# 1 Executive summary

Overview

1.1 The new Government has used its first Budget to loosen significantly the impending squeeze on public services spending that had been pencilled in by the Coalition in March. This is being financed by welfare cuts, net tax increases and three years of higher government borrowing. The Government has delayed the expected return to a budget surplus by a year to 2019-20, but is then aiming for a slightly bigger surplus in the medium term.

1.2 The Government's provisional spending assumptions imply that Resource Departmental Expenditure Limits (RDEL) – which cover day-to-day central government spending on public services, grants and administration – would be £83.3 billion higher in total over the current Parliament than the Coalition suggested in March. The Government has also announced tax cuts costing £24.6 billion over the Parliament, primarily cutting corporation tax rates, raising the income tax personal allowance and extending inheritance tax relief for main residences.

1.3 These 'giveaways' are being financed from five main sources:

- tax increases raise £47.2 billion over the Parliament, including increases in dividend taxation, insurance premium tax and vehicle excise duty, plus cuts in pensions tax relief, earlier corporation tax payments, and anti-avoidance and evasion measures;

- welfare cuts raise £34.9 billion. These include a four-year freeze in the uprating of most working-age benefits, cuts in the generosity of tax credits and reduced work allowances in universal credit. The Government will also force local authorities and housing associations to cut rents, thereby reducing the cost of housing benefit;

- other spending decisions raise £8.1 billion. These include reductions in departmental capital spending and a cut in funding for the BBC reaching £745 million in 2020-21;

- these various tax and spending decisions have indirect effects that raise a further £14.2 billion. These include the pension contributions that would be paid by additional public sector workers, and higher income tax and NICs receipts; and

- the Budget decisions also imply £3.5 billion of extra borrowing over the Parliament, on top of the £14.6 billion increase implied by our pre-measures forecast. This includes £16.7 billion of additional borrowing between 2016-17 and 2018-19, to help avoid the sharpest cuts in public services spending. Thereafter the Government uses some of the welfare cuts and tax increases to aim for bigger budget surpluses.

1.4   On the basis of these provisional plans, the forthcoming Spending Review would be a lot less challenging than it appeared in March. The Government would have to identify further real cuts in public services spending rising to a peak of £17.9 billion in 2019-20, rather than £41.9 billion in 2018-19. Thereafter spending is assumed to rise again in real terms. Public services spending would fall by an average of 1.5 per cent a year in real terms over this Parliament as a whole, slightly less than the 1.6 per cent a year cuts over the last.

1.5   We now forecast that public sector net borrowing will total £69.5 billion this year, down £5.8 billion since March thanks to stronger-than-expected revenues, the spending cuts announced in June, the rise in insurance premium tax and a delay to the introduction of tax-free childcare. The deficit then declines more slowly than in March, moving into surplus by £10.0 billion in 2019-20, increasing to £11.6 billion in the following year.

1.6   Chart 1.1 summarises the impact of the Budget policy decisions across the forecast. Modest spending cuts and tax increases reduce borrowing a little this year. Over the following three years the welfare cuts and tax increases mount steadily, but they are not large enough to pay for the higher public services spending and tax cuts – hence the need for more borrowing to fill the gap. In the final two years the welfare cuts, tax increases and indirect effects more than pay for the tax cuts and (smaller) additions to public services spending – increasing the then budget surplus. In 2020-21, the Budget raises £13.3 billion from welfare cuts, £15.9 billion from tax increases and £6.1 billion from lower departmental capital spending, other measures and indirect effects. This pays for £21.6 billion more public services spending, £9.4 billion of tax cuts and a £4.3 billion bigger budget surplus.

Chart 1.1: The impact of Budget policy decisions over the forecast
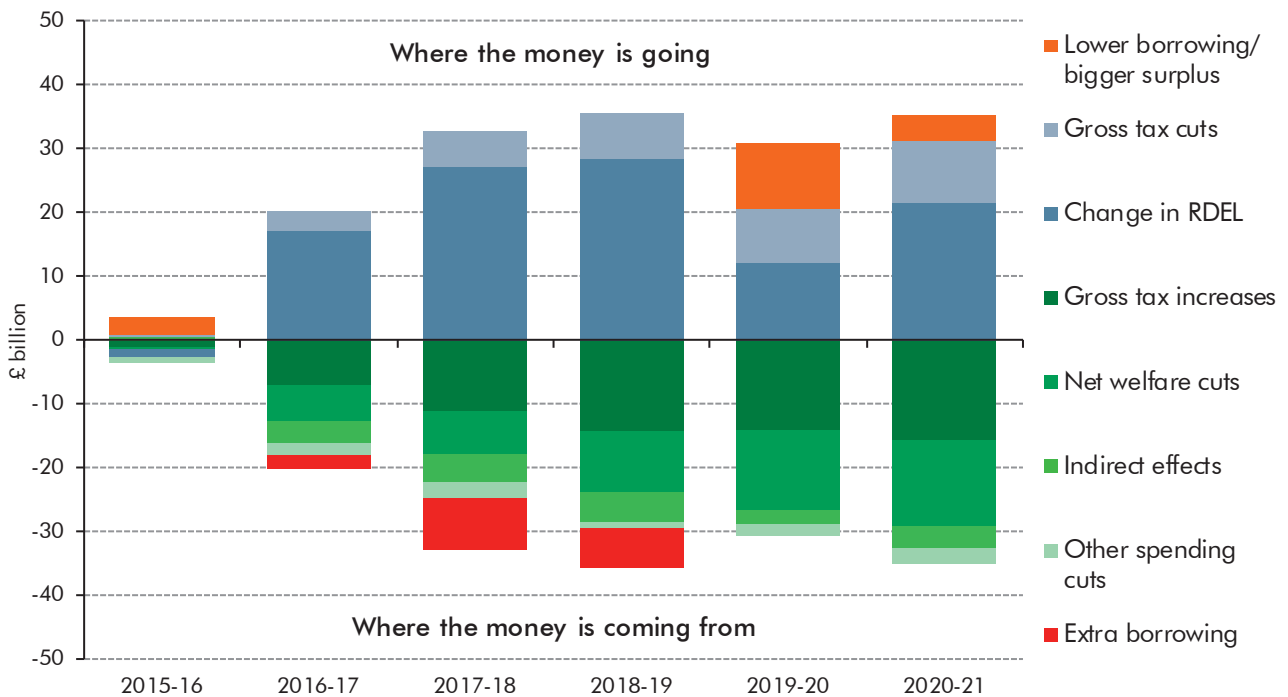
Source: OBR

1.7 The Chancellor said in his March Budget speech that he wanted to raise £12 billion from welfare cuts and £5 billion from anti-avoidance and evasion measures by 2017-18. As defined in the Treasury's scorecard of policy measures, this Budget raises £7.0 billion from welfare cuts and £2.4 billion from 'avoidance and tax planning, evasion and compliance, and imbalances in the tax system'. These rise to £12.1 billion and £5.0 billion in 2019-20.

1.8 The Budget policy measures take place against the backdrop of an underlying economic and fiscal forecast that has changed relatively little since our last forecast in March. We have not adjusted our economy forecast for the potentially disruptive events in Greece that were still unfolding when we closed the pre-measures forecast on 25 June.

