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On Wednesday 23 November 2016 the new Chancellor Philip Hammond presented to Parliament the economic and fiscal forecast of the Office for Budget Responsibility (OBR).

Legislation requires the OBR to forecast on the basis of existing Government policy and in the context of looming Brexit negotiations this has proved to be far from straightforward. The OBR have no information about the Government's goals or expectations for those negotiations, that are not already in the public domain.

Brexit negotiations will determine the scope and scale of any ongoing financial flows between the UK and EU. Although the OBR cannot make a precise forecast they have produced a 'no referendum' *counterfactual* – a forecast of the flows as if the UK had not voted to leave the EU, on an assumption of greater resulting domestic spending.

The **EU referendum** has so far had little effect on overall economic growth. Consumer spending has continued to underpin growth, while business investment has continued to be weak.

Since November 2015 economic developments have been disappointing with the outlook for productivity growth in particular, and consequently public finances, looking much weaker. Hence, the budget deficit has been revised up by £12.7 billion this year primarily owing to a weakness in income tax receipts that largely pre-dates the referendum.

The annual publication of the Blue Book enables the Office for National Statistics (ONS) to make methodological changes, incorporating new data into **GDP growth estimates** for the UK:

2010:	*2011:*	*2012:*	*2013:*	*2014:*	*2015:*	*2016:*
1.9%	***1.5%***	***1.3%***	***1.9%***	***3.1%***	***2.2%***	***2.1%***

Economic growth slowed in 2015, while remaining convincingly within historic norms at **2.2%,** once again underpinned by further increasing consumer spending. GDP has now increased for 15 consecutive quarters and is estimated to be over 8% above the pre-economic downturn peak.

GDP by Expenditure: household consumption is still the largest element of expenditure, accounting for 62% of the total in 2015. Government consumption accounted for 19% and investment for 17%.

In 2015, the service industries accounted for 80% of total UK economic output (83% of UK jobs).

The "Markit/CIPS" UK Services **Purchasing Managers' Index** is an important indicator of output and confidence for service industries, including retail, financial and cultural activities. In October the index was **54.5**, up from 52.6 in September. July had seen a substantial fall in the index (to 47.4) but August and September were similar to that before the EU referendum. A figure above 50 is taken as a signal that UK output is increasing.

Confidence surveys released ahead of statistical data indicate changes and turning points in the economic cycle, these also tend to now show the same confidence levels as seen before the Brexit vote.

Nevertheless, the OBR expect the growth rate of UK GDP to slow in the next year owing to uncertainty, migration, delayed business investment and the falling value of the pound. Their **2017 growth forecast** next year dips to **1.4%** and 2018: to 1.7%; growth remaining positive with no 'job shedding' or precautionary saving by consumers, each apparently posing economic risks on the road toward Brexit.

The OBR assume that the cumulative growth potential of the economy is weaker over the forecast period, largely because they expect weaker business investment which is then assumed to depress future productivity growth.

However, the OBR also believe potential GDP growth is depressed by a weaker outlook for net inward migration, which in their forecast would have increased (by 80,000 a year), but for the referendum vote.

The OBR believe that 'significant' downward revisions to growth forecasts occur in 2017 and 2018, but changes little thereafter. *Growth in per capita GDP is weaker than headline growth because population increases over the forecast.*

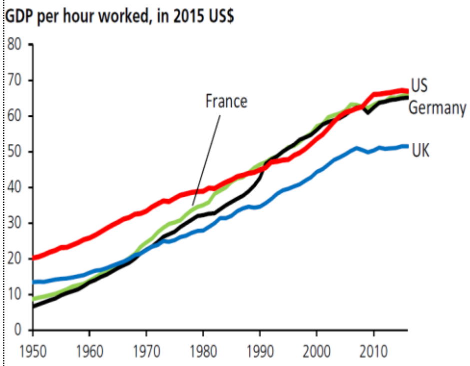
Two main judgements underpin the OBR forecast: firstly the OBR assume growth slows in 2017/18 as uncertainty regarding future trade and migration policies leads business to defer investment, exacerbated by price-inflation squeezing consumer spending. However, that effect is partially offset by a boost to GDP from stronger export trade.

Secondly, the OBR assume that potential growth in productivity is weaker owing to weaker investment, but acknowledge that this link is not well understood.

The net result is that the OBR expect the whole level of activity in the economy to be about *1½% lower* at the end of the forecast period than they foresaw in March, although dipping in total nearly 2½% through the potential curtailment of net inward migration.

