Economic outlook and public spending

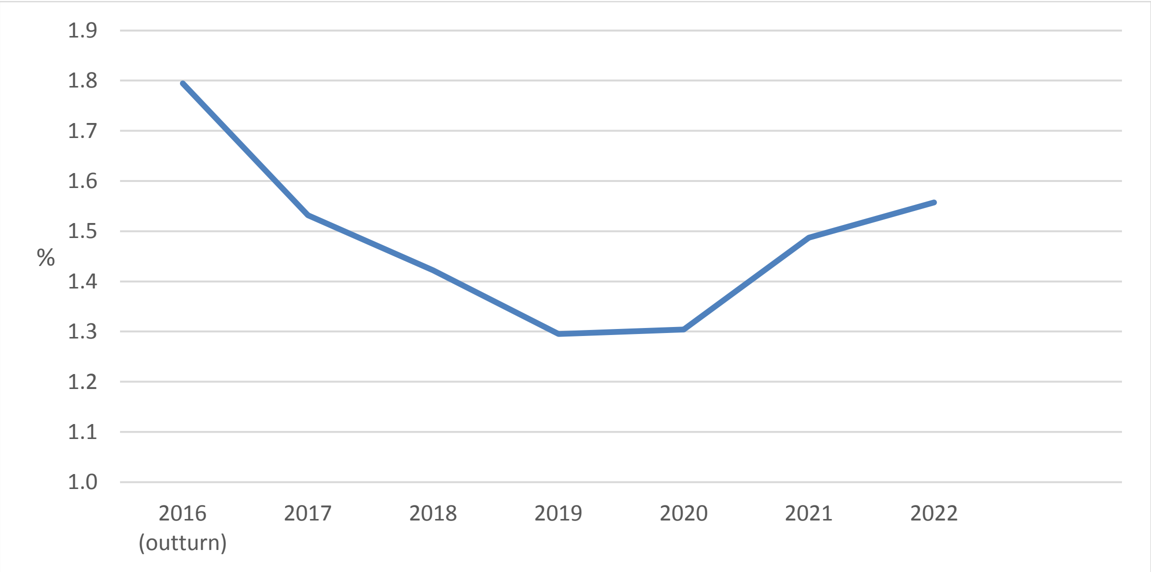
A.2.1. The Council's financial and service planning takes place within the context of the national economic and public expenditure plans and under global economic influences. This appendix explores that context and identifies the broad global and national assumptions within which the draft budget and MTFP have been framed.

The UK Economy

A.2.2. The strongest impact on the economic outlook has the process of the United Kingdom's withdrawal from European Union, in particular the progress in the Article 50 negotiations between the UK and the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff edge, but may also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

A.2.3. The UK economy has slowed this year, the Gross Domestic Product (GDP) growth forecast by the Office for Budget Responsibility (OBR) was revised downward by 0.5% to 1.5% in 2017, then growth is expected to slow down to 1.4% during 2018 and 2019, before rising to 1.6% during 2022. Services remain the strongest contributor to GDP growth. Graph A.2.1 shows the revised forecast in the Autumn budget (November 2017).

