1 Executive summary

Overview

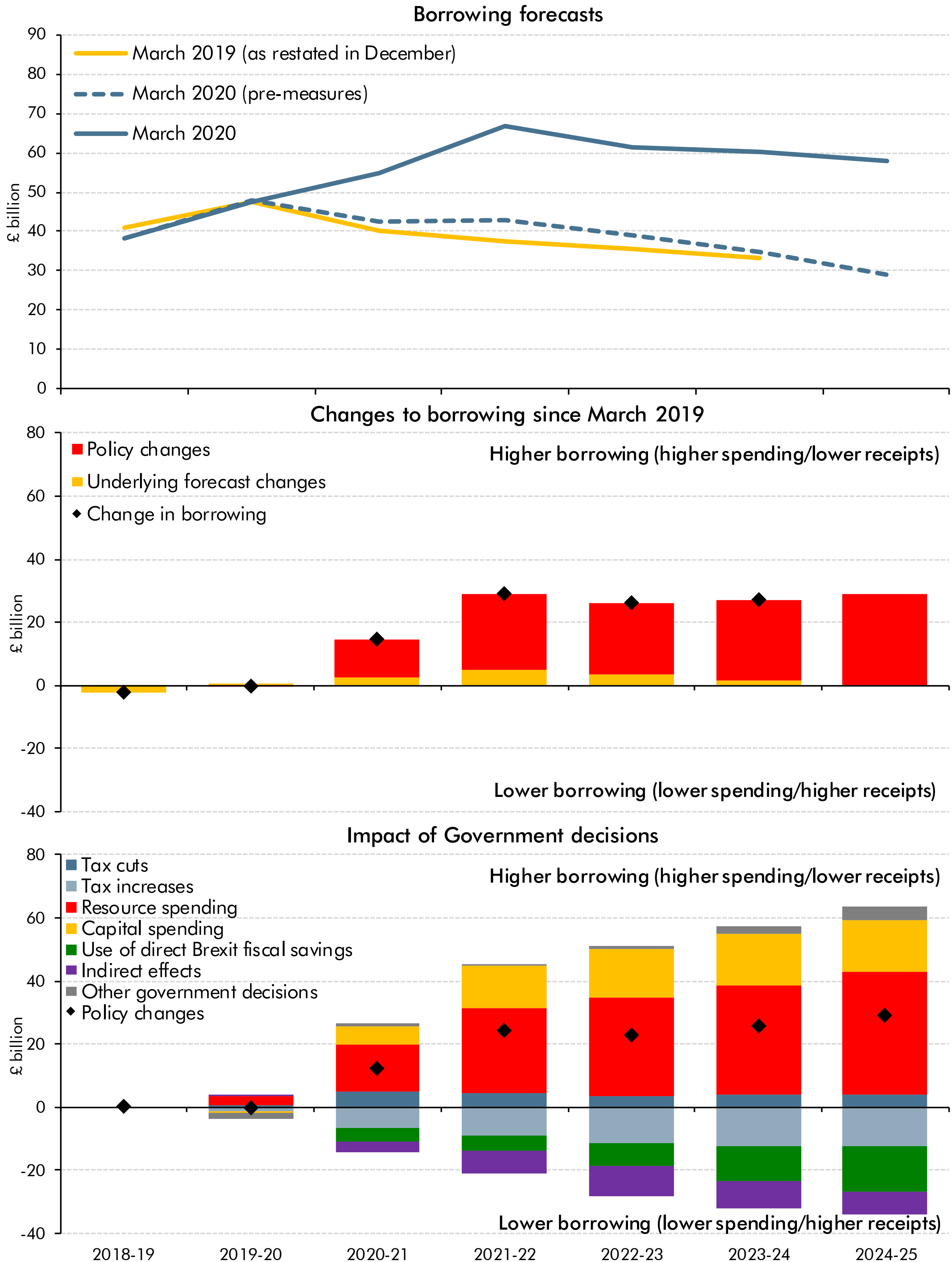
1.1 In addition to its impact on public health, the coronavirus is likely to have a significant adverse effect on the economy and public finances in coming quarters. But neither the size nor the duration of this effect are possible to predict with any confidence. The Chief Medical Officer has declared that an epidemic in the UK is now "*likely*", while the Bank of England Governor has said that the shock to the economy "*could prove large*".

1.2 With large numbers of people potentially sick – or restricting their movements to avoid becoming so – the coronavirus is likely to reduce both the demand for goods and services in the economy and the ability of businesses at home and abroad to supply them. That will temporarily reduce private sector incomes and spending (and hence tax revenues), while putting upward pressure on government spending to help address the outbreak. This implies additional upward pressure on the budget deficit and public debt. But the impact on the public finances over the medium and longer term is likely to be less significant, unless the outbreak inflicts lasting damage on the economy's supply capacity.

1.3 As regards this fiscal event, the Treasury as usual asked us to close our pre-measures forecasts for the economy and the public finances some way in advance of the Budget – on 18 and 25 February respectively – so that it had a stable base against which to finalise its policy decisions. (With the spread of coronavirus then expected to be relatively limited, the impact on the forecasts in this *Economic and fiscal outlook* (*EFO*) is largely confined to a modestly weaker outlook for growth in world trade and the UK's export markets.) The only subsequent changes to the forecast were to reflect the Budget measures and other policy announcements since our previous forecast in March 2019 – notably the new migration regime and further rises in the National Living Wage. Under the circumstances, the precise forecasts for the economy and public finances in this *EFO* can no longer be regarded as central – particularly in the near term – but scrutinising and analysing the impact of the Government's policy decisions even against this baseline remains informative.

