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Forecast evaluation report

January 2021

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Forecast evaluation report

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Contents

Charts and tables data are available on our website.

Foreword

The Office for Budget Responsibility (OBR) was created in 2010 to provide independent and authoritative analysis of the UK public finances. Twice a year – at the time of each Budget and Autumn/Spring Statement – we publish a set of forecasts for the economy and the public finances over the coming five years in our *Economic and fiscal outlook (EFO)*. We use these forecasts to assess the Government's progress against the fiscal targets that it has set for itself.

In each *EFO*, we stress the uncertainty that lies around all such forecasts. We compare our central forecasts to those of other forecasters. We highlight the limited confidence that should be placed in our central forecast given the inaccuracy of past official forecasts. We use sensitivity and scenario analysis to show how the public finances could be affected by alternative economic outcomes. And we highlight the residual uncertainties in the public finances, even if one were confident about the path the economy was going to take – for example, because of uncertain estimates of the cost or yield associated with new policy measures. We prepare a fiscal stress test in each *Fiscal risks report*.

Notwithstanding these uncertainties – and the fact that no one should expect any forecast to be met in its entirety – we believe that it is important to spell out our forecast in considerable quantitative detail. We also believe that is important to examine regularly how these forecast compares to outturn data and to explain any discrepancies so that we can learn from our mistakes.

This year our *Forecast evaluation report* is much less detailed than usual as the task of analysing and explaining the impact on the economy and public finances of the coronavirus and the numerous associated government policy announcements, as well as the outcome of the EU exit negotiations, has limited the resources we have had to focus on forecast evaluation this year. The effects of the pandemic will also mean that our forecast errors for the current and next few years will be larger than ever, and the average accuracy of our forecasts will also be heavily skewed because of the unprecedented shock to the economy. We will return to an evaluation of the judgements and conclusions of our virus-affected forecasts once we have the outturn data.

The forecasts we publish represent the collective view of the three independent members of the OBR's Budget Responsibility Committee (BRC), we take full responsibility for the judgements underpinning the forecasts and for the performance of them presented in this report.

In line with our memorandum of understanding with government departments, we provided a full and final copy of this report to the Treasury 24 hours in advance of publication.

Richard Hughes　　Sir Charles Bean　　Andy King

The Budget Responsibility Committee

1 Context

Introduction

1.1 In this year's report we evaluate our March 2018 and March 2019 forecasts for the 2019-20 financial year. At the time that they were produced, the largest uncertainties around our economic and fiscal forecasts appeared to stem from the familiar risks to our productivity forecast and the range of potential outcomes to the ongoing Brexit negotiations. In the event, however, it is the initial effects of the coronavirus pandemic in the final weeks of 2019-20 that explains the majority of the forecast differences.

1.2 When we come to evaluate our forecasts for 2020-21 in next year's report, they will reflect the full scale of the economic and fiscal shock from the pandemic. With real GDP in 2020 set to fall more sharply than in any calendar year since the Great Frost of 1709, our forecast errors will be off the scale relative to any on record (our database reaches back to 1983). Indeed, it would have required Lord High Treasurer Sidney Godolphin, on the back of passing the 1707 Act of Union, to have published a multi-year forecast for GDP growth for history to provide an example of a larger economic forecast error.

Our 2019-20 forecast differences

1.3 Both the March 2018 and March 2019 forecasts for real GDP growth were broadly on track – despite volatility in the quarterly path due to the effects of shifting Brexit deadlines on trade flows and stock levels – until the 3 per cent fall in GDP in the first quarter of 2020 as the seriousness of the virus outbreak began to be felt. This was already the largest quarterly fall on record (since 1955), and a steeper decline than experienced in any quarter during the financial crisis or in any post-war recession. Our forecasts for nominal GDP growth, the metric that matters more for the accuracy of our fiscal forecasts, recorded smaller errors due to partly offsetting under-predictions of whole-economy inflation.

1.4 To evaluate our March 2018 and March 2019 forecasts for the budget deficit we have deployed a simple approach of splitting the forecast differences into the pandemic and underlying pre-virus effects. Our March 2018 forecast overestimated borrowing by £3.7 billion on a pre-virus basis, as a broadly based upside surprise to receipts exceeded higher-than-expected spending, largely due to the additional NHS spending announced in June 2018. But the early effects of the significant virus-related hit to receipts and the more modest boost to spending were sufficient to turn the underlying overestimate into a total underestimate of borrowing of £9.9 billion. Our March 2019 borrowing forecast was very close to the latest outturn on an underlying pre-virus basis, with the impact of the virus explaining almost all the £13.4 billion upside surprise.

