November 2017 *Economic and Fiscal Outlook* Briefing

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Good afternoon ladies and gentlemen.

My name is Robert Chote, Chairman of the OBR, and I would like to welcome you to this briefing on our latest *Economic and Fiscal Outlook*.

I am going to take you through some of the highlights and then we will be very happy to answer your questions. The slides and my speaking notes will be available on our website after we finish.

[SLIDE] Let me start with the usual background.

The EFO contains our latest five-year forecasts for the economy and the public finances and an assessment of the Government's progress against its fiscal and welfare spending targets.

The views expressed are the responsibility of the Budget Responsibility Committee. But, as always, we have relied on the hard work of the OBR's staff and officials in other departments and agencies.

As usual, the forecast went through a number of iterations to reflect new judgements, new data and proposed policy measures. We provided the Chancellor with our final pre-scorecard forecast on November 9th.

We have been provided with all the information we asked for, although the Government did alter its planned profile of public spending too late for us to incorporate the change fully into our economy forecast. The effect on the economy would have been small, but - as we shall see - the direct effect was sufficient to keep net debt falling as a share of GDP this year.

We have come under no pressure to change any of our conclusions.

[SLIDE] So now let me turn to a brief overview of the report.

Economic growth has been slightly weaker so far this year than we expected. Looking forward, we expect weaker growth throughout the forecast than in March, thanks largely to a downward revision to potential productivity growth.

In the meantime, the public finances have been performing better than we expected. The ONS has revised its estimate of public sector borrowing in 2016-17 down from £51.7 billion to £45.7 billion and we have revised down our forecast for this year from £58.3 billion to £49.9 billion.

Thereafter weaker economic growth implies weaker tax revenues and puts upward pressure on borrowing. In addition, the Government has announced a significant fiscal giveaway over the next two years, reducing in size thereafter and ending with a small takeaway in 2022-23. Despite some helpful statistical changes – including the reclassification of English housing associations from the public to the private sector - borrowing is higher than in March from 2019-20 onwards.

Nonetheless, the Government remains on course to hit its targets for borrowing and debt in 2020-21 — but with less room for manoeuvre left than it had in March. This means that its longer-term objective of balancing the Budget also looks even more challenging now than it did in March.

[SLIDE] Turning to the detail, let me start with the economy. And with what has happened to GDP growth since our last forecast in March.

[SLIDE] As expected, real GDP growth has slowed noticeably this year. The fall in the pound following the EU referendum has pushed up consumer price inflation, squeezing household incomes and spending and acting as a drag on the economy. Export growth has picked up a bit, but this has provided only a partial offset and has been accompanied by unexpectedly strong import growth.

The resulting slowdown in GDP growth came one quarter earlier than we expected in March, so the total rise in GDP of 0.9 per cent that we have seen over the first three quarters of this year was 0.2 percentage points weaker than we had forecast. We expect growth to remain steady into the fourth quarter, so the performance to date looks consistent with growth of 1.5 per cent for 2017 as a whole, down from 2 per cent in our last forecast and in line with the average of other forecasts.

[SLIDE] The slowdown this year is in contrast to the experience of other major industrial economies. Growth in the UK has been weaker so far this year than in the second half of last year. But in the eurozone, the US, Canada and Japan, growth has been stronger this year than late last year – and stronger than in the UK.

[SLIDE] That said, growth so far this year – shown in the blue bars - has diverged only a little from our March forecast. [SLIDE] But the breakdown between employment and productivity shows a bigger divergence.

Over those same three quarters employment has risen by 230,000 – more than twice as fast as expected – while average hours worked per person have been close to flat rather than falling as expected.

As a result, total hours worked in the economy have increased by 0.7 per cent rather than the 0.1 per cent we forecast, while output per hour has risen by 0.2 per cent rather 1.1 per cent.

This pattern – of unexpectedly strong employment growth and unexpectedly weak productivity growth – has been a consistent feature of our (and indeed most people's) forecasts for some time. And it has held true both when we have under-predicted GDP growth and when we have over-predicted it.

