HOUSE OF COMMONS LIBRARY

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Spring Statement 2019

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Summary

The Chancellor, Philip Hammond, will make his Spring Statement on 13 March 2019. The Office for Budget Responsibility (OBR) will publish revised forecasts for the economy and public finances on the same day.

The Chancellor's statement is likely to largely be a response to the OBR's forecasts.

Brexit: votes in Parliament (section 1.2)

Spring Statement 2019 is set to take place at a time when Parliament's attention will be focused on the UK's withdrawal from the EU. In particular, the House of Commons is set to have a 'meaningful vote' on the EU-UK Withdrawal Agreement and framework for the future relationship on or before 12 March 2019. If the Commons again rejects the deal, there will be a vote on whether MPs support leaving the EU without a deal, on 13 March. If the Commons rejects leaving without a deal, there will be a vote on requesting an extension of the withdrawal process (Article 50), on 14 March.

Brexit: the OBR's forecasts (section 1.2)

Forecasting is difficult at the best of times. The UK's withdrawal from the EU makes it even more so, not least because Brexit isn't a momentary event, but an extended process of changing policy.

Since the EU referendum result the OBR has assumed that the UK-EU negotiations "lead to an orderly transition to a new long-term relationship, whatever that relationship may be." If the UK's withdrawal is less than orderly, then the OBR's outlook for the economy and public finances is likely to become more pessimistic in future forecasts.

Economic situation (section 2)

GDP growth of 1.4% in 2018 was the slowest since 2012, with growth easing towards the end of the year. Two key factors behind this slowdown were a weaker global economy and uncertainty related to Brexit.

The world economy has been characterised by the Chinese economy growing less quickly, trade tensions (particularly between the US and China), and a sharply slowing Eurozone economy. Domestically, Brexit-related uncertainty has been blamed for falling business investment as the UK approaches its scheduled date for leaving the EU on March 29. Consumer spending has underpinned growth recently, supported by a historically-high proportion of the population in employment and average wage growth starting to pick-up.

The outlook for 2019 is dominated by Brexit and on what terms the UK leaves the EU. Under an assumption of an 'orderly' or 'smooth' departure from the EU, GDP growth of around 1-1½% for 2019 is generally forecast by economists. Should the UK leave the EU without a deal, disruption is expected to lead to weaker growth. The Bank of England Governor Mark Carney has said he "guarantee[s]" the Bank's GDP forecasts would be lowered in such a scenario. The OBR has

previously warned that there could be severe short-term implications of a no-deal Brexit, although the scale is hard to predict.

Public finances (section 3)

Government borrowing has decreased from the peaks reached following the 2007-2008 financial crisis, and is now at a more typical level. Government borrowed £42 billion in 2017/18 to make up the difference between its spending and income raised from taxes and other sources. At 2% of GDP, this was below the average for the past 70 years.

While the Government's borrowing situation has improved, its debt – broadly speaking the stock of past borrowing – remains high. Public sector net debt at the end of 2017/18 was equal to 85% of GDP. The debt-to-GDP ratio was last above 85% in the mid-to-late 1960s, when it was still recovering from reaching over 200% of GDP during World War II.

Further information

The Library will publish a summary of Spring Statement 2019 on the evening of 13 March.

The Library will publish its summary of UK Economic Indicators before the Budget.

1. Spring Statement and Brexit

1.1 The second Spring Statement

The Chancellor, Philip Hammond, will make his Spring Statement on 13 March 2019.

Recent tradition had seen the Chancellor of the Exchequer present the Budget in spring. However, the current Chancellor moved the Budget to autumn, and has introduced a Spring Statement starting in 2018.

What can we expect from the statement?

On the day, the Office for Budget Responsibility (OBR) – the UK's public finances watchdog – will publish its updated forecasts for the economy and public finances. The Chancellor's Spring Statement will largely provide a formal response to the OBR's forecasts. The OBR is required to present updated forecasts twice a year (they publish their other set of forecasts alongside the autumn Budget).[1] As part of its forecast, the OBR will assess the Government's progress against their targets for the public sector finances (see section 2.3)

The Chancellor does not envisage using Spring Statements as an opportunity to make new spending or tax announcements: he has said that Spring Statements will be 'no major fiscal event'.

If unexpected economic changes require it, the Chancellor has reserved "the right to announce actions at the Spring Statement", but has said that he "will not make significant changes twice a year just for the sake of it."[2]

The wider challenges for the economy and public finances may be reviewed at the Spring Statement, and consultations launched on how they may be addressed.[3]

1.2 Brexit

Key votes in Parliament

Spring Statement 2019 is set to take place at a time when Parliament's attention will be focused on the UK's withdrawal from the EU:

- The House of Commons is expected to have a "meaningful vote" on the Withdrawal Agreement and the framework for the future relationship by 12 March 2019;[4]
- If the Withdrawal Agreement is not approved in the meaningful vote then there will be a vote on whether MPs support leaving the EU without a deal on 13 March 2019. If MPs do not support a no-

1 The requirement is laid out in the Charter for Budget Responsibility
2 HC Deb 23 November 2016 c910
3 HM Treasury press notice, *The new Budget timetable: 7 things you need to know*, 23 November 2016
4 The Library briefing A User's Guide to the Meaningful Vote explains what the meaningful vote is and Parliament's role in approving the Withdrawal Agreement.

deal Brexit, then on 14 March 2018 MPs will vote on requesting an extension to the two-year Article 50 negotiation process;[5]

- The European Council (the heads of state or government of the Member States) will meet on 21-22 March;
- If Article 50 is not extended, the UK will cease to be an EU Member State on 29 March 2019, either with a Withdrawal Agreement or without (following a vote by MPs to support a no-deal exit).[6]

The "meaningful vote" is set to take place days (or even a day) before Spring Statement 2019: the result of the vote may have an impact on the tone and content (and potentially the date) of the Chancellor's statement.

Whatever the result of the "meaningful vote" it will not come in time for the OBR to factor the outcome into their forecasts for the economy and public finances. Broadly speaking, the forecast process takes 10 weeks with the OBR providing its final forecast during the week before the statement. The following section explains how the fiscal watchdog have incorporated Brexit into their forecasts since the referendum result.

The OBR: forecasting and Brexit

The OBR is required to produce its forecasts for the economy and public finances on the basis of current Government policy and the forecasts are adopted by the Government as their official forecasts.[7] The OBR cannot consider alternative policy scenarios. This means that the OBR cannot produce forecasts based on different outcomes for the UK's withdrawal from the EU.

Forecasting is difficult at the best of times. The UK's withdrawal from the EU makes it even more so. As the OBR explains, this is because it isn't a momentary event, but an extended process of policy development "to which the economy and the public finances are already responding in real time – based not just on concrete policies implemented, but also (especially to date) on how decision makers in both the public and private sectors expect policy to evolve."[8]

Since the referendum result, the OBR's forecasts have been based on some broad brush assumptions about the UK's withdrawal and its potential impact.

What has the OBR assumed about the impact of the referendum result and Brexit?

