Commentary on the

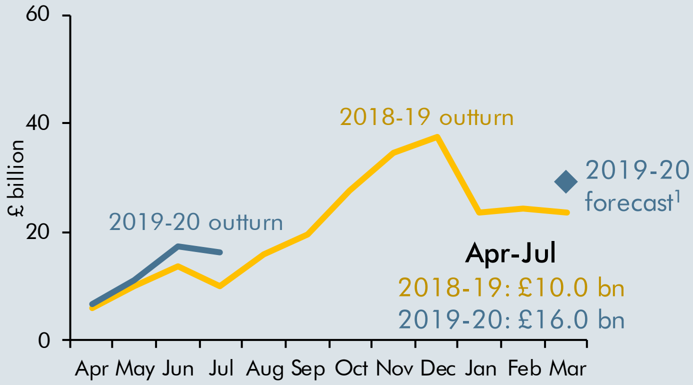
Public Sector Finances: July 2019

21 August 2019

Sharp rise in borrowing so far in 2019-20

Borrowing has risen relative to last year in each of the past four months. For the year to date, it is now up £6.0 billion on a year earlier – already a little above the £5.7 billion full-year rise implied by our March forecast. Spending growth has picked up to around twice the rate we assume for the full year. But only four months into the year, it is too early to say for certain that the deficit will exceed our March forecast (like-for-like).

Cumulative public sector net borrowing



[1] March 2019 forecast

Headlines

- **A budget surplus** of £1.3 billion was recorded in July, £2.2 billion smaller than last July's.
- **Year-to-date borrowing** was up £6.0 billion (60 per cent) on the same period last year. To meet our full-year forecast for public sector net borrowing (PSNB), borrowing needs to rise by £5.7 billion (24 per cent) from the latest 2018-19 outturn – i.e., absent revisions to 2018-19 or the start of this year, borrowing would need to fall slightly in the rest of 2019-20.
- **Central government receipts** (excluding PSNB-neutral transfers related to 'quantitative easing') were up 2.5 per cent in July. Year-to-date receipts growth of 3.4 per cent is a little above our full-year forecast of a 2.7 per cent rise (on a like-for-like basis).
- **Central government spending** (excluding PSNB-neutral grants to local authorities) was up 6.9 per cent in July and 6.3 per cent for the year to date, well above our full-year forecast of a 3.3 per cent rise (on a like-for-like basis).
- **Net debt** was 1.3 per cent of GDP lower in July 2019 than it was in July 2018.
- **Next month's release** will include significant revisions, including the revised treatment of student loans that will add £12 billion to the measured deficit in 2018-19.

Full commentary

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the July 2019 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, currently the March 2019 *Economic and fiscal outlook* (*EFO*).

Public sector net borrowing

2. Public sector net borrowing (PSNB) recorded a surplus of £1.3 billion in July, £2.2 billion smaller than last year and £1.4 billion smaller than market expectations. Abstracting from PSNB-neutral transfers related to quantitative easing, a £4.2 billion (6.4 per cent) rise in central government (CG) spending outstripped the £1.7 billion (2.5 per cent) rise in CG receipts. Borrowing by local authorities was £0.3 billion lower than last year while borrowing by public corporations was unchanged.

