

Commentary on the Public Sector Finances: August 2020

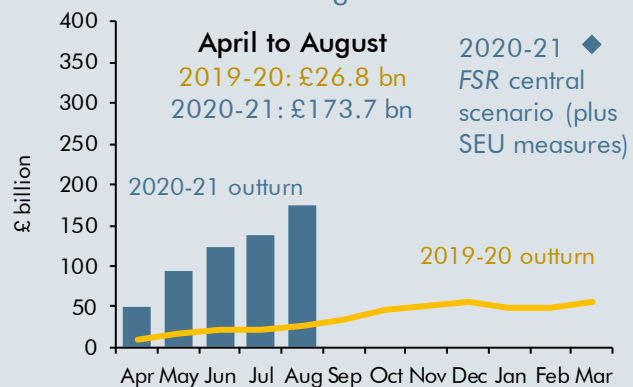
Office for
**Budget
Responsibility**

25 September 2020

Budget deficit reaches £174 billion in just five months

Less than halfway through the 2020-21 fiscal year, the budget deficit has already topped full-year borrowing in 2009-10 (at the peak of the financial crisis). Despite that, year-to-date borrowing is lower than assumed in the central scenario from our *Fiscal sustainability report*, as both GDP and tax receipts have fared less badly than assumed. With the virus taking hold again and the Chancellor announcing new support measures, prospects for the rest of the year remain highly uncertain.

Public sector net borrowing



Headlines

- Today's data highlight the growing fiscal cost of the **coronavirus crisis**, although it will still be many months before the full impact of the shock becomes clear.
- **Public sector net borrowing (PSNB)** totalled £35.9 billion in August, £2.1 billion lower than market expectations. Borrowing over the first five months of the year reached £173.7 billion, despite the deficit for April to July being revised down by £12.7 billion.
- **HMRC cash receipts** over the first five months of 2020-21 were 26 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 were also down on a year earlier, but fell by less than assumed in our central scenario.
- **Central government spending** so far in 2020-21 is 33 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 21.8 per cent of GDP on a year earlier to 101.9 per cent in August, its highest level since 1960-61.

Monitoring the public finances through the lockdown

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the August 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 impact on the economy and public finances of 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.
2. In a Written Statement on 11 September, the Chancellor informed Parliament that he has requested the OBR to prepare an economic and fiscal forecast to be published in mid to late November. This *Economic and fiscal outlook* will take account of the cost of all government policy measures announced by that point, including those set out by the Chancellor in the Winter Economic Plan presented to Parliament on 24 September, and any others we are notified of prior to publication.

The public finances in August 2020

3. Today's initial estimate of public sector net borrowing (PSNB) in August 2020 was £35.9 billion, up £30.5 billion on August 2019 but £2.1 billion lower than market expectations. The sharp rise on last year reflected a £21.3 billion rise in central government spending, plus an £8.5 billion fall in central government receipts (excluding transfers relating to the Asset Purchase Facility). Local authorities' borrowing was up £1.1 billion on last year, reflecting higher spending. Borrowing by public corporations (excluding APF transfers) was £0.4 billion down on last year.
4. Over the first five months of the year, PSNB totalled £173.7 billion, up £146.9 billion on the same period last year. Year-to-date borrowing has now exceeded the record annual total of £157.7 billion, set during the peak of the financial crisis in 2009-10. The jump in year-to-date borrowing comes despite PSNB across April to July being revised down by £12.7 billion this month, almost entirely explained by updated estimates of departmental spending. The revision also reflects a number of statistical and accounting treatment changes, including the reclassification of the 'Pool Re' into the public sector and changes to estimates of funded public sector pensions schemes. Overall, these statistical changes reduced PSNB by £3.9 billion in 2019-20. We will reflect them in our next forecast in mid-November.
5. PSNB over the first five months of 2020-21 is currently £49.8 billion (22.3 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 £15.7 billion over this period in our scenario), which is not currently recorded in the outturn data. The remaining £34.2 billion (15.3 per cent) like-for-like difference is explained by lower outturn central government spending and by stronger HMRC cash receipts over June to August. The recent strength in tax receipts is partly down to timing effects, with some of the arrears built up at the start of the

¹ <https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/August2020>

year being repaid sooner than assumed (perhaps as taxpayers' cashflow was boosted by various Government support schemes). But it also appears to be broadly consistent with the faster-than-assumed recovery in real GDP through the summer.

