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Budget Responsibility

Economic and fiscal outlook

November 2020

CP 318

Office for Budget Responsibility: Economic and fiscal outlook

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the Exchequer Secretary to the Treasury by
Command of Her Majesty

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Foreword

The Office for Budget Responsibility (OBR) was established in 2010 to provide independent and authoritative analysis of the UK's public finances.

In this *Economic and fiscal outlook* (*EFO*) we set out a central forecast to 2025-26. While we have always supplemented our forecasts with a range of uncertainty analysis, we present and focus more on scenarios in this *EFO*, given the huge uncertainty surrounding the course of the pandemic and its consequences for the economy and public finances and, to a somewhat lesser extent, the continued uncertainty regarding our future trading relationship with the EU. The forecasts and scenarios presented in this document represent the collective view of the three independent members of the OBR's Budget Responsibility Committee (BRC). We take full responsibility for the judgements that underpin them and for the conclusions we have reached.

We have been greatly supported in the work on this *EFO* by the staff of the OBR who have risen to both the analytical and practical challenges of producing these forecasts and scenarios while working remotely for much of the time. We are enormously grateful for their hard work, expertise and professionalism.

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

Given the continued central importance of the path of the pandemic and associated public health interventions to the economic and fiscal outlook, in this *EFO* we have also drawn on the expertise of government scientists, epidemiologists, and public health experts, including from the Scientific Pandemic Influenza Group on Modelling (SPI-M), the Department of Health and Social Care, NHS England and NHS Improvement, the Government Office for Science, the Joint Biosecurity Centre, the UK Vaccines Task Force and the Joint Committee on Vaccination and Immunisation. These discussions have been enormously valuable in helping us to understand the potential scenarios for the future path of the pandemic and their economic and fiscal implications. At the same time, we retain sole responsibility for the health-related assumptions underpinning the projections in this *EFO* and none of the scenarios for the course of the virus, public health restrictions, or vaccines should be seen to represent the official views of the Government or any of these bodies.

We have also held useful discussions with the Bank of England, National Institute for Economic and Social Research, Institute for Fiscal Studies, Resolution Foundation and Institute for Government about their latest forecasts and economic analysis for which, again, we are very grateful.

On 3 October, Robert Chote stepped down as Chair of the OBR at the end of his 10-year term. He was succeeded by Richard Hughes who took up the position on the same date. The BRC and OBR staff greatly appreciate all the work that Robert has done to lay the foundations of the OBR in its first decade. Robert was not involved in the production of this *EFO*, but it aims to continue his commitment to rigour, objectivity, and transparency in the preparation and presentation of the official economic and fiscal forecast and the uncertainties that lie around it.

At the time of going to print, the lockdown in England was due to expire on 2 December, and the arrangements that would be put in place subsequently had not been announced, other than that they would follow "*a regional approach, based on the latest data*".[1] We sought information about the government's central assumptions or scenarios regarding the path of the virus over the next six months; the timing and possible effectiveness of a vaccine; updates on policy regarding restrictions on economic and social activity; and the impact of current and future policy measures. The Treasury pointed us to a range of publicly available information and discussed with us its internal assessment of the available data showing the impact of the virus on the economy so far. It did not provide specific estimates of the economic implications of particular public health restrictions.

The Treasury also facilitated meetings with the various epidemiological and public health experts listed above. These meetings have helped us to understand the factors influencing the path of the virus and their relative importance, the likely effectiveness of different levels of restrictions and of test, trace and isolate in different circumstances, the potential availability of vaccines in terms of both timing and numbers of doses, the possible roll-out schedule for successful vaccines, and potential longer-term scenarios, as well as the constraints and uncertainties surrounding all of these. Those discussions have informed our assumptions about the effect of the latest lockdowns, and broad-brush assumptions about the subsequent level of public health restrictions relative to the pre-lockdown position, their duration and rate of easing, and their potential impact on the economy.

As regards Brexit, we asked the Government to confirm its policies in areas that are likely to be affected once the transition period ends on 31 December, including with respect to the Northern Ireland Protocol, new border procedures and their effects on tax compliance, the operation of the new migration regime and several other issues with direct consequences for our receipts and spending forecasts. We received some clarifications in specific policy areas, which are detailed throughout the *EFO*, but on several issues we have needed to make our own assumptions in the absence of more specific policy and operational detail. We also asked the Government to clarify its position on achieving an agreement with the EU on the future relationship and any further information on areas that we had not identified but which could have a material effect on the forecast. The Treasury, understandably, could not provide clarity on the ultimate outcome of the negotiations, and we continue to base our forecast on the assumption that a deal is reached.

[1] HM Government, *New National Restrictions from 5 November*, last updated 20 November 2020.

As regards the forecast timetable, we received an initial internal notification of a window for the publication of this forecast on 17 August. But as we noted in our March *EFO*, while advance notice is useful for making our own preparations, we cannot plan properly with other departments in the absence of a firm public announcement. It was not until 28 October that the publication date was announced, the same date on which we sent the Treasury the third round of our economy forecast. This confirmation was just four weeks ahead of the forecast publication date – by some distance the shortest formal notice we have been given of the publication date for our forecast since the OBR was established. While we are clearly operating in exceptional circumstances, this is now the fourth consecutive occasion on which we have not been given the 10 weeks' notice stipulated in the Memorandum of Understanding between the OBR and HM Treasury.

The full forecast timetable has been as follows:

- On 17 August the Treasury notified us that we should prepare to publish a forecast between 9 and 27 November and that the date would be confirmed in early September. On 11 September, we were informed that the window had changed to mid- to late-November, which was also announced publicly via a Written Ministerial Statement to Parliament. The date was confirmed to us and announced publicly on 28 October.

- In terms of the forecast itself, we began with OBR staff preparing an economy forecast, drawing on data released since our previous forecast in March 2020 and with our preliminary judgements on the outlook for the economy. We sent our first economy forecast to the Chancellor on 16 September.

- Using the economic determinants from this forecast (such as the components of nominal income and spending, unemployment, inflation and interest rates) we then commissioned new forecasts from the relevant government departments for the various tax and spending items that in aggregate determine the state of the public finances. We discussed these in detail with the officials producing them, which allowed us to investigate proposed changes in forecasting methodology and to assess the significance of recent tax and spending outturns. In many cases, the BRC requested changes to methodology and/or the interpretation of recent data. We sent our first fiscal forecast on 30 September and met the Chancellor to discuss the emerging forecast on 6 October.

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

- This provided the basis for a further round of fiscal forecasts. Discussion of these with HMRC, DWP and other departments gave us the opportunity to follow up our requests for further analysis, methodological changes and alternative judgements made during the previous round. We provided our second economy and fiscal forecast to the Chancellor on 22 October.

- We then produced a third economy and fiscal forecast, which took on the latest data and incorporated our judgements on the fiscal forecast. We sent it to the Treasury on 6 November.

- Meanwhile, we scrutinised the costing of tax and spending measures announced since the March 2020 forecast. As usual, the BRC requested changes to almost all the draft costings prepared by departments.

- In normal circumstances, we agree with the Treasury that the third round of the forecast is the final opportunity to incorporate changes to the pre-measures forecast, in order to give the Chancellor a stable base on which to take policy decisions. On this occasion, given the rapidly changing environment, we continued to update the forecast to reflect the emergence of a second wave of infections, the subsequent tightening of public health restrictions, and news concerning vaccines. The final round of the forecast also incorporated all policy announcements since the Summer Economic Update in July and further data releases.

- In line with the agreed forecast timetable, we were provided with details of the final policy decisions with a potential wider impact on the economy forecast on 13 November, including provisional Spending Review totals. We sent a near-final fiscal forecast to the Treasury on 18 November and took on final policy decisions that were sent to us on 19 November. The BRC met the Chancellor on 20 November to discuss the final forecast.

- The Treasury made a written request, as provided for in the MoU between us, that we provide the Chancellor and an agreed list of his special advisers and officials with a near-final draft of the *EFO* on 20 November. This allowed the Treasury to prepare the Chancellor's statement. We also provided 24 hours pre-release access to the full and final *EFO* on 24 November.

During the forecasting period, the BRC held around 45 scrutiny and challenge meetings with officials from other departments, in addition to numerous further meetings at staff level. We have been provided with all the information and analysis that we requested and have come under no pressure from Ministers, advisers or officials to change any of our conclusions as the forecast has progressed. A full log of our substantive contact with Ministers, their offices and special advisers can be found on our website. This includes the list of special advisers and officials that received the near-final draft of the *EFO* on 20 November.

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

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

Richard Hughes

Sir Charles Bean

Andy King

The Budget Responsibility Committee

1 Executive summary

Overview

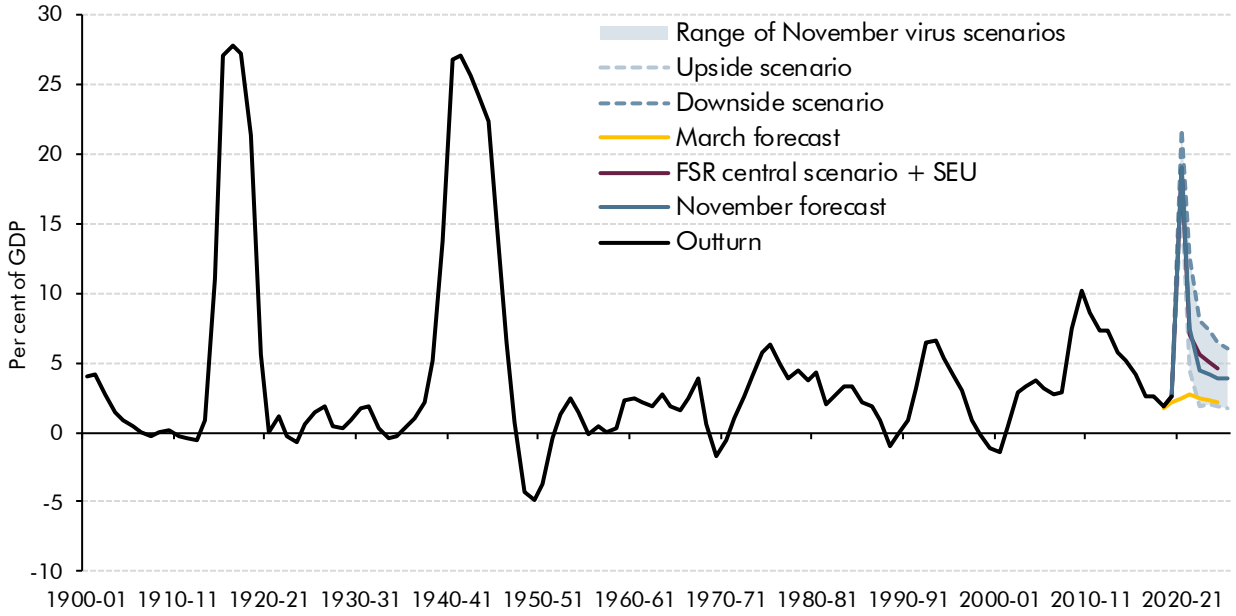
1.1 The coronavirus pandemic has delivered the largest peacetime shock to the global economy on record. It has required the imposition of severe restrictions on economic and social life; driven unprecedented falls in national income; fuelled rises in public deficits and debt surpassed only in wartime; and created considerable uncertainty about the future. The UK economy has been hit relatively hard by the virus and by the public health restrictions required to control it.

1.2 During the first wave of infections, the UK locked down later and for longer than some of its European neighbours and experienced a deeper fall and slower recovery in economic activity. A resurgence of infections is now in progress across Europe and North America, prompting the tightening of public health restrictions and reimposition of national lockdowns and taking the wind out of an already flagging recovery. That includes the UK, where GDP is set to fall by 11 per cent this year – the largest drop in annual output since the Great Frost of 1709.

1.3 The virus has also exacted a heavy and mounting toll on the public finances. In our central forecast, receipts this year are set to be £57 billion lower, and spending £281 billion higher, than last year. The Government has committed huge sums to treat the infected, control the spread of the virus, and cushion its financial impact on households and businesses. As support has been expanded and extended, including in the wake of the second wave of infections, its total cost this year has risen from £181 billion at the time of the Summer Economic Update, to £218 billion at the time of the Winter Economy Plan, to £280 billion in this forecast.

1.4 In our central forecast, the combined impact of the virus on the economy and the Government's fiscal policy response pushes the deficit this year to £394 billion (19 per cent of GDP), its highest level since 1944-45, and debt to 105 per cent of GDP, its highest level since 1959-60 (Chart 1.1). Borrowing falls back to around £102 billion (3.9 per cent of GDP) by 2025-26, but even on the loosest conventional definition of balancing the books, a fiscal adjustment of £27 billion (1 per cent of GDP) would be required to match day-to-day spending to receipts by the end of the five-year forecast period.

Chart 1.1: Public sector net borrowing: central forecast and scenarios



Source: ONS, OBR

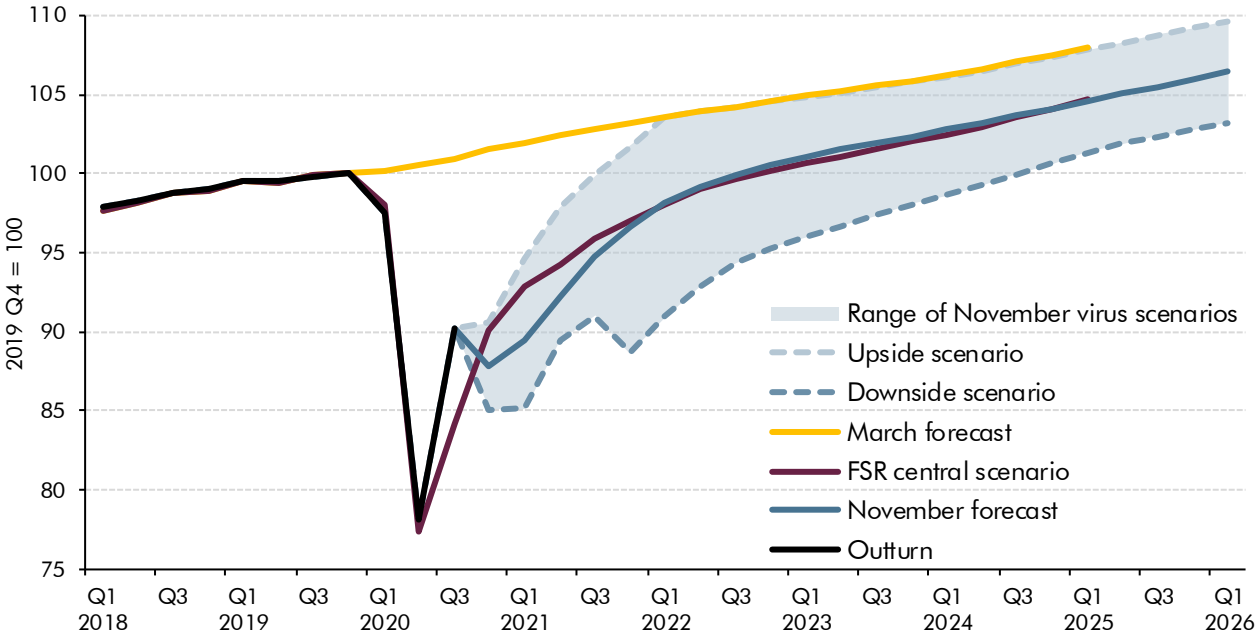
1.5 The support provided to households and businesses has prevented an even more dramatic fall in output and attenuated the likely longer-term adverse effects of the pandemic on the economy's supply capacity. And the Government's furlough scheme has prevented a larger rise in unemployment. Grants, loans, and tax holidays and reliefs to businesses have helped them to hold onto workers, keep up to date with their taxes, and avoid insolvencies. Nonetheless, we anticipate a significant rise in unemployment – to 7.5 per cent in our central forecast – as this support is withdrawn in the spring.

1.6 The economic outlook remains highly uncertain and depends upon the future path of the virus, the stringency of public health restrictions, the timing and effectiveness of vaccines, and the reactions of households and businesses to all of these. It also depends on the outcome of the continuing Brexit negotiations. In such circumstances, the value of a single 'central' forecast is limited.

1.7 We therefore present three scenarios for the virus: an upside scenario, in which lockdown succeeds in bringing the second wave of infections under control and the rapid rollout of effective vaccines enables output to return to its pre-virus level late next year; a central one, in which restrictive public health measures need to be kept in place until the spring and vaccines are rolled out more slowly, leading to a slower return to pre-virus levels of activity at the end of 2022; and a downside one, in which lockdown has to be extended, vaccines prove ineffective in keeping the virus in check, and a more substantial and lasting economic adjustment is required with economic activity only recovering to its pre-virus level at the end of 2024 (Chart 1.2). In the upside scenario, output eventually returns to its pre-virus trajectory, but output is left permanently scarred by the pandemic in the other two scenarios, by 3 and 6 per cent respectively. All three assume a smooth transition to a free-trade agreement with the EU in the new year. But we also describe an alternative scenario in

which the Brexit negotiations end without a deal. This would further reduce output by 2 per cent initially and by 1½ per cent at the forecast horizon.

Chart 1.2: Real GDP: central forecast and alternative scenarios

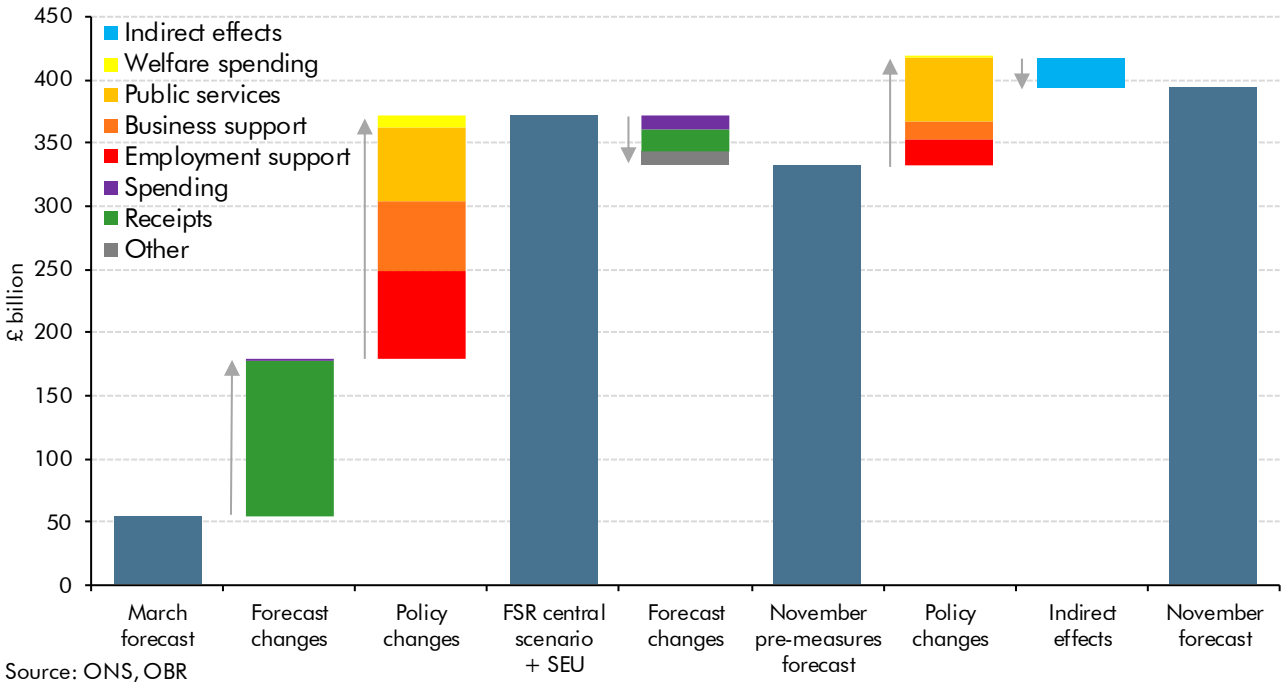


Source: ONS, OBR

1.8 The same uncertainty clouds the fiscal outlook. Our virus scenarios suggest the deficit this year will peak at between £353 and £440 billion (17 to 22 per cent of GDP). Depending on the damage to potential output in the medium term, the deficit settles at between 1.7 and 6.1 per cent of GDP by the forecast horizon in 2025-26. Public debt (excluding the uneven effects of Bank of England schemes) continues to rise as a share of GDP over the next five years in all but the upside scenario.

1.9 Unlike in previous recessions, the greater portion of the fiscal cost of the virus arises from the Government's discretionary policy response rather than the hit to the economy caused by the virus. Of the £339 billion upward revision to borrowing between our March and November central forecasts, roughly three quarters is due to policy measures (in particular additional spending on the health service and the furlough scheme) and the rest is due to lower economic activity (mostly due to lower tax receipts) (Chart 1.3). Moreover, the connection between the public health restrictions and the levels of support offered to workers and businesses underscores the importance of controlling the virus to containing the longer-run cost of the pandemic.

Chart 1.3: Change in net borrowing in 2020-21



Source: ONS, OBR

1.10 Under our central forecast, the pandemic leaves the public finances in a weaker position in the medium term and significantly adrift from any definition of balance contained in previous fiscal frameworks. Headline borrowing remains close to 4 per cent of GDP and the current budget remains in deficit by 1 per cent of GDP by the end of the forecast, missing the Government's Budget 2020 target to balance it by 2023-24. The Government meets the other two targets included in its manifesto: net investment remains below 3 per cent of GDP on average and the ratio of debt interest spending to revenue reaches a new historical low of 1.7 per cent on the back of further falls in interest rates. The latter reflects investors' continuing trust in the safety of UK government debt, as well as the support provided by the Bank of England's gilt purchases in pursuit of its inflation target. But that trust rests on investors' confidence that responsible fiscal and monetary policies will be maintained. So long as these conditions hold, a debt-to-GDP ratio over 100 per cent should not prove particularly onerous by historical standards.

1.11 The increase in borrowing does, however, render the public finances more vulnerable to changes in financing conditions and other future shocks. This heightened vulnerability is compounded by the shortening of the effective maturity of that debt as a result of both a greater focus on short-term debt issuance by the Treasury and further Bank of England purchases of longer-dated gilts financed through the creation of floating rate reserves. Taken together, these leave debt interest spending twice as sensitive to changes in short-term interest rates than prior to the pandemic. Arresting the continued rise in public debt is likely to require some fiscal adjustment once the virus has run its course. Only in our upside scenario, in which the pandemic is swiftly ended and there is little lasting damage to activity, does borrowing fall below the level required to stabilise the debt-to-GDP ratio by the forecast horizon. In our central forecast and downside scenario, tax rises or spending cuts of

between £21 billion and £46 billion (between 0.8 and 1.8 per cent of GDP) would be required merely to stop debt rising relative to GDP.

Table 1.1: Summary of virus scenarios

	Virus scenarios		
	Upside	Central	Downside
Public health assumptions			
Lockdown ends	2 December	2 December	2 December
Test, trace and isolate	Effective	Partly effective	Ineffective
Public health restrictions: lockdown to vaccine[1]	Medium-low	High-medium	Very high[2]
Vaccines widely available	From Spring 2021	From mid-2021	Ineffective
Economic effects (per cent, unless otherwise stated)			
Real GDP growth in 2020	-10.6	-11.3	-12.0
Return to pre-virus peak (2019Q4)	2021Q4	2022Q4	2024Q4
Peak unemployment rate	5.1	7.5	11.0
Long-term GDP scarring	0.0	3.0	6.0
Fiscal effects (per cent)			
Public sector net borrowing in 2020-21	16.7	19.0	21.7
Public sector net borrowing in 2025-26	1.7	3.9	6.1
Public sector net debt in 2025-26	90.5	104.7	123.1
Budget 2020 fiscal targets			
Current budget balance in 2023-24	Met	Not Met	Not Met
Net investment below 3 per cent of GDP	Met	Met	Not Met
Debt interest to revenue ratio below 6 per cent	Met	Met	Met

[1] Low, medium and high are broadly equivalent to October 2020 tiers 1, 2 and 3 in England. Very high is between October 2020 tier 3 and November 2020 lockdown in England.
[2] Restrictions to ease to low by end of 2021.

The economic outlook

1.12 The coronavirus pandemic has resulted in the largest and most synchronised shock to the global economy in living memory. The virus spread rapidly around the world in the first half of 2020, leading to widespread falls in activity. This contraction was driven partly by the public health restrictions required to contain the spread of the virus and partly by voluntary social distancing by individuals seeking to avoid infection.

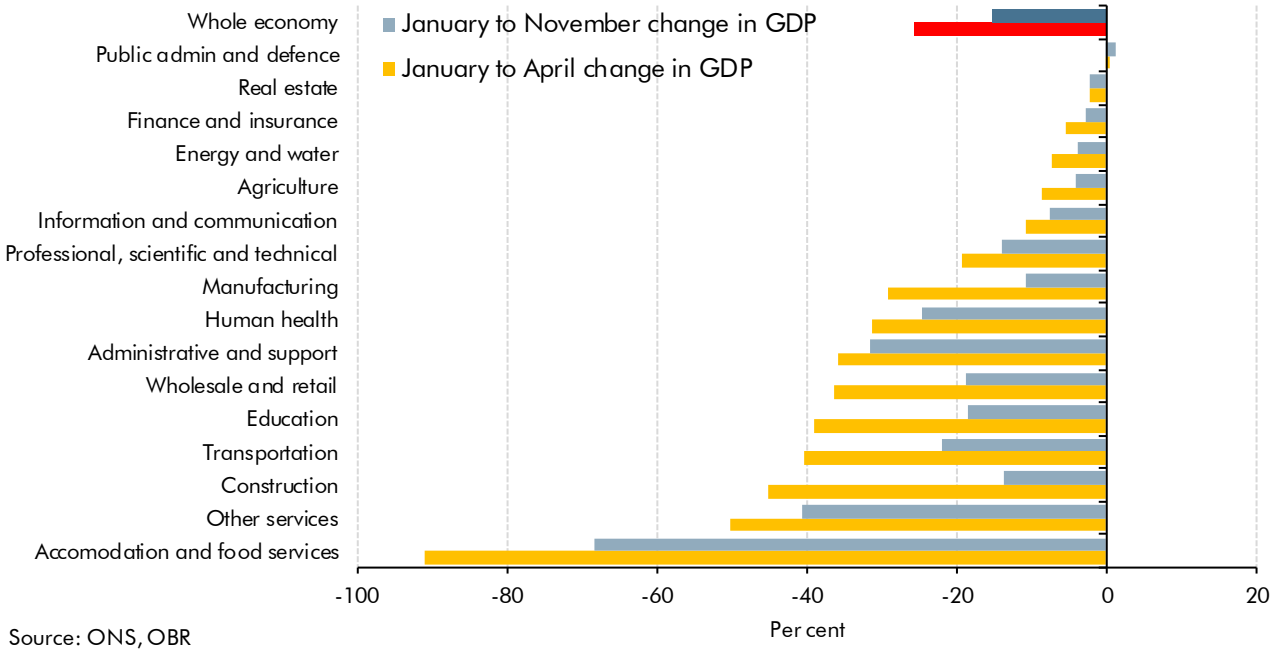
1.13 The global economy bounced back strongly in the third quarter of 2020 as case numbers fell and public health restrictions were eased. But a resurgence of cases and subsequent reimposition of lockdowns across much of Europe and North America will drag on the recovery over the next two quarters. By contrast, some East Asian countries that managed to rapidly contain and suppress the virus are forecast to see modest growth this year. Overall, global output is forecast to contract by 4.4 per cent in 2020, a far more severe hit than the zero global growth recorded in the wake of the 2008-9 financial crisis.

1.14 During the first wave of the pandemic, the UK experienced one of the highest rates of infections, hospital admissions and deaths among advanced economies. In addition, the UK introduced more stringent public health restrictions later but maintained them for longer than in many other European countries. The combination of the severity of the outbreak and

the length and stringency of the first lockdown in the UK saw output fall by over a fifth between the fourth quarter of 2019 and second quarter of 2020 – its sharpest contraction on record and one of the largest among advanced economies.

1.15 The shock to the economy has been unusual not only in its speed and severity but also in its differential impact across sectors. Sectors most reliant on face-to-face interactions, such as hospitality, transport, and entertainment, saw the biggest falls in activity as they were most directly affected by public health restrictions and the difficulties in implementing social distancing. By contrast, sectors that were largely able to continue to operate while adhering to social distancing rules, such as financial services, energy, and agriculture, have been spared the worst economic consequences of the pandemic (Chart 1.4).

Chart 1.4: Peak-to-trough falls in sectoral output



Source: ONS, OBR

1.16 As case numbers fell and public health restrictions were eased in the late spring, the economy rebounded more strongly than anticipated in even our July *Fiscal sustainability report* (*FSR*) upside scenario. GDP rose by 15.5 per cent in the third quarter. Even so, by September activity was still almost 9 per cent below its pre-virus peak in January, with persistent weakness in some sectors. The recovery was fuelled primarily by a rebound in consumption as households undertook delayed purchases of durable goods, spent some of the savings accumulated during lockdown, and took advantage of time-limited tax reliefs and incentives for the housing and hospitality sectors. Business investment, which had stagnated since the Brexit referendum in 2016, remained 20 per cent below its pre-virus level in the third quarter.

1.17 A resurgence of infections and subsequent tightening of public health restrictions in different parts of the UK took the wind out of the recovery going into fourth quarter. Real-time indicators of mobility and cash payments pointed to a plateauing of activity levels in

September, followed by a fall in October. Falls in activity were most pronounced in regions where case numbers were rising fastest and tighter restrictions were put in place to try to contain them. As case numbers, hospital admissions, and deaths mounted across the country through October, the Government announced a second lockdown in England from 5 November to 2 December. Tighter restrictions were also put in place in Scotland, Wales and Northern Ireland at different points through the Autumn.

1.18 The renewed lockdown is certain to dent activity in November and after, depending on the stringency of the health measures and voluntary social distancing that follow. But the impact is likely to be less pronounced than during the first wave of infections in the spring – with the fall in output expected to be three-fifths that seen during the first lockdown. This time around, schools have remained open and businesses have been encouraged to continue operating where they can. Moreover, businesses in some sectors, like financial services, have adapted to having staff working from home, while those in others – such as manufacturing and construction – have reorganised to accommodate the social distancing of their employees. But sectors involving close public interaction, such as hospitality, transport, and entertainment, are likely to suffer another severe drop in output (Chart 1.4).

1.19 The pandemic and the associated sharp contraction in activity have prompted an unprecedented economic policy response. Health spending related to the virus has been ramped up, while substantial support has been provided to individuals and businesses affected by the pandemic to mitigate the impact on employment and incomes and limit the long-term damage to the economy. Notably, the Coronavirus Job Retention Scheme (CJRS) and Self-Employment Income Support Scheme (SEISS) translated what could have been a very large and rapid increase in unemployment (as seen in the US) into a very large fall in average hours worked, as firms retained furloughed workers on zero (or greatly reduced) hours. Well over a million firms have taken out government-guaranteed loans, while those in the hospitality and recreation sectors have also benefitted from a 15 per cent VAT cut and the Eat Out to Help Out Scheme in August. These measures, together with forbearance on the part of creditors, have helped to reduce the number of insolvencies so far this year by almost a third compared to 2019. The Monetary Policy Committee (MPC) has also cut Bank Rate twice since March, reducing it from 0.75 to 0.1 per cent, and increased its stock of corporate and UK government bond purchases – 'quantitative easing' – by £250 billion to £895 billion. Despite this array of support, the number of employees has fallen by 750,000 between March and September of this year according to HMRC's real-time data.

1.20 There remains considerable uncertainty concerning the future path of the virus, the public health restrictions required to keep it in check and the prospects for effective vaccines or treatment, all of which have material implications for the economic and fiscal outlook. Therefore, as in our July *FSR*, we consider three scenarios for the future path of the economy and public finances. A variety of intermediate scenarios are also possible, and we make no attempt to assign probabilities to particular outcomes.

1.21 Our **upside scenario** assumes that the national lockdown now in place substantially reduces the infection rate by 2 December. Thereafter, an effective test, trace, and isolate (TTI) programme keeps outbreaks in check together with a return to a tiered system of local

public health restrictions similar to that in place prior to the lockdown. While these may vary in intensity both regionally and temporally, they are broadly the same as remaining at the equivalent of England's pre-lockdown Tier 2 until the spring. An effective vaccine becomes widely available in the spring of 2021, permitting a further easing of health restrictions and a gradual return to normality as the year progresses. The medium-term economic impact of the pandemic is negligible in this scenario.

1.22 In our **central forecast**, a higher infection rate at the end of the lockdown and a less effective TTI system necessitate keeping a more stringent set of public health restrictions in place over the winter. These may vary regionally and temporally but are broadly the same as remaining at the equivalent of England's pre-lockdown Tier 3 until the spring. The arrival of warmer weather then allows an easing of the restrictions. An effective vaccine becomes widely available in the latter half of the year, permitting a gradual return to more normal life, though at a slower pace than in our upside scenario. In this scenario there is also a lasting adverse impact of the pandemic on the economy.

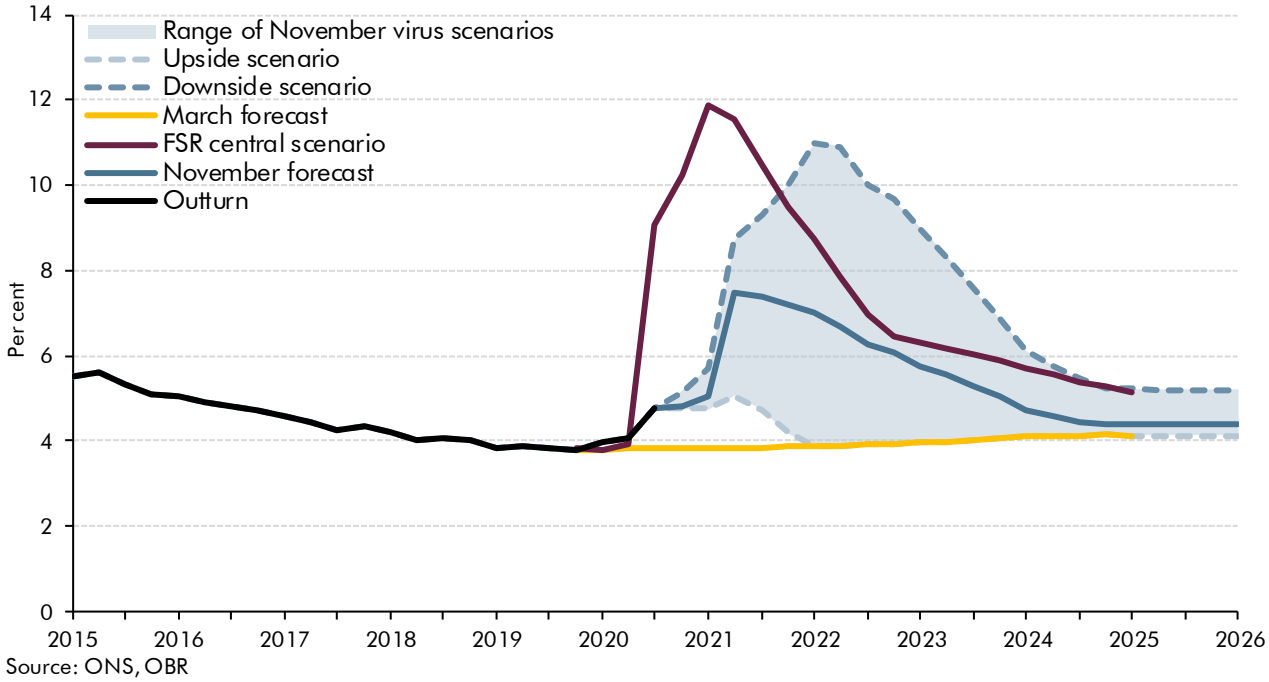
1.23 In our **downside scenario**, continued high infection rates after the current lockdown ends on 2 December mean that a less effective TTI system must be augmented by even more stringent public health restrictions than in our central forecast to be kept in place throughout the winter. These may vary regionally and temporally but are broadly equivalent to somewhere between England's pre-lockdown Tier 3 and the November lockdown. The arrival of spring again permits some easing of the restrictions but, unlike in our central forecast, a sufficiently effective vaccine does not become available. Subsequent waves of infection necessitate the periodic reimposition of health restrictions, while the continued risk of infection induces more lasting changes in economic and social life. In this scenario, we include a third wave of infections next winter whose impact is roughly half that of the present wave. In this scenario, the longer-term economic impact of the pandemic is significantly greater than in our central forecast.

1.24 Support provided up to and including the Chancellor's Summer Economic Update is included in the baseline, pre-measures forecast. With new measures announced since then totalling around £86 billion in 2020-21 and £40 billion in 2021-22, real GDP would have been materially weaker in the near term in their absence. A mechanical application of our (slightly modified) 'fiscal multipliers' would imply that the level of GDP would have been almost 3 per cent lower absent the latest measures at the peak of their impact at the start of 2021. In the medium term, the economic recovery is supported by the strong growth in public investment announced in the March Budget.

1.25 The recently announced extensions to the CJRS, SEISS and various business support measures both delay and attenuate the rise in unemployment. Under our central forecast, unemployment peaks at 7.5 per cent in the second quarter of 2021. The CJRS extension is expected to result in the peak in unemployment occurring two quarters later and at a lower level than would have occurred in its absence. The CJRS extension, along with other new measures, are expected to lower the level of unemployment in the second quarter of 2021 by around 300,000 compared to what would have happened in their absence. The unemployment rate rises to just a little over 5 per cent in our upside scenario as the

economy has all but returned to normal by the time the CJRS closes. But it rises to 11 per cent in our downside scenario as the third wave strikes next winter.

Chart 1.5: Unemployment rate: central forecast and alternative scenarios



Source: ONS, OBR

1.26 As well as preventing job losses, the CJRS has also helped to support earnings by subsidising the pay of employees who are producing little or no output. That means average earnings continue to rise this year in our upside and central scenarios, despite the pandemic. In the medium term, earnings growth picks up steadily as labour market slack declines, reaching 3.5 per cent by 2025.

1.27 CPI inflation falls under all three scenarios from 1.8 per cent last year to 0.8 per cent in 2020, due in part to lower indirect taxes and energy prices, as well as increased slack in the economy. Thanks primarily to relatively weak average earnings growth, inflation remains subdued over the next three years, returning to the 2 per cent target by the end of 2024. Whole economy inflation (as measured by the GDP deflator) is erratic in the short term, driven by the statistical treatment of public sector output (for example, school closures and the cancellation of non-virus-related operations are treated as raising the implicit price of education and health services). In the medium term, GDP deflator inflation settles at 2 per cent.

1.28 Relative to our March forecast, nominal GDP in the first quarter of 2025 – the forecast horizon at the time – is 4½ per cent lower in our central forecast. Lower real GDP accounts for roughly two-thirds of that, with a lower GDP deflator accounting for the rest. The main contributor to lower real GDP is a 2 percentage point scarring effect on productivity, with smaller contributions coming from a smaller population (due to lower migration), lower labour force participation and a slightly higher equilibrium unemployment rate.

1.29 The uncertainty created by the pandemic is compounded by the presently unresolved nature of the UK's future trading relationship with the EU after the transition period ends on 31 December. Our three scenarios all assume that the UK makes an orderly transition to a typical free-trade agreement (FTA). This new trading relationship is expected to lead to a long-run loss of output of around 4 per cent compared to remaining in the EU, which was already incorporated into our March forecast. But given the continued uncertainty over the outcome of the Brexit negotiations, we also include a scenario in which the UK's trading relationship defaults to WTO terms on 1 January, with some accompanying short-term disruption. This would further reduce output by 2 per cent initially and 1½ per cent at the forecast horizon.

Table 1.2: Overview of the central economy forecast

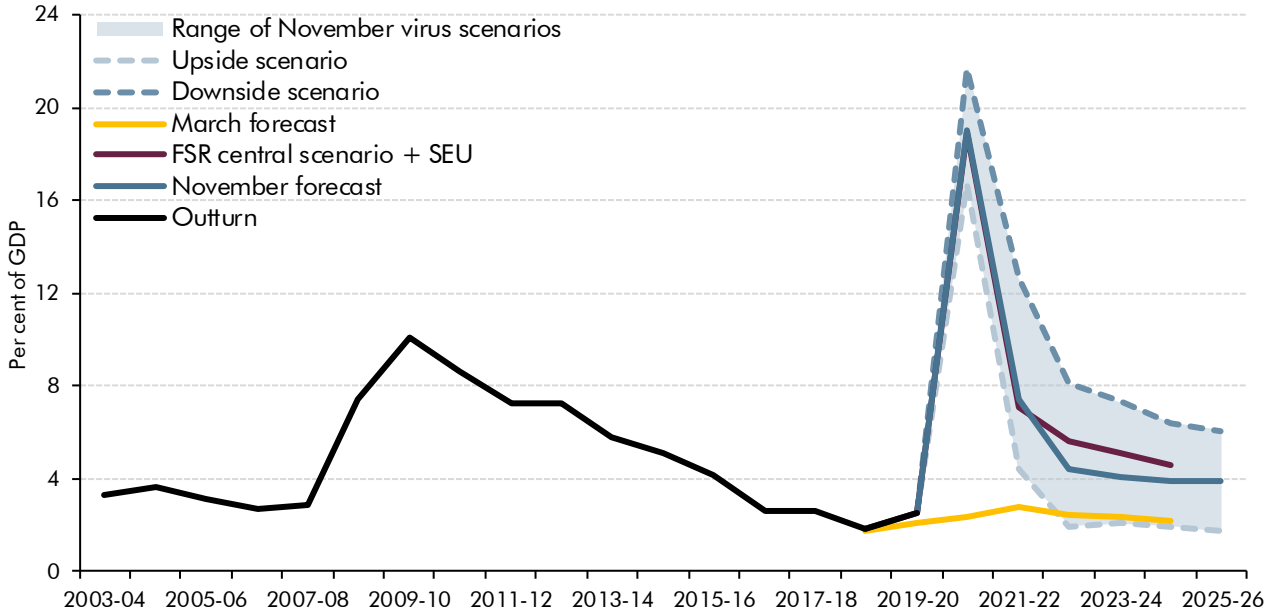
	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
Output at constant market prices							
Gross domestic product (GDP)	1.3	-11.3	5.5	6.6	2.3	1.7	1.8
GDP per capita	0.7	-11.8	5.2	6.2	2.0	1.4	1.5
GDP levels (2019=100)	100.0	88.7	93.6	99.7	102.0	103.7	105.6
Output gap	0.1	-0.6	-1.1	-0.8	-0.3	-0.2	-0.1
Expenditure components of real GDP							
Household consumption	0.9	-15.1	7.5	9.7	1.7	1.2	1.5
General government consumption	4.1	-7.9	21.1	-3.8	1.2	2.4	2.0
Business investment	1.1	-18.1	1.2	13.7	9.7	6.2	4.6
General government investment	4.0	7.0	5.5	6.1	2.7	1.5	1.5
Net trade[1]	-0.2	2.8	-4.5	-0.3	-0.2	-0.4	-0.2
Inflation							
CPI	1.8	0.8	1.2	1.6	1.7	1.9	2.0
Labour market							
Employment (million)	32.8	32.7	31.9	32.2	32.7	33.1	33.2
Average earnings	2.9	1.2	2.1	2.0	2.4	3.0	3.5
LFS unemployment (rate, per cent)	3.8	4.4	6.8	6.5	5.4	4.5	4.4

[1] Contribution to GDP growth.

The fiscal outlook

1.30 The pandemic has driven public sector net borrowing to levels not seen since the two world wars. In our central forecast, the deficit hits 19 per cent of GDP (£394 billion), its highest level since 1944-45. Even in the upside scenario it hits 17 per cent, while in the downside it reaches 22 per cent. In any scenario, this will be a peacetime peak – around twice the previous high reached in 2009-10 as a result of the financial crisis – and will approach the Second World War peak of 27 per cent in 1941-42 and the First World War peak of 28 per cent in 1916-17.

Chart 1.6: Public sector net borrowing: central forecast and alternative scenarios



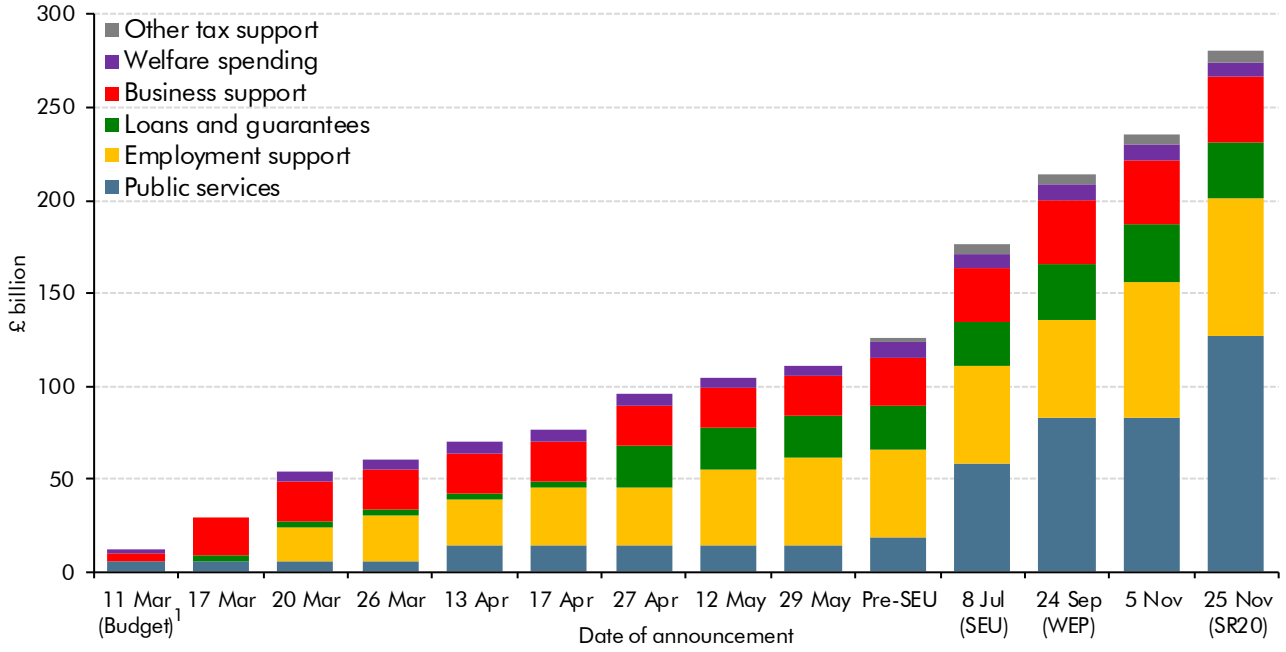
Source: ONS, OBR

1.31 In our central forecast, receipts fall by £57 billion in 2020-21, driven largely by the sharp fall in GDP. But the drop is £32 billion less than assumed in our July *FSR* central scenario, reflecting the stronger economic rebound and less extensive use of tax deferral policies in the first half of 2020-21. But the second wave and further tax measures mean that the upside news from the first half of the year does not carry through to the second.

1.32 Spending rises by £281 billion (16 per cent of GDP) in 2020-21, £54 billion more than assumed in our *FSR* central scenario, driven by a combination of further health spending and the extension of further support to households and businesses during the second wave and associated lockdown. These higher costs are partly offset by lower than expected welfare spending.

1.33 Unlike in previous recessions, more of the jump in borrowing this year has been the result of government policy interventions than the drop in activity. Year-on-year borrowing increases by £337 billion, of which £280 billion is down to virus-related support measures. These include: additional funding for public services (£127 billion), especially health; employment and income support measures (£73 billion); and business support measures (£66 billion). Fiscal support has also been repeatedly extended as deadlines loomed or public health measures had to be tightened to bring the outbreak back under control (Chart 1.7). This year has seen fourteen separate fiscal policy announcements starting with the March Budget, costing an average of £20 billion per event in 2020-21. Each of these would have constituted a substantial Budget package in normal times.

Chart 1.7: The evolving cost of the coronavirus policy response in 2020-21



[1] Cost based on figures announced by the Chancellor in the Budget. All other costs based on our November forecast estimates.
Source: OBR

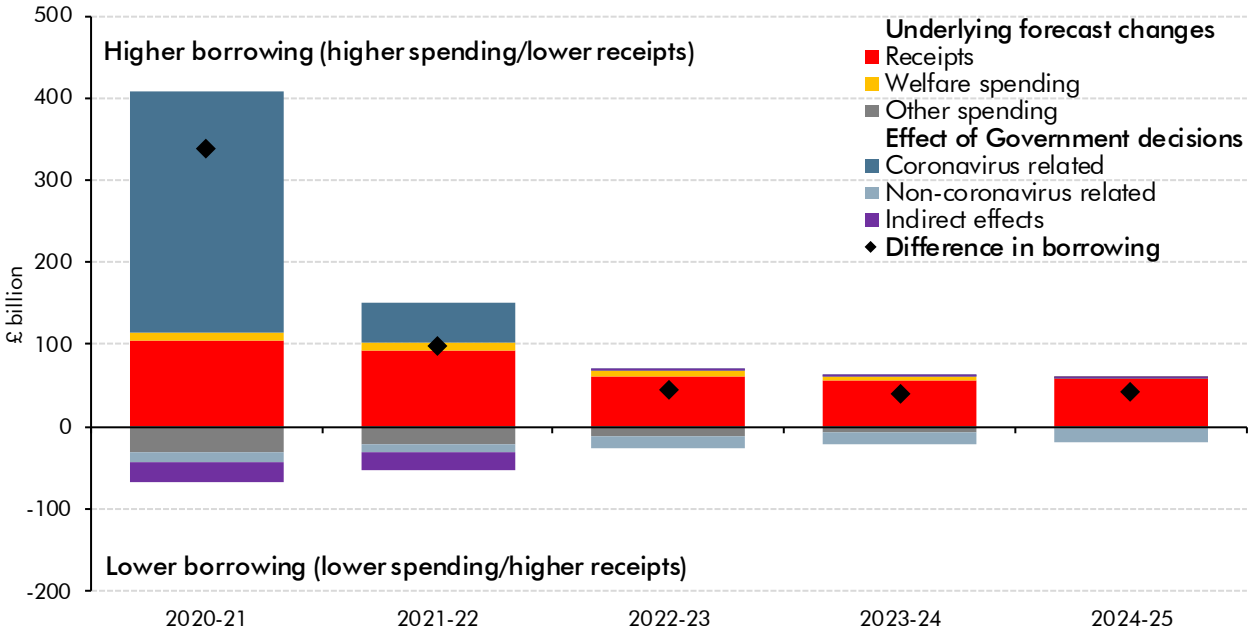
1.34 Receipts bounce back in 2021-22 as the economy reopens, activity normalises, and earnings and profits recover. But despite that, revenues remain £58 billion below our March forecast in 2024-25 thanks largely to nominal GDP being 4.5 per cent lower at the forecast horizon, overlaid by a modestly weaker effective tax rate. The latter reflects a somewhat greater hit to tax-rich labour income than to relatively lightly taxed profits, plus lost fiscal drag from weaker real earnings growth (dragging fewer taxpayers into higher income tax brackets) and the effect of lower equity and house prices on capital gains tax and stamp duty.

1.35 Spending falls dramatically in 2021-22 as the temporary increase in departmental spending and support to firms and households wanes, but is lifted by an additional £45 billion in virus-related expenditure, the bulk of which is for the test and trace programme. It falls further in 2022-23 as that virus-related spending comes to an end and unemployment starts to fall. Spending in 2024-25 is £16 billion lower than our March forecast, more than explained by lower debt interest spending and a lower medium-term path for departmental resource spending announced at the Spending Review. Despite the unwinding of the temporary virus-related spending over the forecast period, spending in 2025-26 only falls to 41.9 per cent of GDP, which is 2.1 per cent of GDP higher than its pre-virus level in 2019-20 and in line with the level in 2014-15.

1.36 Borrowing also falls rapidly in 2021-22 as economic activity and tax receipts recover and much of the temporary fiscal support to households and businesses expires. It falls further in 2022-23 as virus-related spending ends and, in our central forecast, settles at around £100 billion a year over the remainder of the forecast (around 4 per cent of GDP). Relative to our March forecast, the £339 billion upward revision to borrowing this year drops to £98 billion

next year, settling at around £42 billion higher from 2022-23 onwards. This medium-term difference is more than explained by lower receipts thanks to the scarring of real GDP and tax bases, but is partly offset by much lower debt interest spending and the £10 to £12 billion a year cut in departmental resource spending relative to March totals.

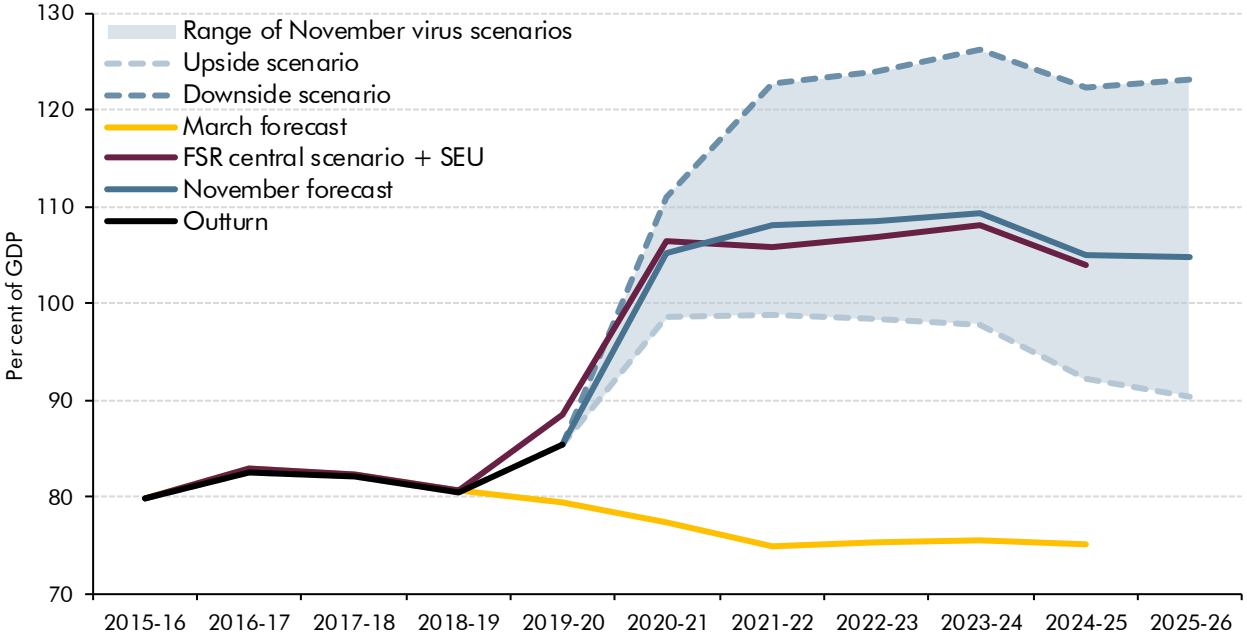
Chart 1.8: Changes in public sector net borrowing since our March forecast



Note: Indirect effects are calculated only on measures introduced since FSR+SEU for reasons set out in paragraph 3.4
Source: OBR

1.37 Headline public sector net debt (PSND) rises by £473 billion in 2020-21, taking it above 100 per cent of GDP for the first time since 1960-61. Thereafter it rises steadily until 2024-25, after which the repayment of loans under the Bank of England's Term Funding Scheme reduces headline PSND. Excluding the Bank of England schemes, net debt is lower but still rises to 91.9 per cent of GDP this year and increases steadily in every year of the forecast period to reach 97.5 per cent in 2025-26.

Chart 1.9: Public sector net debt: central forecast and alternative scenarios



Source: ONS, OBR

1.38 Despite sharply higher debt, further falls in interest rates and further gilt purchases by the Bank of England under quantitative easing mean that the cost of servicing that debt is actually lower than we forecast in March. So while debt reaches its highest level as a share of GDP since 1958-59, the debt interest-to-revenue ratio falls from 3.5 per cent in 2019-20 to a new post-war low of 1.7 per cent in 2021-22 before rising back to 2.2 per cent by 2025-26.

1.39 These favourable financing conditions suggest that the sharp rise in debt to absorb the cost of the pandemic has not undermined the sustainability of the public finances. Indeed, it is more likely that sustainability would have been damaged if the Government had not stepped in to support the private sector. But the higher stock of public debt and the significant shortening in the effective maturity of that debt this year, through both a reduction in the average maturity of primary issues and the purchases of longer-dated gilts on the secondary market by the Bank of England, has increased the vulnerability of the public finances to future economic shocks, in particular to a sharp increase in short-term interest rates. Since March, the sensitivity of debt interest to a 1 percentage point rise in short rates has doubled from £6 billion (0.2 per cent of GDP) to £12 billion (0.5 per cent of GDP).

1.40 As with the economy, the fiscal outlook depends upon the path of the pandemic and associated public health restrictions. This is especially true given that in some cases the Government has linked particular levels of financial support to particular levels of public health restrictions. In the scenarios either side of our central forecast, we therefore assume that the level of fiscal support varies with the severity of the virus and stringency of public health restrictions. Specifically:

- In the **upside scenario** we assume no differences in policy measures, but their cost is lower due to the more favourable path for the virus and public health measures. Employment support and guaranteed loan schemes cost £16 billion less than in our central forecast, with lower spending and stronger receipts leading borrowing to peak at £353 billion in 2020-21 (17 per cent of GDP), and to fall back to £47 billion (1.7 per cent of GDP) by 2025-26. Medium-term borrowing is actually a little lower than predicted in our March forecast thanks to the combined effect of lower debt interest spending and the lower medium-term path of departmental resource spending set out in the Spending Review. Debt stands at 90 per cent of GDP in 2025-26.

- In the **downside scenario** employment support and guaranteed loan schemes cost £19 billion more in 2020-21, and the third wave next year is assumed to prompt a further £30 billion of spending in support of public services, households and businesses. Borrowing peaks at £440 billion in 2020-21 (22 per cent of GDP), remains at £265 billion (13 per cent of GDP) in 2021-22, and then falls back to £156 billion (6 per cent of GDP) by 2025-26. Headline debt rises to 123 per cent of GDP in 2025-26.

1.41 The fiscal outlook is also contingent on the outcome of negotiations concerning our future trading relationship with the EU. While leaving the EU without a deal would provide a direct benefit to the public finances through higher tariffs on EU imports, this would be more than offset by the indirect fiscal costs associated with the attendant disruption to economic activity in the near term and lower productivity in the longer term. This would add a further £12 billion (0.7 per cent of GDP) to borrowing relative to our central forecast in 2021-22 and result in debt rising to 108 per cent of GDP by 2025-26, a level last seen in 1959-60. Combined with our upside virus scenario, debt would reach 93 per cent of GDP in 2025-26, while combined with our downside scenario it would reach 126 per cent.

Table 1.3: Overview of the central fiscal forecast

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Revenue and spending							
Public sector current receipts	37.3	37.3	38.2	37.7	38.0	38.0	38.1
Total managed expenditure	39.8	56.3	45.6	42.1	42.1	42.0	41.9
Budget 2020 fiscal targets							
Current budget deficit	0.6	15.1	4.6	1.5	1.2	1.1	1.0
Public sector net investment	1.9	3.9	2.8	2.9	2.9	2.9	2.8
Debt-interest-to-revenue ratio (per cent)	3.5	2.7	1.7	2.0	2.3	2.2	2.2
Legislated fiscal target and objective							
Public sector net borrowing	2.5	19.0	7.4	4.4	4.1	3.9	3.9
Cyclically adjusted net borrowing	2.6	18.6	6.7	3.9	3.9	3.8	3.8
Public sector net debt	85.5	105.2	108.0	108.6	109.4	105.0	104.7
	£ billion						
Revenue and spending							
Public sector current receipts	827.6	771.0	847.3	885.9	927.0	964.4	1004.3
Total managed expenditure	883.7	1164.6	1011.5	990.5	1027.4	1064.0	1106.1
Budget 2020 fiscal targets							
Current budget deficit	13.8	312.0	101.7	36.4	29.1	26.7	27.0
Public sector net investment	42.3	81.6	62.5	68.2	71.3	72.9	74.9
Legislated fiscal target and objective							
Public sector net borrowing	56.1	393.5	164.2	104.6	100.4	99.6	101.8
Cyclically adjusted net borrowing	57.8	384.4	148.6	92.5	94.2	96.2	100.4
Public sector net debt	1801	2274	2478	2602	2721	2714	2817

Performance against the Government's fiscal targets

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

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

1.43 All three legislated borrowing and debt targets are missed by wide margins in our central forecast and all our scenarios, whereas the welfare cap (restated in this event to reflect a change in how we forecast universal credit) is missed in our central forecast and downside scenario. In our March 2020 forecast, before the impact of the pandemic became apparent, the Government was on course to meet the debt target and welfare cap, to miss

the near-term structural deficit target by a narrow margin, and was getting further and further away from its longer-term objective to balance the budget.

1.44 The Government has not published a new draft *Charter*, but the Chancellor framed his March 2020 Budget against the three fiscal criteria that had featured in the Conservative Party's 2019 election manifesto, which are materially looser than the legislated targets. They require:

- the current budget to be in balance by the third year of the forecast (2023-24 in this one);
- public sector net investment (PSNI) not to exceed 3 per cent of GDP on average; and
- net debt interest spending to not exceed 6 per cent of non-interest receipts.

1.45 Only in our upside scenario are all three targets met:

- In our central forecast the **current budget** target is missed by £29 billion (1.2 per cent of GDP), while in our downside scenario it is missed by £99 billion (4.2 per cent of GDP). In our upside scenario this target is met with a margin of £19 billion (0.8 per cent of GDP), little changed from the time of our March forecast.
- The **PSNI** target is missed by the tiniest of margins in our downside scenario, but met by only slightly bigger margins in our central forecast (0.1 per cent of GDP) and upside scenario (0.2 per cent of GDP). It was met by a small margin in March too.
- The **debt-interest-to-revenue ratio** rule is comfortably met in all three scenarios, and by a larger margin than in March, despite debt being materially higher.

1.46 In the March Budget, the Government also promised to "*review the fiscal framework, consulting widely with a range of experts*" and "*report back in the autumn*" if "*any changes are necessary*". The pandemic has, understandably, led to a postponement of that review and no new official rules or targets have been articulated. However, in a speech to the Conservative Party conference in October, the Chancellor stated that the Government will "*protect the public finances*" by "*over the medium term getting our borrowing and debt back under control*", and that "*this Conservative government will always balance the books*".

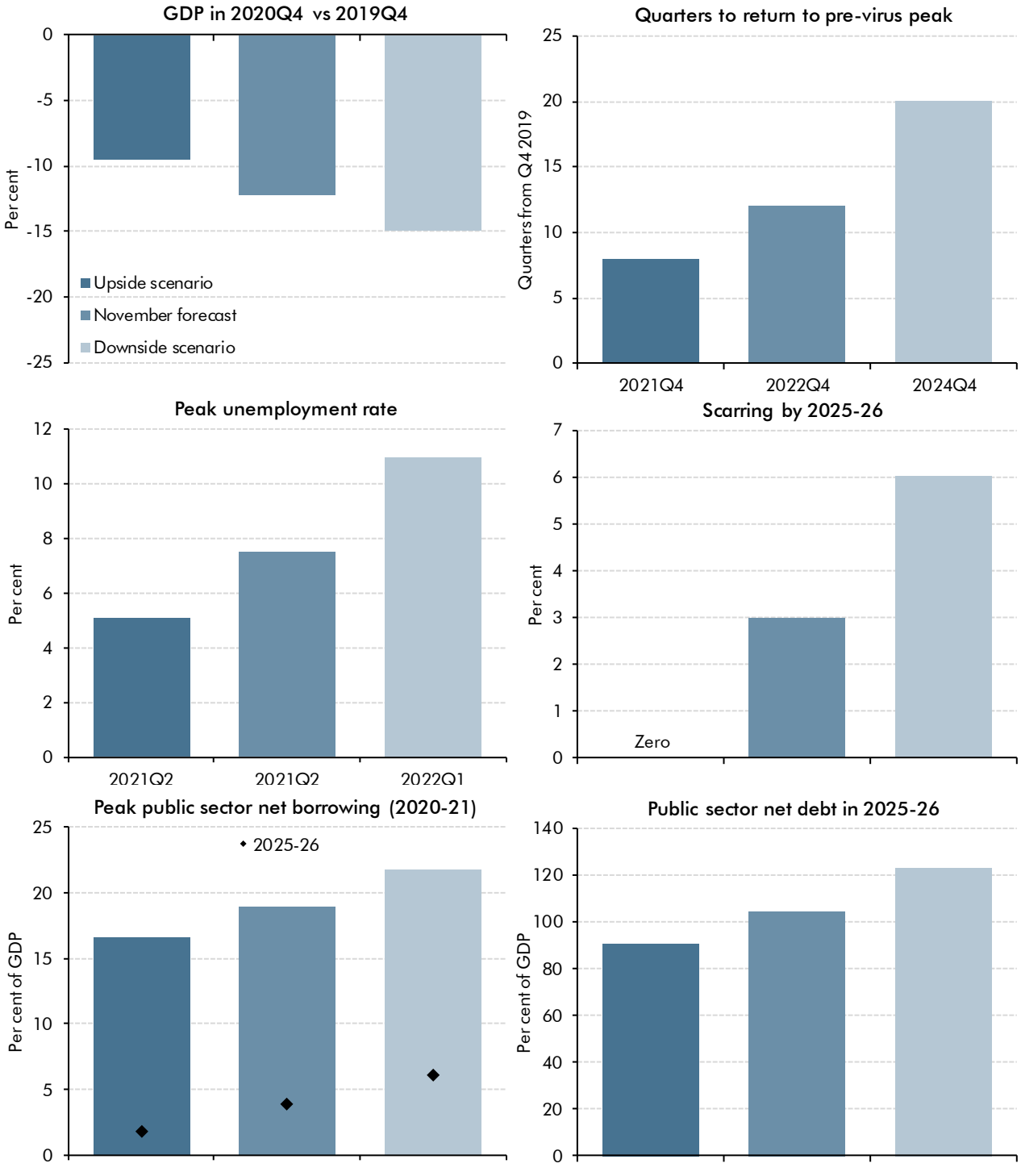
1.47 There were no specific metrics attached to these statements and 'balancing the books' and 'getting debt back under control' can mean different things to different people and in different contexts. But we have looked at several conventional definitions of fiscal balance and debt stabilisation over the five-year forecast horizon:

- Regarding **restoring the public finances to balance**, under our central forecast achieving a current balance, primary balance, or overall balance of zero would require tax rises or spending cuts of 1.0, 3.0, and 3.9 per cent of GDP respectively by

2025-26. Only in the upside scenario could a current balance of zero be achieved by then, with the primary balance and overall balance still in deficit.

- As regards **stabilising debt**, putting the headline debt-to-GDP ratio onto a flat or falling trajectory, is achieved by 2025-26 in both the central and upside scenarios but missed in the downside scenario. However, that is only true in the first two cases thanks to the repayment of Bank of England Term Funding Scheme loans at their four-year term. The underlying debt-to-GDP ratio, excluding the Bank of England, rises in 2025-26 under the central and downside scenario by between 0.8 and 1.8 per cent of GDP, though it falls in the upside scenario. The ratio of public sector net financial liabilities to GDP falls in 2025-26 in our central forecast and upside scenarios and rises only modestly in our downside scenario. Bringing debt under control on this metric therefore looks more achievable than on the other two.

Chart 1.10: Summary of virus scenario results



Source: ONS, OBR

2 Economic outlook

Introduction

2.1 This chapter describes:

- the assumptions regarding **the coronavirus pandemic and associated public health restrictions** that underpin our central forecast and scenarios (from paragraph 2.2);
- our assumptions concerning the UK's **future trading relationship with the European Union** in our central forecast and scenarios (from paragraph 2.11, and in an alternative no deal Brexit scenario (described in Annex B);
- our assumptions relating to **fiscal and monetary policy and asset prices** (from paragraph 2.13);
- the path of **real GDP** since the onset of the pandemic, together with possible future trajectories in light of the resurgence in infections and the renewed lockdown this Autumn (from paragraph 2.23);
- the associated paths for the **expenditure components** of GDP (from paragraph 2.45;
- the implications for the **labour market** (from paragraph 2.59) and for **inflation** (from paragraph 2.74);
- the outlook for **nominal GDP** (from paragraph 2.81), the **property market** (from paragraph 2.85) and **sectoral balances** (from paragraph 2.91); and
- a range of recent **external forecasts** for comparison (from paragraph 2.93).

Conditioning assumptions

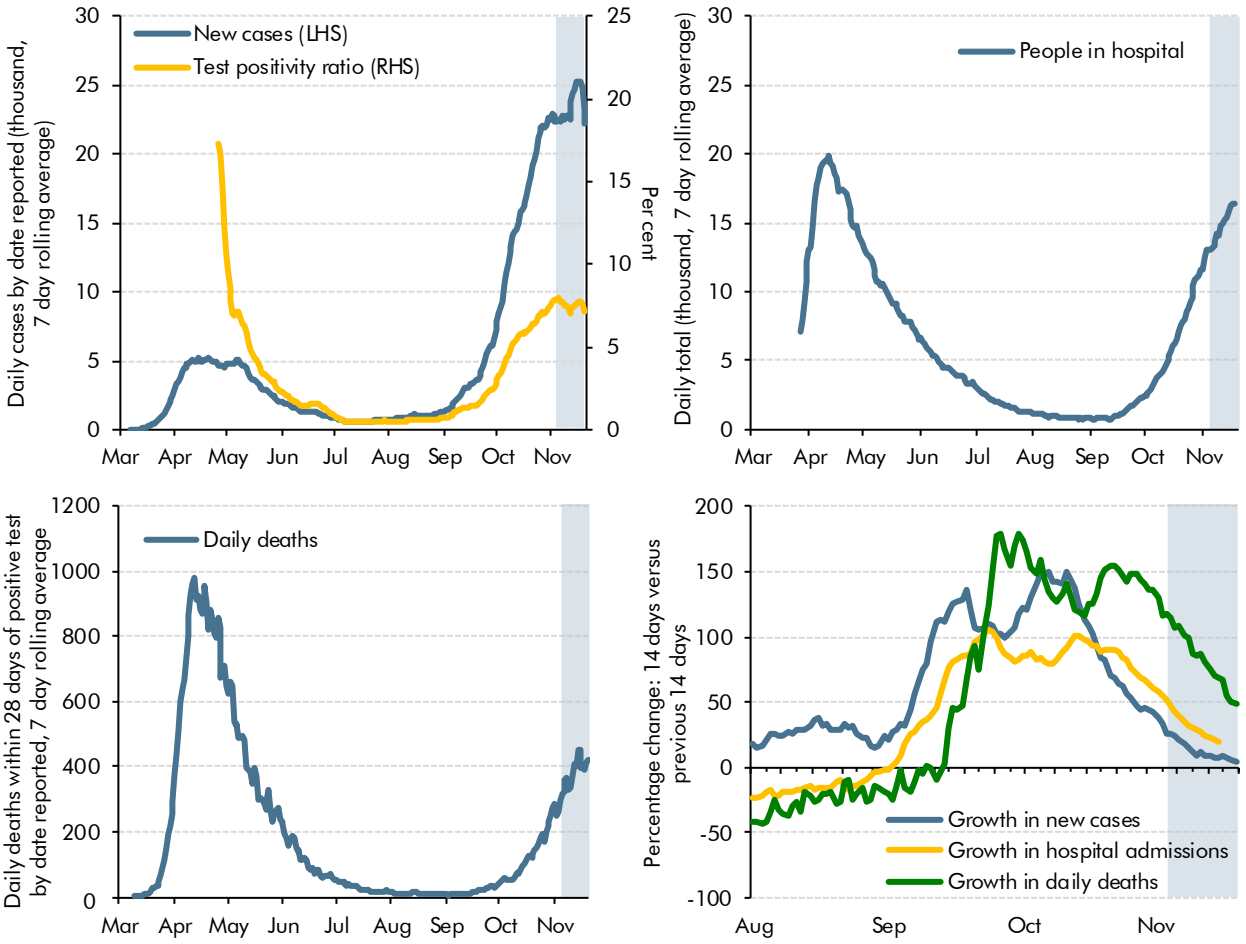
Coronavirus pandemic

2.2 The coronavirus pandemic has delivered the largest shock to the global and UK economies in living memory. During the first half of 2020, rising infections, hospitalisations and deaths led many governments to introduce public health restrictions to reduce the rate of transmission, while individuals sought to lower their risk of exposure by reducing social and economic interactions ('voluntary social distancing'). Those actions were successful in lowering infections in the northern hemisphere through the summer, but they inflicted considerable short-term damage on the level of economic activity. This represents the cost of bringing the virus back under control – it is not possible to say how much short-term

damage the virus would have inflicted had it been allowed to spread unchecked, overwhelming health services and taking even more lives. But we can be confident that the medium-term outlook would have been far worse had the Government not stepped in to provide the unprecedented peacetime levels of financial support to individuals and businesses extended since March.

2.3 Unfortunately, a resurgence of infections is now occurring across Europe and the US, including here in the UK. Vastly increased testing means that it is not meaningful to compare the current level of daily new cases to the first wave, but the recent rapid spread of the infection in the UK is evident. Meaningful comparisons can be made between the numbers in hospital with coronavirus and the numbers of deaths recorded within 28 days of testing positive, which have respectively reached around 80 per cent and 40 per cent of the peak levels experienced during the first wave of the virus (Chart 2.1). Growth in new cases has been slowing since around the middle of October when tiered restrictions were introduced in England, while growth in hospital admissions and deaths have slowed more recently, consistent with the lags between infection, hospitalisation and death when the virus proves fatal.

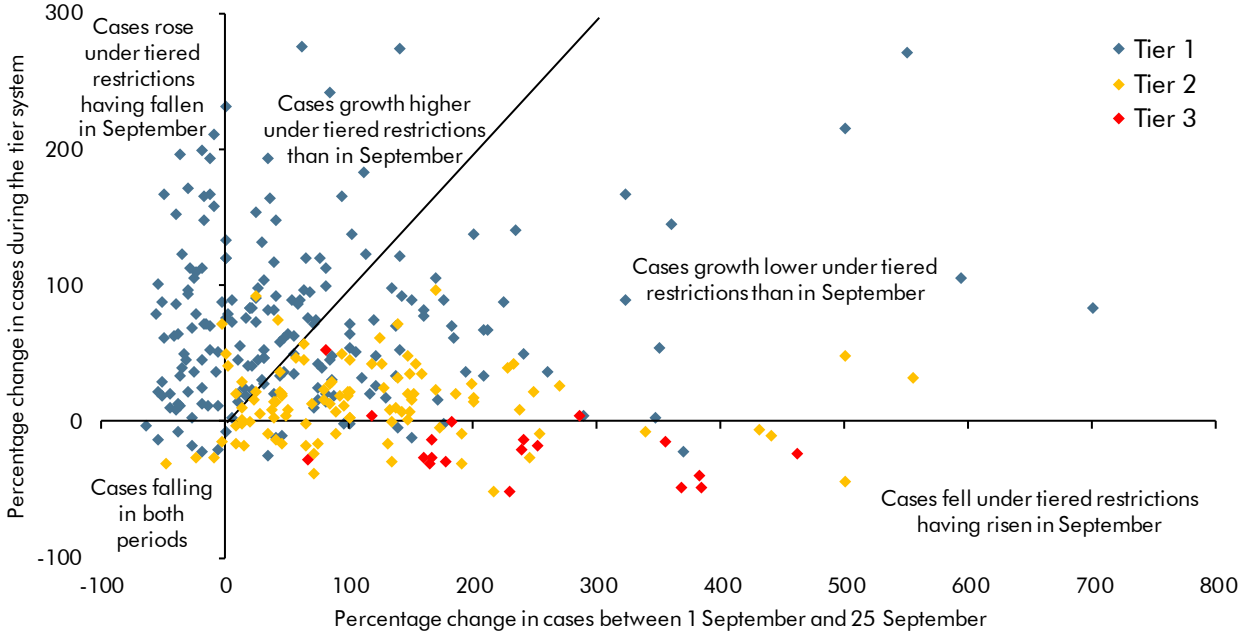
Chart 2.1: Coronavirus cases, hospitalisations and deaths



Note: Shaded area represents November lockdown period.
Source: GOV.UK

2.4 In response to this resurgence in infections, governments around Europe have tightened public health restrictions or reintroduced nationwide lockdowns. In the UK, the relevant authorities applied locally differentiated restrictions during the early autumn. These appeared to have contributed to a slowing in the rate of growth of infections, with growth in new cases generally slowing in places subject to Tier 2 in October and cases generally falling in places subect to Tier 3 restrictions (Chart 2.2). But the rising trajectory of hospital admissions was of sufficient concern for the Government to impose a second lockdown in England that began on 5 November and is presently due to end on 2 December. The Scottish Government implemented a new five-tier system from 2 November. A lockdown was introduced in Wales on 23 October that ended on 9 November, while heightened restrictions in Northern Ireland are due to be introduced on 27 November for two weeks.

