Office for
Budget
Responsibility

PRESS NOTICE 19 March 2014

Economic and fiscal outlook – March 2014

Budget forecast to be back in balance by 2018-19

We have revised up our short-term growth forecast and revised borrowing down, with the budget back in balance by 2018-19. The improvements are cyclical rather than structural. The Government is on track to meet its fiscal mandate, but not its supplementary debt target.

The UK economy has continued to recover. In the final quarter of 2013, GDP growth matched our December forecast, inflation fell back to target and unemployment dropped more quickly than expected. But productivity and wage growth remained disappointing.

Revised data published since our last forecast suggest the economy grew slightly faster over 2013 as a whole than we expected in December, with GDP up 1.8 per cent on the previous year. Consumer spending, supported by a falling saving ratio, has been the biggest driver of recent growth, while the latest data suggest business investment is recovering. Housing market indicators have picked up sharply, but export performance remains disappointing.

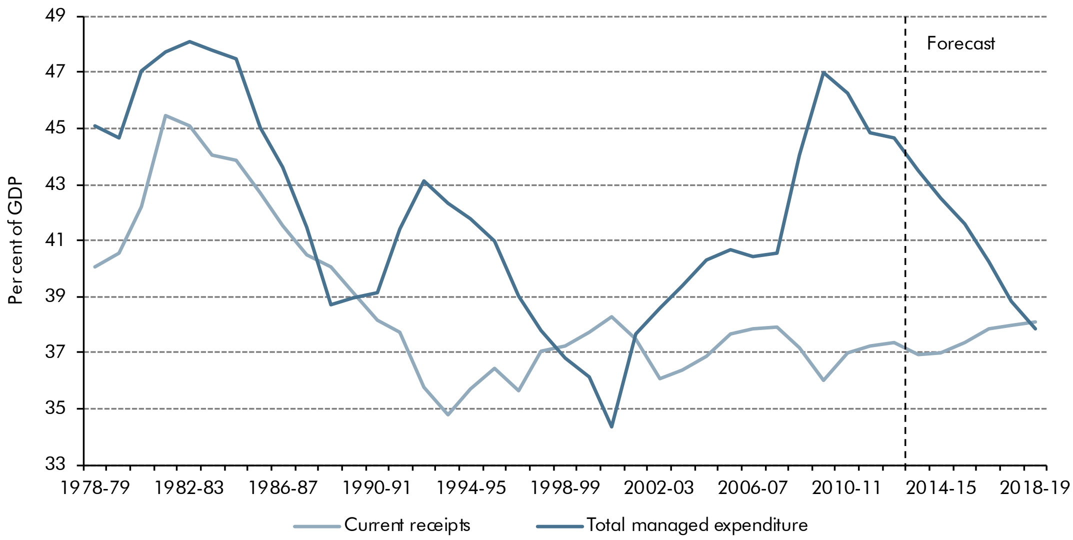
Given the momentum the economy carried into 2014, we have revised our GDP growth forecast up slightly to 2.7 per cent in 2014 and 2.3 per cent in 2015. We expect quarterly growth rates to ease through 2014 as consumer spending growth slows to rates more aligned with household income growth. The outlook for productivity growth, which underpins income growth and the sustainability of the recovery, remains the key uncertainty. We expect inflation to remain close to target and unemployment to continue falling in the coming years, though at a slower pace than in recent months.

We estimate that activity in the economy was 1.7 per cent below its sustainable potential level at the end of 2013, a slightly narrower output gap than in our December forecast. This is consistent with the unexpectedly large fall in the unemployment rate to 7.2 per cent in the fourth quarter. Combining this narrower output gap with a slightly stronger GDP growth forecast, we now expect the economy to return to normal capacity and the output gap to close by mid-2018, around a year earlier than forecast in December.

Public sector net borrowing (PSNB) – the gap between what the Government spends and raises in revenue – is expected to be £107.8 billion this year (measured on an underlying basis, excluding transfers related to the Royal Mail Pension Plan and quantitative easing). This is £3.4 billion lower than our December forecast and £7.0 billion lower than in 2012-13. Borrowing is forecast to fall by a further £12.4 billion in 2014-15, to £95.5 billion, moving below £100 billion for the first time in six years. The largest drivers of our downward revisions to borrowing in 2013-14 are an upward revision to stamp duty receipts (due to higher house prices and property transactions) and a downward revision to debt interest costs (due to lower inflation).

