Institute for Fiscal Studies

Winter is Coming: the 2016 Autumn Statement

Paul Johnson

15 November 2016

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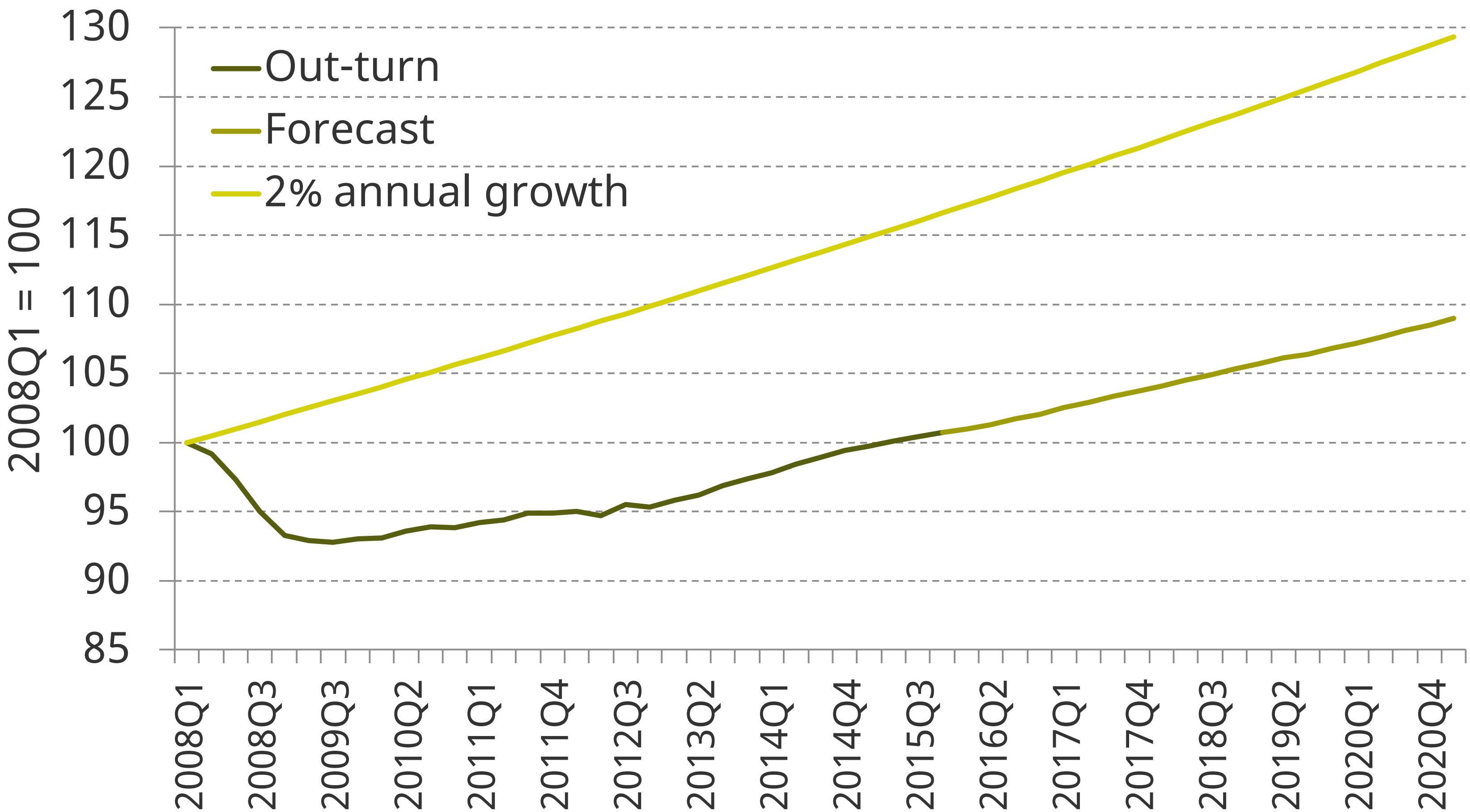
Pre-referendum forecast: GDP per capita only just back to pre-crisis levels



