

Office for
**Budget
Responsibility**

Supplementary forecast

March 2020



Office for Budget Responsibility: Supplementary forecast

Presented to Parliament by
the Chief Secretary to the Treasury by
Command of Her Majesty

March 2020



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Foreword

The Budget Responsibility and National Audit Act 2011 requires the OBR to publish two forecasts in each financial year. Our first forecast of 2019-20 was published on 11 March.

As we set out in a letter to the Chancellor on 27 February, the cancellation of the Budget that was planned for November 2019 limited the time available to produce two meaningful forecasts. We described some options in the light of this: a legislative remedy removing the requirement for two forecasts in this financial year; as full an update as possible as late in the financial year as possible; or a swifter and more limited update. In his response, the Chancellor commissioned a swift forecast update to be published on 13 March.

This update incorporates an additional step in the forecast process that we undertook for the March 2020 Budget. The rapid pace of the final stages of our forecast process requires us to 'ready-reckon' the final debt interest forecast to reflect the consequences of the final package of policy measures that are announced. This typically provides a very close estimate of what the final debt interest forecast would look like if fully modelled, but with a fiscal loosening of the magnitude announced in the Budget, there is value in this further refinement. This update does *not* reflect any news in respect of coronavirus and the policy response to it by the Bank of England and Treasury.

We are very grateful to the analysts at the Debt Management Office (DMO) and Treasury who have provided the additional analysis necessary for this forecast update.

The full process for this supplementary forecast update was:

- Given the size of the evolving policy package we undertook an additional round of the economy forecast, using a provisional policy package, to start the process of refining the indirect effects of a large fiscal easing. We sent the relevant economic determinants and an estimate of the Government's financing requirement that are used to produce the debt interest forecast from this round to the DMO on 24 February.
- The DMO and Treasury returned a debt interest forecast consistent with this to us on 27 February. We used this as the base from which to ready reckon the debt interest consequences of the final Budget policy package relative to the provisional one.
- The Budget forecast was finalised on 6 March and we sent the final iteration of the determinants to the DMO on 9 March after we had sent the *Economic and fiscal outlook* to print. The DMO and Treasury returned revised forecasts to us by 10 March.
- We finalised the forecast on 12 March and provided the Treasury with a pre-release copy of our final *Supplementary forecast* on the same day.

1 Forecast update

Fiscal aggregates

1.1 The key economic determinants underpinning the *Supplementary forecast* are unchanged from those in our *March 2020 Economic and fiscal outlook (EFO)*. These are set out in Table 1.1. The main determinants driving our debt interest forecast are:

- The **Retail Prices Index** that determines the payments accrued on index-linked gilts.
- Our assumptions for **conventional and index-linked gilt rates** that are used to forecast debt interest payments on those gilts.
- Our **Bank Rate** assumption that is used to forecast the debt interest payments on the Asset Purchase Facility's loan. As described in the *EFO*, this assumption was adjusted to account for the large fiscal expansion announced in the Budget.
- Our assumption for **short-term market interest rates** that is used to project payments on Treasury bills and other short-term debt instruments. This is very close to Bank Rate.

Table 1.1: Economic determinants of the fiscal forecast

	Percentage change on previous year, unless otherwise specified							Growth over forecast
	Outturn		Forecast					
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	
RPI	3.1	2.6	2.1	2.9	3.0	2.9	2.8	17.6
Market short-term interest rates (%) ¹	0.8	0.8	0.8	0.8	0.9	0.9	0.9	0.1
Market gilt rates (%) ²	1.4	0.8	0.9	0.9	0.9	1.0	1.1	-0.3
Bank Rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.00

¹ 3-month sterling interbank rate (LIBOR).

² Weighted average interest rate on conventional gilts.

1.2 In addition we have used the following assumptions specific to the fiscal forecast:

- The initial **central government net cash requirement (CGNCR)** for this supplementary forecast was the final CGNCR from the Budget.
- The Government's published **financing remits for 2019-20 and 2020-21** determined the high-level composition of the instruments used to finance borrowing.

1.3 We have then updated the more granular composition of individual bonds within that high-level remit. This is generated by a DMO model that projects an auction calendar that aims to mimic choices that would be made – without prejudging what the DMO would actually choose in any given situation. It breaks down the financing remit into a series of auctions of

specific gilts at specific times. As usual we asked the DMO to produce an auction calendar near the start of the March 2020 forecast process. In subsequent forecast rounds, we then scaled the amounts issued in each modelled auction to meet the changed financing needs implied at each round. Again as usual, we kept the auction-by-auction gilt composition unchanged. For this supplementary forecast we have asked the DMO to produce an updated auction calendar consistent with the now much larger CGNCR. It is this new more realistic calendar that drives the changes in this supplementary forecast.

