

Commentary on the Public Sector Finances: July 2020

Office for
**Budget
Responsibility**

21 August 2020

Public sector net debt hits £2 trillion for the first time

The budget deficit rose sharply again in July, topping £150 billion for the year to date and pushing public sector net debt over £2 trillion for the first time. But year-to-date borrowing is lower than in our *Fiscal sustainability report* central scenario. That reflects lower departmental spending and loan guarantee write-off costs that have yet to be incorporated into outturn data, as well as surprisingly strong tax receipts.

Public sector net borrowing



Headlines

- Today's data highlight the building fiscal consequences of the **coronavirus crisis**, although it will be many months before the full impact of the shock becomes clear.
- **Public sector net borrowing (PSNB)** totalled £26.7 billion in July, £1.9 billion lower than market expectations. Borrowing over the first four months of the year reached £150.5 billion, despite the deficit for April to June being revised down by £4.1 billion.
- **HMRC cash receipts** over the first four months of 2020-21 were 31 per cent lower than a year earlier, with VAT accounting for the bulk of the deterioration thanks to the Government's deferral scheme (which ended on 30 June) and lower consumer spending. Income tax and NICs receipts are also lower than a year earlier, but fell by less than assumed in our central scenario.
- **Central government spending** so far in 2020-21 is 36 per cent higher than a year earlier, reflecting the cost of the coronavirus job retention and self-employment income support schemes, plus additional grants to local authorities and higher public services spending.
- **Net debt** rose by 20.4 per cent of GDP on a year earlier to 100.5 per cent in July. In cash terms, net debt hit £2 trillion for the first time, doubling in just over a decade.

Monitoring the public finances through the lockdown

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the July 2020 Public Sector Finances this morning.¹ Each month the OBR provides a brief analysis of the data and a comparison with our most recent forecast. Given the large shock to the economy and public finances caused by the coronavirus pandemic and associated lockdown, it would not be meaningful to compare the latest data with our March 2020 *Economic and fiscal outlook (EFO)*. Instead, we compare them to monthly profiles consistent with the central scenario in our July *Fiscal sustainability report (FSR)*, updated for the cost of the policy measures that were announced in the Chancellor's Summer Economic Update but finalised too late to incorporate in that scenario. These monthly profiles are available on our website.

The public finances in July 2020

2. Today's initial estimate of public sector net borrowing (PSNB) in July 2020 was £26.7 billion, up £28.3 billion on the small surplus recorded in July 2019 but £1.9 billion lower than market expectations. The sharp rise on last year reflected a £15.3 billion rise in central government spending, compounded by a £13.0 billion fall in central government receipts (excluding transfers relating to the Asset Purchase Facility). Local authorities' borrowing was up £0.4 billion on last year, reflecting higher spending. Borrowing by public corporations (excluding APF transfers) was £0.4 billion down on last year.
3. Over the first four months of the year, PSNB totalled £150.5 billion, up £128.4 billion on the same period last year. Full-year borrowing has only exceeded £150.5 billion once, at the peak of the financial crisis in 2009-10. The jump in year-to-date borrowing comes despite PSNB across April, May and June being revised down by £4.1 billion this month, more than explained by higher accrued tax receipts, in turn reflecting stronger cash receipts in July.
4. PSNB over the first four months of 2020-21 is currently £28.7 billion (16.0 per cent) below our updated *FSR* central scenario. Part of the difference relates to spending associated with future calls on government-guaranteed loan schemes (worth £12.9 billion over this period in our scenario), which is not currently recorded in the outturn data. The remaining £15.7 billion (8.8 per cent) like-for-like difference is explained by lower outturn central government spending and by stronger HMRC cash receipts in June and July (which largely accrue back to earlier months and were not available at the time of completing our *FSR* scenario).
5. As we set out last month, and as illustrated by the revisions to outturn data reported today, initial estimates of accrued spending, receipts and borrowing are likely to be particularly prone to revision over the coming months. In many cases, the outturn data are currently based on our scenario profiles or other forecasts, reflecting the often significant lag between the underlying economic activity and corresponding tax payments, and the lags in collating and transmitting outturn departmental spending data to the ONS. As more cash data become available over the coming months and these initial assumptions are replaced, large revisions can be expected. These issues are overlaid with other challenges, such as adjusting the accrued tax data for non-payment of liabilities and subsequent repayment of arrears.

