



HM Treasury

2016-17 Convergence Programme for the United Kingdom:

submitted in line with the Stability
and Growth pact



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Growth pact

April 2017



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Foreword

The UK economy showed considerable momentum in the run up to the EU referendum, and has shown significant resilience since. The British people's decision to leave the EU presents new opportunities, but also new challenges. The economy will need to adjust to new relationships with the EU and the rest of the world.

Continuing the trend of robust economic growth across much of the year, UK real GDP grew by 0.7% in the final quarter of 2016. GDP grew by 1.8% over the year as a whole, and employment reached a new record high. The Office for Budget Responsibility (OBR) forecasts GDP growth of 2.0% in 2017, 1.6% in 2018, and then 1.7% in 2019, 1.9% in 2020 and 2.0% in 2021.

Household and business spending have been stronger to date than was forecast in November's Autumn Statement. The fall in sterling over the course of 2016 is expected to push inflation to 2.4% in 2017 and 2.3% in 2018, before falling back to 2.0% in 2019. As a result, the OBR expects the pace of consumer spending to slow. It also forecasts private investment to remain subdued.

However, in the near term, rising inflation, largely caused by the sterling depreciation, is expected to weigh on household consumption growth. The OBR also continues to judge that business investment will be constrained due to economic uncertainty over the next few years. These effects combine to give a shallower, but slightly longer period of slower growth. Over the medium term, the OBR has not materially changed its main judgements about the economic outlook and its expectation for potential output growth over the next five years is therefore unchanged.

The government remains committed to returning the public finances to balance at the earliest possible date. In light of the changed economic circumstances that date will be in the next Parliament. To support this objective, the government published a revised Charter for Budget Responsibility in Autumn Statement 2016.

The government is on course to reduce its Treaty deficit below 3% of GDP in 2016-17. Stronger economic activity in the near term, timing effects and other one-off factors significantly reduce borrowing in 2016-17 relative to forecasts at Autumn Statement 2016, though the medium-term outlook for the public finances is essentially unchanged from November.

To achieve this, and to ensure the UK lives within its means, the government will maintain discipline on public spending. This responsible approach to setting fiscal policy improves the sustainability of the public finances and provides certainty and security to businesses and households.

1 Introduction

1.1 The Stability and Growth Pact (SGP) requires member states to provide information on economic developments in their country for the purposes of the multilateral surveillance procedure under Articles 121 and 126 of the EU Treaty. Member states submit either annual Stability Programmes (euro area countries) or annual Convergence Programmes (non euro area countries) setting out their medium-term fiscal policies.

1.2 The UK is not a member of the single currency and cannot face sanctions under the EU's SGP. The UK's obligation under the SGP is to "endeavour to avoid an excessive government deficit" as a result of its Protocol to the EU Treaties (Protocol 15). The Convergence Programme sets out the UK's medium-term fiscal policies.

1.3 Major fiscal events since the last Convergence Programme have been Autumn Statement 2016 and Spring Budget 2017. This Convergence Programme draws on those publications, particularly Spring Budget 2017.

1.4 The forecasts for the economy and public finances included in the UK's Convergence Programme are prepared by the independent Office for Budget Responsibility (OBR), information on which is set out in Chapter 5. The forecasts set out in the Convergence Programme are from the OBR's March 2017 Economic and fiscal outlook, which was published alongside Budget 2017.

1.5 Under Section 5 of the European Communities (Amendment) Act 1993, Parliament is required to approve the government's assessment of the UK's medium-term economic and budgetary position. This forms the basis of the UK's Convergence Programme. The UK presents copies of assessments of its Convergence Programme to Parliament.

Structure of the Convergence Programme

1.6 The first five chapters of this Convergence Programme set out the government's policy on the fiscal position, sustainability of the public finances and the macro-economy, as required by the Stability and Growth Pact Code of Conduct.

1.7 Detail on the OBR's economic and fiscal forecasts is set out separately in Annex A of the Convergence Programme, drawing upon the OBR's March 2017 'Economic and fiscal outlook' and 2017 'Fiscal sustainability report'.

1.8 Annex B provides details of the financial impact of Autumn Statement 2016, and Budget 2017 policy decisions. The government has decided not to proceed with the class 4 National Insurance Contributions measures set out in the Spring Budget. The government will set out in the Autumn Budget further measures to fund, in full, this decision. Annex C provides supplementary data.

2 Overall policy framework and objectives

2.1 This section contains chapters 1, 3, 4 and 5 of Spring Budget 2017.

2.2 The government has decided not to proceed with the class 4 National Insurance Contributions measures set out in the Spring Budget. The government will set out in the Autumn Budget further measures to fund, in full, this decision.

1

Economy and public finances

Economic context

1.1 Data released since Autumn Statement 2016 have provided further evidence of the fundamental strength and resilience of the UK economy.¹ Real Gross Domestic Product (GDP) is now 8.6% larger than its pre-financial crisis peak in early 2008, and employment is at a record high. It is from this position of strength that the UK enters into a period of negotiation with its European partners.

1.2 The Office for Budget Responsibility (OBR) judges that, in large part, the outlook for the UK economy has not changed since Autumn Statement 2016. The forecast for the level of GDP at the end of 2021 is broadly unchanged, although the expected path of growth has been revised slightly. The OBR continues to judge that growth will moderate during 2017, largely due to a slowdown in consumer demand growth as rising inflation, resulting from sterling's depreciation, weighs on real incomes. Business investment is also expected to remain subdued due to economic uncertainty as the UK negotiates its departure from the EU. The OBR has not revised its judgement of the medium-term effect of leaving the EU on the UK economy.

UK economy

Growth

1.3 The Office for National Statistics (ONS) estimates that the economy grew 1.8% in real terms in 2016, second only to Germany among major advanced economies. Growth remained robust in the second half of the year, at 0.6% in Q3 and 0.7% in Q4 2016, stronger than the OBR anticipated at Autumn Statement 2016. On a per capita basis, UK GDP increased 1.1% in 2016.

1.4 All major sectors of the economy made a positive contribution to growth in 2016, with services output increasing 2.9%, construction 1.5% and production 1.2%. Private business surveys suggest that all sectors have continued to expand in the early months of 2017.

1.5 Household consumption accounted for 65% of GDP in 2016 and growth has remained strong, increasing to 3.0% last year. Consumer confidence is near its long-run average and borrowing costs are low, which appear to have supported consumer spending.

1.6 While consumption growth has been robust in recent years, this has not been accompanied by a sharp increase in debt. Total household debt as a proportion of disposable income in Q3 2016 was 10% below the peak reached in Q1 2008. Within this unsecured debt as a proportion of disposable income rose over the year to Q3 2016, but remained 8% below the peak reached in Q1 2007. Consumer credit funded less than a tenth of the growth in consumption over 2016. Household saving as a proportion of disposable income declined gradually over the two years to Q2 2016, before falling more sharply to 5.6% in Q3 2016.

¹ Details of the sources of all numerical references, including National Statistics, used in this section, can be found in 'Spring Budget 2017 data sources'.

1.7 Business investment fell 1.0% in Q4 2016, following a modest increase of 0.7% in Q3 2016. This resulted in a 1.5% decline in business investment in 2016. Private business surveys cited uncertainty about future demand and the outcome of the EU negotiations as weighing on activity and investment.

1.8 The UK has run a deficit on trade in goods and services for almost twenty years. This continued in 2016, and at 1.9% of GDP was in line with its average since 2010. Within this, the trade in goods deficit widened to 7.0% of GDP, but was partially offset by a larger surplus of 5.1% of GDP on trade in services. A range of private business surveys report that export orders are increasing due to increases in global demand as well as the fall in the value of sterling since mid-2016.

1.9 The current account deficit remains large by international and historical standards, widening to 4.9% of GDP in the first three quarters of 2016. The primary income balance has driven the larger current account deficit in recent years, due to the relatively lower return on assets held overseas by UK investors, and this deficit remained high at 1.6% of GDP in the first three quarters of 2016.

Prices

1.10 Inflation has risen in recent months, with the 12-month increase in the Consumer Prices Index (CPI) reaching 1.8% in January 2017. This has been driven by global oil price rises, amplified by the post-referendum depreciation of sterling, which have led to increases in the contribution of the transport component of CPI inflation. Past decreases in food and fuel prices have dropped out of the annual comparison, further pushing up on inflation. Services inflation has been broadly stable over the last year and remains below its long-run average.

Labour market

1.11 The labour market has remained robust in recent months. The employment rate reached a new record high of 74.6% in the three months to December 2016, while the unemployment rate was 4.8%, the lowest in 11 years. The increase in employment over the past year was primarily driven by a rise in full-time employment, which accounted for 72% of employment growth in 2016.

1.12 UK labour productivity growth was subdued in 2016, continuing to reflect the trends observed in most advanced economies since the financial crisis. Output per hour increased 0.4% in Q4 2016, in line with the average quarterly growth across the year as a whole. Raising productivity growth sustainably remains the central long-term economic challenge facing the UK.

1.13 Earnings growth has been stable in recent months. Both total pay and regular pay (excluding bonuses) rose 2.6% in the three months to December 2016 compared with the same period a year earlier.

1.14 Real household disposable income (RHDI) per head rose sharply from the end of 2014, and in 2015 recorded its fastest annual growth in 14 years. RHDI per head rose further in the first half of 2016, reaching its highest ever level, and remained close to this level in Q3 2016 as the pick-up in inflation constrained further real income growth.

Global economy

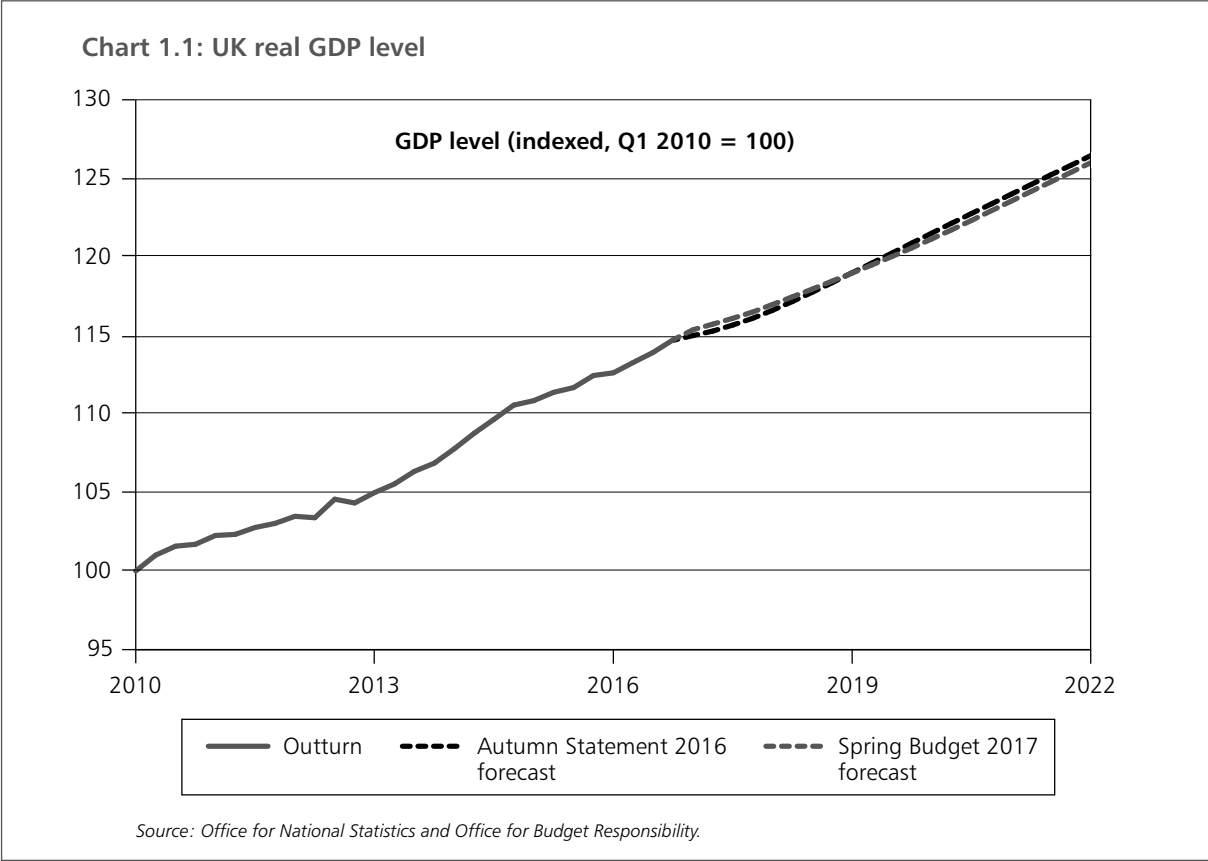
1.15 The UK has always been an outward-facing trading nation. A strong global economy, with robust activity in the UK's major trading partners, would benefit the economy as the UK builds on this reputation and forges new relationships with the EU and trading partners worldwide.

1.16 Global growth remained broadly stable in the second half of 2016, although performance has varied across economies. Momentum has been sustained in advanced economies: euro area growth, which has picked up in recent years, remained steady in the second half of the year, to give annual growth of 1.7%; US activity rebounded after a slower start to last year, with annual growth of 1.6%. Performance in emerging economies was mixed: the Chinese and Indian economies grew 6.7% and 6.6% respectively in 2016, while the Brazilian and Russian economies both contracted.

1.17 The International Monetary Fund forecasts that global growth will increase slightly to 3.4% in 2017. It judges that the outlook has improved in advanced economies, where growth in the second half of 2016 exceeded its earlier forecasts, while growth prospects have marginally worsened in emerging economies. Uncertainty around the global outlook is heightened at present, associated, among other things, with policy and political risks.

Economic outlook

1.18 The OBR’s Spring Budget 2017 forecast for the level of GDP at the end of 2021 is broadly unchanged from Autumn Statement 2016, although the expected profile of growth has been revised. The OBR now forecasts stronger GDP growth in 2017 than previously expected, as a result of stronger economic data over the past few months; in particular, consumption growth has been stronger than anticipated. However, in the near term, rising inflation, largely caused by the post-referendum sterling depreciation, is expected to weigh on household consumption growth. The OBR also continues to judge that business investment will be constrained due to economic uncertainty over the next few years. These effects combine to give a shallower, but slightly longer period of slower growth. Over the medium term, the OBR has not materially changed its main judgements about the economic outlook and its expectation for potential output growth over the next five years is therefore unchanged.



1.19 In the longer term, the economy will adjust to new relationships with the EU and the rest of the world. In producing the forecast, the OBR has not attempted to predict the precise outcome of negotiations, nor the breadth and depth of new relationships that may be negotiated bilaterally with the EU or other trading partners. Instead, its assumptions on the effects of leaving the EU on trade, unchanged from those which underpinned the Autumn Statement 2016 forecast, are in line with a range of external studies. The OBR notes that there is a higher than usual degree of uncertainty in this forecast.

Table 1.1: Summary of the OBR's central economic forecast¹ (Percentage change on a year earlier, unless otherwise stated)

	2015	2016	Forecast				
			2017	2018	2019	2020	2021
GDP	2.2	1.8	2.0	1.6	1.7	1.9	2.0
GDP per capita	1.4	1.1	1.3	0.9	1.1	1.2	1.4
Main components of GDP							
Household consumption ²	2.4	3.0	1.8	0.9	1.7	1.7	1.9
General government consumption	1.3	0.8	1.2	0.7	0.4	0.9	1.3
Fixed investment	3.4	0.5	0.8	3.0	3.3	3.9	3.4
Business	5.1	-1.5	-0.1	3.7	4.2	3.9	3.6
General government	-2.6	1.4	0.1	1.2	2.1	6.1	3.8
Private dwellings ³	3.0	4.8	2.5	2.9	2.4	2.9	3.0
Change in inventories ⁴	-0.2	-0.5	0.0	0.0	0.0	0.0	0.0
Net trade ⁴	0.0	-0.4	0.3	0.3	0.0	-0.1	-0.1
CPI inflation	0.0	0.7	2.4	2.3	2.0	2.0	2.0
Employment (millions)	31.3	31.7	31.9	32.1	32.2	32.3	32.5
LFS unemployment (% rate)⁵	5.4	4.9	4.9	5.1	5.2	5.2	5.1
Productivity per hour	0.8	0.5	1.6	1.5	1.7	1.8	1.9

¹ All figures in this table are rounded to the nearest decimal place. This is not intended to convey a degree of unwarranted accuracy. Components may not sum to total due to rounding and the statistical discrepancy.

² Includes households and non-profit institutions serving households.

³ Includes transfer costs of non-produced assets.

⁴ Contribution to GDP growth, percentage points.

⁵ Labour Force Survey.

Source: Office for National Statistics and Office for Budget Responsibility.

Growth

1.20 With higher than expected growth in Q4 2016 and stronger near-term momentum in the economy, the OBR has revised up its forecast for GDP growth in 2017 by 0.6 percentage points to 2.0%. Thereafter there is a shallower slowdown and a more gradual recovery, with growth revised down to 1.6% in 2018, 1.7% in 2019, and 1.9% in 2020, followed by an unchanged forecast of 2.0% growth in 2021.

1.21 The upward revision to 2017 GDP growth is due in large part to an increase in the expected path of household consumption, which was stronger than anticipated in recent months. However, consumption growth is expected to slow over the year, as the post-referendum sterling depreciation puts upward pressure on inflation, restraining real income growth, and household saving stabilises. The OBR forecasts consumption growth of 1.8% in 2017 and 0.9% in 2018 before increasing to between 1.7% and 1.9% growth for the remainder of the forecast period.

1.22 The OBR expects a further reduction in the saving ratio to support consumer spending in the near term, as rising inflation weighs on household budgets, before it stabilises during 2017. The OBR forecasts household saving of 4.6% of disposable income in 2017, followed by gradual increases to 5.2% in 2018, 5.4% in 2019, 5.8% in 2020 and 5.9% in 2021.

1.23 Household debt as a proportion of income is forecast to remain below pre-financial crisis levels, but to increase gradually over the forecast period, reaching 153% in 2021. This is higher than at Autumn Statement 2016, due to a small upward revision to the stock of household debt and a downward revision to household disposable income. Average house prices are forecast to increase at an average annual rate of 4.8%; this contributes to expected increases in household net wealth, which is forecast to reach 879% of household income in 2021.

1.24 Small upward revisions to the OBR's near-term forecast for business investment, based on stronger than expected growth in Q3 2016, also contribute to the improved outlook for GDP growth in 2017. The OBR now judges that the effect of uncertainty on investment will be less severe but more drawn out than previously assumed, leading to downward revisions to investment growth in the later years of the forecast. The OBR forecasts a 0.1% fall in business investment in 2017, before uncertainty begins to dissipate and business investment starts to recover, picking up to 3.7% in 2018, 4.2% in 2019, 3.9% in 2020 and 3.6% in 2021.

1.25 Net trade is forecast to make a positive contribution of 0.3 percentage points to GDP growth in 2017 and 2018, as the post-referendum sterling depreciation is expected to support exports and reduce imports in the short term. Thereafter, the trade forecast is broadly unchanged from Autumn Statement 2016, as the OBR has not revised its judgement, based on a range of external studies, of the effect of leaving the EU on UK trade.

1.26 The OBR forecasts that the current account deficit will narrow, to 3.5% of GDP in 2017, 3.2% of GDP in 2018, 2.6% of GDP in 2019, 2.2% of GDP in 2020 and 2.0% of GDP in 2021. This is largely driven by an improvement in the primary income balance as the net rate of return on the UK's stock of foreign assets normalises and the depreciation of sterling increases the value of the income earned on those assets.

1.27 The outlook for potential output growth is unchanged since Autumn Statement 2016. The OBR continues to judge that the subdued path of business investment, which is likely to remain constrained due to economic uncertainty, will in turn weigh on productivity in the medium term.

Prices

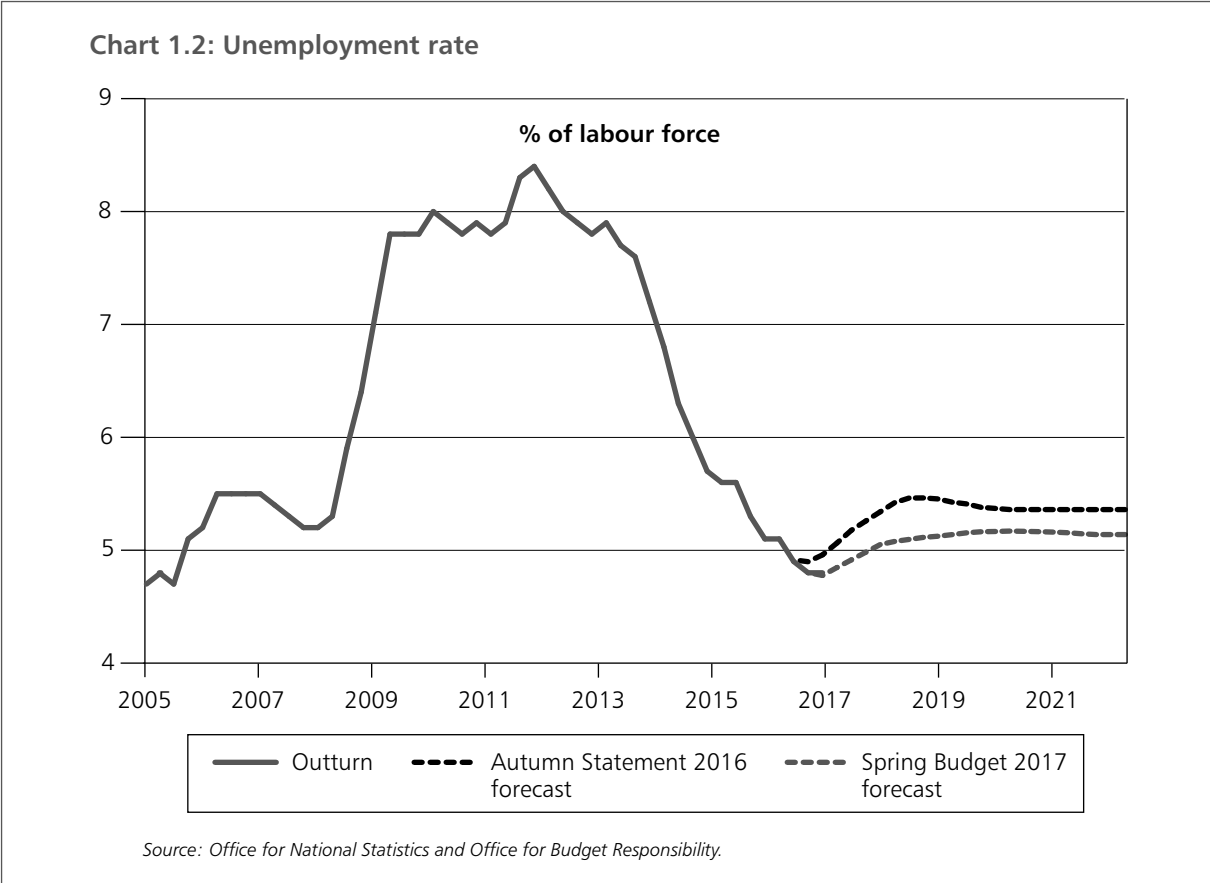
1.28 The OBR forecasts that CPI inflation will increase to 2.4% in 2017 before falling back to 2.3% in 2018 and 2.0% from 2019 to 2021. Sterling has appreciated 3.3% on a trade-weighted basis since the beginning of November 2016, but remains 11.9% below its level of early June 2016, while global oil prices have increased 16.3% since the beginning of November. The two effects broadly counterbalance each other. Combined with the OBR's judgement on the effect of policy measures, this means that inflation is expected to be slightly higher in the near term and slightly lower in later years than forecast at Autumn Statement 2016.

Labour market

1.29 The OBR has revised down its forecast for the unemployment rate, based on a revised judgement on the equilibrium rate of unemployment in the economy, the lowest unemployment rate which can be sustained while maintaining stable inflation. While the number of people in employment is expected to continue to increase, reaching 32.5 million in 2021, the unemployment rate is forecast to rise slightly as the economy slows, reaching 4.9% in 2017, 5.1% in 2018 and 5.2% in 2019 and 2020, before falling back to 5.1% in 2021.

1.30 The OBR forecasts that productivity growth will be 1.6% in 2017, 1.5% in 2018, 1.7% in 2019, 1.8% in 2020 and 1.9% in 2021. This is largely unchanged relative to the Autumn Statement 2016 forecast. The OBR has not revised its judgement on trend productivity growth, and continues to emphasise that this is the most important and most uncertain judgement in its economic forecast.

1.31 The OBR’s forecast for earnings growth is little changed in the near term, but has been revised down slightly in later years, largely reflecting small revisions to expected inflation and productivity growth. The OBR anticipates average earnings growth of 2.6% in 2017 and 2.7% in 2018, followed by annual growth at or above 3.0% through to 2021. Earnings growth is an important determinant of the OBR’s forecast for the public finances.



1.32 Following strong gains in recent years, higher inflation is expected to weigh on RHDl per head in 2017 before growth resumes later in the forecast. The OBR forecast a fall of 0.7% in 2017, as the recent sterling depreciation raises inflation while nominal earnings growth increases slightly. The OBR expects that RHDl per head will return to growth in 2018 with a 0.1% increase, and then pick up to 0.4% in 2019, 1.0% in 2020 and 1.2% in 2021. By the end of the forecast period RHDl per head is expected to be 2.0% above its 2016 level.

Monetary policy

1.33 The Monetary Policy Committee of the Bank of England has full operational independence to set monetary policy to meet the inflation target. Monetary policy is a critical element of the UK’s macroeconomic framework, responsible for maintaining price stability and supporting the economy.

1.34 In this Budget, the government reaffirms the symmetric inflation target of 2% for the 12-month increase in the CPI, which applies at all time. The government also confirms that the Asset Purchase Facility will remain in place for the financial year 2017-18.

Outlook for the public finances

1.35 Since 2010, the government has made good progress in restoring the public finances to health. The deficit is now forecast to have been cut by almost three-quarters from its post-war peak of 9.9% of GDP in 2009-10 to 2.6% in 2016-17, a level not seen since before the 2008 financial crisis.² Nevertheless, both borrowing and debt remain too high. And the combination of the need to improve productivity and an ageing population poses a challenge for the public finances in the long run.

1.36 The government's new fiscal rules, approved by Parliament in January, commit to returning the public finances to balance at the earliest possible date in the next Parliament.³ In the interim, the government is committed to reducing the cyclically-adjusted deficit below 2% of GDP and putting debt on a downward path by 2020-21. These rules take a balanced approach, combining the flexibility to support the economy, if necessary, in the near term, with the commitment to return the public finances to a sustainable position in the long term.

1.37 The OBR judges that the government remains on track to meet its interim targets two years early.⁴ Underscoring its commitment to fiscal discipline, new discretionary policy decisions announced at the Budget are funded over the forecast period. This responsible approach to setting fiscal policy underpins the sustainability of the public finances and provides certainty and security to businesses and households.

The fiscal outlook

1.38 Public sector receipts have proven resilient since Autumn Statement 2016. Total receipts in 2016-17 are expected to significantly outperform the Autumn Statement 2016 forecast, especially corporation tax, income tax and Capital Gains Tax. The OBR attributes this to a combination of economic activity being stronger than expected in the short term, a structural improvement in some taxes, and timing effects and one-off factors, including higher forestalling of dividend income.

1.39 However, the OBR's medium-term economic outlook is largely unchanged from the autumn and earnings growth and consumption growth are expected to be slightly weaker than in November. This means that much of this near-term strength in receipts does not carry through to the later years of the forecast. Therefore the OBR expects total revenues in 2021-22 to be close to those forecast at Autumn Statement 2016.

1.40 Public spending is significantly lower in 2016-17 than forecast at Autumn Statement 2016, but broadly unchanged by the end of the forecast period. Lower spending in the near term reflects increased forecast underspending by departments, as well as a one-off change in the timing of EU contributions that moves some spending from 2016-17 into 2017-18. Upward revisions to spending in later years result from a combination of higher debt interest and local authority spending. Costs associated with changes to the personal injury discount rate also increase borrowing in every year.

1.41 The OBR notes that the action taken by the Department for Work and Pensions (DWP) to clarify Personal Independence Payment policy offsets most of the cost arising from recent legal judgments. These restore the government's original policy intent.

² 'Public sector finances', ONS, January 2017, and 'Economic and fiscal outlook', OBR, March 2017.

³ 'Charter for Budget Responsibility: autumn 2016 update', HM Treasury, January 2017.

⁴ 'Economic and fiscal outlook', OBR, March 2017.

1.42 Accounting changes reduce borrowing by £1.1 billion on average in every year relative to Autumn Statement 2016, with the biggest effect being a reduction of £3.0 billion in 2016-17. The most significant change is the completion of the move to an accruals-based recording of onshore corporation tax receipts, in line with the ONS's updated methodology.⁵

Table 1.2: Changes to the OBR's forecast for public sector net borrowing since Autumn Statement 2016 (£ billion)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Autumn Statement 2016	68.2	59.0	46.5	21.9	20.7	17.2
Total forecast changes since Autumn Statement 2016 ¹	-16.4	-3.8	-7.5	-2.3	0.8	0.2
<i>of which</i>						
Receipts forecast	-7.5	-4.3	-4.6	-1.5	1.5	2.4
Spending forecast	-6.0	1.5	-0.7	0.2	-1.5	-1.8
Accounting changes	-3.0	-1.0	-2.2	-0.9	0.8	-0.4
Total effect of government decisions since Autumn Statement 2016	0.0	3.1	1.8	1.7	-1.0	-0.6
Total changes since Autumn Statement 2016	-16.4	-0.7	-5.7	-0.6	-0.2	-0.4
Spring Budget 2017	51.7	58.3	40.8	21.4	20.6	16.8

¹ Equivalent to lines from Table 1.3 of the March 2017 Economic and fiscal outlook; full references available in 'Spring Budget 2017 data sources'.
Source: Office for Budget Responsibility and HM Treasury calculations. Figures may not sum due to rounding.

1.43 Mirroring the revisions to the economic outlook, the net effect of these changes is that borrowing is expected to be lower in the near term but essentially unchanged from 2019-20 onwards. The OBR's public sector net borrowing (PSNB) forecast is £0.4 billion lower in 2021-22 than was forecast at Autumn Statement 2016.

1.44 However, the combination of a stronger than expected economy in the near term, timing effects and one-off factors has significantly lowered the borrowing forecast for 2016-17 relative to other years. The deficit in 2016-17 is predicted to be £16.4 billion lower than had been forecast at Autumn Statement 2016. Over half of this reduction in borrowing results from a range of one-off factors, including changes to the timing of corporation tax receipts, dividend income brought forward ahead of forthcoming tax rises, changes to the timing of EU payments, and lower forecast spending by departments this year – a number of which serve to push up borrowing in 2017-18.

1.45 Borrowing is lower in every year of the forecast compared with Autumn Statement 2016 and expected to fall to £16.8 billion or 0.7% of GDP by 2021-22. This is forecast to be the lowest deficit as a share of GDP in two decades.⁶

Table 1.3: Overview of the OBR's borrowing forecast as a percentage of GDP

	Estimate	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net borrowing	3.8	2.6	2.9	1.9	1.0	0.9	0.7
Cyclically-adjusted public sector net borrowing	3.6	2.6	2.9	1.9	0.9	0.9	0.7
Treaty deficit ¹	4.0	2.7	2.8	1.9	1.1	0.9	0.9
<i>Memo: Output gap²</i>	-0.2	0.1	0.1	-0.1	-0.1	-0.1	0.0
<i>Memo: Total policy decisions³</i>			-0.1	0.0	0.0	0.0	0.0

¹ General government net borrowing on a Maastricht basis.

² Output gap measured as a percentage of potential GDP.

³ Equivalent to the 'Total policy decisions' line in Table 2.1.

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations.

⁵ 'Improvements to accruals methodology for Corporation Tax, Bank Corporation Tax Surcharge and the Bank Levy', ONS, February 2017.

⁶ 'Public sector finances', ONS, January 2017.

1.46 Debt as a percentage of GDP is also lower in every year than forecast at Autumn Statement 2016. Lower borrowing reduces cash debt in each year of the forecast compared to Autumn Statement 2016, although in 2016-17 this is offset by slightly faster take-up of the Bank of England's Term Funding Scheme. Slightly higher nominal GDP in the near term also reduces the debt-to-GDP ratio. As a result, the OBR now forecasts that public sector net debt (PSND) will peak at 88.8% of GDP in 2017-18, before falling each year thereafter to 79.8% of GDP in 2021-22.

Table 1.4: Overview of the OBR's debt forecast as a percentage of GDP

	Estimate		Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net debt ¹	83.6	86.6	88.8	88.5	86.9	83.0	79.8
Public sector net debt ex Bank of England ¹	81.4	80.9	81.1	81.0	79.7	78.2	77.0
Public sector net financial liabilities ²	76.4	75.8	76.1	75.0	72.8	70.4	67.7
Treaty debt ³	87.6	87.5	87.7	87.7	86.5	84.8	83.6

¹ Debt at end of March; GDP centred on end of March.

² Public sector net financial liabilities at end of March, GDP centred on end of March; outturn for 2015-16 is an experimental ONS statistic.

³ General government gross debt on a Maastricht basis.

Source: Office for National Statistics and Office for Budget Responsibility.

Box 1.A: The long-term fiscal outlook

Over the next Parliament and beyond, the public finances will continue to be influenced by demographic trends, such as the retirement of the large baby-boomer cohort and increasing life-expectancy. The OBR's recent 'Fiscal sustainability report' projects that these demographic trends will drive increased spending in age-related areas such as health, long-term care and the state pension, if policy remains unchanged.⁷ The OBR projects that factors such as the rising prevalence of chronic health conditions and technological advancements will place further upward pressure on health spending. Spending on the State Pension will rise from 5.0% of GDP in 2021-22 to 7.1% of GDP by 2066-67. However, the same demographic and economic trends will leave revenues broadly stable. Without changes to policy, these pressures would therefore put public sector debt on an unsustainable upward trajectory, almost tripling as a share of GDP over the next 50 years.

The government's capacity to meet the needs of an ageing population depends crucially on the productive potential of the economy. Productivity is currently 30% higher in the United States and 35% higher in Germany than in the UK.⁸ At Autumn Statement 2016 the government took further action to address the longstanding need to improve productivity, including through a new National Productivity Investment Fund (NPIF) to support high value investment in innovation, infrastructure, and housing. The Budget focuses on improving skills, in order to boost productivity and living standards over the long term.

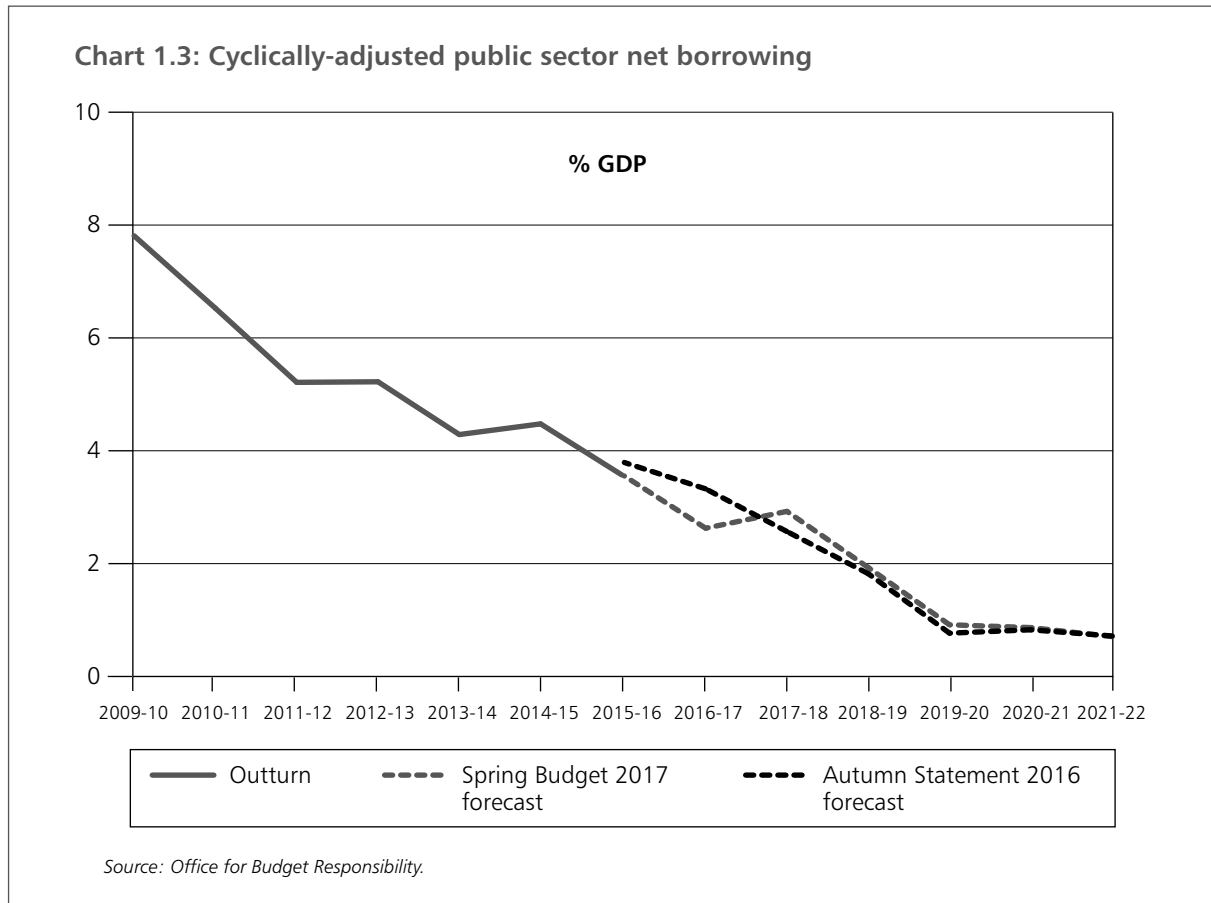
⁷ 'Fiscal sustainability report', OBR, January 2017.

⁸ 'International comparisons of productivity', ONS, October 2016.

Performance against the fiscal rules

The fiscal mandate

1.47 The OBR's 'Economic and fiscal outlook' assesses the government against the fiscal mandate. It demonstrates that the government remains on target to bring cyclically-adjusted borrowing below 2% of GDP by the end of this Parliament. The OBR predicts that this target will be met two years early, and that by 2020-21 cyclically-adjusted public sector net borrowing will be 0.9% of GDP. The government therefore remains on track to meet its fiscal mandate, with 1.1% of GDP or £26 billion headroom in 2020-21. Compared with Autumn Statement 2016, the OBR estimates the probability of the government meeting its fiscal mandate to be unchanged at 65%, based on historic forecast errors.

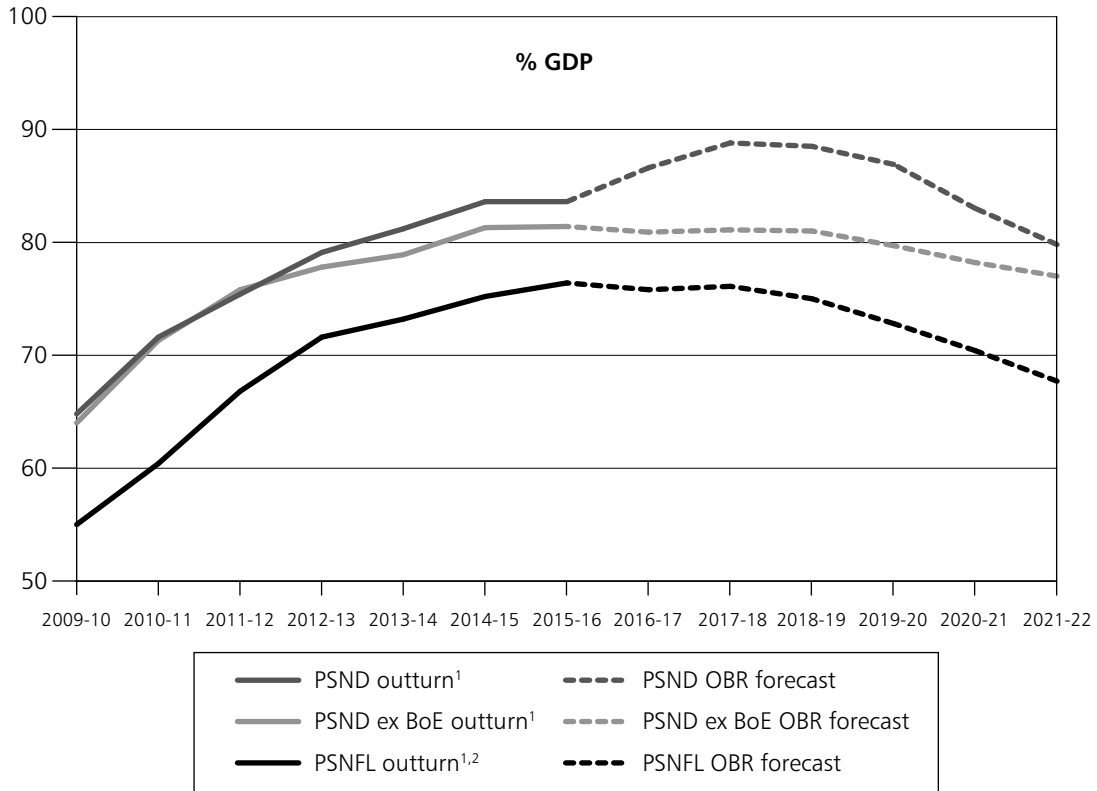


1.48 The government is committed to the 3.0% deficit target set out in the EU's Stability and Growth Pact. The OBR's latest forecast indicates that this target will be met in 2016-17, for the first time since 2007-08, and in every year thereafter.

The supplementary debt target

1.49 The OBR also judges the government to be on track to meet its supplementary debt target, with PSND falling as a share of GDP from 2018-19 onwards. PSND excluding the Bank of England (PSND ex BoE) and public sector net financial liabilities (PSNFL) are both forecast to fall as shares of GDP from 2018-19 onwards (see Box 1.B).

Chart 1.4: Public sector debt



¹ Outturn for 2015-16 is an OBR estimate with GDP based on the ONS 22 February 2017 GDP release.

² Experimental ONS statistic.

Source: Office for National Statistics and Office for Budget Responsibility.

1.50 In light of the economic outlook, the government’s decision to live within its means, while investing in the future, will enhance the UK’s economic resilience. Reducing the government’s indebtedness will also reduce the burden placed on future generations, who would otherwise need to service higher debt interest payments, paid for by lower public spending or higher taxation.

Box 1.B: Supplementary fiscal aggregates

Public sector net debt (PSND) is a well-established measure of the government's debt burden. However, the majority of the increase in PSND as a percentage of GDP over 2016-17 and 2017-18 is due to the Bank of England's Term Funding Scheme (TFS), which was announced in August 2016. Through the TFS, the Bank of England provides secured lending of central bank reserves backed by the full range of collateral as detailed in the Bank of England's Sterling Monetary Framework.⁹ As PSND captures the liabilities of the TFS operations but does not fully capture the assets, these temporary actions are forecast to lead to an increase in debt over the next two years.¹⁰ The take-up of the TFS has been slightly faster than the OBR expected at Autumn Statement 2016, and this partly offsets the OBR's lower borrowing forecast. The TFS will unwind from 2020-21 onwards, as loans are repaid.

At Autumn Statement 2016, the government asked the ONS to develop,¹¹ and the OBR to forecast, these measures, to provide policymakers with two alternative views of the government's fiscal position. These are:

- PSND excluding the Bank of England (PSND ex BoE) – which excludes the assets and liabilities held on the Bank of England's balance sheet from PSND
- Public Sector Net Financial Liabilities (PSNFL) – a broader fiscal aggregate which recognises all public sector financial assets and liabilities recorded in the national accounts

PSND is forecast by the OBR to peak at 88.8% of GDP in 2017-18, partly as a result of the effects of the TFS, before falling from that point onwards. In contrast, PSND ex BoE is forecast to remain roughly flat at 81% of GDP until 2018-19. Similarly, PSNFL stabilises at 76% of GDP between 2015-16 and 2017-18. From 2018-19 onwards, both of these alternate measures of debt are expected to fall as a share of GDP.

Welfare cap

1.51 Between 1980 and 2014 spending on working-age welfare trebled in real terms.¹² The government remains committed to ensuring the welfare system is put on a sustainable footing. The welfare cap, designed to improve Parliamentary accountability of welfare spending, was reset at Autumn Statement 2016. The cap is based on the OBR's forecast at Autumn Statement 2016 of the benefits and tax credits within its scope, and will apply to welfare spending in 2021-22.¹³

1.52 Performance against the cap will be formally assessed by the OBR in 2020-21; the cap will be breached if spending exceeds the cap plus a 3% margin at the point of assessment. In the interim years, progress towards the cap will be managed internally, based on the OBR's monitoring of forecasts of welfare spending. The OBR's forecast of the level of welfare spending against the cap is set out in its 'Economic and fiscal outlook', March 2017.

1.53 The OBR forecasts welfare spending to remain within the cap and margin set at Autumn Statement 2016. The government will deliver welfare savings already identified but has no plans to introduce further welfare savings in this Parliament beyond those already announced.

⁹ 'Letter from the Chancellor of the Exchequer to the Governor of the Bank of England 04/08/2016', HM Treasury, August 2016.

¹⁰ 'Economic statistics classification article: statistical treatment of the Bank of England's Term Funding Scheme in the UK national accounts and public sector finances', ONS, October 2016.

¹¹ 'Autumn Statement: Supplementary fiscal aggregates: 2016', ONS, October 2016.

¹² 'Benefit Caseload and Expenditure Tables', DWP, 2016.

¹³ See Annex B of the Autumn Statement 2016 document.

Public spending

1.54 With the deficit still too high, control of public spending and an ongoing drive to improve the efficiency of public bodies is vital.

1.55 As set out at Autumn Statement 2016, the government will meet the commitments on public spending set out for this Parliament including commitments to priority public services, to international development and defence, and to pensioners. The government will maintain a disciplined approach to public spending to reach a balanced budget and live within its means. The commitments it is able to make on protecting public spending priorities in the next Parliament will need to be determined in light of evolving prospects for the fiscal position. The government will do this at the next Spending Review.

1.56 To ensure that the State Pension remains sustainable and fair across generations, the government is carrying out the first statutory review of State Pension age. The government will consider all the evidence – including an independent report by John Cridland – before publishing its review by 7 May 2017.

1.57 As a result of efforts to reduce the deficit to a level that gets debt falling, government spending as a share of GDP has been brought down from 44.9% in 2010-11 to 40.0% in 2015-16.¹⁴ Total Managed Expenditure as a share of GDP is forecast to fall from 39.3% in 2016-17 to 37.9% in 2021-22, roughly the same proportion of GDP as in 2004.¹⁵ Table 1.5 sets out the path for Total Managed Expenditure (TME), Public Sector Current Expenditure (PSCE) and Public Sector Gross Investment (PSGI) to 2021-22.

Table 1.5: Total Managed Expenditure (£ billion, unless otherwise stated)^{1, 2}

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Current expenditure						
Resource AME	363.6	392.2	400.7	407.5	421.3	440.4
Resource DEL excluding depreciation ³	305.3	305.4	307.4	308.5	314.0	319.0
Ring-fenced depreciation	26.2	21.9	22.8	23.3	21.9	22.8
Total public sector current expenditure	695.1	719.5	730.9	739.2	757.2	782.2
Capital expenditure						
Capital AME	24.7	26.4	27.7	27.1	28.9	30.9
Capital DEL	53.0	56.5	58.6	61.6	69.3	73.2
Total public sector gross investment	77.7	82.9	86.3	88.7	98.2	104.1
Total managed expenditure	772.8	802.4	817.2	827.9	855.4	886.4
<i>Total managed expenditure % of GDP</i>	<i>39.3%</i>	<i>39.6%</i>	<i>39.0%</i>	<i>38.2%</i>	<i>38.0%</i>	<i>37.9%</i>

¹ Budgeting totals are shown including the Office for Budget Responsibility (OBR) forecast Allowance for Shortfall. Resource DEL excluding ring-fenced depreciation is the Treasury's primary control within resource budgets and is the basis on which departmental Spending Review settlements are agreed. The OBR publishes Public Sector Current Expenditure (PSCE) in DEL and AME, and Public Sector Gross Investment (PSGI) in DEL and AME. A reconciliation is published by the OBR.

² The treatment of spending on Research and Development (R&D) was updated in the OBR's November 2016 forecast to align with the revised treatment in the National Accounts. It is now treated as capital rather than resource spending.

³ The Scottish Government's resource DEL block grant has been adjusted from 2016-17 onwards as agreed in the Scottish Government's Fiscal Framework. In 2016-17 an adjustment of £5.5bn reflects the devolution of SDLT and Landfill Tax and the creation of the Scottish Rate of Income Tax. In 2017-18 an adjustment of £12.5bn additionally reflects the devolution of further Income Tax powers and revenues from Scottish courts. In 2018-19 and 2019-20, adjustments of £13.0bn and £13.4bn additionally reflect the devolution of Air Passenger Duty. Resource DEL numbers for 2020-21 and 2021-22 are indicative as budgets have not been set.

Source: Office for Budget Responsibility and HM Treasury calculations.

¹⁴ 'Public finances databank', OBR, March 2017.

¹⁵ 'Public finances databank', OBR, March 2017.

Efficiency Review

1.58 The government will deliver £3.5 billion of resource savings in 2019-20, supported by the Efficiency Review. The government intends to allocate £1 billion of these savings for re-investment in priority areas. The Chief Secretary to the Treasury, supported by the Minister for the Cabinet Office, is leading the Review, and has commissioned relevant Whitehall departments to consider options for reducing departmental spend in 2019-20. In delivering the Review, the government will meet the commitments on public spending set out for this Parliament including commitments to priority public services, to international development and defence, and to pensioners.

1.59 Alongside delivering savings in 2019-20, the Efficiency Review is also committed to embedding a culture of efficiency across government. Incremental improvements to the delivery of public services should be made each year to maximise value for money for taxpayers across government spending. The Chief Secretary to the Treasury has asked Sir Michael Barber to lead a review on strengthening the culture of efficiency in government to support this goal. This work will explore how efficiency is incentivised and measured across government, including considering the analytical frameworks used to inform choices on public spending. The government will report on progress on the Efficiency Review in autumn 2017.

Departmental Expenditure Limits

1.60 Tables 1.6 and 1.7 show the departmental resource and capital totals set at Spending Review 2015, adjusted to reflect subsequent announcements. In line with Autumn Statement 2016, before additional investment over the forecast period, departmental resource spending will continue to grow in line with inflation in 2020-21, and departmental spending will also grow with inflation in 2021-22.

Table 1.6: Departmental Resource Budgets (£ billion)

	Estimate	Plans		
	2016-17	2017-18	2018-19	2019-20
Resource DEL excluding depreciation¹				
Defence ²	26.7	27.5	28.2	29.0
Single Intelligence Account	1.9	1.8	1.9	2.0
Home Office	10.7	10.8	10.7	10.7
Foreign and Commonwealth Office	2.0	1.2	1.2	1.3
International Development	7.5	8.0	9.1	9.1
Health (inc. NHS)	116.1	117.6	120.3	123.2
Work and Pensions	6.1	6.3	6.0	5.4
Education	59.6	61.4	62.1	62.7
Business, Energy and Industrial Strategy	2.0	2.0	1.9	1.7
Transport	1.6	2.1	2.1	1.7
Exiting the European Union	0.0	0.1	0.1	0.1
International Trade	0.3	0.3	0.3	0.3
Culture, Media and Sport	1.4	1.4	1.5	1.5
DCLG Communities	2.6	3.1	2.3	2.2
DCLG Local Government	8.2	6.5	5.5	5.4
Scotland ³	20.7	14.2	13.6	13.2
Wales	13.1	13.4	13.4	13.5
Northern Ireland	9.9	10.0	10.0	10.0
Justice	6.9	6.6	6.2	6.0
Law Officers Departments	0.5	0.5	0.5	0.5
Environment, Food and Rural Affairs	1.7	1.6	1.5	1.4
HM Revenue and Customs	3.6	3.5	3.2	2.9
HM Treasury	0.2	0.1	0.1	0.1
Cabinet Office	0.4	0.3	0.2	0.2
Small and Independent Bodies	1.5	1.4	1.3	1.3
Reserves	0.0	5.1	4.9	7.2
Adjustment for Budget Exchange ⁴	0.0	-0.4	0.0	0.0
Adjustment for planned efficiency savings	0.0	0.0	0.0	-3.5
Total Resource DEL excluding depreciation	305.3	306.1	308.1	309.2
<i>OBR allowance for shortfall</i>	<i>0.0</i>	<i>-0.8</i>	<i>-0.8</i>	<i>-0.8</i>
OBR resource DEL excluding depreciation forecast	305.3	305.4	307.4	308.5

¹ Resource DEL excluding depreciation is the Treasury's primary control total within resource budgets and the basis on which Spending Review settlements were made.

² The defence budget for 2016-17 reflects changes made in-year, such as the drawdown of funding from the special reserve for the net additional cost of military operations. No such allocations have yet been made for 2017-18 onwards.

³ The Scottish Government's resource DEL block grant has been adjusted from 2016-17 onwards as agreed in the Scottish Government's Fiscal Framework. In 2016-17 an adjustment of £5.5bn reflects the devolution of SDLT and Landfill Tax and the creation of the Scottish Rate of Income Tax. In 2017-18 an adjustment of £12.5bn additionally reflects the devolution of further Income Tax powers and revenues from Scottish courts. In 2018-19 and 2019-20, adjustments of £13.0bn and £13.4bn additionally reflect the devolution of Air Passenger Duty.

⁴ Departmental budgets in 2017-18 include amounts carried forward from 2016-17 through Budget Exchange, which will be voted at Main Estimates. These increases will be offset at Supplementary Estimates in future years so are excluded from spending totals.

Table 1.7: Departmental Capital Budgets (£ billion)

	Estimate	Plans			
	2016-17	2017-18	2018-19	2019-20	2020-21
Capital DEL					
Defence ¹	8.8	8.5	8.7	9.0	9.6
Single Intelligence Account	0.6	0.6	0.6	0.7	0.7
Home Office	0.5	0.6	0.5	0.5	0.4
Foreign and Commonwealth Office	0.1	0.1	0.1	0.1	0.1
International Development	2.6	3.6	3.2	3.5	3.6
Health (inc. NHS)	4.6	6.1	6.0	6.0	5.9
Work and Pensions	0.3	0.4	0.3	0.2	0.2
Education	6.3	5.3	6.2	4.7	4.7
Business, Energy and Industrial Strategy ²	11.0	10.8	10.4	11.1	6.0
Transport	5.5	6.4	8.1	11.1	12.4
Exiting the European Union	0.0	0.0	0.0	0.0	0.0
International Trade	0.0	0.0	0.0	0.0	0.0
Culture, Media and Sport	0.3	0.5	0.5	0.6	0.5
DCLG Communities	5.2	6.2	6.6	6.3	7.2
DCLG Local Government	0.0	0.0	0.0	0.0	0.0
Scotland	3.3	3.4	3.5	3.7	3.8
Wales	1.5	1.6	1.7	1.8	1.9
Northern Ireland	1.0	1.2	1.2	1.3	1.3
Justice	0.4	0.7	0.7	0.4	0.1
Law Officers Departments	0.0	0.0	0.0	0.0	0.0
Environment, Food and Rural Affairs	0.7	0.7	0.7	0.5	0.5
HM Revenue and Customs	0.3	0.2	0.2	0.2	0.2
HM Treasury	0.0	0.2	0.2	0.2	0.1
Cabinet Office	0.0	0.0	0.0	0.0	0.0
Small and Independent Bodies	0.1	0.1	0.1	0.1	0.1
Reserves	0.0	1.2	0.8	1.2	1.2
Capital spending not yet in budgets ³	0.0	0.0	0.0	0.4	2.3
Adjustment for Budget Exchange ⁴	0.0	-0.5	0.0	0.0	0.0
Adjustment for Research & Development RDEL to CDEL switch ⁵	0.0	0.0	0.0	0.0	6.5
Total Capital DEL	53.1	58.0	60.4	63.7	69.3
<i>Remove CDEL not in public sector gross investment⁶</i>	<i>-6.8</i>	<i>-7.5</i>	<i>-6.4</i>	<i>-6.2</i>	<i>-5.0</i>
<i>OBR Allowance for shortfall</i>	<i>-0.1</i>	<i>-1.5</i>	<i>-1.8</i>	<i>-2.1</i>	<i>-</i>
Public Sector Gross Investment in CDEL	46.2	49.0	52.2	55.4	64.3

¹ The defence budget for 2016-17 reflects changes made in-year, such as the drawdown of funding from the special reserve for the net additional cost of military operations. No such allocations have yet been made for 2017-18 onwards.

² Full BEIS CDEL budgets for 2020-21 have not yet been set. See footnote 5.

³ This represents funding not yet allocated to departments. It is presented net of the Office of Budget Responsibility's (OBR) allowance for shortfall in 2020-21.

⁴ Departmental budgets in 2017-18 include amounts carried forward from 2016-17 through Budget Exchange, which will be voted at Main Estimates. These increases will be offset at Supplementary Estimates in future years so are excluded from spending totals.

⁵ Following the implementation of ESA10, all research and development (R&D) spending is classified as capital. Departmental R&D budgets have not been set in full in 2020-21. The table contains a forecast assumption for R&D which is not yet in departments' budgets. The government will set 2020-21 R&D budgets for all departments in due course.

⁶ Capital DEL that does not form part of public sector gross investment, including financial transactions in Capital DEL.

Devolved administrations

1.61 The application of the Barnett formula to spending decisions taken by the UK government at the Budget will provide each of the devolved administrations with additional funding to be allocated according to their own priorities. The Scottish and Welsh governments' block grants will be further adjusted as set out in their respective fiscal frameworks.

Financial transactions

1.62 Some policy measures do not directly affect PSNB in the same way as conventional spending or taxation. These include financial transactions that directly affect only the central government net cash requirement (CGNCR) and PSND. Table 1.8 shows the effect of the financial transactions announced at the Budget on CGNCR.

Table 1.8: Financial Transactions from 2017-18 to 2021-22 (£ million)^{1,2}

	2017-18	2018-19	2019-20	2020-21	2021-22
i Doctoral loans	0	-5	-5	-10	-10
ii Part-time maintenance loans	0	75	130	95	65
iii Further Education maintenance loans	0	0	-15	-40	-70
Total policy decisions	0	70	110	45	-15

¹ Costings reflect the Office for Budget Responsibility's latest economic and fiscal determinants.

² Negative numbers in the table represent a cost to the Exchequer.

Asset sales

1.63 The government remains committed to returning the financial sector assets acquired in 2008-09 to the private sector, subject to market conditions and achieving value for taxpayers:

- **Lloyds** – The government launched a trading plan on 7 October 2016 to sell its shares in Lloyds Banking Group in the market in an orderly and measured way.¹⁶ Sales already exceed its previous 2016-17 projection by £1.0 billion and remain on track to fully return Lloyds to the private sector by the end of 2017-18.¹⁷ When taken alongside previous share sales and dividends received the government has recovered over £19.0 billion for the taxpayer¹⁸ and is on track to recover all of the £20.3 billion injected in to the bank.
- **RBS** – The government will continue to seek opportunities for disposals, but the need to resolve legacy issues makes it uncertain as to when these will occur.
- **UK Asset Resolution (UKAR)** – UKAR's balance sheet has already reduced from £115.8 billion in 2010 to £36.9 billion as at 30 September 2016¹⁹ and its £15.65 billion programme of sales of Bradford & Bingley (B&B) mortgage assets continues to progress to plan with full conclusion expected before the end of 2017-18²⁰.

¹⁶ 'Sale of public share in Lloyds to restart shortly', HM Treasury, October 2017.

¹⁷ 'Economic and fiscal outlook', OBR, November 2016, 'Economic and fiscal outlook', OBR, March 2017.

¹⁸ 'Taxpayers' stake in Lloyds now below 4%', HM Treasury, February 2017.

¹⁹ 'UK Asset Resolution Limited Group Interim Financial Report for the 6 months to 30 September 2016', UKAR, November 2016.

²⁰ 'Economic and fiscal outlook', OBR, March 2017.

1.64 The government continues to explore options for the sale of wider corporate and financial assets, where there is no longer a policy reason to retain them and when value for money can be secured for taxpayers. This is an integral part of the government's plan to repair the public finances. On 6 February, the government began the process to sell part of the pre-2012 income contingent repayment student loan book²¹. The sale process is expected to take several months and remains subject to market conditions and a final assessment of value for money. This is the first tranche of a programme of sales which is forecast to raise £12 billion by 2020-21.²² The sale process for the Green Investment Bank is ongoing.

Debt and reserves management

1.65 The government's financing plans for 2017-18 are summarised in Annex A. They are set out in full in the 'Debt management report 2017-18', published alongside the Budget.²³

1.66 The government will provide £6.0 billion of sterling financing for the Official Reserves in 2017-18.

²¹ 'Government launches first sale from the student loan book', Department for Education, HM Treasury and Student Loans Company, February 2017.

²² 'Economic and fiscal outlook', OBR, March 2017.

²³ 'Debt management report 2017-18', HM Treasury, March 2017.

3

Tax

Introduction

3.1 From autumn 2017, the government's intention is to move towards a single fiscal event each year, an autumn Budget. The Spring Budget takes the first step in that transition. It will move towards a more stable and certain tax environment, helping businesses and individuals to plan better. Where it is possible to do so without creating a forestalling risk, changes will be announced well ahead of the next financial year.

3.2 From spring 2018, a Spring Statement will respond to the OBR's forecast and will provide the opportunity to launch consultations on future reforms. Aligned with that approach, this Budget launches a number of consultations, looking at fairness, sustainability, and competitiveness in the tax system.

3.3 The government continues to pursue a tax system with competitive rates and a sustainable base. This will ensure that the UK remains one of the best places in the world to set up and grow a business, and builds on its reputation as a competitive and open economy. At the same time, it will ensure that public services can be funded sustainably. This chapter sets out steps the Budget will take towards this.

Personal tax

Income tax & National Insurance

3.4 Since 2010, the government has taken action to reduce taxes and enable working people to keep more of what they earn. Next month, the government will build on this progress by increasing the personal allowance by more than inflation for the seventh consecutive year, raising it by £500 to £11,500. This means the amount someone can earn tax-free in 2017-18 will be over 75% higher than in 2010. Raising the personal allowance to £11,500, alongside a £2,000 increase to the higher rate threshold, will cut income tax for 31 million taxpayers compared to the beginning of this Parliament – including taking 1.3 million out of income tax altogether.¹

3.5 Class 4 National Insurance contributions (NICs) – The government has already announced that it will abolish Class 2 NICs – a flat-rate charge on the self-employed – from April 2018. On its own this would increase the differential between the rates of National Insurance paid by employees and those paid by the self-employed. Since April 2016, the self-employed also have access to the same State Pension as employees, worth £1,800 a year more to a self-employed individual than under the previous system.² To reduce the differential and reflect more equal pension entitlement, the Budget announces that the main rate of Class 4 NICs will increase from 9% to 10% in April 2018, and to 11% in April 2019. Taken together with the abolition of Class 2 NICs, this means that only self-employed individuals with profits above £16,250 will have to pay more NICs. Alongside Matthew Taylor's review into employment practices, the government will consider whether there is a case for greater parity in parental benefits between the employed and self-employed. (15)

¹ HM Treasury analysis based on personal tax parameters, ONS CPI series, HMRC analysis based on Survey of Personal Incomes (SPI) 2013-14 data, and Budget 2016 OBR forecasts.

² This is derived from published weekly state pension rates for 2016-17. Further information is available at: <https://www.gov.uk/state-pension/what-youll-get> and <https://www.gov.uk/new-state-pension/what-youll-get>

3.6 Dividend allowance – The tax-free dividend allowance will be reduced from £5,000 to £2,000 from April 2018. This will reduce the tax differential between the employed and self-employed on the one hand and those working through a company on the other,³ and raise revenue to invest in our public services. It will ensure that support for investors is more effectively targeted, and make the total amount of income they can receive tax-free fairer and more affordable. This takes account of the increased ISA allowance, which will rise to £20,000 from this April, as well as further increases to the tax-free personal allowance which is additional to the dividend allowance. A £2,000 dividend allowance will continue to mean that 80% of general investors pay no dividend tax, including those with sizeable investments (typically, up to £50,000). (16)

3.7 Different forms of remuneration – Employers can choose to remunerate their employees in a range of different ways, but the tax system treats these different forms of remuneration inconsistently. The government is considering how the tax system could be made fairer and more coherent, including by looking at the taxation of benefits in kind and employee expenses. The government is consulting on the following:

- **Taxation of benefits in kind** – The government will publish a call for evidence on exemptions and valuation methodology for the income tax and employer NICs treatment of benefits in kind, in order to better understand whether their use in the tax system can be made fairer and more consistent.
- **Accommodation benefits** – The government will publish a consultation with proposals to bring the tax treatment of employer-provided accommodation and board and lodgings up to date. This will include proposals for when accommodation should be exempt from tax and to support taxpayers during any transition.
- **Employee expenses** – The government will publish a call for evidence to better understand the use of the income tax relief for employees' expenses, including those that are not reimbursed by their employer.

Pensions and savings

3.8 The government is committed to supporting savers at all stages of their lives. Recent reforms mean that now 98% of adults pay no savings tax.⁴ The government has almost doubled ISA limits since 2010 and will introduce the Lifetime ISA on 6 April this year. The Lifetime ISA allows younger adults to save up to £4,000 each year and receive a generous bonus of up to £1,000 a year on these contributions, which can be withdrawn tax-free to put towards a first home or when they turn 60.

3.9 NS&I Investment Bond final rate – The Budget confirms the rate on the NS&I Investment Bond announced at Autumn Statement 2016. The Investment Bond will offer a market-leading rate of 2.2% over a term of 3 years and will be available for 12 months from April 2017. The Bond will be open to everyone aged 16 and over, subject to a minimum investment limit of £100 and a maximum investment limit of £3,000. At £3,000 the investment limit is enough to cover all the savings of over half of UK households.⁵ This will support savers who have been affected by low interest rates.

3.10 Master trust tax registration – The government will amend the tax registration process for master trust pension schemes to align with the Pensions Regulator's new authorisation and supervision regime. This will help to boost consumer protection and improve compliance.

³ HRMC analysis estimates that the Exchequer cost of the existing discretionary company population, as defined by the OBR in its November 2016 *Economic and fiscal outlook*, will be over £6 billion in 2021-22.

⁴ Internal HMRC analysis.

⁵ 52% of UK households hold total savings and investments of between £0 and £3,000 ('Family Resources Survey: financial year 2014/15', Department for Work and Pensions, June 2016).

Business tax

3.11 The UK is one of the most open economies in the world, and a highly competitive business tax regime remains a key factor in retaining that position. The UK's corporate tax rate is the lowest in the G20. As set out at Autumn Statement 2016, the government will cut the rate of corporation tax to 19% from April this year and then again to 17% in 2020. Reflecting the move to a single major fiscal event in the autumn, the Budget does not make major changes to the business tax regime, but continues to provide a stable and certain environment to support business investment, consistent with the business tax road map.⁶

Corporate tax

3.12 Research and development (R&D) tax review – The Industrial Strategy green paper sets out the government's ambition to drive up the level of private investment in science, research and innovation across the economy. The review of the R&D tax regime has found that the UK's R&D tax credits regime is an effective and internationally competitive element of the government's support for innovation. To further support investment, the government will make administrative changes to the Research and Development Expenditure Credit to increase the certainty and simplicity around claims and will take action to improve awareness of R&D tax credits among SMEs. The government will continue to keep the competitiveness of the UK environment for R&D under review to ensure that the UK is profoundly pro-innovation.

3.13 Patient capital review – The review aims to ensure that high growth businesses can access the long-term capital that they need to fund productivity enhancing investment. Alongside identifying barriers to institutional investment in long-term finance, the review will also consider existing tax reliefs aimed at encouraging investment and entrepreneurship to make sure that they are effective, well targeted, and provide value for money.

3.14 Withholding tax on interest – In order to encourage investment in the UK and make it easier for businesses to raise finance, the government will:

- renew and extend the administrative simplifications of the Double Taxation Treaty Passport scheme to assist foreign lenders and UK borrowers. This scheme simplifies access to reduced withholding tax rates on interest that are available within the UK's tax treaties with other countries
- introduce an exemption from withholding tax for interest on debt traded on a Multilateral Trading Facility, removing a barrier to the development of UK debt markets. The government will consult in spring 2017 on implementation of the exemption

Property tax

3.15 Business rates – At Budget 2016 the government announced reductions in business rates worth almost £9 billion over the next 5 years. This included permanently doubling Small Business Rate Relief and extending the thresholds of the relief to ensure that 600,000 businesses will not pay business rates again.

3.16 The business rates revaluation takes effect in England from April 2017. In addition to the £3.6 billion transitional relief which was announced in November 2016, the government will provide £435 million of further support for businesses facing significant increases in bills from the English business rates system. This includes:

- support for small businesses losing Small Business Rate Relief to limit increases in their bills to the greater of £600 or the real terms transitional relief cap for small businesses each year (6)

⁶ 'Business tax road map', HM Treasury, March 2016.

- providing English local authorities with funding to support £300 million of discretionary relief, to allow them to provide support to individual hard cases in their local area (5)

3.17 The government will also introduce a £1,000 business rate discount for public houses with a rateable value of up to £100,000, subject to state aid limits for businesses with multiple properties, for one year from 1 April 2017. (7)

3.18 Local government will be fully compensated for the loss of income as a result of these measures.

3.19 At Budget 2016 the government announced an aim to deliver more frequent revaluations of properties – at least every 3 years. The government will set out its preferred approach for delivering this aim at Autumn Budget 2017 and will consult ahead of the next revaluation in 2022.

3.20 Stamp Duty Land Tax – As a result of consultation, the government will delay the reduction in the filing and payment window until 2018-19. (18)

3.21 Offshore property developers – The government will amend legislation to ensure that all profits realised by offshore property developers developing land in the UK, including those on pre-existing contracts, are subject to tax, with effect from 8 March 2017.

3.22 Rent-a-room relief – The government will consult on proposals to redesign rent-a-room relief, to ensure it is better targeted to support longer-term lettings. This will align the relief more closely with its intended purpose, to increase supply of affordable long-term lodgings.

Energy and transport taxes

3.23 Vehicle Excise Duty (VED) – From 1 April 2017, VED rates for cars, vans and motorcycles registered before April 2017 will increase by Retail Prices Index (RPI).

3.24 HGV VED and Road User Levy – HGV VED and Road User Levy rates will be frozen from 1 April 2017. A call for evidence on updating the existing HGV Road User Levy will be launched this spring. The government will work with industry to update the Levy so that it rewards hauliers that plan their routes efficiently, to incentivise the efficient use of roads and improve air quality. (20)

3.25 Red diesel – The government will publish a call for evidence on the use of red diesel in order to improve understanding of eligible industries and current use. Evidence is particularly sought on the use of red diesel in urban areas.

3.26 Air Passenger Duty (APD) – APD rates for 2018-19 will be updated in line with RPI. To provide good notice for the airline industry, rates for 2019-20 will be set at Autumn Budget 2017.

3.27 Carbon pricing – The government remains committed to carbon pricing to help decarbonise the power sector. Currently, UK prices are determined by the EU Emissions Trading System and Carbon Price Support. Starting in 2021-22, the government will target a total carbon price and set the specific tax rate at a later date, giving businesses greater clarity on the total price they will pay. Further details on carbon prices for the 2020s will be set out at Autumn Budget 2017.

3.28 Levy Control Framework – The government recognises the need to limit costs to businesses and households as the UK decarbonises its energy supplies. The existing Levy Control Framework has helped to control the costs of low carbon subsidies in recent years, and will be replaced by a new set of controls. These will be set out later in the year.

3.29 Oil and gas: Tax for late-life oil and gas assets – The UK already has one of the most competitive tax regimes for oil and gas in the world.⁷ But to maximise economic recovery the fiscal regime needs to ensure support for the transfer of late-life assets. To determine the best approach, the government will publish a formal discussion paper alongside the Finance Bill on the case for allowing transfers of tax history between buyers and sellers. The government will also establish a new advisory panel of industry experts to ensure appropriate scrutiny of the options. The review will report at Autumn Budget 2017.

3.30 Aggregates Levy – The Aggregates Levy rate for 2017-18 will be frozen at £2 per tonne, continuing the freeze that has been in place since 2009. (19)

3.31 Landfill Tax – The value of the Landfill Communities Fund (LCF) for 2017-18 will remain unchanged at £39.3 million and the cap on contributions by landfill operators will be increased to 5.3%. This cap will be maintained, subject to consideration of Landfill Tax receipts, continued progress in reducing the level of unspent funds held by environmental bodies and the proportion of LCF funds spent on administration costs. The government will also consult on extending the scope of Landfill Tax to illegal disposals of waste made without the required permit or licence.

3.32 Packaging recycling targets – The government will legislate to set new statutory packaging recycling targets for 2018 to 2020, to ensure compliance with the Packaging Directive. By 2020, the government will increase recycling targets for paper to 75.0%, aluminium to 64.0%, steel to 85.0% and for wood packaging to 48.0%. Targets for overall packaging recycling will increase to 75.4% and for recovery to 82.0% by 2020. (21)

Indirect taxes

Alcohol and tobacco

3.33 Alcohol duty rates and bands – From 13 March 2017, the duty rates on beer, cider, wine and spirits will increase by RPI inflation, in line with previous forecasts. The government will also consult on:

- introducing a new duty band for still cider just below 7.5% abv to target white ciders
- the impacts of introducing a new duty band for still wine and made-wine between 5.5% and 8.5% abv

3.34 Tobacco duty rates – As announced at Budget 2014, duty rates on all tobacco products will increase by 2% above RPI inflation. This change will come into effect from 6pm on 8 March 2017.

3.35 Minimum Excise Tax – The government will introduce a Minimum Excise Tax for cigarettes. This will target the cheapest tobacco and promote fiscal sustainability. The rate will be set at £268.63 per 1,000 cigarettes. It will take effect from 20 May 2017.

Other indirect taxes

3.36 Value Added Tax (VAT): Registration and deregistration thresholds – From 1 April 2017 the VAT registration threshold will increase from £83,000 to £85,000 and the deregistration threshold from £81,000 to £83,000.

3.37 Soft Drinks Industry Levy – The levy rate for added sugar drinks with a total sugar content of 5 grams or more per 100 millilitres will be set at 18 pence per litre, and those with 8 grams or more per 100 millilitres will be set at 24 pence per litre.

⁷ 'Maximising Economic Recovery UK in practice', Oil and Gas Authority, 26 October 2016.

3.38 Insurance Premium Tax (IPT) – The government will legislate to introduce anti-forestalling provisions and increase the standard rate of IPT to 12% from 1 June 2017, as announced at Autumn Statement 2016.

Tax administration

3.39 Digital administration – The government will provide an extra year, until April 2019, before Making Tax Digital is mandated for unincorporated businesses and landlords with turnover below the VAT threshold. This will provide them with more time to prepare for digital record keeping and quarterly updates. The government will also consult on the design aspects of the tax administration system, including interest and penalties, with the aim of adopting a consistent approach across taxes. This will simplify the system for taxpayers. (17)

3.40 Tax simplification – Following consultation, the government will increase the cash basis entry threshold to £150,000, and exit threshold to £300,000, and will extend the use of the cash basis to unincorporated landlords. The government will also simplify the rules on capital and revenue expenditure within the cash basis, to make it easier for businesses to work out whether their expenditure is deductible for tax. (17)

3.41 HMRC large business risk review – HMRC will work constructively with businesses and interested parties to consult over the summer on its process for risk profiling large businesses and promoting stronger compliance.

Avoidance, evasion and compliance

3.42 In this Parliament, the government has announced it will legislate for over 35 measures to tackle avoidance, evasion and aggressive tax planning. This builds on the progress of the last Parliament, during which over 40 changes to tax law were made, closing down loopholes and introducing major reforms to the UK tax system. Since 2010, HMRC has secured around £140 billion in additional tax revenue through tackling avoidance, evasion and non-compliance, and the UK's tax gap remains one of the lowest in the world.⁸

Avoidance

3.43 Promoters of Tax Avoidance Schemes (POTAS) – New legislation will ensure that promoters of tax avoidance schemes cannot circumvent the POTAS regime by re-organising their business by either sharing control of a promoting business, or putting a person or persons between themselves and the promoting business. This will ensure that HMRC can apply the POTAS regime as intended.

3.44 Strengthening tax avoidance sanctions and deterrents – As announced at Autumn Statement 2016, the government will introduce a new penalty for a person who has enabled another person or business to use a tax avoidance arrangement that is later defeated by HMRC. This new regime reflects an extensive consultation and input from stakeholders. The government will also remove the defence of having relied on non-independent advice as taking 'reasonable care' when considering penalties for a person or business that uses such arrangements. (22)

3.45 Tax treatment of appropriations to trading stock – The government will remove the ability for businesses to convert capital losses into trading losses from 8 March 2017. This will eliminate an unfairness in the tax code which is being exploited by certain businesses. (24)

⁸ 'HMRC'S Annual report and accounts', HMRC, 28 June 2012 and 14 July 2016; 'HMRC quarterly performance updates', HMRC, 16 February 2017; and 'Measuring tax gaps', HMRC, 20 October 2016.

3.46 Qualifying recognised overseas pension schemes (QROPS): introduction of transfer charge – The government will introduce a 25% charge on transfers to QROPS. This charge is targeted at those seeking to reduce the tax payable by moving their pension wealth to another jurisdiction. Exceptions will apply to the charge allowing transfers to be made tax-free where people have a genuine need to transfer their pension, including when the individual and the pension are both located within the European Economic Area. (23)

3.47 VAT: Use and enjoyment provisions for business to consumer mobile phone services – The government will remove the VAT use and enjoyment provisions for business to consumer mobile phone services to individuals. This will resolve the inconsistency where UK VAT is applied to mobile phone use by UK residents when in the EU, but not when outside the EU. It will also ensure mobile phone companies cannot use the inconsistency to avoid UK VAT. This will bring UK VAT rules into line with the internationally agreed approach. (25)

Evasion

3.48 VAT: Fraud in the provision of labour in the construction sector – The government will consult on options to combat missing trader VAT fraud in the provision of labour in the construction sector, in particular, applying the reverse charge mechanism so the recipient accounts for VAT.

3.49 VAT: ‘Split Payment’ model – Some overseas traders avoid paying UK VAT, undercutting online and high street retailers and abusing the trust of UK consumers who purchase goods via online marketplaces. Building on the measures introduced in Budget 2016, the government will shortly publish a call for evidence on the case for a new VAT collection mechanism for online sales. This would harness technology to allow VAT to be extracted directly by the Exchequer from online transactions at the point of purchase. This is often referred to as a ‘Split Payment’ model. This is the next step in tackling the non-payment of VAT by some overseas traders selling goods online to UK consumers.

Compliance

3.50 Image rights – The government is aware that some employers pay image rights in respect of employees under separate contractual arrangements to employment income. HMRC will publish guidelines for employers who make payments of image rights to their employees to improve the clarity of the existing rules.

3.51 Employment Allowance – HMRC is actively monitoring National Insurance Employment Allowance compliance following reports of some businesses using avoidance schemes to avoid paying the correct amount of NICs. The government will consider taking further action in the event that this avoidance continues.

Fraud, error and debt

3.52 Tax credit debt – As announced by the Secretary of State on 9 February 2017, DWP will recover a volume of HMRC tax credit debt using its existing powers including the use of Direct Earnings Attachment. (26)

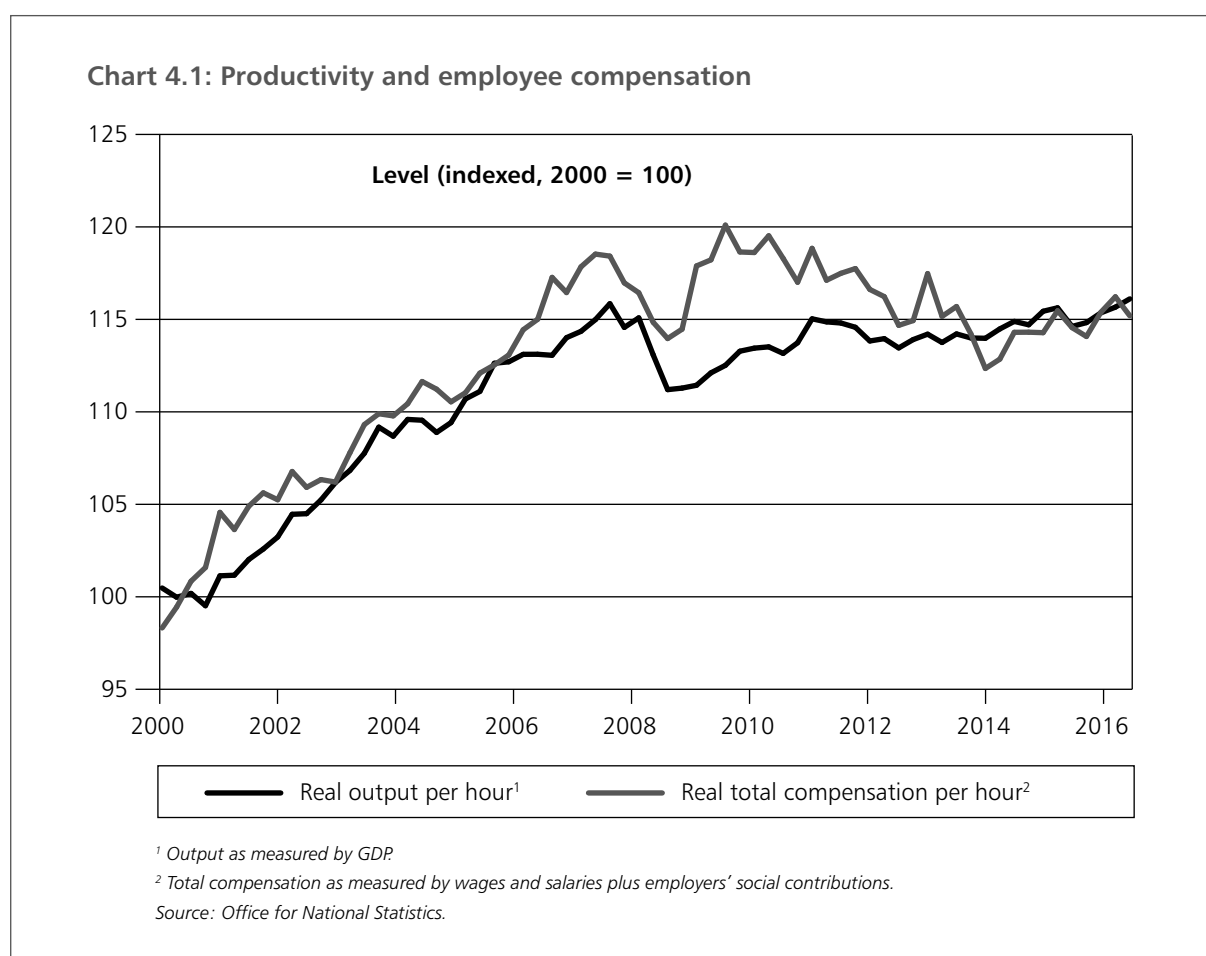
3.53 Benefit fraud and error – As announced by the Secretary of State on 9 February 2017, DWP will work in partnership with an external data provider to better identify fraud and error caused by undeclared partners. (27)

4

Productivity

Introduction

4.1 Over the long term, improving productivity – the amount of output produced per hour worked – is the best way to boost pay and increase living standards. More productive firms pay higher wages, are more competitive and therefore better able to succeed internationally. As set out in Chart 4.1, while wage and productivity growth can differ in the short run, they tend to move together over time. By supporting wages and profits, better productivity increases tax receipts and in turn the government’s ability to provide public services.



4.2 It is essential that the UK overcomes the persistent challenge of weak productivity. In 2015, UK output per hour stood 18 percentage points behind the average for other G7 countries, 35 percentage points behind Germany, 27 percentage points behind France, and 30 percentage points behind the USA.¹ The government has already taken major steps to improve the UK’s long-term productivity, including through committing over £23 billion of additional investment between 2017-18 and 2021-22 through the National Productivity Investment Fund (NPIF), announced at Autumn Statement 2016.

