Office for
Budget Responsibility

Economic and fiscal outlook

March 2021

CP 387

Office for Budget Responsibility: Economic and fiscal outlook

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the Exchequer Secretary to the Treasury by
Command of Her Majesty

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Contents

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Foreword

In this *Economic and fiscal outlook* (*EFO*) we set out a central forecast to 2025-26 taking account of the latest data and Government policies announced up to and including in the 2021 Budget. Uncertainty around the economic outlook remains considerable, so we continue to present our latest central forecast alongside the upside and downside scenarios produced in our November 2020 *EFO*, which have not been updated. The forecasts and scenarios presented in this document represent the collective view of the three independent members of the OBR's Budget Responsibility Committee (BRC). We take full responsibility for the judgements that underpin them and for the conclusions we have reached.

We have been greatly supported in our work by the staff of the OBR, who have again risen to both the analytical and practical challenges of producing these forecasts, while working remotely throughout. We are enormously grateful for their hard work, expertise and professionalism.

We have also drawn heavily on the work and expertise of numerous officials across government in preparing these forecasts, including in HM Treasury, HM Revenue and Customs, the Department for Work and Pensions , the Ministry of Housing, Communities and Local Government, the Department for Education, the Department for Business, Energy and Industrial Strategy, the Ministry of Justice, the Home Office, the Department for Transport, the Oil and Gas Authority, the Office for National Statistics, the UK Debt Management Office, the British Business Bank, Homes England, UK Government Investments, the Government Actuary's Department, the Insolvency Service, the Scottish Government, the Scottish Fiscal Commission, the Welsh Government, the Department for Communities and the Department of Finance in Northern Ireland, Transport for London and various public service pension schemes. We are grateful for their expertise, hard work, and patience in challenging circumstances for them too.

Given the continued central importance of the path of the pandemic, the effectiveness and rollout of the vaccines, and associated public health interventions to the economic and fiscal outlook, in this *EFO* we have once again drawn on the expertise of government scientists, epidemiologists, and public health experts, including the Chief Medical Officer, the Scientific Pandemic Influenza Group on Modelling (SPI-M), the Department of Health and Social Care, NHS England and NHS Improvement, the Government Office for Science, the Joint Biosecurity Centre, the UK Vaccines Task Force and the Joint Committee on Vaccination and Immunisation. These discussions have been enormously valuable in helping us to understand the potential scenarios for the future path of the pandemic and their economic and fiscal implications.

We have also held useful discussions with the Bank of England, National Institute for Economic and Social Research, Institute for Fiscal Studies, Resolution Foundation, Institute for Government, Ian Mulheirn (Tony Blair Institute for Global Change), Jonathan Portes (King's College London) and Michael O'Connor about their latest forecasts and economic analysis for which we are very grateful.

At the same time, we retain sole responsibility for all the assumptions in this *EFO*.

We asked the Treasury to inform us of the Government's view on the path of the virus, vaccine rollout, and associated public health restrictions at various stages throughout the forecast and held constructive discussions with the Treasury as the forecast was developed. The Government's Roadmap announced by the Prime Minister on 22 February has been incorporated into our forecast and is a key driver of the near-term path for the economy and public finances.

The date of the Budget was announced on 17 December, more than ten weeks ahead of the publication date. A return to the agreed notice period is very welcome. As the Budget is slightly earlier than usual, we agreed to compile the forecast with one fewer iteration than normal, delivering two 'pre-measures' rounds to the Treasury, rather than the typical three. In addition to the Budget policy measures, we also incorporated the most recent GDP data and the relevant features of the Roadmap in the final round.

The full forecast timetable has been as follows:

- The OBR staff prepared an initial economy forecast, drawing on data released since our previous forecast in November 2020 and incorporating our preliminary judgements on the outlook for the economy. This economy forecast was sent to the Chancellor on 20 January.

- Using the economic determinants from this forecast (such as the components of nominal income and spending, unemployment, inflation and interest rates) we commissioned updated forecasts from the relevant government departments for the various tax and spending items that in aggregate determine the position of the public finances. We discussed these in detail with the officials producing them, which allowed us to investigate proposed changes in forecasting methodology and to assess the significance of recent tax and spending outturns. In many cases, the BRC requested changes to methodology and/or the interpretation of recent data. Our first fiscal forecast was sent to the Chancellor on 3 February.

- As the process continued, we identified key judgements that we would need to make to generate our full economy forecast. Where we thought it would be helpful, we commissioned analysis from the relevant analysts in the Treasury to inform our views. The BRC then agreed further key judgements, allowing the production by OBR staff of a second economy forecast, which was sent to the Treasury on 8 February. We met the Chancellor to discuss the emerging forecast on 11 February.

- The second economy forecast provided the basis for a further round of fiscal forecasts. Discussion of these with HMRC, DWP and other departments gave us the opportunity to follow up our requests for further analysis, methodological changes and alternative judgements made during the previous round. We provided the final version of our second fiscal forecast to the Chancellor on 17 February. The emerging forecast was being developed in parallel to both the Roadmap and the policy measures that the Government has announced in the Budget. In order to facilitate these processes, we also shared an early view of the emerging fiscal forecast with the Treasury in draft on 12 February.

- Concurrently, we scrutinised the costing of tax and spending measures announced since the November 2020 forecast. As usual, the BRC requested further information and/or changes to almost all the draft costings prepared by departments.

- In normal circumstances, we agree with the Treasury that the penultimate round is the final opportunity to incorporate changes to the pre-measures forecast, in order to give the Chancellor a stable base on which to take policy decisions. On this occasion (and as was necessary in November too) the rapidly changing environment meant that we continued to update the forecast to ensure the timetable for easing public health restrictions confirmed in the Roadmap was taken into account. The final round of the forecast also incorporated all policy announcements since November.

- In line with the agreed forecast timetable, we were provided with details of the final policy decisions with a potential wider impact on the economy forecast on 19 February. We sent the final economy forecast to the Treasury on 23 February and a near-final fiscal forecast on 24 February. The forecast was finalised on 26 February and included the remaining policy decisions that were sent to us the preceding day.

- The Treasury made a written request, as provided for in the *Memorandum of Understanding* (MoU) between us, that we provide the Chancellor and an agreed list of his special advisers and officials with a near-final draft of the *EFO* on 26 February. This allowed the Treasury to prepare the Chancellor's statement. We also provided 24 hours pre-release access to the full and final *EFO* on 2 March.

During the forecasting period, the BRC held more than 40 scrutiny and challenge meetings with officials from other departments, in addition to numerous further meetings at staff level. We have been provided with all the information and analysis that we requested and have come under no pressure from Ministers, advisers or officials to change any of our conclusions as the forecast has progressed. A full log of our substantive contact with Ministers, their offices and special advisers can be found on our website. This includes the list of special advisers and officials that received the near-final draft of the *EFO* on 26 February.

Our non-executive members, Sir Christopher Kelly and Bronwyn Curtis OBE, provide additional assurance over how we engage with the Treasury and other departments including by reviewing any correspondence that OBR staff feel either breaches the MoU requirement that it be confined to factual comments only or could be construed as doing so. That review will take place over the next two weeks and any concerns our non-executive members have will be raised with the Treasury's Permanent Secretary or the Treasury Select Committee, if they deem that appropriate.

We would be pleased to receive feedback on any aspect of the content or presentation of our analysis. This can be sent to feedback@obr.uk.



Richard Hughes Sir Charles Bean Andy King

The Budget Responsibility Committee

1 Executive summary

Overview

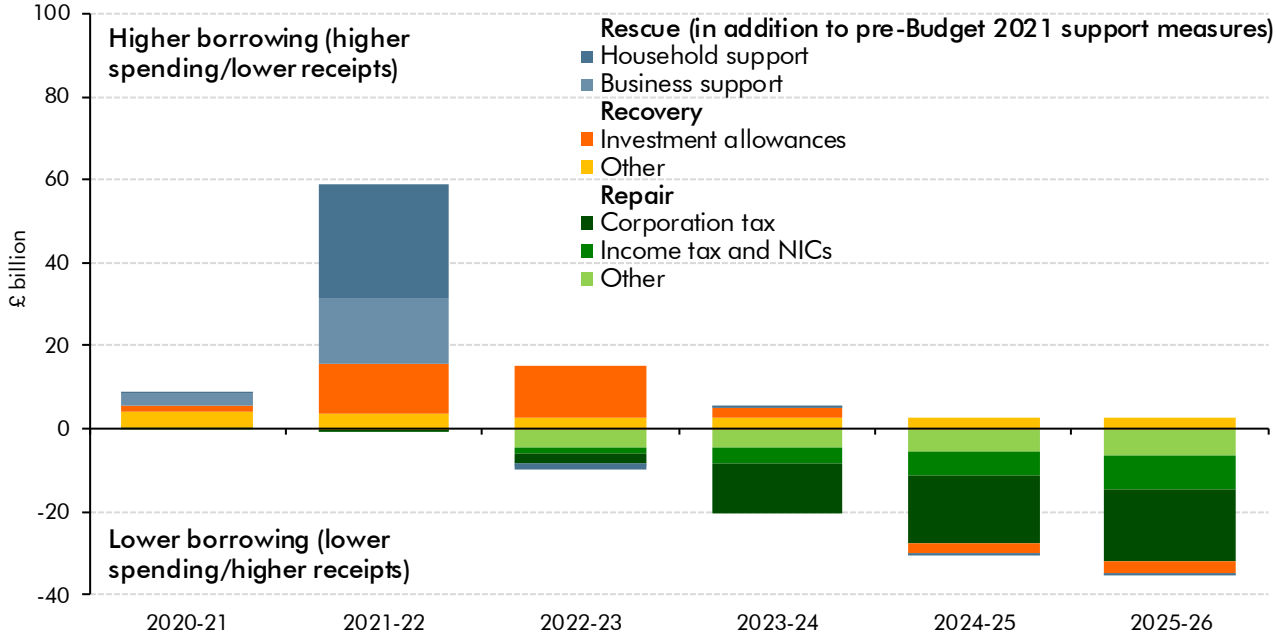
1.1 More than a year on from its start, the coronavirus pandemic continues to exact a heavy toll in lives and livelihoods. Around the globe, more than 100 million people have had the virus and around 2½ million have died from it, and world GDP fell by 3½ per cent in 2020 as governments imposed public health restrictions in an attempt to control the virus. The UK has been hit particularly hard. Following a resurgence of infections over the winter, around 1 in 5 people have so far contracted the virus, 1 in 150 have been hospitalised, and 1 in 550 have died, the fourth highest mortality rate in the world. And GDP fell 9.9 per cent in 2020, the largest decline in the G7. While output partially recovered in the second half of last year – and somewhat more strongly than we previously thought – the latest lockdown and temporary disruption to EU-UK trade at the turn of the year is expected to result in output falling again in the first quarter of this year.

1.2 The pandemic has, however, also spurred a global scientific effort to develop new and effective vaccines at unprecedented speed, with the UK in the vanguard of their discovery and rollout. More than 200 million people worldwide have already received their first dose of one of those vaccines. In the UK, that figure has topped 20 million – more than a third of all adults and the fourth highest vaccination rate worldwide. Early evidence from the UK and other countries indicates that the vaccines are broadly as effective in reducing illness and death as suggested in clinical trials. The Government aims to have offered a first dose to everyone over 50 or at risk by 15 April and to all adults by 31 July, slightly earlier than assumed in our November central forecast.

1.3 The rapid rollout of effective vaccines offers hope of a swifter and more sustained economic recovery, albeit from a more challenging point than we forecast in November. The easing of public health restrictions in line with the Government's 22 February Roadmap should permit a rebound in consumption and output through this year, partially supported by the release of extra savings built up by households during the pandemic. GDP is expected to grow by 4 per cent in 2021 and to regain its pre-pandemic level in the second quarter of 2022, six months earlier than we forecast in November. Unemployment still rises by a further 500,000 to a peak of 6.5 per cent at the end of 2021, but the peak is around 340,000 less than the 7.5 per cent assumed in our November forecast, thanks partly to the latest extension of the furlough scheme. The pandemic is nevertheless still expected to lower the supply capacity of the economy in the medium term by around 3 per cent relative to pre-virus expectations.

1.4 Faced with an economy that is weaker in the near term but rebounding faster than we forecast in November, the Chancellor has done three things in this Budget. First, he has extended the virus-related **rescue** support to households, businesses and public services by a further £44.3 billion, taking its total cost to £344 billion. Second, he has boosted the **recovery**, most notably through a temporary tax break costing more than £12 billion a year that encourages businesses to bring forward investment spending from the future into this year and next. Third, as the economy normalises, he has taken a further step to **repair** the damage to the public finances in the final three years of the forecast by raising the headline corporation tax rate, freezing personal tax allowances and thresholds, and taking around £4 billion a year more off annual departmental spending plans, raising a total of £31.8 billion in 2025-26 (Chart 1.1).

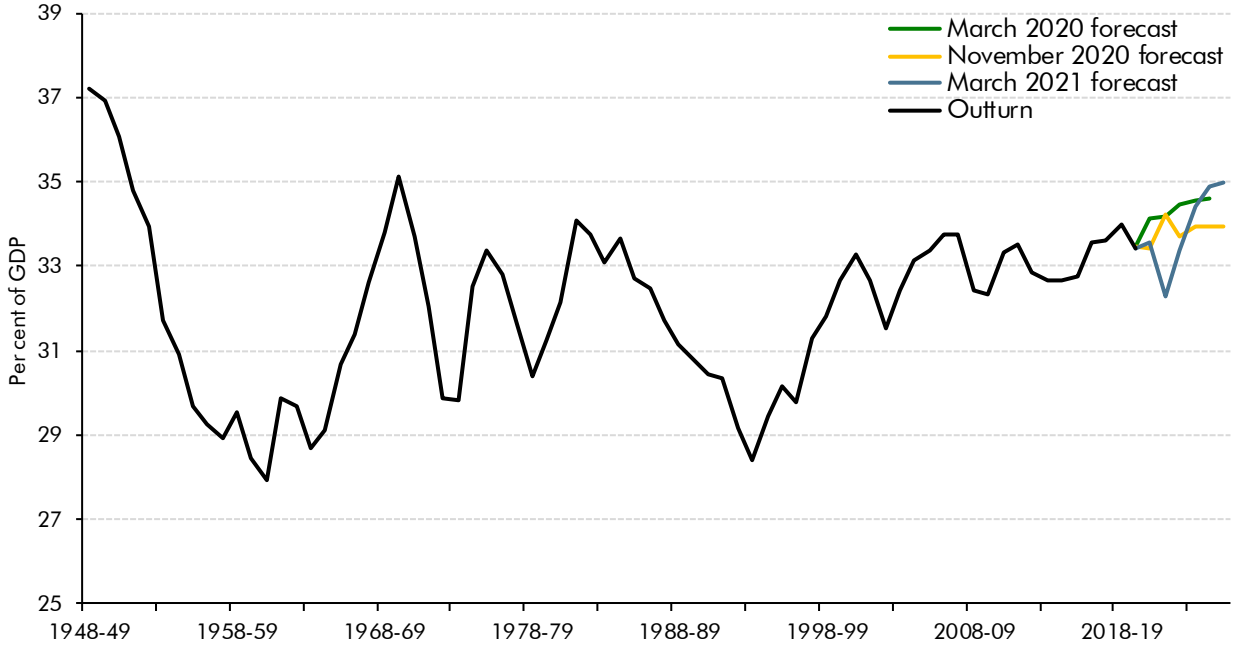
Chart 1.1: The impact of Budget measures on public sector net borrowing



Source: OBR

1.5 The tax rises announced in this Budget increase the tax burden from 34.0 to 35.0 per cent of GDP in 2025-26, its highest level since Roy Jenkins was Chancellor in the late 1960s (Chart 1.2). Over half of this increase is as a result of a 6 percentage point increase in the corporation tax rate to 25 per cent. This brings the headline corporation tax rate back into line with the advanced economy average but still well below its long-run historical average in the UK of around 35 per cent. However, the widening of the tax base over the past decade means that this relatively modest increase in the headline rate leaves corporation tax raising 3.2 per cent of GDP in revenue by 2025-26, its highest since 1989-90. Freezes to the income tax personal allowance and higher rate threshold for four years bring 1.3 million people into the tax system and create 1 million higher rate taxpayers by 2025-26.

Chart 1.2: Tax as a share of nominal GDP



Source: ONS, OBR

1.6 As the economy reopens and emergency fiscal support is withdrawn, government borrowing is forecast to fall from a peacetime high of £355 billion (16.9 per cent of GDP) in 2020-21 to £234 billion (10.3 per cent of GDP) in 2021-22 (still higher than the 2009-10 peak at the height of the financial crisis). In 2022-23, as fiscal policy moves from rescue to recovery, the deficit falls back to £107 billion (4.5 per cent of GDP). Thereafter, as policy focuses on repair and taxes rise, borrowing falls to £74 billion (2.8 per cent of GDP) in 2025-26.

1.7 Headline debt tops 100 per cent of GDP this year and remains above that level throughout our forecast. Underlying debt (excluding the Bank of England) peaks at 97.1 per cent of GDP in 2023-24 before falling back to 96.8 per cent of GDP by the end of the forecast. Despite the stock of debt reaching its highest level as a share of the economy since 1958-59, the costs of servicing that debt falls to a historic low of just 2.4 per cent of total revenues thanks to the decline in interest rates. Unlike previous post-crisis Chancellors who cut back capital spending to reduce borrowing and rein in debt, this one has left in place the significant increase in public investment, from 1.9 per cent of GDP last year to 2.7 per cent of GDP by 2025-26, that he announced a year ago.

1.8 The Chancellor has not set new fiscal targets in this Budget (despite two of the existing ones expiring this month) and is instead proceeding with the review of the fiscal framework proposed in last year's Budget. But the absence of formal fiscal targets does not mean that the Chancellor has not been guided by particular metrics when selecting his medium-term Budget policies. The tax rises and spending cuts he has announced are sufficient to eliminate all but a £0.9 billion current budget deficit in 2025-26, while they are just enough to see underlying public sector net debt as a share of GDP fall by a similarly small margin of £0.7 billion in 2024-25 and £4.1 billion in 2025-26.

1.9 Uncertainty around the economic outlook remains considerable, with the course of the pandemic still the greatest single risk. A quicker rollout of vaccines with greater effectiveness in reducing infection and illness, the development of new therapies and treatments, or a faster rundown in household savings built up during the pandemic could deliver a swifter economic recovery and less medium-term scarring. Against that, setbacks in the rollout of the vaccines, the emergence of new vaccine-resistant variants, or reduced compliance with residual public health restrictions could force governments back into periodic lockdowns, with more adverse consequences for the economy in the short and medium term. So, the upside and downside scenarios set out in our November *Economic and fiscal outlook* (*EFO*) remain a reasonable guide to the range of possible future outcomes.

1.10 Assuming the Chancellor can maintain the tax burden close to historic highs, the main fiscal risks come from the legacy of the pandemic for public services. While public spending is set to be 2 per cent higher as a share of GDP in 2025-26 than in 2019-20, most of this reflects increases in health, education and public investment announced before the pandemic. The Government's spending plans make no explicit provision for virus-related costs beyond 2021-22, despite its Roadmap recognising that annual vaccination programmes and continued testing and tracing are likely to be required. The Government will also need to decide how to catch up on services disrupted by the virus, notably the backlogs in non-urgent procedures in the NHS that have built up and the months of lost or impaired schooling for some pupils.

1.11 Faced with these post-pandemic pressures, the Government has so far cut more than £15 billion a year from departmental resource spending from 2022-23 onwards, setting up a challenging Spending Review later this year. The public finances are also much more sensitive than they were to rises in short-term interest rates, due to a combination of the higher debt stock and its effective refinancing by the Bank of England through quantitative easing, which has shortened the median maturity public debt from more than seven years before the financial crisis to less than two today. To illustrate this risk, the 30 basis point increase in interest rates that has happened since we closed our forecast on 5 February would already add £6.3 billion to the interest bill in 2025-26 published in this document. All else equal, that would be enough to put underlying debt back on a rising path relative to GDP in every year of the forecast.

Developments since the start of the pandemic

1.12 The virus has taken a heavy toll on our lives, economy, and public finances. Just over a year on from the first confirmed case in the UK, around 1 in 5 people have so far contracted the virus, about 1 in 150 have been hospitalised, and around 1 in 550 have died. Five of the past 11 months in England have been spent in three separate lockdowns, with public health restrictions of varying stringency in place for the remainder. Public health restrictions in Scotland, Wales and Northern Ireland have followed similar paths.

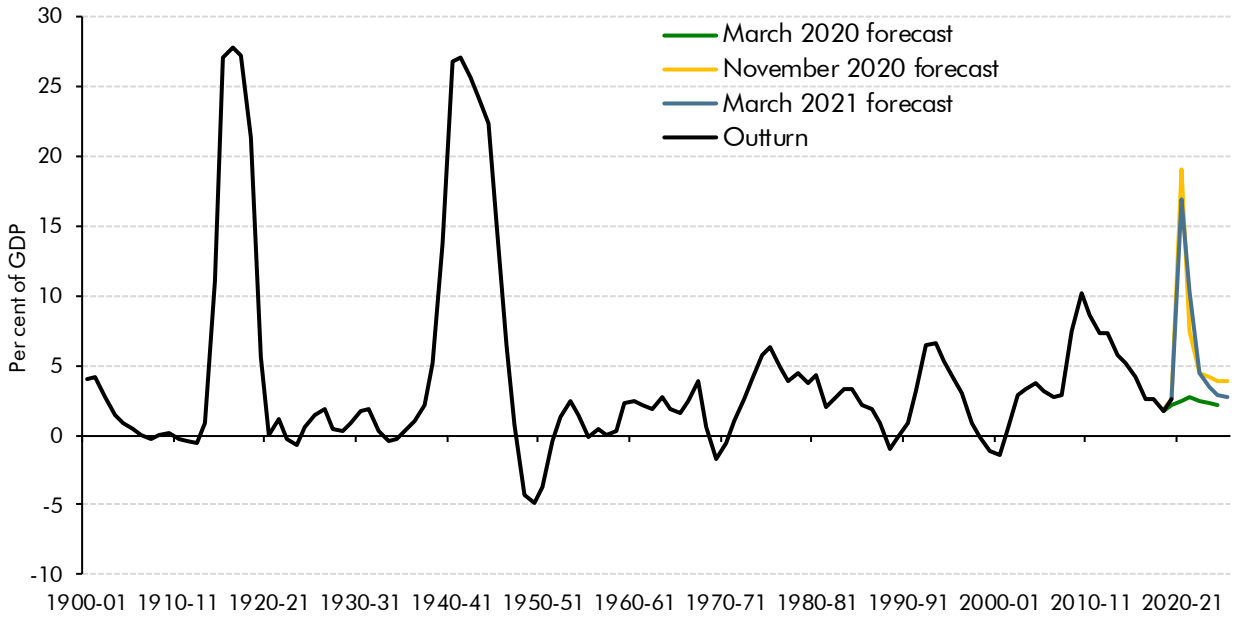
1.13 As a result of the virus and the public health restrictions necessary to control it, the UK economy has suffered its largest economic shock in over 300 years, with output falling 9.9 per cent in 2020. Even after correcting for measurement differences between countries, the

UK has experienced one of the largest economic contractions among the major advanced economies. By the end of the first lockdown in June, 3.6 million new claims had been made for universal credit, a peak of 8.9 million jobs had been furloughed, and 2.6 million self-employed individuals had received an income support grant.

1.14 The costs of the pandemic have been concentrated in particular sectors, with some, such as hospitality, suffering a 90 per cent fall in output during the first lockdown, while others, such as finance, have hardly been affected. The shock to employment and earnings has also varied greatly across households, with some experiencing dramatic falls in income and rising debt while others, whose incomes were unaffected but whose opportunities to spend were curtailed by lockdowns, have saved unprecedented amounts.

1.15 The pandemic has also pushed government borrowing up to a post-war high and debt to its highest level in sixty years (Chart 1.3). In 2020-21, public sector net borrowing is forecast to reach 16.9 per cent of GDP (£355 billion), its highest level since 1944-45 and public sector net debt to rise to 100.2 per cent of GDP, its highest level since 1960-61. Most of the £298 billion increase in borrowing this year is due to an unprecedented peacetime expansion in government spending, with the full-year cost of the Government's virus-related support to public services, households, and businesses reaching £250 billion this financial year and £344 billion in total. This support has prevented an even more dramatic fall in output and diminished the potential longer-term adverse effects on the supply capacity of the economy.

Chart 1.3: Public sector net borrowing since 1900



Source: ONS, OBR

1.16 The pandemic has also created an extraordinary degree of uncertainty regarding the future paths of the economy and the public finances. At the time of our November *EFO*, England was in the midst of a second lockdown aimed at bringing a second wave of infections under control. Encouraging results from the phase three trials of several candidate vaccines were

also beginning to emerge. And the UK and EU were still negotiating the terms of the Brexit deal, with the end of the transition period approaching on 31 December.

1.17 Reflecting this uncertainty, we presented three scenarios for the path of the economy:

- An **upside scenario** in which the second lockdown and an effective test, trace, and isolate system brought the second wave of infections under control and effective vaccines were rolled out rapidly. That allowed an early easing of restrictions, with output rebounding to its pre-pandemic level by the end of 2021.

- A **central forecast** in which the country exited the second lockdown into a stricter set of tiered public health restrictions, with a less effective test, trace, and isolate system, and slower rollout of the vaccines. That allowed only a more gradual recovery, with output regaining its pre-pandemic level by the end of 2022.

- A **downside scenario** in which the second lockdown failed to reduce cases to manageable numbers, test, trace, and isolate was overwhelmed, and stricter restrictions were imposed through the spring of this year. Vaccines proved ineffective in keeping the virus in check giving rise to a third wave of infections over the winter. This required a more substantial, costly, and permanent economic adjustment, with output only regaining its pre-pandemic levels at the end of 2024.

Economic outlook

Developments since November

1.18 Developments since our November forecast have been mixed. The November lockdown failed to reduce cases to manageable levels. After restrictions were relaxed, infections surged once more, fuelled by the emergence of the more transmissible Kent variant of the virus. A rapid rise in hospitalisations and deaths followed, and all three have exceeded their peaks during the first wave last spring. The partial relaxation of public health restrictions over Christmas proved brief as the virus spread rapidly, with another national lockdown imposed in early January that remains in place to today.

1.19 Set against this, the news since November concerning the performance, approval, and acquisition of various vaccines has been overwhelmingly positive. Three vaccines have so far been approved for use in the UK and the Government has procured a total of 457 million doses of eight vaccines, equivalent to more than eight doses for every adult in the UK. Rollout of the vaccines to the population is also proceeding faster than assumed in our November central forecast. By 25 February, 20 million doses had been administered and 36 per cent of all adults had received their first dose. Vaccine take-up to date has also been high with over 90 per cent of over 70s receiving at least their first dose. The Government aims to have offered a first dose to everyone who is 50 and over or at risk by 15 April, and to all adults by 31 July. Early evidence suggests the effectiveness of the vaccines may be at least as good as found in clinical trials.

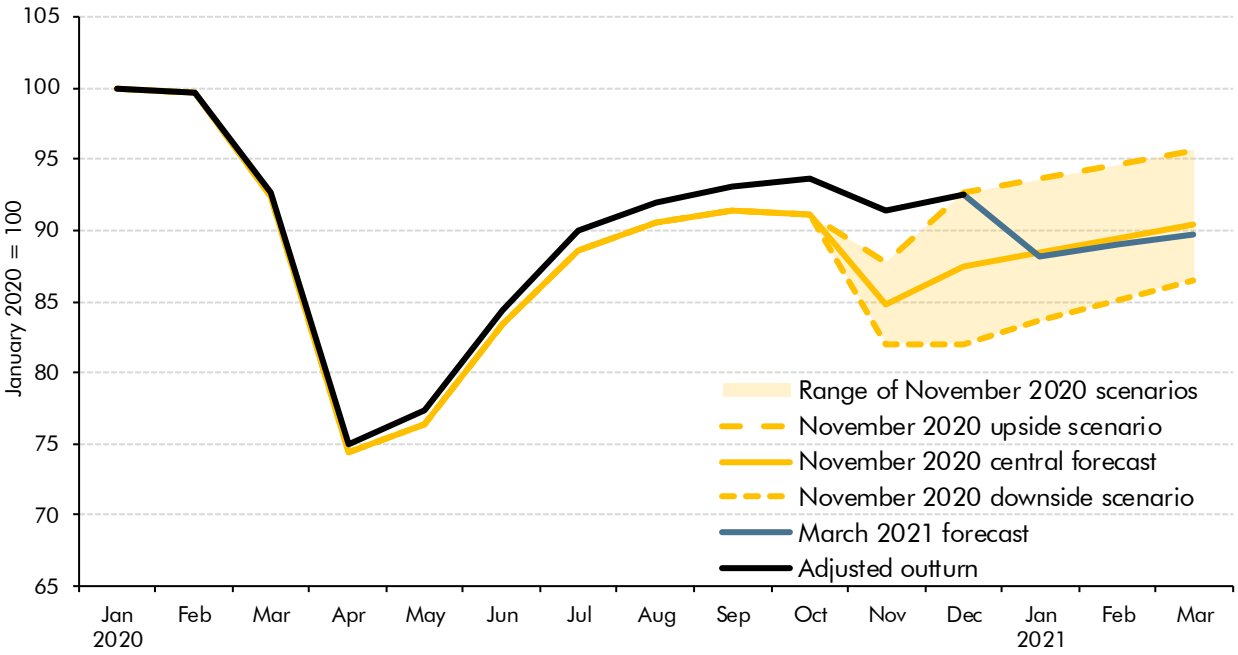
1.20 The economy also appears to have become increasingly adapted to public health restrictions since the start of the pandemic. The share of retail sales taking place online has jumped by 15 percentage points to over 36 per cent since the first lockdown, accelerating a trend that was underway before the pandemic. Between the first and November lockdowns, the proportion of businesses that closed or paused trading fell from 24 per cent to 11 per cent, as firms found ways of operating in a socially distanced manner. As a result, the output in November was only 8 per cent below the pre-virus peak compared to 24 per cent in April. And the economy managed to grow by 1 per cent over the final quarter of 2020. When combined with substantial upward revisions to output in prior months of 2020, in part reflecting the better incorporation of NHS Test and Trace, that left GDP in December around the level predicted in our November upside scenario.

1.21 The conclusion of the UK-EU Trade and Cooperation Agreement (TCA) on 24 December has also partially resolved four and a half years of uncertainty concerning our future trading relationship with our single largest trading partner. We judge the terms of the agreement to be broadly in line with the typical free-trade agreement assumed in our previous forecasts, which entailed a long-run loss of productivity of around 4 per cent compared with remaining in the EU. However, the implementation of the agreement and introduction of health checks at the border has involved more short-term disruption to UK-EU trade than was assumed in our November forecast. The arrangements for trade in financial and other services remain subject to further discussion.

Near-term economic outlook

1.22 The resurgence in infections, imposition of another lockdown, and temporary disruption to UK-EU trade are expected to cause output to fall by 3.8 per cent in the first quarter of 2021 (Chart 1.4). This drags the level of output down to 11 per cent below pre-pandemic levels and slightly below our November central forecast. The number of people on the Coronavirus Job Retention Scheme (CJRS) has also risen from 4.0 million at the end of 2020 to 4.7 million at the end of January.

Chart 1.4: Monthly real GDP



Source: ONS, OBR

Medium-term economic prospects

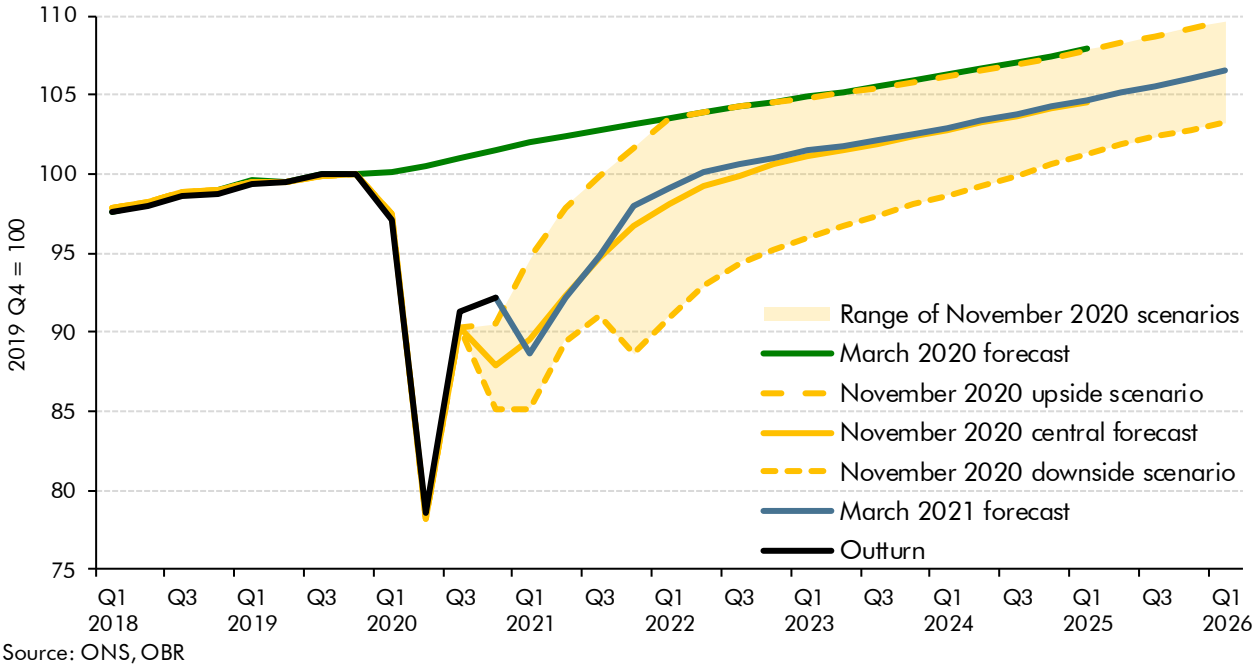
1.23 Our forecast is broadly consistent with the Government's Roadmap, which envisages the progressive removal of public health curbs between early March and late June, though with some residual restrictions on activity which may include travel restrictions, local lockdowns, guidance on home working, continued test, trace and isolate activities, limits on large gatherings, mask wearing, and communications on hand washing and other hygiene practices. The accelerated rollout of vaccines means we assume that the majority of restrictions are removed earlier than we predicted in our November central forecast.

1.24 The rapid rollout of vaccines and easing of public health restrictions fuels a more rapid recovery in output to its pre-pandemic levels by the middle of 2022, six months faster than our November central forecast. This is driven by a rebound in consumption as the economy is reopened and given a further boost by a partial rundown of household savings built up over successive lockdowns. And a recovery in business investment is supported by greater clarity over the implications of Brexit, growing confidence about the medium-term outlook, and the generous temporary uplift in capital allowances announced in this Budget, which brings forward investment from future periods. The overall pace of the recovery in output slows toward the end of this year, once the majority of restrictions have been lifted, with the recovery dampened slightly further over the winter, reflecting the potential for some seasonal resurgence.

1.25 Beyond March 2022, the effect of the virus lingers through its 'scarring' impact on the supply capacity of the economy. What little evidence that has accrued since November regarding the likely extent of scarring has been mixed. The ONS has revised up its estimates of business investment and the Chancellor's measures should speed the recovery in

investment, together suggesting less damage to the capital stock. But, against that, recent analysis of labour market data suggests that the population may be substantially smaller than official statistics suggest as a result of falls in net migration. We therefore continue to assume that the pandemic lowers output in the medium term by 3 per cent relative to its pre-pandemic path (Chart 1.5).

Chart 1.5: Real GDP: central forecast and scenarios



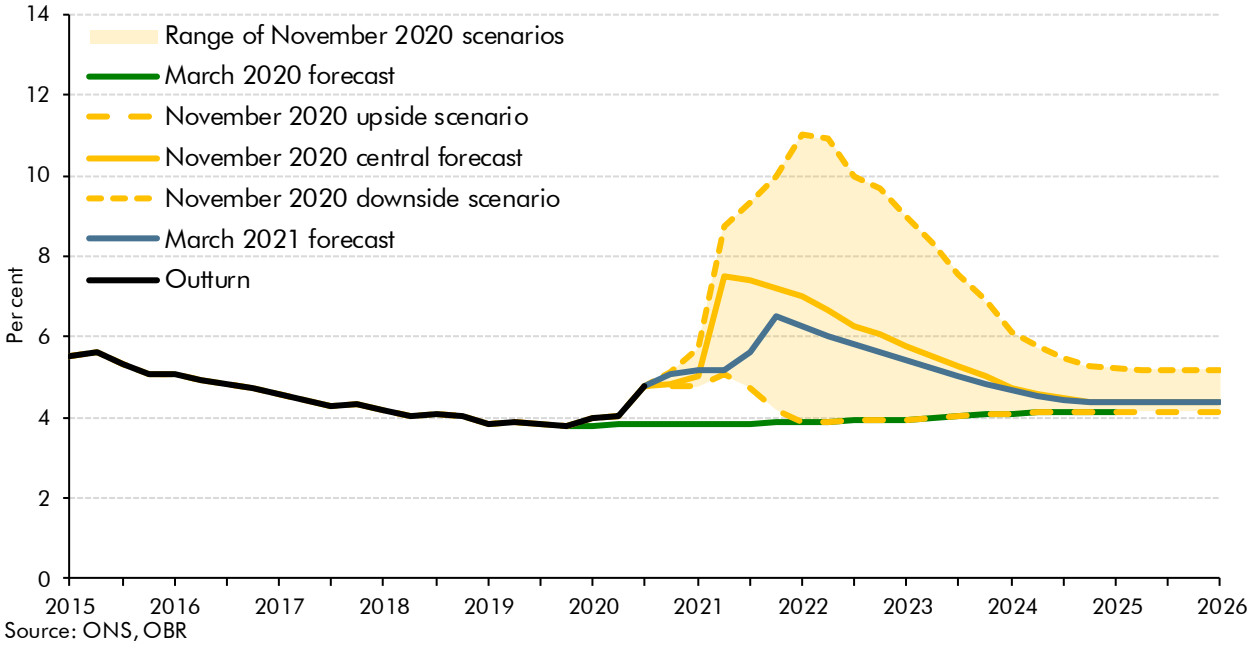
Source: ONS, OBR

1.26 Government support continues to play an important role, both in preserving the supply capacity of the economy and supporting the recovery in demand over this year and next. Continued spending on the NHS and other public services engaged in combatting the virus has a direct impact on demand this year. The extension of the CJRS and grants for the self-employed provide further support to employment, incomes, and consumption. Government grants and guaranteed loans to businesses have helped to keep viable firms alive and solvent, albeit with higher debts than before the pandemic. However, these interventions have to some extent delayed, rather than avoided, some of the higher unemployment and business insolvencies that will inevitably accompany the withdrawal of government support and an end to government-sanctioned forbearance by creditors, landlords, and tax authorities.

1.27 The faster recovery in output, combined with the extended CJRS and additional fiscal support announced in this Budget, help to limit the further rise in unemployment to below the levels anticipated in our November forecast. The unemployment rate rises from 5.1 per cent in the fourth quarter of 2020 to a peak of just 6.5 per cent (2.2 million) at the end of 2021 (Chart 1.6). That represents a rise of 490,000 over the year, but is 340,000 lower and six months later than in our November forecast. The ultimate rise in unemployment reflects the residual constraints on activity in some sectors such as accommodation and transport, as well as firms' adoption of less labour-intensive modes of operation in sectors

like retail and hospitality. It also reflects the scarring effect of the long spells away from employment experienced by some CJRS beneficiaries, 475,000 of whom have been away from work for more than six months over the past year.[1]

Chart 1.6: Unemployment rate



Source: ONS, OBR

1.28 CPI inflation has fallen well below target, reaching 0.5 per cent in the fourth quarter of 2020, largely driven by falls in fuel and utility prices (Table 1.1). Over the remainder of 2021 and 2022, we expect CPI inflation to remain a little below the MPC's 2 per cent target, as the rise in unemployment dampens wage growth, outweighing the effects of higher oil prices. Thereafter, CPI inflation rises gradually back to target by 2025 as the economy recovers. Whole economy (GDP deflator) inflation remains volatile in the short term, driven by sharp movements in the implied price of government output.

1.29 Nominal GDP fell sharply in 2020, by 4.8 per cent. Falls in nominal (as opposed to real) GDP have been unusual in recent decades, with the smaller fall of 2.6 per cent recorded in 2009 being the only previous post-war decline. The recovery in real activity causes nominal GDP to rebound this year and next, before growing at rates broadly in line with those seen in the few years before the pandemic. Relative to our March 2020 forecast, nominal GDP is around 4 per cent lower in the medium term. Roughly three-quarters of that shortfall is attributable to the scarring of supply capacity, with the remainder reflecting a lower GDP deflator.

[1] N. Cominetti, K. Hanehan, H. Slaughter and G Thwaites, *Long Covid in the Labour Market*, Resolution Foundation, February 2021.

Table 1.1: Overview of the economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
Output at constant market prices							
Gross domestic product (GDP)	1.4	-9.9	4.0	7.3	1.7	1.6	1.7
GDP per capita	0.9	-10.4	3.8	6.9	1.4	1.3	1.5
GDP levels (2019=100)	100.0	90.1	93.7	100.5	102.3	103.9	105.7
Output gap	0.1	-0.6	-1.1	-0.4	-0.2	-0.1	-0.1
Expenditure components of real GDP							
Household consumption	1.1	-11.0	2.9	11.1	1.2	1.8	1.3
General government consumption	4.0	-5.7	12.0	1.4	0.8	2.3	2.1
Business investment	1.1	-10.7	-2.2	16.6	3.0	-2.3	5.1
General government investment	4.0	3.8	17.8	4.2	1.9	1.4	1.2
Net trade[1]	-0.1	0.7	-3.6	-0.4	0.3	0.0	-0.1
Inflation							
CPI	1.8	0.9	1.5	1.8	1.9	1.9	2.0
Labour market							
Employment (million)	32.8	32.7	32.3	32.4	32.8	33.1	33.2
Average earnings	3.0	1.1	1.9	2.7	2.2	2.8	3.5
LFS unemployment (rate, per cent)	3.8	4.5	5.6	5.9	5.1	4.5	4.4

[1] Contribution to GDP growth.

Risks to the economic outlook

1.30 Despite encouraging news regarding vaccines, there remains considerable uncertainty surrounding the future path of the pandemic and the economy. Modelling published by the Government's Scientific Advisory Group on Emergencies (SAGE) alongside the Roadmap predict a rise in infections as health restrictions are lifted, but with vaccinations weakening the link to subsequent hospitalisations and deaths. However, this modelling is based on a range of assumptions about the future course of the virus, the effectiveness of vaccines, the duration of immunity and people's behaviour after vaccination, any or all of which may turn out to be overly optimistic or pessimistic.

1.31 So, on the one hand, it is possible that the vaccines bring a quicker end to the pandemic than anticipated, consumers spend more of their savings, and the economy rebounds faster with minimal scarring of potential output. In this case the outcome may be closer to our November upside scenario. But, on the other hand, it is possible that mutations in the virus and reduced vaccine effectiveness result in further waves of hospitalisations, necessitating the periodic reimposition of health restrictions and further blows to the recovery, generating more scarring of potential output. In this case, the outcome may be closer to our November downside scenario.

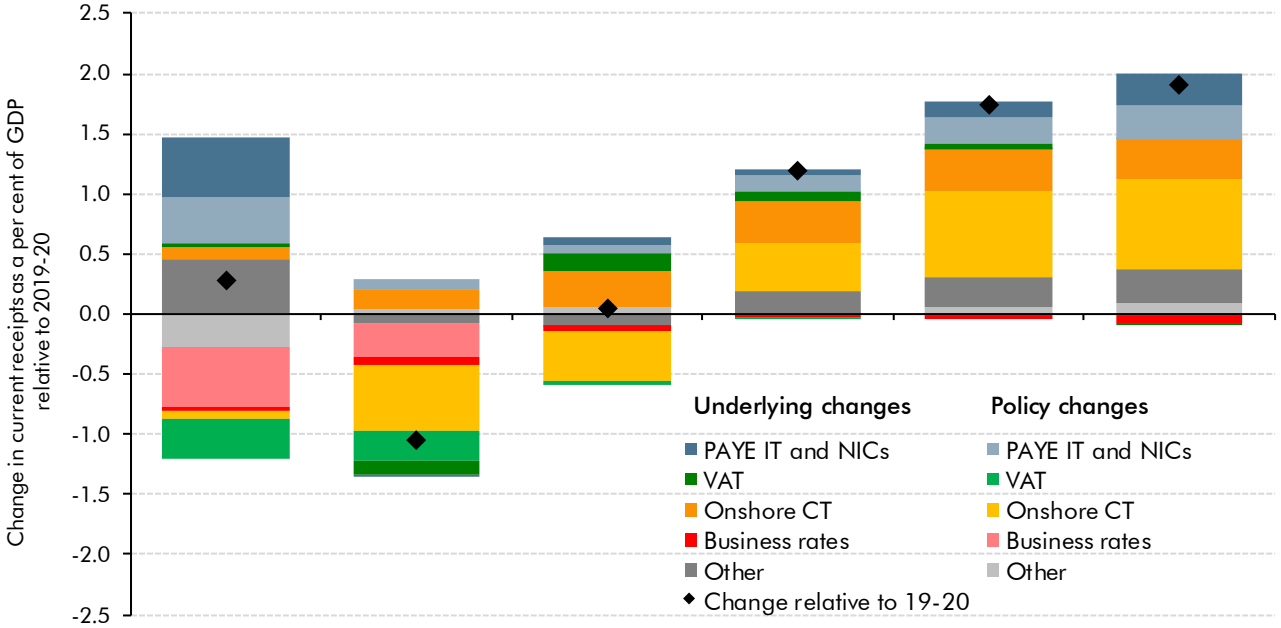
Fiscal outlook

1.32 Borrowing in 2020-21 reaches a peacetime record of £355 billion, or 16.9 per cent of GDP. This is £298 billion higher than the deficit in 2019-20 – a six-fold increase – and

£300 billion or 14.5 per cent of GDP higher than our pre-virus March 2020 forecast. But it is £39 billion lower than our November forecast for 2020-21. Stronger receipts account for £15 billion of this improvement (with £10 billion due to stronger performance of the economy, while another £6 billion is due to lower take-up of virus-related tax deferrals for self-assessment, which brings revenues forward from next year). The remaining £24 billion is due to lower spending, of which £11 billion is largely attributable to less rapid growth in virus-related spending, while the CJRS is now expected to cost £3.8 billion less in the period up to March than we assumed in November.

1.33 Receipts rise by £33.0 billion (4.2 per cent) in 2021-22, but remain below their 2019-20 level in cash terms. As this modest pick-up does not keep pace with the recovery in GDP, receipts as a share of GDP fall sharply, driven primarily by the virus-related tax reliefs. From 2022-23, receipts rise considerably faster than GDP, initially due to the withdrawal of temporary tax cuts, but then dominated by the effect of raising the main rate of corporation tax and freezing the main income tax thresholds in cash terms. In 2025-26, receipts are expected to reach 39.1 per cent of GDP, the highest share since 1984-85. Relative to our November forecast, the newly announced tax rises increase the tax burden by 1 percentage point to 35 per cent of GDP in 2025-26, its highest level since 1969-70 (Chart 1.7).

Chart 1.7: Change in the receipts-to-GDP ratio relative to 2019-20



Source: OBR

1.34 The Budget includes three large tax measures:

- **A two-year temporary capital allowances super deduction.** In 2021-22 and 2022-23, companies will be able to offset 130 per cent of investment spending on eligible plant and machinery against profits. As described above, this provides a very strong incentive to bring investment forward from future periods, supporting economic recovery over the next two years. It is expected to cost over £12 billion a year in the

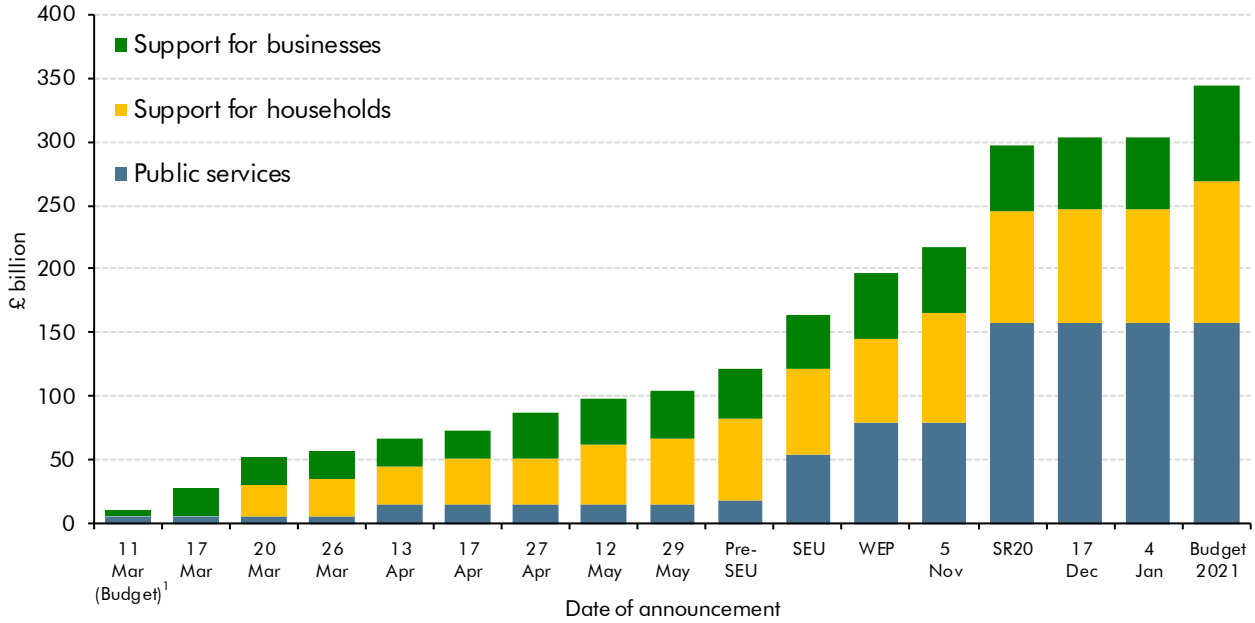
two years that it applies, making it over ten times more generous than the equivalent temporary capital allowance measure that was announced in Budget 2009 with the aim of supporting investment that had been hit hard by the financial crisis.

- **Raising the headline rate of corporation tax from 19 to 25 per cent from April 2023.** After a decade in which successive Conservative Chancellors have cut the rate of corporation tax from 28 to 19 per cent, this one has chosen to raise it back to 25 per cent – the first time the rate has been raised since Dennis Healey did so in his 1974 Budget. It is expected to raise £17 billion a year by 2025-26 and to take corporation tax receipts as a share of GDP to the highest they have been since the height of the Lawson boom in 1989-90. Achieving historically high receipts with a still historically low rate reflects the broadening of the tax base over the past decade, with restrictions placed on several of the deductions that reduce taxable profits relative to total profits.

- **Freezing the income tax personal allowance and higher rate threshold in cash terms for the four years to 2025-26.** In his final Budget in 2018, Philip Hammond raised the personal allowance and the higher-rate threshold for 2019-20 to £12,500 and £50,000 respectively, and held them at that level in 2020-21 before returning to raising them with CPI inflation. After rising with inflation in 2021-22, they will now be frozen for a further four years. This raises £8 billion a year by 2025-26 relative to the thresholds rising with inflation – and brings 1.3 million more people into paying income tax and 1 million more into paying at the higher rate. Indeed, in real terms the personal allowance in 2025-26 will be back to a level it last stood at in 2014-15.

1.35 Total public spending is expected to hit a post-war peak of 54.4 per cent of GDP in 2020-21. This spike partly unwinds next year as virus-related spending drops and as GDP starts to recover, before spending settles around 2.1 per cent of GDP higher than its pre-virus level in 2025-26. Higher departmental spending explains all the rise over the medium term, with resource spending rising by 1.0 per cent of GDP and capital spending by 1.1 per cent. Spending has been revised down £24 billion this year relative to our November forecast due to greater underspending by departments, but has been revised up £42 billion in 2021-22 as virus-related support measures have been extended. Thereafter, a £3 billion annual cut to departmental spending totals in cash terms is slightly more than offset by higher welfare spending and debt interest costs, leaving total spending in 2025-26 a little higher. The total cost of the pandemic support measures, of which public services spending makes up 46 per cent, has now reached £344 billion (Chart 1.8).

Chart 1.8: The evolving cost of the coronavirus policy response

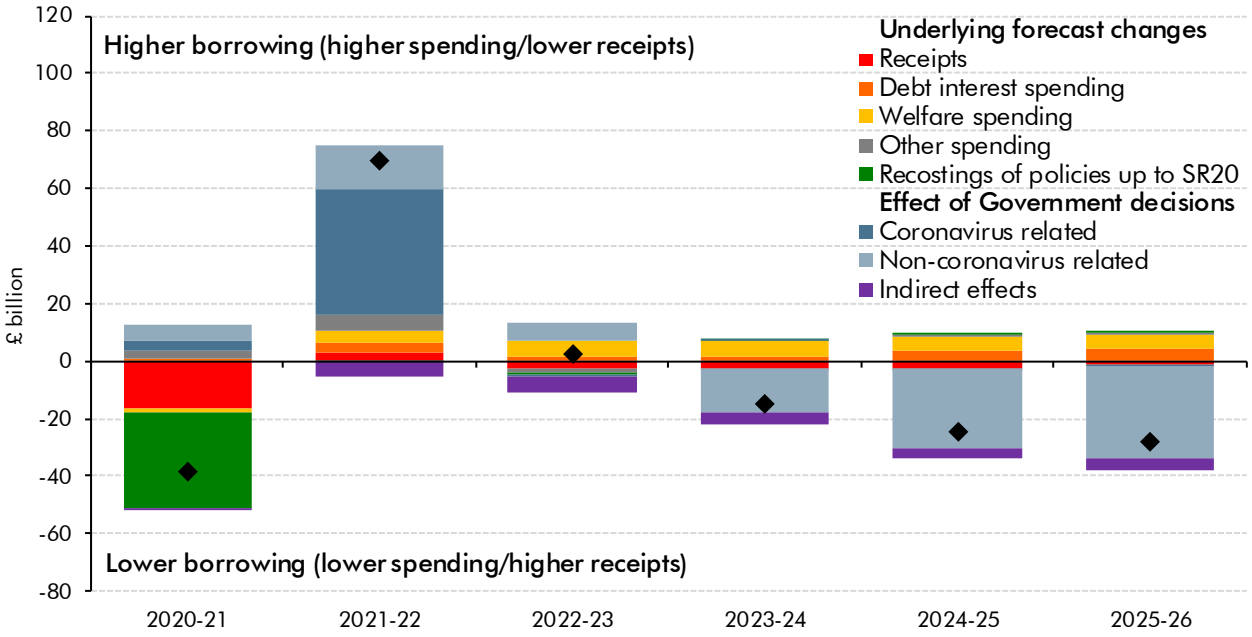


[1] Cost based on figures announced by the Chancellor in SB20. Other costs based on outturn and our March 2021 forecast estimates.
Source: OBR

1.36 One potential risk to our spending forecasts relates the Government's future policy choices as existing virus-related spending schemes end and the pandemic's legacy for public services becomes clearer. The direct health costs of coronavirus could be more persistent than the Government currently expects, for example due to ongoing costs of annual revaccination and NHS Test and Trace as new variants of the virus emerge. The indirect costs of the pandemic could also prove to be greater than allowed for in the Government's existing spending plans, for example due to the cost to the NHS of clearing the backlog of non-virus-related activity, schools providing additional resources for pupils to catch up on lost schooling, and the potential cost of ongoing support for disrupted sectors such as railways and air travel. The extent to which accommodating any of these pressures would represent a fiscal risk would depend on other policy choices, including whether to bear down on other spending to make space, or to raise taxes further rather than allowing borrowing and debt to rise.

1.37 The post-war record peak in borrowing this year is £39 billion lower than we expected in November, thanks to higher than expected receipts and lower than expected departmental spending (with plans being underspent by even more than we had assumed). Borrowing then declines from this lower peak more gradually than previously forecast, due to the extension of virus-related support into 2021-22 and the introduction of time-limited tax incentives on business investment. With both our assumption of 3 per cent economic scarring from the pandemic and the level of public spending largely unchanged since our November forecast, the lower level of borrowing by the end of the forecast is more than accounted for by the tax rises announced in this Budget (Chart 1.9).

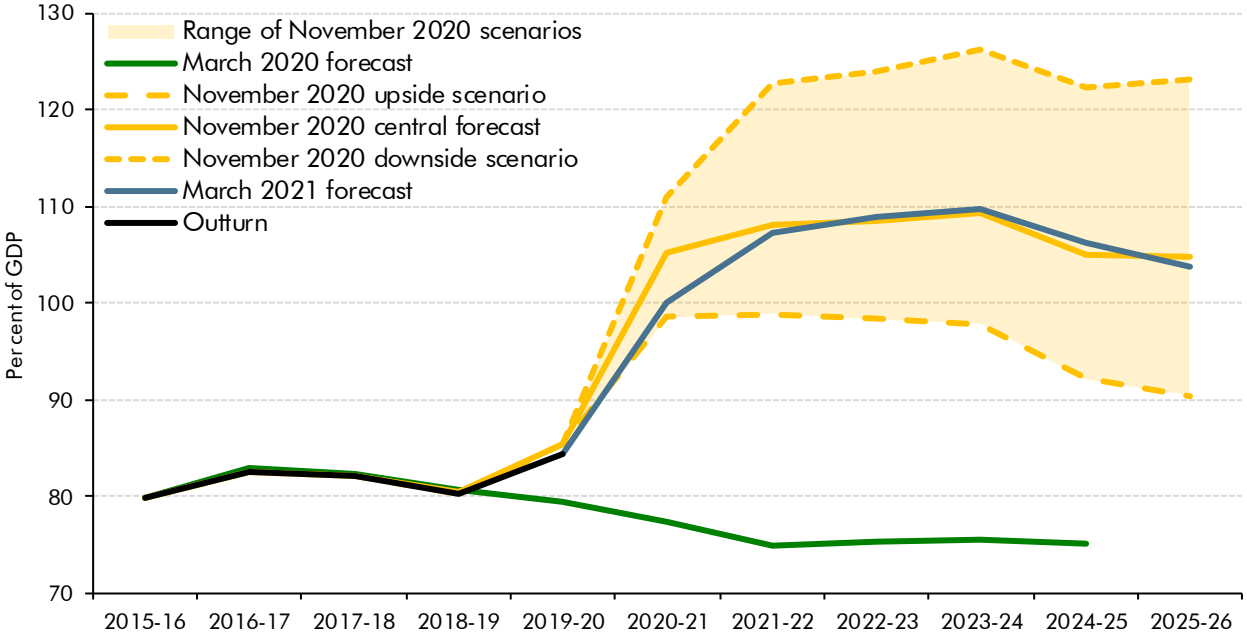
Chart 1.9: Changes in public sector net borrowing since our November forecast



Source: OBR

1.38 The underlying debt-to-GDP ratio, excluding the impact of Bank of England schemes, rises to a peak of 97.1 per cent of GDP in 2023-24, before edging lower by 0.1 and then 0.2 per cent of GDP in the final two years of the forecast. In our November *EFO* this measure of debt was expected to rise throughout the forecast period and by 1.2 per cent of GDP in 2025-26. The change in this Budget is entirely due to the impact of the Government's policy measures – our pre-measures forecast continued to show the underlying debt-to-GDP ratio rising by 1.3 percentage points in 2025-26. Headline public sector net debt rises above 100 per cent of GDP this year and peaks at 109.7 per cent of GDP in 2023-24, its highest level since 1958-59. It then falls as a share of GDP, helped by both the fall in underlying debt and the repayment of loans under the Bank of England's Term Funding Scheme (Chart 1.10).

Chart 1.10: Public sector net debt



Source: ONS, OBR

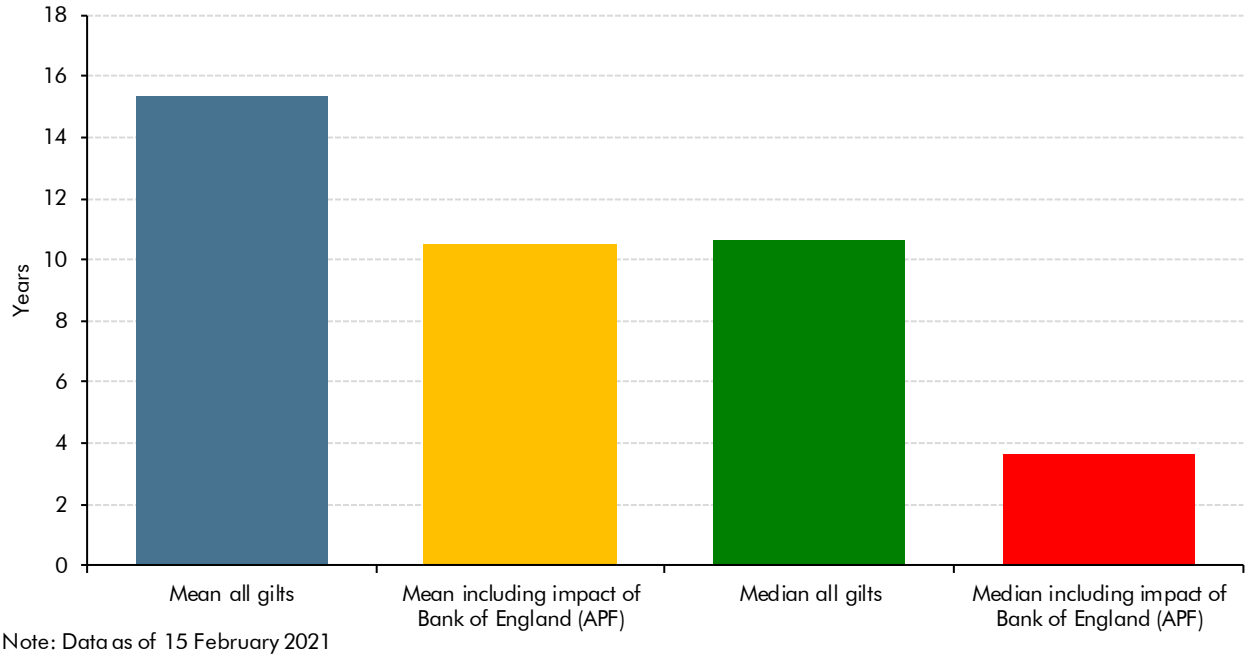
1.39 Despite this significant increase in the government's stock of debt since the start of the pandemic, debt interest spending has been revised down very sharply from its pre-virus level – peaking at a £13.4 billion reduction in 2022-23, then diminishing progressively to £5.6 billion in 2024-25. This is thanks to historically low interest rates, especially at shorter maturities, and the near-doubling of quantitative easing, which further reduces the net interest costs of the public sector as a whole. Relative to our November forecast, we have revised debt interest spending higher, particularly in the later years where interest rate expectations are higher and in 2021-22 where inflation has been revised up.

1.40 Our forecast reflects market expectations for interest rates as they stood on 5 February, after the Bank of England's latest Monetary Policy Report, but before the rises in market interest rates in the past fortnight. All else equal, if our debt interest forecast had been based on market interest rates as they stood on 26 February, spending would be £6.3 billion higher in 2025-26. Only partly offsetting that, interest on the Government's financial assets and income tax on savings income would also be £0.7 billion higher in 2025-26.

1.41 While the government's debt stock has become more affordable in recent years, thanks in part to the 'refinancing' effect of quantitative easing by the Bank of England, this has come at the cost of much greater sensitivity to changes in interest rates. Since 2009 the Bank has acquired through its Asset Purchase Facility (APF) around one-third of the total stock of UK government bonds (gilts) with a median maturity of eight years and average interest rate of 2.1 per cent. It has financed these purchases by creating its own liabilities in the form of central bank reserves which, in essence, carry an overnight rate of interest, Bank Rate, which is currently 0.1 per cent. The net result has been an interest rate saving to the public sector as a whole of £17.8 billion in 2021-22 from the difference between rates on gilts and Bank Rate. But these savings have also come at the expense of a significant reduction in the

median maturity of the outstanding gilt stock from 11 years (before netting off APF holding) to less than four years (after netting off APF holdings) (Chart 1.11).

Chart 1.11: Mean and median maturity of gilts



Note: Data as of 15 February 2021
Source: Bank of England, DMO, OBR

1.42 The combination of the public sector's higher overall debt stock and the sharp reduction in the median maturity of that debt has markedly increased the sensitivity of the public finances to future changes in short-term interest rates. By way of illustration, if short- and long-term interest rates were both 1 percentage point higher than the rates used in our forecast – a level that would still be very low by historical standards – it would increase debt interest spending by £20.8 billion (0.8 per cent of GDP) in 2025-26. To put this into context, it is equivalent to roughly two-thirds of the medium-term fiscal tightening announced by the Chancellor in this Budget.

Table 1.2: Overview of the fiscal forecast

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Revenue and spending							
Public sector current receipts	37.2	37.5	36.2	37.3	38.4	39.0	39.1
Total managed expenditure	39.8	54.4	46.5	41.8	41.9	41.9	41.9
Budget 2020 fiscal targets							
Current budget deficit	0.6	13.3	7.6	1.7	0.6	0.1	0.0
Public sector net investment	1.9	3.6	2.7	2.8	2.9	2.8	2.7
Debt interest to revenue ratio (per cent)	3.5	2.6	2.5	2.3	2.4	2.5	2.5
Legislated fiscal target and objective							
Public sector net borrowing	2.6	16.9	10.3	4.5	3.5	2.9	2.8
Cyclically adjusted net borrowing	2.6	16.5	9.7	4.2	3.3	2.8	2.7
Public sector net debt	84.4	100.2	107.4	109.0	109.7	106.2	103.8
	£ billion						
Revenue and spending							
Public sector current receipts	828.2	786.3	819.3	885.4	944.7	994.2	1037.8
Total managed expenditure	885.2	1140.9	1053.3	992.3	1030.1	1068.7	1111.5
Budget 2020 fiscal targets							
Current budget deficit	14.0	278.8	171.8	40.0	15.2	3.2	0.9
Public sector net investment	43.1	75.9	62.2	67.0	70.1	71.2	72.8
Legislated fiscal target and objective							
Public sector net borrowing	57.1	354.6	233.9	106.9	85.3	74.4	73.7
Cyclically adjusted net borrowing	58.8	345.4	219.3	99.2	81.6	71.9	72.5
Public sector net debt	1798	2198	2503	2631	2747	2761	2804

Performance against the government's fiscal targets

1.43 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of meeting its fiscal targets under current policy. The targets currently on the statute books (two of which expire this month) were proposed by Chancellor Philip Hammond in November 2016 and approved by Parliament in the latest version of the *Charter* in January 2017. These require:

- cyclically adjusted borrowing to be under 2 per cent of GDP in 2020-21;
- debt to be falling as a share of GDP in 2020-21;
- overall borrowing to be zero or in surplus by 2025-26; and
- welfare spending to be below a pre-defined cap in 2024-25.

1.44 These legislated targets are all set to be missed by wide margins based on our latest forecast. Cyclically adjusted borrowing in 2020-21 is over 16 per cent of GDP rather than under 2 per cent, and debt ends the year up 16 per cent of GDP. Overall borrowing falls over the forecast period but only to 2.8 per cent of GDP by 2025-26. The welfare cap is on track to be missed by a margin of £3.1 billion in 2024-25.

1.45 The Government has not yet decided what will replace the fiscal mandate that expires this month and the other fiscal targets in the existing *Charter*. Given the currently exceptional levels of uncertainty, the Treasury is instead proceeding with the review of the fiscal framework proposed at the March 2020 Budget that was postponed due to the pandemic. But the absence of formal fiscal targets does not mean that the Chancellor has not been guided by particular metrics when selecting his medium-term Budget policies. He has calibrated his Budget decisions to deliver a current budget that is very close to balance and underlying public sector net debt that is very close to stable in the medium term.

1.46 Relative to the fiscal targets that featured in the Conservative Party's manifesto and that guided Budget 2020, our latest forecast and the Chancellor's Budget decisions suggest that a focus on the current balance is retained, but the goal of achieving that by the third year of the forecast period is not; and the focus on stabilising debt has shifted from headline debt (including the uneven effects of the Bank of England) to underlying debt (excluding the Bank of England). The Budget 2020 targets also included a ceiling on public sector net investment as a share of GDP of 3 per cent on average over the five-year forecast period; and a threshold for the ratio of debt interest to revenues of 6 per cent, above which action would be taken to put the debt-to-GDP ratio on a downward path.

1.47 On these four metrics:

- Our pre-pandemic forecast predicted a **current budget** surplus of 0.8 per cent of GDP (£21.2 billion) in 2024-25. In the absence of the measures announced in this Budget, the lasting consequences of the pandemic would have left a current budget deficit of 1.4 per cent of GDP (£37.1 billion) in 2025-26 (with the forecast horizon having moved on a year since our March 2020 forecast). But the medium-term tax rises and spending cuts announced in this Budget reduce that current deficit by £36.2 billion in 2025-26, leaving a very small deficit of just £0.9 billion (0.03 per cent of GDP).

- The **underlying debt-to-GDP ratio (excluding the Bank of England)** rises sharply in 2020-21, then continues to rise until it peaks in 2023-24, after which it falls very slightly (by 0.1 and 0.2 percentage points a year) in 2024-25 and 2025-26. This broadly flat position in the medium term is similar to that reached in our March 2020 forecast, albeit with underlying debt more than 20 per cent of GDP higher. But it contrasts with our November forecast of underlying debt rising by 0.8 per cent of GDP in 2025-26 and our latest pre-measures forecast of a 1.3 per cent rise. Again, it is the medium-term tax rises and spending cuts announced in the Budget that explain the difference.

- The **debt interest to revenue ratio** is lower in every year of our latest forecast compared to our March 2020 forecast, despite debt being materially higher due to the pandemic. This is thanks to lower interest rates, especially at shorter maturities, and the doubling in quantitative easing by the Bank of England, which further reduces debt interest. Compared to November, the ratio is higher in all years of the forecast, primarily due to higher interest rates. It remains at less than half the 6 per cent threshold on both a pre- and post-measures basis throughout the forecast period.

- **Public sector net investment** rises significantly from its pre-pandemic level of 1.9 per cent of GDP to an average of 2.8 per cent of GDP over the next five years (after having spiked even higher in 2020-21. This reflects the increases in capital spending announced in last year's Budget. The Chancellor did not change his medium-term capital spending plans in this Budget, so public sector net investment continues to average just less than 3 per cent of GDP over the next five years.

2 Economic outlook

Introduction

2.1 This chapter describes:

- the assumptions regarding the **coronavirus pandemic**, and the **Government's associated vaccination programme and public health restrictions,** that underpin our central forecast (from paragraph 2.2);
- our assumptions concerning the **UK's trading relationship with the European Union** (from paragraph 2.14);
- our assumptions relating to **fiscal and monetary policy** and **asset prices** (from paragraph 2.15);
- the path of **real GDP** since the onset of the pandemic and over the near term as vaccines are rolled out and public health restrictions eased (from paragraph 2.28);
- the outlook for **real GDP over the medium term** and the possible long-run **economic scarring** from the pandemic (from paragraph 2.38);
- the associated paths for the **expenditure components** of GDP (from paragraph 2.49);
- the implications for the **labour market** (from paragraph 2.64) and for **inflation** (from paragraph 2.82);
- the outlook for **nominal GDP** (from paragraph 2.90), the **property market** (from paragraph 2.94) and **sectoral balances** (from paragraph 2.100); and
- how our economic forecast compares with a range of recent **external forecasts** (from paragraph 2.102).

Conditioning assumptions

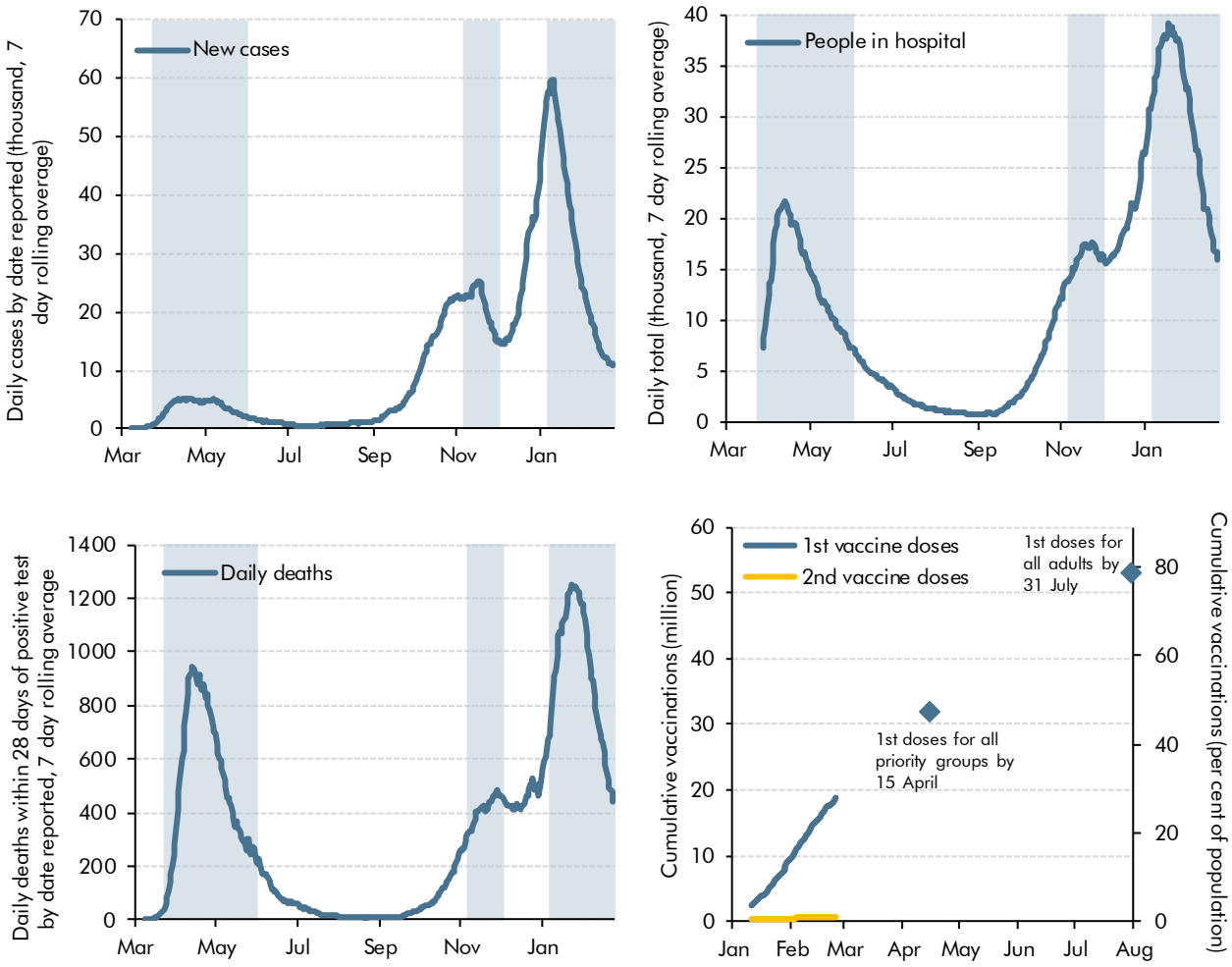
Coronavirus pandemic

2.2 The path of the coronavirus pandemic, and the associated vaccination programme and public health restrictions, remain the most important immediate determinants of the UK's economic and fiscal prospects. At the time of our previous forecast in November, a resurgence in infections was building across North America and Europe, including in the UK. The number of virus-related hospitalisations and deaths in the UK had reached around

80 per cent and 40 per cent of their respective peaks in the first wave of infections. In response, public health restrictions were tightened, including the imposition of a second lockdown in England from 5 November.

2.3 The Government ended this second lockdown in early December, at which point the 7-day average of new cases was down 42 per cent from its peak at 14,800, but the number of people in hospital and the numbers dying had fallen only marginally (Chart 2.1). The end of lockdown led to a renewed spike in infections, fuelled by the spread of the more infectious 'Kent' variant of the virus. New cases quadrupled to almost 60,000 a day by the start of January. This prompted the reintroduction of a nationwide lockdown in early January of similar stringency to that introduced during the first wave last spring and somewhat stricter than the lockdown in England in November. But with case prevalence so high by the time these tighter restrictions were instituted, daily hospitalisations and deaths reached around 180 per cent and 130 per cent of their first-wave peaks respectively.