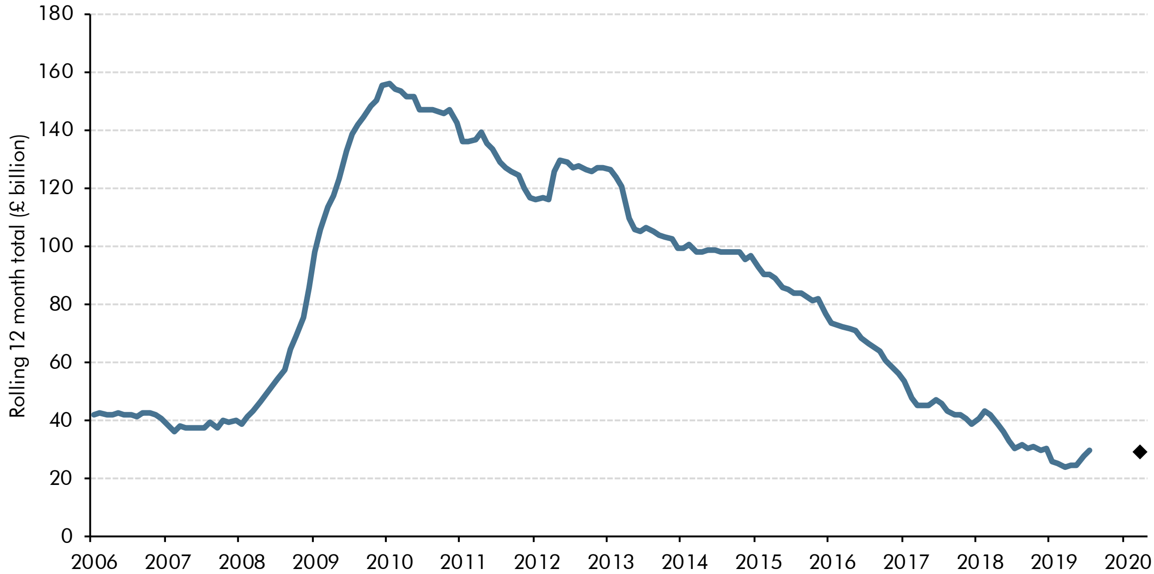
3. With borrowing having deteriorated relative to last year in each of the first four months of 2019-20, the year-to-date deficit is currently £6.0 billion higher than at the same point in 2018-19. Given the relatively small deficit last year, that translates into a 60 per cent rise in year-to-date borrowing. A simple extrapolation to the full-year position using this growth rate would imply 2019-20 borrowing much higher than our March forecast, which implies only a £5.7 billion rise relative to the latest estimate of borrowing in 2018-19 (itself a little higher than we assumed in March).

4. It is too early to say whether such an extrapolation provides a better guide to the full-year position than our March forecast. It is notable that all the apparent surprise relative to our forecast is down to faster spending growth, where monthly data in the early part of the year are more heavily based on forecast – including departmental forecasts of their own spending. If 'other CG current spending' were to exceed our full-year forecast by the margin implied by the year-to-date growth rate, it would imply departments overspending the limits set for them by the Treasury, which would be very unusual.

5. Chart 1.1 shows outturn PSNB on a 12-month rolling basis, relative to our latest full-year forecast for 2019-20. The small rise in borrowing we expect in 2019-20 would only partly reverse the large fall in 2018-19. Our forecast reflects an expectation of slower growth in receipts due to the Budget 2018 announcements on the income tax personal allowance and higher rate threshold, the temporary rise in the annual investment allowance to £1 million, and slower growth in the main nominal tax bases in 2019. CG spending is expected to rise faster than in 2018-19, particularly DEL spending on public services thanks mainly to additional resources for the NHS.

