TONY BLAIR
INSTITUTE
FOR GLOBAL
CHANGE

All Pain, Little Gain: An Economic and Fiscal Forecast of the Growth Plan

JAMES BROWNE
IAN MULHEIRN
DANIEL NEWPORT

Contents

Published at https://institute.global/policy/all-pain-little-gain-economic-and-fiscal-forecast-growth-plan on September 29 2022

Our Future of Britain project seeks to reinvigorate progressive politics to meet the challenges the country faces in the decades ahead. Our experts and thought leaders are setting out a bold, optimistic policy agenda across six pillars: Prosperity, Transformative Technology, Net Zero, Community, Public Services and Britain in the World.

Executive Summary

The UK economy is at a perilous point. The economic and fiscal outlook have deteriorated sharply since the Office for Budget Responsibility's (OBR's) last forecast in March. And the Bank of England is hiking interest rates at a rapid pace to curb surging inflation.

Against this backdrop the new prime minister and chancellor have announced two very large fiscal interventions. The first, the Energy Price Guarantee (EPG), a temporary package of support for households and businesses with high energy costs, will set a £2,500 ceiling on the typical annual household energy bill for the next two years, and provide similar support to businesses for at least the next six months. The second was the chancellor's Growth Plan, a package of permanent tax cuts amounting to some £45 billion per year by 2026–27.

In the absence of any OBR forecast, there is no official assessment of the impact of these measures on likely economic growth and the public finances. This is unfortunate not only because of the huge direct fiscal cost of the measures announced, but also because the chancellor's Growth Plan has the explicit goal of being a macroeconomically significant event. What, we should ask, are the likely macroeconomic implications of these policies, around which the government is constructing its narrative of growth, and how do they in turn affect the public finances?

To fill this gap, the Tony Blair Institute for Global Change (TBI) has partnered with Oxford Economics to produce an economic and fiscal forecast of the policies' likely effects on economic growth and the public finances.

We find that:

- The EPG will have a material impact on reducing the depth and length of the likely recession, which would otherwise have been severe. Without any additional policy measures, GDP would have fallen by around 2 per cent over the next year; the EPG reduces this fall to 0.6 per cent. We estimate that the gross cost of the EPG to the Exchequer will be £66 billion over the next six months, £78 billion in 2023–24 and £21 billion in 2024–25, but by mitigating the impact of the recession, which would reduce tax revenues and increase benefit spending, the net cost is significantly smaller.

- By adding substantially to the deficit, the package of tax cuts contained in the Growth Plan is set to push up interest rates further than would otherwise have been the case. Our forecast suggests that bank rate will peak at 5.25 per cent next year rather than around 4.5 per cent without it.
- This will increase the already accelerating cost of government borrowing, raising the deficit further beyond the cost of the tax cuts themselves. While the tax-cut package accounts for some £169 billion of additional borrowing over the five years to 2026–27, our forecasts suggest that the impact of higher gilt rates on the cost of government borrowing will add a further £82 billion to the public-sector net debt by the end of 2026–27, substantially increasing the direct cost of the tax cuts.
- Households with mortgages will also feel the pinch from rising interest rates. Higher mortgage rates are likely to lead to falling house prices as affordability for new homebuyers and those remortgaging declines sharply. But by pushing interest rates even higher than would otherwise be necessary, the tax-cut package increases the risk of significant house-price falls.
- While support for household and business energy bills makes a material difference to economic growth in the short term, we find that the Growth Plan tax cuts have an almost negligible impact on the size of the economy by the end of the forecast period, with output only around 0.4 per cent higher by 2027–28 than it would have been without the tax cuts. The Growth Plan's tax measures therefore look set to fall well short of the chancellor's stated aim of boosting GDP growth back to 2.5 per cent from the OBR's previous assessment of trend growth settling at around 1.7 per cent per year.
- Absent the tax cuts, public-sector net borrowing would be expected to reach £209 billion in 2023–24, in part due to the costs of the EPG support package. But this rises to £258 billion once the tax cut package is added. This takes the deficit to 9.7 per cent of GDP next year.
- Without the tax cuts announced on Friday 23 September, debt would have been expected to stand at 91.6 per cent of GDP by 2026–27 and be on a steady downward path. Instead, under our forecast, continued high deficits lead public-sector net debt to peak at 97.8 per cent of GDP in 2026–27. This would appear to contradict the chancellor's intention to have debt falling as a proportion of national income in the medium term. It is likely that the debt-GDP ratio would remain around this level rather than gradually falling over time.
- The tax cuts announced in the Growth Plan have implications for the government's fiscal rules. The fiscal mandate, requiring debt to be falling as a proportion of GDP in the third year of the forecast, is *not met* by a margin of £27 billion under our forecast of current policy. Without the tax-cut package this rule would have been *met* with a margin of £29 billion.
- The government's supplementary target requires the current budget to be balanced at the same point at the third year of the rolling forecast period. Under our forecast for current policy this rule is also *not met*, with £85 billion of excess borrowing in 2025–26. This rule would also have been missed without the tax cuts, but by a much smaller margin of £15 billion.
- Despite the claims made by the government, the tax cuts announced in the Growth Plan are unlikely to stimulate significant growth, and certainly not enough to offset the cost of the tax cuts

themselves to the public finances. They will, however, push up interest rates in the short and medium term, substantially exacerbating the deficit as government debt-service costs rise as well as worsening the pain for households with mortgages and potentially leaving many recent homebuyers in negative equity. The government now faces politically toxic choices if it is to re-establish fiscal credibility.

Introduction

The UK economy is at a perilous point. Even if the government had not announced any policy changes since March, it is likely that the OBR forecast for growth, inflation and the public finances would have deteriorated significantly since the spring.

Back in March, the Office for Budget Responsibility (OBR) was expecting gas prices to fall back to normal levels relatively quickly based on prices in the futures market at that time. Although the gas-futures curve is lower than it was at its peak in August, high prices are now expected to peak this winter at a much higher rate than in the OBR's March forecast (more than £5 per therm compared to £3 per therm) and endure for much longer, not falling below £2 per therm (roughly the point at which government has frozen prices) until 2025.

Consumer price index (CPI) inflation was expected to peak at below 9 per cent in the fourth quarter of this year; it is already above 10 per cent. In response to this, the Bank of England has tightened monetary policy more quickly than expected. Based on market expectations, the OBR expected in March that bank rate would peak below 2 per cent at the end of 2023, a level that has already been surpassed, and expectations of the peak were heading higher throughout August. Similar developments have occurred in other major advanced economies. Over the summer, the Bank of England forecast that the UK economy would skate very close to recession over the next two years, with economic growth flatlining and unemployment rising.

Shortly after becoming prime minister, Liz Truss's first act was to announce perhaps the biggest single fiscal measure in British history as she committed to freeze household and business energy bills. This puts the Exchequer on the hook for potentially hundreds of billions of pounds of borrowing over the next few years. At present, the government has no clear exit strategy from this liability apart from hoping that energy prices fall.

It was against this unusually turbulent backdrop last week that new Chancellor of the Exchequer Kwasi Kwarteng announced his Growth Plan, characterised by some £45 billion of tax cuts by 2026–2027. No OBR forecast was requested by HM Treasury for what was essentially a budget in all but name. This lack of independent scrutiny was concerning not only because of the scale of the policy measures contained in the plan, nor the uncertain economic environment into which they have been pitched, but because the measures claimed to be of macroeconomic significance.