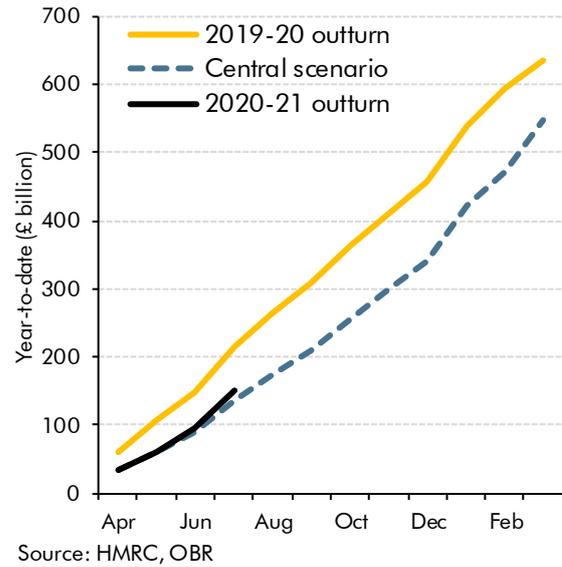
¹ <https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/july2020>

Receipts

Cash receipts collected by HMRC

HMRC collects around 90 per cent of all central government cash receipts. Receipts in the first four months of 2020-21 were down by £66.4 billion (31 per cent) on last year, but were £14.2 billion (10.4 per cent) higher than our central scenario.

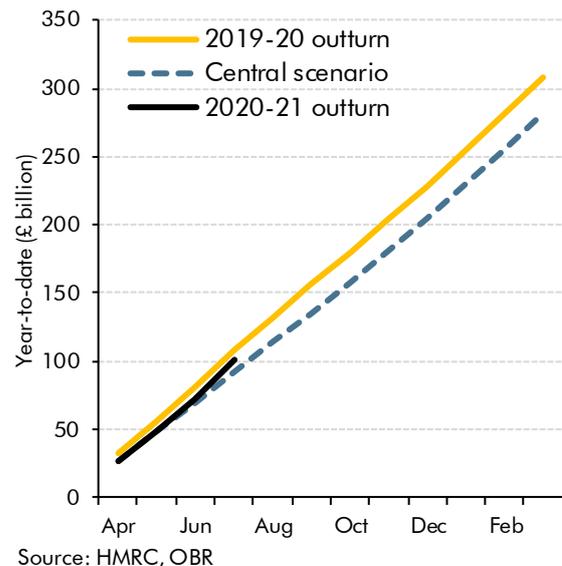
PAYE income tax and NICs account for more than half the surplus against our scenario, with VAT and self-assessment (SA) income tax making up most of the remainder. So far, the surplus relative to our scenario appears largely to reflect differences in the pattern of deferred and unpaid tax liabilities, including in response to the VAT and SA deferral schemes. Part of the difference will also reflect movements in underlying tax bases.



PAYE income tax and National Insurance contributions (cash basis)

July cash receipts for PAYE income tax and NICs mainly relate to June liabilities. Cash receipts in July continue to be unexpectedly strong, up 1.5 per cent on a year earlier following a 1.4 per cent rise in June. That followed steep falls of 16.0 and 13.6 per cent in April and May. The path for cash receipts contrasts with data from HMRC's 'real-time information' (RTI), which show a steady decline in total pay over April to June. Initial data for July showed a faster decline in the total number of employees, but an uptick in median pay growth.

