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Autumn Budget 2017

On Wednesday 22nd November the Chancellor Philip Hammond presented to Parliament the Conservative Government's fourth Budget, his second and the 'first Autumn Budget'. This is under a new Parliamentary schedule, intended to end tax announcements being made twice each year. The idea is to announce tax changes well in advance of the tax year.

The Office for Budget Responsibility (OBR) also published their updated forecast, which they have been doing since 2010.

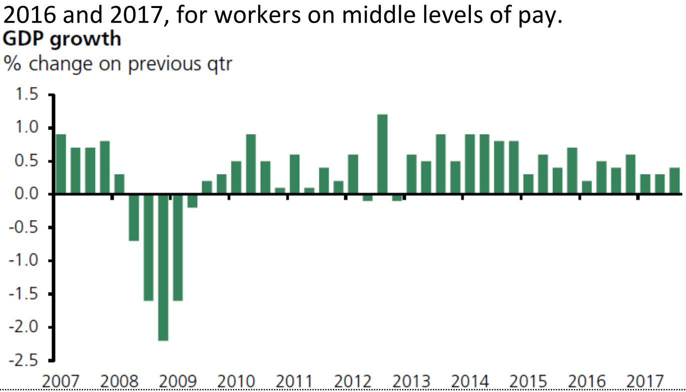
GDP growth slightly subdued, but steady

In March this year, UK consumer confidence appeared undented by the EU referendum result for Brexit, with UK economic growth during the second half of 2016 continuing unabated, arising from the strongest annual expansion of consumer spending since 2004.

This year, 2017, GDP growth has been slightly subdued, but steady, primarily owing to a slower rate of growth in consumer spending.

In fairness, even though this may be described as a 'noticeable slowdown' from those higher growth rates seen in recent years, the latest quarterly GDP growth in the third quarter of 2017 is similar to that reported for the first two quarters of the year.

The cause may well be that, on average, real average earnings have continued to fall. Yet earnings are increasing above inflation for the lowest-paid employees, who have benefited from the National Living Wage. The main beneficiaries being part-time workers, in contrast to weaker earnings, between 2016 and 2017, for workers on middle levels of pay.



The Treasury's survey of forecasters indicates **GDP growth** for 2017 of around **1.6%.** At the March 2017 Budget the OBR had forecast growth in 2017 of 2%, now revised down by 0.5 percentage points. The OBR expect a steady fourth quarter, reinforcing performance consistent with growth of **1.5% for 2017** as a whole.

Last year, the OBR had expected growth to slow, mainly owing to higher inflation and their continuing concerns over weaker business investment which it assumed depressed future productivity growth.

The OBR have now significantly revised their opinion about the prospects for **UK productivity**, which changed markedly in the wake of the 2008/09 Crash, leading to a revision of economic growth throughout their forecast.

Although the outcome has been that economic growth this year has not diverged greatly from the OBR's March forecast, the breakdown of the relationship between employment and productivity has shown a much greater divergence.

Over the last three quarters of 2017 employment has risen by nearly one quarter of a million people at a rate that is twice as fast as expected, but average hours worked per person in the UK have been close to flat rather than falling as expected.

The pattern of unexpectedly strong employment growth and unexpectedly weak productivity growth has been a consistent and constant feature of economic forecasts since the Crash.

This inescapable fact has led the OBR to revise assumptions about the potential size of the UK economy based on historic rates of potential productivity growth.

Productivity growth has been much weaker since the Crash than for decades beforehand. Output per hour has risen by just **0.2% each year** since 2008, compared to an average of 2.1% a year over the preceding 35 years.

Any judgement about potential hours worked in an economy reflects judgements about population size of those active and employed, and the number of hours worked on average.

To the OBR it now seems sensible, some might say realistic, to take account of weaker UK productivity. Review of this critical assumption has taken some time in coming.

Gross domestic product (GDP), the monetary value of all the finished goods and services produced, has had unbroken growth for 19 consecutive quarters, the latest revised official statistics from the ONS estimate growth to be 1.8% in 2016.

As an indicator of confidence and predictor of performance, the **Purchasing Managers' Index** was 54.5 this time last year. It has kept stable, above the 'magic 50' level, for fifteen consecutive months following the EU referendum. It is now **53.8 (Dec' 17)**, having previously shown the fastest pace of growth in business activity for six months.

In 2016, the service sector accounted for 79% of economic output, the production sector 14%, construction 6% and agriculture 1%. Growth in the dominant services sector (retail, financial, leisure) accounts for 84% of workforce jobs, but has slowed this year.

In contrast, **manufacturing output** has been growing at an average annual rate of **2.2%** in the past four quarters, seemingly benefitting from an increase in export orders.

Recently, the Confederation of British Industry (CBI) survey suggests that UK manufacturers are reporting the strongest order books since 1988.

