Office for
Budget
Responsibility

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Commentary on the Public Sector Finances release: September 2016

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the September 2016 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 2016 *Economic and fiscal outlook (EFO)*.

2. Our next *EFO* will be published on 23 November, the day after the next public finances data release, so we do not plan to publish a commentary on next month's figures. We will not have pre-release access to that data release to inform our November forecast, which will have been closed on 18 November. But we will be able to draw on administrative sources consistent with some elements of the full dataset – in particular in relation to tax receipts.

3. Our November forecast will be produced on the basis of the classification decisions that the ONS has announced in today's release (described at the end of this commentary), even where those decisions will not be implemented in the official data until a later date. The most significant of these are the change to the accruals treatment of corporation tax receipts and the treatment of forthcoming lending under the Bank of England's new Term Funding Scheme as an illiquid asset for the purposes of public sector net debt.

Summary

4. Public sector net borrowing (PSNB) was £10.6 billion in September, up £1.3 billion on a year earlier and £2.1 billion above market expectations. The main reason for the rise in borrowing on last year was a 4.5 per cent rise in central government spending, only partly offset by a 2.6 per cent rise in central government receipts. The rise in spending reflects an increase in debt interest payments and a different monthly profile of EU payments.

[1] https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/sept2016

5. Meeting our March *EFO* forecast for PSNB in 2016-17 would require it to fall by £20.5 billion over the full financial year. Six months into the year, PSNB was only £2.3 billion lower than last year. Growth in PAYE, NICs and stamp duty land tax (SDLT) in particular have been slower than would be required to meet our March forecast for the year as a whole. But this weakness is not seen across all receipts streams – corporation tax has shown stronger growth so far this year than assumed for the full year.

6. While it is now clear that our March forecast is very unlikely to be met, the full-year fall in borrowing is also unlikely to be as simple as twice the £2.3 billion fall seen in the first half of the year. First, the year-to-date comparison is affected by one-off factors which reduced borrowing by around £1 billion in the early part of last year.[2] Second, we expect receipts to be end-loaded during 2016-17. In particular, we expect a £2½ billion boost to self-assessment (SA) income tax receipts over the last few months of the year, reflecting forestalling ahead of the April 2016 rise in dividend tax (SA receipts are received with a one year lag).

7. We have now had three full months of data since the UK's referendum on membership of the EU, but it is still too early to assess its impact on the public finances. It is possible that some of the weakness in income tax and NICs receipts could reflect uncertainty in the run-up to and aftermath of the referendum. And looking at the three possible early indicators of its effects that we identified in July:

- **SDLT receipts** are sensitive to changes in market sentiment. In the July-to-September post-referendum period receipts are up 0.4 per cent, much lower than our March forecast for 19 per cent growth over the year as a whole. Uncertainty around the referendum result seems to have reduced receipts growth, with falls in receipts from top-end residential and commercial transactions, particularly in London;

- central government **debt interest payments** are higher this September than last year, however this will not yet fully reflect recent increases in RPI inflation due to the lagged nature of the impact of RPI on index-linked gilts. To the extent that the drop in the value of the pound since the referendum pushes up RPI inflation via its effect on import prices, that will raise spending associated with index-linked gilts with a lag of three to eight months. Gilt yields have risen over the past month, but remain lower than pre-referendum. The impact of this will take much longer to manifest itself significantly because of the long-average maturity of the outstanding stock. September payments on the Bank of England's reserve liabilities, including those raised to finance the Asset Purchase Facility (APF) will have been reduced by the 0.25 per cent cut in Bank Rate last month. This reduces the cost of financing the APF's liabilities; and

- quarterly instalment payments of **CT receipts** by large firms partly reflect their expectations of profits for the whole financial year. July CT receipts were stronger than expected, but much of this strength related to liabilities from previous years, making it difficult to infer any referendum related effect. Instalment payments in October may

[2] See our commentary on the August 2016 PSF release for more detail.

provide more information. We will have access to administrative data on those payments before we close our November *EFO* forecast.

Detailed commentary

8. PSNB was £10.6 billion in September, up £1.3 billion on last year. A £2.5 billion rise in central government spending was only partly offset by a £1.2 billion rise in central government receipts. Borrowing by local authorities was up by £0.3 billion on a year earlier, while borrowing by public corporations was down by £0.2 billion on a year earlier.

