

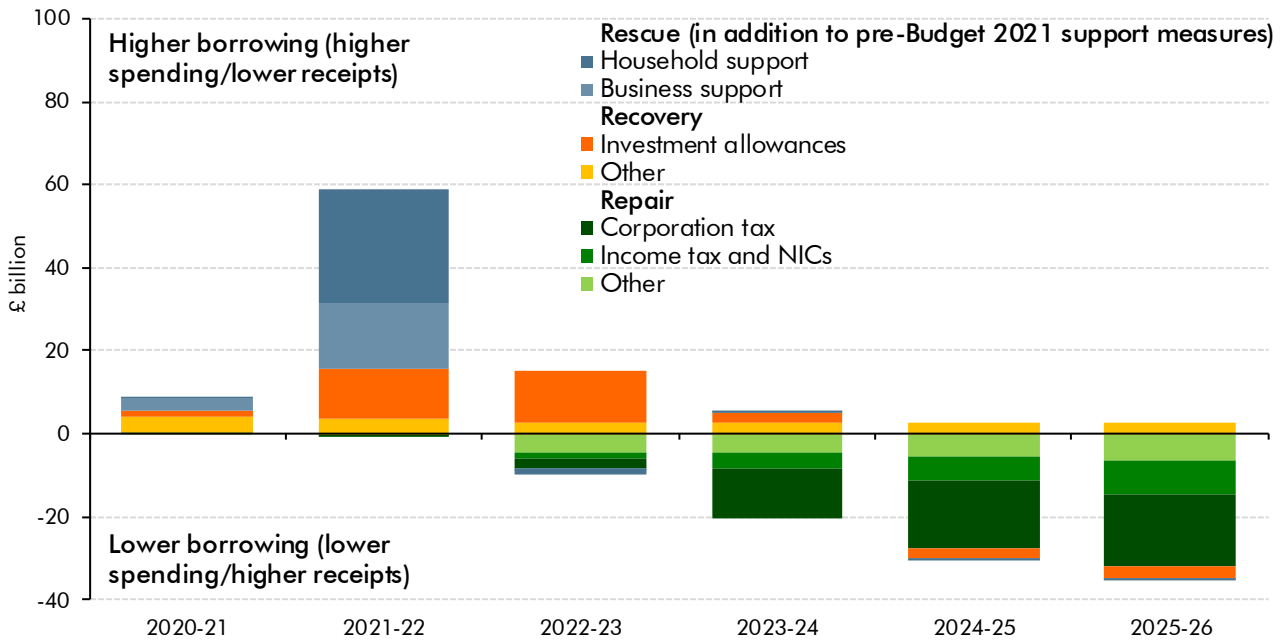
1 Executive summary

Overview

- 1.1 More than a year on from its start, the coronavirus pandemic continues to exact a heavy toll in lives and livelihoods. Around the globe, more than 100 million people have had the virus and around 2½ million have died from it, and world GDP fell by 3½ per cent in 2020 as governments imposed public health restrictions in an attempt to control the virus. The UK has been hit particularly hard. Following a resurgence of infections over the winter, around 1 in 5 people have so far contracted the virus, 1 in 150 have been hospitalised, and 1 in 550 have died, the fourth highest mortality rate in the world. And GDP fell 9.9 per cent in 2020, the largest decline in the G7. While output partially recovered in the second half of last year – and somewhat more strongly than we previously thought – the latest lockdown and temporary disruption to EU-UK trade at the turn of the year is expected to result in output falling again in the first quarter of this year.
- 1.2 The pandemic has, however, also spurred a global scientific effort to develop new and effective vaccines at unprecedented speed, with the UK in the vanguard of their discovery and rollout. More than 200 million people worldwide have already received their first dose of one of those vaccines. In the UK, that figure has topped 20 million – more than a third of all adults and the fourth highest vaccination rate worldwide. Early evidence from the UK and other countries indicates that the vaccines are broadly as effective in reducing illness and death as suggested in clinical trials. The Government aims to have offered a first dose to everyone over 50 or at risk by 15 April and to all adults by 31 July, slightly earlier than assumed in our November central forecast.
- 1.3 The rapid rollout of effective vaccines offers hope of a swifter and more sustained economic recovery, albeit from a more challenging point than we forecast in November. The easing of public health restrictions in line with the Government's 22 February Roadmap should permit a rebound in consumption and output through this year, partially supported by the release of extra savings built up by households during the pandemic. GDP is expected to grow by 4 per cent in 2021 and to regain its pre-pandemic level in the second quarter of 2022, six months earlier than we forecast in November. Unemployment still rises by a further 500,000 to a peak of 6.5 per cent at the end of 2021, but the peak is around 340,000 less than the 7.5 per cent assumed in our November forecast, thanks partly to the latest extension of the furlough scheme. The pandemic is nevertheless still expected to lower the supply capacity of the economy in the medium term by around 3 per cent relative to pre-virus expectations.

1.4 Faced with an economy that is weaker in the near term but rebounding faster than we forecast in November, the Chancellor has done three things in this Budget. First, he has extended the virus-related **rescue** support to households, businesses and public services by a further £44.3 billion, taking its total cost to £344 billion. Second, he has boosted the **recovery**, most notably through a temporary tax break costing more than £12 billion a year that encourages businesses to bring forward investment spending from the future into this year and next. Third, as the economy normalises, he has taken a further step to **repair** the damage to the public finances in the final three years of the forecast by raising the headline corporation tax rate, freezing personal tax allowances and thresholds, and taking around £4 billion a year more off annual departmental spending plans, raising a total of £31.8 billion in 2025-26 (Chart 1.1).

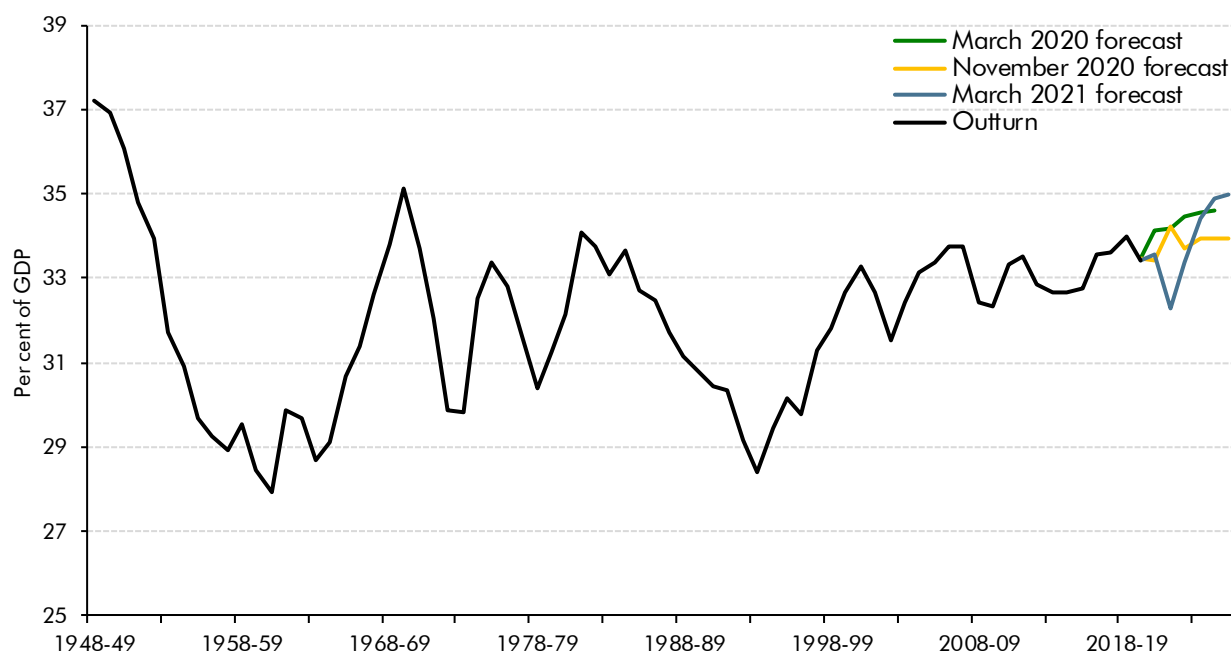
Chart 1.1: The impact of Budget measures on public sector net borrowing



Source: OBR

1.5 The tax rises announced in this Budget increase the tax burden from 34.0 to 35.0 per cent of GDP in 2025-26, its highest level since Roy Jenkins was Chancellor in the late 1960s (Chart 1.2). Over half of this increase is as a result of a 6 percentage point increase in the corporation tax rate to 25 per cent. This brings the headline corporation tax rate back into line with the advanced economy average but still well below its long-run historical average in the UK of around 35 per cent. However, the widening of the tax base over the past decade means that this relatively modest increase in the headline rate leaves corporation tax raising 3.2 per cent of GDP in revenue by 2025-26, its highest since 1989-90. Freezes to the income tax personal allowance and higher rate threshold for four years bring 1.3 million people into the tax system and create 1 million higher rate taxpayers by 2025-26.