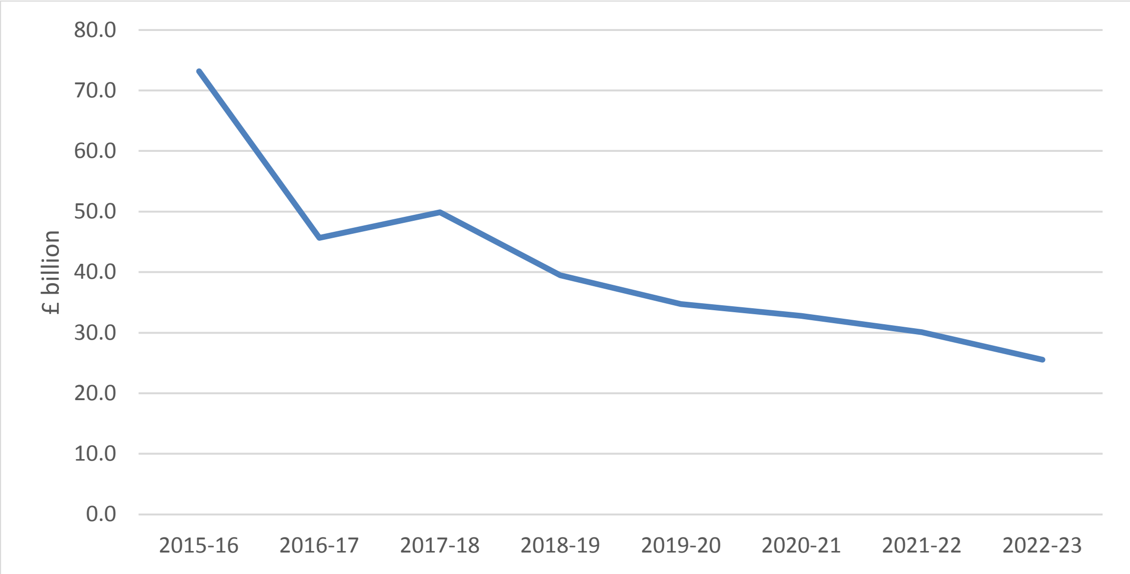
Graph A.2.1 The UK GDP growth forecast



Source: Office for Budget Responsibility

A.2.4. The amount of money the Government borrows each year, Public Sector Net Borrowing (PSNB) decreased by £3.1bn in comparison of the period April – November 2017 and the same period in 2016. The OBR forecasts PSNB (excluding public sector banks) will be £49.9bn during the financial year 2017/18. Graph A.2.2 shows the declining trend in the borrowing forecast. Public sector net debt (PSND) (excluding public sector banks) was £1,734.8bn in November 2017, which is equivalent to 84.6% of GDP, an increase of £72.2bn from November 2016.

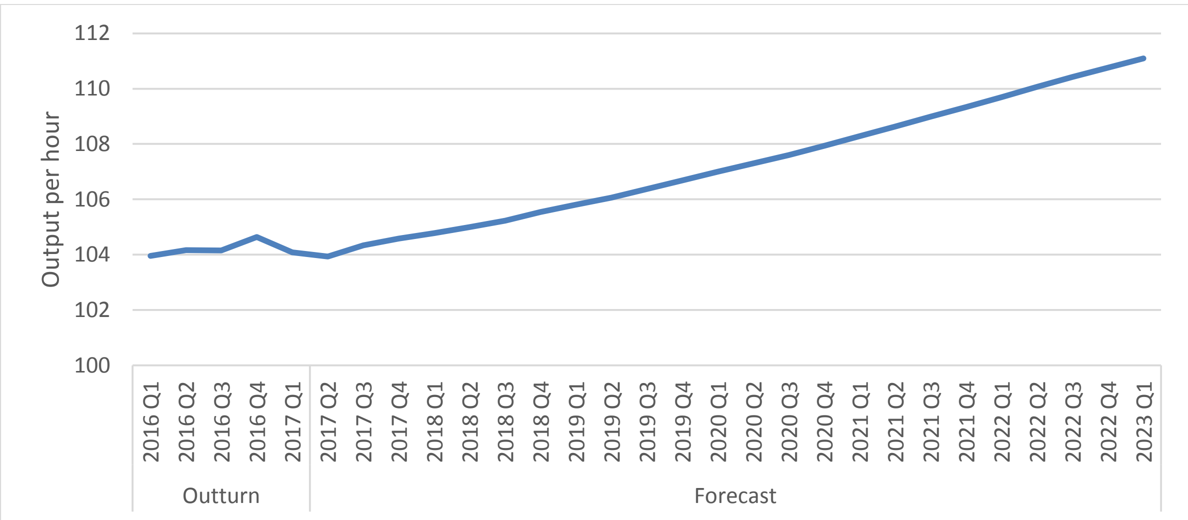
A 2.2 Public sector net borrowing forecast



Source: Office for Budget Responsibility

A.2.5. A persistent weakness of the UK economy is productivity growth. The OBR's November 2017 Economic and Fiscal Outlook statistics show 0.1% decrease in productivity (measured in units per hour) and over a longer time period, productivity growth has been lower on average than prior to the economic downturn. Consequently earnings and cost of labour growth outpaced the productivity growth. The OBR revised down the trend of potential productivity growth in November 2017 while reflecting the recent trends and admitting that huge uncertainty remains around the diagnosis of the recent weakness and the prognosis for the future. The revised trend is expected to rise from 0.9% this year to 1.22% in 2022. In January 2018 Office for National Statistics (ONS) released more optimistic statistics showing 0.9% of estimated productivity growth from Quarter 2 to Quarter 3 of 2017.