Chart 2.1: Coronavirus cases, hospitalisations, deaths and vaccines



Note: Shaded areas represent the periods of lockdown in England. Vastly increased testing means that it is not meaningful to compare the recorded level of new cases during the first wave to the recorded levels of new cases during subsequent waves but deaths and people in hospital can be compared.
Source: GOV.UK

2.4 Set against the unwelcome resurgence of cases and reimposition of lockdown, the news regarding the development, acquisition and rollout of vaccines since our November *Economic and fiscal outlook* (*EFO*) has been overwhelmingly positive. The Pfizer-BioNTech (Pfizer), Oxford-AstraZeneca (Oxford) and Moderna vaccines have been approved by UK regulators. The UK has secured 40 million doses of the Pfizer vaccine, 100 million doses of the Oxford vaccine and 17 million doses of the Moderna vaccine, all three of which require two doses for maximum protection.[1] Significant progress has been made rolling out the first two of these, with 20 million doses administered as of 25 February. The Government achieved its target to offer a first dose to those in the four most vulnerable groups, accounting for 28 per cent of the adult population, by 15 February. It is now aiming to offer a first dose to everyone over 50 or at risk (60 per cent of the adult population), by 15 April and to all adults by 31 July.

2.5 The large numbers of people that have been infected since the start of the pandemic should also convey a degree of natural immunity. A January survey by the ONS found that around 1 in 5 people in England tested positive for antibodies, the vast majority of which would have been the result of past infection given the early stage of the vaccine rollout.[2] For those aged 80 and over who have been prioritised for vaccines in the UK, around 2 in 5 tested positive for antibodies, suggesting a strong initial impact of vaccines on antibody levels.

2.6 The third lockdown, growing natural immunity and the early results of the vaccination programme have substantially reduced case numbers: by 23 February, the 7-day average of new cases was down to 10,900, less than 20 per cent of their mid-January peak and 26 per cent below the level when the November lockdown was lifted. Hospital occupancy and daily deaths have also fallen, to 41 per cent and 36 per cent of their respective mid-January peaks. As of 23 February, hospital occupancy was 1 per cent above the level when the November lockdown was lifted while daily deaths were 2 per cent below the level when the November lockdown was lifted.

2.7 Our central forecast is conditioned on the latest information on the course of the pandemic, vaccine rollout, as well as the Government's 'Roadmap' for the lifting of public health restrictions that was published on 22 February (just as we were closing our economy forecast).[3] The Roadmap sets out four steps for easing restrictions in England[4]:

- In **step 1,** schools reopen on 8 March and some outdoor sports and social activities are allowed from 29 March.

- In **step 2**, and no earlier than 12 April, non-essential retail, outdoor hospitality, outdoor attractions, personal care, self-contained accommodation without household mixing and indoor leisure facilities without household mixing are allowed.

[1] Department of Health and Social Care, *UK COVID-19 vaccines delivery plan*, 11 January 2021.
[2] ONS, *Coronavirus (COVID-19) Infection Survey, antibody data for the UK: 16 February 2021*.
[3] HM Government, *COVID-19 Response – Spring 2021*, February 2021.
[4] The Devolved Administrations are setting out separate plans for Scotland, Wales and Northern Ireland. While the vaccine rollout is expected to be similar across the UK, there will likely be some differences in planned steps for easing restrictions. For instance, Scotland reopens schools before the rest of the UK but plans to reopen non-essential retail later than planned in the Roadmap. Such small differences in the easing of restrictions in Devolved Administrations would be unlikely to have a material impact on the economic forecast.

- In **step 3**, and no earlier than 17 May, indoor hospitality, indoor attractions, remaining accommodation, remaining outdoor entertainment, indoor events for up to 1,000 people and outdoor events for up to 10,000 people are allowed.

- In **step 4**, and no earlier than 21 June, all limits on social contact are removed and nightclubs and large events are allowed.

2.8 Before taking each new step, the Government intends to review the latest data against four criteria. These are:

- whether the **vaccine rollout** remains on track;

- the **effectiveness of vaccines** in reducing hospitalisations and deaths;

- whether **infection rates** and the risk that subsequent hospitalisations could overwhelm the NHS; and

- whether there are threatening **new variants of the virus**.

Each new step is thus contingent on the data. Also, because there must be at least five weeks between successive steps, a delay at one step would result in a corresponding delay to subsequent steps.

2.9 The Roadmap draws on advice from the Scientific Advisory Group for Emergencies (SAGE) which in turn has been informed by modelling from the Scientific Pandemic Influenza Group on Modelling (SPI-M) produced by academics at the University of Warwick and Imperial College, London. This modelling was published on 22 February and considers a range of scenarios for easing restrictions in the first half of 2021. None align perfectly with the steps in the Roadmap but the modelling shows that, under a central set of assumptions, restrictions can be eased broadly in line with it while keeping hospital occupancy below previous peaks. Both the Roadmap and the supporting modelling nevertheless stress the uncertainties and the need to respond to the data when deciding the pace of easing. In particular, SPI-M note the sensitivity of the projected paths for hospitalisations and deaths to relatively small changes in the key assumptions.

2.10 Our central forecast assumes that the restrictions are eased gradually from March and have returned to a level of stringency equivalent to that of the old October 2020 'Tier 1' by June 2021. It is thus broadly equivalent to the pace set out in the Roadmap, assuming that there are no significant delays. We are therefore implicitly assuming that loosening public health restrictions is consistent with keeping the virus, and its economic impact, sufficiently in check.

2.11 For the period beyond 21 June, the Roadmap notes that some measures to limit transmission may still be needed even once all adults have been offered a vaccine, given that the vaccines will not be 100 per cent effective and that take-up will be less than complete. The extent to which such measures will be required and for how long is unknown.

In our central forecast, we assume some residual measures remain in place through to the end of next winter (the end of March 2022). This residual set of measures may include travel restrictions, local lockdowns, guidance on home working, continued test, trace and isolate activities, limits on large gatherings, mask wearing, and communications on hand washing and other hygiene practices. Taken together, such measures would have some economic impact where activity cannot fully return to pre-pandemic levels of intensity. Annual vaccinations or booster jabs may also be needed.

2.12 Box 2.1 considers the uncertainties around key epidemiological assumptions and the risks they pose – ranging from an optimistic outcome in which the virus impinges little on daily lives (perhaps thanks to very effective therapeutics and vaccines) to a pessimistic outcome in which the Government needs to reimpose restrictions in the face of future waves (perhaps as a result of threatening new variants). Under the optimistic outcome, output could grow quickly with minimal medium-term scarring, potentially moving the economy towards the upside scenario in our November 2020 EFO where output returned to its pre-pandemic level by the end of 2021. Under the pessimistic outcome, output growth could be weaker with substantial medium-term scarring, potentially moving the economy towards the downside scenario in our November 2020 EFO where output returned to its pre-pandemic level by the end of 2024.

Box 2.1: Uncertainties around key epidemiological assumptions

The Roadmap and our central forecast assume that the vaccine rollout will deliver a substantial reduction in virus-related morbidity and mortality. The epidemiological modelling carried out by the Government's public health advisors and academics at the University of Warwick and Imperial College, London show just how much of an improvement is possible while lifting the bulk of public health restrictions.[a] But it also demonstrates the sensitivity of hospitalisations and deaths to small changes in the transmissibility of the virus, vaccine effectiveness, and individuals' behaviour. This reflects the exponential nature of the spread of the virus, especially the new Kent variant which accounts for the majority of cases in the UK.

Given the unpredictability of the virus and the novelty of the vaccines, there is still considerable uncertainty as to how the pandemic will unfold henceforth. Key sources of uncertainty include:

- **Vaccine rollout.** Modelling by the Government's public health advisors assumes a rollout speed reaching 4 million per week from 25th April, continuing at 3.9 million per week in May before being sustained at this level in a fast rollout scenario.[b] The Government plans to have offered first doses of vaccines to all priority groups (covering 32 million people) by 15 April and all adults (53 million) by 31 July.[c] If the early February rollout speed of around 3 million doses a week were maintained, these targets should be met. But the quicker the vaccine rollout, the sooner transmission, hospitalisations and deaths can be reduced. If the rollout speed increased further to 4 million a week from March onwards, all adults could receive their first dose by June.
- **Vaccine take-up**. The modelling assumes take-up of 95 per cent for over 80s, 85 per cent for 50 to 80-year olds and 75 or 85 per cent for under 50s in their central scenarios.[d]

Surveys conducted at the end of 2020 suggested that some people could be reluctant to be vaccinated.[e] However, take-up among the top priority groups has so far been very high. As of mid-February, over 90 per cent of over-75s in the UK had been vaccinated.[f] This suggests that take-up across the population could be higher than expected. But take-up may still be low for groups who perceive the risks from infection to be low, including the young, or who distrust the public authorities. This could result in clusters of infections, hospitalisations and deaths that require localised restrictions to control.

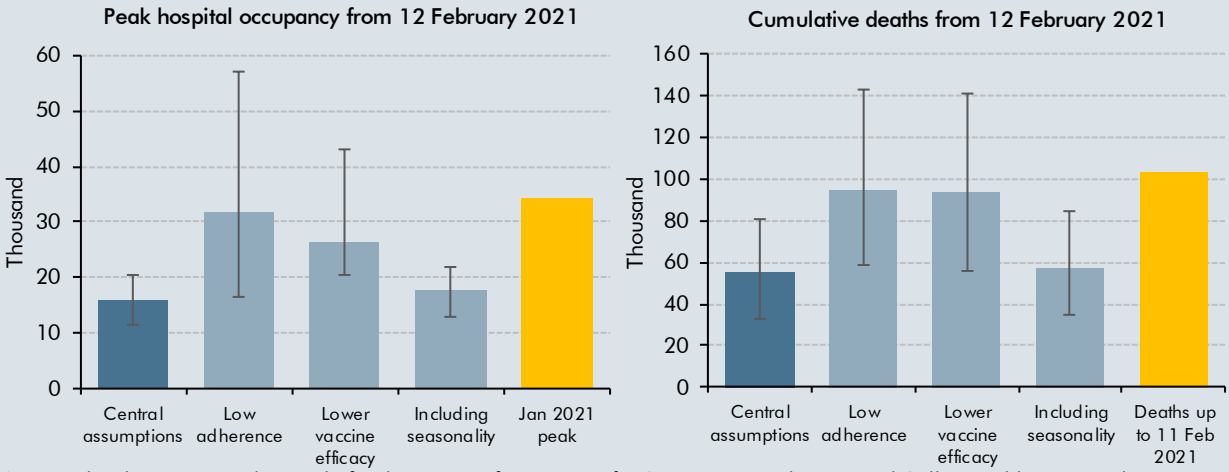
- **The effectiveness of vaccines in reducing hospitalisation and deaths**. Consistent with evidence from clinical trials, the modelling assumes vaccines reduce the risk of hospital admission and death by 70 to 86 per cent after one dose and by 80 to 98 per cent after two doses. Typically, however, the impact of vaccines in the community is less than in trials, so actual effectiveness could be lower. That said, early evidence suggests that effectiveness in the community is at least as good as in trials. For example, early data analysed by Public Health England suggests that hospitalisation and death from the virus will be reduced by over 75 per cent in those who have received one dose of the Pfizer vaccine.[g]
- **The impact of vaccines on virus transmission.** The modelling assumes vaccines reduce the risk of becoming infected (as opposed to suffering serious illness) by 48 to 65 per cent after one dose and by 60 to 94 per cent after two doses. This is a crucial assumption because it determines the extent to which the vaccinated can still spread the virus to the unprotected. Initial studies suggest that a single dose of the Oxford vaccine reduces the acquisition of infection (with or without symptoms) by 64 per cent.[h] A University of Warwick study found that under relatively pessimistic assumptions about vaccine take-up, even an 85 per cent transmission reduction may be insufficient to keep the reproduction rate of the virus, R, below 1 once restrictions are fully lifted.[i]
- **Duration of immunity.** Modelling (which is typically over a relatively short time horizon) generally assumes full immunity persists. But declining immunity is observed after infection by other coronaviruses and a small number of recovered individuals are known to have been reinfected indicating that recovery does not guarantee subsequent immunity.[j] A UK Biobank study of over 20,000 individuals who had tested positive found that while 99 per cent of participants showed antibodies three months after infection, that had declined to 88 per cent after six months.[k] This study did not consider the duration of immunity as a result of vaccinations. Given the first vaccinations were given in real world conditions in the UK in December 2020, data on the duration of immunity from vaccination will take more time to accrue. It is not unreasonable, however, to expect people to suffer periodic reinfections before they are vaccinated and to need regular booster vaccinations.
- **New virus variants.** The modelling assumes no impact of novel variants other than the Kent variant, so the possibility of further new variants represents a key downside risk. Were a new variant to be resistant to existing vaccines, they would need to be reconfigured – which can be expected to take several months – and a new vaccine programme rolled out (much as happens annually with influenza vaccinations). In the

interim, such a new variant would result in additional hospitalisations and deaths unless offset by the reimposition of public health restrictions. Early evidence suggests that existing vaccines remain effective against the Kent variant[l] but that the existing Oxford vaccine may be less effective against the South African variant.[m] The emergence of new variants is more likely the higher the prevalence of the disease. Rapid and effective testing and isolation are both necessary to slow their spread.

- **Seasonality of infections.** The modelling generally abstracts from seasonality, though it is considered in sensitivity analysis. The full extent of seasonality for coronavirus is not yet clear, although more social interaction takes place indoors in the winter and there is evidence that the virus is less transmissible in the summer.[n] That suggests a seasonal pattern is likely, as with other respiratory illnesses, such as influenza.
- **Compliance with public health restrictions.** The modelling usually avoids explicit assumptions about compliance with public health restrictions. Lower compliance would reduce the effectiveness of a given set of restrictions in reducing transmission. It seems likely that compliance will decline once a significant fraction of the population has been vaccinated. Evidence from vaccine rollouts for Lyme disease and influenza in the USA found that adherence to rules indeed fell.[o] And a December 2020 YouGov survey found nearly a third of respondents said they would be less strict in sticking to the rules after being vaccinated while one in ten would 'probably no longer follow the rules' at all.[p]
- **New treatments and/or therapeutics.** The modelling assumes no impact from new treatments or therapeutics, drawing on past data in setting infection-hospitalisation and infection-fatality rates. So successful new treatments could have a material beneficial effect on future levels of hospitalisation and death for a given level of infection. More importantly for our forecasts, if the 'fear factor' associated with the virus was to be largely removed for most of the population, economic activity could return closer to pre-virus norms. Randomised trials in 2020 found that steroid treatments can reduce deaths by up to one third in hospitalised patients and trials of other treatments are under way.[q]

The Government's modelling considered the epidemiological risks posed by several of these assumptions, including: low adherence to restrictions; lower vaccine efficacy; and seasonality. Chart A displays results from epidemiological modelling by Imperial College, London for an easing scenario similar to the Roadmap, under central assumptions and alternative assumptions. Results for potential future deaths and hospital occupancy peaks are compared against past deaths and hospital occupancy peaks. The Chart shows that more pessimistic assumptions about either adherence to restrictions or vaccine efficacy could result in around 95,000 deaths over the period from February 2021 to June 2022, around 40,000 more than under central assumptions. Future hospital occupancy peaks are kept well below the January 2021 peak under central assumptions but more pessimistic assumptions about adherence or vaccine efficacy could result in peaks of similar magnitudes to January 2021.

Chart A: Potential future epidemiological outcomes as restrictions are eased compared to past outcomes



Notes: The charts present the results for the easing of restrictions for Scenario 5a in the Imperial College publication under central assumptions as well as three sensitivities. The easing of restrictions in this scenario does not perfectly align withthe steps of the Roadmap. All modelled estimates shown are for the period 12 February 2021 to 30 June 2022 and ranges represent 95% confidence intervals. Modelled future deaths are compared against deaths up to 11 February 2021 and modelled future hospital occupancy peaks are compared against the peak in January 2021, the highest to date. The low adherence sensitivity assumes a higher transmissibility level after restrictions are lifted than the central assumptions. Alldata are for England only.
Source: Imperial College London, Unlocking Roadmap Scenarios for England, February 2021; GOV.UK

[a] See: SPI-M, *Summary of further modelling of easing restrictions*, 22 February 2021; Imperial College London, *Unlocking roadmap scenarios for England,* 22 February 2021; University of Warwick, *Roadmaps for relaxation of NPIs*, 22 February 2021.
[b] The modelling also considers a slower rollout scenario of 2 million per week from 21 June 2021.
[c] HM Government, *COVID-19 Response – Spring 2021*, February 2021.
[d] Take up would need to be very high to substantially reduce transmission. Given the natural transmissibility of the virus, around 80 per cent of the population would need to be immune – either through vaccine or infection – to achieve herd immunity.
[e] For example: Imperial College London, *Covid-19: Global attitudes towards a COVID-19 vaccine*, November 2020.
[f] Department of Health and Social Care, *UK COVID-19 vaccine uptake plan*, 13 February 2021.
[g] Public Health England, *First real-world UK data shows Pfizer-BioNTech vaccine provides high levels of protection from the first dose*, 22 February 2021. See also Public Health Scotland, *Vaccine linked to reduction in risk of COVID-19 admissions to hospitals*, 22 February 2021.
[h] Voysey, M. et al, *Single Dose administration and the influence of the timing of the booster dose on immunogenicity and efficacy of ChAdOx1 nCoV-19 (AZD1222) Vaccine: a pooled analysis of four randomised trials*, 19 February 2021.
[i] Moore, S. et al, *Vaccination and Non-Pharmaceutical Interventions: When can the UK relax about COVID-19?*, 26 January 2021.
[i] Iwaski, A., *What reinfections mean for COVID-19,* October 2020.
[k] UK Biobank, *UK Biobank SARS-CoV-2 Serology Study*, 15 January 2021.
[l] Emary, K. et al, *Efficacy of ChAdOx1 nCoV-19 (AZD1222) Vaccine Against SARS-CoV-2 VOC 202012/01 (B.1.1.7)*, 4 February 2021.
[m] University of the Witwatersrand, *Oxford Covid-19 vaccine trial results*, 7 February 2021.
[n] Carleton, T. et al, *Global evidence for ultraviolet radiation decreasing COVID-19 growth rates*, 5 January 2021.
[o] SPI-B, *SPI-B: Possible impact of the COVID-19 vaccination programme on adherence to rules and guidance about personal protective behaviours aimed at preventing spread of the virus*, 17 December 2020.
[p] YouGov, *YouGov / Sky Survey Results*, December 2020.
[q] RECOVERY Press release, *Low-cost dexamethasone reduces death by up to one third in hospitalised patients with severe respiratory complications of COVID-19*, 16 June 2020.

2.13 In addition to taking account of the level of official restrictions, we need to make assumptions about the prevalence of voluntary social distancing in response to the pandemic which also affects both levels of consumption and the efficiency of production. Current vaccines will neither eliminate the possibility of infection nor reach the entirety of the population, so some level of continued infections is likely for the foreseeable future.[5] We assume the Roadmap progresses broadly as planned and that vaccines, remaining restrictions and natural immunity are together enough to keep hospitalisations and deaths in check. But because of continuing infections – which may pick up again next winter – we have assumed a level of voluntary social distancing persists initially, although it moderates thereafter. Persistent social distancing behaviours in the future could include increased sickness absences from work relative to rates prevailing before the pandemic, thanks both to continued infections and to people being more likely to stay at home when sick.

EU exit

2.14 On 24 December, four and a half years after the EU referendum, the UK and the European Union concluded the Trade and Cooperation Agreement (TCA) that will govern our future trading relationship. For the first time, this provides us with a formal agreement on which to condition our forecast of UK-EU trade, as well as some initial data concerning the first two months of its operation. Box 2.2 compares the provisions of the TCA against our previous broad-brush assumption that UK-EU trade would take place under the terms of a 'typical' free-trade agreement. It also discusses the evidence regarding its short-term impact.

[5] Modelling from Imperial College, London estimates that cumulative incidence between February 2021 and June 2022 could be around 10 million in England under central assumptions.

Box 2.2: Impact of the Brexit trade agreement on our economy forecast

Our November 2020 *EFO* was conditioned on the broad-brush assumption that the additional trade barriers associated with leaving the EU would reduce the long-run productivity of the UK by around 4 per cent.[a] The full impact was assumed to take 15 years to be realised. Around two-fifths of the 4 per cent impact has effectively already occurred as a result of uncertainty since the referendum weighing on investment and capital deepening. With the terms of the deal now known, we can assess how the TCA compares with our previous assumption of a 'typical' FTA, and take account of the early evidence on its immediate impact.

How does the deal compare to a 'typical' FTA?

Free-trade agreements are complex. No two are the same, and most involve the removal of trade barriers rather than their reimposition. The impact of the new trading relationship assumed in our previous forecasts was based on an average of several external studies of the economic impact of trading with the EU on 'typical' FTA terms.[b] These studies are based on estimates of reducing the cost of trading across borders which increases the intensity of trading activity and raises long-run potential productivity. Using them to estimate the potential impact of the TCA, which instead increases trading costs, adds an extra layer of uncertainty around the estimated magnitude of its economic effects.

Table A summarises our assessment of the TCA against a 'typical' FTA of the sort embodied in these studies and assumed in our recent forecasts, drawing on independent analysis where possible. That analysis concludes that the TCA:

- Retains the position of **no tariffs or quotas on goods** traded between the UK and the EU, subject to meeting appropriate qualifying conditions, such as those on 'rules of origin'. This goes somewhat beyond a typical FTA, where some tariffs – typically on agriculture – are often retained.
- Some flexibilities have been achieved around **rules of origin requirements**, although the Trade Policy Observatory (TPO) note that there are no standard international benchmarks upon which to assess this aspect of the deal.[c] There are commitments to streamline some aspects of **customs administration**, for example, IPPR highlight the commitment on working towards simplified customs procedures, basing controls on risk management and creating a 'trusted traders' programme.[d]
- In other areas, the deal exhibits broadly typical goods trade barriers. **Sanitary and phytosanitary checking** and **technical barriers to trade provisions** are similar to those required of other non-EU countries. Deloitte conclude that these provisions "*very much mirror the basic texts from other FTAs which the EU has agreed*".[e]
- Introduces significant barriers to **trade in services**. The IfG note that while the deal follows the broad ambition set in the EU-Canada FTA to **mutually recognise professional qualifications**, no qualifications have yet been recognised under this framework.[f] The **mobility of service workers** is now subject to significant restrictions, with provisions that can also be found in other EU FTAs. In terms of **market access for services**, the TPO note that while the deal is similar to EU agreements with Canada and Japan, in practice there

will be a variety of rules in supplying services to each member state, meaning that many firms will need to establish a new commercial presence within the EU.[g]

- The deal has *"very little to say about the cross-border provision"* of **financial services** and many of the EU's unilateral equivalence decisions for the UK have been postponed.[h] The UK and EU are aiming to agree a 'memorandum of understanding' on the future framework for financial services regulation over the coming months.

Table A: Assessment of the deal, relative to a typical FTA

Key trade barriers		TCA vs. typical FTA
Tariff barriers (goods)	Zero-tariffs on traded goods	Better
Non-tariff barriers (goods)	Rules of origin requirements	Some extra flexibilities
	Customs administration and delays	Some extra commitments
	Sanitary and phyto-sanitary checking	Broadly similar
	Technical barriers to trade	Broadly similar
Non-tariff barriers (services)	No mutual recognition of professional qualifications	Broadly similar
	Limited mobility for service workers	Broadly similar
	Market access for services	Some extra commitments
	Financial services	Not yet clear

Overall, the TCA goes beyond a typical FTA with regards to tariffs on goods, by not introducing tariffs on the agriculture sector, but that has a relatively small aggregate economic impact. While some extra commitments have been achieved with respect to non-tariff barriers to goods trade, many of these are similar to other FTAs. The introduction of non-tariff barriers in services, which accounted for 42 per cent of the UK's exports to the EU in 2019, is far more significant. It is this channel that accounts for much of the long-term reduction in productivity, in line with the findings of some of the studies that informed our previous assessment.[i] And, as set out above, some trade experts suggest the new trading arrangements for services may necessitate some firms establishing new subsidiaries within the EU to continue trading. At this point, we therefore see no case for altering our 4 per cent loss of productivity assumption.

Impact of disruption on our short-term trade outlook

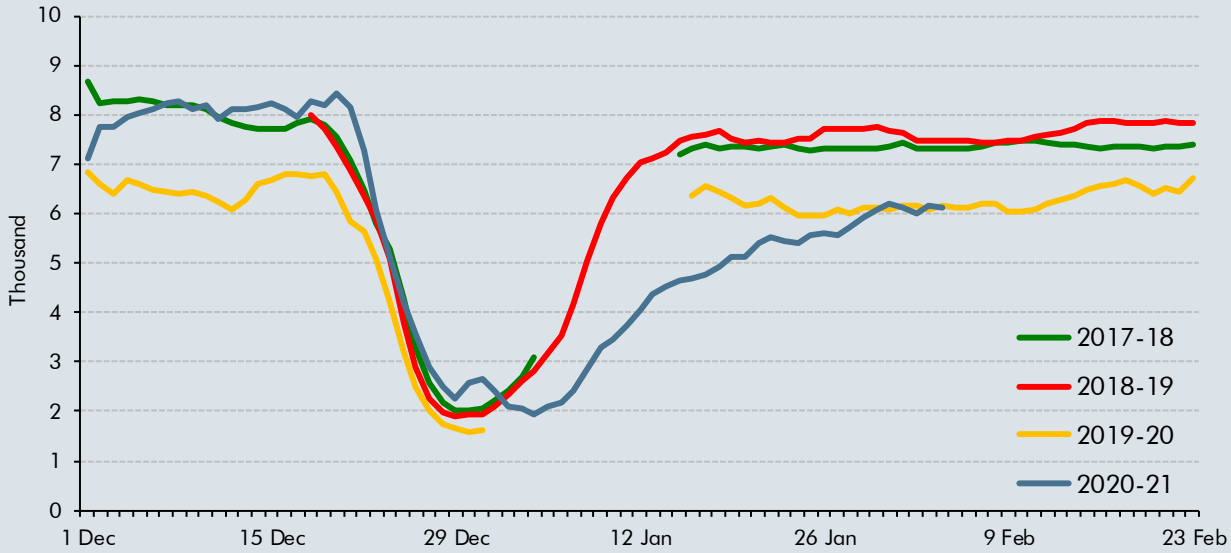
Our previous forecasts assumed a smooth transition to the new trading relationship, with both the UK and EU exercising forbearance in the imposition of border checks and administrative requirements to give traders time to adjust. In practice, while the UK has delayed or reduced stringency in the application of some tax burdens and checks until July 2021, the EU has applied full customs requirements due on exports from Great Britain to the EU since 1 January.

While official data on trade volumes in January will not be available until 12 March, commercial traffic flows through the main channel ports fell significantly in January. Chart B shows that HGV traffic around Dover was 10 to 15 per cent lower over the second half of January than a year earlier, although traffic levels appears to have recovered in February. Data on traffic volumes is only a partial indicator of trade activity and will not reflect factors such as the proportion of empty vehicles and the value of goods in transit. The picture is also clouded by the introduction of additional health checks at the EU-UK border to restrict the spread of the 'Kent' strain of the

virus, and stockpiling by traders on either side of the Channel in the run-up to the end of the transition period.

Taking all these factors into account, we now expect the temporary near-term disruption to EU-UK goods trade to reduce GDP by 0.5 per cent in the first quarter of this year. This reflects both that exports appear to have been hit harder than imports and that the trade disruption will affect UK supply chains. As firms on both sides of the Channel grow accustomed to new trading arrangements, this disruption dissipates, though further disruption is possible when the UK enforces the agreement in full on its side of the border later in the year.

Chart B: Number of heavy goods vehicles on roads around Dover



Note: Seven-day moving averages based on road traffic sensor data. The data cover traffic going both in and out of the port of Dover and are not seasonally adjusted. Gaps in the series are the result of sensor data not being available.
Source: Highways England and Bank of England calculations.

[a] See Box 2.1 of our March 2020 *EFO*.
[b] See Chapter 2 of our discussion paper, *Brexit and the OBR's forecasts* for more information.
[c] UK Trade Policy Observatory, *Taking Stock of the UK-EU Trade and Cooperation Agreement: Trade in Goods*, Briefing Paper 52, January 2021.
[d] IPPR, *The agreement on the future relationship: a first analysis*, December 2020.
[e] Deloitte, *Technical barriers to trade and SPS measures*, Brexit deal analysis.
[f] Institute for Government, *UK–EU future relationship: the deal, Mobility*.
[g] UK Trade Policy Observatory, *Taking Stock of the UK-EU Trade and Cooperation Agreement: Trade in Services and Digital Trade*, Briefing Paper 53, January 2021.
[h] Deloitte, *Financial services*, Brexit deal analysis.
[i] For example, see World Bank, *Deep integration and UK-EU Trade Relations*, January 2017.

Key forecast assumptions

2.15 As well as requiring assumptions about coronavirus and Brexit, several conventional conditioning assumptions are necessary to produce our economic forecasts. As mandated by Parliament, we base our forecasts on the Government's current stated policies on taxes, public spending and financial transactions. We also assume that domestic and international interest rates, the exchange rate and oil prices move in line with market expectations. In this forecast, we have used the 10-day average to 29 January for most of these variables, but

for Bank Rate and gilt yields we have based the forecast on the rates prevailing on 5 February, which incorporated the news about the likelihood of negative Bank Rate contained in the Bank of England's February *Monetary Policy Report*. We felt this departure from our standard practice was appropriate given the importance of this assumption for our fiscal forecast – in particular, negative Bank Rate would imply commercial banks paying the public sector interest on the £895 billion of central bank reserves outstanding as a result of quantitative easing.

Fiscal policy

2.16 Since March 2020, the Government has announced increases in spending that are unprecedented in peacetime (as well as some temporary tax reductions and deferrals). The additional spending has funded the immediate pressures of the pandemic on health and other public services, supported household incomes, and compensated businesses affected by public health restrictions. This comes on top of the substantial increases in spending – on public investment in particular – that were announced in the March 2020 Budget.

2.17 In the short term, this extra spending has cushioned the blow to employment, consumption, and business finances that would otherwise have resulted from the pandemic and associated public health restrictions. And in the medium term, it will have reduced unnecessary job losses and business failures, thus limiting any persistent 'scarring' of the economy's supply capacity and future tax base. The Government has, in effect, operated as an 'insurer of last resort', with private sector incomes falling considerably less than private sector output and expenditure. In so doing, government borrowing this year has reached a peacetime high.

2.18 Box 2.3 summarises how our economy forecast has been affected by the policy measures announced in the Budget and since our November forecast. Chapter 3 and Annex A describe the corresponding fiscal impacts. Further detail about each Budget measure is set out in the Treasury's documents.

Box 2.3: The economic effects of policy measures

To estimate the effect of fiscal policy decisions on GDP growth we use 'multipliers' drawn from the empirical literature. These capture the indirect effects of the fiscal measures on activity over and above their immediate effect on demand, through raising private incomes and spending. They also take account of the upward pressure this puts on wages and prices and the monetary policy response by the Bank of England necessary to keep inflation at target.[a]

In Box 2.1 of our November 2020 *Economic and fiscal outlook* (*EFO*), we considered whether the unusual nature and size of the current economic shock and the Government's response meant different multipliers should be applied. Several factors could be raising multipliers (such as the proximity of interest rates to their lower bound) but other factors could be lowering them (such as restrictions limiting individuals' ability to spend any extra cash). So, as in that report, we have left our multipliers broadly unchanged. But the uncertainty surrounding them is considerable.

In the Budget, the Government announced plans to loosen fiscal policy by almost £60 billion in 2021-22. This includes an extension of the Coronavirus Job Retention Scheme (CJRS), two further Self-Employed Income Support Scheme (SEISS) payments, and extensions to various temporary tax cuts. The Government also announced a large temporary increase in capital allowances. As a temporary measure, it should not affect the long-run cost of capital or level of the capital stock in the long run (see paragraph 2.55), but it should have a temporary effect and, moreover, provides companies with a very strong incentive to bring forward investment from future periods to take advantage of the temporarily much more generous allowances. As a result of the measures announced since November, we estimate that GDP will be around ¾ per cent higher at the peak of their impact in the spring and summer of 2021.

From 2023-24, the Government plans to tighten fiscal policy by increasing the corporation tax rate, freezing the income tax personal allowance and higher-rate threshold, and lowering day-to-day departmental spending limits. The increase in the corporation tax rate will increase the cost of capital, lowering the desired capital stock and business investment in the medium term. On top of this, the boost to business investment from the temporary capital allowance measure goes into reverse, though some of that happens beyond the forecast horizon. But because we assume that the Bank of England adjusts monetary policy to keep inflation on track to meet the target, the fiscal tightening provides only a modest drag on GDP in the medium term.

The combined effect of the higher path of output from the near-term fiscal stimulus and the extension of the CJRS means that, without the latest measures, unemployment would have peaked two quarters earlier and at a higher level. Specifically, we estimate that unemployment would have been about 300,000 higher in the fourth quarter of 2021 in their absence.

Several other measures also have effects on our economy forecast:

- A handful of measures directly affect **inflation**, including the one-year fuel and alcohol duty freezes and the extension of the reduced rate of VAT for hospitality to March 2022. In total, these lower inflation by 0.2 percentage points in 2021-22.
- The stamp duty holiday extension's main effect on our **housing market forecast** is to shift transactions to just before the scheme's new end date, though it does result in some additional transactions and raises house prices a little. The six-month extension is assumed to lower residential transactions by around 30,000 in 2020-21 and increase transactions by about 43,000 in 2021-22. The new mortgage guarantee scheme has not been sufficiently specified to be incorporated in our forecast, but there is some evidence that a similar scheme introduced in 2013 modestly raised transactions.

Temporary support measures, like the CJRS, have also helped people and businesses adapt to operating in a more socially-distanced environment. Without their extension, a tighter path of restrictions and greater voluntary distancing would have lowered activity in April 2021 even further below our November 2020 forecast than the mechanical application of fiscal multipliers would imply. As Box 2.1 sets out, the risks surrounding the epidemiological assumptions on which our forecast is conditioned remain significant. Were the pandemic to unfold less favourably than in our central forecast, necessitating fresh public health restrictions, then the Government may again choose to provide further support to prevent sharp falls in output.

[a] See Box 2.2 in our December 2019 *Forecast evaluation report*, for a summary of our usual approach.

Monetary policy and asset prices

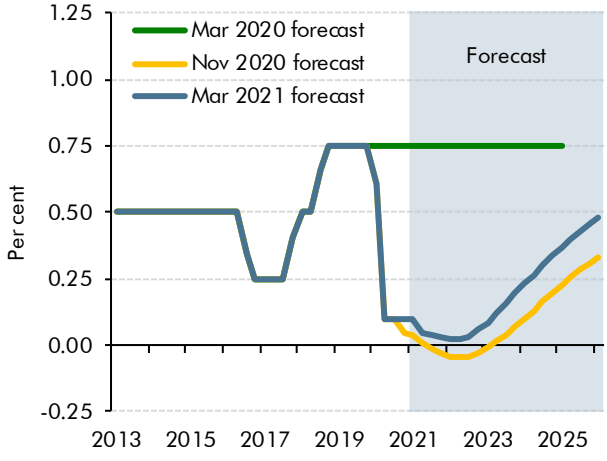
2.19 At the onset of the pandemic in March 2020, the Monetary Policy Committee (MPC) reduced Bank Rate from 0.75 per cent to 0.1 per cent. It also increased the stock of corporate and UK government bond purchases (quantitative easing) by £210 billion to £645 billion. With Bank Rate already very close to zero, subsequent monetary easing has solely taken the form of further quantitative easing, which is now set to reach £895 billion following further expansions announced in June and November 2020. Our forecast for Bank Rate is conditioned on market participants' expectations for its future path, which decline to close to zero in the short term and then rise very gradually over the remainder of the forecast (Chart 2.2). We assume that the stock of asset purchases under quantitative easing will remain at £895 billion throughout the forecast period, with market expectations for Bank Rate falling short of the 1.5 per cent that the MPC has previously signalled as the threshold at which it would consider starting to unwind quantitative easing.

2.20 The sterling effective exchange rate was volatile in 2020 but has appreciated slightly since our November forecast. We assume that it will remain flat in nominal terms, reflecting the similarity of the yield curves at home and abroad (Chart 2.3).

2.21 Oil prices fell at the onset of the pandemic but have subsequently recovered, rising further since our November forecast. Oil futures imply a modest fall in the near term. Thereafter, we assume they remain constant in real terms (Chart 2.4).

2.22 Equity prices fell sharply in the early stages of the pandemic but rebounded strongly around the beginning of this year, in part reflecting the good news regarding the availability and effectiveness of vaccines. Equity prices are assumed to grow in line with nominal GDP, and as a result they exceed their pre-virus peak in 2022 (Chart 2.5).

Chart 2.2: Bank Rate



Source: Bank of England, Datastream, OBR

Chart 2.3: Sterling effective exchange rate

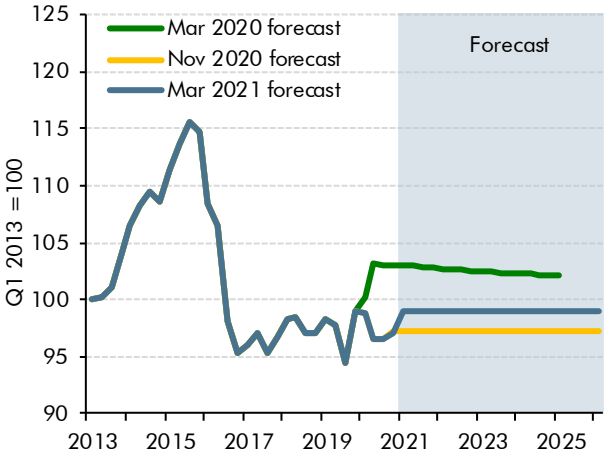


Chart 2.4: Oil prices

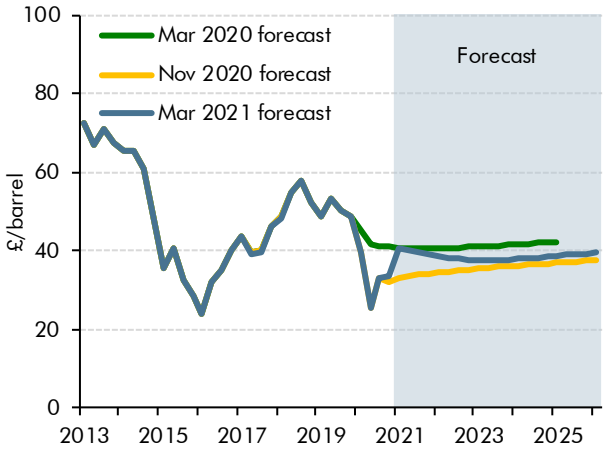
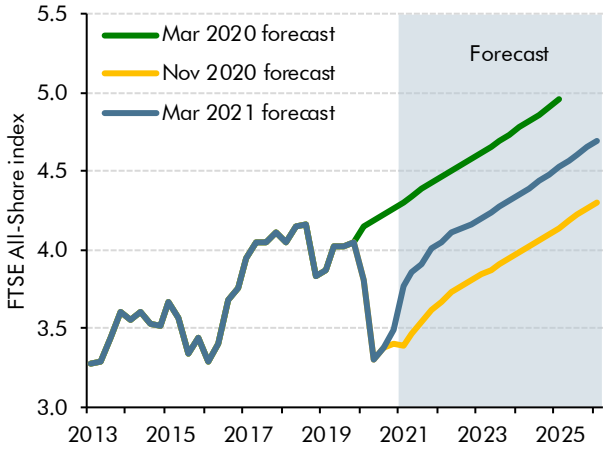


Chart 2.5: Equity prices



Source: Datastream, OBR

World economy

2.23 Our world economy forecast draws heavily on the IMF's *World Economic Outlook* (*WEO*), the latest edition of which was published in January. That incorporated recent good news about the availability and efficacy of vaccines as well as recent bad news about new variants and the powerful wave of infections being experienced in some countries, including the UK. Global growth estimates are stronger than forecast in November, reflecting both vaccine news and the announcement of additional policy support in several large economies. Global output is expected to have fallen by 3.5 per cent in 2020, 0.9 percentage points less than projected in November, reflecting stronger than expected momentum in the second half of the year across several advanced and emerging economies.

2.24 We expect euro area GDP to have fallen by 7.2 per cent in 2020, 1 percentage points less than in our November forecast, despite the emergence of a second wave of infections and subsequent tightening of health restrictions. Euro area GDP then grows by 4.2 per cent in 2021 as vaccine rollout permits an easing of restrictions. US GDP is expected to have fallen by a much smaller 3.5 per cent in 2020, 0.8 percentage points less than estimated in November. Following the approval of a $900 billion policy package in December, our forecast for US GDP growth in 2021 is 2 percentage points higher than our November forecast at 5.1 per cent. However, this does not include the new Biden administration's proposed $1.9 trillion fiscal package (equivalent to around 9 per cent of US GDP and 2 per cent of world GDP). If this were to be implemented, it would significantly raise our near-term projections for both US and global growth.

2.25 World trade has also fared better than we expected in November. Trade volumes are expected to have fallen by 9.6 per cent in 2020, 0.9 percentage points less than in our November forecast. However, services trade is expected to recover at a slower rate than goods trade, as stricter border controls and travel restrictions weigh on tourism. Global trade is expected to rebound by 8.1 per cent in 2021. The outlook for UK export markets is also slightly better than in our November forecast, having contracted by 9.1 per cent in 2020, 1.5 percentage points less than previously forecast, before rebounding in 2021.

2.26 Over the medium term, GDP growth at the world level, and in the US and euro area, is expected to return to rates that prevailed before the pandemic struck. But these paths imply a degree of scarring to the *level* of real GDP relative to their pre-virus trajectories, with cumulative growth between 2019 and 2024 revised down 4.4 percentage points for the world, 0.5 percentage points for the US and 2.6 percentage points for the euro area. These compare with the 3 per cent scarring of the UK economy assumed in our central forecast. World trade and export markets also recover to a somewhat lower level than their pre-virus trends.

Table 2.1: Global GDP and trade growth

	Percentage change on a year earlier						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
GDP							
Euro area	1.3	-7.2	4.2	3.6	2.2	1.7	1.4
US	2.2	-3.5	5.1	2.5	2.3	1.9	1.8
World	2.8	-3.5	5.5	4.2	3.8	3.6	3.5
Trade							
UK export markets	1.8	-9.1	7.9	6.0	4.2	3.7	3.5
World	1.0	-9.6	8.1	6.3	4.3	3.8	3.6

2.27 While the pandemic affected all countries in 2020, the 9.9 per cent fall experienced in the UK was larger than in most other advanced economies. In part that reflects differences in how certain activities are measured in the UK, but even correcting for measurement differences, the UK does seem to have been hit harder than many other advanced economies (Box 2.4).

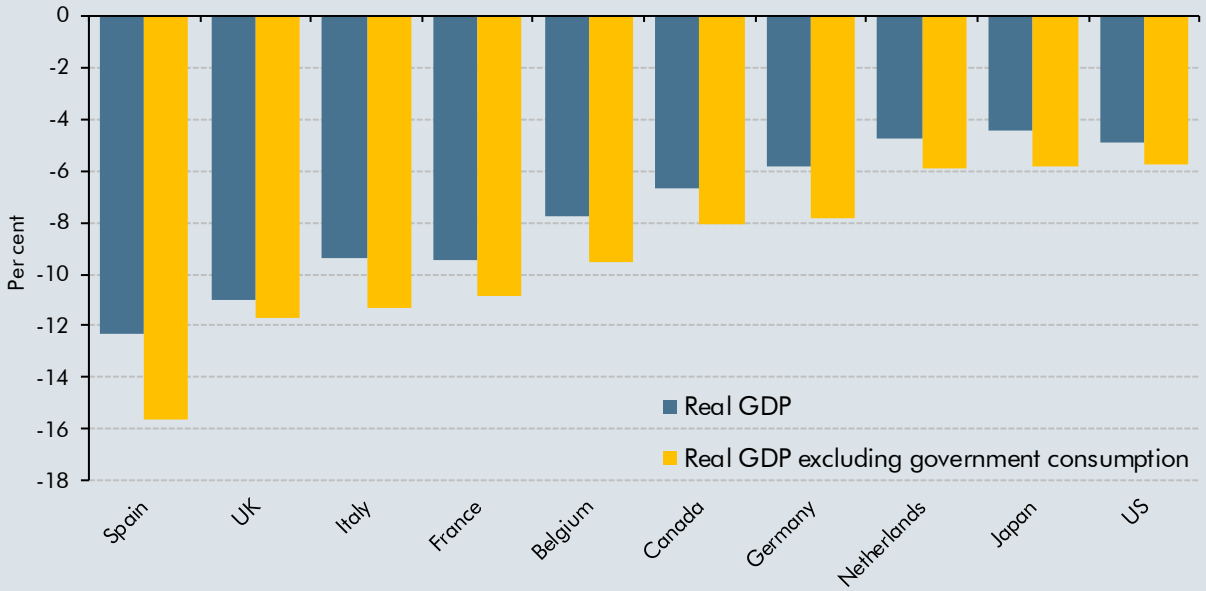
Box 2.4: International comparisons of the economic impact of the pandemic

Most advanced economies in Europe and North America experienced large falls in both nominal and real GDP in 2020. While the UK's fall in nominal GDP was not out of line with these other countries, the recorded fall in UK real GDP of nearly 10 per cent was greater than in most others. This Box considers a range of factors that may explain why the pandemic has apparently taken such a heavy economic toll on the UK.

A potentially important factor is differences in the way that national statistical institutes (NSIs) measure real GDP, and specifically the way government output in health and education – for which market prices are typically unavailable – is captured. There are broadly two approaches NSIs can take: (i) rely on direct measures of output, such as hospital operations performed and numbers of pupils taught; or (ii) use deflated costs or inputs, such as employment, as a proxy for output. The former is regarded as best practice, and the ONS has been a pioneer in the use of such methods. But most other NSIs still produce estimates of the volume of public healthcare and education services that are largely based on the latter approach.

During the lockdowns, many of the output indicators that the ONS rely on to measure public output fell sharply. In health, the prioritisation of coronavirus patients was accompanied by falls in elective care, GP consultations and outpatient services (offset slightly subsequently when NHS Test and Trace activity was better recorded). So, despite extra health spending, recorded real health output fell, leading to a sharp rise in the corresponding implicit price deflator. This is not replicated in countries that primarily use inputs as a proxy. Similarly, school closures led to a reduction in the measured volume of education output in the UK but not in most other countries.[a] Because of these differences in measurement methods, it is more meaningful at the current juncture to compare the behaviour of output excluding real government consumption. Looked at this way, the disparity in the UK's economic performance is significantly reduced, although a gap still remains (Chart C).

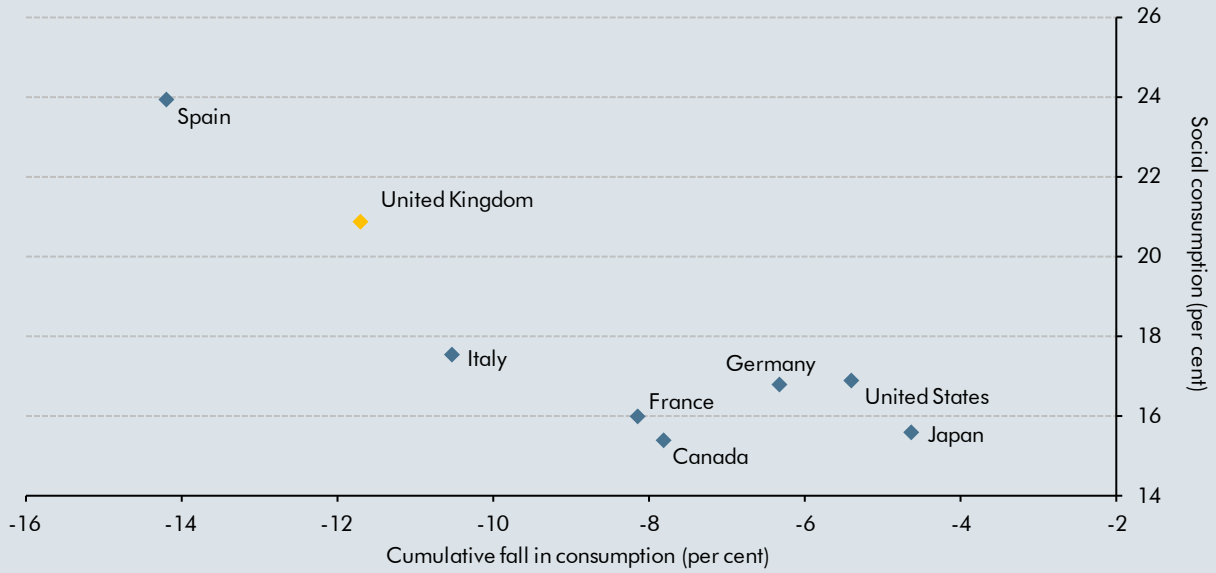
Chart C: Shortfall in real GDP with and without government consumption



Note: Chart shows the average shortfall in output over the first three quarters of 2020 relative to the fourth quarter of 2019.
Source: OECD, ONS, OBR

Differences in the sectoral composition of economic activity across countries explains some of the remaining differences. High-contact social consumption activities including recreation, restaurants and hotels have been hit particularly hard by the public health restrictions introduced in many places. The UK economy is somewhat more highly weighted towards this type of spending. Consistent with this, economies like the UK, Italy, and Spain that have large social consumption sectors have also experienced greater falls in consumption (Chart D).

Chart D: Share of social consumption and falls in household consumption



Note: Cumulative consumption lost between the fourth quarter of 2019 and the third quarter of 2020 and the proportion of total household spending in 2018 allocated to spending on recreation and culture, and restaurants and hotels.
Source: OECD, ONS, OBR

But after accounting for these differences, the primary reason that the UK has suffered a greater economic hit from the pandemic is simply that the UK has experienced higher rates of infection, hospitalisations, and deaths from the virus than other countries. The UK has spent longer in stricter lockdowns than other advanced economies (see Box 2.2 of our November *EFO*), with that period continuing to increase after the imposition of the latest lockdowns in November and January. In addition to requiring tighter public health restrictions, a greater prevalence of the virus also raises voluntary social distancing which, according to IMF estimates, account for around half of the total decline in economic activity associated with the pandemic.[b]

[a]ONS, *International comparisons of GDP during the coronavirus (COVID-19) pandemic*, 2021.

[b] IMF, World economic outlook: Chapter 2 – Dissecting the Economic Effects, 2020.

Real GDP forecast and scenarios

Scenarios

2.28 Given the continued uncertainty about the course of the pandemic and its economic impact in both the short and medium term, it makes little sense to focus attention on just a single

central forecast. As summarised in Table 2.2, our November 2020 *EFO* presented three scenarios intended to illustrate the range of possible outcomes of the pandemic:

- An **upside scenario** in which the virus was speedily brought under control by the November lockdown. It was then kept under control by the rapid deployment of effective vaccines (reaching the majority of adults in the spring) and the effective operation of test, trace and isolate, with only relatively low levels of public health restrictions. The economy therefore rebounded strongly to its pre-pandemic level by the end of 2021, and there was no medium-term economic scarring relative to our March 2020 forecast.

- A **central forecast**, in which the virus was only partly brought under control by the November lockdown, effective vaccines were rolled out more slowly (reaching the majority of adults by the middle of the year) and test, trace and isolate was only partly effective in controlling the virus. As such, relatively stringent health restrictions remained in place until mid-year. The economy therefore recovered more slowly, reaching its pre-pandemic level by the end of 2022 and suffering a moderate degree of medium-term economic scarring which lowered real GDP by 3 per cent relative to our March forecast.

- A **downside scenario** in which the virus was not brought under control by the November lockdown, vaccines were of limited effectiveness (in part because of mutations in the virus), and test, trace and isolate was largely ineffective. As a result, stringent restrictions remained in place over the first quarter of 2021 and there was also a further wave of infections the following winter. Output recovered even more slowly, only regaining its pre-pandemic level by 2024, and there was a high degree of medium-term economic scarring, which lowered real GDP by 6 per cent relative to our March forecast.

Table 2.2: Scenario assumptions in our November 2020 *EFO*

	November virus scenarios		
	Upside	Central	Downside
Public health assumptions			
Lockdown ends	2 December	2 December	2 December
Test, trace and isolate	Effective	Partly effective	Ineffective
Public health restrictions: lockdown to vaccine[1]	Medium-low	High-medium	Very high[2]
Vaccines widely available	From Spring 2021	From mid-2021	Ineffective
Economic effects (per cent, unless otherwise stated)			
Real GDP growth in 2020	-10.6	-11.3	-12.0
Return to pre-virus peak (2019Q4)	2021Q4	2022Q4	2024Q4
Peak unemployment rate	5.1	7.5	11.0
Long-term GDP scarring	0.0	3.0	6.0

[1] Low, medium and high are broadly equivalent to October 2020 tiers 1, 2, and 3 in England. Very high is between October 2020 tier 3 and November 2020 lockdown in England.

[2] Restrictions to ease to low by end of 2021.

2.29 We judged that the upside scenario was about the best that could be hoped for, but that even worse outcomes than the downside scenario were conceivable. We noted that a variety of intermediate outcomes were also possible. The course of the pandemic since then has included elements of all three scenarios. In the near term, the emergence of new variants and a resurgence in infections has required the reimposition of lockdown, in line with our downside scenario. However, the early and rapid rollout of effective vaccines has meant that the central forecast (or even upside scenario) may be a better characterisation of the upcoming quarters.

2.30 In this *EFO*, we have updated our central forecast to take account of developments since November, but we have left our upside and downside scenarios as they were in November in order to put recent developments into context. We continue to believe that there is sufficient uncertainty over both the future course of the pandemic and its longer-term consequences for our upside and downside scenarios to remain plausible illustrations of the range of possible outcomes in the medium term. As before, we make no claim to be able to assign probabilities to particular outcomes and, for that reason, our central forecast should not be interpreted as representing a median, mean or modal forecast. Rather it represents a plausible intermediate scenario lying somewhere within the range of possibilities.

Developments since our November forecast

2.31 The first wave of the pandemic led to a 24.2 per cent fall in real GDP from January 2020 to its trough in April. Output rebounded sharply in the summer as restrictions were eased but the pace of the recovery had begun to slow by early autumn when a second wave of infections began to take hold. In our November forecast, we expected GDP to fall in October and November as health restrictions were tightened again, so that by December it would be 12.5 per cent below its January 2020 level.

2.32 In the event, economic activity held up better than expected during the November lockdown, and over the fourth quarter of 2020 as a whole, leaving December GDP down by a much smaller 6.5 per cent relative to January 2020, around the level in our November upside scenario. The positive surprise relative to our central forecast reflects several factors. Around half is due to upward revisions to the data up to October, with particularly large revisions to health sector output related to methodological changes and the incorporation of data on the activity of NHS Test & Trace. Private sector output was also more resilient than we had assumed to the November lockdown and the relatively tight restrictions that followed (notably in the wholesale and retail sector, as well as in manufacturing and construction). This suggests that people and businesses have increasingly adapted to living with the pandemic and accompanying restrictions (as discussed in Box 2.5). Health output also exceeded our November forecast by increasing margins in November and December, partly reflecting the continuing increase in the volume of coronavirus tests being carried out.

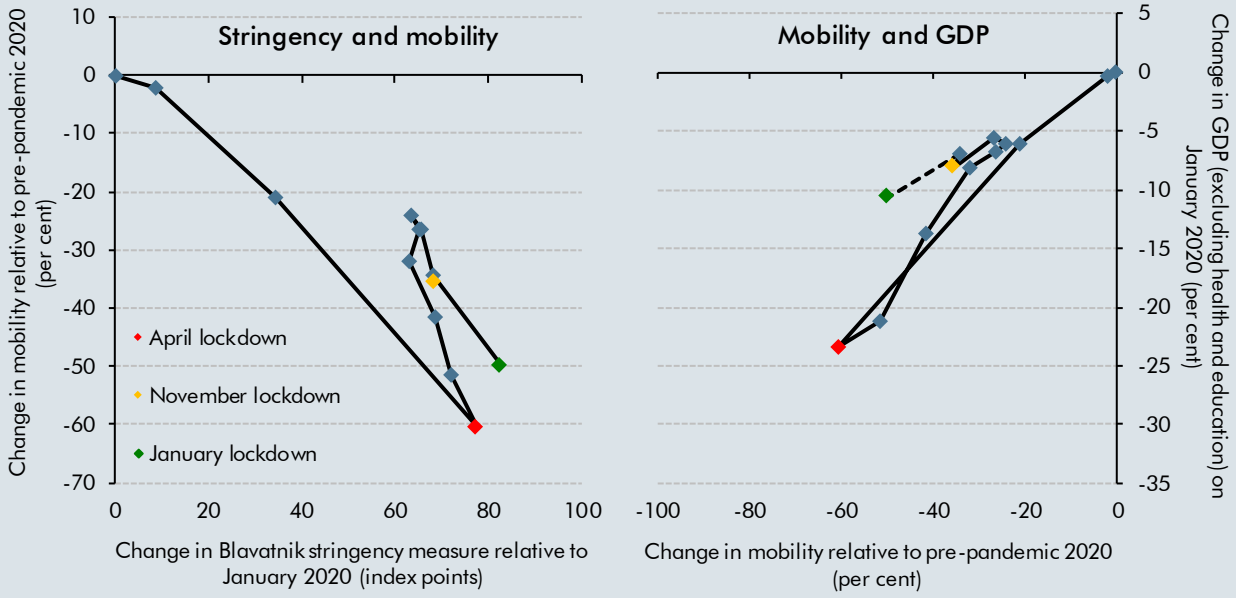
Box 2.5: How the economy has adapted to the virus

The performance of the UK economy over the past year has revealed a dynamic relationship between public health restrictions, mobility and economic activity – with the economy becoming increasingly adapted to operating under lockdowns and other public health restrictions.

This can be seen in the changing relationship between the severity of public health restrictions, measured by the Blavatnik stringency index, and high-frequency indicators of activity, such as Google's economic activity mobility indices. The left-hand panel of Chart E shows that, despite the current lockdown being roughly as strict as that of a year ago, average economic mobility[a] was only 50 per cent below pre-pandemic levels compared to 61 per cent in April 2020. The November lockdown in England saw an even smaller shortfall in mobility of 36 per cent, in part because it did not apply to the entire UK and schools remained open. This suggests that a given level of restrictions has been associated with progressively higher levels of mobility as the pandemic has progressed.

The relationship between mobility and GDP has also become more attenuated over the course of the pandemic. The right-hand panel of Chart E shows that the sharp fall in mobility in April was associated with sharply lower GDP, which fell to 23 per cent below pre-pandemic levels (excluding health and education). But since then, it has improved by more than the recovery in mobility alone would imply, being only 8 per cent below pre-pandemic levels during the second lockdown in November. Together, these scatter plots suggest that people and businesses have gradually adapted to working, travelling, socialising, consuming and producing while restrictions are in force. Our forecast for the economic impact of the stricter lockdown in January assumes continued adaptation, with GDP falling to just 11 per cent below pre-pandemic levels despite a similar level of stringency in public health restrictions as in April.

Chart E: The evolving effect of the virus on economic activity

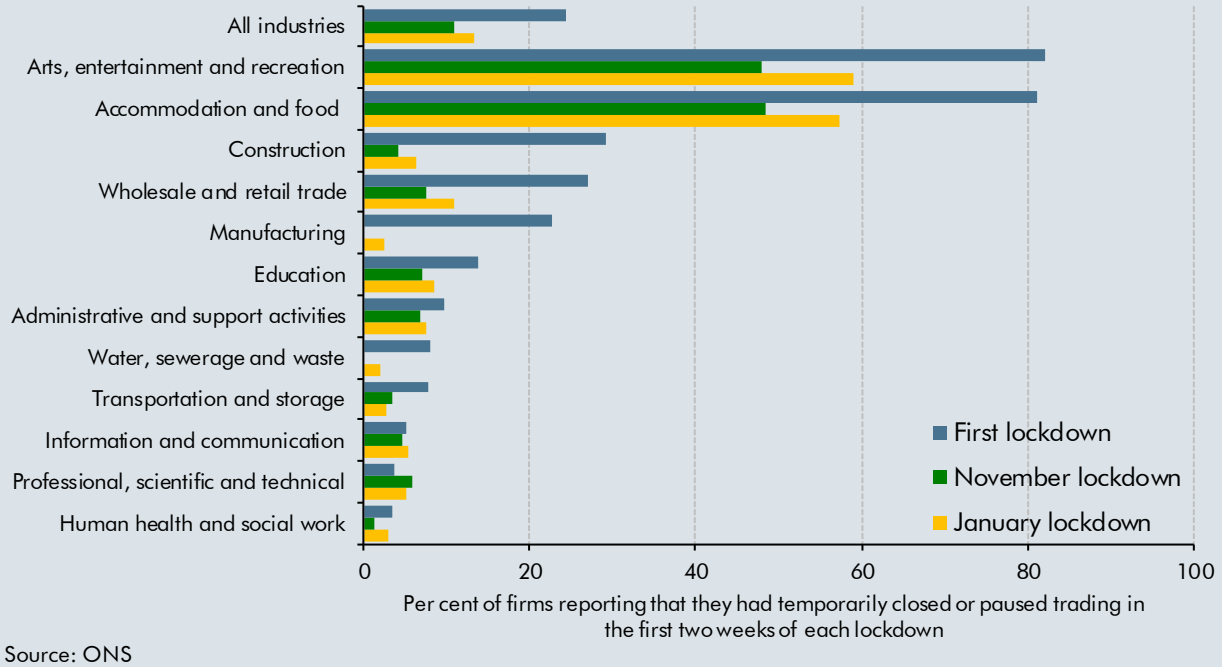


Notes: January GDP figure is forecast. 'Mobility' averages all Google mobility indicators, except for parks and residential.
Source: Blavatnik School of Government, Google, ONS, OBR

Of course, such scatter plots do not capture in full the complex interrelations between restrictions, mobility, and economic activity. GDP is seasonally adjusted while mobility levels vary with the changing weather, especially in the areas of face-to-face retail and social consumption. Changes to the mix of restrictions can allow greater mobility and economic activity for a given rate of infection, such as requiring most people to wear face masks on public transport and in public indoor spaces. Individual perceptions of their risk of infection can also influence this relationship, either through the growth of 'lockdown fatigue' or heightened concern about the new and more transmissible strains of the virus that emerged at the end of 2020.

Evidence of adaptation on the part of businesses to public health restrictions comes from survey data. According to the ONS's BICS survey, 24 per cent of responding firms closed temporarily or paused trading in the first lockdown in April, whereas only 11 per cent did so in the first two weeks of November and 13 per cent did so in the first two weeks of January. To take an example, the 24 percentage point increase in the share of businesses operating in the accommodation and food sector compared to the first lockdown reflects adaptations, like more venues installing plastic screens and supplying takeaway food. One popular takeaway food delivery app reported that sales were 387 per cent higher in the fourth quarter of 2020 than a year earlier.[b]

Chart F: Firms closing or pausing trading at the start of each lockdown

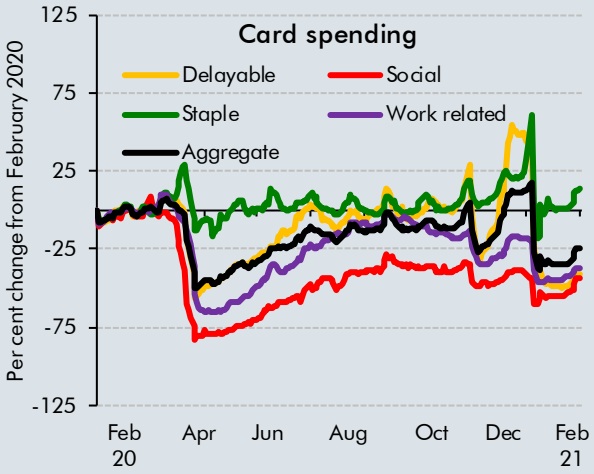


Source: ONS

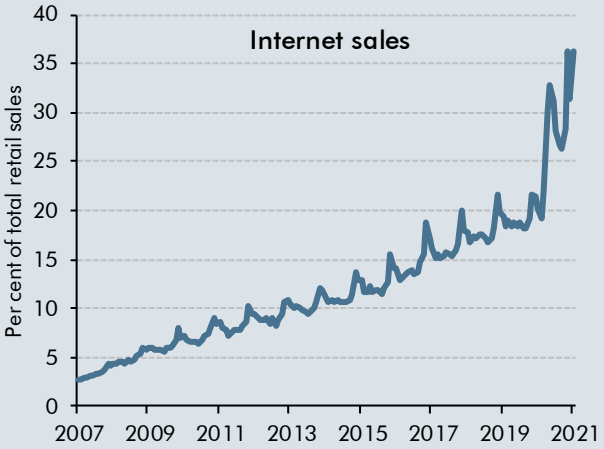
Consumers have also adapted their spending levels and patterns to lockdowns and other public health restrictions over the course of the past year. According to Bank of England card data, aggregate consumption held up better in the second and third lockdowns than in the first, with shortfalls of 14 and 34 per cent respectively, compared to 44 per cent in April. Within that, there is some evidence of consumers shifting away from 'social consumption' (such as spending on restaurants, hotels and air travel) and towards goods. There is also evidence that consumers have significantly changed *how* they make purchases over the course of the pandemic. In

particular, the share of retail sales taking place online had been rising gradually prior to the pandemic from below 5 per cent on average in 2008 to 21 per cent by the end of 2019. But the pandemic has sharply accelerated this trend, with the proportion of retail sales taking place online rising by 15 percentage points to over 36 per cent at its peak in January 2021.

Chart G: Consumer adaptation to a socially-distanced economy



Source: ONS



Source: ONS

Relative to our previous forecast, the upward revision to November and December GDP partly reflected a greater degree of adaptation to the lockdown than we had expected. Government support is likely to have helped and, in light of its continuation, we expect there to be further adaptation to public health restrictions in 2021.

[a] Calculated as the average change in visits to the following places: retail and recreation, supermarket and pharmacy, public transport, and workplaces (i.e., all Google's mobility indicators except for parks and residential).
[b] Just Eat, *Just Eat Takeaway.com Q4 2020 Trading Update*, 13 January 2021.

2.33 The ONS's monthly figures are only produced for the output measure of GDP. In the fourth quarter of 2020, the output figure was 1.3 per cent higher than headline quarterly GDP. To be consistent with the detailed income and expenditure components that enter the fiscal forecast, we have had to estimate headline GDP on a monthly basis. In what follows, we have therefore scaled down the monthly output figures so that our forecast is consistent with the headline GDP data for the latest full quarter.

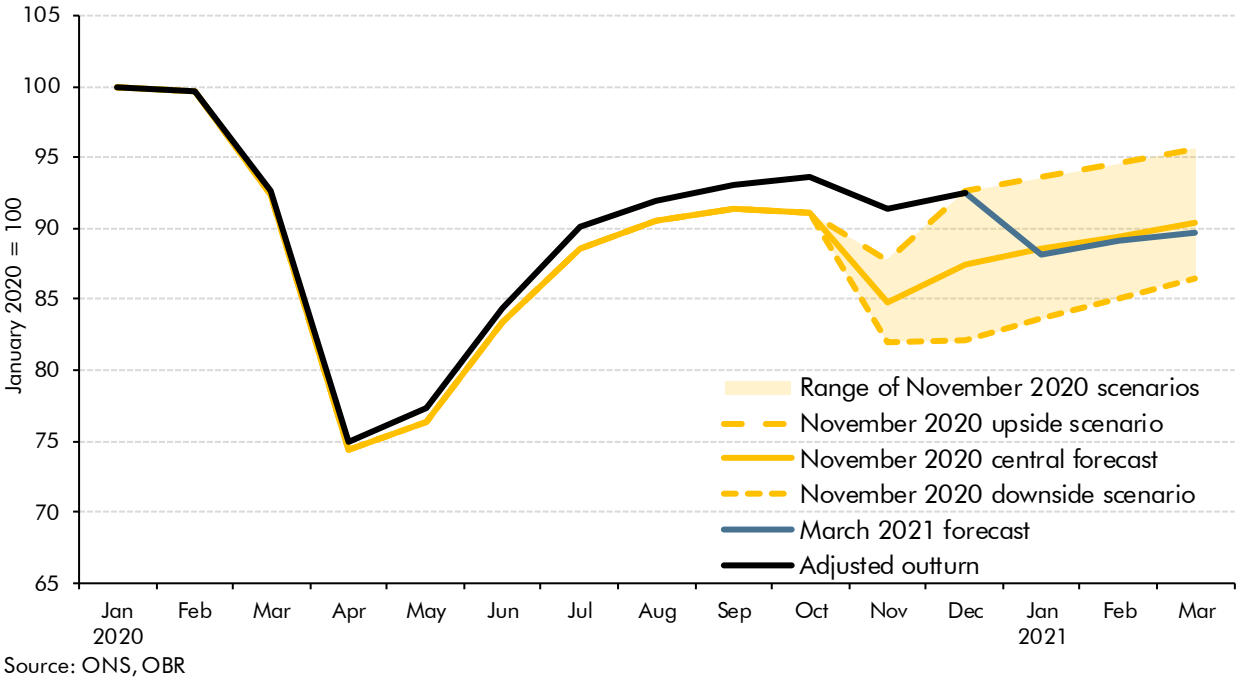
The short-term outlook for GDP

2.34 The imposition of a new national lockdown in early 2020 (and to a much lesser extent the disruption caused by the transition to new trading arrangements with the EU) is expected to lead to a further fall in activity in January. The ONS *Business Impact of COVID-19 Survey* points to a 5 per cent monthly fall in average turnover. But as this survey covers only private-sector businesses, we also need to incorporate the effect of the restrictions on education (with schools shut) and health (with elective procedures once again on hold). We assume that output in the education sector will have fallen back to the levels seen last July and that output in the health sector would have fallen back to June levels were it not for the effect of additional testing and other methodological changes. In addition to virus-related

restrictions on activity, it is clear that moving to new trading arrangements with the EU has caused considerable disruption for some exporters and associated transportation services. We have assumed that this contributes 0.5 percentage points to the reduction in output in the first quarter as a whole, with the effect being greatest in January.

2.35 Altogether, we assume that GDP in January 2021 was 12 per cent below its January 2020 level, compared to the 25 per cent shortfall at the peak of the first wave in April 2020, and the 9 per cent shortfall during the November lockdown. Output gradually picks up over the remainder of the first quarter of 2021 as short-term Brexit disruption recedes, pressures on the health system abate, schools reopen, and businesses and households continue to adapt to the constraints of lockdown. It ends the quarter 10 per cent below its January 2020 level, 1 per cent lower than we forecast in November (Chart 2.6).

Chart 2.6: Monthly real GDP and November scenarios up to March 2021



Source: ONS, OBR

2.36 From this modestly weaker starting level of output in the first quarter of 2021, the easing of public health restrictions set out in the Roadmap and the additional fiscal support announced in the Budget help to bring output back to around 2 per cent below its pre-virus peak by the end of 2021 – somewhere between our November central and upside scenarios. Output recovers its pre-virus peak in the second quarter of 2022, two quarters earlier than in our November forecast, in part thanks to the business investment that we expect to be brought forward as a result of the generous temporary capital allowances announced in the Budget (as described below in paragraph 2.55).

Table 2.3: The short-term quarterly GDP profile

	Percentage change on previous quarter											
	2020				2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
March 2020 forecast	0.2	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.3
November 2020 forecast[1]	-2.5	-19.8	15.5	-2.7	1.9	3.1	2.7	2.1	1.5	1.1	0.7	0.7
March 2021 forecast[2]	**-2.9**	**-19.0**	**16.1**	**1.0**	**-3.8**	**3.9**	**3.0**	**3.3**	**1.1**	**1.1**	**0.5**	**0.4**
Change since March 2020[3]	-3.1	-19.4	15.7	0.5	-4.3	3.5	2.6	2.9	0.7	0.7	0.1	0.1
Change since November 2020[3]	-0.4	0.8	0.6	3.7	-5.7	0.8	0.3	1.3	-0.4	0.0	-0.3	-0.3

[1] Forecast from the third quarter of 2020.

[2] Forecast from the first quarter of 2021.

[3] Changes may not sum due to rounding.

2.37 We cross-check our short-term output growth assumptions by considering the implications of the course of the pandemic, level of public health restrictions and other factors for individual sectors. Table 2.4 presents an illustrative sectoral path of output consistent with our central forecast up to June 2021 when only a residual level of public health restrictions remains. In absolute terms, the level of output during the January lockdown lies between the level seen during the lockdowns in April and November last year in most sectors. The greatest contributions to the fall relative to November result from falls in the education and retail sectors. By June, activity in most sectors has recovered significantly, but we assume that some voluntary distancing and residual official restrictions depress activity in some sectors, including accommodation and food, and transport.

Table 2.4: Short-term sectoral growth

Sector	Per cent				
	Change in GDP relative to January 2020				Weight in whole economy
	April 2020	November 2020	January 2021	June 2021	
Accommodation and food services	-90	-64	-71	-20	2.9
Other services	-47	-35	-45	-22	3.7
Construction	-43	-1	-6	-4	6.4
Transportation	-37	-15	-23	-18	4.0
Wholesale and retail	-36	-4	-10	-2	10.4
Administrative and support	-35	-19	-19	-19	5.3
Education	-35	-7	-19	-6	5.7
Manufacturing	-30	-3	-4	-5	10.1
Human health	-26	-2	-8	2	7.5
Agriculture	-17	-11	-11	-11	0.6
Professional, scientific and technical	-17	-5	-5	-5	7.7
Information and communication	-10	-6	-8	-6	6.6
Energy, water and mining	-9	-7	-7	-4	3.8
Finance and insurance	-5	-3	-3	-2	6.8
Real estate	-2	-2	-2	-2	13.5
Public admin and defence	1	2	2	2	4.9
Total	-24	-8	-11	-6	100

Potential output and medium-term economic scarring

2.38 In the medium term, the level of output is anchored by our projection for the supply capacity of the economy, also known as potential output. This reflects the quantity of capital and labour available to businesses and the efficiency with which they are deployed. We normally assume that by the forecast horizon a combination of monetary and fiscal policies and natural economic adjustment mechanisms have driven demand back into line with potential output. Were that not to be the case, the excess (shortfall) of demand over supply would tend to lead to rising (falling) inflation.

2.39 Our baseline projection for potential output is provided by our pre-virus forecast of March 2020. In that forecast, we assumed that potential output would on average grow by 1.4 per cent a year between 2019 and 2024, though gradually accelerating towards the end, reflecting a pickup in productivity growth from the unusually low rates seen since the financial crisis.

2.40 In our November *EFO*, the upside, central and downside scenarios assumed scarring (defined as the shortfall in potential output relative to the pre-pandemic trajectory at the five-year forecast horizon) of 0, 3 and 6 per cent respectively. These represented a range of plausible assumptions and did not presume a mechanical connection to the specific near-term policies or outcomes under each scenario.

2.41 We also provided a putative decomposition of the 3 per cent scarring assumption in our central forecast into its constituent components (see Table 2.5):[6]

- **Lower investment** ('capital shallowing') accounted for 0.8 percentage points, or roughly a third of the total effect on productivity.
- **Lower total factor productivity** accounted for the remainder of the productivity scarring, namely 1.2 percentage points.[7]
- **Lower labour supply** accounted for 1 percentage point. Within this, half was down to the effect of lower participation, reflecting the long-run health consequences of the virus for some of those who were infected and a decision by some older workers to retire earlier. The remainder was split roughly equally between: a modestly higher equilibrium unemployment rate as a result of the need to reallocate some workers across jobs, sectors and occupations; and a smaller population as a result of lower net inward migration.

[6] This abstracts from a 0.2 per cent upward revision to potential output that resulted from our standard annual update of the detailed labour market participation model that underpins our medium- and long-term projections. This related to pre-virus data revisions.
[7] In reality, some of the TFP shortfall would also reflect capital scrapping as a result of business failures or faster depreciation of the remaining capital stock due to the adoption of new – and less efficient – modes of operation as result of the virus. But effects of this sort are unlikely to be picked up in the official capital stock statistics, so would instead show up in measures of TFP.

Table 2.5: Virus-related scarring assumed in our November 2020 *EFO*

	Per cent
	Breakdown of virus related scarring
Total scarring	**3.0**
of which:	
Hourly productivity	**2.0**
Capital shallowing	0.8
Total factor productivity	1.2
Labour supply	**1.0**
Population	0.2
Participation	0.5
Equilibrium unemployment	0.3

2.42 Relatively little information has accrued since November regarding the likely extent of medium-term scarring, though several factors are worth mentioning:

- The ONS has revised up its estimates of **business investment** in the third quarter of 2020 by 9 per cent, suggesting less damage to the capital stock from the pandemic and associated health restrictions (see paragraph 2.54). Against that, the renewed lockdown has led to a further deterioration in the **financial position** of businesses, despite additional Government support. For instance, the ONS BICS survey reports an 8 per cent rise in the proportion of firms expecting their cash reserves to last three months or less. Finally, the generous **temporary uplift to capital allowances** announced in this Budget should accelerate the recovery in investment. Our new investment profile suggests that the capital shallowing effect might turn out to be a little smaller than estimated in November, at 0.7 percentage points.