Apparently **net trade** has contributed modestly to overall growth in the first half of 2017, contrary to the OBR's expectation. Exports have been boosted by a strengthening global economy, and in particular from the Eurozone.

GDP by Expenditure: household consumption is the largest element of expenditure across the economy, accounting for 63% of the total in 2016. Government consumption accounted for 19% and **investment** 16%. The Bank of England believes Brexit-related uncertainty is weighing on investment. The overall level of investment in the economy is only slightly higher (2%) in 2017 compared with 2007, the pre-recession peak level.

In contrast with the UK's latterly subdued economic growth, the **world economy** has strengthened during 2017. The IMF has said that improved growth of the world economy is "notable because it is broad-based".

Inflation and monetary policy

Headline **inflation** has tipped just over **3%**. Although, the **CPI** measure averaged 2.6% in 2013 and 1.5% in 2014, it was very low for most of 2015, at near zero, before picking up again. That historic fall in inflation was largely owing to the fall in the oil price and lower food prices. These have since increased.

The fall in the value of the pound since late 2015 and following the EU referendum in June 2016 has caused higher import prices, which probably have been passed onto consumers.

One of the key drivers of inflation is the price of food, around half of food and drink consumed in the UK is imported.

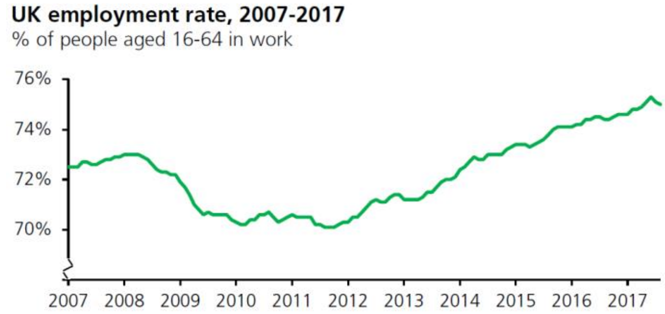
Bank of England research suggests price pressures faced by producers have eased in recent months. The Bank forecasts inflation to ease to around 2% to 2½% next year, relieving the squeeze on households' finances.

Higher inflation was the cue to raise **interest rates** for the first time since 2007. Reversing the previous policy decision to reduce rates following the EU referendum which had held the **Bank Rate** at **0.5%** for seven years prior to August 2016.

Consumers and households have been somewhat squeezed by inflation, average wage growth adjusted for inflation (July-September 2017) was 0.6% lower than a year before. Remarkably though, wage growth remains weak despite unemployment being at its lowest rate since 1975 and near-record UK employment rates, confounding economists' expectations.

Labour market

The UK labour market continues to surprise following the 2011 dip. From then on, UK employment has grown relentlessly from 29 million; **32.06 million people** in the UK were recorded in work in the three months to October 2017, just over **75% of people aged from 16 to 64** in the UK, an increase of over 3 million people in the workforce since 2011.



Public finances

Once again, public finances have been performing much better than the OBR have expected. The revised estimate of **annual public sector borrowing** for 2017/18 is **£50 billion** - previously forecast as £58 billion.

Government spending in excess of tax and other revenues is commonly known as **'the deficit'**. Government borrowing for the deficit has fallen considerably since the massive borrowing during the financial crisis, from a peak of £153 billion in 2009/10 to **£46 billion in 2016/17**. As an indicator of size this is just over **2% of GDP** and similar in scale to the level of borrowing before the 2007-2008 financial crisis - the historical average from the mid-1970s to 2007/8 is 2.6%; post-war average to date is 2.4%.

The principal reason the OBR have revised their expectation of future growth is owing to a downward revision of potential productivity growth. If UK productivity does not improve then pressure may mount on future Government borrowing.

The OBR say Government remains on course to hit the looser targets set for borrowing and debt in 2020-21, but with less room for manoeuvre. The longer-term objective of "balancing the Budget", which was the ambition of the 2010 Coalition Government to achieve in 2015/16, now looks more challenging.

But, they are on their way to getting there. Government borrowed less in the first half of 2017/18 than during the first half of 2016/17.

Public sector net debt

In March the OBR expected public sector net debt (PSND), the total **stock of Government debt**, to peak at nearly 89% of GDP this year, 2017-18. It is still considered that debt will peak during the fiscal year, but at the slightly lower figure of **87% GDP.**

As a comparison, the 2010 emergency budget predicted the gargantuan figure of 70% GDP, and Alistair Darling, Chancellor in the last Labour government, had planned for it to rise to no more than 75% GDP, from the **pre-crisis base of 35% GDP.**

Alternatively, another comparison might be the recorded public-sector net debt after World War 2 (1946/47), which was then a truly whopping **259% of GDP**!