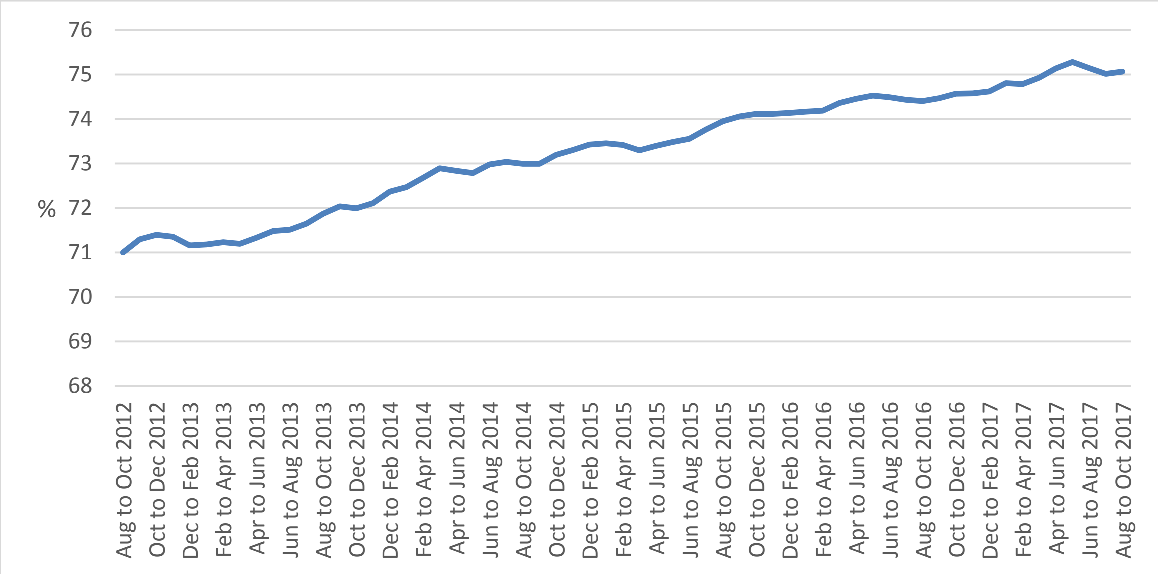
A 2.3 Productivity growth forecast (output per hour)



Source: Office for Budget Responsibility

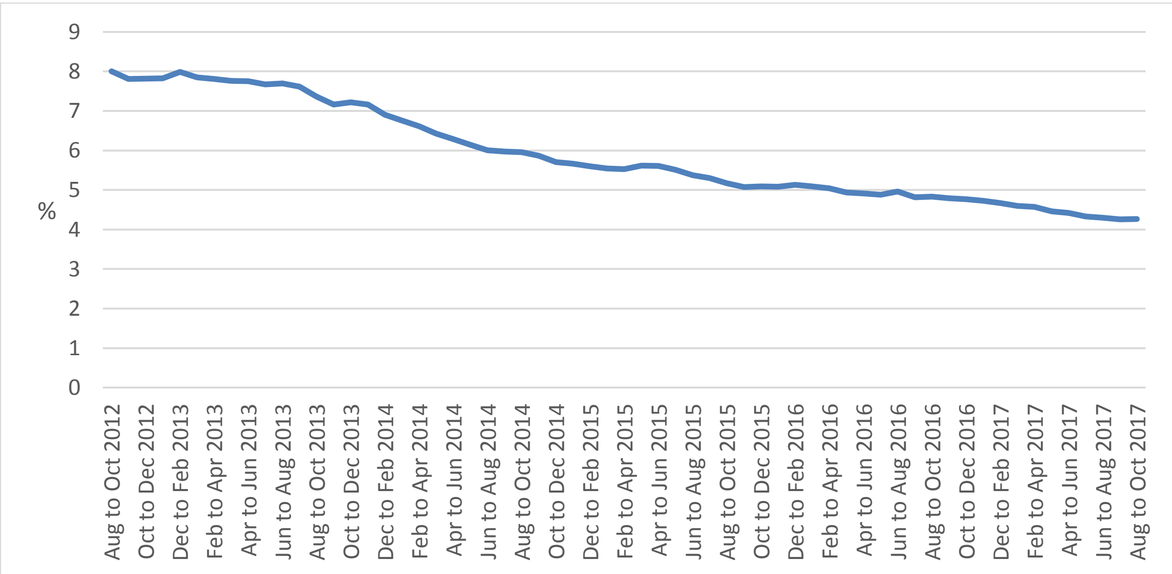
A.2.6. The UK labour market continues to perform well. The number of people in work has risen over the last year as shown in Graph A.2.4. Unemployment continued to fall, as shown in Graph A.2.5 and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. Graph A.2.6 shows the structure of the UK Labour Market.

