1 Executive summary

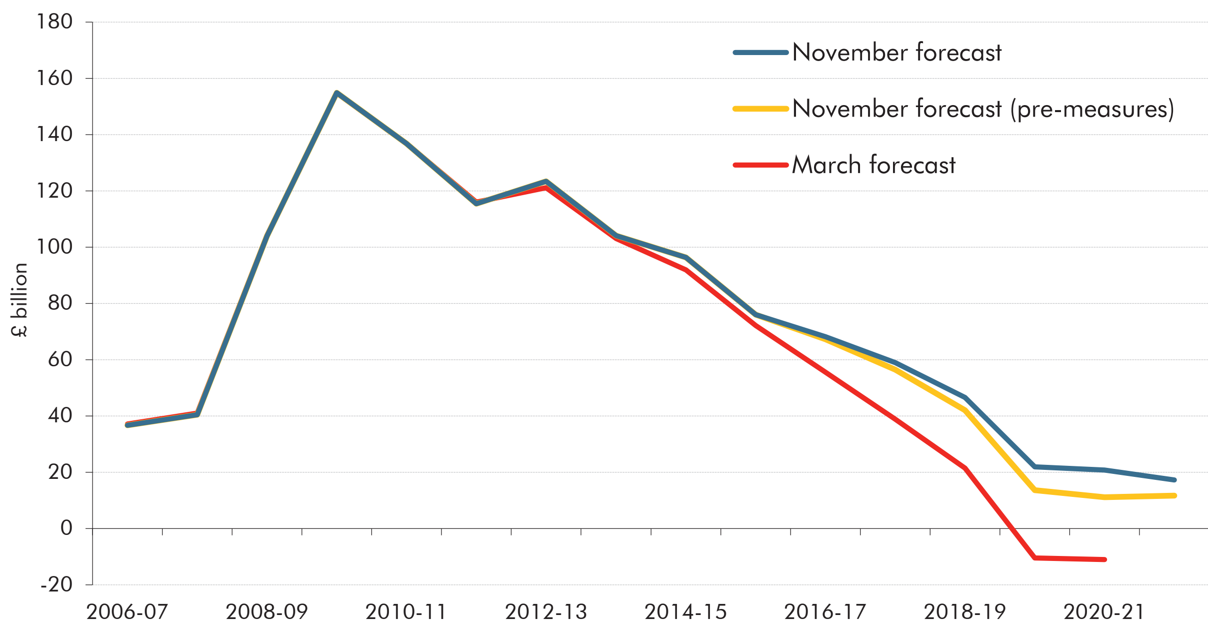
Overview

1.1 The Government is no longer on course to balance the budget during the current Parliament and has formally dropped this ambition in a significant loosening of its fiscal targets. Public sector net borrowing is now expected to fall more slowly than we forecast in March, primarily reflecting weak tax receipts so far this year and a more subdued outlook for economic growth as the UK negotiates a new relationship with the European Union.

1.2 Confronted by a near-term economic slowdown and a structural deterioration in the public finances, the Government has opted neither for a large near-term fiscal stimulus nor for more austerity over the medium term. Instead the Chancellor has proposed a much looser 'fiscal mandate' that gives him scope for almost 2½ per cent of GDP (£56 billion) more structural borrowing in 2020-21 than his predecessor was aiming for in March.

1.3 Forecast revisions have absorbed 0.9 per cent of GDP (£20 billion) of this extra room for manoeuvre and the Chancellor has given away 0.4 per cent of GDP (£9½ billion), mostly in infrastructure spending. This leaves 1.2 per cent of GDP (£26½ billion) spare, in case the structural outlook is worse than we think or he wants to announce more giveaways. (He can also run a bigger deficit if the cyclical slowdown is more severe.) But, if the Chancellor did borrow more, his aim to balance the budget as early as possible in the next Parliament would become even more challenging, especially given age-related spending pressures.

Chart 1.1: Public sector net borrowing



Source: ONS, OBR

1.4 The OBR is required by legislation to produce its forecasts on the basis of current stated Government policy (but not necessarily assuming that specific objectives will be met). In the current context of looming Brexit negotiations, this is far from straightforward. Quite appropriately, we have been given no information regarding the Government's goals or expectations for the negotiations that is not already in the public domain.

1.5 Given the uncertainty surrounding the choices and trade-offs that the Government may have to make, and the consequences of different outcomes, we have not attempted to predict the precise end result of the negotiations. Instead we have made a judgement – consistent with most external studies – that over the time horizon of our forecast any likely Brexit outcome would lead to lower trade flows, lower investment and lower net inward migration than we would otherwise have seen, and hence lower potential output. In time the performance of the economy will also be affected by future choices that the Government makes about regulatory and other policies that are currently determined at the European level. These could move in either a growth-enhancing or a growth-impeding direction.

1.6 In the near term, as the negotiations get under way, we assume that GDP growth will continue to slow into next year as uncertainty leads firms to delay investment and as consumers are squeezed by higher import prices, thanks to the fall in the pound. But we do not assume that firms shed jobs more aggressively or that consumers increase precautionary saving, both of which are downside risks if the path to Brexit is bumpy. Our forecasts are currently somewhat less pessimistic than those in the Bank of England's November *Inflation Report* and the Treasury's published pre-referendum analysis, but in current circumstances the uncertainty around them is even greater than it would be in normal times.

1.7 The negotiations will also determine the scope and scale of any ongoing financial flows between the UK and the EU. Again we do not know enough about the Government's preferences, or its chances of achieving them, to make a precise forecast. Instead we produce a 'no referendum' counterfactual for our transfers to the EU – a forecast of the flows we would expect to see if the UK had not voted to leave the EU – and make the fiscally neutral assumption that any reduction would be recycled into extra domestic spending.

