2 Maintaining macroeconomic stability

The global economy is in the early stages of recovery following the most severe and synchronised downturn since the Great Depression in the 1930s. The UK economy stabilised in the second half of 2009, aided by the significant macroeconomic policy stimulus and government intervention in the financial system. In line with the judgement made in Budget 2009 and the 2009 Pre-Budget Report (PBR), UK output returned to modest growth in the final quarter of 2009. The Government's forecast for GDP growth remains largely unchanged from the 2009 Pre-Budget Report with slightly lower growth in 2011 reflecting weaker growth in UK export markets. While extreme downside risks to the economy have receded over the year, the Budget 2010 economic forecast remains subject to significant uncertainty and risks. Macroeconomic policy will continue to support the economy throughout this year; monetary policy, in particular, is expected to continue to provide an ongoing and powerful stimulus.

In recent months, tax receipts have been higher than expected in Budget 2009 and the 2009 Pre-Budget Report. As a result, public sector net borrowing in 2009-10 is now projected to be £11 billion lower than forecast in the Pre-Budget Report. That contributes to a fall in the net financing requirement in 2009-10 and 2010-11, which means that the remit for gilt sales in 2010-11 is £25.7 billion lower than projected in the Pre-Budget Report.

The policies announced in Budget 2010 are fiscally neutral, providing further support for growth in 2010-11, balanced by measures that raise revenue in later years. Discretionary policy delivers a £1.4 billion loosening in 2010-11, more than offset by tightening in later years, building to a £1.6 billion tightening in 2014-15. Forecast and policy changes in Budget 2010 result in a lower path for borrowing and debt in each year of the forecast period relative to Budget 2009. The Budget forecast shows:

- PSNB declining to 5.2 per cent of GDP in 2013-14 and 4.0 per cent in 2014-15;
- cyclically-adjusted or 'structural' net borrowing falling from 8.4 per cent of GDP in 2009-10 to 2.5 per cent in 2014-15, a reduction of more than two-thirds over the forecast horizon; and
- net debt projected at 74.5 per cent of GDP in 2013-14, £100 billion lower than the Budget 2009 forecast, and peaking in 2014-15 at 74.9 per cent of GDP.

The Fiscal Responsibility Act (FRA) has passed into law, setting a ceiling for public sector net borrowing in 2013-14 and a requirement for debt to be falling in 2015-16. Budget 2010 provides a margin of flexibility against these requirements should future revenues turn out to be lower than expected. If the economy performs better than expected, the Government will be able to reduce the structural deficit more quickly than the path shown in this Budget.

Budget 2010 makes further progress in setting out the detail of the Government's fiscal consolidation plans, including further details of how the Government will deliver lower growth in public spending. Following the passage of Finance Bill 2010 the Government intends that around half of the tax measures that have been announced as part of the consolidation plan will have been passed into legislation.

Economic developments and prospects

World recovery

2.1 After successive shocks from commodity markets and the global financial system, G20 policy action and unprecedented co-ordination has helped to stabilise financial markets and demand, boosting short-term global prospects. However, the nascent recovery remains fragile and there is a marked difference in the pace of recovery between advanced and emerging economies.

2.2 The return to growth has been largely driven by two common factors in most countries outside Asia: stimulus measures and a turn in the inventory cycle. While financial sector interventions have helped to improve conditions in financial markets, expansionary monetary and fiscal policies have helped to stabilise demand and firms have been able to reduce stocks at a slower pace, helping to boost growth. This impetus from inventories may be uneven but is likely to continue well into 2010, as will the effects of fiscal and monetary stimulus.

2.3 The capacity of private demand to drive growth will be key in determining the prospects for the global economy and recent data show tentative signs of a recovery. The global manufacturing purchasing managers survey compiled by JP Morgan reached a five and a half year high in early 2010 and world trade in goods has risen sharply. According to the CPB Netherlands Bureau for Economic Analysis, world trade rose by 6 per cent in the fourth quarter of 2009, the fastest quarterly growth since records began in 1991. Improvements in the global economy have also been reflected in global financial markets, with the gains made during 2009 being consolidated since the 2009 Pre-Budget Report. In particular, world stock prices remain over 60 per cent above their February 2009 level, helping to reinforce confidence.

2.4 Maintaining confidence and reducing uncertainty will be essential to the continued recovery in private sector demand. Recent events have shown how quickly risk appetite can be reversed and how fragile financial market sentiment in the recovery can be.

Global prospects

2.5 The Budget forecast for growth in the world economy remains largely unchanged from the 2009 Pre-Budget Report, although growth in the euro area and UK export markets is somewhat weaker. The world economy is estimated to have contracted by 1 per cent in 2009, the largest annual fall in the post-war era. This is broadly in line with the forecast at Budget 2009. The world economy is forecast to grow by 3¼ per cent in 2010, before rising to 4¼ per cent in 2011 and 2012. Almost 80 per cent of global growth in 2010 is likely to be generated by emerging economies with the G7 economies set to experience a more modest rebound, growing by 1¾ per cent in 2010, 3 per cent in 2011 and 3¼ per cent in 2012. Consistent with below trend growth in 2010 and downward pressure on prices from large negative output gaps, G7 inflation is forecast to remain subdued.

Government action to stabilise the UK economy

2.6 In response to the downturn in the UK, the Government has:

- undertaken major interventions to restore and maintain the stability of the banking system and ensure the ongoing supply of credit to the economy. This action has been crucial in averting the more severe downside risks to the economy and supporting recovery;
- authorised the Bank of England to provide monetary support to the economy through a £200 billion programme of asset purchases;
- implemented a fiscal stimulus of 1 per cent of GDP in 2009-10 and allowed the automatic stabilisers to operate in full, contributing to total fiscal support of almost 5 per cent of GDP in that year; and
- provided targeted support for businesses and individuals, including through support for jobs, homeowners and businesses facing cash-flow problems.

2.7 The authorities' actions have been successful in helping to limit the severity of the downturn and its impact on businesses and individuals. The UK economy returned to growth in the fourth quarter of 2009 and evidence suggests that:

- while the unemployment rate has risen to 7.8 per cent, this compares with almost 10 per cent in the US and euro area and is also lower than at the same stage following the 1990s recession in the UK. The claimant count reached 1.6 million at the end of 2009, almost half a million lower than the average of independent forecasters expected at the time of Budget 2009; [1]

- repossessions are below forecast levels: the Council of Mortgage Lenders (CML) revised down its forecast for repossessions in 2009 from an initial 75,000. The final number of repossessions in the year was 46,000 according to the CML. The rate of repossessions has been around half that of the 1990s recession; and
- the annual rate of company liquidations remains well below its peak in the 1990s recession, at 0.9 per cent in the fourth quarter of 2009, compared with a peak of 2.6 per cent in the 1990s recession.

Support for recovery

2.8 During the early stages of the recovery, the significant macroeconomic stimulus in place will continue to support the UK economy. Bank Rate is at a historically low level and, together with the feed-through to the economy of the Bank's programme of asset purchases, it is expected to continue to provide an ongoing and powerful stimulus throughout this year. Government borrowing of 11.1 per cent of GDP will also continue to support the level of economic activity in 2010-11.

Ensuring economic stability

2.9 Recent events have demonstrated the close ties between the financial sector and the economy, as well as the interconnected nature of global financial markets. As set out in Chapter 3, Government action to reform financial services is now focused on enhancing the stability and resilience of financial markets for the long term and ensuring that the economy, and businesses within it, have access to finance for future growth. An update on international work on macro-prudential regulation is provided in Box 2.1.

2.10 Setting a credible fiscal consolidation plan to ensure sustainable public finances is a key part of the Government's macroeconomic strategy and is essential for economic stability and the long-term health of the economy. Sound public finances provide the conditions for growth, helping to maintain low long-term interest rates and giving businesses the confidence to plan and invest for the future. The Government's consolidation path has been embedded in legislation through the Fiscal Responsibility Act. A detailed update on the Government's fiscal strategy is provided later in this chapter.