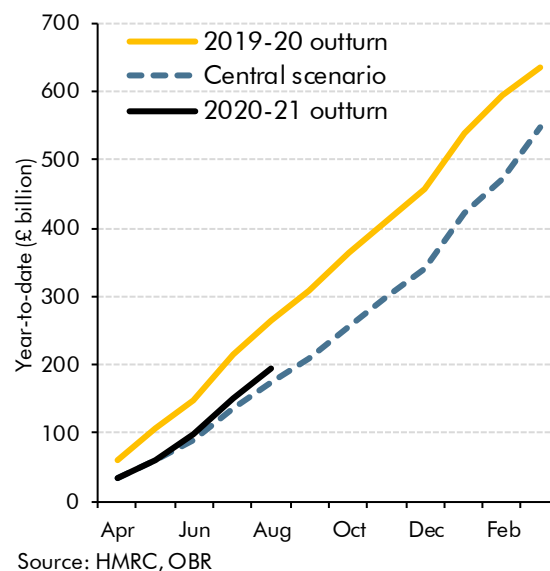
6. As we have stressed, and as has again been illustrated by the revisions to outturn data reported today, initial estimates of accrued spending, receipts and borrowing are likely to be particularly prone to revision over the coming months. In many cases, the outturn data are currently based on our scenario 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.

Receipts

Cash receipts collected by HMRC

HMRC collects around 90 per cent of all central government cash receipts. Receipts in the first five months of 2020-21 were down by £69.9 billion (26 per cent) on last year, but were £20.8 billion (12 per cent) higher than our central scenario.

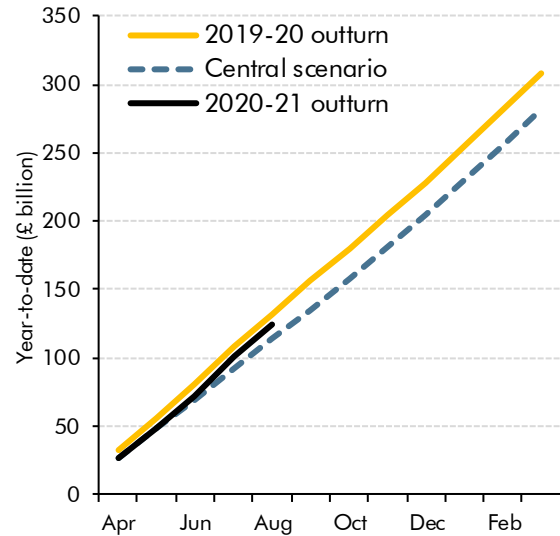
PAYE income tax and NICs account for more than half the surplus against our scenario, with VAT and self-assessment (SA) income tax making up most of the remainder. In part, this outperformance will reflect the strength in recent GDP data. It will also be heavily influenced by differences in the pattern of deferred and unpaid tax liabilities, including in response to the VAT and SA deferral schemes. These latter differences are likely to be temporary in nature and so comparisons of the receipts and GDP data should be interpreted with some caution.



PAYE income tax and National Insurance contributions (cash basis)

August cash receipts for PAYE income tax and NICs mainly relate to July liabilities. Cash receipts in August continue to be unexpectedly strong, up 1.7 per cent on a year earlier. Total receipts for the first five months of this year are £10.9 billion (10 per cent) above our central scenario. HMRC's 'real-time information' (RTI) for July shows growth in median pay alongside a decline in the number of employees, suggesting a concentration of job losses at the lower end of the income distribution.

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

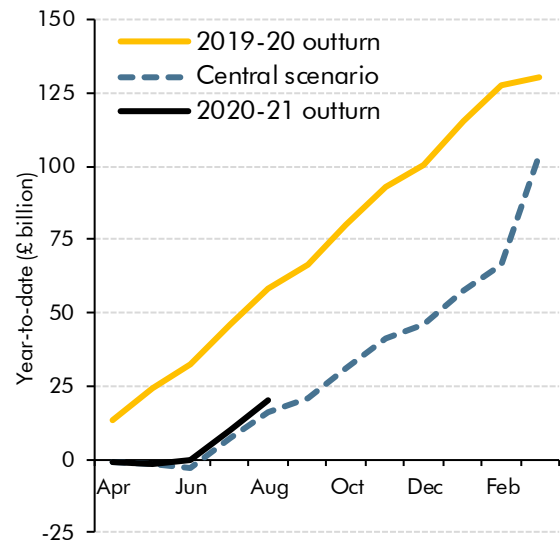


Source: HMRC, OBR

VAT receipts (cash basis)

Cash VAT receipts in August were £10.1 billion, continuing the strong rebound seen in July following the end of the Government's VAT deferral scheme on 30 June. August receipts were 17 per cent above our central scenario, which in part is explained by strength in consumer spending.