¹ ‘International Comparisons of Productivity – First Estimates 2015’, ONS, October 2016.

4.3 The recently published Industrial Strategy green paper set out how the government will create the conditions for firms to invest and grow across the country.² It outlined an holistic approach to raising productivity, including through investment in research and innovation, developing the UK's skills base, upgrading infrastructure, and encouraging investment. This chapter sets out further actions the government is taking in these areas.

Skills

4.4 Education and skills are drivers of productivity and growth in the UK economy, and important factors for regional variations in productivity.³ Weaknesses in the UK's skills base have contributed to its longstanding productivity gap with France and Germany.⁴

4.5 As the UK begins the formal process of exiting the EU, creating a highly-skilled workforce will ensure businesses across the country have the talent and skills needed to succeed in global markets. Employer demand for skills is increasing; over the coming years, 42% of businesses expect to have more jobs requiring intermediate-level skills, and 74% expect to demand more higher-level skills.^{5, 6}

4.6 Evidence shows that skills qualifications are also clearly linked to higher wage returns. An individual with a level 3 apprenticeship (broadly equivalent to A-levels) as their highest qualification can expect to earn between £77,000 and £117,000 more on average over their lifetime, compared to individuals with a lower-level qualification.⁷

4.7 Investing in education and skills will help young people succeed in the workplace and increase their earnings, and support businesses of all sizes to thrive.

Further and Higher Education

4.8 The government's ambition, funded in the Budget, is for England's technical education system to match the excellence of its world-leading higher education system. The academic route from GCSEs, to A-levels, to higher education is well regarded and high quality. The UK is home to 12 of the top 100 universities in the world,⁸ and there are now more young people from England entering full-time undergraduate study at university than ever before, including record numbers of 18 year olds from disadvantaged backgrounds.⁹

4.9 The government has already strengthened employment-based technical education; the introduction of the apprenticeship levy in April 2017 will support the delivery of 3 million apprenticeship starts by 2020.

4.10 But as the Industrial Strategy green paper outlined, more needs to be done. England's technical education system is confusing for students, with around 13,000 qualifications available – many of them of little value.^{10, 11} Employers consistently cite a lack of skills as a major concern.

² 'Building our Industrial Strategy: Green Paper', Department for Business, Energy and Industrial Strategy, January 2017.

³ 'Unlocking Regional Growth', CBI, December 2016.

⁴ 'Fixing the foundations: creating a more prosperous nation', HM Treasury, July 2015.

⁵ 'CBI/Pearson education and skills survey 2016', CBI, July 2016.

⁶ Firms reporting increased demand minus those reporting decreased demand.

⁷ 'Intermediate and low level vocational qualifications: economic returns', BIS, September 2011.

⁸ 'Times Higher Education World University Rankings', Times Higher Education, 2017.

⁹ 'UCAS End of Cycle Resources 2016', UCAS, 2016.

¹⁰ 'Section 96 – Qualifications (Learning and Skills Act 2000)', DfE, 2000.

¹¹ 'Report of the Independent Panel on Technical Education', Independent Panel on Technical Education, July 2016.

Box 4.A: Lord Sainsbury's Independent Review on Technical Education

The government commissioned an independent panel, led by Lord Sainsbury, to recommend options for a technical education system to rival our world-leading academic system. The panel's report was published in July 2016,¹² alongside the government's Skills Plan that accepted all of the panel's recommendations.¹³ The recommendations included replacing the current system, comprised of thousands of qualifications, with a framework of 15 routes to skilled employment extending from level 2 and level 3 up to higher skill levels, with a streamlined set of valuable qualifications.

Central to the panel's recommendations was that the routes should focus on stretching technical content, shaped by industry professionals who are best placed to advise on the knowledge, skills and behaviours required to succeed.

For 16-19 year olds on college-based technical routes, the panel recommended that programmes last for 2 years. This would start with a core curriculum for the route that all pupils would study, followed by specialisation. Students would also complete a high-quality industry work placement, and be expected to reach a minimum standard of English and maths. Young people would therefore leave college with a quality qualification focused on a specific occupation or set of occupations; experience in their chosen field; and wider employability skills.

4.11 The Budget announces:

- **T-levels: 16-19 Technical education** – The government will deliver the recommendations of Lord Sainsbury's panel. The government will increase the number of programme hours of training for 16-19 year olds on technical routes by more than 50%, to over 900 hours a year on average, including the completion of a high quality industry work placement during the programme. To ensure the routes are well-designed and colleges properly prepared, they will be introduced from 2019-20, increasing funding in line with this roll out, with over £500 million of additional funding invested per year once routes are fully implemented.¹⁴ (1)
- **Further Education maintenance loans** – The government's aim is to encourage students to continue their training at high quality institutions such as National Colleges or Institutes of Technology. This will create real parity with the academic route and develop the higher-level skills employers demand. From 2019-20, the government will provide maintenance loans, like those available to university students, to students on technical education courses at levels 4 to 6 in National Colleges and Institutes of Technology. This will also support adults to retrain at these institutions.

4.12 In the modern global economy, the government recognises that individuals should have the opportunity to retrain and upskill at all points in their life, and to develop skills at the highest level. The Budget sets out further steps to achieve this ambition:

- **Lifelong learning pilots** – The changing nature of work makes retraining and reskilling essential and so the government will spend up to £40 million by 2018-19 to test different approaches to help people to retrain and upskill throughout their working lives.
- **Return to work support** – The government will work with business groups and public sector organisations to identify how best to increase the number of returnships, supported by £5 million of new funding. Returnships offer people who have taken lengthy career breaks a clear route back to employment. (4)

¹² 'Report of the Independent Panel on Technical Education', Independent Panel on Technical Education, July 2016.

¹³ 'Post-16 skills plan', DfE, BIS, July 2016.

¹⁴ Based on current hourly rates.

- **Part-time maintenance loans** – To promote equality with full-time undergraduate study and support lifelong learning, the government confirms the terms of maintenance loans for part-time undergraduates, previously announced at Spending Review 2015. These loans will become available for degree level study in 2018-19, with an extension to distance learning and sub-degree study in 2019-20.
- **Doctoral loans** – The government confirms the terms of doctoral loans for 2018-19, previously announced at Budget 2016. These new loans will provide up to £25,000 for doctoral study and have the potential to reach a wider range of students and research than before.

Schools

4.13 The government's aim is for a good school place for every child, whatever their background. Almost 1.8 million more pupils are now taught in good or outstanding schools than in 2010.¹⁵ Free schools and academies programmes have ensured that the best schools and head teachers can extend their success and the new curriculum and qualifications are restoring rigour. The Pupil Premium, introduced for publicly funded schools in England, focuses on the most disadvantaged children; the attainment gap between disadvantaged and other pupils is now narrowing year on year. As a result of these reforms, 89% of schools in England are now rated as good or outstanding – the highest proportion ever recorded.¹⁶

4.14 However, there are still 1 million children in underperforming schools.¹⁷ At Autumn Statement 2016, the government confirmed £50 million per year of new funding to expand existing grammar schools. The Budget sets out further steps the government is taking to ensure every child has the opportunity of a place at a good school:

- **Schools investment** – The government is committed to giving parents greater choice in finding a good school for their child, and will deliver the manifesto commitment to open 500 new free schools by 2020. The government will extend the free schools programme with investment of £320 million in this Parliament to help fund up to 140 schools, including independent-led, faith, selective, university-led and specialist maths schools. Of these 140 schools, 30 will open by September 2020 and count towards the government's existing commitment. The new free schools will be located where they are most needed to improve the choice of schools available to parents, following a rigorous assessment of local factors. (2)
- **School maintenance** – To improve the condition of the school estate, the Budget provides a further £216 million investment in school maintenance, taking total investment in school condition to well over £10 billion over this Parliament. (3)
- **School transport** – The government wants to ensure that children from disadvantaged backgrounds have every opportunity to access the best possible education, without the cost of transport acting as a barrier. Pupils typically travel nearly three times as far to attend selective schools.¹⁸ The government is therefore expanding the current 'extended rights' entitlement for children aged 11 to 16, who receive free school meals or whose parents claim Maximum Working Tax Credit. They will now get free transport to attend the nearest selective school in their area,¹⁹ bringing it in line with free transport provision for those travelling to their nearest school on faith or belief grounds.

¹⁵ 'Maintained schools and academies inspection outcomes as at 31 August 2016', DfE, November 2016.

¹⁶ 'Maintained schools and academies inspection outcomes as at 31 August 2016', DfE, November 2016.

¹⁷ 'Maintained schools and academies inspection outcomes as at 31 August 2016', DfE, November 2016.

¹⁸ 'Response by Department for Education to Parliamentary Question on 25 October 2016', DfE, October 2016.

¹⁹ Entitlement will apply to pupils attending a selective school within 2 to 15 miles of their home.

National Productivity Investment Fund

4.15 At Autumn Statement 2016, the government established the NPIF to provide over £23 billion of high-value investment between 2017-18 and 2021-22, with a focus on priority areas that are critical for improving productivity: economic infrastructure, housing and R&D. This built on existing plans for major investment over this Parliament, including resurfacing 80% of the strategic road network and the largest investment in the railways since Victorian times.²⁰

4.16 The NPIF provides the financial backbone to the government's Industrial Strategy, and will:

- support market roll-out of the fast and reliable full-fibre connections that will help businesses to grow
- tackle congestion and ensure the UK's transport networks are fit for the future
- enhance the UK's position at the forefront of technological progress globally
- accelerate new housing supply

4.17 This will provide a significant boost to the UK's productivity in the long term. The Budget sets out further detail of how NPIF funds will be invested in priority transport, digital communications and R&D programmes.

4.18 Digital infrastructure – The NPIF will invest £740 million in digital infrastructure by 2020-21, to support the next generation of fast and reliable mobile and broadband communications for consumers and businesses. The Budget announces the first steps towards this ambition.

4.19 5G – The government's 5G Strategy, published today, sets out steps for the UK to become a world leader in the next wave of mobile technology and services. This includes:

- a new National 5G Innovation Network to trial and demonstrate 5G applications. The first phase will invest up to £16 million in a cutting edge 5G facility with the technology to run the trials, delivered through cooperation between leading 5G research institutions. A new centre of 5G expertise within government will oversee this programme, working with public and private sector partners. Funding for future trials will be awarded on a competitive basis
- the government's response to the National Infrastructure Commission's Connected Future report and recommendations on 5G.²¹ This will include developing commercial options for improving coverage on roads and rail, and working with Ofcom to ensure the UK has a regulatory environment fit for 5G

4.20 Full-fibre broadband – Starting in 2017, the government will invest £200 million to fund a programme of local projects to test ways to accelerate market delivery of new full-fibre broadband networks. These will combine the following approaches:

- bringing together local public sector customers, to create enough broadband demand to reduce the financial risk of building new full-fibre networks
- offering full-fibre broadband connection vouchers for businesses, to increase take-up of services where new networks are built through the programme
- directly connecting public sector buildings, such as schools and hospitals. This will bring fibre closer to more homes and businesses, allowing them to be connected
- opening up public sector assets, such as existing ducts, to allow fibre to be laid more cheaply

²⁰ 'Largest Investment in railways since Victorian times will continue', Network Rail, November 2015.

²¹ 'Connected Future', National Infrastructure Commission, December 2016.

4.21 Complementing the NPIF programmes, the new Digital Infrastructure Investment Fund will be launched in spring 2017. Government investment of £400 million will be at least matched by private sector investors, and will accelerate the deployment of full-fibre networks by providing developers with greater access to commercial finance.

4.22 Transport – Autumn Statement 2016 announced £1.1 billion from the NPIF to support local transport and £220 million to address pinch points on the national road network, improving productivity by making it easier for people and goods to move within and between towns and cities. The government has already made progress on allocating NPIF funding, and the Budget announces further details of support for transport:

- **Local transport** – NPIF allocations have already been made for 2017-18, supporting local projects like improvements in Blackpool town centre, improving the A483 corridor in Cheshire, major maintenance of the Leicester Outer Ring Road, and a new roundabout at Hales in Norfolk. £690 million more will be competitively allocated to local authorities, with £490 million made available by early autumn 2017.
- **National road network** – The government has completed a strategic study on relieving congestion in the south-west sections of the M25 and will now develop options ahead of the next Road Investment Strategy. The Budget announces regional allocations of the £220 million NPIF investment for pinch points on the strategic road network, with details of individual schemes to be announced by Department for Transport shortly.

4.23 R&D – Autumn Statement 2016 announced £4.7 billion from the NPIF for R&D, to support the UK's world-leading research and ensure that the next generation of discoveries are made, developed and commercialised in Britain. The Budget announces the first investments.

4.24 Industrial Strategy Challenge Fund (ISCF) – The new ISCF will support collaborations between business and the UK's science base. An initial investment of £270 million in 2017-18 will kick-start the development of disruptive technologies that have the potential to transform the UK economy. Following engagement with experts in academia and industry, the Budget announces that the first wave of challenges funded from the ISCF will include the following:

- leading the world in the development, design and manufacture of batteries that will power the next generation of electric vehicles, helping to tackle air pollution
- developing cutting-edge artificial intelligence and robotics systems that will operate in extreme and hazardous environments, including off-shore energy, nuclear energy, space and deep mining
- accelerating patient access to new drugs and treatments through developing brand new medicine manufacturing technologies, helping to improve public health

4.25 Talent funding – The NPIF will invest £250 million over the next four years to continue to build the pipeline of high-skilled research talent necessary for a growing and innovative economy:

- £90 million will provide an additional 1,000 PhD places in areas aligned with the Industrial Strategy. Around 85% will be in STEM disciplines, and 40% will directly help strengthen collaboration between business and academia through industrial partnerships
- a further £160 million will support new fellowships for early and mid-career researchers in areas aligned to the Industrial Strategy

4.26 Global research talent – The government will invest over £100 million over the next 4 years to attract the brightest minds to the UK, to help maintain the UK’s position as a world-leader in science and research. This includes:

- £50 million of NPIF funding specifically ring-fenced for fellowship programmes to attract global talent
- over £50 million from existing international funds will support fellowships that attract researchers to the UK from emerging research powerhouses like India, China, Brazil and Mexico

Cities and regions

4.27 As set out in the Industrial Strategy green paper, the government’s ambition is to support growth in all areas of the UK. The government will shortly be announcing the Midlands Engine Strategy, and is continuing to build the Northern Powerhouse. (8)

4.28 Devolution – The government has agreed a Memorandum of Understanding on further devolution to London. The agreement with the Greater London Authority (GLA) and London Councils includes joint working to explore the benefits of, and scope for, locally-delivered criminal justice services; action to tackle congestion; and a taskforce to explore piloting a new approach to funding infrastructure. The agreement also commits to explore options for devolving greater powers and flexibilities over the administration of business rates and greater local influence over careers services and employment support services, as well as working with the GLA and London Councils to ensure that employers can take advantage of the opportunities offered by the apprenticeship levy. The government and London partners will agree a second Memorandum of Understanding on Health and Social Care. The government is also in discussions with Greater Manchester on future transport funding.

4.29 City deals in Scotland and Wales – The government continues to make good progress towards city deals for Edinburgh and Swansea and is working constructively with local partners and the Scottish and Welsh Governments respectively to achieve this. The government has also opened negotiations for a city deal for Stirling and looks forward to considering proposals as they are brought forward for a Tay Cities Deal and a North Wales Growth Deal.

5

Public services and markets

Introduction

5.1 The government is committed to ensuring public services deliver for everyone – whether by giving individuals the chance to develop skills at every stage of their lives, or supporting those in their old age – while maximising value for current and future taxpayers. The Budget takes further steps to improve the services people care most about, including education, health and social care.

5.2 Public services should be complemented by private markets that work well for consumers. The Budget announces some of the key steps the government is taking to ensure that competition and markets can work more effectively to deliver lower prices and more choice, which will be taken forward as part of the competition and markets green paper later this year.

Social care and the NHS

5.3 Social care – During this Parliament the government has already taken a number of steps to help secure a stable system of social care in England. The government has created the improved Better Care Fund to help support health and social care integration, introduced the new social care precept, and provided councils with funding certainty across every year of the Parliament through the Local Government Finance Settlement.

5.4 Recognising the challenges of an ageing and growing population, last year the government introduced short-term measures to support councils to manage adult social care. This included allowing councils to raise funding sooner from the social care precept, whilst continuing to protect local tax payers from large bill increases.

5.5 At this Budget, the government is building on these with further support in the medium term. The government will provide an additional £2 billion to councils in England over the next 3 years to spend on adult social care services. £1 billion of this will be provided in 2017-18, ensuring councils can take immediate action to fund care packages for more people, support social care providers, and relieve pressure on the NHS locally. Building on the approach to the Better Care Fund, councils will need to work with their NHS colleagues to consider how the funding can be best spent, and to ensure that best practice is implemented more consistently across the country. This funding will be supplemented with targeted measures to help ensure that those areas facing the greatest challenges make rapid improvement, particularly in reducing delayed transfers of care between NHS and social care services. Overall, local government will be able to increase social care-specific resources in real terms in each of the remaining 3 years of the Parliament. (9)

5.6 In the longer term, the government is committed to establishing a fair and more sustainable basis for adult social care, in the face of the future demographic challenges set out in the OBR's Fiscal Sustainability Report.¹ The government will set out proposals in a green paper to put the system on a more secure and sustainable long term footing.

¹ 'Fiscal Sustainability Report 2017', OBR, 2017.

5.7 Accident & Emergency (A&E) capital investment – Recognising the particular pressures in A&E, the government will provide an additional £100 million to the NHS in England in 2017-18 for capital investment in A&E departments. This will enable Trusts to invest in measures to help manage demand on A&E services and ensure that patients are able to access the most appropriate care as quickly as possible. For example, the funding will allow for better assessment of patients when they arrive at A&E and increase the provision of on-site GP facilities. (10)

5.8 Sustainability and Transformation Plans – The government recognises the progress that local NHS leaders have made, working collaboratively with partners, to develop local Sustainability and Transformation Plans. These local plans are an important part of the NHS's commitment to deliver more effective services to patients. The government will invest £325 million over the next three years to support the local proposals for capital investment where there is the strongest case to deliver real improvements for patients and to ensure a sustainable financial position for the health service. In the autumn, a further round of local proposals will be considered, subject to the same rigorous value for money tests. Investment decisions will also consider whether the local NHS area is playing its part in raising proceeds from unused land, to reinvest in the health service. (11)

Competition and consumer markets

5.9 Consumers and markets green paper – The government will shortly bring forward a green paper to examine markets that are not working efficiently or fairly. The Budget sets out the initial steps the government will take to make a difference for consumers, including:

- legislating at the earliest opportunity to allow consumer enforcement bodies, such as the Competition and Markets Authority, to ask the courts to order civil fines against companies that break consumer law. This will be a strong and effective deterrent, and will enable consumer bodies to take tough action against firms that mislead or mistreat consumers
- developing proposals to protect consumers from facing unexpected payments when a subscription is renewed or when a free trial ends
- considering how to make terms and conditions clearer, simpler and shorter for consumers to engage with, building on the call for evidence on terms and conditions last year

5.10 Reducing the burden on small co-operatives – The government will bring forward legislation to reduce the regulatory burden on small co-operatives, increasing the turnover threshold for which co-operatives are required to conduct a full audit from £5.6 million to £10.2 million, and the assets threshold from £2.8 million to £5.1 million. By aligning these thresholds to those of companies, small co-operatives will be able to use more of their resources to benefit their members.

Spending

5.11 Air quality – The government is committed to improving air quality, and will consult on a detailed draft plan in the spring which will set out how the UK's air quality goals will be achieved. Alongside this, the government will continue to explore the appropriate tax treatment for diesel vehicles, and will engage with stakeholders ahead of making any tax changes at Autumn Budget 2017.

5.12 Centenary fund – The government will create a new £5 million fund for projects to celebrate the centenary of voting rights being extended to women for the first time in 1918. (14)

5.13 Tackling domestic violence and abuse – The government will provide an additional £20 million over the Parliament to support organisations working to combat domestic violence and abuse, and to support victims. This builds on the government’s commitment to bring forward a Domestic Violence and Abuse Act, and increases the total funding for implementing the government’s Ending Violence Against Women and Girls Strategy to £100 million over the Parliament. (12)

5.14 Tampon Tax Fund for women’s charities – A range of women’s charities across the UK, including those that tackle violence against women and girls, will collectively benefit from £12 million as part of the 2016-17 round of the Tampon Tax Fund. The list of charities will be published before the end of March.

5.15 400th anniversary of the Mayflower crossing – To celebrate the 400th anniversary of the Atlantic crossing of the Mayflower, the government will appoint a Government Representative for Mayflower Anniversary Celebrations to assist in co-ordinating the UK wide events.

5.16 Exceptions to limiting support to two children – As confirmed on 20 January 2017, the government will provide exceptions to limiting support to two children for the child element in Child Tax Credits and Universal Credit. These exceptions are for third and subsequent children where parents face particular circumstances, such as multiple births. (28)

3 Excessive deficit procedure

3.1 The UK entered into the excessive deficit procedure (EDP) under the EU's Stability and Growth Pact (SGP) following a decision by ECOFIN Council in July 2008. In November 2009, the Council made recommendations to the UK, including setting a target to correct its excessive deficit. In June 2015, the Council made new recommendations to the UK, including setting a revised target to correct its excessive deficit.

3.2 Since 2010, the government has made good progress in restoring the public finances to health. The Treaty deficit is now forecast to have been cut from 10.2% of GDP in 2009-10 to 2.7% in 2016-17, a level not seen since before the 2008 financial crisis. Nevertheless, both borrowing and debt remain too high. And the combination of the need to improve productivity and an ageing population poses a challenge for the public finances in the long run.

3.3 The government's new fiscal rules, approved by Parliament in January, commit to returning the public finances to balance at the earliest possible date in the next Parliament. In the interim, the government is committed to reducing the cyclically-adjusted deficit below 2% of GDP and putting debt on a downward path by 2020-21. These rules take a balanced approach, combining the flexibility to support the economy, if necessary, in the near term, with the commitment to return the public finances to a sustainable position in the long term.

3.4 Public sector receipts have proven resilient since Autumn Statement 2016. Total receipts in 2016-17 are expected to significantly outperform the Autumn Statement 2016 forecast, especially corporation tax, income tax and Capital Gains Tax. The OBR attributes this to a combination of economic activity being stronger than expected in the short term, a structural improvement in some taxes, and timing effects and one-off factors, including higher forestalling of dividend income.

3.5 The OBR's medium-term economic outlook is largely unchanged from the autumn and earnings growth and consumption growth are expected to be slightly weaker than in November. This means that much of this near-term strength in receipts does not carry through to the later years of the forecast. Therefore the OBR expects total revenues in 2021-22 to be close to those forecast at Autumn Statement 2016.

3.6 Public spending is significantly lower in 2016-17 than forecast at Autumn Statement 2016, but broadly unchanged by the end of the forecast period. Lower spending in the near term reflects increased forecast underspending by departments, as well as a one-off change in the timing of EU contributions that moves some spending from 2016-17 into 2017-18. Upward revisions to spending in later years result from a combination of higher debt interest and local authority spending.

3.7 The combination of a stronger than expected economy in the near term, timing effects and one-off factors has significantly lowered the borrowing forecast for 2016-17 relative to other years. The deficit in 2016-17 is predicted to be £16.4 billion lower than had been forecast at Autumn Statement 2016. Over half of this reduction in borrowing results from a range of one-off factors, including changes to the timing of corporation tax receipts, dividend income brought forward ahead of forthcoming tax rises, changes to the timing of EU payments, and lower forecast spending by departments this year – a number of which serve to push up borrowing in 2017-18.

3.8 The government remains committed to bringing the UK's Treaty deficit in line with the 3% target set out in the Stability and Growth Pact. As Table 3.A shows, the OBR's forecast indicates

that this target will be met in 2016-17, and the deficit is forecast to remain below 3% over the forecast horizon.

Table 3.A: OBR fiscal forecast on a Maastricht basis

	%GDP						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Deficit							
Treaty deficit ^a	4.0	2.7	2.8	1.9	1.1	0.9	0.9
Cyclically adjusted Treaty deficit	3.7	2.7	2.9	1.9	1.0	0.9	0.9
Debt							
Treaty debt ^b	87.6	87.5	87.7	87.7	86.5	84.8	83.6
^a General government net borrowing on a Maastricht basis ^b General government gross debt on a Maastricht basis							
<i>Source: Office for Budget Responsibility</i>							

4 Quality of public finances

4.1 The UK will maintain a disciplined approach to public spending to reach a balanced budget and live within its means. The commitments it is able to make on protecting public spending priorities in the next Parliament will need to be determined in light of evolving prospects for the fiscal position. The government will do this at the next Spending Review.

4.2 To ensure that the State Pension remains sustainable and fair across generations, the UK government is carrying out the first statutory review of State Pension age. The government will consider all the evidence before publishing its review by 7 May 2017.

4.3 As a result of efforts to reduce the deficit to a level that gets debt falling, government spending as a share of GDP has been brought down from 44.9% in 2010-11 to 40.0% in 2015-16. Total Managed Expenditure as a share of GDP is forecast to fall from 39.3% in 2016-17 to 37.9% in 2021-22, roughly the same proportion of GDP as in 2004. Table 4.A sets out the path for Total Managed Expenditure (TME) to 2021-22.

Table 4.A: Total Managed Expenditure¹

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
CURRENT EXPENDITURE						
Resource AME	363.6	392.2	400.7	407.5	421.3	440.4
Resource DEL, excluding depreciation ²	305.3	305.4	307.4	308.5	314.0	319.0
Ring-fenced depreciation	26.2	21.9	22.8	23.3	21.9	22.8
Public Sector Current Expenditure	695.1	719.5	730.9	739.2	757.2	782.2
CAPITAL EXPENDITURE						
Capital AME	24.7	26.4	27.7	27.1	28.9	30.9
Capital DEL	53.0	56.5	58.6	61.6	69.3	73.2
Public Sector Gross Investment	77.7	82.9	86.3	88.7	98.2	104.1
TOTAL MANAGED EXPENDITURE	772.8	802.4	817.2	827.9	855.4	886.4
<i>Total Managed Expenditure (% GDP)</i>	<i>39.3%</i>	<i>39.6%</i>	<i>39.0%</i>	<i>38.2%</i>	<i>38.0%</i>	<i>37.9%</i>

¹ Budgeting totals are shown including the Office for Budget Responsibility (OBR) forecast allowance for shortfall. Resource DEL excluding ring-fenced depreciation is the Treasury's primary control total within resource budgets and is the basis on which departmental Spending Review settlements are agreed. The OBR publishes Public Sector Current Expenditure (PSCE) in DEL and AME, and Public Sector Gross Investment (PSGI) in DEL and AME. A reconciliation is published by the OBR.

² The Scottish Government's resource DEL block grant has been adjusted from 2016-17 onwards as agreed in the Scottish Government's Fiscal Framework. In 2016-17 an adjustment of £5.5bn reflects the devolution of SDLT and Landfill tax and the creation of the Scottish Rate of Income Tax. In 2017-18 an adjustment of £12.5bn additionally reflects the devolution of further Income Tax powers and revenues from Scottish courts. In 2018-19 and 2019-20, adjustments of £13.0bn and £13.4bn additionally reflect the devolution of Air Passenger Duty. Resource DEL numbers for 2020-21 and 2021-22 are indicative as budgets have not been set.

Source: Budget 2017

Departmental Expenditure Limits

4.4 Tables 4.B and 4.C show the departmental resource and capital totals set at Spending Review 2015, adjusted to reflect subsequent announcements. In line with Autumn Statement 2016, before additional investment over the forecast period, departmental resource spending will continue to grow in line with inflation in 2020-21, and departmental spending will also grow with inflation in 2021-22.

Devolved administrations

4.5 The application of the Barnett formula to spending decisions taken by the UK government at the Budget will provide each of the devolved administrations with additional funding to be allocated according to their own priorities. The Scottish and Welsh governments' block grants will be further adjusted as set out in their respective fiscal frameworks.

Other information

4.6 Other information relevant to the quality of public finances is presented in Chapter 2:

- paragraphs 2.38 to 2.60 deal with the government's fiscal plan
- paragraphs 3.4 to 3.38 deal with taxes for individuals and business
- paragraphs 3.39 to 3.53 cover ensuring a fair contribution through the tax system

Table 4.B: Departmental Resource Budgets (Resource DEL excluding depreciation)

	£ billion			
	Estimate	Plans		
	2016-17	2017-18	2018-19	2019-20
Resource DEL excluding depreciation¹				
Defence	26.7	27.5	28.2	29.0
Single Intelligence Account	1.9	1.8	1.9	2.0
Home Office	10.7	10.8	10.7	10.7
Foreign and Commonwealth Office	2.0	1.2	1.2	1.3
International Development	7.5	8.0	9.1	9.1
Health (inc. NHS)	116.1	117.6	120.3	123.2
Work and Pensions	6.1	6.3	6.0	5.4
Education	59.6	61.4	62.1	62.7
Business, Energy and Industrial Strategy	2.0	2.0	1.9	1.7
Transport	1.6	2.1	2.1	1.7
Exiting the European Union	0.0	0.1	0.1	0.1
International Trade	0.3	0.3	0.3	0.3
Culture, Media and Sport	1.4	1.4	1.5	1.5
DCLG Communities	2.6	3.1	2.3	2.2
DCLG Local Government	8.2	6.5	5.5	5.4
Scotland ²	20.7	14.2	13.6	13.2
Wales	13.1	13.4	13.4	13.5
Northern Ireland	9.9	10.0	10.0	10.0
Justice	6.9	6.6	6.2	6.0
Law Officers Departments	0.5	0.5	0.5	0.5
Environment, Food and Rural Affairs	1.7	1.6	1.5	1.4
HM Revenue and Customs	3.6	3.5	3.2	2.9
HM Treasury	0.2	0.1	0.1	0.1
Cabinet Office	0.4	0.3	0.2	0.2
Small and Independent Bodies	1.5	1.4	1.3	1.3
Reserves	0.0	5.1	4.9	7.2
Adjustment for Budget Exchange ³	0.0	-0.4	0.0	0.0
Adjustment for planned efficiency savings	0.0	0.0	0.0	-3.5
Total Resource DEL excluding depreciation	305.3	306.1	308.1	309.2
<i>OBR allowance for shortfall</i>	0.0	-0.8	-0.8	-0.8
OBR resource DEL excluding depreciation forecast	305.3	305.4	307.4	308.5

¹ Resource DEL excluding depreciation is the Treasury's primary control total within resource budgets and the basis on which Spending Review settlements were made.

² The Scottish Government's block grant has been adjusted from 2016-17 onwards as agreed in the Scottish Government's Fiscal Framework. In 2016-17 an adjustment of £5.5bn to reflects the devolution of SDLT and Landfill tax and the creation of the Scottish Rate of Income Tax. In 2017-18 an adjustment of £12.5bn additionally reflects the devolution of further Income Tax powers and revenues from Scottish courts. In 2018-19 and 2019-20, adjustments of £13.0bn and £13.4bn additionally reflect the devolution of Air Passenger Duty.

Table 4.C: Departmental Capital Budgets (Capital DEL)

	£ billion				
	Estimate		Plans		
	2016-17	2017-18	2018-19	2019-20	2020-21
Capital DEL					
Defence ¹	8.8	8.5	8.7	9.0	9.6
Single Intelligence Account	0.6	0.6	0.6	0.7	0.7
Home Office	0.5	0.6	0.5	0.5	0.4
Foreign and Commonwealth Office	0.1	0.1	0.1	0.1	0.1
International Development	2.6	3.6	3.2	3.5	3.6
Health (inc. NHS)	4.6	6.1	6.0	6.0	5.9
Work and Pensions	0.3	0.4	0.3	0.2	0.2
Education	6.3	5.3	6.2	4.7	4.7
Business, Energy and Industrial Strategy ²	11.0	10.8	10.4	11.1	6.0
Transport	5.5	6.4	8.1	11.1	12.4
Exiting the European Union	0.0	0.0	0.0	0.0	0.0
International Trade	0.0	0.0	0.0	0.0	0.0
Culture, Media and Sport	0.3	0.5	0.5	0.6	0.5
DCLG Communities	5.2	6.2	6.6	6.3	7.2
DCLG Local Government	0.0	0.0	0.0	0.0	0.0
Scotland	3.3	3.4	3.5	3.7	3.8
Wales	1.5	1.6	1.7	1.8	1.9
Northern Ireland	1.0	1.2	1.2	1.3	1.3
Justice	0.4	0.7	0.7	0.4	0.1
Law Officers Departments	0.0	0.0	0.0	0.0	0.0
Environment, Food and Rural Affairs	0.7	0.7	0.7	0.5	0.5
HM Revenue and Customs	0.3	0.2	0.2	0.2	0.2
HM Treasury	0.0	0.2	0.2	0.2	0.1
Cabinet Office	0.0	0.0	0.0	0.0	0.0
Small and Independent Bodies	0.1	0.1	0.1	0.1	0.1
Reserves	0.0	1.2	0.8	1.2	1.2
Capital spending not in budgets ³	0.0	0.0	0.0	0.4	2.3
Adjustment for Budget Exchange ⁴	0.0	-0.5	0.0	0.0	0.0
Adjustment for Research & Development RDEL to CDEL switch ⁵	0.0	0.0	0.0	0.0	6.5
Total Capital DEL	53.1	58.0	60.4	63.7	69.3
Remove CDEL not in PSGI ⁶	-6.8	-7.5	-6.4	-6.2	-5.0
OBR Allowance for shortfall	-0.1	-1.5	-1.8	-2.1	-
Public Sector Gross Investment in CDEL	46.2	49.0	52.2	55.4	64.3

¹ The defence budget for 2016-17 reflects changes made in-year, such as the drawdown of funding from the special reserve for the net additional cost of military operations. No such allocations have yet been made for 2017-18 onwards.

² Full BEIS CDEL budgets for 2020-21 have not yet been set. See footnote 5.

³ This represents funding not yet allocated to departments. It is presented net of the Office of Budget Responsibility's (OBR) allowance for shortfall in 2020-21.

⁴ Departmental budgets in 2017-18 include amounts carried forward from 2017-17 through Budget Exchange, which will be voted at Main Estimates. These increases will be offset at a Supplementary Estimates in future years so are excluded from spending totals.

5 Institutional features of public finances

The fiscal policy framework

5.1 In recent years, many governments internationally have used fiscal targets as a tool to demonstrate political commitment to fiscal policy goals. Increasingly they have established independent fiscal institutions (IFIs) to assess compliance with these targets, and to increase trust in the forecasts and analysis on which such assessments are usually based.

5.2 In the case of the UK, the Office for Budget Responsibility (OBR) was established in 2010 to “ensure that policy is made on an unbiased view of future prospects, improving confidence in the fiscal forecasts”.¹

Office for Budget Responsibility

5.3 The government established the OBR on an interim basis on 17 May 2010. Since then the OBR has been placed on a permanent, statutory footing through the Budget Responsibility and National Audit Act 2011 (the act), which received Royal Assent on 22 March 2011.

5.4 The OBR is comprised of the Chair of the OBR and two other members of the Budget Responsibility Committee (BRC), and two non-executive members. It is supported by a civil service staff.

5.5 The three BRC members: Robert Chote (Chair of the OBR), Charlie Bean and Graham Parker were appointed by the Chancellor with the approval of the Treasury Select Committee. Robert Chote and Graham Parker were appointed in October 2010 and Charlie Bean in September 2016. The Chancellor re-appointed for a second term of office Graham Parker in October 2014 and Robert Chote, Chair of the OBR in September 2015.

5.6 The two non-executive members: Lord Terry Burns and Dame Kate Barker were appointed by the Chancellor in June 2011. In June 2014, Dame Kate Barker was re-appointed to serve a second term of office and in June 2015, Lord Terry Burns was also re-appointed to serve a second term.

Remit of the OBR

5.7 The government’s fiscal policy decisions are based on the independent forecasts of the economy and public finances, prepared by the OBR. Since the general election in May 2010, the OBR has produced all the official forecasts of the economy and public finances, independently of ministers.

5.8 The act sets out the main duty of the OBR; to examine and report on the sustainability of the public finances. This duty feeds directly into the Treasury’s fiscal objective to deliver sound and sustainable public finances.

5.9 As set out in the act, the OBR’s responsibilities include:

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210667/press_01_10.pdf

- the production of at least two fiscal and economic forecasts each financial year, including independent scrutiny of the impact of policy measures and any resultant impact on the forecasts and the main risks and assumptions
- an assessment of the extent to which the fiscal and debt management objectives have been, and are likely to be, achieved alongside these forecasts
- an assessment on the accuracy of the previous fiscal and economic forecasts
- an analysis of the sustainability of the public finances

Operating framework

5.10 The Charter for Budget Responsibility provides guidance to the OBR in line with, and in support of, the provisions in the act. This guidance helps to explain the role of the OBR within the fiscal framework and provide greater clarity as to the OBR's duty to independently examine and report on the sustainability of the public finances.

5.11 This guidance provides for the OBR to investigate the impact of trends and policies on the public finances from a multitude of angles including through forecasting, long-term projections and balance sheet analysis. The OBR must perform its duty objectively, transparently and impartially and on the basis of government policy. This protects the independence of the OBR and ensures a clear separation between analysis (which is the role of the OBR) and policy making (which is the responsibility of ministers). The OBR has complete discretion in the performance of its duty subject to its statutory obligations.

5.12 As set out in the Charter, the OBR has additional responsibilities including:

- the production of a fiscal risks statement setting out the main risks to the public finances, including macroeconomic risks and specific fiscal risks, to be produced at least once every two years. This requirement was included in amendments to the Charter in October 2015
- the assessment of spending against the welfare cap and margin at the first Budget or fiscal update of each new Parliament, coinciding with the incoming government's setting of a new cap. In addition, the OBR will monitor welfare spending against the pathway and margin at each Budget and fiscal update before the formal assessment against the cap

5.13 To ensure credibility of the fiscal framework and protect the independence of the OBR it is vital for there to be transparency in the responsibilities of the OBR. A Memorandum of Understanding established a transparent framework for cooperation between the OBR and the Treasury, as well as other parts of government that the OBR needs to work closely with to perform its forecasting and analytical duties.

5.14 The OBR is accountable to Parliament and the Chancellor for the analysis it produces and the way it uses public funds. A framework document sets out the broad governance and management framework within which the OBR operates.

5.15 The Charter requires the government to set out before Parliament its fiscal policy objectives, and the means by which these objectives will be attained ("the fiscal mandate").

The fiscal mandate and supplementary targets

5.16 The Charter was modified in November 2016 to reflect the government's new fiscal rules. The fiscal rules approved by Parliament on 24 January 2017 are:

- in order to provide for sustainable public finances, ensure confidence in the economy, and support the effectiveness of monetary policy, the Treasury's objective for fiscal policy is to: **return the public finances to balance at the earliest possible date in the next Parliament**
- in order to achieve the above objective, the Treasury's mandate for fiscal policy in this Parliament is: **a target to reduce cyclically-adjusted public sector net borrowing to below 2% of GDP by 2020-21**
- the Treasury's mandate for fiscal policy is supplemented by: **a target for public sector net debt as a percentage of GDP to be falling in 2020-21**
- to ensure that expenditure on welfare remains sustainable, the Treasury's mandate for fiscal policy is further supplemented by: **a target to ensure that expenditure on welfare in 2021-22 is contained within a predetermined cap and margin set by the Treasury at Autumn Statement 2016**
- in the event of a significant negative shock to the UK economy, the Treasury will review the appropriateness of the fiscal mandate and supplementary targets as a means of returning the public finances to balance as early as possible in the next Parliament

Accounting and statistics

5.17 The independent Office for National Statistics and HM Treasury compile monthly statistics for the public sector and sub-sectors, on both a cash and accrued basis. Reconciliation tables between these are produced. The production is guided by the UK's code of practice which is consistent with the United Nations Fundamental Principles of Official Statistics and the European Statistics Code of Practice.

5.18 Information on the UK's contingent liabilities is published for all central government departments. The publication of the audited 'Whole of Government Accounts' (WGA), based on International Financial Reporting Standards, extends the coverage across government, with the latest report covering the year ended 31 March 2015. A summary of publicly available information on contingent liabilities is also published in the OBR's 'Fiscal sustainability report'.

5.19 WGA is a full accruals based set of accounts covering the whole public sector and audited by the National Audit Office. WGA is a consolidation of the accounts of around 5,500 organisations across the public sector, including central government departments, local authorities, devolved administrations, the health service, and public corporations.

A OBR analysis

A.1 This annex contains analysis prepared by the Office for Budget Responsibility (OBR). The first three pieces of analysis included are Chapters 3, 4 and 5 of the OBR's March 2017 'Economic and fiscal outlook'. They cover, in turn, the economic outlook, the fiscal outlook, and the performance against the government's fiscal targets. The final part of this annex is the executive summary of the OBR's 2017 'Fiscal sustainability report'.

3 Economic outlook

Introduction

3.1 This chapter:

- describes the assumptions that we have made in respect of **the UK's forthcoming exit from the EU** (from paragraph 3.2);
- sets out our estimates of the amount of **spare capacity** in the economy and our assumption regarding the growth in its productive potential (from paragraph 3.5);
- describes the key **conditioning assumptions** for the forecast, including monetary policy, fiscal policy and the world economy (from paragraph 3.22);
- sets out our short- and medium-term real GDP **growth forecasts** (from paragraph 3.44) and the associated outlook for **inflation** (from paragraph 3.54) and nominal GDP (from paragraph 3.67);
- discusses recent developments and prospects for the household, corporate, government and external **sectors of the economy** (from paragraph 3.70); and
- outlines **risks and uncertainties** (from paragraph 3.122) and compares our central forecast with those of selected external organisations (from paragraph 3.124).

Assumptions regarding the UK's exit from the EU

3.2 The OBR is required by legislation to produce its forecasts on the basis of current Government policy (but not necessarily assuming that particular policy objectives will be met). With negotiations over the UK's exit from the EU still yet to commence, this is not straightforward. We have again asked the Government for any additional information that it wished to provide on its current policies that would be relevant to our forecasts. As set out in the Foreword, it directed us to two recent statements in which it has set out its objectives at greater length: a speech by the Prime Minister in January and a white paper published in February. These note that precise outcomes will depend on further policy development by the UK authorities and on forthcoming negotiations with the EU.

3.3 While the Government has now set out some of its objectives more formally, there is understandably little detail about how it intends to achieve them. In many areas the policy outcome will depend not just on decisions made by the UK Government, but also on those of the parties that will be negotiating with it on behalf of the EU and other countries with

which it might wish to establish new trading arrangements. On trade policy, the white paper stated that the Government “will prioritise the freest and most frictionless trade possible” with the EU and that in terms of new trade agreements with other countries “work is underway to define the Government’s approach to trade policy”.¹ On immigration, it stated that the Government is “considering very carefully the options that are open to [it] to gain control of the numbers of people coming to the UK from the EU.”²

3.4 Given the uncertainty regarding how the Government will respond to the choices and trade-offs with which it will be confronted in the negotiations, there is no meaningful basis for predicting the precise end-point of the negotiations as a basis for our forecast. There is also considerable uncertainty about the economic and fiscal implications of different outcomes, even if they were predictable. So we have retained the same assumptions that underpinned our November forecast, which are consistent with a range of possible outcomes. Specifically, as regards the economy forecast, we assume that:

- **the UK leaves the EU in April 2019** – two years after the date by which the Prime Minister has stated that Article 50 will be invoked;
- **the negotiation of new trading arrangements with the EU and others slows the pace of import and export growth for the next 10 years.** We have calibrated this slowdown on the basis of a range of external studies of different trade regimes; and
- **the UK adopts a tighter migration regime than that currently in place,** but not sufficiently tight to reduce net inward migration to the desired ‘tens of thousands’.

Potential output and the output gap

3.5 Judgements about the margin by which economic activity exceeds or falls short of its sustainable level (the ‘output gap’) and the growth rate of potential output provide the foundations of our forecast. Together they determine the scope for growth in GDP over the next five years as activity returns to a level consistent with maintaining stable inflation in the long term. GDP growth is an important driver of trends in the overall budget deficit and the path of public sector debt.

3.6 Estimating the output gap allows us to judge the size of the structural budget deficit, in other words the deficit that would be observed if the economy were operating at its sustainable level.³ When the economy is running below potential, part of the headline deficit will be cyclical (and would therefore be expected to diminish as above-trend growth boosts revenues and reduces spending). If the economy is running above potential, the structural deficit will be larger than the headline deficit as a period of below-trend growth would be

¹ See Chapter 8 preamble and paragraph 9.8 of ‘The United Kingdom’s exit from and new partnership with the European Union’.

² See paragraph 5.9 of ‘The United Kingdom’s exit from and new partnership with the European Union’.

³ The methodology we use to do so is described in Helgadottir et al (2012): OBR Working Paper No.3: *Cyclically adjusting the public finances*.

expected to depress receipts and push up spending as the output gap returns to zero. The Government has a target for the structural deficit in 2020-21 (the 'fiscal mandate').

- 3.7 In this section, we first assess how far from potential the economy is currently before considering the pace at which potential output will grow in the future. These estimates relate to national output excluding the small but volatile oil and gas sector. We then add on a forecast for oil and gas production to complete our GDP forecast.

The latest estimates of the output gap

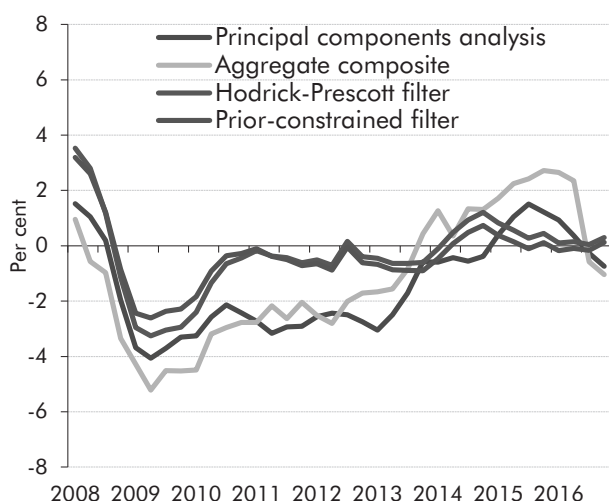
- 3.8 The first step in our forecast is to assess how the current level of activity in the economy compares with the level consistent with stable inflation in the long term ('potential output'). Potential output cannot be directly observed, but various techniques can be used to infer it indirectly, including cyclical indicators based on surveys, statistical filters and production functions. Every method has its limitations and no approach can avoid the need to exercise judgement. We therefore consider a broad range of evidence afresh at each forecast. Since our December 2014 forecast, we have looked at estimates of the output gap implied by nine different techniques in order to inform our judgement. Methodological details, and some of the strengths and weaknesses of each approach, were set out in *Working Paper No.5: Output gap measurement: judgement and uncertainty*, available on our website.
- 3.9 Cyclical indicator approaches use survey and other indicators of spare capacity and recruitment difficulties, aggregating them into a single indicator of the output gap. The results from two different cyclical indicator approaches are shown in Chart 3.1:
- the '**aggregate composite**' (AC) estimate implies that output moved above its sustainable level towards the end of 2013 and that by the second quarter of 2016 it was far above trend, reflecting in particular the strength of the British Chamber of Commerce (BCC) service sector indicators. These fell sharply in the third quarter (and further in the fourth), implying that output was below its sustainable level; and
 - the '**principal components analysis**' (PCA) estimate has been positive since 2015. It began to narrow by the end of that year and fell slightly below zero in the third quarter of 2016. It continued to fall in the fourth.⁴
- 3.10 Statistical filters decompose time series variables into a smooth underlying trend and a cyclical component. The two statistical filters we use that utilise output data alone (also shown in Chart 3.1) imply that the economy is currently operating slightly above potential. We place least weight on these measures as the estimate of potential output for the most recent data can be overly influenced by recent movements in actual output (the so-called 'end-point problem') and can be revised substantially as new output data become available.

⁴ More details on these methodologies are set out in our *Briefing Paper No.2: Estimating the output gap* and in Pybus (2011): *OBR Working Paper No.1: Estimating the UK's historical output gap*.

3.11 Chart 3.2 shows estimates that augment the output data with other information reflecting the economy’s cyclical position, such as inflation and indicators of capacity utilisation. We typically place more weight on these because of the wider pool of information they bring to bear. In the latest quarter, these measures tell a broadly consistent story of an economy operating a little above potential, and slightly more so in the fourth quarter of last year:

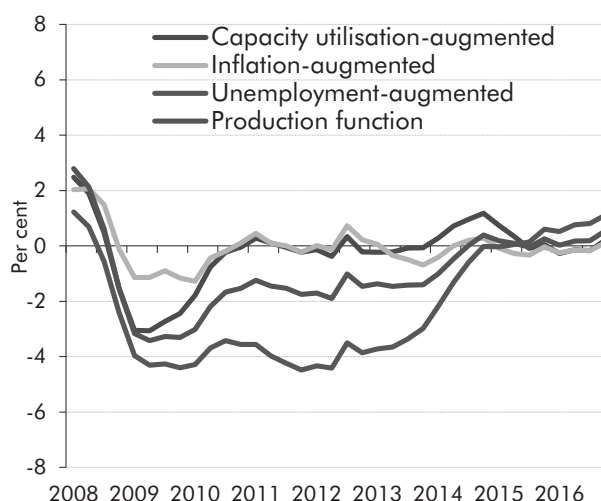
- the **inflation-augmented** measure points to a positive, albeit small, output gap for the first time since 2014. The inflation measure employed excludes the direct influence of food and oil costs to proxy domestically-generated inflation better, though changes in these may have an indirect effect on other prices. This measure will be affected by the past depreciation of sterling that is contributing to the present pick-up in CPI inflation;
- **capacity utilisation** indicators suggest businesses are operating slightly above normal levels, having been operating slightly below those levels earlier in 2016;
- the **unemployment** rate has continued to fall. Complementing output data with an estimate of the gap between actual unemployment and a filter-based estimate of the equilibrium unemployment rate (informed by changes in real wages and productivity) suggests that the output gap was close to zero in 2015 and has moved further into positive territory than other measures suggest; and
- a **production function**, which applies filters to the individual factors of production (capital and labour, for example), suggests that output has been slightly above potential over the past year. It also points to the gap widening over that period.

Chart 3.1: Cyclical indicators and filter-based estimates of the output gap



Source: OBR

Chart 3.2: Multivariate filter-based estimates of the output gap

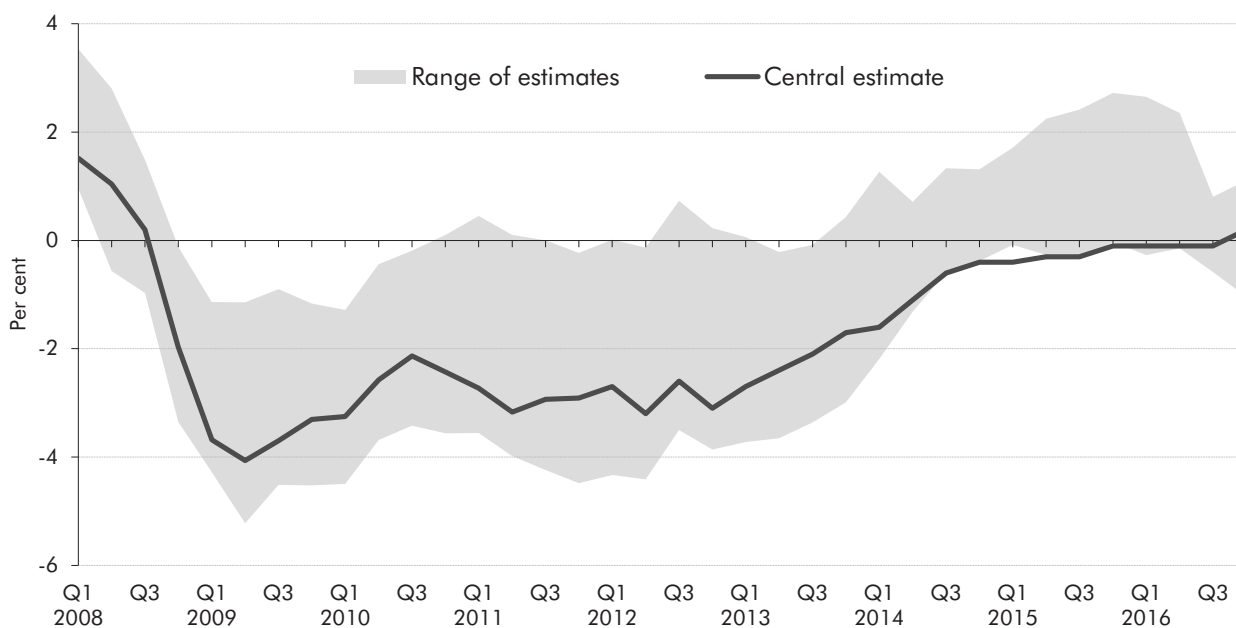


3.12 These estimates produce a range that is shown in Chart 3.3 along with our own latest judgement informed by these various measures. The cyclical indicators suggest a small negative gap, while all other estimates suggest a small positive gap. The range has been relatively wide during the past couple of years, although it narrowed significantly in the third

quarter of 2016 as the BCC survey moved the AC measure from the top to the bottom of the range. The estimates currently vary between -1.0 and +0.8 per cent.

- 3.13 Our broad judgement about the cyclical position of the economy at the end of 2016 is little changed from November – there appears to be little evidence either of much spare capacity or of overheating, suggesting that the economy is operating near potential and that the output gap is small. In order to put a number on that judgement, we consider the swathe shown in Chart 3.3 and particularly the path of those indicators upon which we place most weight. We sense-check our judgement by considering the profile it implies in the latest quarter against the profile of output growth and the unemployment rate in the same period.
- 3.14 Taking all these factors into account, we judge that the economy was operating very marginally above potential in the fourth quarter of 2016 – by 0.2 per cent. That is the first time the output gap is judged to have been in positive territory since the early stages of the financial crisis. Our latest estimate lies in the middle of the swathe of estimates in Chart 3.3.
- 3.15 We have also tweaked our judgements regarding the present composition of the output gap. In particular, with wage growth remaining relatively muted, we have reduced our estimate of the equilibrium unemployment rate in 2016 to 5.0 per cent from 5.2 per cent. We have then offset the effect of this change by assuming that actual productivity is below trend by a smaller margin. These compositional changes mean that, for a given GDP forecast, more will be attributable to employment growth and less to productivity growth. These changes do not, however, represent a significant modification in our view of the functioning of the labour market or the productive potential of the economy.

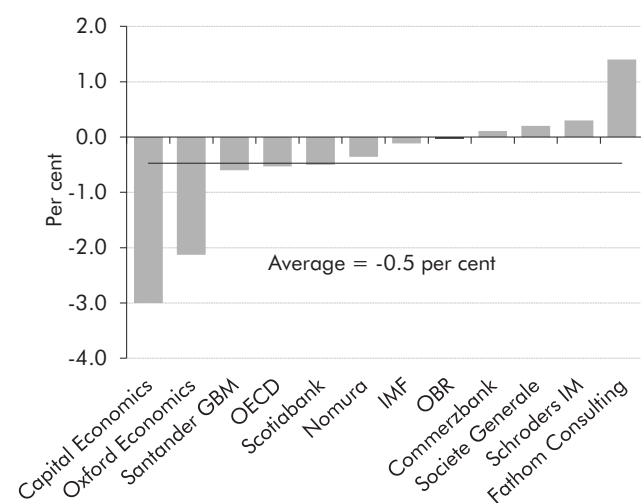
Chart 3.3: Range of output gap model estimates



Source: OBR

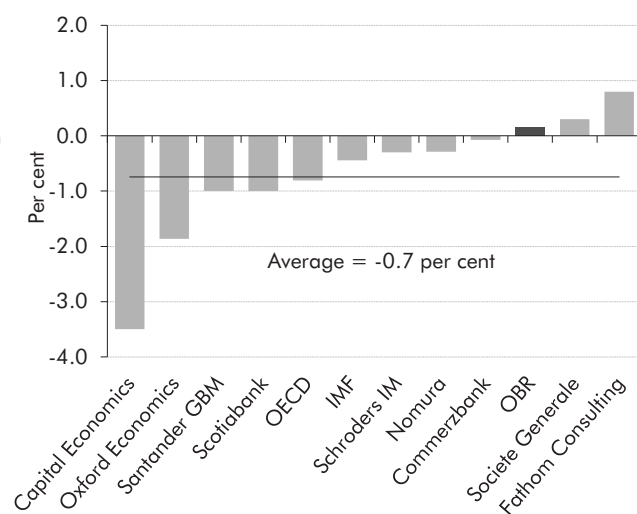
3.16 Charts 3.4 and 3.5 compare our central estimates of the output gap for 2016 and 2017 to those produced by other forecasters, as set out in the Treasury’s February *Comparison of independent forecasts*. These will vary due to differences of judgement, but also any differences in the concept of potential output against which actual output is being compared. The average estimate is -0.5 per cent in 2016 and -0.7 per cent in 2017, somewhat wider than our estimates of 0.0 and 0.2 per cent for those years. The estimates for 2017 range from -3.5 per cent to +0.8 per cent.

Chart 3.4: Estimates of the output gap in 2016



Source: HM Treasury

Chart 3.5: Estimates of the output gap in 2017



The path of potential output

3.17 The most important determinant in our forecast for the size of the economy in the long run is our judgement regarding the prospective path for potential output. There is always considerable uncertainty around this judgement, to which uncertainties associated with the UK’s exit from the EU are likely to add. As in November, we have not conditioned this forecast on a specific outcome expected from the negotiations. Rather we have made the judgement – in line with a range of external studies – that most outcomes are likely to depress investment, at least temporarily, and lead to lower net inward migration than would otherwise have been the case. Productivity growth could also be affected by lower trade and FDI than otherwise. Together, these lower the prospective path for potential output but the precise impact will remain highly uncertain, even in hindsight.

3.18 As ever, the outlook for trend productivity is the most important and uncertain judgement in our forecast. Productivity growth has slowed since the financial crisis, in the UK and most advanced economies. Having revised trend productivity growth down in our last two forecasts, we have not made any further changes this time. We assume that trend hourly productivity growth will gradually recover, reaching 1.8 per cent by the end of the forecast.

3.19 We continue to base our population growth assumptions on the ONS ‘principal’ population variant, which assumes net inward migration falls to 185,000 by 2021. The latest estimate

for net inward migration in the year to September 2016 was 273,000 – the first time it has fallen below 300,000 since the year to September 2014.

- 3.20 As discussed above, we have reduced our estimate of the equilibrium unemployment rate. This does not affect potential output growth over the forecast because we have made an offsetting change to our estimate of the productivity gap so as to leave the overall output gap unaffected. But it does mean that actual unemployment rises more slowly than in our November forecast, as it starts closer to equilibrium. The change to the productivity gap means that actual productivity growth is correspondingly slightly weaker than in November.
- 3.21 We continue to expect the long-term decline in average hours to reassert itself as productivity growth recovers, and that rises in the National Living Wage (NLW) will put upward pressure on equilibrium unemployment. We project the potential participation rate using the cohort labour market model that underpins our long-term projections. By projecting age-specific participation rates, this model captures the implications of an ageing population and the effect on labour market activity rates of the ongoing rises in the state pension age.⁵ This implies a participation rate that is relatively stable over the first half of the forecast period, but falling in the second half due to population ageing.

Table 3.1: Potential output growth forecast

	Percentage change on a year earlier, unless otherwise stated					Potential output ³
	Potential productivity ¹	Potential average hours	Potential employment rate ²	Potential population ²	Potential	
2016	1.0	0.0	0.1	0.7	1.7	
2017	1.4	-0.2	0.0	0.7	1.9	
2018	1.5	-0.2	0.0	0.6	1.8	
2019	1.6	-0.2	-0.1	0.6	1.9	
2020	1.8	-0.2	-0.2	0.6	2.0	
2021	1.8	-0.2	-0.2	0.6	2.0	

¹ Output per hour.

² Corresponding to those aged 16 and over.

³ Components may not sum to total due to rounding.

Key economy forecast assumptions

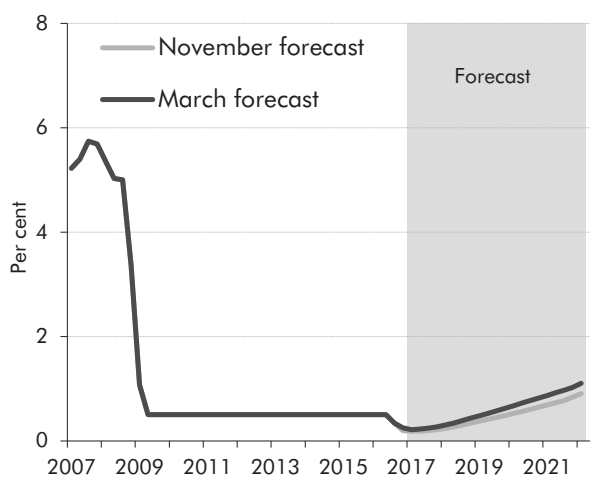
- 3.22 Our economic forecasts are conditioned on a number of assumptions. Among them, we assume that domestic and international interest rates, the exchange rate, equity prices and oil prices move in line with market expectations, taking the 10-day average to 16 February. We also base our forecasts on the Government's current stated policies on taxes, public spending and financial transactions, as required by Parliament. While the Government has laid out in a white paper what it seeks to achieve when the UK leaves the EU, it has not so far set out detailed policies. The assumptions we have made in this regard were described in paragraph 3.4. The risks to our forecasts are discussed later in the chapter.

⁵ Annex A of our July 2014 *Fiscal sustainability report* discusses our longer-term approach to labour market modelling in more detail.

Monetary policy and government bond yields

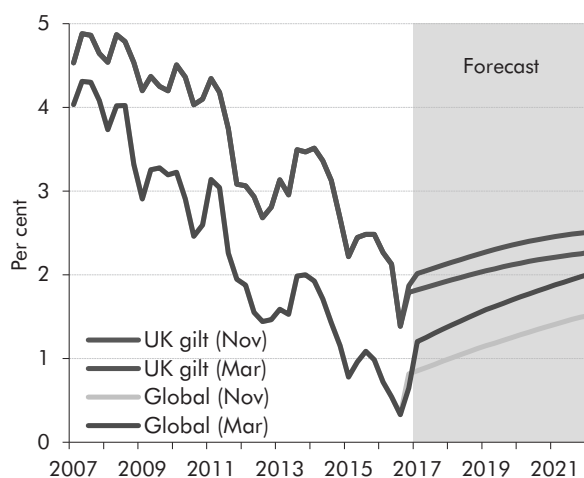
- 3.23 Our forecast assumes that the Bank of England will bring CPI inflation back to the 2 per cent target over the medium term, consistent with the Chancellor’s remit to the Monetary Policy Committee (MPC). That remit permits temporary deviations from the target in the face of events such as the recent depreciation of sterling if this avoids undue volatility in output. In its February 2017 *Inflation Report*, the MPC’s central projection was for CPI inflation to remain a little above the 2 per cent target at its 3-year forecast horizon, with the Committee noting that it “*must balance the trade-off between the speed with which it intends to return inflation to the target and the support that monetary policy provides to jobs and activity*”.
- 3.24 Bank Rate remained at what was then a historical low of 0.5 per cent from March 2009 to July 2016. In August 2016, following the referendum result, the MPC cut it further to 0.25 per cent. Market participants expect Bank Rate to rise only gradually over the next five years, reaching just 1.1 per cent by the end of our forecast period (Chart 3.6).
- 3.25 As well as reducing Bank Rate, the MPC introduced a package of measures designed to provide additional monetary stimulus. They included: a Term Funding Scheme (TFS) providing up to £100 billion of funding for banks at interest rates close to Bank Rate, intended to reinforce the pass-through of the cut in Bank Rate; an additional £60 billion of gilt purchases; and the purchase of up to £10 billion of UK corporate bonds. These are being implemented through the Asset Purchase Facility (APF) and financed by the issuance of additional bank reserves.
- 3.26 Gilt rate expectations and global bond yields are both higher than at the time of our November forecast, as shown in Chart 3.7. One factor driving these changes has been market speculation over the extent to which US fiscal policy will be loosened under the new administration.

Chart 3.6: Bank Rate



Source: Bank of England, Datastream, OBR

Chart 3.7: Global bond yields



Note: 20-year gilts for UK, trade weighted bond rates for global.

Macroprudential policy

- 3.27 The Bank of England's Financial Policy Committee (FPC) has statutory responsibility for "the identification of, monitoring of, and taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system". In its latest *Financial Stability Report*, the FPC noted that, aided by the Bank's actions, the UK financial system had remained resilient during the period of heightened market volatility following the referendum. But risks to financial stability remain, particularly associated with: the global environment; the commercial real estate market; the financing of the UK's large current account deficit; and the high level of household debt.
- 3.28 The FPC did not make any new recommendations in its latest *Report*, maintaining the countercyclical capital buffer at 0 per cent of banks' UK exposure.⁶ The limits on loan-to-income ratios and mortgage affordability tests on new owner-occupied mortgage lending were unchanged following a review of these recommendations. The FPC is expected to be granted powers of direction in the buy-to-let market this year, which will allow it to set limits on loan-to-value, debt-to-income and interest-coverage ratios.

Credit conditions

- 3.29 Having increased at the start of 2016, bank funding costs fell in the second half of the year, reflecting the cut in Bank Rate, and the introduction of the TFS. Together with narrowing margins, this has contributed to lower average mortgage rates. We project mortgage rates to fall further, reaching 2.6 per cent in the second quarter of 2017, and then rise in line with the expected pick-up in Bank Rate. This path is higher than in our November forecast, reflecting the higher expected path for Bank Rate.
- 3.30 Net lending to individuals continued to grow strongly in late 2016, increasing by 4 per cent in the year to December. This was driven by strong consumer credit lending, which increased by more than 10 per cent in the year to December. As discussed in Box 3.1, lower interest rates, easing credit conditions and innovations in consumer finance seem to be driving this. Net mortgage lending in the final quarter of 2016 was 3.1 per cent higher than a year earlier. We expect mortgage debt to increase over the forecast period at a similar rate to our November forecast.
- 3.31 Bank lending to businesses grew by 3.6 per cent in the year to December. While growth in lending to large businesses increased, growth in lending to small and medium-sized enterprises (SMEs) slowed from 2.1 per cent in September to 1.6 per cent in December. According to the Bank of England's latest *Credit Conditions Survey*, credit demand from SMEs fell significantly in the third and fourth quarters, despite unchanged availability.

⁶ The countercyclical capital buffer is set to reflect prevailing economic and financial market conditions. A high capital buffer is designed to give banks greater access to liquidity during times where risks are deemed to be higher than usual. A reduction in the buffer would increase capacity for lending to households and businesses.

Box 3.1: Recent trends in consumer credit

Consumer credit growth has been on an upward trend since 2012. The Bank of England's data on consumer credit flows are reported in net terms – i.e. new credit extended less the amount repaid on existing credit – but excluding write-offs, revaluations or other changes in the stock. On that basis, consumer credit net lending was 36 per cent higher in 2016 than in 2012. It increased 10.4 per cent in the year to December, the fastest increase since 2005 (Chart A).

Much of the strength in consumer credit growth in recent years can be attributed to dealership car finance, which allows car buyers to pay monthly instalments rather than a lump sum. An increasing proportion of cars has been bought in such a manner, for instance through personal contract purchase or hire purchase. Consequently the majority of consumer finance relating to car purchases is secured against the vehicle. Data from the Finance & Leasing Association suggest that, between 2012 and 2016, dealership car finance contributed around three-fifths of the growth in total net consumer credit flows. Within that, around four-fifths reflected strong growth in car sales, with the remainder accounted for by a higher proportion of cars bought using dealership car finance. It seems likely that the contribution of dealership car finance to overall consumer credit growth will decline as that market reaches maturity.

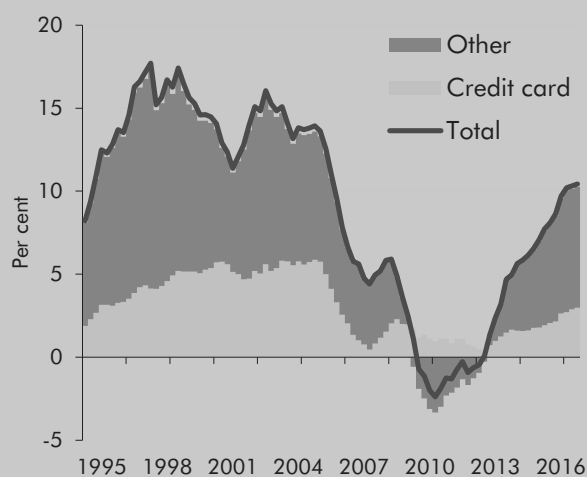
Over the past year, credit card lending has also played a bigger role in consumer credit growth, contributing 3.2 percentage points to the 10.6 per cent growth in 2016, up from 2.3 percentage points in 2015 and the highest since 2005. The Bank of England has pointed to greater competition in the credit card market – for example, longer interest-free periods on balance transfers – as contributing to easier credit conditions.

There has also been significant growth in other forms of lending over the past year. These include a variety of finance products, such as personal loans, payday loans, and home-credit and second-charge mortgages. Again, innovations in finance products and easier credit conditions may have contributed to this growth, while quoted interest rates on personal loans have fallen substantially in recent years, approaching the lower level of Bank Rate (Chart B).

Cheaper and more easily available credit will have supported household consumption, but the annual amount of net lending is relatively small, so it is unlikely to have been a major influence. The net flow of consumer credit was equivalent to just 1.2 per cent of household consumption in 2015 and 1.5 per cent in 2016, so in a purely accounting sense the increase in the net flow of consumer credit accounted for 0.3 percentage points of the 4.2 per cent growth in nominal household consumption last year. This suggests that the sharp fall in the saving ratio (excluding pension contributions) in the second half of 2016 was partly accounted for by a slowdown in households' accumulation of assets, rather than solely attributable to a pick-up in credit.

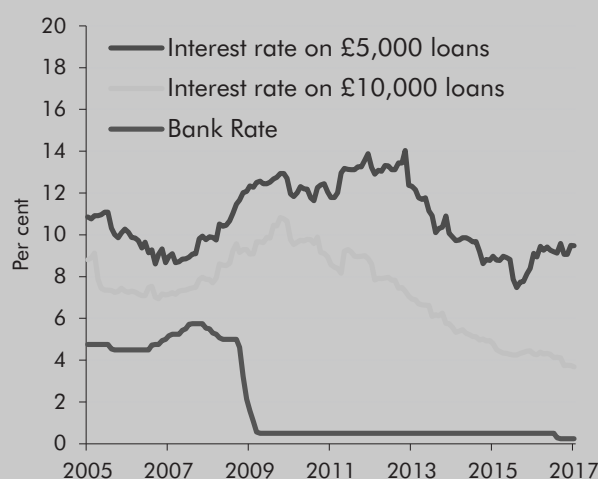
We forecast a broader National Accounts measure of unsecured debt – i.e. total household liabilities less loans secured on dwellings (mortgage debt). Our forecast is informed by a model relating the growth in unsecured debt to our forecasts for nominal consumption, the unemployment rate and property transactions. We have revised down nominal consumption growth and expect slower growth in unsecured debt than in the November *EFO*. But with the ONS having revised up the stock of unsecured debt in 2016, the ratio of unsecured debt to household income by 2021 is a little higher than in our November forecast, at 47 per cent.

Chart A: Contributions to annual consumer credit net lending growth



Note: Other includes dealership car finance
Source: Bank of England, OBR

Chart B: Interest rates on personal loans



Fiscal policy and Budget measures

- 3.32 Our forecast is conditioned on current Government policy and the ongoing fiscal consolidation. Reductions in government spending and increases in tax receipts mean that the structural deficit is expected to narrow between 2017-18 and 2019-20, before stabilising. Chapter 4 sets out our fiscal forecasts, while Box 3.2 sets out how this economy forecast has been affected by fiscal and other policy changes announced in this Budget.

Box 3.2: The economic effects of policy measures

This box considers the possible effects on the economy of the policy measures announced in this Budget and since the Autumn Statement. Further detail about each Budget measure is set out in the Treasury's documents. We assess their fiscal implications in Chapter 4 and Annex A.

The Government has very modestly loosened **fiscal policy in aggregate** in the near term, largely by increasing departmental current spending. To capture the impact on economic growth we have applied the same 'multipliers' we have used in previous forecasts. (The shorter the period between a policy's announcement and its subsequent implementation, the larger the multiplier.) Together, the measures imply small effects on the profile of real GDP growth, adding less than 0.1 percentage points in 2017-18 and subtracting even smaller amounts each year thereafter.

We have adjusted our inflation forecasts for the reduction in the **personal injury discount rate** to *minus* 0.75 per cent that was announced by the Ministry of Justice on 27 February. At that time, the Prudential Regulation Authority (PRA) estimated the cost to insurers of this decision at around £2 billion a year, with a wide range of uncertainty around that figure. This estimate may be revised as more information on the effects of the change become available. We have assumed that these costs will be passed on in full and almost immediately to insurance premiums.

In the case of motor insurance premiums, this has a direct and therefore immediate effect on consumer price inflation as they are included in the CPI basket. We also expect increases in employer liability insurance premiums, which are not in the CPI basket but which we assume will over time be passed on to the prices of final goods and services that are.

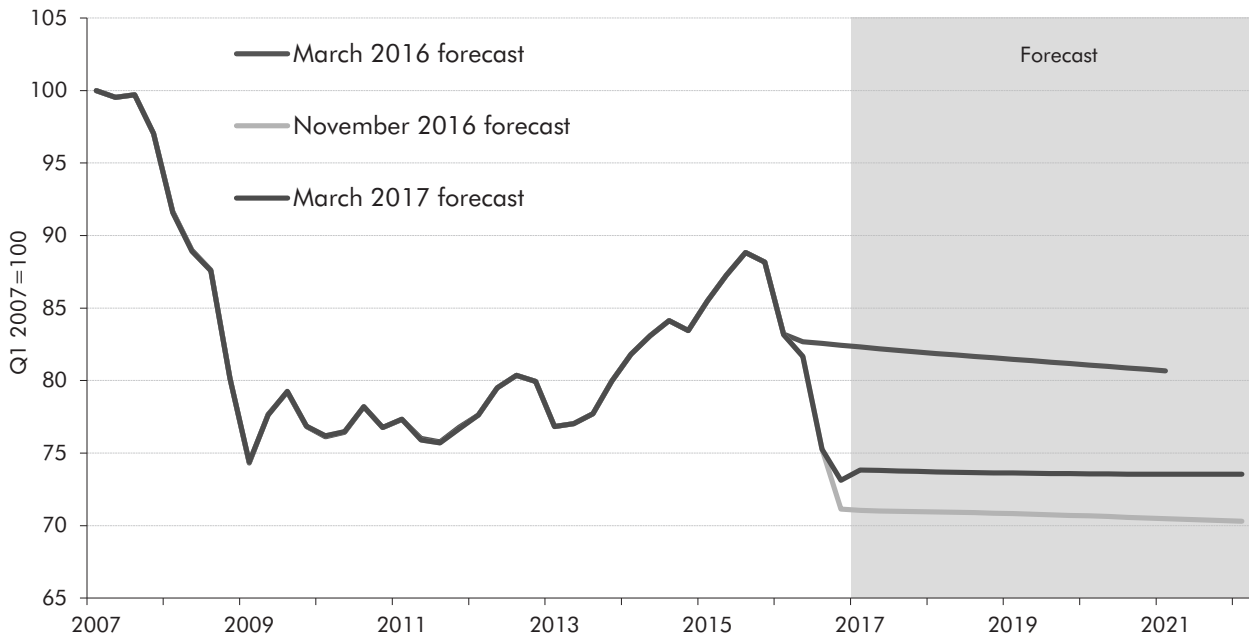
Together, we estimate that these effects will increase CPI inflation by a little under 0.1 percentage points, but increase RPI inflation by a little over 0.2 percentage points cumulatively by the end of 2017-18. The RPI effect is bigger because motor insurance has a weight four times larger in the RPI than in the CPI. This is because it is measured on a 'gross' basis in the RPI (reflecting only the premiums paid) but 'net' in the CPI (premiums paid net of amounts paid out).

As well as the uncertainty around the PRA's central estimate of the cost to insurers, other uncertainties include the pace and extent to which insurers will pass that cost onto customers. Their behaviour may also be influenced by the Government's simultaneous announcement that it would launch a consultation that "*will consider whether there is a better or fairer framework for claimants and defendants*" – which implies that the change could be wholly or partially reversed.

Sterling effective exchange rate

- 3.33 The sterling effective exchange rate has been on a downward trend since the third quarter of 2015 and fell sharply after the referendum last year. This is likely to reflect market participants lowering their expectations for returns on UK assets. It could also represent investors attaching a higher risk premium to UK assets. While sterling has appreciated relative to the assumption underpinning our November forecast, it remains significantly lower than at the time of the referendum. Comparing the 10-day average to 16 February that underpins this forecast with the recent peak in the third quarter of 2015, sterling was down 20 per cent against the US dollar and 16 per cent against the euro.
- 3.34 From its current level, we assume that the exchange rate will follow the path implied by uncovered interest parity: namely that it will move to reflect the difference between UK and overseas interest rates so as to equalise the expected return to investing at home and abroad. On average over the forecast period our latest sterling effective exchange rate assumption is 4.1 per cent above our November assumption, but around 10 per cent below our March 2016 assumption (Chart 3.8). It is expected to depreciate slightly further over time, as UK forward interest rates lie a touch above an average of the corresponding forward interest rates in the UK's major trading partners (shown in Chart 3.7 above).

Chart 3.8: Sterling effective exchange rate assumptions

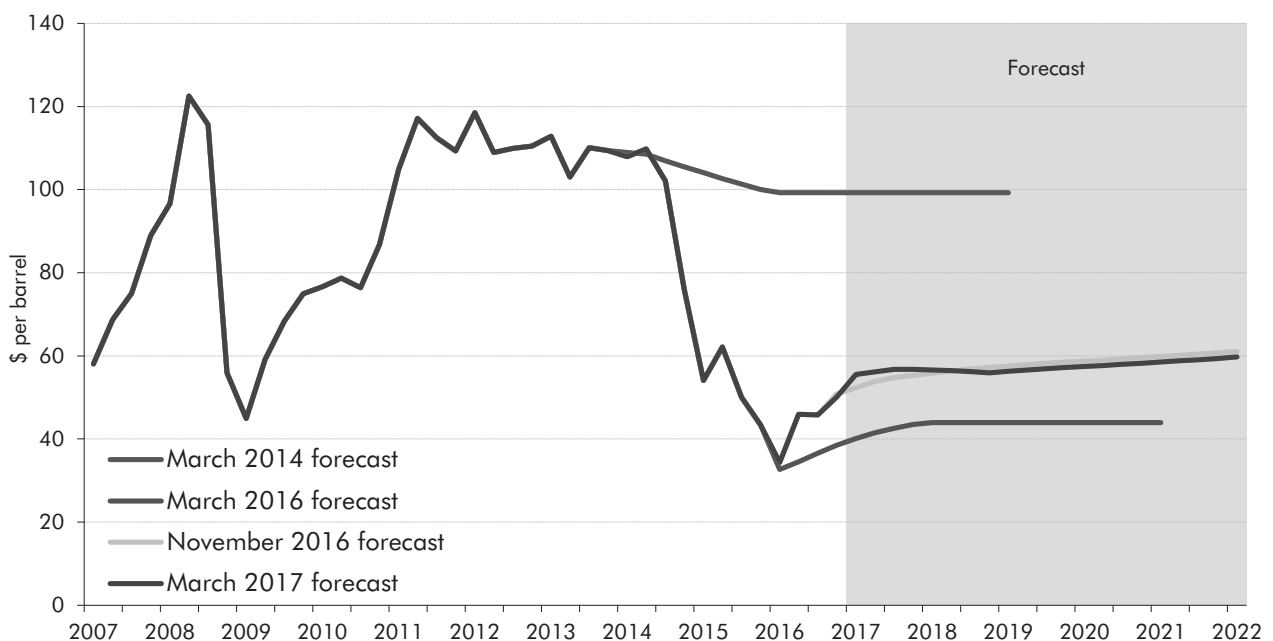


Source: Bank of England, Bloomberg, OBR

Oil prices

3.35 As Chart 3.9 shows, oil prices have risen over the past year, with the futures curve based assumption for the first quarter of 2017 around 40 per cent higher than in our forecast a year ago. But it is little changed since November and remains 44 per cent lower than our March 2014 assumption. Among the factors affecting oil prices in recent months has been the OPEC supply cut announced in September 2016 and implemented in January this year.

Chart 3.9: Oil price assumptions



Source: Datastream, IMF, OBR

World economy

- 3.36 World GDP is estimated to have increased by 3.1 per cent in 2016, in line with our November forecast. In its January 2017 *World Economic Outlook Update*, the IMF forecast for world GDP growth up to 2018 was unrevised. We use that to inform our own forecast, which is also unrevised in all years. World GDP growth is expected to rise gradually over the forecast, reaching 3.7 per cent in 2021.
- 3.37 In the final quarter of 2016, euro area GDP was 1.7 per cent higher than a year earlier. Over the same period, GDP grew by 1.8 per cent in Germany, 1.1 per cent in France and 1.1 per cent in Italy, but growth was higher in Spain, at 3.0 per cent. For 2016 as a whole, euro area GDP is estimated to have grown by 1.7 per cent, in line with our November forecast.⁷ Despite that, slightly stronger-than-expected growth at the end of 2016 has raised our forecast for the annual euro area growth rate in 2017. We now expect growth of 1.6 per cent in 2017 and 2018, and 1.5 per cent a year thereafter.
- 3.38 Euro area inflation reached 2.0 per cent in February, having picked up sharply since November, largely due to energy prices. Core inflation (which excludes energy, as well as food, alcohol and tobacco) stood at 0.9 per cent, only slightly higher than in November. Unemployment was 9.6 per cent in January, continuing its recent declining path.
- 3.39 US GDP is estimated to have increased by 0.5 per cent in the final quarter of 2016, driven by higher private consumption, private investment and stockbuilding, offset by a drag from net trade. This was lower than in the preceding quarter and implies growth of 1.6 per cent for 2016 as a whole. In its latest *WEO Update*, the IMF revised up its forecast for US GDP growth in 2017 and 2018 on the basis of an expected fiscal stimulus, but highlighted the uncertainty around this “*in light of potential changes in the policy stance*”. Our global forecast is consistent with the IMF’s assumptions regarding the effects of US fiscal policy on growth in the coming years. These revisions to US GDP growth are not large enough to result in a different path for world GDP in our forecast.

World trade and UK export market growth

- 3.40 World trade is now estimated to have grown by 1.9 per cent in 2016, lower than forecast in November. World trade growth was weak in the first half of 2016 and available data suggest that this weakness continued in the second half of the year. We continue to assume a gradual pick-up in trade growth relative to world GDP growth over the forecast period, but from a lower starting point. As such, we have revised down our world trade forecast in 2017 and 2018, where we now expect growth of 3.1 and 3.6 per cent respectively. World trade growth is largely unchanged in the final two years of the forecast. We continue to assume a lower trade intensity of world GDP growth than implied by the latest IMF forecast.

⁷ Revised euro area GDP data were published on 7 March, after the point at which they could be included in our forecast or reported in this document.

3.41 We have revised down growth in UK export markets in 2017 and 2018, largely due to the downward revision to world trade growth, but also because the weakness is concentrated in markets that account for a relatively high proportion of UK exports. This is consistent with the IMF's January *WEO Update*, which forecasts lower trade growth in the advanced economies relative to emerging markets. Advanced economies generally have a higher weight in UK export markets than in world trade overall. As with world trade, our UK export market growth forecast is unchanged since November in the final two years.