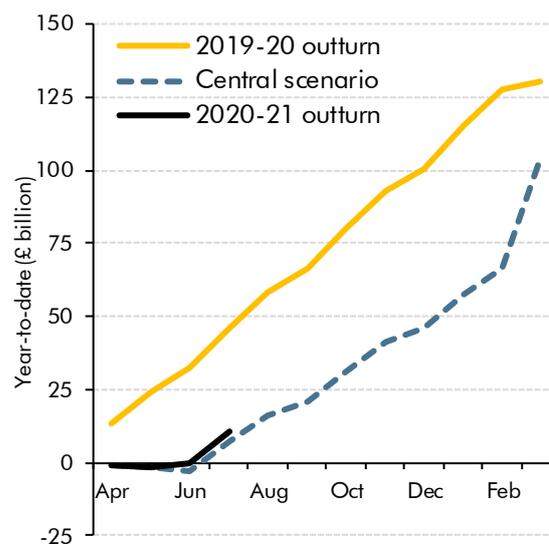
The difference between cash receipts and the labour market data are likely to reflect non-payments of tax liabilities and subsequent repayment of tax debts. Firms initially struggled to meet their usual tax payment schedules, so they built up significant amounts of PAYE tax debt. But it looks like firms paid off significant amounts of that debt in June and July, perhaps helped by the loans, grants and CJRS income that have now been disbursed.



VAT receipts (cash basis)

Cash VAT receipts rebounded to £10.7 billion in July, following the end of the Government's VAT deferral scheme on 30 June. Deferrals left April-to-June receipts at *minus* £0.5 billion, with total repayments exceeding payments.

Total receipts so far this year are £3.1 billion higher than assumed in our central scenario. It is not clear at this stage how much of that outperformance reflects movements in the underlying tax base (such as the pace at which consumer spending has recovered) versus differences in the extent to which the VAT deferral scheme was taken up.

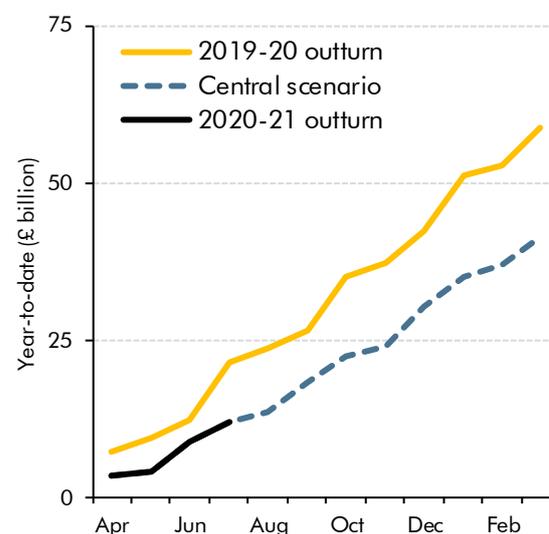


Source: HMRC, OBR

Onshore corporation tax receipts (cash basis)

On a cash basis, year-to-date onshore corporation tax receipts were down £9.6 billion (45 per cent) on last year – very close to our central scenario.

The fall relative to last year largely reflects two factors. First, the change in quarterly payment deadlines for very large companies has altered the monthly pattern of receipts (reflected in the monthly profile of our central scenario). Second, many companies paying in quarterly instalments will have revised down their estimates of total liabilities for the year, reflecting both a weaker profit outlook and higher anticipated use of loss relief schemes.



