1 Executive summary

Overview

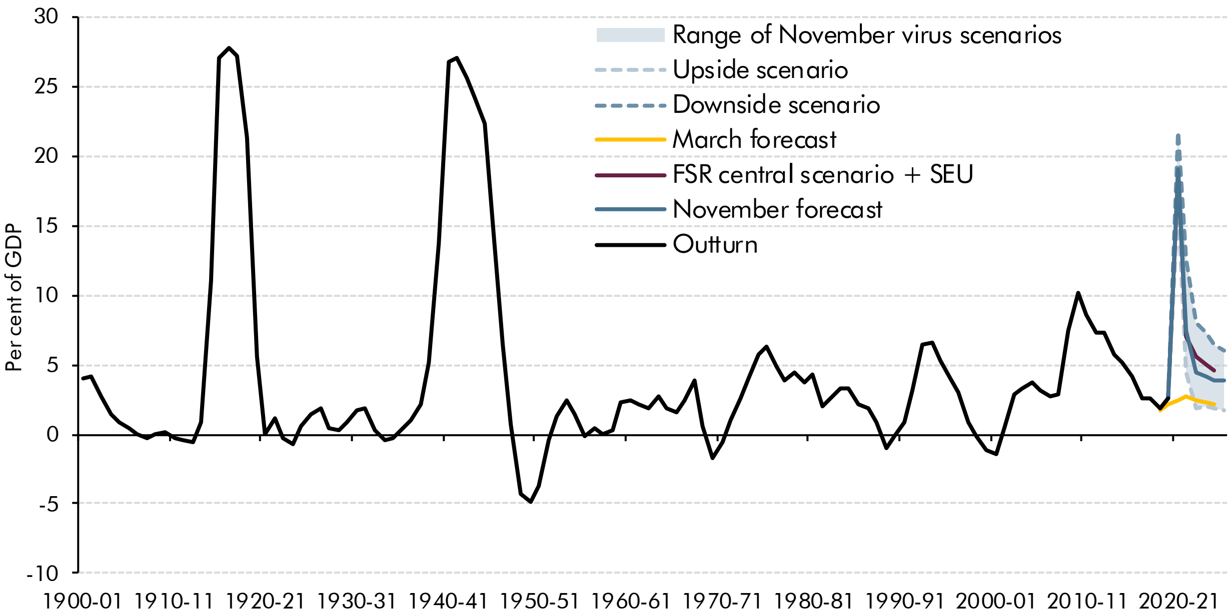
1.1 The coronavirus pandemic has delivered the largest peacetime shock to the global economy on record. It has required the imposition of severe restrictions on economic and social life; driven unprecedented falls in national income; fuelled rises in public deficits and debt surpassed only in wartime;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