Budget forecast: deficit reduced from peak, but some way off being eliminated

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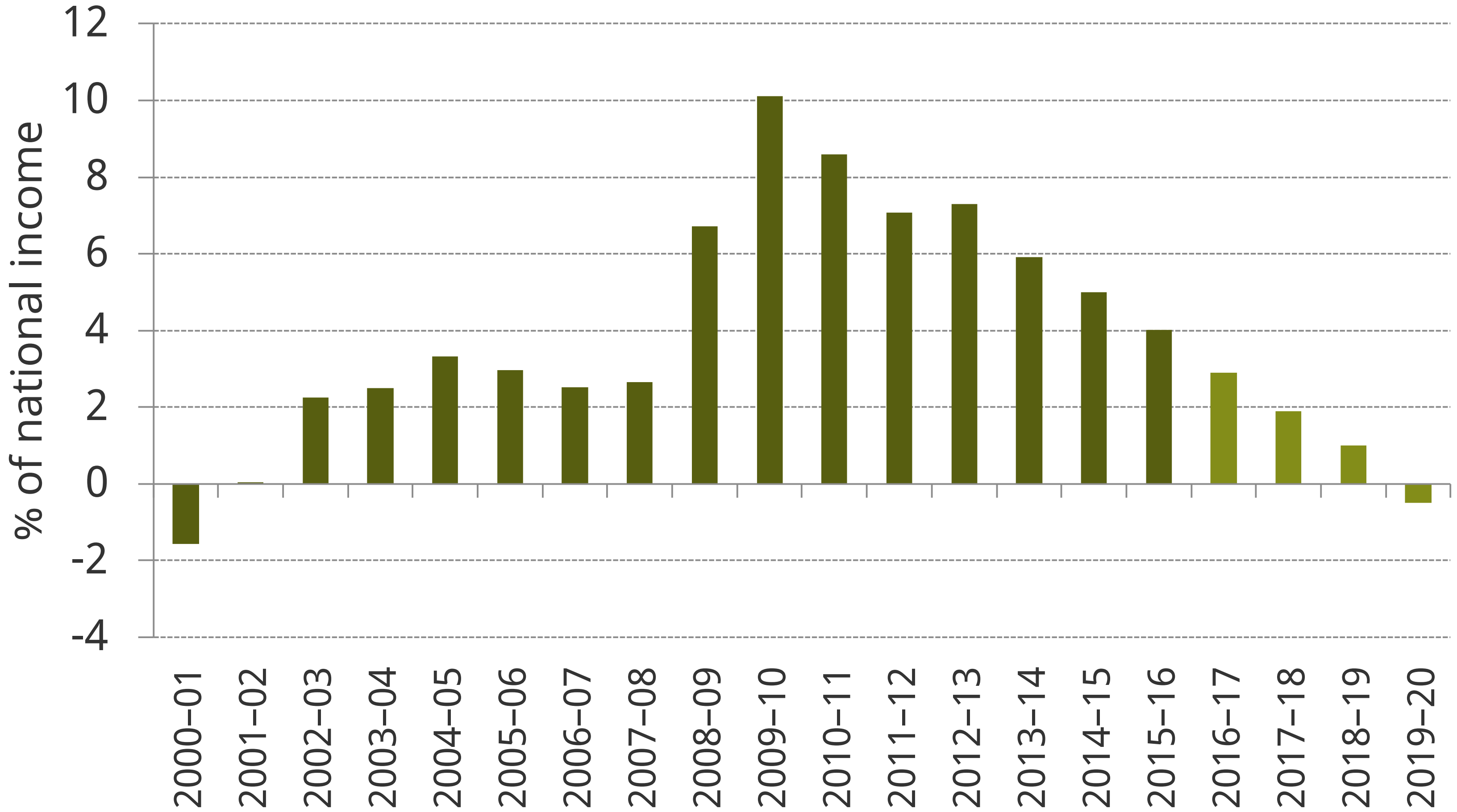