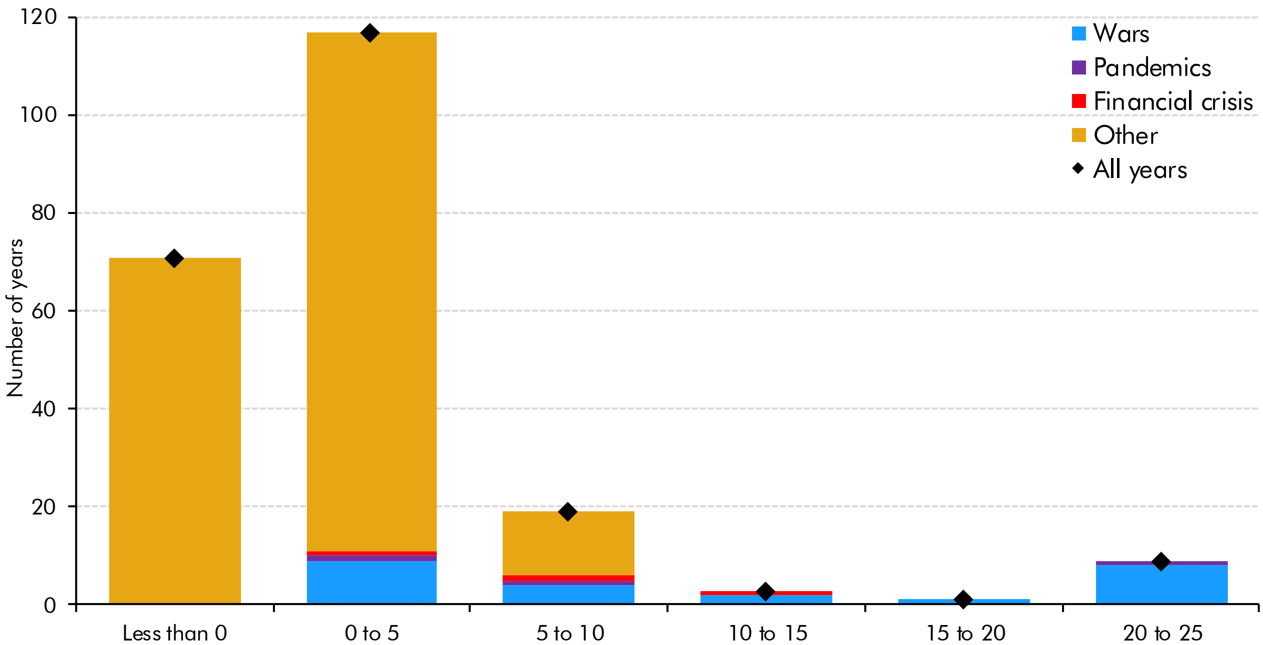
Historical context

1.5 In previous *FER*s we noted that our economy forecasts, and to a lesser extent our fiscal forecasts, had tended to be more accurate than the official Treasury forecasts produced in the 20 years before the creation of the OBR. But we stressed that this comparison was flattered by the fact that we had not yet had to forecast through a major downturn. That eventuality has, of course, now come to pass.

1.6 The forecast differences for 2019-20 are not large by historical standards but, driven as they are by the initial – relatively modest – effects of the virus in the last few weeks of the financial year, they are a precursor of the unprecedently large forecast differences that we will no doubt confront when we come to evaluate our forecasts for 2020-21.

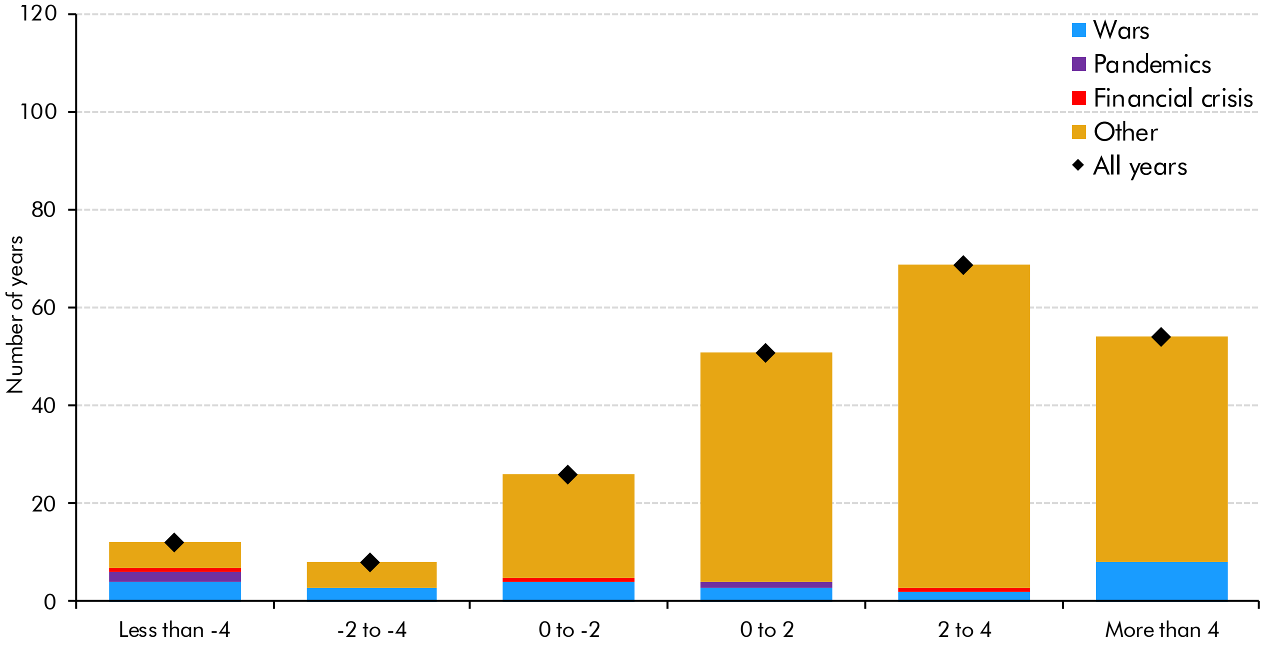
1.7 The exceptional nature of the impact of the pandemic on the economy and public finances can be seen in Charts 1.1 and 1.2. The budget deficit in 2020-21, which we forecast in our most recent November *Economic and fiscal outlook* (*EFO*) to reach 19 per cent of GDP (in the central forecast), is expected to reach levels only previously experienced in times of war, or earlier pandemics. Our most recent forecast of real GDP growth for 2020 is for a fall of 11 per cent – the largest drop in annual output since the Great Frost of 1709.