Chart 2.2: Impact of tiered restrictions on growth in case numbers in England



Note: This chart shows the correlation between the tier in which each local authority in England was placed for the majority of the period between 14 October and 4 November and the change in case growth relative to the 1 September to 25 September that preceded the restrictions imposed on 26 September (which became Tier 1 on 14 October) in England.
Source: GOV.UK, Public Health England

2.5 The announcements that the Pfizer-BioNTech and Moderna vaccines had achieved excellent results in preventing infection in late-stage clinical trials, which arrived just as our forecasts were being finalised, is undoubtedly very positive news. However, it does not automatically imply an immediate or complete return to normal economic life for the whole population for several reasons. First, the Government has purchased enough of the Pfizer-BioNTech vaccine to immunise only 20 million people and enough of the Moderna vaccine for 2½ million (with delivery not expected until the spring). Widespread vaccination beyond vulnerable groups during 2021 would also likely require the Oxford-AstraZeneca vaccine to be successful. Second, the effectiveness of the Pfizer-BioNTech vaccine in preventing asymptomatic transmission is as yet unknown, as is the longevity of the immune response. Third, the rolling out of the vaccines across the bulk of the population represents a considerable logistical challenge and will take time. Finally, there is a possibility the virus

will mutate in a way that renders the vaccines ineffective; the recent mutation via mink farms in Denmark is indicative of the risks.

2.6 The uncertain course of the pandemic and its severe impact on economic life and the public finances mean that the economic and fiscal outlook also remains highly uncertain. The future path of the virus, the public health restrictions required to keep it in check and the prospects for the rollout of an effective vaccine are all uncertain, as is the response of governments, businesses and households to the unfolding situation. In this context, it makes little sense to focus attention on a single central forecast. Rather, as in our July 2020 *Fiscal sustainability report* (*FSR*), we believe it is more useful to illustrate the range of plausible outcomes by presenting several scenarios, each of which embodies different assumptions regarding the course of the pandemic. So, as well as our central forecast, we have produced upside and downside scenarios that embody optimistic and pessimistic assumptions respectively regarding the path of the pandemic, associated public health measures, and their economic and fiscal impact.

2.7 Our **upside scenario** assumes that the lockdown now in place substantially reduces the infection rate by 2 December. Thereafter, an effective test, trace, and isolate (TTI) programme keeps outbreaks in check together with a return to a tiered system of local public health restrictions similar to that in place prior to the lockdown. While these may vary in intensity both regionally and temporally, they are broadly the same as remaining at the equivalent of England's pre-lockdown Tier 2 until the spring. An effective vaccine becomes widely available in the spring of 2021, permitting a further easing of health restrictions and a gradual return to normality as the year progresses. The medium-term economic impact of the pandemic is assumed to be negligible in this scenario.

2.8 In our **central forecast**, a higher infection rate at the end of the lockdown and a less effective TTI system necessitate keeping a moderately stringent set of public health restrictions in place over the winter. These may vary regionally and temporally but are broadly the same as remaining at the equivalent of England's pre-lockdown Tier 3 until the spring. The arrival of warmer weather then allows an easing of the restrictions. An effective vaccine becomes widely available in the latter half of the year, permitting a gradual return to more normal life, though at a slower pace than in our upside scenario. In this scenario, there is also a lasting, though modest, adverse impact of the pandemic on the economy.

2.9 In our **downside scenario**, continued high infection rates after the lockdown ends on 2 December and a relatively ineffective TTI system mean that very stringent public health restrictions need to be kept in place throughout the winter. These may vary regionally and temporally but are broadly equivalent to somewhere between England's pre-lockdown Tier 3 and the November lockdown. The arrival of spring again permits some easing of the restrictions but, unlike in our central forecast, a sufficiently effective vaccine does not become available. Subsequent waves of infection necessitate the periodic re-imposition of health restrictions, while the continued risk of infection induces more lasting changes in economic and social life. In this scenario, we include a third wave of infections next winter whose economic impact is roughly half that of the present wave. The longer-term economic impact of the pandemic is also significantly greater than in our central forecast.

2.10 A variety of intermediate outcomes are also possible. For instance, it is possible that the downside scenario may turn out to be the best guide in the short term but the early rollout of an effective vaccine means that the central forecast or upside scenario provides a better description of the medium term. Rather, the upside and downside scenarios have been chosen to illustrate a range of plausible outcomes. The upside scenario represents a 'reasonable best case'. It is, though, possible to envisage even worse economic outcomes than in our downside scenario. We also make no attempt to assign probabilities to any particular outcomes, so our central forecast is best interpreted as representing an intermediate scenario rather than a median (or mean) forecast. Finally, we have not produced the upside and downside scenarios in as much detail as the central forecast, concentrating on the variables that are most important for the public finances.

EU Exit

2.11 We continue to assume that the UK and EU conclude a free-trade agreement (FTA) and that there is a smooth transition to the new trading relationship after the transition period ends on 31 December 2020. However, there is evidence that neither the Government nor businesses are fully prepared for the imminent changes even if a deal is agreed.[1] For example, the Bank of England's Decision Maker Panel survey for October reports that over a third of firms are either only partially prepared or not prepared at all. If an agreement is successfully concluded, we assume that officials on both sides of the border will display a degree of discretion in order to minimise disruption to trade. But some short-term disruption, especially to exports, remains a downside risk – the Bank's latest forecast assumes that such disruption will reduce GDP by around 1 per cent in the first quarter of 2021. We factor no such short-term disruption into our central forecast, upside scenario or downside scenario but maintain our assumption from previous forecasts that an FTA will lower both export and import intensity over time, and that productivity will be 4 per cent lower in the long run than if the UK had remained a member of the EU. These assumptions are based on an average of external estimates of the impact of moving from being a member of the EU to trading under a 'typical' FTA.[2]

2.12 The unresolved nature of the negotiations between the UK and EU means that other outcomes are possible, including that no agreement is reached and the UK defaults to trading with the EU on World Trade Organization (WTO) terms from 1 January 2021. Annex B considers the potential economic and fiscal consequences of such an outcome. It concludes that a 'no deal' Brexit could reduce real GDP by a further 2 per cent in 2021, due to various temporary disruptions to cross-border trade and the knock-on impacts. As these abate, the longer-term effects of lower trade intensity continue to build such that output is 1.5 per cent lower than our central forecast after five years, and 2 per cent lower in the long run (with the impact on GDP in the first year and after five years similar to the scenario presented in our 2019 *Fiscal risks report* (*FRR*)). Outcomes lying between a typical FTA and WTO terms are of course also possible.

[1] *The UK border: preparedness for the end of the transition period*, National Audit Office, 6 November 2020.
[2] See Discussion Paper No.3: *Brexit and the OBR's forecasts,* October 2018; and Box 2.1 of the March 2020 *Economic and fiscal outlook*.

Fiscal policy

2.13 Since March, the Government has announced increases in spending that are unprecedented in peacetime (and some temporary tax reductions and deferrals) designed to meet the hugely increased pressures on health and other public services, and to support households and businesses. That comes on top of the substantial increases in spending – on public investment in particular – that had already been announced in the March 2020 Budget. In the short term, this extra spending will cushion the blow to household incomes and business finances arising from the pandemic. And in the medium term, it should reduce unnecessary job losses and business failures, thus limiting any persistent 'scarring' of the economy's supply capacity and future tax base. The Government has, in effect, operated as an 'insurer of last resort', with private sector incomes falling considerably less than private sector output and expenditure. It has also pushed government borrowing this year to a post-war high.

2.14 The cost of policy measures announced since our March forecast up to and including the Chancellor's Summer Economic Update (SEU) on 8 July totalled £192 billion (9.3 per cent of GDP) in 2020-21. Further fiscal measures have been announced in the period since then, ramping up as public health restrictions have been tightened in the face of the second wave of infections. These included the Winter Economy Plan on 25 September and subsequent amendments to it, as well as the Spending Review announced alongside this forecast. We estimate that these announcements will add a further £99 billion (4.8 per cent of GDP) to the total cost of measures in 2020-21.

2.15 Our standard approach to evaluating the economic effects of fiscal policy measures is to construct a 'pre-measures' forecast, which describes the path of the economy in the absence of any policy response. Our final 'post-measures' forecast then incorporates our estimate of the marginal economic impact of the policy measures using our standard 'fiscal multipliers'. But such an approach would not be fruitful in the present circumstances given the near-impossibility of quantifying the immense economic damage that would have been inflicted had the authorities not provided any additional support to firms and households since March. Given this, and the fact that a significant proportion of the short-run economic effect of the policy response has already taken place, we have adopted a different approach for this *Economic and fiscal outlook (EFO)*. We have instead focused on producing a plausible set of 'post-measures' economic scenarios and used a modified version of our standard fiscal multipliers (Box 2.1) to estimate the economic impact of just the additional policy measures announced since the SEU, which reveal an implied 'pre-measures' baseline.

Box 2.1: The impact of fiscal policy on GDP growth and unemployment

We normally evaluate the output consequences of fiscal measures by applying 'fiscal multipliers' based on the historical impact of additional public spending or tax cuts on the economy. These multipliers capture the indirect effects of the fiscal measures on activity over and above their immediate effect on demand and through raising private incomes and spending. However, they also take account of the consequent upward pressure this puts on wages and prices and the monetary policy response by the Bank of England necessary to keep inflation at target, which

explains why they taper to zero over the five year forecast horizon.[a] The unusual nature and size of the current economic shock and of the Government's fiscal response raise the question of whether such multipliers should be different in the present circumstances.

There are several reasons why multipliers might be higher than usual at the moment:

- The **proximity of policy interest rates to their lower bound** means monetary policy may be less able to respond to changes in the margin of spare capacity and inflationary pressure.[b] If that were the case, then 'financial crowding out' would be weaker. Policymakers at the Bank of England believe, however, that they still have considerable monetary firepower available in the form of further asset purchases (quantitative easing) and targeted loan support (credit easing) and which could be scaled back if inflationary pressures were to build.[c]
- There is **less room to crowd out private sector investment** when private capital spending has already been cut sharply in response to the pandemic and Brexit. In our central forecast, business investment in the second half of the 2020-21 fiscal year is down almost 25 per cent on a year earlier.
- There may be **less upward pressure on inflation** from extra spending when there is a large margin of spare capacity in the economy. While we do judge there to be a modest output gap of around 1 per cent in the second half of 2020-21, the simultaneous fall in supply and demand as a result of the virus and related public health measures means that it is very much less than the reduction in activity. It is also small compared to the output gap that followed the 2008 financial crisis.

There are also several reasons why multipliers might be lower than usual:

- **Public health restrictions and voluntary social distancing by households** mean that spending in sectors such as hospitality, transport and tourism may be quite insensitive to fiscal expansion, with some consumers (especially those with higher incomes) saving more instead. That may explain why the household saving rate leapt to 28 per cent in the second quarter of this year, though the extra savings may subsequently sustain a stronger rebound in spending.
- In addition to this 'forced' saving, **households' concerns about future employment and earnings prospects** could prompt an increase in precautionary saving. This would also reduce households' propensity to spend out of extra income received via any fiscal stimulus.
- Some of the **additional government spending during the pandemic has an unusually high import content**. The vast majority of government spending on personal protective equipment (PPE) and coronavirus testing kits to date has been on imports.[d] This increased foreign 'leakage' reduces the domestic fiscal impulse provided by government spending and thus its effect on GDP in the UK.

Given the arguments on both sides, there is considerable uncertainty about the appropriate multipliers to apply at the current juncture. The US Congressional Budget Office recently

published an analysis of the likely effects of pandemic-related measures there on output, which also posited several factors that might leave multipliers higher or lower at the moment.[e]

In this *EFO*, we have largely employed the same set of multipliers as in previous forecasts but have diverged from these in three respects. First, we have reduced the impact multiplier on departmental spending by a quarter to reflect the greater import-intensity of that spending relative to existing departmental spending. Second, we have assumed that spending on the extended job retention and self-employment support schemes has one quarter of the impact on demand as typical non-departmental spending, to reflect the greater likelihood of forced or precautionary saving by recipients and that some could have borrowed in the absence of these schemes to smooth consumption. Third, in the absence of a standard approach to factoring in the impact of loan guarantee schemes, we have assumed that extending the schemes has a modest short-term effect on demand.

Extending the Coronavirus Job Retention Scheme (CJRS) to March also means that the output consequences of the second wave and the public health restrictions to contain it are mainly felt in lower average hours worked rather than in higher unemployment, delaying and lowering the rise in unemployment.

In addition to the short-term economic impact of the fiscal measures, there is the important question of their impact in the longer term.

- By helping to **contain the spread of the virus**, some of the health-related spending, especially on testing and tracing, and on vaccine development and deployment, facilitates the application of less stringent public health restrictions and an earlier return to normal life. It thus helps to push the trajectory of output towards our more optimistic scenario. It is very difficult to know how to calibrate this effect, but the experience of South Korea, where test, trace and isolate has been effective in keeping the economy open, demonstrates just how significant it may be.
- A key objective of the CJRS and the loan guarantee schemes is to **avoid the long-term scarring** of potential output that could arise if viable jobs and businesses are lost. Again, it is extremely difficult to quantidy this effect of the measures because there is so little previous experience to draw on, though it too may be substantial.

Table A summarises the fiscal multipliers used in this *EFO*. As in recent *EFOs* we assume that the multipliers taper from the point of announcement rather than from the point of implementation.

Table A: Fiscal multipliers

	Impact of a one per cent of GDP increase in category on real GDP					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Tax	0.33	0.30	0.23	0.14	0.05	0.00
RDEL	0.34	0.31	0.22	0.10	0.03	0.00
CDEL	1.00	0.83	0.43	0.23	0.07	0.00
CJRS	0.15	0.14	0.11	0.06	0.02	0.00
Other AME	0.60	0.57	0.43	0.23	0.07	0.00

With new measures factored into this forecast totalling around £100 billion in 2020-21 and £40 billion in 2021-22, real GDP would have likely taken a materially weaker near-term path in their

absence. A mechanical application of the multipliers in Table A implies that the level of GDP would have been almost 3 per cent lower, absent the latest measures, at the peak of their impact at the start of 2021. The combined effect of this and the extension of the CJRS, means that unemployment would have peaked two quarters earlier and at a higher level without the latest measures. We estimate that unemployment would have been about 300,000 higher in the second quarter of 2021 in the absence of these measures.

[a] See Box 2.2, *Forecast evaluation report*, December 2019, for a summary of our usual approach.
[b] For instance: DeLong and Summers, "Fiscal Policy in a Depressed Economy", *Brookings Papers on Economic Activity*, Spring 2012.
[c] "The central bank balance sheet as a policy tool: past, present and future", speech by Governor Andrew Bailey at the Federal Reserve Bank of Kansas Symposium, August 2020.
[d] Department of Health and Social Care, *Huge increase in UK personal protective equipment production*, 28 September 2020.
[e] The Effects of Pandemic-Related Legislation on Output, US Congressional Budget Office, September 2020.

2.16 The cost and economic impact of several virus-related measures vary across the upside, central and downside scenarios, as outlined in Chapter 3. Moreover, the Government has in some cases linked levels of financial support to particular levels of public health restrictions. We assume no early withdrawal or additional policy in the upside scenario, but do reduce the forecast cost of existing support to firms and households consistent with the more rapid recovery in activity, employment and earnings. In the downside scenario, we therefore assume that there is an additional fiscal policy response next year of a size that is proportional to the smaller relative severity of the third wave of the virus in that scenario. This would support output relative to a world in which the virus re-emerged and public health restrictions were re-imposed, but additional fiscal support did not follow.

Monetary policy and asset prices

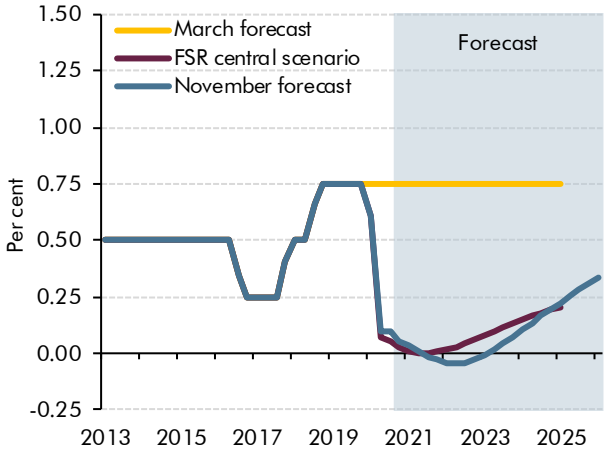
2.17 The Monetary Policy Committee (MPC) has cut Bank Rate twice since March, reducing it from 0.75 to 0.1 per cent. It has also increased the stock of corporate and UK government bond purchases – 'quantitative easing' – by £250 billion to £895 billion. Equity and oil prices fell significantly in March as the pandemic began to spread globally, but rebounded somewhat thereafter. The sterling effective exchange rate has been volatile in 2020, falling noticeably during the second quarter of 2020 following lockdown, perhaps because activity in the UK was hit harder than in our main trading partners (see Box 2.2).

2.18 For our forecast of financial market variables we typically use market-implied expectations over a 10-day window – a period that aims to be short enough to capture the latest market view, but long enough not to be susceptible to day-to-day volatility. On this occasion, the announcement of the Pfizer-BioNTech vaccine late-stage trial results on 9 November lifted UK and global equity prices and other financial markets in a way that seemed likely to be sustained. We have therefore used the level at which financial markets closed on 9 November as the starting point for this forecast.

2.19 Following our normal approach equity prices are then projected to grow in line with nominal GDP. Oil prices follow the futures curve initially and are flat in real terms thereafter. The exchange rate is assumed to stay flat in nominal terms. The resulting forecasts and how they compare to our March forecast and *FSR* scenario are shown in

Charts 2.3 to 2.6. We have adopted the same conditioning assumptions in our upside and downside scenarios.

Chart 2.3: Bank rate



Source: Bank of England, Datastream, OBR

Chart 2.4: Sterling effective exchange rate

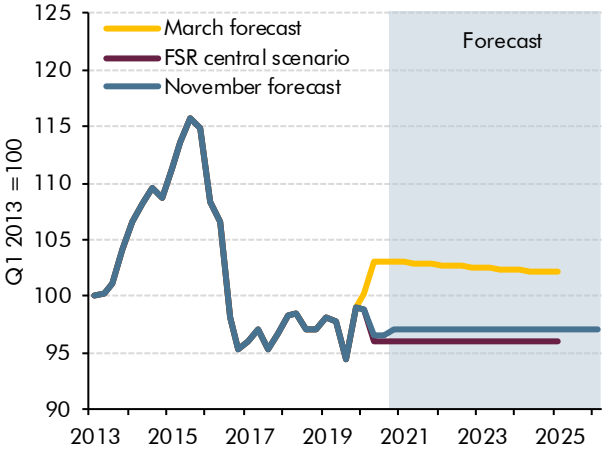
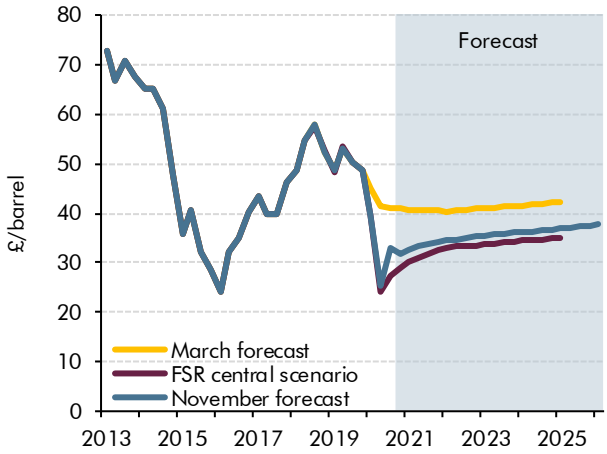
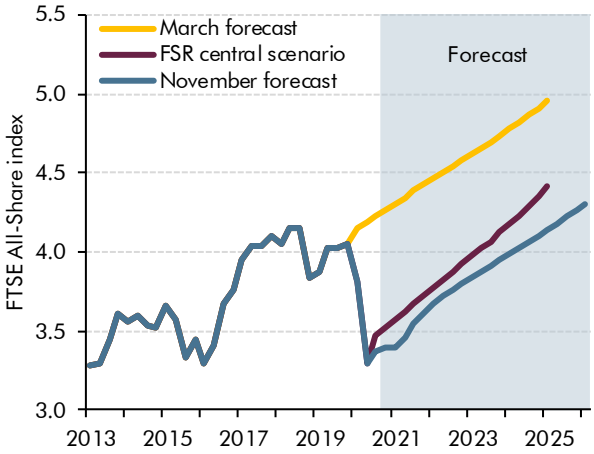


Chart 2.5: Oil prices



Source: Bank of England, Datastream, OBR

Chart 2.6: Equity prices



World economy

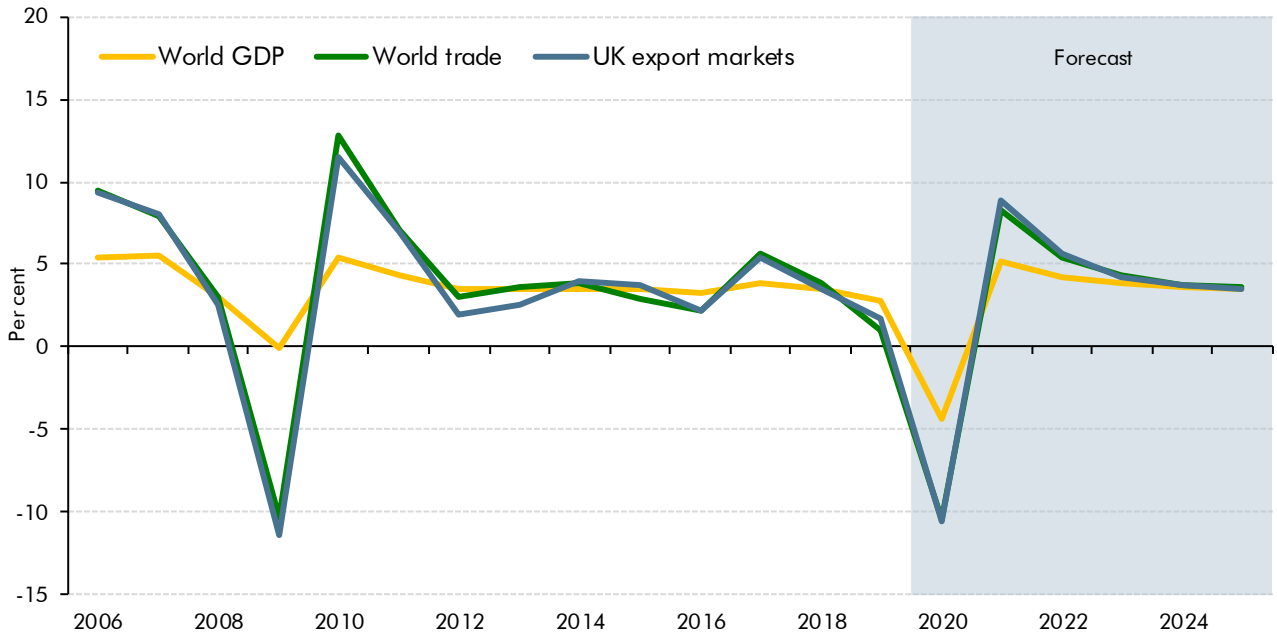
2.20 As usual, our world economy forecast draws heavily on the IMF's *World Economic Outlook* (*WEO*), the latest edition of which was published in October. That incorporated the sharp decline in global output in the first half of this year and the subsequent partial recovery, together with initial estimates of the longer-term implications of the pandemic for activity. The projections were, however, compiled before the strength of the second wave in Europe and the US became evident.

2.21 Global growth estimates have been cut sharply since our March *EFO* as a result of the pandemic. Euro area GDP collapsed in the first half of 2020, falling by 15.1 per cent, reflecting the impact of official lockdowns and voluntary social distancing. The fall in US GDP was smaller, but still a substantial 10.1 per cent. China managed to record growth of 0.5 per cent on the back of strong public investment and an increase in exports of medical

equipment. Global output is projected to fall by 4.4 per cent over 2020 – a much larger contraction than experienced in 2009 following the financial crisis (Chart 2.7). The fall in global output, and the incomplete subsequent recovery, result in world GDP being around 6 per cent lower in 2024 than forecast in March.

2.22 World trade has also fallen sharply, even more so than world GDP. Trade volumes are expected to fall by 10.4 per cent in 2020, reflecting both depressed global activity and firms reducing their reliance on foreign suppliers. UK export markets are also expected to contract sharply in 2020, falling by 10.6 per cent, slightly less than the 11.4 per cent contraction following the 2009 financial crisis. The medium-term forecast then largely matches the profile for world trade growth.

Chart 2.7: Growth in world GDP, world trade and UK export markets



Source: IMF, OBR

Table 2.1: Global GDP and trade growth

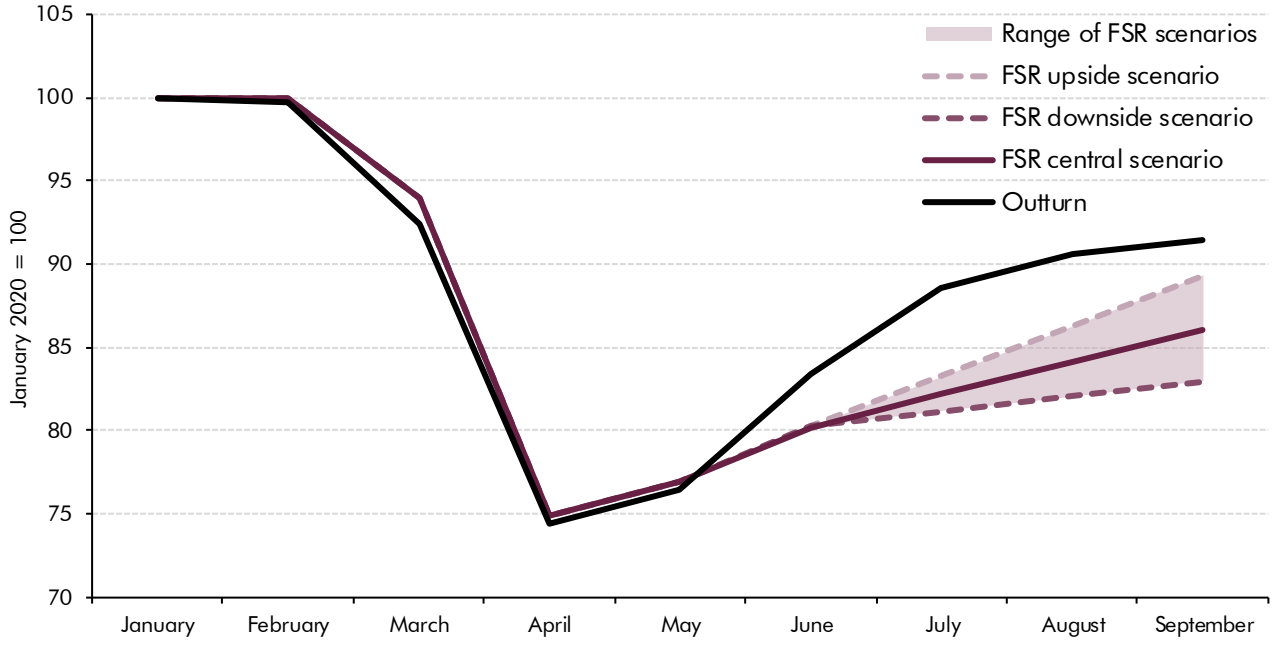
	Percentage change on a year earlier						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
GDP							
Euro area	1.3	-8.3	5.2	3.1	2.2	1.7	1.4
US	2.2	-4.3	3.1	2.9	2.3	1.9	1.8
World	2.8	-4.4	5.2	4.2	3.8	3.6	3.5
Trade							
UK export markets	1.7	-10.6	8.8	5.7	4.2	3.7	3.5
World	1.0	-10.4	8.3	5.4	4.3	3.8	3.6

Real GDP forecast and scenarios

Recent developments

2.23 The first wave of the virus and the associated lockdown and voluntary social distancing led to a 25.6 per cent fall in real GDP between its pre-virus peak in January 2020 and its trough in April. Output rebounded sharply in the summer after the lockdown was eased, and government policy shifted towards restoring normal economic activity in some sectors. In particular, the Chancellor's £0.8 billion 'Eat Out to Help Out' subsidy in August supported a 68 per cent rise in accommodation and food services output that month. The rebound in activity overall took GDP back to 8.6 per cent below its pre-virus peak by September, which was above even our *FSR* upside scenario (Chart 2.8). But the pace of recovery was already slowing by then as the second wave of infections began to take hold.

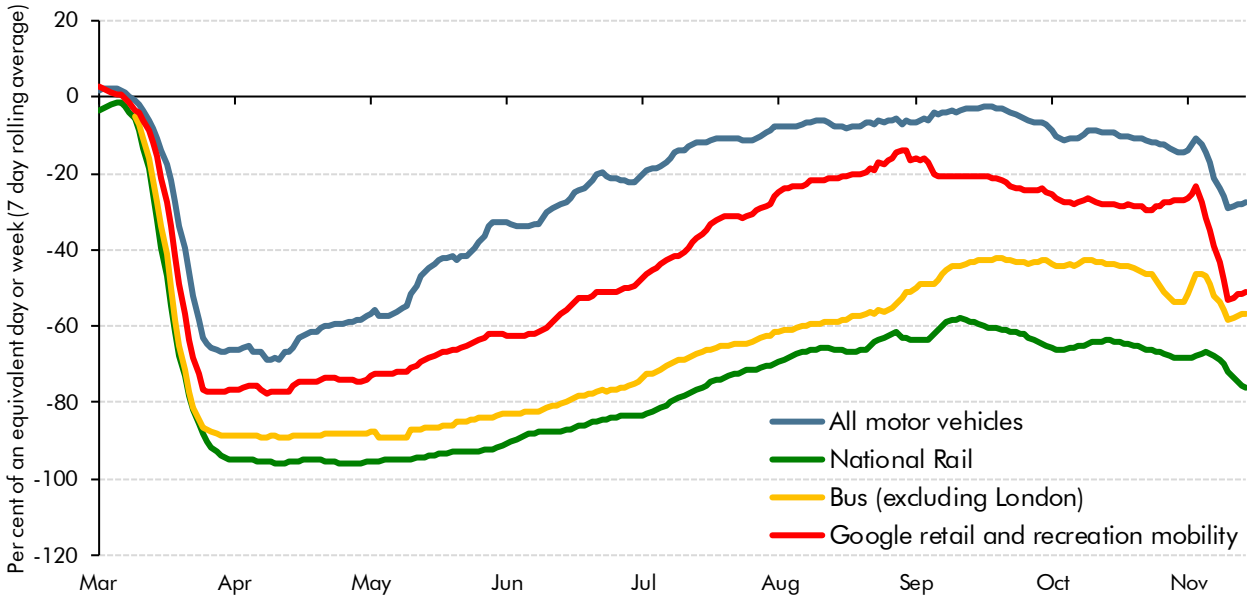
Chart 2.8: Monthly real GDP



Source: ONS, OBR

2.24 The signal from the slowing pace of monthly GDP growth is matched in high-frequency indicators that suggest the resurgence in infections, stricter public health measures and increased voluntary social distancing had already caused activity to slow before the latest lockdown was imposed in England. This was true of Google's mobility indicators and the Department for Transport's transport usage data (Chart 2.9).

Chart 2.9: Real time mobility indicators



Note: A 7 day rolling average from the 1 March to 15 November 2020. The DfT motor vehicle data is relative to the equivalent day in the first week of February. The National Rail data is relative to the equivalent week in 2019. The bus data is relative to the equivalent day of the third week of January 2020. The Google mobility data is UK retail and recreation visits relative to the median value for the corresponding day of the week during period between 3 January to 6 February.
Source: Department for Transport, Google

2.25 Many other countries also experienced sharp declines in activity during the first half of the year. Box 2.2 sets the UK experience of the virus and its economic impact in international context. It notes that the severity of the virus, the stringency and duration of the lockdown and the economic damage were all greater in the UK than in most other countries.

Box 2.2: International comparisons of the virus and activity

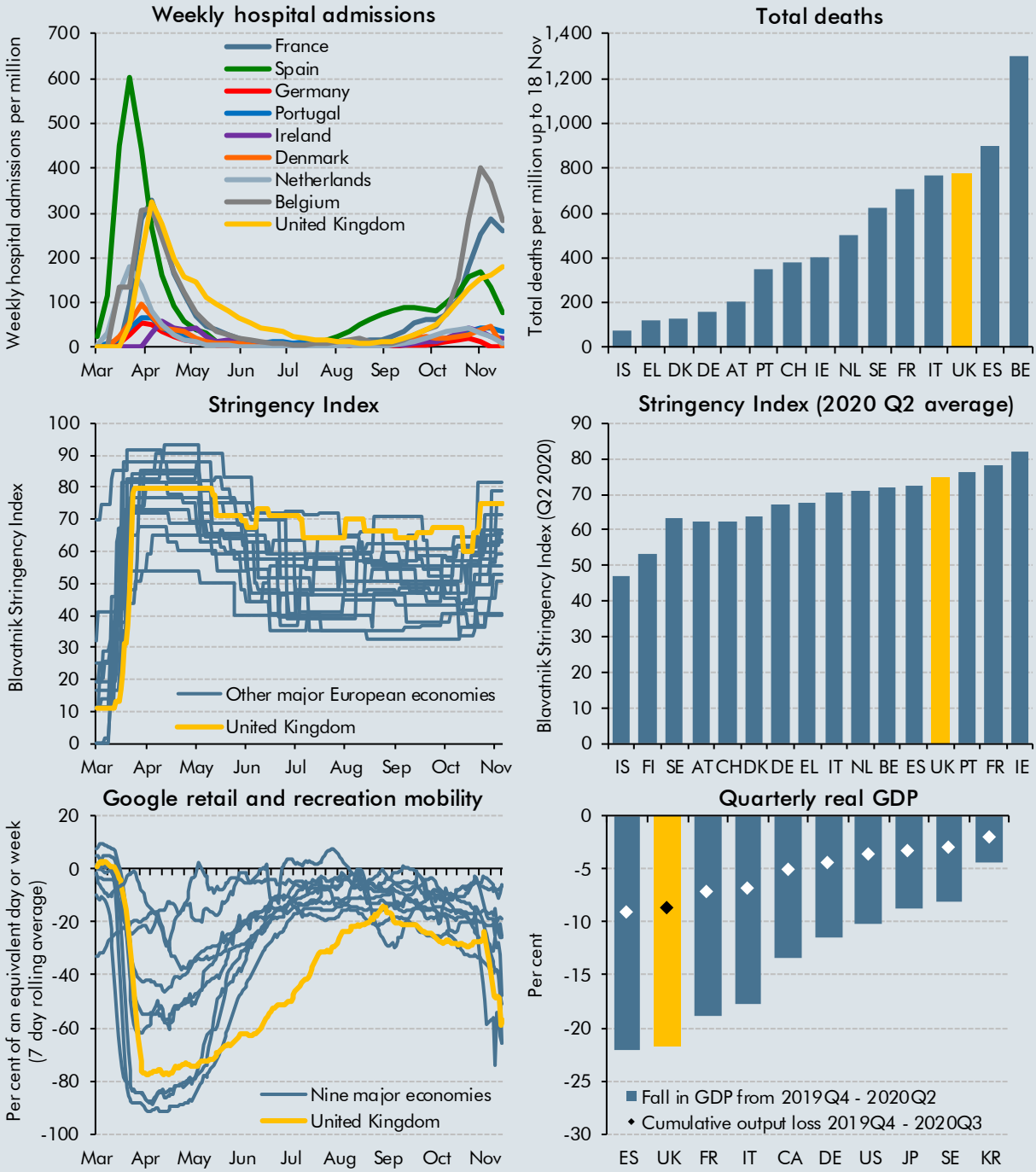
The coronavirus pandemic has forced governments around the world to implement a variety of social distancing measures and restrictions on social and economic life in order to curb the spread of the disease. The stringency of the restrictions has varied between countries and over time depending on, among other things, the prevalence of the disease and the effectiveness of test, trace, and isolate. Both public anxiety about contracting and transmitting the virus and the severity of official restrictions have played a role in depressing economic activity, with the IMF estimating that internationally each contributed about half to the fall in output during the first wave of infections.[a]

A key factor determining the strictness of public health restrictions in the UK was the number of hospitalisations, as the Government sought to prevent the National Health Service being overwhelmed. Chart A (top-left panel) shows weekly hospital admissions in major European countries from March to November. The UK was among those with the highest number of admissions, reaching a peak of 325 a week per million people. Deaths follow admissions with a lag of a couple of weeks or so (top-right panel). The UK also ranks comparatively highly relative to other major European countries in the overall number of deaths attributed to coronavirus.

The UK Government responded to the first wave of infections by introducing a lockdown on 23 March that lasted until 4 July, during which all but essential travel was limited, and industries such as non-essential retail, hotels, pubs and restaurants were largely forced to close. Similar lockdown measures were introduced across Europe and throughout large parts of the rest of the world, but varied in their severity, scope, and duration. Chart A (middle panels) also shows the 'Stringency Index', constructed by Oxford University's Blavatnik School of Government, which measures the severity of public health restrictions. It covers 16 major European countries where the onset of the surge in cases early in the year roughly coincided. From March, the stringency index for all these countries increased, with the UK being among the last to move. As infection rates and hospital admissions began to fall, restrictions were partially relaxed everywhere. But the level of stringency remained relatively high and for longer in the UK than the other countries. Several countries have tightened restrictions in recent weeks, with regional 'tiered' restrictions introduced in England on 14 October, followed by a second lockdown on 5 November.

The effect of restrictions and voluntary social distancing was a sharp slowdown in activity, especially in those sectors involving high levels of personal interaction. Chart A (bottom-left panel) shows the particularly large drops in activity in the retail and recreation sector, as measured by Google's mobility index. The UK experienced one of the larger falls, down 77 per cent in April relative to pre-virus levels.[b] Activity was also slower to recover in the UK as restrictions were eased, with output still 8.5 per cent below pre-virus levels in September, while it had recovered completely in some other countries. This contributed to the UK experiencing one of the largest falls in GDP over the first half of 2020 (down approximately 22 per cent between the final quarter of 2019 and second quarter of 2020) and a relatively high cumulative loss of GDP by the third quarter of 2020, with only Spain faring worse among major economies (bottom-right panel).[c]

Chart A: International comparisons of virus, public health measures and economic impact



Note: Hospital admissions data are only available for a subset of major European countries. Of the 16 that aren't included in the hospital admissions chart (Iceland, Greece, Finland, Sweden, Austria, Switzerland and Italy), only Italy saw hospital occupancy reach higher levels per million people than in the UK.
Source: Blavatnik School of Government, Google, Our World In Data.

[a] See Chapter 2 of the October 2020 IMF World Economic Outlook.
[b] Pre-coronavirus baseline is the median value for the corresponding day of the week, during the five-week period 3rd January to 6th February 2020.
[c] Some countries, including the UK, use direct measures of some public sector output but others assume that it is given by the associated inputs. If the latter approach were still used in the UK, then the fall in GDP the second quarter would have been around 4 percentage points smaller.

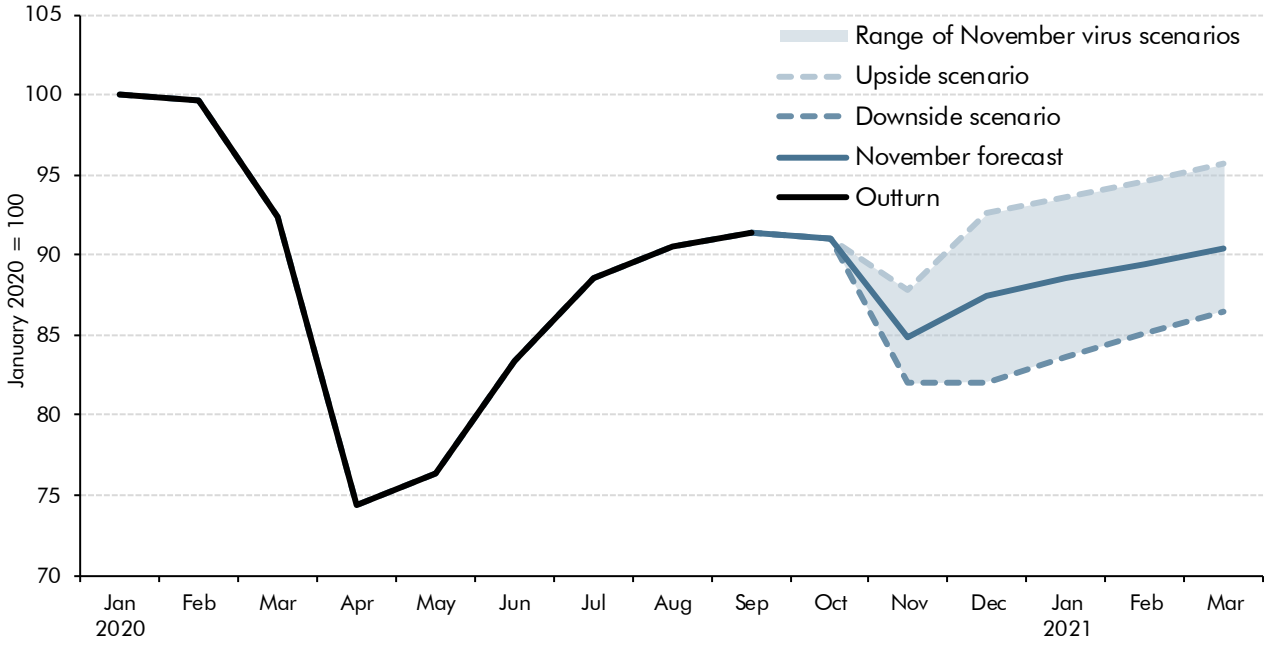
The short-term outlook for GDP

2.26 With England in lockdown until 2 December and public health restrictions of varying stringency in place in Scotland, Wales and Northern Ireland, UK-wide output can be expected to fall sharply in November. The path of output over the subsequent few months will depend upon the effectiveness of the lockdown in bringing cases down, the severity of post-lockdown health restrictions necessary to keep the virus in check, and the response of households and businesses to both the path of the virus and the official restrictions. As outlined at the start of this chapter, our central forecast, upside scenario, and downside scenario embody different assumptions about these factors.

2.27 Our short-term GDP forecast starts with an estimate of October GDP growth based on the latest ONS Business Impact of Covid Survey, which points to a 0.4 per cent monthly fall in output. To calibrate the effect of the second lockdown in November, we looked at the level of output in the midst of the first lockdown in April relative to its pre-virus peak in each sector of the economy and considered the extent to which the impact of the latest public health measures and voluntary social distancing were likely to be different this time. For example, schools have not been closed this time, which means education output will only fall to the extent that outbreaks force individual establishments to close and students to miss school. This will also mean that parents' ability to work will not be curtailed to the same extent as during the first lockdown. The manufacturing and construction sectors have been encouraged to remain open and have had time to make workplaces virus-safe. Also, restaurants appear to be more prepared to continue business via takeaway and delivery services. Fear of the virus is also likely to be less powerful than in the first wave thanks to increased use of face masks and a better understanding of which groups are more or less at risk of developing a severe form of the disease. On this basis, we have assumed a 7 per cent fall in output in our central forecast for November. This would take the level back to 15 per cent below the pre-virus peak in January, three-fifths the size of the first lockdown.

2.28 Output is assumed to then pick up as the ending of lockdown on 2 December is followed by a relaxation of the restrictions, in line with the assumptions laid out in paragraphs 2.7 to 2.9. In our upside scenario, output recovers relatively quickly to be only around 4 per cent below its pre-virus peak in March 2021. In our central forecast, the continuation of moderately strong public health measures leave it around 10 per cent below the peak. Finally, greater prevalence of the virus and the continuation of quite stringent restrictions mean that output is still about 14 per cent below its pre-virus peak in our downside scenario (Chart 2.10).

Chart 2.10: Monthly GDP forecast and scenarios



Source: ONS, OBR

2.29 In putting these short-term paths together, we have drawn on several sources of evidence, although ultimately these are judgement-based scenarios rather than relying on estimated relationships between the virus, public health measures and economic output. One key source is the international evidence from the first wave of lockdowns drawn together in Chapter 2 of the IMF's October WEO. It suggests that official lockdown restrictions and voluntary behavioural responses (social distancing) made roughly equal contributions to the fall in output. It seems likely that the relative importance of these factors will vary as people's perceptions of the risk associated with the virus and the efficacy of the public health measures evolve. As regards the public health measures, we drew on the experience of the first wave, and preliminary evidence of the response of mobility in different parts of the country to the imposition of different tiers of restrictions. Combining these assumptions allows us to infer a path for output in our central forecast and scenarios that is consistent with the broader conditioning assumptions underpinning them.

2.30 We cross-checked these top-down judgements by constructing bottom-up sectoral paths that would deliver these overall output paths. Table 2.2 presents a sectoral path of output consistent with our central forecast. In absolute terms, the trough in output during the second wave is smaller than in the first across all sectors, but in relative terms some sectors are hit much less hard this time around than they were in April – notably education, construction and manufacturing, reflecting the factors discussed above. Output losses continue to vary significantly across sectors by March.

Table 2.2: Short-term sectoral growth

Sector	Per cent			
	January to April 2020 change in GDP	January to November 2020 change in GDP	January 2020 to March 2021 change in GDP	Weight in whole economy
Accomodation and food services	-91	-68	-26	29
Other services	-50	-40	-29	37
Construction	-45	-14	-10	64
Transportation	-40	-22	-17	40
Education	-39	-19	-14	57
Wholesale and retail	-36	-19	-2	104
Administrative and support	-36	-32	-25	53
Human health	-31	-24	-21	75
Manufacturing	-29	-11	-8	101
Professional, scientific and technical	-19	-14	-10	77
Information and communication	-11	-8	-7	66
Agriculture	-8	-4	-2	6
Energy and water	-7	-4	0	38
Finance and insurance	-5	-3	-2	68
Real estate	-2	-2	-2	135
Public admin and defence	0	1	1	49
Total	-26	-15	-10	1000

2.31 Beyond next spring, our central forecast assumes strong quarterly growth rates through 2021, consistent with public health restrictions being eased further and an effective vaccine becoming widely available in the second half of the year (Table 2.3). Thereafter, the pace of growth moderates, with the economy regaining its pre-virus peak by late 2022.

Table 2.3: The quarterly GDP profile

	Percentage change on previous quarter											
	2020				2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
March forecast	0.2	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.3
FSR central scenario[1]	-2.0	-21.1	8.8	7.0	3.2	1.4	1.8	1.2	1.1	1.0	0.6	0.5
November forecast[2]	-2.5	-19.8	15.5	-2.7	1.9	3.1	2.7	2.1	1.5	1.1	0.7	0.7
Change since March[3]	-2.7	-20.2	15.1	-3.2	1.4	2.7	2.3	1.7	1.1	0.8	0.4	0.4
Difference from FSR[3]	-0.5	1.3	6.7	-9.7	-1.3	1.7	0.9	0.9	0.4	0.1	0.2	0.1

[1] Outturn data up to the first quarter of 2020.

[2] Forecast from the third quarter of 2020.

[3] Changes may not sum due to rounding.

Longer-term scarring effects

2.32 The initial economic shock from the pandemic is unusual in that it simultaneously reduces both demand and supply, and to varying extents across different sectors. Fear of infection makes consumers reluctant to engage in transactions that require close proximity to others (such as travel and dining out). And businesses are encouraged to adopt different – and often less productive – ways of working (such as spatial separation of employees and

customers, greater working from home, and more frequent deep cleaning). Lockdowns go even further by preventing some businesses from operating at all. If and when the pandemic recedes and a semblance of normality returns, these effects will diminish.

2.33 The pandemic is quite likely, however, to leave lasting 'scars' on supply capacity. These can arise through a variety of channels, including:

- **deferred or cancelled investment in physical capital and lower innovation** as a result of the heightened uncertainty and increased levels of debt incurred during the pandemic;
- the **destruction of valuable firm-specific capital and knowledge** arising from business failures;
- a **loss of human capital** due to sustained unemployment as the economy restructures away from contact-intensive sectors;
- **earlier retirement from the labour force** prompted by the pandemic; and
- increased **loss of days worked** due to sick leave as it becomes unacceptable to turn up to work showing virus-like symptoms.

2.34 The pandemic could also generate some lasting positive effects. For example, the accelerated adoption of new technologies could bring forward productivity gains, as could the more rapid shift from physical to online retailing and towards a cashless economy. But it seems unlikely that such benign consequences will outweigh the adverse effects.

2.35 The degree of scarring will be affected by how quickly the virus is brought under control, the pace of the recovery, and the effectiveness of policy in keeping workers attached to employers and viable firms in business. Many of the Government's measures have been designed to minimise avoidable scarring. But it is difficult to know how large such scarring effects will prove to be as there is little relevant historical experience to draw on. In this *EFO*, we retain the top-down assumptions we made in the *FSR* in July:

- In our **upside scenario**, the economy returns to pre-virus norms relatively quickly. Deferred investment is subsequently made up, while any impact on human capital is minimal. That allows the economy to return to its pre-virus trajectory in the medium term. This seems about the best that could be hoped for, though it has been rendered more likely by the recent announcement of successful late-stage vaccine trials.
- The **central forecast** and our **downside scenario** both rest on the assumption that people will need to find ways to live with the virus to varying degrees, requiring lasting changes to behaviour. These are greater in the downside scenario, which does not assume wide availability of an effective vaccine and therefore requires some permanent degree of social distancing to keep the virus in check. Moreover, the hangover from the pandemic in terms of deferred investment and loss of human capital will be greater the slower is the recovery. Both our central forecast and our

downside scenario assume some scarring, with output at the five-year horizon lying 3 and 6 per cent respectively below the pre-pandemic trajectory.

2.36 Our long term scarring effects are broadly in line with an array of external estimates.[3] In their recent Article IV review of the UK economy, the IMF projected GDP to lie between 3 and 6 per cent below its pre-virus trend in the medium term. Estimates by Pujol, based on consensus forecasts, put the long-term loss of output at around 3 per cent for the UK.[4] Official forecasts for other European countries also assume similar levels of output loss.[5] The Bank of England assume a somewhat lower degree of scarring, at around 1¾ of potential GDP, though that does not incorporate any long term impact from changes in how people work in the future.[6]

The composition of potential output and the output gap

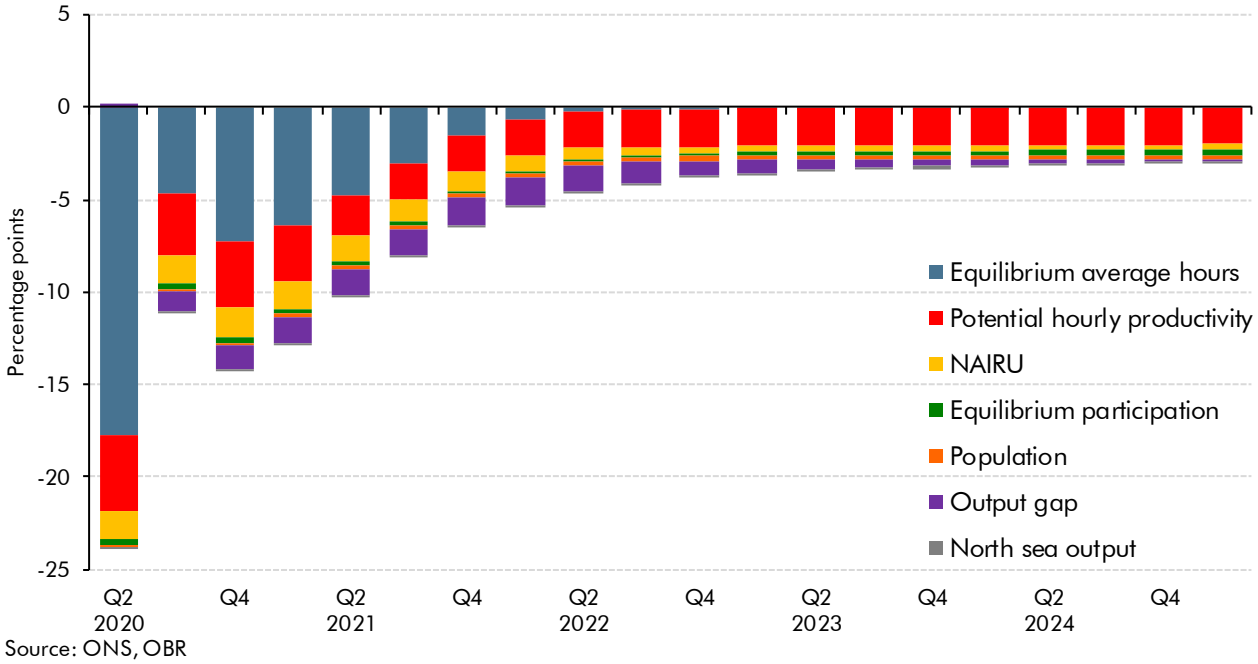
2.37 For the purposes of our fiscal forecasts, it is the path of GDP (and nominal GDP in particular) that is of primary interest. However, a breakdown of GDP into potential output (and its component parts) and the output gap is of interest for three reasons. First, it helps in understanding the impact of the shock on the economy and acts as a cross-check on the plausibility of our GDP profiles. Second, the output gap is an input into our inflation forecast. Third, the legislated 'fiscal mandate' applies to cyclically adjusted public sector net borrowing in 2020-21, so evaluating the Government's compliance with this target also requires us to generate a measure of the output gap.

2.38 In normal times, when output is driven by fluctuations in demand around a smoothly rising path for potential output, the output gap is a useful concept, albeit one that poses considerable estimation challenges.[7] As already indicated, however, the pandemic has had a significant depressing effect on supply as well as demand, reflecting the impact of both the Government's restrictive health measures and voluntary social distancing. For instance, hospitality venues that are mandated to close may appear to have spare capacity but cannot respond to an increase in demand even if customers wished to come. And furloughed employees, though not working, are unable to be deployed elsewhere in the economy; it is as if they had temporarily withdrawn from the labour force altogether. So much of the very sharp contraction in activity during the first lockdown and again this winter is best seen as a simultaneous fall in supply and demand. As restrictions are lifted, the CJRS ends and unemployment rises, so a conventional – though quite small – margin of spare capacity is likely to emerge, closing gradually thereafter as conditions normalise.

[3] See also: J. Portes, "The lasting scars of the Covid-19 crisis: Channels and impacts", VoxEU, June 2020; R. Hughes et al, *Doing more of what it takes*, Resolution Foundation, May 2020; and C. Lenoel & G. Young, "Prospects for the UK Economy", *National Institute Economic Review*, April 2020.
[4] T. Pujol, *The long-term economic cost of Covid-19 in the Consensus Forecasts*, Covid Economics (44), August 2020
[5] For example, see CPB Netherlands, *Macro Economic Outlook 2021*, September 2020; Stabilitatsrat, *Statement by the Independent Advisory Board of the Stability Council*, Spring 2020; Ufficio Parlamentare Di Bilancio, *2020 Budget Planning Report,* July 2020.
[6] "The Potential long-term effects of Covid", Speech by Dave Ramsden at the Institute for Policy and Engagement, University of Nottingham, November 2020.
[7] See OBR Working Paper no 5: *Output Gap Measurement: judgement and uncertainty,* July 2014.

2.39 Assessing the path of potential output and the output gap is therefore especially challenging at present. Nevertheless, Chart 2.11 shows a putative decomposition of the change in the level of GDP in our central forecast relative to the pre-virus trajectory implicit in our March forecast, broken down into the constituent elements of potential output – population, participation rate, equilibrium (un)employment rate, average hours and hourly productivity – together with the implied output gap and North Sea output (which sits outside our measure of potential output). The initial path is dominated by swings in average hours which are facilitated by the CJRS heavily incentivising the use of furlough over job shedding for those unable to work. By 2022, lower equilibrium employment and weaker productivity explain most of the shortfall in GDP. And by the forecast horizon, it is productivity that dominates.

Chart 2.11: Contributions to shortfall in real GDP relative to our March forecast



Source: ONS, OBR

2.40 Focusing on the 3 per cent virus-related scarring at the forecast horizon:

- Lower **productivity** accounts for 2 percentage points of the pandemic-related hit. In the short term, this is related to the immediate need for businesses to organise production in less efficient ways so as to meet social distancing requirements. This eventually eases but is replaced by the cumulative effects of depressed investment and capital scrapping on the capital stock, overlaid by the effect of higher business debt and an increase in business failures on innovation and total factor productivity.

- The pandemic discourages migration, so – as a net recipient of migrants – the UK is likely see a temporary fall in net inward migration and a consequent reduction in the size of the **population**. That lowers potential output by 0.2 per cent relative to our March forecast.[8] Operational challenges implementing the new points-based

[8] Our central forecast is based on the 'natural change' variant of the ONS population projections up to the second quarter of 2021, then reverts to the 'zero net EU migration' variant that underpinned our March forecast thereafter. Our population forecast is based on the

immigration regime following the end of the Brexit transition period could also impede inflows.

- **Participation** rates will be lower as some older workers are likely to decide to retire earlier as a result of the pandemic. The decline in hiring during the pandemic is also likely to discourage unemployed people from actively seeking work. While most of these should re-enter the labour market when conditions improve, some may not. Reduced inward migration will also lower participation as migrants are more likely to be in or seeking work. We have assumed that these effects together lower potential output by 0.5 per cent at the forecast horizon.

- The **structural unemployment rate** is likely to rise for a while due to permanent behavioural changes prompted by the pandemic (such as more working from home, less business travel and the shift to online retail) that require labour to shift across occupations, sectors and regions, compounding the restructuring necessitated by Brexit. We assume that the structural unemployment rate rose to around 5.5 per cent in the second quarter of 2020 and then gradually falls back as reallocation takes place, reaching 4.4 per cent at the forecast horizon, up from 4.1 per cent in March. That small increase reflects the fact that it can take a long time for some unemployed workers to retrain or relocate appropriately. This reduces potential output relative to March by around 0.3 percentage points at the forecast horizon.

2.41 Prior to the pandemic, the participation rate rose to a level that was higher than we had expected. On its own, that would have resulted in an increase in potential output of around 0.2 per cent at the forecast horizon. Together with the adjustment for the pandemic, this means that potential participation is 0.3 per cent lower than at the March forecast horizon.

2.42 Our potential output and output gap forecasts excludes the small, but volatile, oil and gas sector. So to produce our GDP forecast we need a forecast for oil and gas production. Our production forecasts are informed by the projections published by the Oil and Gas Authority (OGA) and suggest that output will fall over the forecast period. Based on the OGA's latest Stewardship Survey, we have revised production down compared to March. This forecast change, along with an ONS revision increasing oil and gas output in the past, means that oil and gas output lowers GDP in the medium term by 0.2 per cent relative to March.

The medium-term outlook for GDP

2.43 Combining our assumptions about the immediate effect on GDP of the recent re-introduction of lockdown measures, the short-term recovery paths from there and longer-term scarring, yields the medium-term GDP paths in Chart 2.12:

- Beyond the first quarter of 2021, output recovers quickly in our **upside scenario**, regaining the pre-virus peak by the end of 2021 and returns close to the March

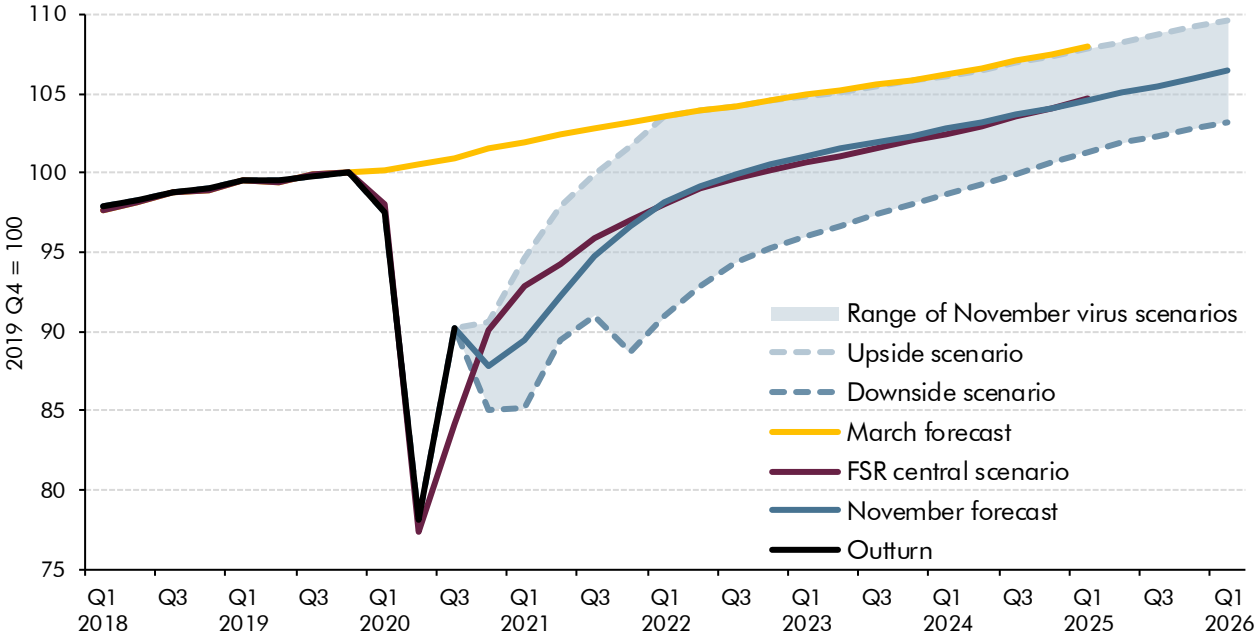
Labour Force Survey population estimates, which use population projections to gross up to an economy wide picture. Current population projections are based on 2018 data and will not capture the fluctuations in net migration from the pandemic. For more information, refer to the Labour Force Survey (LFS) QMI and LFS User Guide Volume 1.

forecast path in the medium term. This speed of recovery is somewhat less benign than our *FSR* upside scenario because of the hiatus induced by the second wave of infections and subsequent lockdown measures, which means activity is recovering from a lower level.

- The set-back to the recovery is deeper and more durable in our **central forecast**. But after an effective vaccine becomes widely available in the second half of 2021, output recovers to its pre-virus peak by the end of 2022. However, output never returns to the March path, mainly reflecting our 3 per cent scarring assumption.

- The recovery is even more gradual and uneven in our **downside scenario**. We assume that there is a third wave of infections next winter – with an economic impact about half the size of the second wave – that further hampers the recovery. Output only regains its pre-virus peak by the end of 2024. Without a fully effective vaccine, the longer-term scarring effects from coronavirus are twice as large in this scenario as in our central forecast, at 6 per cent relative to the March path.

Chart 2.12: Real GDP paths



Source: ONS, OBR

2.44 At of the time we finalised this document, it was still possible that the Brexit negotiations could end with UK-EU trade defaulting to WTO terms, either through a breakdown in negotiations or failure of the UK or European parliaments to ratify the deal. Our WTO scenario would leave output 1½ per cent lower after five years than would be the case with a smooth transition to an FTA (see Annex B for more detail). Combining that scenario with the three virus-related scenarios, would deliver an output loss in the first quarter of 2025 of between 1½ and 7½ per cent relative to the March forecast.

Expenditure composition of GDP in our central forecast

2.45 The expenditure composition of the downturn and recovery are important determinants of our fiscal forecast because consumer spending is taxed relatively heavily, while business investment attracts capital allowances that lower receipts in the short term. We have only produced an expenditure breakdown for our central forecast (Table 2.4). Counterintuitively, government consumption contributes negatively in 2020 despite the enormous rise in public spending. That reflects how real spending in health and education is measured, with closed schools and reduced non-virus-related medical procedures lowering real spending as measured. The recovery in 2021 is assumed to be led by consumers (as official and voluntary restrictions on spending opportunities ease) and the Government (as much down to the recovery of real activity in the health and education sectors as the additional spending announced in the Spending Review). In 2022, government spending makes a negative contribution as virus-related spending ends but business investment makes a significant positive contribution as virus-related uncertainty eases. In the medium term, the contributions are more balanced, including a significant contribution from government spending, reflecting the substantial increase in government investment that was announced in the March 2020 Budget.

Table 2.4: Expenditure contributions to real GDP

	Percentage points, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
GDP growth (per cent)	**1.3**	**-11.3**	**5.5**	**6.6**	**2.3**	**1.7**	**1.8**
Main contributions:							
Private consumption	0.6	-9.7	4.6	6.1	1.1	0.8	1.0
Business investment	0.1	-1.8	0.1	1.2	0.9	0.6	0.5
Dwellings investment[1]	0.1	-0.9	0.3	0.3	0.2	0.2	0.1
Government[2]	0.9	-1.3	4.4	-0.7	0.3	0.5	0.5
Change in inventories	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net trade	-0.2	2.8	-4.5	-0.3	-0.2	-0.4	-0.2
Other[3]	-0.2	-0.4	0.6	0.0	0.0	0.0	0.0

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

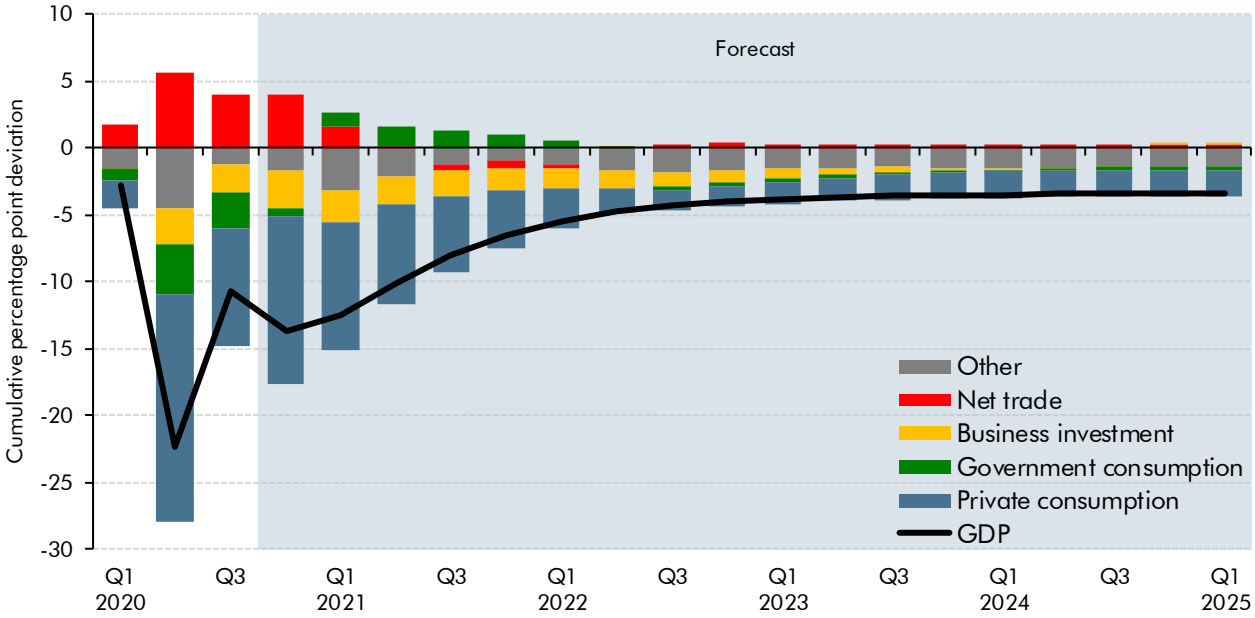
[2] The sum of government consumption and general government investment.

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

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

2.46 Relative to our March forecast, private consumption makes the largest contribution to the downward revision to real GDP (Chart 2.13). Net trade is broadly neutral in its contribution to GDP relative to March in the medium term. Private investment is lower than March over the forecast – which weighs on the capital and housing stock – but it has broadly recovered to the March level at the forecast horizon.

Chart 2.13: Expenditure contributions to the real GDP revision since March



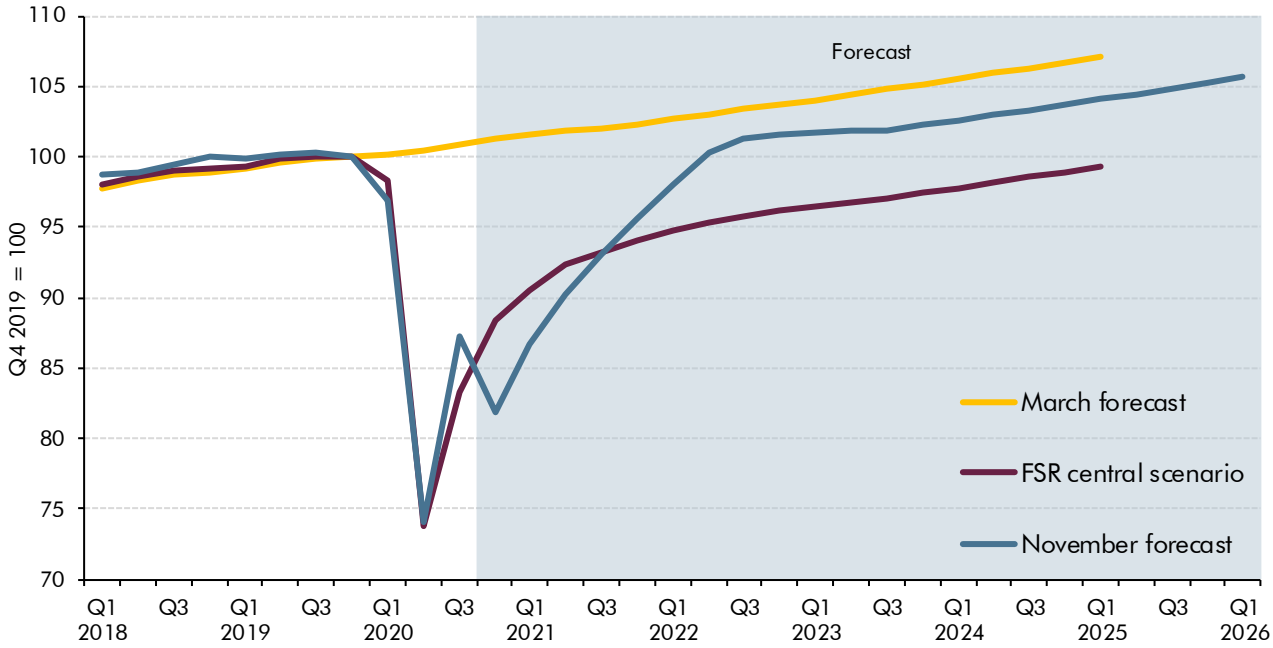
Note: Contributions in Q1 2020 are distorted by trade in non-monetary gold.
Source: ONS, OBR

Private consumption

2.47 Private consumption fell by 24 per cent in the second quarter as lockdown mandated the closure of non-essential shops, strict social distancing was imposed, and households voluntarily reduced social interactions. Spending at restaurants and hotels, transport, and recreation and culture was hit particularly hard. Private consumption then jumped 18 per cent in the third quarter as the lockdown was lifted and social distancing eased back. We expect private consumption to fall 6 per cent in the fourth quarter due to increased voluntary social distancing in the face of the resurgence in cases, reimposition of lockdown in England during November, and tighter measures being put in place across the rest of the UK.

2.48 Private consumption returns to its pre-virus peak by the middle of 2022, slightly sooner than the economy as a whole. This is a much stronger recovery than assumed in our *FSR* central scenario, where consumption had not recovered to its pre-virus peak by the forecast horizon (Chart 2.14).

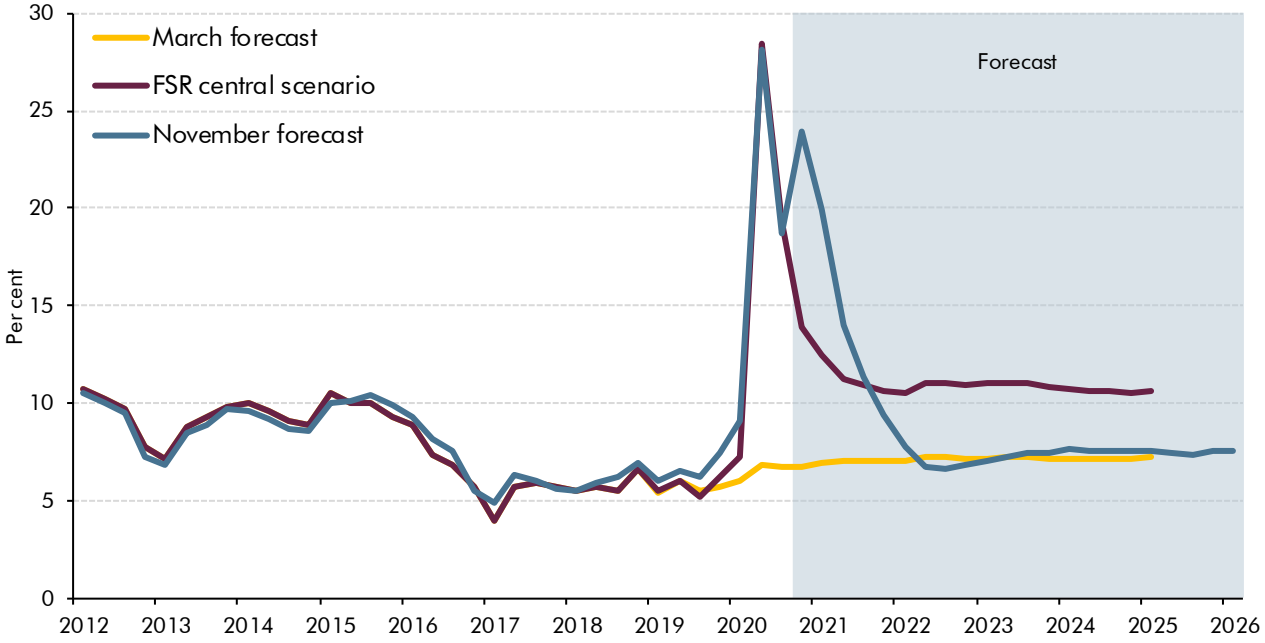
Chart 2.14: Real private consumption



Source: ONS, OBR

2.49 The stronger recovery in consumer spending in our central forecast primarily reflects the fact that we now assume that more of the boost to household finances from forced saving during lockdown is spent as the economy returns to normality. The saving ratio rose to a record high of over 28 per cent in the second quarter of 2020, as consumer spending fell sharply, while household income – supported by the CJRS and SEISS schemes – fell only moderately. As restrictions ease and consumption picks up, we expect the saving ratio to return to more normal levels. After a more modest second spike during the second wave and lockdown in England, it settles at around 7½ per cent over the medium term (Chart 2.15). This is closer to the level in our March forecast and considerably lower than in our *FSR* central scenario, which implied a persistent rise in precautionary saving.

