

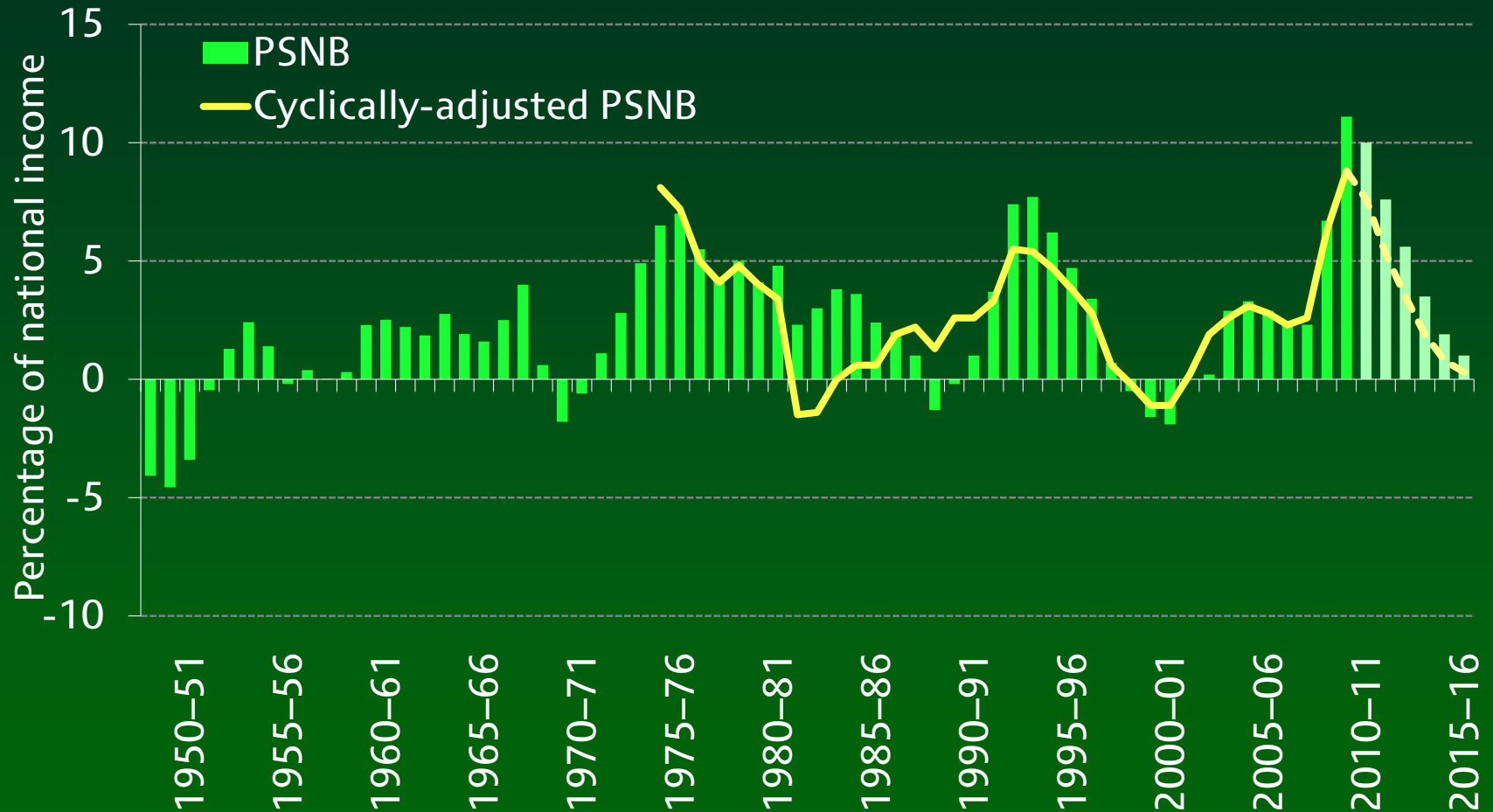
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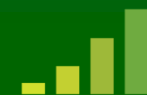
Public finance forecasts and Budget judgement

Rowena Crawford, Carl Emmerson and Gemma Tetlow

Context: deficit needs to fall from post WW2 peak



Source: IFS calculations; HM Treasury; Office for Budget Responsibility.