Recent economic developments in the UK

2.11 The UK economy stabilised in the second half of 2009, following a substantial fall in output in the wake of the global financial crisis. The cumulative decline in output over the recession is estimated at around 6 per cent. This is similar to the loss in output seen in the 1980s recession, but greater than the fall in output in the early 1990s. Through 2009, the pace of decline eased as the substantial policy stimulus fed through into the economy and global and domestic confidence picked up. In line with the Budget 2009 and 2009 Pre-Budget Report forecasts, the UK economy returned to growth in the final quarter of 2009. The Office for National Statistics (ONS) estimate GDP to have risen by 0.3 per cent in the fourth quarter, as government consumption continued to support the economy and household consumption rose. Nominal GDP rose by 1.9 per cent in the second half of 2009, although in the fourth quarter it remained 3 per cent below its pre-recession peak in the second quarter of 2008. Nominal GDP did not fall in the 1980s and 1990s recessions.

2.12 Although bad weather has complicated the assessment, a range of measures suggests output continued to recover at the start of 2010. Consumer and business confidence measures have improved and labour market indicators have started to stabilise at a relatively

[1] *Forecast for the UK economy: a comparison of independent forecasts*, HM Treasury, April 2009.

early stage in the recovery. The latest estimate from the National Institute of Economic and Social Research suggests that output rose by 0.3 per cent over the three months to February.[2]

2.13 Consumer price inflation has increased from its trough of 1.1 per cent in September 2009, as expected in the 2009 Pre-Budget Report forecast. CPI inflation reached 3.5 per cent in January 2010, reflecting higher fuel prices and the change in the VAT rate, but it fell back to 3.0 per cent in February.

Box 2.1: Macro-prudential regulation

Financial markets have shown they are prone to 'pro-cyclicality' – periods of overly accommodative lending conditions in good times, and overly restrictive conditions in downturns. This can amplify the economic cycle, making the expansion phase stronger and the following downturn more severe.

Given the global nature of financial markets, and the ease with which banks and financial institutions can transfer internal resources, any country acting alone is unlikely to be very effective. It is essential, therefore, that governments work together to deepen their understanding of domestic and global financial markets and to develop policy tools to mitigate risks from pro-cyclical behaviour. The Basel Committee on Banking Supervision (Basel) and the European Commission are taking this work forward, and both have published papers addressing macro-prudential regulation since the autumn.[a]

Both the Basel and the European Commission papers discuss a similar range of potential counter-cyclical measures. These include measures to:

- ensure banks make forward-looking provisions, so that they put aside money for potential future losses on loans even in the good times;
- ensure banks build counter-cyclical capital buffers, so that during the upswing of the economic cycle they are required to raise their capital ratios, providing a buffer which can be used to absorb losses during the downturn; and
- reduce the cyclicality of banks' minimum capital requirements by adjusting regulatory capital risk weights. This is because the minimum capital requirement currently has the potential to be pro-cyclical, allowing banks to run down the level of capital they hold during the upswing and requiring them to increase their capital during the downturn.

These are all regulatory tools that were identified in *Reforming financial markets*,[b] and the Government welcomes their discussion in international fora. In addition, at the European level member states have agreed to establish a European Systemic Risk Board, which will monitor systemic risks to financial stability. At a global level, the International Monetary Fund and the Financial Stability Board are taking forward work to identify and rectify gaps in data collection in order to improve monitoring of developments in the financial system as a whole.

The Government is working closely with the Bank of England and the Financial Services Authority to take this work forward in Basel and in Europe. The European Commission is expected to publish proposals in July this year; Basel proposals are likely to continue to be developed throughout 2010. The Council for Financial Stability will play an important role in coordinating the work of the regulatory authorities in responding to the challenges of managing systemic risk, both in the UK and internationally.

[a] *Strengthening the resilience of the banking sector,* Basel Committee on Banking Supervision consultative document, December 2009; and *Possible further changes to the capital requirements directive*, European Commission staff working paper, February 2010.
[b] *Reforming Financial Markets*, HM Treasury, July 2009.

[2] *NIESR monthly estimate of GDP,* National Institute of Economic and Social Research, 10 March 2010.

UK growth prospects

2.14 The Budget 2010 economic forecast is underpinned by the following assumptions, that:

- the G20 continues to deliver on policy commitments, which are effective and support a robust recovery in the world economy. UK export market growth is notably weaker than world trade growth reflecting the relatively slower recovery in the UK's largest trading partner, the euro area;
- fiscal policy supports the level of economic activity through 2010, before tightening from 2011 onwards to ensure sound public finances and to facilitate the rebalancing of private and public sector contributions to demand;
- through the course of 2010, the price of credit continues to return closer to historical norms, adjusted for a general re-pricing of risk, and that credit availability continues to improve;
- the positive impact of the monetary policy stimulus will continue to support demand in the economy throughout the forecast horizon, with market expectations suggesting Bank Rate will remain historically low; and
- the shape of the recovery in the UK economy reflects an orderly adjustment in sectoral financial balances, and a rebalancing between domestic and external demand supported by sterling's depreciation.

GDP growth

2.15 Reflecting recent developments, the GDP growth forecast for 2010 remains unchanged from the 2009 Pre-Budget Report, with GDP forecast to rise by 1 to 1½ per cent. This is in line with the March average of independent forecasts.[3]

2.16 GDP growth is forecast to rise to 3 to 3½ per cent in 2011. This is slightly lower than the 2009 Pre-Budget Report forecast, reflecting a weaker outlook for the UK's largest trading partner, the euro area. GDP growth is then expected to rise to 3¼ to 3¾ per cent in 2012. The public finances projections run off the bottom end of the range. The Bank of England's mean forecast is around 3 per cent in both 2011 and 2012. The independent forecast average is rather weaker at 2.1 per cent in 2011, but with a wide range of 0.9 to 3.4 per cent reflecting the degree of uncertainty.

Table 2.1: Summary of UK forecast[1]

			Forecast		
	2008	2009	2010	2011	2012
GDP growth (per cent)[1]	½	-5	1 to 1½	3 to 3½	3¼ to 3¾
CPI inflation (per cent, Q4)	4	2	2	1½	2

[1] *See footnote to Table B9 for explanation of forecast ranges.*

UK inflation prospects

2.17 In the near term, CPI inflation is expected to remain above the target, reflecting the impact of the VAT change. Fuel prices and the pass-through of sterling's depreciation will have a positive but declining impact on inflation over the coming year, while the lagged effect of the large degree of spare capacity becomes a more dominant influence. Consequently, inflation is expected to weaken and reach 2 per cent by the end of 2010 and then to fall further through the first half of 2011, as the negative output gap continues to exert downward pressure and the effect of the VAT change drops out of the annual comparison.

[3] *Forecasts for the UK economy: a comparison of independent forecasts*, HM Treasury, March 2010.

2.18 CPI inflation is expected to rise back to target by the end of 2012, as the economy continues to grow at above trend rates, consistent with the mean forecast in the Bank of England's February Inflation Report. Although a degree of spare capacity is expected to remain throughout the forecast, the resulting downward pressure on inflation is expected to be offset by the effect of the monetary policy framework anchoring inflation expectations close to the inflation target.

Risks and uncertainty

2.19 The economic forecast remains subject to significant uncertainty across a broad range of factors, including: the resolution of the global financial crisis and its impact on confidence and activity; and the implementation and effectiveness of the unprecedented global policy response to the economic downturn.

2.20 A key uncertainty over near-term prospects in the UK and globally relates to the strength and sustainability of private sector demand. There is also uncertainty surrounding the impact of the global financial shock on the supply side of the economy and its compounding effect on the path of inflation.

2.21 The degree to which households try to increase saving further to rebuild their finances, and the speed with which any further adjustment takes place, will also affect the strength of the recovery. Recent increases in financial asset prices, improved confidence and the stabilisation in the labour market should help to temper this. Business investment fell sharply last year, but the healthy aggregate financial position of the corporate sector has been sustained through the recession and should help support investment through the recovery. There are also upside and downside risks to the forecast related to the availability of credit and restoration of business and consumer confidence. These risks and their implications for the forecast are discussed in more detail in Chapter B.