1.4 Turning to those policy decisions, the Government has proposed the largest sustained fiscal loosening since the pre-election Budget of March 1992 (which was reversed within months after the UK left the European exchange rate mechanism in September that year). Relative to our pre-measures baseline forecast, the Government's policy decisions increase the budget deficit by 0.9 per cent of GDP on average over the next five years and add £125 billion (4.6 per cent of GDP) to public sector net debt by 2024-25.

Chart 1.1: Public sector borrowing: March 2020 versus restated March 2019



Source: ONS, OBR

1.5 The largest components of the fiscal loosening are significant increases in departmental spending plans – for both current and capital. As regards current spending, the Budget completes the reversal of the cuts to real departmental spending per person undertaken by the Coalition Government. The turnaround started in the Conservative Government's post-election Budget in July 2015, but really took hold with the multi-billion pound NHS settlement in June 2018. The capital spending turnaround is more dramatic still – the Coalition Government's early cuts (which had been a feature of the previous Labour Government's March 2010 Budget plans) will have been almost fully reversed this year. Spending is set to be around a third higher at the end of our forecast than in 2010-11.

1.6 The net tax rise announced in the Budget reduces borrowing by an average of £5.5 billion a year. This is more than explained by the decision to cancel the planned cut in the main rate of corporation tax from 19 to 17 per cent this April. The Budget also cuts National Insurance and freezes fuel and alcohol duties for a year (again), but restricts eligibility to use cheaper 'red diesel' to just a handful of uses. This leaves the receipts-to-GDP ratio on a steadily rising path, reaching its highest level since 1984-85 at the forecast horizon.

1.7 Despite a year having passed since our last full forecast, the near-term economic outlook at the time we closed this forecast appeared little changed. That has of course been overtaken by coronavirus. Against our stable but subdued pre-measures forecast baseline, the profile for GDP growth reflects the impact of the Government's policy decisions. In broad terms, they deliver a boost to demand in the near term that dissipates by the end of the forecast. This overlays a steadily building drag on potential output, largely via the effect of the new migration regime on population growth. GDP growth peaks at 1.8 per cent in 2021, thanks to the fiscal loosening, before easing back to around 1½ per cent a year.

1.8 The Government set this Budget against the materially looser set of fiscal rules outlined in the Conservative Party manifesto and confirmed in the Queen's Speech. Based on these *EFO* forecasts, the Government would meet its new target of a current budget balance in the third year of our forecast (currently 2022-23) by a margin of £11.7 billion. Public sector net investment (PSNI) rises to 3.0 per cent in 2022-23 and remains there, meeting the 'maximum investment' rule. This incorporates our assumption that 20 per cent of the additional capital plans will go unspent (reflecting past experience when governments try to ramp up capital spending quickly). This leaves public sector net debt broadly stable. These assessments reflect the forecasts underpinning them, so near-term risks are to the downside. The extent to which that is true further out, when the rules apply, is unclear.

1.9 Formally speaking, the fiscal rules approved by Parliament in the January 2017 *Charter for Budget Responsibility* remain in force for now – and the Government is not on course to meet them. Our forecast shows a structural budget deficit of 2.4 per cent of GDP in 2020-21, missing the 'fiscal mandate' by £9.2 billion. The formal 'fiscal objective' is to return the Budget to balance. The Government was on course to achieve a small budget surplus by 2023-24 in our October 2018 pre-measures forecast, but thanks to two expansionary budgets and improved accounting for student loans the deficit is now set to rise and then level off at around £60 billion a year. The Government says that it intends to review the

fiscal framework ahead of the next Budget, so the next *Charter* could incorporate different fiscal targets to those that have underpinned the decisions in the Budget.

1.10 The Government's fiscal plans are rooted in the assumption that its borrowing costs will remain relatively low, as market expectations indeed suggest. Rather than aim for budget balance and a clear decline in the debt-to-GDP ratio – as Philip Hammond did initially as Chancellor – the new administration is content to borrow significant sums on an ongoing basis and merely to stabilise the debt-to-GDP ratio. This looks sustainable over the medium term on current interest rate and growth forecasts. But, as we have noted in our *Fiscal risks reports*, financing conditions may not remain this favourable. The debt-to-GDP ratio is twice as high as in the pre-crisis period, the stock of index-linked gilts is much larger and the Bank of England's asset purchases have shortened the effective maturity of the public debt. Taking both fresh borrowing and the need to roll over existing debt into account, the Government's gross financing requirement averages around £150 billion a year over the next five years, around half as much again as a share of GDP as in the five years prior to the financial crisis even though the budget deficit is around a fifth smaller. So the public finances are more vulnerable to adverse inflation and interest rate surprises than they were.

The economic outlook

1.11 The UK left the European Union on 31 January. Under the Withdrawal Agreement, we are now in a transition period until the end of 2020. From that point on, our forecast assumes an orderly move to a new trading arrangement – although still one that has to be painted with a broad brush pending the outcome of the negotiations. On 27 February the UK formally set out its objectives for the negotiations, which are consistent with a free trade agreement. We have not assumed the specific form that this will take, but have instead drawn on an average of external estimates of the effect of a typical free trade agreement. In broad terms, this implies around a 4 per cent loss of potential GDP over 15 years, relative to what would have happened under existing trading arrangements.

1.12 We estimate that the economic effects of the referendum vote have so far reduced potential output by around 2 per cent, relative to what would have happened in its absence. Part of this reflects lower net inward migration, but mostly it reflects weaker productivity growth on the back of depressed business investment and the diversion of resources from production towards preparing for potential Brexit outcomes. Real business investment has barely grown since the referendum, whereas our March 2016 forecast assumed it would have risen more than 20 per cent by now. We expect this shortfall to be partly reversed as the specifics of the trading relationship are clarified, hence reducing uncertainty. But, working in the other direction, we expect the adverse effect of higher trade barriers to build through our five-year forecast period and beyond. Broadly speaking, we believe that around one third of the long-run hit to productivity from Brexit has already happened, that another third is likely to come over the forecast period and the rest comes through beyond our forecast horizon.