1.9 In terms of our economy forecast, since March:

- we have revised GDP growth in 2015 down to 2.4 per cent, reflecting the weaker-than-expected start to the year and a small drag from the in-year public spending cuts announced in June. Growth is unchanged since March in 2016, as we assume that the effect of the in-year cuts will be back-loaded, offsetting the slower cuts in 2016-17. Growth is then up a little in 2017, reflecting the slower pace of fiscal tightening;

- we have made small upward revisions to unemployment and downward revisions to hours worked in the final years of the forecast. That reflects higher labour costs from the introduction of the National Living Wage. We assume that this would raise the effective minimum wage for those aged 25 and above by over 13 per cent by 2020;

- the negative output gap is estimated to be slightly wider at the start of 2015, and is expected to close slightly later, in mid-2018; and

- our inflation forecast is little changed, remaining very low for the rest of the year, then rising in 2016 and returning slowly to the 2 per cent target over the forecast period.

1.10 Excluding the impact of policy measures, our forecasts for public sector net borrowing are up a little since March. Receipts are stronger, by an average of £3.9 billion a year across the forecast, but our forecast for annually managed expenditure is up by £6.3 billion a year. That includes the effect of higher interest rates on debt interest payments, higher spending associated with environmental levies and a methodological change that raised our net public sector pensions forecast.

1.11 In addition to the sales of Lloyds shares and mortgage assets held by UK Asset Resolution that were announced in March, the Government has now said that it will sell some of its RBS shares, its remaining stake in Royal Mail and its shares in King's Cross Central Partnership this year. Together with the initial tranche of sales of the pre-2012 student loan book, these asset sales should reduce public sector net debt by £32 billion in 2015-16. The Government has also announced plans to sell three-quarters of its shares in RBS over the Parliament, which we assume will raise around £6 billion a year from 2016-17 to 2019-20. Financial asset sales typically bring forward cash that would otherwise have been received later in mortgage repayments and dividends, so they only reduce net debt temporarily.

1.12 The Government has proposed two new fiscal targets in this Budget: to achieve a surplus on public sector net borrowing in 2019-20 (and then every year in 'normal times') and for public sector net debt to fall as a share of GDP every year up to 2019-20. Our central forecast is consistent with it meeting those targets, as well as those still in force from the previous Coalition government, namely: the fiscal mandate (to balance the cyclically adjusted current budget in the third year of the forecast period) and the supplementary target (for debt to fall as a share of GDP in the fixed year of 2016-17).

Economic developments since our previous forecast

1.13 Since our previous forecast was published in March, the Office for National Statistics (ONS) has revised up GDP growth in 2014 to 3.0 per cent, with stronger private consumption and private investment growth explaining most of the change. But the ONS has also estimated that GDP growth in the first quarter of 2015 was 0.4 per cent, below the 0.7 per cent we forecast in March. CPI inflation has moved in line with our March expectation, partly reflecting the relative stability of oil prices in recent months.

1.14 Global developments have been mixed since we finalised our March forecast. GDP in the US unexpectedly fell in the first quarter of 2015, although some of the weakness related to bad weather and to labour disputes disrupting port activity. In contrast, the euro area had been looking more positive as monetary policy has been eased, fiscal tightening has slowed, and recent falls in the euro and a lower oil price have supported the economy. But those tentative signs of improvement in activity must be weighed against the risks associated with the escalation of the Greek debt crisis in recent weeks.

The economic outlook

1.15 GDP growth was lower than we had expected in the first quarter of 2015, but we do not expect that weaker momentum to have persisted into the second quarter. CPI inflation and unemployment have moved much as we expected. Absent the effect of policy changes, our quarterly GDP forecast would have been unchanged through the rest of 2015. But there is particular uncertainty associated with the Greek debt crisis, which was still unfolding as we closed our forecast. We have not adjusted the forecast to reflect any instability in the euro area or spillover effects to the UK economy that might result, but the experience of 2011 and 2012 (let alone 2008 and 2009) shows that international shocks that undermine wider financial, business and consumer confidence can damage growth prospects.

1.16 With relatively little news affecting our economy forecast since March, the small changes we have made mostly result from the policy changes announced in the Budget:

- the pace and composition of fiscal consolidation has changed significantly. Bigger cuts in public spending in 2015-16 have reduced quarterly growth in late 2015 and early 2016. The significant slowing in the pace of spending cuts thereafter has raised quarterly growth through the rest of 2016. We have assumed that changes in later years will have only small effects on growth as the Bank of England will be able to factor them into its judgements when setting monetary policy;

- our inflation forecast has been affected by a number of policy measures, the most significant of which are the increase in vehicle excise duty rates in 2017 and the decision to force social sector landlords to reduce rents by 1 per cent a year from 2016. As these are administered prices, we have assumed that the Bank of England will look through these effects when setting monetary policy; and

- we have made small adjustments to our assumptions for structural unemployment and potential output in light of the Government's decision to introduce a Living Wage Premium on top of the National Minimum Wage for people aged 25 and over. The response of firms and the impact on the labour market are subject to significant uncertainty. We have assumed that the increased labour costs will lead to a reduction in total hours worked of around 0.4 per cent – split equally between reduced average hours and around 60,000 fewer people in employment. But we have assumed a smaller reduction in total output of around 0.1 per cent, since the reduction in hours worked will be concentrated among people earning lower wages. Annex B describes how we have estimated these effects, and the uncertainties around them.

1.17 We forecast stable GDP growth over the forecast, averaging 2.4 per cent a year and dipping only slightly in 2016 when the pace of fiscal tightening is greatest. That reflects above-trend growth in the early years of the forecast, as the small negative output gap closes, then on-trend growth thereafter. The underlying trend rate of growth picks up slowly over the forecast, as productivity growth slowly returns to historically normal rates. Inflation is forecast to remain very low for the rest of 2015, to pick up quite sharply in 2016 and then to return slowly to the 2 per cent target. The small but persistent negative effect on inflation from the social rents policy is one reason for the protracted return to target, along with the lagged effect of recent sterling appreciation and falls in global commodity prices.