We have revised borrowing lower in each subsequent year of the forecast, reflecting stronger receipts in every year and slightly lower spending from 2015-16, including the effects of policy measures. The downward revision averages almost £6 billion a year from 2015-16 to 2017-18, before falling to £2.6 billion in 2018-19. The improvement in 2018-19 is smaller because of slower GDP and employment growth, once the output gap has closed, and the Government's assumption that it will raise total public spending in line with whole economy inflation in that year, the forecast for which we have revised higher since December. In 2018-19, we forecast the public finances to move into surplus for the first time in 18 years.

Chart A: Total public spending and receipts



Source: ONS, OBR. Excludes Royal Mail and APF transfers.

The tax and spending measures that the Treasury has included in its Budget policy decisions table have little cumulative effect on borrowing over the forecast, with a £5½ billion cumulative net tax cut offset by a £5¾ billion cumulative reduction in spending. The net tax cut reflects the partly offsetting effects of a number of measures that reduce receipts – including raising the income tax personal allowance, the package of savings measures and the temporary increase in the annual investment allowance to £500,000 – and others that increase receipts – including accelerated payments in anti-avoidance cases and the income tax associated with more flexible access to pension assets. Spending cuts are focused in the years from 2016-17 to 2018-19, for which detailed plans have not yet been set. A number of these measures have markedly different implications for revenue beyond the 5-year scorecard period than within it.

Our forecast implies that by 2018-19 the UK's budget deficit will have fallen by 11.2 per cent of GDP from its post-war peak in 2009-10 (around £190 billion in today's terms). Just over 80 per cent of the reduction is accounted for by lower public spending and just under 20 per cent by higher receipts.

The Government's 'fiscal mandate' requires it to balance the cyclically-adjusted current budget (CACB) – the amount the Government has to borrow to finance non-investment spending, adjusted for the state of the economy – five years ahead. In December, we forecast that the CACB would be in surplus by 1.6 per cent of GDP in 2018-19. We now forecast the surplus in 2018-19 to be 1.5 per cent of GDP, fractionally less than we forecast in December.

The Government's supplementary target is for public sector net debt (PSND) to be falling as a share of GDP in 2015-16. As in each forecast we have produced since December 2012, we expect PSND still to be rising in that year. We now expect PSND to peak at 78.7 per cent of GDP in 2015-16, to fall by a small margin in 2016-17 and then to fall more rapidly to 74.2 per cent of GDP by 2018-19. Debt as a share of GDP is lower in each year of our forecast than in December, reflecting lower borrowing and upward revisions to our nominal GDP forecast.

Needless to say, there is huge uncertainty around all public finance projections, which increases over longer time horizons. We stress test the Government's chances of achieving its targets using sensitivity and scenario analysis. A key risk is that potential output turns out to be lower over the coming five years than we currently assume. More of the deficit would then be structural and would remain after the economy recovers.

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, assessing progress against the Government's fiscal targets, and reporting on long-term fiscal sustainability.
2. All of the documents published by the OBR today are available on our website at: http://budgetresponsibility.org.uk/
3. The OBR has also announced today that the next *Fiscal sustainability report* will be published on 10 July 2014.
4. The OBR will release supplementary information on the *Economic and fiscal outlook* on 26 March in response to requests received by 23 March. We will release a list of any information to be published at 9.30am on 25 March.
5. Questions about the *Economic and fiscal outlook* should be sent to OBRpress@obr.gsi.gov.uk.

