1 Executive summary

Overview

1.1 In the first combined Spending Review and Autumn Statement since 2007, the Government has taken advantage of an improvement in the outlook for tax receipts – concentrated in the middle years of this Parliament – to further loosen the impending squeeze on public services spending, to increase capital spending and to reverse the main tax credit cuts it announced in July, while still delivering a modestly stronger budget balance in most years on a like-for-like basis. As the boost to receipts begins to ebb, the Government increases departmental spending by less and relies more on tax increases to maintain the bottom line improvement.

1.2 The Spending Review sets out firm plans for spending on public services and capital investment by all central government departments through to 2019-20, plus plans for capital spending for all and public services spending for some departments in 2020-21. In aggregate, these further reduce the squeeze on public services spending planned for this Parliament, implying real cuts more than a third smaller on average than those delivered over the last Parliament and around two thirds smaller than those pencilled in by the Coalition back in March. But the remaining cuts vary significantly by department.

1.3 Taken together with the other measures in the Autumn Statement, the Government has announced a net fiscal giveaway of £6.2 billion next year, more than half of which is the cost of reversing the tax credit cut. This outweighs a £2.9 billion improvement in the underlying forecast in that year and thereby pushes up the deficit. The giveaway is similar in 2017-18, before declining steadily to £2.2 billion in 2019-20, by which point an £8.0 billion increase in total departmental spending is largely offset by a £7.2 billion net tax increase (mostly the new apprenticeship levy and larger rises in council tax). These giveaways are smaller than the improvements in the underlying forecast in these three years, delivering smaller deficits and then a bigger surplus than in July.

1.4 The improvement in the underlying forecast since July (excluding the impact of the decision by the Office for National Statistics (ONS) to reclassify housing associations[1] in England to the public sector) is largely due to an improvement in expected revenues. This reflects higher expected receipts from income taxes, corporation tax and VAT – some of which result from modelling changes to our NICs and VAT deductions forecasts. But the improvement diminishes towards the end of the forecast as lower growth in wages and salaries weighs on income tax receipts in particular. Spending on debt interest is also lower in all years, reflecting a further fall in market interest rates.

[1] Strictly speaking, it is "private registered providers" of social housing in England that are being reclassified. These include most housing associations as well as some for-profit housing bodies. We refer to housing associations in most of the text for simplicity.

1.5 The Autumn Statement policy decisions are expected to have a small impact on the economy, boosting growth a little in the short term (because the pace of fiscal tightening has been eased), but weighing on wage growth in the medium term (as employers are assumed to pass most of the cost of the apprenticeship levy onto their employees).

1.6 For the public finances, the measures ensure that public sector net debt continues to fall in every year of the forecast as a share of GDP and that the budget reaches a surplus of £10.1 billion in 2019-20 – thereby meeting the Government's legislated fiscal targets. However, the Government is set to breach its self-imposed cap on parts of welfare spending, thanks to the reversal of the main July tax credit cuts and slow progress with disability benefit reform.

1.7 Over the full five years of our forecast, from 2016-17 to 2020-21, the Government's decisions add a cumulative £18.7 billion to public sector net borrowing (significantly less than the £27.0 billion improvement in the underlying forecast). The 'giveaways' include:

- higher spending within **Resource Departmental Expenditure Limits (RDEL)** – which cover day-to-day central government spending on public services, grants and administration. Taking into account the usual tendency for departments to underspend these limits, we estimate that the Spending Review implies additional spending of £22.9 billion over the five years, relative to the numbers pencilled in by the Government in July. That comprises a £26.4 billion increase in the years covered by the detailed Spending Review plans, followed by a £3.6 billion cut pencilled in for 2020-21 (thereby further smoothing the path of public services spending). These higher totals mean that RDEL spending is set to fall by an average of 1.1 per cent a year in real terms over this Parliament, compared to 1.6 per cent a year on average over the last Parliament;

- higher spending within **Capital Departmental Expenditure Limits (CDEL)** – which cover central government investment and capital grants. Again taking likely underspending into account, these imply extra spending of £11.9 billion over the five years. The increases average £3.1 billion a year in the next two years, followed by small cuts in the subsequent two years and then a sudden jump of £6.4 billion in 2020-21. This gives a cumulative real increase in capital spending of 20 per cent over this Parliament, followed by a further 17 per cent increase in the first year of the next Parliament alone. The leap in 2020-21 is sufficient to ensure that total public spending in that year remains above its late 1990s lows as a share of GDP;

- a £5.0 billion increase in **welfare spending**. Reversing the main tax credit cuts announced in July will cost £9.4 billion over the five years of the forecast, with the annual cost dropping from £3.4 billion in 2016-17 to £0.5 billion in 2020-21. By that latter year, the cost of the tax credit reversal is more than offset by cuts to a variety of other benefits, which rise from £0.4 billion in 2016-17 to £0.8 billion in 2020-21;

- **gross tax cuts** that total just £1.7 billion, the largest of which is the latest one-year extension to the doubling of small business rates relief; and

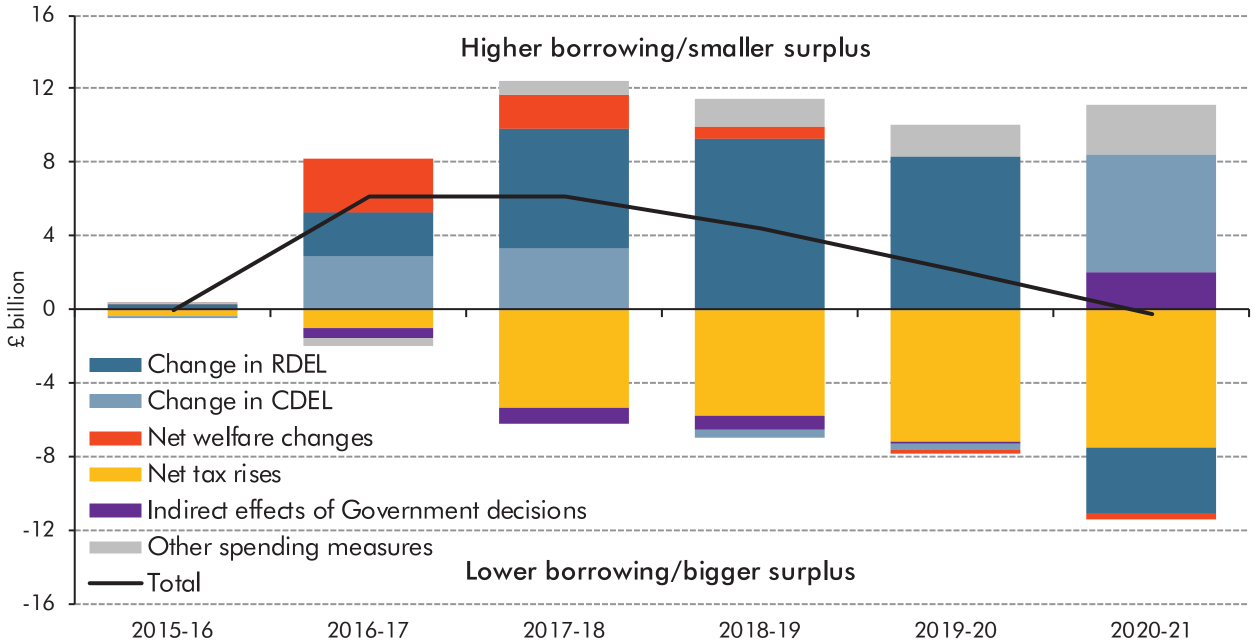
- **other measures that increase spending**, mainly the local government spending that will be financed by making it easier for local authorities to raise council tax.

1.8 These giveaways are partly offset over the five-year period by:

- **gross tax increases** that total £28.5 billion. These include the new apprenticeship levy (£11.6 billion), higher council tax (£6.2 billion), and the introduction of higher rates of stamp duty land tax for second homes and buy-to-let purchases (£3.8 billion); and

- small **indirect effects** from the Government's decisions. Positive effects include the boost to revenues from the near-term increase in GDP growth, while smaller cuts to central government workforces (from higher RDEL) increase pension contributions and so reduce net spending on public service pensions. Working in the opposite direction, helping some local authorities to raise council tax will push up debt interest costs (via its impact on the Retail Prices Index), while the imposition of the apprenticeship levy will reduce tax revenues by weakening earnings growth.