As we explained in our *Forecast evaluation report* last month, this has led us to review our assumptions about potential productivity growth looking forward, as well as the other assumptions that determine how strongly we think the economy can grow over the medium term consistent with the Bank of England setting monetary policy in order to hit its inflation target.

So let me set out the conclusions that we have reached.

[SLIDE] As the breakdown that we have just looked at suggests, we can think about potential output in the economy as a combination of potential hours worked and potential output per hour. And any judgement about potential hours worked reflects four further judgements, about: the size of the adult population, the proportion of adults active in the labour market, the proportion of those in employment, and the number of hours they work on average. We have revised each of these since March.

[SLIDE] Let me start with potential productivity.

As you know, productivity growth has been far weaker since the financial crisis than it was for decades beforehand. Output per hour has risen by just 0.2 per cent a year since 2008, compared to an average of 2.1 per cent a year over the preceding 35 years.

As we discussed last month, there are a number of explanations that may have been more or less convincing at different times: labour hoarding, a dysfunctional financial system, weak investment, very low interest rates and slack in the labour market, to which one could add mismeasurement of output and an unfavourable composition of employment growth.

Many of the explanations that we have pointed to in past forecasts suggested a temporary slowdown in productivity growth. But as this remarkable period of weakness lengthens – and as the financial crisis recedes further into the past – it seems sensible to place more weight on weak performance of the recent period as a guide to the outlook for the next few years, but without abandoning hope of a recovery altogether. We are reinforced in this judgement by the fact that weak productivity growth has been, and remains, a global phenomenon and not purely a domestic one, although the performance in the UK is weaker than most.

Back in March we assumed that potential productivity growth would pick up gradually to 1.8 per cent a year by the end of the forecast, only a little below the historic average rate. But we now assume that trend productivity growth picks up to 1.2 per cent by 2022, taking actual productivity growth up to 1.3 per cent. As you can see this is roughly half way between the paths based on the pre- and post-crisis average rates. This judgement on its own reduces the potential size of the economy by 3 per cent in 2021-22, compared to the forecast we published in March.

Turning to potential hours worked, the first judgement we need to make is about the size of the adult population. We base this on the 'principal' population projection from the ONS. This was updated in October and projects a smaller population than the projection we had in March. [SLIDE] Net inward migration is now expected to slow to 165,000 a year over the next five years, down from 185,000 a year in the last projections, as you can see here. [SLIDE] More importantly the age profile of net inward migration looks less favourable, with a smaller proportion of immigrants being of working age. All in all the fall in the expected size of the adult population reduces potential output by 0.2 per cent by 2021-22.

[SLIDE] The proportion of the population active in the labour market is expected to edge lower as the ageing of the population outweighs a rise in the still relatively low participation rates for people at older ages. Thanks to the latest population projections and recent outturn data, we expect the participation rate to fall a little more slowly than in March, increasing potential output by 0.2 per cent in 2021-22.

[SLIDE] Turning to unemployment, we assumed in March that the economy could sustain a rate as low as 5 per cent of the labour force without putting upward pressure on inflation. But the unemployment rate has continued to fall below that level without much sign of wage inflation. In response, we have reduced the assumed sustainable rate to 4.5 per cent, which increases potential output in all years by half a per cent.

[SLIDE] Average hours worked per person have risen since the financial crisis, but to date we have assumed that the long-standing downward trend would reassert itself over the forecast period. But this has not happened yet, perhaps because people are working longer hours than they otherwise would have to cushion their incomes from the impact of weak earnings growth. Given our downward revision to expected productivity growth in this forecast - and the weaker growth in earnings that implies - we now assume a flat trend in average hours over the medium term, raising potential output by 0.9 per cent in 2021-22.

[SLIDE] So what is the net effect of all this?

This chart shows our March forecast for potential output [SLIDE] and then our November forecast - higher to begin with, because the economy can sustain lower unemployment, but growing less quickly thereafter, because of weaker trend productivity growth.

By 2021-22 the potential size of the economy is 1.6 per cent smaller than in the March forecast. [SLIDE] We estimate that the economy is running a little below potential at the moment, so actual GDP growth can grow a little faster than potential over the next few years. We forecast that it will grow by 5.7 per cent between 2017-18 and 2021-22, significantly less than the 7.5 per cent we forecast in March.