1.13 Global growth was weaker last year than expected, with world GDP rising 2.9 per cent in 2019 versus our forecast of 3.5 per cent. Global trade growth has slowed even more thanks largely to trade tensions between US and China. UK export markets have weakened too.

1.14 At the point that we closed our global forecast on 14 February, the coronavirus outbreak was mostly concentrated in China, with only limited spread to other countries. Based on the information then available, we lowered our forecast for the growth of world trade and UK export markets in 2020 by 0.5 and 0.2 percentage points respectively, reducing UK GDP growth by around 0.1 percentage points. In calibrating the size of the effect, we were guided by the impact of the 2003 SARS outbreak. Since we closed our forecast, it has become clear that the spread of coronavirus will be far wider than assumed in our baseline forecast, pointing to a deeper – and possibly more prolonged – slowdown.

1.15 Absent coronavirus, the near-term economic outlook for the UK would have been little changed since our previous forecast last March, although weaker growth around the turn of the year has lowered annual growth in 2020 significantly. Based on unchanged plans for tax and spending, we would have also lowered our GDP growth forecast slightly in 2021 and 2022. Those medium-term revisions reflect a weaker outlook for potential productivity growth (in the light of continued weak outturns, subdued business investment and the incorporation of an effect from higher trade barriers). The effect of that on potential output is tempered by an upward revision to labour market participation – again reflecting trends in recent data. We judge that the economy was operating only very slightly below potential at the end of 2019, so there is very little spare capacity to be used up.

1.16 Policy measures announced since last March have a material effect on the medium-term path of GDP growth. The new migration regime announced on 19 February has led us to revise down net inward migration – moving from using the ONS's 'principal' population variant to its 'zero net EU migration' variant (though we do not expect net EU migration necessarily to be zero). This reduces assumed net inward migration in 2024-25 from 190,000 to 129,000. This means slower population growth, particularly among those of working age, and a slightly lower participation rate, reduces employment by 0.4 per cent by 2024-25. As the forgone migration is concentrated among those with lower incomes, average productivity across the smaller workforce is 0.1 per cent higher. This leaves real GDP 0.3 per cent lower in 2024-25 but GDP per capita little changed.

1.17 Raising the National Living Wage (NLW), so that it reaches two-thirds of median earnings of the relevant population by October 2024, boosts average earnings at the expense of lower profits. It also reduces employment thanks to a small increase in the equilibrium unemployment rate, equivalent to around 50,000 more unemployed in 2024-25.

1.18 The large and sustained fiscal loosening announced in the Budget raises output in the near term, with the effect peaking at around 0.5 per cent in early 2022. The effects of fiscal policy changes on demand influence the path of real GDP in the short and medium term, but we generally assume that they fade eventually as the economy adjusts. The large planned increase in public investment should boost potential output too – eventually by around 2.5 per cent if the increases in general government investment as a share of GDP in the Budget were to be sustained indefinitely. But we assume that these favourable consequences for supply are likely to be felt mainly beyond our five-year forecast horizon.

1.19 One reason that fiscal loosening has only a temporary effect on output is because tighter monetary policy is necessary to keep inflation on track to meet the 2 per cent target. Our forecast for Bank Rate is usually derived from market expectations, which were consistent with Bank Rate falling to around 0.5 per cent and remaining there over the medium term. We felt that would be inconsistent with our economic and fiscal forecasts, which require a tighter monetary stance to eliminate the positive output gap generated by the Budget package. So, on this occasion, we adopted an alternative path for Bank Rate (and the exchange rate) that delivers such a tighter monetary stance. (However, market interest rate expectations have since fallen significantly in response to the spread of coronavirus.)

1.20 Overall, real GDP growth dips to 1.1 per cent this year as the deterioration in the global outlook and continuing drag from uncertainty over Brexit are only partly offset by the fiscal expansion. It then picks up to 1.8 per cent in 2021 as the effect of the fiscal expansion reaches its peak, before settling at an average of 1.4 per cent in the medium term. Risks to the near-term path in particular are, of course, now very clearly to the downside.

1.21 Large rises in public spending mean that general government expenditure contributes over half of GDP growth this year and next, despite accounting for only around a fifth of GDP. The fiscal easing crowds out some consumer spending, private investment and net trade. Exports fall 3.6 per cent over the forecast, in large part due to higher trade barriers.