Chart 1.2: Tax as a share of nominal GDP



Source: ONS, OBR

- 1.6 As the economy reopens and emergency fiscal support is withdrawn, government borrowing is forecast to fall from a peacetime high of £355 billion (16.9 per cent of GDP) in 2020-21 to £234 billion (10.3 per cent of GDP) in 2021-22 (still higher than the 2009-10 peak at the height of the financial crisis). In 2022-23, as fiscal policy moves from rescue to recovery, the deficit falls back to £107 billion (4.5 per cent of GDP). Thereafter, as policy focuses on repair and taxes rise, borrowing falls to £74 billion (2.8 per cent of GDP) in 2025-26.
- 1.7 Headline debt tops 100 per cent of GDP this year and remains above that level throughout our forecast. Underlying debt (excluding the Bank of England) peaks at 97.1 per cent of GDP in 2023-24 before falling back to 96.8 per cent of GDP by the end of the forecast. Despite the stock of debt reaching its highest level as a share of the economy since 1958-59, the costs of servicing that debt falls to a historic low of just 2.4 per cent of total revenues thanks to the decline in interest rates. Unlike previous post-crisis Chancellors who cut back capital spending to reduce borrowing and rein in debt, this one has left in place the significant increase in public investment, from 1.9 per cent of GDP last year to 2.7 per cent of GDP by 2025-26, that he announced a year ago.
- 1.8 The Chancellor has not set new fiscal targets in this Budget (despite two of the existing ones expiring this month) and is instead proceeding with the review of the fiscal framework proposed in last year's Budget. But the absence of formal fiscal targets does not mean that the Chancellor has not been guided by particular metrics when selecting his medium-term Budget policies. The tax rises and spending cuts he has announced are sufficient to eliminate all but a £0.9 billion current budget deficit in 2025-26, while they are just enough to see underlying public sector net debt as a share of GDP fall by a similarly small margin of £0.7 billion in 2024-25 and £4.1 billion in 2025-26.

- 1.9 Uncertainty around the economic outlook remains considerable, with the course of the pandemic still the greatest single risk. A quicker rollout of vaccines with greater effectiveness in reducing infection and illness, the development of new therapies and treatments, or a faster rundown in household savings built up during the pandemic could deliver a swifter economic recovery and less medium-term scarring. Against that, setbacks in the rollout of the vaccines, the emergence of new vaccine-resistant variants, or reduced compliance with residual public health restrictions could force governments back into periodic lockdowns, with more adverse consequences for the economy in the short and medium term. So, the upside and downside scenarios set out in our November *Economic and fiscal outlook (EFO)* remain a reasonable guide to the range of possible future outcomes.
- 1.10 Assuming the Chancellor can maintain the tax burden close to historic highs, the main fiscal risks come from the legacy of the pandemic for public services. While public spending is set to be 2 per cent higher as a share of GDP in 2025-26 than in 2019-20, most of this reflects increases in health, education and public investment announced before the pandemic. The Government's spending plans make no explicit provision for virus-related costs beyond 2021-22, despite its Roadmap recognising that annual vaccination programmes and continued testing and tracing are likely to be required. The Government will also need to decide how to catch up on services disrupted by the virus, notably the backlogs in non-urgent procedures in the NHS that have built up and the months of lost or impaired schooling for some pupils.
- 1.11 Faced with these post-pandemic pressures, the Government has so far cut more than £15 billion a year from departmental resource spending from 2022-23 onwards, setting up a challenging Spending Review later this year. The public finances are also much more sensitive than they were to rises in short-term interest rates, due to a combination of the higher debt stock and its effective refinancing by the Bank of England through quantitative easing, which has shortened the median maturity public debt from more than seven years before the financial crisis to less than two today. To illustrate this risk, the 30 basis point increase in interest rates that has happened since we closed our forecast on 5 February would already add £6.3 billion to the interest bill in 2025-26 published in this document. All else equal, that would be enough to put underlying debt back on a rising path relative to GDP in every year of the forecast.

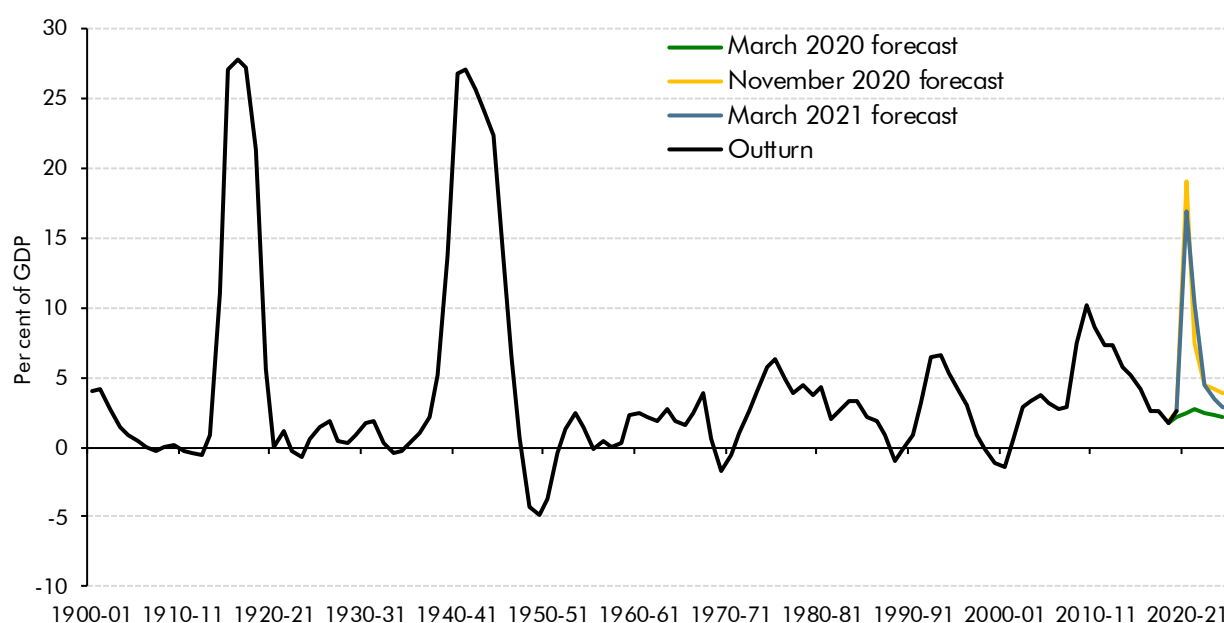
Developments since the start of the pandemic

- 1.12 The virus has taken a heavy toll on our lives, economy, and public finances. Just over a year on from the first confirmed case in the UK, around 1 in 5 people have so far contracted the virus, about 1 in 150 have been hospitalised, and around 1 in 550 have died. Five of the past 11 months in England have been spent in three separate lockdowns, with public health restrictions of varying stringency in place for the remainder. Public health restrictions in Scotland, Wales and Northern Ireland have followed similar paths.
- 1.13 As a result of the virus and the public health restrictions necessary to control it, the UK economy has suffered its largest economic shock in over 300 years, with output falling 9.9 per cent in 2020. Even after correcting for measurement differences between countries, the

UK has experienced one of the largest economic contractions among the major advanced economies. By the end of the first lockdown in June, 3.6 million new claims had been made for universal credit, a peak of 8.9 million jobs had been furloughed, and 2.6 million self-employed individuals had received an income support grant.