Chart 1.1: The effect of Government decisions on public sector net borrowing



Source: OBR

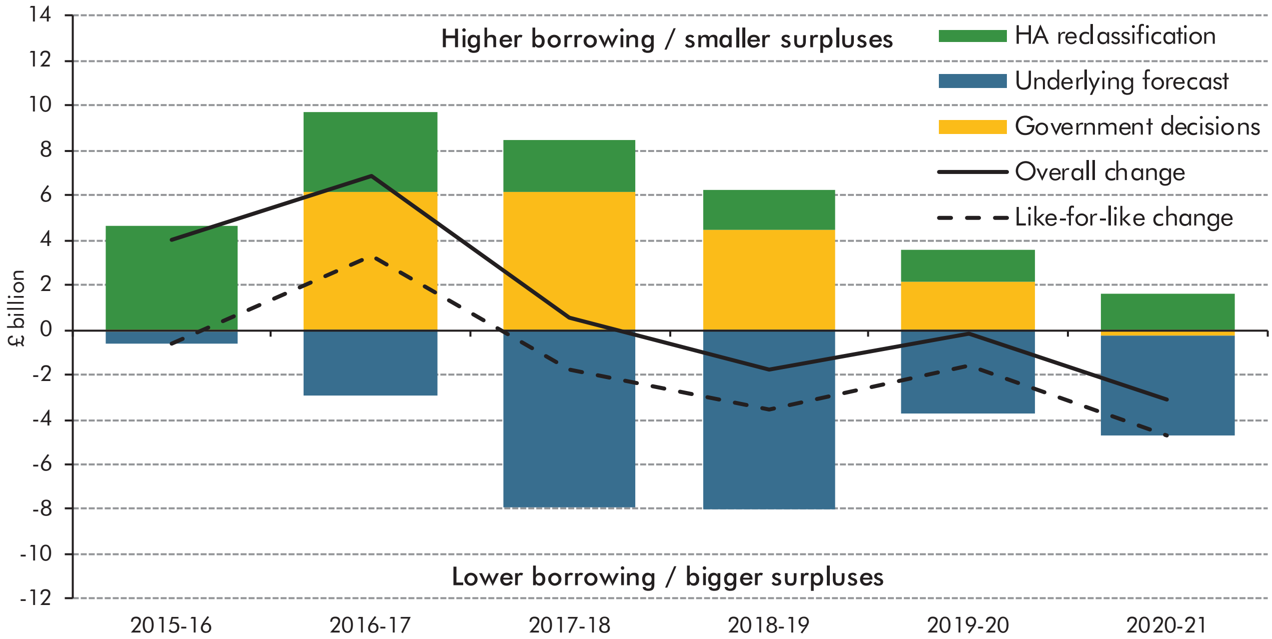
1.9 As we warned might happen in our last *EFO*, the ONS has announced that housing associations will be reclassified from the private to the public sector, with effect from 2008. It intends to implement that decision in the published public finances data sometime before Budget 2016. But we have included estimates of the effect in this forecast, including an outturn for 2014-15. This increases borrowing by between £1.4 and £4.6 billion a year and adds 3.1 to 3.4 per cent of GDP to public sector net debt.

1.10 Compared to our July forecast, adjusted for that classification change, we have revised net borrowing this year down by £0.6 billion to £73.5 billion, as higher-than-expected receipts outweigh higher-than-expected spending on disability benefits and by local authorities. We expect a sharper fall in the deficit over the rest of the year than we have seen to date.

1.11 Borrowing then falls to just under £50 billion in 2016-17 and to less than £5 billion by 2018-19. In 2019-20 the Government is on course for a surplus of £10 billion, matching the headline figure at the July Budget despite a £1½ billion hit from the housing association reclassification. The Government then aims for a surplus of just under £15 billion in 2020-21, slightly larger than in July both including and excluding the reclassification.

1.12 As Chart 1.2 summarises, including the reclassification of housing associations means that the budget balance is weaker in headline terms between 2015-16 and 2017-18, and then stronger thereafter, than in July. On a like-for-like basis it is weaker only in 2016-17 because the policy giveaway is smaller than the forecast improvement in the other years.

Chart 1.2: Contributions to public sector net borrowing changes since July



Source: OBR

1.13 Despite the upward revision to public sector net debt that results from the reclassification of housing associations, we still expect debt to have peaked as a share of GDP in 2014-15 and to fall this year and across the forecast period (although it continues to rise in cash terms). As in July, asset sales make the difference between debt rising and falling as a share of GDP in 2015-16, with £30 billion expected in the financial year as a whole and £24 billion realised to date. Financial asset sales typically bring forward cash that would otherwise have been received later (e.g. in mortgage repayments and dividends), so they only reduce net debt temporarily. And when the Government gives away some of the assets, as with Royal Mail shares and the planned retail offering of Lloyds shares early next year, the sale will raise less than the asset is worth and the public sector's net worth is reduced.

1.14 In terms of our economy forecast, since July:

- our GDP growth forecast is unchanged in 2015 at 2.4 per cent. We have then revised growth up a little in 2016 and 2017, reflecting both higher population growth (driven by higher net migration) and the Government's decision to slow the pace of fiscal tightening. Growth is slightly lower in the final year of the forecast, when we now assume that demographic trends will cause the employment rate to edge lower;

- our estimate of the current output gap – the amount of spare capacity in the economy – is unchanged and we continue to expect it to narrow slowly and to close during 2018. Our inflation forecast is also little changed relative to July; and

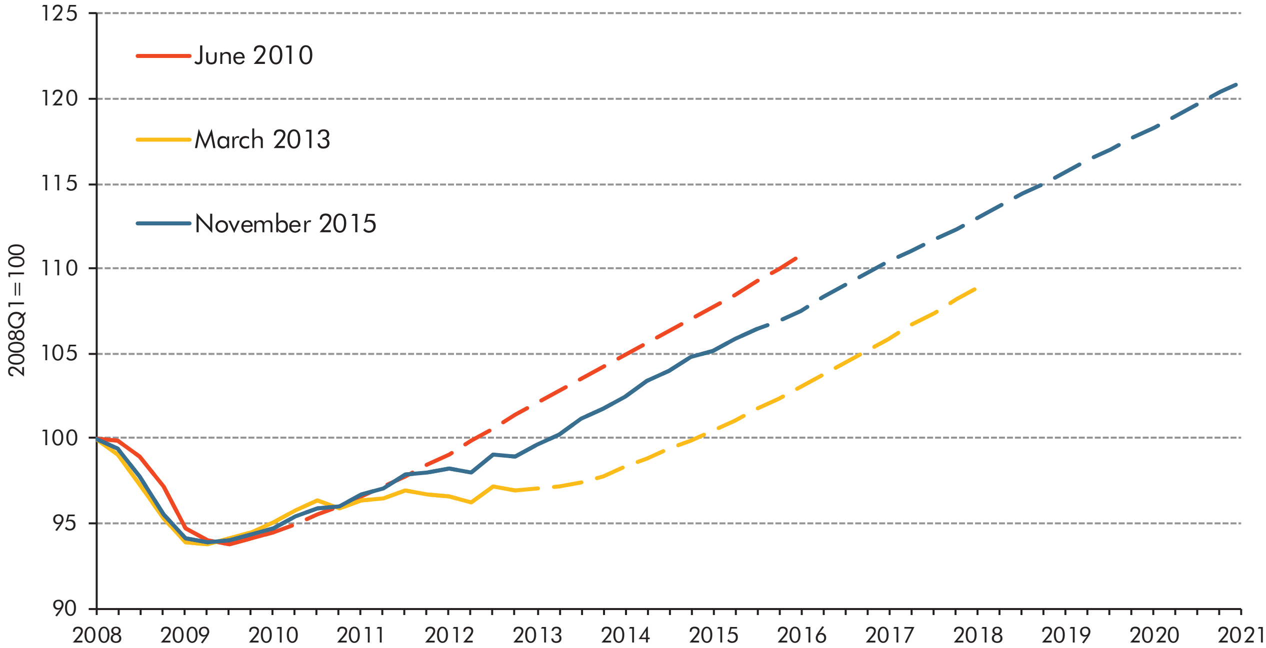
- we continue to expect employment growth to slow as productivity growth picks up. We have adjusted our earnings growth forecast to take account of the additional costs to employers from auto-enrolment into pensions saving and the newly announced apprenticeship levy. Both are economically equivalent to payroll taxes, the cost of which we assume will be passed largely onto employees.

