Commentary on the

Public Sector Finances: March 2020

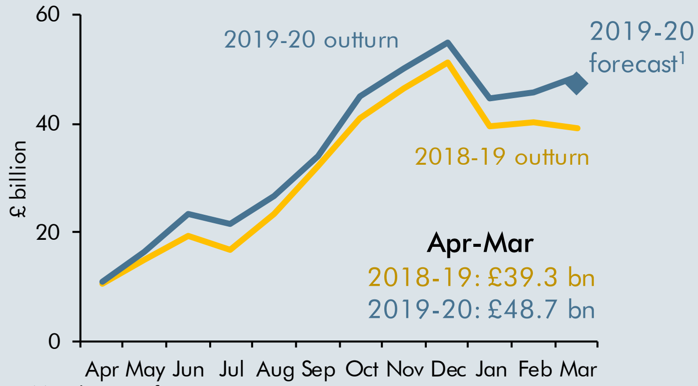
Office for Budget Responsibility

23 April 2020

March HMRC cash receipts fall 5 per cent on last year

Some initial effects of the unfolding coronavirus shock to the public finances are visible in the March cash data. Receipts fell sharply – particularly VAT, where payments have been deferred. Spending increased, in part due to the cost of business support measures. These effects have yet to feed through to the headline accruals measure of the budget deficit or to central government cash borrowing, which was temporarily cushioned by other factors.

Cumulative public sector net borrowing



[1] March 2020 forecast

Headlines

- The impact of the **coronavirus** crisis and the Government's response to it on tax revenues and public spending will only feed through fully to the public finances data with a lag, both because initial outturn data are partly based on pre-crisis forecasts and because it will take time for some new policies to see money pass to the beneficiaries. The Bank of England's latest interventions will feed through to debt as soon as gilts are purchased or TFS loans drawn down.
- **HMRC cash receipts** fell by 5 per cent on a year earlier in March. Cash VAT payments were down 70 per cent on a year earlier, largely reflecting the Government's VAT deferral policy.
- **Central government current spending** was up 12.3 per cent in March, reflecting higher debt interest spending and grants to local authorities that will pay for business support measures.
- **Net debt** was 1.0 per cent of GDP lower in March 2020 than a year earlier, but this is based on a GDP denominator that does not yet reflect the downturn in economic activity underway.
- **Public sector net borrowing (PSNB)** over the whole of 2019-20 was provisionally estimated to have been £48.7 billion, £1.2 billion higher than we expected back in March. We can expect this figure to be revised up over the coming months as more outturn data become available.
- This is the last monthly commentary that will compare outturn data to our 11 March Budget forecast. From next month – and for as long as it remains meaningful – we will use our **coronavirus reference scenario** as the basis for monitoring the incoming data.

Full commentary

Background

Monitoring the public finances through the coronavirus lockdown

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the March 2020 Public Sector Finances this morning, providing the initial outturn estimate for 2019-20.[1] Each month the OBR provides a brief analysis of the data and a comparison with our most recent forecast, currently from the March 2020 *Economic and fiscal outlook* (*EFO*). This remains a useful exercise for 2019-20 because the coronavirus crisis had had only a limited effect on the public finances by the end of March. But from April onwards, there would be little value in monitoring new data against a baseline that assumed only a modest effect from the coronavirus outbreak on the UK economy and public finances.

2. From next month – and for as long as it remains meaningful – we will monitor the incoming public finances data against a monthly profile consistent with the coronavirus reference scenario that we published on 14 April. This scenario was not a central forecast. We assumed for the purposes of illustration that the current public health restrictions remain in place throughout the second quarter of 2020 and are partially relaxed through the third, but we have no basis yet for knowing what the Government's actual policy will be. In addition, the scenario did not incorporate the impact of any scarring of future economic potential – via reduced investment, widespread business failures and some of the unemployed losing contact with the labour market. Nor did it incorporate any impacts from firms and households deciding to continue to restrict activity over and above the official public health measures, once they begin to be eased. Both factors would slow the pace of recovery and lower the path of output to which the economy returns. Some scarring of potential and behavioural consequences are probably inevitable, but their scale will depend on the scope and duration of the economic lockdown and the effectiveness of government policy measures designed to mitigate the adverse effects of it. We expect to say more about this in our forthcoming *Fiscal sustainability report* (assuming the normal timetable can be maintained), but meanwhile we believe the scenario represents a suitable baseline against which to interpret near-term developments.