- 1.14 The costs of the pandemic have been concentrated in particular sectors, with some, such as hospitality, suffering a 90 per cent fall in output during the first lockdown, while others, such as finance, have hardly been affected. The shock to employment and earnings has also varied greatly across households, with some experiencing dramatic falls in income and rising debt while others, whose incomes were unaffected but whose opportunities to spend were curtailed by lockdowns, have saved unprecedented amounts.
- 1.15 The pandemic has also pushed government borrowing up to a post-war high and debt to its highest level in sixty years (Chart 1.3). In 2020-21, public sector net borrowing is forecast to reach 16.9 per cent of GDP (£355 billion), its highest level since 1944-45 and public sector net debt to rise to 100.2 per cent of GDP, its highest level since 1960-61. Most of the £298 billion increase in borrowing this year is due to an unprecedented peacetime expansion in government spending, with the full-year cost of the Government's virus-related support to public services, households, and businesses reaching £250 billion this financial year and £344 billion in total. This support has prevented an even more dramatic fall in output and diminished the potential longer-term adverse effects on the supply capacity of the economy.

Chart 1.3: Public sector net borrowing since 1900



Source: ONS, OBR

- 1.16 The pandemic has also created an extraordinary degree of uncertainty regarding the future paths of the economy and the public finances. At the time of our November *EFO*, England was in the midst of a second lockdown aimed at bringing a second wave of infections under control. Encouraging results from the phase three trials of several candidate vaccines were

also beginning to emerge. And the UK and EU were still negotiating the terms of the Brexit deal, with the end of the transition period approaching on 31 December.

1.17 Reflecting this uncertainty, we presented three scenarios for the path of the economy:

- An **upside scenario** in which the second lockdown and an effective test, trace, and isolate system brought the second wave of infections under control and effective vaccines were rolled out rapidly. That allowed an early easing of restrictions, with output rebounding to its pre-pandemic level by the end of 2021.
- A **central forecast** in which the country exited the second lockdown into a stricter set of tiered public health restrictions, with a less effective test, trace, and isolate system, and slower rollout of the vaccines. That allowed only a more gradual recovery, with output regaining its pre-pandemic level by the end of 2022.
- A **downside scenario** in which the second lockdown failed to reduce cases to manageable numbers, test, trace, and isolate was overwhelmed, and stricter restrictions were imposed through the spring of this year. Vaccines proved ineffective in keeping the virus in check giving rise to a third wave of infections over the winter. This required a more substantial, costly, and permanent economic adjustment, with output only regaining its pre-pandemic levels at the end of 2024.

Economic outlook

Developments since November

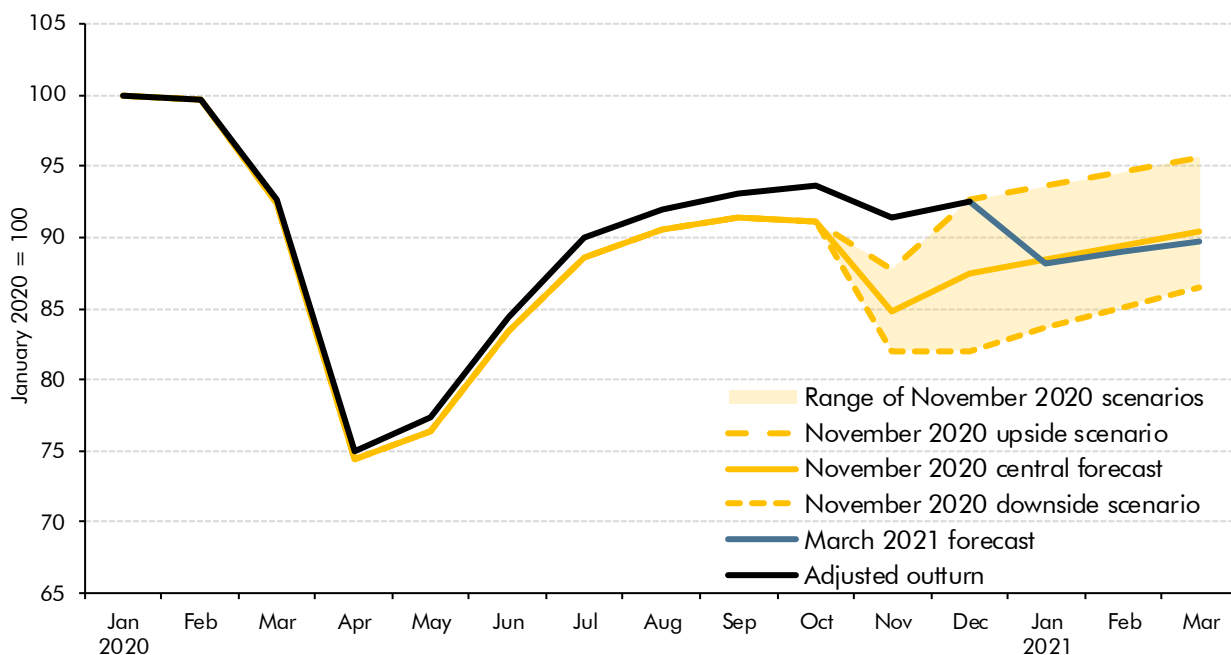
- 1.18 Developments since our November forecast have been mixed. The November lockdown failed to reduce cases to manageable levels. After restrictions were relaxed, infections surged once more, fuelled by the emergence of the more transmissible Kent variant of the virus. A rapid rise in hospitalisations and deaths followed, and all three have exceeded their peaks during the first wave last spring. The partial relaxation of public health restrictions over Christmas proved brief as the virus spread rapidly, with another national lockdown imposed in early January that remains in place to today.
- 1.19 Set against this, the news since November concerning the performance, approval, and acquisition of various vaccines has been overwhelmingly positive. Three vaccines have so far been approved for use in the UK and the Government has procured a total of 457 million doses of eight vaccines, equivalent to more than eight doses for every adult in the UK. Rollout of the vaccines to the population is also proceeding faster than assumed in our November central forecast. By 25 February, 20 million doses had been administered and 36 per cent of all adults had received their first dose. Vaccine take-up to date has also been high with over 90 per cent of over 70s receiving at least their first dose. The Government aims to have offered a first dose to everyone who is 50 and over or at risk by 15 April, and to all adults by 31 July. Early evidence suggests the effectiveness of the vaccines may be at least as good as found in clinical trials.

- 1.20 The economy also appears to have become increasingly adapted to public health restrictions since the start of the pandemic. The share of retail sales taking place online has jumped by 15 percentage points to over 36 per cent since the first lockdown, accelerating a trend that was underway before the pandemic. Between the first and November lockdowns, the proportion of businesses that closed or paused trading fell from 24 per cent to 11 per cent, as firms found ways of operating in a socially distanced manner. As a result, the output in November was only 8 per cent below the pre-virus peak compared to 24 per cent in April. And the economy managed to grow by 1 per cent over the final quarter of 2020. When combined with substantial upward revisions to output in prior months of 2020, in part reflecting the better incorporation of NHS Test and Trace, that left GDP in December around the level predicted in our November upside scenario.
- 1.21 The conclusion of the UK-EU Trade and Cooperation Agreement (TCA) on 24 December has also partially resolved four and a half years of uncertainty concerning our future trading relationship with our single largest trading partner. We judge the terms of the agreement to be broadly in line with the typical free-trade agreement assumed in our previous forecasts, which entailed a long-run loss of productivity of around 4 per cent compared with remaining in the EU. However, the implementation of the agreement and introduction of health checks at the border has involved more short-term disruption to UK-EU trade than was assumed in our November forecast. The arrangements for trade in financial and other services remain subject to further discussion.