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

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

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

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



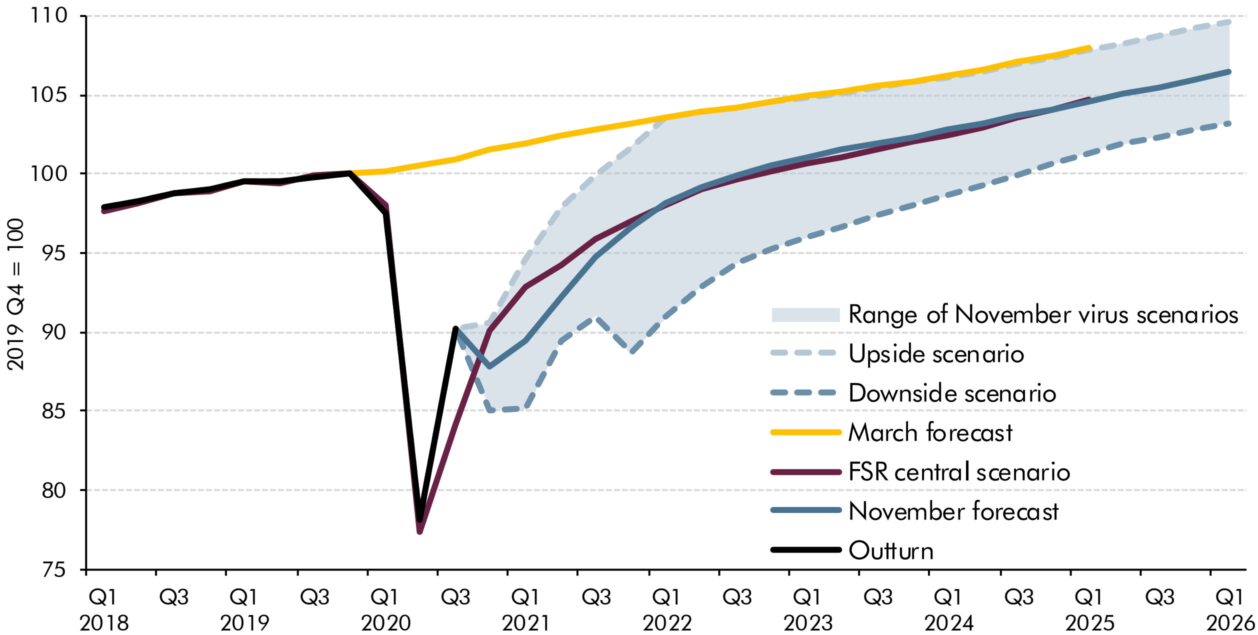
Source: ONS, OBR

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

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

1.7 We therefore present three scenarios for the virus: an upside scenario, in which lockdown succeeds in bringing the second wave of infections under control and the rapid rollout of effective vaccines enables output to return to its pre-virus level late next year; a central one, in which restrictive public health measures need to be kept in place until the spring and vaccines are rolled out more slowly, leading to a slower return to pre-virus levels of activity at the end of 2022; and a downside one, in which lockdown has to be extended, vaccines prove ineffective in keeping the virus in check, and a more substantial and lasting economic adjustment is required with economic activity only recovering to its pre-virus level at the end of 2024 (Chart 1.2). In the upside scenario, output eventually returns to its pre-virus trajectory, but output is left permanently scarred by the pandemic in the other two scenarios, by 3 and 6 per cent respectively. All three assume a smooth transition to a free-trade agreement with the EU in the new year. But we also describe an alternative scenario in which the Brexit negotiations end without a deal. This would further reduce output by 2 per cent initially and by 1½ per cent at the forecast horizon.