£13 bn of tax rises planned by 2019-20

- Tax rises
  - £6 billion is CT receipts pushed into 2019–20 from two previous years
  - apprenticeship levy (£3 billion);
  - new tax on sugary soft drinks (£0.5 billion);
  - tackling evasion and 'avoidance' (£5 billion);
  - restricting pension tax relief for very high earners (£1 billion);
  - increased dividend taxation (£2 billion)
- And some cuts
  - Increased personal allowance and higher-rate threshold (£2.6 billion);
  - new main homes inheritance tax allowance (£0.8 billion)

£12bn of benefit cuts announced since election

- Four-year freeze of most working age benefit rates (£3.8 billion, we estimate will be revised up by £1.4 billion)
- New two-child limit (£1.1 billion)
- Cuts to universal credit (£2.7 billion)
- Cut ESA for work-related activity group (£0.4 billion)
- Reduced household benefit cap (£0.4 billion)

More real cuts to public service spending

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	2010–11 to 2016–17	2016–17 to 2019–20	2010–11 to 2019–20
Total	–7.6%	**–3.6%**	–10.9%

More real cuts to public service spending

	2010–11 to 2016–17	2016–17 to 2019–20	2010–11 to 2019–20
Total	–7.6%	**–3.6%**	–10.9%
NHS	+11.1%	**+1.1%**	+12.3%
Schools	+6.5%	**+0.9%**	+7.5%
Defence	–13.2%	**+4.4%**	–9.4%
DfID	+26.6%	**+0.9%**	+27.7%

More real cuts to public service spending

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'Unprotected'	–20.5%	**–10.2%**	–28.6%

Fiscal targets

Cap forecast welfare spending

Reduce public sector net debt as a share of national income every year until a surplus is achieved

New fiscal mandate: achieve a headline surplus every year from 2019–20, unless growth drops below 1%

Fiscal targets: nought out of three

Cap forecast welfare spending

- missed in Autumn 2015

Reduce public sector net debt as a share of national income every year until a surplus is achieved

- debt rose between 2014–15 and 2015–16

New fiscal mandate: achieve a headline surplus every year from 2019–20, unless growth drops below 1%

- target abandoned after the referendum

What drives economic impacts of Brexit?

Short run: increased uncertainty & lower exchange rate likely to dominate

- may lead to lower investment and consumption but may boost exports
- Exchange rate will push prices about 2.6% higher than otherwise

