Consequences of the economic downgrade

Thomas Pope
OBR now more pessimistic about productivity

Successive forecasts for productivity growth

Pre-crisis average
Forecast
Post-crisis average

Output per hour (2008 Q1=100)

Source: OBR Economic and Fiscal Outlook November 2017
Downgrade to the real GDP forecast

Successive forecasts for GDP growth

Source: Successive OBR Economic and Fiscal Outlooks
Lower GDP per capita as a result

Successive forecasts for GDP per capita

Source: Successive OBR Economic and Fiscal Outlooks
GDP per capita growth slowing in advanced economies

Forecast annual GDP per capita growth in advanced economies

Source: IMF World Economic Outlooks Database, October 2017
But OBR expects UK to perform worse than main competitors

Forecast cumulative real GDP per capita growth in the G7, 2016–2022

- Germany
- France
- United States
- Japan
- Italy
- UK (IMF)
- Canada
- UK (OBR)

Source: IMF World Economic Outlooks Database, October 2017 and OBR EFO November 2017
This means lower real earnings growth

Successive forecasts for median earnings, £ per annum

Source: IFS Calculations using the Annual Survey of Hours and Earnings and OBR Economic and Fiscal Outlooks
Large increases in borrowing forecast since March 2016

Successive forecasts for Public Sector Net Borrowing

Source: Successive OBR Economic and Fiscal Outlooks
Large increases in borrowing forecast since March 2016

Successive forecasts for Public Sector Net Borrowing

Source: Successive OBR Economic and Fiscal Outlooks
Higher borrowing in the medium term

Changes to the underlying borrowing forecast

-6.3

IFS ‘weak scenario’

Source: OBR Economic and Fiscal Outlook November 2017

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Decomposing borrowing changes this year

**Sources of changes to the 2017–18 borrowing forecast**

<table>
<thead>
<tr>
<th>Source</th>
<th>Change (£ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>March forecast</td>
<td>55.5</td>
</tr>
<tr>
<td>Productivity downgrade</td>
<td>+9.0</td>
</tr>
<tr>
<td>Improved hours and employment</td>
<td>-3.2</td>
</tr>
<tr>
<td>Other underlying</td>
<td>-12.1</td>
</tr>
<tr>
<td>November forecast (before policy measures)</td>
<td>49.2</td>
</tr>
</tbody>
</table>

Source: OBR Economic and Fiscal Outlook November 2017
Decomposing borrowing changes in 2021–22

Sources of changes to the 2021–22 borrowing forecast

- Productivity downgrade: +25.8
- Improved hours and employment: -10.7
- Other underlying: +2.5
- November forecast (before policy measures): 28.6

£ billion

March forecast: 11.0

Source: OBR Economic and Fiscal Outlook November 2017
Policy measures increase medium term deficit

Effect of announced policy changes, Autumn Budget 2017

- £1 billion net tax cut
- £0.5 billion spending increase

Source: OBR Economic and Fiscal Outlook November 2017
Not the end of Austerity

Net tax rises of £4 billion to come by 2021–22

Net welfare cut of £11½ billion to come by 2021–22

Day-to-day Departmental spending per capita cuts worth £10 billion by 2022–23 (in today’s terms)
Fiscal target still being met but fiscal objective looks very ambitious

Public Sector Net Borrowing out-turn and latest forecast

Percent of national income

Source: OBR Economic and Fiscal Outlook November 2017
Fiscal target still being met but fiscal objective looks very ambitious

Public Sector Net Borrowing out-turn and latest forecast

- Cyclically-adjusted net borrowing
- 2% target: £15 bn headroom

Source: OBR Economic and Fiscal Outlook November 2017
Large increases in borrowing forecast since March 2016

Successive forecasts for Public Sector Net Borrowing

Source: Successive OBR Economic and Fiscal Outlooks
Changes in borrowing since March 2016

Changes in 2020–21 borrowing, Budget 2016 to Autumn Budget 2017

<table>
<thead>
<tr>
<th>Category</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2016 forecast</td>
<td>-11.0</td>
</tr>
<tr>
<td>Underlying changes</td>
<td>+31.8</td>
</tr>
<tr>
<td>Policy changes</td>
<td>+12.2</td>
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<tr>
<td>November 2017 forecast</td>
<td>32.8</td>
</tr>
</tbody>
</table>

Source: Successive OBR Economic and Fiscal Outlooks
Borrowing relatively low by historical standards by end of forecast period

Source: OBR Databank, November 2017
But debt far above pre-crisis levels and set to fall slowly

Source: OBR Economic and Fiscal Outlook November 2017
Higher deficit and slower growth would mean higher debt burden

Debt profiles under different scenarios for borrowing

- Deficit 1.1% GDP, prod. growth 1.2%
- Deficit 1.1% GDP, prod. growth 2%
- Surplus 0.5% GDP, prod. growth 2%

Source: OBR Economic and Fiscal Outlook November 2017 and Fiscal Sustainability Report January 2017
Where is Brexit in all of this?

Public finances weaker due to effects on wider economy, unchanged since November 2016
- Reduced immigration, increased uncertainty, higher prices
  - ≈£15 billion per year

£3 billion over two years to prepare for Brexit

No allowance for any one-off ‘divorce bill’ (£40 billion?)

UK’s net contribution to EU assumed to continue or be spent elsewhere, rather than saved (≈£8–£10 billion per year)

All of this is very uncertain
Summary

Big downgrade to productivity growth bad news for all of us
- GDP per capita 3.1% lower in 2020–21 than forecast less than two years ago
- Annual real median wages revised down by £1,400 in that time

Underlying borrowing higher by £18 billion in 2021–22

Policy loosened in response

Fiscal targets for this parliament on course to be met but fiscal objective seems increasingly ambitious
Consequences of the economic downgrade

Thomas Pope