- There is little new information regarding the impact on **TFP** but recent external analysis of the Bank of England's Decision Makers Panel (DMP) survey suggests that the pandemic could reduce private sector TFP by around one per cent in the medium term.[8] This is broadly consistent with our central assumption.

- Recent analysis of labour market data (discussed in paragraphs 2.67 to 2.71 below) suggests that the **population** may be substantially smaller than official statistics suggest as a result of significant numbers of foreign-born nationals returning home during the pandemic and lower levels of immigration than pre-pandemic projections assumed. Many of those leaving will have settled status and some can be expected to return after the pandemic but potential new migrants from the EU will henceforth face a tougher immigration regime. And unless most of these 'missing workers' do indeed return or are replaced by other migrants after the pandemic, the scarring impact from net outward migration may be rather larger than we previously assumed. Indeed, on a worst-case basis the population could be as much as 2 per cent smaller.

[8] N Bloom *et al. The Impact of Covid-19 on Productivity,* NBER Working Paper 28233, December 2020.

- Finally, we have not attempted to calibrate the consequences for medium-term scarring had the Government imposed the **public health restrictions** assumed in our current forecast, but only provided the degree of **fiscal support** assumed in our November forecast – i.e. we have not produced pre- and post-measures scarring assumptions. But it is clear that the scope for scarring would have been considerably greater if the full effect of public health measures on output had fed through to private sector employment and incomes rather than continuing to be partly borne by the Government via the furlough scheme, business support grants and other measures.

2.43 In view of this limited, though somewhat conflicting, news since November, we have retained our overall assumption of 3 per cent scarring for our central forecast in this EFO, though we continue to emphasise the uncertainty surrounding it, and indeed on the future evolution of potential output more generally. We will continue to monitor the evidence on scarring in our future EFOs as it accrues.

2.44 Our 3 per cent central scarring assumption lies within the initial array of external estimates (Table 2.6).[9] In its Article IV review of the UK economy, the IMF projected GDP to lie between 3 and 6 per cent below its pre-virus trend in the medium term.[10] The National Institute of Economic and Social Research predict virus-related scarring of 4 per cent in the medium term.[11] A study by Pujol that draws on consensus forecasts put the long-term loss of output at around 3 per cent for the UK.[12] Official forecasts for other European countries also assume similar levels of output loss.[13] The Bank of England assume a somewhat lower degree of scarring, at around 1¾ per cent.

Table 2.6: Selected estimates of medium-term scarring of real GDP

Scarring estimates (per cent)[1]			
Estimates for the UK		International estimates[3]	
OBR	3	Italy	3
IMF Article IV	3 to 6	Germany	3
NIESR[2]	4	Netherlands	4
Bank of England	1.75	USA	3.4
Pujol	3.1		

[1] Relative to a pre-pandemic baseline, unless otherwise stated.

[2] NIESR's central estimate is 6 per cent, of which around 2 percentage points is the impact of the TCA, therefore their implied estimate for virus related scarring is 4 percentage points.

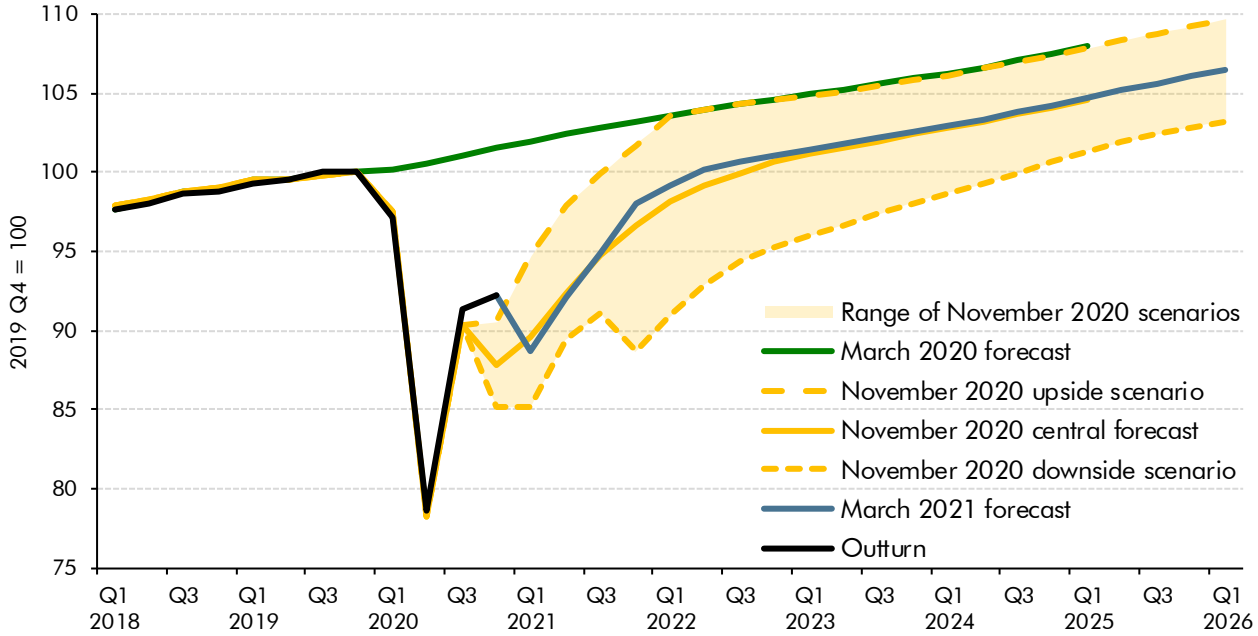
[3] Source: Ufficio Parlamentare Di Bilancio, Stabilitätsrat, CPB Netherlands and Congressional Budget Office.

[9] See also: J. Portes, *The lasting scars of the Covid-19 crisis: Channels and impacts*, VoxEU, June 2020; R. Hughes *et al*, *Doing more of what it takes*, Resolution Foundation, May 2020; and C. Lenoel and G. Young, *Prospects for the UK Economy*, National Institute Economic Review, April 2020.
[10] IMF, *United Kingdom: Staff Concluding Statement of the 2020 Article IV Mission*, October 2020.
[11] H. Kucuk, C.Leonel and R. Macqueen, *UK Economic Outlook February 2021: Brexit Britain in Covid Recovery Ward*, National Institute Economic Review, February 2021.
[12] T. Pujol, *The long-term economic cost of Covid-19 in the Consensus Forecasts*, Covid Economics (44), August 2020.
[13] For example, see CPB Netherlands, *Macro Economic Outlook 2021*, September 2020; Stabilitatsrat, *Statement by the Independent Advisory Board of the Stability Council*, Spring 2020; Ufficio Parlamentare Di Bilancio, *2020 Budget Planning Report*, July 2020. CBO, *An Update to the Economic Outlook: 2020 to 2030,* July 2020

The medium-term outlook for GDP

2.45 Combining our assumptions about the immediate effect on GDP of the current lockdown, the short-term recovery paths after restrictions are eased, and longer-term scarring yields the medium-term GDP paths in Chart 2.7. Beyond March 2022, we assume the effects of the virus on the economy are limited to medium-term scarring effects, with any voluntary or official restrictions on social activity having little economic impact. Our latest forecast shows activity regaining its pre-crisis level by the middle of 2022, six months faster than in our November central forecast thanks partly to the investment incentives announced in the Budget. From 2023 onwards, the path of GDP is little changed from November, reflecting our unchanged assumptions about medium-term scarring.

Chart 2.7: Real GDP paths



Source: ONS, OBR

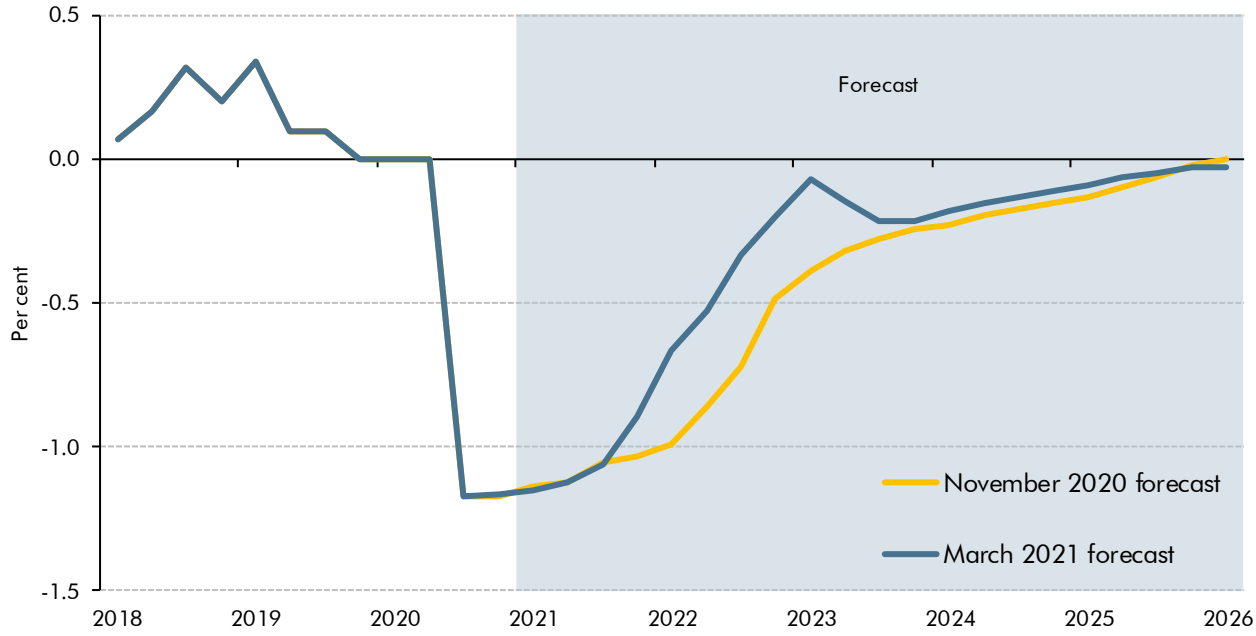
The output gap

2.46 The gap between actual and potential output – the 'output gap' – plays a central role in economic forecasting and discussion of policy. The output gap is a key input into the inflation forecast. And the legislated 'fiscal mandate' applies to cyclically adjusted public sector net borrowing in 2020-21, so evaluating the Government's compliance with this target necessarily requires us to generate a measure of the output gap.

2.47 In normal times, when output is driven by fluctuations in demand around a smoothly rising path for potential output, the output gap is a useful concept, albeit one that poses considerable estimation challenges. The public health restrictions to control the pandemic have, however, simultaneously restricted both supply and demand (and to differing degrees in different sectors). Consequently, it is extremely difficult to assess the effective level of potential output and the associated output gap during the pandemic, though as restrictions are lifted one might expect a margin of spare capacity to emerge, which then closes gradually as conditions normalise.

2.48 Subject to these caveats, Chart 2.8 shows our estimate of the output gap that goes alongside the GDP profile shown in Chart 2.7. It shows only a small margin of spare capacity since the start of the pandemic, reflecting our judgement that most of the fall in output during 2020 should be thought of as a simultaneous contraction in demand and supply. Demand and supply rise together as the health restrictions are lifted and voluntary social distancing eases. The fiscal measures announced in this Budget – especially the temporary investment incentives – also help to close the output gap, reducing it by ½ percentage points in 2022.

Chart 2.8: Output gap



Source: OBR

Expenditure composition of GDP

2.49 Looking at the composition of GDP by expenditure component, the economic impact of the pandemic in 2020 was concentrated in falls in private consumption and business investment (Table 2.7). Somewhat counterintuitively, government consumption also fell, despite the enormous rise in public spending. That reflects the ONS's approach to measuring real output and expenditure in health and education (discussed above in Box 2.4), with the closure of schools and the displacement of elective medical procedures lowering the estimates of real spending in each respectively. Imports fell by more than exports in 2020 leaving the net trade contribution to GDP growth positive over 2020.

2.50 The recovery from 2021 onwards is led initially by consumers, as spending responds to the easing of health restrictions and abating fears of infection, and supported by the drawdown of some of the additional savings accumulated during the pandemic (see Box 2.6). Government spending also contributes to the pick-up, thanks to the recovery of measured real activity in the health and education sectors, as well as the additional spending announced in the Spending Review. The underlying recovery in business investment is

slower, reflecting initial uncertainty about the pace of recovery, the consequences of the pandemic and Brexit for the structure of production, and the burden of additional debt that some firms carry (also discussed in Box 2.6). But investment is augmented by the impact of the generous temporary uplift to capital allowances this year and next, which also encourages businesses to bring forward investment projects from the future. Net trade acts a significant drag on the recovery this year (as imports recover from last year's large fall and as Brexit initially weighs on exports more than imports) and next (as a result of the import-intensive nature of the increase in consumption and investment), but has a more modest impact in the medium term.

Table 2.7: Expenditure contributions to real GDP

	Percentage points, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
GDP growth (per cent)	**1.4**	**-9.9**	**4.0**	**7.3**	**1.7**	**1.6**	**1.7**
Main contributions:							
Private consumption	0.7	-7.1	1.8	7.0	0.8	1.1	0.8
Business investment	0.1	-1.1	-0.2	1.5	0.3	-0.2	0.5
Dwellings investment[1]	0.1	-0.6	0.3	0.3	0.1	0.1	0.1
Government[2]	0.9	-1.0	3.0	0.4	0.2	0.5	0.5
Change in inventories	0.1	-0.7	2.4	-1.6	0.0	0.0	0.0
Net trade	-0.1	0.7	-3.6	-0.4	0.3	0.0	-0.1
Other[3]	-0.4	-0.2	0.4	0.0	0.0	0.0	0.0

[1] The sum of public corporations and private sector investment in new dwellings, improvements to dwellings and transfer costs.

[2] The sum of government consumption and general government investment.

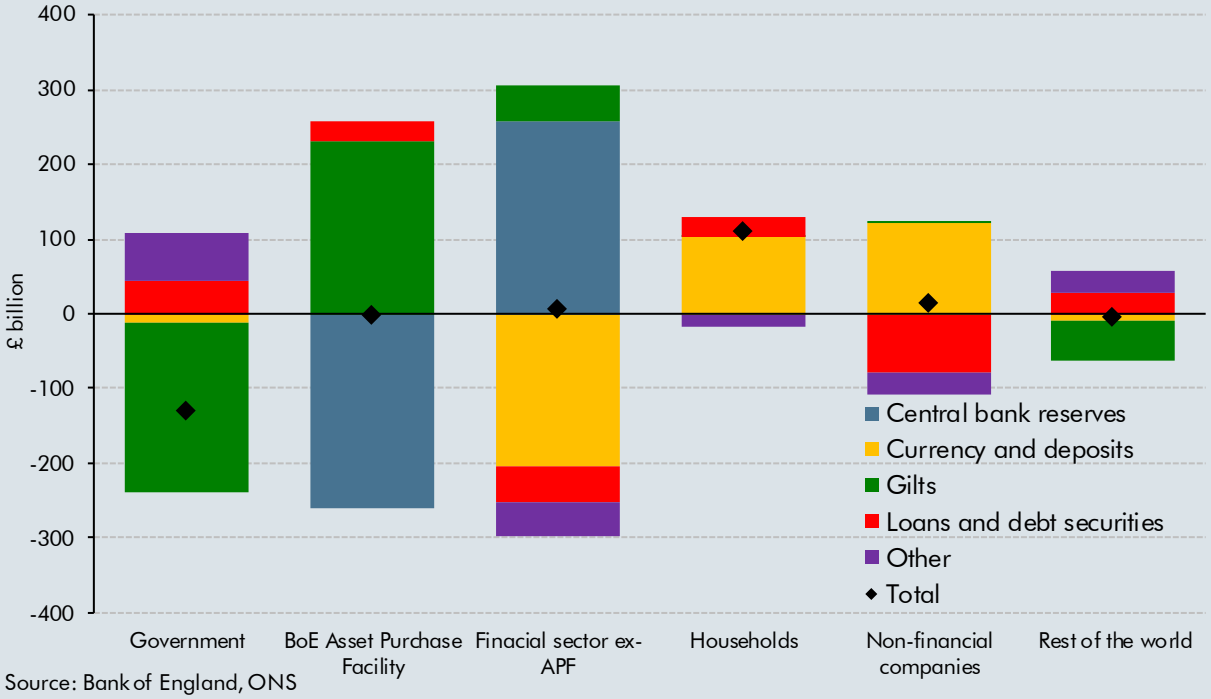
[3] Includes the statistical discrepancy and net acquisition of valuables.

Note: Components may not sum to total due to rounding.

Box 2.6: Coronavirus and the flow of funds

The pandemic and associated policy response have dramatically changed the flow of funds between the different sectors of the UK economy. How these flows unwind as the pandemic passes has potential implications for the pace and sustainability of the recovery.

Chart H: Difference in net acquisition of assets between the first three quarters of 2020 and the final three quarters of 2019



Source: Bank of England, ONS

The National Accounts framework divides the economy into five sectors: government, households, financial corporations and intermediaries, non-financial corporations, and the rest of the world. Any net borrowing on the part of one sector must be accompanied by net lending on the part of another (e.g. a new loan from a bank to a business simultaneously creates an asset for the bank and a liability for the business). The data for the first three quarters of 2020 show dramatic changes in the pattern of flows between sectors, as shown in Chart H:

- The **Government** has provided financial support to households and businesses that is unprecedented in peacetime. To finance this, in net terms it issued £261 billion gilts (green) in the first three quarters of 2020, compared with £34 billion in the preceding three quarters.
- A roughly equivalent quantity of gilts has been purchased on the secondary market by the **Bank of England's Asset Purchase Facility (APF)** as part of its quantitative easing (QE) programme. The Bank has financed the purchase of these gilts (and some corporate bonds) by issuing an equivalent amount of its own liabilities in the form of central bank reserves (blue), leaving the net asset/liability position unchanged.
- These additional reserves all constitute extra (highly liquid) assets of the rest of the **financial sector**. The counterpart to these extra reserves is primarily the additional deposits

from households and non-financial corporations arising from the government's measures in response to the pandemic (yellow). This also leaves their net lending position broadly unchanged.

- **Households** have been the most important source of additional lending over this period, increasing their deposits (yellow) by £148 billion in the first three quarters of 2020, over £100 billion more than the £45 billion accumulated in the preceding three quarters. This pandemic-associated increase in household liquid savings has been intermediated to government via the financial sector and the Bank of England through the mechanisms described above.
- While the net lending of **non-financial corporations** has changed little, that obscures important changes in its composition, with borrowing rising substantially (accumulating £108 billion more in net loans and other liabilities than in the preceding three quarters) but deposit accumulation also rising (by £123 billion). This probably reflects significant heterogeneity in the experience of firms in different sectors, with some taking on more debt while others have prospered.
- The **rest of the world** net lending position has also changed little, with foreign investors apparently playing a limited role in financing the dramatic increase in government borrowing over the first nine months of the year.

The unwinding of these various financial flows once the pandemic passes has potential implications for the pace and sustainability of the recovery.

Households

While there has been some substitution into purchases of goods and other services (as discussed in Box 2.5), the primary reason for the increased accumulation of household deposits has been the curtailment of social and retail consumption as a result of the public health restrictions, coupled with extensive income support. The strong recovery in consumption in our central forecast over the second half of 2021 is primarily a direct consequence of the re-opening of these parts of the economy as restrictions are relaxed.

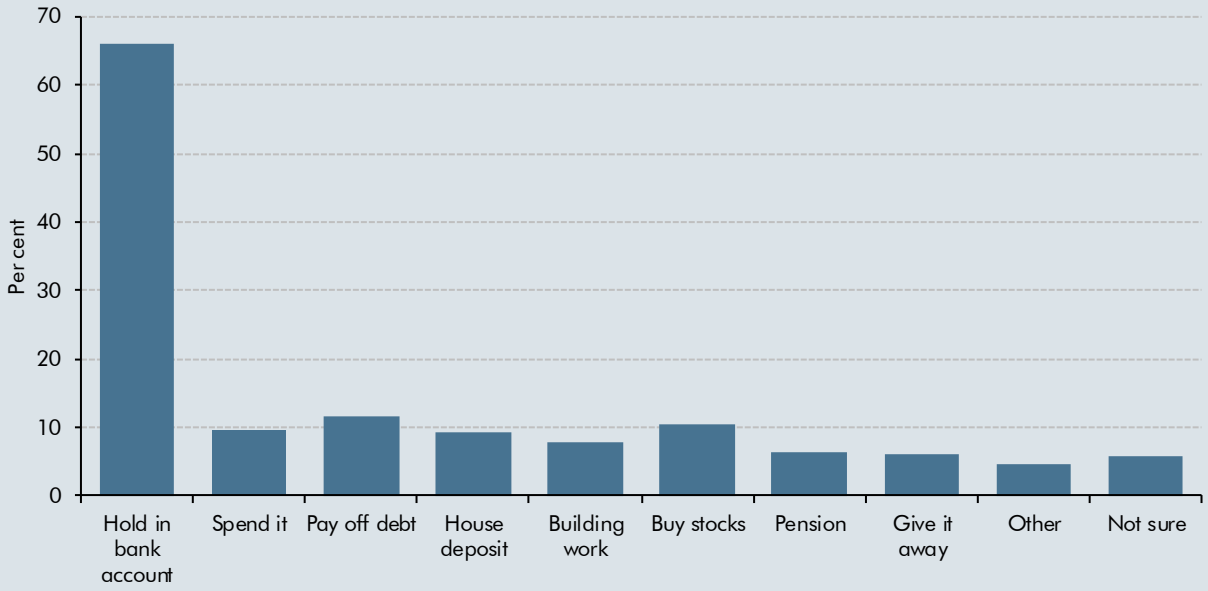
The extra household savings accumulated during the pandemic may add extra impetus. By the middle of 2021 households additional deposit accumulation during the pandemic is expected to reach around £180 billion. Were this all to be spent over the next four quarters, it would add around 6 per cent to consumption in 2021 and 2022.

Standard consumption theory suggests, however, that rather than immediately spending all of an unanticipated increment to their wealth (or, equivalently, a temporary increase in their income), households are instead likely to save most of it in order also to allow higher consumption in the future. Empirical evidence typically suggests that annual spending rises by around 5-10 per cent of such an increment, with the effect being larger for poorer households than for richer ones.[a] A recent Bank of England survey suggests that the rise in savings has indeed been mainly by better-off households, with 42 per cent of high-income households saving more and 16 per cent less, compared to 23 per cent of low-income households saving more and 24 per cent saving less.[b]

There are, however, several reasons why spending might turn out to be higher. First, there may be a degree of euphoria once the pandemic is past, leading households to wish to treat themselves. Second, spending on durables is a form of saving as the associated flow of services is spread over time. Some durables spending, such as on cars, has been especially weak during the pandemic, and there is therefore scope for a strong rebound. Third, the additional household savings have been held primarily in liquid form, allowing them to be run down more easily.

An autumn 2020 Bank of England survey of households' plans for the additional savings built up during the pandemic found that only 10 per cent planned to spend them with around two-thirds planning to retain them in their bank account (Chart I).[c]

Chart I: NMG survey responses on what households plan to do with additional savings built up during the pandemic



Note: Some respondents picked more than one option.
Source: Bank of England, OBR

The consumption path in our central forecast is consistent with households on average spending 5 per cent of the extra deposits accumulated during the pandemic each year, but somewhat front-loaded into the second half of 2021 and first half of 2022. This means that by the end of the forecast period around 25 per cent of the total stock of £180 billion built up during the pandemic will have been used for consumption. Given the difficulties in 'making up for lost time' in social consumption (one can only eat so many meals in a day, however expensive), we have assumed that the additional expenditure over the second half of 2021 and first half of 2022 largely goes on the purchase of durable goods whose consumption is more likely to have been delayed.

Businesses

Although the net lending position of businesses has changed little, there is more going on beneath the surface, with additional borrowing largely offset by the accumulation of deposits. In some cases, businesses may have taken advantage of generous government-guaranteed loan

schemes to build up extra liquid assets as a precaution, but the juxtaposition of a rise in borrowing with higher deposit accumulation is likely mainly to reflect the heterogeneity in firms' experiences during the pandemic. For instance, across the second half of 2020 on average three-quarters of the businesses in the hospitality sector reported a fall in turnover relative to normal times compared to just a third in the information and communication sector.[d]

Businesses' balance sheets matter for the pace of the recovery in business investment. Those with healthy balance sheets will be well placed to invest as demand and confidence return. But evidence suggests that highly indebted firms face higher borrowing costs and invest less.[e]

Government

The Government has been able to borrow heavily and cheaply in part because the Bank of England has simultaneously been buying large quantities of gilts on the secondary market. And the flow of funds reveal that the ultimate counterpart of that higher borrowing can be seen mainly in higher domestic household savings. A key question is what will happen if inflationary pressures start to build as the recovery proceeds. In that case, short and long-term interest rates may rise and the MPC may choose to begin unwinding its asset purchases. This potentially raises the cost of servicing the public debt (see Box 4.1) and increases the likelihood that the Government may experience difficulties in finding enough willing buyers for its newly issued debt. That highlights the importance of the Government maintaining the credibility of its commitment to low inflation and sound public finances.

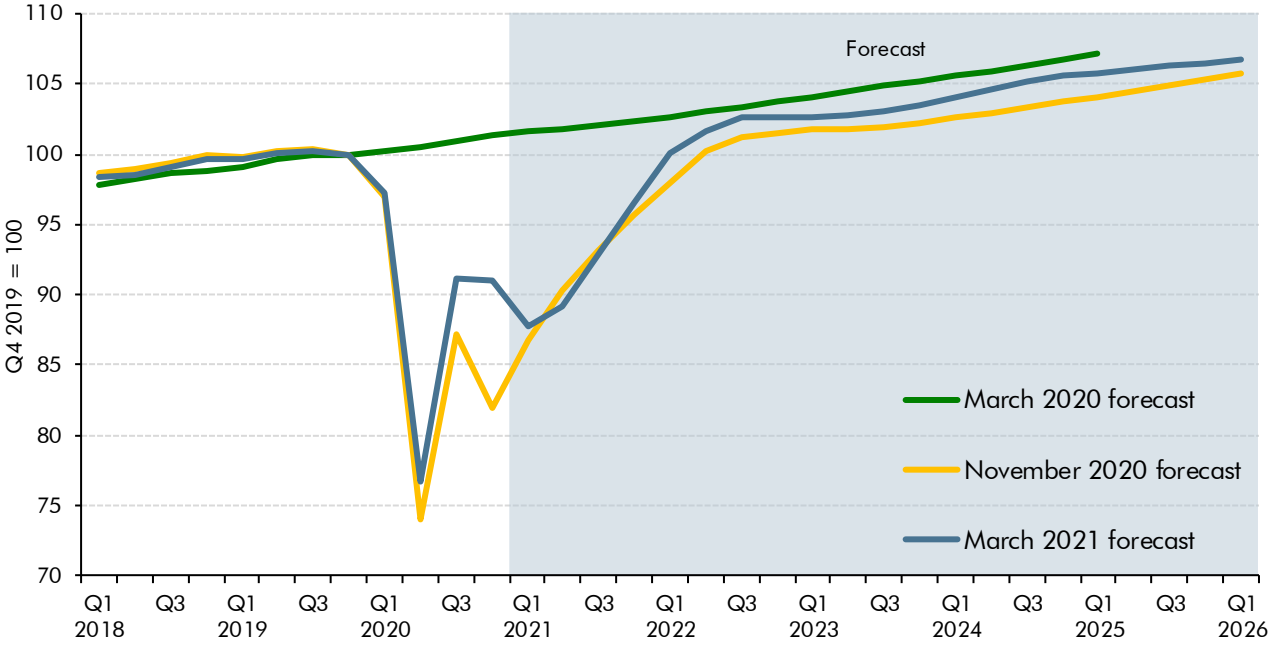
[a] See *The Consumption Response to Income Changes*, Jappelli and Pistaferri, 2010.
[b] See chart 3.6 of the *Monetary Policy Report*, Bank of England, February 2021. For further evidence also see *Caught in a (Covid) trap*, Resolution Foundation, November 2020.
[c] 2020 NMG household survey, Bank of England.
[d] *Business insights and impact on the UK economy*, ONS, 2020.
[e] See *Insolvency and debt overhang following the COVID-19 outbreak: assessment of risks and policy responses*, Demmou, Calligaris, Franco, Dlugosch, McGowan and Sakha, February 2021, *The cost of corporate debt overhang*, Blickle and Santos, October 2020, and *Debt overhang, rollover risk and corporate investment: evidence from the European crisis*, Kalemli-Özcan, Laeven and Moreno, ECB working paper No 2241, February 2019.

Private consumption

2.51 Private consumption fell by 23 per cent between the fourth quarter of 2019 and the second quarter of 2020 in response to the first lockdown and increased voluntary social distancing, before recovering more than half that fall in the third quarter as the pandemic eased and restrictions were lifted. Reopening of non-essential retail, hospitality and recreational and cultural facilities was bolstered by extra fiscal support measures including the temporary VAT cut and subsidies for eating out. But the second wave of infections that took hold in early autumn and the subsequent tightening of public health restrictions caused consumption to fall slightly in the final quarter. The reimposition of a nationwide lockdown at the start of this year is expected to lead to a smaller fall in consumption than in the first lockdown a year ago. Retail sales fell by 8.2 per cent in January 2021, compared with 22.2 per cent in April 2020. But, in the first quarter of this year, we still expect a shortfall in consumption of 12 per cent relative to its pre-pandemic peak (Chart 2.9).

2.52 Consumer spending should rebound strongly as restrictions are eased. That mainly reflects the direct consequence of the reopening of sectors that are presently unable to trade or else can only do so to a limited degree. In addition, consumption across the forecast period is supported by households spending part of the savings they have built up during the crisis (see Box 2.6). We expect this to add about £45 billion to spending over the five years of the forecast (equivalent to about ½ percentage point a year), with some of it being front-loaded as households buy more durables, especially those (such as cars) on which spending was depressed during the pandemic. Consumption returns to its pre-virus peak by the first quarter of 2022, slightly earlier than output as a whole. With households having built up such large unexpected deposit balances, risks to this forecast could be greater than usual – particularly if consumers were to opt to spend more of those extra savings in the short term. By the first quarter of 2025, the level of private consumption is 2 per cent above our November forecast and around 1 per cent below our March 2020 forecast.

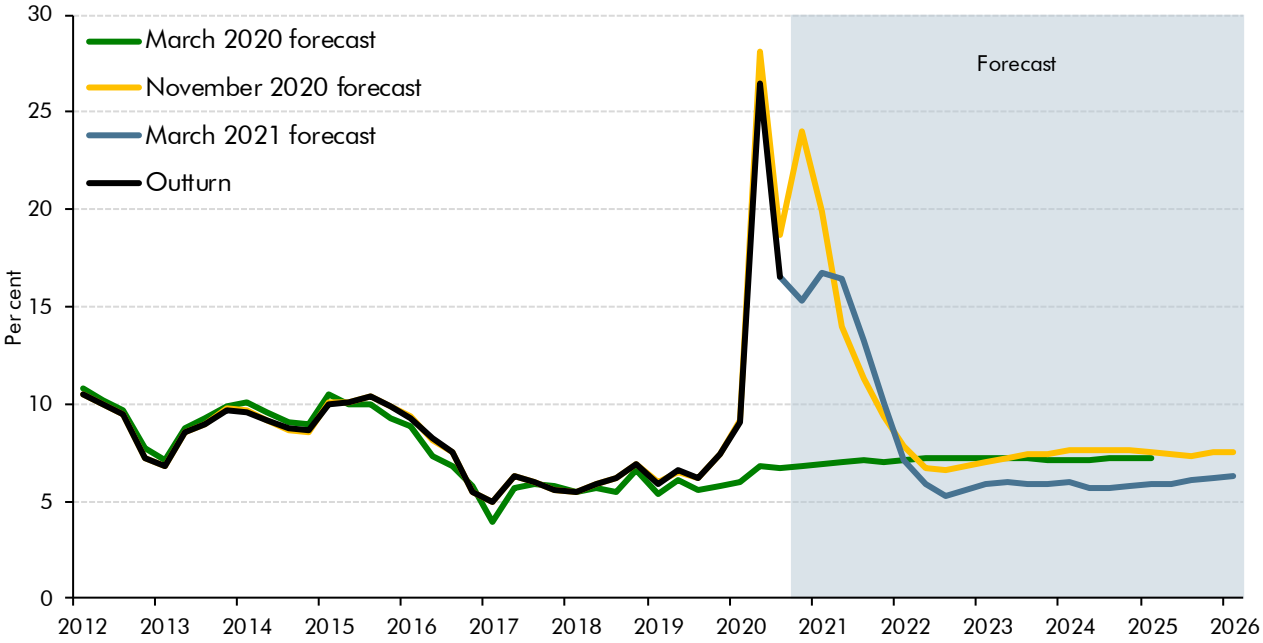
Chart 2.9: Real private consumption



Source: ONS, OBR

2.53 The saving ratio rose to a record high of nearly 27 per cent in the second quarter of 2020, as consumer spending fell sharply, while household income was supported by the CJRS and SEISS schemes. The saving ratio then fell back in the third quarter when restrictions were eased allowing consumer spending to revive. Our forecast assumes that the latest lockdown produces another pick-up in the saving ratio to around 17 per cent in the first quarter of 2021, before it then falls back to more historically normal levels as restrictions ease and the economy normalises, settling at around 6 per cent in the medium term (Chart 2.10). All else equal, we assume that a quarter of the unplanned savings built up over the past year will be spent over the coming five years which means the saving ratio will settle at a level that is around ½ percentage point lower on average than would otherwise have been the case.

Chart 2.10: Household saving ratio



Source: ONS, OBR

Business investment

2.54 The ONS has revised up outturn business investment data which has led us to revise up the first part of the forecast relative to our November forecast. Business investment fell by 22 per cent in the second quarter of 2020 as the first lockdown and heightened uncertainty led businesses to put capital projects on hold (Chart 2.11). It recovered slightly in the second half of the year but remained around 10 per cent down on its pre-virus level at the end of 2019. We expect a further decline of 9.5 per cent in the first quarter of this year due to the renewed lockdown.

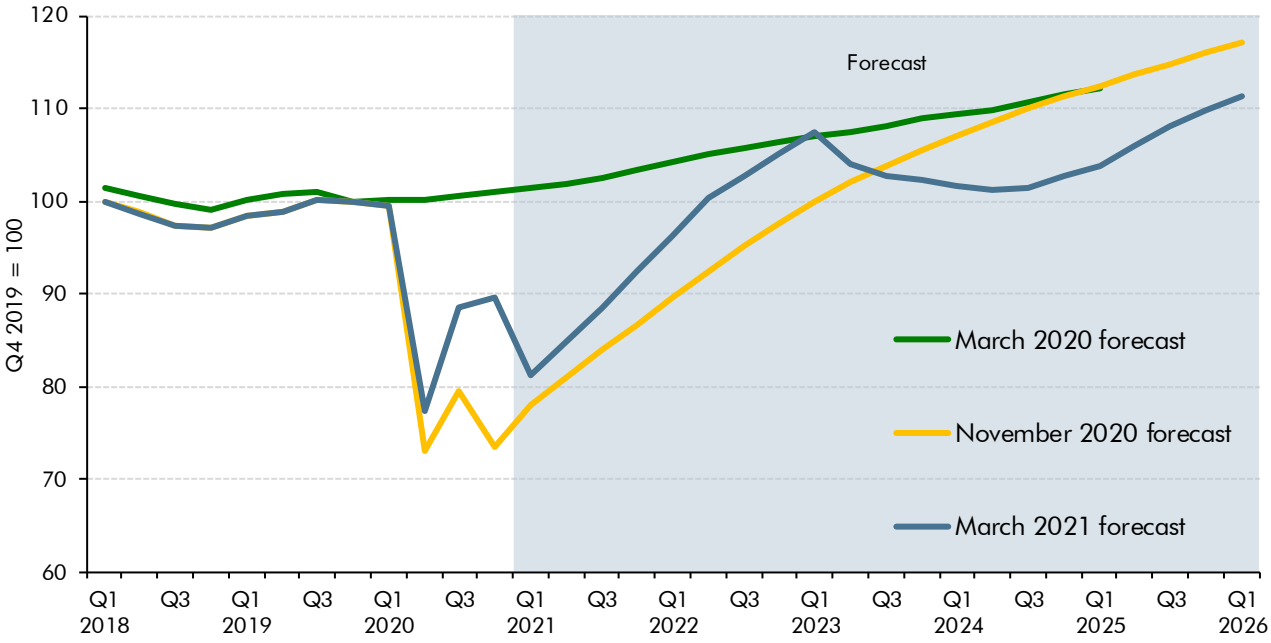
2.55 The underlying trend in business investment over the forecast period is one of gradual recovery as uncertainty about the pandemic and the implications of Brexit recedes only slowly. In addition, some businesses will carry forward higher levels of debt and this can be expected to weigh on spending (see Box 2.6). But the large temporary uplift to capital allowances announced in the Budget can be expected to boost investment spending materially in the first half of the forecast. As a temporary measure, it does not affect the long-run level of the cost of capital or capital stock, though it should raise capital spending during the period of enhanced allowances by making more projects profitable. But, in addition, it provides companies with a very strong incentive to bring forward spending from future periods to take advantage of the much more generous allowances. Empirical studies of similar schemes in the US suggest that investment is very responsive to such temporary incentives.[14] At its peak in the financial year 2022-23, we have assumed that this will raise the level of business investment by around 10 per cent (equivalent to around £20 billion per year) as spending is brought forward.

[14] Wen, J., IMF, *Temporary Investment Incentives*, 2020.

2.56 Once the incentive is withdrawn, the increase in investment from the measure begins to reverse and business investment is expected to fall back before picking up again towards the end of the forecast. The substantial increase in the main rate of corporation tax will increase the cost of capital and lower the desired capital stock in the long run. We expect this, therefore, also to weigh on business investment in the medium term, but its effects should be modest relative to the incentive to shift investment between years created by the temporary capital allowances measure.

2.57 These policy-induced changes lead business investment to regain its pre-virus peak faster than in our November forecast – in the first half of 2022 – but business investment is then down relative to November from the second half of 2023 onwards. Cumulative business investment since the start of the pandemic to the start of 2025 is around 8 per cent lower than in our pre-pandemic March 2020 forecast.

Chart 2.11: Real business investment



Source: ONS, OBR

Government

2.58 Government consumption increased by 14 per cent in cash terms in the second quarter of 2020 to fund virus-related pressures on health and other public services, but in real terms it fell by 15 per cent. That difference reflects lower measured health and education activity due to the postponement or cancellation of elective healthcare treatments in response to the pandemic and the closures of schools. As schools reopened and elective healthcare treatments resumed, real government consumption jumped 13 per cent in the third quarter while cash spending was flat on the quarter. Over 2020 as a whole, real government consumption fell by 6 per cent despite a 16 per cent rise in nominal spending. The challenge of incorporating new programmes – notably NHS Test & Trace and the vaccine rollout – in the official statistics have led to material revisions to the 2020 data and generate continuing uncertainties for our forecast.

2.59 The Government's spending plans are consistent with government consumption in nominal terms rising in 2021 by 10 per cent before falling back by 8 per cent in 2022. However, in real terms, we expect government consumption to rise 12 per cent over 2021 as health and education normalise and then to increase by just 1 per cent in 2022 as virus-related government spending falls away. In the medium term, we expect real government consumption to grow gradually, broadly in line with our November forecast from 2023.

2.60 Government investment grows significantly over the forecast period, mainly due to the large spending increases that were announced in the March 2020 Budget. Average growth between 2022 and 2025 is around 2 per cent a year, locking in the higher level resulting from 18 per cent growth in 2021.

Residential investment

2.61 Real residential investment fell by 33 per cent in the second quarter of 2020, reflecting lower construction activity and the temporary closure of the housing market. But it recovered completely in the third quarter on the back of the reopening of building sites and the housing market. The transactions element of residential investment was also boosted by the announcement of the stamp duty holiday. Residential investment rose slightly further in the fourth quarter. We expect residential investment to fall back sharply in the first quarter of 2021, as the boost to construction activity appeared to partly reflect accelerated housing completions rather than new starts. We expect residential investment to then rise back above its pre-pandemic level by the start of 2022. Average quarterly growth of around 0.4 per cent from 2023 onwards brings it to a level above our pre-pandemic forecast at the forecast horizon as some delayed investment is recovered.

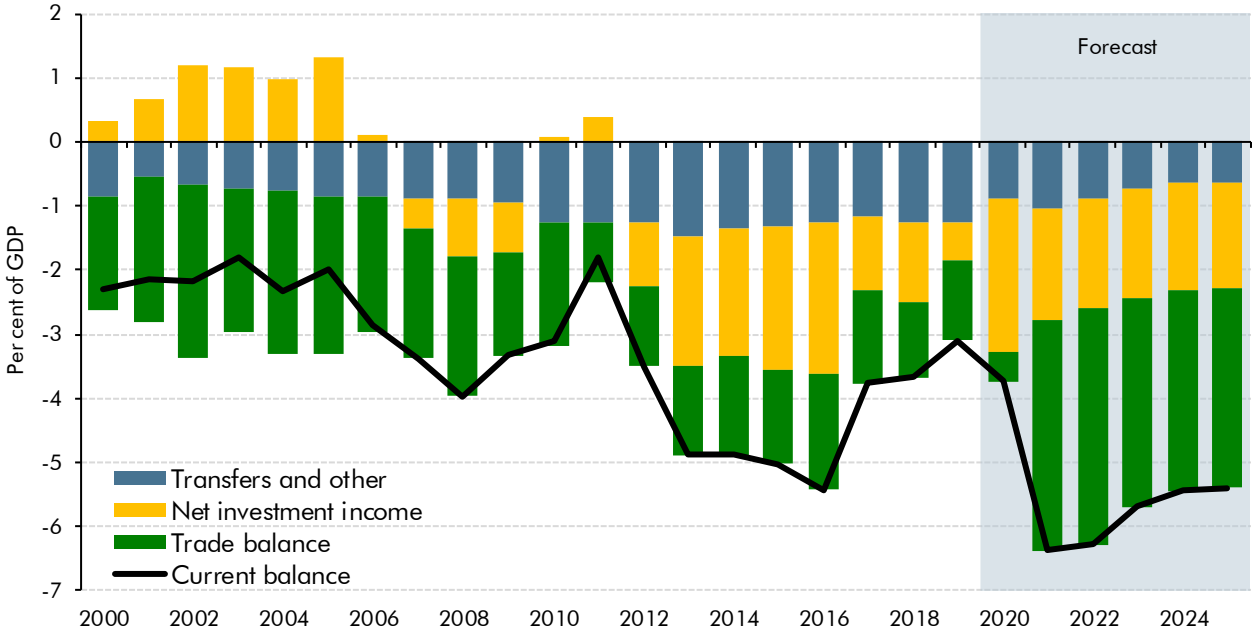
Trade and the current account

2.62 The pandemic has led to large falls in both imports and exports, reflecting lower domestic demand and the contraction in global trade due to falls in global demand and the disruption to international supply chains. Given the extra frictions associated with the latest lockdown, new heath checks at the border, and the commencement of the new UK-EU trading arrangements, we expect a dip in trade in the first quarter of this year (see Box 2.2 above). We expect both imports and exports to recover quickly over 2021 and 2022, with a faster increase in imports driven by the increases in consumption and business investment. But while imports rise modestly in the medium term, exports fall slightly. This reflects the UK's departure from the EU lowering our export market share and import penetration rate, layered on top of what was a historically declining trend in export market share but an increasing import penetration rate.

2.63 Over the past couple of years, the current account has on average been in deficit by around 3½ per cent of GDP. We expect it to widen to 6.4 per cent in 2021 driven by the trade balance, as imports grow strongly as a result of the recovery in import-intensive components of consumption and investment. This would be the widest annual UK current deficit since the Second World War (1945). The trade deficit narrows from 2023 onwards, reflecting the moderation in business investment. Deficits in both transfers and net investment income narrow slightly over the forecast as a share of GDP. This leaves the current account deficit at

around 5 per cent of GDP in the medium term, a similar level to 2016 and our November forecast (Chart 2.12).

Chart 2.12: Current account deficit



Source: ONS, OBR

Labour market forecast and scenarios

2.64 Large movements in output are typically accompanied by similarly large swings in employment. But that has not been the case over the past year. Instead, the sharp fall in output last year was accompanied by a sharp fall in average hours worked, leaving employment down only modestly. That in turn largely reflects the support provided through the CJRS, which meant millions of employees could be kept on payrolls while not working, and assistance for the self-employed through the SEISS, which facilitated equivalent short-time or non-working for millions more. We expect the support provided by these two schemes eventually to total £107 billion.

2.65 During the first lockdown, on average 8.3 million jobs (25 per cent of employees) were furloughed under the CJRS during the second quarter of 2020, with take-up peaking at 8.9 million in May. The first round of SEISS grants in June was taken up by 2.6 million people (55 per cent of the self-employed population). This facilitated the largest fall in average hours worked on record. Output fell 19 per cent in the second quarter and total hours worked fell 18.2 per cent (with hourly productivity down just 1.3 per cent). But within that, employment was down only 1.0 per cent while average hours fell 17.4 per cent (from 31.2 to 25.8 hours a week), thanks to millions of workers' hours falling to zero.

2.66 Average earnings have therefore held up much better than output. Indeed, by the third quarter of 2020 they had already recovered their pre-pandemic levels, partly as a consequence of the CJRS subsidising the pay of employees producing little or no output.

Developments since our November forecast

2.67 Unemployment has risen by slightly more than anticipated in our November forecast, rising to 5.1 per cent in the fourth quarter (and 5.1 per cent on the single month measure in December). That was despite output in the fourth quarter exceeding our November forecast. Our forecast was closed before the fourth quarter labour market data were available, but our estimate was consistent with the outturn.

2.68 These data predate the imposition of the latest lockdown in January. Information on the impact of the January lockdown on the labour market is largely restricted to data on the number of people on furlough, which shows a rise from 4.0 million in December to 4.9 million in January, with all of that increase accounted for by fully furloughed staff. But this was still well below the peak of 8.9 million in May 2020 during the first lockdown.

2.69 Although the broad picture is clear, the available labour market indicators have sometimes provided conflicting signals on the precise details since the pandemic began. For instance, the fall in employee numbers reported in RTI of approximately 800,000 between March and December would, all else equal, suggest that the current unemployment rate should be closer to 6 per cent. That may be a reflection of the ONS's difficulty during the pandemic in ensuring that the LFS, the main source of labour market information, is drawn from a suitably representative sample of the population. Another issue with the LFS, is that it is still based on pre-pandemic assumptions about the size of the population. The latest published data suggest that a large fall in the foreign-born population over the past year of over 980,000 has been more than offset by a large rise in the UK-born population of around 1 million.

2.70 O'Connor and Portes[15] have suggested that it is implausible that the UK-born population has increased to the extent indicated by the official statistics. Instead, they argue that it is more plausible that the UK-born population is roughly unchanged while the total population has shrunk as a result of foreign-born residents returning home during the pandemic. According to their calculations, the outward flow could be as high as 1.3 million – though they note that this is likely to be an upper estimate. Other analysis confirms that there is likely to have been a fall in the migrant population, though it may be rather less than 1.3 million.[16]

2.71 It seems likely that the risk to the overall size of the population lies squarely to the downside (and that this could also be one way to reconcile the differences between the LFS and RTI data). As noted earlier, that also poses a risk to potential output in the longer term if those foreign workers who have left do not return after the pandemic and are not replaced by others. Prior to the pandemic, EU migrants made up 27 per cent of inflows. While some may be able to return if they have obtained settled or pre-settled status, others may not meet the criteria to return or be discouraged by tighter immigration rules. The true extent of the impact of the pandemic on the population may unfortunately not be revealed until well after the 2021 census.

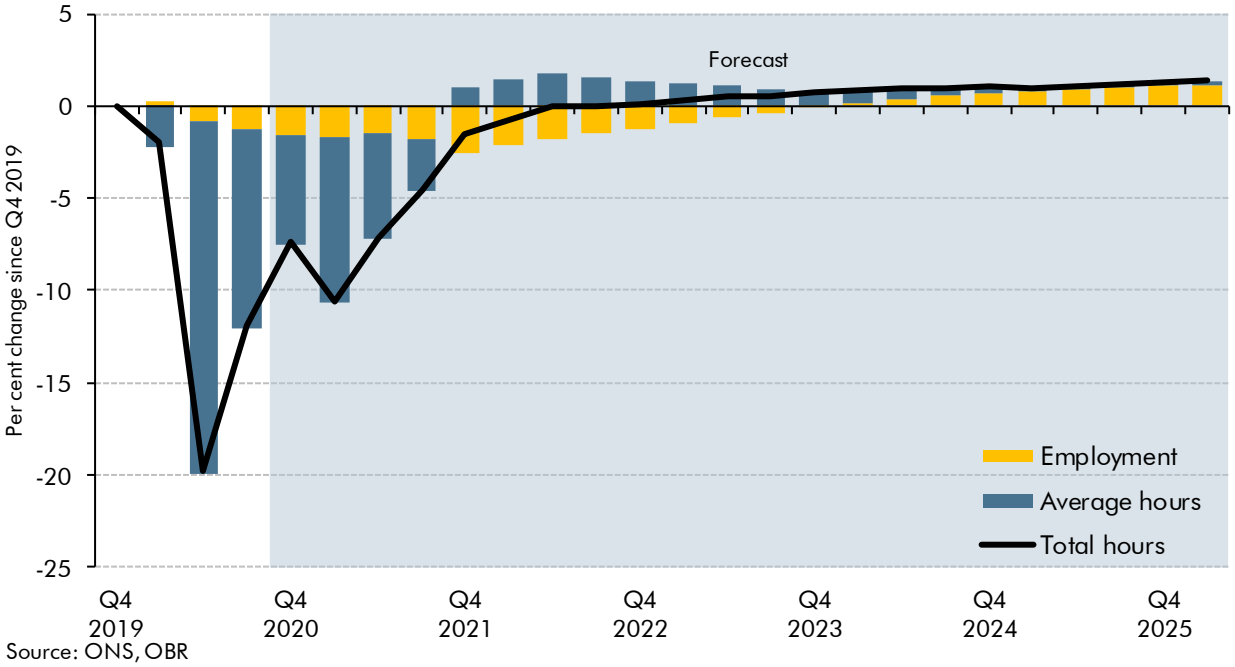
[15] M. O'Connor and J. Portes, *Estimating the UK population during the pandemic*, ESCoE Blog, January 2021.
[16] M. Sumption, *Where did all the migrants go? Migration data during the pandemic*, Migration Observatory, February 2021. See also, N. Cominetti, K. Hanehan, H. Slaughter and G. Thwaites, *Long Covid in the Labour Market*, Resolution Foundation, February 2021.

Prospects for employment and unemployment

2.72 Our November forecast and scenarios assumed that the CJRS would close at the end of March, as was then planned, with unemployment then rising sharply as a more normal relationship between employment and output reasserted itself (Chart 2.14). The Budget extends the CJRS in full until the end of June and in a less generous form (similar to what was in place last summer) until the end of September. The CJRS therefore remains in operation beyond the point at which the Government's Roadmap envisages all but a minimal degree of public health measures being removed, so that most of the shortfall in output relative to pre-pandemic levels over the next six months is felt in lower average hours and higher government borrowing rather than higher unemployment.

2.73 Chart 2.13 illustrates the extent to which CJRS-subsidised swings in average hours worked have dominated in allowing total hours worked to move with fluctuations in output without causing correspondingly large movements in employment.

Chart 2.13: Contributions of employment and average hours to total hours growth

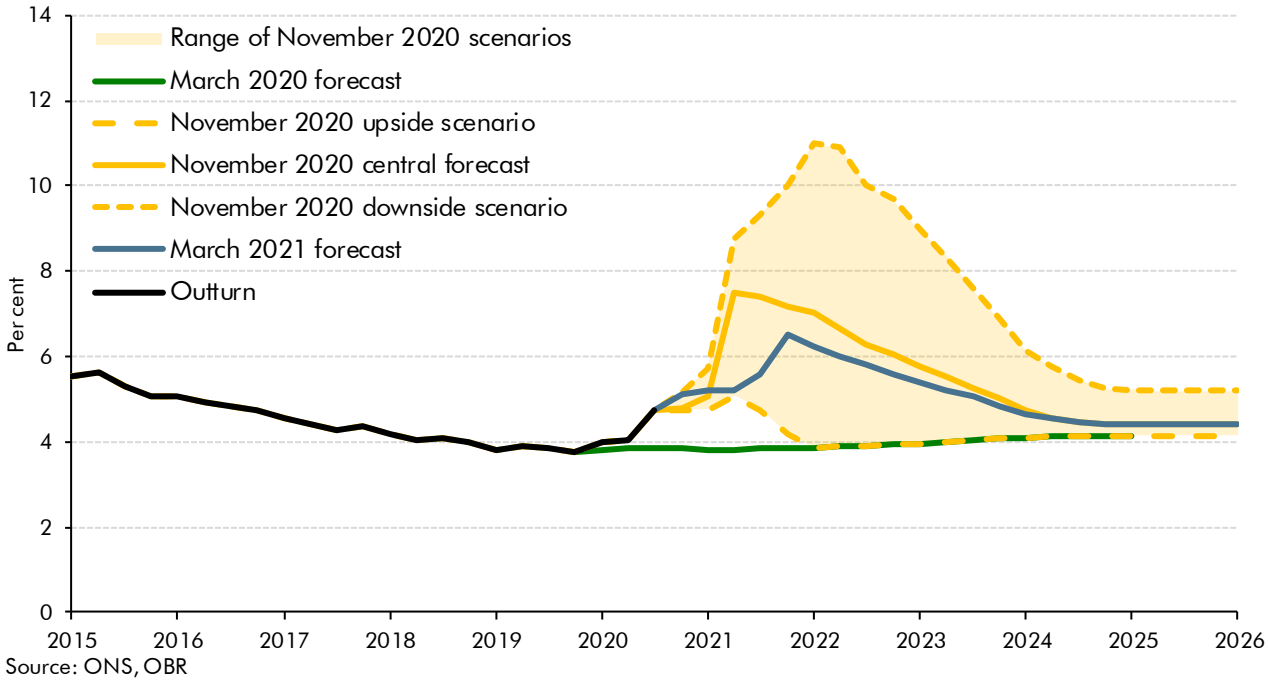


Source: ONS, OBR

2.74 We now expect unemployment to peak at 6.5 per cent (2.2 million) in the final quarter of 2021, once the CJRS has closed. That is both lower and later than the 7.5 per cent (2.6 million) in the second quarter that we expected in our November forecast (again, after the CJRS was planned to have closed). This is largely due to the extension of the CJRS and the additional fiscal support measures, which extend further into the vaccine rollout, when more sectors of the economy have reopened, and the recovery in activity is more advanced. This extended support in turn means that we also expect some firms to hold onto more staff in anticipation of an expected normalisation in demand.

2.75 Without the short-term fiscal easing announced in the Budget, and in particular the CJRS extension, we estimate that unemployment might have been around 300,000 higher in the fourth quarter of this year than the 2.2 million in our central forecast. The fact that unemployment still rises once the CJRS closes is a reflection of the shortfall in output relative to the pre-virus path that persists (GDP is 5.0 per cent below our previous March forecast at the point the CJRS now closes, with employment down 3.1 per cent, average hours up 0.5 per cent, and hourly productivity down 2.4 per cent).

Chart 2.14: Unemployment rate



Source: ONS, OBR

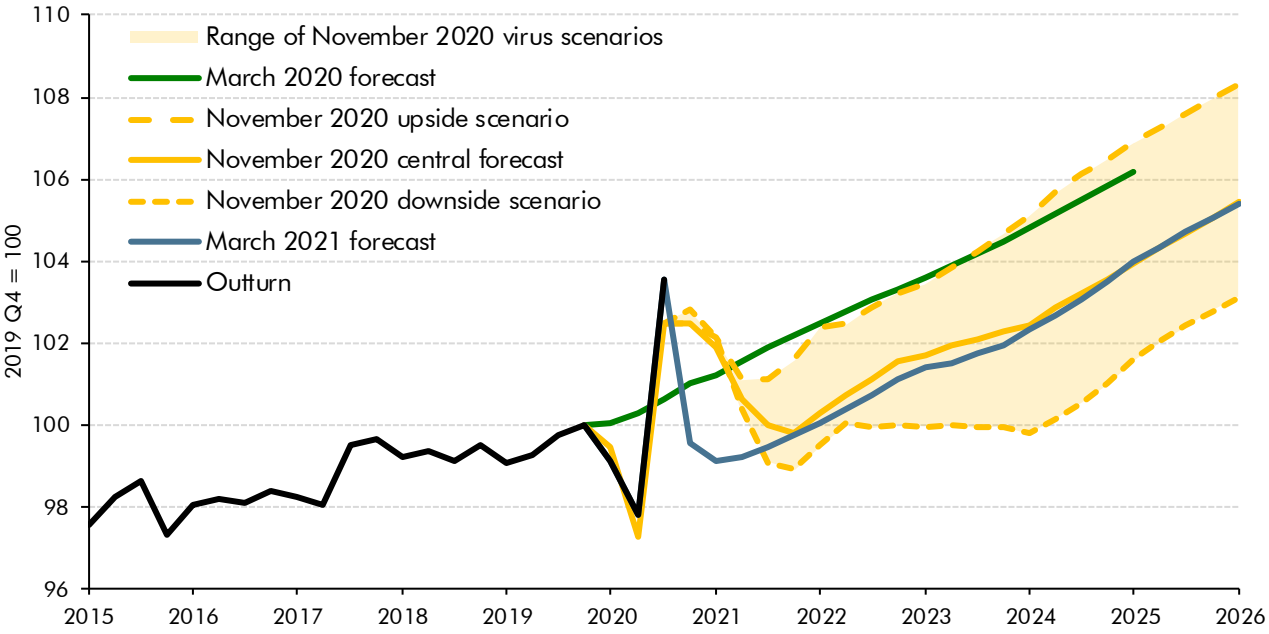
Productivity

2.76 Output per hour worked has been volatile through the pandemic. It fell in the first and second quarters of 2020 to be 2.2 per cent below the pre-pandemic level. It then jumped back up in the third quarter to be 3.6 per cent above the pre-pandemic level before falling back to ending the year broadly in line with pre-pandemic levels.[17] This reflects the net effect of two competing forces: the loss of efficiency arising from changes in working practices necessitated by the virus and lockdown; and the concentration of the effect of lockdown on hours worked in below-average productivity jobs, generating an upward 'batting average' effect.

2.77 Productivity is expected to recover gradually as efficiency-reducing restrictions are eased and business investment rises. In the medium term, productivity remains broadly 2 per cent below our March 2020 forecast.

[17] Although our forecast closed before the release of the fourth quarter labour market data, our estimate for productivity in the fourth quarter of 2020 is broadly consistent with the level indicated by the data.

Chart 2.15: Output per hour



Source: ONS, OBR

Earnings growth

2.78 Our forecast for earnings growth uses an implied measure constructed by dividing the National Accounts measure of wages and salaries by the number of employees, rather than the official ONS average weekly earnings (AWE) series. This allows us to fit our earnings forecast directly into the National Accounts framework on which our fiscal forecast is based – particularly the wages and salaries measure that is a key determinant of tax receipts.

2.79 On the more familiar AWE measure, the latest single-month estimate for December has earnings growth at 4.5 per cent. HMRC's more timely RTI data record a different pattern and suggest that earnings growth eased in January, with early estimates of median pay for payrolled employees up by 4.0 per cent, compared to the December estimate of 5 per cent. The measure derived from the National Accounts that we use suggests that earnings growth in the fourth quarter was lower at 2.4 per cent.

2.80 In 2021, we expect earnings growth to increase, reflecting the extension of government support to households. Earnings growth rises further in 2022, with an increase in productivity growth and falling slack in the labour market. This is unwound in 2023, with earnings growth broadly recovering thereafter to 3.5 per cent at the forecast horizon.

2.81 Relative to our March 2020 forecast, the level of average earnings in 2024 is 6 per cent lower (Chart 2.17). Around 2 percentage points of that difference reflects the assumed medium-term productivity scarring and 1½ percentage points from lower whole economy inflation. We also assume that labour market slack and the need for some firms to repair balance sheets by rebuilding margins will weigh on the labour share of income.

Chart 2.16: Average earnings growth

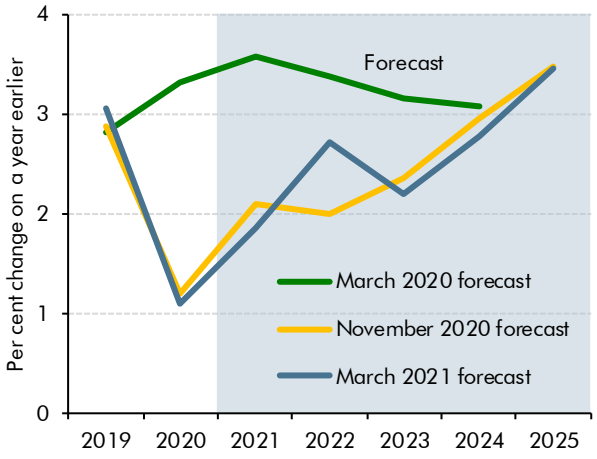
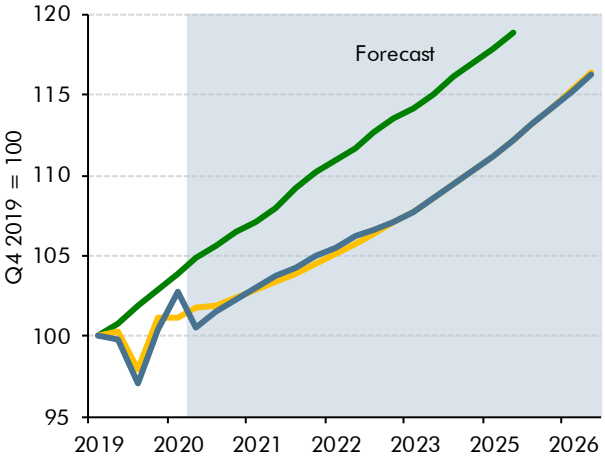


Chart 2.17: Average earnings level



Source: ONS, OBR

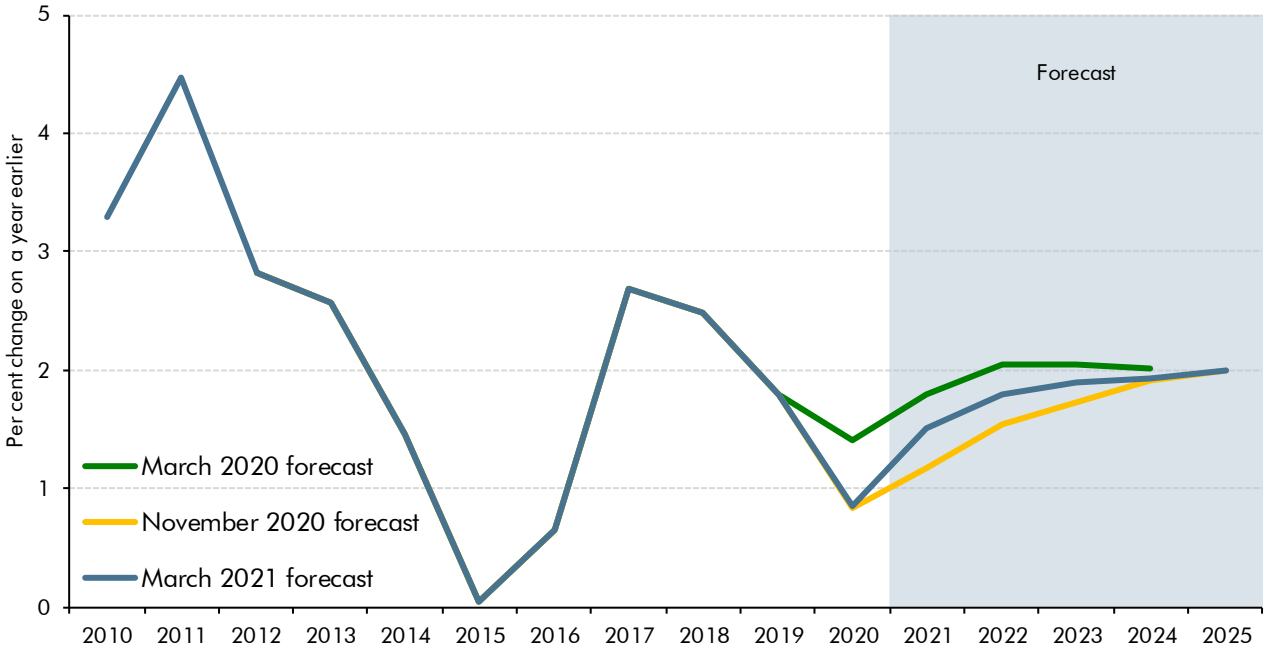
Prospects for inflation

2.82 CPI inflation has fallen well below target in the months since the pandemic broke, reaching 0.5 per cent in the fourth quarter of 2020. The decline reflects falls in fuel and utility prices, plus the cut in VAT for the hospitality and tourism sector. We assume that inflation will pick up over the first half of 2021, in large part as the sharp falls in oil and fuel prices seen early in the pandemic fall out of the annual comparison. The Ofgem energy price cap is set to increase in April this year, which also contributes to the rise.

2.83 Over the remainder of 2021 and 2022, we expect CPI inflation to remain a little below the MPC's 2 per cent target, as the rise in unemployment dampens wage growth. This is sufficient to outweigh the upward pressure from the rise in utility prices and the pass-through of higher oil prices into fuel prices, the latter of which is also moderated by the Government's customary decision to freeze fuel duty for a year. The effects of Brexit-related trade disruption at the start of the year also generate some cost pressures for UK importers, which we assume are largely passed through to consumers by the end of 2021, adding around a quarter of a percentage point to CPI inflation. The impact of new CPI weights provides a partial offset, as the relative weight on services (where we assume higher inflation over the medium term, relative to goods) has been reduced in the latest ONS release.

2.84 As health restrictions are eased and the economy recovers over the medium term, we assume that spare capacity in the economy is eroded, in part due to the bringing forward of investment following the announcement of the super-deduction. Inflation remains close to target from the middle of 2022 onwards and we continue to assume that the MPC will be successful in setting policy so as to keep it there over the medium term. The overall path for CPI inflation is somewhat higher than our November forecast.

Chart 2.18: CPI inflation



Source: ONS, OBR

RPI inflation

2.85 RPI inflation averaged 1.1 per cent in the fourth quarter of 2020, 0.2 percentage points higher than our November forecast. Alongside the 2020 Spending Review, the Government and UK Statistics Authority published their response to the consultation on the timing of reform to the RPI, confirming that reform will not be implemented before 2030. Until then, we will continue with our current methodology of adding a 'wedge' to our CPI inflation forecast to create RPI inflation.

2.86 Over the near term, movements in our forecast for the RPI wedge broadly reflect our assumptions for house price growth, which affect the housing depreciation component of RPI. RPI inflation peaks at 3.1 per cent by the second quarter of 2021, reflecting the sharp rise in house prices in the preceding quarters, in part reflecting heightened market activity ahead of the original tax holiday deadlines. RPI inflation falls back to 2 per cent over mid-2022, in line with our assumption that house prices will fall back as the labour market deteriorates. RPI inflation gradually reaches around 3 per cent in 2025, consistent with our current estimate of the long-term wedge between CPI and RPI inflation.

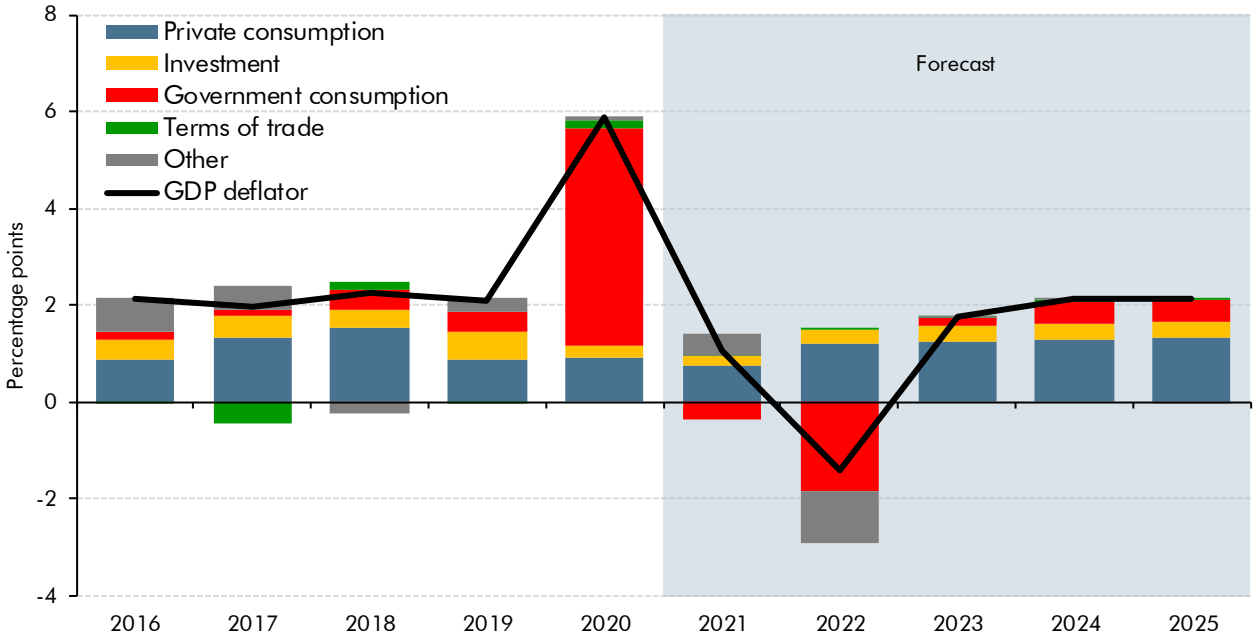
GDP deflator

2.87 The GDP deflator is a broad measure of prices in the domestic economy. It reflects the prices of all goods and services included in GDP, including those relating to private and government consumption, investment and the relative price of exports to imports (the 'terms of trade'). GDP deflator inflation rose sharply to 5.9 per cent in 2020, almost entirely driven by a rapid rise in the government consumption deflator. As discussed in Box 2.4 above, this reflects the sharp fall in measured real government output over the lockdown period, set alongside sharply rising nominal expenditure.

2.88 GDP deflator inflation is expected to fall back to 1.1 per cent in 2021, higher than our November forecast, reflecting the additional impact of the January lockdown on education and health output. The private consumption deflator remains subdued in the near term, due to the same factors affecting our CPI forecast. GDP deflator inflation then returns to around 2.1 per cent in 2024, once the sharp movements in government output fall out of the calculation and CPI inflation returns close to target.

2.89 The Government has chosen to link its departmental resource spending plans to our forecast for GDP deflator inflation from a 2021-22 fiscal year base. On this measure, it is down 1.0 percentage points in 2022-23, with little further change thereafter. The government consumption deflator is by far the largest contribution to this revision, reflecting the downward revision to government output during 2021 (in line with the imposition of further health restrictions over the lockdown period) which boosts the deflator in 2021-22, leaving a negative base effect on annual growth in 2022-23.

Chart 2.19: Contributions to GDP deflator inflation

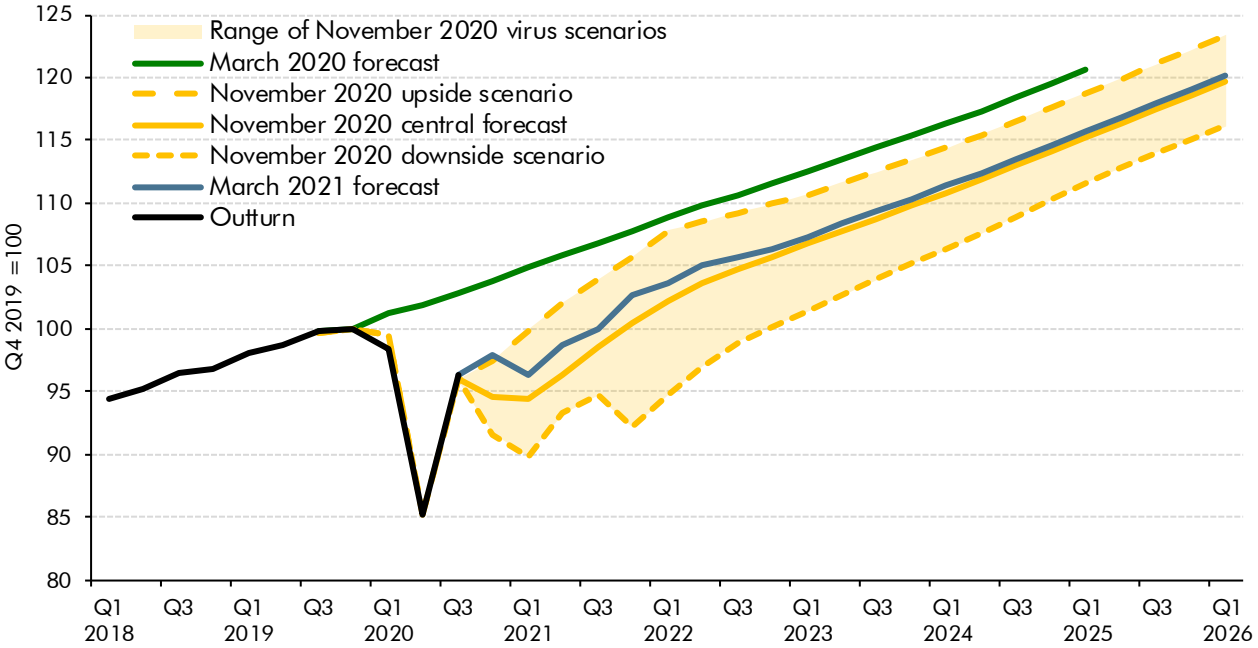


Source: ONS, OBR

Nominal GDP forecast and scenarios

2.90 Nominal GDP fell sharply in 2020, by 4.8 per cent (Chart 2.20). Falls in nominal (as opposed to real) GDP have been unusual in the post-war period, with the smaller fall of 2.6 per cent recorded in 2009 being the only previous decline. The recovery in real activity and inflation causes nominal GDP to rebound this year and next, before settling at pre-pandemic growth rates. Relative to our March 2020 forecast, that leaves nominal GDP around 4 per cent lower in the medium term. Roughly three-quarters of that shortfall is attributable to real GDP scarring, with the remainder reflecting a lower GDP deflator.

Chart 2.20: Nominal GDP



Source: ONS, OBR

Income composition of nominal GDP growth

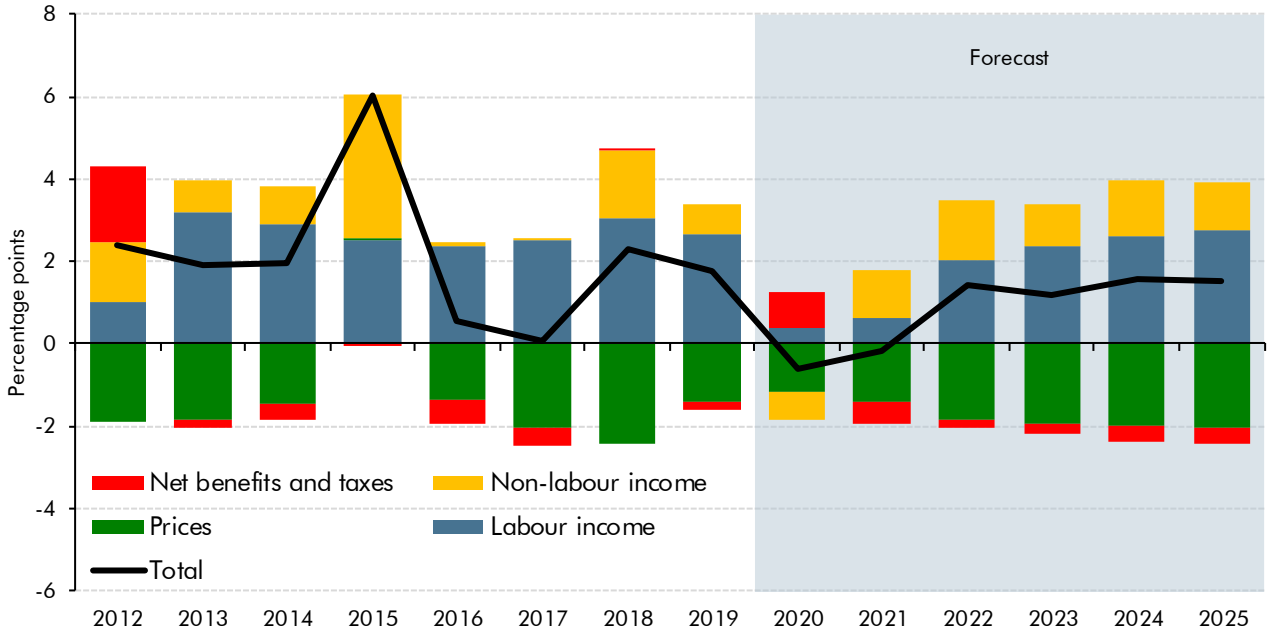
Households

2.91 Real household disposable income is forecast to have fallen in 2020, and then expected to be little changed in 2021 (Chart 2.21). The main component of this is labour income, which had contributed 2.7 percentage points to income growth in 2019 but this slowed to just 0.4 and 0.6 percentage points in 2020 and 2021 respectively. This slowdown reflects the rise in unemployment and the hit to average earnings growth associated with the pandemic. That is despite the support provided by the CJRS and SEISS. Support to household incomes in 2020 is also provided by the provision of higher benefits, while taxes on income and wealth impose less of a drag. Non-labour income, which includes household dividends that are expected to have fallen sharply last year, falls in 2020 but starts to recover in 2021. From 2022 onwards, household income growth picks up to an average of 1.4 per cent, driven by stronger labour income growth.