Chart 1.1: Historical distribution of public sector net borrowing as share of GDP since 1800



Source: Bank of England, OBR

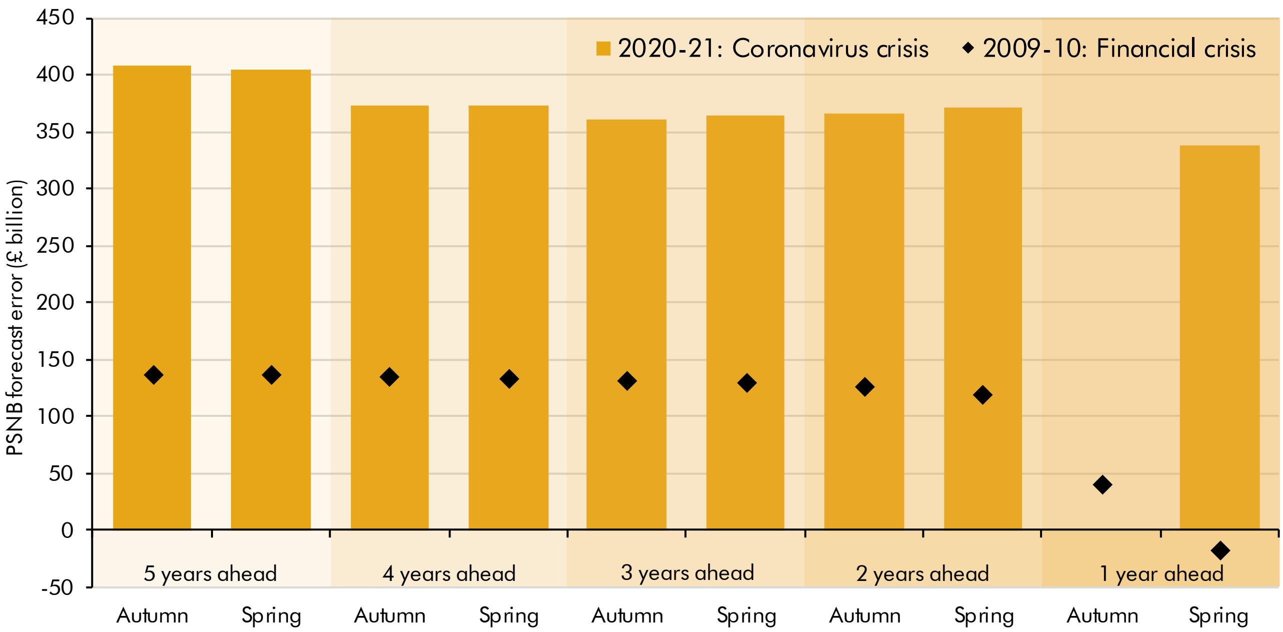
Chart 1.2: Historical distribution of real GDP growth since 1800



Source: Bank of England, OBR

1.8 It is possible to illustrate the likely size of the forecast differences for 2020-21 we will confront in future *FER*s by comparing our ten previous forecasts for that year to our latest prediction, as a proxy for the eventual outturn (Chart 1.3). On that basis, the error ranges from £339 billion relative to our March 2020 forecast for the year ahead up to £409 billion for our 5-year ahead forecast from November 2015. In all instances, the error will dwarf the equivalent errors for the Treasury's successive forecasts for borrowing in 2009-10, when the effect of the financial crisis on the budget deficit peaked.

Chart 1.3: Possible 2020-21 forecast differences for public sector net borrowing



Note: the missing column reflects the cancelled budget in November 2019.
Source: ONS, OBR

Conclusion

1.9 In the face of such massive forecast errors, it might seem tempting to conclude that all forecasts are worthless. But, as with the financial crisis a decade ago, the lesson from this episode is not that forecasting serves no purpose, but rather that it is as least as important to recognise the risks and uncertainties around any central forecast as it is to understand the central forecast itself. Moreover, our forecasts provide a transparent benchmark against which to judge the significance of incoming economic and fiscal data and to estimate and explain the likely impact of policy decisions. That is why transparency about our assumptions and a detailed consideration of risks are integral to our approach to forecasting. This approach was reflected in our November 2020 *Economic and fiscal outlook* in the construction of three different scenarios for the future path of the pandemic and public health measures required to control it, as well as the presentation of an alternative No Deal scenario for the Brexit negotiations.

1.10 Analysing the full range of short, medium and long run risks to the potential paths for the economy and public finances beyond coronavirus and Brexit is also vital. If the last two decades have taught us anything, it is that no two macroeconomic shocks are the same. This was recognised in the Act of Parliament that established the OBR, which requires us to set out the main risks that we have taken into account in any report, and was enhanced in the October 2015 edition of the *Charter for Budget Responsibility*, which introduced the requirement for us to publish a biennial *Fiscal risks report*. A key takeaway from the pandemic is that extremely costly shocks do indeed crystallise from time to time, even in peacetime. Bad events do happen, and the Government and other users of our forecasts need to take those into account when making financial decisions. We will be returning to these issues in our next edition of the *Fiscal risks report* this summer.

2 The economy

Introduction

2.1 The focus of this year's *Forecast evaluation report* (*FER*) is the performance of our March 2018 and March 2019 forecasts in the financial year 2019-20. The early effects of the coronavirus pandemic therefore impinged on some of the data towards the end of the period although the vast majority will appear in the following financial year. In this chapter, we compare key fiscal determinants from our economy forecasts against the latest outturn data. In particular, we examine:

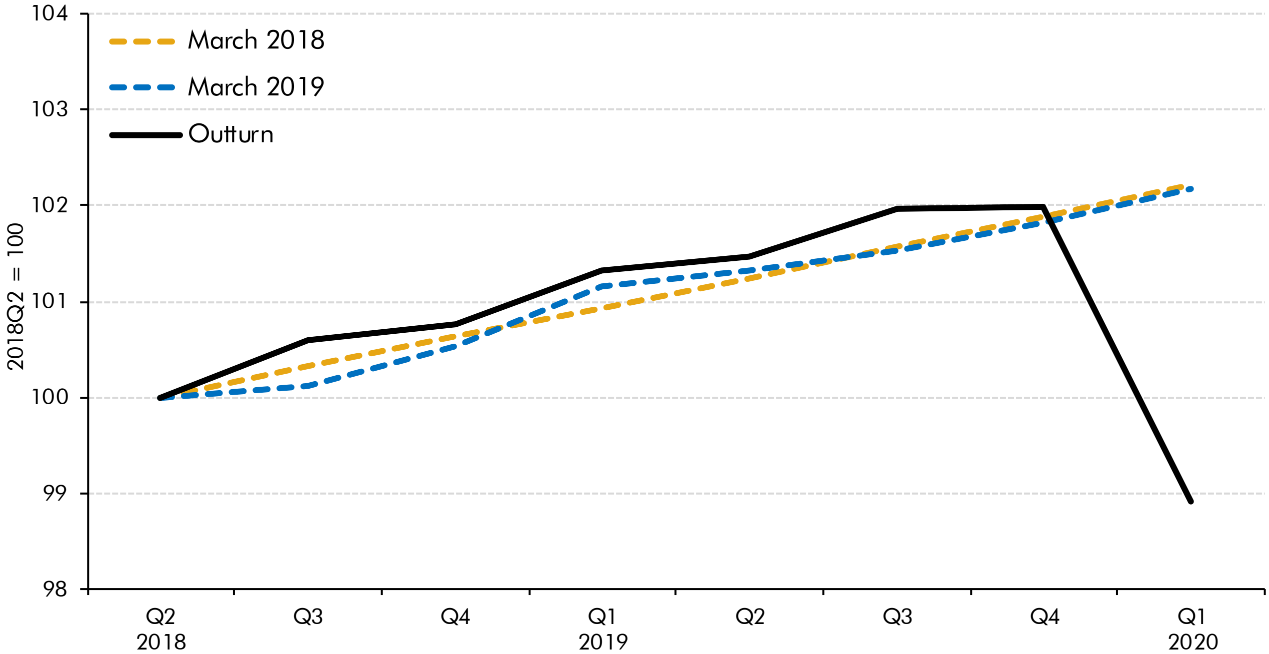
- the growth and composition of **real and nominal GDP**;
- movements in **wages, employment and productivity**;
- developments in **consumer price inflation**; and
- changes in **monetary policy and asset prices** relative to the prevailing expectations of market participants.

Real and nominal GDP

2.2 In our March 2018 and March 2019 forecasts, we expected real GDP to grow by around 0.3 per cent a quarter in 2019-20 (Chart 2.1) and by 1.2 per cent in the year as a whole. These forecasts assumed the conclusion and implementation of an EU Withdrawal Agreement on 29 March 2019, followed by a smooth transition to the then-still-undefined subsequent trading arrangements. In the event, real GDP growth came in at just 0.4 per cent for the financial year 2019-20 – 0.8 percentage points lower than forecast. That was mostly due to the impact of the coronavirus outbreak towards the end of the period.

2.3 Quarterly outturn data through the financial year were volatile as a result of changing Brexit deadlines and the associated impact on inventories and trade. The second quarter of 2019 was weak, partly driven by firms running down stocks built up before the 29 March deadline and car manufacturers bringing forward summer shutdowns to April. A subsequent increase in stocks and a rebound in car production boosted GDP in the third quarter. Growth was again weaker than anticipated in the fourth quarter as weak retail sales weighed on private consumption. During the first quarter of 2020, real GDP fell by 3 per cent, reflecting the impact on behaviour of rising awareness of the seriousness of the virus outbreak and the eventual introduction of a nationwide lockdown on 23 March which enforced a sharp decline in social consumption and the temporary closure of many businesses.

Chart 2.1: Real GDP outturns and forecasts



Source: ONS, OBR

2.4 Table 2.1 shows the contributions to real GDP growth in 2019-20 from the various expenditure components and compares our forecasts with the latest outturn data. Private consumption grew by 0.1 per cent – the lowest annual growth since 2011-12. After falling in 2018-19, business investment grew by 1.8 per cent – less than we expected in our March 2018 forecast but more than in our March 2019 forecast – though not enough to recover its peak at the end of 2017. In March 2019, we expected total government spending to contribute more to growth over the period than we expected in March 2018, largely reflecting the increase in NHS spending announced in June 2018. After stronger-than-expected growth in the first half of 2019 this was offset in the first quarter of 2020 as real government expenditure fell, reflecting falls in education and elective healthcare as a result of the pandemic.

2.5 Net trade and other private investment (including the net acquisition of valuables) was volatile, driven by the shifting Brexit deadlines and latterly the developing pandemic. Overall, exports grew by less than we expected in both forecasts, while imports fell rather than growing as expected. Consequently, net trade contributed 1.9 percentage points to GDP growth over 2019-20.

Table 2.1: Expenditure contributions to real GDP growth in 2019-20

	Percentage points						
	Private consumption	Business investment	Other private investment	Total government	Net trade	Stocks and statistical discrepancy	GDP
March 2018 forecast	0.6	0.2	0.0	0.2	0.2	0.0	1.2
March 2019 forecast	0.7	0.0	0.0	0.5	-0.3	0.1	1.2
Latest data	0.1	0.2	-1.3	0.5	1.9	-1.0	0.4
Difference[1]							
March 2018	-0.6	0.0	-1.3	0.3	1.7	-1.0	-0.8
March 2019	-0.6	0.1	-1.4	0.0	2.2	-1.1	-0.8

[1] Difference in unrounded numbers.

2.6 Nominal GDP – the cash value of goods and services produced in the economy – is more important than real GDP for the public finances. That is because tax liabilities are mostly determined by cash quantities (for example, VAT is levied on nominal consumer spending, income tax on nominal earnings and corporation tax on nominal profits). In addition, a large share of public spending is also set in nominal terms, either through multi-year cash plans (public services, grants, administration and capital spending) or because it is linked to consumer price inflation (social security and public service pensions).

