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BRIEFING

Freshly Squeezed

Autumn Budget 2017 response

November 2017

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Summary

For his first Autumn Budget, the Office for Budget Responsibility has given Philip Hammond a truly catastrophic set of economic forecasts. After a decade of unrealised productivity forecasts, the OBR has now delivered the mother of all downgrades; all but halving its view of the UK's capacity to grow. As a result it now expects the economy to grow by an average of just 1.4 per cent a year over the coming five years, leaving our economy 2 per cent smaller in 2022 than it previously expected. In the longer term, the OBR's pessimism about the UK economy is even starker – over 30 years its effect would be to reduce the amount each British worker produces by one-quarter.

Inevitably this has big implications for the public finances, more than wiping out recent good news from stronger tax revenues. Lower productivity growth drives borrowing up £91 billion over the forecast period. Even with some compensatory changes on employment, the OBR has told the Chancellor that forecast changes mean he should expect to be borrowing £13.7 billion more in 2020-21. In the face of those downgrades the Chancellor has decided not only to accept the lost ground, but to actually further increase borrowing.

As a result, the ambition to see significant reductions in public sector net debt has also gone out of the window. It is now forecast to remain around 80 per cent of GDP through to the end of the forecast period. We now appear to have a new normal for government debt that runs at precisely double the pre-crisis level of 40 per cent. And even those debt levels are dependent on avoiding another downturn, which history teaches us is, to put it politely, unlikely.

Significant as these fiscal downgrades are, they still leave the Chancellor with £14.8 billion headroom against his fiscal target for cyclically adjusted borrowing to be below 2 per cent of GDP in 2020-21. His generally relaxed demeanour yesterday and decision to actively borrow more may reflect the fact that this headroom is broadly in line with the average headroom Chancellors have had against their fiscal targets since 2010.

That headroom is however only being bought by an ongoing programme of austerity. Real spending per person is set to be 1.4 per cent lower in 2022-23 than in 2008-09, an unprecedented stagnation. And within those totals capital spending by government departments is set to increase significantly in the years ahead, while day-to-day resource spending per person now looks set to fall by a further 4 per cent by 2022-23. That includes a pencilled in, but unallocated, £4.7 billion additional cut announced yesterday.

In practice the Chancellor looks to have abandoned his overall fiscal objective (and manifesto aim) of reaching an absolute surplus by the middle of the next decade, instead being on course to reach that point by 2030. That would mean we are only a third of the way through a 20-year programme of deficit reduction since 2010. Were he to try to stick to his fiscal objective by 2025 it would require three years of deficit reduction from 2023-24 at double the pace currently projected for the three years from 2020-21.

While the outlook for the public finances is bad, it is possibly not quite as bad as some were expecting. Unfortunately however, the future for family finances implied by yesterday's forecasts is unremittingly grim. Lower productivity feeds through directly to pay, which is now forecast to be £1,000 a year lower on average than the OBR thought back in March. We project that this would mean average pay not recovering to its pre-crisis peak until 2025 – a full 17 years after the pay squeeze began.

The pay downgrade feeds through into weak projections for family incomes, despite offsetting revisions to employment levels and hours worked. Disposable income per person is now set to be £540 lower by 2022 than previously expected, with the current fall in real incomes set to continue and to become the longest on record. Indeed the OBR projects that the current period of falling incomes will last 19 quarters: longer than the (deeper) 17 quarter income squeeze recorded in the immediate aftermath of the financial crisis.

In the face of this living standards disaster, the Chancellor has not done enough to protect families from further squeezes through the social security system. Welcome steps were taken to shorten the time period people wait for their first Universal Credit payment, to make it easier for families to draw down bigger advances and reduce the risk of rent arrears for those moving onto Universal Credit from Housing Benefit.

But the Chancellor has chosen to press ahead with major cuts to working-age benefits in the next few years, with Universal Credit remaining significantly less generous than the legacy benefits it replaces and working-age benefits being frozen during a period of relatively high inflation. The decision to push ahead with these cuts means that while Philip Hammond is the Chancellor, the tax and benefit policies being delivered are very much those of his predecessor George Osborne. On average, we expect the combined impact of policies announced from the Summer Budget 2015 onwards to leave each of the bottom five deciles as net losers. The poorest third of households will be an average £715 a year worse off by 2022-23, while the richest third of households will be an average of £185 a year better off.

Different household types are set to experience different impacts from changes to policy and the economy. Looking purely at the economic forecast changes in the Autumn Budget, a low paid dual -earning couple with children are set to be £280 a year worse off in 2022-23 from a combination of higher inflation increasing the effect of the benefit squeeze and weaker pay growth. Accounting for all economic and policy changes from the Summer Budget 2015 onwards, some working families face losses of as much as £4,000.

More positive than the failure to act on the short-term living standards challenge of welfare cuts, is the Chancellor's very welcome decision to put the longer-term living standards and intergenerational priority of housing at the centre of his Budget. Welcome moves to invest significantly more in house building look set to return capital spending on housing above the levels than seen in the 2000s (outside of the fiscal stimulus peak of 2008-10). This should drive significant progress towards the government's target of building 300,000 homes a year; although actually achieving it will require a more active role for the state, not least in building more homes for social rent.

The biggest single housing measure however had nothing to do with increasing the supply of housing, and instead focused on supporting demand by scrapping stamp duty for first time buyers of property worth up to £300,000. Despite costing nearly £600 million a year, the OBR expects this policy to lead to just an extra 3,500 first time buyers who would not otherwise have become home owners. That equates to a unit cost of £160,000 per additional owner – sufficient to have actually bought them a typical property outright in 26 per cent of local authorities across England and Wales. The cumulative cost of £3 billion over the coming five years would have also been sufficient to build 40,000 homes for social rent or well over 100,000 homes through the government's own Housing Infrastructure Fund.

Faced with a grim economic backdrop the Chancellor has been seen to play his hand well. He will certainly see this Budget as a political success. But from the perspective of Britain's families it is very hard to see it as such because of the bleak outlook it paints for their living standards. Hopefully it will prove to be wrong because while the first sentence of the Budget document reads "the United Kingdom has a bright future" the brutal truth is: not on these forecasts it doesn't.

The OBR has almost halved its projection for trend productivity growth, meaning output per hour is now forecast to be 4.6 per cent lower in 2022 than previously thought

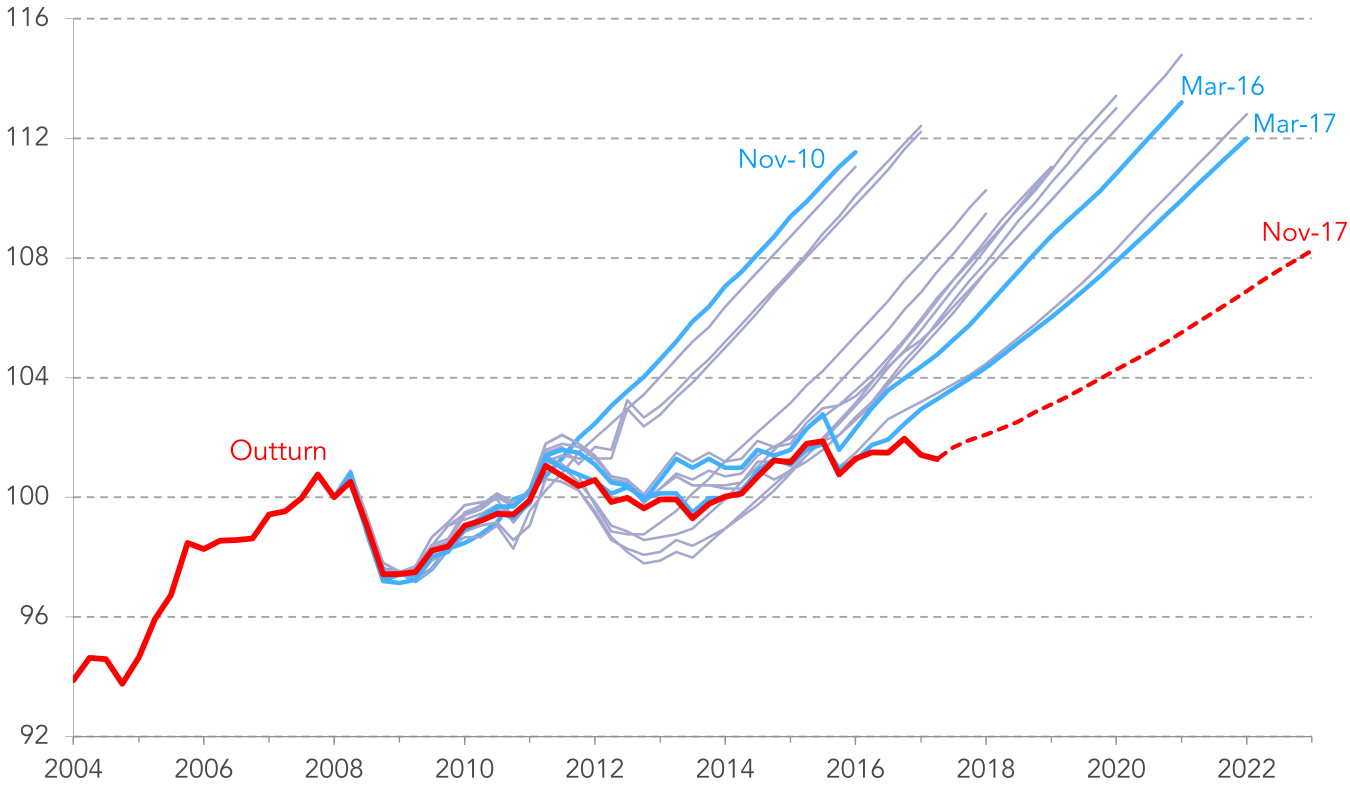
The biggest news in the OBR's latest forecasts – much trailed beforehand – related to the organisation's decision to significantly lower its assessment of trend productivity growth. Faced with post-crisis stagnation in productivity growth that has now stretched to almost a decade, the

OBR has concluded that it is no longer sensible to assume that the UK will shortly return to the pre-crisis trend level of productivity growth in the medium-term.

As Figure 1 shows, the new projection for productivity growth implies output per hour coming in some 4.6 per cent lower at the start of 2022 than was forecast at the Spring Budget in March. That makes this the largest downgrade in the OBR's history.

Figure 1: Successive OBR productivity growth forecasts

Indices of non-oil GVA per hour (Q1 2008 = 100)



Source: OBR, *Economic and Fiscal Outlook*, various

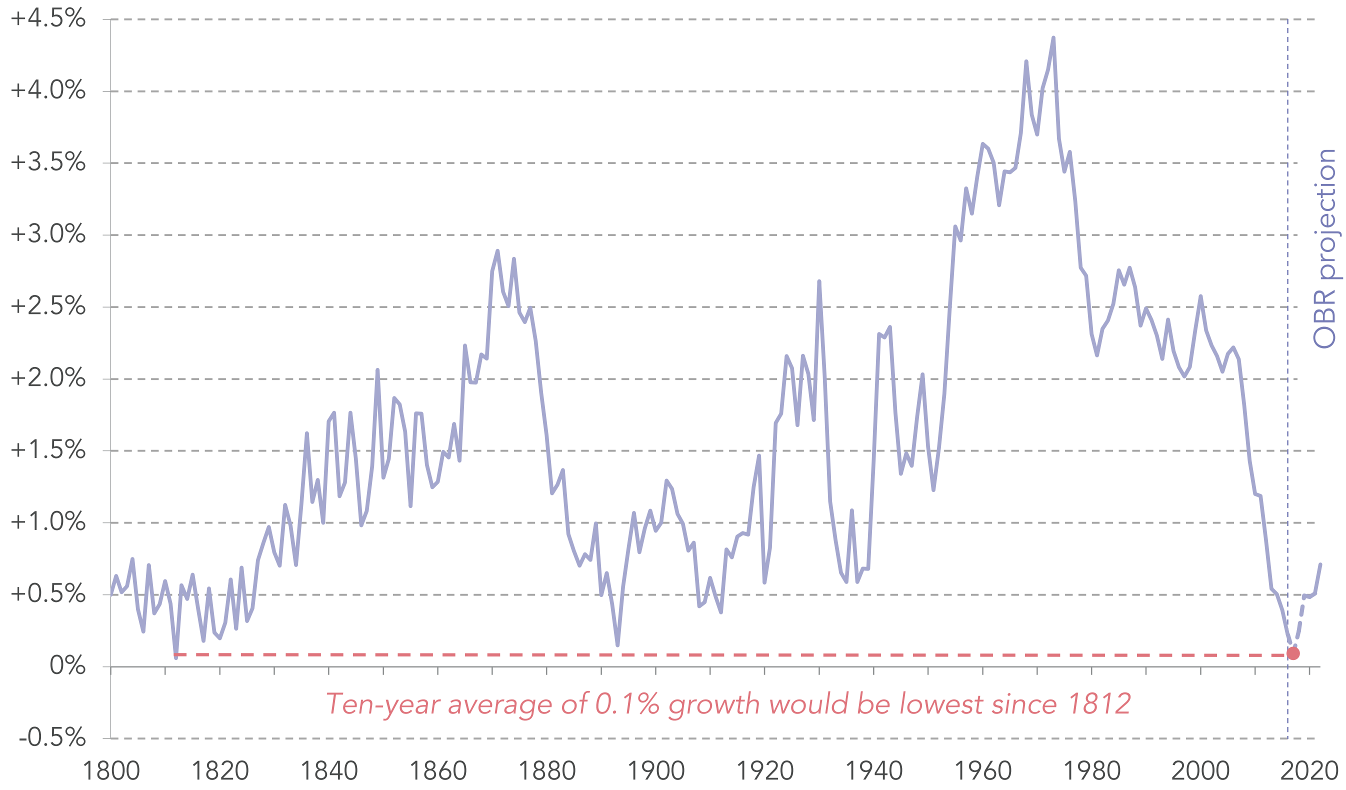
Prior to Budget 2016, the OBR had assumed that the stagnation apparent after 2008 would prove temporary. Productivity growth was thus expected to return to its estimate of the pre-crisis average (2.2 per cent a year). In Budget 2016, the OBR made a modest adjustment – accepting that at least *some* of the post-crisis slowdown in growth was likely to reflect a shift in potential productivity growth. It therefore lowered its trend growth estimate to 2 per cent. It lowered its near-term projection for trend productivity growth to 1.8 per cent in November 2016, reflecting an expectation of a further temporary reduction associated with lower investment amid the uncertainty of the post-referendum period.

The downgrade applied in the latest *Economic and Fiscal Outlook* lowers trend productivity growth by an average of 0.7 percentage points a year over the forecast horizon – meaning growth of 0.9 per cent this year and 1.2 per cent in 2022 (at which point *actual* productivity growth is expected to be 1.3 per cent). Over the space of 18 months then, the OBR's assessment of trend productivity growth has nearly halved, falling from 2.2 per cent to just 1.2 per cent.

Given the persistence of the productivity puzzle, the OBR's downward revision is understandable. The awfulness of the UK's recent record on growth in output per hour is even more apparent when viewed over a longer period, as Figure 2 sets out. On a ten-year rolling basis, average annual growth in productivity has fallen to 0.2 per cent. That figure is set to fall to 0.1 per cent by the end of 2017, marking this as the worst decade for productivity growth since 1812 – when Napoleon invaded Russia.

Figure 2: Average annual productivity growth

Ten-year rolling average of annual growth in real-terms output per hour



Source: Bank of England & OBR, *Economic and Fiscal Outlook*

The ten-year average is set to pick-up slightly thereafter as 2008 and 2009 (when productivity growth was negative) drop out of the figure. But a forecast ten-year average of 0.7 per cent by 2022 would remain lower than anything seen between the Second World War and the financial crisis. This productivity crisis means that the UK's output per hour is currently 21 per cent below an extrapolation of its pre-crisis trend. The OBR assesses that this 'lost productivity' will reach 27 per cent by the start of 2023.[1]

[1] OBR, *Economic and Fiscal Outlook*, November 2017, para 1.16

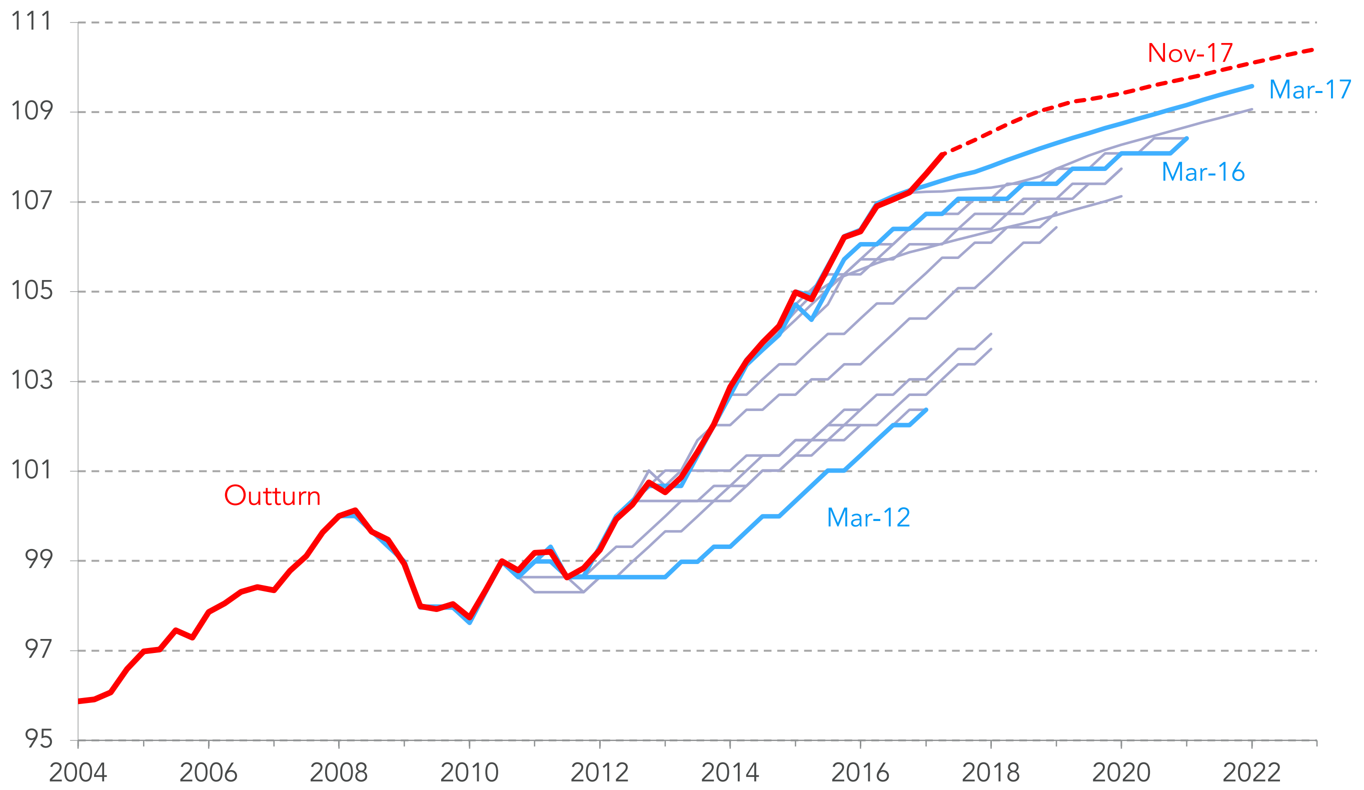
The effect of that downgrade on total output has been partially offset by sunnier forecasts for employment and hours, with total hours worked in 2021 set to rise by 1.7 per cent relative to the March projection

Alongside downgrading its forecast for output per hour worked, the OBR has *increased* its projections for both the number of people in work and the average hours worked by those in employment.

Figure 3 sets out the new projection for employment, highlighting the extent to which the OBR has consistently under-estimated the number of people moving into work in the UK. Its latest projections imply some 150,000 more people being in employment at the start of 2022 than was forecast at the Spring Budget.

