

Commentary on the Public Sector Finances release: June 2016

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the June 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)*. Most of the period covered by these data preceded the referendum on membership of the EU, so they provide very little information about how the result of the referendum might affect the public finances during the rest of 2016-17.

Summary

2. Public sector net borrowing (PSNB) was £7.8 billion in June, £2.2 billion lower than last year, and £1.7 billion below market expectations. A rise in central government receipts of £2.0 billion relative to last year was partly offset by a £0.8 billion rise in central government spending. Borrowing by local authorities was £1.0 billion lower than last year while borrowing by public corporations was unchanged.
3. Meeting our March *EFO* forecast for PSNB in 2016-17 would require it to fall by £19.8 billion over the full financial year, relative to the latest revised estimate of borrowing in 2015-16. A quarter of the way through the financial year, PSNB was only £2.3 billion lower than last year – although the overall pace of improvement has picked up month by month over the first quarter. While prospects for the rest of the year are subject to greater uncertainty than usual due to the result of the EU referendum, it is still worth noting that receipts and spending data are volatile from month to month and prone to revision, especially at this relatively early stage of the year. The year-to-date comparison has been affected by:
 - **one-off factors** affecting last year that were not repeated this year. Capital receipts of £0.5 billion from the British Coal staff superannuation scheme reduced net capital

¹ <https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/june2016>

spending in April 2015, while £0.6 billion of fines levied by the Financial Conduct Authority boosted receipts in May and June 2015; and

- we expect growth in **central government receipts to be end-loaded** during 2016-17. This is primarily because of the Government's decision to pre-announce the dividend tax increase which took effect in April 2016. Taxpayers are likely to have shifted dividend income into 2015-16 to pre-empt the higher rate, boosting receipts with a lag in 2016-17. We estimate that this will increase receipts by £2½ billion this year, which will show up in self-assessment (SA) receipts in January and February 2017.

4. Almost all the data for June in this month's release reflect economic activity prior to the EU referendum. That means that there is little firm evidence here on how the referendum result might affect the public finances this year. However, there is already some evidence that growth in PAYE, NICs and stamp duty land tax (SDLT) was slower in the first three months of the year than would be required to meet our March forecast for the year as a whole. In particular, SDLT receipts in May and June were 1.5 per cent down on a year earlier, compared with our full-year forecast growth of around 19 per cent. In part this is likely to reflect the larger-than-expected rush of property purchases that took place ahead of the pre-announced 3 per cent surcharge on second homes that took effect in April – more forestalling at the end of 2015-16 would imply less activity at the start of 2016-17. But uncertainty prior to the referendum may also have contributed to the weakness of receipts related to residential and commercial properties in London and higher-priced transactions in general.

5. Looking ahead, it is unlikely that the monthly public finances data will provide any clear signals about the impact of the referendum result for some time:

- the most forward-looking component of receipts is the quarterly **corporation tax** (CT) instalments paid by large firms. These should reflect firms' profit expectations for the tax year, rather than past performance. July is the next big month for quarterly CT payments, but it will be very difficult to interpret those data. Firms' expectations for taxable profits will be affected by what they expect to happen to their domestic and overseas sales and how their investment plans and other costs evolve. Any changes driven by these factors are likely to offset each other to some extent;
- one area where relatively clear signals are likely to emerge is the effect of property market developments on **SDLT**, where HMRC's administrative data are relatively timely, detailed and complete; and
- the referendum result might be expected to affect **debt interest spending** through three main channels. First, any changes to short-term interest rates would affect the cost of servicing short-term debt and the saving associated with gilts held in the Bank of England's Asset Purchase Facility. Second, any significant depreciation of sterling would likely push up accrued interest on index linked gilts, as higher import costs increase RPI inflation. And, third, any decline in gilt yields would reduce the cost of servicing conventional gilts. The short-term interest rate effect is very rapid and the RPI effect would show up with a roughly three to eight month lag. But the impact of

changing gilt yields would take much longer to manifest itself, because of the long average maturity of the outstanding stock of conventional gilts.