After the EU referendum the OBR downgraded its economic forecasts. In the short to medium term, the downgrade was based on the OBR's judgement that Brexit related uncertainty will lead firms to delay

5 See the Library Insight The Brexit timetable: One promise. Two weeks. Three key votes for more on the votes
6 The Library briefing paper, Extending Article 50: could Brexit be delayed? explains the Article 50 process and how the process could be extended
7 The Government retains the right to disagree with the OBR's forecasts and, if this is the case, will explain why to Parliament. The Government has not yet disagreed.
8 OBR, Discussion paper No. 3: Brexit and the OBR's forecasts, October 2018, para 1.2

investment and consumers will be squeezed by higher import prices, following the post-referendum fall in the pound.

In terms of the period after the UK leaves the EU, the OBR has attempted to base its judgements on Government policy but, as the final outcome will depend on further UK policy development as well as the result of negotiations with the EU, the OBR has had "no meaningful basis" for predicting the future EU-UK relationship.[9] Faced with this uncertainty, the OBR has made some broad-brush judgements – consistent with most external studies – about the period after Brexit. The OBR assumes that for the period of its five-year forecasts any likely Brexit outcome will lead to: lower trade flows; lower business investment; and lower net inward migration than would otherwise have been seen. Taken together these result in lower potential economic output.[10]

In its October 2018 forecast, the OBR incorporated the transition period in which the EU-UK trading relationship will remain as it is now. This delays the expected decline in trade intensity once the UK leaves the EU but has no material impact on economic growth.[11]

In the longer term the OBR says that decisions made by UK Governments in areas such as trade and regulation will determine whether future economic growth is enhanced or impeded.[12] The Government has published analysis of the long-term impact of Brexit on the economy. The Library Insight [Brexit and the economy: Government analysis of the long-term impact] summarises the Government's analysis.

While the OBR has set out how it incorporates Brexit in its forecasts, it notes that there is "significant uncertainty about the effects of Brexit on the UK economy, especially since no major country has left the EU or a similar trading bloc".[13]

What has the OBR assumed about Brexit negotiations?

Since the referendum, the OBR has assumed that the UK-EU negotiations "lead to an orderly transition to a new long-term relationship, whatever that relationship may be. This implies reaching a Withdrawal Agreement in time for it to be ratified by the UK and European Parliaments before the UK is due to leave the EU at 11pm on 29 March 2019."[14]

If the UK's exit turns out to be less orderly than the OBR assumes then its outlook for the economy and public finances is likely to become more pessimistic in future forecasts. The OBR has said that a disorderly exit "could have a severe short-term impact on demand and supply in the economy and on the public finances."[15]

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9 OBR. Economic and fiscal outlook – October 2018, para 1.17
10 OBR. Economic and fiscal outlook – November 2016, para 1.5
11 OBR. Economic and fiscal outlook – October 2018, para 3.4
12 OBR. Economic and fiscal outlook – November 2016, para 1.5
13 OBR. Discussion paper No. 3: Brexit and the OBR's forecasts, October 2018 para 5.16
14 ibid, para 1.23
15 ibid., para 5.15

2. Economic situation

Summary

GDP growth of 1.4% in 2018 was the slowest since 2012, with growth easing towards the end of the year. Two key factors behind this slowdown were a weaker global economy and uncertainty related to Brexit.

The world economy has been characterised by the Chinese economy growing less quickly, trade tensions (particularly between the US and China), and a sharply slowing Eurozone economy. Domestically, Brexit-related uncertainty has been blamed for falling business investment – it fell in every quarter of 2018 – as the UK approaches its scheduled date for leaving the EU on 29 March. Consumer spending has underpinned growth recently, supported by a historically-high proportion of the population in employment and average wage growth starting to pick-up.

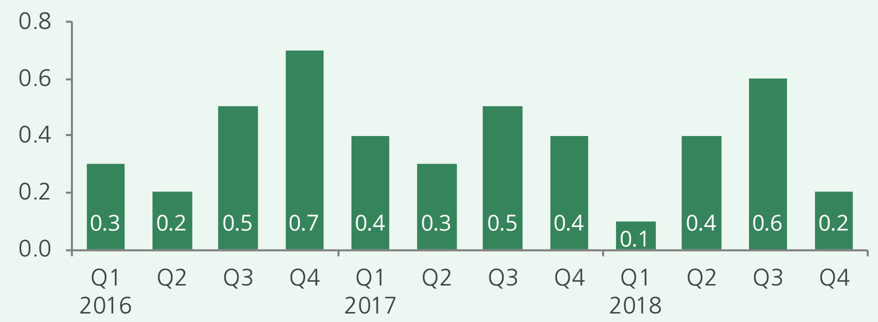
The outlook for 2019 is dominated by Brexit and on what terms the UK leaves the EU. Most forecasts, including those from the Office for Budget Responsibility (OBR), assume an 'orderly' or 'smooth' departure with a transition period – with the economic relationship between the UK and EU essentially unchanged – being implemented until the end of 2020. Under this assumption, GDP growth of around 1-1½% for 2019 is generally forecast by economists. Should the UK leave the EU without a deal, disruption is expected to lead to weaker growth – Bank of England Governor Mark Carney has said he "guarantee[s]" the Bank's GDP forecasts would be lowered in such a scenario. The OBR has previously warned that there could be severe short-term implications of a no-deal Brexit, although the scale is hard to predict.

2.1 Recent economic developments

Economic growth slowed towards end of 2018...

Annual GDP growth of 1.4% in 2018 was the slowest since 2012.[16] GDP was volatile over the course of the year: a relatively strong period of growth during the middle of the year was sandwiched between weakness at the beginning and end of 2018.

GDP growth slowed at end of 2018
% change in GDP compared with previous quarter



Source: ONS, series IHYQ

Periods of severe winter weather contributed to the poor performance in the first quarter of 2018: GDP growth was 0.1% in Q1 2018 compared with the previous quarter. Strong recoveries in the

16 ONS, series IHYP

construction and retail sectors subsequently supported a pick-up in GDP growth in the spring and summer: 0.4% in Q2 and 0.6% in Q3 2018.[17]

Growth slowed to 0.2% in the final quarter, due mostly to a large quarterly decline in manufacturing production and slowing growth in services sector output (partly due to sluggish retail sales). In addition, construction output fell slightly during the quarter.[18]

Brexit-related uncertainty, particularly as it relates to falling business investment, may also have played a role. Commenting on the GDP data for Q4 2018, the Chancellor said that Brexit uncertainty was "overshadowing" the economy:

> ...there is no doubt that our economy is being overshadowed by the uncertainty created by the Brexit process and the sooner we can resolve that the better, the quicker we can get back to more robust growth in the future.[19]

Data for GDP growth in January 2019 will be published at 9.30am on Tuesday 12 March, the day before the Spring Statement is scheduled.[20] The Library's economic indicator page on GDP will be updated shortly after the Office for National Statistics release the data.[21]

...as did the world economy

A period of subdued UK growth came against the backdrop of a weaker global economy. After entering 2018 on its strongest footing since the 2008/09 global financial crisis, the world economy has slowed. The slowdown in the pace of Chinese economic growth, global trade tensions (most notably between the US and China) and rising interest rates in the US – which have knock-on effects around the world – were three of the contributing factors.