3. The uncertainty surrounding both the scenario and the associated monthly profile are enormous, but the analysis is worth undertaking to get a sense of how much borrowing that the Government may need to do this year (and the associated near-term financing challenge). In addition, the evolution of the public finances may shed light on whether the economy has been subject to a smaller or larger hit than in the scenario. That is likely to be achieved best by monitoring cash data for revenues and spending rather than the usual headline accrued numbers, and by stripping out – as best we can – the often lumpy effects of policy measures.

4. This will not be straightforward. The March 2020 *cash* data are already clouded by such effects. VAT receipts have fallen sharply thanks to the Government's decision to defer this quarter's payments to the end of 2020-21; income tax receipts have been hit by cashflow problems causing some firms not to pay over their employees' liabilities; time-to-pay arrangements have affected fuel duty and air passenger duty receipts; and central government spending has been boosted by grants to local authorities to meet the cost of measures that are

[1] https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/march2020

being delivered via them. Such effects will only get larger, and they will soon be overlaid by the uncertain costs of the large job retention and self-employed income support schemes.

5. We aim to publish monthly profiles consistent with the reference scenario ahead of the May public sector finances release, covering sufficient receipts and spending lines to facilitate the monitoring process. This may require some revisions to the fiscal scenario itself as we dig into the implications of the scenario for different parts of the public finances, and as we incorporate the effects of newly announced policy measures or new information about those that were contained in the initial scenario. Even so, it will necessarily remain a broad-brush exercise – for example, simply pro-rating the full-year hit across the months the lockdown is in force.

Cash versus accruals measures

6. PSNB is an accrued measure of borrowing, which means that, where possible, income and expenditure are recorded when the underlying economic activity takes place rather than when the associated cash payments occur. On the receipts side, the time taken to firm up initial estimates depends on the lag between activities that give rise to tax liabilities occurring and the resulting cash payment to HMRC. This varies significantly from tax to tax.[2] On the spending side, lags can be significant, for example as departments' forecasts are replaced with outturns.

7. Forecasts are used to fill gaps in accrued estimates for months where the associated cash payments have yet to be made. This will present a particular challenge for the ONS in the coming months given the large but hugely uncertain fall in receipts that can be expected. Other challenges are already apparent in this month's data, with some February income tax liabilities not being paid off in March – which the ONS has chosen to ignore for now for PSNB purposes. The boost to central government spending from business support measures has so far not affected fiscal balances either, because the sums transferred to local authorities have so far been recorded as lowering their borrowing ahead of being transferred to the private sector.

8. Cash measures of receipts and spending have been affected more quickly than the headline accrued PSNB measure. Public sector net debt has also been affected immediately, including by the initial transactions related to the Bank of England's latest interventions. These effects raise PSND in cash terms but the effect of the coronavirus lockdown on GDP has not yet fed through to the measured debt-to-GDP ratio. By convention, this ratio is measured using the sum of GDP over the four quarters that straddle the month in question, so it relies on forecasts for recent and future periods until outturns are available. In this release, the ONS has used our March 2020 forecast for that purpose. To the extent that GDP falls below that forecast over the coming months – as must surely be the case – the debt ratio will be revised up. For example, if GDP fell as sharply as in our reference scenario, the ratio at the end of 2019-20 would be 13 percentage points higher than reported in this month's release.

Next steps on the coronavirus reference scenario

9. Our reference scenario was predicated on several key assumptions, in particular: that output would be 35 per cent lower than in the Budget forecast during the period of full economic lockdown; and that the full lockdown would extend for three months, with restrictions on activity having half that effect over the subsequent three months. As noted above, for simplicity we did

[2] We cover these issues in more detail in Chapter 4 of *Working Paper No 13, 'In-year fiscal forecasting and monitoring'*, Taylor J. and Sutton A., September 2018.

not incorporate any allowance for the scarring of potential GDP from the downturn or the behavioural response of firms and households, so that output recovered fully to the Budget forecast by early 2021. In practice, some scarring seems inevitable, even if the Government's policy measures do prove to be effective in their aim of limiting the damage to the economy's supply potential. We will learn more about the first two of these over the coming weeks and months, as the ONS publishes monthly GDP estimates and the Government's public health policies evolve. But, as regards scarring, it will be very hard to assess the accuracy of any estimate we make, even after the event, as the outlook for potential GDP is already clouded by uncertainty as a result of the ongoing productivity puzzle and the additional impact of Brexit.

