Fiscal risks report

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Team Leader, Fiscal risks and sustainability

IFoA, December 2018
Background to the FRR

- Weak risk reporting a failing against IMF Fiscal Transparency Code

- In 2015 the Treasury decided that the OBR should publish a risks report every two years and required this in legislation, including a commitment for the Government to respond within a year

- Most other FRRs produced by finance ministries or cabinet offices

- Scoping report in 2016: IMF guidelines and international experience.

- First FRR published and laid in parliament in July 2017

- FRR II due in 2019
Our approach

• The IMF defines fiscal risks as
  – “the possibility of deviations of fiscal outcomes from what was expected at the time of the Budget or other forecast”

• We adapted this to focus on risks
  – To our most recent (March 2017) forecast over the medium term
  – To fiscal sustainability over the longer term
  – With greater attention to downside risks in both cases

• We were particularly interested in
  – The probability of particular risks and their potential impact
  – Whether they were correlated with other risks
  – What the government was doing about them
Structure of the report

- Introduction: analytical framework
- Macroeconomic risks
- Financial sector risks
- Revenue risks
- Primary spending risks
- Balance sheet risks
- Debt interest risks
- A fiscal stress test
- Conclusions

Including 57 issues that the Government might wish to consider in its response
Figure 10.1: Sources of fiscal risk over the medium term

- Fiscal stress test
- Financial crisis
- Typical recession
- Weak productivity growth
- Lower consumption and labour income shares
- Higher interest rates (1 ppt)
- Higher inflation (1 ppt a year)
- Low migration
- Higher tax litigation costs
- Lower incomes for high earners
- Faster growth in self-employment and incorporations
- Lower prices for expensive houses
- Lower dutiable consumption
- Income tax policy commitments
- Lower consumption share
- Triple lock: higher cost
- Additional adult social care spending
- Additional health spending
- No fuel duty RPI increases

Source: OBR
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Source: OBR
Debt interest spending

- Other public corporations
- Local authorities
- Central government net of the APF

Per cent of GDP


March 2017
EFO
Maturity of the debt stock

£ trillion

Central government gilts

Plus Treasury bills and NS&I products

Plus central bank reserves to finance APF purchases

- Over 10 years
- Up to 10 years
- Up to 5 years
- <1 year
Figure 10.1: Sources of fiscal risk over the medium term

<table>
<thead>
<tr>
<th>Impact on public sector net debt by 2021-22 (per cent of GDP)</th>
<th>Probability of crystallisation (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low (Less than 1)</td>
<td>Very low (Less than 10)</td>
</tr>
<tr>
<td>Very low</td>
<td>Low (10-40)</td>
</tr>
<tr>
<td>Low</td>
<td>Medium (40-60)</td>
</tr>
<tr>
<td>Medium (1-10)</td>
<td>High (60-90)</td>
</tr>
<tr>
<td>High (Over 10)</td>
<td>Very high (Over 90)</td>
</tr>
</tbody>
</table>

- **Fiscal stress test**
- **Financial crisis**
- **Typical recession**
- **Weak productivity growth**
- **Lower consumption and labour income shares**
- **Higher interest rates (1ppt)**
- **Higher inflation (1ppt a year)**
- **Low migration**
- **Higher tax litigation costs**
- **Additional health spending**
- **No fuel duty RPI increases**

Source: OBR
Actual and default fuel duty rates

- June 2010 with outturn RPI
- March 2017
- Outturn rates

Main fuel duty rate (pence per litre)

2008-09 2012-13 2016-17 2020-21
Impact of policy measures in 2017-18

Per cent of GDP

-3.0 -2.5 -2.0 -1.5 -1.0 -0.5 0.0 0.5 1.0


Individual fiscal events

Net giveaways

Cumulative effect

Net takeaways
Figure 10.2: Sources of risk to fiscal sustainability

Possible major fiscal risks not considered in this report:
- Major wars
- Climate change

- Higher growth-corrected interest rate
- Health spending: other cost pressures

- Lower productivity growth
- A typical recession every decade
- Adult social care: other cost pressures
- Health spending: ageing
- Financial crisis

- Triple lock: high cost
- Adult social care: central

- Low migration
- Greater fuel efficiency
- Lower smoking

- Continued growth in incorporations
- Adult social care: ageing

Source: OBR
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- Greater fuel efficiency
- Lower smoking
- Adult social care: ageing

Impact on public sector net debt by 2066-67 (per cent of GDP)

Source: OBR
The ageing population

Per cent of UK population

<table>
<thead>
<tr>
<th>Year</th>
<th>0-15</th>
<th>16-54</th>
<th>55-64</th>
<th>65-84</th>
<th>85+</th>
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</thead>
<tbody>
<tr>
<td>1967</td>
<td>25</td>
<td>50</td>
<td>12</td>
<td>12</td>
<td>1</td>
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<tr>
<td>2017</td>
<td>17</td>
<td>45</td>
<td>11</td>
<td>20</td>
<td>2</td>
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<tr>
<td>2067</td>
<td>12</td>
<td>51</td>
<td>16</td>
<td>16</td>
<td>7</td>
</tr>
</tbody>
</table>

Office for Budget Responsibility
Health spending as % of GDP

Per cent of GDP

No other cost pressures
Health spending and pressures

- Demographic and other cost pressures accommodated from 2018-19.
Health spending and pressures

Per cent of GDP

FSR 2018
Demographic and other cost pressures accommodated from 2018-19

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- Health spending: ageing
- Financial crisis

- Triple lock: high cost

Source: OBR
What’s left to do?

• Major risks:
  • Major wars
  • Climate change
  • Cyber security

• Cross-cutting themes
  • Inflation
  • Housing market
  • Mental health and chronic physical conditions
  • Interactions between different tax/spending items