Slowing growth has been particularly evident in the Eurozone, where GDP rose by 0.2% on a quarterly basis in both Q3 and Q4 2018 (after 0.4% in Q1 and Q2, and 0.7% on average in 2017). The German economy, the largest in Europe, has seen growth hit the buffers, with its economy contracting by 0.2% in Q3 2018 and then recording no growth in Q4.[22]

All this has resulted in weaker global trade growth. This weaker demand has been evident in UK export figures.[23] Exports, in volume terms, grew by just 0.2% in 2018, with goods exports falling by 0.3% and services exports rising by 0.7%.[24]

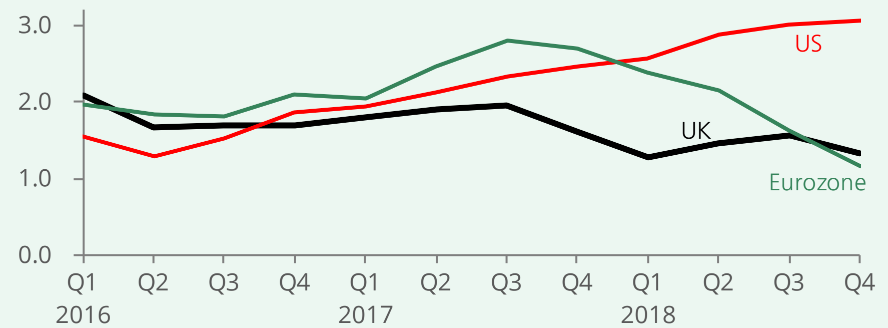
Largely bucking this trend, the US economy continued to grow strongly throughout 2018, boosted by tax cuts, higher government spending and low unemployment. More recently there have been signs that

17 ONS, GDP first quarterly estimate, UK: October to December 2018, 11 February 2019
18 ibid.
19 Interview with Sky News, 11 February 2019
20 The new data will be available at ONS, GDP monthly estimate
21 Library briefing paper, Gross Domestic Product (GDP): Key Economic Indicators
22 OECDstat, Quarterly National Accounts, GDP growth [accessed 5 March 2019]
23 Bank of England, Inflation Report: February 2019, p15
24 ONS, GDP first quarterly estimate, UK: October to December 2018, 11 February 2019, table H2

economic growth may ease in 2019, with the effects of the tax reforms set to fade and uncertainty with regards to trade remaining.[25]

While recording growth at an annual rate of close to 3% in the second half of 2017, the Eurozone has noticeably slowed and at 1.2% in Q4 2018 was slightly below the UK's growth rate of 1.3%, on this basis.[26]

Eurozone growth has slowed sharply during 2018
Year-on-year % change in GDP

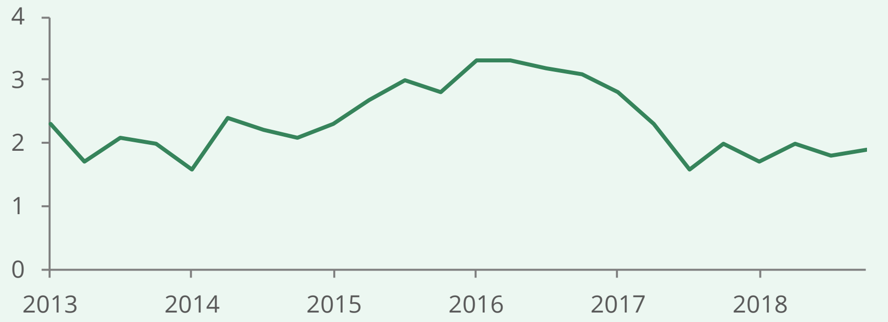


Source: OECDstat

Consumer spending the main source of growth

The UK economy in 2018 was supported by consumer spending, which contributed 1.2%-points out of the overall 1.4% growth rate.[27] Despite this *relatively* strong performance compared with other parts of the economy, consumer spending growth has been subdued of late when measured against historical trends.[28]

Consumer spending growth stable over 2018
% change on previous year



Source: ONS, series KGZ7

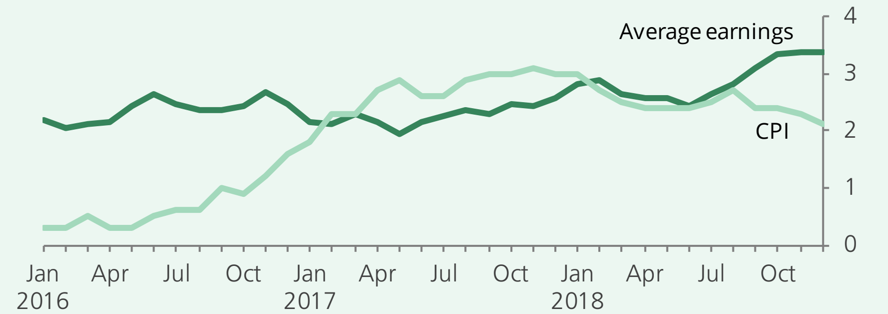
Household budgets were squeezed following the post-referendum fall in the value of the pound, which increased import prices. This effect has now faded. The CPI annual inflation rate has declined over the past year, from 3.0% in January 2018 to 1.8% in January 2019.[29] It is

25 Speech by Gertjan Vlieghe, Bank of England MPC member, "The economic outlook: Fading global tailwinds, intensifying Brexit headwinds", 14 February 2019
26 OECDstat, Quarterly National Accounts, GDP growth [accessed 5 March 2019]
27 ONS, GDP first quarterly estimate, UK: October to December 2018, 11 February 2019, table AB, series ZZ6M
28 ONS series KGZ7
29 ONS, Consumer price inflation, UK: January 2019, 13 February 2019

forecast to remain close to 2% during 2019, assuming a smooth Brexit.[30]

Average earnings growth has begun to accelerate, to 3.4% on an annual basis in Q4 2018, resulting in real (inflation-adjusted) earnings increasing again. Wage growth has been modest since the 2008/09 recession, while average real wage levels are still below that seen since before the recession.[31]

Average earnings growth now outpacing inflation
% change in average earnings and CPI inflation compared with year before



Source: ONS, series KAB9 (AWE) and D7G7 (CPI); three-month average data to month shown

With the proportion of working-age people in work (75.8% in Q4 2018) at its joint-highest level since comparable records began in 1971 and the unemployment rate (4.0%) the joint-lowest since 1975, the performance of the labour market has been described as "remarkably robust".[32]

Should the trend of high employment and rising real incomes continue, it will provide support for consumer spending growth in 2019. However, there are other factors that may act to weaken consumer spending, including:

- The household **saving ratio** – the proportion of disposable income not spent – is at very low levels (4.3% in Q3 2018), suggesting consumers are unlikely to reduce savings rates much further and may save more (thereby reducing spending growth).[33]
- The **housing market** is subdued, with UK house price inflation of 2.5%, the lowest annual rate since July 2013.[34]
- **Consumer confidence**, as measured by GfK, dipped towards the end of 2018 and remained stable in the early month of 2019. The survey suggests consumers' future expectations of

[30] HM Treasury, Forecasts for the UK economy: February 2019, 20 February 2019 [to be clear, these are not Treasury forecasts but a survey of independent economists]
[31] ONS, UK labour market: February 2019, 19 February 2019
[32] Ibid. and speech by Gertjan Vlieghe, Bank of England MPC member, "The economic outlook: Fading global tailwinds, intensifying Brexit headwinds", 14 February 2019
[33] ONS series NRJS
[34] ONS, UK House Price Index: December 2018, 13 February 2019

the overall economy have deteriorated over the past year, while their view of their own personal finances has remained stable.[35]