9. Central government (CG) accrued receipts (excluding APF transfers) in September were up 2.6 per cent on a year earlier. The rise was driven by growth in NICs receipts, reflecting the abolition of the contracting-out rebate from April 2016 (which is expected to raise £5.6 billion over the whole of 2016-17). September growth in PAYE IT, VAT and CT receipts were weaker than our full year forecast.

10. For the first six months of 2016-17, 3.5 per cent growth in CG receipts (ex-APF) was slower than the 5.2 per cent needed to meet our full-year forecast (on a like-for-like basis). As discussed in paragraph 6, our March 2016 forecast for SA income tax assumes a 24 per cent rise in receipts in 2016-17 as a whole, boosted by forestalling from the pre-announced dividend tax rise. The majority of SA receipts are received towards the end of the tax year in January and February. But growth in PAYE IT and NICs receipts of 4.0 per cent in the year-to-date is significantly below our full-year forecast of 7.5 per cent. Growth in PAYE IT and NICs receipts have been weak both before and after the EU referendum. In contrast, year-to-date CT receipts have risen slightly more than our full-year forecast assumes.

11. Total CG spending in September was £2.5 billion higher than a year earlier, reflecting a £1.8 billion increase in current spending and a £0.7 billion increase in capital spending. The higher current spending reflected higher debt interest payments (up by £0.9 billion, reflecting differences in the monthly profile of RPI), higher payments to the EU (up by £0.7 billion), and higher other current spending on public services (up by £0.6 billion). The higher payments to the EU reflect a different monthly profile. The payment this September is a full month's payment, whereas the payment in September 2015 was around a third of the normal monthly payment. That lower profile was unwound later in the year. Other current spending on public services was 2.4 per cent higher than a year ago. This was a lower than the 5.0 per cent increase expected for the year as a whole in our March *EFO*, but the profile of monthly payments will change between years.

12. For the first six months of the financial year, total CG spending excluding grants to local authorities increased by 3.4 per cent, in line with our forecast (on a like-for-like basis) of 3.4 per cent for 2016-17 as a whole. Current and capital grants to local authorities were £3.0 billion lower over the first six months. That mainly reflected the expected reductions in the Revenue Support Grant, where the initial payments of grants were £3.0 billion lower in April this year. Reductions in CG grants are likely to have an offsetting effect on local authority borrowing in the short term.

13. Public sector net debt (PSND) in September fell by 1.0 per cent of GDP on a year earlier. The year-on-year comparison has been helped by large gilt auction premia (due to the fall in gilt yields, particularly on index-linked gilts) and revaluation effects from the unhedged components of the official foreign currency reserves (due to the fall in sterling). Much of the nominal GDP denominator used in the ratio remains a forecast,[3] so this is likely to be revised in future. Our March forecast assumed a 1.1 per cent of GDP fall in PSND between the end of 2015-16 and the end of 2016-17. That reflected a further expected fall in borrowing and the Government's announced programme of financial asset sales, which was expected to raise £21 billion in 2016-17. So far this year, the PSND figure has been reduced by only £0.5 billion by asset sales, reflecting the balancing payment on the sale of the Granite securitisation vehicle relating to former Northern Rock mortgages. Any effects of post-referendum financial market volatility or other factors on the Government's plans for financial asset sales – and the proceeds they might generate – will be factored into our next forecast in November.

Table 1.1: Accrued and cash borrowing measures, and public sector net debt

	September			Full year		
	£ billion			£ billion		
	2016	2015	change	2016-17 forecast	2015-16 outturn	change
Public sector net borrowing[1]	73.8	87.4	-13.7	55.5	76.0	-20.5
CG net cash requirement ex[1,2]	85.3	87.3	-2.0	62.1	78.5	-16.4
Public sector net cash requirement[1]	44.0	67.7	-23.7	58.1	52.1	6.0
	Public sector net debt (PSND)					
PSND (£ billion)	1627	1588	40	1638	1603	36
PSND (per cent of GDP)	83.3	84.3	-1.0	82.6	84.0	-1.4

[1] 12 month rolling total.

[2] CGNCR excluding NRAM, B&B and Network Rail.

March 2016 EFO forecast published 16 March 2016 excluding public sector banks on a National Accounts basis.