2.7 Table 2.2 shows that although real GDP was 0.8 percentage points lower than in each of our forecasts, nominal GDP growth for 2019-20 nevertheless came in in line with our March 2018 forecast, due to an offsetting forecast error in the associated deflator. For the March 2019 forecast, the error in the deflator was significantly smaller, so that around half of the forecast error in real GDP growth was reflected in a corresponding forecast error for nominal GDP growth.

Table 2.2: Expenditure contributions to nominal GDP growth in 2019-20

	Percentage points					
	Private consumption	Private investment	Total government	Net trade	Stocks and statistical discrepancy	GDP
March 2018 forecast	1.9	0.3	0.5	0.2	0.0	2.8
March 2019 forecast	2.1	0.3	1.0	-0.4	0.2	3.2
Latest data	1.0	-0.6	1.3	1.9	-0.7	2.8
Difference[1]						
March 2018	-0.9	-1.0	0.8	1.8	-0.7	0.0
March 2019	-1.1	-0.9	0.2	2.4	-0.9	-0.4

[1] Difference in unrounded numbers.

Table 2.3: Growth in National Accounts deflators in 2019-20

	Per cent						
	Private consumption	Private investment	Total government	Exports	Imports	Terms of trade	GDP
March 2018 forecast	1.9	0.9	1.1	-0.5	-0.3	-0.2	1.6
March 2019 forecast	2.1	1.5	2.3	-0.4	0.1	-0.5	2.0
Latest data	1.4	3.6	3.3	1.4	1.5	-0.1	2.4
Difference[1]							
March 2018	-0.5	2.7	2.2	2.0	1.8	0.1	0.8
March 2019	-0.7	2.2	1.1	1.9	1.4	0.5	0.4

[1] Difference in unrounded numbers.

Labour market

2.8 Employment rose 348,000 over the course of 2019-20 from the previous financial year, markedly more than in our March 2018 and March 2019 forecasts. Unemployment was also lower than in both forecasts. Average hours came in broadly in line with our expectations, so total hours worked surprised to the upside.

2.9 Average earnings growth was broadly in line with our expectations for 2019-20. Subdued inflation has meant that average earnings growth has been higher than forecast in real terms.

2.10 Growth in hourly productivity was just 0.2 per cent in 2019-20, even weaker than the lacklustre 0.9 per cent we forecast at both March 2018 and March 2019. This weakness more than offset the stronger employment growth, consistent with downside surprise in real GDP growth. We had expected steady productivity growth of around 0.2 per cent a quarter over 2019-20. While the growth in hourly productivity was in line with that for much of the year, it fell sharply in the first quarter of 2020 as the pandemic triggered a sharp reduction in output.

Table 2.4: Labour market indicators in 2019-20

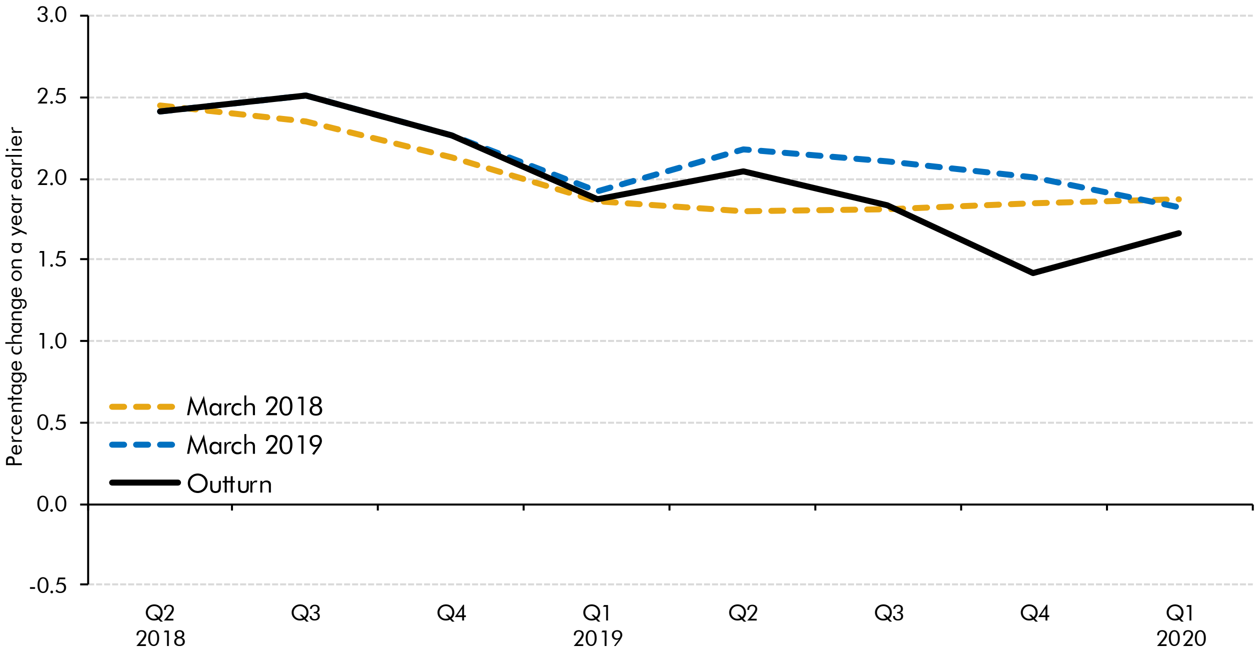
	Per cent, unless otherwise stated			
	Total employment (thousands)	LFS unemployment rate	Average earnings growth	Productivity per hour growth
March 2018 forecast	131	4.5	2.4	0.9
March 2019 forecast	119	4.1	3.0	0.9
Latest data	348	3.9	3.0	0.2
Difference[1]				
March 2018	217	-0.7	0.6	-0.7
March 2019	229	-0.2	0.1	-0.6

[1] Difference in unrounded numbers.