Chart 1.2: Real GDP: central forecast and alternative scenarios

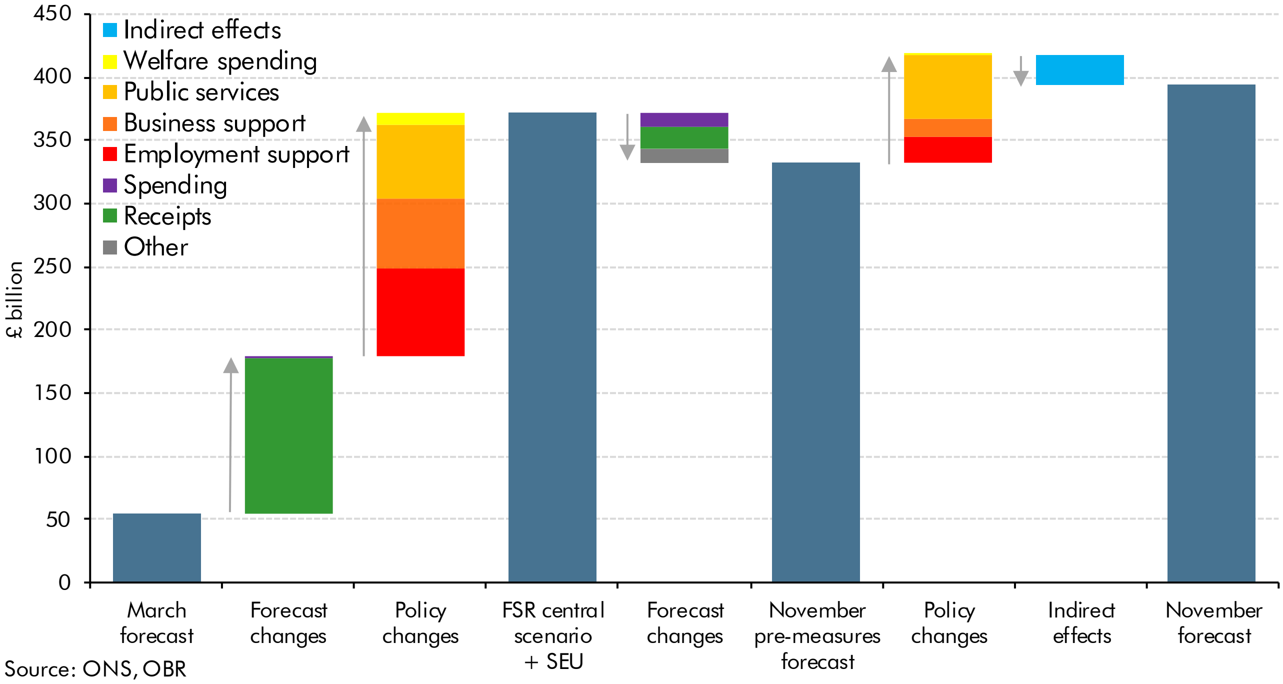


Source: ONS, OBR

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

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

Chart 1.3: Change in net borrowing in 2020-21



Source: ONS, OBR

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

1.11 The increase in borrowing does, however, render the public finances more vulnerable to changes in financing conditions and other future shocks. This heightened vulnerability is compounded by the shortening of the effective maturity of that debt as a result of both a greater focus on short-term debt issuance by the Treasury and further Bank of England purchases of longer-dated gilts financed through the creation of floating rate reserves. Taken together, these leave debt interest spending twice as sensitive to changes in short-term interest rates than prior to the pandemic. Arresting the continued rise in public debt is likely to require some fiscal adjustment once the virus has run its course. Only in our upside scenario, in which the pandemic is swiftly ended and there is little lasting damage to activity, does borrowing fall below the level required to stabilise the debt-to-GDP ratio by the forecast horizon. In our central forecast and downside scenario, tax rises or spending cuts of between £21 billion and £46 billion (between 0.8 and 1.8 per cent of GDP) would be required merely to stop debt rising relative to GDP.

Table 1.1: Summary of virus scenarios

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

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

The economic outlook

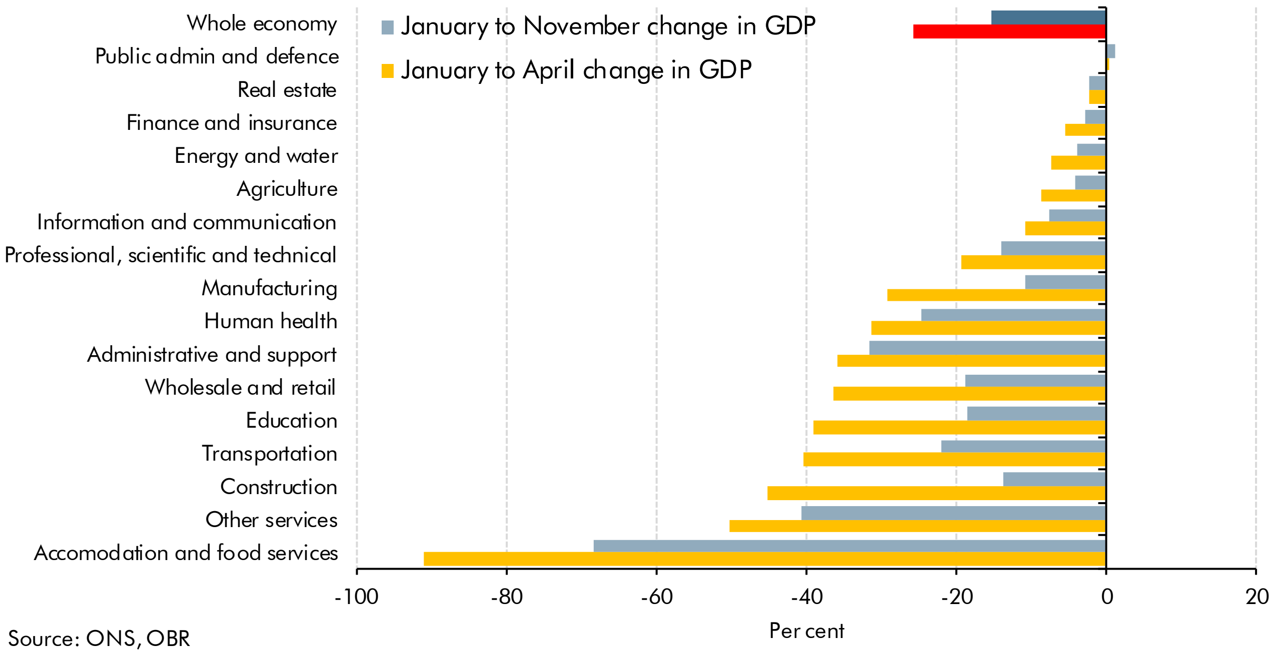
1.12 The coronavirus pandemic has resulted in the largest and most synchronised shock to the global economy in living memory. The virus spread rapidly around the world in the first half of 2020, leading to widespread falls in activity. This contraction was driven partly by the public health restrictions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