MONETARY POLICY ACTION

The monetary policy framework

2.22 Price stability is a precondition for high and stable levels of growth and employment. Monetary policy remains the key tool for the management of demand in the economy and therefore inflation. The monetary policy framework is based on four key principles:

- clear and precise objectives. The primary objective of monetary policy is to deliver price stability. The adoption of a single, symmetrical inflation target ensures that outcomes below target are treated as seriously as those above, so that monetary policy also supports the Government's objective of high and stable levels of growth and employment;
- full operational independence for the Monetary Policy Committee (MPC). **The Government reaffirms in Budget 2010 the target of 2 per cent for the 12-month increase in the Consumer Prices Index (CPI), which applies at all times;**
- openness, transparency, and accountability. These are enhanced through publication of MPC members' voting records, minutes of MPC meetings and quarterly Inflation Reports; and
- credibility and flexibility to allow the MPC to decide how to react to events, within the constraints of the inflation target and the open letter system. If inflation deviates by more than one percentage point above or below target, the Governor of the Bank of England must explain in an open letter to the Chancellor the reasons for the deviation, the action the MPC proposes to take, the expected duration of the deviation and how the proposed action meets the remit of the MPC.

2.23 On 19 January 2009, the Government established the Asset Purchase Facility (APF) to help increase the availability of corporate credit and to provide a framework for the MPC to use asset purchases for monetary policy purposes. With Bank Rate at historically low levels, the Chancellor authorised the use of the APF for monetary policy purposes on 3 March 2009. The objectives of the monetary policy framework have not changed with the use of this additional monetary policy instrument.

Action taken by the MPC

2.24 Monetary policy has been an important element of the overall support provided to the economy. The MPC has maintained Bank Rate at 0.5 per cent since March 2009, and undertaken a programme of asset purchases financed by the issuance of central bank reserves totalling £200 billion. The MPC has said that it will continue to monitor the appropriate scale of the asset purchase programme and further purchases would be made should the outlook warrant them.[4]

2.25 The stock of past purchases, together with the low level of Bank Rate, will continue to impart a substantial monetary stimulus to the economy for some time to come. Although there remains uncertainty about the speed and strength with which the effects of the asset purchase programme are feeding through to the economy, developments in corporate debt markets and financial markets are consistent with its expected effects. For example, the APF would be expected to support higher asset prices, as investors use their increased money holdings to purchase other assets. Equity prices have risen by over 50 per cent since March 2009 while corporate bond yields have fallen significantly since early 2009, reflecting increased bond prices. Net corporate bond issuance in 2009 was 68 per cent higher than in 2008 and 26 per cent higher than in 2007. Asset purchases are also likely to have supported broad money growth, which has been stronger than might have been expected given the slowdown in nominal GDP growth.[5]

2.26 The Governor of the Bank of England wrote an open letter to the Chancellor on 15 February as CPI inflation rose to 3.5 per cent in January. The rise in inflation was largely the result of short-run factors, and it was expected to be temporary as the Chancellor acknowledged in his reply to the Governor.[6] The MPC's remit allows it to look through short-term movements in inflation.

The Asset Purchase Facility

2.27 Following the MPC's decision to maintain the stock of asset purchases financed by the issuance of central bank reserves at £200 billion on 4 February, the Chancellor wrote to the Chairman of the Treasury Select Committee to confirm that the APF would continue to offer facilities for commercial paper, corporate bonds, and secured commercial paper.[7] Purchases of these assets are now being financed by the issuance of Treasury bills, as set out in the Chancellor's letter to the Governor of 29 January 2009. **The Government confirms in Budget 2010 that the Asset Purchase Facility will remain in place in financial year 2010-11.**

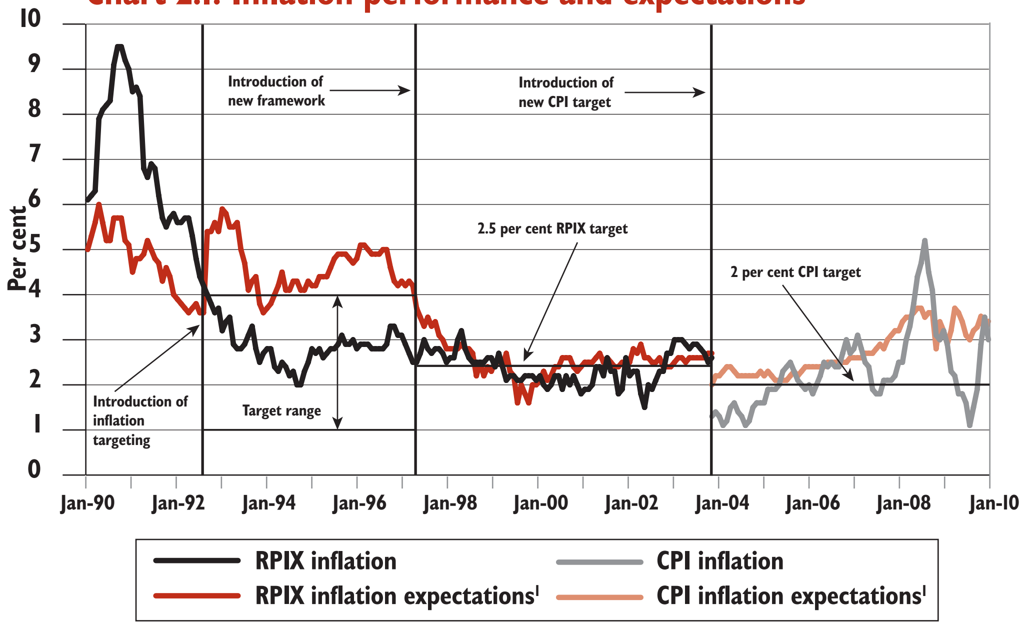
Inflation expectations

2.28 Inflation expectations for the medium to long term remain anchored to the CPI target, demonstrating the credibility that the monetary policy framework has built up since 1997. Both market and survey expectations of inflation have moved within a much smaller range than CPI inflation over the past year. For example, the YouGov/Citigroup measure of household expectations for five- to ten-years ahead has moved within a range of 0.4 percentage points while inflation has ranged 2.4 percentage points. Measures of inflation expectations derived from financial markets, as shown in Chart 2.1, can be affected by other market developments, including changes in market estimates of the wedge between RPI and CPI inflation, and have been more difficult to interpret given recent financial market

[4] *MPC News Release*, 4 February 2010, available at www.bankofengland.co.uk.
[5] *Interpreting monetary policy*, D.Miles, February 2010.
[6] All open letters are available at www.hm-treasury.gov.uk.
[7] Available at www.hm-treasury.gov.uk.

volatility. These measures do not point to a significant de-anchoring of expectations from the inflation target.

Chart 2.1: Inflation performance and expectations



1 Implied expectations of average RPI inflation ten-years ahead are derived from the difference between yields on nominal and index-linked government bonds. Implied CPI inflation expectations are derived from these RPI expectations and stylised assumptions about expected differences between RPI and CPI inflation in the medium term, including that the geometric averaging lowers CPI inflation by 0.5 percentage points relative to RPI inflation.

Source: ONS, Bank of England and HM Treasury.

Monetary policy during the recovery

2.29 The Government will continue to support the Bank of England in the forward-looking decisions it takes to meet the inflation target. Assuming the economy strengthens in line with the Budget forecast, it will be appropriate and necessary to withdraw some of the monetary stimulus in place. The MPC will determine the timing and pace of the transition towards more normal monetary policy settings, based on their assessment of the policy stance required to meet the inflation target.

2.30 Within this, the MPC will determine the appropriate combination of increasing Bank Rate and the sale of assets under the APF, but the Bank of England will consult closely with the Debt Management Office (DMO) to minimise disruption to the gilt market. In his letter to the Chancellor of 17 February 2009, the Governor of the Bank of England said that the MPC would have due regard for the impact of those sales on the Government's debt management operations.

