1 Executive summary

Overview

1.1 Against a broadly unchanged economic and fiscal backdrop since March, this Budget delivers a large, sustained increase in spending, taxation, and borrowing. Budget policies increase spending by almost £70 billion (a little over 2 per cent of GDP) a year over the next five years, of which two-thirds goes on current and one-third on capital spending. As a result, the size of the state is forecast to settle at 44 per cent of GDP by the end of the decade, almost 5 percentage points higher than before the pandemic. Half of the increase in spending is funded through an increase in taxes, mainly on employer payrolls, on assets, and through greater tax compliance. These raise £36 billion (just over 1 per cent of GDP) a year in additional revenue and push the tax take to a historic high of 38 per cent of GDP by 2029-30. The other half of the increase in spending is funded by a £32 billion (1 per cent of GDP) a year increase in borrowing, one of the largest fiscal loosenings of any fiscal event in recent decades.

1.2 Having stagnated last year, the economy is expected to grow by just over 1 per cent this year, rising to 2 per cent in 2025, before falling to around 1½ per cent, slightly below its estimated potential growth rate of 1⅔ per cent, over the remainder of the forecast. Budget policies temporarily boost output in the near term, but leave GDP largely unchanged in five years. If the increased level of public investment were sustained, it would permanently raise supply in the long term and by significantly more than it does in the forecast period. Budget policies push up CPI inflation by around ½ a percentage point at their peak, meaning it is projected to rise to 2.6 per cent in 2025, and then gradually fall back to target.

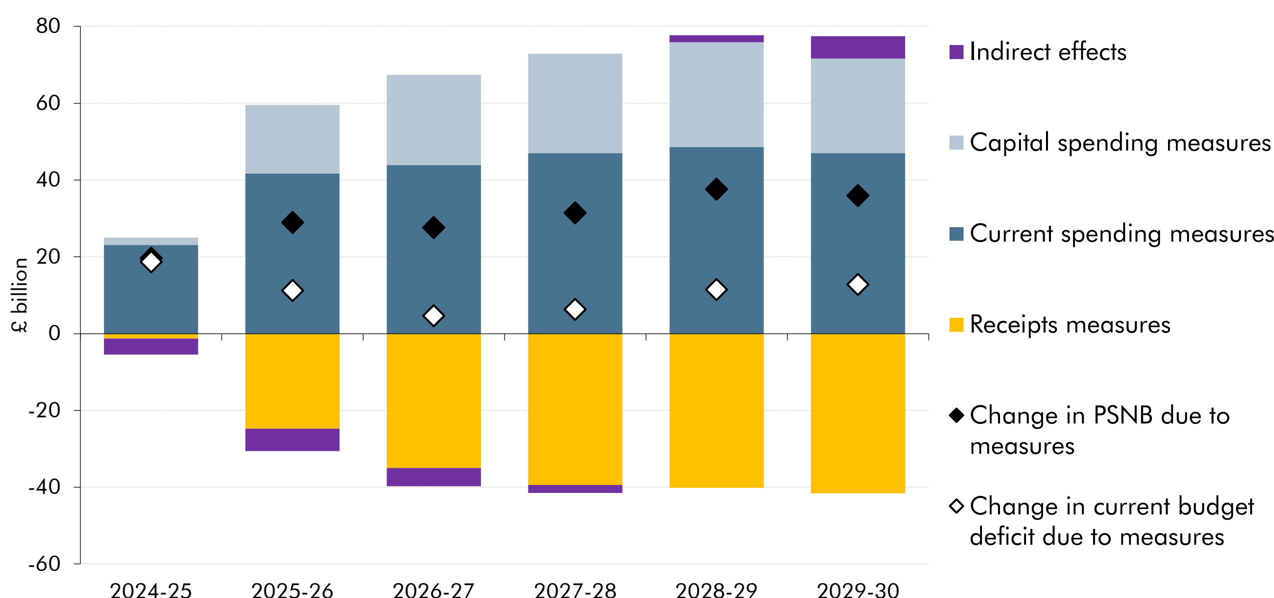
1.3 This Budget slows the pace of deficit reduction relative to the previous Government's plans. Borrowing is projected to rise marginally from £122 billion (4.5 per cent of GDP) last year to £127 billion this year, before falling back to £71 billion (2.1 per cent of GDP) in 2029-30. Net debt falls as a share of GDP from 98.4 per cent this year to 97.1 per cent by the end of the decade. But underlying debt, excluding the Bank of England, rises as a share of GDP in every year of the forecast. The Budget sets two new fiscal rules: to deliver a current balance and for net financial liabilities to be falling, both initially in five years. On the central forecast they are on course to be met by margins of £9.9 billion and £15.7 billion.

1.4 These margins are a small fraction of the risks around that central forecast. The economic outlook depends on uncertain judgements on the paths for productivity, inactivity, and net migration. The fiscal forecast also remains highly sensitive to movements in interest rates and inflation given the level of debt. The Budget crystallises much of the significant upside risk to spending highlighted in previous forecasts, but only sets detailed departmental plans for one more year and is still based on seldom-implemented fuel duty rises.

Budget policies

1.5 **The net effect of Budget policies is to increase borrowing by £19.6 billion this year and by an average of £32.3 billion over the next five years.** Policy decisions increase current and capital spending in total by an average of £69.5 billion a year from 2025-26. Around half of this is offset by tax policies, which increase revenue by £36.2 billion a year on average. The fiscal impacts of the indirect effects of these policies on the economy are largely offsetting. Overall, policy decisions raise the current budget deficit by an average of £9.3 billion a year over the next five years, as the policy-driven increase in current spending is not fully offset by the increase in receipts.

Chart 1.1: Impact of measures on public sector net borrowing and current deficit



Source: OBR

1.6 **Budget spending policies add £69.5 billion (2.2 per cent of GDP) a year over the next five years, and £71.6 billion by the end of the decade, to the level of public expenditure.** On average £45.6 billion goes on current spending and £23.8 billion goes on capital spending. The main components are:

- an increase in **departmental current expenditure** (resource DEL) of £22.9 billion this year rising to £48.8 billion by 2029-30;
- an increase in **departmental capital expenditure** (capital DEL) of £21.6 billion by 2029-30;
- additional payments for the **infected blood and Post Office Horizon compensation schemes** of £1.4 billion in 2029-30, and £13.6 billion in total over the forecast; and
- cost savings of £3.5 billion from **DWP fraud and error** measures and £1.7 billion from the means-testing of **winter fuel payments** by 2029-30.