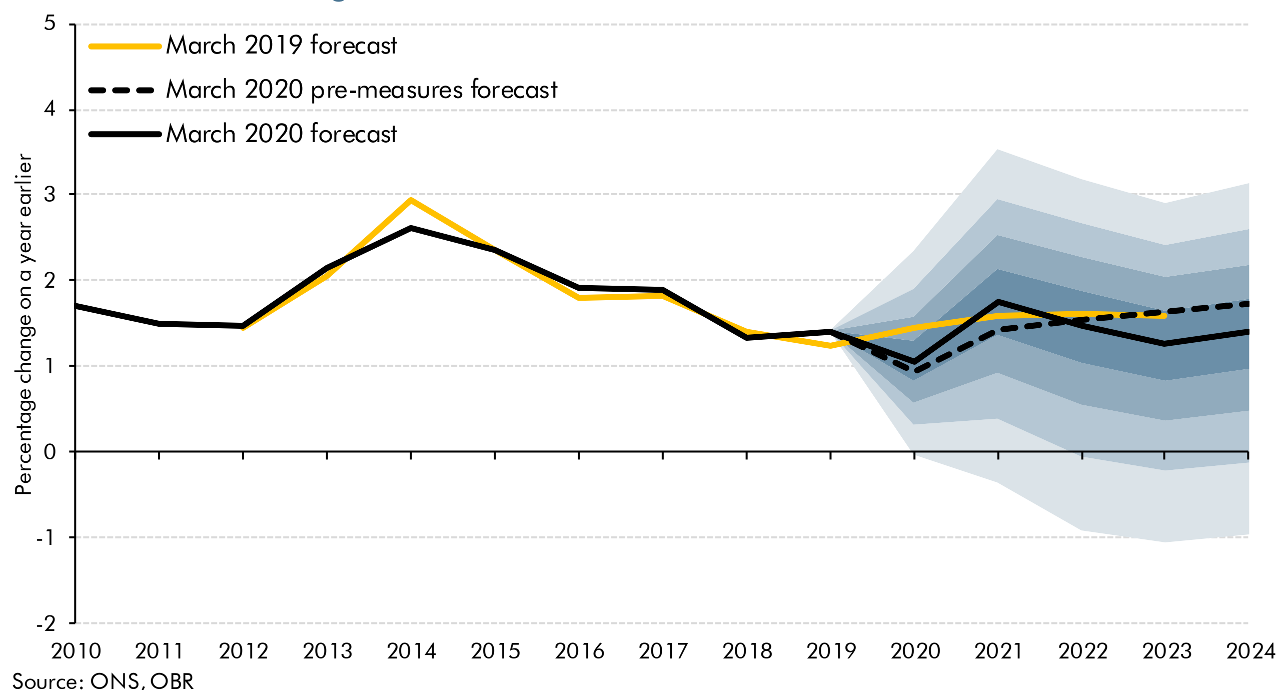
1.22 The unemployment rate is currently 3.8 per cent – just below our estimate of its underlying equilibrium rate – despite the slowing in GDP growth. We expect it to rise modestly through the forecast period to 4.1 per cent as the increases in the NLW price some workers out of employment. Whole economy employment increases by 520,000 over the forecast period, but we expect growth in government employment to account for virtually all the increase. Earnings growth is expected to increase to 3.6 per cent, boosted by the Budget package, but then eases back to a little above 3 per cent in the medium term.

1.23 We expect CPI inflation to come in at 1.8 per cent in the first quarter of 2020, but to drop to 1.2 per cent in the second quarter – thanks in part to the announced cut in the Ofgem energy price cap for April 2020. It is then expected to rise to reach the 2 per cent target by the end of 2021 – aided by the fiscal expansion pushing output above potential.

1.24 The future is, of course, uncertain. One way to illustrate the uncertainty around our GDP growth forecast is shown in Chart 1.2. This presents our central forecast together with a fan showing the probability of different outcomes based on past errors in official forecasts. The solid black line shows our median forecast, with successive pairs of lighter shaded areas around it representing 20 per cent probability bands. It implies a roughly one-in-ten chance of the economy shrinking in calendar year 2020 and a similar probability of growth exceeding 2.5 per cent – closer to the average pre-crisis growth rate.

1.25 But these probabilities do *not* reflect our subjective assessment of the risks facing the UK economy today. Historically, the chance of the economy falling into recession at some point in a five-year period is roughly one-in-two. But a recession this year is quite possible if the spread of coronavirus causes widespread economic disruption.

Chart 1.2: Real GDP growth fan chart



Source: ONS, OBR

Table 1.1: Overview of the economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2018	2019	2020	2021	2022	2023	2024
Output at constant market prices							
Gross domestic product (GDP)	1.3	1.4	1.1	1.8	1.5	1.3	1.4
GDP per capita	0.7	0.8	0.5	1.3	1.1	0.9	1.1
GDP levels (2018=100)	100.0	101.4	102.5	104.3	105.8	107.1	108.6
Output gap	0.2	0.1	-0.1	0.4	0.4	0.2	0.0
Expenditure components of real GDP							
Household consumption	1.6	1.3	1.1	1.2	1.2	1.4	1.4
General government consumption	0.4	3.6	3.7	2.8	2.1	1.9	2.2
Business investment	-1.5	0.3	0.0	1.8	3.0	2.4	2.3
General government investment	1.3	2.1	1.9	10.9	4.6	1.8	1.2
Net trade[1]	-0.2	0.0	-0.1	-0.3	-0.2	-0.4	-0.3
Inflation							
CPI	2.5	1.8	1.4	1.8	2.1	2.1	2.0
Labour market							
Employment (millions)	32.4	32.8	33.0	33.1	33.2	33.3	33.4
Average earnings	3.3	2.8	3.3	3.6	3.4	3.1	3.1
LFS unemployment (rate, per cent)	4.1	3.8	3.8	3.8	3.9	4.0	4.1

The fiscal outlook

1.26 Public sector net borrowing fell from a high of £158.3 billion (10.2 per cent of GDP) in 2009-10 to £38.4 billion (1.8 per cent) by 2018-19. In our restated March 2019 forecast, we expected it to rise in 2019-20, but then shrink to £33.3 billion by 2023-24. But, thanks to the fiscal loosening in the Budget, we now expect it to hit a six-year high of £66.7 billion in 2021-22 and to remain at £57.9 billion (2.2 per cent of GDP) in 2024-25.