Chart 2.15: Household saving ratio



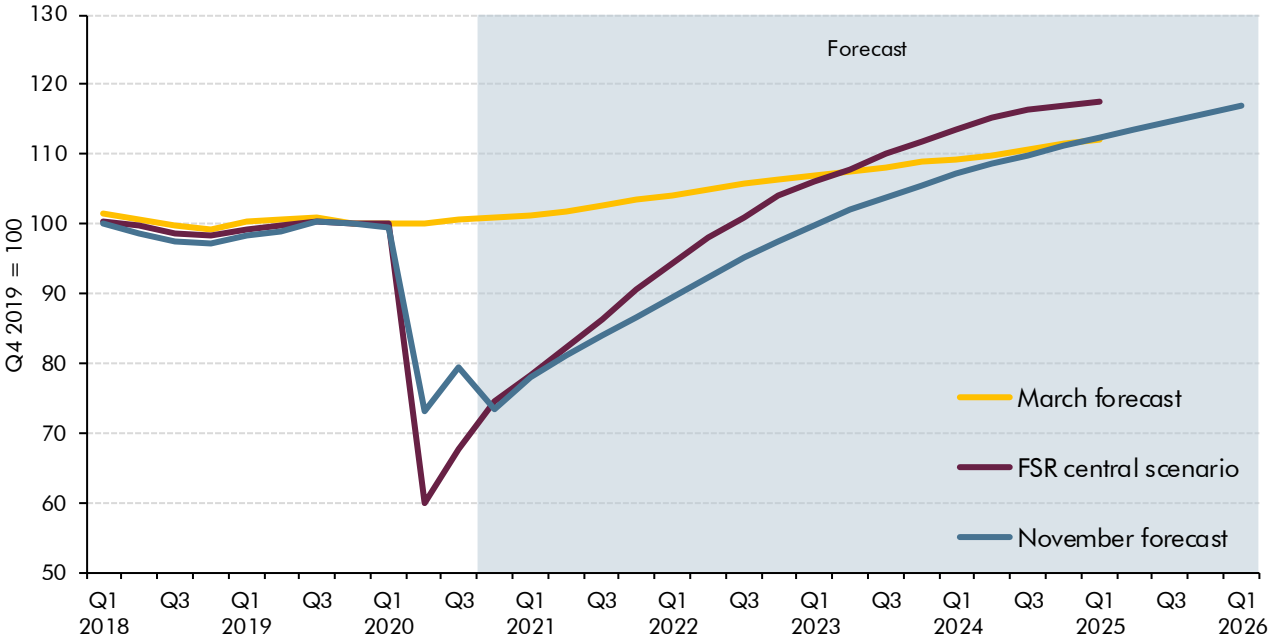
Source: ONS, OBR

Business investment

2.50 Business investment fell 27 per cent in the second quarter as the lockdown and heightened uncertainty led businesses to put investment on hold (Chart 2.16). It recovered only slightly in the third quarter, with investment still more than 20 per cent down on its level at the end of 2019. We expect it to fall again in the fourth quarter as the second wave hits just as Brexit uncertainty peaks towards the end of the transition period (see also Annex B). Investment then recovers steadily as the economy normalises and uncertainty about the virus and Brexit recedes. It regains its pre-virus peak by mid-2023, a little later than GDP as a whole, and eventually rises above the level we forecast in March, as projects that were put on hold this year are subsequently restarted.

2.51 Despite that recovery, cumulative business investment is around 10 per cent lower than we predicted in March. This reflects the fact that while uncertainty recedes, it does not dissipate altogether. For example, uncertainty over potential changes in working patterns – such as increased working from home – and lasting changes in consumer preferences even after the virus is under control, could lead businesses to delay investment decisions until the picture becomes clearer. Lower cumulative business investment is part of the explanation for the scarring of productivity in the medium term.

Chart 2.16: Real business investment



Source: ONS, OBR

Government

2.52 Government consumption increased by 16 per cent in cash terms in the second quarter of 2020 to fund virus-related pressures on health and other public services, but in real terms it *fell* by 15 per cent. That difference reflects lower measured health and education activity due to the postponement or cancellation of elective healthcare treatments in response to the pandemic and the closures of schools. As schools reopened and elective healthcare treatments resumed, real government consumption jumped 8 per cent in the third quarter while cash spending was flat on the quarter. We estimate that real government consumption will fall by 8 per cent in 2020 as a whole.

2.53 Government consumption will be boosted by the extra departmental expenditure across 2020-21 and 2021-22 that has been announced since the SEU (around £100 billion, a significant share of which is set to be spent on the TTI programme). This, plus the unwinding of the measurement effects, means that real government consumption is forecast to rise by 21 per cent in 2021. It then falls by 4 per cent in 2022 as the virus-related boost to spending falls away. Growth then rises to an average of around 2 per cent a year from 2023 onwards.

2.54 Government investment grows significantly over the forecast period, averaging an annual 3.5 per cent in calendar years 2021 to 2025, following 7 per cent growth in 2020, mainly due to the large spending increases announced in the March 2020 Budget.

Residential investment

2.55 Real residential investment fell by 41 per cent in the second quarter, reflecting lower construction activity and the temporary closure of the housing market. But it recovered nearly all of this reduction in the third quarter on the back of the reopening of building sites and the housing market – the transaction element of residential investment was also boosted by the announcement of the stamp duty holiday. We expect residential investment to fall again in the short term, as the boost to construction activity appeared to partly reflect accelerated housing completions at the expense of new starts, and as transactions drop back. We expect a steadier pace of recovery thereafter.

Trade and the current account

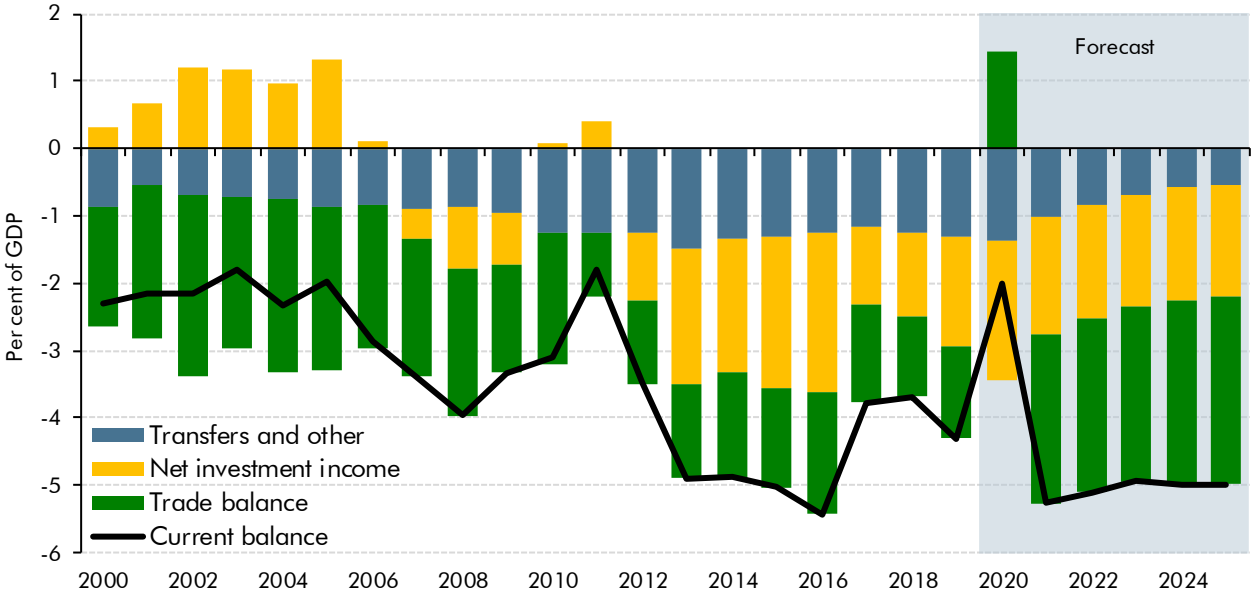
2.56 The pandemic has led to large falls in imports and exports, reflecting a marked fall in global trade due falls in domestic demand worldwide and the disruption to global supply chains. Ahead of both the March and October Brexit deadlines, imports and exports increased in anticipation of higher barriers to trade. Imports rose as UK firms stockpiled goods made in the EU, while exports rose as their EU counterparts did likewise. A similar effect ahead of the 31 December deadline is unlikely to outweigh the weakness caused by coronavirus.

2.57 Given the extra frictions on trade with the EU as we move from the single market to trading under an FTA, we expect exports to fall modestly in the medium term after the recovery from virus-related disruption in 2021 and 2022. Imports rise modestly in the medium term after a similar recovery in 2021 and 2022. We expect cumulative growth in exports and imports between the fourth quarter of 2019 and first quarter of 2025 to be 4.5 and 5.6 per cent lower than in March, respectively, mainly as a result of coronavirus. This means that the cumulative contribution of net trade to GDP is similar to March by the first quarter of 2025.

2.58 Over the past couple of years, the current account has on average been in deficit by around 4 per cent of GDP. In the second quarter of 2020 the deficit narrowed sharply to just 0.6 per cent of GDP, but that was driven by temporary factors – including the relative timing and restrictiveness of lockdowns in different countries and trade in non-monetary gold – that boosted the trade balance.[9] As these temporary factors unwind, we expect the trade deficit to increase. We expect both the net investment income deficit and transfer balance deficit to narrow slightly over the forecast as a share of GDP, with the latter effected by changes in overseas development aid. This leaves the current account deficit at around 5 per cent on average in the medium term, reestablishing the run of consistently wide deficits seen during the recovery after the financial crisis (Chart 2.17). Overseas investors are consequently significant net lenders to the UK, which could pose risks. For example, a large loss of confidence in the UK economy might lead to a sharp fall in sterling and bring about an abrupt demand-led narrowing of the current account deficit and spike in inflation.

[9] Non-monetary gold is gold that excludes reserves held by central banks. Movements in non-monetary gold (and other precious metals) that are held in accounts for trading are included in the trade balance. They can be volatile and as London is the global centre for gold trading can cause significant movements in the UK's trade figures. The gold trades are offset in the measure of the change in valuables – a component of the broad measure of investment in the National Accounts – so do not affect UK GDP.

Chart 2.17: Current account balance



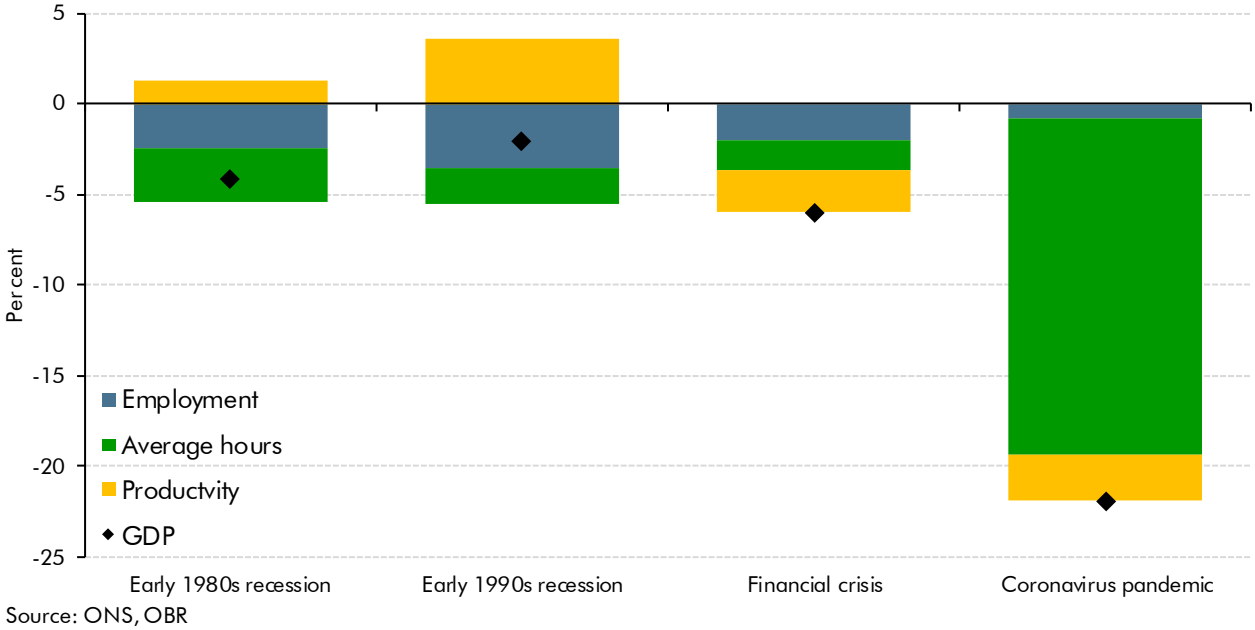
Source: ONS, OBR

Labour market

Participation, employment and hours

2.59 The effect of the pandemic on the labour market has been dramatic. But the presence of the Government's support schemes, especially the CJRS, means that the adjustment to the collapse in output has been markedly different from that seen in previous recessions, when the fall in total hours worked was split roughly equally between heads and average hours worked. On this occasion, firms have furloughed employees rather than cut jobs and average hours have cratered instead (Chart 2.18).

Chart 2.18: Output, hours and productivity in previous recessions



Source: ONS, OBR

2.60 While the big picture is clear, the available labour market indicators have sometimes provided conflicting signals on the details in recent months. That may be a reflection of the ONS's difficulty during the pandemic in ensuring that the main source of labour market information, the Labour Force Survey (LFS), is obtained from a suitably representative sample of the population.[10] With that caveat in mind, the latest data as of 21 November indicate that:

- **Average hours worked** fell sharply, down by 19.2 per cent between the fourth quarter of 2019 and the second quarter of 2020. They recovered by 10.4 per cent in the third quarter of 2020.

- **Employment has fallen.** According to the LFS, employment fell by nearly half a million between the first and third quarters of 2020, taking the employment rate down 1.1 percentage points. The LFS shows this fall as mainly concentrated in self-employment, with employee numbers holding up. This contrasts with HMRC's real-time information (RTI) from the PAYE tax system, which recorded a fall in employee numbers of 750,000 between March and September. As RTI is effectively a census of all employees in the tax system, it is likely to provide a more accurate picture, at least for those on payroll (though late returns can lead to revisions to recent data). The drop in employment recorded in the LFS is significantly smaller than was assumed in our *FSR* central scenario.

- **Unemployment** has risen. The LFS reports only a modest rise in unemployment so far this year, with the rate up from 4.0 per cent in January to 4.9 per cent in September on the single-month measure. But the fall in employee numbers reported in RTI would suggest the current rate should be closer to 6 per cent at present. The rise in LFS unemployment is also hard to square with the 1.4 million increase in the claimant count between March and September, and the rise in claims for universal credit (UC) to over 2 million above normal levels for the same period. It is possible that the more benign picture offered by the LFS is partly a reflection of the requirement that, to be classed as unemployed in the LFS, someone must have searched for work in the past month and those without jobs are less likely to search for work when there are few jobs on offer (a 'discouraged worker' effect).

- Measured **inactivity** has risen. The latest LFS data suggests that the fall in employment is mostly a result of flows into inactivity rather than unemployment. The inactivity rate has risen by 0.6 percentage points between the first and third quarters, or an increase of around 380,000. This is also consistent with the presence of a discouraged worker effect.

- **Redundancies** have risen, with the latest data showing the fastest quarterly increase in redundancies and the highest level on record at 314,000.

- **Vacancies** fell to their lowest levels on record during the first lockdown and have only recovered modestly since then.

[10] J. Athow, "*Measuring the Labour Market During the Pandemic*", ONS, October 2020 and ONS, *Coronavirus and the Effects on Labour Market Statistics*, 6 May 2020

Employment support schemes

2.61 The path of the labour market this year and the nature of the shake-out and recovery thereafter are greatly influenced by the major employment support schemes the Government has put in place. The CJRS was introduced both to provide income support to people whose incomes would otherwise have fallen sharply as a result of the lockdown and to minimise the effect of the pandemic on the long-run supply capacity of the economy (i.e. to reduce scarring). The scheme has several effects over the short and medium term:

- First, it effectively **subsidises labour hoarding**, so that total hours adjust to the sharp fall in activity resulting from the public health restrictions mainly through lower average hours rather than fewer jobs. That prevents unemployment from rising as much as it would otherwise have done. By facilitating labour hoarding through to the point where an effective vaccine is rolled out and demand recovers, it also means that more of the output shortfall relative to the pre-virus trajectory is absorbed in productivity rather than hours or job losses once the scheme closes, lowering the peak in unemployment.

- Second, it **protects viable firm-specific human capital and job matches**, reducing scarring relative to what would have otherwise occurred. This is clearly an important supply-side benefit of providing labour market support commensurate with the public health restrictions, but – as already noted in Box 2.1 – it is not something that can easily be quantified.

- Third, but working in the opposite direction, it has **allowed some businesses to continue to operate that would have otherwise closed** because they were not viable. In effect, it therefore subsidises a misallocation of resources. The fact that insolvencies are around 40 percent lower than a year ago indicates the potential importance of this effect. Even so, the costs are likely to be modest compared to the gains from avoiding the unnecessary destruction of jobs and businesses that do have a viable future. But this misallocation cost will rise the longer the schemes are in operation, the less effective any vaccine proves to be, and the greater the reallocation ultimately required.

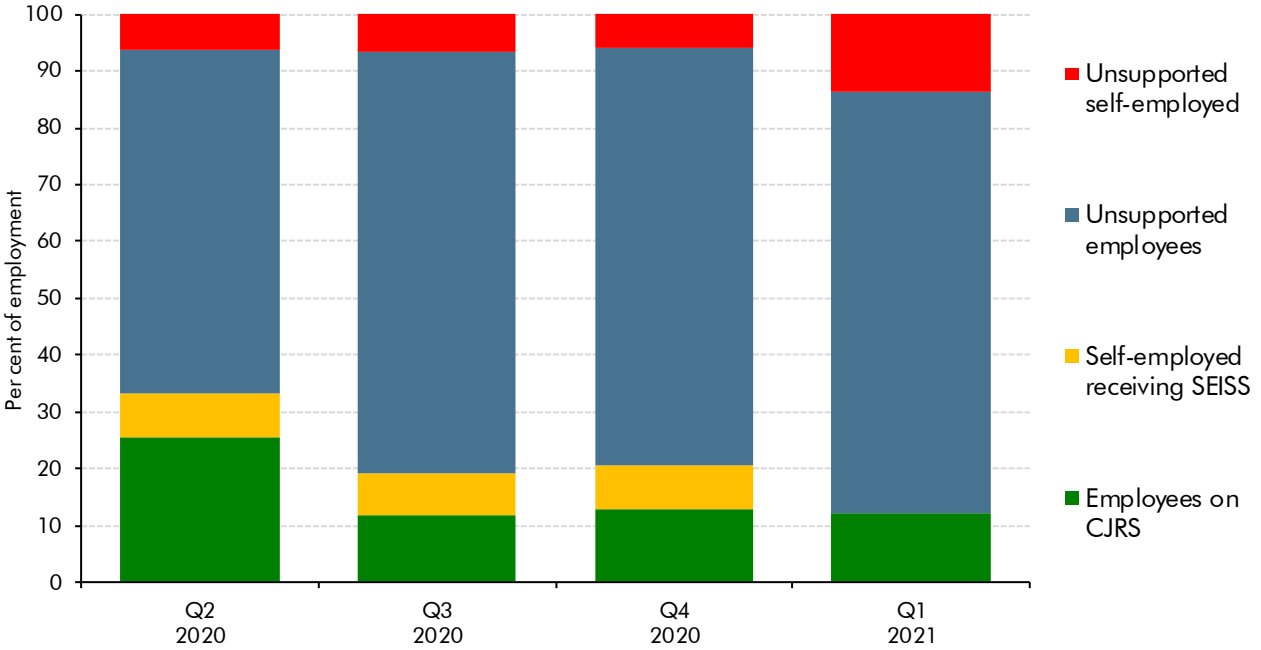
2.62 Our *FSR* scenarios were conditioned on the CJRS closing at the end of October, as was planned at the time. But following the resurgence in virus cases and the reimposition of lockdown in England, the Chancellor announced on 5 November that the CJRS would be extended, running until end March. Support is therefore available over the period that our forecast assumes relatively restrictive public health measures will remain in place.

2.63 The Chancellor has also extended the SEISS, with a third payment equivalent to 80 per cent of pre-virus profits being paid in the fourth quarter. A fourth payment next year is promised, but the rate has not yet been set so it is not reflected in our forecast. The SEISS is a simple income support measure that varies only with pre-virus profits, not with the extent to which the virus has hit profits. Indeed, survey evidence suggests that many self-employed individuals will be better off this year as a result of the SEISS grants received.[11]

[11] M. Brewer et al. *Jobs, jobs, jobs: Evaluating the effects of the current economic crisis on the labour market,* Resolution Foundation, October 2020. T. Waters, *Self-employment income support and the second national lockdown,* IFS, November 2020

2.64 At its peak in early May, 8.9 million employee jobs were supported via the CJRS, equivalent to 32 per cent of all employees (the true proportion will be a little lower since individuals can be furloughed from more than one job). Average take-up during the second quarter was 8.3 million and 30 per cent of employees. The first round of SEISS grants was taken up by 2.6 million people, equivalent to 55 per cent of all self-employed. So in total, around a third of people in employment in the second quarter had their earnings supported directly by these schemes. Chart 2.19 shows that this proportion dipped to 19 per cent in the third quarter, largely due to employees coming off furlough. We expect it to rise to 21 per cent in the fourth quarter as CJRS take-up rises from an estimated 1.8 million in October back to 6 million in November before declining again thereafter. The ratio falls back to 12 per cent in the first quarter because no SEISS grants are factored in.

Chart 2.19: Proportion of employment supported by the CJRS and SEISS



Source: HMRC, ONS, OBR

Prospects for employment and unemployment

2.65 The outlook for the labour market is contingent on what happens when the support schemes wind down. Each scenario assumes that the number of workers on the CJRS will decline with the recovery in output until the schemes close in March 2021, so more people are on the CJRS in the downside than in the central forecast, and in the central forecast than in the upside scenario. In each scenario, the prospects for employment and unemployment are dictated by what happens to these workers once the support schemes are closed. That in turn depends on the extent to which output recovers and how much of the remaining shortfall translates into lost jobs rather than continued short-time working by employees or squeezed profit margins for employers.

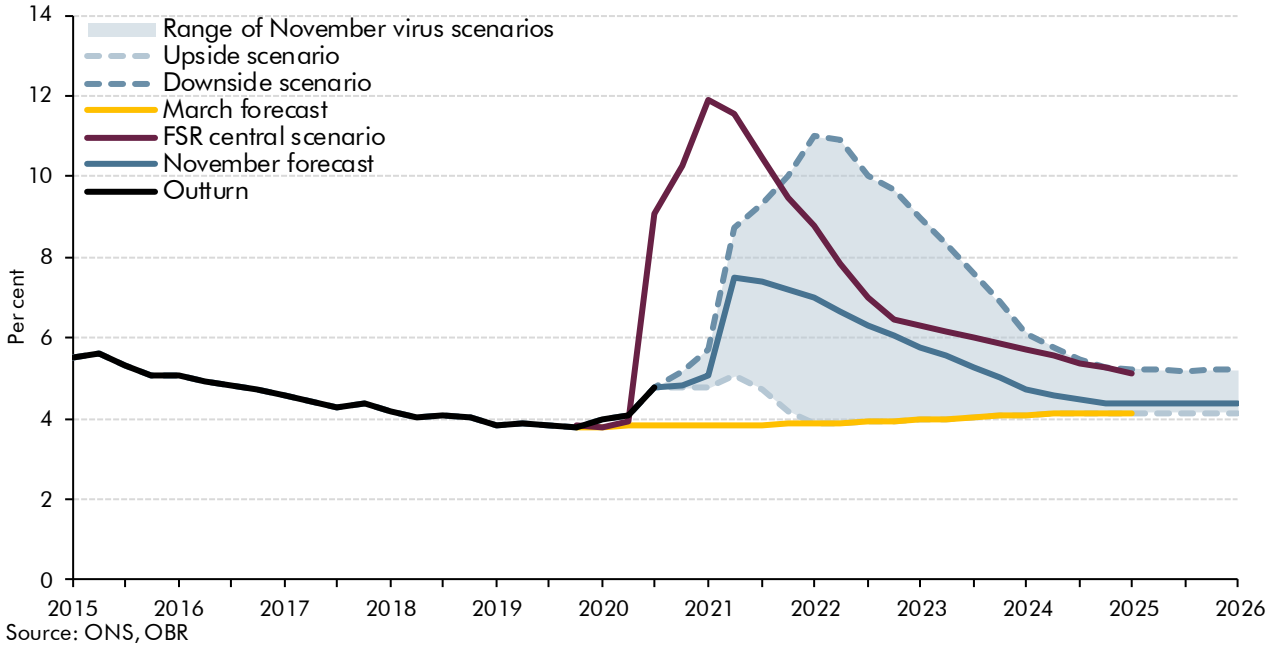
2.66 In the central forecast, we have assumed that the fall in output during the second wave of infections will be concentrated in lower average hours among the 4.1 million employees covered by the CJRS on average during the fourth quarter of 2020 and first quarter of

2021, meaning we only expect a modest 100,000 rise in unemployment between the third quarter of 2020 and first quarter of 2021. Unemployment rises a further 800,000 in the second quarter of 2021 following the end of the CJRS in March, peaking at a total of 2.6 million or 7.5 per cent. In the absence of the fiscal package and extension of the CJRS, we estimate that unemployment would have been about 300,000 higher in the second quarter. Total employment falls by 1.3 million from its peak, in the first quarter of 2020, to its low point in the second quarter of 2021. The recovery in employment and fall in the unemployment rate broadly follows the recovery in GDP thereafter, with the latter reaching 4.4 per cent at the forecast horizon.

2.67 The near-term spike in unemployment is less severe than the almost 12 per cent that was assumed to be reached in our *FSR* scenarios, as well as occurring two quarters later due to the extension of the CJRS (Chart 2.20). The main reason for the lower peak is that our earlier projection overestimated the extent to which the fall in output would lead to a shedding of low-wage low-productivity workers. However, the lower peak also reflects the extension of the CJRS. The latter means that the ending of the scheme happens closer to the vaccine rollout and an expected return towards normality. That in turn makes it more likely that businesses will hold on to staff even if demand is still depressed in the spring.

2.68 The path of unemployment in the upside and downside scenarios broadly reflects differences in the pace of economic recovery and the degree of labour reallocation required. In the downside scenario, unemployment rises markedly higher after the CJRS is withdrawn, reflecting the weaker recovery in output, and there is a further spike following the third wave of the virus at the end of 2021. Unemployment is also higher further out in the forecast, reflecting the need for greater labour reallocation. In the upside scenario, unemployment does not rise much more as output has largely recovered by the time the CJRS ends. In this case, the CJRS has succeeded almost perfectly in bridging the labour market across the pandemic.

Chart 2.20: Unemployment rate

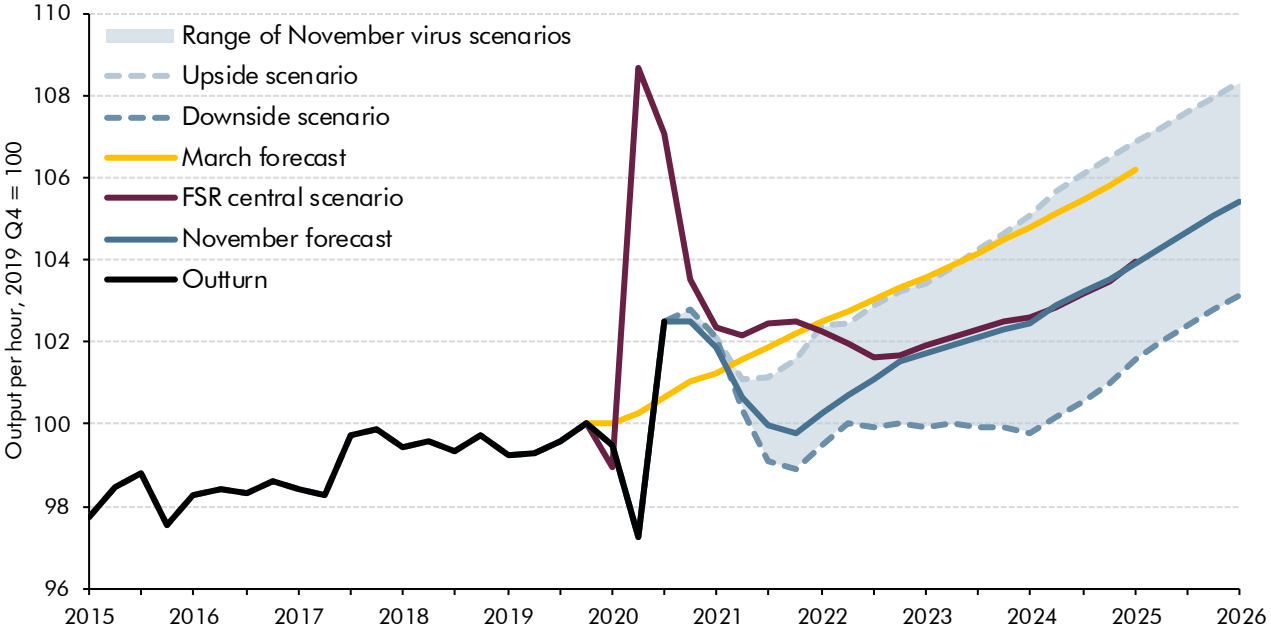


Source: ONS, OBR

Productivity

2.69 Following the initial fall in the second quarter of 2020, productivity rebounded as the economy reopened through the summer. We expect the recovery in productivity to stall as the restrictions to fight the second wave curtail activity, and for it remain depressed for a while as firms hang on to staff in anticipation of the return to normality as the vaccines are rolled out. As discussed previously, we envisage some degree of scarring in both our central forecast and downside scenarios (Chart 2.21).

Chart 2.21: Output per hour



Source: ONS, OBR

Earnings growth

2.70 We use an implied measure of average earnings constructed by dividing the National Accounts measure of wages and salaries by the number of employees, rather than the official ONS average weekly earnings (AWE) series. This allows us to fit our earnings forecast directly into the National Accounts framework on which our economy forecast is based – particularly the wages and salaries measure that is a key determinant of receipts. On the more familiar AWE measure, earnings fell by 1.2 per cent in the year to the second quarter before picking up to 1.3 per cent growth in the year to the third quarter. RTI data record a similar pattern and suggest that earnings growth continued to pick up in October, with early estimates of median pay for payrolled employees up by 4.6 per cent.

2.71 Despite the substantial fall in nominal GDP in 2020, we estimate that average earnings will grow, though at a slower pace than in 2019 (Chart 2.22). The continued growth in average earnings is partly a consequence of the CJRS subsidising the pay of employees producing little or no output, which means that earnings held up relative to nominal GDP in the near term. In 2021, we expect a sharp rebound in earnings growth as the economy starts to recover from the virus-related weakness in 2020. Earnings growth moderates in 2022

before picking up again toward the end of the forecast as slack in the labour market declines and upward pressure on earnings builds.

2.72 Relative to our March forecast, the level of average earnings in 2024 is 6 per cent lower (Chart 2.23). Around 2 percentage points of that difference reflects the assumed medium-term scarring of productivity and 1½ percentage points from lower whole economy inflation. We also assume that labour market slack and the need for some firms to repair balance sheets by rebuilding margins will weigh on the labour share of income.

Chart 2.22: Average earnings growth

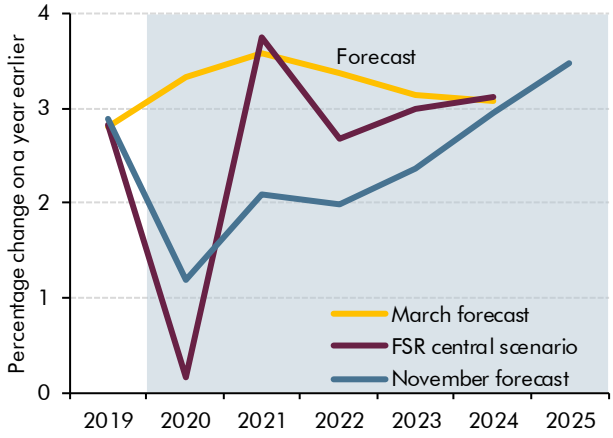
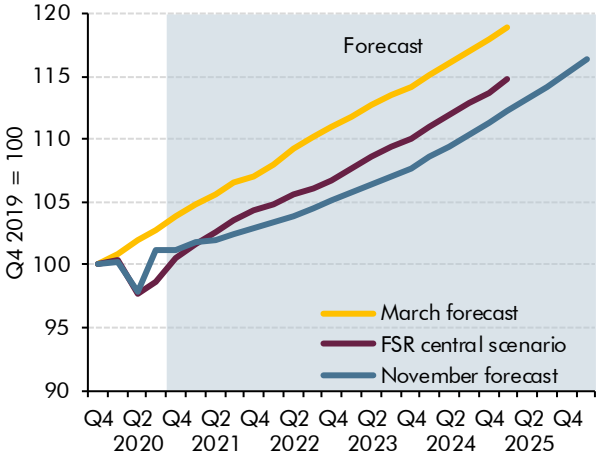


Chart 2.23: Average earnings level



Source: ONS, OBR

Prospects for inflation

CPI inflation

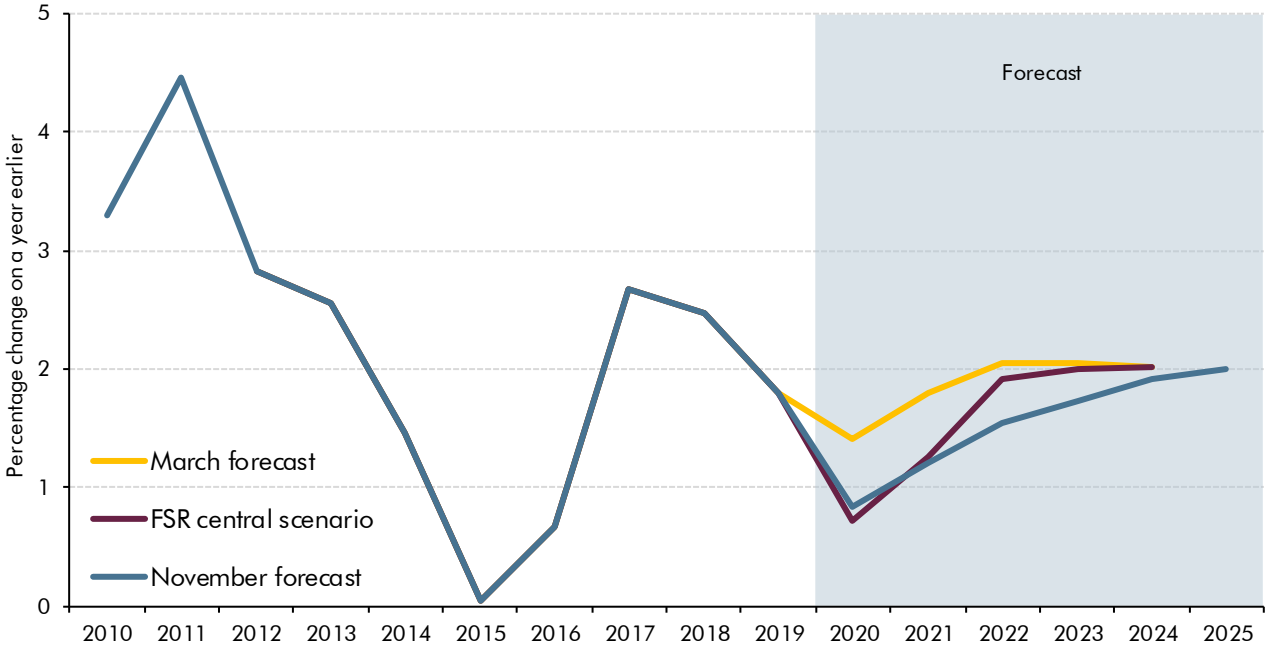
2.73 Before the pandemic, underlying inflationary pressures appeared broadly consistent with meeting the 2 per cent target in the medium term. CPI inflation has fallen since then to well below 2 per cent. CPI inflation was 1.4 per cent in the first quarter of 2020, dipping to 0.6 per cent in the second and third quarters on the back of lower oil prices.

2.74 Policy has also significantly lowered inflation in recent months. CPI inflation fell to 0.2 per cent in August thanks to the Eat Out To Help Out scheme discounts and the temporary reduction in the rate of VAT for hospitality services. These policies reduced prices for catering and accommodation services respectively. CPI inflation picked up to 0.5 per cent in September following the end of the Eat Out To Help Out scheme.

2.75 With only a modest degree of spare capacity assumed in the short term, we assume that CPI inflation rises back to target as the recovery continues, oil prices rebound and temporary policy measures are withdrawn (Chart 2.24). Once inflation is back to target, we continue to assume that the MPC will be successful in setting policy so as to keep it there over the medium term. As such, the paths of CPI inflation and the GDP deflator are the same in all three scenarios.

2.76 In Annex B, we set out a scenario for inflation if the UK defaults to trading with the EU on WTO terms on 1 January 2021. Imposing tariffs on imports from the EU, increases in non-tariff barriers and an assumed steling depreciation would push the level of CPI higher by an estimated 1.5 per cent relative to our central forecast.

Chart 2.24: CPI inflation



Source: ONS, OBR

RPI inflation

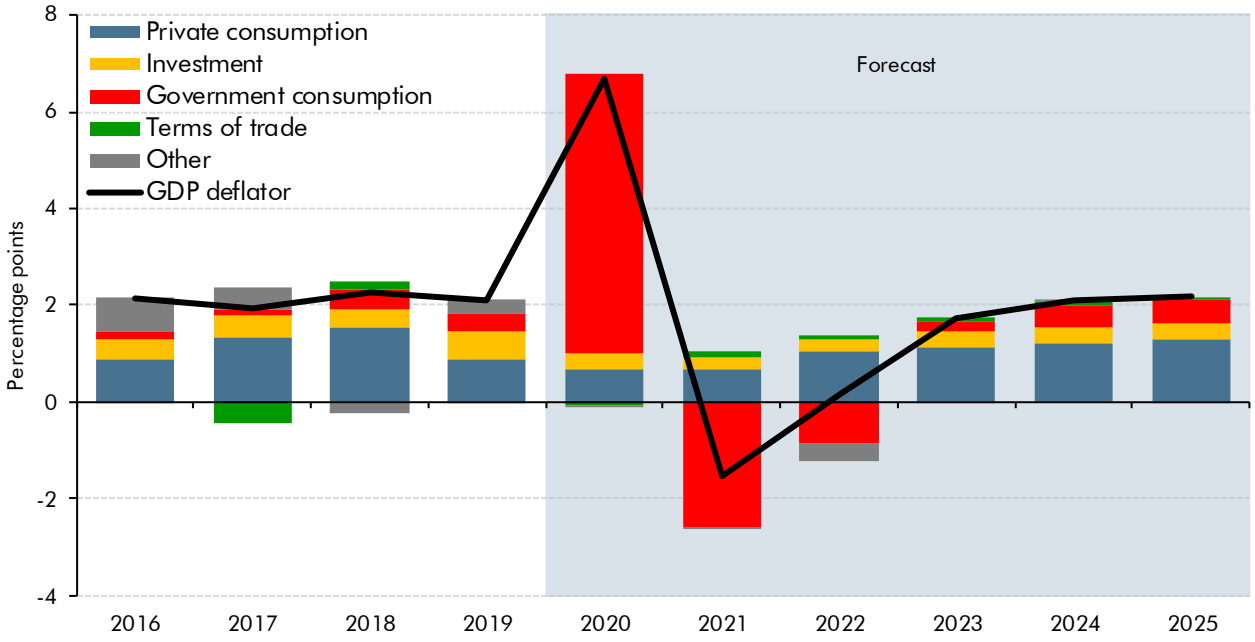
2.77 RPI inflation falls more quickly than CPI inflation, reflecting lower house prices (which affect the housing depreciation component of RPI and are discussed below), alongside lower interest rates and housing transactions (both of which affect the mortgage interest payments component of RPI). The wedge between RPI and CPI inflation turns negative in the near term and remains so until the middle of 2022, the first time that has happened since the financial crisis. It then rises in line with the recovery in the housing market.

GDP deflator

2.78 Our scenarios assume that GDP deflator inflation rises from 2.1 per cent in 2019 to 6.9 per cent in 2020, largely due to the fall in measured real government consumption discussed in paragraph 2.52. With nominal government consumption actually rising over this period, the implied government consumption deflator rose rapidly. Quarterly National Accounts (QNA) revisions introduced by the ONS in September 2020 also raised the government consumption deflator relative to our March forecast. These revisions featured significant increases in the private consumption deflator and the price of inventories. The government consumption deflator in 2020 and 2021 is also supported by the additional spending announced since the SEU of around £100 billion in 2020-21 and 2021-22 combined.

2.79 Chart 2.25 shows how the various constituents contribute to GDP deflator inflation over the forecast period. GDP deflator inflation falls back rapidly to -1.3 per cent in 2021, largely because the government consumption deflator falls back from its temporary high as measured real government consumption also falls. Private consumption inflation is also weaker in 2020 and 2021 due to the same factors affecting the CPI forecast: lower oil and energy prices, the Eat Out To Help Out scheme and the temporarily reduced rate of VAT for hospitality services. GDP deflator inflation then returns to around 2 per cent from 2024 onward as government consumption inflation normalises and consumer price inflation returns to target. In level terms, the GDP deflator is 1.5 per cent lower in 2024 than we forecast back in March.

Chart 2.25: Contributions to GDP deflator inflation

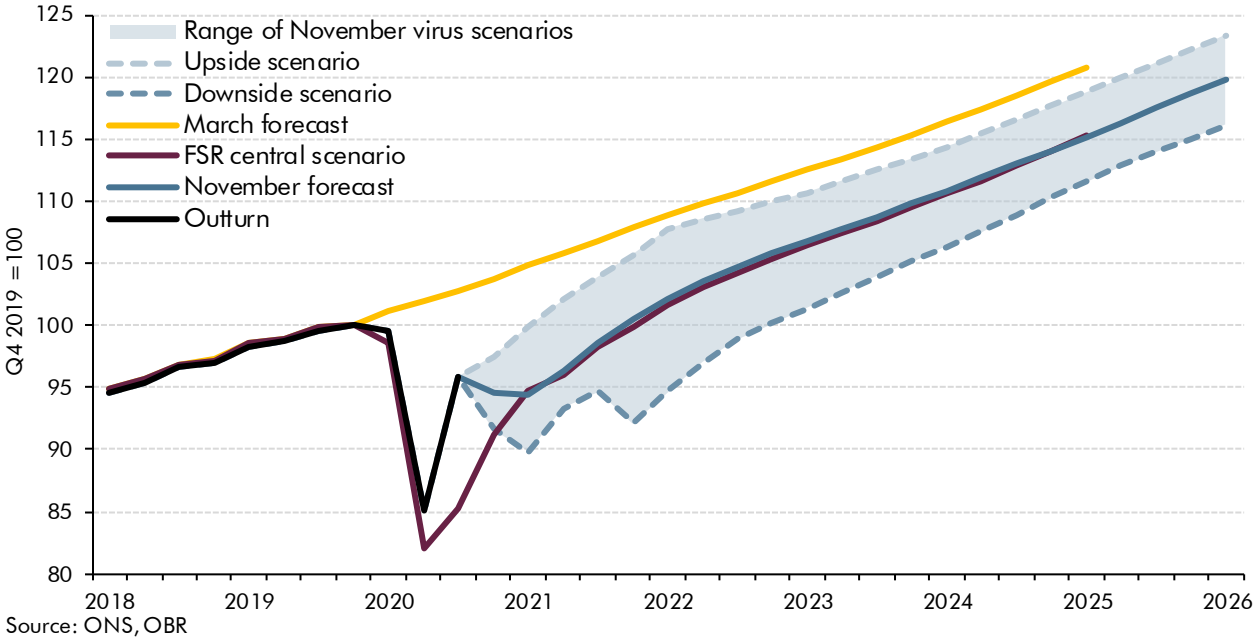


Source: ONS, OBR

Nominal GDP forecast and scenarios

2.80 Given the assumptions for real GDP and the GDP deflator described earlier in the chapter, our forecast and scenarios each show sharp falls in nominal GDP this year (by 4.7, 5.4 and 6.1 per cent in the upside, central and downside respectively) (Chart 2.26). That compares to a fall of 2.6 per cent recorded in 2009, the only previous post-war occasion when nominal GDP fell. It then recovers in line with the paths for real GDP outlined above.

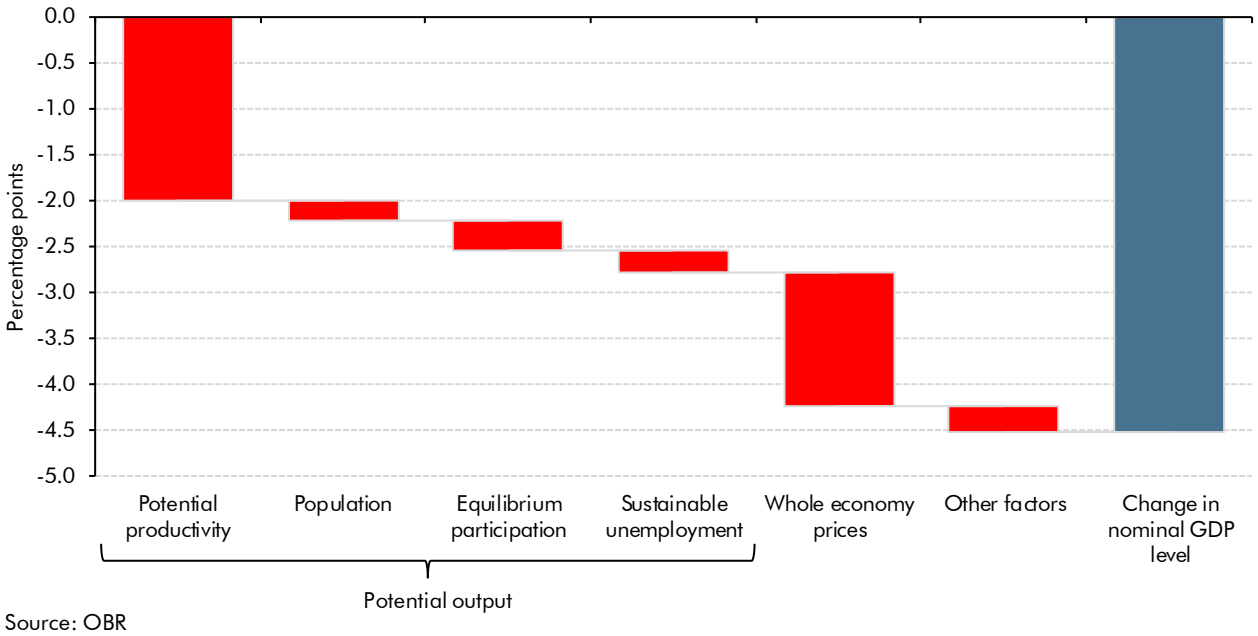
Chart 2.26: Nominal GDP growth



Source: ONS, OBR

2.81 Relative to our March forecast, the level of nominal GDP in the first quarter of 2025 – the forecast horizon at the time – is down 4½ per cent. As Chart 2.27 shows, that loss is split roughly two-thirds real GDP effects with one third due to a lower GDP deflator. In terms of real GDP, the 2 per cent scarring to potential productivity dominates, with smaller contributions from a smaller population (due to lower migration), lower labour market participation (with higher virus-related inactivity partly offset by stronger outturn data) and a higher equilibrium unemployment rate (also a scarring effect). A small negative output gap and weaker outlook for North Sea production (which we forecast separately from potential output) also reduce real GDP relative to March in the first quarter of 2025.

Chart 2.27: Contributions to change in nominal GDP in 2025Q1 since March



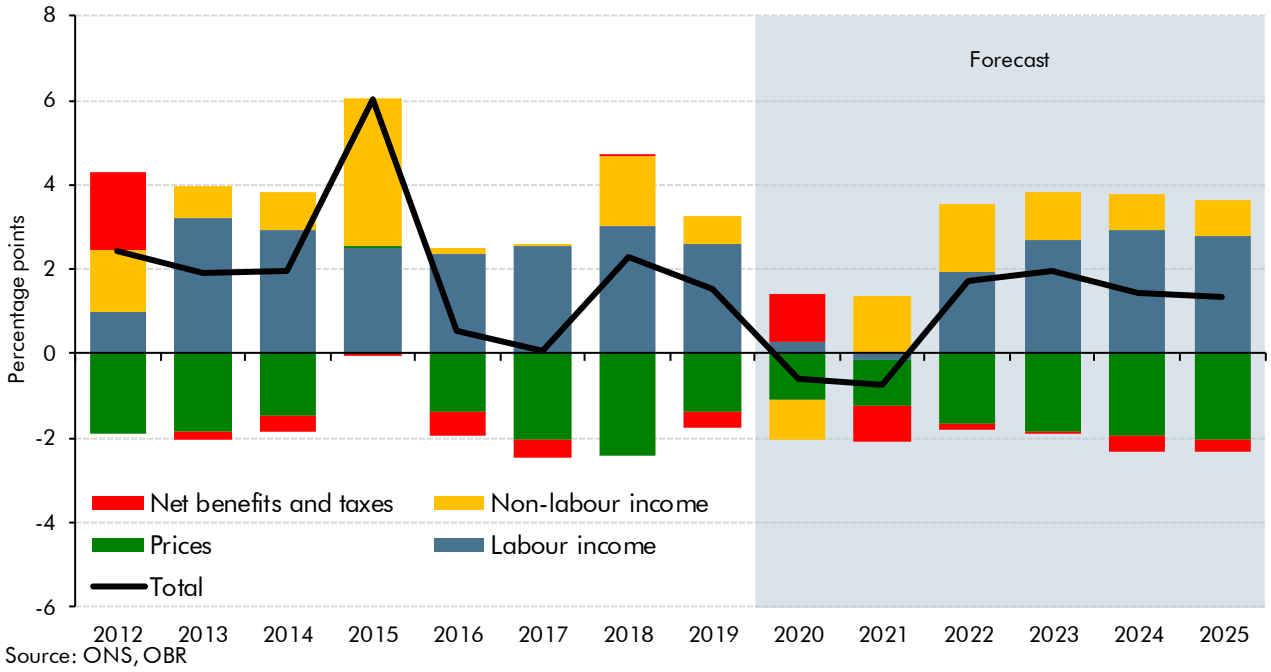
Source: OBR

Income composition of nominal GDP growth

Households

2.82 Real household disposable income is forecast to fall in 2020 and 2021 (Chart 2.28). The main driver of this is labour income which is broadly flat in both years, with growth down by 2.4 and 3.0 percentage points in 2020 and 2021 respectively compared to our March forecast, reflecting the rise in unemployment and the hit to average earnings growth associated with the pandemic. That is despite the support provided by the CJRS and SEISS schemes. Support to household incomes in 2020 is also provided by households receiving higher benefits while taxes on income and wealth provide less of a drag, but this reverses in 2021 as households pay more taxes while benefits are little changed. From 2022 onwards, household income growth picks up driven by stronger labour income growth.

Chart 2.28: Contributions to real household income growth



Source: ONS, OBR

Corporate sector

2.83 Private non-oil non-financial profits fell in the second quarter of 2020 by almost 10 per cent, despite being supported by £12 billion of business grants paid out in that quarter. Profits will be supported by further grants in subsequent quarters, but to a smaller degree. As a consequence, we expect no recovery in total profits in the near term, as underlying profits pick up but grant income falls. Profits growth is subdued next year as we assume some labour hoarding takes place after the CJRS closes but while output is still depressed. In the medium term, profits recover with the share of profits in GDP rising to 16.5 per cent, around its pre-virus level, up from 14.5 per cent at the end of 2020.

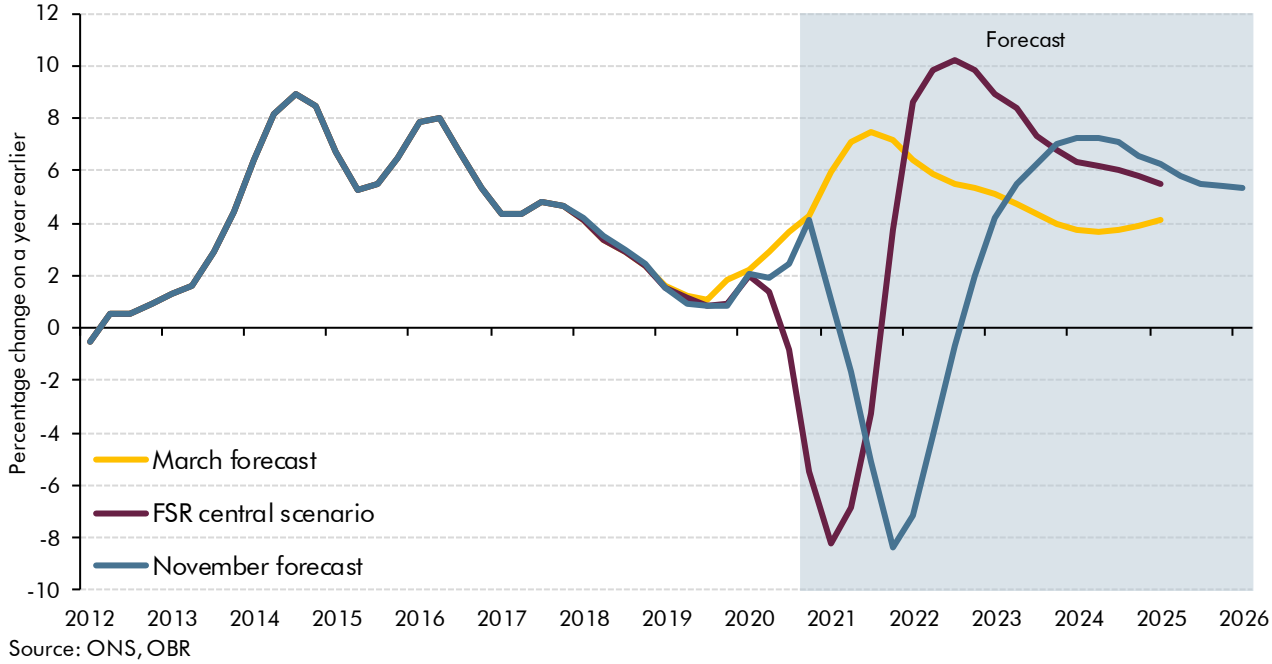
The housing market

2.84 House prices fell briefly as the pandemic struck, but recent indicators suggest they have subsequently recovered quite strongly. This follows the easing of public health restrictions and the stamp duty holiday for residential property transactions that took effect on 8 July 2020. The stamp duty holiday takes transactions up to £500,000 out of stamp duty altogether until March 2021, with higher priced transactions benefitting from a tax cut of £15,000 on the first £500,000 of the price.

2.85 Annual house price inflation according to the ONS measure edged up from 1.3 per cent in April to 2.5 per cent in August. The Halifax and Nationwide measures of house prices, which are based on mortgage approvals rather than completed transactions (and therefore lead the ONS measure), rose by 7.5 per cent and 5.8 per cent respectively in October suggesting that house prices will remain buoyant in the near term.

2.86 Chart 2.29 shows our central forecast for house price inflation. House prices are expected to fall back in 2021, driven by end of the stamp duty holiday and the hit to household incomes from the labour market adjustment that we assume will follow the end of the CJRS. Despite a steady recovery from 2022 onwards, the level of house prices remains around 17 per cent lower at the forecast horizon compared to our March forecast.

Chart 2.29: House price inflation

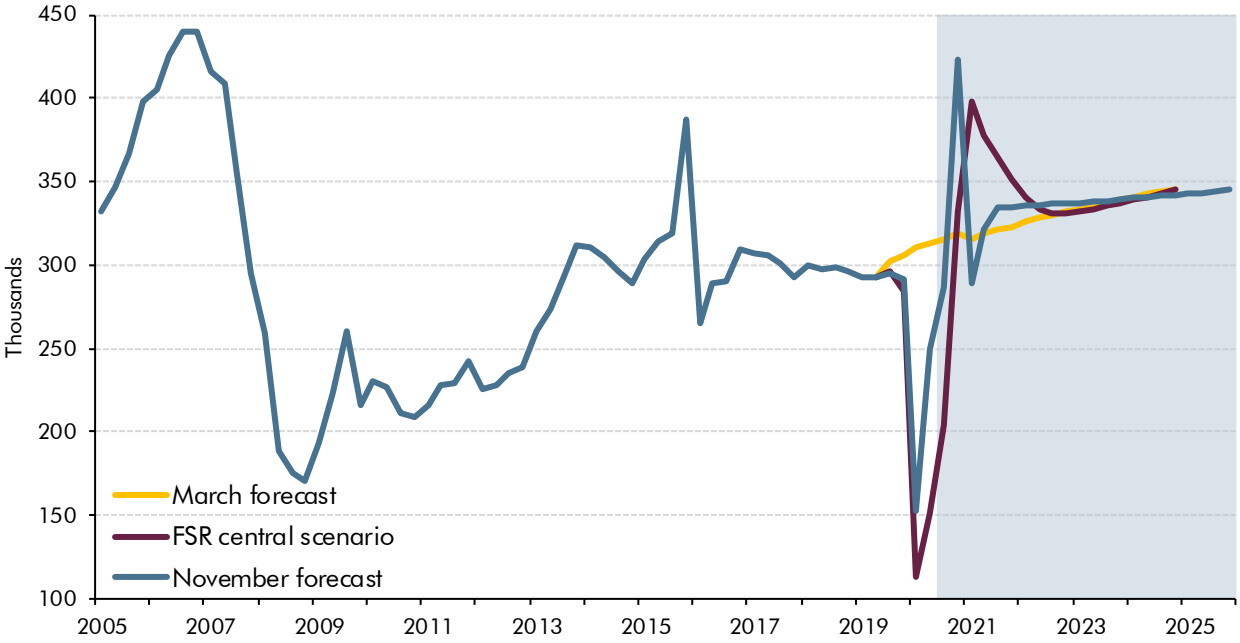


Source: ONS, OBR

2.87 Residential property transactions fell sharply during lockdown but have rebounded following the easing in restrictions (Chart 2.30). The stamp duty holiday has added further impetus to transactions, though there are reports that it is also creating bottlenecks in the system. Due to forestalling, we expect the number of transactions to rise sharply in the first quarter of 2021 and then drop off sharply in the second quarter of 2021. Transactions are then

expected to rise gradually back to a level consistent with longer-term average rates of housing market turnover.

Chart 2.30: Residential property transactions



Source: HMRC, OBR

Commercial property

2.88 Commercial property is likely to be more adversely affected than residential property by the changes triggered by the pandemic over the medium term. We use the IPF consensus forecast to inform our near-term forecast, which implies that commercial prices will fall by 9.2 per cent in 2020-21. We then assume that prices will recover slowly, so that by the forecast horizon they are 1.7 per cent below the March forecast.

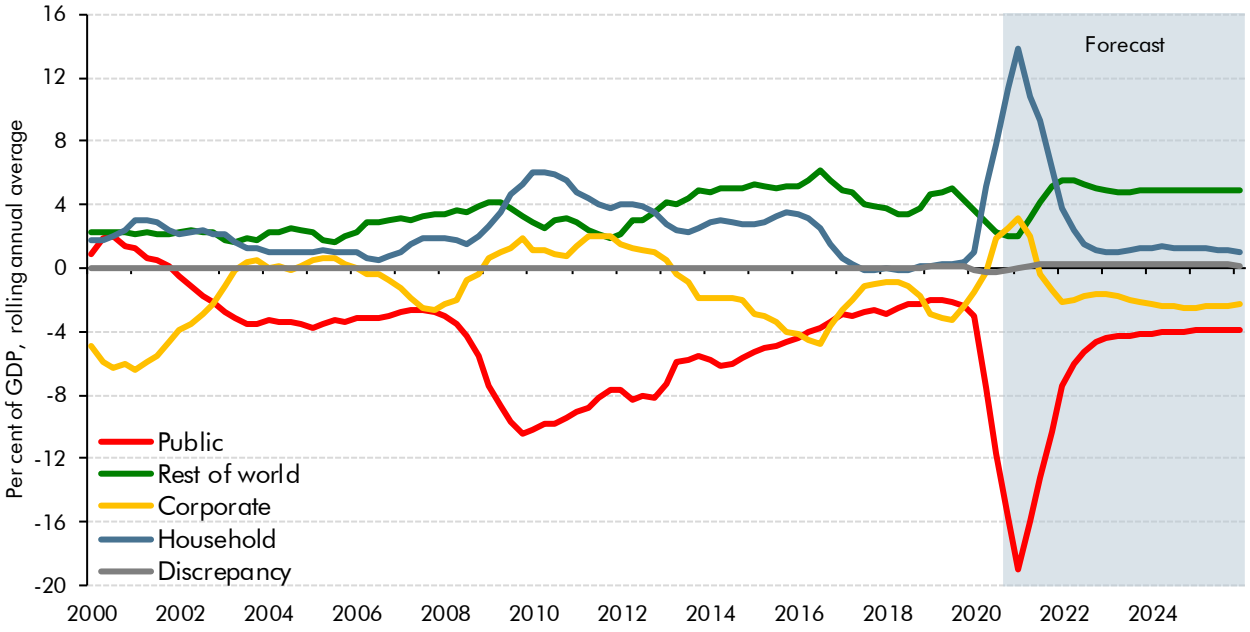
2.89 Commercial property transactions are assumed to follow a similar path to our *FSR* central scenario. Following the initial hit to transactions seen across 2020, we assume commercial property transactions grow steadily across the forecast, such that by 2024-25, transactions are only slightly below our March forecast.

Sectoral net lending

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

2.91 This framework is helpful for understanding the broad flows of money in the economy this year as a result of the pandemic and the huge fiscal support provided to cope with it (Chart 2.31). The spike in government borrowing to around 16 per cent of GDP on this measure in 2020 has meant that household and corporate incomes have not fallen nearly as fast as their output or expenditure. As a result, the household financial surplus rises to historically high level of over 11 per cent of GDP in 2020, while the corporate balance moves from deficit into a historically high surplus of 2.5 per cent of GDP. Thereafter, as the economy recovers and household and corporate spending rise more into line with income, government borrowing falls. Over the medium term, sectoral net lending positions return to more usual levels while there remains a large and stable rest of world surplus (a current account deficit).

Chart 2.31: Sectoral net lending



Source: ONS, OBR

Comparison with external forecasters

2.92 In this section, we compare our latest projections with those of selected outside forecasters. The differences between our forecast and those of external forecasters mostly reflect uncertainty around the speed of recovery of the economy and the amount of medium-term scarring following the economic effect of the virus.

2.93 In its November 2020 *Monetary Policy Report*, the Bank of England's modal forecast for GDP falls by 10.9 per cent in 2020, compared to our 11.3 per fall (Table 2.5), reflecting a decline in supply and an opening up of a small amount of spare capacity in the economy. GDP then rises by 7.1 per cent in 2021 and by 6.1 per cent in 2022, reflecting both a recovery in supply and a narrowing of the output gap.

2.94 Chart 2.32 compares our forecast for the level of GDP with other forecasters. Our GDP forecast is around the same level as the consensus forecast in 2021, and below the Bank of England and IMF's. Over the medium term, the Bank of England's forecast lies between our central forecast and our upside scenario, whereas the IMF and consensus forecast lies between our central forecast and our downside scenario. Our upside scenario lies above the most optimistic of the external forecasters that produce projections out to 2024, consistent with this being a reasonable best case scenario rather than anyone's central case. Our downside scenario is broadly in line with the most pessimistic medium-term forecast.

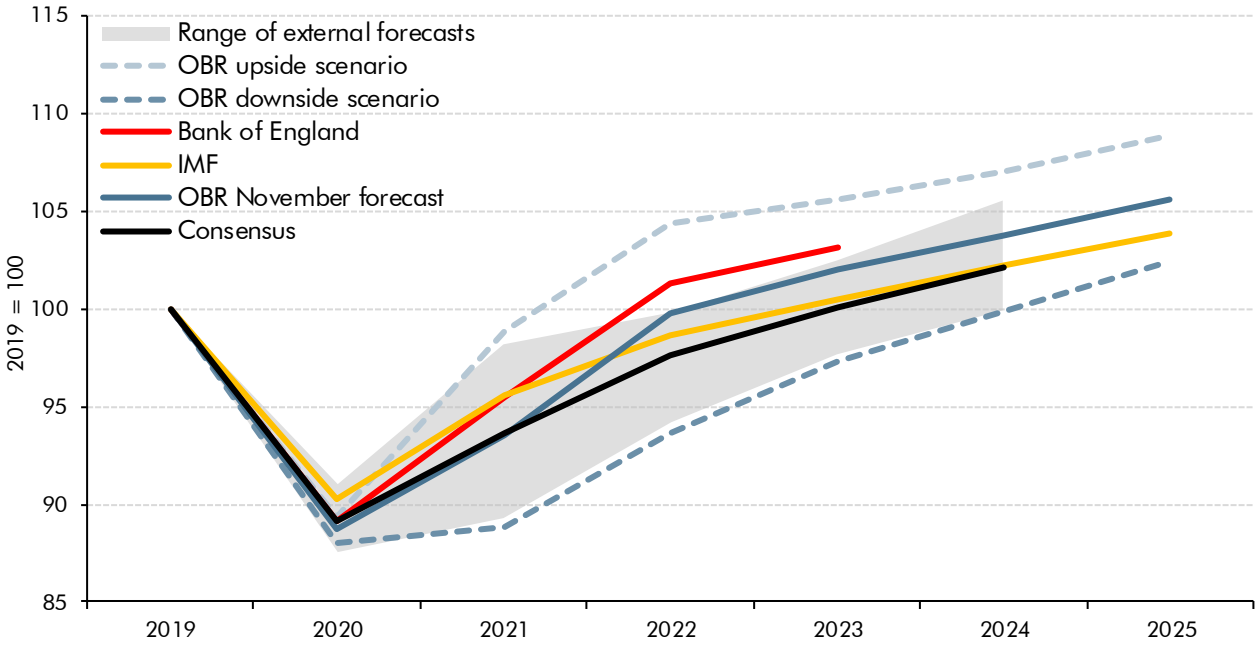
2.95 The Bank's modal CPI inflation forecast is higher than ours, ending at 2.1 per cent in the fourth quarter of 2023 compared to our forecast of 1.8 per cent. This is driven by stronger domestic price pressures as excess demand arises.

Table 2.5: Comparisons with external forecasters

	Per cent					
	2020	2021	2022	2023	2024	2025
OBR (November 2020)						
GDP growth	-11.3	5.5	6.6	2.3	1.7	1.8
CPI inflation	0.8	1.2	1.6	1.7	1.9	2.0
Unemployment	4.4	6.8	6.5	5.4	4.5	4.4
Bank of England (November 2020)[1]						
GDP growth (mode)	-10.9	7.1	6.1	1.8		
CPI inflation (mode)[2]	0.6	2.1	2.0	2.1		
Unemployment[3]	6.3	6.7	4.9	4.3		
NIESR (November 2020)						
GDP growth	-10.5	5.9	3.7	2.8	2.0	1.6
CPI inflation	0.9	1.1	2.2	2.2	2.2	2.1
Unemployment	5.0	7.6	6.5	5.4	4.9	4.7
IMF (October 2020)						
GDP growth	-9.8	5.9	3.2	1.9	1.7	1.6
CPI inflation	0.8	1.2	1.7	1.9	2.0	2.0
Unemployment	5.4	7.4	6.1	5.2	4.5	4.2

[1] Forecast based on market interest rates.
[2] Fourth quarter year-on-year growth rate.
[3] Fourth quarter unemployment rate.

Chart 2.32: Real GDP forecast comparison



Source: Bank of England, HM Treasury, IMF, ONS, OBR

Detailed summary of our economic scenarios

Table 2.6: Detailed summary of the forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
UK economy							
Gross domestic product (GDP)	1.3	-11.3	5.5	6.6	2.3	1.7	1.8
GDP per capita	0.7	-11.8	5.2	6.2	2.0	1.4	1.5
GDP level (2019=100)	100.0	88.7	93.6	99.7	102.0	103.7	105.6
Nominal GDP	3.4	-5.4	3.9	6.8	4.1	3.8	4.0
Output gap (per cent of potential output)	0.1	-0.6	-1.1	-0.8	-0.3	-0.2	-0.1
Expenditure components of GDP							
Domestic demand	1.5	-14.0	10.1	6.8	2.4	2.0	2.0
Household consumption[1]	0.9	-15.1	7.5	9.7	1.7	1.2	1.5
General government consumption	4.1	-7.9	21.1	-3.8	1.2	2.4	2.0
Fixed investment	1.5	-13.9	3.3	10.1	6.9	4.6	3.6
Business	1.1	-18.1	1.2	13.7	9.7	6.2	4.6
General government[2]	4.0	7.0	5.5	6.1	2.7	1.5	1.5
Private dwellings[2]	-1.9	-11.9	15.3	6.7	7.0	4.0	2.8
Change in inventories[3]	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	2.8	-13.8	1.7	3.0	-0.1	-0.4	-0.4
Imports of goods and services	3.3	-21.8	17.2	3.9	0.6	0.8	0.4
Balance of payments current account							
Per cent of GDP	-4.3	-2.0	-5.3	-5.1	-4.9	-5.0	-5.0
Inflation							
CPI	1.8	0.8	1.2	1.6	1.7	1.9	2.0
RPI	2.6	1.5	1.4	1.5	2.6	3.0	3.0
GDP deflator at market prices	2.1	6.9	-1.7	0.2	1.7	2.1	2.2
Labour market							
Employment (million)	32.8	32.7	31.9	32.2	32.7	33.1	33.2
Productivity per hour	0.0	0.9	0.1	0.3	1.1	1.0	1.4
Wages and salaries	3.5	1.9	0.4	2.5	3.6	3.9	3.7
Average earnings[4]	2.9	1.2	2.1	2.0	2.4	3.0	3.5
LFS unemployment (% rate)	3.8	4.4	6.8	6.5	5.4	4.5	4.4
Household sector							
Real household disposable income	1.5	-0.6	-0.7	1.7	2.0	1.5	1.3
Saving ratio (level, per cent)	6.5	19.9	13.7	7.0	7.3	7.6	7.4
House prices	1.0	2.6	-3.5	-2.6	5.8	7.0	5.7
World economy							
World GDP at purchasing power parity	2.8	-4.4	5.2	4.2	3.8	3.6	3.5
Euro area GDP	1.3	-8.3	5.2	3.1	2.2	1.7	1.4
World trade in goods and services	1.0	-10.4	8.3	5.4	4.3	3.8	3.6
UK export markets[5]	1.7	-10.6	8.8	5.7	4.2	3.7	3.5

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

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

[3] Contribution to GDP growth, percentage points.

[4] Wages and salaries divided by employees.

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

Table 2.7: Detailed summary of differences since FSR

	Percentage change on a year earlier, unless otherwise stated					
	Outturn	Forecast				
	2019	2020	2021	2022	2023	2024
UK economy						
Gross domestic product (GDP)	-0.1	1.1	-3.2	2.1	0.2	-0.2
GDP level (2019=100)	0.0	-0.8	-8.9	-4.6	-3.7	-3.4
Expenditure components of GDP						
Household consumption[1]	-0.2	-1.2	-0.1	6.4	0.2	-0.3
General government consumption	0.6	-6.3	12.7	-5.9	-0.7	0.2
Fixed investment	1.0	9.5	-12.7	-3.8	-0.3	-0.3
Business	0.5	6.3	-10.4	-4.1	0.0	0.1
General government[2]	2.6	15.1	-14.7	-1.6	0.9	0.3
Private dwellings[2]	-2.0	18.9	-7.2	-3.9	1.6	-0.6
Balance of payments current account						
Per cent of GDP	-0.5	1.9	-1.7	-1.7	-1.6	-1.6
Inflation						
CPI	0.0	0.1	-0.1	-0.4	-0.3	-0.1
RPI	0.0	0.2	0.3	-1.5	-0.7	-0.1
GDP deflator at market prices	0.3	4.1	-1.7	-1.8	-0.3	0.1
Labour market						
Employment (million)	0.0	1.3	1.0	0.0	0.0	0.1
Wages and salaries	0.1	5.1	-1.0	-4.3	-0.6	0.2
Average earnings[3]	0.1	1.0	-1.7	-0.7	-0.6	-0.2
ILO unemployment (% rate)	0.0	-4.4	-3.3	-0.4	-0.5	-0.8
Household sector						
Saving ratio (level, per cent)	0.8	2.8	2.4	-3.9	-3.7	-3.0
House prices	-0.1	3.4	0.2	-12.2	-2.1	1.0
Nominal Indicators						
Nominal GDP	0.1	4.7	-5.0	0.2	-0.2	-0.2

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

[2] Includes transfer costs.

[3] Wages and salaries divided by employees.

Table 2.8: Detailed summary of differences since March

	Percentage point difference, unless otherwise stated					
	Outturn	Forecast				
	2019	2020	2021	2022	2023	2024
UK economy						
Gross domestic product (GDP)	-0.1	-12.4	3.7	5.1	1.0	0.3
GDP per capita	-0.1	-12.3	3.9	5.1	1.1	0.3
GDP level (2019=100)[1]	0.0	-12.3	-9.1	-4.5	-3.6	-3.3
Nominal GDP	0.1	-8.5	0.1	3.1	0.7	0.3
Output gap (per cent of potential output)	0.0	-0.5	-1.5	-1.2	-0.5	-0.2
Expenditure components of GDP						
Domestic demand	-0.1	-15.1	8.1	5.1	0.8	0.3
Household consumption[2]	-0.4	-16.2	6.3	8.5	0.3	-0.2
General government consumption	0.5	-11.6	18.3	-5.9	-0.7	0.2
Fixed investment	1.1	-13.1	-0.1	7.2	4.9	2.8
Business	0.8	-18.1	-0.6	10.7	7.3	3.9
General government[3]	1.9	5.1	-5.4	1.5	0.9	0.3
Private dwellings[3]	-1.6	-7.7	13.8	5.1	5.7	2.8
Change in inventories[4]	0.0	0.1	-0.1	0.0	0.0	0.0
Exports of goods and services	-0.9	-13.2	2.2	3.6	1.0	0.6
Imports of goods and services	-0.3	-21.6	16.8	3.7	0.4	0.6
Balance of payments current account						
Per cent of GDP	-0.4	1.8	-1.4	-1.1	-0.9	-0.9
Inflation						
CPI	0.0	-0.6	-0.6	-0.5	-0.4	-0.1
RPI	0.0	-0.7	-1.3	-1.6	-0.4	0.1
GDP deflator at market prices	0.3	4.9	-3.7	-2.0	-0.4	0.0
Labour market						
Employment (million)	0.0	-0.3	-1.2	-1.0	-0.6	-0.3
Productivity per hour	0.0	0.0	-1.1	-0.9	0.0	-0.2
Wages and salaries	0.0	-1.7	-3.4	-1.1	0.3	0.7
Average earnings[5]	0.1	-2.1	-1.5	-1.4	-0.7	-0.1
LFS unemployment (% rate)	0.0	0.6	3.0	2.6	1.4	0.4
Household sector						
Real household disposable income	0.7	-1.7	-2.3	0.4	0.6	0.1
Saving ratio (level, per cent)	0.8	13.3	6.7	-0.2	0.1	0.4
House prices	-0.5	-0.7	-10.5	-8.4	1.2	3.2
World economy						
World GDP at purchasing power parity	-0.1	-7.4	1.6	0.7	0.2	0.0
Euro area GDP	0.1	-9.4	3.8	1.7	0.9	0.4
World trade in goods and services	-0.1	-12.3	4.4	1.8	0.6	0.0
UK export markets[6]	0.2	-12.2	5.4	2.4	0.8	0.2

[1] Per cent change since March 2019.

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

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

[4] Contribution to GDP growth, percentage points.

[5] Wages and salaries divided by employees.