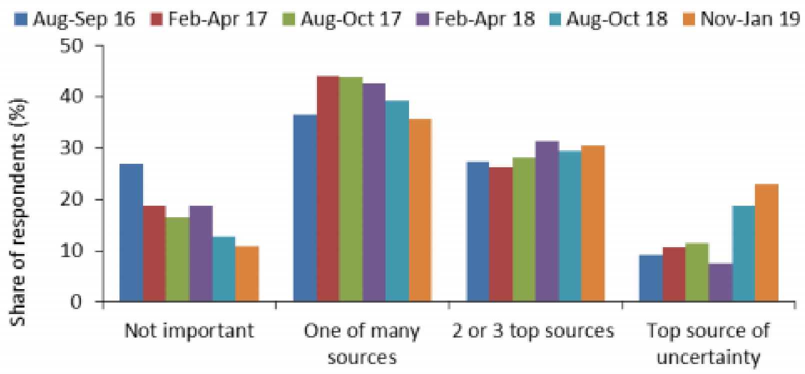
And the biggest unknown of all relates to **Brexit**. At the time of writing, parliament was due to vote on whether to approve the Prime Minister's Withdrawal Agreement with the EU by 12 March (see section 1.2). Consumers may become more cautious if the prospect of leaving the EU without a deal increases, or indeed if the UK leaves without a deal.

Business investment has declined

Business investment fell by 0.9% in 2018 compared with 2017. On a quarterly basis, business investment fell in all four quarters of 2018. Looking at changes over the previous year, in Q4 2018 business investment was down 3.7% compared with the same quarter a year earlier (Q4 2017).[36]

Many economists believe this poor performance is related to uncertainty over Brexit and the UK's future trading relationship with the EU, with firms delaying or cancelling investment.[37] This reflects business surveys, such as the Bank of England's Decision Maker's Panel which shows a growing number of firms citing Brexit as a key source of uncertainty (see chart from Bank of England below).[38]

Figure 13: Decision Maker Panel results of Brexit as a source of uncertainty



Notes: Bars show responses to the question "How much has the result of the EU referendum affected the level of uncertainty affecting your business?"

Source: Decision Maker Panel, Bank of England calculations

Other surveys reflect similar findings. For example, Deloitte's Q4 2018 survey of Chief Financial Officers of large UK companies found that Brexit was cited as the top risk factor facing businesses.[39]

At the time of writing, parliament had not approved the Brexit Withdrawal Agreement, which would result in a transition period after

35 GfK press release, "UK Consumer Confidence is "stoic amid fear of the unknown"", 28 February 2019
36 ONS, GDP first quarterly estimate, UK: October to December 2018, 11 February 2019, table C2 of PDF
37 For example see National Institute of Economic and Social Research (NIESR), Prospects for the UK economy, 6 February 2019
38 Speech by Gertjan Vlieghe, Bank of England MPC member, "The economic outlook: Fading global tailwinds, intensifying Brexit headwinds", 14 February 2019
39 Deloitte, Deloitte CFO Survey: 2018 Q4, February 2019; this is a quarterly survey of 110 CFOs of mostly large private companies

Brexit whereby the UK remains in the EU Single Market and Customs Union until at least the end of 2020.

The Chancellor has stated that he believes there is some pent-up investment in the economy as a result of the Brexit uncertainty that could be "unleashed" in the event of a Brexit deal being agreed by parliament (see section 3.3 for more on what the Chancellor has called the "deal dividend"):

> …my view is that we have a huge amount of pent-up investment that has not gone ahead over the last two and a half years because of uncertainty. Once we can provide clarity to British business about our future, which we do by supporting the deal that my right hon. Friend the Prime Minister will be bringing forward next week, we will unleash that investment…[40]

2.2 Economic outlook

Modest GDP growth expected in early 2019

The economic slowdown seen towards the end of 2018 – quarterly GDP growth was 0.2% in Q4 2018 – is expected to have continued in the first few months of 2019. The Bank of England in its February *Inflation Report* forecast GDP growth of 0.2% in Q1 2019, the same as estimated by the National Institute of Economic and Social Research's (NIESR) 'GDP tracker'.[41]

Economic indicators, such as the IHS Markit Purchasing Managers' Surveys (PMI), have reported business activity growing but fairly weakly in the first few months of the year. The latest services sector PMI suggested Brexit-related uncertainty is playing a role in holding back activity:

> Reports from survey respondents suggested that Brexit-related uncertainty remained by far the most prominent factor acting as a brake on business activity growth in February. There were widespread reports that political uncertainty had encouraged delays to corporate spending decisions and a general rise in risk aversion among clients.[42]

More upbeat retail sales figures – which are not included in the services PMI indicator – from January suggest consumer spending could support GDP growth in Q1 2019.[43]

OBR unlikely to change its growth forecasts much

The average among forecasters surveyed in February was for GDP growth of 1.4% for 2019 as a whole.[44] The Bank of England's Monetary Policy Committee in early February forecast growth of 1.2%.[45] These forecasts expect consumer spending to be the key driver

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40 HC Deb 5 March 2019, c790

41 Bank of England, Inflation Report: February 2019, p10 and NIESR, latest GDP tracker, 11 Feb 2019

42 IHS Markit/CIPS UK services PMI news release, 5 March 2019

43 ONS, Retail sales, Great Britain: January 2019, 15 February 2019

44 HM Treasury, Forecasts for the UK economy: February 2019, 20 February 2019 [to be clear, these are not Treasury forecasts but a survey of independent economists]

45 Bank of England, Inflation Report: February 2019, p.38, table 5.G

of growth, with some support from increased government spending and tax cuts as announced in the Autumn Budget 2018.[46]

At the time of Autumn Budget 2018 the Office for Budget Responsibility (OBR) forecast GDP growth of 1.6% for 2019 and 1.4% for 2020.[47] The OBR is unlikely to make large revisions to these forecasts given the economic developments since then.

Previous OBR forecasts for GDP growth
Annual GDP growth (%); OBR forecasts from Mar'18 and Oct'18

Source: OBR, Economic and fiscal outlook, Mar'18 and Oct'18

Forecasts assume a 'smooth' Brexit

Most economic forecasters, including those from the Bank of England and the OBR, assume that there will be a Withdrawal Agreement and therefore a transition period – where the UK remains in the EU single market and customs union – after the UK leaves the EU, currently scheduled for 29 March 2019. There will then be an orderly transition to a new long-term UK-EU relationship, whatever that will be. This is often referred to as a 'smooth' or 'orderly' Brexit.