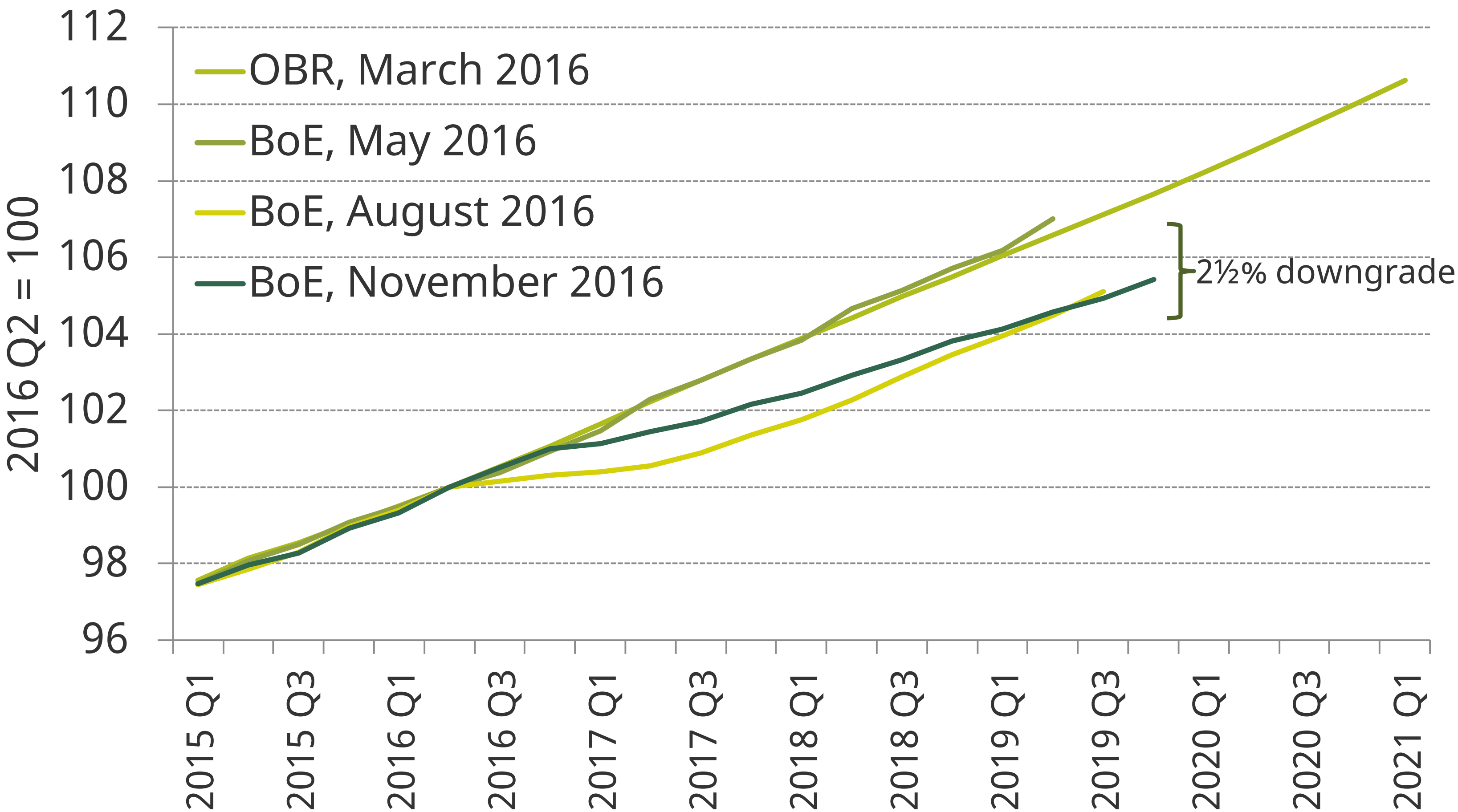
Long run impacts from:

- rising trade costs, impact depending on nature of trade deal / membership of single market
- any reduction in foreign direct investment which would reduce productivity