Inflation

2.11 We expected CPI inflation to remain below the 2 per cent target over 2019-20 in our March 2018 forecast. In our March 2019 forecast, we expected CPI inflation to rise slightly above and then fall slightly below its target after the first quarter of 2020. In the event, CPI inflation fell below expectations, particularly in the fourth quarter of 2019 following the lowering of the Ofgem energy price cap.

Chart 2.2: Forecasts and outturns for CPI inflation



Source: ONS, OBR

2.12 We forecast RPI inflation by adding a 'wedge' to our CPI forecast. In March 2018, we expected this wedge to average 1.1 percentage points in 2019-20, and lowered this to 0.9 percentage points in the March 2019 forecast. In the event, it came in a little lower, at 0.8 percentage points, reflecting a lower contribution from mortgage interest payments.

Market assumptions

2.13 Table 2.5 compares our March 2018 and 2019 market assumptions with outturns for 2019-20:

- **Bank Rate** was lower than assumed, averaging 0.72 per cent as the Bank of England responded to the onset of the pandemic in the first quarter of 2020.

- **Sterling oil prices** were significantly higher than our March 2018 forecast, averaging £47.9 per barrel. Compared to our March 2019 forecast assumption, oil prices on average were pretty much in line.

- UK **equity prices**, as measured by the FTSE All-share index, were lower than assumed in our March 2018 forecast, though higher than in our March 2019 forecast.
- The **sterling effective exchange rate** was a little lower than assumed in both forecasts.

Table 2.5: Conditioning assumptions for 2019-20

	Bank Rate (per cent)	Oil price (£ per barrel)	Equity prices (FTSE All-share)	ERI exchange rate (index)
March 2018 forecast	1.06	40.8	4151	80.5
March 2019 forecast	0.79	47.6	3930	78.4
Latest data	0.72	47.9	3979	78.3
Difference[1]				
March 2018	-0.3	17.2	-4.1	-2.7
Mach 2019	-0.1	0.6	1.2	-0.2

[1] Per cent difference except Bank Rate in percentage points.

3 The public finances

Introduction

3.1 This chapter discusses the performance of:

- our March 2018 and March 2019 forecasts for 2019-20 for **public sector net borrowing** (PSNB) (from paragraph 3.3);
- the **receipts** (from paragraph 3.4) and **spending** (from paragraph 3.12) forecasts underpinning them; and
- our forecasts for **public sector net debt** in 2019-20 (from paragraph 3.14).

3.2 The Office for National Statistics (ONS) periodically makes statistical and methodological changes to the public finances data that mean our past forecasts are not fully comparable with the latest outturn data. This was particularly true of the September 2019 data release, which incorporated several classification changes, including a new accounting treatment for student loans and a material correction to corporation tax receipts. A fuller discussion of them, and their effects on our March 2019 forecast, was presented in our December 2019 *Restated March 2019 forecast* publication. We use that restated March 2019 forecast in this chapter and have restated our March 2018 forecast to be on the same basis too. We have made further restatements to both forecasts that reflect the September 2020 data release and inconsistencies between our forecast and ONS outturn.[1] In addition, we have restated our March 2018 forecast to include the classification and methodological changes outlined in our October 2018 *Economic and fiscal outlook (EFO)*. Further detail on our approach to forecast restatements can be found in our *Evaluating forecast accuracy* briefing paper.

Public sector net borrowing

3.3 Tables 3.1 and 3.2 set out our March 2018 and March 2019 forecast differences for PSNB in 2019-20. In early 2020, the impact of coronavirus and associated public health interventions on the economy and the wider public finances began to be felt. In order to split our 2019-20 forecast differences into elements associated with the pandemic and other pre-virus effects, we proxy the initial impact of the virus on our forecasts by calculating the difference between our March 2020 forecast (which was largely unaffected by coronavirus) and the latest outturn. The remainder of the difference is taken to represent the underlying pre-virus error and is calculated from the change between the forecast being analysed and our March 2020 forecast. On that basis:

[1] Set out in Supplementary table 3.20 in our March 2020 *EFO*.

- Our **March 2018 forecast** underestimated borrowing by £9.9 billion (Table 3.1). This is more than explained by spending exceeding our forecast by £11.3 billion, primarily due to the pre-virus increase in NHS spending announced in June 2018 rather than in response to the pandemic whose pressures were only starting to be felt in 2019-20. Receipts came in higher than our forecast, but by only £1.4 billion. Higher spending was largely concentrated in departmental spending, reflecting policy changes since Spring Statement 2018. The more modest upside surprise in receipts was dominated by PAYE income tax and NICs receipts. Abstracting from the virus, underlying borrowing in 2019-20 would have been below our March 2018 forecast. But the virus-related hit to receipts, and the modest initial boost to spending, more than offset that underlying improvement, leaving borrowing higher than forecast. Within receipts, virus-related hits were widespread, whereas there were large, but largely offsetting, effects across different elements of spending. These differences are examined below.

- Our **March 2019 forecast** underestimated borrowing by £13.4 billion (Table 3.2). Receipts fell short of our forecast by £6.0 billion while spending exceeded it by £7.4 billion. On an underlying basis, receipts and spending were both higher than expected by roughly equal amounts, which would have left borrowing close to forecast. So the virus-related hit to receipts and more modest boost to spending explain virtually all the overall error against this forecast.