Table 1.1: Overview of the economy forecast

|	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2014	2015	2016	2017	2018	2019	2020
Output at constant market prices							
Gross domestic product (GDP)	3.0	2.4	2.3	2.4	2.4	2.4	2.4
GDP levels (2014=100)	100.0	102.4	104.8	107.4	109.9	112.5	115.2
Output gap	-1.0	-0.6	-0.4	-0.2	0.0	0.0	0.0
Expenditure components of GDP							
Household consumption	2.5	3.0	2.5	2.4	2.4	2.3	2.0
General government consumption	1.6	1.2	0.5	0.3	0.1	0.3	2.6
Business investment	8.0	6.0	7.2	6.9	6.6	6.5	4.7
General government investment	3.4	2.4	-0.1	0.9	2.4	2.3	2.0
Net trade[1]	-0.6	-0.5	-0.4	-0.2	-0.2	-0.2	-0.2
Inflation							
CPI	1.5	0.1	1.1	1.6	1.8	1.9	2.0
Labour market							
Employment (millions)	30.7	31.2	31.5	31.6	31.7	31.9	32.1
Average earnings	2.6	2.2	3.6	3.9	3.9	4.1	4.4
LFS unemployment (% rate)	6.2	5.4	5.1	5.2	5.3	5.4	5.4
Claimant count (millions)	1.04	0.78	0.73	0.75	0.77	0.78	0.79
	Changes since March forecast						
Output at constant market prices							
Gross domestic product (GDP)	0.4	-0.1	0.0	0.1	0.1	0.0	
GDP levels (2014=100)	0.0	-0.1	0.0	0.0	0.1	0.1	
Output gap	0.0	-0.2	-0.2	-0.1	0.0	0.0	
Expenditure components of GDP							
Household consumption	0.5	0.5	-0.2	-0.1	0.0	0.1	
General government consumption	0.0	0.5	1.3	1.2	0.3	-1.2	
Business investment	1.2	0.9	-0.3	0.4	0.1	2.1	
General government investment	-3.9	0.0	-2.1	-0.7	0.9	-0.5	
Net trade	-0.1	-0.4	0.0	0.0	0.0	0.0	
Inflation							
CPI	0.0	-0.1	-0.1	0.0	-0.1	-0.1	
Labour market							
Employment (millions)	0.0	0.1	0.1	0.1	0.0	0.0	
Average earnings	0.4	-0.1	0.5	0.2	0.0	-0.3	
LFS unemployment (% rate)	0.0	0.1	-0.1	-0.1	0.0	0.0	
Claimant count (millions)	0.00	0.01	-0.01	-0.01	0.00	0.01	

[1] Contribution to GDP growth.

1.18 Employment growth has remained relatively strong in early 2015, while productivity has continued to disappoint. We forecast that employment will increase by 1.1 million over the next six years, more than explained by population growth. Our unemployment forecast is little changed in the early years of the forecast, but has been revised up fractionally later. That reflects a number of offsetting factors that have shifted our assumption about the structural unemployment rate (specifically, the non-accelerating inflation rate of unemployment or NAIRU). Before looking at the effect of policy changes announced in the Budget, we would have reduced the NAIRU slightly as unemployment was approaching our

previous estimate with only early signs of earnings growth picking up. But our estimate of the effect on employment of the Living Wage Premium has slightly more than offset that pre-measures judgement, lifting our medium-term estimate of the NAIRU to 5.4 per cent.

1.19   We have made relatively small adjustments to our residential property forecasts. We expect property transactions to be a little stronger this year than we forecast in March, in part reflecting the pick-up in mortgage approvals in recent months. But we have revised down our expectations for house price growth, having taken the view that the rationing effects of the regulatory and banking environment are likely to persist for longer than we assumed in March. That judgement about mortgage availability also means that we have revised down our forecast of the household debt-to-income ratio.

1.20   There is considerable uncertainty around any economic forecast. Chart 1.2 presents our central growth forecast with a fan showing 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.

Chart 1.2: Real GDP growth fan chart
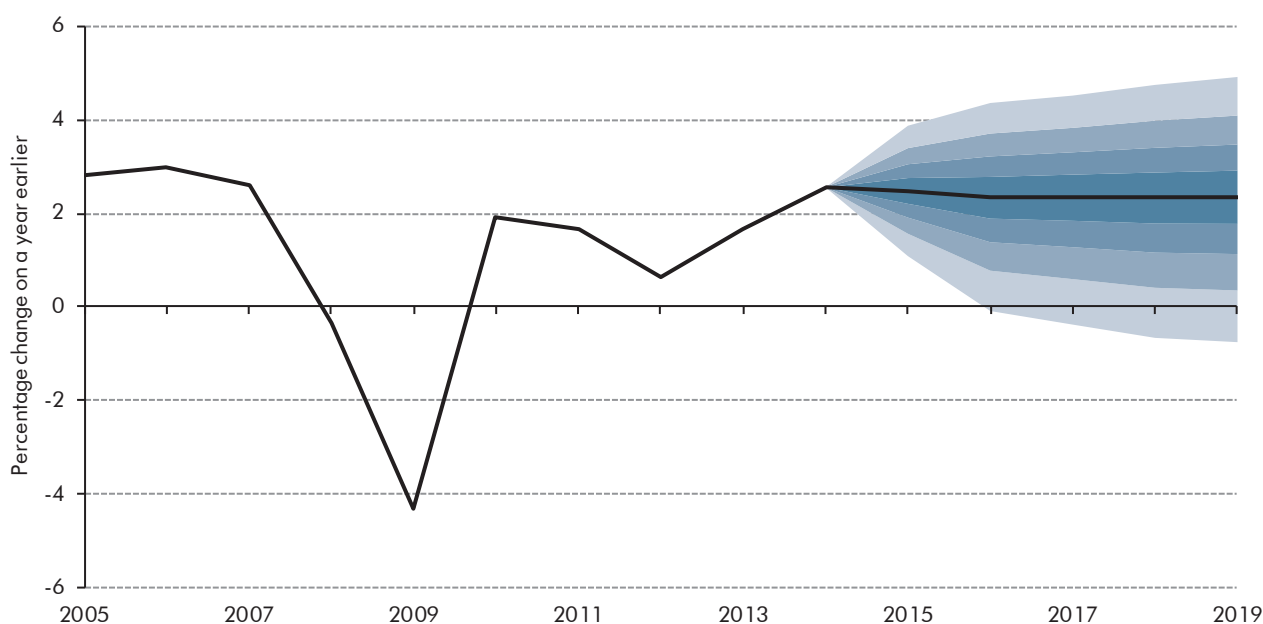
Source: ONS, OBR

The fiscal outlook

1.21   Public sector net borrowing peaked at 10.2 per cent of GDP (£153.5 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 4.9 per cent of GDP (£89.2 billion) by 2014-15. Table 1.2 shows that we expect the deficit to continue falling, and the budget to move into surplus in 2019-20, a year later than in our March forecast.

1.22   In structural terms – adjusting for the ups and downs of the economic cycle – the 0.5 per cent of GDP surplus in 2019-20 and 2020-21 would be the largest in at least 40 years, just topping the 0.4 per cent estimate for 2000-01. The table also shows that we expect public sector net debt to have peaked as a share of GDP last year and to fall in each year of the forecast period. Net debt is expected to fall to 68.5 per cent of GDP in 2020-21, having reversed around a quarter of the increase seen in the wake of the financial crisis.

Table 1.2: Fiscal forecast overview

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Headline fiscal aggregates							
Public sector net borrowing	4.9	3.7	2.2	1.2	0.3	-0.4	-0.5
Cyclically adjusted net borrowing	4.1	3.2	2.0	1.1	0.3	-0.5	-0.5
Current budget deficit	3.2	2.2	0.8	-0.2	-1.1	-1.8	-1.9
Fiscal mandate and supplementary target							
Cyclically adjusted deficit on current budget	2.4	1.7	0.5	-0.3	-1.1	-1.8	-1.9
Public sector net debt	80.8	80.3	79.1	77.2	74.7	71.5	68.5
	Changes since March forecast						
Headline fiscal aggregates							
Public sector net borrowing	-0.1	-0.3	0.2	0.6	0.5	-0.1	
Cyclically adjusted net borrowing	-0.1	-0.4	0.1	0.5	0.5	-0.1	
Current budget deficit	0.1	0.3	-0.2	-0.6	-0.6	0.1	
Fiscal mandate and supplementary target							
Cyclically adjusted deficit on current budget	0.1	0.4	-0.1	-0.5	-0.6	0.1	
Public sector net debt	0.4	0.0	-0.6	-0.6	-0.1	-0.1	

Changes in public sector net borrowing and net debt

1.23   Chart 1.3 shows how our borrowing forecasts have changed between March and July. The pattern of revisions across the forecast is uneven from year to year, largely reflecting the uneven path of borrowing in March – in particular the steep fall in 2016-17 and 2017-18 – that has been smoothed by the Government in this Budget.