1.8 On the basis of these assumptions, our central forecast suggests:

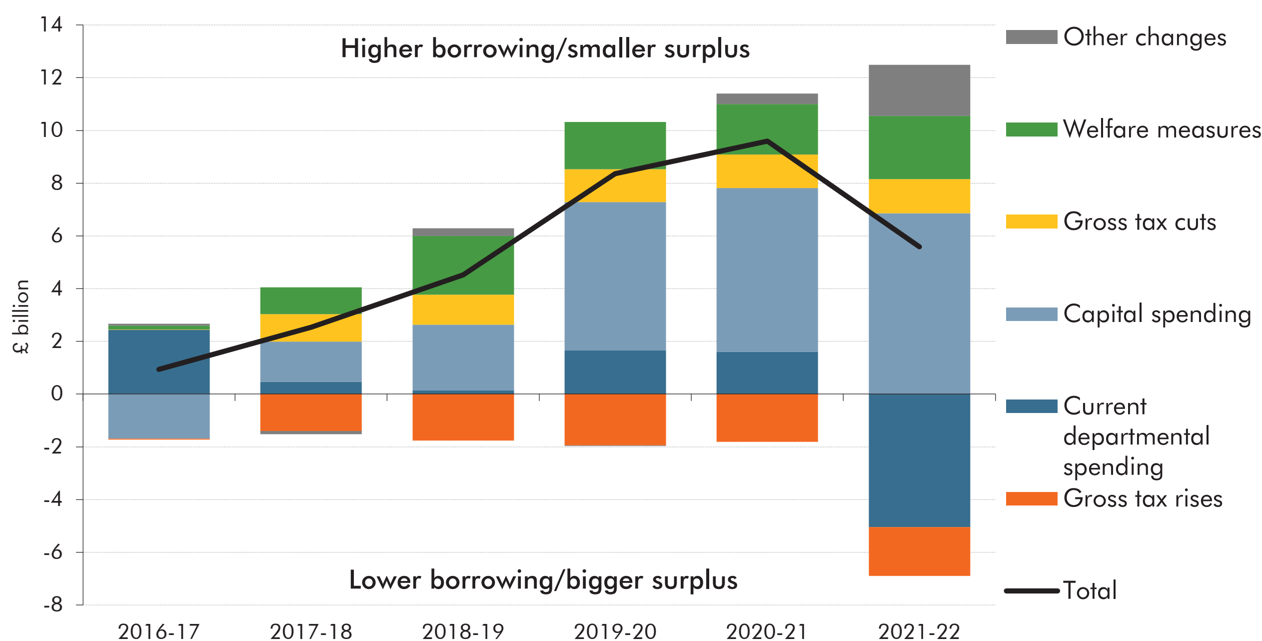
- the **economy** will grow more slowly than we expected in March, with GDP growth in 2017 revised down from 2.2 to 1.4 per cent and cumulative growth over the whole forecast revised down by 1.4 percentage points. A weaker outlook for investment and therefore productivity growth is the main cause. Inflation is forecast to peak at 2.6 per cent and unemployment to rise modestly to 5.5 per cent during 2018. Subdued earnings growth and higher inflation mean that real income growth stalls in 2017;

- the **budget deficit** has been revised up by £12.7 billion this year, thanks primarily to weakness in income tax receipts that largely pre-dates the referendum. The weaker growth outlook means that our pre-policy-measures forecast revision rises to £18.1

billion by 2020-21. Again, weaker income tax receipts are the biggest factor, reflecting the downward revision we have made to productivity and earnings growth; and

- on top of that, **Autumn Statement policy decisions** add to the deficit in every year. As Chart 1.2 shows, capital spending has been increased by rising amounts across the Spending Review years to 2020-21 and into 2021-22. The Government has also announced a small net tax increase. Tax rises include another increase in the insurance premium tax and more anti-avoidance measures. These outweigh the tax cuts, notably freezing fuel duty next year for the sixth year in a row. Welfare spending is higher after the disability benefit cuts announced in the March Budget were abandoned and because of a decision to taper away universal credit awards less aggressively. Departmental resource spending plans have been increased in 2019-20 and 2020-21, but held flat in real terms in 2021-22. So in that year they fall in real per capita terms and as a share of GDP. Taking forecast changes, classification changes and policy measures into account, we now forecast a deficit of £20.7 billion (0.9 per cent of GDP) in 2020-21, compared to an £11.0 billion surplus in March.

Chart 1.2: The effect of Autumn Statement decisions on public sector net borrowing



Source: OBR

1.9 With our underlying borrowing forecast higher – and policy decisions pushing the deficit up further – the Government's three existing fiscal targets would all be missed by considerable margins. The current fiscal mandate requires a budget surplus in 2019-20, but we now forecast a deficit of £21.9 billion. The 'supplementary target' requires debt to fall relative to national income every year, but we now expect it to rise sharply this year and next – partly due to the measured effect of August's monetary policy changes. And the 'welfare cap' requires a subset of welfare spending to be held below a cash limit set in July 2015, but we now expect this to overshoot by more than 7 per cent by 2020-21. These rules do not apply

in the event of a 'significant negative shock', on the Government's definition, but with our growth forecast remaining above 1 per cent this escape clause is not triggered.

1.10 The Government has proposed new fiscal targets in a draft *Charter* alongside the Autumn Statement. These are much less constraining than the existing ones. The new fiscal mandate requires a structural deficit – i.e. borrowing unrelated to temporary weakness in the economy – below 2 per cent of GDP in 2020-21, which would mean halving it in this Parliament. Separately, net debt must fall relative to GDP in 2020-21. The new welfare cap only applies in 2021-22 and is only to be assessed at the start of the next Parliament.

1.11 Our central forecast shows the new targets all being met. But given the uncertainty around any fiscal forecast at that horizon, the chance of any being missed is significant. For the fiscal mandate, past forecast performance suggests that there is a 35 per cent chance of the new target being missed despite £26.6 billion of headroom.

Economic developments since our last forecast

1.12 GDP growth – and consumer spending in particular – has held up since our last forecast. It was stronger than expected in the second quarter and in line with our March forecast in the third. But growth has slowed since the referendum and business investment is falling. Employment growth has been a little stronger than expected, while productivity and earnings growth have been a little weaker. Inflation has picked up as expected.

1.13 Since the referendum, the value of the pound has fallen significantly. While it has picked up somewhat from the multi-year lows seen in October, the assumption that underpins our forecast is around 13 per cent weaker than that used in March. With dollar oil prices having also risen since March, upward pressure on inflation has built.

1.14 Survey indicators of economic activity fell sharply after the referendum, but have since picked up. One factor that may have supported sentiment was the package of monetary stimulus measures announced by the Bank of England in August. As well as cutting Bank Rate to 0.25 per cent, the Bank announced purchases of government bonds, corporate bonds and a scheme to provide cheap funding to banks to ensure that the cut in Bank Rate is passed on to the interest rates paid by people and firms.

1.15 Most forecasters have revised down their expectations for GDP growth – particularly in 2017. As with the activity surveys, forecasts were first revised down sharply before being revised back up a little. The latest average of external forecasters' predictions for GDP growth in 2017 is somewhat more pessimistic than our forecast in this *EFO*.

The economic outlook

1.16 As noted above, our economy forecast is not based on a precise prediction of the outcome of the Brexit negotiations, but rather on broad-brush judgements consistent with a range of possible outcomes. We have been given no information about the Government's goals and

expectations for the negotiations that is not already in the public domain. And we would not in any event wish to base our forecast on assumptions we could not be transparent about.

1.17 Our central forecast assumes:

- **that the UK leaves the EU in April 2019** – two years after the date by which the Prime Minister has stated that Article 50 will be invoked;
- **that the negotiation of new trading arrangements with the EU and others slows the pace of import and export growth for the next 10 years.** We have calibrated this on the basis of a range of external studies of possible trade regimes; and
- **that the UK adopts a tighter migration regime than that currently in place**, but not sufficiently tight to reduce net inward migration to the desired 'tens of thousands'.