Total receipts so far this year are £4.4 billion (28 per cent) 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.

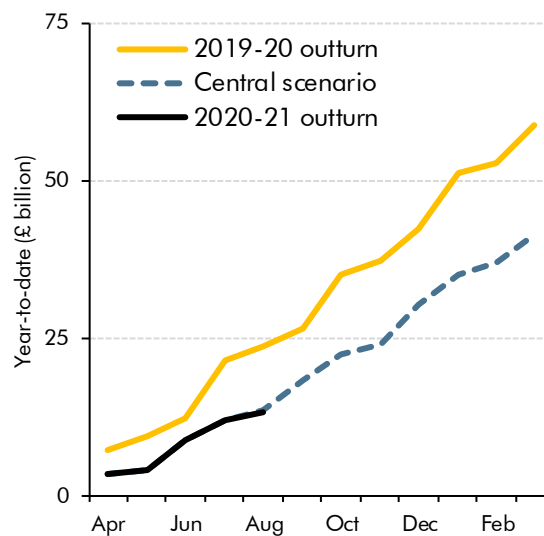


Source: HMRC, OBR

Onshore corporation tax receipts (cash basis)

On a cash basis, year-to-date onshore corporation tax receipts were down £10.2 billion (43 per cent) on last year – 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

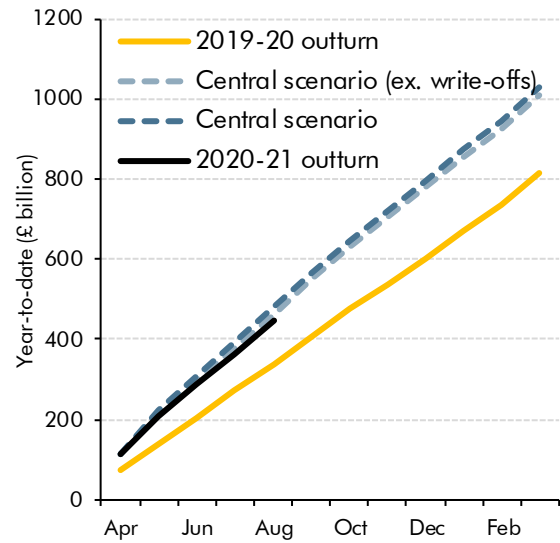
Other notable movements in cash receipts include:

- **Self-assessment (SA)** income tax receipts in August were £1.7 billion higher than assumed in our central scenario. This relates to SA taxpayers' second payments-on-account, which are due in July but partly spill over into August. As we set out last month, many fewer taxpayers' have utilised the Government's deferral scheme than was assumed in our central scenario.
- **Fuel duty** receipts for April to August were down £3.9 billion (33 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 44 per cent on last year, but is £0.3 billion (15 per cent) above our central scenario. **Stamp duty on shares** is up 10 per cent on last year, having been boosted by higher stock market turnover.
- **Alcohol duty** receipts are up 2.2 per cent year to date relative to last year and were up 20 per cent in August alone. That has left receipts £0.9 billion (23 per cent) above our central scenario in the year to date.
- **Air passenger duty** remains exceptionally weak where year to date receipts are down 90 per cent on last year 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 £111.8 billion (33 per cent) on last year, with that rate of growth continuing in August (up £21.3 billion or 34 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 £15.0 billion (3.2 per cent) below our scenario. That reflects lower than assumed spending on public services and on net social benefits, partly offset by higher net investment spending.

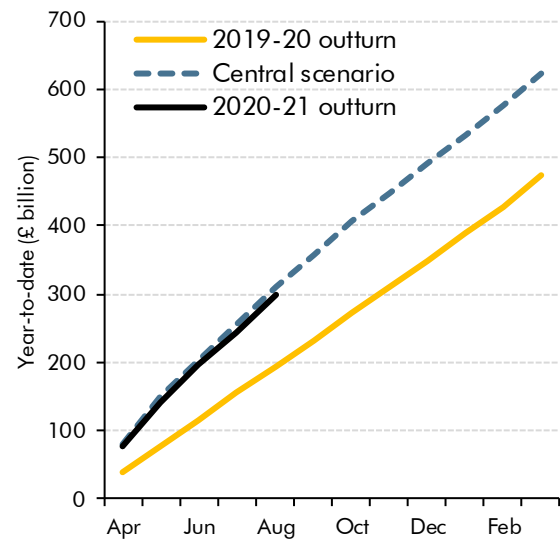


Source: ONS, OBR

'Other current expenditure' (largely departmental spending)

