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(FSSR)

AUTUMN STATEMENT AND SPENDING REVIEW 2015: OVERVIEW

This document provides an overview of the joint Autumn Statement and Spending Review, published on 25 November. Further briefing will be provided at next week's pre-MPC presentation.

Key Points

- **Section A: The government remains on track to meet its fiscal mandate and supplementary target as set out in the revised *Charter for Budget Responsibility*. The welfare cap is, however, expected to be breached in the initial years of the forecast. Public sector net borrowing is now expected to be higher in the next few years and the OBR judge that GDP growth in 2016 will be boosted by 0.2pp due to new net loosening policy measures.**
- **Section B: The November IR real GDP forecast remains higher than the OBR's November forecast, despite upward revisions of 0.1pp to the OBR's forecast in 2016 and 2017. The OBR have revised their inflation forecast upward by around 0.1pp, reflecting a change in the assumed effect of unit labour costs on inflation. It remains below the Bank's November IR inflation forecast in 2017H2 and beyond.**
- **Section C: The Budget contained a series of announcements on the housing market (of particular interest for FPC readers) – eg, higher stamp duty for BTL and second home purchasers, an extension of the HtB Equity Loan scheme until 2021, and a more generous version of the scheme in London.**

A) Fiscal forecast

1 The OBR judge that the fiscal mandate and supplementary target set out in the most recent version[1] of the *Charter for Budget Responsibility* are on course to be met. The welfare cap is however likely to be breached between 2016-17 and 2018-19.

2 The targets[2], as set out in the *Charter,* are:

[1] A revised Charter was approved by the House of Commons in October

[2] The targets set out under the previous Charter included: *"a forward-looking aim to achieve cyclically adjusted current balance by the end of the third year of the rolling, 5-year forecast period";* "an aim for public sector net debt as a percentage of GDP to be falling in 2016-17"; and a cap on a subset of welfare spending..

- A **fiscal mandate***: which sets a target for "a surplus on public sector net borrowing by the end of 2019-20 and in each subsequent year"*. This target will *"…apply unless and until the OBR assess that there is a significant negative shock to the UK. A significant negative shock is defined as real GDP growth of less than 1 per cent on a rolling 4 quarter-on-4 quarter basis."*

- A **supplementary target***: "a target for public sector net debt as a percentage of GDP to be falling in each year to 2019-20*", and

- A **welfare cap**: a ceiling on cash spending on a subset of social security benefits and tax credits. The cap on welfare spending was lowered significantly in the Summer Budget (13% lower in 2019-20) relative to the previous Charter.

Table 1: Key fiscal aggregates (% GDP)