Chart 1.3: Public sector net borrowing
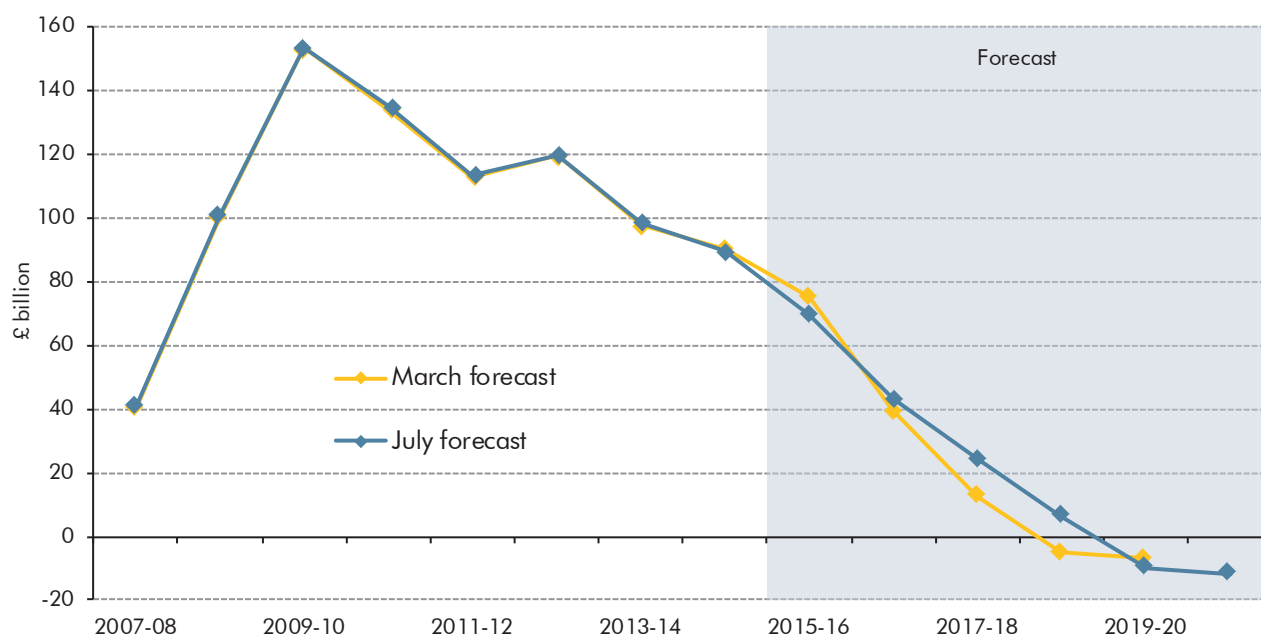
Source: ONS, OBR

1.24 Table 1.3 breaks down the revision in borrowing since March into different sources of change. (The table shows the effect of revisions on borrowing, so an upward revision to receipts is shown as a negative since it reduces borrowing.)

1.25 We have revised borrowing down by £5.8 billion in 2015-16. That reflects:

- stronger than expected receipts growth, particularly income tax, VAT and stamp duty on property transactions; and

- Government decisions that bear down more heavily on the deficit this year, including in-year cuts to DEL spending, raising the insurance premium tax rate and the decision to delay the introduction of tax-free childcare following a legal challenge.

1.26 We have revised borrowing up in 2016-17 and more significantly in 2017-18, while the surplus of £5.2 billion in 2018-19 that we forecast in March is now expected to be a deficit of £6.4 billion. The higher borrowing over these three years reflects the net effect of:

- upward revisions to our receipts forecast (before the effects of Budget policy decisions). The biggest source of improvement has been income tax and NICs. Receipts have also been boosted relative to March by a classification change, with expected costs of tax litigation cases switched from negative tax to capital grants (in line with National Accounts guidelines) and by an upward revision to environmental levies, which are neutral for borrowing because they increase spending equally;

- upward revisions to annually managed expenditure (AME) (again, before the effects of Budget policy measures). A methodological change raised our forecast of net public

service pension costs, while higher gilt rates, the revisions to environmental levies and the treatment of tax litigation costs also raised AME. Our forecast for payments to EU institutions is higher for 2016-17 than in March, due to a change in the expected timing of adjustments to UK contributions;

- the receipts and AME measures on the Budget 'scorecard' reduce borrowing by £12.8 billion a year on average. These include a net tax increase averaging £5.3 billion a year and cuts in welfare spending averaging £7.4 billion a year. We note in Annex A that the uncertainty around the expected yield from many of the revenue-raising measures exceeds that around most of the tax cuts;

- the scorecard measures are more than offset by the Government's decision to increase provisional departmental spending totals significantly relative to the amounts pencilled in by the Coalition Government in March. The increases in day-to-day spending on public services, grants and administration (RDEL in the table) by £24.2 billion a year on average. Relative to March, RDEL has been increased by around 6 per cent in 2016-17, 9 per cent in 2017-18 and 10 per cent in and 2018-19. Conversely, capital DEL has been reduced by a relatively modest £1.6 billion a year on average. (We treat changes in DEL spending as policy decisions, as the Government is aware of the rest of our forecast when setting the path of spending from which DELs are inferred); and

- part of the overall fiscal loosening is unwound through its indirect effects on the economy and therefore net borrowing. The largest indirect effects come through higher income tax receipts (due to higher nominal GDP growth) and lower net public service pension costs (due to smaller falls in the workforce making contributions to the schemes). The introduction of the Living Wage Premium also has a very small net effect on borrowing, as described in Annex B.

1.27 In 2019-20, we have revised the expected surplus up a little. The Government chose to increase RDEL by less than for the earlier years, which means that scorecard measures were sufficient to offset forecast changes that would otherwise have reduced the expected surplus.

1.28 The surplus rises very slightly in 2020-21, as the Government has chosen to increase RDEL as a share of GDP. This offsets various factors that would otherwise have increased the surplus further. (In Table 1.3, this increase in RDEL as a share of GDP explains why the change in cash terms is shown rising from £12.1 billion in 2019-20 to £21.6 billion in 2020-21.) The underlying factors that would have increased the surplus include fiscal drag in the tax system (when income tax thresholds rise by inflation, but earnings rise faster because of productivity) and in the welfare system (when benefits rise by inflation, reducing average awards relative to average earnings in the wider economy).

