Public finance risks

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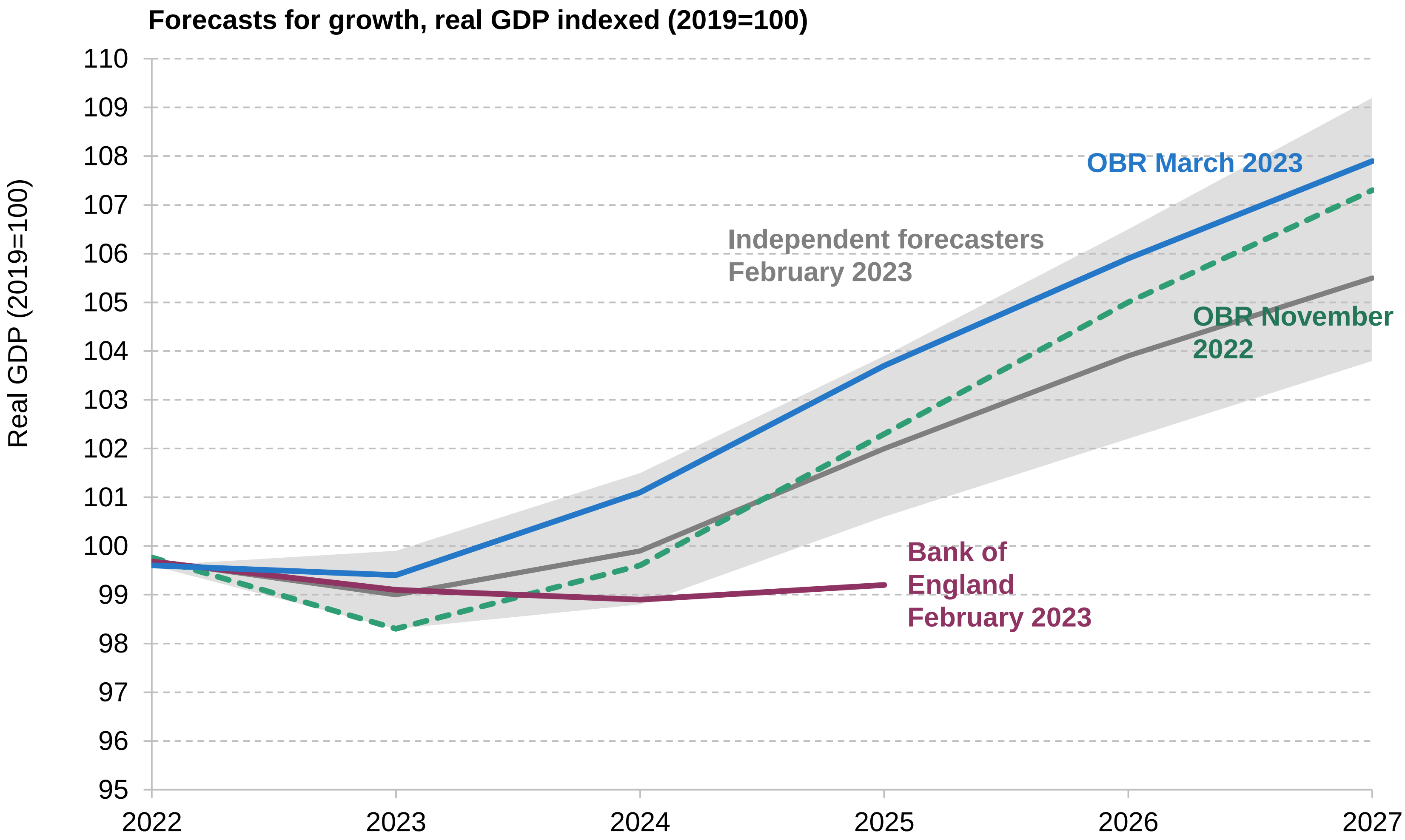
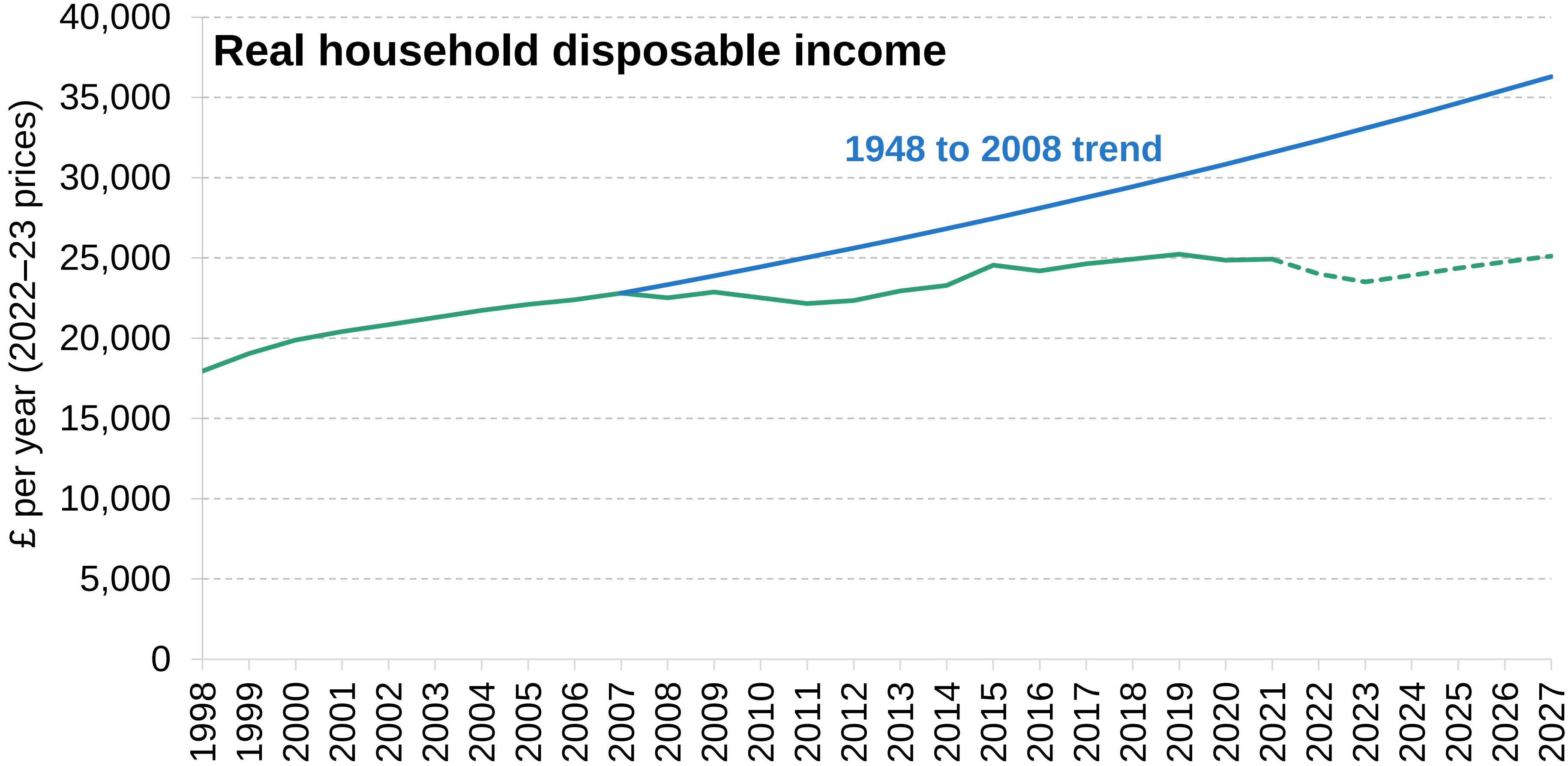
Economic and Social Research Council