Summary

- Green Budget baseline forecast
 - current budget deficit and public sector net borrowing in 2010–11 to be £2.9 billion lower than the OBR’s autumn forecast
 - over next five years: this small gap reduces and then returns
 - public sector net debt peaks at a slightly lower level
- Barclays central forecast
 - worse outlook for the macro economy than the OBR forecasts
 - borrowing falls by less over the next five years, cyclically-adjusted current budget in deficit in 2015–16
- Barclays alternative cases
 - ‘optimistic’ case: better outlook for the macro economy but still only leads to public finances evolving broadly as the OBR expects
 - ‘pessimistic’ case: worse outlook for the macro economy leads to smaller fall in borrowing and debt still rising in 2015–16

Forecasts for 2010–11

£ billion	OBR November 2010	Green Budget February 2011	Difference
Current receipts	549.7	552.6	+2.9
Current spending	655.9	655.9	0.0
Current budget surplus	-106.2	-103.3	+2.9



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Current receipts	549.7	552.6	+2.9
Current spending	655.9	655.9	0.0
Current budget surplus	-106.2	-103.3	+2.9
Net investment	42.3	42.3	0.0
Borrowing	148.5	145.6	-2.9



Differences in 2010–11 forecast

- Receipts (+£2.9 billion)
 - income tax (+£1.5 billion)
 - National Insurance contributions (+£1.5 billion)
 - corporation tax (+£0.4 billion)
 - fuel duties (–£0.4 billion)
 - VAT (–£0.5 billion)
 - other taxes (net +£0.4 billion)
- Spending (£0.0 billion)
 - we assume OBR forecasts for current spending and public sector net investment are correct

Medium-term forecasts: baseline assumptions

- Economy performs as the OBR expects
 - far greater information provided by OBR means fewer gaps need to be filled in
- Total departmental spending totals for 2011–12 to 2014–15 kept to in cash terms
- Current spending and investment spending frozen in real terms in 2015–16
- Only new policies are those committed to in Budgets/PBRs/Spending Reviews

Possible new policies?