THE GOVERNMENT'S FISCAL STRATEGY

2.31 The Government's fiscal policy objectives are:

- over the medium term, to ensure sound public finances and that spending and taxation impact fairly within and between generations; and
- over the short term, to support monetary policy and, in particular, to allow the automatic stabilisers to help smooth the path of the economy.

2.32 The financial crisis and global downturn have had a profound and persistent impact on the public finances, resulting in a significant increase in government borrowing and debt. Responding to these developments, in line with its fiscal objectives, the Government's fiscal strategy has been to:

- base policy decisions on a realistic fiscal forecast, based on a range of assumptions, some of which are designed to provide caution to allow for uncertainty;
- set out a credible plan for delivering a sustained consolidation over the medium term, to ensure sound public finances and create space in the short term for continued fiscal support;
- ensure that the fiscal policy framework is set to deliver the Government's fiscal policy objectives given the outlook for the public finances and the economy; and
- minimise the long-term cost of debt issuance, subject to risk, and reduce refinancing risk, all else equal, by issuing a larger proportion of long-maturity and index-linked gilts.

2.33 The Government judges that this strategy remains appropriate in light of developments since the 2009 Pre-Budget Report and continuing uncertainty. Budget 2010:

- estimates that public sector net borrowing in 2009-10 is £11 billion lower than forecast in the 2009 Pre-Budget Report. Net borrowing is also forecast to be lower in the later years of the forecast period;
- is fiscally neutral over the forecast period and provides further detail on how the Government's consolidation plans will be delivered;
- confirms that the Fiscal Responsibility Act has passed into law, requiring a year-on-year reduction in borrowing to 2015-16, so that public sector net borrowing is more than halved over the four years to 2013-14, and debt is falling in 2015-16; and
- projects a significant fall in the net financing requirement and required gilt sales in 2010-11 relative to the 2009 Pre-Budget Report forecast. The Budget sets out the Government's debt management strategy for 2010-11.

The fiscal outlook

Impact of the downturn on the public finances

2.34 The global financial crisis has resulted in a significant increase in borrowing relative to pre-crisis levels, which can be broken down into two categories:

- *temporary and cyclical borrowing:* the recession has caused a temporary increase in borrowing due to lower tax receipts and higher government spending, as the Government allows the automatic stabilisers to operate to support the economy. The temporary, discretionary measures that the Government has implemented to provide fiscal support to the economy also have a short-term impact on borrowing; and
- *cyclically-adjusted or 'structural' impacts:* the financial crisis has also had a more persistent impact on the public finances, due to its downward impact on the trend level of output in the economy, which is assumed to be just over 5 per cent, a permanent loss of tax receipts from the financial and housing sectors and the projected rebalancing of economic activity, which will result in less tax-rich growth in the recovery. The fiscal consolidation that the Government has planned over the medium term is necessary to address these persistent effects.

2.35 Budget 2009 and the 2009 Pre-Budget Report set out a realistic forecast of the fiscal position, including cautious assumptions for the level of unrealised losses on financial sector interventions, oil and equity prices, the VAT gap and claimant count unemployment. In the July 2009 Article IV Assessment of the UK, the International Monetary Fund stated that *"the 2009 Budget acknowledged transparently the scale of deterioration of the fiscal position. Of particular note, it comes to the conservative judgment that the structural component of the deficit is… about four-fifths of the total deficit in 2009-10".* [8]

Recent developments

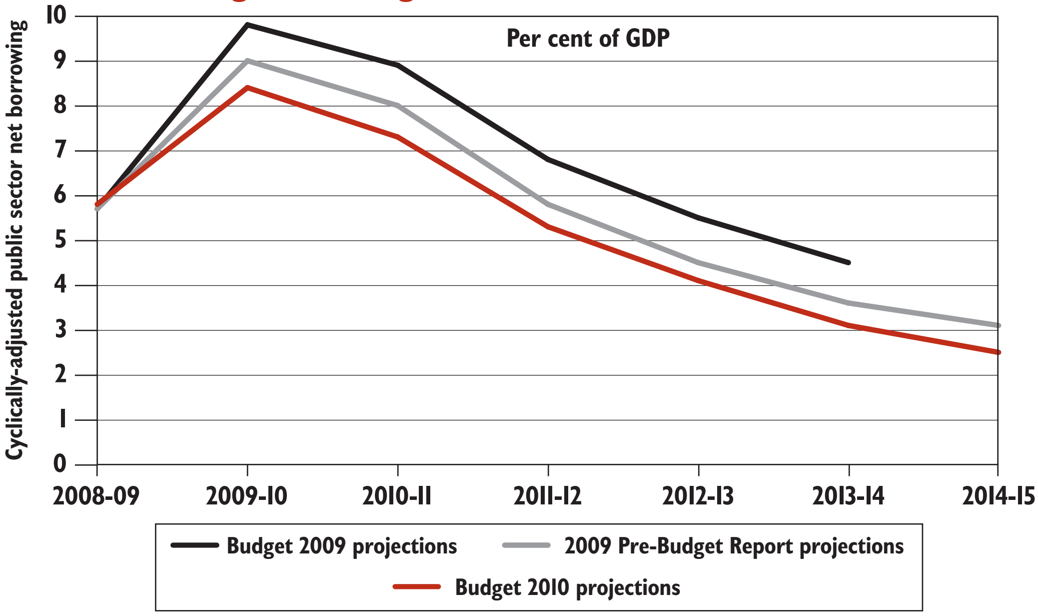
2.36 Public sector net borrowing in 2009-10 is now estimated to be £11 billion lower than forecast in the 2009 Pre-Budget Report. Tax receipts since November are now expected to be £9½ billion higher than previously forecast. Receipts were higher than expected across a number of major tax bases, in particular:

- self-assessed income tax paid in January relates to economic activity in 2008-09 at the worst point of the downturn. Receipts from self-assessment fell by 3.2 per cent compared with last year but were higher than the forecast made in the 2009 Pre-Budget Report;
- VAT receipts have been stronger than expected, possibly because businesses have repaid more VAT debt than expected, and possibly due to stronger consumer spending ahead of the planned reversal of the temporary VAT rate cut and the end of the Government's vehicle scrappage scheme; and
- a more rapid stabilisation in profits, in particular from the financial sector, has boosted Corporation Tax and PAYE from bonuses.

2.37 As a result, cyclically-adjusted net borrowing is estimated to be 8.4 per cent of GDP in 2009-10, lower than the 9.0 per cent of GDP projection made in the 2009 Pre-Budget Report and the 9.8 per cent of GDP forecast in Budget 2009. Budget 2010 continues to estimate that a significant proportion – over 70 per cent – of overall borrowing in 2009-10 is cyclically-adjusted or 'structural', meaning that either discretionary policy tightening or a change in the structure of the economy that results in higher effective tax rates (ie. increases the amount of tax raised for a given level of economic activity) is required to eliminate it.

[8] *United Kingdom: 2009 Article IV Consultation*, International Monetary Fund, July 2009.

Chart 2.2: Change in projection of cyclically-adjusted net borrowing since Budget 2009



Source: HM Treasury.

The fiscal outlook

2.38 The lower outturn for borrowing in 2009-10, combined with the economic growth path discussed above, means that public sector net borrowing is forecast to be lower in the medium term than projected in the 2009 Pre-Budget Report. Cyclically-adjusted net borrowing is forecast to fall from 8.4 per cent of GDP in 2009-10 to 2.5 per cent in 2014-15, a reduction of over two-thirds over the forecast horizon. This is a similar pace to Budget 2009 and the 2009 Pre-Budget Report, as show in Chart 2.2.