10. Over the coming period, we will publish updates to the scenario's fiscal results – for 2020-21 in particular – as we have them to inform the data monitoring process. For example, it is likely to be possible to update costings for various policy measures as they are rolled out and administrative data on their use becomes available. And we may revise the overall fiscal results as we work through some of the receipts and spending lines that were not considered for the initial version of the scenario – and if the monthly profiling exercise reveals issues to address.

The public finances in March 2020

11. The headline accrued measures of receipts, spending and borrowing for March 2020 show little effect from the coronavirus lockdown, but that is largely because they are based on out-of-date near-term monthly forecasts. Cash payments to HMRC have already been hit, while central government spending has already started to rise. But other factors cushioned the effect of that on the central government cash deficit in March – for example, local authorities temporarily deposited at the DMO the cash they received from central government in March and that is now being paid out in grants to eligible local businesses. Indeed, the central government net cash requirement was actually down £0.8 billion relative to March 2019.

HMRC cash receipts

12. HMRC collects around 90 per cent of all central government cash receipts. HMRC cash receipts in March 2020 were down £2.2 billion (5.1 per cent) on a year earlier, despite corporation tax receipts being up £4.5 billion (205 per cent) thanks to the faster instalment payment profile for the largest companies that came into effect in 2019-20. These instalment payments were due on 14 March, so were made before many of the public health restrictions came into effect.

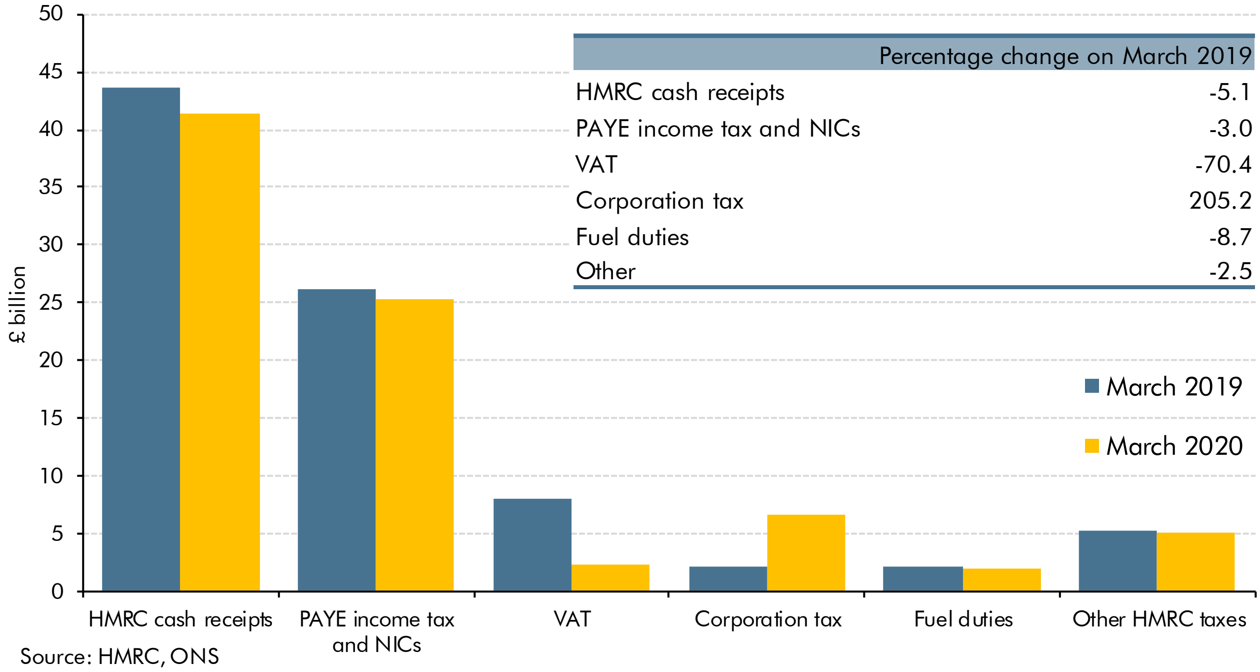
13. As discussed above, cash payments of tax liabilities are generally received with a lag and so much of the deterioration this month will reflect timing and payment issues, rather than the hit to underlying tax liabilities that is now unfolding. The main sources of weakness included:

- **Cash payments of VAT** were down 70 per cent on a year earlier. On 20 March, the Government announced that VAT payments due between that date and 30 June 2020 could be deferred until later in 2020-21. With many VAT payments usually paid on the final day of the month, a large proportion of firms were able to take advantage of the deferral announcement. This explains the bulk of the cash fall this month. For the purposes of generating an accrued VAT estimate – the ONS has assumed that this timing change does not affect underlying liabilities.