Table 1.2: Overview of the fiscal forecast

	Per cent of GDP, unless otherwise stated						
	Outturn	Forecast					
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Revenue and spending							
Public sector current receipts	37.5	37.7	37.9	38.0	38.3	38.4	38.5
Total managed expenditure	39.3	39.8	40.3	40.8	40.8	40.8	40.7
Budget 2020 fiscal targets							
Current budget deficit	-0.3	-0.1	-0.2	-0.1	-0.5	-0.7	-0.8
Public sector net investment	2.0	2.2	2.6	2.9	3.0	3.0	3.0
Debt-interest-to-revenue ratio (per cent)	4.1	3.8	3.3	3.5	3.3	3.1	2.9
Legislated fiscal target and objective							
Public sector net borrowing	1.8	2.1	2.4	2.8	2.5	2.4	2.2
Cyclically adjusted net borrowing	1.9	2.2	2.4	3.0	2.7	2.5	2.2
Public sector net debt	80.6	79.5	77.4	75.0	75.4	75.6	75.2
	£ billion						
Revenue and spending							
Public sector current receipts	812.9	839.3	872.9	910.8	949.2	984.7	1022.3
Total managed expenditure	851.3	886.8	927.7	977.4	1010.7	1044.9	1080.2
Budget 2020 fiscal targets							
Current budget deficit	-5.8	-1.7	-4.9	-2.7	-11.7	-16.7	-21.2
Public sector net investment	44.3	49.1	59.7	69.3	73.2	77.0	79.1
Legislated fiscal target and objective							
Public sector net borrowing	38.4	47.4	54.8	66.7	61.5	60.2	57.9
Cyclically adjusted net borrowing	41.4	48.2	55.3	71.8	68.1	63.9	58.7
Public sector net debt	1774	1799	1818	1827	1900	1969	2031

Public sector net borrowing

1.27 Borrowing has been revised up since March 2019 by an average of 0.8 per cent of GDP. The revision is exceeded only by those in our November 2011 and November 2016 forecasts, both occasions when we revised the outlook for potential GDP growth significantly lower. (Indeed, taking December's statistical restatement and this forecast together, the overall revision since March 2019 is the largest we have ever made.) In contrast to previous large upward revisions to borrowing, the underlying outlook is only modestly worse. The average upward revision to the pre-measures deficit is just 0.1 per cent of GDP, while the bulk of the revision reflects the impact of the Government's policy decisions.

1.28 Between 2020-21 and 2023-24, borrowing on a pre-measures basis has been revised up by an average of £3.1 billion a year. This reflects several factors:

- Total **receipts** have been revised down by £3.0 billion a year on average, despite an upward revision of £4.9 billion in 2019-20 (much of which reflects one-off factors). The deterioration is more than explained by changes in our economy forecast, in particular the weaker outlook for earnings growth and household spending.

- **Debt interest spending** has been revised down by £7.4 billion a year on average. This reflects lower Bank Rate expectations (which lower spending almost immediately), lower gilt yields (the effect of which builds up as more new debt is issued) and lower RPI inflation (which reduces spending in all years, but by decreasing amounts).

- **Other current spending** has been revised up by £2.8 billion a year on average, mostly in the near term. Roughly two-thirds of this reflects higher spending on R&D tax credits, following large increases in use of the small firms' element in recent years. Welfare spending has also been revised up, in particular on incapacity benefits.

- **Public sector net investment** has been revised up by £4.6 billion thanks largely to higher local authorities' capital spending and higher capital transfers associated with new student loans. This more than explains the upward revisions to borrowing.

1.29 Government decisions increase borrowing by progressively larger amounts, reaching £29.1 billion (1.1 per cent of GDP) in 2024-25. This includes both the direct impact of Budget tax and spending measures and the indirect effect of those measures, plus the migration and NLW announcements, on the economy. The direct impact arises from:

- Large increases in **current departmental spending** (RDEL) that rise from £15.2 billion in 2020-21 to £38.9 in 2024-25 (reflecting higher plans and our assumptions about underspending relative to them).

- The removal of the 'DEL in waiting' that we included in our previous post-referendum forecasts, having assumed that **direct fiscal savings from Brexit** (i.e. contributions not paid plus customs duties retained) would be fully recycled into higher UK spending. As that has now happened, removing the 'DEL in waiting' assumption lowers current spending by £4.3 billion in 2020-21 rising to £14.6 billion in 2024-25, with the rising profile reflecting the declining cost of the divorce bill over those years.

- **Other spending measures** (both on and off the Treasury's scorecard) raise borrowing by £1.7 billion a year on average. This is more than explained by the Government's decision to raise the spending envelope of the Scottish Government by £4.9 billion a year on average between 2021-22 and 2024-25 (in line with higher DEL).

- **Receipts measures** (both on and off the scorecard) reduce borrowing by an average of £6.4 billion a year. This is fully explained by the decision to cancel the April 2020 cut in the main rate of corporation tax from 19 to 17 per cent, which raises £6.4 billion a

year on average. Raising the National Insurance 'primary threshold' to £9,500 in 2020-21 costs £2.3 billion a year on average, while restricting eligibility for 'red diesel' raises £1.8 billion a year from 2022-23 onwards.

- Significant increases in **departmental capital spending** (CDEL) that rise from £5.7 billion in 2020-21 to £16.7 billion in 2024-25. These amounts would have been higher still had we not assumed that 20 per cent of the increase in capital spending announced by the Treasury will go unspent – reflecting past difficulties governments have faced in ramping up capital spending quickly.

1.30 The indirect effects of the Government's decisions reduce borrowing across the forecast:

- Indirect effects of Budget **tax and spending measures** reduce borrowing by £7.2 billion a year on average. The significant overall easing in fiscal policy delivers a cyclical boost to the economy that lifts tax receipts via higher incomes and consumer spending in particular. Its temporary effect on inflation leads to permanently higher nominal GDP and tax bases. The boost to receipts therefore peaks at £11.5 billion in 2022-23, but remains at £8.9 billion in 2024-25. Higher departmental spending lifts public service pension contributions, reducing the net cost of these schemes (in the medium term). Conversely, the higher borrowing, higher interest rates and temporarily higher RPI inflation combine to raise debt interest spending.

- Raising the **National Living Wage** to reach two-thirds of median earnings by October 2024 reduces borrowing by £1.2 billion in 2024-25. This includes the boost to income tax and NICs receipts and the reduction in welfare spending from higher pay (outweighing the depressing impact of slightly lower employment). These effects are partly offset by the effect of lower profits on corporation tax receipts and modestly higher inflation on debt interest spending.