Economic developments since our previous forecast

1.15 Since our July forecast, the ONS has published the 2015 Blue Book. Methodological and other changes have led to upward revisions to the level of nominal GDP – by 1.1 per cent in the first quarter of 2015. The ONS has also revised real GDP growth down from 1.9 per cent to 1.5 per cent in 2010, but then up by between 0.3 and 0.5 percentage points in each of 2011, 2012 and 2013. Overall, the Blue Book has revised up cumulative GDP growth since the low point of the late 2000s recession from 11.2 to 12.1 per cent.

1.16 As Chart 1.3 shows, this continues the pattern of earlier data revisions in strengthening and smoothing the apparent path of the economic recovery. Relative to the pre-recession peak, real GDP is now estimated to be around 2 per cent higher at the end of 2012 than it looked at the time. And the estimated level of real GDP today is now closer to our optimistic June 2010 forecast than to our pessimistic March 2013 forecast.

Chart 1.3: Selected vintages of ONS real GDP estimates and OBR forecasts



Note: Solid lines indicate ONS data and dotted lines indicate OBR forecasts.
Source: ONS, OBR

1.17 Quarterly GDP growth was slightly stronger than we forecast in the second quarter at 0.7 per cent, but slightly weaker in the third quarter at 0.5 per cent. Our forecast for the composition of growth was subject to bigger errors, thanks largely to extremely volatile trade growth. Net trade contributed 1.4 percentage points to GDP growth in the second quarter, but monthly data suggest that it may have then subtracted around 1 percentage point in the third. As expected, consumer price inflation has fallen to zero. Unemployment has also fallen in line with our July forecast, reaching 5.3 per cent in the third quarter.

1.18 GDP growth in advanced economies in the second quarter of 2015 was below our July forecast. The US economy picked up after a weak first quarter, but GDP fell in both Canada and Japan, while growth in the euro area remains weak. Inflation in most major advanced economies is currently close to zero. China's economy continued to slow in the third quarter, with GDP growth at its slowest rate in six years.

The economic outlook

1.19 Since our last forecast, the ONS has updated its population projections. The new projections assume slightly faster population growth (driven by higher net inward migration) and slightly higher mortality rates among older people. We have also fully modelled the effects of the changing age structure of the population on employment rates for this forecast. This suggests that net inward migration of predominantly working-age people will lift the employment rate in the near term, but population ageing will bring it back down in the final years of the forecast. We have also made a small downward revision to underlying productivity growth in the near term, though we continue to expect it to return to historical average rates by the end of the forecast. The net effect of all these changes is a small downward revision to cumulative potential output growth over the forecast period, in other words the amount of growth the economy can sustain without inflation taking off.

1.20 These changes to potential output growth combine with the impact of the Government's policy decisions to explain most of the changes to our real GDP forecast since July. Growth in 2015 is unchanged at 2.4 per cent, but we have revised it higher in 2016 and 2017 by 0.1 percentage points in each year. In 2016, that mainly reflects the Government's decision to ease the pace of fiscal tightening. In 2017, the revisions to underlying potential output growth are more important. We have also revised GDP growth down in 2020 because of the effect of population ageing on the employment rate.

1.21 We have also made some changes to the composition of GDP growth. We expect net trade to be a smaller drag than we assumed in July, following downward revisions to imports growth that outweigh the impact of downward revisions to world trade growth on UK exports. The balance of domestic demand has also been affected by the Government's decision to increase departmental current and capital spending in the Spending Review.

1.22 We have made only small changes to our inflation forecast. Oil prices have fallen further since July, but sterling has depreciated – with broadly offsetting effects. Unit labour costs place slightly greater upward pressure on inflation in the next couple of years, but policy measures in the Autumn Statement lower CPI inflation slightly in 2017 via lower energy bills. The latter also affects RPI inflation in 2017, but across the forecast it is more than offset by the decision to make it easier for some local authorities to raise council tax. That adds just under 0.1 percentage points a year to RPI inflation, but does not affect CPI inflation.

1.23 Employment has grown strongly this year, taking it above 31 million for the first time. But we expect employment growth to slow over the forecast period as productivity growth recovers towards its historical average. Meanwhile, the unemployment rate has fallen to 5.3 per cent and wage growth has picked up. Despite this pick-up, we have revised average earnings growth lower relative to our July forecast. That partly reflects small adjustments to our productivity growth forecast, but also an assumption that the ongoing costs of auto-enrolment and the introduction of an apprenticeship levy will weigh on earnings growth. These are both economically equivalent to payroll taxes, so – consistent with evidence on the incidence of such taxes – we assume that most of the cost will ultimately be borne by employees. Together, auto-enrolment and the new apprenticeship levy reduce cumulative wage growth over the forecast period by 0.7 per cent. This estimate relies on assumptions about how firms respond to such changes, so is subject to considerable uncertainty.

1.24 We expect house price inflation to average around 5 per cent a year over the forecast period, leading to a continued rise in the ratio of average house prices to earnings. This forecast is little changed from July. But we have revised down our forecast for property transactions, reflecting recent research suggesting that private landlords tend to hold properties for longer than owner-occupiers. This means that the rising proportion of the housing stock owned by private landlords would be consistent with fewer property transactions in the steady state. We have also assumed that property transactions will be reduced by the Government's decision to introduce an additional stamp duty land tax charge of 3 per cent on purchases of properties as a second home or as a buy-to-let.