Summary

3.42 To summarise, the key assumptions underpinning our central forecast are that:

- **the UK leaves the EU in April 2019**, that the trading regime will be less open than before and that the UK adopts a tighter migration regime than is currently in place;
- **monetary policy** remains highly accommodative, although slightly less so than we assumed in November, reflecting slightly higher expectations of Bank Rate on the part of market participants;
- there will be little change in **credit conditions** given the orientation of macroprudential policy, while the financial system will continue on a path of gradual normalisation;
- **fiscal policy** follows a broadly similar path to the one set out in November, with fiscal consolidation set to continue throughout the forecast period;
- **sterling** is slightly stronger than was assumed in November, but around 10 per cent lower than assumed a year ago;
- dollar **oil prices** are higher than assumed in November. Beyond the two-year horizon they are assumed to remain constant in real terms; and
- **global GDP and the demand for UK exports** increases steadily, although in the near term UK export markets grow slightly more slowly than expected in November.

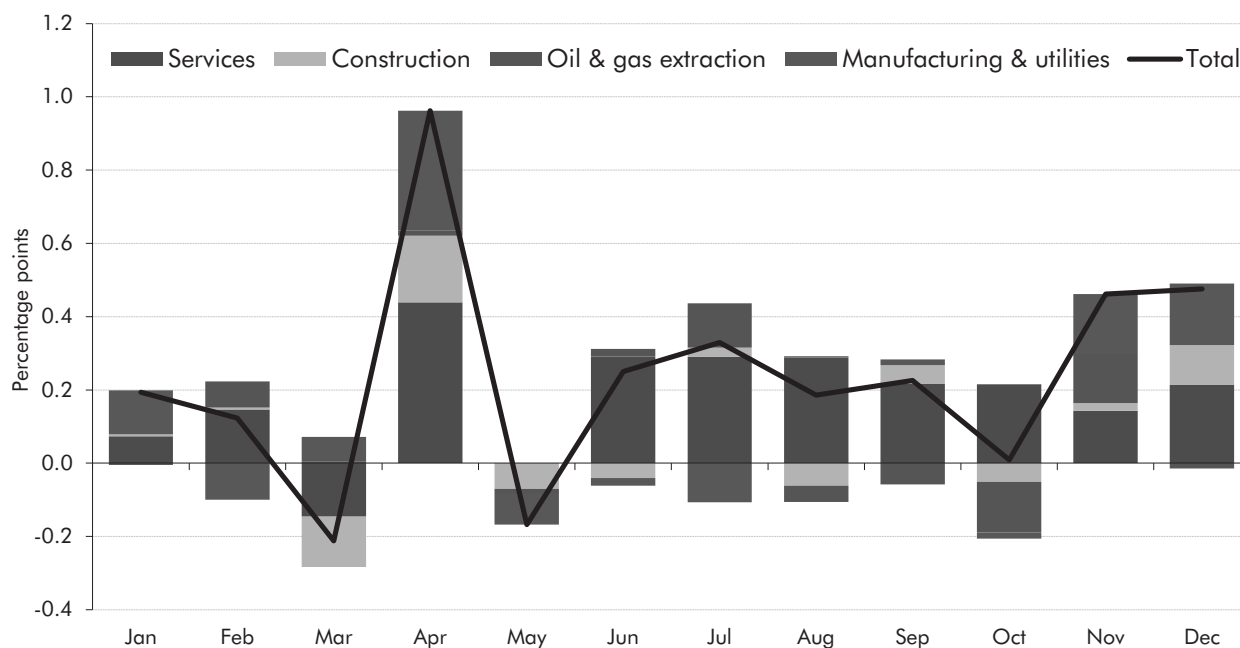
3.43 Risks and uncertainties associated with these assumptions and other facets of the forecast are discussed later in the chapter.

Prospects for real GDP growth

The short-term outlook for GDP

3.44 The services sector grew robustly in the second half of 2016. The other sectors account for smaller shares of overall output, but tend to be more volatile, so in some cases had significant effects on quarterly GDP growth in 2016. Manufacturing output rose over 2016, having fallen in 2015. Construction output also rose in 2016, but less rapidly than in 2015.

Chart 3.10: Contributions to monthly output growth in 2016



Source: ONS

- 3.45 Real GDP increased by 0.7 per cent in the final quarter of 2016, higher than our November forecast of 0.4 per cent. Growth in the third quarter was also revised up relative to the latest estimate available at the time of our November forecast, but growth at the start of the year was revised down. Quarterly growth has therefore picked up slightly in the second half, rather than slowing as the indicators available at the time of our November forecast suggested. Overall, GDP is estimated to have grown by 1.8 per cent in 2016, slightly lower than we forecast in November due to the downward revision at the start of the year.
- 3.46 Given stronger momentum in GDP growth in late 2016, we have revised up our forecast for quarterly GDP growth in the first quarter of 2017 to 0.6 per cent, although the Purchasing Managers Index published after our forecast closed may suggest a weaker figure. Thereafter we continue to expect quarterly GDP growth to moderate – to 0.3 per cent a quarter, as shown in Table 3.2. As in November, we expect real consumption growth to slow as the past depreciation of sterling boosts inflation, weighing on household real incomes, and as household saving stabilises after the sharp drop over the past year. We also expect business investment to remain subdued after the fall over the past year, although that weakness is somewhat shallower and more drawn out than expected in November. These two effects are partly offset by a positive contribution to growth from net trade, reflecting a boost from the weaker exchange rate and the knock-on effects of weaker domestic demand.
- 3.47 While the depreciation of sterling since late 2015 has been substantial, we judge that the consequent boost to net trade is likely to be relatively modest in historic terms, consistent with the relatively weak response of net trade to the previous substantial depreciation of sterling that took place during the financial crisis (see paragraph 3.108). This boost is not sufficient to offset the prospective weakening in domestic demand.

- 3.48 While we continue to expect quarterly GDP growth to be slightly weaker this year than last, unexpectedly strong growth in the second half of 2016, together with slightly more momentum in early 2017, means that annual GDP growth is now expected to reach 2.0 per cent this calendar year, 0.6 percentage points higher than expected in November.

Table 3.2: The quarterly GDP profile

	Percentage change on previous quarter											
	2016				2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
March forecast ¹	0.2	0.6	0.6	0.7	0.6	0.3	0.3	0.3	0.4	0.4	0.4	0.4
November forecast ²	0.4	0.7	0.5	0.4	0.3	0.2	0.3	0.4	0.4	0.5	0.5	0.5
Change³	-0.3	-0.1	0.1	0.3	0.3	0.1	0.0	0.0	0.0	-0.1	-0.1	-0.1

¹ Forecast from first quarter of 2017.

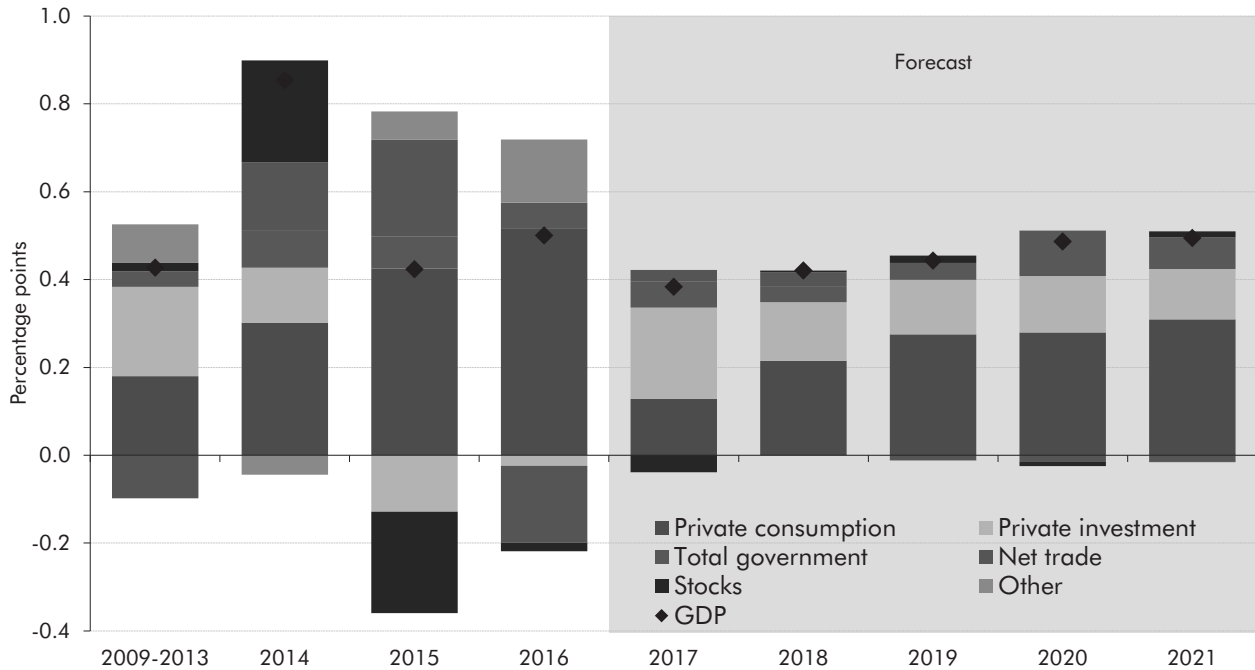
² Forecast from fourth quarter of 2016.

³ Changes may not sum due to rounding.

The medium-term outlook

- 3.49 Our forecasts for growth in the medium term are based on a judgement that actual output will return towards its potential level. The conditioning assumptions discussed in the previous section inform the judgement as to what extent the gap between actual output and potential output closes over the forecast horizon, and how quickly that occurs.
- 3.50 As set out above, we expect quarterly GDP growth to slow more noticeably from the second quarter of 2017. It is assumed to pick up slightly to an average rate of around 0.4 per cent in 2018 and 2019, as uncertainty begins to dissipate and business investment starts to recover, while household spending is supported by stronger real earnings growth on the back of stronger productivity growth and attenuating inflation. With output close to its potential level throughout the forecast, the modest strengthening of GDP growth from 2018 onwards is consistent with our assumption that potential productivity growth will pick up towards its historic average in the coming years.

Chart 3.11: Contributions to average quarterly GDP growth

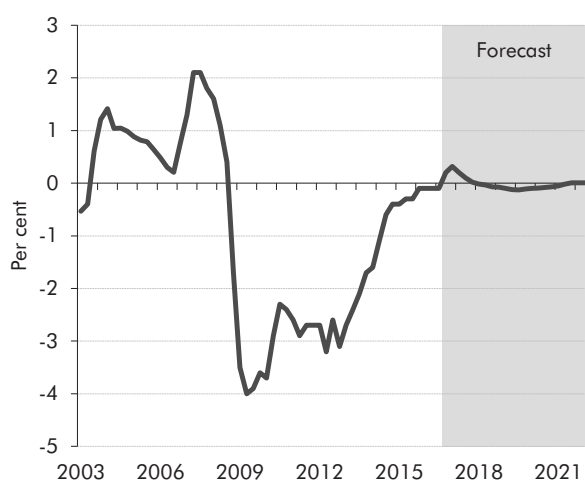


Note: 'Other' category includes the statistical discrepancy and the residual between GDP and the expenditure components prior to the base year (2013).

Source: ONS, OBR

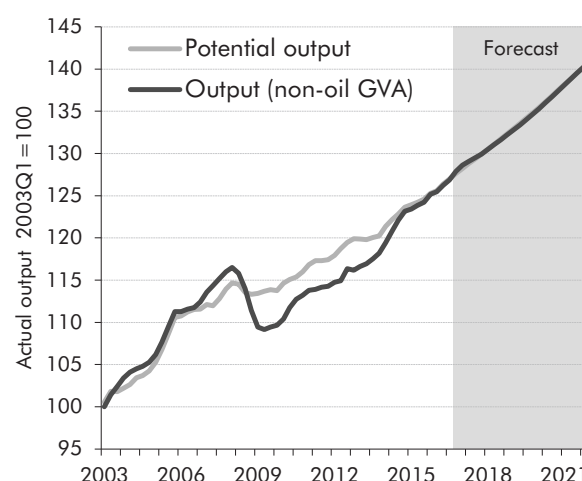
3.51 Relative to our November forecast, stronger consumption growth at the end of 2016 implies that output has moved slightly above trend. The shallow growth slowdown over the coming year means we expect a small margin of unused capacity to open up by the end of 2017. The subsequent recovery in business investment and consumption is more gradual than we forecast in November, with the output gap closing at a similar point in the medium term. But given how small the output gap is at any point in our forecast, judgements about the pace at which it closes are not material to our overall GDP growth forecast.

Chart 3.12: The output gap



Note: Output gap estimates on a quarterly basis, based on the latest National Accounts data and expressed as actual output less trend output as a percentage of trend output (non-oil basis).
Source: OBR

Chart 3.13: Projections of actual and potential output



Source: ONS, OBR

3.52 Table 3.3 summarises the expenditure composition of the GDP forecasts described above.

Table 3.3: Expenditure contributions to real GDP

	Percentage points, unless otherwise stated					
	Outturn	Forecast				
	2016	2017	2018	2019	2020	2021
GDP growth (per cent)	1.8	2.0	1.6	1.7	1.9	2.0
Main contributions						
Private consumption	1.9	1.2	0.6	1.1	1.1	1.2
Business investment	-0.1	0.0	0.3	0.4	0.4	0.3
Dwellings investment ¹	0.2	0.1	0.1	0.1	0.1	0.1
Government ²	0.2	0.2	0.2	0.1	0.3	0.3
Change in inventories	-0.5	0.0	0.0	0.0	0.0	0.0
Net trade	-0.4	0.3	0.3	0.0	-0.1	-0.1
Other ³	0.6	0.1	0.0	0.0	0.0	0.0

¹ The sum of public corporations and private sector investment in new dwellings, improvements to dwellings and transfer costs.

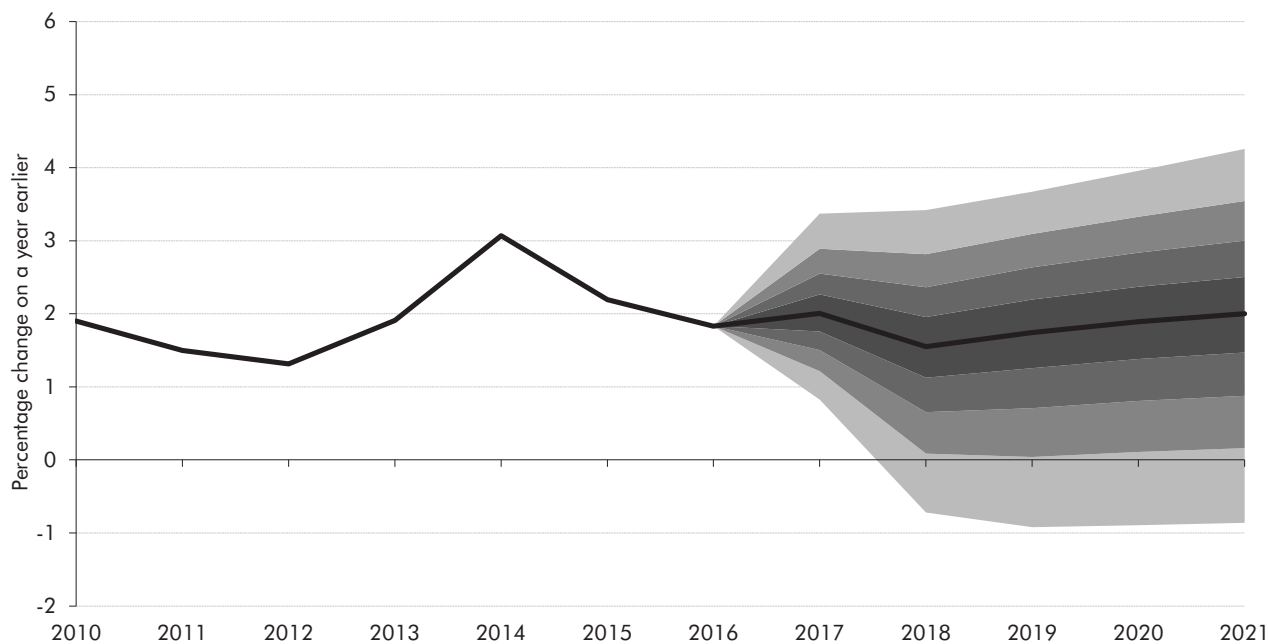
² The sum of government consumption and general government investment.

³ Includes the statistical discrepancy and net acquisition of valuables.

Note: Components may not sum to total due to rounding.

3.53 Our central GDP growth forecast is shown in Chart 3.14. The distribution surrounding the central forecast shows the probability of different outcomes based on past forecast performance. The solid black line shows our median forecast, with successive pairs of lighter shaded areas around it representing 20 per cent probability bands. These are based on the historical distribution of official forecast errors. They do not represent a subjective measure of the distribution of risks and uncertainties around our central forecast. Such risks and uncertainties are discussed at the end of the chapter.

Chart 3.14: Real GDP growth fan chart



Source: ONS, OBR

Prospects for inflation

- 3.54 In assessing the outlook for the economy and the public finances, we are interested in several measures of inflation, but principally the Consumer Prices Index (CPI) and the Retail Prices Index (RPI). The source information is the same for both indices, although there are a number of differences in coverage and methodology (see Box 3.3 of the March 2015 *EFO* for details). We also need to forecast the GDP deflator and its components, which are required to generate a projection for nominal GDP.
- 3.55 CPI and RPI inflation affect the public finances in several ways. The Government uses the CPI to index many tax allowances and thresholds, and for the uprating of benefits and public sector pensions. The RPI is used to calculate interest payments on index-linked gilts, student loan payments and the revalorisation of excise duties. The ONS also publishes several other inflation measures, such as CPIH, but as these do not currently affect the public finances, we do not need to forecast them.

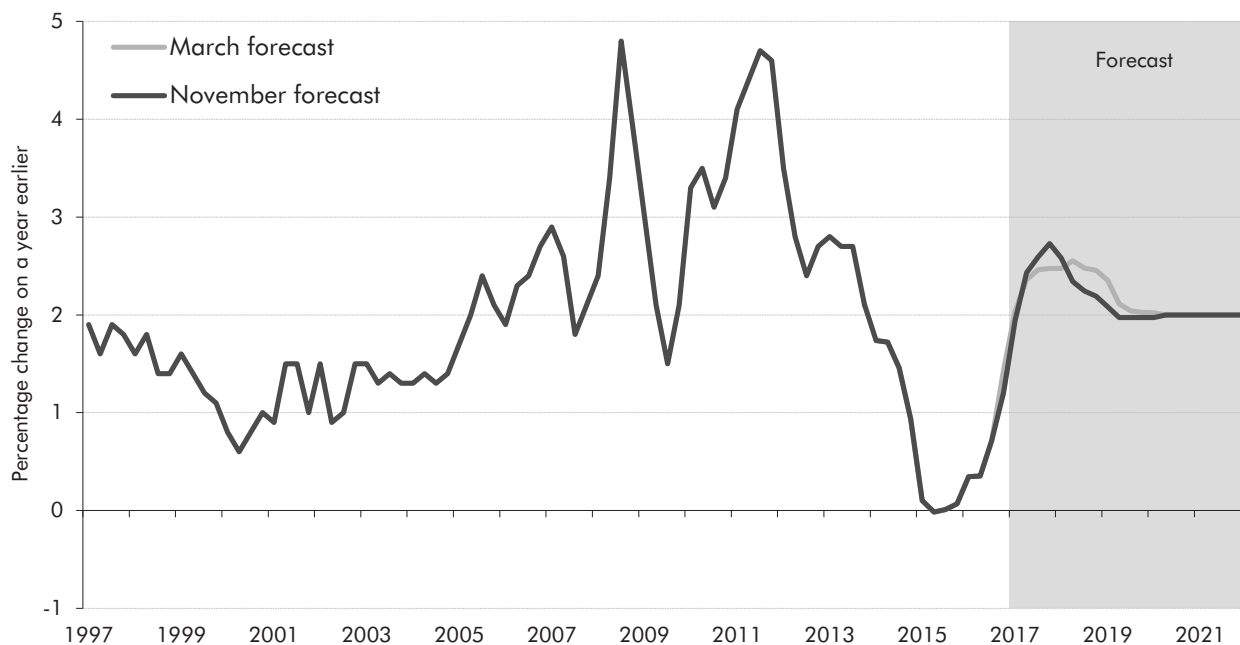
CPI inflation

- 3.56 Since our November forecast, the annual rate of CPI inflation has picked up, rising by 0.9 percentage points in the past four months. This was driven by the increase in import prices caused by the depreciation in sterling, and by rising global commodity and energy prices.
- 3.57 CPI inflation averaged 1.2 per cent in the fourth quarter of last year, 0.2 percentage points below our November forecast. The latest monthly data show CPI inflation at 1.8 per cent in January, its highest rate since mid-2014 and close to the MPC's 2 per cent target.

- 3.58 We now expect CPI inflation to average 2.4 per cent in 2017, up from 2.3 per cent in November. We expect it to peak at 2.7 per cent in the final quarter of 2017, before gradually declining. Since November, other than policy changes, the main developments that have affected our central inflation forecast are as follows:
- across the forecast period, **sterling** is now 4.1 per cent higher than the level our November forecast was based on. This implies less prospective upward pressure on import prices. In addition, the effect of the past depreciation in sterling has been slower to materialise in food price increases that we assumed in November, though we continue to expect food price inflation to turn positive in the first quarter of 2017;
 - **oil prices** are expected to be 6.2 per cent higher in the first quarter of 2017 than in our November forecast. Recent developments in the global oil market, past falls in oil prices dropping out of the 12-month comparison, and the past depreciation of sterling against the US dollar mean fuel prices are likely to boost CPI inflation in 2017; and
 - several **utility companies** have announced significant price rises, citing higher wholesale energy prices and the cost of delivering Government policy as the main reasons for doing so. The weighted average effect of these announcements will be to increase electricity and gas prices from the second quarter of 2017; and
 - we have revised down the estimated effects of the upcoming **soft drinks industry levy**, to reflect our judgement that the pace and extent to which producers will reformulate their products towards lower sugar content will be greater. This reduces CPI inflation in 2018-19 by less than 0.1 percentage points.
- 3.59 In addition, there is one policy announcement that has affected our central forecast:
- the Ministry of Justice has announced that the **personal injury discount rate** will be lowered from the 2.5 per cent that has prevailed since 2001 to *minus* 0.75 per cent, increasing the likely size of one-off cash settlements substantially. This is expected to generate significant additional costs for insurers, which we have assumed will be passed on in full to motor insurance premiums paid by consumers (see Box 3.2).
- 3.60 CPI inflation is expected to move above the Bank of England's 2 per cent target in the first quarter of 2017. While the Bank noted in its February 2017 *Inflation Report* that there were limits to the "*extent that above-target inflation can be tolerated*", the MPC also reiterated that, given the exceptional circumstances of sterling's depreciation, the current stance of monetary policy remained appropriate given the trade-off it faced. Market interest rates suggest that, in light of this guidance, market participants do not expect the MPC to seek to attenuate the short-term inflation overshoot by materially tightening policy. Consistent with this view, our central forecast is that inflation will remain above the target until the first half of 2019. We assume that inflation will remain at the target thereafter.

3.61 While we do not currently produce fan charts to illustrate the scale of uncertainty around our central forecast for inflation, the variation in outturns over the past decade shown in Chart 3.15 provides an indication of that uncertainty.

Chart 3.15: CPI inflation



Source: ONS, OBR

RPI inflation

3.62 As the ONS has noted, the definition of RPI inflation does not meet accepted international statistical standards,⁸ but we need to forecast it as an input into our fiscal forecasts – notably as a key determinant of the interest paid on the burgeoning stock of index-linked gilts.

3.63 RPI inflation averaged 2.2 per cent in the final quarter of 2016, 0.2 percentage points below our November forecast. The small revisions to our forecast for CPI inflation are reflected in the corresponding forecast for RPI inflation. There are also a number of factors specific to our RPI forecast:

- the estimated effect of higher motor insurance premiums due to the Government’s decision to lower the **personal injury discount rate** is just over four times bigger than on CPI inflation, because the weight of motor insurance premiums in the RPI is based on gross spending on premiums rather than net spending after deducting payouts;⁹
- we have factored in the effect of the Government allowing local authorities to raise **council tax** faster over the coming two years to finance adult social care spending,

⁸ ONS, *Response to the National Statistician’s consultation on options for improving the Retail Prices Index*, February 2013.

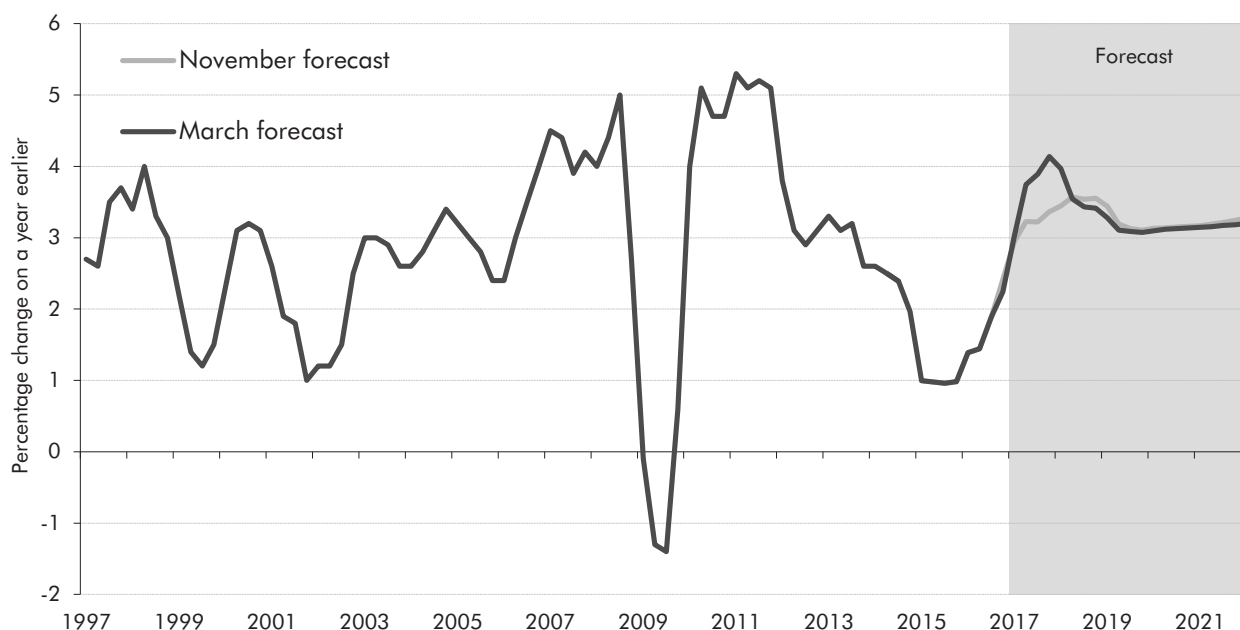
⁹ The weighting of insurance in the CPI is consistent with that of other European Harmonized Index of Consumer Price measures. The gross weighting approach taken in the construction of RPI deviates from this internationally accepted approach.

which was announced in December. This only affects RPI inflation, as council tax is not included in the CPI;

- the upward revision to our **house price inflation** forecast feeds into the housing depreciation component of RPI inflation; and
- **market expectations of the future path of Bank Rate** have risen since November, increasing our forecast for growth in mortgage interest payments (MIPs) across the forecast period. This implies a stronger contribution from MIPs to RPI inflation.

3.64 The wedge between CPI and RPI inflation rises to 1.2 percentage points by the end of the forecast period. This is slightly above our estimate of the long-term steady-state wedge because mortgage interest rates are expected to be rising at that point.

Chart 3.16: RPI inflation



Source: ONS, OBR

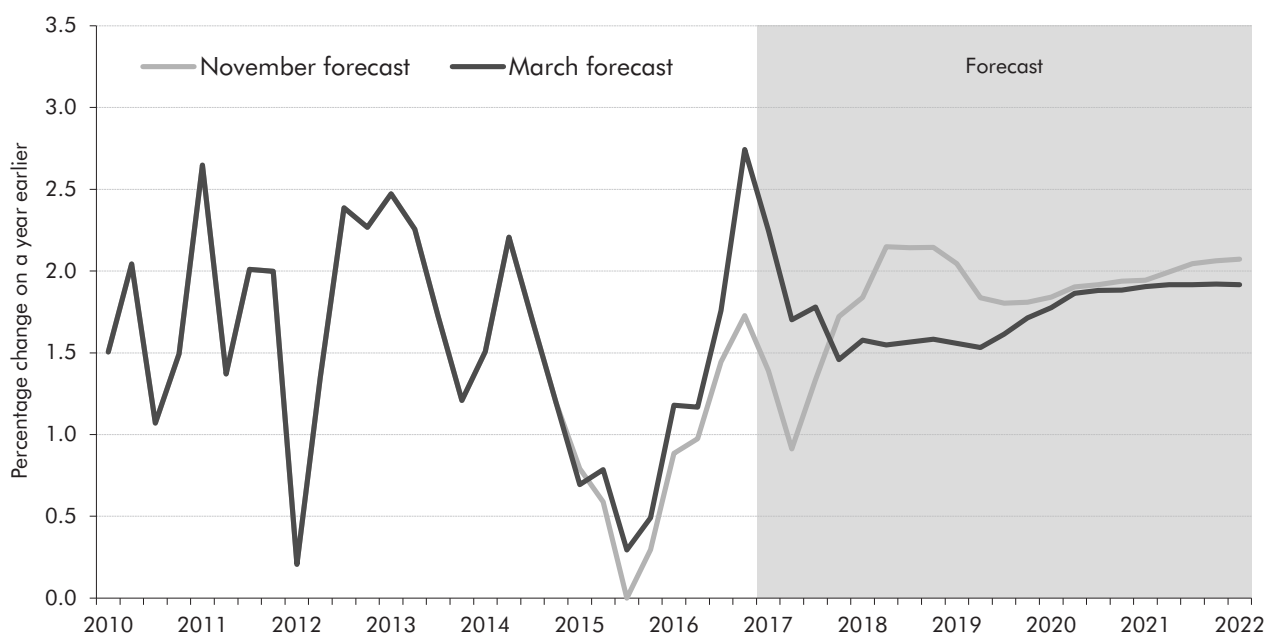
The GDP deflator

3.65 GDP deflator inflation represents the broadest measure of inflation in the domestic economy. It reflects changes in the prices of all the goods and services that comprise GDP, including price movements in private and government consumption, investment and the relative price of exports and imports – the terms of trade.

3.66 Relative to the corresponding quarter a year earlier, the GDP deflator rose by 1.8 and 2.8 per cent in the third and fourth quarters of 2016 respectively, slightly above our November forecasts. In the short term, the upward revision to the level of the GDP deflator in 2017 is largely attributable to a higher forecast for the personal consumption deflator, linked to our revised projection for CPI. After 2017, the downward revision to GDP deflator inflation is driven by several factors:

- **personal consumption deflator** inflation is lower, largely driven by the revisions to our CPI forecast;
- the **terms of trade** contribution to GDP deflator inflation is smaller, reflecting somewhat stronger sterling; and
- **government consumption deflator** inflation is lower, reflecting a methodological change that better reflects recent historical trends, as discussed from paragraph 3.103.

Chart 3.17: GDP deflator



Source: ONS, OBR

Prospects for nominal GDP

3.67 Most public discussion of economic prospects focuses on real GDP – the volume of goods and services produced in the economy. But the nominal or cash value – and its composition by income and expenditure – is more important for understanding the behaviour of the public finances. Taxes are driven more by nominal than real GDP. So too is the share of GDP devoted to public spending, as a large proportion of that spending is set out in multi-year cash plans (public services, grants and administration, and capital spending) or linked to measures of inflation (including benefits, tax credits and interest on index-linked gilts).

3.68 Nominal GDP growth picked up in 2016, with quarterly growth averaging 1.2 per cent, compared to an average of 0.5 per cent in 2015. Much of this pick-up was concentrated in private consumption. We expect quarterly nominal GDP growth to fall back slightly in 2017 and 2018, partly reflecting slower growth of household consumption as the saving ratio is expected to stabilise. Nominal GDP growth then increases steadily from 2019 as business investment recovers somewhat and a modest acceleration in productivity supports a pick-up in wage growth and hence also consumer spending. From 2020, annual nominal GDP

growth settles at around 4 per cent, slightly weaker than we forecast in November, with this revision partly reflecting weaker growth of the GDP deflator.

- 3.69 Our forecast for cumulative nominal GDP growth to 2022 is slightly weaker than in November. We now expect growth of 20.1 per cent between the fourth quarter of 2016 and the first quarter of 2022, down from 22.0 per cent in November. The majority of this 1.9 percentage point downward revision is explained by the change to our deflator forecast, with cumulative real GDP growth only slightly smaller than in our November forecast.

Prospects for individual sectors of the economy

- 3.70 This section covers our forecasts for the household sector (including the labour market), the corporate sector, the government sector and the rest of the world (including the current account balance).

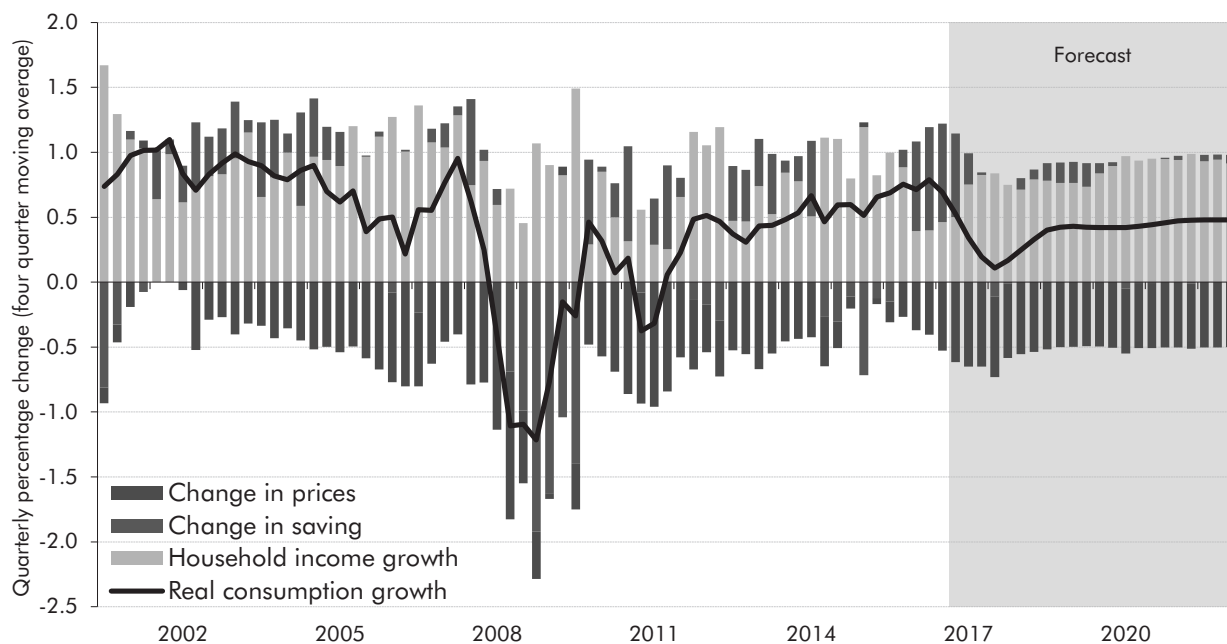
The household sector

- 3.71 The household sector dominates income and spending in the economy. In 2016, consumer spending made up 65 per cent of nominal GDP by expenditure and household disposable income made up 66 per cent of nominal GDP by income.

Real consumer spending

- 3.72 Real consumption grew by 3.0 per cent in 2016, slightly higher than our November forecast and the strongest annual growth since 2004. That strength was associated with a sharp fall in the household saving ratio, in part perhaps reflecting a delayed response of spending to the strong growth in real incomes in the preceding year. As noted below, it is also the case that the path of the saving ratio has been affected by weakness in the pensions and dividend income components, to which consumer spending might be less responsive.
- 3.73 Chart 3.18 decomposes our forecast of real consumption growth into its main components: household income growth, changes in saving, and changes in consumer prices. We continue to expect real consumption growth to slow this year, as household incomes are squeezed by higher inflation, while household saving is assumed to stabilise. Consumption growth is therefore expected to slow to 1.8 per cent on an annual basis in 2017, which is higher than our November forecast as a result of the stronger growth seen at the end of 2016. From 2018 onwards, we expect quarterly real consumption growth to pick up as inflation falls back to target and a gradual recovery in productivity growth supports household incomes. Non-pension saving is assumed to remain broadly stable from 2018.

Chart 3.18: Contributions to real consumption growth



Source: ONS, OBR

Labour market

- 3.74 The unemployment rate stood at 4.8 per cent of the labour force in the fourth quarter of last year, close to its pre-crisis low. As GDP growth moderates, we expect it to edge up in 2017, reaching 5.2 per cent by 2019. This corresponds to an increase of around 120,000 in the number of unemployed between 2016 and 2019. The unemployment rate is then expected to fall back a touch, reaching 5.1 per cent by the end of the forecast period. That is higher than the current rate, in part as a result of a higher NLW putting upward pressure on equilibrium unemployment. But it is lower than in our November forecast due to the downward revision to our view of the current equilibrium unemployment rate and because we expect the NLW to have a slightly smaller effect than we assumed in November.¹⁰
- 3.75 We expect the claimant count to follow the broader measure of unemployment in most years. One exception is this year, when we expect it to rise a little faster as the lone parent obligation – which moves parents off income support and typically onto jobseeker’s allowance in the first instance – is extended to lone parents of 3-year olds. The rollout of universal credit (UC) is expected to broaden the coverage of the claimant count. To prevent any double counting in our fiscal forecast, we continue to forecast the claimant count as if this change was not happening – focusing on those on jobseekers’ allowance and its equivalents in UC. Our forecast is therefore likely to be below the published ONS series, which the ONS has in any case announced will be dropped from the monthly labour market statistical bulletin as it ceases to be a reliable indicator during the UC rollout.

¹⁰ The level of the National Living Wage consistent with our forecast has been revised down slightly since November – from £8.80 to £8.75 an hour in 2020, reflecting revisions to our earnings growth forecast. The assumed annual path of the National Minimum Wage and National Living Wage consistent with our forecast are available in the supplementary economy tables on our website.

- 3.76 We currently judge the participation rate to be close to its underlying potential rate. The participation rate falls later in the forecast as the population ages. The 0.7 million rise in employment over the forecast is therefore attributable to additional population growth. The ONS population projections underpinning our forecast imply that around half the expected population growth over the forecast period is associated with net inward migration but, since inward migrants are disproportionately of working age, that around three-quarters of the projected rise in employment is accounted for by net inward migration.
- 3.77 In past forecasts, we assumed that the shares of employees and the self-employed in total employment remained unchanged over the forecast period. Since we also assumed that earnings growth of the two groups was the same – partly because the mixed income data are so volatile and revision-prone – that did not affect our household income growth forecast. But it is likely to have contributed to past income tax forecast errors because of the different tax treatment of the incomes of employees and the self-employed. In this forecast, and reflecting recent trends, we have instead projected the self-employment share to continue rising by 0.1 percentage points a year over the forecast period. That is faster than the average since 1992, the period for which consistent data are available, though slower than the post-crisis average. The consequences of this change for our tax forecasts are described in paragraph 4.49 in Chapter 4.

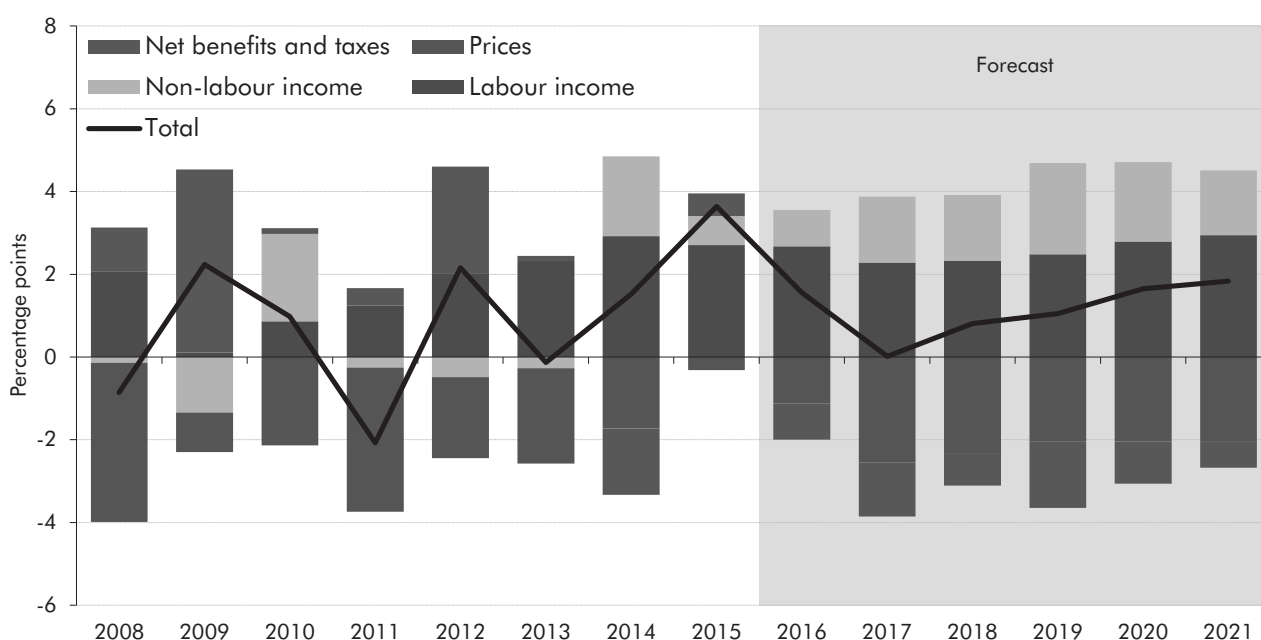
Average earnings

- 3.78 Our forecast uses an implied measure of average earnings constructed by dividing the National Accounts measure of wages and salaries by the number of employees (rather than the official ONS measure of average weekly earnings). On the National accounts measure, average earnings were broadly in line with our forecast for the third quarter of 2016. Wages and salaries data are not yet available for the fourth quarter, but the more timely average weekly earnings measure grew a little slower than we expected in November.
- 3.79 In November, we revised down our forecast for average earnings growth by an average of 0.4 percentage points over the forecast period, reflecting lower productivity growth, greater labour market slack and a modest decline in the share of labour in national income. We have since revised our judgement regarding the labour share, assuming a flatter profile, which, all else equal, would increase our forecast for earnings. However, downward revisions to our forecasts for growth in productivity per worker and the GDP deflator – the key inputs into our earnings forecast – have offset this. That has resulted in an average downward revision to earnings growth of 0.1 percentage points over the forecast period, with the growth rate rising progressively from 2.6 per cent this year to 3.6 per cent in 2021.
- 3.80 Some of the weakness in our central earnings growth forecast reflects judgements about the impact of various Government business policies. We assume that the ultimate burden of these interventions is largely borne by workers through lower wages than would otherwise be the case. The most significant of these are the introduction of the apprenticeship levy and the continued rolling out of auto-enrolment into workplace pensions, which we estimate will reduce average earnings by 0.3 and 0.4 per cent respectively by 2021. Levying NICs on termination payments has an analogous effect, but on a much smaller scale.

Household disposable income

3.81 Relatively weak earnings growth, together with higher CPI inflation, means that real household disposable incomes are expected to stagnate in 2017 (Chart 3.19). Thereafter real household disposable income growth gradually recovers as the assumed pick-up in productivity growth supports faster labour income growth. The contribution of other sources of household income, such as actual and imputed pension contributions (reflecting greater auto-enrolment and higher pension contribution rates), also rises, although the freeze in most working-age benefits and tax credits, together with fiscal drag in the tax system, continues to weigh on household income growth.

Chart 3.19: Contributions to real household income growth



Source: ONS, OBR

The saving ratio

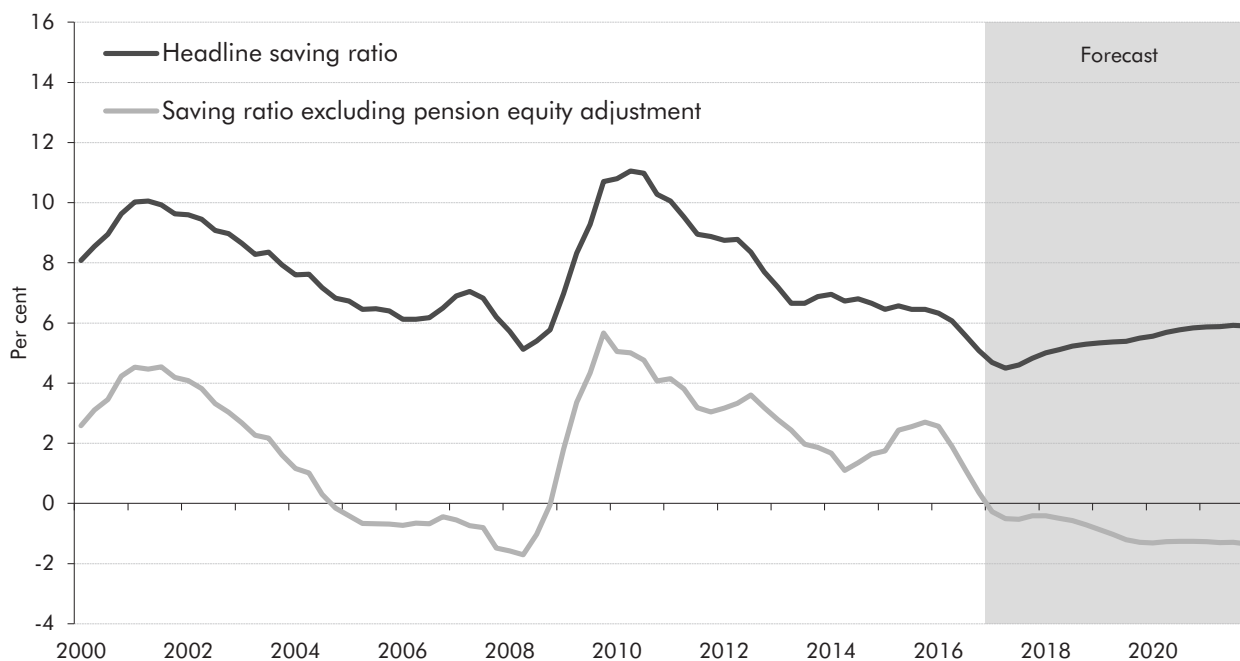
3.82 According to the latest National Accounts, the headline saving ratio fell to 5.6 per cent in the third quarter of 2016 as consumer spending growth outpaced household disposable income growth. While estimates for the fourth quarter will not be published until later in March, the available data suggest that pattern was repeated. We estimate that the saving ratio fell by around 1 percentage point in the fourth quarter. These falls continue the downward trend seen since 2010 as consumer confidence gradually recovered from the deep recession that followed the financial crisis.

3.83 The headline saving ratio is now at its lowest since before the collapse of Lehman Brothers in the autumn of 2008. Excluding pension saving, it had fallen almost to zero in the third quarter and we estimate that it turned negative in the fourth quarter (Chart 3.20). This means that households remain overall net borrowers after factoring in their investment spending (see paragraphs 3.120 to 3.121). However, it is worth noting that the weakness in

household income growth over the past year was most marked in pension and dividend income – to which consumer spending might be relatively unresponsive in the short term.

- 3.84 The historically low level of the saving ratio – together with the relatively high and rising ratio of unsecured debt to income (see Box 3.1) – suggests that there are limits to the extent to which consumption growth can be financed by further reductions in saving. Our central forecast for consumption is therefore based on the assumption that non-pension saving stabilises this year, and remains broadly flat over the forecast period. The headline saving ratio is expected to increase gradually, as wider coverage of auto enrolment and higher contribution rates support a rise in pension saving. There are upside and downside risks to this judgement – households could choose to continue running down non-pension saving or they could choose to retrench, with consumer spending correspondingly stronger or weaker as a result. In Chapter 5 we explore two alternative scenarios for household saving and consumption, and discuss their implications for the public finances.
- 3.85 Relative to our November forecast we have revised up household saving by the end of the forecast, with the saving ratio now expected to reach 5.9 per cent in 2021, up from 4.4 per cent in November. This reflects a number of factors:
- we have revised up **pension saving**. We expect it to reach just under 8 per cent of household disposable income in 2021, up from just over 5 per cent in November. This reflects a higher starting point in the data for the third quarter of 2016, with little change to our forecast of the growth of pension saving thereafter;
 - we have revised down **nominal consumption**. The level in 2021 is around 0.5 per cent lower than we forecast in November. Nominal consumption in the fourth quarter was slightly stronger than expected, but this has been offset by somewhat weaker nominal consumption growth over the forecast period; and
 - these changes are partly offset by a weaker forecast for **household disposable income**. The level in 2021 is around 1.3 per cent lower than our November forecast. Much of this revision reflects a weaker starting point, with the level of household disposable income just over 1 per cent lower than expected in the third quarter of 2016.

Chart 3.20: The household saving ratio



Note: Both series show four-quarter moving averages. The estimate of the saving ratio excluding the pension equity adjustment is calculated as household disposable income less consumption, as a proportion of household disposable income.

Source: ONS, OBR

The housing market and residential investment

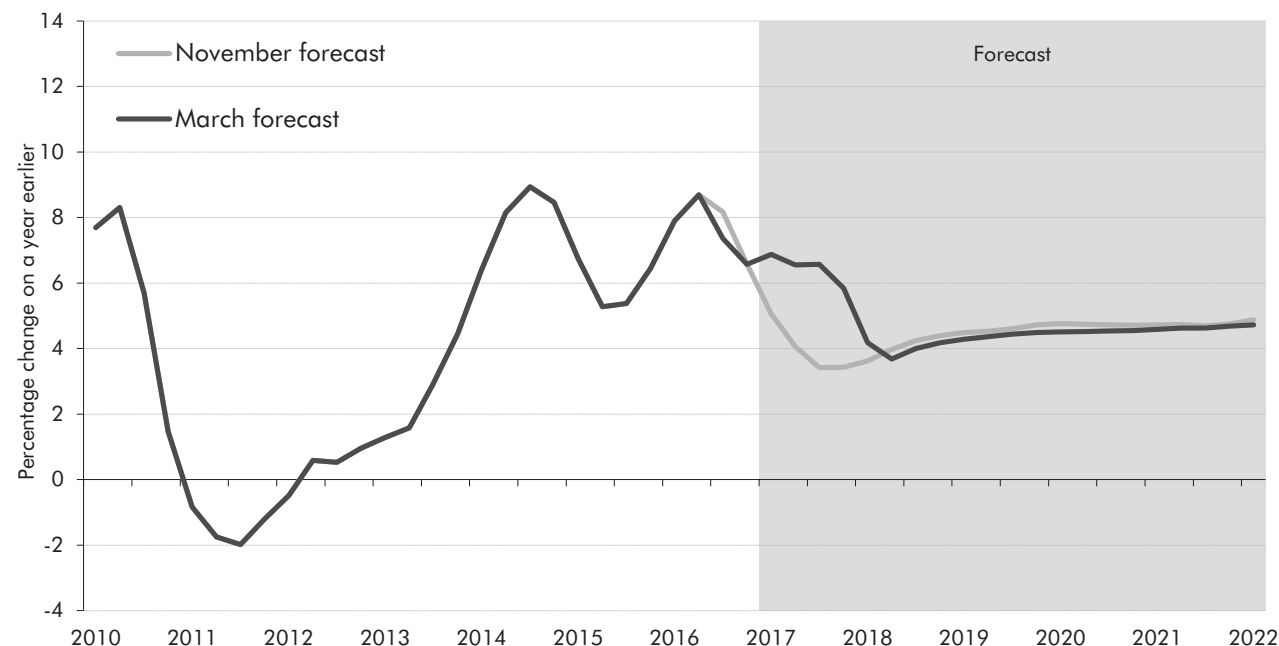
- 3.86 House price inflation was 6.6 per cent year-on-year in the fourth quarter of 2016, down from 7.4 per cent in the third quarter. We expect annual house price inflation to slow looking forward, reaching a low of around 4 per cent in mid-2018 (Chart 3.21). The major lenders' measures – which tend to lead the ONS measure – have slowed in recent months. On the Halifax measure, in the year to January it slowed to 3.7 per cent; on the Nationwide measure, it slowed to 4.3 per cent.
- 3.87 Our forecast for the first quarter of 2017 draw on a variety of indicators of housing market activity, including survey data from the Royal Institution of Chartered Surveyors (RICS) and mortgage data from the Bank of England. Most of these fell sharply last year following the referendum but recovered in the second half of the year and point to a slightly higher path for house price inflation in the near term. House price inflation in the first half of 2017 is 2.4 percentage points higher than we forecast in November.
- 3.88 Our medium-term forecast draws on our own house price model, as well as other information. The main influence is growth in incomes, as this drives demand for housing and, since the overall supply of housing rises only slowly, prices too. By the end of the forecast, we assume that annual house price inflation will settle 1 percentage point higher than average earnings growth. This judgement is conditioned on our views on other drivers of house prices:
- growth in the **supply of housing** has not kept pace with projected growth in the number of households, resulting in the long-term downward trend in average household size

reversing since 2009. We consider this an endogenous response of households to a lack of housing supply, rather than housing supply slowing in response to changing preferences about household size. We expect this trend to continue, putting upward pressure on prices;

- average **mortgage rates** have fallen significantly since 2009, contributing to growth in demand for housing in recent years. We expect mortgage rates to rise a little over the forecast period, but to remain historically low. Low borrowing costs are not expected to contribute as much to house price inflation in the forecast as in recent years; and
- **credit conditions** are likely to remain tighter than pre-crisis norms. According to the Bank of England's latest *Credit Conditions Survey*, the availability of secured credit to households has fallen since the start of 2016, but forward-looking indicators suggest it will improve. Mortgage approvals for house purchases remain far below pre-crisis levels – there were around 200,000 in the fourth quarter of 2016, compared to an average of 325,000 a quarter between 2003 and 2008. The Bank's Financial Policy Committee (FPC) has the power to set macroprudential policies that could also influence credit conditions. For example, in June 2014, the FPC directed mortgage lenders not to extend more than 15 per cent of new lending at loan-to-income multiples of greater than 4.5. That was not expected to bind in the central forecast, but limits the scope for upside surprises to mortgage lending and therefore house prices.

3.89 Beyond the near term, our forecast is little changed from November. It remains consistent with house prices rising faster than average earnings in every year. In the five years since the recovery in house prices began in 2012, the ratio of average house prices to average annual earnings has risen 17 per cent, returning to around its pre-crisis level. Over the next five years, we expect it to rise by around another 8 per cent.

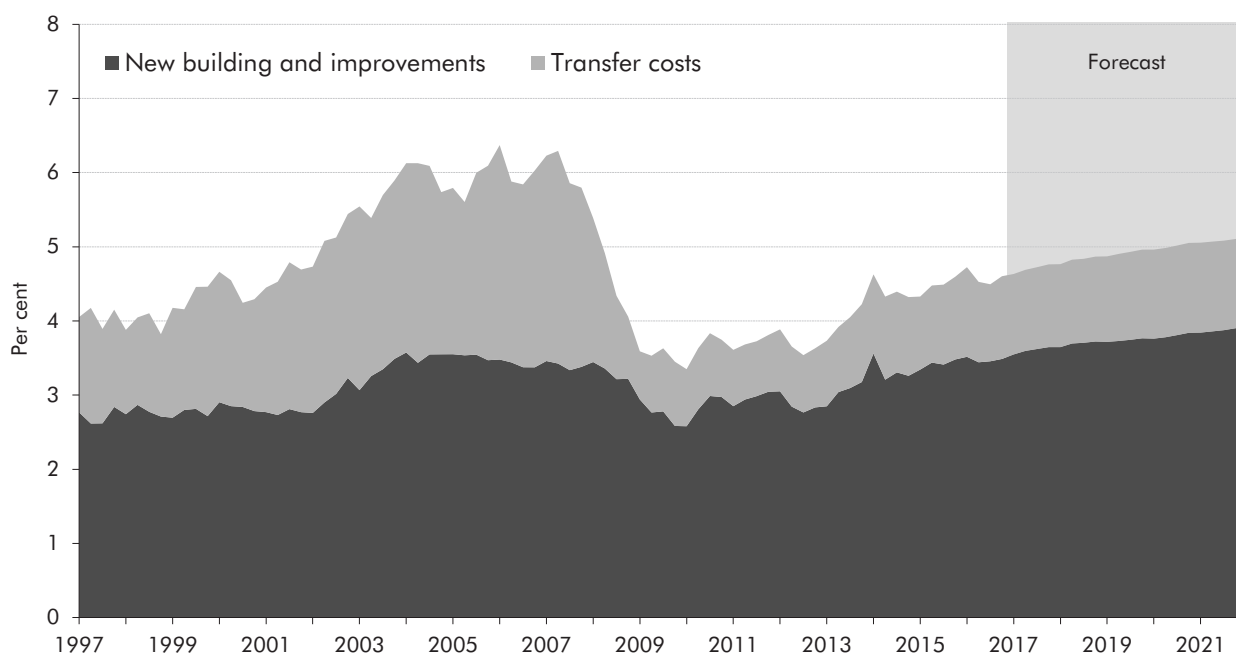
Chart 3.21: House price inflation forecast



Source: ONS, OBR

- 3.90 Since November, we have introduced a new methodology to forecast property transactions in the coming quarter using leading indicators, much as we forecast house prices in the near term. These indicators include survey data from RICS and mortgage lending data from the Bank of England and British Bankers’ Association. Most have picked up in the last few months, leading to a higher outlook for the first quarter of 2017 than in our November forecast. We now expect around 25,000 more transactions in this quarter.
- 3.91 Our medium-term forecast is anchored to an assumed turnover rate. This is unrevised since November, so a stronger forecast for the current quarter reduces scope for further growth until that turnover rate has been reached in 2020. Property transactions are assumed to grow in line with the housing stock thereafter.
- 3.92 Residential investment grew by 4.8 per cent in 2016, higher than we forecast in November and consistent with higher-than-expected transactions and house price growth. We have revised down our forecast for 2017 and 2018 and it is little changed thereafter.

Chart 3.22: Residential investment as a share of nominal GDP



Source: ONS, OBR

Net lending and the household balance sheet

- 3.93 Our forecast for the household balance sheet is built up from the accumulation of household assets and liabilities (mortgage debt and unsecured debt), constrained to be consistent with our forecast for households' net lending.
- 3.94 We expect gross household debt – which includes both mortgage and unsecured debt – to reach 153 per cent of household disposable income by the start of 2022, up slightly from 149 per cent in our November forecast. This reflects a small upward revision to the stock of household debt and a downward revision to household disposable income. Table 3.4 decomposes these changes.

Table 3.4: Sources of change to the household debt forecast since November

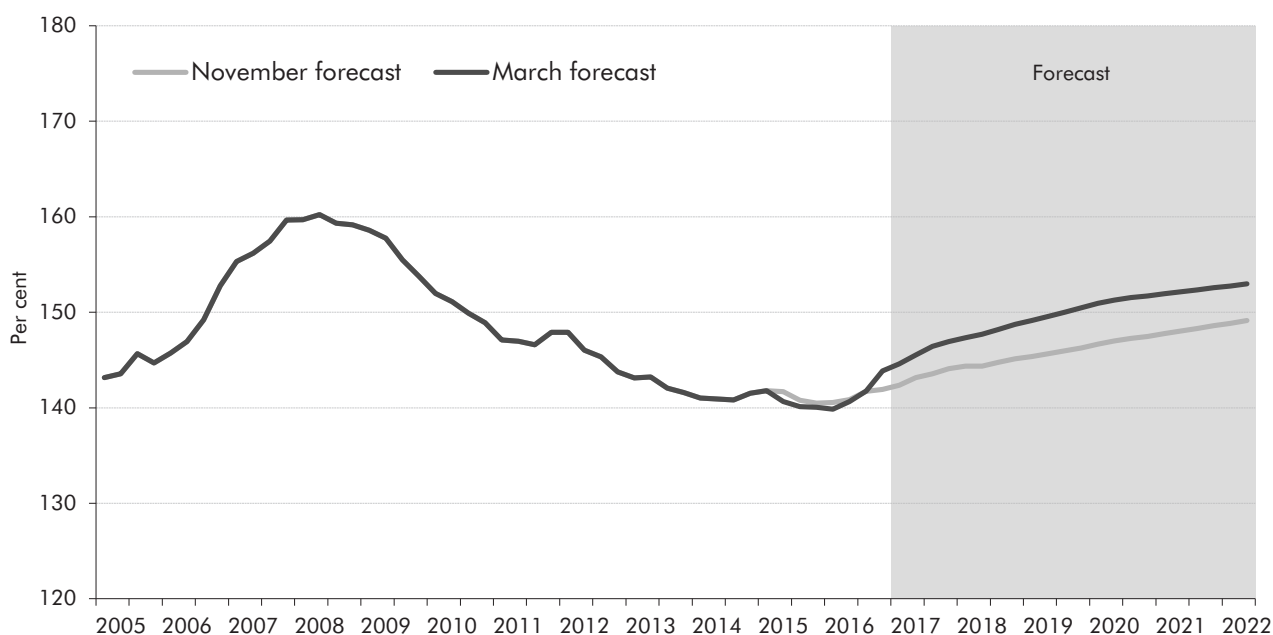
	Per cent of household disposable income ¹					
	2017	2018	2019	2020	2021	2022
November forecast	143.1	144.3	145.7	147.0	148.0	149.2
March forecast	145.5	147.7	149.6	151.3	152.2	153.0
Change (percentage points)	2.4	3.4	3.9	4.3	4.1	3.8
of which:						
Change in household debt	1.6	2.5	2.7	2.6	2.3	1.8
Change in household disposable income ²	0.7	0.9	1.2	1.7	1.9	2.0
	£ billion ³					
November forecast	1850	1923	2004	2093	2190	2294
March forecast	1871	1955	2041	2129	2223	2322
Change	21	33	37	37	33	28
of which:						
Revision to starting point	19	19	19	19	19	19
Revision to accumulation of secured debt	2	10	15	17	15	13
Revision to accumulation of unsecured debt	0	4	4	2	-1	-3

¹ Level of household debt in first quarter of calendar year divided by sum of household disposable income in preceding four quarters.

² Positive values indicate a downward revision to household disposable income.

³ Level of household debt in first quarter of calendar year.

Chart 3.23: Household gross debt to income



Source: ONS, OBR

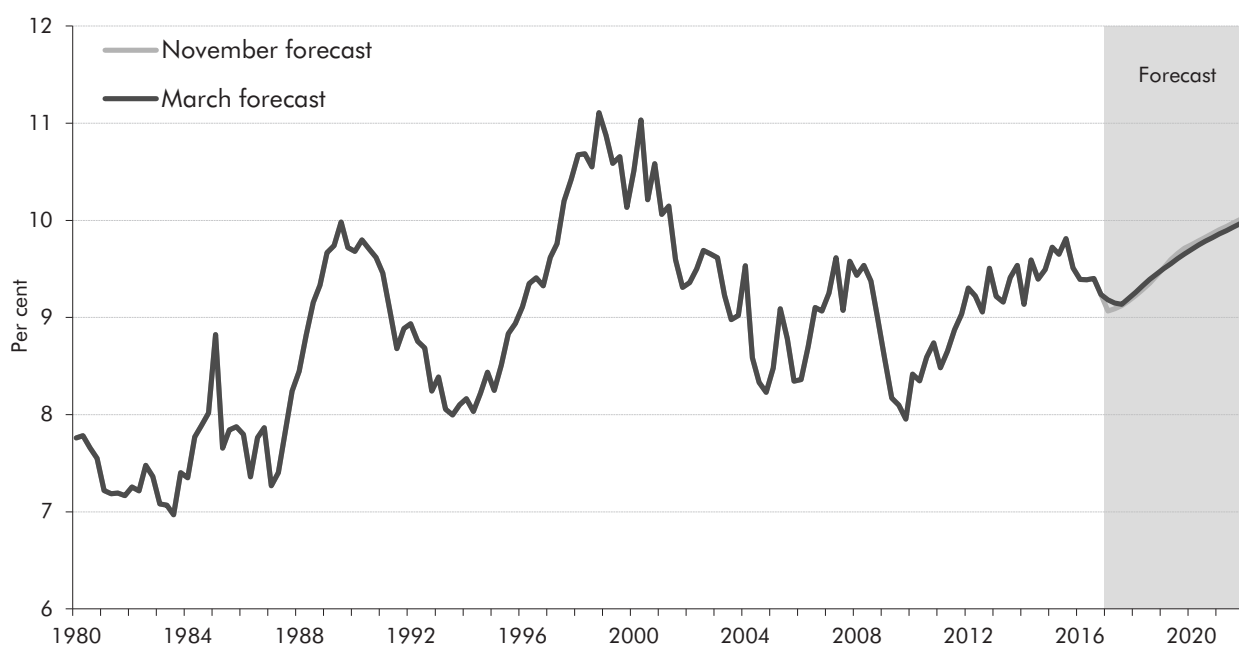
The corporate sector

3.95 The corporate sector contributes to the expenditure measure of GDP through business investment and stockbuilding and to the income measure in the form of profits. Much corporate spending is tax-deductible, while corporate profits are taxed less heavily than most forms of household income.

Business investment and stockbuilding

- 3.96 The latest data suggest that business investment in the second half of 2016 was 1.6 per cent lower than a year earlier. In November, we forecast a relatively sharp fall in business investment in 2017 as heightened uncertainty following the EU referendum led some businesses to put investment projects on hold. Surveys conducted by the Bank of England and the Confederation of British Industry have reported slightly stronger investment intentions since our November forecast and we now expect the fall in business investment growth to be more gradual so that, on an annual basis, it falls by 0.1 per cent in 2017. As discussed in Box 2.1, business investment data are particularly prone to revision, so it is quite possible that our judgements will change as the latest data are revised.
- 3.97 Over the forecast period as a whole, we have not changed our judgement that business investment is likely to be lower than otherwise as a result of uncertainty regarding the UK's new relationship with the EU and our future trading relationships with other nations. But given the slightly stronger survey indicators described above, we now expect this effect to be less pronounced initially, but more drawn out, with a more gradual slowdown in the near term followed by less of a pick-up in subsequent years. Business investment rises by around 1.6 per cent over the forecast period, slightly less than in November. It also rises as a share of GDP over the forecast period – as in our previous forecasts (Chart 3.24).

Chart 3.24: Real business investment as a share of real GDP



Source: ONS, OBR

- 3.98 The latest data suggest stockbuilding acted as a drag on growth last year. We expect it to be broadly neutral across the forecast period.

Corporate profits

- 3.99 The latest data indicate that corporate profits have risen strongly in recent quarters. Non-oil corporate profits are estimated to have increased by just under 11 per cent in the year to the third quarter of 2016, and the limited income data available for the fourth quarter suggest continued strength. This raises our forecast for profit growth in 2016 as a whole to just over 10 per cent from 7½ per cent in November. As GDP growth slows, we expect profits to grow less quickly than nominal GDP, with annual profit growth slowing to around 3 per cent in 2017 and around 2 per cent in 2018. As the output gap closes we anticipate a small cyclical improvement in the ratio of profits to GDP, so that profits grow slightly more quickly than GDP in 2019 and 2020. Relative to our November forecast, we expect a less pronounced near-term slowing in profit growth and a more gradual recovery in subsequent years, consistent with the narrower output gap profile over the forecast period.

The government sector

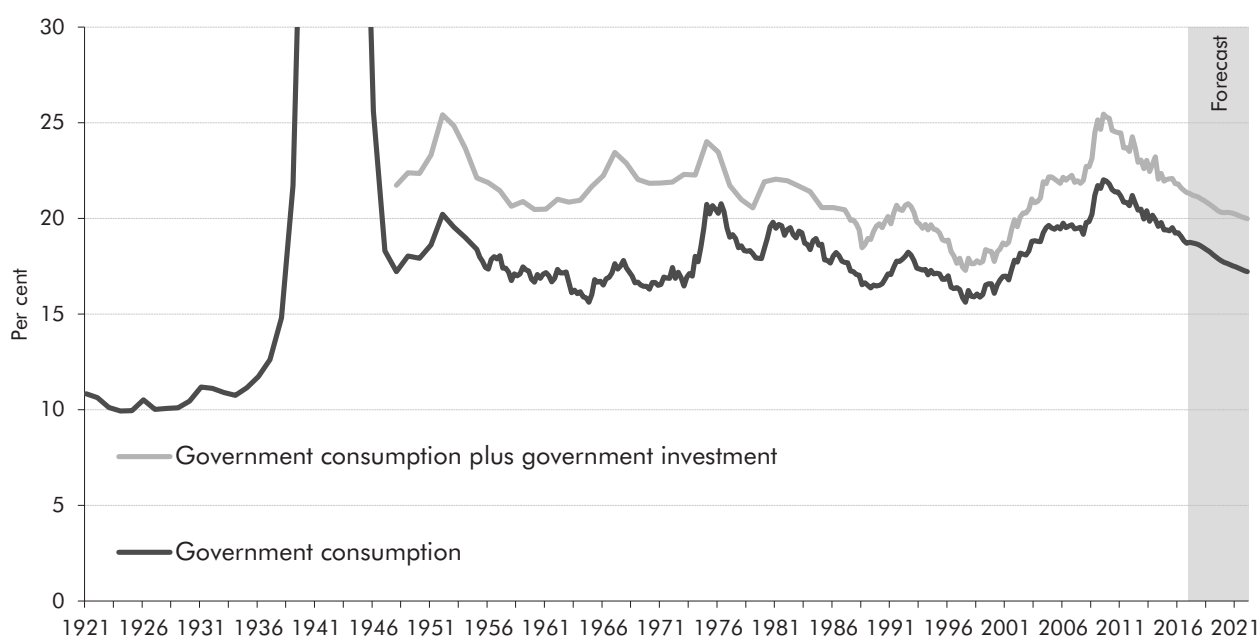
- 3.100 Total public spending amounted to 40 per cent of GDP in 2015-16.¹¹ But not all government spending contributes directly to GDP. Spending on welfare payments and debt interest, for example, merely transfers income from some individuals to others. The government sector contributes directly to GDP via its consumption of goods and services, and investment. These together accounted for 22 per cent of GDP in 2015-16.

Nominal government consumption

- 3.101 Nominal government consumption grew by 1.4 per cent in 2016, slightly more than we forecast in November. The Government's updated fiscal plans imply that it will grow by 2.4 per cent in 2017, higher than our November forecast. Growth then slows in the next few years, reaching just 0.8 per cent in 2019, before picking up again in the last two years of the forecast. Revisions to this expected path from 2018 onwards are small relative to previous forecast changes. This revised path implies that nominal government consumption falls from 19.0 per cent of GDP in 2016 to 17.4 per cent of GDP in 2021, slightly higher than in November (Chart 3.25).

¹¹ Total managed expenditure (TME).

Chart 3.25: Government consumption and investment

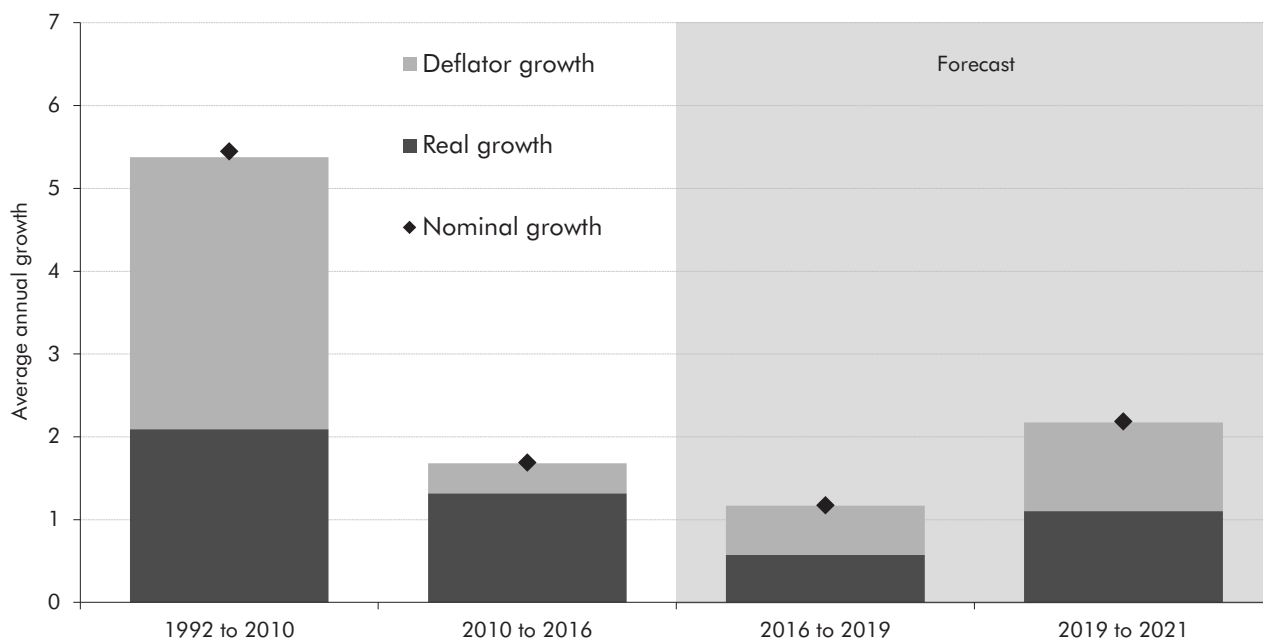


Note: Government consumption as a share of GDP is estimated to have peaked at 54.0 per cent of GDP in 1944.

Real government consumption

- 3.102 Real government consumption grew by 0.2 per cent in the final quarter of 2016, in line with our November forecast, but revisions to previous quarters mean that it is now estimated to have grown by 0.8 per cent over 2016 as a whole, slightly lower than we expected.
- 3.103 For a given forecast for nominal government consumption growth, we have previously assumed that roughly one third would be reflected in real growth and the remaining two thirds in price changes. That was based on the way that government consumption is measured by the ONS, as described in Box 3.3 of the March 2016 *EFO*. In recent years, however, the split has been tilted more towards real government consumption and less towards prices, so we have changed this assumption to be around half and half.
- 3.104 Real government consumption growth is expected to grow by 1.2 per cent in 2017, slightly higher than in November, reflecting higher cash spending growth. Our forecast for nominal government consumption from 2018 onwards is little changed but the change to the volume-price split means we have revised up real growth in each of those years.

Chart 3.26: General government consumption



Source: ONS, OBR

General government employment

- 3.105 In the absence of specific workforce plans, we project general government employment based on some simple assumptions. We begin by assuming that the total paybill will grow in line with a measure of current government spending. We forecast government sector wage growth separately, taking into account recent data, stated government policy (such as the current 1 per cent limit on pay growth), historic rates of pay drift and whole economy earnings growth over the medium term. We then combine total and average pay growth to derive an implied projection for general government employment.
- 3.106 Slow growth in cash spending and low annual wage growth imply that general government employment falls by around 0.1 million between the first quarter of 2016 and the first quarter of 2022, leading to a total fall from early 2011 of 0.4 million.¹² We expect the fall to be more than offset by a rise in market sector employment.

The external sector

- 3.107 The external sector contributes to the expenditure measure of GDP through net trade. In addition to the trade balance, other income flows into and out of the UK will also affect the income measure of GDP. These are captured as part of the current account.

¹² These estimates exclude a classification change introduced in the second quarter of 2012, which moved around 196,000 employees from the public to the private sector. Further details about the assumptions for public sector wages and employment can be found in the supplementary economy tables available on our website.

The impact of the EU referendum result on trade flows

3.108 Our assumptions regarding the way the EU referendum result and its subsequent implementation will affect trade flows are unchanged since November:

- we expect **the sharp depreciation of sterling to support net trade**, despite a slight appreciation since November. We expect the boost to be relatively modest in historic terms because the warranted expansion in export supply as a result of the more favourable exchange rate is likely to require some businesses to undertake associated investment, which we continue to expect to be depressed by the heightened uncertainty following the referendum result. Furthermore, reflecting the greater openness of the UK economy and the internationalisation of supply chains, some firms now import a large fraction of their inputs. As a consequence, an exchange rate depreciation boosts export revenues but also raises production costs more than it used to. The effect of a weaker currency is thus diluted.¹³ This is consistent with the unexpectedly weak pick-up in net trade following the sterling depreciation in 2007-08;
- **slower growth in business investment and private consumption** is expected to reduce demand for imports. This should boost net trade most over the next two years; but
- at least over the forecast period, the process of **leaving the EU and negotiating new trading arrangements** is assumed to be associated with a lower trade intensity of UK economic activity. As Chart 3.27 shows, trade intensity has been on an upward path since the Second World War, but has risen less rapidly since the financial crisis. In our March 2016 forecast, we expected the upward trend to reassert itself. We now expect it to reverse for a period, although by far less than was seen in the interwar years.

¹³ See: Mary Amiti, Oleg Itskhoki and Jozef Konings, "Importers, Exporters, and Exchange Rate Disconnect", *American Economic Review*, July 2014; and Maciej Albinowski, Jan Hagemeyer, Stefania Lovo and Gonzalo Varela, *The Role of Exchange Rate and Non-Exchange Rate Related Factors in Polish Firms' Export Performance*, World Bank working paper 7899, November 2016.

Chart 3.27: Sum of UK exports and imports as a share of GDP

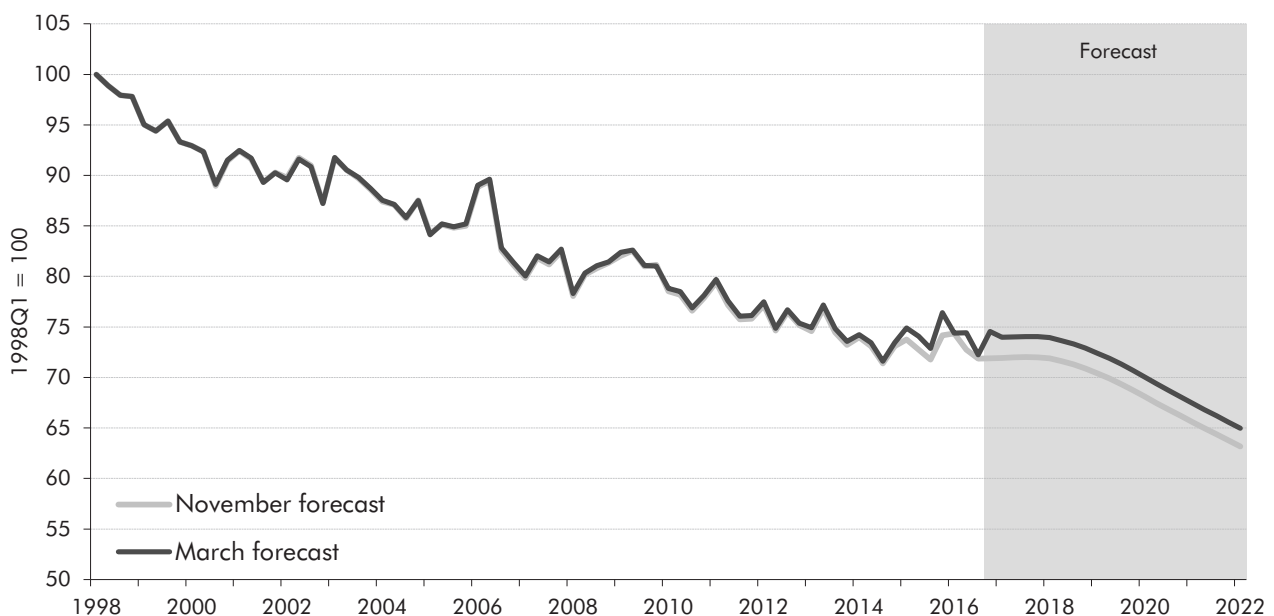


Source: Bank of England, OBR

Export growth

- 3.109 Revisions to past data mean that exports grew by 1.4 per cent in 2016 as a whole, less than expected in November despite higher-than-expected growth in the final quarter. Other things equal, the strong end to the year would imply stronger calendar year growth in 2017. But recent volatility in reported quarterly export growth has been associated with offsetting movements in the net acquisition of valuables, which comprises various items including 'non-monetary gold'. This relates to cross-border transactions in gold bullion in the London bullion market. Those transactions have only recently been incorporated into the ONS trade and GDP data, and have generated significant volatility. We assume that the large movements in the fourth quarter of 2016 will unwind in the first quarter of 2017, which implies lower export growth and a pick-up in the valuables component of investment.
- 3.110 The net effect of higher outturns at the end of 2016 and changes to our first quarter forecast, plus an unchanged assumption about the extent to which sterling's depreciation supports export growth in the near term, leads to a forecast of 3.4 per cent export growth in 2017. That is higher than our November forecast. Changes to our 2018 forecast are driven by lower expected growth in UK export markets in that year. Our forecast for 2019 onwards is little changed, reflecting little change in expectations for growth in UK export markets and an unchanged assumption that Brexit will result in a lower UK share of EU markets.

Chart 3.28: UK export market share

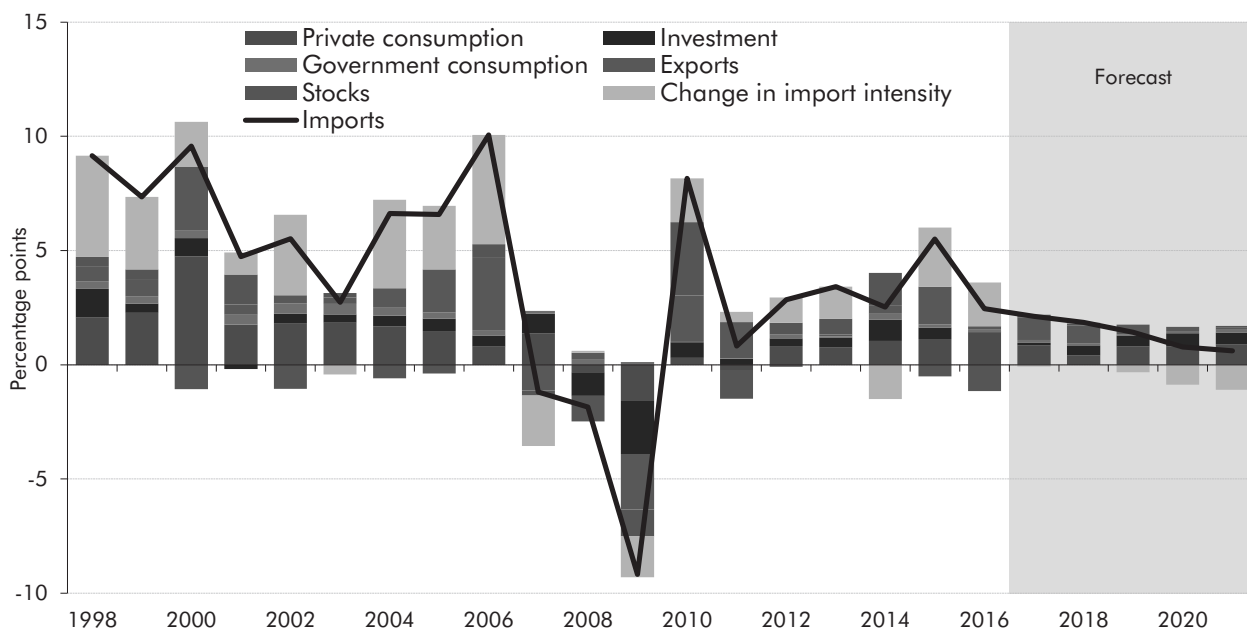


Note: UK export share defined as exports divided by UK export markets, where exports series have been adjusted to account for the effect of VAT Missing Trader Intra Community (MTIC) fraud, although there is uncertainty around MTIC data prior to 2007.
Source: OECD, ONS, OBR

Import growth

- 3.111 Imports grew by 2.5 per cent in 2016, less than we expected in November, reflecting revisions to past data as well as a fall in imports in the final quarter.
- 3.112 With our judgements regarding the impact of the sterling depreciation and new trading arrangements resulting from Brexit unchanged, revisions to our imports forecast are driven primarily by changes to import-weighted domestic demand. We have revised up our imports forecast in 2017, but lowered it for 2018 and 2019, with little change thereafter. This leaves imports unchanged as a share of import-weighted domestic demand since November.