- 1.4 Table 1.2 shows that debt interest, and consequently the level of borrowing, is a little lower in 2019-20 than in our March 2020 *EFO*, largely reflecting outturn data from the most recent DMO auctions. In all other years, debt interest is essentially unchanged. This is as one would expect since accrued debt interest costs are determined by projections for interest rates and RPI inflation, which are unchanged from those used in the *EFO*.

Table 1.2: Changes to debt interest

	£ billion					
	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
March 2020 forecast	58.5	55.7	60.1	61.2	61.7	62.3
March 2020 forecast update	58.3	55.7	60.1	61.2	61.7	62.3
Change	-0.2	0.0	0.0	0.0	0.0	0.0

- 1.5 Table 1.3 shows that revisions to the CGNCR are a little larger. As with debt interest, the change in 2019-20 reflects the latest outturns. Changing the mix of gilt issuance over the forecast period modestly reduces cash spending in later years. This reflects the fact that different gilts are associated with different cash coupon payments, affecting cash spending.

Table 1.3: Changes to CGNCR

	£ billion					
	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
March 2020 forecast	44.2	64.8	73.1	70.4	64.0	72.2
March 2020 forecast update	44.0	64.8	73.1	70.3	63.9	72.1
Change	-0.2	0.0	0.0	-0.1	-0.1	-0.1

- 1.6 Table 1.4 shows that public sector net debt is reduced slightly by the cumulative impact of lower CGNCR, but affected more by the path of gilt premia. These premia are the difference between the proceeds at each auction and the nominal value of each gilt recorded in PSND. They are therefore sensitive to the precise choice of gilts being auctioned.

Table 1.4: Changes to public sector net debt

	£ billion					
	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
March 2020 forecast	1,799	1,818	1,827	1,900	1,969	2,031
March 2020 forecast update	1,798	1,818	1,828	1,900	1,970	2,032
Change	-1	0	0	1	1	1
<i>of which:</i>						
CGNCR	0	0	0	0	0	-1
Gilt premia	-1	0	1	1	1	1

1.7 Table 1.5 shows the fiscal aggregates from this supplementary forecast.

Table 1.5: Fiscal aggregates

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Receipts and expenditure							
Public sector current receipts (a)	37.5	37.7	37.9	38.0	38.3	38.4	38.5
Total managed expenditure (b)	39.3	39.8	40.3	40.8	40.8	40.8	40.7
of which:							
Public sector current expenditure (c)	35.0	35.3	35.4	35.7	35.6	35.5	35.4
Public sector net investment (d)	2.0	2.2	2.6	2.9	3.0	3.0	3.0
Depreciation (e)	2.3	2.2	2.3	2.3	2.3	2.3	2.3
Legislated fiscal mandate and supplementary target							
Cyclically adjusted net borrowing	1.9	2.2	2.4	3.0	2.7	2.5	2.2
Public sector net debt ¹	80.6	79.5	77.4	75.0	75.4	75.6	75.3
Budget 2020 fiscal targets							
Current budget deficit (c+e-a)	-0.3	-0.1	-0.2	-0.1	-0.5	-0.7	-0.8
Debt-interest-to-revenue ratio (per cent)	4.1	3.8	3.3	3.5	3.3	3.1	2.9
Other deficit measures							
Public sector net borrowing (b-a)	1.8	2.1	2.4	2.8	2.5	2.4	2.2
Cyclically adjusted current budget deficit	-0.1	-0.1	-0.2	0.1	-0.2	-0.5	-0.8
Primary deficit	0.3	0.7	1.2	1.5	1.2	1.2	1.1
Cyclically adjusted primary deficit	0.4	0.8	1.2	1.7	1.5	1.3	1.1
Financing							
Central government net cash requirement	2.4	2.0	2.8	3.1	2.8	2.5	2.7
Public sector net cash requirement	2.1	1.4	1.1	0.3	2.9	2.6	2.7
Alternative balance sheet metrics							
Public sector net debt ex. Bank of England	72.3	71.8	72.0	72.3	72.9	73.1	72.9
Public sector net financial liabilities	67.4	66.7	65.9	65.3	64.9	64.4	63.3
Stability and Growth Pact							
Treaty deficit ²	1.8	2.2	2.5	3.1	2.6	2.4	2.4
Cyclically adjusted Treaty deficit	1.9	2.3	2.5	3.3	2.8	2.5	2.4
Treaty debt ratio ³	84.1	83.2	82.9	83.2	83.3	83.3	83.0
£ billion							
Current budget deficit	-5.8	-1.9	-4.9	-2.7	-11.7	-16.7	-21.2
Public sector net investment	44.3	49.1	59.7	69.3	73.2	77.0	79.1
Public sector net borrowing	38.4	47.2	54.8	66.6	61.5	60.2	57.9
Cyclically adjusted net borrowing	41.4	48.0	55.3	71.8	68.1	63.9	58.7
Cyclically adjusted current budget deficit	-2.8	-1.2	-4.4	2.4	-5.1	-13.1	-20.4
Public sector net debt	1774	1798	1818	1828	1900	1970	2032
Net debt interest	32.5	30.7	28.1	31.2	30.5	29.3	28.5
Non-interest receipts	788.9	811.8	845.3	881.9	918.6	952.3	988.4
Memo: Output gap (per cent of GDP)	0.3	0.0	0.1	0.4	0.4	0.1	0.0