Figure 3: Successive OBR employment forecasts

Indices of number of people in employment, 16+ (Q1 2008 = 100)

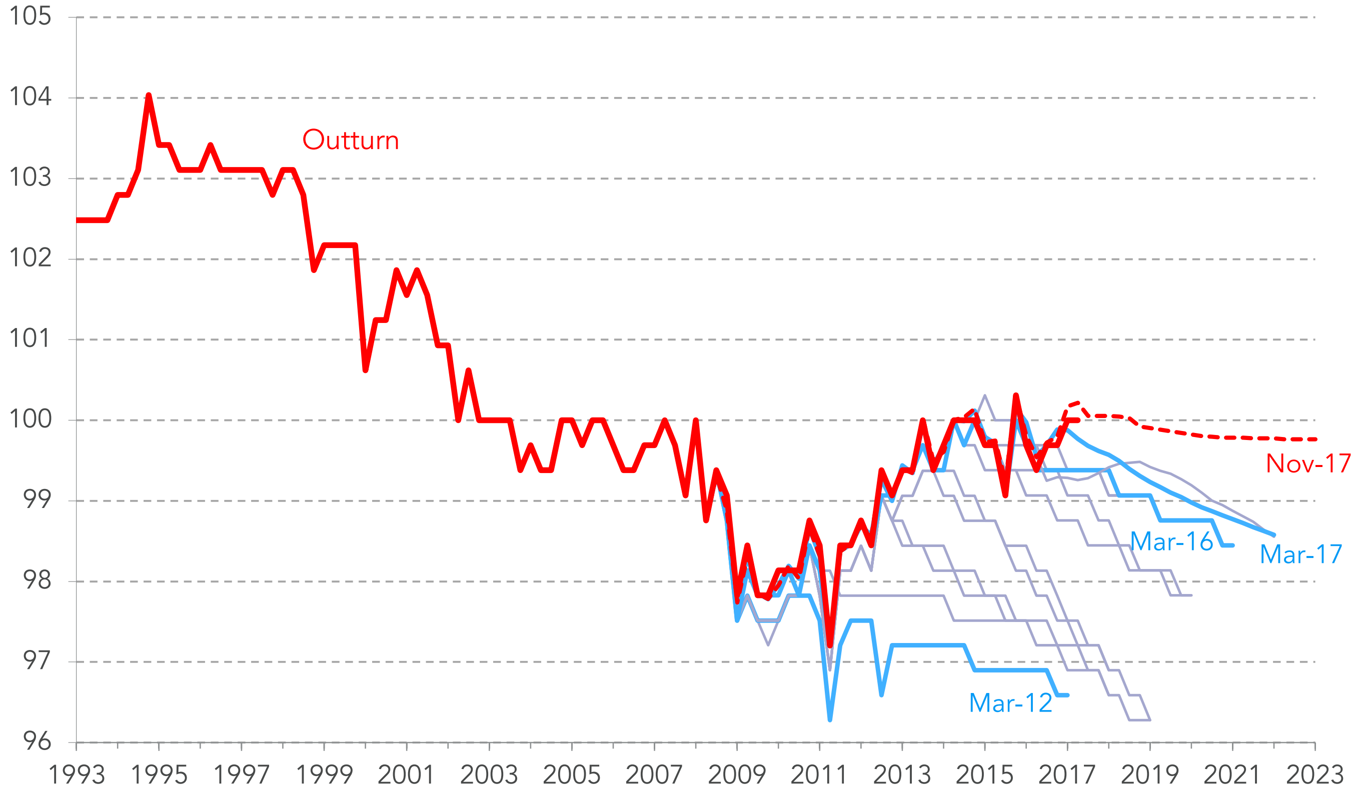


Source: OBR, *Economic and Fiscal Outlook*, various

The OBR has similarly under-estimated workers' willingness since 2009 to buck the long-held trend of falling average hours. Figure 4 compares the OBR's latest position with its previous forecasts, with a much shallower reduction in average hours now assumed to occur over the coming years. The latest outlook implies that average weekly hours in 2022 will fall only slightly to 32.1, rather than the 31.7 hours previous assumed.

Figure 4: Successive OBR average weekly hours forecasts

Indices of average weekly hours of work (Q1 2008 = 100)



Source: OBR, *Economic and Fiscal Outlook* various

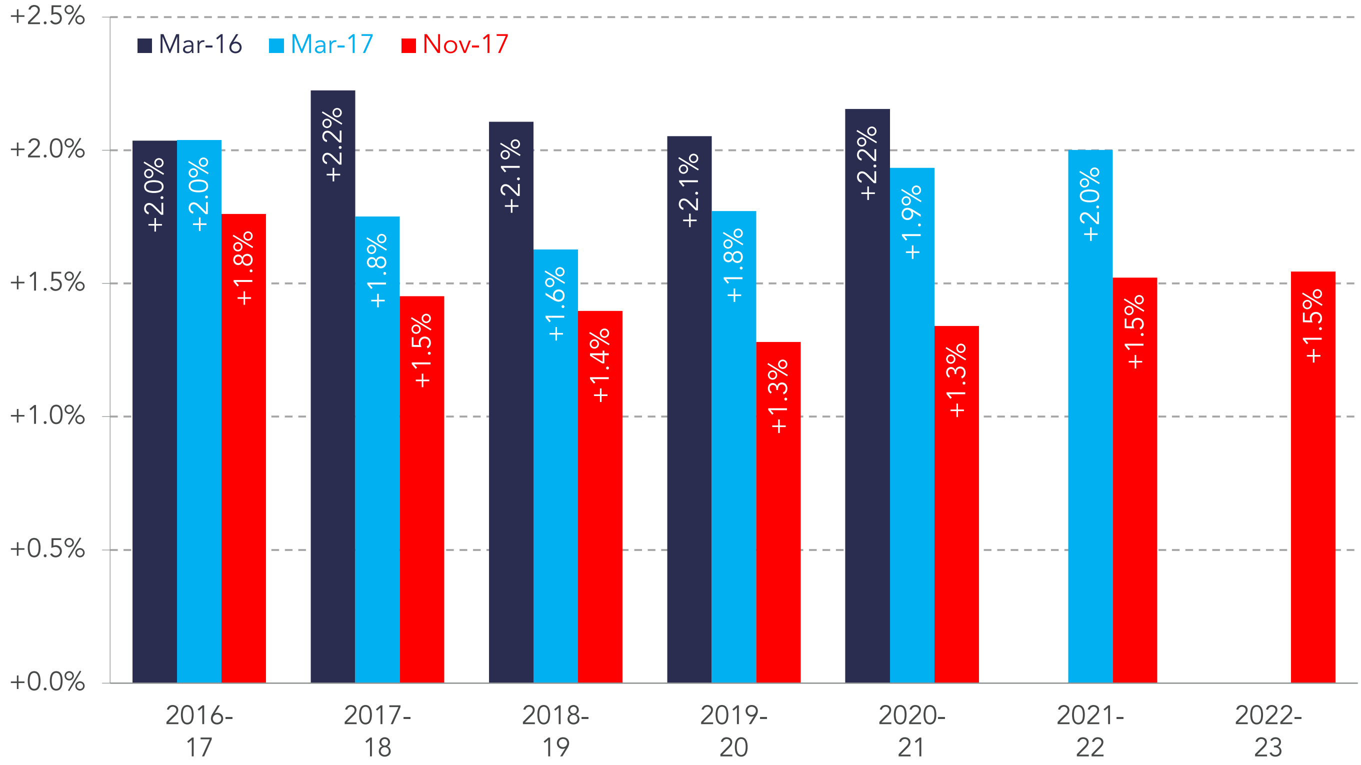
Taken together, these new forecasts for employment and hours have a non-trivial effect on labour supply. The OBR now forecasts that we will work 20.4 million more hours each week at the start of 2022 than it had predicted at the time of the Spring Budget.

Despite working harder however, the OBR's new assessment suggests that the economy will be £42 billion smaller in 2021 than previously thought

The combination of increased labour supply and lower productivity in the OBR's new forecasts results in a net overall reduction in projected output. Figure 5 details the reduction in the OBR's projections for annual GDP growth relative to its forecasts at Budget 2016 and at the Spring Budget earlier this year. It shows that growth is now expected to be significantly lower in each year of the forecast.

Figure 5: Successive OBR GDP growth forecasts

Year-on-year growth in real-terms GDP (chained volume measure)

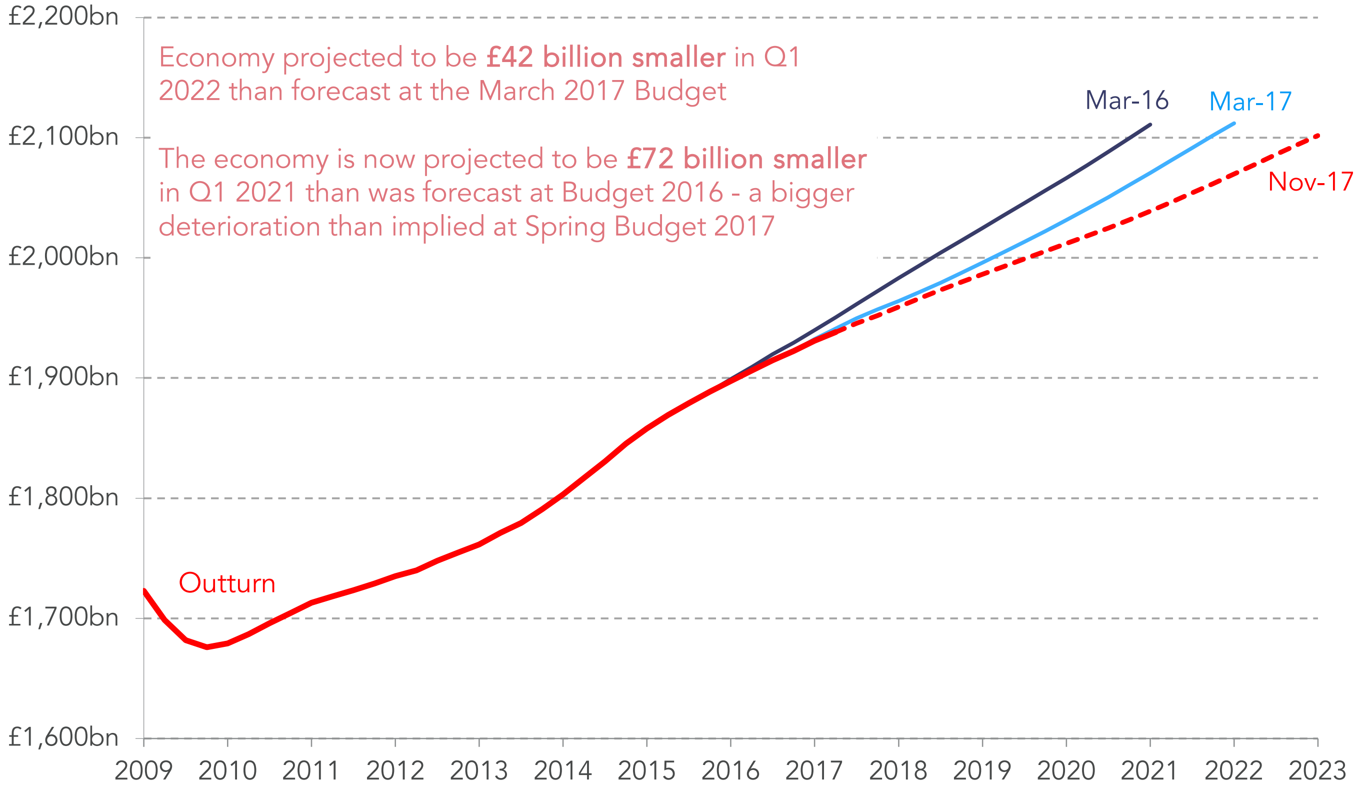


Source: OBR, *Economic and Fiscal Outlook*, various

In cumulative terms, this downgrade has a significant effect. Figure 6 shows the GDP trajectory implied by the growth projections in the same three fiscal statements. It shows that the economy is now expected to be roughly £42 billion smaller at the start of 2022 than was thought back in March. This downgrade comes on top of the deterioration pencilled in after the Brexit vote of June 2016. As such, the latest GDP projections point to an economy that will be £72 billion (or 3.4 per cent) smaller in 2021 than had been projected in March 2016.

Figure 6: Successive OBR GDP forecasts

Real-terms GDP (chained volume measure, rolling four-quarter total)



Source: OBR, *Economic and Fiscal Outlook*, various

These projections contribute to a £7billion reduction in the Chancellor's headroom relative to his fiscal mandate by £7 billion; with new policy giveaways expanding the overall reduction in headroom to £11 billion

Reductions in GDP inevitably feed through into reductions in expected tax revenues. Taking its productivity downgrade in isolation, the OBR estimates a cumulative impact on borrowing of £91 billion over the period from 2017-18 to 2021-22. This includes £23 billion in 2020-21 – the year in which the Chancellor has a 'fiscal mandate' to meet.

This 'mandate' requires cyclically-adjusted public sector net borrowing (the 'structural deficit') to be less than 2 per cent of GDP by 2020-21. In the March Budget, the Chancellor had £26 billion of 'headroom' relative to this target. He now has £15 billion of headroom, losing 43 per cent of the previous breathing space.[2]

This reduction occurs despite a number of positive trends that have reduced headline borrowing, including some classification changes that simply flatter the figures. Notably, outturn borrowing is lower than the OBR predicted in March, with some of this improvement expected to persist into the future. The employment and hours revisions discussed above also lower projected borrowing. Together these changes – all else equal – would have eliminated the previously forecast structural deficit of £19 billion entirely in 2020-21.

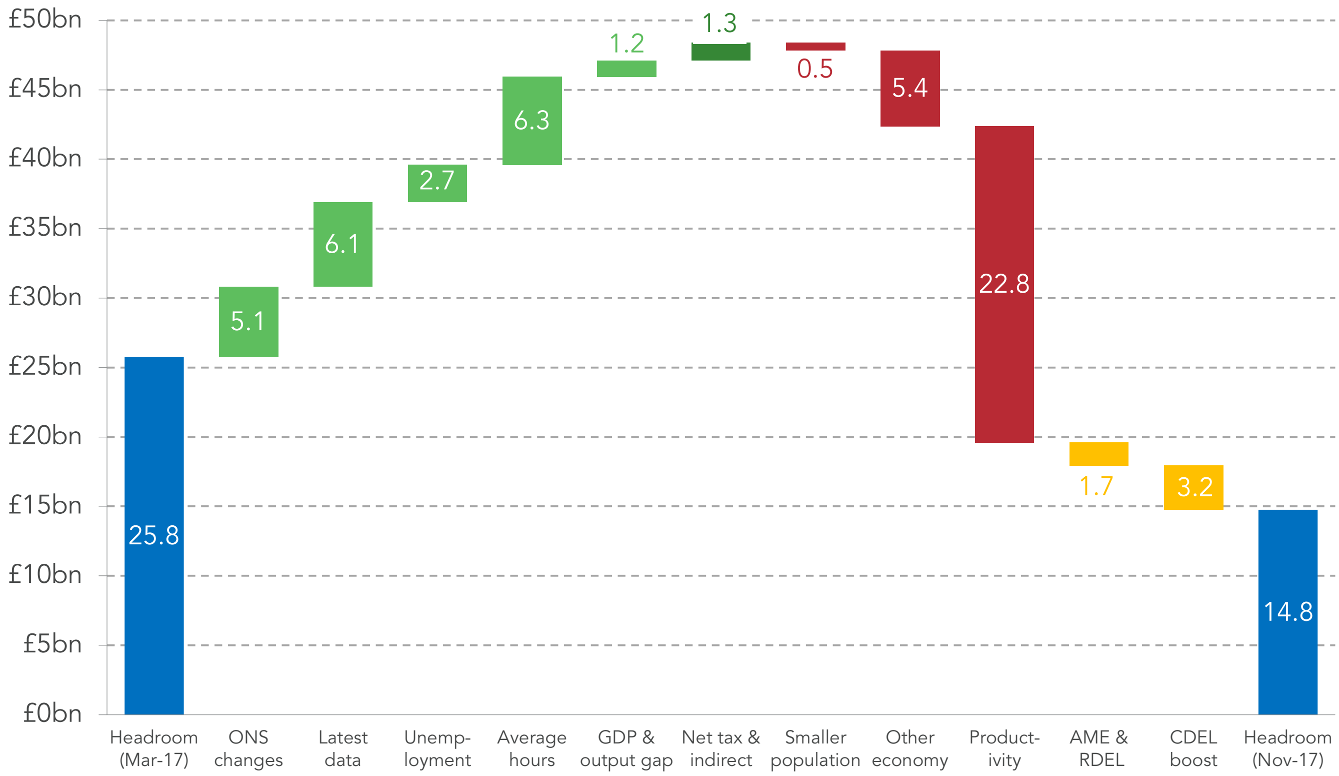
[2] This is similar to the results of the scenario we modelled pre-Budget, which gave £14 billion. M Whittaker, *Revised Statement*, Resolution Foundation: *productivity, prospects and priorities ahead of the Autumn Budget*, November 2017

However, these largely positive trends are more than offset by the impacts of lower productivity, as well as a £0.5 billion reduction stemming from a lower expected working-age population and other economic forecasting downgrades.

As Figure 7 shows, faced with a fiscal downgrade – a net reduction of around £7 billion in 2020-21 – the Chancellor has also chosen to borrow more in order to fund policy changes. These include a small net tax rise and small resource and welfare spending increases, but the largest change is a £3.2 billion increase in capital spending in 2020-21.

Figure 7: Explaining the cut in the Chancellor's 2020-21 fiscal headroom

Borrowing in 2020-21

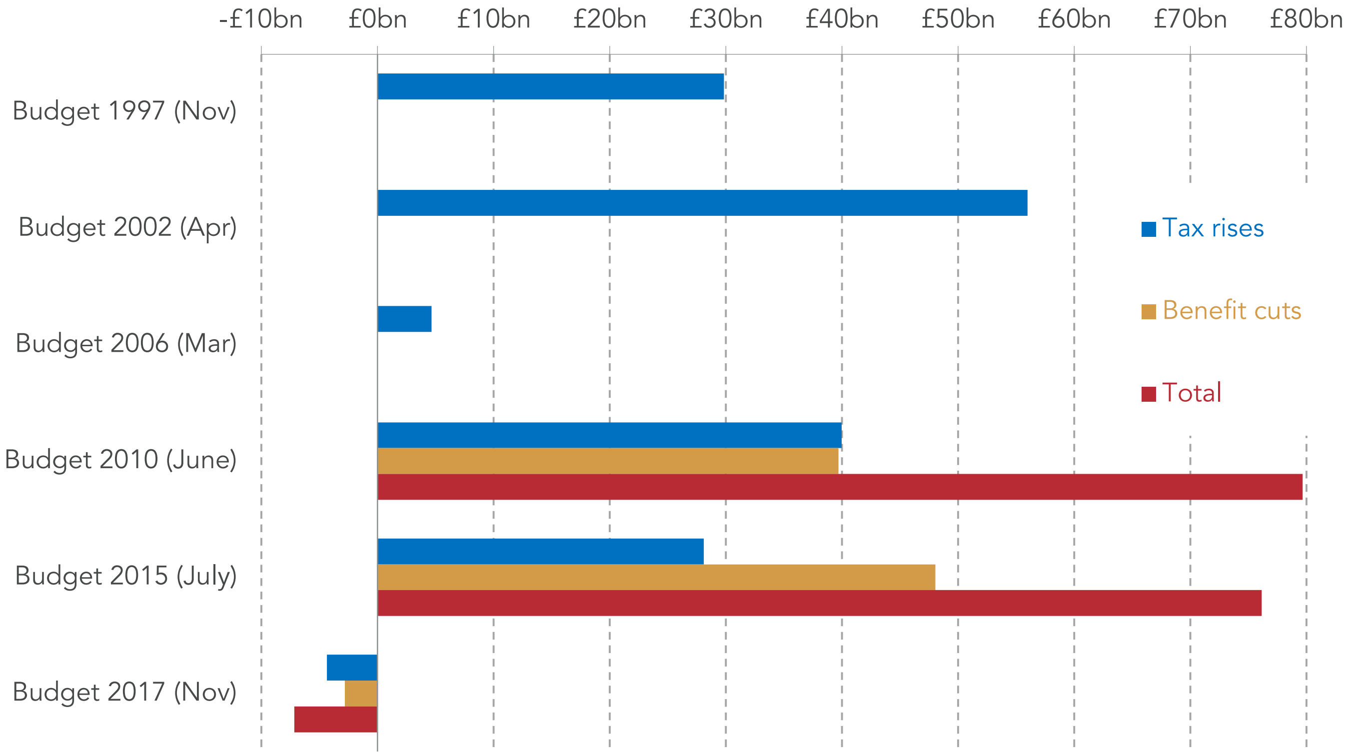


Source: OBR, *Economic and Fiscal Outlook*, various

This small net giveaway is relatively modest. But it is unusual when compared with other fiscal statements that immediately follow a general election. As Figure 8 shows, significant net tax rises are the norm in post-election Budgets, and large welfare cuts featured in 2010 and 2015.