Graph A.2.4 UK employment rate (people aged 16 to 64), seasonally adjusted



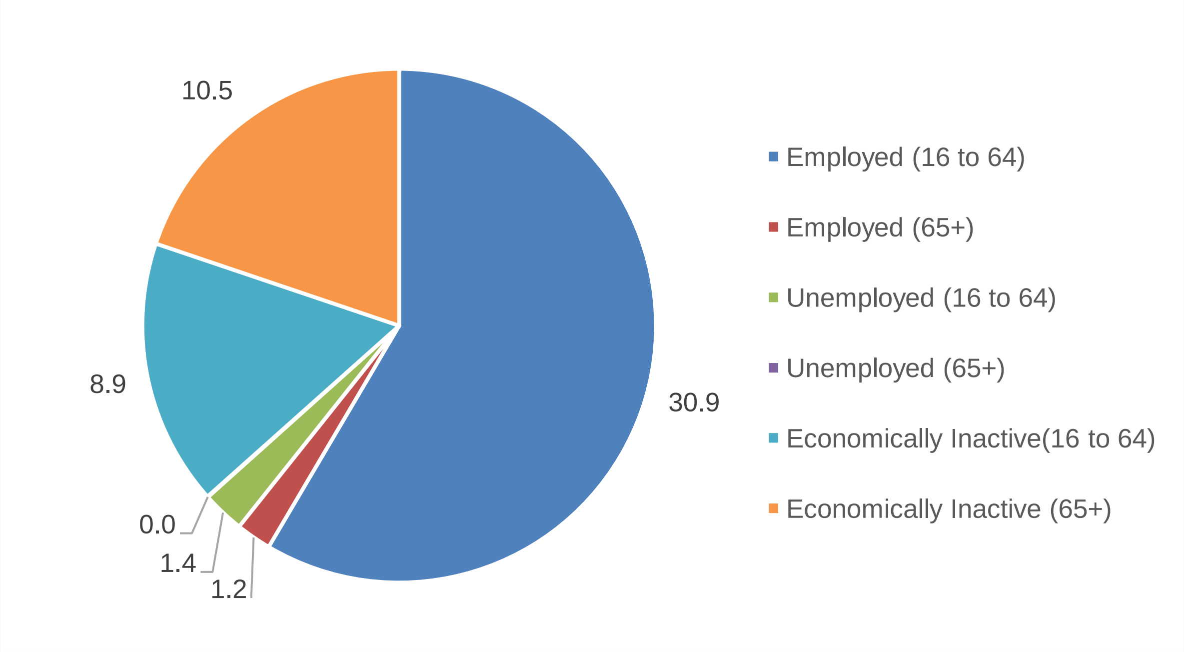
Source: Office for National Statistics

Graph A.2.5 UK Unemployment rate (people aged 16 to 64), seasonally adjusted



Source: Office for National Statistics

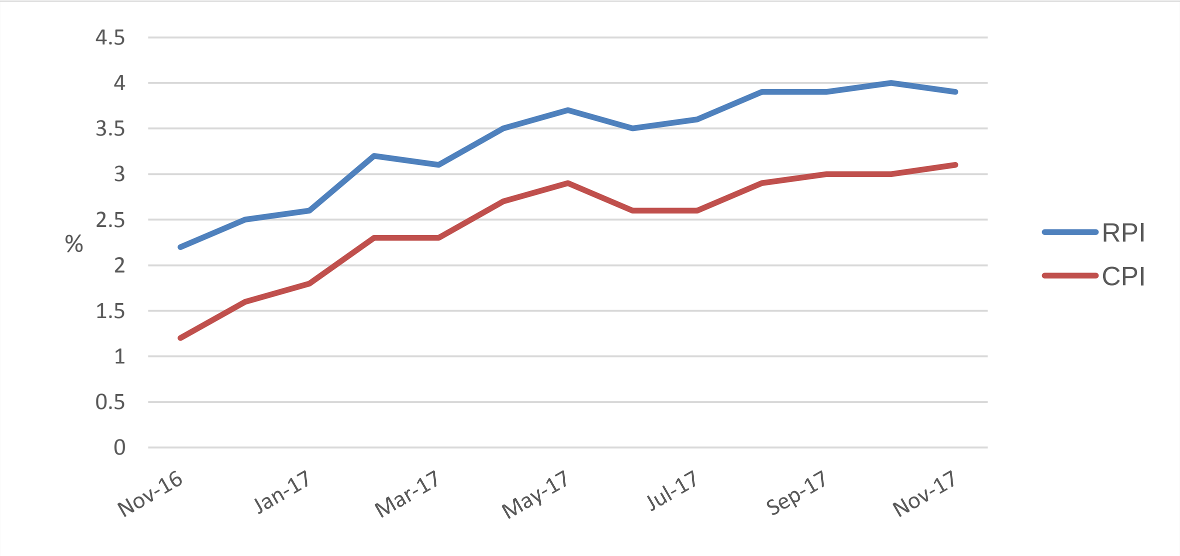
Graph A.2.6 Summary of UK Labour Market in millions as at October 2017