- Total **income tax and NICs cash payments** were down 3.4 per cent on a year earlier in March. These primarily reflect February liabilities. Early data from HMRC's 'real-time information' system suggests that this was not primarily due to fewer employees or weakness in earnings,[3] so most of the deterioration this month is likely to reflect the non-payment of liabilities due to cashflow problems at employers. For now, the ONS has treated this as a timing effect rather than weaker liabilities.

- Payments on several **excise duty** streams fell heavily on a year earlier. Fuel duty payments fell by 8.7 per cent and air passenger duty payments fell by 71 per cent. March payments for these taxes will generally relate to liabilities generated before the Prime Minister's advice against all 'non-essential' travel on 16 March. By the end of March, motor vehicle use had fallen by roughly two-thirds relative to the period before this advice, suggesting that fuel duty receipts next month will be much lower.[4]

Chart 1.1: HMRC cash receipts in March 2020



Source: HMRC, ONS

Central government spending

14. Central government current spending in March was up £7.1 billion (12.3 per cent) on last year. Much of that rise was explained by coronavirus-related spending:

- **Debt interest payments** were £1.4 billion higher than in March 2019, reflecting the monthly path of RPI-measured inflation and increased short-term financing.

- **Current grants from central government to local authorities** were £4.2 billion (44 per cent) higher than in March 2019. The increase largely reflects grants from MHCLG and BEIS to local authorities in respect of the coronavirus outbreak. The increase comes despite the move to universal credit reducing grants related to housing benefit.

[3] Earnings and employment from Pay As You Earn Real Time Information, UK, ONS, April 2020.
[4] Slides and datasets to accompany coronavirus press conference, Cabinet Office, 21 April 2020.

- **Net social benefits** were up £0.4 billion. This figure will not reflect the latest sharp rises in universal credit claims. It is, in any case, hard to interpret due to the move to universal credit increasing net social benefits and reducing grants to local authorities.

- **Other current spending** – mostly departmental spending – was £1.5 billion (5.2 per cent) higher than in March 2019. Higher spending by DHSC comprises both the increased NHS settlement in 2019-20 and some additional coronavirus-related costs.

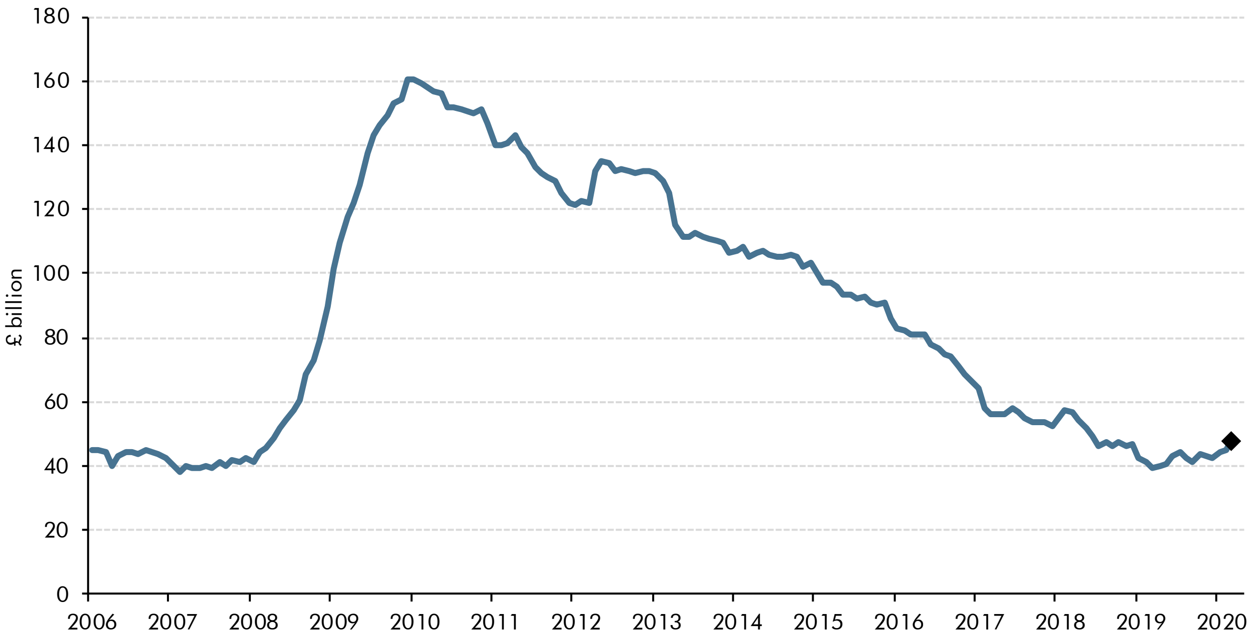
15. Central government net investment was £0.2 billion (3.2 per cent) higher than in March 2019.