2.92 The impact of the economic slowdown has been very uneven across households. Higher earners have generally stayed working, spent less and saved more.[18] In contrast, lower income households have been more at risk of losing their job or being furloughed, and have been more likely to run down their savings in order to maintain their consumption. The implications for future consumption are discussed in Box 2.6.

[18] *The living standards outlook 2021*, January 2021, Resolution Foundation.

Chart 2.21: Contributions to real household income growth



Source: ONS, OBR

Corporate profits

2.93 Private non-oil non-financial profits are forecast to have fallen 3.2 per cent in 2020, despite support from business grants. We expect profits to fall again in the near term following the reimposition of lockdown, although somewhat offset by the Government's announcement on further business grants, leaving profits growth broadly flat in 2021. In the medium term, they recover as the profit share of GDP rises from 15.8 per cent in 2021 to an average of 16.5 per cent from 2023 onwards.

The housing market

2.94 House prices have proved resilient during the pandemic. At its low point in April 2020, annual house price inflation dropped to 0.7 per cent, but has picked up sharply since then, reaching 8.5 per cent in December (the highest rate since October 2014). In part, the strength of house prices is likely to be due to the smaller impact of the pandemic on the incomes of high earners, who typically account for an outsized share of home purchases. Indeed, housing might have provided one outlet for those that have built up large unanticipated savings due to restrictions on social consumption. The announced tax holidays for property purchases are likely to have supported house prices too.

2.95 Short-term indicators suggest that house price inflation will moderate over the coming months. Average prices recorded from mortgage approvals data fell on a month earlier in January 2021 and the latest RICS survey suggests that growth in new demand has been moderating alongside weaker expectations for price growth. We therefore expect prices to fall on a quarterly basis over the second half of 2021 and 2022. However, our expectation for the level of house prices in 2021 and 2022 is 10 per cent higher on average than in November, reflecting the strength in recent outturn data, stronger household income growth

– supported by additional fiscal support including the extension of the CJRS – and a smaller expected rise in unemployment.

2.96 Over the medium term, house price inflation picks up to historically more typical rates that are a little higher than earnings growth, averaging 3.0 per cent a year from 2023 onwards. This rising path for the ratio of house prices to earnings in the second half of the forecast leads to the ratio broadly returning to its pre-crisis level by 2024. The level of house prices at the forecast horizon is similar to our projection from November.

Chart 2.22: House price forecast

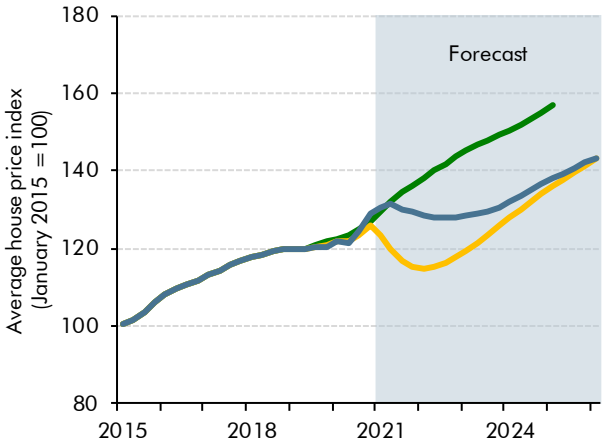
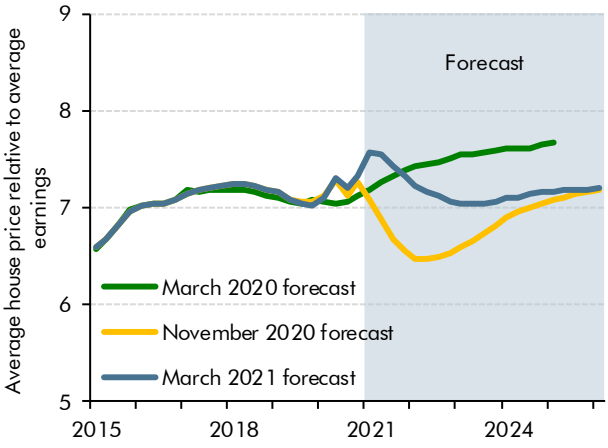


Chart 2.23: House price to earnings ratio



Source: ONS, OBR

2.97 Residential property transactions fell sharply during the first lockdown but rebounded once restrictions had been eased (Chart 2.24). The stamp duty holiday has boosted transactions despite the tightening of health restrictions during the fourth quarter, with outturns coming in above our November forecast. The extension of the stamp duty holiday until the end of September means that some of the forestalling ahead of the previous March end date is now unlikely to happen, while some forestalling activity will take place in the second and third quarter of this year instead. This causes transactions to dip towards the end of the year. Transactions are then expected to rise back gradually to a level consistent with longer-term average rates of housing market turnover.

Chart 2.24: Residential property transactions

Source: HMRC, OBR

2.98 As in our November forecast, we continue to assume that commercial property is more adversely affected than residential property by the changes triggered by the pandemic over the medium term. We use the IPF's Autumn consensus forecast alongside the latest tax receipts data to inform our near-term forecast, so we assume that commercial prices will have fallen by 15.6 per cent in 2020 and will grow by only 5.5 per cent in 2021. We then assume that prices recover slowly, so that by the forecast horizon they are 1.7 per cent below the March 2020 forecast.

2.99 Commercial property transactions are also assumed to follow a similar path to our November 2020 central forecast. Following the initial hit to transactions seen in the first two quarters of 2020, and the strong bounce back in the third and fourth, we assume commercial property transactions grow steadily across the forecast, so that by 2024-25 transactions are only slightly below our March forecast.

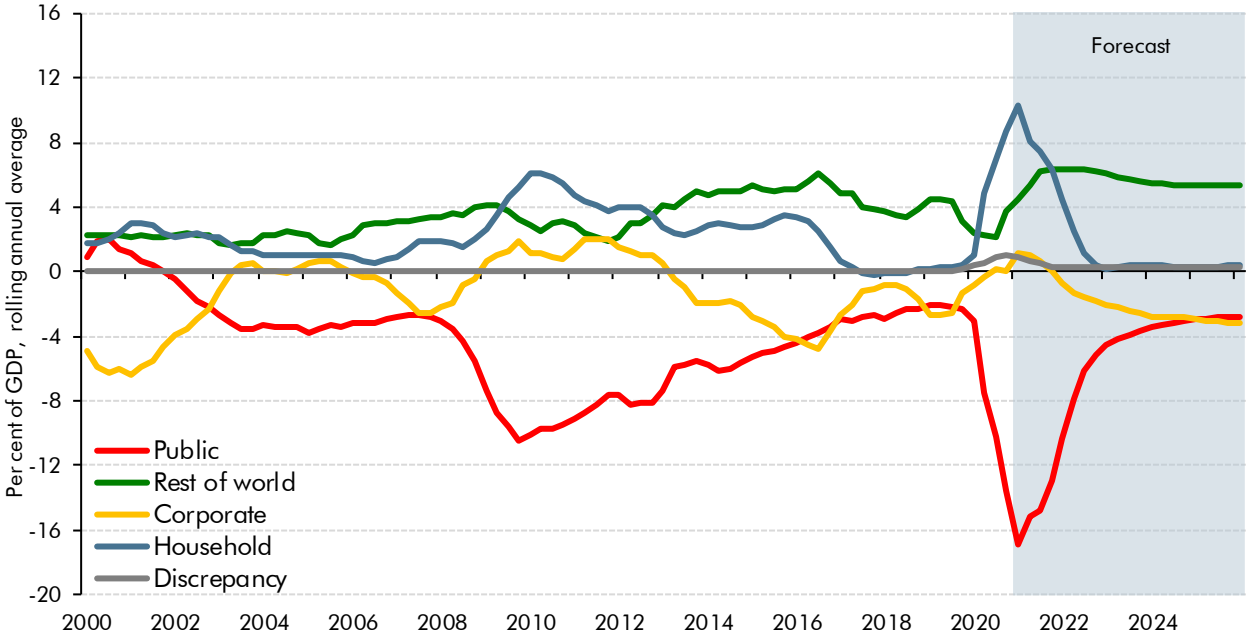
Sectoral net lending

2.100 In the National Accounts framework that underpins our economy forecast, the income and expenditure of the different sectors of the economy imply a path for each sector's net lending to, or borrowing from, the others. In practice, ONS estimates of sectoral net lending do not sum precisely to zero, reflecting differences between the income and expenditure measures of GDP (the 'statistical discrepancy'). Our standard practice is to assume that this difference remains flat over the forecast period from the most recent data.

2.101 This framework is helpful for understanding the broad flows of money in the economy as a result of the pandemic and the huge fiscal support provided in response (see Box 2.6). The spike in government net borrowing to around 14 per cent of GDP in 2020 means that

household and corporate incomes have not fallen nearly as much as their expenditure or output (Chart 2.25). The household financial surplus rises to a historically high level around 9 per cent of GDP in 2020, while the corporate balance moves from deficit into a small surplus (of 0.1 per cent of GDP). These imbalances persist into 2021 as restrictions and support remain in place, though to a lesser degree. Thereafter, household and corporate spending rise more into line with income, and government borrowing falls. Over the medium term, sectoral net lending positions return to more usual levels, but significant fiscal and current account deficits (rest of world surplus) persist.

Chart 2.25: Sectoral net lending



Source: ONS, OBR

Comparison with external forecasters

2.102 In this section, we compare our latest projections with those of selected outside forecasters. The differences between our forecasts and those of external forecasters mostly reflect uncertainty around the speed of recovery and the degree of medium-term scarring, and our forecast incorporates the new Budget measures.

2.103 The latest Bank of England forecast, set out in its February 2021 *Monetary Policy Report*, is more optimistic about the outlook for GDP than our forecast – and indeed than most other forecasters – sitting at the top of the range of external estimates compiled by the Treasury (Chart 2.26). The Bank expects a stronger recovery in GDP growth in 2021 than we do and for the economy to reach its pre-pandemic level by the start of 2022 – one quarter earlier than our forecast.

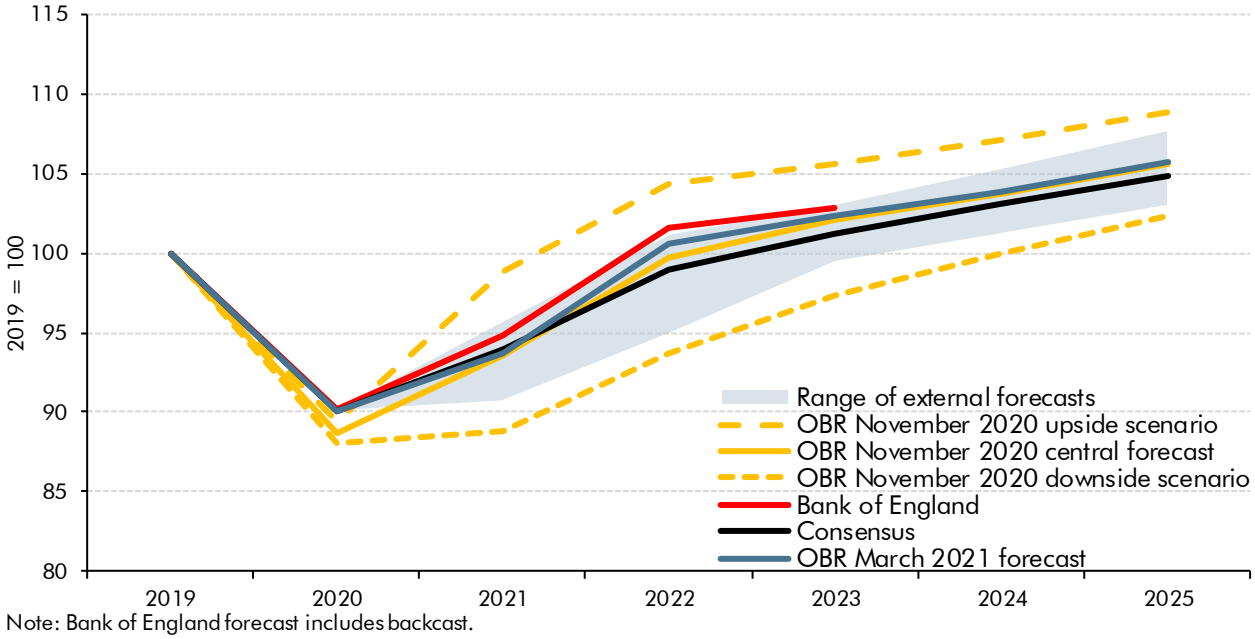
2.104 The difference between our GDP forecasts and the Bank's is driven not just by different judgements about the speed of the near-term recovery, but also about the degree of economic scarring caused by the pandemic. The Bank assumes a hit to potential output of

1¾ per cent, in comparison to our assumption of a 3 per cent hit, which more than explains the 0.5 per cent gap between our forecasts for the level of GDP in 2023.

2.105 In comparison to the range of external forecasters, we are broadly in line with the external consensus in the short term with both expecting growth of around 4 per cent in 2021. Our GDP path is slightly above the external consensus in the medium term. Our upside scenario from November is above that of the most optimistic external forecaster, while our November downside scenario is below the most pessimistic external forecast, suggesting they continue to provide a reasonable range for plausible future outcomes.

2.106 The Bank's modal CPI inflation forecast is higher than ours, ending at 2.0 per cent in the fourth quarter of 2023 compared to our forecast of 1.9 per cent. This is partly driven by a faster narrowing of the output gap.

Chart 2.26: Real GDP forecast comparison



Note: Bank of England forecast includes backcast.
Source: Bank of England, HM Treasury, ONS, OBR

Table 2.8: Comparison with external forecasters

	Per cent					
	2020	2021	2022	2023	2024	2025
OBR (March 2021)						
GDP growth	-9.9	4.0	7.3	1.7	1.6	1.7
CPI inflation	0.9	1.5	1.8	1.9	1.9	2.0
Unemployment	4.5	5.6	5.9	5.1	4.5	4.4
Bank of England (February 2021)[1]						
GDP growth (mode)[2]	-9.8	5.1	7.2	1.3		
CPI inflation (mode)[3]	0.9	1.9	2.2	2.0		
Unemployment[4]	5.1	6.6	5.4	5.0		
NIESR (February 2021)						
GDP growth	-9.9	3.4	4.3	2.4	1.9	1.7
CPI inflation	0.8	1.0	1.9	1.6	1.7	1.8
Unemployment	4.6	6.5	7.1	6.0	5.3	4.9
IMF (January 2021)[5]						
GDP growth	-10.0	4.5	5.0			
CPI inflation	0.8	1.2	1.7	1.9	2.0	2.0
Unemployment	5.4	7.4	6.1	5.2	4.5	4.2

[1] Forecast based on market interest rates.

[2] Includes backcast.

[3] Fourth quarter year-on-year growth rate.

[4] Fourth quarter unemployment rate.

[5] GDP growth for 2020-22 uses January forecast. Others from October forecast.

Detailed summary of our central forecast

Table 2.9: Detailed summary of our March 2021 forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
UK economy							
Gross domestic product (GDP)	1.4	- 9.9	4.0	7.3	1.7	1.6	1.7
GDP per capita	0.9	-10.4	3.8	6.9	1.4	1.3	1.5
GDP level (2019=100)	100.0	90.1	93.7	100.5	102.3	103.9	105.7
Nominal GDP	3.6	-4.8	5.2	5.8	3.5	3.7	3.9
Output gap (per cent of potential output)	0.1	-0.6	-1.1	-0.4	-0.2	-0.1	-0.1
Expenditure components of GDP							
Domestic demand	1.6	-10.5	7.6	7.3	1.4	1.5	1.8
Household consumption[1]	1.1	-11.0	2.9	11.1	1.2	1.8	1.3
General government consumption	4.0	-5.7	12.0	1.4	0.8	2.3	2.1
Fixed investment	1.5	-8.7	3.7	10.8	2.6	-0.5	3.3
Business	1.1	-10.7	-2.2	16.6	3.0	-2.3	5.1
General government[2]	4.0	3.8	17.8	4.2	1.9	1.4	1.2
Private dwellings[2]	-1.9	-5.5	15.0	5.1	5.4	2.7	1.2
Change in inventories[3]	0.1	-0.7	2.4	-1.6	0.0	0.0	0.0
Exports of goods and services	2.7	-16.7	0.2	8.1	0.3	-0.5	-0.5
Imports of goods and services	2.7	-18.1	12.5	8.1	-0.7	-0.5	0.0
Balance of payments current account							
Per cent of GDP	-3.1	-3.7	-6.4	-6.3	-5.7	-5.4	-5.4
Inflation							
CPI	1.8	0.9	1.5	1.8	1.9	1.9	2.0
RPI	2.6	1.5	2.5	2.0	2.4	2.7	3.0
GDP deflator at market prices	2.1	5.9	1.1	-1.4	1.7	2.1	2.1
Labour market							
Employment (million)	32.8	32.7	32.3	32.4	32.8	33.1	33.2
Productivity per hour	0.2	0.5	-0.6	1.2	1.1	1.2	1.6
Wages and salaries	3.7	1.7	1.4	2.6	3.1	3.4	3.6
Average earnings[4]	3.0	1.1	1.9	2.7	2.2	2.8	3.5
LFS unemployment (% rate)	3.8	4.5	5.6	5.9	5.1	4.5	4.4
Unemployment (million)	1.3	1.5	1.9	2.0	1.8	1.6	1.5
Household sector							
Real household disposable income	1.8	-0.6	-0.2	1.4	1.2	1.6	1.5
Saving ratio (level, per cent)	6.5	16.8	14.1	6.0	5.9	5.8	6.0
House prices	1.0	3.4	5.1	-1.7	0.8	3.9	4.3
World economy							
World GDP at purchasing power parity	2.8	-3.5	5.5	4.2	3.8	3.6	3.5
Euro area GDP	1.3	-7.2	4.2	3.6	2.2	1.7	1.4
World trade in goods and services	1.0	-9.6	8.1	6.3	4.3	3.8	3.6
UK export markets[5]	1.8	-9.1	7.9	6.0	4.2	3.7	3.5

[1] Includes households and non-profit institutions serving households.

[2] Includes transfer costs of non-produced assets.

[3] Contribution to GDP growth, percentage points.

[4] Wages and salaries divided by employees.

[5] Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

Table 2.10: Detailed summary of changes since March 2020

	Percentage point difference, unless otherwise stated					
	Outturn	Forecast				
	2019	2020	2021	2022	2023	2024
UK economy						
Gross domestic product (GDP)	0.0	-11.0	2.3	5.8	0.5	0.2
GDP per capita	0.1	-10.9	2.4	5.8	0.5	0.2
GDP level (2019=100)[1]	0.0	-11.0	-9.1	-3.8	-3.4	-3.2
Nominal GDP	0.3	-7.9	1.4	2.2	0.2	0.2
Output gap (per cent of potential output)	0.0	-0.5	-1.4	-0.8	-0.4	-0.2
Expenditure components of GDP						
Domestic demand	0.1	-11.7	5.5	5.7	-0.2	-0.2
Household consumption[2]	-0.2	-12.1	1.7	9.9	-0.2	0.3
General government consumption	0.4	-9.4	9.2	-0.8	-1.1	0.1
Fixed investment	1.1	-7.9	0.3	7.9	0.6	-2.3
Business	0.8	-10.6	-4.1	13.5	0.6	-4.6
General government[3]	1.9	1.9	6.9	-0.3	0.1	0.2
Private dwellings[3]	-1.6	-1.3	13.4	3.5	4.1	1.5
Change in inventories[4]	0.0	-0.5	2.2	-1.6	0.0	0.0
Exports of goods and services	-1.1	-16.1	0.7	8.7	1.4	0.5
Imports of goods and services	-0.8	-17.9	12.1	7.9	-0.9	-0.6
Balance of payments current account						
Per cent of GDP	0.8	0.0	-2.4	-2.3	-1.7	-1.4
Inflation						
CPI	0.0	-0.6	-0.3	-0.3	-0.2	-0.1
RPI	0.0	-0.7	-0.2	-1.0	-0.6	-0.1
GDP deflator at market prices	0.3	3.9	-0.9	-3.6	-0.3	0.0
Labour market						
Employment (million)	0.0	-0.3	-0.8	-0.8	-0.5	-0.3
Productivity per hour	0.3	-0.4	-1.8	0.0	0.0	0.0
Wages and salaries	0.2	-2.0	-2.4	-1.0	-0.2	0.2
Average earnings[5]	0.2	-2.2	-1.7	-0.7	-0.9	-0.3
LFS unemployment (% rate)	0.0	0.6	1.8	2.0	1.1	0.4
Unemployment (million)	0.0	0.2	0.6	0.7	0.4	0.1
Household sector						
Real household disposable income	1.0	-1.7	-1.7	0.1	-0.2	0.2
Saving ratio (level, per cent)	0.8	10.2	7.1	-1.2	-1.3	-1.4
House prices	-0.5	0.1	-1.9	-7.5	-3.8	0.2
World economy						
World GDP at purchasing power parity	-0.2	-6.4	1.9	0.7	0.2	0.0
Euro area GDP	0.1	-8.3	2.8	2.2	0.9	0.4
World trade in goods and services	-0.1	-11.5	4.2	2.7	0.6	0.1
UK export markets[6]	0.3	-10.7	4.5	2.7	0.8	0.3

[1] Per cent change since March 2020.

[2] Includes households and non-profit institutions serving households.

[3] Includes transfer costs of non-produced assets.

[4] Contribution to GDP growth, percentage points.

[5] Wages and salaries divided by employees.

[6] Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

Table 2.11: Detailed summary of changes since November 2020

	Percentage point difference, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
UK economy							
Gross domestic product (GDP)	0.2	1.4	-1.5	0.7	-0.6	-0.1	0.0
GDP per capita	0.2	1.4	-1.5	0.7	-0.6	-0.1	0.0
GDP level (2019=100)[1]	0.0	1.6	0.2	0.8	0.2	0.1	0.1
Nominal GDP	0.2	0.6	1.4	-1.0	-0.6	-0.1	-0.1
Output gap (per cent of potential output)	0.0	0.0	0.0	0.3	0.1	0.0	0.0
Expenditure components of GDP							
Domestic demand	0.2	3.5	-2.6	0.6	-1.0	-0.5	-0.1
Household consumption[2]	0.2	4.1	-4.6	1.4	-0.4	0.6	-0.2
General government consumption	-0.1	2.2	-9.1	5.1	-0.4	-0.1	0.1
Fixed investment	0.0	5.2	0.4	0.7	-4.2	-5.0	-0.3
Business	0.0	7.4	-3.5	2.9	-6.8	-8.5	0.5
General government[3]	0.0	-3.2	12.3	-1.8	-0.8	0.0	-0.3
Private dwellings[3]	0.0	6.4	-0.3	-1.6	-1.7	-1.3	-1.6
Change in inventories[4]	0.1	-0.7	2.4	-1.6	0.0	0.1	0.1
Exports of goods and services	-0.1	-2.9	-1.4	5.0	0.4	0.0	-0.1
Imports of goods and services	-0.5	3.7	-4.7	4.3	-1.2	-1.3	-0.4
Balance of payments current account							
Per cent of GDP	1.2	-1.7	-1.1	-1.2	-0.8	-0.4	-0.4
Inflation							
CPI	0.0	0.0	0.3	0.2	0.2	0.0	0.0
RPI	0.0	0.0	1.1	0.5	-0.2	-0.2	0.0
GDP deflator at market prices	0.0	-1.0	2.8	-1.6	0.0	0.0	0.0
Labour market							
Employment (million)	0.0	0.0	0.4	0.2	0.1	0.0	0.0
Productivity per hour	0.2	-0.4	-0.8	0.8	0.0	0.2	0.1
Wages and salaries	0.2	-0.2	1.0	0.2	-0.5	-0.5	-0.1
Average earnings[5]	0.2	-0.1	-0.2	0.7	-0.2	-0.2	0.0
LFS unemployment (% rate)	0.0	0.1	-1.2	-0.6	-0.3	0.0	0.0
Unemployment (million)	0.0	0.0	-0.4	-0.2	-0.1	0.0	0.0
Household sector							
Real household disposable income	0.2	0.0	0.6	-0.3	-0.8	0.1	0.2
Saving ratio (level, per cent)	0.0	-3.2	0.4	-1.0	-1.4	-1.8	-1.5
House prices	-0.1	0.8	8.6	0.9	-5.0	-3.1	-1.4
World economy							
World GDP at purchasing power parity	0.0	0.9	0.4	0.0	0.0	-0.1	0.0
Euro area GDP	0.0	1.0	-1.0	0.4	0.1	0.0	0.0
World trade in goods and services	0.0	0.9	-0.2	0.9	0.0	0.0	0.0
UK export markets[6]	0.1	1.5	-0.9	0.4	0.0	0.0	0.0

[1] Per cent change since November 2020.

[2] Includes households and non-profit institutions serving households.

[3] Includes transfer costs of non-produced assets.

[4] Contribution to GDP growth, percentage points.

[5] Wages and salaries divided by employees.

[6] Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

Table 2.12: Determinants of the fiscal forecast

	Percentage change on previous year, unless otherwise specified							*Growth*
	Outturn	Forecast						*over*
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	*forecast*
GDP and its components								
Real GDP	0.4	-11.5	9.5	5.0	1.5	1.6	1.7	6.8
Nominal GDP[1]	2.8	-5.7	8.0	4.9	3.5	3.8	3.9	19.2
Nominal GDP (£ billion)[1,2]	2,224	2,097	2,264	2,375	2,459	2,552	2,652	428
Nominal GDP (centred end-March £bn)[1,3]	2,131	2,194	2,331	2,413	2,505	2,600	2,703	572
Wages and salaries[4]	3.7	0.9	2.0	2.9	3.0	3.6	3.6	17.0
Non-oil PNFC profits[4,5]	1.0	-3.6	-0.1	9.5	4.6	3.9	3.8	18.9
Consumer spending[4,5]	2.5	-9.7	4.1	13.1	3.2	3.8	3.3	17.6
Prices and earnings								
GDP deflator	2.2	7.1	-1.6	-0.1	2.0	2.1	2.1	11.9
RPI	2.6	1.3	2.6	2.1	2.5	2.8	3.0	15.1
CPI	1.7	0.6	1.7	1.9	1.9	2.0	2.0	10.5
Average earnings[6]	3.0	0.7	2.4	2.5	2.1	3.1	3.5	15.3
'Triple-lock' guarantee (September)	4.0	2.5	4.6	2.7	2.5	2.6	3.5	19.8
Key fiscal determinants								
Employment (million)	32.9	32.5	32.3	32.5	32.9	33.1	33.3	0.4
Output gap (per cent of potential output)	0.1	-0.9	-0.9	-0.3	-0.2	-0.1	0.0	-0.1
Financial and property sectors								
Equity prices (FTSE All-Share index)	3,979	3,484	3,958	4,150	4,297	4,459	4,634	655
HMRC financial sector profits[1,5,8]	1.3	-10.0	8.0	5.0	1.8	1.9	2.0	7.9
Residential property prices[9]	1.0	4.8	2.8	-1.3	1.6	4.3	4.1	17.3
Residential property transactions (000s)[10]	1,172	1,170	1,249	1,340	1,356	1,367	1,378	206
Commercial property prices[10]	4.6	-8.7	-0.9	0.1	1.8	2.1	2.2	-3.8
Commercial property transactions[10]	-6.6	-19.5	10.9	4.9	3.9	3.8	3.4	4.5
Oil and gas								
Oil prices ($ per barrel)[5]	64.1	42.3	54.4	52.0	51.3	52.2	53.3	-10.8
Oil prices (£ per barrel)[5]	50.2	33.2	38.8	38.0	37.5	38.2	38.9	0.0
Gas prices (p/therm)[5]	34.7	24.8	47.0	44.1	45.0	45.9	46.8	0.0
Oil production (million tonnes)[5]	48.7	44.6	41.3	38.8	36.5	34.4	32.2	-16.5
Gas production (billion therms)[5]	13.1	13.0	12.5	12.4	11.2	10.2	9.2	-3.9
Interest rates and exchange rates								
Market short-term interest rates (%)[11]	0.8	0.1	0.0	0.1	0.2	0.4	0.5	-0.2
Market gilt rates (%)[12]	0.7	0.4	0.6	0.7	0.8	0.9	1.0	0.3
Euro/Sterling exchange rate (€/£)	1.14	1.12	1.13	1.13	1.13	1.13	1.13	-0.02

[1] Non-seasonally adjusted.
[2] Denominator for receipts, spending and deficit forecasts as a per cent of GDP.
[3] Denominator for net debt as a per cent of GDP.
[4] Nominal. [5] Calendar year.
[6] Wages and salaries divided by employees.
[7] Adjusted for timing effects.
[8] HMRC Gross Case 1 trading profits.
[9] Outturn data from ONS House Price Index.
[10] Outturn data from HMRC information on stamp duty land tax.
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

Table 2.13: Changes in determinants of the fiscal forecast since March 2020

	Percentage point difference, unless otherwise specified					
	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
GDP and its components						
Real GDP	-0.6	-12.9	7.8	3.6	0.2	0.2
Nominal GDP[1]	0.0	-9.1	4.1	1.4	0.2	0.1
Nominal GDP (£ billion)[1,2]	-4.6	-207.8	-129.4	-103.2	-102.4	-102.4
Nominal GDP (centred end-March £bn)[1,3]	-132.0	-154.3	-105.2	-105.7	-101.3	-99.5
Wages and salaries[4]	0.2	-2.9	-1.7	-0.9	-0.2	0.2
Non-oil PNFC profits[4,5]	-3.2	-6.2	-3.0	6.2	1.2	-0.1
Consumer spending[4,5]	-0.1	-12.0	1.0	9.8	-0.3	0.3
Prices and earnings						
GDP deflator	0.3	5.1	-3.7	-2.3	0.0	0.0
RPI	0.0	-0.8	-0.4	-0.9	-0.5	0.0
CPI	0.0	-0.7	-0.2	-0.2	-0.1	-0.1
Average earnings[6]	0.1	-2.9	-0.9	-0.9	-0.9	-0.1
'Triple-lock' guarantee (September)	0.0	-0.7	0.9	-0.7	-0.7	-0.4
Key fiscal determinants						
Employment (million)	0.0	-0.5	-0.8	-0.7	-0.5	-0.3
Output gap (per cent of potential output)	0.1	-1.0	-1.3	-0.7	-0.3	-0.1
Financial and property sectors						
Equity prices (FTSE All-Share index)	-86.0	-760.4	-450.8	-415.2	-420.7	-429.3
HMRC financial sector profits[1,5,8]	-0.2	-11.7	6.1	3.2	0.1	0.1
Residential property prices[9]	-0.6	0.6	-4.3	-6.8	-2.7	0.5
Residential property transactions (000s)[10]	-19.8	-88.4	-29.3	23.0	11.4	-6.0
Commercial property prices[10]	6.5	-7.3	-0.9	-0.6	-0.3	0.0
Commercial property transactions[10]	-1.5	-17.8	9.2	3.5	2.7	2.3
Oil and gas						
Oil prices ($ per barrel)[5]	0.0	-13.8	-0.5	-3.1	-4.9	-5.1
Oil prices (£ per barrel)[5]	0.1	-9.0	-1.8	-2.6	-3.8	-3.7
Gas prices (p/therm)[5]	0.0	-1.7	11.5	7.9	8.1	8.3
Oil production (million tonnes)[5]	-2.9	-6.4	-7.0	-7.1	-7.1	-7.2
Gas production (billion therms)[5]	0.2	0.0	0.0	0.6	0.0	-0.5
Interest rates and exchange rates						
Market short-term interest rates (%)[11]	0.0	-0.7	-0.8	-0.8	-0.7	-0.5
Market gilt rates (%)[12]	-0.1	-0.5	-0.3	-0.3	-0.2	-0.2
Euro/Sterling exchange rate (€/£)	0.0	0.0	-0.1	-0.1	-0.1	0.0

[1] Non-seasonally adjusted.
[2] Denominator for receipts, spending and deficit forecasts as a per cent of GDP.
[3] Denominator for net debt as a per cent of GDP.
[4] Nominal. [5] Calendar year.
[6] Wages and salaries divided by employees.
[7] Adjusted for timing effects.
[8] HMRC Gross Case 1 trading profits.
[9] Outturn data from ONS House Price Index.
[10] Outturn data from HMRC information on stamp duty land tax.
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

Table 2.14: Changes in determinants of the fiscal forecast since November 2020

	Percentage point difference, unless otherwise specified						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
GDP and its components							
Real GDP	0.1	1.3	-0.9	0.0	-0.4	-0.1	0.0
Nominal GDP[1]	0.3	1.0	0.8	-1.1	-0.3	-0.1	-0.1
Nominal GDP (£ billion)[1,2]	6.2	27.2	45.2	24.0	18.4	16.1	14.9
Nominal GDP (centred end-March £bn)[1,3]	24.0	32.3	37.3	16.9	17.9	14.9	13.6
Wages and salaries[4]	0.1	-0.4	1.9	-0.5	-0.7	-0.3	-0.1
Non-oil PNFC profits[4,5]	0.2	5.9	-1.1	-4.1	-1.3	0.2	0.0
Consumer spending[4,5]	0.2	4.4	-4.6	1.7	-0.3	0.6	-0.2
Prices and earnings							
GDP deflator	-0.3	0.3	1.2	-1.0	0.2	0.0	0.0
RPI	0.0	0.2	1.2	0.3	-0.3	-0.2	0.0
CPI	0.0	0.1	0.3	0.3	0.1	0.0	0.0
Average earnings[6]	0.1	-0.2	0.3	0.4	-0.3	-0.1	-0.1
'Triple-lock' guarantee (September)	0.0	0.0	0.5	0.2	0.0	-0.2	0.0
Key fiscal determinants							
Employment (million)	0.0	0.0	0.5	0.2	0.1	0.0	0.0
Output gap (per cent of potential output)	0.0	0.0	0.1	0.3	0.1	0.0	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	0.0	116.3	383.8	364.9	366.7	376.2	387.9
HMRC financial sector profits[1,5,8]	0.0	5.0	-2.0	-5.0	-0.1	-0.1	0.0
Residential property prices[9]	-0.2	2.5	8.4	-1.6	-5.0	-2.5	-1.4
Residential property transactions (000s)[10]	-0.1	59.1	-30.5	-6.2	2.4	3.1	3.2
Commercial property prices[10]	1.3	0.6	0.0	-1.6	-0.2	0.1	0.1
Commercial property transactions[10]	0.0	1.6	1.9	-1.0	-1.0	-1.0	-1.0
Oil and gas							
Oil prices ($ per barrel)[5]	0.0	0.7	10.3	6.1	4.2	4.2	4.3
Oil prices (£ per barrel)[5]	0.1	0.7	5.3	3.1	1.7	1.7	1.7
Gas prices (p/therm)[5]	0.0	-0.1	9.8	5.5	5.6	5.7	5.8
Oil production (million tonnes)[5]	-3.1	-6.4	-6.5	-6.2	-5.8	-5.4	-5.1
Gas production (billion therms)[5]	0.0	0.1	0.1	0.9	0.6	0.2	0.0
Interest rates and exchange rates							
Market short-term interest rates (%)[11]	0.0	0.0	0.1	0.1	0.1	0.2	0.2
Market gilt rates (%)[12]	0.0	0.1	0.2	0.2	0.2	0.2	0.2
Euro/Sterling exchange rate (€/£)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

[1] Non-seasonally adjusted.
[2] Denominator for receipts, spending and deficit forecasts as a per cent of GDP.
[3] Denominator for net debt as a per cent of GDP.
[4] Nominal. [5] Calendar year.
[6] Wages and salaries divided by employees.
[7] Adjusted for timing effects.
[8] HMRC Gross Case 1 trading profits.
[9] Outturn data from ONS House Price Index.
[10] Outturn data from HMRC information on stamp duty land tax.
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

3 Fiscal outlook

Introduction

3.1 This chapter:

- summarises our assumptions in respect of the **coronavirus pandemic** and associated public health restrictions and the **UK's exit from the EU** (from paragraph 3.6);
- explains the effects of **new policies announced since November 2020**, and the combined effect of all policies announced since the start of the pandemic, on the fiscal forecast (from paragraph 3.11);
- notes **classification issues** affecting our forecast (from paragraph 3.12);
- describes the outlook for **public sector receipts** (from paragraph 3.16) and **public sector expenditure** (from paragraph 3.65);
- presents forecasts for the key measures of the **fiscal deficit**, including headline and structural measures of the budget deficit (from paragraph 3.108);
- describes the outlook for the **public sector balance sheet** and for government lending to the private sector and other **financial transactions** (from paragraph 3.122); and
- summarises key **uncertainties and risks to the fiscal outlook**, including those related to how the pandemic unfolds and its lasting fiscal consequences (paragraph 3.146).

3.2 Further breakdowns of receipts and expenditure and other details of our forecast are provided in supplementary tables on our website. The forecasts in this chapter start from the estimates of 2019-20 outturn data published by the Office for National Statistics (ONS) on 19 February. We then present an in-year estimate for 2020-21 that makes use of ONS outturn data for April 2020 to January 2021. Finally, we present forecasts for 2021-22 to 2025-26. Given the size of the economic shock associated with the pandemic, comparisons are made with both our pre-virus March 2020 *Economic and fiscal outlook* (*EFO*) and our most recent *EFO* published in November.

3.3 The Foreword to this document describes the timetable that was followed in producing the forecasts presented here. In normal circumstances, the penultimate round of our iterative forecast process would provide the final opportunity to incorporate changes to the pre-measures forecast, in order to give the Chancellor a stable base to make policy decisions. At that point, we would condition our interest rate forecasts on a 10-day average of market participants' expectations. But, in this forecast, for Bank Rate and gilt yields, rather than using the 10-day average to 29 January, we have instead based our forecasts on the rates

prevailing on 5 February, after the Bank of England's February *Monetary Policy Report*. Interest rates have risen further since then, particularly over the past week – the implications of which are discussed in the debt interest section of this chapter. Given the rapidly changing environment, we also kept our pre-measures economy and fiscal forecasts open until the final round that was closed on 24 February, to allow us to include the most up-to-date public finance data and the latest information on the Government's 22 February Roadmap for the easing of public health restrictions over the coming months. At the same time, we also incorporated the fiscal policy measures announced in the Budget.

3.4 This fiscal forecast:

- Represents our **central view** of the path of the public finances, conditioned on the current policies of the Government, and assumptions about the path of the virus, public health measures, and associated fiscal support. As set out in Chapter 2, we see no meaningful way of attaching probabilities to those virus-related assumptions, which means that a central view *conditioned on these assumptions* cannot be interpreted as being a 'central forecast' in the conventional sense. The virus and associated public health policies could clearly take many other paths with different fiscal implications.

- Is based on **announced Government policy** on the indexation of rates, thresholds and allowances for taxes and benefits, and incorporates estimates of the effects of new policies announced since our previous forecast in November 2020.

- Focuses on official **'headline' fiscal aggregates** that exclude public sector banks.

3.5 As in our November *EFO*, it has been necessary to depart from our usual 'bottom-up' approach to identifying the indirect effects on the fiscal forecast of policy measures through their wider economic impact. As noted, we kept our final economy and fiscal forecast rounds open to incorporate pre-measures changes. This meant that the indirect effects of measures cannot simply be derived by comparing two forecast rounds and subtracting their direct effects. Instead, a top-down approach has been deployed using ready-reckoners that link receipts and spending changes to changes in nominal GDP and unemployment induced by the Budget fiscal package. While this is more broad-brush than our usual approach to distinguishing between forecast and policy changes, it should still provide a reasonable guide to how the Budget measures affect the fiscal position via their impact on the economy.

Coronavirus and EU exit assumptions

Coronavirus

3.6 Our assumptions concerning the course of the pandemic and its impact on the economy are set out in Chapter 2 (see paragraphs 2.2 to 2.13). Broadly speaking, in our central forecast we assume that health restrictions are gradually eased between now and June in line with the Government's Roadmap, which, together with growing immunity in the UK's population and the boost from further fiscal support measures announced in the Budget, allows economic activity to rebound over the coming months and to return to pre-pandemic levels by the middle of next year. We continue to assume that the virus has a lasting adverse

impact on the supply capacity of the economy in the medium term. Virus-related fiscal policy assumptions are summarised in the policy section below, with further detail in Annex A.

EU exit

3.7 The UK-EU Trade and Cooperation Agreement (TCA) was concluded on 24 December and came into force on 1 January. In our November *EFO*, we had assumed that such an agreement would be reached and, as a result, it has a relatively modest impact on our fiscal forecast. As we describe in Chapter 2, the terms of the TCA are broadly consistent with those of a typical free-trade agreement (FTA), which was basis for the broad-brush assumptions that underpinned our previous economic forecast.

3.8 Following the end of the Withdrawal Agreement on 31 December 2020, several previously announced policies have come into effect, including:

- In our November forecast, we included for the first time the impact from the **UK Global Tariff** (UKGT), the new 'most-favoured nation' tariff schedule. It replaced the EU's 'common external tariff' (CET) from 1 January. While the UKGT has lower average tariff rates than the CET, our forecast assumes that the resulting £1 billion a year loss in customs duties from non-EU imports will be more than offset by additional duties on those EU imports for which traders are unable, or choose not to, meet the terms of the TCA (perhaps due to difficulties in meeting rules of origin requirements or because the administration costs exceed the benefits). Evidence from other FTAs suggests that between 80 and 90 per cent of EU imports will arrive tariff-free under the terms of the TCA, but the remainder will generate around £1billion a year in additional customs duties. The Government has also now concluded and implemented new preferential agreements with third countries that the UK previously had agreements with as a member of the EU, including 64 free-trade agreements.

- The **UK Emissions Trading Scheme** (UK ETS) replaced its EU equivalent on 1 January and the Government published detailed guidance on 11 February. The TCA included a commitment for the UK and EU to "*cooperate on carbon pricing*" and to "*give serious consideration to linking their respective carbon pricing systems*". The UK ETS maintains many of the features of its EU equivalent, with the guidance confirming the auction reserve price. Uncertainties remain around the free level of allowances participants will receive under the scheme, with the Government intending to set these with reference to the EU's 'Phase IV' benchmarks, which will not be released until later in 2021. There is also uncertainty over how carbon prices in the UK will evolve once trading commences May 2021.

- A host of **VAT and duty-related policy changes** came into effect from 1 January. The Government abolished the VAT Retail Export Scheme and tax-free airside shopping to align the UK with WTO rules (it could alternatively have kept both and extended them to EU visitors). Exports of certain financial services to the EU became zero-rated for VAT, aligning treatment with exports to non-EU countries. Duty-free sales are now extended to passengers travelling to the EU, aligning the treatment with non-EU

travellers, while inbound UK travellers will now be subject to the same personal alcohol allowances as those coming from non-EU destinations, though the alcohol allowances have been increased around four-fold. Low-value consignment relief has been abolished and replaced by a new regime whereby an online seller or marketplace will instead become liable for UK VAT for parcels of up to £135 in value. Finally, a new UK version of the EU's tour operators margin scheme has been introduced, requiring operators to pay VAT on travel services within the UK, but introducing a zero-rate of VAT on EU travel services, to align with the rest of the world. All but the last of these was included in our November forecast, and their net impact is to lower receipts by around £0.3 billion a year.

- With the introduction of the Government's new **points-based immigration system** from 1 January, various immigration fees now apply to (non-Irish) EEA nationals. These include visa fees (varying by visa), the immigration health surcharge (costing £624 per year covered by a visa), and the immigration skills charge (which for larger employers costs £1,000 a year). The extension of these charges were all included in our November forecast.

- The **eligibility rules for accessing student finance in England** have changed. EU nationals domiciled in the UK, EEA or Switzerland who are not covered by the Withdrawal Agreements are no longer eligible for home-fee status and for various forms of financial support from Student Finance England for courses starting in or after academic year 2021-22.

3.9 There remains uncertainty in some areas where the Government's long-term policy is still being determined or is subject to ongoing negotiations. These include:

- **Financial services**, where the UK and EU have made a joint commitment to agree a 'memorandum of understanding' over the coming months that will establish a framework for regulatory cooperation. For now, the UK Government has unilaterally decided a package of equivalence decisions, allowing UK and EEA clients to continue their current activities in a number of areas. So far, the EU has granted four central bank exemption decisions, and time-limited equivalence decisions for central counterparties and central securities depositories.

- The TCA does not change the declaration requirements that the Government has set out in its **border operating model**. This introduces measures to ease the initial burden on businesses of new border controls by delaying their full implementation to 1 July. Customs processes on imports from the EU will be 'staged', so that from 1 January only importers of certain controlled goods or traders that HMRC has identified as high risk will be required to complete full declarations at the time of importation. Otherwise, declarations can be made up to 175 days after importation and payment made then. The border operating model also includes provisions for businesses to postpone their accounting of import VAT until they complete their VAT return.

- On 10 December 2020 the UK-EU Joint Committee that was tasked with overseeing the implementation of the **Northern Ireland protocol** published a series of decisions on how the protocol will operate. These included the creation of a new UK Trader Scheme to which businesses can self-declare when the goods they are moving from Great Britain to Northern Ireland are not 'at risk' of onward movement into the EU. This prevents them being subject to EU tariffs. The Joint Committee and HMRC commissioner decisions also included several temporary 'grace periods' requested by the UK Government. For example, supermarkets and their suppliers bringing agri-food into Northern Ireland from Great Britain have been granted a grace period until 1 April. A recent Government letter to the European Commission requesting an extension of certain grace periods to 2023 suggests uncertainty over the longer-term implementation of the protocol will continue for some time. The UK Government has separately set out arrangements for qualifying Northern Ireland goods to gain 'unfettered access' to Great Britain, in the initial phase granting that status to all goods in free circulation in NI, with further implementation later in 2021.

3.10 In Box 2.2 in Chapter 2, we discuss the short-term disruption at the UK's main ports for UK-EU trade since 1 January. There is little sign of this disruption affecting the public finances at this stage, but this will partly reflect the approach taken to phase in new border procedures – in particular the fact that import declarations and customs duties on most goods are not due until the middle of the year. But to the extent to which the disruption has hit firms' sales or raised their costs, it can be expected to feed through to receipts. However, distinguishing that effect from wider virus-related disruption will be very difficult.

Policy announcements

3.11 The three main policy elements to this Budget are the large sums of additional virus-related support in the near term, the measures designed to stimulate economic recovery over the next two years, and the significant tax rises in the later years of the forecast. Taking each of these in turn:

- The Government has increased its **virus-related support** to households and businesses by extending most of its main support schemes to cover the second wave of the pandemic. This Budget confirms an extra £3.3 billion of support in 2020-21, and announces a further £43.2 billion in 2021-22. The six-month extension to the Coronavirus Job Retention Scheme (CJRS) and two further rounds of grants under the Self-Employed Income Support Scheme (SEISS) account for around 80 per cent of the £26 billion of support to households, while the close to £20 billion of additional support to businesses comes largely from extensions to the business rates holiday, business grants and the temporary reduced rate of VAT for the hospitality and accommodation sectors. This takes the total cumulative cost of the support measures since the start of the pandemic to £344 billion (see Box 3.1).

- The most significant contributor to the **economic recovery measures** is the time-limited 130 per cent capital allowances super deduction that will be in place in 2021-22 and 2022-23. This is expected to cost £27 billion in total between 2021-22 to 2023-24,

with the direct cost sensitive to how successful it is in incentivising firms to invest more while it is in place. But since it largely brings forward planned investment from future years, it boosts receipts by the end of the forecast as investment then is lower than it would have been in the absence of the measure. There are more modest costs from the decision to extend from one to three the number of years that firms can carry back losses to offset against corporation tax, and the customary freezing of duty rates for fuel and alcohol. The launch of the 'Recovery Loan Scheme' to succeed the existing virus-related loan schemes also adds to recorded spending this year when the expected losses on the new scheme are scored.

- The **medium-term fiscal tightening** rises to £32 billion in the final year of the forecast (including the final-year effects of some of the rescue and recovery measures). Around half of that (£17.2 billion) is due to the 6 percentage point increase in the main rate of corporation tax from April 2023 (tempered by the reintroduction of the small profits rate). Around a quarter (£8.2 billion) is due to the freezing of the income tax personal allowance and the higher rate threshold in cash terms from April 2022 to the end of the forecast period. A seventh of the final year consolidation (£4.2 billion) is due to further planned cuts to pre-virus departmental spending totals.

Table 3.1: Summary of the total effect of Government decisions since November

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total effect of Government decisions	**-8.5**	**-53.5**	**0.0**	**19.1**	**31.5**	**36.4**
of which:						
Direct effect of scorecard policies	-6.0	-58.9	-7.8	13.1	25.0	29.7
Direct effect of non-scorecard policies	-3.0	0.0	2.3	2.0	2.4	2.6
Indirect effect of Government decisions	0.5	5.4	5.5	4.0	4.0	4.1
of which:						
Virus-related support measures	**-3.3**	**-43.2**	**1.3**	**-0.1**	**0.3**	**0.6**
of which:						
Support for households	-0.5	-27.2	1.1	-0.1	0.3	0.6
Support for business	-2.8	-16.0	0.1	0.0	0.0	0.0
Other measures	0.0	0.0	0.0	0.0	0.0	0.0
Economic recovery measures	**-5.6**	**-15.7**	**-15.3**	**-5.1**	**-0.5**	**0.0**
of which:						
Capital allowances super deduction	-1.7	-12.3	-12.7	-2.4	2.1	2.8
Losses carry back	-0.8	-0.2	0.6	0.3	0.2	0.1
Duty freezes	0.0	-1.3	-1.3	-1.3	-1.3	-1.3
Other measures	-3.0	-2.0	-1.9	-1.7	-1.5	-1.6
Fiscal consolidation measures	**-0.1**	**0.0**	**8.5**	**20.3**	**27.7**	**31.8**
of which:						
Corporation tax rate increase	0.0	0.0	2.4	11.9	16.3	17.2
Income tax threshold freezes	0.0	0.0	1.6	3.7	5.8	8.2
RDEL cuts	0.0	0.0	4.0	3.5	3.9	4.2
Other measures	-0.1	0.0	0.5	1.2	1.8	2.3
of which:						
Receipts	-3.5	-25.1	-9.0	11.9	23.4	27.9
Resource DEL	-0.2	-8.5	3.1	2.7	3.2	3.5
Capital DEL	0.1	0.2	0.0	0.0	0.0	0.0
AME spending	-5.5	-25.5	0.4	0.6	0.8	0.9

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).

Box 3.1: The rising cost of the coronavirus policy response

In our November *EFO* we described the evolution of the Government's fiscal policy response to the pandemic, whose total cost in 2020-21 had increased from the £12 billion announced in the March Budget to £280 billion by the November Spending Review, via twelve 'mini-Budgets' through the course of the year. At the Spending Review, the Chancellor also announced £55 billion of additional virus-related funding for public services in 2021-22. All told, the total cost of virus-related support measures across the forecast period in November (including the small number that have lasting effects beyond 2021-22) was £337 billion. But we anticipate some underspending by departments relative to the large increases in plans at the Spending Review, so the expected cost was somewhat lower at £331 billion.

Since November there have been three further policy announcements:

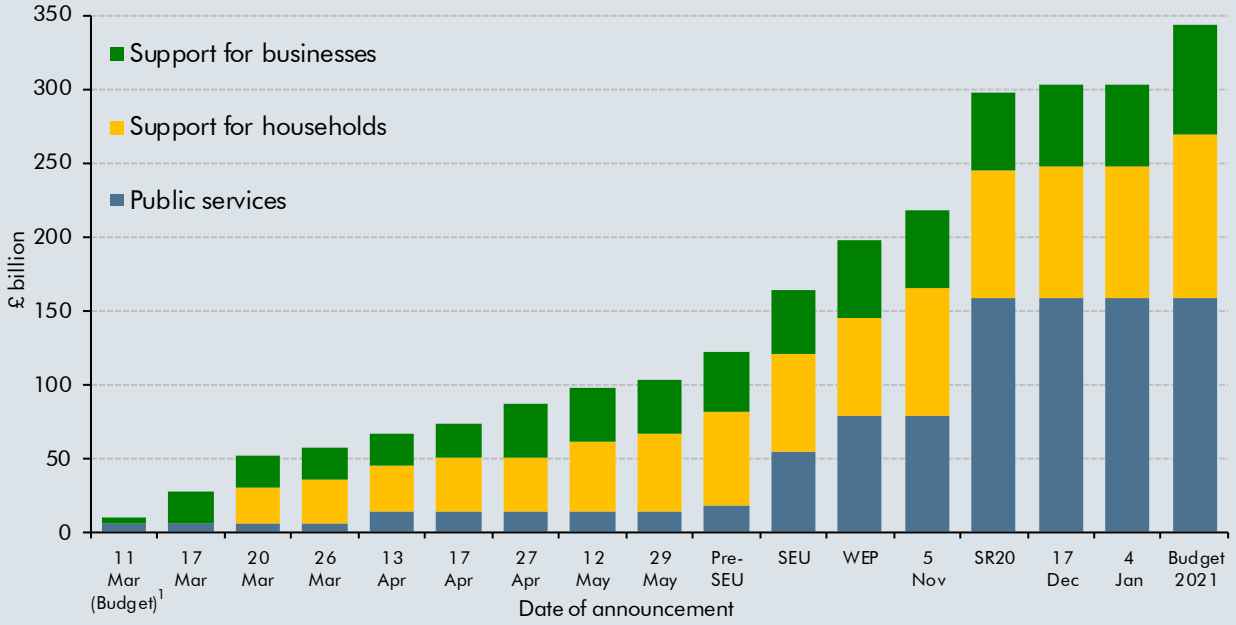
- On **17 December**, the extension of the CJRS by one month to the end of April and the government-backed loan schemes by two months to the end of March.
- on **5 January**, £4.6 billion in grants to businesses affected by the third nationwide lockdown, and a £594 million discretionary fund for other affected businesses. (This was funded from within existing allocations, so does not add to total cost of support.)
- **This Budget** includes a further £3 billion in virus-related support in 2020-21 and £43 billion in 2021-22, most notably the extensions of the CJRS and SEISS.

Taken together, these latest announcements add £44 billion to the total cost of the support measures since the start of the pandemic. But the overall cost has risen by a much smaller £8 billion relative to our November estimate, to stand at £344 billion. That reflects several interventions costing less than expected in 2020-21, lowering our estimate of the total cost of measures announced up to the Spending Review from £331 billion to £300 billion.

In particular, virus-related spending on public services in 2020-21 has been revised down by £11 billion (largely due to somewhat less rapid growth in health spending) and by £6 billion in 2021-22. The CJRS is now expected to cost £3.5 billion less in the period up to March than we assumed in November, while the SEISS and government-backed loan schemes also cost less than expected.

Chart A repeats the running total we presented in November, but this time based on the totals costs of announcements across the forecast period. It is based on revised costs of previous announcements to reflect our latest estimates and adds the new announcements since November. It shows that support for public services accounts for 46 per cent of the total at £158 billion. The majority of this is on health, including the cost of personal protective equipment, NHS Test and Trace, and the procurement and rollout of vaccines. Support for households accounts for 32 per cent of the total at £111 billion, of which 81 per cent comes via the CJRS and SEISS. Finally, support for businesses makes up the remaining 22 per cent at £75 billion. This cost is dominated by grants and business rates holidays, and the upfront recording of expected write-offs relating to the government-backed loan schemes.

Chart A: Total cost of successive virus-related policy announcements



[1] Cost based on figures announced by the Chancellor in SB20. Other costs based on outturn and March 2021 forecast estimates.
Source: OBR

Classification and other statistical changes

3.12 Since our November forecast the ONS has implemented a decision on the recording of the return of **business rates relief** from various companies to the Government. As the relief means that these companies do not have a business rates liability this year, the payments are considered unrequited 'gifts' from the company and therefore treated as capital grants to government (which in turn are treated as negative spending) rather than as business rates revenue (positive tax receipts). The extension of the business rates reliefs into 2021-22 will come with an opt-out mechanism that means companies that do not want to benefit will have a business rates liability. Pending an ONS decision on the classification of this unusual situation, whereby a company can choose to be issued with a liability, we have treated the associated payments as business rates receipts.

3.13 On the advice of Treasury classification experts, we have included some other policies and transactions in our central forecast pending ONS decisions. These include:

- The new **Recovery Loan Scheme**, which we have assumed will be treated in line with predecessor government-backed schemes that were established last year, with an upfront estimate of write-offs recorded as spending when the guarantees are extended.

- The **UK Infrastructure Bank** (described in Box 3.6), where we assume that the investments are all financial transactions (affecting debt but not directly the deficit). We assume that the loans extended will not have a high degree of contingency, and that guarantees extended will be large and bespoke. As such we assume that the ONS will record losses on these instruments at the point of the loan write-off or guarantee call.

3.14 Where possible, our forecasts reflect classification decisions that the ONS has already taken but has not yet implemented in the public finances data. The largest of these relates to the various existing government guaranteed loan schemes. The ONS has said that expected future calls on the guarantees should be recorded as public spending at the point the loans are issued. In our central forecast, these add £23.6 billion to spending in 2020-21 and £1.0 billion in 2021-22. This will leave a large gap between our forecasts and outturn until the ONS has firm enough estimates to incorporate these costs in the official data.

3.15 We have not anticipated the impacts of two changes announced by the ONS but not yet implemented in the statistics: the reduction of the discount rate applied to many funded pension schemes from 5 to 4 per cent; and the reclassification of the Financial Services Compensation Scheme from the central government to the public corporations sector. The impact of both is expected to be largely neutral for the budget deficit.

Public sector receipts

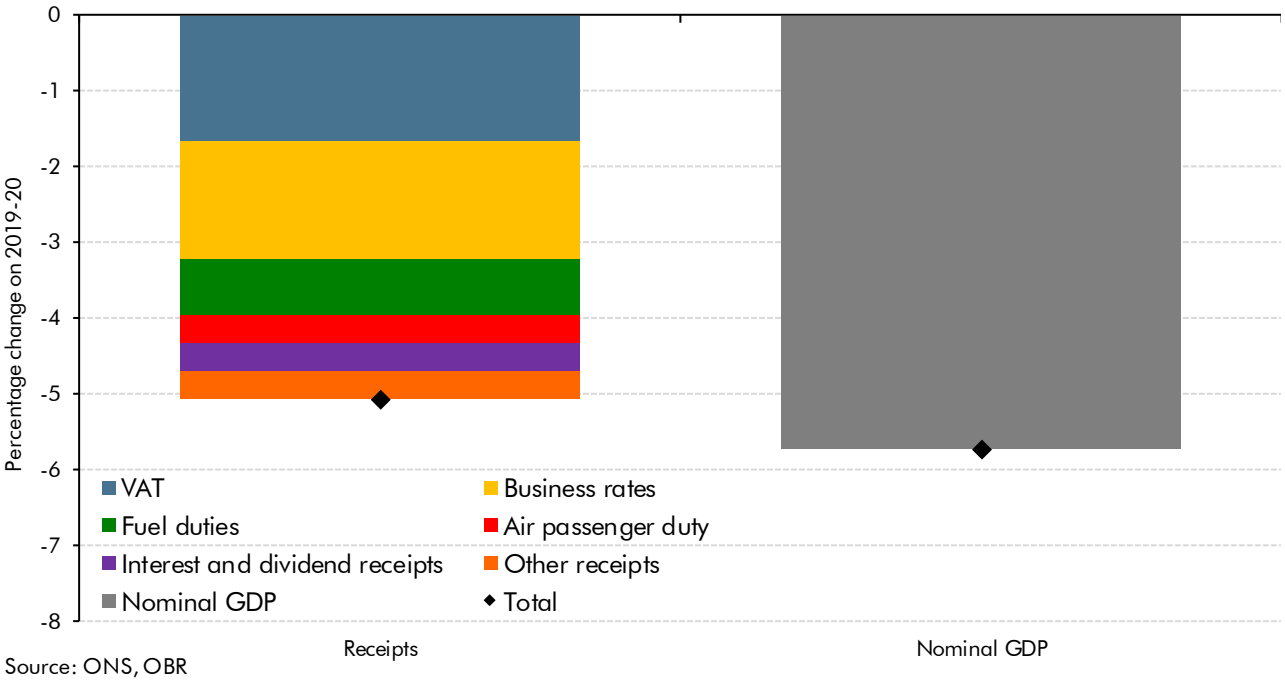
Summary of the receipts forecast

3.16 In this section we discuss our latest forecast of public sector receipts, and how it has changed since both our March 2020 forecast (illustrating the fiscal consequences of the pandemic) and our November 2020 forecast (showing how our assessment of those consequences has evolved).

3.17 Our latest forecast shows receipts in 2020-21 falling by £41.8 billion (5.1 per cent) on a year earlier, a slightly smaller drop than the 5.7 contraction in nominal GDP this year. Receipts consequently rise modestly as a share of GDP this year, up 0.3 percentage points on 2019-20. Receipts typically move closely with nominal GDP because the latter comprises all the major tax bases, but it is unusual for them not to decline relative to GDP in a downturn. By far the most important reason for this is that support from the CJRS means that wages and salaries *rise* by 0.9 per cent in 2020-21, despite the fall in nominal GDP. As a result, income tax and NICs receipts rise by 0.9 per cent of GDP.

3.18 The extent to which different tax streams have been hit this year is uneven. Chart 3.1 shows the biggest contributors to the fall in receipts. For both business rates and VAT, this can largely be explained by virus-related policy measures such as the business rates holidays and temporary cuts to VAT for the hospitality and accommodation sectors. Alongside this, there have been disproportionate hits to certain tax bases, such as road and air travel that have been directly affected by the public health restrictions, weighing on fuel duties and, in particular, air passenger duty (APD). Interest and dividend receipts have been hit by lower interest rates and by NatWest not paying dividends this year.

Chart 3.1: The fall in receipts and nominal GDP in 2020-21

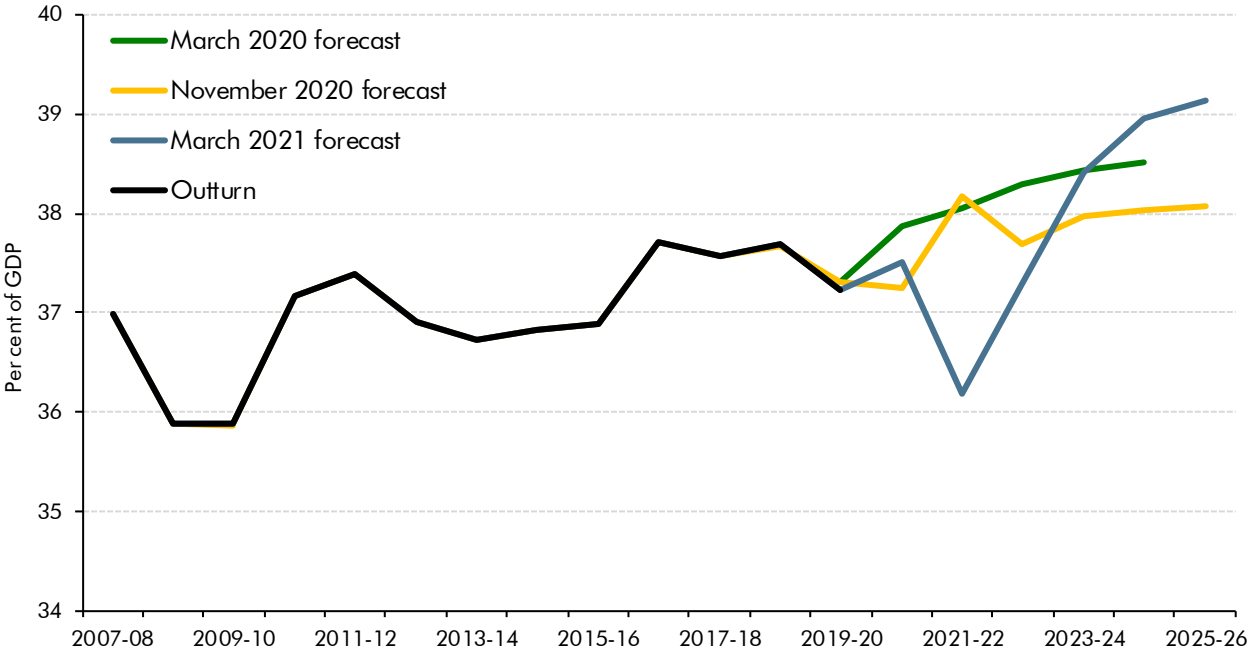


Source: ONS, OBR

3.19 Receipts rise by £33.0 billion (4.2 per cent) in 2021-22, but remain below their 2019-20 level in cash terms. As this modest pick-up does not keep pace with the recovery in GDP, receipts as a share of GDP fall sharply. This largely reflects the cost of Budget measures next year – most importantly, the introduction of generous time-limited capital allowances, but also the extension of the VAT cut for hospitality as well as the business rates and stamp duty holidays. On top of this, the ending of the furlough scheme at the end of September means the shares of wages and salaries, and of income tax and NICs receipts, in nominal GDP fall back.

3.20 From 2022-23 onwards, receipts rise considerably faster than GDP, moving above the share in our March 2020 forecast by 2024-25 and reaching 39.1 per cent of GDP in 2025-26 – the highest share since 1984-85. While some of the upward trend reflects the economic recovery, much of it is the result of Budget measures. Initially this reflects the withdrawal of temporary tax cuts, but by the end of the period it is dominated by the effect of raising the main rate of corporation tax and freezing the main income tax thresholds in cash terms. Together, these measures add 1.0 percentage points to the receipts-to-GDP ratio in 2025-26 – and take corporation tax receipts to a share of GDP last witnessed at the height of the Lawson boom of the late 1980s (see Box 3.2).

Chart 3.2: Receipts as a share of nominal GDP



Source: ONS, OBR

Table 3.2: Major receipts as a share of GDP

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax	8.7	9.3	8.8	8.8	8.9	9.1	9.4
NICs	6.5	6.9	6.5	6.4	6.4	6.4	6.4
Value added tax	6.0	5.7	5.6	6.1	6.1	6.1	6.0
Onshore corporation tax	2.1	2.1	1.7	2.0	2.9	3.2	3.2
Council tax	1.6	1.8	1.8	1.7	1.7	1.7	1.7
Capital taxes[1]	1.4	1.4	1.3	1.4	1.5	1.5	1.6
Business rates	1.4	0.9	1.1	1.3	1.4	1.4	1.3
Fuel duties	1.2	1.0	1.1	1.2	1.2	1.2	1.2
Alcohol and tobacco duties	1.0	1.0	1.0	0.9	0.9	0.9	0.9
Other taxes	3.4	3.5	3.4	3.3	3.4	3.4	3.3
National Accounts taxes	**33.4**	**33.6**	**32.3**	**33.4**	**34.4**	**34.9**	**35.0**
Interest and dividend receipts	1.2	1.1	1.1	1.1	1.2	1.2	1.3
Other receipts	2.6	2.8	2.8	2.8	2.9	2.9	2.9
Current receipts	**37.2**	**37.5**	**36.2**	**37.3**	**38.4**	**39.0**	**39.1**

[1] Includes capital gains tax, inheritance tax, property transaction taxes and stamp taxes on shares.

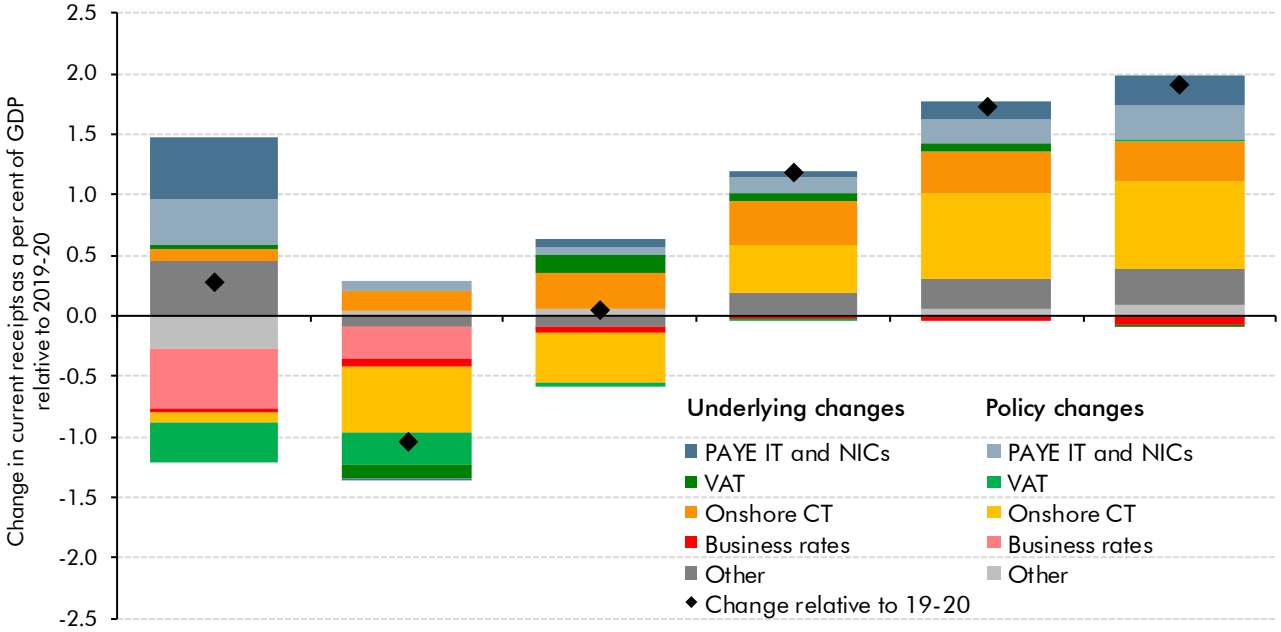
Comparisons with pre-virus levels and pre-virus expectations

3.21 The large changes in the path of receipts delivered by the measures announced in the Budget leave the receipts-to-GDP ratio in 2025-26 1.9 percentage points higher than its pre-pandemic level. The medium-term rise is also faster and to a higher level than we forecast in March 2020 on the basis of the Government's pre-pandemic tax policies.

3.22 Chart 3.3 shows how the change between 2019-20 and 2025-26 varies by year and how it splits between underlying and policy-related drivers for four of the largest sources of revenue. Underlying factors raise receipts steadily relative to GDP, thanks in particular to real earnings growth generating fiscal drag for income tax and NICs (whereby over time larger shares of income are taxed and at higher rates) and the temporary effect of pandemic-related losses on corporation tax receipts reducing.

3.23 But most of the large changes, in both directions, reflect policy measures. In the near term, temporary tax cuts lower VAT, business rates and stamp duty, while the temporary capital allowances super-deduction lower corporation tax receipts sharply in 2021-22 and 2022-23. The impact of policy then reverses in 2023-24 as the headline rate of corporation tax is raised from 19 to 25 per cent. This adds to the steadily building effect of freezing the income tax personal allowance and higher rate threshold in cash terms for four years, which generates even greater fiscal drag in the income tax system.

Chart 3.3: Receipts-to-GDP ratio change relative to 2019-20



Source: OBR

3.24 Our March 2020 forecast predicted receipts would reach 38.5 per cent of GDP in 2024-25, so our latest forecast is 0.4 per cent of GDP higher than we predicted then on the basis of Budget 2020 tax policy settings. Chart 3.4 explains the sources of this difference and shows that:

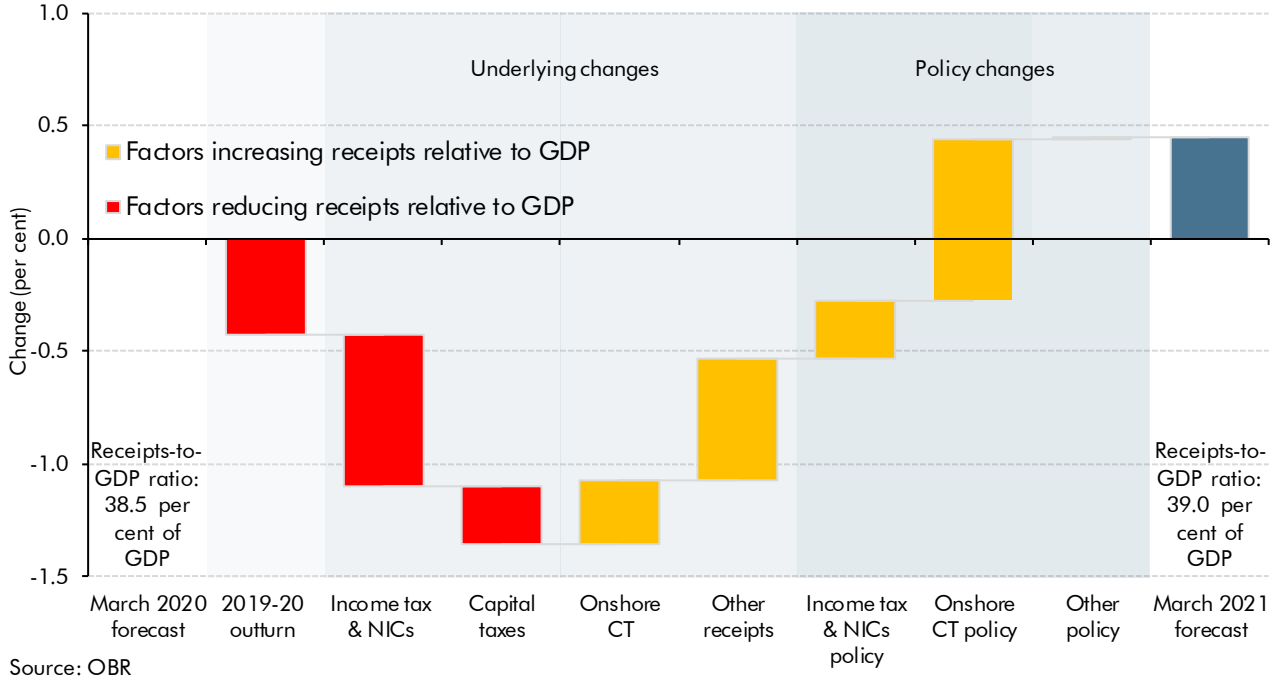
- **The 2019-20 starting point** was 0.4 percentage points lower than we assumed in March 2020 – in part reflecting the initial effects of the pandemic on receipts and nominal GDP in the final months of the year.

- **Underlying factors** lift the ratio by 0.1 percentage points less than was assumed in our March 2020 forecast. This pandemic-related scarring is more than explained by

weaker average earnings growth reducing the extent of fiscal drag on income tax. Capital tax receipts rise less quickly as a share of GDP, largely reflecting the lower level of equity prices and house prices than assumed pre-pandemic.

- **Policy measures** announced over the past year more than offset this scarring, raising receipts by 1.0 per cent of GDP in 2024-25. Most notably, this reflects the corporation tax rise and income tax threshold freezes.

Chart 3.4: Sources of change in the receipts-to-GDP ratio change in 2024-25



Source: OBR

Comparison with previous forecasts

3.25 In cash terms, our latest receipts forecast is well below our March 2020 in all years, despite the tax rises announced in the Budget. The shortfall is more than £85 billion this year and next, and then declines steadily to reach £28 billion in 2024-25. In all but 2021-22 and 2022-23, these shortfalls are smaller than we forecast in November. Upward revisions this year reflect higher than expected receipts, which largely match stronger than expected economic activity. Budget measures explain much of the large downward revision to receipts in 2021-22 and much of the progressively larger upward revisions from 2022-23 onwards.

3.26 Table 3.3 shows the sources of changes in our forecast since March 2020. In 2020-21:

- **Receipts are £86.6 billion *lower* than our March 2020 forecast**. Around half the fall reflects the substantial hit to almost all tax bases and other economy-related determinants of receipts. Around a third is due to receipts streams that have performed worse than high-level economic developments alone would predict, for example the loss of fuel duty and APD due to travel restrictions. The remaining fifth reflects the direct cost of tax cuts, including the business rates reliefs, the VAT rate cut for hospitality and accommodation, and the stamp duty holiday.