¹Debt at end October; GDP centred on end October.

²General government net borrowing.

³General government gross debt. Uses financial year GDP.

Risks and uncertainties

- 1.8 We described the many potential sources of risk to our first March 2020 forecast in Chapters 2 and 3 of the *EFO* and considered sensitivity analysis and alternative scenarios in Chapter 4. These remain relevant. Since completing that *EFO*, global oil prices and stock markets have fallen further, generating further uncertainty around near-term forecasts.
- 1.9 The *EFO* listed various sources of policy risk to the forecast, including the Budget announcements of coronavirus measures that were, unavoidably, finalised after we had closed our forecasts. The Treasury has put a figure of £12 billion on this package, but there is obviously a lot of uncertainty around that. There is £5 billion for the NHS, which will be added to if necessary. There are measures to limit as far as possible the effect on household incomes – partly at the expense of Government and partly at the expense of employers. And there are measures to absorb or offset some of those costs for business and to make sure that temporary cashflow problems do not cause otherwise healthy companies to fail. The cost of support to households and businesses will of course largely depend on how many people are affected by the outbreak, which we simply cannot know at present.

2 Performance against the Government's fiscal targets

2.1 Table 2.1 shows our assessment of performance against the legislated fiscal targets and the Budget 2020 fiscal targets. This assessment is unchanged from that set out in Chapter 4 of the *EFO*. The Government is on course to meet all the Budget 2020 fiscal targets, but is not on course to meet the legislated fiscal mandate (or the fiscal objective).

Table 2.1: Performance against the Government's fiscal and welfare targets

		Per cent of GDP		£ billion	
		Forecast	Margin	Forecast	Margin
Legislated fiscal targets					
Fiscal mandate: Cyclically adjusted public sector net borrowing in 2020-21	Not met	2.4	-0.4	55.3	-9.2
Supplementary target: Year-on-year change in public sector net debt in 2020-21	Met	-2.0	2.0		
Welfare cap: Specified welfare spending in 2022-23	Met			127.0	3.4
Budget 2020 fiscal targets					
Current budget rule: Current budget balanced by 2022-23 ¹	Met	-0.5	0.5	-11.7	11.7
Investment rule: Public sector net investment no more than 3 per cent on average	Met	2.9	0.1		
Welfare cap: Specified welfare spending in 2024-25 (£ billion)	Met			133.5	4.1
Debt-interest-to-revenue ratio: Interest costs no more than 6 per cent of revenue	Met	3.5	2.5		

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

A Economy forecast

Economy forecast

A.1 Our economy forecast and the risks around it are unchanged from our March 2020 EFO. Table A.1 shows the main economic variables that underpin this supplementary forecast.

Table A.1: Economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2018	2019	2020	2021	2022	2023	2024
Output at constant market prices							
Gross domestic product (GDP)	1.3	1.4	1.1	1.8	1.5	1.3	1.4
GDP per capita	0.7	0.8	0.5	1.3	1.1	0.9	1.1
GDP levels (2018=100)	100.0	101.4	102.5	104.3	105.8	107.1	108.6
Output gap	0.2	0.1	-0.1	0.4	0.4	0.2	0.0
Expenditure components of real GDP							
Household consumption	1.6	1.3	1.1	1.2	1.2	1.4	1.4
General government consumption	0.4	3.6	3.7	2.8	2.1	1.9	2.2
Business investment	-1.5	0.3	0.0	1.8	3.0	2.4	2.3
General government investment	1.3	2.1	1.9	10.9	4.6	1.8	1.2
Net trade ¹	-0.2	0.0	-0.1	-0.3	-0.2	-0.4	-0.3
Inflation							
CPI	2.5	1.8	1.4	1.8	2.1	2.1	2.0
Labour market							
Employment (million)	32.4	32.8	33.0	33.1	33.2	33.3	33.4
Average earnings	3.3	2.8	3.3	3.6	3.4	3.1	3.1
LFS unemployment (rate, per cent)	4.1	3.8	3.8	3.8	3.9	4.0	4.1