Table 1.3: Changes to public sector net borrowing since March

	£ billion						
	Estimate	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
March forecast	90.2	75.3	39.4	12.8	-5.2	-7.0	
July forecast	89.2	69.5	43.1	24.3	6.4	-10.0	-11.6
Change	**-1.0**	**-5.8**	**3.7**	**11.5**	**11.6**	**-3.0**	
Changes to the receipts forecast[1]	**-1.9**	**-5.5**	**-10.3**	**-12.6**	**-13.5**	**-10.0**	
Forecast changes	-1.9	-4.9	-3.7	-4.0	-3.5	-3.1	
Effect of Government decisions	0.0	-0.6	-6.5	-8.5	-9.9	-6.9	-8.2
of which:							
Scorecard measures	0.0	-1.0	-4.0	-5.1	-6.8	-5.8	-6.5
Indirect effect of Government decisions	0.0	0.4	-2.5	-3.4	-3.1	-1.1	-1.7
Changes to current AME spending[1]	**0.6**	**2.2**	**-2.3**	**-2.0**	**-2.5**	**-3.7**	
Forecast changes	0.6	2.2	4.1	6.0	8.8	10.1	
Effect of Government decisions	0.0	0.0	-6.5	-8.1	-11.3	-13.8	-15.7
of which:							
Welfare scorecard measures	0.0	-0.3	-5.6	-6.9	-9.7	-12.5	-13.3
Other scorecard measures	0.0	0.1	0.0	0.0	-0.1	-0.3	-0.6
Indirect effect of Government decisions	0.0	0.2	-0.9	-1.2	-1.5	-1.0	-1.8
Changes to RDEL spending[2]	**0.9**	**-1.3**	**17.2**	**27.0**	**28.3**	**12.1**	**21.6**
Changes to capital spending[1]	**-0.5**	**-1.3**	**-0.8**	**-0.9**	**-0.8**	**-1.3**	
Forecast AME changes[3]	-0.1	-0.3	0.9	1.4	0.1	0.4	
Scorecard AME measures	0.0	0.0	0.0	-0.2	0.0	-0.1	-0.1
Changes to CDEL spending[2,3]	-0.5	-1.0	-1.8	-2.1	-0.8	-1.6	-1.9
	Summary of changes						
Total forecast change	**-1.4**	**-3.0**	**1.3**	**3.4**	**5.4**	**7.4**	
Total effect of Government decisions	**0.4**	**-2.8**	**2.4**	**8.0**	**6.3**	**-10.4**	**-4.3**
of which:							
Scorecard receipts and AME measures	0.0	-1.2	-9.6	-12.2	-16.7	-18.7	-20.5
RDEL and CDEL changes[3]	0.4	-2.3	15.4	24.8	27.5	10.5	19.8
Indirect effect of Government decisions	0.0	0.6	-3.4	-4.6	-4.6	-2.2	-3.5

[1] 2014-15 has been adjusted to remove the effect of ONS measurement differences. See supplementary tables published on our website for more information.

[2] The change in 2020-21 is relative to a baseline that assumes spending by departments would otherwise have remained constant as a share of potential GDP.

[3] CDEL and capital AME changes have been adjusted to exclude the £0.9 billion switch from CDEL to capital AME in 2015-16 as a result of the GAD-Milne case, and to exclude the switch from CDEL to capital AME that reflects the reclassification of government grants to Network Rail in our forecast, which is explained in note 1 of Table 4.17.
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.

1.29　As Table 1.2 showed, the changes described above mean that the budget balance improves in every year of the forecast, but less quickly than we forecast in March. We also expect public sector net debt (PSND) to fall as a share of GDP in every year of the forecast. As well as changes to borrowing, our debt forecast has been revised substantially due to the further asset sales announced in the Budget and to a number of changes to the way we convert our borrowing forecast (an accrued measure) to an estimate of the net cash requirement (the cash measure of borrowing that drives changes in net debt). Table 1.4 shows that:

- upward revisions to our nominal GDP forecast have reduced the ratio in most years, but the downward revision to in 2019-20 has had the opposite effect;

- changes to net borrowing have added £17 billion to debt by 2019-20;

- additional asset sales have taken a further £8 billion off net debt in 2015-16, rising to £31 billion by 2019-20. The biggest effect over the forecast comes from the Government's announcement that it will sell three-quarters of its holdings of RBS shares over the Parliament. We have assumed that this will raise around £25 billion in total, with £2 billion raised this year and around £6 billion a year thereafter; and

- revisions to outturn data have raised net debt in 2014-15, which is pushed through to subsequent years of the forecast. A correction to the treatment of APF cash balances in our forecast has also increased debt from 2015-16 onwards.

Table 1.4: Changes to public sector net debt since March

| | Per cent of GDP | | | | | | |
| | Estimate | Forecast | | | | | |
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
March forecast	80.4	80.2	79.8	77.8	74.8	71.6	
July forecast	80.8	80.3	79.1	77.2	74.7	71.5	68.5
Change	**0.4**	**0.0**	**-0.6**	**-0.6**	**-0.1**	**-0.1**	
of which:							
Change in nominal GDP[1]	0.1	0.1	-0.4	-0.4	-0.2	0.3	
Change in cash level of net debt	0.3	-0.1	-0.2	-0.1	0.1	-0.4	
	£ billion						
March forecast	1479	1533	1580	1606	1617	1627	
July forecast	1486	1532	1576	1603	1619	1618	1627
Change in cash level of net debt	**6**	**-1**	**-5**	**-3**	**1**	**-9**	
of which:							
Changes to borrowing	-1	-7	-3	8	20	17	
Asset sales	0	-8	-14	-19	-25	-31	
Gilt premia	1	4	3	1	0	0	
Asset purchase facility	0	2	2	2	2	2	
Outturns	3	3	3	3	3	3	
Other factors	3	4	4	2	1	0	

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

1.30 The level of PSND can be affected by classification decisions that move institutions across the boundary between private and public sectors in the National Accounts. One classification uncertainty that may be relevant to future forecasts relates to housing associations. At present, these are classified in the private sector, so their income, spending and debt do not feature in our forecast. But there is a risk that Government policies – including the social rent measure in this Budget and the Right-to-Buy proposals that are not yet firm enough to be included in this forecast – could prompt the ONS to reconsider this classification. If housing associations were to be classified as part of the public sector, their approximately £60 billion of debt would be added to PSND while the social rent reduction

policy announced in this Budget would increase rather than reduce PSNB because the full amount of the rent reduction would then reduce public sector income, and outweigh the housing benefit and other expenditure savings.

The path of departmental spending over the forecast

1.31   The most striking feature of the fiscal plans set out in this Budget is the implications they have for the potential path of public services spending. Resource Departmental Expenditure Limits (RDEL) – which cover day-to-day central government spending on public services, grants and administration – are £83.3 billion higher in total over the current Parliament (2015-16 to 2019-20) than was assumed in the March Budget. On the basis of these provisional plans, the forthcoming Spending Review looks a lot less challenging. The squeeze pencilled in for the first year of the next Spending Review period – 2016-17 – has been eased very significantly. Over the Parliament as a whole, public services spending would fall by an average of 1.5 per cent a year in real terms, roughly in line with 1.6 per cent a year in the last. No year would see cuts as severe as in 2011-12 and 2012-13.

