Commentary on the

Public Sector Finances: August 2019

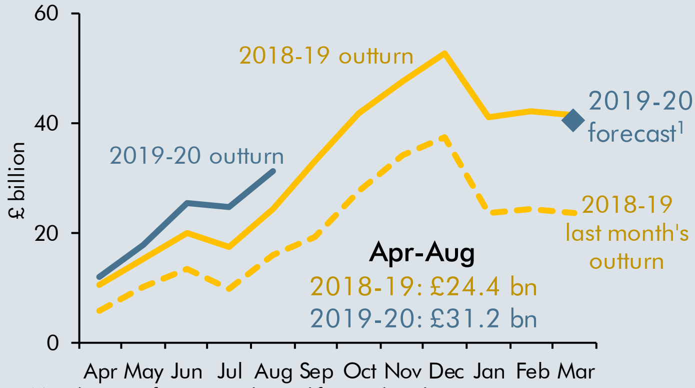
Office for Budget Responsibility

24 September 2019

Data revisions raise borrowing significantly

Borrowing in 2018-19 was revised up by £17.8 billion this month to £41.4 billion, thanks largely to statistical changes. These include planned improvements to the accounting treatment of student loans and a substantial correction to corporation tax data. The effect of the changes in 2019-20 leaves the deficit on course to exceed our March forecast (even restated for the new student loans treatment).

Cumulative public sector net borrowing



[1] March 2019 forecast adjusted for student loan estimate

Headlines

- **Public sector net borrowing (PSNB)** was £6.4 billion in August, £0.5 billion lower than a year ago. Lower borrowing this month contrasts with year-on-year rises in borrowing in each of the first four months of 2019-20.
- **Year-to-date borrowing** was up £6.8 billion (27.9 per cent) on the same period last year. In our March forecast (including our estimate at the time of the student loans change), we assumed a £7.2 billion (21.8 per cent) rise in borrowing for 2019-20 as a whole. Stronger than expected spending growth is driving the faster rise in the deficit so far this year.
- **Central government receipts** (excluding PSNB-neutral transfers related to 'quantitative easing') were up 3.4 per cent in August. Year-to-date receipts growth of 2.9 per cent is a little above our March forecast of a 2.6 per cent rise in 2019-20 (on a like-for-like basis).
- **Central government spending** (excluding PSNB-neutral grants to local authorities) was up 1.9 per cent in August and 5.1 per cent for the year to date, well above our March forecast of a 3.3 per cent rise in 2019-20 (on a like-for-like basis).
- **Net debt** was 1.5 per cent of GDP lower in August 2019 than a year earlier.

Full commentary

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the August 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*).

2. Substantial classification and other statistical changes incorporated into this month's release make like-for-like comparisons of forecast and outturn difficult. So, for this commentary, we have restated our March borrowing forecast for the student loans accounting treatment change, using the estimates presented in Annex B of our March *EFO*. These underestimated the upward revision to borrowing in 2018-19 by £1.9 billion, largely due to the treatment of student loan sales, which we could not anticipate at the time. Elsewhere we have concentrated on year-on-year changes which should be less affected by the various statistical changes. The level effects of these changes are described at the end of this commentary.