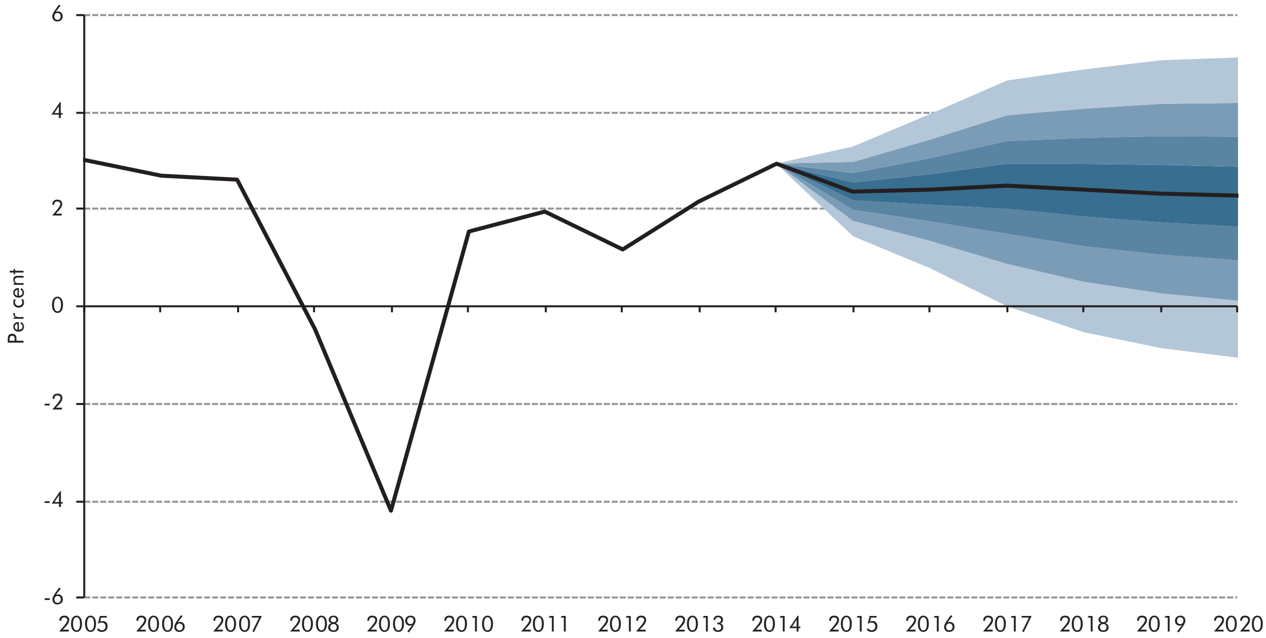
Table 1.1: Overview of the economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2014	2015	2016	2017	2018	2019	2020
Output at constant market prices							
Gross domestic product (GDP)	2.9	2.4	2.4	2.5	2.4	2.3	2.3
GDP levels (2014=100)	100.0	102.4	104.8	107.4	110.0	112.6	115.1
Output gap	-1.0	-0.7	-0.4	-0.1	0.0	0.0	0.0
Expenditure components of GDP							
Household consumption	2.6	2.9	2.6	2.3	2.3	2.1	1.9
General government consumption	1.9	1.7	0.4	0.6	0.5	0.5	1.1
Business investment	4.6	6.1	7.4	7.1	7.0	6.6	4.5
General government investment	7.6	3.0	0.8	0.6	-1.6	1.7	9.2
Net trade[1]	-0.4	0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Inflation							
CPI	1.5	0.1	1.0	1.8	1.9	2.0	2.0
Labour market							
Employment (millions)	30.7	31.1	31.5	31.7	31.9	32.0	32.2
Average earnings	1.5	2.6	3.4	3.7	3.6	3.7	3.9
LFS unemployment (% rate)	6.2	5.5	5.2	5.2	5.3	5.4	5.4
Claimant count (millions)	1.04	0.80	0.77	0.82	0.86	0.87	0.88
	Changes since July forecast						
Output at constant market prices							
Gross domestic product (GDP)	-0.1	-0.1	0.1	0.1	0.0	0.0	-0.1
GDP levels (2014=100)	0.0	-0.1	0.0	0.1	0.1	0.1	-0.1
Output gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure components of GDP							
Household consumption	0.2	-0.1	0.1	0.0	0.0	-0.2	-0.2
General government consumption	0.3	0.5	-0.1	0.3	0.4	0.2	-1.5
Business investment	-3.4	0.1	0.2	0.2	0.4	0.1	-0.2
General government investment	4.2	0.6	0.9	-0.4	-4.0	-0.6	7.2
Net trade[1]	0.3	0.6	0.2	0.1	0.1	0.2	0.1
Inflation							
CPI	0.0	-0.1	-0.1	0.1	0.1	0.1	0.0
Labour market							
Employment (millions)	0.0	-0.1	0.0	0.1	0.2	0.1	0.1
Average earnings	-1.1	0.5	-0.2	-0.2	-0.3	-0.4	-0.4
LFS unemployment (% rate)	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Claimant count (millions)	0.00	0.02	0.04	0.07	0.09	0.09	0.09

[1] Contribution to GDP growth.

1.25 There is considerable uncertainty around any economic forecast. Chart 1.4 presents our central growth forecast with a fan showing the probability of different outcomes based on past official forecast errors. The solid black line shows our median forecast, with successive pairs of lighter shaded areas around it representing 20 per cent probability bands.

Chart 1.4: Real GDP growth fan chart



Source: ONS, OBR

The fiscal outlook

1.26 Public sector net borrowing peaked at 10.2 per cent of GDP (£153.5 billion) in 2009-10 as the late 2000s recession and financial crisis dealt the public finances a significant blow. Fiscal consolidation and economic recovery then reduced the deficit to 4.9 per cent of GDP (£90.1 billion) by 2014-15 (excluding the impact of the housing association reclassification described below). Table 1.2 shows that on current policy we expect the deficit to continue falling, and the budget to move into surplus in 2019-20, unchanged from our July forecast.

Table 1.2: Fiscal forecast overview

	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue and spending							
Public sector current receipts	35.8	35.8	36.5	36.9	36.9	36.9	37.1
Total managed expenditure	40.9	39.7	39.1	38.1	37.2	36.5	36.4
Deficit: Fiscal mandate							
Public sector net borrowing	5.2	3.9	2.5	1.2	0.2	-0.5	-0.6
Cyclically adjusted current budget deficit	2.4	1.6	0.5	-0.5	-1.2	-1.9	-2.4
Debt: Supplementary target							
Public sector net debt	83.1	82.5	81.7	79.9	77.3	74.3	71.3
	Like-for-like changes since July forecast						
Revenue and spending							
Public sector current receipts	-0.3	-0.4	-0.3	0.0	0.0	-0.1	0.0
Total managed expenditure	-0.3	-0.5	-0.1	-0.1	-0.2	-0.2	-0.2
Deficit: Fiscal mandate							
Public sector net borrowing	0.0	-0.1	0.1	-0.1	-0.2	-0.1	-0.2
Cyclically adjusted current budget deficit	0.0	0.0	0.0	-0.1	-0.1	0.0	-0.5
Debt: Supplementary target							
Public sector net debt	-0.9	-1.2	-0.8	-0.7	-0.7	-0.4	-0.3

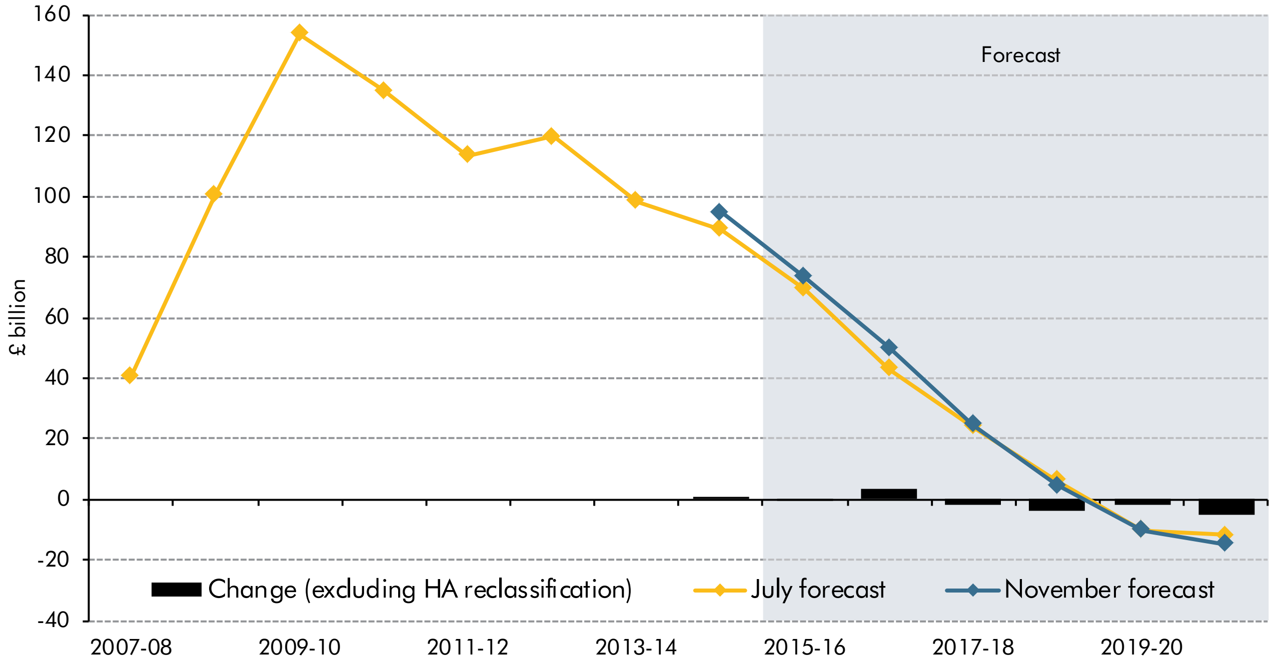
Changes in public sector net borrowing and net debt

1.27 Since our last forecast in July, the ONS has announced that it will reclassify housing associations from the private to the public sector, taking effect from 2008. It intends to implement that reclassification in the public finances data before Budget 2016. We always try to forecast the public finances consistent with how the ONS will measure them once it has implemented its classification decisions, so that our forecasts will be consistent with that eventual treatment. We have therefore included estimates of the effect on spending, receipts, borrowing and debt in this forecast (described in detail in Annex B).