- However, **receipts in 2020-21 are £15.3 billion *higher* than our November 2020 forecast**. Half the surprise reflects higher than anticipated self-assessment income tax and CGT receipts on 2019-20 liabilities paid in January and February. Take-up of the more lenient self-serve time-to-pay scheme announced in the autumn was much lower than assumed, boosting receipts this year at the expense of next year. VAT and corporation tax receipts have also performed better than expected. And we expect the impact of the current lockdown on receipts to be less dramatic than the first one, with real-time indicators pointing to smaller shortfalls in, for example, consumer spending and road traffic use compared to the first few months of 2020-21.

3.27 From 2021-22 onwards:

- **The shortfall in receipts relative to our March 2020 forecast gets progressively smaller**. The size and relative contributions to the shortfall in 2021-22 are similar to those in 2020-21, but as temporary tax cuts end, the degree to which the shortfall is explained by our judgements about scarring to real GDP and various taxes rises. And then as the effect of medium-term tax rises announced in the Budget build, the overall shortfall is more than explained by these underlying forecast judgements. By 2024-25 the overall shortfall of £28.0 billion reflects an underlying hit of £53.0 billion (5.2 per cent), around half of which is offset by the £25.0 billion yield from tax increases.

- **Changes to receipts relative to our November forecast move from a large downward revision in 2021-22 to a large upward one by 2025-26**. Next year's downward revision is dominated by the £25.1 billion cost of Budget measures and the £5.6 billion timing effect in self-assessment income tax. The forecast is little changed in 2022-23, while the progressively larger upward revisions thereafter largely reflect Budget measures, notably the corporation tax rise and the effect of freezing the main income tax thresholds in cash terms for four years.

Table 3.3: Sources of difference to the receipts forecast since March 2020

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	872.9	910.8	949.2	984.7	1022.3	
November 2020 forecast	771.0	847.3	885.9	927.0	964.4	1004.3
March 2021 forecast	786.3	819.3	885.4	944.7	994.2	1037.8
Change since November	15.3	-27.9	-0.5	17.7	29.8	33.5
Change since March	**-86.6**	**-91.4**	**-63.8**	**-39.9**	**-28.0**	
Underlying forecast changes since March 2020						
Total (including indirect effects)	**-70.2**	**-69.9**	**-56.0**	**-53.2**	**-53.0**	
of which:						
Key tax bases	**-42.1**	**-53.7**	**-46.8**	**-50.3**	**-50.1**	
of which:						
Average earnings	-13.1	-19.7	-24.5	-28.5	-30.1	
Employee numbers	-3.2	-8.8	-4.6	-1.2	0.4	
Non-financial company profits	-2.8	-4.2	-1.7	-1.2	-1.4	
Consumer spending	-18.3	-13.7	-1.5	-3.0	-2.1	
Other income and expenditure bases	-3.1	-6.2	-7.1	-7.2	-7.5	
Other economic determinants	**-0.8**	**-2.5**	**-7.9**	**-10.7**	**-11.2**	
Other assumptions	**-28.9**	**-14.7**	**-8.7**	**-1.5**	**-1.2**	
of which:						
Fuel duty judgement	-4.6	-0.2	0.2	0.6	0.6	
APD judgement	-3.0	-2.5	-2.1	-1.2	-0.2	
PAYE and SA judgment	-6.0	-0.2	2.8	-0.6	-1.7	
VAT judgement	-2.6	-4.0	-0.9	-1.5	-1.6	
CT judgement	-7.6	-3.1	-1.8	-1.5	-2.0	
Other judgements	-5.2	-4.7	-6.9	2.7	3.7	
Direct effect of government decisions since March 2020						
Total	**-16.4**	**-21.5**	**-7.8**	**13.3**	**25.0**	**29.7**
of which:						
Measures up to and including SR20	-13.0	3.6	1.1	1.4	1.6	1.8
March 2021 measures	-3.5	-25.1	-9.0	11.9	23.4	27.9
Memo: March 2021 pre-measures forecast	*802.7*	*840.8*	*893.2*	*931.4*	*969.2*	*1008.1*

Detailed current receipts forecast

3.28 Our detailed receipts forecast, and changes since our March 2020 and November 2020 forecasts, are presented in Tables 3.4, 3.5 and 3.6. Further breakdowns are available on our website. Scottish and Welsh devolved taxes are discussed in our *Devolved tax and spending forecasts* publication.

Table 3.4: Current receipts

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax[1]	193.6	194.8	198.2	208.7	220.0	233.2	248.2
of which: Pay as you earn	165.2	167.3	170.8	181.6	190.1	201.1	213.9
Self assessment	32.2	30.8	30.7	30.3	33.0	35.4	37.7
Other income tax	-3.8	-3.3	-3.3	-3.3	-3.2	-3.3	-3.3
National insurance contributions	145.0	143.8	146.8	152.6	157.4	163.6	170.2
Value added tax	133.8	119.9	127.9	145.6	149.7	155.1	159.2
Corporation tax[2]	48.4	45.5	40.3	48.8	71.3	81.7	85.3
of which: Onshore	47.4	45.0	39.5	48.1	70.8	81.3	84.9
Offshore	1.0	0.6	0.8	0.6	0.5	0.4	0.4
Petroleum revenue tax	-0.4	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2
Fuel duties	27.6	21.5	26.0	29.2	30.1	30.6	31.2
Business rates	31.0	18.1	23.8	31.6	33.8	34.5	35.0
Council tax	36.3	38.1	39.9	41.2	42.6	44.1	45.6
VAT refunds	19.0	21.5	22.8	22.7	23.7	24.8	26.2
Capital gains tax	9.8	10.1	8.7	10.7	12.2	13.2	14.4
Inheritance tax	5.1	5.2	6.0	5.8	5.7	6.1	6.6
Property transaction taxes[3]	12.5	9.6	12.3	14.5	15.1	16.2	17.3
Stamp taxes on shares	3.6	3.5	3.4	3.3	3.4	3.6	3.7
Tobacco duties	9.7	9.0	9.6	9.4	9.3	9.1	9.1
Alcohol duties	11.5	12.7	12.4	12.7	13.1	13.8	14.3
Air passenger duty	3.7	0.6	1.3	2.0	3.1	4.3	4.4
Insurance premium tax	6.5	6.3	6.5	6.7	6.8	6.9	7.1
Climate change levy	2.1	1.7	2.1	2.2	2.3	2.3	2.4
Bank levy	2.5	1.9	1.0	1.0	1.0	1.0	1.0
Bank surcharge	1.5	1.2	1.2	1.3	1.3	1.4	1.4
Apprenticeship levy	2.8	2.9	2.9	3.0	3.1	3.2	3.4
Soft drinks industry levy	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Digital services tax	0.0	0.3	0.4	0.5	0.6	0.7	0.7
Other HMRC taxes[4]	7.3	6.7	7.0	7.5	7.6	7.7	8.0
Vehicle excise duties	6.8	6.9	7.0	7.1	7.2	7.3	7.5
Licence fee receipts	3.3	3.8	3.8	3.8	3.9	3.9	3.9
Environmental levies	8.0	9.5	10.2	10.0	10.6	10.8	11.2
EU ETS auction receipts	1.6	1.1	1.3	1.2	1.2	1.2	1.3
Other taxes	10.2	8.0	8.8	9.4	9.8	9.7	9.7
National Accounts taxes	**743.0**	**704.2**	**731.6**	**792.8**	**846.1**	**890.0**	**928.2**
Less own resources contribution to EU	-3.2	-2.1	-	-	-	-	-
Interest and dividends	26.5	23.5	25.1	26.4	28.4	30.8	33.3
Gross operating surplus	57.0	56.5	58.7	62.2	66.2	69.6	72.5
Other receipts	4.8	4.1	3.9	4.0	4.0	3.7	3.9
Current receipts	**828.2**	**786.3**	**819.3**	**885.4**	**944.7**	**994.2**	**1,037.8**
Memo: UK oil and gas revenues [5]	*0.6*	*0.3*	*0.6*	*0.4*	*0.3*	*0.2*	*0.2*

[1] Includes PAYE, self assessment, tax on savings income and other minor components, such as income tax repayments.
[2] National Accounts measure, gross of reduced liability tax credits.
[3] Includes stamp duty land tax (SDLT), devolved property transaction taxes and the annual tax on enveloped dwellings (ATED).
[4] Consists of landfill tax (excluding Scotland and Wales), aggregates levy, betting and gaming duties, customs duties and diverted profits tax.
[5] Consists of offshore corporation tax and petroleum revenue tax.

Table 3.5: Current receipts: changes since March 2020

	£ billion					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax[1]	-1.6	-12.7	-19.2	-18.6	-16.6	-13.4
of which: Pay as you earn	-0.1	-8.2	-13.5	-11.7	-10.9	-8.6
Self assessment	-0.1	-3.5	-5.2	-6.9	-5.9	-5.1
Other income tax	-1.4	-1.0	-0.5	0.0	0.2	0.3
National insurance contributions	-0.4	-6.4	-10.3	-11.4	-12.9	-13.5
Value added tax	-2.8	-20.6	-18.0	-5.3	-6.1	-5.6
Corporation tax[2]	-6.8	-12.6	-19.7	-13.8	6.4	14.5
of which: Onshore	-6.6	-12.2	-19.4	-13.3	7.2	15.3
Offshore	-0.1	-0.4	-0.3	-0.5	-0.8	-0.8
Petroleum revenue tax	0.0	0.0	0.0	0.0	0.0	0.0
Fuel duties	-0.1	-5.9	-2.1	-1.3	-1.0	-1.1
Business rates	-0.2	-13.4	-9.6	-2.7	-1.2	-1.8
Council tax	0.1	0.1	0.8	0.8	1.0	1.2
VAT refunds	-0.2	1.4	1.8	1.0	1.2	1.0
Capital gains tax	-0.2	-1.3	-4.0	-3.5	-3.5	-3.8
Inheritance tax	0.0	-0.3	0.1	-0.5	-1.0	-1.1
Property transaction taxes[3]	-0.2	-4.2	-2.4	-1.7	-2.3	-2.5
Stamp taxes on shares	0.2	-0.1	-0.3	-0.6	-0.6	-0.6
Tobacco duties	1.0	0.0	0.8	0.6	0.5	0.4
Alcohol duties	-0.6	0.8	0.0	-0.2	-0.2	-0.1
Air passenger duty	-0.1	-3.4	-2.9	-2.4	-1.5	-0.5
Insurance premium tax	-0.1	-0.3	-0.2	-0.2	-0.2	-0.2
Climate change levy	0.0	-0.4	-0.1	-0.1	-0.1	-0.3
Bank levy	0.1	0.0	0.0	0.0	0.0	-0.1
Bank surcharge	0.0	-0.4	-0.4	-0.3	-0.4	-0.4
Apprenticeship levy	0.0	0.0	-0.2	-0.2	-0.2	-0.2
Soft drinks industry levy	0.0	0.0	0.0	0.0	0.0	0.0
Digital services tax	-0.1	0.0	0.0	0.1	0.1	0.1
Other HMRC taxes[4]	-0.1	-0.7	-0.6	-0.2	-0.1	-0.1
Vehicle excise duties	0.0	-0.1	0.0	-0.1	-0.2	-0.3
Licence fee receipts	0.0	0.1	0.0	0.0	0.0	0.0
Environmental levies	-2.2	-0.1	0.3	0.2	0.2	0.0
EU ETS auction receipts	0.1	-0.1	0.0	-0.1	-0.1	-0.1
Other taxes	1.4	-1.0	-0.5	-0.3	0.0	-0.3
National Accounts taxes	-12.7	-82.0	-86.6	-60.8	-38.9	-28.5
Less own resources contribution to EU	0.1	0.3	-	-	-	-
Interest and dividends	-1.0	-4.1	-3.7	-4.2	-3.9	-3.0
Gross operating surplus	2.6	-0.5	0.0	1.0	2.7	3.4
Other receipts	-0.2	-0.4	-1.1	0.2	0.2	0.1
Current receipts	-11.2	-86.6	-91.4	-63.8	-39.9	-28.0
Memo: UK oil and gas revenues [5]	*-0.2*	*-0.4*	*-0.3*	*-0.5*	*-0.7*	*-0.8*

[1] Includes PAYE, self assessment, tax on savings income and other minor components, such as income tax repayments.
[2] National Accounts measure, gross of reduced liability tax credits.
[3] Includes stamp duty land tax (SDLT), devolved property transaction taxes and the annual tax on enveloped dwellings (ATED).
[4] Consists of landfill tax (excluding Scotland and Wales), aggregates levy, betting and gaming duties, customs duties and diverted profits tax.
[5] Consists of offshore corporation tax and petroleum revenue tax.

Table 3.6: Current receipts: changes since November 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax[1]	0.0	6.6	-5.4	3.7	4.9	7.6	10.8
of which: Pay as you earn	0.0	0.4	0.6	4.2	4.8	6.8	9.2
Self assessment	0.0	6.1	-5.5	-0.3	0.1	0.7	1.3
Other income tax	0.0	0.1	-0.5	-0.2	0.0	0.1	0.3
National insurance contributions	0.0	3.0	0.9	1.3	-0.1	-1.1	-1.9
Value added tax	0.0	3.7	-3.5	3.6	3.3	4.6	4.4
Corporation tax[2]	0.4	1.7	-9.2	-8.7	9.9	18.4	19.5
of which: Onshore	0.4	1.7	-9.0	-8.2	10.6	19.0	20.1
Offshore	0.0	-0.1	-0.2	-0.5	-0.7	-0.6	-0.7
Petroleum revenue tax	0.0	0.0	-0.1	-0.1	-0.1	-0.1	0.0
Fuel duties	0.0	-0.3	-0.7	-0.5	-0.7	-0.6	-0.6
Business rates	0.1	-1.2	-8.2	-1.1	-0.7	-0.4	-0.3
Council tax	0.0	-0.1	0.1	-0.1	-0.2	-0.2	-0.1
VAT refunds	0.0	-3.7	-0.9	-1.6	-1.7	-1.7	-1.7
Capital gains tax	0.0	2.0	-1.3	2.0	2.2	2.3	2.5
Inheritance tax	0.0	0.0	0.7	1.0	0.7	0.8	0.9
Property transaction taxes[3]	0.0	0.5	0.3	1.8	1.0	0.6	0.4
Stamp taxes on shares	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Tobacco duties	0.0	0.3	0.3	0.3	0.2	0.2	0.1
Alcohol duties	0.0	-0.3	-0.3	-0.2	-0.3	-0.2	-0.1
Air passenger duty	0.0	0.1	-0.5	-0.9	-0.9	0.1	0.0
Insurance premium tax	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Climate change levy	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0
Bank levy	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Bank surcharge	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.2
Apprenticeship levy	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Soft drinks industry levy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Digital services tax	0.0	0.1	0.1	0.1	0.1	0.1	0.2
Other HMRC taxes[4]	0.0	0.1	-1.1	-0.8	-0.8	-0.8	-0.7
Vehicle excise duties	0.0	0.1	0.2	0.3	0.3	0.2	0.2
Licence fee receipts	0.0	0.2	0.1	0.1	0.1	0.1	0.1
Environmental levies	0.0	-0.1	0.0	0.0	0.0	0.0	-0.1
EU ETS auction receipts	0.0	0.0	0.2	0.0	0.0	0.0	0.0
Other taxes	0.3	0.1	0.1	-0.1	0.1	-0.2	-0.1
National Accounts taxes	1.0	12.7	-28.5	-0.1	17.5	29.6	33.0
Less own resources contribution to EU	0.0	0.0	-	-	-	-	-
Interest and dividends	-0.1	0.8	1.0	1.2	1.1	1.1	1.2
Gross operating surplus	0.0	1.8	-0.4	-1.5	-0.9	-1.0	-0.8
Other receipts	-0.3	0.1	0.0	-0.1	0.0	0.1	0.1
Current receipts	0.6	15.3	-27.9	-0.5	17.7	29.8	33.5
Memo: UK oil and gas revenues [5]	*0.0*	*-0.1*	*-0.2*	*-0.6*	*-0.7*	*-0.6*	*-0.7*

[1] Includes PAYE, self assessment, tax on savings income and other minor components, such as income tax repayments.
[2] National Accounts measure, gross of reduced liability tax credits.
[3] Includes stamp duty land tax (SDLT), devolved property transaction taxes and the annual tax on enveloped dwellings (ATED).
[4] Consists of landfill tax (excluding Scotland and Wales), aggregates levy, betting and gaming duties, customs duties and diverted profits tax.
[5] Consists of offshore corporation tax and petroleum revenue tax.

Tax-by-tax analysis

Income tax and NICs (excluding self-assessment)

3.29 Income tax and NICs receipts (excluding self-assessment (SA) income tax) rise modestly in 2020-21 despite the sharp fall in GDP, but are expected to fall £15.6 billion short of our pre-pandemic March 2020 forecast. Earnings growth and employment have held up remarkably given the collapse in output but are still the main drivers of the shortfall relative to pre-virus expectations. The many millions of jobs furloughed under the CJRS, and the much smaller number of jobs lost, have been concentrated among lower-paid and part-time workers, while the employment and earnings of those further up the income distribution have been much less affected. The effective tax rate paid on CJRS-supported earnings is low, but nevertheless the fact that the more tax-rich part of the income distribution has been more insulated from the shock has supported tax receipts.

3.30 Compared with March 2020, the shortfall in income tax and NICs receipts (excluding SA) then averages £23.2 billion a year between 2021-22 and 2024-25. Average earnings are around 6 per cent lower in cash terms by the forecast horizon than we assumed last March, reflecting virus-related scarring of labour productivity, lower whole economy inflation and higher unemployment weighing on earnings growth. This represents a structural hit to receipts, with lower earnings taking around £30 billion off by 2024-25 relative to our March 2020 forecast. In contrast, the hit to receipts from employment diminishes as the economy recovers. Freezing the personal allowance and higher rate threshold from 2022-23 to 2025-26 eventually adds £6.5 billion to income tax and NICs receipts in 2025-26.

3.31 Compared with our November forecast, income tax and NICs paid on employee salaries via the PAYE system is £4.3 billion higher than expected in 2020-21. This reflects stronger earnings growth in the final months of 2020 and an upward revision to our assumption on the tax paid on bonuses. In line with strong sectoral data through the year, we assume that bonuses in professional services rise by 5 per cent, and that higher bonuses in investment banks will partly compensate for lower payments in retail banks.

3.32 Receipts have been revised up in every year relative to our November forecast. In the near term this reflects stronger average earnings and a lower peak for unemployment next year. In the medium term it is largely due to the Budget threshold freezes that mean more of people's incomes will be taxed, with greater proportions being taxed at the higher rate.

Table 3.7: Non-SA income tax and NICs: changes since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	308.4	323.4	338.5	354.2	367.9	383.2	
November 2020 forecast	306.4	304.3	313.3	325.7	339.6	355.6	373.2
March 2021 forecast	306.4	307.8	314.2	331.0	344.4	361.4	380.7
Change since November	0.0	3.5	1.0	5.3	4.8	5.8	7.5
Change since March	**-2.0**	**-15.6**	**-24.2**	**-23.1**	**-23.6**	**-21.8**	
	Underlying forecast changes since March 2020						
Total		**-22.0**	**-26.2**	**-24.7**	**-27.0**	**-27.2**	
of which:							
Economic determinants		**-16.8**	**-28.3**	**-28.1**	**-27.5**	**-26.9**	
of which:							
Average earnings		-13.1	-19.7	-24.5	-28.5	-30.1	
Employee numbers		-3.2	-8.8	-4.6	-1.2	0.4	
Inflation		0.0	1.0	1.6	2.5	3.1	
Other economic determinants		-0.5	-0.8	-0.5	-0.4	-0.3	
Outturn receipts and modelling		**-5.2**	**2.2**	**3.4**	**0.5**	**-0.4**	
	Direct effect of Government decisions since March 2020						
Total		**6.3**	**1.9**	**1.5**	**3.4**	**5.5**	**7.7**

Self-assessment (SA) income tax

3.33 SA income tax receipts fell 4.3 per cent in 2020-21 and are not expected to recover their pre-pandemic peak until 2023-24. They are down by 14 per cent on average between 2020-21 and 2024-25 relative to our March 2020 forecast. But they are around £6 billion higher this year than expected in our November forecast. Much of this relates to far fewer taxpayers taking up the self-serve time-to-pay arrangements announced last autumn, which allow taxpayers to defer payment of SA liabilities into 2021-22 via an online form. In addition, the initial SA deferral policy announced last March allowed July 2020 payments to be delayed until January 2021. It looks like that much of these were paid back to that deadline rather than being deferred further. It is possible that taxpayers have been using government support grants to stay up to date with their taxes.

3.34 As SA receipts are recorded on a cash basis rather than accrued to the year of the underlying liability, these timing effects have large implications for our forecast. With receipts being brought forward from 2021-22 relative to our November assumptions, this adds £6.6 billion to 2020-21 but lowers receipts in 2021-22 by £5.6 billion. The effect does not cancel out completely because we assume that some deferred taxes will eventually be written off rather than paid.

3.35 The shortfalls in SA income tax relative to our March 2020 forecast reflect both timing effects and underlying weakness. The £3.5 billion shortfall in 2020-21 reflects greater than normal use of time-to-pay arrangements (even though much less so than we assumed in November), and smaller initial payments on account for 2020-21 liabilities. These were due in January and would normally be based on the previous year's liabilities, but preliminary

data suggest that some taxpayers have reduced these payments (as one would expect given the extent to which 2020-21 liabilities will have been affected by the pandemic).

3.36 The underlying weakness reflects scarring to income from self-employment, dividends, savings and rents that are all permanently lower relative to the March 2020 forecast, reducing SA receipts by over £7 billion a year from 2021-22. Having received less government support than other taxpayers, we have assumed that the proprietors of small incorporated businesses that pay themselves largely through dividends will experience a sharper fall in income than larger firms.

3.37 The freeze in income tax thresholds and the corporation tax rises announced in this Budget raise SA receipts by £1.4 billion by 2025-26. The effect of the higher corporation tax rate on SA via reduced incentives for the self-employed to incorporate is, though, relatively modest. That reflects the reintroduction of a small profits rate, which leaves a large difference between the amounts of tax paid as an unincorporated versus incorporated business for those with mid-to-high incomes that are likely to be influenced by this disparity.

Table 3.8: SA income tax: changes since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	32.3	34.3	35.9	37.2	38.9	40.5	
November 2020 forecast	32.2	24.7	36.2	30.6	32.9	34.7	36.4
March 2021 forecast	32.2	30.8	30.7	30.3	33.0	35.4	37.7
Change since November	0.0	6.1	-5.5	-0.3	0.1	0.7	1.3
Change since March	**-0.1**	**-3.5**	**-5.2**	**-6.9**	**-5.9**	**-5.1**	
	Underlying forecast changes since March 2020						
Total		**-2.6**	**-8.3**	**-8.3**	**-6.4**	**-6.2**	
of which:							
Self employment income		-0.7	-3.7	-6.1	-4.1	-3.8	
Dividend income		-1.1	-2.1	-1.4	-0.8	-0.8	
Savings income		0.0	-0.1	-0.2	-0.3	-0.3	
Other modelling and determinant changes		-0.8	-2.4	-0.6	-1.1	-1.3	
	Direct effect of Government decisions since March 2020						
Total		**-0.9**	**3.1**	**1.5**	**0.4**	**1.1**	**2.0**

VAT

3.38 VAT receipts are expected to have fallen 10.4 per cent in 2020-21 and do not regain their pre-virus peak in cash terms until 2022-23. Relative to our March 2020 forecast, receipts are lower by £20.6 billion (14.7 per cent) in 2020-21 and remain down by £5.6 billion in 2024-25. This reflects a lower profile for consumer spending, overlaid by a lower share of that spending subject to VAT. Policy measures also lower receipts in the near term, including the temporary cut in the rate of VAT for the hospitality and accommodation sectors from 20 to 5 per cent. That has been extended until September 2021 in the Budget, after which it is raised to 12½ per cent until March 2022, returning to 20 per cent thereafter. Overall that leaves receipts in 2021-22 down £18.0 billion on our March 2020 forecast. Government

procurement this year and next supports VAT receipts, as much of the extra spending (such as purchases of personal protective equipment) falls outside the VAT refunds scheme.

3.39 Relative to our November forecast, we have revised up receipts in 2020-21 by £3.7 billion. Recent cash receipts have surprised on the upside, which initial indications suggest largely reflects early repayment of VAT deferred from March to June last year. Underlying strength in the tax base, including consumption of durables, is also likely to have supported receipts. The early repayment of deferred VAT is a cash timing effect with no impact on underlying liabilities and only affects accrued receipts to the extent that we assume an element of the deferred payments will ultimately go unpaid. VAT receipts next year have been revised down by £3.5 billion relative to November, largely due to Budget measures. From 2022-23 onwards, VAT receipts have been revised up by £4.0 billion a year on average, largely thanks to the stronger path of consumer spending relative to our November forecast. That in turn reflects our assumption that wealth built up via unplanned saving over the past year will support higher spending for several years – particularly on durables in the near term.

Table 3.9: VAT: changes since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	136.6	140.6	145.9	151.0	155.8	160.7	
November 2020 forecast	133.8	116.3	131.4	142.0	146.4	150.5	154.8
March 2021 forecast	133.8	119.9	127.9	145.6	149.7	155.1	159.2
Change since November	0.0	3.7	-3.5	3.6	3.3	4.6	4.4
Change since March	**-2.8**	**-20.6**	**-18.0**	**-5.3**	**-6.1**	**-5.6**	
Underlying forecast changes since March 2020							
Total		**-13.7**	**-12.1**	**-4.7**	**-6.1**	**-5.7**	
of which:							
Household spending		-11.3	-8.6	-1.7	-2.6	-2.3	
Standard rated share		-2.1	-0.2	-0.8	-0.5	-0.1	
Government spending		2.2	0.7	-1.3	-1.4	-1.6	
Outturn and other economic determinants		-2.6	-4.0	-0.9	-1.5	-1.6	
Direct effect of Government decisions since March 2020							
Total		**-6.9**	**-5.8**	**-0.7**	**0.0**	**0.1**	**0.2**
of which:							
Measures up to and including SR20		-6.8	-0.9	-0.5	-0.1	-0.1	-0.1
March 2021 measures		-0.1	-4.9	-0.1	0.1	0.2	0.3
Memo: VAT gap (per cent)		*7.4*	*8.0*	*7.7*	*7.3*	*7.4*	*7.4*

3.40 We continue to assume that disruption at the UK-EU border following the end of the Brexit transition period will have temporarily increased the VAT gap. This reflects a combination of factors, including risks around trader readiness, infrastructure, IT and staffing following the adoption of the new border operating model.[1] It also reflects the Government's decision to phase in the introduction of customs controls over the first half of 2021, which limit the extent of trade disruption at the expense of reduced tax compliance. The 'implied VAT gap'

[1] These issues have been reviewed by other organisations, including the National Audit Office in its report *The UK border: preparedness for the end of the transition period*, November 2020.

shown in Table 3.9 is the difference between the theoretical total and actual VAT receipts. It is adjusted for timing factors where they can be estimated, including the large effects of this year's VAT deferral measures. Changes in the estimated VAT gap can reflect both real-world changes in non-compliance and measurement errors in estimating the theoretical total, which could be material this year.

Onshore corporation tax

3.41 Onshore corporation tax (CT) is levied on the taxable profits of limited companies and other organisations, after taking into account various deductions (for the costs of running the business) and allowances (for example capital allowances for investment spending). Receipts are expected to have fallen by 5.1 per cent in 2020-21 and then to fall 12.2 per cent in 2021-22, taking them down to £7.9 billion below their pre-pandemic level in 2019-20. They are then forecast to more than double in the space of four years, taking onshore corporation tax receipts to 3.2 per cent of GDP in the final two years of the forecast.

3.42 This uneven path for receipts over the next five years reflects Budget measures, which include large near-term giveaways and medium-term takeaways, and that overlay the underlying damage to profits caused by the pandemic. In particular, the temporary capital allowances super-deduction in place over the next two years lowers receipts in 2021-22 and 2022-23, while raising the main rate from 19 to 25 per cent in April 2023 (tempered by the reintroduction of a small profits rate) raises progressively larger amounts thereafter.

3.43 Table 3.10 shows the sources of changes in our forecast since March 2020. Abstracting from the effect of policy measures, it shows that weaker profits weigh on receipts throughout, with the medium-term hit reflecting our overall judgement that the economy will be permanently scarred by the pandemic. Greater trading losses are also assumed to depress receipts for several years as they are offset against companies' past and future profits, or to offset current profits of other companies within groups. The lower pre-measures path for business investment provides a modest offset via less use of capital allowances – but this is swamped by the effect of the new capital allowances measures.

3.44 The corporation tax measures announced in this Budget are large by historical standards and generate material changes in the profile and level of receipts. Box 3.2 places these changes in historical and international context, while Annex A provides further detail on the estimates of their cost and yield. In summary:

- **Capital allowances.** For the two years from April 2021, a 130 per cent 'super-deduction' will be available on most types of investment in plant and machinery, with a 50 per cent first-year allowance available on other longer-term types of plant and machinery investment. This will provide a generous tax benefit to firms who invest during this period, and a large incentive for them to bring investment forward from future years to make the most of that benefit. The extent of this response and therefore the cost of the measure are hugely uncertain. Our central forecast assumes that it reduces receipts by £12.5 billion a year on average while it is in effect, but raises receipts by £2.4 billion a year over the final three years of the forecast period, in part due to lower investment.

- **Main rate and small profits rate.** From 1 April 2023, the main rate of corporation tax will be raised from 19 to 25 per cent, but a small profits rate will also be reintroduced at 19 per cent for profits up to £50,000, with the rate then in effect tapered until it reaches 25 per cent at profits of over £250,000. This raises progressively larger amounts, reaching £16.4 billion in 2025-26 – raising the corporation tax burden in that year by around a quarter relative to the pre-measures forecast baseline.

- **Loss relief.** Companies will be allowed to use trading losses generated in 2020-21 and 2021-22 to offset corporation tax liabilities from the previous three years rather than the usual one, up to a limit of £2 million. This will boost repayments of corporation tax in the short term, but will reduce the extent to which losses are carried forward to future years. It costs £0.8 billion in 2020-21, but yields modest sums thereafter.

Table 3.10: Corporation tax: changes since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	54.0	57.2	58.9	61.4	63.6	66.0	
November 2020 forecast	47.0	43.2	48.5	56.4	60.2	62.3	64.8
March 2021 forecast	47.4	45.0	39.5	48.1	70.8	81.3	84.9
Change since November	0.4	1.7	-9.0	-8.2	10.6	19.0	20.1
Change since March	**-6.6**	**-12.2**	**-19.4**	**-13.3**	**7.2**	**15.3**	
	Underlying forecast changes since March 2020						
Total	**-6.6**	**-10.6**	**-7.0**	**-3.5**	**-2.7**	**-3.0**	
of which:							
Non-financial profits		-2.8	-4.2	-1.7	-1.2	-1.4	
Financial profits		-0.8	-0.4	-0.2	-0.2	-0.2	
Business investment		0.6	0.8	0.3	0.2	0.6	
Losses modelling and outturn data	-6.6	-7.6	-3.1	-1.8	-1.5	-2.0	
	Direct effect of Government decisions since March 2020						
Total		**-1.6**	**-12.4**	**-9.8**	**9.9**	**18.3**	**19.6**
of which:							
Measures up to and including SR20		1.1	-0.1	0.0	0.1	0.1	0.1
Main rate and small profits rate		0.0	0.0	2.3	11.8	15.8	16.4
Capital allowance measures		-1.7	-12.3	-12.7	-2.4	2.1	2.8
Extended loss carry back		-0.8	-0.1	0.6	0.3	0.2	0.1
Other March 2021 measures		-0.1	0.1	0.0	0.1	0.2	0.2

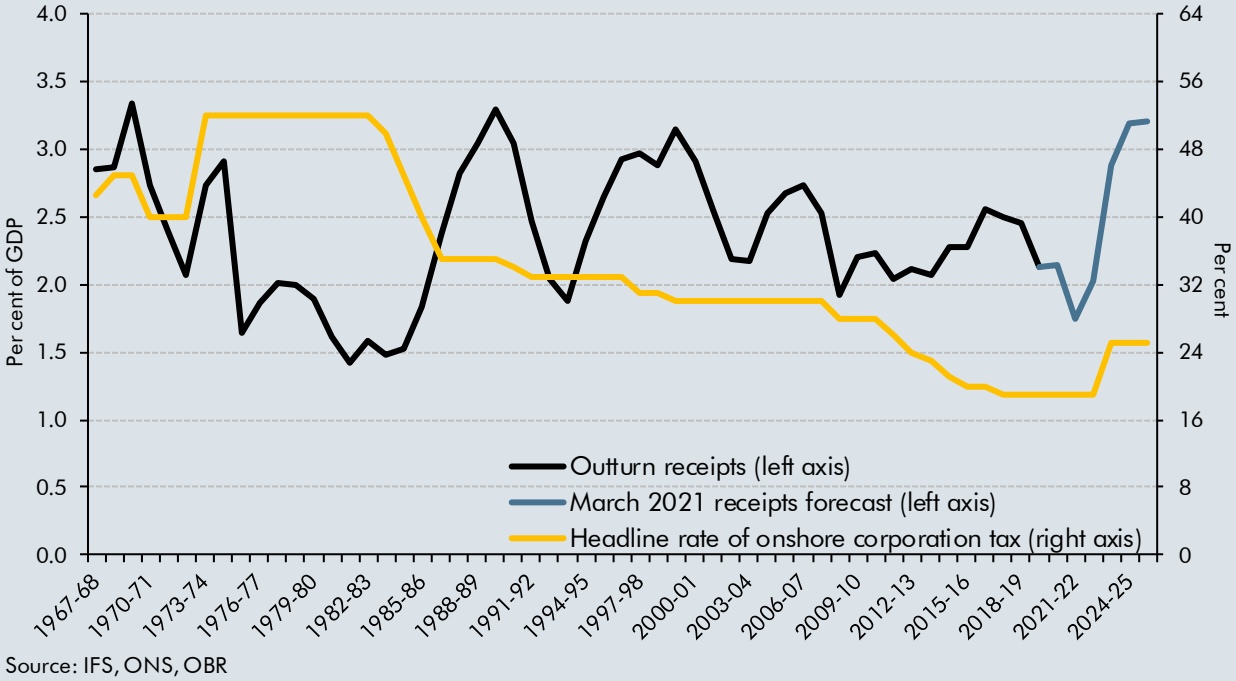
Box 3.2: Corporation tax in historical and international context

A decade ago, the headline rate of onshore corporation tax (CT) stood at 28 per cent. Over the following seven years, the Coalition and then Conservative Governments cut it gradually to an all time low of 19 per cent in 2017-18 and had announced a further cut to 17 per cent to take effect in April 2020. That last step down was cancelled in last year's Budget, while in this Budget the Chancellor has decided to raise it back to 25 per cent with effect from April 2023.

The rise in the headline rate takes our forecast for onshore CT receipts in 2025-26 up to 3.2 per cent of GDP, its highest level since the height of the Lawson boom in 1989-90, and far above the 2.4 per cent average of the past five decades. Chart B shows that the headline rate has fallen steadily over this time. This Budget represents the first announced rise in the rate since Denis Healey raised it from 40 to 52 per cent in his 1974 Budget. But despite this downward path for the headline rate, onshore CT receipts have fluctuated around a fairly stable average relative to GDP. In the tax's 55 years in existence, they have only exceeded 3 per cent of GDP in three brief periods:

- Corporation tax was introduced in 1965 and by **1969-70** it raised 3.3 per cent of GDP, which remains the highest on record. In part that reflects the 45 per cent headline rate.
- Between **1988-99 and 1990-91**, onshore CT raised 3.1 per cent of GDP on average. This was a period in which the economy was overheating and profits had risen materially as a share of GDP (from 15.0 to 20.6 per cent between 1981-82 and 1989-90).
- Between **1997-98 and 1999-2000**, onshore CT receipts averaged 3.0 per cent of GDP. Again, this was a period of strong growth as the dotcom bubble inflated before bursting in 2000. The peak in 1999-00 also reflects the temporary boost from the introduction of the quarterly instalment regime for larger companies, which required earlier payment of liabilities.

Chart B: Onshore corporation tax receipts versus the headline rate



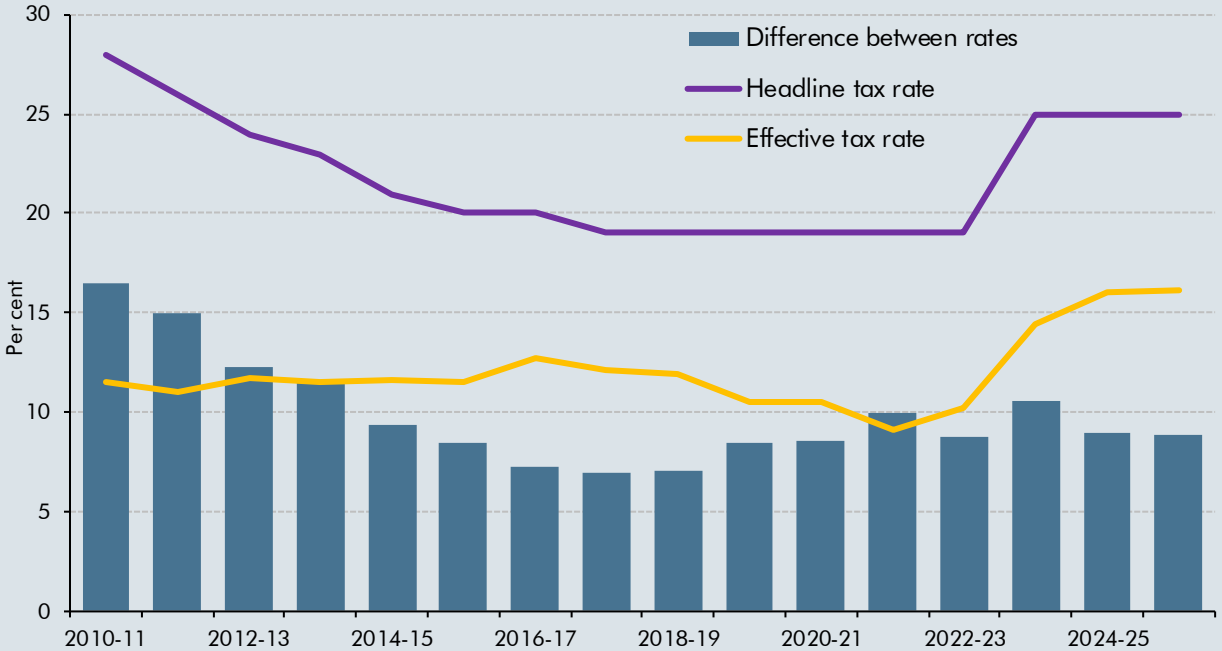
Source: IFS, ONS, OBR

The fact that onshore CT revenues have fluctuated around a broadly constant average while the headline rate has fallen largely reflects a widening of the tax base over time. Chart C focuses on this pattern over the past decade, by comparing the headline rate against a measure of the 'effective tax rate', defined as receipts as a share of overall profits.[a] This captures other aspects

of the tax system, such as the generosity and take-up of various reliefs and deductions that mean *taxable* profits vary relative to total profits. It shows that:

- **Between 2010-11 and 2017-18**, the headline rate was cut by 9 percentage points, but the effective tax rate remained almost unchanged. As we have set out before,[b] the cost of successive rate cuts was offset by the yield from progressively tighter restrictions on the scope of allowances and reliefs via policy measures. This was overlaid by the recovery in profits following the financial crisis, which led to a fall in the use of loss reliefs.
- By contrast, **between 2020-21 and 2025-26**, our forecast shows the headline and effective tax rates rising broadly in step (by 6 and 5.7 percentage points respectively). This reflects the fact that the rise in the headline rate has not been accompanied by any permanent reversal of the restrictions on reliefs in the medium term. It also takes the effective rate 5 per cent above its 2010-11 level when the headline rate was 28 per cent. The path is distorted somewhat by the large temporary expansion of reliefs announced in the Budget (the capital allowances super deduction and extended loss carry backs). Abstracting from these, the effective tax rate rises steadily (and somewhat more smoothly than the headline rate because of the decline in deductions relative to profits in our underlying forecast.)

Chart C: Effective tax rate versus the headline tax rate

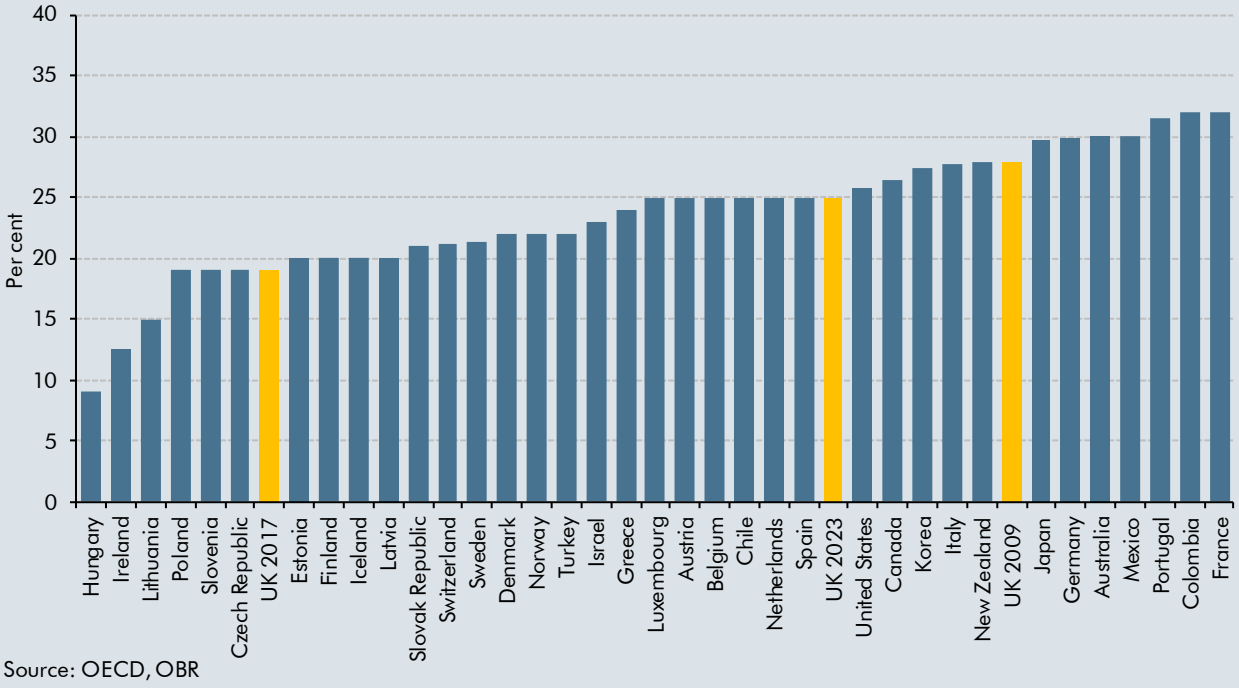


Source: IFS, HMRC, OBR, ONS

Chart D puts the rise in the headline tax rate in the context of equivalent rates in 2020 across 37 OECD countries (many of which have been cutting rates over the past decade). The 2010-11 rate inherited by the Coalition Government would be the joint eighth highest in today's terms; while the 19 per cent rate inherited by the current administration places the UK joint fourth lowest. Today's changes, which come into effect in 2023-24, would, absent any changes to other countries' rates, see the UK return to the top-half of the international league table. But it is

of course possible that other countries will make similar decisions about how to respond to the fiscal legacy of the pandemic and raise corporation tax rates too.

Chart D: International comparison of corporate tax rates in 2020



Source: OECD, OBR

[a] This has been defined here as: National Accounts measure of non-oil, non-financial gross trading profits plus the HMRC measure of financial company gross trading profits (excluding life assurance companies).
[b] Mee, J., The evolution of public sector receipts over the past decade, OBR Working Paper No.15, April 2020.

Property transaction taxes

3.45 Relative to March 2020, we have revised our forecast of property transaction taxes down by £2.2 billion a year on average across the forecast. This mostly reflects a lower path for house prices, which we expect to fall relative to earnings next year as fiscal support for household incomes is partly withdrawn. We have also revised down property transactions somewhat over the medium term. Receipts in 2020-21 and 2021-22 are also lower as a result of the stamp duty holiday in England and Northern Ireland that was announced by the Chancellor in July and extended in this Budget, plus similar measures announced by the Scottish and Welsh Government's in respect of their devolved property transaction taxes.

3.46 Relative to our November forecast, we have revised up receipts across the forecast period, largely thanks to the upward revisions to our house price forecast.

Table 3.11: Property transaction taxes: changes since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	12.8	13.8	14.7	16.2	17.4	18.7	
November 2020 forecast	12.5	9.1	12.0	12.7	14.1	15.6	17.0
March 2021 forecast	12.5	9.6	12.3	14.5	15.1	16.2	17.3
Change since November	0.0	0.5	0.3	1.8	1.0	0.6	0.4
Change since March	**-0.2**	**-4.2**	**-2.4**	**-1.7**	**-2.3**	**-2.5**	
	Underlying forecast changes since March 2020						
Total		**-1.7**	**-0.1**	**-1.7**	**-2.3**	**-2.5**	
of which:							
Residential property prices		0.7	-2.9	-3.3	-3.1	-2.8	
Residential property transactions		-1.6	0.8	0.4	0.3	0.1	
Commercial property determinants		-1.0	-0.7	-0.6	-0.5	-0.4	
Outturn receipts and modelling		0.2	2.7	1.7	0.9	0.6	
	Direct effect of Government decisions since March 2020						
Total		**-2.5**	**-2.3**	**0.0**	**0.0**	**0.0**	**0.0**
of which:							
July 2020 stamp duty holiday		-2.2	-1.0	0.0	0.0	0.0	0.0
Budget 2021 extension of stamp duty holiday		-0.2	-1.3	0.0	0.0	0.0	0.0
Scottish and Welsh Government measures		-0.1	0.0	0.0	0.0	0.0	0.0

Taxes on capital

3.47 **Capital gains tax** (CGT) receipts have been revised down since the start of the pandemic, reflecting the large fall in equity prices. Relative to our March 2020 forecast we have revised receipts down by £1.3 billion (11.2 per cent) in 2020-21. The shortfall rises to £3.8 billion (22.6 per cent) in 2024-25, by which point equity prices are 8.8 per cent lower than we assumed in March 2020. We have revised receipts up slightly since November as equity prices have risen. We have also moved some receipts into 2020-21 and out of 2021-22, following strong January receipts this year – reflecting lower than expected take-up of the Government's time-to-pay scheme, which would have deferred payments into next year.

3.48 **Inheritance tax** receipts have also been revised down substantially relative to our pre-pandemic forecast thanks to lower equity prices and lower house prices. The effect of these on growth in the value of estates more than offsets the small lift to receipts due to the increase in deaths this year. As described in the state pensions section of this chapter, we have revised up our assumption for excess deaths this year and next relative to November, as higher virus-related deaths in the current wave of the virus have outweighed the effect of lockdown reducing deaths from other causes, particularly from influenza and other respiratory diseases.

Excise duties

3.49 **Fuel duties** are set to fall short of our March 2020 forecast by £5.9 billion (21.6 per cent) in 2020-21. The shortfall this year largely reflects travel restrictions during lockdowns, which significantly reduced motor vehicle traffic. We have assumed that a greater prevalence of

home working will reduce vehicle use for commuting, modestly reducing the volume of fuel purchased relative to economic activity in the medium term. On top of this, the Government has, as is customary, frozen fuel duty rates next year rather than raising them by RPI inflation as it claims is its default indexation policy. This costs just £0.9 billion a year on average and leaves receipts £1.1 billion below our March 2020 forecast in 2024-25.

3.50 As a result of the reimposition in January of a nationwide lockdown and the associated travel restrictions, we have revised fuel duties in 2020-21 down by £0.3 billion relative to our November forecast. This temporary effect unwinds, but the fuel duty freeze means that receipts are £0.5 billion down on average across the forecast period.

3.51 **Alcohol duties** have been revised up by £0.8 billion (6.6 per cent) this year relative to our March 2020 forecast – one of the few tax streams that has outperformed our pre-virus forecast. Total receipts have held up as alcohol consumption has been one of the few tax bases unscathed by the virus. Higher sales in supermarkets and other shops have more than offset the loss in receipts from the closures of pubs and restaurants for large parts of the year. A compositional change to the underlying streams of alcohol duties is assumed to persist in the medium term with a slight shift towards wine and spirits, of which sales in supermarkets and other shop sales form a greater proportion, and away from beer and cider. The one-year freeze in alcohol duties next year announced in the Budget lowers receipts by £0.3 billion a year on average from 2021-22 onwards, leaving receipts down modestly relative to both our March and November forecasts over the medium term.

3.52 **Tobacco duties** remain little changed this year relative to our March 2020 forecast due to the non-cyclical nature of tobacco consumption, which is largely unaffected by economic downturns. Across the forecast, tobacco duty receipts are on average £0.5 billion higher than in March, reflecting higher outturn receipts and higher RPI inflation.

3.53 **Air passenger duty** receipts have been hit harder by the pandemic and public health measures than any other source of revenue. We have revised receipts in 2020-21 down by £3.4 billion (85 per cent) from our March 2020 forecast. Relative to that forecast we assume a small degree of scarring to business passenger numbers in the medium term, due in part to the switch from face-to-face meetings to digital conferencing. We continue to expect a gradual recovery in passenger numbers, similar in pace to that observed in the wake of the 9/11 terrorist attacks in the US, where US air passengers only exceeded pre-attack levels three years later.[2] As new variants of the virus have emerged and the Government has imposed more stringent travel restrictions since our November forecast, significant disruption to the aviation industry is set to continue into 2021-22. We have therefore pushed the assumed recovery of receipts to their lower 'new normal' level out by one year to 2024-25. But modestly higher outturn data means we have revised up our estimate for receipts in 2020-21 a little relative to our November forecast.

[2] US Bureau of Transportation Statistics, *Airline Travel Since 9/11*, December 2005.

Business rates and council tax

3.54 **Business rates** are expected to raise £18.1 billion in 2020-21, down 42 per cent on the previous year and £13.4 billion lower our March 2020 forecast. This primarily reflects the virus-related holidays in place for the retail, hospitality, leisure and nursery sectors in England, and similar schemes in Scotland and Wales. Revenues will also be hit by losses from irrecoverable debts and the potential for successful appeals for liabilities to be reduced due to material changes of circumstances ('MCC appeals' heard by the Valuation Office Agency (VOA)). The announcement by some large retailers that they would not take advantage of the business rates holiday is expected to result in over £2 billion being returned to the Exchequer. For statistical purposes, these are recorded as gifts rather than additional business rates revenue, since the companies in question do not have a tax liability this year.

3.55 The VOA has received an unprecedented number of business rates appeals since the start of pandemic, with 282,000 checks on rateable values in England between April and December 2020, up from around 55,000 in the same period in 2019. Many of these will be MCC appeals based on the effects of public health restrictions seeking a reduction in the rateable value of the property. The proportion of appeals that will be upheld, the scale of any resulting reduction in rateable value, and the time period over which they are resolved are all subject to considerable uncertainty. Budget measures provide a further £6.1 billion of business rates relief in 2021-22, with the full holidays for retail and other badly hit sectors extended to the end of June 2021, and relief continuing at a reduced and capped level over the remainder of 2021-22. Compared with our March 2020 forecast, we expect business rates to be over £9 billion lower in 2021-22. Thereafter, the reduction in receipts averages around £2 billion a year in the final few years of the forecast, reflecting a modest permanent hit to the tax base and new information from local authorities that suggests lower yield in 2021-22 than previously anticipated.

3.56 **Council tax** is £0.8 billion a year higher than in our March 2020 forecast. This is more than explained by the Government's decision at the Spending Review to allow councils to increase council tax rates by up 5 per cent without calling a local referendum rather than the 2 per cent that our March 2020 forecast assumed. This raises around £1 billion a year, and is partly offset by increases in working-age local council tax support as a result of higher unemployment, which increases the numbers eligible for support.

Other taxes

3.57 Our forecast for **oil and gas** revenues have been revised down substantially since November, and more so since last March. Offshore corporation tax is down by around £½ billion a year on average relative to those forecasts, with receipts now expected to be just £0.3 billion this year and £0.2 billion in 2025-26. Downward revisions since November reflect higher expenditure and lower production forecasts, reflecting the Oil and Gas Authority's latest survey of producers. A higher sterling oil price partly offset these effects.

3.58 **Environmental levies** include levy-funded spending policies such as the renewables obligation (RO), contracts for difference (CfD) and the capacity markets scheme. Compared

with March 2020, levies are up by around £¼ billion a year between 2021-22 and 2023-24. This mainly reflects the effect of lower wholesale energy prices on CfD spending. Lower energy prices mean more subsidy because the wholesale price will be further away from the guaranteed strike price. Our forecast is little changed from November.

3.59 **Customs duty** receipts in 2020-21 are set to be £0.4 billion lower than our March 2020 forecast, mostly due to the virus-related hit to imports. Underlying weakness in the forecast has more than offset the extra revenue generated from levying tariffs on those EU imports that fail to meet the terms of the UK-EU Trade and Cooperation Agreement.

3.60 **VAT refunds** have been revised up £1.3 billion a year on average against our March 2020 forecast, reflecting higher government procurement and investment spending. The rise in VAT refunds is less steep than the rise in central government procurement this year and next, since much of the extra spending, including the purchases of personal protective equipment and virus tests, falls outside the VAT refunds scheme. Since November, we have revised the forecast down by £3.7 billion in 2020-21 and by £1.5 billion a year on average from 2021-22 onwards. This reflects the latest outturn, which indicates the rise in central government procurement has boosted VAT refunds by less than we forecast in November.

Other receipts

3.61 **Interest and dividend receipts** include income from the government's financial assets such as student loans and bank deposits. Compared with our March 2020 forecast, interest and dividend receipts are down by nearly £4 billion a year on average from 2020-21 onwards. The lower path for short-term interest rates relative to pre-pandemic expectations is the key driver of lower receipts, but lower RPI inflation has also reduced accrued interest on student loans. Relative to our November forecast, receipts have been revised up by around £1 billion a year, reflecting in-year data, a modest rise in market expectations of interest rates, and higher NatWest dividends from the reprofiling of government asset sales.

3.62 Home Office charges, **visa fees** and the **immigration health surcharge** are little changed from our November forecast. The path these take will depend on the path net migration takes over the next few years, which is subject to much greater uncertainty than usual.

3.63 We have revised our **car emissions fines** forecast relative to March 2020, which are expected to raise £1.0 billion across the forecast, down from £1.6 billion last March. Correcting the accounting treatment to score fines in the year they are paid moves most of the revenue to 2022-23, a year later than we assumed last March. We have also revised down receipts by around a third to reflect the extent to which car producers will be able to use flexibilities such as 'eco-innovations' and 'super-credits' to reduce their liabilities relative to what they would be on a simple measure of the average emissions of their fleets. The UK regulation took effect in January 2021 and covers new car sales in Great Britain.

3.64 **Public sector gross operating surplus (GOS)** is higher than our March 2020 forecast by an average of £1.3 billion a year. This comprises two components that move in opposite directions. General government depreciation and the associated GOS has been revised up

by an average of £4.5 billion a year as a result of incorporating new ONS data on capital stocks and higher plans for direct government investment. This is offset by falls in public corporations' GOS since March 2020 by an average of £3.2 billion a year, which reflects lower trading income across several corporations, notably Transport for London (TfL). Some of TfL's 2020-21 losses have been compensated by central government already, but TfL's latest revised budget still assumes large losses going forward in the absence of grants from central government. This hits our forecast as lower GOS, although it could eventually shift into higher spending if further central government support were to follow to maintain services.

Public sector expenditure

Definitions and approach

3.65 This section explains our forecast for public spending, which is based on the National Accounts aggregates for public sector current expenditure (PSCE), public sector gross investment (PSGI) and total managed expenditure (TME) – the sum of PSCE and PSGI. We combine these National Accounts aggregates with the two administrative aggregates used by the Treasury to manage spending, each of which covers roughly half the total:

- **Departmental expenditure limits (DELs)** mostly cover spending on public services, grants and administration ('resource' spending), and investment ('capital' spending). These are items that in normal times can be planned over extended periods. Our fiscal forecast therefore shows PSCE in resource DEL and PSGI in capital DEL. We typically assume (in line with historical experience) that departments will underspend the final limits that the Treasury sets for them, so – unless otherwise stated – when we refer to PSCE in RDEL and PSGI in CDEL (or RDEL and CDEL for simplicity) we mean the net amount that we assume will actually be spent rather than the limits themselves.

- **Annually managed expenditure (AME)** covers items less amenable to multi-year planning, such as social security and debt interest. It also includes the virus-related income support schemes (such as the CJRS) and the upfront spending recorded to reflect future expected write-offs on the virus-related guaranteed loan schemes (such as the Bounce Back Loan Scheme). Again, our fiscal forecast shows PSCE in current AME and PSGI in capital AME.

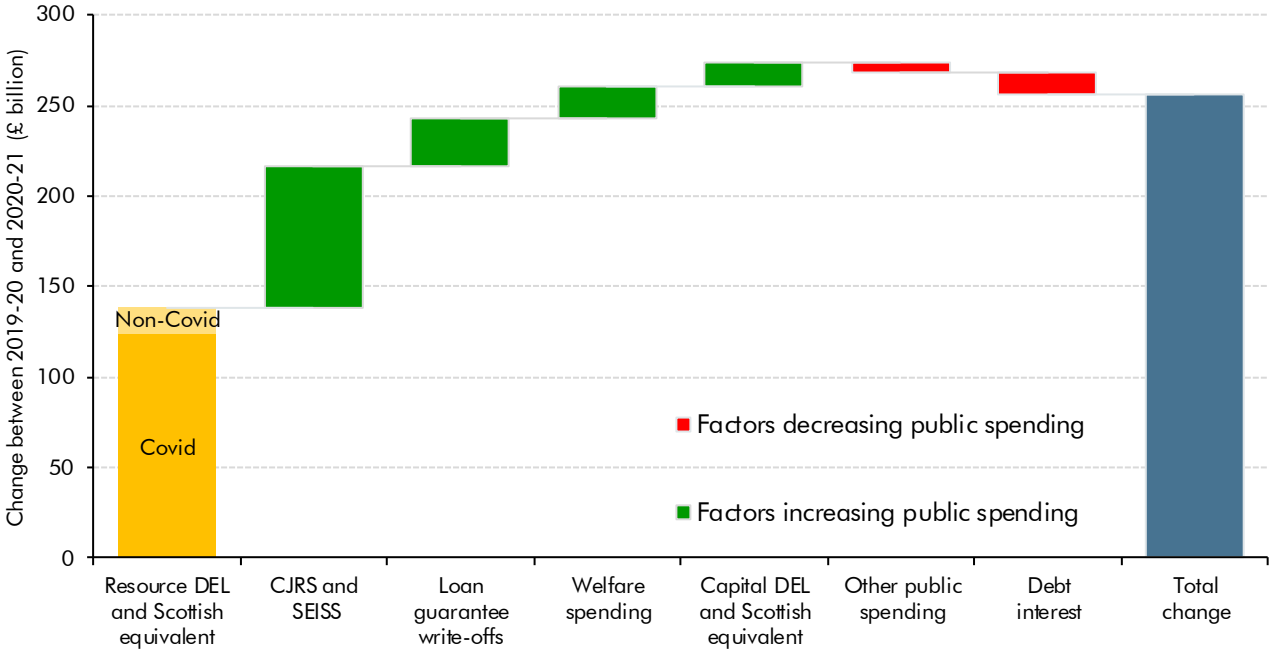
3.66 The distinction between these two administrative categories has diminished in the past two years, with the Treasury in effect managing DEL budgets on an annual basis too for most departments in both its one-year 2019 Spending Round and the one-year 2020 Spending Review. There have been exceptions to this *de facto* return to annual budgeting, including for the NHS (where a multi-year settlement was announced in June 2018, albeit outside the normal Spending Review and Budget processes), schools, defence and selected capital projects. But, overall, this represents the longest period that departments, the devolved administrations and local authorities have needed to plan without a multi-year settlement since the introduction of multi-year planning at the 1998 Comprehensive Spending Review.

Summary of the expenditure forecast

3.67 This section discusses the path of government spending and how it has changed since our March 2020 forecast (illustrating the cost of the pandemic) and since our November 2020 forecast (showing how our assessment of that cost has evolved).

3.68 Total public spending is expected to rise by £256 billion (29 per cent) in 2020-21 – the largest cash rise on record and the largest percentage rise in nominal terms since 1974-75, in the aftermath of the oil crisis. This reflects very large increases in departmental resource spending (particularly on health) and welfare spending, plus the introduction of virus-related support schemes for furloughed employees, the self-employed and (via grants and government-backed loans) businesses. Pre-virus departmental capital spending plans also contribute significantly. The only major source of declining spending in 2020-21 is debt interest, thanks to lower interest rates and the substantial net interest saving that results from the resumption of quantitative easing.

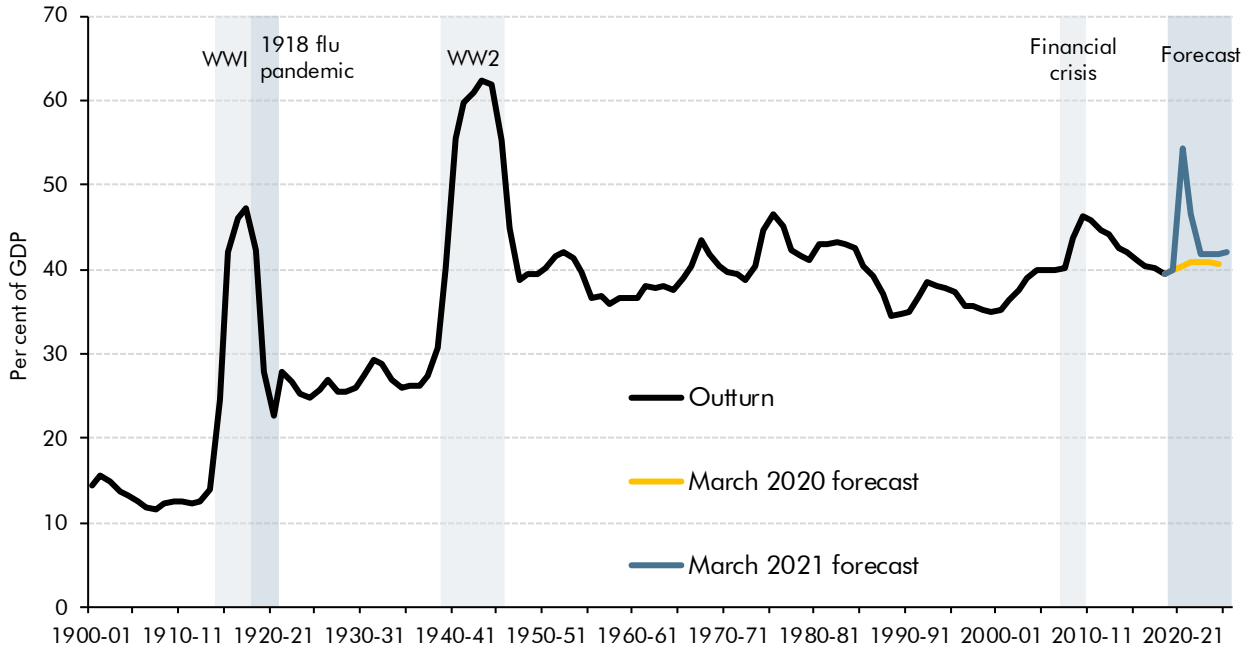
Chart 3.5: The rise in public spending in 2020-21



Source: ONS, OBR

3.69 As a share of GDP, total public spending is expected to have risen by 14.6 percentage points in 2020-21 to 54.4 per cent – the highest level recorded outside the world wars (as shown in Chart 3.6). This spike partly unwinds next year as virus-related spending drops and GDP starts to recover. It falls back further in 2022-23, as the Government's spending plans continue to assume that virus-related departmental spending falls back to zero. From 2022-23 onwards, spending stabilises at just below 42 per cent of GDP – levels that were last seen on a sustained basis from the late 1970s to the mid-1980s (although it was at a similar, though declining, level through the post-financial crisis decade).

Chart 3.6: Public spending as a share of GDP



Source: Bank of England, ONS, OBR

3.70 Despite the Government's plans including no virus-related spending beyond 2021-22, public spending in 2025-26 remains 2.1 per cent of GDP higher than its pre-virus level in 2019-20. Higher departmental spending explains all the rise, with RDEL rising by 1.0 per cent of GDP and CDEL by 1.1 per cent. Within AME spending, welfare spending rises, as a result of modestly higher medium-term unemployment and the lasting consequences of the pandemic for health-related welfare benefits. But offsetting that, debt interest spending is lower in 2025-26 than in 2019-20 despite higher debt, thanks to the combination of lower interest rates and a larger stock of gilts having been purchased through quantitative easing and thereby paying interest at Bank Rate rather than the somewhat higher rates on gilts.

Table 3.12: TME split between DEL and AME

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
TME	**39.8**	**54.4**	**46.5**	**41.8**	**41.9**	**41.9**	**41.9**
of which:							
TME in DEL	**17.0**	**24.6**	**21.9**	**18.9**	**19.1**	**19.1**	**19.2**
of which:							
Virus-related support measures in DEL	0.1	6.1	2.8	0.0	0.0	0.0	0.0
Other PSCE in RDEL	14.3	15.4	15.4	15.2	15.3	15.4	15.4
Other PSGI in CDEL	2.6	3.1	3.7	3.6	3.7	3.7	3.7
TME in AME	**22.8**	**29.8**	**24.6**	**22.9**	**22.8**	**22.8**	**22.7**
of which:							
Virus-related support measures in AME[1]	0.1	6.0	1.3	0.0	0.0	0.0	0.0
Other welfare spending	10.2	11.3	10.9	10.7	10.7	10.6	10.6
Debt interest, net of APF	1.6	1.1	1.1	1.0	1.1	1.2	1.3
Other AME	10.8	11.3	11.3	11.1	11.0	10.9	10.9

[1] All AME measures since March 2020.

Summary of changes since March 2020

3.71 Spending in 2020-21 exceeds our pre-pandemic March 2020 forecast by £213 billion (23 per cent). The upward revision falls to £76 billion in 2021-22, turning into a downward revision of around £15 billion a year on average from 2022-23 onwards. These changes can be split into:

- **Underlying pre-measures forecast changes**. These lower spending slightly in the short term, as the caseload-driven rise in welfare spending is offset by a large drop in debt interest spending. Both of these effects diminish over time, roughly halving in size by 2024-25. Locally financed spending is lower throughout, with the largest change coming from lower investment as the pandemic makes investment in commercial property a less attractive proposition. Depreciation has been revised up by progressively larger amounts, reflecting new ONS data on capital stocks. (Relative to our November forecast, both welfare spending and debt interest are higher across the forecast period, but other pre-measures forecast changes are relatively small.)

- **Government policy measures**. These dwarf the underlying forecast changes, especially in the short term, where they add £226 billion to spending in 2020-21. Just over half of this reflects £116 billion of additional departmental spending (plus Barnett consequentials) announced since March, while most of the remainder is the cost of the CJRS and SEISS (£80 billion) and the virus-related loan schemes (£27 billion). We now estimate the cost of these interventions to be somewhat less than we did in November, thanks to greater departmental underspending and lower take-up of the CJRS, SEISS and loans schemes. In 2021-22 additional departmental spending adds £52 billion, most of which was announced in the Spending Review, alongside the £25 billion cost of extending the CJRS and SEISS and launching the new Recovery Loan Scheme at this Budget. All told, spending measures announced for 2021-22 are expected to cost £82 billion. From 2022-23 onwards, policy measures lower spending relative to our March 2020 forecast. This is driven by cuts to departmental spending totals relative to those that were set in Budget 2020. Taking RDEL and the Barnett consequentials for Scottish Government AME together, these reduce spending by £16 billion in 2022-23, rising to £20 billion in 2024-25, relative to March totals. Around four-fifths of this reduction was announced at the Spending Review, with smaller additional cuts being announced in the Budget. We discuss the pressures this might create on the next Spending Review in Box 3.3.

Table 3.13: Sources of differences in spending versus March 2020

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	927.7	977.4	1,010.7	1,044.9	1,080.2	
November 2020 forecast	1,164.6	1,011.5	990.5	1,027.4	1,064.0	1,106.1
March 2021 forecast	1,140.9	1,053.3	992.3	1,030.1	1,068.7	1,111.5
Change since November	-23.6	41.8	1.8	2.7	4.7	5.4
Change since March	**213.3**	**75.9**	**-18.4**	**-14.8**	**-11.5**	
Underlying forecast changes since March 2020						
Total (including indirect effects)	**-12.2**	**-4.6**	**-4.5**	**2.2**	**6.9**	
of which:						
Debt interest	-10.6	-13.0	-13.4	-9.6	-5.6	
Locally financed current and capital expenditure	-3.7	-4.0	-5.2	-4.5	-4.0	
Welfare spending	5.2	6.1	6.0	5.2	4.2	
Depreciation	2.5	3.9	4.8	5.4	6.0	
Scottish Government's expenditure	-0.3	3.2	0.7	1.1	1.0	
Net public service pension payments	-2.3	-2.6	0.4	0.9	1.3	
Public corporations' capital expenditure	-3.4	-2.1	-1.8	-1.7	-1.7	
Company tax credits	1.0	0.4	0.6	1.3	2.0	
VAT refunds	1.8	1.9	1.1	1.4	1.2	
Other forecast changes	-2.3	1.6	2.3	2.7	2.4	
Direct effect of Government decisions since March 2020						
Total	**225.5**	**80.4**	**-13.9**	**-17.0**	**-18.4**	
of which:						
DEL measures	105.2	52.3	-13.5	-14.5	-15.6	
plus Barnett consequentials	10.5	1.0	-2.8	-3.1	-3.5	
CJRS, SEISS	79.7	24.3	0.0	0.0	0.0	
Loan guarantees	27.2	0.7	0.0	0.0	0.1	
Welfare measures	8.4	5.2	2.1	1.2	0.9	
Locally financed current and capital expenditure measures	-6.7	-1.1	0.8	0.8	1.1	
Other measures	1.1	-2.0	-0.5	-1.4	-1.4	

Detailed spending forecasts

3.72 Tables 3.14, 3.15 and 3.16 detail our latest spending forecast and how it differs from our March 2020 and November 2020 forecasts.

Table 3.14: Total managed expenditure

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector current expenditure (PSCE)							
PSCE in RDEL	320.8	445.0	413.6	362.4	377.3	393.0	409.7
PSCE in AME	470.1	566.6	520.9	503.8	520.9	540.1	561.9
of which:							
Welfare spending	227.7	244.8	249.1	254.9	263.3	271.9	282.3
Virus-related income support schemes[1]	2.2	79.7	24.3	0.0	0.0	0.0	0.0
Locally financed current expenditure	53.7	48.3	51.5	54.6	57.0	59.3	61.0
Central government debt interest, net of APF[2]	36.6	23.9	24.8	24.5	27.7	31.1	33.7
Scottish Government's current spending	29.2	43.4	39.8	35.1	36.6	37.9	39.4
EU financial settlement	10.9	10.4	11.0	8.7	4.3	2.2	1.6
Net public service pension payments	6.4	1.9	0.4	2.4	2.2	1.7	1.6
Company and other tax credits	7.4	8.3	8.3	9.1	10.2	11.4	12.4
BBC current expenditure	3.5	3.6	4.1	4.1	4.0	4.2	4.2
National Lottery current grants	1.0	1.5	1.3	1.2	1.1	1.0	1.0
General government imputed pensions	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Public corporations' debt interest	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Funded public sector pension schemes	17.7	18.9	19.7	20.8	22.0	23.1	24.2
General government depreciation	44.6	46.7	49.6	52.2	54.7	57.3	59.8
Current VAT refunds	16.6	19.5	20.3	20.2	21.1	22.1	23.4
Environmental levies	9.0	10.4	11.3	11.1	11.7	11.8	12.1
Other PSCE items in AME	1.8	2.5	2.9	2.5	2.3	2.4	2.3
Other National Accounts adjustments	0.0	1.2	0.8	0.9	0.9	0.9	0.9
Total public sector current expenditure	**790.8**	**1,011.6**	**934.5**	**866.3**	**898.2**	**933.1**	**971.7**
Public sector gross investment (PSGI)							
PSGI in CDEL	58.0	71.0	81.8	86.6	91.5	94.8	98.6
PSGI in AME	36.4	58.3	37.0	39.4	40.3	40.8	41.2
of which:							
Locally financed capital expenditure	14.7	7.2	8.8	8.7	8.2	8.3	8.4
Public corporations' capital expenditure	10.8	9.0	9.3	9.6	10.0	10.3	10.4
Student loans	10.2	10.6	11.2	11.7	12.2	12.6	13.0
Funded public sector pension schemes	0.7	2.0	2.0	2.7	2.2	1.7	1.2
Scottish Government's capital spending	4.0	4.9	5.4	5.9	6.1	6.3	6.6
Tax litigation	0.0	0.0	0.7	1.4	1.6	1.6	1.6
Calls on virus-related loan schemes	0.0	27.2	0.7	0.0	0.0	0.1	0.1
Other PSGI items in AME	0.3	-0.2	-0.7	0.8	0.8	0.7	0.7
Other National Accounts adjustments	-4.3	-2.4	-0.4	-1.4	-0.9	-0.8	-0.7
Total public sector gross investment	**94.4**	**129.4**	**118.8**	**126.1**	**131.8**	**135.6**	**139.8**
Less public sector depreciation	-51.3	-53.5	-56.6	-59.1	-61.7	-64.4	-67.0
Public sector net investment	43.1	75.9	62.2	67.0	70.1	71.2	72.8
Total managed expenditure	**885.2**	**1,140.9**	**1,053.3**	**992.3**	**1,030.1**	**1,068.7**	**1,111.5**

[1] Includes the coronavirus job retention scheme and the self-employment income support scheme.

[2] Includes reductions in debt interest payments due to the APF.

Table 3.15: Total managed expenditure: changes since March 2020

	£ billion					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Public sector current expenditure (PSCE)						
PSCE in RDEL	4.5	105.2	52.3	-13.5	-14.5	-15.6
PSCE in AME	-1.1	90.6	28.1	-1.7	2.9	7.9
of which:						
Welfare spending	3.1	13.6	11.3	8.1	6.4	5.1
Virus-related income support schemes[1]	2.2	79.7	24.3	0.0	0.0	0.0
Locally financed current expenditure	-0.2	-6.7	-3.6	-2.3	-1.6	-0.8
Central government debt interest, net of APF[2]	-1.4	-10.6	-13.0	-13.4	-9.6	-5.6
Scottish Government's current expenditure	-2.8	9.9	4.2	-2.3	-2.3	-2.8
EU financial settlement	-0.1	1.4	-0.1	0.2	-0.4	0.0
Net public service pension payments	-0.5	-2.3	-2.6	0.4	1.0	1.4
Company and other tax credits	0.6	1.0	0.4	0.7	1.4	2.2
BBC current expenditure	-0.3	-0.4	0.1	0.0	0.0	-0.1
National Lottery current grants	-0.2	0.2	0.2	0.1	0.2	0.1
General government imputed pensions	0.0	0.0	0.0	0.0	0.0	0.0
Public corporations' debt interest	0.0	0.0	0.0	0.0	0.0	0.0
Funded public sector pension schemes	-1.8	-1.6	-1.7	-1.6	-1.5	-1.5
General government depreciation	2.5	2.5	3.9	4.8	5.4	6.0
Current VAT refunds	-0.3	1.8	1.9	1.1	1.4	1.2
Environmental levies	-1.8	-0.2	0.3	0.2	0.1	-0.2
Other PSCE items in AME	0.2	1.3	1.5	1.0	0.8	0.8
Other National Accounts adjustments	-0.4	1.1	1.0	1.4	1.7	2.1
Total public sector current expenditure	**3.4**	**195.8**	**80.4**	**-15.2**	**-11.6**	**-7.7**
Public sector gross investment (PSGI)						
PSGI in CDEL	-1.9	-0.2	-0.4	0.0	0.0	0.0
PSGI in AME	-2.8	17.6	-4.1	-3.2	-3.2	-3.8
of which:						
Locally financed capital expenditure	1.6	-3.7	-1.4	-2.1	-2.1	-2.2
Public corporations' capital expenditure	-0.2	-2.4	-2.1	-1.8	-1.7	-1.7
Student loans	0.3	0.0	0.0	-0.2	-0.2	-0.2
Funded public sector pension schemes	-0.1	1.1	1.1	1.8	1.3	0.8
Scottish Government's capital expenditure	0.0	0.3	0.0	0.2	0.3	0.3
Tax litigation	0.0	-1.8	-0.5	0.3	0.5	0.5
Calls on virus-related loan schemes	0.0	27.2	0.7	0.0	0.0	0.1
Other PSGI items in AME	-0.5	-1.0	-1.5	0.0	0.1	0.1
Other National Accounts adjustments	-3.9	-2.1	-0.4	-1.4	-1.5	-1.5
Total public sector gross investment	**-4.7**	**17.4**	**-4.5**	**-3.2**	**-3.2**	**-3.8**
Less public sector depreciation	-1.4	-1.3	-2.6	-3.1	-3.6	-4.1
Public sector net investment	-6.1	16.2	-7.2	-6.3	-6.8	-7.9
Total managed expenditure	**-1.3**	**213.3**	**75.9**	**-18.4**	**-14.8**	**-11.5**

[1] Includes the coronavirus job retention scheme and the self-employment income support scheme.
[2] Includes reductions in debt interest payments due to the APF.