Chart 3.29: Contributions to import-weighted domestic demand and import growth

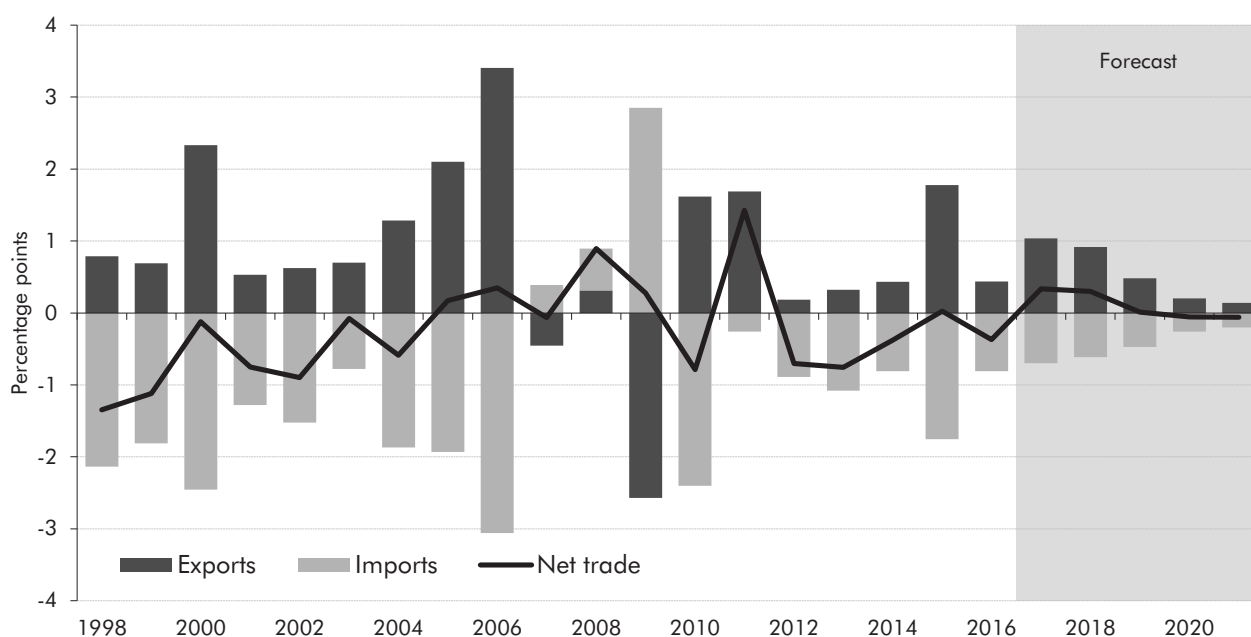


Source: ONS, OBR

Net trade

3.113 Net trade is estimated to have reduced GDP growth in 2016 by 0.4 percentage points, a slightly greater drag than forecast in November and reflecting a larger downward revision to exports than to imports. The revisions to our trade forecast mean that the contribution to growth from net trade is broadly unchanged since November. In 2017 and 2018 we continue to expect it to boost growth as the past depreciation of sterling supports exports and reduces imports, and weaker domestic demand growth further reduces imports. We expect the net trade contribution to be neutral in 2019 and then subtract marginally from growth in 2020 and 2021 as domestic demand growth edges up.

Chart 3.30: Net trade contributions to real GDP



Source: ONS, OBR

The current account balance

3.114 The current account deficit remains large by historical standards. The latest ONS data indicate that the annual deficit stood at 4.3 per cent of GDP in 2015, revised down from the estimate of 5.4 per cent at the time of our November forecast. The quarterly path remains volatile: having widened sharply at the end of 2015, it improved in the first half of 2016 before widening to 5.2 per cent of GDP in the third quarter as the trade deficit worsened.

3.115 Current account data are prone to substantial revisions, which adds to the challenge of forecasting. Table 3.5 shows how the size and composition of the current account deficit in 2015 has been revised significantly, with the latest data indicating a deficit that is around £20 billion smaller than previously estimated. The sources of this revision include:

- a narrower **trade deficit**, revised down by £9 billion relative to the data available at the time of our November forecast. This reflects an upward revision to the value of exports in 2015, partly reflecting corrections to the treatment of non-monetary gold; and
- a smaller **income account deficit**, revised down by £11 billion, largely reflecting the introduction of annual benchmarks from the 2015 Foreign Direct Investment survey.

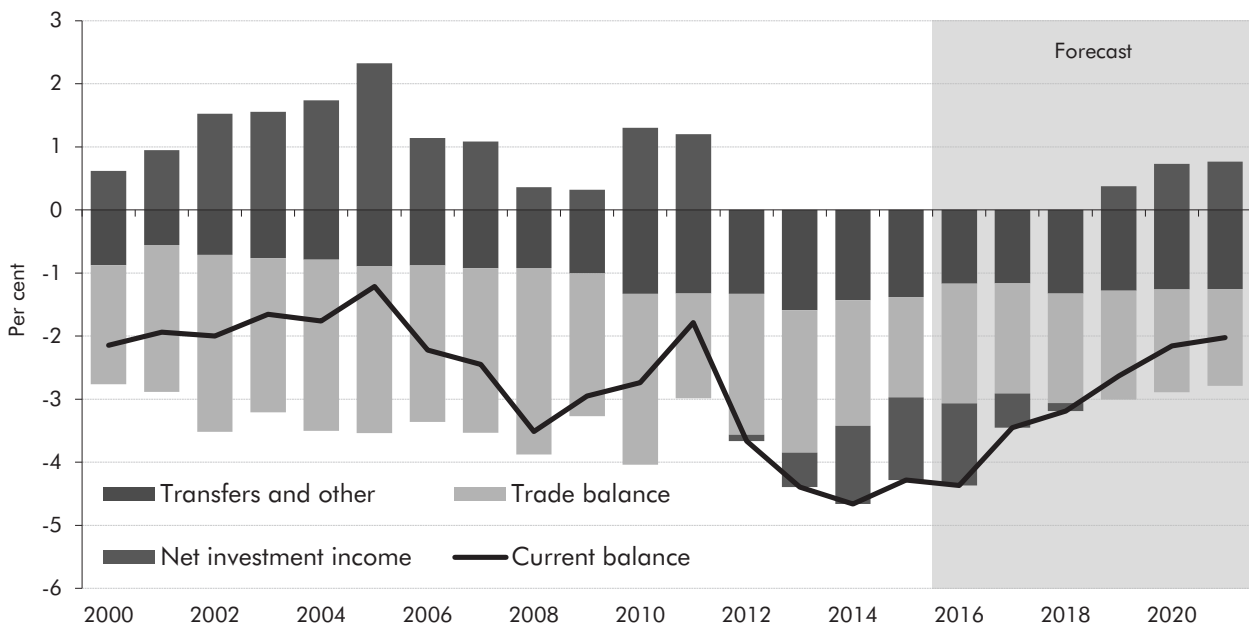
3.116 The deterioration in the current account deficit in recent years has largely been driven by a significant worsening in the net investment income balance. Having averaged a surplus of just over 1 per cent of GDP in the decade to 2012, the net investment income balance subsequently swung into deficit, reaching 1.3 per cent of GDP in 2015. Some of the factors behind that may be temporary – for example, the effects of relatively weak euro area growth on foreign equity earnings. While not verifiable in the published data, large cross-border fines and compensation recently paid by UK firms abroad may also have depressed

measured rates of return on overseas assets. The investment income balance may also be affected by tax-driven changes in the domicile of corporate headquarters, although ONS analysis suggests that there is little evidence that such financial engineering has materially affected FDI statistics in recent years.¹⁴

3.117 Recent quarterly data indicate that the deficit on the investment income account has narrowed steadily since the end of 2015: from 2.5 per cent of GDP in the final quarter of 2015 to 1.0 per cent of GDP in the third quarter of 2016. We expect it to continue to improve steadily over the forecast period, reaching a surplus of almost 1 per cent in 2021. This reflects:

- continued recovery in the **rates of return** on euro area and other assets, which are assumed to normalise by 2020. This assumption is little changed from November; and
- the past **depreciation of sterling**, which increases the sterling value of the income earned on the UK’s foreign assets. The modest appreciation of sterling in recent months means that this effect is slightly weaker than in November.

Chart 3.31: Current account balance as a share of GDP



Source: ONS, OBR

¹⁴ ONS, *An analytical study into the potential impact of financial engineering on UK Foreign Direct Investment: July 2016*.

3.118 Table 3.5 shows how our forecast of the current account has changed since November:

- we expect the **current account deficit** to be narrower in the near term, but broadly unchanged by the end of the forecast period;
- this profile change is partly explained by changes to our forecast of the **investment income balance**, as the latest income account data have led us to increase our short-term forecast of the net rate of return, while the appreciation of sterling since then means a slightly smaller income surplus by the end of the forecast;
- the **trade deficit** is expected to be narrower throughout the forecast, reflecting a smaller than expected deficit at the end of 2016, partly offset by a deterioration in the terms of trade in 2018 and 2019; and
- the deficit on the **transfers balance** is expected to be broadly unchanged from our November forecast. This forecast does not incorporate any future changes in transfer flows between the UK and the EU associated with Brexit. These will be incorporated once a clearer idea of their likely magnitude is available.

Table 3.5: Change to the current account since November

	£ billion						
	Outturn	Forecast					
	2015	2016	2017	2018	2019	2020	2021
November forecast	-100.2	-111.0	-99.3	-86.7	-73.9	-63.1	-62.1
March forecast	-80.2	-84.8	-69.6	-66.2	-56.6	-48.1	-46.9
Change	19.9	26.2	29.7	20.4	17.3	15.0	15.2
<i>of which:</i>							
Trade balance	8.9	17.8	28.0	22.5	21.7	22.3	22.8
Volumes	7.0	4.9	6.0	6.8	8.2	8.4	8.5
Prices	1.9	12.9	21.9	15.6	13.5	13.9	14.3
Investment income balance	11.1	7.6	2.3	-1.3	-4.5	-7.2	-7.8
Transfers and other	-0.1	0.8	-0.5	-0.8	0.1	-0.1	0.2

Sectoral net lending

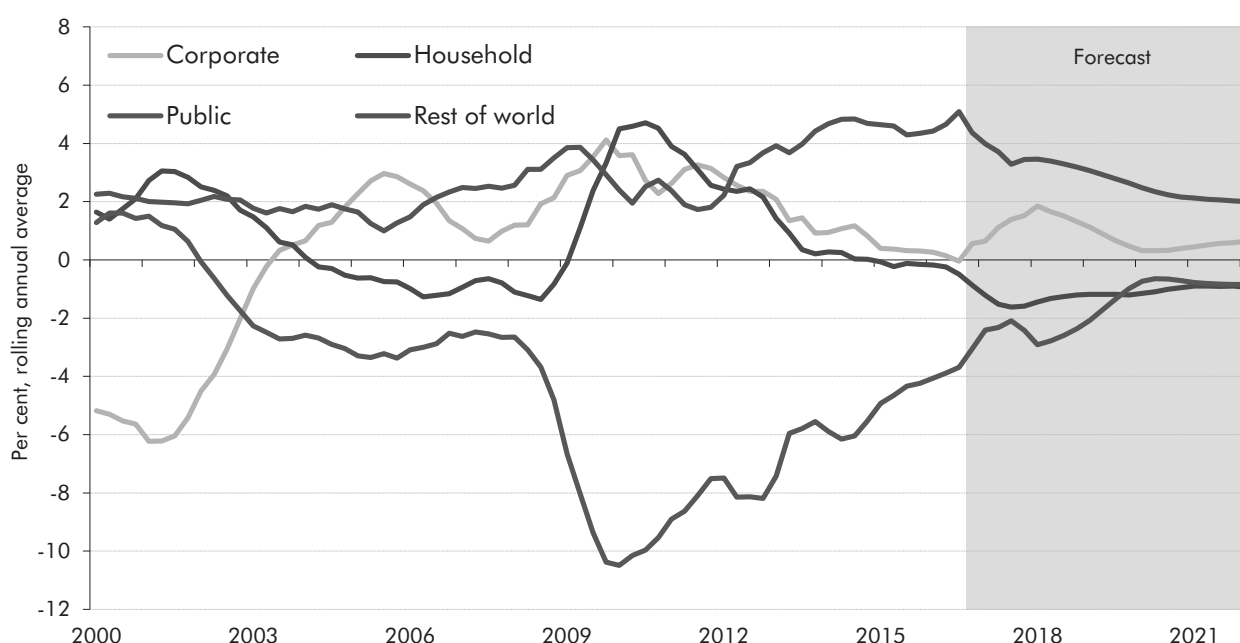
3.119 In the National Accounts framework underpinning our economic forecast, the income and expenditure of the different sectors imply a path for each sector's net lending or borrowing from others. These must sum to zero – for each pound borrowed, there must be a pound lent. In 2016, for which three quarters of data are now available, it appears that the public and household sectors were both in deficit, the rest of world sector was in surplus and the corporate sector was close to balance (Chart 3.32).

3.120 On current government policy, including the delivery of planned further public spending cuts, we expect the public sector deficit to narrow, offset by a narrowing of the rest of the world surplus (i.e. a narrowing current account deficit) and a widening of the corporate deficit. The household deficit is expected to widen slightly in the near term and narrow gradually thereafter, consistent with the gently rising saving ratio. Relative to our November

forecast, we expect the current account deficit to narrow more slowly. The household sector is expected to remain in deficit, although the scale of the deficit is slightly smaller than expected in November, reflecting both data revisions and higher household saving.

3.121 The persistence of the household deficit over the forecast period could be considered consistent with the scale of the fiscal consolidation and the accommodative monetary policy upon which the forecast is conditioned. Nevertheless, alternative adjustment paths are possible. In Chapter 5 we explore the implications of alternative scenarios for household saving, which would also imply different trajectories for household net lending.

Chart 3.32: Sectoral net lending



Source: ONS, OBR

Risks and uncertainties

3.122 As always, we emphasise the uncertainties that lie around our central forecast for the economy, and the implications that these can have for the public finances (see Chapter 5). There are some risks and uncertainties common to all forecasts: conditioning assumptions may prove inaccurate; shocks may hit the economy; and previously stable relationships that have described the functioning of the economy may change.

3.123 Some specific risks that we would highlight include:

- **private consumption growth has outpaced income growth** in recent years, but our forecast implies lower household spending relative to incomes compared with the recent past. This could pose a risk to our forecast, either because consumption continues to grow faster than incomes, reducing the saving ratio further, or because households cut back their spending by more than we expect to bolster saving. We explore these possibilities further in the scenarios presented in Chapter 5;

- leading up to and following the UK's exit from the EU, **policies will evolve to replace those associated with EU membership**. These policies, and the response of households and businesses to them, are subject to great uncertainty and there is little by way of precedent on which to base any forecast assumptions;
- the **current account deficit** remains large by historic standards, despite a recent narrowing. This means that overseas investors are acting as net lenders to the UK, which could pose risks if those investors' confidence in the UK economy was to be damaged by uncertainty or changes in policy. That could lead to a sharper fall in sterling and a more abrupt demand-led narrowing of the current account deficit;
- the outlook for **productivity growth** remains uncertain. We expect it to pick up over the forecast, following an extended period of weak growth in recent years. This assumption has been subject to repeated disappointment in previous forecasts; and
- despite the recent modest appreciation, **sterling** remains around 10 per cent lower than we assumed a year ago. The effects on the UK's export market share and import substitution, and the speed and extent to which it passes through to consumer prices and affects real consumer spending, are all subject to significant uncertainty.

Comparison with external forecasters

3.124 In this section, we compare our latest projections with those of selected outside forecasters. The differences between our forecast and those of external forecasters are generally small compared with the uncertainty that surrounds any one of them.

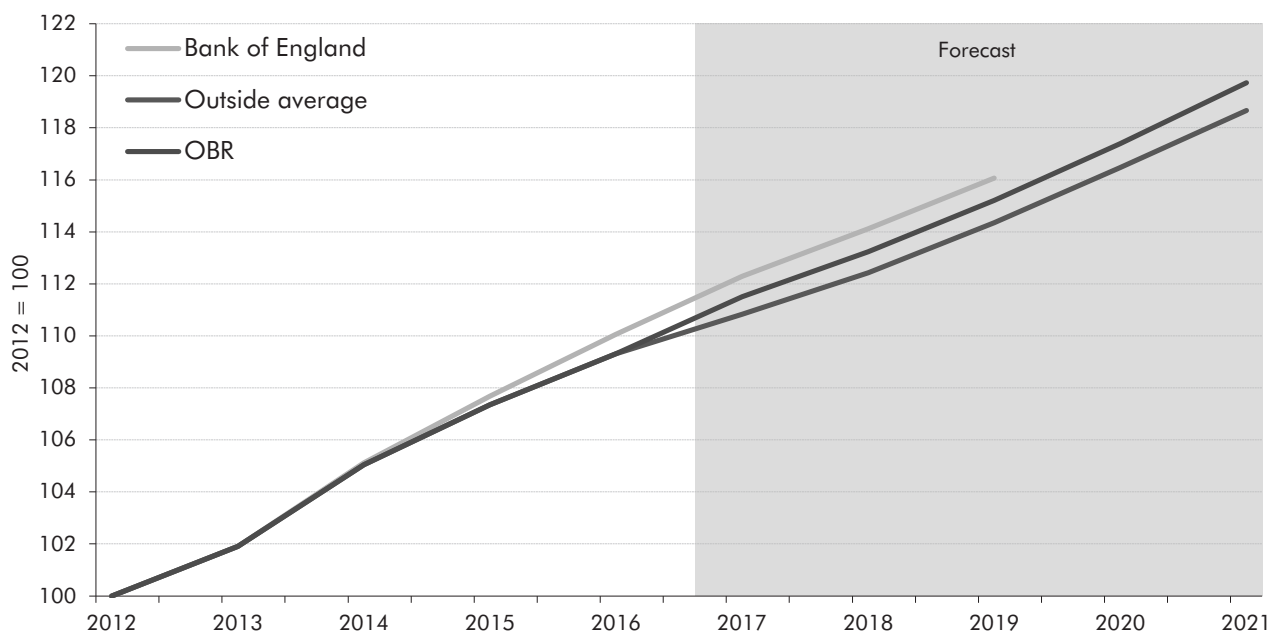
Comparison with the Bank of England's *Inflation Report* forecast

3.125 Alongside its February 2017 *Inflation Report*, the Bank of England published additional information about its forecast that can be compared against our own (see Table 3.6). This included the Bank staff's forecasts for the expenditure composition of GDP, consistent with the MPC's central forecasts for GDP, CPI inflation and the unemployment rate.

3.126 The MPC's modal forecast for GDP growth is 2.0 per cent in 2017, in line with our forecast. However, there are some differences in the expenditure composition of GDP, as the Bank expects slightly higher private consumption growth and lower business investment growth. The Bank's forecasts for 2018 and 2019 are also close to ours.

3.127 Both sets of forecasts are somewhat higher than the average external forecast, particularly in the near term. Chart 3.33 shows the Bank's forecast for the level of GDP, which is slightly higher than ours. This reflects the higher starting point implied by the Bank's 'backcast' of GDP, where it attempts to forecast revisions to the data.

Chart 3.33: Comparison of forecasts for the level of GDP projections



Source: Bank of England, HM Treasury, ONS, OBR

Table 3.6: Comparison with the Bank of England's forecast and projections

	Per cent			
	2016 ²	2017	2018	2019
Bank of England February Inflation Report forecast¹				
Household consumption	2¾	2	1	1¼
Business investment	-1¼	-¼	1¼	3¼
Housing investment ^{3,4}	4	3	2	1
Exports	1¼	2½	1	½
Imports	2½	1½	-¼	-¼
Employment ⁵	1	½	½	¾
Unemployment rate ⁶	5.1	4.9	5.0	5.0
Productivity ⁷	¾	1¾	1¼	1¼
Average weekly earnings ^{4,5}	2¾	3	3¼	3¼
Difference from OBR forecast				
Household consumption	-0.2	0.2	0.1	-0.4
Business investment	0.3	-0.2	-2.4	-0.9
Exports	-0.2	-0.9	-2.0	-1.1
Imports	0.0	-0.6	-2.1	-1.7
Employment ⁵	0.0	0.1	0.0	0.3
Unemployment rate ⁶	0.0	0.1	-0.1	-0.1
Productivity ⁷	0.3	0.2	-0.2	-0.4

¹ Percentage change, year on year, unless otherwise stated.² 2016 estimates contain a combination of data and projections.³ Whole economy measure. Includes transfer costs of non-produced assets.⁴ We have not shown a comparison for housing investment and average weekly earnings as they are not directly comparable.⁵ Four-quarter growth rate in Q4.⁶ LFS unemployment rate in Q1.⁷ Output per hour.

Comparison with other external forecasters

3.128 Table 3.7 presents a range of external forecasts. It shows that:

- in its most recent *World Economic Outlook Update*, the **IMF** forecasts growth of 1.5 per cent in 2017 and 1.4 per cent in 2018, lower than our central forecast. This was published before the most recent data showing stronger growth at the end of 2016;
- the **OECD** updated its short-term forecast for GDP growth shortly after we published our November *EFO*. The OECD's forecast is below ours in 2017 and 2018, but again does not reflect the latest data;
- in its February *Economic Review*, the **National Institute for Economic and Social Research** (NIESR) forecast GDP growth of 1.7 per cent in 2017, slightly lower than our forecast, due to lower contributions from both private consumption and investment. NIESR's forecast is higher than ours between 2018 and 2020, with higher contributions from investment and net trade, but is slightly lower in 2021; and
- the **European Commission's** forecast for GDP growth is lower than ours in 2017 due to lower government consumption and higher imports growth. It is also lower than ours in 2018 due to lower government consumption and investment growth.

Table 3.7: Comparison with external forecasts

	Per cent					
	2016	2017	2018	2019	2020	2021
OBR (March 2017)						
GDP growth	1.8	2.0	1.6	1.7	1.9	2.0
CPI inflation	0.7	2.4	2.3	2.0	2.0	2.0
Output gap	0.0	0.2	0.0	-0.1	-0.1	0.0
Oxford Economics (February 2017)						
GDP growth	2.0	1.6	1.3	1.6	2.1	2.3
CPI inflation	0.6	2.6	2.1	1.9	1.9	1.9
Output gap	-2.1	-1.9	-1.9	-1.6	-1.2	-0.8
Bank of England (February 2017)^{1,2}						
GDP growth (mode)	2.2	2.0	1.6	1.7		
CPI inflation (mode) ³	1.2	2.7	2.6	2.4		
European Commission (February 2017)						
GDP growth	2.0	1.5	1.2			
CPI inflation	0.7	2.5	2.6			
Output gap	0.6	0.6	0.2			
NIESR (February 2017)¹						
GDP growth	2.0	1.7	1.9	2.1	2.0	1.9
CPI inflation	0.7	3.3	2.9	2.3	2.0	1.9
OECD (November 2016)						
GDP growth	2.0	1.2	1.0			
CPI inflation	0.6	2.4	2.9			
Output gap	-0.5	-0.8	-1.3			
IMF (October 2016)⁴						
GDP growth	1.8	1.1	1.7	1.8	1.9	1.9
CPI inflation	0.7	2.5	2.6	2.0	2.0	2.0
Output gap	-0.1	-0.4	-0.4	-0.3	-0.1	0.0

¹ Output gap not published.

² Forecast based on market interest rates and the Bank of England's 'backcast' for GDP growth.

³ Fourth quarter year-on-year growth rate.

⁴ The IMF has since published its January 2017 *World Economic Outlook Update*. For the UK, GDP growth was revised up to 1.5 per cent in 2016 and down to 1.4 per cent in 2017.

Table 3.8: Detailed summary of forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2015	2016	2017	2018	2019	2020	2021
UK economy							
Gross domestic product (GDP)	2.2	1.8	2.0	1.6	1.7	1.9	2.0
GDP per capita	1.4	1.1	1.3	0.9	1.1	1.2	1.4
GDP level (2015=100)	100.0	101.8	103.9	105.5	107.3	109.4	111.5
Nominal GDP	2.8	3.6	3.8	3.1	3.4	3.8	4.0
Output gap (per cent of potential output)	-0.3	0.0	0.2	0.0	-0.1	-0.1	0.0
Expenditure components of GDP							
Domestic demand	1.9	1.6	1.5	1.2	1.7	1.9	2.0
Household consumption ¹	2.4	3.0	1.8	0.9	1.7	1.7	1.9
General government consumption	1.3	0.8	1.2	0.7	0.4	0.9	1.3
Fixed investment	3.4	0.5	0.8	3.0	3.3	3.9	3.4
Business	5.1	-1.5	-0.1	3.7	4.2	3.9	3.6
General government ²	-2.6	1.4	0.1	1.2	2.1	6.1	3.8
Private dwellings ²	3.0	4.8	2.5	2.9	2.4	2.9	3.0
Change in inventories ³	-0.2	-0.5	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	6.1	1.4	3.4	3.0	1.6	0.7	0.5
Imports of goods and services	5.5	2.5	2.1	1.9	1.4	0.8	0.6
Balance of payments current account							
Per cent of GDP	-4.3	-4.4	-3.5	-3.2	-2.6	-2.2	-2.0
Inflation							
CPI	0.0	0.7	2.4	2.3	2.0	2.0	2.0
RPI	1.0	1.7	3.7	3.6	3.1	3.1	3.2
GDP deflator at market prices	0.6	1.7	1.8	1.6	1.6	1.9	1.9
Labour market							
Employment (millions)	31.3	31.7	31.9	32.1	32.2	32.3	32.5
Productivity per hour	0.8	0.5	1.6	1.5	1.7	1.8	1.9
Wages and salaries	3.9	3.2	3.0	3.0	3.3	3.7	3.9
Average earnings ⁴	1.9	2.2	2.6	2.7	3.0	3.4	3.6
LFS unemployment (% rate)	5.4	4.9	4.9	5.1	5.2	5.2	5.1
Claimant count (millions)	0.80	0.78	0.83	0.86	0.87	0.88	0.88
Household sector							
Real household disposable income	3.6	1.6	0.0	0.8	1.0	1.6	1.8
Saving ratio (level, per cent)	6.5	5.6	4.6	5.2	5.4	5.8	5.9
House prices	6.0	7.6	6.5	4.0	4.4	4.5	4.6
World economy							
World GDP at purchasing power parity	3.3	3.1	3.4	3.5	3.6	3.7	3.7
Euro area GDP	1.9	1.7	1.6	1.6	1.5	1.5	1.5
World trade in goods and services	2.6	1.9	3.1	3.6	4.0	4.1	4.1
UK export markets ⁵	4.1	2.2	3.1	3.8	4.2	4.3	4.3

¹ Includes households and non-profit institutions serving households.

² Includes transfer costs of non-produced assets.

³ Contribution to GDP growth, percentage points.

⁴ Wages and salaries divided by employees.

⁵ Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

Table 3.9: Detailed summary of changes to the forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2015	2016	2017	2018	2019	2020	2021
UK economy							
Gross domestic product (GDP)	0.0	-0.2	0.6	-0.2	-0.4	-0.2	0.0
GDP per capita	0.0	-0.2	0.6	-0.2	-0.4	-0.2	0.0
GDP level (2015=100) ¹	0.0	-0.2	0.4	0.2	-0.1	-0.3	-0.3
Nominal GDP	0.1	0.3	1.1	-0.7	-0.6	-0.3	-0.1
Output gap (per cent of potential output)	0.0	0.2	0.7	0.6	0.2	0.0	0.0
Expenditure components of GDP							
Domestic demand	-0.5	-0.3	0.4	-0.2	-0.4	-0.2	0.0
Household consumption ²	-0.1	0.1	0.6	-0.2	-0.4	-0.3	-0.1
General government consumption	-0.2	-0.2	0.5	0.2	0.1	0.3	0.4
Fixed investment	0.1	0.6	-0.4	-0.6	-0.6	-0.6	0.1
Business	0.0	0.7	0.2	-0.4	-1.2	-0.2	0.0
General government ³	-0.6	-1.0	-3.2	-0.9	0.2	-2.7	0.5
Private dwellings ³	0.2	2.0	-0.3	-0.8	0.0	0.0	0.0
Change in inventories ⁴	0.0	-0.5	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	1.6	-0.9	0.8	-0.2	0.0	0.0	0.0
Imports of goods and services	0.1	-0.4	0.6	-0.2	-0.2	0.0	0.0
Balance of payments current account							
Per cent of GDP	1.1	1.4	1.5	1.0	0.8	0.7	0.7
Inflation							
CPI	0.0	-0.1	0.1	-0.2	-0.1	0.0	0.0
RPI	0.0	0.0	0.5	0.1	-0.1	0.0	0.0
GDP deflator at market prices	0.1	0.5	0.5	-0.5	-0.3	0.0	-0.1
Labour market							
Employment (millions)	0.0	0.0	0.1	0.2	0.2	0.1	0.1
Productivity per hour	0.0	-0.4	0.2	0.0	-0.1	-0.2	-0.1
Wages and salaries	0.0	0.0	0.3	0.0	-0.6	-0.4	-0.2
Average earnings ⁵	0.0	0.0	0.2	-0.1	-0.4	-0.2	-0.1
LFS unemployment (% rate)	0.0	-0.1	-0.3	-0.3	-0.2	-0.2	-0.2
Claimant count (millions)	0.00	0.01	0.01	-0.01	0.01	0.02	0.01
Household sector							
Real household disposable income	0.3	-0.8	-0.1	-0.1	-0.2	-0.1	-0.1
Saving ratio (level, per cent)	0.3	1.1	0.8	1.0	1.2	1.4	1.5
House prices	0.0	-0.2	2.5	-0.1	-0.2	-0.2	-0.1
World economy							
World GDP at purchasing power parity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Euro area GDP	0.0	0.0	0.1	0.0	0.0	0.0	0.0
World trade in goods and services	-0.1	-0.4	-0.3	-0.1	0.0	0.0	-0.1
UK export markets ⁶	-0.1	-0.7	-0.6	-0.2	0.0	0.0	0.0

¹ Per cent change since November.² Includes households and non-profit institutions serving households.³ Includes transfer costs of non-produced assets.⁴ Contribution to GDP growth, percentage points.⁵ Wages and salaries divided by employees.⁶ Other countries' imports of goods and services weighted according to the importance of those countries in the UK's total exports.

4 Fiscal outlook

Introduction

4.1 This chapter:

- describes the assumptions that we have made in respect of **the UK's forthcoming exit from the EU** (from paragraph 4.4);
- sets out the key **economic and market determinants** that drive the fiscal forecast (from paragraph 4.7);
- explains the **effects of new policies** announced in this Budget – and since the Autumn Statement – on the fiscal forecast (from paragraph 4.9);
- describes the **outlook for public sector receipts**, including a tax-by-tax analysis explaining how the forecasts have changed since November (from paragraph 4.31);
- describes the **outlook for public sector expenditure**, focusing on spending covered by departmental expenditure limits and the components of annually managed expenditure, including those subject to the 'welfare cap' (from paragraph 4.97);
- describes **the outlook for government lending to the private sector and other financial transactions**, including asset sales (from paragraph 4.161);
- describes the **outlook for the key fiscal aggregates**, including headline and structural measures of the deficit, and public sector net debt (from paragraph 4.188);
- summarises **risks and uncertainties** (paragraph 4.208); and
- compares our forecasts to those of **international organisations** (from paragraph 4.209).

4.2 Further breakdowns of receipts and expenditure and other details of our fiscal forecast are provided in the supplementary tables on our website. The forecasts in this chapter start from outturn 2015-16 data.¹ We then present an in-year estimate for 2016-17 that makes use of published Office for National Statistics (ONS) outturn data for April to January and some administrative receipts data for February. Finally, we present forecasts for 2017-18 to 2021-22.

¹ Outturn data for 2015-16 are consistent with the *Public Sector Finances January 2017 Statistical Bulletin* (released in February) published by the ONS and HM Treasury.

4.3 As in previous *Economic and fiscal outlooks (EFOs)*, this fiscal forecast:

- **represents our central view** of the path of the public finances, conditioned on the current policies and policy assumptions of the Government, including some assumptions that we have needed to make about the future policy settings in respect of the UK's forthcoming exit from the EU. On that basis, we believe that in the absence of any policy changes the outturns – which will be affected by any errors in our forecast assumptions – would be as likely to be above the forecast as below it;
- is **based on announced Government policy** on the indexation of rates, thresholds and allowances for taxes and benefits, and incorporates certified costings for all new policy measures announced by the Chancellor in the Budget; and
- **focuses on official 'headline' fiscal aggregates** that exclude public sector banks.

Assumptions regarding the UK's exit from the EU

4.4 The OBR is required by legislation to produce its forecasts on the basis of current Government policy (but not necessarily assuming that particular policy objectives will be met). With negotiations over the UK's exit from the EU still to commence, this is not straightforward. We have again asked the Government for any additional information that it wishes to provide on its current policies that would be relevant to our forecasts. As set out in the Foreword, it has directed us to two recent statements in which it has set out at greater length its objectives: a speech by the Prime Minister in January and a white paper published in February. These note that precise outcomes will depend on further policy development by the UK authorities and on forthcoming negotiations with the EU.

4.5 While the Government has now set out some of its objectives more formally, there is – understandably – little detail about how it intends to achieve them and in many areas the policy outcome will depend not just on decisions made by the UK Government but also on those of the parties with which it will be negotiating. On contributions to the EU, the white paper stated that *"There may be European programmes in which we might want to participate. If so, it is reasonable that we should make an appropriate contribution"*.² On customs policy, it stated that the Government will *"seek a new customs arrangement with the EU"*, but that *"The precise form of this new agreement will be the subject of negotiation."*³

4.6 Given the uncertainty regarding how the Government will respond to the choices and trade-offs with which it will be confronted in the negotiations, there is no meaningful basis for predicting the precise end-point on which to base for our forecast. There is also considerable uncertainty about the economic and fiscal implications of different outcomes, even if those outcomes were predictable. So we have used the same assumptions that underpinned our November forecast, which are consistent with a range of possible outcomes. Specifically, as regards the fiscal forecast, we assume that:

² See paragraph 8.51 of *'The United Kingdom's exit from and new partnership with the European Union'*.

³ See paragraph 8.45 of *'The United Kingdom's exit from and new partnership with the European Union'*.

- **the UK leaves the EU in April 2019** – two years after the date by which the Prime Minister has stated that Article 50 will be invoked;
- any reduction in **expenditure transfers to EU institutions** would be recycled fully into extra domestic spending. This assumption is fiscally neutral;
- no allowance for **any one-off or ongoing EU exit-related payments** – the ‘divorce settlement’ – can be made until more information becomes available; and
- there are no changes to the structure or membership of **tax systems for which there are common EU rules** (such as VAT and the EU emissions trading scheme or the customs duties that are deemed to be collected on behalf of the EU).

Economic determinants of the fiscal forecast

4.7 Our fiscal forecasts are based on the economic forecasts presented in Chapter 3. Most economic forecasts focus on the outlook for real GDP, but it is nominal GDP – affected both by volumes and prices – that matters most when forecasting the public finances. Forecasts of tax receipts are particularly dependent on the profile and composition of economic activity. On the income side, labour income is generally taxed more heavily than company profits. On the expenditure side, consumer spending is subject to VAT and other taxes while business investment attracts capital allowances that reduce corporation tax receipts in the short term. And while around half of public sector spending is set out in multi-year cash plans, large elements (such as social security and debt interest payments) are linked to developments in the economy – notably inflation, interest rates and the labour market.

4.8 Table 4.1 sets out some of the key economic determinants of the fiscal forecast. Table 4.2 shows how these have changed since our November forecast. Detailed descriptions of these forecasts and changes are provided in Chapter 3. In summary:

- cumulative **nominal GDP** growth between 2016-17 and 2021-22 has been revised down 1.2 percentage points relative to our November forecast. This reflects our judgement that activity in the economy is now running slightly above its sustainable level (which very slightly reduces cumulative real GDP growth looking forward) and weaker GDP deflator growth (reflecting revisions to the terms of trade and weaker government consumption deflator growth);
- on the income side of GDP, **wages and salaries** are forecast to grow by 3.4 per cent a year on average between 2016-17 and 2021-22, down slightly from November. This partly reflects changes to our forecast of the composition of employment growth, which has been tilted towards more self-employed and fewer employees, in line with recent trends. (While overall growth in wages and salaries is the key determinant of taxes on labour income, its composition is important too (see Box 4.1).) Non-oil, non-financial **profits** grow by 4.7 per cent a year on average, up from 4.3 per cent in November;

- on the expenditure side of GDP, **nominal consumer spending** is forecast to grow by 3.8 per cent a year on average between 2016 and 2021, down very slightly from our November forecast;
- the CPI measure of **inflation** is slightly higher in 2017 and slightly lower in 2018 than we forecast in November. This reflects movements in sterling, oil prices and utility prices, while policy changes are also expected to raise inflation on both measures in the near term – and more so for RPI inflation (see Box 3.2). CPI inflation remains above the Bank of England’s 2 per cent target until 2019-20. We continue to expect RPI inflation to be higher than CPI inflation throughout the forecast period because of differences in the ONS approach to constructing the two measures;
- **house price inflation** has been revised up in the short term in line with a pick-up in leading indicators, but is little changed thereafter. **Residential property transactions** have also been revised up in the short term;
- we still expect **commercial property prices** to fall in 2016-17 and 2017-18, reflecting developments at the top end of the market since the referendum, but to a lesser extent than we forecast in November. We have moved our **commercial property transactions** forecast to a seasonally adjusted measure, in line with HMRC’s published statistics. Transactions rise slightly less than in our November forecast, reflecting recent outturns;
- market-derived assumptions for **equity prices, interest rates and oil and gas prices** reflect average prices in the 10 days to 16 February. Equity and (in the short term only) oil prices have been revised up slightly since November in line with recent outturns. Market expectations of interest rates have risen;
- our **oil and gas production** forecasts are informed by the central projections published by the Oil and Gas Authority. We have revised our oil production forecast up slightly, reflecting stronger-than-expected growth in recent months, but the profile remains the same. We expect higher production to persist over the forecast, reflecting the high levels of investment in recent years; and
- the **output gap** – which we use to estimate the structural health of the public finances – is expected to average +0.1 per cent in 2016-17, revised from -0.2 per cent in November. We expect the output gap to remain close to zero throughout the forecast period, falling just below zero over the next year and then returning to zero by the end of the forecast. The output gap is considerably narrower in most years than it was in our November forecast, in part due to the shallower near-term growth slowdown.

Box 4.1: PAYE income tax and the distribution of wage growth

PAYE income tax is the Government's single most important source of revenue. But, as Chart A illustrates, our forecasts since 2010 have tended to be over-optimistic and we have revised them down over time. The shortfalls have reflected weakness in average growth in wages and salaries and in the amount of tax raised per pound of wages and salaries – the effective tax rate.

Weakness in total wages has reflected weak earnings growth, itself reflecting weak productivity growth. This was partly offset by stronger employment growth, but that has weighed on the effective tax rate because an additional pound of wages due to earnings growth is taxed at the marginal rate (20, 40 or 45 per cent), but an additional pound from employment growth at the average rate (less than 19 per cent in 2015-16, including the effect of the personal allowance).

Chart A: Successive forecasts for PAYE income tax receipts, wages and salaries and the effective tax rate



Source: ONS, OBR

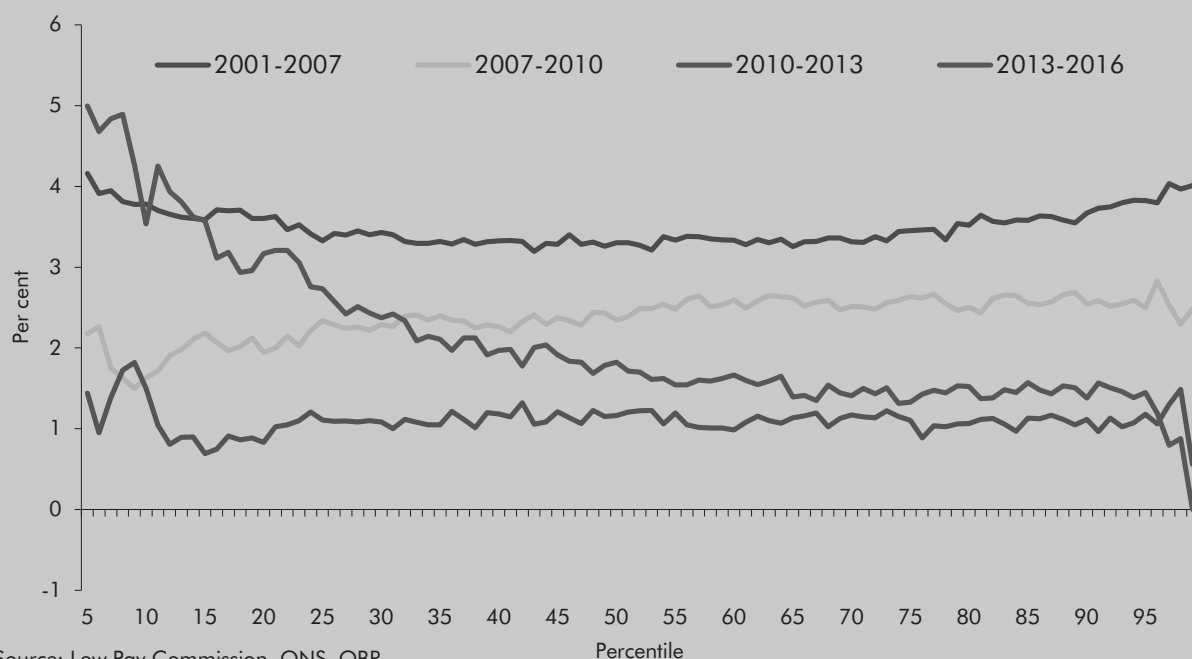
Differences in wage growth at different points in the income distribution are also likely to have contributed to errors in our effective tax rate forecasts. Chart B shows how earnings growth has changed across the distribution for employees aged 22 and over, using ASHE data. These relate to a single pay period in April each year, so will not necessarily be a good guide to changes in income subject to PAYE through the whole year. It suggests four distinct periods since 2001:

- **between 2001 and 2007**, wage growth was around 3½ per cent a year at both mean and median earnings (where the mean tends to be just above the 60th percentile), but higher at both the bottom of the distribution (thanks in part to the National Minimum Wage (NMW)) and the top (continuing the trend of the 1980s and 1990s);
- **between 2007 and 2010**, wage growth in the top half of the distribution was stronger (at around 2½ per cent a year) than in the bottom half;
- **between 2010 and 2013**, wage growth was much slower (at a little over 1 per cent a year) and broadly stable between the 20th and the 95th percentiles. There was slightly higher growth at the very bottom of the distribution; and
- **since 2013**, thanks to relatively large increases in the NMW and, in 2016, the

introduction of the National Living Wage (NLW), the pattern looks very different. Earnings growth picked up a little to roughly 1½ per cent a year from the mean to around the 95th percentile, but was stronger throughout the bottom half.

We moved to assuming a relatively even distribution of earnings growth (before NLW effects) in recent forecasts, reducing the extent to which it pushed up the effective tax rate. The pattern since 2013 may help explain why receipts have been weaker than expected recently.

Chart B: Weekly earnings growth by percentile



Earnings growth lower in the distribution yields less revenue than it used to because the personal allowance was increased around eight times faster than average earnings between 2010-11 and 2015-16, narrowing the tax base. As well as reducing the number of income taxpayers by moving the personal allowance up the earnings distribution (by around 7 percentiles), this reduces the effective tax rate further up the distribution. A basic rate taxpayer working 36 hours a week at median hourly earnings would have paid 13.7 per cent of their wages in income tax in 2010-11, but 10.4 per cent in 2015-16 because of the higher personal allowance.

PAYE receipts will also have been depressed by the lack of earnings growth at the top of the distribution, which is particularly marked since 2013. This is likely to reflect a number of factors, including previously high-paid employees choosing to incorporate (see Box 4.1 of our November *EFO*) and compositional effects – e.g. post-war baby-boomers retiring or leaving full-time employment to be replaced by younger less well-paid people. We have noted similar compositional effects in our public service pensions forecast, including for teachers and GPs.

Looking ahead, our PAYE forecasts assume relatively uniform earnings growth across the distribution, but that the top end will be disproportionately hit by the UK exiting the EU (due to effects on higher-paying sectors, including financial services). Changes in the distribution are therefore expected to deliver a small drag on the effective tax rate over the next five years.

Table 4.1: Determinants of the fiscal forecast

	Percentage change on previous year, unless otherwise specified						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
GDP and its components							
Real GDP	1.9	2.0	1.8	1.6	1.8	1.9	2.0
Nominal GDP ¹	2.8	4.2	3.3	3.3	3.5	3.8	4.0
Nominal GDP (£ billion) ^{1,2}	1886	1964	2029	2095	2168	2251	2340
Nominal GDP (centred end-March £bn) ^{1,3}	1921	1998	2061	2130	2208	2295	2386
Wages and salaries ⁴	3.4	3.5	2.9	3.1	3.3	3.7	3.9
Non-oil PNFC profits ^{4,5}	3.0	10.1	3.2	2.2	4.2	4.2	4.0
Consumer spending ^{4,5}	2.7	4.2	4.3	3.2	3.7	3.7	3.9
Prices and earnings							
GDP deflator	0.7	2.0	1.6	1.6	1.7	1.9	1.9
RPI (September) ⁶	0.8	2.0	3.9	3.4	3.1	3.1	3.2
CPI (September) ⁶	-0.1	1.0	2.6	2.2	2.0	2.0	2.0
Average earnings ⁷	1.8	2.6	2.6	2.8	3.0	3.5	3.7
'Triple-lock' guarantee (September)	2.9	2.5	2.6	2.7	2.9	3.4	-
Key fiscal determinants							
Claimant count (millions)	0.78	0.79	0.85	0.87	0.88	0.88	0.88
Employment (millions)	31.4	31.8	31.9	32.1	32.2	32.4	32.5
Implied VAT gap (per cent)	9.6	9.7	9.4	9.0	8.5	8.3	8.2
Output gap (per cent of potential output)	-0.2	0.1	0.1	-0.1	-0.1	-0.1	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	3412	3696	4009	4138	4282	4447	4623
HMRC financial sector profits ^{1,5,8}	2.6	4.1	1.7	1.6	1.7	1.9	4.0
Residential property prices ⁹	6.3	7.4	5.8	4.0	4.5	4.5	4.7
Residential property transactions (000s) ¹⁰	1321	1164	1280	1294	1305	1315	1322
Commercial property prices ¹⁰	11.9	-4.0	-2.8	1.6	1.7	1.9	1.9
Commercial property transactions ¹⁰	4.4	4.5	1.7	1.7	1.8	1.9	2.0
Volume of stampable share transactions	12.5	-9.1	-1.1	0.0	0.0	0.0	0.0
Oil and gas							
Oil prices (\$ per barrel) ⁵	52.4	44.0	56.3	56.3	56.7	57.9	59.0
Oil prices (£ per barrel) ⁵	34.3	32.5	45.1	44.6	44.4	44.7	44.9
Gas prices (p/therm) ⁵	43.0	34.6	48.1	46.2	47.3	48.2	49.0
Oil production (million tonnes) ⁵	45.3	47.4	47.4	47.4	47.4	45.0	42.8
Gas production (billion therms) ⁵	14.0	14.6	13.8	13.1	12.5	11.9	11.3
Interest rates and exchange rates							
Market short-term interest rates (%) ¹¹	0.6	0.4	0.4	0.6	0.8	1.0	1.2
Market gilt rates (%) ¹²	1.9	1.2	1.5	1.7	1.9	2.0	2.2
Euro/Sterling exchange rate (€/£)	1.37	1.19	1.16	1.16	1.15	1.14	1.14

¹ Not seasonally adjusted.² Denominator for receipts, spending and deficit forecasts as a per cent of GDP.³ Denominator for net debt as a per cent of GDP.⁴ Nominal. ⁵ Calendar year.⁶ Q3 forecast used as a proxy for September.⁷ Wages and salaries divided by employees.⁸ HMRC Gross Case 1 trading profits.⁹ Outturn data from ONS House Price Index.¹⁰ Outturn data from HMRC information on stamp duty land tax.¹¹ 3-month sterling interbank rate (LIBOR).¹² Weighted average interest rate on conventional gilts.

Table 4.2: Changes in the determinants of the fiscal forecast

	Percentage change on previous year, unless otherwise specified						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
GDP and its components							
Real GDP	-0.1	0.0	0.5	-0.2	-0.3	-0.1	0.0
Nominal GDP ¹	0.2	0.5	0.7	-0.8	-0.5	-0.2	-0.1
Nominal GDP (£ billion) ^{1,2}	3	13	27	12	1	-3	-6
Nominal GDP (centred end-March £bn) ^{1,3}	9	23	21	7	-2	-4	-7
Wages and salaries ⁴	0.0	0.1	0.3	-0.1	-0.6	-0.4	-0.2
Non-oil PNFC profits ^{4,5}	0.2	2.7	2.4	-0.9	-1.7	-0.6	-0.1
Consumer spending ^{4,5}	-0.1	0.2	0.7	-0.4	-0.6	-0.3	-0.1
Prices and earnings							
GDP deflator	0.2	0.6	0.2	-0.6	-0.2	0.0	-0.1
RPI (September) ⁶	0.0	0.0	0.7	-0.1	0.0	0.0	0.0
CPI (September) ⁶	0.0	0.0	0.1	-0.3	0.0	0.0	0.0
Average earnings ⁷	0.0	0.1	0.2	-0.2	-0.4	-0.2	-0.1
'Triple-lock' guarantee (September)	0.0	0.0	0.1	0.0	-0.4	-0.2	-
Key fiscal determinants							
Claimant count (millions)	0.00	0.02	0.01	-0.01	0.01	0.02	0.01
Employment (millions)	0.0	0.0	0.1	0.2	0.1	0.1	0.2
Implied VAT gap (per cent)	-0.8	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Output gap (per cent of potential output)	0.0	0.3	0.7	0.5	0.2	0.0	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	0	20	115	87	70	64	61
HMRC financial sector profits ^{1,5,8}	-0.1	0.4	0.5	-0.5	-0.3	-0.1	-0.2
Residential property prices ⁹	0.0	0.3	2.1	-0.2	-0.2	-0.2	-0.1
Residential property transactions (000s) ¹⁰	-8	35	80	52	35	13	4
Commercial property prices ¹⁰	0.0	1.1	0.4	-0.5	-0.2	-0.1	-0.1
Commercial property transactions ¹⁰	-0.3	-2.2	0.4	-0.2	-0.3	-0.1	0.0
Volume of stampable share transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Oil and gas							
Oil prices (\$ per barrel) ⁵	0.0	-0.2	2.2	-0.3	-1.3	-1.3	-1.3
Oil prices (£ per barrel) ⁵	0.0	-0.2	1.0	-1.1	-2.2	-2.5	-2.8
Gas prices (p/therm) ⁵	0.0	0.6	1.7	-0.5	-0.6	-0.6	-0.6
Oil production (million tonnes) ⁵	0.0	0.3	0.3	0.3	0.3	0.2	0.3
Gas production (billion therms) ⁵	0.0	0.6	0.5	0.5	0.5	0.5	0.5
Interest rates and exchange rates							
Market short-term interest rates ¹¹	0.0	0.0	0.1	0.1	0.1	0.2	0.2
Market gilt rates ¹²	0.0	0.1	0.1	0.2	0.2	0.2	0.3
Euro/Sterling exchange rate (€/£)	0.00	0.02	0.05	0.05	0.05	0.05	0.05

¹ Not seasonally adjusted.² Denominator for receipts, spending and deficit forecasts as a per cent of GDP.³ Denominator for net debt as a per cent of GDP.⁴ Nominal. ⁵ Calendar year.⁶ Q3 forecast used as a proxy for September.⁷ Wages and salaries divided by employees.⁸ HMRC Gross Case 1 trading profits.⁹ Outturn data from ONS House Price Index.¹⁰ Outturn data from HMRC information on stamp duty land tax.¹¹ 3-month sterling interbank rate (LIBOR).¹² Weighted average interest rate on conventional gilts.

Policy announcements, risks and classification changes

4.9 The Government publishes estimates of the direct impact on the public finances of selected tax and spending policy decisions in its 'scorecard'. It also shows some changes within departmental spending. We discuss the costing of each measure in detail with officials and, if we were to disagree with any of the final numbers that the Government chooses to publish, we would use our own estimates in our forecast. (We do not scrutinise individual changes within departmental spending, but rather make a judgement on the extent to which the Government's overall resource and capital spending limits will be over- or underspent.) We are also responsible for assessing any indirect effects of policy measures on our economy forecast.⁴ These are discussed in Box 3.2 in Chapter 3. We note as risks to the fiscal forecast any significant policy commitments that are not quantifiable, as well as any potential statistical classification changes.

The effect of new policy announcements on the public finances

- 4.10 We consider the effects of all policy announcements that affect the public finances, so long as they can be quantified with reasonable accuracy and assigned to specific years. This includes the direct effects of policies presented on the Treasury's scorecard and other policies that it chooses not to present that way. It also includes our estimate of their indirect effects on the public finances – for example, changing the rate of VAT would affect inflation, which would have knock-on effects on the cost of servicing index-linked gilts.
- 4.11 All these effects are summarised in Table 4.3, which follows the Treasury convention of showing costs that raise borrowing as negative and savings that reduce it as positive. The scorecard reports modest giveaways of £1.7 billion and £0.7 billion in the first two years, and then small takeaways averaging £0.7 billion a year thereafter (including the selected elements of departmental spending shown on the scorecard).
- 4.12 Policy changes not reported on the Treasury scorecard include a number of relatively big but largely neutral changes: allowing faster council tax rises to finance higher local authority spending on adult social care; piloting local business rates retention by cutting grants to selected local authorities; and introducing a new structure for probate fees that is likely to be treated as a tax in the public finances. The Government has also revised the profile of grants to housing associations via the affordable homes programme. In aggregate, the non-scorecard measures amount to a giveaway averaging a little over £1 billion a year.
- 4.13 Taking scorecard and non-scorecard measures together, and disregarding the switches out of government grants for the business rates pilots (which are offset in AME), departmental resource spending has been increased by £2.4 billion or more in every year. This includes additional funding for adult social care (reported on the scorecard) and money set-aside to meet the costs to the public sector (in particular the NHS Litigation Authority) of reducing the personal injury discount rate, which will substantially increase the size of one-off settlement

⁴ In March 2014, we published a briefing paper on our approach to scrutinising and certifying policy costings, and how they are fed into our forecasts, which is available on our website: *Briefing paper No 6: Policy costings and our forecast*.

payments (not reported on the scorecard). Departmental capital spending has been increased by £0.6 billion a year on average up until 2019-20, but then reduced by £1.0 billion a year on average in 2020-21 and 2021-22.

- 4.14 The small indirect effect of Government decisions largely reflects the changes to our economy forecast as a result of Government decisions, discussed in Box 3.2. In particular, higher inflation (the knock-on effect of lowering the personal injury discount rate) has raised PSNB (see Box 4.2). The slight boost to nominal GDP growth from the small fiscal loosening in 2017-18 has pushed income tax and VAT receipts a little higher in the near term.
- 4.15 We discuss the effects of policy decisions in more detail in Annex A, where we also set out our assessment of the degree of uncertainty associated with each costing that we have certified. Annex A also provides an update on various previous measures.

Table 4.3: Summary of the effect of Government decisions on the budget balance

	£ billion				
	Forecast				
	2017-18	2018-19	2019-20	2020-21	2021-22
Total effect of Government decisions	-3.1	-1.8	-1.7	1.0	0.6
Direct effect of policies on the scorecard	-1.7	-0.7	0.8	0.9	0.4
<i>of which:</i>					
Receipts	-0.2	0.5	1.5	1.4	1.5
AME	0.1	0.1	0.2	0.1	0.1
RDEL	-1.4	-1.0	-0.6	-0.3	-0.5
CDEL	-0.3	-0.3	-0.3	-0.3	-0.7
Direct effect of policies off the scorecard	-1.3	-1.3	-2.6	-0.2	0.0
<i>of which:</i>					
Receipts	0.3	0.5	0.3	0.3	0.3
AME	-2.7	-2.5	-0.4	0.5	0.0
RDEL	0.0	-0.2	-1.8	-2.2	-2.0
CDEL	1.0	0.9	-0.7	1.2	1.7
Indirect effect of Government decisions	-0.1	0.2	0.1	0.2	0.1
Total effect of Government decisions	-3.1	-1.8	-1.7	1.0	0.6
<i>of which:</i>					
Gross tax increases	0.5	1.1	2.0	2.2	2.2
Gross tax cuts	-0.3	-0.2	-0.2	-0.5	-0.4
Total RDEL policy changes	-1.4	-1.2	-2.4	-2.5	-2.5
Total CDEL policy changes	0.8	0.6	-1.0	0.9	1.0
Total AME policy changes	-2.6	-2.4	-0.3	0.6	0.1
Indirect effects of Government decisions	-0.1	0.2	0.1	0.2	0.1
Financial transactions ¹	0.0	0.1	0.1	0.0	0.0

¹ Affects PSNCR, not PSNB.

Note: The full Treasury scorecard can be found in Annex A. This table uses the Treasury scorecard convention that a positive figure means an improvement in PSNB, PSNCR and PSND. The supplementary tables on our website shows how each measure is attributed between receipts, AME and DEL.

- 4.16 As Chart 4.1 shows, the effect of the Government's decisions on borrowing follows the often-repeated profile of short-term loosening followed by medium-term tightening. While that profile is relatively smooth when considering only the policies that have been reported

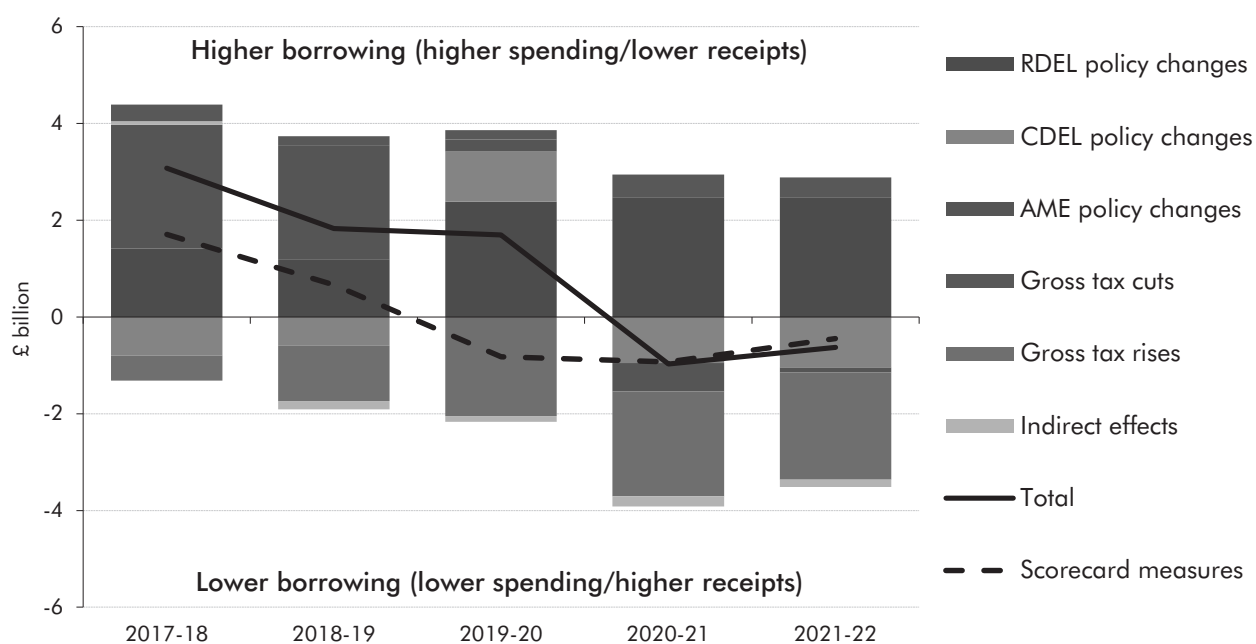
on the scorecard, the shift from a £1.7 billion giveaway in 2019-20 to a £1.0 billion takeaway in 2020-21 is more striking when all Government decisions are factored in. This £2.7 billion turnaround is sufficient to ensure that borrowing falls by £0.8 billion year-on-year in 2020-21, instead of rising by £1.9 billion in our pre-policy forecast.

4.17 The biggest contributor to this turnaround has been to ‘reprofile’ spending from 2020-21 into 2019-20, including:

- £0.6 billion of **Department for Education capital spending** (some of which was brought forward to 2018-19 too);
- £0.5 billion of **housing associations’ capital spending** (by changing the timing of grant payments from central government);
- £0.4 billion of **unallocated capital spending** from the large unallocated amount in 2020-21 that was added in Spending Review 2015; and
- £0.3 billion of **official development assistance resource spending** by the Department for International Development.

4.18 None of this ‘reprofiling’ is reported on the Treasury’s scorecard. Unusually, it does report schools-related capital spending of £0.3 billion in 2020-21 and £0.7 billion in 2021-22 for which it has not increased the capital envelope. This also contributes to the smoother profile of the scorecard relative to the total effect of Government decisions on the deficit.

Chart 4.1: The effect of Budget decisions on public sector net borrowing



Source: OBR

Box 4.2: The personal injury discount rate

In February, the Ministry of Justice announced that the personal injury discount rate would be reduced from 2.5 to minus 0.75 per cent (in inflation-adjusted real terms). This discount rate is used when calculating lump-sum awards in respect of financial loss due to personal injury. A lower discount rate increases the net present value of projected future flows, leading to higher awards. At the same time, the Government announced that it would launch a consultation that “will consider whether there is a better or fairer framework for claimants and defendants”. The effect of any policy changes that follow will be reflected in future forecasts.

As Table A shows, reducing the discount rate has three effects on our fiscal forecast:

- **the Government has added around £1.2 billion a year to the RDEL reserve** to meet the expected costs to the public sector, in particular to the NHS Litigation Authority;
- **an expected increase in IPT receipts of around £0.1 billion a year** as the increased costs for the insurance industry, particularly in the motor sector, are passed on in higher premiums. We assume that these costs will be fully passed on to consumers, raising motor insurance premiums by around 10 per cent this year (although this is highly uncertain). It may also have pushed premiums up in recent months, as the industry anticipated a change. We also assume that this change will raise the cost of public and employer liability insurance. Our estimate of the IPT effect allows for consumers responding to higher prices by reducing the value of their coverage; and
- **higher insurance premiums will increase inflation** – directly in the case of motor insurance and indirectly via costs to business in the case of employer liability insurance. As set out in Box 3.2, the effect is around four times bigger on RPI than CPI inflation due to differences in the weight of motor insurance in each index. The biggest effect via RPI inflation is to push up the cost of accrued interest on index-linked gilts, increasing borrowing by £0.8 billion in 2017-18 and £0.1 billion in 2018-19. There is a smaller but persistent RPI effect via the revalorisation of excise duties, while higher CPI inflation also leads to changes to tax and benefit thresholds. Together these effects are largely offsetting.

Table A: Lowering the personal injury discount rate: estimated fiscal effects

	£ billion				
	Forecast				
	2017-18	2018-19	2019-20	2020-21	2021-22
Effect on receipts (PSCR)	0.1	0.3	0.3	0.2	0.2
IPT boost from higher premiums	0.1	0.1	0.1	0.1	0.1
Effect of higher inflation on receipts	0.1	0.1	0.2	0.1	0.1
Effect on spending (TME)	1.9	1.2	1.2	1.2	1.2
Higher RDEL	1.2	1.1	1.2	1.2	1.2
Effect of higher RPI on CG debt interest	0.8	0.1	0.0	0.0	0.0
Effect of higher inflation on other spending	0.0	0.1	0.2	0.2	0.2
Total effect on PSNB	1.8	0.9	0.9	1.0	1.0

Policy risks

4.19 Parliament requires that our forecasts only reflect current Government policy. As such, when the Government or governing party sets out ‘ambitions’ or ‘intentions’ we ask the Treasury to confirm whether they represent firm policy. We use that information to determine what should be reflected in our forecast. Where they are not yet firm policy, we note them as a source of risk to our central forecast. Abstracting from the wider policy uncertainty associated with the forthcoming negotiations on leaving the EU, for this forecast we note:

- commitments on **income tax allowances**: the Government has set out that it “*is determined to support those in work by continuing to cut taxes and has committed to raise the personal allowance to £12,500 and the higher rate threshold to £50,000 by the end of this Parliament.*” These objectives are specified in terms of the levels being targeted and by when (the end of the Parliament), but the Government has not set out how it would get from the current level to £12,500. As such, we are not able to quantify the effect on each year of the forecast of achieving this goal. In April 2017 the personal allowance is due to increase to £11,500 and the higher rate threshold to £45,000. The Government’s policy assumption is that these thresholds are uprated in line with CPI inflation in years for which it has not set specific parameters, so in our forecast the personal allowance reaches £12,070 by 2019-20 and £12,310 by 2020-21. For the higher rate threshold, those figures are £47,270 and £48,210. Due to the much larger number of taxpayers affected by changes in the personal allowance, it is that element of the Government’s commitment that would be most costly to meet. We estimate that closing the remaining gaps between the levels of the personal allowance and higher rate threshold reached in our central forecast and the Government’s commitments would cost around £1.3 billion. If ‘the end of this Parliament’ was interpreted as 2019-20, the cost would be closer to £3 billion;
- the intention to **localise all business rates** and to provide some additional discretion to local authorities in setting them, while also shifting some new spending responsibilities to local authorities. There are elements of this prospective package that could be quantified now, but it would be misleading to include only part of it in our central forecast when the Government has stated that when fully specified it will be fiscally neutral as a whole. When the package is fully specified, we will include it in the forecast and judge whether we do indeed expect it to be fiscally neutral. The Government is piloting the policy, which is reflected in this forecast, and is launching a further consultation on the full policy. It has ruled out transferring responsibility for attendance allowance to local authorities as a means of achieving fiscal neutrality;
- the **intention to expand right-to-buy to tenants of housing associations**. An initial pilot scheme has been running since April 2016 and an expanded pilot is due to begin in April 2017. The Housing and Planning Act received Royal Assent in May 2016, but the Treasury has informed us that the secondary legislation detailing how the policy will work has not yet been introduced. A further consultation on some key parameters is planned. Until these details are specified and the implementation timetable is sufficiently clear, we cannot estimate the effects of this policy on a year-by-year basis;

- the Department for Work and Pensions and Department of Health issued a **consultation on work, health and disability** that closed in February 2017. The Government's response could lead to changes to work capability assessments in employment and support allowance – or other changes – with implications for our welfare spending forecast. Until the Government takes any decisions on the basis of this consultation, we note it as a risk to our central forecast;
- the **devolution of corporation tax to Northern Ireland**. The Corporation Tax (Northern Ireland) Act received Royal Assent in March 2015, with devolution due to begin in April 2018. The Northern Ireland Executive has announced its intention to set a 12.5 per cent rate, to match that in the Republic of Ireland. While legislation has been passed, final devolution is subject to agreement between the UK Government and the Northern Ireland Executive. This has not yet been reached, so we have not included the effect of the proposed tax cut in our central forecast; and
- the **intention to ban additional fees charged by private letting agents**, announced in Autumn Statement 2016. Specific details about timing and implementation remain outstanding, so we have not adjusted our forecast. Nevertheless it is possible that a ban on fees would be passed through to higher private rents. If this was the case, it could affect our housing benefit spending forecast.

4.20 Uprating policy presents some risks to our forecast. For example, the Government's stated uprating assumption is that fuel duty will rise in line with RPI inflation each year. But it has been frozen since 2010-11. RPI-based uprating explains all the £2.5 billion rise in fuel duty receipts over the forecast period. The same pattern has been seen with some smaller taxes too: aggregates levy has been frozen since 2009-10 and vehicle excise duty for heavy-goods vehicles since 2001.

Contingent liabilities

4.21 We have asked the Treasury to identify any changes to future contingent liabilities as a result of policy announcements since November. While a number of relatively small contingent liabilities have been notified to Parliament, there are none that we consider fiscally significant. We also asked the Treasury whether any liabilities had been entered into as a result of the Government's discussions with Peugeot. We were told that *"The Department for Business, Energy and Industrial Strategy (BEIS) is the lead department on this issue. BEIS has confirmed to HM Treasury that no liabilities, contingent or otherwise, have been created."*

Classification changes

4.22 The ONS has implemented two classification decisions since our last forecast. The most significant relates to recording corporation tax receipts on a time-shifted basis that means the public finances data are more closely aligned with the activity generating the tax liability, rather than the later point when the tax is paid. We have now fully reflected the new methodology in our forecasts, as discussed later in this chapter. The ONS has also incorporated data on housing associations in Scotland, Wales and Northern Ireland.

- 4.23 The ONS has also announced that it is looking at adopting time-shifted methodologies for other taxes – self-assessed income tax, capital gains tax and stamp duty land tax – which are currently scored on a cash basis. Given that both self-assessed income tax and CGT are usually paid more than a year in arrears and are volatile, moving the recording basis would lead to significant changes to both outturn and to our forecast. In addition there are two measures in our forecast – for CGT and SDLT – where reducing payment windows temporarily boost cash receipts, so on the current methodologies temporarily reduce the deficit too. Were the ONS to move to a time-shifted approach for these taxes, the effect of these measures on the deficit would be zero.
- 4.24 As we noted in November, the ONS has recently classified a number of smaller funded pension schemes to the public sector, as part of its work programme evaluating schemes against the requirements of ESA10. This is part of a broader review of the treatment of pensions in the National Accounts. Both are likely to affect imputed pensions spending in our forecast. Given this ongoing work and the uncertainty around its results, we have not yet factored in the latest classification decisions.
- 4.25 Our forecast also contains a number of relatively small items that relate to classification decisions that the ONS has taken but has not yet implemented. These are detailed in a supplementary fiscal table on our website.
- 4.26 One potential classification risk to future forecasts relates to the Government’s decision to move to a graduated structure for probate fees, which it estimates will raise around £300 million a year. Smaller estates will pay no fee, with fees then rising in steps from £300 up to £20,000 (for estates over £2 million). We have accepted Treasury advice that the ONS is likely to treat this as a tax. This would be consistent with ESA10 guidance for cases where fees do not bear sufficiently close relation to the cost of the service being provided. But it is possible that the ONS will conclude these are fees from the provision of a service – and so negative spending. That would be neutral for our borrowing forecast, with equal effects on tax and spending. The ONS is currently considering the classification of a number of other smaller fees, so further changes are possible.

Financial sector interventions

- 4.27 The Government undertook a number of interventions in the financial sector in response to the financial crisis and subsequent recession of the late 2000s. In each *EFO* we update the estimated net effect of them on the public finances. Table 4.4 summarises the position as at end-January 2017.⁵ This is an estimate of the direct effect of these interventions and the financing associated with them. It is not an attempt to quantify their overall effect on the public finances relative to a counterfactual where the Government had not intervened to support the banking system as the financial crisis unfolded.

⁵ The Lloyds and RBS figures show the position at 16 February, so they are consistent with the market-derived assumptions used in the rest of our fiscal forecast. All other figures reflect end-January data, allowing time for detailed scrutiny before the figures are provided to us.

- 4.28 In total, £137 billion was disbursed by the Treasury during and following the crisis. By end-January, principal repayments on loans, proceeds from share sales and redemptions of preference shares amounted to £67 billion. That is up from the £63 billion we reported in November, reflecting £1.9 billion proceeds from Lloyds shares sales and repayments of £1.6 billion on the Treasury loans to UKAR. In total, the Treasury has also received a further £21 billion in other fees and interest, leaving a net cash shortfall of around £49 billion.
- 4.29 As of end-January, the Treasury was still owed £26 billion (almost entirely by UKAR, since the £15.7 billion FSCS loan also relates to UKAR). The value of the shares it retained in RBS and Lloyds had risen to £22 billion by mid-February, up from £20 billion in November, as higher bank equity prices more than offset the sale of nearly half its Lloyds shares. The Treasury's holdings in UKAR had an equity book value of around £8 billion.
- 4.30 If the Treasury were to receive all loan payments in full, and sold its remaining shares at their mid-February values, it would realise an overall cash surplus of £7.2 billion. That is £4.4 billion higher than in November, with the change largely explained by the increase in the RBS share price. But that estimate excludes the costs to the Treasury of financing these interventions. If all interventions were financed through gilts, the Treasury estimates that the additional debt interest costs would have amounted to £30.7 billion by end-January, mainly due to the costs associated with RBS and UKAR. Together this implies an overall cost of £23.5 billion to the Government, £3.3 billion lower than we estimated in November.

Table 4.4: Gross and net cash flows of financial sector interventions

	£ billion								Change since November EFO ⁵
	Lloyds	RBS	UKAR ¹	FSCS ²	CGS ³	SLS ⁴	Other	Total	
Cash outlays	-20.5	-45.8	-44.1	-20.9	0.0	0.0	-5.3	-136.6	0.0
Principal repayments	18.8	3.8	33.7	5.2	0.0	0.0	5.2	66.8	3.5
Other fees received ⁶	3.2	4.2	4.3	2.7	4.3	2.3	0.2	21.1	0.1
Net cash position	1.4	-37.8	-6.1	-12.9	4.3	2.3	0.2	-48.8	3.6
Outstanding payments	0.0	0.0	10.0	15.7	0.0	0.0	0.1	25.7	-1.6
Market value ⁷	2.3	19.7	8.3	0.0	0.0	0.0	0.0	30.2	2.5
Implied balance	3.7	-18.2	12.1	2.7	4.3	2.3	0.3	7.2	4.4
Exchequer financing	-3.6	-11.0	-10.2	-6.5	0.9	0.2	-0.5	-30.7	-1.1
Overall balance	0.1	-29.2	1.9	-3.7	5.1	2.5	-0.2	-23.5	3.3
<i>Memo: change in overall balance since November⁵</i>	0.5	3.3	-0.3	-0.3	0.0	0.0	0.0	3.3	

¹ Holdings in Bradford & Bingley and Northern Rock Asset Management plc are now managed by UK Asset Resolution.

² Financial services compensation scheme.

³ Credit Guarantee Scheme.

⁴ Special Liquidity Scheme.

⁵ November EFO figures were consistent with 30 September 2016 data.

⁶ Fees relating to the asset protection scheme and contingent capital facility are included within the Lloyds and RBS figures.

⁷ Lloyds and RBS figures are based on average share prices in the 10 working days to 16 February 2017. UKAR is book value of equity derived from its accounts published 8 November 2016 (value up to date to 30 September 2016).

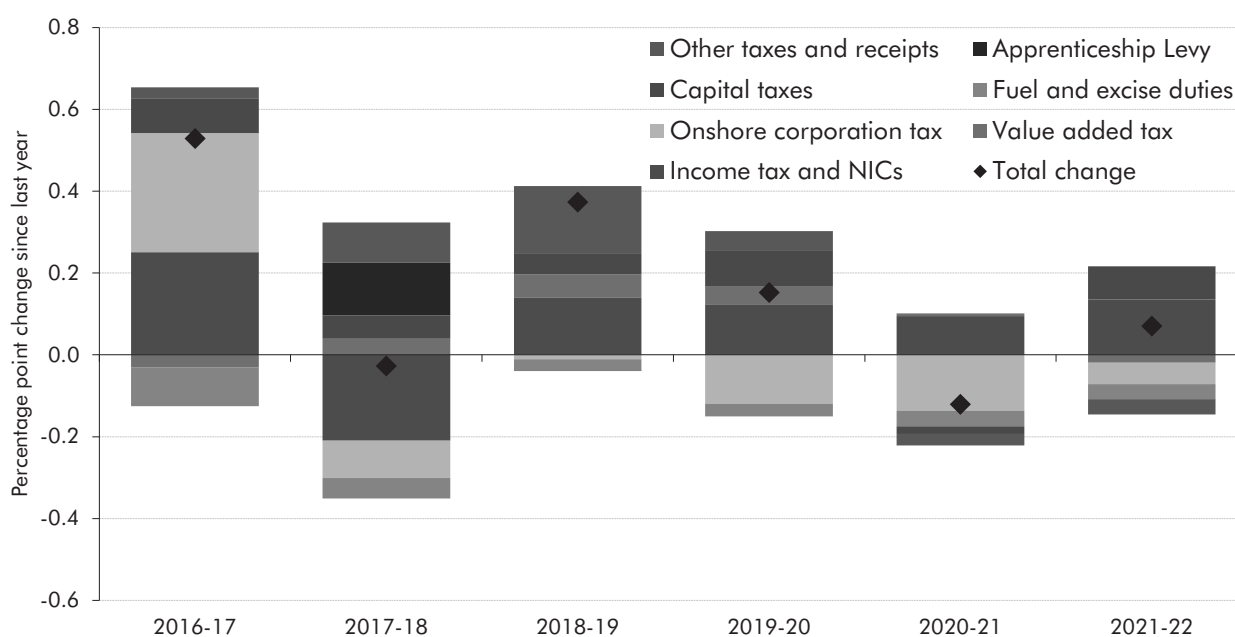
Public sector receipts

4.31 Table 4.5 summarises our receipts forecast as a share of GDP. As shown in Chart 4.2, the tax-to-GDP ratio has risen this year (largely due to past policy measures that boost self-assessment income tax, including the effect of forestalling ahead of the April 2016 rise in dividend tax, and NICs receipts) and is expected to be flat next year (as the introduction of the apprenticeship levy and higher environmental levies offset the unwinding of forestalling effects). The ratio rises again in 2018-19, from where it remains relatively flat.

Table 4.5: Major receipts as a per cent of GDP

	Per cent of GDP						
	Outturn 2015-16	Forecast					
		2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Income tax and NICs	15.0	15.3	15.0	15.2	15.3	15.4	15.5
Value added tax	6.2	6.1	6.2	6.2	6.3	6.3	6.3
Onshore corporation tax	2.4	2.7	2.6	2.6	2.5	2.3	2.3
Fuel duties	1.5	1.4	1.4	1.3	1.3	1.3	1.3
Business rates	1.5	1.5	1.5	1.5	1.5	1.5	1.4
Council tax	1.5	1.5	1.6	1.6	1.6	1.6	1.6
Excise duties	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Capital taxes	1.4	1.5	1.5	1.6	1.7	1.7	1.7
UK oil and gas receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	2.9	3.0	3.3	3.3	3.3	3.2	3.2
National Accounts taxes	33.4	34.0	34.0	34.3	34.4	34.3	34.3
Interest and dividend receipts	0.3	0.3	0.3	0.4	0.4	0.5	0.5
Other receipts	2.4	2.4	2.4	2.4	2.3	2.4	2.4
Current receipts	36.2	36.7	36.7	37.1	37.2	37.1	37.2

Chart 4.2: Year-on-year changes in the receipts-to-GDP ratio



Source: OBR

Sources of changes in the tax-to-GDP ratio

4.32 Movements in the tax-to-GDP ratio arise from two sources:

- changes in the **composition of GDP** can lead to specific tax bases growing more or less quickly than the economy as a whole; and
- the **effective tax rate paid on each tax base** can change due to policy or other factors.

Change in the tax-to-GDP ratio over the forecast period

4.33 Chart 4.3 shows that the main sources of the overall 0.2 percentage point rise between 2016-17 and 2021-22 are:

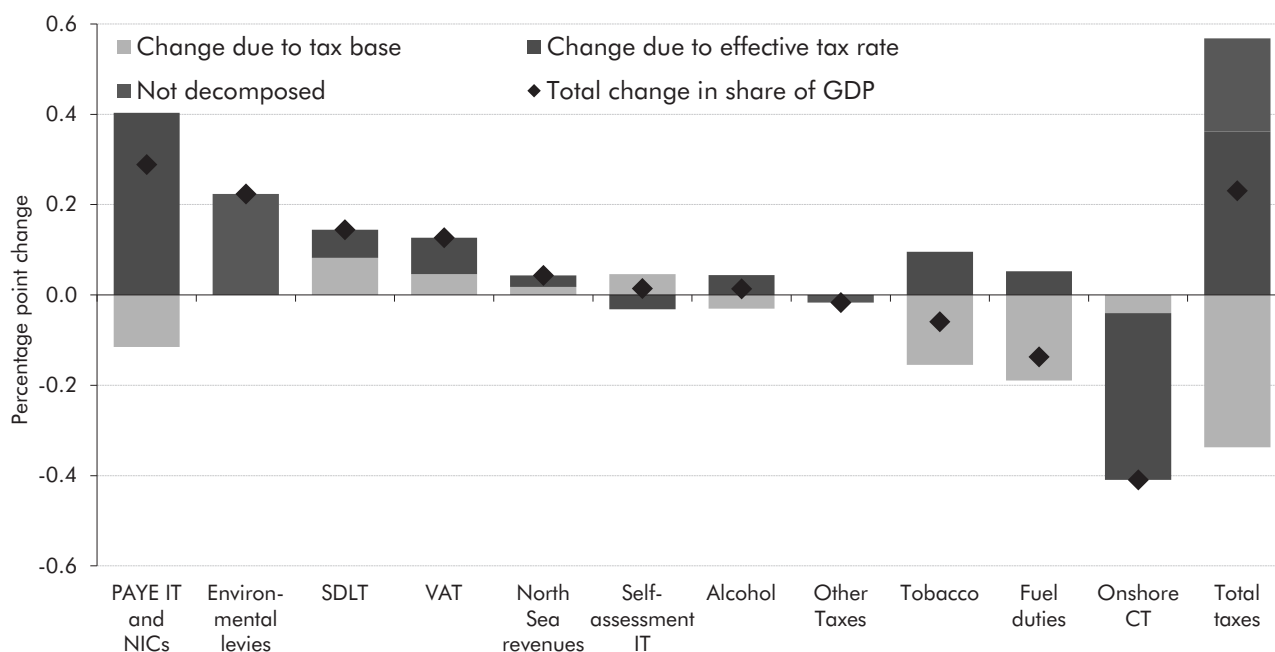
- a 0.3 per cent of GDP rise in **PAYE income tax and NICs** receipts. This is more than explained by a rise in the effective tax rate. Most of this is due to ‘fiscal drag’ as productivity and real earnings growth pick up (to still historically subdued rates), dragging more income into higher tax brackets;
- a 0.2 per cent of GDP rise in receipts from **environmental levies**. The biggest effect is from levies within the ‘levy control framework’ that are scored as both tax and spending and which are therefore neutral for overall borrowing. The rise over the forecast is driven by rising renewable electricity generation;
- a 0.1 per cent of GDP rise in **taxes on property transactions** (stamp duty land tax (SDLT) and the Scottish land and buildings transactions tax (LBTT)). This reflects both the tax base and effective tax rate. Tax base growth largely reflects rising property prices. With thresholds still fixed in cash terms over the forecast period, the rise in the effective tax rate reflects rising house prices dragging a greater proportion of the value of residential transactions into higher tax brackets; and
- a 0.1 per cent of GDP rise in **VAT** receipts. Household consumption rises as a share of nominal GDP in the near term (because the business investment share is forecast to fall, while higher CPI inflation means that the weakness of real consumption is not matched in nominal consumption). We expect the gap between the theoretical total VAT receipts and the actual amount paid – reflecting receipts lost to evasion and non-compliance, plus any errors in estimating the theoretical total – to narrow over the forecast due to recent policy measures. That boosts the effective tax rate.

4.34 Partly offsetting these rises are:

- a 0.2 per cent of GDP fall in **excise duties**. This is explained by declining tax bases, due to trends in alcohol and tobacco consumption and rising fuel efficiency. These are only partly offset by rises in duty rates, raising the effective tax rate; and
- a 0.4 per cent of GDP fall in **onshore corporation tax** receipts. This is driven by a falling effective tax rate – as the main corporation tax rate will be cut to 17 per cent by

2020-21, growth in investment increases the use of capital allowances and the financial sector sets past losses against future liabilities. The tax base also contributes negatively because we expect financial company profits to grow more slowly than the whole economy in the near term (due to post-referendum uncertainty, the effect of litigation provisions and pressures from regulation).

Chart 4.3: Sources of changes in the tax-to-GDP ratio (2016-17 to 2021-22)



Source: OBR

Detailed current receipts forecast

4.35 Our detailed receipts forecasts and changes since November are presented in Tables 4.6 and 4.7. Further detailed breakdowns are available in supplementary fiscal tables on our website. Our forecasts for Scottish and Welsh devolved taxes are discussed in our separate *Devolved tax forecasts* publication.