1.28 To ensure that our latest forecast can be compared with July on a like-for-like basis, we have shown what the July forecast would have looked like had housing associations been included in the public sector then. We have also included an estimate of the effect in 2014-15, so that year-on-year changes in 2015-16 remain meaningful. But we have not adjusted any outturn data for prior years.

1.29 We expect borrowing to fall by £21.2 billion in 2015-16, which is a bigger drop than would be implied by extrapolating from the year-on-year change in borrowing in the first seven months of the year. There are a number of factors that we expect to push borrowing down at a faster pace in the rest of 2015-16. These include policy measures boosting self-assessment receipts, the December 2014 reform to stamp duty land tax (which depresses year-on-year comparisons until November 2015) and pressures on departmental spending subject to Treasury controls (including the effect of in-year spending cuts that the Government announced in June). Abstracting from the housing associations reclassification, borrowing has then been revised up in 2016-17, but lower thereafter. Including the reclassification, the deficit is slightly bigger through to 2017-18 than in July, while the surplus expected in 2019-20 is little changed. The Government then aims to achieve a bigger surplus in 2020-21 than it was on course to do in July.

Chart 1.5: Public sector net borrowing



Note: November forecast for 2014-15 includes our estimate of the effect of housing associations.
Source: ONS, OBR

1.30 Table 1.3 sets out how changes due to the housing association reclassification, our underlying forecast judgements and the Government's policy decisions have affected our forecast for public sector net borrowing. It shows that:

- incorporating **housing associations** would have added £4.6 billion to our July forecast in 2015-16, but diminishing amounts thereafter. The fall in borrowing after 2015-16 reflects the effect on their capital spending of the July Budget measures to force social landlords to reduce rents by 1 per cent a year for four years and to require certain tenants to 'pay to stay' in their accommodation. We assume that the resulting fall in housing associations' rental income will lead to a greater fall in their capital spending, rather than the one-to-one relationship we assumed for our economy forecast in July. This has led to a declining path for housing associations' net borrowing on the basis of Government policy as it stood in July;

- we have revised up our **pre-measures receipts forecast** (which reduces borrowing and therefore shows up as negative figures in the table). Stronger-than-expected income tax and corporation tax receipts this year have boosted all years of the forecast. Improved modelling of national insurance contributions and correcting a systematic overestimate of VAT deductions has also raised receipts. Partly offsetting that, we have revised down stamp duty land tax receipts reflecting a substantial fall in the number of transactions at very high prices. The net boost to receipts peaks in 2017-18 and then declines as slightly lower nominal GDP growth reduces income taxes in particular;

- our **pre-measures forecast for AME spending** is higher in the near term, but lower in the latter part of the forecast. Welfare spending, particularly on disability benefits, and local authority spending are higher than expected. But debt interest spending is revised down by increasing amounts from 2016-17 onwards, reflecting lower interest rates and an assumed delay to the reversal of quantitative easing;

- the **direct effect of the Government's policy decisions** has been to push borrowing higher between 2016-17 and 2019-20, but to increase the surplus in 2020-21. The Government has chosen to increase departmental current spending across the Spending Review period, but to reduce it in 2020-21. It has also raised departmental capital spending in the first half of the Spending Review period but reduced it slightly in the second half. Then in 2020-21 it has added £6.4 billion to capital spending. Policy measures on the Treasury's 'scorecard' include tax rises in every year, plus welfare giveaways in the near term (reversing July's main cuts to tax credits) that are more than offset by other welfare cuts by the end of the forecast. The Government has also announced that some local authorities will be allowed to raise council tax faster than previously assumed to meet some of the costs of social care and policing. That raises tax and local authority spending, with an almost neutral effect on borrowing; and

- the net **indirect effects** on the public finances of the Government's decisions are small. Positive effects include the boost to revenues from the near-term increase in GDP growth, while smaller cuts to central government workforces (from higher RDEL) increase pension contributions and so reduce net spending on public service pensions. Working in the opposite direction, helping some local authorities to raise council tax will push up debt interest costs (via its impact on the Retail Prices Index), while the imposition of the apprenticeship levy will reduce tax revenues by weakening earnings growth. (Lower earnings growth also reduces the amount by which the triple lock uprates the state pension, thereby reducing spending a little too.)

Table 1.3: Changes to public sector net borrowing since July

	£ billion						
	Estimate	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
July forecast	89.2	69.5	43.1	24.3	6.4	-10.0	-11.6
Housing associations reclassification	4.5	4.6	3.5	2.3	1.8	1.4	1.6
July forecast restated to include HAs	93.7	74.1	46.7	26.5	8.2	-8.5	-10.0
Total forecast changes	**0.9**	**-0.5**	**-2.9**	**-7.9**	**-8.0**	**-3.8**	**-4.4**
of which:							
Receipts	-1.5	-2.5	-4.1	-6.3	-5.4	-2.8	-2.8
AME spending	2.4	2.1	1.4	-1.4	-2.3	-0.8	-1.4
Revisions to DEL spending	0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
November forecast pre-policy decisions	94.7	73.6	43.8	18.6	0.2	-12.3	-14.4
Total effect of Government decisions		**-0.1**	**6.2**	**6.2**	**4.4**	**2.2**	**-0.3**
of which:							
Scorecard receipts measures		-0.3	-0.6	-4.5	-4.6	-5.5	-5.3
Scorecard AME spending measures		0.0	2.6	1.7	0.3	-0.7	-1.1
Non-scorecard measures		0.0	-0.4	0.1	0.5	0.5	1.2
Changes to RDEL spending		0.3	2.3	6.5	9.3	8.3	-3.6
Changes to CDEL spending		-0.1	2.9	3.3	-0.4	-0.3	6.4
Indirect effect of Government decisions		0.0	-0.6	-0.9	-0.7	-0.1	2.0
November forecast	94.7	73.5	49.9	24.8	4.6	-10.1	-14.7
Change on a like-for-like basis	**0.9**	**-0.6**	**3.3**	**-1.7**	**-3.6**	**-1.6**	**-4.7**
Memo: November forecast excluding housing association reclassification	*90.1*	*68.9*	*46.8*	*22.4*	*2.2*	*-12.1*	*-17.6*

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.

1.31 We expect public sector net debt (PSND) to have peaked as a percentage of GDP in 2014-15 and to fall in every year of the forecast. Table 1.4 shows how our forecast has changed since July. At that time we highlighted the risk that the Government's decision to force housing associations to cut rents by 1 per cent a year for four years might prompt the ONS to reconsider their classification as private sector entities – and that if they were reclassified to the public sector it would lead to a significant rise in the level of PSND. That has in fact happened, with effect from 2008. We estimate that our July forecast for PSND would have been between 3.1 and 3.4 per cent of GDP higher over the forecast period if housing associations had been classified in the public sector at that time.

1.32 Abstracting from this reclassification, our forecast for PSND has been revised up in cash terms but down as a share of GDP since July. That reflects:

- upward revisions to the level of **nominal GDP** in Blue Book 2015, which lower the debt-to-GDP ratio in every year of the forecast;
- **cumulative borrowing** across the forecast has been revised down slightly, measured on a like-for-like basis. That reflects a downward revision in our pre-measures forecast for borrowing, partly offset by the impact of the Government's policy decisions, which increase spending by more in aggregate than they increase revenue;

- the Bank of England announced in November that it would keep the stock of gilts held in the **Asset Purchase Facility (APF)** at £375 billion until Bank Rate reaches a level from which it can be cut materially. The MPC currently judge this to be around 2 per cent – a level that markets are not pricing in until beyond our five-year horizon.[2] This reduces debt interest spending (and thus borrowing). But it also increases PSND because the nominal (as opposed to the market) value of the gilts the APF holds exceeds the value of the reserves the Bank created to purchase them. (In other words, the Bank pays more for the gilts than they will be worth on redemption.) This effect diminished over time in our previous forecast, as the Bank was assumed to stop buying gilts to replace those that were redeemed from early 2016-17. So the decision to continue doing so for longer adds increasing amounts to PSND, reaching £18 billion by 2020-21. (Netting off the debt interest saving, the total increase in PSND is £12 billion);

- there have been a number of changes to our forecast for **asset sales**. We have revised up the expected proceeds from UKAR sales, with the Granite sale having been completed earlier in the year than we expected and further sales having been announced on top of the natural rundown of UKAR's assets. Conversely, we no longer expect the first student loan book sale to be completed in 2015-16, while the Royal Mail share sale raised less than expected (partly due to a lower share price and partly because the Government chose to give more shares to Royal Mail staff for free). We have also revised down the expected proceeds from the remaining Lloyds share sales, to reflect both the current share price and the Government's intention to give some 'bonus' shares away to retail investors. The Government has also announced that it will sell a further £5.8 billion of RBS shares in 2020-21; and

- **other changes** include a lower adjustment to align our forecasts of the net cash requirement and net borrowing (an effect that is offset within borrowing), as well as small changes to gilt premia.