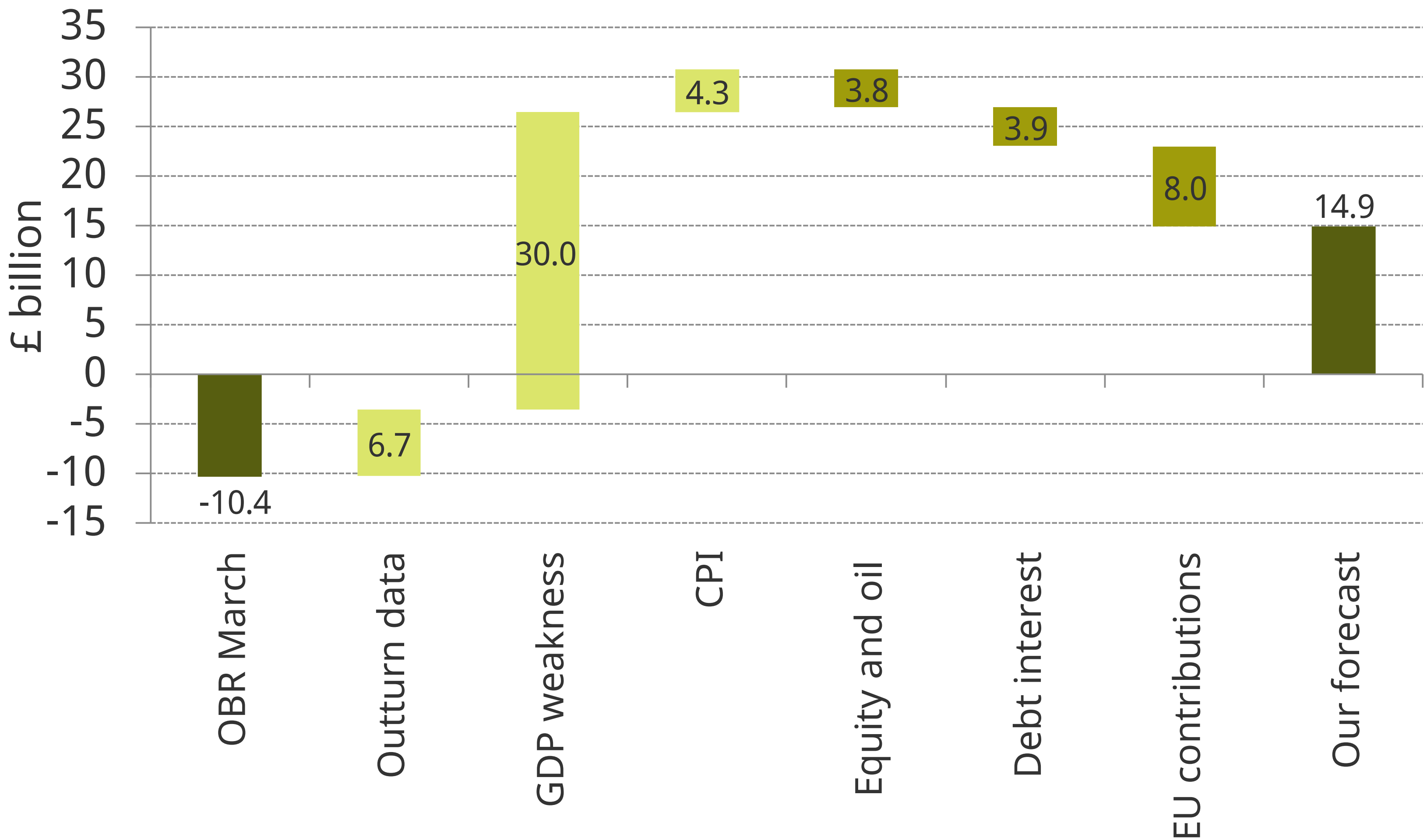
Wide variety of long run estimates

- ranging from small GDP losses to losses of 8% or more
- (best estimates suggest membership of EU had big positive impact on GDP)

