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Topic covered in this issue:

Initial Analysis of the 2014 UK Autumn Statement

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Autumn Statement 2014

The following are some of the key points in relation to the UK government's Autumn Statement for 2015 and the accompanying 'Economic and Fiscal Outlook' by the Office for Budget Responsibility (OBR).

UK economy

The OBR updated forecasts on the UK economy include:

- **GDP** growth for this year (2014) is now expected to reach 3%, but is then expected to fall below 2.5% in each year up to 2019.
- **Inflation** is forecast to bottom out at 1.2% in 2015, and then rise back to the Bank of England target rate of 2% by 2017, and stabilise at that rate.
- **Average earnings** are forecast to recover to almost 4% by 2017 and to stay around that level to 2019, a real terms increase of around 2% a year (given the OBR's inflation forecasts).
- **Interest rates** (i.e., 3-month interbank rate or LIBOR) are expected to slowly but steadily rise from 0.6% this financial year to 2.4% in 2019-20.

UK's fiscal position based on the OBR forecasts

On **fiscal projections**, another year has been added to the OBR's forecasts, which shows a further real terms cut to spending on public services in 2019-20.

This means that UK public service budgets face another five years (at least) of cuts on top of the five years already experienced. Furthermore, and contrary to what the UK government has implied, the cuts to come are of a greater magnitude than those already experienced.

Most of the upcoming cuts involve **day-to-day spending** rather than capital projects. The latest OBR projections show real terms cuts of between 3% and 6.7% in UK spending on such services in each year from 2016-17 to 2019-20. Such day-to-day cuts will not be easy to achieve, especially if spending on the NHS continues to be protected against inflation.

Thanks to the rise in infrastructure projects, the UK **capital budget** will be higher, in real terms, in 2019-20 than it is now. However, this rise is projected to be back-ended, i.e., all taking place in 2018-19 and 2019-20. This leave open the potential for this expenditure to be subject to revision by whatever party, or parties, form the next UK government.

The OBR's lower forecast for **inflation** has delivered a budget saving, as some benefits now rise at a lower rate than assumed in the March budget. However, it also reduces the rate at which inflation erodes the real value of the UK's debt obligations.

The uprating of the poundage rate to be applied to English **non-domestic rates** is capped at 2%, as opposed to the RPI measure for September (2.3% in 2014), which has been used in recent years. This cap has been extended for another year, while a wider review, due to report by the 2016 Budget, is undertaken. The Scottish government need not apply the same cap. Any such capping and reviews have implications both for businesses and for the level of government tax receipts.

The **Scottish budget** will receive a temporary fillip of £213 million as a result of the workings of the Barnett formula. Of this, £127 million stems from extra funds for the NHS in England and the Scottish government has already promised to pass this sum on, in full, to the NHS in Scotland.

Fiscal targets

The **UK fiscal mandate target**, to balance the cyclically adjusted current budget (CACB, which excludes spend on capital projects), by the end of a 5 year rolling period is expected to be met. The OBR now forecast a small surplus of taxes over public spending for the UK of £4 billion in financial year 2018-19.

However, the supplementary target, to see public sector debt falling (as a % of GDP) in 2015-16, is not now expected to happen until a year later (2016-17).

These contrasting fortunes can largely be explained by the fact that the former target has a rolling end date (and so which has been extended since initially set) while the latter has a fixed one. Hence, as the pace of austerity has been moderated in past Budgets and Autumn Statements, this makes an ambitious past fixed date target more difficult to achieve but a rolling target potentially less so.

Devolution of economic powers

A week after the **Smith Commission** recommended that Scotland gains near full control of Income Tax, the Chancellor is minded to devolve control of **Corporation Tax** to Northern Ireland. Wales is also on course to get power over business taxes and there is an increasing move, in terms of both funds and powers, to strengthen the economic position of 'Northern England'.

This asymmetric devolution of such powers may seem a little messy but it does appear to signal a desire to weaken the central control of such economic powers by Whitehall.

A positive side effect of this move towards '**tax competition**' across the UK was unveiled by the Chancellor at the end of his speech when he radically altered Stamp Duty in England, in a similar manner to that already undertaken by John Swinney with regards to a power newly devolved to Scotland. This shows one of the potential advantages of such 'competition' where good ideas can be copied.

Just how all these changes will impact on Scotland will not be fully known until their impact feeds through via the yet to be agreed adjustments to the **Barnett formula mechanism**.

Oil and gas

Offshore - North Sea tax revenues

While future oil revenues no longer have the same importance in the political debate post referendum, they will no doubt continue to be monitored closely.

Due to the fall in the oil price these revenues are projected, yet again, to be lower than previously forecast. For next year (2015-16) the OBR now estimates they will contribute £2.2 billion in UK taxes, as against £3.8 billion at the time of the last UK Budget in March.

This fall in North Sea revenues has been cushioned by exchange rate movements and by assuming a price of $85, rather than the current $71.

The Chancellor cheered the oil industry by introducing an immediate reduction of two percentage points in its tax rate, the first such reduction in 21 years, as well as allowing for greater offset of costs against future production. However, the UK government's wider intentions on how to improve the long term prospects for the North Sea will only be outlined in full today, in Aberdeen, when Ministers unveil their roadmap for the future.

Onshore - fracking tax revenues

The Autumn Statement announced the establishment of a new sovereign wealth fund which would ensure that tax revenues from the exploitation of shale gas would be used in local projects in England. In Scotland this power has been included in the Smith Commission recommendations to be devolved, but any plans for a similar style sovereign wealth fund in Scotland are as yet unknown.

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