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

Table 2.9: Determinants of the fiscal forecast

	Percentage change on previous year, unless otherwise specified							*Growth over forecast*
	Outturn	Forecast						
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	
GDP and its components								
Real GDP	0.3	-12.9	10.4	5.0	1.9	1.7	1.8	6.6
Nominal GDP[1]	2.5	-6.7	7.2	5.9	3.8	3.9	4.0	18.9
Nominal GDP (£ billion)[1,2]	2218	2069	2219	2351	2441	2536	2637	419
Nominal GDP (centred end-March £bn)[1,3]	2107	2162	2294	2397	2487	2586	2689	582
Wages and salaries[4]	3.6	1.2	0.0	3.4	3.7	3.9	3.7	16.9
Non-oil PNFC profits[4,5]	0.8	-9.5	1.0	13.6	5.9	3.7	3.8	18.2
Consumer spending[4,5]	2.3	-14.1	8.7	11.4	3.5	3.1	3.6	15.0
Prices and earnings								
GDP deflator	2.5	6.8	-2.8	0.9	1.9	2.1	2.2	11.3
RPI	2.6	1.1	1.4	1.8	2.7	3.0	3.0	13.7
CPI	1.7	0.6	1.4	1.6	1.8	1.9	2.0	9.6
Average earnings[6]	2.9	0.9	2.2	2.1	2.5	3.1	3.6	15.2
'Triple-lock' guarantee (September)	4.0	2.5	4.1	2.5	2.5	2.8	3.5	19.3
Key fiscal determinants								
Employment (million)	32.9	32.5	31.8	32.3	32.8	33.1	33.3	0.4
Output gap (per cent of potential output)	0.1	-0.9	-1.0	-0.6	-0.3	-0.2	0.0	-0.1
Financial and property sectors								
Equity prices (FTSE All-Share index)	3979	3368	3574	3785	3931	4083	4246	267
HMRC financial sector profits[1,5,8]	1.4	-15.0	10.0	10.0	1.9	1.9	2.0	9.0
Residential property prices[9]	1.2	2.4	-5.6	0.3	6.5	6.8	5.5	16.4
Residential property transactions (000s)[10]	1172	1111	1279	1346	1353	1364	1375	203
Commercial property prices[10]	3.3	-9.2	-0.8	1.7	2.0	2.0	2.0	-2.8
Commercial property transactions[10]	-6.6	-21.0	9.0	5.8	4.9	4.7	4.4	4.5
Oil and gas								
Oil prices ($ per barrel)[5]	64.0	41.6	44.1	45.9	47.1	48.0	48.9	-15.1
Oil prices (£ per barrel)[5]	50.1	32.5	33.5	34.9	35.8	36.5	37.2	-12.9
Gas prices (p/therm)[5]	34.7	24.8	37.2	38.7	39.4	40.2	41.0	6.3
Oil production (million tonnes)[5]	51.8	51.0	47.8	45.0	42.3	39.8	37.3	-14.5
Gas production (billion therms)[5]	13.1	12.9	12.4	11.5	10.7	10.0	9.2	-3.9
Interest rates and exchange rates								
Market short-term interest rates (%)[11]	0.8	0.1	0.0	0.0	0.1	0.2	0.4	-0.4
Market gilt rates (%)[12]	0.7	0.3	0.4	0.5	0.6	0.7	0.8	0.1
Euro/Sterling exchange rate (€/£)	1.14	1.11	1.11	1.11	1.11	1.11	1.11	-0.03

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

Table 2.10: Differences in determinants of the fiscal forecast since FSR

	Percentage point difference, unless otherwise specified					
	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
GDP and its components						
Real GDP	-0.2	0.5	-1.4	1.2	0.0	-0.3
Nominal GDP[1]	0.2	4.5	-4.9	0.0	-0.2	-0.2
Nominal GDP (£ billion)[1,2]	2.7	101.2	12.4	13.5	10.5	6.3
Nominal GDP (centred end-March £bn)[1,3]	65.8	43.4	14.7	12.5	9.0	6.9
Wages and salaries[4]	0.1	7.0	-5.0	-2.8	-0.1	0.1
Non-oil PNFC profits[4,5]	-0.6	10.4	-12.7	6.9	1.5	-0.8
Consumer spending[4,5]	-0.1	-0.8	-0.3	6.3	0.0	-0.4
Prices and earnings						
GDP deflator	0.6	4.1	-2.9	-1.2	-0.2	0.1
RPI	0.0	0.2	-0.2	-1.4	-0.5	-0.1
CPI	0.0	0.1	-0.2	-0.4	-0.2	-0.1
Average earnings[6]	0.2	1.0	-2.1	-0.5	-0.6	-0.1
'Triple-lock' guarantee (September)	0.0	0.0	-0.9	-0.2	-0.5	-0.3
Key fiscal determinants						
Employment (million)	0.0	1.9	0.5	0.0	0.1	0.1
Output gap (per cent of potential output)	-	-	-	-	-	-
Financial and property sectors						
Equity prices (FTSE All-Share index)	0.0	-96.0	-126.9	-114.2	-165.9	-237.0
HMRC financial sector profits[1,5,8]	0.2	25.0	-10.0	-10.0	-18.1	-0.1
Residential property prices[9]	0.0	5.7	-6.0	-9.4	-0.7	0.9
Residential property transactions (000s)[10]	7.0	311.0	-211.6	10.1	14.6	-3.9
Commercial property prices[10]	-0.6	4.5	-1.7	-0.9	0.5	0.0
Commercial property transactions[10]	0.1	2.6	-11.3	2.1	3.0	2.7
Oil and gas						
Oil prices ($ per barrel)[5]	-0.1	4.3	5.7	5.0	5.4	5.5
Oil prices (£ per barrel)[5]	0.0	2.3	2.2	1.5	1.8	1.8
Gas prices (p/therm)[5]	0.0	4.4	4.2	5.1	5.2	5.3
Oil production (million tonnes)[5]	0.1	1.0	1.3	1.6	1.9	2.3
Gas production (billion therms)[5]	0.0	0.2	0.3	0.3	0.3	0.3
Interest rates and exchange rates						
Market short-term interest rates (%)[11]	0.0	0.1	0.0	-0.1	0.0	0.0
Market gilt rates (%)[12]	0.0	0.0	0.0	0.0	0.1	0.1
Euro/Sterling exchange rate (€/£)	-	-	-	-	-	-

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

3 Fiscal outlook

Introduction

3.1 This chapter:

- summarises the assumptions that we have made in respect of the **coronavirus pandemic** and associated public health restrictions and the **UK's exit from the EU** (from paragraph 3.8);
- explains the effects of **new policies announced since March 2020** on the fiscal forecast (from paragraph 3.13);
- notes **classification issues** affecting our forecast (from paragraph 3.15);
- describes the outlook for **public sector receipts** (from paragraph 3.18) and **public sector expenditure** (from paragraph 3.66);
- presents forecasts for the key measures of the **fiscal deficit**, including headline and structural measures of the budget deficit (from paragraph 3.130);
- describes the outlook for key **balance sheet aggregates**, such as public sector net debt, and for government lending to the private sector and other **financial transactions**, including financial asset sales (from paragraph 3.141); and
- summarises key **uncertainties and risks to the fiscal outlook,** including different **scenarios for the fiscal impact of coronavirus** (paragraph 3.161). No deal Brexit scenarios are presented in Annex B.

3.2 Further breakdowns of receipts and expenditure and other details of our forecast are provided in supplementary tables on our website. The forecasts in this chapter start from the estimates of 2019-20 outturn data published by the Office for National Statistics (ONS) on 20 November. When finalising the forecast, we did not have access to the ONS data for October, but were able to draw on administrative data on most taxes and some spending lines for October. Finally, we present forecasts for 2021-22 to 2025-26. Comparisons are made with both our March *Economic and fiscal outlook* (*EFO*) and our July *Fiscal sustainability report* (*FSR*). The latter includes announcements made in the Chancellor's Summer Economic Update (SEU) on 8 July, that were too late to include in our *FSR*.

3.3 The Foreword to this document describes the timetable that was followed in producing the forecasts presented here. This included keeping our pre-measures economy and fiscal forecasts open until the final round that was closed on 18 November to allow us to include

the most up-to-date public finance data, latest fiscal policy announcements, and latest information on the path of the coronavirus, public health response, and development of potential vaccines. The forecasts reflect information gathered from financial market prices on 9 November, after news of Pfizer's vaccine broke, the outcome of the US Presidential election had become clear, and the Bank's Monetary Policy Report had been published.

3.4 As with previous *EFO*s, the forecast is based on announced Government policy in respect of taxes, public spending and other fiscal variables (while making assumptions about public health measures), and it focuses on 'headline' fiscal aggregates that exclude public sector banks. The pre-measures forecast includes the virus-related policy measures announced up to 26 June that were included in our July *FSR*, together with the measures announced in the SEU on 8 July, that were too late to include in our *FSR*. Our post-measures forecast also includes all virus-related policy measures announced since the SEU, the Spending Review settlements for 2021-22, medium-term departmental spending totals published alongside this forecast, and non-coronavirus-related policies announced since our March *EFO*.

3.5 With the final round of the forecast coming after the announcement of the November lockdown in England, as well as several significant pieces of economic and fiscal data, the process of identifying the effect of policy measures on the forecast has departed from our usual detailed bottom-up approach. The indirect fiscal effects of measures presented in this chapter have instead been generated top down using ready-reckoners that link receipts and spending changes to changes in nominal GDP and unemployment. While this is more broad-brush than our usual approach, it should provide a reasonable picture overall.

3.6 The sheer scale of the economic and fiscal shock precipitated by the pandemic means that the central forecasts presented in this chapter are subject to much more uncertainty than usual. In contrast to previous *EFO*s, we do not claim that our central fiscal forecast represents the median of the probability distribution of possible outcomes. The coronavirus shock is so severe and idiosyncratic that there is no reasonable basis for forming a view on the likelihood of any particular outcome. But we believe our central forecast lies towards the middle of the range of plausible outcomes. Moreover, the volume of fiscally material forecast judgements that have been necessary and the challenge of interpreting very large swings in monthly receipts and spending data mean that many of the smaller issues that we would usually review have been subject to less detailed scrutiny than usual.

3.7 Given this uncertainty we therefore also explore the implications for the public finances of upside and downside scenarios for the path of the pandemic in the risks and uncertainties section at the end of the chapter. And given the continued uncertainty regarding the outcome and ratification of any post-Brexit trade agreement between the UK and EU, this section also summarises the results of an alternative 'no deal' scenario (the details of which are provided in Annex B) in which the UK's trading relationship with the EU defaults to World Trade Organization (WTO) terms on 1 January.

Coronavirus and EU exit assumptions

Coronavirus

3.8 Our assumptions concerning the course of the pandemic and its impact on the economy pandemic are set out in Chapter 2 (see paragraphs 2.2 to 2.10). Broadly speaking, in our central forecast we assume that health restrictions depress activity over the winter, until the warmer weather allows an easing of health restrictions in the spring. Effective vaccines become widely available by the latter half of next year, permitting a gradual return to more normal life thereafter, although we assume that the virus has a lasting adverse impact on the economy. The upside scenario assumes a more rapid return to normal economic and social life, with no medium-term economic scarring, while the downside scenario assumes a lack of effective vaccines and more substantial economic scarring. Virus-related policy assumptions are summarised in the policy section below and in Annex A.

EU exit

3.9 The OBR is required by legislation to base its forecasts on current government policy (but not necessarily assuming that particular policy objectives will be met). With negotiations over the UK's future relationship with the EU still in progress when we closed our forecast, it was necessary to make some assumptions regarding the outcome. We asked the Government to confirm its policies in areas that are likely to be affected by our departure from the EU once the transition period ends on 31 December 2020. The Government confirmed it "*remains committed to working hard*" to reach a free-trade agreement (FTA) with the EU, but was also ready to trade without an FTA, on WTO terms. It also provided further information in several specific policy areas covering taxation, trade and migration.

3.10 As set out in Chapter 2, we continue to assume that the UK and EU conclude an FTA and that there is a smooth transition to the new trading relationship after the transition period ends. The unresolved nature of the negotiations means that other outcomes are possible, including that there is no agreement and the UK defaults to trading with the EU on WTO terms, the economic and fiscal implications of which are considered in Annex B.

3.11 Since our March 2020 *EFO*, Government policy has been confirmed for the following key areas (more detail is provided in Annex A):

- In May, the Government announced the **UK global tariff (UKGT)**, the UK's new 'most-favoured nation' tariff regime. The UKGT will replace the EU's 'common external tariff' (CET) on 1 January 2021 at the end of the transition period.

- In June, the Government confirmed the eligibility rules for accessing **student finance in England**. EU nationals domiciled in the UK, EEA or Switzerland will no longer be eligible for home-fee status or various forms of financial support from Student Finance England for courses starting in academic year 2021-22.

- In July, the Government published its new **'border operating model'**, setting out the technical detail on how the border with the EU will work after the transition period. The Government published a further clarification to the model in October.

- In September, the Government announced several changes to **the duty- and tax-free goods regime**. This included the ending of the 'VAT retail export scheme' for international visitors to Great Britain, as well as the extension of duty-free shopping to outgoing passengers bound for the EU from January 2021.

3.12 There are several ancillary areas where the Government's post-transition policy and operating models are less clear, and we have needed to make our own assumptions to construct our fiscal forecast. We asked the Government for further clarification but ultimately made our own assumptions in the following areas:

- As part of the new border operating model, the Government has made several concessions in recognition of the difficulties that businesses face in preparing for the end of the transition period, including **the phasing in of border controls** between January and July 2021. The National Audit Office cited evidence that neither the public sector nor businesses are fully prepared for the imminent border changes.[1] As a combined result of these concessions and the lack of readiness, we assume that non-compliance rates for VAT, customs duties and excise duties will rise temporarily in 2021 and 2022. Annex A sets out the impact of these assumptions in more detail.

- The **'UK's approach to the Northern Ireland protocol'** was published in May, setting out the Government's principles for operationalising the protocol. Much of the detail behind how the protocol will work in practice has yet to be finalised and the Government told us that *"further guidance will be published before the end of the Transition Period"*. Given the lack of clarity, we have not made specific assumptions in respect to its operation, but it is likely to contribute to some increase in non-compliance affecting tax revenues as is the case with the new border operating model.

- The Government has promised to pursue an approach to **vehicle emissions regulation** "*at least as ambitious*"[2] as the current arrangements and a system of **carbon pricing** of "*at least the same effectiveness and scope*" as the EU emissions trading system. In the absence of firm policies in these areas, we have retained the assumptions used in our March forecast, assuming the EU schemes continue, consistent with the stated position that UK replacement schemes will be at least equivalent in effect. Any changes that follow the end of the transition period will be costed against this neutral baseline.

[1] *The UK border: preparedness for the end of the transition period*, National Audit Office, 6 November 2020.
[2] Office for Low Emission Vehicles, *The Road to Zero*, September 2018.

Policy announcements

3.13 As in other advanced economies, the Government has committed very significant sums to treat the infected, control the spread of the virus, and cushion its financial impact on households and businesses. As support has been expanded and extended, including in the wake of the second wave, its total cost this year has risen from £192 billion at the time of the SEU, to £280 billion by the time of this forecast (see Box 3.1).

3.14 The Government's fiscal policy response to the pandemic is summarised in Table 3.1, along with the more modest effects of several Brexit-related policy measures and the lower path for medium-term departmental spending announced in the Spending Review:

- Split **by time period**, the top panel shows that around two-thirds of the cost of virus-related interventions relates to measures announced by the time of the Chancellor's Summer Economic Update (SEU) in early July. Measures announced over recent months as the virus took hold again, including those in the Spending Review, have cost relatively less, though still huge sums by historical standards.

- Split **by type of measure**, the middle panel shows that virus-related measures dominate. Support for public services (especially health), for employment (via furlough support and payments to the self-employed), and for businesses (via grants, business rates holidays and guaranteed loans), all run into the tens of billions of pounds. Over the medium term, Spending Review decisions reduce borrowing through the £10 to £12 billion cuts to departmental resource spending relative to March Budget totals.

- Split **by receipts and spending lines**, the bottom panel shows that departmental resource spending dominates (where the health costs sit), followed by annually managed resource spending (where the employment support measures sit).

- The **indirect fiscal effect of decisions** relates only to measures announced since the SEU. It largely reflects the boost to receipts via a higher path for GDP from further rises in departmental spending and the extension of various virus-related support measures.

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

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Government decisions since March	**-1.8**	**-242.5**	**-20.1**	**10.7**	**14.0**	**14.8**	**13.9**
Direct effect of decisions since March	**-1.8**	**-266.6**	**-43.3**	**11.0**	**15.2**	**16.0**	**15.5**
of which:							
Direct effect of decisions up to SEU	-4.1	-192.3	-0.1	-0.2	-1.4	-0.9	0.0
Recostings of FSR plus SEU	2.4	11.5	-3.7	-0.8	0.3	-0.1	-1.0
Direct effect of decisions since SEU	-0.1	-85.7	-39.5	12.0	16.3	17.1	16.5
of which:							
Winter Economy Plan	-0.1	-37.3	5.2	-0.7	0.0	0.0	0.0
CJRS, SEISS extensions	0.0	-21.1	0.9	0.0	0.0	0.0	0.0
New policy measures	0.0	-27.2	-45.6	12.7	16.3	17.1	16.5
of which:							
Virus-related support measures	-1.8	-280.0	-52.7	-1.9	-0.7	-0.7	-0.5
of which:							
Public services	0.0	-127.1	-58.8	0.1	0.3	0.0	0.0
Employment support	-1.8	-73.3	2.5	0.0	0.0	0.0	0.0
Loans and guarantees	0.0	-31.4	-0.4	0.0	0.0	0.0	0.0
Business support	-0.2	-34.1	6.5	-0.6	0.0	-0.1	-0.1
Welfare spending	0.0	-8.3	-1.7	-1.3	-0.8	-0.5	-0.3
Other tax measures	0.1	-5.7	-0.8	-0.1	-0.2	-0.1	-0.1
Spending Review (non-virus)	0.0	0.0	12.3	11.9	13.3	13.8	14.0
Other measures	0.0	13.4	-2.9	1.0	2.6	3.0	2.0
of which:							
Resource DEL	0.0	-121.0	-47.4	10.5	12.7	13.2	12.5
Capital DEL	0.0	-5.8	0.3	0.0	0.0	0.0	0.0
Resource AME	-2.1	-94.7	-5.4	-0.3	0.7	0.7	0.7
Capital AME	0.0	-29.5	0.9	0.3	0.3	0.4	0.4
Receipts	0.3	-15.5	8.4	0.5	1.5	1.7	1.8
Indirect effect of decisions since SEU	**0.0**	**24.0**	**23.2**	**-0.3**	**-1.2**	**-1.3**	**-1.6**

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

Box 3.1: The rising cost of the coronavirus policy response

In the Budget on 11 March, the Chancellor announced the first step in the Government's fiscal response to the pandemic, setting aside £5 billion for the NHS and announcing £7 billion support for the self-employed, businesses and vulnerable people. This turned out to be the first of many virus-related support packages this year, several of which would have qualified as major fiscal events in their own right in a normal year.

Chart A documents the main steps along the road to the £280 billion total cost attached to virus-related policy measures in our central forecast. It uses the latest available cost of each measure rather than any that were stated at the time of an announcement or in one of our subsequent policy monitoring databases. And for policies that have been amended several times since their initial announcement, it only splits costs between announcements where they are material – as with the extensions to the CJRS – and where we have estimates to do so.

On 17 March, the Chancellor significantly increased the scale of the support measures announced the previous week – including the government-guaranteed loan schemes, business rates holidays and business grants. Based on our latest estimates, the initial cost of virus-related support had already reached £30 billion.

On 20 March, the Chancellor introduced the CJRS, which was to run for three months to the end of May (costing £18 billion in outturn), and announced the £20 a week increases in universal credit and working tax credits awards, and that local housing allowance rates for low-income private renters would rise (at a combined cost of £7 billion). On 26 March, he announced the first SEISS grant, covering a three-month period (costing £6 billion).

Further announcements followed in April. On 13 April, a statement disclosed that £14.5 billion in public services spending had been approved. On 17 April the CJRS was extended by one month to the end of June (costing £7 billion). And on 27 April the Chancellor supplemented the original business interruption loans with the fully guaranteed Bounce Back Loan Scheme (BBLS). Future calls on BBLS guarantees with respect to loans taken out by the initial end date of the end of October are expected to reach £19 billion.

The CJRS was extended by a further four months on 12 May (though full details of the flexible element came at the end of the month). On 29 May the second SEISS grant was announced. Together these cost £15 billion, taking the total cost of support above £100 billion.

Several smaller announcements made between the March Budget and the Summer Economic Update (SEU) were reflected in our *Fiscal sustainability report* in July or shortly after that.

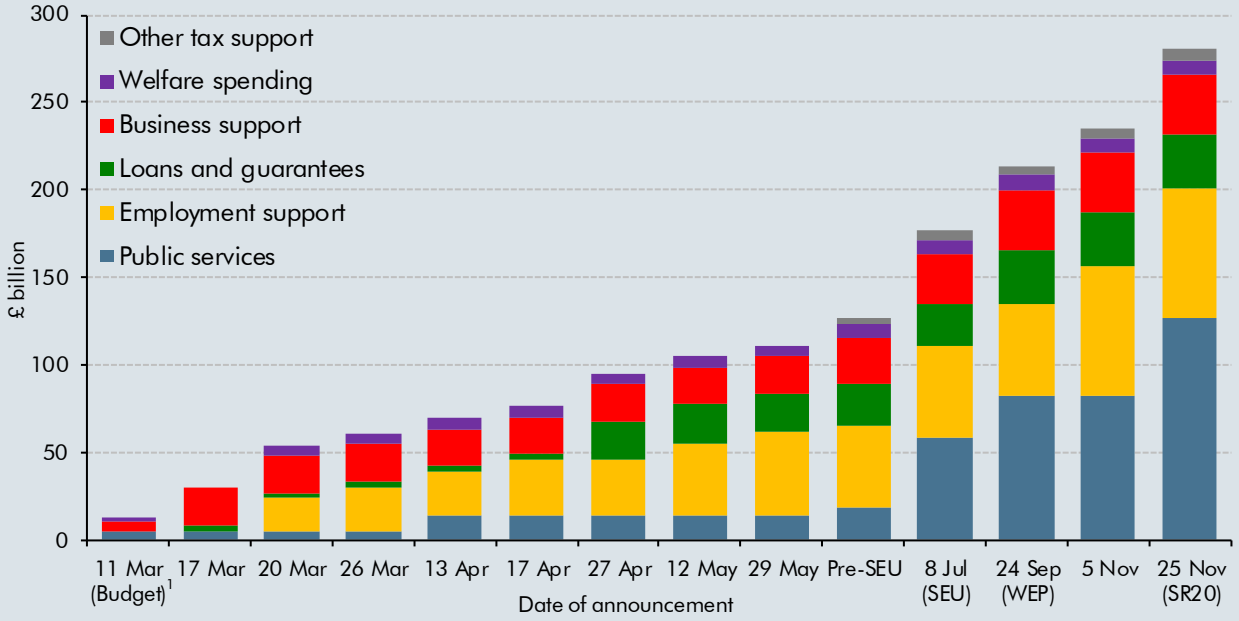
At the SEU on 8 July, the Chancellor announced his *Plan for Jobs*, including a stamp duty holiday, temporary VAT cut for the hospitality industry and the Eat Out to Help Out scheme. Overall these cost £10 billion. More significantly, £40 billion of further public services spending was disclosed by this point. The job retention bonus included in the SEU has been shelved for now, so it does not add to the overall cost of support measures.

The Winter Economy Plan (WEP) on 24 September was the next major announcement. The loan schemes and temporary VAT cut were extended and a third and fourth SEISS payment added, but at significantly reduced generosity that was later increased. Again, the largest cost was attached to further public services spending (£24 billion). The WEP also included the job support scheme, which was overtaken by subsequent announcements, so does not add to the total. The WEP announcements took the total cost of virus-support for the year above £200 billion.

As England entered lockdown on 5 November, the generosity of third SEISS grant was increased back to the level of the first one, and the CJRS was extended to the end of March 2021. This added a further £21 billion to the overall cost for the year. The further virus support measures captured in this forecast raises the total by an additional £45 billion to £280 billion, almost entirely from increases to public services spending announced in the Spending Review.

The twelve major post-Budget fiscal policy announcements this year therefore cost an average of £22 billion each. This compares to the £22 to £29 billion a year fiscal loosening between 2021-22 and 2024-25 announced in the Budget in March, which was itself the largest sustained fiscal loosening since the pre-election Budget of March 1992.

Chart A: Cumulative cost of virus-related policy measures in 2020-21



[1] Cost based on figures announced by the Chancellor in the Budget. All other costs based on our November forecast estimates.
Source: OBR

Classification and other statistical changes

3.15 In September, the ONS implemented several classification and other changes to the public finances.[3] We have restated our *FSR* projections on a consistent basis. The changes include:

- the reclassification of **Pool Re, London North Eastern Railway** and **Northern Rail** from the private sector to central government;
- the reclassification of some **Home Office immigration charges** from fees for services (negative spending) to various kinds of taxes and social contributions (receipts);
- new data sources and other updates for **funded public sector pension schemes**; and
- updated estimates for **capital consumption** and **student loans**.

3.16 Of these changes, those to pensions are the most significant. In 2019-20, they reduce public sector net borrowing (PSNB) by £3.2 billion and reduce public sector net debt (PSND) by £4.6 billion.

3.17 Following the introduction of emergency measures agreements (EMAs) for train operating companies (TOCs), the ONS has reclassified most TOCs to the public sector. These agreements were replaced by emergency recovery measures agreements (ERMAs) in September. Absent any announcements on government policy in respect of the TOCs beyond the term of the ERMAs, we have assumed that they remain in the public sector.

[3] For details see *Recent and upcoming changes to public sector finance statistics: August 2020,* ONS.

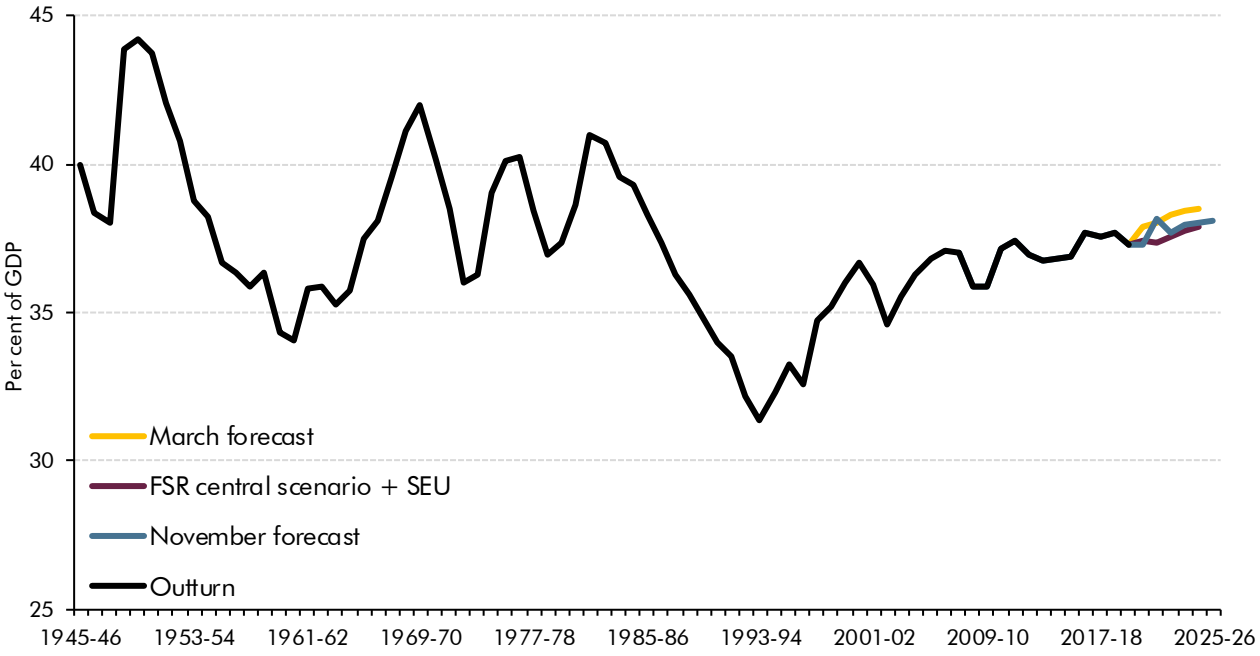
Public sector receipts

Summary of the receipts forecast

3.18 Our central forecast shows receipts in 2020-21 falling by £57 billion (6.8 per cent) on a year earlier, almost exactly in line with the 6.7 per cent fall in nominal GDP. Receipts are therefore little changed as a share of GDP in 2020-21. They are reduced by several virus-related policy measures, including business rates holidays and cuts in VAT and stamp duty. Other policy measures defer tax payments rather than lowering receipts overall (notably the VAT deferral) and so have a limited effect on the headline measure of accrued receipts. Abstracting from the direct impact of tax policy measures, receipts rise as a share of GDP in 2020-21, more than explained by income tax and NICs, where overall employment has been supported by the various government support schemes.

3.19 Receipts rebound by £76 billion in 2021-22 (rising 9.9 per cent on a year earlier) as the lifting of public health restrictions facilitates a normalisation of activity, earnings and profits. Receipts growth is also boosted as time-limited reliefs expire and self-assessment liabilities deferred from 2020-21 are paid. Abstracting from these timing effects, receipts fall as a share of GDP over 2021-22 and 2022-23, as income tax is hit as unemployment rises. Receipts rise marginally faster than GDP towards the end of the forecast, as earnings growth outstrips the rise in inflation-linked tax thresholds. This means a progressively higher proportion of labour income is subject to higher income tax and NICs rates.

Chart 3.1: Receipts as a share of nominal GDP



Source: ONS, OBR

Table 3.2: Major receipts as a share of GDP

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax	8.7	9.1	9.2	8.7	8.8	8.9	9.0
NICs	6.5	6.8	6.6	6.4	6.5	6.5	6.5
Value added tax	6.0	5.6	5.9	6.0	6.0	5.9	5.9
Onshore corporation tax	2.1	2.1	2.2	2.4	2.5	2.5	2.5
Council tax	1.6	1.8	1.8	1.8	1.8	1.7	1.7
Capital taxes[1]	1.4	1.2	1.4	1.3	1.3	1.4	1.4
Business rates	1.4	0.9	1.4	1.4	1.4	1.4	1.3
Fuel duties	1.2	1.1	1.2	1.3	1.3	1.2	1.2
Alcohol and tobacco duties	1.0	1.0	1.0	0.9	0.9	0.9	0.9
Other taxes	3.4	3.7	3.6	3.5	3.5	3.5	3.5
National Accounts taxes	**33.5**	**33.4**	**34.2**	**33.7**	**33.9**	**33.9**	**33.9**
Interest and dividend receipts	1.2	1.1	1.1	1.1	1.1	1.2	1.2
Other receipts	2.7	2.7	2.8	2.9	2.9	2.9	2.9
Current receipts	**37.3**	**37.3**	**38.2**	**37.7**	**38.0**	**38.0**	**38.1**

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

Comparison with the March *EFO* and the July *FSR* central scenario

3.20 In cash terms, our latest receipts forecast is substantially weaker than that presented in our March *EFO*, but not as weak as the central scenario from our July *FSR*.

The performance of receipts in 2020-21

3.21 Receipts in 2020-21 are £101.9 billion lower than our March forecast thanks to the combined effect of the weaker economy hitting almost all tax bases (explaining around 90 per cent of the shortfall) and the direct impact of policy measures (explaining the remainder). That leaves the major taxes down substantially: income tax and NICs by £28.7 billion (on weaker labour income); VAT by £24.3 billion (as consumer spending fell, especially during lockdown, and reliefs were extended to the hospitality sector); and corporation tax by £14.3 billion (on weaker profits). Air passenger duty, property taxes, and fuel duties all see particularly sharp percentage falls. We also assume a temporary rise in tax non-compliance this year.

3.22 Despite these sharp falls, HMRC cash receipts over the first seven months of 2020-21 were up by £35.9 billion (14.0 per cent) relative to our *FSR* central scenario. This largely reflected strength in the wider economy, in particular stronger earnings growth and smaller falls in consumer spending. Tax debts generated during the initial lockdown also appear to have been repaid much more quickly than we had anticipated and take-up of the self-assessment deferral option in July was much lower than assumed.

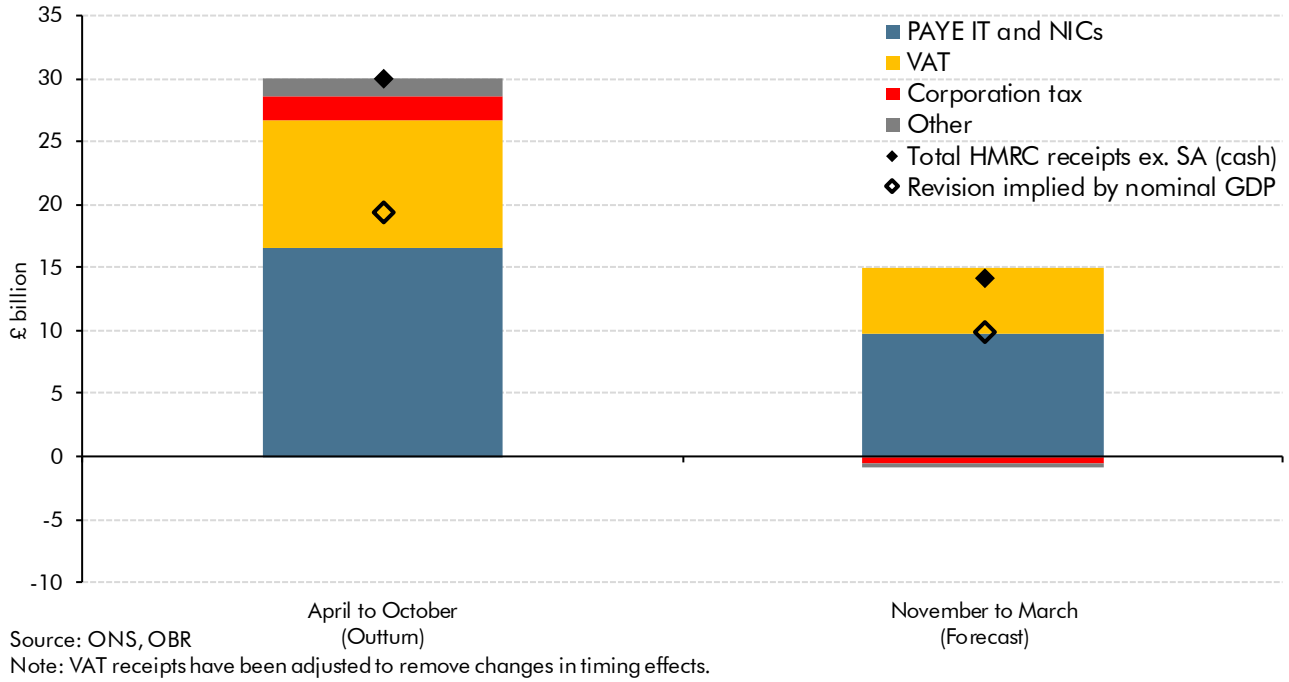
3.23 The strength of recent months is not expected to persist, largely because the rebound in the economy through the summer has been halted by the resurgence of the virus and subsequent reimposition of strict public health measures. Abstracting from timing effects related to self-assessment (SA) and VAT deferral measures, we have revised receipts up by

£14.1 billion (5.7 per cent) over the final five months of the year, relative to a £30.1 billion (11.8 per cent) surplus over the first seven months. Chart 3.2 shows which taxes contribute to these differences and relates them to revisions to our nominal GDP forecast:

- Movements in the **wider economy** explain the bulk of the difference. Nominal GDP in the first half of 2020-21 was 6.9 per cent higher than in our *FSR* central scenario.[4] On its own and based on historical experience, this could be expected to boost receipts by between £16 and £21 billion.[5] But nominal GDP in the second half of 2020-21 is only 3.6 per cent higher than our *FSR* central scenario, which could be expected to increase receipts by a more modest £8 to £11 billion.

- Timing effects related to the **repayment of tax debts** explain another part of the difference. Debt built up rapidly as lockdown was imposed, particularly in PAYE, the largest source of receipts. Our *FSR* central scenario assumed debt would continue to build into the autumn, but in the event much of it was quickly repaid. This is likely to reflect the boost to cashflow from government support schemes. The *FSR* assumed some repayment of debt in the second half, but we now assume a further modest increase associated with the tightening in public health restrictions.

Chart 3.2: HMRC cash receipts in 2020-21 (excluding self-assessment and VAT deferrals): differences from our *FSR* central scenario monthly profiles



Source: ONS, OBR
Note: VAT receipts have been adjusted to remove changes in timing effects.

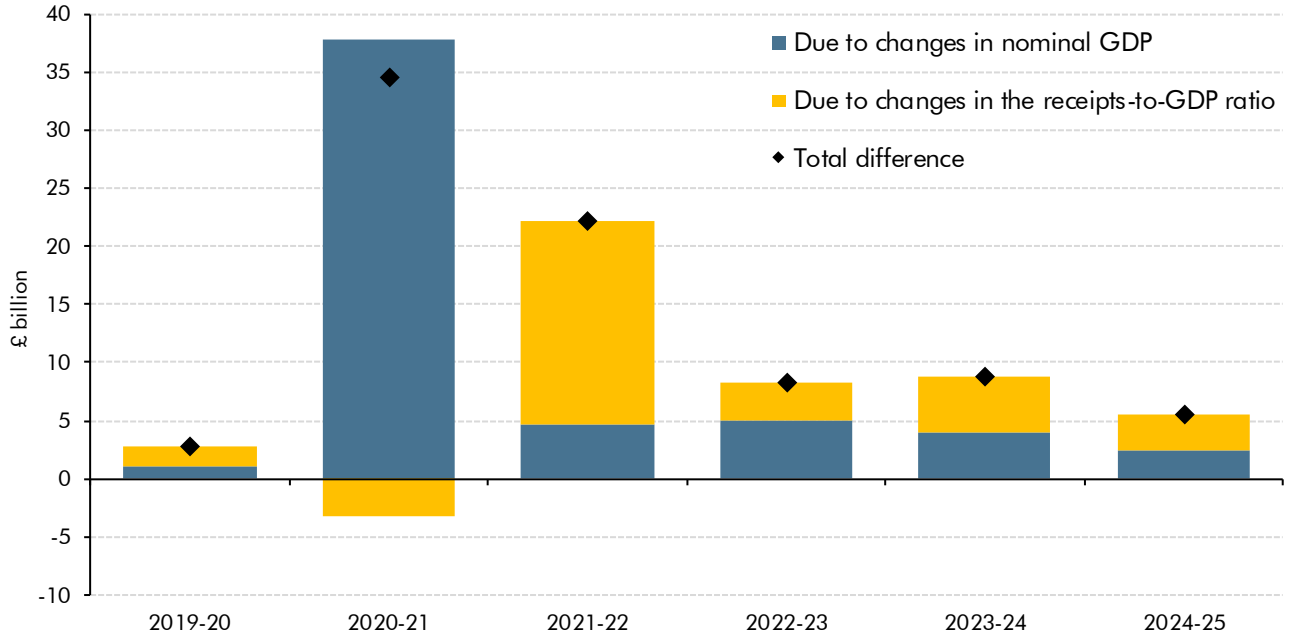
[4] This is based on the non-seasonally adjusted measure of nominal GDP, since tax receipts data are not seasonally adjusted either.
[5] Between 1971-72 and 2018-19, the average relationship between nominal GDP growth and policy-adjusted growth in National Accounts taxes implies a 1.1 per cent change in receipts for every 1 per cent change in nominal GDP (within a range of about 0.9 to 1.2). Chart 3.2 uses the 1.1 per cent figure.

Medium-term receipts path

3.24 Relative to our March forecast, receipts are £58 billion (5.7 per cent) lower in 2024-25, thanks largely to nominal GDP being 4.5 per cent lower at the forecast horizon, overlaid by a modestly lower effective tax rate. The latter reflects a greater hit to tax-rich labour income than to more lightly taxed profits. Lower cumulative real earnings growth means fewer taxpayers fall into higher income tax brackets, while lower equity and house prices reduce the take from capital gains and stamp duty taxes.

3.25 Relative to our *FSR* central scenario, receipts are higher over the medium term, but by a diminishing margin over the forecast period. The £35 billion improvement this year falls to £22 billion in 2021-22 and then to £8 billion a year on average thereafter. Chart 3.3 splits these upward revisions into the component due to differences in the path of nominal GDP (which explains the bulk in most years) and the component arising from a different path for the receipts-to-GDP ratio. The tax ratio boost in 2021-22 partly reflects measures that delay 2020-21 tax payments into next year and partly reflects less weakness in the labour market than assumed in the *FSR*. The boost in later years mostly reflects a proportionately larger upward revision to household consumption on the back of a swifter normalisation of household saving than assumed in the *FSR*, which raises VAT receipts.

Chart 3.3: Sources of difference to the receipts forecast since *FSR* central scenario



Source: ONS, OBR

Medium-term scarring of the receipts-to-GDP ratio

3.26 One important judgement in our central forecast is a degree of scarring of the receipts-to-GDP ratio relative to our pre-virus March forecast. Once the large swings in the ratio in 2020-21 and 2021-22 have passed, the rise in the receipts-to-GDP ratio between its pre-virus level in 2019-20 and its post-virus level in 2022-23 is 0.3 per cent of GDP less than over the same period in our March forecast. As shown in Chart 3.4, this receipts-specific 'scarring' reflects the fact that:

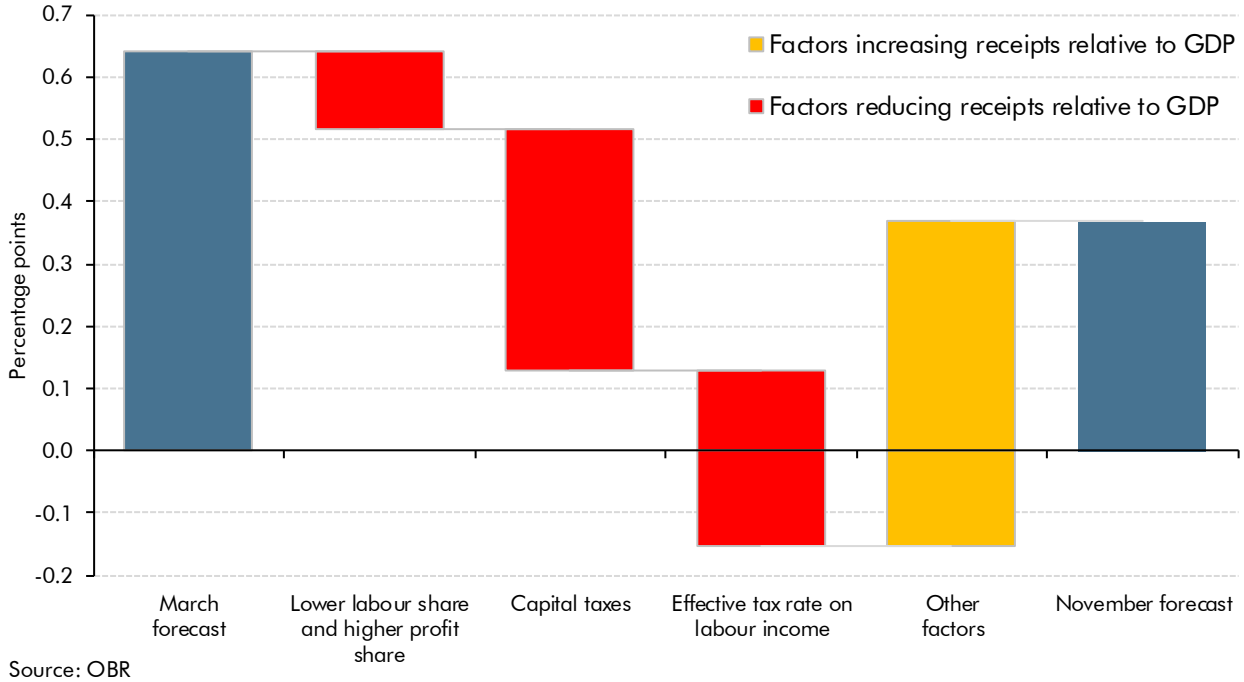
- The **composition of total income is less tax-rich** than we assumed pre-virus. Greater labour market slack and higher margins as firms seek to rebuild their balance sheets result in a lower labour share and a higher profit share.

- **Equity and house prices are permanently lower relative to nominal GDP**. This hits all capital taxes, and particularly capital gains tax (CGT). On average over the past, changes in CGT receipts have been roughly three times larger than changes in equity prices, so the effect of lower equity prices is magnified on CGT. A similar pattern followed the financial crisis, where capital taxes were depressed for several years.

- Lower real earnings growth means that the **level of earnings is permanently lower relative to inflation-linked tax thresholds**. This results in fewer income taxpayers and smaller proportions of those above the personal allowance paying tax at the higher and additional rates, lowering the amount of income tax raised per pound of income.

3.27 There is a partly offsetting effect from other factors. For example, council tax and business rates are typically more robust than other taxes to downturns. With receipts little changed in cash terms but GDP weaker, they rise as a share of GDP relative to our March forecast.

Chart 3.4: Receipts-to-GDP ratio change between 2019-20 and 2022-23: differences between our March and November central forecasts



Source: OBR

Detailed current receipts forecasts

3.28 Our detailed receipts forecasts and differences from our March forecast and *FSR* central scenario are presented in Tables 3.3, 3.4 and 3.5. Further breakdowns are available on our website. Scottish and Welsh devolved taxes are discussed in our *Devolved tax and spending forecasts* publication.

Table 3.3: Current receipts

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax[1]	193.6	188.2	203.6	205.0	215.0	225.7	237.5
of which: Pay as you earn	165.2	166.9	170.2	177.5	185.3	194.4	204.7
Self assessment	32.2	24.7	36.2	30.6	32.9	34.7	36.4
Other income tax	-3.8	-3.4	-2.8	-3.1	-3.2	-3.4	-3.6
National insurance contributions	145.0	140.8	145.9	151.3	157.5	164.6	172.1
Value added tax	133.8	116.3	131.4	142.0	146.4	150.5	154.8
Corporation tax[2]	48.0	43.8	49.5	57.5	61.3	63.3	65.8
of which: Onshore	47.0	43.2	48.5	56.4	60.2	62.3	64.8
Offshore	1.0	0.6	1.0	1.1	1.1	1.0	1.0
Petroleum revenue tax	-0.4	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1
Fuel duties	27.6	21.8	26.7	29.7	30.8	31.2	31.7
Business rates	30.8	19.3	32.1	32.7	34.5	34.9	35.3
Council tax	36.3	38.1	39.8	41.3	42.8	44.3	45.7
VAT refunds	19.0	25.2	23.7	24.4	25.4	26.5	27.9
Capital gains tax	9.8	8.1	10.0	8.8	9.9	10.9	11.9
Inheritance tax	5.1	5.2	5.3	4.8	5.0	5.3	5.7
Property transaction taxes[3]	12.5	9.1	12.0	12.7	14.1	15.6	17.0
Stamp taxes on shares	3.6	3.4	3.3	3.2	3.3	3.4	3.6
Tobacco duties	9.7	8.7	9.3	9.1	9.0	9.0	9.0
Alcohol duties	11.5	12.9	12.7	12.9	13.4	13.9	14.4
Air passenger duty	3.7	0.5	1.9	2.9	4.0	4.2	4.4
Insurance premium tax	6.5	6.4	6.6	6.8	6.9	6.9	7.1
Climate change levy	2.1	1.8	2.1	2.2	2.3	2.3	2.4
Bank levy	2.5	2.0	1.1	1.1	1.1	1.1	1.0
Bank surcharge	1.5	1.2	1.4	1.4	1.5	1.5	1.6
Apprenticeship levy	2.8	2.9	2.8	3.0	3.1	3.2	3.3
Soft drinks industry levy	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Digital services tax	0.0	0.2	0.3	0.4	0.5	0.5	0.6
Other HMRC taxes[4]	7.3	6.6	8.0	8.3	8.4	8.6	8.9
Vehicle excise duties	6.8	6.9	6.8	6.8	6.9	7.0	7.2
Licence fee receipts	3.3	3.6	3.7	3.7	3.8	3.8	3.9
Environmental levies	8.0	9.6	10.2	10.0	10.6	10.8	11.3
EU ETS auction receipts	1.6	1.1	1.1	1.2	1.2	1.2	1.3
Other taxes	9.9	7.8	8.7	9.5	9.7	9.9	9.7
National Accounts taxes	**742.1**	**691.6**	**760.1**	**792.9**	**828.6**	**860.4**	**895.1**
Less own resources contribution to EU	-3.2	-2.1	-	-	-	-	-
Interest and dividends	26.7	22.8	24.2	25.2	27.3	29.7	32.1
Gross operating surplus	56.9	54.7	59.2	63.7	67.1	70.6	73.3
Other receipts	5.1	4.0	3.8	4.1	4.0	3.6	3.8
Current receipts	**827.6**	**771.0**	**847.3**	**885.9**	**927.0**	**964.4**	**1,004.3**
Memo: UK oil and gas revenues [5]	*0.6*	*0.3*	*0.8*	*1.0*	*1.0*	*0.9*	*0.9*

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

Table 3.4: Current receipts: changes since March 2020

	£ billion					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax[1]	-1.6	-19.3	-13.8	-22.3	-21.6	-20.9
of which: Pay as you earn	-0.1	-8.6	-14.1	-15.9	-15.7	-15.3
Self assessment	-0.1	-9.6	0.3	-6.6	-6.0	-5.8
Other income tax	-1.4	-1.1	0.0	0.2	0.2	0.2
National insurance contributions	-0.4	-9.4	-11.1	-12.7	-12.8	-12.5
Value added tax	-2.8	-24.3	-14.5	-8.9	-9.4	-10.2
Corporation tax[2]	-7.1	-14.3	-10.5	-5.1	-3.5	-3.9
of which: Onshore	-7.0	-14.0	-10.4	-5.1	-3.4	-3.7
Offshore	-0.1	-0.3	-0.2	0.0	-0.1	-0.2
Petroleum revenue tax	0.0	0.0	0.1	0.1	0.1	0.1
Fuel duties	-0.1	-5.7	-1.4	-0.8	-0.3	-0.5
Business rates	-0.4	-12.3	-1.3	-1.6	-0.5	-1.4
Council tax	0.1	0.2	0.7	1.0	1.2	1.4
VAT refunds	-0.2	5.0	2.7	2.6	2.9	2.8
Capital gains tax	-0.2	-3.3	-2.7	-5.5	-5.8	-6.1
Inheritance tax	0.0	-0.3	-0.6	-1.5	-1.7	-1.8
Property transaction taxes[3]	-0.2	-4.7	-2.7	-3.5	-3.4	-3.1
Stamp taxes on shares	0.2	-0.2	-0.4	-0.7	-0.7	-0.7
Tobacco duties	1.0	-0.3	0.5	0.4	0.3	0.3
Alcohol duties	-0.5	1.1	0.3	0.1	0.0	0.1
Air passenger duty	-0.1	-3.6	-2.3	-1.5	-0.6	-0.6
Insurance premium tax	-0.1	-0.2	-0.1	-0.1	-0.1	-0.2
Climate change levy	0.0	-0.3	0.0	-0.1	-0.1	-0.2
Bank levy	0.1	0.1	0.0	0.0	0.0	0.0
Bank surcharge	0.0	-0.4	-0.3	-0.2	-0.2	-0.2
Apprenticeship levy	0.0	-0.1	-0.2	-0.3	-0.3	-0.3
Soft drinks industry levy	0.0	0.0	0.0	0.0	0.0	0.0
Digital services tax	-0.1	-0.1	-0.1	0.0	0.0	0.0
Other HMRC taxes[4]	-0.1	-0.8	0.4	0.6	0.7	0.8
Vehicle excise duties	0.0	-0.2	-0.2	-0.4	-0.5	-0.6
Licence fee receipts	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Environmental levies	-2.2	0.0	0.3	0.2	0.2	0.0
EU ETS auction receipts	0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other taxes	1.0	-1.1	-0.6	-0.2	-0.1	-0.1
National Accounts taxes	-13.7	-94.7	-58.1	-60.7	-56.4	-58.2
Less own resources contribution to EU	0.1	0.3	-	-	-	-
Interest and dividends	-0.9	-4.9	-4.7	-5.4	-5.1	-4.1
Gross operating surplus	2.6	-2.2	0.4	2.4	3.6	4.4
Other receipts	0.1	-0.5	-1.1	0.3	0.2	0.0
Current receipts	-11.7	-101.9	-63.5	-63.3	-57.7	-57.9
Memo: UK oil and gas revenues [5]	*-0.2*	*-0.3*	*-0.1*	*0.1*	*0.0*	*-0.1*

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

Table 3.5: Current receipts: differences from *FSR* central scenario

	£ billion					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax[1]	-1.7	5.8	7.2	-3.2	-3.6	-3.5
of which: Pay as you earn	-0.6	14.0	2.5	-2.4	-2.5	-2.4
Self assessment	0.2	-7.1	4.8	-0.9	-1.3	-1.3
Other income tax	-1.4	-1.1	0.0	0.2	0.2	0.2
National insurance contributions	0.7	9.1	3.0	-1.7	-2.4	-2.3
Value added tax	0.1	10.7	1.9	4.1	4.2	3.9
Corporation tax[2]	-2.5	6.3	5.5	6.8	5.1	2.6
of which: Onshore	-2.5	6.4	5.4	6.5	4.8	2.2
Offshore	0.0	0.0	0.1	0.3	0.3	0.4
Petroleum revenue tax	0.0	0.0	0.1	0.1	0.1	0.1
Fuel duties	0.0	-1.0	0.2	0.4	0.8	0.5
Business rates	-0.3	-1.0	-0.2	-0.6	0.6	-0.3
Council tax	-0.3	0.9	0.7	1.0	1.2	1.4
VAT refunds	0.0	4.8	2.9	2.8	3.1	2.9
Capital gains tax	-0.1	-2.3	2.4	-1.4	-1.1	-1.5
Inheritance tax	0.0	-0.2	0.0	-0.4	-0.7	-0.9
Property transaction taxes[3]	0.0	2.0	-0.1	-1.3	-1.4	-1.4
Stamp taxes on shares	0.1	0.2	0.2	-0.1	-0.2	-0.2
Tobacco duties	0.0	-0.3	0.6	0.5	0.4	0.4
Alcohol duties	-0.2	2.0	1.0	0.7	0.6	0.7
Air passenger duty	0.3	-0.8	-1.8	-0.9	0.1	0.1
Insurance premium tax	0.1	-0.2	0.0	0.0	0.0	-0.1
Climate change levy	0.0	0.0	0.2	0.1	0.0	-0.1
Bank levy	0.0	0.9	0.3	0.2	0.1	0.1
Bank surcharge	0.0	0.4	0.2	0.1	-0.1	-0.1
Apprenticeship levy	0.0	0.2	0.0	-0.1	-0.1	-0.1
Soft drinks industry levy	0.0	0.0	0.0	0.0	0.0	0.0
Digital services tax	-0.1	-0.1	-0.1	0.0	0.0	0.0
Other HMRC taxes[4]	0.1	0.1	0.9	1.0	1.1	1.1
Vehicle excise duties	0.0	0.2	0.1	0.0	-0.1	-0.2
Licence fee receipts	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Environmental levies	0.0	0.0	0.3	0.2	0.2	0.0
EU ETS auction receipts	1.3	-0.1	-0.1	-0.1	-0.1	-0.1
Other taxes	1.1	0.0	0.3	0.6	0.7	0.7
National Accounts taxes	-1.4	37.5	25.6	8.8	8.2	3.5
Less own resources contribution to EU	0.1	0.3	-	-	-	-
Interest and dividends	0.7	-2.7	-3.2	-3.7	-3.5	-2.7
Gross operating surplus	3.1	-0.1	0.8	2.7	3.9	4.7
Other receipts	0.3	-0.5	-1.0	0.4	0.3	0.1
Current receipts	2.8	34.6	22.2	8.2	8.8	5.5
Memo: UK oil and gas revenues [5]	*0.0*	*-0.1*	*0.1*	*0.4*	*0.4*	*0.5*

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

Tax-by-tax analysis

Income tax and NICs (excluding self-assessment)

3.29 Income tax and NICs receipts (excluding self-assessment income tax) are £19.1 billion lower in 2020-21 and then on average £27½ billion lower a year over the rest of the forecast, compared with our March forecast. In the near term, this is driven by both employment falls and weaker earnings growth. Thereafter, receipts are dragged down by weaker real earnings growth and the associated loss of fiscal drag, driven by the assumption of 3 per cent scarring to the level of real GDP by the end of the forecast period.

3.30 However, relative to the *FSR* central scenario, we have revised accrued PAYE income tax and NIC receipts on employee salaries up by £23 billion in 2020-21, reversing just over half of the shortfall in the *FSR* central scenario relative to March. This reflects the fact that:

- **Cash receipts have been much stronger** than the *FSR* central scenario (up over £16 billion in the April to October period). This reflects both less weakness in the labour market and the repayment of some PAYE tax debts built up during the initial lockdown.
- **Employment and earnings have held up better** than expected over the summer Together these add £16½ billion to receipts in 2020-21.
- **Job losses have been concentrated among lower-paid and part-time workers** (as is also the case for those furloughed via the CJRS). Both employment and earnings for those further up the income distribution have been much less affected, meaning less of a hit to receipts than implied by what weakness there has been in wages and salaries.
- **The extension of the CJRS scheme to March 2021** both delays and reduces the substantial job losses previously expected after the scheme closed.

3.31 Movements in PAYE tax debts make it challenging to discern the true strength in cash receipts. Tax debts rose sharply during the initial lockdown but there were sizeable repayments over the summer, no doubt helped by cash flow support from government grants, the CJRS and access to guaranteed loans. The pace at which tax debt is being repaid is now diminishing and we expect a modest pick-up in new tax debts during the latest lockdown. As in the *FSR* (and consistent with ONS treatment), we assume that 7 per cent of identifiable tax debts will never be repaid, with 93 per cent being accrued in the normal way on the assumption that HMRC will receive the cash later.

3.32 Much of the boost to PAYE income tax and NICs receipts in 2020-21 relative to the *FSR* central scenario disappears in 2021-22, while receipts thereafter are weaker than assumed in the *FSR*. The key driving factor is the lower earnings level from 2021-22 onwards thanks in part to a lower labour share of income than assumed in the *FSR*. The upward revisions to employment since the *FSR* also diminish across the forecast period, while the boost to the effective tax rate from the distribution of income is assumed to last only a year.

Table 3.6: Non-SA income tax and NICs: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	308.4	323.4	338.5	354.2	367.9	383.2	
FSR central scenario + SEU	307.6	282.4	307.8	329.7	344.3	360.1	
November forecast	306.4	304.3	313.3	325.7	339.6	355.6	373.2
Change since March	**-2.0**	**-19.1**	**-25.2**	**-28.4**	**-28.3**	**-27.6**	
Change since FSR central + SEU	**-1.2**	**22.0**	**5.4**	**-4.0**	**-4.7**	**-4.5**	
	Underlying forecast changes since FSR central + SEU						
Total		**19.2**	**5.5**	**-4.0**	**-4.7**	**-4.6**	
of which:							
Economic determinants		**14.7**	**3.3**	**-5.7**	**-6.2**	**-5.7**	
Average earnings		5.4	-3.2	-5.4	-8.5	-9.7	
Employee numbers		11.0	8.9	2.2	4.1	5.1	
Inflation		-0.2	-0.5	-0.6	0.1	0.7	
Other economic determinants		-1.6	-1.9	-1.9	-1.9	-1.8	
Other							
Other income tax and NICs streams		-1.5	-0.7	-0.5	-0.5	-0.4	
Outturn receipts and modelling		6.0	2.9	2.3	1.9	1.5	
	Direct effect of Government decisions since FSR central + SEU						
Total		**2.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**

Self-assessment (SA) income tax

3.33 SA income tax receipts are expected to be £9.6 billion lower in 2020-21 than in our March forecast. This forecast is particularly uncertain since the majority of SA liabilities are only due at the end of January and will depend on the extent to which more widely available time-to-pay arrangements are taken up. Abstracting from expected deferrals, SA income tax is around £6 billion lower in the later years of the forecast than in our March forecast. This reflects permanent hits to self-employment income, dividend, rental and savings income.

3.34 The Government announced in March that SA taxpayers would be allowed to defer the July payment on account until the final January 2021 SA deadline. Take-up was around half the level we assumed in the *FSR*. The Chancellor announced in the Winter Economy Plan that this deferral would be followed by an enhanced time-to-pay service for SA taxpayers for the January payment deadline. This extends the eligibility to allow those with tax debts up to £30,000 (up from £10,000 previously) to arrange a 12-month agreement online and will be promoted by HMRC. We assume this shifts around £3 billion of receipts from 2020-21 into 2021-22. This is in addition to a similar sized amount of tax expected to be deferred from 2020-21 to future years which would have been either collected through the existing time-to-pay service or debt collection.

3.35 Relative to the *FSR* central scenario and abstracting from timing changes, SA income tax is just over £1 billion a year weaker on average. This reflects lower self-employment income, partly offset by higher dividend income from a less steep fall in profits than in the *FSR*.

Table 3.7: SA income tax: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	32.3	34.3	35.9	37.2	38.9	40.5	
FSR central scenario + SEU	32.0	31.8	31.4	31.5	34.2	36.0	
November forecast	32.2	24.7	36.2	30.6	32.9	34.7	36.4
Change since March	**-0.1**	**-9.6**	**0.3**	**-6.6**	**-6.0**	**-5.8**	
Change since FSR central + SEU	**0.2**	**-7.1**	**4.8**	**-0.9**	**-1.3**	**-1.3**	
	Underlying forecast changes since FSR central + SEU						
Total		**-4.0**	**0.6**	**-0.3**	**-1.3**	**-1.4**	
of which:							
Self employment income		-0.3	-2.8	-2.0	-2.5	-2.4	
Dividend income		-0.4	0.7	0.7	1.1	1.0	
Savings income		0.1	0.4	0.7	0.6	0.5	
Deferrals and payment timing changes		-3.0	2.7	0.6	0.0	0.0	
Other modelling and determinant changes		-0.3	-0.5	-0.2	-0.5	-0.6	
	Direct effect of Government decisions since FSR central + SEU						
Total		**-3.1**	**4.2**	**-0.6**	**0.0**	**0.1**	**0.3**

VAT

3.36 Relative to our March forecast, VAT receipts are down £24.3 billion this year and down £10.2 billion in 2024-25. This reflects lower consumption in every year, a lower share of consumer expenditure in durables, and policy measures, including the cut in the rate of VAT for the hospitality sector from 20 to 5 per cent this year. Government procurement this year and next provides some support to VAT receipts as much of the extra spending (such as purchases of 'personal protective equipment') falls outside the VAT refunds scheme.

3.37 Relative to our *FSR* central scenario, we have revised up our pre-measures forecast for VAT receipts every year. Receipts in 2020-21 are £10.7 billion higher thanks largely to consumer spending on standard-rated durable goods holding up better than assumed in the *FSR*. The strength in receipts this year does not fully carry over into 2021-22 when receipts are up only £1.9 billion, largely because the standard-rated share of spending has less room to recover than assumed in the *FSR*. From 2022-23 onwards, the upward revision to receipts reflects a stronger path for consumer spending. The large movements in cash receipts due to the extended VAT deferral measure only affect accrued receipts to the extent that we assume some of the deferred payments will ultimately go unpaid. In cash terms, the new deferral measure announced in September shifts £15 billion from 2020-21 to 2021-22.

3.38 We assume that issues surrounding the UK border following the end of the transition period will increase the VAT gap roughly by ½ a percentage point in 2021-22 falling to ¼ of a percentage point in 2022-23 (lowering receipts by £0.6 billion and £0.3 billion respectively). This assumption reflects a combination of factors, including risks around trader readiness, infrastructure, IT and staffing following the adoption of the new border

operating model,[6] as well as the Government's decision to phase in the introduction of customs controls over the first half of 2021, which should facilitate smoother trade flows at the expense of reduced tax compliance. These and other Brexit-related issues are covered in more detail in Annex A.

Table 3.8: VAT: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	136.6	140.6	145.9	151.0	155.8	160.7	
FSR central scenario + SEU	133.7	105.6	129.5	137.9	142.2	146.6	
November forecast	133.8	116.3	131.4	142.0	146.4	150.5	154.8
Change since March	**-2.8**	**-24.3**	**-14.5**	**-8.9**	**-9.4**	**-10.2**	
Change since FSR central + SEU	**0.1**	**10.7**	**1.9**	**4.1**	**4.2**	**3.9**	
	Underlying forecast changes since FSR central + SEU						
Total		**12.2**	**2.8**	**4.6**	**4.3**	**4.0**	
of which:							
Household spending		-0.6	1.1	6.1	5.8	5.8	
Standard rated share		3.4	-2.2	-1.9	-1.4	-0.9	
Outturn and other economic determinants		9.4	3.9	0.4	-0.1	-0.9	
	Direct effect of Government decisions since FSR central + SEU						
Total		**-1.5**	**-0.9**	**-0.5**	**-0.1**	**-0.1**	**-0.1**
of which:							
Scorecard and non-scorecard measures		-1.3	-0.2	-0.2	-0.1	-0.1	-0.1
Brexit non-compliance		-0.2	-0.6	-0.3	0.0	0.0	0.0
Memo: VAT gap (per cent)		*7.6*	*8.4*	*7.5*	*7.3*	*7.3*	*7.4*

3.39 The 'implied VAT gap' shown in Table 3.8 is the difference between a theoretical total and actual VAT receipts. It is adjusted for timing factors where they can be estimated, including the large effects of this year's VAT deferral measures. Changes in the estimated VAT gap can reflect both real-world changes in non-compliance and measurement errors in estimating the theoretical total, which could be particularly material this year.

Onshore corporation tax

3.40 Onshore corporation tax (CT) is levied on the gross profits of companies after taking account of various deductions. In the event of a trading loss, firms can utilise a range of loss reliefs to reduce their past and future tax liabilities, while firms within groups can use losses at one firm to reduce current liabilities of profit-making firms within the same group.

3.41 The value of profits and losses generated and the extent to which various relief schemes are utilised are key judgements in our CT forecast. Many firms have faced cash flow pressures that can be partially alleviated by 'carrying-back' losses to offset tax payments in respect of earlier years' liabilities. Many smaller firms appear to be underpaying CT on previous years' liabilities that are due this year, perhaps in anticipation of higher loss carry-back claims that can only be made at a future date when they file tax returns for the current year.

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

3.42 Overall, we assume that the value of losses arising in 2020 will rise by around 60 per cent on a year earlier, with the majority of these losses being either carried back to offset 2019 liabilities or shifted sideways via group relief to offset 2020 liabilities. These judgements are informed by year-to-date cash receipts, which have fallen faster than implied by the drop in profits in our economy forecast. We assume that this extra stock of losses will then be gradually eroded over time via loss carry-forward claims.

3.43 Large monthly swings in outturn receipts data mean these assumptions are highly uncertain. For large firms, monthly receipts entirely reflect instalment payments in anticipation of annual tax liabilities – we will not find out how accurate these were until after the tax year has ended. For small firms, payments are being made against liabilities generated at least nine months ago. It will be many months, and in some cases years, until we can draw clearer conclusions from completed tax returns about the relative importance of movements in profits, losses and other effects on receipts this year.

3.44 Relative to our March forecast, onshore CT receipts are £14.0 billion lower in 2020-21 and £3.7 billion lower in 2024-25. This reflects higher corporate losses in the near term and lower profits from a real economy that is 3 per cent smaller by the end of the forecast period. The impact of the spike in losses during 2020 diminishes over the forecast, as firms gradually erode this via loss carry-forward claims.

3.45 Relative to our *FSR* central scenario, we have revised onshore CT receipts up by £5.1 billion a year on average (Table 3.9). This is dominated by the effect of a less weak path for profits in our latest economy forecast (the corollary to the weaker path for the labour share of income described above). Stronger outturn receipts, particularly in September (a peak month given large firms' payment patterns) also boost receipts in the early years of the forecast. The extension of the £1 million threshold for the annual investment allowance by a year costs relatively little, with the most significant reduction in receipts in 2021-22.

Table 3.9: Corporation tax: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	54.0	57.2	58.9	61.4	63.6	66.0	
FSR central scenario + SEU	49.5	36.8	43.1	49.9	55.4	60.1	
November forecast	47.0	43.2	48.5	56.4	60.2	62.3	64.8
Change since March	**-7.0**	**-14.0**	**-10.4**	**-5.1**	**-3.4**	**-3.7**	
Change since FSR central + SEU	**-2.5**	**6.4**	**5.4**	**6.5**	**4.8**	**2.2**	
	Underlying forecast changes since FSR central + SEU						
Total		**6.5**	**5.7**	**6.5**	**4.7**	**2.2**	
of which:							
Company profits		6.5	1.7	4.3	4.2	4.1	
Other economic determinants		-0.4	0.0	0.2	0.2	0.3	
Losses modelling and outturn data		0.4	4.1	2.1	0.3	-2.2	
	Direct effect of Government decisions since FSR central + SEU						
Total		**-0.1**	**-0.3**	**0.0**	**0.1**	**0.1**	**0.1**

3.46 Many banks have reported a sharp fall in profits so far this year, largely due to a spike in loan-loss provisions as the pandemic has hit borrowers' finances. In the *FSR* we assumed that financial sector profits would fall by 40 per cent in 2020-21 and then take three years to recover back to 2019-20 levels (as a share of GDP). Financial sector corporation tax receipts and bank earnings reports have since performed much better than we had assumed, so we have revised this hit down to 15 per cent and shortened the recovery period to two years. Relative to March, this leaves our bank surcharge forecast down by £0.4 billion (24 per cent) in 2020-21 and by an average of £0.2 billion a year thereafter. Bank levy receipts are little changed since March and higher than in our *FSR* scenario.

Property transaction taxes

3.47 Relative to our March forecast, property transaction taxes are £4.7 billion lower this year reflecting the stamp duty holiday and lower transactions. They remain down £3.1 billion in 2024-25 thanks to a weaker outlook for property markets. We have revised our forecasts down in most years relative to the paths assumed in the *FSR* (adjusted for the stamp duty holiday announced in the SEU). This is due mainly to lower stamp duty land tax in England and Northern Ireland, which makes up most of property transaction taxes. Despite the stronger rebound in transactions boosting receipts in 2020-21 relative to the *FSR*, a weaker forecast for property prices thereafter leaves receipts lower from 2021-22 onwards.

Taxes on capital

3.48 **Capital gains tax** (CGT) receipts are £3.3 billion below our March forecast in 2020-21 and £6.1 billion down in 2024-25, mostly due to lower equity prices. We have revised down CGT receipts in most years relative to our *FSR* central scenario, also primarily reflecting lower equity prices. We also assume that some CGT liabilities due in 2020-21 will be deferred and some will go unpaid, consistent with our assumptions about SA income tax.

3.49 We have also revised down **inheritance tax** receipts relative to the *FSR* due to lower equity and house prices. This is partly offset by the near-term effect on receipts of excess deaths this year (assumed to be just over 100,000 across both the first and second waves, as explained more fully in paragraph 3.98 below).

Excise duties

3.50 **Fuel duties** fall short of our March forecast by £5.7 billion this year and by £0.5 billion in 2024-25. We have assumed that a greater prevalence of home-working will reduce vehicle use for commuting, modestly reducing the volume of fuel purchased relative to economic activity in the medium term. Relative to the *FSR*, we have revised fuel duties down by £1.0 billion in 2020-21 but up by £0.5 billion a year on average from 2021-22 onwards. The downward revision for this year reflects the tightening of public health measures this autumn. The upward revision in future years is explained by the stronger GDP path.

3.51 **Alcohol duties** have been revised up by £1.0 billion a year on average relative to our *FSR* central scenario. Receipts in 2020-21 held up much better than assumed, so we have revised them up by £2.0 billion (around 20 per cent). The loss in receipts from closures of

pubs and restaurants has been more than offset by higher sales in supermarkets and other shops. Alcohol consumption has therefore been one of the few tax bases left relatively unscathed by the virus. In the medium term, the composition of alcohol duty receipts is assumed to shift slightly towards wine and spirits sales, for which a larger share of purchases is in supermarkets and other shops.

3.52 **Tobacco duties** have been revised up by £0.3 billion a year on average relative to our *FSR* central scenario and are also up relative to our March forecast. This reflects the non-cyclical nature of tobacco consumption, which is largely unaffected by economic downturns.

3.53 **Air passenger duty** (APD) receipts are set to fall almost 90 per cent this year and have been revised down £3.6 billion relative to our March forecast. They are down a further £0.8 billion in 2020-21 relative to our *FSR* central scenario as the latest travel restrictions have put paid to the second-half recovery assumed in the *FSR*. We expect passenger numbers to recover relatively gradually, reaching pre-virus levels by 2023-24. A similar recovery path was observed in the wake of the 9/11 terrorist attacks in the US, where US air passenger numbers only exceeded pre-attack levels three years later.[7] The slower recovery in aviation leaves receipts down by £0.7 billion a year on average from the *FSR*. The recovery in APD will depend in large part on the duration of the restrictions on international travel here and abroad. Our forecast also assumes that business passenger numbers will remain down a quarter in the medium term, reflecting things like greater use of digital conferencing in the future.[8]

Business rates and council tax

3.54 The £11.5 billion drop in receipts from business rates in 2020-21 largely reflects the holidays in place for the retail, hospitality, leisure and nursery sectors in England, and similar schemes in Wales and Scotland. The cost of the scheme in England has been revised up by £1 billion since the *FSR*. We assume some additional losses on collection from irrecoverable tax debts, losses from 'material change of circumstances' appeals, and greater use of empty property relief in the near term.

3.55 Further out, the freeze in the multiplier in 2021-22 and the lower path for inflation reduce receipts. As in our *FSR* projection, we assume only a modest permanent hit to the tax base. The business rates tax base held up well during the financial crisis and the removal of properties from the rating list requires change to residential use, demolition or buildings falling into such disrepair that they are not capable of beneficial occupation. Economic conditions will affect rateable values at a revaluation. However, the intention at revaluations is for business rates overall to be held constant in real terms (via the setting of the multiplier) taking into account that yield will be eroded over time by successful appeals. The next revaluation has been delayed until 2023-24.

[7] Bureau of Transportation Statistics, *Airline Travel Since 9/11*, December 2005.
[8] This assumption is informed by studies published by several bodies on the potential loss of passenger numbers relative to pre-virus projections, including Oliver Wyman and IATA.

3.56 Our forecasts are based on announced policy, so the specific relief for the retail sector (and other sectors benefitting from this year's holidays) falls to zero from next year. As a result, business rates receipts rise by £12.8 billion (66 per cent) between 2020-21 and 2021-22 – a sharp rise in the tax burden on these sectors as they recover from the pandemic. This represents one material pressure on company finances that could affect the recovery.

3.57 Our forecast for **council tax** is up by £0.9 billion in 2020-21 and by £1.0 billion on average over the forecast period relative to our *FSR* central scenario. The smaller hit to council tax this year as part of a more detailed modelling of local authority finances relative to the top-down approach used in the *FSR*. We have revised down revenues in future years as a result of increased eligibility for local council tax support due to higher unemployment, but this is more than outweighed by the Government's decision to allow councils to increase council tax rates by up to 5 per cent in 2021-22, with the option to defer some of that to 2022-23. We assume that most councils take advantage of this flexibility, raising council tax by around £1.0 billion a year on average from 2022-23 onwards.

Other taxes

3.58 Our forecast for **oil and gas revenues** is up by £0.3 billion a year on average relative to the *FSR*. This primarily reflects higher oil and gas prices, as well as a less pessimistic outlook for production over the medium term. Our forecasts for production and expenditure are informed by projections from the Oil and Gas Authority (OGA). We now assume that overall production falls by 6 per cent a year on average from 2021 onwards.

3.59 **Environmental levies** include levy-funded spending policies such as the renewables obligation (RO), contracts for difference (CfD) and the capacity markets scheme. In 2020-21, the effect of lower electricity demand on RO spending has been offset by the effect of lower wholesale energy prices on CfD spending. The lower path for energy prices both in 2020-21 and subsequent years means more subsidy because the wholesale price will be further away from the guaranteed strike price.

3.60 **Vehicle excise duty (VED)** has been revised up £0.2 billion in 2020-21 relative to our *FSR* central scenario reflecting higher car sales than we assumed during the first half of the year. The initial buoyancy of receipts this year and next is not maintained for the second half of the forecast. From 2022-23 onwards, VED has been revised down, which is partly explained by lower RPI inflation. This has left the forecast unchanged on average from the *FSR*.

3.61 Our forecast for **VAT refunds** in 2020-21 is £4.8 billion higher than in our *FSR* central scenario, reflecting higher government procurement and investment spending. The rise in VAT refunds is less steep than the rise in central government procurement this year, reflecting the fact that much of this extra spending (such as purchases of 'personal protective equipment' (PPE)) falls outside the VAT refunds scheme. We assume this reduction in the effective refund rate for government spending is only temporary and that it will recover to its 2019-20 level by 2022-23. Thereafter, VAT refunds are higher by £2.9 billion a year, largely reflecting the wider increase in spending by local authorities.

Other receipts

3.62 **Interest and dividend receipts** include income from the government's financial assets such as student loans and bank deposits. With short-term interest rates expected to be close to zero throughout the forecast, we lowered interest and dividend receipts in the *FSR*. Since then, we have lowered them by further £3.2 billion a year on average. This reflects both lower accrued interest on student loans (in part reflecting the lower path for RPI inflation), which we did not incorporate in the *FSR*, and news in the latest in-year data. As in the *FSR*, we have assumed that NatWest Group, like other banks, will not pay a dividend in 2020-21.

3.63 The reclassification of some **Home Office immigration charges** from 'fees for services' to various kinds of taxes and social contributions adds to receipts and spending in equal measure (the latter because fees are treated as negative spending in the public finances). These changes raised receipts and spending by £1.6 billion in 2019-20. We assume that visa applications will fall over time, broadly in line with our assumption that net inward migration will be lower under the new points-based immigration system. Fees this year have also been reduced by the disruption caused by the pandemic. Our forecast reflects the alignment of migration policy for EU and non-EU migrants from January 2021 (discussed in Box 2.4 of our March 2020 *EFO*), though the effect of this is highly uncertain.