Methodological and classification changes

14. This month, the ONS has announced that it plans to move from a cash-based measure of corporation tax receipts to an accruals-based measure. This change would move cash receipts so that the four quarterly instalment payments fell into the correct accounting year. The ONS expects that the net effect of these changes will be to increase central government receipts by approximately £1.4 billion in 2013-14.

15. We plan to reflect this methodology in our November forecast, anticipating its implementation by the ONS next year. As we have set out in previous *EFOs,* this methodology change will remove much of the effect on PSNB from the July 2015 measure to bring forward payment dates for large companies in 2017-18. The implementation date was moved back two years to 2019-20 in the March 2016 Budget. In our March *EFO*, we estimated that this measure

[3] For the full financial year, the GDP denominator used in the PSND to GDP ratio is centred end-March. For the end of 15-16, this would be sum of the fourth quarter of 2015 and the first three quarters of 2016. The denominator for the end-September 2016 ratio would be the sum of the second, third and fourth quarters of 2016 and the first quarter of 2017.

would increase cash receipts by around £6 billion in 2019-20 and by around £4 billion in 2020-21.

16. The ONS has also announced its classification decision on the Term Funding Scheme (TFS) announced by the Bank of England in August. The TFS provides Bank of England funding to UK banks and building societies that choose to participate. They will be able to borrow for four years. Use of the scheme will add to PSND, since the reserves created to finance it will add to debt but loans will be treated as illiquid assets that do not net off PSND. The value of lending in the TFS will be determined by participants' demand for the scheme. The Bank of England has noted that *"the value of this lending would increase in line with the amount outstanding in the TFS and could reach around £100 billion – though in practice the amount will be determined by the usage of the scheme"*.

17. We will incorporate this classification decision in our November forecast. We will also update our debt forecast to include other effects from August's monetary policy announcements. Corporate bond purchases of up to £10 billion would raise PSND by an equivalent amount, while further gilt purchases will affect PSND in the same way as previous purchases via the difference between the nominal value of the gilts purchased and the market price paid by Bank of England when they are purchased.

18. In 2015, the ONS implemented its decision to reclassify private registered providers of social housing in England into the public sector (see Annex B of our November 2015 *EFO* for more detail). It will now extend that coverage to private registered providers of social housing in Scotland, Wales and Northern Ireland. In 2015-16, this is expected to increase PSNB by approximately £0.4 billion and to increase PSND by between £6.5 billion and £7.0 billion.[4]

Issues for next month's release

19. October is an important month for corporation tax. Many medium and large onshore firms will pay the second of four instalment payments on their 2016 profits.

[4] For more information: https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/statisticalclassificationofregisteredprovidersofsocialhousinginscotlandwalesandnorthernireland/september2016

Table 1.2: Public sector receipts, expenditure and net borrowing[1]