[2] See "The MPC's asset purchases as Bank Rate rises", a box in the November 2015 *Inflation Report*.

Table 1.4: Changes to public sector net debt since July

	Per cent of GDP						
	Estimate	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
July forecast	80.8	80.3	79.1	77.2	74.7	71.5	68.5
Housing association reclassification							
Per cent of GDP	3.2	3.3	3.4	3.3	3.3	3.2	3.1
£ billion	59	64	67	69	71	72	74
July forecast restated to include HAs	84.0	83.6	82.5	80.6	78.0	74.7	71.6
Change	**-0.9**	**-1.2**	**-0.8**	**-0.7**	**-0.7**	**-0.4**	**-0.3**
of which:							
Change in nominal GDP[1]	-1.0	-1.3	-1.3	-1.3	-1.3	-1.2	-0.9
Change in cash level of net debt	0.0	0.2	0.5	0.6	0.5	0.8	0.6
November forecast	83.1	82.5	81.7	79.9	77.3	74.3	71.3
	£ billion						
July forecast restated to include HAs	1545	1596	1643	1672	1690	1691	1700
November forecast	1546	1599	1652	1685	1702	1708	1715
Change in cash level of net debt	**1**	**4**	**10**	**12**	**12**	**18**	**14**
of which:							
Borrowing	1	0	4	2	-2	-3	-8
APF gilt valuation effect	0	0	4	8	12	17	18
UKAR and other asset sales	0	4	1	1	0	0	-5
Gilt premia	0	-2	1	-1	-1	0	-1
Lending	0	-1	0	1	1	3	6
CGNCR adjustment	0	1	1	2	2	3	3
Other factors	0	2	-1	0	-1	-2	0

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

The path from deficit to surplus

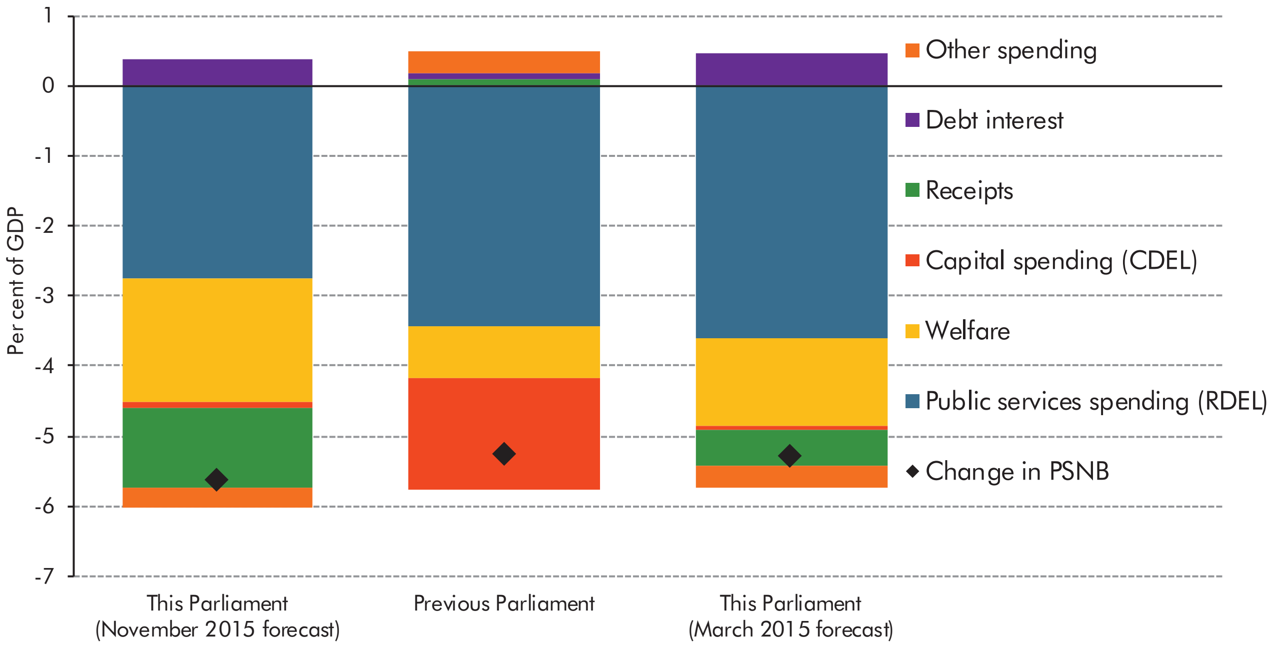
1.33 On the basis of the latest ONS estimates, which do not yet include the effect of reclassifying housing associations to the public sector, the budget deficit fell by 5.3 per cent of GDP over the last Parliament. We expect the deficit (including housing associations) to fall by 1.3 per cent of GDP this year and on the basis of our latest forecast – now based on firm spending plans detailed in the Government's Spending Review – there is a further 4.3 per cent of GDP improvement planned for the rest of this Parliament. That would take the budget into surplus for the first time since 2001-02.

1.34 As Chart 1.6 shows, the composition of the improvement in the budget balance that the Government plans to deliver over this Parliament (from 2014-15 to 2019-20) differs from that achieved in the last Parliament (from 2009-10 to 2014-15) and from the Coalition's plans in March. In particular:

- **compared with the last Parliament**, the cuts to public services spending (as a share of GDP) are around a fifth smaller. Capital spending – which contributed to deficit reduction in the last Parliament when it was cut back after the 2009-10 fiscal stimulus – is planned to remain almost flat as a share of GDP in this Parliament. Lower welfare spending is expected to contribute more than twice as much to improving the budget balance than it did in the last Parliament, while receipts are expected to rise as a share of GDP where they were flat in the last Parliament. That reflects both policy measures and the effects of economic growth interacting with the structure of the tax and benefits systems. Most tax rates and benefit awards move with inflation rather than earnings, so growth in real earnings drags more income into higher tax brackets and reduces the generosity of benefits relative to average earnings in the rest of the economy. In the last Parliament policy measures to increase taxes were offset in their impact on revenues, for example by the impact of weak earnings growth and changes in the distribution of wages on income taxes, and by falling North Sea receipts; and

- **compared with the forecast for this Parliament that we prepared for the Coalition's final Budget in March**, the extent to which public services spending will be cut as a share of GDP is around a quarter lower following the increases announced in the July Budget and added to in this Spending Review. Tax rises and welfare spending cuts also contribute a more to the change in the deficit than the Coalition planned in March, while debt interest is set to rise less.