Detailed commentary

6. Public sector net borrowing (PSNB) was £7.8 billion in June 2016, £2.2 billion lower than last year. Lower borrowing reflects a £2.0 billion year-on-year rise in central government receipts, partly offset by a £0.8 billion rise in central government spending. Borrowing by local authorities was £1.0 billion lower than last year, while borrowing by public corporations was unchanged.
7. Central government (CG) accrued receipts in June were up 4.2 per cent on a year earlier driven by a strong 11.1 per cent rise in NICs receipts. This reflects the abolition of the NICs contracting-out rebate from April 2016 (expected to raise £5.6 billion over the whole of 2016-17). For the first quarter of the financial year, growth in central government receipts (excluding APF transfers) of 3.5 per cent was slower than the 5.8 per cent needed to meet our full-year forecast. As set out in paragraph 3, year-to-date receipts growth has been affected by one-off factors that boosted receipts in early 2015-16, while we expect receipts to be end-loaded this year because of the boost to SA from the pre-announced dividend tax rise.
8. Total CG spending in June was £0.8 billion higher than a year earlier. There was a £0.8 billion fall in debt interest payments, reflecting volatility in the monthly profile of RPI. Spending on net social benefits was flat, while there were £0.5 billion, £0.7 billion and £0.4 billion rises in CG current grants to local authorities, other current spending and net investment respectively.
9. For the first three months of the financial year, CG current spending was down by 0.1 per cent on a year ago, compared with a full-year forecast of 2.3 per cent. This partly reflects weaker growth in debt interest payments and other CG current spending (largely on public services) than projected in the full-year forecast. CG current grants to local authorities were also £2.4 billion lower than last year (mainly reflecting reductions in the Revenue Support Grant). The full-year drop in our March EFO forecast was not much higher at £2.8 billion, so much of the fall has come through at the start of the year. Reductions in CG grants are likely to have an offsetting effect on local authority borrowing. In contrast, growth in CG net investment is much stronger so far in 2016-17 than in our full-year forecast. This partly reflects the one-off effect from the capital receipt related to the British Coal Staff superannuation scheme and a PSNB-neutral effect from a Welsh Housing Revenue Account receipt.
10. Public sector net debt (PSND) in June fell by 0.1 per cent of GDP from a year earlier. This was the first year-on-year drop in PSND as a share of GDP since September 2002. At that point, PSND was just under 30 per cent of GDP rather than 84 per cent of GDP now. Much of the nominal GDP denominator used in the ratio remains a forecast,² so this is likely to be revised

² 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-June 2016 ratio would be the sum of the four quarters of 2016.

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, the PSND figure has been reduced by only £0.5 billion by asset sales in 2016-17, 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.

11. The ONS has this month announced a methodological change³ to the treatment of exchange rate movements in the liquid assets element of the PSND calculation. Previously, all foreign exchange reserve assets were revalued each month to reflect any exchange rate movements. Now, where foreign currency reserves are hedged against exchange rate movements, that hedging will be reflected in the valuation of the assets in the PSND calculation. In the absence of this change, the depreciation of sterling since the EU referendum would have boosted the sterling value of the foreign exchange reserves deducted from the gross debt figure when calculating PSND by £6 to £7 billion relative to the figures published today. In our March *EFO*, we noted that the reserves effect was a statistical peculiarity, given the hedging that takes place in reality. This change therefore brings the PSND calculation more into line with reality.
12. The ONS is also planning to make a number of further changes to the calculation of PSND in September. Initial indications are that these will add around £8½ billion to the level of PSND for 2015-16.

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

	June			Full year		
	£ billion			£ billion		
	2016	2015	change	2016-17 forecast	2015-16 outturn	change
Public sector net borrowing ¹	73.0	87.4	-14.4	55.5	75.3	-19.8
CG net cash requirement ex ^{1,2}	76.5	88.4	-11.9	62.1	78.4	-16.3
Public sector net cash requirement ¹	48.9	70.1	-21.2	58.1	50.2	7.9
Public sector net debt (PSND)						
PSND (£ billion)	1621	1573	48	1638	1600	38
PSND (per cent of GDP)	84.0	84.1	-0.1	82.6	83.7	-1.1

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.

³ <https://www.ons.gov.uk/news/statementsandletters/impactofforeignexchangeratemovementsonpublicsectornetdebt>

Issues for next month's commentary

13. July is usually the second highest month for receipts during the financial year. This reflects:

- many **medium and large onshore firms paying the first of four corporation tax instalment payments** on their 2016 profits. These will be based on their view of profits for the full calendar year, so are likely to be affected by expectations of profitability over the remainder of 2016;
- **oil and gas firms paying their first of three CT instalment payments** on their 2016 profits. Our March forecast assumed that CT payments would be very weak this year given low oil and gas prices and the assumption that the sterling-dollar exchange rate would remain relatively stable; and
- the **second payment on account for self-assessment liabilities** for 2015-16 due on 31 July.

