.3% of GDP
- Pre-measures forecast: increase of 0.2% of GDP

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Sensitivity analysis

- Test how sensitive the public finance forecasts are to four parameters:
  - Size of the output gap
  - Pace of the recovery
  - Interest rates on government debt
  - Impact of the economic cycle

- Further downward revision to potential GDP the greatest danger

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Scenario analysis

- Tests significance of key judgements
- Three scenarios
  - Persistent tight credit conditions: unhelpful
  - No structural hit from crisis: helpful
  - Higher structural unemployment, but growth unaffected: little net impact
- Disorderly euro outcome hard to quantify

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