£ billion	September				April to September				Implied October to March				March forecast			
			change				change				change		2016-17	2015-16	change	
	2016	2015	£bn	%	2016-17	2015-16	£bn	%	2016-17	2015-16	£bn	%	March EFO	outturn	£bn	%
Central government (CG) current receipts																
Taxes on production	20.7	20.3	0.4	2.1	123.5	119.7	3.8	3.1	129.8	122.7	7.1	5.8	253.3	242.4	10.9	4.5
Of which: VAT (accrued)	11.1	10.9	0.2	1.4	65.9	64.4	1.5	2.3	68.9	66.1	2.8	4.3	134.8	130.5	4.3	3.3
Taxes on income and wealth	13.8	13.9	-0.1	-0.6	99.7	97.1	2.6	2.7	133.2	123.4	9.7	7.9	232.9	220.5	12.3	5.6
Of which:																
Income tax and CGT (accrued)	11.4	11.3	0.1	1.2	78.7	76.6	2.1	2.7	110.4	99.3	11.1	11.2	189.1	175.9	13.2	7.5
Corporation tax	2.3	2.5	-0.2	-8.7	21.0	20.3	0.7	3.5	22.5	24.1	-1.7	-6.8	43.5	44.4	-0.9	-2.1
Other taxes	1.6	1.6	0.0	0.1	9.4	9.5	-0.1	-1.0	8.7	9.2	-0.5	-5.2	18.1	18.6	-0.6	-3.1
Compulsory social contributions	9.8	9.0	0.7	8.0	59.3	55.4	3.9	7.0	67.2	58.7	8.5	14.5	126.5	114.1	12.4	10.9
Interest & dividends	1.1	1.1	0.0	2.3	9.4	8.6	0.8	9.0	9.5	8.6	0.9	10.5	18.9	17.2	1.7	9.8
Other receipts	1.9	1.8	0.1	7.5	11.5	11.5	0.1	0.5	11.5	11.0	0.5	4.6	23.0	22.5	0.6	2.5
Total CG current receipts	**49.0**	**47.7**	**1.2**	**2.6**	**312.7**	**301.8**	**11.0**	**3.6**	**359.8**	**333.5**	**26.3**	**7.9**	**672.6**	**635.3**	**37.3**	**5.9**
CG current expenditure																
Interest payments	3.3	2.5	0.9	34.6	25.8	23.9	1.9	7.9	22.0	21.2	0.8	3.7	47.8	45.1	2.7	5.9
Net social benefits	17.2	17.2	0.0	0.1	102.7	101.9	0.8	0.8	103.2	101.6	1.5	1.5	205.9	203.5	2.4	1.2
CG current grants to LAs	9.1	9.4	-0.3	-3.0	59.3	62.8	-3.5	-5.5	55.5	55.2	0.3	0.5	114.8	118.0	-3.2	-2.7
Other	24.8	23.5	1.2	5.3	144.8	139.2	5.6	4.0	153.9	146.7	7.2	4.9	298.7	285.9	12.8	4.5
Total current expenditure	**54.4**	**52.6**	**1.8**	**3.5**	**332.6**	**327.8**	**4.9**	**1.5**	**334.5**	**324.7**	**9.8**	**3.0**	**667.1**	**652.5**	**14.6**	**2.2**
Depreciation	1.7	1.5	0.1	8.9	9.8	9.1	0.7	8.1	9.7	9.2	0.5	5.3	19.6	18.3	1.2	6.7
CG current budget deficit	**7.1**	**6.4**	**0.7**		**29.7**	**35.1**	**-5.4**	**-15.3**	**-15.6**	**0.4**	**-16.1**		**14.1**	**35.6**	**-21.4**	**-60.2**
CG net investment	2.8	2.2	0.5	24.2	16.0	15.0	1.0	6.8	22.9	18.7	4.2	22.4	38.9	33.7	5.2	15.5
of which: CG capital grants to LA	0.6	0.7	0.0	-5.9	6.5	6.0	0.4	7.1	7.6	5.8	1.8	30.5	14.0	11.8	2.2	18.6
CG net borrowing	**9.9**	**8.6**	**1.3**	**14.8**	**45.8**	**50.1**	**-4.4**	**-8.7**	**7.3**	**19.1**	**-11.9**	**-62.1**	**53.0**	**69.2**	**-16.2**	**-23.4**
Local authorities net borrowing	1.7	1.4	0.3		0.0	-2.3	2.3		2.5	9.2	-6.7	-72.7	2.5	7.0	-4.4	
Public corporations net borrowing	-1.0	-0.7	-0.2	31.9	-0.3	-0.1	-0.2		0.3	0.0	0.3	###	0.0	-0.1	0.1	
Public sector net borrowing	**10.6**	**9.3**	**1.3**	**14.5**	**45.5**	**47.7**	**-2.3**	**-4.8**	**10.0**	**28.3**	**-18.3**	**-64.6**	**55.5**	**76.0**	**-20.5**	**-27.0**
Public sector net investment	**3.2**	**2.6**	**0.6**	**22.1**	**13.6**	**13.1**	**0.5**	**3.7**	**22.8**	**20.3**	**2.5**	**12.2**	**36.4**	**33.4**	**3.0**	**8.9**
Public sector current budget	**7.4**	**6.7**	**0.8**		**31.9**	**34.7**	**-2.8**	**-8.0**	**-12.8**	**8.0**	**-20.7**		**19.1**	**42.6**	**-23.5**	

March 2016 EFO forecast published 16 March 2016 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/sept2016
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: http://budgetresponsibility.org.uk/download/economic-and-fiscal-outlook-march-2016/
OBR supplementary fiscal tables: http://budgetresponsibility.org.uk/download/economic-and-fiscal-outlook-supplementary-fiscal-tables-march-2016/