Table 3.1: March 2018 receipts, spending and net borrowing forecasts for 2019-20

	£ billion				
				of which:	
	Restated forecast	Outturn	Difference	Underlying difference	Covid impact[1]
Public sector net borrowing	**47.5**	**57.4**	**9.9**	**-3.7**	**13.6**
Public sector current receipts	**826.5**	**827.9**	**1.4**	**13.5**	**-12.1**
of which:					
Income tax	195.2	193.6	-1.6	0.0	-1.6
of which:					
Pay as you earn (PAYE)	163.2	165.2	2.0	2.1	-0.1
Self-assessement (SA)	32.8	32.2	-0.6	-0.5	-0.1
National insurance contributions	140.6	145.0	4.4	4.8	-0.4
Value added tax	134.6	133.8	-0.8	2.0	-2.8
Onshore corporation tax	51.1	47.1	-4.1	2.9	-6.9
Stamp duty land tax	13.4	11.9	-1.4	-0.6	-0.8
Tobacco duties	9.0	9.7	0.7	-0.3	1.0
Other	282.6	286.8	4.2	4.7	-0.5
Total managed expenditure	**873.9**	**885.2**	**11.3**	**9.8**	**1.5**
of which:					
Consumption	393.6	430.4	36.9	31.3	5.6
Interest and dividend payments	62.4	54.6	-7.8	-4.0	-3.9
Net social benefits	227.8	223.0	-4.7	-7.2	2.5
General government depreciation	45.6	44.6	-1.0	-0.5	-0.5
Gross investment	98.2	94.4	-3.8	-1.2	-2.7
Other	46.3	38.1	-8.2	-8.7	0.5

[1]Estimated as the difference between our March 2020 forecast for 2019-20 and the latest outturn data.

Table 3.2: March 2019 receipts, spending and net borrowing forecasts for 2019-20

	£ billion				
				of which:	
	Restated forecast	Outturn	Difference	Underlying difference	Covid impact[1]
Public sector net borrowing	**44.0**	**57.4**	**13.4**	**-0.2**	**13.6**
Public sector current receipts	**833.8**	**827.9**	**-6.0**	**6.1**	**-12.1**
of which:					
Income tax	195.7	193.6	-2.1	-0.5	-1.6
of which:					
Pay as you earn (PAYE)	163.9	165.2	1.3	1.4	-0.1
Self-assessment (SA)	34.0	32.2	-1.9	-1.8	-0.1
National insurance contributions	143.4	145.0	1.6	2.0	-0.4
Value added tax	136.6	133.8	-2.8	0.0	-2.8
Onshore corporation tax	52.5	47.1	-5.4	1.5	-6.9
Stamp duty land tax	11.8	11.9	0.1	1.0	-0.8
Tobacco duties	9.1	9.7	0.6	-0.4	1.0
Other	284.8	286.8	2.0	2.4	-0.5
Total managed expenditure	**877.8**	**885.2**	**7.4**	**6.0**	**1.5**
of which:					
Consumption	417.0	430.4	13.4	7.8	5.6
Debt interest	60.5	54.6	-5.8	-2.0	-3.9
Net social benefits	222.4	223.0	0.6	-1.8	2.5
General government depreciation	45.3	44.6	-0.7	-0.1	-0.5
Gross investment	98.0	94.4	-3.6	-0.9	-2.7
Other	34.6	38.1	3.5	3.0	0.5

[1]Estimated as the difference between our March 2020 forecast for 2019-20 and the latest outturn data.

Receipts

3.4 Receipts in 2019-20 exceeded our March 2018 forecast by £1.4 billion, as a £13.5 billion underlying surplus was less than fully offset by the £12.1 billion virus-related hit at the end of the year (in particular from VAT and corporation tax receipts). By contrast, receipts were £6.0 billion below our March 2019 forecast, thanks to a smaller underlying surplus of £6.1 billion that was therefore more than offset by the virus-related hit.

3.5 **PAYE income tax and NICs receipts** exceeded our March 2018 forecasts by £2.0 billion and £4.4 billion respectively and exceeded our March 2019 forecasts by £1.3 billion and £1.6 billion respectively. These surpluses were dominated by the underlying differences, which stem from wages and salaries exceeding our forecasts. The virus-related impact on PAYE income tax and NICs in 2019-20 is small as only the very early stages of the virus-induced shock to the labour market emerged during March 2020.

3.6 **Self-assessment (SA) income tax receipts** fell short of both our March 2018 and March 2019 forecasts (by £0.6 billion and £1.9 billion respectively). SA receipts in 2019-20 relate to 2018-19 liabilities and were due in January 2020, so it is not surprising that there is little virus-related effect. Neither difference is large relative to the yearly variability of SA receipts.

3.7 **VAT receipts** fell short of our March 2018 and March 2019 forecasts by £0.8 billion and £2.8 billion respectively. Absent the virus hit, VAT receipts would have exceeded our March 2018 forecast by £2.0 billion, which appears to partly reflect a more tax-rich composition of spending than we expected. This surplus was more than offset by the virus-related hit to consumer spending and VAT receipts at the end of the year. The shortfall in receipts against our March 2019 forecast is entirely explained by the impact of the virus. The initial lockdown in March 2020 forced many businesses to close temporarily, which restricted consumer spending in the final weeks of 2019-20. (The large movements in cash receipts due to the VAT deferral measure only affect accrued receipts to the extent that we assume some of the deferred payments will ultimately go unpaid.)

3.8 **Onshore corporation tax** (CT) receipts have repeatedly over-performed in recent years, as set out in Box 3.2 of our December 2018 *Forecast evaluation report*. But they fell short of our March 2018 and March 2019 forecasts by £4.1 billion and £5.4 billion respectively. The impact of the virus, which reduced receipts by £6.9 billion, more than explains these shortfalls, thanks to both downward revisions to firms' profit expectations as well as increases in actual or anticipated use of loss reliefs. Given the lag in collecting CT tax return data, it will be a long time before we have a complete picture of the sources of these forecast differences.