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

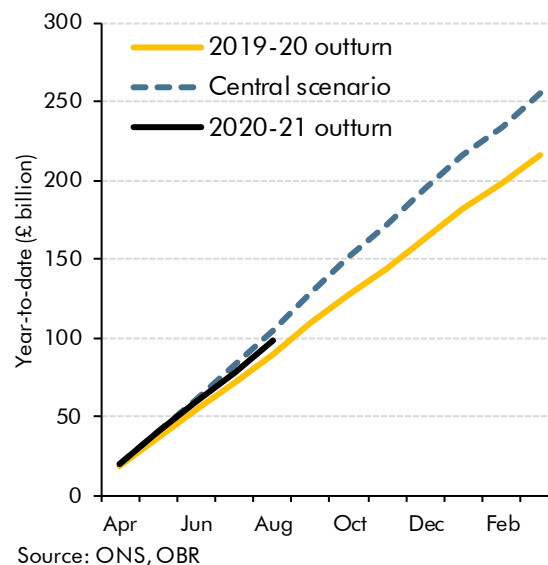
Year-to-date spending is up £105.5 billion (54 per cent) on last year, but £11.0 billion (3.6 per cent) lower than assumed in our central scenario. The jump relative to last year is largely explained by the CJRS (with around £42 billion accrued so far in 2020-21) and the SEISS (around £12.2 billion). Both are close to our scenario. Departmental spending in the early months of the year has been revised down significantly this month.



Source: ONS, OBR

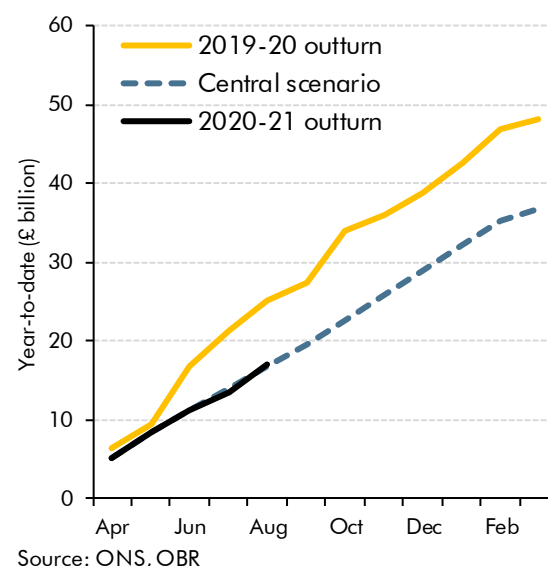
Net social benefits spending

This category includes both welfare spending and net public service pension payments. Year-to-date CG net social benefits spending is up £8.2 billion (9 per cent) on last year, but is £6.6 billion lower than our central scenario assumes. Given the sharp rise in the universal credit caseload, this is likely to reflect differences in the characteristics of new claimants that mean they are entitled to smaller awards on average than in our scenario.



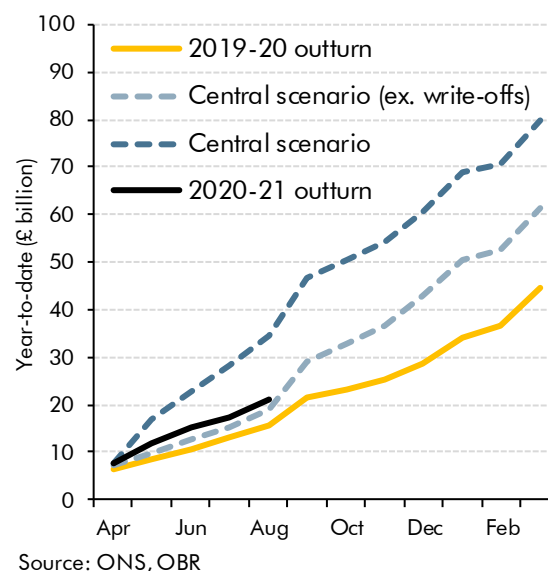
Central government debt interest spending

Debt interest spending so far this year is down £8.0 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.



Central government net investment

CG net investment so far this year is £5.7 billion (37 per cent) higher than last year. Abstracting from loan guarantee write-offs, spending is £2.3 billion (12 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 assumed that the disruption to construction activity would weigh on capital spending in the initial months of 2020-21, but to date that is not particularly apparent in the provisional data.