- The new **migration regime** raises borrowing by amounts rising to £1.0 billion in 2024-25. We have assumed that the new regime will leave the population in that year 0.4 smaller than it would otherwise have been. But this will be concentrated among those who would have been lower paid, so the effect on nominal GDP is smaller at 0.3 per cent. This reduces tax receipts in 2024-25 by £1.5 billion, but also reduces welfare spending by £0.5 billion.

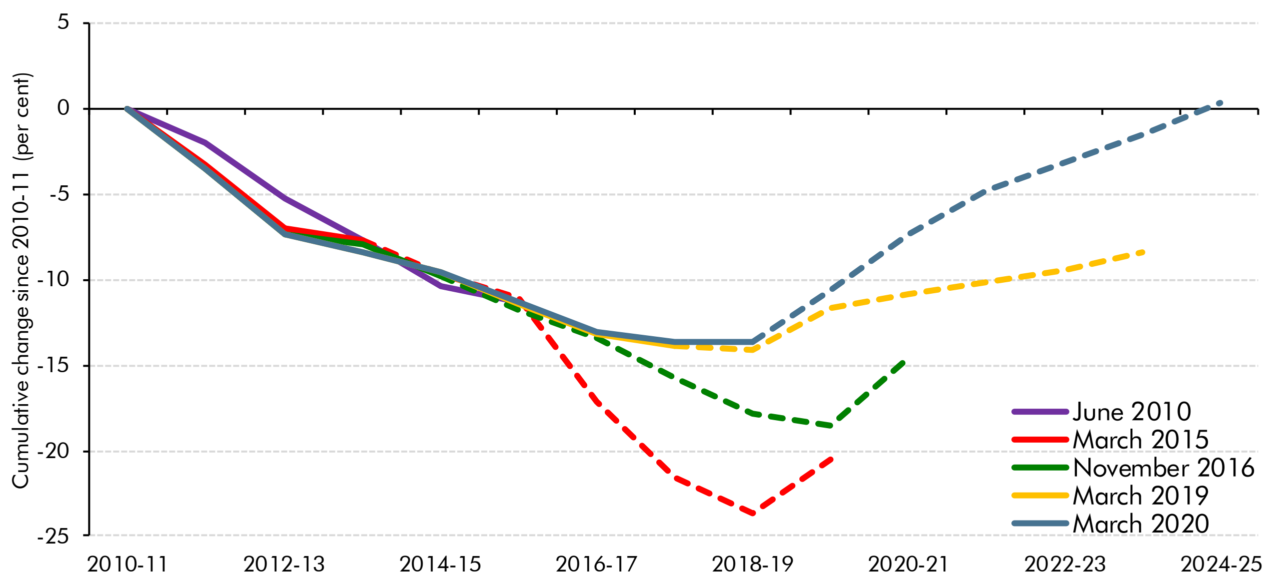
Table 1.3: Changes to public sector net borrowing

	£ billion						
	Outturn	Forecast					
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Restated March 2019 forecast	41.0	47.6	40.2	37.6	35.4	33.3	
March 2020 forecast	38.4	47.4	54.8	66.7	61.5	60.2	57.9
Change	**-2.5**	**-0.2**	**14.6**	**29.1**	**26.0**	**26.9**	
Underlying revisions	**-2.5**	**0.4**	**2.3**	**5.1**	**3.6**	**1.5**	
of which:							
Receipts[1]	-3.3	-4.9	1.0	3.5	4.1	3.5	
Debt interest	0.5	-2.0	-6.7	-6.6	-7.7	-8.5	
Other spending[1]	0.3	7.3	7.9	8.2	7.1	6.5	
Total effect of Government decisions[2]		**-0.6**	**12.3**	**24.0**	**22.5**	**25.4**	**29.1**
of which:							
Current departmental spending[2]		2.9	15.2	27.0	31.2	34.9	38.9
Capital departmental spending[2]		-0.5	5.7	13.4	15.4	16.1	16.7
Use of direct Brexit fiscal savings		0.0	-4.3	-5.0	-7.1	-11.3	-14.6
Receipts measures[3]		-1.0	-2.0	-4.6	-8.0	-8.6	-8.5
Other spending measures[3]		-2.1	1.1	0.3	0.7	2.6	3.9
Indirect effects of Government decisions		0.0	-3.3	-7.1	-9.7	-8.4	-7.2
of which:							
Due to tax and spending measures		0.0	-3.4	-7.2	-9.7	-8.3	-7.0
Raising the National Living Wage		0.0	0.0	-0.3	-0.6	-0.9	-1.2
New migration regime		0.0	0.0	0.3	0.5	0.8	1.0
Memo: March 2020 pre-measures forecast	*38.4*	*48.1*	*42.5*	*42.7*	*39.0*	*34.9*	*28.8*

[1] Excludes the impact of customs duties switch, which raises receipts and current spending by the same amount.
[2] The change in 2024-25 is relative to a baseline that assumes DEL would otherwise have remained constant as a share of GDP.
[3] Includes both scorecard and non-scorecard measures. See Annex A for more information.
Note: this table uses the convention that a negative figure means a reduction in PSNB. i.e. an increase in receipts or a reduction in spending will have a negative effect on PSNB.

1.31 Chart 1.3 shows the striking turnaround in the path of resource spending by central government departments across the UK set out in this Budget. Viewed in terms of real spending per person, the eight years of cuts from 2010-11 are entirely reversed by 2024-25, with almost half reversed just this year and next. The increased resource spending announced in this Budget, in last year's Spending Round and in the NHS settlement of June 2018, continue the reversal of the spending tide that started in the Summer Budget of July 2015, when the newly elected Conservative Government moderated the sharp cuts in RDEL spending previously pencilled into the March 2015 pre-election Budget. But, viewed as a share of GDP, only around a third of the cuts will have been reversed by 2024-25.