3.9 **Stamp duty land tax** fell well short of our March 2018 forecast, but was close to our March 2019 forecast. Property transactions were weaker than both forecasts assumed, with the March 2020 lockdown sharply lowering transactions. Weaker house price inflation than forecast in March 2018 also contributed to lower receipts.

3.10 **Tobacco duties** were stronger than expected in 2019-20 relative to both forecasts. Unlike most other receipts, tobacco duties exceeded our March 2020 forecast resulting in a positive virus impact of £1.0 billion on the simple methodology used here. This occurred despite the non-cyclical nature of tobacco consumption, which is largely unaffected by economic downturns. Instead, this is likely to reflect payment timing effects around forestalling patterns occurring in the final months of 2019-20 ahead of the duty rate rise on 11 March 2020.

3.11 **Other receipts** exceeded both our March 2018 and March 2019 forecasts (by £4.2 billion and £2.0 billion respectively). Contributions to the remaining receipts surplus include higher VAT refunds from the local authority sector (by £0.8 billion on average) as well as higher capital gains tax (by £0.9 billion on average), partly reflecting strength in equity prices. The underlying surpluses have partly been offset by the virus-related deterioration in several taxes – for example, a £0.1 billion shortfall in fuel duty related to the initial impact of travel restrictions during the first lockdown period.

Spending

3.12 On the basis of our simple approach to splitting virus and non-virus effects, the impact of the pandemic was to raise spending by £1.5 billion in 2019-20. This is more than accounted for by higher consumption spending (largely departmental spending) reflecting spending on public services to respond directly to the virus (£5.6 billion); higher net social benefits (£2.5 billion); and higher other spending (£0.5 billion), which is more than explained by the March 2020 cost of the coronavirus job retention scheme (CJRS). Offsetting this was a fall in debt interest payments (£3.9 billion, reflecting lower interest rates) and lower public sector gross investment (£2.7 billion, due to the lockdown).

3.13 Abstracting from these effects associated with the pandemic, total spending in 2019-20 was £9.8 billion higher than in our March 2018 forecast and £6.0 billion higher than in our March 2019 forecast, mostly reflecting the loosening of fiscal policy announced since these forecasts. By component of spending, these underlying differences reflect:

- **Consumption expenditure on goods and services** was £31 billion higher than in our March 2018 forecast, due to a higher path of resource spending by departments. This includes the effect of the 5-year NHS settlement that was announced in June 2018, as well as additional non-NHS spending announced ahead of our March 2019 forecast. Compared with that forecast, spending on consumption was £7.8 billion higher, largely due to higher planned spending, including to deal with Brexit preparations.

- **Debt interest spending** was lower than in our March 2018 and March 2019 forecasts by £4.0 billion and £2.0 billion respectively. This reflected a combination of lower interest rates and lower-than-expected RPI inflation.

- **Net social benefits** spending was £7.2 billion lower than our March 2018 forecast and £1.8 billion lower than our March 2019 forecast. These were mostly due to lower unemployment and stronger earnings lowering in-work benefits spending.

- **General government depreciation** was slightly lower than forecast in March 2018 and March 2019, mostly reflecting new data on capital stocks from the ONS.

- **Public sector gross investment** was £1.2 billion lower than our March 2018 forecast and £0.9 billion lower than our March 2019 forecast, mainly due to the cancellation of the planned 2019-20 sale of student loans, which would have incurred a capital charge due to the sales taking place at a discount.

- **Other spending** (which includes lines such as transfers to the EU, subsidies, grants abroad and domestic current grants, many of which offset one another) was lower than our March 2018 forecast but higher than our March 2019 forecast. The principal areas of significant movement were higher-than-forecast subsidies and lower-than-forecast EU contributions, the latter reflecting slower implementation of the EU budget than we had anticipated.

Public sector net debt

3.14 There have been significant errors in our two most recent March forecasts for public sector net debt (PSND) relative to GDP at the end of 2019-20, with outturn PSND overshooting by 3 and 6 percentage points respectively. By contrast, our March 2018 forecast was close to outturn (thanks to offsetting errors). Table 3.3 shows that the key drivers were:

- Large downward revisions to the 2019-20 **GDP denominator** explain the majority of the differences, adding an average of 4.9 percentage points to the outturn debt-to-GDP ratio over the three forecasts. This reflects the GDP figure used as the denominator being centred on end-March 2020 and hence reflecting the full virus-related hit in the first half of 2020-21, sharply raising PSND as a per cent of GDP.

- Downward revisions to the **starting point of cash debt** explain 1.8 and 1.7 percentage points of the March 2018 and March 2019 forecast differences respectively. The bulk of these reflect statistical changes made in the September 2019 public sector finances release, in particular revisions to the treatment of public sector pensions.

- **Accrued borrowing (PSNB)** in 2019-20 was appreciably higher than we anticipated in our March 2019 and 2020 forecasts, as described in the preceding sections of the chapter. Relative to our March 2018 forecast, weaker borrowing in 2018-19 fully offset the impact of higher borrowing in 2019-20, leaving accrued borrowing slightly lower than projected.

- **Other factors** lowered cash net debt relative to our forecasts. This partly reflects the fact that some Term Funding Scheme (TFS) loans extended by the Bank of England were repaid by firms earlier than we had expected.

Table 3.3: Public sector net debt forecasts for 2019-20

	Per cent of GDP		
	March 2018 forecast	March 2019 forecast	March 2020 forecast
Forecasts	85.1	82.2	79.5
2019-20 outturn	85.5	85.5	85.5
Difference	**0.3**	**3.2**	**6.0**
of which:			
GDP denominator	3.9	4.9	5.9
Cash debt (starting point)	-1.8	-1.7	-0.2
Cash debt (PSNB effect)	-0.2	0.6	0.5
Cash debt (other factors)	-1.6	-0.7	-0.2

Index of charts and tables

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