1.18 Reflecting these assumptions, and in light of the reaction in financial markets since the referendum, our updated economy forecast has been built around five key judgements:

- **the referendum result and forthcoming post-Article 50 negotiations have generated uncertainty for firms that will lead to some investment being postponed or cancelled.** We have revised business investment down relative to our March forecast in all years, which also reduces trend productivity growth due to slower capital deepening;
- **the fall in the pound will squeeze households' real incomes by pushing up import prices.** We expect the pound's fall to add almost 2 per cent to the level of consumer prices over the next two years, relative to our March assumption. Real earnings growth will consequently fall close to zero next year. That squeeze is expected to hold back real private consumption growth in 2017 and 2018;
- **the depreciation of sterling will boost net trade in the short term.** The pound has fallen 14 per cent relative to the assumption that underpinned our March forecast. That is expected to boost net trade over the next two years, with UK exports more competitive in overseas markets and imports to the UK less attractive relative to domestically produced goods and services. That will provide a temporary boost to GDP growth. Net trade will also be boosted as weaker domestic demand reduces imports growth;
- **exiting the EU will reduce growth in exports and imports during the transition to a less trade-intensive economy.** We have not modelled the effect of specific post-exit trading regimes, but have instead drawn on a range of external studies to calibrate a downward adjustment to exports and imports that we assume would be complete by 2025. We have assumed that exports and imports are similarly affected, so that the effect on net trade and GDP growth is broadly neutral. We have not revised trend productivity growth lower explicitly to reflect lower trade intensity (as the Treasury did in its pre-referendum analysis) given the lack of certainty around this link; and

- **exiting the EU will be associated with lower net migration than would otherwise have been the case.** Once again we have not modelled the effects of a specific post-exit migration control regime, but we do assume that it will be tighter than the current system. In addition, pull factors attracting migrants to the UK may be less powerful than previously. Our forecast uses the same net inward migration assumption as in March, but we would have revised it up to levels closer to recent outturns in the absence of the referendum result.

1.19 There have also been policy changes since the referendum – including in this Autumn Statement – that have a bearing on our forecast:

- the **monetary policy** easing announced by the Bank of England in August is likely to have reduced the impact of post-referendum uncertainty on GDP growth. This implies a faster effect on the economy than is typical in economic models, but is consistent with the Bank having acted to head off a drop in activity before signs of it appeared in actual data. This effect was not factored into some pre-referendum predictions of the short-term hit to growth from a vote to leave; and

- the Government has eased the pace at which **fiscal policy** will be tightened. Relative to the path of consolidation underpinning our March forecast, it has loosened policy between 2017-18 and 2020-21, largely reflecting increases in capital spending. This has small effects on the profile of real GDP growth, adding 0.1 percentage points in 2017-18 and subtracting less than 0.1 percentage points a year thereafter.

1.20 Reflecting these assumptions and judgements we have:

- revised down **potential output growth** by 0.3 percentage points a year on average between 2017 and 2020 relative to March (due to lower trend productivity growth). Our forecast is a further 0.2 percentage points a year lower than it would have been had we revised up net inward migration in the absence of the referendum vote. Cumulative potential output growth between 2016 and 2021 is around 1.5 per cent lower than in March and around 2.4 per cent lower than it would have been if we had incorporated the assumption of higher net inward migration;

- revised down **actual GDP growth**. We expect growth to slow further, reaching a trough of 0.2 per cent a quarter in the second quarter of 2017. Growth then picks up gradually in the second half of 2017 and through 2018. We expect the economy to be running 0.7 per cent below full capacity by the end of 2017 (compared to 0.2 per cent in the third quarter this year), with above-trend growth then closing this output gap by mid-2021. At this stage we have not assumed any further uncertainty-related hit to growth in 2019 when the UK's exit from the EU is assumed to be completed;

- revised up **CPI inflation** as the weaker pound pushes up import prices and therefore consumer prices. CPI inflation is forecast to rise from 0.9 per cent in October to above 2 per cent in early 2017, then to rise further before peaking at 2.6 per cent in mid-2018. We assume that it will return slowly to target over the following two years;

- assumed that the short-term slowing in GDP growth is driven by **business investment**, after which **private consumption** becomes a more significant source of weakness due to the squeeze on real incomes from higher inflation. **Net trade** offsets some of that weakness, thanks to the boost from a weaker currency and to the knock-on effects of weaker business investment and consumer spending on imports; and

- revised up **unemployment** over the next two years, as slower growth in real GDP generates spare capacity in the economy. Unemployment is expected to peak at 5.5 per cent of the labour force in mid-2018, up around 0.3 percentage points (or around 100,000 people) relative to our March forecast. We do not, at this stage, forecast that Brexit-related uncertainty will prompt more aggressive job-shedding. Average **earnings growth** has been revised down. Combined with higher inflation, this means that real earnings are expected to fall year-on-year in the second half of 2017.

1.21 Risks to our central forecast include the concurrence of large fiscal and current account deficits, the alternative trading arrangements that will ultimately replace EU rules and the effect of sterling depreciation on export market share, import substitution and consumer prices. For this and subsequent forecasts, there are numerous risks and uncertainties associated with the period leading up to and following the UK's exit from the EU, related to policy setting and the response of households and firms, with little by way of precedent to guide the assumptions in this forecast. But it is important to remember that Brexit has not supplanted, but has rather increased, the main uncertainty already surrounding the outlook for UK economy, namely the prospects for productivity growth.