Table 4.6: Current receipts

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Income tax (gross of tax credits) ¹	168.9	174.7	174.9	183.6	191.9	200.6	211.2
of which: Pay as you earn	146.2	148.5	153.3	157.9	164.3	171.7	180.2
Self assessment	24.3	28.7	24.8	29.1	31.2	32.5	34.5
National insurance contributions	114.1	125.0	130.3	134.5	140.0	146.2	152.4
Value added tax	116.4	120.7	125.4	130.8	136.2	141.6	146.7
Corporation tax ²	45.6	53.6	54.1	55.5	54.9	53.9	54.7
of which: Onshore	45.2	52.8	52.7	54.2	53.5	52.5	53.3
Offshore	0.4	0.8	1.4	1.3	1.5	1.4	1.4
Petroleum revenue tax	-0.6	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
Fuel duties	27.6	27.9	27.5	28.0	28.5	29.2	30.0
Business rates	28.8	28.8	29.6	31.0	32.2	33.0	33.7
Council tax	29.0	30.4	32.1	33.7	34.9	35.9	37.0
VAT refunds	14.1	13.8	13.8	13.9	13.9	14.3	14.7
Capital gains tax	7.1	8.7	9.1	10.0	11.8	11.2	12.8
Inheritance tax	4.7	4.7	5.0	5.2	5.5	5.8	6.2
Stamp duty land tax ³	10.9	11.6	13.1	14.0	14.8	15.9	17.0
Stamp taxes on shares	3.3	3.6	3.4	3.5	3.6	3.7	3.9
Tobacco duties	9.1	8.7	8.9	9.0	9.0	9.0	8.9
Spirits duties	3.1	3.3	3.6	3.6	3.8	3.9	4.0
Wine duties	4.0	4.1	4.4	4.6	4.8	5.1	5.3
Beer and cider duties	3.6	3.6	3.8	3.9	4.0	4.0	4.1
Air passenger duty	3.0	3.2	3.4	3.5	3.7	3.8	4.0
Insurance premium tax	3.7	5.0	5.7	6.0	6.0	6.0	6.1
Climate change levy	1.8	1.9	1.8	2.0	2.2	2.2	2.2
Other HMRC taxes ⁴	7.1	7.4	7.3	7.5	7.6	7.6	7.7
Vehicle excise duties	5.7	5.8	6.0	6.2	6.3	6.6	6.8
Bank levy	3.2	3.0	2.9	2.7	2.7	2.2	1.3
Bank surcharge	0.4	1.5	1.4	1.4	1.4	1.4	1.5
Apprenticeship levy	0.0	0.0	2.6	2.7	2.8	2.9	3.0
Licence fee receipts	3.1	3.2	3.2	3.3	3.4	3.4	3.5
Environmental levies	4.6	6.9	8.7	10.7	11.9	12.6	13.5
EU ETS auction receipts	0.5	0.5	0.4	0.4	0.4	0.3	0.4
Scottish taxes ⁵	0.6	0.6	0.7	0.7	0.8	0.8	0.9
Diverted profits tax	0.0	0.1	0.1	0.1	0.1	0.1	0.0
Soft drinks industry levy	0.0	0.0	0.0	0.4	0.4	0.4	0.4
Other taxes	6.7	7.2	7.5	7.3	7.7	8.0	8.4
National Accounts taxes	630.0	668.6	690.3	719.2	746.7	771.2	802.0
Less own resources contribution to EU	-3.1	-3.3	-3.5	-3.5	-3.5	-3.5	-3.5
Interest and dividends	6.2	5.6	6.1	7.6	9.1	10.3	11.8
Gross operating surplus	46.4	47.9	49.3	51.1	52.3	54.7	57.5
Other receipts	2.7	2.2	2.0	1.9	2.0	2.0	1.8
Current receipts	682.3	721.1	744.2	776.4	806.5	834.8	869.5
<i>Memo: UK oil and gas revenues</i> ⁶	-0.2	0.1	0.9	0.8	1.0	1.0	0.9

¹ Includes PAYE, self assessment, tax on savings income and other minor components.

² National Accounts measure, gross of reduced liability tax credits.

³ Forecast for SDLT is for England, Wales and Northern Ireland.

⁴ Consists of landfill tax (excluding Scotland), aggregates levy, betting and gaming duties and customs duties.

⁵ Consists of Scottish LBTT and landfill tax but not the Scottish rate of income tax or aggregates levy.

⁶ Consists of offshore corporation tax and petroleum revenue tax.

Table 4.7: Changes to current receipts since November

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Income tax (gross of tax credits) ¹	0.0	1.0	-0.5	0.2	-0.7	-1.4	-1.9
of which: Pay as you earn	0.0	1.3	2.3	0.9	0.1	-0.5	-0.8
Self assessment	0.0	0.0	-2.6	-0.3	-0.4	-0.5	-0.6
National insurance contributions	0.0	0.6	1.2	1.5	1.2	0.8	0.3
Value added tax	0.0	0.7	0.8	0.8	0.1	-0.5	-0.9
Corporation tax ²	1.2	7.4	3.5	3.9	1.6	-0.3	0.5
of which: Onshore	1.3	6.9	3.8	4.7	2.5	0.4	1.1
Offshore	-0.1	0.5	-0.3	-0.9	-0.9	-0.8	-0.6
Petroleum revenue tax	0.0	0.1	0.3	0.2	0.1	0.1	0.0
Fuel duties	0.0	-0.1	0.1	0.1	0.0	0.0	0.0
Business rates	0.0	-0.2	0.3	0.7	1.0	1.2	1.4
Council tax	0.0	0.0	0.3	0.5	0.3	0.3	0.2
VAT refunds	0.0	-0.1	-0.3	-0.2	-0.2	-0.4	-0.3
Capital gains tax	0.0	1.4	1.7	1.7	1.5	1.2	1.8
Inheritance tax	0.0	0.0	0.1	0.3	0.4	0.5	0.5
Stamp duty land tax ³	0.0	0.3	0.8	0.8	0.5	0.3	0.2
Stamp taxes on shares	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Tobacco duties	0.0	-0.6	-0.3	-0.4	-0.4	-0.4	-0.4
Spirits duties	0.0	-0.1	0.1	0.0	0.0	0.0	-0.1
Wine duties	0.0	-0.1	0.1	0.0	-0.1	-0.1	-0.2
Beer and cider duties	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Air passenger duty	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance premium tax	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Climate change levy	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Other HMRC taxes ⁴	0.0	0.1	-0.1	0.0	0.0	0.0	-0.1
Vehicle excise duties	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Bank levy	-0.2	0.1	0.2	0.2	0.2	-0.2	0.0
Bank surcharge	0.4	0.5	0.2	0.2	0.2	0.2	0.3
Apprenticeship levy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Licence fee receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Environmental levies	0.0	-0.1	-1.1	-0.8	0.3	0.4	0.5
EU ETS auction receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Scottish taxes ⁵	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Diverted profits tax	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Soft drinks industry levy	0.0	0.0	0.0	-0.2	-0.1	-0.1	-0.1
Other taxes	0.0	-0.4	-0.2	-0.5	-0.4	-0.4	-0.3
National Accounts taxes	1.4	10.9	7.1	9.0	5.5	1.2	1.6
Less own resources contribution to EU	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0
Interest and dividends	0.1	0.1	0.2	0.5	0.5	0.4	0.5
Gross operating surplus	1.1	-0.6	-1.0	-0.9	-1.2	-1.5	-1.6
Other receipts	0.0	0.2	0.0	-0.1	-0.1	-0.1	-0.1
Current receipts	2.5	10.5	6.1	8.4	4.8	-0.1	0.4
<i>Memo: UK oil and gas revenues⁶</i>	<i>-0.1</i>	<i>0.6</i>	<i>0.0</i>	<i>-0.7</i>	<i>-0.8</i>	<i>-0.6</i>	<i>-0.6</i>

¹ Includes PAYE, self assessment, tax on savings income and other minor components.

² National Accounts measure, gross of reduced liability tax credits.

³ Forecast for SDLT is for England, Wales and Northern Ireland.

⁴ Consists of landfill tax (excluding Scotland), aggregates levy, betting and gaming duties and customs duties.

⁵ Consists of Scottish LBTT and landfill tax but not the Scottish rate of income tax or aggregates levy.

⁶ Consists of offshore corporation tax and petroleum revenue tax.

Changes in the receipts forecast since November

4.36 On a like-for-like basis (excluding the effect of measuring corporation tax on a time-shifted accruals basis) we have revised our pre-measures receipts forecast up between 2016-17 and 2019-20 (by £4.5 billion a year on average), but down in 2020-21 and 2021-22 (by £2.0 billion on average). As Table 4.8 shows, the main upward revisions are explained by:

- **onshore corporation tax** receipts, which have been higher than expected in recent months, with the January quarterly instalment payment by large firms particularly strong. We have assumed that roughly half the upward revision since November reflects higher underlying liabilities, which is pushed through the forecast, while the remainder is assumed to reflect a different pattern of cash payments relative to liabilities than last year. Under the new time-shifted accruals method of recording corporation tax receipts, our forecast for higher cash receipts in 2017-18 also boosts 2016-17 as some of that strength will accrue to this year;
- **capital gains tax** receipts in the last quarter of 2016-17, which relate to liabilities in the previous tax year. These were £1.4 billion higher than we expected, due to very strong growth in gains on disposals of financial assets. We have pushed most of this effect through the forecast; and
- **PAYE income tax and national insurance contributions (NICs)** cash receipts growth, which has picked up since our November forecast. We have raised our 2016-17 estimate by £1.8 billion, which is pushed into future years. But this is more than offset by weaker average earnings growth by the end of the forecast.

4.37 The main sources of downward revision include:

- **self-assessment income tax**, where forestalling ahead of the April 2016 rise in dividend tax has been much greater than expected, reducing receipts in future years (see Box 4.3). Greater forestalling has masked the underlying weakness in self-assessment tax receipts in 2016-17. It is this underlying position that will persist in future years; and
- a modelling correction that has reduced **North Sea revenues** by around £1 billion a year. This relates to how the use of past losses against future liabilities was being modelled, which was overstating the effective tax rate.

4.38 Over the forecast period as a whole, Government decisions raise receipts by £2.4 billion in 2021-22 (£1.9 billion a year on average from 2017-18). This includes:

- cutting the **dividend tax allowance** from £5,000 to £2,000 from April 2018; and
- raising the **main rate of Class 4 NICs** paid on self-employment profits from 9 to 10 per cent in April 2018 and further to 11 per cent in April 2019.

Table 4.8: Sources of change to the receipts forecast since November

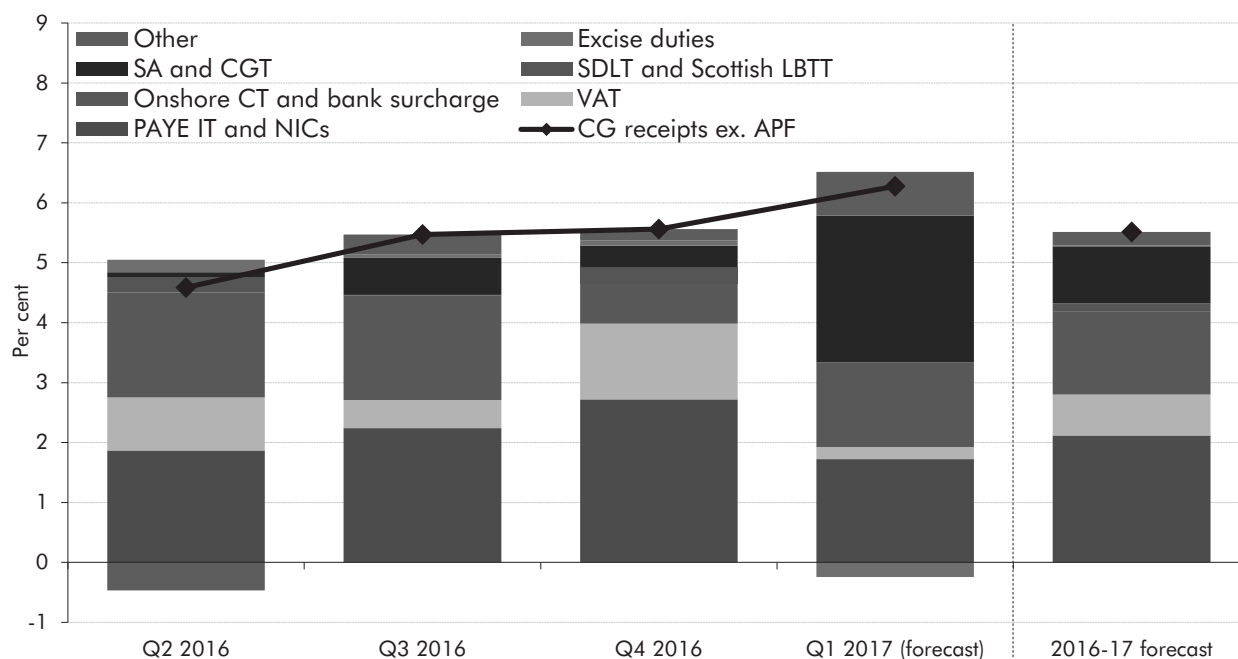
	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	710.6	738.0	768.0	801.8	834.8	869.2
Accounting treatment change ¹	3.0	1.0	2.2	0.9	-0.8	0.4
November forecast restated	713.6	739.0	770.2	802.7	834.1	869.6
March forecast	721.1	744.2	776.4	806.5	834.8	869.5
Like-for-like change	7.5	5.1	6.2	3.9	0.7	0.0
	Underlying OBR forecast changes					
Total change to underlying forecast	7.5	4.3	4.6	1.5	-1.5	-2.4
<i>of which:</i>						
Income and expenditure	1.2	3.5	2.2	-1.2	-3.3	-4.4
Average earnings	-0.5	-0.4	-1.0	-2.5	-3.6	-4.3
Employee numbers	0.7	1.2	1.4	0.9	0.5	0.1
Non-financial company profits	0.7	1.2	0.7	0.1	-0.2	-0.2
Consumer expenditure	0.2	0.8	0.4	-0.2	-0.5	-0.7
Investment	0.0	-0.1	-0.1	0.0	0.0	0.0
Self-employment income	0.0	0.1	0.5	0.8	0.9	1.2
Other	0.2	0.7	0.2	-0.3	-0.4	-0.5
North Sea	0.4	0.9	0.5	0.3	0.3	0.2
Oil and gas prices	0.0	0.1	-0.1	-0.2	-0.2	-0.3
Production and expenditure	0.4	0.8	0.5	0.5	0.6	0.5
Property markets	0.2	1.0	1.0	0.9	0.6	0.5
Market-derived assumptions	-0.3	-0.1	-0.4	-0.4	-0.5	-0.6
Equity prices	0.1	0.6	0.1	-0.2	-0.4	-0.6
Interest rates	-0.4	-0.6	-0.4	-0.1	0.0	0.1
Exchange rates	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Prices	0.0	0.1	0.0	0.3	0.5	0.4
Other economic determinants	0.0	0.0	0.0	0.0	0.0	0.0
Other assumptions	5.9	-1.1	1.3	1.7	0.8	1.4
IT and NICs receipts and modelling	1.3	-1.3	-0.1	-0.7	-0.6	-0.9
North Sea receipts and modelling	-0.1	-1.0	-1.2	-1.1	-0.9	-0.7
Corporation tax receipts and modelling	4.0	2.2	2.5	2.2	1.9	1.8
VAT SRS, receipts and modelling	0.4	-0.5	0.1	0.0	-0.2	-0.4
CGT outturn and modelling	1.4	1.5	1.7	1.8	1.6	2.4
Excise duty receipts and modelling	-0.8	-0.2	-0.4	-0.5	-0.5	-0.6
Gross operating surplus	-0.6	-1.0	-0.9	-1.2	-1.5	-1.6
Environmental levies modelling	-0.1	-1.1	-0.8	0.3	0.4	0.5
Business rates outturn and modelling	-0.2	0.5	0.6	0.8	1.0	1.2
Other judgements and modelling	0.5	-0.3	-0.1	0.0	-0.4	-0.4
	Effect of Government decisions					
Total effect of Government decisions	0.0	0.9	1.6	2.3	2.2	2.4
<i>of which:</i>						
Scorecard measures	0.0	-0.2	0.5	1.5	1.4	1.5
Non-scorecard measures	0.0	0.3	0.5	0.3	0.3	0.3
Indirect effects of government decisions	0.0	0.7	0.6	0.5	0.5	0.6
<i>Memo: March forecast on a pre-measures basis</i>	<i>721.1</i>	<i>743.3</i>	<i>774.8</i>	<i>804.2</i>	<i>832.5</i>	<i>867.1</i>

¹ Reflects ONS methodological changes for onshore CT, offshore CT, the bank surcharge and the bank levy.

Receipts in 2016-17

- 4.39 We have revised up receipts in 2016-17 by £7.5 billion on a like-for-like basis, with most of that revision explained by faster growth in cash receipts over the last three months. In November, we assumed that very strong October onshore CT receipts (up around 20 per cent on a year earlier in the data available at the time) would not be repeated. In fact, the January instalment was stronger still, with cash receipts up around 26 per cent on a year earlier. Cash PAYE income tax and NICs growth has also picked up over the last three months, averaging 6.8 per cent on a year earlier (compared to 4.5 per cent over the first seven months of the year). VAT and SDLT receipts growth has also been relatively strong.
- 4.40 The remaining part of the upward revision reflects CGT receipts, which were much stronger than expected. This appears to reflect very strong growth in gains on disposals of financial assets, although there remains considerable uncertainty around the provisional analysis upon which this assessment is based. These changes are discussed in more detail below.
- 4.41 It is worth noting that under the new approach to recording CT receipts in the official public finances data, our forecasts will play a greater role in early monthly outturn estimates. For smaller companies' payments, forecasts will remain part of the information used by the ONS for as much as 21 months, while for larger firms' payments the period is shorter at up to six months. The upward revision to our CT forecast in this *EFO* is therefore likely to prompt revisions to ONS data in the near term. Further revisions will follow as actual cash receipts replace HMRC's monthly profiling of our fiscal year forecasts.
- 4.42 Chart 4.4 illustrates how receipts growth picked up in the final quarter of 2016 and how strong SA and CGT receipts are set to sustain that in the first quarter of 2017. The effect of strong growth in cash CT towards the end of 2016-17 is smoothed over the preceding months under the new accruals methodology. PAYE income tax growth is expected to slow over the final months of the year as we assume no growth in financial sector bonuses relative to last year. Tobacco duty receipts are also expected to slow significantly towards the end of 2016-17, reflecting the latest HMRC operational information.

Chart 4.4: Quarter-on-a-year-earlier growth in central government receipts



Source: ONS, OBR

Note: The 2016-17 forecast is adjusted to reflect ONS classification decisions that have been announced but not yet implemented. More detail is available in the fiscal supplementary tables on our website.

Tax-by-tax analysis

Income tax and NICs

- 4.43 Receipts of income tax and NICs have been revised up by £1.6 billion in 2016-17 relative to our November forecast. This is primarily due to a £1.8 billion rise in tax on employee salaries. Self-assessment (SA) income tax receipts in 2016-17 were in line with our November forecast, although higher-than-expected forestalling ahead of the rise in dividend tax offset weaker receipts from the non-dividend elements of SA.
- 4.44 The upward revision to PAYE and NICs receipts for 2016-17 only partly reverses the £8.4 billion downward revision in our November forecast. Of the £6.6 billion shortfall since our March 2016 forecast, around £2 billion reflects lower-than expected receipts in 2015-16 lowering the base from which the forecast grows, another £2 billion reflects lower wage and salary growth (more than explained by weaker earnings growth), with the remainder a combination of a lower effective tax rate on employee salaries and weaker-than expected tax from occupational pensions.
- 4.45 The abolition of the NICs contracting-out rebate from April 2016 was expected to raise receipts by £5.6 billion (0.3 per cent of GDP) in 2016-17. Initial indications suggest that the yield could be a little higher at £5.9 billion. Sectoral data indicate that receipts growth has been in those sectors most affected by this measure, particularly those with a high concentration of employees in the public sector. Tax from occupational pensions has declined so far this year. This is likely to be because there was an initial surge in pension flexibility withdrawals last year that has not been repeated. The overall yield from the

pensions flexibility measure is expected to be higher than originally estimated in 2016-17 and 2017-18, since the average tax rate paid on flexible withdrawals has been higher and individuals may be spreading their withdrawals over a shorter time period. We have assumed that those spreading their withdrawals will do so over three years rather than four, which reduces receipts in 2018-19.

- 4.46 With financial and non-financial sector bonuses concentrated in the final months of the year, PAYE and NICs receipts for the full financial year remain very uncertain. We have assumed no growth in financial sector bonuses in 2016-17. The stronger-than-expected receipts in recent months are assumed to be largely structural and pushed through the forecast. But, due to a weaker earnings growth forecast, PAYE and NICs receipts are lower from 2020-21 relative to our November forecast. Lower earnings growth takes off over £4 billion by the end of the forecast.
- 4.47 As well as wages and salaries growth, there are a number of important judgements and assumptions that drive this forecast. Our judgement on the effect of employees choosing to incorporate is little changed from that outlined in Box 4.1 of our November *EFO*. We have also retained our November assumption that high-paying sectors such as financial and business services could be more adversely affected than other sectors by the UK leaving the EU. We have assumed that earnings growth for the top 10 per cent of the distribution will be around $\frac{1}{4}$ percentage points lower than the average for four years from 2018-19. The strongest earnings growth is likely to be at the bottom end of the income distribution given the commitments to raise the National Living Wage. But this is likely to have only a modest effect on income tax and NICs revenues. This is illustrated in Box 4.1 above, which considers differences in earnings growth across the income distribution in recent years.
- 4.48 SA income tax receipts in 2016-17 (relating to 2015-16 liabilities) are expected to be up by £4.4 billion from the previous year, with forestalling ahead of the dividend tax rise explaining around £4 billion of this change (see Box 4.3). The profile of receipts over the next two years is heavily influenced by the unwinding of this forestalling. In 2017-18, we expect forestalling to depress receipts by £4.8 billion. Abstracting from forestalling, we expect policy measures to boost SA income tax receipts over time. The higher dividend tax rates will boost SA receipts by over £2 billion from 2017-18, with the cut in the dividend tax allowance announced in this Budget adding around £0.9 billion a year from 2019-20, primarily from owner-directors of companies with significant amounts of dividend income. The newly announced rise in the main rate of Class 4 NICs (liable on self-employed income currently between £8,060 and £43,000) from 9 to 10 per cent in April 2018 and then to 11 per cent in April 2019 raises NICs receipts by around £0.4 billion by 2021-22. In addition, the reforms to savings tax mean that much of the remaining liabilities from savings income will now be collected via SA. This is expected to boost receipts by £1 billion in 2017-18 and somewhat less thereafter. Other recent policy measures such as changes to non-domicile rules, HMRC compliance and 'making tax digital' measures, and restrictions on residential landlords' deductions from taxable income also boost receipts later in the forecast period.
- 4.49 The non-dividend element of SA income tax receipts was weaker than we assumed in our November forecast. Preliminary analysis of SA returns suggests that the effective tax rate on

SA income streams was lower than expected. Self-employment numbers have risen strongly in recent years, but that rise has been concentrated at the lower end of the income distribution. The weaker non-dividend element of SA is assumed to be structural and has been pushed through the forecast. This is the key reason for lower SA receipts relative to our November forecast in the final years of the forecast. As noted in Chapter 3, we have assumed that the share of self-employed continues to rise over the forecast period instead of holding the share flat as we had in previous forecasts. This boosts SA receipts but is more than offset by the effect on PAYE receipts from slower growth in employee numbers. By 2021-22, the effect is to reduce overall income tax and NICs receipts by around £1 billion. This reflects the lower effective tax rate on the self-employed relative to employees, in particular due to the fact that employer NICs is only paid in respect of employees.

Table 4.9: Key changes to the income tax and NICs forecast since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	298.1	304.5	316.5	331.4	347.3	365.2
March forecast	299.7	305.2	318.2	331.9	346.7	363.6
Change	1.6	0.7	1.7	0.5	-0.6	-1.5
	Underlying OBR forecast changes					
Total	1.6	0.1	1.1	-1.0	-2.1	-3.1
<i>(by economic determinant)</i>						
Average earnings	-0.5	-0.4	-1.0	-2.5	-3.6	-4.3
Employee numbers	0.7	1.2	1.4	0.9	0.5	0.1
Self-employment income	0.0	0.1	0.5	0.8	0.9	1.2
Other economic determinants	0.1	0.6	0.3	0.5	0.7	0.7
<i>(by other category)</i>						
Outturn PAYE and NICs receipts	1.4	1.4	1.4	1.5	1.6	1.7
Outturn SA receipts (exc. forestalling)	-0.9	-0.5	-1.2	-1.2	-1.3	-1.3
Incorporations modelling	0.1	0.2	0.2	0.2	0.2	0.2
Dividend forestalling	1.4	-1.9	0.7	-0.3	0.1	0.0
Pensions flexibility re-costing	0.5	0.7	-0.3	0.2	0.1	0.1
Other modelling and receipts changes	-1.2	-1.2	-1.0	-1.0	-1.4	-1.7
	Changes due to Government decisions					
Scorecard measures	0.0	0.1	0.4	1.5	1.3	1.3
Indirect effects of Government decisions	0.0	0.5	0.1	0.0	0.1	0.2

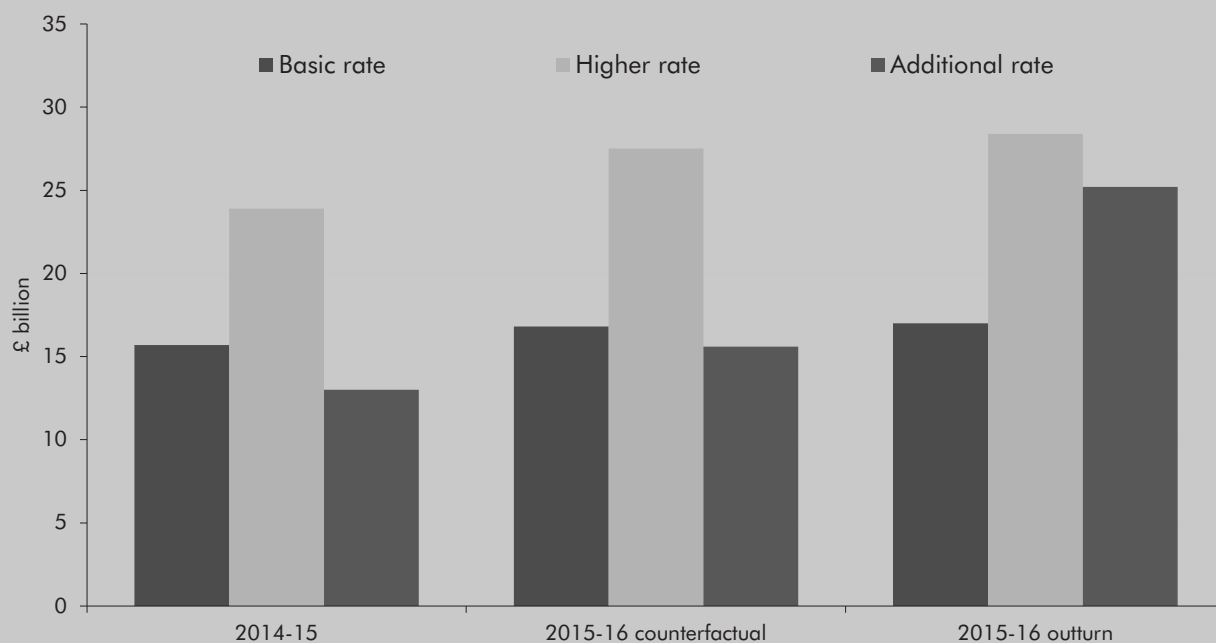
Box 4.3: The effect of dividend forestalling on self-assessment receipts

In its July 2015 Budget, the Government announced reforms to the taxation of individual dividend income, raising the basic, higher and additional rates by 7.5 percentage points and introducing a tax-free allowance on the first £5,000 of taxable annual dividend income (cut to £2,000 in this Budget). These came into effect in April 2016, giving those affected a period in which to bring forward dividend income into 2015-16 so that it was taxed at the lower rate. Dividends are subject to income tax (with the same thresholds but different rates) mainly via self-assessment (SA), so 2015-16 liabilities were mostly paid in January and February 2017.

The original costing estimated that £7.6 billion of income would be brought forward to 2015-16, about two-thirds of this by additional rate taxpayers with incomes over £150,000. This estimate was based on HMRC’s evaluation of forestalling that occurred with the introduction of the 50p rate in 2010-11 (where around £18 billion of income was brought forward into 2009-10, mostly dividends). The estimate was adjusted for the distribution of those affected, the relative change in the tax rate and the assumed responsiveness of taxpayers to rate changes. Dividend income is typically much easier to bring forward than other types of income as the majority of it is received by owner-directors of companies who have freedom over when to withdraw their profits.

Preliminary HMRC analysis of 2015-16 SA returns suggests that forestalling of this change was underestimated by a significant amount. It is now estimated that £10.7 billion of dividend income (around 40 per cent more than originally predicted) was brought forward into 2015-16. This estimate is sensitive to the choice of counterfactual for dividend income growth in 2015-16 if no rate change had taken place. Dividend income (particularly from high earners) has been subject to frequent episodes of income shifting ahead of pre-announced tax changes in recent years, which makes it particularly difficult to choose an appropriate counterfactual. We have used different historical averages for basic, higher and additional rate taxpayers and assumed growth rates of 7, 15 and 20 per cent on a year earlier respectively. Regardless of the precise counterfactual chosen, Chart C shows that additional rate taxpayers reported a much bigger rise in 2015-16 dividend income than higher or basic rate taxpayers.

Chart C: Dividend income by taxpayer marginal rate – counterfactual and outturn



Source: HMRC

While the shifting of dividend income has clearly had a bigger effect on 2016-17 SA receipts than expected, considerable uncertainty remains over the effect on future years from which income has been shifted. A taxpayer who took twice their normal dividend income in 2015-16 might be expected not to withdraw further income in 2016-17, while someone taking three times their normal income might take two years to unwind. By comparing the growth in dividend

income between 2014-15 and 2015-16 for each taxpayer, HMRC has estimated that around 80 per cent of the unwinding will take place within the first year, slightly more than first predicted.

Table B: Effect of dividend income forestalling on tax receipts

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Original estimate	2.6	-2.9	-0.6	0.2	0.0	0.0
Latest estimate	4.0	-4.8	0.1	-0.1	0.1	0.0
Difference	1.4	-1.9	0.7	-0.3	0.1	0.0

On the basis of the counterfactual we have used, our latest estimate is that dividend income shifting increased 2016-17 SA receipts by £4.0 billion (higher than the initial estimate of £2.6 billion) but will reduce future receipts by £4.8 billion. This implies that pre-announcing the policy allowed taxpayers to reduce their bills by around £0.8 billion at the same cost to the Exchequer. HMRC analysis suggests that around one pound in seven of that saving benefited just 100 individuals who were able to withdraw dividends averaging £30 million each from their companies before the higher tax rate took effect.

VAT

- 4.50 We expect accrued VAT receipts to rise by 3.7 per cent in 2016-17 from a year earlier. We have revised them up by £0.7 billion (0.6 per cent) relative to our November forecast, based on receipts for the year to date. This is likely to reflect the strength of nominal consumer spending and particularly imports in recent months. VAT related to imports is likely to reflect intermediate consumption by businesses, which will be reclaimed by them as final goods are sold. Hence we assume that only around a quarter of the strength in 2016-17 receipts will feed through to 2017-18. By the end of the forecast, accrued VAT receipts have been revised down by £0.9 billion, due largely to a downward revision to consumer spending growth that reflects an updated judgement about household saving.
- 4.51 We have moved to using a new model to forecast the share of consumer spending subject to the standard rate of VAT (the 'standard-rated share' or SRS). Over the past two decades, movements in the SRS have tended to reflect changes in the share of cash spending on durable goods (e.g. cars and household appliances). Spending on durables fell significantly during the 2000s, as cheaper imports reduced prices. The durables share has recovered since 2012, partly reflecting strong growth in the volume of new car purchases.
- 4.52 The SRS has been sensitive to the profile of, and revisions to, imputed rents of owner-occupiers that are included in ONS estimates of consumer spending. We have therefore moved to a model that estimates the SRS using a denominator excluding imputed rents, and also actual rents and measured spending on financial services (which are not subject to VAT). The model relates the SRS to spending on durables and movements in oil prices (which are associated with spending on non-standard rated goods such as utilities). The net effect has been to reduce VAT receipts by around £0.4 billion by 2021-22.

- 4.53 The 'implied VAT gap' reported in Table 4.1 is the difference between the theoretical total VAT receipts produced by the forecast model and actual VAT receipts. It reflects a number of factors, including non-compliance but also any modelling and measurement errors. The level and profile of recent changes could therefore reflect real-world movements in non-compliance or errors in estimating the theoretical total. The implied gap rises this year by 0.1 percentage points as cash VAT receipts have risen slightly more slowly than the model predicts. We assume that gap narrows over the forecast due to policy measures announced in Autumn Statement 2015 and Budget 2016. This accounts for around 10 per cent of the £26.0 billion rise in VAT receipts across the forecast period.

Table 4.10: Key changes to the VAT forecast since November

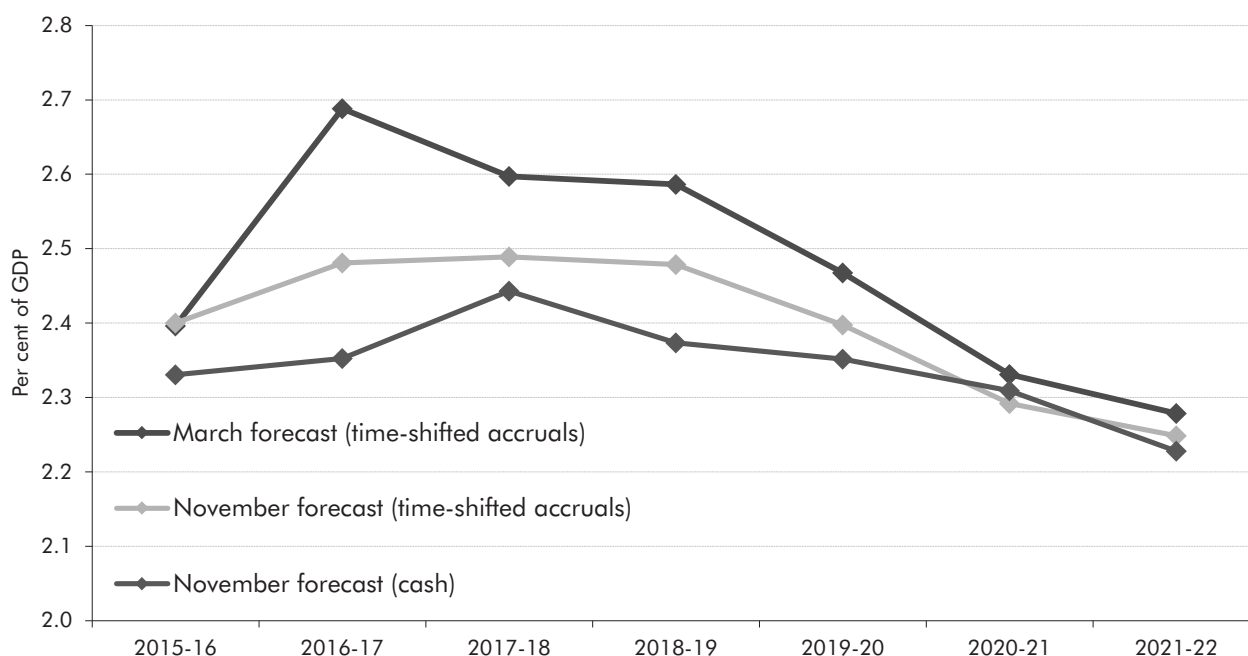
	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	120.0	124.7	129.9	136.1	142.0	147.6
March forecast	120.7	125.4	130.8	136.2	141.6	146.7
Change	0.7	0.8	0.8	0.1	-0.5	-0.9
	Underlying OBR forecast changes					
Total	0.7	0.6	0.6	-0.1	-0.7	-1.1
<i>of which:</i>						
Household spending	0.2	0.7	0.4	-0.1	-0.4	-0.6
Standard rated share	-0.1	-0.4	0.1	0.1	-0.2	-0.4
Other economic determinants	0.1	0.4	0.1	0.0	-0.1	-0.1
Outturn receipts and modelling	0.5	0.0	0.0	0.0	0.0	0.0
	Changes due to Government decisions					
Scorecard measures	0.0	0.1	0.1	0.1	0.1	0.1
Indirect effects of Government decisions	0.0	0.1	0.1	0.1	0.1	0.1

Onshore corporation tax

- 4.54 Last year the ONS announced that it would move from recording corporation tax (CT) receipts in the public sector finances data on a cash basis (when the tax is received by HMRC) to a time-shifted accruals basis (closer to when the activity generating the liability is generated). This change was implemented in the February public finances data release.
- 4.55 Box 4.2 of our November *EFO* set out the detail behind that methodology change. In November, we removed the effect of the Budget 2016 measure that changes the timing of instalment payments for large companies in 2019-20 and 2020-21, as this will no longer affect the year in which CT receipts are recorded in the public finances. We have now adjusted the rest of our forecast to be entirely on a time-shifted accruals basis.
- 4.56 In general, if a tax stream is rising over time and cash is received with a lag, moving to a time-shifted accruals basis will raise the level of recorded receipts in any year. This is the case in 2016-17, where accrued CT receipts are higher than cash CT receipts. Another effect is that more of a CT rate cut will accrue to the year in which it takes effect. (The effect of recosting some of the bigger previous CT measures on a time-shifted basis is set out in

Annex A.) Chart 4.5 shows that on the new basis the forecast is more uneven, with accrued CT receipts falling in 2017-18 and 2020-21, the years in which the main CT rate is cut.

Chart 4.5: Onshore corporation tax receipts



Source: ONS, OBR

4.57 Relative to our November forecast, we have revised up onshore CT by £6.9 billion in 2016-17. This reflects:

- the effect of the **methodological change on our November forecast**. We have restated that forecast on the new basis to facilitate like-for-like comparisons. It would have been £2.5 billion higher. Table 4.11 shows the steps involved, moving our November cash forecast onto a time-shifted accruals basis consistent with the latest ONS data. In particular the sharp 2017-18 rise in cash receipts from small companies in our November forecast, which partly reflects a less generous annual investment allowance (£200,000 from January 2016 after a temporary rise to £500,000), will now be mainly accrued back to 2016-17;
- our **forecast of cash receipts** for 2016-17 has been revised up by £2.8 billion since November, reflecting stronger monthly outturns. Cash receipts in January, when many medium and large firms pay their third quarterly instalment payment on 2016 profits, were up 26 per cent on a year earlier. In part that reflects strong profit growth, which the latest ONS data suggest will have been just over 10 per cent in 2016. Receipts from the financial sector have also risen strongly, helped by the Budget 2016 measure that further restricts the use of trading losses by banks. There have also been a number of one-off payments, including some associated with litigation cases; and
- the **interaction between the timing of cash payments through 2016-17 and the new time-shifted methodology** adds a further £1.6 billion to 2016-17 accrued receipts. The

very strong instalment payments in October and January accrue back to earlier in 2016-17, but the weaker instalment payments in April and July accrue back to 2015-16. On top of that, some of the upward revision to 2017-18 cash receipts relative to our November forecast accrues back to 2016-17.

Table 4.11: Moving onshore corporation tax to a time-shifted accruals basis

	£ billion						
	Outturn	Forecast					
		2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
November forecast (cash)	43.9	45.9	48.9	49.4	56.6	55.2	52.3
Removal of CT timing measure ¹	-	-	-	-	-5.6	-3.2	-
November forecast as published (removing CT timing measure)	43.9	45.9	48.9	49.4	51.0	52.0	52.3
Accounting treatment change	1.3	2.5	0.9	2.2	1.0	-0.4	0.5
November forecast restated (time-shifted accruals)	45.2	48.4	49.8	51.6	51.9	51.6	52.7

¹ The payment dates measure also affects bank surcharge receipts, which is not captured here.

4.58 Beyond 2016-17, the upward revision relative to November dwindles. After higher non-oil, non-financial profit growth in the near term, we expect more modest growth later in the forecast than we did in November. In addition, not all the positive surprise in 2016-17 (beyond the element that can be explained by stronger profit growth) is pushed through to future years because we think some of it reflects changes in the timing of payments relative to liabilities between 2015-16 and 2016-17.

Table 4.12: Key changes to the onshore corporation tax forecast since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	45.9	48.9	49.4	51.0	52.0	52.3
Accounting treatment change	2.5	0.9	2.2	1.0	-0.4	0.5
November forecast restated	48.4	49.8	51.6	51.9	51.6	52.7
March forecast	52.8	52.7	54.2	53.5	52.5	53.3
Like-for-like change	4.4	2.9	2.5	1.5	0.8	0.6
	Underlying OBR forecast changes					
Total	4.4	2.8	2.5	1.5	0.7	0.5
<i>of which:</i>						
Industrial and commercial company profits	0.7	1.2	0.7	0.1	-0.2	-0.2
Industrial and commercial company investment	0.0	-0.1	-0.1	0.0	0.0	0.0
Other economic determinants	-0.3	-0.5	-0.6	-0.8	-0.9	-1.1
Modelling and recostings	-0.3	-0.2	0.4	0.3	-0.1	-0.1
Outturn receipts	4.3	2.4	2.1	1.9	1.9	2.0
	Changes due to Government decisions					
Scorecard measures	0.0	0.1	0.0	0.0	0.1	0.1

UK oil and gas revenues

- 4.59 The ONS methodology change for CT receipts also applies to offshore CT. Our forecast for UK oil and gas revenues has been revised down by £0.5 billion a year on average from 2017-18 onwards since November (on a like-for-like basis). Positive effects include lower tax-deductible expenditure and higher outturn receipts, but these are more than offset by a significant change to the modelling of losses carried forward and set against future profits.
- 4.60 Oil and gas prices (denominated in pounds) are lower by the end of the forecast, largely reflecting a slightly stronger pound. That reduces receipts by £0.3 billion in 2021-22. We have revised our production forecast up slightly in every year, reflecting higher-than-expected production at the end of 2016 that we assume will persist, boosting the forecast by around £0.1 billion a year. The latest survey data suggest that expenditure by oil and gas firms in 2016 was much lower than previously anticipated. We assume that this effect is sustained over the forecast, boosting receipts by £0.5 billion a year on average.
- 4.61 We have been working with HMRC to build a new forecasting model for oil and gas revenues. While the new model is not yet ready to use, the process of scrutinising the differences between its outputs and those of the existing model revealed an error in the way that company-level losses were being carried forward to be set against future profits. This was overstating the extent to which those future profits would be taxed. Correcting that error has led to a downward revision to receipts of around £1 billion a year from 2017-18 onwards. We expect to be able to use the new model for our next forecast.
- 4.62 Moving the forecast onto a time-shifted accruals basis increases recorded receipts by £0.1 billion next year and reduces them by less than £0.1 billion by the end of the forecast.

Table 4.13: Key changes to the oil and gas forecast since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	-0.5	0.9	1.5	1.8	1.6	1.5
Accounting treatment change	0.4	0.1	0.0	0.0	0.0	0.0
November forecast restated	-0.2	1.0	1.6	1.7	1.6	1.4
March forecast	0.1	0.9	0.8	1.0	1.0	0.9
Like-for-like change	0.3	-0.1	-0.7	-0.8	-0.6	-0.5
	Underlying OBR forecast changes					
Total	0.3	-0.1	-0.7	-0.8	-0.6	-0.5
<i>of which:</i>						
Production	0.0	0.1	0.1	0.2	0.1	0.1
Expenditure	0.4	0.7	0.4	0.3	0.4	0.5
Dollar oil price	0.0	0.1	0.0	-0.1	-0.1	-0.1
Exchange rate	0.0	-0.1	-0.1	-0.1	-0.1	-0.2
Gas prices	0.0	0.1	0.0	0.0	0.0	0.0
Modelling and outturn receipts	-0.1	-1.0	-1.2	-1.1	-0.9	-0.7

Stamp duties

- 4.63 Receipts from **stamp duty land tax (SDLT)** (excluding the Scottish land and buildings transactions tax) are forecast to increase from £11.6 billion in 2016-17 to £17.0 billion in 2021-22.⁶ This strong rise reflects both tax base effects – mainly rising prices – as well as a rising effective tax rate, as those price rises drag a greater proportion of the value of residential transactions into higher tax brackets.
- 4.64 Compared with November, SDLT receipts in 2016-17 have been revised up by £0.3 billion. Residential transactions and prices have been a little stronger than expected in recent months, but transactions are expected to fall year-on-year in 2016-17 as a whole, partly because of the effect of forestalling in advance of the additional properties surcharge. Transactions at the top of the market have fallen the most (but have also recovered somewhat since our November forecast). These make up an increasing share of receipts across the forecast period due to fiscal drag from fixed thresholds and continued growth in prices. We have revised up receipts from commercial property by small amounts due to slightly stronger in-year receipts that are pushed through to later years.
- 4.65 Receipts from the 3 per cent surcharge on additional properties (i.e. buy-to-let investments and second homes) that came into effect last April have been revised up in the short term as outturn receipts continue to be higher than expected. They have accounted for around a quarter of receipts from residential property in recent months. This rise does not feed through to later years as some of the recent strength appears to reflect the seasonal pattern of the market, which had not been fully factored into the forecast. There is continued uncertainty over the proportion of receipts that will ultimately be refunded – individuals have 36 months to make a claim, so we will not have full outturns for some time. We have retained our November assumption that 15 per cent will be refunded in steady-state, but will keep this under review as more data become available.

⁶ A breakdown of our stamp duty forecast into its component parts – residential (excluding additional properties), additional properties, and commercial – is available in a supplementary fiscal table on our website.

Table 4.14: Key changes to the SDLT forecast since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	11.3	12.2	13.2	14.3	15.6	16.8
March forecast	11.6	13.1	14.0	14.8	15.9	17.0
Change	0.3	0.8	0.8	0.5	0.3	0.2
	Underlying OBR forecast changes					
Total	0.3	0.9	0.7	0.5	0.3	0.2
<i>of which:</i>						
House prices	0.0	0.3	0.4	0.3	0.3	0.4
Residential property transactions	0.2	0.5	0.4	0.3	0.1	0.0
Commercial property market	0.0	0.0	0.0	-0.1	-0.1	-0.1
Other modelling and receipts outturns	0.1	0.0	0.0	-0.1	-0.1	-0.2
	Changes due to Government decisions					
Scorecard measures	0.0	-0.1	0.1	0.0	0.0	0.0

Note: Excludes receipts from the Scottish land and buildings transactions tax (LBTT). More detail on LBTT can be found in the *Devolved tax forecasts* publication on our website.

4.66 We have increased our forecast for **stamp duty on shares** by £0.1 billion a year on average from 2017-18 onwards, largely reflecting higher equity prices and stronger in-year receipts that are pushed through the forecast.

Taxes on capital

4.67 **Capital gains tax (CGT)** is currently paid in the final quarter of the financial year after the year in which the gains from the sale of an asset are realised. So receipts in 2016-17 reflect asset disposals in 2015-16. CGT receipts were £8.7 billion in 2016-17, up 23 per cent on a year earlier. This followed rises of 27 per cent in 2015-16 and 42 per cent in 2014-15, so receipts have more than doubled since 2013-14.

4.68 CGT receipts in 2016-17 were much stronger than would have been suggested by changes in equity prices in 2015-16, which were down year-on-year according to the FTSE All-share index that we use as the basis for our forecasts. By contrast, receipts from disposals of financial assets were up significantly. Preliminary analysis suggests gains on disposals of unlisted shares contributed most to the higher receipts, rising by more than a third and making up almost half of total chargeable gains.

4.69 CGT is highly geared to changes in equity prices, since around two-thirds of chargeable gains are related to financial assets and CGT is only charged on the gain rather than the disposal price. Compared to our November forecast, CGT receipts are £1.4 billion higher in 2016-17, with the upward revision reaching £1.8 billion in 2021-22. Simply pushing the higher 2016-17 outturn through the forecast would have led to an even bigger upward revision, but we felt that it was likely that growth in chargeable gains would slow a little from the very rapid rates seen in the past three years.

- 4.70 Receipts from **inheritance tax (IHT)** are expected to rise by just 1.0 per cent to £4.7 billion in 2016-17, unchanged from our November estimate. IHT receipts were unusually high in 2015-16, reflecting more deaths in 2014-15 (the majority of IHT receipts are received with a 6 to 12 month lag) and a number of payments from very high value estates. Receipts have been revised up over the forecast period due to slightly higher equity and house prices.
- 4.71 Having completed its consultation last year, the Government has confirmed its plans to change the **fees payable for an application for a grant of probate**. The new rates come into effect in May and range between £300 and £20,000, depending on the value of the estate. Given the structure of the fees, the Treasury expects the ONS to classify them as a tax on capital rather than payment for a service (which is treated as negative spending and had been factored into the Ministry of Justice's resource DEL). This will add to receipts and spending in equal measure, because the new tax is offset by the removal of negative spending from resource DEL.
- 4.72 The Government expects the new fee structure to raise around £300 million a year. We were only provided with details of this estimate on the day the fee structure was announced, which coincided with closing our pre-scorecard forecast. As the Treasury has chosen not to present this policy on its scorecard, that meant we did not have time to scrutinise the estimated yield. We have used the Government's estimate in this forecast and will return to it in our next.
- 4.73 We have reduced our inheritance tax forecast by around £30 million a year to reflect the incentive for individuals with estates worth close to the thresholds in the new probate fee structure to reduce the value of their estates (through genuine or contrived means) to remain within a lower fee band. This effect is expected to be relatively small, since the inheritance tax liability itself already provides a significant incentive to reduce the value of estates.

Fuel duties

- 4.74 Fuel duty receipts are expected to reach £27.9 billion in 2016-17, up 0.9 per cent on the previous year but £0.1 billion down on our November forecast. With duty rates frozen, this reflects a small rise in fuel clearances. Fuel clearances fell in every year between 2007-08 and 2012-13, as fuel efficiency improved and the late 2000s recession reduced miles driven. Since then, clearances have risen slowly, partly reflecting the drop in pump prices between late 2014 and early 2016 boosting demand for fuel. In particular, traffic from light goods vehicles has increased sharply, rising by around 17 per cent in the past four years⁷ and currently accounts for around 15 per cent of total vehicle traffic.
- 4.75 Despite moderate growth in recent years, we expect fuel clearances in 2017-18 to fall as higher oil prices and a weak pound push up pump prices despite the latest duty rate freeze. Taken together, we expect receipts to fall to £27.5 billion in 2017-18. In line with stated Government policy, we assume that duty rates are updated with inflation each year from April 2018. This explains all the £2.5 billion rise in fuel duty receipts over the remainder of

⁷ Department for Transport, *Provisional Road Traffic Estimates: Great Britain January 2016 – December 2016, February 2017*.

the forecast. This could be considered a source of policy risk to the forecast given repeated decisions to cancel planned duty rises in recent years. Box 4.3 of our November *EFO* reviewed this pattern.

Alcohol and tobacco duties

- 4.76 **Alcohol duty** is expected to rise from £11.0 billion in 2016-17 to £13.4 billion in 2021-22. Receipts from wine and spirits are expected to increase by £1.2 billion and £0.8 billion respectively. But we expect a rise of just £0.5 billion over the same period in receipts from beer and cider. We have updated the econometric models of alcohol clearances that underpin this forecast to take on recent outturn data. This has reduced receipts slightly – we now expect wine clearances to rise more slowly over the forecast in line with recent trends.
- 4.77 We have revised our **tobacco duties** forecast down by £0.6 billion to £8.7 billion in 2016-17. That reflects the latest HMRC information on expected trader activity over the rest of the year, which suggests much weaker clearances than we assumed in our November forecast. Given the uncertainty surrounding recent regulatory changes and forestalling behaviour, we have only pushed around two-thirds of this deterioration through the forecast. Receipts are relatively flat over the rest of the forecast, despite rises in duty of RPI plus 2 per cent each year until the end of the Parliament. That reflects the downward trend in cigarette clearances, thanks in part to recent increases in duty, changing attitudes to smoking, policies (such as the display ban) and the growing popularity of e-cigarettes.

Other taxes

- 4.78 **Business rates** receipts are calculated by multiplying the rateable value of non-domestic property by the multiplier (which is updated in line with inflation – on an RPI basis until 2020-21 and CPI thereafter). Compared with November, our forecast is higher from 2017-18 onwards. This reflects a higher near-term path for RPI inflation and provisional information from local authorities about expected yield in 2017-18.
- 4.79 The Government has announced a number of business rates measures that reduce receipts by £220 million in 2017-18 and by £50 million a year on average between 2018-19 and 2021-22. These reductions are smaller than the expected increases in business rates due to the higher path of RPI inflation, hence the overall upward revision to our forecast.
- 4.80 Receipts from **council tax** have been revised up by £0.3 billion a year on average compared to our November forecast. This partly reflects the Government decision to allow faster council tax rises in order to fund spending on adult social care. This is explained in more detail in the local authority expenditure section of this chapter. We assume that council tax receipts are spent by local government, so they are neutral for borrowing in our forecast.
- 4.81 **Environmental levies** include levy-funded spending policies such as the renewables obligation (RO), contracts for difference (CfD), feed-in tariffs (FITs), the capacity market scheme and the warm home discount. We also include receipts from the carbon reduction commitment until its abolition from the end of the 2018-19 compliance year. Receipts rise sharply from close to £7 billion in 2016-17 to £13½ billion by 2021-22. This mainly reflects

the build-up in the CfD scheme, which is designed to boost renewable energy, and the development of the capacity market scheme that focuses on security of supply.

- 4.82 In November we allowed for a supplementary capacity auction that was assumed to add £1.3 billion in 2017-18 and £1.2 billion in 2018-19. We had based our cost estimates on the lower end of the range of possible clearing prices outlined in BEIS's Impact Assessment. The auction has now taken place with the clearing price only a fraction of that expected. This has lowered our forecast by around £1 billion a year in 2017-18 and 2018-19.
- 4.83 Receipts from **insurance premium tax (IPT)** are expected to rise by around 33 per cent in 2016-17, as the standard rate was increased from 6 per cent in October 2015 to 10 per cent in October 2016. Receipts rise by around 16 per cent in 2017-18, reflecting another rise in the standard rate to 12 per cent in June 2017. Underlying growth in IPT receipts over the rest of the forecast is modest. Relative to November, our weaker outlook for consumer spending reduces receipts by around £0.1 billion in 2021-22. But as set out in Box 4.2, the Government's recent announcement of a reduction in the personal injury discount rate is expected to boost IPT receipts by around £0.1 billion a year due to the knock-on effect from the lower discount rate to higher insurance premiums.
- 4.84 **Air passenger duty (APD)** receipts are expected to rise from £3.2 billion in 2016-17 to £4.1 billion in 2021-22. This reflects RPI-linked duty rate rises and continued growth in passenger numbers. Our forecast is little changed since November. More detail is available in our *Devolved taxes document*, since APD is set to be devolved to the Scottish Government from April 2018.
- 4.85 **Vehicle excise duty (VED)** is levied annually on road vehicles and is expected to rise from £5.8 billion in 2016-17 to £6.8 billion in 2021-22. This reflects the uprating of duties in line with RPI inflation and the major reforms announced in the July 2015 Budget. Our forecast is little changed since November.
- 4.86 Receipts from the **climate change levy (CCL) and the carbon price floor (CPF)** are expected to be close to their November forecast. The rise of renewable electricity generation at the expense of coal-fired electricity generation continues to put downward pressure on CPF receipts over the forecast period. Higher CCL rates from 2019-20 will boost receipts in the final years of the forecast.
- 4.87 **Bank levy** receipts are expected to fall from £3.0 billion in 2016-17 to £1.3 billion in 2021-22. This mainly reflects announced cuts in the bank levy rate from 0.18 per cent in 2016 to 0.10 per cent by 2021. The bulk of the largest cut takes place during the final year of the forecast, in which receipts fall by almost half. Stronger-than-expected receipts so far this year, which we assume will persist over the forecast period, have raised our forecast by around £0.2 billion a year (on a like-for-like basis) relative to November.
- 4.88 The ONS now records bank levy receipts on a time-shifted accruals basis, which we have reflected in our forecast. This reduces receipts by less than £0.1 billion in most years, as the

declining trend over the forecast period is accrued back to earlier years. It reduces receipts by £0.3 billion in 2020-21 – reflecting the rate cut in January 2021.

- 4.89 The **bank surcharge** came into effect from January 2016 and we estimate that it will have raised £1.1 billion on a cash basis in 2016-17. This compares with an initial estimate of £0.9 billion, when it was announced in the July 2015 Budget. As with other corporate taxes, the recording of the bank surcharge in the National Accounts is now on a time-shifted accruals basis, where cash receipts are shifted back closer to the point at which the activity generating the liability took place. On this basis, we estimate that receipts from the bank surcharge will be £1.5 billion in 2016-17.
- 4.90 **Customs duties** comprise the majority of ‘traditional own resources’ or TOR-based UK contributions to the EU. Our forecast is little changed since November. Box 4.4 sets out the treatment of customs duties in the public finances and the approach we have taken with this forecast in the absence of firm details about policy in this area after the UK leaves the EU.
- 4.91 **VAT refunds** to central and local government are neutral for borrowing, as they are offset within spending. The forecast for VAT refunds largely reflects the path of government procurement and investment. Relative to November, our forecast is lower by around £0.3 billion a year, reflecting changes to overall central and local government spending.
- 4.92 We have revised down our forecast for receipts from the **soft drinks industry levy** to reflect a judgement that producers will reformulate a higher proportion of their products towards lower sugar content. This is based on initial information from industry and reduces receipts by over £150 million in 2021-22. Following the recent consultation, some aspects of the policy have also been changed. In its original announcement at Budget 2016, the Government chose to exclude small producers and importers, as measured by volume, from the levy. It has now decided that imports of major brands will not attract this relief, regardless of the volumes imported. This is expected to increase yield by £45 million in 2021-22. The net effect of these changes is to reduce receipts by around a quarter on average over the 2018-19 to 2021-22 period, to £0.4 billion a year. The Government has announced a main rate of 18 pence a litre and a higher rate of 24 pence a litre, as in the original costing of the measure it provided to us.
- 4.93 Our forecast for **BBC licence fee** receipts is unchanged from November. We were not informed of the agreed fee increase for 2017-18 in time to include the effect in this forecast (as set out in paragraph 4.148).

Other receipts

- 4.94 **Interest and dividend** receipts include interest income on the government’s stock of financial assets, which includes student loans and holdings related to previous financial sector interventions. The path for market interest rates is a little higher than in November, with rates up by 0.2 percentage points towards the end of the forecast period. This raises the return on the stock of central and local government assets and is the main reason for the £½ billion upward revision from 2018-19 onwards relative to our November forecast.

- 4.95 Receipts from interest and dividends are expected to slightly more than double between 2016-17 and 2021-22. Of the £6.2 billion rise between these years, £5.1 billion reflects accrued interest on the fast-growing stock of student loans. The rest mainly reflects the modest rise in short-term interest rates expected over that period.
- 4.96 Our forecast of public sector **gross operating surplus (GOS)** has been revised down by an average of £1.1 billion a year. These revisions reflect changes in our forecasts for general government depreciation (which is neutral for borrowing, being directly offset in the spending forecast) and public corporations' GOS. Most of the changes in this forecast are attributable to movements in the former (averaging £1.0 billion a year) and are discussed in further detail in the spending section below.

Box 4.4: Customs duties assumptions post-Brexit

In our November 2016 *EFO* we set out our assumptions regarding the UK's exit from the EU, which we have retained for this *EFO*. In terms of financial flows between the UK and the EU after the UK's exit, the assumptions we have made are fiscally neutral. The actual situation post-Brexit will no doubt differ in its composition and its effect on borrowing. One area where this will be relatively complex relates to custom duties, which are currently collected on behalf of the EU.

Customs duties are taxes levied on imports by all EU member states under the common customs tariff.^o The receipts are passed on to the EU, minus a fixed share (currently 20 per cent) retained to cover collection costs. In the UK, these retained receipts are recorded in the public finances as sales of services, which are deemed to be negative expenditure rather than positive receipts. (The treatment of expenditure transfers to EU institutions is covered from paragraph 4.128.)

The treatment of customs duties in the public finances data – and therefore in our forecast – involves two steps. The taxes are collected by HMRC, so are reflected in the 'National Accounts taxes' aggregate. But as they are collected on behalf of the EU, neither the collection of the taxes nor their subsequent transfer affect 'public sector current receipts' or the budget deficit. The positive effect on National Accounts taxes is therefore offset by a negative line in other receipts. Our current forecast for customs duties is shown in Table C.

Table C: Customs duties in the public finances

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Customs duties (collected by HMRC)	3.4	3.4	3.5	3.5	3.5	3.5
Less own resources contribution to the EU	-3.3	-3.5	-3.5	-3.5	-3.5	-3.5
Net effect on PSCR	0.1	-0.1	0.0	0.0	0.0	0.0

Note: The numbers in this table for 2016-17 and 2017-18 are slightly different because of different timings in the availability of latest outturn data in 2016-17. These numbers will align when outturn is final, with no impact on PSCR.

The Government's white paper on exiting the EU states that post-exit the UK "will not be bound by the EU's common external tariff". It does not set out precisely what future tariff regime it will seek, beyond replicating as far as possible the EU's goods and services schedules at the World Trade Organisation. So we are not in a position to make any forecast of the level of customs duty the Government intends to levy in future or the extent to which it will wish to reallocate any

net income.

Instead for this forecast we maintain the fiscally neutral impact of customs duties on the forecast as given in Table C. An alternative fiscally neutral assumption could be made that the same level of duties are collected after exiting the EU, but that they are retained as UK receipts and spent within the UK. As this involves more assumptions and deviating further from the current treatment in the public finances we have chosen not to do this. When the Government does establish a post-exit customs regime, its effect on our forecasts will be set out transparently.

^a Our forecast for customs duties also include sugar levies. These taxes together form the Traditional Own Resources portion of the EU budget.

Public sector expenditure

Definitions and approach

4.97 This section explains our central forecast for public sector expenditure, which is based on the National Accounts aggregates for public sector current expenditure (PSCE), public sector gross investment (PSGI) and total managed expenditure (TME), which is the sum of PSCE and PSGI. In our forecast, we combine these National Accounts aggregates with the two administrative aggregates used by the Treasury to manage public spending:

- **departmental expenditure limits (DELs)**⁸ – mostly covering spending on public services, grants, administration and capital investment, which can be planned over extended periods. Our fiscal forecast therefore shows PSCE in resource DEL and PSGI in capital DEL. We typically assume (in line with historical experience) that departments will underspend the limits that the Treasury sets for them, so – unless otherwise stated – when we refer to PSCE in RDEL and PSGI in CDEL (or RDEL and CDEL for simplicity) we are referring to the net amount that we assume is actually spent; and
- **annually managed expenditure (AME)** – categories of spending less amenable to multi-year planning, such as social security spending and debt interest. Again, our fiscal forecast shows PSCE in current AME and PSGI in capital AME.

Summary of the expenditure forecast

4.98 Table 4.15 summarises our latest forecast for public spending. TME is expressed as a share of GDP, but not all of public spending contributes directly to GDP – benefit payments, debt interest and other cash transfers merely transfer income from some individuals to others. The table also shows how TME is split between DEL spending and AME. It shows that TME is expected to fall by 1.8 per cent of GDP over the four years of the latest Spending Review period up to 2019-20, with falls forecast in all years except 2017-18. It then falls by a

⁸ Our presentation of expenditure only shows those components of RDEL, CDEL and AME that are included in the fiscal aggregates of PSCE and PSGI. For budgeting purposes, the Treasury also includes other components in DEL and AME such as non-cash items and financial transactions, which are discussed later in this chapter.

further 0.3 per cent of GDP by 2021-22. That 2.1 per cent of GDP fall over six years is driven by further cuts in RDEL (down 2.1 per cent of GDP) and welfare spending (1.2 per cent of GDP). These come on top of the Coalition Government's cuts in the last Parliament. They are partly offset by higher CDEL, which is set to rise by 0.6 per cent of GDP.

Table 4.15: TME split between DEL and AME

	Per cent of GDP						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
TME	40.0	39.3	39.6	39.0	38.2	38.0	37.9
<i>of which:</i>							
TME in DEL	18.7	18.3	18.1	17.8	17.4	17.5	17.2
<i>of which:</i>							
PSCE in RDEL	16.4	15.9	15.7	15.3	14.9	14.6	14.3
PSGI in CDEL	2.3	2.4	2.4	2.5	2.6	2.9	2.9
TME in AME	21.3	21.1	21.4	21.2	20.7	20.5	20.7
<i>of which:</i>							
Welfare spending	11.5	11.1	10.9	10.7	10.5	10.3	10.3
Debt interest net of APF	1.8	1.8	2.0	1.9	1.9	1.8	1.9
Locally financed current expenditure	2.2	2.2	2.3	2.3	2.3	2.2	2.2
Net public service pension payments	0.6	0.6	0.6	0.7	0.6	0.6	0.7
Other PSCE in AME	3.7	3.7	3.9	4.0	4.0	4.0	4.1
PSGI in AME	1.5	1.6	1.7	1.6	1.5	1.5	1.6

Note: Forecasts for PSGI in CDEL and PSGI in AME include a methodological change that routes some capital grants to housing associations via local government. This increases PSGI in CDEL and reduces PSGI in AME by the amounts shown in Table 4.19, from 2016-17 onwards.

4.99 Tables 4.16 and 4.17 detail our latest spending forecast and the changes since November.

Table 4.16: Total managed expenditure

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector current expenditure (PSCE)							
PSCE in RDEL	309.0	313.0	318.3	320.8	322.8	328.6	335.3
PSCE in AME	373.3	382.2	401.2	410.0	416.4	428.6	446.9
of which:							
Welfare spending	216.1	217.9	221.1	224.4	226.8	231.9	240.3
of which:							
Inside welfare cap	120.0	119.3	119.6	120.0	120.0	122.4	125.1
Outside welfare cap	96.2	98.6	101.5	104.3	106.8	109.5	115.2
Company and other tax credits	2.8	3.2	3.5	3.6	3.7	3.9	4.0
Net public service pension payments	11.3	11.5	12.1	13.7	13.2	14.2	15.7
National lottery current grants	1.3	1.3	1.3	1.3	1.3	1.4	1.4
BBC current expenditure	3.5	3.8	4.0	3.7	3.7	3.6	3.6
Network Rail other current expenditure ¹	0.8	0.7	0.7	0.2	-0.2	-0.2	-0.3
Other PSCE items in departmental AME	1.4	0.7	0.7	0.8	0.8	0.8	0.8
Expenditure transfers to EU institutions	10.5	8.8	11.5	12.6	-	-	-
Assumed domestic spending in lieu of EU transfers ²	-	-	-	-	12.7	13.1	13.7
Locally financed current expenditure	41.8	43.8	46.6	48.7	49.1	50.5	52.0
Central government debt interest, net of APF ³	33.4	36.0	41.5	39.1	40.1	40.9	44.0
Public corporations' debt interest	3.3	3.8	3.9	4.0	4.2	4.3	4.4
General government depreciation	29.4	30.5	32.0	33.4	34.9	36.6	38.6
Current VAT refunds	11.9	12.1	12.2	12.3	12.3	12.5	12.8
Environmental levies	4.2	6.9	8.8	11.0	12.4	13.7	14.6
Local authority imputed pensions	2.0	2.1	2.2	2.3	2.4	2.5	2.6
Other National Accounts adjustments	-0.5	-0.9	-1.0	-1.0	-1.0	-1.1	-1.2
Total public sector current expenditure	682.4	695.1	719.5	730.9	739.2	757.2	782.2
Public sector gross investment (PSGI)							
PSGI in CDEL	43.0	46.2	49.0	52.2	55.4	64.3	67.7
PSGI in AME	28.6	31.5	33.9	34.1	33.3	33.9	36.4
of which:							
Tax litigation	0.0	0.0	1.6	1.6	1.6	1.6	1.6
Network Rail capital expenditure	6.4	6.5	5.8	5.7	6.4	6.5	6.7
Other PSGI items in departmental AME	0.5	1.0	1.3	1.6	1.9	2.4	2.7
Locally financed capital expenditure	7.3	7.7	7.2	6.4	5.8	5.0	5.5
Public corporations' capital expenditure	14.5	17.1	18.5	19.2	18.2	18.5	20.0
Other National Accounts adjustments	-0.1	-0.8	-0.5	-0.4	-0.6	-0.2	0.0
Total public sector gross investment	71.6	77.7	82.9	86.3	88.7	98.2	104.1
Less public sector depreciation	-40.0	-41.2	-42.8	-44.4	-46.0	-48.0	-50.2
Public sector net investment	31.6	36.5	40.1	41.9	42.7	50.2	53.9
Total managed expenditure	753.9	772.8	802.4	817.2	827.9	855.4	886.4

Note: Forecasts for PSGI in CDEL and PSGI in AME include a methodological change that routes some capital grants to housing associations via local government. This increases PSGI in CDEL and reduces PSGI in AME by the amounts shown in Table 4.19, from 2016-17 onwards.

¹ Other than debt interest and depreciation, which are included in totals shown separately in this table.

² As we do not have sufficient detail about the Government's negotiation preferences, or the chances of achieving them, we are not able to forecast how spending will be affected after the UK leaves the EU. We therefore make the fiscally neutral assumption that any reduction in transfers to the EU would be recycled into extra domestic spending. See the section on this below.

³ Includes reductions in debt interest payments due to the APF. For further detail, see Table 4.30.

Table 4.17: Changes to total managed expenditure since November

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector current expenditure (PSCE)							
PSCE in RDEL	0.0	-2.4	1.4	1.2	2.9	2.6	2.7
PSCE in AME	-0.4	-2.3	5.1	0.2	0.1	0.1	-0.6
<i>of which:</i>							
Welfare spending	0.0	-0.5	-0.1	-0.2	-0.7	-1.3	-1.5
<i>of which:</i>							
Inside welfare cap	0.0	-0.6	0.0	0.0	-0.5	-0.8	-0.9
Outside welfare cap	0.0	0.1	-0.1	-0.2	-0.2	-0.5	-0.7
Company and other tax credits	0.0	0.0	0.1	0.2	0.2	0.3	0.4
Net public service pension payments	-0.1	0.3	0.0	0.1	-0.2	-0.3	-0.4
National lottery current grants	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
BBC current expenditure	-0.1	-0.1	0.2	-0.2	0.0	0.1	-0.1
Network Rail other current expenditure ¹	0.0	-0.2	0.2	0.2	0.0	0.0	0.0
Other PSCE items in departmental AME	0.0	-0.1	0.1	0.1	0.1	0.2	0.2
Expenditure transfers to EU institutions	0.0	-1.9	1.4	0.1	-	-	-
Assumed domestic spending in lieu of EU transfers ²	-	-	-	-	-0.3	-0.3	-0.2
Locally financed current expenditure	0.0	1.6	2.4	2.9	1.7	1.8	1.7
Central government debt interest, net of APF ³	0.0	-0.3	3.5	-0.2	0.9	1.3	1.2
Public corporations' debt interest	0.5	-0.1	-0.1	-0.1	0.0	0.1	0.1
General government depreciation	0.0	-0.5	-0.7	-1.0	-1.1	-1.3	-1.4
Current VAT refunds	0.0	0.3	0.1	0.1	0.1	0.1	0.1
Environmental levies	0.0	0.0	-1.1	-0.8	0.3	0.4	0.4
Local authority imputed pensions	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other National Accounts adjustments	-0.7	-0.9	-1.0	-1.0	-1.0	-1.0	-0.9
Total public sector current expenditure	-0.4	-4.7	6.5	1.5	3.0	2.7	2.1
Public sector gross investment (PSGI)							
PSGI in CDEL	0.0	0.2	-0.8	-0.6	1.0	-0.9	-1.0
PSGI in AME	-1.5	-1.4	-0.3	1.8	0.1	-2.0	-1.1
<i>of which:</i>							
Tax litigation	0.0	-0.2	0.0	0.0	0.0	0.0	0.0
Network Rail capital expenditure	0.0	-0.1	-0.4	0.5	0.0	0.0	0.0
Other PSGI items in departmental AME	0.0	0.0	-0.1	0.0	0.1	0.0	-0.1
Locally financed capital expenditure	0.3	0.4	0.3	0.8	-0.5	-1.0	-0.7
Public corporations' capital expenditure	-2.6	-0.4	0.6	1.3	1.6	0.0	0.5
Other National Accounts adjustments	0.8	-1.2	-0.8	-0.8	-1.1	-1.0	-0.9
Total public sector gross investment	-1.5	-1.2	-1.1	1.2	1.2	-2.9	-2.2
Less public sector depreciation	-0.3	0.4	0.6	0.9	1.1	1.2	1.5
Public sector net investment	-1.8	-0.9	-0.5	2.1	2.2	-1.7	-0.7
Total managed expenditure	-1.8	-6.0	5.4	2.7	4.2	-0.2	0.0

¹ Other than debt interest and depreciation, which are included in totals shown separately in this table.

² As we do not have sufficient detail about the Government's negotiation preferences, or the chances of achieving them, we are not able to forecast how spending will be affected after the UK leaves the EU. We therefore make the fiscally neutral assumption that any reduction in transfers to the EU would be recycled into extra domestic spending. See the section on this below.

³ Includes reductions in debt interest payments due to the APF. For further detail, see Table 4.30.

4.100 Table 4.18 summarises the sources of changes to our spending forecast since November.

- **inflation forecast changes** – in particular changes to RPI inflation – have increased spending in 2017-18, but reduced it thereafter. The biggest effect relates to the accrued cost of servicing the burgeoning stock of index-linked gilts. (Government policy decisions that affect inflation add further to spending in 2017-18 in particular);
- **interest rates** have also raised debt interest spending by progressively larger amounts due to higher gilt yields and higher market expectations of Bank Rate. This effect is partly offset by a lower financing requirement, due to the downward revision to cumulative borrowing across the forecast period;
- **welfare spending** is lower in all years – more so in 2016-17 and towards the end of the forecast. In the near term this reflects fewer claimants of tax credits than we expected. By the end of the forecast it reflects a bigger saving from universal credit and lower state pensions spending;
- our forecasts for **National Accounts adjustments** are significantly lower in all years, reducing spending by an average of £1.9 billion a year, mainly relating to local authority spending. About £0.8 billion a year of these adjustments are neutral for borrowing due to offsetting adjustments in current receipts;
- **local authorities' self-financed expenditure** (LASFE) is higher in all years. While a number of the changes to this line are neutral overall, some of the increase affects total spending and borrowing. In particular, we have revised up our forecast for local authorities' use of reserves, which raises spending and borrowing from 2016-17 to 2018-19;
- the **profile of spending in 2016-17 and 2017-18** has changed due to a £2.3 billion downward revision to departmental spending in 2016-17, where we expect departments to underspend their July plans by more than we thought in November, and a smaller draw-forward of member contributions by the European Commission in calendar year 2017, which moves £1.8 billion of spending from 2016-17 into 2017-18; and
- **Government decisions** increase spending in all years, adding between £3.4 billion and £4.0 billion a year in the Spending Review period, and lower amounts thereafter. This includes additional DEL spending on adult social care and the amount set aside by the Treasury to meet the cost of having lowered the personal injury discount rate. It also includes an additional £1.5 billion of spending in 2019-20 that the Government has brought forward from 2020-21 by reprofiling spending (see paragraphs 4.17 and 4.109). LASFE has been boosted by faster council tax rises, again to finance adult social care spending. The indirect effects of Government decisions on spending mainly relate to higher RPI inflation adding to accrued debt interest on index-linked gilts.

Table 4.18: Sources of changes to the spending forecast since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	778.8	797.0	814.5	823.7	855.6	886.4
March forecast	772.8	802.4	817.2	827.9	855.4	886.4
Change	-6.0	5.4	2.7	4.2	-0.2	0.0
Forecast changes since November	-6.0	1.5	-0.7	0.2	-1.5	-1.8
<i>of which:</i>						
Economic determinants	0.1	2.4	-1.1	-0.6	-0.9	-1.2
<i>of which:</i>						
Inflation	0.0	2.4	-0.8	-0.3	-0.5	-0.8
Other	0.1	0.0	-0.3	-0.3	-0.4	-0.4
Market assumptions: interest rates	0.2	0.7	1.1	1.6	2.1	2.3
Other assumptions and changes	-6.2	-1.6	-0.6	-0.8	-2.6	-2.9
<i>of which:</i>						
DEL forecast changes	-2.3	0.0	0.0	0.6	0.1	0.2
Other welfare changes	-0.5	-0.3	-0.3	-0.6	-0.9	-1.0
Expenditure transfers to EU institutions forecast changes ¹	-1.9	1.4	0.3	0.0	0.0	0.0
Locally financed current expenditure	1.6	1.1	1.5	1.7	1.8	1.7
Locally financed and public corporations' capital expenditure	0.1	-0.1	1.0	0.7	-0.6	-0.2
Other net debt interest changes	-0.5	-0.4	-0.7	-0.7	-0.7	-0.8
General government depreciation	-0.5	-0.7	-1.0	-1.1	-1.3	-1.4
Environmental levies	0.0	-1.1	-0.8	0.3	0.4	0.4
Other National Accounts adjustments	-2.1	-1.8	-1.8	-2.0	-2.0	-1.8
Other	-0.1	0.3	1.0	0.5	0.5	0.0
	Effect of Government decisions					
Total effect of Government decisions	0.0	3.9	3.4	4.0	1.3	1.8
<i>of which:</i>						
AME scorecard measures	0.0	-0.1	-0.1	-0.2	-0.1	-0.1
AME non-scorecard measures	0.0	2.7	2.5	0.4	-0.5	0.0
RDEL changes ²	0.0	1.4	1.2	2.4	2.5	2.5
CDEL changes ²	0.0	-0.8	-0.6	1.0	-0.9	-1.0
Indirect effects of Government decisions	0.0	0.8	0.4	0.3	0.3	0.4

¹ This shows changes in our forecast on a 'no referendum' basis, which has been produced as a baseline forecast. We have then made the fiscally neutral assumption that any reduction in these transfers after the UK leaves the EU will be recycled into higher domestic spending. As a result, only changes to the baseline forecast contribute to the revision to our spending forecast since November.

² Excludes changes to DELs that are forecast or classification changes.

Spending within departmental expenditure limits (DELs)

DEL spending and changes since November

4.101 In this section, we use 'RDEL spending' and 'CDEL spending' to refer to PSCE in RDEL and PSGI in CDEL. The basis of our latest forecasts includes:

- **departments' latest 'forecast outturns' for 2016-17** that were sent to the Treasury in February, plus our assumptions regarding any further underspending relative to them;

- departments' final plans for 2017-18 to 2019-20 as published in *Public expenditure statistical analyses (PESA) 2016*, plus policy changes included in our November EFO and those announced in this Budget, and our assumptions regarding likely underspending against the new plans; and
- the Government's latest provisional total DELs for 2020-21 and 2021-22, where DELs will not be finalised until the next Spending Review (with the exception of capital DELs and RDELs for the NHS, Ministry of Defence and the Security Intelligence Agencies in 2020-21, which were set in Spending Review 2015).

4.102 Our latest DEL forecasts include significant switches between CDEL and local authorities' and public corporations' capital spending in AME, relating to the treatment of capital grants to housing associations. These switches include a methodological change to recognise that some of the Government's capital grants to housing associations are routed via local government.⁹ Rather than show offsetting changes to CDEL spending and capital AME for all these switches, we have restated our November forecasts to include them. The remaining changes that are reported for CDEL spending and capital AME are those that affect TME.¹⁰ Table 4.19 shows our restated November CDEL forecasts.

Table 4.19: DEL and AME switches since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast for PSGI						
PSGI in CDEL	46.1	49.9	52.7	54.4	64.8	68.2
PSGI in AME	32.9	34.1	32.4	33.2	36.2	38.1
Total PSGI	79.0	84.0	85.1	87.5	101.1	106.3
Changes to government capital grants to housing associations						
	0.0	-0.1	0.2	0.0	0.4	0.5
<i>of which:</i>						
Local government grants ¹	0.4	0.3	0.6	0.4	0.9	1.0
Central government grants ²	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
November forecast restated to include March changes						
PSGI in CDEL restated	46.1	49.8	52.8	54.3	65.2	68.7
PSGI in AME restated	32.9	34.2	32.3	33.2	35.8	37.5
Total PSGI (unchanged)	79.0	84.0	85.1	87.5	101.1	106.3

¹ These changes increase PSGI in CDEL and reduce local authorities' self-financed capital spending in PSGI in AME by an offsetting amount in each year.

² These changes reduce PSGI in CDEL and increase public corporations' capital spending in PSGI in AME by an offsetting amount in each year.

⁹ Our November forecast assumed that all capital grants went directly from central government to housing associations, so adjusted CDEL spending to remove these intra-public sector flows. This prevented double-counting, since grant-financed capital spending by housing associations is included in capital AME. Now that we have changed our forecasts to reflect the routing of some grants via local authorities, we have reduced our previous adjustments, but introduced another to remove the local authority capital grants from local authorities' self-financed capital spending in AME.

¹⁰ An exception to this is the change to include the pilot schemes for further business rates retention in 2017-18 and 2018-19. Under these pilot schemes, local authorities keep more of the business rates that they collect locally, which increases their self-financed current and capital spending in AME. But they receive commensurately lower grants from central government, which means that there are offsetting reductions to RDEL and CDEL. See paragraph 4.139.

4.103 Table 4.20 shows our forecasts for resource (RDEL) and capital (CDEL) spending and overall changes relative to our restated November forecast. (The sources of these changes are set out in Table 4.22.) Table 4.20 shows that:

- actual **resource spending** has been revised down significantly in 2016-17, but is then higher in all subsequent years. This mainly reflects Government decisions to increase overall spending limits. We have also reduced our underspend assumption in 2019-20 to reflect the particular spending pressures in that year; and
- **capital spending** has been reduced in all future years except 2019-20, where it has been increased. In 2017-18 and 2018-19, lower spending reflects the pilots for the retention of more business rates in certain local authorities that switch spending from DEL to local authorities' self-financed spending. The rise and fall in 2019-20 and 2020-21 reflects 'reprofiling' by the Treasury – described in paragraphs 4.17 and 4.109.

Table 4.20: RDEL and CDEL spending and total changes since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
PSCE in RDEL						
November forecast						
Limits	316.1	317.6	320.3	321.1	327.2	333.9
Assumed underspend ¹	-0.8	-0.8	-0.8	-1.3	-1.3	-1.3
Actual spending	315.4	316.9	319.6	319.8	326.0	332.7
March forecast						
Limits	316.1	319.1	321.6	323.5	329.8	336.6
Assumed underspend ¹	-3.2	-0.8	-0.8	-0.8	-1.3	-1.3
Actual spending	313.0	318.3	320.8	322.8	328.6	335.3
Changes						
Limits	0.0	1.4	1.2	2.4	2.6	2.7
Assumed underspend ¹	-2.4	0.0	0.0	0.5	0.0	0.0
Actual spending	-2.4	1.4	1.2	2.9	2.6	2.7
PSGI in CDEL						
November forecast (restated)²						
Limits	47.1	51.3	54.6	56.3	70.7	72.7
Assumed underspend ¹	-1.0	-1.5	-1.8	-2.0	-5.5	-4.0
Actual spending	46.1	49.8	52.8	54.3	65.2	68.7
March forecast						
Limits	47.1	50.5	54.0	57.4	69.7	71.7
Assumed underspend ¹	-0.8	-1.5	-1.8	-2.1	-5.4	-4.0
Actual spending	46.2	49.0	52.2	55.4	64.3	67.7
Changes						
Limits	0.0	-0.8	-0.6	1.1	-1.0	-1.0
Assumed underspend ¹	0.2	0.0	0.0	-0.1	0.1	0.0
Actual spending	0.2	-0.8	-0.6	1.0	-0.9	-1.0
Per cent of GDP						
PSCE in RDEL (actual spending)						
November forecast	16.2	15.8	15.3	14.8	14.5	14.2
March forecast	15.9	15.7	15.3	14.9	14.6	14.3
Change	-0.2	-0.1	0.0	0.1	0.1	0.1
PSGI in CDEL (actual spending)						
November forecast (restated) ²	2.4	2.5	2.5	2.5	2.9	2.9
March forecast	2.4	2.4	2.5	2.6	2.9	2.9
Change	0.0	-0.1	0.0	0.0	0.0	0.0
¹ Underspends are measured against the plans set out in PESA 2016, adjusted for the policy changes announced in the 2016 Autumn Statement and the 2017 March budget, and are net of amounts carried forward from previous years under Budget Exchange.						
² Restated for switches between DEL and AME. See Table 4.19.						