Chart 1.4: Year-on-year real growth in resource DEL
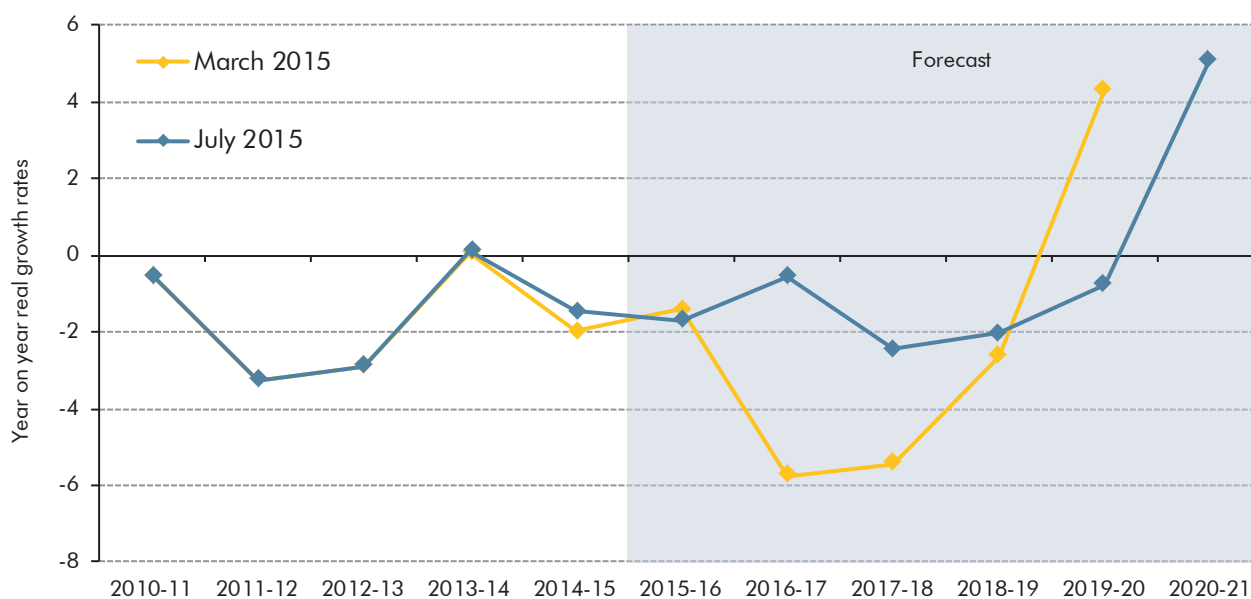
Note: RDEL series excludes major historical switches with AME. Details are in the supplementary fiscal tables on our website.
Source: OBR

1.32   Relative to the planned level of spending in 2015-16, these numbers imply that the Government would have to identify further real cuts in public services spending reaching a peak of £17.9 billion in 2019-20. That is less than half the £41.9 billion cut – required a year earlier in 2018-19 – that was implied by the numbers that the Coalition chose to assume in March. In both cases, once the budget balance has reached surplus (2019-20 in this forecast; 2018-19 in March) the real cut in RDEL spending begins to be reversed.

Chart 1.5: Change in real RDEL from 2015-16
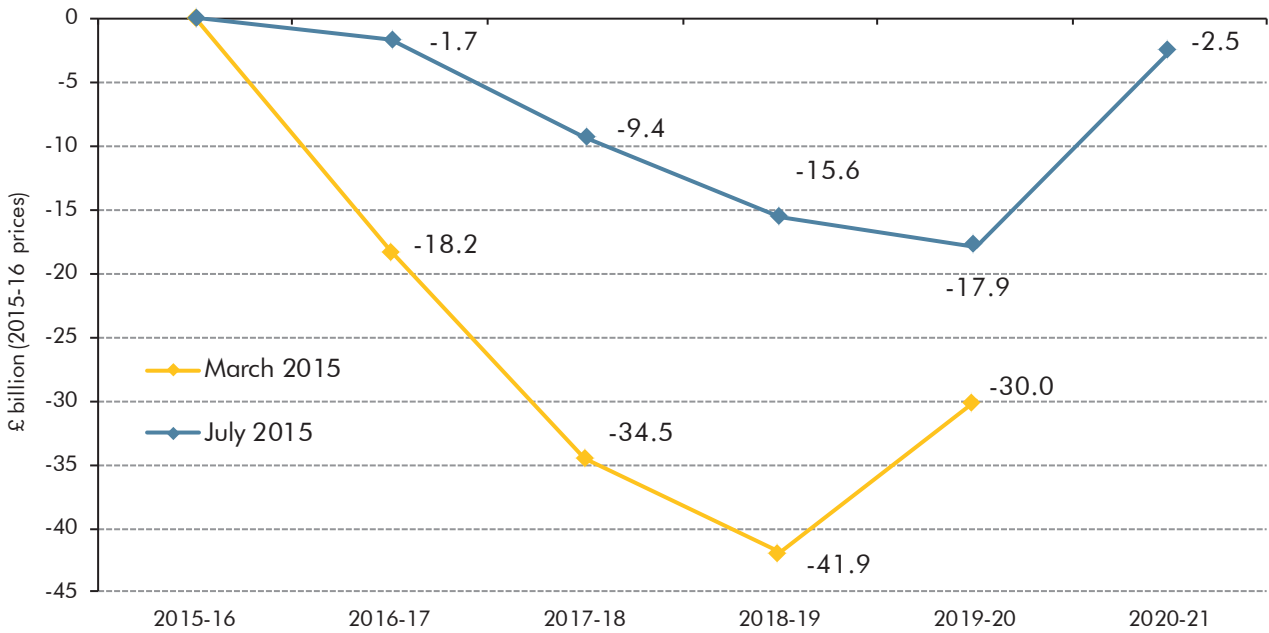
Source: OBR

1.33 While the pace of real cuts that was pencilled into the March forecast has been reduced, Chart 1.6 shows that cuts to RDEL as a share of GDP in this Parliament are still expected to be of a similar size and profile as those that took place in the previous Parliament. Between the peak in 2009-10 and the planned trough in 2019-20, RDEL spending is expected to have been reduced by 6.4 per cent of GDP (£120 billion in today's terms) – with 3.3 per cent of GDP delivered in the last Parliament and 3.1 per cent of GDP in this one. At 14.5 per cent of GDP, the trough in 2019-20 would likely be the lowest share of GDP spent on public services since 1964-65, judging from the most comparable long run data.