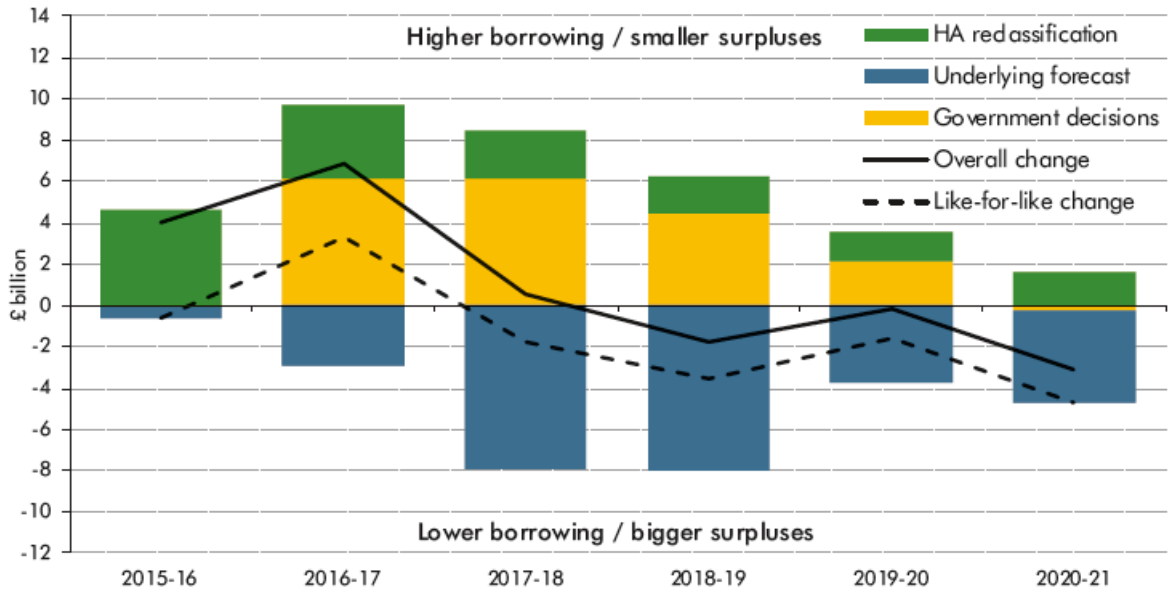
	Per cent of GDP						
	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue and spending							
Public sector current receipts	35.8	35.8	36.5	36.9	36.9	36.9	37.1
Total managed expenditure	40.9	39.7	39.1	38.1	37.2	36.5	36.4
Deficit: Fiscal mandate							
Public sector net borrowing	5.2	3.9	2.5	1.2	0.2	-0.5	-0.6
Cyclically adjusted current budget deficit	2.4	1.6	0.5	-0.5	-1.2	-1.9	-2.4
Debt: Supplementary target							
Public sector net debt	83.1	82.5	81.7	79.9	77.3	74.3	71.3
	Like-for-like changes since July forecast						
Revenue and spending							
Public sector current receipts	-0.3	-0.4	-0.3	0.0	0.0	-0.1	0.0
Total managed expenditure	-0.3	-0.5	-0.1	-0.1	-0.2	-0.2	-0.2
Deficit: Fiscal mandate							
Public sector net borrowing	0.0	-0.1	0.1	-0.1	-0.2	-0.1	-0.2
Cyclically adjusted current budget deficit	0.0	0.0	0.0	-0.1	-0.1	0.0	-0.5
Debt: Supplementary target							
Public sector net debt	-0.9	-1.2	-0.8	-0.7	-0.7	-0.4	-0.3

Source: OBR Economic and Fiscal Outlook November 2015

3 **Table 1** sets out the OBR forecast for the key fiscal aggregates. Public Sector Net Debt (PSND) as a % of GDP is expected to fall in each in year of the forecast, from 83% in 2014-15 to 71% in 2020-21, meeting the Government's supplementary target. The declines in both 2015-16 and 2016-17 - at around 0.6pps and 0.7pps respectively - are heavily influenced by asset sales such as Lloyds bank shares and the Granite securitisation vehicle (related to the government's interventions with Northern Rock). But thereafter, with planned receipts from RBS shares also contributing, improvements in the primary fiscal balance help drive somewhat faster declines in the government debt/GDP ratio of around 2-3pps per annum.

4 Public Sector Net Borrowing (PSNB) has been revised up somewhat over the next couple of years, but downwards slightly from fiscal year 2018-19 onwards . That reflects the combination of two factors. Firstly, Housing Associations were reclassified from the private sector to the public sector, pushing up PSNB throughout the forecast, though with those effects diminishing over time. Secondly, on a like-for-like basis - ie stripping out the effects of those reclassifications - PSNB was revised moderately higher in the near-term, but moderately lower from 2017 onwards (**Chart 1**).