1.7 **Budget tax measures increase total revenues by £36.2 billion (1.1 per cent of GDP) a year on average and £41.5 billion by the end of the decade.** The main components of the increase are:

- an increase in **employer NICs**, via a higher rate and lower threshold, raising £25.7 billion by 2029-30 before allowing for its indirect effects on the economy;
- several **tax compliance measures** raising £3.5 billion by 2029-30, and **debt collection measures** raising a further £2.7 billion;
- changes to the regimes for **capital taxes and for non-domiciled taxpayers**, which together raise £5.2 billion by 2029-30;
- levying of **VAT on private school fees**, raising £1.7 billion by 2029-30;
- **other net tax changes**, including increasing the rate of the energy profits levy and extending it to 2029-30 and increasing air passenger duty rates, raising a total of £3.6 billion by 2029-30; and
- these are slightly offset by an **extension of the freeze and 5p cut to fuel duty rates** to 2025-26, costing £3.0 billion in 2025-26 and £0.9 billion by 2029-30.

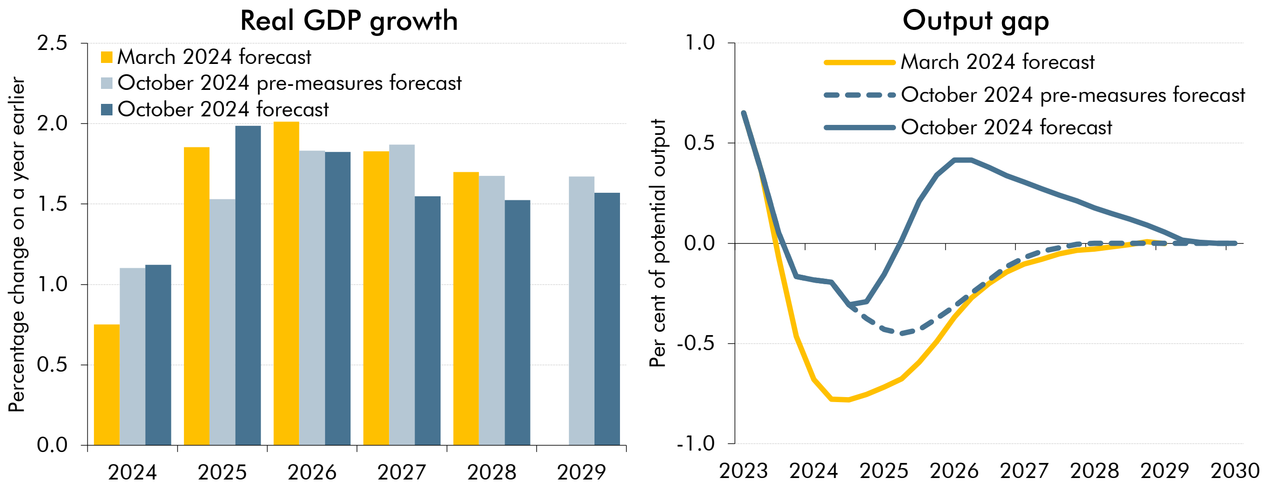
Economic outlook

1.8 **Budget policies deliver a temporary boost to GDP in the near term and some crowding out of private activity in the medium term.** We estimate that the policy package boosts real GDP by 0.6 per cent at its peak in 2025-26 as the fiscal loosening temporarily raises output above its potential level. This temporary stimulus fades to zero over the remainder of the forecast as we assume monetary policy acts to rein in any excess demand. Budget policies also have lasting impacts on the supply potential of the economy. The employer NICs rise is estimated to reduce labour supply by 50,000 average-hours equivalents, while the net fiscal loosening would crowd out some private investment in an economy with little spare capacity. At the same time, the increase in public investment boosts potential output by raising the public capital stock and incentivising some private investment. Taken together, Budget policies leave the level of output broadly unchanged at the forecast horizon. In the longer term, the net effect of Budget policies would be positive for the economy-wide capital stock and potential output if the increase in public investment were to be sustained.

1.9 **Real GDP growth is therefore forecast to pick up from close to zero last year, to 1.1 per cent this year, 2.0 per cent in 2025, and 1.8 per cent in 2026, before falling back to around 1½ per cent thereafter.** Stronger growth in the near term, supported by the easing in monetary policy, pushes GDP above our estimate of potential output. The economy moves from having a small negative output gap in 2024 to a positive output gap, which peaks at just under ½ a per cent in 2026. As the effects of monetary policy loosening and the temporary boost to demand in this Budget fade, the output gap is expected to close over the rest of the forecast. This lowers GDP growth to around 1½ per cent in the final three years of the

forecast, slightly below our estimate of medium-term potential output growth of 1⅔ per cent. Compared to our March forecast, growth is forecast to be an average of a ¼ percentage point higher this year and next. This reflects stronger GDP and real wage growth in recent quarters, and the net fiscal loosening in this Budget. Growth is then weaker between 2026 and 2028 as these temporary effects fade.