Source: HMRC, OBR

Selected other HMRC cash receipts

Other notable movements in cash receipts include:

- Self-assessment (SA) income tax** receipts in July were £3.8 billion higher than assumed in our central scenario. July SA receipts reflect taxpayers' second payments-on-account in respect of tax liabilities in the previous year which are calculated mechanically based on last year's tax payments (so this July's payment-on-account for 2019-20 liabilities is based on 2019-20 tax payments in respect of 2018-19 liabilities). This means the amount paid is typically reasonably predictable but also that it tells us little about tax receipts for the full year. In March 2020, the Government announced that all SA taxpayers could defer their July 2020 payment-on-account until January 2021. Our central scenario assumed that 90 per cent of payments would be deferred, but the surplus this month (with receipts only down by 49 per cent on last July) suggests considerably lower take up. All else equal, fewer deferrals and higher receipts in July will mean lower receipts in January 2021. The lower than assumed

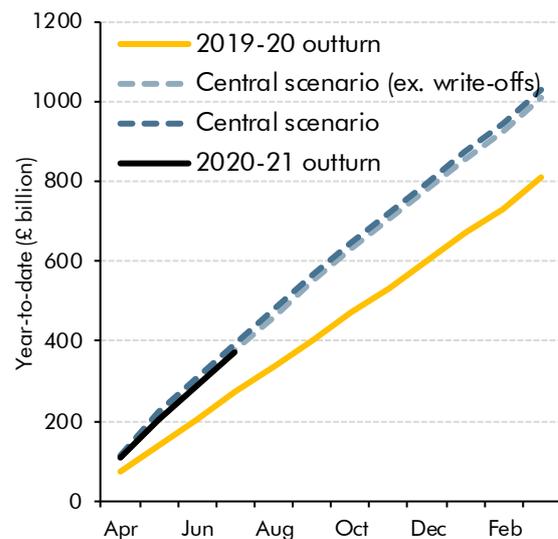
deferral rate could reflect the wording on the HMRC website, which advised taxpayers that “you can still make the payment by 31 July 2020 as normal if you’re able to do so”.

- **Fuel duty** receipts for April to July were down £3.6 billion (39 per cent) on a year earlier, broadly in line with our central scenario. This largely reflects the sharp fall in motor vehicle use during the lockdown period, probably overlaid by some non-payment of liabilities.
- **Stamp duty land tax** in the year to date is down 43 per cent on last year, but is £0.3 billion (16 per cent) above our central scenario (which now incorporates the impact of the temporary cut in the tax rate). **Stamp duty on shares** is up 23 per cent on last year, having been boosted by higher stock market turnover.
- **Alcohol duty** receipts are down just 2.4 per cent year to date relative to last year and were up 12.1 per cent in July alone as arrears built up earlier in the year were repaid. That has left receipts £0.6 billion (18 per cent) above our central scenario in the year to date.
- **Air passenger duty** remains exceptionally weak – down 89 per cent on last year in the first four months thanks to the collapse in the number of flights taken.

Public spending

Central government spending (accruals basis)

Total CG spending in the year to date is up £99.0 billion (36 per cent) on last year, with the rate of growth slowing a little in July (up £15.3 billion or 22 per cent). Comparisons with our central scenario are currently distorted because it included costs associated with accruing future calls on loan guarantees that are yet to be included in outturn. Abstracting from that, year-to-date CG spending was £5.2 billion (1.4 per cent) below our scenario. That reflects lower than assumed spending on public services and on net social benefits, which are partially offset by higher than assumed net investment spending.

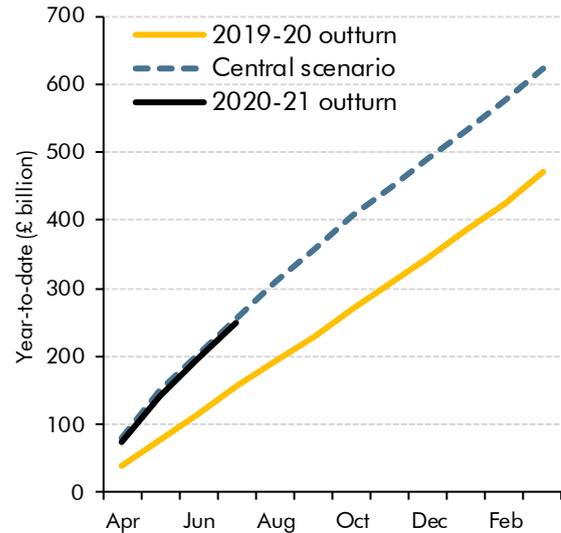


Source: ONS, OBR

'Other current expenditure' (largely departmental spending)

'Other current expenditure' includes departmental spending and grants to local authorities, plus subsidies like the CJRS and SEISS.