2.39 Public sector net debt is now forecast to peak at 74.9 per cent of GDP in 2014-15. This is 2.8 per cent of GDP lower than forecast in the 2009 Pre-Budget Report, driven by lower projected borrowing over the forecast period. Debt in 2013-14 is now projected to be 4.5 per cent of GDP, or £100 billion, lower than forecast in Budget 2009. [9]

2.40 Table 2.2 compares the projections for public sector net borrowing, cyclically-adjusted PSNB, the cyclically-adjusted current budget and net debt with those published in Budget 2009 and the 2009 Pre-Budget Report. Table 2.3 provides full projections for the key fiscal aggregates. Further detail on the public finance projections is provided in Chapter C.

[9] At Budget 2009 the Government provisionally estimated that potential losses from financial interventions might lie within a range of £20 billion to £50 billion, and the measure of debt used for fiscal policy purposes incorporated the high end of this range. As the Asset Protection Scheme was finalised and risks receded, the Government reduced its estimate of net losses to around £10 billion, in line with the treatment in the National Accounts.

Table 2.2: Changes to the fiscal aggregates

	Outturn[1]	Estimate[2]	Projections				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Net borrowing (£ billion)							
Budget 2009	**90.0**	**175.4**	**173**	**140**	**118**	**97**	**-**
Effect of revisions and forecasting changes[3]	5.4	2.6	- ½	-4 ½	-2 ½	0	-
Effect of PBR 2009 policy decisions	0.0	-0.4	1	-3 ½	-5	-6	-
Effect of other discretionary changes[4]	0.0	0.0	2 ½	7 ½	7	5	-
2009 Pre-Budget Report	**95.4**	**177.6**	**176**	**140**	**117**	**96**	**82**
Effect of revisions and forecasting changes	0.7	-11.0	-14 ½	-9	-7	-6 ½	-6 ½
Effect of Budget 2010 policy decisions	0.0	0.0	1 ½	0	- ½	-1	-1 ½
Effect of other discretionary changes[4]	0.0	0.0	0	0	0	0	0
Budget 2010	**96.1**	**166.5**	**163**	**131**	**110**	**89**	**74**
Cyclically-adjusted surplus on current budget (per cent of GDP)							
Budget 2009	-3.1	-6.7	-6.4	-4.9	-3.9	-3.2	-
2009 Pre-Budget Report	-2.6	-5.5	-5.4	-3.9	-3.0	-2.3	-1.9
Budget 2010	**-2.5**	**-4.8**	**-4.6**	**-3.4**	**-2.5**	**-1.8**	**-1.3**
Cyclically-adjusted net borrowing (per cent of GDP)							
Budget 2009	5.7	9.8	8.9	6.8	5.5	4.5	-
2009 Pre-Budget Report	5.7	9.0	8.0	5.8	4.5	3.6	3.1
Budget 2010	**5.8**	**8.4**	**7.3**	**5.3**	**4.1**	**3.1**	**2.5**
Net debt (per cent of GDP)[5]							
Budget 2009[6]	46.5	59.0	68.4	74.0	77.5	79.0	-
2009 Pre-Budget Report	44.0	55.6	65.4	71.7	75.4	77.1	77.7
Budget 2010	**43.8**	**54.1**	**63.6**	**69.5**	**73.0**	**74.5**	**74.9**

Note: Totals may not sum due to rounding. Budget 2009 aggregates, except for net debt, were on the basis which includes the temporary effects of financial interventions. All 2009 Pre-Budget Report and Budget 2010 aggregates are on the basis which excludes the temporary effects.

[1] The 2008-09 figures were estimates in Budget 2009.

[2] The 2009-10 figures were projections in Budget 2009.

[3] This includes the impact of moving from PSNB to PSNB excluding financial interventions. At the time of the 2009 Pre-Budget Report, the impact on 2008-09 was £10.4 billion, while the impact on 2009-10 was negligible.

[4] Including any changes to forecasting assumptions on spending growth from 2011-12 onwards.

[5] Debt at end March; GDP centred on end March.

[6] Measure of debt used for fiscal policy purposes at Budget 2009. This included a cautious provision for losses from the financial interventions of £50 billion.

Table 2.3: Summary of public sector finances

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Fiscal stance							
Public sector net borrowing (PSNB)	6.7	11.8	11.1	8.5	6.8	5.2	4.0
Cyclically-adjusted PSNB	5.8	8.4	7.3	5.3	4.1	3.1	2.5
Surplus on current budget	-3.4	-8.3	-8.4	-6.6	-5.2	-3.9	-2.8
Cyclically-adjusted surplus on current budget	-2.5	-4.8	-4.6	-3.4	-2.5	-1.8	-1.3
Net investment	3.3	3.6	2.7	1.9	1.6	1.3	1.3
Sustainability							
Public sector net debt[1]	43.8	54.1	63.6	69.5	73.0	74.5	74.9
Core debt[1]	42.5	49.5	55.4	58.5	60.0	60.3	60.0
Net worth[2]	22.4	18.0	7.4	1.8	-1.6	-4.1	-5.0
Primary balance	-5.0	-9.9	-8.5	-5.8	-3.7	-2.0	-0.7
Financing							
Central government net cash requirement	11.3	14.3	11.4	9.0	6.8	5.5	4.0
Public sector net cash requirement	4.2	11.8	11.6	9.2	7.1	5.7	4.2
Stability and Growth Pact							
Treaty deficit[4]	6.7	12.2	11.2	8.6	6.9	5.3	4.2
Cyclically-adjusted Treaty deficit[4]	5.7	8.7	7.4	5.4	4.2	3.2	2.7
Treaty debt ratio[5]	55.5	71.4	80.5	86.0	88.7	89.2	88.7
Memo: Output gap	*-2.0*	*-6.1*	*-5.2*	*-4.4*	*-3.6*	*-2.7*	*-1.9*

Note: All measures are shown on the basis which excludes the temporary effect of financial interventions, except net worth and the aggregates shown in the Financing and Stability and Growth Pact sections.

[1] *Debt at end March; GDP centred on end March.*

[2] *Estimate at end December; GDP centred on end December.*

[4] *General government net borrowing on a Maastricht basis.*

[5] *General government gross debt on a Maastricht basis.*

Financing and debt management

2.41 The Government's debt management framework, which is implemented by the Debt Management Office (DMO), has been resilient throughout the turbulence in global and UK financial markets. When it has been necessary, the Government has adapted the framework to ensure it continues to deliver the Government's objectives effectively. For example, in April 2009 the Government introduced a programme of syndications and mini-tenders for the first time to enable it to issue more long-maturity and index-linked gilts than would have been possible through auctions alone. Incremental further changes to the operations schedule are announced in this Budget. More information on the UK's debt management performance is provided in Box 2.2 and in the *Debt and reserves management report 2010-11*, published alongside the Budget.[10]

2.42 Lower than expected borrowing in 2009-10 and 2010-11 and lower than anticipated financial transactions in 2009-10 have a consequential impact on the Government's financing requirements, significantly reducing the central government net cash requirement (CGNCR) in both years. The CGNCR is projected to be £22 billion lower in 2009-10 than forecast in the 2009 Pre-Budget Report and £7.6 billion lower in 2010-11.

2.43 The fall in projected gilt sales in 2010-11 is even greater than the fall in the CGNCR in 2010-11. This is because improvements in expected receipts in 2009-10 came towards the end of the financial year. To adjust gilt sales at short notice would have been at odds with the principles of transparency and predictability that underpin the debt management framework, and so the fall in the CGNCR in 2009-10 was not reflected in lower gilt sales. As a result, there is an increase in the forecast level of the DMO's short-term net cash position of

[10] *Debt and reserves management report 2010-11*, HM Treasury, March 2010.

£24.0 billion, which will be used to reduce gilt sales in 2010-11. Together with the downward revision to the projected CGNCR in 2010-11, this results in a significant fall in projected gilt sales of £25.7 billion in 2010-11 relative to the 2009 Pre-Budget Report forecast, as shown in Table 2.4. Full details and a revised financing table can be found in Chapter C.