Table 3.16: Total managed expenditure: changes since November 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector current expenditure (PSCE)							
PSCE in RDEL	0.0	-11.0	8.5	-3.2	-2.8	-3.3	-3.7
PSCE in AME	0.9	-6.4	33.1	5.6	5.7	8.6	9.9
of which:							
Welfare spending	0.0	-1.4	2.4	3.1	3.8	4.4	4.6
Virus-related income support schemes[1]	0.0	-3.8	24.3	0.0	0.0	0.0	0.0
Locally financed current expenditure	0.2	-0.5	-5.1	-2.0	-1.5	-1.1	-1.1
Central government debt interest, net of APF[2]	-0.3	0.4	7.2	3.3	2.2	3.8	4.7
Scottish Government's current spending	0.0	1.2	3.6	0.2	0.3	0.1	-0.1
EU financial settlement	0.0	0.3	-0.3	-0.3	-0.5	-0.1	0.0
Net public service pension payments	0.1	0.5	0.0	0.9	1.2	1.3	1.4
Company and other tax credits	0.0	0.0	0.3	0.0	-0.2	-0.2	0.0
BBC current expenditure	0.0	-0.1	0.1	0.1	0.1	0.1	0.0
National Lottery current grants	0.0	-0.1	0.1	0.0	0.1	-0.2	0.0
General government imputed pensions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public corporations' debt interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Funded public sector pension schemes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government depreciation	-0.1	-0.1	0.6	0.9	1.1	1.2	1.4
Current VAT refunds	0.1	-3.6	-1.0	-1.6	-1.6	-1.6	-1.6
Environmental levies	0.0	-0.2	0.0	0.0	0.0	-0.1	-0.2
Other PSCE items in AME	0.0	0.0	-0.1	0.0	-0.1	-0.1	-0.1
Other National Accounts adjustments	0.9	0.9	1.1	1.0	0.9	0.9	1.0
Total public sector current expenditure	**0.9**	**-17.3**	**41.6**	**2.4**	**2.9**	**5.3**	**6.2**
Public sector gross investment (PSGI)							
PSGI in CDEL	0.0	-1.0	-0.1	0.0	0.0	0.0	0.0
PSGI in AME	0.7	-5.3	0.3	-0.6	-0.2	-0.6	-0.8
of which:							
Locally financed capital expenditure	1.7	0.4	1.5	0.2	0.2	0.0	-0.1
Public corporations' capital spending	0.0	-1.0	-1.1	-1.1	-0.9	-0.8	-0.9
Student loans	0.0	0.0	0.0	0.0	0.0	-0.2	-0.3
Funded public sector pension schemes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Scottish Government's capital spending	0.0	-0.1	0.5	0.0	0.0	0.0	0.0
Tax litigation	0.0	-1.5	-0.5	0.3	0.5	0.5	0.5
Calls on virus-related loan schemes	0.0	-2.2	0.7	0.0	0.0	0.1	0.1
Other PSGI items in AME	0.0	-0.9	-1.4	0.0	0.1	0.0	0.0
Other National Accounts adjustments	-1.0	0.0	0.5	0.0	-0.2	-0.2	-0.2
Total public sector gross investment	**0.7**	**-6.3**	**0.1**	**-0.6**	**-0.2**	**-0.6**	**-0.8**
Less public sector depreciation	0.1	0.6	-0.4	-0.7	-0.9	-1.1	-1.2
Public sector net investment	0.8	-5.7	-0.3	-1.3	-1.1	-1.6	-2.1
Total managed expenditure	**1.6**	**-23.6**	**41.8**	**1.8**	**2.7**	**4.7**	**5.4**

[1] Includes the coronavirus job retention scheme and the self-employment income support scheme.
[2] Includes reductions in debt interest payments due to the APF.

Spending within departmental expenditure limits

3.73 In this section, we use 'RDEL spending' and 'CDEL spending' to refer to PSCE in RDEL and PSGI in CDEL, respectively. Given the large movements in Scottish Government AME since March 2020 due to the automatic knock-ons from the extra virus-related DEL funding (known as 'Barnett consequentials' as they are calculated using the Barnett formula), we also note the combined effect of changes in DEL spending and Scottish Government AME.

3.74 Our forecasts reflect:

- **Departments' latest 'forecast outturns' for 2020-21** that were sent to the Treasury in February, the latest local government finance settlement, this year's Supplementary Estimates, plus our assumptions regarding any further underspending relative to them. Departments' forecast outturns reflect the £122 billion increase in RDEL plans announced since March 2020. We have also used the Treasury's estimates of departments' outturn cash spending to inform judgements on likely levels of underspending.

- **Departments' plans for 2021-22** as announced in the 2020 Spending Review, plus £10 billion of additional funding announced at this Budget. These plans include £66 billion of additional virus-related spending since March, alongside the £10 billion cuts to non-virus-related spending relative to March 2020 totals that were announced in November, plus our assumptions about underspending against the latest plans. These plans continue to be subject to an unusual degree of policy risk given both the novelty of the programmes, the difficulty we have seen actually spending such large increases, and continued uncertainty as to the length of the pandemic.

- **The Government's DEL totals for 2022-23 to 2025-26** that were set in the 2020 Spending Review and have been cut a little further in cash terms in this Budget. Although some DELs have already been allocated in the form of multi-year settlements for specific departments, programmes, or projects, plans for most will not be finalised until the 2021 Spending Review. DELs already allocated include the NHS RDEL settlement to 2023-24, the schools RDEL settlement to 2022-23, the defence settlement to 2024-25, and non-defence investment projects accounting for around a third of the CDEL budget. These control totals include the £14 to 17 billion a year in unspecified cuts to non-virus-related spending relative to March 2020 totals – £11 to 13 billion of which were announced in November's Spending Review, with the remainder added in this Budget. Our forecast includes our assumptions about underspending against these latest totals.

- In all years we have added **Scottish Government AME** onto the DEL totals, reflecting Barnett consequentials and our judgements on additions to or use of reserves. Taking RDEL and Scottish Government AME together, the Government has lowered resource spending in 2022-23 by £16 billion, rising to £19 billion in 2024-25.

RDEL spending in 2020-21

3.75 Relative to our March 2020 forecast, RDEL spending has been revised up by around £105 billion in 2020-21. But that is around £11 billion lower than in our November forecast. Around £3 billion of this reflects reductions in total plans that departments agreed with the Treasury through the Supplementary Estimates process, but £8 billion reflects a change in our estimate of the degree of underspending relative to those lower final plans.

3.76 In November we estimated that around £12 billion (or 2.5 per cent) of total plans would be underspent. This was higher than the 1 per cent we assumed in March 2020, which was a more historically typical proportion. While large underspends were always possible when plans were being ramped up so quickly, our latest estimate of £20 billion is equivalent to around 5 per cent of total plans. We have arrived at this figure by considering bottom-up evidence from the information that departments provide to the Treasury and top-down evidence from the cash and accrued spending that underpins the public sector finances statistics. It points to significant underspends against hugely increased control totals for those departments most heavily involved in the response to the pandemic – the Department of Health and Social Care, but also the Department for Business, Energy and Industrial Strategy that oversees vaccine procurement. Spending by these departments is up very sharply on last year, but not by quite as much as the Treasury set aside for them. The Government also set aside a very large reserve at the Spending Review to cope with unforeseen virus-related requirements, almost all of which was allocated to departments at Supplementary Estimates. But it appears that not all of this will need to be called upon this year.

RDEL spending in 2021-22

3.77 RDEL spending has been revised up significantly in 2021-22 relative to our March 2020 forecast, although not to the same extent as in 2020-21. The £52 billion increase reflects a £56 billion increase in limits set by the Treasury, which has led us to increase the amount that we expect those limits to be underspent by £4 billion. Spending is around £9 billion higher than in our November 2020 forecast, reflecting the additional £4 billion of business grants to support companies hit by the renewed public health restrictions, and £4 billion to compensate local authorities for income that they would otherwise lose as a result of further business rates relief. Since most of this extra spending is in the form of grants rather than procurement or staff costs, we do not expect them to lead to any increase in the amount of underspending next year.

Medium-term RDEL spending from 2022-23 onwards

3.78 Relative to our March 2020 forecast, RDEL spending is lower by £13 billion in 2022-23, rising to £16 billion in 2024-25. Most of these cuts relative to March 2020 totals were announced in the 2020 Spending Review, although detailed plans for how they would be delivered were not set out. At this Budget, the Government has further lowered RDEL totals from 2022-23 onwards – by £3.3 billion in 2022-23, rising to £3.9 billion in 2025-26. It has linked these reductions to revisions in our forecast for GDP deflator growth in the period from 2021-22 onwards. The key change relates to the 1.0 percentage point downward

revision to deflator growth in 2022-23, which in turn can be traced back to the current lockdown and how it affects the government consumption component of the deflator when schools are closed and elective health procedures postponed. So, in effect it is the present disruption to public services that has led to the Budget reductions in RDEL totals in 2022-23 and beyond. As discussed in Box 3.3, this could make the next Spending Review more challenging.

Table 3.17: Changes in departmental resource spending since March and November 2020

	£ billion					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast						
Limits	343.0	365.2	380.0	396.0	413.0	
Assumed underspend	-3.2	-3.9	-4.1	-4.3	-4.4	
Actual spending	339.8	361.3	375.9	391.8	408.6	
November 2020 forecast						
Limits	468.0	411.2	369.1	383.6	400.0	417.3
Assumed underspend	-12.0	-6.1	-3.5	-3.6	-3.7	-3.9
Actual spending	456.0	405.1	365.6	380.1	396.3	413.4
March 2021 forecast						
Limits	465.0	421.0	365.7	380.7	396.5	413.4
Assumed underspend	-19.9	-7.5	-3.3	-3.4	-3.5	-3.7
Actual spending	445.0	413.6	362.4	377.3	393.0	409.7
Change since March						
Limits	122.0	55.9	-14.3	-15.3	-16.5	
Assumed underspend	-16.7	-3.6	0.8	0.8	0.9	
Actual spending	105.2	52.3	-13.5	-14.5	-15.6	
Change since November						
Limits	-3.1	9.9	-3.3	-2.9	-3.5	-3.9
Assumed underspend	-7.9	-1.4	0.2	0.1	0.2	0.2
Actual spending	-11.0	8.5	-3.2	-2.8	-3.3	-3.7

Table 3.18: Departmental capital spending

	£ billion					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2021 forecast						*Implied plans*
Limits[1]	77.0	89.3	94.5	99.5	102.9	107.0
Assumed underspend	-6.0	-7.5	-7.8	-8.0	-8.1	-8.5
Actual spending	71.0	81.8	86.6	91.5	94.8	98.6

[1] In the years covered by the Spending Review, limits reflect the departmental spending allocations agreed with HM Treasury at the latest Spending Review, adjusted for policy changes and classification changes since. In years beyond the Spending Review this reflects the implied limits consistent with what HM Treasury intends to spend and our view on underspends.

Box 3.3: Departmental spending risks at the next Spending Review and beyond

The remit set for the OBR by Parliament requires us to base our forecasts on the current policy of the Government, and not to consider alternative policies. But we are also tasked with producing a central forecast and assessing risks to that forecast. One of the most significant risks to the medium-term fiscal outlook relates to the potential legacy of the pandemic for spending on public services. The huge sums allocated to fight the virus mean that departmental resource spending (RDEL) is expected to have risen by 36 per cent or £122 billion in 2020-21. However, only £56 billion (equivalent to a 15 per cent increase on pre-pandemic RDEL plans) has been added to fund virus-related activities in 2021-22 and no provision for virus-related spending has been added to pre-pandemic plans thereafter. As a result, RDEL spending rises from 14.4 to 21.2 per cent of GDP in 2020-21, but then falls back to 15.3 per cent of GDP in 2022-23. The resulting increase between 2019-20 and 2022-23 is a slightly smaller rise than the Government had planned in its pre-pandemic Budget in March 2020.

Historical experience suggests that it is easier to increase public spending during a crisis than it is to reduce it once the crisis has abated. RDEL rose from 16.3 to 18.3 per cent of GDP during the two peak years of the financial crisis in 2009-10, but fell back by only half as much, to 17.2 per cent, over the subsequent two. Overall public spending five years after the first and second world wars was respectively 11 and 9 per cent of GDP higher than it had been on the eve of those conflicts, with the tax-to-GDP ratio also significantly higher to pay for a state whose scope of activities had significantly expanded.

Given this context, this box considers the potential upward pressures that could impinge upon RDEL spending in the 2021 Spending Review and beyond. These pressures come from a combination of the direct legacy costs of the pandemic itself on public services, the backlog of non-virus-related public service activities that have been postponed as a result of the pandemic, and the wider economic disruption brought about by coronavirus. Several of these likely future pressures were discussed in the Government's Roadmap out of the pandemic.[a]

The extent to which any additional spending in these areas leads to higher RDEL spending overall would depend on choices made at future Spending Reviews. The Government might, for example, choose to allocate less than it otherwise would have done to its pre-pandemic priorities given the changed circumstances. And if the Government did choose to increase overall RDEL spending to accommodate higher spending in some areas without reducing it in others, the extent to which it would represent a risk to medium-term borrowing would depend on choices about cuts to other spending and/or further tax rises.

The most direct virus-related costs that could persist longer than currently factored into the Government's plans are the **direct health costs of coronavirus**. So long as the virus continues to circulate in the UK, there could be ongoing costs from NHS Test and Trace, which have been running at several billion pounds a month so far this year. Similarly, the Government noted in the Roadmap that "*vaccinations – including revaccination… is likely to become a regular part of managing COVID-19*". There could also be greater-than-assumed medium-term implications for spending as a result of 'long Covid' cases and the consequences for mental health arising from

the pandemic and the lockdowns. The Health Foundation estimates that just the mental ill-health legacy of the pandemic could cost at least £1 billion a year over the next few years.[b]

In addition to these direct demands on the health service, the Government stated in the Roadmap that it is "*committed to building resilience for any future pandemics, both domestically and on the international stage.*" This could require building **greater spare capacity in the health service** so that it is more resilient to sudden surges in demand of the type experienced over the past year. The OECD reports that, internationally, the UK entered the pandemic with relatively high levels of bed occupancy and relatively low average per capita numbers of critical care beds.[c] The NHS estate might also need to be reconfigured so that managing large numbers of infectious patients and segregating them from the non-infected population does not routinely disrupt other treatments – something that is made more challenging in the UK by the relatively old NHS hospital estate.[d] The Health Foundation notes that continued social distancing and infection control measures could reduce NHS productivity relative to pre-crisis assumptions, calculating that every percentage point of productivity lost could generate £1.4 to £1.7 billion a year of spending pressure.[e]

In addition to these virus-related pressures, there are likely to be costs associated with clearing the **backlog of non-virus-related activity in the NHS**. Between April and December 2020, there were 5.3 million fewer referrals for hospital care in England than over the same period in 2019. At least some of these people not seen last year will need treatment eventually, which can be expected to add to the 4.5 million already on a waiting list for NHS care. Waiting times have already risen: the latest figures show that 224,000 people have been on NHS waiting lists for more than a year, compared to just over 1,500 a year ago.[f] In November, the Health Foundation estimated that clearing the backlogs and reducing waiting times would cost around £2 billion a year over the next three years, but also warned that the level of increased activity required to do so might not be achievable due to staffing constraints.[b]

The Department of Health and Social Care's (DHSC's) 'core' non-virus budget in 2021-22 was set at £147.1 billion in the last Spending Review. While an additional £50.1 billion was added in 2020-21 and £20.3 billion was added in 2021-22, no additional resources beyond those in its multi-year settlement have been provided to deal with the above pressures in future years.

While the health service faces the most direct set of costs from the legacy of the pandemic, the events of the past year could also generate spending pressures in other areas:

- **Social care.** The pandemic hit the old-age social care sector particularly hard. The combination of additional future pressures and the high proportion of coronavirus deaths that have occurred in care homes is likely to increase pressure on the Government to deliver the funding reform that it committed to in its 2019 Manifesto. In May 2020, the House of Lords Economic Affairs committee wrote to the Chancellor proposing a funding model that the Health Foundation and King's Fund have estimated would cost an additional £7 billion a year.[g] In his response, the Chancellor noted that this proposal came "*at a time when the vital work done by the sector is at the forefront of the public's minds*" and committed to "*bring forward a plan for social care for the longer term.*"[h]

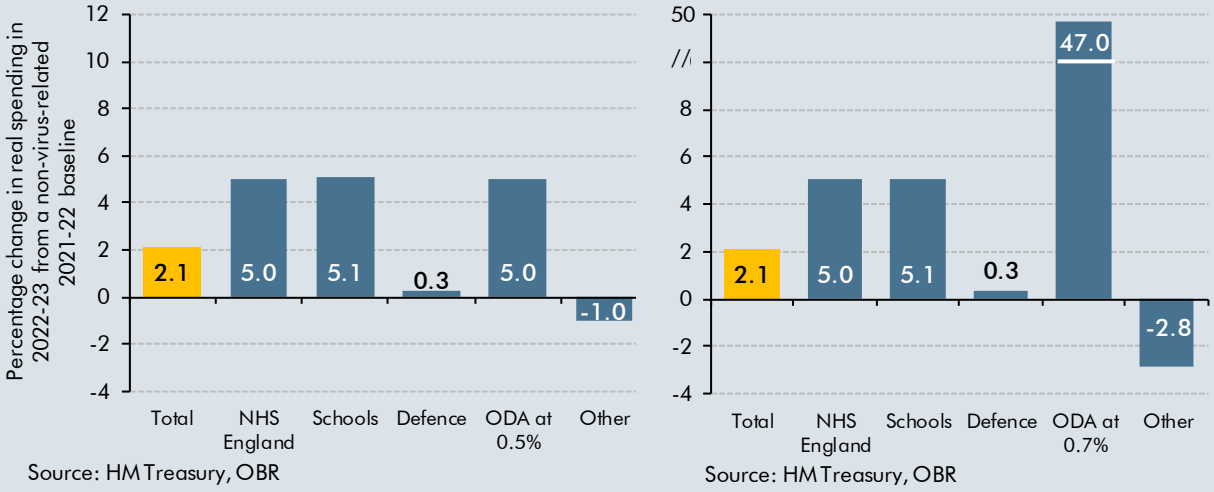
- **Education.** The closure of schools for significant periods of the past year has significantly reduced the number of teaching hours received by the current cohort of school-aged children. The Prime Minister has stated that "*no child will be left behind as a result of the pandemic*" and an intention to "*develop a long-term plan to make sure pupils have the chance to make up their learning over the course of this Parliament*."[i] The Roadmap highlights "*studies suggesting the total loss in face-to-face learning could amount to around half a school year*" and states that an Education Recovery Commissioner has been appointed "*to oversee a comprehensive programme of recovery aimed at young people who have lost out on learning due to the pandemic*". In three successive announcements since the start of the pandemic, the Government has committed to an additional £1.7 billion to funding catch-up schooling in England. This includes £0.4 billion in this Budget, which has been allocated from the 2021-22 Covid reserve that was set aside at the Spending Review.
- **Local authorities.** Central government support for local authorities makes up £7 billion of the overall cost of virus-related measures the Government has announced so far. Since the start of the pandemic, one local authority has issued a 'Section 114 notice' (in effect, declaring itself bankrupt), while five have received special access to borrowing to cover day-to-day spending in this Budget. There is potential for further significant calls on central government to maintain local services in some scenarios.
- **Transport.** The pandemic has also significantly disrupted domestic and international transport and generated calls for substantial and lasting fiscal support. The Government has already intervened this year with direct support to the railways and to Transport for London at a cost of £12.8 billion. With restrictions on international travel and new quarantine measures in place, the Government may also face calls for support from airports, airlines, and other transport providers.

Because of the Government's decision to suspend multi-year budget planning and revert to annual spending rounds for most departments, whether and how the Government plans to respond to these pressures is not yet known. However, since the start of the pandemic, the Government has actually reduced planned RDEL spending in 2022-23 by £14.3 billion (0.6 per cent of GDP) rising to £16.5 billion (0.6 per cent of GDP) relative to the totals that it set out in Budget 2020. That includes cuts to plans announced in this Budget ranging from £3.3 billion in 2022-23 up to £3.9 billion in 2025-26 (described in paragraph 3.78).

This implies increasingly tight budgets for non-protected departments (i.e. those outside health, education, defence and overseas aid) going into the next Spending Review this autumn, especially given the Government's stated intention to return the aid budget to 0.7 per cent of national income "*when the fiscal position allows*". As shown in Chart E, even before taking account of any of the legacy pressures of the pandemic discussed above, were the Government to stick to the RDEL totals set out in this Budget while retaining the multi-year settlements made in Spending Review 2020 and keeping aid spending at the 0.5 per cent of national income it was cut to in the Spending Review, RDEL budgets for unprotected departments would need to fall by 1 per cent in real terms between 2021-22 and 2022-23. If it deemed that the aid budget could

return to 0.7 per cent of national income, that would require the RDEL budgets of unprotected departments to fall by 2.8 per cent in real terms between 2021-22 and 2022-23.

Chart E: Change in real RDEL spending in 2022-23



Source: HM Treasury, OBR

Source: HM Treasury, OBR

[a] *Covid-19 Response – Spring 2021*, HM Government, February 2021.
[b] *Spending Review 2020, Priorities for the NHS, social care and the nation's health*, Health Foundation, November 2020.
[c] *Beyond containment: health system responses to Covid-19 in the OECD*, OECD, 2020.
[d] *Here to stay? How the NHS will have to learn to live with coronavirus*, Nuffield Trust, May 2020.
[e] *Spending Review 2020: Managing uncertainty, COVID-19 and the NHS long term plan*, Health Foundation, November 2020.
[f] *Referral to Treatment Waiting Times, England,* Department of Health and Social Care, December 2020.
[g] *Lord Forsyth of Drumlean, Letter to Chancellor of the Exchequer,* 26 May 2020.
[h] Chancellor of the Exchequer, Letter to Lord Forsyth of Drumlean, Chairman of the Economic Affairs Committee, 5 June 2020.
[i] *The crisis in lost learning calls for a massive national policy response*, IFS, February 2021.
[i] *New Commissioner appointed to oversee education catch-up*, Prime Minister's Office, February 2021.

Welfare spending

3.79 Total welfare spending in our forecast refers to AME spending on social security and tax credits. Around half is subject to the Government's 'welfare cap', which excludes the state pension and those payments most sensitive to the economic cycle. We provide an update on performance against the cap in Chapter 4. The different virus-related job and income support schemes introduced last year are not treated as welfare spending in the public finance statistics (they are treated as subsidies to employers), so are discussed separately in the next section. But in an economic sense they perform the same role – in effect creating more generous, though temporary, benefit systems for employees and the self-employed.

Table 3.19: Total welfare spending

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Pensioner spending[1]	111.6	113.9	117.7	124.2	130.1	135.9	142.2
UC and legacy equivalents[2]	64.3	79.5	75.3	74.6	74.7	75.4	76.7
Disability benefits[3]	26.1	24.7	25.7	27.3	28.9	30.3	32.1
Child benefit	11.5	11.6	11.6	11.8	11.9	11.9	11.9
Other spending[4]	14.1	15.1	15.7	16.5	17.3	18.2	19.1
Direct effect of Government decisions	0.0	0.1	3.0	0.4	0.3	0.2	0.3
Total welfare spending	**227.7**	**244.8**	**249.1**	**254.9**	**263.3**	**271.9**	**282.3**
of which:							
Inside welfare cap	118.7	123.0	122.0	122.8	125.7	127.9	130.4
Outside welfare cap	109.0	121.8	127.1	132.1	137.6	144.0	152.0

[1] Pensioner spending includes pensioner housing benefit, pension credit, state pension expenditure and winter fuel payments.
[2] UC and legacy equivalents includes personal tax credits, housing benefit (excluding pensioner part), income-related and contributory employment and support allowance, income support and income-based and contributory jobseeker's allowance.
[3] Disability benefits includes disability living allowance, personal independence payment, and attendance allowance.
[4] Other spending includes all Northern Ireland social security expenditure.

3.80 Total welfare spending in 2020-21 has been revised up sharply relative to our March 2020 forecast (by £13.6 billion). This represents an 8 per cent rise in cash terms on a year earlier, which, when combined with the sharp fall in nominal GDP, means it rises by 1.4 per cent of GDP relative to 2019-20. Around 40 per cent of the upward revision in cash terms relative to March is driven by the sharp spike in the universal credit (UC) caseload, which increased very rapidly in the initial months of the pandemic before stabilising. But 60 per cent reflects the £8 billion cost of policy measures, primarily the £20 a week increase to the UC standard allowance and to the basic element of working tax credit.

3.81 Spending on UC and its equivalents in the legacy system fall back slightly in 2021-22, despite the rise in unemployment this year. This largely reflects the cost of the Budget measure extending the £20 a week uplift to UC for six months being £2.2 billion in 2021-22, whereas the uplift for the whole of 2020-21 is estimated to have cost £4.6 billion. As working tax credit awards cannot be changed for part of a year, an equivalent £500 payment is being made via HMRC's DEL budget at a cost of £0.7 billion. This is reflected in our RDEL forecast.

3.82 From 2022-23 onwards, spending returns to its more typical pre-pandemic trajectory, with pensioner spending rising gently as a share of GDP due to the ageing population, and working-age spending falling gently as unemployment falls and as benefits are uprated with inflation and so fall relative to earnings. By 2024-25, spending is 0.6 per cent of GDP higher than our March forecast.

3.83 Table 3.20 documents the sources of changes to our welfare spending forecast since March 2020. The majority of these changes were reflected in our November forecast, with changes since then adding an average of £3.7 billion a year from 2021-22 onwards:

- **UC and its predecessors**. The largest source of higher spending since March is a higher caseload, the effect of which peaks in 2021-22. This reflects the spike in new recipients last year, followed by a further, more modest, rise expected later this year as unemployment rises after the furlough scheme closes. Higher labour market inactivity also boosts caseloads in the medium term. The cost of the £20 a week uplift is greatest in 2020-21, then roughly halves in 2021-22 thanks to the six-month extension announced in the Budget, before falling away to zero from 2022-23 onwards.

- **State pensions spending**. The primary driver of lower spending is the weaker outlook for average earnings growth, which lowers the effect of triple lock uprating. Excess deaths due to the pandemic have also reduced the number of people receiving pensions relative to the assumptions underpinning our March 2020 forecast. Indeed, with virus-related deaths rising sharply again in recent months, we have revised up the number of excess pensioner-age deaths in 2020-21 from 90,000 in our November forecast to around 100,000 in this one. This revision may appear small given the severity of the current wave, but the lockdown brought in to control the coronavirus has also dramatically reduced the number of influenza deaths this winter relative to a normal year. Our forecast now also assumes some excess deaths in 2021-22, drawing on academic modelling published alongside the Government's Roadmap (as discussed in Box 2.1). Excess deaths lower pensioner spending by £0.6 billion in 2020-21 and by £0.9 billion in 2021-22 relative to our March 2020 forecast. DWP has also identified underpayments of state pension relating to entitlements for certain married people, widows and over-80s back to 1992. Our forecast reflects an initial estimate that it will cost around £3 billion over the six years to 2025-26 to address these underpayments, with costs peaking at £0.7 billion in 2021-22.

- **Disability benefits**. This has revised up since November by £0.5 billion a year on average, reflecting higher caseloads and outturn expenditure, partly related to our assumptions about increases in labour market inactivity and associated health conditions as a result of the pandemic. These could be directly related to the virus (e.g. 'long covid') or indirectly related (e.g. increased prevalence of mental health conditions).

- **Other welfare spending is also higher**, largely due to virus-related increases in welfare spending in Northern Ireland.

3.84 Within the overall path for welfare spending, the share that is subject to the welfare cap has been revised down, as we now expect a larger share of the universal credit caseload in future years to be in the 'intensive work search' group that the Government has stipulated should not be subject to the welfare cap. This reflects a refinement to how the caseload is modelled rather than a change in judgement about the underlying drivers of that caseload.

3.85 Our forecast assumes that one lasting effect of the pandemic will be to raise labour market inactivity and the caseload prevalence for incapacity benefits. But we have not made any explicit assumptions about the mental health effects of the pandemic on disability benefits take-up among children or adults. Our January 2019 *Welfare trends report* noted how

important trends in mental health conditions had become as a driver of disability benefits, so this is an issue that we are likely to need to return to in future forecasts.

Table 3.20: Welfare spending: changes since March 2020 and November 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total welfare spending							
March 2020 forecast	224.6	231.2	237.8	246.8	256.9	266.8	
November 2020 forecast	227.7	246.2	246.7	251.8	259.5	267.5	277.8
March 2021 forecast	227.7	244.8	249.1	254.9	263.3	271.9	282.3
Change since March	3.1	13.6	11.3	8.1	6.4	5.1	
Change since November	**0.0**	**-1.4**	**2.4**	**3.1**	**3.8**	**4.4**	**4.6**
	Underlying forecast changes since March 2020						
Total	**3.1**	**5.2**	**6.1**	**6.0**	**5.2**	**4.2**	
of which:							
Universal credit and legacy equivalents[1]	0.5	5.5	7.4	6.1	5.4	4.8	
Pensioner spending	-0.1	-0.8	-1.9	-1.3	-2.0	-2.6	
Disability benefits[2]	2.9	0.4	0.4	0.9	1.3	1.5	
Child benefit	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	
Other benefits	-0.2	0.2	0.4	0.5	0.6	0.8	
	Direct effect of Government decisions since March 2020						
Total	**0.0**	**8.4**	**5.2**	**2.1**	**1.2**	**0.9**	**1.0**
of which:							
Measures up to and including SR20	0.0	8.3	2.1	1.7	0.9	0.7	0.7
Scorecard measures	0.0	0.0	2.4	-0.1	-0.2	-0.2	-0.1
Non-scorecard measures	0.0	0.1	0.7	0.6	0.5	0.4	0.4

[1] UC and legacy equivalents includes personal tax credits, housing benefit (excluding pensioner part), income-related and contributory employment and support allowance, income support and income-based and contributory jobseeker's allowance.
[2] Disability benefits includes disability living allowance, personal independence payment, and attendance allowance.

Virus-related income support schemes

3.86 The gross cost of the CJRS and SEISS combined is expected to reach £79.7 billion in 2020-21, £3.8 billion less than we forecast in November, but higher than one might have expected after taking the positive surprise on GDP growth into account (Box 3.4). Both schemes have been extended again in the Budget, at an expected cost of £24.3 billion in 2021-22. The success of the schemes in cushioning household incomes from the drop in output over the past year, and the Government's repeated extensions to both as the pandemic has continued, points to the risk that society could demand this more expensive element of the countercyclical fiscal toolkit be deployed again in future downturns.

3.87 The £3.8 billion downward revision to spending in 2020-21 is mainly due to the CJRS, where the outturn in November and December was lower than expected. The effect of that is partly offset by upward revisions to the monthly costs for January to March as a result of the lockdown that was imposed in early January. Take-up of the third SEISS grant was also lower than expected, which may partly be due to the tighter restrictions on eligibility compared with the first two grants.

3.88 The Government announced in December that the CJRS would be extended by a month to the end of April, and in the Budget has extended it by a further five months to the end of September. We expect the cost of these extensions to be much lower than in previous months thanks to the easing of public health restrictions and associated pick-up in economic activity; a growing proportion of the employees being on part-time rather than full-time furlough; and the progressive reduction in the proportion of wages that will be subsidised in the final three months of the scheme. All told, we expect the gross cost of CJRS from April to September 2021 to be £10.8 billion, falling progressively from £3.0 billion in April to as low as £0.7 billion in September.

3.89 The SEISS has also been extended further, with two more grants in April/May (covering the months of February to April) and from July (covering May to September). Eligibility has also been expanded to those who traded for the first time in 2019-20, but the criteria to be eligible for the fifth grant have been tightened through adding a 'financial impact test'. These two additional grants are expected to cost £13.5 billion.

Box 3.4: The evolution of different sectors' usage of the CJRS

Before the pandemic struck, the concept of furloughing staff was little known in the UK (unlike in the US, for example) and there was no programme of government support for short-time working (like Germany's famous *kurzarbeit* system). That changed with the introduction of the CJRS last March. At its peak on 8 May, 8.9 million individual 'employments' (i.e. the number of jobs as measured by HMRC's PAYE system) were furloughed – representing almost a third of all jobs in the UK.[a] As restrictions were eased through the summer, the number of people on the scheme fell quickly to a low of 2.4 million at the end of October, but they jumped again to 4.1 million in mid-November as England returned to lockdown and rose further in January to 4.9 million, with all the UK back in lockdown. Our forecast assumes it declines steadily thereafter.

As we discuss in Box 2.5, people and businesses seem to have adapted to public health restrictions over the past year so that output has held up better and fewer jobs have been furloughed in the recent periods of lockdown than in the first one. But businesses also appear to have adapted to the availability of the CJRS, with more people on furlough for a given fall in output in recent months than was the case in the first lockdown. In part that reflects increasing use of part-time furloughing, which was not permitted during the first four months of the scheme. But it may also reflect businesses getting the most out of the scheme while it is available. They could also be using it more extensively as a form of subsidised sick pay.

The changing intensity of furlough use relative to output across the whole economy is plotted in the top-left panel of Chart F. Movements diagonally from bottom-right to top-left and back again show the relationship between output shortfalls and furlough use, while the upward shift in recent months shows the greater furlough intensity of output. As with much of the economic fallout from the pandemic, different sectors exhibit different shifts in the relationship between the fraction of workers on furlough and the corresponding shortfall in GVA:

- **Wholesale and retail trade** has been one of the most intensive users of furlough yet output in the sector has remained high, boosted by online sales and 'click and collect'

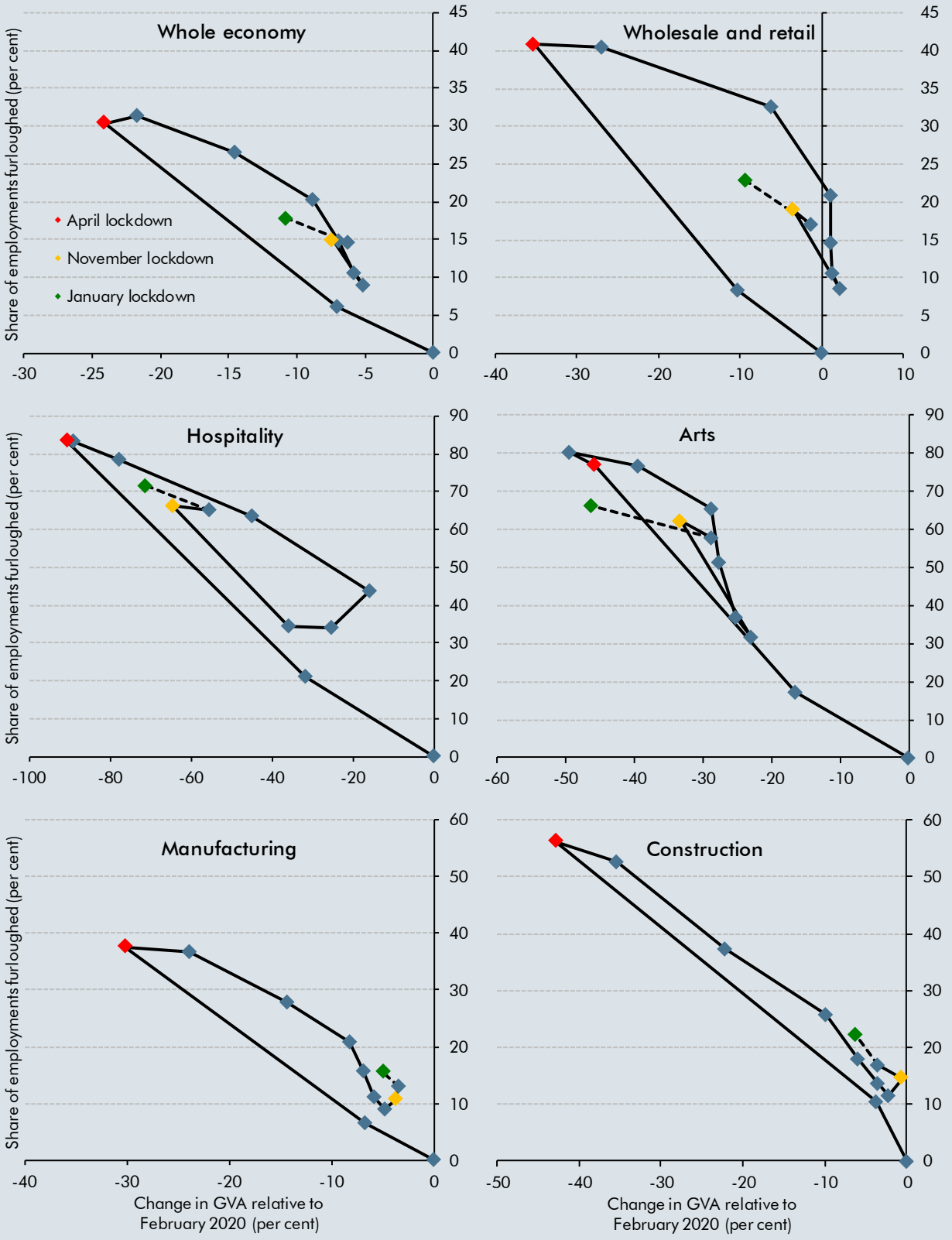
orders. And even in July, when non-essential retail was open, over a fifth of jobs were still on furlough despite output having returned to pre-pandemic levels. There will be much variation within this sector – most of the furloughed staff will have been customer-facing, whereas warehouse staff are likely to have increased to deal with online business.

- The **hospitality and accommodation** sector has been another heavy user of the scheme and also appears to have adapted to its availability, though less markedly than wholesale and retail. Furlough use remained high in January, at around 70 per cent of all jobs in the sector, but notably it did not fall below a third even during August, despite the boost hospitality sector activity provided by the Chancellor's 'eat out to help out' scheme.
- The **arts and entertainment** sector has also been a heavy user, with two-thirds of employments furloughed in January. Furlough use has shifted less relative to output than in other sectors, perhaps reflecting limited capacity to boost output without labour input.
- By contrast, usage in the **manufacturing and construction** sectors was large during the first lockdown, with many employers closing despite these sectors not being mandated to do so. But furlough use has been less prevalent since then, as businesses have been able to adapt their workplaces and as Government advice to these sectors has been clearer that they should continue trading. Even so, both sectors continue to use subsidised furloughing more intensively for a given level of output than earlier in the pandemic.

These developments generate some uncertainty over the pace and extent to which furlough use will decline as different sectors of the economy reopen. There is also uncertainty about the extent to which those currently on CJRS-subsidised furlough will return to their existing jobs, find new ones, or face a period of unemployment once the scheme is closed in October.

[a] Calculated as a share of all jobs recorded in HMRC's PAYE real-time information (RTI) system; an individual can be furloughed from more than one job at any given time.

Chart F: Sectoral furlough usage versus GVA shortfalls relative to February 2020



Source: HMRC, ONS, OBR

Virus-related loan schemes

3.90 The fiscal costs of guarantees extended by the Government for the Coronavirus Business Interruption Loan Scheme (CBILS), the Coronavirus Large Business Interruption Loan Scheme (CLBILS) and the Bounce Back Loan Scheme (BBLS) arise from the product of assumed default and loss-given-default rates, and the proportion of losses that are covered. The cost of these expected calls on government guarantees are scored in the year that the guarantees are extended rather than when the defaults actually occur. We detailed the nature of the schemes and how they feature in the public finances in Chapter 3 of our 2020 *Fiscal sustainability report*.

3.91 Our November forecast was based on the schemes being open until January 2021. We estimated the upfront costs in 2020-21 to be around £29.5 billion, with the overwhelming majority arising from the BBLS. Since then, fewer loans have been issued (mostly under the BBLS programme) than we expected, lowering expected write-offs over the period to January by £4.8 billion. The Government announced in December that the schemes would be extended to March 2021, which at the reduced pace of lending witnessed in recent months leads to a further £2.5 billion of expected write-offs rising in 2020-21, taking the total expected costs of these schemes to be £27.2 billion (down £2.2 billion on November).

3.92 The Government has also announced that after these schemes close, a Recovery Loan Scheme will be established in its place. Guarantees will be offered on similar terms to the existing CBILS scheme. It is expected to cover loans worth £12 billion in 2021-22, leading to estimated write-offs of just under £1 billion (a fiscal loss rate of less than 10 per cent).

Locally financed current expenditure

3.93 We forecast spending by local authorities by projecting their various sources of income – including grants from central government together with local sources, such as council tax, retained business rates and trading income – and the extent to which they then overspend or underspend that income by varying their reserves or borrowing. Our forecast therefore encompasses spending financed by grants, which is mostly in DELs, and locally financed expenditure, which is in AME. Table 3.21 focuses on locally financed expenditure. Further detail is available in supplementary tables on our website.

3.94 Relative to our March 2020 forecast, locally financed current expenditure is down by around £7 billion in 2020-21. Most of the change is due to the business rates holiday for the retail, leisure and hospitality sector, which reduces retained receipts for local authorities. But central government has largely compensated local authorities for that with additional grants, so the drop in locally financed expenditure from this source is offset by higher grant-financed expenditure. There has also been a smaller fall in council tax receipts net of local council tax support due to increased eligibility for support as unemployment has edged higher. Central government has again compensated local authorities for most of the losses from this, so again this switches spending from locally financed to grant-financed.

3.95 Our forecast reflects the Spending Review decision to increase the amounts that council tax can be increased by without calling a local referendum to 5 per cent in 2021-22. The latest data point to an average increase of 4.3 per cent, which raises £0.8 billion relative to the assumption of a 2 per cent increase that underpinned our March 2020 forecast.

3.96 Since our November forecast, a small number of local authorities have reached agreements with central government for exceptional financial support. These packages are worth around £0.2 billion in borrowing for current spending purposes, much of which will need to be repaid by those authorities through asset sales. There is a continuing risk that such interventions will be required to support more local authorities as they struggle to cope with the financial burden that the pandemic has imposed in terms of lost income and increased costs.

Table 3.21: Locally financed current expenditure: changes since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	53.9	55.0	55.1	56.9	58.6	60.1	
November 2020 forecast	53.5	48.8	56.6	56.6	58.5	60.4	62.1
March 2021 forecast	53.7	48.3	51.5	54.6	57.0	59.3	61.0
Change since November	0.2	-0.5	-5.1	-2.0	-1.5	-1.1	-1.1
Change since March	**-0.2**	**-6.7**	**-3.6**	**-2.3**	**-1.6**	**-0.8**	
	Underlying forecast changes since March 2020						
Total	**-0.2**	**0.1**	**-2.5**	**-3.1**	**-2.5**	**-1.9**	
of which:							
Council tax	0.1	-0.1	-0.3	-0.4	-0.3	-0.1	
Business rates (England)	1.1	0.4	-0.8	-1.3	-1.2	-0.9	
Business rates (Scotland)[1]	0.1	-0.9	-0.9	-0.4	-0.1	-0.1	
Net use of current reserves	-0.7	1.6	0.1	0.1	0.1	0.0	
Income from sales, fees and charges	-0.1	-0.7	-0.1	-0.8	-0.7	-0.3	
Capital spending financed from revenues	-0.4	0.2	-0.4	-0.3	-0.3	-0.2	
Other	-0.3	-0.3	-0.2	-0.1	-0.1	-0.3	
	Direct effect of Government decisions since March 2020						
Total	**0.0**	**-6.8**	**-1.1**	**0.8**	**0.9**	**1.2**	**1.2**
of which:							
Council tax: adult social care precept	0.0	0.0	0.9	1.0	1.0	1.1	1.1
Business rates: pilots and reliefs	0.0	-6.6	-1.9	-0.1	-0.1	-0.1	-0.1
Other	0.0	-0.2	-0.1	-0.1	-0.1	0.2	0.2

[1]Includes the decision by the Scottish Government to provide business rates relief for hospitality, retail and leisure, which is included in the underlying changes as it is not a UK Government decision.

Locally financed and public corporations' capital expenditure

3.97 Locally financed capital expenditure is measured net of capital spending by authorities' housing revenue accounts (HRAs) and Transport for London's subsidiaries; in both cases, these are treated as public corporations in the National Accounts.[3] So we switch these items from locally financed to public corporations' capital expenditure in our forecast to ensure consistency. All these forecasts are net of asset sales, forecasts for which are available in supplementary tables on our website.

3.98 Locally financed and public corporations' capital expenditure is £6.1 billion lower in 2020-21 than in our March 2020 forecast, and £3.8 billion lower by the end of the forecast period. The fall in 2020-21 is mostly driven by lower outturn data so far from local authorities (including through their HRAs), as well as lower spending in TfL's revised budget, partially offset by lower asset sales than we had forecast. As we present our forecast net of asset sales, a reduction in sales leads to a corresponding increase in capital expenditure.

3.99 Over the remainder of the forecast period, we assume that local authorities will carry out less capital spending financed by unsupported borrowing than we did in March 2020. This reflects the expected impact of the pandemic on their willingness to invest in commercial property. Since revised this forecast in November, many councils have reported further losses on such investments and scaled back plans for new projects of that kind. We assume that the attractiveness of those investments will not recover over the forecast period, while the Treasury also reduced the scope for such investments in the Spending Review.

3.100 TfL's revised budget showed a drop in capital spending of around £0.7 billion in 2020-21 relative to our March 2020 forecast, which mostly reflects the bailouts agreed with central government, as part of which TfL agreed to reduce capital spending financed from its own revenues given the scale of its expected operational losses. Since our November forecast, we have also reflected TfL's latest business plan, which reduced capital expenditure in the near term and increased it by £0.4 billion by 2024-25.

[3] These TfL transport subsidiaries trade under the company name 'Transport Trading Ltd' (TTL). The ONS currently classifies all the large TTL subsidiaries as public corporations apart from Crossrail, which is classified as part of the local government sector.

Table 3.22: Locally financed capital expenditure and public corporations' capital expenditure: differences from March 2020 and November 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	24.1	22.3	21.6	22.3	21.9	22.4	
November 2020 forecast	23.8	16.8	17.7	19.3	18.9	19.3	19.9
March 2021 forecast	25.5	16.2	18.1	18.4	18.2	18.6	18.9
Change since November	1.7	-0.6	0.4	-0.9	-0.7	-0.8	-1.0
Change since March	**1.4**	**-6.1**	**-3.5**	**-3.9**	**-3.8**	**-3.8**	
	Underlying forecast changes since March 2020						
Total	**1.4**	**-7.0**	**-3.5**	**-3.9**	**-3.7**	**-3.7**	
of which:							
Prudential borrowing (non-TfL, non-HRA)	2.0	-3.7	-0.9	-1.1	-1.0	-0.6	
Housing revenue account	-0.5	-1.0	-1.6	-1.2	-1.2	-1.2	
Major repairs reserve and capital receipts from sales	-1.3	-1.5	-1.6	-1.4	-1.4	-1.6	
Less asset sales	-0.1	1.4	1.4	1.2	1.1	1.0	
TfL capital spending	0.0	-1.4	0.3	0.2	0.4	0.4	
Other public corporations' capital spending	0.3	-1.1	-1.1	-1.2	-1.2	-1.3	
Other	1.0	0.3	0.1	-0.5	-0.4	-0.5	
	Direct effect of Government decisions since March 2020						
Total	**0.0**	**0.9**	**0.0**	**0.0**	**-0.1**	**-0.1**	**-0.1**

Central government debt interest

3.101 Relative to our March 2020 forecast, debt interest spending has been revised down very sharply – with the resulting savings peaking at £13.4 billion in 2022-23, then diminishing progressively to £5.6 billion in 2024-25. This reflects the combined effects of lower inflation, lower interest rates and an expanded Asset Purchase Facility (APF), which have collectively outweighed the impact of significantly greater debt issuance. The uneven profile of revisions across years largely relates to the profile of revisions to RPI inflation.

3.102 But relative to our November forecast, we have revised debt interest spending higher, particularly in the later years where interest rate expectations are higher, and in 2021-22 where inflation has been revised up. Our forecast reflects interest rates as they stood on 5 February, after the Bank of England's latest Monetary Policy Report, but before the rises in market interest rates in recent weeks. All else equal, if our debt interest forecast had been based on market interest rates as they stood on 26 February, spending would have been £6.3 billion higher in 2025-26.

Table 3.23: Central government debt interest net of the APF: changes since March 2020 and November 2020

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	38.0	34.5	37.8	37.9	37.3	36.7	
November 2020 forecast	36.9	23.5	17.6	21.2	25.5	27.3	29.0
March 2021 forecast	36.6	23.9	24.8	24.5	27.7	31.1	33.7
Change since November	-0.3	0.4	7.2	3.3	2.2	3.8	4.7
Change since March	**-1.4**	**-10.6**	**-13.0**	**-13.4**	**-9.6**	**-5.6**	
	Total changes since March 2020						
Total	**-1.4**	**-10.6**	**-13.0**	**-13.4**	**-9.6**	**-5.6**	
of which:							
Interest rates		-1.9	-3.7	-3.7	-2.5	-0.9	
Inflation		-3.5	-3.2	-4.3	-2.6	-0.6	
Financing		0.6	1.9	2.7	2.8	2.5	
Asset Purchase Facility		-5.8	-8.1	-8.0	-6.7	-5.3	
Other factors		0.0	0.0	-0.1	-0.6	-1.3	

Public sector pensions

3.103 Spending on public sector pensions consists of:

- Net public service pension payments by **unfunded public sector pension schemes**, which include central government pay-as-you-go schemes and locally administered police and firefighters' scheme.[4] Our forecast covers gross expenditure on pensions in payment, less employer and employee contributions received. (The corresponding spending by departments on employer contributions is included in RDEL.) A breakdown of spending and income for the major schemes we cover can be found in the supplementary tables on our website.

- **Funded public sector pension schemes**, which are classified as public corporations in the public sector finances. This includes funded schemes with largely public sector members (notably the Local Government Pension Scheme), and also the Pension Protection Fund (PPF) and the National Employment Savings Trust (NEST).[5]

3.104 Relative to our March 2020 forecast, net public service pension payments are down more than £2 billion a year in 2020-21 and 2021-22, largely thanks to the increase in contributions from a larger NHS pensionable paybill, and reduced pension payments in the Armed Forces due to fewer retirements in response to the weak external job market. Spending is modestly higher thereafter. Relative to our November forecast, spending has been revised up by £1.2 billion a year from 2022-23 onwards, reflecting the higher path for CPI inflation and lower pay growth assumptions.

[4] The police and firefighters' pension schemes are administered at a local level, but pensions in payment are funded from AME, along with other public service pension schemes. They are therefore included in our pensions forecast.
[5] See our *Restated March 2019 forecast* for more detail on the impact of these schemes in the public finances.

Box 3.5: Government response to the McCloud-Sargeant case

In February 2021 the Government published its response to the *Public service pension schemes: changes to the transitional arrangements to the 2015 schemes* consultation.[a] This consultation was in response to the December 2018 Court of Appeal ruling that the transitional protection arrangements in place across public service pension schemes gave rise to unlawful discrimination on the basis of age, commonly referred to as the McCloud-Sargeant case. The remedy the Government has chosen will have material implications for spending over the long term, since they allow affected scheme members to choose the most beneficial terms on which to calculate their retirement benefits at the point at which they retire. It is not yet clear precisely how individual schemes will implement this response, so it has not been possible to reflect it in our current forecast. This is therefore a policy risk that will raise spending at our next forecast.

The Government presented its own estimate of the long-term cost in the consultation, but did not updated this in the February response.[a] This cost was estimated at £2.5 billion per year of affected accruals (also known as the remedy period, which runs from 1 April 2015 to 1 April 2022), giving a total cost of £17.5 billion.[b] This should not be confused with a public spending cost of £2.5 billion a year – this figure represents the discounted future cost of pension rights accrued in each year of the remedy period, but these will only begin to be paid once each affected member retires and will be spread over the period of their retirement.

This means that if the Government's estimate of overall cost is a reasonable guide, the £17.5 billion will be spread over the next 60 to 70 years, with implementation unlikely to begin until October 2023 for most schemes. Approximately two thirds of affected scheme members are currently under 60 years of age and are therefore unlikely to retire and start drawing on their more generous pension payments within our present medium-term forecast horizon.

Members who have retired or died before these changes are implemented will require retrospective remediation. Such members would typically not have been in active service for the whole of the remedy period and as such they would be expected to receive a smaller additional benefit compared to future retirements. These retrospective benefits will be paid as a single backdated payment, although the exact scale and timing is uncertain. This is likely to mean that when costed, the remedy will involve relatively small annual costs over the medium term (perhaps in the low hundreds of millions), but with the potential for a somewhat larger spike at the point at which retrospective remediation payments are made.

[a] *Public service pension schemes: changes to the transitional arrangements to the 2015 schemes*, Government response to consultation, HM Treasury, 4 February 2021.
[b] *Public service pension schemes: changes to the transitional arrangements to the 2015 schemes,* Consultation, HM Treasury, July 2020.

3.105 Our forecast for spending related to funded pension schemes is little changed from November. In our next forecast we will reflect an ONS announcement that it will lower the discount rate and the rate of return it assumes in the calculation of assets and liabilities of funded schemes from this September's public finances data release. This will reduce both receipts and spending associated with these schemes, while leaving PSNB little changed.

Student loans

3.106 When student loans are issued, the public finances record an amount of spending equal to the expected portion of the loan that will ultimately not be repaid. This spending rises from £10.2 billion in 2019-20 to £13.0 billion in 2025-26, thanks to growth in student numbers and to tuition fees and loans rising in line with the RPIX measure of inflation after the 2022-23 academic year. These forecasts have been revised only modestly relative to both our March 2020 and November forecasts. The pandemic has resulted in higher student numbers in England, but the UK's exit from the EU has meant that EU-domiciled students are no longer eligible for loans. In this Budget, the Government has frozen tuition fees for a year rather than raising them in line with RPIX inflation, reducing the amount of lending and write-offs relative to our pre-measures forecast.

Other AME

3.107 The main changes to other AME spending items include:

- **General government depreciation** is £2.5 billion higher in 2020-21 than in our March 2020 forecast, and by rising amounts throughout, being £6.0 billion higher in 2024-25. Differences are much smaller compared with our November forecast, as the revision to capital stocks data by the ONS underpinning most of the change was released in September. Revisions since November reflect changes in the composition of Government plans that has increased direct fixed capital formation in 2020-21 at the expense of capital grants to the private sector. As there are no set plans beyond 2020-21, we hold this proportional allocation fixed across for future years, with the effect being to increase general government capital stocks and therefore depreciation charges. Depreciation is neutral to PSNB, but it increases the current budget deficit.

- **Spending on the EU financial settlement** is £1.4 billion higher in 2020-21 than in our March 2020 forecast as higher EU spending during the transition period feeds through mechanically to the UK's contribution. It is little changed thereafter.

- Some elements of our spending forecast are largely neutral for borrowing because they are directly offset in receipts. These include **environmental levies** (which have uneven revisions across the forecast) and **VAT refunds to central and local government** (which have been revised up). These changes are detailed in the receipts section.

Deficit aggregates

3.108 Our central forecast for the Government's budget deficit – 'public sector net borrowing' (PSNB) – is the difference between the forecasts for receipts and expenditure set out in the preceding sections of this chapter. In this section we discuss our latest forecast for the path of borrowing, and how it has changed since our March 2020 forecast (illustrating the fiscal consequences of the pandemic) and since our November 2020 forecast (showing how our assessment of those consequences has evolved). We also consider other deficit and expenditure aggregates – the current budget balance, cyclically adjusted measures of the

headline and current budget balance, the primary balance and public sector net investment – that feature in the Government's array of previous and current fiscal objectives.

Public sector net borrowing

The deficit in 2020-21

3.109 Borrowing in 2020-21 reaches a peacetime record of £355 billion, or 16.9 per cent of GDP. This is £298 billion higher than the deficit in 2019-20 – a six-fold increase – and £300 billion or 14.5 per cent of GDP higher than our pre-virus March 2020 forecast. But it is £39 billion lower than our November forecast for 2020-21, thanks to better than expected receipts performance and lower than expected departmental spending (with the large virus-related increases assigned in November's Spending Review being underspent by even more than the significant margin we assumed at the time).

3.110 Chart 3.7 shows the factors that have contributed to the increase in borrowing in 2020-21 relative to our pre-virus forecast. These are dominated by the cost of policy measures introduced to support public services, households and businesses through the pandemic, the direct effect of which totals £250 billion this year. On top of that, the lockdown-induced recession has hit receipts and boosted welfare spending, with underlying changes adding £82 billion to borrowing overall. This is partly offset by our estimates of the indirect effects of policy, which reduces borrowing by £25 billion. In the absence of this enormous degree of fiscal support, these underlying changes would have been much greater as lockdowns would have resulted in sharply higher job losses and business failures that hit all the major taxes bases.

3.111 The largest sources of the underlying forecast changes since March 2020 include:

- An £89 billion shortfall in **receipts**. All the major tax bases have been hit, with income tax and NICs down £24.6 billion, VAT down £13.7 billion and corporation tax down £10.6 billion. Some smaller tax bases have been hit particularly hard, with air passenger duty down £3.4 billion (85 per cent) and property transaction taxes down £1.7 billion (13 per cent), before factoring in the cost of temporary tax cuts.[6]

- A £5.2 billion upside surprise in **welfare spending** – before factoring in the cost of policy measures. This rise is dominated by the 1.2 million increase in households claiming UC in 2020-21.

- These increases are partly offset by **debt interest spending** being £10.6 billion lower than forecast – down a third on the previous year and almost a third less than forecast – as the beneficial effect of lower Bank Rate and a near doubling in the amount of quantitative easing dramatically lowered the effective interest rate paid on the public sector's liabilities, despite the sharp rise in the stock of those liabilities.

- Small changes in **other spending**.

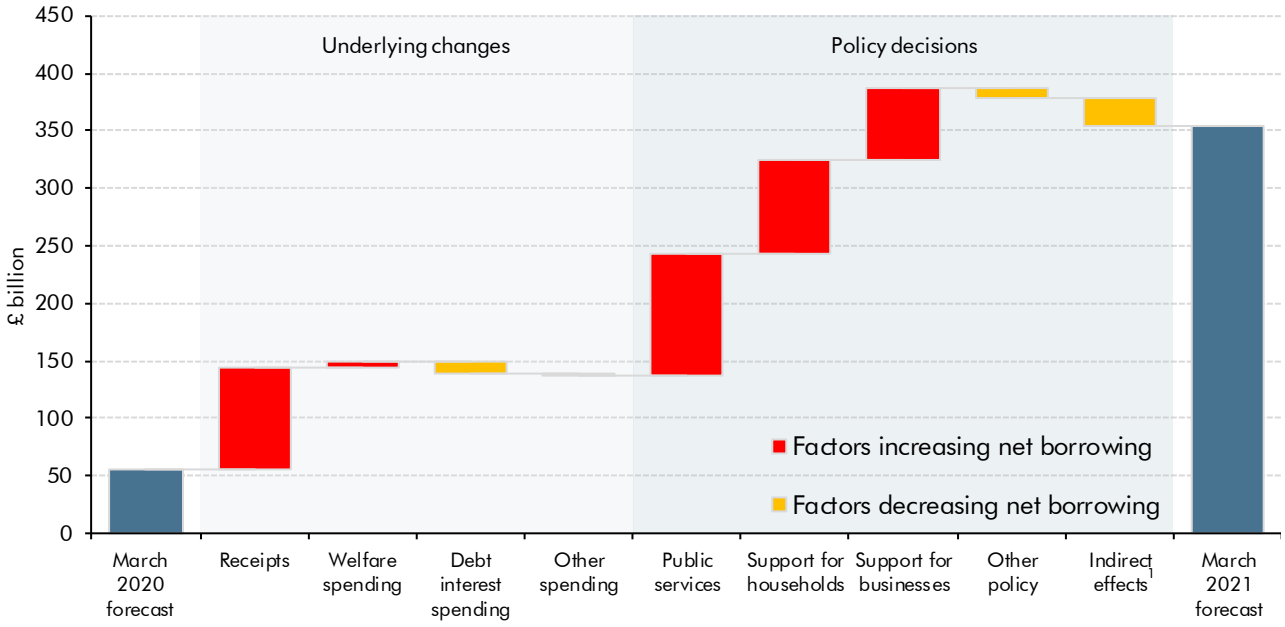
[6] Changes to individual tax heads include both underlying changes and the indirect effect of measures.

3.112 The cost of the Government's fiscal policy response to the pandemic this year are detailed in Box 3.1. In summary, the direct costs include:

- The £106 billion of support for **public services**, most significantly on health spending, including the cost of personal protective equipment supplies, millions of coronavirus tests, and the development and procurement of vaccines.
- The £82 billion of **support for households**, the largest elements of which have been the CJRS (£55 billion) and SEISS (£19 billion), alongside £8 billion of welfare spending measures, including the £20 a week boost to UC.
- The £62 billion of **support for businesses**, including grants and business rates holidays, plus estimated write-offs relating to the government-backed loan schemes.
- **Non-virus policy** decreases borrowing by £8 billion.

3.113 From this we subtract the indirect effects of policy measures announced since the Chancellor's Summer Economic Update in July 2020 – i.e. the fiscal consequences of their impact on the economy. We did not attempt to estimate the indirect effects of the initial round of measures between March and July 2020 as we did not think it would be meaningful to produce a counterfactual path for the economy in the absence of fiscal support in order to do so. What is clear is that the scale of the underlying deterioration in the public finances this year would have been much greater in the absence of that support.

Chart 3.7: Changes in net borrowing in 2020-21: March 2021 versus March 2020

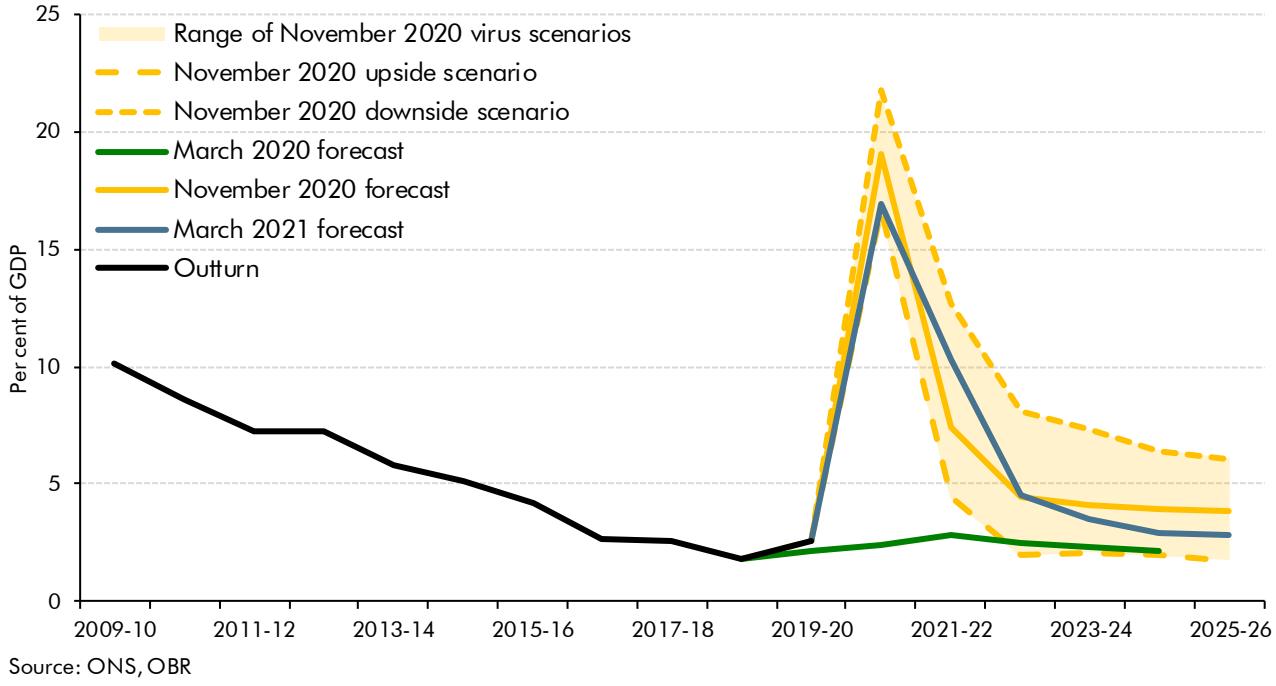


[1]This only includes indirect effects of measures since the Summer Economic Update on 8 July 2020
Source: ONS, OBR

Medium-term forecast

3.114 From its peak in 2020-21, borrowing drops by £121 billion in 2021-22 to stand at £234 billion (10.3 per cent of GDP). At this level, it still exceeds the previous peacetime record that was reached at the height of the financial crisis in 2009-10. The deficit falls back sharply again in 2022-23 – by £127 billion to £107 billion – as the Government's spending plans assume that all virus-related spending will have ended by then. And it falls more slowly thereafter – thanks largely to the substantial tax rises announced in the Budget. Despite those rises, and the cuts to medium-term departmental spending totals announced in the Spending Review and in this Budget, borrowing in 2024-25 is £17 billion (0.7 per cent of GDP) higher than our pre-virus March 2020 forecast. That in turn reflects the 3 per cent virus-related scarring to real GDP assumed in our central forecast, the fiscal implications of which more than outweigh the medium-term fiscal tightening.

Chart 3.8: Public sector net borrowing



Source: ONS, OBR

Sources of difference between our latest forecast and March 2020

3.115 Table 3.24 details the sources of difference between our latest central forecast and our March 2020 forecast for borrowing over the next five years. It shows that the underlying deterioration in 2020-21 described above gets larger in 2021-22 before getting progressively smaller over the subsequent three years. By contrast, the huge cost of policy interventions in 2020-21 falls back sharply in 2021-22 and switches sign in 2022-23 as fiscal support turns to fiscal tightening in the medium term. By 2024-25 it shows that:

- **Underlying differences** add £63 billion to borrowing, dominated by lower receipts due to the consequences of a persistently weaker economy for all the major tax bases. Debt interest spending remains lower, as lower interest rates and the doubling of quantitative easing more than offset the effect of higher debt. Welfare spending

remains higher thanks to modestly higher unemployment and the consequences of the pandemic for incapacity benefits. (Other spending is higher too, although much of this reflects statistical revisions to depreciation spending that are neutral for borrowing.)

- **The direct effect of policy changes** lower borrowing by £43 billion, with tax rises (notably to corporation tax and to income tax and NICs) and spending cuts (dominated by reductions in pre-virus RDEL spending totals) combining to offset around two-thirds of the structural fiscal damage assumed in our central forecast.

- The **indirect effects** of measures announced since the Summer Economic Update reduce borrowing by a further £3 billion. By that stage, policy measures will depress GDP growth only modestly since the Bank of England will be able to factor them into its monetary policy decisions. But nominal GDP will remain slightly higher than it otherwise would have been thanks to the diminishing effects of earlier fiscal easing, hence these indirect effects lowering borrowing despite policy takeaways in that year.

Table 3.24: Changes to public sector net borrowing since March 2020

	£ billion						
	Outturn	Forecast					
	2019-20[1]	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	47.2	54.8	66.6	61.5	60.2	57.9	
March 2021 forecast	57.1	354.6	233.9	106.9	85.3	74.4	73.7
Difference	**9.8**	**299.9**	**167.3**	**45.4**	**25.1**	**16.5**	
of which:							
Underlying differences[2]		**82.5**	**93.9**	**56.7**	**58.2**	**62.7**	
of which:							
Receipts		89.5	96.4	59.9	54.8	55.3	
Welfare spending		5.2	6.1	6.0	5.2	4.2	
Debt interest spending		-10.6	-13.0	-13.4	-9.6	-5.6	
Other spending		-1.5	4.4	4.1	7.8	8.7	
Direct effect of policy decisions[3]		**241.9**	**101.9**	**-6.1**	**-30.2**	**-43.4**	**-47.8**
of which:							
Virus related policy		**249.9**	**93.3**	**-0.1**	**0.8**	**0.4**	**-0.1**
of which:							
Public services		105.7	53.1	-0.1	-0.3	0.0	0.0
Support for households		81.8	27.7	0.3	1.0	0.4	-0.2
Support for businesses		62.4	12.5	-0.2	0.1	0.1	0.1
Non-virus related policy		**-8.1**	**8.6**	**-6.0**	**-31.0**	**-43.8**	**-47.7**
of which:							
Spending decisions		-9.5	-5.5	-15.1	-17.5	-19.0	-18.5
Receipts decisions		1.5	14.2	9.1	-13.5	-24.9	-29.3
Indirect effects of decisions since SEU		**-24.5**	**-28.6**	**-5.2**	**-2.8**	**-2.8**	**-2.5**

Note: This table uses the convention that a negative figure means a reduction in PSNB i.e. an increase in receipts or a reduction in spending will have a negative effect on PSNB.

[1] Includes updates for outturn. Totals may not sum due to these updates.

[2] Includes classification changes.

[3] The cost of policy decisions announced up to and including at SR20 includes updates to estimates via the usual recosting process.

Sources of difference between our latest forecast and November 2020

3.116 Relative to our November forecast:

- **Borrowing in 2020-21** has been revised down £39 billion (2.1 per cent of GDP). This is more than explained by two factors: the stronger near-term performance of the economy and receipts; and downward revisions to the estimated costs of measures announced up to the Spending Review, notably a larger than expected shortfall in virus-related departmental spending relative to the increases allocated at the Spending Review and lower costs of the CJRS, SEISS and government-backed loan schemes.

- **Borrowing in 2021-22** has been revised up by £70 billion or 2.9 per cent of GDP. This is dominated by the £59 billion (2.6 per cent of GDP) fiscal loosening announced in the Budget, with several virus-related rescue programmes extended and generous temporary capital allowances put in place to support the recovery.

- **Borrowing from 2022-23 onwards** moves back into line with our November forecast, then lower by progressively larger amounts. Our underlying forecast is little changed, reflecting our unchanged assumption about the extent to which real GDP will be scarred in the medium term, with lower borrowing largely due the tax rises and additional spending cuts announced in this Budget.

Table 3.25: Changes to public sector net borrowing since November 2020

	£ billion						
	Outturn	Forecast					
	2019-20[1]	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November 2020 forecast	56.1	393.5	164.2	104.6	100.4	99.6	101.8
March 2021 forecast	57.1	354.6	233.9	106.9	85.3	74.4	73.7
Difference	**1.0**	**-38.9**	**69.7**	**2.3**	**-15.1**	**-25.1**	**-28.2**
of which:							
Underlying differences[2]		**-47.4**	**16.2**	**2.3**	**4.1**	**6.3**	**8.3**
of which:							
Receipts		-16.3	3.3	-2.5	-2.6	-2.6	-1.4
Welfare spending		-1.3	4.4	5.3	5.2	5.1	4.8
Debt interest spending		0.8	2.9	1.5	1.6	3.5	4.3
Other spending		3.1	5.8	-1.3	-0.3	0.3	0.5
Recostings of policies up to SR20		-33.6	-0.2	-0.6	0.1	0.1	0.1
Direct effect of policy decisions		**9.0**	**58.9**	**5.5**	**-15.1**	**-27.5**	**-32.4**
of which:							
Virus related policy		**3.3**	**43.2**	**-1.3**	**0.1**	**-0.3**	**-0.6**
of which:							
Public services		0.0	0.0	0.0	0.0	0.0	0.0
Support for households		0.5	27.2	-1.1	0.1	-0.3	-0.6
Support for businesses		2.8	16.0	-0.1	0.0	0.0	0.0
Non-virus related policy		**5.7**	**15.7**	**6.8**	**-15.2**	**-27.1**	**-31.8**
of which:							
Spending decisions		2.8	1.1	-3.4	-3.3	-4.0	-4.5
Receipts decisions		2.9	14.6	10.2	-11.9	-23.1	-27.3
Indirect effects of decisions since SR20		**-0.5**	**-5.4**	**-5.5**	**-4.0**	**-4.0**	**-4.1**

Note: This table uses the convention that a negative figure means a reduction in PSNB i.e. an increase in receipts or a reduction in spending will have a negative effect on PSNB.

[1] Includes updates for outturn. Totals may not sum due to these updates.

[2] Includes classification changes.

Other fiscal aggregates

3.117 **Cyclically adjusted public sector net borrowing (CAPSNB)** estimates the underlying or 'structural' level of borrowing by removing the impact of the economic cycle. In other words, the level of borrowing if the output gap were zero. Estimating potential output, and hence the output gap, is notoriously difficult, and, as explained in Chapter 2, is especially problematic at present. Furthermore, applying a cyclical correction based solely on the output gap fails to recognise the large but temporary downward effect of public health restrictions on potential output. Nevertheless, applying the output gap path in our central forecast gives a CAPSNB of £345 billion (16 per cent of GDP) in 2020-21, a little below the headline PSNB figure, with the two measures relatively close to each other thereafter.

3.118 The **current budget deficit** is the difference between receipts and current expenditure in each year and is equal to PSNB excluding borrowing to finance net investment spending. It is expected to hit £279 billion (13 per cent of GDP) in 2020-21, primarily due to the huge spike in virus-related spending. We expect it to fall back to £172 billion in 2021-22 and to £40 billion in 2022-23 as public health restrictions are eased and virus-related public

spending is assumed to end. Thereafter, the Budget tax rises place the current budget deficit on a steadily declining path, reaching a figure of just £0.9 billion in 2025-26.

3.119 The **cyclically adjusted current budget (CACB)** is the current budget we would see if the output gap were zero. It is hence subject to the same issues with the estimation of potential output as the CAPSNB. As with headline current borrowing, the CACB deficit peaks in 2020-21 (at 13 per cent of GDP), before falling sharply thereafter. As with the headline current balance, the CACB is very slightly in deficit in 2025-26 (by £0.3 billion).

3.120 The **primary deficit** refers to the difference between non-interest spending and non-interest receipts. The measure gives an idea of the underlying fiscal position by removing non-discretionary debt interest spending. Despite high and growing levels of public debt, near-zero interest rates and the effects of quantitative easing mean debt interest spending is currently at 10-year lows. In line with market expectations, interest rates are assumed to stay low over the forecast, implying no unwinding of quantitative easing. The primary deficit therefore tracks PSNB closely throughout, peaking at £335 billion in 2020-21 and falling thereafter to reach £49 billion in 2025-26.

3.121 **Public sector net investment (PSNI)** is the difference between gross capital spending and depreciation and represents the change, in cash terms, of the public sector's net capital stock. This jumps to 4 per cent of GDP in 2020-21, largely due to a smaller GDP denominator and the upfront cost of expected calls on government guaranteed loans. It is then expected to remain just below 3 per cent of GDP for the rest of the forecast.

Balance sheet aggregates

Generating our balance sheet forecasts

3.122 We forecast several measures of the public sector balance sheet to help understand the sustainability of the public finances and elucidate the impact of financial transactions not captured in conventional fiscal aggregates. For more than two decades, the Government's headline balance sheet measure has been public sector net debt (PSND). PSND is the stock equivalent of the public sector net cash requirement (PSNCR) and captures those financial liabilities recognised as 'Maastricht debt liabilities' (a narrower measure than all financial liabilities) and those financial assets held by public entities that are deemed to be 'liquid' (i.e. that could be sold readily and quickly for cash).

3.123 Starting from our forecast for the accrued measure of the deficit (PSNB) we produce forecasts of changes in the cash in the level of PSND in three steps:

- First, we adjust for **timing effects** to arrive at a cash measure of the deficit. Timing effects occur when, as is often the case, estimates of accrued revenue and spending are not recorded at the same point as the associated cash transactions.

- Second, we forecast the other **financial transactions** that do not contribute to PSNB but do alter the government's cash needs. These include loans and repayments between

the public and private sectors, sales or purchases of financial assets, and various Bank of England schemes. These are then added to the measure of borrowing to arrive at an estimate of the PSNCR.

- Third, we forecast the **valuation effects** on relevant liability and liquid asset holdings recognised in PSND and (when necessary) the impact of **classification changes** that reconcile the PSNCR with the year-on-year change in PSND.

3.124 We use similar approaches to forecast other balance sheet measures, starting from the relevant deficit measure and adding other elements as required.

Year-on-year change in PSND

3.125 Headline PSND rises by £400 billion (and by 15.8 per cent of GDP) to just over 100 per cent of GDP this year and remains above 100 per cent across the forecast. As set out in Table 3.26, debt increases in cash terms in all years reaching £2.8 trillion in 2025-26. The bulk of the increases are driven by net borrowing, and they more than explain the rise in the final two years of the forecast. Financial transactions add £160 billion to debt in the four years to 2023-24, but reduce it by £88 billion in the subsequent two years. This uneven path is dominated by loans being issued under the Bank of England's Term Funding Scheme (TFS) and later repaid. Valuation effects are smaller and uneven.