Chart 1.3: Change in real RDEL spending per person since 2010-11



Note: 2017-18 and 2018-19 exclude the effects of business rates pilots. All other figures include both RDEL and Scottish Government current AME and are adjusted as far as possible for consistency with the latest forecast. See source table in the supplementary expenditure tables on our website.
Source: OBR

1.32 Overall the impact of the Government's policy decisions on borrowing is around half as large again as the previous largest policy loosening over the past decade (in Budget 2018). The only time fiscal policy has been changed by a larger margin in our forecasts was the 1.4 per cent of GDP average fiscal tightening in the Coalition Government's first Budget in June 2010, when it set out its plans to reduce the post-crisis budget deficit it had inherited.

1.33 Looking back further, this is the largest planned sustained giveaway at any fiscal event since Norman Lamont's ill-fated pre-election Budget in 1992. The loosening is similar in shape and modestly larger in scale to that in Gordon Brown's 2000 Budget, which – like this one – was dominated by public spending increases. These were predicated on the continuation of strong tax receipts, but were then undermined when the dotcom bubble burst.

Public sector net debt

1.34 Public sector net debt (PSND) is now essentially flat at around 75 per cent of GDP in the later years of the forecast (after falling in the initial years as the Bank of England's Term Funding Scheme (TFS) loans are repaid). This contrasts with our March 2019 forecast, when it fell in every year of the forecast – with or without the effect of TFS loans being repaid.

1.35 Higher nominal GDP reduces PSND relative to GDP in all years of the forecast, on average by 1.1 percentage points. Underlying forecast revisions also reduce cash debt in all years, though by decreasing amounts across the forecast. But government policy decisions add progressively more to debt, reaching £125 billion in 2024-25.

1.36 As regards underlying forecast revisions, cumulative borrowing raises cash debt modestly by 2023-24, while a weaker pound against the dollar raised the sterling value of the foreign currency reserves by a broadly offsetting amount. The early repayment of TFS loans reduces debt in the early years of the forecast, but that effect unwinds by 2021-22 once they have all been repaid.

1.37 As regards Government decisions:

- The direct effects of the Budget package on **public sector net borrowing** add progressively more to debt over the period, reaching £148 billion in 2024-25.
- **Delays and cancellations to asset sales** also add steadily to debt. Delaying the sale of UKAR and RBS assets increases debt at the start of the period, but this largely unwinds over the forecast. The cancellation of student loans sales raises our debt forecast by increasing amounts due to the proceeds foregone. This accounts for the majority of the £12 billion upward revision to debt from financial transactions in 2024-25.
- The **wider effects of policy measures on the economy** – including the temporary effects of the Budget package and the persistent ones of the new migration regime and higher path for the NLW – reduce debt by £36 billion in 2024-25.

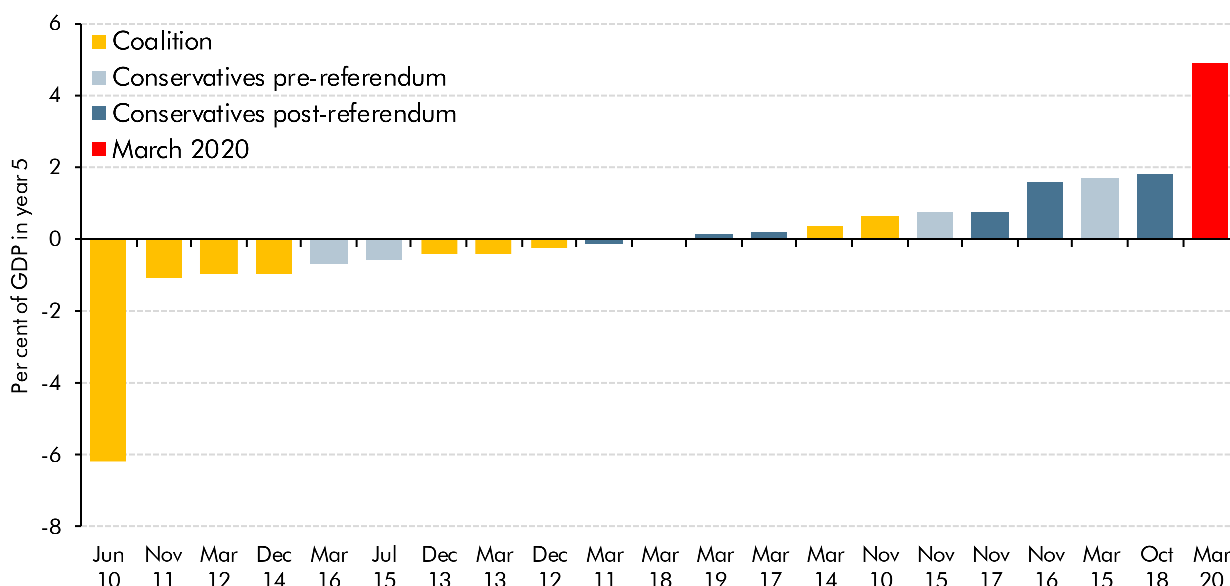
Table 1.4: Changes to public sector net debt since March 2019