- NHS spending
- Income tax personal allowance

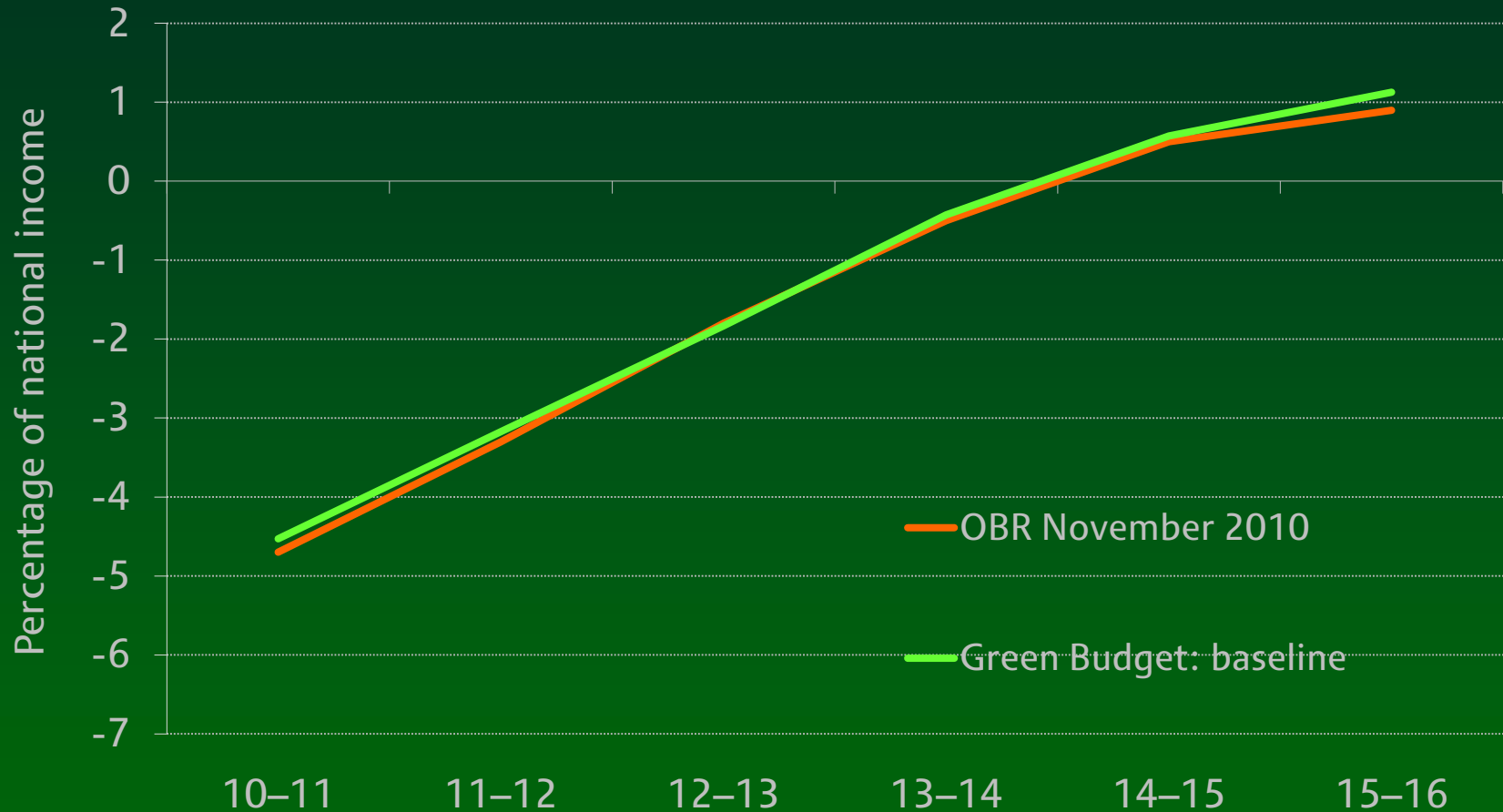
Possible new policies?

- NHS spending
 - coalition agreement commits to year-on-year real increases
 - OBR's November forecast revised up expected inflation, so that planned small real increase in England now a planned small real cut
 - we assume funds are reallocated from the DEL reserve
- Income tax personal allowance