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

1.14 During the first wave of the pandemic, the UK experienced one of the highest rates of infections, hospital admissions and deaths among advanced economies. In addition, the UK introduced more stringent public health restrictions later but maintained them for longer than in many other European countries. The combination of the severity of the outbreak and the length and stringency of the first lockdown in the UK saw output fall by over a fifth between the fourth quarter of 2019 and second quarter of 2020 – its sharpest contraction on record and one of the largest among advanced economies.

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

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



Source: ONS, OBR

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

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

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

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

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

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

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

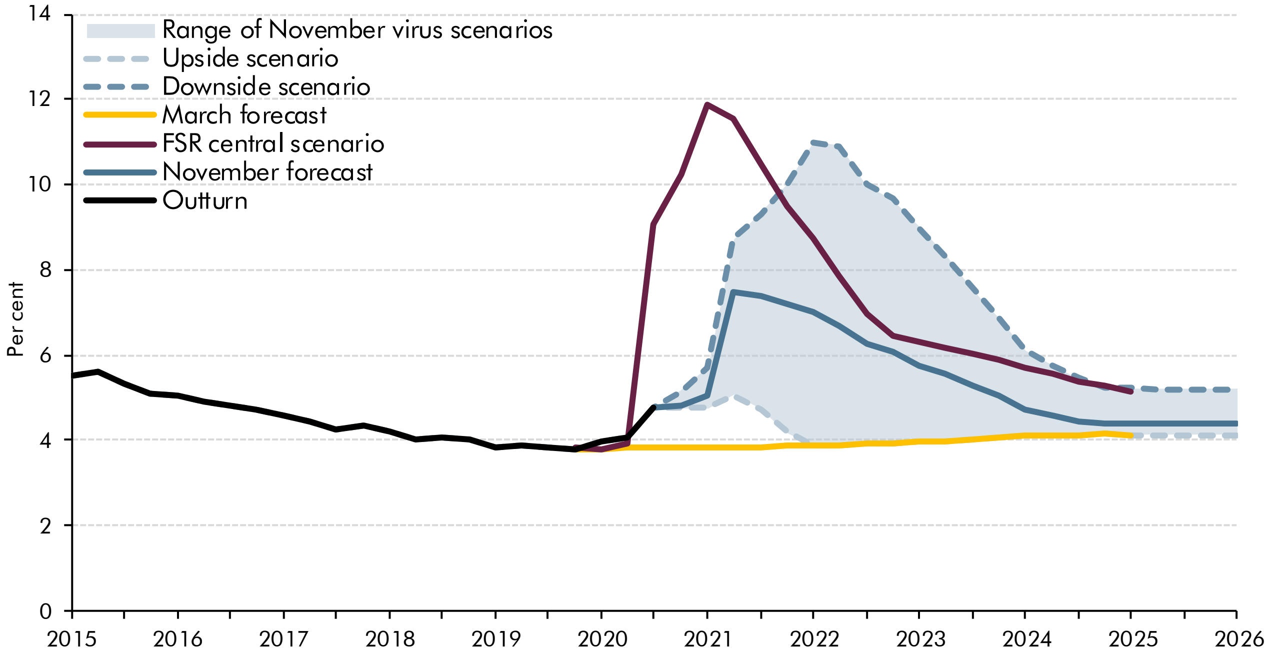
1.22 In our **central forecast**, a higher infection rate at the end of the lockdown and a less effective TTI system necessitate keeping a more stringent set of public health restrictions in place over the winter. These may vary regionally and temporally but are broadly the same as remaining at the equivalent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

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

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

1.25 The recently announced extensions to the CJRS, SEISS and various business support measures both delay and attenuate the rise in unemployment. Under our central forecast, unemployment peaks at 7.5 per cent in the second quarter of 2021. The CJRS extension is expected to result in the peak in unemployment occurring two quarters later and at a lower level than would have occurred in its absence. The CJRS extension, along with other new measures, are expected to lower the level of unemployment in the second quarter of 2021 by around 300,000 compared to what would have happened in their absence. The unemployment rate rises to just a little over 5 per cent in our upside scenario as the economy has all but returned to normal by the time the CJRS closes. But it rises to 11 per cent in our downside scenario as the third wave strikes next winter.