Huge medium-term uncertainty

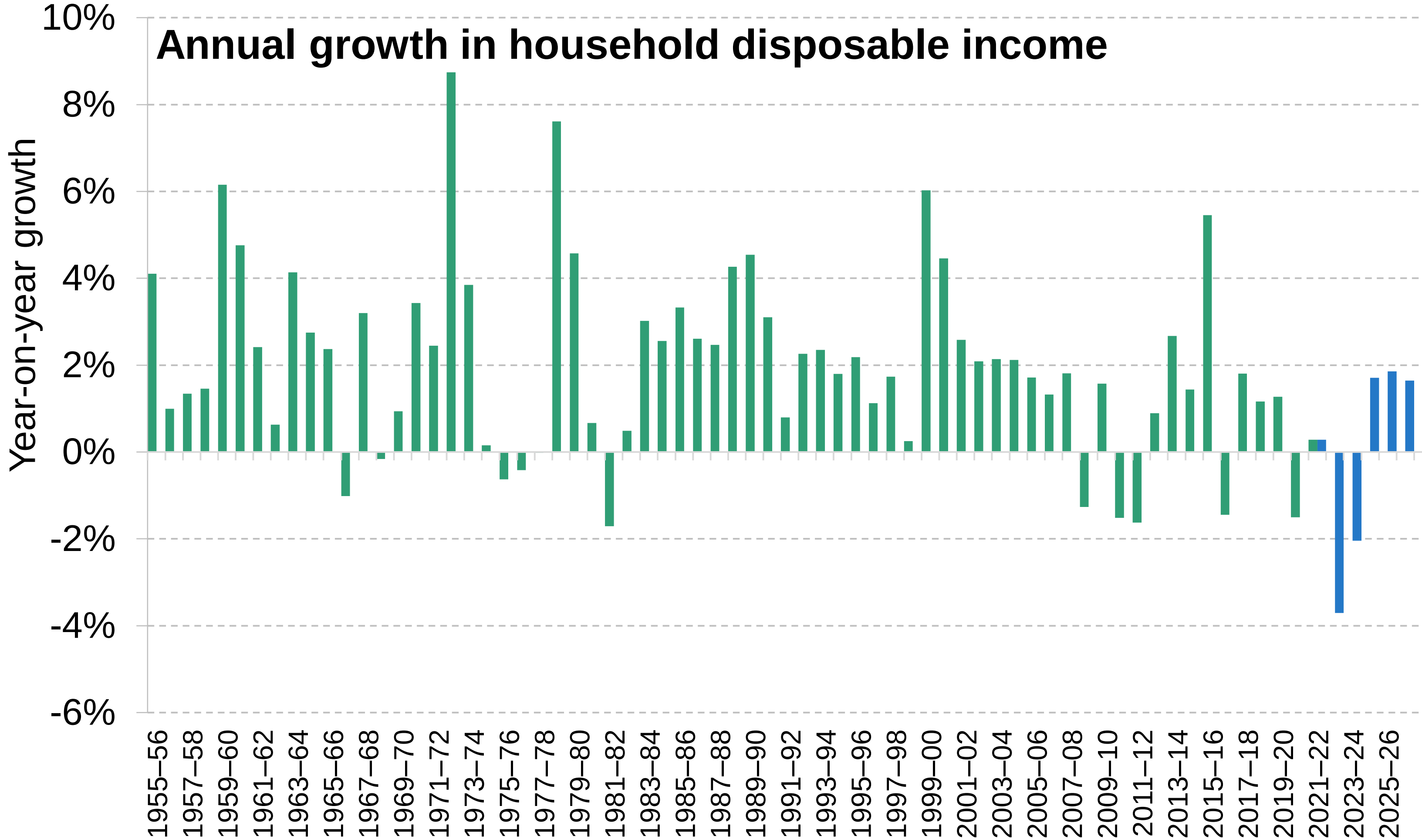


Poor household income growth to continue…



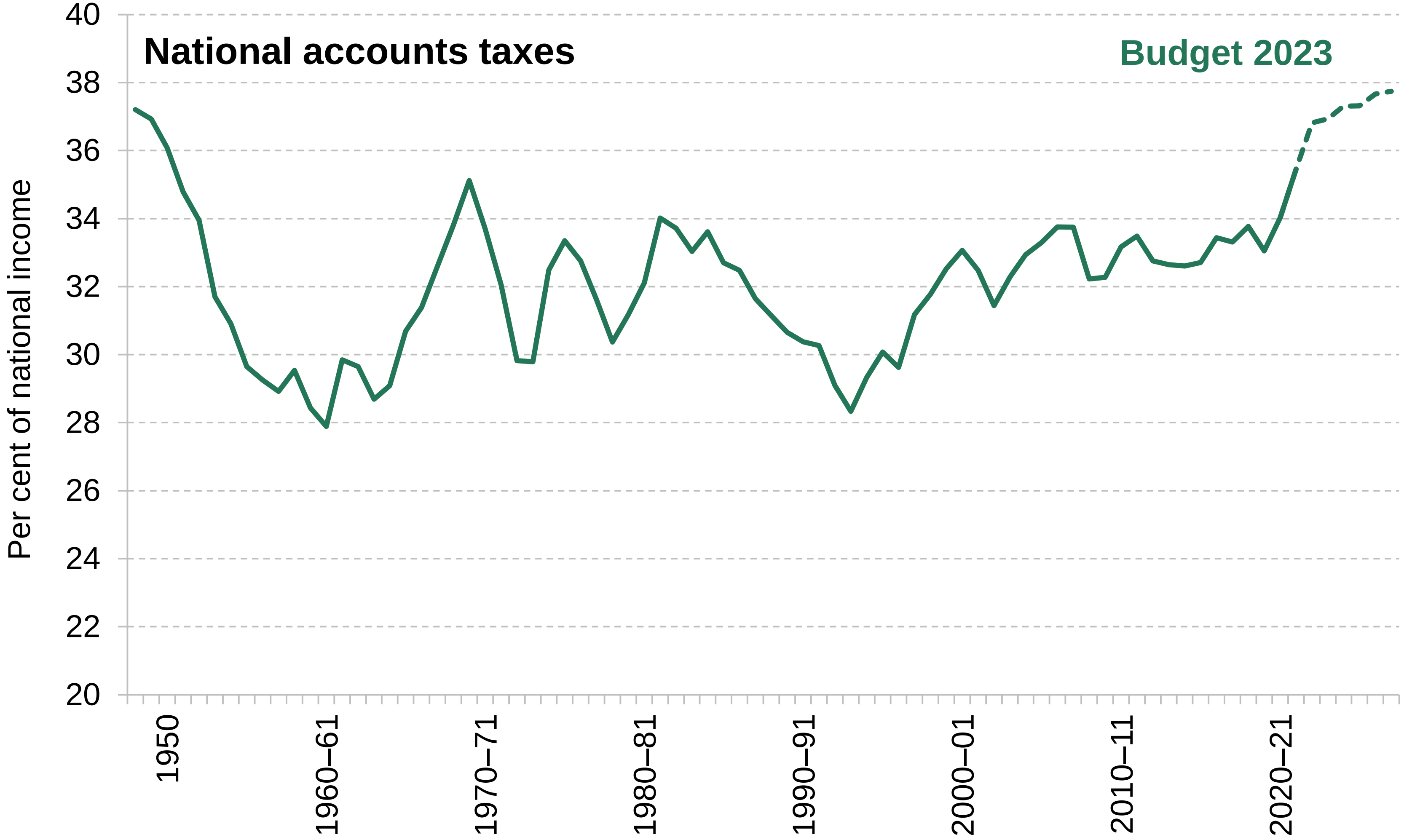
Source: IFS calculations based on ONS UK Economic Accounts (historical RHDI and population statistics), OBR EFO March 2023 (forecast per-capita RHDI)