Near-term economic outlook

- 1.22 The resurgence in infections, imposition of another lockdown, and temporary disruption to UK-EU trade are expected to cause output to fall by 3.8 per cent in the first quarter of 2021 (Chart 1.4). This drags the level of output down to 11 per cent below pre-pandemic levels and slightly below our November central forecast. The number of people on the Coronavirus Job Retention Scheme (CJRS) has also risen from 4.0 million at the end of 2020 to 4.7 million at the end of January.

Chart 1.4: Monthly real GDP



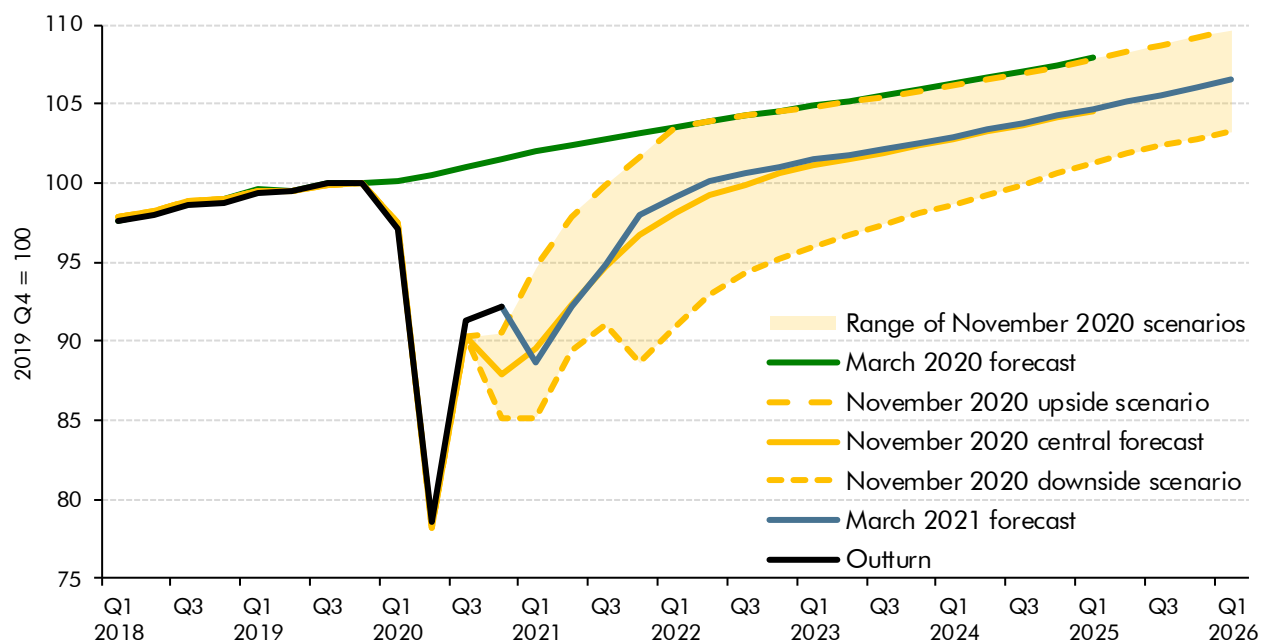
Source: ONS, OBR

Medium-term economic prospects

- 1.23** Our forecast is broadly consistent with the Government’s Roadmap, which envisages the progressive removal of public health curbs between early March and late June, though with some residual restrictions on activity which may include travel restrictions, local lockdowns, guidance on home working, continued test, trace and isolate activities, limits on large gatherings, mask wearing, and communications on hand washing and other hygiene practices. The accelerated rollout of vaccines means we assume that the majority of restrictions are removed earlier than we predicted in our November central forecast.
- 1.24** The rapid rollout of vaccines and easing of public health restrictions fuels a more rapid recovery in output to its pre-pandemic levels by the middle of 2022, six months faster than our November central forecast. This is driven by a rebound in consumption as the economy is reopened and given a further boost by a partial rundown of household savings built up over successive lockdowns. And a recovery in business investment is supported by greater clarity over the implications of Brexit, growing confidence about the medium-term outlook, and the generous temporary uplift in capital allowances announced in this Budget, which brings forward investment from future periods. The overall pace of the recovery in output slows toward the end of this year, once the majority of restrictions have been lifted, with the recovery dampened slightly further over the winter, reflecting the potential for some seasonal resurgence.
- 1.25** Beyond March 2022, the effect of the virus lingers through its ‘scarring’ impact on the supply capacity of the economy. What little evidence that has accrued since November regarding the likely extent of scarring has been mixed. The ONS has revised up its estimates of business investment and the Chancellor’s measures should speed the recovery in

investment, together suggesting less damage to the capital stock. But, against that, recent analysis of labour market data suggests that the population may be substantially smaller than official statistics suggest as a result of falls in net migration. We therefore continue to assume that the pandemic lowers output in the medium term by 3 per cent relative to its pre-pandemic path (Chart 1.5).

Chart 1.5: Real GDP: central forecast and scenarios

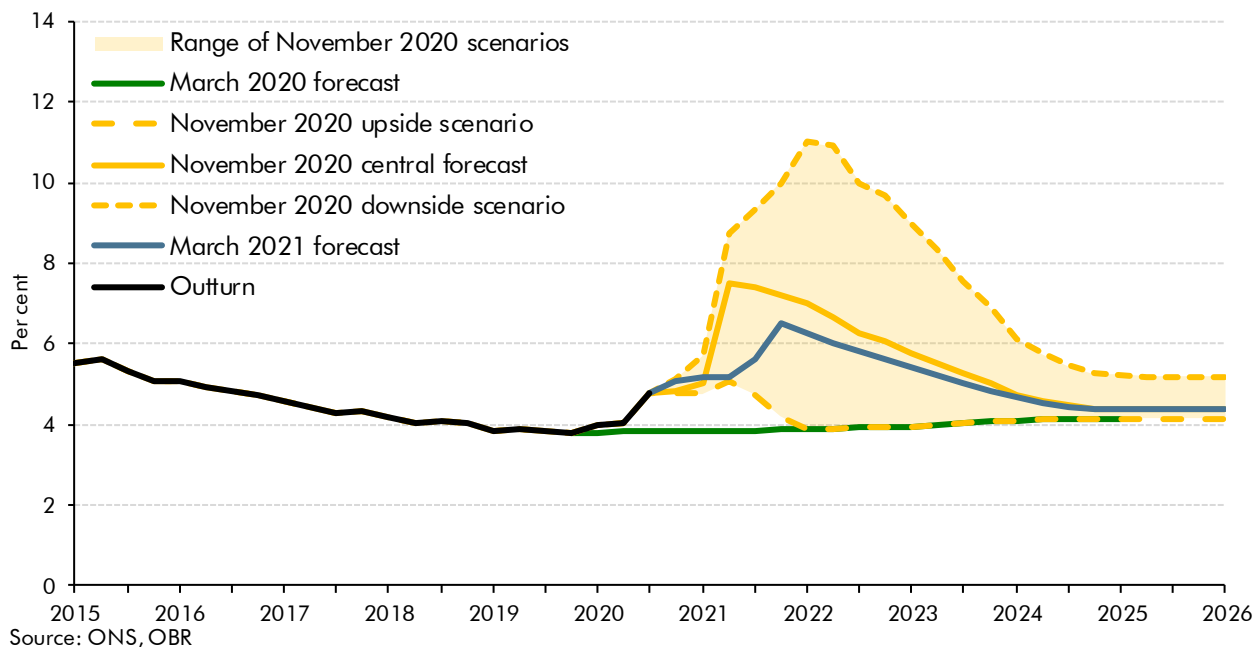


Source: ONS, OBR

- 1.26** Government support continues to play an important role, both in preserving the supply capacity of the economy and supporting the recovery in demand over this year and next. Continued spending on the NHS and other public services engaged in combatting the virus has a direct impact on demand this year. The extension of the CJRS and grants for the self-employed provide further support to employment, incomes, and consumption. Government grants and guaranteed loans to businesses have helped to keep viable firms alive and solvent, albeit with higher debts than before the pandemic. However, these interventions have to some extent delayed, rather than avoided, some of the higher unemployment and business insolvencies that will inevitably accompany the withdrawal of government support and an end to government-sanctioned forbearance by creditors, landlords, and tax authorities.
- 1.27** The faster recovery in output, combined with the extended CJRS and additional fiscal support announced in this Budget, help to limit the further rise in unemployment to below the levels anticipated in our November forecast. The unemployment rate rises from 5.1 per cent in the fourth quarter of 2020 to a peak of just 6.5 per cent (2.2 million) at the end of 2021 (Chart 1.6). That represents a rise of 490,000 over the year, but is 340,000 lower and six months later than in our November forecast. The ultimate rise in unemployment reflects the residual constraints on activity in some sectors such as accommodation and transport, as well as firms' adoption of less labour-intensive modes of operation in sectors

like retail and hospitality. It also reflects the scarring effect of the long spells away from employment experienced by some CJRS beneficiaries, 475,000 of whom have been away from work for more than six months over the past year.¹