3.126 Relative to our pre-virus March 2020 forecast (Table 3.27), debt rises much more rapidly in the near term (thanks to higher borrowing and the extension of TFS loans) and continues to rise more quickly up to 2023-24 (due to higher borrowing) before rising more slowly in 2024-25 (as TFS loans start to be repaid). Relative to our November forecast (Table 3.28), revisions are uneven. Debt rises more slowly in 2020-21 (on lower borrowing and a slower pace of TFS lending); more quickly in 2021-22 (as TFS lending continues); revisions are then smaller from 2022-23 to 2024-25, before debt falls more quickly in 2025-26 (thanks to tax rises and spending cuts announced in the Budget and the later repayment of TFS loans that reflects the slower pace of lending at the start of the period).

Table 3.26: Sources of year-on-year changes in public sector net debt

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Year-on-year change in PSND (a+b+c+d)	**399.7**	**305.0**	**127.7**	**116.5**	**13.9**	**43.1**
Public sector net borrowing (a)	**354.6**	**233.9**	**106.9**	**85.3**	**74.4**	**73.7**
Financial transactions (b)	**41.2**	**65.4**	**24.5**	**28.6**	**-52.7**	**-34.8**
of which:						
DEL net lending	**6.2**	**4.0**	**3.4**	**2.0**	**2.0**	**2.0**
Help to Buy outlays	4.1	2.2	2.7			
Other DEL	3.6	3.3				
DEL beyond current Spending Review			1.3	2.6	2.6	2.6
Allowance for shortfall	-1.6	-1.6	-0.6	-0.6	-0.6	-0.6
Other government net lending	**8.6**	**8.6**	**9.7**	**8.5**	**7.2**	**6.5**
Student loan outlays[1]	9.4	9.6	9.7	9.9	10.3	10.7
Student loan repayments[2]	-2.7	-3.1	-3.5	-3.9	-4.3	-4.9
Scottish Government	0.6	0.2	0.5	0.3	0.3	0.3
UK Infrastructure Bank	0.0	0.7	1.3	1.6	1.6	1.4
UK Export Finance	1.3	1.7	1.3	1.2	0.1	-0.3
Other AME	1.0	1.1	2.3	1.6	1.6	1.5
Help to Buy repayments	-1.1	-1.7	-2.0	-2.1	-2.3	-2.2
Sales or purchases of financial assets	**-5.4**	**-3.1**	**-2.6**	**-2.9**	**-2.6**	**-2.6**
NatWest Group	0.0	-2.6	-2.6	-2.6	-2.6	-2.6
UKAR asset sales and rundown	-4.5	-0.5	0.0	-0.3	0.0	0.0
Other sales	-0.9	0.0	0.0	0.0	0.0	0.0
Bank of England schemes	**24.5**	**60.2**	**0.1**	**1.7**	**-77.2**	**-47.0**
Term Funding Scheme	12.9	50.0	0.0	0.0	-85.0	-50.0
Other effects	11.6	10.2	0.1	1.7	7.8	3.0
Cash flow timing effects	**7.3**	**-4.3**	**14.0**	**19.4**	**17.8**	**6.3**
Student loan interest[2]	2.5	2.6	2.8	3.3	3.9	4.7
Corporation tax	-1.8	2.1	4.8	11.9	5.9	2.5
Other receipts	22.5	-18.5	5.4	4.5	5.0	4.2
Funded public pension schemes	-2.0	-2.2	-2.9	-2.1	-1.5	-0.9
Index-linked gilt uplift[3]	3.9	-10.8	-3.8	-8.2	-3.9	-11.2
Other gilt accruals	6.7	7.8	7.8	8.3	8.9	8.9
Guarantee schemes write offs	-22.7	17.1	2.0	3.8	1.6	0.2
Other expenditure	-1.9	-2.5	-2.2	-2.0	-2.0	-2.0
Public sector net cash requirement (a+b)	*395.8*	*299.3*	*131.4*	*114.0*	*21.7*	*38.9*
Valuation effects (c)	**3.9**	**5.7**	**-3.7**	**2.6**	**-7.8**	**4.2**
of which:						
Gilt premia	-35.6	-13.1	-8.2	-6.0	-6.7	-6.6
Asset Purchase Facility gilt premia	51.4	8.0	0.6	0.3	-5.0	-0.4
Index-linked gilts uplift[3]	-3.9	10.8	3.8	8.2	3.9	11.2
International reserves	-7.9	0.1	0.0	0.0	0.0	0.0
ONS statistical changes (d)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

[1] This records the non-spending part of outlays, the remainder is recorded as capital transfers.
[2] Cash payments of interest on student loans are included within 'Student loan repayments', as we cannot easily separate them from repayments of principal. To prevent double counting, the 'student loan interest' timing effect removes all accrued interest.
[3] This reconciliation to the public sector net cash requirement does not affect public sector net debt.

Table 3.27: Public sector net debt profile: changes since March 2020

	£ billion				
	Forecast				
	2020-21	2021-22	2022-23	2023-24	2024-25
Year-on-year change in PSND (a+b+c+d)	**380.4**	**296.0**	**55.3**	**47.3**	**-48.2**
Public sector net borrowing (a)	**299.8**	**167.3**	**45.4**	**25.1**	**16.5**
Financial transactions (b)	**70.7**	**125.7**	**13.8**	**22.3**	**-65.6**
of which:					
DEL net lending	**0.1**	**-0.3**	**-1.1**	**0.0**	**0.0**
Help to Buy outlays	0.3	0.0	0.3		
Other DEL	1.2	0.6			
DEL beyond current Spending Review			-1.4	0.0	0.0
Allowance for shortfall	-1.3	-1.0	0.0	0.0	0.0
Other government net lending	**1.8**	**1.3**	**2.7**	**3.0**	**2.3**
Student loan outlays[1]	-0.2	-0.4	-0.8	-1.2	-1.3
Student loan repayments[2]	1.0	1.1	1.1	1.1	1.1
Scottish Government	-0.2	-0.6	-0.3	-0.6	-0.6
UK Infrastructure Bank	0.0	0.7	1.3	1.6	1.6
UK Export Finance	-0.6	0.3	0.1	0.7	-0.1
Other AME	1.4	-0.1	0.9	0.8	1.1
Help to Buy repayments	0.4	0.3	0.4	0.5	0.5
Sales or purchases of financial assets	**5.2**	**0.4**	**1.5**	**0.7**	**0.7**
NatWest Group	3.8	1.0	1.6	0.7	0.7
UKAR asset sales and rundown	1.0	-0.5	0.0	0.0	0.0
Other sales	0.4	0.0	0.0	0.0	0.0
Bank of England schemes	**68.2**	**123.6**	**0.1**	**1.7**	**-77.2**
Term Funding Scheme	56.6	113.4	0.0	0.0	-85.0
Other effects	11.6	10.2	0.1	1.7	7.8
Cash flow timing effects	**-4.6**	**0.6**	**10.6**	**17.0**	**8.6**
Student loan interest[2]	-0.4	-0.6	-1.1	-1.2	-1.0
Corporation tax	-1.0	-0.4	2.9	10.3	4.3
Other receipts	15.5	-23.7	1.4	-0.1	0.7
Funded public pension schemes	-0.2	-0.2	-0.9	-0.1	0.6
Index-linked gilt uplift[3]	3.4	3.1	3.2	1.2	-1.0
Other gilt accruals	2.1	3.4	2.9	2.9	3.2
Guarantee schemes write offs	-22.7	17.1	2.0	3.8	1.6
Other expenditure	-1.4	1.9	0.2	0.2	0.2
Public sector net cash requirement (a+b)	*370.5*	*293.0*	*59.2*	*47.4*	*-49.1*
Valuation effects (c)	**9.8**	**3.1**	**-3.9**	**-0.1**	**0.8**
of which:					
Gilt premia	-27.1	-5.1	-0.6	1.1	1.9
Asset Purchase Facility gilt premia	49.9	11.1	-0.2	-0.1	-2.1
Index-linked gilts uplift[3]	-3.4	-3.1	-3.2	-1.2	1.0
International reserves	-9.5	0.1	0.1	0.1	0.1
ONS statistical changes (d)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

[1] This records the non-spending part of outlays, the remainder is recorded as capital transfers.

[2] Cash payments of interest on student loans are included within 'Student loan repayments', as we cannot easily separate them from repayments of principal. To prevent double counting, the 'student loan interest' timing effect removes all accrued interest.

[3] This reconciliation to the public sector net cash requirement does not affect public sector net debt.

Table 3.28: Public sector net debt profile: changes since November

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Year-on-year change in PSND (a+b+c+d)	**-73.6**	**100.4**	**4.0**	**-2.2**	**20.8**	**-59.4**
Public sector net borrowing (a)	**-38.9**	**69.7**	**2.3**	**-15.1**	**-25.1**	**-28.2**
Financial transactions (b)	**-25.6**	**22.0**	**-4.6**	**12.4**	**44.5**	**-33.6**
of which:						
DEL net lending	**1.6**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**
Help to Buy outlays	**1.6**	**0.4**	**0.5**			
Other DEL	**-2.5**	**0.5**				
DEL beyond current Spending Review			**-0.5**	**0.0**	**0.0**	**0.0**
Allowance for shortfall	**2.5**	**-0.7**	**0.0**	**0.0**	**0.0**	**0.0**
Other government net lending	-0.3	0.7	1.0	1.4	1.0	0.7
Student loan outlays[1]	**0.0**	**0.0**	**-0.1**	**-0.4**	**-0.4**	**-0.5**
Student loan repayments[2]	0.0	-0.1	-0.1	0.0	0.1	0.1
Scottish Government	0.0	-0.3	0.0	0.0	0.0	0.0
UK Infrastructure Bank	0.0	0.7	1.3	1.6	1.6	1.4
UK Export Finance	-0.1	0.4	0.2	0.2	-0.3	-0.3
Other AME	-0.2	0.1	-0.2	-0.1	0.0	0.0
Help to Buy repayments	-0.1	0.0	-0.1	0.0	0.0	0.0
Sales or purchases of financial assets	**-0.1**	**0.2**	**0.2**	**0.2**	**0.2**	**-2.6**
NatWest Group	0.0	0.2	0.2	0.2	0.2	-2.6
UKAR asset sales and rundown	-0.1	0.0	0.0	0.0	0.0	0.0
Other sales	0.0	0.0	0.0	0.0	0.0	0.0
Bank of England schemes	**-30.1**	**30.0**	**0.0**	**0.0**	**39.9**	**-30.2**
Term Funding Scheme	-30.0	30.0	0.0	0.0	40.0	-30.0
Other effects	-0.1	0.0	0.0	0.0	-0.1	-0.2
Cash flow timing effects	**3.3**	**-9.2**	**-5.8**	**10.8**	**3.4**	**-1.5**
Student loan interest[2]	0.0	0.2	0.5	0.2	-0.3	-0.3
Corporation tax	-2.1	-2.2	0.3	10.0	4.3	0.6
Other receipts	0.8	-2.6	1.3	-0.7	-0.7	-1.3
Funded public pension schemes	0.0	0.0	0.0	0.0	0.0	0.0
Index-linked gilt uplift[3]	-0.6	-5.6	-0.4	1.5	0.6	0.1
Other gilt accruals	0.1	-0.4	-0.6	-0.8	-0.8	-0.9
Guarantee schemes write offs	4.9	2.2	-6.9	0.3	0.1	0.0
Other expenditure	0.1	-0.8	0.1	0.3	0.3	0.3
Public sector net cash requirement (a+b)	*-64.5*	*91.7*	*-2.3*	*-2.7*	*19.4*	*-61.8*
Valuation effects (c)	**-9.1**	**8.7**	**6.3**	**0.5**	**1.4**	**2.4**
of which:						
Gilt premia	-1.2	3.9	6.0	2.6	3.2	3.5
Asset Purchase Facility gilt premia	-7.3	-0.8	-0.2	-0.6	-1.2	-1.0
Index-linked gilts uplift[3]	0.6	5.6	0.4	-1.5	-0.6	-0.1
International reserves	-1.1	0.0	0.0	0.0	0.0	0.0
ONS statistical changes (d)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

[1] This records the non-spending part of outlays, the remainder is recorded as capital transfers.

[2] Cash payments of interest on student loans are included within 'Student loan repayments', as we cannot easily separate them from repayments of principal. To prevent double counting, the 'student loan interest' timing effect removes all accrued interest.

[3] This reconciliation to the public sector net cash requirement does not affect public sector net debt.

Loans and repayments

3.127 Government net lending to the private sector generally declines over the forecast period as increasing outlays on student loans are offset by increasing repayments on those loans, repayments on Help to Buy loans and the front-loading of outlays in respect of several other schemes. Relative to our November forecast, the main changes include:

- Higher lending under **Help to Buy** as the share of new builds under the scheme have been higher than assumed. We now expect nearly 45 per cent of new builds to come under the scheme this year, up from the 30 per cent assumed in November.

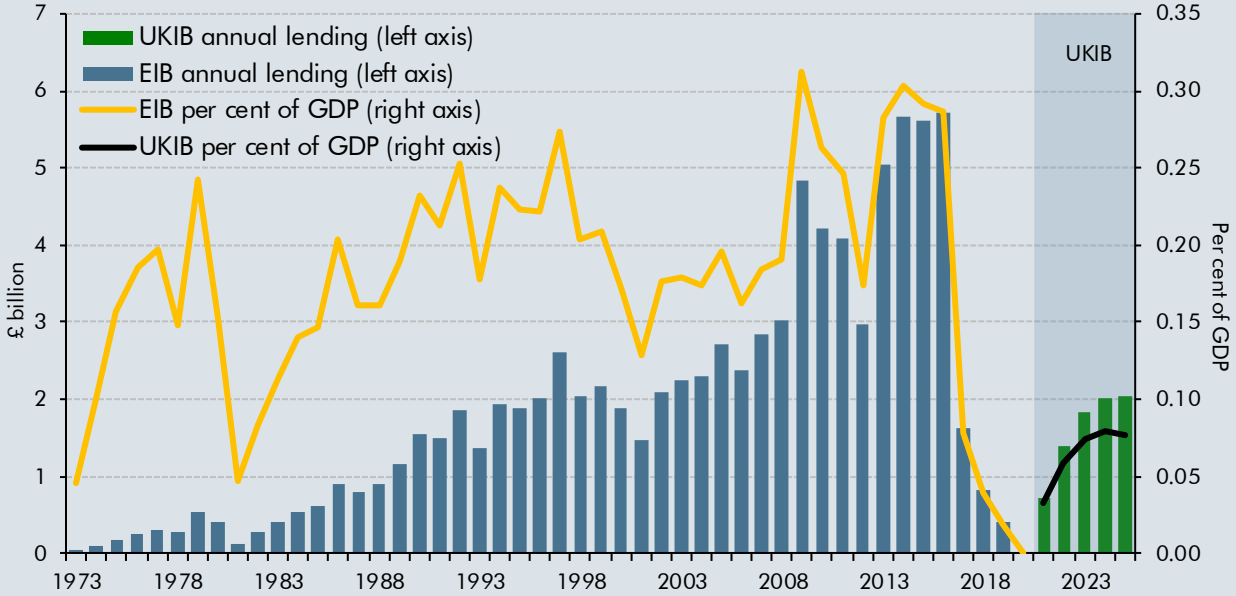
- The activities of the new **UK Infrastructure Bank** announced in this Budget increase outlays by an average of £1.5 billion a year. The Bank is discussed in Box 3.6.

Box 3.6: UK Infrastructure Bank

The Government has announced the establishment of a new UK Infrastructure Bank (UKIB) this year to help deliver on its National Infrastructure Strategy.[a] Like the European Investment Bank (EIB) of which the UK is no longer a member, the UKIB will extend loans, equity financing, and guarantees to fund projects that will help tackle climate change ('net zero') and to support regional and local economic growth ('levelling up'). The Treasury has placed a cap on the bank's capital over the next five years that amounts to £12 billion in actual liabilities (to finance loans and equity) and a further £10 billion in contingent liabilities (in the form of guarantees). The Bank also will take over the UK Guarantee Scheme, which can currently issue up to £40 billion in guarantees, though the Bank will initially be able to issue £10 billion of this.

As an EU member state, the UK received almost €120 billion (or £89 billion) in loans and equity from the EIB between 1973 and 2019. In the five years prior to the EU referendum in 2016, EIB lending averaged £5 billion a year, but it fell sharply in 2017 and was less than £1 billion a year in 2018 and 2019. The Government forecasts that the UKIB will lend and invest around £1½ billion a year (net of lending to local authorities that would otherwise have taken place through the Public Works Loans Board). This would be equivalent to around a third of the financing that was provided by the EIB prior to the EU referendum (Chart G). National investment banks exist in many countries. One of the largest and longest established is Germany's Kreditanstalt für Wierderaufbau (KfW), which as of 2019 has total assets of €506 billion (14.7 per cent of Germany's GDP).

Chart G: UKIB lending forecast relative to historical EIB lending



Note: EIB figures are on a calendar year basis; UKIB figures are on a financial year basis. Both sets of figures are exclusive of guarantees.
Source: EIB, OBR

The Government's intent for UKIB is to boost private sector investment in UK infrastructure. We therefore considered whether to reflect its launch explicitly in our economy forecast. However, given the scale its operations (at around 0.1 per cent of GDP a year) and the fact that it replaces only some EIB activity, we have not adjusted our economy forecast. Our fiscal forecast reflects the direct effect of the bank's activities on public sector net debt (which rises to £6.6 billion by 2025-26) and its more modest effects on public sector net borrowing (which lower it by amounts that rise to £0.3 billion in 2025-26, largely from guarantee fees).

The UKIB's balance sheet will provide another channel along which the public sector as a whole is exposed to wider economic risks, thereby increasing the potential impact of future economic shocks on the fiscal position. The projects that the UKIB will invest in are likely to involve a reasonable degree of risk, as will the financing tools it will use. Projects may have revenue or construction risks, resulting in loss of forecast revenue or additional costs, or the Government could see calls on guarantees or loans may be unpaid.

As well as being a potential source of real world fiscal risk, the UKIB's operations could generate statistical classification risks. Our forecast assumes that the UKIB itself will be classified as a central government body, while any private sector entities that it engages with will remain classified as such. But if the UKIB were to be deemed to have taken sufficient control over those entities, they could be classified to the public sector, or large infrastructure projects could be recorded on the public sector's balance sheet. If reclassified, the liabilities of these entities would be captured in headline measures of public sector net debt but their non-liquid financial assets (such as equity) and fixed assets (such the infrastructure networks themselves) would not be recognised as assets in public sector net debt.

Sales and purchases of financial assets

3.128 The Government now plans to sell its remaining NatWest Group shares (formerly RBS) over the five years to 2025-26, rather than over four years as it had previously planned. This lowers the volume of shares sold each year up to 2024-25, but the effect of this on our forecast has been largely offset by a higher share price. The new sales in 2025-26 then generate sales proceeds for that year where there were previously none.

Bank of England schemes

3.129 The Bank of England's lending schemes, especially the two Term Funding Schemes , continue to be the largest element of the financial transaction forecast, adding to debt in the first two years and then reducing it in the final two years as loans are repaid. The Bank's schemes lend to banks and building societies with repayments due four or more years later.

3.130 Since November the Bank has extended the TFSME[7] drawdown period from April to October 2021. As a result, the end-of-scheme build-up that our November forecast assumed has not yet materialised. We still expect that TFSME lending will reach £170 billion, but now expect £50 billion of that to happen in 2021-22 rather than in 2020-21. As the loans are of at least four years duration, we therefore also expect more to be repaid in 2025-26 and less in 2024-25. In addition, we have revised up the proportion of loans that will extend the repayment period to up to 10 years (to align with BBLS terms) by £10 billion. This means we no longer expect those loans to be repaid within the forecast period.

Cash payments on guarantees and other timing effects

3.131 Abstracting from the uplift on index-linked gilts (for which there is an offsetting valuation effect), timing effects between 2020-21 and 2025-26 add to the PSNCR by a total of £21.8 billion less than we expected in November. Of this:

- The net effect of lower write-offs under the existing **government-guaranteed loan schemes** and their extension to the end of March, and the introduction of the new **Recovery Loan Scheme**, reduces net cash outlays relative to accrued spending at the start of the period, but raises them towards the end.

- Timing effects related to **corporation tax measures** also have an uneven effect across years thanks to the large temporary tax cut afforded by the capital allowances measure, followed by the progressively larger tax rise from raising the main rate.

Valuation effects

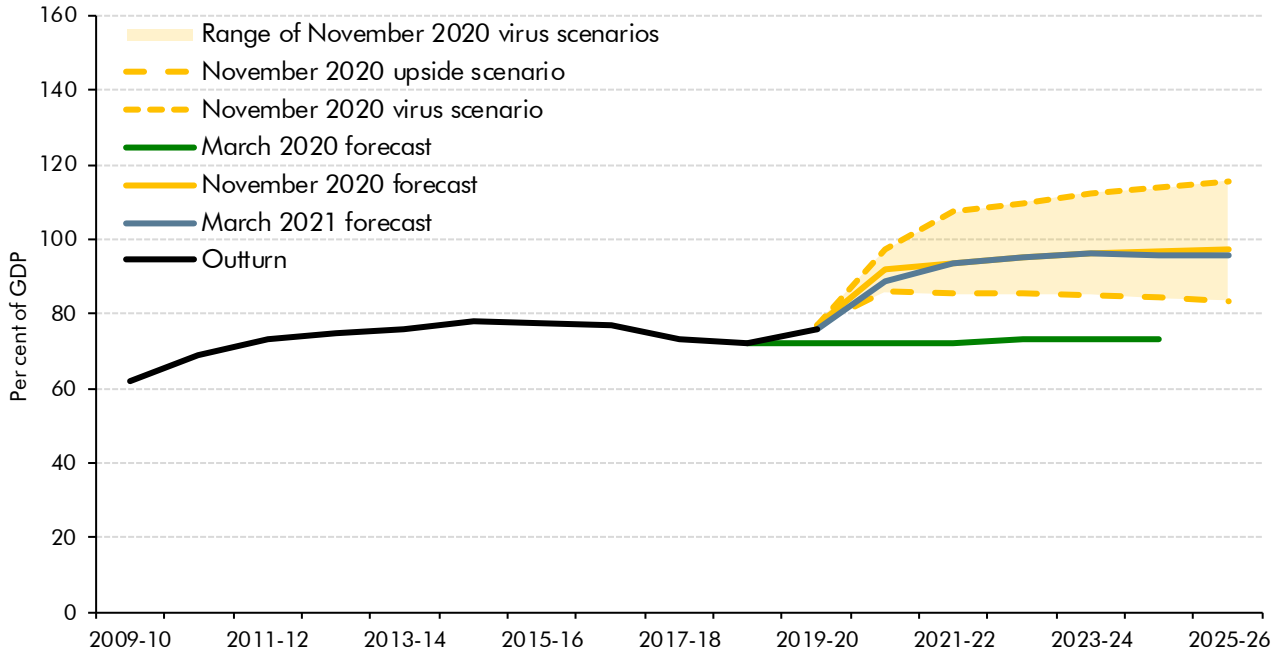
3.132 Overall valuation effects (abstracting from the uplift on index-linked gilts) have large effects on the profile of PSND in 2020-21, with premia on hugely increased gilt issuance lowering it by £36 billion, but the accounting effect of the APF purchasing gilts from the market at prices above the nominal values at which they are recorded in PSND raising it by £51 billion. The latter figure has been revised down somewhat since November. From 2021-22 onwards, the largest changes relative to our November forecast relate to gilt premia as a result of higher gilt yields, the latest outturn data and the latest government financing remit.

[7] The TFSME is the new Term Funding Scheme with additional incentives for SMEs that was announced on 11 March 2020.

Public sector net debt

3.133 For the first time since 1960-61, public sector net debt (PSND) rises above 100 per cent of GDP this year, climbs to a peak of 109.7 per cent in 2023-24 and then declines to 103.8 per cent over the subsequent two years. Some of the sharp rise in headline PSND this year and next, and the falls at the end of the period, are due to TFS loans being extended and subsequently repaid. PSND excluding the Bank of England jumps somewhat less sharply to 88.8 per cent of GDP in 2020-21, then continues to rise until it peaks at 97.1 per cent in 2023-24 and then broadly stabilises, falling by 0.1 per cent of GDP in 2024-25 and by 0.2 per cent in 2025-26. This stabilisation in the final three years of the forecast is a consequence of the tax rises and spending cuts announced in the Budget, without which PSND excluding the Bank of England would have remained on a rising path throughout the medium term.

Chart 3.9: Public sector net debt excluding the Bank of England



Source: ONS, OBR

3.134 Relative to our pre-virus forecast in March 2020, debt is sharply higher in all years, and remains 30.9 per cent of GDP higher in 2024-25. The lower path of nominal GDP explains relatively little of that upward revision, which is largely due to the cash level of debt being £729 billion higher at that point. Of this, £554 billion comes from higher cumulative borrowing (a third of which relates to policy measures and two-thirds to underlying factors), while £175 billion reflects a larger Bank of England balance sheet.

3.135 Relative to our November forecast, higher nominal GDP reduces the debt-to-GDP ratio in all years, whereas cash debt is lower in the first and final years of the forecast but higher in between. The largest contribution to these changes in both the level and profile of cash debt comes from the policy measures announced in the Budget, with near-term giveaways eventually outweighed by medium-term takeaways.

Table 3.29: Public sector net debt: changes since March 2020

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2020 forecast	79.5	77.4	75.0	75.4	75.6	75.3	
March 2021 forecast	84.4	100.2	107.4	109.0	109.7	106.2	103.8
Difference	**4.9**	**22.7**	**32.3**	**33.6**	**34.1**	**30.9**	
of which:							
Change in nominal GDP[1]	4.9	4.9	1.6	2.2	1.9	1.8	
Change in cash level of net debt	0.0	17.8	30.8	31.3	32.2	29.1	
	£ billion						
March 2020 forecast	1,798	1,818	1,828	1,900	1,970	2,032	
March 2021 forecast	1,798	2,198	2,503	2,631	2,747	2,761	2,804
Difference	**0**	**379**	**675**	**730**	**777**	**729**	
of which:							
Underlying forecast revisions		**164**	**381**	**420**	**469**	**458**	
PSNB (pre-measures)		82	176	233	291	354	
Financial transactions (pre-measures)		72	191	178	169	95	
Valuation and classification changes		10	13	9	9	10	
Effect of Government decisions		**215**	**295**	**310**	**308**	**271**	
Affecting public sector net borrowing		217	291	279	246	200	
Affecting financial transactions		-2	4	31	62	71	

[1] Non-seasonally adjusted GDP centred end-March.

Table 3.30: Public sector net debt: changes since November 2020

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November 2020 forecast	85.5	105.2	108.0	108.6	109.4	105.0	104.7
March 2021 forecast	84.4	100.2	107.4	109.0	109.7	106.2	103.8
Difference	**-1.1**	**-5.0**	**-0.7**	**0.4**	**0.3**	**1.2**	**-1.0**
of which:							
Change in nominal GDP[1]	-1.0	-1.5	-1.7	-0.8	-0.8	-0.6	-0.5
Change in cash level of net debt	-0.1	-3.5	1.1	1.2	1.0	1.8	-0.5
	£ billion						
November 2020 forecast	1,801	2,274	2,478	2,602	2,721	2,714	2,817
March 2021 forecast	1,798	2,198	2,503	2,631	2,747	2,761	2,804
Difference	**-2**	**-76**	**24**	**28**	**26**	**47**	**-12**
of which:							
Underlying forecast revisions	**-2**	**-80**	**-40**	**-49**	**-47**	**1**	**-18**
PSNB (pre-measures)		-47	-31	-29	-25	-18	-10
Financial transactions (pre-measures)	-2	-24	-8	-26	-29	12	-18
Valuation and classification changes		-9	0	6	6	8	10
Effect of Government decisions		**4**	**64**	**78**	**73**	**46**	**6**
Affecting public sector net borrowing		8	62	62	43	11	-25
Affecting financial transactions		-4	2	16	30	34	31

[1] Non-seasonally adjusted GDP centred end-March.

Central government net cash requirement

3.136 The central government net cash requirement (CGNCR) is a key determinant of the government's overall net financing requirement. Table 3.31 reconciles CGNCR with PSNCR by removing transactions associated with local authorities and public corporations. It also removes transactions relating to Bradford & Bingley (B&B), Northern Rock Asset Management (NRAM) and Network Rail, to produce 'CGNCR ex', which the Treasury uses as the basis for the Debt Management Office's financing remit.

3.137 PSNCR varies from nearly £400 billion in 2020-21 down to as low as £22 billion in 2024-25. Removing the uneven impact of sectors other than central government (in particular that of the Bank of England) reveals a CGNCR that reduces dramatically from £370 billion this year down to £88 billion in 2025-26.

Table 3.31: Reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector net cash requirement (NCR)	**395.8**	**299.3**	**131.4**	**114.0**	**21.7**	**38.9**
of which:						
Local authorities and public corporations NCR	27.7	59.8	4.1	5.3	-76.7	-48.1
Central government (CG) NCR own account	368.1	239.5	127.4	108.7	98.4	87.0
CGNCR own account	368.1	239.5	127.4	108.7	98.4	87.0
Net lending within the public sector	1.2	1.0	1.0	1.0	1.0	1.0
CG net cash requirement	**369.3**	**240.4**	**128.4**	**109.7**	**99.4**	**88.1**
B&B, NRAM and Network Rail adjustment	0.4	0.0	-0.5	0.0	0.3	0.0
CGNCR ex. B&B, NRAM and Network Rail	**369.7**	**240.4**	**127.9**	**109.7**	**99.7**	**88.1**

Alternative balance sheet aggregates

3.138 Our *Fiscal risks reports* have discussed how PSND provides only a partial picture of the public finances. It includes only a limited range of debt and debt-like liabilities and an even smaller range of liquid financial assets. This makes it susceptible to 'fiscal illusions' – when movements in a fiscal aggregate do not reflect true changes in the underlying health of the public finances. With PSND, this is particularly the case when government creates, acquires, or sells illiquid assets like loans, shares, or real estate, or when it increases or reduces non-debt liabilities like pension entitlements.

3.139 Alternative metrics often do a better job than PSND of reflecting the overall state of the government finances, although none is perfect:

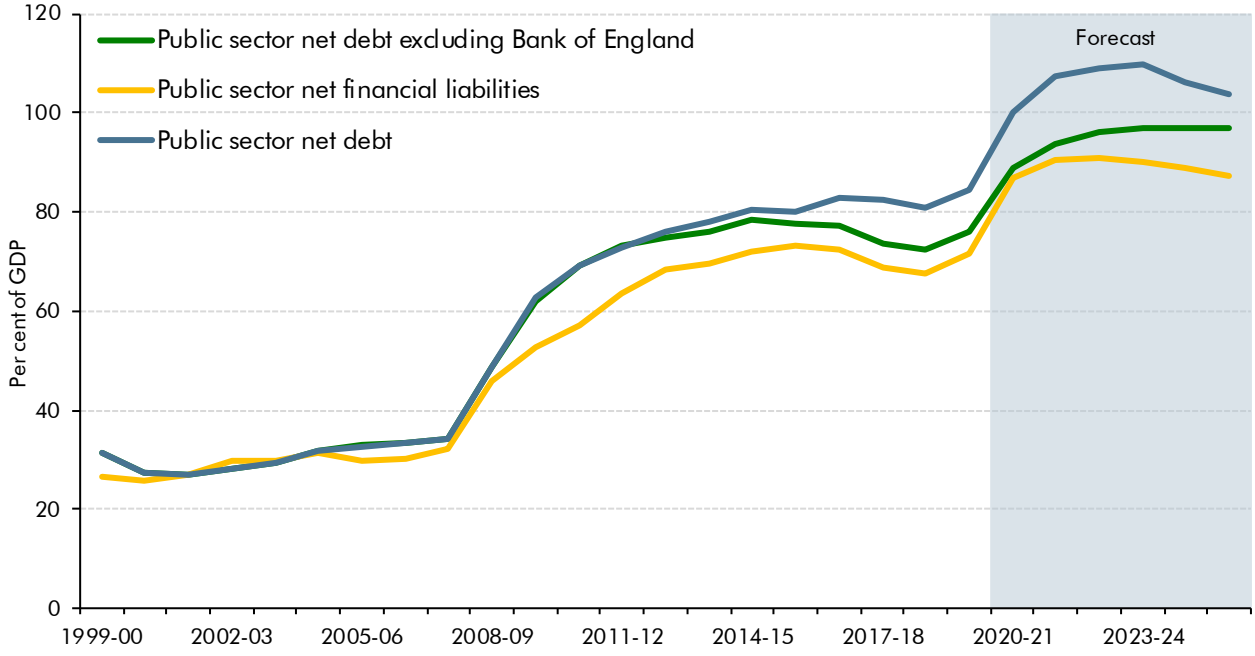
- **PSND excluding the Bank of England** (PSND ex BoE) removes the uneven effects across years caused in particular by the TFS, whose acquisition of illiquid assets (the TFS loans, which are not netted off PSND) are funded by the issuance of central bank reserves (a form of debt that is captured in PSND).

- **Public sector net financial liabilities** (PSNFL) provides a more comprehensive picture of the financial balance sheet by capturing all (liquid and illiquid) financial assets held by the public sector. In doing so, it provides a more transparent picture of the effect of the creation, acquisition, or sale of financial assets.

- **Public sector net worth** (PSNW), the broadest measure, also reflects the value of real non-financial assets that governments own and invest in, although placing a meaningful value on these can be challenging. We do not currently forecast this measure but will explore methodologies for doing so in the future.

3.140 Headline PSND rises sharply in 2020-21 and more slowly after that (Chart 3.10). As TFS loans start to be repaid in 2024-25, it begins to fall, but remains above 100 per cent of GDP in all years. PSND ex BoE rises less sharply in 2020-21, then rises more slowly to peak at 97.1 per cent in 2023-24, and broadly stabilises thereafter. By this point, the remaining difference between this measure and headline PSND relates to gilts that are purchased under quantitative easing for which the Bank pays a market price that exceeds their nominal value and to outstanding TFS loans.[8] PSNFL peaks earlier and lower than the other measures, at 90.8 per cent of GDP in 2022-23, before declining to 87.4 per cent of GDP by 2025-26.

Chart 3.10: The public sector balance sheet: various measures



Source: ONS, OBR

[8] The accounting effects of quantitative easing in the public finances are explained in *The direct fiscal consequences of unconventional monetary policies,* March 2019, available on our website.

Financing and the balance sheet

3.141 The Government has had to revise its financing remit for 2020-21 several times as the impact of the pandemic has grown. The additional financing has largely been met through the issuance of conventional gilts and to a lesser extent NS&I deposits. The Government has now published an initial financing remit for 2021-22. The proposed composition of issuance by instrument and maturity moves closer to the original plans for 2020-21, but continues the reduction in the share of index-linked issuance we have seen in recent years. In the absence of a medium-term statement on financial policy from the Government, our forecast assumes that the composition of the 2021-22 remit is repeated in subsequent years.

Table 3.32: Total gross financing

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Central government net cash requirement[1]	369.7	240.4	127.9	109.7	99.7	88.1
Gilt redemptions	97.6	79.3	103.9	82.8	104.3	109.8
Financing for the reserves	0.0	0.0	0.0	0.0	0.0	0.0
Change in DMO cash position[2]	17.9	-17.4	0.0	0.0	0.0	0.0
Total gross financing	**485.2**	**302.3**	**231.8**	**192.5**	**204.1**	**197.8**
of which:						
Conventional gilts	450.6	259.1	201.3	167.0	175.9	170.0
Index-linked gilts	33.2	35.2	26.2	21.3	24.0	23.8
Treasury bills	-2.0	1.8	0.0	0.0	0.0	0.0
NS&I	20.0	6.0	4.0	4.0	4.0	4.0
Other central government	0.8	0.3	0.2	0.2	0.1	0.0

[1] Excluding Northern Rock, Bradford and Bingley, and Network Rail.
[2] Change in Debt Management Office cash position.

3.142 The consequences of the government's financing plans for the composition of public sector net debt are shown in Table 3.33. The 19.4 per cent of GDP rise in PSND between 2019-20 and 2025-26 reflects an 18.0 per cent of GDP increase in debt liabilities and a 2.7 per cent of GDP decline in liquid assets, slightly offset by a reduction in the net contribution from the Bank of England of 1.3 per cent of GDP. Within liabilities a 22.4 per cent of GDP increase in the stock of conventional gilts is partly offset by falls in index-linked gilts, Treasury bills and NS&I liabilities. Most classes of liquid assets decrease, especially foreign exchange reserves and in local government.

Table 3.33: The composition of public sector net debt

	Per cent of GDP[1]						
	Forecast						
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector debt liabilities[2] (a)	**87.3**	**100.6**	**104.1**	**105.7**	**106.2**	**106.0**	**105.4**
of which:							
Conventional gilts	50.0	64.0	67.9	70.4	71.9	72.4	72.5
Index-linked gilts	21.0	20.7	20.9	20.4	19.9	19.6	19.3
Treasury bills	3.9	3.7	3.5	3.4	3.3	3.2	3.1
NS&I	8.4	9.1	8.8	8.6	8.5	8.3	8.2
Other central government	3.9	3.0	2.8	2.7	2.6	2.5	2.4
Local government[3]	0.9	0.9	0.9	0.8	0.8	0.8	0.8
Non-financial public corporations[4] (b)	-0.7	-0.7	-0.7	-0.8	-0.8	-0.8	-0.8
Public sector liquid assets[2] (c)	**11.3**	**11.8**	**10.3**	**9.7**	**9.2**	**9.0**	**8.6**
of which:							
Reserves	6.4	6.6	6.2	6.0	5.8	5.6	5.4
Other central government	2.3	3.0	2.1	2.0	1.9	1.8	1.7
Local government[3]	1.5	1.2	0.9	0.7	0.5	0.4	0.2
Non-financial public corporations[4]	1.1	1.0	1.1	1.0	1.0	1.2	1.3
Bank of England net contribution (d)	**8.3**	**11.4**	**13.5**	**13.0**	**12.6**	**9.2**	**7.0**
Public sector net debt (PSND) (a-c+d)	**84.4**	**100.2**	**107.4**	**109.0**	**109.7**	**106.2**	**103.8**
Memo: PSND excluding Bank of England (a-c)	*76.1*	*88.8*	*93.8*	*96.0*	*97.1*	*97.0*	*96.8*
Memo: general government gross debt (a-b)	*88.1*	*101.4*	*104.8*	*106.4*	*107.0*	*106.8*	*106.2*

[1] Non-seasonally adjusted GDP centred end-March.
[2] Excluding the Bank of England.
[3] Net of debt liabilities / liquid assets held by central government.
[4] Net of debt liabilities / liquid assets held by central and local government.
[5] Largely reserves issued to fund TFS loans and the APF's corporate bond purchases, plus premia on the APF's conventional gilt

Contingent liabilities

3.143 As usual, we have asked the Treasury to identify any changes to future contingent liabilities since our November forecast. Its dedicated reporting system recorded 18 in that period, with a total maximum exposure of £25.8 billion for those that have been quantified and approved. Contingent liabilities continue to arise in response to the pandemic, with several newer indemnities relating to the sourcing and administering of vaccines.

3.144 The Government has also guaranteed tens of billions of pounds worth of loans via the CBILS, CLBILS, and BBLS schemes that were established last year, to which our forecast assumes that it will add £12 billion more due to lending guaranteed under the Recovery Loan Scheme announced in the Budget that will succeed the previous schemes. For the purposes of our forecast we have applied the same treatment as the ONS has deemed appropriate for its predecessors, recording the expected write-offs up front.

3.145 Other recent policies also increase contingent liabilities. These include guarantees extended by the new UK Infrastructure Bank (see Box 3.6), and the proposed remedy for the McCloud-Sargeant pension case (Box 3.5). The Government has estimated that these remedies will increase pension liabilities by around £17 billion. As explained earlier in this chapter because of the way the ONS treats unfunded pensions this decision is likely to have

only a small impact on the deficit in the medium term. It is also not reflected in either PSND or PSNFL, which treat the liabilities of unfunded pension schemes as contingent. However, the increase in liabilities will eventually show up in the measures of public sector net worth that the ONS produces, as these are based on the IMF's accounting framework that treats both funded and unfunded pension liabilities equally.

Table 3.34: Fiscal aggregates: central forecast

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Receipts and expenditure							
Public sector current receipts (a)	37.2	37.5	36.2	37.3	38.4	39.0	39.1
Total managed expenditure (b)	39.8	54.4	46.5	41.8	41.9	41.9	41.9
of which:							
Public sector current expenditure (c)	35.6	48.2	41.3	36.5	36.5	36.6	36.6
Public sector net investment (d)	1.9	3.6	2.7	2.8	2.9	2.8	2.7
Depreciation (e)	2.3	2.6	2.5	2.5	2.5	2.5	2.5
Legislated fiscal mandate and supplementary target							
Cyclically adjusted net borrowing	2.6	16.5	9.7	4.2	3.3	2.8	2.7
Public sector net debt[1]	84.4	100.2	107.4	109.0	109.7	106.2	103.8
Budget 2020 fiscal targets							
Current budget deficit (c+e-a)	0.6	13.3	7.6	1.7	0.6	0.1	0.0
Debt interest to revenue ratio (per cent)	3.5	2.6	2.5	2.3	2.4	2.5	2.5
Other deficit measures							
Public sector net borrowing (b-a)	2.6	16.9	10.3	4.5	3.5	2.9	2.8
Cyclically adjusted current budget deficit	0.7	12.9	6.9	1.4	0.5	0.0	0.0
Primary deficit	1.3	16.0	9.5	3.7	2.6	2.0	1.8
Cyclically adjusted primary deficit	1.4	15.5	8.8	3.4	2.4	1.9	1.8
Financing							
Central government net cash requirement	2.5	17.6	10.6	5.4	4.5	3.9	3.3
Public sector net cash requirement	0.8	18.9	13.2	5.5	4.6	0.9	1.5
Alternative balance sheet metrics							
Public sector net debt ex. Bank of England	76.1	88.8	93.8	96.0	97.1	97.0	96.8
Public sector net financial liabilities	71.5	86.9	90.4	90.8	90.2	88.9	87.4
Stability and Growth Pact							
Treaty deficit[2]	2.8	17.1	10.6	4.5	3.5	3.1	3.1
Cyclically adjusted Treaty deficit	2.9	16.6	10.0	4.2	3.4	3.0	3.0
Treaty debt ratio[3]	84.4	107.6	107.2	107.8	109.3	110.0	110.4
				£ billion			
Current budget deficit	14.0	278.8	171.8	40.0	15.2	3.2	0.9
Public sector net investment	43.1	75.9	62.2	67.0	70.1	71.2	72.8
Public sector net borrowing	57.1	354.6	233.9	106.9	85.3	74.4	73.7
Cyclically adjusted net borrowing	58.8	345.4	219.3	99.2	81.6	71.9	72.5
Cyclically adjusted current budget deficit	15.7	269.5	157.1	32.2	11.5	0.7	-0.3
Public sector net debt	1798	2198	2503	2631	2747	2761	2804
Net debt interest	28.2	19.6	19.9	19.4	21.6	23.7	25.0
Non-interest receipts	801.0	762.8	794.2	859.0	916.3	963.4	1004.5
Memo: Output gap (per cent of GDP)	*0.1*	*-0.9*	*-0.9*	*-0.3*	*-0.2*	*-0.1*	*0.0*

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

[2] General government net borrowing.

[3] General government gross debt. Uses financial year GDP.

Risks and alternative scenarios

3.146 In our *Fiscal risks reports*, we follow the IMF in defining a 'fiscal risk' over the medium term as any potential deviation from our central forecast.[9] These shocks can arise from several sources that can be grouped under two broad headings:

- **Exogenous risks** are ones over which governments have little control (such as global financial crises, natural disasters and pandemic diseases).
- **Endogenous risks** are those arising from policy (such as the Government's decision to guarantee loans to businesses or to pay a proportion of furloughed workers wages).

3.147 Of course, no matter their source, most risks end up being neither purely exogenous nor purely endogenous. For instance, even if the emergence of the current pandemic was beyond the Government's control, effective public health policies can help to contain its transmission and thereby limit its economic and fiscal impact here. And the costs of guaranteed loan schemes depend on the course of the pandemic and how well businesses withstand the shock to revenues it has caused, which in turn is influenced by other forms of government support for businesses and households.

3.148 Before the pandemic, we found that the distribution of past fiscal forecast errors provided a useful benchmark for thinking about the probability and impact of future fiscal risks. However, as discussed in Chapter 4, these past forecast errors are calculated based on data going back only as far as 1988 when the Treasury first started producing comparable medium-term fiscal forecasts. As the economic shock resulting from the pandemic and the Government's response to it are unprecedented in peacetime, this approach is unlikely to capture the potential range of outcomes around our latest central forecast.

3.149 To try to capture the degree of uncertainty around a forecast being made in the middle of a pandemic, in November we produced a set of plausible upside and downside scenarios varying assumptions about the future path of the virus. These should better illustrate the present degree of virus-related forecast uncertainty, although scenarios outside the range presented are also entirely possible. In the following sections we:

- present the **fiscal implications of the November alternative coronavirus scenarios**, which vary assumptions about the path of the virus and its economic implications, relative to our latest forecast;
- discuss **how our latest fiscal forecast compares with those scenarios**, taking account of economic developments and new policies announced since November; and
- illustrate the potential impact of three **other pandemic-related specific risks** to the fiscal outlook.

[9] International Monetary Fund, *Analyzing and managing fiscal risks – best practices*, June 2016.

Alternative coronavirus scenarios

3.150 The path of the coronavirus pandemic remains the key risk to our forecast. As discussed in Chapter 2, our central forecast assumes that the vaccination programme allows public health restrictions to be eased in line with the Government's 22 February Roadmap. But there are still significant risks to our forecast, for example relating to mutations of the virus, the effectiveness of vaccines, in the field, and individuals' behaviour in response to public health restrictions. Changing any of these assumptions could lead to very different outcomes to our central forecast for both the economy and public finances.

3.151 Given these uncertainties around our central forecast, we think the upside and downside scenarios presented in our November *EFO* still represent plausible paths for both the economy and the public finances over the medium term. The assumptions underpinning them are presented in Chapter 2 in the November *EFO*. As before, we make no attempt to assign probabilities to each scenario.

3.152 The effect of the two scenarios on key fiscal variables is shown in Chart 3.11. The path of our latest central forecast relative to these scenarios is discussed next. In the scenarios:

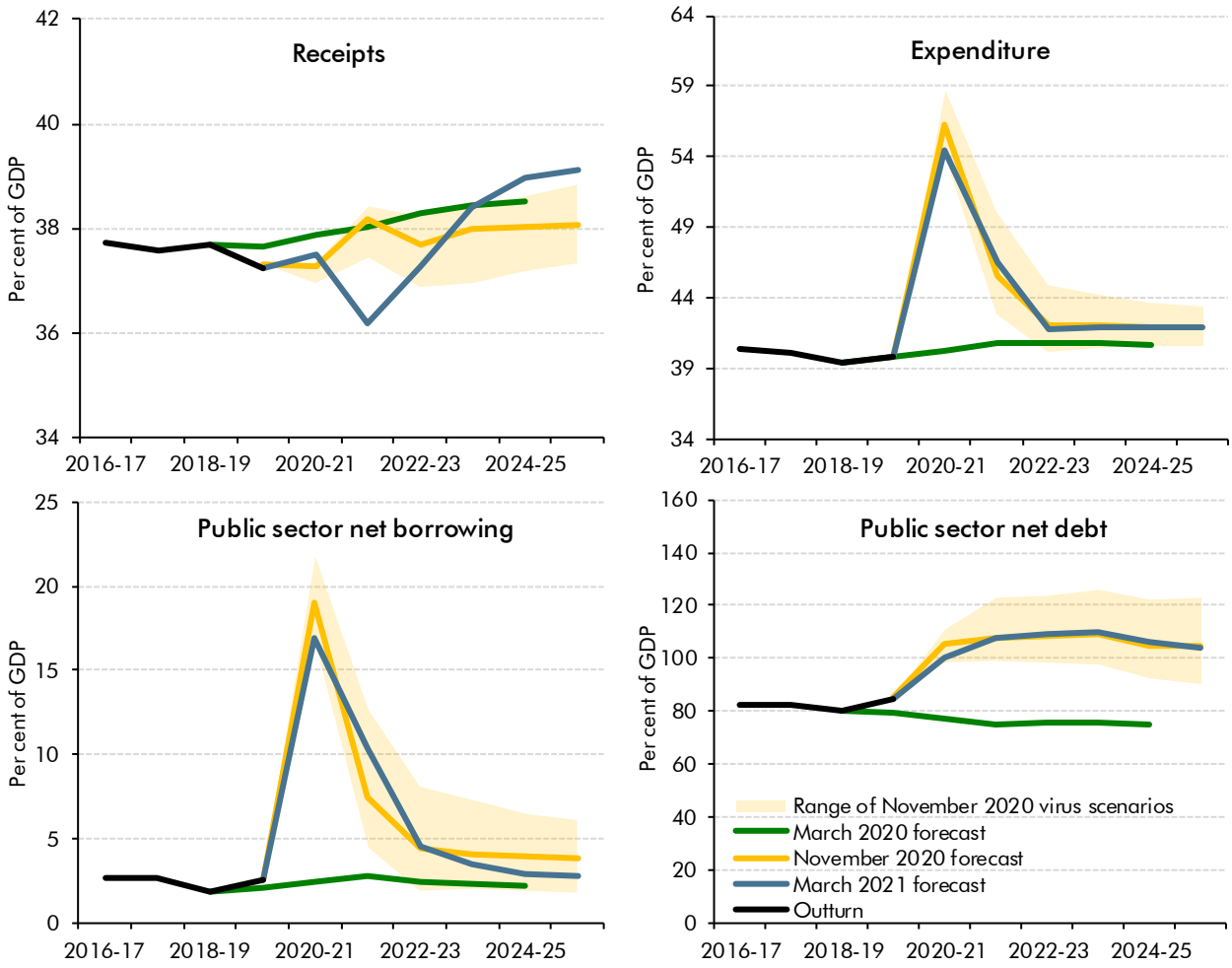
- **Receipts** fall roughly in line with the economy and therefore differ only moderately as a share of GDP across the scenarios. By 2025-26, receipts are 1.5 per cent of GDP lower in the downside scenario than in the upside scenario.

- **Spending** in each scenario largely moves with the Government's policy decisions as they stood in November. In 2021-22, spending is 7.3 per cent of GDP higher in the downside scenario than in the upside, reflecting £45 billion higher public spending and a weaker nominal GDP denominator. By 2025-26, the 2.8 per cent of GDP difference between the scenarios is almost wholly accounted for by differences in GDP.

- Given these receipts and spending profiles, **borrowing** spikes in 2020-21 to 16.7 per cent of GDP in the upside scenario and 21.7 per cent of GDP in the downside scenario. The rapid economic recovery and absence of any medium-term scarring of potential output in the upside scenario means that by 2025-26 the deficit falls to 1.7 per cent of GDP (a lower deficit than in our March 2020 forecast thanks to lower debt interest spending and a lower medium-term path for RDEL spending). The slower economic recovery and 6 per cent scarring in the downside scenario mean that borrowing in 2025-26 settles at 6.1 per cent – 4.4 per cent of GDP higher than in the upside scenario.

- In both scenarios, **debt** rises sharply in 2020-21, reflecting higher borrowing and falling GDP. Thereafter, debt falls gently to 90 per cent of GDP by 2025-26 in the upside scenario. In the downside scenario, debt rises to a peak of 126 per cent of GDP in 2023-24, before falling temporarily in 2024-25 as TFS loans are repaid.

Chart 3.11: Key fiscal aggregates in scenarios



Source: ONS, OBR

Our latest forecast relative to November's alternative scenarios

3.153 As described earlier in the chapter, we have revised borrowing down this year (on better outturns), up next year (thanks to Budget measures), and then down in the medium term (thanks to the tax rises and spending cuts announced in the Budget). This has fed through to a slightly lower path for debt. Comparing our latest forecast with November's scenarios:

- **Receipts** are above the upside scenario in 2020-21 but fall to well below the downside scenario in 2021-22. That reflects more self-assessed income tax and capital gains tax receipts being paid on time in 2020-21 rather than being deferred into 2021-22, plus the cost of the temporary capital allowances announced in the Budget. By 2025-26, receipts move back above our November upside scenario on the back of rises in corporation tax and personal taxes announced in the Budget.

- **Spending** remains closer to the path of our November central scenario, though it has been revised down to closer to the upside scenario in 2020-21 (on the lower cost of virus-related measures and greater underspending by departments). It then moves up to between our central forecast and downside scenario in 2021-22 due to the

extension of several virus-related support measures announced in the Budget. The medium-term path is little changed from our November central forecast.

- Reflecting these changes, **borrowing** peaks at 16.9 per cent of GDP in 2020-21, close to our upside scenario. By the forecast horizon, it falls to between our central forecast and upside scenario thanks to the fiscal tightening announced in the Budget.

- **Debt** is close to our upside scenario in 2020-21 thanks to lower borrowing but rises back to close to our central forecast in 2021-22 due to the cost of Budget measures. For the rest of the period, it remains close to our November central forecast.

Other pandemic-related risks

3.154 The path of the pandemic itself, and the associated restrictions on economic activity, remain the most significant source of uncertainty around our fiscal forecast. But even if the pandemic unfolds in line with our latest assumptions, there are related risks that could worsen the fiscal outlook. Here we discuss three pandemic-related risks. These should be considered in the context of other risks to fiscal sustainability, such as long-term demographic pressures, cost pressures in health, and the implications of climate change:

- **Greater sensitivity to changes in interest rates.** As discussed in Box 4.1, the fiscal and monetary policy response to the pandemic has left the consolidated public sector with a higher stock of debt and much shorter average effective maturity than a year ago. While this has allowed the Government to benefit from falling interest rates since the start of the pandemic, it has also increased its vulnerability to future increases in interest rates. As an example, in our latest forecast a one percentage point rise in short- and long- term interest rates would add £20.8 billion (0.8 per cent of GDP) to debt interest payments in 2025-26. However, the risk to the public finances depends on the reason for any increase in interest rates. The fiscal risk from rising interest rates due to strong economic growth, most likely accompanied by higher receipts, would be more benign than a sharp increase in rates driven by rising risk premia on UK government debt.

- **Net emigration since start of the pandemic.** In Chapter 2, we note the risk to our forecast relating to the size of the population based on analysis by O'Connor and Portes,[10] which suggests that up to 1.3 million people may have left the UK during the pandemic. Some of these emigrants may return, but the post-Brexit change in immigration rules is likely to make it harder for new migrants to move to the UK. Although the extent of net emigration is still highly uncertain, the risk to the size of the population appears to be firmly to the downside. Such an outcome could reduce the potential output of the economy via a lower labour supply, leading to greater post-pandemic scarring than the 3 per cent included in our central forecast. This is a risk to the outlook for the public finances as a smaller economy would reduce tax receipts, amplified by the fact that migrants are more likely to be of working age and net

[10] M. O'Connor and J. Portes, *"Estimating the UK population during the pandemic"*, ESCoE Blog, January 2021.

contributors to the public finances. It would, however, reduce demands on public services.

- **Departmental spending pressures.** In Box 3.3, we consider risks to RDEL spending that arise from the Government's future policy choices, as existing virus-related spending schemes end and the pandemic's legacy for public services becomes clearer. The direct health costs of coronavirus could be more persistent than the Government currently expects, for example due to ongoing costs of NHS Test and Trace as new variants of the virus emerge. The indirect costs of the pandemic could also prove to be greater than allowed for in the Government's existing spending plans, for example due to the cost to the NHS of clearing the backlog of non-virus-related activity, providing additional resources for pupils to catch up on lost schooling and the potential cost of ongoing support for disrupted sectors such as railways and air travel. The extent to which accommodating any of these pressures would represent a fiscal risk would depend on other policy choices, including whether to bear down on other spending to make space, or to raise taxes further rather than allowing borrowing and debt to rise.

4 Performance against the Government's fiscal targets

Introduction

4.1 This chapter:

- sets out the **current legislated fiscal targets** and assesses their likelihood of being met on current policy under our central forecast (from paragraph 4.2);
- discusses the Government's **approach to setting fiscal policy in the March 2021 Budget** while it continues to review the form that new fiscal rules should take, and the outlook for the relevant fiscal metrics (from paragraph 4.5); and
- considers the challenges in estimating **uncertainty around the fiscal forecast** in the wake of an unprecedented shock like coronavirus (from paragraph 4.12).

The legislated fiscal targets

4.2 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of meeting its fiscal targets under current policy. The *Charter* has been updated several times over the past decade.[1] The latest version was approved by Parliament in January 2017. It specifies:

- A longer-term **fiscal objective** to "*return the public finances to balance at the earliest possible date in the next Parliament*". In practice this has been interpreted as bringing public sector net borrowing to balance by 2025-26.
- A near-term **fiscal mandate** that requires the structural deficit (cyclically adjusted public sector net borrowing) to be less than 2 per cent of GDP by 2020-21.
- A near-term **supplementary debt target** that requires the ratio of public sector net debt to GDP to be falling in 2020-21.
- A medium-term **welfare cap** that requires a subset of welfare spending to be less than a ceiling of £127 billion in 2024-25, with that cap adjusted for subsequent changes in our inflation forecast and for the effects of welfare spending devolution in Scotland.

[1] The latest and previous versions are available on the 'Legislation and related material' page of our website.

The implications of our central forecast

4.3 Table 4.1 summarises expected performance against the legislated fiscal targets and how the margins against achieving them have changed since our pre-pandemic forecast in March 2020 (showing the effect of the pandemic on those margins) and since November 2020 (showing how that effect has evolved). Given the uncertainties surrounding the outlook during the pandemic, there is no meaningful way to attach precise probabilities to the likelihood of meeting these targets, although for the two that fall due in less than a month, it would require something out of the ordinary in those weeks for them to be met.

4.4 In our central forecast all targets are much more likely to be missed than met:

- The legislated **fiscal mandate** is missed by £303.4 billion (14.5 per cent of GDP), having been on course to be missed by just £9.2 billion (0.4 per cent of GDP) in our pre-virus March 2020 forecast. The margin has narrowed by £39.6 billion (2.1 per cent of GDP) since our November forecast, as receipts have held up better than expected and virus-related departmental spend and support measures have cost less.

- The legislated **supplementary debt target** is missed by a margin of 15.8 per cent of GDP, a narrower margin than we predicted in November. In contrast, the target was on course to be met by a margin of 2.0 per cent of GDP in March 2020.

- Spending subject to the **welfare cap** is on course to exceed the cap in 2024-25 by £6.9 billion and to exceed the cap plus margin by £3.1 billion (Table 4.2). This compares with spending exceeding the cap by £1.1 billion in our November forecast.

- The legislated **fiscal objective** was interpreted as requiring PSNB to be in balance or surplus in 2025-26. Our central forecast projects a deficit of 2.8 per cent of GDP in that year, thereby missing the objective by £73.7 billion. This is a narrower margin than in November, when we expected a deficit of 3.9 per cent of GDP, mainly due to the tax rises announced in this Budget. Our March 2020 forecast did not extend to 2025-26, but it predicted a deficit of 2.2 per cent of GDP in 2024-25.

Table 4.1: Performance against the Government's legislated targets

		Per cent of GDP		£ billion	
		Forecast	Margin	Forecast	Margin
Fiscal mandate: Cyclically adjusted public sector net borrowing in 2020-21					
March 2020 forecast	Not Met	2.4	-0.4	55.3	-9.2
November 2020 forecast	Not Met	18.6	-16.6	384.4	-343.0
March 2021 pre-measures forecast	Not Met	15.9	-13.9	332.6	-290.7
March 2021 forecast	Not Met	16.5	-14.5	345.4	-303.4
Supplementary target: Year-on-year change in public sector net debt in 2020-21					
March 2020 forecast	Met	-2.0	2.0		
November 2020 forecast	Not Met	19.7	-19.7		
March 2021 pre-measures forecast	Not Met	15.8	-15.8		
March 2021 forecast	Not Met	15.8	-15.8		
Welfare cap: Specified welfare spending in 2024-25					
March 2020 forecast	Met			133.5	4.1
November 2020 forecast	Not Met			125.2	-1.1
March 2021 forecast	Not Met			127.9	-3.1
Public sector net borrowing in 2025-26[1]					
November 2020 forecast	Not Met	3.9	-3.9	101.8	-101.8
March 2021 pre-measures forecast	Not Met	4.2	-4.2	110.1	-110.1
March 2021 forecast	Not Met	2.8	-2.8	73.7	-73.7

[1] The forecast horizon did not extend up to 2025-26 in March.

Table 4.2: Performance against the welfare cap

	£ billion, unless otherwise stated					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Welfare cap						**126.8**
Pathway	119.2	119.4	119.2	121.2	124.1	
Margin (per cent)	0.5	1.0	1.5	2.0	2.5	3.0
Margin	0.6	1.2	1.8	2.4	3.1	3.8
Welfare cap and pathway plus margin	**119.8**	**120.6**	**121.0**	**123.6**	**127.2**	**130.6**
Latest forecast and update on performance against cap and pathway						
March 2021 forecast	118.7	123.0	122.0	122.8	125.7	127.9
Inflation adjustment	0.0	0.0	1.1	1.4	1.7	1.9
Scottish welfare block grant adjustment	0.3	3.2	3.3	3.5	3.7	3.9
March 2021 forecast after adjustments	**118.9**	**126.2**	**126.4**	**127.7**	**131.2**	**133.7**
Difference from:						
Cap and pathway	-0.3	6.7	7.1	6.6	7.0	6.9
Cap and pathway plus margin	**-0.9**	**5.5**	**5.3**	**4.1**	**3.9**	**3.1**
Memo: cumulative percentage point change in preceding September (Q3) rates of inflation since our March forecast.	*0.0*	*0.0*	*-0.8*	*-1.1*	*-1.3*	*-1.5*

Note: The inflation adjustment is positive for future years as inflation is lower in forecast years than forecast in our March 2020 EFO. This takes the effect of the change in inflation out of the spending forecast.

The Government's approach to fiscal policy in Budget 2021

4.5 The Budget Responsibility and National Audit Act requires the Treasury to specify its fiscal objectives and the means by which they will be obtained – its "*fiscal mandate*" – in a *Charter for Budget Responsibility* approved by Parliament. The current legislated fiscal mandate expires at the end of this month, but the Government has not yet decided what will replace it and the other fiscal targets in the existing *Charter*. Given the currently exceptional levels of uncertainty, the Treasury is instead proceeding with the review of the fiscal framework proposed at the March 2020 Budget that was postponed due to the pandemic.

4.6 But the absence of formal fiscal targets does not mean that the Chancellor has not been guided by particular objectives when selecting his medium-term Budget policies. As the forecasts presented in Chapter 3 show, he has calibrated his Budget decisions to deliver a current budget that is very close to balance and underlying public sector net debt (i.e. excluding the uneven effects of the Bank of England) that is very close to stable in the medium term. In doing so he has returned to two key metrics that formed the basis for the two most durable sets of fiscal rules that have guided Chancellors over the past 24 years: Gordon Brown's 'golden rule' and 'sustainable investment rule' that were in place from 1997 to 2008; and George Osborne's 'fiscal mandate' and 'supplementary debt target' that were in place from 2010 to 2015.

4.7 Aiming to balance the current budget and to stabilise the underlying debt-to-GDP ratio in the medium term also accord with one of the three possible interpretations we looked at in November of the Chancellor's commitment to "*balance the books*" and "*[get] debt back under control*" that was made at the Conservative Party Conference last October.[2]

4.8 Relative to the fiscal targets that featured in the Conservative Party's manifesto and that guided Budget 2020, our latest forecast and the Chancellor's Budget decisions suggest that:

- A focus on the **current balance** is retained, but the goal of achieving that by the third year of the forecast period is not.
- The focus on **stabilising debt** has shifted from headline debt (including the uneven effects of the Bank of England) to underlying debt (excluding the Bank of England)

4.9 The Budget 2020 targets also included a threshold for **the ratio of debt interest to revenues** of 6 per cent, above which action would be taken to put the debt-to-GDP ratio on a downward path; and a ceiling on **public sector net investment** as a share of GDP of 3 per cent on average over the five-year forecast period.

4.10 Table 4.3 shows our latest and two preceding forecasts for these four fiscal metrics. We also identify the impact of the Budget measures on these metrics relative to our underlying 'pre-measures' forecast. It shows that:

[2] Chancellor of the Exchequer, *Keynote speech to the Conservative Party conference*, 5 October 2020.

- Our pre-pandemic forecast predicted a **current budget** surplus of 0.8 per cent of GDP (£21.2 billion) in 2024-25. In the absence of the measures announced in this Budget, the lasting consequences of the pandemic would have left a current budget deficit of 1.4 per cent of GDP (£37.1 billion) in 2025-26 (with the forecast horizon having moved on a year since our March 2020 forecast). But the medium-term tax rises and cuts in spending plans announced in this Budget reduce that current deficit by £36.2 billion in 2025-26, leaving a very small deficit of just £0.9 billion (0.03 per cent of GDP).

- The **underlying debt-to-GDP ratio (excluding the Bank of England)** rises sharply in 2020-21, then continues to rise until it peaks in 2023-24, after which it falls very slightly (by an average of 0.1 percentage points a year) in 2024-25 and 2025-26. This broadly flat position in the medium term is similar to that reached in our March 2020 forecast, albeit with underlying debt more than 20 per cent of GDP higher. This contrasts with our November forecast which showed underlying debt rising by 0.8 per cent of GDP in 2025-26 and our latest pre-measures forecast of a 1.2 per cent rise. Again, it is the medium-term tax rises and cuts in spending plans announced in the Budget that explain the difference and stabilise underlying debt as a share of GDP.

- The **debt interest to revenue ratio** is lower in every year of our latest forecast compared to our March 2020 forecast, despite debt being materially higher due to the pandemic. This is thanks to lower interest rates, especially at shorter maturities, and the doubling in quantitative easing by the Bank of England, which further reduces the net interest costs of the public sector as a whole. However, the higher stock of debt and shorter maturity of new debt issuance has also significantly increased the sensitivity of the public finances, and this ratio, to future changes in interest rates (see Box 4.1). Compared to November, the ratio is higher in all years of the forecast, primarily due to higher interest rates. The ratio remains at less than half the 6 per cent threshold on both a pre- and post-measures basis throughout the forecast period.

- **Public sector net investment** rises significantly from its pre-pandemic level of 1.9 per cent of GDP to an average of 2.8 per cent of GDP over the next five years (after having spiked even higher in 2020-21). This reflects the increases in capital spending announced in last year's Budget. The Chancellor did not change his medium-term capital spending plans in this Budget, so public sector net investment continues to average just less than 3 per cent of GDP over the next five years.

Table 4.3: Targeted fiscal aggregates

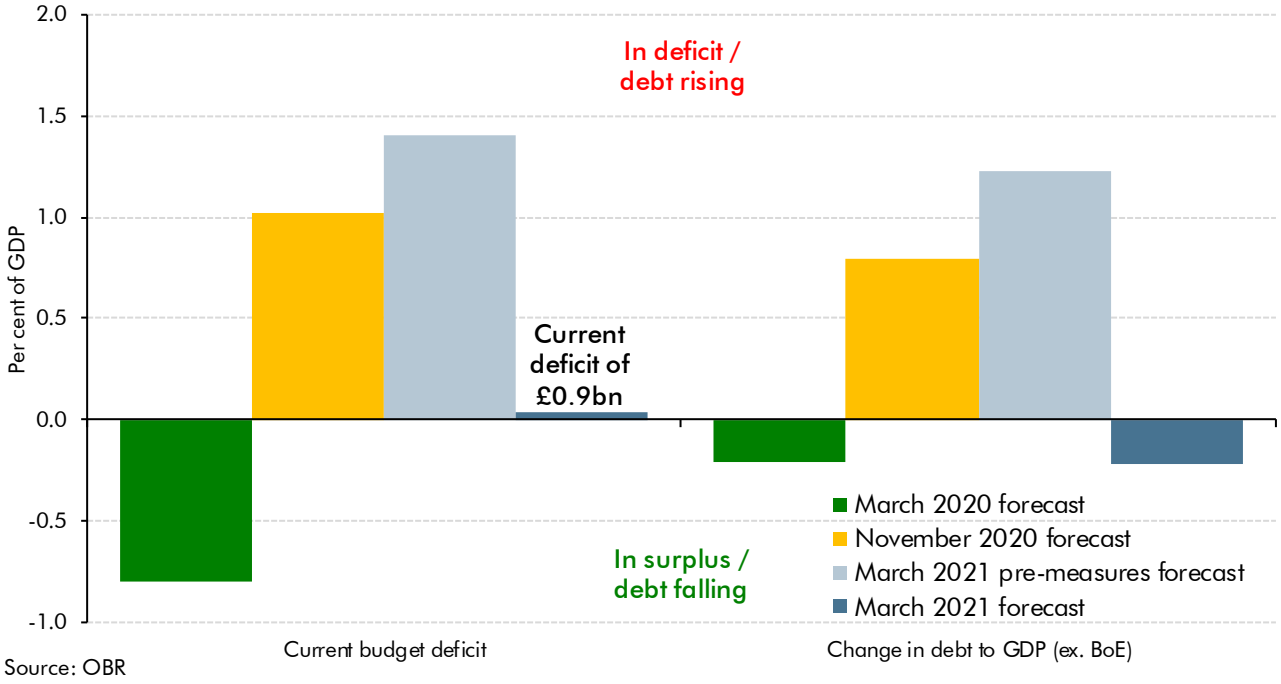
	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Current budget[1]							
March 2020 forecast	-0.1	-0.2	-0.1	-0.5	-0.7	-0.8	
November 2020 forecast	0.6	15.1	4.6	1.5	1.2	1.1	1.0
March 2021 pre-measures forecast	0.6	13.1	5.3	1.7	1.4	1.4	1.4
March 2021 forecast[2]	0.6	13.3	7.6	1.7	0.6	0.1	0.0
Year-on-year change in public sector net debt excluding Bank of England							
March 2020 forecast	-0.5	0.1	0.4	0.6	0.2	-0.2	
November 2020 forecast	5.1	14.8	1.8	1.2	1.2	0.6	0.8
March 2021 pre-measures forecast	4.2	12.7	2.9	2.2	1.7	1.2	1.2
March 2021 forecast	4.2	12.7	5.1	2.2	1.1	-0.0	-0.2
Debt interest to revenue ratio							
March 2020 forecast	3.8	3.3	3.5	3.3	3.1	2.9	
November 2020 forecast	3.5	2.7	1.7	2.0	2.3	2.2	2.2
March 2021 pre-measures forecast	3.5	2.6	2.4	2.2	2.4	2.5	2.6
March 2021 forecast	3.5	2.6	2.5	2.3	2.4	2.5	2.5
Public sector net investment							
March 2020 forecast	2.2	2.6	2.9	3.0	3.0	3.0	
November 2020 forecast	1.9	3.9	2.8	2.9	2.9	2.9	2.8
March 2021 pre-measures forecast	1.9	3.5	2.7	2.8	2.9	2.8	2.8
March 2021 forecast	1.9	3.6	2.7	2.8	2.9	2.8	2.7

[1] A negative value means the current budget is in surplus.

[2] The 2025-26 forecast is a deficit of £0.9 billion

4.11 The medium-term tax rises and cuts in spending plans announced in the Budget are sufficient to eliminate all but a tiny current budget deficit in 2025-26, while being just enough to see public sector net debt (excluding the Bank of England) fall by a tiny margin in that year (Chart 4.1). But margins of this size – both positive and negative – are not particularly meaningful at that horizon in the face of the very large range of risks around our forecast (or indeed any forecast).

Chart 4.1: Achieving current balance and stable underlying debt in 2025-26



Source: OBR

Box 4.1: Debt maturity, quantitative easing and interest rate sensitivity

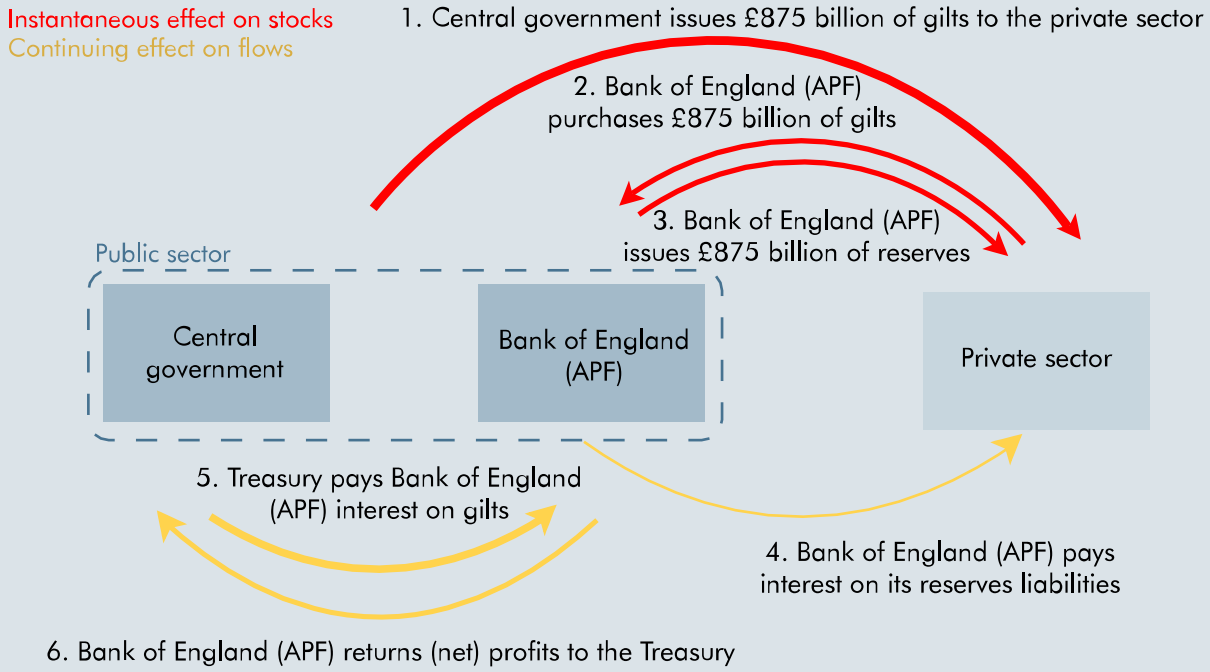
The average maturity of *UK government bonds* (known as gilts) is longer than the average maturity of government debt in most other advanced economies. But the average maturity of the *net debt of the public sector as a whole* (including the Bank of England) has shortened considerably since the global financial crisis. This is due to large-scale gilt purchases by the Bank of England, via its Asset Purchase Facility (APF), as part of its quantitative easing (QE) operations.

These gilt purchases have been financed through the creation of extra central bank reserves. These can be thought of as akin to a deposit account that private banks hold at the central bank, on which the Bank pays interest at its policy rate ('Bank Rate'). The gilts are therefore effectively replaced as a liability of the public sector (the outstanding interest on the debt is returned to the Treasury via the APF) by the reserves created to finance their purchase (Figure A).

By the end of 2021-22, 32 per cent of the public sector's gross debt (£875 billion out of £2.7 trillion) will be in the form of central bank reserves issued to finance gilt purchases. As these reserves currently pay an interest rate of 0.1 per cent – whereas the gilts they have in effect refinanced pay an average interest rate of 2.1 per cent – the net interest saving for the public sector as a whole is estimated at £17.8 billion in 2021-22.

However, because the gilts purchased by the Bank have an average maturity of 13 years, whereas the liabilities issued to finance them carry an overnight rate of interest, this net saving comes at the price of a significant reduction in the average maturity of the net debt of the public sector as a whole. This dramatically increases the sensitivity of debt interest spending to changes in short-term interest rates.