[1] https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/july2019

Chart 1.1: Public sector net borrowing: rolling 12-month total



Source: ONS, OBR

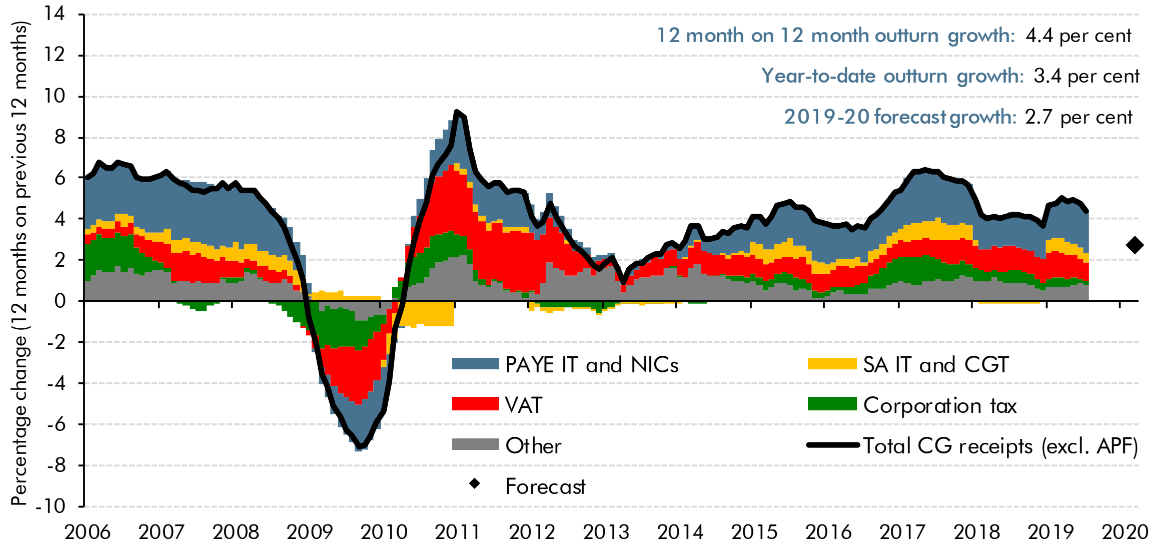
Central government receipts

6. Relative to last year, CG receipts (excluding APF transfers) were up 2.5 per cent in July and up 3.4 per cent in the first four months of 2019-20, above the 2.7 per cent rise we expect for the year as a whole (on a like-for-like basis). Receipts growth in July mainly reflected rises in National Insurance contributions (NICs), self-assessment (SA) income tax and VAT receipts. The second payment on account for 2018-19 SA liabilities was due on 31 July. SA income tax receipts were up 3.5 per cent in July on a year earlier. But as some payments will be recorded in August, a full year-on-year assessment will not be possible until both July and August data are available. But even this will not provide any meaningful information about prospects for the full year, since these payments on account are based mechanically on 2017-18 liabilities.

7. For the year to date, growth in PAYE income tax and NICs receipts of 4.1 per cent outpaces our full-year forecast for 2019-20 of 2.2 per cent. This is likely to reflect stronger-than-expected earnings growth in recent months. In addition, overall year-to-date receipts growth has benefited from the £0.8 billion special dividend received on the Government's RBS shares that scored in April. In contrast, year-to-date growth in several smaller tax streams has been weaker than our full-year forecasts for them. These include fuel, tobacco and alcohol duties, stamp duty land tax and inheritance tax. Stamp duty is down 4.5 per cent so far this year thanks to the slowing housing market. Inheritance tax is down 12.7 per cent, probably due to some payments having been brought forward to March to avoid the sharp rise in probate fees for high-value estates that was slated to take effect in April, but was subsequently delayed.

8. Chart 1.2 shows the rolling 12-month average growth in CG receipts. On this metric, growth is currently being boosted by January 2019 SA receipts. We would expect it to slow towards the year-to-date and forecast growth rates as 2019-20 progresses.

Chart 1.2: Growth in central government receipts: rolling 12-month average



We have adjusted these figures for differences between our forecasts and ONS outturns that stem from classification decisions the ONS has taken but not yet implemented. Full details are available in a supplementary table on our website.
Source: ONS, OBR