Will they lead to the economic growth the chancellor has promised? And how will the macroeconomic implications play back on the public finances? Compared to most fiscal events, these questions are unusually salient in light of the chancellor's announcement, making a full macroeconomic assessment even more pressing to adjudicate the claims being made. While the OBR was not asked to give its assessment, it was left to financial markets to deliver their verdict on the likely impact. With gilt yields ballooning and sterling dropping sharply, their lack of confidence has been all too apparent.

So how might the OBR have assessed the macroeconomic consequences of the tax cuts and deregulation measures contained in the plan? In this paper, the Tony Blair Institute for Global Change (TBI) has worked with Oxford Economics, using its macroeconomic and fiscal models to provide a forecast of the outlook for the economy and the public finances, both with and without the Truss-Kwarteng Growth Plan. Our intention is to simulate as closely as possible what the OBR's macroeconomic assessment would have been, had it been asked to produce a forecast.

Will the Growth Plan make an impact on the state of the economy in the coming years? What does it mean for interest rates and the national debt? And finally, what are the implications of the package for the government's fiscal rules, designed to keep debt and borrowing under control? Our fiscal forecast offers answers to these questions.

Recent Economic Developments

Since the March budget, the economic outlook has deteriorated significantly, primarily as a result of surging wholesale gas prices. Energy prices have risen to historic highs across Europe as a result of an almost complete halt in supplies of natural gas from Russia, alongside nuclear and hydroelectric outages in Europe. These developments have ratcheted up pressure on household budgets and led to rapidly rising inflation, prompting the Bank of England to embark on a series of interest-rate hikes intended to contain inflation. In August the Bank forecast that the economy would enter recession later this year, with no growth expected until 2024.

The outlook for energy prices remains challenging. While prices have fallen back from late-August highs of over £6 per therm to under £3 per therm today, futures prices for delivery this winter remain above £5 per therm. By contrast, a price below £2 per therm would be required to take typical household bills back below £2,500, and around 50p per therm to take prices back to pre-crisis levels. Based on recent futures prices for natural gas, we estimate that absent any government intervention, the typical annual household bill would rise to around £5,000 this winter and fall slowly towards £2,000 by 2026, still around double the level seen in recent years. Similar cost increases would be felt by business, threatening a wave of liquidations.

Figure 1 – UK gas-futures prices as of 19 September 2022

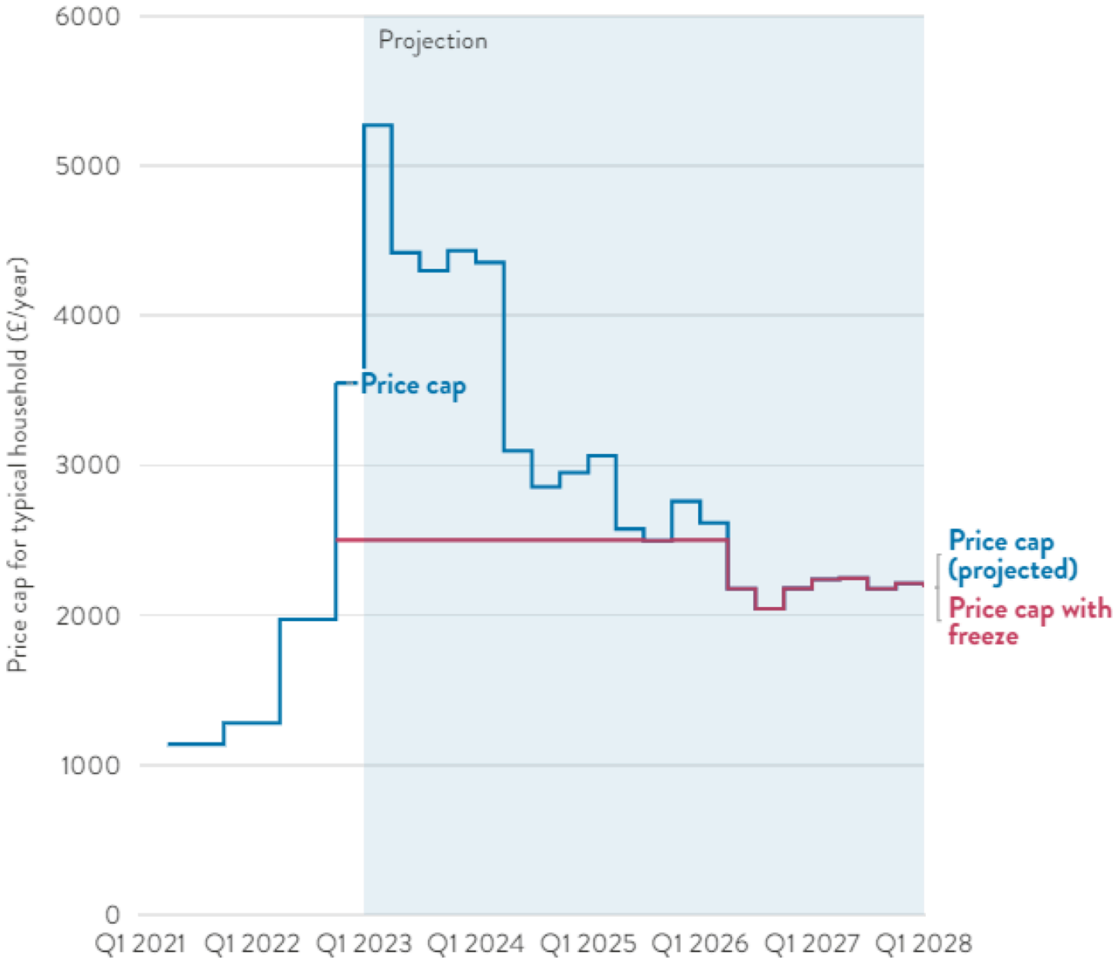
Source: https://www.theice.com/products/910/UK-Natural-Gas-Futures/data?marketId=5351153

Unabated, this increase in wholesale energy costs would have put a major strain on household and business finances. Households would have had to significantly reduce spending in other areas to be able to afford typical energy costs, expected to top £5,000 a year. This would have further weighed on demand elsewhere in the economy, lowering business profits, slowing growth and increasing unemployment. Our forecasts suggest that without any policy measures, growth would have been 1.2 per cent in 2023–24.

September Policy Measures

In the face of this unprecedented spike in energy costs, the prime minister announced further support for households and businesses on 8 September – the Energy Price Guarantee (EPG). Household energy bills will be subsidised to put a ceiling on costs for the typical household at £2,500 for two years from October 2022 to October 2024. Although the government has only committed to financial support for households for two years, for the purposes of this forecast we assume that it will not be viable to remove support until typical bills are below £2,500. Based on the latest futures prices, this is not expected to happen until 2026.

Figure 2 – Projected evolution of the price cap with and without Energy Price Guarantee



Source: ICE data, Ofgem data, TBI and Oxford Economics calculations

Businesses are being supported to a similar level in the short term, with the government extending the energy price freeze to businesses for six months from October. The government has committed to reducing or restricting business support after six months following a review. While there is no policy clarity as yet, for the purposes of the forecast we assume that such a review will reduce the ongoing Exchequer cost of supporting businesses by 50 per cent. We have scaled the fiscal cost of supporting businesses by the ratio of total business energy consumption to household energy consumption (around 95 per cent). On these assumptions we estimate the total cost of the EPG to be £66.5 billion over the next six months and a further £78 billion, or 2.9 per cent of GDP, in 2023–24.

