Group Economics

Ulster Bank

UK Autumn Budget Statement - UK borrowing figures suggest an extended age of austerity

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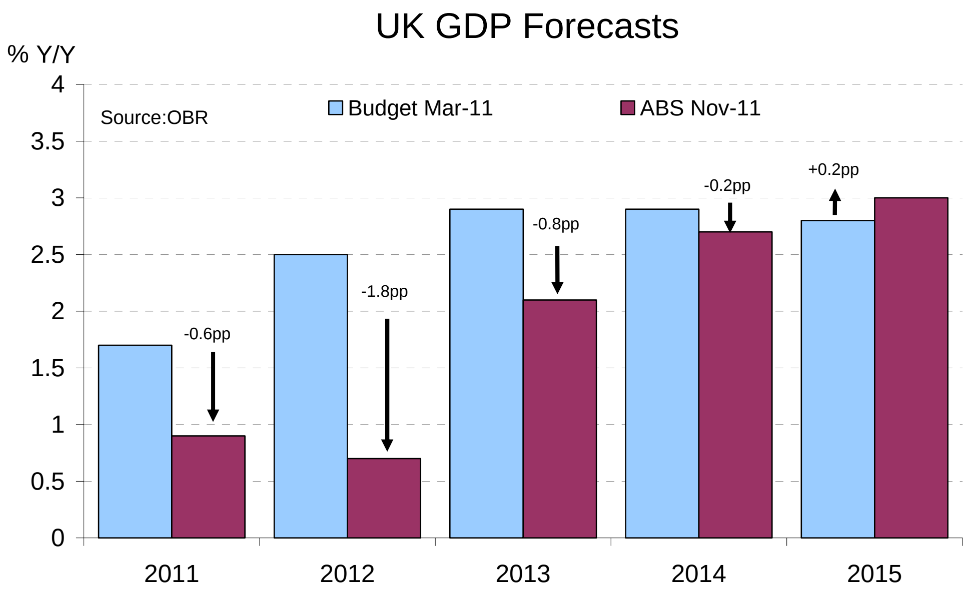
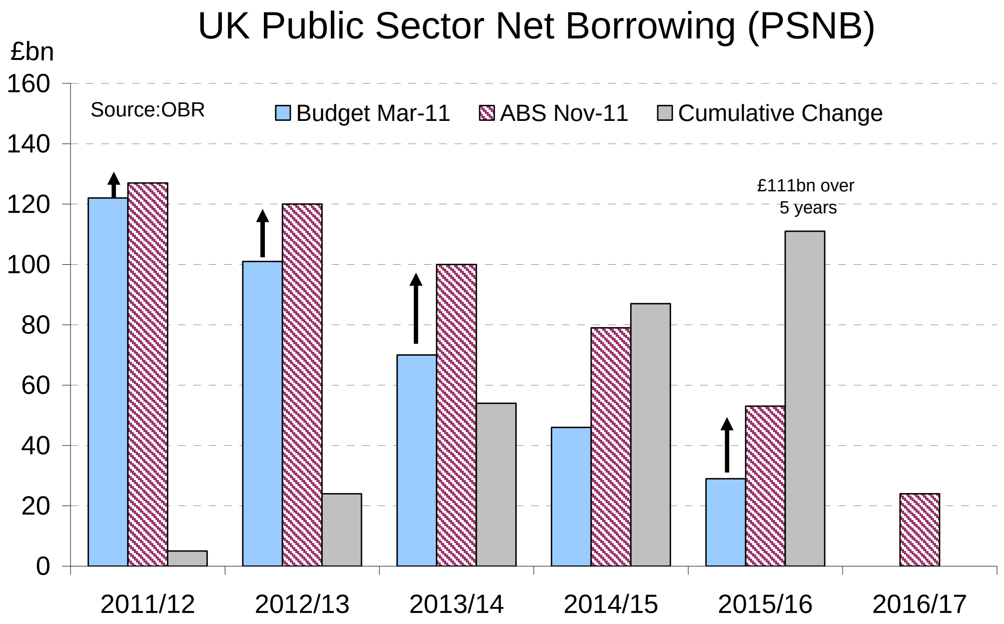
UK Economic growth forecasts revised down

On 29 November the UK Chancellor unveiled a sombre Autumn Budget Statement *(ABS)*. The main focus of the Statement was not on the Chancellor but on the dire set of forecasts supplied by the Office for Budget Responsibility *(OBR)*. As expected, the OBR's GDP forecasts were cut significantly relative to the last forecasting round in back in March. The UK economy is now expected to grow by 0.9% in 2011 and just 0.7% in 2012. The latter represents a 1.8 percentage point fall on the March 2011 estimate with the economic recovery also weaker than previous forecasts in 2013 & 2014. Given Northern Ireland's reliance on the UK economy this will lead to an even weaker economic recovery in Northern Ireland. In addition, the huge, as yet unspecified, public spending cuts in 2015/16 & 2016/17 highlight that even in five years' time, the public sector will remain a significant drag on the economy. Indeed, revised forecasts show public sector employment shrinking by 12% *(710,000)* over the course of austerity *(by 2017)*.