As described in section 1.2, the OBR will likely continue with its approach of assuming an 'orderly' Brexit with a transition period at the Spring Statement. With regards to the possibility of a 'disorderly' Brexit, such as in a 'no-deal' departure, the OBR said in October that this could have severe short-term implications:

> In the near term, it is worth emphasising that this forecast assumes a relatively smooth exit from the EU next year. A disorderly one could have severe short-term implications for the economy, the exchange rate, asset prices and the public finances. The scale would be very hard to predict, given the lack of precedent.[48]

In late February the Government published a report on the preparedness of government and business for a no-deal Brexit on 29 March 2019, which stated that "the impact of a 'no deal' scenario is expected to be significant in a number of areas" and concluded that many businesses were not prepared for no deal:

> Despite communications from the Government, there is little evidence that businesses are preparing in earnest for a no deal

46 For more see Library briefing paper, Autumn Budget 2018: A summary, 29 October 2019
47 OBR, Economic and fiscal outlook – October 2018, 29 October 2018, table 3.10
48 OBR, Economic and fiscal outlook – October 2018, 29 October 2018, p7, para 1.12

> scenario, and evidence indicates that readiness of small and medium-sized enterprises in particular is low.[49]

In late February Bank of England Governor Mark Carney told the Treasury Select Committee that in the event of a no-deal Brexit he "guarantees" that the Bank's GDP forecasts would be lowered:

> If we come back in May [the date of the next Bank forecast], if there is no deal and no transition, I guarantee you the path of GDP in our forecast will be materially lower than it is in this February forecast, which assumes that there is a deal and a smooth transition. By the way, that is absolutely the view of businesses up and down this country.[50]

For more on the potential impact of a no-deal Brexit and on the economic impact of Brexit more generally, see the following Library briefings:

- *Brexit deal: Economic analyses*, December 2018
- *What if there's no Brexit deal?*, February 2019

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49 HM Government, Implications for Business and Trade of a No Deal Exit on 29 March 2019, 26 February 2019

50 Bank of England Governor Mark Carney, Commons Treasury Select Committee, Bank of England Inflation Reports – oral evidence, 26 February 2019, Q388

3. The public finances

Summary

Government borrowing has decreased from the peaks reached following the 2007-2008 financial crisis, and is now at a more typical level. Government borrowed £42 billion in 2017/18 to make up the difference between its spending and income raised from taxes and other sources. At 2% of GDP, borrowing was below the average for the past 70 years.

Government borrowing has continued to fall during 2018/19 and the Office for Budget Responsibility (OBR) forecast that it will fall further over the next five years. However, Brexit uncertainty makes the OBR's job of producing forecasts more challenging than usual.

While the Government's borrowing situation has improved, its debt – broadly speaking the stock of past borrowing – remains high. Public sector net debt at the end of 2017/18 was equal to 85% of GDP. The debt-to-GDP ratio was last above 85% in the mid-to-late 1960s, when it was still recovering from reaching over 200% of GDP during World War II.

In its forecasts, the OBR will assess the Government's progress against its targets for borrowing and debt. The Treasury Committee has questioned whether the Government's overall objective for borrowing – reaching a budget surplus in the mid 2020s – accurately reflects the Chancellor's priorities and plans. In Autumn Budget 2018, rather than reach a forecast budget surplus in 2023/24 the Chancellor chose to increase spending.

3.1 Government borrowing (the deficit)

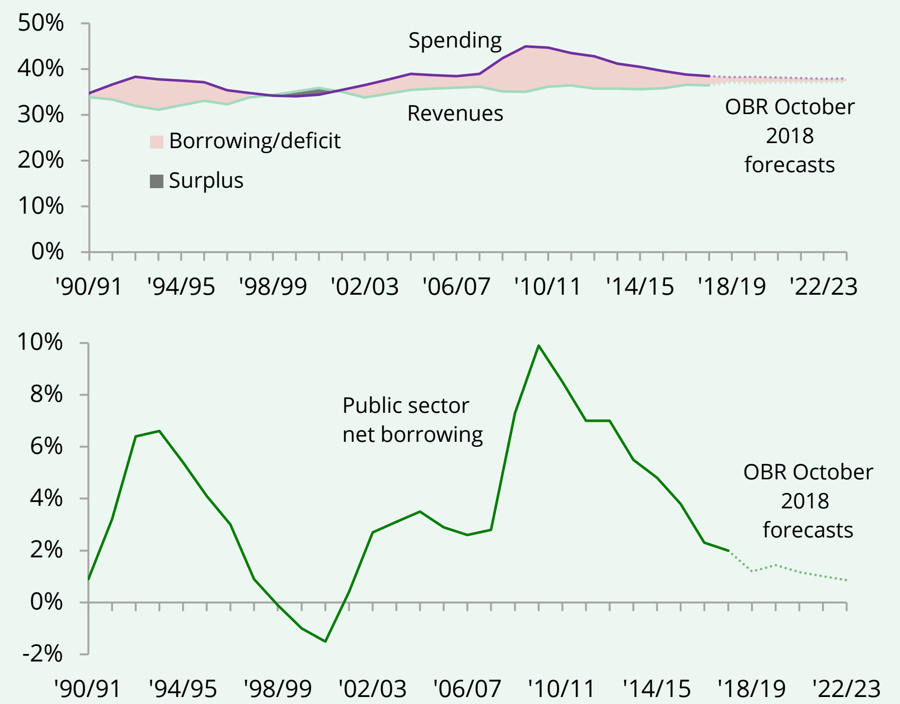
When the Government spends more than the revenue it raises from taxes and other sources it has to borrow. In 2017/18, the Government borrowed £42 billion to fund its spending.[51] The borrowing is sometimes referred to as the deficit.

Borrowing has fallen significantly since 2010….

Government borrowing peaked at 10% of GDP in 2009/10, following the 2007-2008 financial crisis, but is at a more typical level now. Borrowing in 2017/18 is equivalent to 2% of GDP, which is below the average for the past 70 years and the lowest level since 2001/02.

[51] All figures in this section are from ONS' public sector finances or the OBR's economic and fiscal outlook – October 2018. All data exclude public sector banks.

When total spending is higher than revenues, government has a deficit and must borrow, % GDP



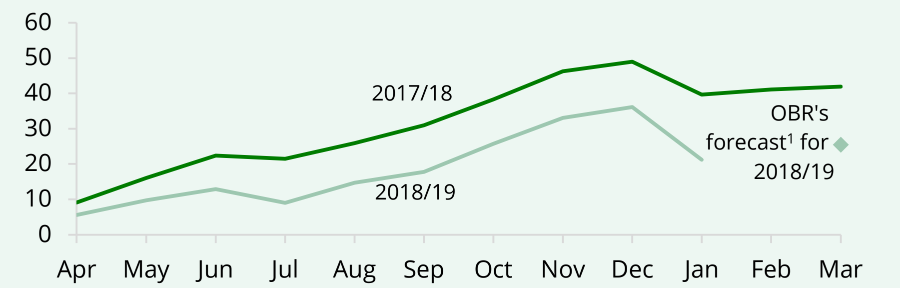
….has been falling in 2018/19….

The Government borrowed £21 billion in the first ten months of 2018/19 – according to provisional data – which is the lowest level of borrowing for the first ten months of any financial year since 2001/02.

Government borrowing was 47% lower during the first ten months of 2018/19 than it was during the same period in 2017/18. Meeting the OBR's latest forecast for the 2018/19 financial year as a whole (made in October 2018) would require a fall of 39% on 2017/18.