Aside from the crisis response, the Truss administration has also been quick to set out an ambitious tax-cutting and deregulation agenda in its Growth Plan announced by the chancellor last week. Kwasi Kwarteng announced the cancellation of the new Health and Social Care Levy and planned increases in corporation-tax rates that were due to be implemented from next April. He also brought forward a 1p cut in the basic income-tax rate set to be introduced in 2024. In a surprise move, the 45 per cent "additional" income-tax rate was abolished, lowering the top income-tax rate to 40 per cent.

The scrapped tax rises were expected to raise £13 billion [1] and £19 billion respectively in 2026–27; the abolition of the 45 per cent income-tax rate is expected to reduce revenues by £2 billion a year in the long run. These changes are intended to boost output by strengthening workers' incentives to earn more and encourage firms to invest in the UK. Together with a range of other tax cuts, including to stamp-duty land tax and VAT for foreign shoppers, these measures added up to a net giveaway of £45 billion per year by 2026–27.

The tax measures in the Growth Plan were also accompanied by announcements on the government's intended direction of travel on deregulation. Notably, the chancellor committed to introducing Investment Zones around the country in which businesses will benefit from lower taxes, planning liberalisation and greater control over local growth funding.

Previous OBR assessments have expressed scepticism about the overall growth impact of spatial-growth measures. In response to Rishi Sunak's announcement of a similar policy in 2021, the watchdog concluded that "the main effect of the freeports will be to alter the location rather than the volume of economic activity, so the costs have been estimated on the basis of activity being displaced from elsewhere." We adopt a similar approach in this forecast, assuming no net impact on national economic growth from the measure within the forecast period.

The OBR has typically been reluctant to alter its estimates of the potential capacity of the economy in response to regulatory policy changes. For example, in response to the Plan for Growth published alongside Budget 2011, containing changes to planning policy and regulatory changes, the OBR said that "identifying the quantitative impact of such policies may not be possible for some time. Set against this uncertainty, we judge there is insufficient evidence at this stage to adjust our trend growth assumptions in light of these measures”. [2] Indeed, the OBR made no changes to its assessment of the capacity of the economy in response to policy changes for the first decade of its existence, only doing so for the first time in March 2020 in response to higher planned public investment. We assume that they would follow a similar practice in response to the regulatory changes hinted at in the Growth Plan.

Economic Forecast

To assess the macroeconomic and fiscal impact of these measures, TBI has worked with Oxford Economics to develop three scenarios for the economy and public finances between now and 2027–28.

1. The **baseline scenario** captures the outlook for the economy as it was in August, on the assumption of no further measures from the government on either taxation or energy bills beyond what had previously been announced. In keeping with usual OBR methodology, we adopt market expectations for the outlook for interest rates in the ten working days up to 22 August for the baseline scenario.
2. The **Energy Price Guarantee scenario** assumes the government's energy price freeze for households, in line with the assumptions outlined above. For interest rates in this scenario we take market expectations in the ten working days from 5 September, the day of the announcement that Liz Truss would be the new prime minister, after which point the outline of the EPG became clear.
3. The **Growth Plan scenario** incorporates all fiscal measures taken so far, both the EPG and the measures announced by the chancellor on Friday 23 September. In this scenario interest rates evolve in line with the Oxford Economics macroeconomic model.

Our results suggest that in the baseline scenario of no further policy action, the UK would have experienced a significant recession, with GDP falling by a little more than 2 per cent from its peak by the third quarter of 2023. Taken together, the policy measures announced since the start of September are insufficient to prevent the UK sliding into recession next year. However, they do make the predicted recession much milder – the peak-to-trough decline in GDP is only 0.6 per cent following the announcements made in the Growth Plan and earlier in September.

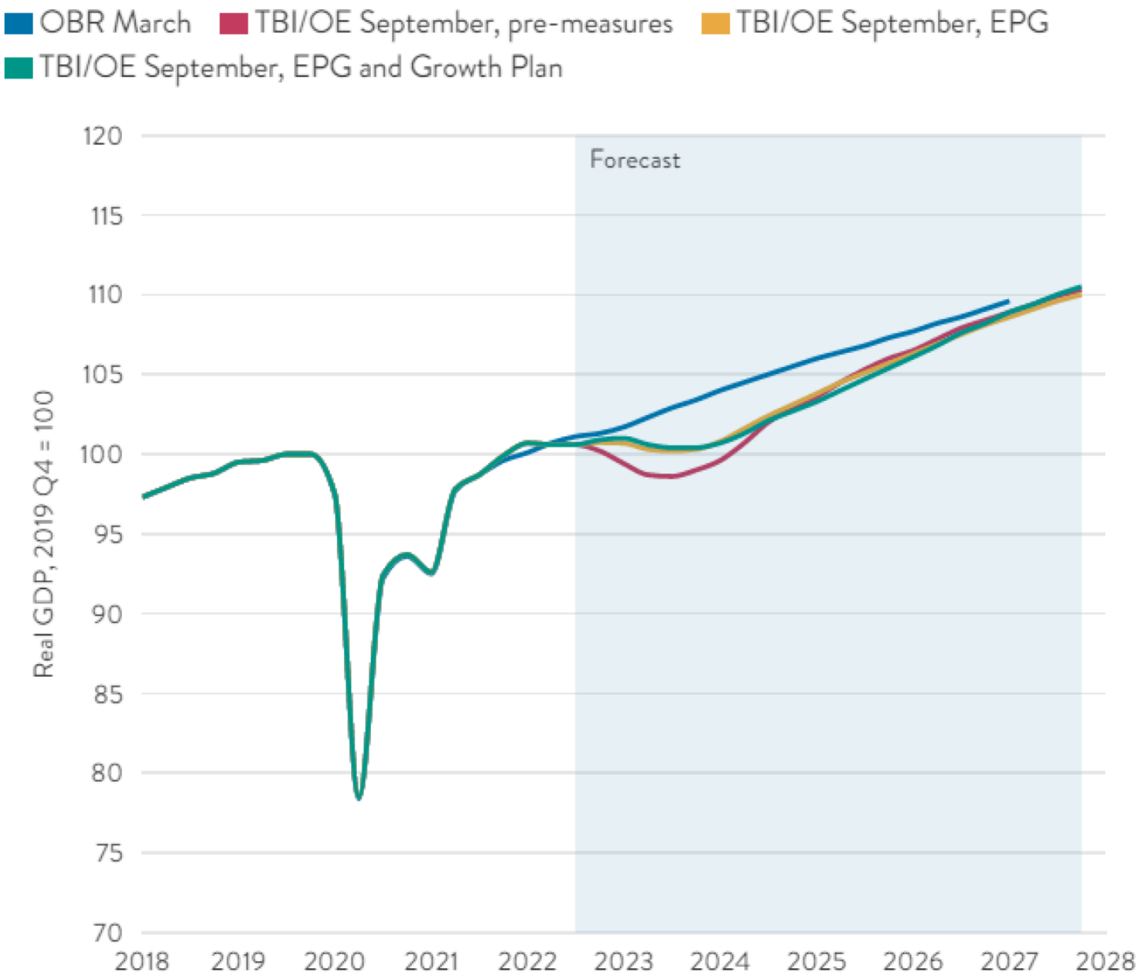
The government's Growth Plan tax cuts make barely any difference to the short-term outlook for growth; indeed, with interest rates rising further and faster as a result, the level of GDP is slightly lower than it would have been without the tax cuts in 2024 and 2025.

In the longer term, energy prices are expected to fall back to more normal levels: the energy price cap would be below £2,500 even without government interventions and inflation falls back towards its 2 per cent target in all scenarios. By the end of the forecast period in 2027–28 national income is only very slightly lower than the OBR expected in March under the baseline scenario and following the EPG support package.