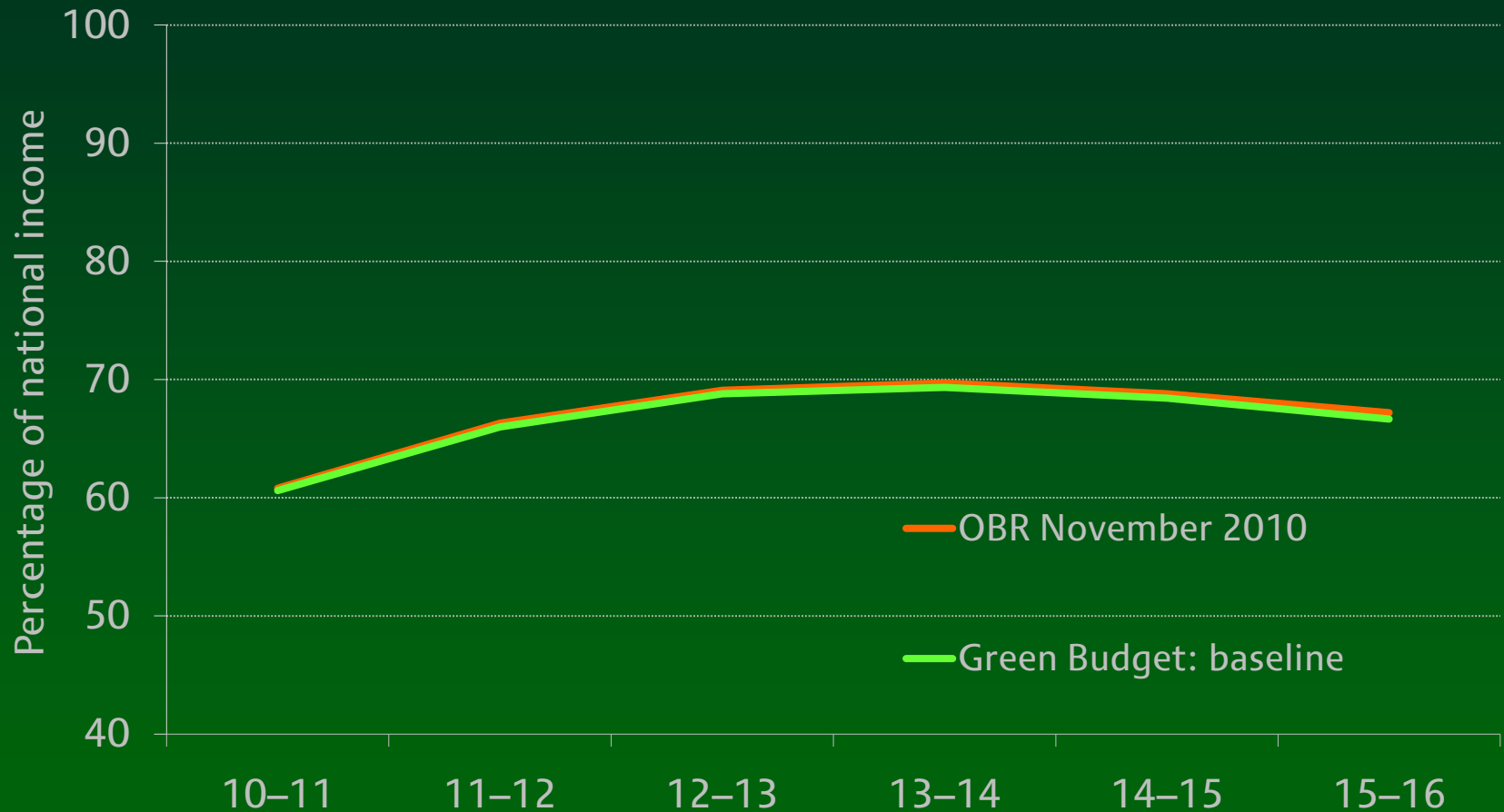
Possible new policies?

- NHS spending
- Income tax personal allowance
 - coalition agreement says “We will further increase the personal allowance to £10,000, making real terms steps each year towards meeting this as a longer-term policy objective. We will prioritise this over other tax cuts, including cuts to Inheritance Tax.”
 - increasing personal allowance to £10,000 in 2015–16 while clawing gains back from higher-rate taxpayers would cost £4.3 billion
 - we do not allow for this policy in our forecasts