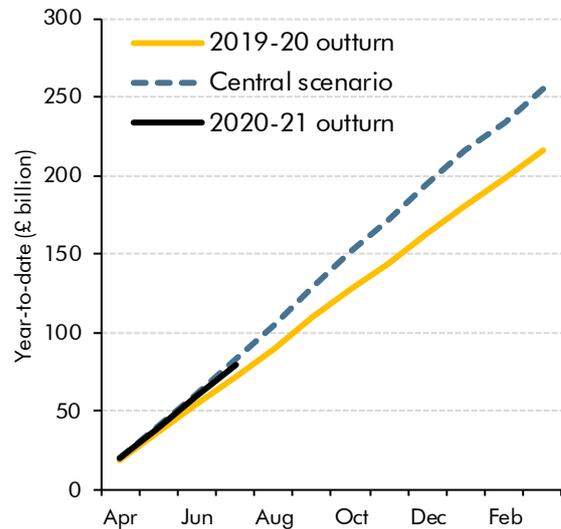
Year-to-date spending is up £94.4 billion (60 per cent) on last year, but £4.1 billion (1.6 per cent) lower than assumed in our central scenario. The jump relative to last year is largely explained by the CJRS (with around £36 billion accrued so far in 2020-21) and the SEISS (around £7.5 billion). Both are close to our scenario. Departmental spending in the early months of the year has been revised up this month, bringing it closer to our scenario.



Source: ONS, OBR

Net social benefits spending

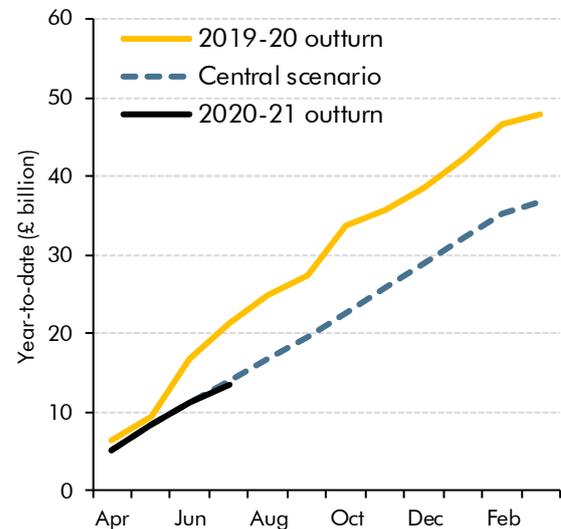
This category includes both welfare spending and net public service pension payments. Year-to-date CG net social benefits spending is up £7.1 billion (10 per cent) on last year, but is £3.9 billion lower than our central scenario assumes. Given the sharp rise in claimant count unemployment, this could reflect differences in the characteristics of new claimants that mean they are entitled to smaller awards on average than in our scenario.



Source: ONS, OBR

Central government debt interest spending

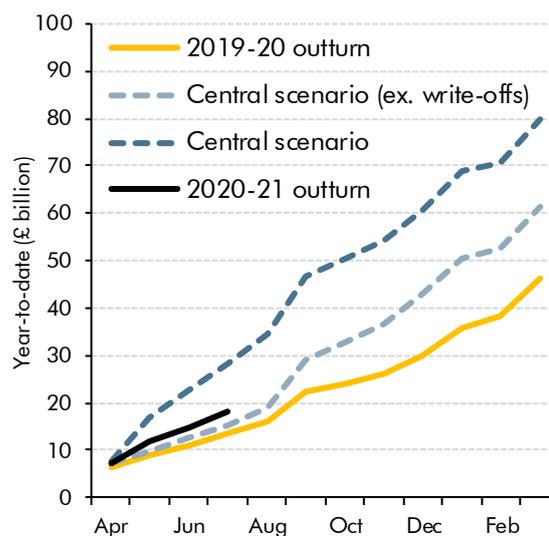
Debt interest spending so far this year is down £7.7 billion on last year, but is very close to our central scenario. The fall is mostly due to lower RPI inflation, which reduces accrued spending on index-linked gilts relative to last year.