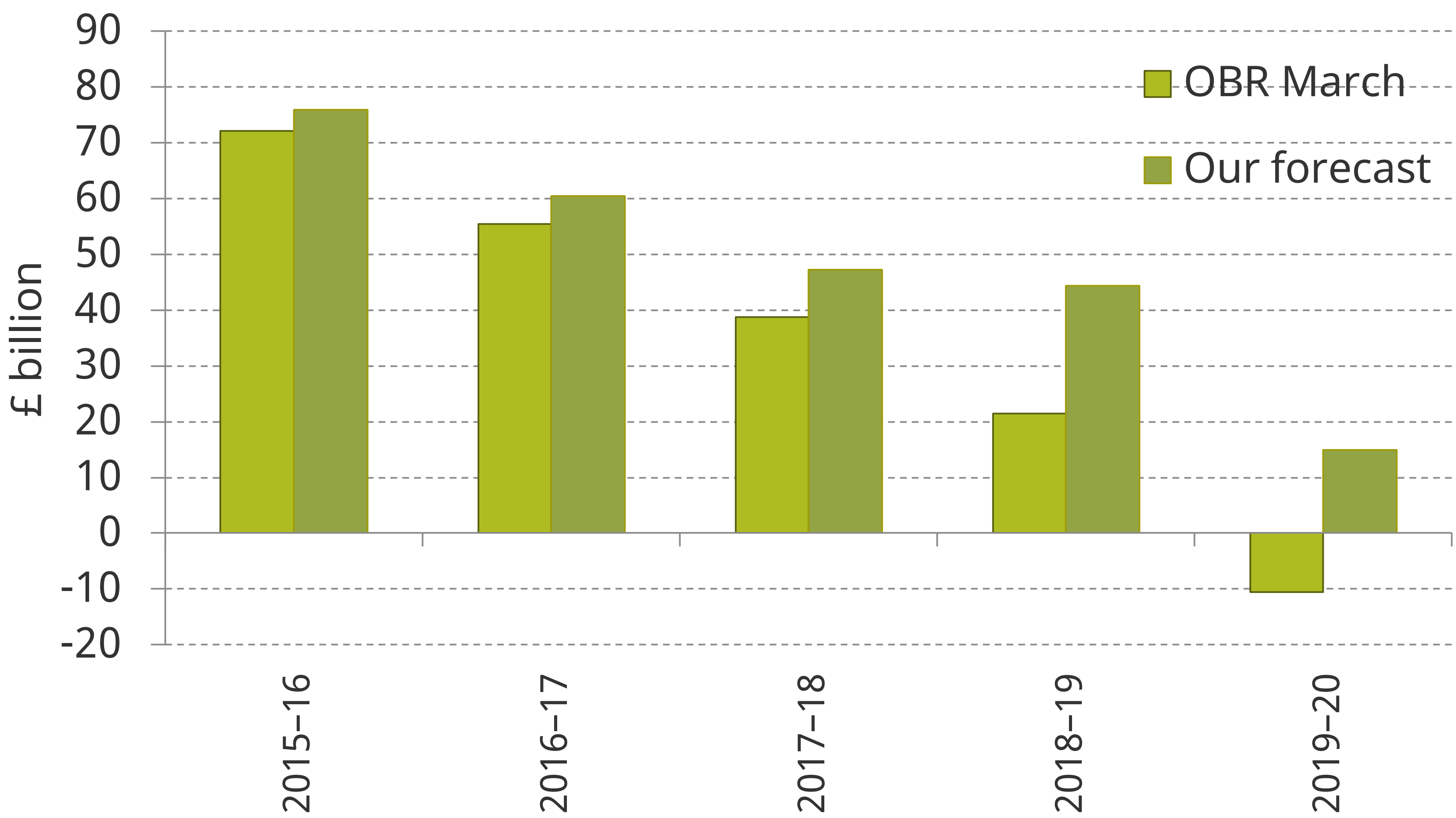
Developments since the referendum: Bank of England growth forecasts downgraded sharply