Central government spending

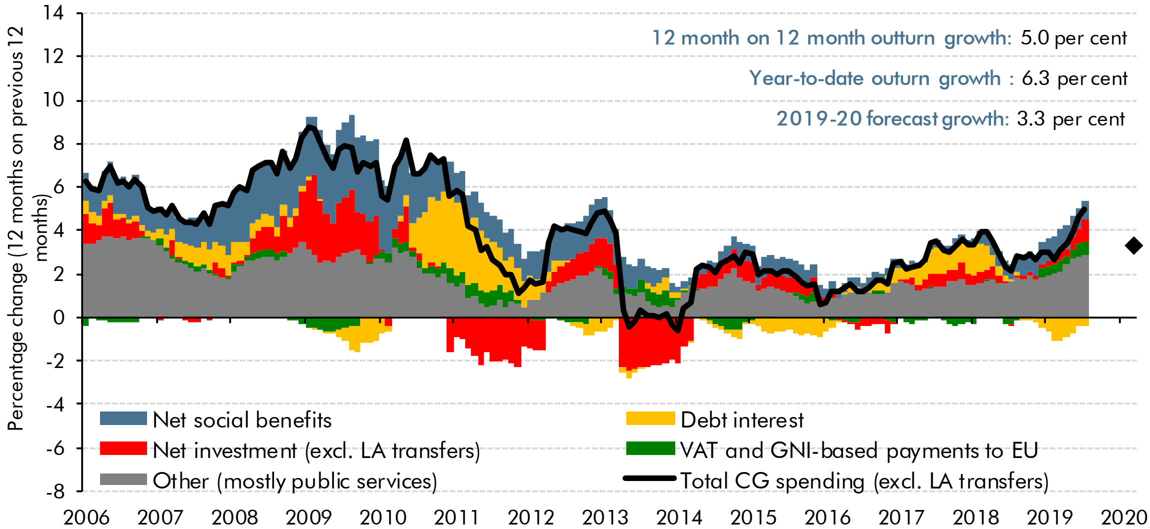
9. Relative to last year, total CG spending (excluding grants to local authorities) was up 6.9 per cent in July and up 6.3 per cent for the year to date. That is well above our full-year forecast for 2019-20 of 3.3 per cent growth (on a like-for-like basis), although spending data this early in the financial year are still very provisional and subject to revision. The £4.2 billion rise in CG spending in July primarily reflects a £1.9 billion rise in other CG current expenditure (largely spending on public services) and a £1.6 billion rise in CG net investment. In the first four months of 2019-20, other CG current expenditure was up 8.1 per cent, boosted by the more generous NHS settlement.

10. Faster than expected spending growth is fuelling the faster rise in the deficit than we forecast in March. It is too soon to say whether this faster growth will persist through the year to outstrip our full-year forecast or whether it will slow through the year. If the full-year growth rate were 6.3 per cent, CG spending (excluding grants to local authorities) would exceed our March forecast by £19.4 billion. And if other CG current expenditure was up 8.1 per cent in 2019-20 as a whole it would exceed our forecast by £8.8 billion, implying a significant overspend of the departmental expenditure limits set by the Treasury. This would be very unusual, which might suggest growth is more likely to slow.

11. One major development since March has been the sharp drop in gilt yields. Ten-year interest rates have fallen from around 1.3 per cent in early March to around 0.5 per cent now. This will only have a small effect in 2019-20 since changes to gilt rates only affect new and maturing gilts, so the effect on debt interest payments is small initially but builds up over a period of years if the lower interest rates persist.

12. Chart 1.3 shows CG spending growth on a 12-month rolling basis. As noted, if the momentum in spending growth shown on this metric and in the year-to-date position were to persist, full-year spending would exceed our forecast by a significant margin.