Chart 1.5: Unemployment rate: central forecast and alternative scenarios



Source: ONS, OBR

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

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

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

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

Table 1.2: Overview of the central economy forecast

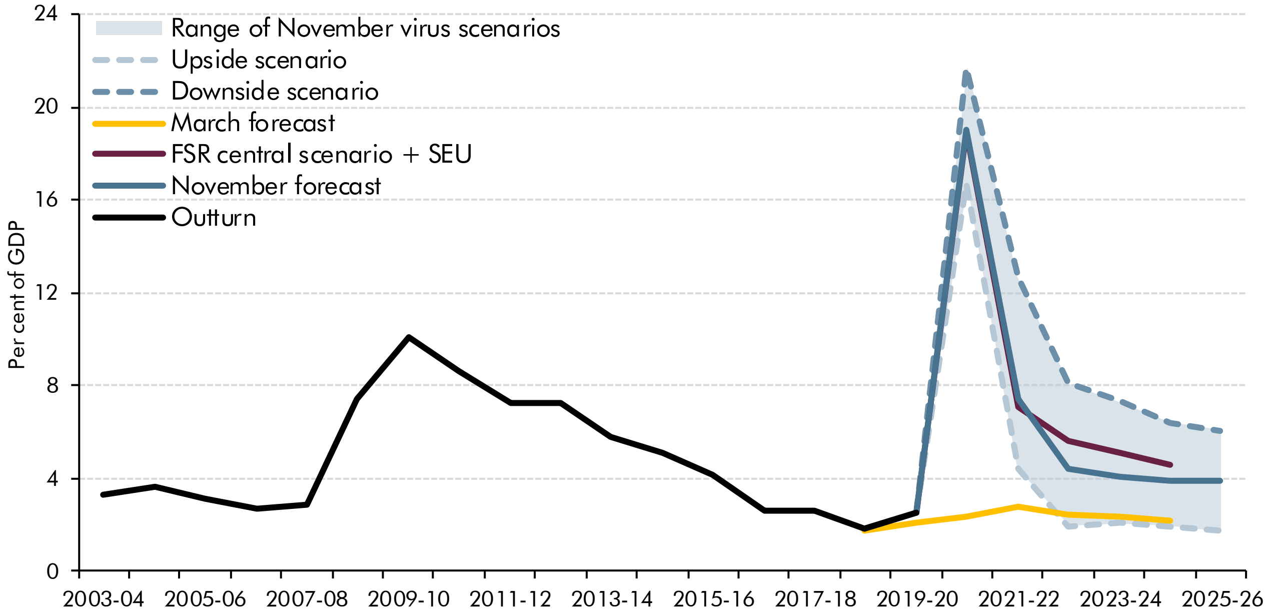
	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2019	2020	2021	2022	2023	2024	2025
Output at constant market prices							
Gross domestic product (GDP)	1.3	-11.3	5.5	6.6	2.3	1.7	1.8
GDP per capita	0.7	-11.8	5.2	6.2	2.0	1.4	1.5
GDP levels (2019=100)	100.0	88.7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

[1] Contribution to GDP growth.