The tax policy package announce in the Growth Plan does not significantly improve economic growth by 2027–28. Despite being the centrepiece of the government's growth drive, cutting corporation tax and abolishing the Health and Social Care Levy, combined with the various other tax measures, have only a small impact on economic growth over the next five years.

By 2026–27, the economy is forecast to be just 0.4 per cent larger than in the scenario where the tax cuts were not introduced. Adding less than 0.1 percentage points to the growth rate over the forecast, the Growth Plan looks set to fall well short of the chancellor's stated aim of boosting GDP growth back to 2.5 per cent from the OBR's previous assessment of trend growth settling at around 1.7 per cent per year.

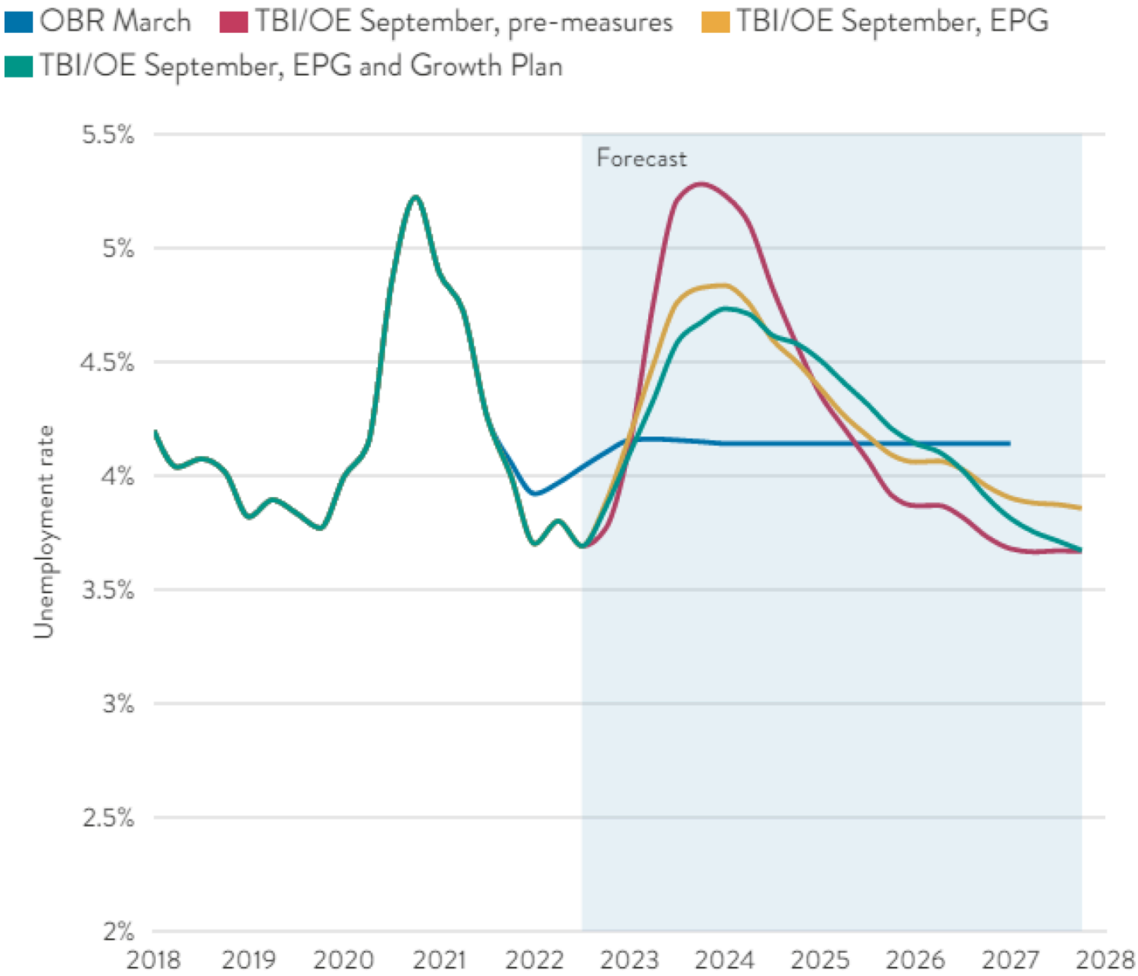
Figure 3 – Real GDP (2019 Q4 = 100)



Source: Oxford Economics/Haver Analytics

Unemployment increases by less as a result of the government's action on energy bills, remaining below 5 per cent, whereas it would have peaked at 5.3 per cent without any further support to households.

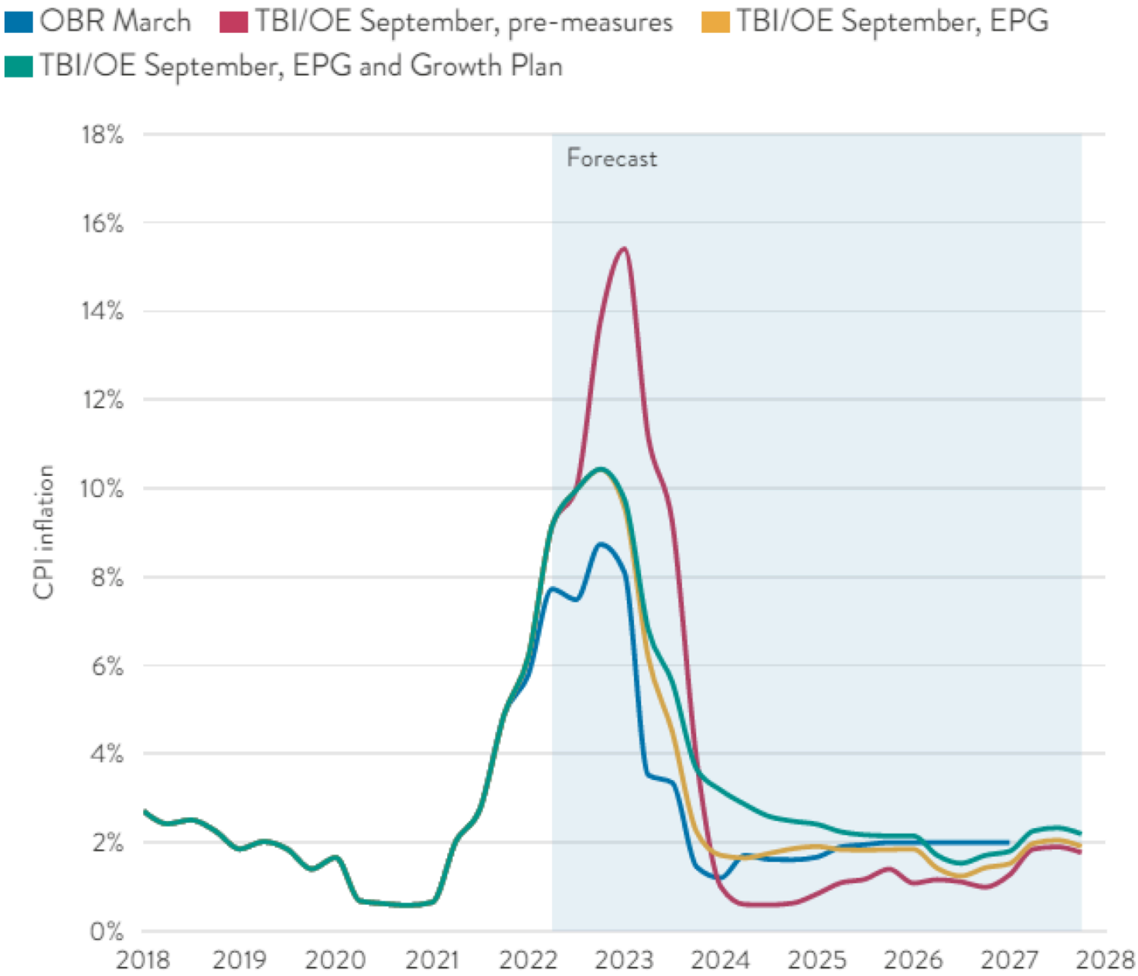
Figure 4 – Unemployment (International Labour Organization definition)



Source: Oxford Economics/Haver Analytics

By lowering energy prices relative to the pre-measures scenario, the EPG has a large mechanical impact on CPI inflation. In light of all the policy measures announced, the forecast sees inflation peaking relatively soon at a little over 10 per cent and then falling relatively quickly over the following two years. By contrast, without any intervention, it is estimated that inflation would have risen to more than 15 per cent in the first quarter of next year before falling back even more rapidly as energy prices come down in line with gas-futures curves.