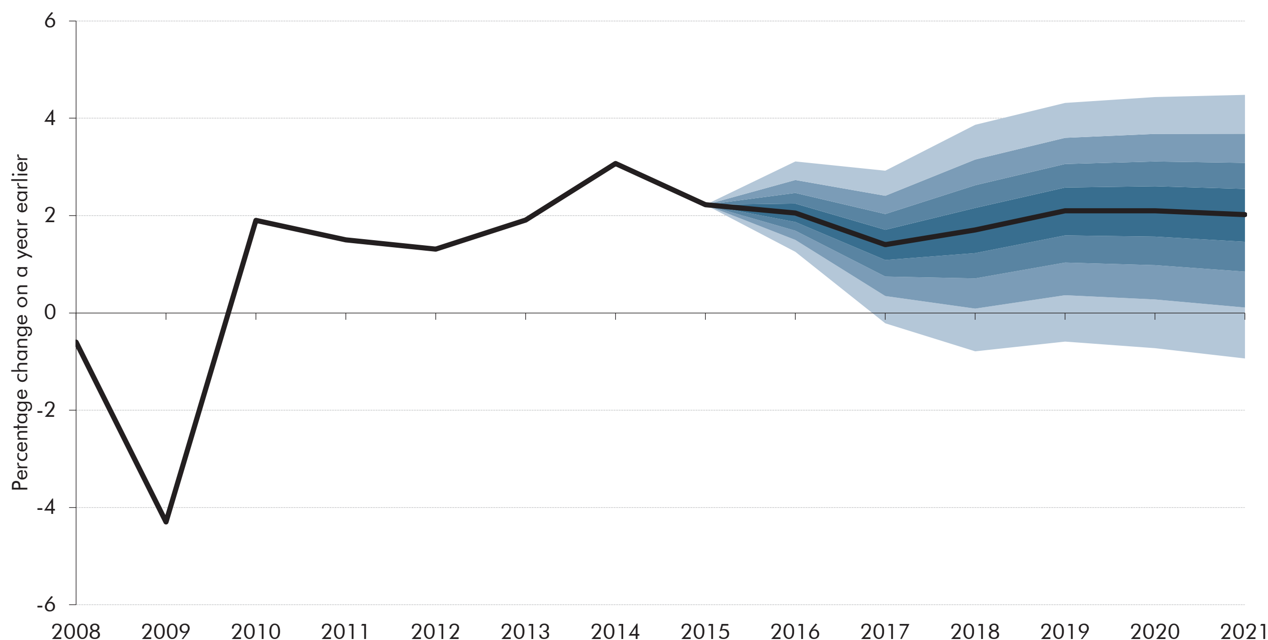
1.22 One way of illustrating the uncertainty around our GDP growth forecast is shown in Chart 1.3. This presents our central forecast with a fan that represents the probability of different outcomes based on past official forecast errors. The solid black line shows our median forecast, with successive pairs of lighter shaded areas around it representing 20 per cent probability bands. These are not subjective judgements about the extent of uncertainty, which for the reasons discussed above could be greater than usual at present.

Table 1.1: Overview of the economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2015	2016	2017	2018	2019	2020	2021
Output at constant market prices							
Gross domestic product (GDP)	2.2	2.1	1.4	1.7	2.1	2.1	2.0
GDP per capita	1.4	1.3	0.7	1.0	1.4	1.4	1.4
GDP levels (2015=100)	100.0	102.1	103.5	105.2	107.4	109.7	111.9
Output gap	-0.3	-0.2	-0.6	-0.6	-0.3	-0.1	0.0
Expenditure components of real GDP							
Household consumption	2.5	2.8	1.2	1.1	2.1	2.0	2.0
General government consumption	1.5	1.0	0.6	0.5	0.3	0.6	0.8
Business investment	5.1	-2.2	-0.3	4.1	5.3	4.1	3.6
General government investment	-2.0	2.3	3.3	2.1	1.9	8.8	3.3
Net trade[1]	-0.4	-0.2	0.3	0.3	-0.1	-0.1	-0.1
Inflation							
CPI	0.0	0.7	2.3	2.5	2.1	2.0	2.0
Labour market							
Employment (millions)	31.3	31.7	31.8	31.9	32.0	32.2	32.3
Average earnings	1.8	2.2	2.4	2.8	3.3	3.6	3.7
LFS unemployment (rate, per cent)	5.4	5.0	5.2	5.5	5.4	5.4	5.4
Claimant count (millions)	0.80	0.76	0.82	0.87	0.86	0.86	0.87
	Changes since March forecast						
Output at constant market prices							
Gross domestic product (GDP)	0.0	0.1	-0.8	-0.4	0.0	0.0	
GDP per capita	0.0	0.1	-0.8	-0.4	0.0	0.0	
GDP levels (2015=100)	0.0	0.1	-0.7	-1.2	-1.1	-1.1	
Output gap	0.0	0.0	-0.6	-0.7	-0.3	-0.1	
Expenditure components of real GDP							
Household consumption	-0.4	0.4	-1.0	-1.0	0.1	0.1	
General government consumption	-0.2	0.8	0.0	0.0	0.1	-0.1	
Business investment	0.3	-4.7	-6.3	-1.8	-0.2	-0.3	
General government investment	-4.1	2.2	1.4	2.3	2.1	2.3	
Net trade[1]	0.1	0.2	0.4	0.4	0.0	0.0	
Inflation							
CPI	0.0	0.0	0.7	0.5	0.1	0.0	
Labour market							
Employment (millions)	0.1	0.2	0.1	0.0	0.1	0.1	
Average earnings	-0.5	-0.4	-1.1	-0.7	-0.1	0.0	
LFS unemployment (rate, per cent)	0.0	0.0	0.2	0.3	0.1	0.0	
Claimant count (millions)	0.00	0.02	0.04	0.03	0.01	0.00	

[1] Contribution to GDP growth.

Chart 1.3: Real GDP growth fan chart



Source: ONS, OBR

The fiscal outlook

1.23 Public sector net borrowing peaked at 10.1 per cent of GDP (£154.9 billion) in 2009-10 as the late 2000s recession and financial crisis dealt the public finances a significant blow. Fiscal consolidation and economic recovery then reduced the deficit to 4.0 per cent of GDP (£76.0 billion) by 2015-16.[1] We estimate that the economy was operating just below full capacity in that year, so the structural deficit – which is adjusted to remove the effects of the economic cycle – was slightly smaller at 3.8 per cent of GDP.

1.24 Table 1.2 shows that on current policy – including the decisions announced in this Autumn Statement and the assumptions that we have made about the UK's exit from the EU – we expect the deficit to continue falling, but more slowly than we forecast in March. By 2019-20, when the Government previously sought to achieve a surplus, we now expect a deficit of £21.9 billion. In 2020-21, when the Government now seeks to bring the *structural* deficit below 2 per cent of GDP, we expect a structural deficit of 0.8 per cent of GDP.

[1] Our forecast and this document have been produced on the basis of the September 2016 public sector finances data published by the Office for National Statistics on 21 October. We did not have pre-release access to the October 2016 data released on 22 November (the day before this publication), although we were able to consider administrative data on most tax receipts for the month.

Table 1.2: Fiscal forecast overview

	Per cent of GDP						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Revenue and spending							
Public sector current receipts	36.1	36.4	36.9	36.9	37.0	37.0	37.1
Total managed expenditure	40.1	39.9	39.8	39.1	38.0	38.0	37.8
Deficit: Fiscal mandate measures							
Public sector net borrowing	4.0	3.5	2.9	2.2	1.0	0.9	0.7
Cyclically adjusted net borrowing	3.8	3.3	2.6	1.8	0.8	0.8	0.7
Cyclically adjusted current budget deficit	2.0	1.4	0.5	-0.1	-1.1	-1.5	-1.6
Debt: Supplementary target							
Public sector net debt	84.2	87.3	90.2	89.7	88.0	84.8	81.6
	£ billion						
Revenue and spending							
Public sector current receipts	679.8	710.6	738.0	768.0	801.8	834.8	869.2
Total managed expenditure	755.8	778.8	797.0	814.5	823.7	855.6	886.4
Deficit: Fiscal mandate measures							
Public sector net borrowing	76.0	68.2	59.0	46.5	21.9	20.7	17.2
Cyclically adjusted net borrowing	71.6	64.9	51.4	37.9	16.6	18.5	16.7
Cyclically adjusted current budget deficit	38.2	27.5	10.7	-1.9	-23.9	-33.4	-38.0
Debt: Supplementary target							
Public sector net debt	1610	1725	1840	1904	1945	1950	1952

Changes in public sector net borrowing and net debt

Expected borrowing in 2016-17

1.25 We expect borrowing to fall from £76.0 billion in 2015-16 to £68.2 billion this year, a £12.2 billion upward revision from March (on a like-for-like basis). Most of that revision is explained by two developments. First, income tax and national insurance receipts from pay-as-you-earn have fallen far short of our March forecast, prompting a £10.5 billion downward revision for 2016-17 as a whole. Second, spending – particularly local authority spending – was higher than expected in 2015-16, which we assume will persist this year.