The fiscal outlook

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

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



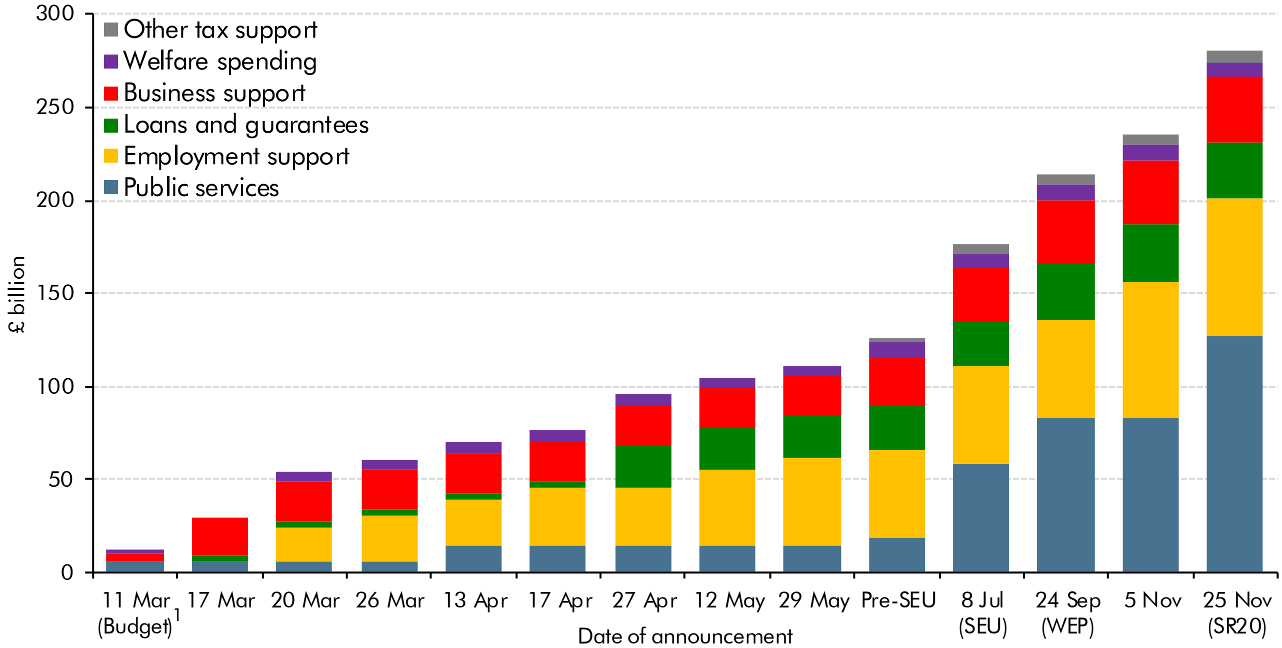
Source: ONS, OBR

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

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

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

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



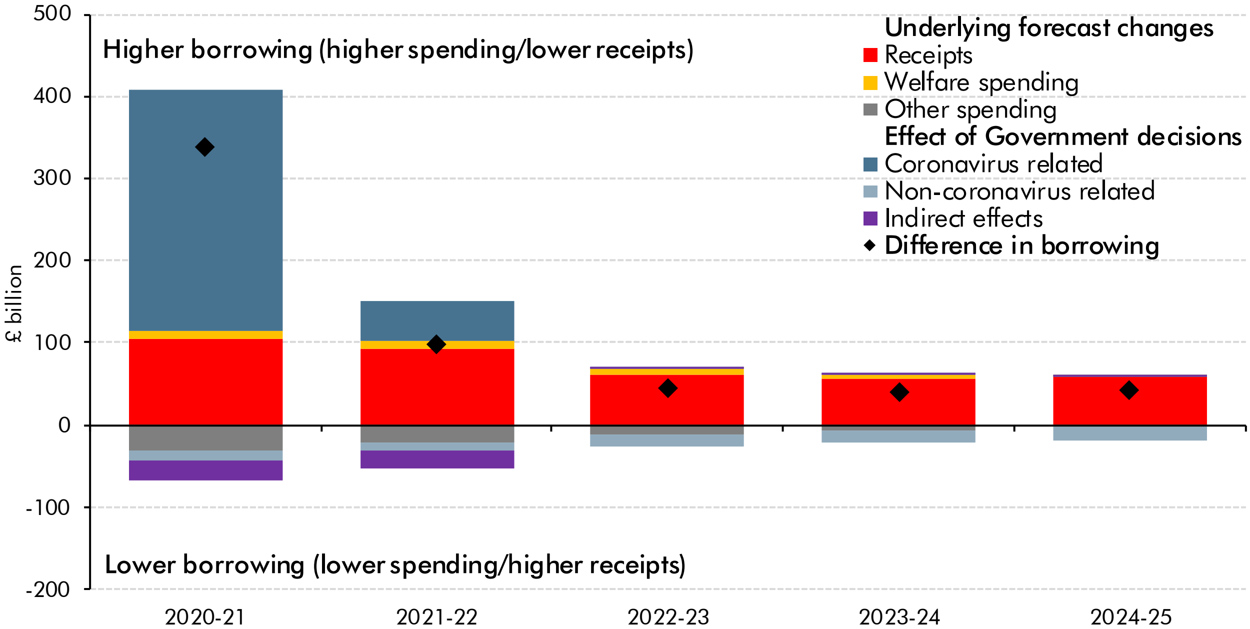
[1] Cost based on figures announced by the Chancellor in the Budget. All other costs based on our November forecast estimates.
Source: OBR