## Chart 1.6: Resource DEL as a share of GDP in successive Parliaments
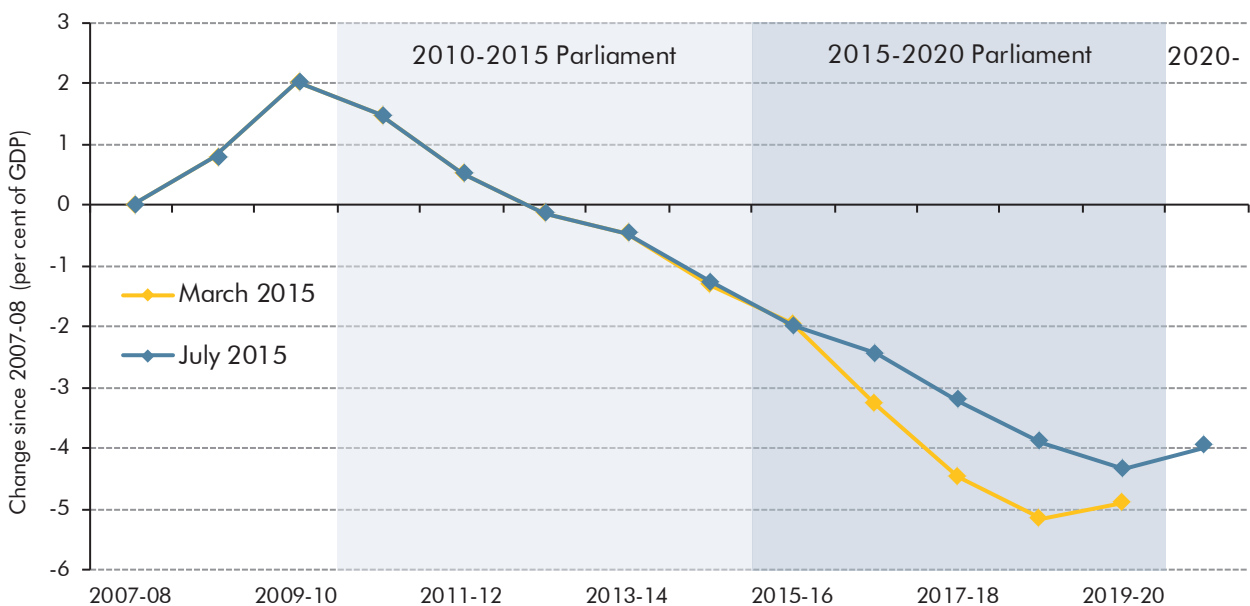
Note: RDEL series excludes major historical switches with AME. Details are in the supplementary fiscal tables on our website.
Source: OBR

Structural fiscal tightening

1.34   Our estimate of the margin of spare capacity in the economy is small in 2015-16 at just 0.6 per cent of potential output and we expect this 'output gap' to close in 2018-19. So the path of structural borrowing is similar to that of headline borrowing described above.

1.35   The year-on-year change in the structural budget deficit – public sector net borrowing adjusted for the size of the output gap – is a common measure of the pace of fiscal consolidation. It has drawbacks when estimates of potential output change significantly, but is more useful when, as currently appears the case, potential output growth is more stable.

1.36   Chart 1.7 shows how the Government's decision to slow the fiscal tightening and smooth the path from year to year implies a more even pace of consolidation than in our last forecast. The figures assumed by the Coalition in March implied a substantial acceleration in the consolidation next year, with the planned reduction in the structural budget deficit rising from 0.5 per cent of GDP in 2015-16 to 1.8 per cent in 2016-17. (That would have equalled the sharpest tightening on this measure since 1981-82.) Thanks to the in-year spending cuts announced in June and the stronger-than-expected receipts growth this year – followed by the Government's willingness to allow more headline borrowing in 2016-17 – the acceleration in the consolidation next year is now much less marked, with the structural deficit falling by 0.9 per cent of GDP in 2015-16 and then 1.3 per cent in 2016-17.

Chart 1.7: Year-on-year changes in cyclically adjusted net borrowing
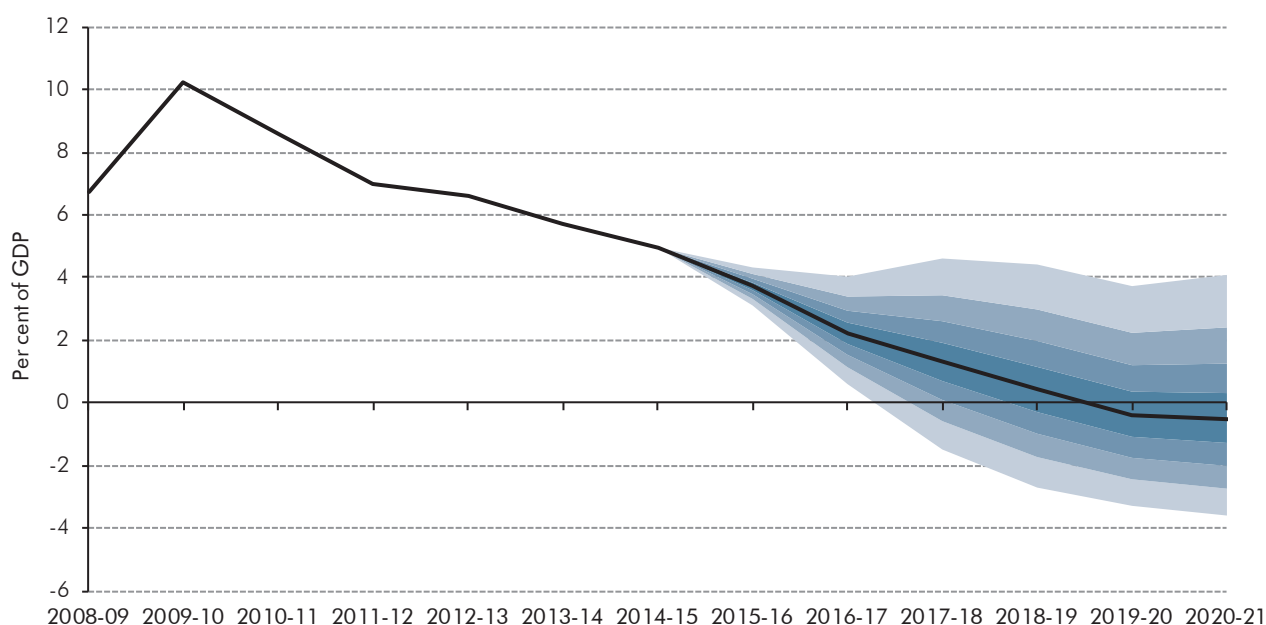