Figure 8: Net revenue changes in first post-election Budgets

Total (nominal) impact on revenue over the subsequent five years of post-election Budgets



Notes: Spending changes unavailable prior to 2010

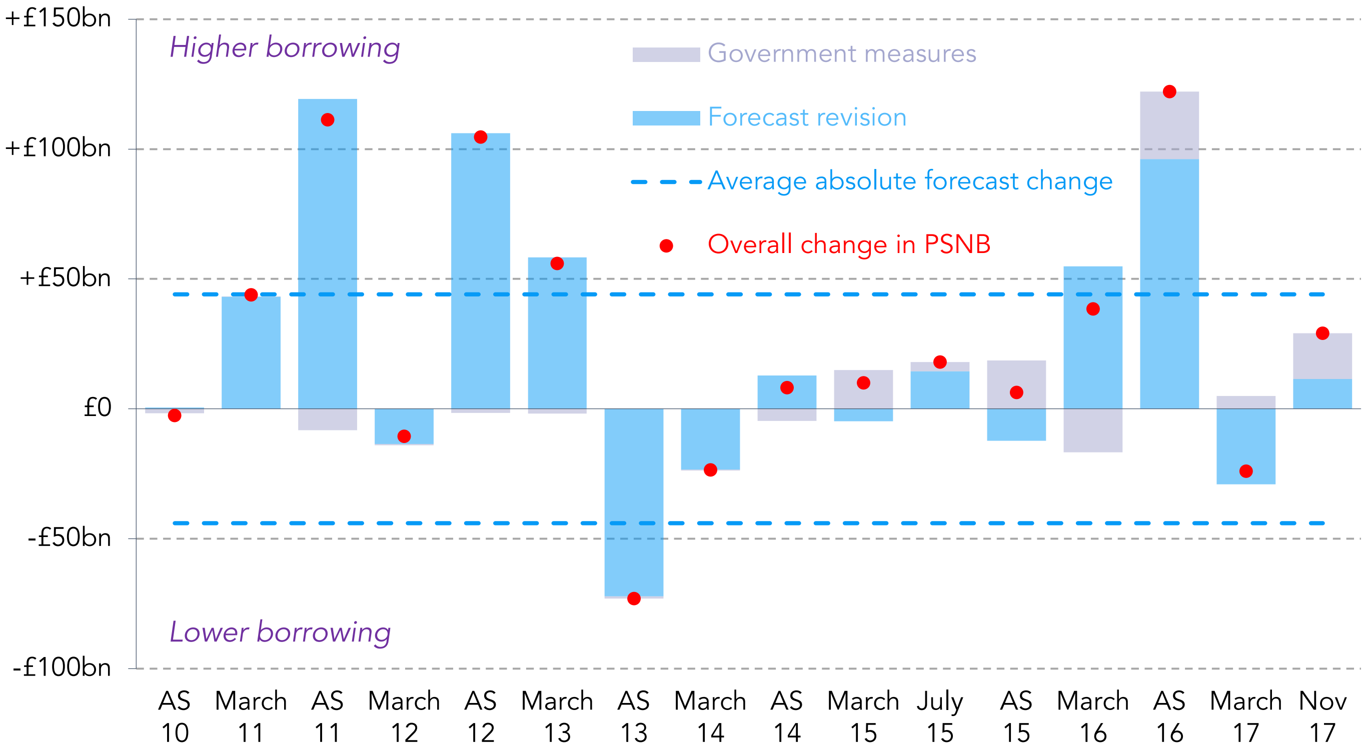
Source: OBR, *Economic and Fiscal Outlook*, various

Indeed, over the period from 2017-18 to 2021-22 as a whole, the net increase in borrowing due to new measures (£18 billion) is greater than the net change from forecast and classification revisions (a net £11 billion).[3] The overall forecast change is in fact relatively small in magnitude compared to the average across previous fiscal statements, as Figure 9 shows.

[3] Alternatively, over the entire fiscal horizon (2016-17 to 2022-23), there is a £25 billion windfall from classification changes offset by £30 billion of other forecast changes, and the government has decided not only to accept that public finance deterioration but to increase it by a further £15 billion.

Figure 9: Changes in borrowing at successive fiscal events

Change in cumulative public sector net borrowing over forecast horizon relative to previous fiscal statement (nominal)

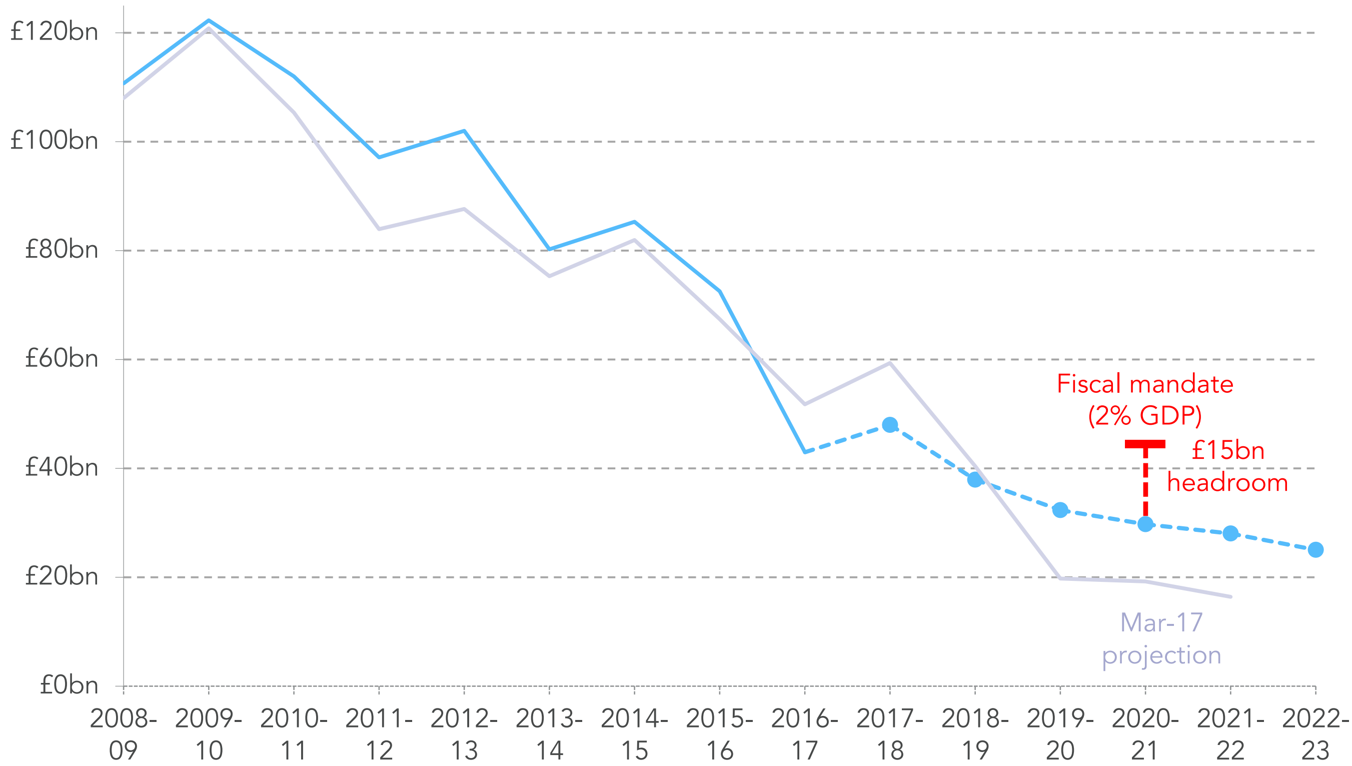


Source: OBR, *Economic and Fiscal Outlook*, various

However, this projected change in cumulative borrowing hides some important timing differences. As Figure 10 shows, borrowing has been revised down in the short-term relative to the Spring Budget, but up from 2019-20 onwards.

Figure 10: Forecast headroom against the fiscal mandate

Cyclically-adjusted net borrowing: outturn and OBR projection (nominal)



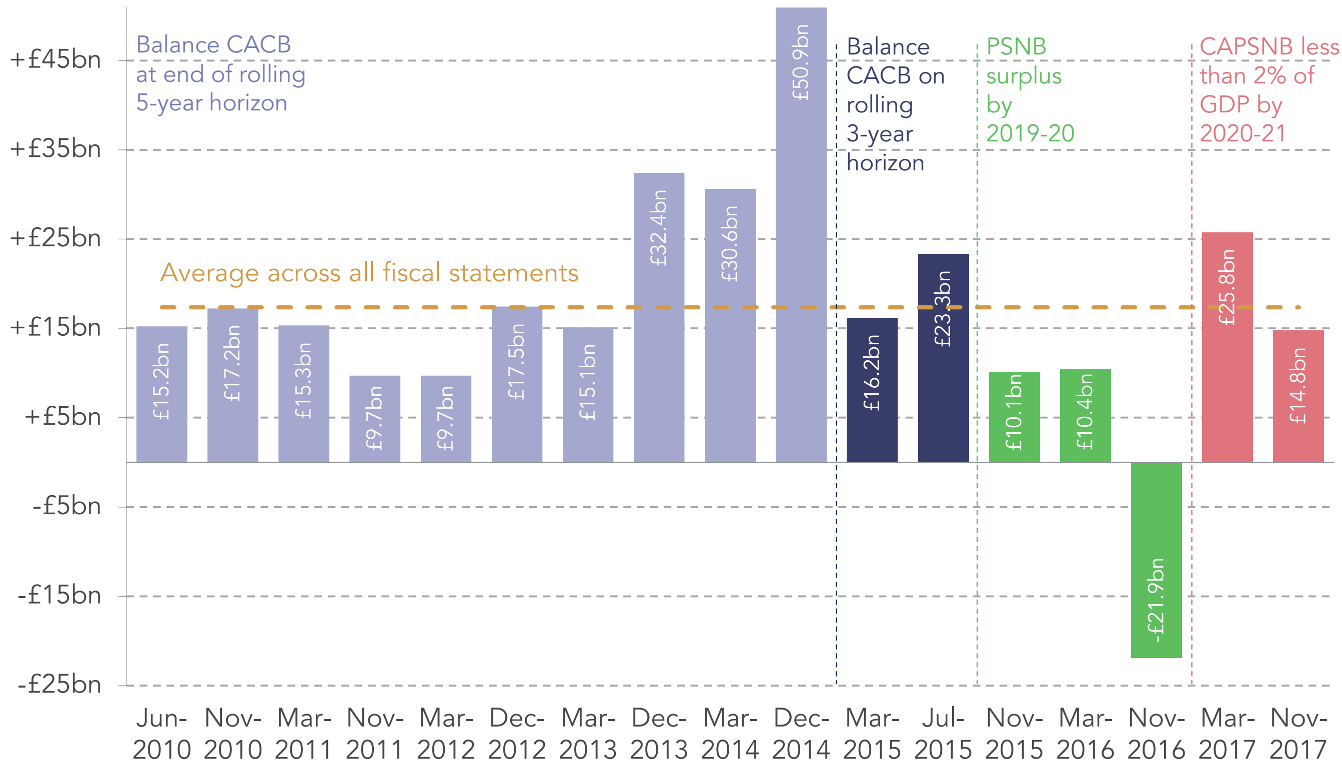
Source: OBR, *Economic and Fiscal Outlook*, various

While disappointing, a reduction in headroom in 2020-21 to £15 billion leaves the Treasury with roughly the same room for manoeuvre as in previous fiscal events since 2010

Although considerably reduced, the £15 billion of headroom is close to the average of £17 billion that Chancellors have enjoyed since 2010, as shown in Figure 11.

Figure 11: Successive forecasts for headroom available relative to the fiscal mandate

Forecast headroom against contemporary fiscal goal (nominal)



Source: OBR, *Economic and Fiscal Outlook*, various

However, it should be noted – among the many other uncertainties in the latest projections – that a potential Brexit 'divorce bill' could easily have a large impact on the deficit figures over the next few years (though with little long-term impact). Sums of around £40 billion have been reported, though it is not clear how such payments would be structured or when they would be made.

With the Chancellor still targeting an overall surplus, today's figures imply a continuation of austerity into the next parliament and beyond

Although the Chancellor's 'fiscal mandate' is simply to borrow less than 2 per cent of GDP in 2020-21, the Treasury's broader 'objective for fiscal policy' is "to return the public finances to balance at the earliest possible date in the next Parliament".[4]

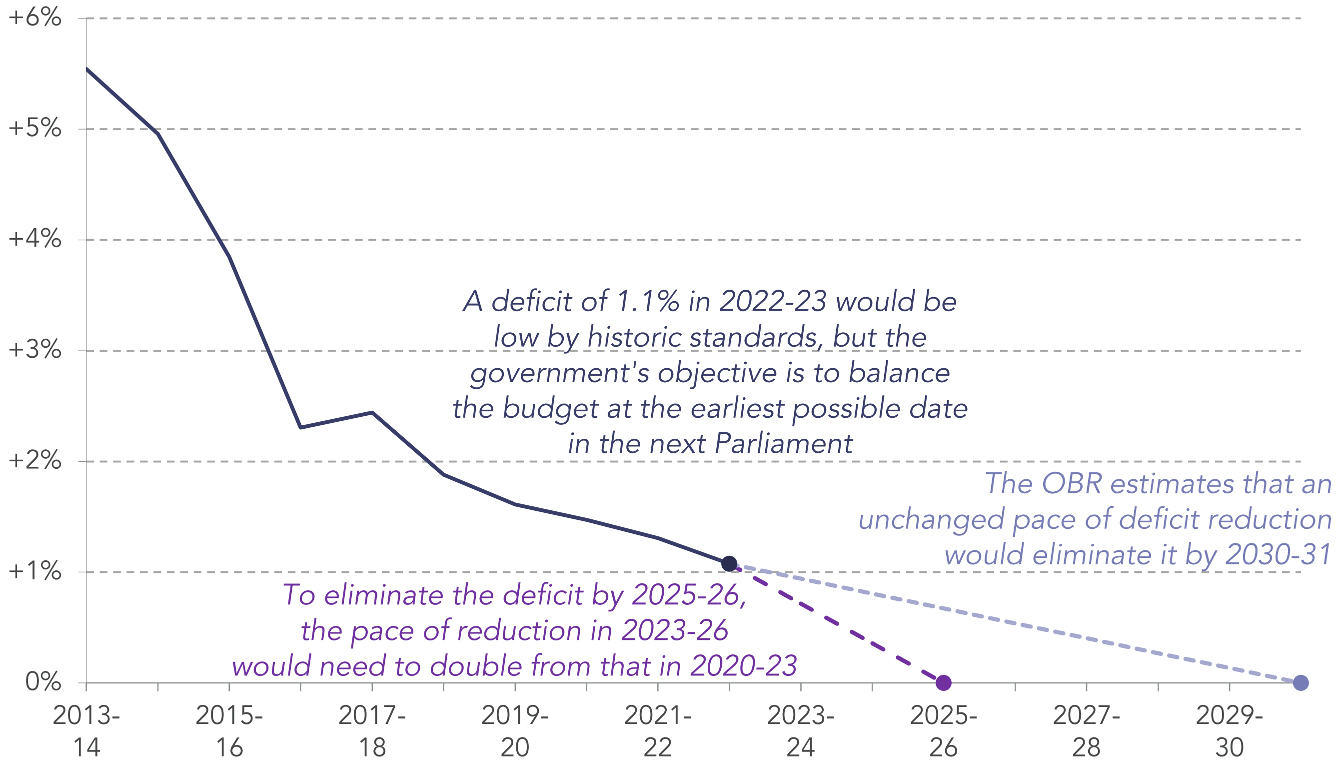
The OBR has stated that this balance would only be reached in 2030 if the average pace of deficit reduction projected for the three years to 2022-23 were to be maintained beyond the forecast horizon. The implication then is that meeting the government's objective at an earlier date would require more significant 'austerity' measures.

As Figure 12 shows, reaching balance by 2025-26 (in line with the Conservative manifesto pledge to eliminate the deficit "by the middle of the next decade") would imply a pace of deficit reduction in the three years from 2023-24 that was double that currently projected for the three years to 2022-23.

[4] HMT, *Charter for Budget Responsibility*

Figure 12: Borrowing measures and the Chancellor's fiscal rules

Public sector net borrowing as a share of GDP

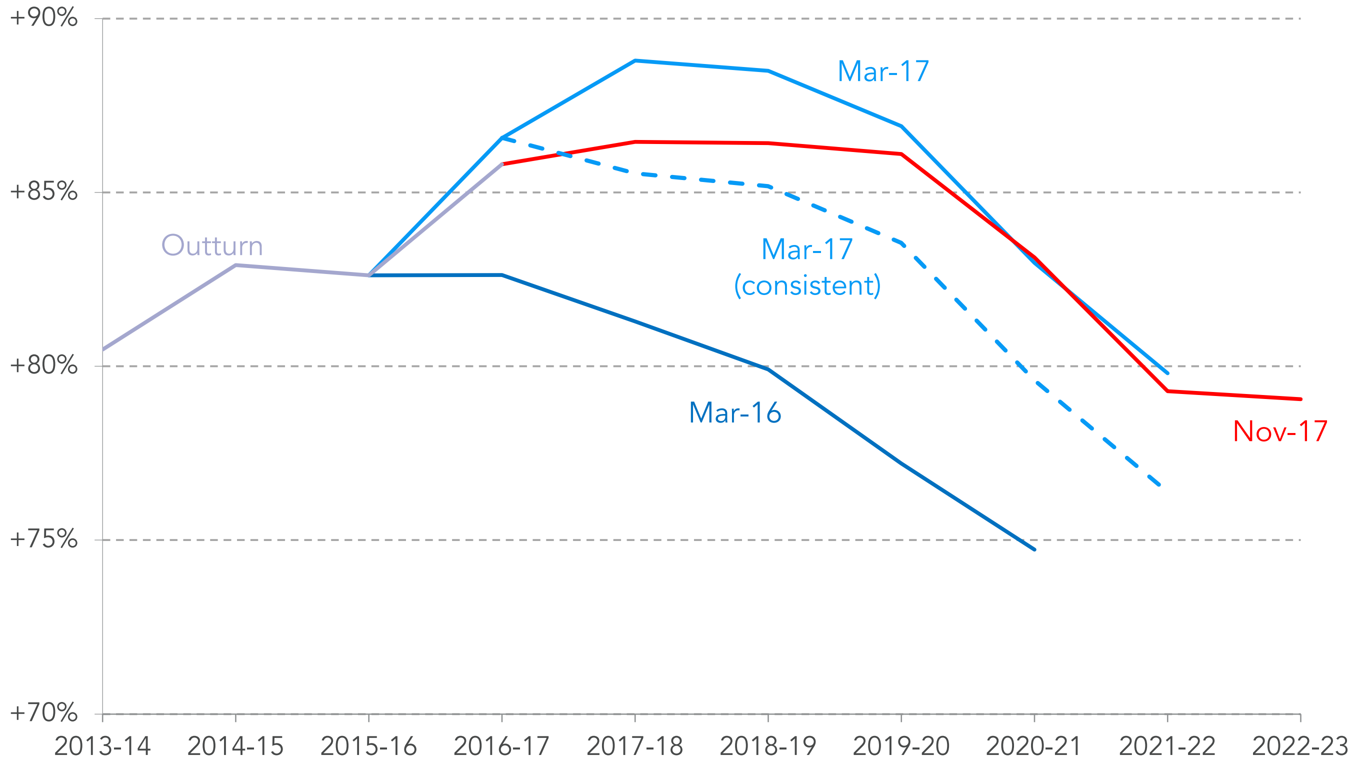


Source: OBR, *Economic and Fiscal Outlook*, various

The government's supplementary target requires "public sector net debt (PSND) as a percentage of GDP to be falling in 2020-21". The new forecast for debt, included in Figure 13, is in fact largely below that given in March. However, this is due to a reclassification of English housing associations.