1.26 On a like-for-like basis – removing the impact of ONS classification decisions that have been announced but not yet implemented – our forecast for borrowing in 2016-17 implies a 10.9 per cent fall year-on-year. That is a little faster than we have seen over the year to date, even though we expect the economy to slow further. We expect the improvement in the deficit to accelerate over the remainder of the year because:

- policy measures – notably forestalling ahead of the dividend tax rate increase this April – are expected to boost **self-assessment income tax** receipts at the end of the year;

- strong **onshore corporation tax** receipts in October boost our receipts estimate for the full year. We had access to administrative data before closing our forecast; and

- two timing effects related to **net transfers to the EU** reduce spending in the second half of the year relative to 2015-16. They relate to the profile of total EU budget spending across the multi-year framework that underpins it and the timing of payments and rebates associated with implementing the 2014 Own Resources Decision.

Forecast borrowing from 2017-18 onwards

1.27 Our forecast from 2017-18 onwards reflects the assumptions we have made about the UK's exit from the EU. As well as those regarding future trading arrangements and the migration regime that are most relevant to our economy forecast, the assumptions most relevant to our fiscal forecast include that:

- **the UK leaves the EU in April 2019** – two years after the date by which the Prime Minister has stated that Article 50 will be invoked;
- any reduction in **expenditure transfers to EU institutions** is recycled fully into extra domestic spending. This assumption is fiscally neutral; and
- there are no changes to the structure or membership of **tax systems for which there are common EU rules** (such as VAT and the EU emissions trading scheme). We will return to these assumptions when any details become clear.

1.28 Table 1.3 shows how classification changes, our underlying forecast judgements and the Government's policy decisions have affected our forecast for borrowing:

- in order to compare the forecasts on a like-for-like basis, we have restated our March forecast for the effects of two ONS **classification changes** – the reclassification of Scottish, Welsh and Northern Irish housing associations into the public sector[2] (bringing them into line with last year's reclassification of most English housing associations) and the decision to record corporation tax receipts on a time-shifted accruals basis rather than a cash basis. The latter is only partly reflected in this forecast – we have removed the effect of the Budget 2016 payment dates policy measure in 2019-20 and 2020-21, since that only affected the timing of cash receipts. It will be fully reflected in our next forecast;[3]
- we have revised down our **pre-measures receipts forecast** significantly (which raises borrowing and therefore shows as positive figures in this table). The overall revision reaches £15.3 billion in 2020-21, which is more than explained by weaker income tax and NICs receipts. These are down £23.1 billion in 2020-21, as the weakness this year is compounded by the downward revision to our productivity and earnings growth forecasts and our belief that more people than we previously thought will incorporate over coming years, which lowers their tax bills. Stronger corporation tax receipts – both onshore and from the North Sea – offset some of this latter change;

[2] ONS, *Statistical classification of registered providers of social housing in Scotland, Wales and Northern Ireland*, September 2016.
[3] ONS, *Public sector finances statistical bulletin (Recent events and forthcoming methodological changes)*, November 2016.

- our **debt interest forecast** is lower from 2017-18 onwards, having been pushed up by higher RPI inflation in 2016-17. That reflects lower interest rates, which more than offset the upward pressure on debt interest from higher inflation and borrowing;
- **other spending** has been revised up. The bigger changes include higher expected local authority spending and significant further upward revisions to incapacity and disability benefits spending. This revision also includes the effects of weaker sterling on our forecast for transfers to the EU from 2018-19 onwards, given our assumption that any future reduction in those transfers after leaving the EU will be recycled into extra domestic spending; and
- the **policy decisions** increase the deficit in every year. Capital spending plans have been increased by rising amounts across the Spending Review years to 2020-21 and into 2021-22. Gross tax rises (including another rise in the insurance premium tax and more anti-avoidance measures) outweigh its gross tax cuts (notably freezing fuel duty once again). Welfare spending is higher due to the decision shortly afterwards to abandon disability benefit cuts announced in the March Budget and the Autumn Statement decision to taper universal credit awards more slowly. Departmental resource spending has been boosted in 2019-20 and 2020-21, but has been held flat in real terms in 2021-22, thereby falling in real per capita terms and as a share of GDP. Other policy effects pushing up the deficit include a change in the policy assumption that the Government provided in relation to Network Rail capital spending beyond 2018-19 and the debt interest costs associated with higher borrowing.

1.29 Abstracting from classification changes, the cumulative increase in borrowing over the five years from 2016-17 to 2020-21 is equivalent to 1.1 per cent of GDP. Of this, 0.8 per cent of GDP reflects the revision to our pre-measures forecast, which makes it the third largest such revision we have made (after November 2011 and December 2012).

Table 1.3: Changes to public sector net borrowing since March

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
March forecast	**72.2**	**55.5**	**38.8**	**21.4**	**-10.4**	**-11.0**	
Classification changes		0.5	0.4	0.5	6.4	4.1	
March forecast post-classification change[1]	**72.2**	**56.0**	**39.2**	**21.9**	**-4.1**	**-6.9**	
Total forecast changes	**3.9**	**11.2**	**17.2**	**20.1**	**17.7**	**18.1**	
of which:							
Receipts	2.0	6.7	9.3	13.1	15.2	15.3	
CG debt interest spending	-0.7	0.8	-0.8	-3.4	-4.5	-4.3	
Other spending	2.5	3.7	8.7	10.4	6.9	7.0	
November forecast pre-policy decisions	**76.0**	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**	**11.6**
Total effect of Government decisions	**0.0**	**0.9**	**2.5**	**4.5**	**8.4**	**9.6**	**5.6**
of which:							
Scorecard receipts measures	0.0	0.0	-0.4	-0.6	-0.7	-0.6	-0.6
Scorecard AME spending measures	0.0	0.2	2.3	3.3	2.7	2.2	2.4
Changes to RDEL spending[2]	0.0	2.4	0.5	0.1	1.7	1.6	-5.0
Changes to CDEL spending[2]	0.0	-1.7	0.3	1.6	3.5	4.8	5.8
Non-scorecard measures	0.0	0.0	-0.3	0.0	0.9	0.9	0.9
Indirect effect of Government decisions	0.0	0.1	0.1	0.1	0.3	0.7	2.1
November forecast	**76.0**	**68.2**	**59.0**	**46.5**	**21.9**	**20.7**	**17.2**
Memo items:							
Overall change since March	*3.9*	*12.7*	*20.2*	*25.1*	*32.4*	*31.8*	
Overall like-for-like change since March	*3.9*	*12.2*	*19.8*	*24.6*	*26.0*	*27.7*	

[1] 2015-16 reflects outturn data and has not been adjusted for ONS classification decisions that have been announced but not yet implemented.
[2] The change in 2021-22 is relative to a baseline that assumes spending by departments would otherwise have remained constant as a share of potential GDP.
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.