4.104 Table 4.22 details the changes that we have included in our latest forecast, and breaks them down between our underlying forecast judgements and the Government's decisions.

4.105 The main changes to our forecast judgements since November relate to our underspending assumptions, which have increased by £2.3 billion in 2016-17 reflecting the detailed in-year information made available to us, and reduced by £0.4 billion in 2019-

20 we have brought forward £0.1 billion of underspend from 2020-21, in response to the Government's reprofiling of CDEL plans (see paragraphs 4.17 and 4.109).

- 4.106 The relatively large increase in underspending expected in 2016-17 reflects the final plans for departments' DELs in the Supplementary Estimates¹¹ and departments' February 'forecast outturns' submitted to the Treasury. Table 4.21 shows that the Supplementary Estimates reduced RDEL spending by £3.1 billion and CDEL spending by £0.7 billion. These are larger reductions than in recent years. They include £0.8 billion of underspends that departments have been allowed to transfer to 2017-18 under Budget Exchange.¹² The reductions also reflect the fact that, unusually, the Treasury did not use its central DEL reserves in full. That may be a timing effect, with spending pressures pushed into 2017-18. The larger underspends are also likely to reflect the less challenging real terms change in DEL plans in 2016-17 relative to plans from 2017-18 onwards as they stood before this Budget.
- 4.107 In light of this information, our revised assumption for the overall level of underspending this year – which is measured against the initial PESA plans¹³ – now only depends on the amounts that departments will underspend against their Supplementary Estimates. Since these are limits, departments are required not to breach them. Historically, they have usually underspent against them by large amounts. However, in 2015-16 departments' total underspend against Supplementary Estimates was only £0.1 billion for CDEL spending, and although the total underspend for RDEL was £0.9 billion, the Department of Health overspent its limit.¹⁴ For this year, our central expectation is that there will be only small further underspends on each of RDEL and CDEL against final plans.

Table 4.21: DEL shortfalls against PESA plans for 2016-17

	£ billion					
	PSCE in RDEL		PSGI in CDEL		TME in DEL	
	Outturn 2015-16	Forecast 2016-17	Outturn 2015-16	Forecast 2016-17	Outturn 2015-16	Forecast 2016-17
Changes measured against PESA plans¹						
Supplementary estimates (final plans) ²	0.4	-3.1	-0.6	-0.7	-0.2	-3.8
Shortfall against final plans in departments' forecast outturn in February	-0.7	-0.1	0.0	0.0	-0.7	-0.1
OBR estimate of further shortfall	-0.1	0.0	-0.1	-0.1	-0.2	0.0
Net underspend	-0.4	-3.2	-0.7	-0.8	-1.2	-4.0

¹ Changes measured against plans in PESA 2016, after taking account of policy changes included in the 2016 Autumn Statement, and net of increases in spending from Budget Exchange carried forward from earlier years.

² Provisional estimates.

¹¹ HM Treasury, *Central Government Supply Estimates 2016-17: Supplementary Estimates and New Estimates*, February 2017, HC 946.

¹² Budget Exchange is the Treasury's system for controlling the transfer of a limited amount of departmental underspending into future years' DEL plans. The supplementary fiscal tables on our website include two tables that show the historical series for underspends included in Supplementary Estimates, and the subsequent underspending against those final plans, and also total underspends, measured net and gross of Budget Exchange.

¹³ The PESA plans that are used as the base for measuring underspends are adjusted for policy measures announced at the Autumn Statement, so that those policy measures are not included as part of the underspends.

¹⁴ The limit that the Department of Health overspent against was their limit for RDEL excluding depreciation.

- 4.108 For 2017-18 onwards, our underspend assumptions take into account the level of recent underspends, the pressures that departments will face from the real terms reduction in their DELs and any known transfers of spending pressures from earlier years. We also consider the Treasury's assessment of pressures against the central reserves. Our review of these factors led to only one forecast change: we reduced our previous assumption for underspending against RDEL by £0.5 billion in 2019-20, the year of the Spending Review in which the real terms cut is steepest (see Chart 4.6 below). Given greater underspending in 2016-17, we considered increasing our underspend assumptions in 2017-18, but judged it to be likely that it would be offset by additional spending pressures transferred from 2016-17, for instance via Budget Exchange.
- 4.109 The DEL changes in Table 4.22 that result from Government decisions include measures reported on the Treasury scorecard that increase spending by £1.1 billion a year on average. The biggest increases relate to additional funding for adult social care, which adds £1.2 billion in 2017-18 and smaller amounts in the next two years. There are also several changes to DEL spending that are not reported on the Treasury scorecard:
- RDEL and CDEL in 2017-18 and 2018-19 have both been reduced by £1.2 billion a year on average due to the **pilots for full business rates retention**. These reductions are fully offset by the increases in local authorities' self-financed current and capital expenditure (see paragraph 4.139);
 - **additions to the Treasury's central RDEL reserves** of about £1.2 billion a year to meet the costs for the public sector (in particular for the NHS Litigation Authority) resulting from the decision to reduce the personal injury discount rate, as discussed in Box 4.2;
 - changes to the structure of **probate fees** that the Treasury advises are likely to mean that they will be treated as a tax in the National Accounts in future. That increases RDEL by about £0.3 billion a year by removing the negative spending associated with the fees, but has an offsetting positive effect on current receipts (see paragraphs 4.26 and 4.71);
 - **reprofiling existing plans**, which largely moves spending out of 2020-21 into 2019-20. This includes £0.3 billion of RDEL spending by the Department for International Development's official development assistance programme, £0.6 billion of CDEL spending by the Department for Education and £0.4 billion of unallocated CDEL spending. We brought forward £0.1 billion of underspend from 2020-21 into 2019-20, in response to this reprofiling of CDEL plans; and
 - the Government's latest top-down policy decisions on **DEL spending beyond the Spending Review period**. These increase RDEL but reduce CDEL.
- 4.110 We have made small adjustments to our underspending assumptions in response to these policy changes. We have also reduced slightly the extent to which we expect local authorities to draw down their reserves in 2017-18 and 2018-19 thanks to the additional DEL funding for adult social care.

Table 4.22: Sources of changes to DELs since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
PSCE in RDEL						
November forecast	315.4	316.9	319.6	319.8	326.0	332.7
March forecast	313.0	318.3	320.8	322.8	328.6	335.3
Change	-2.4	1.4	1.2	2.9	2.6	2.7
<i>of which:</i>						
Forecast changes	-2.4	0.0	0.0	0.6	0.1	0.2
Assumed underspend	-2.4	-	-	0.5	-	-
Net increases in Scottish Government self-financed spending	-	-	0.0	0.1	0.1	0.2
Effect of Government decisions	0.0	1.4	1.2	2.4	2.5	2.5
Scorecard measures	0.0	1.4	1.0	0.6	0.3	0.5
Business rates retention pilots ¹	-	-1.4	-1.2	-	-	-
Personal injury discount rate	-	1.2	1.1	1.2	1.2	1.2
Probate fees increase and reclassification	-	0.2	0.3	0.3	0.3	0.4
Net increases in Scottish Government self-financed spending (indirect effects)	-	0.0	0.1	0.1	0.1	0.1
ODA reprofiling	-	-	-	0.3	-0.3	-
Additional policy changes to DELs in 2020-21 and 2021-22	-	-	-	-	0.9	0.4
PSGI in CDEL						
November forecast (restated)	46.1	49.8	52.8	54.3	65.2	68.7
March forecast	46.2	49.0	52.2	55.4	64.3	67.7
Change	0.2	-0.8	-0.6	1.0	-0.9	-1.0
<i>of which:</i>						
Forecast changes	0.2	-	-	-	-	-
Assumed underspend	0.2	-	-	-	-	-
Effect of Government decisions	0.0	-0.8	-0.6	1.0	-0.9	-1.0
Scorecard measures	0.0	0.3	0.3	0.3	0.3	0.7
Business rates retention pilots ²	-	-1.0	-1.1	-	-	-
Reprofiling of DfE capital	-	-	0.2	0.4	-0.6	-
Reprofiling of unallocated capital	-	-	-	0.4	-0.4	-
Assumed underspend (indirect effects)	-	-	-	-0.1	0.1	-
Additional policy changes to DELs in 2020-21 and 2021-22	-	-	-	-	-0.3	-1.7

¹ Offset in local authorities' current self-financed expenditure.

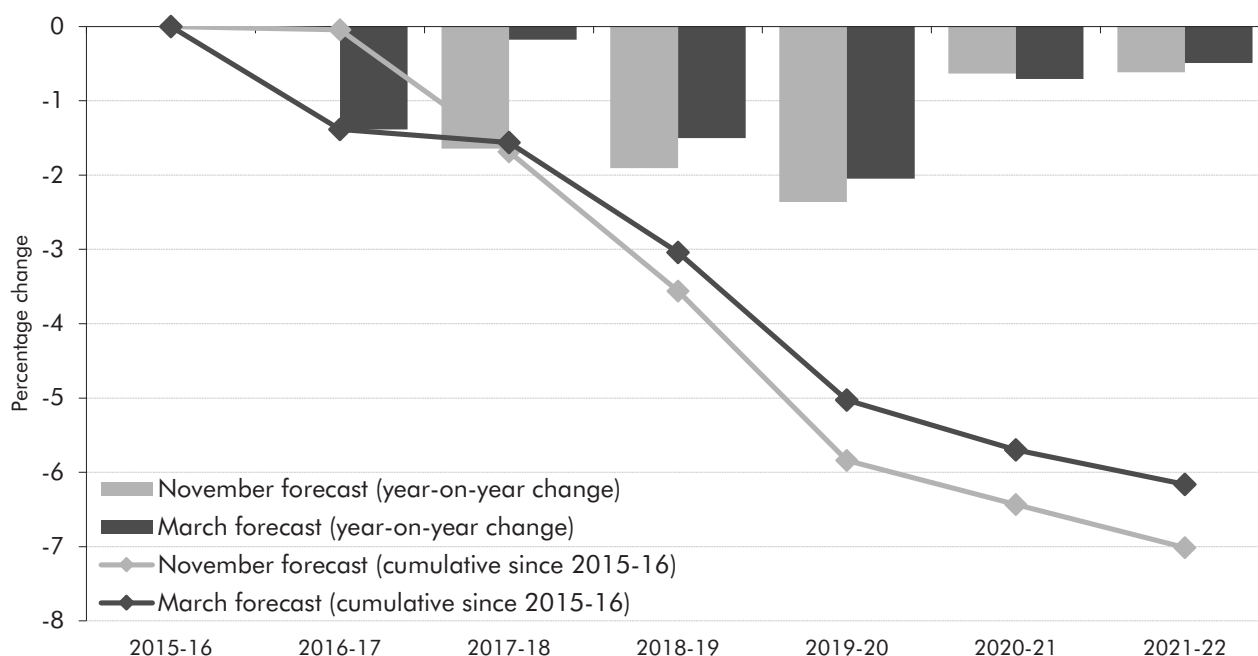
² Offset in local authorities' capital self-financed expenditure.

The path of resource and capital DEL spending over the forecast period

4.111 The Government has boosted departmental resource spending by around £2.5 billion a year from 2017-18 (excluding the effects of business rates pilots that switch spending from DEL to AME). Nevertheless, resource spending per person falls by 4.8 per cent in real terms over the next five years (see Chart 4.6). This is a less steep fall than in our November forecast. The biggest falls to come are the final two years of the Spending Review period. In 2020-21 and 2021-22, overall resource spending rises in line with whole economy prices, so falls by an average of 0.6 per cent a year in real per capita terms. Those falls will take

place against a backdrop of upward pressure on spending – particularly health spending – from an ageing population.

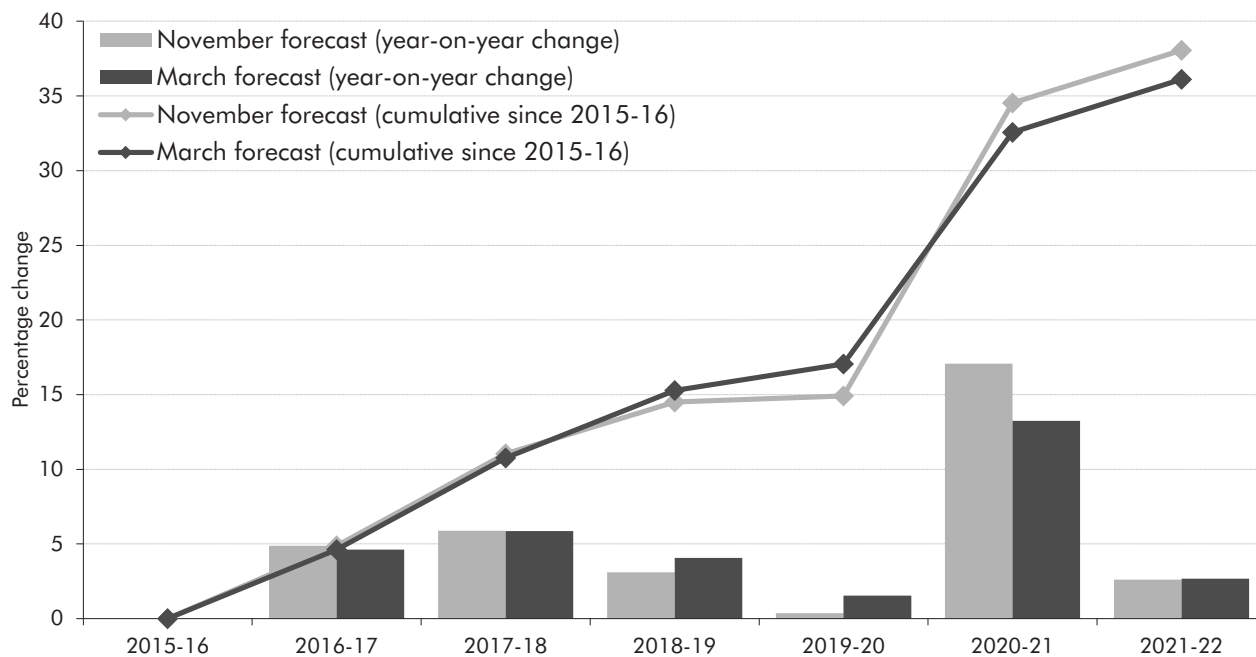
Chart 4.6: Change in real RDEL spending per capita from 2015-16



Note: The chart has been adjusted to remove the reduction in RDEL in 2017-18 and 2018-19 due to 100 per cent business rates retention pilots.
Source: OBR

4.112 The path of departmental capital spending (again excluding the effects of business rates pilots) is little changed from November. The changes that have been made temper slightly the very sharp rise planned for 2020-21. As Chart 4.7 shows, departmental capital spending is set to increase by more than a third in real per capita terms by 2021-22.

Chart 4.7: Change in real CDEL spending per capita from 2015-16



Note: The chart has been adjusted to remove the reduction in CDEL in 2017-18 and 2018-19 due to 100 per cent business rates retention pilots. November forecast and 2015-16 figures have been adjusted so that they are on the same basis as this forecast.
Source: OBR

Annually managed expenditure (AME)

4.113 Table 4.16 set out our latest central projection of AME spending to 2021-22, based on the economy forecast described in Chapter 3, and our latest estimates of the effects existing policies and the new measures announced in this Budget and since the Autumn Statement.

Welfare spending (including spending subject to the 'welfare cap')

4.114 Total welfare spending in our forecast refers to AME spending on social security and tax credits – a subset of which is subject to the Government's 'welfare cap' (around 55 per cent in 2016-17). The terms of the welfare cap were changed at the last Autumn Statement, but the items subject to it remain the same. We provide an update on performance against the cap in Chapter 5.

4.115 Table 4.23 shows that total welfare spending is forecast to rise by 10.3 per cent over the forecast period, reaching £240 billion in 2021-22. Spending on items subject to the cap (predominantly working-age welfare spending) is projected to rise by 4.9 per cent, a 5.7 per cent fall in real terms (relative to CPI inflation). By contrast, spending on items outside the cap – largely state pensions – is expected to rise by 16.8 per cent, 5.0 per cent in real terms.

4.116 Relative to the size of the economy, welfare spending is forecast to fall by 0.8 per cent of GDP between 2016-17 and 2021-22, with spending inside the welfare cap falling by 0.7 per cent and spending outside the cap falling by 0.1 per cent. That would take overall welfare spending to its lowest share of GDP since 2006-07 and spending on items subject to the welfare cap to its lowest since 1991-92.

Table 4.23: Welfare spending forecast overview

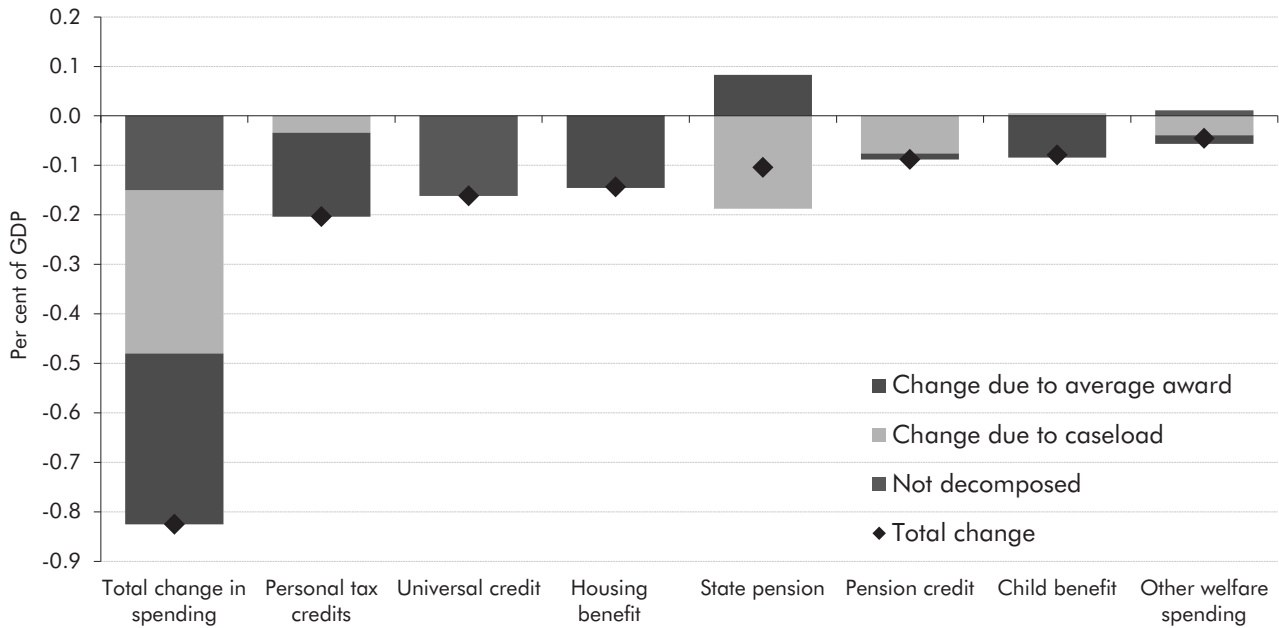
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
£ billion							
Total welfare spending	216.1	217.9	221.1	224.4	226.8	231.9	240.3
of which:							
Inside welfare cap	120.0	119.3	119.6	120.0	120.0	122.4	125.1
Outside welfare cap	96.2	98.6	101.5	104.3	106.8	109.5	115.2
Per cent of GDP							
Total welfare spending	11.5	11.1	10.9	10.7	10.5	10.3	10.3
of which:							
Inside welfare cap	6.4	6.1	5.9	5.7	5.5	5.4	5.3
Outside welfare cap	5.1	5.0	5.0	5.0	4.9	4.9	4.9

4.117 Chart 4.8 splits the 0.8 per cent of GDP fall in welfare spending expected over the forecast period into its main components and their drivers. These include lower spending as a share of GDP on:

- **tax credits:** in particular, the uprating freeze between 2016-17 and 2019-20 means that average awards fall relative to average earnings, reducing spending on tax credits as a share of GDP. Cuts in support for first children and families with more than two children also reduce average awards;
- **universal credit:** specifically, rising savings associated with the rollout of universal credit, which is less generous on average than the benefits and tax credits that it replaces. (A supplementary fiscal table on our website sets out how this marginal saving can be broken down into various sources of gross cost – e.g. higher take-up of elements that require separate claims in the existing system – and gross saving – e.g. the cuts to work allowances in universal credit that were announced in July 2015, but unlike similar cuts to tax credits were not reversed in Autumn Statement 2015);
- **housing benefit inside the cap:** almost entirely driven by a reduction in average awards relative to average earnings, which largely reflects the freeze in working-age benefit uprating and social-sector rent policy that places additional burdens on landlords;
- **state pensions:** driven by lower caseloads reflecting increases in the state pension age (which reaches 65 for women by November 2018, then rises to 66 for both men and women by October 2020), partly offset by awards rising faster than earnings at the start of the forecast due to the triple lock on uprating;
- **pension credit:** as the rising female state pension age – which determines the qualifying age for both men and women – reduces the caseload;
- **child benefit:** as awards fall relative to average earnings due mainly to the uprating freeze until 2019-20; and

- other welfare spending:** this includes lower spending on incapacity benefits (as work capability assessments reduce the ESA caseload as a share of the population and awards outside the ESA 'support group' are frozen for four years, while the work-related activity component is cut), and income support (where inflows have been falling and the extended lone parent obligation moves cases onto jobseeker's allowance).

Chart 4.8: Sources of changes to welfare spending (2016-17 to 2021-22)



Source: OBR

4.118 Table 4.24 sets out our detailed welfare spending forecasts for 2016-17 to 2021-22 on a pre-scorecard basis, plus the total effect on welfare spending of policy decisions announced in this Budget. A detailed post-measures forecast for each line is available in a supplementary fiscal table on our website, but the effect of measures in this Budget is small – largely reflecting a measure that transfers responsibility for collecting some tax credits debts from HMRC to DWP, which has broader powers to do so.

Table 4.24: Welfare spending

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Welfare cap							
DWP social security	76.3	76.5	76.3	76.8	76.9	78.3	80.1
of which:							
Housing benefit (not on JSA) ¹	21.8	21.4	21.1	21.2	20.7	21.1	21.5
Disability living allowance and personal independence payments	16.2	16.7	17.2	18.0	18.9	19.5	20.2
Incapacity benefits ²	15.1	15.2	15.5	15.5	15.7	16.1	16.5
Attendance allowance	5.5	5.5	5.5	5.7	5.9	6.2	6.4
Pension credit	6.0	5.7	5.3	5.0	4.8	4.6	4.7
Carer's allowance	2.6	2.7	2.9	3.2	3.3	3.5	3.6
Statutory maternity pay	2.3	2.3	2.4	2.5	2.5	2.6	2.7
Income support (non-incapacity)	2.4	2.3	2.0	1.9	2.0	2.0	2.1
Winter fuel payments	2.1	2.1	2.0	2.0	2.0	2.0	2.0
Universal credit ³	0.0	0.5	-0.1	-0.5	-1.2	-1.6	-1.9
Other DWP in welfare cap	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Personal tax credits	28.5	27.5	27.6	27.3	27.0	27.6	28.1
Child benefit	11.7	11.6	11.6	11.5	11.5	11.8	12.0
Tax free childcare	0.0	0.0	0.4	0.8	0.9	0.9	1.0
NI social security in welfare cap	3.4	3.5	3.5	3.5	3.6	3.7	3.8
Paternity pay	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Budget measures	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
Non-scorecard measures	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Indirect effects	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare cap⁴	120.0	119.3	119.6	120.0	120.0	122.4	125.1
Welfare spending outside the welfare cap							
DWP social security	94.0	96.2	99.1	101.7	104.0	106.7	112.1
of which:							
State pension	89.4	91.6	94.0	96.4	98.7	101.2	106.5
Jobseeker's allowance	2.3	1.9	2.8	2.9	2.9	3.0	3.1
Housing benefit (on JSA)	1.9	1.6	2.2	2.4	2.4	2.5	2.5
Universal credit ³	0.5	1.1					
NI social security outside welfare cap	2.3	2.4	2.5	2.5	2.6	2.7	2.9
Budget measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indirect effects	0.0	0.0	0.0	0.1	0.2	0.1	0.2
Total welfare outside the welfare cap⁴	96.2	98.6	101.5	104.3	106.8	109.5	115.2
Total welfare	216.1	217.9	221.1	224.4	226.8	231.9	240.3
<i>Memo: welfare cap as proportion of total welfare</i>	<i>55.5</i>	<i>54.7</i>	<i>54.1</i>	<i>53.5</i>	<i>52.9</i>	<i>52.8</i>	<i>52.1</i>

¹ Housing benefit (not on jobseeker's allowance) is made up of a number of claimant groups. The main claimant groups are pensioners, those on incapacity benefits, lone parents, and housing benefit only claimants.

² Incapacity benefits includes incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).

³ Universal credit additional costs not already included against other benefits (i.e. UC payments that don't exist under current benefit structure).

⁴ Total welfare outturn inside and outside of the welfare cap in 2015-16 is sourced from OSCAR, consistent with PESA 2016. For 2015-16 only, the components reflect departments' own outturns, which may not be on a consistent basis to OSCAR. For this year the components may not sum to the total for this reason.

- 4.119 Table 4.25 sets out the changes to our welfare spending forecast since November. It shows that before the small effects of scorecard measures we have revised spending down by increasing amounts, reaching £1.5 billion in 2021-22 (split relatively evenly inside and outside the welfare cap).
- 4.120 In 2016-17, the main change is spending on tax credits – down £0.6 billion relative to our November forecast. That comes on top of the downward revision we made then. The number of claimants continues to be lower than expected and has now fallen in each of the past six years. The explanation remains unclear and we continue to work with HMRC to understand it. In the meantime, this forecast is subject to greater-than-usual uncertainty.
- 4.121 Changes in our economy forecast have little impact on welfare spending inside the cap. Lower earnings growth raises spending marginally on means-tested payments such as tax credits and housing benefit, but lower CPI inflation reduces the annual change from uprating. Outside the cap, lower earnings growth feeds through to lower spending on state pensions during this Parliament via the triple lock. A slightly higher claimant count adds to spending on jobseeker’s allowance and associated housing benefit.
- 4.122 We have made a number of other changes affecting our pre-measures forecast:
- spending on **state pensions** is £0.7 billion lower in 2021-22. This reflects a higher proportion of people choosing to defer their claim and a slightly higher mortality rate, in addition to the effect of lower earnings growth on the triple lock;
 - the marginal saving from **universal credit** (UC) is £0.6 billion bigger in 2021-22. The main reasons are a correction to the knock-on effects of the cut to tax credits income disregards announced in July 2015 (which reduce savings from UC but had been double-counted) and greater savings arising from the fact that UC does not contain disability-related premiums that are contingent on receipt of personal independence payment (PIP). The latter partly offsets the upward revision to spending on those premiums in our November 2016 incapacity benefits forecast, the knock-on effect of which was not captured at the time;
 - spending on **tax-free childcare** has been revised down £0.2 billion in 2017-18 as we have revised down expected caseloads. The Government has pushed the start date for the policy back once more – to April 2017, although that is still subject to Ministerial confirmation – and we have assumed that the pace of take-up thereafter will be slower than we did in November. We have made a similar small adjustment to the expected reduction in tax credits and associated welfare spending from the introduction of 30 hours of free childcare for working families, where it seems likely that the supply of places will rise more slowly over the first two years than originally assumed; and
 - spending on **disability benefits** is £0.2 billion higher in 2021-22, reflecting higher in-year outturns driven by higher PIP assessment success rates. Recent legal judgements relating principally to the mobility component of PIP would have raised spending in 2021-22 by a further £0.9 billion (and £3.7 billion across the forecast) absent any

Government policy response. (This estimate reflects the 'static' cost, assuming no behavioural response from potential claimants.) It would have added around 3 per cent to average awards and 4 per cent to the overall PIP caseload in 2021-22. The Government has announced legislative changes that are expected to reduce the impact to £110 million in 2017-18, with no ongoing cost.

Table 4.25: Key changes to welfare spending since November

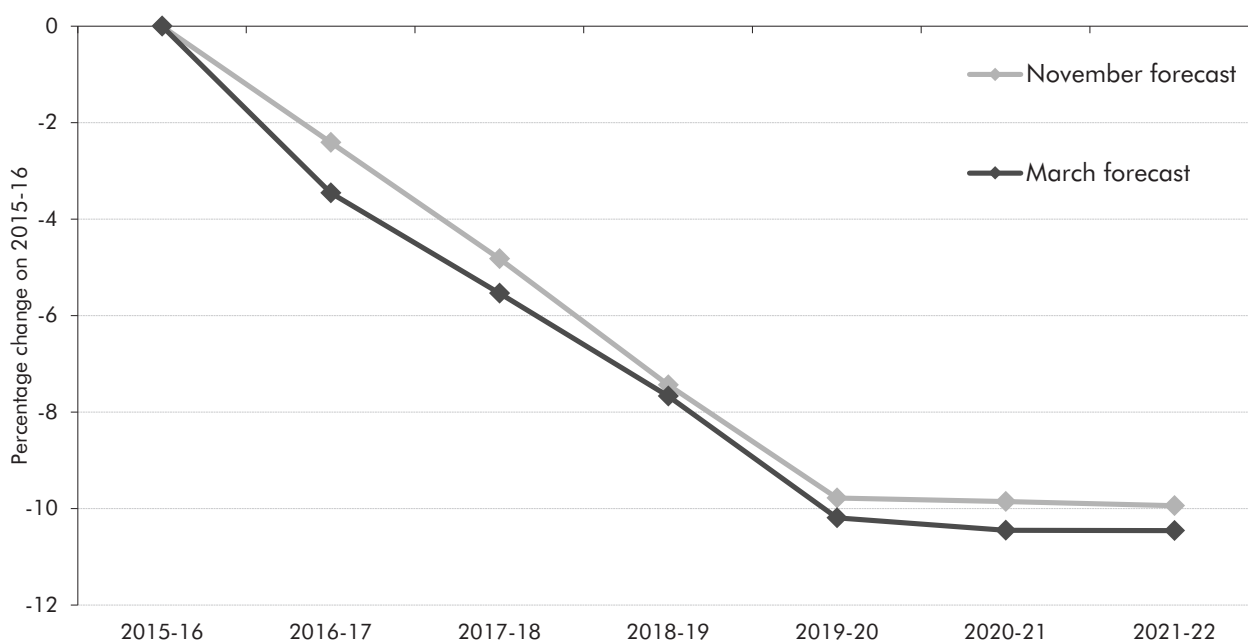
	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Welfare spending inside the welfare cap							
November forecast	120.0	119.8	119.6	120.1	120.5	123.2	126.0
March forecast	120.0	119.3	119.6	120.0	120.0	122.4	125.1
Change	0.0	-0.6	0.0	0.0	-0.5	-0.8	-0.9
<i>of which:</i>							
Economic determinants	0.0	0.0	0.0	0.0	0.0	-0.1	0.0
Estimating/modelling changes	0.0	-0.6	-0.1	0.0	-0.3	-0.6	-0.8
Universal credit (inside of cap)	0.0	-0.1	0.0	-0.2	-0.4	-0.6	-0.7
Incapacity benefits ¹	0.0	0.2	0.3	0.2	0.1	0.1	0.0
Disability benefits ²	0.0	0.1	0.1	0.2	0.2	0.2	0.2
Personal tax credits	0.0	-0.6	-0.3	-0.3	-0.3	-0.3	-0.3
Other	0.0	-0.2	-0.1	0.1	0.1	0.1	0.0
Budget measures	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
Non-scorecard measures	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Welfare spending outside the welfare cap							
November forecast	96.2	98.5	101.6	104.6	107.0	110.0	115.9
March forecast	96.2	98.6	101.5	104.3	106.8	109.5	115.2
Change	0.0	0.1	-0.1	-0.2	-0.2	-0.5	-0.7
<i>of which:</i>							
Economic determinants	0.0	0.0	0.0	0.1	0.1	-0.2	-0.4
CPI inflation	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
Claimant count unemployment	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Triple lock	0.0	0.0	0.0	0.1	0.1	-0.2	-0.4
Estimating/modelling changes	0.0	0.1	-0.1	-0.3	-0.3	-0.3	-0.3
Budget measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare spending							
November forecast	216.1	218.4	221.2	224.6	227.5	233.2	241.8
March forecast	216.1	217.9	221.1	224.4	226.8	231.9	240.3
Change	0.0	-0.5	-0.1	-0.2	-0.7	-1.3	-1.5
<i>of which:</i>							
Economic determinants	0.0	0.0	0.0	0.1	0.1	-0.3	-0.4
Estimating/modelling changes	0.0	-0.5	-0.3	-0.3	-0.6	-0.9	-1.0
Budget measures	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
Non-scorecard measures	0.0	0.0	0.1	0.0	0.0	0.0	0.0

¹ Incapacity benefits includes incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).

² Disability benefits refers to disability living allowance and personal independence payment.

4.123 On current policy, welfare cap spending is projected to fall in real per capita terms in every year of the forecast (Chart 4.9). In the first four years, those falls are between 2 and 3 per cent a year – driven largely by the cash freeze applied to most working-age benefit and tax credit awards up to 2019-20. In the final two years of the forecast, it falls only slightly as awards return to standard uprating (by CPI inflation in most cases). Those falls reflect a number of factors – notably the ongoing rollout of UC, which is less generous on average than the benefits and tax credits that it replaces. By the end of the forecast period, real per capita welfare cap spending would be around 10 per cent lower than its 2015-16 level.

Chart 4.9: Change in real welfare cap spending-per-capita



Source: OBR

Box 4.5: Universal credit and the legacy benefits in 2017-18

Our welfare spending forecast is constructed by forecasting the existing ‘legacy’ benefits system as though universal credit did not exist, then subtracting from it an estimate of the marginal saving associated with rolling out universal credit (UC).

This allows us to base the forecast on as much administrative data as possible, but it does not reflect what will happen in the real world, where spending on the legacy benefits will fall while spending on UC will rise. As the UC rollout proceeds, the real world and this approach will diverge further. As soon as is practical, we will switch to forecasting UC on a gross rather than marginal basis.

To facilitate monitoring of our forecast against the monthly outturn data over the coming year, Table D sets out estimates for actual gross spending in 2017-18 on UC and the legacy benefits and tax credits that it is replacing and compares that to spending in our ‘no UC’ central forecast. It shows that:

- (income-based) **jobseeker’s allowance** is £0.9 billion (36 per cent) lower than our ‘no

UC' forecast. This is the legacy benefit for which the real world has diverged from our forecasting approach most significantly. That also has implications for the claimant count measure of unemployment, where around a third of the claimant count is now made up of individuals in receipt of UC. The ONS has announced that the claimant count will be dropped from the monthly labour market statistical bulletin as it ceases to be a reliable indicator during the UC rollout;

- (income-related) **employment and support allowance** is £0.5 billion (4 per cent) lower than in our 'no UC' forecast;
- **income support** (non-incapacity) is £0.1 billion (3 per cent) lower than in our 'no UC' forecast;
- **tax credits** spending (including both working and child tax credit) is £0.8 billion (3 per cent) lower than in our 'no UC' forecast. Spending in 2016-17 has come in lower than expected, even after adjusting for the equivalent estimate of UC actual costs. Part of this may be explained by higher UC costs in relation to tax credit equivalent cases than we currently assume;
- **housing benefit** is £1.8 billion (10 per cent) lower than in our 'no UC' forecast. Actual costs related to in-work housing benefit equivalent cases may also be higher than we currently assume; and
- actual expenditure on **UC** is estimated to be £3.9 billion, £0.1 billion less than the sum of the lower spending on legacy benefits. This marginal saving reflects the fact that UC is less generous on average – particularly for tax credits equivalent cases and those who would have received disability premiums in the legacy system due to also receiving PIP. This saving will rise over time.

Table D: Universal credit expenditure in 2017-18

	£ billion		Per cent difference
	Current presentation ¹	Actual costs presentation ²	
Legacy benefits			
Jobseeker's allowance	2.5	1.6	-36
Employment and support allowance	10.6	10.1	-4
Income support (non-incapacity)	2.0	2.0	-3
Tax credits	27.6	26.8	-3
Housing benefit	17.8	16.1	-10
Universal credit	-0.1	3.9	-
Total	60.5	60.5	-

¹ Current forecast presentation: legacy benefits on a counterfactual basis with the marginal saving from UC subtracted.

² Actual costs presentation: actual payments on each welfare item.

Public service pensions

- 4.124 The public service pensions forecast covers net expenditure on benefits paid less employer and employee contributions received. (The corresponding spending on employer contributions is included within our departmental spending forecast.) It includes central

government pay-as-you-go schemes and locally administered police and firefighters' schemes.¹⁵ A breakdown of spending and income for the major schemes covered by our forecast is included in the supplementary fiscal tables on our website.

4.125 Table 4.26 details the changes to our public service pensions forecast since November. Net expenditure is up in the first half of the forecast but down by the end. Gross expenditure has been revised up in 2016-17, but down in the second half of the forecast. Contributions have been revised up in most years, mainly due to higher than expected NHS receipts in 2016-17, which we assume will persist.

4.126 Changes since our November forecast reflect:

- an increase in **gross expenditure** in the civil service pension scheme as higher-than-expected numbers retired through early release schemes. This generated large one-off lump sum-payments in 2016-17, with smaller upward revisions in future years. This is more than offset by a fall in gross spending in the Scottish NHS and teachers' pension schemes, in particular in later years. This reflects a higher mortality forecast and lower values of new pension and lump-sum awards in these schemes;
- lower **receipts in the teachers' pension scheme**. The timing of the academic year means that much recruitment and retirement activity takes place in the autumn months. New data received since our last forecast show that, while overall staff numbers have remained relatively stable, the pensionable paybill is declining. This reflects structural changes in the composition of the workforce, with more younger staff on lower salaries replacing older higher-earners;
- higher **NHS pension scheme receipts**. Workforce growth in the bulk of the NHS has been higher than expected in 2016-17, which we assume will persist. Contributions from GPs, which make up around 6 per cent of all NHS receipts, have been on a declining trend. This has largely been driven by changes in the composition of the GP workforce who are participants in the NHS pension scheme. A rising share of GPs are women, whose pensionable pay is on average around a third lower than male GPs. The precise reasons for this are unclear from available pension scheme data, but it seems likely that differences in the average age of female GPs and the average hours worked will be contributing factors; and
- updated forecasts for **pensionable earnings growth rates**. In the absence of firm spending plans beyond 2019-20 (and beyond 2020-21 for the NHS and armed forces), we assume that scheme pensionable paybills grow in line with departmental budgets. Adjustments in Spending Review years reflect scheme experience to-date, including small revisions that some schemes have made to their workforce plans.

¹⁵ The police and firefighters' pension schemes are administered at a local level, but pensions in payment are funded from AME, along with other public service pension schemes. They are therefore included in our pensions forecast.

4.127 Since our November forecast, there have been three decisions in legal cases that could affect future forecasts: the McCloud and Sargeant cases relate to transitional protection arrangements in the Ministry of Justice and firefighters' pension schemes respectively, while the Brewster case relates to entitlement of unmarried partners for death-in-service cases. With appeals processes either ongoing or unclear, we are not yet in a position to estimate the spending effect of these decisions. They will be factored in once any become clear.

Table 4.26: Key changes to public service pensions since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Net public service pensions						
November forecast	11.1	12.1	13.6	13.4	14.6	16.1
March forecast	11.5	12.1	13.7	13.2	14.2	15.7
Change	0.3	0.0	0.1	-0.2	-0.3	-0.4
Expenditure						
November forecast	39.8	41.1	42.9	44.8	46.6	48.7
March forecast	40.1	41.1	42.9	44.7	46.4	48.4
Change	0.4	0.0	0.0	-0.2	-0.2	-0.3
<i>of which:</i>						
CPI inflation	0.0	0.0	0.0	-0.1	-0.1	-0.1
CSPS early release scheme payments	0.3	0.1	0.1	0.0	0.0	0.0
Scottish schemes	0.0	-0.1	-0.1	-0.1	-0.1	-0.2
Other	0.1	0.0	0.0	0.0	0.0	-0.1
Income						
November forecast	-28.6	-29.0	-29.2	-31.4	-32.1	-32.6
March forecast	-28.7	-29.0	-29.2	-31.5	-32.2	-32.7
Change	0.0	0.0	0.1	-0.1	-0.1	-0.1
<i>of which:</i>						
TPS paybill growth	0.1	0.1	0.2	0.2	0.2	0.2
NHS paybill growth	0.0	-0.1	-0.1	-0.2	-0.2	-0.2
Other	-0.1	-0.1	0.1	0.0	-0.1	-0.1

Net expenditure transfers to EU institutions and possible substitute spending

4.128 In our November *EFO*, we explained that our forecast included the fiscally neutral assumption that, when the UK leaves the EU, any reductions in the UK's net expenditure transfers to the EU would be fully recycled into extra domestic spending. That recycled domestic spending could include:

- any additional spending to meet **other domestic spending priorities**;
- any **payments made to private or public sector recipients** to compensate them for the loss of EU funding; and
- any **payments made to the EU** after the UK exits, if the Government agreed to make such payments. For instance, the Government's February white paper stated that

“There may be European programmes in which we might want to participate. If so, it is reasonable that we should make an appropriate contribution.”¹⁶

4.129 In Box 4.4 of our November *EFO*, we summarised various issues that external commentators had been discussing in respect of possible future financial flows between the UK and the EU. While there has been further discussion of these issues – for example, the Centre for European Reform published a paper on issues relating to the possibility of an ‘exit bill’ for the UK – there have not been any developments that would allow us to make meaningful assumptions about future transfers to the EU. As such, this forecast continues to assume that any reduction in expenditure transfers to EU institutions are recycled fully into extra domestic spending. And, as in November, we have updated our no-referendum counterfactual forecast that forms the baseline for that fiscally neutral assumption.

Table 4.27: Expenditure transfers to EU institutions and possible substitute spending

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
March forecast for ‘no-referendum’ counterfactual	8.8	11.5	12.6	12.7	13.1	13.7
<i>Which is reflected in our forecast as:</i>						
Expenditure transfers to EU institutions	8.8	11.5	12.6	-	-	-
Assumed domestic spending in lieu of EU transfers	-	-	-	12.7	13.1	13.7

4.130 Table 4.28 summarises the main changes to our forecast since November, which include:

- lower spending mainly from 2018-19 onwards due to changes in the **exchange rate**, with the pound having appreciated against the euro since November. The effect of stronger sterling on the UK’s contributions is not straightforward. It raises the UK’s share in euro-denominated GNI and VAT bases, but the bigger impact is to reduce the sterling value of euro-denominated payments, abatements and receipts;
- a large **timing effect within calendar year 2017** that leads to a significant downward revision to 2016-17 and upward revision to 2017-18. This relates to the extent to which the European Commission draws forward 2017 contributions into the first quarter. Our November forecast assumed that the maximum five months’ worth of payments would be drawn forward, as has been the case in most recent years, but instead only three months’ worth were requested. As the National Accounts record these payments when the cash payments are made, that moves £1.8 billion of spending from 2016-17 to 2017-18, but has no effect on the calendar year; and
- a change in the expected **profile of EU budget spending** across the Multiannual Financial Framework (MFF, which runs to 2020). The final adopted budget for 2016 was €8 billion lower than the original ceiling. That underspend can be carried forward to later years in the MFF. With external commentators and the European Parliament suggesting that implementation of structural funds spending has been slower than

¹⁶ See paragraph 8.51 of *‘The United Kingdom’s exit from and new partnership with the European Union’*.

planned, we expect a further underspend in 2017. Indeed, the initial budget adopted in December is already below the level of final spending that we had assumed would be implemented in our November forecast, and is significantly below the 2017 ceiling. We have now assumed that the underspend from 2014 to 2016 will be reallocated to increase the ceilings from 2018 onwards, with the ceiling increased by the maximum amount in 2018. And we have increased our forecasts for implemented expenditure to reflect the reallocated underspend, with most reallocated to 2018 and the rest to 2019. The main effect is to reduce spending in 2017-18 and increase it in 2018-19.

Table 4.28: Key changes to expenditure transfers to EU institutions on a 'no referendum' counterfactual basis

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	10.7	10.2	12.5	13.0	13.4	13.9
March forecast	8.8	11.5	12.6	12.7	13.1	13.7
Change	-1.9	1.4	0.1	-0.3	-0.3	-0.2
<i>of which:</i>						
Exchange rates	0.0	0.0	-0.3	-0.3	-0.3	-0.3
Change to contributions drawn forward into the first quarter of 2017	-1.8	1.8	-	-	-	-
Change in profile of EU budget spending across the 2014-2020 MFF	-	-0.4	0.4	0.1	0.0	0.1
Other	-0.1	0.0	-0.1	-0.1	0.0	0.0

Note: The supplementary fiscal tables on our website show details of our latest forecasts for our GNI and VAT payments and the rebate, and the various annual adjustments to those transactions that are assumed within our forecast. They also include a table that shows our assumptions about the EU annual budgets, and the adjustments to budget ceilings under the various flexibilities allowed in the 2014-2020 Multiannual Financial Framework, and our assumptions about implementation rates against the adjusted ceilings.

Note: As we do not have sufficient detail about the Government's negotiation preferences, or the chances of achieving them, we are not able to forecast how spending will be affected after the UK leaves the EU. We therefore make the fiscally neutral assumption that any reduction in transfers to the EU would be recycled into extra domestic spending. See pages 158-162 of our November 2016 EFO.

Locally financed current expenditure

4.131 We forecast local authority spending by forecasting the sources of income that local authorities use to finance their spending, and then the extent to which spending will be higher or lower than that through additions to or withdrawals from their reserves. Our forecast therefore encompasses spending financed by grants from central government, which are mostly in DEL, and local authority self-financed expenditure (LASFE) in AME. Table 4.29 focuses on LASFE, while further detail on all aspects of our local authority spending forecast are available in supplementary tables on our website.

4.132 There are currently a number of important uncertainties affecting this forecast:

- **financing from central government.** Our forecasts now reflect departments' detailed spending plans that allocate their Spending Review settlements across responsibilities. This will have included future splits of Dedicated Schools Grant (DSG) funding between local authorities (for schools) and direct payments to academies, which are classified as part of central government. Some uncertainty remains about the pace at which

schools will convert to academies in future years, which could itself be affected by the Government's consultation on future schools systems. This could affect total funding and spending by local authorities, but not LASFE; and

- **100 per cent business rates retention.** The Government intends for local authorities to retain all business rates by the end of the Parliament (up from 50 per cent at present). We described the potential implications in Box 4.3 in our March 2016 *EFO*. Since then, the Government has published a consultation on how this could work and the responsibilities that should be devolved.¹⁷ It responded to the consultation in February 2017.¹⁸ In March 2016, the Government also announced that it proposed to pilot some elements from April 2017. The pilots are limited to local authorities that have agreed devolution deals with the Government.¹⁹ As with full retention of business rates, the effects of these pilots are fiscally neutral.

4.133 Table 4.29 summarises the main changes to our current LASFE forecast. When looking at these changes, it is important to distinguish between those related to council tax and business rates – which will be offset in our receipts forecast and are therefore neutral for borrowing – and those related to the net use of current reserves or change in the amounts set aside to repay debt – which affect our borrowing forecast.

4.134 Our November forecast assumed that local authorities in aggregate would hold their stock of reserves flat across the forecast period, in light of the growing pressures on local authority budgets. The stock of reserves increased significantly between 2010-11 and 2014-15, perhaps in anticipation of future budget pressures. English local authorities drew down £0.4 billion from reserves in 2015-16. We expect them to do so again in 2016-17 by £1.3 billion. This amount is subject to significant uncertainty.

4.135 In subsequent years, budget pressures are mitigated somewhat by the adult social care precept on council tax bills and additional DEL funding for the same purpose announced in the Budget: the Government will provide £2.4 billion of additional funding in total between 2017-18 and 2019-20. We have assumed that this will reduce slightly the extent to which reserves will be used up, but we still expect local authorities to draw down £0.6 billion in 2017-18 and £0.2 billion in 2018-19. We assume that reserves will remain flat thereafter.

4.136 Charts 4.10 and 4.11 present two of the trends that informed our judgement on local authorities' use of reserves. Respectively, they show:

- the **downward trend in local authorities' total spending as a share of GDP.** This includes spending financed by grants from central government as well as locally financed spending. Although some of the reduction is caused by the 'academisation' of schools (since academies are funded by central government), the number of schools converting has itself been on a downward trend since 2011; and

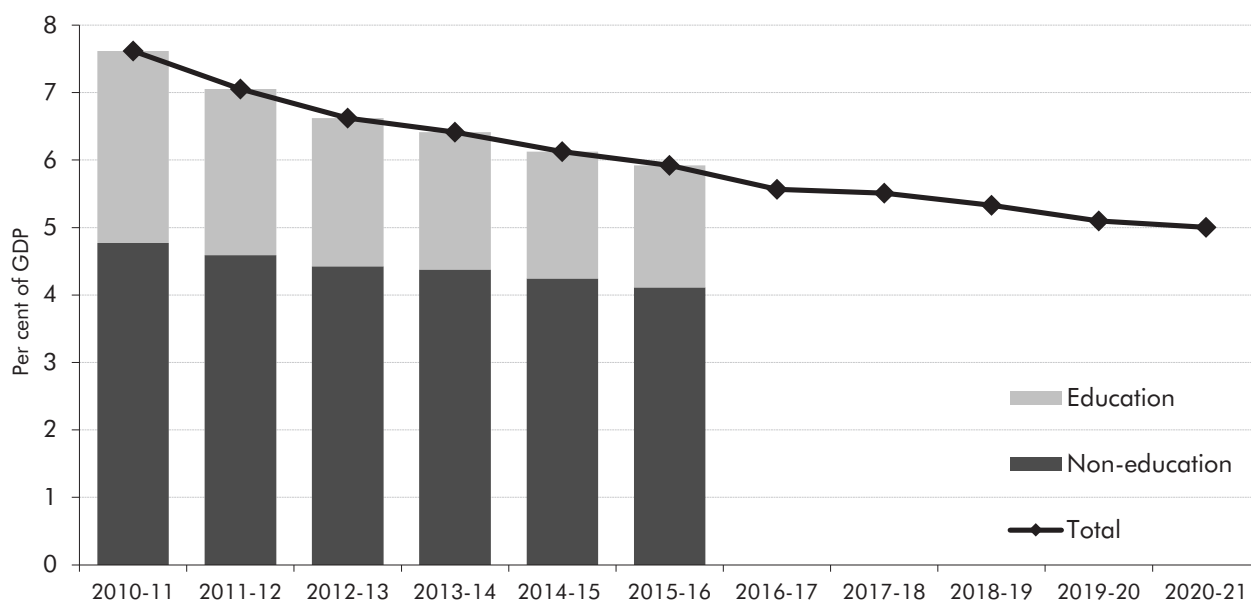
¹⁷ *Self-sufficient local government: 100% Business Rates Retention – Consultation Document*, July 2016.

¹⁸ *Self-sufficient local government: 100% Business Rates Retention – Consultation: Summary of responses and Government response*, February 2017.

¹⁹ The pilot areas are: Cornwall, the Greater London Authority, Liverpool, Manchester, West of England and West Midlands.

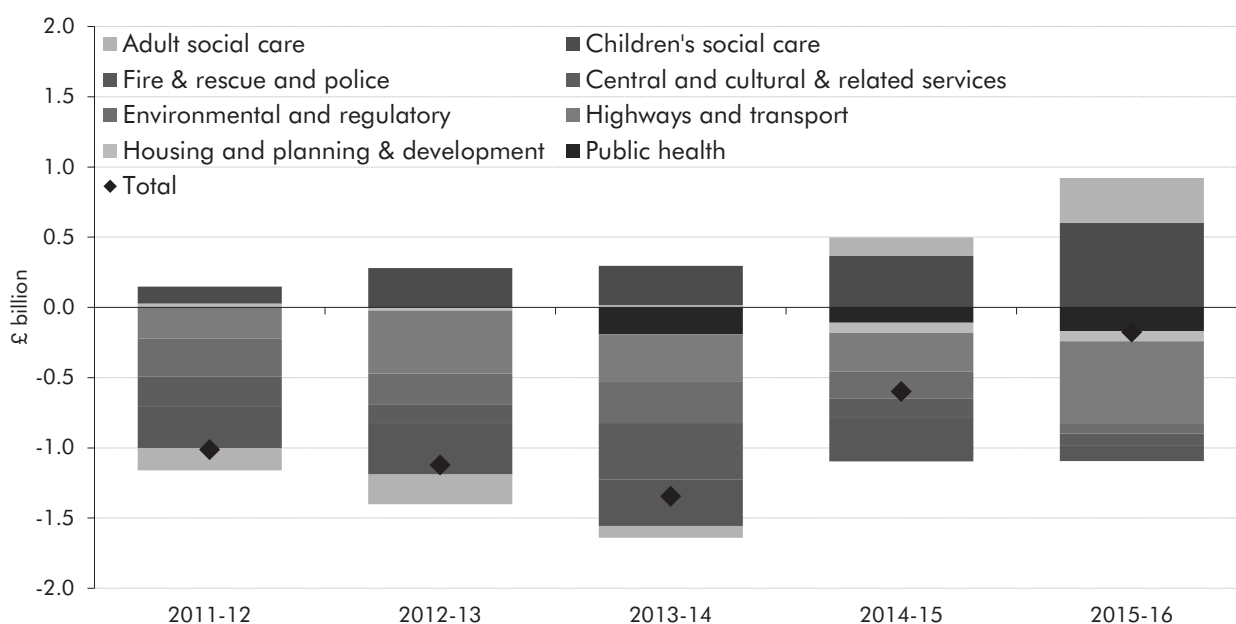
- recent trends in **local authority under- and overspending against specific budget areas**. It is notable that their spending on children’s social services has exceeded budgets since 2010-11, while spending on adult social care has exceeded plans by increasing amounts over the past two years.

Chart 4.10: Local authority net current expenditure (England)



Note: Responsibility for spending on public health was transferred to local authorities from 2013-14, so numbers in previous years are not directly comparable.
Source: DCLG, OBR

Chart 4.11: English local authority under- and overspends against revenue budgets by service area



Note: Excludes spending on education and 'other' spending (which has not been allocated to one of the service areas listed). Housing services covers general fund revenue account (GFRA) spending only. Responsibility for spending on public health was transferred to local authorities from 2013-14, so numbers in previous years are not directly comparable.
Source: DCLG, OBR

- 4.137 We have incorporated the effects of two policy changes announced since our last forecast that the Treasury has chosen not to report on its scorecard: further flexibility over the rates of council tax increase for local authorities eligible to use the adult social care precept and 100 per cent business rates retention pilots. Both are neutral for borrowing.
- 4.138 In November 2015, the Government announced that it would allow local authorities that deliver adult social care to raise council tax by an additional 2 per cent a year for three years from 2017-18 to 2019-20. (This is in addition to a 'core' increase of just under 2 per cent, which is permitted without a referendum.) In December 2016, it announced that local authorities would have further flexibility to decide how the maximum 6 percentage point increase over the three years is delivered.²⁰ Based on the latest available information, we have forecast total average council tax increases for these authorities of 4.3 per cent in both 2017-18 and 2018-19 and 2.7 per cent in 2019-20. (In terms of total 'core' and precept-related increases, this is equivalent to assuming that around 55 per cent of the relevant council tax bills are raised by just under 5 per cent in the first two years and then by just under 2 per cent in the third, 40 per cent by just under 4 per cent in each of the three years and 5 per cent increase by only the 'core' of just under 2 per cent in each year.) Relative to the initial precept policy, the additional flexibility increases council tax income by £0.1 billion in 2017-18 and by £0.2 billion in 2018-19.
- 4.139 The Government has also announced the details of 100 per cent business rates retention pilots, allowing us to include their effects in our forecast for the first time. These pilots only involve retention of business rates to the extent of the agreed reduction in funding from central government. The policy is therefore fiscally neutral by definition, as the local authorities retain an amount raised from business rates that is directly equal to the RDEL and CDEL grants from central government foregone.²¹
- 4.140 The remaining changes to our forecast for current LASFE shown in Table 4.29 include:
- small increases to **council tax**, due to upward revisions to our council tax base forecast;
 - upward revisions to the **locally retained share of business rates**, which reflects similar revisions to the business rates forecast, discussed in the receipts section above; and
 - increases in current income and spending due to downward revisions to our forecast for **capital expenditure from revenue account (CERA)**. As less money is transferred from current to capital spending, this reduces capital spending and increases current spending by an offsetting amount. These changes relate to new information from the latest Transport for London (TfL) business plan and reductions in our forecast for income and spending associated with the community infrastructure levy (CIL), where

²⁰ Authorities can now increase council tax by up to 3 per cent a year in 2017-18 and 2018-19 and increase by up to 2 per cent in 2019-20, while being capped at a maximum total of a 6 percentage point rise over the period 2017-18 to 2019-20. This means local authorities can now, for example, elect to increase council tax by an additional 3 per cent in both 2017-18 and 2018-19, but would then not be able to apply any further increase in 2019-20.

²¹ CDEL grants are used to finance local authority capital spending. As these grants are replaced by business rates income, we assume that an amount of the additional business rates income is transferred from local authorities' revenue accounts to finance capital spending, where the amount transferred is equal to the CDEL grant foregone.

the CIL income is transferred to capital spending via CERA. We have made a number of changes to our forecast for CIL. These have ensured consistency with our economy forecast, while also revising up the amount of time taken for participating local authorities to reach steady-state levels of income and reducing the lag between authorities receiving income and spending it via CERA (from two years to six months).

Table 4.29: Key changes to locally financed expenditure and public corporations' expenditure since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Locally financed current expenditure						
November forecast	42.2	44.3	45.8	47.4	48.7	50.2
March forecast	43.8	46.6	48.7	49.1	50.5	52.0
Change	1.6	2.4	2.9	1.7	1.8	1.7
<i>of which, changes in sources of local finance:</i>						
Forecast changes	1.6	1.1	1.5	1.7	1.8	1.7
Council tax	0.0	0.2	0.3	0.3	0.3	0.3
Retained business rates	0.0	-0.1	0.6	0.6	0.6	0.7
Net use of current reserves	1.3	0.8	0.3	0.0	0.0	0.0
Revenue used to finance capital expenditure (CERA)	0.2	0.2	0.5	0.7	0.8	0.8
Other	0.1	0.0	-0.1	0.0	0.0	-0.1
Effect of Government decisions	0.0	1.3	1.3	0.0	0.0	0.0
Scorecard measures	0.0	-0.1	-0.1	0.0	0.0	0.0
Non-scorecard policy change: business rates pilots	0.0	1.4	1.2	0.0	0.0	0.0
Non-scorecard policy change: council tax precept flexibility	0.0	0.1	0.2	0.0	0.0	0.0
Indirect effects of Government decisions	0.0	-0.1	0.0	0.1	0.1	0.1
Locally financed and public corporations' capital expenditure						
November forecast (restated) ¹	24.7	24.8	23.5	22.9	24.6	25.7
March forecast	24.8	25.7	25.6	24.1	23.6	25.5
Change¹	0.1	0.9	2.1	1.1	-1.0	-0.2
<i>of which:</i>						
Forecast changes	0.1	-0.1	1.0	0.7	-0.6	-0.2
Housing associations' capital spending ¹	-0.4	0.8	1.0	1.0	0.3	0.4
<i>Local authority capital spending financed by:</i>						
Prudential borrowing ²	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3
Capital expenditure financed from revenue (CERA)	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4
Community infrastructure levy (via CERA)	0.1	0.2	-0.1	-0.3	-0.4	-0.4
Other TfL elements of local authority and public corporations' capital spending	0.6	-0.5	0.7	0.5	0.1	0.6
Other	0.2	0.0	0.0	0.0	0.0	0.0
Effect of Government decisions	0.0	1.0	1.1	0.5	-0.5	0.0
Non-scorecard policy change: reprofiling of housing association capital grants	0.0	0.0	0.0	0.5	-0.5	0.0
Non-scorecard policy change: business rates pilots	0.0	1.0	1.1	0.0	0.0	0.0

¹ The November forecast has been restated to include the change in our March forecast for central government capital grants to housing associations. This means that the changes shown since November in this table exclude the change in housing associations' capital spending directly financed by these grants. This presentation excludes offsetting changes to both CDEL and public corporations' capital spending in capital AME. See Table 4.19.

² Prudential borrowing by TfL is included within the numbers shown for other TfL elements of local authority and public corporations' capital spending.

Locally financed and public corporations' capital expenditure

- 4.141 Our latest forecasts for locally financed capital expenditure (capital LASFE) and public corporations' capital spending are shown in Table 4.29 above. These are net of asset sales, forecasts for which are shown in the supplementary tables on our website. Capital LASFE is measured net of capital spending by local authorities' Housing Revenue Accounts (HRAs), and the Transport for London (TfL) subsidiaries that are treated as public corporations in the National Accounts.²² For this forecast we have also netted off the capital grants that local authorities provide to housing associations. All these items are switched out of capital LASFE in AME and included in our forecast for public corporations' capital expenditure to ensure it is consistent with the National Accounts.
- 4.142 We group the changes for LASFE and public corporations' capital spending together, so that any changes to the switches net out and do not obscure the changes that affect TME. The main changes since November include:
- increases in **housing associations' capital spending**, particularly from 2017-18 to 2019-20. These changes are explained in the housing associations section below;
 - downward revisions to **prudential borrowing** that average £0.2 billion a year over the forecast. This largely reflects changes to 2016-17, which has been revised down in line with the results from the latest provisional in-year data for local authority capital spending. Our forecast assumes borrowing in subsequent years is also lower as a result. These figures exclude the changes in our forecast for TfL prudential borrowing, as these are included with the other TfL changes separately in the table;
 - revisions to **CERA** and capital spending financed by the **community infrastructure levy**, as described in the section on locally financed current spending; and
 - increases in our forecast for **other TfL elements of capital LASFE and public corporations' capital spending**. These reflect revised forecasts that we have received from TfL, following publication of its latest business plan in December.²³ They also affect CERA (described above) and National Accounts adjustments in AME (described below). The revisions shown as 'other TfL elements of local authority and public corporations' capital spending' need to be considered alongside the downward revisions to capital spending from CERA and to National Accounts adjustments, which together more than offset these increases. The profile of the revisions is uneven because it includes changes to the timing of capital spending on Crossrail. Our previous forecasts assumed some spending would be pushed back into later years, reflecting expected slippage in the construction project, with unspent funding added to the Crossrail capital reserves. We now assume that more of these reserves will have been released and spent in 2016-17, as Crossrail nears completion, and less will be released and spent in 2017-18.

²² These TfL transport subsidiaries trade under the company name 'Transport Trading Ltd' (TTL). The ONS currently classifies all the TTL subsidiaries as public corporations apart from Crossrail, which is classified as part of the local authority sector.

²³ TfL, *Transport for London Business plan*, December 2016.

Central government debt interest

- 4.143 Central government debt interest payments are forecast by applying appropriate interest rates to the corresponding stocks of conventional and index-linked gilts outstanding at different maturities and other debt, such as NS&I products and Treasury bills. Financial market expectations are used to derive relevant interest rates (for example, coupons on newly issued conventional gilts), while our inflation forecast is used for index-linked gilts and other index-linked debt.²⁴ Flows associated with the Bank of England's Asset Purchase Facility (APF) similarly apply appropriate market-derived interest rates to the stocks of the APF's loan liability and to its gilt, corporate bond and loan assets.
- 4.144 Central government debt interest payments (net of APF) are expected to remain broadly flat as a per cent of GDP over the forecast period as projected increases in interest rates broadly offset the impact of net debt falling as a share of GDP in most years. In 2017-18, the impact of higher RPI inflation on accrued payments on index-linked gilts raises spending on debt interest. Thereafter, higher gilt yields – including real yields on the burgeoning stock of index-linked gilts – drive up central government debt interest payments in cash terms.
- 4.145 Table 4.30 shows that we have revised up debt interest spending in most years of the forecast – for the first time since July 2015. This reflects several factors:
- **gilt yields have risen.** This increases spending by progressively larger amounts over the forecast, contributing about £1.1 billion of the £1.4 billion total increase by 2021-22;
 - **market expectations of Bank Rate have increased.** Higher Bank Rate increases the cost of financing the reserves created to fund the APF's asset purchases. The effect reaches £0.9 billion in 2021-22. MPC guidance is that the stock of gilts in the APF will be kept unchanged until Bank Rate reaches a level from which it can be cut materially, which the MPC currently judges to be around 2 per cent. On the market expectations underpinning our forecast, that is currently beyond our five-year forecast horizon and so our central expectation is for no reductions in the holdings of the APF;
 - **higher RPI inflation** has increased the accrued cost of servicing index-linked gilts, especially in 2017-18 when it adds £2.4 billion on a pre-measures basis. Changes in RPI inflation affect spending associated with index-linked gilts with a lag of three to eight months;
 - a lower **pre-measures financing requirement** reduces debt interest spending by about £0.4 billion in 2021-22; and
 - **Government decisions** increase debt interest spending. This is largely due to the decision to reduce the personal injury discount rate, which is expected to increase insurance premiums and so RPI inflation. The biggest effect of this is to raise debt interest payments on index-linked gilts in 2017-18.

²⁴ Our forecasting approach was explained in Box 4.4 of our March 2015 *EFO*. We publish a supplementary fiscal table on our website that presents the different stocks, flows and effective interest rates that make up our debt interest forecast.

4.146 In this forecast, we have included estimates of the income from the APF's holdings of corporate bonds based on the average of eligible bonds. Net of the cost of financing these assets, this increases APF income by £0.2 billion a year on average. We assume that the MPC guidance for the stock of gilts also applies to the APF's holdings of corporate bonds.

Table 4.30: Key changes to central government debt interest since November

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast (net of APF)	36.3	38.0	39.2	39.3	39.6	42.7
March forecast (net of APF)	36.0	41.5	39.1	40.1	40.9	44.0
Change	-0.3	3.5	-0.2	0.9	1.3	1.2
November forecast (gross of APF)	49.3	52.2	52.6	51.7	51.0	53.0
March forecast (gross of APF)	49.1	55.8	52.3	52.2	51.9	53.7
Change	-0.2	3.5	-0.3	0.5	0.9	0.7
<i>of which:</i>						
Interest rates	0.1	0.5	0.6	1.0	1.3	1.4
Inflation	0.0	2.4	-0.8	0.0	-0.1	-0.4
Financing	0.0	-0.1	-0.3	-0.3	-0.4	-0.4
Other forecast changes (including outturn)	-0.2	0.0	-0.1	-0.1	0.0	0.0
Effect of Government decisions	0.0	0.9	0.2	0.0	0.1	0.1
Changes from the Asset Purchase Facility						
November forecast	-13.0	-14.3	-13.4	-12.4	-11.3	-10.3
March forecast	-13.1	-14.3	-13.2	-12.0	-10.9	-9.7
Change	-0.1	0.0	0.1	0.4	0.4	0.5
<i>of which:</i>						
Interest rates	0.1	0.2	0.4	0.6	0.8	0.9
Other	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4

Other AME spending

- 4.147 Spending on **company tax credits** has been revised up by an average of £0.2 billion a year over the forecast. This relates to spending on research and development tax credits.
- 4.148 Our forecast of **BBC licence fee income** is unchanged. Consistent with previous forecasts, these projections assume that the licence fee rises in line with our forecast for CPI inflation from 2017-18 onwards. The Government did not inform us of the agreed fee increase to £147.00 for 2017-18 in time for us to include the effect in this forecast. This is lower than the £149.50 implied by our CPI inflation forecast. Including the new fee would have reduced our licence fee receipts forecast by less than £0.1 billion a year, which would have led us to reduce our spending forecast by an equivalent amount (as licence fee changes are neutral for borrowing in our forecast). Our **BBC current spending forecast** is little changed overall, although spending has been reprofiled over the period based on the latest assumptions regarding when efficiency savings will materialise.
- 4.149 Our forecast for **Network Rail current spending** is up slightly on November. This mostly reflects working capital movements, including a lower forecast for Network Rail debt interest payments to central government, which frees up funds for spending on other current

spending items that affect National Accounts spending totals. (Transfers between public sector bodies do not affect borrowing, so do not score in the National Accounts.) **Network Rail capital spending** is also little changed in total over the forecast. Some of the debt interest saving is recycled into more capital spending, while changes in 2017-18 and 2018-19 largely reflect an updated profile of asset sales and capital spending plans.

- 4.150 Taken together, our forecasts for **other PSCE in departmental AME** and **other PSGI in departmental AME** have been revised up by small amounts since November, with changes averaging £0.1 billion a year. A number of small factors have affected both forecasts. More detail can be found in the supplementary spending tables on our website.
- 4.151 Our forecast for **general government depreciation** has been revised down by progressively larger amounts over the forecast, and by an average of £1.0 billion a year. Our November forecast contained much too large a step up between the final quarter of outturn and the first quarter of forecast. Smoothing this transition from outturn to forecast has lowered the starting point from which the forecast grows. General government depreciation affects the current budget but is neutral for borrowing.
- 4.152 **VAT refunds** expenditure is neutral for borrowing, as it is offset in receipts. Downward revisions to the forecast reflect changes to overall central and local government spending.
- 4.153 **Environmental levies** include levy-funded spending policies such as the renewables obligation (RO), contracts for difference (CfD), feed-in tariffs (FITs), the capacity market scheme and the warm home discount. Most are neutral for borrowing as they are directly offset by measured receipts. These forecasts and the revisions since November are explained in the receipts section.
- 4.154 The AME forecast includes **other National Accounts adjustments**, which are included in the definitions for PSCE and PSGI. Table 4.17 shows that we have reduced our forecast for these adjustments in respect of PSCE by about £1 billion a year. This reflects two main changes to adjustments in local authority spending. First, following the ONS's decision to reclassify Rail for London as a public corporation (previously classified to the local authority sector), we have anticipated its implementation in the public finances data by removing an accounting adjustment in local authority current spending. This reduces spending by £0.6 billion a year. Second, we have reflected ONS revisions to the latest outturn adjustment for the local authority imputed subsidy for equity injection into the Housing Revenue Account. This reduces our forecast of local authority current spending by an average of £0.5 billion a year. This adjustment is offset in public corporations' gross operating surplus in current receipts, so is neutral for borrowing.
- 4.155 On the capital side, we have reduced our forecast for the adjustments that affect PSGI by £1.0 billion a year on average. This also reflects two main changes in local authority spending. First, we have updated our forecast for financial transactions that are included within local authority capital spending, and which we remove as an accounting adjustment. The revisions mainly reflect revised TfL inputs to our forecast. Second, we have revised down

our forecasts for the adjustment that includes local authorities' VAT refunds on capital spending. This adjustment is offset in current receipts, so is neutral for borrowing.

4.156 Further details of our forecasts for all our National Accounts adjustments are included in the supplementary spending tables on our website. Explanations and the background to National Accounts adjustments are given in Annex D to PESA 2016.²⁵

Housing associations

4.157 Since our November forecast the Homes and Communities Agency has released 2015-16 Global Accounts data for English housing associations and the ONS has incorporated housing associations in Scotland, Wales and Northern Ireland into the public finances. (We anticipated the latter in our November forecast, but simply by grossing up our England forecast.) These have resulted in significant revisions to outturn data for 2015-16 (which were previously based on our forecast):

- both **capital spending and associated capital grants from government** were considerably lower than we had assumed. Capital spending was £2.7 billion lower and grants received £0.2 billion lower, while other elements were much closer to our assumptions. As a result, English housing associations' net borrowing in 2015-16 was £2.8 billion lower than we expected;
- the **Global Accounts have moved onto an IFRS accounting basis**, so the ONS has had to map these onto the National Accounts measures required for PSNB; and
- the production of **outturn data for housing associations in Scotland, Wales and Northern Ireland** shows that, compared to their English counterparts, they are more reliant on grant funding than external borrowing to finance capital spending. In the five years to 2015-16, capital grants were on average equal to 34 per cent of housing associations' capital spending outside England but only 14 per cent in England. This has generated differences relative to our simple grossed up November forecast.

4.158 We had assumed that all capital grants disbursed by central government would be received by housing associations in the same financial year, leading to increased borrowing and capital spending in that year. In 2015-16 this was not the case, as grants routed via the Greater London Authority were not fully passed on. We expect that to be repeated in 2016-17. These changes reduce housing associations' capital spending and borrowing in our model, reducing housing associations' own net borrowing by £0.3 billion and total PSNB (including lower grant expenditure) by £0.6 billion in 2016-17. We have assumed that this is a timing effect that will be reversed in the following three years, so that total grants from 2015-16 to the end of the forecast are unchanged. These changes increase housing associations' borrowing by £0.4 billion a year and total PSNB by £0.7 billion.

²⁵ See HM Treasury, *Public expenditure statistical analyses 2016*, July 2016

- 4.159 With the outturn data and estimates of grants for future years we can now forecast housing associations outside England using a similar model to our English one, replacing the simple grossing up used in November. The change to housing associations' own borrowing from the new model is small. However, the outturn data show that housing associations outside England are more reliant on grants than we assumed – by about £0.3 to £0.4 billion annually. This adds to the total impact on PSNB, but an offsetting reduction in devolved administrations' grant spending makes the grant element of this change PSNB neutral.
- 4.160 The Government has revised the profile of grants to housing associations via the Affordable Homes Programme. This moves £200 million of grants from 2020-21 to 2019-20, which, after taking into account housing associations leveraging this funding, raises PSNB in 2019-20 by £0.5 billion and lowers it in 2020-21 by a similar amount.

Table 4.31: Housing associations

	£ billion						
	Outturn 2015-16	Forecast					
		2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Gross operating surplus	7.6	7.4	7.2	7.1	6.9	7.4	7.9
Interest and dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Interest payments	3.4	3.5	3.6	3.7	3.8	3.9	3.9
Gross fixed capital formation	6.4	8.4	9.7	10.3	9.6	9.8	11.1
Capital grants (net) within public sector	-0.8	-1.0	-2.0	-2.4	-2.4	-2.2	-2.5
Debt write offs	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Housing association net borrowing	1.2	3.3	3.9	4.3	3.9	3.9	4.5
Total PSNB impact¹	2.0	4.3	5.9	6.7	6.3	6.1	7.0
of which:							
England	1.7	3.4	5.0	5.8	5.4	5.1	6.0
Scotland, Wales and Northern Ireland	0.3	0.9	0.9	0.9	0.9	1.0	1.0
Housing association net debt	66.7	69.8	73.6	77.8	81.6	85.4	89.8

¹ Total impact is equal to housing association net borrowing minus capital grants within public sector.

Table 4.32: Key changes to housing associations since November

	£ billion						
	Outturn 2015-16	Forecast					
		2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Gross operating surplus	0.1	0.0	-0.1	0.0	0.0	0.1	0.1
Interest and dividends	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest payments	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Gross fixed capital formation	-2.7	0.0	1.2	1.4	1.9	0.2	0.8
Capital grants (net) within public sector	0.2	0.0	-0.7	-0.6	-0.9	-0.1	-0.3
Debt write offs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Housing association net borrowing	-2.8	-0.2	0.3	0.6	0.9	-0.1	0.3
Total PSNB impact¹	-3.0	-0.2	1.0	1.2	1.8	0.1	0.6
of which:							
England	-2.7	-0.6	0.6	0.8	0.8	0.2	0.3
Scotland, Wales and Northern Ireland	-0.3	0.4	0.5	0.4	0.5	0.3	0.3
Reprofiling of capital grants	0.0	0.0	0.0	0.0	0.5	-0.5	0.0
Housing association net debt	0.2	1.9	2.2	3.1	3.2	3.9	4.3

¹ Total impact is equal to housing association net borrowing minus capital grants within public sector.

Loans and other financial transactions

- 4.161 Public sector net borrowing (PSNB) is the difference between total public sector receipts and expenditure each year, measured on an accrued basis. But the public sector's fiscal position also depends on the flow of financial transactions, such as loans and repayments between government and the private sector, and the sale of financial assets to the private sector. These do not directly affect PSNB, but they do lead to changes in the Government's cash flow position and stock of debt.
- 4.162 The public sector net cash requirement (PSNCR) is the widest measure of the public sector's cash flow position in each year.²⁶ It drives our forecast of public sector net debt (PSND), which is largely a cash measure. Estimating the PSNCR also allows us to estimate the central government net cash requirement (CGNCR), which in turn largely determines the Government's financing requirement – the amount it needs to raise from instruments including treasury bills, gilt issues and NS&I products.
- 4.163 Differences between the PSNCR and PSNB can be split into the following categories:
- **loans and repayments:** loans that the public sector makes to the private sector do not directly affect PSNB, but the cash flows affect the PSNCR;
 - **transactions in other financial assets:** the public sector may acquire or sell financial assets such as loans, equity or corporate bonds. When it sells an asset for cash, the initial transaction does not affect PSNB, whereas the cash received will reduce the PSNCR. But both PSNB and the PSNCR will be higher in future years if the government foregoes an income stream that flowed from the asset sold;
 - **monetary policy operations:** in August 2016, the Bank of England announced a package of measures to support the economy that will affect the PSNCR;
 - **UK Asset Resolution:** we separately identify transactions relating to UKAR holdings, including asset sales and the natural rundown of loan books that the Government acquired during the late 2000s financial crisis;
 - **accruals adjustments:** PSNB is an accruals measure of borrowing in which, where possible, spending and receipts are attributed to the year of the activity to which they relate. In contrast, PSNCR is a cash measure in which spending and receipts are attributed to the year in which the cash flow takes place. These timing differences need to be adjusted for; and
 - an **alignment adjustment** between PSNB and PSNCR accounts for other factors that are expected to persist.

²⁶ Consistent with the measures of debt and deficit used in this forecast, PSNCR excludes the public sector banks.

Table 4.33: Reconciliation of PSNB and PSNCR

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net borrowing	51.7	58.3	40.8	21.4	20.6	16.8
Loans and repayments	19.6	21.1	21.7	21.7	21.9	23.8
<i>of which:</i>						
Student loans ^{1,2}	12.6	14.5	16.1	17.4	18.2	18.7
DFID ³	0.5	1.2	0.8	1.0	1.2	-
Green Investment Bank	1.0	0.2	0.2	0.1	0.0	-
Business Bank/Partnership	0.3	0.2	-0.1	0.2	-0.2	-
Help to Buy	2.3	1.7	1.7	1.8	1.8	-
UK Export Finance	0.3	0.5	0.4	0.7	0.7	-
Ireland	0.0	0.0	0.0	-1.6	-1.6	-
Other lending ⁴	2.6	3.1	2.9	2.6	2.3	5.4
Allowance for shortfall	-0.1	-0.4	-0.4	-0.6	-0.6	-0.4
Transactions in financial assets	-3.5	-6.4	-2.5	-2.4	-2.4	0.0
<i>of which:</i>						
Student loan book	0.0	-4.7	-2.4	-2.4	-2.4	0.0
Lloyds Banking Group share sales	-2.8	-1.4	0.0	0.0	0.0	0.0
RBS share sales	0.0	0.0	0.0	0.0	0.0	0.0
Other	-0.7	-0.3	-0.1	-0.1	-0.1	0.0
Bank of England schemes	57.5	42.5	0.0	0.0	-50.0	-40.0
UKAR asset sales and rundown	-4.9	-18.6	-5.2	-0.7	-0.7	-0.7
Accruals adjustments	12.2	-0.4	-1.5	-6.7	2.9	-2.4
<i>of which:</i>						
Student loan interest ^{1,2}	2.0	3.0	4.5	5.5	6.2	7.1
PAYE income tax and NICs	0.8	1.7	0.7	1.4	1.3	1.5
Indirect taxes	0.0	0.7	1.0	0.8	0.7	0.6
Corporation tax and bank surcharge	4.7	0.5	1.8	-5.8	-4.6	1.3
Other receipts	3.1	3.0	3.1	3.4	2.9	3.2
Index-linked gilts ⁵	0.2	-13.3	-14.9	-14.1	-6.0	-18.3
All gilts	3.9	5.3	4.6	4.7	5.0	4.6
Network Rail	0.0	1.4	0.5	0.5	0.7	0.9
Other expenditure	-2.7	-2.8	-2.9	-3.0	-3.1	-3.3
Other factors	-0.6	-0.8	-0.8	-0.8	-0.8	-0.8
<i>of which:</i>						
Alignment adjustment	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Public sector net cash requirement	132.1	95.5	52.6	32.4	-8.6	-3.3

¹ The table shows the net flow of student loans and repayments. This can be split out as follows:

Cash spending on new loans	15.1	16.9	18.6	20.2	21.4	22.3
Cash repayments	2.5	2.4	2.5	2.8	3.2	3.5

² Cash payments of interest on student loans are included within 'Loans and repayments' as we cannot easily separate them from repayments of principal. To prevent double counting the 'Student loan interest' timing effect therefore simply removes accrued interest.

³ DFID figures include loan disbursements, loan repayments and equity investments.

⁴ Other lending in 2021-22 includes an estimate of aggregate lending by a range of government schemes.

⁵ This reconciliation to the net cash requirement does not affect public sector net debt.

Table 4.34: Changes in the reconciliation of PSNB and PSNCR

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net borrowing	-16.4	-0.7	-5.7	-0.6	-0.2	-0.4
Loans and repayments	1.3	0.2	-0.3	-0.5	-1.0	-1.1
<i>of which:</i>						
Student loans ^{1,2}	0.1	0.0	-0.3	-0.6	-0.8	-1.0
DFID ³	0.0	0.0	0.0	0.0	0.0	-
Green Investment Bank	0.6	0.0	0.0	0.0	0.0	-
Business Bank/Partnership	0.0	0.1	0.0	0.0	0.1	-
Help to Buy	0.5	0.0	0.0	0.0	0.0	-
UK Export Finance	0.0	-0.1	-0.2	0.1	0.1	-
Ireland	0.0	0.0	0.0	0.0	0.0	-
Other lending ⁴	0.1	0.1	0.1	0.0	-0.3	-0.3
Allowance for shortfall	-0.1	0.2	0.2	-0.1	-0.1	0.2
Transactions in financial assets	-2.2	1.1	0.0	0.0	0.0	0.0
<i>of which:</i>						
Student loan book	0.0	0.0	0.0	0.0	0.0	0.0
Lloyds Banking Group share sales	-1.8	1.1	0.0	0.0	0.0	0.0
RBS share sales	0.0	0.0	0.0	0.0	0.0	0.0
Other	-0.4	0.0	0.0	0.0	0.0	0.0
Bank of England schemes	21.1	-16.1	0.0	0.0	-16.9	11.9
UKAR asset sales and rundown	0.0	0.0	0.0	0.0	0.0	0.1
Accruals adjustments	4.4	-2.2	2.4	0.2	-1.8	1.1
<i>of which:</i>						
Student loan interest ^{1,2}	0.0	0.0	0.2	0.1	-0.1	-0.1
PAYE income tax and NICs	0.2	0.0	0.0	-0.1	-0.4	-0.2
Indirect taxes	-0.7	0.3	0.3	0.2	0.2	0.2
Corporation tax and bank surcharge	4.7	0.5	1.8	0.1	-1.1	1.3
Other receipts	0.0	0.1	-0.1	0.0	-0.3	0.0
Index-linked gilts ⁵	0.8	-3.1	0.6	0.1	0.1	0.2
All gilts	-0.1	-0.2	-0.3	-0.3	-0.2	-0.2
Network Rail	-0.4	0.3	0.0	0.2	0.2	0.2
Other expenditure	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other factors	0.0	0.0	0.0	0.0	0.0	0.0
<i>of which:</i>						
Alignment adjustment	0.0	0.0	0.0	0.0	0.0	0.0
Public sector net cash requirement	8.2	-17.8	-3.7	-0.9	-19.9	11.6

¹ The table shows the net flow of student loans and repayments. This can be split out as follows:

Cash spending on new loans	-0.1	-0.2	-0.4	-0.6	-0.8	-0.9
Cash repayments	-0.1	-0.1	-0.1	-0.1	0.0	0.0

² Cash payments of interest on student loans are included within 'Loans and repayments' as we cannot easily separate them from repayments of principal. To prevent double counting the 'Student loan interest' timing effect therefore simply removes accrued interest.