[SLIDE] Here you can see what this means for the profile of quarterly growth rates – 0.3 to 0.4 per cent a quarter looks like the new normal, although we know from experience that the path will be much bumpier than this, even if we are right about the average rate.

[SLIDE] As you can see here, the cumulative downgrade to GDP across the forecast is reflected in most areas of spending. Business investment suffers the largest proportional hit, consistent with the weakness of productivity. But consumer spending - which is much bigger to begin with - makes the largest absolute contribution to the total downward revision.

Investment in residential dwellings is also down significantly, consistent with the weaker outlook for productivity growth, house price inflation and property transactions. This is not a reflection of the housing measures announce in the Budget, but it does represent a challenging baseline for the Government's housebuilding target.

[SLIDE] In terms of the annual profile for GDP growth, you can see here that the new forecast is materially weaker than the last one, but that the difference is not in fact that large relative to the uncertainty that lies around any GDP forecast implied by past forecast performance.

[SLIDE] As regards specific calendar years, we expect growth of 1.5 per cent this year, slowing slightly in 2018 and again in 2019 as the boost to net trade from the fall in the pound fades, public spending cuts intensify and as Brexit-related uncertainty weighs on the economy. Growth picks up modestly thereafter as productivity growth slowly improves and as remaining spare capacity in the economy is absorbed. The short-term fiscal giveaway announced in the Budget boosts growth a little in 2018 and 2019 and then lowers it a little in the subsequent two years.

Looking over the forecast as a whole, growth averages 1.4 per cent a year, down from 1.8 per cent a year in March.

So far we have been talking about growth in real GDP, the volume of goods and services produced in the economy. This is what most public discussion of economic forecasts focuses on. But the nominal or cash value of GDP, which reflects prices as well as volumes, is more important as a driver of the public finances. And we expect whole economy price inflation to be a little weaker over the forecast than we thought in March.

As a result nominal GDP grows by 12.6 per cent between 2017-18 and 2021-22, down from 15.3 per cent in March. [SLIDE] This chart summarises that 2.7 percentage point downward revision. As you can see, unemployment, participation and average hours are all positives, compared to March, but they are outweighed by weaker population growth, productivity growth and whole economy inflation. The productivity judgement is clearly the most significant of these.

[SLIDE] As this table shows, weaker growth in nominal GDP implies weaker growth in the major sources of tax revenue, notably wages and salaries, consumer spending and corporate profits. Investment growth is weaker too, but this is positive for the public finances - at least in the short term.

[SLIDE] The largest single hit comes from weaker growth in wages and salaries, as lower productivity growth reduces growth in average earnings. This chart shows our forecasts for nominal and real growth in average earnings in March [SLIDE] and now in November. It is significantly weaker today, with real earnings growth averaging just 0.6 per cent a year across the forecast. Indeed, with an ageing population set to weigh on employment growth, fiscal drag set to push up income tax payments and uprating policy hold back growth in benefits, real household disposable income per person grows by just 0.3 per cent a year.

Needless to say, there is as always considerable uncertainty around our forecasts for the economy and therefore the consequences for the public finances. In chapter 5 of the EFO we look at the fiscal implications of stronger and weaker growth in productivity than we have assumed.

Brexit is of course another source of uncertainty. There remains no meaningful basis upon which we can predict the precise outcome of the negotiations. So we have stuck with the broad-brush assumptions that we made in March and last November about the Brexit process and the possible implications for growth, trade and migration.

[SLIDE] So now let me turn from the economy to the public finances.

This chart shows our March forecast for public sector net borrowing in billions of pounds [SLIDE] and our new forecast today. [SLIDE] Borrowing is now expected to be £8.4 billion lower this year than we forecast in March at £49.9 billion. The forecast for next year has barely moved, but in each of the following three years the deficit is around £13 billion higher than we forecast in March.

[SLIDE] So what explains these changes? There are four main elements:

- [SLIDE] First, there are some small favourable statistical changes that the ONS implemented in September, notably regarding imputed pensions spending.