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

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

1.36 Borrowing also falls rapidly in 2021-22 as economic activity and tax receipts recover and much of the temporary fiscal support to households and businesses expires. It falls further in 2022-23 as virus-related spending ends and, in our central forecast, settles at around £100 billion a year over the remainder of the forecast (around 4 per cent of GDP). Relative to our March forecast, the £339 billion upward revision to borrowing this year drops to £98 billion next year, settling at around £42 billion higher from 2022-23 onwards. This medium-term difference is more than explained by lower receipts thanks to the scarring of real GDP and tax bases, but is partly offset by much lower debt interest spending and the £10 to £12 billion a year cut in departmental resource spending relative to March totals.

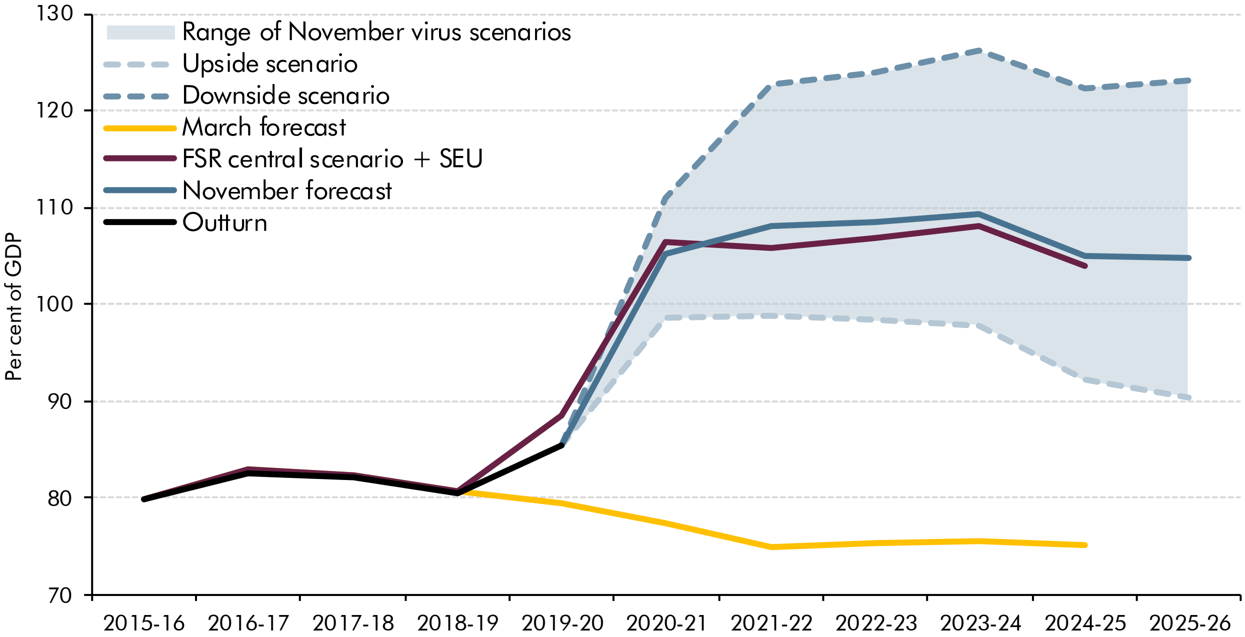
Chart 1.8: Changes in public sector net borrowing since our March forecast



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

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

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



Source: ONS, OBR

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

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

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

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

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

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

Table 1.3: Overview of the central fiscal forecast

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

Performance against the Government's fiscal targets

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

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

1.43 All three legislated borrowing and debt targets are missed by wide margins in our central forecast and all our scenarios, whereas the welfare cap (restated in this event to reflect a change in how we forecast universal credit) is missed in our central forecast and downside scenario. In our March 2020 forecast, before the impact of the pandemic became apparent, the Government was on course to meet the debt target and welfare cap, to miss the near-term structural deficit target by a narrow margin, and was getting further and further away from its longer-term objective to balance the budget.