Public sector net borrowing

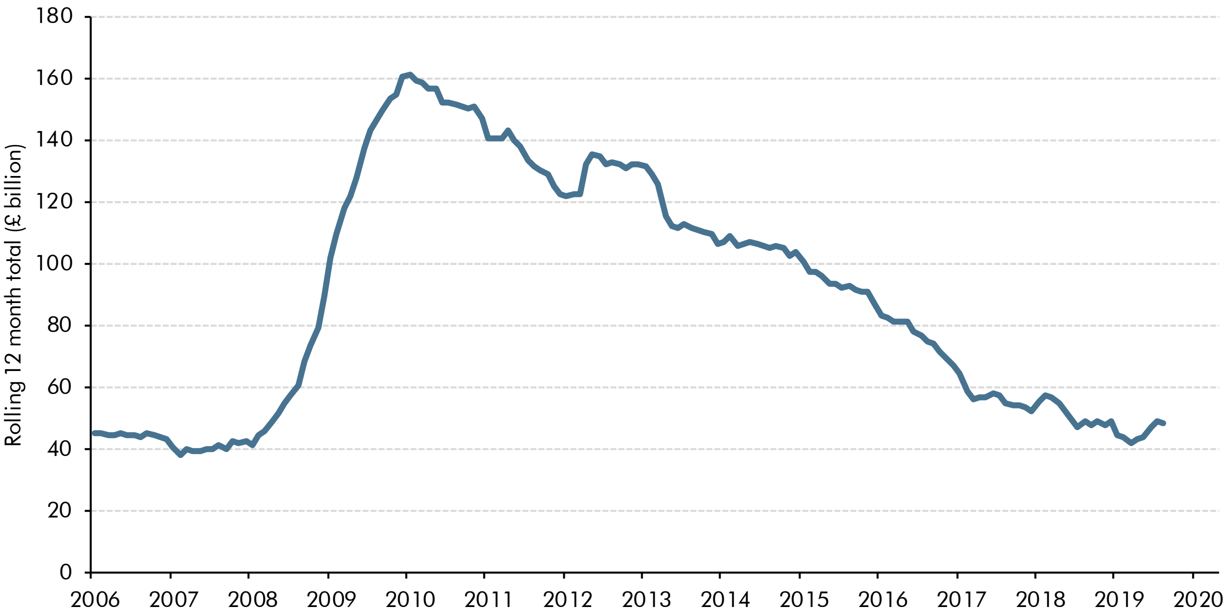
3. Public sector net borrowing (PSNB) was £6.4 billion in August, £0.5 billion lower than last year and £0.6 billion lower than market expectations. A £1.9 billion (3.4 per cent) rise in central government (CG) receipts outstripped a £0.5 billion (0.8 per cent) rise in CG spending. Borrowing by local authorities was £1.0 billion higher than last year while borrowing by public corporations was £0.1 billion lower.

4. While borrowing in August was down on last year, it had risen year-on-year in each of the first four months of 2019-20. This has left the year-to-date deficit £6.8 billion higher than at the same point in 2018-19. Our restated March forecast was for a £7.2 billion full-year rise in borrowing in 2019-20. This forecast rise reflects an expectation of slower growth in receipts due to the Budget 2018 policies raising the income tax personal allowance and higher rate threshold, and temporarily raising the annual investment allowance to £1 million, and to slower growth in the main tax bases in 2019. In addition, 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.

5. Chart 1.1 shows outturn PSNB on a 12-month rolling basis. It is already higher than our full-year 2019-20 forecast, thanks to the student loans accounting treatment change being larger than we anticipated in March, and to the other revisions – notably the correction to corporation tax data – that also raise borrowing. Following these revisions, it now seems likely that borrowing will exceed our restated March forecast for 2019-20.