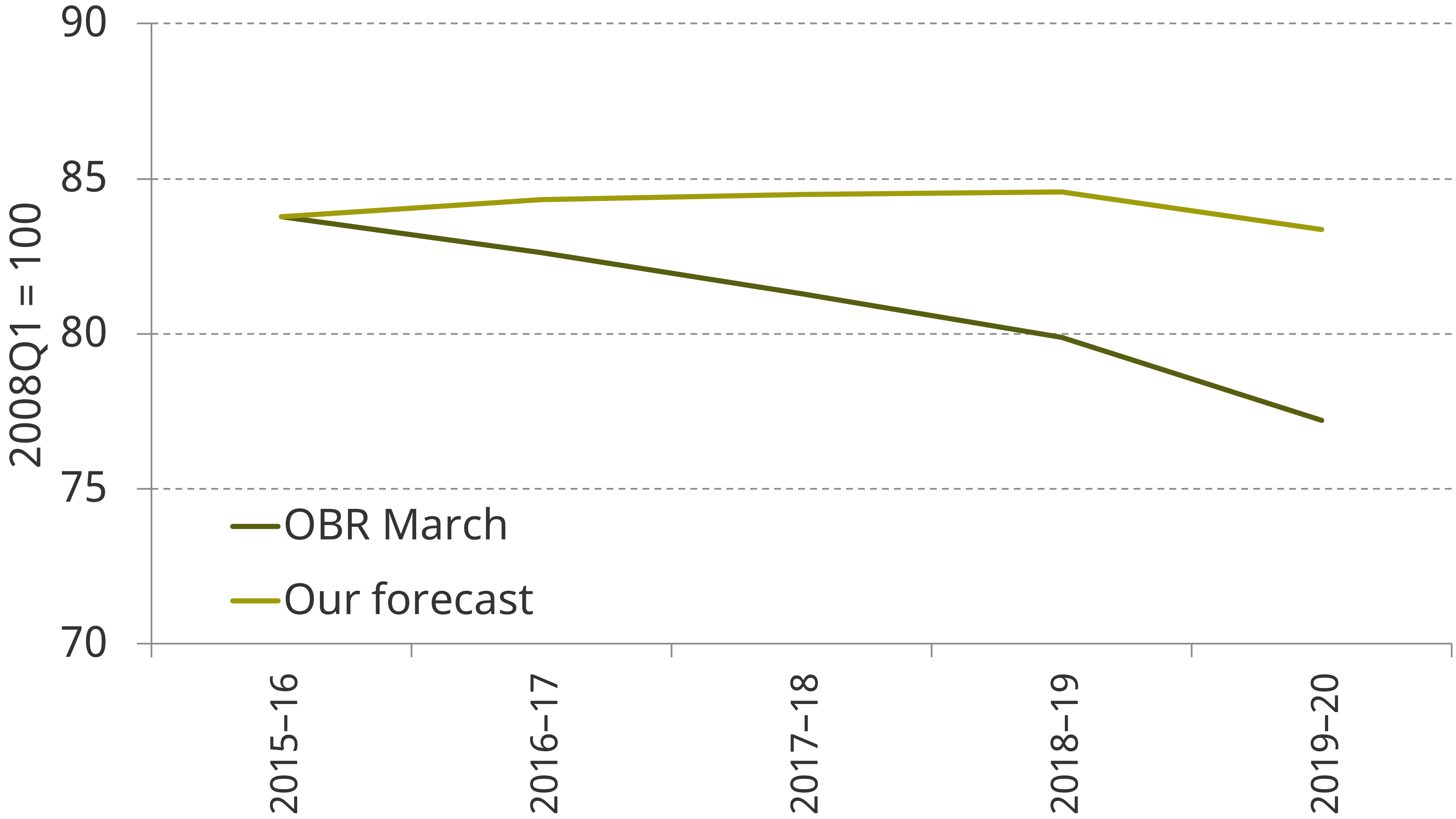
Change in borrowing in 2019–20



Borrowing to fall much less quickly over the next two years



Debt not to fall below 2015–16 levels until 2019–20



So where now for fiscal policy?

Sensibly the government is no longer committed to delivering an overall budget surplus in 2019–20

- despite this target being legislated just a year ago

But that need not mean the "end of austerity"

- Mr Hammond might in fact decide to extend austerity

Or he might decide on something else entirely

- good economic reasons for allowing borrowing to finance investment spending, which is an approach long-favoured by the Labour Party
- reverting to Mr Osborne's initial, flexible, rule of a targeting the deficit five years out

Uncertainty over economic developments is pervasive

Short run stimulus is possible

Very difficult judgment given uncertainty

- would add to borrowing, but borrowing currently extremely cheap

***Only* a response to short run economic cost**

- if potential output reduced by Brexit in the end tighter policy needed

Any stimulus package should be Targeted, Timely and Temporary

Could push back the already planned fiscal tightening and/or could announce new measures, such as

- one-off boost to public sector investment spending
- temporary cut to the main rate of VAT to encourage consumers to spend
- a time-limited tax break to encourage companies to invest
- a stamp duty holiday to stimulate housing transactions

Conclusions

Substantial further fiscal tightening planned as of March

Downgrade to expected growth suggests outlook for public finances weakened by around £25 billion in 2019–20

- despite assuming no net contribution to EU in that year, saving £8 billion
- would mean a deficit of £15 billion rather than a surplus of £10 billion

In the Autumn Statement the new Chancellor will need to decide

- what level of borrowing to aim for in the longer-term, and how quickly to try to get there: further austerity beyond 2019–20 likely
- whether to announce a temporary fiscal easing

In the context of even greater than usual uncertainty over the path of the economy

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