Table 2.4: Central government net cash requirement and gilt sales

	£ billion	
	2009-10	2010-11
Central government net cash requirement		
2009 Pre-Budget Report	223.3	174
Budget 2010	**200.9**	**166**
Gilt sales		
2009 Pre-Budget Report	225.1	213
Budget 2010	**227.6**	**187**
Change in Treasury bill stock		
Pre-Budget Report 2009	21.6	-
Budget 2010	**18.7**	**-2**

Note: A projection for gilt sales for 2010-11 was not made at the 2009 Pre-Budget Report. However, other factors held constant, the projected financing requirement for 2010-11 is the same as projected gross gilt sales.

2.44 Auctions will remain the Government's primary method by which to issue gilts in 2010-11. However, the Government has decided to continue to use supplementary methods: 15.6 per cent of projected gross gilt issuance of £187.3 billion in 2010-11 will be issued by syndication and 5.3 per cent by mini-tender.

2.45 This use of supplementary methods will facilitate higher issuance of long-maturity and index-linked gilts, with the Government projected to issue 31.5 per cent of the total as short conventional gilts (i.e. 1-7 year maturity), 24.0 per cent as medium conventional gilts (i.e. 7-15 year maturity), 24.2 per cent as long conventional gilts (i.e. of maturity above 15 years) and 20.3 per cent as index-linked gilts. All else equal, the high maturity of the UK's outstanding debt reduces refinancing risk because the UK has less debt to roll over each year.

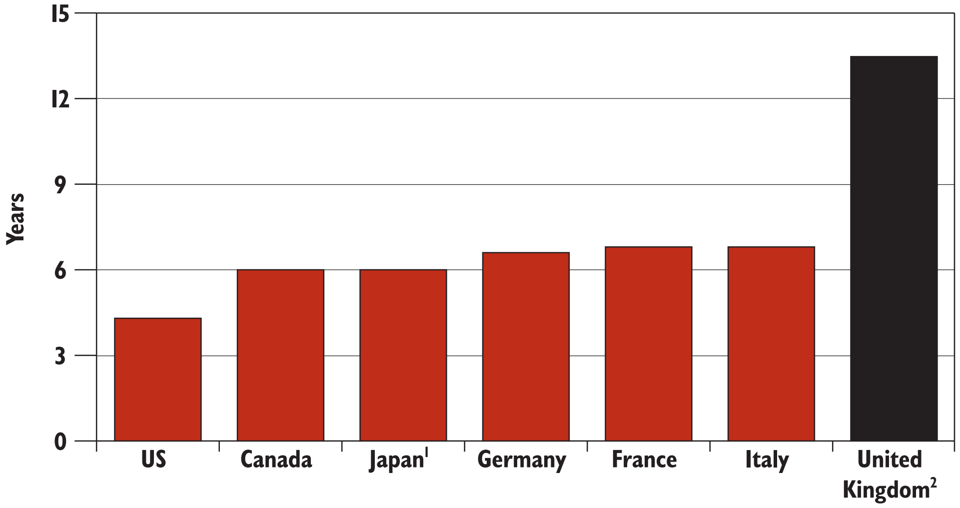
Box 2.2: Debt management in the UK

2009-10 was an unprecedented year for debt management: a record amount of gilts were issued and the Bank of England intervened in the secondary market to buy gilts for monetary policy purposes. Following consultation, the Government introduced a programme of syndications and mini-tenders to facilitate increased sales of long-maturity and index-linked gilts above levels that would have been possible through the use of auctions alone. Of total gross gilt sales of £227.6 billion in 2009-10, a record £80.9 billion was in long- and indexed-linked gilts.

There is strong and structural demand for long-maturity and index-linked gilts in the UK, in particular, from insurance companies and pension funds. The high issuance of long-maturity and index-linked gilts in the UK raises the average maturity of outstanding debt and reduces refinancing risk. Refinancing risk is the risk that a government cannot roll over (i.e. re-issue) existing debt effectively as it matures. Lower refinancing can also reduce volatility in debt interest payments.

Chart a shows a comparison between the average maturity of the UK's outstanding debt and that of other G7 countries. The chart shows that, at 13.5 years as at end-December 2009, the average term to maturity of the UK's outstanding debt is the longest of the G7 countries. Furthermore, the UK and France are the only two G7 countries to have issued a 50-year bond in 2009-10 to date.

Chart a: Average maturity of outstanding debt by country in 2008



[1] As in 2007.
[2] As at end December 2009.

Source: OECD and Debt Management Office.

In recent years, the maturity of the UK's outstanding debt has been increasing. Despite a small decline in 2008-09 and 2009-10, reflecting the need to issue a high volume of short maturity debt to finance the recapitalisation of the banking sector, the average maturity is projected to rise again in 2010-11.

Index-linked gilts are also subject to high demand from investors and increased issuance demonstrates the Government's confidence that inflation will remain low and stable and that the Bank of England will meet its inflation target.

Risks and uncertainty

2.46 While there are signs that the economy and financial markets are stabilising, both the economy forecast and the public finance projections remain subject to a significant degree of uncertainty. In particular, while risks surrounding the short-term projections for the public finances are receding, a significant degree of uncertainty regarding the medium-term projections remains. This is demonstrated by the range of independent forecasts for PSNB in 2011-12, which vary in magnitude by 5.8 per cent of GDP.[11]

2.47 Recognising these uncertainties, the fiscal projections reflect a realistic view of the position of the public finances by incorporating some cautious assumptions, including:

- a downward adjustment to the economy's trend level of output in light of the global financial shock of just over 5 per cent;
- that financial sector profits as a share of GDP only return to their 20-year average by 2014-15; and
- the NAO-audited assumptions, in particular on the VAT gap, claimant count unemployment and the trend rate of economic growth, which is assumed to be ¼ per cent below the centre of the forecast range. Further information on the NAO-audited assumptions is provided in Chapter C.

2.48 There is particular uncertainty regarding the structural position of the public finances at the current juncture. Estimates of cyclically-adjusted borrowing are subject to the following uncertainties:

- there are significant uncertainties around the cyclical position of the economy, as discussed further in Chapter B. These uncertainties are important, since the judgement reached around the impact of the global economic shocks on trend growth is key to estimating the persistent impact of the shocks on the public finances. For example, if there were less spare capacity than the Government estimates then the structural proportion of a given deficit would be greater. If there were more spare capacity, the structural proportion would be less; and
- since the co-efficients used in the Treasury's cyclical-adjustment methodology are calculated using data over full economic cycles, they may not fully pick up any disproportionate impacts on receipts and spending arising during recessions.

Fiscal policy: supporting recovery while ensuring sustainability

Budget decisions

2.49 The Budget 2010 fiscal judgement balances the need to support the economy through the early stages of recovery and the need to deliver sustainable public finances over the medium term through a sustained period of fiscal consolidation. Budget 2010 provides further temporary and targeted support for growth in 2010-11, balanced by measures that raise revenue in later years. Discretionary policy delivers a £1.4 billion loosening in 2010-11 more than offset by tightening in later years, building to a £1.6 billion tightening in 2014-15.

2.50 Budget 2010 announcements include:

- measures to support enterprise, growth and households in 2010-11, including a temporary increase in the level of small business rate relief, funding for an

[11] *Forecasts for the UK economy: a comparison of independent forecasts*, HM Treasury, February 2010.

additional 20,000 higher education places next year, an additional payment alongside the Winter Fuel Payment, and staging this year's fuel duty increase; and

- tax measures, which more than offset the targeted and temporary support in the early part of the forecast period, including continuing real terms increases in fuel, alcohol and tobacco duties to 2014-15, and an additional 5 per cent rate of stamp duty land tax for properties over £1 million from 2011-12.

2.51 Together, this fiscally neutral policy package and the underlying improvement in the position of the public finances result in a lower path for borrowing, cyclically-adjusted borrowing and net debt in each year of the forecast period, relative to Budget 2009 and the 2009 Pre-Budget Report. The Budget fiscal forecast shows:

- PSNB declining to 5.2 per cent of GDP in 2013-14 and 4.0 per cent in 2014-15;
- cyclically-adjusted or 'structural' net borrowing falling from 8.4 per cent of GDP in 2009-10 to 2.5 per cent in 2014-15, a reduction of more than two-thirds over the forecast horizon; and
- net debt projected at 74.5 per cent of GDP in 2013-14, £100 billion lower than the Budget 2009 forecast, and peaking at 74.9 per cent of GDP in 2014-15.