Initial outturn for 2019-20

Public sector net borrowing

16. The provisional estimate of public sector net borrowing in 2019-20 was £1.2 billion higher than we predicted in our March 2020 forecast (on a like-for-like basis). CG receipts (excluding APF transfers) were £4.5 billion lower than expected, in large part reflecting lower VAT receipts in March. CG spending was £2.7 billion lower than expected, as debt interest payments in March were lower than predicted. Borrowing by local authorities was £0.7 billion lower than forecast, while borrowing by public corporations was £0.2 billion higher than forecast.

Chart 1.2: Public sector net borrowing: rolling 12-month total

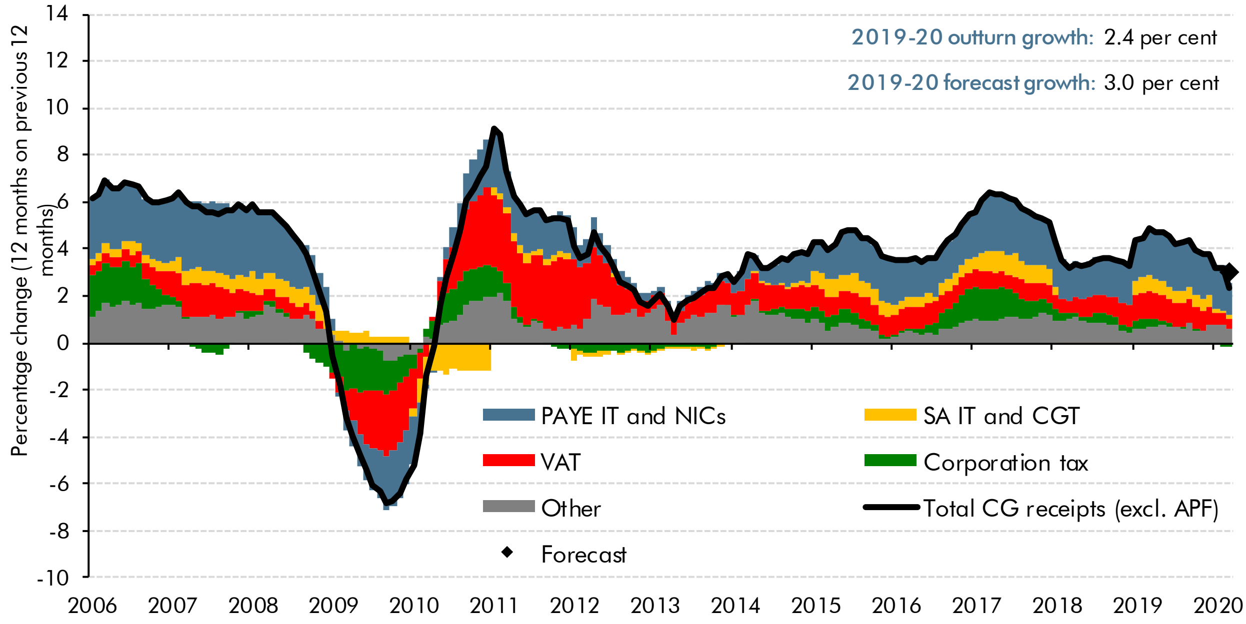


Source: ONS, OBR

Central government receipts

17. Relative to last year, CG receipts (excluding APF transfers) in 2019-20 were up 2.4 per cent relative to our full-year forecast of 3.0 per cent growth (on a like-for-like basis). Around half of that difference reflects VAT receipts between December 2019 to February 2020, which were revised down this month by £1.4 billion. This revision reflects changes in payment patterns prior to the public health measures taking effect and so does not reflect either the VAT deferral scheme nor any assessment of the impact of the economic slowdown. Chart 1.3 shows the rolling 12-month average growth in CG receipts.