UK economic productivity

The persistent weakness in productivity puzzles economists, the average annual increase historically has been about 2%. Over the eight years following the financial crisis and recession, productivity has stagnated: "unprecedented in the post-war period" (ONS). UK economic productivity is estimated by the ONS to have increased last year (2015) by just under **1%**.



In the G7, the UK was in equal fifth place with Canada (Germany top and Japan bottom) and nearly a fifth below the average: the same **gap** as 2014 and largest since 1991.

Growth during the recovery since 2008/9 has been attained by increasing the number of people working in the UK instead of increasing productivity. The OBR acknowledge that the current and continuing weakness in productivity growth is not owing to the EU referendum. Productivity growth is the biggest and most important source of uncertainty for public finances which will continue to deteriorate without improvement to productivity.

Public sector net borrowing – the fiscal mandate

Owing to Brexit the Government has formally dropped the stated ambition of balancing the budget during the life of this Parliament, with a significant loosening of fiscal targets and which are now much less constraining than before.

Since the referendum, the value of the pound has fallen significantly, the **Sterling Exchange Rate Index** is over **18% lower** than the same period last year - 29% below the 2007 peak, before the crash. The OBR's forecast for sterling is around 13% weaker across the forecast than that used in March.

Accordingly **inflation** is forecast to peak at **2.6%** and with subdued earnings growth, real income growth is likely to stall in 2017, squeezing consumer spending. Confronted by the possibility of a near-term economic slowdown the Chancellor has opted for neither a large near-term stimulus nor more austerity. Instead Mr Hammond has chosen a looser 'fiscal mandate' that gives him scope for **£56 billion more borrowing** in 2020-21 (about 2½% of GDP).

Forecast revisions absorb £20bn of this extra room for manoeuvre, giveaways £9½bn (mostly infrastructure spending), leaving £26½ billion spare in case the outlook worsens.

The OBR now forecast a deficit of **£68.2 billion** this year 2016-17 (vs. an outturn 2015-16: £76.0 bn) and a forecast deficit of just over £20 billion in 2020-21, the previously expected year of 'break-even'.

The reversal of Mr Osborne's 'accounting measures' for recording corporation tax revenues, fiscal giveaways and forecast revisions mean the OBR expect the mandate to be missed by more than £20 billion. Even so, such are the uncertainties around the net borrowing forecast there is still a ***35% chance*** of that target being hit based on past forecast performance.

Where is the rabbit?

If there was a 'rabbit' in the Autumn Statement it is the announcement that this will be the last. Instead future Budgets will be in November, with the Chancellor responding to the OBR's forecast in the spring! Plus ça change, plus c'est la même chose?

Personal tax - *Personal allowance and thresholds*

The 2017-18 personal allowance will be **£11,500** and the higher rate threshold (the personal allowance plus the basic rate band) will be **£45,000**. Mr Hammond repeated a commitment to increase the personal allowance to £12,500 and the higher rate threshold to £50,000 by the end of this parliament, but from then on up-rated in line with the consumer price index.

Pension flexibilities

A brief recap and overview of the flexi-access drawdown regime.

Before the changes on 6 April 2015, the pension tax rules were much more prescriptive about payments that could be taken from a money purchase or defined contribution pension scheme. The options now available are one or other or a combination of the following:

- Leaving your pot untouched;
- Taking a guaranteed income (an annuity);
- Taking an adjustable income (flexi-access drawdown);
- Taking the whole pot as a lump sum or series of lump sums (known as 'uncrystallised funds pension lump sums' or 'UFPLS').

For either an annuity or flexi-access drawdown, there should usually be the option of a '25% tax-free lump sum' at the time of taking payment. For UFPLS, normally 25% of each withdrawal is deemed 'tax free' (exactly how a payment is treated for tax depends on whether a member is age 75+). At age 75 all uncrystallised benefits are tested against the lifetime allowance.

The compulsion of tax legislation to purchase an annuity has been removed. Even those already in 'capped' drawdown arrangements in 2015 may change to flexi-access drawdown.

Although, where pension savings are drawn down by flexi-access, recycling of cash by pension contribution is restricted (£4,000 pa). Also, Government has now decided not to allow existing annuity holders to sell their income stream to a third party.

Those aged 55+ may make withdrawals "how they want, subject to their marginal rate of income tax in that year." Apart from the option of the 25% 'tax-free' pension commencement lump sum, withdrawals are effectively taxed as pension income at the individual's marginal rate.

The 6 April 2006 A-Day changes to the pensions' tax system introduced a single set of rules for saving across pension schemes, including benefits and payments, characterised as either authorised or unauthorised. Unauthorised payments have an extra tax charge of 55% and schemes may also be liable for a sanction charge.