[1] https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/august2019

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



Source: ONS, OBR

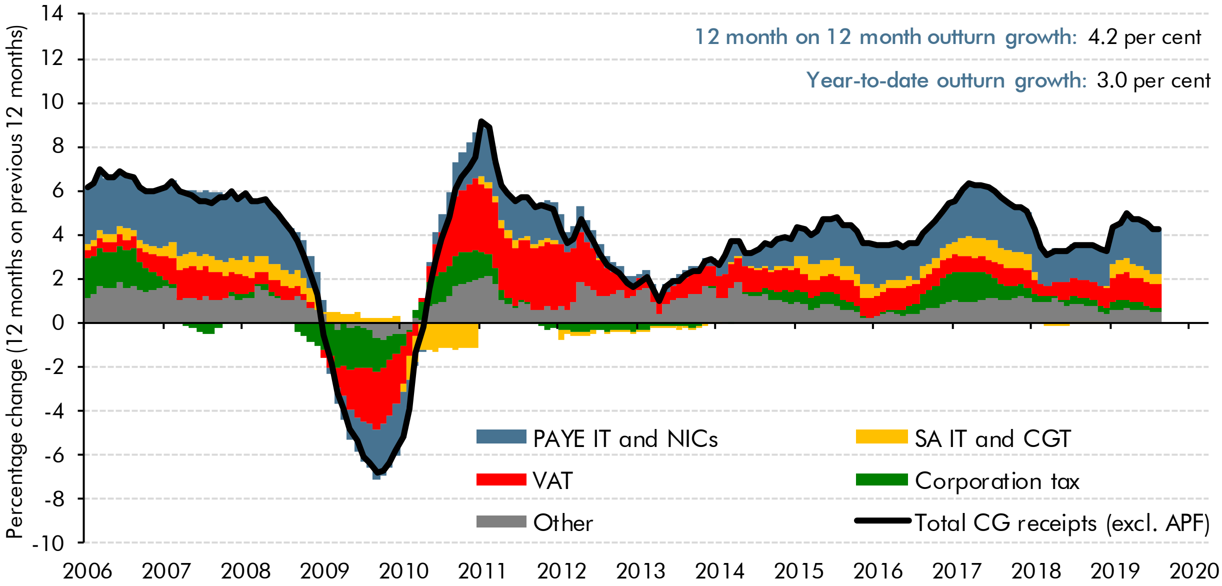
Central government receipts

6. Relative to last year, CG receipts (excluding APF transfers) were up 3.4 per cent in August and up 2.9 per cent in the first five months of 2019-20. Receipts growth in August mainly reflected rises in National Insurance contributions (NICs), self-assessment (SA) income tax and VAT receipts. SA income tax receipts were up 28 per cent in August on a year earlier. But as some payments are recorded in July and some in August, a full year-on-year assessment should look at the two months together. This shows receipts up 6.7 per cent on a year earlier. 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 3.9 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. Year-to-date receipts growth has also 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 5.9 per cent so far this year thanks to the slowing housing market. Inheritance tax is down 13.1 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

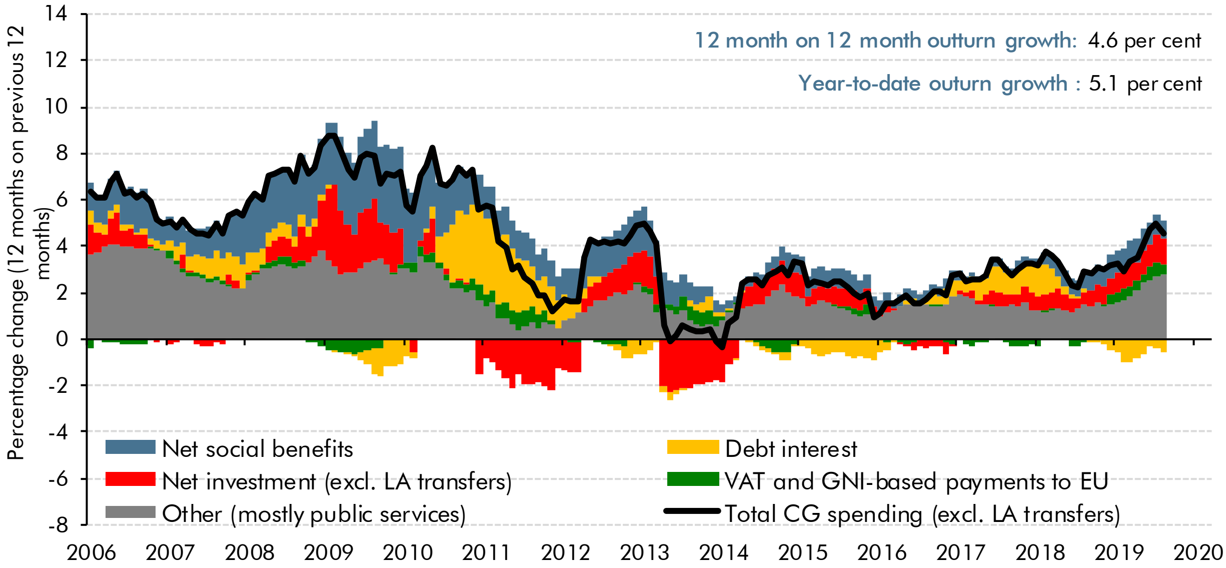
9. Relative to last year, total CG spending (excluding grants to local authorities) was up 1.9 per cent in August, up 5.1 per cent for the year to date and well above our March forecast for growth over 2019-20 as a whole. The £1 billion rise in CG spending on this basis in August was more than explained by a £1.7 billion rise in other CG current expenditure (largely spending on public services). This was partly offset by a £0.9 billion decline in debt interest payments. In the first five months of 2019-20, other CG current expenditure was up 7.6 per cent, boosted by the more generous NHS settlement.