… with OBR still forecasting the worst two years on record

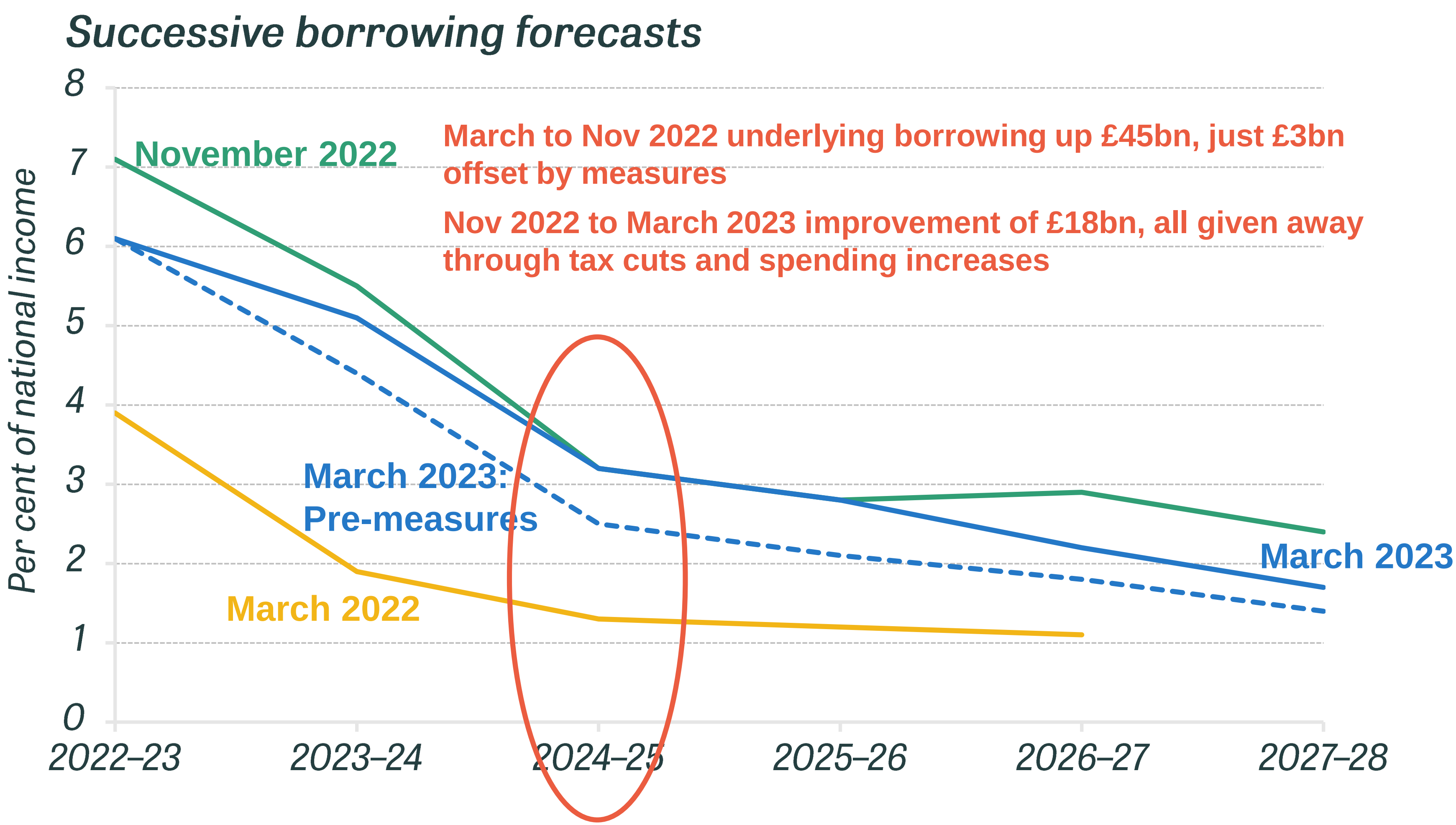


Source: IFS calculations based on ONS UK Economic Accounts (historical RHDI and population statistics), OBR EFO March 2023 (forecast per-capita RHDI)