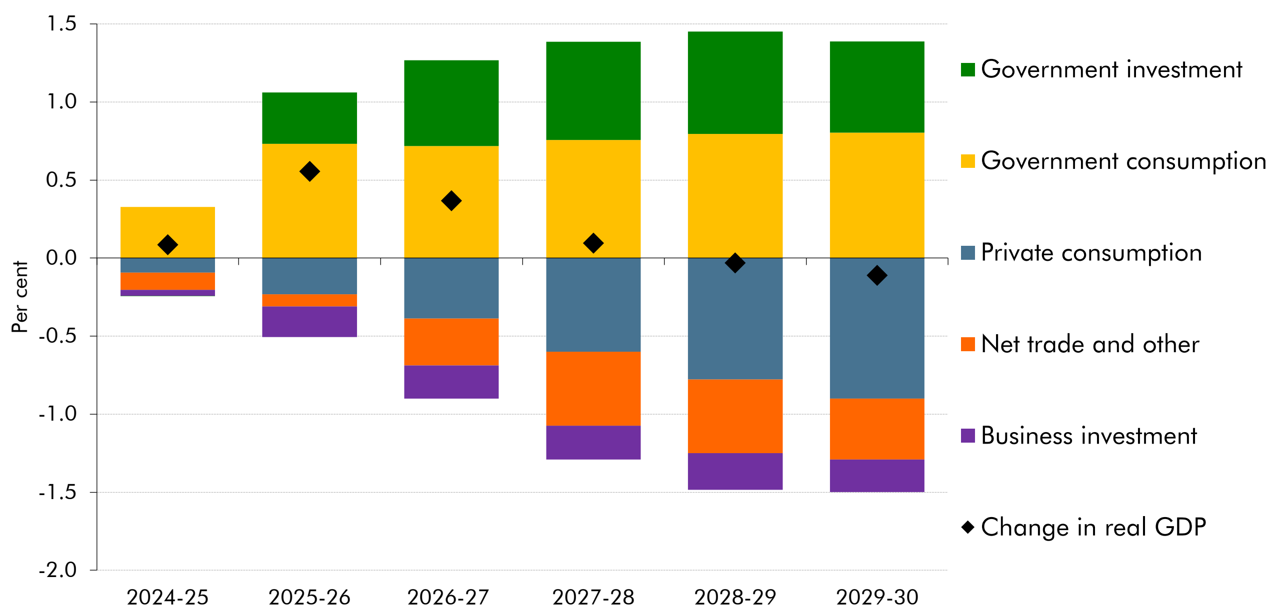
Chart 1.2: Real GDP growth and the output gap



Source: ONS, OBR

1.10 **Policies announced in this Budget lead to a sustained increase in real government spending as a share of GDP.** Government consumption rises by around 0.8 percentage points of GDP between 2023 and 2029. Government investment remains broadly flat, rather than falling by around ¾ of a percentage point as in our pre-measures forecast. The increase in government activity, alongside a net fiscal loosening, crowds out some private consumption, business investment and net trade in a capacity-constrained economy. Tax rises in this Budget weigh on real incomes, so private consumption falls as a share of GDP. Corporate profits are expected to continue falling as a share of GDP in the near term, before rising gradually from 2026 as firms rebuild margins and pass on more of the cost of the employer NICs rise. Over the forecast, business investment falls as a share of GDP as profit margins are squeezed, and the net impact of Budget policies lowers business investment. Higher government investment increases incentives for businesses to invest but that is more than offset by the crowding out effect of the fiscal loosening.

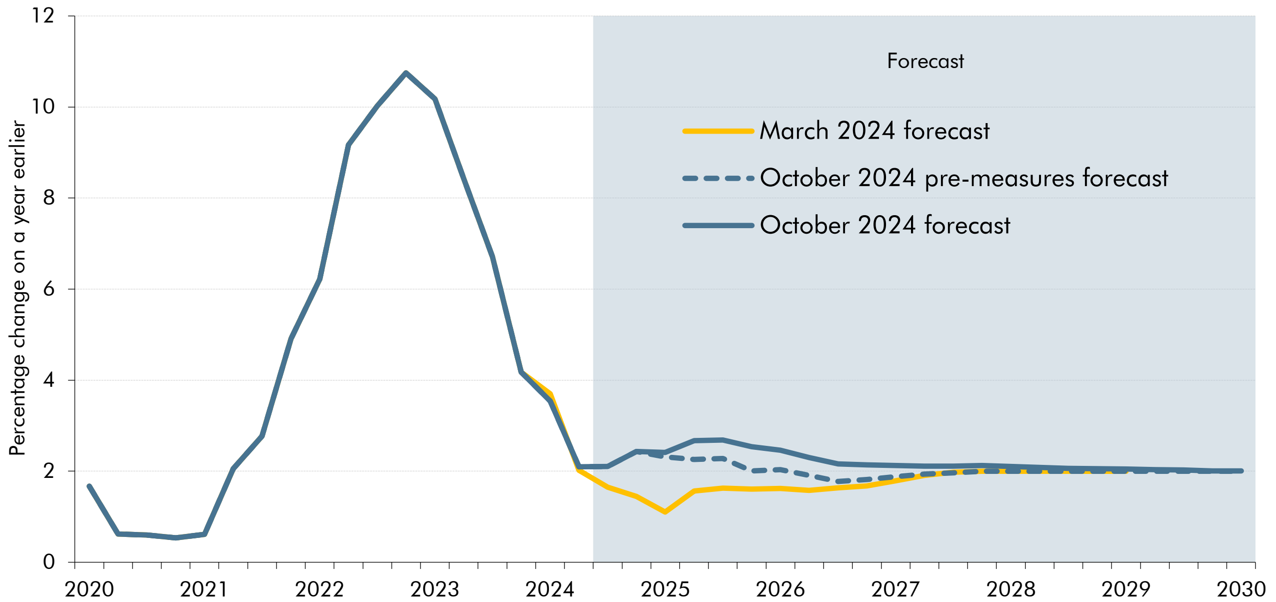
Chart 1.3: Policy impacts on real GDP and its components



Source: OBR

1.11 **Having fallen back to around the 2 per cent target in mid-2024, we expect CPI inflation to pick up to 2.6 per cent in 2025 partly due to the direct and indirect impact of Budget measures.** Inflation then slowly returns to the 2 per cent target by the forecast horizon as the effect of these measures fades and the positive output gap closes. Compared to our March forecast, inflation is 1.1 percentage points higher in 2025 and 0.6 percentage points higher in 2026, driven mainly by greater-than-expected persistence in wage growth and the impact of the near-term fiscal loosening in this Budget. We estimate that Budget policy measures increase inflation by 0.4 percentage points at their peak effect in 2026, mainly reflecting the impact of the excess demand generated by the fiscal loosening and some pass-through of employer NICs to consumer prices. A further escalation of the conflicts in the Middle East poses a risk to our inflation forecast, initially via its impact on energy prices. Market expectations for 2025 oil prices have ranged between 68 and 84 dollars a barrel since the March forecast, compared to 71 dollars a barrel in our central forecast.

