MONTHLY ECONOMIC INSIGHT

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Written by:

Lee Hopley
Director,
Economic Insight and Research

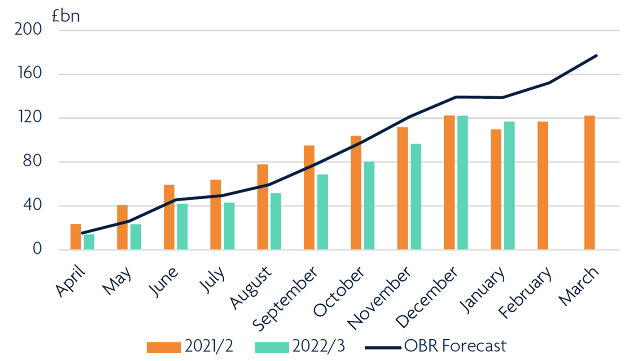
This month's review takes a look ahead to the forthcoming Budget statement later in March. The last fiscal statement was focused on some serious repair work to the public finances and the government's fiscal credibility, while also delivering much needed support to households and businesses against a backdrop of sharply rising prices and a deteriorating growth outlook – but where are we now?

PUBLIC FINANCES AHEAD OF THE BUDGET

We'll start with the public finances. ONS has published data for the first ten months of financial year 2022/3 (**Chart 1**), and there will have been a pleasant upside surprise for the Chancellor compared with the OBR's forecasts for borrowing in the autumn.

The headline to January is that borrowing was tracking below the OBR's expectations, which could offer some wiggle room for new or additional measures in the spring statement. Borrowing in the year to January was £117 billion – ahead of 2021/2, but over £20 billion better than forecast.

Chart 1: Public sector net borrowing, cumulative £ billion



Source: ONS

Behind the better-than-expected numbers were a few factors. First receipts – revenues are running nearly £10 billion ahead of forecast, with a larger than expected increase in January.

In addition, lower government spending was also working in the chancellor's favour. Key to this is the lower cost profile of the energy price guarantee, which brought the cap paid by households down to £2,500, with the public purse picking up the difference. Falling wholesale gas prices and the milder winter contributed to containing the cost of the scheme (more on this later).

And finally, debt interest spending was a further big ticket spending item that has also been less than expects (but just under £4 billion). The OBR, in its analysis of the official figures, notes that this can be high volatile from month to month and despite this year's undershoot debit interest is still costing the Exchequer nearly 60 per cent more than in the previous financial year.

Is this all this likely to lead the chancellor to loosen the purse strings later this month? Potentially, but headlines of £30 billion headroom in the public finances is one consideration, policy goals and longer-term priorities are another, arguably larger consideration.

With that in mind, there is some speculative chatter about what these might be.

- As a counter to the rise in corporation tax, the chancellor may look to measures such as fixed period tax breaks to increase the attractiveness and maintain the strength of the UK market relative to international competitors.
- During the last spring budget, the price cut to fuel duty was announced and due to finish at the end of March. With the pressures of cost of living remaining high, there is a view that the chancellor could extend and freeze this cut for a period to ease those pressures on households.
- The state pension age-rise to 68 could be accelerated, with the increase from 66 to 67 meant to be met by 2028 and then a subsequent increase to 68 expected to be between 2044 and 2046. In addition, he could increase the pensions' Lifetime Allowance (LTA), to allow more to be saved before tax. This could be used as an incentive to encourage the older population to enter/remain in employment and benefit from this increased allowance.
- Finally, HM Treasury will be conscious of the loss of fuel duty revenues as electric vehicle become more common. When will the time be right for the start of a conversation about road pricing?

UK Finance's recommendations for measures to grow the economy, level up the country and ensure support is given to those who need it in a challenging economic environment can be found **here**.

ENERGY PRICE CAP DOWN, BUT ENERGY PRICES SET TO RISE (PROBABLY)

Missing from this list is the action that a host of charities and, no doubt, households will be looking for – more action on energy bills.