Chart 1.6: Unemployment rate



1.28 CPI inflation has fallen well below target, reaching 0.5 per cent in the fourth quarter of 2020, largely driven by falls in fuel and utility prices (Table 1.1). Over the remainder of 2021 and 2022, we expect CPI inflation to remain a little below the MPC’s 2 per cent target, as the rise in unemployment dampens wage growth, outweighing the effects of higher oil prices. Thereafter, CPI inflation rises gradually back to target by 2025 as the economy recovers. Whole economy (GDP deflator) inflation remains volatile in the short term, driven by sharp movements in the implied price of government output.

1.29 Nominal GDP fell sharply in 2020, by 4.8 per cent. Falls in nominal (as opposed to real) GDP have been unusual in recent decades, with the smaller fall of 2.6 per cent recorded in 2009 being the only previous post-war decline. The recovery in real activity causes nominal GDP to rebound this year and next, before growing at rates broadly in line with those seen in the few years before the pandemic. Relative to our March 2020 forecast, nominal GDP is around 4 per cent lower in the medium term. Roughly three-quarters of that shortfall is attributable to the scarring of supply capacity, with the remainder reflecting a lower GDP deflator.

¹ N. Cominetti, K. Hanehan, H. Slaughter and G Thwaites, *Long Covid in the Labour Market*, Resolution Foundation, February 2021.

Table 1.1: Overview of the 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)	1.4	-9.9	4.0	7.3	1.7	1.6	1.7
GDP per capita	0.9	-10.4	3.8	6.9	1.4	1.3	1.5
GDP levels (2019=100)	100.0	90.1	93.7	100.5	102.3	103.9	105.7
Output gap	0.1	-0.6	-1.1	-0.4	-0.2	-0.1	-0.1
Expenditure components of real GDP							
Household consumption	1.1	-11.0	2.9	11.1	1.2	1.8	1.3
General government consumption	4.0	-5.7	12.0	1.4	0.8	2.3	2.1
Business investment	1.1	-10.7	-2.2	16.6	3.0	-2.3	5.1
General government investment	4.0	3.8	17.8	4.2	1.9	1.4	1.2
Net trade ¹	-0.1	0.7	-3.6	-0.4	0.3	0.0	-0.1
Inflation							
CPI	1.8	0.9	1.5	1.8	1.9	1.9	2.0
Labour market							
Employment (million)	32.8	32.7	32.3	32.4	32.8	33.1	33.2
Average earnings	3.0	1.1	1.9	2.7	2.2	2.8	3.5
LFS unemployment (rate, per cent)	3.8	4.5	5.6	5.9	5.1	4.5	4.4

¹ Contribution to GDP growth.

Risks to the economic outlook

- 1.30** Despite encouraging news regarding vaccines, there remains considerable uncertainty surrounding the future path of the pandemic and the economy. Modelling published by the Government's Scientific Advisory Group on Emergencies (SAGE) alongside the Roadmap predict a rise in infections as health restrictions are lifted, but with vaccinations weakening the link to subsequent hospitalisations and deaths. However, this modelling is based on a range of assumptions about the future course of the virus, the effectiveness of vaccines, the duration of immunity and people's behaviour after vaccination, any or all of which may turn out to be overly optimistic or pessimistic.
- 1.31** So, on the one hand, it is possible that the vaccines bring a quicker end to the pandemic than anticipated, consumers spend more of their savings, and the economy rebounds faster with minimal scarring of potential output. In this case the outcome may be closer to our November upside scenario. But, on the other hand, it is possible that mutations in the virus and reduced vaccine effectiveness result in further waves of hospitalisations, necessitating the periodic reimposition of health restrictions and further blows to the recovery, generating more scarring of potential output. In this case, the outcome may be closer to our November downside scenario.

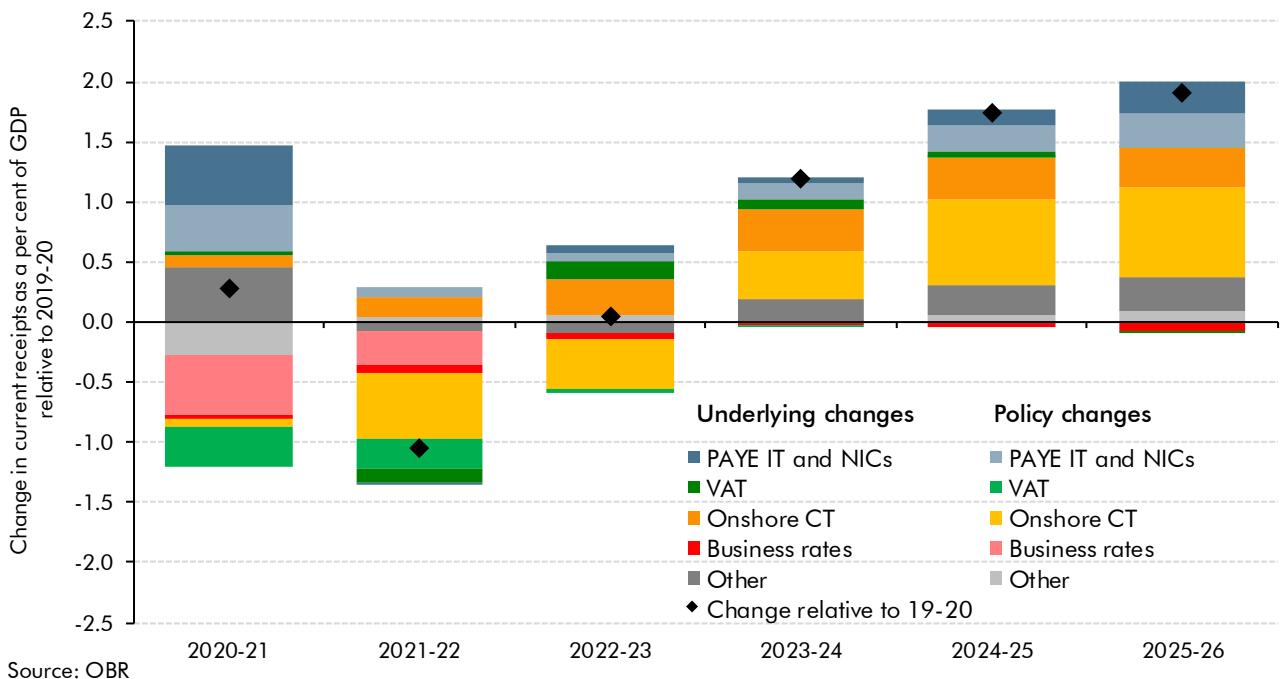
Fiscal outlook

- 1.32** Borrowing in 2020-21 reaches a peacetime record of £355 billion, or 16.9 per cent of GDP. This is £298 billion higher than the deficit in 2019-20 – a six-fold increase – and

£300 billion or 14.5 per cent of GDP higher than our pre-virus March 2020 forecast. But it is £39 billion lower than our November forecast for 2020-21. Stronger receipts account for £15 billion of this improvement (with £10 billion due to stronger performance of the economy, while another £6 billion is due to lower take-up of virus-related tax deferrals for self-assessment, which brings revenues forward from next year). The remaining £24 billion is due to lower spending, of which £11 billion is largely attributable to less rapid growth in virus-related spending, while the CJRS is now expected to cost £3.8 billion less in the period up to March than we assumed in November.