Despite there only being two months of the financial year left, there is still uncertainty over what the final full-year figure for 2018/19 will be: the data published so far is provisional and there is uncertainty about income tax receipts and government spending in the final months of the year.[52]

Borrowing in the first ten months of 2018/19 has been 47% lower than during the same period of 2017/18
Cumulative public sector net borrowing, £ billion



[1] OBR's October 2018 forecast

[52] OBR. Commentary on the Public Sector Finances: January 2019, 21 February 2019

….and is forecast to fall further.

In its latest forecast (October 2018) the OBR forecast that borrowing would decrease across the next five years. The OBR forecast than in 2023/24 borrowing will be around £20 billion or 0.8% of GDP. However, there is an unusually high level of uncertainty surrounding the OBR's current forecasts

Forecasting is difficult at the best of times, but the uncertainty over the final shape of the UK's withdrawal from the EU makes it particularly challenging at the moment. Section 1.2 explains that the OBR's forecasts assume an orderly exit from the EU. The OBR's outlook for the public finances is likely to worsen if the UK's withdrawal is less than orderly.

Box 1: The Government's current budget is in surplus

The current budget deficit is the difference between government current spending – day-to-day spending on running public services, grants and administration – and government income from taxes and other sources. Unlike public sector net borrowing, the current budget deficit doesn't include investment spending and therefore is said to measure the degree to which taxpayers meet the cost of paying for the services provided to them.

The current budget was in surplus in 2017/18 by £0.9 billion, equivalent to less than 0.05% of GDP. This means that the Government's current spending – on the day-to-day spending on running public services, grants and administration – was a little smaller than the taxes and other revenues it received. The OBR forecast a current budget surplus of £16 billion (0.7% of GDP) in 2018/19.

Box 2: Accounting for student loans: a significant change to come

The Office for National Statistics (ONS) is changing the way it accounts for student loans, which will increase Government borrowing in the recent past and future. The change isn't included in the data presented above and won't be fully incorporated into the ONS's figures until autumn 2019. The OBR will not incorporate the change in its March 2019 forecast: they will wait for the ONS to finalise its full methodology.

The accounting change, which aims to ensure that the treatment of the loans better reflects how they work in practice, is likely to have a relatively significant impact on borrowing in the short-term. The OBR have estimated that the change could add around £13-17 billion to the deficit over each of the next five years.[53] Additional borrowing will make it more difficult for the Government to meet some of its borrowing targets for the public finances (see section 2.3).

It is important to say that nothing real has changed to the loans. This is all about how the loans are accounted for in Government borrowing – the change ensures that the losses expected on the loans are recognised when they are issued, rather than in 30 years' time when they are written off. The change has no direct impact on government debt.

Further information about the change is available in the Library Insight Student loans: ONS changes accounting rules.

3.2 Public sector net debt

Public sector net debt is the overall level of government indebtedness, built up over many years. Broadly speaking, it is the stock of borrowing arising from past deficits.

[53] OBR. Economic and fiscal outlook – October 2018, Box 4.3

The debt-to-GDP ratio remains relatively high….

Before the financial crisis, public sector net debt was around 34-35% of GDP. Following the crisis, debt increased sharply. The debt-to-GDP ratio was 85% of GDP at the end of 2016/17 and 2017/18. The last time debt was higher than 85% in the mid-to-late 1960s, when it was still recovering from reaching over 200% of GDP during World War II.[54]

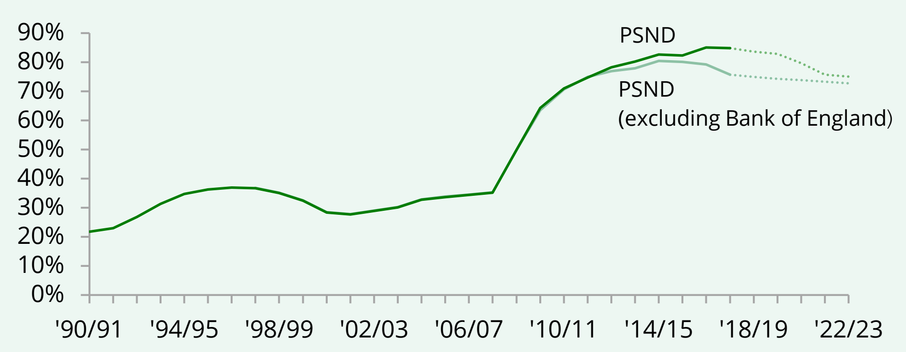
….but has started to fall

The debt-to-GDP ratio has been falling during 2018/19 and the OBR forecasts that it will be 83.7% by the end of the financial year.

In October 2018, the OBR forecast that the debt-to-GDP ratio will fall gradually to just under 74% of GDP by 2023/24. As discussed above, and in section 1.2, the OBR's forecasts assume that the UK's withdrawal from the EU is orderly.

Public sector net debt includes the impact of some temporary measures taken by the Bank of England following the EU referendum result. As the impact is largely temporary, the ONS and OBR have published a measure of public sector net debt that excludes the Bank of England. On this measure the path of public sector net debt is smoother.

Public sector net debt is forecast to fall over the forecast
Public sector net debt (PSND), % GDP



3.3 Targets for the public sector finances

The Government has an objective for the public finances and targets to help it meet this objective, they are set out in the Charter for Budget Responsibility.[55] The OBR will judge whether the Government is meeting its objective and targets in its March 2019 forecast.

The **overall objective for the public finances** is to return the 'public finances to balance at the earliest date in the next Parliament'. This would mean government spending being no greater than government revenues from taxes and other sources. The target date for the public finances reaching balance is open to interpretation given the early General Election in 2017, but the Conservative Manifesto suggests the Government is still aiming at the 'middle of the next decade'.[56]

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54 OBR. *Public finances databank*, February 2019
55 See Library briefing The Office for Budget Responsibility and Charter for Budget Responsibility for more.
56 2017 Conservative Manifesto, page 14

The Government has targets to help it meet its overall objective. Chief amongst these is the **fiscal mandate**, a target for controlling the level of borrowing. This focuses on a measure of borrowing that is adjusted for the ups and downs of the economy: the fiscal mandate is for cyclically adjusted borrowing to be below 2% of GDP by 2020/21.

The Government also has a target for the debt-to-GDP ratio to be falling in 2020/21 and a welfare cap.

The Treasury can review the appropriateness of the targets for the public finances if there has been a 'significant economic shock to the UK economy'. It is for the Treasury to decide what is considered a shock.

There is more on the public finance targets in the following Library briefings:

- The Office for Budget Responsibility and Charter for Budget Responsibility (section 3), January 2019
- Balanced budget rule, January 2019

Treasury Committee recommends that the targets should be updated

In January 2018, the Treasury Committee recommended that the Chancellor should update the public finance targets:[57]

- to clear up the ambiguity over the target date for reaching a budget balance; and,
- to move away from a debt target that focuses on one year (2020/21) to one which targets a continuously falling debt-to-GDP ratio.

The Chancellor has not acted on the Committee's recommendations.