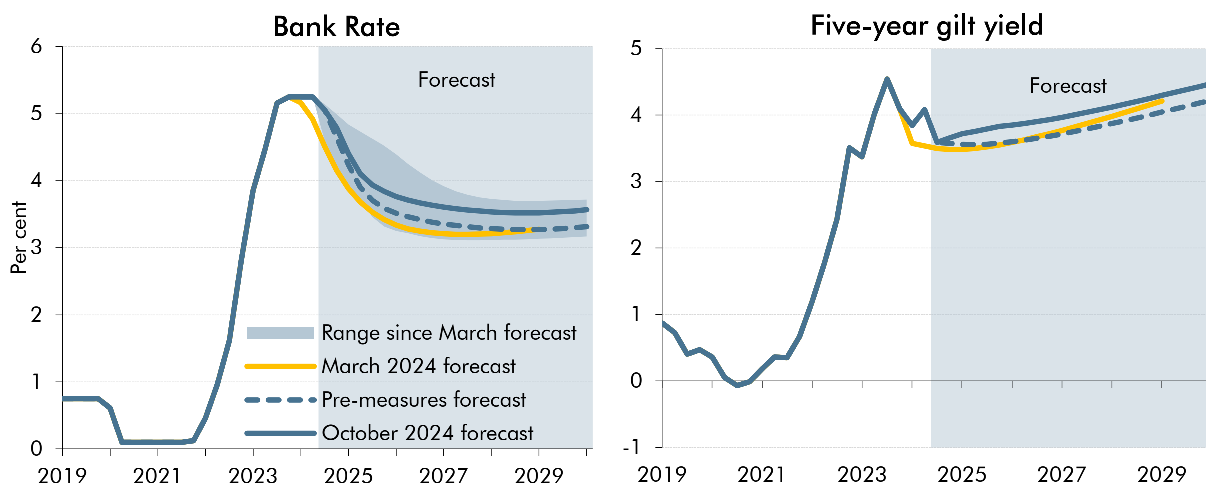
Chart 1.4: CPI inflation



Source: ONS, OBR

1.12 **From its current level of 5 per cent, Bank Rate is expected to fall to 3.5 per cent in the final year of the forecast.** Over 2025 and 2026, this is around ½ a percentage point higher than the level of Bank Rate in our March forecast, partly reflecting market expectations at the time we closed our pre-measures interest rate forecast on 12 September. However, the full extent of discretionary fiscal easing in this Budget is unlikely to have been anticipated by market participants at this time, so we have raised Bank Rate and gilt yields by a ¼ percentage point across the forecast. This is broadly consistent with where market expectations for interest rates were when we finalised our post-measures forecast.

Chart 1.5: Bank Rate and five-year gilt yield



Note: March 2024 forecast is the average of 10 working days to 23 January. Pre-measures forecast is the average of 10 working days to 12 September. Range is the minimum and maximum daily value between our March forecast and 23 October.
Source: Bank of England, OBR

1.13 **Supported by the temporary boost to demand from this Budget, the unemployment rate falls from 4.3 per cent this year to 4.0 per cent in 2026 before returning to its estimated structural rate of 4.1 per cent in 2028.** The impact of Budget policy measures accounts for nearly all the reduction in the unemployment rate relative to the March forecast, with a peak impact of 0.3 percentage points (100,000 people) in 2025. The participation rate declines slightly over our forecast to reach 62½ per cent in 2029 – well down from the peak of 64¼ per cent in the first quarter of 2020. The biggest drag comes from the ageing of the population, with the rise in employer NICs in this Budget also having a small negative effect. The overall effect of tax rises in this Budget is to lower the participation rate by 0.1 percentage points, leaving it 0.2 percentage points below our March forecast in 2028. The employment rate rises a little in the near term and then declines to just under 60 per cent by the forecast horizon, but population growth means that total employment increases by 1.2 million people from 2024 to 2029.

1.14 **We expect nominal earnings growth to fall from 4.7 per cent this year to around 3½ per cent in 2025 and then average 2¼ per cent over the remainder of the forecast.** Compared to our March forecast, this is over 1 percentage point higher this year due to higher private and public sector wage settlements. Next year, it is around 1½ percentage points higher, partly due to the fiscal loosening in this Budget. But forecast and policy changes leave nominal and real earnings growth lower over the remainder of the forecast as employers pass on the NICs rise, rebuild profit margins, and the temporary boost to demand fades. Real earnings growth is around 2½ per cent in 2024, but then falls to around zero in 2026 and 2027. Real wages are around 1½ per cent higher than our March forecast in 2028, despite being lowered by around ½ a per cent due to Budget policies, due to a higher starting point.