Chart 1: Contributions to public sector net borrowing changes since July



Source: OBR Economic and Fiscal Outlook November 2015

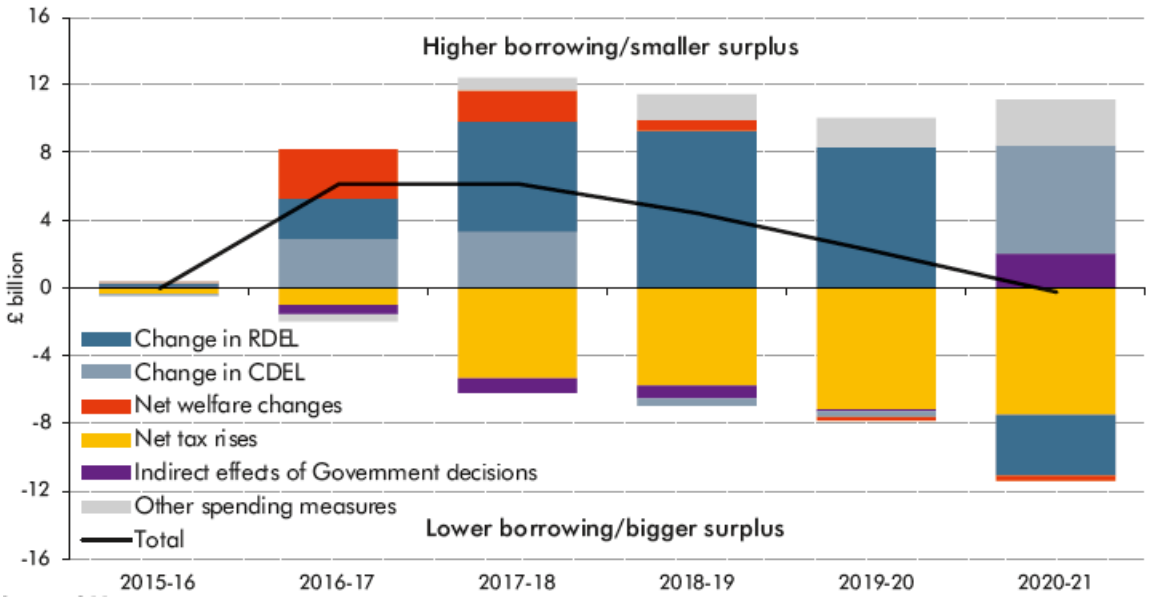
5 The changes in the like-for-like PNSB forecast were the net of a stronger underlying public finances picture (on a pre-measures basis), and an overall loosening in new discretionary fiscal measures. New discretionary giveaways amounted to a net +0.3% of GDP in 2016-17 (yellow bars), slowly fading away to around zero again by 2020-21.

6 Within the composition of those changes, smaller cuts to government consumption and investment, along with the abolition of the majority of the planned cuts in tax credits, more than offset net increases in taxes **(Chart 2)**. Planned increases in taxes include an apprenticeship levy, changes to council tax and higher stamp duty for purchasers of BTL properties and second homes.

7 Relative to the Summer Budget the forecasts for Total Managed Expenditure (TME) are higher throughout the forecast. This reflects further reductions in the extent of departmental spending cuts and increases in capital spending. Spending on debt interest is expected to fall as a result of a lower market yield curve and the MPC's decision to keep the stock of asset purchases at £375bn until Bank Rate reaches 2% (for further information).

8 The OBR anticipate materially higher receipts, relative to the forecasts made at the time of the Summer Budget. The upward revisions to the receipts forecast are in large part due to strong outturn receipts on corporation tax, PAYE and national insurance contributions (NICs); as well as modelling changes to PAYE, NICs and VAT receipts. Between 2016-17 and 2018-19 PAYE and NICs receipts are expected to be between £3bn and £4bn higher per year, relative to the Summer Budget forecast.

Chart 2: The impact of Government decisions on public sector net borrowing



Source: OBR Economic and Fiscal Outlook November 2015

9 The OBR expect the measures announced in the Autumn Statement and Spending Review to provide a 0.2pp boost to real GDP in 2016-17, thereafter dragging on real GDP by 0.1pp in 2017-18 and 2018-19 as the initial boost unwinds. In the absence of an immediate update of the IFS 'action-based' measures we would normally use to assess the impact of a fiscal event, an initial back of the envelope calculation (based on empirical estimates of the relevant fiscal multipliers) suggests a similar scale impact.

B) Macroeconomic forecast

10 Real GDP growth in 2015 has been revised down in the OBR forecast by 0.1 percentage point, but in 2016 and 2017 the forecast has been revised up by 0.1 percentage point, partly reflecting a slower pace of fiscal tightening (see Section A). The OBR's growth forecast is 2.4% in 2016, 2.5% in 2017 and 2.4% in 2018, compared to the November IR forecast of 2.5% in 2016, 2.6% in 2017 and 2.5% in 2018. Compared with the November IR, the medium term composition of

growth in the OBR's forecast reflects lower household consumption and business investment, a higher contribution from net trade, and higher productivity growth.

11 As in the November IR, the OBR note that the pace of wage growth suggests that there is still slack in the labour market, and they estimate that the output gap was -0.6% of potential output in Q3 2015, unchanged from their estimate in July. The OBR attribute around half of this gap to employment being below its sustainable rate, and half to productivity per worker being below its potential rate. This contrasts with the November IR output gap, which consisted of a larger labour market gap offset by above normal capacity utilisation (i.e. productivity above trend).