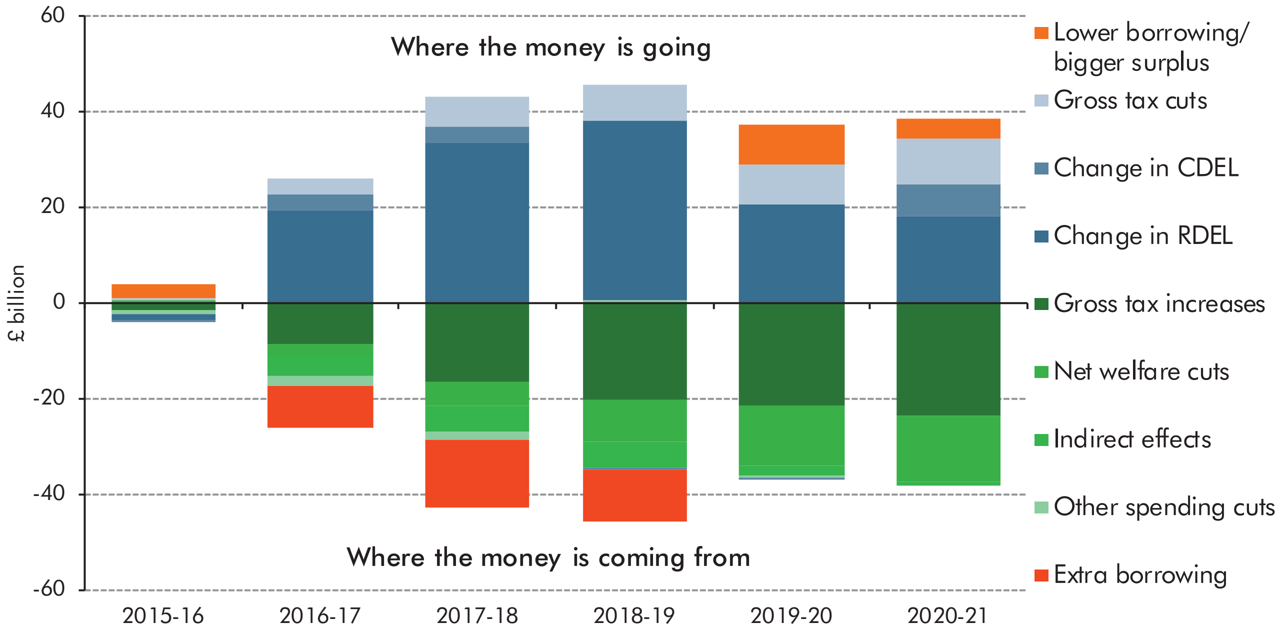
Chart 1.6: Fiscal consolidation over two Parliaments



Source: ONS, OBR

1.35 Chart 1.7 summarises the cumulative impact across the forecast of the Government's policy decisions since March. July's modest spending cuts and tax increases reduced borrowing a little this year. Over the following three years, welfare cuts and tax increases mount steadily, but they are not large enough to pay for the higher public services spending and tax cuts – hence the need for more borrowing to fill the gap. In the final two years the welfare cuts, tax increases and indirect effects more than pay for the tax cuts and (smaller) additions to public services spending – increasing the then budget surplus. In aggregate over the full five years, the measures in the two statements increase RDEL spending by £129 billion and deliver £36 billion of tax cuts. This is paid for by £91billion of tax increases, £43 billion of welfare cuts, £19 billion of indirect revenue and spending effects and £21 billion more borrowing.

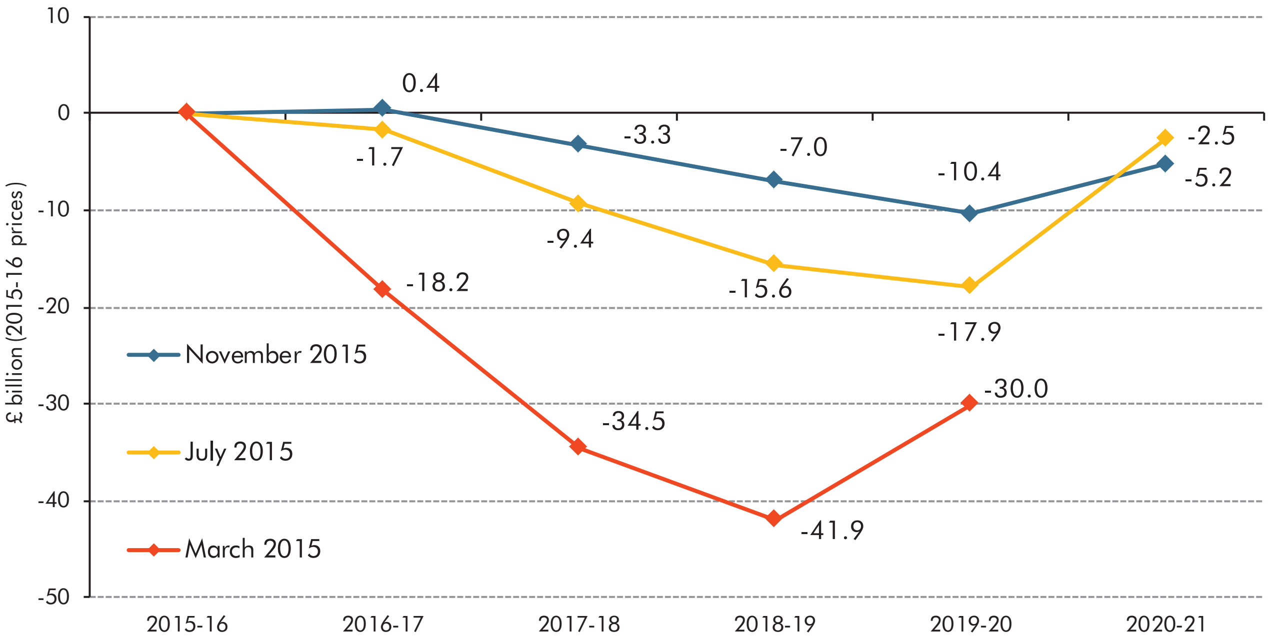
Chart 1.7: The impact of Government policy decisions on the forecast since March



Source: OBR

1.36 As a result of the decisions the Government has taken in July and now, it has lifted and smoothed the path of **current (RDEL) spending**. Taking account of expected underspending against the Government's plans, we expect RDEL spending to be cut by £10.4 billion in real terms by 2019-20. That is around 40 per cent less than the £17.9 billion cut by that year pencilled in by the Government in July and only around a quarter of the £41.9 billion peak cut pencilled in by the Coalition in March (which was to be delivered a year earlier in 2018-19). In contrast to March and July, the Government also no longer assumes that, once the budget has moved into surplus, the real cut to spending will shift significantly into reverse. It is also now expected to fall appreciably less quickly in real terms over this Parliament than the last – by an average of 1.1 per cent a year, compared to 1.6 per cent a year.

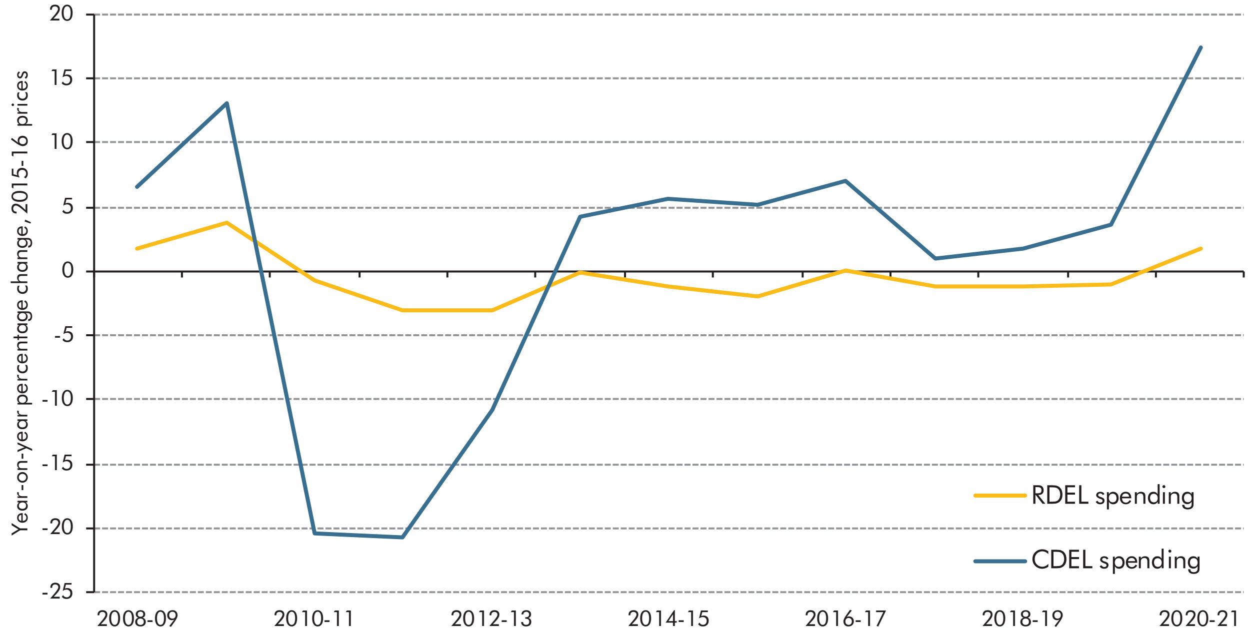
Chart 1.8: Change in real RDEL from 2015-16