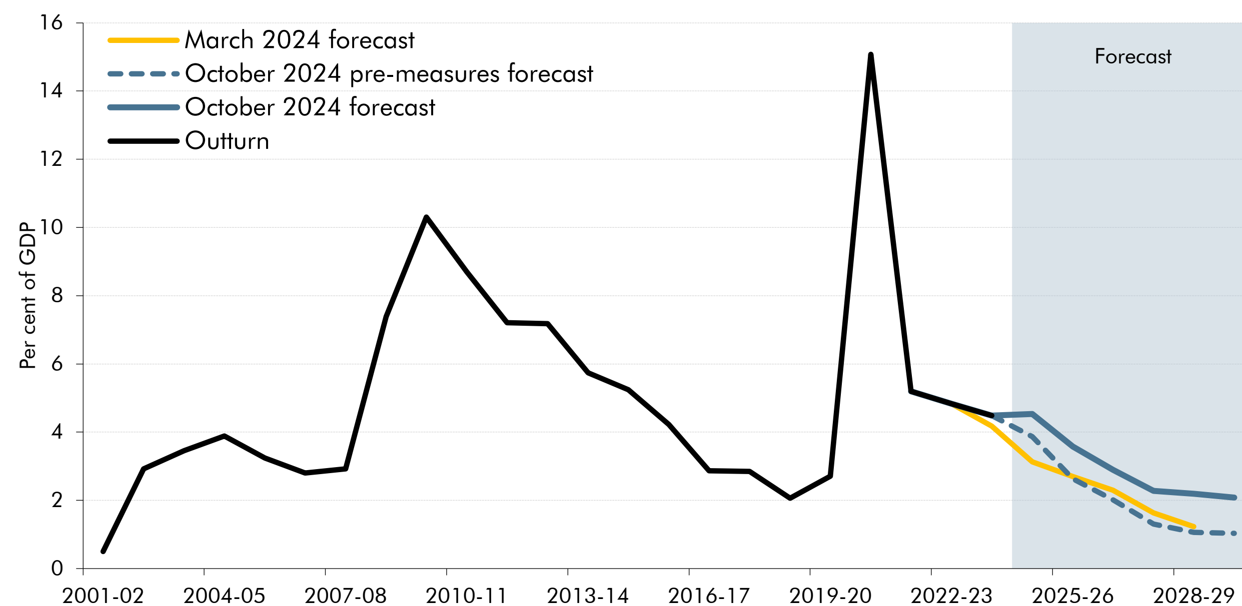
1.15 **Real household disposable income (RHDI) per person, a measure of living standards, grows by an average of just over ½ a per cent a year over the forecast**. But the profile is uneven, with strong real wage increases resulting in growth of 1¼ per cent this fiscal year and next before RHDI per person stalls for two years in the middle of the forecast as real wage growth slows and taxes increase. Compared to our March forecast, the level of RHDI per person is just over 2 per cent higher at the start of the forecast due to data revisions, but 1¼ per cent lower by the start of 2029. The bulk of this difference (around 85 per cent) is explained by policies announced in this Budget.

1.16 **Nominal GDP growth is expected to average 3.8 per cent from 2024-25, around ½ a percentage point higher than in our March forecast.** More persistent domestically generated inflation and the impact of this Budget mean higher GDP deflator growth more than offsets slightly lower real GDP growth. However, the upward revision to nominal GDP growth is not fully reflected in stronger growth in the key tax bases. Growth in wages and salaries and profits are constrained by the increase in employer NICs. And consumption growth is lowered by the effect of policy measures on household incomes.

Fiscal outlook

1.17 **Public sector net borrowing is forecast to rise from £121.9 billion (4.5 per cent of GDP) last year to £127.5 billion this year, before falling steadily back to £70.6 billion (2.1 per cent) by 2029-30.** Overall, borrowing is £28.4 billion (0.9 per cent of GDP) a year higher on average over the forecast compared to March. By far the largest driver of the increase in the medium term is the Budget policy changes, which increase borrowing by £32.3 billion a year on average from 2025-26 to 2029-30. Pre-measures changes to the forecast increase borrowing by £20.7 billion this year, due mainly to higher inflation pushing up debt interest spending. In the medium term, pre-measures borrowing is £5.2 billion lower in 2028-29 relative to March, due to higher nominal earnings and equity prices increasing receipts by more than spending.

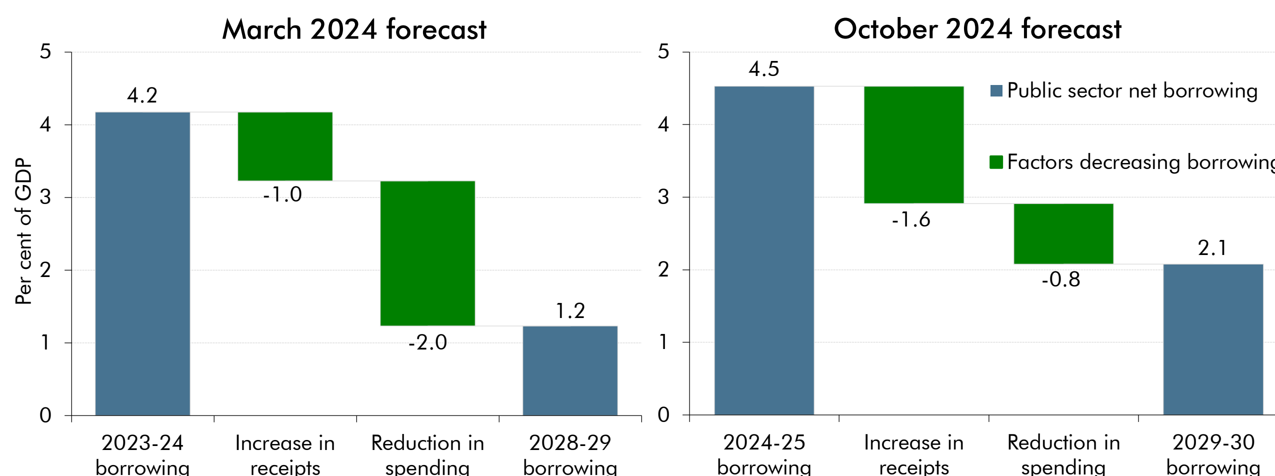
Chart 1.6: Public sector net borrowing



Source: ONS, OBR

1.18 **Overall these changes mean that, compared to March, borrowing is now projected to decline less sharply from its peak to the end of the forecast.** And while in March most of the decline was driven by spending falling as a share of GDP over the forecast, now it is mainly driven by taxes rising as a share of GDP. In March, borrowing was projected to fall by 2.9 per cent of GDP between 2023-24 and 2028-29, with one-third due to increases in receipts and two-thirds due to a reduction in spending. At this Budget, borrowing is forecast to fall by 2.5 per cent of GDP between 2024-25 and 2029-30, with around two-thirds driven by higher revenues and the rest by a reduction in spending as a share of GDP.