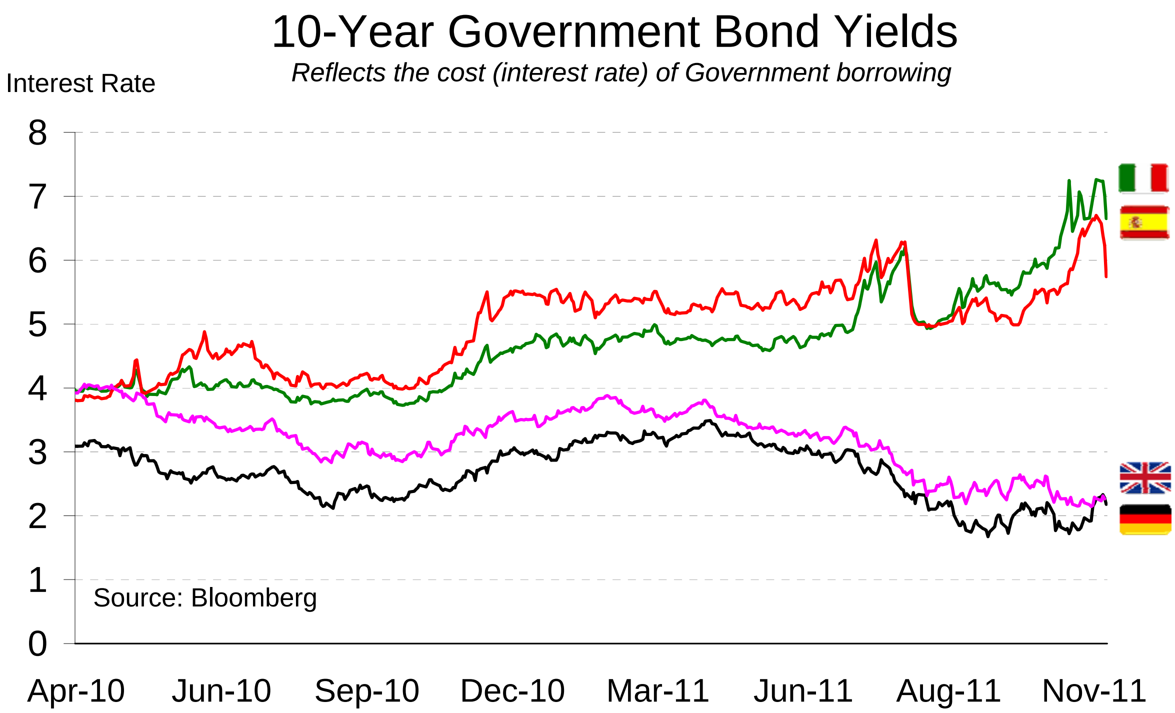
With even more public sector borrowing required

A natural consequence of weaker economic growth is falling revenues. Revenues are expected to fall by £40bn per year *(£158bn cumulatively)* due to subdued corporate profitability, wage growth, investment and household consumption. For example, export growth next year (3.1%) is expected to be less than half the rate anticipated eight months ago. Meanwhile consumer spending is expected to rise by just 0.2% next year, less than 1/6th of the growth rate expected in March 2011. Against this backdrop public sector net borrowing (PSNB) has to rise. The PSNB in the current fiscal year is expected to be £5bn higher than previously forecast. However, the amount of additional borrowing accelerates in later years with the cumulative amount of government borrowing over the next five years £111bn higher than forecast in March 2011. Running up additional borrowing would not be a problem if it was viewed to be cyclical, i.e. a temporary requirement linked purely to the economic cycle which would be eliminated when normal growth returns. However, the OBR estimate that an additional £35bn is structural or permanent.