Source: OBR

1.37 The Government has also set plans that – again taking account of expected underspending – will see **capital (CDEL) spending** rise by 14 per cent in real terms over the Spending Review period to 2019-20, increasing it slightly as a share of GDP. Then in 2020-21, the Government has told us that its policy assumption is for CDEL plans to rise by 20 per cent in real terms. Even assuming, as we have, that such rapid growth would be accompanied by a greater degree of underspending, CDEL spending would rise by 17 per cent in real terms in that year, faster even than the Labour Government delivered as part of the fiscal stimulus in 2009-10. Large investment projects can affect the path of capital spending from year to year, but it is striking how much more volatile it has been than current spending, both in outturn and in the latest set of Government plans and projections, despite its inherently long-term nature.

Chart 1.9: Real growth in departmental current and capital spending



Note: Both series have been adjusted for the effects of significant discontinuities, details of which are in the supplementary fiscal tables on our website.
Source: HMT, OBR

Performance against the Government's fiscal targets

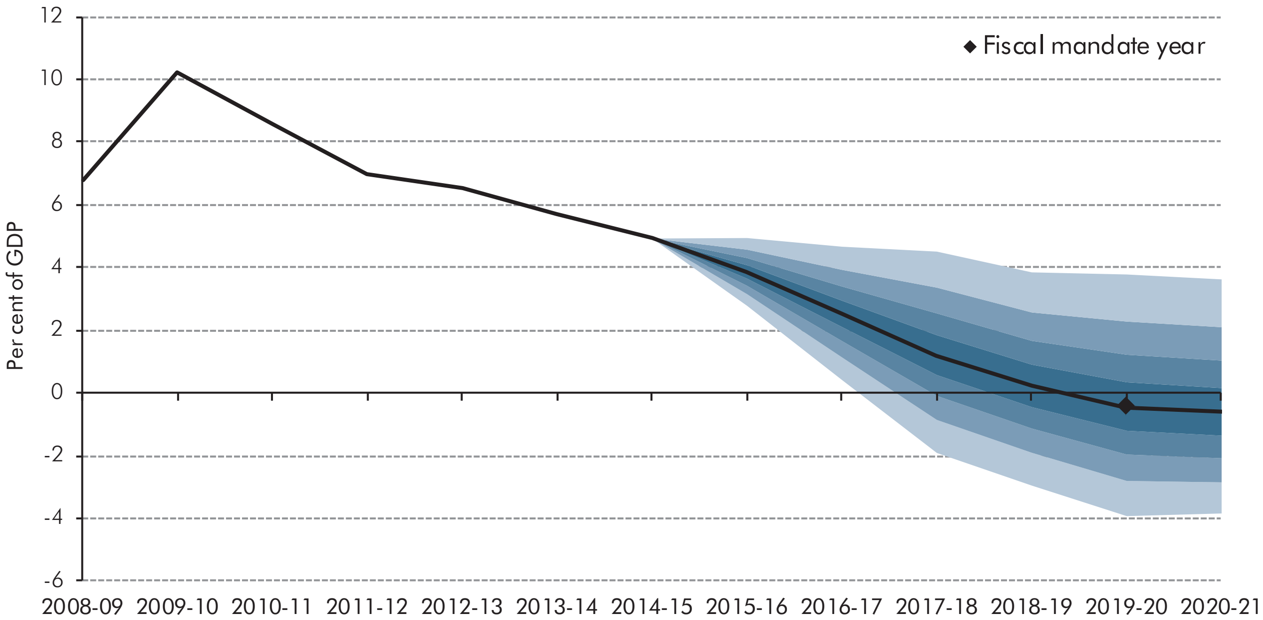
1.38 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of hitting its fiscal targets under existing policy. The *Charter* has been updated again since our last forecast, with the latest version approved by Parliament in October (and available on our website). It sets out the targets for borrowing, debt and welfare spending that are assessed in this forecast:

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

1.39 On our central forecast, we judge that the Government has a greater than 50 per cent chance of meeting the fiscal mandate and supplementary target. We expect the budget to be in surplus by 0.5 per cent of GDP (£10.1 billion) in 2019-20 and public sector net debt to fall by 0.6 per cent of GDP in 2015-16 and by bigger margins in subsequent years.

1.40 All forecasts are subject to significant uncertainty. Chart 1.10 shows our median forecast for public sector net borrowing. Successive pairs of shaded areas around the median forecast represent 20 per cent probability bands. As in Chart 1.4 for our GDP growth forecast, the bands show the probability of different outcomes if past official errors were a reasonable guide to future forecast errors.

Chart 1.10: Public sector net borrowing fan chart



Source: ONS, OBR

1.41 For the purpose of assessing the fiscal mandate, the Government now asks us to assess whether the economy will be in 'normal times' after 2019-20, which it has defined as growing by more than 1 per cent on a 4-quarter-on-4-quarter basis. On our central forecast, growth will be above 1 per cent on that metric, but the probability distribution used to generate Chart 1.4 suggests there is a 30 per cent probability of growth falling below the threshold in 2020.

1.42 Our central forecast shows that the terms of the welfare cap are set to be breached in three successive years from 2016-17 to 2018-19, with the net effect of policy measures raising welfare cap spending in each of those years, and to well above the 2 per cent forecast margin in 2016-17 and 2017-18. The terms of the cap are set to be observed by very small margins in 2019-20 and 2020-21, with spending above the cap but within the forecast margin and with the net effect of measures in those years reducing spending.

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

- first, by looking at **past forecast errors**, if our central forecasts are as accurate as official forecasts were in the past, then there is a roughly 55 per cent chance that PSNB will be in balance or surplus in 2019-20 (as the fiscal mandate requires);

- second, by looking at its **sensitivity to varying key features of the economic forecast**. The surplus in 2019-20 could fall to zero due to relatively small differences in the output gap (if it were -0.6 per cent in that year, not zero), potential output (if it were 0.8 per cent lower), whole economy prices (1.1 per cent lower), debt interest spending (due to interest rates 0.9 percentage points higher than market expectations or a 2.2 percentage point upside surprise in RPI inflation), effective tax rates (a 0.5 percentage point lower tax-to-GDP ratio, due to the composition of GDP, distribution of incomes or movements in asset prices), or the delivery of public spending cuts (a quarter less than planned); and

- third, by looking at **alternative economic scenarios**. Since all the Government's fiscal targets are now sensitive to cyclical as well as structural movements in the economy, we have considered three scenarios that involve illustrative cyclical shocks hitting in 2018. The 'positive shock' scenario sees the deficit move to surplus a year earlier than in our central forecast and the debt-to-GDP ratio falling by bigger amounts each year. Welfare cap spending would remain within the forecast margin. The 'growth slowdown' scenario, calibrated to be similar to the slowdown in 2012 where (on the latest data) GDP growth remained just above the 1 per cent 'normal times' threshold defined in the fiscal mandate, would see the deficit persist in 2019-20, so the fiscal mandate would be missed. Debt would continue to fall as a share of GDP in every year and welfare cap spending would remain within the forecast margin during the slowdown. Finally, in the 'negative shock' scenario, which we have calibrated such that real and nominal GDP fall in absolute terms, the fiscal mandate and supplementary debt targets would be missed. Welfare cap spending would be close to the top of the forecast margin, but the increase would be comparatively small since the most cyclical elements of welfare spending are outside the cap. Tax credits spending would be pushed up due to weaker earnings, but much lower inflation would offset much of that effect via lower upratings.