1.30 Table 1.4 presents an alternative decomposition of the changes in our forecast since March, highlighting the assumed impact of the referendum result. This should be regarded only as illustrative, as we have to make simplifying assumptions about the degree to which movements in economic determinants and fiscal outturns since our last forecast can be attributed to the referendum result. Our approach is set out in Annex B. It is subject to considerable uncertainty, since we cannot be sure what would have happened in the absence of the vote and because movements in receipts and spending ahead of the referendum might have been affected by anticipation of the result.

1.31 After adjusting for classification changes and excluding the impact of measures, the table shows that our 'no referendum' counterfactual borrowing forecast would have been weaker than in March even though the economy forecast would have been stronger. Specifically:

- higher-than-projected **net inward migration** in the year to March would have prompted us to revise up our migration assumption for later years. This would have reduced borrowing up to 2018-19 and increased the surplus from 2019-20 onwards; but

- **receipts were lower and spending higher** than we forecast in March, even before the referendum. This suggests that the public finances were in a structurally weaker position than we thought, more than offsetting the effect of higher GDP growth; and

- **other fiscal forecast changes** would have been small and uneven from year to year. These would have included the boost to North Sea revenues from the higher oil price and the latest upward revision to spending on incapacity and disability benefits.

1.32 Relative to that illustrative 'no referendum' counterfactual, we have revised borrowing up significantly. That reflects a number of factors that we consider mostly referendum-related:

- **lower migration**. We have used the same migration assumption as in March, so this reverses the improvement that would have been in the counterfactual;

- **lower trend productivity growth**. This feeds through to weaker growth in earnings, profits and consumer spending, all of which reduce receipts. But it also feeds through to weaker growth in business investment, which boosts receipts by reducing the use of capital allowances. This effect builds steadily over the forecast period;

- **the cyclical slowdown in GDP growth**. This affects borrowing along the same channels as weaker trend productivity growth, but the effect is concentrated at the start of the forecast when we expect a negative output gap to open up;

- **higher inflation**. After stripping out the effect of higher dollar oil prices, we assume that most of the remaining upward revision to inflation in this forecast is predominantly referendum-related via the weaker pound. This pushes up borrowing via debt interest, public sector pensions, those elements of welfare spending that are not subject to the uprating freeze, and the cost of indexation in the tax system. That is only partly offset by the boost to excise duties where rates rise with inflation;

- **lower interest rates**. This reduces borrowing as the beneficial effect on debt interest spending more than offsets the loss of interest income on government assets; and

- **other factors**, including the fall in the pound, reduced activity in the property market, the effect on debt interest spending of the Bank's August monetary stimulus package and the strength of the stock market, push the deficit down in most years.

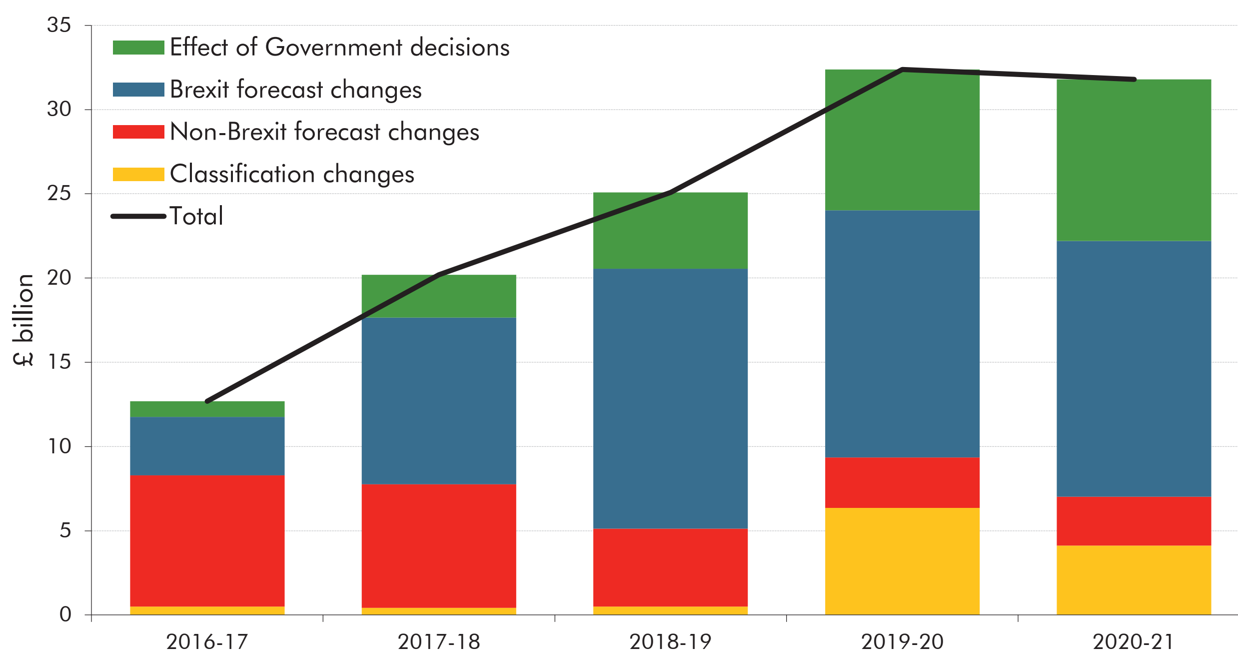
Table 1.4: Alternative decomposition of pre-measures borrowing forecast changes

	£ billion				
	Forecast				
	2016-17	2017-18	2018-19	2019-20	2020-21
March forecast	**55.5**	**38.8**	**21.4**	**-10.4**	**-11.0**
Classification changes	0.5	0.4	0.5	6.4	4.1
March forecast post-classification change	**56.0**	**39.2**	**21.9**	**-4.1**	**-6.9**
Changes unrelated to the referendum result and exiting the EU	**7.8**	**7.3**	**4.6**	**3.0**	**2.9**
of which:					
Higher migration and GDP growth	-0.8	-1.9	-3.0	-4.4	-5.9
Weaker in-year receipts	4.5	4.6	4.8	5.0	5.3
Higher in-year spending	2.9	2.9	2.9	2.9	2.9
Other factors	1.2	1.7	-0.1	-0.6	0.6
November counterfactual	**63.8**	**46.5**	**26.6**	**-1.1**	**-4.0**
Changes related to the referendum result and exiting the EU	**3.5**	**9.9**	**15.4**	**14.7**	**15.2**
of which:					
Lower migration	0.8	1.9	3.0	4.4	5.9
Lower trend productivity growth	0.0	1.2	4.2	5.5	7.2
Cyclical slowdown	2.3	7.6	8.6	5.4	2.3
Higher inflation	0.9	2.7	2.3	2.0	2.2
Lower interest rates	-0.5	-1.1	-1.3	-1.6	-1.8
Other factors	0.0	-2.5	-1.5	-1.1	-0.6
November forecast pre-policy decisions	**67.2**	**56.4**	**42.0**	**13.6**	**11.2**
Total effect of Government decisions	0.9	2.5	4.5	8.4	9.6
November forecast	**68.2**	**59.0**	**46.5**	**21.9**	**20.7**

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.