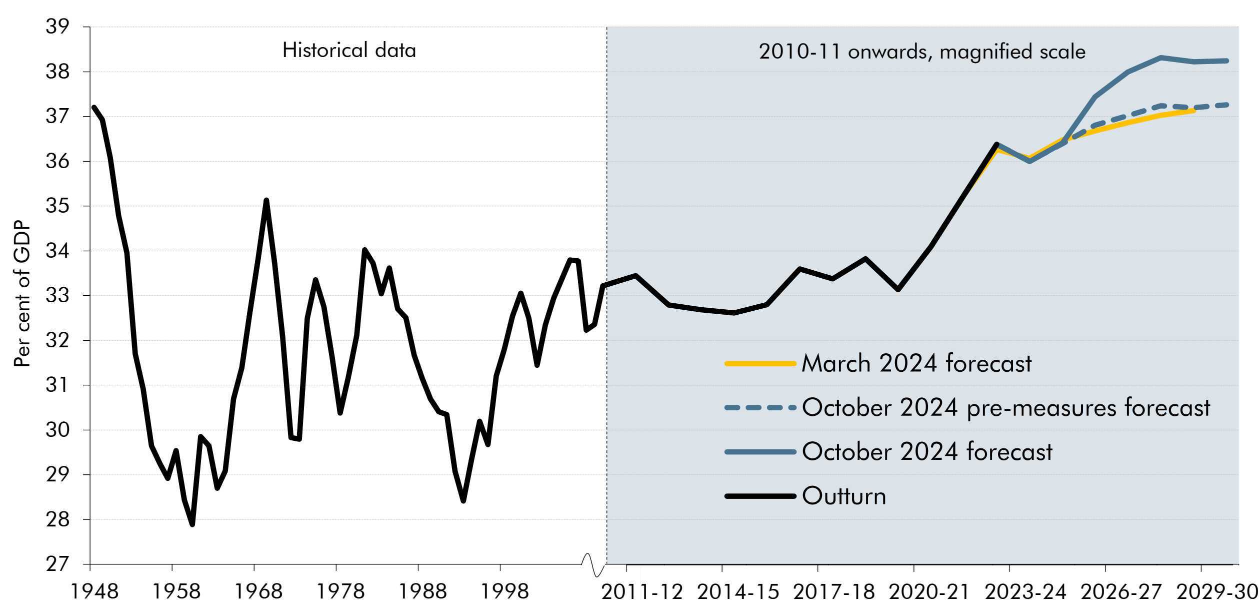
Chart 1.7: Change in borrowing over forecast periods: March and October



Source: OBR

1.19 **Tax as a share of GDP is forecast to rise from 36.4 per cent this year to a historic high of 38.2 per cent in 2029-30, 5.1 per cent of GDP higher than before the pandemic.** The increase is driven mainly by personal taxes (including the impact of the employer NICs measures in this Budget, earnings growth and frozen thresholds) and by capital taxes, (reflecting the path of equity prices, property prices and measures in this Budget). The tax take in 2028-29 is 1.1 per cent of GDP higher than in the March forecast.

Chart 1.8: National Accounts taxes as a share of GDP

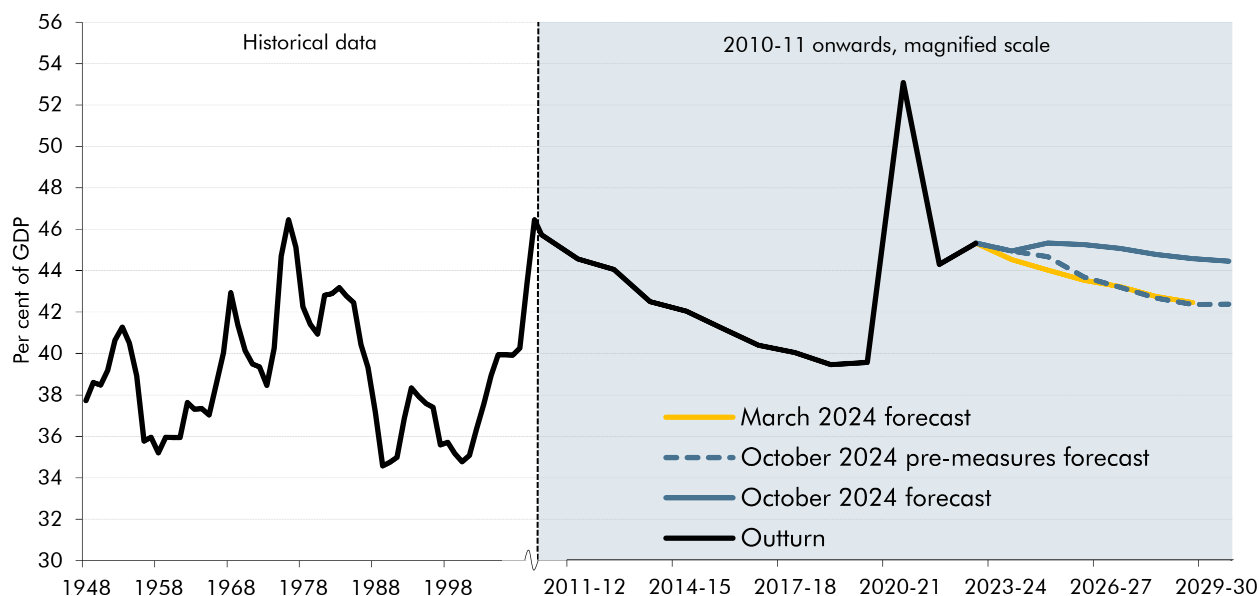


Source: ONS, OBR

1.20 **Spending as a share of GDP is forecast to rise from 44.9 per cent last year to 45.3 per cent this year, before falling back slightly to 44.5 per cent in 2029-30, 4.9 percentage points higher than pre-pandemic.** Additions to departmental spending, additional payments for the infected blood and Post Office Horizon compensation schemes, and higher debt interest costs all push up the spending-to-GDP ratio this year and next. The decline in spending as a

share of GDP over the remainder of the forecast reflects departmental spending growing more slowly than the economy and declines in spending on unfunded pensions and student loans. Debt interest and welfare spending remain broadly flat as a share of GDP.