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

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

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

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

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

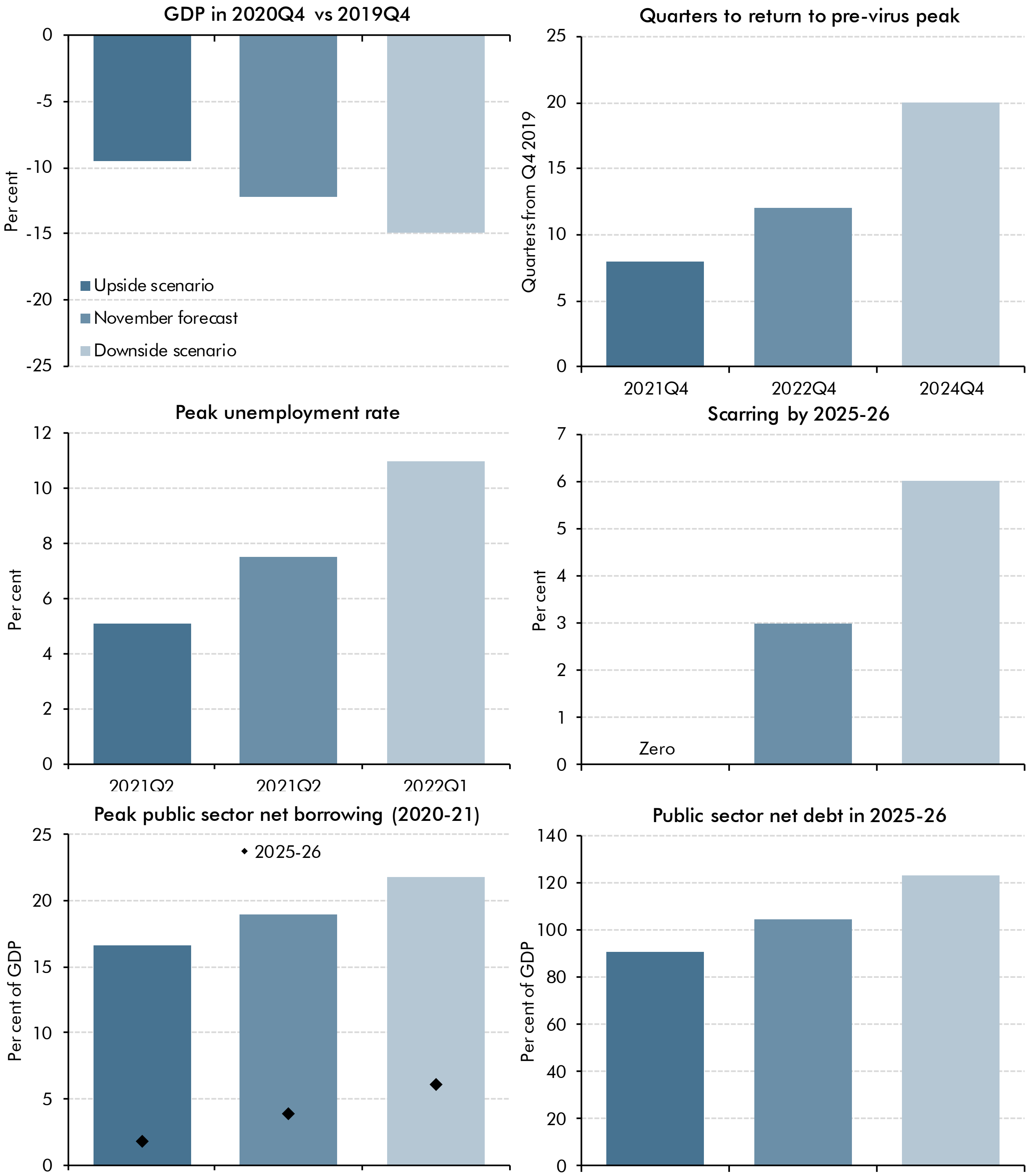
1.47 There were no specific metrics attached to these statements and 'balancing the books' and 'getting debt back under control' can mean different things to different people and in different contexts. But we have looked at several conventional definitions of fiscal balance and debt stabilisation over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

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

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

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

Chart 1.10: Summary of virus scenario results



Source: ONS, OBR