- [SLIDE] Second, there are the changes to our underlying forecast for the budget deficit. There is a downward revision to the deficit this year. This partly reflects the fact that the ONS has revised last year's deficit lower and some of that good news feeds through into subsequent years. Thereafter, our forecast changes push the deficit higher, primarily because weaker economic growth reduces tax receipts by increasing amounts over time.

- [SLIDE] Third, there is the impact of the policy decisions in this Budget, plus some others that have been announced since March. These add £2.7 billion to borrowing next year and more than £9 billion in 2019-20. The giveaway then diminishes and ultimately becomes a £3.1 billion takeaway in 2022-23.

- [SLIDE] Finally there is the impact of the ONS's decision to reclassify English housing associations out of the public sector, prompted by legislation to reduce government control over them. This reduces borrowing by a little under £4 billion a year on average. It helps the Government meet its fiscal targets, but - as we shall see later - it is hard to argue that this reflects an improvement in the underlying health of the public finances.

So let us look at the main elements here in a bit more detail and begin with the changes to the underlying forecast in blue.

[SLIDE] This moves from a favourable revision of £6.3 billion this year to an unfavourable one of £17.6 billion in 2021-22.

[SLIDE] The first thing to note is the public finances start from a stronger position than we expected in March, which is reflected in the latest outturn data. Viewed on a like-for-like basis, the latest data show that borrowing in 2016-17 was £5 billion lower than we forecast in March, and borrowing over the first half of this year has been lower than expected too. Much of this good news is expected to carry through into future years of the forecast, for example tax receipts from financial sector and other bonuses were higher last year than we anticipated, which provides a higher baseline for future growth.

[SLIDE] This biggest hit to the borrowing forecast comes from the cut in our productivity growth assumption. This increases borrowing by just over £25 billion a year by 2021-22, half of which reflects lower income tax receipts as a result of weaker growth in earnings. Lower consumer spending hits VAT and excise duties, while lower profits reduce corporation tax.

As we discussed a moment ago, the impact of our productivity assumption on GDP growth - and therefore on expected growth in tax revenues - is partly offset by our assumptions on [SLIDE] average hours and [SLIDE] employment, but slightly reinforced by [SLIDE] slower population growth.

[SLIDE] Other changes to the economy forecast reduce borrowing in the near term. For example, wages and salaries have been boosted this year by stronger employment growth than we expected while earnings have held up better than expected relative to productivity growth. But later in the forecast these effects dissipate, while weaker house price inflation weighs on tax receipts.

[SLIDE] Specific fiscal forecasting changes also increase borrowing towards the end of the forecast, for example we have revised the expected cost of disability benefits up and the expected savings from Universal Credit down.

Among the other fiscal forecasting judgements we have to make, we need to assess the extent to which central government departments and local authorities are likely to over or underspend their budgets for public services and capital spending.

The latest information suggests that central government departments will underspend against their July plans by £4.6 billion, which has prompted us to reduce our forecast for their spending (and therefore overall borrowing) by £3.2 billion since March. This reduces borrowing this year, but is not necessarily a good guide to future years.

[SLIDE] For local authorities, it is very a different story. For years we assumed that they would sustain their spending in the face of cuts to their grant income by drawing down their reserves. But for years they did not do so, preferring to add to their reserves despite the squeeze.

But they now appear to have turned the corner. As this chart shows, last year English local authorities over-spent their non-education revenue budgets for the first time since the financial crisis, in large part reflecting overspends on social care.

[SLIDE] As a result, councils with social care responsibility drew down £1.4 billion from their reserves in 2016-17, having added to them as recently as 2014-15. We assume that local authorities as a whole will draw down another £1 billion this year and £1.7 billion in total by 2019-20. [SLIDE] Nonetheless, this would see local authority current spending in England fall towards 4 per cent of GDP by the end of the forecast, down from more than 6 per cent in 2010-11. Part of that reflects some schools funding moving from local to central government, but the underlying trend is downward too.