Table A: Overview of OBR March 2014 economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn		Forecast				
	2012	2013	2014	2015	2016	2017	2018
Output at constant market prices							
Gross domestic product (GDP)	0.3	1.8	2.7	2.3	2.6	2.6	2.5
GDP levels (2012=100)	100.0	101.8	104.5	107.0	109.7	112.6	115.4
Output gap	-2.8	-2.2	-1.4	-1.1	-0.7	-0.3	0.0
Expenditure components of GDP							
Household consumption	1.5	2.3	2.1	1.8	2.5	2.7	2.4
General government consumption	1.6	0.9	1.2	-0.5	-1.2	-1.8	-0.9
Business investment	3.9	-1.2	8.0	9.2	8.1	8.7	7.7
General government investment	0.6	-6.4	10.7	1.0	2.2	0.8	-0.5
Net trade[1]	-0.7	0.1	-0.2	0.1	0.0	0.0	-0.1
Inflation							
CPI	2.8	2.6	1.9	2.0	2.0	2.0	2.0
Labour market							
Employment (millions)	29.5	29.9	30.4	30.6	30.9	31.2	31.4
Average earnings	2.0	1.5	2.5	3.2	3.6	3.7	3.8
LFS unemployment (% rate)	7.9	7.6	6.8	6.5	6.1	5.7	5.4
Claimant count (millions)	1.59	1.42	1.20	1.13	1.06	0.98	0.94
	Changes since December forecast						
Output at constant market prices							
Gross domestic product (GDP)	0.1	0.3	0.3	0.1	0.0	0.0	-0.3
GDP levels (2012=100)	0.0	0.3	0.7	0.8	0.8	0.7	0.5
Output gap	-0.2	0.1	0.4	0.5	0.5	0.4	0.2
Expenditure components of GDP							
Household consumption	0.3	0.4	0.2	0.2	0.1	-0.2	-0.4
General government consumption	-0.1	0.3	0.8	0.1	-0.3	0.0	0.3
Business investment	1.2	4.2	2.9	0.6	-0.7	-0.2	-0.3
General government investment	-4.0	0.5	3.3	-0.1	0.1	0.3	0.6
Net trade	0.0	0.3	-0.2	0.0	0.0	0.0	0.0
Inflation							
CPI	0.0	0.0	-0.4	-0.1	0.0	0.0	0.0
Labour market							
Employment (millions)	0.0	0.0	0.2	0.2	0.2	0.2	0.2
Average earnings	0.0	0.1	0.0	-0.1	0.1	0.0	0.1
LFS unemployment (% rate)	0.0	0.0	-0.3	-0.4	-0.4	-0.4	-0.2
Claimant count (millions)	0.00	-0.01	-0.07	-0.10	-0.12	-0.15	-0.16

[1] Contribution to GDP growth.

Table B: Overview of OBR March 2014 fiscal forecast

	Per cent of GDP						
	Outturn	Forecast					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Excluding Royal Mail and APF transfers							
Public sector net borrowing	7.3	6.6	5.5	4.2	2.4	0.8	-0.2
Cyclically-adjusted net borrowing	5.3	5.0	4.5	3.4	1.9	0.6	-0.3
Surplus on current budget	-5.9	-5.1	-3.9	-2.7	-0.9	0.5	1.5
Headline fiscal aggregates							
Public sector net borrowing	5.1	5.8	4.9	3.8	2.2	0.9	-0.1
Cyclically-adjusted net borrowing	3.1	4.3	3.8	3.0	1.7	0.7	-0.1
Surplus on current budget	-5.4	-4.4	-3.3	-2.3	-0.7	0.5	1.5
Fiscal mandate and supplementary target							
Cyclically-adjusted surplus on current budget	-3.5	-2.8	-2.2	-1.5	-0.2	0.7	1.5
Public sector net debt	74.2	74.5	77.3	78.7	78.3	76.5	74.2
	Changes since December forecast						
Excluding Royal Mail and APF transfers							
Public sector net borrowing	0.0	-0.2	-0.1	-0.2	-0.4	-0.4	-0.1
Cyclically-adjusted net borrowing	-0.1	-0.2	0.2	0.1	0.0	-0.1	0.0
Surplus on current budget	0.1	0.2	0.1	0.2	0.3	0.3	0.1
Headline fiscal aggregates							
Public sector net borrowing	0.0	-0.2	0.0	-0.2	-0.4	-0.4	-0.1
Cyclically-adjusted net borrowing	-0.1	-0.2	0.2	0.1	0.0	-0.1	0.0
Surplus on current budget	0.1	0.2	0.0	0.2	0.3	0.3	0.1
Fiscal mandate and supplementary target							
Cyclically-adjusted surplus on current budget	0.2	0.1	-0.2	-0.2	0.0	0.0	0.0
Public sector net debt	0.3	-1.0	-1.0	-1.2	-1.6	-1.9	-1.8

Table C: Public sector net borrowing: change since previous forecast

	£ billion					
	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Public sector net borrowing[1]						
December forecast	111.2	96.0	78.7	51.1	23.4	-2.2
March forecast	107.8	95.5	75.2	44.5	16.5	-4.8
Change	**-3.4**	**-0.6**	**-3.5**	**-6.6**	**-6.9**	**-2.6**
of which:						
Changes in the receipts forecast[1,2]	-1.1	-2.0	-3.5	-4.7	-4.0	-2.5
Changes in the spending forecast[1,2]	-2.3	0.9	-0.6	-1.7	-2.2	0.3
Receipts measures in the Treasury's policy decision table	0.0	0.0	0.6	1.8	1.4	1.7
Spending measures in the Treasury's policy decision table	0.0	0.5	-0.1	-2.0	-2.1	-2.1

[1] Excluding APF transfers.

[2] This includes the re-allocation of the policy measure for tax free childcare announced in Budget 2013. More information is available in our online supplementary fiscal tables.