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

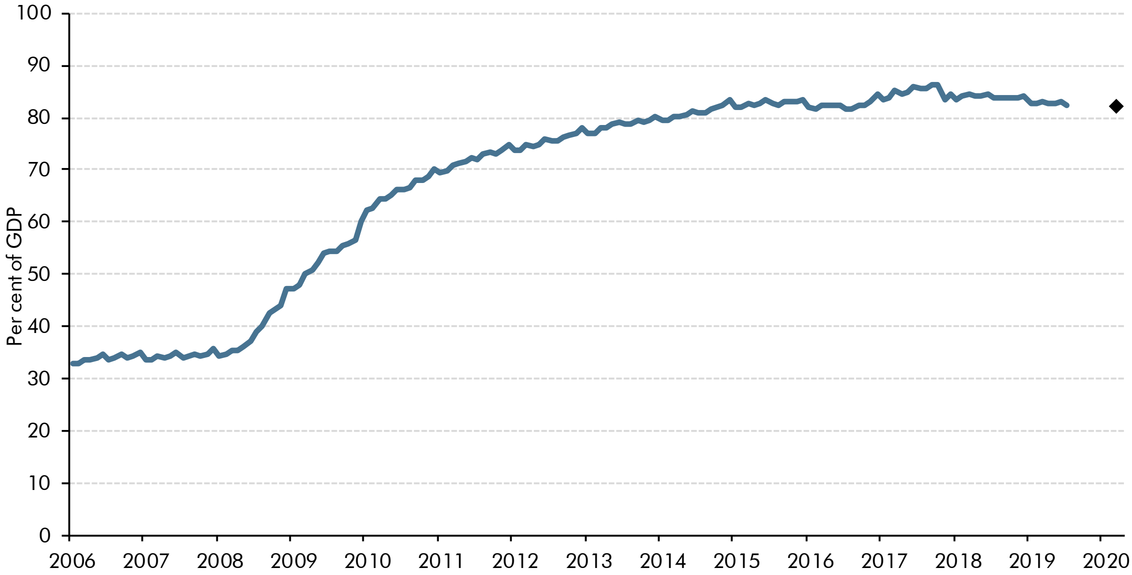


We have adjusted these figures for differences between our forecasts and ONS outturns that stem from classification decisions the ONS has taken but not yet implemented. Full details are available in a supplementary table on our website.

Debt

13. Public sector net debt (PSND) in July 2019 was down 1.3 per cent of GDP from a year earlier. Around 0.4 per cent of this drop is explained by the £4.9 billion sale of Bradford and Bingley mortgages by UK Asset Resolution (UKAR) in April and £4.5 billion in early repayments of Term Funding Scheme (TFS) loans since the start of the financial year. The UKAR sale was part of the £16.4 billion of financial asset sales expected during 2019-20 in our March forecast, but we did not assume that any further TFS loans would be repaid early.

Chart 1.4: Public sector net debt



Source: ONS, OBR

Forthcoming public sector finances developments

14. The ONS is planning to incorporate several changes in methodology in its public sector finances release in September. We intend to reflect these changes in our next fiscal forecast. These changes include:

- The improvement in the accounting treatment of **student loans** will add materially to borrowing – by £12.0 billion in 2018-19. Outlays will no longer all be treated as loans despite the fact that a significant proportion are expected to be written off rather than repaid. Instead, that portion will be treated as spending rather than lending and will add to borrowing as it happens. The spending portion will not accrue interest. This removes the most problematic 'fiscal illusions' generated by the existing treatment.

- Public employment-related **pension schemes and the Pension Protection Fund** will be moved within the public sector boundary. This would reduce public sector net debt in 2018-19 by £30.9 billion (1.4 per cent of GDP), reflecting the gilts and liquid assets they hold. The liabilities of these schemes are not 'debt liabilities' – they are accrued pension rights – so do not add to the liabilities side of public sector net debt.