Figure 5 – Consumer price index (CPI) inflation

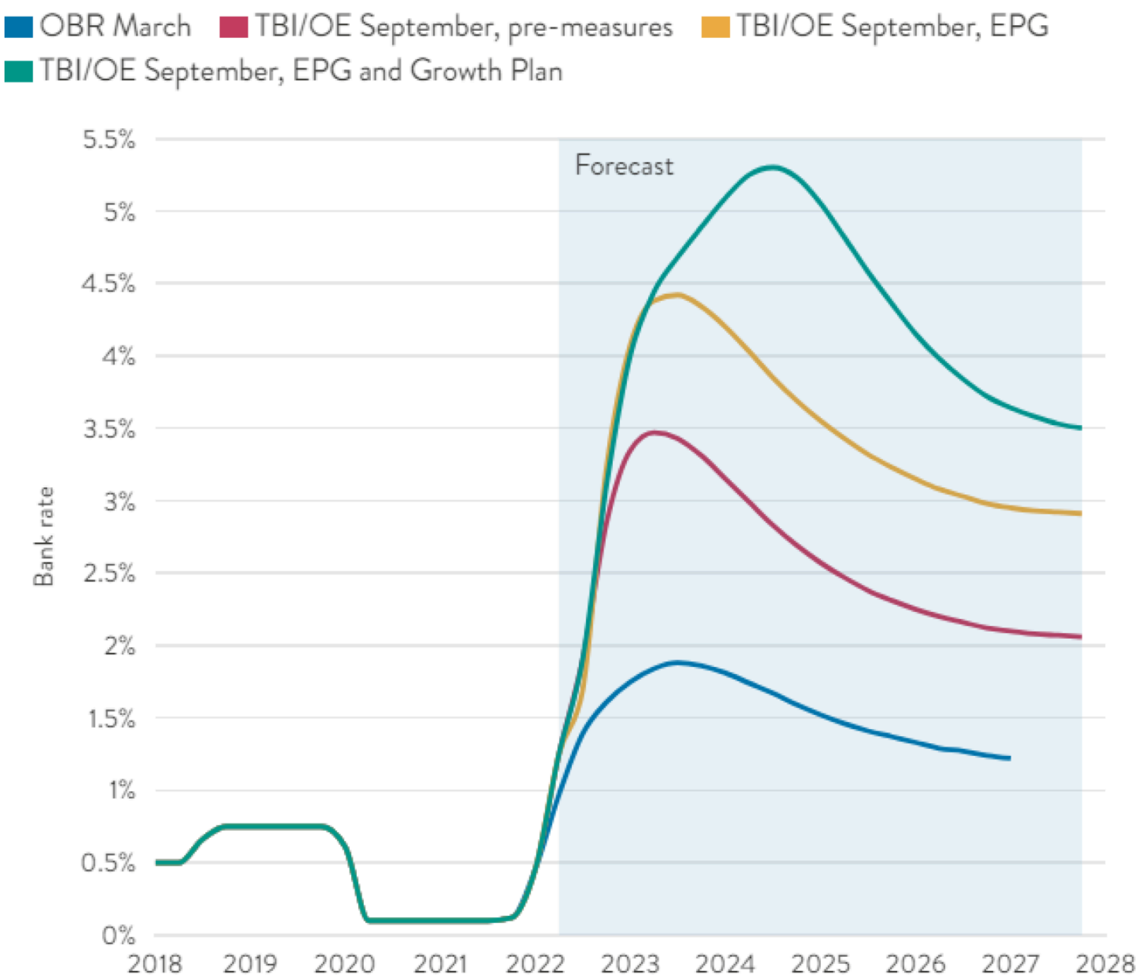


Source: Oxford Economics/Haver Analytics

The extra demand-side boost brought about by reducing household and business energy bills forces the Bank of England to raise interest rates further to return inflation to its 2 per cent target. Whereas bank rate would have peaked at 3.5 per cent in the second quarter of 2023 without any of the policy changes announced since the beginning of September, under the EPG-only scenario the Bank of England has to raise rates to 4.5 per cent by the middle of 2023.

The additional demand-side stimulus from tax cuts announced in the Growth Plan increases the size of the required rise in interest rates still further, to return inflation to its 2 per cent target. Once these are added, we expect bank rate to continue rising to 5.25 per cent by the middle of 2024 and it remains around one percentage point higher until the end of the forecast. Monetary tightening offsets fiscal loosening, leading to essentially no change in the size of the economy by the end of 2024.

Figure 6 – Bank rate



Source: Oxford Economics/Haver Analytics

This will increase debt-servicing costs for both the government and households, worsening the pain for households with mortgages in particular. Lower affordability for homebuyers from higher mortgage rates is also likely to lead to a drop in house prices, which could be significant. A recent Bank of England Working Paper suggests that a one percentage point increase in long-term interest rates from recent levels is associated with a 20 per cent reduction in house prices. [3] With the effect of the tax cuts on interest rates coming on top of an already significant spike, there is a growing risk that many recent homebuyers could find themselves in negative equity as a result.

Fiscal Outlook

Turning to the fiscal implications of the measures announced to date, both the EPG measures and the tax cuts announced in the Growth Plan are expensive and so drive up the government's budget deficit in the near term. We estimate the EPG measures will cost some £66 billion in the first six months alone (slightly higher than the Treasury's assessment of £60 billion). Since we assume that half of the support for business is maintained after six months, these measures increase spending by £78 billion in 2023–24 and £21 billion in 2024–25 also, with the support expiring thereafter.