2.52 Budget 2010 forecasts borrowing in 2013-14 to be slightly below the ceiling set under the Fiscal Responsibility Act of 5.5 per cent of GDP, providing a margin of flexibility should future revenues turn out to be lower than expected. If the economy performs better than expected, the Government will be able to reduce the structural deficit more quickly than the path shown in this Budget.

Timing of consolidation

2.53 The Government judges that, in the face of economic uncertainty, it is important to continue to allow fiscal policy to support the economy in 2010-11, and that the medium-term consolidation plan provides space for targeted and temporary support measures in the short term. Continued fiscal support will be provided next year primarily through:

- planned increases in government spending, with Total Managed Expenditure rising by over £11 billion in real terms in 2010-11;
- the automatic stabilisers, which will continue to provide fiscal support worth almost 4 per cent of GDP in 2010-11; and
- the Government's decision at Budget 2009 to increase those benefits and tax credits normally linked to RPI by 1.5 per cent in April 2010, and to increase the basic state pension by 2.5 per cent, despite a period of negative RPI inflation in 2009, providing an effective real terms increase to transfer payments of around £4 billion.

2.54 The Government judges that the focus of fiscal policy should shift towards consolidation in 2011-12, when the economy should be able to support this tightening because:

- GDP growth is forecast to pick up to an above trend rate of 3 to 3½ per cent in 2011;
- as financial market conditions improve and the monetary policy transmission mechanism becomes more effective, the low Bank Rate expected by the market will provide an ongoing and powerful stimulus to spending by

businesses and individuals, supporting household real disposable incomes and reducing the economy's reliance on fiscal support; and

- market expectations are for Bank Rate to rise moderately towards the end of 2010 and rise further over 2011 and 2012. This implies that there is likely to be greater space for the Monetary Policy Committee to use interest rates to support demand by 2011-12, should that be warranted.

The fiscal consolidation plan

2.55 The Government has set out a detailed plan to deliver a sustained fiscal consolidation over the medium term. This plan is based on announced tax rises, spending plans and the Government's forecasts for economic growth. In total, measures announced since the 2008 Pre-Budget Report will reduce borrowing by £57 billion in 2013-14.

2.56 Including the measures announced in this Budget, tax measures will reduce borrowing by £19 billion in 2013-14. They include:

- an additional rate of income tax of 50 per cent for incomes over £150,000 and the restriction of the personal allowance for those with incomes of over £100,000, from April 2010;
- the restriction of pensions tax relief for those with gross of incomes of £130,000 and over, from April 2011;
- a one percentage point increase in the employee, employer and self-employed rates of National Insurance Contributions (NICs) from April 2011; and
- a one penny per litre above inflation increase in fuel duty and real terms increases to alcohol and tobacco duties, due to be delivered in each year to 2014-15.

2.57 The Government has also announced reduced spending growth assumptions from 2011-12 onwards, which will reduce borrowing by £38 billion in 2013-14. Public sector current expenditure will grow at an average of 0.8 per cent a year from 2011-12 to 2014-15[12] and public sector net investment will decrease to 1¼ per cent of GDP by 2013-14 and remain at that level in 2014-15. To support the delivery of reduced spending growth and to protect key frontline public services, the Government has also announced a package of over £20 billion of savings by 2012-13. These include £11 billion of operational efficiencies and other cross-cutting savings, £5 billion of savings from targeting and prioritising spending, and savings from restraint on public sector pay and reforms to public sector pensions.

Progress on consolidation plans in Budget 2010

2.58 Building on announcements to date, Budget 2010 and the forthcoming Finance Bill make further progress in setting out the detail of the Government's fiscal consolidation plan. On tax, Budget 2010 announces further measures that will reduce borrowing by £1 billion in 2013-14. More details are set out in Chapter A. Following the passage of Finance Bill 2010 the Government intends that around half of the tax measures that have been announced as part of the consolidation plan will have been passed into legislation.

2.59 On spending, Budget 2010 announces that the £11 billion of savings announced under the Operational Efficiency Programme have now been identified department-by-department, and sets out further details on how they will be delivered in the next Spending Review period. Budget 2010 also gives further details on how the Government will deliver the £5 billion of savings by 2012-13 from targeting and prioritising projects and programmes, and outlines the next steps in reforming public sector pay and pensions. More details can

[12] Excluding the additional time-limited resource expenditure announced in the 2009 Pre-Budget Report and all additional expenditure announced in Budget 2010.

be found in Chapter 6. The Government will set out further plans when the next Spending Review is published later this year.

The Fiscal Responsibility Act

2.60 The Government's consolidation plans are underpinned by legislation. The Fiscal Responsibility Act 2010 received Royal Assent on 10th February 2010. It requires that the Government set out at all times a legislative fiscal plan for delivering sound public finances, to be approved by Parliament, and places a binding duty on the Government to meet that plan. A revised *Code for Fiscal Stability* and the duty to reduce PSNB to 5.5 per cent of GDP or less in 2013-14 are being formally laid before Parliament alongside this Budget. [13]

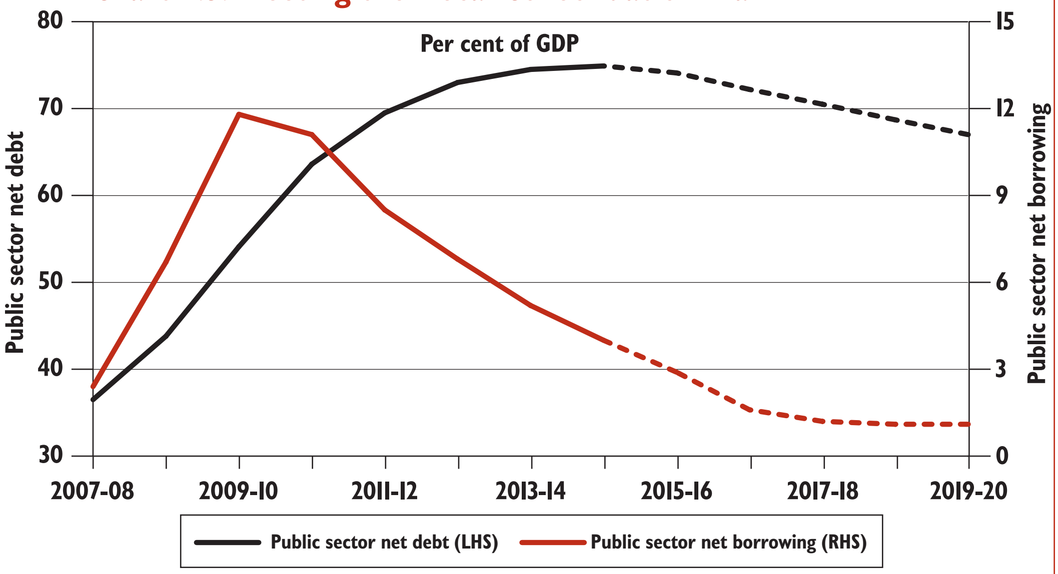
Progress against legislative duties

2.61 Overall, the requirements that have been placed on the Government are for:

- borrowing to be more than halved to 5.5 per cent of GDP or less in 2013-14;
- borrowing to be reduced as a share of GDP in each and every year from 2009-10 to 2015-16; and
- public sector net debt to be falling as a share of GDP in 2015-16.