3.64 We have made small changes to our forecast for **car emission fines** relative to March. Correcting the accounting treatment to score fines in the year they are paid moves most revenue to 2022-23, a year later than assumed in our March forecast. The virus-related drop in new car sales plus a broad-brush assumption to account for use of 'flexibilities' in the system (such as 'super-credits' and 'eco-innovations') lower receipts overall. But we continue to expect some firms to miss their targets, so some fines to be levied. There are large uncertainties around this forecast, due to the fact that some policy parameters in the UK system to be applied from January 2021 are yet to be fully finalised.

3.65 Our forecast for **public sector gross operating surplus** (GOS) is £2.4 billion higher on average than in our *FSR* central scenario. This comprises two components that move in opposite directions. General government depreciation (which is offset in spending) is higher by an average of £3.8 billion, mostly as a result of new ONS capital stocks data. Public corporations' GOS is down by £2.8 billion in 2020-21 and by £1.0 billion on average thereafter. This is the result of worse than anticipated trading revenue from public corporations in the first three months of the financial year, for which we now have provisional outturn data. Central government absorbed around £1.8 billion of Transport for London losses in its 31 October bailout (with the precise figure depending on the extent of passenger revenue losses). This increases spending and reduces the hit to GOS, but TfL's most recent revised budget still predicts large losses for 2021-22 that are yet to be covered. This hits our forecast as lower GOS, although in reality it could be translated into higher spending if further central government support were to follow to maintain services.

Public sector expenditure

Definitions and approach

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

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

- **Annually managed expenditure (AME)** covers items less amenable to multi-year planning, such as social security and debt interest. Again, our fiscal forecast shows PSCE in current AME and PSGI in capital AME.

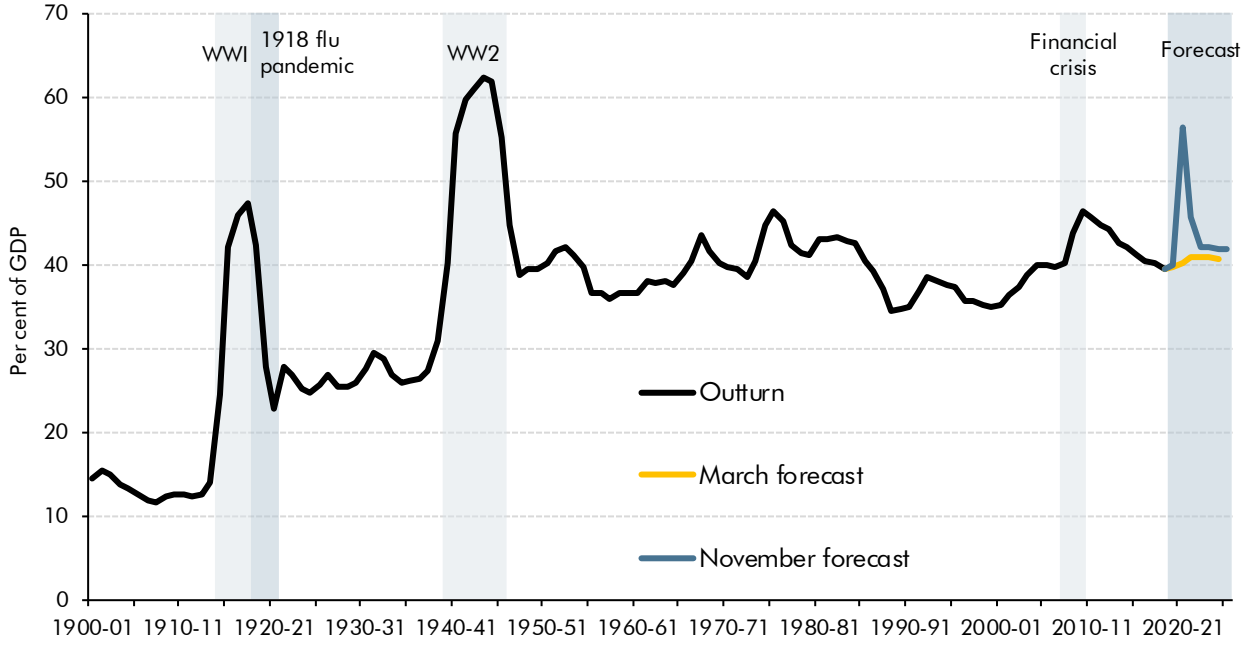
3.67 The distinction between these two administrative categories has diminished in the past two years, with the Treasury in effect managing DEL budgets on an annual basis too for most departments in both its 2019 Spending Round and 2020 Spending Review. There have been exceptions to this *de facto* return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

Summary of the expenditure forecast

3.68 Total public spending is forecast to rise by 16.4 per cent of GDP in 2020-21 to 56.3 per cent – the highest level recorded outside the World Wars (as shown in Chart 3.5). (Among advanced economies, the IMF expects only Canada to see a larger increase in government spending as a share of the economy in 2020.) This spike partly unwinds next year as virus-related spending drops and as GDP starts to recover, but public spending remains elevated. It then falls back further in 2022-23 (as virus-related departmental spending falls back to zero) and more slowly thereafter (as unemployment falls).

3.69 Despite the unwinding of the temporary virus-related spending over the forecast period, TME in 2025-26 only falls to 41.9 per cent of GDP, which is 2.1 per cent of GDP higher than its pre-virus level in 2019-20 and in line with the level in 2014-15.

Chart 3.5: Public spending as a share of GDP



Source: Bank of England, ONS, OBR

3.70 Comparing 2025-26 with pre-virus levels in 2019-20, higher resource and capital departmental spending more than explain the 2.1 per cent of GDP rise in TME (with RDEL rising by 1.3 per cent of GDP and CDEL by 1.1 per cent), as shown in Table 3.10. These rises more than offset the 0.2 per cent of GDP fall in AME spending over the period. That fall is more than explained by debt interest, which falls by 0.6 per cent of GDP despite debt (excluding the Bank of England) rising from 77 to 98 per cent of GDP over that period.

Table 3.10: TME split between DEL and AME

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
TME	**39.8**	**56.3**	**45.6**	**42.1**	**42.1**	**42.0**	**41.9**
of which:							
TME in DEL	**17.1**	**25.5**	**21.9**	**19.2**	**19.3**	**19.4**	**19.4**
of which:							
Virus-related support measures in DEL[1]	0.1	6.2	2.4	0.0	0.0	0.0	0.0
Other PSCE in RDEL	14.4	16.1	15.7	15.5	15.5	15.6	15.6
Other PSGI in CDEL	2.6	3.2	3.8	3.7	3.7	3.7	3.7
TME in AME	**22.8**	**30.8**	**23.6**	**22.9**	**22.8**	**22.6**	**22.5**
of which:							
Virus-related support measures in AME[2]	0.1	6.0	0.2	0.0	0.0	0.0	0.0
Other welfare spending	10.3	11.5	11.0	10.6	10.6	10.5	10.5
Debt interest, net of APF	1.7	1.1	0.8	0.9	1.0	1.1	1.1
Other AME	10.7	12.1	11.6	11.3	11.1	11.0	10.9

[1] See Table 3.14 for the breakdown of RDEL measures between virus- and non-virus-related measures.

[2] All AME measures since March.

Summary of changes since our March forecast and *FSR* central scenario

Changes since March

3.71 Our March forecast incorporated the Government's medium-term plans for faster growth in resource spending and significantly higher capital spending. TME was predicted to rise from 39.8 per cent of GDP in 2019-20 to 40.8 per cent in 2021-22 and to stay at roughly that level thereafter. Spending this year is now expected to be £237 billion higher than we predicted in March and £34 billion higher in 2021-22, thanks largely to virus-related support for public services, households and businesses. So, as Chart 3.5 above showed, the rise in spending as a share of GDP in the short term is much greater.

3.72 From 2022-23 to 2024-25, TME is materially lower than we forecast in March – by £18 billion a year on average – a difference that is more than explained by departmental spending being cut relative to March totals and by much lower debt interest spending. But thanks to the weaker outlook for nominal GDP, despite lower cash spending, the ratio of TME to GDP is actually higher than we forecast in March, settling at around 42 per cent.

Differences from our *FSR* central scenario

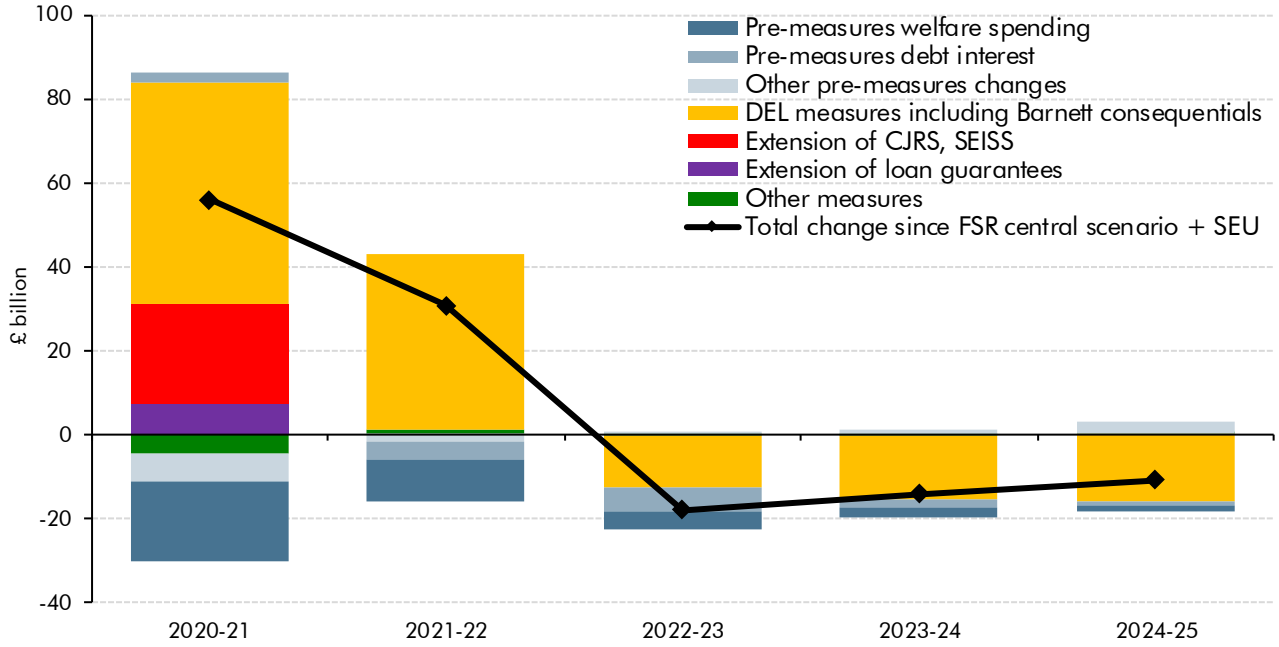
3.73 On a pre-measures basis (i.e. excluding the effects of policies announced and departmental spending disclosed since the SEU), spending is materially lower than in our *FSR* central scenario in the short term (by £23 billion and £13 billion in 2020-21 and 2021-22 respectively), but is little changed in the medium term (Chart 3.6). The difference is dominated by lower welfare spending, which reflects fewer unemployed recipients of universal credit (UC) and the fact that this year's new UC cases have been eligible for considerably smaller awards than the pre-virus average assumed in our *FSR* scenario. The cost of the CJRS up to the end of October, the closing date at the time of the *FSR*, is also lower than assumed in July as the number of people furloughed has fallen more quickly. And debt interest is lower in most years thanks to additional savings associated with further quantitative easing, plus a lower path for RPI inflation.

3.74 In the near term, this lower pre-measures path for spending is more than outweighed by additional spending announced since the SEU, including the amounts announced in the Spending Review alongside this forecast. By far the largest of these are additional departmental spending (£52 billion this year and £42 billion next year). This, together with the extension of the CJRS, a further round of SEISS payments and further business support grants, explains the majority of an additional £79 billion of spending this year. This brings the total cost of spending measures announced for 2020-21 to £251 billion. And while the £52 billion announced for 2021-22 is much smaller, the experience of this year points to a material risk of further spending announcements if further restrictive public health measures are needed and/or job losses mount as support is withdrawn.

3.75 From 2022-23 onwards, departmental spending has been cut by £11.8 billion a year on average relative to the totals set in the Budget. This reflects the fact that the £46 billion increase in RDEL totals in 2021-22 is £10 billion less than the £56 billion allocated to virus-related spending, with non-virus-related spending therefore cut by £10 billion relative to

March totals. These underlying cuts relative to March totals are repeated in future years, while virus-related spending falls to zero. Changes to non-virus-related spending in 2021-22 include: a public sector pay freeze for all but NHS employees in 2021-22 that leaves pay levels on a lower path in future years; cuts in the overseas aid budget; and reductions in grants to local authorities.

Chart 3.6: Sources of differences in spending versus our *FSR* central scenario



Source: ONS, OBR

Detailed spending forecasts

3.76 Tables 3.11, 3.12 and 3.13 detail our latest spending forecast and how it differs from our March forecast and our *FSR* central scenario respectively.

Table 3.11: Total managed expenditure

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector current expenditure (PSCE)							
PSCE in RDEL	320.8	456.0	405.1	365.6	380.1	396.3	413.4
PSCE in AME	469.2	572.9	487.8	498.2	515.3	531.5	552.0
of which:							
Welfare spending	227.7	246.2	246.7	251.8	259.5	267.5	277.8
Virus-related income support schemes[1]	2.1	83.4	0.0	0.0	0.0	0.0	0.0
Locally financed current expenditure	53.5	48.8	56.6	56.6	58.5	60.4	62.1
Central government debt interest, net of APF[2]	36.9	23.5	17.6	21.2	25.5	27.3	29.0
Scottish Government's current spending	29.2	42.3	36.2	34.9	36.3	37.7	39.4
EU financial settlement	10.9	10.1	11.3	8.9	4.9	2.3	1.7
Net public service pension payments	6.3	1.4	0.4	1.5	1.0	0.4	0.3
Company and other tax credits	7.4	8.3	8.0	9.1	10.4	11.6	12.4
BBC current expenditure	3.5	3.7	4.0	4.0	4.0	4.1	4.2
National Lottery current grants	1.0	1.6	1.2	1.2	1.1	1.2	1.0
General government imputed pensions	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Public corporations' debt interest	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Funded public sector pension schemes	17.7	18.9	19.7	20.8	22.0	23.1	24.2
General government depreciation	44.7	46.7	49.0	51.3	53.6	56.0	58.5
Current VAT refunds	16.6	23.0	21.3	21.8	22.7	23.7	25.0
Environmental levies	9.0	10.6	11.3	11.0	11.6	11.8	12.3
Other PSCE items in AME	1.8	2.5	3.0	2.5	2.4	2.5	2.4
Other National Accounts adjustments	-1.0	0.2	-0.3	-0.1	0.0	0.0	-0.1
Total public sector current expenditure	**790.0**	**1,028.9**	**892.8**	**863.8**	**895.3**	**927.8**	**965.4**
Public sector gross investment (PSGI)							
PSGI in CDEL	58.0	72.0	81.9	86.6	91.5	94.8	98.6
PSGI in AME	35.7	63.6	36.8	40.0	40.5	41.3	42.1
of which:							
Locally financed capital expenditure	13.0	6.8	7.4	8.5	7.9	8.2	8.5
Public corporations' capital expenditure	10.8	10.0	10.3	10.7	10.9	11.1	11.3
Student loans	10.2	10.6	11.2	11.7	12.2	12.8	13.2
Funded public sector pension schemes	0.7	2.0	2.0	2.7	2.2	1.7	1.2
Scottish Government's capital spending	4.0	5.0	4.9	5.9	6.1	6.3	6.6
Tax litigation	0.0	1.5	1.2	1.1	1.1	1.1	1.1
Virus-related loan schemes	0.0	29.5	0.0	0.0	0.0	0.0	0.0
Other PSGI items in AME	0.3	0.7	0.7	0.7	0.7	0.7	0.6
Other National Accounts adjustments	-3.4	-2.4	-0.9	-1.3	-0.7	-0.6	-0.5
Total public sector gross investment	**93.7**	**135.7**	**118.7**	**126.7**	**132.0**	**136.1**	**140.7**
Less public sector depreciation	-51.4	-54.1	-56.2	-58.4	-60.8	-63.3	-65.8
Public sector net investment	42.3	81.6	62.5	68.2	71.3	72.9	74.9
Total managed expenditure	**883.7**	**1,164.6**	**1,011.5**	**990.5**	**1,027.4**	**1,064.0**	**1,106.1**

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

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

Table 3.12: Total managed expenditure: changes since March 2020

	£ billion					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Public sector current expenditure (PSCE)						
PSCE in RDEL	4.5	116.2	43.8	-10.3	-11.7	-12.2
PSCE in AME	-2.0	96.9	-5.0	-7.3	-2.8	-0.7
of which:						
Welfare spending	3.1	15.0	8.9	5.0	2.5	0.7
Virus-related income support schemes[1]	2.1	83.4	0.0	0.0	0.0	0.0
Locally financed current expenditure	-0.4	-6.2	1.5	-0.3	-0.1	0.3
Central government debt interest, net of APF[2]	-1.1	-11.0	-20.2	-16.7	-11.8	-9.4
Scottish Government's current expenditure	-2.8	8.7	0.6	-2.5	-2.6	-2.9
EU financial settlement	-0.1	1.1	0.2	0.5	0.2	0.1
Net public service pension payments	-0.6	-2.8	-2.5	-0.5	-0.3	0.1
Company and other tax credits	0.6	0.9	0.1	0.6	1.6	2.4
BBC current expenditure	-0.3	-0.3	0.0	-0.1	-0.1	-0.2
National Lottery current grants	-0.2	0.3	0.1	0.1	0.1	0.3
General government imputed pensions	0.0	0.0	0.0	0.0	0.0	0.0
Public corporations' debt interest	0.0	0.0	0.0	0.0	0.0	0.0
Funded public sector pension schemes	-1.8	-1.6	-1.7	-1.6	-1.5	-1.5
General government depreciation	2.6	2.6	3.4	3.9	4.3	4.8
Current VAT refunds	-0.3	5.3	2.9	2.7	3.0	2.8
Environmental levies	-1.8	0.0	0.3	0.1	0.1	-0.2
Other PSCE items in AME	0.3	1.3	1.6	1.0	0.9	0.9
Other National Accounts adjustments	-1.3	0.1	-0.1	0.5	0.8	1.1
Total public sector current expenditure	**2.5**	**213.1**	**38.8**	**-17.6**	**-14.5**	**-12.9**
Public sector gross investment (PSGI)						
PSGI in CDEL	-1.9	0.8	-0.3	0.0	0.0	0.0
PSGI in AME	-3.5	22.9	-4.4	-2.6	-3.0	-3.3
of which:						
Locally financed capital expenditure	-0.1	-4.1	-2.9	-2.3	-2.3	-2.2
Public corporations' capital expenditure	-0.2	-1.4	-1.0	-0.7	-0.8	-0.8
Student loans	0.3	0.0	-0.1	-0.2	-0.2	0.0
Funded public sector pension schemes	-0.1	1.1	1.1	1.8	1.3	0.8
Scottish Government's capital expenditure	0.0	0.4	-0.5	0.2	0.3	0.3
Tax litigation	0.0	-0.3	0.0	0.0	0.0	0.0
Calls on virus-related loan schemes	0.0	29.5	0.0	0.0	0.0	0.0
Other PSGI items in AME	-0.4	0.0	-0.1	-0.1	0.0	0.0
Other National Accounts adjustments	-3.0	-2.1	-0.9	-1.3	-1.3	-1.3
Total public sector gross investment	**-5.4**	**23.7**	**-4.7**	**-2.6**	**-3.0**	**-3.3**
Less public sector depreciation	-1.5	-1.9	-2.2	-2.4	-2.7	-3.0
Public sector net investment	-6.9	21.9	-6.9	-5.0	-5.7	-6.2
Total managed expenditure	**-2.9**	**236.9**	**34.1**	**-20.2**	**-17.5**	**-16.2**

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

Table 3.13: Total managed expenditure: differences from *FSR* central scenario

	£ billion					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Public sector current expenditure (PSCE)						
PSCE in RDEL	4.5	51.7	42.6	-10.9	-12.3	-12.2
PSCE in AME	3.1	2.5	-8.3	-5.7	1.1	4.7
of which:						
Welfare spending	3.1	-19.0	-9.2	-4.0	-2.8	-2.2
Virus-related income support schemes[1]	-0.4	10.1	0.0	0.0	0.0	0.0
Locally financed current expenditure	-0.4	-11.5	0.8	-0.9	-0.7	-0.3
Central government debt interest, net of APF[2]	-1.0	2.9	-5.8	-7.5	-3.6	-2.2
Scottish Government's current spending	-2.8	8.7	0.6	-2.5	-2.6	-2.9
EU financial settlement	-0.1	1.1	0.2	0.5	0.2	0.1
Net public service pension payments	-0.6	-2.8	-2.1	0.0	0.3	0.7
Company and other tax credits	0.6	3.9	1.8	1.7	2.5	3.2
BBC current expenditure	-0.3	-0.3	0.0	-0.1	-0.1	-0.2
National Lottery current grants	-0.2	0.3	0.1	0.1	0.1	0.3
General government imputed pensions	0.0	0.0	0.0	0.0	0.0	0.0
Public corporations' debt interest	0.0	0.0	0.0	0.0	0.0	0.0
Funded public sector pension schemes	-1.8	-1.6	-1.7	-1.6	-1.5	-1.6
General government depreciation	3.0	2.6	3.4	3.9	4.3	4.8
Current VAT refunds	-0.3	5.2	3.1	2.9	3.2	3.0
Environmental levies	-1.8	0.0	0.3	0.1	0.1	-0.2
Other PSCE items in AME	2.2	0.7	0.3	1.1	0.9	0.9
Other National Accounts adjustments	3.8	2.2	-0.1	0.5	0.8	1.1
Total public sector current expenditure	**7.6**	**54.3**	**34.3**	**-16.6**	**-11.2**	**-7.5**
Public sector gross investment (PSGI)						
PSGI in CDEL	-1.9	-1.0	0.9	1.3	0.0	0.0
PSGI in AME	-3.5	2.8	-4.5	-2.6	-2.9	-3.3
of which:						
Locally financed capital expenditure	-0.1	-4.1	-2.9	-2.3	-2.3	-2.2
Public corporations' capital spending	-0.2	-0.9	-1.0	-0.7	-0.8	-0.8
Student loans	0.3	0.0	0.1	0.1	0.1	0.2
Funded public sector pension schemes	-0.1	0.9	0.8	1.6	1.1	0.6
Scottish Government's capital spending	0.0	-3.1	-0.5	0.2	0.3	0.3
Tax litigation	0.0	-0.3	0.0	0.0	0.0	0.0
Calls on virus-related loan schemes	0.0	12.4	0.0	0.0	0.0	0.0
Other PSGI items in AME	-0.4	0.0	-0.1	-0.1	0.1	0.0
Other National Accounts adjustments	-3.0	-2.1	-0.9	-1.3	-1.3	-1.3
Total public sector gross investment	**-5.4**	**1.8**	**-3.6**	**-1.3**	**-2.9**	**-3.3**
Less public sector depreciation	-2.0	-1.9	-2.2	-2.4	-2.7	-3.0
Public sector net investment	-7.4	-0.1	-5.8	-3.7	-5.6	-6.3
Total managed expenditure	**2.2**	**56.0**	**30.7**	**-18.0**	**-14.1**	**-10.8**

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

Spending within departmental expenditure limits

3.77 In this section, we use 'RDEL spending' and 'CDEL spending' to refer to PSCE in RDEL and PSGI in CDEL. Given the very large movements in Scottish Government resource and capital AME due to the automatic knock-ons from the extra virus-related DEL funding (known as 'Barnett consequentials' as they are calculated using the Barnett formula), we have also included Scottish Government AME spending in this discussion of DEL spending.

3.78 Our forecasts reflect:

- **Departments' latest outturns for 2020-21** that were sent to the Treasury in October, the local government finance settlement, this year's Main Estimates and the succession of additional multi-billion pound disclosures of virus-related spending, plus our assumptions regarding any further underspending relative to them.

- **Departments' plans for 2021-22** as announced in the 2020 Spending Review, including significant further virus-related spending alongside cuts to some non-virus-related spending relative to March totals, plus our assumptions about underspending against these latest plans. These plans are subject to an unusual degree of policy risk.

- **The Government's latest revisions to total DEL envelopes for 2022-23 to 2024-25** that have been revised as a consequence of this year's Spending Review. These are unchanged from March in terms of CDEL but are materially lower for RDEL. Although some DELs have already been allocated in the form of multi-year settlements for specific departments, programmes, or projects, most will not be finalised until the next Spending Review. DELs already allocated include the NHS RDEL settlement to 2023-24, the schools RDEL settlement to 2022-23, the defence settlement to 2024-25, and non-defence investment projects accounting for around a third of the CDEL budget.

- The Government's new **provisional total DELs in 2025-26**. As this is the first time 2025-26 has featured in our forecasts, there are no previous plans to compare these totals against. We therefore compare them with a neutral assumption that spending would have remained flat as a share of GDP between 2024-25 and 2025-26.

- In all years we have added **Scottish Government AME** onto the DEL totals, reflecting Barnett consequentials and our judgements on additions to or use of reserves.

3.79 Our March forecast incorporated the large increases in RDEL and CDEL spending plans announced by the Chancellor in the Budget. We noted then that the striking turnaround in the path of RDEL spending and equivalent spending in Scotland meant that the cuts in real spending per person over the eight years from 2010-11 would be entirely reversed by 2024-25, with almost half the reversal taking place in 2020-21 and 2021-22. Increases in CDEL spending were proportionately even greater than those to RDEL, taking real spending per person by 2024-25 to around a third higher than the level in 2010-11 before the Coalition Government's post-crisis investment cuts took effect.

Spending in 2020-21

3.80 Departmental spending in 2020-21 is set to hit 25.5 per cent of GDP, up from 17.1 per cent last year. The current approach to control of departmental spending means that full like-for-like historical comparisons are not possible, but based on the government consumption element of GDP that loosely corresponds to RDEL spending, the spike this year is unprecedented outside the two World Wars. The Treasury has made four separate announcements of newly approved departmental spending this year that have averaged £33 billion each – on a similar scale to the medium-term increases in RDEL announced in the March Budget that represented the largest sustained giveaway since Budget 1992.

3.81 In total, RDEL spending plans have increased by £125 billion (around a third) and Scottish Government AME by £9 billion relative to the plans that underpinned our March forecast. Chart 3.7 shows how those announcements have built up through the year and what it means for our RDEL spending forecast:

- By the time we produced our ***FSR* central scenario**, £44 billion of additional spending had already been announced, split roughly half for business support, a quarter for health services and a quarter for other public services.

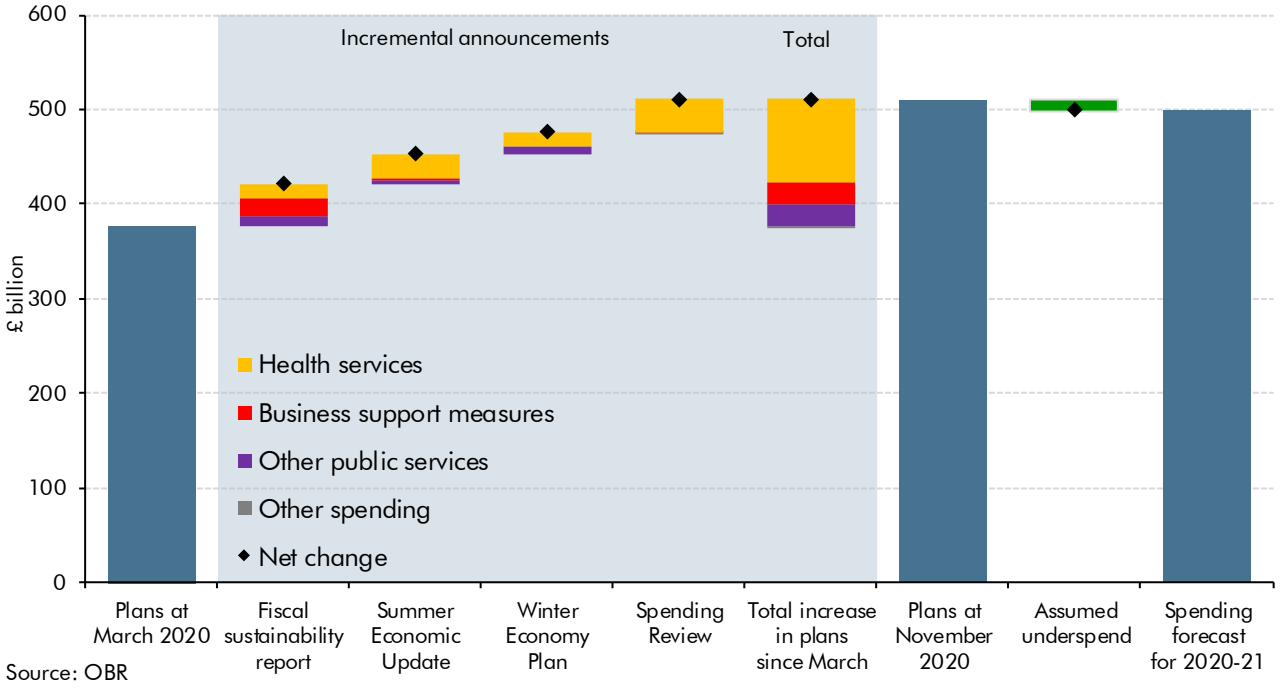
- In the **Summer Economic Update** a further £32 billion was added, largely for health services and associated Barnett consequentials, with around a fifth for business support. Of the £24 billion allocated to health services, around £15 billion was for personal protective equipment and £10 billion for 'test, trace, contain and enable'.

- In the **Winter Economy Plan** a further £24 billion was disclosed, with two-thirds on health services and a third on local government support and other public services.

- In **Spending Review 2020**, another £34 billion has been added, with the majority being allocated to public services.

- Relative to these much-increased plans, we have increased the amount by which we expect **departments to underspend**, from around £3 billion in our March forecast to £12 billion in this forecast. This assumes that 5 per cent of the additional amounts announced this year will not be spent given the pace at which spending would have to run over the final months of the year to meet these plans.

Chart 3.7: Changes in 2020-21 departmental resource spending plus Scottish Government equivalent in AME since March



Source: OBR

3.82 In total, CDEL spending plans in 2020-21 have increased by £7 billion (9 per cent) relative to those that underpinned our March forecast, reflecting the following factors:

- Spending factored into the ***FSR* and SEU** added £6 billion, with the majority allocated to a package of infrastructure measures and to the green homes grant. On the former, the £5.6 billion cost announced reflected a combination of new money and the bringing forward of existing spending commitments.

- Spending disclosed at the **WEP and Spending Review** adds a further £1.2 billion (some of which will be held in reserve).

- We have increased assumed **underspending against those revised plans** from around £4 billion in our March forecast to £10 billion in this one. This reflects the combination of significant further underspending against plans as they stood in March, thanks largely to the lockdowns, plus further shortfalls against the new plans.

Spending Review 2020 plans for 2021-22

3.83 Spending Review 2020 sets out detailed plans for departmental spending in 2021-22. It includes both temporary virus-related spending and the larger totals for non-virus-related or 'business-as-usual' activities.

3.84 In summary:

- **Total DEL plans** are up £45 billion relative to plans as they stood in March. This is due to the £46 billion rise in RDEL plans, with CDEL plans little changed. Scottish Government AME is also up a little relative to March.

- **Virus-related spending plans** more than account for the increase in RDEL plans, with £56 billion more overall.

- **Business-as-usual spending plans** are therefore lower by £10 billion relative to March totals. These include lowering official development assistance (ODA) to 0.5 per cent of national income from the legislated 0.7 per cent; freezing public sector pay in 2021-22 for all but NHS employees; and replacing some grant funding for local authorities with increased local funding via council tax increases.

3.85 We have assumed that 5 per cent of the net addition to RDEL plans will not be spent next year, increasing our overall underspend assumption from £3.9 billion in our March forecast to £6.1 billion in this one.

Medium-term spending plans for 2022-23 onwards

3.86 In the years beyond which departmental budgets are allocated, virus-related spending plans fall to zero. Relative to the totals set in the Budget in March, the Government has decided to cut non-virus-related RDEL spending by £12.5 billion in 2022-23 and by somewhat larger amounts in 2023-24 and 2024-25. In effect, this locks in the real terms effect of business-as-usual cuts relative to March totals in 2021-22, by setting cash totals that mean 'RDEL excluding depreciation' grows from that lower base at 2.1 per cent in real terms, the same rate as at the Budget in March. For CDEL plans to 2024-25 the Government has chosen to retain the same cash levels as in March.

3.87 We have adjusted underspending assumptions in response to new plans by reducing RDEL underspends by 5 per cent of the reduction in those in plans. We might expect greater underspending in periods of relatively strong real growth,[9] but history suggests that future increases in plans rather than smaller underspends are at least as great a risk.

3.88 Table 3.14 and 3.15 bring together all the changes to departmental resource and capital spending plans and totals, plus our assumptions about underspending relative to those plans, to generate our latest forecasts for actual RDEL and CDEL spending.

[9] *The planning and control of UK public expenditure, 1993–2015*, Crawford, Johnson and Zaranko, July 2018.

Table 3.14: Changes in departmental resource spending since March

	£ billion					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast						
Limits	343.0	365.2	380.0	396.0	413.0	
Assumed underspend	-3.2	-3.9	-4.1	-4.3	-4.4	
Actual spending	339.8	361.3	375.9	391.8	408.6	
November forecast						
Limits	468.0	411.2	369.1	383.6	400.0	417.3
Assumed underspend	-12.0	-6.1	-3.5	-3.6	-3.7	-3.9
Actual spending	456.0	405.1	365.6	380.1	396.3	413.4
Change						
Limits	125.0	46.0	-10.9	-12.4	-12.9	
Assumed underspend	-8.8	-2.2	0.6	0.7	0.7	
Actual spending	116.2	43.8	-10.3	-11.7	-12.2	
Change: *of which*						
Government policy since March	**125.0**	**46.0**	**-10.9**	**-12.4**	**-12.9**	
of which:						
Non-SR policy announcements	92.6					
Spending Review totals	32.4	46.0	-10.9	-12.4	-12.9	
of which:						
Temporary virus-related spending	35.2	55.9				
Non-virus related spending	-2.8	-9.9				
Lower post-SR spending totals			-10.9	-12.4	-12.9	
Allowance for shortfall	**-8.8**	**-2.2**	**0.6**	**0.7**	**0.7**	

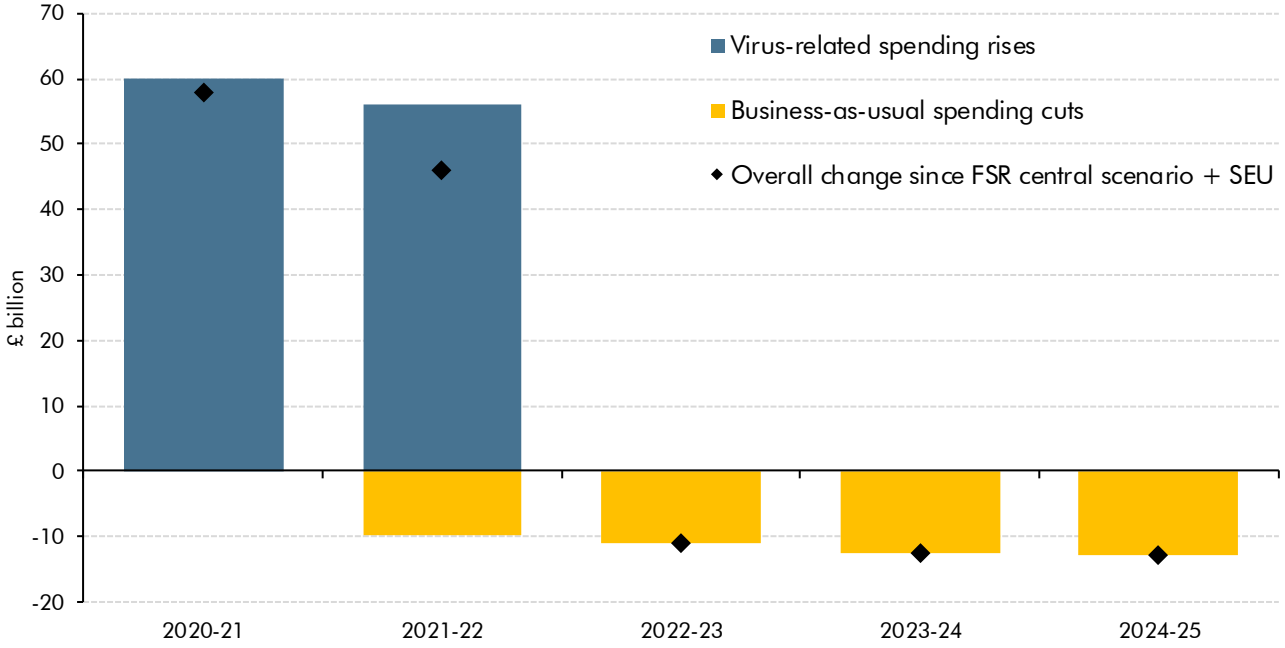
Table 3.15: Departmental capital spending

	£ billion					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November forecast						*Implied plans*
Limits[1]	81.8	89.1	94.5	99.5	102.9	107.0
Assumed underspend	-9.8	-7.3	-7.8	-8.0	-8.1	-8.5
Actual spending	72.0	81.9	86.6	91.5	94.8	98.6

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

3.89 Chart 3.8 shows how changes in RDEL plans relative to the March totals that underpinned our *FSR* central scenario split between the large temporary boost from virus-related spending and the lower planned totals for other business-as-usual activities. The latter are the largest single contributor to lower medium-term borrowing relative to the *FSR*.

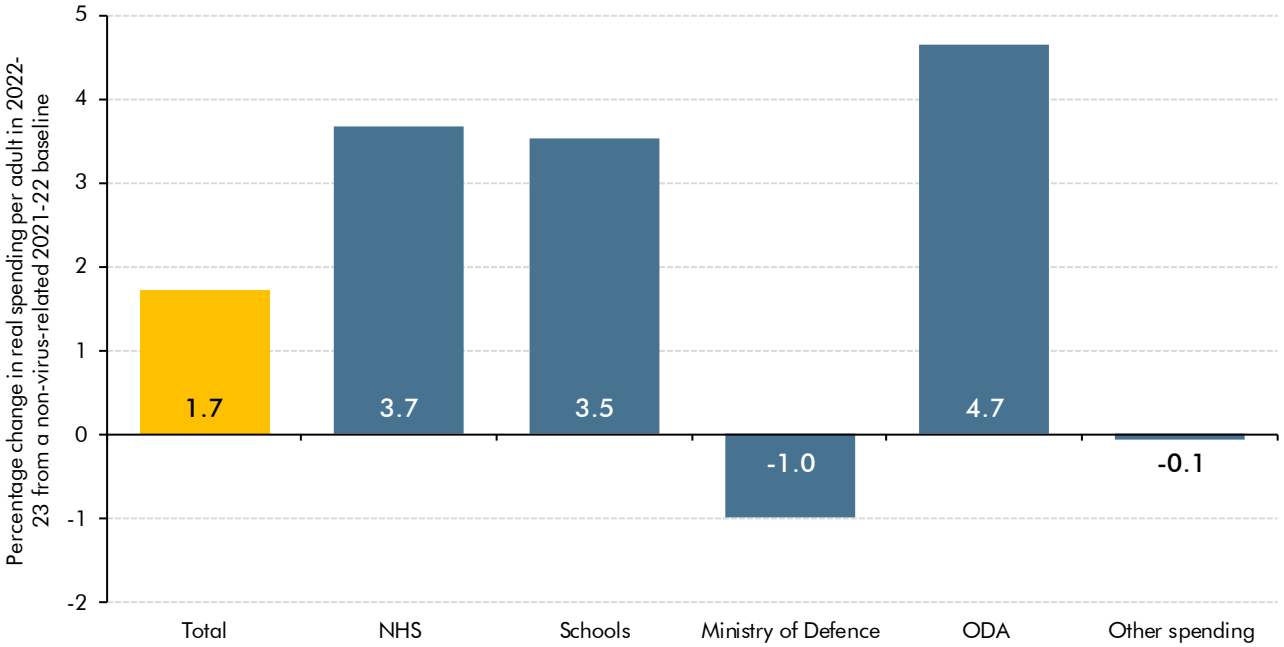
Chart 3.8: PSCE in RDEL plans: differences since *FSR* scenario



Source: OBR

3.90 The £11 billion reduction in the RDEL envelope for 2022-23 could set up another challenging Spending Review next year. Within the £397 billion total for which plans will need to be set, £143 billion has already been allocated to the NHS, £52 billion to schools, and £32 billion to defence, leaving £170 billion for all other public services. Even if ODA spending were kept at 0.5 per cent of national income (as assumed in the chart below and implying £3 billion lower spending in RDEL than if it returned to the legislated 0.7 per cent that was also committed to in the Conservative Party's election manifesto), that would still leave the remaining £163 billion of spending on other public services down £9 billion relative to March totals. As Chart 3.9 shows, that would imply spending on those 'unprotected' public services being broadly flat in real per capita terms in 2022-23 relative to the lower 2021-22 baseline set in this Spending Review.

Chart 3.9: Change in real RDEL spending per adult in 2022-23



Source: HM Treasury, OBR

Welfare spending

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

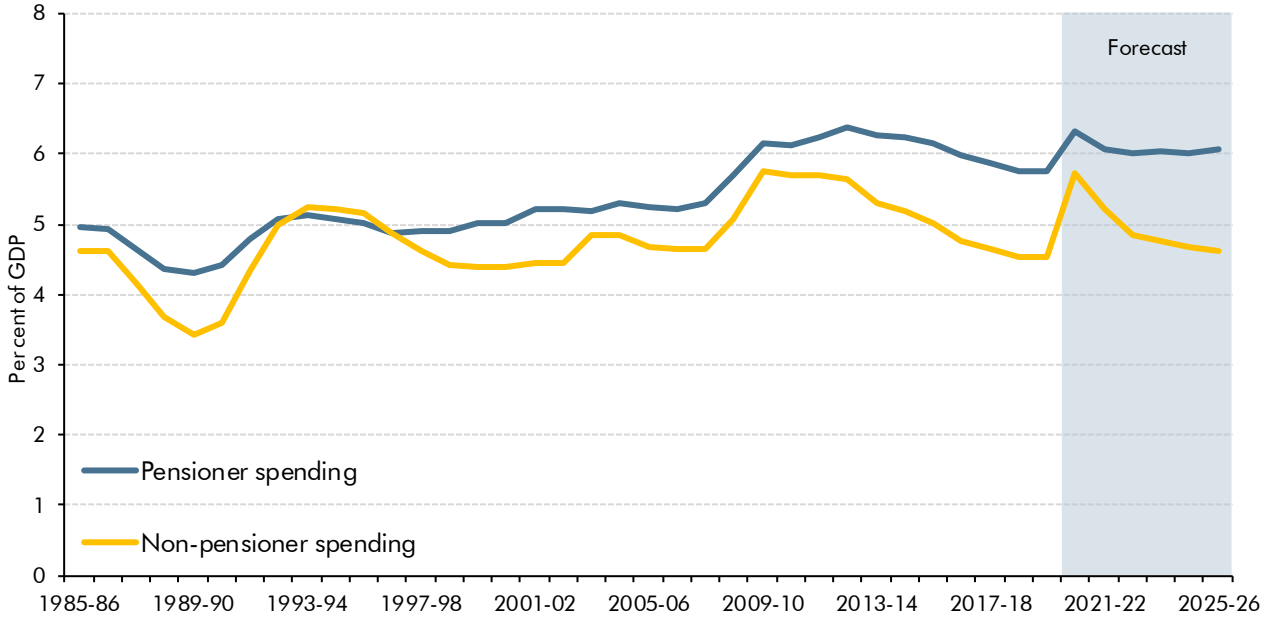
3.92 The virus-related surge in claims for universal credit (UC) has necessitated a change in the way we forecast welfare spending in this *EFO*. Previously, we formed the working-age forecast by estimating a counterfactual in which the pre-UC 'legacy' system continued as though UC did not exist, and then superimposing an estimate of the marginal cost of rolling out UC. This approach made sense while UC was still in its infancy and made use of as much administrative data as possible. We had been working towards adopting a more typical bottom-up forecasting model, reflecting the steady growth in the UC caseload, but have been forced to accelerate those plans. UC is therefore forecast on an actual cost basis (as it appears in the real world) for the first time in this *EFO*. The methodological changes underpinning this move are complex, so we will explain them in more detail in our next *Welfare trends report* (*WTR*), to be published by the end of 2020-21.

3.93 Total welfare spending rises sharply this year – up 8 per cent in cash terms relative to 2019-20 and by 1.6 per cent of GDP (thanks also to the fall in GDP). Most of this increase is due to working-age welfare spending, and UC in particular. Indeed, the 1.2 per cent of GDP

rise in non-pensioner spending takes it to 5.7 per cent of GDP, the joint highest share of GDP on record (level with its financial crisis-related peak in 2009-10). As the economy recovers and unemployment falls, non-pensioner spending drops back steadily to reach 4.6 per cent of GDP by 2025-26 (similar to the 2019-20 level thanks to most benefit rates being uprated with CPI inflation, and therefore falling relative to average earnings). That leaves total welfare spending at 10.5 per cent of GDP in 2025-26, close to its pre-virus 2019-20 level, as the fall in non-pensioner spending is offset by the rising cost of pensioner benefits as the population ages. These trends are illustrated in Chart 3.10.

3.94 The step down in spending in 2021-22 includes the £6.2 billion reduction from the removal in April of the virus-related £20 a week increase in UC and working tax credits awards. This figure represents a 0.3 per cent of GDP drop in spending on those benefits and involves taking around £1,000 a year from around 6.2 million households. As discussed in the *FSR*, measures creating cash losers – like this return to pre-virus benefit and tax credit rates – have in the past frequently been reversed, delayed or diluted.

Chart 3.10: Historical trends in welfare spending



Note: Scottish welfare BGA has been added in forecast years to show on an equivalent basis with outturn years.
Source: DWP, OBR

3.95 Table 3.16 summarises our latest welfare spending forecast, while Table 3.17 reports differences from our March forecast and our *FSR* central scenario.

Table 3.16: Total welfare spending

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Pensioner spending[1]	111.6	114.2	117.9	124.0	129.5	135.2	141.6
UC and legacy equivalents[2]	64.4	80.4	75.6	72.3	72.6	73.1	75.1
Disability benefits[3]	26.1	24.5	25.5	27.1	28.7	29.9	30.9
Child benefit	11.5	11.6	11.6	11.8	11.8	11.8	11.8
Other spending[4]	14.1	15.4	15.5	16.2	17.0	17.8	18.5
Direct effect of Government decisions	0.0	0.1	0.7	0.4	-0.2	-0.4	-0.3
Total welfare spending	**227.7**	**246.2**	**246.7**	**251.8**	**259.5**	**267.5**	**277.8**
of which:							
Inside welfare cap	118.7	124.4	121.0	122.0	123.6	125.2	127.7
Outside welfare cap	109.0	121.8	125.7	129.8	135.8	142.3	150.1

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

3.96 Welfare spending is up £15.0 billion in 2020-21 relative to our March forecast, dominated by higher spending on UC as a result of the sharp rise in the caseload, together with the £20 increase to the UC standard award and other smaller policy measures. The scale of the upward revision drops in 2021-22 as the £20 increase is withdrawn, then diminishes more steadily thereafter as unemployment falls back towards our March forecast.

3.97 Despite being up relative to March, welfare spending in 2020-21 is £19 billion lower than in our *FSR* central scenario. That difference then roughly halves in 2021-22 and diminishes further thereafter. These differences are dominated by lower UC spending:

- Our **unemployment forecast** is considerably lower than in our *FSR* central scenario, which lowers the UC caseload relative to what we assumed then. Recent data also show a smaller proportion of the rise in unemployment is feeding through to successful claims for UC than we assumed. Together these effects lower UC spending in 2020-21 by £12.9 billion relative to the *FSR* (including by lowering the estimated cost of increasing the standard element by £20 a week). This effect diminishes in future years as our unemployment forecast converges to the path assumed in the *FSR*.

- In the *FSR,* we assumed that the virus-related addition to the UC caseload would receive similar average amounts of benefit to existing cases (implicitly assuming they would have similar characteristics on average). In the event, they have been much less likely to have children and less likely to be eligible for housing support payments, so **the average award to new claimants** has been materially lower than for existing claimants (by around 30 per cent in the April to August period at £620 a month versus £860 a month for pre-virus cases still on the caseload in that period). This effect also diminishes over the forecast as the caseload steadily returns to closer to the pre-virus composition. Average amounts for new claimants have risen more recently, although this relates to a much slower flow of new claims than during the initial spike.

- We have included an explicit assumption about the lasting effect of the pandemic on **labour market inactivity** and associated claims of incapacity-related benefits. This raises our forecast for UC cases with a 'limited capability for work-related activity' and for 'new style' employment and support allowance (ESA) by around 300,000. This effect builds up steadily to add £3.2 billion to UC and ESA spending in 2024-25 relative to the *FSR*. (This also affects disability benefits spending, as set out below.) This broad-brush assumption is very uncertain and will be refined over time. Historical experience in the aftermath of previous recessions has varied – inactivity rose by less than this in the period after the financial crisis, but by significantly more in the five years following the 1990s recession. Neither recession was precipitated by a public health crisis, which could clearly have more lasting health effects on the population.

3.98 Other sources of difference from the *FSR* include:

- **State pensions.** Spending is lower due to the effect of a smoother – and on average weaker – path of average earnings on triple lock uprating, with the effect peaking at £1.6 billion lower spending in 2024-25. Spending is also reduced by excess deaths, where we have revised up our assumption for excess pensioner-age deaths this year from 62,000 in the *FSR* to 90,000 as a result of the resurgence of infections. This is a top-down assumption based on excess deaths in the second half of 2020-21 being around half the level of virus-specific deaths assumed in the Government's July 'reasonable worst case' scenario, reflecting the more stringent public health measures now in place. It is clearly very uncertain – while we were able to discuss virus-related modelling with the relevant government health experts, at the time we closed the forecast there were no official projections of the impact of the latest restrictions on the path of excess deaths. We assume that two-thirds of this year's excess pensioner deaths are brought forward from within the next five years and the remainder from beyond the forecast horizon, informed by analysis published by NIESR.[10] As a result, these deaths reduce spending by £0.6 billion in 2020-21 (up by £0.5 billion from the *FSR*), diminishing to £0.6 billion in 2025-26.

- **Disability benefits.** We have revised spending up by £0.9 billion a year on average, reflecting higher caseloads, partly related to the assumed increases in labour market inactivity and associated health conditions as a result of the pandemic. These could be directly related to the virus (e.g. 'long covid') or indirectly related (e.g. increased prevalence of mental health conditions due to economic conditions or lockdowns).

- **Other welfare spending** is also higher, largely due to virus-related increases in welfare spending in Northern Ireland, which was understated in the *FSR*.

3.99 Modest effects from new policy measures include the cost of extending the relaxation of the minimum income floor in UC until April 2021, and increasing pension credit, offset in later years by the decision to freeze local housing allowance rates in cash terms at the higher levels set this year. The extension of the CJRS delays and reduces the peak in unemployment, which also reduces spending on UC relative to our pre-measures forecast.

[10] *Living with Covid-19: balancing costs against benefits in the face of the virus,* Miles, Stedman and Heald, July 2020.

Table 3.17: Welfare spending: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total welfare spending							
March forecast	224.6	231.2	237.8	246.8	256.9	266.8	
FSR central scenario + SEU	224.6	265.2	255.9	255.8	262.3	269.7	
November forecast	227.7	246.2	246.7	251.8	259.5	267.5	277.8
Change since March	**3.1**	**15.0**	**8.9**	**5.0**	**2.5**	**0.7**	
Change since FSR central + SEU	**3.1**	**-19.0**	**-9.2**	**-4.0**	**-2.8**	**-2.2**	
	Underlying forecast changes since FSR central + SEU						
Total	**3.1**	**-19.1**	**-9.9**	**-4.4**	**-2.6**	**-1.8**	
of which:							
Universal credit and legacy equivalents[1]	0.5	-20.0	-10.7	-4.9	-2.6	-1.3	
of which:							
Due to caseload		-12.9	-4.4	-4.7	-5.2	-4.5	
Due to average awards		-7.1	-6.8	-2.3	-0.6	0.0	
Due to long term inactiviity		0.0	0.5	2.1	3.1	3.2	
Pensioner spending	-0.1	0.1	0.1	-0.8	-1.4	-2.1	
Disability benefits[2]	2.9	0.4	0.6	1.0	1.2	1.3	
Other benefits	-0.2	0.4	0.1	0.3	0.2	0.3	
	Direct effect of Government decisions since FSR central + SEU						
Total	**0.0**	**0.1**	**0.7**	**0.4**	**-0.2**	**-0.4**	**-0.3**

[1] UC and legacy equivalents includes personal tax credits, housing benefit (excluding pensioner part), income-related and contributory employment and support allowance, income support and income-based and contributory jobseeker's allowance.

[2] Disability benefits includes disability living allowance, personal independence payment, and attendance allowance.

Virus-related income support schemes

3.100 The Government has introduced two multi-billion pound schemes to support the incomes of employees and self-employed individuals adversely affected by the public health measures introduced to contain the virus. The coronavirus job retention scheme (CJRS) supports eligible employees whose employers place them on furlough for some or all of their pre-virus hours, while the self-employment income support scheme (SEISS) provides grants to eligible self-employed individuals based on previous profits. From an economic perspective these subsidies have similar qualities to welfare spending, but with higher income replacement rates than individuals would have received had they had to rely on UC.

3.101 The gross cost of these schemes in 2020-21 is estimated to be around £83 billion (4 per cent of GDP). As the payments are taxable, we expect that a share of them will return to the Exchequer, so the net cost is estimated to be £71 billion. These costs are higher than assumed in our *FSR* central scenario because the schemes have been extended, although their cost up to their previously expected closing dates was lower than assumed.

Coronavirus job retention scheme (CJRS)

3.102 The CJRS was initially announced by the Government on 20 March. The period it covers was extended by one month on 17 April, then by a further three months on 12 May, then by a

further month on 31 October and finally by a further four months on 5 November. These announcements have resulted in six phases for the scheme's operation:

- From **March to June**, the CJRS paid employers a taxable grant worth 80 per cent of a furloughed employee's wage cost, up to a maximum of £2,500 a month, plus the associated employer NICs and the minimum auto-enrolment employer pension contribution on the subsidised wage. During this phase, employers were only able to claim support for workers that had been furloughed completely for a minimum of three weeks.[11] Employers could not pay furloughed employees less than the 80 per cent subsidy, but they were free to top up their employees' wages to previous levels, which many chose to do.

- In **July**, only employees that had been furloughed for at least three consecutive weeks during the first phase remained eligible for the scheme, making 10 June the effective cut-off point for new claims. From 1 July employers had the flexibility to bring furloughed workers back on reduced hours, with the Government covering the costs of furloughed hours on the same terms as during the initial phase.

- In **August**, the Government no longer covered the cost of employer NICs and minimum pension costs. The subsidy for wage costs was unchanged.

- In **September**, employers needed to cover at least 10 per cent of an employee's gross pay (up to £312.50), as the wage subsidy element was reduced to 70 per cent.

- In **October**, employers needed to cover at least 20 per cent of an employee's gross pay (up to £625), as the subsidy was reduced to 60 per cent.

- From **November to next March**, the scheme reverts to its August formulation – 80 per cent wage replacement for the hours furloughed with flexibility on reduced hours, but with employers having to pay employer NICs and pension contributions.[12] The Government has announced that it will review the level of subsidy in January.

3.103 The gross cost of the CJRS is determined by the number of jobs furloughed and for how long; the number of people on full-time or reduced hours furlough and how many hours they work; and the average subsidy per job per time period. We estimate that the total gross cost in 2020-21 for CJRS will be £62.5 billion, with £40.5 billion of the cost relating to the period to the end of October and £22 billion to the extension to the end of March.

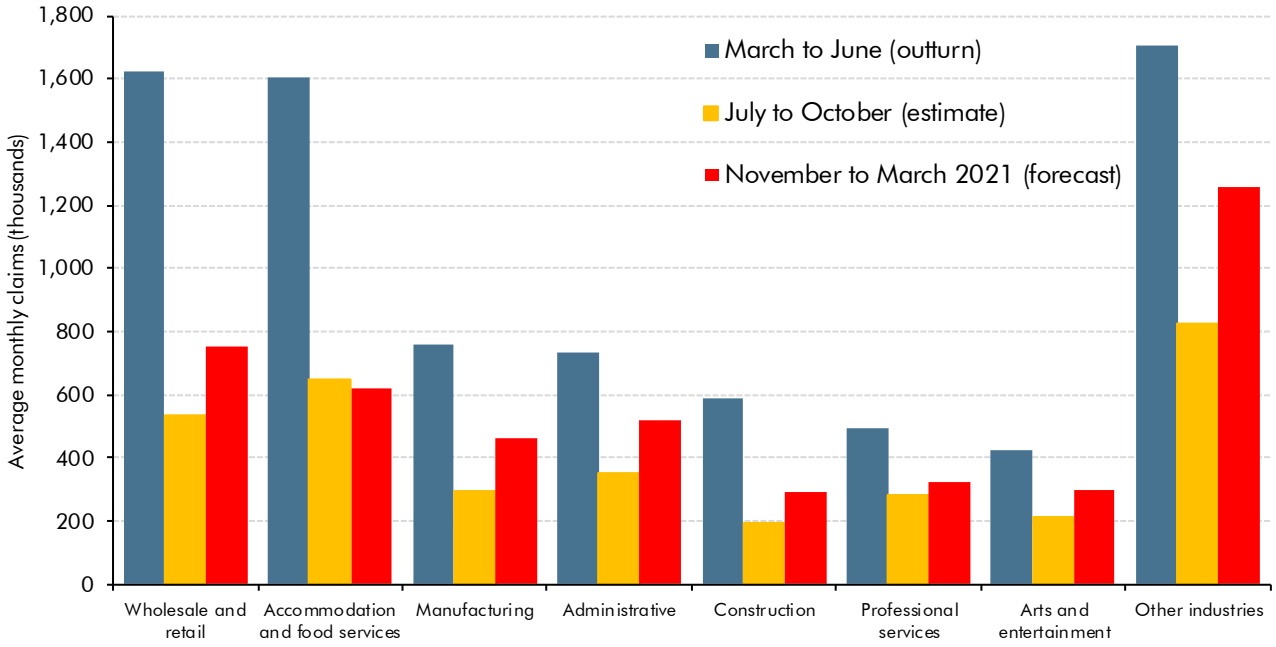
3.104 Chart 3.11 shows how the average monthly CJRS claims breaks down by industry in the periods up to 30 June, for which there is outturn data; from 1 July to 31 October, which is estimated based on grossed up claims that HMRC has received to date; and then from 1

[11] The scheme was open to all UK employers though there are some restrictions around the eligibility of employees: claims could only be made in respect of furloughed employees that were employed on 19 March, and who were also on an employer's PAYE payroll on or before 19 March and for whom an accompanying real-time information (RTI) submission had been made to HMRC by that date.
[12] The cut-off date for employee eligibility and the associated RTI submission requirement has been moved to 30 October, with employees that had been made redundant after 23 September allowed to be re-employed and retroactively furloughed. The minimum length of furlough requirement was also removed.

November onwards, which takes the sectoral output assumptions consistent with our central economy forecast (described in Chapter 2) and combines them with evidence from outturn CJRS use to estimate demand for the scheme until the end of March. The main difference in terms of sectoral composition is that we expect accommodation and food services to be less severely affected than in the first lockdown, as the sector is more ready to adopt alternative ways of operating than back in March (e.g. restaurants offering take-away food).

3.105 The cost of the CJRS extension is, of course, subject to significant uncertainty – both in respect of the extent to which output will fluctuate in different sectors over the coming months and how use of the furlough scheme might vary relative to that. Given the rise in redundancies and unemployment, it is likely that some jobs that were furloughed during the last lockdown have now been terminated. But it is possible that some firms unaffected by the virus might take advantage of the scheme to cope with any Brexit-related disruption in the new year reflected in our 'no deal' scenario (see Annex B).

Chart 3.11: CJRS claims



Source: HMRC, OBR

3.106 The £12 billion downward revision to the cost of the scheme between March and October relative to our *FSR* scenario is largely explained by claims falling faster than expected, with more modest differences in average amounts paid to each furloughed employee. Table 3.18 reports outturns for March to July and grossed-up estimates from provisional outturns for August to October relative to our *FSR* central scenario, alongside the assumed monthly path of costs up to March 2021 due to the extension.

Table 3.18: CJRS from March to October: differences from *FSR* central scenario

	Millions of furloughed employees							
	Monthly average							
	Apr to Jun	Jul to Oct	Forecast					Nov to Mar
	Outturn	Estimate	Nov	Dec	Jan	Feb	Mar	Forecast
FSR central scenario + SEU								
Number of furloughed individuals	8.4	5.2						
Average monthly subsidy (£)	1,200	1,042						
Gross monthly cost (£ billion)	**10.1**	**5.5**						
Cumulative gross cost (£ billion)	**30.2**	**52.1**	**52.1**	**52.1**	**52.1**	**52.1**	**52.1**	
November forecast								
Number of furloughed individuals	8.3	3.1	5.9	4.8	4.4	3.9	3.5	4.5
Average monthly subsidy (£)	1,151	955	1,000	987	980	975	969	982
Gross monthly cost (£ billion)	**9.6**	**3.0**	**5.9**	**4.7**	**4.3**	**3.8**	**3.3**	**22.1**
Cumulative gross cost (£ billion)	**28.7**	**40.5**	**46.4**	**51.2**	**55.4**	**59.2**	**62.6**	
Difference								
Number of furloughed individuals	-0.1	-2.1	5.9	4.8	4.4	3.9	3.5	4.5
Average monthly subsidy (£)	-49	-87	1,000	987	980	975	969	982
Gross cost of the programme (£ billion)	**-0.5**	**-2.5**	**5.9**	**4.7**	**4.3**	**3.8**	**3.3**	**22.1**
Cumulative gross cost (£ billion)	**-1.6**	**-11.6**	**-5.7**	**-1.0**	**3.3**	**7.1**	**10.5**	

Self-employment income support scheme (SEISS)

3.107 The SEISS is a taxable grant for the self-employed and members of partnerships. It was initially announced on 26 March as a single payment covering three months, and worth 80 per cent of average monthly profits in 2016-17, 2017-18 and 2018-19, up to a maximum of £7,500. On 29 May the Chancellor announced that 13 July would be the closing date for the first grant, but also that the scheme would be extended to include a second grant worth 70 per cent of average monthly profits and capped at £6,570 in total. Eligibility for both grants required the filing of a 2018-19 tax return; that annual trading profits did not exceed £50,000; that more than half of recipients' total income was derived from self-employment; and that recipients' trade had been adversely affected.

3.108 The first grant was paid to 2.6 million individuals, with claims totalling £7.6 billion and an average award of £2,900. We estimate that 2.3 million grants will have been paid in the second instalment at a total cost of £6.0 billion (almost all of which have been claimed already). The gross cost of these two grants of £13.5 billion is below the £15.2 billion assumed in our *FSR* central scenario, thanks largely to lower take-up of the second grant.

3.109 On 24 September, the Chancellor announced two more rounds of SEISS grants to cover the periods from November to January (at a much reduced rate of 20 per cent of average monthly profits) and February to April (at a rate to be set in January). On 2 November, the rate for November was increased to 80 per cent, giving an average rate for the third grant of 55 per cent. Then on 5 November, the Chancellor announced that the third grant would be at a rate of 80 per cent across all three months. We estimate the cost will be £7.3 billion, which is just under the cost for the first round. This brings the total cost of SEISS in 2020-21 to around £21 billion. The extent to which this rises when the fourth grant is paid will depend on its generosity. At 20 per cent, it might cost around £1½ to 2 billion; at 80 per cent it might cost around £7 billion.

Virus-related loan schemes

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

3.111 Our *FSR* central scenario was based on the schemes being open until November 2020. We provisionally estimated the upfront costs in 2020-21 to be around £17 billion, with the overwhelming majority of the costs arising from the BBLS. The extension of each of these schemes to January 2021 means more guaranteed loans are expected to be issued. We have also revised expected loss rates to be in line with the higher estimates published by the British Business Bank. Together these changes have led to the expected costs of these schemes in 2020-21 to be revised up by £12 billion to £29 billion (see also Annex A).

Locally financed current expenditure

3.112 We forecast spending by local authorities by projecting their various sources of income – including grants from central government together with local sources, such as council tax, retained business rates and trading income – and the extent to which they then overspend or underspend that income by varying their reserves or borrowing. Our forecast therefore encompasses spending financed by grants, which is mostly in DELs, and locally financed expenditure, which is in AME. Table 3.19 focuses on locally financed expenditure. Further detail is available in supplementary tables on our website.

3.113 Relative to both our March forecast and our *FSR* central scenario we have made some fairly large changes. We now expect locally financed expenditure to be £48.8 billion in 2020-21, which is £6.2 billion lower than in March and £11.5 billion lower than in our *FSR* central scenario. When looking at these changes, it is important to distinguish between those related to council tax and business rates (which also affect our receipts forecast and are therefore broadly neutral for borrowing) and those related to the net use of reserves or changes in the amounts set aside to repay debt (which reflect authorities spending more or less than their income and therefore contribute to public sector net borrowing). In our *FSR* central scenario, we took a broad-brush approach, assuming that local authorities would draw down on reserves by £5.3 billion more than we had forecast in March. While that approach recognised the impact the pressures on local government finances would have on public sector net borrowing, we have now reflected in our forecast the fact that more of the pressures on local government finances have been absorbed by central government.

3.114 We have lowered our forecast for retained business rates by £6.8 billion in 2020-21 due to the business rates holidays. Central government compensates local authorities for the fall in retained revenues, so this increases grant-financed and reduces locally financed spending. The pandemic has also hit council tax receipts via both non-payment and greater eligibility for council tax support. Central government has given authorities flexibility to reflect council

tax losses across three years rather than immediately as they normally would and has ensured that councils do not have to bear the direct consequences of paying over the central share of business rates on the basis of the much higher pre-virus forecasts for revenues. This smooths the path of local authorities' expenditure, although we still assume that they will need to draw down £1.6 billion from reserves this year.

3.115 In future years, the main sources of change are measures. Further pilots for a higher share of retained business rates increase locally financed spending by around £2.0 billion in 2021-22; and flexibility for local authorities to increase the adult social care precept of council tax in 2021-22 by up to 3 per cent without having to call a local referendum. Based on historical evidence, we assume that almost all authorities will take up the full increase. This increases the forecast by around £1 billion a year from 2021-22 onwards, although as discussed above, it is broadly fiscally neutral as it comes from an increase in receipts.

Table 3.19: Locally financed current expenditure: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	53.9	55.0	55.1	56.9	58.6	60.1	
FSR central scenario + SEU	53.9	60.3	55.8	57.5	59.2	60.7	
November forecast	53.5	48.8	56.6	56.6	58.5	60.4	62.1
Change since March	**-0.4**	**-6.2**	**1.5**	**-0.3**	**-0.1**	**0.3**	
Change since FSR central + SEU	**-0.4**	**-11.5**	**0.8**	**-0.9**	**-0.7**	**-0.3**	
	Underlying forecast changes since FSR central + SEU						
Total	**-0.4**	**-11.2**	**-1.9**	**-1.7**	**-1.6**	**-1.4**	
of which:							
Council tax	0.1	0.8	-0.3	-0.2	0.0	0.2	
Retained business rates	1.1	-6.8	-0.2	0.3	0.1	0.0	
Net use of current reserves	-0.6	-3.0	0.3	0.3	0.3	0.0	
Debt interest payments	-1.0	-1.2	-1.5	-1.7	-2.0	-2.2	
Other	0.1	-1.1	-0.2	-0.4	-0.1	0.6	
	Direct effect of Government decisions since FSR central + SEU						
Total		**-0.3**	**2.7**	**0.8**	**0.9**	**1.2**	**1.2**
of which:							
Council tax: adult social care precept		0.0	0.9	1.0	1.0	1.1	1.1
Business rates retention pilots		0.0	2.0	0.0	0.0	0.0	0.0
Other		-0.3	-0.2	-0.2	-0.2	0.1	0.1

Locally financed and public corporations' capital expenditure

3.116 Locally financed capital expenditure is measured net of capital spending by authorities' housing revenue accounts (HRAs) and Transport for London's subsidiaries; in both cases, these are treated as public corporations in the National Accounts.[13] So we switch these items from locally financed to public corporations' capital expenditure in our forecast to ensure consistency. All these forecasts are net of asset sales, forecasts for which are available in supplementary tables on our website.

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

3.117 Relative to our *FSR* central scenario, we have revised down locally financed and public corporations' capital expenditure by £5.2 billion in 2020-21 and by progressively smaller amounts thereafter, falling to £3 billion in 2024-25. The main reason is the lower capital expenditure seen in outturn data for the first quarter of 2020-21 from local authorities (including though their HRAs), as well as lower spending in TfL's latest revised budget, partially offset by lower than forecast asset sales. As we present our forecast net of asset sales, a reduction in sales leads to a corresponding increase in capital expenditure.

3.118 Over the remainder of the forecast, we assume that local authorities reduce their capital spending financed by unsupported borrowing in light of the virus-related shock to returns on commercial property investments. Croydon Borough Council has already issued a Section 114 notice, while many other councils are reported to have made losses on such investments. We assume that the attractiveness of those investments will not recover over the forecast period, and therefore have reduced our forecast for financing for unsupported borrowing down to almost zero. The Treasury has additionally reduced the scope for such investments, but we assume it has little impact over and above the impact of the virus. In the event that commercial property rebounded more strongly and local authorities again saw it as a source of additional income, the tighter rules would have a greater effect on spending.

3.119 TfL's revised budget showed a drop in capital spending of around £0.5 billion in 2020-21 relative to our March forecast. This is in line with the 14 May TfL bailout, as part of which TfL agreed to reduce capital spending financed from revenue given its forecast of operational losses. We had already incorporated this is in our *FSR* central scenario, but it represents a further change relative to our March forecast.

Table 3.20: Locally financed capital expenditure and public corporations' capital expenditure: differences from March forecast and *FSR* central scenario

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	24.1	22.3	21.6	22.3	21.9	22.4	
FSR central scenario + SEU	24.1	21.8	21.6	22.3	21.9	22.4	
November forecast	23.8	16.8	17.7	19.3	18.9	19.3	19.9
Change since March	**-0.3**	**-5.5**	**-3.9**	**-3.0**	**-3.1**	**-3.0**	
Change since FSR central + SEU	**-0.3**	**-5.0**	**-3.9**	**-3.0**	**-3.1**	**-3.0**	
	Underlying forecast changes since FSR central + SEU						
Total	**-0.3**	**-5.2**	**-4.0**	**-3.0**	**-3.0**	**-3.0**	
of which:							
Prudential borrowing (non-TfL)	0.0	-5.0	-3.3	-2.7	-2.4	-2.1	
Major repairs reserve and capital receipts from sales	-0.5	-1.6	-1.1	-0.8	-0.9	-1.0	
Less asset sales	0.0	1.4	1.2	0.9	0.7	0.5	
TfL capital spending	-0.1	-0.1	0.2	0.0	0.0	0.0	
Other	0.2	0.1	-0.9	-0.4	-0.4	-0.4	
	Effect of Government decisions since FSR central + SEU						
Total		**0.1**	**0.0**	**0.0**	**0.0**	**-0.1**	**-0.1**

Central government debt interest

3.120 Having fallen sharply in 2020-21 thanks to the drop in short-term interest rates and expansion of quantitative easing, central government debt interest (net of the savings associated with quantitative easing) falls further in 2021-22 due to low RPI inflation. It then increases steadily thereafter. Relative to our March forecast, debt interest spending is down by £13.8 billion a year on average – and by more than half in 2021-22. With inflation, interest rates and quantitative easing all lowering spending, it is only the cost of financing much higher borrowing that pushes in the opposite direction. But with interest rates on new borrowing so low, that effect is only modest

3.121 Relative to our *FSR* central scenario, debt interest net of the APF has been revised down from 2021-22 onwards, thanks in particular to lower inflation and further increases in quantitative easing. These more than offset the effect of modestly higher interest rates and an upward revision to financing needs.

Table 3.21: Central government debt interest net of the APF: differences from March and *FSR* central scenario

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	34.5	37.8	37.9	37.3	36.8	
FSR central scenario + SEU	20.6	23.4	28.6	29.2	29.5	
November forecast	23.5	17.6	21.2	25.5	27.3	29.0
Change since March	**-11.0**	**-20.2**	**-16.7**	**-11.8**	**-9.5**	
Change since FSR central scenario +SEU	**2.9**	**-5.8**	**-7.5**	**-3.6**	**-2.2**	
of which:						
Interest rates	0.8	-0.2	0.2	0.5	0.9	
Inflation	1.7	-4.0	-5.7	-2.3	-1.2	
Financing	0.1	0.2	0.4	0.6	0.5	
Asset Purchase Facility	0.2	-1.4	-2.1	-1.8	-1.2	
Other factors	0.0	-0.3	-0.2	-0.6	-1.2	

Public sector pensions

3.122 Spending on public sector pensions consists of:

- Net public service pension payments by **unfunded public sector pension schemes**, which include central government pay-as-you-go schemes and locally administered police and firefighters' schemes.[14] Our forecast covers gross expenditure on pensions in payment, less employer and employee contributions received. (The corresponding spending by departments on employer contributions is included in RDEL.) A breakdown of spending and income for the major schemes we cover can be found in the supplementary tables on our website.

[14] The police and firefighters' pension schemes are administered at a local level, but pensions in payment are funded from AME, along with other public service pension schemes. They are therefore included in our pensions forecast.

- **Funded public sector pension schemes**, which are classified as public corporations in the public sector finances. This includes funded schemes with largely public sector members (notably the Local Government Pension Scheme), and also the Pension Protection Fund (PPF) and the National Employment Savings Trust (NEST).[15]

3.123 Net public service pension payments in 2020-21 are £1.3 billion lower than in our *FSR* central scenario before accounting for the effect of Government decisions, largely due to an increase in contributions from a larger NHS pensionable paybill in response to the pandemic. (The cost of this in terms of higher future pension costs will be felt beyond the forecast horizon.) Gross expenditure is lower throughout the forecast due to revised retirement assumptions for the NHS pension scheme and the continued decline in the average age of teachers' pension scheme members. This is offset in the later years of the forecast by weaker pre-measures paybill growth in other schemes.

3.124 Despite higher near-term RDEL spending being announced in the Spending Review, this adds only £1.5 billion on average to pension scheme income this year and next due to it being heavily skewed towards procurement (for example, the millions of coronavirus tests being carried out each month). Lower RDEL spending from 2022-23 onwards has the opposite effect, lowering scheme income and raising net spending by £0.6 billion a year.

3.125 Our forecast for funded public sector pensions reflects offsetting changes. The latest ONS outturn, which incorporates more recent valuation results for schemes, reduces expenditure and income by an average of £1.4 billion and £0.3 billion a year respectively over the forecast. Taking into account information from the PPF, we have revised our assessment of spending in respect of the liabilities of insolvent firms' pension schemes. This has increased capital spending relative to our *FSR* central scenario by increasing amounts until 2022-23, peaking at £1.6 billion in that year and falling to £0.8 billion by the end of the forecast. The scale and timing of insolvencies of firms with eligible pension schemes remains highly uncertain, although the impact on the public sector finances is likely to be lagged.

Student loans

3.126 When student loans are issued, the public finances record an amount of spending equal to the expected portion of the loan that will ultimately not be repaid. This spending rises from £10.2 billion in 2019-20 to £13.2 billion in 2025-26 thanks to growth in student numbers and to tuition fees and loans rising in line with the RPIX measure of inflation.

3.127 Differences from our *FSR* central scenario are small. Revisions relative to our March 2020 forecast reflect changes in economic determinants since March and new assumptions on student numbers, as a larger proportion of school leavers have delayed their entry into the job market in the current academic year, and this is expected to persist in future.

3.128 Our forecast also includes the effect of policy changes, such as the tuition fees freeze for the 2021-22 academic year and the simultaneous removal of EU student finance. Both policies are expected to reduce spending slightly compared to our pre-measures forecast.

[15] See our *Restated March 2019 forecast* for more detail on the impact of these schemes in the public finances.

Other AME

3.129 The main changes to other AME spending items include:

- Spending on the **EU financial settlement** is up by £1 billion in 2020-21 as higher EU spending and changes to the UK rebate feed through mechanically to the UK's contribution. It is little changed thereafter.