On the capital side, local authority spending financed by borrowing was markedly higher than we forecast in March, part of which reflected increased commercial activity by authorities seeking alternative sources of income. We assume much of this will persist over the forecast.

[SLIDE] So now let us turn from forecast changes to the impact of the Government's Budget policy decisions. As you will recall, these involve a near-term giveaway reaching £9.2 billion in 2019-20, shrinking thereafter and ending with a small net takeaway in 2022-23.

So how is this package composed?

[SLIDE] First there are changes in day-to-day or 'resource' spending on public services and administration. These include temporary increases of £3 billion each for the NHS and Brexit preparations. The Government has also scaled back its 2019-20 'efficiency review' by £1 billion. Conversely, at the end of the forecast, it has penciled in a cut in resource spending as a share of GDP in 2022-23.

[SLIDE] So how does this affect the profile of resource spending that was already in place? This chart shows the cumulative change in real resource spending per capita from 2015-16 in our March forecast and today. The main difference is that this year's underspend and next year’s extra money means that there is no longer a significant drop in 2018-19. The overall decline from 2015-16 remains roughly 6 per cent, but the remainder of that cut has in effect been delayed by a year.

[SLIDE] Second, there are increases in capital spending, particularly in 2019-20 and 2020-21. These include more money for the NHS and the expansion of various housing schemes.

[SLIDE] As you can see here, this increases the already substantial rise in real per capita capital spending that was planned through to 2020-21. It is much flatter thereafter. There remains a very big jump in capital spending planned for 2020-21 and we assume that not all of the money allocated will get out of the door.

[SLIDE] Third, there are some modest increases in other spending, including extra money for Universal Credit – reducing the six week waiting time – and greater scope for local authority housing spending.

[SLIDE] Fourth, there are tax cuts, the largest of which are the stamp duty relief for first time buyers and - inevitably - another freeze in fuel duty. We estimate that the stamp duty relief will increase house prices by 0.3 per cent. So the main financial gainers will actually be people who already own properties, rather than first-time buyers themselves.

[SLIDE] Fifth, there is a much larger number of much smaller tax increases. These include a raft of new anti-avoidance and evasion measures, focused on additional resources for HMRC, plus a freeze in the indexation allowance for corporation tax. Interestingly the only year in which tax increases outweigh tax cuts is in the fiscal target year of 2020-21. This is the result of delaying by a year the introduction of the new capital gains tax payment window – which boosts receipts in its first year of operation. When it was announced in Autumn Statement 2015, it boosted receipts in the then target year of 2019-20.

[SLIDE] Finally, the measures have indirect effects on government borrowing that reduce the deficit somewhat in most years, mostly because the increases in departmental spending (including on pay) are assumed to boost the economy a little.

[SLIDE] Returning to the overall pattern of the Budget measures, we have a near-term giveaway followed by the promise of an eventual takeaway. As you can see, this is in line with the pattern seen in most fiscal events since 2010, but somewhat looser each year than the average. St Augustine remains the patron saint of fiscal policy: "Give me chastity and continence, but not yet."

[SLIDE] Of course the concern is that if you loosen fiscal policy today, but promise to tighten tomorrow, tomorrow never comes. Indeed, if you look at the impact of successive Budget and Autumn Statement measures in 2018-19, policy was tightened in the Autumn Statements of 2013 and 2014, when 2018-19 was a long way away, but it has been loosened at every fiscal event since as the Government has become less ambitious about the structural balance it wants to achieve in that year. Indeed, all the original tightening has now been reversed.

[SLIDE] Before turning to the Government's fiscal targets, let us look for a moment at the last factor that helps explain why our borrowing forecasts have changed since March – namely the reclassification of English housing associations from the public to the private sector.

[SLIDE] The ONS decides whether to classify bodies as part of the public sector on the basis of the ESA10 international statistical standards. As the ONS says: "The fundamental question is 'does the government exercise significant control over the general corporate policy of the unit?", not who owns the body or finances it.

On this basis the ONS decided in 2015 to classify English housing associations as part of the public sector from July 2008. The decision was prompted by policies announced in Summer Budget 2015 that highlighted existing government controls over housing associations' operations. Associations outside England soon came into the public sector as well. This significantly increased measured public sector borrowing and debt, making the public finances look worse.