Costs of UK government borrowing briefly dip below Germany

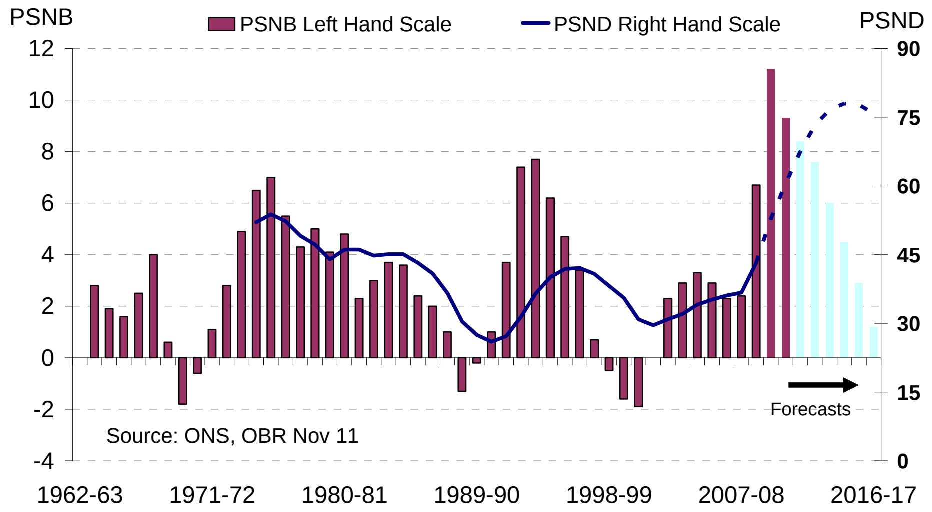
One of the few fiscal tailwinds that the UK economy has benefited from has been the lower cost of issuing new government debt. Following the Coalition government's emergency budget and Comprehensive Spending Review, the UK economy has held onto its coveted triple-A status. This perception, within the financial markets, of a credible deficit reduction plan has meant the demand for UK government debt *(Gilts)* has remained strong pushing up the price and conversely pushing down the yield. The latter is the interest rate to attract investors and reflects the cost of government borrowing. The cost of the benchmark 10-Yr UK Gilt recently hit a record low of 2.1% and indeed briefly fell below the equivalent cost of borrowing in Germany. This contrasts with the record borrowing costs in Italy which have pushed well above 7%. These lower interest rate payments have significantly reduced the overall cost of UK government borrowing.



Additional borrowing adds to the overall debt mountain

Despite the lower costs of borrowing, the overall levels of public sector debt remain huge both in terms of the annual amount and the overall stock of debt. The Chart below highlights the share of UK's Public Sector Net Borrowing as a percentage of GDP. This can be viewed as the annual fiscal deficit. This ratio is set to fall from a peak of 11.2% in 2009/10 to 8.4% in the current financial and eventually falling back to 1.2% by 2016/17. The Table below puts the UK's evolving fiscal position into a European context. It involves slightly different calculations than appeared in the ABS/OBR forecasts to aid comparability. Looking at 2012 *(calendar year not financial)*, the UK has the largest annual fiscal deficit after Ireland. It is noted that the UK's overall stock of debt as a % of GDP will not start to fall until 2015/16 having peaked in 2014/15 at 78%. Before then, using the European Commission methodology, which includes support to financial institutions, the UK national debt will hit 91.3%. While worryingly high, it still compares favourable with several EU states.