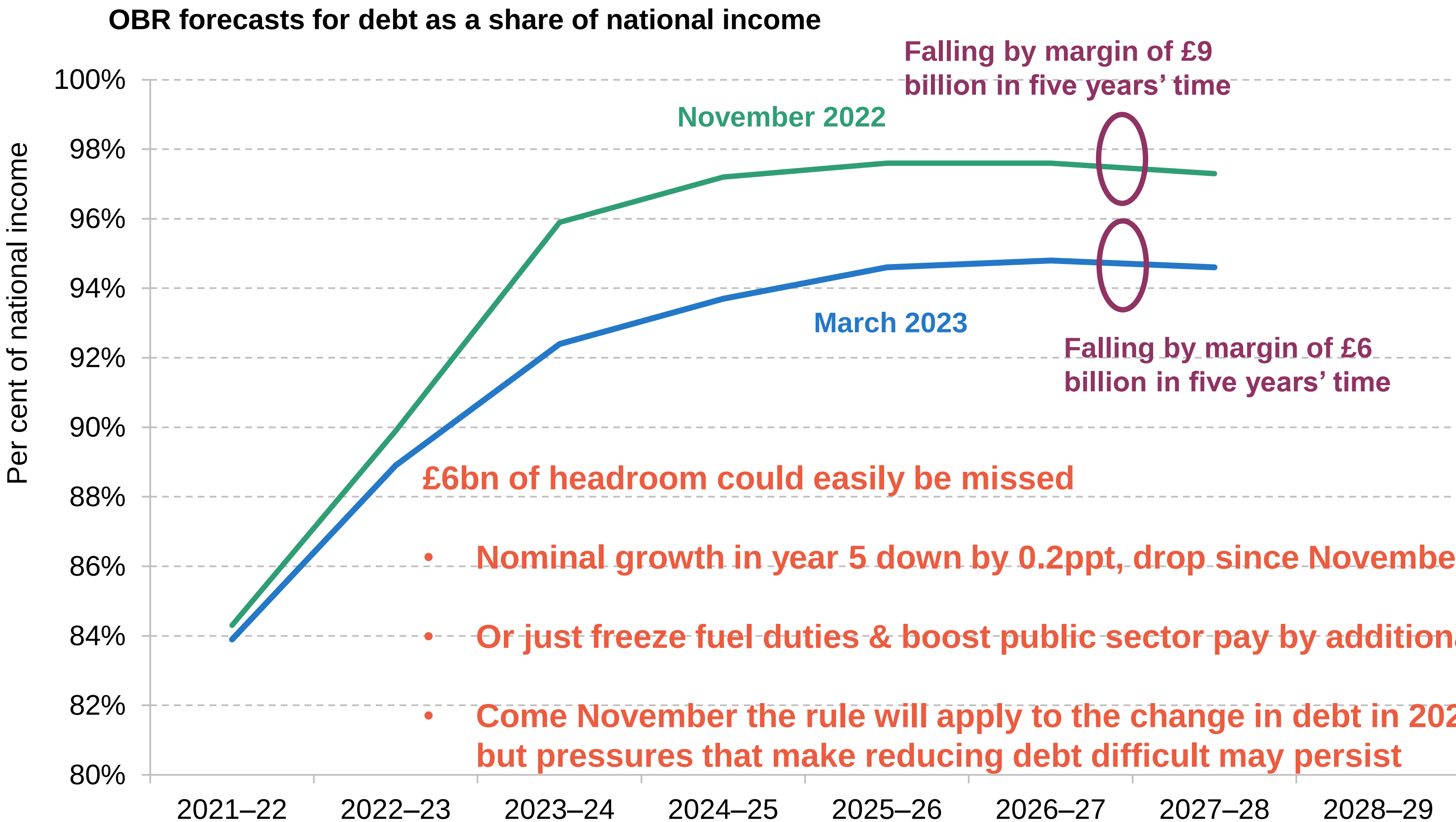
Partly due to rising taxes



A significant borrowing windfall



Tiny margin against poorly designed debt target



£6bn of headroom could easily be missed

- **Nominal growth in year 5 down by 0.2ppt, drop since November 0.4ppt**
- **Or just freeze fuel duties & boost public sector pay by additional 1%**
- **Come November the rule will apply to the change in debt in 2028–29, but pressures that make reducing debt difficult may persist**

How easy will reducing debt be?