Chart 1.9: Public spending as a share of GDP



Source: ONS, OBR

1.21 **Overall departmental spending is an average of £55.3 billion a year higher than in our March forecast, in which the previous Government's plans entailed spending falling by 1 per cent of GDP between 2023-24 and 2028-29.**

- **Current spending** now grows in real terms by 4.8 per cent this year, 3.1 per cent next year, and by an average of 1.3 per cent between 2025-26 and 2029-30. The £23.2 billion increase in current spending in 2024-25 relative to the March forecast reflects a combination of the funding of undisclosed spending pressures that existed at the time of the March Budget and have since come to light, and the cost of new policies announced by this Government.

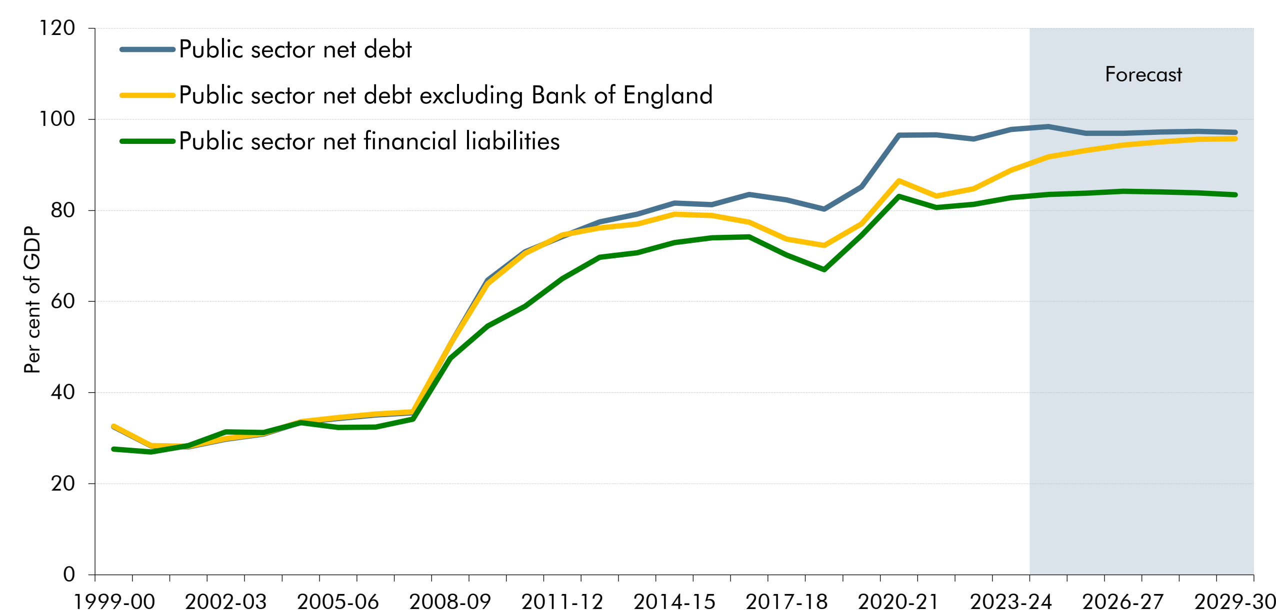
- **Capital spending** grows in real terms by 9.8 per cent in 2025-26 and then flattens off, before falling slightly in the final two years of the forecast. Taking account of expected under-execution, estimated average annual real growth in capital spending between 2023-24 and 2028-29 is 2.6 per cent, compared to real annual falls averaging 1.1 per cent in our March forecast.

1.22 **Public sector net debt (PSND) falls from a peak of 98.4 per cent of GDP this year to 97.1 per cent of GDP in 2029-30.** The fall is mainly driven by Term Funding Scheme repayments in 2025-26, after which debt is stable as a share of GDP as borrowing declines over the rest of the forecast. But due to the additional borrowing in this Budget, debt is 3.0 per cent of GDP (£169.8 billion) higher in 2028-29 than we projected in March. And the measure of debt excluding the Bank of England now rises as a share of GDP in every year, from 91.8

per cent this year to 95.8 per cent in 2029-30. The elevated level of debt means the public finances are highly sensitive to changes in interest rates. Market expectations for interest rates remain volatile, with expectations for Bank Rate in 2025 varying between 3.6 and 4.7 per cent and daily five-year gilt spot yields varying between 3.5 and 4.2 per cent since the March forecast.

1.23 **Public sector net financial liabilities (PSNFL) – a wider measure of the balance sheet that includes all financial assets, but not physical assets such as hospitals, schools, and infrastructure – are forecast to increase from 83.5 per cent of GDP this year to 84.2 per cent in 2026-27, then fall to 83.4 per cent in 2029-30.** While PSND rises very slightly (by 0.2 per cent of GDP) between 2026-27 and 2029-30, PSNFL falls gently (by a total of 0.8 per cent of GDP). The difference is more than explained by the accumulation of student loan assets, which increase by 1.7 per cent of GDP over this period. Financing the loans increases PSND but is neutral for PSNFL where both the asset and liability are counted.

