

OBR fiscal risks and sustainability report

Synopsis: The Office for Budget Responsibility (OBR) has published its latest long term examination of the fiscal outlook for the UK. It does not make cheery reading for the Chancellor – if she can take her eyes off the government's short term financial problems.

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Against a backdrop of warnings that U-turns and a downward revision to growth that could mean £20bn of extra tax/savings need to be delivered in the Autumn Budget, the Office for Budget Responsibility (OBR) has published a new set of fiscal projections. However, these are not the next-five-years figures which will appear in the Economic and Fiscal Outlook (EFO), but a much longer term view, starting where the EFO ends and running through to 2073/74.

The OBR's Fiscal Risks and Sustainability Report ([FRSR](#)) examines the 50-year path of government debt, based upon current government policy and the latest demographic projections. The base line of the FRSR is that "Over the long term, the demographic pressures of an ageing population and rising costs of healthcare and other age-related expenditures are still, on current policy settings, projected to push borrowing above 20% and debt above 270% of GDP by the early 2070s.

This year's report focuses on three areas that the OBR sees as potentially having a significant impact on public finances...

The Public and Private Pensions System

State pension costs are projected to rise from 5% to 7.7% of GDP by 2070s due to...

- **An ageing population** The number of adults below State Pension Age per pensioner fell to 3.2 in the early 1980s before flattening out and then rising during the 2010s. However, it is expected to fall again to 2.7 by the early 2070s.
- **The Triple Lock** A combination of volatile inflation and poor earnings growth since the introduction of the Triple Lock in 2010 means that the OBR projects that by 2029/30 the cost of the lock will cost £15.5bn a year, three times more than originally expected. That is despite the controversial one-year suspension of the lock during the pandemic.
- **Private pension gap** The OBR refers to recent research suggesting that 40% of working-age individuals are likely to fall short of the Pensions Commission's 'target replacement rate', while around 10% would fall short of the Pensions UK (formerly PLSA) 'minimum living standards' benchmark. The OBR also highlights the same specific issues affecting the self-employed and private renters that the Institute for Fiscal Studies mentioned in its recent final report. The corollary of the shortfall in private provision is increased future welfare costs.

- Declining demand for UK government debt: The shift from Defined Benefit (DB) to defined contribution (DC) pensions reduces the pension sector's demand for gilt holdings, particularly longer-dated and index-linked stock. Total pension scheme holdings of gilts are projected to fall from 29.5% of GDP in 2024/25 to 10.9% in the early 2070s, within which:
- DB holdings are projected to fall from 26.7% of GDP today to 5.6% in the early 2070s; and...
 - DC holdings are projected to rise from 2.8% of GDP today to 5.3% by the early 2070s, at which point DC accounts for the vast majority of private sector pension provision, but entails lower contribution rates in working age and a lower allocation of assets to gilts.

The OBR estimates that this decline in the pensions sector's gilt holdings could push up interest rates on government debt by around 0.8 percentage points, assuming the stock of debt remains close to 100% of GDP, as higher interest rates would be needed to entice more price-elastic buyers, such as overseas investors.

Public Sector Balance Sheet

The OBR sees three main risks to the outlook for the Public Sector Net Financial Liabilities (PSNFL), the replacement yardstick for Public Sector Net Debt (PSND) which was introduced in last year's Budget:

- Transactions These are the difference between...
 - (a) spending on consumption and non-financial assets, or the purchase or sale of financial assets at amounts that differ from their market value, which will increase PSNFL; and
 - (b) receipts from taxes and other sources which will decrease PSNFL.

Following in from the 2025 Spending Review, a total of £26.4bn has now been allocated for financial transactions within the departmental expenditure limits. The OBR believes that ensuring its forecasts for PSNFL reflect the worth of the financial assets created or acquired through these transactions will be a challenge.

- Valuation changes Alterations to the value of the stocks of assets or liabilities already held on the balance sheet will happen for all assets recorded at their market value, such as listed equities, or for assets held in foreign currencies. Valuation changes can also arise from impairments, such as write-downs in the value of non-performing loans. Sudden changes, eg in a recession, pose a risk to the PSNFL outlook. The OBR calculates that shocks could raise the level of PSNFL by between 1.0% and 2.6% of GDP in a single year.
- Classification changes The ONS moves the recording of institutions or other bodies in and out of the public sector as circumstances change. This can

- cause the level of PSNFL to change with no corresponding transaction or valuation change recorded, if the financial balance of the reclassified body is different from that of the rest of the public sector.

The OBR says the main risks here revolve around water companies (although it does not mention Thames Water by name), housing associations and higher education institutions. The first two could increase the PSNFL by 2.8% of GDP and 3.5% respectively, while higher education would have a minimal impact and could even decrease the PSNFL.

Climate Change

The OBR's view is that coping with climate change creates three main fiscal risks...

- **Mitigation costs** The OBR has updated work it undertook in 2021 in assessing the mitigations costs. Its central estimate through to 2050/51 is £803bn (21% of GDP), or £30 billion a year on average.

Two-thirds of the cost can be attributed to revenue losses from declining consumption of hydrocarbons - £20.5bn (0.5% of GDP) per year on average between 2024/25 and 2050/51. As we await the next round of Budget arguments about frozen fuel duty, it is noteworthy that three-quarters of that revenue loss comes from declining fuel taxes as petrol-driven cars are replaced by electric vehicles.

The remaining one third is the share of the whole-economy investment costs in mitigation borne by the state.

- **Damage costs** The OBR estimates that the fiscal costs from climate-related damage could add 2.0% of GDP to primary borrowing by the early 2070s, 0.7 percentage points higher than its previous estimate. The estimate is based on a scenario where global temperatures rise to just below 3°C above pre-industrial levels. Climate damage is now estimated to reduce the level of GDP by 8% by the early 2070s.

Adaptation costs The costs to government of measures taken to reduce the impact on, and increase the resilience of, the economy to higher temperatures and increasingly volatile and extreme weather have not yet been quantified but are likely to be significant. The OBR says that there is currently no reliable data on current or planned levels of UK government spending on adaptation.

020 7183 3931
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