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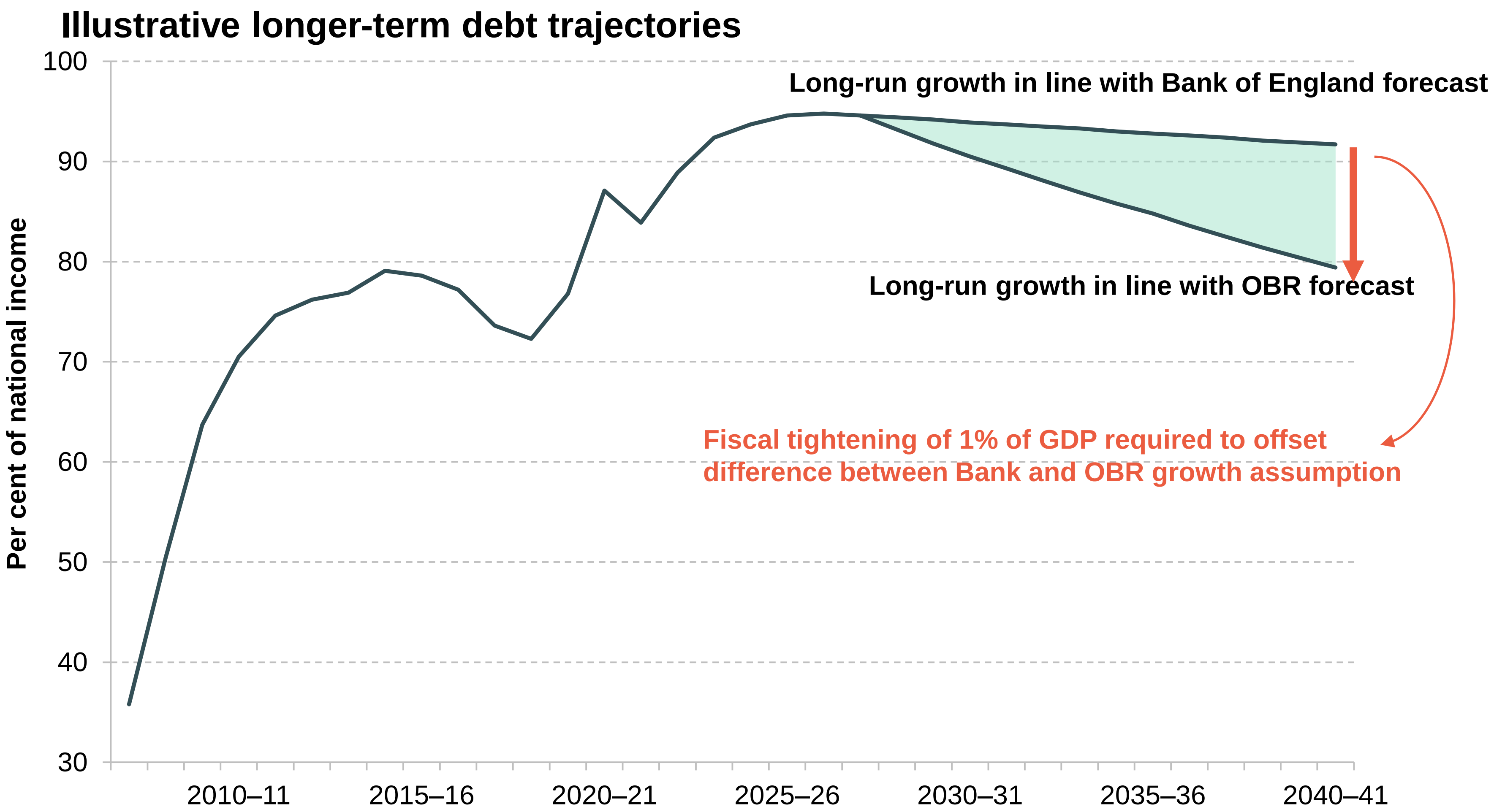
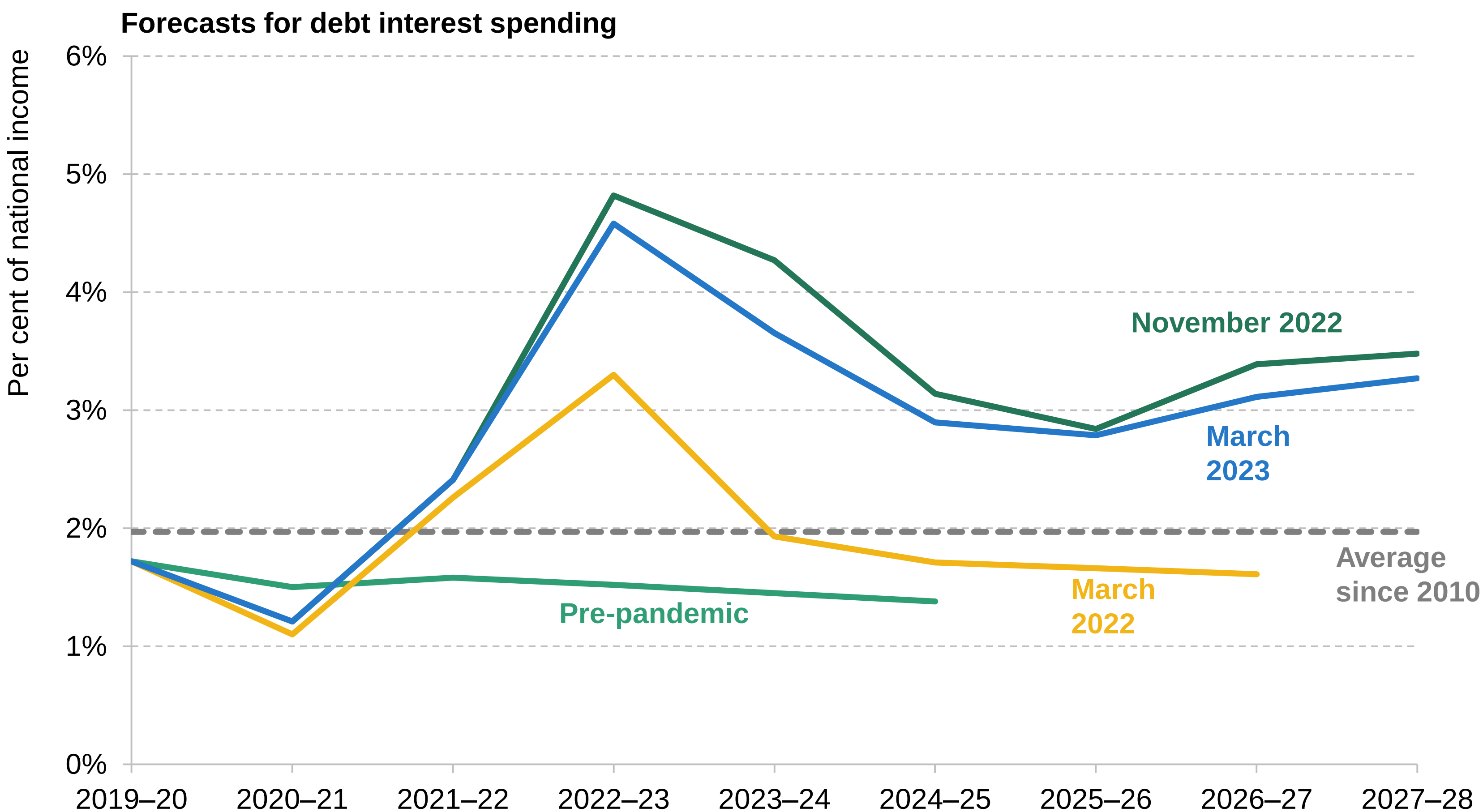