10. Stronger than expected spending growth is fuelling a faster rise in the deficit than we forecast in March. It is too soon to say for certain whether this faster growth will persist through the year to outstrip our full-year forecast or whether it will slow further through the year. The growth rate in other CG current expenditure in the first five months of 2019-20 (7.6 per cent) is significantly higher than the 5.3 per cent in our March forecast for 2019-20 as a whole.

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 0.6 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 August 2019 was down 1.5 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 £5.0 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.

Classification and data changes

14. The ONS has incorporated several methodology and data changes in today's release. We will reflect these changes in our next fiscal forecast. They include:

- The improved accounting treatment of **student loans** adds £12.4 billion to borrowing in 2018-19. Outlays are no longer all treated as loans (since a significant proportion are expected to be written off rather than repaid). Instead, that portion is 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. In March we estimated that the new accounting treatment would add £10.5 billion to borrowing in 2018-19, widening to £13.6 billion by 2023-24. The difference between our March estimate and the ONS outturn in 2018-19 largely reflects the ONS treatment of sales of student loans at a discount to their value as recorded in the public finances, where spending equal to the discount adds to the deficit. We were not able to anticipate this effect in March. Incorporating it in our next forecast will add further to borrowing in all years in which loan sales are assumed to take place (i.e. 2019-20 to 2022-23).

- Correcting **corporation tax** (CT) data. First, HMRC identified a problem with the algorithm that split corporation tax data between larger quarterly payers and smaller annual payers. Correcting this adds £4.7 billion to payments from smaller payers in 2018-19 and lowers payments from larger instalment payers by the same amount. This has very little effect on cash receipts, but affects accrued CT receipts as recorded in the public finances due to the different accruals methods used for quarterly and annual payers. Second, HMRC identified double-counting of the directly payable tax credits element of CT receipts. This lowers accrued receipts by £2.6 billion in 2018-19. Both changes will affect our next forecast and are likely to persist over the medium term.

- Revisions to **capital stock and depreciation data** for Blue Book 2019. This adds £8.4 billion to depreciation in 2018-19, raising current spending and reducing net investment in equal measure. This worsens the current budget position, but leaves PSNB unchanged.

- Public employment-related funded **pension schemes and the Pension Protection Fund** have been recorded within the public sector boundary for the first time. Counterintuitively, this reduces public sector net debt in 2018-19 by £28.6 billion (1.3 per cent of GDP). This reflects the fact that the schemes hold some gilts and other liquid assets that net off PSND, but their liabilities are not 'debt liabilities' – they are accrued pension rights – so do not add to PSND.

15. It is not possible to say precisely what effect these changes will have on our next forecast or would have had on our March one, but clearly they leave measured PSNB and the current budget balance looking significantly worse and PSND a little better. The effect on PSNB is likely of the order of at least £15 billion a year (from the student loan accounting change and lower corporation tax) while the current budget could also be worse by around £15 billion a year (from the higher depreciation, lower corporation tax and the lower accrued student loan interest income).