Since then, the Government has been seeking to reduce local and central government control over housing associations, most recently through 'The regulation of social housing (influence of local authorities) (England) Regulations 2017', which were approved by Parliament a week ago. When this instrument was passed, the Treasury formally invited the statisticians to reconsider the classification of housing associations and, applying the ESA10 rules, the ONS duly confirmed that it would move them back to the private sector from this month. As a result, we produce our forecasts in this EFO on that basis.

[SLIDE] Referring to the decision, the Secretary of State for Communities and Local Government said in a speech last Thursday: “Today we’re reclassifying housing associations. I know it sounds like a piece of bureaucratic box-ticking, but the results will be far-reaching. Freed from the distractions of the public sector, housing associations will be able to concentrate on developing innovative ways of doing their business, which is what matters most: building more homes.”

But the rationale sounded slightly different in written evidence that the department submitted to a House of Lords Committee earlier in the autumn. [SLIDE] This said that: “The only reason these regulations have been introduced is to seek ONS to reclassify housing associations to the private sector. In preparing them, we have ensured that these only go as far as we have to, to reclassify housing associations… Local authorities remain able to influence housing associations through the various contracts and other agreements jointly negotiated.”

Given this unusually candid account of the Government’s motivation, we have been careful throughout this EFO to show the implications of this reclassification as transparently as we can. [SLIDE] This chart shows the contribution that housing associations made to public sector net borrowing and public sector net debt in our March forecast and [SLIDE] how that has changed today following the reclassification of the English associations. The impact of the reclassification in 2018-19 will be to reduce borrowing by £4 billion and net debt by £71 billion.

Does this matter? Well, nothing underhand has been done – the Government has been open about its motives and the ONS has applied the rules from ESA10. As we shall see, the change helps the Government achieve its fiscal objectives, although one could argue that those objectives were set in the knowledge that the Government thought housing associations should be off the balance sheet.

Most importantly, the reclassification does not imply a significant improvement in the underlying health or riskiness of the public finances. Given their role in delivering social housing, it seems unlikely that the Government would be any less likely to offer assistance to the sector if it got into serious trouble just because the statisticians now consider it part of the private sector. As we noted in our *Fiscal risks report* in July, similar ambiguities arise with other institutions, such as universities.

[SLIDE] So now let me turn to the Government's fiscal targets.

As we shall see, the Government remains on course to achieve its fiscal mandate for structural borrowing, to achieve its supplementary target for net debt and to stay within its cap on welfare spending. But it is not yet on course to achieve its so-called 'fiscal objective' – to balance the public finances 'as soon as possible in the next Parliament', which was expected to end in 2025-26 when the target was set.

[SLIDE] Let's start with the fiscal mandate.

This requires the Government to bring the structural budget deficit below 2 per cent of GDP by 2020-21. The structural deficit is the one you would see if activity in the economy was running at its potential level, consistent with stable inflation. With some spare capacity in the economy, the structural deficit is a little smaller than the headline deficit through most of this forecast.

This chart shows the path of the structural deficit from our March forecast – and the 2 per cent ceiling. By 2020-21 the deficit reached 0.9 per cent of GDP, leaving headroom against the target of 1.1 per cent of GDP. [SLIDE] Now let's add the structural deficit from this forecast and – as you can see – it remains below the ceiling at 1.3 per cent of GDP, but the remaining room for manoeuvre has almost halved to 0.7 per cent of GDP.

[SLIDE] You can see here that this loss of room for manoeuvre reflects a 0.5 per cent of GDP rise in our underlying forecast for the structural deficit in the target year, plus the 0.2 per cent policy giveaway. These are partly offset by the 0.2 per cent improvement in the deficit thanks to the reclassification of housing associations. So the reclassification helps to safeguard the mandate, but it is not decisive. On a like-for-like basis, taking housing associations out of the March forecast, the remaining room for manoeuvre has almost exactly halved.