Chart 1.3: Growth in central government receipts: rolling 12-month average

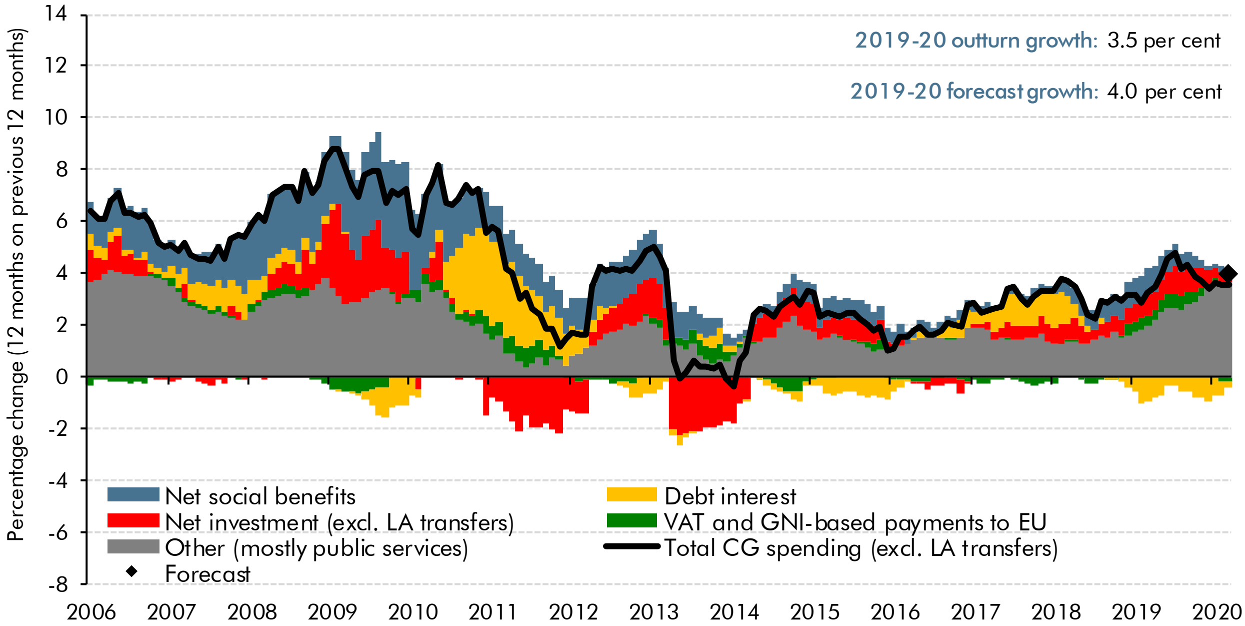


Source: ONS, OBR

Central government spending

18. Relative to last year, CG spending was up 3.5 per cent, compared with our March 2020 forecast for 4.0 per cent growth. This is mainly due to lower debt interest payments than we had forecast, and reflects the path of outturn interest rates. Chart 1.4 shows the rolling 12-month average growth in CG spending.