12 The OBR have taken into account new ONS population projections and have updated their assessment of underlying productivity growth. Inward migration is judged to raise the employment rate in the near term, but population ageing weighs against this later in the forecast. In addition, the OBR have made a small downward revision to underlying productivity growth, though they continue to expect productivity growth to return to its historic average rates by the end of the forecast. The output gap is expected to close gradually over the period to mid-2018.

13 Average earnings growth has been revised down in the OBR's forecast, reflecting the downward revision to underlying productivity growth along with an assumption that employers will pass on the costs of auto-enrolment (once it is implemented after a delay) and a new apprenticeship levy, set at 0.5% of employers' gross pay bills (with an allowance of £3 million before employers have to pay the levy). The assumed effect of these policy costs reduces wage growth by 0.7% over the forecast.

14 The OBR expects unemployment to fall to 5.1% by the end of 2016, compared to the November IR forecast of 5.2% for Q4 2016. The OBR's forecast for unemployment then rises to 5.4% by the end of their forecast period, partly due to estimated effects of the National Living Wage.

15 The OBR have revised their inflation forecast upward by around 0.1 percentage points, reflecting a change in the assumed effect of unit labour costs on inflation. In terms of news to the Bank's forecast from the Autumn Statement, the OBR have incorporated a downward revision of 0.1 percentage points in 2017 to reflect policy measures aimed at reducing energy bills.

C) Housing policy announcements

16 Housing policy was a major focus of this year's Autumn Statement. The government announced various new policies as well as restating some that had already been announced – eg, Starter Homes, Right to Buy extension to housing associations, Help to Buy ISAs and planning reforms.

17 The government has announced that it will increase the stamp duty rates levied on additional properties by 3pp from April 2016. The OBR expect this policy, on top of those announced in July (reduction of mortgage interest relief for higher rate tax payers and removal of wear and tear allowance), to reduce the number of property transactions by around 3% in 2016-17 and then 2% in subsequent years.

Table 2 : Stamp Duty marginal tax rates

House price	Standard marginal tax rate	Additional property tax rate
£0-40,000	0%	0%
£40-125,000	0%	3%
£125,001-250,000	2%	5%
£250,000-925,000	5%	8%
£925,001-1.5mn	10%	13%
£1.5mn+	12%	15%

Chart 3: Tax liability by house purchase price

18 Simple calculations suggest that for a median buy-to let investor with a 70% LTV mortgage, their stamp duty bill will have increased from £800 to £4,550. While this is a substantial increase, it is likely to be significantly less than the capital gains tax the investor would be liable for when selling the property. We will look at incorporating the effects of this policy into our forecast for housing activity as part of the February IR forecast round. We also need to consider the possibility that there will be some front loading of housing transactions ahead of the change in April.

19 The OBR have also revised down their forecast for transactions due to the ongoing tenure shift towards the private rented sector (PRS). They now expect the upward trend in the PRS to continue and therefore the number of transactions to be lower (as these properties transact less often). In addition, they have adjusted their judgement of the impact of the social sector rent cap which reduces their forecast for housebuilding by housing associations. Both of these contribute to a downwards revision to the OBR forecast for housing investment.

20 The Help to Buy: equity Loan (HtB:EL) scheme will be extended by a further year to 2021 and will be adjusted for London purchases. London buyers will now be offered up to a 40% equity loan, interest free for five years, as long as they provide a 5% deposit. This means that buyers will only need to take out a mortgage for 55% of the value of the property.

21 On average, a London property bought with HtB:EL has cost £310,000 which requires a £15,500 deposit and a 75% LTV mortgage of £232,500. Under the new scheme, for the same deposit, a household would only need a mortgage of £170,500 which is likely to be at a much lower interest rate (and more affordable) although that will depend on what products the lenders launch to support this policy.

22 Help to Buy Equity Loan transactions currently make up around 2% of total transactions and so far about 6% have been in London. Housebuilders have looked favourably on the HtB:EL scheme so far and feel it has supported the new build market, although it has always been hard to judge the true additionality of the scheme.

23 The Help to Buy: Shared Ownership scheme is part of the government's plan to deliver 400,000 affordable housing starts by 2020-21. They expect to deliver 135,000 shared ownership homes with wider eligibility than the previous scheme. Currently, there are very few shared ownership new build sales; just over 1% of mortgages in August and September. Using this assumption over our forecast would imply far fewer than 135,000 homes sold under shared ownership which suggests that the government are expecting this policy to increase supply.

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