- Spending on **company tax credits** is up £2.6 billion a year relative to the *FSR* central scenario, but only up £1.1 billion a year relative to our March forecast. Early data suggest that the value of research and development (R&D) claims from smaller firms continued to rise sharply in 2018-19 – and has now grown by around 30 per cent a year on average over the past four years. R&D claims from large companies also showed sharp growth on a year earlier. Rising take-up (as opposed to larger average claims) is the most likely driver of the surge in spending. We assume that strong growth will persist, but at a diminishing rate over the forecast period.

- **General government depreciation** is up by £3.8 billion a year on average, mostly due to changes in how the ONS estimates depreciation.

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

Deficit aggregates

3.130 Our central forecast for the Government's budget deficit, public sector net borrowing, is the difference between the forecasts for receipts and expenditure set out earlier in this chapter. In this section we discuss the path of borrowing and how it has changed since our March forecast and our *FSR* central scenario. We also consider other deficit and expenditure aggregates including cyclically adjusted borrowing, the current budget balance, the cyclically adjusted current budget balance and public sector net investment that feature in the Government's array of fiscal objectives.

Public sector net borrowing

The deficit in 2020-21

3.131 Our central forecast for the deficit in 2020-21 is £394 billion, up £21 billion from our *FSR* central scenario plus the impact of measures announced in the SEU. It is £339 billion or seven times higher than the £54.8 billion we expected back in March, before the effect of any virus-related policy measures had been incorporated or any but the most minor virus-related effects on the economy factored in. At 19 per cent of GDP, borrowing in 2020-21 is set to be almost double the previous peacetime record of 10.1 per cent in 2009-10 immediately after the financial crisis, and to approach the wartime peaks of 27 per cent of GDP in 1941-42 and 28 per cent of GDP in 1916-17.

3.132 Chart 3.12 shows the factors that have contributed to the increase in borrowing in 2020-21 relative to the pre-virus starting point of our March 2020 forecast:

- **Our July *FSR* central scenario estimated that the effect of the virus and public health restrictions on the economy would add £125 billion to borrowing**, before accounting for new policy measures announced since the Budget. This reflected the damage to almost all sources of receipts from first wave of infections and the initial lockdown, plus somewhat smaller increases in welfare spending. These sources of higher borrowing were offset in part by lower debt interest spending as interest rates fell to historic lows and the Bank undertook more quantitative easing.

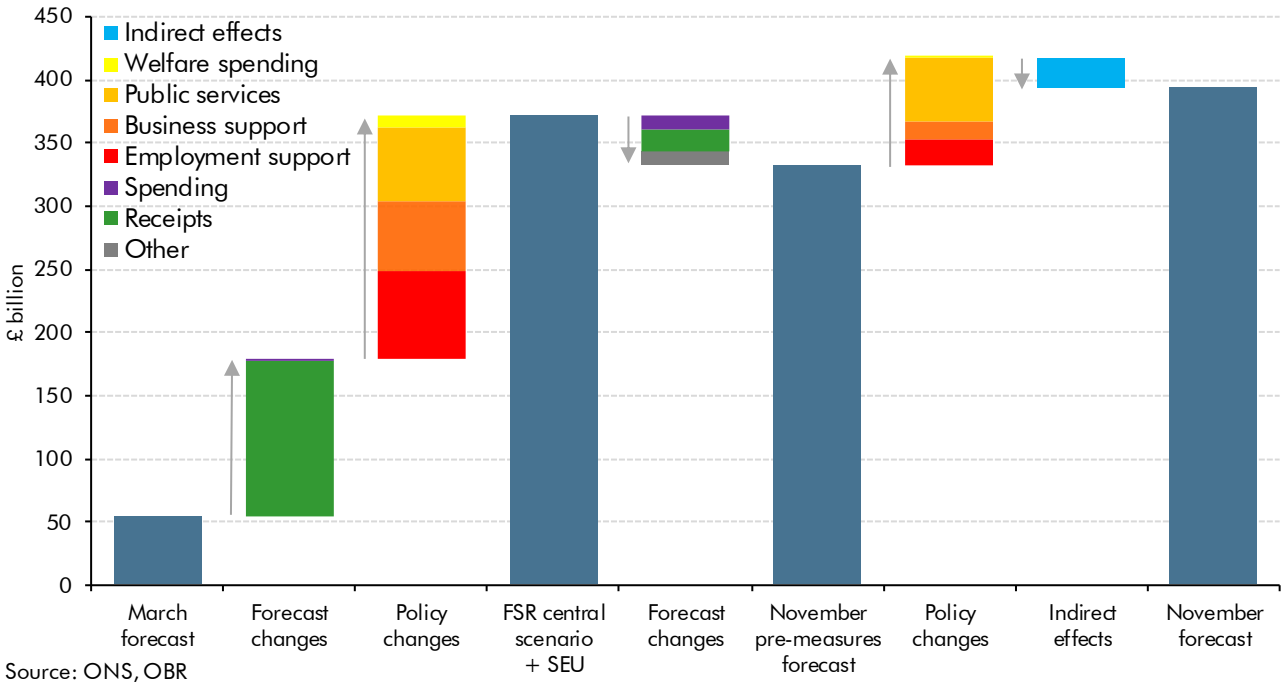
- **Virus-related policy measures announced up to and including the SEU added a further £192 billion to borrowing**, with tens of billions allocated to health services, employment and income support measures, business rates holidays and business grants, and the upfront costs of expected calls on government-guaranteed lending. This left our *FSR* central scenario for borrowing (plus SEU measures) at £372 billion.

- Output rebounded more quickly through the summer than assumed in our *FSR* scenarios, boosting receipts, while welfare spending increased less sharply. The furlough scheme also cost less than expected in the period up to October owing to the number of claims falling faster than expected. So, **in our latest pre-measures forecast, we have revised borrowing down by £40 billion relative to the *FSR* (including SEU measures)**. This gives a pre-measures borrowing forecast in this *EFO* of £332 billion.

- **Virus-related measures announced since the SEU have added a further £86 billion to borrowing**. This includes a further £64 billion for public services, £21 billion in employment support (including the extension of the CJRS and SEISS), and £6 billion for business support. The indirect fiscal effects of these measures via the economy lowers borrowing by £24 billion, largely due to higher receipts associated with a higher path for nominal GDP. (We do not estimate the indirect effect of all measures announced since March as we do not consider it possible to produce a meaningful pre-measures counterfactual.)

- Taking all forecast and policy changes since March into account **leaves our November borrowing forecast at £394 billion**, £339 billion higher than we forecast in March.

Chart 3.12: Changes in net borrowing in 2020-21

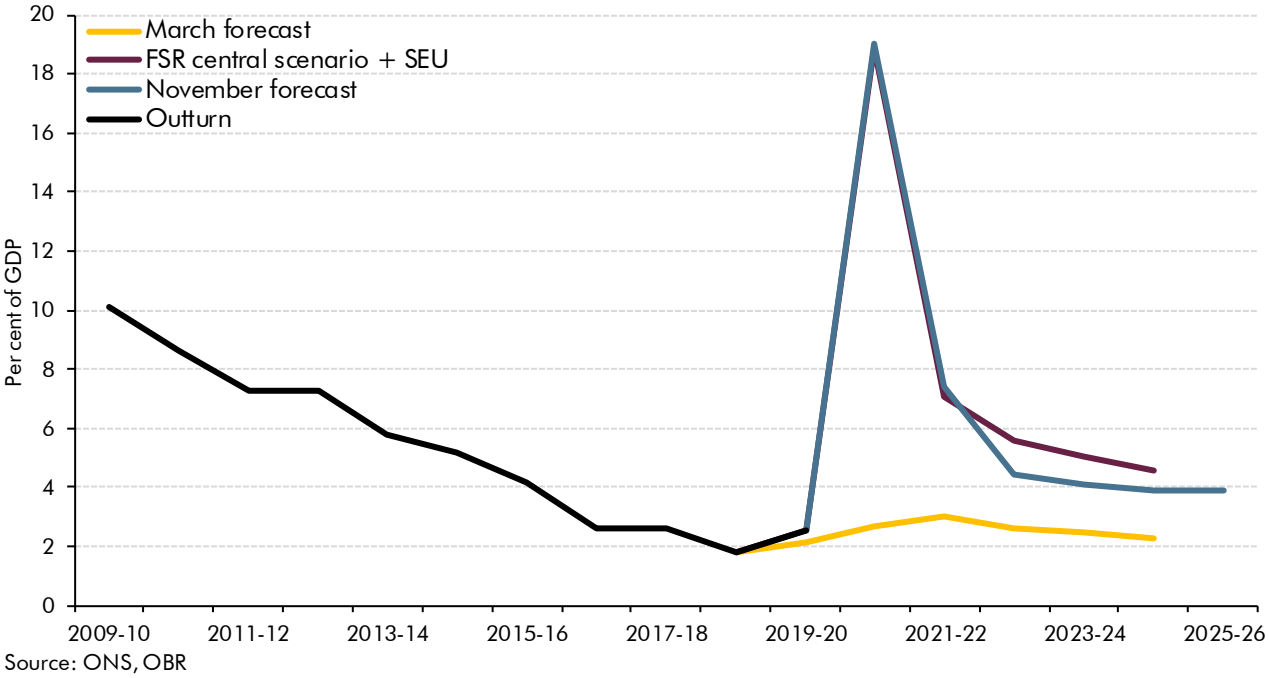


Source: ONS, OBR

Medium-term forecast

3.133 Borrowing declines sharply in 2021-22 to a still historically high £164 billion (7.4 per cent of GDP) as activity recovers and much of the temporary fiscal support expires, but is lifted by the additional £54 billion of virus-related public spending announced in the Spending Review. Borrowing continues to fall more gradually thereafter to reach £102billion (3.9 per cent of GDP) in 2025-26. Despite this decline, borrowing at the forecast horizon remains £46 billion (1.3 per cent of GDP) higher than in 2019-20. This is a consequence of the 3 per cent 'scarring' of potential output described in Chapter 2, which leaves both GDP and receipts on permanently lower paths. Consequently, spending in the medium term, though lower in cash terms, is higher as a share of GDP than in our pre-virus forecast, so contributes to borrowing being higher as a share of GDP.

Chart 3.13: Public sector net borrowing



Source: ONS, OBR

Sources of difference between our latest forecast and the *FSR* central scenario

3.134 Relative to our *FSR* central scenario plus the SEU measures, the £21 billion upward revision to borrowing in 2020-21 described above eases to a £8 billion upward revision in 2021-22. Beyond that, borrowing has been revised down by £22 billion a year on average. Table 3.22 lays out the contributions of different factors to these revisions, splitting them into those that relate to underlying forecast revisions and those due to new policy measures.

3.135 Underlying revisions lower borrowing in earlier years relative to the *FSR*, but leave it little changed by 2024-25. The large downward revision to pre-measures borrowing in 2020-21 diminishes rapidly in 2021-22 and 2022-23 as our latest economy forecast converges on the *FSR* central scenario. As Table 3.22 shows, on a pre-measures basis:

- **Receipts** are £17 billion above the *FSR* scenario in 2020-21, and £7 billion above it on average over the subsequent four years. Most taxes outperformed our *FSR* expectations through the summer as activity bounced back more quickly than assumed, but with output now expected to fall back during the second lockdown, that outperformance of receipts is expected to diminish too. The modest improvement in the medium term is largely explained by corporation tax and VAT, reflecting a stronger outlook for profits and household consumption.

- **Welfare spending** has been revised down by £13 billion in 2020-21 and by diminishing amounts thereafter. This largely reflects the lower path for unemployment and for spending on universal credit.

- **Other spending** has been revised down in the near term but is higher by the forecast horizon. Debt interest spending is lower in most years thanks to additional savings

associated with further quantitative easing, plus a lower path for RPI inflation. The rise in later years reflects changes in depreciation costs.

- Our latest estimates of the **cost of previously announced measures** leaves borrowing lower in 2020-21. Lower CJRS costs up to October dominate in 2020-21.

3.136 The direct effect of Government decisions announced since the SEU, including those announced in the Spending Review alongside this *EFO*, is to raise borrowing significantly in 2020-21 and 2021-22, but to reduce it from 2022-23 onwards. This profile is dominated by changes to departmental spending, and by the extension of the CJRS this year. As regards the former, the £64 billion in virus-related spending this year and £54 billion next year overlay what in normal times would be relatively large cuts in 'business-as-usual' departmental spending next year relative to the totals that were set out in March. The Treasury has locked these in to future years so that departmental spending is on a lower path than in our March forecast in the years beyond the Spending Review. As discussed earlier in the chapter, several pressures point to these totals being subject to policy risk. The indirect fiscal effects of measures announced since the SEU lower borrowing materially in the short term, largely via their effects on receipts due to the higher path of nominal GDP.

Table 3.22: Changes to public sector net borrowing

	£ billion						
	Outturn	Forecast					
	2019-20[1]	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	**47.2**	**54.8**	**66.6**	**61.5**	**60.2**	**57.9**	
Underlying revisions	5.8	125.0	89.1	69.1	61.7	57.1	
Policy changes	3.6	142.2	-2.0	1.5	1.4	0.9	
FSR central scenario	**56.6**	**322.0**	**153.7**	**132.0**	**123.3**	**116.0**	
SEU measures	-	50.2	2.0	-1.3	0.0	0.0	
FSR central + SEU	**56.6**	**372.2**	**155.8**	**130.8**	**123.3**	**115.9**	
Change since FSR central + SEU	**-0.6**	**21.4**	**8.5**	**-26.2**	**-22.9**	**-16.4**	
of which:							
Underlying differences[2]	1.8	-28.8	-11.6	-15.3	-7.5	-0.7	
of which:							
Receipts	-3.0	-16.6	5.2	-9.0	-9.0	-5.4	
Welfare	3.1	-13.0	-8.3	-3.4	-1.9	-1.3	
Other spending	1.7	0.9	-8.5	-2.9	3.5	6.0	
Recosting previous measures[3]	-2.4	-11.5	3.7	0.8	-0.3	0.1	
New policy measures[4]		85.7	39.5	-12.0	-16.3	-17.1	-16.5
of which:							
Public services (virus related)[5]		64.2	54.0	-0.3	-0.3	0.0	0.0
Public services (non-virus related)		-2.8	-9.9	-10.9	-12.4	-12.9	-12.2
Employment support[5]		21.1	-0.9	0.0	0.0	0.0	0.0
Business support[5]		6.0	-4.6	0.9	0.0	0.1	0.1
Loans and guarantees[5]		7.3	0.0	0.0	0.0	0.0	0.0
Welfare spending[5]		0.1	0.2	0.0	-0.3	-0.5	-0.7
Other tax measures[5]		0.4	0.1	0.1	0.1	0.1	0.1
Brexit measures		0.1	0.2	-0.3	-0.6	-0.6	-0.6
Other policy measures		-10.7	0.3	-1.7	-2.9	-3.2	-3.2
Indirect effects of decisions		-24.0	-23.2	0.3	1.2	1.3	1.6
November forecast	**56.1**	**393.5**	**164.2**	**104.6**	**100.4**	**99.6**	**101.8**
Change since March forecast	**8.8**	**338.8**	**97.6**	**43.1**	**40.2**	**41.7**	

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] Includes updates for outturn. Totals may not sum due to these updates.
[2] Includes classification changes.
[3] Updates to estimates of the cost of FSR and SEU measures as part of the standard policy costing process.
[4] The change in 2025-26 is relative to a baseline that assumes DEL would otherwise have remained constant as a share of GDP.
[5] Reflects virus related measures.

Box 3.2: International comparison of change in fiscal positions

The coronavirus pandemic has had severe economic and fiscal consequences for countries around the world. National lockdowns and other restrictions on individual and business activity have resulted in recessions in all major economies. Having considered the global economic impact of the pandemic in Chapter 2, here we consider its immediate and longer-term fiscal impacts across major countries (the G7 plus Spain and South Korea). As the latest data is drawn from the IMF's October 2020 *Fiscal Monitor* and *World Economic Outlook (WEO)*, it does not

fully incorporate the consequences of the second wave of infections, further lockdowns, and the extension of fiscal support in these countries.

The IMF predicts the UK to see the second largest year-on-year rise in its primary deficit (revenue minus non-interest spending) in 2020 (Chart B, top left panel). Unlike during the financial crisis, the bulk of this fiscal deterioration comes not from the deterioration in the economy (the non-discretionary element) but from governments' policy responses (the discretionary element). These discretionary policy responses have tended to be larger in countries like the UK, US, and Canada, with less generous welfare systems, compared with countries like Italy, Spain, and France, which have more generous social insurance systems. The increase in claims on these systems during the pandemic are therefore classed as part of the operation of the non-discretionary automatic stabilisers, rather than as discretionary policy as in the case of the UK's CJRS or the increase in payments to the unemployed in the US.

The top-right panel shows the IMF's estimates for the size of those fiscal policy responses, split by direct tax and spending measures (such as the CJRS, increases to UC, and grants to business in the UK) and liquidity support to firms and individuals, in the form of loans or guarantees (such as the government guaranteed loan schemes in the UK). The policy response to this crisis has also been exceptional in the scale and scope of the latter form of 'off balance sheet' support, much of which is not recorded in the conventional measures of government deficits and debts. The UK ranks in the middle in both the size of its overall policy response and the split between direct and liquidity support. Germany's programme of liquidity support stands out as it includes their Economy Stabilisation Fund, which offers up to €600 billion in guarantees, loans, and equity injections to firms that suffered a significant economic impact from the virus. Estimates of liquidity support are less comparable than direct tax and spend policies, as the ceilings on schemes can be many times actual take-up.

The middle-left panel shows the revision in the IMF's estimates of structural deficits in 2024 between its October 2019 and October 2020 *WEO*s. On this measure the UK has suffered a larger hit to its fiscal position in the medium term, with the structural deficit revised up by 3.5 percentage points. Even stripping out our estimate of the pre-virus fiscal loosening in the March Budget, the UK remains the hardest hit fiscally by the pandemic. This partly reflects the IMF's assumption that the UK economy will suffer greater scarring than these other countries.

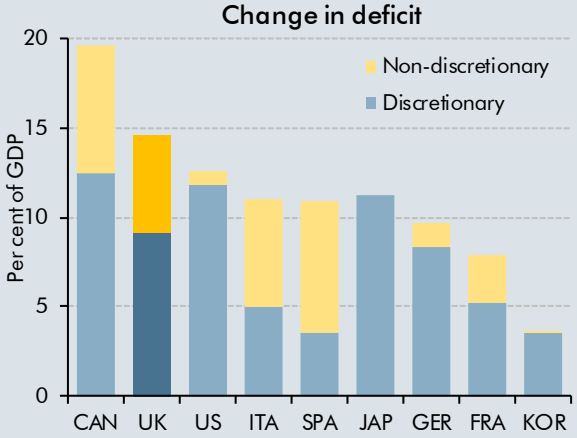
The middle-right panel shows the revision in the IMF's estimates of general government net debt in 2024 between its October 2019 and October 2020 *WEO*s. Unsurprisingly, even after adjusting for the March fiscal loosening, the UK also experiences the largest increase in its debt-to-GDP ratio, owing to its relatively large and persistent deficits over this period.

The bottom-left panel shows the IMF's estimates for the structural deficits countries will be left with in 2024, with the UK projected to have one of the highest. It is second only to the US, which was expected to run a large fiscal deficit prior to the pandemic. Only Germany is set to return to a budget surplus by 2024, reflecting the strong fiscal position it held entering the crisis and the relatively rapid recovery in its economic activity following the first wave of the pandemic.

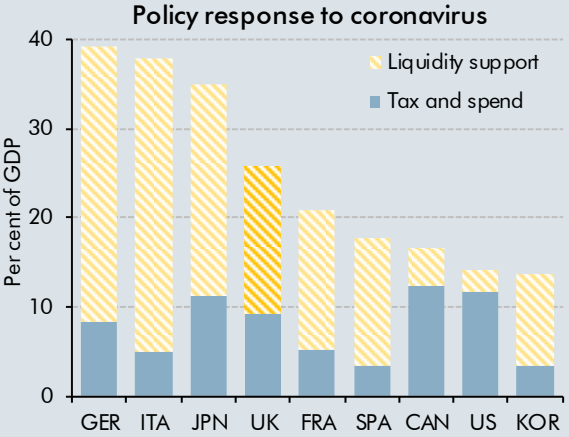
The bottom-right panel shows the IMF's latest forecasts for net debt in 2024. They suggest that the UK can expect to see net debt remain above 100 per cent of GDP in 2024. Only Germany,

Canada and Korea are projected to keep net debt well below this level, reflecting lower debt going into the crisis and the more rapid economic and fiscal recovery after the first wave.

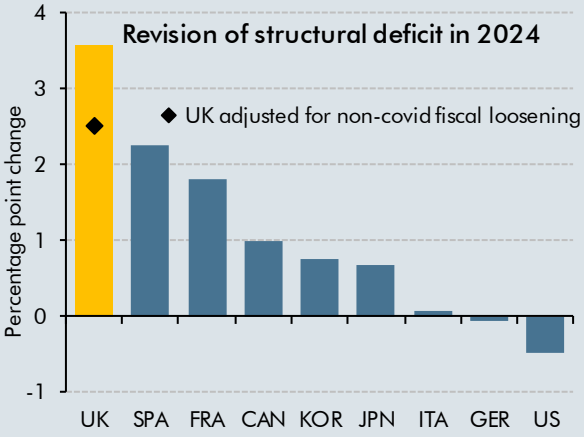
Chart B: Fiscal aggregates and policy response



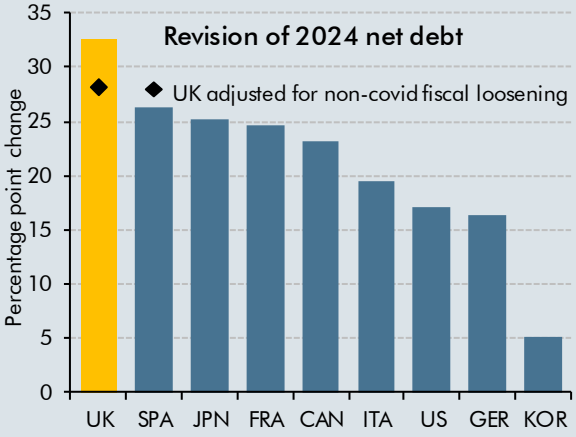
Note: Change in primary net borrowing between 2019 and 2020.



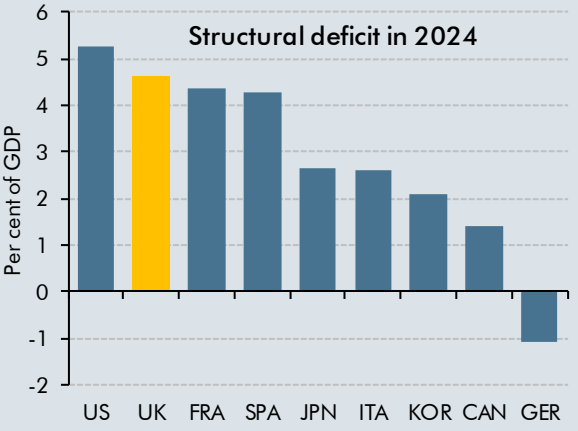
Note: Direct cost in 2020 calendar year.



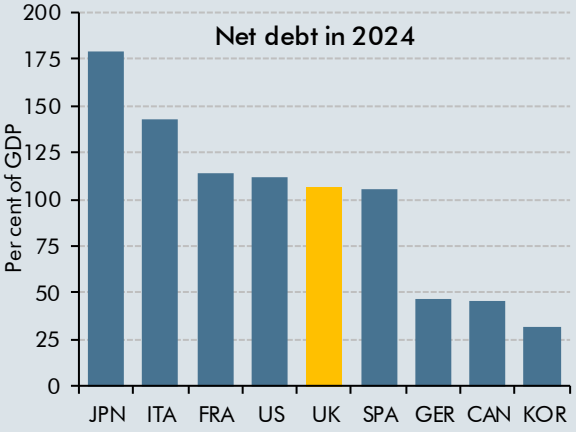
Note: WEO revisions between October 2019 and 2020 publication.



Note: WEO revisions between October 2019 and 2020 publication.



Note: Projections for government net borrowing.
Source: IMF



Note: Projected net debt by 2024.

Other fiscal aggregates

3.137 **Cyclically adjusted public sector net borrowing (CAPSNB)** removes the impact of the economic cycle in order to give a picture of underlying or 'structural' borrowing. In effect, it estimates the level of borrowing if the output gap were zero. But, as explained in Chapter 2, the output gap is a somewhat problematic concept at the current juncture, while applying a cyclical correction based on the output gap alone fails to recognise the large but temporary downward effect on potential output as a result of the public health measures necessary to control the virus. Mechanically applying the estimates of the output gap in Chapter 2 gives a CAPSNB of £384 billion (18.6 per cent of GDP) in 2020-21, just £9 billion shy of the corresponding headline figure. A large part of that cyclically-adjusted deficit can, though, be expected to disappear automatically once the restrictive public health measures are eased and activity rebounds. By 2025-26, CAPSNB converges to within £1.4 billion of PSNB as the economy recovers and the output gap closes over the forecast.

3.138 The **current budget balance** is the difference between receipts and public sector current expenditure each year and is equal to PSNB excluding borrowing to finance net investment in fixed capital. The current budget deficit this year is expected to be £312 billion (15 per cent of GDP), reflecting weak receipts and the huge spike in virus-related spending. In 2021-22 it falls sharply to £102 billion as most virus-related measures expire, and it continues to fall as receipts further recover and business-as-usual departmental spending is reduced. We expect the relative fall in the current budget deficit slightly to outpace that of PSNB as most of the improvement in borrowing relates to current spending.

3.139 The **cyclically adjusted current budget (CACB)** is the current budget we would expect to see if the output gap were zero, so is subject to the same estimation issues as the CAPSNB. It rises sharply this year, but by less than the headline deficit, before falling over the next two years to £24 billion in 2022-23. Conversely, it then rises slightly over the rest of the forecast, leaving the CACB deficit at £26 billion in 2025-26.

3.140 **Public sector net investment (PSNI)** is the difference between gross capital spending and depreciation and represents the change, in cash terms, of the public sector's net capital stock. From 2010-11 to 2019-20, PSNI hovered around 2 per cent of GDP but is expected to rise to 4 per cent in 2020-21 (boosted by the upfront cost of expected future calls on government guaranteed loans) and to remain just below 3 per cent for the rest of the forecast (as is required by the Government's PSNI rule).

Balance sheet aggregates

Generating our balance sheet forecasts

3.141 We forecast several measures of the public sector balance sheet to help understand the sustainability of the public finances. For more than two decades, the Government's headline balance sheet measure has been public sector net debt (PSND). PSND is the stock equivalent of the public sector net cash requirement (PSNCR) and captures those financial liabilities recognised as 'Maastricht debt liabilities' (a narrower measure than all financial

liabilities) and those financial assets held by public entities that are deemed to be 'liquid' (i.e. that could be sold readily and quickly for cash). Starting from our forecast for the accrued measure of the deficit (PSNB) we produce forecasts of changes in the cash level of PSND (largely a cash measure) in three steps:

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

- Second, we forecast the other **financial transactions** that do not contribute to PSNB (the deficit on an accrued basis) but do increase or reduce the government's cash needs. These include loans and repayments between the public and private sectors, sales or purchases of financial assets, and Bank of England schemes. These are then added to the measure of borrowing to arrive at an estimate of PSNCR.

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

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

Year-on-year change in PSND

3.143 Headline PSND rises by over £470 billion in 2020-21, taking it above 100 per cent of GDP for the first time since 1960-61. Thereafter it increases by at least £100 billion in every year but 2024-25, when repayment of loans under the Bank of England's Term Funding Scheme (TFS) reduce debt.

3.144 Increases in net debt are largely driven by the elevated path for net borrowing. Financial transactions push debt higher in the years to 2023-24, but then reduce it in the final two years as large amounts of TFS loans are repaid. Valuation effects are smaller and uneven. This is set out in Table 3.23.

3.145 Debt rises more quickly in the first two years of our forecast relative to the *FSR* thanks to both higher borrowing and more financial transactions (especially those related to Bank of England schemes). Thereafter debt rises more slowly as lower borrowing outweighs further increases in financial transactions. These changes are detailed in Table 3.25.

Table 3.23: Sources of year-on-year changes in public sector net debt

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Year-on-year change in PSND (a+b+c+d)	**473.4**	**204.6**	**123.8**	**118.7**	**-6.8**	**102.6**
Public sector net borrowing (a)	**393.5**	**164.2**	**104.6**	**100.4**	**99.6**	**101.8**
Financial transactions (b)	**66.8**	**43.3**	**29.1**	**16.3**	**-97.2**	**-1.1**
of which:						
DEL net lending	**4.6**	**3.7**	**3.4**	**2.0**	**2.0**	**2.0**
Help to Buy outlays	2.5	1.8	2.3			
Devolved administrations	0.5					
Other DEL	5.7	2.8				
DEL beyond current Spending Review			1.8	2.6	2.6	2.6
Allowance for shortfall	-4.1	-0.9	-0.6	-0.6	-0.6	-0.6
Other government net lending	**8.8**	**7.8**	**8.7**	**7.1**	**6.2**	**5.9**
Student loan outlays[1]	9.4	9.6	9.9	10.2	10.7	11.2
Student loan repayments[2]	-2.7	-3.0	-3.4	-3.9	-4.4	-5.0
Scottish Government	0.6	0.5	0.6	0.3	0.3	0.3
UK Export Finance	1.3	1.3	1.1	1.0	0.4	0.0
Other AME	1.2	1.0	2.5	1.6	1.5	1.5
Help to Buy repayments	-1.0	-1.7	-1.9	-2.1	-2.3	-2.1
Sales or purchases of financial assets	**-5.3**	**-3.3**	**-2.8**	**-3.1**	**-2.8**	**0.0**
NatWest Group	0.0	-2.8	-2.8	-2.8	-2.8	0.0
UKAR asset sales and rundown	-4.4	-0.5	0.0	-0.3	0.0	0.0
Other sales	-0.9	0.0	0.0	0.0	0.0	0.0
Bank of England schemes	**54.7**	**30.2**	**0.1**	**1.7**	**-117.1**	**-16.8**
Term funding scheme	42.9	20.0	0.0	0.0	-125.0	-20.0
Other effects	11.7	10.2	0.1	1.7	7.9	3.2
Cash flow timing effects	**4.0**	**4.9**	**19.8**	**8.6**	**14.4**	**7.8**
Student loan interest[2]	2.5	2.4	2.3	3.1	4.2	5.0
Corporation tax	0.3	4.3	4.5	1.9	1.7	1.9
Other receipts	21.6	-15.9	4.1	5.2	5.7	5.5
Funded public pension schemes	-2.0	-2.2	-2.9	-2.1	-1.5	-0.9
Index-linked gilt uplift[3]	4.5	-5.2	-3.4	-9.7	-4.5	-11.3
Other gilt accruals	6.6	8.2	8.5	9.1	9.7	9.7
Guarantee schemes write offs	-27.5	15.0	8.9	3.5	1.5	0.2
Other expenditure	-2.0	-1.7	-2.2	-2.3	-2.3	-2.3
Public sector net cash requirement (a+b)	*460.3*	*207.6*	*133.7*	*116.7*	*2.3*	*100.7*
Valuation effects (c)	**13.0**	**-3.0**	**-10.0**	**2.1**	**-9.2**	**1.8**
of which:						
Gilt premia	-34.4	-17.0	-14.2	-8.6	-9.9	-10.2
Asset Purchase Facility gilt premia	58.7	8.8	0.8	0.9	-3.8	0.6
Index-linked gilts uplift[3]	-4.5	5.2	3.4	9.7	4.5	11.3
International reserves	-6.8	0.0	0.0	0.0	0.0	0.0
ONS statistical changes (d)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

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

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

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

Table 3.24: Public sector net debt profile: changes since March 2020

	£ billion				
	Forecast				
	2020-21	2021-22	2022-23	2023-24	2024-25
Year-on-year change in PSND (a+b+c+d)	**454.0**	**195.6**	**51.3**	**49.5**	**-69.0**
Public sector net borrowing (a)	**338.8**	**97.6**	**43.1**	**40.2**	**41.7**
Financial transactions (b)	**96.3**	**103.7**	**18.4**	**10.0**	**-110.1**
of which:					
DEL net lending	**-1.4**	**-0.6**	**-1.1**	**0.0**	**0.0**
Help to Buy outlays	-1.4	-0.4	-0.2		
Devolved administrations	0.0				
Other DEL	3.7	0.2			
DEL beyond current Spending Review			-0.9	0.0	0.0
Allowance for shortfall	-3.8	-0.3	0.0	0.0	0.0
Other government net lending	**2.0**	**0.6**	**1.7**	**1.6**	**1.3**
Student loan outlays[1]	-0.3	-0.4	-0.6	-0.8	-0.9
Student loan repayments[2]	1.0	1.2	1.2	1.1	1.0
Scottish Government	-0.2	-0.3	-0.3	-0.6	-0.6
UK Export Finance	-0.6	-0.1	-0.2	0.5	0.2
Other AME	1.5	-0.1	1.1	0.9	1.1
Help to Buy repayments	0.5	0.3	0.5	0.5	0.5
Sales or purchases of financial assets	**5.3**	**0.2**	**1.3**	**0.5**	**0.5**
NatWest Group	3.8	0.8	1.4	0.5	0.5
UKAR asset sales and rundown	1.1	-0.5	0.0	0.0	0.0
Other sales	0.4	0.0	0.0	0.0	0.0
Bank of England schemes	**98.3**	**93.6**	**0.1**	**1.7**	**-117.1**
Term funding scheme	86.6	83.4	0.0	0.0	-125.0
Other effects	11.7	10.2	0.1	1.7	7.9
Cash flow timing effects	**-7.9**	**9.8**	**16.4**	**6.2**	**5.2**
Student loan interest[2]	-0.4	-0.8	-1.6	-1.4	-0.7
Corporation tax	1.1	1.8	2.7	0.3	0.1
Other receipts	14.7	-21.2	0.1	0.7	1.4
Funded public pension schemes	-0.2	-0.2	-0.9	-0.1	0.6
Index-linked gilt uplift[3]	4.0	8.7	3.6	-0.3	-1.6
Other gilt accruals	2.0	3.8	3.5	3.7	4.0
Guarantee schemes write offs	-27.5	15.0	8.9	3.5	1.5
Other expenditure	-1.5	2.7	0.1	-0.1	-0.1
Public sector net cash requirement (a+b)	*435.1*	*201.2*	*61.5*	*50.1*	*-68.4*
Valuation effects (c)	**18.9**	**-5.6**	**-10.2**	**-0.6**	**-0.6**
of which:	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Gilt premia	-25.9	-9.0	-6.6	-1.5	-1.3
Asset Purchase Facility gilt premia	57.2	12.0	0.0	0.4	-0.9
Index-linked gilts uplift[3]	-4.0	-8.7	-3.6	0.3	1.6
International reserves	-8.4	0.1	0.1	0.1	0.1
ONS statistical changes (d)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

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

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

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

Table 3.25: Public sector net debt profile: differences from *FSR* central scenario

	£ billion				
	Forecast				
	2020-21	2021-22	2022-23	2023-24	2024-25
Year-on-year change in PSND (a+b+c+d)	**24.6**	**46.7**	**-11.4**	**-13.4**	**-9.1**
Public sector net borrowing (a)	**21.4**	**8.5**	**-26.2**	**-22.9**	**-16.4**
Financial transactions (b)	**5.6**	**31.0**	**21.8**	**7.7**	**4.8**
of which:					
DEL net lending	**0.3**	**0.6**	**-0.3**	**0.0**	**0.0**
Help to Buy outlays	0.4	0.8	0.6		
Devolved administrations	0.0				
Other DEL	3.7	0.2			
DEL beyond current Spending Review			-0.9	0.0	0.0
Allowance for shortfall	-3.8	-0.3	0.0	0.0	0.0
Other government net lending	**1.9**	**0.4**	**1.6**	**1.5**	**1.3**
Student loan outlays[1]	-0.3	-0.3	-0.5	-0.7	-0.8
Student loan repayments[2]	1.0	1.2	1.2	1.1	1.0
Scottish Government	-0.2	-0.3	-0.3	-0.6	-0.6
UK Export Finance	-0.6	-0.1	-0.2	0.5	0.2
Other AME	1.5	-0.1	1.1	0.9	1.1
Help to Buy repayments	0.4	0.0	0.3	0.3	0.4
Sales or purchases of financial assets	**-5.3**	**-3.3**	**6.2**	**-1.0**	**-0.3**
NatWest Group	0.0	-2.8	-0.6	-0.7	-0.3
UKAR asset sales and rundown	-4.4	-0.5	5.5	-0.3	0.0
Other sales	-0.9	0.0	1.2	0.0	0.0
Bank of England schemes	**11.7**	**30.2**	**0.1**	**1.7**	**2.9**
Term funding scheme	0.0	20.0	0.0	0.0	0.0
Other effects	11.7	10.2	0.1	1.7	2.9
Cash flow timing effects	**-3.1**	**3.1**	**14.3**	**5.5**	**0.9**
Student loan interest[2]	-0.4	-0.8	-1.5	-1.3	-0.6
Corporation tax	4.9	0.6	1.5	-0.4	-1.0
Other receipts	13.0	-16.4	2.0	2.7	1.5
Funded public pension schemes	-0.2	-0.2	-0.9	-0.1	0.6
Index-linked gilt uplift[3]	-2.1	4.3	5.3	1.4	0.4
Other gilt accruals	0.4	0.9	1.1	1.1	0.9
Guarantee schemes write offs	-13.7	10.4	5.4	1.0	-0.2
Other expenditure	-5.1	4.4	1.3	1.2	-0.6
Public sector net cash requirement (a+b)	*27.0*	*39.5*	*-4.4*	*-15.2*	*-11.5*
Valuation effects (c)	**-2.5**	**7.2**	**-7.0**	**1.9**	**2.4**
of which:	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Gilt premia	-6.9	-0.8	-2.2	2.8	3.0
Asset Purchase Facility gilt premia	6.2	11.8	0.0	0.0	-0.7
Index-linked gilts uplift[3]	2.1	-4.3	-5.3	-1.4	-0.4
International reserves	-3.9	0.4	0.4	0.4	0.4
ONS statistical changes (d)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

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

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

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

Loans and repayments

3.146 Government net lending to the private sector generally declines over the forecast period, as the rising path in gross lending to students is increasingly offset by higher repayments in student loans and Help to Buy, while some other schemes' lending is also front-loaded. Relative to our *FSR* central scenario, the main changes include:

- The Government has increased financial transactions within DEL in 2020-21. A large portion of this has been allocated to the **Future Fund** and **lending to higher education.**
- We have increased our estimate of the **allowance for shortfall** in 2020-21 recognising the difficulty departments have had in distributing loans during the pandemic and an assessment that it is unlikely that new programmes will utilise all their allocations.
- Changes to **student loans** relate to student numbers and several policy measures. The effects of these largely offset resulting in small increases in financial transactions in the early years but small decreases by the end of the forecast.

Sales and purchases of financial assets

3.147 The Government plans to dispose of £17.3 billion of financial assets over the forecast period, with nearly two-thirds coming from sales of NatWest shares. The proceeds come earlier than in our *FSR* central scenario, which assumed all major sales included in our March forecast would be delayed by two years. The major financial asset sales affecting our latest forecast include:

- The Government has informed us that its policy in respect of the sale of its **shareholdings in NatWest Group** (as it is now called) remains as stated in Budget 2020: "*The government intends to fully dispose of its Royal Bank of Scotland shareholding, subject to market conditions and achieving value for money for taxpayers. The government expects the programme of sales to be completed by 2024-25.*" Consistent with our wider conditioning assumptions, we assume that sales can restart next year and that all shares can be sold by 2024-25. The NatWest share price was 138 pence on the 10 November, 38 per cent less than in the period used in our March forecast. The £11.2 billion raised between 2021-22 and 2024-25 in this forecast is therefore £6.9 billion less than assumed in March. The effect of share price movements on the direct cost of the financial interventions undertaken during the financial crisis in the late 2000s is summarised in Annex C.
- The £5.0 billion sale of **the remaining mortgage books of UKAR** (Northern Rock and Bradford & Bingley), which we expect to be largely completed this financial year.
- **Smaller sales**, including a £1.3 billion sale of mobile phone spectrum.
- The $500 million **purchase of OneWeb**. We assume that this is concluded in 2020-21 and that the ONS record this purely as a financial transaction. It could instead decide that some or all of the transaction represents a transfer from the public sector, which would then be recorded as spending in the year the transaction concludes.

Bank of England schemes

3.148 Loans issued under the Bank's two Term Funding Schemes and corporate bonds purchased as part of quantitative easing all add one-for-one to the level of headline PSND. We assume that all £107 billion of outstanding loans under the TFS that was launched in 2016 are repaid this year, but that drawings under this year's new TFSME[16] will total £150 billion in 2020-21 with a further £20 billion of drawings in 2021-22. We assume that £145 billion of TFSME loans will have four-year terms and so will be repaid later within the forecast period (with the remainder linked to BBLS loans and having a longer maturity).

3.149 So far in 2020-21, the Bank has purchased an additional £10.3 billion of corporate bonds. In November the MPC chose to maintain its target for the level of corporate bond purchases at £20 billion. Rolling over of redeeming gilts in the APF requires it to use some of its cash reserves to cover the difference between the gilts' original cash value and their redemption value. The reduction in these cash reserves can be large in some years and reaches in £10.2 billion in 2021-22.

Cash payments on guarantees and other timing effects

3.150 Abstracting from the uplift on index-linked gilts (for which there is an offsetting valuation effect), timing effects reduce debt in 2020-21 and increase it in all other years. This pattern is driven by expected calls on government guarantees of virus-related loan schemes. Our central forecast assumes that £29.5 billion will be written off over the lifetime of the loans, with this cost recorded in PSNB as the loans are issued (consistent with the provisional classification of these schemes by the ONS). The effect on PSND will be felt more gradually as the cash flows out to lenders when they call on the guarantees as borrowers default. The scale and timing of these effects is subject to very high uncertainty.

3.151 A large timing effect is caused by VAT deferrals, which leave accrued receipts largely unchanged but move around £15 billion of cash receipts from 2020-21 into 2021-22.

Public sector net debt

3.152 Debt rises to 105 per cent of GDP this year, then rises gently until the repayment of TFS loans brings it back down to around 105 per cent of GDP again in 2025-26. Relative to our March forecast, debt is around 30 per cent of GDP higher across all years. Relative to our *FSR* central scenario it is higher from 2021-22 onwards, as increases in the cash level of debt more than offset increases in nominal GDP (Table 3.26). Revisions to the pre-measures forecast reduce cash debt in all years, with lower borrowing only partially offset by increases in financial transactions (notably related to Bank of England schemes), but policy measures, particularly additional near-term virus-related spending, increase cumulative cash borrowing. The extension of the various guaranteed loan schemes adds to accrued borrowing in 2020-21, but only affects cash borrowing when the guarantees are called, hence the large negative financial transactions effect of Government decisions. Excluding the Bank of England, net debt rises to 91.9 per cent of GDP this year and then increases steadily each year to reach 97.5 per cent by 2025-26.

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

Table 3.26: Public sector net debt: differences from March and *FSR* central scenario

	Per cent of GDP						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	79.5	77.4	75.0	75.4	75.6	75.3	
FSR central scenario + SEU	88.5	106.5	105.9	106.9	108.2	104.0	
November forecast	85.5	105.2	108.0	108.6	109.4	105.0	104.7
Change since March	**6.0**	**27.7**	**33.0**	**33.1**	**33.8**	**29.7**	
Change since FSR + SEU	**-3.0**	**-1.3**	**2.2**	**1.7**	**1.2**	**0.9**	
of which:							
Change in nominal GDP[1]	-2.8	-2.2	-0.9	-0.7	-0.5	-0.3	
Change in cash level of net debt	-0.3	0.9	3.0	2.4	1.7	1.3	
	£ billion						
FSR central scenario + SEU	1,806	2,255	2,413	2,548	2,680	2,683	
November forecast	1,801	2,274	2,478	2,602	2,721	2,714	2,817
Change in cash debt	**-6**	**19**	**65**	**54**	**41**	**32**	
of which:							
Underlying forecast revisions	**-6**	**-50**	**-7**	**-9**	**-8**	**-1**	
Public sector net borrowing (pre-measures)		-40	-48	-63	-70	-71	
Financial transactions (pre-measures)		-8	40	59	67	72	
Valuation and classification changes	-6	-2	1	-6	-4	-2	
Effect of Government decisions		**69**	**72**	**63**	**48**	**33**	**18**
Affecting public sector net borrowing		62	78	66	51	35	20
Affecting financial transactions		7	-6	-3	-3	-3	-3

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

Central government net cash requirement

3.153 The central government net cash requirement (CGNCR) is a key determinant of the government's overall net financing requirement. Table 3.27 reconciles CGNCR with PSNCR by removing transactions associated with local authorities and public corporations. It also removes transactions relating to Bradford & Bingley (B&B), Northern Rock Asset Management (NRAM) and Network Rail, to produce 'CGNCR ex', which the Treasury uses as the basis for the Debt Management Office's financing remit.

3.154 PSNCR varies dramatically across the forecast period, from a high of nearly £460 billion this year to a low of £2.3 billion in 2024-25. But after removing the impacts of local authorities and public corporations (and in particular the TFS-related swings in the Bank of England's contribution to the measured cash requirement), CGNCR ex peaks at £403 billion in 2020-21 after which it reduces and is relatively more stable from 2022-23 onwards at between £110 billion and £130 billion a year. The peak in 2020-21 is £204 billion higher than the previous record cash deficit of £199 billion in 2009-10, when the fiscal costs of the financial crisis peaked.

Table 3.27: Reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector net cash requirement (NCR)	**460.3**	**207.6**	**133.7**	**116.7**	**2.3**	**100.7**
of which:						
Local authorities and public corporations NCR	59.8	30.1	2.4	3.8	-118.0	-19.7
Central government (CG) NCR own account	400.5	177.5	131.4	112.9	120.4	120.5
CGNCR own account	400.5	177.5	131.4	112.9	120.4	120.5
Net lending within the public sector	1.6	1.0	1.2	1.2	1.2	1.2
CG net cash requirement	**402.1**	**178.4**	**132.5**	**114.1**	**121.6**	**121.7**
B&B, NRAM and Network Rail adjustment	0.4	0.0	-0.5	0.0	0.3	0.0
CGNCR ex. B&B, NRAM and Network Rail	**402.5**	**178.4**	**132.1**	**114.1**	**121.9**	**121.7**

Alternative balance sheet aggregates

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

3.156 Alternative metrics often do a better job than PSND of reflecting the underlying picture, although none is perfect:

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

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

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

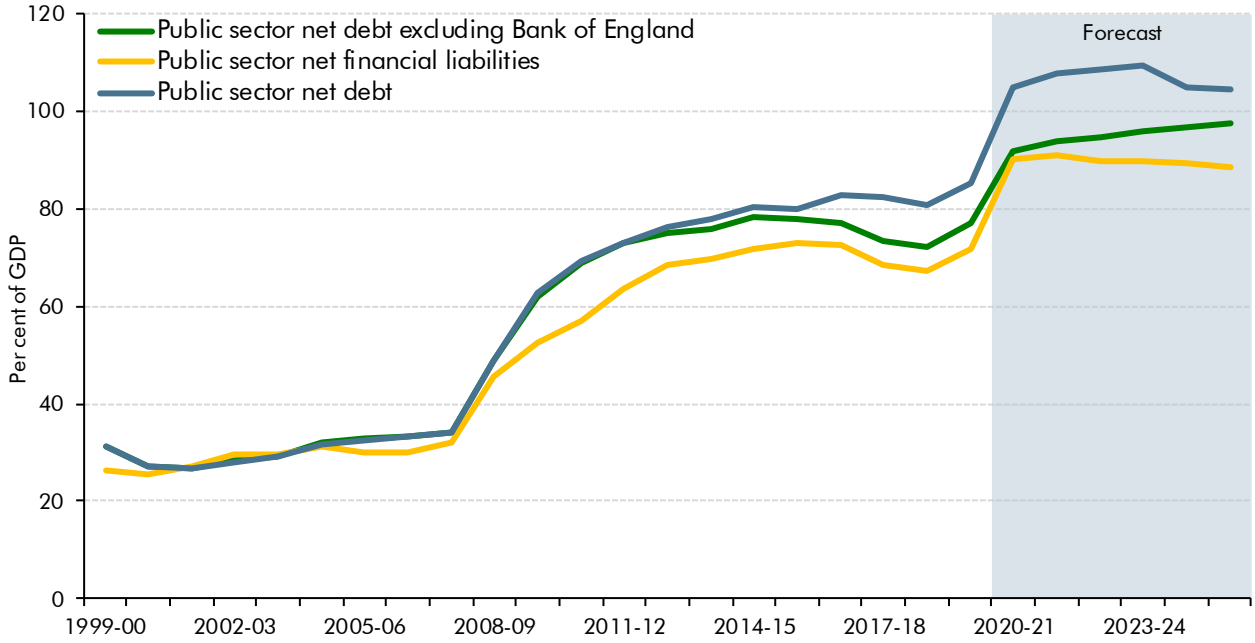
3.157 The medium-term paths of these three balance sheet measures differ (Chart 3.14):

- **Headline PSND** rises sharply in 2020-21 to over 100 per cent of GDP, then rises more slowly to 2023-24. It then falls in 2024-25 as TFS loans are repaid and is at a similar level in 2025-26. PSND remains above 100 per cent of GDP in all years.

- **PSND excluding the distortions related to Bank of England schemes** follows a smoother path that rises less sharply than headline PSND in 2020-21, continues to rise but more slowly in 2021-22 as nominal GDP rebounds, and rises steadily thereafter. This measure of PSND remains below 100 per cent of GDP in all years. By 2025-26, with most TFS loans repaid, the remaining difference between the headline and ex Bank measures of PSND largely relates to gilts that are purchased under quantitative easing for which the Bank pays a market price that exceeds their value in PSND.[17]

- **PSNFL** also increases sharply in 2020-21, and slightly in 2021-22, but declines gradually thereafter. The different path relative to PSND excluding the Bank of England largely represents the build-up of student loan assets.

Chart 3.14: The public sector balance sheet: various measures



Source: ONS, OBR

Financing and the balance sheet

3.158 The Government has needed to revise its financing remit for 2020-21 several times as the impacts of the pandemic have continued to build. The additional financing has largely been met through the issuance of conventional gilts and to a lesser extent NS&I deposits. From 2021-22 onwards we assume the Government reverts to the financing composition as at the March 2020 financing remit. This implies a greater contribution from index-linked gilts and a much smaller one from NS&I.

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

Table 3.28: Total gross financing

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Central government net cash requirement[1]	402.5	178.4	132.1	114.1	121.9	121.7
Gilt redemptions	97.6	79.3	103.9	82.8	104.3	109.8
Change in DMO cash position[2]	18.4	0.0	0.0	0.0	0.0	0.0
Total gross financing	**518.5**	**257.7**	**235.9**	**196.9**	**226.3**	**231.4**
of which:						
Conventional gilts	450.9	216.7	198.1	164.8	190.0	194.4
Index-linked gilts	31.9	36.7	33.6	27.9	32.2	32.9
Treasury bills	0.0	0.0	0.0	0.0	0.0	0.0
NS&I	35.0	4.0	4.0	4.0	4.0	4.0
Other central government	0.8	0.3	0.2	0.2	0.1	0.0

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

3.159 The consequences of the Government's financing plans are that conventional gilts more than account for the increase in debt liabilities over the forecast period, with the share of other central government sources declining. This includes a gradual fall in reliance on index-linked gilts in line with the Government's stated strategy. Liquid assets also decline relative to GDP over the forecast. The largest contributor to this comes from the foreign exchange reserves, where the Government has decided not to finance any additional reserves over the next five years, ending the approach that has added £66 billion over the past 10 years. This leaves the reserves roughly flat in cash terms across the forecast period and therefore declining relative to GDP.

Table 3.29: The composition of public sector net debt

	Per cent of GDP[1]					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Public sector debt liabilities[2] (a)	**103.7**	**105.0**	**105.5**	**106.3**	**106.7**	**107.2**
of which:						
Conventional gilts	65.0	67.1	68.7	70.2	71.3	72.3
Index-linked gilts	21.0	21.0	20.5	20.2	20.0	19.9
T-bills	3.8	3.6	3.5	3.3	3.2	3.1
NS&I	9.9	9.5	9.2	9.1	8.9	8.7
Other central government	3.8	3.6	3.5	3.3	3.2	3.1
Local government[3]	0.9	0.9	0.9	0.9	0.9	0.9
Non-financial public corporations[4] (b)	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Public sector liquid assets[2] (c)	**11.8**	**11.2**	**10.6**	**10.2**	**10.0**	**9.7**
of which:						
Reserves	6.6	6.2	6.0	5.8	5.5	5.3
Other central government	3.1	2.9	2.7	2.6	2.5	2.4
Local government[3]	1.3	1.0	0.8	0.7	0.6	0.5
Non-financial public corporations[4]	0.8	1.1	1.1	1.1	1.4	1.4
Bank of England net contribution (d)	**13.3**	**14.3**	**13.6**	**13.3**	**8.2**	**7.2**
Public sector net debt (PSND) (a-c+d)	**105.2**	**108.0**	**108.6**	**109.4**	**105.0**	**104.7**
Memo: PSND excluding Bank of England (a-c)	*91.9*	*93.7*	*94.9*	*96.2*	*96.7*	*97.5*
Memo: general government gross debt (a-b)	*104.5*	*105.7*	*106.3*	*107.1*	*107.5*	*108.0*

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

Contingent liabilities

3.160 The Treasury holds a database listing the amount and type of contingent liabilities that departments have assumed in relation to both the public and private sector over the previous and current year. As usual, we have asked the Treasury to identify any changes since our March 2020 forecast. Its dedicated reporting system records 28 that were entered into over that period, with a total maximum exposure of £372 billion for those that have been quantified and approved. The Treasury's now larger indemnity to the expanded APF – which represents a liability from one part of the public sector to another rather than a liability of the public sector as a whole – makes up £300 billion of this. Many of the new contingent liabilities arise from responses to the pandemic including government guarantees on the various virus-related loan schemes and indemnities and guarantees relating to the production of medical equipment and vaccines. A significant proportion of the contingent liabilities in respect of guaranteed loan schemes are expected to crystallise and the ONS has decided that these expected losses should be scored at upfront spending.

Table 3.30: Fiscal aggregates: central forecast

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Receipts and expenditure							
Public sector current receipts (a)	37.3	37.3	38.2	37.7	38.0	38.0	38.1
Total managed expenditure (b)	39.8	56.3	45.6	42.1	42.1	42.0	41.9
of which:							
Public sector current expenditure (c)	35.6	49.7	40.2	36.7	36.7	36.6	36.6
Public sector net investment (d)	1.9	3.9	2.8	2.9	2.9	2.9	2.8
Depreciation (e)	2.3	2.6	2.5	2.5	2.5	2.5	2.5
Legislated fiscal mandate and supplementary target							
Cyclically adjusted net borrowing	2.6	18.6	6.7	3.9	3.9	3.8	3.8
Public sector net debt[1]	85.5	105.2	108.0	108.6	109.4	105.0	104.7
Budget 2020 fiscal targets							
Current budget deficit (c+e-a)	0.6	15.1	4.6	1.5	1.2	1.1	1.0
Debt interest to revenue ratio (per cent)	3.5	2.7	1.7	2.0	2.3	2.2	2.2
Other deficit measures							
Public sector net borrowing (b-a)	2.5	19.0	7.4	4.4	4.1	3.9	3.9
Cyclically adjusted current budget deficit	0.7	14.6	3.9	1.0	0.9	0.9	1.0
Primary deficit	1.3	18.0	6.8	3.7	3.3	3.1	3.0
Cyclically adjusted primary deficit	1.3	17.6	6.1	3.2	3.0	3.0	3.0
Financing							
Central government net cash requirement	2.5	19.4	8.0	5.6	4.7	4.8	4.6
Public sector net cash requirement	0.8	22.2	9.4	5.7	4.8	0.1	3.8
Alternative balance sheet metrics							
Public sector net debt ex. Bank of England	77.1	91.9	93.7	94.9	96.2	96.7	97.5
Public sector net financial liabilities	72.0	90.3	90.9	89.9	90.0	89.4	88.8
Stability and Growth Pact							
Treaty deficit[2]	2.8	19.0	7.7	4.5	4.2	4.1	4.2
Cyclically adjusted Treaty deficit	2.9	18.6	7.0	4.0	3.9	4.0	4.1
				£ billion			
Current budget deficit	13.8	312.0	101.7	36.4	29.1	26.7	27.0
Public sector net investment	42.3	81.6	62.5	68.2	71.3	72.9	74.9
Public sector net borrowing	56.1	393.5	164.2	104.6	100.4	99.6	101.8
Cyclically adjusted net borrowing	57.8	384.4	148.6	92.5	94.2	96.2	100.4
Cyclically adjusted current budget deficit	15.5	302.8	86.1	24.2	22.9	23.3	25.5
Public sector net debt	1801	2274	2478	2602	2721	2714	2817
Net debt interest	28.1	20.0	13.7	17.2	20.5	21.0	21.5
Non-interest receipts	800.9	748.3	823.1	860.6	899.7	934.7	972.2
Memo: Output gap (per cent of GDP)	*0.1*	*-0.9*	*-1.0*	*-0.6*	*-0.3*	*-0.2*	*0.0*

[1] Debt at end March; GDP centred on end March.
[2] General government net borrowing.

Risks, uncertainties and alternative scenarios

3.161 In our *Fiscal risks reports* (*FRR*), we follow the IMF in defining a 'fiscal risk' over the medium term as any potential deviation from our central forecast.[18] These shocks can arise from several sources that can be grouped under two broad headings:

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

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

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

3.164 To try to capture the degree of uncertainty around a forecast being made in the midst of a pandemic, we have therefore produced a set of plausible upside and downside scenarios varying assumptions about key risks to our central forecast. These should better illustrate the present degree of forecast uncertainty, although, as described in Chapter 2, scenarios outside the range presented are also entirely plausible. In the following sections we:

- present the **fiscal implications of the coronavirus scenarios** described in Chapter 2, which vary assumptions about the path of the virus and its economic implications;
- briefly discuss a **'no deal' Brexit scenario**, which *also* varies the nature of UK's future trading relationship with the European Union (Annex B describes this in further detail);
- illustrate the potential impact of several **other specific risks** to the fiscal outlook, including shocks to debt interest spending; and
- conclude by considering how the **credibility** of the UK's macroeconomic framework and institutions protect against an adverse realisation of these risks.

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

Coronavirus scenarios

3.165 Our scenarios embody different assumptions regarding: the effectiveness of the second lockdown in reducing infection rates; the effectiveness of a reformed test, trace and isolate system and its implications for the stringency and duration of public restrictions after 2 December; the effectiveness of available vaccines and the speed with which they are rolled out; and the degree to which normal life is able to resume in the coming years. These help to determine both the timing and pace of the near-term rebound in GDP as well as the extent of any long-term economic 'scarring'. Moving from the upside, to the central, to the downside scenario, therefore results in slower recoveries and increasingly large and long-term falls in GDP relative to the pre-virus path in our March forecast, with corresponding effects on unemployment. Differences between the scenarios are assumed to be structural in nature, so monetary policy, interest rates and inflation do not differ between them.

3.166 We produce our upside and downside fiscal scenarios using simple 'ready reckoners' derived from our *FSR* scenarios and scaled to reflect the difference between our latest scenarios and the central forecast. This means they embody the same assumptions as those set out in Chapter 3 of our July *FSR* in respect of the fiscal impact of each pound of GDP gained or lost relative to the central projection. These include the extent to which changes in unemployment feed through to welfare spending, in how much fiscal drag lifts tax receipts, and in how the composition of economic activity affects the revenues gained by taxing it.

3.167 Since July, however, discretionary fiscal support has also been repeatedly expanded and extended as public health measures have had to be tightened to bring the second wave of infections back under control. In some cases, the government has linked particular levels of financial support to particular levels of public health restrictions. For instance, when announcing national lockdown, the Prime Minister noted the impacts on businesses and reiterated that he would do *"whatever it takes to support them"*, citing furlough scheme extensions and grants to businesses and councils as examples of this.[19] To ignore this evident connection between public health restrictions and fiscal support would understate the likely fiscal implications of the downside scenario.

3.168 We have therefore made the following further assumptions about the link between public health measures and discretionary fiscal support provided under each scenario:

- **The furlough scheme** has been extended over the remainder of 2020-21 at a costing of £20 billion in our central forecast. The cost of the CJRS is £8 billion lower in the upside scenario, as take-up is lower, but £8 billion higher in the downside scenario.

- **Guaranteed loan schemes** cost £29 billion in our central forecast – a figure that is dominated by losses on the Bounce Back Loan Scheme for small businesses. We have used the range of loss rates presented by the British Business Bank to calibrate costs in our upside and downside scenarios.[20] This yields a figure of £22 billion in our upside scenario but £40 billion in our downside scenario.

[19] Prime Minister's Office and the Rt Hon Boris Johnson MP, *Statement to the House of Commons on coronavirus*, 4 November 2020.
[20] Department for Business, Energy, and Industrial Strategy, *BEIS annual report and accounts 2019 to 2020*, September 2020.

- **Third wave support**: In response to the downside scenario's third wave of infections, we assume the Government provides a further £30 billion in support. This could come from any source but would be consistent with the provision of business grants, support for furloughed employees and the self-employed, local authority support, and health spending all being linked to the state of the virus. It is roughly half the extra public services spending provided, via the Winter Economy Plan and Spending Review, since the second wave began to emerge and reflects our assumption that the economic cost of the third wave is half as severe as the second.

Results

3.169 The effects of these assumptions on key fiscal variables is shown in Chart 3.15:

- **Receipts** fall more or less in line with the economy and therefore differ only moderately as a share of GDP between the scenarios. The effects of loss reliefs and lower financial company profits on corporation tax help explain the 0.3 percentage point sharper fall in receipts in 2020-21 in the downside scenario than the 0.1 percentage points fall in our central forecast. From that starting point, slow real income growth generates almost no fiscal drag, so receipts grow by only 0.4 per cent of GDP over the remainder of the scenario. In the upside scenario, the slightly smaller initial fall and significantly greater subsequent growth in real incomes means that by 2025-26 receipts are 1.5 per cent of GDP higher than in the downside scenario.

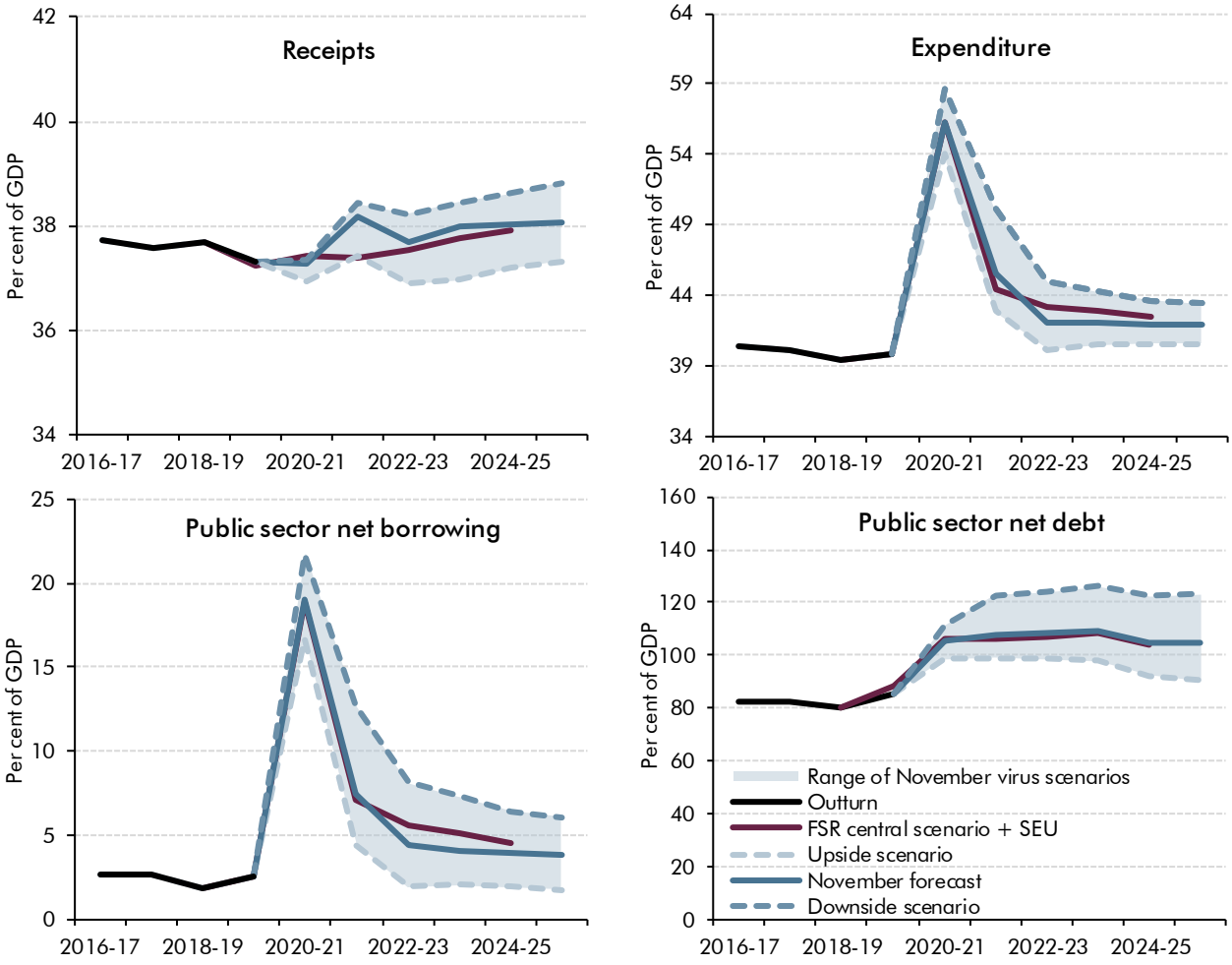
- In 2020-21, **spending** in the downside scenario is 4.7 per cent of GDP higher than in the upside scenario (and 2.4 per cent of GDP higher than in the central forecast). This is partly due to the greater costs of the furlough and guaranteed loan schemes, which drive a 2.2 per cent of GDP (£46 billion) difference in spending. A weaker nominal GDP denominator accounts for the remaining 2.5 percentage points. By 2025-26, the 2.8 per cent of GDP difference between the scenarios is almost wholly accounted for by differences in GDP.

- Given these receipts and spending profiles, **borrowing** spikes in 2020-21 to £353 billion (16.7 per cent of GDP) in the upside scenario and £440 billion (21.7 per cent of GDP) in the downside scenario. The latter figure is just 6.0 per cent of GDP below the 27.8 per cent of GDP peak reached in the midst of the First World War. The rapid economic recovery and lack of long-term scarring in the upside scenario means that by 2025-26 the headline deficit falls to 1.7 per cent of GDP (a lower deficit than in our March forecast thanks to lower debt interest spending and the lower medium-term path for RDEL spending announced in the Spending Review). The slower economic recovery and 6 per cent long-run scarring mean that borrowing in 2025-26 settles at 6.1 per cent in the downside scenario, 2.2 per cent of GDP above the central forecast.
- In all three scenarios, **debt** rises sharply in 2020-21, reflecting higher borrowing and falling GDP, reaching over 100 per cent of GDP in the central and downside scenarios and just under that in the upside scenario. Thereafter, debt falls gently to 90 per cent of GDP by 2025-26 in the upside scenario. Debt hovers above 100 per cent of GDP in the central forecast, falling slightly in the final two years due to TFS loans being repaid.

In the downside scenario, debt rises to a peak of 126 per cent of GDP in 2023-24, before falling temporarily in 2024-25. The small falls in debt towards the end of the central forecast and downside scenarios are entirely due to repayments of TFS loans – debt excluding the Bank of England increases in each year of the forecast.

- Chapter 4 shows what the scenarios mean for several of the **other fiscal variables** used to assess the Government's many fiscal rules.

Chart 3.15: Selected fiscal aggregates: scenarios versus central forecast



Source: ONS, OBR

3.170 Table 3.31 shows the fiscal implications of the scenarios in cash terms and Table 3.32 shows them as a share of GDP.

Table 3.31: Fiscal aggregates: scenarios versus central forecast (£ billion)

	£ billion						
	Outturn	November forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total managed expenditure	884	1165	1011	990	1027	1064	1106
Public sector current receipts	828	771	847	886	927	964	1004
Public sector net borrowing	56	394	164	105	100	100	102
Public sector net debt	1801	2274	2478	2602	2721	2714	2817
Public sector net debt ex. BoE	1624	1987	2150	2276	2391	2501	2622
Upside scenario							
Total managed expenditure	884	1143	1004	983	1022	1061	1102
Public sector current receipts	828	790	900	936	970	1010	1055
Public sector net borrowing	56	353	104	47	52	51	47
Public sector net debt	1801	2240	2380	2444	2514	2457	2505
Public sector net debt ex. BoE	1624	1953	2052	2118	2184	2244	2311
Downside scenario							
Total managed expenditure	884	1189	1049	999	1033	1068	1110
Public sector current receipts	828	749	783	819	863	910	954
Public sector net borrowing	56	440	265	180	170	157	156
Public sector net debt	1801	2310	2622	2824	3014	3065	3222
Public sector net debt ex. BoE	1624	2024	2294	2497	2684	2853	3028

Table 3.32: Fiscal aggregates: scenarios versus central forecast (per cent of GDP)

	Per cent of GDP						
	Outturn	November forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total managed expenditure	39.8	56.3	45.6	42.1	42.1	42.0	41.9
Public sector current receipts	37.3	37.3	38.2	37.7	38.0	38.0	38.1
Public sector net borrowing	2.5	19.0	7.4	4.4	4.1	3.9	3.9
Public sector net debt	85.5	105.2	108.0	108.6	109.4	105.0	104.7
Public sector net debt ex. BoE	77.1	91.9	93.7	94.9	96.2	96.7	97.5
Upside scenario							
Total managed expenditure	39.8	54.0	42.8	40.2	40.5	40.6	40.6
Public sector current receipts	37.3	37.3	38.4	38.2	38.5	38.6	38.8
Public sector net borrowing	2.5	16.7	4.4	1.9	2.1	1.9	1.7
Public sector net debt	85.5	98.6	98.9	98.4	97.9	92.2	90.5
Public sector net debt ex. BoE	77.1	86.0	85.2	85.3	85.1	84.2	83.4
Downside scenario							
Total managed expenditure	39.8	58.7	50.1	45.0	44.3	43.6	43.4
Public sector current receipts	37.3	36.9	37.4	36.9	37.0	37.2	37.3
Public sector net borrowing	2.5	21.7	12.7	8.1	7.3	6.4	6.1
Public sector net debt	85.5	111.1	122.7	123.9	126.2	122.4	123.1
Public sector net debt ex. BoE	77.1	97.3	107.4	109.6	112.4	113.9	115.7

Brexit scenarios

3.171 In Annex B, we use the same approach to present a 'no deal' scenario that illustrates the economic and fiscal implications of the UK's trading relationship defaulting to WTO terms at the end of the transition period on 31 December 2020. As Table 3.33 shows, this raises borrowing by around 0.5 per cent of GDP on average from 2021-22 onwards and debt by 2.9 per cent of GDP by 2025-26. By 2025-26, if a no deal Brexit is combined with our downside virus scenario, debt stands at 126.3 per cent of GDP.

Table 3.33: Borrowing and debt under different coronavirus and Brexit scenarios

	Per cent of GDP						
	Outturn	Public sector net borrowing					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Upside virus scenario	2.5	16.7	4.4	1.9	2.1	1.9	1.7
November forecast	2.5	19.0	7.4	4.4	4.1	3.9	3.9
Downside virus scenario	2.5	21.7	12.7	8.1	7.3	6.4	6.1
Upside virus, WTO scenario	2.5	17.1	4.9	2.4	2.5	2.2	2.0
Central WTO scenario	2.5	19.5	8.1	5.0	4.6	4.2	4.2
Downside virus, WTO scenario	2.5	22.2	13.5	8.7	7.9	6.8	6.4
				Public sector net debt			
Upside virus scenario	85.5	98.6	98.9	98.4	97.9	92.2	90.5
November forecast	85.5	105.2	108.0	108.6	109.4	105.0	104.7
Downside virus scenario	85.5	111.1	122.7	123.9	126.2	122.4	123.1
Upside virus, WTO scenario	85.5	99.7	100.7	100.7	100.3	94.6	93.0
Central WTO scenario	85.5	106.5	110.3	111.2	112.2	107.7	107.6
Downside virus, WTO scenario	85.5	112.4	125.4	127.0	129.3	125.5	126.3

Other specific risks

3.172 No set of scenarios could hope to capture the full range of potential fiscal outcomes over the next five years. In particular, ensuring that the scenarios largely reflect differences in the course of the virus and Brexit negotiations has required us to hold many other assumptions constant. In this section we therefore consider some other specific risks that might affect our forecast, drawing on the analysis presented in our 2019 *FRR* and in this summer's *FSR*.

3.173 The most impactful non-virus risks come from the real economy and financial sector. Even holding all epidemiological assumptions fixed, a wide range of outcomes are possible, consistent with different cyclical, structural, and compositional economic risks crystallising. For fiscal sustainability, long-term effects on potential output – such as the outlook for productivity or labour market scarring – are the most important. To date, the virus has not seen fiscal risks crystallising via the financial sector, largely because the Government has provided unprecedented support to individuals and businesses itself, but in part also because of greater loss-absorbing capacity built up in the aftermath of the financial crisis.

3.174 Looking beyond the possible impact of a no deal Brexit, what might the *next* whole-economy risk be? The past two recessions have been global shocks, amplified by the integrated nature of today's economies and whose fiscal costs have reflected government's growing role as the insurer of last resort, the implications of which were explored in a timely Treasury publication.[21] One obvious potential source of future global shocks is climate change, as discussed in our 2019 *FRR*. These can include physical risks (related to extreme weather events and global warming) and transition risks (related to the shift to a low-carbon economy). Cyberattacks were also highlighted (alongside pandemic influenza) in the Government's most recent published National Risks Register.[22] We are yet to examine the fiscal implications of this sort of shock.

3.175 Endogenous risks can be split into those affecting receipts, spending, and the balance sheet:

- **Risks to tax revenues** can be split into how the tax system interacts with the structure of economy, the buoyancy of revenues, and the non-payment of liabilities. This forecast provides examples of all three types crystallising: falling spending on cars and other durable goods lowers VAT receipts this year; corporate losses built up this year weigh on the buoyancy of corporation tax receipts in the future; and a temporary rise in non-compliance associated with the shift to new arrangements at the border next year is assumed to reduce VAT, excise and customs duties receipts over the next two years.

- **Risks to non-interest spending** include a steady erosion of the UK's much lauded system of multi-year expenditure planning and control. The government has not run a multi-year spending review since 2015. Health budgets have been topped up for at least the fourth time since March. The months since our July *FSR* have also provided examples – ranging from multiple extensions to the furlough scheme to free school meals – that withdrawing temporary support can be difficult. In this context the time-limited nature of the £20 a week addition to UC, due to expire at the end of March 2021, also poses a clear risk. A previous policy that would have generated cash losses to large numbers of families – the cuts to tax credits announced after the 2015 election – was reversed before being implemented in the face of widespread opposition.