Chart 1.4: Growth in central government spending: rolling 12-month average



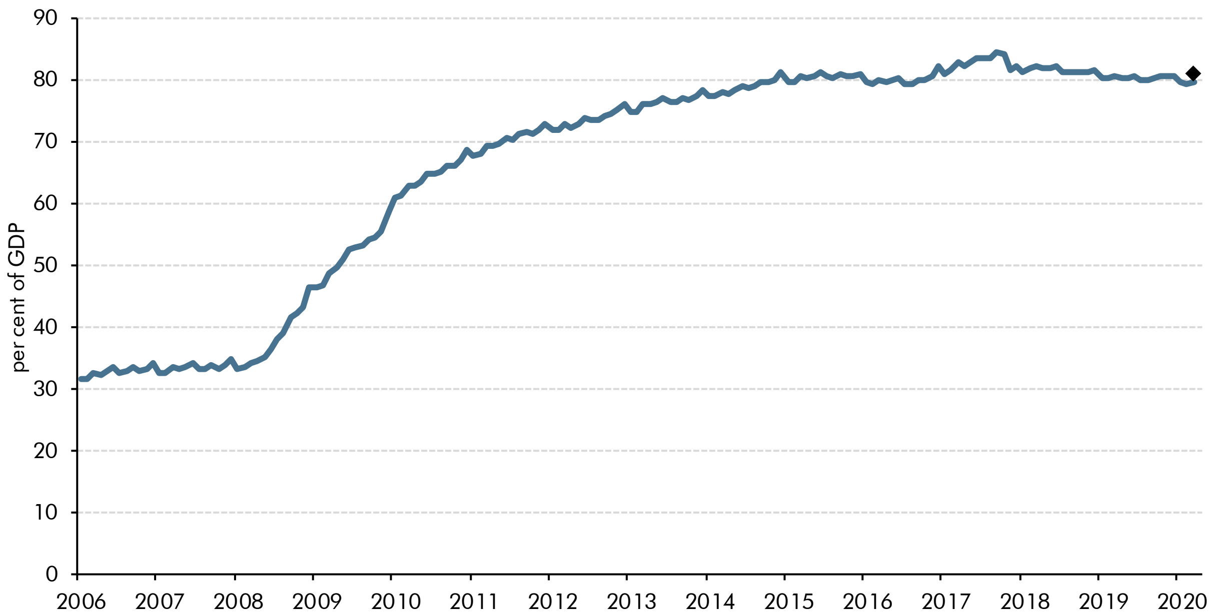
Source: ONS, OBR

Public sector net debt

19. Public sector net debt (PSND) was down 1.0 per cent of GDP from a year earlier. This is broadly in line with the 1.1 per cent of GDP drop assumed in our March forecast for the end of 2019-20. Recent measures by the Bank of England have had little impact on PSND so far. The additional Term Funding Scheme for small and medium-sized enterprises opened in April 2020 and so has had no impact on PSND yet.

20. By ONS convention, the debt-to-GDP ratio at the end of the financial year is measured as the stock of debt in March relative to the sum of GDP over the four quarters that straddle the end of the year – i.e. PSND in March 2020 as a percentage of GDP over the four quarters from 2019Q4 to 2020Q3 for 2019-20. In this month's release, the ONS has used our March 2020 forecast for nominal GDP to fill in the period for which GDP data are not yet available. If it were based on our reference scenario instead, with its sharp fall in GDP in the second and third quarters, the measured debt-to-GDP ratio would rise from 79.7 to 93.0 per cent of GDP.

Chart 1.5: Public sector net debt



Source: ONS, OBR

Financing

21. Alongside today's PSF bulletin, the Debt Management Office has updated its financing remit. In light of the uncertainty regarding the Government's financing needs this year, it only covers the period from May to July. The DMO plans to raise £180 billion from gilt auctions in this period, on top of the £45 billion it plans to raise in April. This means in the first four months of the year the DMO plans to raise more than the full-year Budget 2020 remit of £156.1 billion – a figure that included £97.6 billion of financing for gilt redemptions. The DMO noted that it does not expect this pace of gilt issuance to persist over the full year.

Issues for next month's release

22. Given the uncertainty surrounding this month's figures, we can expect several revisions to March data over the coming months. These could include:

- **Central government spending** in March being revised up next month, following the provisional ONS classification decision that the Coronavirus Job Retention Scheme (CJRS) will score as current spending.

- **Central government receipts** in March being revised down next month, as better information becomes available on the impact of the economic slowdown on tax liabilities.

- Reflecting both of those factors, **public sector net borrowing** in March and therefore in 2019-20 as a whole is likely to be revised up, perhaps significantly.

- The inevitable weakness in nominal GDP while the public health restrictions are in place will raise the recorded **debt-to-GDP ratio** at the end of 2019-20.

Table 1.1: Public sector receipts, expenditure and net borrowing[1]