More recently, the Treasury Committee concluded that the Chancellor should replace the overall objective for the public finances with something that "accurately reflects Government policy and priorities".[58] The Committee's view is that the Chancellor "appears to be disregarding" the objective of reaching a budget surplus and has himself said that securing economic growth is a better way of reducing the public debt-to-GDP ratio than running a budget surplus. The Committee has pointed out that the Chancellor chose to announce additional spending in Autumn Budget 2018, rather than reaching the budget surplus the OBR would have otherwise forecast in 2023/24.[59]

[57] Treasury Committee, Autumn Budget 2017, 17 January 2018, HC600 2017-19, para 55

[58] Treasury Committee, Autumn Budget 2018, 12 February 2019, HC1601 2017-19, para 55

[59] The Library Insight Budget 2018: Where has the Chancellor's money come from? discusses how the OBR's underlying forecast for Autumn Budget 2018 showed a budget surplus in 2023/24.

The "deal dividend"

In his Autumn Budget 2018 speech the Chancellor suggested that the public finances may receive a double "Deal Dividend" if the UK agrees a final Withdrawal Agreement with the EU.

The Chancellor believes that reaching a managed withdrawal could boost the UK economy as ending the uncertainty will improve business confidence and increase investment. The Treasury Committee has pointed out that the OBR already assumes an orderly exit from the EU so simply avoiding a disorderly exit shouldn't result in a "deal dividend". The Committee agrees that there could be an improvement in business confidence and investment that isn't currently forecast by the OBR, but "It is not credible that this be described as a dividend."[60]

The other part of the double "deal dividend" relates to the Chancellor's target for borrowing (the fiscal mandate). The Chancellor has been maintaining a £15 billion margin below this target. He has said that the margin, or headroom, could be used to provide an economic stimulus if the UK leaves the EU in a disorderly way. He has also said that if the UK leaves with a Withdrawal Agreement, then he wouldn't need to maintain the same margin and could let borrowing "rise a little and eat into that headroom".[61] As the Treasury Committee points out, this suggests "that all or part of it will be spent both in orderly and disorderly Brexit scenarios".[62]

3.4 The 2019 Spending Review

The Chancellor has confirmed that there will be a Spending Review this year. Spending Reviews set the Government's spending plans for the next few years; there have been eight so far since 1998, each covering from one to four years. The most recent was in 2015.

Spending Reviews set the Departmental Expenditure Limits (DEL) for each department – this covers spending that can reasonably be planned in advance, and accounts for around half of all public spending. The Chancellor usually also uses the Review to provisionally set the Government-wide amount of Annual Managed Expenditure (AME), which covers more variable or demand-driven spending such as on welfare benefits.

Although there is no statutory mechanism for running a Spending Review, in the past they have involved each department entering negotiations with the Treasury to determine their budget. Some spending announcements have already been made, such as on the NHS, and some budgets have been protected (such as those for defence and international aid). This may reduce the Chancellor's freedom to allocate money.

60 Treasury Committee, Autumn Budget 2018, 12 February 2019, HC1601 2017-19, para 55
61 Treasury Committee, Oral evidence: Budget 2018, HC1606, 5 November 2018, Q206
62 op cit, para 63

There is little known about the detail of the Spending Review – indeed, responses to MP's questions in parliament suggest that departments do not know exactly when it will be, and we also do not know how many years it will cover. However, it seems likely that the final results of the Review will be announced in the autumn, and it is possible (although by no means certain) that the Spring Statement will include the total amount of spending within which departmental allocations will be made.

Provisional spending plans

At Autumn Budget 2018, the Chancellor set out provisional figures for the total amount of the resource element of DEL – which covers departments' day-to-day spending on public services, grants and administration – to 2023/24. From 2019/20 to 2023/24 such spending will grow by an average of 1.2% per year in inflation adjusted terms – this includes the additional money announced for the NHS.[63] Prior to Autumn Budget 2018, resource DEL was expected to fall over the period.

The Chancellor felt able to increase his spending plans at the Budget largely because the OBR's forecast included an underlying improvement in the public finances.[64] The Chancellor's loosening of the purse strings was described by the OBR as the largest since it was created.[65] The increase in the spending plans were large enough to indirectly impact on the OBR's forecasts for economic growth.

63 Budget 2018: Philip Hammond's speech
64 This is discussed in the Library Insight Budget 2018: Where has the Chancellor's money come from?
65 OBR. Economic and fiscal outlook – October 2018, para 1.7

4. Parliament's fiscal year

Parliament has a role in both the raising of tax and approving Government spending. Parliament's fiscal calendar can vary, but the below is a summary of the process and timings for a typical financial year:

- April: Government departments' spending plans (Main Estimates) are published
- July: Government departments' spending plans (Main Estimates) are debated in the House
- July: a Supply and Appropriation (Main Estimates) Bill is introduced and, if agreed, receives Royal Assent, formalising Main Estimates as departments' initial budgets for the year
- July: Government departments lay their Annual Reports and Accounts (for the financial year ending the previous March) before Parliament
- November: the Budget is published. Following the Budget a Finance Bill is introduced. Royal Assent of the Bill should be reached in the spring, before the start of the following financial year.
- November: the OBR publishes its economic and fiscal forecasts.
- February: Government departments' revised spending plans (Supplementary Estimates) are published, debated in the House
- February: Government requests advance funding for the first four months of the next financial year (Vote on Account) for each department.
- March: a Supply and Appropriation (Anticipations and Adjustments) Bill is introduced and, if agreed, receives Royal Assent, formally agreeing to revise in-year budgets as set out in Supplementary Estimates; and advance money for the new year in the Vote on Account
- March: the OBR's economic and fiscal forecast is published. The Chancellor makes a formal response to the forecast in the Spring Statement. The Spring Statement may also review, and consult on, wider challenges for the economy and public finances.

Further information is available in the following Library briefings:

- The Budget and the annual Finance Bill, November 2018
- Public spending: New debates in the House, January 2018
- Main Estimates: Government spending plans for 2018/19, May 2018
- Revised Government spending plans for 2018/19, February 2019

Parliament's Scrutiny Unit also publishes useful information on the estimates process and scrutiny of public spending.

Appendix 1: Further information

Library’s Brexit briefings

The Library’s briefings, and other relevant parliamentary material, on Brexit are pulled together in parliament’s Brexit hub. Below are a selection that could be pertinent to developments in Parliament and the Spring Statement.

The process of leaving

The Brexit timetable: One promise. Two weeks. Three key votes.

Extending Article 50 and European Parliament elections

Extending Article 50: could Brexit be delayed?

A User's Guide to the Meaningful Vote

Brexit: how does the Article 50 process work?

The Withdrawal Agreement and Future Framework

The UK's EU Withdrawal Agreement

Withdrawal Agreement: The financial settlement

The Political Declaration on the Framework for Future EU-UK Relations

Brexit: the exit bill

What if there's no Brexit deal?

What are the ‘other’ Brexit options?