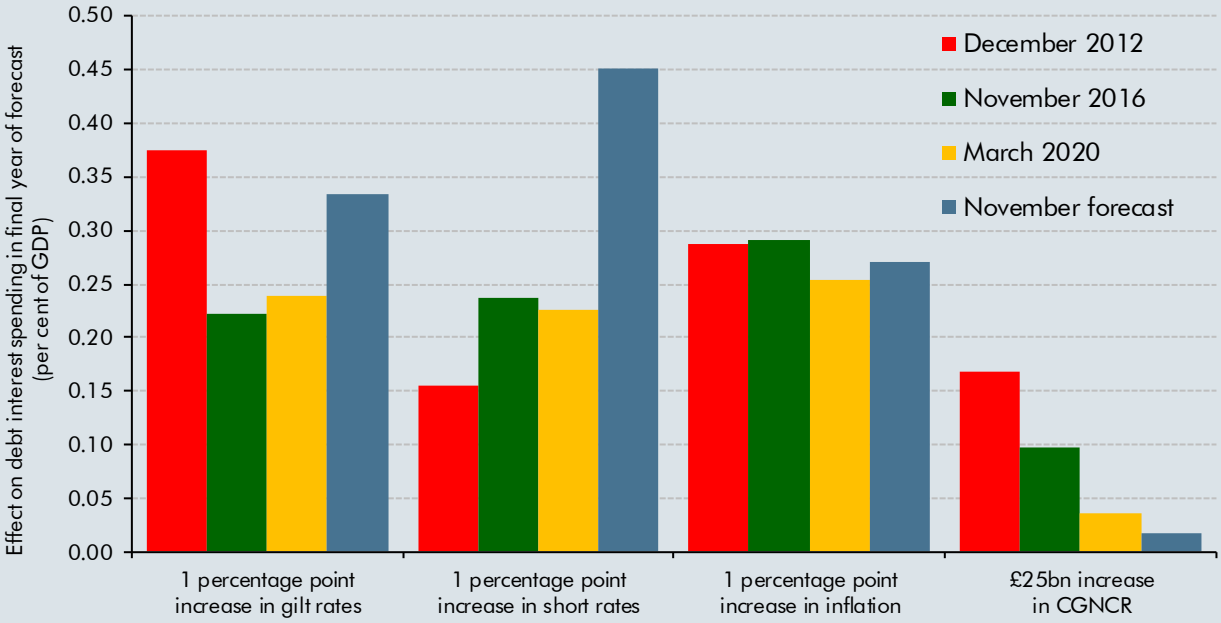
- Looking at the balance sheet, many of the **risks to debt interest spending** that we highlighted in July have not crystallised. For instance, the DMO has been able to find buyers for all the debt it has issued. And debt interest costs have fallen further. But risks to debt interest spending remain important given the government's greater debt stock and its growing sensitivity to shifts in market sentiment, as explored in Box 3.3.

[21] HM Treasury, *Government as insurer of last resort: managing contingent liabilities in the public sector*, March 2020.
[22] Cabinet Office, *National Risk Register of Civil Emergencies, 2017 Edition*, 2017.

Box 3.3: The sensitivity of debt interest spending

Government spending on debt interest reaches a new historic low as a share of total government revenue over the forecast period, but the public finances have simultaneously become more sensitive to future changes in the cost of servicing this higher debt burden. Chart C shows how the effect of various shocks to the cost of government debt at the forecast horizon has changed over four-year intervals since our December 2012 forecast (the earliest date for which we are able to present forecasts on a comparable basis), and since our March 2020 forecast.

Chart C: Sensitivity of successive debt interest spending forecasts



Note: All increases are assumed to take effect at the beginning of the first year of the forecast and continue until the final year.
Source: Debt Management Office, OBR

Since March of this year, debt interest spending has become:

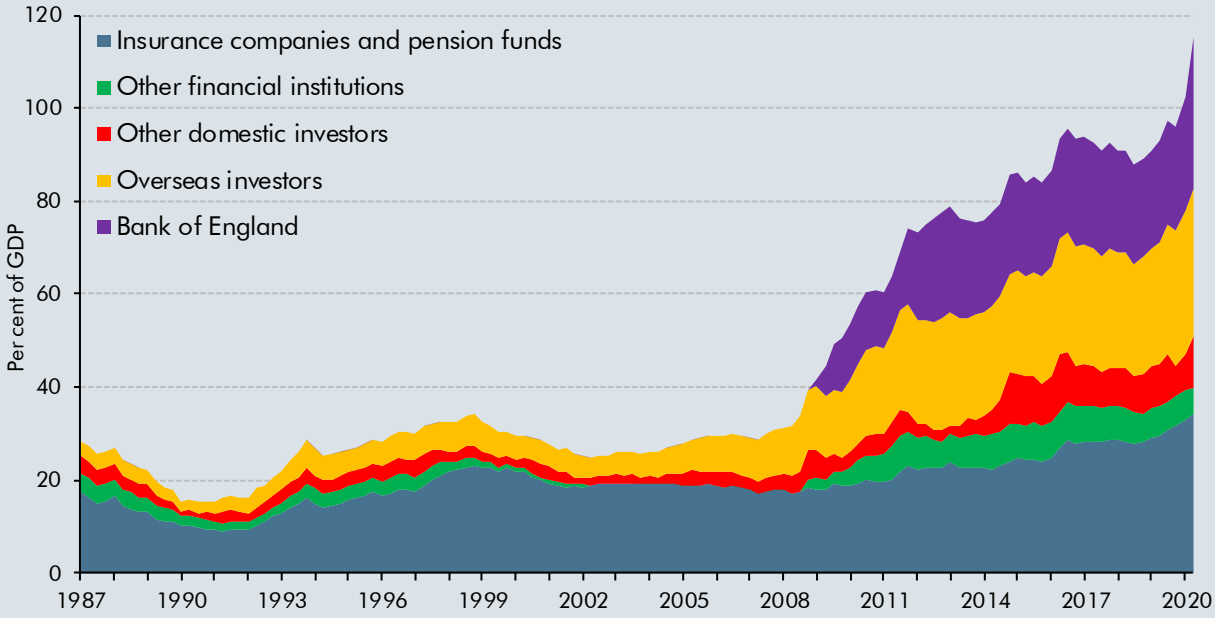
- 40 per cent more sensitive to a 1 percentage point increase in **gilt rates**. This partly reflects the higher initial debt, which is forecast to have risen from 79 to 105 per cent of GDP. And it partly reflects higher net borrowing over the period: the net cash requirement averages 5.6 per cent of GDP over the remainder of the forecast, compared to 2.8 per cent in March. The sensitivity to gilt rates is approaching levels last seen almost a decade ago, when the Treasury was running substantial deficits, while also refinancing the debt issued during the height of the financial crisis.
- Twice as sensitive to a 1 percentage point increase in **short interest rates** – the interest rate paid on the Bank of England reserves that finance the APF's holdings of gilts and TFS assets and on Treasury bills. Successive extensions of the APF have further reduced the effective maturity of government debt by substituting gilts with an average maturity of around 13 years with floating rate central bank reserves.
- The sensitivity to a 1 percentage point increase in **retail price inflation** is unchanged. This reflects the government's deliberate strategy to reduce the share of inflation-linked debt in total issuance. However, the UK's relatively large stock of inflation-linked debt still

makes it more difficult for the government to rely, as previous ones have, on future inflation surprises to erode the nominal value of its obligations.

- 50 per cent less sensitive to a £25 billion (roughly 1 per cent of GDP in today's terms) increase in **cash borrowing**. This reflects much lower interest rates on newly issued debt, assuming interest rates remain at the historically low levels reflected in our central forecast. The average effective interest rate on new issuance has fallen from 2.8 per cent in 2010-11 to 1.9 per cent in 2015-16 to 0.3 per cent in 2020-21.

In addition to becoming more sensitive to changes in interest rates, the cost of debt has become more exposed to changes in investor appetite for gilts and sterling-denominated assets more generally. As Chart D shows, the share of gilts held by overseas investors has risen from 11 per cent in 1987 to 27 per cent today (and they now hold 38 per cent of gilts not held by the Bank of England). The fact that the government has been able to continue to borrow from these investors at historically low cost reflects the continued confidence that the UK government will honour its debt obligations, as well as a growing surplus of global saving. Since the onset of the virus, a further increase domestic and overseas saving, heightened uncertainty about the returns on private sector assets, as well as additional quantitative easing, have put further downward pressure on government bond yields. However, the UK's reliance on foreign investors to finance its fiscal deficits, combined with an increasing stock of debt held by overseas investors, leaves it at risk to changes in investor sentiment in future.

Chart D: Gilt holdings by sector



Note: Debt at the end of each quarter is divided by the surrounding four quarters' nominal GDP.
Source: Debt Management Office, OBR

Conclusions

3.176 In the wake of two 'once in a lifetime' economic shocks – the global financial crisis and the coronavirus pandemic – identifying, analysing, and managing risks has become an increasingly important part of fiscal forecasting and policymaking. In this section, we have demonstrated the wide array of potential paths for the UK public finances, depending on the path of the virus and the outcome of the Brexit negotiations. We have also illustrated the greater sensitivity of the public finances to a reversal of the downward trend in interest rates that has so far served to alleviate some of the fiscal pressures of these shocks.

3.177 The Government's growing debt stock and increasing reliance on short-term financing and international investors leaves it increasingly exposed to shifts in perceptions, confidence, and assessment of relative country and sovereign risk. The financial crisis and coronavirus pandemic were global shocks that triggered a general flight to safety. This reduced sovereign debt yields in many advanced economies (with the notable exception of the euro area periphery in the early 2010s). But the next shock to the UK may be more idiosyncratic, putting its economic and fiscal resilience under greater scrutiny by international investors.

3.178 Maintaining market confidence in the credibility and sustainability of the government's fiscal policies and the institutional frameworks that support them is key. The UK has only rarely been a pioneer in economic governance but has frequently been held up as an example of best practice – including in recent assessments by the IMF and OECD.[23] Moody's has, however, injected a note of caution by citing "*weakening in the UK's institutions and governance*" as part of the justification for its downgrade of the UK's sovereign creditworthiness.[24] In contrast, Fitch and Standard and Poor's left the UK's credit rating unchanged, with the latter noting that "*the UK government and the Bank of England*" had "*demonstrated significant fiscal and monetary flexibility in their response to the pandemic*". The Government's ongoing review of the fiscal framework provides an opportunity to clarify its fiscal objectives and how it intends to meet them.

[23] For instance, when concluding the Article IV assessment of the UK economy, the IMF's Managing Director, Kristalina Georgieva, noted the UK's "*strong institutions, highly credible fiscal and monetary policy frameworks, and flexible labor markets*" as advantages. And, looking just at fiscal frameworks, in a recent review of the OBR, the OECD noted that "*the OBR has earned the respect of peer institutions and is considered by many as a model independent fiscal institution*", OECD, *OECD Independent Fiscal Institutions Review: Office for Budget Responsibility of the United Kingdom*, September 2020.

[24] From 'Aa2' (like France and South Korea) to 'Aa3' (like Belgium and Taiwan). Moody's UK rating has fallen by three notches since 2012, although it is now judged to be 'stable'.

4 Performance against the Government's fiscal targets

Introduction

4.1 This chapter:

- sets out the **current legislated fiscal targets** and assesses their likelihood of being met on current policy under our central forecast (from paragraph 4.2);
- describes the **other targets framing the March 2020 Budget** and assesses their likelihood of being met on current policy (from paragraph 4.7);
- explores **other measures of fiscal sustainability**, including alternative interpretations of what it would mean to 'balance the books' and 'get debt under control' (from paragraph 4.12); and
- discusses the challenges in estimating and communicating the **uncertainty around the fiscal forecast** in the wake of an unprecedented shock like coronavirus (from paragraph 4.20).

The legislated fiscal targets

4.2 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of meeting the fiscal targets articulated therein under current policy. The *Charter* has been updated several times over the past decade.[1] The most recent edition was approved by Parliament in January 2017 and codifies former Chancellor Philip Hammond's fiscal rules. It specifies:

- A longer-term **'objective' for fiscal policy** to "*return the public finances to balance at the earliest possible date in the next Parliament*". At the time it was drawn up, the next Parliament was expected to run from 2020 to 2025, although "*the earliest possible date*" was left unspecified.
- A near-term '**mandate' for fiscal policy** that requires the structural deficit (cyclically adjusted public sector net borrowing) to lie below 2 per cent of GDP by 2020-21.

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

- A near-term **'supplementary target' for fiscal policy** that requires public sector net debt to fall relative to GDP in 2020-21.

- A medium-term **'welfare cap'** that requires a subset of welfare spending to lie below a ceiling of £127 billion in 2024-25, with the cap adjusted for subsequent changes in our inflation forecast and for the effects of welfare devolution in Scotland.

The implications of our central forecast

4.3 Table 4.1 shows our central forecasts for the fiscal aggregates used to assess performance against these legislated fiscal objectives and targets: cyclically adjusted public sector net borrowing, public sector net debt, spending under the welfare cap, and public sector net borrowing. These forecasts are described in detail in Chapter 3.

Table 4.1: Forecasts for the Government's legislated target measures

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Fiscal mandate: Cyclically adjusted public sector net borrowing in 2020-21							
March forecast	2.2	2.4	3.0	2.7	2.5	2.2	
November forecast	2.6	18.6	6.7	3.9	3.9	3.8	3.8
Supplementary target: Year-on-year change in public sector net debt in 2020-21							
March forecast	79.5	77.4	75.0	75.4	75.6	75.3	
November forecast	85.5	105.2	108.0	108.6	109.4	105.0	104.7
Welfare cap: Specified welfare spending in 2024-25 (£ billion)							
March forecast	119.0	122.6	124.3	127.0	130.2	133.5	
November forecast	118.7	124.4	121.0	122.0	123.6	125.2	127.7
Fiscal objective: Public sector net borrowing up to 2025-26							
March forecast	2.1	2.4	2.8	2.5	2.4	2.2	
November forecast	2.5	19.0	7.4	4.4	4.1	3.9	3.9

Note: Figures in target years are shaded in blue.

4.4 Table 4.2 summarises performance against the legislated fiscal targets in the relevant years and how the margins against them have changed since March 2020. As discussed later in this chapter, there is no meaningful way to attach precise probabilities to the likelihood of meeting these targets given the uncertainties around the economic and fiscal outlook in the wake of the coronavirus pandemic. That said, all the legislated deficit and debt targets are more likely to be missed than met based on our central forecast by very large margins:

- The legislated **fiscal mandate** requires the structural deficit to be less than 2 per cent of GDP by 2020-21. Our central forecast shows this being missed by £343 billion (16.6 per cent of GDP), having been on course to be missed by just £9.2 billion in our pre-virus March forecast. Only £31.5 billion of the deterioration in headline borrowing relative to our March forecast is deemed to be cyclical. But as we stress in Chapter 2, splitting this year's output losses between structural and cyclical elements, and thus stripping cyclical fluctuations from the deficit, is particularly hard at present.

- The legislated **supplementary debt target** requires PSND to fall relative to GDP in 2020-21. Based on our central forecast, the target is missed by a margin of 19.7 per cent of GDP. It had been on course to be met by a margin of 2.0 per cent of GDP in March. As well as the £394 billion budget deficit in 2020-21 pushing debt higher, the Bank of England's expanded quantitative easing and the new Term Funding Scheme add a further £156 billion to PSND by the end of the year.

- As described below, the **welfare cap** has been restated in the Spending Review. This results from the methodological change to our universal credit forecasts rather than the real-world changes to welfare spending due to the pandemic. The cap is only formally assessed at the first Budget in each Parliament, but on this basis, spending is on course to breach the cap in 2024-25 by £4.9 billion and to breach the cap plus margin by £1.1 billion. This compares with a £4.1 billion margin against the cap plus margin in our March forecast.

- The legislated **fiscal objective** was interpreted during Philip Hammond's tenure as Chancellor as requiring PSNB to be in balance or surplus in 2025-26. This *Economic and fiscal outlook* (*EFO*) therefore presents our first chance to assess it formally as the forecast now extends to 2025-26. It projects a deficit of 3.9 per cent of GDP in that year, thereby missing the objective by £102 billion.

Table 4.2: Performance against the Government's legislated targets

		Per cent of GDP		£ billion	
		Forecast	Margin	Forecast	Margin
Fiscal mandate: Cyclically adjusted public sector net borrowing in 2020-21					
March forecast	Not Met	2.4	-0.4	55.3	-9.2
November forecast	Not Met	18.6	-16.6	384.4	-343.0
Supplementary target: Year-on-year change in public sector net debt in 2020-21					
March forecast	Met	-2.0	2.0		
November forecast	Not Met	19.7	-19.7		
Welfare cap: Specified welfare spending in 2024-25					
March forecast	Met			133.5	4.1
November forecast	Not Met			125.2	-1.1
Public sector net borrowing in 2025-26[1]					
November forecast	Not Met	3.9	-3.9	101.8	-101.8

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

Welfare cap restatement

4.5 In Chapter 3 we describe a methodological change to our welfare spending forecasts that has been necessitated by the pandemic and its impact on universal credit. This change in how we forecast universal credit and the legacy benefits and tax credits that it replaces has required the Treasury to update the definition of spending on jobseekers that lies outside the welfare cap and thus also to restate the welfare cap on this definition. This relates to the fact that considerably more spending lies outside the welfare cap when jobseekers are defined as 'full conditionality' cases in universal credit than when defined as spending on jobseeker's allowance plus passported housing benefit. Under the terms of the *Charter*,

when the Treasury restates the welfare cap for such a fiscally neutral classification change, we are required to certify it as such. The restatement relates to how our welfare spending forecasts are produced and presented, not to spending in the real world. It means that £10.4 billion less welfare spending in 2024-25 is subject to the welfare cap and that £10.4 billion more is outside the cap. We have therefore certified it as neutral.

4.6 Table 4.3 shows our latest forecast for capped welfare spending, the inflation adjustment stipulated in the *Charter* and the Scottish block grant adjustment that relates to capped welfare spending, and compares them to the restated welfare cap. The cap is only formally assessed at the first Budget in each Parliament, but on this basis, spending is on course to breach the cap in 2024-25 by £4.9 billion and to breach the cap plus margin by £1.1 billion. This compares with a £4.1 billion margin against the cap in our March forecast. Given the restatement and change of forecast methodology, it is not possible to identify the precise contributions of different factors to this deterioration, but among the more important will be the higher labour market inactivity assumed in our central forecast and associated increase in incapacity and disability-related benefits that are subject to the cap.

Table 4.3: Performance against the restated welfare cap

	£ billion, unless otherwise stated					
	Outturn	Forecast				
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Welfare cap						**126.8**
Pathway	119.2	119.4	119.2	121.2	124.1	
Margin (per cent)	0.5	1.0	1.5	2.0	2.5	3.0
Margin	0.6	1.2	1.8	2.4	3.1	3.8
Welfare cap and pathway plus margin	**119.8**	**120.6**	**121.0**	**123.6**	**127.2**	**130.6**
Latest forecast and update on performance against cap and pathway						
November forecast	118.7	124.4	121.0	122.0	123.6	125.2
Inflation adjustment	0.0	0.0	1.0	1.7	2.3	2.6
Scottish welfare block grant adjustment	0.3	3.2	3.3	3.5	3.7	3.8
November forecast after adjustments	**119.0**	**127.6**	**125.4**	**127.1**	**129.6**	**131.6**
Difference from:						
Cap and pathway	-0.2	8.1	6.1	5.9	5.4	4.9
Cap and pathway plus margin	**-0.8**	**6.9**	**4.3**	**3.5**	**2.3**	**1.1**
Memo: cumulative percentage point change in preceding September (Q3) rates of inflation since our March forecast.	*0.0*	*0.0*	*-0.8*	*-1.3*	*-1.9*	*-2.3*

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

The Budget 2020 fiscal targets

4.7 The Chancellor framed his March 2020 Budget against the three fiscal criteria that had featured in the Conservative Party's 2019 election manifesto. These were to:

- have the current budget in balance or surplus by the third year of the rolling five-year forecast period (**the current balance rule**);

- ensure that public sector net investment did not exceed 3 per cent of GDP on average over the rolling five-year forecast period (**the maximum investment rule**); and

- take action to put the debt to GDP ratio on a declining path if net interest costs were expected to exceed 6 per cent of primary receipts for a sustained period (**the debt interest to revenue ratio rule**).

The implications of our central forecast and alternative scenarios

4.8 Table 4.4 shows our March forecast and November forecast and scenarios for the measures relevant to the Budget 2020 targets. Table 4.5 further below then summarises performance against these targets and the margins by which they are met or missed in each scenario.

Table 4.4: Forecasts and scenarios for the Budget 2020 target measures

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Current budget rule: Current budget balanced by 2023-24[1]							
March forecast	-0.1	-0.2	-0.1	-0.5	-0.7	-0.8	
November upside scenario	0.6	13.2	1.8	-0.9	-0.8	-0.9	-1.0
November forecast	**0.6**	**15.1**	**4.6**	**1.5**	**1.2**	**1.1**	**1.0**
November downside scenario	0.6	17.2	9.7	5.0	4.2	3.5	3.2
Investment rule: Public sector net investment no more than 3 per cent of GDP on average							
March forecast	2.2	2.6	2.9	3.0	3.0	3.0	
November upside scenario	1.9	3.5	2.7	2.8	2.8	2.8	2.8
November forecast	**1.9**	**3.9**	**2.8**	**2.9**	**2.9**	**2.9**	**2.8**
November downside scenario	1.9	4.6	3.0	3.1	3.1	3.0	2.9
Debt interest to revenue ratio: Interest costs no more than 6 per cent of revenue							
March forecast	3.8	3.3	3.5	3.3	3.1	2.9	
November upside scenario	3.5	2.6	1.6	1.9	2.1	2.1	2.0
November forecast	**3.5**	**2.7**	**1.7**	**2.0**	**2.3**	**2.2**	**2.2**
November downside scenario	3.5	2.8	1.8	2.2	2.5	2.5	2.5

[1] A negative value means the current budget is in surplus.
Note: Figures in target years are shaded in blue.

The current balance rule

4.9 The lasting consequences of the pandemic have moved the current budget from an expected surplus of £11.7 billion in 2022-23 in our March forecast to a deficit of £36.4 billion in that year in our latest central forecast. With the target year now having rolled on to 2023-24, the current balance rule is met in our upside scenario with a surplus of £19.4 billion (0.8 per cent of GDP), but missed in our central forecast by £29.1 billion (1.2 per cent of GDP), and missed in our downside scenario by £99.1 billion (4.2 per cent of GDP).

The maximum investment rule

4.10 As in the March Budget, public sector net investment averages 2.9 per cent of GDP between 2021-22 and 2025-26 in our central forecast, thereby meeting this rule with a small margin of 0.1 per cent of GDP (£2.7 billion in today's terms). Given the way the Government has

defined this rule, the chances of meeting it are clearly sensitive to movements in nominal GDP over the forecast period (the denominator), and to policy decisions and the ability to meet capital spending plans (which drive the numerator). Variation in the path of nominal GDP across our upside and downside scenarios means that the rule is met by a slightly larger, but still small, margin (0.2 per cent of GDP) in the upside scenario. In the downside scenario, where net investment averages 3.0 per cent of GDP over the five years, the rule is missed by the tiniest margin (0.003 per cent of GDP).

The debt interest to revenue ratio rule

4.11 The debt interest to revenue ratio rule is met comfortably under all scenarios, by a margin ranging between 3.2 and 3.4 per cent of revenue. In our central forecast, the margin is 0.9 percentage points larger than it was in March, despite debt being materially higher. This is thanks to a further decline in interest rates, especially at shorter maturities, and an expansion in quantitative easing by the Bank of England, which further reduces the net interest costs of the public sector as a whole. However, the higher debt stock, shorter maturity of new debt issuance, and further expansion of quantitative easing has also significantly increased the sensitivity of the public finances, and this rule, to future changes in interest rates. The reasons for this are discussed further in Box 4.1.

Table 4.5: Performance against the Budget 2020 fiscal targets

		Per cent of GDP		£ billion	
		Forecast	Margin	Forecast	Margin
Current budget rule: Current budget balanced by 2023-24[1]					
March forecast	Met	-0.5	0.5	-11.7	11.7
November upside scenario	Met	-0.8	0.8	-19.4	19.4
November forecast	Not Met	**1.2**	**-1.2**	**29.1**	**-29.1**
November downside scenario	Not Met	4.2	-4.2	99.1	-99.1
Investment rule: Public sector net investment no more than 3 per cent of GDP on average					
March forecast	Met	2.9	0.1		
November upside scenario	Met	2.8	0.2		
November forecast	Met	**2.9**	**0.1**		
November downside scenario	Not Met	3.0	0.0		
Debt interest to revenue ratio: Interest costs no more than 6 per cent of revenue					
March forecast	Met	3.5	2.5		
November upside scenario	Met	2.6	3.4		
November forecast	Met	**2.7**	**3.3**		
November downside scenario	Met	2.8	3.2		

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

Other measures of fiscal sustainability

4.12 In his March Budget, as the extent of the pandemic was only just starting to become evident, the Chancellor promised to "*review the fiscal framework, consulting widely with a range of experts*", committing to "*report back in the autumn*" if "*any changes are necessary*". As the full force of the pandemic has become clear, the Government cancelled the Budget and multi-year Spending Review and has instead announced a one-year Spending Review. The

conclusions of the Government's review of the fiscal framework have also been postponed and no new official rules or targets have been articulated.

4.13 However, in a speech to the Conservative Party conference in October, the Chancellor stated that the Government will "*protect the public finances*" by "*over the medium term getting our borrowing and debt back under control*" and that "*this Conservative government will always balance the books*".[2] There were no specific metrics attached to these statements, but they point to a desire to restore the public finances to some measure of balance and return debt to a more sustainable path. In this section we therefore look at different ways that 'the books' might be balanced and debt brought under control and the extent to which these objectives are met by the current forecast horizon.

Balancing the books

4.14 'Balancing the books' can mean different things to different people and in different contexts. Under the Budget Responsibility and National Audit Act, it is for the Government to specify its fiscal targets in a revised *Charter for Budget Responsibility*. Pending such clarification, we examine the outlook for several potential and widely recognised definitions of fiscal balance. These relate to:

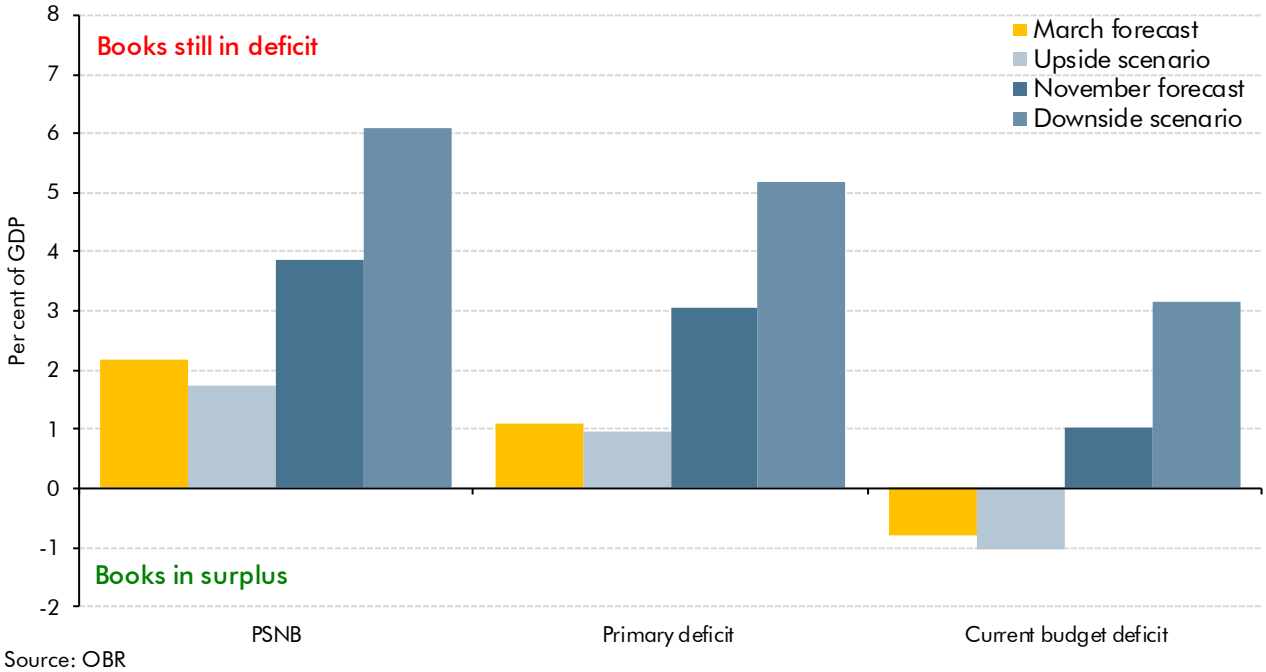
- the **overall deficit** (public sector net borrowing);
- the **current budget deficit** (current spending minus current receipts); and
- the **primary deficit** (non-interest spending minus non-interest receipts).

4.15 Chart 4.1 shows our previous and latest projections for each of these three measures at the forecast horizon (2024-25 in our March forecast; 2025-26 for this forecast and the upside and downside scenarios). These would suggest:

- Delivering an **overall balance** (eliminating the deficit on PSNB) would be the most challenging interpretation of 'balancing the books'. The Government was already far from meeting this legislated objective in our March forecast, and it has become even more demanding in our central forecast – with the deficit standing at 3.9 per cent of GDP (£102 billion) in 2025-26.
- As net debt interest spending is around 1 per cent of GDP across our scenarios, eliminating the **primary deficit** would be slightly less challenging, with the deficit on this measure at 3.0 per cent of GDP (£80 billion) in 2025-26 in our central forecast.
- As net investment spending is around 3 per cent of GDP by 2025-26, achieving **current balance** would be less challenging still. The Government was on track to post a modest current surplus by the end of our March forecast. That is still the case in our central forecast, in which the deficit on this measure stands at 1.0 per cent of GDP (£27 billion) in 2025-26.

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

Chart 4.1: Three measures of 'balancing the books' at the forecast horizon



Source: OBR

Getting debt under control

4.16 'Getting debt under control' could also mean different things to different people. Recent UK fiscal frameworks have interpreted it as arresting the rise in some measure of government liabilities in relation to the size of the economy. Three potential measures of those liabilities would be:

- **headline public sector net debt** (PSND), which includes all government debt net of its liquid assets;
- **PSND excluding the Bank of England** (PSND ex BoE), which excludes the effects of the Bank's gilt purchases under quantitative easing and the loans it extends under the Term Funding Scheme that are neutral for broader balance sheet measures; and
- **public sector net financial liabilities** (PSNFL), which includes all financial liabilities and financial assets held by the public sector, including by the Bank of England.[3]

4.17 Chart 4.2 shows our previous and latest projections for each of these three measures at the respective forecast horizons. Focussing just on the results for our central forecast, these show that:

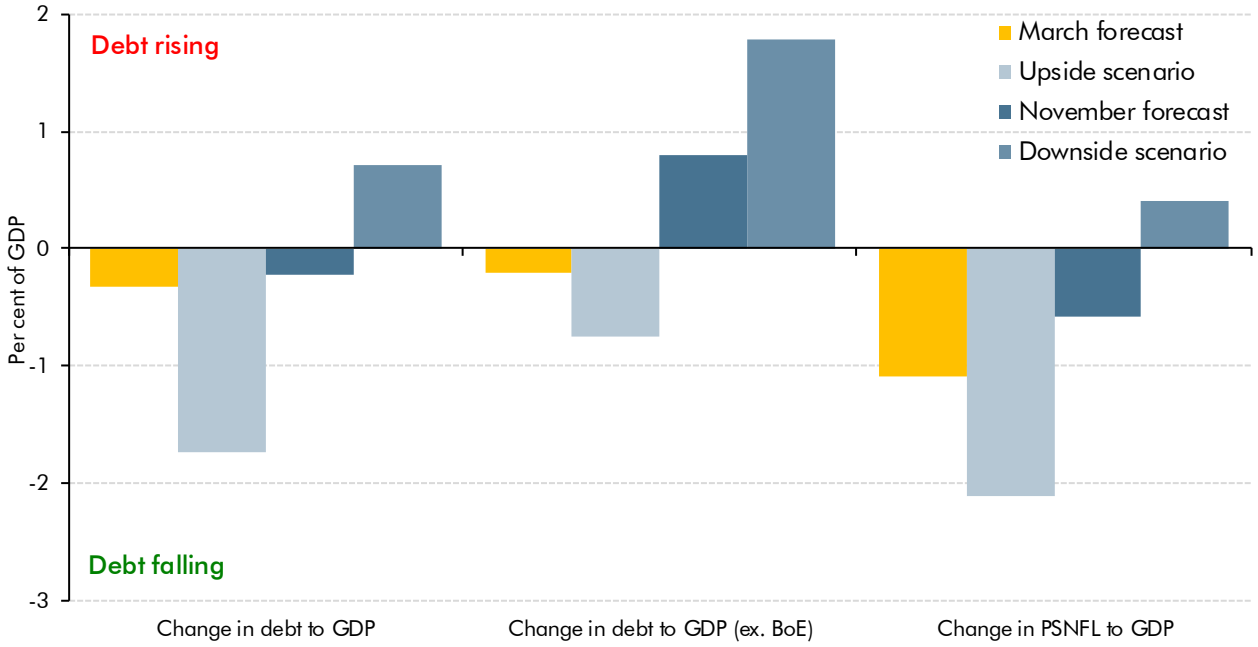
- The **headline debt to GDP ratio** falls by 0.2 percentage points in 2025-26. But that is only thanks to the repayment of TFS loans at end of their four-year term, which more than explains the year-on-year decline in the debt to GDP ratio in 2025-26.

[3] Broader measures of the public sector balance sheet also exist. Since June 2019 the ONS has been publishing estimates of public sector net worth (PSNW) based on the *IMF's Government Finance Statistics framework in the public sector finances*, October 2019. This is a measure of the sustainability of the public finances that takes account of all assets and liabilities held by the public sector. A forthcoming OBR working paper will examine the issues and methods for forecasting PSNW as a supplementary measure of fiscal sustainability.

- The **underlying debt to GDP ratio, excluding the Bank of England** rises by 0.8 percentage points in 2025-26. The margin by which debt rises is smaller than the size of the deficit projected on the three measures considered above.

- The **PSNFL-to-GDP ratio** falls by 0.6 percentage points in 2025-26. Bringing debt under control on a sustained basis looks more achievable on this metric than on the others.

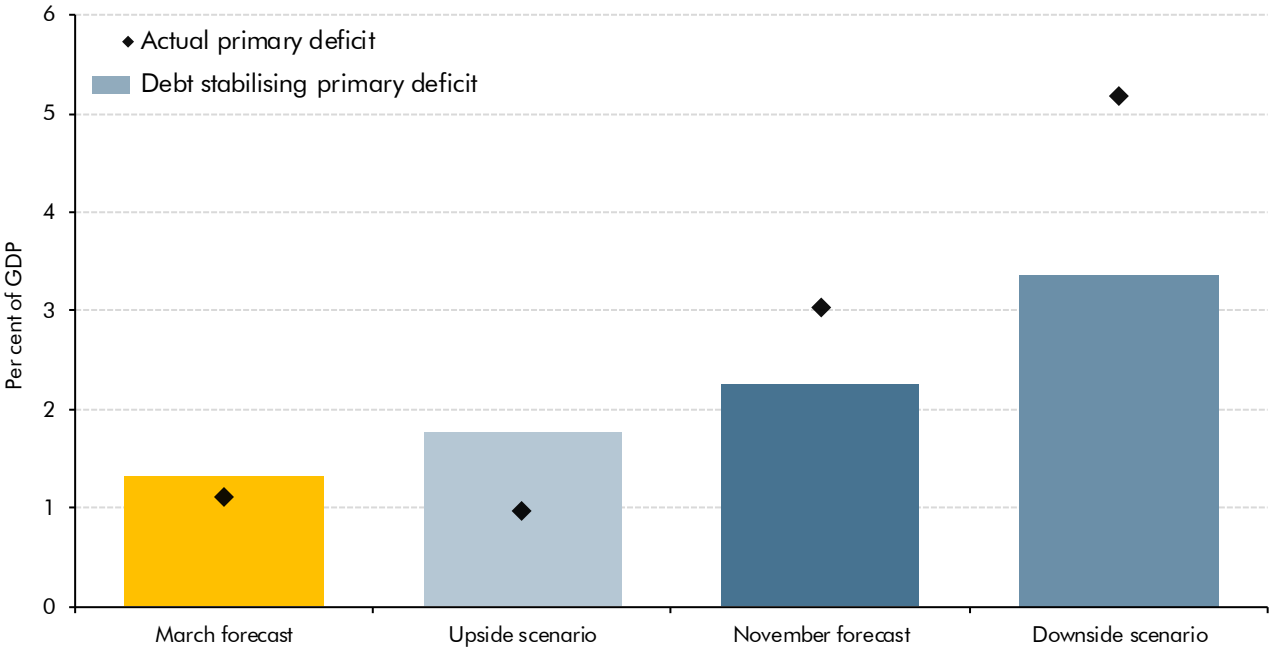
Chart 4.2: Three measures of 'getting debt under control' at the forecast horizon



Source: OBR

4.18 The relationship between 'balancing the books' and 'getting debt under control' is not constant, but depends on the level of debt, the performance of the economy, and the real rate of interest. Chart 4.3 compares the level of the primary deficit at the end of each of our three forecast scenarios with the level required to stabilise the debt to GDP ratio (on the measure that excludes the Bank of England) in the same year. It shows that, even though the debt stabilising primary deficit is higher in the central forecast and downside scenarios, it is only in the upside scenario that the primary deficit falls below its debt stabilising level.

Chart 4.3: Debt stabilising versus actual primary deficits at the forecast horizon



Source: OBR

4.19 Box 4.1 discusses the historical evolution of the debt stabilising primary balance. It also explains why it may appear to be 'easier' to stabilise debt the higher it rises, and the fiscal risks that such an interpretation entails.

Box 4.1: Trends in the debt stabilising primary deficit

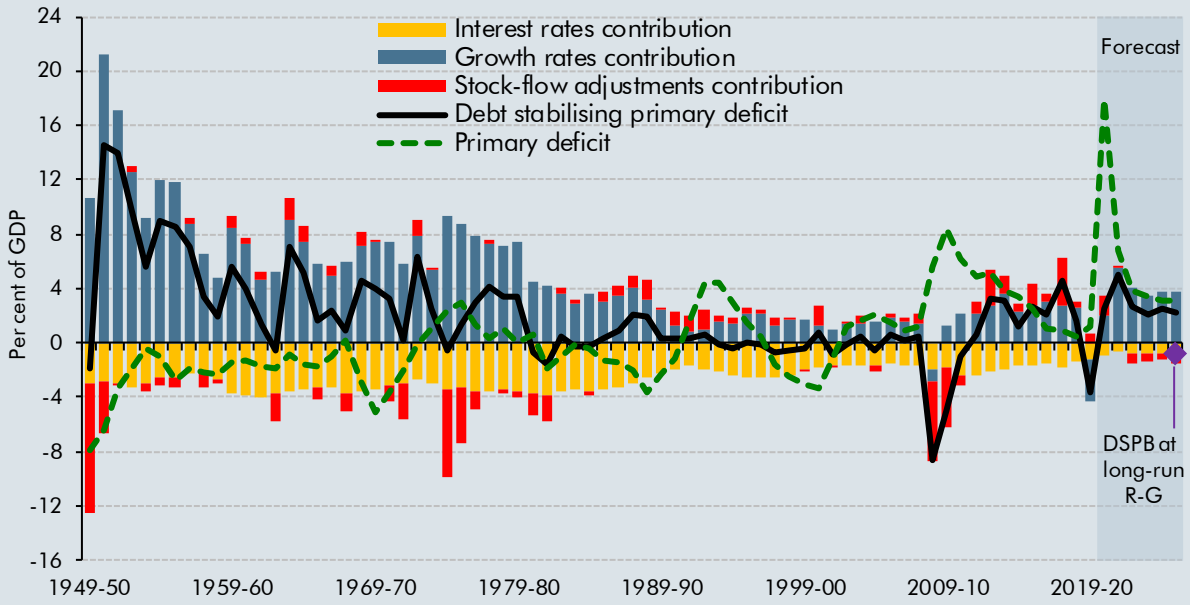
The debt stabilising primary deficit (DSPD) is the level of the primary (i.e. non-interest) deficit at which debt would stay constant as a share of GDP.[a] It must be large enough to offset the effects of: (i) the growth rate of nominal GDP, which lowers debt relative to GDP, and so raises the DSPD; (ii) the nominal interest rate on government debt, which has the opposite effect; and (iii) any stock-flow adjustments (factors other than borrowing that affect debt), like loans and asset sales, which can have either a positive or negative effect.

If the interest rate exceeds the growth rate, then – absent stock-flow adjustments – a primary *surplus* would be necessary to stabilise debt. If, as in recent years, growth rates exceed interest rates then a primary deficit would be necessary to stop debt from falling. Moreover, the higher the starting debt level is, the higher the debt stabilising level of the deficit: not only can more be borrowed without debt rising, more *must* be borrowed to stop it falling. So, at face value, it appears 'easier' to stabilise the debt to GDP ratio when it is higher. But this also leaves the public finances more vulnerable to rises in financing costs.

As Chart A shows, the DSPD was at its most favourable (at 15 per cent of GDP) in 1951-52, when high debt and an expanding economy helped bring the debt to GDP ratio down from its post Second World War peak. It was at its least favourable (at minus 8.7 per cent of GDP) in 2008-09, when the government acquired stakes in several large banks during the financial crisis. The DSPD averages 2.8 per cent of GDP in our central forecast which is high by post-war

standards when it spent decades close to zero. These historically favourable dynamics reflect the higher debt level, catch-up growth after the sharp fall in output this year, and the financing of deficits at ever lower interest rates. However, at our estimate of long-run interest and growth rates, a primary *surplus* of 0.9 per cent of GDP would be required to stabilise debt – a 4 per cent of GDP improvement relative to the primary deficit in 2025-26 implied by the government's current plans.

Chart A: Trends in the debt stabilising primary deficit



Note: Chart shows the debt stabilising primary deficit that stabilises debt *excluding* the Bank of England.
Source: ONS, OBR

[a] If R_t is the effective nominal interest rate on government debt, G_t is the nominal growth rate, d_t is the debt to GDP ratio, and sfa_t is stock-flow adjustments (as a share of GDP), then the debt stabilising primary deficit is the negative of $[(R_t - G_t) / (1 + G_t)] d_{t-1} + sfa_t$.

Recognising uncertainty

4.20 The *Charter for Budget Responsibility* requires the OBR to assess whether the government has a greater than evens chance of meeting its fiscal objectives. In normal times we therefore aim to produce a median forecast. But coronavirus is an exceptional economic and fiscal shock with few historical parallels. A broad array of outcomes from the pandemic are possible, and we have no meaningful way of attaching probabilities to particular outcomes or judging whether the eventual outturn is as likely to be above as below our central forecast. However, given the broad range of paths for the virus, economy, and public finances over the coming months and years, it is even more important than usual to appreciate the uncertainty inherent in making economic and fiscal projections.

4.21 In this final section we therefore conclude our assessment of the Government's performance against the fiscal targets by looking at three ways of assessing the degree of uncertainty surrounding the fiscal outlook based on:

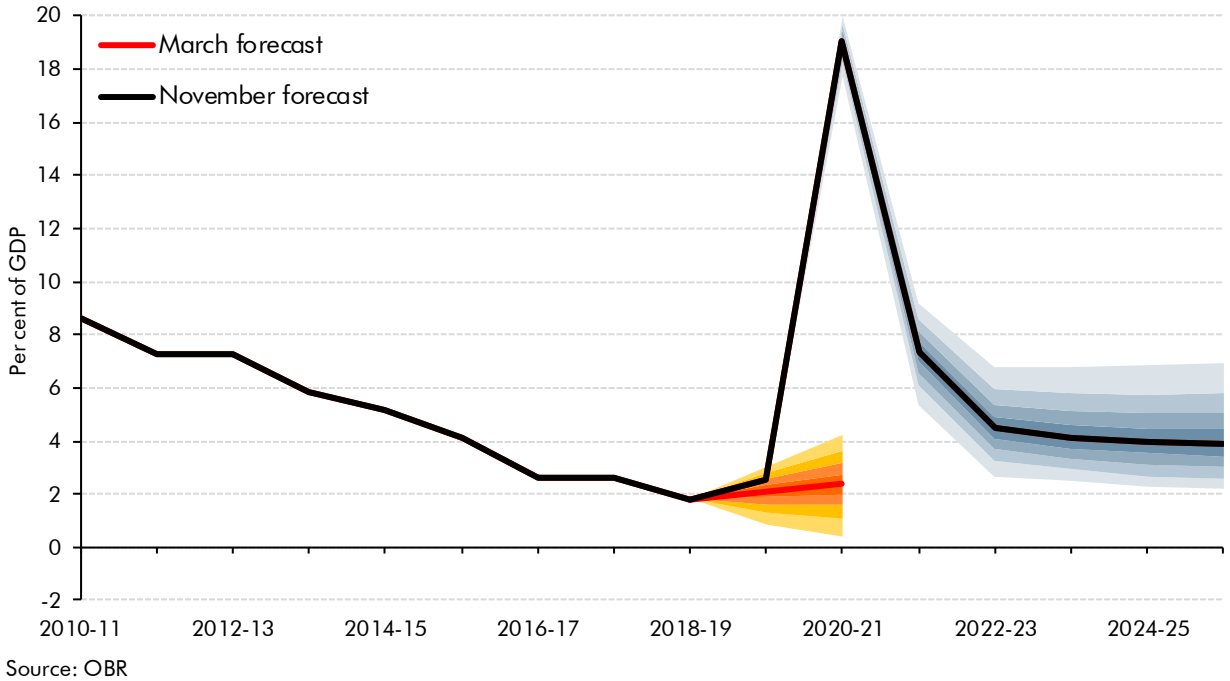
- the size and distribution of past fiscal forecasting errors;
- the evidence from the historical scale and frequency of major fiscal shocks over a longer timeframe; and
- alternative scenarios for the paths of coronavirus and the Brexit negotiations.

Past performance

4.22 Our conventional way of presenting uncertainty around our central forecast is to base it on past differences between official public finance forecasts (both our own and the Treasury's before us) and outturns. These historical forecast errors can then be illustrated using fan charts showing the probability distribution around our central forecast. The problem with this approach is that the shocks experienced during the 31-year period from which the forecast errors are drawn are not comparable with the disruption created by the coronavirus pandemic and the fundamental uncertainties it has created around the path ahead.

4.23 This can be illustrated by comparing the fan chart generated by those historical forecast errors against our March 2020 PSNB forecast. It suggests that the chance of borrowing this year hitting the 19 per cent of GDP in our central forecast was less than 0.5 per cent – a once-in-every 200 years shock, which is perhaps reasonable given the rarity of global pandemics. But it also suggests that we can be 80 per cent confident that the deficit will be between 5 and 9 per cent of GDP in 2021-22, which seems much less reasonable given we are still in the middle of such a pandemic. The virus-related uncertainty around the five-year path for borrowing is therefore undoubtedly much greater than is suggested by a fan chart generated using our standard methodology (Chart 4.4). But we do not consider there to be a credible way of overwriting this methodology with a subjective probability distribution.

Chart 4.4: Fan chart around our PSNB central forecast



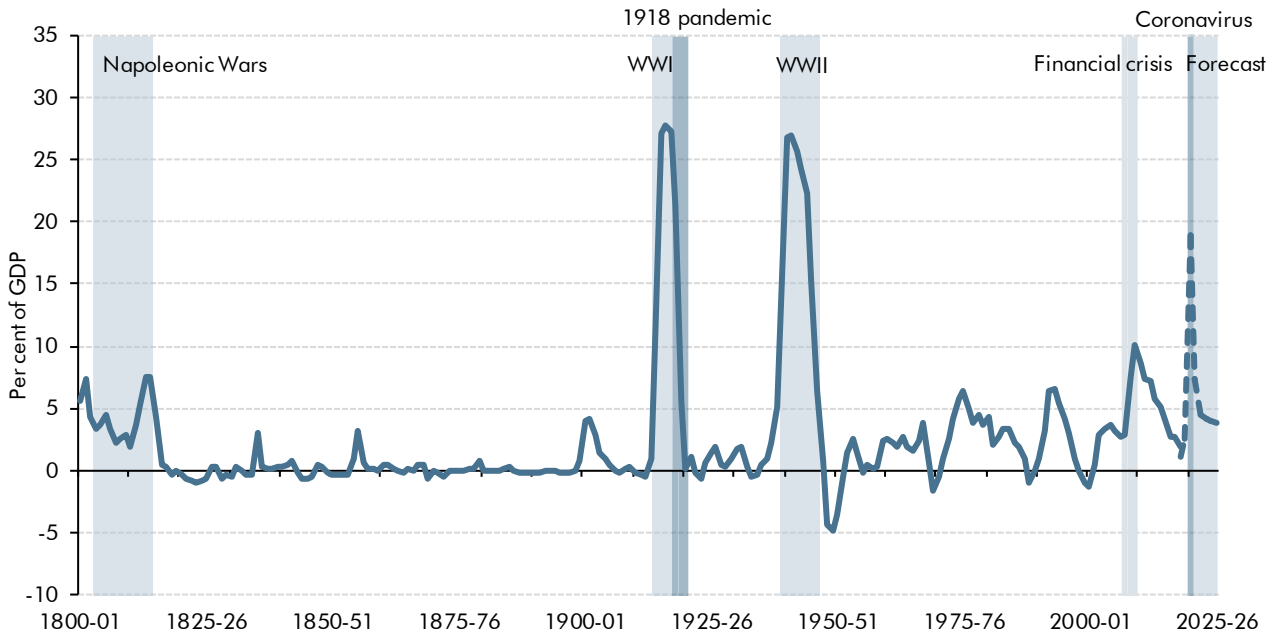
Source: OBR

Historical trends in the public finances

4.24 Another way to consider the potential uncertainty surrounding the fiscal outlook in the wake of such an unusually large shock is to look at longer-run historical trends in key fiscal aggregates. This captures a much broader range of more extreme events such as wars, previous pandemics, and severe economic depressions, and therefore puts the coronavirus shock in context. It also provides a better illustration of the potential immediate impact and legacy of the coronavirus shock for the public finances. We therefore look in this section at trends in the deficit and debt over the past two centuries.

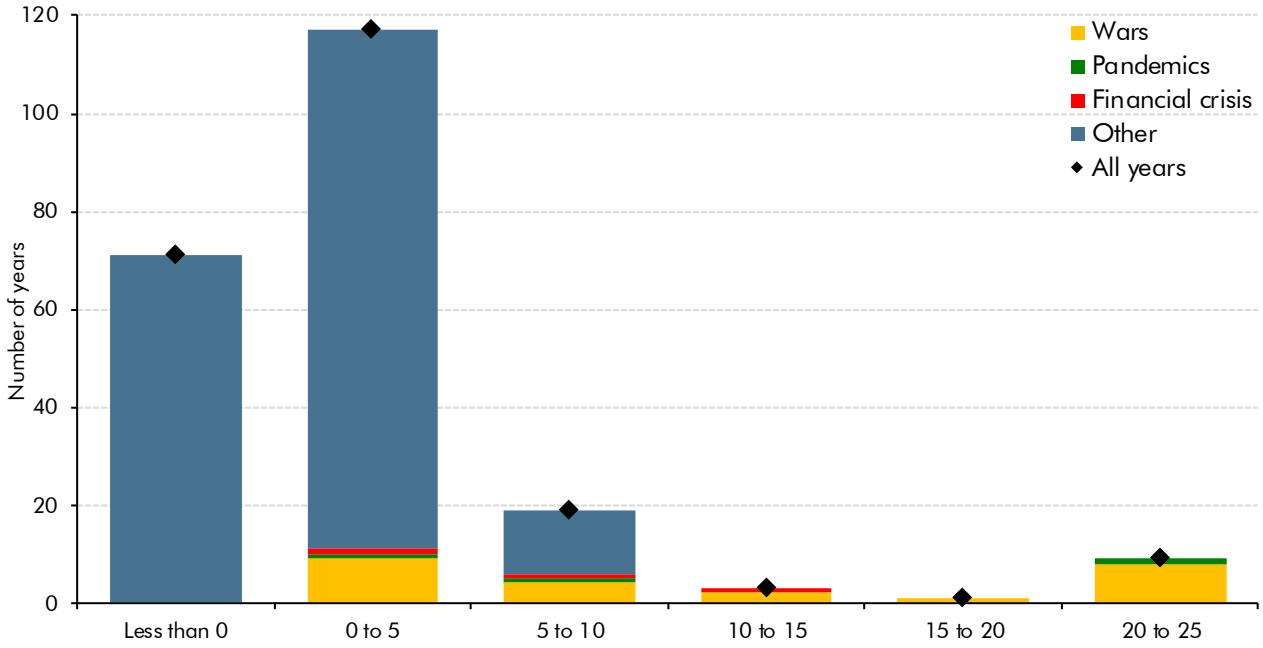
4.25 Chart 4.5 shows how borrowing has evolved as a share of GDP since 1800, while Chart 4.6 shows the distribution of those deficits across those 220 years. In most years headline deficits have been below 5 per cent (including those years where the budget was in surplus). PSNB was close to balance – between -1 and 1 per cent of GDP – a little over half the time (119 out of 220 years). Only during extreme events like the two world wars did government borrowing reach as high as the levels we forecast for the current fiscal year.

Chart 4.5: Public sector net borrowing since 1800



Source: Bank of England, OBR

Chart 4.6: Historical distribution of public sector net borrowing as a share of GDP

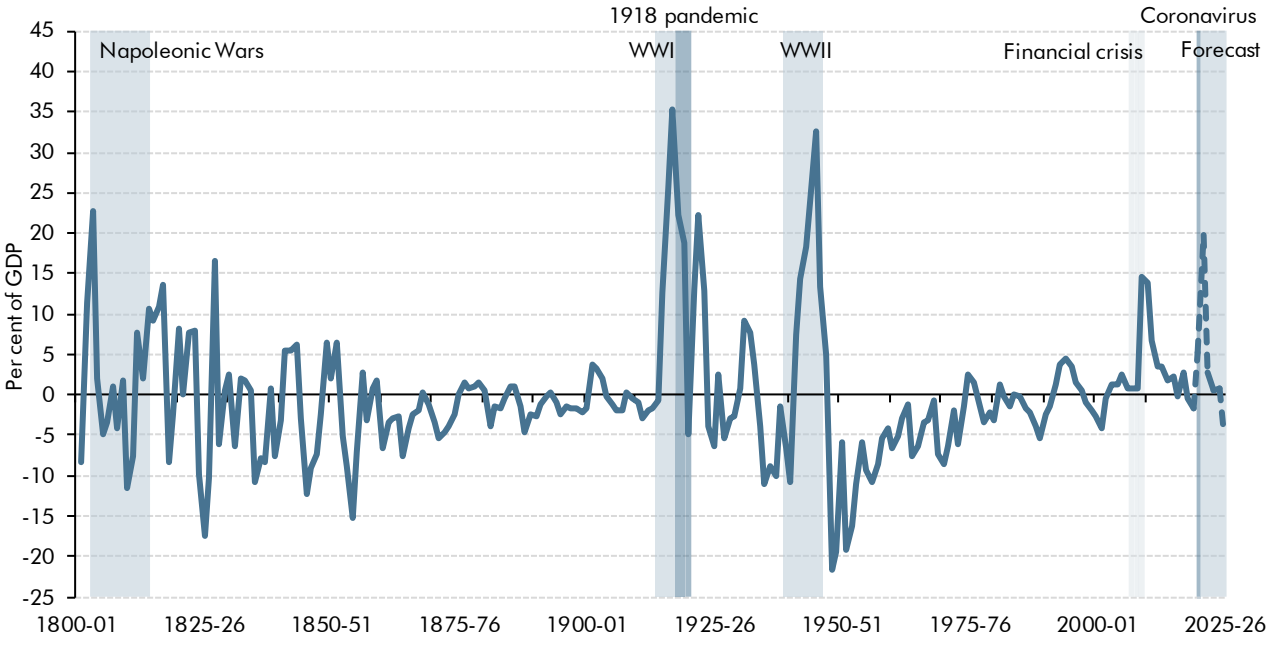


Source: Bank of England, OBR

4.26 Borrowing has been more volatile since the Second World War than it was in previous peacetime eras. This partly reflects the increase in the size of the welfare state and the more active role it has played in stabilising the macroeconomy and insulating households and firms from economic shocks. Over the past six decades each spike in headline PSNB has also been higher than the previous one, while surpluses have become less and less frequent (occurring in only seven years, mainly at the end of the 1960s, 1980s and 1990s). This suggests that the public finances have not only become more exposed to shocks, but also those shocks have been biased towards the downside. In short, over the past two decades we appear to have abolished fiscal booms but not busts.

4.27 Sudden, large increases in the debt to GDP ratio of the scale we have seen this year are also rare in peacetime. The debt to GDP ratio has only risen by more than 20 percentage points in a single year on seven occasions since 1800, five of which were during world wars. The coronavirus shock can therefore be thought of as a 'once in a century' shock to the level of debt or a 'tail event' in probability terms. Because debt is a stock and shocks to borrowing are asymmetrically negative, large debt shocks have also proved persistent over time. Governments therefore had to run sustained primary surpluses following periods of rapid debt accumulation during the Napoleonic, First, and Second World Wars in order to bring debt down again afterwards.

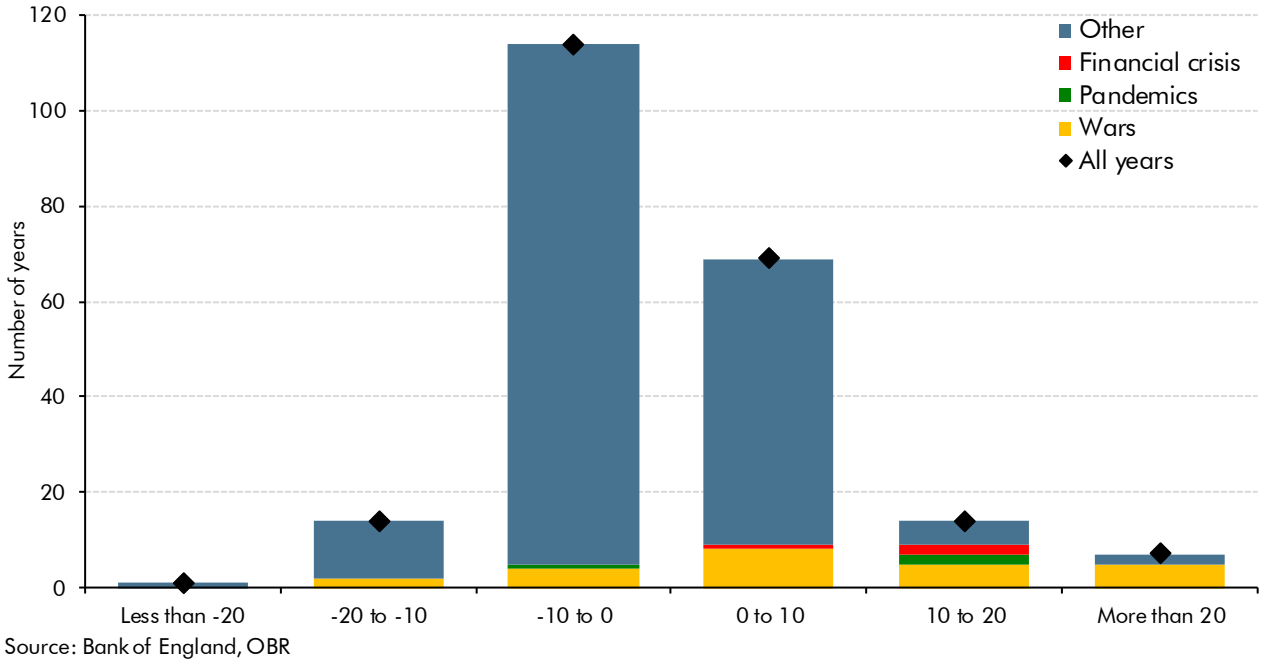
Chart 4.7: Changes in public sector net debt as a per cent of GDP since 1800



Source: Bank of England, OBR

4.28 The full history of year-on-year changes in the debt to GDP ratio would suggest that improvements in the debt position relative to the economy have occurred more often than deteriorations, but this frequency has reduced over the same past five decades as real growth, inflation, and average fiscal surpluses have all declined. The peak rise in the debt to GDP ratio during the financial crisis was not followed by the 22 per cent fall observed after the second world war. Reductions of this size are indeed infrequent and occurred in only one year out of 220.

Chart 4.8: Historical distribution of changes in PSND as a per cent of GDP



Source: Bank of England, OBR

4.29 Applying the historical distribution of annual shocks to borrowing to the future path of borrowing would widen our fan charts compared to those which rely on recent forecast errors. A fan chart constructed based on five-year forecast errors over the past 31 years has a 60 per cent confidence interval of 3.2 per cent of GDP and a 90 per cent confidence interval of 6.0 per cent. By contrast, the historical distribution of borrowing shocks from the past 220 years would imply a 60 per cent confidence interval of 4.1 per cent and a 90 per cent confidence interval of 12.0 per cent. At the 60 per cent confidence interval, the fan chart implied by the long-run volatility in borrowing would therefore be 27 per cent wider than implied by forecast errors over the past three decades. At the 90 per cent confidence interval it would be twice as wide given the 'fat tails' of the historical distribution of shocks.

4.30 However, the uncertainty faced at the current juncture is still greater than that experienced on average over the past two centuries, as we are still in the throes of a large idiosyncratic economic shock. It is more akin to the midst of world wars or the 1918-19 flu pandemic than periods before or after. But the path of borrowing in the middle of these previous shocks provides limited guidance as to the risks surrounding the current outlook, as no two had the same duration, economic impact, or implications for the public finances. The fact that the First World War and 1918-19 flu pandemic occurred in quick succession further complicates any effort to extract clear lessons concerning the latter's impacts. And at the current juncture, virus-related uncertainty is compounded by continued uncertainty about the path of the Brexit negotiations.

Scenario analysis

4.31 Given the limitations of both recent forecast errors and historical volatility in capturing the degree of uncertainty surrounding the fiscal outlook in the midst of the coronavirus pandemic and the Brexit negotiations, we rely on scenario analysis to portray the degree of uncertainty around our forecast. As stated above, there is no meaningful way to assess the probability of any given scenario occurring. And the 8.3 per cent range between our upside and downside scenarios in 2021-22 serves to highlight that a wide range of outcomes are possible. Normally, such a wide range would lie outside the 99 per cent confidence interval based on historical one-year ahead forecast errors and correspond to almost a 90 per cent confidence interval based on historical experience. But as we have stressed above, from our present vantage point all three futures appear possible.

4.32 As outlined above and in Chapter 3, the range of potential outcomes for borrowing and debt over the medium-term across these three scenarios is very wide. Borrowing could range anywhere from below 2 per cent in the upside scenario to over 6 per cent of GDP in the downside scenario in 2025-26. And debt could range from around 90 per cent of GDP to over 120 per cent of GDP in five years' time. These scenario ranges are closer to the confidence internals implied by the longer run historical distribution of fiscal shocks than those based on more recent forecast errors. We will continue to reflect on our methods for modelling and communicating the uncertainty around our forecasts in future *EFOs*.

A Policy measures announced since March

Overview

A.1 Our *Economic and fiscal outlook (EFO)* forecasts incorporate the expected impact of the policy decisions announced in each Budget or other fiscal statement. In the run-up to each one, the Government provides us with draft estimates of the cost or gain from each policy measure it is considering. We discuss these with the relevant experts and then suggest amendments as necessary. This is an iterative process where individual measures can go through several stages of scrutiny. After this process is complete, the Government chooses which measures to announce and which costings to include in its main policy decisions scorecard. For these scorecard costings we choose whether to certify them as 'reasonable and central', and whether to include them – or alternative costings of our own – in our forecast. We also include the effects of policy decisions that do not appear on the scorecard. In this *EFO* we have certified all measures as reasonable and central. As well as the particular uncertainties associated with each one, they are of course also clouded by the more fundamental uncertainties associated with the future course of the pandemic.

A.2 Given the unusual and challenging circumstances under which officials across departments have been working – and the variety of novel measures being costed – the process worked remarkably efficiently. We are grateful to all those involved for providing the information we requested in order to complete the scrutiny process that enabled us to certify the costings.

Government policy decisions

A.3 The Government's fiscal policy response to the pandemic is summarised in Table A.1, along with the more modest effects of several Brexit-related policy measures, the lower path for medium-term departmental spending announced in the Spending Review, and other minor measures:

- Split **by time period**, the top panel shows that around two-thirds of the cost of virus-related interventions relates to measures announced by the time of the Chancellor's Summer Economic Update (SEU) in early July. Measures announced over recent months as the virus took hold again, including those in the Spending Review, have cost relatively less, though they are still large sums by historical standards.

- Split **by type of measure**, the middle panel shows that virus-related measures dominate. Support for public services (especially health), for employment (via furlough support and payments to the self-employed), and for businesses (via grants, business rates holidays and guaranteed loans), all run into the tens of billions of pounds. From

2022-23 onwards, the single most important measure is the Spending Review decision to cut £10 to £12 billion from departmental resource spending relative to the totals set in the Budget in March.

- Split **by receipts and spending lines**, the bottom panel shows that departmental resource spending dominates (where the health costs sit), followed by annually managed resource spending (where the employment support measures sit).

- The **indirect fiscal effect of decisions** relates only to measures announced since the SEU. It largely reflects the boost to receipts via a higher path for GDP from further rises in departmental spending and the extension of various virus-related support measures.

Table A.1: Summary of the total effect of Government decisions since March

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Government decisions since March	**-1.8**	**-242.5**	**-20.1**	**10.7**	**14.0**	**14.8**	**13.9**
Direct effect of decisions since March	**-1.8**	**-266.6**	**-43.3**	**11.0**	**15.2**	**16.0**	**15.5**
of which:							
Direct effect of decisions up to SEU	-4.1	-192.3	-0.1	-0.2	-1.4	-0.9	0.0
Recostings of FSR plus SEU	2.4	11.5	-3.7	-0.8	0.3	-0.1	-1.0
Direct effect of decisions since SEU	-0.1	-85.7	-39.5	12.0	16.3	17.1	16.5
of which:							
Winter Economy Plan	-0.1	-37.3	5.2	-0.7	0.0	0.0	0.0
CJRS, SEISS extensions	0.0	-21.1	0.9	0.0	0.0	0.0	0.0
New policy measures	0.0	-27.2	-45.6	12.7	16.3	17.1	16.5
of which:							
Virus-related support measures	-1.8	-280.0	-52.7	-1.9	-0.7	-0.7	-0.5
of which:							
Public services	0.0	-127.1	-58.8	0.1	0.3	0.0	0.0
Employment support	-1.8	-73.3	2.5	0.0	0.0	0.0	0.0
of which:							
CJRS	-1.8	-53.7	0.0	0.0	0.0	0.0	0.0
SEISS	0.0	-19.6	2.5	0.0	0.0	0.0	0.0
Loans and guarantees	0.0	-31.4	-0.4	0.0	0.0	0.0	0.0
Business support	-0.2	-34.1	6.5	-0.6	0.0	-0.1	-0.1
Welfare spending	0.0	-8.3	-1.7	-1.3	-0.8	-0.5	-0.3
Other tax measures	0.1	-5.7	-0.8	-0.1	-0.2	-0.1	-0.1
Spending Review (non-virus)	0.0	0.0	12.3	11.9	13.3	13.8	14.0
Other measures	0.0	13.4	-2.9	1.0	2.6	3.0	2.0
of which:							
Resource DEL	0.0	-121.0	-47.4	10.5	12.7	13.2	12.5
of which:							
Virus-related RDEL	-2.2	-123.1	-56.0	-0.7	-0.8	-0.8	-0.8
Capital DEL	0.0	-5.8	0.3	0.0	0.0	0.0	0.0
Resource AME	-2.1	-94.7	-5.4	-0.3	0.7	0.7	0.7
Capital AME	0.0	-29.5	0.9	0.3	0.3	0.4	0.4
Receipts	0.3	-15.5	8.4	0.5	1.5	1.7	1.8
Indirect effect of decisions since SEU	**0.0**	**24.0**	**23.2**	**-0.3**	**-1.2**	**-1.3**	**-1.6**

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

Virus-related policy measures

A.4 In the following sections we document the £280 billion of virus-related policy interventions announced since March that account for almost three quarters of the record peacetime budget deficit this year. (In Box 3.1 in Chapter 3 we show how this cost built up this year.)

Public services spending

A.5 Virus-related spending on public services is the largest contributor to the overall cost this year at £127.1 billion. At £58.8 billion in 2021-22, it more than explains the total cost in that year. The vast majority of this additional spending relates to health services, including the purchase of PPE and the cost of the Test and Trace programme, as discussed in Chapter 3. The Spending Review reduces business-as-usual (or non-virus-related) RDEL spending in the medium term relative to the totals that were set in the Budget in March.

Employment support measures

A.6 The **coronavirus job retention scheme** (CJRS) was first announced on 20 March, initially to run until the end of May but now to continue until the end of March 2021 (see Chapter 3). The gross cost of the subsidy has risen to £64.6 billion, with £62.5 billion of that in 2020-21. The cost relating to the period to the end of October is £42.5 billion (£12.1 billion less than we estimated in the *FSR* largely due to claims falling faster than expected).

A.7 Close to £9 billion of the gross cost comes directly back to the Exchequer in the form of the tax and NICs paid on the subsidised wages. Around £0.3 billion of payments had been repaid by employers by the end of October, reducing the net cost. But around £0.2 billion net loss of compliance yield across the tax system is due to the fact that HMRC is diverting staff from higher yielding activities to focus on CJRS recoveries. Taking all these factors into account gives a net cost of £55.5 billion over the lifetime of the scheme (see Table A.1).

A.8 The **self-employed income support scheme** (SEISS) is a taxable grant for the self-employed and members of partnerships. It was initially announced on 26 March as a single payment covering three months, and worth 80 per cent of average monthly profits over the preceding three tax years, up to a maximum of £7,500. A second grant worth 70 per cent of average monthly profits and capped at £6,570 in total was announced on 29 May, with a third following on 5 November, this time reverting to the 80 per cent rate. The gross cost of the three grants is £20.9 billion, all falling in 2020-21. £3.6 billion is recouped in income tax and NICs, around two-thirds of which falls in 2021-22 due to the lag in self-assessment payments. This gives a net cost of £17.1 billion (see Table A.1). A fourth grant has been announced, but the terms on which it will be paid have not yet been set.

Business support: loan guarantees

A.9 On 17 March, the Government pledged up to £330 billion in guarantees to support the economy. Following subsequent announcements, this now covers several loan schemes and a reinsurance agreement with trade credit insurance providers. As we explained in our July

FSR, the £330 billion is not a good guide to the likely fiscal costs, which will depend on both the volume of guaranteed lending and the proportion that is eventually called.

A.10 Our *FSR* central scenario estimated lifetime fiscal costs of £19.7 billion for all loan and guarantee schemes, based on the policies at the time. Since then the Government has extended the Bounce Back Loans Scheme (BBLS), the Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Large Business Interruption Loan Scheme (CLBILS) so that they are now open until 31 January 2021. The Government also announced a *Pay As You Grow* plan that provides more flexible repayment options for BBLS and CBILS borrowers should they need them. This includes options to increase the repayment period to 10 years, take repayment holidays, or make interest-only payments.

A.11 As of 15 November 2020, over £65 billion of lending had been provided through the three schemes with almost 1.5 million facilities approved. We have assumed that this will rise to £87 billion by the time the schemes close. Our *FSR* scenarios for the fiscal costs of the schemes used broad-brush assumptions about loss rates by scheme that drew on some historical precedents. The British Business Bank (BBB) has since published its own estimates of lifetime loss rates on each scheme.[1] As with our initial assumptions, these lie in broad ranges, with central estimates that imply even higher loss rates than we had assumed, though with the same key conclusion that uncertainty over future costs is large. We have used the BBB's estimates in the updated costings in this *EFO*. The combined effect of these higher loss rates and the scheme extensions is to increase the expected calls on the guarantees from £16.9 billion at the *FSR* to £29.5 billion in this forecast.

Table A.2: Costings for loan guarantees

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
BBLS	Spend	-26.6	-0.2	0.0	0.0	0.0	0.0
CBILS	Spend	-3.8	-0.2	0.0	0.0	0.0	0.0
CLBILS	Spend	-0.5	0.0	0.0	0.0	0.0	0.0
Other guarantees	Spend	-0.5	0.0	0.0	0.0	0.0	0.0
Loans and guarantees		**-31.4**	**-0.4**	**0.0**	**0.0**	**0.0**	**0.0**
Memo: Cash impacts							
BBLS	*Cash*	*-1.3*	*-13.6*	*-8.3*	*-2.9*	*-1.1*	*0.0*
CBILS	*Cash*	*-0.6*	*-1.1*	*-0.6*	*-0.6*	*-0.4*	*-0.2*
CLBILS	*Cash*	*-0.1*	*-0.3*	*-0.1*	*0.0*	*0.0*	*0.0*

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Business support: tax and spending measures

A.12 Several tax and spending measures provide businesses with further support, at a total cost of £28.5 billion. Many were described in our July *FSR*, so this list describes the main changes to the *FSR* costings plus new announcements since the SEU:

[1] Department for Business, Energy, and Industrial Strategy, *BEIS annual report and accounts 2019 to 2020*, September 2020.

- **Business rates relief** and **business grants** are the two most costly measures. At £20.8 billion in total, the cost is around £1 billion higher than estimated in the *FSR*, largely due to outturn data.[2] **Freezing the business rates multiplier in 2021-22** rather than raising it by CPI inflation was announced in the Spending Review, saving business rates payers (other than those already benefitting from full relief) £0.1 billion a year.

- The **VAT payment deferral** measure now has two elements. The original measure allowed VAT payments that were due between 20 March and 30 June 2020 to be deferred to no later than 31 March 2021. In the *FSR* we assumed all payments would be made on the initial due date (other than some non-payment by firms that go out of business). In reality it is likely that many will go into staggered payment arrangements, which alters the payment profile. The second element is the **'New Payment Scheme'** that was announced in the Winter Economy Plan (WEP) and that effectively extends the deferral period by allowing taxpayers to pay their deferred VAT payments in up to 11 equal instalments, starting no later than 31 March 2021. Around £34 billion of VAT payments have been deferred (around £4 billion lower than we assumed in the *FSR*). We maintain our original assumption that the non-payment rate for the original measure is 5 per cent, but add a further 1.5 per cent to the extension on the basis that more time to pay will also involve more time for firms to go out of business. The costings now also account for some yield from HMRC's debt recovery activities.

- The **income tax and NICs self-assessment (SA) payment deferral** now also includes two parts. The original measure allowed taxpayers to defer the July payment-on-account to the January 2021 final SA deadline. An estimated £5.8 billion of SA payments have been deferred, much lower than the £11.8 billion assumed in the *FSR*, probably at least partly due to the messaging from HMRC and tax advisers. In the WEP the deferral was effectively extended with the announcement that the **eligibility criteria for Self-Service Time to Pay (TTP) arrangements would be widened** to include taxpayers with outstanding SA tax bills of up to £30,000 (previously £10,000). This allows them to arrange a TTP of up to 12 months online. The costs from these measures relate to the amount of deferred tax that is not then repaid. We retain the 10 per cent non-payment rate we assumed for the original measure in the *FSR* and add a further 1.5 per cent for the second measure, again to allow for additional defaults given the longer deferrals. The costing accounts for payments received through HMRC's debt recovery activities.

- In the SEU the Government announced a **temporary cut to VAT for the 'hospitality, accommodation and attractions' sectors**, from 20 to 5 per cent. It was initially due to last until 12 January but was subsequently extended to 31 March 2021 in the WEP. The cost of the combined measures is £2.5 billion. Further support for the hospitality sector came from the '**Eat Out to Help Out'** scheme that was also announced in the SEU and offered 50 per cent discounts up to £10 per head on Mondays to Wednesdays through August. The final cost of the scheme is £0.8 billion, with 160

[2] The *FSR* total included the Barnett consequentials, while for this *EFO* they are captured within public services spending.

million meals having been subsidised at a total of 70,000 restaurants, pubs and other eateries. This is two-thirds higher than the Treasury's initial estimate of £0.5 billion.

- Other tax and spending business support measures include **extending the temporary increase in the annual investment allowance to £1 million by a further year** (so it now runs until 31 December 2021) that was announced in November 2020.

- One of the largest proportionate downward revisions to a virus-related measure has been to the **statutory sick pay rebate**. In the March Budget, the Treasury estimated that this might cost £2 billion. We initially put a figure of £1 billion on it, before revising it down again to £200 million in the *FSR*, by which point it was clear that furloughing under the CJRS meant that sick leave would be much less prevalent than initially assumed. Outturn data to the end of October are now available and suggest that the cost will amount to just £50 million this year.

Table A.3: Costings for business support: tax and spending

		£ billion						
		Outturn	Forecast					
	Head	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Business rates relief	Tax/Spend	0.2	-9.6	0.3	-0.1	0.0	0.0	0.0
Business rates: freeze multiplier	Tax/Spend	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Business grant schemes	Spend	0.0	-11.7	0.0	0.0	0.0	0.0	0.0
VAT payment deferral	Tax	-0.3	-1.9	0.0	0.0	0.0	0.0	0.0
Self-assessed tax and NICs payment deferral	Tax/Spend	-0.1	-7.2	6.9	-0.3	0.0	0.0	0.0
Temporary VAT cut for hospitality & accomodation	Tax	0.0	-2.5	0.0	0.0	0.0	0.0	0.0
Eat Out to Help Out	Spend	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Other measures	Spend	0.0	-0.3	-0.5	-0.1	0.1	0.1	0.0
Business support		**-0.2**	**-34.1**	**6.5**	**-0.6**	**0.0**	**-0.1**	**-0.1**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Welfare spending measures

A.13 Welfare spending measures have contributed £8.3 billion to the overall cost of virus-related support measures in 2020-21 and £12.9 billion in total over the forecast period:

- The largest measure is the **temporary £20 a week increase in the standard allowance of universal credit (UC)**. This costs £4.6 billion in 2020-21, which is £0.9 billion lower than we assumed in the *FSR*, reflecting the smaller rise in the UC caseload than we assumed then. The possibility that this measure (and its equivalent in tax credits) is extended rather than being withdrawn next April poses a risk to our spending forecast.