Table 1.2: Public sector receipts, expenditure and net borrowing¹

£ billion	June				April to June				Implied July to March				March forecast			
	2016	2015	change		2016-17	2015-16	change		2016-17	2015-16	change		2016-17	2015-16	change	
			£bn	%			£bn	%			£bn	%	March EFO	outturn	£bn	%
Central government (CG) current receipts																
Taxes on production	20.4	19.9	0.5	2.3	60.2	58.6	1.6	2.7	193.1	183.1	10.0	5.5	253.3	241.7	11.6	4.8
Of which: VAT (accrued)	10.8	10.7	0.2	1.8	32.1	31.7	0.4	1.3	102.7	98.8	3.9	3.9	134.8	130.5	4.3	3.3
Taxes on income and wealth	14.2	13.3	0.9	6.7	45.4	44.3	1.1	2.5	187.4	176.2	11.2	6.4	232.9	220.5	12.3	5.6
Of which:																
Income tax and CGT (accrued)	12.2	11.5	0.7	6.3	35.7	34.7	1.0	2.9	153.4	141.3	12.2	8.6	189.1	175.9	13.2	7.5
Corporation tax	1.9	1.8	0.1	4.6	9.6	9.5	0.2	1.6	33.8	34.9	-1.1	-3.2	43.5	44.4	-0.9	-2.1
Other taxes	1.6	1.6	0.0	-1.2	4.6	4.6	0.0	0.7	13.4	14.0	-0.6	-4.2	18.1	18.6	-0.6	-3.0
Compulsory social contributions	10.4	9.4	1.0	11.1	30.3	27.8	2.4	8.6	96.2	85.6	10.6	12.4	126.5	113.4	13.0	11.5
Interest & dividends	0.5	0.7	-0.1	-19.4	5.9	5.9	0.0	0.2	13.0	11.3	1.6	14.2	18.9	17.3	1.6	9.4
Other receipts	1.9	2.2	-0.3	-12.9	5.8	6.1	-0.3	-4.7	17.3	16.5	0.8	4.8	23.0	22.5	0.5	2.2
Total CG current receipts	49.0	47.1	2.0	4.2	152.2	147.3	4.9	3.3	520.4	486.8	33.6	6.9	672.6	634.1	38.5	6.1
CG current expenditure																
Interest payments	3.6	4.5	-0.8	-19.0	13.3	13.4	-0.1	-0.5	34.5	31.6	2.9	9.3	47.8	44.9	2.9	6.4
Net social benefits	16.7	16.7	0.0	0.2	51.0	50.6	0.4	0.9	154.9	152.9	2.0	1.3	205.9	203.4	2.4	1.2
CG current grants to LAs	11.8	11.3	0.5	4.6	31.9	34.3	-2.4	-7.0	82.9	83.3	-0.4	-0.4	114.8	117.6	-2.8	-2.4
Other	23.3	22.7	0.7	3.0	71.5	69.6	1.9	2.8	227.2	216.7	10.5	4.9	298.7	286.2	12.5	4.4
Total current expenditure	55.5	55.1	0.4	0.7	167.7	167.8	-0.1	-0.1	499.4	484.4	15.1	3.1	667.1	652.2	15.0	2.3
Depreciation	1.6	1.5	0.1	7.4	4.9	4.6	0.3	7.4	14.7	13.9	0.8	6.0	19.6	18.4	1.2	6.3
CG current budget deficit	8.1	9.6	-1.5		20.4	25.1	-4.6	-18.5	-6.3	11.5	-17.8		14.1	36.5	-22.4	-61.3
CG net investment	2.9	2.6	0.4	13.6	9.4	7.1	2.3	32.3	29.4	26.8	2.6	9.9	38.9	33.9	5.0	14.6
of which: CG capital grants to LA	0.8	0.7	0.1	19.9	4.3	3.2	1.1	36.0	9.7	8.3	1.4	16.7	14.0	11.5	2.5	22.0
CG net borrowing	11.1	12.2	-1.1	-9.3	29.9	32.2	-2.3	-7.2	23.1	38.3	-15.1	-39.5	53.0	70.4	-17.4	-24.7
Local authorities net borrowing	-2.5	-1.5	-1.0		-5.7	-5.9	0.2		8.2	10.3	-2.1	-20.2	2.5	4.4	-1.9	
Public corporations net borrowing	-0.8	-0.7	0.0	3.4	1.4	1.6	-0.2		-1.5	-1.2	-0.3	26.4	0.0	0.4	-0.5	
Public sector net borrowing	7.8	10.0	-2.2	-21.8	25.6	27.9	-2.3	-8.3	29.9	47.4	-17.5	-36.9	55.5	75.3	-19.8	-26.3
Public sector net investment	2.5	2.3	0.1	5.1	6.0	5.1	0.9	18.2	30.3	28.7	1.6	5.6	36.4	33.8	2.5	7.5
Public sector current budget	5.4	7.6	-2.3		19.5	22.8	-3.2	-14.3	-0.4	18.7	-19.1		19.1	41.5	-22.4	

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/june2016>

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/>