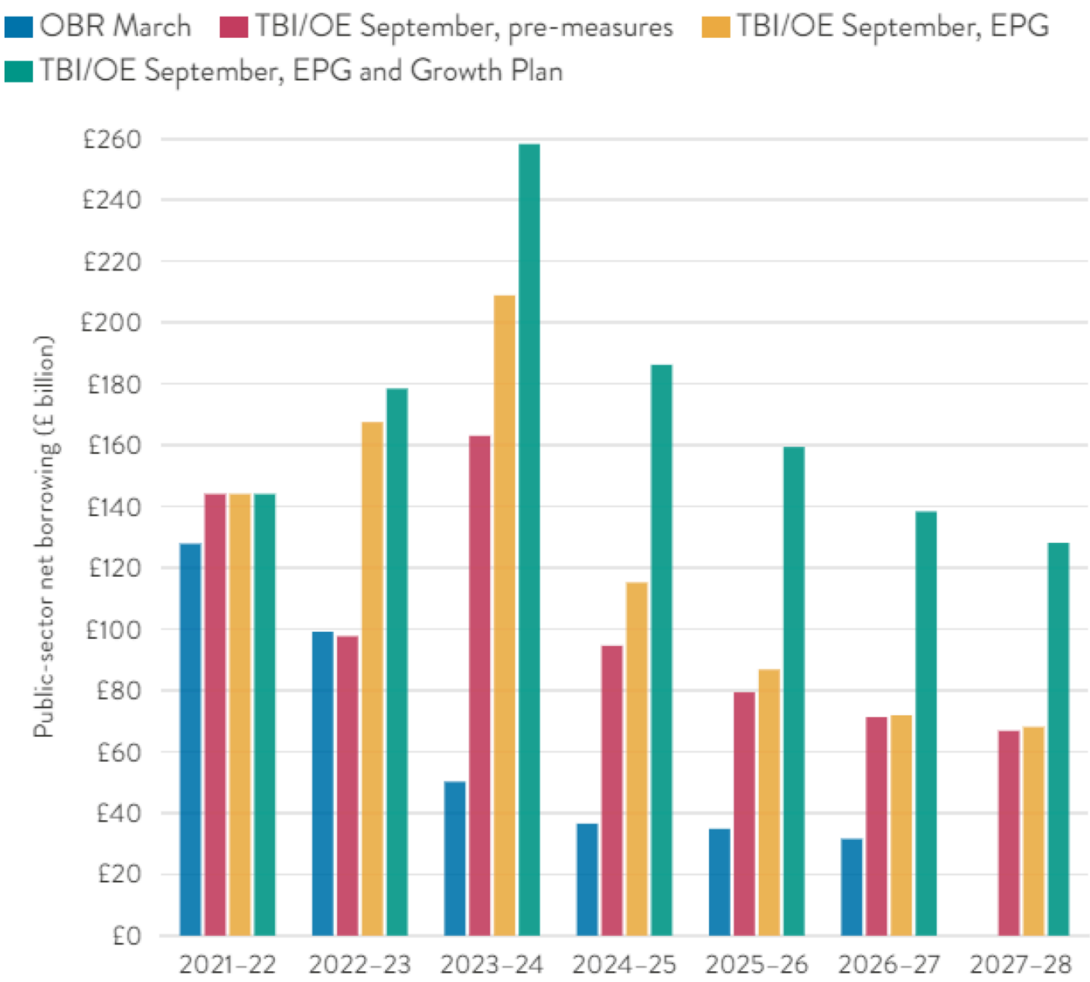
On the other hand, our scenarios show that not supporting households and businesses with their energy costs would also have been expensive for the Exchequer. Our modelling results suggest that lower tax revenues and higher benefit payments associated with a much more severe recession would have increased the deficit substantially in any case. In the no-policy baseline, the deficit would be expected to hit £163 billion in 2023–24, compared to £209 billion with the EPG in place. This suggests that the net cost of intervening in this way is significantly lower than the total spending on these measures.

By contrast, the tax cuts announced last week add substantially to the deficit without significant offsetting macroeconomic effects on growth. As a consequence, with all measures in place we now expect the deficit in 2023–24 to hit £258 billion.

Following all the announcements made in September, then, our results show the government's budget deficit peaking at 9.7 per cent of GDP in 2023–24 before falling to 4.0 per cent of GDP by 2027–28. This represents government borrowing some £128 billion in the final year of the forecast. Absent the tax-cut package, under the EPG alone, these figures would have been significantly lower, at 7.9 per cent and 2.2 per cent respectively. Overall, between 2022–23 and 2027–28 the government now looks set to borrow a huge £1.05 trillion in total, compared to around £720 billion without the tax cuts.

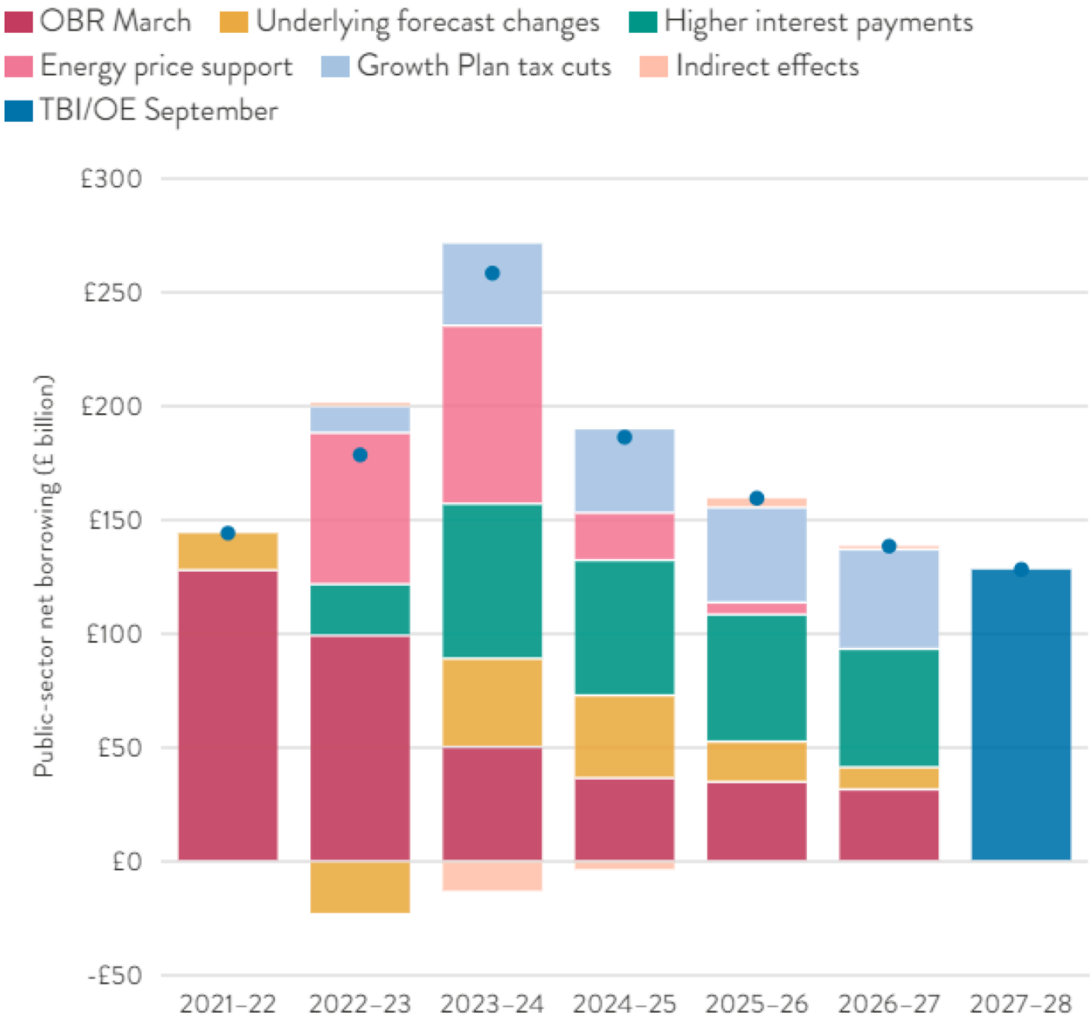
Compared with the OBR's March expectations, under both the no-policy baseline and the EPG-only scenarios the deficit at the end of the forecast period is set to be around twice the level of the OBR's expectation of 1.1 per cent by 2026–27. This is largely due to higher debt-interest payments resulting from higher interest rates than the OBR had forecast. Even in the scenario without any intervention, debt-interest costs are forecast to be around 2.5 per cent of GDP in 2026–27, significantly more than the 1.6 per cent the OBR expected in March. Offsetting this, higher inflation has reduced the budgets of government departments in real terms, as these are set in cash terms. In line with OBR practice, we have assumed that the government sticks to these spending limits and does not top up these budgets to meet the additional costs they face.