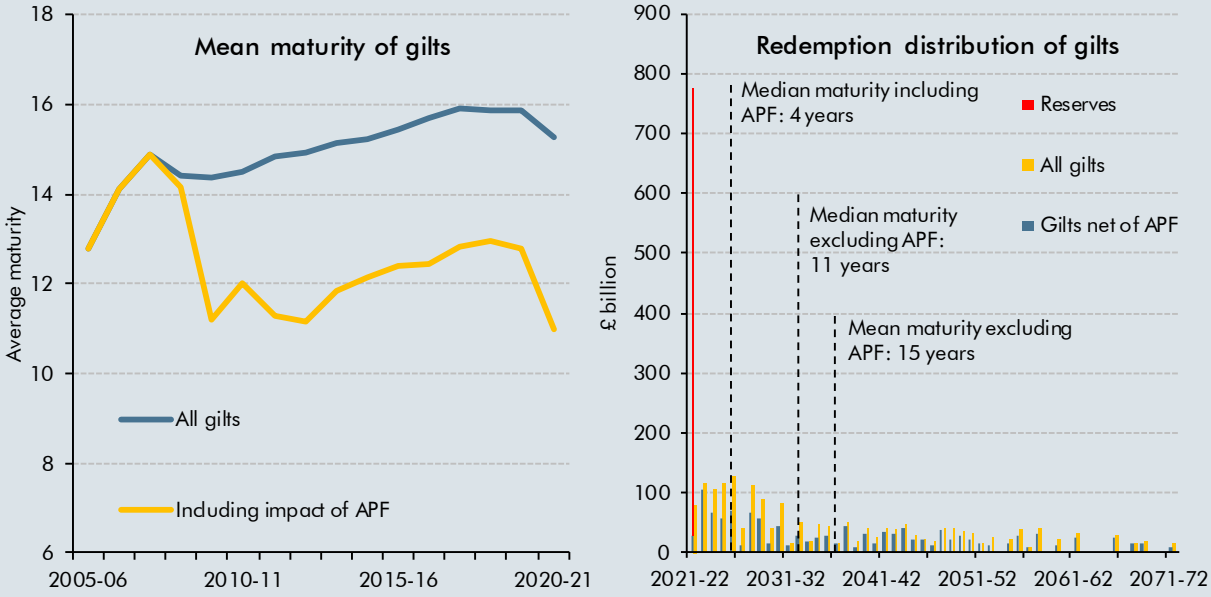
Figure A: Direct effects of the Asset Purchase Facility on the public finances



To illustrate this, the left-hand panel of Chart A shows that the mean maturity of the government's total gilt liabilities, including those held in the APF, was over 15 years at the end of 2020, very long by international standards. This means that changes in long-term interest rates affect debt interest payments relatively slowly (with around a third of the effect felt within five years). By contrast, the interest paid on the entire stock of central bank reserves responds immediately to changes in Bank Rate. The Bank has not yet completed all the purchases necessary to complete its latest round of QE, but the effect of the £750 billion worth of gilts by the end of 2020 has been to reduce the effective mean maturity of the gilt stock to 11 years. By the end of the current gilt purchase programme in 2021-22, it will have fallen further to around 10 years. This lower mean maturity results in greater interest rate sensitivity.

On the face of it, this looks very similar to what would have happened if there had been no gilt purchases by the Bank but the Government had issued an equivalent quantity of Treasury bills (which typically pay a rate of interest that is very close to Bank Rate) instead of the gilts that were acquired by the APF. And the response of debt interest spending to changes in interest rates would indeed be very similar. Such Treasury bills would need to be refinanced as they matured, however, leaving the Government exposed to financing risk. That is not an issue with financing through the issuance of central bank reserves, as reserves do not mature as bills do and can only be redeemed into cash. So while the effect on interest rate sensitivity is similar to what would have happened if the Government had financed its borrowing by issuing £875 billion of 3-month Treasury bills, the effect on financing risk is the equivalent to having done so by issuing that amount of perpetual floating-rate bonds.

Chart A: Mean maturity and redemption distribution of gilts



Note: 2020-21 figure includes data up to 31 December 2021. Note: data as of 15 February 2021.
Source: Bank of England, DMO, OBR

But when assessing medium-term fiscal risks, the median maturity – representing the point at which half of the stock will have responded to interest rate changes – is probably a more useful summary statistic than the mean; the latter will be heavily influenced by the presence of very long maturity debt whereas the redemption profile of gilts is very front-loaded. The right-hand panel of Chart A shows the impact of QE on the median maturity of public sector debt. With large redemptions in the near term and a tail of smaller very long-dated gilts, this results in a median maturity that is considerably lower than the mean – 11 years versus 15 when ignoring the APF, but a more dramatic shortening to 4 years rather than 11 when the effects of the APF are factored in.

This median maturity will continue to decline over 2021 as the Bank continues to buy gilts. In addition, the other main sources of government financing (Treasury bills and NS&I savings products) are either variable rate or short-dated, which further increases interest rate sensitivity relative to that implied by gilt liabilities alone. Including these liabilities as well reduces the median maturity to less than one year by March 2022.

Overall, this means that 59 per cent of the government's debt liabilities will respond to interest rate changes over the forecast period. The equivalent figure would have been 44 per cent prior to the commencement of the QE programme in 2009 when debt levels were also much lower.

To illustrate the potential fiscal impact of an increase in interest rates, if short- and long-term interest rates were both 1 percentage point higher than the rates used in our forecast – a level that would still be very low by historical standards – it would increase debt interest spending by £20.8 billion (0.8 per cent of GDP) in 2025-26. To put this into context, it is roughly equivalent to two-thirds of the medium-term fiscal tightening announced by the Chancellor in this Budget.

In isolation, such a rise in interest rates would therefore make the task of keeping debt on a sustainable path more difficult. But debt sustainability is also affected by the level of debt, the

rate of growth in GDP and the primary balance, so any assessment of the broader fiscal risks posed by greater interest rate sensitivity also needs to take on board the reason for the increase in interest rates:

- **In a benign scenario** where the increase in interest rates reflects higher economic growth, the debt stock could ultimately be lower and the primary balance more favourable, all resulting in a virtuous fiscal circle.
- **But malign scenarios are possible too**. If interest rates rise because investors demand a higher risk premium for some reason, this would be more likely to be accompanied by a deteriorating economic and fiscal position, resulting in a vicious fiscal circle. In such circumstances, governments can find it difficult to make the spending cuts and tax rises necessary to restore the debt trajectory to a sustainable path.

Recognising uncertainty

4.12 The OBR is required to assess whether the Government has a better than evens chance of meeting its fiscal objectives. As we discussed in our November *EFO*, the exceptional economic and fiscal shock of the pandemic renders our forecast very uncertain. This means that assessing the chances of meeting the Government's fiscal targets is a much more demanding task than usual. The pandemic has few historical parallels and it is all but impossible to attach probabilities to the different possible paths for the virus and the associated economic consequences. We therefore use this section to discuss how to view uncertainty around our forecast.

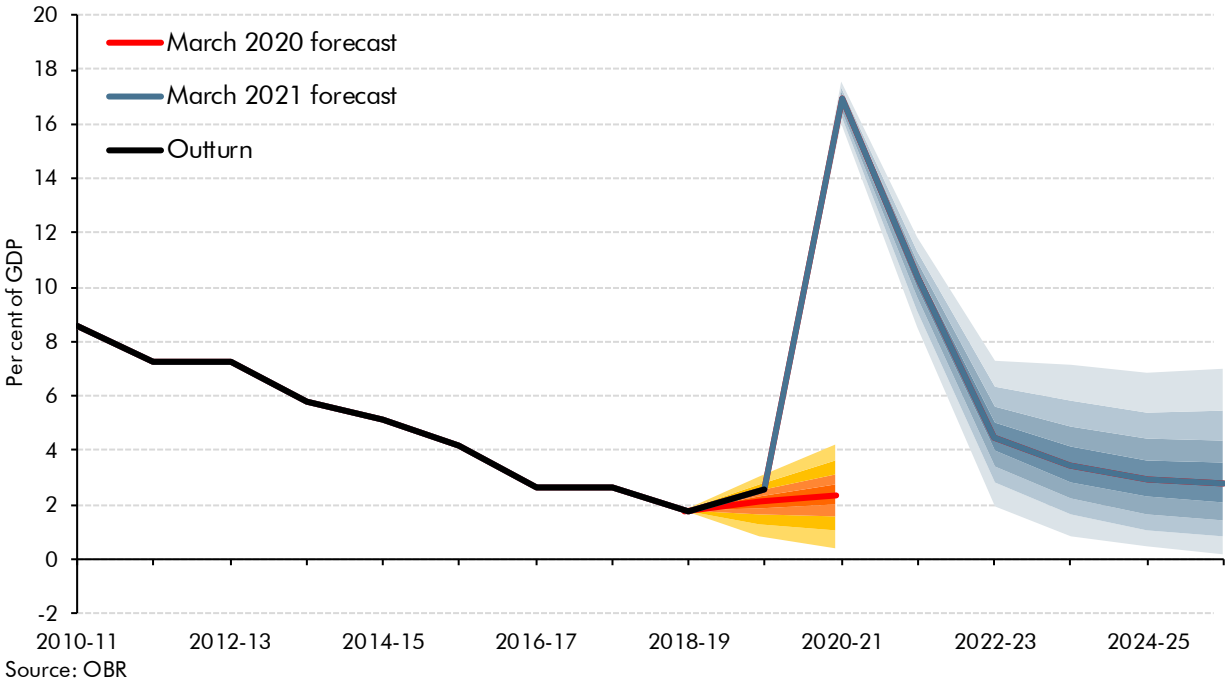
Past performance

4.13 Our pre-virus approach was to present uncertainty around our central forecast with reference to past differences between official public finance forecasts and outturns. We illustrated this using a fan chart showing the probability distribution around our central forecast for public sector net borrowing. Chart 4.2 shows our March 2020 forecast fan chart for PSNB relative to our latest projection. Our current forecast for PSNB in 2020-21 lies far outside the March 2020 fan chart. This is no doubt reasonable given the rarity of severe global pandemics relative to the more typical, more modest, shocks to the economy and public finances that might be expected over any five-year forecast horizon.

4.14 But there are problems with using historical forecast errors to portray the degree of uncertainty surrounding our central forecast. This is because we are drawing forecast errors from only a 31-year history of relative economic and fiscal stability and during which nothing comparable to the pandemic occurred. The blue fan chart around our latest central forecast (Chart 4.2) is generated using the same historical forecast errors, which means it assumes that the uncertainty around PSNB over the next five years is no greater than uncertainty over a typical five-year horizon. In particular, it suggests that the uncertainty around borrowing over the next year or two is equivalent to the average uncertainty of the three decades that preceded the pandemic, which clearly understates reality.

4.15 The extent to which near-term uncertainty is understated by the historically calibrated fan charts is illustrated by the revisions to our forecasts since November. Borrowing in 2020-21 has been revised down by 2.1 per cent of GDP, while borrowing in 2021-22 has been revised up 2.9 per cent of GDP. Both changes would be deemed to be rare events when compared to the distribution of historical forecast errors embodied in the fan chart. But in the context of the fiscal shocks wrought by the pandemic, these revisions are relatively small and surprises of a similar scale are quite likely to feature in subsequent forecasts. In practice, we might consider them a better guide to the normal scale of forecast errors as long as the pandemic continues to be the key driver of economic and fiscal prospects.

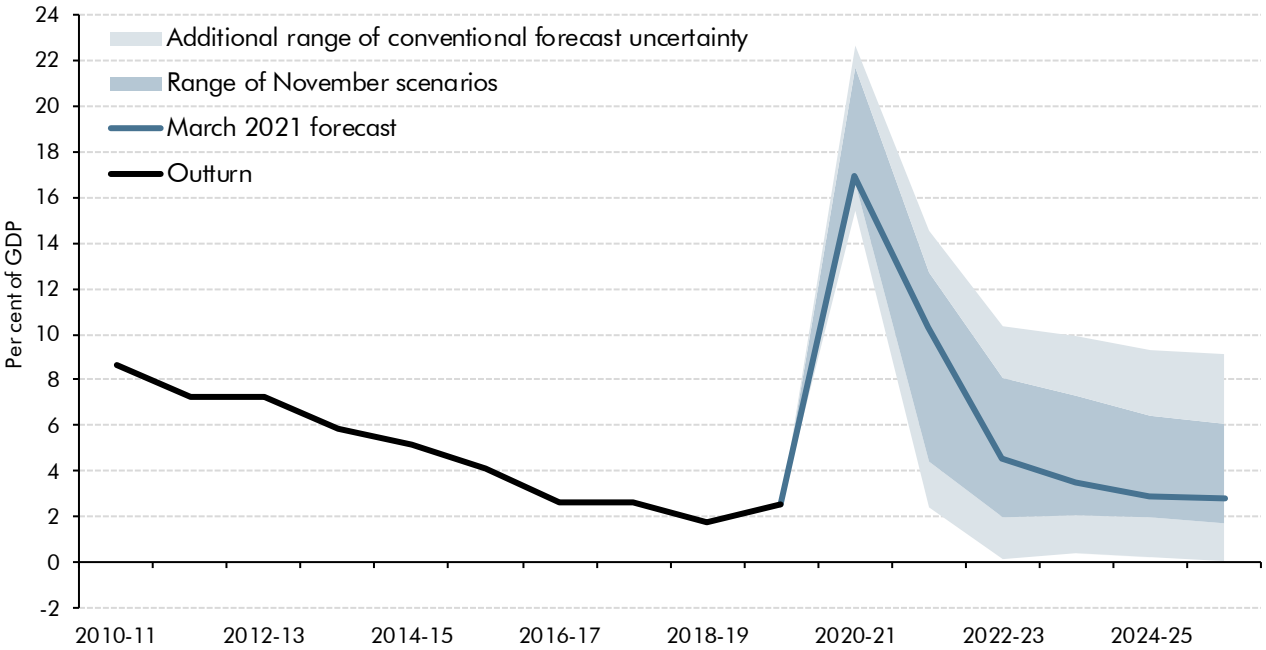
Chart 4.2: Fan chart around our PSNB central forecast



Source: OBR

4.16 While the distribution of forecast errors underpinning our fan charts is of limited use as a guide to the uncertainty posed by pandemic-related risks, it remains a useful guide to other sources of uncertainty that have been supplemented rather than replaced. One way of illustrating the combined effect of pandemic and conventional sources of uncertainty is to combine our standard fan charts with our scenarios used to illustrate the uncertainty associated with the pandemic. That has the effect of further extending the range of possible outcomes. This is shown in Chart 4.3, which adds conventional forecast uncertainty, as illustrated in our fan charts, onto the range of outcomes generated by our pandemic scenarios. This shows a very large range of outcomes are possible at our forecast horizon.

Chart 4.3: Illustrative virus and conventional uncertainty around PSNB



Source: OBR

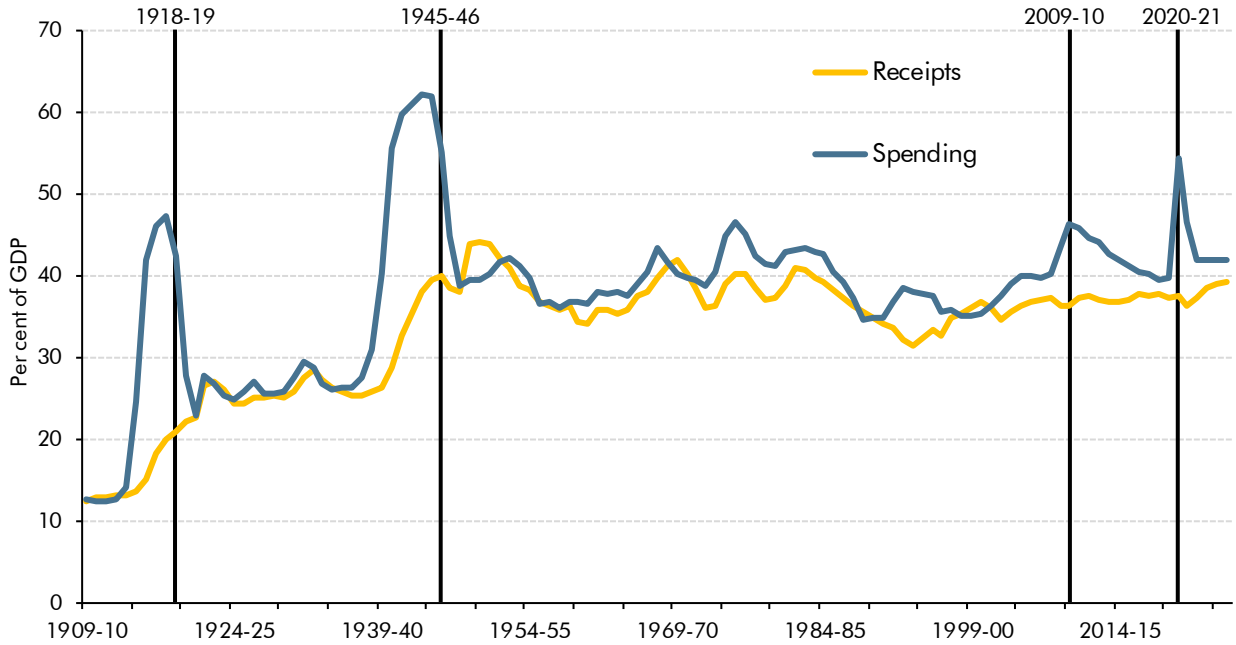
4.17 Our latest forecast for PSNB shows it moving towards the downside scenario in 2021-22 as the impact of the pandemic lasts for longer than we had assumed in November. However, it also moves towards the upside scenario later in the forecast period as the Government's consolidation measures narrow the deficit compared to our November forecast. But these outcomes are still very uncertain. As shown in Chart 4.3, borrowing is only likely to fall on a sustained basis once the acute stage of the pandemic ends and the economy reopens. This path for borrowing also assumes that the pandemic leaves no material legacy for public spending, unlike previous crises of this size (see Box 3.3).

4.18 One can place these risks in context by comparing the current path of borrowing with the scale and pace of the recovery in public finances after previous major economic and fiscal shocks. Chart 4.4 shows that the sharp increase in the spending-to-GDP ratio during the pandemic is about half that which accompanied the outbreak of the two world wars but twice that seen during the financial crisis. The fall in spending envisaged in the wake of the pandemic is of a pace similar to that seen following the two world wars but much faster than experienced after the financial crisis.

4.19 Some similarities in the nature of the economic shock caused by wars and the pandemic can help explain why such a steep post-crisis fall in spending and borrowing might be plausible. Both are exogenous shocks that artificially supressed private sector output and demand – either to divert resources toward the war effort or prevent the spread of the virus. Both involved large numbers of people being taken onto the public payroll and extensive state support being provided to industry. Both should unwind relatively quickly – either when an armistice was signed or when the bulk of the adult population is vaccinated. This should permit the rapid removal of artificial restrictions on private economic activity and bring about a rapid recovery in private consumption, employment, and investment. This, in turn,

should enable the rapid withdrawal of temporary support to firms and households, and so a decline in government spending as a share of the economy.

Chart 4.4: Receipts and spending as a percentage of GDP

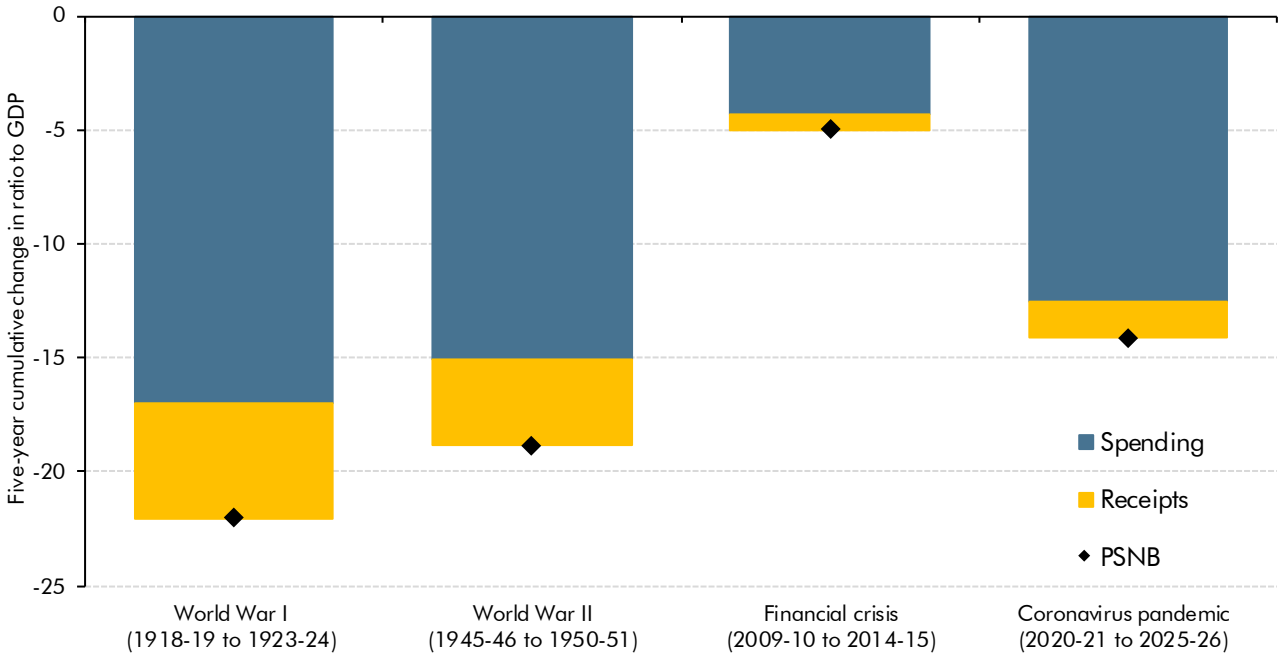


Source: Bank of England, OBR

4.20 However, while public spending fell by around 20 per cent of GDP at the conclusion of both world wars, in both cases it settled over 10 per cent of GDP higher than its pre-war level in the aftermath of the conflict, albeit to fund major and permanent expansions in the welfare state. Only after the financial crisis did spending fall back to its pre-crisis share of GDP and then only after a decade. Furthermore, in the aftermath of the two wars, the tax burden increased in the order of 5 per cent of GDP, and settled over 10 per cent of GDP higher than its pre-war level, helping to restore fiscal sustainability.

4.21 The Government's post-pandemic spending plans envisage only a 2 per cent increase in spending as a share of the economy after five years and a similar increase in revenues. Crucially, as discussed in Box 3.3, this rise in spending was already planned pre-pandemic and makes only minimal provision for the potential legacy costs of the pandemic for the health service, education, local authorities, and transport. Indeed, this Budget cut a further £3 billion a year on average off departmental budgets from 2022-23 onwards on top of the £12 billion-a-year cut made in the November Spending Review. The Government's ability to absorb these potential legacy costs within this lower spending envelope constitutes a significant source of uncertainty around the achievement of its latest fiscal objectives.

Chart 4.5: Sources of post-crisis falls in Public Sector Net Borrowing



Source: Bank of England, OBR

A Policy measures

Overview

A.1 Our *Economic and fiscal outlook* (*EFO*) forecasts incorporate the expected impact of the policy decisions announced in each Budget or other fiscal statement. In the run-up to each one, the Government provides us with draft estimates of the cost or gain from each policy measure it is considering. We discuss these with the relevant experts and then suggest amendments as necessary. This is an iterative process where individual measures can go through several stages of scrutiny. After this process is complete, the Government chooses which measures to announce and which costings to include in its main policy decisions scorecard. For these scorecard costings we choose whether to certify them as 'reasonable and central', and whether to include them – or alternative costings of our own – in our forecast. We also include the effects of policy decisions that do not appear on the scorecard. In this *EFO* we have certified all tax and AME measures as reasonable and central.

A.2 Once again, we are grateful to officials across departments for ensuring the process worked as smoothly as it did under difficult circumstances, and for providing the information that we required to complete the scrutiny process. We were first notified of one measure five days after the deadline for new measures agreed with the Treasury. On some previous occasions, late notification has meant we have needed to use uncertified costings that we return to at the next forecast. But on this occasion we were content to certify the costing on the basis that it was a straightforward change to one that had been previously certified. Again, all our questions about it were answered fully and promptly to allow that to happen.

A.3 Table A.1 summarises the direct and indirect effects of the Government's policy decisions. Table A.2 reproduces the Treasury scorecard alongside our subjective assessment of the uncertainty around each costing. Table A.3 provides the costings and uncertainty assessments of non-scorecard measures.

Government policy decisions

A.4 The three main policy elements to this Budget are the large sums of additional virus-related support in the near term, measures designed to stimulate economic recovery over the next two years, followed by significant tax rises in the medium term. Taking each of these in turn:

- The Government has increased its **virus-related support** to households and businesses by extending most of its main support schemes to cover the second wave of the pandemic. This Budget confirms an extra £3.3 billion of support in 2020-21, and announces a further £43.2 billion in 2021-22. The six-month extension to the

Coronavirus Job Retention Scheme (CJRS) and two further rounds of grants under the Self-Employed Income Support Scheme (SEISS) account for around 80 per cent of the £26 billion of support to households, while the close to £20 billion of additional support to businesses comes largely from extensions to the business rates holiday, business grants and the temporary reduced rate of VAT for the hospitality and accommodation sectors. This takes the total cumulative cost of the Covid rescue package since the start of the pandemic to £344 billion (see Box 3.1).

- The most significant contributor to the **economic recovery measures** is the time-limited 130 per cent capital allowances super deduction that will be in place in 2021-22 and 2022-23. This is expected to cost £27 billion in total between 2021-22 to 2023-24, with the direct cost sensitive to how successful it is in incentivising firms to invest more while it is in place. But since it largely brings forward planned investment from future years, it boosts receipts by the end of the forecast as investment then is lower than it would have been in the absence of the measure. There are more modest costs from the decision to extend from one to three the number of years that firms can carry back losses to offset against corporation tax, and the customary freezing of duty rates for fuel and alcohol. The launch of the 'Recovery Loan Scheme' to succeed the existing virus-related loan schemes also adds to recorded spending this year.

- The **medium-term fiscal tightening** rises to £32 billion in the final year of the forecast (including the final-year effects of some of the rescue and recovery measures). Around half of that (£17.2 billion) is due to the 6 percentage point increase in the main rate of corporation tax from April 2023 (tempered by the reintroduction of the small profits rate). Around a quarter (£8.2 billion) is due to the freezing of the income tax personal allowance and the higher rate threshold in cash terms from April 2022 to the end of the forecast period. A seventh of the final year consolidation (£4.2 billion) is due to further planned cuts to pre-virus departmental spending totals.

Table A.1: Summary of the total effect of Government decisions since November

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total effect of Government decisions	**-8.5**	**-53.5**	**0.0**	**19.1**	**31.5**	**36.4**
of which:						
Direct effect of scorecard policies	-6.0	-58.9	-7.8	13.1	25.0	29.7
Direct effect of non-scorecard policies	-3.0	0.0	2.3	2.0	2.4	2.6
Indirect effect of Government decisions	0.5	5.4	5.5	4.0	4.0	4.1
of which:						
Virus-related support measures	**-3.3**	**-43.2**	**1.3**	**-0.1**	**0.3**	**0.6**
of which:						
Support for households	-0.5	-27.2	1.1	-0.1	0.3	0.6
Support for business	-2.8	-16.0	0.1	0.0	0.0	0.0
Other measures	0.0	0.0	0.0	0.0	0.0	0.0
Economic recovery measures	**-5.6**	**-15.7**	**-15.3**	**-5.1**	**-0.5**	**0.0**
of which:						
Capital allowances super deduction	-1.7	-12.3	-12.7	-2.4	2.1	2.8
Losses carry back	-0.8	-0.2	0.6	0.3	0.2	0.1
Duty freezes	0.0	-1.3	-1.3	-1.3	-1.3	-1.3
Other measures	-3.0	-2.0	-1.9	-1.7	-1.5	-1.6
Fiscal consolidation measures	**-0.1**	**0.0**	**8.5**	**20.3**	**27.7**	**31.8**
of which:						
Corporation tax rate increase	0.0	0.0	2.4	11.9	16.3	17.2
Income tax threshold freezes	0.0	0.0	1.6	3.7	5.8	8.2
RDEL cuts	0.0	0.0	4.0	3.5	3.9	4.2
Other measures	-0.1	0.0	0.5	1.2	1.8	2.3
of which:						
Receipts	-3.5	-25.1	-9.0	11.9	23.4	27.9
Resource DEL	-0.2	-8.5	3.1	2.7	3.2	3.5
Capital DEL	0.1	0.2	0.0	0.0	0.0	0.0
AME spending	-5.5	-25.5	0.4	0.6	0.8	0.9

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).

A.5 Table A.2 reproduces the Treasury's scorecard alongside our subjective assessment of the uncertainty around each costing.[1]

[1] We present a more detailed tax and spending breakdown of each costing in a supplementary table that is available on our website.

Table A.2: Treasury scorecard of policy decisions and OBR assessment of the uncertainty of costings

		Head[2]	£ million[1]						Uncertainty
			2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	
Protecting the jobs and livelihoods of the British									
1	Coronavirus Job Retention Scheme (CJRS): extension to September 2021	Spend	0	-6,945	0	0	0	0	Medium-High
2	Self-employment income support scheme (SEISS): two further grants[3]	Spend	-55	-12,760	+1,650	0	0	0	Medium-High
3	Restart Grants and Additional Restrictions Grants	Spend	0	-5,005	0	0	0	0	N/A
4	Business Rates: three months 100% holiday, nine months 66% relief with cap[4]	Tax	+135	-6,835	+135	-35	0	0	Medium-Low
5	VAT: extension to reduced rate for hospitality, accommodation and attractions (5% to 30 September 2021 then 12.5% to 31 March 2022)	Tax	0	-4,720	0	0	0	0	Medium-High
6	VAT: extend the window for starting deferred payments through the VAT New Payment Scheme by up to three months	Tax	-80	0	0	0	0	0	Medium-High
7	Stamp Duty Land Tax: maintain nil-rate band at £500k until 30 June 2021, £250k until 30 September 2021	Tax	-255	-1,350	*	*	-5	0	High
8	Fuel Duty: one year freeze in 2021-22	Tax	0	-795	-885	-910	-925	-945	Low
9	Alcohol Duty: one year freeze in 2021-22	Tax	-45	-315	-320	-325	-340	-350	Medium-Low
10	Traineeships: extension for 16-24 year olds in England	Spend	0	-100	-50	0	0	0	N/A
11	Universal Credit: maintain £20 increase to standard allowance for six months	Spend	0	-2,240	0	0	0	0	Medium
12	£500 payment to eligible Working Tax Credit recipients[5]	Spend	0	-765	-20	0	0	0	N/A
13	Universal Credit: three month delay to Minimum Income Floor reintroduction	Spend	0	-25	-60	-5	0	0	Medium-Low
14	Universal Credit: maintain surplus earnings de minimis at £2,500 in 2021-22	Spend	0	-110	0	0	0	0	Medium-High
15	Shared Accommodation Rate (SAR): accelerate introduction of exemptions	Spend	0	-10	-10	-5	0	0	Medium-High
16	Statutory Sick Pay Rebate Scheme: extension	Spend	0	-35	0	0	0	0	Low
17	COVID-19: HMRC exemptions	Tax	0	-105	-5	*	*	*	High
Investment-led recovery									
18	Capital allowances: 130% Super Deduction for main rate assets and 50% First Year Allowance for special rate assets for two years	Tax	-1,735	-12,255	-12,695	-2,395	+2,090	+2,780	Very High
19	Loss carry back: extended to 3 years with £2,000,000 cap	Tax	-840	-205	+580	+325	+160	+80	Very High
20	Help to Grow: management	Spend	0	-60	-75	-85	0	0	N/A
21	Help to Grow: digital	Spend	0	-50	-115	-130	0	0	N/A

Strengthening the public finances									
22	Corporation Tax: 19% rate for profits up to £50,000, tapering to main rate of 25% for profits over £250,000, from April 2023	Tax	-5	+20	+2,390	+11,900	+16,250	+17,200	Medium
23	Income Tax: maintain personal allowance and higher rate threshold at 2021-22 levels up to and including 2025-26[6]	Tax	0	*	+1,555	+3,655	+5,790	+8,180	Medium
24	VAT: maintain registration threshold at £85,000 up to and including 2023-24	Tax	0	0	+55	+125	+135	+165	Medium-High
25	Inheritance Tax: maintain thresholds at 2020-21 levels up to and including 2025-26	Tax	0	+15	+70	+165	+290	+445	Medium
26	Pensions Lifetime Allowance: maintain at £1,073,100 up to and including 2025-26	Tax	-10	+80	+150	+215	+255	+300	High
27	Capital Gains Tax: maintain the Annual Exempt Amount at £12,300 up to and including 2025-26	Tax	0	*	+5	+10	+20	+30	Medium-High
Fair and sustainable tax system									
28	Corporation Tax: exemption for the Northern Ireland Housing Executive	Tax	0	-20	-10	-10	-10	-10	Low
29	EU Interest and Royalties Directive: repeal	Tax	0	+10	+10	+10	+5	0	Medium-High
30	Red Diesel: exemptions	Tax	0	0	-80	-85	-100	-110	Very High
31	Vehicle Excise Duty: freeze for HGVs in 2021-22	Tax	0	-5	-5	-5	-5	-5	Low
32	HGV Road User Levy: suspend for a further 12 months from August 2021 and freeze rates	Tax	0	-140	-75	-5	-5	-5	Low
33	Carbon Price Support (CPS) rate: maintain in 2022-23	Tax	0	0	-5	-10	-10	-5	Medium-Low
34	Aggregates Levy: one year freeze in 2021-22	Tax	0	-10	-15	-15	-15	-15	Low
35	Interest harmonisation and tax penalty reform	Tax	0	0	+5	+90	+155	+155	High
36	VAT: powers to tackle Electronic Sales Suppression (ESS)	Tax	*	+5	+20	+20	+20	+20	Very High
37	OECD Mandatory Disclosure Rules	Tax	0	0	*	+5	+5	+5	Very High
38	HMRC: investment in compliance[7]	Tax	-55	-500	-460	+110	+750	+1,310	High
39	HMRC: investment in digital infrastructure	Spend	0	-30	-25	-15	-5	*	N/A
40	DWP: investment in compliance	Spend	0	-10	+190	+235	+250	+250	High
Financial Transactions									
41	Public sector net borrowing impact of changes to financial transactions and guarantees	Spend	-2,690	-945	+280	+365	+410	+435	High

Previously announced policy decisions									
42	CJRS: extension to April 2021	Spend	0	-2,665	0	0	0	0	Medium-High
43	Research and Development PAYE Cap: updated design	Spend	0	*	-20	-80	-105	-115	Medium-High
44	Business rates: changes to tax deductibility of business rate repayments	Tax	-160	-30	0	0	0	0	Medium-Low
45	UK Emissions Trading Scheme	Tax	0	+15	+50	+35	+15	0	Very High
46	VAT: Tour Operators Margin Scheme	Tax	-5	-30	-45	-70	-100	-105	Medium
47	VAT: reversal of the removal of Second Hand Margin Scheme for cars	Tax	*	-5	-5	-5	-5	-5	Medium-Low
48	VAT: repeal the VAT Treatment of Transactions Order 1992	Tax	0	+5	+15	+15	+15	+15	Low
49	Self-assessment: penalty easement	Tax	-105	+100	*	*	*	0	Medium
50	COVID-19: easement for employer-provided cycles exemption	Tax	-5	*	0	0	0	0	Medium
51	HMRC: additional resource for debt pursuit, delay from September 2020 to April 2021	Tax	-55	*	0	0	0	0	Medium-High
52	UK-EU Future Relationship Agreement on Social Security Coordination: benefit rules	Spend	*	*	+5	+5	+5	+5	Medium-High
53	Local government: exceptional financial support for Local Authorities through a capitalisation direction	Spend	-60	-55	+30	+30	+30	+30	Low
	Total policy decisions [8]		**-6,010**	**-58,865**	**-7,785**	**+13,105**	**+25,025**	**+29,735**	
	Total spending policy decisions [8]		-2,765	-34,770	+215	+345	+720	+875	
	Total tax policy decisions [8]		-3,245	-24,095	-8,005	+12,760	+24,305	+28,860	
	Memo: Resource DEL: maintain real terms growth assumption for future years, reflecting latest OBR deflators (2.1% real)		0	0	+3,975	+3,520	+3,875	+4,160	

*Negligible.

[1] Costings reflect the OBR's latest economic and fiscal determinants.

[2] Many measures have both tax and spend impacts. Measures are identified as tax or spend on the basis of their largest impact.

[3] Self-Employment Income Support Scheme grants are taxable income and also subject to National Insurance contributions.

[4] Business rates are deductible for corporation tax and income tax self-assessment. Increased business rates relief reduces the amount of business rates paid and so increases these other tax receipts.

[5] Includes measure to exempt payment from income tax.

[6] Including the National Insurance Upper Earnings Limit and Upper Profits Limit, which will remain aligned to the higher rate threshold at £50,270 for these years.

[7] Includes funding for HMRC, impacts on compliance yield reflecting reprioritisation (including to respond to COVID-19), and additional compliance yield from higher staffing levels and new programmes.

Policy decisions not on the Treasury scorecard

A.6 Our forecasts include the effect of several policy decisions that the Treasury has chosen not to present on its scorecard:

- **RDEL spending beyond the Spending Review period**: Spending Review 2020 set plans for 2021-22 only, with the Government setting totals for future years but not allocating them fully to departments. In the Budget it has reduced those totals from 2022-23 onwards, by amounts that rise from £4 billion in 2022-23 to £4.2 billion in 2025-26, including the effect of smaller assumed underspending against the lower totals.

- **Other departmental spending changes**: these mostly relate to the reprofiling of spending between 2020-21 and 2021-22 and include a neutral reallocation of £0.9 billion from RDEL to CDEL.

- **Rollover free-trade agreements:** the Government has now concluded 64 agreements with third countries that have free-trade deals with the EU that the UK is therefore no longer a party to. The UK Global Tariff came into effect from 11pm on 31 December 2020 and we included its impact for the first time in our November forecast, but only allowing for those rollover deals that had been agreed by that time. This costing relates to the additional deals agreed since then. Just under a half of the £1 billion a year cost relates to imports from Turkey, around a quarter to imports from Bangladesh, and around a sixth to the combined imports from Japan and Cambodia.

- **State pension underpayment correction:** an administration error identified in March 2020 suggested that a small number of people had been underpaid in the 'category BL' element of the state pension. The underpayment affected married women whose husbands reached pensionable age before 2008 and who were unknowingly entitled to 'enhanced pension' that would have boosted their payments by up to 60 per cent. DWP investigations between May and December 2020 uncovered a systematic underpayment of state pensions, meaning tens of thousands of married, divorced and widowed people may have been underpaid since 2008. A repayment programme began on 11 January 2021, with the associated costs set out in Table A.3, some of which are expected to fall outside the forecast period. This costing is subject to a high degree of uncertainty as the true extent of the underpayment is not yet established.

- **Natwest Group (NWG) share sale:** the Government has delayed completion of the disposal of its remaining holdings of former RBS shares by a year. Based on the share price as of 29 January, this reduces PSND in 2025-26 by £2.6 billion, but with fewer shares being sold in earlier years than was assumed in our November forecast, increases it by £0.2 billion a year prior to that. Table A.3 shows the relatively modest impact of this on our receipts forecast via the dividends received on the shares.

- **Universal credit (UC) managed migration:** the Government has again paused the pilot phase of the UC managed migration scheme, this time until April 2022. The surge of new UC claims during the early stages of the pandemic led to a pause in managed migrations as operational capacity became stretched. It also increased the number of 'natural migrations' from legacy benefits, reducing anticipated managed migration volumes by 50,000. There remain around 3 million cases on the legacy benefits that will transfer to UC, with 1.6 million of those expected to go through managed migration. The full rollout is still assumed to finish in September 2026.

- **Personal independent payment (PIP) legal case**: DWP will implement an Upper Tribunal ruling that deaf or severely hearing-impaired claimants are at risk of not hearing fire alarms if required to remove hearing aids when washing.[2] Claimants' PIP

[2] KT and SH v Secretary of State for Work and Pensions.

assessments and payments will now reflect a higher score for 'ability to wash independently'. The ruling means that some existing claimants will be eligible for a higher rate of PIP, while others will become eligible where they previously were not.

- **PIP telephone assessments**: at the onset of the pandemic DWP introduced a range of 'easements' and moves away from face-to-face appointments. This costing reflects that one of these, relating to PIP assessments carried out by telephone, will continue beyond the point at which our November forecast assumed it would have ended.[3]

Table A.3: Costings for policy decisions not on the Treasury scorecard and OBR assessment of the uncertainty of costings

		£ million						Uncertainty
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	
Spending assumption	Spend	0	0	3,975	3,520	3,875	4,160	N/A
Other DEL spending changes	Spend	-2,640	1,605	-160	-140	-170	-185	N/A
Rollover free trade deals	Tax	-225	-970	-1,020	-1,025	-1,030	-1,045	Medium
State pension underpayment	Spend	-120	-670	-625	-635	-535	-390	High
Natwest group share sale	Tax	0	-5	45	120	150	85	Medium
UC managed migration	Spend	5	25	80	180	150	30	Medium
PIP legal case	Spend	0	-5	-15	-10	-10	-15	Medium-low
PIP telephony assessments	Spend	20	30	-5	-15	0	0	Medium
Direct effect of Government		**-2,965**	**10**	**2,275**	**2,000**	**2,430**	**2,635**	

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).

Scottish and Welsh Government policy decisions

A.7 Our UK public finances forecasts are also affected by decisions taken by the devolved administrations. These can affect UK-wide taxes, such as income tax and NICs, or those that have been fully devolved, such as the Scottish land and buildings transactions tax (LBTT). Since November both the Scottish and Welsh Governments have announced measures that have been reflected in this forecast:[4]

- **Scottish non-domestic rates:** the Scottish Government has made several changes to business rates policy. First, the **100 per cent relief for the retail, hospitality, leisure and aviation sectors will be extended** by twelve months, to 31 March 2022. We expect this to cost around £0.7 billion in 2021-22. Second, the **poundage for 2021-22 will be set at 49p**, which cuts the basic rate of tax applied to a property's rateable value by 0.8p compared to 2020-21. Rates are assumed to rise in line with CPI inflation thereafter. Third, it is **changing the eligibility criteria for the Business Growth Accelerator relief**. This expands eligibility for the relief to include properties where there has been a change of use, effective from 1 April 2021. These measures have implications for local authority spending, which we have assumed will move one-for-one with the changes in local authority income they generate.

[3] Telephone assessment easements for the work capability assessment are continuing in line with the PIP ones.
[4] For more information see our *Devolved taxes and spending forecasts*, published alongside this *EFO* and available on our website. The effects detailed here need to be considered alongside the fiscal consequences set out in the Treasury's fiscal framework agreements with the Scottish and Welsh Governments respectively, which set out the methodology by which block grant adjustments are made.

- **Land transaction tax:** the Welsh Government announced two new policies in its draft Budget, both effective from 22 December. First, it **raised the higher rates on additional property purchases** by one percentage point, to 4 per cent. This is expected to raise around £15 million a year from 2021-22 onwards. Second, it **raised the tax-free threshold for commercial transactions** from £150,000 to £225,000, as well as the tax-free threshold for transactions that have a lease rent net present value liable for tax.

- **Welsh non-domestic rates: freezing the multiplier in 2021-22:** this measure freezes business rates in 2021-22, rather than them uprating in line with CPI inflation.

Table A.4: Costings for devolved administration policy decisions

	Head	£ million					
		2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Scottish Government policy decisions							
Non-domestic rates: setting the 2021-22 poundage at 49p	Receipts	0	-65	-65	-75	-80	-80
Non-domestic rates: extension of relief for retail, hospitality, leisure and aviation	Receipts	0	-740	0	0	0	0
Non-domestic rates: changing the eligibility criteria for BGAc relief	Receipts	0	neg	-5	-5	-5	-5
Direct effect of Scottish Government decisions		**0**	**-805**	**-65**	**-80**	**-85**	**-85**
Welsh Government policy decisions							
Land transaction tax: raising the higher rates on additional property purchases	Receipts	5	15	15	15	15	15
Land transaction tax: raising the tax-free threshold for commercial transactions	Receipts	neg	neg	neg	neg	neg	neg
Non-domestic rates: freezing the multiplier in 2021-22	Receipts	-10	-5	-5	-5	-5	-5
Direct effect of Welsh Government decisions		**-10**	**5**	**5**	**5**	**5**	**5**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). These costings are included in our pre-measures forecast, with the post-measures forecast only accounting for policy decisions by the UK Government.

Policy costings and uncertainty

A.8 In order to be transparent about the potential risks to our forecasts, we assign each certified costing a subjective uncertainty rating, shown in Tables A.2 and A.3. These range from 'low' to 'very high'. In order to determine the ratings, we assess the uncertainty arising from each of three sources: the data underpinning the costing; the complexity of the modelling required; and the possible behavioural response to the policy change. We take into account the relative importance of each source of uncertainty for each costing. The full breakdown that underpins each rating is available on our website. It is important to emphasise that where we see a costing as particularly uncertain, we see risks lying to both sides of what we nonetheless judge to be a reasonable and central estimate.

A.9 Using this approach, we have judged 13 scorecard measures and one non-scorecard measure to have 'high' or 'very high' uncertainty around the central costing. Together, these represent 20 per cent of the scorecard measures by number, or 25 per cent of the tax and

AME measures we have certified (as we do not certify the cost of DEL spending measures). They represent 30 per cent of certified measures by absolute value.[5]

Corporation tax measures

A.10 The Government has announced very significant changes to the corporation tax (CT) regime in this Budget. There are two elements - **the headline rate of CT is to increase from 19 to 25 per cent with effect from April 2023**. This reverses more than half the cumulative 9-percentage point reduction brought in in several steps by the Coalition and Conservative Governments from April 2011 onwards. The measure is estimated to raise amounts rising to £17.2 billion in 2025-26. As discussed in Box 3.2, during the period that the headline rate was being reduced the effective tax rate remained relatively stable, in part thanks to several measures that broadened the tax base. This means that the increase in the rate now yields significantly more than it would have done previously. This part of the costing – the 'static' element – is relatively certain. The main area of uncertainty relates to the behavioural response, where we allow for a small reduction in the yield for 'profit shifting' as large corporations move some taxable income to lower-taxed jurisdictions. There is a broadly offsetting impact by the measure reducing the incentive for individuals to incorporate rather than work as an employee or be self-employed. We also allow for some increase in tax avoidance.

A.11 The second element of this policy – the **reintroduction of a small profits rate of CT** creates greater uncertainty. This will apply the existing 19 per cent rate for those with profits less than £50,000 and the headline rate for those with profits greater than £250,000. For those in between there is a marginal relief, similar to the previous small profits rate policy, so that in effect the average tax rate is tapered. A company with £100,000 of profits will therefore pay around 22 per cent and one with £150,000 of profits will pay roughly 24 per cent.

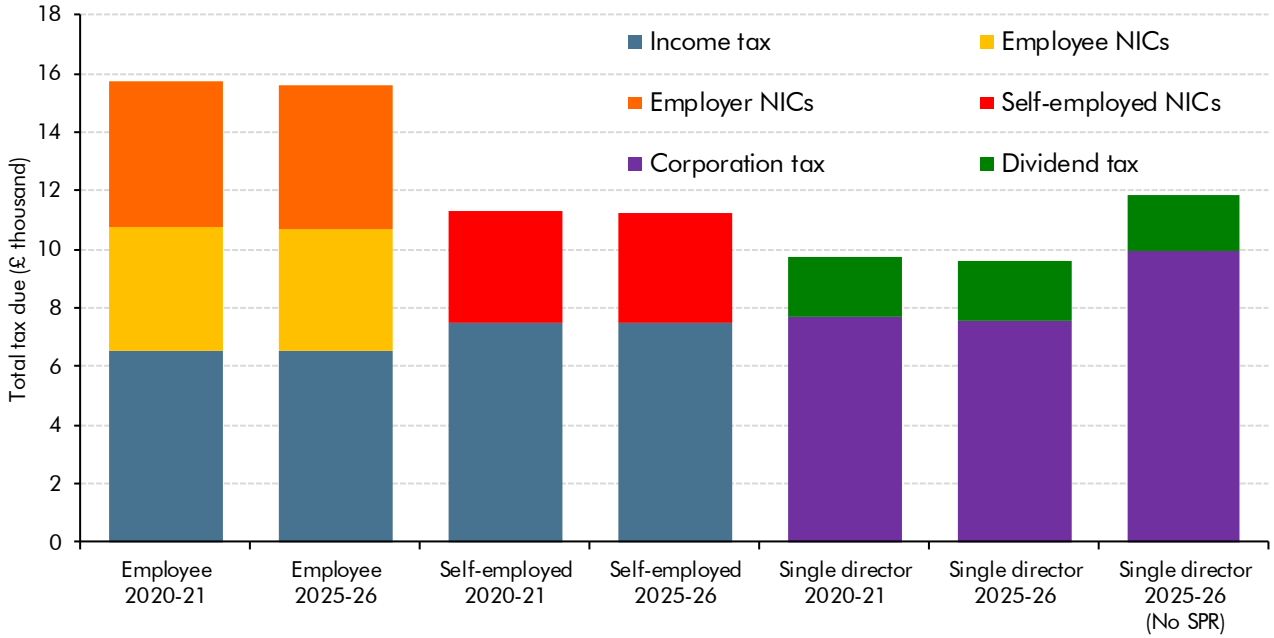
A.12 The main uncertainty with the small profits element of the costing is around how much it reverses the disincentive to incorporate associated with the main rate element. The Institute for Fiscal Studies has previously said that the small profits rate incentivised "*people to set up companies purely as a tax planning device*".[6] The costing assumes that the small profits rate will reduce the amounts raised by reducing the incentive to incorporate by around three-quarters relative to the main rate element of the costing.

A.13 The reason for this large reversal is that the small profits rate maintains a large differential between the amounts of tax paid in different employment statuses at the levels of income where the incentive to incorporate is greatest. Charts A.1 and A.2 show how tax paid under the 2025-26 tax system would compare with that paid under the 2020-21 system for those earning £50,000 or £150,000 – and with 2025-26 shown with and without the effect of the small profits rate for single-director companies.[7]

[5] The absolute value refers to the magnitude of the costing irrespective of whether is it is an Exchequer cost or a gain.
[6] The IFS Green Budget: February 2012.
[7] These calculations assume the individual has only one source of income. The deduction of employer NICs means that less of an employee's total compensation is made up of their wage, thereby paying less income tax but more NICs than the self-employed.

A.14 For an employee or someone in self-employment, the amount barely changes thanks to the personal allowance and higher rate threshold being frozen in cash terms over this period. For someone working as a single-director company, there is little change for someone earning £50,000 – thanks to the small profits rate. But more tax would be paid by someone earnings £150,000 – as the CT rate tapers up towards the headline rate. So the incentive to incorporate barely changes at £50,000 whereas it will have fallen at £150,000. And of course, many more people earn around £50,000 than earn around £150,000.

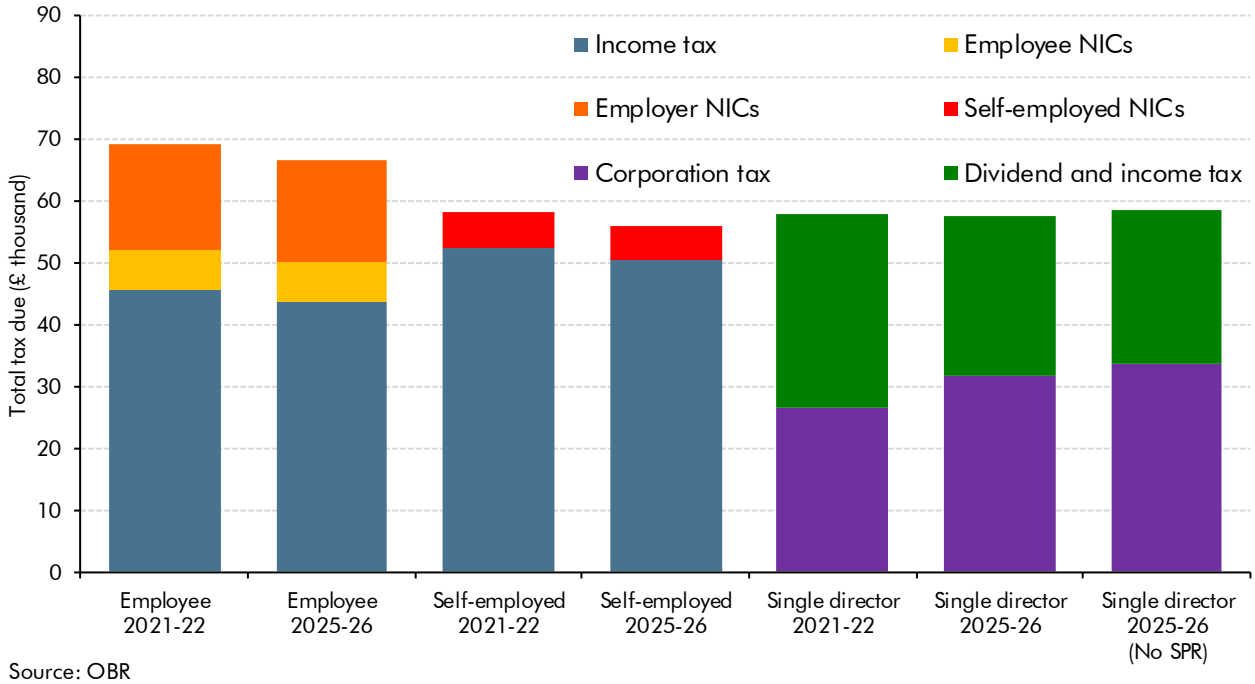
Chart A.1: Tax due on £50,000 of income in 2021-22 and 2025-26



Source: OBR

Company directors are assumed to withdraw profits in the most tax efficient way, paying themselves a salary up to the primary threshold for NICs, and taking the rest as dividends, all in the same year. These examples all reflect taxpayers outside Scotland. In Scotland higher tax rates at the top-end of the distribution create a slightly larger incentive to incorporate

Chart A.2: Tax due on £150,000 of income in 2021-22 and 2025-26



Source: OBR

A.15 The **two-year temporary capital allowances 130 per cent super deduction** applies to expenditure on new plant and machinery that qualifies as a 'main rate' asset, while a 50 per cent rate will apply to expenditure that qualifies for the 'special rate'. Capital allowances on these assets are currently 18 and 6 per cent, so these are very large temporary increases. The allowances only cover companies (since unincorporated businesses rarely invest more than the 100 per cent annual investment allowance). Not only are the rates generous, but they are not limited by value.

A.16 The main uncertainty with the costing relates to behaviour. As a temporary measure, it provides companies with a very strong incentive to bring forward investment from future periods to take advantage of the temporarily much more generous allowances. We assume that at its peak in 2022-23, this will raise the level of business investment by around 10 per cent (equivalent to around £20 billion a year) as spending is brought forward. Overall, the measure costs £29 billion between 2020-21 and 2023-24, with a peak single-year cost of £12.7 billion in 2022-23. To put this in context, in Budget 2009 the Labour Government also introduced a temporary capital allowances measure to support investment that had been hit by the financial crisis. It was for one year and at a rate of 40 per cent, and was expected to cost £1.6 billion in 2009-10. Relative to GDP, that makes this Budget's measure five times more generous in the peak year and over ten times more in total.

A.17 The measure then raises receipts by £4.9 billion in total over the final two years of the forecast due to lower investment and capital allowances claims in those years (since investment has been brought forward to benefit from the measure). This effect would continue beyond the forecast horizon. We have applied a 'very high' uncertainty rating to the behavioural element and the overall costing.

A.18 The **loss carry back** measure extends the period that trading losses from companies, partnerships and self-employed traders can be carried back by a further two years. Losses generated in 2020-21 and 2021-22 can now be offset against liabilities from 2017-18 to 2019-20 rather than just 2019-20. The measure applies to self-assessed income tax as well as CT. The amount that can be carried back to the two additional years is capped at £2 million a year.[8] Each of the elements in this costing are uncertain. The data are highly uncertain since HMRC does not hold full administrative tax data for 2020-21, and will not do until 2022 for income tax. The amount of losses that have been or will be generated is itself dependent on uncertain external factors such as the path of the virus, the resulting level of restrictions and the extent of government support schemes. These uncertainties result in a costing that relies on several assumptions and judgements. We assign it a 'very high' uncertainty rating overall, with both modelling and data rated as 'very high'.

HMRC and DWP compliance measures

A.19 The Government has announced a package of measures designed to generate additional revenue and savings from HMRC and DWP compliance activity. Compliance measures are often subject to a high degree of behavioural uncertainty since they are targeting a subset of individuals or companies that are already actively changing their behaviour to avoid or evade tax or engage in benefit fraud. This kind of uncertainty applies to **'OECD Mandatory Disclosure Rules'**, **'VAT: power to tackle Electronic Sales Suppression (ESS)'**, **'HMRC: investment in compliance'** and **'DWP: investment in compliance'**. The **'interest harmonisation and tax penalty reform'** measure is subject to a different kind of behavioural uncertainty that relates to how taxpayers will respond to a change in HMRC's penalty regime.

A.20 Since compliance measures are directed at uncollected tax or fraudulent benefit claims, there is usually less reliable data available to inform the costing. For example, the ESS measure relies on limited data on the number of businesses that engage in sales suppression. To overcome these challenges many compliance measures rely on complex multi-stage modelling and assumptions that are difficult to test. They are often also subject to uncertainty around operational delivery, such as new IT systems. For example, the costing for the penalty reform measure is tied in with the delivery of HMRC's 'making tax digital' initiative, which is itself uncertain.

Other highly uncertain measures

A.21 The uncertainty around the **state pension underpayment** is described above. The other measures subject to a 'high' or 'very high' uncertainty rating are:

- **'Red Diesel: exemptions':** this measure extends the red diesel relief to fairgrounds, winter wonderlands, circuses, amateur sports clubs, golf clubs, and inland passenger ferries. The main uncertainty in this costing relates to the paucity of reliable data, meaning the estimate of the affected tax base had to be pieced together from a variety

[8] Groups will also be subject to a cap of £2 million a year.

of sources overlaid by uncertain judgements. Overall, we assign this costing a 'very high' uncertainty rating, with data uncertainty also 'very high'.

- **'Stamp duty land tax: maintain nil rate band at £500k until June 2021, £250k until 30 September 2021':** this extension to the stamp duty land tax (SDLT) holiday is given a 'high' uncertainty rating. Previous SDLT changes have demonstrated that buyers will try to bring forward their transactions to benefit from the lower amount of tax that is due. The extent of this behaviour and how it unwinds once SDLT thresholds return to their pre-holiday levels is the main uncertainty.

- **Government-backed loan schemes:** the Government has extended its existing virus-related loan schemes by two months to the end of 2020-21 and has introduced a new Recovery Loan Scheme that will succeed the existing schemes and will run until the end of 2021.[9] The main components of these costings are assumptions about the amount of loans guaranteed and fiscal loss rates (combining overall loss rates with the proportion that is covered by the government guarantee). Loss rates determine the Exchequer cost and are the most uncertain aspect of the costing. We have used past evidence to guide our assumptions but there is limited historical information to confidently reference against in these extraordinary circumstances. The assumed volume of lending under the new scheme is based on recent months' experience with the existing ones, but it is difficult to know how demand for loans might evolve as the output recovers – especially given the strong incentive to bring forward investment created by the temporary capital allowances super deduction. The ONS decision to record expected write-offs in the year that the guarantee was made means that all these uncertainties apply to large costs recorded in 2020-21 and 2021-22, but the true costs of calls on these guarantees will not be known for several years.

- **Pensions lifetime allowance (LTA) freeze**: this measure freezes the limit on the amount of tax relieved pension savings an individual can accumulate over their lifetime at its current level of £1,073,100 until 2025-26. This generates an Exchequer yield via additional income tax and NICs receipts from individuals reducing their pension contributions, as well as from LTA charges paid by those who accumulate pension savings above the limit. The main reason we assign this costing a 'high' uncertainty rating is around the extent of the behavioural response.

- **'COVID-19: HMRC exemptions'**: the main element of this measure is extending employer-provided and employer-reimbursed Covid tests into 2021-22. The data are of 'high' uncertainty because employers are not required to report payments or reimbursements to HMRC now that they are exempt from tax. There are also uncertainties around the variation in the price of tests and the likelihood of employers continuing to provide or reimburse these tests throughout 2021-22. We give this costing a 'high' uncertainty rating.

[9] The three existing schemes are the Bounce Back Loan Scheme, the Coronavirus Business Interruption Loan Scheme, and the Coronavirus Large Business Interruption Loan Scheme.

Update on previous measures

A.22 We cannot review and re-cost all previous measures at each fiscal event (the volume being too great), but we do look at any where the original (or revised) costings are under- or over-performing, and at costings that were identified as particularly uncertain.

Recostings of virus-related support measures

A.23 As we set out in Chapter 3, the cumulative cost of the Government's virus-related support measures has risen to £344 billion, with several measures being extended in this Budget. But the cost of those measures that were included in our November forecast has actually fallen considerably, lowering the 2020-21 cost by £33 billion.

A.24 Table A.5 shows that the main changes are due to:

- A **reduction of £12 billion due to virus-related DEL budgets being underspent** by more than expected, as spending by those departments most heavily involved in the Covid response has not risen quite as sharply as planned (see Chapter 3).

- The **net cost of the CJRS to March 2021 has fallen by £3.5 billion** relative to our November forecast, as the scheme was used less heavily during November and December than we expected, though that is partly offset by upward revisions to the monthly costs for January to March to reflect the third lockdown.

- The latest data suggest **take-up of HMRC's online self-serve time-to-pay facility has been considerably lower than we expected**. This has led to self-assessed income tax receipts being revised up by £3.9 billion in 2020-21, down by £4.5 billion in 2021-22 and up again by £0.7 billion in 2022-23. The modest reduction in the net cost reflects the fact that a proportion of the tax deferred is assumed to go unpaid, so while the timing effect is large, the impact on the overall costing is small, reducing it by £0.1 billion.

- We have **revised down the costs relating to Government-backed loan schemes by £4.8 billion** for 2020-21, as take-up of the Bounce Back Loan Scheme has been lower than expected. The loans are guaranteed by Government, so any that are written off generate a cost to the Exchequer. The ONS has determined that the costs will score in the year that the guarantees are issued, rather than when the default takes place, meaning the estimate will continue to be revised for several years.

- The **net costs relating to the first three rounds of SEISS grants is £1.1 billion lower than expected**. Take-up has been lower than we assumed, and progressively lower from one grant to the next, falling from 77 per cent for the first grant to 69 per cent for the second and 65 per cent for the third. This is likely to be because sectors such as construction have faced lighter restrictions than they did during the initial lockdown. Take-up of the third grant may also have been affected by tighter eligibility rules, something that was not brought to our attention when scrutinising the initial costing.

- The news that **some large retailers will not take advantage of the business rates holiday is expected to result in over £2 billion being returned to the Exchequer**. For statistical purposes, these are recorded as gifts rather than additional business rates revenue, since the companies in question do not have a tax liability this year.

- The costing for the **temporary cut to VAT for the hospitality, accommodation and attractions sectors (to March) has been revised up by £0.5 billion**. This is largely due to incorporating the latest economic data, particularly newly available sectoral GDP outturns. These suggest the initial costing underestimated the pre-measure tax base.

- The **stamp duty holiday (to March) is due to cost £0.4 billion more in 2020-21** than we expected in our November forecast. This is mostly due to both house prices and residential property transactions being higher than we expected, with the latter rebounding once restrictions had been eased, partly as a result of the measure.

- The cost of the measure providing a relief from **import VAT and customs duty for medical equipment has been reduced by £150 million**. The change simply reflects outturn data that show import volumes were lower than expected.

Table A.5: Recostings of virus-related support measures

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November costings		-280.0	-52.7	-1.9	-0.7	-0.7	-0.5
Restated November costings		-246.7	-50.1	-1.2	-0.7	-0.7	-0.5
Difference		**33.3**	**2.5**	**0.7**	**0.0**	**0.0**	**0.0**
of which:							
DEL underspend	Spend	12.0	0.0	0.0	0.0	0.0	0.0
Loan schemes	Spend	4.8	0.0	0.0	0.0	0.0	0.0
CJRS[1]	Spend	3.5	0.0	0.0	0.0	0.0	0.0
Self-serve time-to-pay	Tax	3.9	-4.5	0.7	0.0	0.0	0.0
SEISS[1]	Spend	1.1	-0.1	0.0	0.0	0.0	0.0
Business rates holiday	Spend	0.9	1.5	0.0	0.0	0.0	0.0
VAT: reduced rate for hospitality	Tax	-0.5	0.0	0.0	0.0	0.0	0.0
Stamp duty holiday	Tax	-0.4	-0.1	0.0	0.0	0.0	0.0
Other measures	Tax/ spend	8.0	5.8	0.0	0.0	0.0	0.0

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).
[1] Measure has both tax and spend impacts and only the larger is identified.

Policy reversals

A.25 There are five measures in this Budget that fully or partially reverse past policy decisions:

- Six years ago, the **small profits rate of corporation tax** was phased out when the main rate of corporation tax fell to 20 per cent. It has been reintroduced in this Budget with a similar policy design.

- Three years ago, the then Chancellor introduced a **PAYE cap on the amount of payable R&D tax credit** that can be claimed by a company under the small or medium-sized companies scheme. This was itself a reversal of a 2012 decision to abolish the cap, and was designed to "*prevent abuse*". The cap has yet to be introduced but has already been relaxed twice. At Budget 2020 the Government decided that claims below £20,000 would not be subject to the cap, while in this Budget there are two further concessions relating to R&D carried out by 'connected parties'. These combined changes reduce the medium-term yield from the cap by around a half.

- One year ago, the Government removed **red diesel relief** from around three-quarters of existing consumption, to encourage energy efficiency. Agriculture, fish farming, rail and non-commercial heating retained the relief. In the Budget, it has reversed the effect of the measure for more sectors by extending relief to fairgrounds (including winter wonderlands), circuses, certain sports clubs and inland passenger ferries.

- Four months ago, our forecast included the removal of the **second-hand margin scheme** for VAT that applied to the sale of goods originating in Great Britain and sold in Northern Ireland. This applied particularly to the purchase of second-hand cars by dealers in Northern Ireland. That decision has now been reversed.

- Two months ago, the Government announced that following the conclusion of the UK-EU Trade and Cooperation Agreement the UK would not in fact be applying the EU Directive **'DAC 6'**. This measure, which we first included in our March 2020 forecast, involved the mandatory reporting of cross-border tax arrangements by 'intermediaries', and the Government's announcement is just a few weeks before the first disclosures were due in late January. We have removed its effects from our forecast.

Policy delays

A.26 To certify costings as central, we need to estimate when – as well as by how much – measures will affect the public finances. As we have set out in previous *EFOs*, many policy measures do not meet the timetable factored into the original costings – even where we have required greater contingency margins before certifying them. This continues to pose a risk to our forecast. Policy delays we have been notified about since November include:

- **Universal credit (UC) rollout**: the pandemic means the Government has delayed the managed migration phase of the UC pilot scheme until April 2022. While this is now almost three years later than first planned, it does not further extend the September 2026 end date, which remains nine years behind schedule.

- **Natwest Group**: the Government's disposal of former RBS shares has been further pushed back, and is now expected to conclude by 2025-26.

- **Tax credits: enhanced collection**: this Budget 2017 measure transfers debts owed by tax credits claimants from HMRC to DWP and has been beset by a series of

operational delays from the outset. The transfer of debts has been paused for much of 2020-21, initially as staff were redeployed to virus-related activity, and until there is a confirmed date for resumption we have removed its effects from the forecast.

Policy risks

A.27 Parliament requires that our forecasts only reflect current Government policy. As such, when the Government sets out 'ambitions' or 'intentions' we ask the Treasury to confirm whether they represent firm policy. We use that information to determine what should be reflected in our forecast. Where they are not yet firm policy, we note them as a source of risk to our central forecast. The full list of risks to this forecast and changes from previous updates is available on our website. Risks that are particularly large, have changed materially since our last forecast, or are new include:

- **The 'Augar' review of post-18 education funding** was launched in February 2018 and reported in May 2019. It made recommendations relating to skills, higher education, further education and student contributions. Those with significant fiscal implications include reducing the student fee cap to £7,500 a year and freezing it until 2022-23, and changes to repayment terms. The Government published an interim conclusion in January 2021 and plans to publish a full conclusion alongside the next Spending Review this autumn, which will "*include consideration of elements mentioned in the Augar Report*".

- **The 2018 McCloud-Sargeant ruling** concluded that transitional protections offered as part of the 2015 public service pension reforms were discriminatory. The Government published a consultation in July 2020 setting out two options to remedy the discrimination and a response selecting its favoured remedy was published in February 2021. But there is currently insufficient detail on how it will be implemented by schemes to cost its medium-term implications for public spending (see Box 3.5).

- In July 2020, **the Goodwin case** successfully challenged on the grounds of sexual orientation disparities in rights to survivor's benefits in the Teachers' Pension Scheme (TPS). A consultation is currently underway on options to remedy the discrimination in the TPS, but the Government believes that this will also need to be remedied in those other public service pension schemes where similar circumstances exist.

- In its November 2020 Bidding Prospectus for **'Freeports'**, the Government sought bidders for up to ten potential freeport locations, with the successful locations to be announced in Spring 2021. Further details have been announced in the Budget but came too late to be incorporated into our forecast. We will return to this in our next *EFO*.

- On 10 December 2020 the UK-EU Joint Committee that was tasked with overseeing the implementation of the **Northern Ireland protocol** published a series of decisions on how the protocol will operate. These included the creation of a new UK Trader Scheme to which businesses can self-declare when the goods they are moving from Great

Britain to Northern Ireland are not 'at risk' of onward movement into the EU. This prevents them being subject to EU tariffs. The Joint Committee decisions also included several temporary 'grace periods' requested by the UK Government. For example, supermarkets and their suppliers bringing agri-food into Northern Ireland from Great Britain have been granted a grace period until 1 April. Similarly, 'qualifying goods' in free circulation in Northern Ireland gain temporary 'unfettered access' to Great Britain. A recent Government letter to the European Commission requesting an extension of certain grace periods to 2023 suggests uncertainty over the longer-term implementation of the protocol will continue for some time.

- **Cladding tax.** On 10 February the Government announced further funding for the removal of unsafe cladding in the form of loans and grants. It also announced a new tax, intended to raise £2 billion over a decade. Details of the rate and precise mechanism of the tax are yet to be confirmed, so while the loans and grants are reflected in our forecast, the revenue remains a risk until decisions have been made on these policy parameters.

- The Government is reviewing the **bank surcharge** and intends to set out in the autumn how to ensure that the combined rate of tax on banks' profits does not increase substantially from its current level, that rates of taxation here are competitive with our major competitors in the US and the EU, and that the UK tax system is supportive of competition in the UK banking sector. Given the increase in the corporation tax rate, our forecast is based on corporation tax on banks' profits rising from 27 to 33 per cent in April 2023. If the Government's review deems that to be a substantial increase, it seems likely that the bank surcharge rate will be cut. Bank surcharge receipts rise to £1.4 billion in 2025-26.

A.28 The Government has announced that it will publish a number of **tax consultations** and calls for evidence on 23 March. In a letter to the Treasury Select Committee, the Financial Secretary to the Treasury stated that this would be "*an important part of the Government's 10-year tax administration strategy, 'Building a trusted, modern, tax administration system'*." These consultations are likely to point to future sources of policy risk to our forecasts.

B Major balance sheet interventions

Introduction

B.1 In each *Economic and fiscal outlook (EFO)* we provide an update on the direct costs associated with the major balance sheet interventions undertaken during and after the financial crisis a little over a decade ago. This provides a running commentary on the amounts subsequently recovered and the debt interest costs of financing the interventions. With the Government still owning the majority of NatWest shares, the process of exiting those interventions is still incomplete, so this annex provides our latest update.

B.2 The policy response to the coronavirus pandemic has also involved extensive use of the public sector balance sheet. In particular, the Government has now guaranteed many tens of billions of pounds worth of loans to businesses through three schemes: the Bounce Back Loan Scheme; the Coronavirus Business Interruption Loan Scheme; and the Coronavirus Large Business Interruption Scheme. It has also invested in innovative start-up firms through the Future Fund. The Government has closed these schemes to new entrants and has announced in the Budget that a new Recovery Loan Scheme will provide companies with access to government-guaranteed lending during 2021-22.

B.3 The direct costs of these interventions will only be known after several years as some companies default on loans and some start-ups fail. In future *EFO*s, we will provide a running commentary on the net direct effects of these schemes on the public finances, as we will continue to do for interventions undertaken during the financial crisis.

Crisis-related financial sector interventions

B.4 Table B.1 updates our estimate of the net direct effect on the public finances of the Government's interventions in the financial sector during the financial crisis and subsequent recession. This is not an attempt to quantify their overall effect on the public finances relative to a counterfactual where the Government had not intervened as the crisis unfolded. The costs of the crisis would almost certainly have been much greater in the absence of direct interventions to restore the financial system to stability.[1]

B.5 In total, £136.6 billion was disbursed by the Treasury during and following the crisis. By end-January 2021, principal repayments and other fees received had amounted to £124.7 billion, up slightly relative to our previous update in November 2020, reflecting a dividend receipt from UK Asset Resolution Limited (UKAR) of £0.3 billion. This leaves a smaller net cash shortfall of £11.9 billion. The value of its NatWest Group shares has risen to £11.5 billion,[2] up from the £10.3 billion recorded in our November *EFO*.

[1] We discussed the fiscal implications of financial crises in Chapter 3 of our 2019 *Fiscal risks report*.
[2] Based on NWG's share price on 29 January, consistent with the other market-derived assumptions in our forecast.

B.6 If the Treasury were to receive all loan payments in full and to sell its remaining shares at these values, it would realise an overall cash surplus on all the interventions undertaken during the crisis of £5.8 billion. This is an increase of £1.5 billion from our November estimate, mainly reflecting the higher NatWest share price. However, this cash surplus estimate excludes the costs to the Treasury of financing these interventions. If all interventions are assumed to have been financed through gilts, at the then prevailing market rates, the Treasury estimates that the additional debt interest costs would have amounted to £43.0 billion by January, mainly due to the costs associated with NatWest and UKAR.[3] This cost is larger than estimated in November, partly reflecting four more months servicing debt on interventions yet to be repaid or sold. Together this implies an overall cost of £37.3 billion to the Government (2.4 per cent of 2008-09 GDP), £0.5 billion less than we estimated in November.

B.7 On 26 February 2020 the Government announced that it had completed the final £5 billion sale of Bradford & Bingley plc and NRAM Limited and their remaining mortgage assets and loan portfolios to a private consortium.[4] The sale ends UKAR's ownership of institutions and assets taken on in the financial crisis and is taking place in two stages, with the first expected to complete in a few weeks and the second over the summer. Relative to the figures in Table B.1, which are a snapshot from before the sale was agreed, the proceeds will lower the residual market value of UKAR and raise principal repayments.

Table B.1: Gross and net cash flows of financial sector interventions

	£ billion								
	Lloyds	NWG[1]	UKAR[1]	FSCS[1]	CGS[1]	SLS[1]	Other	**Total**	Change since November 2020[2]
Cash outlays	-20.5	-45.8	-44.1	-20.9	0.0	0.0	-5.3	**-136.6**	0.0
Principal repayments	21.1	6.3	43.7	20.9	0.0	0.0	5.3	**97.3**	0.0
Other fees received[3]	3.2	6.2	7.7	3.5	4.3	2.3	0.3	**27.4**	0.3
Net cash position	3.8	-33.3	7.3	3.5	4.3	2.3	0.3	**-11.9**	0.3
Outstanding payments	0.0	0.0	0.0	0.0	0.0	0.0	0.1	**0.1**	0.0
Market value[4]	0.0	11.5	6.1	0.0	0.0	0.0	0.0	**17.6**	1.2
Implied balance	3.8	-21.8	13.4	3.5	4.3	2.3	0.3	**5.8**	1.5
Exchequer financing[5]	-4.4	-17.0	-13.9	-8.9	1.4	0.4	-0.6	**-43.0**	-1.0
Overall balance	**-0.6**	**-38.8**	**-0.5**	**-5.4**	**5.7**	**2.6**	**-0.3**	**-37.3**	**0.5**
Memo: changes in overall balance since November 2020[2]	*-0.1*	*0.7*	*0.0*	*-0.2*	*0.0*	*0.0*	*0.0*	*0.5*	
While open	-3.7	-17.0	-13.9	-7.6	0.3	0.0	-0.6	-42.5	
After close	-0.7			-1.3	1.1	0.4		-0.5	

[1] These are the Government's ownership of NatWest Group shares (previously RBS Group), UK Asset Resolution (UKAR), which manages holdings in Bradford & Bingley and Northern Rock Asset Management plc., the Financial Services Compensation Scheme (FSCS), Credit Guarantee Scheme (CGS), and Special Liquidity Scheme (SLS).

[2] March 2021 *EFO* figures were consistent with end-January data.

[3] NWG figure contains asset protection scheme and contingent capital facility related fees. UKAR includes dividends paid to Treasury.

[4] UKAR is book value of equity, derived from its accounts as at 31 March 2020 published in July of that year.

[5] This can be split into financing while the intervention was open and after it closed (or after the final payment was received): Lloyds closed in May 2017, FSCS closed in October 2018, CGS closed in November 2012, and SLS closed in April 2012.

[3] The debt interest costs (or savings) associated with interventions that yield an overall deficit (or surplus) continue beyond the point the intervention itself has been wound up. This is the 'Exchequer financing' metric recorded in Table B.1.

[4] *Government completes final £5 billion sale of Bradford and Bingley plc and NRAM Limited*, HM Treasury, February 2020.

Index of charts and tables

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