Public Sector Net Borrowing / Public Sector Net Debt as % of GDP



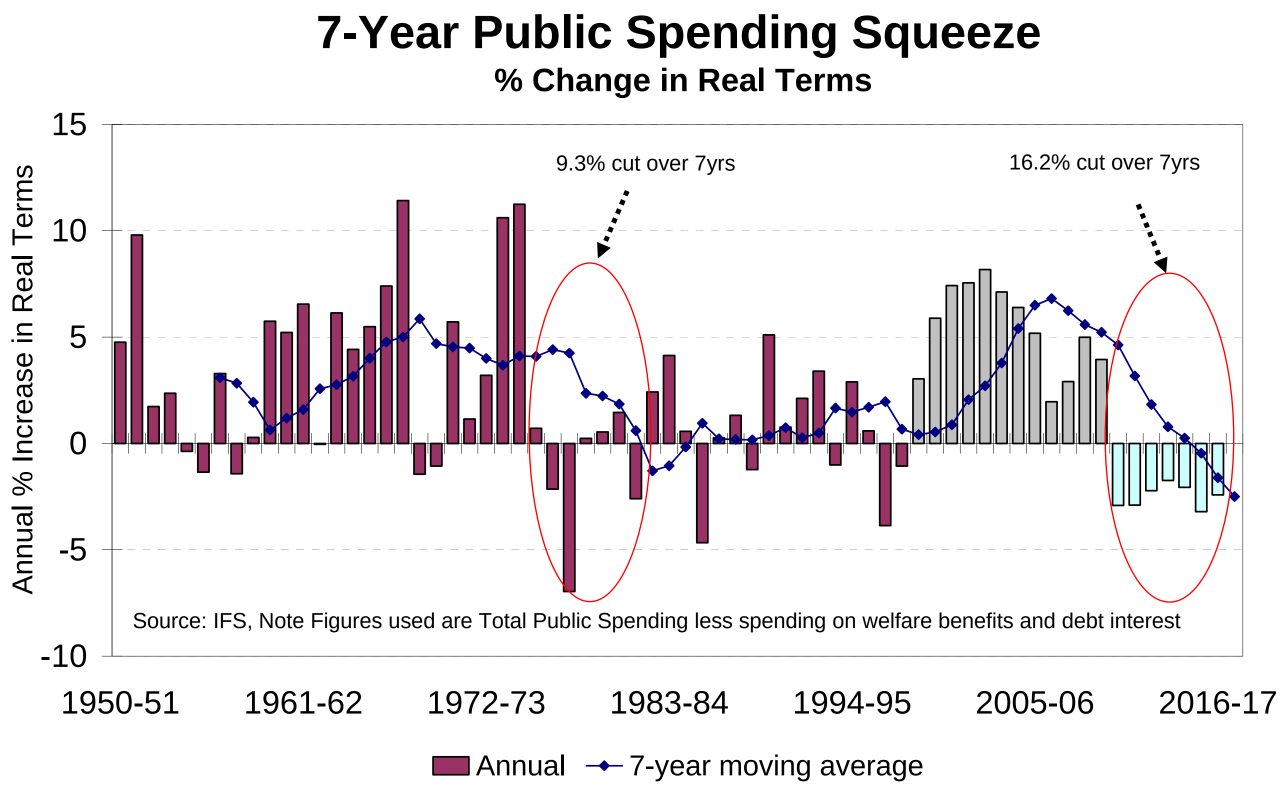
European Debt Champions League

Countries		Fiscal Deficit % of GDP 2011	Fiscal Deficit % of GDP 2012	Fiscal Deficit % of GDP 2013	Government Debt as a %of GDP 2012	Government Debt as a %of GDP 2013
Greece		-8.9%	-7.0%	-6.8%	198.3%	198.5%
Ireland		-10.3%	-8.6%	-7.8%	117.5%	121.1%
Italy		-4.0%	-2.3%	-1.2%	120.5%	118.7%
Portugal		-5.8%	-4.5%	-3.2%	111.0%	112.1%
Belgium		-3.6%	-4.6%	-4.5%	99.2%	100.3%
France		-5.8%	-5.3%	-5.1%	89.2%	91.7%
UK		-9.4%	-7.8%	-5.8%	88.8%	91.3%
EU		-4.7%	-3.9%	-3.2%	84.9%	84.9%
Germany		-1.3%	-1.0%	-0.7%	81.2%	79.9%
Spain		-6.6%	-5.9%	-5.3%	73.8%	78.0%

Eurostat Autumn Forecast 2011 & OBR November 2011

Additional public expenditure cuts required

Given that the UK's structural deficit is even larger than previously estimated the Chancellor faced one of two options. Either he would miss his own fiscal targets or policy would have to be tightened. The former would have jeopardised the fiscal credibility of the UK, which in turn would have jeopardised the UK's triple-A credit rating and pushed up borrowing costs. Instead, the latter option has been chosen. With tax receipts plummeting, further efforts to rein in public spending were announced in the ABS. Overall almost three-quarters of the fiscal adjustment by 2014/15 will be through spending cuts. Total public spending is now set for its tightest squeeze since the end of World War II. The Chart opposite highlights that following the unprecedented 12-year boom in public expenditure growth, the UK now faces an unprecedented squeeze on public spending. Excluding debt interest and welfare payments, public spending is set to fall by 16% over the 7-year period to 2016/17 according to the Institute for Fiscal Studies. This extends austerity 2-years into the next parliament. It is noted that spending cuts of £8bn and £15bn have been identified in 2015/16 and 2016/17 respectively. The Spring 2012 Budget will reveal what these cuts are.



Richard Ramsey,
2nd December 2011