Cyclically-adjusted current budget balance



Public sector net debt



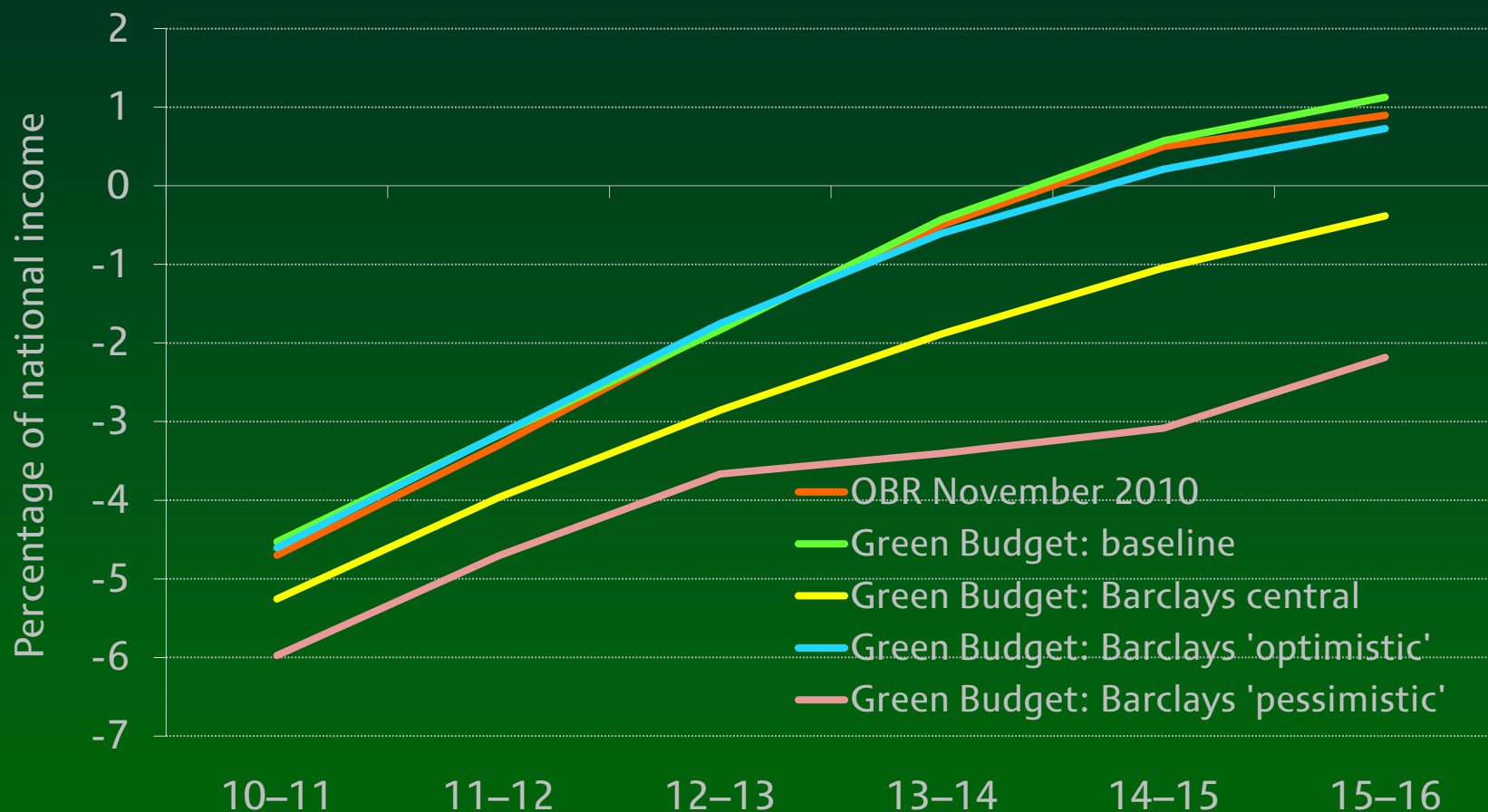
The weak Q4 growth figures

- Economy estimated to have shrunk by 0.5% in last quarter of 2010
 - OBR November forecast was for growth of 0.5%
- Unless view of potential output lowered, higher growth expected in future as economy has further to bounce back
 - this should be true of output lost due to bad weather
- Central government receipts holding up despite this weaker growth
 - weak VAT receipts in December, but we still expect overall receipts to be greater than the OBR forecast for 2010–11
- Should not change fiscal policy with every piece of new information