The energy price cap – which is now updated quarterly – is set to rise again in April. Though, the current policy is for a degree of government support to remain in place with the energy price cap rising from its current level of £2500 to £3000.

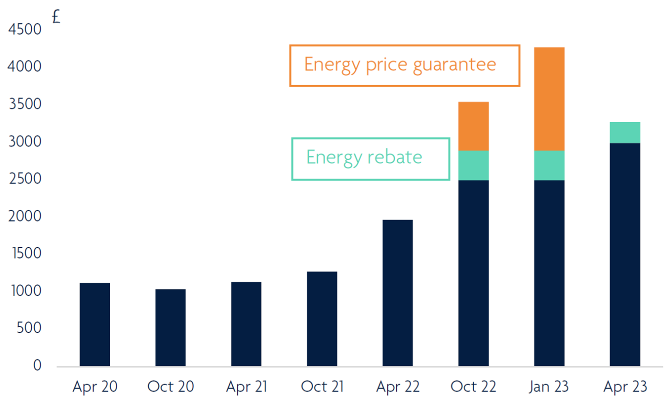
Ofgem recently announced that the actual price cap (in the absence of the EPG) would fall from its current level of £4279 to £3280, which in itself will reduce the cost of the price guarantee subsidy provided by the government.

While the Ofgem cap is falling, households will nevertheless see a further, indicative 20 per cent rise in bills in from April – while a less hefty increase than households felt a year ago, nevertheless another pressure on already squeezed consumers that are also grappling with the still-rising costs of food and other essentials.

Estimates suggest that the cost of retaining the price at £2500 would be in the region of an additional £3 billion. This assumes that we don't experience another spike in wholesale prices, which significantly increase the policy cost. The move would also be helpful in keeping CPI inflation on a downward trajectory.

That said, at time of writing speculation was growing that a move to freeze the cap at current levels was under serious consideration at the Treasury. We'll know what this is rumour or a lifeline for household energy bills in a few weeks' time.

Chart 2: Energy price cap, £



Source: Ofgem

PRIVATE SECTOR PICKS UP IN Q1

As so to the economy. The OBR will be compiling its forecast update to go alongside the statement. We provided a round-up of the autumn forecast in our **December briefing**. The headline numbers were GDP growth forecast to fall by 1.4 per cent this year, with a substantial 1.9 per cent fall in household spending and a rise in unemployment to 4.1 per cent.

While GDP growth since the forecast was non-existent (flat output in 2022 Q4), this is still a bit better than expected. In addition, recent survey indicators for the private sector (**Chart 3**) were also somewhat firmer than expected in February.

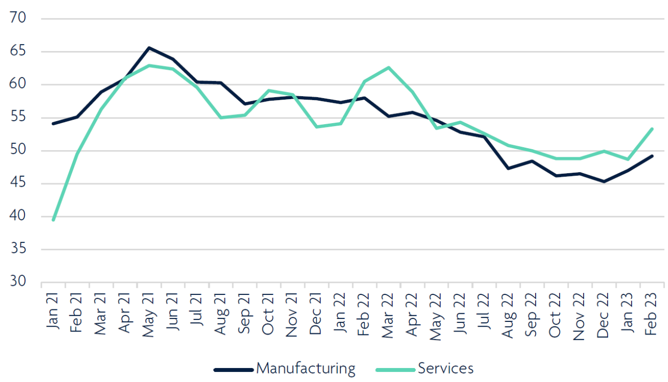
There was a notable uptick in services activity in February with the PMI posting above the 50, no change, mark for the first time since August. Across the service sector new order, including export order rebounded, the survey respondents noting an improvement in confidence as inflationary pressures were expected to ease and political uncertainty had diminished.

Recruitment continued to look soft however – signalling that the slowdown in vacancies seen since last summer is set to continue. Firms noted rising pressure from salaries as a factor containing recruitment activity. Despite expectations of an easing in inflation overall, prices charged in the service industry were still rising sharpy in February – an indicator that will keep the Monetary Policy Committee on high alert.

