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Media comment

Budget 2013: Yet another fiscal slip

20 March 2013

Schroders Azad Zangana, European Economist, comments on this year's budget

"The Chancellor's fourth budget was fraught with conflict between trying to provide tax cuts to stimulate growth (and satisfy his party's backbenchers), but also to bring down the government's public deficit. Osborne's unapologetic and almost confrontational budget seeks to provide useful tax breaks for low earners and corporates, but will be paid for by a further squeeze on departmental spending.

"The Office for Budgetary Responsibility (OBR) has once again downgraded its growth forecast, and revised up its inflation predictions for the coming years. The impact of the changes from the OBR's forecast for growth and inflation were for higher government borrowing than previously expected. In comparison to the OBR's forecast from only last December, government debt is now set to peak one year later, and is expected to be £103 billion higher in 2017/18 – or 7.5% of GDP. This is yet another fiscal slip from the Chancellor, but it highlights his flexibility with regards his own fiscal rules, and the need to support growth.

"The impact overall impact of the policy announcements for the economy is likely to be muted in the near term, but the rebalancing of public spending away from non-investment spending towards investment spending could help provide a boost from 2015. This will largely depend on whether the cuts in non-investment spending will lead to a fall in services being provided, or whether the cuts can be delivered using efficiency savings. If efficiency gains can be made in the public sector, then we could see an acceleration in growth overall.

"Some of the key changes that we believe will help boost growth include the introduction of the National Insurance employment allowance of £2,000 which could help SMEs hire more workers; the additional cut in corporation tax, which will help attract more foreign direct investment, and finally, the expansion of the Funding for Lending Scheme, which is already having a positive impact on the mortgage market.

"The Chancellor has also decided to take advantage of the government's balance sheet to provide guarantees for first time buyers struggling to raise sufficient deposits. In addition to the Help to Buy scheme (an echo of the Thatcher Right to Buy scheme), total off-balance sheet stimulus from the government will be close to £5 billion, which is relatively small when compared to the size of the economy (0.3% of GDP).

"With regards to the Bank of England and monetary policy, the decision to allow for the Bank to set interim thresholds and targets for CPI inflation seems sensible, and the use of forward guidance will help manage market expectations. However, we believe the equilibrium rate of inflation in the UK is no longer compatible with a 2% target, and so the Bank's credibility will once again be questioned in the future.

"Overall, the Chancellor managed to deliver some better than expected changes to taxation which will no doubt satisfy his political party, however, the government could have done more to boost public investment either through greater non-investment spending cuts, or a greater use of their balance sheet through guarantees. The OBR's growth expectations remain too optimistic beyond 2014, which means that further fiscal slippage is likely in the future. "

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