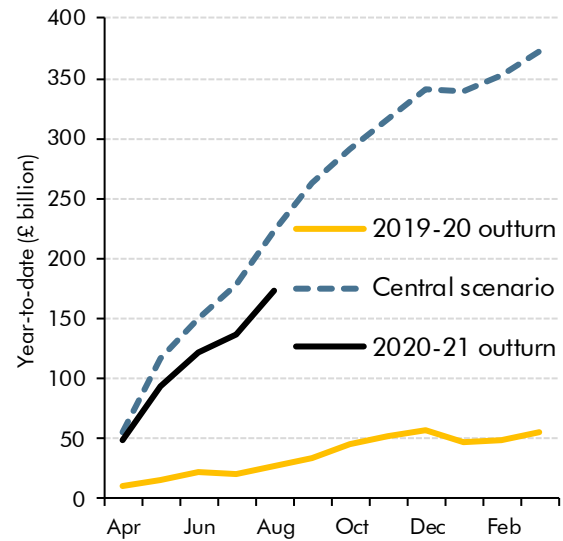


Fiscal aggregates

Public sector net borrowing (PSNB)

Public sector net borrowing so far in 2020-21 totalled £173.7 billion, up £146.9 billion on last year. Abstracting from loan guarantee write-offs, year-to-date borrowing is £34.2 billion lower than in our central scenario, partly because receipts have fallen less than assumed and partly as departmental spending has risen less than assumed.

PSNB across April to July was revised down by £12.7 billion, almost entirely explained by updated estimates of departmental spending.

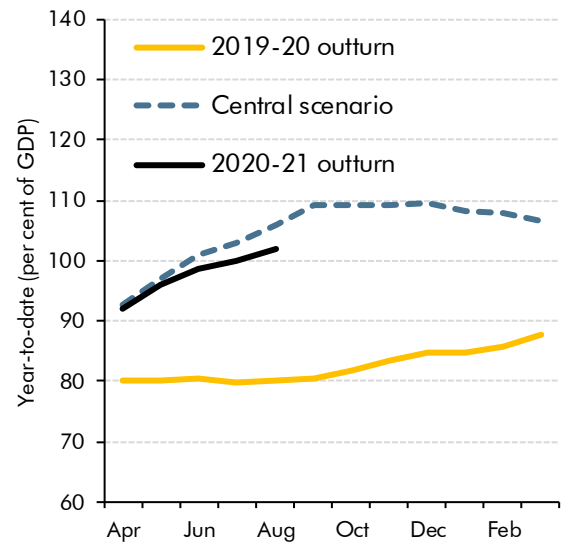


Source: ONS, OBR

Public sector net debt (PSND)

PSND in August rose 21.8 per cent of GDP on a year earlier to reach 101.9 per cent, its highest level since 1960-61. Cash debt rose by £249.5 billion relative to last August, reflecting both higher central government cash borrowing and the Bank of England's new Term Funding Scheme and the expansion of its gilt purchases.

The GDP denominator is still largely based on our central scenario and so further revisions will follow as it is replaced with outturn data.

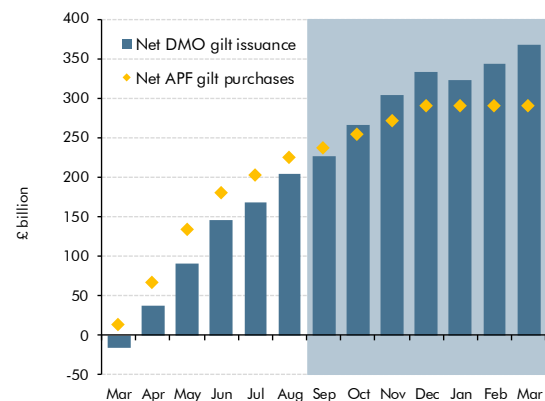


Source: ONS, OBR

Financing

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

To the end of August, the DMO issued £262 billion in gilts – 68 per cent of the £385 billion it plans to issue between April and November (net of redemptions, gilt issuance totalled £220 billion). By the same point, the Bank of England had purchased some £246 billion of gilts (out of a total of planned additional purchases of £300 billion). So, in effect, the Bank has purchased just £17 billion less from the private and overseas sectors than the DMO has issued (and £4 billion more on a net basis). To date the Treasury has not made use of its 'Ways & Means Facility' overdraft at the Bank.



Source: BoE, DMO, OBR

Issues for next month's release and beyond

7. 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 at the earliest opportunity. In the interim period, the ONS will continue to score payments to TOCs (recorded as subsidies to the private sector) as contributing to PSNB. Following the expiry of the EMAs in September, the Government announced that all rail franchises would be replaced by 'emergency recovery measures agreements' (ERMAs).³ The ONS has said it will consider the implications of this at the earliest opportunity and we will aim to incorporate recent announcements on the future of the rail network in our next *EFO*.

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

³ *Rail franchising reaches the terminus as a new railway takes shape*, DfT, 21 September 2020.