Group Economics

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56 Budget measures but eyes should focus on the public finances

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Last month's Budget represented George Osborne's 11th *'fiscal event'* as Chancellor, if you include five Budgets, four Autumn Statements and two Spending Reviews. The Chancellor has two more to go before the next General Election. *'Security / secure'* were the watch words and appeared eight times in the speech with *'delivering security for the people of this country'* the Chancellor's vision and long-term plan.

As expected, the economic growth forecasts were upgraded significantly, representing the biggest inter-budget revision in 30 years. The UK economy is now expected to see growth accelerate from 1.8% last year to 2.7% in 2014, easing to 2.3% next year. The stronger the UK's economic recovery, the better for Northern Ireland, as this automatically translates to a more robust recovery here too. We expect growth of 1.5%-2.0% this year up from an estimated 1.0% for 2013.

A stronger UK economic recovery is good news for the public finances too, translating into more tax revenue, less expenditure on unemployment benefits and less government borrowing. Indeed, through faster economic growth and Budget 2014 measures, the Office for Budget Responsibility (OBR) now estimates that £99bn less borrowing will be required between 2012/13 and 2017/18 - equivalent to the UK's entire Education budget. However, the UK is still set to borrow £95.5bn, equal to the annual Education budget in just the current financial year.

As the Chancellor noted *"there can be no economic security if there is no control of the public finances"*. However, whilst the public finances are improving, it is from a horrendous state to something slightly less dire. Claims that the *'deficit is falling'* are often misunderstood. This means that the annual deficit's share of GDP is falling; but until this turns into a surplus the overall stock of debt will continue to rise. Until then, the Government has to keep on borrowing. Some £572bn is still set to be borrowed in the seven years to 2017/18 - 20 times the annual output of the Northern Ireland economy. UK central government debt interest payments for 2014/15 alone amount to some £53 billion - more than the UK spends on Defence (£38bn).

In 2009/10, the annual deficit *(or net borrowing)* was 11% of GDP. This is set to fall from 6.6% this year to 5.5% in 2014/15. But this still remains one of the largest deficits anywhere in the developed world. Within the EU, only Spain and Cyprus have higher budget deficits in 2014. The UK's annual deficit will not fall below the EU's Stability & Growth Pact deficit ceiling of 3% of GDP until 2016/17. As a result, the UK will have exceeded this deficit ceiling for eight successive years.

The UK's fiscal difficulties are structural as opposed to cyclical. This means that economic growth on its own will not reduce the deficit. Hence the need for an ongoing fiscal adjustment. It will take until 2018/19 before the deficit is eliminated entirely or 2017/18 when adjustment for the economic cycle is made.

As a result, the UK's overall stock of national debt is set to rise until 2018/19 and will push through the £1.5 trillion mark in the preceding year. However, with the economy growing, the overall stock of debt as a share of UK GDP will start falling in 2016/17 from a peak of 78.7% of GDP the previous year. This is two years later than was originally planned in the Coalition Government's first *'Emergency Budget'* in June 2010. Furthermore, assuming no future economic and financial shocks, it will be the early 2030s before the UK's gross government debt to income ratio returns to its pre-credit crunch level of 37%. This assumes there will be no further Eurozone crisis or fallout from a Chinese financial crisis to deflect the UK off its economic growth trajectory.

Also baked into the fiscal plans are public expenditure cuts and public sector pay restraint until at least 2018/19. Much of the detail surrounding these cuts has been kicked into the long grass and beyond next year's General Election. According to the Institute for Fiscal Studies, the UK, and by extension Northern Ireland, has more Departmental public spending cuts ahead than have been delivered to date. Over the period 2010/11 – 2018/19 UK Departmental spending is set to fall in real terms by 20%. As of 2013/14, just 43% of these cuts have been implemented so far.

Meanwhile, outside of Departmental spending, the continuing growth in Annually Managed Expenditure, which includes social security payments, is set to slow. A welfare cap is to be applied from 2015/16 to 2018/19. Whilst this is set to rise by forecast inflation, it will act as a drag on the UK economy, and Northern Ireland in particular, for the rest of the decade and beyond.

Overall, despite 56 separate measures, and a number of giveaways, this was as fiscally neutral a Budget as you could get, costing a net £130 million over five years. With all Budgets, the devil will be in the detail. There are additional cuts in public expenditure and public sector pensions as yet not specified, and we will therefore still have several years of fiscal pain to come. However, the squeeze will not just be confined to the fiscal sphere. The monetary policy squeeze, no matter how mild, is expected to begin next year. Fiscal austerity and rising interest rates is something we haven't experienced yet. But, it is something we will have to get used to.

Richard Ramsey,
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