There was a less pronounced improvement in manufacturing activity, where the story is one of stabilisation rather than growth. Production was reported to have seen a modest expansion, but the new orders continued to weaken, at a slower pace that in the latter part of 2022.

There was better news on inflation from manufacturers – with the rate of price increases falling for the fifth consecutive months, aided by an easing in supply chain bottlenecks.

Chart 3: Purchasing managers' indices, 50 = no change



Source: CIPS/S&P Global

It's just one month of improvement, but the PMI data does suggest there is some resilience in the private sector and any recession may well be shallow and short-lived. To that end some upward revisions to the OBR's outlook are likely.

BUSINESS INVESTMENT REVISITED

One aspect of the ONR's forecast in which we are almost certain to see some upward revisions is to business investment. The OBR's first post-Covid-19 forecast in November 2020 predicted a strong rebound in business investment in 2022 with year-on-year growth of almost 14 per cent expected.

As official data from ONS trickled in through last year and initial estimates suggested a weak profile of business investment, in line with business surveys its forecast was drastically moderated to growth of less than five per cent (November 2022 forecast).

As we noted in December briefing initial estimates for a business investment recovery had so far failed to materialise as business faced headwinds from higher costs and lower demand.

Moreover, the OBR autumn forecast predicted that as UK enters recession, investment will fall faster than GDP and will not return to pre-pandemic levels until the second half of 2025.

However, the latest cut of data suggest that businesses have pushing ahead with investment to a much greater degree than previously thought (**Chart 4**), with fairly robust growth in three out of four quarters last year.

ONS noted that early estimates may not fully capture large capital expenditures, which can lead to some upward revisions in later estimates.

The result of the revisions is annual growth in business investment last year of ten per cent, with investment levels now within touching distance of that seen pre-pandemic.

Chart 4: Business investment, 2019 Q4 = 100

Source: ONS

A higher starting point in 2023 is likely to see the OBR lift it expectations for business investment in 2023 from a fall of around two per cent to a modest expansion this year. The headwinds facing businesses, particularly SMEs – concerns about the risk of recession as well as higher interest rates, will put something of a cap on potential expansion this year.

ROUND UP

While the chancellor will deliver this Budget statement against a slightly more positive backdrop than he faced in the autumn – both in terms of the economic outlook and the public finances – the economic clouds have by no means fully cleared.

Forecasts will likely continue to paint a downbeat picture for household disposable income as inflation continues to outstrip wage growth and, consequently, the prospects for consumer spending. And with that in mind the Chancellor will still have to balance a number of policy choices – both to alleviate short-term pressures and with an eye on long term improvements in the UK's growth potential and productivity – key government priorities.

We'll wrap up with a final thought on the other key policy announcement coming this month – the MPC's second meeting of 2023. In February, the committee voted for another 50-basis point rise in Bank Rate, though members were again split on the need for further increases.

In February, the decision which came alongside the Bank's own quarterly forecast update, the committee noted that inflationary pressures had been firmer than expected, pointing particularly to pay growth and services inflation.

The minutes of the meeting reported that the committee continued to view there were considerable uncertainties around outlook for growth and inflation. *"If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required."*

It is likely that we are at, or close to, the end of this monetary tightening cycle – we'll find out which of those later this month.

Indicator	Period	Value	Change	2023 Forecast*
GDP	Q4 2022	0.0%	↑	-0.7%
CPI inflation	Jan 2023	10.1%	↓	7.4%
Unemployment rate	Dec 2022	3.7%	↔	4.5%
Average earnings	Dec 2023	5.9%	↓	5.0%
Brent crude	Feb 2023	$82.61	↑	-
$ Exchange rate	Feb 2023	$1.21	↓	-
PSNB	Jan 2023	-£5.4 bn	↓	£130.1bn

Source: ONS, HM Treasury, Bank of England, EIA