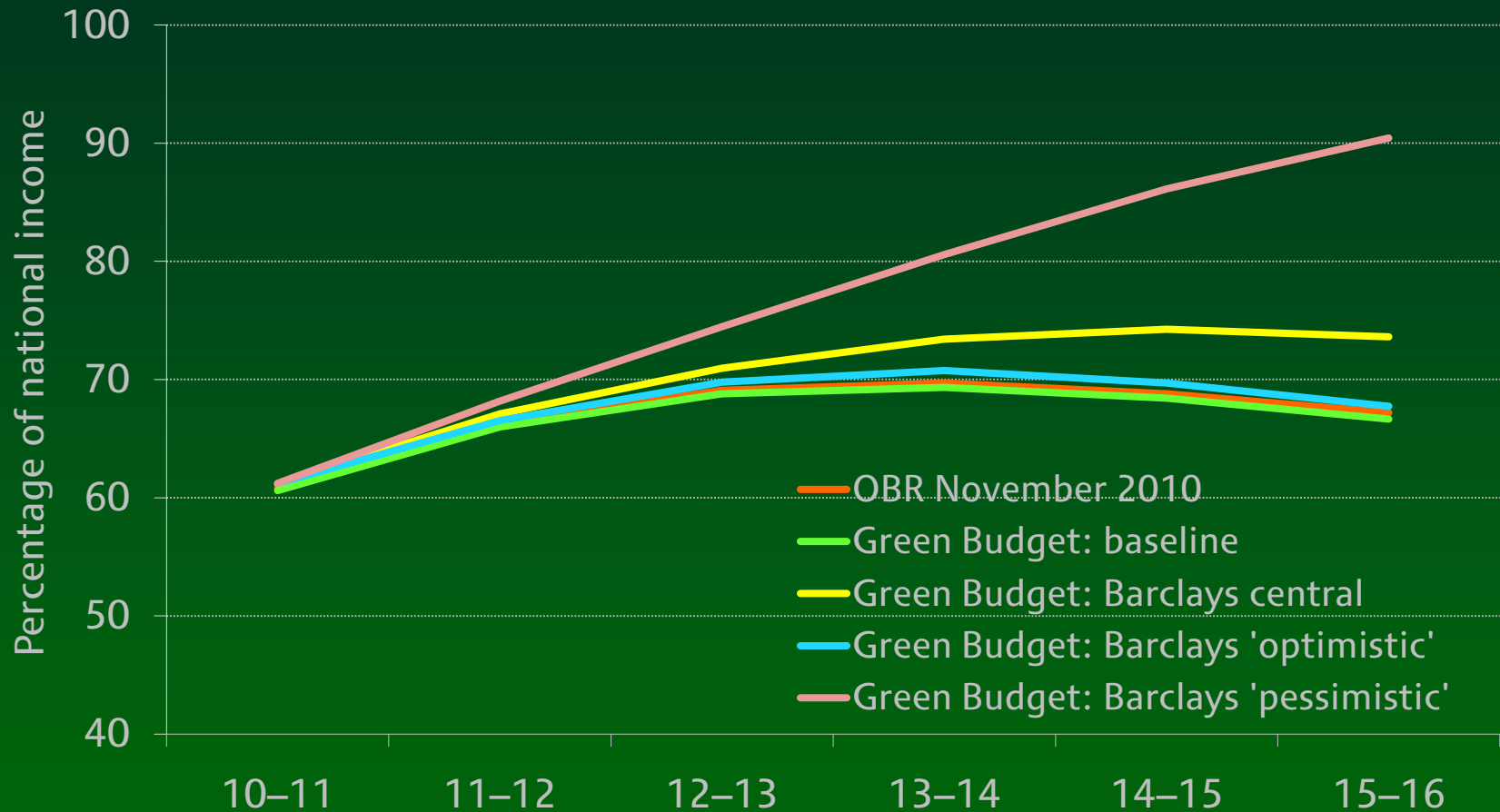
Uncertainties around macroeconomic outlook (1)

- Alternative scenarios highlight downside risk to public finances
 - Also incorporate new information since OBR report
- Barclays central scenario
 - future potential output lower than OBR expects, and national income takes longer to return to this level
- Barclays ‘optimistic’ case
 - future potential output closer to OBR assessment
 - but composition of growth less favourable to public finances
- Barclays ‘pessimistic’ case
 - financial crisis and associated recession assumed to have an even greater detrimental impact on potential output
 - more persistent gap between national income and potential output

Cyclically-adjusted current budget balance



Public sector net debt



Uncertainties around macroeconomic outlook (2)

- Should not change fiscal policy with every piece of new information
- Fiscal plan should acknowledge inherent uncertainty
 - state up-front what broad course of action would be pursued under different possible scenarios
 - more credible than a supposedly fixed plan
 - avoids need for “u-turns”

Budget judgement

- Near term: should the Budget contain a significant net fiscal giveaway to help economy?
- Medium term: should the Budget use any improvement in the fiscal outlook to reduce size of fiscal tightening?

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 - no boost to demand if looser fiscal policy led to tighter monetary policy
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- Better to bank any forecast improvement in the public finances to give greater headroom against these risks
- May be no need to implement alternative policies at this stage, but having alternatives to hand could prove useful



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