Figure 13: Successive OBR public sector debt forecasts

Public sector net debt as a share of GDP



Notes: Mar-17 (consistent) series removes the effect of housing association reclassification

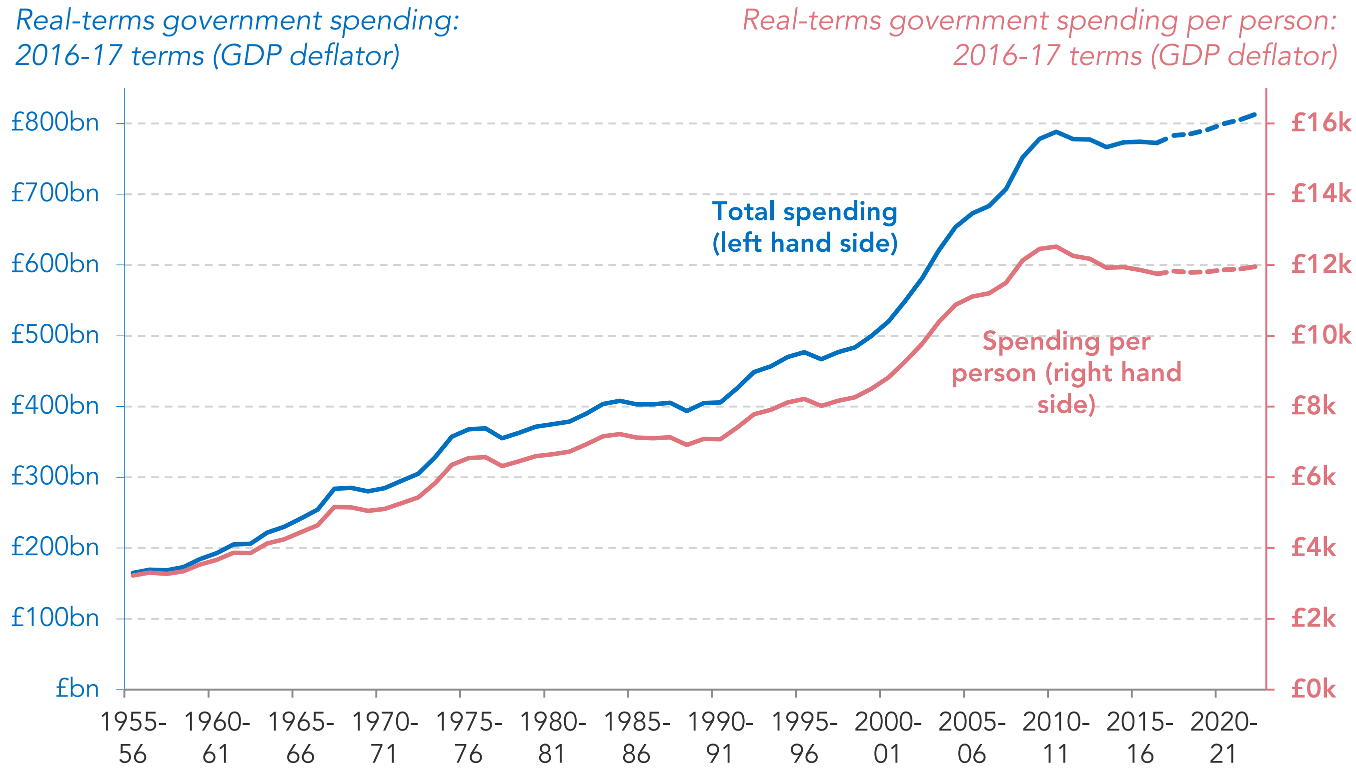
Source: OBR, *Economic and Fiscal Outlook*, various

On a like-for-like basis, the debt forecast has risen. This in turn is down to increased lending under the Bank of England's Term Funding Scheme however, with an expected unwinding of this scheme subsequently producing large falls in net debt in 2020-21 and 2021-22. While a fair comparison is therefore difficult, a loosening of forecast borrowing leads to a more relaxed path for reducing debt as a share of GDP to around 80 per cent.

Deficit reduction has already involved an unprecedented squeeze on government spending per person

Deficit reduction has led to a prolonged squeeze on real public spending, as Figure 14 shows. Real spending per person is expected to be £11,800 in 2018-19, which would be lower than the £12,100 per person spent in 2008-09.

Figure 14: Government spending outturn and projection

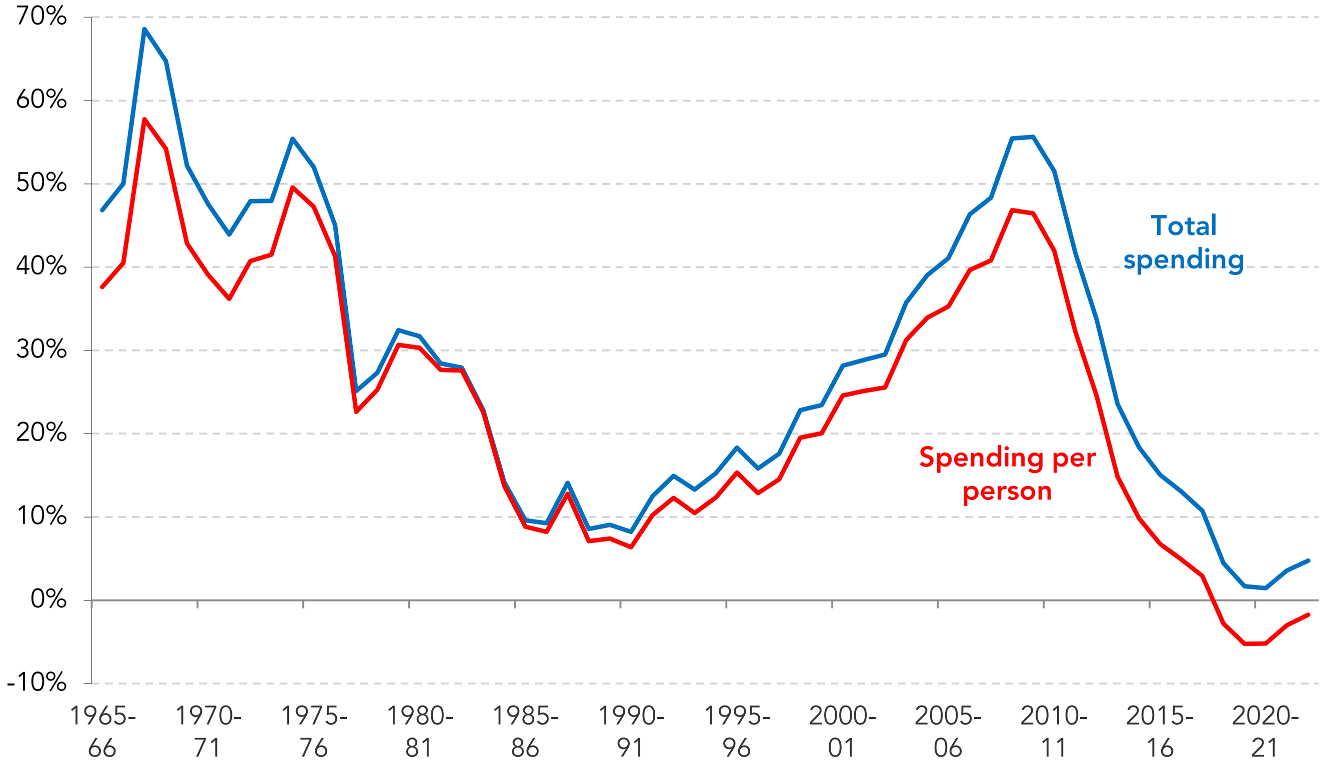


Source: ONS and OBR, *Economic and Fiscal Outlook*, various

As Figure 15 shows, this would be the first ten-year fall in real spending on record. And on these forecasts spending would still be lower in 2022-23 than it was in 2008-09.

Figure 15: 10-year growth in real public spending

Rolling ten-year growth in real public spending (GDP deflator)



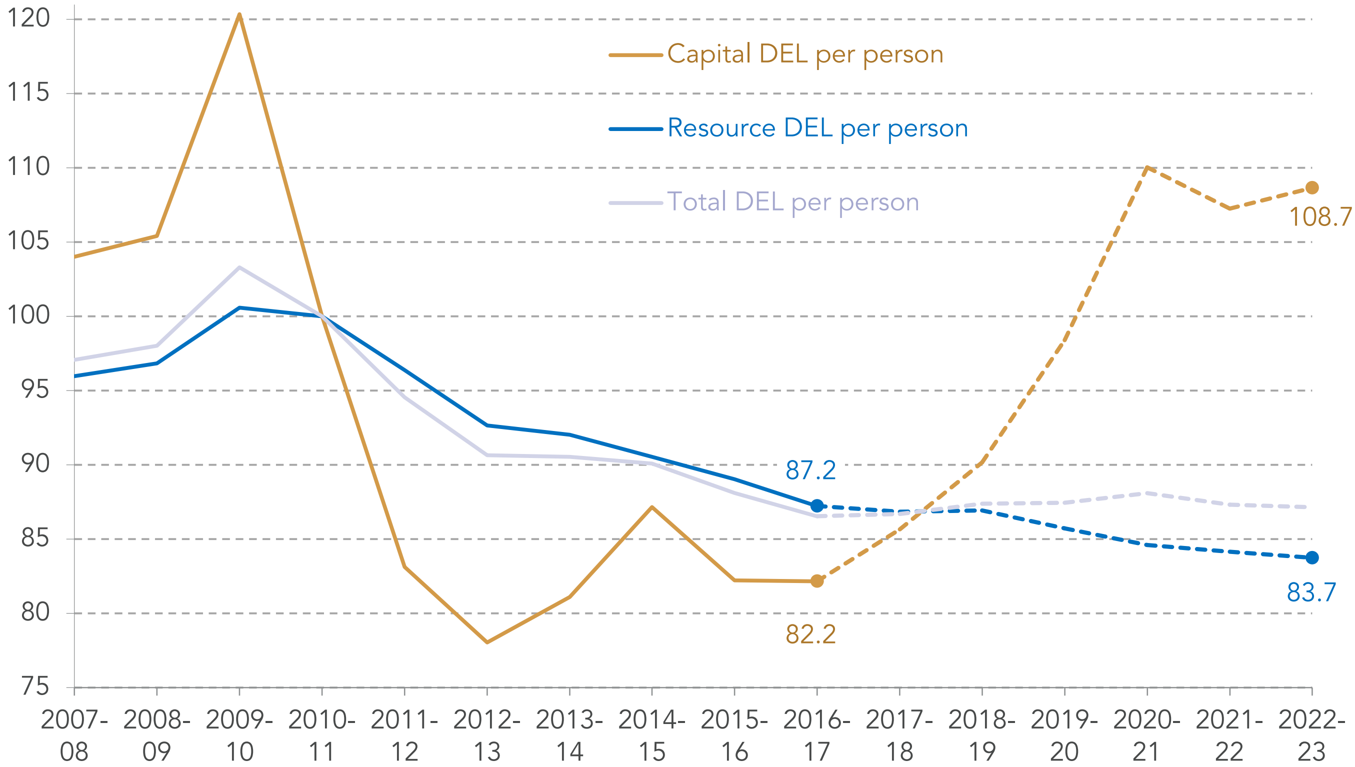
Source: ONS and OBR, *Economic and Fiscal Outlook*, various

In part, this spending squeeze is being achieved through deep reductions in welfare spending for working-age people and children, as set out in previous work[5] and later in this report. But there have also been deep cuts in departmental spending. And going forwards there is a stark difference in the outlook between capital and non-capital spending, as Figure 16 shows. Capital DEL (departmental expenditure limits) per person is expected to be increased back to pre-crisis levels over the next few years. Day-to-day departmental spending per person, on the other hand, is forecast to be 16 per cent lower in 2022-23 than it was in 2010-11. In the short term, however, no overall cut is expected in 2018-19.

[5] M Whittaker, *Ending austerity? The priorities, price tags and practicalities for a government changing course on spending cuts*, Resolution Foundation, July 2017

Figure 16: Departmental spending outturn and projection

Indices of real-terms departmental expenditure limits per person (GDP deflator, 2010-11 = 100)

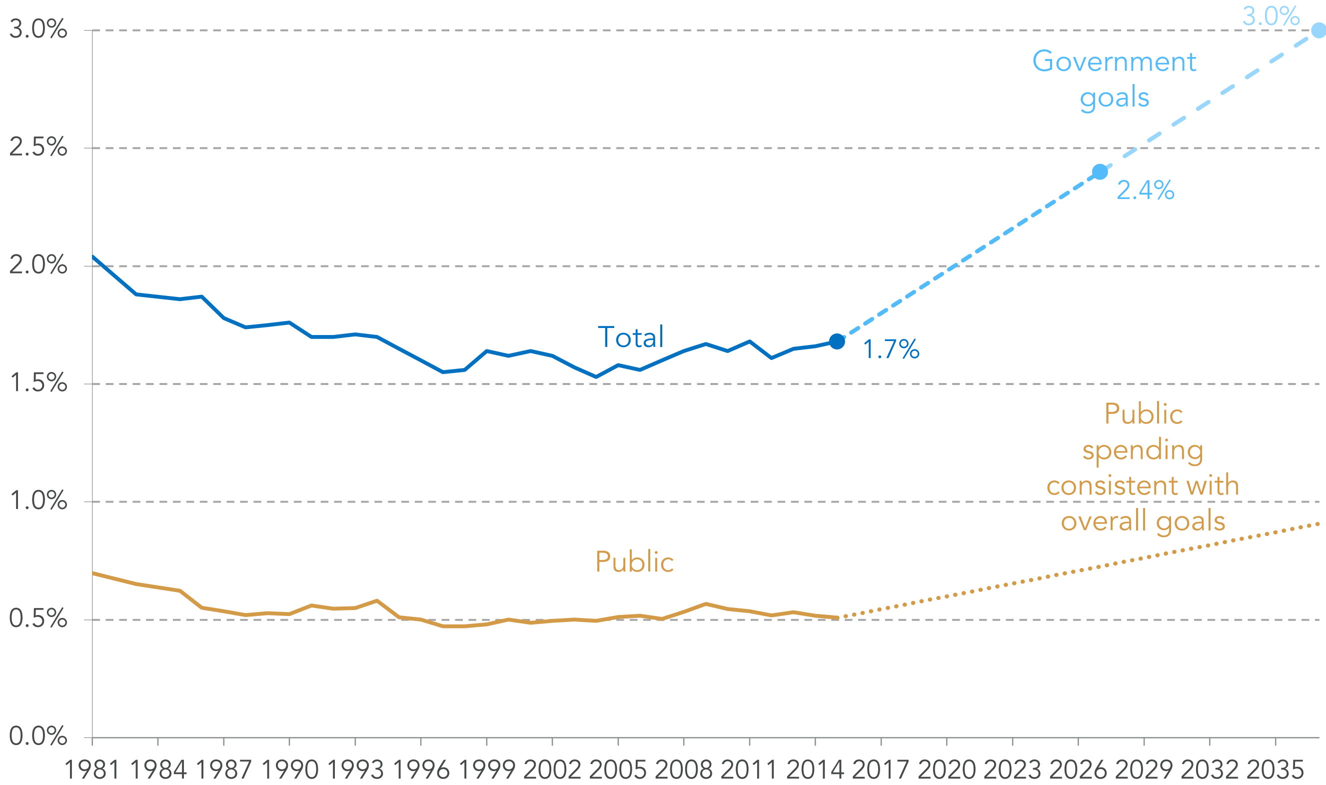


Source: OBR, *Economic and Fiscal Outlook*, various

There is also some indication that the government wishes to expand capital spending – at least in the form of R&D – beyond 2022-23. It has set a goal of public and private R&D spending reaching 2.4 per cent of GDP by 2027 and 3 per cent by an unspecified date beyond that. As shown in Figure 17, these levels would – if achieved – be the highest in decades. Some public spending has been put aside for this up to 2021-22, but it is very likely that further expansion of this as a share of GDP will be needed if the 2.4 per cent and 3 per cent targets are to be met. While welcome, such changes will require either higher borrowing, additional taxation or new spending restraint elsewhere.

Figure 17: Gross expenditure on R&D as a proportion of GDP

Gross expenditure on R&D as a proportion of GDP



Notes: The government has not specified a date for its 3 per cent target. Public spending line beyond 2015 is indicative and assumes public R&D remains at 30 per cent of total R&D, and that the overall goals are met.

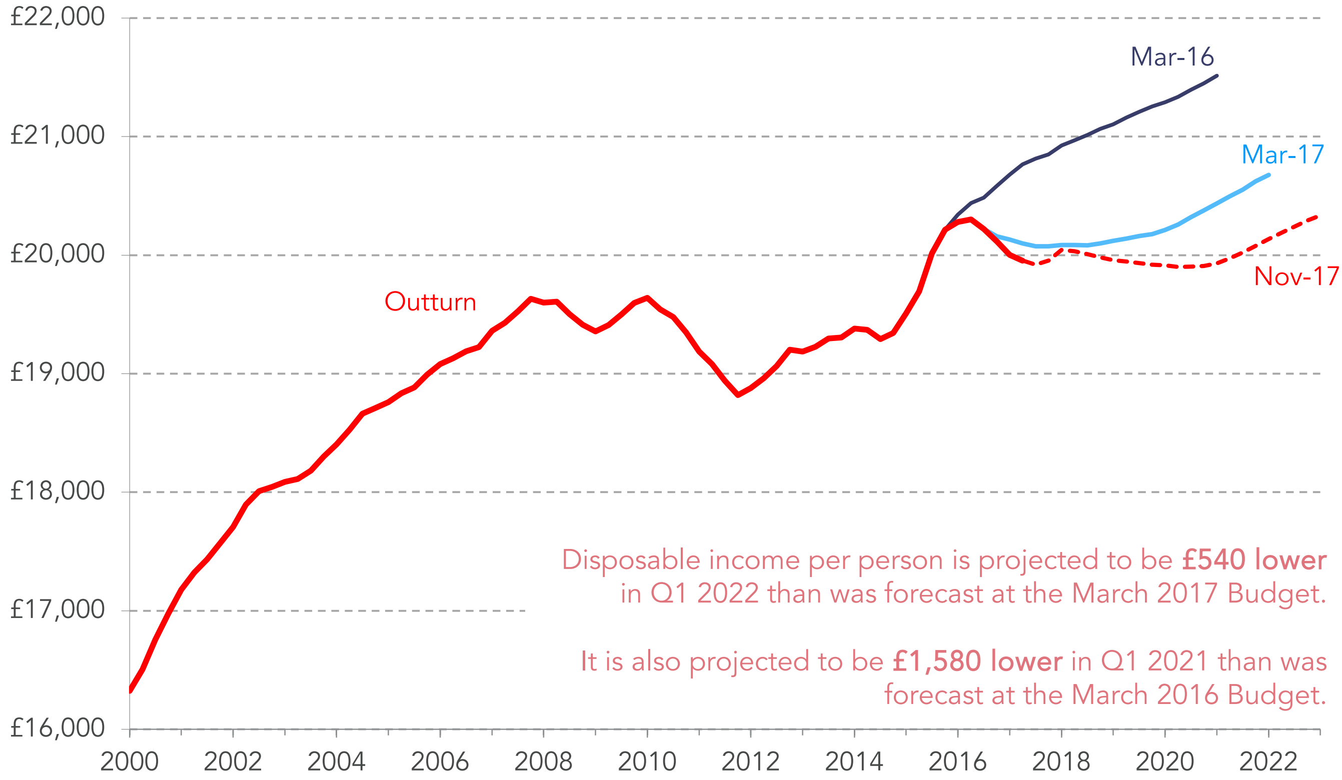
Source: ONS, *GERD*

The new OBR outlook is likely to have an even bigger impact on families' finances than it will on the Chancellor's, with a new squeeze on average income that is forecast to be *longer* than the one that followed the financial crisis

The OBR's reassessment of the future size of the UK economy is undoubtedly bad news for the Chancellor and his public finances, but the outlook appears gloomier still for family finances. Figure 18 compares the revised outlook for average disposable income with those implied by the forecasts presented alongside the 2016 Budget and the 2017 Spring Budget. It shows that average disposable income per person is projected to be £540 lower at the start of 2022 than was forecast back in March. Average income is expected to fall by still more relative to the pre-referendum projections of Budget 2016, coming in £1,580 lower at the start of 2021 than expected in March 2016.