Figure 7 – Borrowing set to remain elevated throughout the forecast period



Source: Oxford Economics/Haver Analytics

Figure 8 – Higher interest payments and fiscal loosening cause forecast borrowing to rise



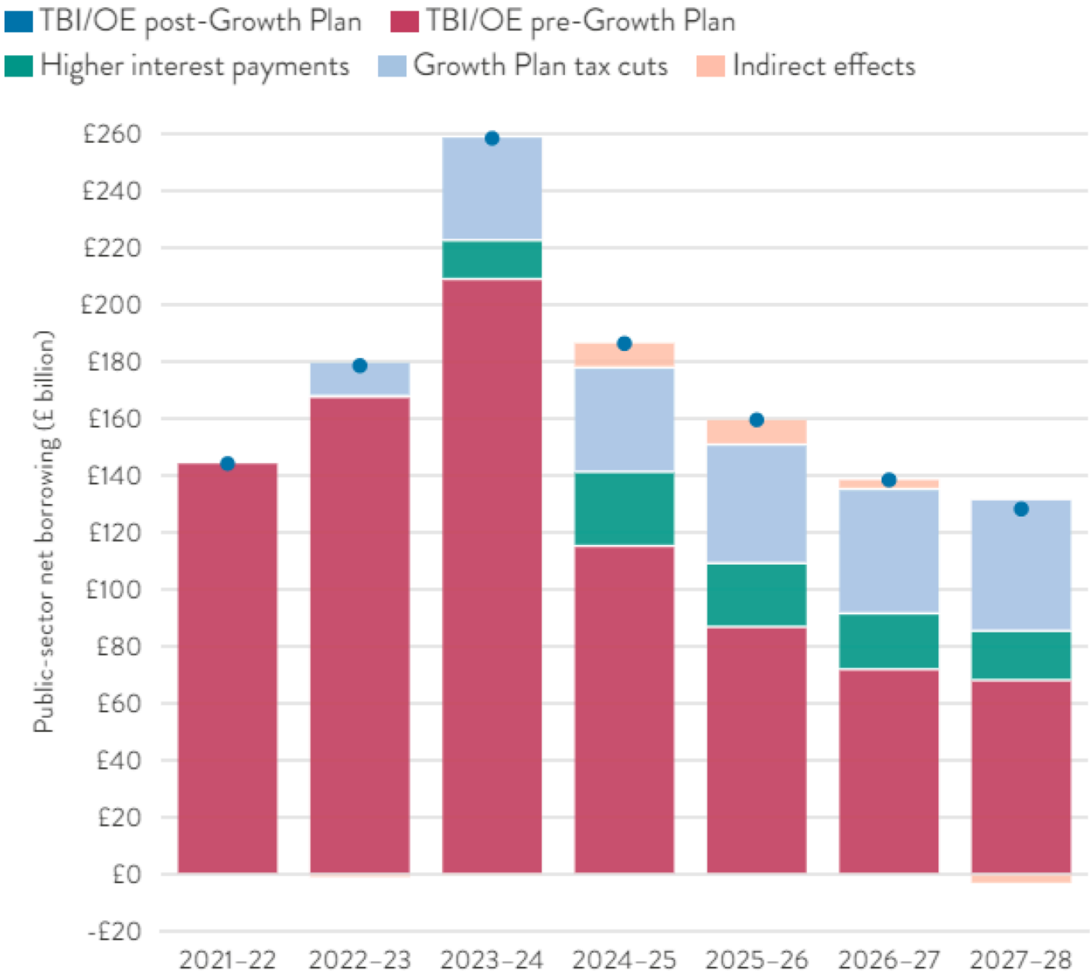
Source: TBI calculations using Oxford Economics/Haver Analytics

We can also isolate the impact of 23 September's Growth Plan. Figure 9 illustrates how the tax cuts announced increase the deficit by much more than the direct cost of the tax cuts themselves. Higher deficits lead to higher debt, and by forcing the Bank of England to raise interest rates higher, the Growth Plan measures increase total borrowing costs considerably. By the end of the forecast period, interest payments are £17 billion higher than they would have been in the absence of these measures.

With the economy ending the forecast period 0.4 per cent bigger than it would be without the Growth Plan, additional tax revenue from this higher economic output pushes in the other direction. However, we estimate that this revenue boost is likely to be only around £6 billion by 2027–28 – a small fraction of the fiscal cost of the measures themselves.

Over the five years to 2026–27, the tax cuts contained in the Growth Plan account for some £169 billion of additional borrowing (excluding pre-announced measures). But our forecasts suggest that the cumulative cost of government borrowing as a result of the tax cuts will add a further £82 billion to the public-sector net debt by the end of 2026–27.

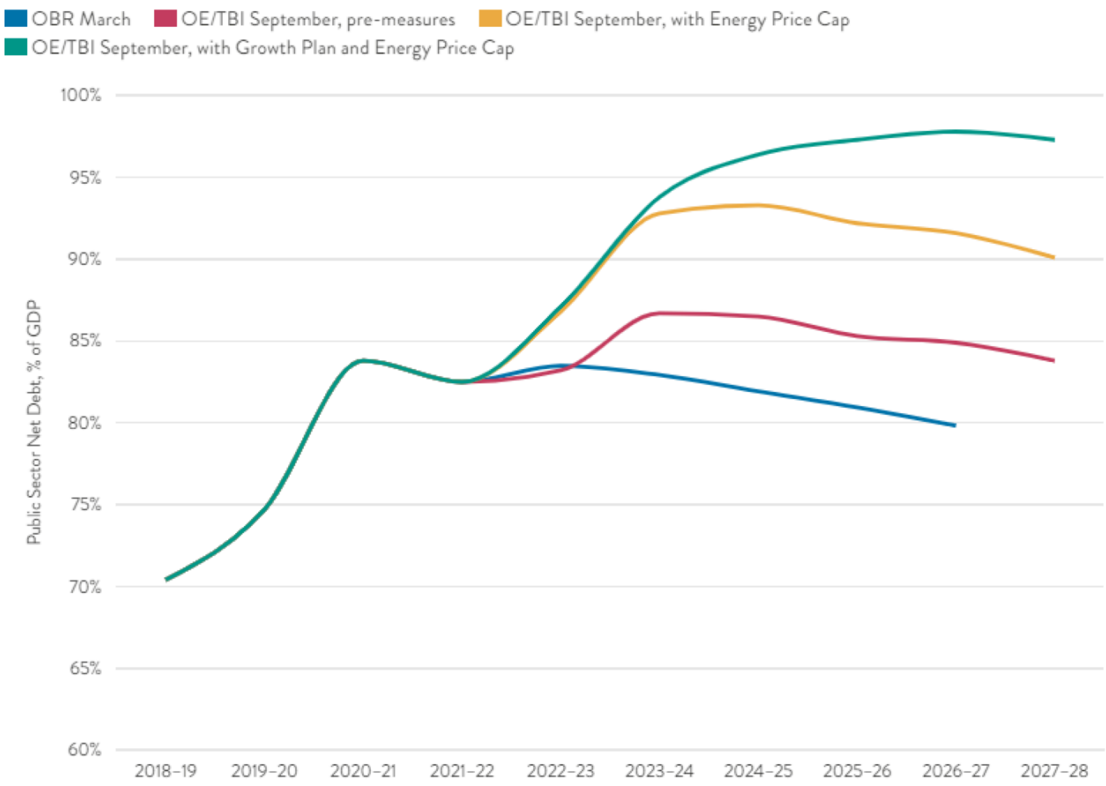
Figure 9 – Growth Plan tax cuts increase borrowing costs



Source: TBI calculations using Oxford Economics/Haver Analytics

Without the tax cuts announced on 23 September, debt would have been expected to peak by 2024–25, and by 2026–27 would be at 91.6 per cent and on a steady downward path. Instead, under our forecast, continued high deficits as a result of the tax-cut package lead to public-sector net debt rising by far more than the OBR expected in March. We now expect public-sector net debt to peak at 97.8 per cent of GDP in 2026–27.