Notes: Underlying debt (excluding the Bank of England) shown. All post 2027–28 scenarios assume primary balance and long-run interest rates in line with OBR March 2022 Economic and Fiscal Outlook.

Debt interest spending still forecast to remain elevated



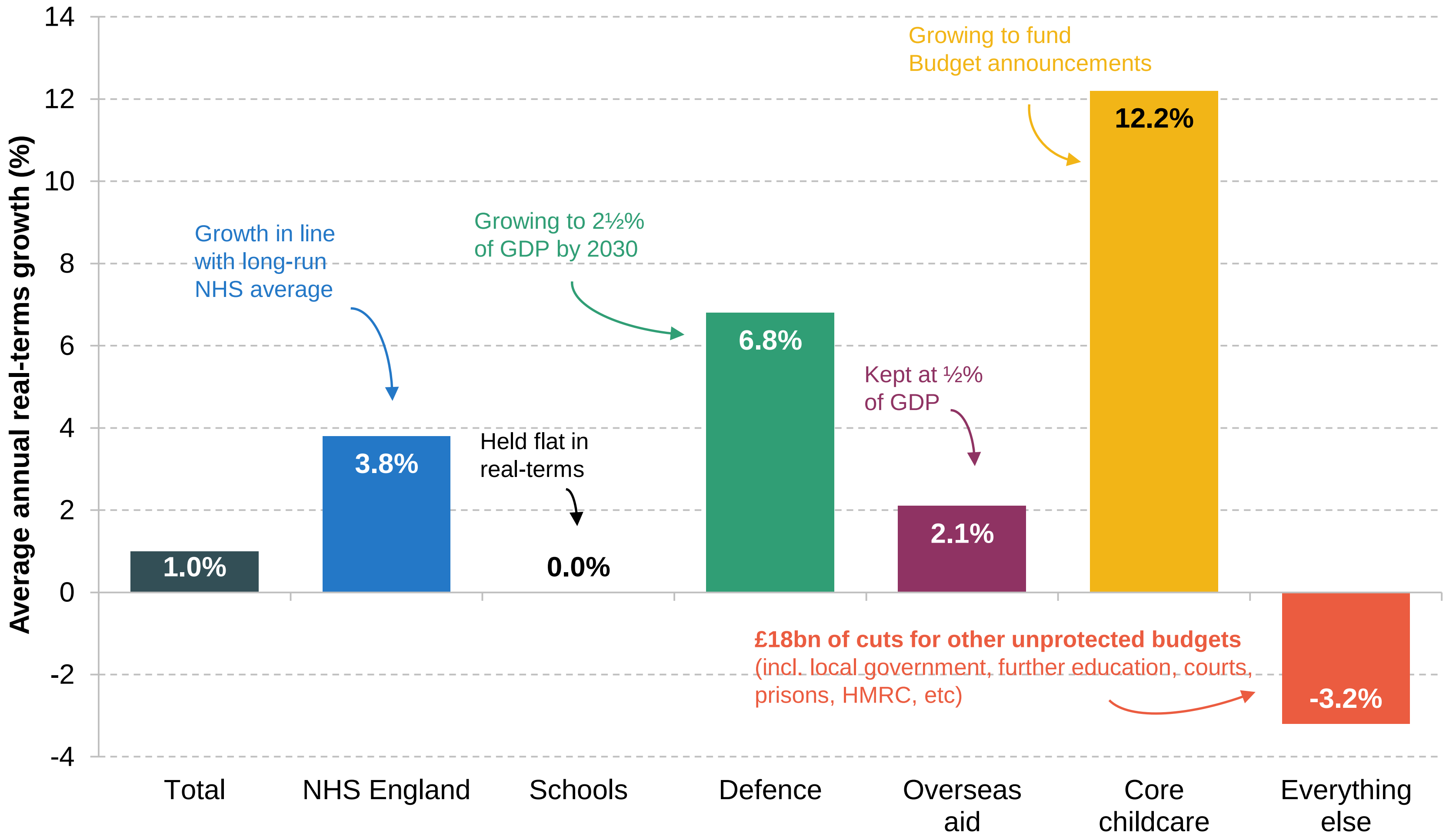
Risks to the forecast: spending

1. **Public sector pay pressures**
   - Nurses down 10% since 2010, experienced teachers down 13% even before this year
   - Departments say they can ‘afford’ awards of ~3.5% next year (2023–24)
     - OBR forecast 4.5% private sector pay growth, BoE more like ~5.5%
   - Matching private sector could add c. £2.5 – £5 billion to pay bill
   - Around £9 billion more to undo last year’s reduction vis-à-vis private sector
   - £14 billion ‘Reserve’ for 2023–24 could fund one-off/backdated pay awards