£ billion	March				April to March				March forecast			
			change				change		2019-20	2018-19	change	
	2020	2019	£bn	%	2019-20	2018-19	£bn	%	Forecast	outturn	£bn	%
Central government (CG) current receipts												
Taxes on production	22.4	22.7	-0.3	-1.2	283.5	280.0	3.5	1.2	286.9	280.0	6.8	2.4
Of which: VAT (accrued)	12.4	12.4	0.0	0.1	154.5	151.4	3.1	2.0	155.8	151.4	4.4	2.9
Taxes on income and wealth	23.5	24.2	-0.7	-3.0	262.4	259.6	2.8	1.1	262.0	259.6	2.4	0.9
Of which:												
Income tax and CGT (accrued)	18.6	19.2	-0.6	-3.3	205.6	201.8	3.8	1.9	205.2	201.8	3.4	1.7
Corporation tax	4.9	4.9	0.0	0.3	56.6	57.8	-1.3	-2.2	56.6	57.8	-1.3	-2.2
Other taxes	1.6	1.7	-0.1	-6.2	18.5	18.6	-0.1	-0.6	18.1	18.6	-0.4	-2.4
Compulsory social contributions	15.4	14.9	0.5	3.3	144.9	137.3	7.6	5.6	145.4	137.3	8.2	5.9
Interest & dividends	1.6	1.3	0.3	21.5	18.7	18.6	0.1	0.4	19.3	18.6	0.7	4.0
Other receipts	2.8	2.9	-0.1	-4.1	34.5	33.3	1.1	3.3	35.1	33.3	1.8	5.3
Total CG current receipts	**67.2**	**67.7**	**-0.5**	**-0.7**	**762.5**	**747.5**	**15.0**	**2.0**	**766.9**	**747.5**	**19.4**	**2.6**
CG current expenditure												
Interest payments	1.3	-0.1	1.4		47.2	48.8	-1.6	-3.3	48.8	48.8	0.0	0.0
Net social benefits	18.1	17.7	0.4	2.2	216.0	214.7	1.2	0.6	216.0	214.7	1.3	0.6
CG current grants to LAs	13.6	9.5	4.2	44.0	115.3	112.7	2.6	2.4	110.8	112.7	-1.8	-1.6
VAT and GNI-based payments to EU[2]	0.7	1.0	-0.4	-37.0	11.6	12.9	-1.3	-10.4	11.7	12.9	-1.2	-9.5
Other	30.9	29.4	1.5	5.2	342.5	318.9	23.6	7.4	342.2	318.9	23.2	7.3
Total current expenditure	**64.6**	**57.5**	**7.1**	**12.3**	**732.5**	**708.0**	**24.5**	**3.5**	**729.5**	**708.0**	**21.4**	**3.0**
Depreciation	2.4	2.4	0.0	0.3	28.7	28.4	0.3	1.1	29.1	28.4	0.7	2.3
CG current budget deficit	**-0.2**	**-7.8**	**7.5**	**-96.9**	**-1.2**	**-11.0**	**9.8**	**-89.2**	**-8.4**	**-11.0**	**2.7**	**-24.1**
CG net investment	8.0	7.8	0.2	3.2	47.0	45.4	1.7	3.6	47.7	45.4	2.3	5.0
of which: CG capital grants to LA	2.3	2.2	0.1	6.7	12.1	11.5	0.6	4.8	11.8	11.5	0.2	2.0
CG net borrowing	**7.8**	**0.0**	**7.8**		**45.8**	**34.4**	**11.5**	**33.4**	**39.3**	**34.4**	**4.9**	**14.4**
Local authorities net borrowing	-3.8	0.0	-3.9		5.2	5.4	-0.2		10.7	5.4	5.3	98.6
Public corporations net borrowing	-0.9	-0.9	0.0	-0.9	-2.4	-0.5	-2.0		-2.6	-0.5	-2.1	
Public sector net borrowing	**3.1**	**-0.9**	**3.9**		**48.7**	**39.3**	**9.3**	**23.7**	**47.4**	**39.3**	**8.1**	**20.7**
Public sector net investment	**7.9**	**7.1**	**0.8**	**11.7**	**49.6**	**44.2**	**5.4**	**12.3**	**49.1**	**44.2**	**5.0**	**11.3**
Public sector current budget	**-4.9**	**-8.0**	**3.1**	**-38.9**	**-0.9**	**-4.8**	**3.9**	**-80.7**	**-1.9**	**-4.8**	**2.9**	
March 2020 EFO forecast published 11 March 2020 excluding public sector banks on a National Accounts basis.												
Memo: CG receipts ex. APF flows	*67.2*	*67.7*	*-0.5*	*-0.7*	*755.3*	*737.8*	*17.5*	*2.4*	*759.8*	*737.8*	*22.0*	*3.0*
Memo: CG spending ex. grants to LAs	*59.0*	*56.0*	*3.0*	*5.4*	*680.9*	*657.7*	*23.3*	*3.5*	*683.7*	*657.7*	*26.0*	*4.0*
Memo: CGNCR ex. B&B, NRAM and NR	*21.3*	*22.1*	*-0.8*	*-3.5*	*56.5*	*36.9*	*19.6*	*53.1*	*42.9*	*36.9*	*6.0*	*16.3*

[1] Data and forecasts contained in this table can be found from the following sources:

ONS public sector finances: https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/March2020

HMRC tax receipts and national insurance contributions: https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk

OBR *Economic and fiscal outlook*: https://obr.uk/efo/economic-and-fiscal-outlook-march-2020/

[2] Net of abatement.