Figure 18: Successive OBR real-terms average household income per capita forecasts

Indices of annualised real household disposable income per capita (chained volume measure, Q3 2007 = 100)

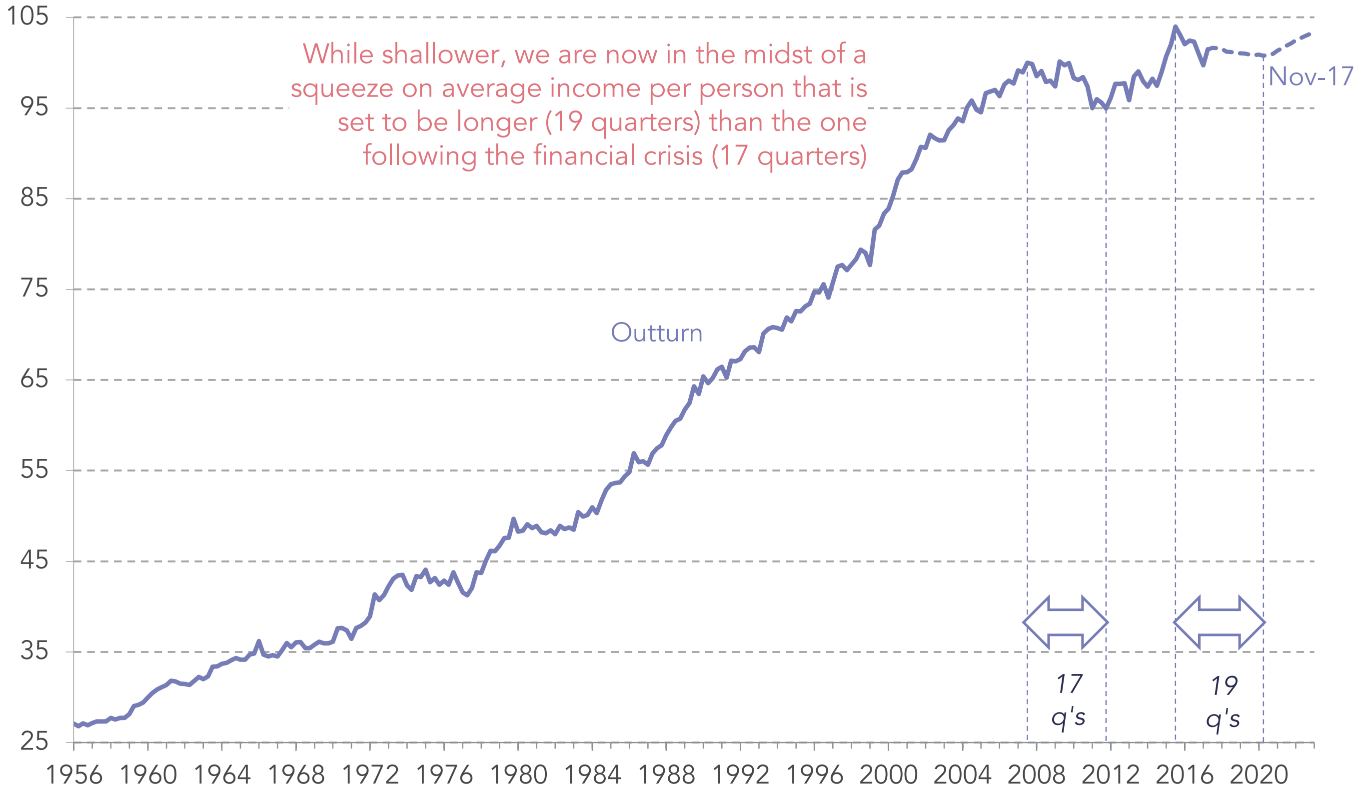


Source: OBR, *Economic and Fiscal Outlook*, various

Figure 19 presents the latest projection in a longer-term context, highlighting the fact that the OBR figures imply that we are part way through a squeeze on average income that is set to be even longer (although not as deep) than the one experienced immediately after the financial crisis. Disposable income per person fell across 17 quarters between Q3 2007 and Q4 2011; but the OBR's outlook suggests that the latest squeeze – which started towards the end of 2015 – is set to last 19 quarters (until Q2 2020).

Figure 19: OBR real-terms average household income per capita forecast

Indices of annualised real household disposable income per capita (chained volume measure, Q3 2007 = 100)



Source: OBR, *Economic and Fiscal Outlook*, various

The latest squeeze is set to be shallower than the post-crisis one, lowering real-terms average income by 3.1 per cent in total (compared with 5.1 per cent in the earlier period). But it is set to be the longest sustained period of falling incomes since the start of this income data series in the 1950s.

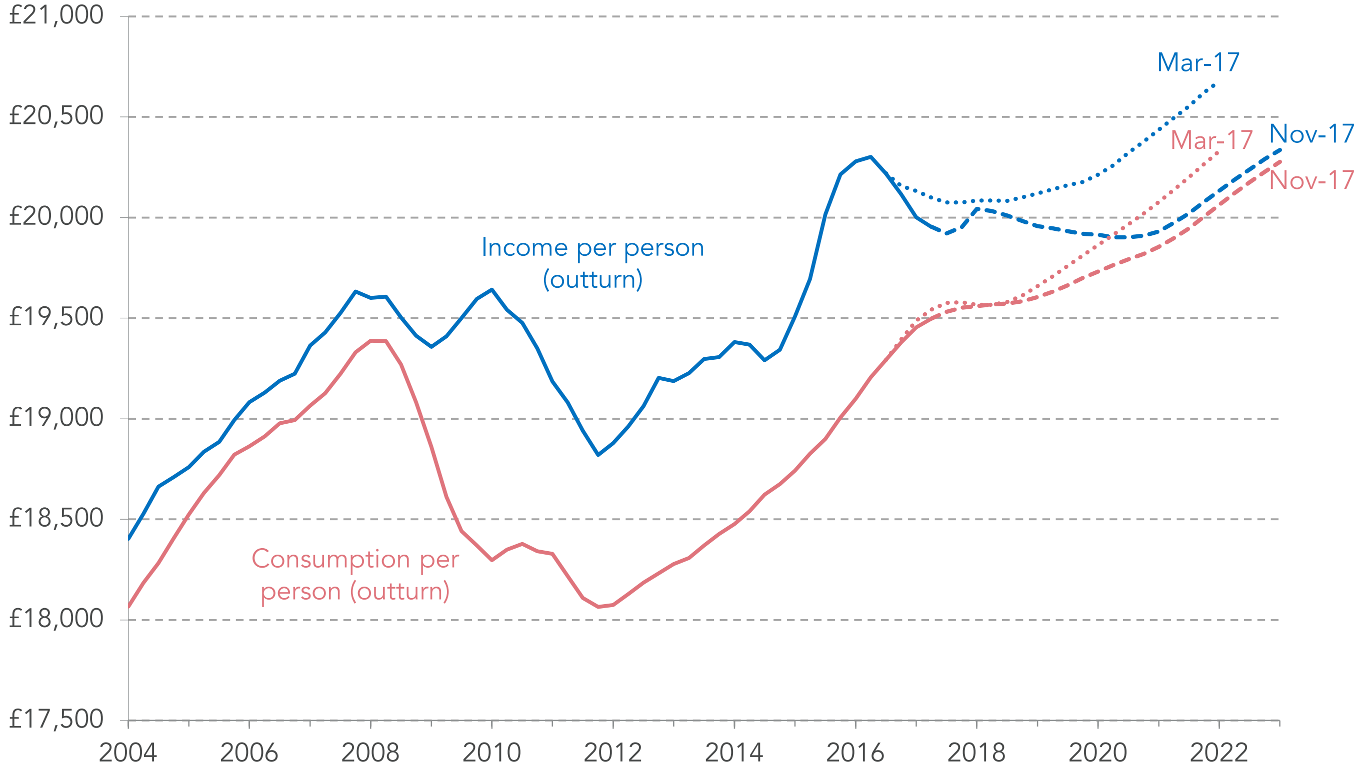
The OBR's projection for consumption growth has also been lowered, but by less than for incomes – implying a falling saving ratio over the coming years

Alongside its income growth downgrade, the OBR has also lowered its projection for consumption growth. But it expects the latter to outpace the former in the near-term "supported by historically-low interest rates and relatively low levels of unemployment".[6] Figure 20 describes this outlook, with a clear narrowing in the forecasts for income and spending. Back at the Spring Budget, income per person was projected to rise to £20,680 by the start of 2022, some £350 higher than average spending per person of £20,330. The new projections suggest that the gap between incomes and spending will narrow to just £60 by 2023 however.

[6] OBR, *Economic and Fiscal Outlook*, November 2017, para 3.91

Figure 20: Income and consumption

Quarterly consumption spending and household income per capita (chained volume measure)



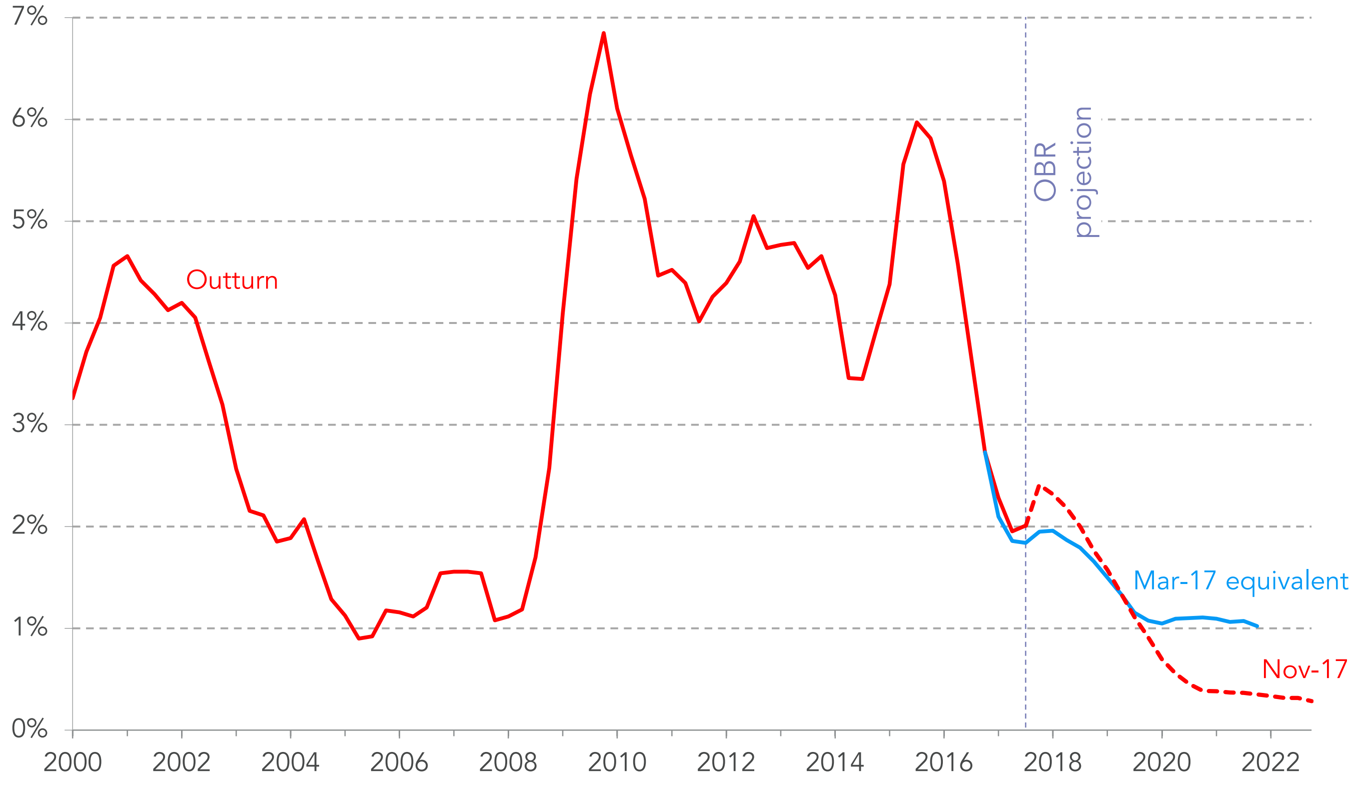
Source: OBR, *Economic and Fiscal Outlook*, various

The implication of this outcome is that the household saving ratio – the amount households have available for saving measured as a share of their disposable income – is set to continue on its recent downward trajectory over the coming years. Figure 20 compares the OBR's latest projection for the saving ratio with the one implied by its Spring Budget outlook.[7]

[7] The saving ratio has been significantly revised since the Spring Budget, meaning the projections set out by the OBR at the two fiscal statements are not directly comparable. To establish a 'Mar-17 equivalent' here, we use the latest outturn data and apply the percentage point changes in the saving ratio set out in the OBR's previous outlook.

Figure 21: Successive OBR household saving ratio forecasts

Saving ratio excluding pension equity adjustment (four-quarter moving average)



Notes: The saving ratio shown excludes the pension equity adjustment that is made to the headline saving ratio measure.

Source: OBR, *Economic and Fiscal Outlook*, various

The implication of the OBR's position is that the saving ratio will fall to just 0.3 per cent towards the end of the forecast period. Any deviation from this outcome would of course have an impact on household consumption and therefore on growth. The OBR acknowledges that the ratio cannot continue to fall indefinitely and describes alternative paths as a "key risk to the forecast".[8]

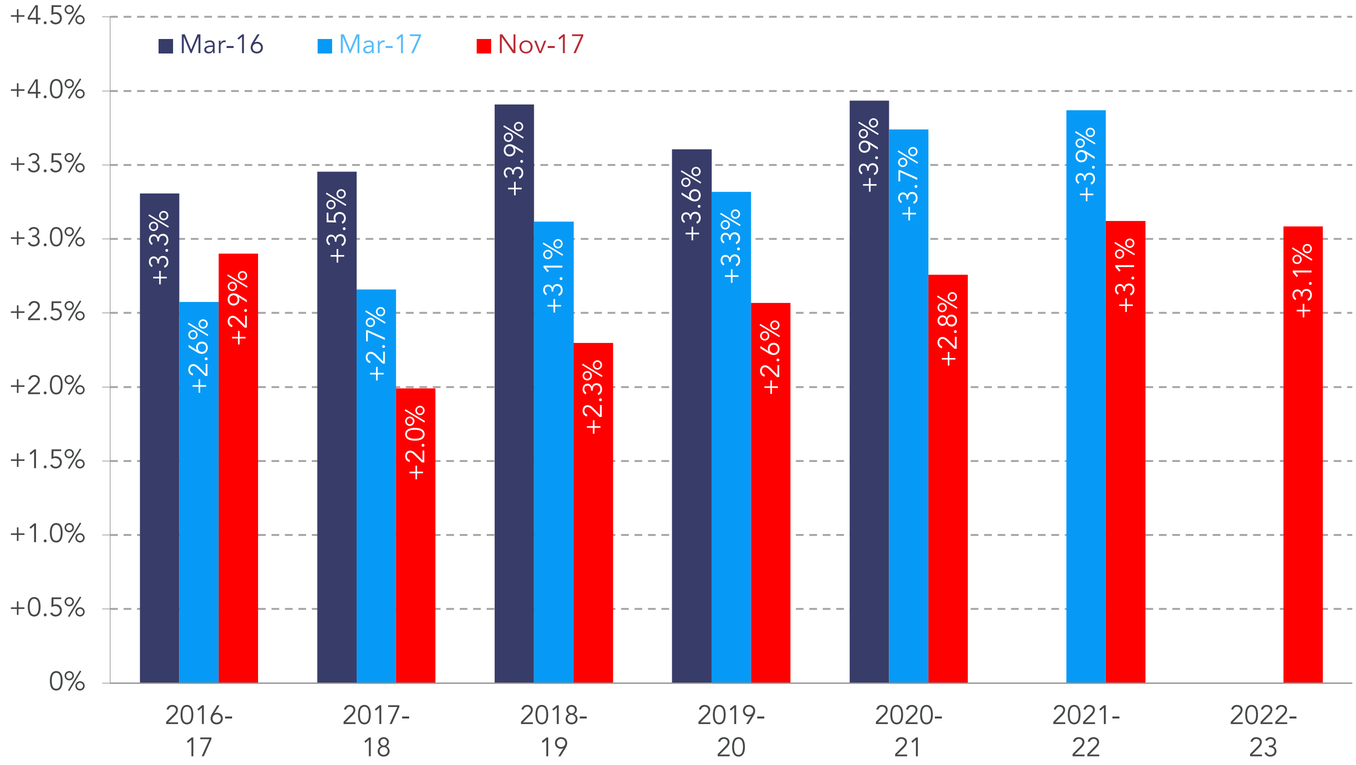
The income squeeze reflects bad news on pay, with average annual earnings set to be £1,000 lower in 2022 than forecast in March and the return to the pre-crisis peak likely to take 17 years in total

The terrible news on incomes is of course driven in large part by a gloomier outlook for pay – which stems in turn from the productivity growth revision. Figure 22 shows the most direct effect of the productivity growth downgrade; lower nominal hourly pay growth. Here the OBR assumes that slower productivity growth feeds directly into slower hourly compensation. As such, the pay growth projection is lowered in every year of the forecast, with forecast growth in 2017-18 and 2018-19 some two-fifths lower than had previously been projected at Budget 2016.