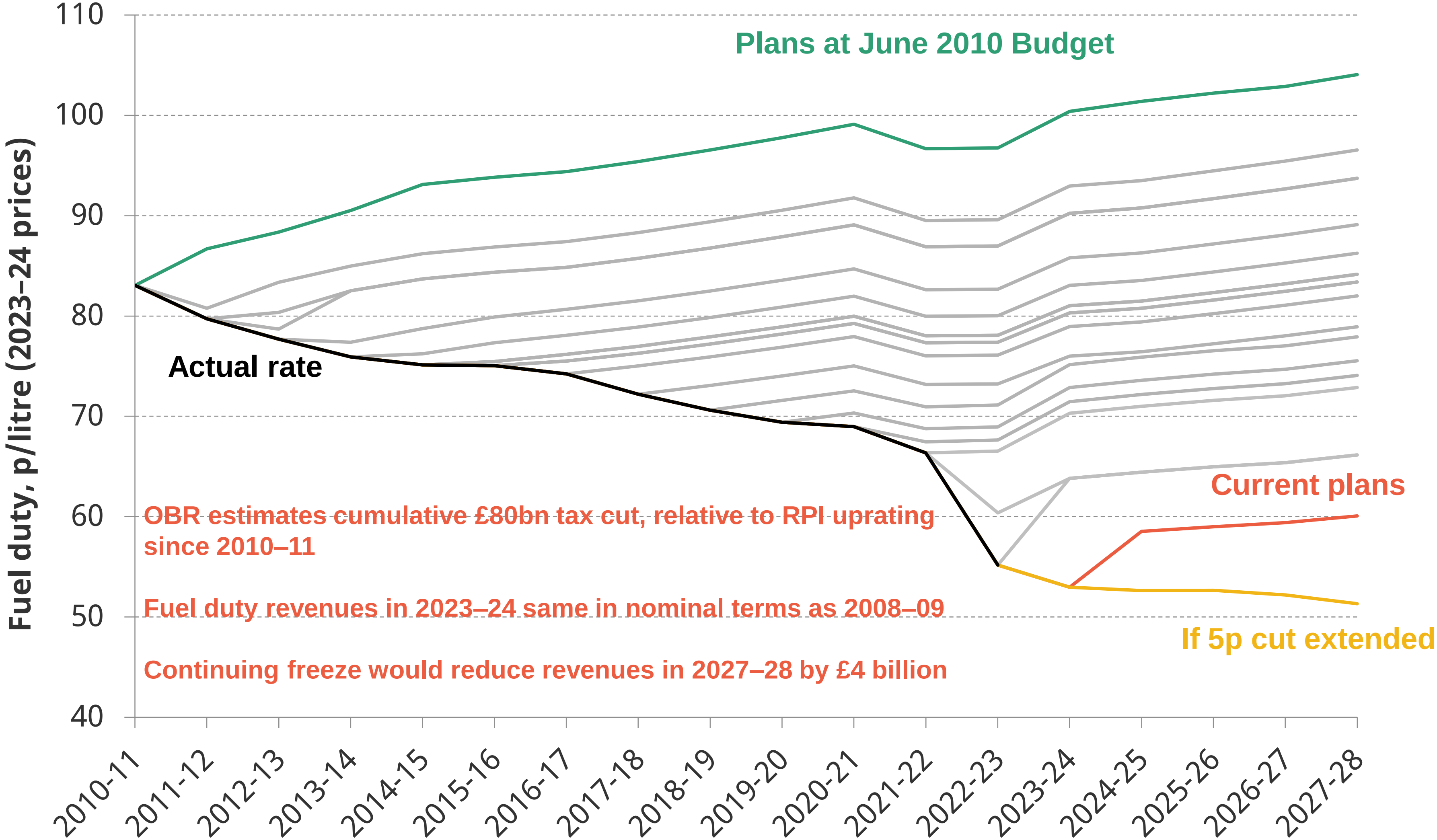
2. **Post-election spending plans**
   - The plans pencilled in for after 2025 imply cuts to some areas
     - Now look even tighter, given ambition to spend 2½% GDP on defence
   - True of both resource (day-to-day) and capital (investment) budgets

Cuts pencilled in for after the next election

Illustrative change in day-to-day funding implied by latest plans, 2024–25 to 2027–28



Risks to the forecast: fuel duty revenues



Conclusions

- Chancellor choose to give away rather than bank most of the improvement in borrowing over the next three years

- Despite a forecast return to current budget surplus a wafer thin margin of error against poorly designed debt target remains
  - possibly pushing Mr Hunt to some unwelcome policy decisions

- Pressures to tax less and spend more could leave debt rising
  - freezing fuel duties, retaining full expensing and avoiding departmental spending cuts could easily cost £25 billion