2.62 Chart 2.3 shows forecasts to 2014-15 and illustrative projections thereafter for public sector net borrowing and net debt, which demonstrate that the Government's fiscal projections are consistent with the requirements of the Fiscal Responsibility Act. The projections show PSNB falling year-on-year from 2009-10 to 5.2 per cent of GDP in 2013-14 and 4.0 per cent of GDP in 2014-15. The illustrative projections beyond 2014-15 are based on the assumptions of an improvement of 0.7 per cent of GDP a year in the cyclically-adjusted current budget until it reaches balance. This is equivalent to the average improvement over the 2009-10 to 2014-15 period, and public sector net investment being held constant at 1¼ per cent of GDP. The chart shows that, under these assumptions, PSNB will continue to decline and debt will be falling in 2015-16.

Chart 2.3: Meeting the Fiscal Consolidation Plan



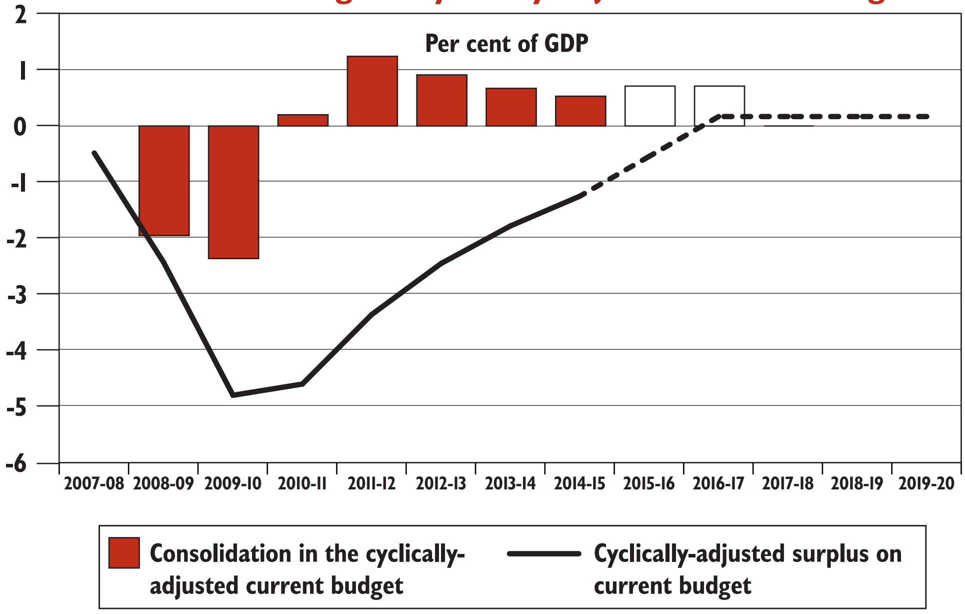
Note: For the financial years 2015-16 to 2019-20 the numbers presented here are illustrative projections.
Source: HM Treasury

[13] *Code for fiscal stability* and secondary legislation available at www.hm-treasury.gov.uk.

Balancing the cyclically-adjusted current budget

2.63 The cyclically-adjusted current deficit improves by, on average, 0.7 per cent a year over the forecast period. Chart 2.4 shows that a further illustrative improvement of 0.7 per cent a year from 2015-16, in line with this average, would eliminate the deficit on the cyclically-adjusted current budget by 2016-17, a year earlier than projected at the 2009 Pre-Budget Report.

Chart 2.4: Balancing the cyclically-adjusted current budget

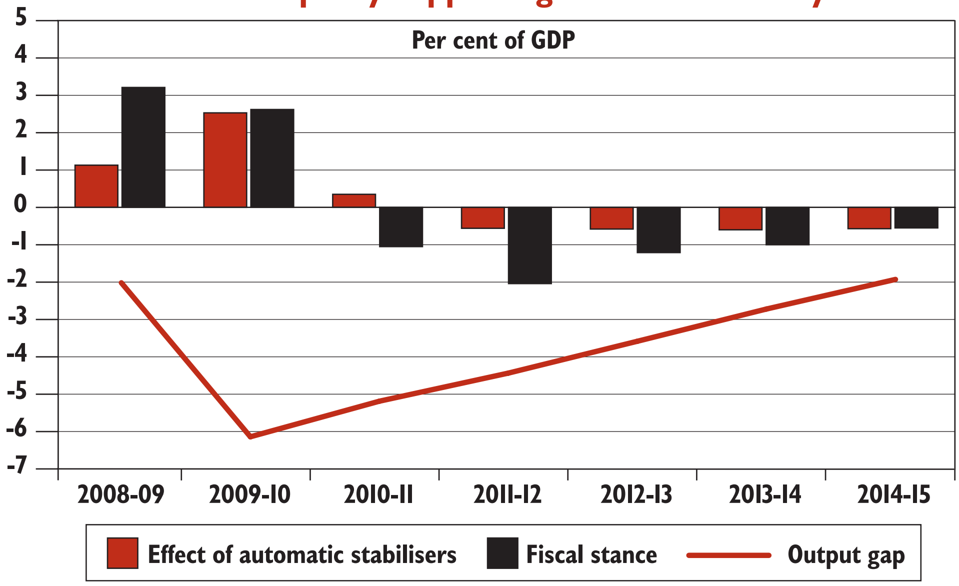


Note: For the financial years 2015-16 to 2019-20 the numbers presented here are illustrative projections.
Source: HM Treasury.

Economic impact

2.64 Chart 2.5 shows that both the automatic stabilisers and the fiscal stance acted to provide a considerable degree of support to growth in 2008-09 and 2009-10, during the economic downturn, with a cumulative impact of around 4 per cent and 5 per cent respectively in those years. In 2010-11, with planned increases in Government spending of £11 billion in real terms, borrowing of 11.1 per cent of GDP continues to support the level of economic activity. From 2011-12, with the economy growing at above trend rates and able to support fiscal consolidation, tightening of policy and the automatic stabilisers work together to deliver a reduction in borrowing.

Chart 2.5: Fiscal policy supporting economic stability



Note: The fiscal stance equals the annual change in the cyclically-adjusted PSNB. The effect of the automatic stabilisers equals the change in the cyclical component of PSNB, i.e. the change in the difference between PSNB and the cyclically-adjusted PSNB.

Source: HM Treasury.

Stability and Growth Pact

2.65 The UK is subject to the Stability and Growth Pact (SGP) as part of its membership of the European Union (EU). Treaty obligations require the UK to endeavour to avoid excessive deficits, defined as 3 per cent of GDP on the Treaty deficit measure. The UK is not subject to sanctions or corrective measures if it does not comply.

2.66 Twenty-one EU member states are currently subject to the Excessive Deficit Procedure of the SGP. EU leaders have agreed that the flexibility provided for in the SGP should be used, and that fiscal consolidation should be undertaken in line with economic recovery. The EU's Economic and Financial Affairs Council has recommended that the UK bring its Treaty deficit below the 3 per cent reference value by 2014-15.

2.67 As explained earlier in this chapter, the Government has taken a judgement on the appropriate pace of fiscal consolidation, consistent with its fiscal policy objectives. The annual pace of consolidation for the UK set out in Budget 2010 is the fastest in the G7 on IMF forecasts for the period up to 2014.[14] As shown in Table 2.3, the Treaty deficit is projected to be 4.2 per cent of GDP in 2014-15.

Long-term fiscal issues

2.68 The *2009 Long-term public finance report*[15] provided a comprehensive assessment of the long-term trends and associated challenges facing the UK, and set out their potential implications for the public finances under a range of different scenarios. The report provided projections for those areas of spending that may be particularly affected by long-term challenges, such as education, pensions and health. Budget 2010 sets out illustrative projections for net debt, public sector net borrowing and the cyclically-adjusted current balance to 2019-20, consistent with the requirements of the *Code for fiscal stability*.

[14] For the countries in the G7, other than the UK, the projected annual average fall in borrowing is as forecast by the IMF on a calendar year basis between 2010 and 2014. For Japan and the US, where borrowing is forecast to peak in 2009, the pace of consolidation is taken over 2009 to 2014. The UK pace is based on the Budget 2010 financial-year projection of PSNB from 2009-10 to 2013-14.

[15] *2009 Long-term public finance report*, HM Treasury, December 2009.