- The **increase in the basic element of working tax credits (WTC) by the equivalent of £20 a week** costs £1.5 billion in 2020-21, similar to our *FSR* estimate. The **£20**

additional earnings disregard in housing benefit measure ensures the majority of WTC claimants do not lose housing benefit as a consequence of their higher WTC awards.

- The **increase in local housing allowance (LHA) rates to equal the 30th percentile of an area's market rents** raises UC or housing benefit awards for eligible private renters. At the time of the *FSR* the Government had not specified LHA rates beyond this year, so we assumed they rose in line with CPI inflation consistent with the default policy assumptions underpinning our March forecast. It has now decided that rates will be frozen in cash terms from 2021-22 onwards. This means the £1 billion cost of the measure in 2020-21 declines to £0.3 billion by 2025-26 (and that LHA rates will fall back below the 30th percentile of local rents over time).

- The **relaxation of the minimum income floor for UC** (the assumed level of income that reduces awards for some self-employed claimants) has been extended to the end of April 2021. The combined cost of the initial relaxation and its extension is £0.8 billion, up £0.3 billion on our *FSR* estimate.

- **Other welfare spending measures** cost £1.8 billion across the forecast period, with the vast majority due to a range of DWP and HMRC 'easements'. The cost falls from £0.9 billion this year to £0.5 billion next year and £0.3 billion in 2022-23.

Table A.4: Costings for welfare spending measures

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Increase weekly UC by £20	Spend	-4.6	0.0	0.0	0.0	0.0	0.0
Increase weekly WTC by £20	Spend	-1.5	0.0	0.0	0.0	0.0	0.0
LHA measures	Spend	-1.0	-1.0	-0.8	-0.7	-0.5	-0.3
UC: minimum income floor	Spend	-0.3	-0.3	-0.2	0.0	0.0	0.0
Other measures	Spend	-0.9	-0.5	-0.3	-0.1	0.0	0.0
Welfare spending		**-8.3**	**-1.7**	**-1.3**	**-0.8**	**-0.5**	**-0.3**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Other virus-related tax measures

A.14 The other virus-related tax measures include:

- **Stamp duty land tax (SDLT): increase the nil-rate threshold to £500,000**. From 8 July 2020 to 31 March 2021, the nil-rate threshold for residential SDLT has been raised from £125,000 to £500,000. This means that, temporarily, around 90 per cent of transactions will be exempt from SDLT. We have revised up the expected cost of this SEU measure from an initial £2.5 billion to £3.3 billion as the housing market recovery of recent months has led to a substantial rise in the number of transactions benefitting from the tax cut. It is not known how strong this recovery would have been in the absence of the measure. Some of the cost is due to transactions that will be brought forward to forestall the 31 March closing date.

- **VAT: zero rate on PPE** and **import VAT and customs duty exemption for medical products**. The combined cost of the two measures has risen ten-fold from our *FSR* estimate to £2 billion. This is largely driven by outturn data, but also a two-month extension to the second measure. As most of the VAT saving accrues to the NHS, the cost in foregone tax receipts largely reduces the amount that would otherwise have had to be allocated to the NHS to fund these purchases to help fight the virus.

- **A package of measures relaxing the immigration health surcharge and visa fees for health care providers**. Together, these cost £0.8 billion across the forecast period.

Table A.5: Costings for other virus-related support tax measures

		£ billion						
		Outturn	Forecast					
	Head	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
SDLT: increase nil-rate threshold to £500,000	Tax/Spend	0.0	-2.3	-1.0	0.0	0.0	0.0	0.0
Import duty: exemption for medical products	Tax	0.0	-1.1	0.0	0.0	0.0	0.0	0.0
VAT: zero rate on PPE	Tax	0.0	-1.0	0.0	0.0	0.0	0.0	0.0
Immigration health surcharge and visa fees	Tax	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other measures	Tax/Spend	0.1	-1.2	0.4	0.0	0.0	0.0	0.0
Other virus-related tax measures		**0.1**	**-5.7**	**-0.8**	**-0.1**	**-0.2**	**-0.1**	**-0.1**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

Devolved administration virus-related support measures

A.15 The devolved administrations have made their own spending decisions, partly funded by the Barnett consequentials of the measures announced by the UK Government that are described above.[3] These are set out below.

[3] These figures are adapted from: *Autumn Budget Revision 2020 to 2021*, Scottish Government, September 2020; *Supplementary Budget 2020-2021*, Welsh Government, October 2020; and *COVID-19 Funding Allocations*, Department of Finance Northern Ireland, 29 October 2020. The latest published figures for the Barnett consequentials are £6.4 billion for Scotland, £4.1 billion for Wales and £2.5 billion for Northern Ireland. The UK Government's guarantee of Barnett consequentials has since increased to a total of £16 billion, of which £8.2 billion is for Scotland, £5 billion is for Wales and £2.8 billion is for Northern Ireland.

Table A.6: Devolved administration virus-related support measures

	£ billion
Scottish Government spending	**6.5**
of which:	
Business support grants	1.2
Non-domestic rates reliefs	1.0
Health and social care	2.5
Community support fund	0.4
Additional support for small businesses and the self-employed	0.2
Other measures	1.2
Welsh Government spending	**4.1**
of which:	
Grants for businesses and charities	0.9
Health, social care and public services	2.1
Economic resilience fund	0.4
Non-domestic rates relief	0.3
Other measures	0.4
Northern Ireland Executive spending	**2.6**
of which:	
Allocated to departments	2.1
Rates support	0.4
Centrally held purposes	0.1

Non-virus-related policy decisions

A.16 Table A.7 sets out the measures announced since March that are unrelated to the virus.

Table A.7: Costings for non-virus-related policy decisions

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Spending Review (non-virus)	Spend	0.0	12.3	11.9	13.3	13.8	14.0
Customs duties: UK Global Tariff	Tax	0.2	0.8	0.9	0.9	0.9	0.9
EU Exit: VAT and excise duty non-compliance	Tax	-0.2	-0.7	-0.3	0.0	0.0	0.0
Abolition of VAT Retail Export Scheme	Tax	0.0	0.2	0.3	0.4	0.4	0.5
Abolition of Tax-Free airside shopping	Tax	0.0	0.1	0.1	0.2	0.2	0.2
VAT: zero rate for EU financial services exports	Tax	-0.2	-0.9	-0.9	-0.9	-1.0	-1.0
Other EU Exit measures	Tax/Spend	0.1	0.3	0.2	0.1	0.1	0.0
Other tax measures	Tax	1.7	0.8	0.9	1.1	1.3	1.5
Other spending measures	Spend	-11.9	3.5	0.2	-0.9	-1.1	0.0
Non-virus-related measures		**-10.3**	**16.4**	**13.4**	**14.1**	**14.6**	**16.1**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). A more detailed breakdown of these costings is available on our website.

A.17 As we set out in Chapter 3, the **Spending Review** reduces business-as-usual (or non-virus-related) RDEL spending totals by amounts rising to £14 billion in 2025-26 relative to the totals that were set in March. For CDEL plans to 2024-25 the Government has chosen to retain the same cash levels as in March.

EU exit measures

A.18 Since our March *EFO* the Government has announced a range of new policy measures for which estimates have been included in this forecast. For several others, such as the 'border operating model' and the 'Northern Ireland protocol', full costings have not been possible as some details are still pending. Some of these are discussed below.

A.19 **Customs duties: UK Global Tariff (UKGT)**. Our forecast assumes that the UK successfully concludes and ratifies a 'typical' free-trade agreement (FTA) with the EU over the next five weeks and makes a smooth transition to these new trading arrangements (Annex B presents a no-deal scenario where trading arrangements default to WTO terms instead).

A.20 The UKGT was first announced on 19 May and is due to replace the EU's Common External Tariff (CET) on 1 January 2021. The average tariff rate is lower than the CET with a greater number of tariff-free lines.[4] However, following the end of the transition period, existing EU trade agreements will not apply automatically to the UK, and the costing only includes replacement agreements that had been signed at the time we closed this forecast. That means that the rollover agreement with Canada that was announced on 21 November is not included. In 2019, imports from Canada accounted for around 5 per cent of the non-EU total, so the agreement will reduce receipts only modestly (the original EU-Canada trade deal took less than £0.1 billion a year off our November 2017 forecast). Its effect will be included in our next forecast along with any other agreements reached by then.

A.21 Switching to the UKGT under an EU-UK FTA generates around £1 billion a year in additional customs duties. The costing has four main elements:

- Before considering any behavioural responses to the new regime, around £1 billion less a year is raised because **tariff rates applied to non-EU imports are lower than under the previous regime**.

- This is more than offset by **customs duties levied on EU imports that cannot meet the terms of the FTA**. This may occur because of, among other things, the administrative costs or other difficulties in meeting rules of origin requirements. Drawing on evidence from 'preferential utilisation rates' (PURs) under existing FTAs, the costing assumes that between 80 and 90 per cent of EU imports will arrive tariff-free with the remainder paying customs duties that yield around £1.4 billion a year.

[4] *Public Consultation: MFN Tariff Policy – The UK Global Tariff. Government Response & Policy*, Department for International Trade, May 2020.

- A further £0.8 billion a year is generated from **imports from countries with which the UK has yet to rollover existing EU trade agreements**. This yield can be expected to decline over time as deals are signed, as with the Canadian agreement. But the timing of these agreements is uncertain, so the costs associated with them will be captured via new policy costings at relevant forecasts.

- The costing is then reduced by around £0.2 billion to allow for additional **non-compliance**, including around the operation of the Northern Ireland protocol.

A.22 **Abolition of the VAT Retail Export Scheme (RES):** this scheme allows individuals from parts of the world other than the EU to claim back VAT on goods purchased in Great Britain. Abolishing it brings the treatment of tourists from outside the EU into line with those from the EU from the end of the transition period (as opposed to extending the scheme to EU tourists). Alignment is a requirement of WTO rules. Most VAT RES beneficiaries do their shopping in luxury stores, particularly those in London and the South East, with 90 per cent of refunds from London and Oxford (Bicester Village). Ending the scheme results in a direct Exchequer saving – around £0.5 billion was refunded through the scheme in 2019 – but there will also be costs as the UK becomes less attractive for affected tourists relative to alternative EU destinations such as Paris or Milan. Estimates of the sensitivity of tourism to price changes generally refer to tourism in general rather than those focused on luxury shopping. The costing takes one UK-specific estimate relating to tourism in general[5] and scales it up by 50 per cent (to an elasticity of 1.9) in recognition of the likely greater responsiveness of those affected by the measure. This reduces the yield slightly, but the estimate is highly uncertain. Several studies have considered the negative consequences of this measure for affected industries. Our forecasts consider such indirect effects at an aggregate level, looking at overall changes in tax and spending (worth tens of billions of pounds at this forecast) rather than measure-by-measure.

A.23 **Abolition of Tax-Free airside shopping:** this measure also aligns the UK with WTO rules. Tax-free airside shopping is currently available for those travelling to destinations outside the EU, but this will be abolished at the end of the transition period. The main impact will be on the sales of beauty products (perfumes and cosmetics) that generate around half of total sales in duty free shops. The yield from this is again subject to uncertainty around the behavioural response. It is not clear how much of the tax rise will be passed through to the prices faced by consumers or the degree that any price rises will reduce sales.

A.24 From 1 January 2021, **exports of financial services to the EU will become zero-rated**, aligning the treatment with exports to non-EU countries. Exports to the EU are generally exempt from VAT at the moment, which means input VAT cannot currently be recovered. The cost of this measure rises to £1 billion a year by 2025-26.

[5] A price elasticity of 1.28, cited in *The Impact of Taxes on the Competitiveness of European Tourism – Final Report*, PWC, October 2017.

Policy costings and uncertainty

A.25 In order to be transparent about the potential risks to our forecasts, we assign each certified costing a subjective uncertainty rating, shown in our online *Policy costings uncertainty database*. These range from 'low' to 'very high'.

A.26 In order to determine the ratings, we assess the uncertainty arising from each of three sources: the data underpinning the costing; the complexity of the modelling required; and the possible behavioural response to the policy change. We take account of the relative importance of each source of uncertainty for each costing. The full breakdown that underpins each rating is also available in the database. It is important to emphasise that where we see a costing as particularly uncertain, we see risks lying to both sides of what we nonetheless judge to be a reasonable and central estimate. It is also worthwhile emphasising that this relates to uncertainty about the costings themselves, abstracting from the wider virus-related uncertainty that affects the underlying forecast.

A.27 In addition to those discussed in this annex, a measure-by-measure discussion of the 'high' and 'very high' uncertainty measures is available in the database.

The post-Brexit border for VAT and excise duties

A.28 Since our March forecast, the Government has announced more information on how the new border between Great Britain and the European Union will operate from the end of the transition period.[6] The direct impact of quantifiable policy costings has been captured in the usual way, as described above. Here we set out some of the indirect risks these changes pose to VAT and excise duty revenues.

A.29 The Government's chosen approach to EU exit means that many aspects of the VAT and excise duty regimes will change. For example, Great Britain is leaving parts of the tax system that are shared across the EU, such as information sharing and tax simplification schemes. The Government is also introducing new rules and systems, such as requiring overseas retailers to collect UK VAT liabilities on the behalf of HMRC.

A.30 The National Audit Office (NAO) published a report this November that reviews the preparedness of UK border procedures for the end of the transition period.[7] The report highlighted two key areas for potential non-compliance risk:

- First, the **risks arising from the measures brought in to ease the burdens on businesses**. From 1 January 2021, the Government will phase in border controls for many goods, potentially increasing opportunities for smuggling and fraud (though 'controlled' goods such as alcohol and tobacco will still be subject to normal declarations). The NAO noted that "*the government accepts its decision to phase in import controls increases fiscal risk in the six-month period when full import controls will not be in*

[6] *The Border Operating Model,* Cabinet Office, July and October 2020.
[7] *The UK border: Preparedness for the end of the transition period,* National Audit Office, 6 November 2020.

place". At the same time, Great Britain will lose access to EU information systems and will introduce 'postponed VAT accounting' rules that allow traders to submit returns for import VAT at a later date than when goods cross the border. Each change carries its own risk but their simultaneous introduction multiplies those risks.[8]

- Second, the NAO says that **neither the Government nor businesses are fully prepared for the imminent changes**. The Government's 'Border and Protocol Delivery Group' (BPDG) highlights two 'red' delivery risks: traders are not ready; and there are not enough customs intermediaries to support them. HMRC estimates that around 235,000 EU-only traders may face difficulties in securing a customs intermediary if the customs intermediary market does not expand.[9] This may impact revenues through increases in errors and 'failure to take reasonable care', which HMRC estimates to have cost a combined £8.6 billion in revenue across all taxes in 2018-19.[10]

- The NAO also highlights significant **risks around the readiness of border infrastructure, IT and staffing** levels from 1 January 2021.

A.31 Quantifying these risks remains a challenge, but the risks to tax receipts from increased non-compliance in VAT and excise duties is clearly on the downside. One way to frame this is to consider past episodes of non-compliance. Chart A.2 shows VAT and excise duty tax gap estimates since 2005-06. It shows that:

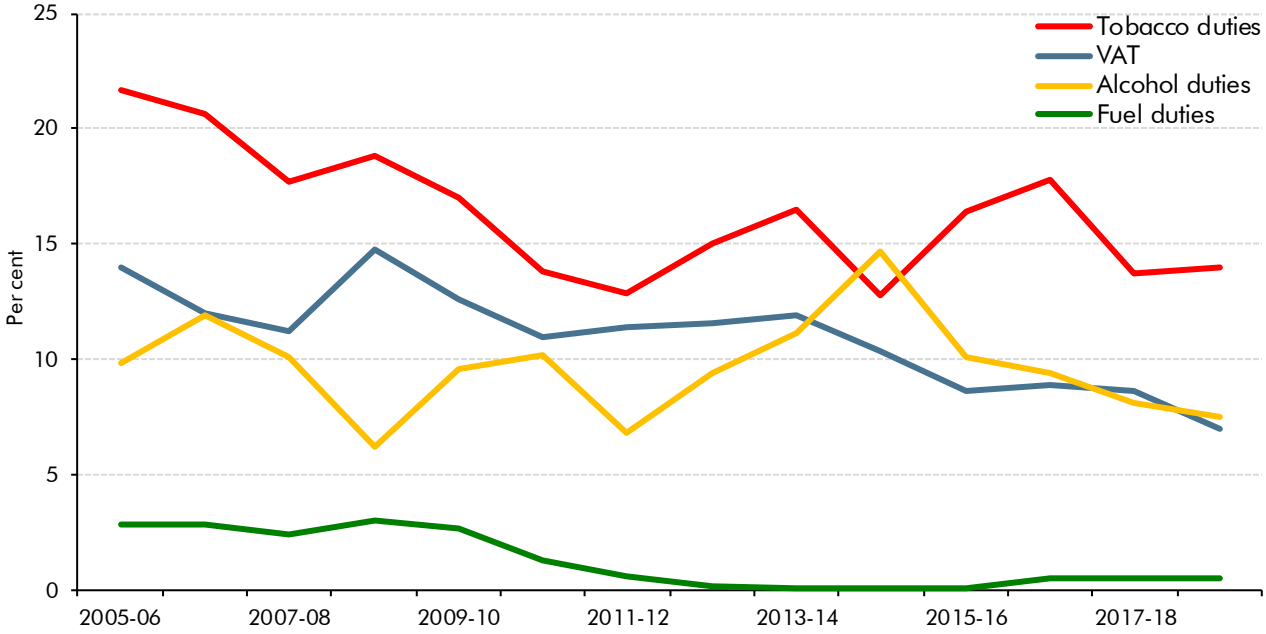
- The VAT gap spiked in 2005-06, reflecting a sharp increase in **'missing-trader' fraud** as criminals exploited VAT rules across EU borders. Previous estimates suggest this fraud cost the exchequer several billions of pounds during the mid-2000s.[11]

- The **tobacco and alcohol** tax gaps have averaged 15.3 and 9.3 per cent respectively over the past decade. The most prevalent form of alcohol and tobacco fraud involves the smuggling or diversion of products into the UK in large commercial quantities.[12]

- The **fuel duty** tax gap is much lower, averaging just 0.9 per cent over the past decade, although the Northern Ireland diesel tax gap has averaged 8.4 per cent.

[8] *Postponed Accounting in the European Union*, International VAT Monitor, 2014 (Volume 25), No 1.
[9] According to the NAO, this estimate incorporates two sets of figures with different populations. In 2019, there were 149,000 VAT-registered businesses who traded only with the EU, of which 135,000 relate to Great Britain. HMRC does not know precisely how many non-VAT registered businesses trade only with the EU but estimates this to be around 100,000 (this figure applies to the UK as a whole).
[10] *Measuring tax gaps 2020 edition,* HM Revenue and Customs, 9 July 2020.
[11] *Stopping the Carousel: Missing Trader Fraud in the EU*, House of Lords European Union Committee, 25 May 2007.
[12] *Alcohol Fraud: Next Steps*, HMRC, 16 January 2014.

Chart A.1: VAT and excise duty tax gaps since 2005-06



Source: HMRC

A.32 Historical variability of tax gaps provides a benchmark against which to consider possible short-term non-compliance costs as tax systems and border processes change in 2021. We have not attempted to estimate these costs bottom-up – i.e. considering how the implementation of each of the several changes being made would interact with all the other changes. Instead we have drawn on the historical evidence and the reviews undertaken by the NAO and others to come to a top-down assumption about overall tax losses. Specifically, we have reduced our forecast for VAT in 2021-22 by £0.6 billion (equivalent to around a half percentage point increase in the VAT gap), with the effect halving in 2022-23. We have also reduced our forecasts for alcohol and tobacco duties by £0.1 billion in 2021-22, roughly equivalent to a quarter of a percentage point increase in the tax gap. It is clearly possible that these figures could be higher if fraudsters or smugglers spot opportunities to exploit the changes in ways that have not been identified.

Uncertainties around the Northern Ireland Protocol

A.33 The '*UK's approach to the Northern Ireland protocol*' was published in May, setting out the Government's principles for operationalising the protocol, though much of the practical detail has yet to be finalised. The Government has told us that "*further guidance will be published before the end of the Transition Period*". Absent that detail, we treat these changes as a fiscal risk to our central forecast that will be quantified as soon as that becomes possible.

A.34 One important aspect that has yet to be clarified is the definition of goods deemed to be 'at risk' of moving through Northern Ireland and into the EU, either from Great Britain or third countries. Details on how Northern Ireland businesses prove their goods qualify for unfettered access to Great Britain are also pending. The NAO concluded that implementation of the protocol in time for 1 January 2021 is "*very high risk*" and that "*any*

tariff differentials between different customs regimes could present new opportunities for fraud, evasion or avoidance and smuggling".[13]

Update on previous measures

A.35 We cannot review and re-cost all previous measures at each fiscal event (the volume being too great), but we do look at any where the original (or revised) costings are under- or over-performing, and at costings that were identified as particularly uncertain.

Policy reversals

A.36 The Government has announced and then scrapped two policies since March:

- **Job retention bonus**: this measure was announced as part of the Chancellor's *Plan for Jobs* on 8 July as a payment to employers of £1,000 for each employee that they had furloughed and who remained continuously employed as at 31 January 2021. On 5 November, when announcing the extension of the CJRS to the end of March, the Chancellor stated that "*the government will redeploy a retention incentive at the appropriate time*". With the terms of that incentive yet to be set, it represents a future policy risk that could increase spending relative to this forecast.

- **Job support scheme**: this was first announced in the Chancellor's Winter Economy Plan on 24 September as a successor to the CJRS that would take effect on 1 November. The terms of the scheme were changed at a second announcement on 9 October, and it was made significantly more generous at a third announcement on 22 October. It was scrapped alongside the 5 November CJRS extension before receiving any claims.

Policy delays

A.37 To certify costings as central, we need to estimate when – as well as by how much – measures will affect the public finances. As we have set out in previous *EFO*s, many policy measures do not meet the timetable factored into the original costings – even where we have required greater contingency margins before certifying the measure. This continues to pose a risk to our forecast. Policy delays we have been notified about since March include:

- **Full PIP rollout delay:** the rollout of personal independence payment (PIP) has been delayed by a further two years as a consequence of the pandemic. This follows several previous delays and means migration is now expected to be complete by 2025, nine years behind the original schedule.

- **18-month PIP award reviews**: this Budget 2020 measure has been delayed to April 2021 from June 2020. The delay is due to the pandemic limiting DWP's ability to conduct PIP assessments.

[13] *The UK border: Preparedness for the end of the transition period,* National Audit Office, 6 November 2020.

- **Off-payroll reform (or 'IR35')**: this measure targets private sector off-payroll workers who work through an intermediary, which enables them to pay less tax and NICs. It moves the burden of responsibility for determining whether existing rules apply to the engager rather than the intermediary. The Government postponed its start date by a year to April 2021 to avoid burdening contractors as the pandemic hit.

- **Construction industry reverse charge delay**: the construction industry reverse charge was first announced in Autumn Budget 2017 and was originally due to come into effect from October 2019. This was delayed to October 2020 in the March Budget and has now been pushed back to March 2021.

- **Notification of uncertain tax treatment**: this Budget 2020 measure requires large business taxpayers to notify HMRC of potential tax disputes if the value of the uncertain tax liability exceeds £1 million. The original April 2021 start date has been delayed by a year in response to feedback from taxpayers at the consultation stage.

Updates on other measures

A.38 The cost or yield associated with several recently announced measures has fallen due to pandemic-related falls in the underlying tax forecasts. Three examples from the March Budget (all of which we had deemed highly uncertain costings pre-pandemic) are:

- **CGT: reducing the lifetime limit in entrepreneurs' relief to £1,000,000**: under this relief (since renamed business asset disposal relief) company owners pay a lower 10 per cent tax rate on disposals of shares up to a lifetime limit for each taxpayer. The measure reduces that limit from £10 million to £1 million. The yield has been revised down by around £0.7 billion a year (41 per cent) from 2022-23 onwards, entirely due to the weakness in the underlying CGT, stamp duty and income tax forecasts.

- **Red diesel: limiting eligibility**: this measure removed red diesel relief from around three-quarters of existing consumption. The costing has been reduced by an average of £0.2 billion a year (13 per cent) from 2022-23 onwards. Around half of this is due to updates to the underlying data, including the data used to estimate the proportion of red diesel eligible for the relief. The remainder is due to a lowering in the amount of consumption affected by the policy. The 'marine voyages relief' provides 100 per cent red diesel relief for eligible journeys other than those in a private pleasure craft. Its continued availability and use was not reflected in the original costing.

- **Changes to the pensions annual allowance and annual allowance taper**: this measure reduced the restrictiveness of the annual allowance taper that was introduced in 2015. The latest estimate reduces the yield by an average of £0.1 billion a year (14 per cent) from 2022-23 onwards to reflect our lower CPI inflation and earnings forecasts.

A.39 Our forecast reflects material updates to three other measures, the first two where the changes are also largely related to the pandemic, plus a third which bucks the trend, as the cost of R&D tax credits continue to surprise on the upside. These measures are:

- **Protecting your taxes in insolvency**: this Budget 2018 measure moves HMRC up the priority list of creditors when businesses go into insolvency.[14] Relative to March, the costing for this year remains unchanged but it has been revised up materially between 2021-22 and 2023-24, raising an additional £135 million across the three-year period despite lower underlying tax forecasts. This reflects the expected rise in business insolvencies next year as the large virus-related fiscal support measures are withdrawn.

- **Working from home allowance**: this was a Budget 2020 measure increasing a little-known and little-used tax relief. It was originally expected to have a negligible cost, but the changes in working practices prompted by the pandemic means the cost has been revised up twelve-fold (to a still modest £25 million this year). The eventual cost remains uncertain and it is possible that awareness and take-up might rise further.

- **R&D PAYE cap**: this Budget 2018 measure introduced a limit on the amount of R&D tax credit a company can claim under the SME scheme to prevent abuse. The policy was modified at Budget 2020 and the implementation date shifted one year back. Its yield has risen in line with the further upward revision to the underlying R&D tax credits forecast, driven by higher than expected take-up across several sectors. The yield from 2023-24 onwards is an average of £115 million a year higher now than in March.

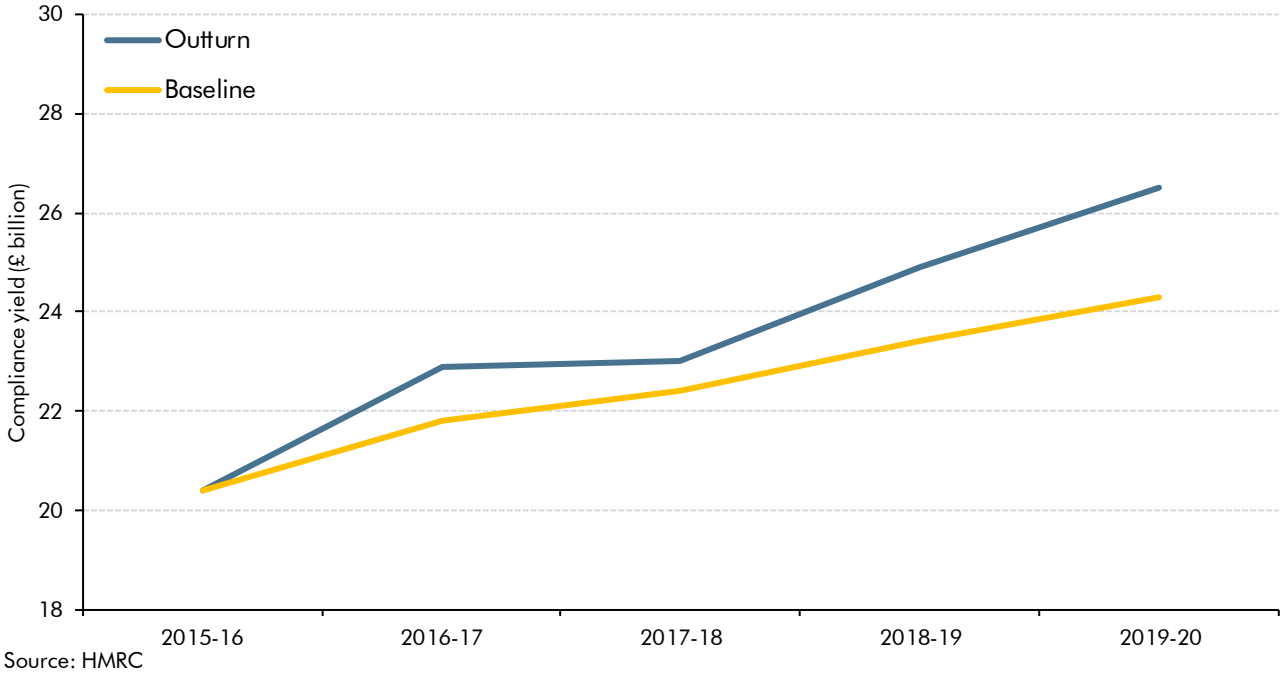
HMRC compliance performance

A.40 In our July 2015 *EFO* we scrutinised evidence on the performance of HMRC compliance activity between 2010 and 2015 and its implications for the required increase in the effectiveness of compliance efforts needed to offset expected resource cuts. This was to satisfy ourselves that the significant package of operational measures announced at the July 2015 Budget would be additional to that baseline performance.

A.41 At the time, as well as guaranteeing the measure-specific resource, the Treasury told us that "*HMRC's compliance yield targets will increase to reflect the impact of the Budget measures*". In our March *EFO* we showed that the yield from that package is relatively close to original expectations. Chart A.2 shows that compliance productivity growth in the five years since has slightly exceeded those 2015 targets, with compliance yield in 2019-20 £2.2 billion higher than the baseline. To put this in context, if HMRC's estimated tax gap had remained at its 2015-16 level (rather than falling) then around £7 billion less tax would have been collected in 2018-19 (the most recent year that tax gap estimates are available).

[14] The announced measure included a second element seeking to prevent taxpayers from avoiding tax through the misuse of insolvency (known as "phoenixism"). The revised costing does not relate to that.

Chart A.2: HMRC baseline compliance yield: outturn versus baseline target



Source: HMRC

Policy risks

A.42 Parliament requires that our forecasts only reflect current Government policy. As such, when the Government sets out 'ambitions' or 'intentions' we ask the Treasury to confirm whether they represent firm policy. We use that information to determine what should be reflected in our forecast. Where they are not yet firm policy, we note them as a source of risk to our central forecast. The full list of risks to this forecast and changes from previous updates is available on our website. Brexit-related policy risks were discussed above. Other risks that are particularly large, have changed materially since our last forecast, or are new include:

- A **ban on the sale of new petrol and diesel vehicles** has been brought forward from 2035 to 2030, as announced by the Prime Minister on 18 November. Hybrid cars will remain on sale until 2035, after which all new cars must be zero emission. There is insufficient detail on implementation and enforcement to score the fiscal impacts at this time, but it is highly likely to reduce VED and fuel duty receipts.

- As set out above, the Government has decided against introducing the **job retention bonus** but has said that it will "*redeploy a retention incentive*" in the future. This intention is not sufficiently clearly specified to incorporate in this forecast. In July, we estimated that the bonus would cost £6 billion.

- The Chancellor announced third and fourth instalments of the **Self-Employed Income Support Scheme** as part of his Winter Economy Plan. The third instalment is included in our central forecast (though on different terms to those originally announced). But the terms of the fourth grant have yet to be set, so its cost cannot be estimated. If the policy design were to remain as per the previous grants, the cost would range from

around £6 billion (if the generosity matched the third grant at 80 per cent of average monthly trading profits) down to £1.5 billion (if instead of paying 80 per cent it paid 20 per cent, the generosity that was originally announced for the third grant).

- **Passenger rail services.** In March 2020 the Government suspended all existing rail franchise agreements through Emergency Measures Agreements and later with Emergency Recovery Measures Agreements. These agreements mean that the Government has taken on all revenue and cost risk, with train operating companies classified to the public sector as a result. Absent detailed spending plans beyond 2021-22, it is unclear what mechanism will be used for delivering passenger rail services in the future and what fiscal risks this might pose.

- The Bidding Prospectus for bidders across England to apply for **'Freeport'** status opened in November 2020. Freeports are secure customs zones enabling business to be carried out inside a country's land border, but where different tax and customs rules apply. Areas granted freeport status will benefit from duty suspension, duty inversion, duty exemption for re-export, and simplified customs procedures.[15] At least seven of ten proposed freeports are expected to be in England. Successful locations should be announced by Spring 2021. The fiscal impact will depend on the precise policy detail and will be reflected at the appropriate time.

- The **2018 McCloud ruling** concluded that transitional protections offered as part of the 2015 public sector pension reforms were discriminatory. The Government published a consultation in July 2020 setting out two options to remedy the discrimination and announced the plan to move all members to the reformed schemes from 2022. The Treasury's latest estimate suggests that this will increase public service pension schemes liability by around £17 billion. The Treasury has told us that a consultation response and policy decision will be published in the new year.

- **Prospective reforms to adult social care**. Having postponed implementation of reforms underpinned by the 2011 'Dilnot Commission', the Government announced in December 2017 that it would publish a green paper on the future of adult social care in the summer of 2018. This did not materialise. The 2019 Conservative manifesto commits to "*urgently seek a cross-party consensus in order to bring forward the necessary proposal and legislation for long-term reform*". The Prime Minister told the BBC in January 2020 that he would be "*bringing forward a proposal*" later this year, and in relation to implementation that "*we will certainly do it in this Parliament*".[16] The Spending Review allows local authorities to raise council tax faster to increase funding for adult social care, but news of long-term reform of the system is still pending.

A.43 The risks listed here and monitored in our database relate to policy-like statements that have not yet been fleshed out sufficiently to be costed and reflected in our forecasts. There are of course broader policy risks that overlay these specific items that we have discussed in

[15] Other tax reliefs are available on purchasing land, constructing and renovating buildings, investing in new plant and machinery assets and on National Insurance contributions.
[16] Prime Minister interviewed by Dan Walker, BBC Breakfast, 14 January 2020.

previous chapters and in our *Fiscal risks reports*. A perennial risk is that posed by the Government's stated policy assumption to raise fuel duty with RPI inflation not matching its annual decisions to freeze the rate in cash terms. A notable near-term risk relates to the temporary nature of the £20 a week increase in amounts paid to millions of families in receipt of universal credit and working tax credits, that is due to expire in April. Its removal will mean year-on-year falls in their incomes. A previous policy that would have generated cash losses to large numbers of families – the cuts to tax credits announced after the 2015 election – was reversed before being implemented in the face of widespread opposition.

B Brexit scenarios

Introduction

B.1 Under the *Charter for Budget Responsibility*, the OBR is mandated, as part of our forecasts, to analyse the key risks surrounding the economic and fiscal outlook. Uncertainty concerning the future path of the pandemic is the single greatest risk to the economy and public finances, and this *Economic and fiscal outlook* (*EFO*) includes three scenarios for the future course of the pandemic. However, the presently unresolved nature of the UK's future trade relationship with the EU, its single largest trading partner, further clouds the outlook.

B.2 The forecast and scenarios provided in the body of this *EFO* assume that the UK successfully concludes and ratifies a 'typical' free-trade agreement (FTA) with the EU over the next six weeks and makes a smooth transition to these new trading arrangements. But the prospect of a 'no deal' Brexit remains a material risk. Our 2019 *Fiscal risks report* (*FRR*) provided an illustrative assessment of the economic and fiscal consequences of leaving the EU without an FTA, drawing on a scenario prepared by the International Monetary Fund.

B.3 This annex provides an updated analysis of the economic and fiscal impact of the UK's defaulting to trading with the EU on World Trade Organization (WTO) terms when the transition period ends on 31 December. The economic costs associated with such an outcome would be additional to the 4 per cent long-run loss of output associated with leaving the EU with a typical FTA that is already in our central forecast. We map these economic and fiscal impacts onto the three coronavirus scenarios discussed in Chapter 2 to show the potential combined effect of coronavirus and a no deal Brexit.

WTO scenario assumptions

B.4 Based on the Government's recent policy statements, and on evidence discussed in our 2018 Brexit discussion paper about their potential economic impact,[1] we make the following assumptions should the UK's future trading relationship with the EU default to WTO terms when the transition period ends on 31 December 2020:

- The UK Government immediately imposes its new **UK global tariff (UKGT) on EU imports** and the **EU imposes its common external tariff on UK imports**.
- There is a larger and more rapid **increase in non-tariff barriers** to EU trade as the UK exits the Single Market without the regulatory equivalence, public procurement and mutual recognition arrangements that are sometimes part of typical trade agreements.

[1] Discussion paper No.3: *Brexit and the OBR's forecasts*, October 2018.

- Traders experience some temporary physical **border disruptions** as they adjust to the new administrative requirements and customs checks without any temporary easements on the part of the EU.

- The UK implements **trade deals** with non-EU countries that have been concluded and signed, such as the UK-Japan Comprehensive Economic Partnership Agreement, though these are also included in our central forecast and do not provide any benefit relative to being a member of the EU. We do not assume the implementation of trade deals for those countries, such as the US, where negotiations are taking place but no agreement has yet been reached.

- Discretionary **fiscal policy** is unchanged from that set out in our central forecast, but automatic fiscal stabilisers are assumed to operate freely. Higher take-up of the CJRS and higher default rates on government guaranteed loans increase the cost of some existing discretionary fiscal policies.

- **Monetary policy** is unchanged from our central forecast as we assume that there is no significant effect on underlying inflationary pressure, although there is a step change in the price level that we assume the Monetary Policy Committee look through (as has been the case with similar shocks in the past).

Economic implications

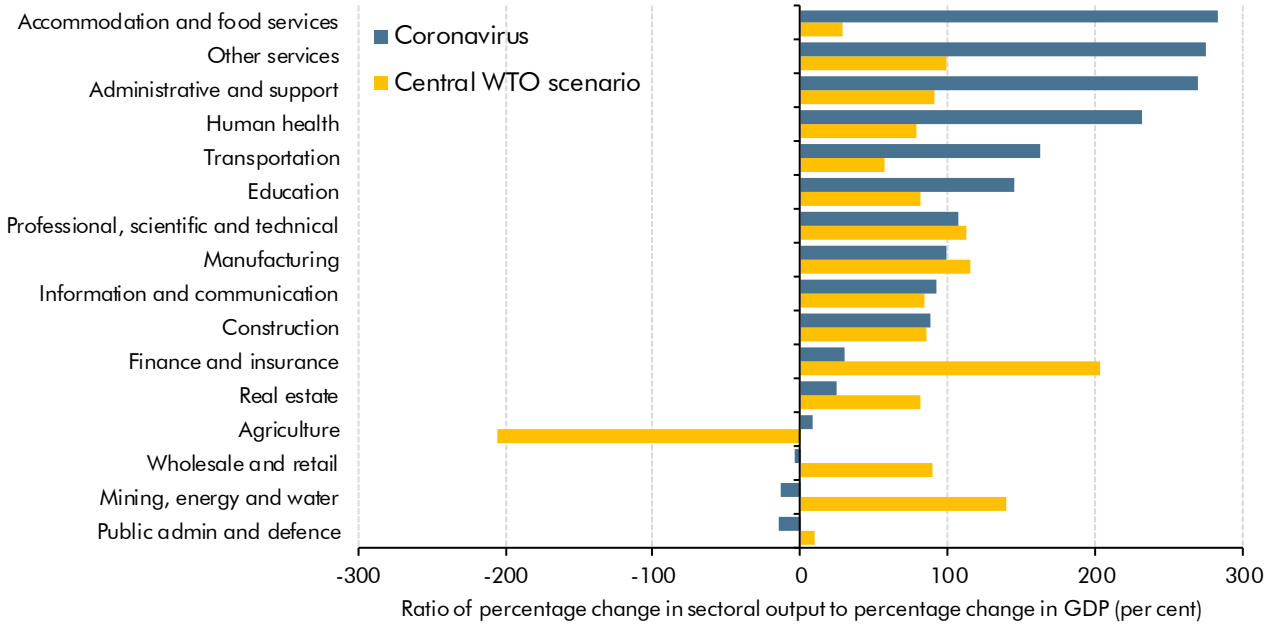
Sectoral impact

B.5 A no deal Brexit is likely to impinge on different sectors of the UK economy to those that have been hardest hit as a result of the pandemic. As described in Chapter 2, businesses involved in the provision of non-tradable, face-to-face services such as hospitality, transport, and entertainment have been hardest hit by coronavirus as they are directly affected by public health restrictions and face difficulties in implementing social distancing. By contrast, firms in the manufacturing, financial services, and mining and quarrying sectors have been spared the worst economic consequences of the pandemic thanks to their ability to continue to operate while adhering to social distancing rules. However, it is these latter, trade-intensive sectors that are most exposed to the loss of unfettered access to the EU market.

B.6 Chart B.1 illustrates this by comparing the relative scale of output losses to date during the pandemic with the relative scale of losses predicted by the average of two external studies of the effect of trading on WTO terms. In absolute terms, the loss of output this year due to coronavirus is obviously much greater, but it is the degree of overlap (or lack of it) in the sectors affected that is relevant to judging the incremental effect of a no deal Brexit. To a first approximation, the non-overlapping sectoral impact suggests that the loss of output associated with defaulting to WTO terms is likely to be largely additive to that suffered from coronavirus. This applies both to the immediate output losses associated with the disruption of trade flows, as well as the longer-term effects. Recent analysis by NIESR also highlights the additive nature of the pandemic and Brexit shocks.[2]

[2] *Prospects for the UK Economy*, National Institute of Economic and Social Research, 2 November 2020.

Chart B.1: Relative intensity of sectoral output hits: virus versus WTO scenario



Note: Coronavirus sector bars are the per cent change in each sectors output relative to the per cent change in GDP between February and September 2020. The central WTO scenario bars are an average of the per cent change in sectors output from studies IMF Nov 2019 and Felbermayr et al Mar 2020, from moving to WTO rules from a FTA, relative to our 2 per cent long run GDP assumption.
Source: Felbermayr, Gröschl and Steininger, Brexit through the Lens of New Quantitative Trade Theory, March 2018, IMF, ONS, OBR

Brexit preparedness and near-term disruption

B.7 The degree of near-term disruption to economic activity associated with defaulting to WTO terms depends in part upon the preparedness of the Government and businesses to manage any additional administrative, regulatory, and customs requirements. While both have had more time to prepare than when we last considered these issues in our 2019 *FRR*, they have also been distracted by the need to deal with the disruption caused by the virus. This is likely to have taken up personnel and resources at some businesses that would have otherwise been used to prepare for a no deal Brexit, while also running down cash reserves and inventories making them more vulnerable to shocks. The CBI reported in a July survey that around a fifth of businesses said their preparations for the end of the transition period had gone backwards since January, while nearly two thirds said their preparedness was unchanged.[3] The Bank of England's Decision Maker Panel survey for October reports that around a third of firms are only partially prepared for the extra requirements of trading with the EU when the transition period ends.[4]

Declining trade intensity and long-run productivity

B.8 In addition to the temporary disruption to economic activity described above, a WTO outcome would also have a longer-term impact on the productive potential of the UK economy. That is because the higher tariffs and non-tariff barriers inhibit trade with the EU, resulting in a loss of some economies of scale and lower trade-related inward investment. These heightened barriers to trade also reduce the degree to which the UK and EU can exploit their respective comparative advantages and realise the gains from specialisation.

[3] *Data reveals firms' concerns over non-negotiated EU exit and lack of preparedness as Brexit talks continue*, CBI, 31 July 2020.
[4] *Monthly Decision Maker Panel – October 2020*, Bank of England, 3 November 2020.

B.9 Our scenarios take account of the implementation of trade deals secured with Japan and a handful of small developing countries, though these are in our central forecast and largely replace existing agreements that the UK already has with these countries as a member of the EU. The scenario does not include potential FTAs with the US and other major economies, including the agreement in principle with Canada to continue trading under existing terms which was announced 21 November after our forecast numbers were closed. However, both the Government's own estimates[5] and those of independent experts suggest that gains from all third-country FTAs are together likely to be modest. For example, the Government estimates that substantial mutual tariff liberalisation with the US would increase GDP by between 0.02 and 0.15 per cent in the long run.[6] Such deals are therefore unlikely to compensate for the costs associated with a failure to secure an FTA with our nearest and largest trading partner.

Real GDP

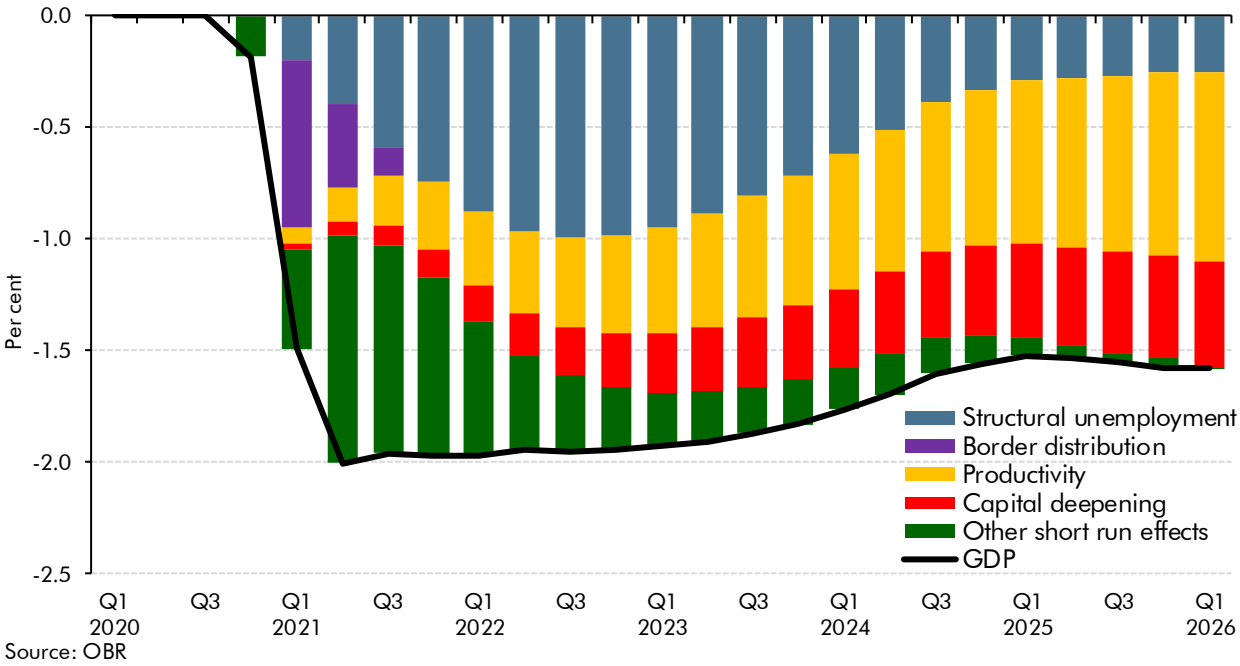
B.10 Based on these assumptions, a no deal Brexit is estimated to reduce real GDP by around a further 2 per cent in 2021. The short-term impact is due to various temporary disruptions to cross-border trade. These effects abate over the course of the year as the Government and businesses become more familiar with the new rules and procedures and find ways to operationalise them. However, the longer-term hit to productivity builds slowly to leave output around 1½ per cent lower than our central forecast after five years. This would continue to build beyond the forecast horizon to reach 2 per cent in steady state. The initial reduction in GDP and the hit at the forecast horizon are similar to the scenario presented in our 2019 *FRR*, although that scenario included a somewhat greater effect in between, reflecting larger and more persistent short-run demand effects.

B.11 A putative decomposition of the hit to GDP is shown in Chart B.2 and comprises:

- **Border disruptions**, which reduce the level of output by 0.75 per cent in the first quarter but disappear by the end of the year as Governments and businesses adjust to the new trading arrangements.
- Other **short run effects** on demand and supply, resulting in part from heightened uncertainty and tighter credit conditions.
- Less **capital deepening** due to lower business investment, reflecting the prospective loss of some export markets due to increased costs and the longer-run consequences of some investment being delayed or cancelled.
- **Lower productivity** owing to the reduction in trade intensity of output relative to where it would otherwise have been.
- A rise in **structural unemployment** as more resources need to be reallocated from declining to expanding sectors than under an FTA.

[5] EU Exit Long-term economic analysis, November 2018.
[6] UK-US Free Trade Agreement, Department for International Trade, 2 March 2020.

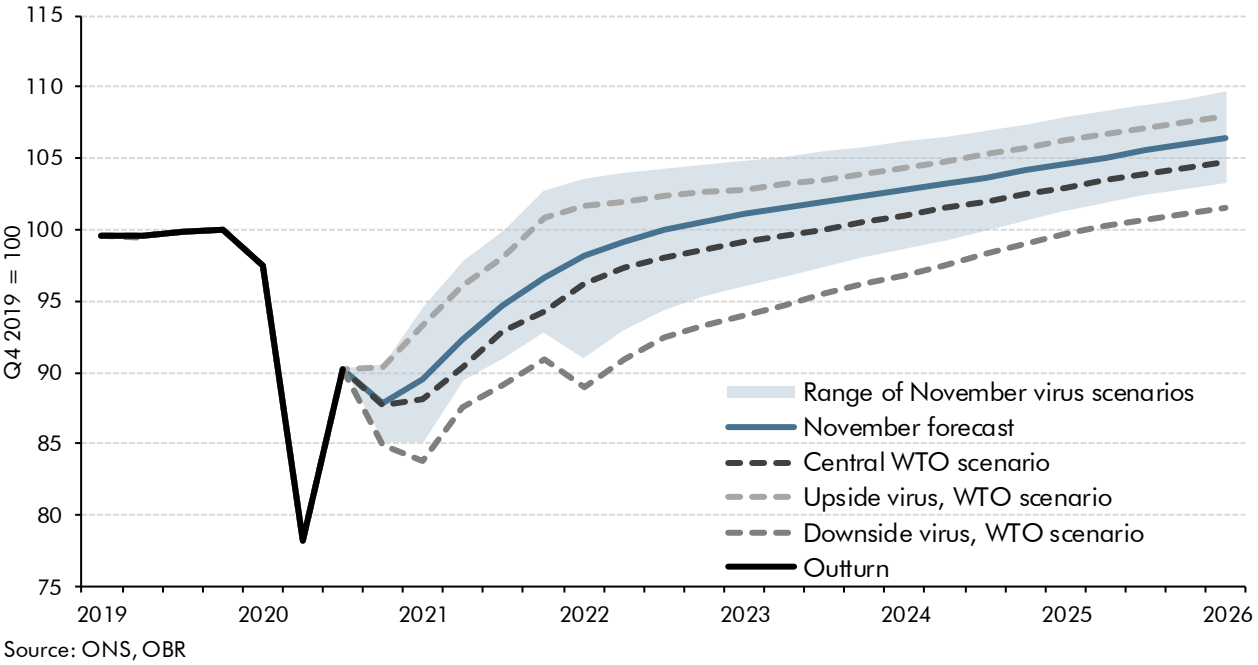
Chart B.2: Difference in real GDP to central forecast



Source: OBR

B.12 Superimposing our WTO scenario onto our central forecast from Chapter 2 has the effect of delaying the point at which output regains its pre-virus peak by almost a year to the third quarter of 2023. In the downside scenario, trading on WTO terms pushes it out half a year to the second quarter of 2025, with output around 4½ per cent lower than our central forecast at the forecast horizon due to the combined effect of greater virus-related scarring and higher trade barriers. In the upside scenario, trading on WTO terms pushes out the crossover point to the start of 2022 and output is around 1½per cent higher than our central forecast at the forecast horizon (Chart B.3).

Chart B.3: Real GDP



Source: ONS, OBR

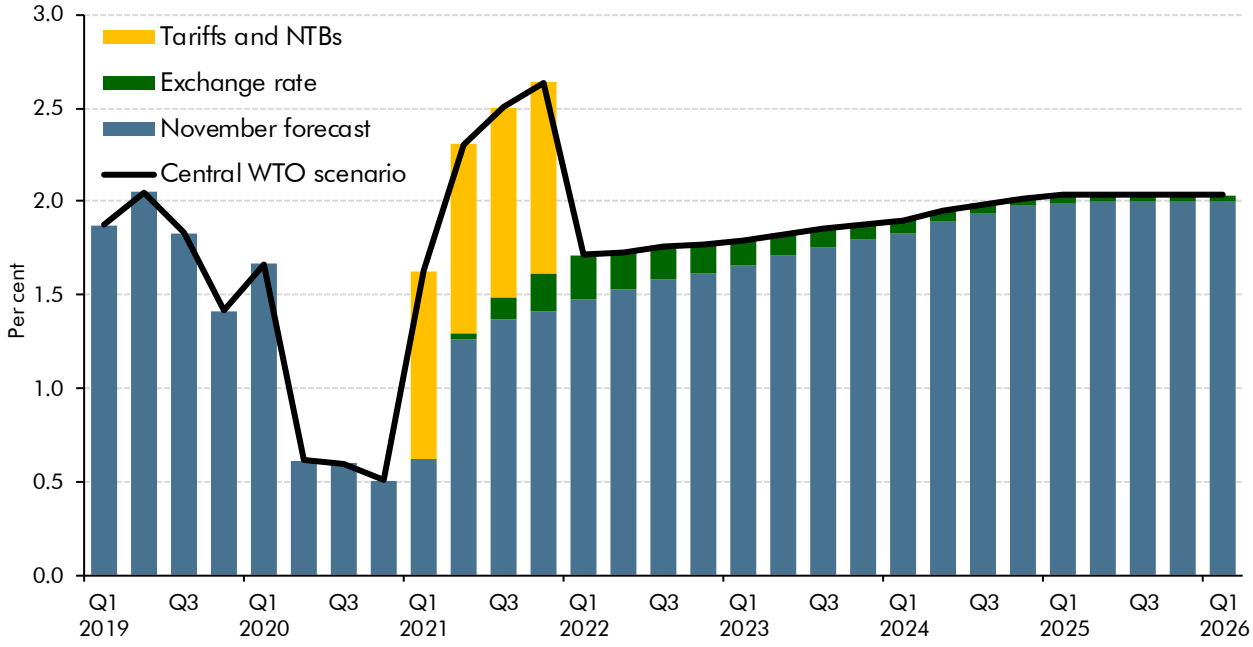
Inflation and nominal GDP

B.13 We have also adjusted nominal GDP for the effects of a WTO outcome on consumer prices. The imposition of tariffs on EU imports, higher non-tariff barriers, and a drop in the exchange rate all raise consumer prices, leaving them 1.5 per cent higher by the forecast horizon than in our central forecast:

- We assume an initial 5 per cent drop in the **exchange rate**, which then partially recovers to leave the pound around 3 per cent lower than in our central forecast. The weaker exchange rate gradually feeds through into import prices and consumer prices, raising the consumer price level by around 0.5 per cent.

- The immediate imposition of the UK global **tariff and higher non-tariff barriers** on EU imports adds 1 per cent to the consumer price level in the first quarter of 2021, which persists thereafter.

Chart B.4: CPI inflation

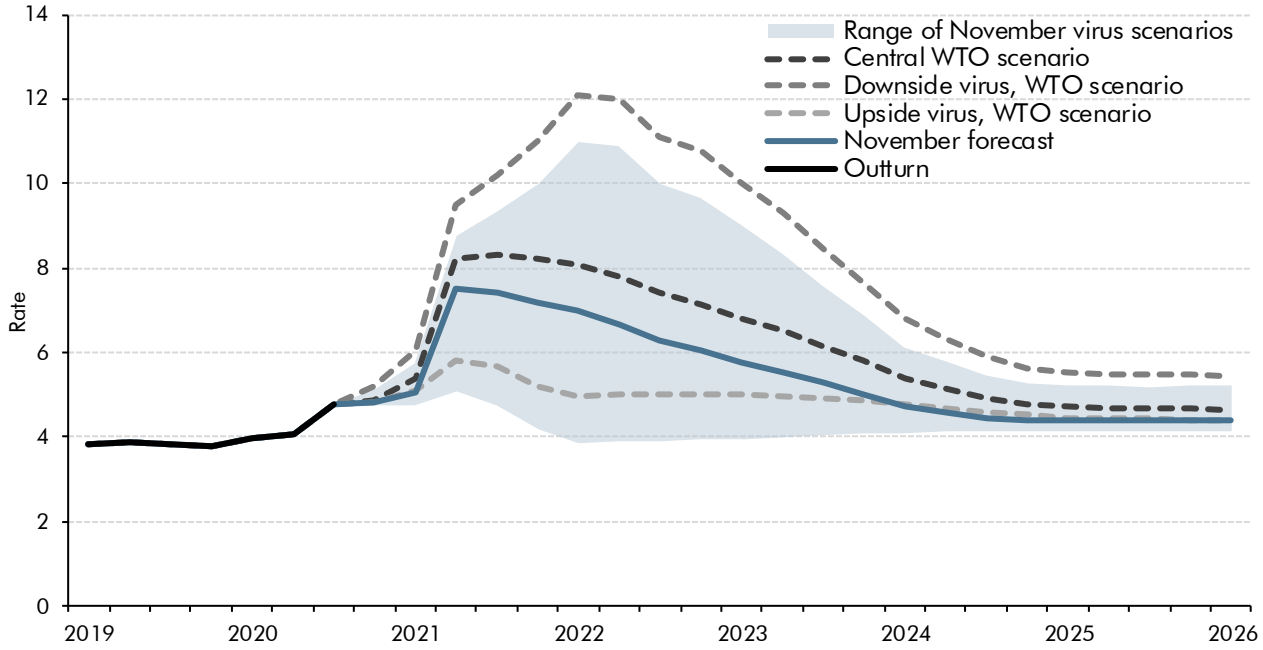


Source: ONS, OBR

Unemployment

B.14 In our central forecast with the WTO scenario superimposed, unemployment peaks at 8.3 per cent in the third quarter of 2021, 0.9 percentage points higher than in our central forecast in that quarter. This increase reflects both short-run demand effects and the initial effects of higher structural unemployment. Thereafter, the short-run effects dissipate and unemployment moves back close to our central forecast, with only a small structural increase in employment remaining at the forecast horizon. When mapped onto our upside and downside coronavirus scenarios, unemployment peaks at 5.8 and 12.1 per cent respectively (Chart B.5).

Chart B.5: Unemployment rate



Source: ONS, OBR

Comparison with external estimates

B.15 There is a range of estimates for the long-term consequences for the UK economy of trading under WTO rules rather than an FTA. Table B.1 highlights several studies, with estimates of the long run GDP impact ranging from -0.5 to -5.0 per cent. Our assumption of an additional 2 per cent impact (on top of the 4 per cent FTA impact in our central forecast) is very close to the average of the range of effects across these studies.

Table B.1 Estimates of the long run effect on GDP of additional barriers on trade with the EU

	Per cent		
Organisation	FTA	WTO	*Difference*
Mayer et al (2018)	-2.4	-2.9	*-0.5*
Netherlands CPB (2016)	-3.4	-4.1	*-0.7*
UK in a Changing Europe (2019)	-2.5	-3.3	*-0.8*
Felbermayr et al (2018)	-1.8	-3.2	*-1.4*
Bank of England (2019)	-3.5	-5.0	*-1.5*
UK in a Changing Europe (2019)	-6.4	-8.1	*-1.7*
NIESR (2018)	-3.8	-5.5	*-1.7*
IMF (2018)	-2.0	-3.8	*-1.8*
Whitehall Study (2018)	-4.9	-7.6	*-2.7*
Netherlands CPB (2016)	-5.9	-8.7	*-2.8*
World Bank (2017)	-10.0	-13.0	*-3.0*
IMF (2018)	-3.3	-6.4	*-3.1*
OECD (2016)	-2.7	-7.7	*-5.0*
Average	**-4.0**	**-6.1**	***-2.1***

Fiscal implications

B.16 The main channels through which a shift to trading on WTO terms affects the public finances are through increased barriers to trade, which reduce real GDP, and the imposition of the UKGT, which both raises additional tariff revenue and increases consumer prices relative to what would otherwise be the case.

B.17 As described in Annex A, under an EU-UK FTA the UKGT raises slightly less from non-EU imports than would be the case under the EU's Common External Tariff (CET), because UKGT rates are lower on average than CET rates. But this revenue loss is largely offset by tariffs levied on EU imports that are unable to meet the terms of the FTA, such as 'rules of origin' requirements, and are therefore liable to the UKGT rates. Table B.2 shows that defaulting to WTO terms would raise much larger amounts from EU imports, since the UKGT would be applied to them all. The overall path of imports would also be lower due to the effect of higher trade barriers. All in all, customs duties raise over £6 billion more a year in a WTO scenario than under the FTA assumptions underpinning our central forecast.

Table B.2 Customs duties: WTO scenario versus central forecast

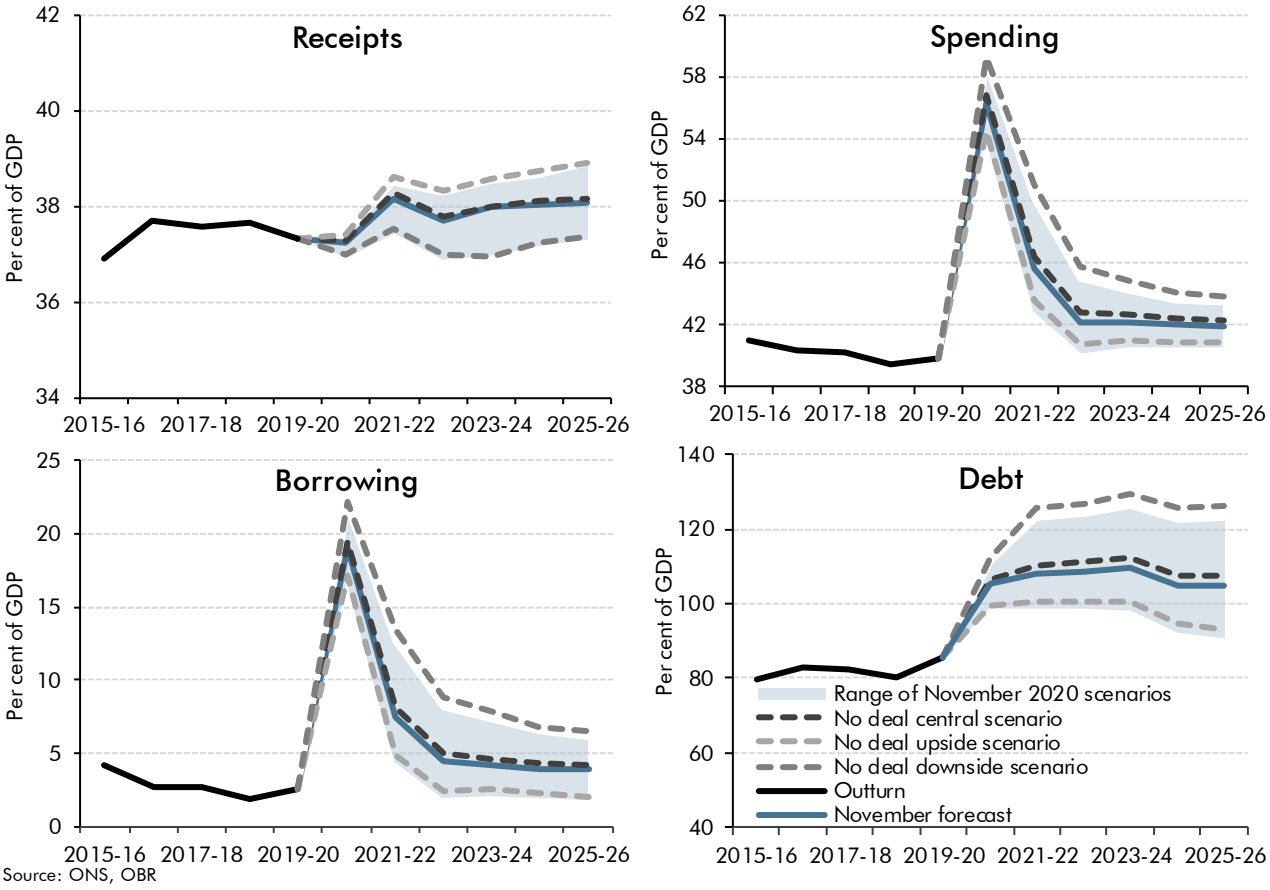
	£ billion					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November forecast	**2.9**	**3.9**	**4.0**	**4.1**	**4.2**	**4.3**
of which:						
Raised from EU trade	0.2	1.0	1.0	1.1	1.1	1.1
Raised from non-EU trade	2.6	2.9	3.0	3.1	3.1	3.2
Central WTO scenario	**4.4**	**9.9**	**10.2**	**10.5**	**10.7**	**10.9**
of which:						
Raised from EU trade	1.8	7.1	7.4	7.6	7.8	7.9
Raised from non-EU trade	2.6	2.8	2.8	2.9	2.9	3.0
Difference	**1.5**	**6.0**	**6.2**	**6.3**	**6.5**	**6.6**
of which:						
Raised from EU trade	1.5	6.1	6.3	6.5	6.7	6.8
Raised from non-EU trade	0.0	-0.1	-0.1	-0.2	-0.2	-0.2

B.18 However, this £6 billion (0.3 per cent of GDP) direct fiscal benefit from tariff revenues is more than outweighed by the £14 billion (0.6 per cent of GDP) overall reduction in all other tax revenues from a smaller economy. In 2025-26, this leaves receipts down just £6 billion relative to our central forecast and the receipts-to-GDP unchanged at 38.1 percentage points (Chart B.6, top left panel).

B.19 On top of this, higher unemployment raises welfare spending and a weaker economy amplifies the cost of the Government's coronavirus support measures: the CJRS is assumed to be £1½ billion more expensive in 2020-21, while increased defaults on guaranteed loan schemes add a further £4 billion. We assume that departmental spending plans remain fixed in cash terms, so become moderately less affordable relative to lower revenues. Overall, total spending is 0.5 per cent of GDP higher on average from 2021-22 onwards than in our central forecast (Chart B.6, top right panel).

B.20 Lower receipts and higher spending mean borrowing is higher by £10 billion (0.5 per cent of GDP) on average from 2021-22 onwards, which drives debt higher by 2.9 per cent of GDP by 2025-26 (Chart B.6, bottom panels).

Chart B.6: Key fiscal variables



Source: ONS, OBR

B.21 Table B.3 details the sources of difference between our central borrowing forecast and the WTO scenario. The additional hit to borrowing is substantially smaller than that assumed in our 2019 *FRR* stress test, largely because we have not assumed material damage to the property market and other asset prices in this scenario. That would represent a clear downside risk in the event of a disorderly shift to trading on WTO terms.

Table B.3 Public sector net borrowing: WTO scenario versus central forecast

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November forecast	56.1	393.5	164.2	104.6	100.4	99.6	101.8
Central WTO scenario	56.1	401.8	176.4	115.7	111.8	106.6	108.7
Difference	**0.0**	**8.3**	**12.1**	**11.1**	**11.4**	**7.1**	**6.9**
of which:							
Tariffs		-1.5	-6.0	-6.2	-6.3	-6.5	-6.6
Other receipts		3.2	15.1	14.9	16.0	12.6	12.6
Welfare		0.4	3.7	2.2	1.3	0.5	0.3
Other spending		6.2	-0.7	0.1	0.5	0.5	0.6

B.22 Table B.4 sets out the implications of the WTO scenario for key fiscal variables in cash terms. It also shows how these vary under different assumptions for the path of the virus. Table B.5 summarises other key features of these virus-WTO scenario combinations.

Table B.4 Summary of key fiscal variables

	£ billion, unless otherwise stated						
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	Public sector current receipts						
November forecast	828	771	847	886	927	964	1004
Upside virus, WTO scenario	828	789	894	928	963	1005	1049
Central WTO scenario	828	769	838	877	917	958	998
Downside virus, WTO scenario	828	747	774	810	852	904	948
	Total managed expenditure						
November forecast	884	1165	1011	990	1027	1064	1106
Upside virus, WTO scenario	884	1150	1006	987	1025	1062	1103
Central WTO scenario	884	1171	1015	993	1029	1065	1107
Downside virus, WTO scenario	884	1196	1052	1001	1035	1069	1111
	Public sector net borrowing						
November forecast	56	394	164	105	100	100	102
Upside virus, WTO scenario	56	360	113	59	62	57	54
Central WTO scenario	56	402	176	116	112	107	109
Downside virus, WTO scenario	56	449	278	191	182	165	163
	Public sector net debt						
November forecast	1801	2274	2478	2602	2721	2714	2817
Upside virus, WTO scenario	1801	2244	2395	2472	2552	2502	2557
Central WTO scenario	1801	2279	2497	2633	2764	2764	2874
Downside virus, WTO scenario	1801	2315	2641	2856	3058	3118	3281
	Public sector net debt, per cent of GDP						
November forecast	85.5	105.2	108.0	108.6	109.4	105.0	104.7
Upside virus, WTO scenario	85.5	99.7	100.7	100.7	100.3	94.6	93.0
Central WTO scenario	85.5	106.5	110.3	111.2	112.2	107.7	107.6
Downside virus, WTO scenario	85.5	112.4	125.4	127.0	129.3	125.5	126.3

Table B.5 Summary of WTO scenario in combination with coronavirus scenarios

	Virus scenarios (WTO assumption)		
	Upside	Central	Downside
Public health assumptions			
Lockdown ends	2 December	2 December	2 December
Test, trace and isolate	Effective	Partly effective	Ineffective
Public health restrictions: lockdown to vaccine[1]	Medium-low	High-medium	Very high[2]
Vaccines widely available	From Spring 2021	From mid-2021	Ineffective
Economic effects (per cent, unless otherwise stated)			
Real GDP growth in 2020	-10.7	-11.4	-12.0
Return to pre-virus peak (2019Q4)	2022Q1	2023Q3	2025Q2
Peak unemployment rate	5.8	8.3	12.1
Long-term GDP scarring	2.0	5.0	8.0
Fiscal effects (per cent)			
Public sector net borrowing in 2020-21	17.1	19.5	22.2
Public sector net borrowing in 2025-26	2.0	4.2	6.4
Public sector net debt in 2025-26	93.0	107.6	126.3
Budget 2020 fiscal targets			
Current budget balance in 2023-24	Met	Not Met	Not Met
Net investment below 3 per cent of GDP	Met	Met	Not Met
Debt interest to revenue ratio below 6 per cent	Met	Met	Met

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

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

C Major balance sheet interventions

Introduction

C.1 In each *Economic and fiscal outlook* (*EFO*) we provide an update on the direct costs associated with the major balance sheet interventions undertaken during and after the financial crisis a little over a decade ago. This provides a running commentary on the amounts subsequently recovered and the debt interest costs of financing the interventions. With the Government still owning the majority of NatWest shares, the process of exiting those interventions is still incomplete, so this annex provides our latest update.

C.2 The policy response to the coronavirus pandemic has also involved extensive use of the public sector balance sheet. In particular, the Government has now guaranteed many tens of billions of pounds worth of loans to businesses through three schemes: the Bounce Back Loan Scheme; the Coronavirus Business Interruption Loan Scheme; and the Coronavirus Large Business Interruption Scheme. It has also invested in innovative start-up firms through the Future Fund. The direct costs of these interventions will only be known after several years as some companies default on loans and some start-ups fail. In future *EFO*s, we will provide a running commentary on the net direct effects of these schemes on the public finances, as we will continue to do for interventions undertaken during the financial crisis.

Crisis-related financial sector interventions

C.3 Table C.1 updates our estimate of the net direct effect on the public finances of the Government's interventions in the financial sector during the financial crisis and subsequent recession. This is not an attempt to quantify their overall effect on the public finances relative to a counterfactual where the Government had not intervened as the crisis unfolded. The costs of the crisis would almost certainly have been much greater in the absence of direct interventions to restore the financial system to stability.[1]

C.4 In total, £136.6 billion was disbursed by the Treasury during and following the crisis. By end-September 2020, principal repayments and other fees received had amounted to £124.4 billion, up slightly relative to March 2020, reflecting ongoing payments from UK Asset Resolution (UKAR). This leaves a smaller net cash shortfall of £12.2 billion.

C.5 As of end-September, virtually all the Treasury's loans to the financial sector had been repaid. The value of its NatWest Group shares (as RBS is now called) had fallen to £10.3 billion,[2] down from the £16.7 billion recorded in our March 2020 *EFO*. The reported value of the Treasury's holdings in UKAR has fallen to £6.1 billion (although this reflects UKAR's

[1] We discussed the fiscal implications of financial crises in Chapter 3 of our 2019 *Fiscal risks report*.
[2] Based on NWG's share price on 9 November, consistent with the other market-derived assumptions in our forecast.

most recent set of accounts moving in line with the repayments figure used in our March estimate, so corrects an inconsistency in that estimate rather than reflecting a genuine reduction in the net direct effect of the intervention).

C.6 If the Treasury were to receive all loan payments in full and to sell its remaining shares at these values, it would realise an overall cash surplus on all the interventions undertaken during the crisis of £4.3 billion. But this cash surplus estimate excludes the costs to the Treasury of financing these interventions. If all interventions are assumed to have been financed through gilts, at the then prevailing market rates, the Treasury estimates that the additional debt interest costs would have amounted to £42.0 billion by September, mainly due to the costs associated with NatWest and UKAR.[3] This cost is larger than estimated in March, partly reflecting eight more months servicing debt on interventions yet to be repaid or sold. Together this implies an overall cost of £37.7 billion to the Government (2.4 per cent of 2008-09 GDP), £10.9 billion more than we estimated last March.

Table C.1: Gross and net cash flows of financial sector interventions

	£ billion								
	Lloyds	NWG[1]	UKAR[1]	FSCS[1]	CGS[1]	SLS[1]	Other	**Total**	Change since March 2020[2]
Cash outlays	-20.5	-45.8	-44.1	-20.9	0.0	0.0	-5.3	**-136.6**	0.0
Principal repayments	21.1	6.3	43.7	20.9	0.0	0.0	5.3	**97.3**	0.0
Other fees received[3]	3.2	6.2	7.5	3.5	4.3	2.3	0.3	**27.1**	0.3
Net cash position	3.8	-33.3	7.0	3.5	4.3	2.3	0.2	**-12.2**	0.3
Outstanding payments	0.0	0.0	0.0	0.0	0.0	0.0	0.1	**0.1**	0.0
Market value[4]	0.0	10.3	6.1	0.0	0.0	0.0	0.0	**16.4**	-9.1
Implied balance	3.8	-23.0	13.1	3.5	4.3	2.3	0.3	**4.3**	-8.8
Exchequer financing[5]	-4.3	-16.5	-13.6	-8.7	1.4	0.4	-0.6	**-42.0**	-2.0
Overall balance	**-0.6**	**-39.5**	**-0.5**	**-5.2**	**5.6**	**2.6**	**-0.3**	**-37.7**	**-10.9**
Memo: changes in overall balance since March	*-0.1*	*-7.3*	*-3.1*	*-0.4*	*0.1*	*0.0*	*0.0*	*-10.9*	

[1] These are the Government's ownership of NatWest Group shares (previously RBS Group), UK Asset Resolution (UKAR), which manages holdings in Bradford & Bingley and Northern Rock Asset Management plc., the Financial Services Compensation Scheme (FSCS), Credit Guarantee Scheme (CGS), and Special Liquidity Scheme (SLS).

[2] March 2020 *EFO* figures were consistent with end-January data.

[3] NWG figure contains asset protection scheme and contingent capital facility related fees. UKAR includes dividends paid to the Treasur

[4] UKAR is book value of equity, derived from its accounts as at 31 March 2020 published in July of that year.

[5] This can be split into financing while the intervention was open and after it closed (or after the final payment was received): Lloyds closed in May 2017, FSCS closed in October 2018, CGS closed in November 2012, and SLS closed in April 2012.

While open	-3.7	-16.5	-13.6	-7.6	0.3	0.0	-0.6	-41.7
After close	-0.6			-1.1	1.1	0.4		-0.2

[3] The debt interest costs (or savings) associated with interventions that yield an overall deficit (or surplus) continue beyond the point the intervention itself has been wound up. This is the 'Exchequer financing' metric recorded in Table C.1.

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