1.33 Receipts rise by £33.0 billion (4.2 per cent) in 2021-22, but remain below their 2019-20 level in cash terms. As this modest pick-up does not keep pace with the recovery in GDP, receipts as a share of GDP fall sharply, driven primarily by the virus-related tax reliefs. From 2022-23, receipts rise considerably faster than GDP, initially due to the withdrawal of temporary tax cuts, but then dominated by the effect of raising the main rate of corporation tax and freezing the main income tax thresholds in cash terms. In 2025-26, receipts are expected to reach 39.1 per cent of GDP, the highest share since 1984-85. Relative to our November forecast, the newly announced tax rises increase the tax burden by 1 percentage point to 35 per cent of GDP in 2025-26, its highest level since 1969-70 (Chart 1.7).

Chart 1.7: Change in the receipts-to-GDP ratio relative to 2019-20



1.34 The Budget includes three large tax measures:

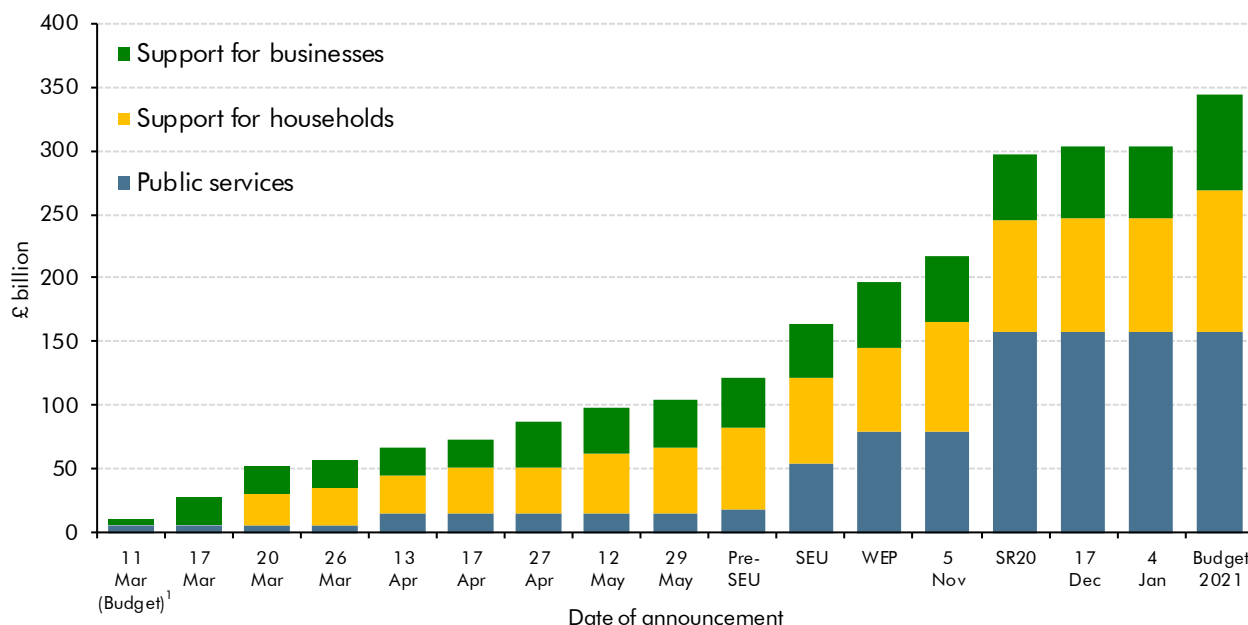
- **A two-year temporary capital allowances super deduction.** In 2021-22 and 2022-23, companies will be able to offset 130 per cent of investment spending on eligible plant and machinery against profits. As described above, this provides a very strong incentive to bring investment forward from future periods, supporting economic recovery over the next two years. It is expected to cost over £12 billion a year in the

two years that it applies, making it over ten times more generous than the equivalent temporary capital allowance measure that was announced in Budget 2009 with the aim of supporting investment that had been hit hard by the financial crisis.

- **Raising the headline rate of corporation tax from 19 to 25 per cent from April 2023.** After a decade in which successive Conservative Chancellors have cut the rate of corporation tax from 28 to 19 per cent, this one has chosen to raise it back to 25 per cent – the first time the rate has been raised since Dennis Healey did so in his 1974 Budget. It is expected to raise £17 billion a year by 2025-26 and to take corporation tax receipts as a share of GDP to the highest they have been since the height of the Lawson boom in 1989-90. Achieving historically high receipts with a still historically low rate reflects the broadening of the tax base over the past decade, with restrictions placed on several of the deductions that reduce taxable profits relative to total profits.
- **Freezing the income tax personal allowance and higher rate threshold in cash terms for the four years to 2025-26.** In his final Budget in 2018, Philip Hammond raised the personal allowance and the higher-rate threshold for 2019-20 to £12,500 and £50,000 respectively, and held them at that level in 2020-21 before returning to raising them with CPI inflation. After rising with inflation in 2021-22, they will now be frozen for a further four years. This raises £8 billion a year by 2025-26 relative to the thresholds rising with inflation – and brings 1.3 million more people into paying income tax and 1 million more into paying at the higher rate. Indeed, in real terms the personal allowance in 2025-26 will be back to a level it last stood at in 2014-15.

1.35 Total public spending is expected to hit a post-war peak of 54.4 per cent of GDP in 2020-21. This spike partly unwinds next year as virus-related spending drops and as GDP starts to recover, before spending settles around 2.1 per cent of GDP higher than its pre-virus level in 2025-26. Higher departmental spending explains all the rise over the medium term, with resource spending rising by 1.0 per cent of GDP and capital spending by 1.1 per cent. Spending has been revised down £24 billion this year relative to our November forecast due to greater underspending by departments, but has been revised up £42 billion in 2021-22 as virus-related support measures have been extended. Thereafter, a £3 billion annual cut to departmental spending totals in cash terms is slightly more than offset by higher welfare spending and debt interest costs, leaving total spending in 2025-26 a little higher. The total cost of the pandemic support measures, of which public services spending makes up 46 per cent, has now reached £344 billion (Chart 1.8).

Chart 1.8: The evolving cost of the coronavirus policy response

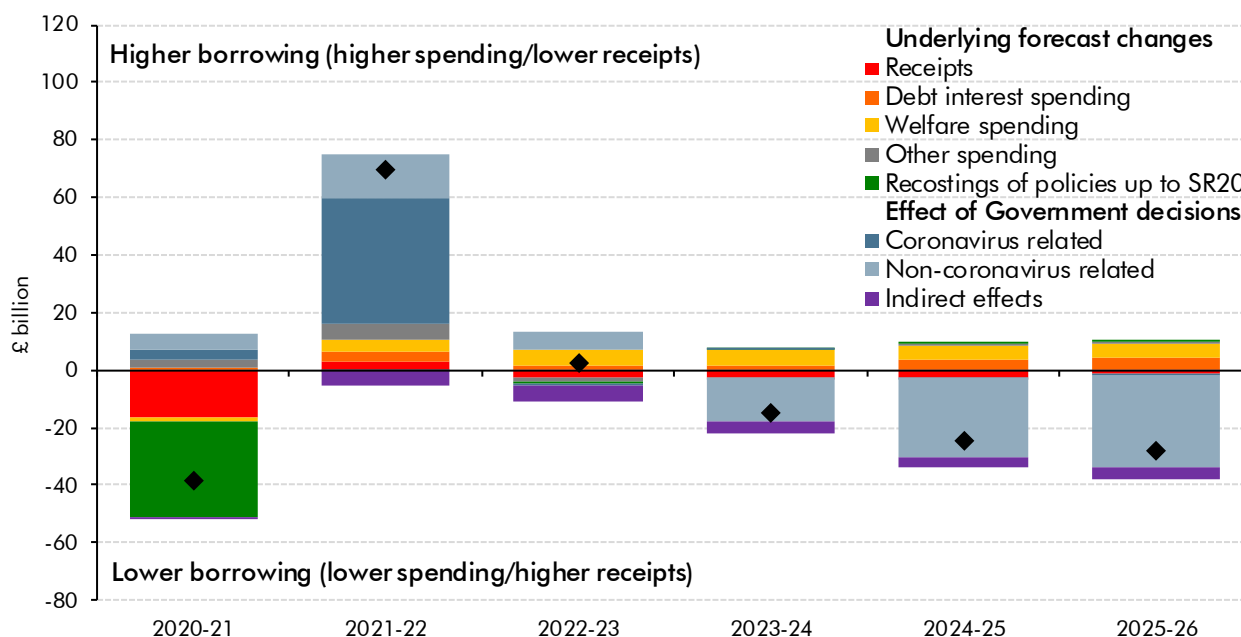


¹ Cost based on figures announced by the Chancellor in SB20. Other costs based on outturn and our March 2021 forecast estimates. Source: OBR