Trade and economics

Brexit and the economy: Government analysis of the long-term impact

Brexit deal: Economic analyses

List of EU trade agreements

No-deal Brexit and WTO: Article 24 explained

Brexit: trade aspects

Information related to Spring Statement 2019

HM Treasury

Autumn Budget 2018

Spring Statement 2018

Autumn Budget 2017

Spring Budget 2017

Autumn Statement 2016

Budget 2016

Office for Budget Responsibility

Economic and fiscal outlook, October 2018

Economic and fiscal outlook, March 2018

Economic and fiscal outlook, November 2017

Economic and fiscal outlook, March 2017

Monthly commentary on the public finances

Public finances databank

Institute for Fiscal Studies

Autumn Budget 2018

Spring Statement 2018

Autumn Budget 2017

Post-Spring Budget 2017 Briefing

Green Budget 2018

Post-Autumn Statement 2016 Briefing

Post-Budget Briefing 2016

Commentary on the January 2018 public finances

The Resolution Foundation

Spring Forward or Fall Back? The questions facing the UK economy ahead of the Spring Statement 2019

How to spend it: Autumn 2018 Budget response

House of Commons Library

Economic indicators (an edition will be published before the Spring Statement)

Monthly economic updates

Autumn Budget 2018: A summary

Budget 2018: Where has the Chancellor's money come from?

Autumn Budget 2018: Background briefing

Spring Statement 2018: A summary

Autumn Budget 2017: A summary

House of Commons Treasury Select Committee

Inquiry into Autumn Budget 2018

Inquiry into Autumn Budget 2017

Inquiry into Budget 2017

Appendix 2: Economic and public finance data 1979-2023

Economic data, 1979-2023			
	Real GDP year on year growth %	Inflation CPI annual rate %	ILO Unemployment Q4, %
1979	3.7%	..	5.5%
1980	-2.0%	..	8.0%
1981	-0.8%	..	10.2%
1982	2.0%	..	11.1%
1983	4.2%	..	11.7%
1984	2.3%	..	11.6%
1985	4.2%	..	11.3%
1986	3.1%	..	11.3%
1987	5.3%	..	9.7%
1988	5.8%	..	8.0%
1989	2.6%	5.2%	7.0%
1990	0.7%	7.0%	7.5%
1991	-1.1%	7.5%	9.5%
1992	0.4%	4.2%	10.4%
1993	2.5%	2.5%	10.3%
1994	3.9%	2.0%	9.0%
1995	2.5%	2.6%	8.3%
1996	2.5%	2.4%	7.8%
1997	4.3%	1.8%	6.5%
1998	3.3%	1.6%	6.1%
1999	3.2%	1.3%	5.8%
2000	3.5%	0.8%	5.2%
2001	2.8%	1.2%	5.2%
2002	2.5%	1.3%	5.1%
2003	3.3%	1.4%	4.9%
2004	2.3%	1.3%	4.7%
2005	3.1%	2.1%	5.1%
2006	2.5%	2.3%	5.5%
2007	2.5%	2.3%	5.2%
2008	-0.3%	3.6%	6.4%
2009	-4.2%	2.2%	7.8%
2010	1.7%	3.3%	7.9%
2011	1.6%	4.5%	8.4%
2012	1.4%	2.8%	7.8%
2013	2.0%	2.6%	7.2%
2014	2.9%	1.5%	5.7%
2015	2.3%	0.0%	5.1%
2016	1.8%	0.7%	4.7%
2017	1.8%	2.7%	4.4%
2018	1.3%	2.6%	3.8%
2019	1.6%	2.0%	3.7%
2020	1.4%	2.0%	3.8%
2021	1.4%	2.1%	3.9%
2022	1.5%	2.1%	4.0%
2023	1.6%	2.0%	4.0%

Sources: ONS (series, IHYP, CZBH, D7G7, MGSX)
OBR, Economic and fiscal outlook, October 2018, Table 3.10, and Economy Supplementary Tables 1.6 & 1.7

Public finance data 1979/80 to 2023/24						
	Public sector net borrowing		Structural deficit		Public sector net debt	
	£ billion	% GDP	£ billion	% GDP	£ billion	% GDP
1979/80	8.5	3.7%	9.2	3.9%	98.2	39.1%
1980/81	11.5	4.3%	7.7	2.9%	113.8	40.4%
1981/82	6.0	2.0%	-0.4	-0.1%	125.2	40.1%
1982/83	8.5	2.6%	2.0	0.6%	132.5	38.7%
1983/84	11.8	3.3%	7.2	2.0%	143.6	38.9%
1984/85	12.5	3.3%	10.7	2.8%	157.0	38.7%
1985/86	9.0	2.1%	9.0	2.1%	162.5	37.1%
1986/87	8.4	1.8%	9.1	2.0%	167.8	34.9%
1987/88	4.7	0.9%	10.7	2.1%	167.4	31.0%
1988/89	-6.0	-1.1%	5.8	1.0%	153.7	25.7%
1989/90	-0.6	-0.1%	7.9	1.3%	151.9	23.1%
1990/91	6.2	0.9%	4.7	0.7%	151.1	21.8%
1991/92	23.0	3.2%	13.2	1.8%	165.8	22.9%
1992/93	47.1	6.4%	35.0	4.8%	201.9	26.8%
1993/94	51.6	6.6%	41.8	5.4%	249.8	31.3%
1994/95	43.8	5.4%	37.1	4.5%	290.0	34.7%
1995/96	35.3	4.1%	23.7	2.8%	322.1	36.2%
1996/97	27.7	3.0%	23.5	2.6%	347.0	36.9%
1997/98	9.1	0.9%	19.5	2.0%	358.6	36.7%
1998/99	-1.1	-0.1%	10.9	1.1%	357.8	35.0%
1999/00	-11.0	-1.0%	1.3	0.1%	349.3	32.4%
2000/01	-16.1	-1.5%	-6.1	-0.6%	316.7	28.3%
2001/02	4.4	0.4%	9.6	0.8%	323.1	27.7%
2002/03	32.1	2.7%	30.6	2.5%	356.2	28.9%
2003/04	38.8	3.1%	40.7	3.2%	391.0	30.1%
2004/05	46.1	3.5%	52.8	4.0%	446.5	32.7%
2005/06	41.6	2.9%	46.6	3.3%	487.2	33.6%
2006/07	38.0	2.6%	42.0	2.8%	523.6	34.4%
2007/08	42.9	2.8%	55.9	3.6%	557.2	35.2%
2008/09	113.5	7.3%	108.3	6.9%	768.3	49.9%
2009/10	153.1	9.9%	121.2	7.8%	1,011.9	64.3%
2010/11	136.5	8.5%	111.7	7.0%	1,157.6	71.0%
2011/12	116.3	7.0%	97.6	5.9%	1,253.1	74.7%
2012/13	120.3	7.0%	101.2	5.9%	1,363.6	78.2%
2013/14	97.7	5.5%	78.9	4.4%	1,464.4	80.2%
2014/15	89.9	4.8%	79.3	4.3%	1,554.7	82.6%
2015/16	71.8	3.8%	64.5	3.4%	1,602.6	82.3%
2016/17	44.9	2.3%	40.5	2.0%	1,726.7	85.1%
2017/18	41.9	2.0%	41.5	2.0%	1,778.9	84.8%
2018/19	25.5	1.2%	28.4	1.3%	1,810.1	83.7%
2019/20	31.8	1.4%	36.0	1.6%	1,851.0	82.8%
2020/21	26.7	1.2%	30.1	1.3%	1,841.1	79.7%
2021/22	23.8	1.0%	25.9	1.1%	1,809.3	75.7%
2022/23	20.8	0.9%	22.2	0.9%	1,856.3	75.0%
2023/24	19.8	0.8%	21.0	0.8%	1,896.4	74.1%

Source: OBR, ONS

Note: figures exclude public sector banks

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