THE UK ECONOMY
Forecast summary

The future relationship between the UK and the EU remains unclear. Despite that uncertainty the economy has gained momentum over the last few months, fiscal outturns have been better and financial markets appear to be sanguine about the uncertainty. It is against this backdrop that the Chancellor will have announced the Budget on 29 October, after this *Review* went to press.

Our main forecast is conditional on a 'soft' Brexit, but we also describe the consequences of an orderly no-deal Brexit. Under our soft Brexit scenario, the Chancellor will have the necessary space under the fiscal mandate to borrow on average an additional £16 billion per year between 2019–20 and 2022–23 compared with the OBR spring forecast. This, together with better revenues, provides room for the Chancellor to spend an average of around £30 billion more over the same period. Under the no-deal Brexit scenario, borrowing would be an average of £14 billion higher than in the soft Brexit case.

Even though the government complies with the fiscal mandate under the soft Brexit scenario, it is unlikely to meet its medium-term objective to balance the budget unless it chooses to tax more.

The UK economy has recently gained momentum with quarterly GDP growth expected at 0.7 per cent in the third quarter after more or less stalling in the first. We provide two forecasts based on a soft Brexit and a no-deal Brexit under which the UK reverts to trade under WTO rules in an orderly way after the end of the Article 50 period.

Our soft Brexit central forecast for GDP growth is broadly unchanged at 1.4 per cent this year and slightly higher next year at 1.9 per cent (1.7 per cent previously). By contrast, under our orderly hard Brexit scenario, economic growth slows to just 0.3 per cent in 2019.

There is an enormous amount of uncertainty around these forecasts and it is against that backdrop as well as an urgent need to improve public services, that the Chancellor will be setting the 2018 Budget.

Fiscal data has surprised to the upside recently. This, together with our soft Brexit assumption, allows the Chancellor to comply with his near-term fiscal targets, which are to achieve a cyclically adjusted deficit that is less than 2 per cent by 2020–21 (fiscal mandate) and a falling debt-to-GDP ratio over the same period (supplementary target), and also borrow £16 billion more on average than the OBR spring forecast between 2019–20 and 2022–23. Higher revenue and additional borrowing provide room for the Chancellor to spend an average of around £30bn more over the same period, more than enough to fund the additional spending that has been pledged for the NHS. By contrast, under our orderly hard Brexit scenario, borrowing would be an average of £14 billion higher than in the soft Brexit case.

All this is not to suggest that a soft Brexit will offer the Chancellor a free reign on spending – it will not. Even under that optimistic scenario, the Chancellor will fail to comply with the fiscal objective which is to achieve overall fiscal balance over the medium term.

In our view, there is no single tax measure that can plug the 2 per cent gap that persists in our soft Brexit scenario which allows for additional spending. As a consequence, we recommend a comprehensive review of taxation and the charges for public services in the UK with the express aim of achieving more equity and efficiency.

Summary of the forecast (based on a soft Brexit scenario, alternative no-deal Brexit forecast in brackets) *Per cent*

	Real GDP	CPI(a)	ILO unemployment	Bank Rate	External current balance	PSNB(b)
	annual growth	Q4/Q4	Q4	end-year	% of GDP	
2018	1.4	2.3	4.1	0.8	–3.1	1.7
2019	1.9 (0.3)	1.9 (3.2)	4.0 (5.3)	1.3 (2.6)	–2.8 (–4.2)	1.7 (2.2)
2020	1.6 (0.3)	2.1 (2.6)	4.5 (5.8)	1.8 (2.5)	–3.3 (–4.0)	1.8 (2.7)

Notes: Calendar years unless otherwise stated. No deal scenario in brackets. (a) Consumer price index. (b) Public sector net borrowing, excludes public sector banks.

https://doi.org/10.1177/002795011824600101 Published online by Cambridge University Press