1.33 Chart 1.4 illustrates the relative importance of these factors and how they build or diminish over the forecast period. Classification changes are concentrated at the end of the period. Revisions between our restated March forecast and the no referendum counterfactual add to borrowing by diminishing amounts as the borrowing overshoot this year is gradually eroded by assuming higher migration. Revisions associated with the referendum and exiting the EU build over time due to the effect of lower productivity growth. Finally, the Government has added to borrowing in every year via Autumn Statement policy decisions.

Chart 1.4: Sources of changes to public sector net borrowing since March



Source: OBR

1.34 In March we expected public sector net debt (PSND) to have peaked as a share of GDP in 2015-16 (at 83.7 per cent) and that it would fall thereafter. Changes to our forecasts for borrowing and asset sales since March would be sufficient to push the peak year back to 2016-17, but once the effects on PSND of the August monetary policy package are added on top, the peak year in this forecast moves back further to 2017-18 at 90.2 per cent.

1.35 Table 1.5 decomposes the changes in our PSND forecast since March. It shows that:

- **weaker nominal GDP growth** at the start of the forecast pushes the debt-to-GDP ratio up in 2016-17 and particularly 2017-18;

- **higher borrowing** adds increasing amounts across the forecast period. The cumulative upward revision to our pre-measures borrowing forecast adds £100 billion to the level of PSND by 2020-21. The Government has added a further £26 billion to that with the policy decisions announced in the Autumn Statement;

- **lower asset sales proceeds** mean that PSND is not reduced by the amounts assumed in our March forecast. Absent any policy changes, lower share prices for Lloyds and particularly RBS would have reduced the forecast by £6 billion. But the biggest effect comes from the Government's decision that now is not the right time to sell RBS shares. That adds a further £12 billion to our PSND forecast relative to March;

- the Bank's **August monetary policy package** and other APF-related changes add over £100 billion to PSND by 2017-18. This includes £85 billion of TFS usage, £17 billion due to gilts being purchased at a premium (rising in future years as redemptions are

rolled over at greater premiums) and £10 billion of corporate bond purchases. The TFS effect unwinds after four years, reflecting the term of the funding provided;

- much higher **gilt premia,** due to the fall in market interest rates, are the only factor that reduces our forecast. In particular, index-linked gilts are sold with a minimum coupon of +0.125 per cent, but real yields at all maturities are currently negative by significant margins generating large premia on new issuance; and

- **other factors** include the small upward revision associated with the reclassification of Scottish, Welsh and Northern Irish housing associations into the public sector and the effect of sterling's fall on the unhedged portion of the foreign currency reserves.

Table 1.5: Changes to public sector net debt since March

	Per cent of GDP					
	Estimate	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
March forecast	83.7	82.6	81.3	79.9	77.2	74.7
November forecast	84.2	87.3	90.2	89.7	88.0	84.8
Change	**0.5**	**4.7**	**8.9**	**9.8**	**10.8**	**10.1**
of which:						
Change in nominal GDP[1]	-0.5	0.3	0.9	0.9	0.8	1.0
Change in cash level of net debt	1.0	4.4	8.0	8.9	10.0	9.2
	£ billion					
March forecast	1591	1638	1677	1715	1725	1740
November forecast	1610	1725	1840	1904	1945	1950
Change in cash level of net debt	**19**	**86**	**163**	**189**	**220**	**210**
of which:						
Pre measures borrowing changes	4	16	33	54	78	100
Effect of Government decisions on borrowing	0	1	3	8	16	26
Pre measures asset sales changes	0	13	5	6	8	8
Effect of Government decisions on asset sales	0	6	8	7	11	11
APF Term Funding Scheme	0	33	85	85	85	52
APF gilt holdings	-1	13	17	20	23	22
APF corporate bond holdings	0	3	10	10	10	10
Gilt premia	1	-8	-11	-14	-18	-24
Other factors[2]	16	10	12	13	9	6

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

[2] Includes the estimated impact of the reclassification of Scottish, Welsh and Northern Irish housing associations to the public sector.

Performance against the Government's fiscal targets

1.36 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of hitting its fiscal targets under existing policy. The *Charter* has been updated a number of times in recent years. The last version was approved by Parliament in October 2015. The Government has presented a new draft *Charter* alongside the Autumn Statement that will be voted on in due course.

1.37 The current version of the *Charter* sets out targets for borrowing, debt and welfare spending that are assessed in this forecast:

- the **fiscal mandate**, which requires a surplus on public sector net borrowing by the end of 2019-20 and in each subsequent year;
- the **supplementary target**, which requires public sector net debt to fall as a percentage of GDP in each year to 2019-20; and
- the **welfare cap**, a limit on a subset of welfare spending, at cash levels set out by the Treasury for each year to 2020-21 in the July 2015 Budget.

1.38 The new draft *Charter* states that the Government's objective for fiscal policy is now to "*return the public finances to balance at the earliest possible date in the next Parliament*". It also sets out proposed targets for borrowing, debt and welfare spending that require:

- the **structural deficit** (cyclically adjusted public sector net borrowing) to be below 2 per cent of GDP in 2020-21;
- **public sector net debt** to fall as a percentage of GDP, but only by 2020-21 rather than in every year from now; and
- a subset of welfare spending to be below a new **welfare cap** that has been set for 2021-22 only and in line with our latest forecast, with no formal assessment to be made until the start of the next Parliament.