Source: ONS, OBR

Central government net investment

CG net investment so far this year is £4.6 billion (33 per cent) higher than last year. Abstracting from loan guarantee write-offs, spending is £3.0 billion (20 per cent) higher than our central scenario assumes. Year-on-year growth reflects some coronavirus-related capital spending, as well as higher spending on High Speed 2 and previously planned increases in health and social care. Our scenario assumes that the disruption to construction activity will weigh on capital spending in the initial months of 2020-21, but to date that is not particularly apparent in the provisional data.



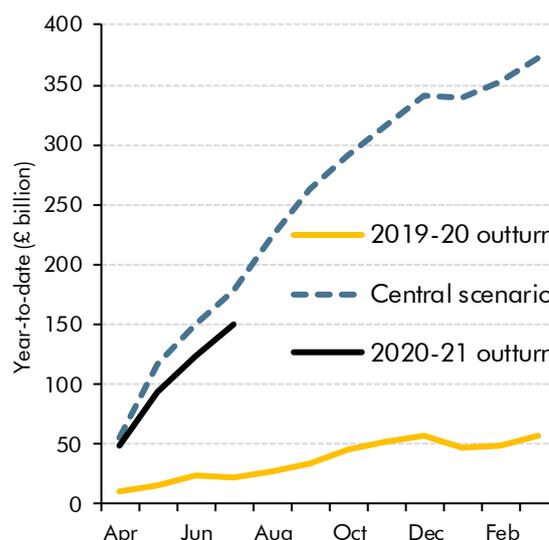
Source: ONS, OBR

Fiscal aggregates

Public sector net borrowing (PSNB)

Public sector net borrowing so far in 2020-21 totalled £150.5 billion, up £128.4 billion on last year. Abstracting from loan guarantee write-offs, year-to-date borrowing is £15.7 billion lower than in our *FSR* central scenario, almost entirely because tax receipts have fallen by less than assumed. Lower central government spending was partly offset by higher local authority borrowing.

PSNB across April, May and June was revised down by £4.1 billion, with the revision more than explained by surprisingly strong cash receipts in July that accrue back to those months.

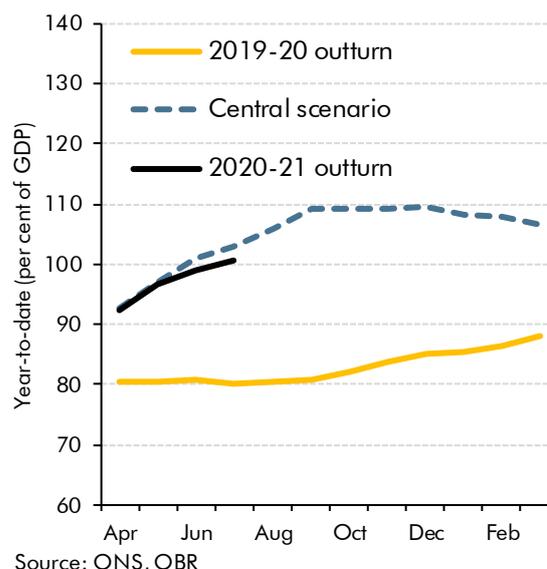


Source: ONS, OBR

Public sector net debt (PSND)

PSND in July rose 20.4 per cent of GDP on a year earlier to reach 100.5 per cent. Cash debt rose by £227.6 billion relative to last July, reflecting both higher central government cash borrowing and the Bank of England's new Term Funding Scheme and the expansion of its gilt purchases. Cash debt hit £2 trillion for the first time this month.