1.36 One potential risk to our spending forecasts relates the Government's future policy choices as existing virus-related spending schemes end and the pandemic's legacy for public services becomes clearer. The direct health costs of coronavirus could be more persistent than the Government currently expects, for example due to ongoing costs of annual revaccination and NHS Test and Trace as new variants of the virus emerge. The indirect costs of the pandemic could also prove to be greater than allowed for in the Government's existing spending plans, for example due to the cost to the NHS of clearing the backlog of non-virus-related activity, schools providing additional resources for pupils to catch up on lost schooling, and the potential cost of ongoing support for disrupted sectors such as railways and air travel. The extent to which accommodating any of these pressures would represent a fiscal risk would depend on other policy choices, including whether to bear down on other spending to make space, or to raise taxes further rather than allowing borrowing and debt to rise.

1.37 The post-war record peak in borrowing this year is £39 billion lower than we expected in November, thanks to higher than expected receipts and lower than expected departmental spending (with plans being underspent by even more than we had assumed). Borrowing then declines from this lower peak more gradually than previously forecast, due to the extension of virus-related support into 2021-22 and the introduction of time-limited tax incentives on business investment. With both our assumption of 3 per cent economic scarring from the pandemic and the level of public spending largely unchanged since our November forecast, the lower level of borrowing by the end of the forecast is more than accounted for by the tax rises announced in this Budget (Chart 1.9).

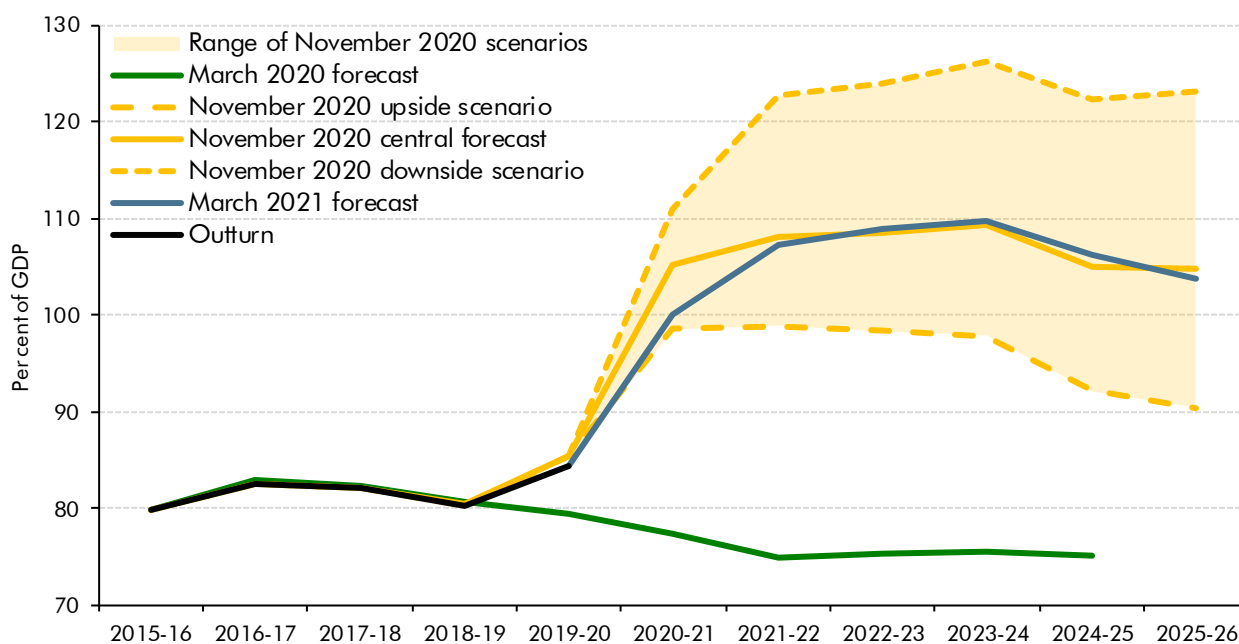
Chart 1.9: Changes in public sector net borrowing since our November forecast



Source: OBR

1.38 The underlying debt-to-GDP ratio, excluding the impact of Bank of England schemes, rises to a peak of 97.1 per cent of GDP in 2023-24, before edging lower by 0.1 and then 0.2 per cent of GDP in the final two years of the forecast. In our November *EFO* this measure of debt was expected to rise throughout the forecast period and by 1.2 per cent of GDP in 2025-26. The change in this Budget is entirely due to the impact of the Government's policy measures – our pre-measures forecast continued to show the underlying debt-to-GDP ratio rising by 1.3 percentage points in 2025-26. Headline public sector net debt rises above 100 per cent of GDP this year and peaks at 109.7 per cent of GDP in 2023-24, its highest level since 1958-59. It then falls as a share of GDP, helped by both the fall in underlying debt and the repayment of loans under the Bank of England's Term Funding Scheme (Chart 1.10).