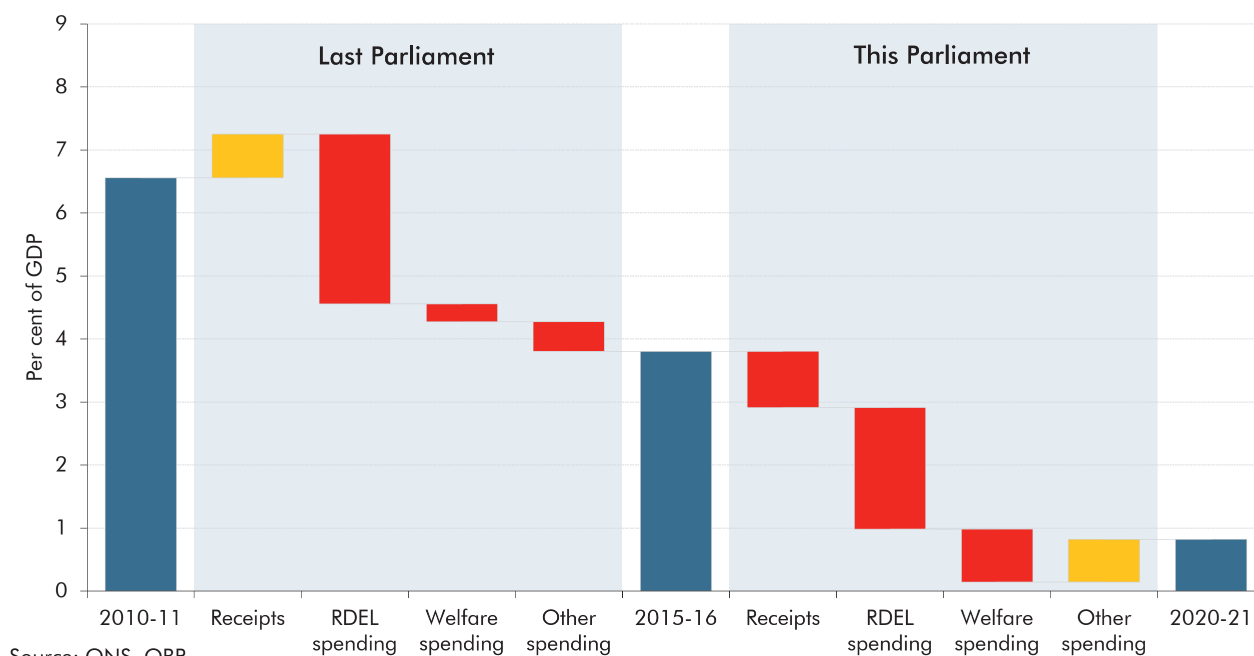
1.39 With our underlying borrowing forecast higher – and policy decisions pushing the deficit up further – the Government's existing fiscal targets would all be missed by considerable margins. The 'fiscal mandate' requires a budget surplus in 2019-20, but we now forecast a deficit of £21.9 billion. The 'supplementary target' requires debt to fall relative to national income every year, but we now expect it to rise sharply this year and next – partly due to August's monetary policy changes. And the 'welfare cap' requires a subset of welfare spending to be held below a cash limit set in July 2015, but we now expect this to overshoot by more than 7 per cent by 2020-21. These rules do not apply in the event of a 'significant negative shock' on the Government's definition, but with our growth forecast remaining above 1 per cent this escape clause is not triggered.

1.40 The Government has proposed new targets in a draft *Charter* alongside the Autumn Statement. These are less constraining than the existing ones. The structural deficit must be below 2 per cent of GDP in 2020-21, which would be met by halving the structural deficit in this Parliament. Debt must fall relative to national income in 2020-21. The new welfare cap only applies in 2021-22 and is only to be assessed at the start of the next Parliament.

1.41 Chart 1.5 shows the factors that contribute to the 3.0 per cent of GDP reduction in the structural deficit over this Parliament – up to the target year of 2020-21 – and how that compares with the 2.8 per cent reduction in the last Parliament. Structural reductions in

public spending are most important in both periods, with cyclically adjusted receipts actually falling by 0.7 per cent of GDP in the last Parliament and rising by only 0.9 per cent in this one. Within spending, cuts to day-to-day departmental spending dominate both periods – 2.7 per cent of GDP in the last Parliament and 1.9 per cent in this – while cuts to welfare spending have also been significant – 0.3 and 0.8 per cent respectively. Day-to-day departmental spending is set to fall 6.4 per cent in real per capita terms in this Parliament.

Chart 1.5: Sources of changes to the structural deficit over two Parliaments



Source: ONS, OBR

1.42 On current policy the structural deficit would narrow significantly in 2019-20 (reflecting the relatively steep spending cuts for that year set out in the March Budget), but is broadly flat over the following two years. This sets the platform for the Government's aim of returning the public finances to balance at the earliest possible date in the next Parliament, which will also take place against a backdrop of significant fiscal headwinds from an ageing population. We will consider this in more detail when we update our long-term fiscal projections later this fiscal year. But these headwinds are evident from our 2015 *Fiscal sustainability report*, which showed that demographic pressures on health, long-term care and state pensions spending would cause the fiscal balance to deteriorate by 0.8 per cent of GDP between 2020-21 and 2025-26.

1.43 Focusing on state pensions, extending our latest spending forecast to 2025-26 shows how much faster the caseload is expected to rise in the next Parliament than in this and the last. Further ageing of the population is one factor, but the biggest difference is that caseload growth has been held down by the ongoing process of equalising the male and female state pension ages at age 65 (due to be completed in November 2018) and then increasing them to 66 for both men and women (scheduled to take place between December 2018 and October 2020). The state pensions caseload increased by 3.0 per cent in the last Parliament

and is expected to fall 2.6 per cent in this Parliament, but in the next it is projected to jump 9.1 per cent. That alone would push state pensions spending up by 0.3 per cent of GDP.

1.44 The uncertainties around our central forecast reflect those regarding the outlook for the economy and those regarding the performance of revenues and spending in any given state of the economy. So we test the robustness of our judgement in three ways:

- first, by looking at **past forecast errors**, if our central forecasts are as accurate as official forecasts were in the past, then there is only a roughly 35 per cent chance that the headline budget balance would be in surplus (as the existing fiscal mandate requires), but a 65 per cent chance that the structural deficit would be below 2 per cent of GDP (as the less constraining proposed fiscal mandate requires);
- second, by looking at its **sensitivity to key features of the economy forecast**. The 1.2 per cent of GDP margin relative to the 2 per cent target could fall to zero if potential output was 2.4 per cent lower, if the effective tax rate was 1.2 per cent of GDP lower for structural reasons or if the planned spending cuts – which reduce RDEL by 1.7 per cent of GDP between 2016-17 and 2020-21 – fell short by around three-quarters; and
- third, by looking at **alternative economic scenarios**. We have considered the implications of higher or lower productivity growth – the most important uncertainty in our (and most people's) forecast. The fiscal implications of these scenarios are largely driven by receipts. Changes in productivity growth affect earnings growth (and thus income tax and NICs receipts), consumer spending (VAT), profits (corporation tax) and business investment (the capital allowances that firms set against corporation tax liabilities). In the weak productivity scenario, all the existing targets are missed – as in our central forecast – but so is the proposed fiscal mandate, narrowly. In the strong productivity scenario, all the proposed targets are met – as in our central forecast – but the existing mandate would be met, with the budget moving into surplus in 2019-20.