	Per cent of GDP						
	Outturn	Forecast					
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Restated March 2019 forecast	82.2	81.3	78.2	74.3	73.6	72.7	
March 2020 forecast	80.6	79.5	77.4	75.0	75.4	75.6	75.2
Like-for-like change	**-1.5**	**-1.8**	**-0.8**	**0.7**	**1.9**	**2.9**	
of which:							
Change in nominal GDP[1]	-1.3	-1.0	-1.1	-1.2	-1.0	-0.9	
Change in cash level of net debt	-0.3	-0.8	0.4	1.9	2.9	3.8	
	£ billion						
Restated March 2019 forecast	1,779	1,817	1,810	1,781	1,827	1,870	
March 2020 forecast	1,774	1,799	1,818	1,827	1,900	1,969	2,031
Like-for-like change in cash debt	**-6**	**-18**	**8**	**46**	**73**	**99**	
of which:							
Underlying forecast revisions	**-6**	**-29**	**-20**	**-7**	**-5**	**-3**	
Public sector net borrowing (pre-measures)	-3	-2	0	5	9	10	
Financial transactions (pre-measures)	-4	-17	-7	0	0	1	
Valuation changes	1	-10	-13	-12	-14	-15	
Effect of Government decisions		**11**	**28**	**54**	**78**	**102**	**125**
Affecting public sector net borrowing		-1	15	46	78	112	148
Affecting financial transactions		13	11	12	16	17	12
Indirect effects		-1	3	-5	-16	-27	-36

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

1.38 The cumulative impact on debt at our forecast horizon of the additional borrowing announced in the Budget is the largest since June 2010, when the Coalition Government's first Budget was expected to reduce debt by 6 per cent of GDP (Chart 1.4). Subsequent fiscal events typically saw much smaller policy packages. Since the 2015 election, successive Conservative Government policy packages have added to debt at the forecast horizon.

Chart 1.4: Cumulative impact of policy on PSND over five years



Note: Does not include the final year of the forecast if it was not included in the previous forecast. Therefore the impact of March 2020 Government decisions is the cumulative impact on 2023-24.
Source: OBR

Performance against the Government's fiscal targets

1.39 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 latest version was approved by Parliament in January 2017.

1.40 The legislated targets in the *Charter* related to the cyclically adjusted deficit and public sector net debt in 2020-21 (a 2 per cent of GDP limit and for it to be falling as a share of GDP respectively), plus a welfare cap that applies in 2022-23 and an objective to balance the budget by the mid-2020s. The Government has not published a new draft *Charter*, but has instead asked us to assess its performance against new fiscal targets that were set out in the Conservative Party manifesto and confirmed in the Queen's Speech. It intends to review the fiscal framework ahead of the next Budget this autumn, so the rules may change again.

1.41 Relative to the legislated targets, the rules adopted for this Budget are materially looser. They require the current budget to be in balance by the third year of the forecast (2022-23 in this one) and public sector net investment (PSNI) not to exceed 3 per cent of GDP. This puts a ceiling of 3 per cent of GDP on the deficit and affords 1 per cent of GDP more space than the legislated deficit rule (£22.3 billion in today's terms) and 3 per cent of GDP more than the legislated fiscal objective (£66.9 billion). A new debt-interest-to-revenue ratio rule requires net interest costs to be less than 6 per cent of non-interest receipts.

1.42 The Conservative manifesto stated that the pursuit of these targets "*means that debt will be lower at the end of the Parliament*". But observing these rules does not mean that debt will always fall relative to GDP. As well as borrowing, the path of debt depends on two other factors: the net cost of financial transactions (which are not covered by the rules) and the rate of nominal GDP growth (over which inflation-targeting governments have little control). Given our medium-term expectations for these variables, the maximum deficit consistent with a stable debt-to-GDP ratio is around 2.5 per cent of GDP. So the Chancellor would need to over-achieve his new rules on average to ensure that debt falls in normal times.

The implications of our central forecast

Performance against Budget 2020 fiscal targets

1.43 Our forecast implies that the Government's Budget 2020 targets are on course to be met:

- **Current balance rule**: the current budget is forecast to be in surplus in 2022-23 by 0.5 per cent of GDP (£11.7 billion). Based on historical forecast errors, this implies a 60 per cent chance of meeting the target. But given the coronavirus outbreak and the likely policy response to it, the odds are likely to be worse than that.

- **Maximum investment rule**: public sector net investment averages 2.9 per cent of GDP between 2020-21 and 2024-25, observing the limit. It is precisely 3.0 per cent of GDP between 2022-23 and 2024-25. Unusually, one risk to this target is that the Government is more successful than we have assumed in spending all that it plans to. We have assumed that 20 per cent of its additional capital plans will go unspent.

- **Debt-interest-to-revenue ratio rule**: net interest payments are forecast to fall in cash terms over the next five years, so with receipts rising steadily the debt-interest-to-revenue ratio falls from 3.8 per cent in 2019-20 to 2.9 per cent in 2024-25 – meeting the rule by a comfortable margin.

Performance against the legislated targets

1.44 As regards the legislated targets that formally remain in force:

- **Fiscal mandate**: the structural deficit is 2.4 per cent of GDP in 2020-21, so the mandate is missed by 0.4 per cent of GDP (£9.2 billion). In our March 2019 forecast it was met by 1.2 per cent of GDP (£26.6 billion), although statistical changes meant that margin was a smaller 0.3 per cent (£7.6 billion) in our restated forecast.

- **Supplementary target**: debt falls by 2.1 per cent of GDP in 2020-21, meeting the target, but by a smaller margin than the 3.2 per cent of GDP in March 2019. The margin is now little above the 1.9 per cent of GDP reduction in debt due to Term Funding Scheme loans being repaid to the Bank of England in that year.

- **Welfare cap**: the relevant welfare spending is forecast to be £0.5 billion higher than the cap in 2022-23 but £3.4 billion below the cap-plus-margin once the adjustments for changes in our inflation forecast and devolved welfare spending have been applied. On that basis, our formal assessment is that the terms of the cap are met.

1.45 These assessments are all subject to uncertainty. In every forecast we test the robustness of our judgements in three ways: by looking at past forecast errors; by conducting sensitivity analyses; and by exploring alternative scenarios. These are reported in Chapter 4. In this forecast, the uncertain economic and fiscal consequences of the coronavirus outbreak present a clear downside risk. The legislated targets are particularly vulnerable since they apply in 2020-21. The risks to performance against the new targets are more uncertain.