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

£ billion	July				April to July				August to March				March forecast			
			change				change				change		2019-20	2018-19	change	
	2019	2018	£bn	%	2019-20	2018-19	£bn	%	2019-20	2018-19	£bn	%	EFO	outturn	£bn	%
Central government (CG) current receipts																
Taxes on production	23.9	23.6	0.3	1.2	93.8	93.1	0.6	0.7	194.7	185.9	8.8	4.7	288.4	279.0	9.4	3.4
Of which: VAT (accrued)	13.2	12.8	0.3	2.6	51.3	50.0	1.3	2.6	103.7	101.5	2.2	2.2	155.0	151.5	3.5	2.3
Taxes on income and wealth[1]	27.2	26.9	0.3	1.0	82.8	80.9	1.9	2.4	182.5	180.9	1.6	0.9	265.3	261.8	3.5	1.3
Of which:																
Income tax and CGT (accrued)	21.9	21.6	0.3	1.5	61.4	59.5	1.9	3.2	143.4	142.2	1.2	0.8	204.8	201.7	3.1	1.5
Corporation tax (accrued)	5.4	5.4	-0.1	-1.1	21.3	21.3	0.0	-0.1	38.9	38.8	0.1	0.4	60.2	60.1	0.1	0.2
Other taxes	1.5	1.5	0.0	-1.8	6.0	6.2	-0.2	-3.5	12.4	12.1	0.3	2.2	18.3	18.3	0.0	0.3
Compulsory social contributions	11.4	11.0	0.5	4.4	46.4	43.7	2.7	6.2	97.0	93.6	3.4	3.7	143.4	137.3	6.1	4.5
Interest & dividends	1.9	3.4	-1.5	-44.2	9.5	9.3	0.2	1.8	12.6	11.6	1.1	9.1	22.1	20.9	1.2	5.9
Other receipts	2.0	1.9	0.1	5.7	8.1	7.6	0.4	5.9	16.2	15.9	0.3	2.1	24.3	23.5	0.8	3.3
Total CG current receipts	**67.9**	**68.3**	**-0.4**	**-0.5**	**246.5**	**240.8**	**5.6**	**2.3**	**515.4**	**499.9**	**15.4**	**3.1**	**761.8**	**740.8**	**21.1**	**2.8**
CG current expenditure																
Interest payments	4.3	4.6	-0.3	-6.5	20.9	19.2	1.7	8.7	30.2	29.4	0.7	2.5	51.1	48.7	2.4	5.0
Net social benefits	18.4	17.9	0.5	2.6	72.1	71.1	1.0	1.4	139.4	143.7	-4.3	-3.0	211.4	214.7	-3.3	-1.5
CG current grants to LAs	12.3	11.9	0.4	3.6	41.5	41.7	-0.2	-0.5	72.7	71.3	1.4	2.0	114.3	113.0	1.2	1.1
VAT and GNI-based payments to EU[2]	1.1	1.0	0.1	8.1	3.5	3.3	0.1	3.9	9.4	9.6	-0.1	-1.3	12.9	12.9	0.0	0.0
Other CG current expenditure	27.6	25.6	1.9	7.5	108.4	100.2	8.1	8.1	217.3	207.3	10.0	4.8	325.7	307.5	18.1	5.9
Total current expenditure	**63.6**	**61.1**	**2.6**	**4.2**	**246.3**	**235.5**	**10.8**	**4.6**	**469.0**	**461.3**	**7.7**	**1.7**	**715.3**	**696.9**	**18.5**	**2.7**
Depreciation	1.6	1.5	0.0	3.0	6.3	6.2	0.2	2.8	12.8	12.4	0.4	3.2	19.1	18.6	0.6	3.1
CG current budget deficit	**-2.7**	**-5.7**	**3.0**	**-53.2**	**6.2**	**0.9**	**5.3**		**-33.5**	**-26.2**	**-7.3**	**28.0**	**-27.4**	**-25.3**	**-2.0**	
CG net investment	4.0	2.4	1.6	64.5	14.0	11.6	2.4	20.7	35.7	32.8	2.9	8.7	49.7	44.4	5.3	11.8
of which: CG capital grants to LA	1.0	0.8	0.2	19.4	4.4	4.0	0.4	8.8	7.2	7.6	-0.4	-5.2	11.6	11.6	0.0	-0.4
CG net borrowing	**1.3**	**-3.3**	**4.6**		**20.2**	**12.5**	**7.7**	**61.8**	**2.2**	**6.6**	**-4.5**		**22.3**	**19.1**	**3.2**	**16.9**
Local authorities net borrowing	-2.2	-1.9	-0.3		-3.6	-4.5	0.8	-18.4	12.9	10.6	2.3	22.0	9.3	6.1	3.2	51.4
Public corporations net borrowing	-0.4	1.6	-2.0		-0.5	2.0	-2.5	-123.8	-1.8	-3.7	1.9		-2.3	-1.6	-0.6	38.9
Public sector net borrowing	**-1.3**	**-3.6**	**2.2**	**-63.0**	**16.0**	**10.0**	**6.0**	**60.0**	**13.3**	**13.6**	**-0.3**	-2.0	**29.3**	**23.6**	**5.7**	**24.3**
Public sector net investment	**3.6**	**2.3**	**1.3**	**54.1**	**9.9**	**8.6**	**1.3**	**15.0**	**37.1**	**33.0**	**4.1**	**12.3**	**47.0**	**41.7**	**5.4**	**12.9**
Public sector current budget	**-4.9**	**-5.9**	**1.0**	**-16.7**	**6.1**	**1.4**	**4.7**	**340.3**	**-23.8**	**-19.4**	**-4.3**		**-17.7**	**-18.1**	**0.4**	

March 2019 EFO forecast published 13 March 2019 excluding public sector banks on a National Accounts basis.

[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/july2019
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://cdn.obr.uk/EFO_March-2019.pdf

[2] Net of abatement.