³ DFID figures include loan disbursements, loan repayments and equity investments.

⁴ Other lending in 2021-22 includes an estimate of aggregate lending by a range of government schemes.

⁵ This reconciliation to the net cash requirement does not affect public sector net debt.

Loans and repayments

Student loans

- 4.164 Net lending by the public sector to the private sector, in particular for student loans, raises the net cash requirement relative to net borrowing in each year of our forecast. Student loan reforms over recent years have increased the size of the loans, with future repayments being made over a longer period. In our 2017 *Fiscal sustainability report (FSR)*, on the prevailing policy settings, we estimated that student loans would increase PSND by 11.1 per cent of GDP in the late-2030s before falling to 9.3 per cent of GDP by 2066-67.
- 4.165 The Government has confirmed that existing EU students and those starting courses in 2016-17 and 2017-18 will continue to be eligible for student loans and home fee status for the duration of their courses.²⁷ It has also confirmed that research councils will continue to fund postgraduate students from the EU whose courses start in 2017-18. We have not made any assumptions about changes in Government policy on eligibility or funding in 2018-19 or subsequent years.
- 4.166 Relative to November, we have revised down our forecast of student numbers in England.²⁸ The latest UCAS entrant data suggest 5,000 fewer students in 2016-17 than we expected. The number of applications in 2017-18 is also lower than we assumed in November (due to fewer applications from EU-domiciled and mature students). But we have assumed that a higher proportion of those applicants will be accepted as higher education institutions seek to fill the places they have available. Similar assumptions have been applied in subsequent years. Taken together, these changes reduce our student numbers forecast by 14,000 in 2021-22 relative to November. There is significant uncertainty around our medium-term forecast as the UK exits the EU.
- 4.167 Our forecast for student loan repayments is little changed since November. It includes an adjustment to the model output that ensures our repayments forecast aligns to the latest HMRC real-time information on repayments so far in 2016-17 (which is slightly lower than the model predicts). That adjustment is tapered away over the forecast period so that in 2021-22 the level of repayments is as predicted by the DfE model (which is better suited to longer-term projections).
- 4.168 The Government has announced the establishment of maintenance loans for students aged 19 and over that undertake technical qualifications at levels 4 to 6 at eligible UK institutions from academic year 2019-20. We assume that students who would not have studied without a maintenance loan will also take out the existing 'advanced learner loan' to cover tuition fees. This is expected to increase outlays by £70 million by 2021-22, but to have no effect on repayments within the forecast horizon. The Government has also confirmed the final terms of a new doctoral income contingent loan system, starting from academic year 2018-19. This was originally announced in the March 2015 Budget. Our forecast also takes

²⁷ *The United Kingdom's exit from and new partnership with the European Union White Paper*, February 2017.

²⁸ Our student numbers forecast covers full-time UK- and EU-domiciled undergraduate entrants to English higher education institutions and further education colleges. Details of our student numbers forecast are available in a supplementary fiscal table on our website.

account of changes to the part-time maintenance loans announced at Autumn Statement 2015, which together reduce outlays by £0.4 billion cumulatively by 2021-22.

Other lending

- 4.169 Other lending covers a range of Government schemes. We produce this forecast using information from the Treasury on planned lending by each institution or scheme, to which we apply a top-down adjustment for expected under-lending relative to those plans (or over-lending if thought appropriate). Relative to our November forecast, planned lending in 2016-17 is little changed (Table 4.34). One exception is lending under Help to Buy, which has been revised up by £0.5 billion, continuing the pattern of recent forecast revisions. Lending by the Green Investment Bank has also been revised up significantly since November as a result of the purchase of a stake in the Lincolnshire offshore wind farm.
- 4.170 We have made small adjustments to the top-down underlending assumptions that we apply, in particular lowering them in 2017-18 and 2018-19 (in light of expected continued strength in Help to Buy lending).

Transactions in other financial assets

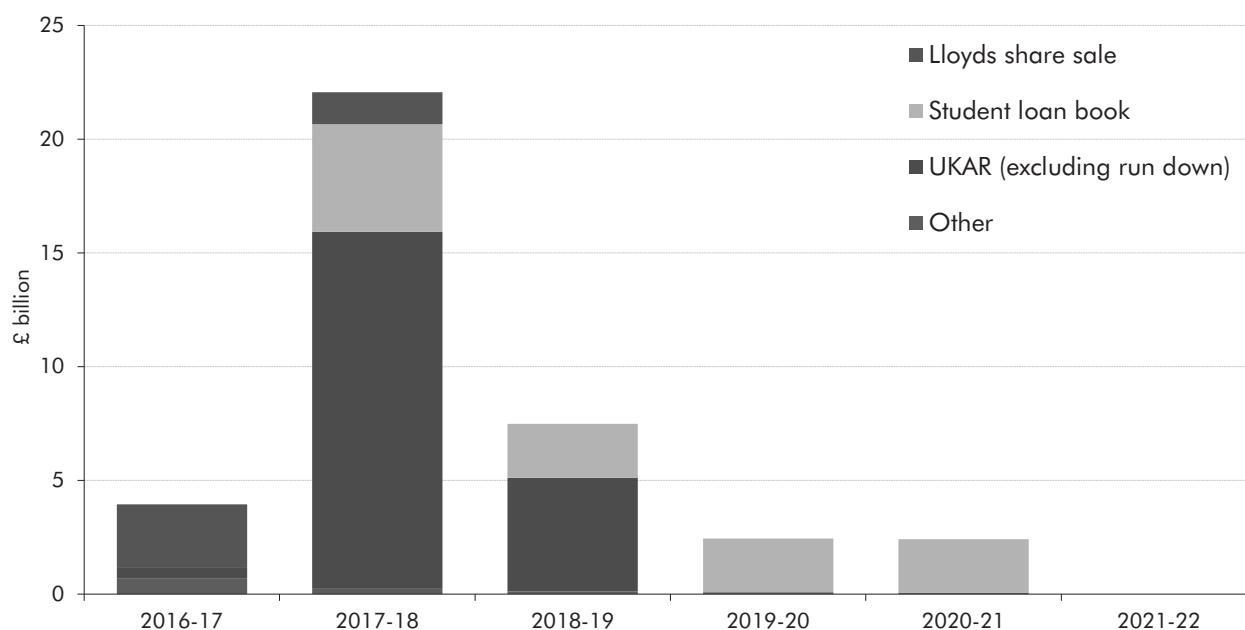
- 4.171 We only include financial asset sales and purchases in our forecasts when firm details are available that allow the effects to be quantified with reasonable accuracy and allocated to a specific year. There are a number of asset sales that currently meet these criteria. Chart 4.12 shows our latest forecast of major asset sales.
- 4.172 In November, we removed any further sales of RBS shares from our forecast in light of the Government's decision that legacy issues at RBS would need to be resolved before further sales could take place. The Treasury has recently proposed to the European Commission an alternative approach to resolve RBS's remaining state aid divestment obligations, which if approved would render the sale of Williams & Glyn no longer necessary. The Commission will consider this proposal in due course. On this basis, we have again assumed no further RBS share sales take place over the forecast period.
- 4.173 The Government is in the process of selling the Green Investment Bank. No deal has been announced and a judicial review challenging the UK Government's decision on the preferred bidder has been launched by a rival bidder. We do not therefore have sufficient certainty over either the size or timing of any sale to include it in our forecast.
- 4.174 Our latest forecast and changes since November reflect several factors:
- sales of the Government's remaining stake in **Lloyds Banking Group** have been revised up by £0.7 billion as the Lloyds share price has risen (averaging just over 66 pence a share in the 10 days to 16 February). As sales have progressed faster than we expected in November, we have increased expected proceeds in 2016-17 to £2.8 billion with the remaining £1.4 billion expected to be sold in 2017-18;

- the Government has informed us that **UK Asset Resolution (UKAR)** has made progress with the programme of sales of mortgage assets it holds from Bradford & Bingley (B&B) that was announced in November. It has also confirmed that the sales are expected to raise sufficient proceeds for B&B to repay the £15.7 billion debt to the Financial Services Compensation Scheme (FSCS), which, in turn, would repay the corresponding loan it received from the Treasury in 2008. We expect the proceeds of these sales to be received in 2017-18. The Government has also confirmed that UKAR will look to make further sales over the course of the Parliament, and which we continue to expect to deliver £5 billion of proceeds (detailed in paragraph 4.179);
- we continue to expect the Government to raise around £12 billion from selling part of the pre-2012 **student loan book**. The first tranche of these sales has been pushed back on several occasions, but the process has now formally started. It remains subject to market conditions and a final value-for-money assessment.²⁹ The sale process is expected to take several months. As in November, we have assumed that the first sale will be completed in early 2017-18 and that a second sale will be completed by the end of 2017-18. Uncertainty over these timings and the rest of the sale programme remains. We have assumed that the sales will be treated in the National Accounts as having transferred the assets to the private sector. The ONS will make a final classification decision after the actual sale and could conclude that there has been insufficient risk transfer to qualify the sale as transferring control from the perspective of the National Accounts; and
- we have included the proceeds from a number of **smaller asset sales**, including £0.3 billion in 2016-17 for the sale of Bio Products Laboratory Ltd and, following completion of the consultation on aspects of the forthcoming auction of 2.3 and 3.4 GHz spectrum, £0.1 billion in 2017-18 from this source.

4.175 We expect financial asset sales to total £3.9 billion in 2016-17, including £0.5 billion received at the start of the year in respect of UKAR assets and the £2.8 billion from Lloyds share sales. A further £34.4 billion is expected over the remainder of the forecast, with the majority coming in 2017-18. Over the full forecast period, proceeds from financial asset sales have been revised up £1.2 billion relative to our November forecast.

²⁹ Government Assets Sale, 6 February 2016, Written Ministerial Statement.

Chart 4.12: Proceeds from asset sales



Source: HM Treasury, OBR

Monetary policy interventions

4.176 Since March 2009, the Monetary Policy Committee (MPC) has deployed unconventional forms of monetary policy to support the economy. The purchase of gilts by the Asset Purchase Facility (APF) affects public sector net debt, but does not affect the flow measures of borrowing or the cash requirement. The interest payments and receipts associated with those gilts does affect borrowing.

4.177 In August 2016, the MPC announced a package of measures that included further gilt purchases and two new measures implemented through the APF: the 'Term Funding Scheme' (TFS) and the 'Corporate Bond Purchase Scheme' (CBPS). The TFS provides funding expected to be up to £100 billion at Bank Rate plus scheme fees to UK banks and building societies choosing to participate. It is demand-led, with an initial drawdown period of 18 months (until the end of February 2018). The CBPS will buy up to £10 billion of sterling non-financial investment-grade corporate bonds issued by firms making a material contribution to the UK economy. These two schemes will increase the public sector net cash requirement, as well as net debt. Since November, we have revised our assumptions on the direct fiscal impact of these schemes in the light of the latest data on usage:

- we have revised up the level and pace at which the **TFS** will extend loans to commercial banks, given greater-than-expected usage to date. We now assume that it will reach £90 billion by 2017-18 – up from the £85 billion we assumed in November. This remains within the range between the £70 billion maximum size reached under the Bank's previous Funding for Lending Scheme and the £100 billion maximum authorised that we used to inform our November forecast. We now expect usage to reach £50 billion by the end of 2016-17 (up £17 billion from our November

assumption). TFS participants can borrow for up to four years and, given the low rate of interest charged, we assume that all loans are paid back the full four years after issuance, reducing the net cash requirement in 2020-21 and 2021-22. The MPC will confirm by August 2017 whether the drawdown period will close in February 2018 or will be extended; and

- we have increased our 2016-17 forecast for total purchase by the **CBPS** in light of faster purchases to date. We now expect purchases to reach £7.5 billion by the end of 2016-17, so that only £2.5 billion of purchases can take place in 2017-18. We have assumed that any redemption proceeds during the period will be reinvested, in line with the MPC's guidance in relation to gilts held in the APF, so there is no period where the CBPS is assumed to reduce the net cash requirement.

UK Asset Resolution (UKAR) asset sales and rundown

- 4.178 The rundown of UKAR's Bradford & Bingley and NRAM plc (B&B and NRAM) loan books directly reduces the net cash requirement. In the meantime, the loans generate net interest that reduces net borrowing. As well as running down as mortgages are repaid, our November forecast reflected UKAR's decision to begin a major sale programme of B&B mortgages. We continue to expect it to be completed during 2017-18. As in November, we also expect it to raise sufficient proceeds for B&B to repay its £15.7 billion liability to the FSCS, and for the FSCS to repay its corresponding loan from the Treasury.
- 4.179 As in November, we expect that UKAR will make further sales over the course of the Parliament expected to total £5 billion. Given UKAR's track record, we have included that amount in our forecast and we expect the proceeds to be received in 2018-19.
- 4.180 As with any major asset sales, UKAR's sales are subject to uncertainty. We have assumed that there will be sufficient private-sector demand for the sales to take place and at a sufficiently attractive price for the transaction to go ahead. There will be effects from foregone mortgage repayments associated with the sale. These reduce interest receipts (affecting both PSNB and PSND) and principal repayments (affecting only PSND).

Accruals adjustments

- 4.181 To move from PSNB to PSNCR, it is necessary to adjust for the expected impact of timing differences between cash flows and accruals. For example, as taxes are generally paid in arrears, if receipts are forecast to rise over time, the cash received each year will generally be lower than the accrued receipts.
- 4.182 A large component of the receipts timing adjustment relates to interest on student loans. This is included in the accrued measure of public sector current receipts as soon as the loan is issued, but cash repayments are not received until the point at which former students earn sufficient income. This part of the forecast is little changed from November. Our forecast includes student interest payments related to all countries of the UK.

- 4.183 A new receipts accruals adjustment relates to corporation tax, bank surcharge and bank levy receipts. As described earlier in this chapter, we have moved our receipts forecast onto a time-shifted accruals basis consistent with the new treatment in the public finances data. As the cash receipts will still be paid with varying lags, we need to apply accruals adjustments to capture the different effects of these receipts on PSNB and PSNCR.
- 4.184 Similar timing adjustments are made for expenditure. The largest is for the timing of payments on index-linked gilts. This is very sensitive to RPI inflation, as well as to the uneven profile of redemptions from year to year. Positive RPI inflation raises the amount the government will have to pay on index-linked gilts when they are redeemed. This commitment is recognised in PSNB as debt interest payments each year, but the actual cash payments do not occur until redemption, which may be many years in the future. Since November, the upward revision to RPI inflation in 2017-18 has increased accrued debt interest in this year with a largely offsetting change in the accrual adjustment.

Alignment adjustment

- 4.185 Cash flows are usually more volatile than the underlying accrued position of the public finances, and reconciling borrowing and estimating the net cash requirement often proves difficult. The net cash requirement has come in lower than the bottom-up receipts, expenditure and financial transactions forecasts we use to project it would suggest.³⁰ We include a £1.1 billion a year 'alignment adjustment' for factors that we expect to persist.

Central government net cash requirement

- 4.186 The central government net cash requirement (CGNCR) is the main determinant of government's net financing requirement. Table 4.35 reconciles CGNCR with PSNCR and Table 4.36 sets out the changes in this reconciliation since November. The CGNCR is derived by adding or removing transactions associated with local authorities and public corporations to the PSNCR. Relative to November, the biggest change in this reconciliation relates to our revised assumptions regarding the Bank of England's August monetary policy operations, which affect the public corporations sector's net cash requirement at the start and end of the forecast period. The CGNCR has been revised down by £13 billion in 2016-17. This is less than the revision to PSNB mainly as a result of CT accruals adjustments.
- 4.187 The classification of B&B and NRAM plc and Network Rail in the central government sector means that the CGNCR is no longer simply a measure of the cash required by the Exchequer to fund its operations, which forms the basis for the Government's net financing requirement.³¹ This has three effects:
- the **banks' own cash requirements are included in the headline CGNCR**. Running down the banks' loan books (including through asset sales) reduces the CGNCR by

³⁰ See Box 4.3 of our July 2015 EFO for a discussion of a number of changes we had made to our forecast as we explored the reasons for this discrepancy.

³¹ The Government is publishing a revised financing remit for 2016-17 and 2017-18 alongside the Budget. The OBR provides the Government with the forecast of the CGNCR for this purpose, but plays no further role in the derivation of the net financing requirement.

£18.6 billion in 2017-18, falling to around £1 billion by 2021-22, but this does not directly affect the Exchequer (this forecast is shown in Table 4.33);

- **interactions between the Exchequer and these bodies net off** within the headline measure. The B&B and NRAM adjustment shows the difference between net cash received by UKAR and that transferred to central government; and
- the Treasury now finances **Network Rail's** new and maturing debt for a fee. Refinancing needs are projected at £2.4 billion in 2016-17, but decline over time.

Table 4.35: Reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net cash requirement (NCR)	132	96	53	32	-9	-3
<i>of which:</i>						
Local authorities and public corporations NCR	64	49	6	3	-46	-40
Central government (CG) NCR own account	68	46	46	29	38	37
CGNCR own account	68	46	46	29	38	37
Net lending within the public sector	1	1	1	1	1	1
CG net cash requirement	69	47	47	30	38	38
B&B and NRAM adjustment	2	-1	2	0	0	0
Network Rail adjustment	2	1	1	-1	0	-1
CGNCR ex. B&B, NRAM and Network Rail	73	47	50	29	39	37

Table 4.36: Changes in the reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net cash requirement (NCR)	8	-18	-4	-1	-20	12
<i>of which:</i>						
Local authorities and public corporations NCR	21	-17	0	0	-17	13
Central government (CG) NCR own account	-13	-1	-4	-1	-3	-1
CGNCR own account	-13	-1	-4	-1	-3	-1
Net lending within the public sector	0	0	0	0	0	0
CG net cash requirement	-13	-1	-4	-1	-3	-1
B&B and NRAM adjustment	0	0	1	0	0	0
Network Rail adjustment	0	0	0	0	0	0
CGNCR ex. B&B, NRAM and Network Rail	-13	-1	-3	-1	-3	-2

Key fiscal aggregates

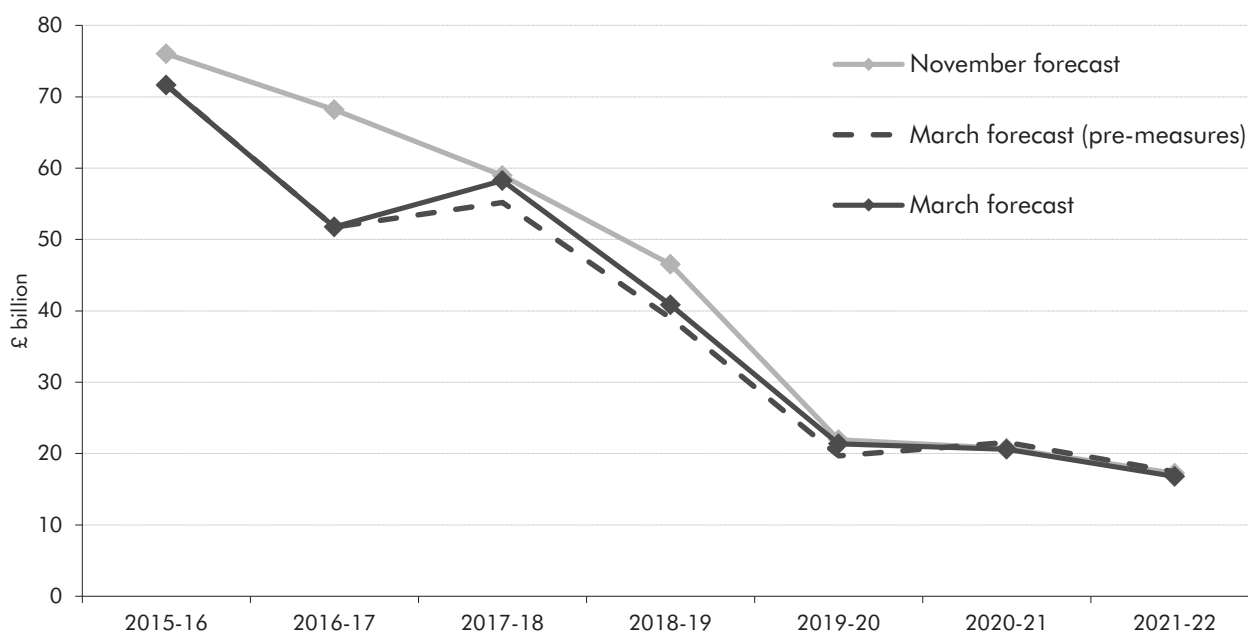
4.188 Our central forecast for the key fiscal aggregates incorporates the forecast for receipts, expenditure and financial transactions set out earlier in this chapter. In this section we explain the changes in a number of key fiscal aggregates:

- **public sector net borrowing:** the difference between total public sector receipts and expenditure on an accrued basis each year. As the widest measure of borrowing, PSNB is a key indicator of the fiscal position. Until recently, it was the fiscal mandate measure. We focus on it when explaining changes since our previous forecast;
- **cyclically adjusted net borrowing:** public sector net borrowing adjusted to reflect the estimated impact of the economic cycle. It is an estimate of underlying or ‘structural’ net borrowing, in other words the borrowing we would expect to see if the output gap was zero. It is the target measure for the Government’s new fiscal mandate;
- the **current budget deficit:** the difference between receipts and public sector current expenditure each year. In effect, this is public sector net borrowing excluding borrowing to finance investment;
- the **cyclically adjusted current budget deficit:** the current budget adjusted to reflect the estimated impact of the economic cycle. It was the target measure for the Coalition Government’s fiscal mandate in the last Parliament;
- **public sector net debt:** a stock measure of the public sector’s net liability position defined as its gross liabilities minus its liquid assets. In broad terms, it is the stock equivalent of public sector net borrowing, measured on a cash basis rather than an accrued basis. It is used for the Government’s supplementary fiscal target (as it was by the Coalition Government in the last Parliament);
- **public sector net debt excluding the Bank of England:** which, by removing the Bank’s balance sheet from the headline measure, abstracts from the uneven effect across years of the Bank’s August 2016 monetary policy stimulus measures; and
- **public sector net financial liabilities:** a broader balance sheet measure that includes all financial assets and liabilities recorded in the National Accounts.

Public sector net borrowing

4.189 We expect borrowing to be significantly lower this year than we forecast in November – and somewhat lower than we forecast a year ago. But revisions thereafter are much smaller, averaging £1.5 billion a year between 2017-18 and 2021-22. As Chart 4.13 shows, the path of deficit reduction is more uneven across years than was the case in our November forecast, reversing temporarily in 2017-18 and almost stalling in 2020-21. On a pre-measures basis, the deficit would have increased slightly in 2020-21 too.

Chart 4.13: Public sector net borrowing and the path of deficit reduction



Source: ONS, OBR

Expected borrowing in 2016-17

- 4.190 We have revised our 2016-17 borrowing forecast down by a total of £16.4 billion. On a like-for-like basis, excluding the effect of the ONS's change to the accounting treatment for corporate taxes, we have revised it down by £13.4 billion. This reflects a £7.5 billion upward revision to receipts and a £6.0 billion downward revision to spending. This more than reverses the underlying upward revision of £11.2 billion we made in November. The changes reflect data revisions to the first half of the year, recent unexpectedly strong growth in receipts and reductions in departmental spending plans.
- 4.191 When we completed our November forecast, we had access to ONS outturn data for April to September and some administrative receipts data for October. The ONS data showed the deficit in the first half of 2016-17 down 4.8 per cent on the same period a year earlier. The latest estimate is that the deficit fell by no less than 16.8 per cent over that period. As Table 4.37 shows, by January, revisions had more than doubled the rate at which the deficit was estimated to have fallen in that period. That partly reflected higher cash receipts, which accrued back to earlier months, as well as revisions to local authority borrowing and spending by central government departments. The further revision in February largely reflected the move to recording corporation tax receipts on a time-shifted accruals basis, which boosts receipts more in 2016-17 than in 2015-16.

Table 4.37: Successive ONS estimates of PSNB in the first half of 2016-17

	£ billion, unless otherwise stated				
	Month of public sector finances release				
	October	November	December	January	February
PSNB over the first half of 2015-16	47.7	47.7	47.4	47.4	43.1
PSNB over the first half of 2016-17	45.5	43.8	42.1	42.6	35.8
First-half-on-first-half	-2.3	-4.0	-5.3	-4.8	-7.2
First-half-on-first-half (per cent)	-4.8	-8.3	-11.1	-10.2	-16.8

4.192 Abstracting from the ONS accounting changes, unexpectedly strong receipts growth since our last forecast is the biggest contributor to lower borrowing. This includes:

- stronger-than-expected growth in cash **onshore corporation tax receipts**. According to the information available to us in November, CT receipts were around 20 per cent higher in October than a year earlier. We assumed that this rate of increase would not persist, but the increase in January was even stronger at around 26 per cent. On a like-for-like basis this lifts our receipts forecast by £4.4 billion this year;
- growth in cash receipts from **PAYE income tax and NICs** has picked up, averaging 6.8 per cent on a year earlier compared to 4.5 per cent over the first seven months of the year. On that basis, we have revised up 2016-17 PAYE and NICs by £1.8 billion; and
- an upward revision of £1.4 billion in our forecast for **capital gains tax** receipts. That reflects very strong growth in gains on disposals of financial assets in 2015-16, despite a fall in the FTSE all-share index in that year.

4.193 Lower spending has also reduced our borrowing forecast. This reflects two main factors:

- **departmental spending** has been revised down by £2.3 billion. This reflects the larger-than-expected downward revision to plans in February's 'Supplementary Estimates' and the latest information departments have provided to the Treasury; and
- changes to the timing of **expenditure transfers to EU institutions**, which move spending from the first quarter of 2017 to later in the year. That reallocated spending within the EU's calendar accounting year, but relative to our November forecast it moves £1.8 billion of spending from the UK's 2016-17 April to March fiscal year into 2017-18.

Forecasts for borrowing from 2017-18 onwards

4.194 Table 4.38 show how accounting treatment changes, our underlying forecast judgements and the Government's policy decisions have affected our forecast for borrowing. (It shows contributions to changes in borrowing since November, so higher receipts are shown as negative contributions). The main changes include:

- in order to compare the forecasts on a like-for-like basis, we have restated our November forecast to take account of the change to **ONS methodology** to record

corporate tax receipts on a time-shifted accruals basis. This has uneven effects across years by concentrating the impact of cuts to the CT rate in the years they take place;

- we have revised up our **pre-measures receipts forecast** by £3.5 billion a year on average between 2017-18 and 2019-20, but down by £2.0 billion a year on average in 2020-21 and 2021-22. The profile reflects some timing effects that boost 2016-17 receipts relative to 2017-18 (in particular forestalling ahead of the April 2016 dividend tax rise). These overlay a small downward revision to cumulative growth in the main tax bases – wages and salaries and nominal consumer spending – that reduce income tax and VAT receipts from 2019-20;
- higher interest rates and (in the short term) RPI inflation have increased **central government debt interest spending**, despite lower cumulative borrowing;
- **other spending** is lower in all years. One of the bigger sources of revision is welfare spending, where our lower earnings growth forecast has reduced spending on state pensions while universal credit is expected to save more over time; and
- **Government decisions** increase borrowing by £3.1 billion in 2017-18 and smaller amounts in 2018-19 and 2019-20. They reduce borrowing in 2020-21 and 2021-22. The Treasury's scorecard reports only some of these decisions. It shows a small giveaway in the near term – in particular central government funding for adult social care. There is a small takeaway in later years – including an increase in Class 4 NICs on self-employment profits and reducing the generosity of the new dividend tax allowance. Decisions not shown on the scorecard include setting aside around £1.2 billion a year to ensure that the NHS and others can meet the cost of a lower personal injury discount rate. That discount rate change is also the biggest source of indirect knock-on effects in our forecast, as it is expected to raise insurance premiums and therefore RPI inflation, adding £0.8 billion to the accrued interest on index-linked gilts.

4.195 Overall, the underlying forecast revision averages just 0.2 per cent of GDP over the full forecast period – one of the smaller revisions since the OBR was created in 2010. That is in spite of the in-year revision to 2016-17 being the largest such change we have made.

Table 4.38: Public sector net borrowing since November

	£ billion						
	Outturn	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	76.0	68.2	59.0	46.5	21.9	20.7	17.2
Accounting treatment change	-1.4	-3.0	-1.0	-2.2	-0.9	0.8	-0.4
November forecast restated	74.7	65.2	58.0	44.3	21.0	21.5	16.8
Total forecast changes	-3.0	-13.4	-2.8	-5.3	-1.4	0.1	0.6
of which:							
Receipts	-1.2	-7.5	-4.3	-4.6	-1.5	1.5	2.4
CG debt interest spending	0.0	-0.3	2.7	-0.4	0.9	1.2	1.2
Other spending	-1.8	-5.7	-1.2	-0.3	-0.7	-2.7	-3.0
March forecast pre-policy decisions	71.7	51.7	55.2	39.0	19.7	21.6	17.4
Total effect of Government decisions			3.1	1.8	1.7	-1.0	-0.6
of which:							
Scorecard receipts measures			0.2	-0.5	-1.5	-1.4	-1.5
Scorecard AME measures			-0.1	-0.1	-0.2	-0.1	-0.1
Total RDEL policy changes			1.4	1.2	2.4	2.5	2.5
Total CDEL policy changes			-0.8	-0.6	1.0	-0.9	-1.0
Non-scorecard receipts and AME measures			2.3	2.0	0.1	-0.8	-0.4
Indirect effect of Government decisions			0.1	-0.2	-0.1	-0.2	-0.1
March forecast	71.7	51.7	58.3	40.8	21.4	20.6	16.8
Memo items:							
Overall change since November	-4.4	-16.4	-0.7	-5.7	-0.6	-0.2	-0.4
Overall like-for-like change since November	-3.0	-13.4	0.3	-3.5	0.3	-0.9	0.0
Direct effect of policies on the scorecard			1.7	0.7	-0.8	-0.9	-0.4
Direct effect of policies not on the scorecard			1.3	1.3	2.6	0.2	0.0

Note: 2015-16 reflects outturn data and has not been adjusted for ONS classification decisions that have been announced but not yet implemented.

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.

Box 4.6: Why does net borrowing now rise in 2017-18?

In our November *EFO*, we expected PSNB to fall by £9.2 billion between 2016-17 and 2017-18. Restating that forecast on the new CT methodology reduces that year-on-year fall to £7.2 billion, due to the April 2017 CT rate cut having a bigger effect in 2017-18 on the new basis. However, on a like-for-like basis we have now revised that year-on-year fall to a rise of £6.5 billion. Excluding the effect of the transfer of the Royal Mail pension fund in 2012-13, this is the first time we have forecast a rise in PSNB in any year of any *post-measures* forecast. (*Pre-measures* forecasts have shown rises before, but they have been offset by policy decisions. That is true in this forecast for 2020-21, which would have risen slightly in cash terms absent policy changes.)

Table E shows that the £13.7 billion like-for-like swing from a fall in borrowing in 2017-18 to a rise reflects six key factors:

- changes to the **timing of expenditure transfers to EU institutions** within calendar year 2017 move spending from the end of 2016-17 into 2017-18. On its own, that contributes £3.6 billion to the change in borrowing;

- more **dividend income brought forward ahead of the rise in dividend tax in April 2016**. This implies lower dividend tax receipts in 2017-18, from where the income was shifted (see Box 4.3), contributing £3.3 billion to the change. The weakness in cash receipts will only come in during the early part of 2018 (as tax on this income is largely paid via self-assessment in the following January), so all else equal the path of deficit reduction over the first three-quarters of 2017-18 will be stronger than our full-year forecast;
- our forecast for **higher RPI inflation** next year (partly knock-on effects from Government decisions) boosts accrued debt interest spending on index-linked gilts. This is only partly offset by higher excise duty rates next year, as the fuel duty rate is frozen again. The net effect contributes £3.1 billion to the change;
- we have increased our **estimate of departmental underspending** in 2016-17, which we assume will not be repeated in 2017-18. This contributes £2.3 billion to the change;
- higher **onshore CT payments** this year have boosted our 2016-17 forecast by £4.4 billion. We have pushed roughly half that sum into next year, as we assume the other half reflects changes in the timing of instalment payments. That reduces year-on-year growth in receipts, contributing £1.9 billion to the change in borrowing profile; and
- the **direct effect of Government decisions** at this Budget pushes the year-on-year rise in PSNB next year up by £3.0 billion. That includes the money set aside to help meet the costs to the public sector of having reduced the personal injury discount rate and the additional grants to local authorities for adult social care spending.

Partly offsetting those factors, the upward revision to our nominal GDP growth forecast has boosted year-on-year tax receipts growth by around £2.8 billion. That reflects upward revisions to growth in wages and salaries, nominal household consumption and company profits.

Table E: Revisions to the profile of PSNB in 2017-18

	Year-on-year change in PSNB in 2017-18
	£ billion
November forecast	-9.2
Accounting treatment change	2.1
November forecast restated	-7.2
March forecast	6.5
Like-for-like change	13.7
<i>of which:</i>	
Timing of expenditure transfers to EU institutions	3.6
Revised profile of SA IT dividend forestalling	3.3
Higher 2017-18 inflation	3.1
DEL underspend assumptions	2.3
Outturn onshore corporation tax receipts	1.9
Other	-0.7
Higher nominal GDP growth	-2.8
Direct effect of Government decisions	3.0

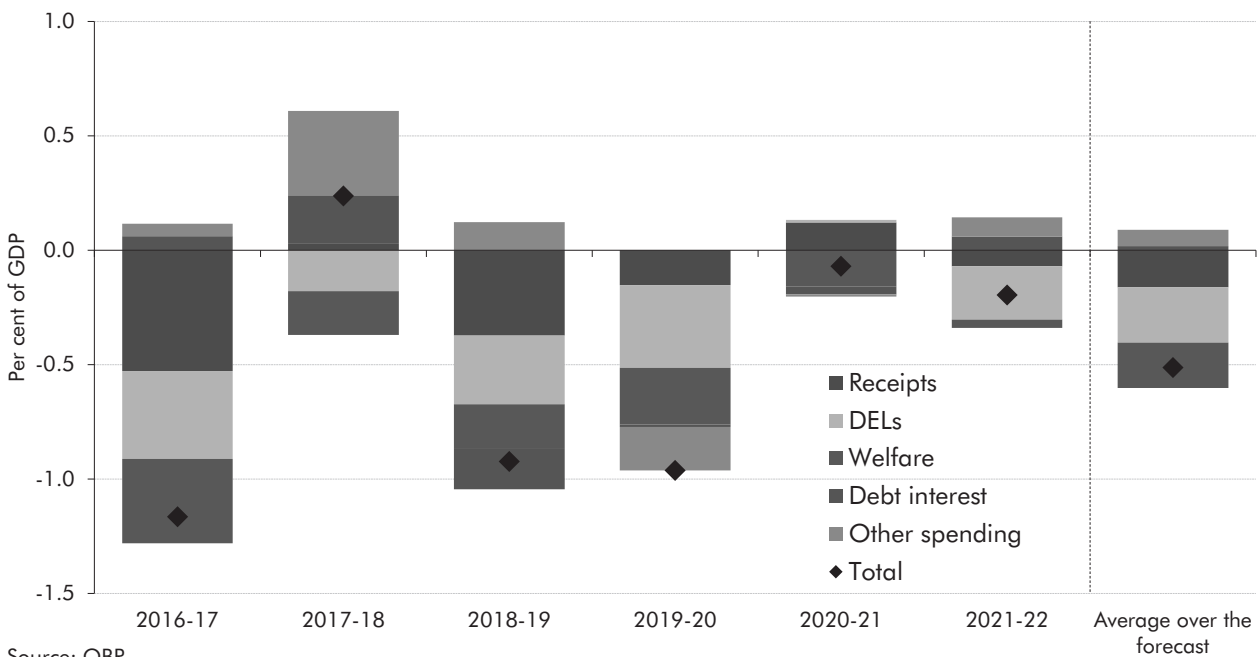
The profile of deficit reduction

- 4.196 Public sector net borrowing has fallen by an average of 1.0 per cent of GDP a year since its post-crisis peak, from 9.9 per cent in 2009-10 to 3.8 per cent in 2015-16. It fell faster at the start of this period, reflecting sharper spending cuts (as a share of GDP) and successive rises in the main VAT rate from 15 to 20 per cent. The pace slowed in 2012-13 and 2013-14 (abstracting from the effect of the one-off transfer of Royal Mail's historic pension fund), reflecting a fall in the tax-to-GDP ratio as weak average earnings growth weighed on income tax and NICs receipts. The deficit has then fallen more quickly over the last two years, reflecting continued spending cuts and rising tax receipts.
- 4.197 We expect borrowing to fall from 3.8 per cent of GDP in 2015-16 to 0.7 per cent in 2021-22 – an average fall of 0.5 per cent of GDP a year. The profile of deficit reduction over the forecast is uneven from year-to-year, and much more so than in November. Chart 4.14 shows the sources of year-on-year changes in the deficit over the forecast and how they compare to the average fall. It shows that:
- in **2016-17** we expect the deficit to fall by 1.2 per cent of GDP, significantly faster than the average. That partly reflects two one-off boosts to tax receipts growth – the abolition of the NICs contracting out rebate and forestalling ahead of the rise in dividend tax. Growth in onshore corporation tax receipts has also been strong, driven by profits growth, flat business investment (which drives the use of tax-deductible allowances), and measures to restrict use of tax-deductible losses. Welfare spending falls relatively quickly, as tax credits caseloads have fallen more than expected;
 - in **2017-18** the deficit rises by 0.2 per cent of GDP. The rise is partly driven by one-off effects on EU and debt interest spending. Tax receipts remain flat as a share of GDP despite the introduction of the apprenticeship levy, as forestalling of dividend income unwinds and the main rate of onshore CT is cut to 19 per cent;
 - fiscal consolidation resumes in **2018-19**, with the deficit falling by 0.9 per cent of GDP, faster than the average decline over the forecast period. Receipts rise by 0.4 per cent of GDP, flattered by the shifting of dividend income between years. Debt interest spending falls by 0.2 per cent of GDP, reflecting in particular lower RPI inflation;
 - in **2019-20**, the deficit falls by 1.0 per cent of GDP, twice the average over the forecast period. This is partly because real departmental resource spending per person falls by 2.0 per cent, the sharpest decline in any year of the 2015 Spending Review and the third sharpest since 2010-11. Net public service pension spending also falls, as a reduction in the discount rate raises required contributions and puts further pressure on departmental resource budgets;
 - in **2020-21**, the deficit falls by just 0.1 per cent of GDP. The main reason it does not fall in line with the average over the forecast is that departmental capital spending rises by 0.3 per cent of GDP. That reflects the large unallocated increase pencilled in for that year in the Spending Review. Onshore CT also falls by 0.1 per cent of GDP,

reflecting the cut in the main rate from 19 to 17 per cent. Our pre-measures forecast showed the deficit rising in 2020-21. The Government’s ‘reprofiling’ of spending – including some of the unallocated capital spending – was sufficient to mean that the deficit falls in our post-measures forecast despite rising pre-measures; and

- deficit reduction continues in **2021-22**, but again at a slower-than-average pace with borrowing falling by 0.2 per cent of GDP. Welfare spending falls at its slowest rate since 2012-13 as state pension spending rises as a share of GDP for the first time since 2015-16. The caseload rises 1.4 per cent as the state pension age stops rising.

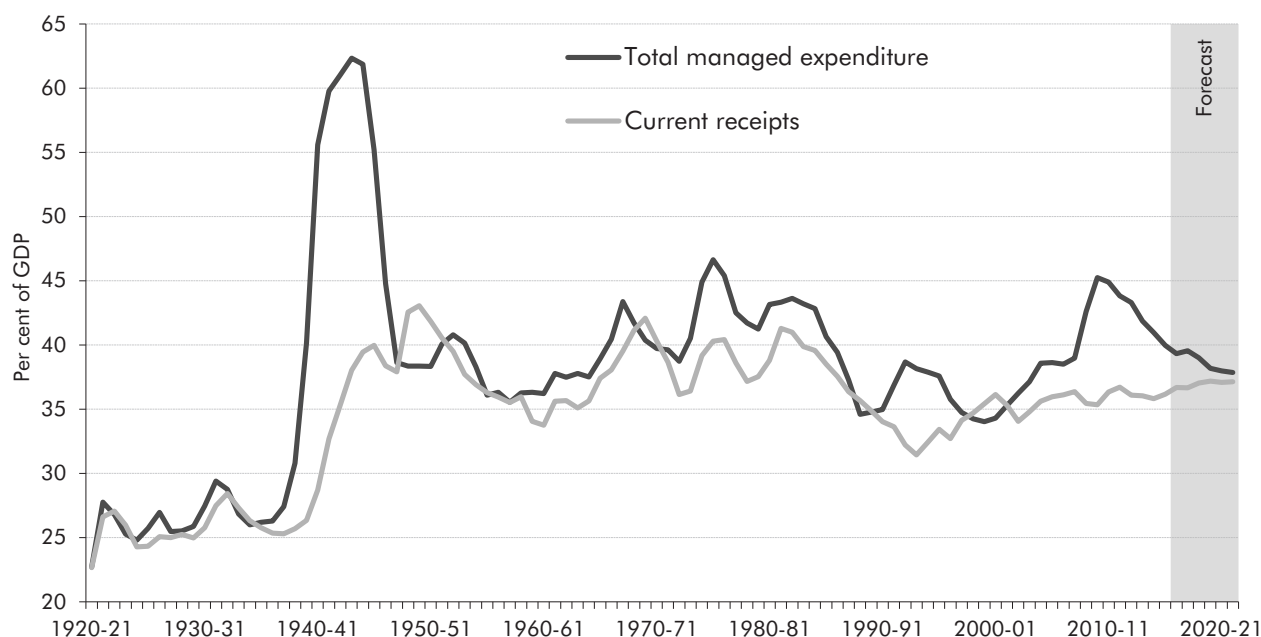
Chart 4.14: The year-on-year profile of deficit reduction



Source: OBR

4.198 Chart 4.15 shows current receipts and total managed expenditure as a share of GDP since 1920-21, combining Bank of England and ONS data. Total spending falls to 37.9 per cent of GDP in 2021-22, while current receipts reach 37.2 per cent of GDP in 2019-20 and 2021-22. In those peak years, the receipts-to-GDP ratio reaches its highest level since 1986-87. The spending-to-GDP ratio in 2021-22 is the lowest since 2003-04.

Chart 4.15: Total public sector spending and receipts



Source: Bank of England, ONS, OBR

Cyclically adjusted net borrowing (the structural fiscal position)

4.199 We see little sign of spare capacity or overheating in the economy at present and our forecast for slower growth over the coming year implies only a small negative output gap will open up. As a result, the profile of cyclically adjusted net borrowing closely follows movements in headline borrowing. The Government's new fiscal target is set in terms of this measure, so its profile is discussed in more detail in Chapter 5. Relative to November, our output gap forecast is closer to zero in most years, implying less of the deficit in any year should be considered cyclical. We have therefore revised up cyclically adjusted borrowing in most years.

Current budget

4.200 We estimate that the current budget deficit, which excludes borrowing to finance net investment spending, will be £15.2 billion in 2016-17, down from a peak of £99.6 billion in 2009-10 and roughly half the £30.8 billion we were expecting in November. Our latest forecast shows the current budget moving into surplus in 2018-19 (a year earlier than in November) and the surplus reaching £37.1 billion in 2021-22.

Cyclically adjusted current budget

4.201 We expect the cyclically adjusted current budget to move from a deficit of 0.8 per cent of GDP in 2016-17 to a surplus of 0.1 per cent in 2018-19. The surplus rises to 1.6 per cent of GDP in 2021-22. This measure was targeted by the Coalition Government during the 2010 to 2015 Parliament.

Public sector net debt

4.202 In November we expected public sector net debt (PSND) to peak at 90.2 per cent of GDP in 2017-18, with the August 2016 monetary policy package raising debt significantly in 2016-17 and 2017-18. We continue to expect debt to peak as a share of GDP in 2017-18, but at a slightly lower 88.8 per cent. As in November, we expect it to fall each year thereafter.

4.203 Table 4.39 decomposes the changes in our PSND forecast since November:

- **nominal GDP** is higher in the near term, but lower by the end of the forecast. That reduces the debt-to-GDP ratio up to 2018-19, but raises it slightly thereafter;
- **lower cumulative borrowing** contributes most to the downward revision to cash debt;
- a change in our modelling of the **accounting effect of future APF gilt purchases** as maturing gilts are rolled over reduces cash debt significantly by the end of the forecast. This relates to the difference between the market and nominal values of gilts that are assumed to be purchased in the next five years as those currently held by the APF are redeemed. The difference was overstated in our November forecast (and previously). The higher yield curve has also reduced this accounting effect relative to November;
- higher expected drawdown of the Bank of England's **Term Funding Scheme**, with the biggest upward effect in 2016-17. Since the loans have a 4-year term, the unwinding of the scheme then has a bigger downward effect on debt in 2020-21;
- higher real and nominal interest rates imply lower **gilt premia** on future debt issuance, raising cash debt relative to November; and
- a **variety of smaller factors** have affected the level of cash debt. For example, the rise in the Lloyds Banking Group share price adds to expected proceeds from future sales under the Government's trading plan, whereas the lower gold price and stronger pound reduce the value of unhedged currency reserves that net off PSND.

Table 4.39: Changes in public sector net debt since November

	Per cent of GDP						
	Estimate	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	84.2	87.3	90.2	89.7	88.0	84.8	81.6
March forecast	83.6	86.6	88.8	88.5	86.9	83.0	79.8
Change	-0.6	-0.7	-1.4	-1.2	-1.1	-1.9	-1.8
<i>of which:</i>							
Change in nominal GDP ¹	-0.4	-1.0	-0.9	-0.3	0.1	0.1	0.2
Change in cash level of net debt	-0.2	0.3	-0.5	-0.9	-1.2	-2.0	-2.0
	£ billion						
November forecast	1610	1725	1840	1904	1945	1950	1952
March forecast	1606	1730	1830	1885	1918	1904	1904
Change in cash level of net debt	-4	5	-10	-19	-27	-46	-48
<i>of which:</i>							
Borrowing	-4	-21	-22	-27	-28	-28	-28
APF modelling changes	0	-1	-3	-6	-10	-13	-20
APF yield curve changes	0	-1	-3	-4	-5	-2	-9
APF Term Funding Scheme	0	17	5	5	5	-12	0
Gilt premia	0	2	7	6	4	5	5
Other factors	0	8	6	8	7	4	4

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

Reconciliation of PSNCR and changes in PSND

4.204 Table 4.40 reconciles the PSNCR, a cash measure of borrowing, with the changes in PSND. PSND is for the most part, but not entirely, the stock equivalent of the PSNCR. The two differ in our forecast for the following reasons:

- the large **gilt premia** associated with low gilt yields. As PSND rises by the nominal value of gilts issued, rather than their market value, selling at a premium reduces the recorded impact on debt;
- **index-linked gilts** are recorded at their uplifted nominal value in PSND, so positive RPI inflation adds to PSND each year but does not affect the PSNCR;
- differences between the nominal and market value of **gilts held by the APF** add to net debt. This will unwind beyond our forecast horizon as the APF stock runs down; and
- movements in sterling affect the value of the unhedged component of the **international reserves** that are netted off PSND. This effect is large in 2016-17.

Table 4.40: Reconciliation of PSNCR and changes in PSND

	£ billion					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Public sector net cash requirement	132.1	95.5	52.6	32.4	-8.6	-3.3
Gilt premia	-18.7	-9.2	-12.7	-14.0	-12.6	-10.7
Index-linked gilts	-0.2	13.3	14.9	14.1	6.0	18.3
APF	15.3	0.1	0.4	0.6	0.6	-4.9
International reserves	-4.4	0.1	0.2	0.3	0.3	0.3
Change in public sector net debt	124.1	99.7	55.4	33.4	-14.3	-0.3

Alternative balance sheet metrics

4.205 The latest version of the *Charter for Budget Responsibility* requires us to publish forecasts for two alternative measures of the public sector balance sheet: public sector net debt excluding the Bank of England and public sector net financial liabilities (PSNFL). These are shown in Table 4.41 and Chart 4.16.

Public sector net debt excluding the Bank of England

4.206 Our forecast for the path of PSND has been significantly affected by the Bank of England's August 2016 monetary policy package. Public sector net debt excluding Bank of England removes these effects – plus other smaller effects relating to cash management within the APF and the Bank's other activities. On this measure, the path of the debt-to-GDP ratio is smoother across years. It peaks at 81.4 per cent of GDP in 2015-16, falls slightly in 2016-17, then rises slightly again in 2017-18 before falling steadily thereafter. These twin peaks are caused by the deficit being larger in 2017-18 than in 2016-17, while nominal GDP rises faster in 2016-17 than in 2017-18.

Public sector net financial liabilities

4.207 Public sector net financial liabilities (PSNFL) is a wider balance sheet measure that includes all public sector financial assets and liabilities recognised in the National Accounts. In particular, it includes the various illiquid assets that are not netted off PSND e.g. student loans and shareholdings in public sector banks. It was described in more detail in Annex C of our November *EFO*. As with the measure of PSND excluding the Bank of England, PSNFL is not greatly affected by the August monetary policy package and so its path is much smoother. As with PSND ex BoE, it also shows twin peaks in 2015-16 and 2017-18. As we expect little change in PSNFL as a share of GDP between 2014-15 and 2018-19, the precise timing of the peak(s) is subject to change.

Table 4.41: Fiscal aggregates

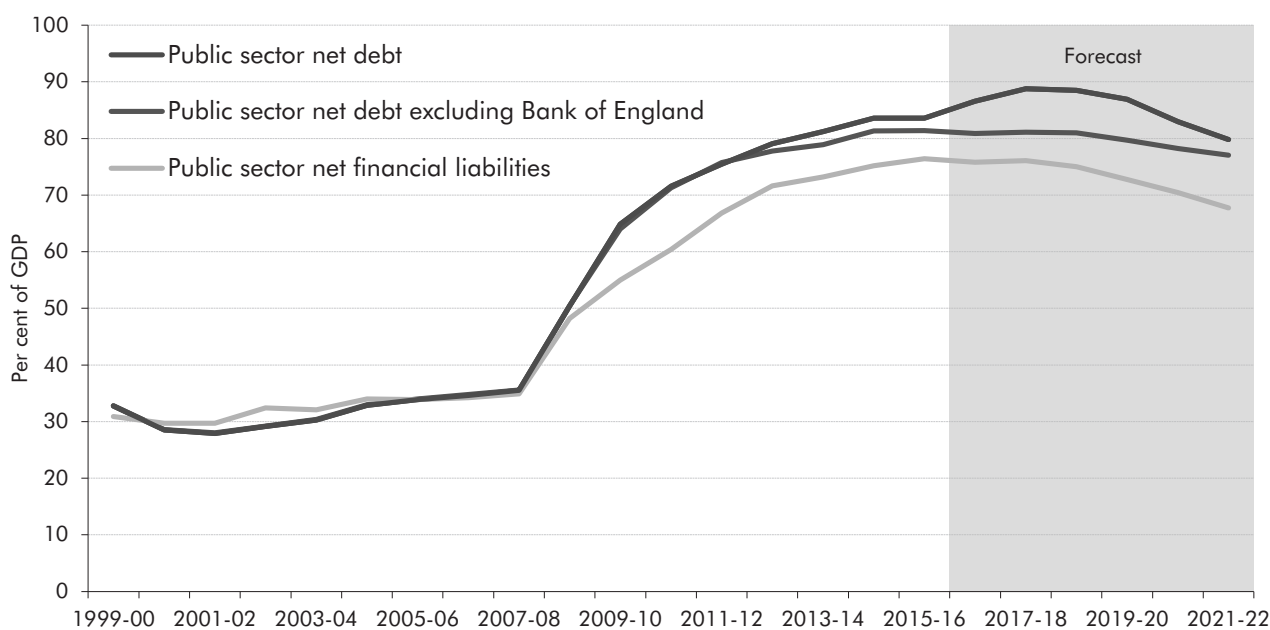
	Per cent of GDP						
	Outturn 2015-16	Forecast					
		2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Receipts and expenditure							
Public sector current receipts (a)	36.2	36.7	36.7	37.1	37.2	37.1	37.2
Total managed expenditure (b)	40.0	39.3	39.6	39.0	38.2	38.0	37.9
of which:							
Public sector current expenditure (c)	36.2	35.4	35.5	34.9	34.1	33.6	33.4
Public sector net investment (d)	1.7	1.9	2.0	2.0	2.0	2.2	2.3
Depreciation (e)	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Fiscal mandate and supplementary target							
Cyclically adjusted net borrowing	3.6	2.6	2.9	1.9	0.9	0.9	0.7
Public sector net debt ¹	83.6	86.6	88.8	88.5	86.9	83.0	79.8
Deficit							
Public sector net borrowing (b-a)	3.8	2.6	2.9	1.9	1.0	0.9	0.7
Current budget deficit (c+e-a)	2.1	0.8	0.9	-0.1	-1.0	-1.3	-1.6
Cyclically adjusted current budget deficit	1.9	0.8	0.9	-0.1	-1.1	-1.4	-1.6
Primary deficit	2.1	0.9	0.9	0.2	-0.7	-0.7	-0.9
Cyclically adjusted primary deficit	1.9	0.9	1.0	0.2	-0.7	-0.7	-0.9
Financing							
Central government net cash requirement	3.2	3.5	2.3	2.3	1.4	1.7	1.6
Public sector net cash requirement	2.7	6.7	4.7	2.5	1.5	-0.4	-0.1
Alternative balance sheet metrics							
Public sector net debt exc. Bank of England	81.4	80.9	81.1	81.0	79.7	78.2	77.0
Public sector net financial liabilities	76.4	75.8	76.1	75.0	72.8	70.4	67.7
Stability and Growth Pact							
Treaty deficit ²	4.0	2.7	2.8	1.9	1.1	0.9	0.9
Cyclically adjusted Treaty deficit	3.7	2.7	2.9	1.9	1.0	0.9	0.9
Treaty debt ratio ³	87.6	87.5	87.7	87.7	86.5	84.8	83.6
£ billion							
Public sector net borrowing	71.7	51.7	58.3	40.8	21.4	20.6	16.8
Current budget deficit	40.1	15.2	18.2	-1.1	-21.3	-29.6	-37.1
Cyclically adjusted net borrowing	67.4	51.8	59.3	40.4	19.8	19.3	16.5
Cyclically adjusted current budget deficit	35.8	15.2	19.3	-1.5	-22.9	-30.9	-37.5
Public sector net debt	1606	1730	1830	1885	1918	1904	1904
Memo: Output gap (per cent of GDP)	-0.2	0.1	0.1	-0.1	-0.1	-0.1	0.0

¹ Debt at end March; GDP centred on end March.

² General government net borrowing on a Maastricht basis.

³ General government gross debt on a Maastricht basis.

Chart 4.16: Public sector balance sheet measures



Source: ONS, OBR

Risks and uncertainties

4.208 As always, we emphasise the uncertainties that lie around our central fiscal forecast. We expose our judgements to different sensitivities and scenarios in Chapter 5. While there are some risks and uncertainties common to all forecasts, in this *EFO* we have highlighted:

- **global and domestic risks associated with the economy**, including the outlook for productivity growth in the UK, the nature of trading arrangements agreed following our departure from the EU and the effects of sterling depreciation on the UK's export market share, import substitution and inflation (Chapter 3);
- specific risks to income tax receipts associated with the **distribution of earnings and what that means for the effective tax rate** (Box 4.1) and the uncertainties surrounding **forestalling ahead of the April 2016 rise in dividend tax** (Box 4.3);
- specific uncertainties related to **expenditure transfers to EU institutions and tax systems for which there are common EU rules** (Box 4.4), including how they may change after the UK leaves the EU;
- ongoing uncertainties around the large **financial asset sales** that are planned to take place over this Parliament (from paragraph 4.171);
- the outcomes of **ongoing legal cases**, including those regarding disability benefit payments (paragraph 4.122), a number of public service pension schemes (paragraph 4.127) and aspects of the removal of the 'spare room subsidy' (Annex A);

- **higher interest rates** clearly pose an upside risk to our spending forecast, although recent experience shows that even at very low interest rates it is possible for them to fall further (see Box 4.4 in our March 2016 EFO); and
- the Government has set out a number of **ambitions or intentions** that have not yet been confirmed as firm policy decisions, but which remain a source of risk to the forecast (paragraph 4.19).

International comparisons

4.209 International organisations, such as the European Commission and the International Monetary Fund (IMF), produce forecasts of deficit and debt levels of different countries on a comparable basis. These are based on general government debt and borrowing, and are presented on a calendar year basis. To facilitate comparisons, Tables 4.42 and 4.43 convert our UK forecasts to a basis that is comparable with that used by these international organisations. With both modelling and reporting of much tax and expenditure in the UK done primarily on a financial year basis, the calendar year forecasts are illustrative and have been derived by simply weighting our financial year forecasts.

Table 4.42: Comparison with European Commission forecasts

	Per cent of GDP					
	Treaty deficit ¹			Treaty debt ²		
	2016	2017	2018	2016	2017	2018
UK (March EFO)	3.1	2.8	2.1	89.2	87.6	87.7
UK (EC)	3.4	2.8	2.5	88.6	88.1	87.0
Germany	-0.6	-0.4	-0.4	68.2	65.5	62.9
France	3.3	2.9	3.1	96.4	96.7	97.0
Italy	2.3	2.4	2.6	132.8	133.3	133.2
Spain	4.7	3.5	2.9	99.7	100.0	99.7
Euro area	1.7	1.4	1.4	91.5	90.4	89.2

¹ General government net borrowing.

² General government gross debt.

Source: European Commission, *European Economic Forecast Winter 2017*, OBR.

Table 4.43: Comparison with IMF forecasts

	Per cent of GDP					
	General government net borrowing			General government net debt		
	2016	2017	2021	2016	2017	2021
UK (March EFO)	3.1	2.8	0.9	80.3	79.2	76.0
UK (IMF)	3.3	2.7	0.7	80.5	80.3	73.6
Germany	-0.1	-0.1	-0.6	45.4	43.7	36.8
France	3.3	3.0	1.0	89.2	89.8	85.8
Italy	2.5	2.2	0.0	113.8	113.9	106.7
Japan	5.2	5.1	3.1	127.9	130.7	131.5
U.S	4.1	3.7	3.7	82.2	82.3	84.4

Source: IMF, *World Economic Outlook*, October 2016, OBR.

5 Performance against the Government's fiscal targets

Introduction

5.1 This chapter:

- sets out the Government's **medium-term fiscal targets** (from paragraph 5.2);
- examines whether the Government has a better than 50 per cent **chance of meeting them** on current policy, given our central forecast (from paragraph 5.6); and
- assesses how robust these judgements are to the **uncertainties** inherent in any fiscal forecast, by looking at past forecast errors, sensitivity to key parameters of the forecast and alternative economic scenarios (from paragraph 5.21).

The Government's fiscal targets

5.2 The *Charter for Budget Responsibility* requires the OBR to judge whether the Government has a greater than 50 per cent chance of hitting its fiscal targets under current policy. It has been updated a number of times in recent years as the Government has revised its fiscal targets. The latest version was approved by Parliament in January 2017.¹

5.3 The *Charter* states that the Government's objective for fiscal policy is to "*return the public finances to balance at the earliest possible date in the next Parliament*". Our current forecast extends only to 2021-22, so we are not able to assess performance against this objective formally over the full duration of the next Parliament, but we can illustrate some of the challenges the Government may face in trying to meet it.

5.4 The *Charter* also sets out targets for borrowing, debt and welfare spending that require:

- the **structural deficit** (cyclically adjusted public sector net borrowing) to be below 2 per cent of GDP by 2020-21 – this is described as the 'fiscal mandate';
- **public sector net debt** to fall as a percentage of GDP in 2020-21 – this is the 'supplementary target'; and
- for welfare spending (excluding the state pension and payments closely linked to the economic cycle) to lie below a '**welfare cap**' set for 2021-22. The Government has in

¹ The latest and previous versions are available on the 'legislation and related material' page of our website.

effect set a cap 3 per cent above our November 2016 forecast for the relevant spending in that year, with the expected level of spending adjusted for changes in our inflation forecast on the basis of a specific methodology of its own choosing.

5.5 In this chapter, we assess the Government's performance against these three specific targets, all of which are on course to be met in our central forecast. We also summarise what our latest forecast would imply for performance against the various fiscal targets set out in previous versions of the *Charter*.

The implications of our central forecast

5.6 Table 5.1 shows our central forecasts for the fiscal aggregates relevant to the current and previous fiscal targets: cyclically adjusted public sector net borrowing (PSNB); headline PSNB; public sector net debt (PSND); spending subject to the welfare cap; and the cyclically adjusted current budget deficit (CACB). These forecasts are described in detail in Chapter 4. They should be interpreted as median forecasts, so we believe it is equally likely that outturns will come in above them as below them.

Table 5.1: Performance against the Government's fiscal targets

	Per cent of GDP						
	Estimate	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Fiscal mandate: Cyclically adjusted public sector net borrowing							
November forecast	3.8	3.3	2.6	1.8	0.8	0.8	0.7
March forecast	3.6	2.6	2.9	1.9	0.9	0.9	0.7
Supplementary target: Public sector net debt							
November forecast	84.2	87.3	90.2	89.7	88.0	84.8	81.6
March forecast	83.6	86.6	88.8	88.5	86.9	83.0	79.8
Spending subject to the welfare cap (£ billion)							
November forecast	120.0	119.8	119.6	120.1	120.5	123.2	126.0
March forecast	120.0	119.3	119.6	120.0	120.0	122.4	125.1
Fiscal mandate (October 2015 to January 2017): Public sector net borrowing							
November forecast	4.0	3.5	2.9	2.2	1.0	0.9	0.7
March forecast	3.8	2.6	2.9	1.9	1.0	0.9	0.7
Fiscal mandate (June 2010 to October 2015): Cyclically adjusted current budget deficit							
November forecast	2.0	1.4	0.5	-0.1	-1.1	-1.5	-1.6
March forecast	1.9	0.8	0.9	-0.1	-1.1	-1.4	-1.6

The current fiscal targets

The fiscal mandate

5.7 The Government's fiscal mandate requires it to reduce the structural deficit below 2 per cent of GDP by 2020-21. We estimate that the structural deficit in 2016-17 is 2.6 per cent of GDP, so meeting this target requires only a small improvement in the structural balance between now and the end of the Parliament. Our central forecast shows that on current policies the structural deficit will have fallen to 0.9 per cent of GDP in 2020-21 (up fractionally from 0.8 per cent of GDP in our November forecast), so the target is on track to

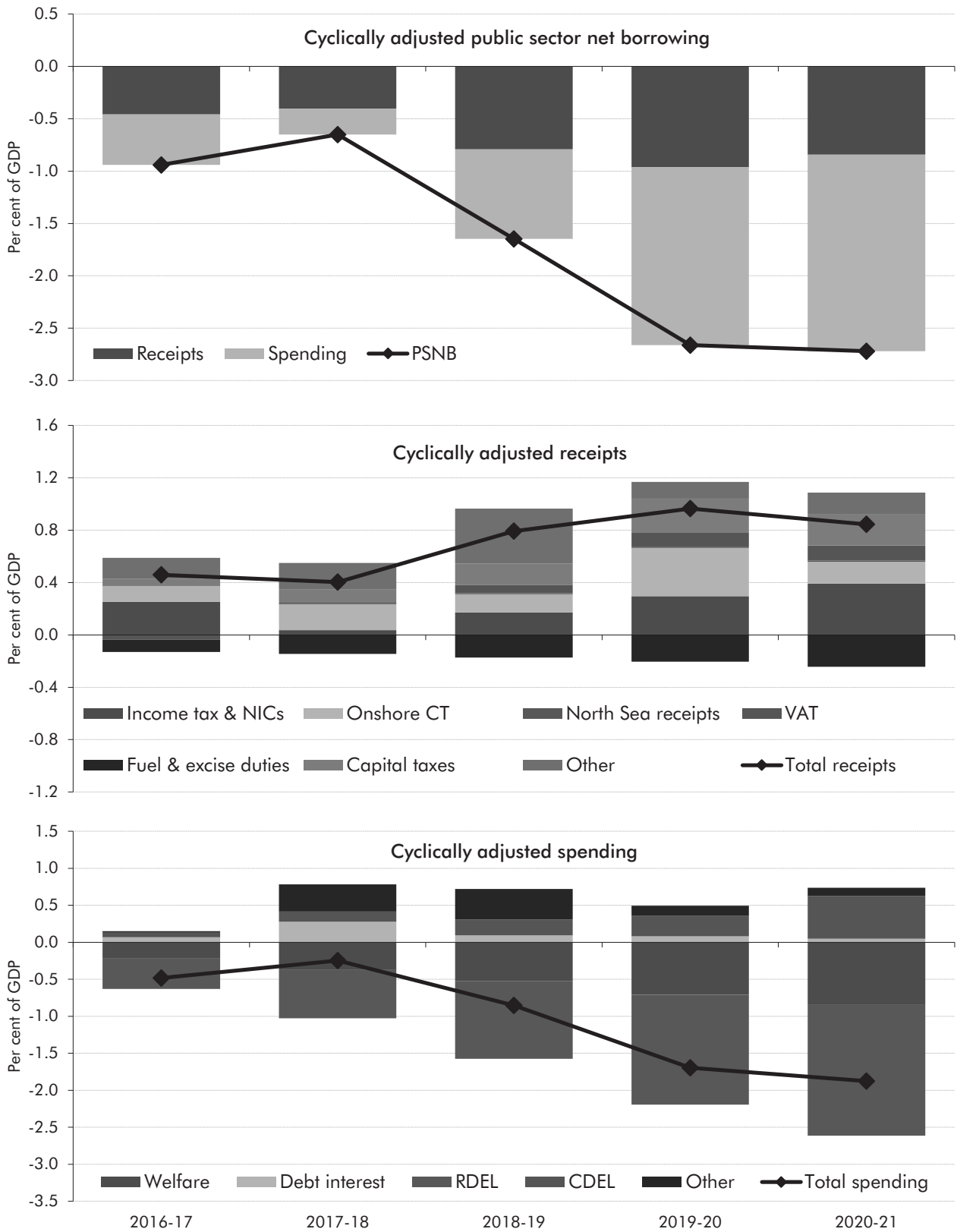
be achieved with a margin of 1.1 per cent of GDP or £25.8 billion (down fractionally from 1.2 per cent of GDP or £26.6 billion in November). As in November, the structural deficit moves below 2 per cent of GDP in 2018-19, two years ahead of the required date.

5.8 Chart 5.1 uses cyclical-adjustment coefficients for different types of receipts and spending² to show how the structural deficit narrows in the run-up to the target year of 2020-21:

- the **structural deficit** is expected to improve by 2.7 per cent of GDP between 2015-16 and 2020-21, with lower spending contributing 1.9 percentage points and higher receipts 0.8 percentage points. Most of the improvement happens by 2019-20, with both receipts and spending stabilising as a share of GDP in 2020-21. The expected reduction is similar to the 3.0 per cent of GDP achieved in the last Parliament;
- **structural receipts** are expected to increase by 1.0 per cent of GDP by 2019-20, but to fall slightly thereafter. In the earlier years, this is largely due to policy measures affecting NICs and self-assessment receipts, plus the introduction of the apprenticeship levy and higher environmental levies boosting other receipts. In later years, real earnings growth raises income tax and NICs receipts as a share of GDP, but that is offset by a fall in fuel and excise duties (due to declining tax bases) and a cut in the main rate of onshore corporation tax that is sufficient to push the overall receipts-to-GDP ratio down in 2020-21; and
- **structural spending** is expected to fall over the four years of the 2015 Spending Review period up to 2019-20. Cuts to departmental resource spending (RDEL) dominate, falling by 1.8 per cent of GDP by the end of the Parliament. Welfare cuts are also significant, reaching 0.8 per cent of GDP in 2020-21. Partly offsetting those cuts, departmental capital spending (CDEL) is set to rise by 0.6 per cent of GDP. The step up in CDEL spending in 2020-21 largely reflects an amount that was added to the limit, but not allocated, in the Spending Review. Spending on debt interest pushes spending up as a share of GDP every year.

² Further details can be found in Helgadóttir *et al.* (2012), *OBR Working Paper No.4: Cyclically adjusting the public finances*.

Chart 5.1: Cumulative changes in the structural deficit since 2015-16



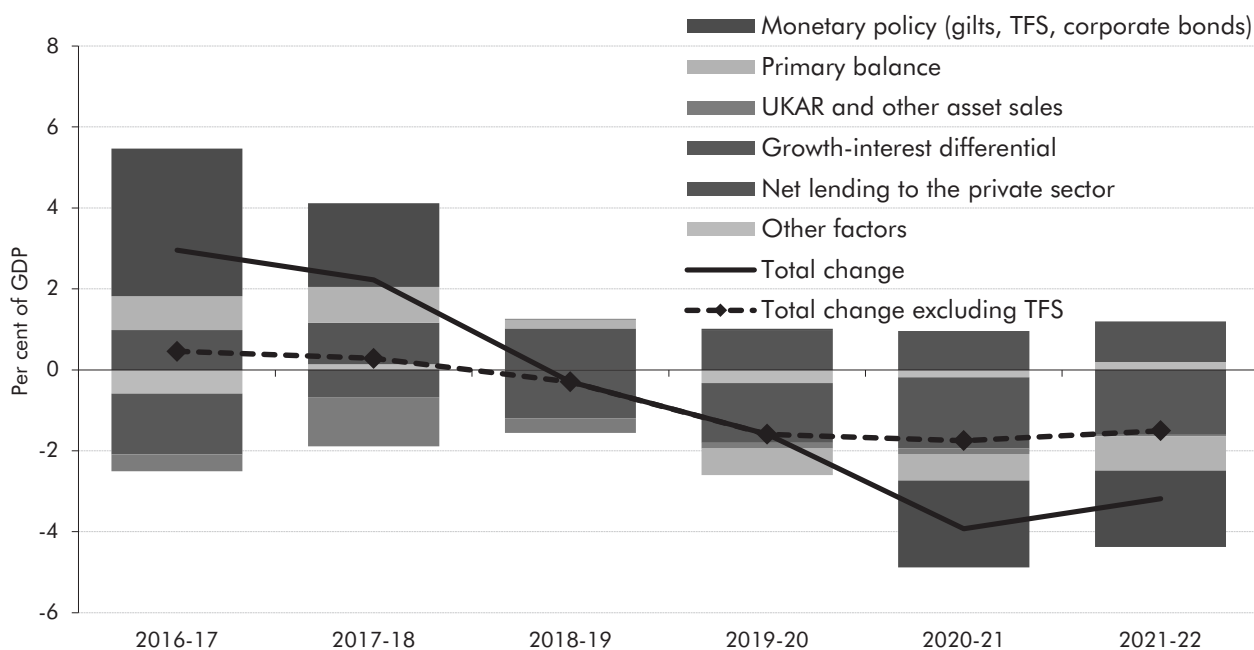
Source: OBR

The supplementary debt target

- 5.9 The supplementary debt target requires PSND to fall as a percentage of GDP in 2020-21. We expect the ratio to peak in 2017-18 and to fall thereafter, with a decline of 3.9 per cent of GDP in this forecast in 2020-21 (up from 3.2 per cent in November). So the Government is on course to meet its supplementary target with slightly more room to spare.
- 5.10 Chart 5.2 decomposes year-on-year changes in the debt-to-GDP ratio over the forecast period. It shows that:
- the **Bank's August 2016 monetary policy package** has a material effect on net debt, pushing it up by £73 billion (3.6 per cent of GDP) and £43 billion (2.1 per cent of GDP) in 2016-17 and 2017-18 respectively. This reflects lending to commercial banks under the Term Funding Scheme (TFS), and the purchase of corporate bonds and of additional gilts at a premium to their nominal value. The repayment of TFS loans after four years then pulls the ratio down in 2020-21 and 2021-22. Lending through the TFS is treated as the acquisition of an illiquid asset, and is therefore not netted off PSND. But it is secured against collateral and thus most unlikely to generate losses for the public sector. Excluding the TFS effect, the path of the debt ratio would be smoother, although it would still rise in 2016-17 and 2017-18, then fall from 2018-19 onwards. Other APF-related factors, including premia paid when gilts mature and the proceeds are reinvested, add small amounts to debt in most years;
 - changes in the year-on-year profile of the debt-to-GDP ratio typically reflect changes in the **primary balance**. But the debt-to-GDP ratio falls in 2018-19 despite there being a primary deficit in that year;
 - **financial asset sales** (in particular the active sale and rundown of UK Asset Resolution (UKAR) assets) are expected to reduce PSND by 1.2 per cent of GDP in 2017-18 and by much smaller amounts in subsequent years. (Financial asset sales do not usually affect the public sector's net worth, as they typically bring forward cash that would otherwise have been received in later years as revenues, in the shape of mortgage repayments and dividends. They consequently only reduce debt temporarily);
 - **nominal GDP growth is expected to exceed nominal interest rates** on the stock of government debt throughout the forecast, reducing the debt ratio every year and by large amounts from 2018-19 onwards. This differential is a key driver of public sector debt dynamics, especially over longer timeframes. In our *Fiscal sustainability reports (FSRs)*, we analyse the impact of different assumptions;
 - **net lending to the private sector** – mainly student loans, but also other lending schemes such as Help to Buy – increases net debt in every year, though as a financial transaction it does not directly affect public sector net borrowing; and
 - **other changes** are largely offsetting. Issuing debt at a premium to its nominal value reduces net debt over the forecast period, but this is ultimately only temporary and will

unwind over the long term. Accrued receipts exceed cash receipts over the medium term, partly because some receipts are collected with a lag (including interest on student loans, where the lag can be many years). In 2016-17, the fall in the pound also increases the sterling value of unhedged foreign currency assets, reducing the change in the ratio in that year.

Chart 5.2: Year-on-year changes to the debt-to-GDP ratio



Source: OBR

5.11 We expect net debt to peak as a share of GDP in 2017-18, in line with our November forecast. Table 5.2 decomposes the changes in the profile of net debt since then:

- in the short term, stronger **nominal GDP growth** reduces the pace at which the debt-to-GDP ratio rises in 2016-17. But slower growth thereafter adds to the year-on-year change in the ratio – particularly in 2018-19 and 2019-20. In those years, our November forecast assumed above-trend growth as spare capacity was absorbed – an effect that is much less pronounced in our latest forecast;
- changes in our **borrowing** forecast have relatively small effects in most years, with the exception of 2016-17 where we have revised borrowing down significantly;
- more rapid take-up of the August 2016 **monetary policy package** pushes debt up by more in 2016-17 and correspondingly less in 2017-18. Since we assume that loans under the Term Funding Scheme will be repaid at the end of their 4-year term, these changes have the opposite effect at the end of the forecast period, in particular pulling debt down by more in 2020-21;

- reductions in the **gilt premia** associated with issuing gilts at prices above their nominal value cause upward revisions to the year-on-year profile of the debt ratio in most years; and
- **other factors** include the effect of sterling appreciation and lower gold prices on the foreign reserves in 2016-17, lending to the private sector (including student loans) and receipts accruals adjustments.

Table 5.2: Changes in the profile of net debt since November

	Change in net debt as per cent of GDP on previous year					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
November forecast	3.1	2.9	-0.5	-1.7	-3.2	-3.3
March forecast	3.0	2.2	-0.3	-1.6	-3.9	-3.2
Change	-0.1	-0.7	0.2	0.1	-0.8	0.1
<i>of which:</i>						
Nominal GDP ¹	-0.6	0.1	0.6	0.4	0.0	0.1
Borrowing	-0.8	0.0	-0.2	0.0	0.0	0.0
August 2016 monetary policy package	1.0	-1.1	-0.2	-0.2	-0.7	0.0
UKAR rundown and other asset sales	-0.1	0.1	0.0	0.0	0.0	0.0
Gilt premia	0.1	0.2	-0.1	-0.1	0.0	0.0
Others	0.3	0.0	0.1	0.0	-0.1	0.0

¹ GDP is centred end-March.

The welfare cap

- 5.12 In Autumn Statement 2016, the Government changed the way its welfare cap operates after the previous version was breached by a significant margin. The cap now applies in only one year – 2021-22 – preceded by a ‘pathway’ set in line with our November 2016 forecast plus a margin for error that rises from 0.5 per cent this year to 3.0 per cent in the target year of 2021-22 (see Table 5.3). When we judge performance against the cap, the *Charter* says that we should adjust our forecast for spending to remove the impact of changes in inflation, according to a methodology of the Government’s choosing. Its current chosen method is to use simplified ready-reckoners to remove the impact of changes in our inflation forecast since November 2016 on expected uprating.³ The effect is shown in Table 5.3.
- 5.13 This methodology is more complicated than simply adjusting the welfare cap itself for changes in our inflation forecast: we have revised down the level of the Consumer Prices Index in 2021-22 by 0.2 per cent since November, which would be equivalent to a £0.2 billion lower cash level for the cap in order to hold it constant in real terms. If other measures of inflation were employed, then the required cash adjustment would be different. The Government’s chosen methodology also gives a different answer to that reached by summing bottom-up estimates of the impact of changes in our inflation forecasts on each line of the welfare spending forecast, which would also subtract £0.2 billion from welfare cap spending in 2021-22.

³ ‘Removing the impact of changes in inflation from the welfare cap’, HM Treasury, March 2017.

- 5.14 With the effects of inflation on uprating removed from the assessment of performance against the cap, the main risks to which it remains subject relate to:
- **higher-than-expected numbers of people receiving** different benefits or tax credits. For example, in recent years we have had to make successive upward revisions to our forecasts for the disability benefits caseload;
 - **changes in the composition of caseloads**, which can affect the average award across benefit recipients beyond the effects of inflation on uprating. For example, a higher-than-expected share of the employment and support allowance (ESA) caseload in the support group has raised average awards, while a lower-than-expected share in the work-related activity group has reduced the amounts saved by policies that cut the amounts and shorten the periods over which ESA can be received by that group; and
 - **legal judgements** can change the scope of benefits, adding to spending unless the Government takes offsetting action. For example, two recent Upper Tribunal judgements expanded the interpretation of PIP assessment criteria. The first judgement held that needing support to take medication and monitor a health condition should be scored in the same way as needing support to manage therapy. The second held that someone who cannot make a journey without assistance due to psychological distress should be scored in the same way as a person who needs assistance because they have difficulties planning and navigating. In the absence of offsetting Government decisions, as announced by the Secretary of State for Work and Pensions on 23 February, both judgements would have led to more people being eligible as well as higher awards for some of those affected, thus increasing spending.
- 5.15 In previous *Welfare trends reports (WTRs)*, we have noted how structural changes to the welfare system have often been associated with unanticipated effects on spending. The introduction of universal credit represents the biggest change to the welfare system for decades, so it is likely that our forecasts will be open to significant future revision. Revisions – up or down – are also likely when we switch to forecasting universal credit on a gross basis rather than estimating its marginal effect relative to the existing benefits and tax credits (see Box 4.5 in Chapter 4 for an estimate of spending in 2017-18 on a gross basis). We plan to examine the universal credit forecast in greater detail in our next *WTR*.
- 5.16 Table 5.3 shows our March 2017 forecast for spending subject to the welfare cap. It shows that the Government is currently on course to meet the terms of the cap, with spending below the effective limit in all years, with or without the small adjustments for the effect of revisions to our inflation forecast on uprating. In November our forecast for spending within the welfare cap was £3.8 billion below the cap plus margin in 2021-22. Adjusted for inflation our new forecast is £4.5 billion below, implying slightly more room for manoeuvre.

Table 5.3: Performance against the welfare cap

	£ billion, unless otherwise stated					
	Forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Welfare cap						126.0
Welfare cap pathway	119.8	119.6	120.1	120.5	123.2	
Margin (per cent)	0.5	1.0	1.5	2.0	2.5	3.0
Margin	0.6	1.2	1.8	2.4	3.1	3.8
Welfare cap and pathway plus margin	120.4	120.8	121.9	122.9	126.3	129.7
Inflation adjustment	0.0	0.0	+0.1	-0.0	-0.1	-0.1
Latest forecast and update on performance against cap and pathway						
March forecast	119.3	119.6	120.0	120.0	122.4	125.1
March forecast with inflation adjustment	119.3	119.6	120.0	120.0	122.5	125.2
<i>Difference from:</i>						
Cap and pathway	-0.6	0.0	-0.1	-0.4	-0.7	-0.7
Cap and pathway plus margin	-1.2	-1.2	-1.9	-2.8	-3.7	-4.5

Fiscal objective for the next Parliament

5.17 According to the *Charter for Budget Responsibility*, the Government's fiscal objective is to "return the public finances to balance at the earliest possible date in the next Parliament". Only one full year of the next Parliament is currently within our forecast horizon. In it, the Government has set policy such that the headline deficit falls by 0.2 per cent of GDP to 0.7 per cent. Meeting its objective beyond that will be challenging. For example:

- if the deficit was **extrapolated to continue falling at the pace that it falls in 2021-22**, it would reach balance in 2025-26. Among other things, the extrapolation would imply the receipts-to-GDP ratio rising by a further 0.3 per cent of GDP and per capita departmental spending continuing to fall each year in real terms;
- as we showed in our 2017 *FSR*, if receipts and annually managed expenditure were **projected forward in line with the approach taken in our medium-term forecast** – but departmental spending was allowed to rise in line with the pressures of an ageing population and other non-demographic pressures on health spending – the deficit would remain roughly flat at around 0.8 per cent of GDP by the end of the next Parliament. Even holding the deficit constant in these circumstances would require the further fiscal tightening implied by uprating tax thresholds and working-age benefits awards for inflation. This would push the receipts-to-GDP ratio up by a further 0.6 per cent of GDP from the 37.2 per cent it reaches in 2021-22 and reduce average working-age welfare payments by a further 10 per cent relative to earnings; and
- using **our central FSR projection** itself, the challenge looks even greater. In this projection, we assume that tax thresholds and working-age benefit awards move with earnings rather than inflation, so receipts are not on an ever-rising path relative to GDP and the incomes of working-age benefit recipients are not on an ever-declining path relative to those of the rest of the population. Adding the pressures on spending from an ageing population, non-demographic pressures specific to health spending

and the cost of the triple lock on the uprating of state pensions would put the deficit on a rising path. In our 2017 FSR, which was based on our November medium-term forecast, it rose from 0.7 per cent of GDP in 2021-22 to 1.8 per cent by 2025-26.

Previous fiscal targets

5.18 Since the OBR was established by the Coalition Government in 2010, we have assessed performance against three previous fiscal mandates, three previous supplementary debt targets and two previous welfare caps:

- the **fiscal mandate** has targeted different measures of the deficit at different horizons. In the last Parliament, it targeted a surplus on the cyclically adjusted current budget balance (i.e. PSNB excluding net investment spending) by the end of the rolling, 5-year forecast period. In December 2014, this was changed to the end of the third year of the forecast period. At the start of this Parliament, it was changed again to target a surplus on the headline measure of PSNB by the end of 2019-20;
- the **supplementary debt target** has always referred to year-on-year changes in the ratio of PSND to GDP, but the reference year has changed. In the last Parliament, it started by targeting a year-on-year fall in the fixed year of 2015-16. In December 2014 that was moved back to 2016-17. At the start of this Parliament, the target was changed to year-on-year falls in every year from 2015-16 onwards; and
- the **welfare cap** has always referred to the same subset of welfare spending, but its level has been changed. Abstracting from movements that related only to classification changes, there were two caps. In March 2014 the Coalition set the cap in line with our latest forecast at the time, then in July 2015 the current Government lowered the cap in line with our updated forecast, including the effects of the welfare cuts announced in its post-election Summer Budget.