Source: Office for National Statistics

A.2.7. Graph A.2.7 shows UK Consumer Price Index (CPI) and Retail Price Index (RPI) inflation between November 2016 and November 2017. Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports and subsequently rose to 3.1% in December. The latest recent upwards contribution to change in CPI can be attributed to rise in air fares, recreational and cultural goods and services. The OBR expects CPI inflation to peak in in 2017 and then fall back to the Government's target of 2.0%, house price inflation is expected to average around 3.0% a year.

Graph A.2.7 UK Inflation



Source: Office for National Statistics

A.2.8. The Bank of England sets monetary policy to maintain 2% CPI inflation while sustaining growth and employment. It raised the Bank Rate from the historic low of

0.25% to 0.5% in November 2017. The Bank's Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

A.2.9. The council's treasury adviser, Arlingclose's central case is for the UK Bank Rate to remain at 0.50% during 2018/19. Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

A.2.10. On 22 November 2017, the Chancellor of the Exchequer, Phillip Hammond, presented his Autumn Budget 2017. The main headlines from this were the near record high employment and the fact that even though borrowing has fallen by three quarters since 2010, debt is still high. UK has £1,735bn debt, which is around £65,000 per household. Expecting a weaker outlook for the economy and the public finances, and growing pressures on public services following years of cuts, the Government added £2.7bn to borrowing in 2018/19 and £9.2bn (0.4% of GDP) in 2019/20. The Budget also includes tax cuts (fuel duty freeze and stamp duty decrease) easing in previously planned cuts to Government spending and further boost to capital spending. There is a prospect of further cuts to public spending as a share of GDP in 2022/23.

A.2.11. The Autumn Budget focuses on the following areas:

- *Brexit* - The government allocated £3bn further for Brexit over the next two years, which will include funding for the border preparation, the future immigration system and the new trade relationship.
- *NHS* - £6.3bn new funding will be used for upgrading NHS buildings, improving care, improving A&E, reducing waiting times and treating more people.
- *New Homes* - £5.3bn new financial support for house building over the next five years, with a view to reach the target of 300,000 new homes each year.
- *Increase of National Living Wage and National Minimum Wage* - The National Living Wage (25+) will increase from £7.50 per hour to £7.83 per hour from April 2018.
- *Business rates* - Business rates currently rise in line with RPI. This will change from April 2018 when business rates will rise by CPI, which tends to be lower than RPI. Business rates revaluation will also take place every three years rather than every five years, starting from 2022.
- *Transport in England* – The Government is allocating significant funds towards transport across England, including £1.7bn to improve transport in English cities

A.2.12. On 19 December 2017, Communities Secretary Sajid Javid announced plans to allow councils to retain 75% of business rates from 2020/21 and a 1% increase in council tax raising powers for 2018/19 and 2019/20. He also announced an overhaul of the formula for distributing funding in local authorities in England with a planned implementation in 2020/21.

The Global Economy

A.2.13. The slowdown in UK GDP growth so far this year contrasts with a pick-up in other advanced economies. Real GDP growth averaged 0.3% a quarter in the UK in the first three quarters of 2017, down from 0.5% in the second half of 2016. In the euro area, US, Canada and Japan, quarterly growth so far this year has been stronger than in the second half of 2016 and stronger than in the UK. Sterling's fall has seen inflation pick up more rapidly in the UK than in the other major economies, contributing to weaker real growth. In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.