Figure 10 – Growth Plan tax cuts cause debt to peak later and higher



Source: Oxford Economics/Haver Analytics

In his speech announcing the Growth Plan, the chancellor committed to publish a Medium-Term Fiscal Plan to reduce debt as a percentage of GDP over the medium term. However, in addition to rising well into the late 2020s, based on current plans it is far from clear that debt would fall after 2027–28. Growth in nominal GDP on our forecast is expected to be 4.8 per cent in that year, faster than the OBR's long-run assumption of around 4 per cent. If the government continued to run deficits of around 4 per cent of GDP in the late 2020s, with nominal GDP growth also expected to run at around 4 per cent, the debt-GDP ratio would stabilise at around 100 per cent, rather than gradually falling over time.

Figure 11 offers a full summary of the fiscal forecast including all announced measures.

Figure 11 – Summary of fiscal forecast

	21–22	22–23	23–24	24–25	25–26	26–27	27–28
			Revenue and spending				
Public-sector current receipts	38.4	39.1	38.4	38.2	38.1	38.2	38.3
Total managed expenditure	44.4	46.1	48.1	44.9	43.5	42.7	42.3
			Deficit: current supplementary targets				
Current budget deficit	3.4	4.8	6.9	4.1	2.9	2.0	1.5
Public-sector net investment	2.7	2.2	2.7	2.5	2.5	2.4	2.4
Public-sector net borrowing	6.0	7.0	9.7	6.6	5.4	4.5	4.0
			Debt: current fiscal mandate				
Public-sector net debt ex BoE	84.9	87.1	93.8	96.4.	97.3	97.8	97.3
Public-sector net debt	98.3	99.1	105.0	106.1	102.8	101.8	101.1

Note: Per cent of GDP unless otherwise stated

Source: Oxford Economics/Haver Analytics

Performance Against the Fiscal Targets

The government currently has four fiscal targets. Its fiscal mandate prescribes that debt excluding Bank of England interventions should be falling as a share of GDP by the third year of the rolling forecast period (that is, for current purposes, lower in 2025–26 than in 2024–25). With the Growth Plan tax cuts in place, this mandate is not met in our forecast – debt increases from 96 per cent to 97 per cent of GDP between those two years.

This would not have been the case in the absence of the chancellor's tax measures. In the scenario including the EPG but without the tax measures, debt falls from 93 per cent to 92 per cent of GDP between these two years, which would have left the government with a similar amount of headroom against this target as the OBR had expected in March (though at that point the third year of the rolling forecast period was 2024–25 not 2025–26).

Second, the government has a supplementary target that requires the current budget to be balanced at the same point at the third year of the rolling forecast period. Under our forecast for current policy, this rule is also not met – and by a wide margin of 2.9 per cent of GDP. To meet this target, £85 billion of tax rises or spending cuts in 2025–26 would be required.

While the current budget target is missed by a huge margin on announced policy, is not just the measures announced on 23 September that cause this: the target is also missed by 0.5 per cent of GDP or £15 billion in the scenario involving only the EPG support package. This contrasts sharply with the OBR's March forecast, in which it expected this target to be met by a margin of 1.2 per cent of GDP or £32 billion.

With no announced changes in investment spending and little change in forecast GDP, the government remains on course to meet its target to limit public-sector net investment to below 3 per cent of GDP over the five-year forecast period. The Oxford Economics model does not allow us to make an assessment of welfare spending levels to assess compliance with the welfare cap.

Figure 12 – Performance against the government's fiscal targets

		Per cent of GDP		£ billion	
		Forecast	**Margin**	**Forecast**	**Margin**
Year-on-year change in public-sector net debt excluding BoE in 2025–26	Not met	0.9	-0.9		-26.7
Current budget surplus in 2025–26	Not met	-2.9	-2.9	85.4	85.4
Public-sector net investment average over five-year forecast	Met	2.5	0.5		13.9

Source: Oxford Economics/Haver Analytics

It is worth noting that, sensibly, the government's fiscal charter enables it to suspend its fiscal targets in the event of a severe adverse shock to the UK economy. Although he did not do so on 23 September, the chancellor could make a plausible case that the ongoing energy crisis constitutes such a shock and suspend these targets in the budget expected later in the autumn.

This would not get him off the hook entirely. Assuming the chancellor remains committed to balancing the current budget at some stage, [4] he would need to announce lower spending or higher taxes over the longer term as our forecast suggests that the current budget deficit will still be £49 billion in 2027–28. However, it would allow him to continue with the announced policies for the moment without ditching the government's fiscal rules completely.

Conclusion

For a fiscal event that claimed to be macroeconomically important, it was unfortunate that the government did not ask the OBR to assess the wider implications of its Growth Plan policies. Our forecasts show that the plan's impact on economic growth is very small, even by 2027–28. However, the cost of the tax cuts, combined with their impact on debt-interest costs, mean that their wider impact on the public finances is severe. This underpins the strong market response we have seen in recent days. Debt looks set to stabilise at around 100 per cent of GDP in the medium term.

The choices ahead for the government are grim. To prevent borrowing costs going still higher, which would have severe consequences for households with mortgages, re-establishing fiscal control will be critical. Doing so via a reversal of the tax cuts just announced would be politically unthinkable. But as pressure on the NHS and other public services builds through the winter, public-spending cuts are likely to be even more politically damaging.

Footnotes

1. ^ This costing is net of £2 billion paid by public-sector employers, for which they were compensated by HM Treasury. In the short term, reversing this tax rise will cost £15 billion as this additional money earmarked for paying employer contributions will be added to the Treasury's reserve rather than this spending being cancelled altogether.
2. ^ See p.39 of OBR (2011), Economic and Fiscal Outlook: March 2011, Cm 8036, https://obr.uk//docs/dlm_uploads/economic_and_fiscal_outlook_23032011.pdf.
3. ^ D. Miles and V. Monro (2019), "UK House Prices and Three Decades of Decline in the Risk-Free Real Interest Rate", Bank of England Staff Working Paper 837, https://www.bankofengland.co.uk/working-paper/2019/uk-house-prices-and-three-decades-of-decline-in-the-risk-free-real-interest-rate.
4. ^ Though it is not entirely clear that the chancellor is still committed to maintaining a current budget balance from an HM Treasury statement on Monday. Announcing a fiscal plan to be published on 23 November, the Treasury said that this document "will set out further details on the government's fiscal rules, including ensuring that debt falls as a share of GDP in the medium term", suggesting that the rules themselves may be changed.

FIND OUT MORE
INSTITUTE.GLOBAL

FOLLOW US
facebook.com/instituteglobal
twitter.com/instituteGC
instagram.com/institutegc

GENERAL ENQUIRIES
info@institute.global