[8] OBR, *Economic and Fiscal Outlook*, November 2017, para 3.91

Figure 22: Successive OBR hourly pay growth forecasts

Year-on-year growth in nominal average hourly employee earnings

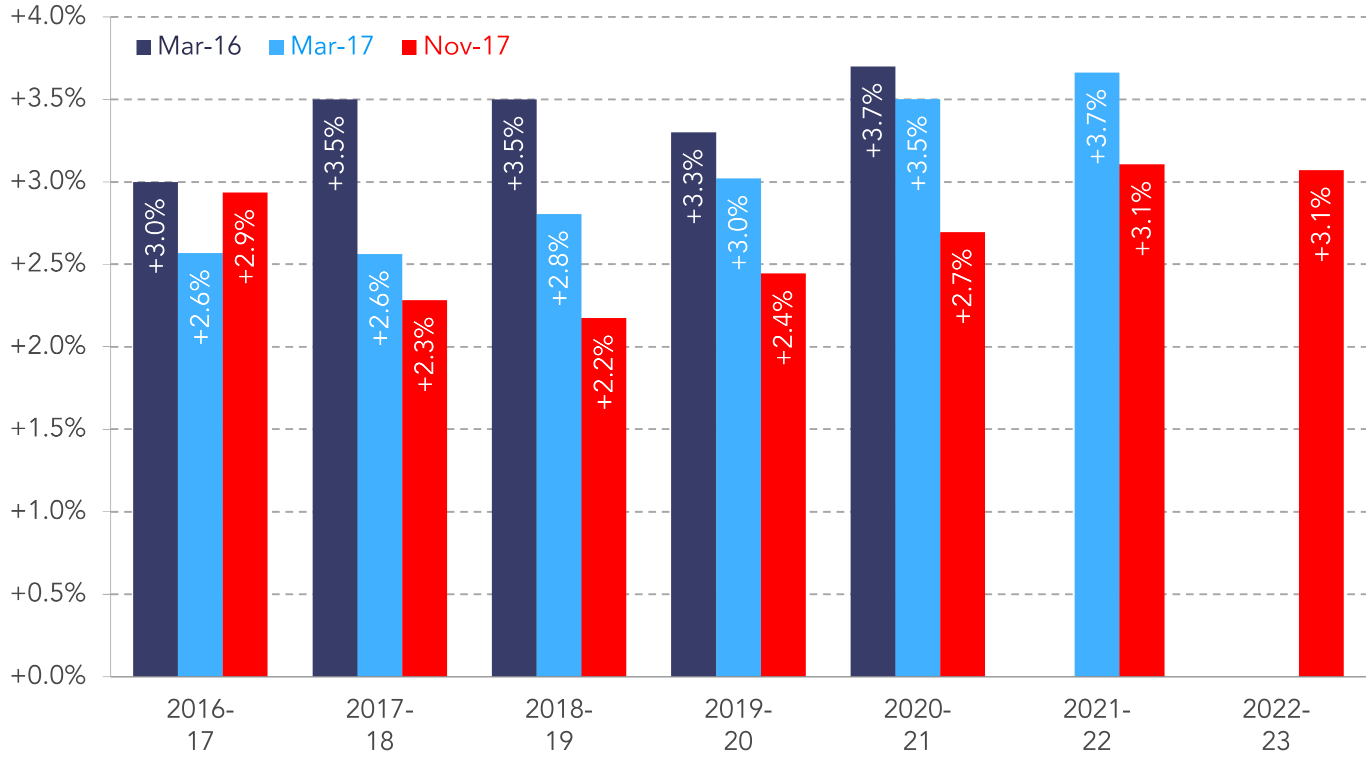


Sources: OBR, *Economic and Fiscal Outlook*, various

As noted above, the OBR assumes average hours will fall over the forecast period, but by less than it previously thought. As such, the downward revision in average *annual* pay that is present in the latest outlook is mitigated to some degree. As Figure 23 shows however, the downward revision is still a very big one. Projected growth rates of 2.3 per cent in 2017-18 and 2.2 per cent in 2018-19 represent reductions of just over one-third on the Budget 2016 equivalents.

Figure 23: Successive OBR annual pay growth forecasts

Year-on-year growth in nominal average annual employee earnings

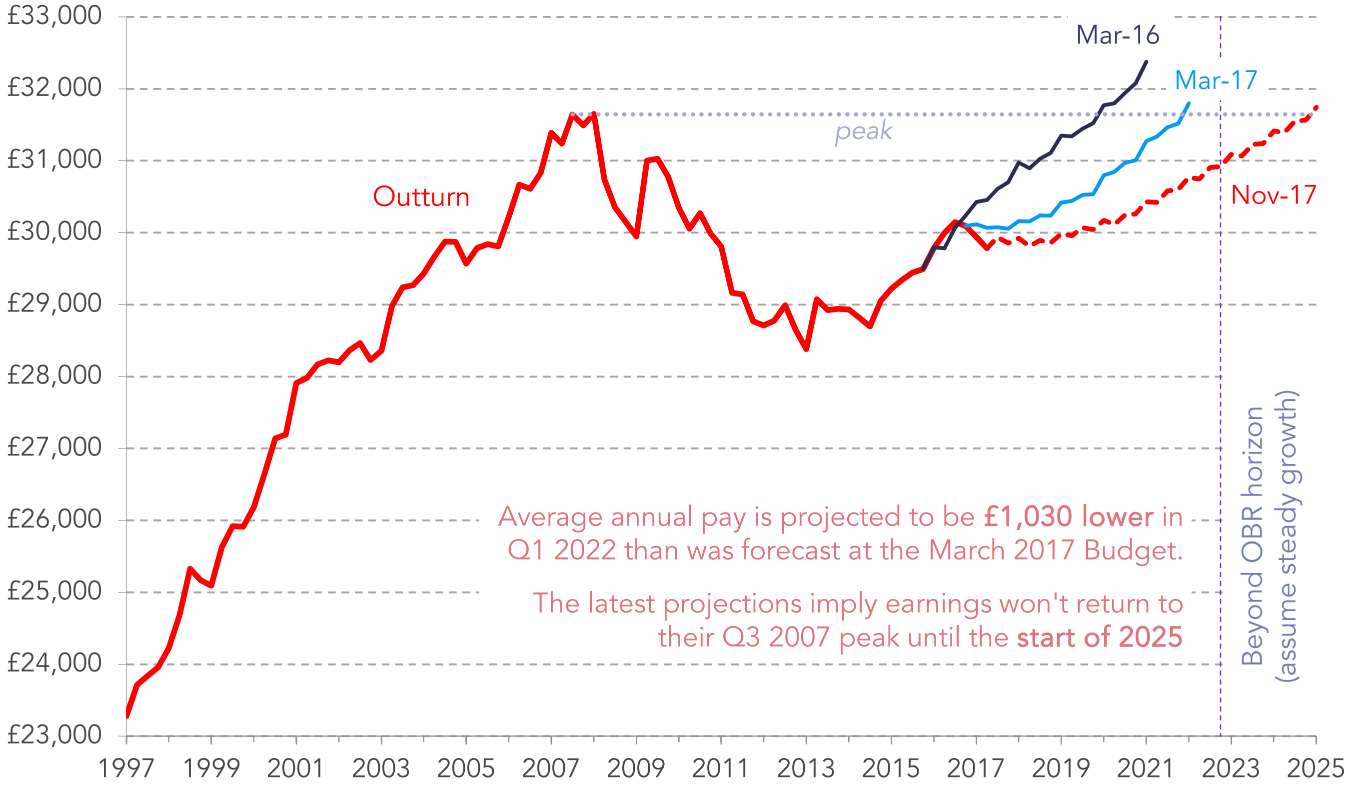


Sources: OBR, *Economic and Fiscal Outlook*, various

In cumulative terms, this downgrade again has a very significant effect on households. Figure 24 sets out the trajectory for average annual earnings implied by these new OBR projections (and its revised inflation forecasts). It shows that earnings are expected to remain broadly flat in real-terms over the next 12 months, reaching £30,770 by the start of 2022 – a full £1,030 lower than the figure implied by the Spring Budget projections. Relative to the Budget 2016 outlook, average pay is now expected to be down by £1,940 in 2021.

Figure 24: Successive OBR real-terms average annual earnings forecasts

Average annual employee earnings (CPI-adjusted, 2016-17 prices)



Sources: ONS, Series *DTWM, ROYK, MGRZ, MGRQ*; OBR, *Economic and Fiscal Outlook*, various

The outcome set out above would leave average earnings £555 below the pre-crisis peak by the end of the OBR's forecast in 2023. That would imply more than 15 years of lost earnings growth. A simple extrapolation of the average increase recorded in the final four quarters of the forecast would mean that the pre-crisis level would only be restored at the start of 2025, suggesting that our post-crisis pay squeeze is on course to extend to an unprecedented 17 years.

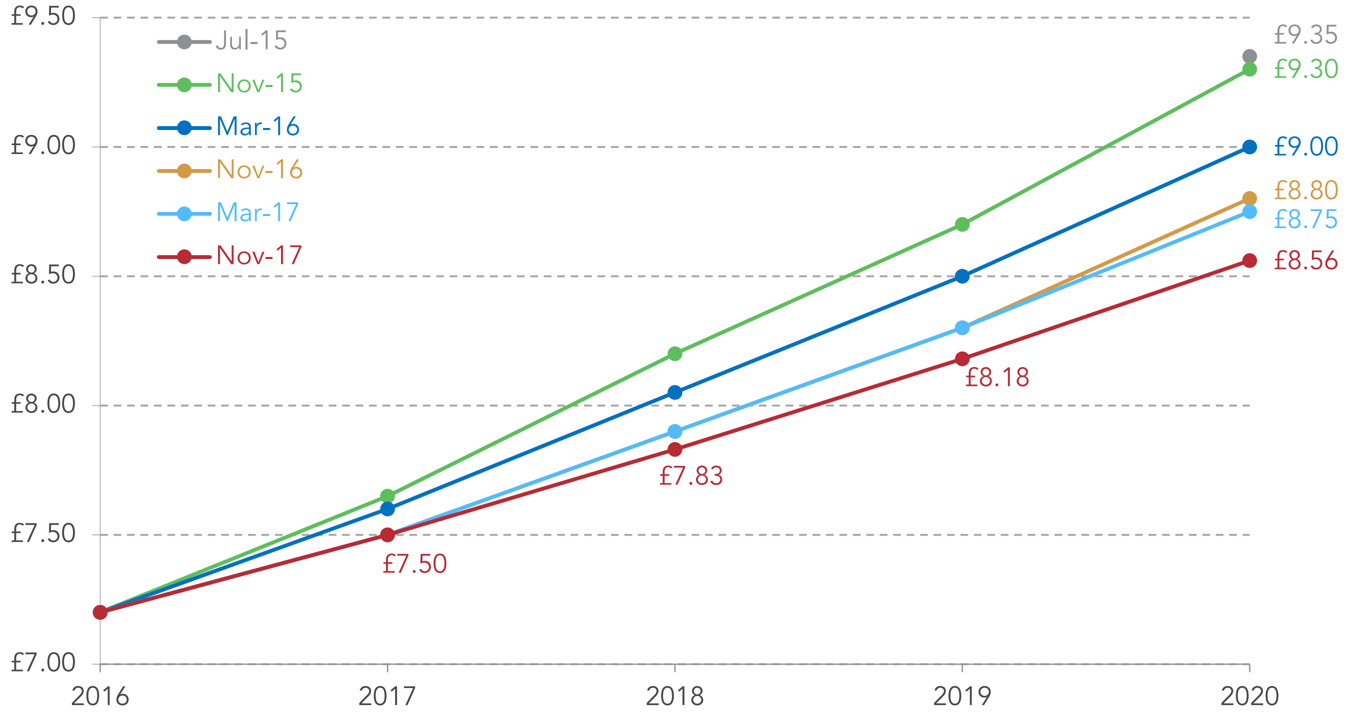
Slower wage growth will directly affect the cash level of the National Living Wage, lowering the projected rate in 2020 to £8.56

One group of workers that has avoided the falling real wages of recent months is those paid at the wage floor. The National Living Wage (NLW) has meant that the lowest earners have experienced the fastest wage growth over the past two years. While this trend is set to continue in the coming years as the NLW moves towards its target of 60 per cent of median earnings (among the over-24s) in 2020, the productivity downgrade will affect minimum wage earners too.

At successive fiscal events, worse-than-expected wage growth has led to estimates for the cash value of the NLW in 2020 – originally forecast at the Summer Budget 2015 to be £9.35 – being adjusted downwards. Figure 25 shows that yesterday's Budget continues that trend. The NLW will still rise to £7.83 in April 2018, a 4.4 per cent rise that is well ahead of inflation and average pay growth. This, however, is a smaller increase than that projected as recently as March 2017, and 37p less than projected two years ago. Overall, weak productivity growth is set to mean that the NLW will now be £8.56 by 2020.

Figure 25: Successive OBR projections of the National Living Wage

Successive OBR projections of the National Living Wage rate (nominal)



Source: OBR, *Economic and Fiscal Outlook*, various

While clearly lower than the much-discussed £9 in 2020, maintaining the NLW's link to median pay remains the soundest approach. On its current trajectory, the NLW will bring faster-than-average pay increases to an unprecedented number of employees. With much uncertainty around the impact on employment, going faster in pursuit of an arbitrary target would move the policy further into uncharted territory.

Inherited policy changes continue to push down on income growth projections for low and middle income households

While the vast majority of coming changes to tax and benefits are not new, the extent of their impact has changed. The higher inflation experienced since the referendum has increased the bite of the benefit freeze, while the weaker outlook for wage growth raises the relative impact of the cuts to support for working families in Universal Credit (UC).

Announced at the Summer Budget 2015, a four-year benefit freeze (which started in April 2016) will mean that most working-age benefits[9] will not be uprated until April 2020. The one exception to this rule will relate to an uprating of Local Housing Allowances (a cap on support through Housing Benefit or UC) helping approximately 140,000 private renters (10 per cent of all private renters on Housing Benefit) living in areas experiencing relatively high increases in rent. This additional £85 million a year will help to reduce pressure on living costs for a handful of households but that equates to only a fraction of the savings the freeze is set to bring.

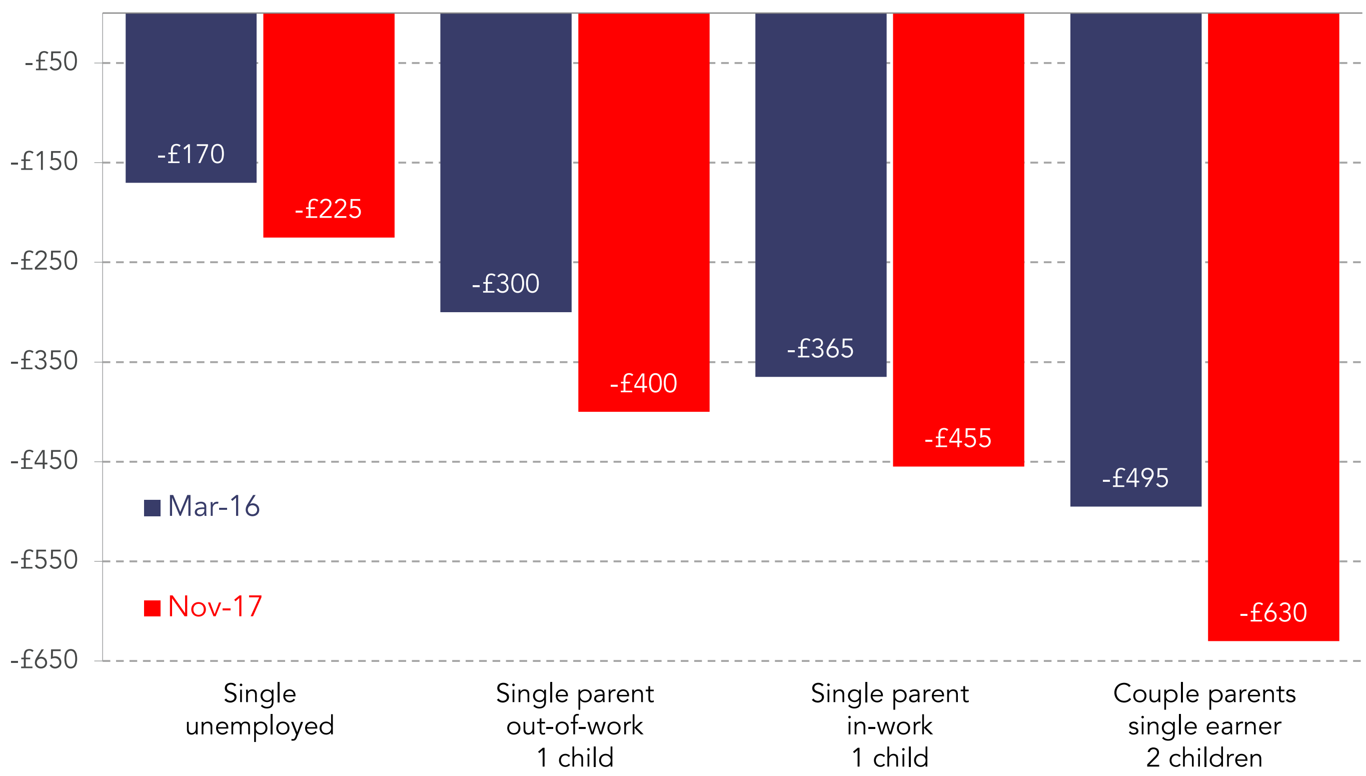
[9] In summary, excluding disability and carer benefits and premia as well as Statutory payments

For most, the real-terms squeeze is now expected to amount to 6.3 per cent in total; that's up from a forecast of 4.4 per cent in March 2016. This has increased the expected savings from the measure by £1.2 billion a year by 2020, raising a total extra £3.6 billion between 2016-17 and 2020-21.

While good news for the Exchequer, this is of course bad news for those families affected. Figure 26 shows how expected losses have increased for different family types since Budget 2016. If inflation follows the pattern set out in yesterday's outlook, a single earning couple with two children would be an additional £135 a year worse off by 2020.

Figure 26: Change in income due to benefit freeze by 2020

Real-terms change in annual income (CPI-adjusted, 2016-17 prices)



Source: RF analysis using OBR, *Economic and Fiscal Outlook, March 2016 and November 2017*

Welcome changes to Universal Credit are important for those affected but fail to deliver the fundamental fix UC needs

As widely anticipated, the government moved to reduce the six-week wait for a first Universal Credit payment to people moving out of work by removing the seven waiting days before a claim can be made from April 2018. The waiting period was an unnecessarily harsh cut affecting people who may have little other income at a time they need it most. Reversing it is a welcome move. Importantly, the government will also allow new claimants with existing Housing Benefit support to have a two week run-on period with their existing housing support when they move onto UC. This should go some way to reducing the build-up of arrears caused by a long wait for a payment of a first award.

Taken together these welcome reforms, and easier access to advances, add an additional £1.5 billion of spend over the forecast period, but costs only £185 million a year in 2022-23.

However, while we await for precise details on this package of reforms from the Secretary of State for Work and Pensions, it is clear that addressing the wait at the start of a claim for a small minority of all families eventually entitled to UC does not go far enough. Significant wider problems with the current design of UC were discussed in detail in recent Resolution Foundation analysis.[10]

The design of UC will still fail to reflect the reality of people's lives, with issues such as its treatment of the self-employed or parents claiming support with childcare costs remaining problematic. As the OBR has pointed out, losses from the Minimum Income Floor (a capping of support to established self-employed workers with low income in any month) will save £1.1 billion a year leading to some big losers among the estimated 600,000 self-employed entitled to UC. A single parent is estimated to lose £6,000 a year.[11]

Despite various revisions to projections for the cost of UC, it is still expected to save the government an overall £1.0 billion a year by 2022-23 when 97.5 per cent of the eventual caseload are expected to be on the new scheme. Even after we strip out temporary spend associated with Transitional Protection and savings from reducing fraud and error, the scheme is still set to be £0.8 billion a year less generous than the one it replaces.

A key driver of that reduced generosity is the £4 billion of cuts to work allowances (the level of net earnings recipients can have before their entitlements are reduced) originally set out in the Summer Budget 2015 and affecting over three million working families. Although these cuts were partially offset by a reduction in the UC taper (the rate at which entitlement is reduced as net earnings rise) costing the government £0.7 billion a year, most will overall lose out. Lower earners and single parents are likely to be most affected.

Reductions in generosity do not just have implications for the level of support on offer, they also have ramifications for the incentive to enter work. UC now reduces the incentive to enter work for many single parents and second earners in a couple with children. If the government is serious about ensuring that UC is a success it must do more and address fundamental issues with its design.

And despite some giveaways, the overall impact of tax and benefit policies announced since the 2015 general election remain negative

Along with the now familiar annual freeze in fuel duty (at a cost of £0.9 billion a year) the Chancellor also froze duty on most forms of alcoholic beverage (at a cost of £240 million a year). While this will provide some help with the rising cost of living, the impact across the income distribution is overall small and discussed in further detail in Box 1. And the revenue lost from freezing duty on alcohol over the forecast period alone outstrips the cost of removing seven waiting days for new claims to UC.

