Steady as we go
or a denial of reality?

Trevor Williams questions some of the data assumptions made in the recent Budget

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This Budget will not live long in the memory or the history books for its vision. It will, however, be remembered for seeing one of the fastest policy reversals of recent Budgets when it comes to tax increases. Fortunately, perhaps, it will also be remembered for being, at least under this Government and Chancellor, the last spring Budget. Recall though that Norman Lamont decided to do something similar about 20 years ago, but it never happened - because he got sacked.

Assuming that that does not happen to this Chancellor, the real action will be in the autumn of each year, as is the case in many other countries. In spring 2018, there will be a brief summary statement of where the Budget position is compared with the projections made the previous autumn.

Phillip Hammond lived up to his sobriquet of 'spreadsheet Phil'. Although there were lots of jokes, little in the way of new policy proposals were made, and there was no big 'vision' at the heart of the Budget. Maybe this was deliberate on the Chancellor's part.

He could be well aware that Budget decisions do not decide the path that the economy takes in the medium term. Much more important are trends in global oil prices, or what key trading partners are doing, or decisions made by the US Central Bank. It is clear that what Trump's USA does regarding its relationship with Russia or NATO or its protectionism will have huge ramifications for the UK economy. Also, if there is a crisis in Europe - our biggest trading area - the UK economy will be severely affected, and the Chancellor can only react.

Small fiscal impact

There were, of course, fiscal changes that will have a meaningful impact on the sectors or individuals affected – higher taxes for the self-employed, for instance, which did not go down well and could have broken a manifesto pledge not to increase National Insurance contributions (and were subsequently quickly revoked). Overall, though, the fiscal impact of the changes was quite small. One estimate is that there were 28 new measures this year, compared with 77 in the last Budget.

The economic forecasts were adjusted, and public sector borrowing and debt projections were pushed out one year and updated. These figures themselves tell a big story about the accuracy and usefulness of such a detailed level of forecasting. Comparing the forecasts made this year with those made last year by George Osborne shows a markedly different picture.

Despite the Brexit vote, the 2016 economic growth forecast of 2% made by George Osborne last year was close to the actual outturn of 1.8%. For this year, he predicted 2.2%, while Hammond has projected growth of 2%, again close. Of course, one could make the point that, if you cannot forecast growth for the year ahead with some degree of accuracy, then what's the point of the exercise?

Difficulties with forecasting

Further out, however, the GDP forecasts made by Mr Osborne currently seem hopelessly optimistic: out by 31% for 2018 (2.1% versus 1.6% by Hammond in the 2017 Budget) and 24% out for 2019 (2.1% versus 1.7%). True, the table shows that the economic forecasts converge by 2020, but who knows what will have happened by then? The clear lesson is that economic forecasts are easily blown off course by events and even one year ahead can have significant variations.

Consumer spending has grown more quickly than expected, but business investment is faring quite poorly. Weak investment spending has negative implications for productivity and long-term growth, wage levels, and ultimately also tax receipts and the Government's ability to spend in areas it deems necessary. Inflation is higher than predicted not just because of the impact of Brexit on the currency, which was declining anyway, but perhaps also due to a combination of the UK's persistent current account deficit and poor productivity.

More importantly, these economic assumptions have a very outsized impact on Government debt and borrowing figures – not least because of the cumulative effect of small changes interacting with the large size of the debt numbers. **Charts 1** and **2** show that public borrowing and debt and are much higher in Chancellor Phillip Hammond's Budget projections for the period ahead than those made last year by George Osborne.

Borrowing not surplus

Instead of a budget surplus of £11 billion by 2020, there is instead borrowing of £21 billion, a £30 billion difference. This difference shows up more starkly in the debt figures, as it cumulates over the period to 2020. Debt this year – 2016/17 – is already running at £1.73 trillion rather than the £1.64 trillion Osborne expected just a year ago.

Instead of declining in 2018/19, and peaking at around £1.7 trillion, net public sector debt is expected to rise to £1.9 trillion by 2020, some £164 billion more than expected in last year's Budget. These are large numbers, making up some 8% of UK GDP in 2020.

No sign of Brexit

The Budget was notable for one enormous omission: it barely mentioned Brexit. This omission might have been on the basis that too much of the deal is unknown at this point to make reasonable assumptions. Some assumptions could have been made, however, that were not, such as assuming a smaller inflow of migrants and assessing the economic impact that this could have on tax revenues and economic growth. And what about the payments to Brussels: a request of £60 billion for the EU as a divorce settlement is already well flagged. Where will that come from, if not from borrowing?

Assumptions in Budgets need to show less certainty and more uncertainty, with bigger margins of error and less in the way of spurious accuracy. The real world is not like the path shown in these projections, but littered with zig-zagging and twists and turns not currently considered in the Budget.

> "Budget decisions do not decide the path that the economy takes in the medium term. Much more important are trends in global oil prices, or what key trading partners are doing."

Chart 1: Net public sector borrowing, £bn

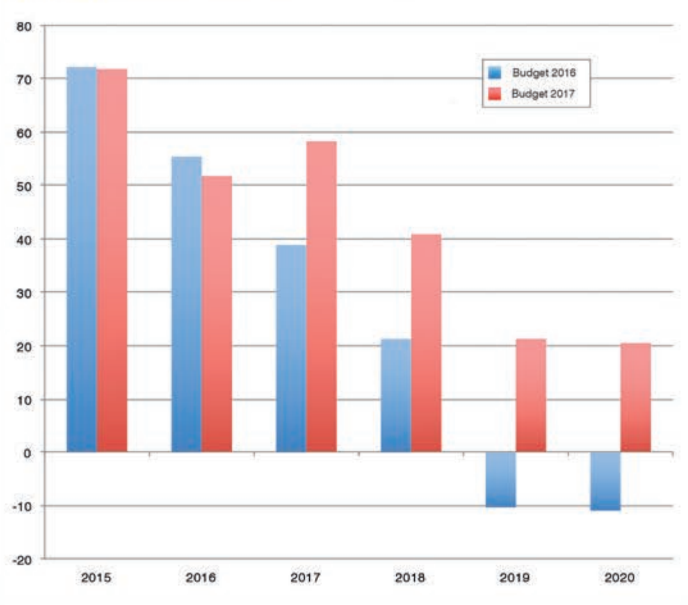

Chart 2: Net public sector debt, £bn