Source: OBR

Economic and fiscal outlook
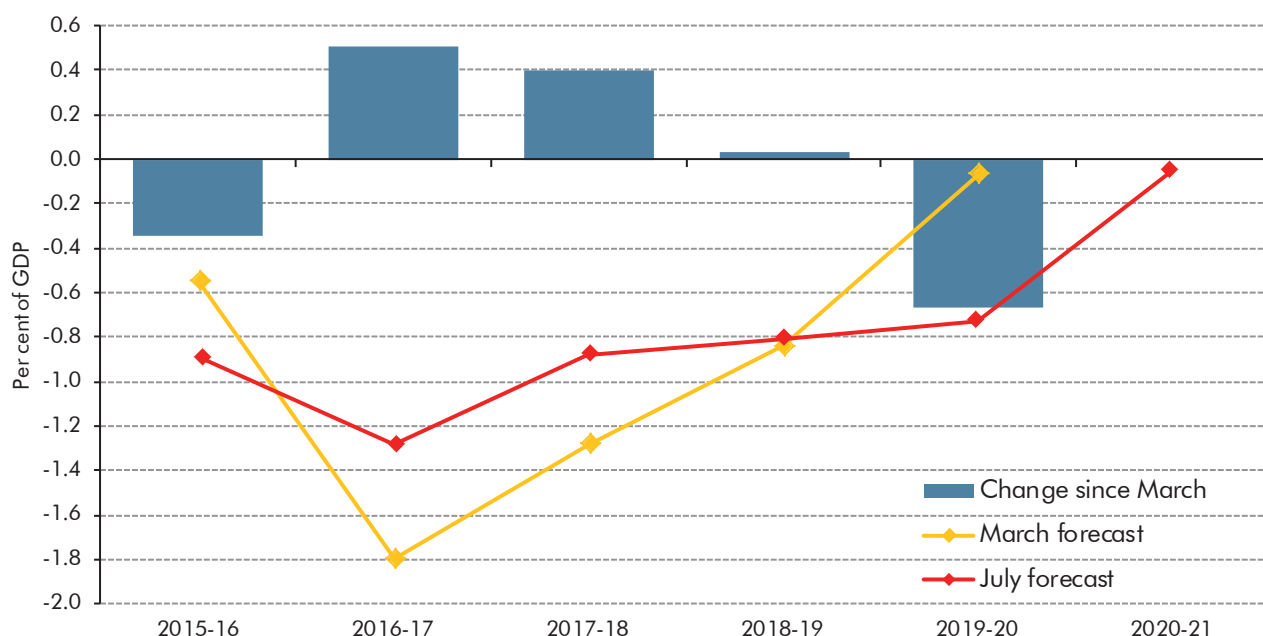
Performance against the Government's fiscal targets

1.37   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 current version of the *Charter* (updated by the Coalition Government in December 2014 and available on our website) sets out three targets formally in place for this forecast:

- the **fiscal mandate**: *"a forward-looking aim to achieve cyclically adjusted current balance by the end of the third year of the rolling, 5-year forecast period"*. For the purposes of this forecast, the third year of the forecast period is 2018-19;

- the **supplementary target**: *"an aim for public sector net debt as a percentage of GDP to be falling in 2016-17"*; and

- the **welfare cap**: a ceiling on cash spending on a subset of social security benefits and tax credits *"at a level set out by the Treasury in the most recently published Budget report, over the rolling 5-year forecast period."* We assess performance against the cap formally at each Autumn Statement and monitor progress in our Budget forecasts.

1.38   But alongside the Budget the new Government has now published a revised draft *Charter* that will be laid before Parliament for approval ahead of our next fiscal forecast. This would:

- replace the current fiscal mandate with *"a target for a surplus on public sector net borrowing by the end of 2019-20"*. Once a headline surplus has been achieved the mandate will require *"a target for a surplus on public sector net borrowing in each subsequent year"*. (The draft *Charter* further specifies that *"these targets apply unless and until the OBR assess that there is a significant negative shock to the UK. A significant negative shock is defined as real GDP growth of less than 1 per cent on a rolling 4 quarter-on-4 quarter basis"*); and

- replace the supplementary target with *"a target for public sector net debt as a percentage of GDP to be falling in each year"* to 2019-20.

1.39   On the basis of our central forecast, we judge that the Government has a greater than 50 per cent chance of meeting both the current and proposed fiscal mandates. We estimate that the cyclically adjusted current balance will move from a deficit of 2.4 per cent of GDP in 2014-15 to a surplus of 1.1 per cent in the mandate year of 2018-19. It is also forecast to be in surplus by 0.3 per cent of GDP in 2017-18, thereby meeting the mandate as it applied in our March forecast – but by a significantly smaller margin than the Government was comfortable with then. Our central forecast also shows a PSNB surplus of £10.0 billion (0.4 per cent of GDP) in 2019-20, meeting the proposed fiscal mandate.

1.40   In terms of the current and proposed supplementary debt targets, our central forecast shows debt falling as a share of GDP in every year of the forecast, thereby meeting both. Debt falls as a share of GDP in 2015-16 thanks only to the significant financial asset sales that are

planned during the year. It falls more comfortably thereafter because the primary budget balance is stronger by then. These conclusions are unchanged from March.

1.41   The Government has reset the level of spending permitted under the welfare cap in this Budget, as the *Charter* requires it to do at the start of each Parliament. The new cap is significantly lower than the old, by 13 per cent in 2019-20. This reflects the Government's decision to lock in the savings from the package of working-age welfare spending cuts that it has announced in the Budget, which reach £12.5 billion in our forecast by 2019-20. The largest of those cuts are focused on reducing the generosity of tax credits and working-age benefits, by freezing most in cash terms for four years, by changing maximum entitlements and withdrawal rates in tax credits and universal credit, and by forcing social sector landlords to cut the rents that are subsidised through housing benefit.

1.42   All forecasts are subject to significant uncertainty. Chart 1.8 shows our median forecast for PSNB – the fiscal aggregate that is targeted in the proposed fiscal mandate. Successive pairs of shaded areas around the median forecast represent 20 per cent probability bands. As in Chart 1.2 above, the bands show the probability of different outcomes if past official errors were a reasonable guide to future forecast errors.

Chart 1.8: Public sector net borrowing fan chart

Source: ONS, OBR

1.43   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 a roughly 70 per cent chance that the CACB will be in balance or surplus in 2018-19 (as the current fiscal mandate requires)

and around a 55 per cent chance that PSNB will be in surplus in 2019-20 (as the proposed fiscal mandate requires);

- second, by looking at its sensitivity to varying key features of the economic forecast. The biggest risk to the achievement of the current fiscal mandate relates to our estimates of future potential output. If potential output is lower than we estimate, implying a positive output gap in the target year, the structural position of the public finances would be worse. If potential output was around 1½ per cent lower than in our central forecast in 2018-19, then the probability of meeting the mandate would fall to 50 per cent, meaning that it would be as likely as not that the mandate would be missed. The proposed fiscal mandate would also be sensitive to cyclical movements in the economy. A shortfall in real GDP of just 0.7 per cent in 2019 would be sufficient to reduce the expected budget surplus to balance; and

- third, by looking at alternative economic scenarios. As this is our first forecast of the new Parliament, we have looked back at the first OBR forecast of the last Parliament in June 2010 and at the errors to which it was subject in order to frame three scenarios. In our 'history repeats' scenario, we assume that we have made similar errors in this forecast to those that were made in June 2010. We assume that employment would be around 1 million higher by the start of 2020, implying total growth of around 2 million over the next five years, but that GDP and productivity growth would be significantly weaker than in the central forecast. In our 'employment-rich growth' scenario, employment again grows by around 1 million more than in our central forecast, but we hold our central GDP forecast unchanged. And in our 'strong GDP growth' scenario, higher employment is accompanied by our central productivity forecast, implying faster GDP growth. Taking these scenarios in reverse order – from most to least favourable – in the 'strong GDP growth' and 'employment-rich growth' scenarios, the current and proposed mandates and supplementary targets would be met, with greater room to spare in the 'strong growth' case, whereas those targets would be missed in the 'history repeats' scenario. Welfare cap spending would be higher in all scenarios, since the cap is set in cash terms and higher population growth leads to higher cash spending; it would be lower as a share of GDP in the 'strong GDP growth' scenario. Welfare cap spending would only exceed the permitted 2 per cent forecast margin in the 'history repeats' scenario.