Chart 1.10: Public sector balance sheet measures



Source: ONS, OBR

Performance against the Government's fiscal targets

1.24 **In this Budget, the Government has announced three new fiscal targets:**

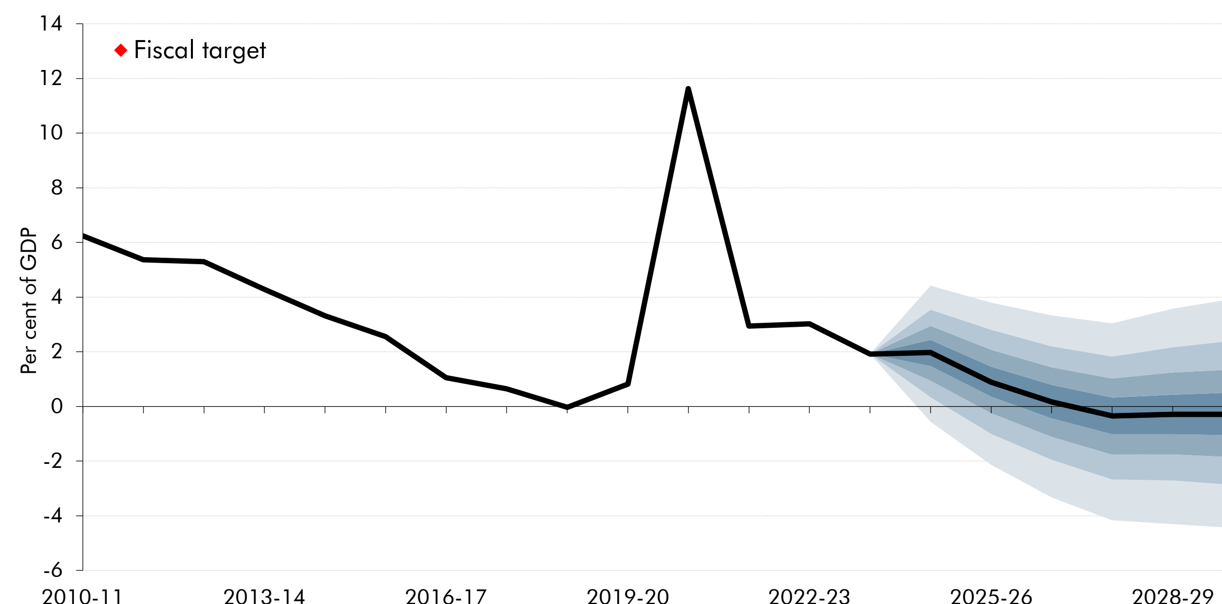
- a fiscal mandate for the **current budget** – revenues minus day-to-day spending – to be in surplus by 2029-30 (until 2029-30 becomes the third year of the forecast period, from which point the mandate applies to the third year);

- a supplementary target for **public sector net financial liabilities** to fall as a share of GDP by 2029-30 (again until 2029-30 becomes the third year of the forecast, from which point this target applies to the third year); and

- a revised **welfare cap**, with the target year updated to 2029-30.

1.25 **In the central forecast, the current budget target is met two years early and by a margin of £9.9 billion (0.3 per cent of GDP) in the target year.** The current budget improves from a deficit of 2.0 per cent of GDP this year to reach surplus in 2027-28, and then holds stable as a share of GDP. In the pre-measures forecast, the rule is met by a margin of £22.7 billion (0.7 per cent of GDP), but the direct and indirect effects of Budget policies reduce this headroom as the increase in current spending exceeds the yield from tax policy measures.

Chart 1.11: Current budget deficit



Source: ONS, OBR

1.26 **The central forecast is that public sector net financial liabilities decrease in each of the final three years of the forecast, and fall by 0.5 per cent of GDP (£15.7 billion) in 2029-30.** The composition and behaviour of PSNFL are explored in more depth in Chapter 6 and Annex B.

Risks and uncertainties

1.27 **These margins are both very small in the context of the significant uncertainties and risks around our central forecast.** The underlying economic and fiscal context for this forecast was not significantly different from March. But previous forecasts have seen significant change due to volatility in energy prices, inflation, interest rates, and wage growth. Key risks for our economy forecast include:

- Market expectations for **Bank Rate and gilt yields** remain volatile. If these were 1.3 percentage points higher across the forecast, it would be enough to wipe out the headroom to the supplementary fiscal target.

- The **inflation** outlook remains uncertain. Our March 2024 *Economic and fiscal outlook* (*EFO*) scenario showed how escalating conflict in the Middle East could raise energy prices, push inflation to 7½ per cent, and increase borrowing by £23 billion on average over the five-year forecast.

- **Productivity growth** is one of our most important and uncertain judgements. In our November 2023 *EFO* we estimated that ½ a per cent higher or lower annual growth in productivity would reduce or raise borrowing by around £40 billion in 2028-29.

- Our scenarios show that, if sustained, the impact of the increase in **public investment** announced in this Budget on potential output in 2073-74 could range between twice and half our central estimate of 1.4 per cent, depending on the degree to which public and private investments are substitutes or complements.

- **Several developing policy areas** pose risks that we will consider as details are finalised. Reforms to the planning system could increase potential output, while the employment rights package could pose downside risks.

1.28 **There are also significant risks directly related to the fiscal forecast.** Over the medium term, these include:

- The **tax-to-GDP ratio** is forecast to rise to a historic high in the late 2020s, with much of the increase driven by tax policy changes in the Budget. The estimated yield of several of these policies is highly uncertain and could undershoot or exceed our central forecast. This also assumes that the seldom-implemented indexation of fuel duty delivers around £4.8 billion in additional revenue by 2029-30.

- Our March 2024 *EFO* highlighted the significant upside risk to **departmental spending**, as at the time spending allocations were only set for 2024-25. The Government has now allocated increased departmental spending for 2025-26 and set a significantly higher spending envelope for the three years beyond that, which will be allocated at next year's Spending Review. Funding has now also been allocated for the infected blood and Post Office compensation schemes. Overall, the spending risks highlighted in our previous forecast are therefore reduced, though significant spending ambitions on defence and overseas aid remain unfunded. And governments have previously topped up the departmental spending envelope further when making final allocations.

- **Welfare spending** on more costly incapacity and disability benefits is forecast to continue rising, from 2.4 per cent of GDP in 2023-24 to 3.0 per cent in 2029-30. This is an uncertain judgement as the increase to date has reflected a complex interaction of drivers across health, the economy, and the operation of the benefits system (as our 2024 *Welfare trends report* explored).

- Unlike debt measures, **public sector net financial liabilities** incorporate the net position of public sector pension schemes, other equities held in the public sector, and loans

made by public bodies. The recording of loans at nominal values is open to a risk of sharp changes in value when bad loans are written off, while changes in the composition and valuation of other assets and liabilities can also be substantial and uncorrelated with wider changes to fiscal policy.

- The Government's revised **fiscal framework** commits to spending reviews covering at least three years of the forecast window, and the fiscal mandate to ultimately take effect from the third year of the forecast. This will eventually reduce the risks around meeting the Government's fiscal targets, as the targets will be earlier in the forecast period and will encompass years for which detailed departmental spending plans have been set.