[10] M Brewer, D Finch & D Tomlinson, *Universal Remedy: Ensuring UC is fit for purpose*, October 2017

[11] OBR, *Economic and Fiscal Outlook*, November 2017

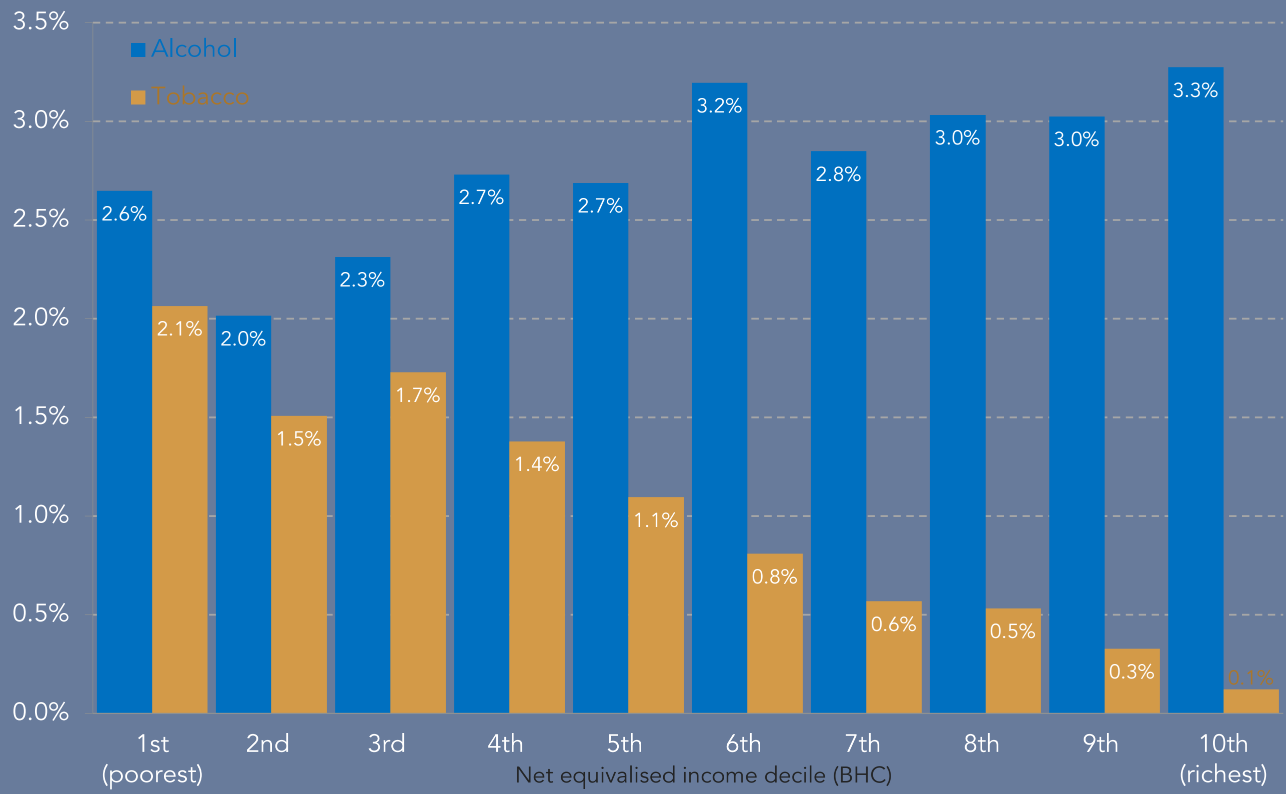
Box 1: Choose your vice wisely

Although the Chancellor announced few significant tax or benefit giveaways he did decide to freeze duties on beer, wine, spirits and most ciders (hard-luck if your tipple of choice is white cider). By contrast he carried on a policy that has been in place since 2010 and raised duties (by 2 percentage points above RPI inflation for cigarettes and an additional 1 percentage point for hand rolling tobacco) on tobacco products. Now there are good reasons why governments should use such 'sin' taxes to discourage consumption. But in this case drinkers would have raised a glass to yesterday's announcement, while it would have left a bad taste in the mouths of smokers.

There is also a distributional element to this choice. Higher income households tend to spend more (as a share of their total spending) on alcoholic drinks than poorer households, while the obverse is true for cigarettes and tobacco (see Figure 27). Households in the second decile of the income distribution allocate 2 per cent of their weekly spending to alcohol on average, compared to an average of 3 per cent among households in the ninth decile. In contrast, households in the ninth decile spend just 0.3 per cent on tobacco products on average, compared with 1.5 per cent among households in the second decile.

Figure 27: Consumption of alcoholic drinks and tobacco as a share of total household spending

Consumption of alcoholic drinks and tobacco as a share of total household spending



Source: RF analysis using ONS, *LCFS 2015-16*

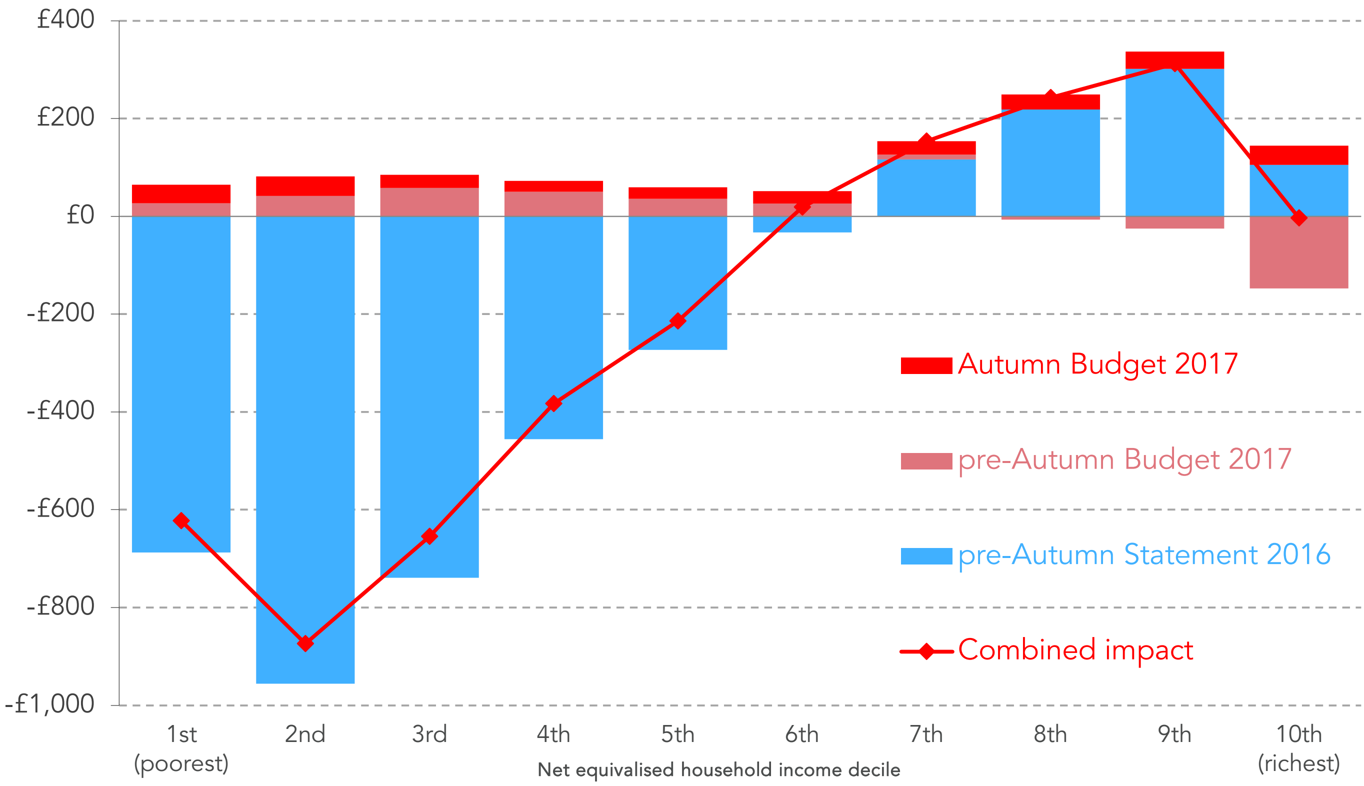
Now, this is not to argue for tax cuts on cigarettes. Rather, at a time when there is pressure on the public finances, freezing excise duties is costly and the benefits disproportionately accrue to richer households (this is also true of the fuel duty freeze because richer households also spend proportionally more on fuel). Many people will undoubtedly benefit from a cheaper celebratory drink in the run-up to Christmas, but some will benefit more.

Taken together the key tax and benefit changes announced in this Budget, and the previous two fiscal events are dwarfed by the scale of the impact of polices put in train back in the Summer Budget of 2015, the impact of which will amount to over £14 billion a year of cuts to welfare in the coming years, alongside the continued income tax giveaways.

Figure 28 shows how the overall impact of measures announced before Autumn Statement 2016 are set to be far greater than the impact of those announced since. When it comes to tax and benefit policy George Osborne is basically still the Chancellor. These earlier policy announcements are set to leave the poorest third of households an average of £795 a year worse off, barely offset by a total mean gain of £75 a year in fiscal events since (including £35 a year from yesterday's Budget). That compares to a mean gain of £210 a year for the richest third of households pre-Autumn 2016 and a net mean loss of £25 a year in measures announced since.

Figure 28: Cumulative impact of tax and benefit policies announced since March 2015: 2022-23

Mean change in income, £ annual (2016-17 CPI terms)



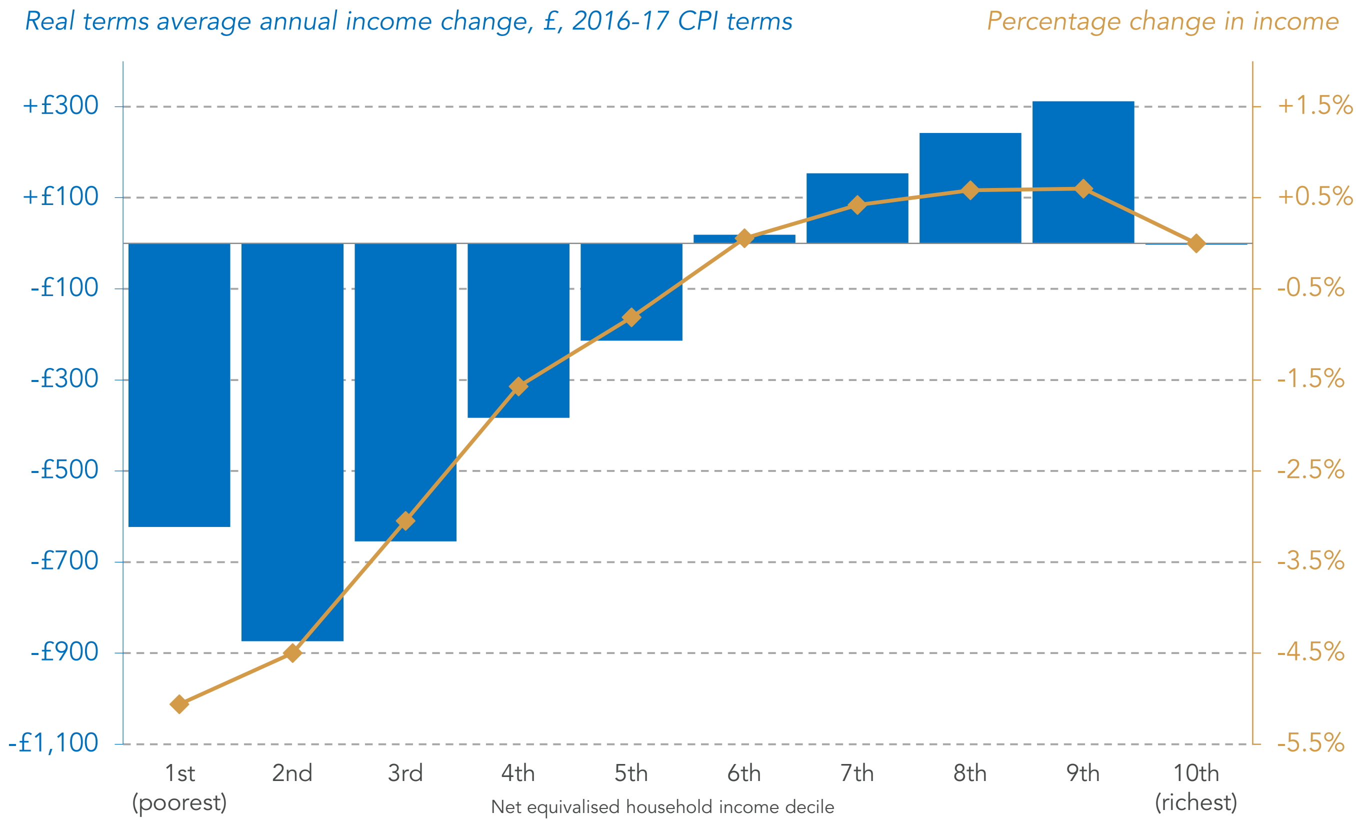
Notes: Includes the introduction of the National Living Wage, announced income tax cuts, additional hours of free childcare for working parents, removal of family element, fuel and alcohol duty freezes, limiting support to two children, a reduced benefit cap, work allowance cuts, pension tax relief cuts, Class 2 NICs abolition, benefit freeze, reducing UC taper to 63%, capital gains tax, reducing the Dividend Allowance and in the most recent period removing the 7 day wait for new claims to UC. Assumes full entitlement take-up with UC fully in place and the gradual impact of measures affecting new claims/births in Universal Credit.

Source: RF analysis using the IPPR tax-benefit model & OBR, *Economic and Fiscal Outlook*, November 2017

Of the measures announced yesterday, the removal of the six-week wait is set to overwhelmingly benefit the bottom third of the income distribution, while freezes to alcohol and fuel duty are more evenly distributed with slightly greater gains for the top half of the income distribution.

Figure 29 provides the net impact of all key tax and benefit polices announced since the general election in 2015, combining the cash impacts set out in the previous figure with the impact expressed as a proportion of net income. In so doing it is clear that as a share of income, tax and benefit policy changes are set to have a much greater impact in the bottom half of the income distribution than in the top half. On average, we expect each of the bottom five deciles to be net losers from these changes. The poorest third of households will lose an average of £715, compared to an average gain among the richest third of households of £185 a year.

Figure 29: Cumulative impact of tax and benefit policies announced since March 2015: 2022-23



Notes: Includes the introduction of the National Living Wage, announced income tax cuts, additional hours of free childcare for working parents, removal of family element, fuel and alcohol duty freezes, limiting support to two children, a reduced benefit cap, work allowance cuts, pension tax relief cuts, Class 2 NICs abolition, benefit freeze, reducing UC taper to 63%, capital gains tax, reducing the Dividend Allowance and in the most recent period removing the 7 day wait for new claims to UC. Assumes full entitlement take-up with UC fully in place and the gradual impact of measures affecting new claims/births in Universal Credit.

Source: RF analysis using the IPPR tax-benefit model & OBR, *Economic and Fiscal Outlook*, November 2017

Delivering the Conservative manifesto's income tax pledge will require the Chancellor to find a further £1.4 billion, with the vast majority of the gains flowing to the richest households

The income tax personal allowance will rise to £11,850 in April 2018, with the higher rate threshold rising to £46,350. That's in line with standard uprating practices, matching the September 2017

CPI of 3 per cent. The government remains committed to meeting its pledge of hitting £12,500 and £50,000 for the respective tax thresholds by 2020, however.[12] Given current projections for inflation, getting there will require some above-inflation increases in the thresholds in the coming years. Doing so would cost £1.4 billion a year.[13] But it will also disproportionately benefit the richest half of households with 87 per cent of gains going to the top half, and 36 per cent to the top 10 per cent alone.

The scale of gains and losses associated with changes in both the economic forecast and in tax and benefit policies vary from family to family

Table 1 outlines ten example families and considers how projections for their net incomes have changed as a result of the various changes to economic forecasts arising since the Spring Budget 2017. As noted above, some of the policy announcements set out by Philip Hammond yesterday will also have an impact on family living standards, but we have not included them here because there were no changes to policy that altered the rates or levels of any direct taxes or benefits.

Table 1: Impact of economic and policy changes in Autumn Budget 2017 for different family types

Net household incomes, Universal Credit system, 2022-23, CPI-adjusted to 2016-17 prices

	Income forecast for **2022-23** in Mar-17	Impact of **economic changes** between Mar-17 and Nov-17	Impact of **policy changes** between Mar-17 and Nov-17	Impact of **all changes** between Mar-17 and Nov-17	Income forecast for **2022-23** in Nov-17
1. Single (no kids), full time, self-employed, low earning *works 37.5 hours per week and earns equivalent of NMW per hour*	£13,310	-£90	-	-£90 -0.7%	£13,220
2. Single (no kids), full time, earning wage floor, renting *works 37.5 hours per week at NMW/NLW , rents privately at 30th pctile*	£12,370	-£320	-	-£320 -2.6%	£12,050
3. Single (1 child), part time, earning wage floor *works 20 hours per week at NMW/NLW*	£12,040	-£130	-	-£130 -1.1%	£11,910
4. Single (1 child), full time, low earning, renting *works 37.5 hours per week at p25 wage , rents social housing at average rents*	£16,730	-£150	-	-£150 -0.9%	£16,580
5. Couple (2 kids), full time single earner on wage floor *main earner works 37.5 hours per week at NMW/NLW*	£19,460	-£180	-	-£180 -0.9%	£19,280
6. Couple (2 kids), low earning/wage floor, renting *main earner works 37.5hrs pw at p25, 2nd earner works 20hrs pw at NMW/NLW, rents privately at 30th pctile*	£28,110	-£280	-	-£280 -1.0%	£27,830
7. Couple (3 kids), low earning/wage floor, renting *main earner works 37.5hrs pw at p25, 2nd earner works 20hrs pw at NMW/NLW, rents privately at 30th pctile*	£28,030	-£270	-	-£270 -1.0%	£27,760
8. Couple (no kids), low/mid earning *both work 37.5 hours per week, main earner at median wage , second earner at p25 wage*	£28,320	-£700	-	-£700 -2.5%	£27,620
9. Couple (2 kids), low/mid earning *both work 37.5 hours per week, main earner at median wage , second earner at p25 wage*	£36,080	-£810	-	-£810 -2.2%	£35,270
10. Couple (no kids), high earning *both work 37.5 hours per week at p90 wage*	£77,810	-£1,730	-	-£1,730 -2.2%	£76,080

Notes: Figures relate to modelled hypothetical outcomes in 2022-23 on the assumption that these families receiving in-work benefits are in the Universal Credit system and are making a new claim. All figures are presented in 2016-17 prices, deflated using CPI. Impacts cover the effects of direct tax and benefit changes, the introduction of the National Living Wage and new childcare support but assume no behavioural changes or dynamic effects. Wage floors (NMW and NLW) reflect OBR projections for 2022. Figures may not sum due to rounding (all are rounded to nearest £10). Inflation and earnings projections are taken from OBR forecasts.

Source: Resolution Foundation analysis using RF microsimulation model.

[12] HMT, *Autumn Budget 2017*, November 2017

[13] OBR, *Economic and Fiscal Outlook*, November 2017

The upward revision to the forecast for CPI in 2017 and the downward revision to the forecast for average wage growth push down on our projections for real incomes in 2022-23. This fall is larger, in cash terms, for those with the highest incomes. For example, family 9 is now projected to be £810 worse-off in 2022-23 than was the case at the time of the March Budget. But the proportional effect is largest for family 2. This single individual with no children working full-time on the NLW suffers the full effect of the repeated downward revisions to the wage floor since 2016 in so far as their lower earnings are not compensated with higher benefit receipt (that is, family 2 receives no benefits).

In contrast, increases in benefit receipt *do* mitigate the effect of economic forecast downgrades for families 3, 4, 5, 6, and 7: UC's taper rate means that every pound reduction in earnings leads to a 63 pence increase in benefits. Consider for example that economic forecast revisions imply that after-tax household earnings for family 6 will be almost £600 lower than was forecast in March, but that this fall is mitigated by a £380 increase in benefit award.

Taking a longer view, Table 2 repeats the exercise above for the same ten families but this time incorporates all changes in economic forecasts and policy measures since the Summer Budget of 2015.