Chart 1.10: Public sector net debt

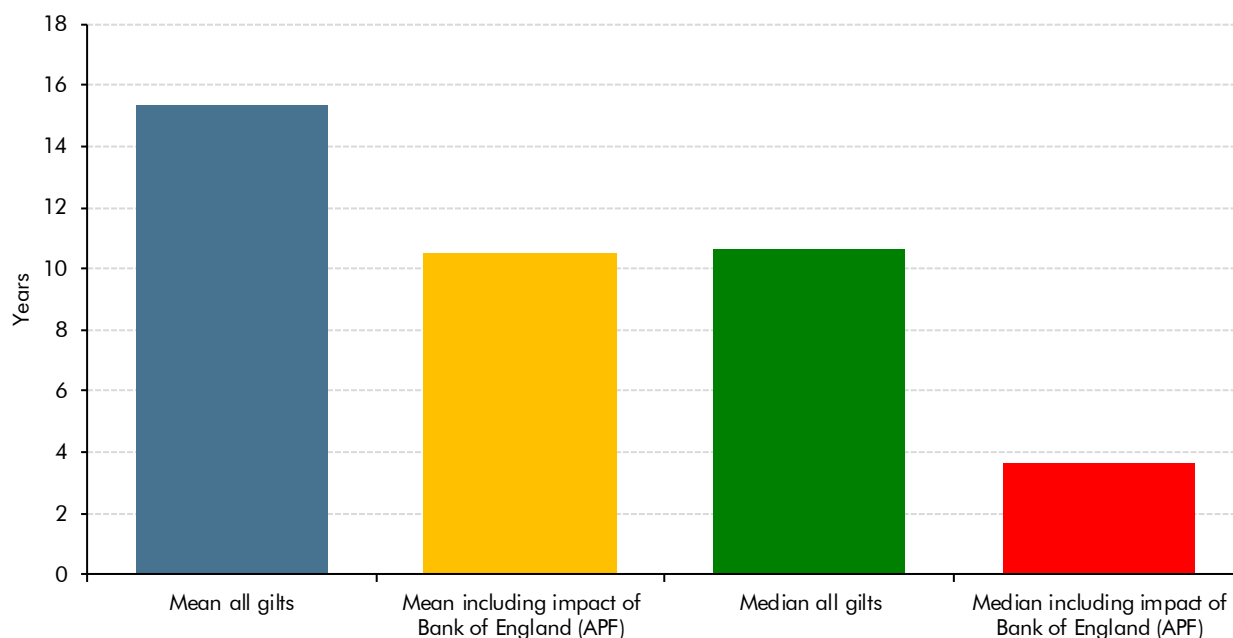


Source: ONS, OBR

- 1.39 Despite this significant increase in the government's stock of debt since the start of the pandemic, debt interest spending has been revised down very sharply from its pre-virus level – peaking at a £13.4 billion reduction in 2022-23, then diminishing progressively to £5.6 billion in 2024-25. This is thanks to historically low interest rates, especially at shorter maturities, and the near-doubling of quantitative easing, which further reduces the net interest costs of the public sector as a whole. Relative to our November forecast, we have revised debt interest spending higher, particularly in the later years where interest rate expectations are higher and in 2021-22 where inflation has been revised up.
- 1.40 Our forecast reflects market expectations for interest rates as they stood on 5 February, after the Bank of England's latest Monetary Policy Report, but before the rises in market interest rates in the past fortnight. All else equal, if our debt interest forecast had been based on market interest rates as they stood on 26 February, spending would be £6.3 billion higher in 2025-26. Only partly offsetting that, interest on the Government's financial assets and income tax on savings income would also be £0.7 billion higher in 2025-26.
- 1.41 While the government's debt stock has become more affordable in recent years, thanks in part to the 'refinancing' effect of quantitative easing by the Bank of England, this has come at the cost of much greater sensitivity to changes in interest rates. Since 2009 the Bank has acquired through its Asset Purchase Facility (APF) around one-third of the total stock of UK government bonds (gilts) with a median maturity of eight years and average interest rate of 2.1 per cent. It has financed these purchases by creating its own liabilities in the form of central bank reserves which, in essence, carry an overnight rate of interest, Bank Rate, which is currently 0.1 per cent. The net result has been an interest rate saving to the public sector as a whole of £17.8 billion in 2021-22 from the difference between rates on gilts and Bank Rate. But these savings have also come at the expense of a significant reduction in the

median maturity of the outstanding gilt stock from 11 years (before netting off APF holding) to less than four years (after netting off APF holdings) (Chart 1.11).

Chart 1.11: Mean and median maturity of gilts



Note: Data as of 15 February 2021
Source: Bank of England, DMO, OBR

1.42 The combination of the public sector's higher overall debt stock and the sharp reduction in the median maturity of that debt has markedly increased the sensitivity of the public finances to future changes in short-term interest rates. By way of illustration, if short- and long-term interest rates were both 1 percentage point higher than the rates used in our forecast – a level that would still be very low by historical standards – it would increase debt interest spending by £20.8 billion (0.8 per cent of GDP) in 2025-26. To put this into context, it is equivalent to roughly two-thirds of the medium-term fiscal tightening announced by the Chancellor in this Budget.

Table 1.2: Overview of the 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	37.2	37.5	36.2	37.3	38.4	39.0	39.1
Total managed expenditure	39.8	54.4	46.5	41.8	41.9	41.9	41.9
Budget 2020 fiscal targets							
Current budget deficit	0.6	13.3	7.6	1.7	0.6	0.1	0.0
Public sector net investment	1.9	3.6	2.7	2.8	2.9	2.8	2.7
Debt interest to revenue ratio (per cent)	3.5	2.6	2.5	2.3	2.4	2.5	2.5
Legislated fiscal target and objective							
Public sector net borrowing	2.6	16.9	10.3	4.5	3.5	2.9	2.8
Cyclically adjusted net borrowing	2.6	16.5	9.7	4.2	3.3	2.8	2.7
Public sector net debt	84.4	100.2	107.4	109.0	109.7	106.2	103.8
£ billion							
Revenue and spending							
Public sector current receipts	828.2	786.3	819.3	885.4	944.7	994.2	1037.8
Total managed expenditure	885.2	1140.9	1053.3	992.3	1030.1	1068.7	1111.5
Budget 2020 fiscal targets							
Current budget deficit	14.0	278.8	171.8	40.0	15.2	3.2	0.9
Public sector net investment	43.1	75.9	62.2	67.0	70.1	71.2	72.8
Legislated fiscal target and objective							
Public sector net borrowing	57.1	354.6	233.9	106.9	85.3	74.4	73.7
Cyclically adjusted net borrowing	58.8	345.4	219.3	99.2	81.6	71.9	72.5
Public sector net debt	1798	2198	2503	2631	2747	2761	2804

Performance against the government's fiscal targets

1.43 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 (two of which expire this month) 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.

1.44 These legislated targets are all set to be missed by wide margins based on our latest forecast. Cyclically adjusted borrowing in 2020-21 is over 16 per cent of GDP rather than under 2 per cent, and debt ends the year up 16 per cent of GDP. Overall borrowing falls over the forecast period but only to 2.8 per cent of GDP by 2025-26. The welfare cap is on track to be missed by a margin of £3.1 billion in 2024-25.

- 1.45 The Government has not yet decided what will replace the fiscal mandate that expires this month and the other fiscal targets in the existing *Charter*. Given the currently exceptional levels of uncertainty, the Treasury is instead proceeding with the review of the fiscal framework proposed at the March 2020 Budget that was postponed due to the pandemic. But the absence of formal fiscal targets does not mean that the Chancellor has not been guided by particular metrics when selecting his medium-term Budget policies. He has calibrated his Budget decisions to deliver a current budget that is very close to balance and underlying public sector net debt that is very close to stable in the medium term.
- 1.46 Relative to the fiscal targets that featured in the Conservative Party's manifesto and that guided Budget 2020, our latest forecast and the Chancellor's Budget decisions suggest that a focus on the current balance is retained, but the goal of achieving that by the third year of the forecast period is not; and the focus on stabilising debt has shifted from headline debt (including the uneven effects of the Bank of England) to underlying debt (excluding the Bank of England). The Budget 2020 targets also included a ceiling on public sector net investment as a share of GDP of 3 per cent on average over the five-year forecast period; and a threshold for the ratio of debt interest to revenues of 6 per cent, above which action would be taken to put the debt-to-GDP ratio on a downward path.
- 1.47 On these four metrics:
- Our pre-pandemic forecast predicted a **current budget** surplus of 0.8 per cent of GDP (£21.2 billion) in 2024-25. In the absence of the measures announced in this Budget, the lasting consequences of the pandemic would have left a current budget deficit of 1.4 per cent of GDP (£37.1 billion) in 2025-26 (with the forecast horizon having moved on a year since our March 2020 forecast). But the medium-term tax rises and spending cuts announced in this Budget reduce that current deficit by £36.2 billion in 2025-26, leaving a very small deficit of just £0.9 billion (0.03 per cent of GDP).
 - The **underlying debt-to-GDP ratio (excluding the Bank of England)** rises sharply in 2020-21, then continues to rise until it peaks in 2023-24, after which it falls very slightly (by 0.1 and 0.2 percentage points a year) in 2024-25 and 2025-26. This broadly flat position in the medium term is similar to that reached in our March 2020 forecast, albeit with underlying debt more than 20 per cent of GDP higher. But it contrasts with our November forecast of underlying debt rising by 0.8 per cent of GDP in 2025-26 and our latest pre-measures forecast of a 1.3 per cent rise. Again, it is the medium-term tax rises and spending cuts announced in the Budget that explain the difference.
 - The **debt interest to revenue ratio** is lower in every year of our latest forecast compared to our March 2020 forecast, despite debt being materially higher due to the pandemic. This is thanks to lower interest rates, especially at shorter maturities, and the doubling in quantitative easing by the Bank of England, which further reduces debt interest. Compared to November, the ratio is higher in all years of the forecast, primarily due to higher interest rates. It remains at less than half the 6 per cent threshold on both a pre- and post-measures basis throughout the forecast period.

- **Public sector net investment** rises significantly from its pre-pandemic level of 1.9 per cent of GDP to an average of 2.8 per cent of GDP over the next five years (after having spiked even higher in 2020-21). This reflects the increases in capital spending announced in last year's Budget. The Chancellor did not change his medium-term capital spending plans in this Budget, so public sector net investment continues to average just less than 3 per cent of GDP over the next five years.