The state of the UK economy

Professor John Fender

The expectation that the economy can be expected to grow at a fairly slow pace in the foreseeable future was confirmed, with the Office for Budget Responsibility predicting growth of 0.6% for 2013 and 1.8% for 2014. The budget deficit, in money terms, is expected to be almost exactly the same this year as last year, with little change next year, before falling more significantly in succeeding years. Of course, since gross domestic product in money terms is still expected to grow, the deficit as a fraction of GDP will shrink, but the debt to GDP ratio is now expected to peak at 85.6% in 2016-7 before starting to fall gradually. This will be painfully close to the 90% ratio that is sometimes believed to be the threshold beyond which economic performance starts to deteriorate significantly. It is not at all surprising, therefore, that he did not relax the fiscal consolidation programme. Arguably, he was right to do so – any significant relaxation could have had very damaging consequences. It does seem that his policy is working – but it is working very slowly.

Whether monetary policy can boost the economy, given that fiscal policy is severely constrained by the deficit problem, is another question. There was speculation that there might be a significant change in the remit given to the Bank of England. This did not happen. There was some change to the remit – or perhaps it would be better to describe it as a change in the way the remit is interpreted. For example, it seems to give the green light to the Bank's recent practice of not tightening policy in periods of above target inflation if it believes inflation will return to its target in due course. Also, the Bank of England is encouraged to consider 'explicit forward guidance' and 'intermediate thresholds'. What this means is practice is to be seen, but the idea is that the Bank may make commitments of some sort to a future time path of interest rates. This may help alleviate fears that interest rates might be hiked as soon as there is the slightest sign of recovery in the air, and this might tend to make monetary policy a little more effective than it currently is.

Although we are supposedly living in a time of austerity, there were a number of significant tax cuts – or cancellations of tax increases. The personal allowance rises to £10,000 in 2014, and corporation tax will fall to 20% in 2015 – down from 28% when the government came to power. Beer drinkers and motorists will benefit from changes to beer and fuel duty. There may be political reasons for such measures, but whether they will lead to any significant improvement in the economy is another question.

Finally, one measure to be skeptical about is the Help to Buy mortgage support scheme. By making more mortgages available, this is likely to push up house prices, but in the absence of any change in the supply of houses, will not enable more people to buy houses. Increasing the supply of housing is crucial in this respect, but the budget did nothing to being this about.

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