5.19 The October 2015 version of the Charter stated also that *"These targets apply unless and until the Office for Budget Responsibility (OBR) assess, as part of their economic and fiscal forecast, that there is a significant negative shock to the UK. A significant negative shock is defined as real GDP growth of less than 1% on a rolling 4-quarter-on-4-quarter basis."* On our latest forecast, that escape clause would not be triggered. The January 2017 Charter maintains an escape clause set in terms of a 'significant negative shock', but has shifted the responsibility for assessing that to the Treasury and no longer specifies what such a shock would look like in terms of real GDP growth or other metrics. This aligns the escape clause with the approach that the Government took after the referendum last year.

5.20 As Table 5.1 at the start of this chapter shows, our latest central forecast would imply:

- meeting the **first and second Coalition fiscal mandates** of a surplus on the cyclically adjusted current budget by a margin of £37.5 billion in 2021-22 and £22.9 billion in 2019-20;

- missing the **first Conservative fiscal mandate** of a headline surplus in 2019-20 by a margin of £21.4 billion;
- missing the **first and second Coalition supplementary debt targets** by margins of just 0.04 per cent of GDP in 2015-16 and a bigger 3.0 per cent of GDP in 2016-17;
- missing the **first Conservative supplementary debt target** due to debt rising significantly as a share of GDP in 2016-17 and 2017-18;
- meeting the **March 2014 welfare cap** due to the relevant spending being within the cap-plus-margin in all four years of the capped period (which extended to 2018-19). In part that reflects the significant cuts to working-age welfare spending that were announced in the July 2015 Budget; and
- missing the **July 2015 welfare cap** by increasing margins, with the relevant spending exceeding the cap-plus-margin in all years and by £3.5 billion on average.

Recognising uncertainty

- 5.21 The future is uncertain and the likelihood of unexpected economic and political developments means that any particular central forecast is most unlikely to be realised. Consequently there are significant upside and downside risks to our central forecasts for the public finances. These reflect uncertainty both about the outlook for the economy and about the level of receipts and spending in any given state of the economy. The looming negotiations about the UK's exit from the EU – and the limited information about the policy settings and international trading arrangements thereafter – create additional uncertainty.
- 5.22 Given these uncertainties, it is important to stress-test our judgements about the Government's performance against its fiscal targets. We do this in three ways:
- by looking at the evidence from **past forecast errors**;
 - by seeing how our central forecast would change if we altered some of the key **judgements and assumptions** that underpin it; and
 - by looking at **alternative economic scenarios**.

Past performance

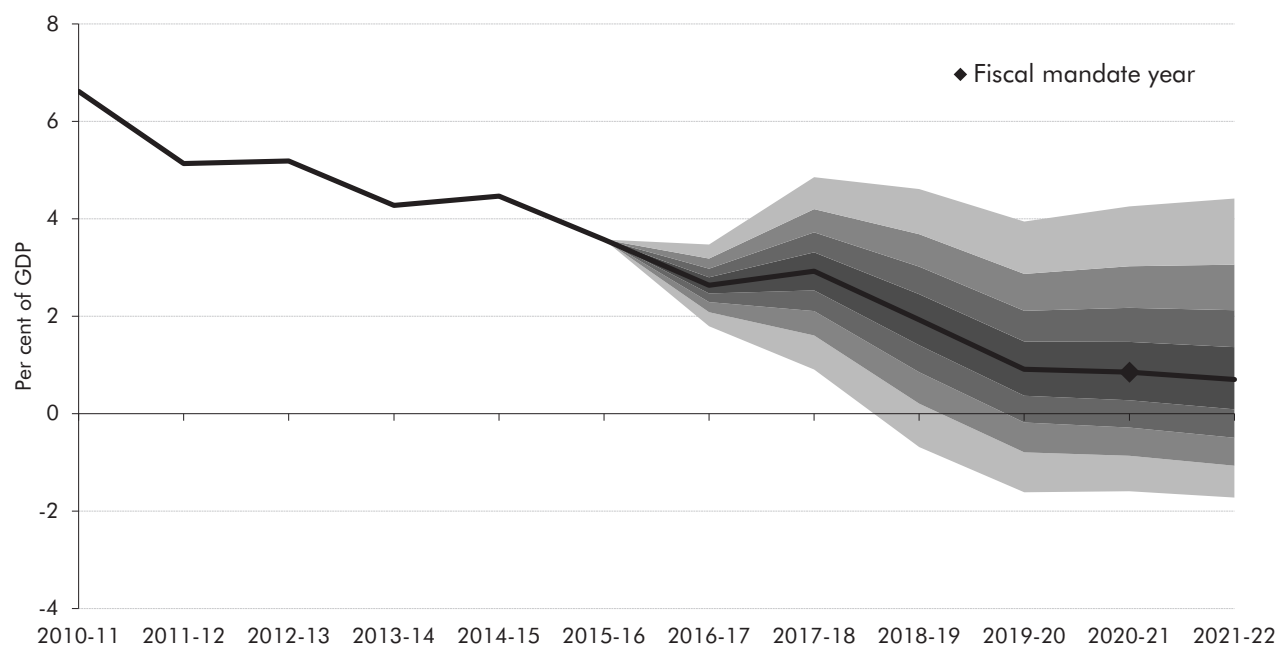
- 5.23 One relatively simple way to illustrate the uncertainty around our central forecast is to consider the accuracy of previous official public finance forecasts – both our own and the Treasury's forecasts that preceded them. This can be done using fan charts like that we presented for GDP growth in Chapter 3. The fan charts do not represent our assessment of specific risks to the central forecast. Instead they show the outcomes that someone might anticipate if they believed, rightly or wrongly, that the distribution of forecast errors in the past offered a reasonable guide to the likely distribution of forecast errors in the future.

- 5.24 It is important to note that the historical forecast errors that underpin our fan charts reflect both underlying forecast errors and the effects of any subsequent policy responses. That is likely to be one reason why the probability distributions around borrowing and other measures of the budget balance do not widen significantly at longer time horizons: when underlying forecast changes push borrowing away from original plans, governments tend to change policy to try to bring it back on track. This was evident in the analysis of past fiscal forecast errors and the fiscal policy response of governments presented in Annex B of our March 2016 *Economic and fiscal outlook (EFO)*.

The fiscal mandate

- 5.25 The probability of the Government meeting its fiscal mandate can be assessed using the distribution of forecast errors that underpin a fan chart for cyclically adjusted PSNB. Relative to headline PSNB, this aims to remove borrowing errors associated with the economic cycle to provide an estimate of the distribution that we would expect to observe if the output gap were always zero. As neither the output gap nor its effect on borrowing can be observed directly, we have no official outturns against which to assess past forecasts. Instead, those forecasts are compared with our own latest estimates.
- 5.26 We only have forecasts for cyclically adjusted PSNB dating back to 2003. The sample of errors is therefore smaller than for headline PSNB. In order to supplement that sample, we have compared the average absolute errors for headline and cyclically adjusted PSNB from 2003 onwards and used that comparison to impute the cyclical component of pre-2003 PSNB errors. Output gap errors contribute to bigger cyclically adjusted borrowing errors on average over short horizons. But with the output gap usually assumed to be closed, or nearly closed, at the forecast horizon, the width of the cyclically adjusted PSNB fan chart five years ahead is similar to that for headline PSNB.
- 5.27 Chart 5.3 shows the fan chart around our central forecast. It shows that the Government is on course to meet the fiscal mandate by 2020-21. The probability of the structural deficit being below 2 per cent of GDP is around 65 per cent from 2019-20 onwards.

Chart 5.3: Cyclically adjusted public sector net borrowing fan chart



Source: ONS, OBR

5.28 Unfortunately, we cannot estimate the probability of achieving the supplementary target as we do not have the joint distribution that would allow us to apply the same technique. But our central forecast shows the debt-to-GDP ratio rising up to 2017-18 and falling in each year thereafter. That implies a more than 50-50 chance that target will be met in 2020-21. We also do not have a long enough disaggregated series of past welfare spending forecasts to produce a fan chart for the welfare cap projections.

Sensitivity analysis

5.29 It is next to impossible to produce a full unconditional probability distribution for the Government's target fiscal variables because they are affected by such a huge variety of determinants – both economic and non-economic – many of which are also interrelated in complex ways. But we can go further than using evidence from past forecast errors by illustrating how sensitive the central forecast is to changes in key economic parameters and judgements.

5.30 In thinking about the evolution of the public finances over the medium term, there are several parameters that have an important bearing on the forecast. Here we focus on:

- the **sensitivity of the fiscal mandate** to changes to the level of potential GDP, inflation, the effective tax rate and planned spending cuts;
- the **sensitivity of the supplementary debt target** to differences in the level of debt or the growth rate of the economy, which both affect how debt changes from year-to-year as a share of GDP; and

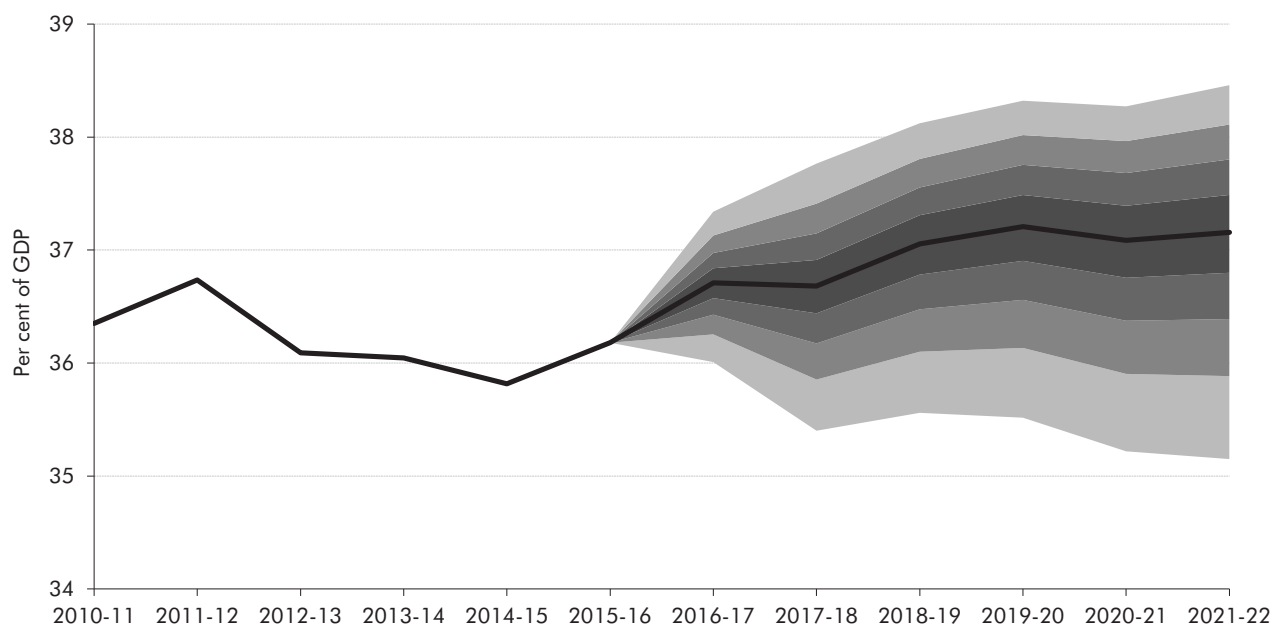
- some of the circumstances in which **the supplementary target could be missed while still meeting the fiscal mandate.**

The fiscal mandate

- 5.31 As Chart 5.3 illustrated, on the basis of past forecast errors we estimate that there is a roughly 35 per cent change that the structural deficit will exceed 2 per cent of GDP in in 2020-21. There are many reasons why such an outcome might occur. For example, the evolution of potential output could be less favourable than we forecast or receipts or spending could turn out differently for a given state of the economy. And while our forecasts are conditioned on current Government policy, that may also change, especially in respect of the policy-setting and international trading arrangements that will apply once the UK has left the EU.
- 5.32 In Annex B of our March 2015 *EFO*, we presented ready-reckoners that show how the public finances could be affected by changes in some of the determinants of our fiscal forecast. It is important to stress that these were stylised exercises that reflect the typical impact of changes in variables on receipts and spending. They are subject to significant uncertainty. But with those caveats in mind, we can use ready-reckoners to calibrate a number of possible adverse surprises relative to our central forecast that would be sufficiently negative to push the structural deficit above 2 per cent of GDP in 2020-21.
- 5.33 This analysis shows that the 1.1 per cent of GDP margin relative to the 2 per cent target could fall to zero if:
- **potential output** were 2.3 per cent lower. That would be 1.1 percentage points bigger than the downward revision to potential output in 2020-21 we made in our November forecast. But it is not large relative to the cumulative downward revisions that have been made since the financial crisis and subsequent recession;
 - the **effective tax rate** – as measured by the tax-to-GDP ratio – were 1.1 percentage point lower and the difference was a consequence of structural changes in the composition of GDP, the income distribution or conditions in asset markets relative to the wider economy. Unpicking the structural and cyclical elements of such changes would be difficult. Chart 5.4 presents a fan chart for receipts as a share of GDP using a similar methodology to that used above. It reflects both cyclical and structural drivers of past forecast errors. It suggests there is a 20 per cent chance that receipts could be 1.1 per cent of GDP lower than forecast;
 - **planned spending cuts** – which reduce RDEL by 1.3 per cent of GDP between 2016-17 and 2020-21 in our forecast – fell short by around four-fifths; or
 - higher **RPI inflation** increased accrued interest on index-linked gilts. Taken in isolation, if RPI inflation was 5.0 percentage points higher than expected in 2020-21, that alone would add 1.1 per cent of GDP to debt interest. Based on past forecast errors, there is

only a small chance of that happening. And of course, this sort of shock to inflation would be likely to have other material effects on the public finances.

Chart 5.4: Receipts fan chart



Source: ONS, OBR

The supplementary debt target

5.34 The supplementary debt target is focused on year-on-year changes in the debt-to-GDP ratio, with the target set for a fixed date of 2020-21. Table 5.4 shows how our central forecast for a 3.9 per cent of GDP fall in PSND in that year would be affected by two sources of sensitivity: differences in the level of debt in the preceding year and by differences in growth in 2020-21. We use cyclical adjustment coefficients to estimate the effect of GDP growth shocks on borrowing, but do not vary interest rates, so that differences in the assumed GDP growth rate result in changes to the interest rate-growth rate differential. On that basis, the table shows that:

- in most cases, the extent to which debt falls in 2020-21 is inversely related to **the level of debt in the preceding year**. That counter-intuitive result is due to the low level of interest rates assumed in our central forecast, which means that the effect of GDP growth on the denominator in the debt-to-GDP ratio is greater than the effect of interest rates on growth in the cash level of debt (via debt interest spending). The higher the starting level of debt, the more the denominator effect outweighs the interest rate effect. It is only the bigger negative growth shocks that see the growth rate fall close to the interest rate. When they are similar (which would be the case if growth was around 2 percentage points lower), the two effects cancel out. If the growth rate was lower than the interest rate, the extent to which debt falls would be positively related to the level of debt in the preceding year; and

- as expected, negative **shocks to GDP growth** reduce the extent by which debt falls as a share of GDP and positive shocks increase it. The year-on-year change in the debt-to-GDP ratio is more sensitive than the deficit to GDP shocks, because it is affected both by the deficit channel (which drives the accumulation of debt in that year) and by the denominator channel (which means the previous year's cash debt is divided by a different level of nominal GDP). A little over half the fall in the debt-to-GDP ratio in 2020-21 reflects the assumed repayment of TFS loans at the end of their 4-year term. Excluding that effect, meeting the target would be at risk to smaller negative shocks to GDP growth.

Table 5.4: Illustrative debt target sensitivities in 2020-21

		Year on year change in the PSND-to-GDP ratio in 2020-21					
		Difference in GDP growth in 2020-21 (percentage points)					
		-3	-2	-1	0	+1	+2
Difference in the level of PSND in 2019-20 (per cent of GDP)	-20	0.5	-0.8	-2.2	-3.5	-4.8	-6.2
	-10	0.6	-0.8	-2.3	-3.7	-5.1	-6.5
	+0	0.7	-0.9	-2.4	-3.9	-5.4	-6.9
	+10	0.8	-0.9	-2.5	-4.1	-5.7	-7.3
	+20	0.9	-0.9	-2.6	-4.3	-6.0	-7.7

5.35 The Government's fiscal targets only apply in or by the fixed year of 2020-21, but each is subject to different sensitivities. For example, holding all other elements of our central forecast constant, but assuming that structural borrowing in 2020-21 was 2 per cent of GDP, it would still be possible for the supplementary target to be missed if:

- cyclical borrowing** caused the primary balance to deteriorate by more than 2.8 per cent of GDP (relative to 0.1 per cent of GDP in our central forecast). Excluding the TFS loan repayment effect, a deterioration of only 0.6 per cent of GDP would be sufficient;
- financial transactions** pushed cash borrowing up relative to PSNB by 2.8 per cent of GDP more than in our central forecast. That could happen if the Bank of England decided that a monetary policy stimulus of the type that was announced last August was necessary in that year. A smaller effect of 0.6 per cent of GDP would be sufficient if the TFS loan repayment effect is excluded; or
- nominal GDP growth** was lower than 2.1 per cent in the year centred on end-March 2021 that is the denominator for the debt-to-GDP ratio in 2020-21 (relative to 4.0 per cent in our central forecast). A shortfall of just 0.4 percentage points would be sufficient if the TFS loan repayment effect is excluded.

Scenario analysis

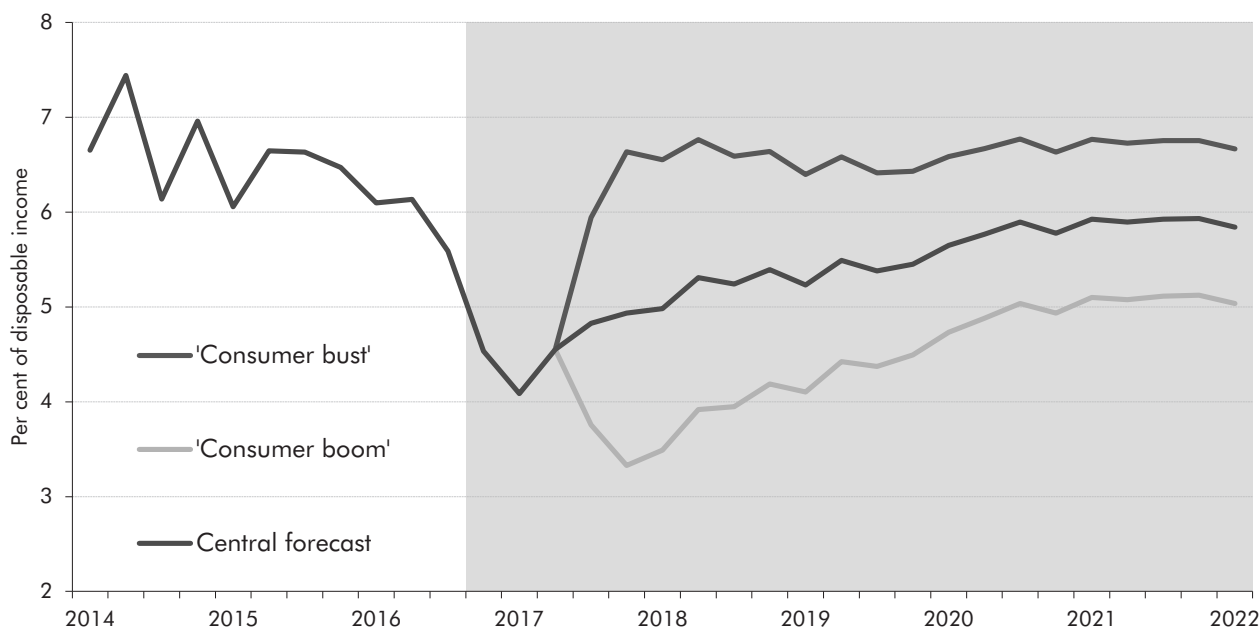
5.36 The sensitivity analysis discussed above focuses on individual factors and therefore offers only a limited assessment of potential uncertainty. In this section, we set out the fiscal implications of some illustrative alternative economic scenarios, designed to test how dependent our conclusions are on some of the key judgements that underpin the forecast.

We stress that these scenarios are not intended to capture all possible ways in which the economy might deviate from the central forecast, nor do we attempt to attach particular probabilities to particular scenarios.

- 5.37 One of the key judgements underpinning our central forecast is that the saving ratio will stabilise, so that consumption growth slows as real incomes are squeezed by higher inflation. The saving ratio has fallen in recent years, reaching a historically low level by the end of 2016, so it is an important, but uncertain, judgement that it broadly stabilises. We therefore explore the fiscal implications of two alternative paths for the saving ratio that are broadly symmetric around our central forecast:
- a '**consumer bust**' scenario, where the saving ratio rises as a result of households choosing to retrench by reducing consumption relative to incomes. A negative output gap opens up, reaching around 3 per cent. This results in lower inflation, reducing nominal GDP further than real GDP. The Bank of England is assumed to respond by loosening monetary policy, raising GDP growth and bringing inflation back to target. The monetary policy response is calibrated using a simple model.⁴ (In the scenario, we allow Bank Rate to fall into negative territory rather than trying to simulate the effects of unconventional forms of monetary easing.) We assume that the labour share of nominal GDP is unchanged from our central forecast, so household incomes fall in line with GDP, whereas the fall in consumption is proportionately greater so that the saving ratio rises to around 7 per cent, near its level at the start of 2015; and
 - a '**consumer boom**' scenario, where the saving ratio continues to fall at a similar pace to the fall over the past year, with households maintaining consumption growth in the face of the squeeze on real incomes. A positive output gap opens up, also reaching around 3 per cent. This pushes inflation up, raising nominal GDP by more than real GDP. The Bank is assumed to tighten monetary policy, reducing GDP growth in order to bring inflation back to target. A similar assumption regarding the labour share means that household incomes are higher, but by less than the rise in consumption, so the saving ratio falls to just over 3 per cent.
- 5.38 In both scenarios, potential growth is unchanged. We have also made the simple assumption that half the effect of changes in output are reflected in actual productivity and half in employment. The shocks have played out by the end of the forecast, leaving real GDP in 2021-22 little changed. However, because inflation moves above or below target for a period, but is then assumed to return to target, the price level is affected permanently. This means the shocks change the level of nominal GDP relative to the central forecast.

⁴ See *Working Paper No.4: A small model of the UK economy*, available on our website.

Chart 5.5: The household saving ratio under alternative scenarios



Source: ONS, OBR

5.39 On the basis of the assumptions above, Table 5.5 summarises the main fiscal implications of each scenario on the current fiscal targets. As one would expect, these relatively large cyclical shocks push borrowing up or down relatively sharply in the near term, which has lasting effects on the level of debt. But they also leave structural changes to the deficit at the end of the forecast. These changes are approximately symmetrical across the scenarios, so we discuss the effects of the 'boom' below, noting any effects that may not be symmetrical in the 'bust'. The changes include:

- **receipts** rise faster than nominal GDP, so the receipts-to-GDP ratio is higher. Consumption rises as a share of GDP, as well as in absolute terms, pushing VAT and excise duties up as a share of GDP. While the labour share is held constant, income tax and NICs receipts are slightly higher as a share of GDP due to fiscal drag. And while the profit share is flat, business investment is lower as a share of GDP, so corporation tax is slightly higher too. Capital taxes rise as a share of GDP due to the gearing of CGT receipts to stock market movements and stamp duty receipts to house prices. While we have modelled all these effects symmetrically in the bust scenario, the corporation tax system allows companies to use past losses to offset future tax liabilities. Following the last recession, this feature weighed heavily on receipts for a number of years. While such an effect is still possible, it would now take place over a longer period due to the recent introduction of restrictions on setting past losses against future liabilities;
- in cash terms, **spending** would be little changed, with departmental spending fixed by Spending Review plans and different factors pushing up and down on annually managed expenditure. For example, lower borrowing would reduce debt interest spending, but higher interest rates and RPI inflation would push it up. In the short term,

the RPI effect dominates. And for welfare spending, lower unemployment would reduce spending on jobseeker's allowance and housing benefit, while higher earnings growth would temporarily reduce spending on means-tested benefits and tax credits. But higher inflation would affect uprating of those benefits not subject to the cash freeze, while higher earnings growth would raise state pensions spending via the triple lock. (State pensions spending would fall proportionately less in the bust than it rises in the boom because the 2.5 per cent floor to the triple lock would apply.) Despite little change in cash spending, the different paths for nominal GDP would leave spending lower as a share of GDP;

- as a result, the **headline deficit** would be smaller. The difference is greatest (around 1 per cent of GDP) in the early years of the forecast, as the shock generates relatively large cyclical changes in borrowing. By the end of the forecast period, the deficit would remain around $\frac{1}{2}$ per cent of GDP lower. Around two-thirds of that is explained by denominator effects on public spending and one-third is due to lasting effects on the receipts-to-GDP ratio, including the effect of consumer spending being permanently higher as a share of GDP, which boosts VAT and other indirect taxes;
- the **structural deficit** would actually be higher in the first year, due to the big one-off effect of changes in RPI inflation on accrued interest on the large stock of index-linked gilts. By the end of the forecast, the effect on headline borrowing described above would largely be structural. But the amount by which it would differ from our central forecast would be small relative to the headroom against the Government's fiscal mandate, which would be met in both scenarios; and
- **public sector net debt** would be lower, due to the cumulative effects of changes in both cyclical and structural borrowing. The difference from our central forecast would build up year by year, given the permanently lower borrowing. Debt would peak as a share of GDP in the same year as our central forecast. It would peak a year later in the bust, but, given the large year-on-year fall in PSND in the target year of 2020-21 in our central forecast, the debt target would still be met. We have not factored in any effects on PSND from unconventional monetary policy easing in the bust scenario, but as our latest forecast shows such effects could be considerable.

Table 5.5: Key economic and fiscal aggregates under alternative scenarios

	Per cent of GDP, unless otherwise stated					
	Central forecast					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Economic assumptions						
GDP growth (per cent on a year earlier)	2.0	1.8	1.6	1.8	1.9	2.0
Output gap (per cent of potential GDP)	0.1	0.1	-0.1	-0.1	-0.1	0.0
Nominal GDP (£ trillion) ¹	1.96	2.03	2.10	2.17	2.25	2.34
Fiscal aggregates						
Public sector current receipts	36.7	36.7	37.1	37.2	37.1	37.2
Total managed expenditure	39.3	39.6	39.0	38.2	38.0	37.9
Public sector net borrowing	2.6	2.9	1.9	1.0	0.9	0.7
Fiscal targets						
Cyclically adjusted public sector net borrowing	2.6	2.9	1.9	0.9	0.9	0.7
Public sector net debt	86.6	88.8	88.5	86.9	83.0	79.8
'Consumer bust' scenario						
Economic assumptions						
GDP growth (per cent on a year earlier)	2.0	-0.5	1.9	2.9	2.6	2.2
Output gap (per cent of potential GDP)	0.1	-2.1	-2.0	-0.9	-0.2	0.1
Nominal GDP (£ trillion) ¹	1.96	1.99	2.05	2.13	2.22	2.31
Fiscal aggregates						
Public sector current receipts	36.7	36.5	36.9	37.1	37.0	37.1
Total managed expenditure	39.3	40.4	39.7	38.7	38.5	38.3
Public sector net borrowing	2.6	3.8	2.8	1.6	1.5	1.3
Fiscal mandate measures						
Cyclically adjusted public sector net borrowing	2.6	2.8	1.4	0.8	1.2	1.2
Public sector net debt	86.6	91.5	92.3	90.7	87.0	84.1
'Consumer boom' scenario						
Economic assumptions						
GDP growth (per cent on a year earlier)	2.0	4.0	1.4	0.7	1.3	1.8
Output gap (per cent of potential GDP)	0.1	2.3	1.8	0.7	0.1	-0.1
Nominal GDP (£ trillion) ¹	1.96	2.07	2.14	2.21	2.29	2.37
Fiscal aggregates						
Public sector current receipts	36.7	36.8	37.2	37.3	37.2	37.3
Total managed expenditure	39.3	38.7	38.3	37.7	37.6	37.4
Public sector net borrowing	2.6	1.9	1.0	0.4	0.4	0.2
Fiscal mandate measures						
Cyclically adjusted public sector net borrowing	2.6	3.0	2.4	1.1	0.5	0.1
Public sector net debt	86.6	86.2	84.8	83.1	79.0	75.5

¹ Not seasonally adjusted.

Executive summary

Overview

- 1 In the *Fiscal sustainability report (FSR)* we look beyond the medium-term forecast horizon of our twice-yearly *Economic and fiscal outlooks (EFOs)* and ask whether the UK's public finances are likely to be sustainable over the longer term.
- 2 In doing so our approach has been twofold:
 - first, we look at the fiscal impact of **past government activity**, as reflected in the assets and liabilities on the public sector's balance sheet. This financial year we published this analysis in a *Fiscal sustainability analytical paper* in July 2016; and
 - second, we look at the potential fiscal impact of **future government activity**, by making 50-year projections of all public spending, revenues and significant financial transactions, such as government loans to students.
- 3 Our latest projections suggest that the public finances are likely to come under significant pressure over the longer term, due to the effects of an ageing population and further upward pressure on health spending from factors such as technological advancements and the rising prevalence of chronic health conditions. Under our definition of unchanged policy, the Government would end up having to spend more as a share of national income on age-related items such as pensions and in particular health care, but the same demographic trends would leave government revenues roughly stable.
- 4 In the absence of offsetting tax rises or spending cuts this would widen budget deficits over time and put public sector net debt on an unsustainable upward trajectory. The fiscal challenge from an ageing population and from additional pressures on health spending is common to many developed nations.
- 5 Viewed on a like-for-like basis, the long-term outlook for the public finances is somewhat less favourable than at the time of our last *FSR* in July 2015. This reflects the fact that the underlying outlook for the public finances over the medium term has deteriorated – thanks largely to a weaker outlook for productivity and GDP growth, which reduces prospective tax revenues. In addition, the Government has increased planned spending on public services, including health spending that we assume will be subject to cost pressures over time. These factors more than offset the impact of the tax increases and cuts to welfare spending that have been announced since the last *FSR*.

- 6 Long-term projections such as these are highly uncertain and the results we present here should be seen as illustrative, not precise forecasts. We quantify some of the uncertainties through sensitivity analyses, particularly relating to demographic trends and health spending.
- 7 It is important to emphasise that we focus here on the additional fiscal tightening that might be necessary beyond our medium-term forecast horizon, which currently ends in 2021-22. The report should not be taken to imply that the substantial fiscal consolidation already in the pipeline for the next five years should be made even bigger. We also look at the tightening that would be necessary beyond 2025-26 if the Government were to meet its new fiscal objective to “*return the public finances to balance at the earliest possible date in the next Parliament*” – an objective that appears challenging given the demographic and health spending pressures considered in this report.
- 8 While not implying a need for further fiscal tightening right away, policymakers and would-be policymakers should certainly think carefully about the long-term consequences of any policies they introduce or propose in the short term. And they should give thought too to the policy choices that will confront them once the current planned consolidation is complete.

Fiscal sustainability analytical papers

- 9 Following the post-referendum cancellation of our planned July 2016 FSR, we published a series of analytical papers covering issues that would have been presented in that FSR. These have informed this report – in particular, our working paper on long-term trends in health spending has led us to revise the assumptions used in our new central projection, with a significant effect on our results.
- 10 In summary, the five *Fiscal sustainability analytical papers* concluded that:
 - the 2016 **Whole of Government Accounts** (WGA) and the 2015-16 departmental accounts that will underpin the 2017 WGA report a number of significant increases in different liabilities. While some of these increases reflect actual emerging pressures, more reflected measurement issues – with changes in discount rates having material effects on a number of measured liabilities (and some assets);
 - upward pressure on **health spending** – beyond the effects of population ageing – has been evident in most developed economies in recent decades and most institutions that produce long-term projections assume that it will continue. While there is agreement about the direction of this pressure, there are differing views on its extent. We have decided to factor in an assumption about these additional cost pressures in our central projections for the UK, which has had a material effect on the scale of the fiscal challenge future governments can expect over the coming decades;
 - updated **population projections** illustrated how the policy link between the State Pension age and expected longevity shares the fiscal risks associated with changes in longevity between future pensioners and future taxpayers. Over the very long term,

one-third of any changes – positive or negative – would be borne by future pensioners and two-thirds by future taxpayers;

- new **student loans policies** announced since the 2015 election have raised the amount by which we expect student loans to add to debt over the long term; and
- the various changes to **private pensions and savings policy** in recent years are likely to have a net cost over the long term that is greater than was apparent when they were announced and costed over a five-year horizon. Taken together, they have made pension saving less attractive – particularly for higher earners – while making non-pension saving more attractive – often in ways that can most readily be taken up by the same higher earners.

Long-term fiscal projections

- 11 We assess the potential fiscal impact of future government activity by making long-term projections of revenue, spending and financial transactions on an assumption of ‘unchanged policy’, as best we can define it. In doing so, we assume that spending and revenues initially evolve over the next five years as we forecast in our November 2016 *EFO*. This allows us to focus on long-term trends rather than making fresh revisions to the medium-term forecast. We have not made any further judgements or assumptions about the nature of the UK’s departure from the European Union beyond those that underpinned our November *EFO*.

Demographic, economic and health-specific assumptions

- 12 Demographic change is a key long-term pressure on the public finances. Like many developed nations, the UK is projected to have an ‘ageing population’ over the next few decades, with the ‘old-age dependency ratio’ – the ratio of the elderly to those of working age – rising. This reflects increasing life expectancy (particularly among older people), relatively low fertility rates, and the retirement of the post-war ‘baby boom’ cohorts.
- 13 We base our analysis on detailed population projections produced by the Office for National Statistics (ONS). In this *FSR* we use its 2014-based population projections – released in October 2015. As in our 2015 *FSR*, we base our fiscal projections on the ‘principal’ ONS population projection. This assumes net inward migration falls to 185,000 a year by 2021 and remains at that level thereafter. We test the sensitivity of our conclusions to using the different ONS variants. Relative to the 2012-based projections that underpinned our 2015 *FSR*, the main differences are higher net migration and slightly higher mortality at older ages – these both mean that the old-age dependency ratio rises less rapidly than in our previous report.
- 14 As regards the economy, we assume in our central projection that whole economy productivity growth will average 2.0 per cent a year, weaker than we assumed in our last report following successive downward revisions to our medium-term assumptions. Partly offsetting that, we have revised up employment growth by around 0.1 percentage points a year as we have factored in more years of outturn to the long-term averages that underpin

our labour market cohort model. We assume CPI inflation of 2.0 per cent (consistent with the Bank of England's target) – unchanged from our last report. But we have made small revisions to other price assumptions, including assuming a transitional period of higher RPI inflation as interest rates are assumed to normalise, before it reverts to our long-term assumption of 3.0 per cent (unchanged from our last report).

- 15 In previous reports, we have presented sensitivity analysis showing how our projections would look if we assumed that productivity growth in the health sector averaged less than in the whole economy, but spending was allowed to rise to keep the volume of health services rising in line with whole economy productivity. That would more closely match past experience and suggested a significantly bigger long-term fiscal challenge.
- 16 In this year's report, in line with the conclusions of our working paper that reviewed the available evidence and the approaches taken by international institutions and the Congressional Budget Office (CBO) in the US, we have decided to alter our central assumptions about health spending. Specifically, we assume that non-demographic cost pressures – a different, but related, concept to weaker health sector productivity growth – add 1 percentage point a year to health spending growth in the long term, with a transitional period up to 2036-37 during which that excess cost growth falls from the latest available estimates for primary and secondary care (which are higher than 1 percentage point) back to the long-term assumption. This approach and the values that we have chosen are most similar to those used by the CBO. Its adoption has pushed up our long-term health spending projection significantly.

Defining 'unchanged' policy

- 17 Fiscal sustainability analysis is designed to identify whether and when changes in government policy may be necessary to move the public finances from an unsustainable to a sustainable path. To make this judgement, we must first define what we mean by 'unchanged' policy over the long term.
- 18 Government policy is rarely clearly defined over the long term. In many cases, simply assuming that a stated medium-term policy continues for 50 years would be unrealistic. Where policy is not clearly defined over the long term, the *Charter for Budget Responsibility* allows us to make appropriate assumptions. These are set out clearly in the report. Consistent with the *Charter*, we only include the impact of policy announcements in our central projections when they can be quantified with "reasonable accuracy".
- 19 In our central projections, our assumption for unchanged policy is that beyond 2021-22 underlying age-specific spending on public services, such as health and education, rises with per capita GDP. Changes in the starting point for our projections are often important. Relative to our 2015 FSR, two sources of change are worth noting:
 - in the **2016 Autumn Statement**, the Government set medium-term fiscal policy in a way that is expected to leave a small deficit in 2021-22 – that contrasts with the March

2015 Budget that underpinned our last projections, where the budget was expected to be in surplus in the final year (2019-20 at that point); and

- spending on public services has been allocated up to 2019-20 – and in some cases 2020-21 – in the **2015 Spending Review**. From a long-term perspective, the most important decision was to allocate a rising share of departmental spending to health, which is subject to both demographic and non-demographic cost pressures.

- 20 We assume that most tax thresholds and benefits are updated in line with earnings growth rather than inflation beyond the medium term, which provides a more neutral baseline for long-term projections. An inflation-based assumption would, other things equal, imply an ever-rising ratio of tax to national income and an ever-falling ratio of benefit payments to average earnings in the rest of the economy.
- 21 We have assumed in our central projection that the ‘triple lock’ on state pensions uprating continues to apply – and have assumed that on average it leads to the state pension being uprated by 0.34 percentage points faster than earnings growth. The Chancellor has said that the Government will review whether this commitment will continue into the next Parliament *“in light of the evolving fiscal position at the next Spending Review”* – the date for which has not yet been set. We test the sensitivity of our projections to assuming no triple lock premium.

Results of our projections

- 22 Having defined unchanged policy, we apply our demographic and economic assumptions to produce projections of the public finances over the next 50 years.

Expenditure

- 23 An ageing population and health-specific cost pressures will put upward pressure on public spending. We project total non-interest public spending to rise from 35.8 per cent of GDP at the end of our medium-term forecast in 2021-22, to 43.8 per cent of GDP by 2066-67. That would represent an overall increase of 8.0 per cent of GDP – equivalent to £156 billion in today’s terms. Of that, 4.5 per cent of GDP (£88 billion) reflects our new assumption about additional non-demographic cost pressures pushing up growth of health spending.
- 24 The main drivers are upward pressures on key items of age-related spending:
- **health spending** rises from 6.9 per cent of GDP in 2021-22 to 12.6 per cent of GDP in 2066-67, rising smoothly as the population ages and non-demographic cost pressures push spending higher. This profile is much steeper than in our last report. Less challenging demographic trends and a change in our assumption about morbidity in later life reduce growth in spending, but a higher starting point and – most importantly – the inclusion of non-demographic cost pressures, push it up much more;
 - **state pension costs** increase from 5.0 per cent of GDP in 2021-22 to 7.1 per cent of GDP in 2066-67 as the population ages. This profile is little changed from our last

report given the relatively small change in the old-age dependency ratio in the latest ONS population projections and that some of the effect of that on spending is offset by the State Pension age being assumed to move with changes in longevity; and

- **long-term social care costs** rise from 1.1 per cent of GDP in 2021-22 to 2.0 per cent of GDP in 2066-67, reflecting the ageing of the population and the previous Government's announcement of a lifetime cap on certain long-term care expenses incurred by individuals. The projections are slightly lower than in our last report as the medium-term decisions that the Government has taken since then imply less spending than in our demand-led assumptions that underpinned that report. As the recent announcement of accelerated increases in council tax-financing for adult social care only affects the profile of spending over the medium term, not the end point, we have not adjusted our projections on that account.

Revenue

- 25 Demographic factors will have less impact on revenues than on spending. Non-interest revenues are projected to be all-but flat across the projection period as a share of GDP. In our central projections, those revenue streams that are not affected by demographics are explicitly held constant as a share of GDP – even though non-demographic factors may affect them in the future. Given the timing of this year's report, we have not undertaken further analysis of such non-demographic factors.

Financial transactions

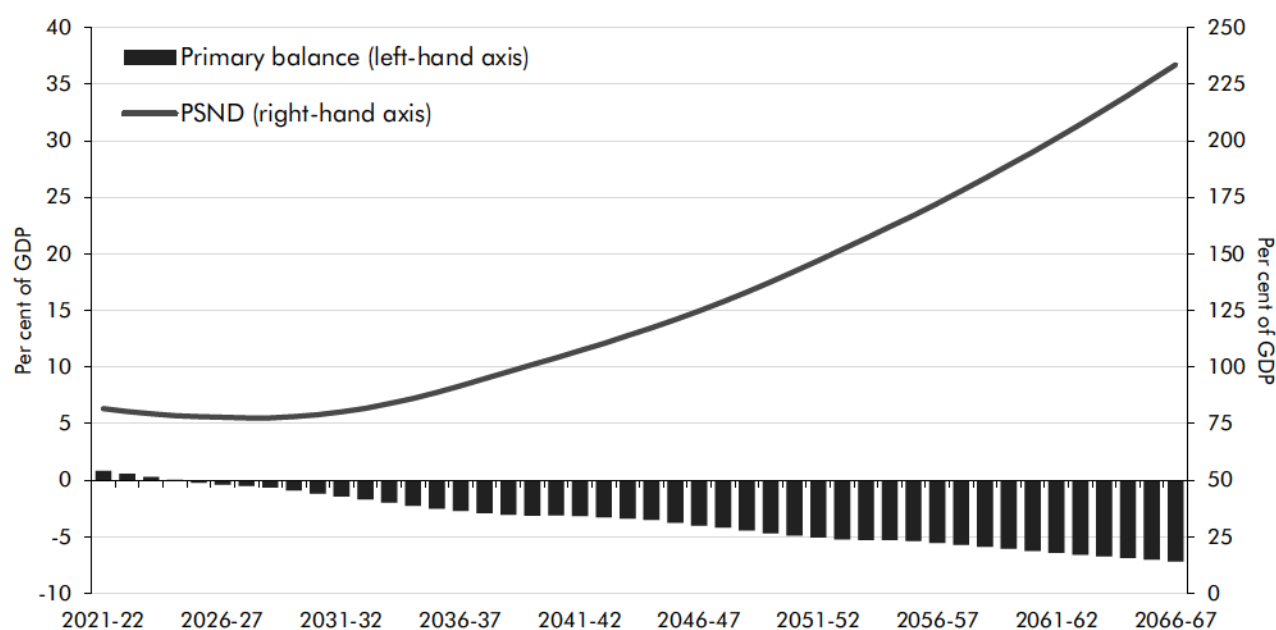
- 26 In order to move from spending and revenue projections to an assessment of the outlook for public sector net debt, we need also to take public sector financial transactions into account. These affect net debt directly, without affecting accrued spending or borrowing.
- 27 For the majority of financial transactions, we assume that the net effect is zero. Student loans are an important exception. Lending to students adds to net debt immediately through financing the outlays. Repayments then reduce that addition, but not completely because some of the lending is expected to be written-off rather than repaid. The biggest effect on our projections since our last report comes from new policies. Some previous grant-funding has been converted into lending (e.g. for nurses), while eligibility has been broadened (e.g. for postgraduate courses). The Government has also changed repayment terms for some graduates, increasing repayments. The net effect has been to push the peak effect on net debt up to 11.1 per cent of GDP in the late-2030s. By 2066-67, the addition to net debt is projected to fall back slightly to 9.3 per cent of GDP.
- 28 The Government continues to reduce the assets held by UKAR through active sales and the natural rundown of mortgages. It has also reduced its shareholding in Lloyds Banking Group to the point where it is expected to have sold its entire stake by the end of 2017-18. But it retains a significant stake in RBS. The sale of financial assets is classified as a financial transaction in the public finances data. Sales reduce public sector net debt directly and indirectly via net borrowing (because interest is paid on a smaller stock of debt), but typically (and in the case of these sales) the government also loses a related income stream. Over the

long term, therefore, the net impact of asset sales on net debt is significantly less than the sale price. The effect on broader balance sheet measures that factor in more types of asset is typically close to zero because the sales involve converting one type of asset (mortgages or shares) into another (cash).

Projections of the primary balance and public sector net debt

- 29 Our central projections show public spending increasing as a share of national income beyond the medium-term forecast horizon, exceeding receipts by increasing amounts over the projection period. As a result, the primary budget balance (the difference between non-interest revenues and spending that is the key to the public sector's debt dynamics) is projected to move from a surplus of 0.8 per cent of GDP in 2021-22 to a deficit by the mid-2020s, with the deficit reaching 7.2 per cent of GDP in 2066-67 – an overall deterioration of 8.0 per cent of GDP, equivalent to £156 billion in today's terms.
- 30 Taking this and our projection of financial transactions into account, PSND is projected to fall from its medium-term peak of just over 90 per cent of GDP in 2017-18 to below 80 per cent of GDP for most of the 2020s, before rising steadily thereafter and reaching 234 per cent of GDP in 2066-67. Beyond this point, debt would remain on a rising path.

Chart 1: Central projection of the primary balance and PSND



Source: OBR

- 31 The primary balance and PSND at the end of the projection period are much higher than in our 2015 FSR projections. As Table 1 shows, this reflects:
- **classification changes** to housing associations, which have been reclassified to the public sector, have a small effect on the primary balance but a larger effect on net debt in the short term that increases over the projection period;

- our judgement in this year's FSR that **health spending will rise to accommodate non-demographic cost pressures** increases the projected budget deficit and public debt since our 2015 FSR;
- the **changes to our projections that reflect policy measures and other developments since the 2015 FSR are more modest**, but on balance imply yet greater pressure on the public finances over the next 50 years. The underlying outlook for the public finances over the medium term has deteriorated and the Government has also chosen to increase planned public services spending, including on health (to which the mounting cost pressures apply). This puts upward pressure on deficits and debt, more than offsetting the impact of the net welfare cuts and tax increases announced since 2015; and
- taking all these factors into account, if left unaddressed **our latest projections suggest that the primary deficit would rise to 7.2 per cent of GDP and PSND to 234 per cent of GDP in 2066-67 and continue rising thereafter**. The big picture of upward pressure from health costs and ageing is common to many industrial countries.

Table 1: Changes in the primary balance and net debt since FSR 2015

	Primary balance 2021-22	Primary balance 2066-67	Net debt 2066-67
FSR 2015	2.0	-2.0	91
Housing Associations reclassification	0.0	0.0	8
Excess cost growth applied after 2021-22 to health spending assumption	0.0	-4.5	89
FSR 2015 restated post-reclassifications and excess health cost growth	1.9	-6.5	188
Weaker medium-term forecast on a pre-measures basis	-1.6	-1.6	54
Other modelling assumptions	0.0	0.6	4
Total pre-policy measures changes	-1.6	-1.0	58
FSR 2017 pre-policy measures	0.3	-7.5	247
Health	-0.3	-0.7	17
Receipts	0.8	0.8	-26
Welfare	0.6	0.6	-21
Other spending	-0.5	-0.4	17
Total policy-related changes	0.5	0.3	-13
FSR 2017	0.8	-7.2	234
<i>Memo: Breakdown of health spending policy change effect:</i>			
Health spending policy changes excluding excess cost growth	-0.3	-0.4	
Excess cost growth on higher health spending	0.0	-0.3	

32 We have not attempted to quantify the impact of Brexit on the change in the projections since the 2015 FSR, as we did in the November EFO for changes in our medium-term forecast since March. Qualitatively, our November judgements about Brexit explain some of the underlying deterioration in the medium-term jumping-off point since our March 2015 EFO, while net migration being lower than would otherwise have been the case would push debt higher. The downward revision to our long-term productivity growth assumption is not a Brexit-related judgement, although given the way our long-term projections are produced,

any changes would affect both numerator and denominator in the debt-to-GDP ratio, so would have little effect on the fiscal projections.

- 33 Needless to say, there are huge uncertainties around any projections that extend this far into the future. Small changes to underlying assumptions can have large effects on the projections once they have been cumulated across many decades. We therefore test these sensitivities using a number of different scenarios.
- 34 The eventual increase in PSND would be greater than in our central projection if long-term interest rates turned out to be higher relative to economic growth, if the age structure of the population was older, or if net inward migration (which is concentrated among people of working age) was lower than in our central projection.
- 35 Given the importance of health spending in the long-term challenge to fiscal sustainability, the rate of productivity growth in the sector or the pace at which non-demographic pressures push spending up are important assumptions. Faster or slower excess cost growth would see health spending rise by more or less than in our central projection – by +2.4/-2.0 per cent of GDP in the +/-0.5 percentage point sensitivity analyses we present. If, rather than assuming excess cost growth, we assume productivity growth was weaker in the health sector than in the rest of the economy, and health spending was to be increased more quickly to compensate, then in our illustrative scenario health spending would rise by 4.8 per cent of GDP between 2021-22 and 2066-67 – 1.0 per cent less than in our central projection.

Summary indicators of fiscal sustainability

- 36 In our central projections, and under the variants we calculate, on current policy we would expect the budget deficit to widen significantly over the long term, putting public sector net debt on a rising trajectory as a share of national income. This would not be sustainable.
- 37 Summary indicators of sustainability can be used to illustrate the scale of the challenge more rigorously and to quantify the tax increases and/or spending cuts necessary to return the public finances to different definitions of sustainability. We focus on a measure of sustainability that asks how big a permanent spending cut or tax increase would be necessary to move public sector net debt to a particular desired level at a particular chosen date. This is referred to as the 'fiscal gap'.
- 38 There is no consensus on what would be an optimal level for the public debt to GDP ratio. So for illustration, we calculate the additional fiscal tightening necessary from 2022-23 to return PSND to 20, 40 or 60 per cent of GDP at the end of our projections in 2066-67. In practice, given that expenditure pressures in our projections build up gradually over time, a phased fiscal adjustment might be considered a more realistic illustration. We also calculate what additional fiscal tightening would be necessary to hit these thresholds in 2066-67 if, to begin with, the Government meets its challenging objective of reducing the overall deficit to zero in the next Parliament (i.e. by 2025-26).

- 39 Under our central projections, a once-and-for-all policy tightening of 4.3 per cent of GDP in 2022-23 (£84 billion in today's terms) would see the debt ratio at 40 per cent of GDP in 2066-67. But this is less than the 7.0 per cent of GDP required to stabilise debt over the longer term and so the debt ratio would continue rising beyond the target date. Tightening policy by 1.5 per cent of GDP a decade would see the debt ratio fall more slowly to begin with, but the overall tightening would be large enough to stabilise the debt ratio at around the target level and prevent it from taking off again. These estimates are significantly bigger than in our last report due to the non-demographic cost pressures factored into our central health spending projection. Targeting debt ratios of 20 and 60 per cent of GDP would require larger and smaller adjustments respectively.
- 40 If the Government was to meet its objective of reducing the deficit to zero in the next Parliament, a further once-and-for-all policy tightening of 2.8 per cent of GDP in 2026-27 would see the debt ratio reach 40 per cent of GDP in 2066-67. Tightening policy by 1.1 per cent of GDP a decade would also stabilise the debt ratio at that level. But balancing the budget in the next Parliament will be challenging in the face of ageing pressures on health, social care and state pensions spending, and if non-demographic pressures on health spending continue at close to their recent pace. That would be true even if tax and benefit thresholds were uprated in line with inflation rather than earnings over the next Parliament, boosting tax receipts through fiscal drag and reducing welfare spending through the erosion of the average awards relative to average earnings.

B Fiscal impact of policy decisions

B.1 The tables in this annex show the fiscal impact of policy decisions taken at Autumn Statement 2016, and Spring Budget 2017; and of measures announced earlier which take effect from April 2017 or later.

B.2 The government has decided not to proceed with the class 4 National Insurance Contributions measures set out in the Spring Budget. The government will set out in the Autumn Budget further measures to fund, in full, this decision.

Table 2.1: Autumn Statement 2016 policy decisions (£ million)¹

	Head	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22 ²	
Changes to Inherited Policy								
1	Personal Independence Payment: not implementing Budget 2016 measure	Spend	-15	-605	-1,250	-1,400	-1,390	-1,410
2	Universal Credit: reprofile	Spend	-20	-295	-445	-185	-110	-425
3	Disability benefits: eligibility test change	Spend	-20	-20	-20	-20	-15	-15
4	Social Sector Rent downrating: exemptions	Spend	0	-5	-10	-15	-15	-15
5	Pay to Stay: do not implement	Spend	0	-280	-15	-100	-100	-105
6	Local Housing Allowance: adjusted roll-out and supported housing fund	Spend	0	0	-305	-265	+160	+125
Public Spending								
7	Efficiency Review: reinvestment	Spend	0	0	0	-1,000	-	-
National Productivity Investment Fund								
8	Housing	Spend	-10	-1,465	-2,060	-2,490	-2,145	-
9	Transport	Spend	0	-475	-790	-705	-1,050	-
10	Telecoms	Spend	0	-25	-150	-275	-290	-
11	Research and Development	Spend	0	-425	-820	-1,500	-2,000	-
12	Long-term investment	Spend	0	0	0	0	0	-7,000
An economy that works for everyone								
13	Fuel Duty: freeze in 2017-18	Tax	0	-845	-845	-860	-885	-910
14	Universal Credit: reduce taper to 63%	Spend	0	-35	-175	-400	-570	-700
15	NS&I Investment Bond	Spend	0	-45	-85	-90	-45	0
16	Right to Buy: expand pilot	Spend	0	-25	-90	-110	-25	0
17	National Living Wage: additional enforcement	Spend	0	-5	-5	-5	-	-
Tax reform								
18	Insurance Premium Tax: 2ppt increase from June 2017	Tax	0	+680	+840	+840	+845	+855
19	National Insurance contributions: align primary and secondary thresholds	Tax	0	+170	+145	+145	+145	+145
20	Salary Sacrifice: remove tax and NICs advantages	Tax	-10	+85	+235	+235	+235	+260
21	Money Purchase Annual Allowance: reduce to £4,000 per annum	Tax	0	+70	+70	+70	+75	+75
22	Company Car Tax: reforms to incentivise ULEVs	Tax	0	0	0	0	+25	+5

	Head	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22 ²
Avoidance, Evasion, and Imbalances							
23 VAT Flat Rate Scheme: 16.5% rate for businesses with limited costs	Tax	0	+195	+130	+130	+125	+115
24 Disguised Remuneration: extend to self-employed and remove company deduction	Tax	+10	+25	+180	+310	+40	+65
25 Adapted motor vehicles: prevent abuse	Tax	0	+20	+15	+15	+15	+15
26 Employee Shareholder Status: abolish tax advantage for new schemes	Tax	*	+10	+15	+15	+25	+50
27 HMRC: administration and operational measures	Tax	-115	-20	+50	+170	+215	+180
28 Offshore Tax: close loopholes and improve reporting	Tax	0	+10	+25	+15	+60	+70
29 Money Service Businesses: bulk data gathering	Tax	0	0	+5	+5	+10	+10
Other Tax and Spending							
30 Overseas Development Assistance: meet 0.7% GNI target	Spend	0	+80	+210	0	–	–
31 MoJ: prison safety	Spend	0	-125	-245	-185	–	–
32 Grammar Schools expansion	Spend	0	-60	-60	-60	-60	–
33 Tax credits: correcting awards	Spend	-95	-80	-65	-55	-40	-25
34 Biomedical catalysts and Technology Transfers	Spend	0	-40	-60	-60	-60	–
35 DCMS Spending	Spend	-10	-10	-20	-15	-10	–
36 Midlands Rail Hub	Spend	0	-5	-5	0	–	–
37 Scotland City Deals and Fiscal Framework	Spend	0	-25	-60	-75	-50	-25
38 Mayfield Review of Business Productivity	Spend	0	-5	-5	-5	–	–
39 Business Rates: support for broadband and increase Rural Rate Relief	Tax	0	-10	-15	-15	-20	-25
40 Gift Aid: reforms	Tax	0	*	-10	-15	-15	-20
41 Museums and Galleries tax relief	Tax	0	-5	-30	-30	-30	-30
42 Social Investment Tax Relief: implement with a £1.5m cap	Tax	0	+10	+5	+5	*	-5
43 Offpayroll working: implement consultation reforms	Tax	0	+25	+20	+20	+25	+25
Total policy decisions		-285	-3,555	-5,695	-7,960	-6,925	-8,715
Total policy decisions excluding NPIF and inherited policy³		-220	+40	+170	-5	+30	+130
<i>Total tax policy decisions</i>		<i>+25</i>	<i>+375</i>	<i>+640</i>	<i>+720</i>	<i>+565</i>	<i>+555</i>
<i>Total spending policy decisions</i>		<i>-310</i>	<i>-3,930</i>	<i>-6,335</i>	<i>-8,680</i>	<i>-7,490</i>	<i>-9,270</i>

* negligible.

¹ Costings reflect the OBR's latest economic and fiscal determinants.

² At Spending Review 2015, the government set departmental spending plans for RDEL for years up to 2019-20 and CDEL for years up to 2020-21. RDEL budgets have not been set for most departments for 2020-21 and beyond and CDEL for 2021-22. Given this, RDEL figures are not set out for 2020-21 and beyond and specific measures of CDEL are not set out for 2021-22.

³ Excluding measures 1-12 on the scorecard.

Table 2.1: Spring Budget 2017 policy decisions (£ million)¹

	Head	2017-18	2018-19	2019-20	2020-21	2021-22 ²	
Raising Productivity and Living Standards							
1	16-19 Technical Education: implement Sainsbury reforms	Spend	0	-60	-115	-250	-445
2	Education capital: extend free schools programme	Spend	-20	-30	-50	-280	-655
3	Education capital: school investment	Spend	0	-130	-130	0	0
4	Labour market participation: funding for returnships	Spend	*	-5	0	-	-
5	Business Rates: discretionary support fund	Tax	-180	-85	-35	-5	0
6	Business Rates: targeted support for Small Business Rate Relief recipients	Tax	-25	-20	-20	-25	-25
7	Business Rates: £1,000 discount for smaller pubs for 2017-18	Tax	-25	*	0	0	0
8	Regional and other spending	Spend	-15	-10	-5	0	0
An economy that works for everyone and public spending							
9	Social Care: additional funding	Spend	-1,200	-800	-400	-	-
10	NHS: Accident and Emergency streaming	Spend	-120	0	0	0	0
11	NHS: Sustainability and Transformation Plans	Spend	-130	-130	-130	0	0
12	Tackling domestic violence and abuse	Spend	0	-10	-10	0	0
13	Free school transport: expand eligibility to selective schools	Spend	0	-5	-5	-5	-5
14	International Women's Day: voting rights centenary commemoration	Spend	-5	0	0	-	-
Tax Sustainability and Fairness							
15	Class 4 NICs: increase to 10% from April 2018 and 11% from April 2019	Tax	0	+325	+645	+595	+495
16	Dividend Allowance: reduce to £2,000 from April 2018	Tax	*	+5	+870	+825	+930
17	Making Tax Digital: one year deferral for businesses with turnover below VAT threshold	Tax	*	-20	-65	-150	-45
18	Stamp Duty Land Tax: delay reduction in payment window to 2018-19	Tax	-105	+95	*	*	*
19	Aggregates Levy: freeze for April 2017	Tax	-15	-15	-15	-15	-15
20	Heavy Goods Vehicles: freeze VED and Road User Levy	Tax	-10	-10	-10	-10	-10
21	Packaging Recycling Targets: set rates for 2018-2020	Tax	*	*	-5	-5	-5
Avoidance, Evasion and Imbalances							
22	Tax avoidance: new penalty for enablers of tax avoidance	Tax	+10	+50	+20	+20	+15
23	Qualifying Recognised Overseas Pension Schemes: targeted charge	Tax	+65	+60	+60	+65	+65
24	Tax treatment of transfers to trading stock: prevent abuse	Tax	+25	+15	+15	+15	+15
25	VAT on telecoms outside the EU: align with international practice and prevent avoidance	Tax	+45	+65	+65	+65	+65

	Head	2017-18	2018-19	2019-20	2020-21	2021-22 ²
Previously announced welfare policy decisions						
26 Tax Credit Debt: enhanced collection	Spend	0	+60	+180	+145	+135
27 Living Together Data Fraud: enhanced data collection	Spend	*	+5	*	*	*
28 Child Tax Credit and Universal Credit: targeted exceptions to two child limit	Spend	-5	-15	-35	-55	-70
Total policy decisions		-1,710	-665	+825	+930	+445
Total spending policy decisions		-1,545	-1,140	-705	-450	-1,040
Total tax policy decisions		-165	+475	+1,530	+1,380	+1,485

* Negligible

¹ Costings reflect the OBR's latest economic and fiscal determinants.

² At Spending Review 2015, the government set departmental spending plans for resource DEL (RDEL) for the years up to and including 2019-20, and capital DEL (CDEL) for the years up to and including 2020-21. Where specific commitments have been made beyond those periods, these have been set out on the scorecard. Where a specific commitment has not been made, adjustments have been made to the overall spending assumption beyond the period.

Table 2.2: Measures announced at Autumn Statement 2016 or earlier that will take effect from April 2017 or later (£ million)¹

	Head	2017-18	2018-19	2019-20	2020-21	2021-22	
Measures announced at Autumn Statement 2016							
a	Social Sector Rent downrating: exemptions	Spend	-5	-10	-15	-15	
b	Local Housing Allowance: adjusted roll-out and supported housing fund	Spend	0	-310	-260	+165	+130
c	Fuel Duty: freeze in 2017-18	Tax	-990	-985	-1005	-1030	-1060
d	Universal Credit: reduce taper to 63%	Spend	-35	-175	-400	-570	-700
e	NS&I Investment Bond	Spend	-65	-95	-100	-30	0
f	Right to Buy: expand pilot	Spend	-25	-90	-110	-25	0
g	Insurance Premium Tax: 2ppt increase from June 2017	Tax	+520	+840	+840	+845	+855
h	National Insurance contributions: align primary and secondary thresholds	Tax	+180	+150	+155	+155	+155
i	Salary Sacrifice: remove tax and NICs advantages	Tax	+85	+235	+235	+235	+260
j	Money Purchase Annual Allowance: reduce to £4,000 per annum	Tax	+65	+70	+70	+70	+70
k	Company Car Tax: reforms to incentivise ULEVs	Tax	0	0	0	+30	+5
l	VAT Flat Rate Scheme: 16.5% rate for businesses with limited costs	Tax	+165	+135	+135	+130	+125
m	Disguised Remuneration: extend to self-employed and remove company deduction	Tax	+65	+170	+290	+45	+70
n	Adapted motor vehicles: prevent abuse	Tax	+20	+15	+15	+15	+15
o	HMRC: administration and operational measures	Tax	-20	+40	+170	+215	+185
p	Offshore Tax: close loopholes and improve reporting	Tax	+15	+25	+15	+65	+80
q	Money Service Businesses: bulk data gathering	Tax	0	+5	+5	+10	+10
r	Business Rates: support for broadband and increase Rural Rate Relief	Tax	-15	-20	-25	-20	-15
s	Gift Aid: reforms	Tax	*	-10	-15	-15	-20
t	Museums and Galleries tax relief	Tax	-40	-35	-35	-35	-40
u	Social Investment Tax Relief: implement with a £1.5m cap	Tax	+10	+5	+5	*	-5
v	Offpayroll working: implement consultation reforms	Tax	+20	+15	+15	+20	+20
Measures announced at Budget 2016							
w	Public Service Pensions: update to discount rate	Spend	0	0	+1975	+2025	+2070
x	Personal Allowance: increase to £11,500 in April 2017	Tax	-1700	-1950	-1940	-1930	-1995
y	Higher Rate Threshold: increase to £45,000 in April 2017	Tax	-380	-640	-595	-605	-610
z	Lifetime ISA and raise ISA limit to £20,000	Spend	-185	-345	-600	-860	-1160
aa	Savings: remove withholding tax obligations	Tax	-240	-45	-80	-95	-100
ab	Financial Advice Markets Review: increase tax relief on employer provided pension advice	Tax	-10	-10	-5	*	*
ac	Soft Drinks Industry Levy	Tax	0	+385	+390	+385	+380

	Head	2017-18	2018-19	2019-20	2020-21	2021-22	
ad	Business Rates: permanently double the Small Business Rate Relief and extend thresholds	Tax	-1375	-1390	-1440	-1485	-1530
ae	Business Rates: increase threshold for higher multiplier to £51,000	Tax	-110	-110	-115	-115	-125
af	Business Rates: switch from RPI in April 2020	Tax	0	0	0	-270	-830
ag	Corporation Tax: reduce to 17% in April 2020	Tax	0	0	-510	-2640	-2570
ah	Corporation Tax: restrict relief for interest	Tax	+1105	+1140	+1080	+980	+1020
ai	Corporation Tax: reform loss relief	Tax	+495	+355	+305	+255	+215
aj	Corporation Tax: extend first year allowance and lower emission thresholds for business cars	Tax	0	+45	+115	+180	+190
ak	Corporation Tax: defer bringing forward payment for large groups for two years	Tax	+35	+30	-15	-10	*
al	Capital Gains Tax: extend reliefs	Tax	-45	-40	-45	-45	-45
am	Self Employed: abolish Class 2 NICs	Tax	0	-405	-430	-380	-350
an	Sharing Economy: £1,000 allowance for both trading and property income	Tax	-30	-235	-195	-200	-215
ao	Business Energy: abolish Carbon Reduction Commitment and offsetting increase to Climate Change Levy	Tax	0	0	+390	+35	+90
ap	Carbon Price Support Rate: cap at £18/tCO2 in April 2019 and uprate in April 2020	Tax	0	0	0	+20	+35
aq	Off-payroll working: transfer liability to public sector employers	Tax	+185	+105	+150	+170	+190
ar	Aligning the tax and employer NICs treatment of termination payments and preventing manipulation of the rules	Tax	+40	+365	+400	+415	+430
as	Value Added Tax: tackling overseas trader evasion	Tax	+65	+130	+315	+365	+325
at	Gambling Duties: reform treatment of freeplays	Tax	+45	+70	+75	+75	+80
au	Help to Save	Spend	0	0	-25	-85	-65
av	Local Housing Allowance: implement for new tenancies from April 2017	Spend	0	-130	-75	-35	-20

Measures announced at Spending Review and Autumn Statement 2015

aw	Apprenticeship Levy (funding employer apprenticeship scheme)	Tax	+2630	+2720	+2810	+2925	+3045
ax	Stamp Duty Land Tax: bringing forward payments	Tax	+100	+5	+5	+10	+10
ay	Capital Gains Tax: reduce payment window for residential property	Tax	0	0	+1190	+315	+105
az	Temporary accommodation: impact of new funding mechanism	Spend	+225	+235	+245	+260	+270
ba	Insurance Premium Tax: reform to motor insurance claims rules	Tax	0	-10	-40	-50	-55
bb	Making Tax Digital: reducing errors through record keeping	Tax	0	+10	+400	+805	+965
bc	Housing Benefit: limit social sector rates to the equivalent private sector rate	Spend	0	+440	+570	+660	+740
bd	Pensions automatic enrolment: align with start of tax year	Tax	+315	+360	-30	-35	-35

	Head	2017-18	2018-19	2019-20	2020-21	2021-22	
Measures announced at Summer Budget 2015							
be	Inheritance Tax: £1m couples allowance from 2020 through new main residence nil-rate band phased in from 2017	Tax	-265	-565	-610	-650	-725
bf	Childcare: 30 hour entitlement for working parents of 3 and 4 year olds	Spend	-415	-680	-700	-715	-710
bg	Corporation Tax: reduce to 19% from 2017-18, and 18% from 2020-21	Tax	-2280	-2190	-3105	-4890	-5245
bh	Corporation Tax: bringing forward payments for large groups	Tax	-35	-30	-20	-20	-20
bi	Residential property: restrict finance relief to basic rate, phase from 2017	Tax	0	+225	+430	+655	+940
bj	VED: reform for new cars purchased from 2017, hypothecated to roads fund from 2020-21	Tax	+175	+675	+895	+1340	+1735
bk	Non-domiciles: abolish permanent status	Tax	-20	+410	+330	+315	+310
bl	Non-domiciles: IHT on UK residential property	Tax	+25	+80	+50	+55	+65
bm	Limit child element to 2 children for new births in tax credits and new claims in UC	Spend	+310	+765	+1205	+1615	+1990
bn	End automatic entitlement for out-of-work 18-21 year olds	Spend	+5	+25	+35	+35	+40
bo	Align Work-Related Activity Group rate with JSA for new claims	Spend	+30	+110	+165	+205	+230
bp	UC parent conditionality from when youngest child turns 3	Spend	-5	0	+35	+35	+35
bq	TV Licence: BBC funding for over-75s	Spend	0	+180	+430	+735	+765
Measures announced at March Budget 2015							
br	Affordable housing: Housing Benefit impact	Spend	0	-5	-15	-20	-20
bs	Company car taxation: 3ppt increase in 2019-20	Tax	0	0	+305	+315	+325
Measures announced at Autumn Statement 2014							
bt	Peer-to-peer lenders: withholding tax regime	Tax	+30	0	+5	+15	+15
bu	Bereavement benefits reform	Spend	-25	-25	0	+35	+60
bv	Work allowances: maintain current level in 2017-18	Spend	+10	+50	+90	+180	+230
Measures announced at Budget 2014							
bw	Company Car Tax: continuing to increase by 2ppt in 2017-18 and 2018-19	Tax	+200	+410	+420	+430	+445
Measures announced at Autumn Statement 2013							
bx	HMRC: extending online services	Tax	+15	+25	+25	+25	+25

* Negligible

¹ Costings reflect the OBR's latest economic and fiscal determinants.

C Supplementary data tables

C.1 Information in these tables is consistent with the OBR's March 2017 'Economic and fiscal outlook' (EFO) and supplementary tables, unless otherwise noted. The OBR's supplementary tables are available at: <http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2017/>

C.2 Any HM Treasury calculations are derived from and consistent with published sources. Further details of outturn statistics drawn from Spring Budget 2017 or EFO can be found in the data sources documents on the HMT and OBR websites respectively.

Table C.1: Macroeconomic prospects

	Level ¹	Rate of change					
	2016	2016	2017	2018	2019	2020	2021
Real GDP	1706.9	1.8	2.0	1.6	1.7	1.9	2.0
Nominal GDP	1675.0	3.6	3.8	3.1	3.4	3.8	4.0
Private consumption expenditure ²	1121.1	3.0	1.8	0.9	1.7	1.7	1.9
Government consumption expenditure	365.3	0.8	1.2	0.7	0.4	0.9	1.3
Gross fixed capital formation	310.6	0.5	0.8	3.0	3.3	3.9	3.4
Changes in inventories and net acquisition of valuables (% of GDP) ³	0.1	-0.5	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	565.1	1.4	3.4	3.0	1.6	0.7	0.5
Imports of goods and services	617.2	2.5	2.1	1.9	1.4	0.8	0.6
Contributions to real GDP growth							
Final domestic demand	-	2.2	1.5	1.2	1.7	1.9	2.0
Changes in inventories and net acquisition of valuables	-	-0.5	0.0	0.0	0.0	0.0	0.0
External balance of goods and services	-	-0.4	0.3	0.3	0.0	-0.1	-0.1

¹ Pounds sterling, billion.

² Includes households and non-profit institutions serving households.

³ Rate of change of changes in inventories and net acquisition of valuables is give as the percentage point year-on-year change.

Table C.2: Price developments

	Level	Rate of change					
	2016	2016	2017	2018	2019	2020	2021
GDP deflator	104.0	1.7	1.8	1.6	1.6	1.9	1.9
Private consumption deflator	103.2	1.2	2.5	2.3	2.0	2.0	2.0
HICP ¹	100.7	0.7	2.4	2.3	2.0	2.0	2.0
Public consumption deflator	100.7	0.6	1.2	0.8	0.4	0.9	1.2
Investment deflator	104.0	1.4	2.1	1.4	1.5	1.5	1.5
Export price deflator (goods and services)	96.4	3.7	5.2	0.8	0.9	1.0	1.0
Import price deflator (goods and services)	94.2	3.7	5.7	1.8	1.0	0.7	0.7

¹ The UK's Harmonised Index of Consumer Prices (HICP) is the Consumer Price Index (CPI).

Table C.3: Labour market developments

	Level	Rate of change					
	2016	2016	2017	2018	2019	2020	2021
Employment, persons (millions) ¹	31741.1	1.4	0.6	0.4	0.4	0.4	0.4
Employment, hours worked ²	1019.0	1.5	0.5	0.1	0.1	0.1	0.2
Unemployment rate (%) ³	4.9	-0.5	0.1	0.2	0.1	0.0	0.0
Labour productivity, persons ⁴	58,784.7	0.4	1.4	1.1	1.3	1.5	1.6
Labour productivity, hours worked ⁵	35.2	0.3	1.5	1.4	1.6	1.7	1.8
Compensation of employees ⁶	962.9	3.7	3.3	3.3	3.4	3.7	3.9
Compensation per employee ⁷	35,696.2	2.8	2.9	3.0	3.1	3.5	3.6

¹ All aged 16 and over

² Millions per week

³ ILO measure, all aged 16 and over. Rate of change is percentage point year on year change

⁴ GDP per worker, pounds sterling

⁵ GDP per hour, pounds sterling

⁶ Pounds sterling, billion

⁷ Pounds per worker

Table C.4: Sectoral balances

% of GDP	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Net lending/borrowing vis-à-vis the rest of the world	4.4	4.0	3.5	3.1	2.5	2.1
<i>of which:</i>						
- Balance on goods and services	-1.6	-1.8	-1.7	-1.7	-1.7	-1.6
- Balance of primary incomes and transfers	-2.9	-2.0	-1.7	-1.3	-0.8	-0.5
- Capital account	0.0	0.0	0.0	0.0	0.0	0.0

Table C.5: General government budgetary prospects

	£ billion				% of GDP			
	Outturn		Forecast					
	2015-16	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Net lending by sub-sector								
General government ¹	74.9	4.0	2.7	2.8	1.9	1.1	0.9	0.9
Central government	68.7	3.6	2.3	2.5	1.7	0.8	0.7	0.7
Local government	6.2	0.3	0.4	0.3	0.3	0.2	0.2	0.2
General government								
Total revenue	675.5	35.8	36.4	36.4	36.8	36.8	36.7	36.5
Total expenditure	750.4	39.8	39.1	39.3	38.7	37.9	37.6	37.4
Net borrowing ¹	74.9	4.0	2.7	2.8	1.9	1.1	0.9	0.9
Interest expenditure	45.9	2.4	2.5	2.8	2.5	2.4	2.3	2.3
Primary balance ²	-29.0	-1.5	-0.2	-0.1	0.6	1.4	1.4	1.4
Selected components of revenue								
Taxes on production and imports	243.2	12.9	12.9	13.1	13.2	13.3	13.2	13.2
Taxes on income and wealth	222.1	11.8	12.1	11.8	12.0	12.0	11.9	12.0
Capital taxes	4.7	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Social contributions	114.1	6.0	6.4	6.4	6.4	6.5	6.5	6.5
Other	91.5	4.8	4.7	4.9	4.9	4.8	4.8	4.5
Total revenue	675.5	35.8	36.4	36.4	36.8	36.8	36.7	36.5
Selected components of expenditure								
Current expenditure on goods and services	365.1	19.4	18.9	18.7	18.3	17.8	17.6	17.3
Net social benefits	230.8	12.2	11.8	11.7	11.5	11.2	11.1	11.1
Interest expenditure	45.9	2.4	2.5	2.8	2.5	2.4	2.3	2.3
Subsidies	12.2	0.6	0.8	0.9	1.0	1.0	1.1	1.1

	£ billion		% of GDP					
	Outturn			Forecast				
	2015-16	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Gross fixed capital formation	45.6	2.4	2.4	2.4	2.4	2.4	2.6	2.7
Other	50.7	2.7	2.5	2.9	3.0	2.9	3.0	3.0
Total expenditure	750.4	39.8	39.1	39.3	38.7	37.9	37.6	37.4

¹ Treaty deficit

² General government net borrowing less interest expenditure

Table C.6: No-policy change projections

	£billion		% of GDP					
	Outturn		Forecast					
	2015-16	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Total revenue at unchanged policies ¹	675.5	35.8	36.4	36.4	36.7	36.7	36.6	36.4
Expenditure on EU programmes fully matched by EU funds revenue ²	2.8	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Cyclical unemployment benefit expenditure ³	2.7	0.1	0.1	0.2	0.2	0.1	0.0	0.0
Discretionary revenue measures ⁴	-	-	-	0.0	0.1	0.1	0.1	0.1

¹ General government total revenue less discretionary revenue measures at Autumn Statement 2016 and Spring Budget 2017 (consistent with the OBR's Economic and fiscal outlook for each event).

² Expenditure on EU programmes fully matched by EU funds revenue is calculated as the 'Public sector receipts from the EU' row from the OBR's Table 2.26 in their March 2017 Economic and fiscal outlook supplementary fiscal tables. This only includes EU receipts that are administered by UK government bodies. (Excludes other private sector receipts that are not administered by UK government bodies.) The EU receipts that are administered by UK government bodies are not netted off current expenditure in the national accounts, because they are deemed to finance spending in the UK by the EU.

³ Cyclical unemployment benefit expenditure is calculated as is defined as COFOG subfunction 10.5, central government own expenditure on unemployment divided by GDP, and is consistent with Public Expenditure Statistical Analyses 2016 Table 6.4. Estimates used for plans data are subject to further revisions by departments. Universal credit additional costs that are not already included against other benefits are not included with the unemployment COFOG category.

⁴ Sum of discretionary revenue measures taken at Autumn Statement 2016 and Spring Budget 2017 (consistent with the OBR's Economic and fiscal outlook for each event). The government has decided not to proceed with the class 4 National Insurance Contributions measures set out in the Spring Budget 2017. The government will set out in the autumn Budget further measures to fund, in full, this decision.

Table C.7: Central government expenditure by function ^{1,2,3}

	% of GDP	
	2014-15	2019-20
General public services	3.4	3.6
Defence, public order and safety	2.8	2.7
Economic affairs	1.5	2.0
Environmental protection	0.3	0.2
Housing and community amenities	0.1	0.1
Health	7.2	7.3
Recreation, culture and religion	0.4	0.3
Education	2.2	2.0
Social protection	11.2	10.9
Total expenditure ⁴	30.9	31.1

¹Spending data used consistent with Public Expenditure Statistical Analyses (PESA) 2016, HM Treasury July 2016

²Central Government data taken from PESA 2016 Table 6.4

³Percentage of GDP calculations consistent with March 2016 EFO

⁴Total expenditure is more than just the sum of the functions, it also includes EU transactions and accounting adjustments

Table C.8: General government debt developments

	% of GDP						
	Outturn	Forecast					
		2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Gross debt ¹	87.6	87.5	87.7	87.7	86.5	84.8	83.6
Change in gross debt ratio	0.2	-0.1	0.2	0.0	-1.2	-1.7	-1.2
Contributions to changes in gross debt							
Primary balance ²	-1.5	-0.2	-0.1	0.6	1.4	1.4	1.4
Interest expenditure	2.4	2.5	2.8	2.5	2.4	2.3	2.3
Stock-flow adjustment ³	-1.4	0.7	0.1	0.9	0.7	0.6	1.1
Implicit interest rate on debt ⁴	2.9	3.0	3.3	3.0	2.9	2.8	2.8

¹Treaty debt

²General government net borrowing less interest expenditure

³Change in Treaty debt less general government net borrowing

⁴Interest expenditure as a percentage of Treaty debt in previous year

Table C.9: Cyclical developments

	% of GDP						
	Outturn			Forecast			
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Net borrowing of general government	4.0	2.7	2.8	1.9	1.1	0.9	0.9
Interest expenditure	2.4	2.5	2.8	2.5	2.4	2.3	2.3
Output gap	-0.2	0.1	0.1	-0.1	-0.1	-0.1	0.0
Cyclical budgetary component ²	0.2	0.0	-0.1	0.0	0.1	0.1	0.0
Cyclically-adjusted balance	-3.7	-2.7	-2.9	-1.9	-1.0	-0.9	-0.9
Cyclically-adjusted primary balance ³	-1.3	-0.2	-0.1	0.6	1.5	1.5	1.4
	Outturn			Forecast			
	2016	2017	2018	2019	2020	2021	2022
Real GDP growth (%) ³	1.8	2.0	1.6	1.7	1.9	2.0	-
Potential GDP growth (%) ³	1.7	1.9	1.8	1.9	2.0	2.0	-

¹Growth in real GDP and growth in potential GDP are expressed in calendar rather than financial years and is calculated on a non-oil basis.

² Treaty deficit less cyclically-adjusted treaty deficit

³ Cyclically-adjusted treaty deficit less interest expenditure

Table C.10: Divergence from previous update¹

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Real GDP growth (%)							
Previous update	2.1	2.0	2.2	2.1	2.1	2.2	-
Current update	1.9	2.0	1.8	1.6	1.8	1.9	2.0
Difference	-0.2	0.0	-0.5	-0.5	-0.3	-0.2	-
Treaty deficit (% GDP)²							
Previous update	3.9	2.9	2.0	1.1	-0.3	-0.4	-
Current update	4.0	2.7	2.8	1.9	1.1	0.9	0.9
Difference	0.1	-0.2	0.9	0.8	1.4	1.4	-
Treaty debt (% GDP)³							
Previous update	88.9	88.3	87.1	85.6	83.0	80.3	-
Current update	87.6	87.5	87.7	87.7	86.5	84.8	83.6
Difference	-1.3	-0.8	0.7	2.2	3.6	4.6	-

¹ Previous update numbers correspond to the OBR's March 2016 Economic and fiscal outlook

² General government net borrowing on a Maastricht basis

³ General government gross debt on a Maastricht basis

Table C11: Long-term sustainability of public finances¹

	% of GDP						
	Outturn	Forecasts/Projections					
		2015-16	2016-17	2020-21	2030-31	2040-41	2050-51
Total expenditure	40.1	39.9	38.0	40.6	44.6	48.0	51.9
Of which: age-related expenditures ²	21.1	20.8	19.9	21.8	23.9	25.4	26.8
State pensions	5.3	5.2	5.0	5.5	6.2	6.5	6.8
Pensioner benefits	0.9	0.9	0.8	0.8	0.9	0.9	0.9
Public service pensions	2.1	2.0	2.1	1.9	1.7	1.4	1.3
Health	7.4	7.3	7.0	8.2	9.6	10.8	12.0
Long-term care	1.0	1.0	1.1	1.4	1.6	1.9	2.0
Education	4.5	4.4	4.0	3.9	3.8	3.8	3.8
Net interest	1.6	1.8	1.5	1.9	3.6	5.2	7.6
Total revenue	36.1	36.4	37.0	37.5	37.9	37.9	38.0

¹Consistent with the central projection in the OBR's January 2017 Fiscal sustainability report

² Sum of pensions, pensioner benefits, public service pensions, health, long-term care and education

Table C.12: Contingent liabilities¹

£ billion	Year	
	2013-14	2014-15
Total quantifiable contingent liabilities	63.8	76.4
<i>Of which: financial stability interventions</i>	0.3	0.4

¹Taken from section 32.2 of 2013-14 Whole of Governments Accounts- year ended 31 March 2015, HM Treasury, 2016.

Table C.13: Basic assumptions

	2015-16	2016-17	2017-28	2018-19	2019-20	2020-21	2021-22
Short-term interest rate ¹ (annual average)	0.6	0.4	0.4	0.6	0.8	1.0	1.2
Long-term interest rate ² (annual average)	1.9	1.2	1.5	1.7	1.9	2.0	2.2
Nominal effective exchange rate ³	90.9	79.5	77.2	77.0	77.0	76.9	76.9
Exchange rate vis-à-vis the € (annual average)	1.37	1.19	1.16	1.16	1.15	1.14	1.14
	2015	2016	2017	2018	2019	2020	2021
Oil prices (Brent, USD/barrel)	52.4	44.0	56.3	56.3	56.7	57.9	59.0
Euro area GDP growth	1.9	1.7	1.6	1.6	1.5	1.5	1.5
Growth of relevant foreign markets	4.1	2.2	3.1	3.8	4.2	4.3	4.3

¹ 3 month sterling interbank rate (LIBOR)

² Weighted average interest rate on conventional gilts

³ Trade-weighted sterling

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