[SLIDE] If we look at the uncertainty that lies around our forecast for the structural deficit, implied by past performance, the Chancellor has a roughly 65 per cent chance of meeting the mandate on current policy.

[SLIDE] The Government's supplementary target for public sector net debt requires it to fall as a share of GDP in 2020-21. In our November forecast net debt peaked at 88.8 per cent of GDP this year and fell by 3.9 per cent of GDP in the target year. [SLIDE] In this forecast the peak is lower at 86.5 per cent, but the decline in the target year is smaller at 3.0 per cent of GDP. So, as with the mandate, the target is on course to be met, but with slightly less room for manoeuvre.

[SLIDE] The improvement in the outlook for net debt since March reflects the reclassification of housing associations, which reduces debt in every year. This is partly offset by greater use of the Bank of England's Term Funding Scheme, by the Budget measures on borrowing and lending, and (towards the end of the forecast) by our underlying forecast changes. The debt-to-GDP ratio is also shifted higher by our downward revision to nominal GDP.

The Term Funding Scheme is particularly helpful in achieving the supplementary target, as the repayment of loans after their four-year term has ended contributes 2.4 percentage points of the 3 per cent of GDP decline in debt in that year.

[SLIDE] In addition to the supplementary target, the Government has also been keen to ensure that debt continues to fall as a share of GDP next year, as it was forecast to do in March.

This table shows that the our revisions to nominal GDP, our other underlying forecast changes and the policy giveaway in the Budget would on their own have turned the 0.3 per cent of GDP fall in net debt that we forecast in March into a 0.6 per cent of GDP increase. But this has been offset by the reclassification of housing associations and changes to the profile of asset sales - delays to the sale of UKAR assets and new sales of RBS shares. As you can see, there is now a tiny fall in the debt to GDP ratio next year, which the Government finally secured by slightly rejigging its chosen profile for departmental spending.

[SLIDE] Turning very briefly to the welfare cap, this requires spending on benefits and tax credits (excluding the state pension and payments linked to the economic cycle) to lie below a specified cash limit in 2021-22. [SLIDE] The cap was set in line with our November 2016 forecast, plus a 3 per cent margin. (Changes in inflation are taken into account.)

Spending within the welfare cap has been revised up since March in most years of the forecast, reflecting higher expected spending on disability benefits and smaller savings from Universal Credit. [SLIDE] Spending is now expected to be £2.5 billion below the cap plus margin in 2021-22, down from £4.5 billion in November. So we formally judge it met on that basis. As this is a first Budget of a new parliament, the Government has set a new, higher cap based on this latest forecast – its fourth in four years.

[SLIDE] The Government describes the fiscal mandate and the supplementary debt target as 'interim targets'. Its stated 'fiscal objective' is to bring the public finances to balance as soon as possible in the next Parliament. When the target was set, this would have been 2025-26 at the latest.

This lies beyond our five-year forecast horizon, so we cannot judge the prospects definitively. But it does look unlikely that the Government would achieve this on current policy settings.

To begin with, our central forecast ends with the Government still running a deficit of 1.1 per cent of GDP in 2022-23, up from 0.7 per cent of GDP in the previous year in our March forecast.

If the deficit was to continue falling at the average rate expected beyond the end of the Spending Review, then it would not disappear until 2030-31. And over this period there is likely to be upward pressure on spending from the ageing of the population and other cost pressures in the health service, as discussed in our *Fiscal sustainability reports*.

[SLIDE] So, finally, let me conclude with a brief summary.

The outlook for the economy over the next five years looks weaker than we forecast in March, primarily because we see less scope for productivity growth.

Public sector borrowing is lower today than we expected in March, but the revisions to our economy forecast weaken the outlook for tax receipts and put upward pressure on borrowing in future years. On top of the forecast changes, the Government has announced a fiscal giveaway that adds to borrowing in all but the last year of the forecast.

Nonetheless, the Government remains on course to achieve its fiscal targets, with the reclassification of housing associations helpful but not decisive. But it now has less room for manoeuvre left than it did in March. And its long-term objective of balancing the budget looks even more challenging.

And, with that, we are happy to take your questions.