Table 2: Impact of economic and policy changes since Budget 2015 for different family types

Net household incomes, Universal Credit system, 2022-23, CPI-adjusted to 2016-17 prices

	Income forecast for **2022-23** in Mar-15	Impact of **economic changes** between Mar-15 and Nov-17	Impact of **policy changes** between Mar-15 and Nov-17	Impact of **all changes** between Mar-15 and Nov-17	Income forecast for **2022-23** in Nov-17
1. Single (no kids), full time, self-employed, low earning *works 37.5 hours per week and earns equivalent of NMW per hour*	£13,850	*-£630*	*+£0*	*-£630* *-4.5%*	£13,220
2. Single (no kids), full time, earning wage floor, renting *works 37.5 hours per week at NMW/NLW , rents privately at 30th pctile*	£11,420	*-£440*	*+£1,070*	*+£630* *5.5%*	£12,050
3. Single (1 child), part time, earning wage floor *works 20 hours per week at NMW/NLW*	£14,740	*-£140*	*-£2,690*	*-£2,830* *-19.2%*	£11,910
4. Single (1 child), full time, low earning, renting *works 37.5 hours per week at p25 wage , rents social housing at average rents*	£18,270	*-£440*	*-£1,250*	*-£1,690* *-9.3%*	£16,580
5. Couple (2 kids), full time single earner on wage floor *main earner works 37.5 hours per week at NMW/NLW*	£21,210	*-£100*	*-£1,830*	*-£1,930* *-9.1%*	£19,280
6. Couple (2 kids), low earning/wage floor, renting *main earner works 37.5hrs pw at p25, 2nd earner works 20hrs pw at NMW/NLW, rents privately at 30th pctile*	£29,160	*-£480*	*-£850*	*-£1,330* *-4.6%*	£27,830
7. Couple (3 kids), low earning/wage floor, renting *main earner works 37.5hrs pw at p25, 2nd earner works 20hrs pw at NMW/NLW, rents privately at 30th pctile*	£31,880	*-£480*	*-£3,640*	*-£4,120* *-12.9%*	£27,760
8. Couple (no kids), low/mid earning *both work 37.5 hours per week, main earner at median wage , second earner at p25 wage*	£29,780	*-£2,260*	*+£100*	*-£2,160* *-7.3%*	£27,620
9. Couple (2 kids), low/mid earning *both work 37.5 hours per week, main earner at median wage , second earner at p25 wage*	£37,770	*-£2,600*	*+£100*	*-£2,500* *-6.6%*	£35,270
10. Couple (no kids), high earning *both work 37.5 hours per week at p90 wage*	£81,150	*-£5,620*	*+£550*	*-£5,070* *-6.2%*	£76,080

Notes: Figures relate to modelled hypothetical outcomes in 2022-23 on the assumption that these families receiving in-work benefits are in the Universal Credit system and are making a new claim. All figures are presented in 2016-17 prices, deflated using CPI. Impacts cover the effects of direct tax and benefit changes, the introduction of the National Living Wage and new childcare support but assume no behavioural changes or dynamic effects. Wage floors (NMW and NLW) reflect OBR projections for 2022. Figures may not sum due to rounding (all are rounded to nearest £10). Inflation and earnings projections are taken from OBR forecasts.

Source: Resolution Foundation analysis using RF microsimulation model

Table 2 paints a clear picture of how substantial the living standards squeeze over the coming years is forecast to be. Economic changes in the OBR's forecasts since early 2015 have been unambiguously bad news for families across the income distribution, with policy changes benefiting higher income families (and those earning at the wage floor) but significantly harming the financial prospects of low to middle income families in receipt of benefits.

Looking in detail at three family types:

- Family 2 is expected to be better off by 2022-23. This individual gains over £1,000 from the impact of the NLW and repeated increases in the income tax personal allowance, but loses out to the tune of £440 as a result of deteriorations to the economic forecasts over the past two years. Overall, their income is now forecast to be £630 (5.5%) higher in 2022-23 than would have been expected in March 2015.
- Family 3 is expected to be significantly worse off. Weaker economic forecasts imply their real income in 2022-23 will be £140 less than forecast two years ago, with policy changes announced since the Summer Budget 2015 reducing their real income by a further £2,690 by 2022-23. This family will have benefited from the introduction of the NLW, but this effect is dwarfed by cuts to working-age benefits since 2015. These cuts include reductions in the generosity of UC and the introduction of the benefits freeze (which is now having a larger impact than originally forecast as a result of higher inflation forecasts).
- Family 8 – a dual-earning couple with three children – is expected to be £4,120 worse off in 2022-23 than had been expected in March 2015. Higher inflation and lower earnings growth cut the projection for this family's real income by £480. In addition, this family loses £3,640 as a result of policies announced since Summer Budget 2015. Again, this figure reflects the balance of the NLW, tax cuts and welfare cuts, with the policy of limiting welfare support to a maximum of two children having a particularly large effect here.

Overall, the large falls in real income projected by 2022-23 are – for low to middle income families – much more a product of the reductions in working-age welfare support announced by George Osborne in July 2015 than the impact of economic downgrades over the same time period. The UK's declining productivity growth clearly matters for living standards in the long-run – it has a direct impact on earnings growth – but in the near-term the cuts to welfare that the government is choosing to stick with matter much more for millions of low to middle income families across the country.

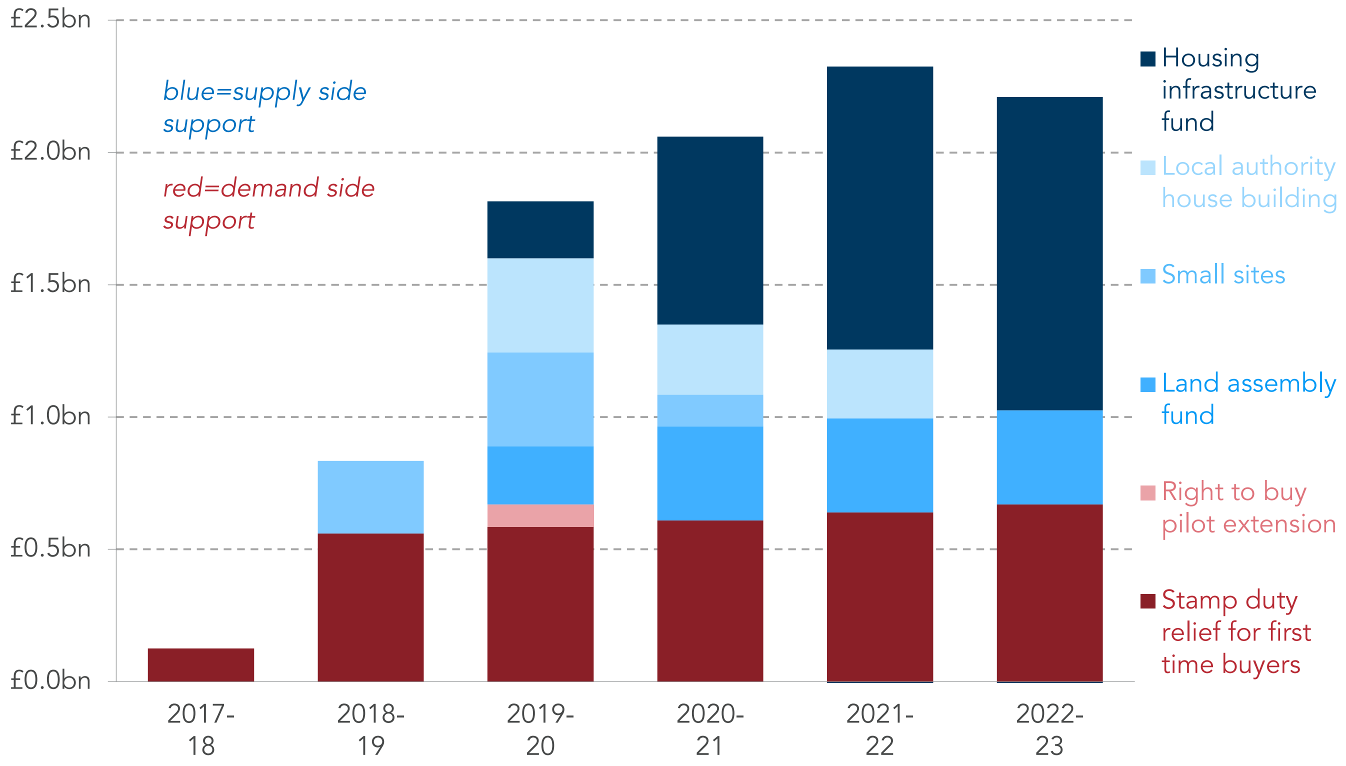
The Chancellor gave a very welcome focus to housing in his Budget – one of Britain's longer term challenges for family living standards

The Budget sets out the government's commitment to bring forward £15.3 billion of support for housing measures over the next five years. Not all of this figure represents new money announced in the Budget. For example the additional £2 billion that Theresa May committed to build 25,000 new social homes at the Conservative Party Conference in October will in part be funded by cuts to the existing Accelerated Constuction and Starter Homes Programmes.[14]

Figure 30 sets out the breakdown of new funding that was provided for housing in the Budget scorecard – totaling £9.3 billion over the period. It is welcome that two-thirds of the new funding is allocated to a range of interventions designed to increase housing supply directly (such as local authority building) or indirectly (through investments in infrastructure and land assembly). But while the bulk of housing related spending was on increasing supply, the single biggest measure costing £3 billion (or a full one third of new spending) is dedicated to the abolition of stamp duty land tax (SDLT) for first-time buyers purchasing a home up to £300,000, and reduction in SDLT for first-time buyers purchasing a home for between £300,000 and £500,000.

[14] OBR EFO A.4

Figure 30: New funding for housing commitments, Budget November 2017



Source: HMT, *Autumn Budget 2017*, Table 2.1

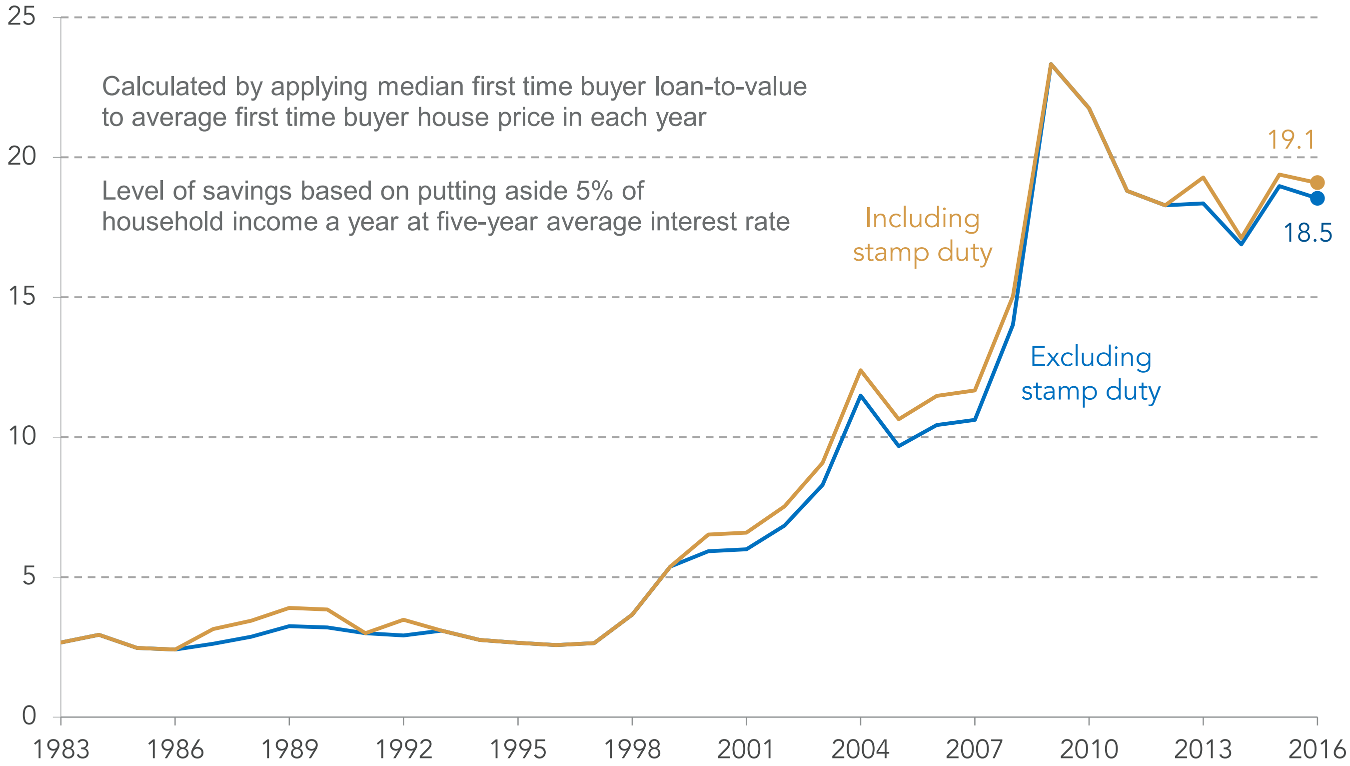
But if the Chancellor's ambition is to improve housing affordability and increase home ownership, has he got the balance right?

This expensive move on stamp duty will affect 95 per cent of first-time buyers that pay SDLT, and means that 80 per cent of first time buyers will pay no SDLT at all in the future. Taken at face value, the SDLT cut is worth £1,600 to a first-time buyer purchasing a house for £205,000 – the average paid by those purchasing a first property in England in September 2017 – and will sound like good news to young people and those on low to middle incomes who have experienced the most rapid declines in home ownership in recent years.

Even on this optimistic reading of the policy's static impact however, the good news is pretty small and does not materially change the up-front affordability for a first time buyer. Figure 31 offers a thought experiment on the average number of years required to save for a first time buyer deposit among younger households. It is calculated on the assumption that households put aside 5 per cent of their income each year and are looking to buy a typical first time buyer home. Having taken around three years throughout the 1980s and early 1990s, the number of years climbed sharply in the 2000s and currently stands at an estimated 19.1 years. As the chart shows, removing stamp duty from the equation makes very little difference, lowering this figure to a still-substantial 18.5 years.

Figure 31: Estimated time to save for a first home, with and without stamp duty

Estimated number of years required to save for a first time buyer deposit among young (28-30 year old) households



Source: RF analysis of ONS, *The effect of taxes and benefits on household incomes*, Lloyds Banking Group, Halifax House Price Index, Historical data FTB (ANN) CML, Table ML2

However, this simplistic reading of the policy misses the fact that the change comes with other significant consequences. Most notably, the OBR expects that it will on average increase house prices by 0.3 per cent. Underpinning this is the OBR view that, because this is a permanent reduction in stamp duty for first time buyers, it will actually increase the price of properties by twice the size of the tax cut. As such prospective first time buyers' net costs will actually *increase* not decrease. In reality, a first-time buyer purchasing an average priced property would experience a £3,200 price increase to offset the £1,600 tax cut.[15]

With the OBR estimating that this policy change will increase the number of first-time buyers by just 3,500, the cost of the policy equates to £160,000 per additional first-time buyer in 2018-19, or £190,000 per additional first-time buyer in 2022-23. To put this figure into context, it would be enough to directly buy and give a typical house to a first time buyer in 26 per cent of English and Welsh local authorities. Alternatively, the £3.2 billion spent on the SDLT relief overall would be sufficient for the government to support the building of 40,000 social rented properties in high-demand areas,[16] or to see around 140,000 properties built through the government's own Housing Infrastructure Fund.[17]

[15] These figures are consistent with OBR, *Residential SDLT elasticities* October 2017 and what was widely reported following previous SDLT cuts, See for example The Economist, *Unexpected bills*, December 11th 2014

[16] Based on the announcement of £2billion of funding for 25,000 social rented properties in high-demand areas at the 2017 Conservative Party Conference.

[17] Based on the announcement earlier this year of £2.3 billion of infrastructure investment funding to unlock 100,000 new homes. See: '£2.3 billion investment in infrastructure for new housing', *Department for Communities and Local Government press releases*, 4 July 2017

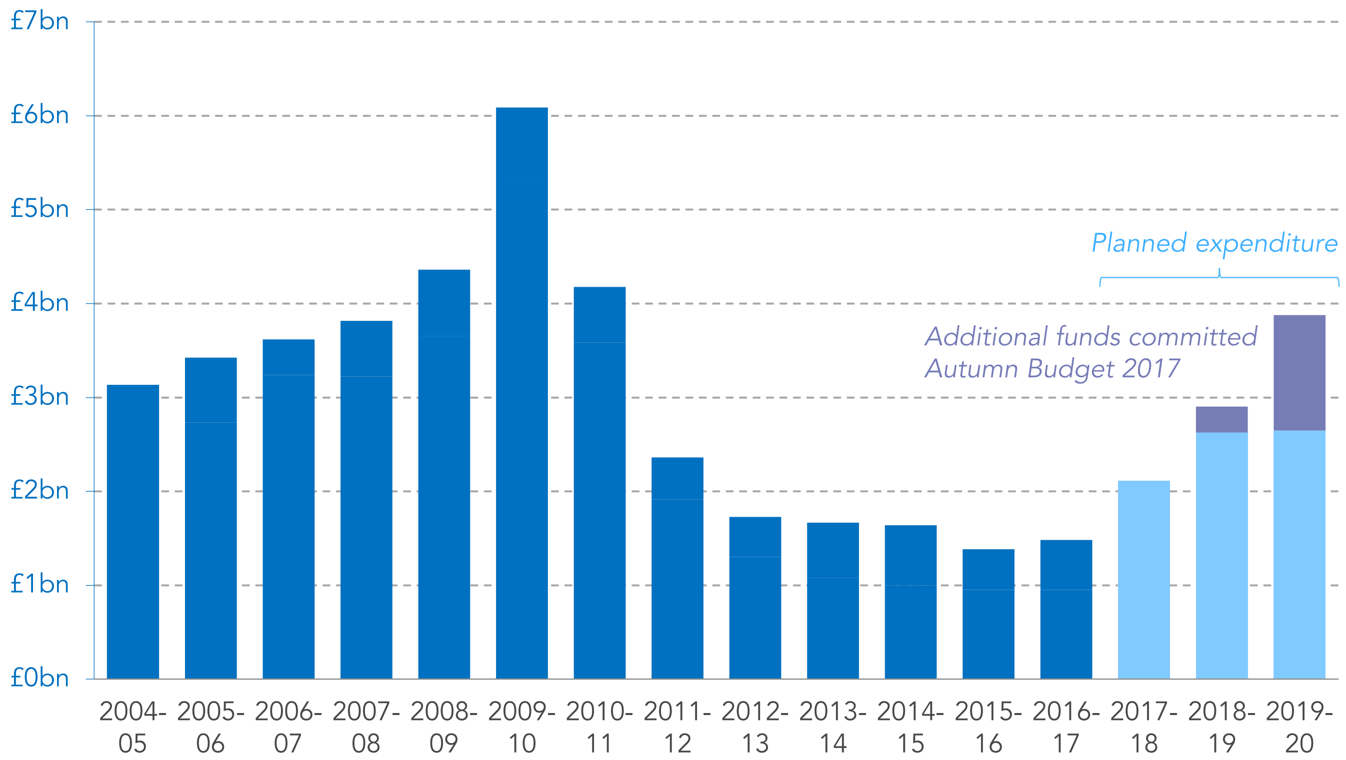
Rather than an intergenerational giveaway as the Chancellor presented the policy to be, the SDLT relief looks set mainly to benefit existing owners, who have an average age of 56.

Additional commitments to boost housing supply are significant

The announcement of new money to boost housing supply, designed to help the government's deliver on its target of building 300,000 new homes a year by the middle of the next decade, is far more welcome.

As Figure 32 shows, the additional funds set out in the scorecard represent a genuine increase to existing planned expenditure on housing and community development over this spending review period, although overall spending will still lag the levels of spending observed in the fiscal stimulus-related peak of spending on housing development during the financial crisis.

Figure 32: Central government housing and community development spending (nominal figures), 2004-05 to 2019-20



Source: HMT, *Public Expenditure Statistical Analyses* 2010-2017 & *Autumn Budget 2017*

Resolution Foundation

Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- *undertaking research and economic analysis to understand the challenges facing people on a low to middle income;*
- *developing practical and effective policy proposals; and*
- *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

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