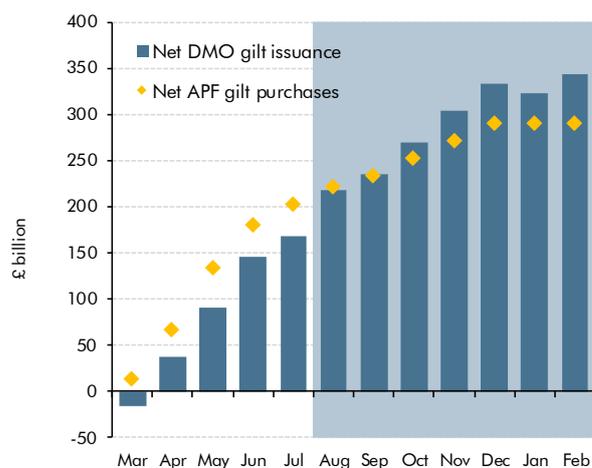
Upward revisions to the GDP denominator have reduced the debt-to-GDP ratio slightly, but this is still based on our central scenario and so further revisions will follow as it is replaced with outturn data. Our revised monthly profiles show PSND at 106.4 per cent of GDP at the end of the year.



Financing

Gilt issuance, QE purchases and use of the Ways & Means Facility

To the end of July, the DMO issued £226 billion in gilts – 59 per cent of the £385 billion it plans to issue between April and November (net of redemptions, gilt issuance totalled £183 billion). By the same point, the Bank of England had purchased some £223 billion of gilts (out of a total of planned additional purchases of £300 billion). So, in effect, the Bank has purchased just £3 billion less from the private and overseas sectors than the DMO has issued (and £19 billion more on a net basis). To date the Treasury has not made use of its 'Ways & Means Facility' overdraft at the Bank.



Issues for next month's release and beyond

6. Significant data revisions can be expected over the coming months, as new data become available and as the ONS incorporates the impact of many Government policies into the public finance statistics. It is difficult to estimate the likely total size and direction of these changes, but some specific issues include:
 - Spending associated with the various **guaranteed loan schemes**. The three main schemes are the coronavirus business interruption loan scheme (CBILS), the coronavirus large business interruption loan schemes (CLBILS) and the bounce back loan scheme (BBLs). The ONS has now determined that all three should be classified as 'standardised guarantee schemes', so the lifetime costs (i.e. the write-offs) are recorded as expenditure

at the time the guarantees are provided (raising PSNB as loans are issued). Our central scenario assumes that these schemes would raise PSNB in 2020-21 by £18.3 billion on gross lending of £76.4 billion. The ONS has not yet incorporated any costs associated with these schemes into the outturn data. When it does, the uncertainty around future default rates means that there could be large future adjustments or revisions to the initial estimates as more is learnt about actual default rates and associated fiscal costs.

- **SEISS payments** have been scored on a cash basis in this release, but the ONS plans to revisit this in the near future.
- The ONS is continuing to consider how to reflect **non-payment of tax liabilities** in the accruals-based receipts figures used when estimating PSNB. The cash receipts data suggest this has been a material issue across many taxes, with subsequent payments of past debts also an issue. Future revisions in respect of these issues are possible.
- There is currently limited information about **taxes not collected by HMRC**, such as business rates, which the ONS notes are currently likely to be overestimated.
- In July, the ONS announced its decision to classify many **train operating companies (TOCs)** into the public sector from 1 April 2020, following 'emergency measures agreements' (EMAs) between them and the Government.² The ONS has not yet incorporated this effect into the statistics, but has said it will aim to do this later in the year. As the EMAs in their current form are temporary, the ONS has said it will review the classification status of TOCs again in the future if the EMAs are amended or expire.

² The ONS classifies train operating companies now running under emergency measures agreements, ONS, 31 July 2020.