Outlook for the public finances

Isabel Stockton
Recapping the October Budget forecasts

- Public spending to settle at a higher share of national income post-pandemic

- Economic bounceback and substantial tax rises to deliver target of a forecast current budget surplus 3 years out
  - Taxes to reach their highest share of national income since 1950
Largest tax rises since 1989 to meet the current budget target

Notes: Policy costings are the final year forecast of the Treasury ‘scorecard’ at each fiscal event divided by nominal GDP as forecast at that fiscal event.

Sources: Office for Budget Responsibility, Policy measures database (Dec 2021), Historical official forecasts database (Oct 2021), Public finances databank (Feb 2022).

Outlook for the public finances
Recapping the October Budget forecasts

- Spending to settle at a higher share of national income post-pandemic
- Economic bounceback and substantial tax rises to deliver target of a forecast current budget surplus 3 years out
  - Taxes to reach their highest share of national income since 1950
- Borrowing to fall sharply, to below the pre-pandemic forecast
- But debt to fall only very modestly
Modestly lower borrowing this year does not affect ‘headroom’

Public sector net borrowing in 2021–22

£183bn

£29bn

£160bn

£6bn

£9bn

£4bn

OBR October forecast

Stronger revenues over Apr-Jan

If continuing Feb & March

Higher spending over Apr-Jan

Higher debt interest Feb & March (IFS)

Borrowing if no other changes

Note: receipts and spending excluding PSNB-neutral intra-public sector flows (the Asset Purchase Facility and local authority grants)

Outlook for the public finances
A gloomy outlook for real growth

Real growth forecasts

Sources: Office for Budget Responsibility, Economic and Fiscal Outlook (October 2021), Bank of England, Monetary Policy Report, November 2021 and February 2022

Outlook for the public finances
Inflation expected to be higher (again), and for longer

Sources: Office for Budget Responsibility, Economic and Fiscal Outlook (March and October 2021), Bank of England, Monetary Policy Report, February 2022, Office for National Statistics (series D7G7).
Impacts of higher inflation on the public finances

- Tax liabilities depend on cash quantities: nominal GDP matters more for revenues than real GDP
  - especially true when thresholds are frozen
- Policy decisions in response to higher inflation could add to borrowing
  - increases in departmental cash spending plans?
  - giveaways to households to help alleviate the squeeze on living standards
- About a quarter of the government’s debt is index-linked
  - we estimate higher RPI will increase debt interest by £11 billion in 2021–22
  - next year could easily add £20 billion or more
After years of downward revisions, debt interest is growing.

As a share of national income, 2021 increase ‘only’ reverses the fall in debt interest spending over 2020.

Sources: Office for Budget Responsibility, Historical Official Forecasts Database, Office for National Statistics (series NMFX)

Outlook for the public finances
Much larger rise in Bank Rate expected over coming financial year

Outlook for the public finances

Expectations for Bank Rate

Conclusions

- Borrowing this year, at around £160 billion, will be lower than the £183 billion forecast in the October Budget
  - despite £12 billion more being spent on debt interest
- Of more importance, in the coming year
  - higher inflation may push up debt interest by £20 billion or more
  - higher Bank Rate expected to push up debt interest by £11 billion due to quantitative easing
  - £9 billion outlay in response to energy price rises, as of early February
  - revenue-raising impact of inflation tempered by gloomy outlook for real growth (even before invasion of Ukraine)
- Additional giveaways to increase borrowing further?