

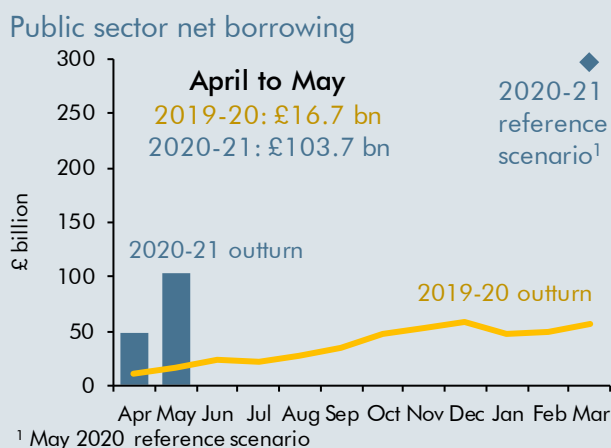
Commentary on the Public Sector Finances: May 2020

Office for
**Budget
Responsibility**

19 June 2020

Budget deficit tops £100 billion in just two months

May's public finances data continue to show the budget deficit rising sharply. Two months into 2020-21, tax payments received by HMRC are down 43 per cent on the same period last year, while central government spending is up 48 per cent. Relative to our April scenario, initial estimates of both GDP and tax receipts have fallen slightly less sharply than we assumed. Debt is estimated to have topped 100 per cent of GDP for the first time since the early 1960s.



Headlines

- Today's data highlight the gathering fiscal impact of the **coronavirus crisis**, but the numbers will be prone to revision. It will be many months before the true scale of the shock becomes clear.
- **Public sector net borrowing (PSNB)** totalled £55.2 billion in May, £5.2 billion higher than market expectations. Borrowing across April and May reached £103.7 billion, despite April's deficit being revised down by £13.6 billion as accrued tax receipts were revised higher.
- **HMRC cash receipts** in May fell by 43 per cent on a year earlier, with VAT again accounting for the bulk of the deterioration thanks to the Government's deferral scheme.
- **Central government spending** was up 48 per cent on last year, reflecting the coronavirus job retention scheme, additional grants to local authorities and higher public services spending.
- **Net debt** rose by 20.5 per cent of GDP on a year earlier to 100.9 per cent in May (the first time it has exceeded 100 per cent of GDP since the early 1960s). This reflects the impact of higher borrowing and Bank of England schemes on cash debt, as well as the falls in nominal GDP over the coming months assumed in the reference scenario we published on 14 April.
- Relative to our reference scenario, initial estimates show that **GDP** and overall tax receipts have performed a little less badly than assumed, while **average earnings** have fallen less sharply. The headline **unemployment** measure has yet to show much effect from the crisis, but the claimant count measure that relates directly to benefit claims has climbed very sharply.

Monitoring the public finances through the lockdown

1. The Office for National Statistics and HM Treasury published their Statistical Bulletin on the May 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. But given the large shock to the economy and public finances caused by the coronavirus lockdown, it is no longer meaningful to compare the latest data with our March 2020 *Economic and fiscal outlook (EFO)*. Instead, this commentary compares the latest numbers to the monthly profiles we published on 14 May consistent with our April coronavirus reference scenario (available on our website).
2. We will update our coronavirus scenario analysis in our annual *Fiscal sustainability report (FSR)* on 14 July. This will reflect the smaller-than-assumed peak-to-trough fall in GDP indicated by last week's GDP release (discussed below) and the public sector finances data to date. From this updated starting point we will explore three economic scenarios: one that updates our illustrative April reference scenario, with a sharp rebound in activity and no medium-term economic scarring; one that sees activity recover more slowly and incorporates some scarring to potential GDP; and one where recovery is slower still and scarring is deeper.

The latest GDP and labour market data

3. High frequency indicators suggest that April represented the nadir in economic activity. So the April GDP data that were released last week provide the first estimate of the peak-to-trough fall in output due to the lockdown, although they will be subject to revision. Between February and April, GDP is currently estimated to have fallen by 25 per cent – an unprecedented decline, though somewhat less than the 35 per cent peak-to-trough fall assumed in our April reference scenario. Table 1.1 compares current estimated outturns with that scenario.
4. The largest differences were in the education and health sectors. The former contracted much less than we expected, whereas the latter contracted while we had assumed output would rise. In part this reflects how the ONS has taken on board the closure of schools and the reduction in non-coronavirus-related NHS activity, which was not clear when we prepared our reference scenario.² In terms of market sector output, activity fell less sharply than we expected in manufacturing, construction, finance, business services and real estate. Only the last of these reflected measurement issues, where we had not properly captured the share of real estate output made up of actual and imputed rents that have been less affected by the lockdown.
5. Our reference scenario assumed for simplicity that full lockdown would be maintained for the whole of the second quarter, but in practice it has begun to ease already and activity indicators have correspondingly begun to improve. Although we will not have GDP data for May until July 14, the ONS Business Impact of Coronavirus Survey (BICS) – also shown in Table 1.1 – provides a timelier source of information, and is used by the ONS to inform its GDP estimate. We estimate that the April BICS results were consistent with private sector turnover 36 per cent below normal – a sharper fall than shown in the GDP data, although the figures for those sectors for which consistent data are available do match up better. The May

¹ <https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/April2020>

² ONS, *Coronavirus and the effects on UK GDP*, 6 May 2020 and ONS, *Coronavirus and the impact on measures of UK government education output*, 13 May

BICS results were consistent with private sector turnover being 31 per cent below normal, suggesting that GDP is likely to have remained around a fifth below its pre-virus level.

Table 1.1: April GDP relative to the reference scenario

Sector	Per cent						
	Weight in whole economy value added	Peak-to-2020Q2 change in April scenario	February-to-April change in April GDP estimate	Difference from scenario (ppts)	April private sector turnover vs normal implied by ONS BICS	Difference from April scenario (ppts)	Difference between GDP & ONS BICS (ppts)
Agriculture	0.7	0	-6	-6	N/A	N/A	N/A
Mining, energy and water supply	3.4	-20	-13	7	-28	-8	15
Manufacturing	10.2	-55	-28	27	-36	19	9
Construction	6.1	-70	-44	26	-50	20	6
Wholesale, retail and motor trades	10.5	-50	-34	16	-46	4	12
Transport and storage	4.2	-35	-38	-3	-33	2	-5
Accommodation and food services	2.8	-85	-92	-7	-87	-2	-5
Information and communication	6.6	-45	-15	30	-15	30	0
Financial and insurance services	7.2	-5	-6	-1	N/A	N/A	N/A
Real estate*	14.0	-20	-3	17	-30	-10	28
Professional, scientific and technical activities	7.6	-40	-21	19	-18	22	-3
Administrative and support activities	5.1	-40	-36	4	-33	7	-3
Public administration and defence	4.9	-20	0	20	N/A	N/A	N/A
Education	5.8	-90	-43	47	N/A	N/A	N/A
Human health and social activities	7.5	50	-23	-73	N/A	N/A	N/A
Other services**	3.5	-60	-48	12	-86	-26	38
Total	100.0	-35	-25	10	-36	0	11

Note: *BICS excludes rents and imputed rents **BICS only includes arts, entertainment and recreation. BICS results are a weighted sum of the responses within each band, respondents can choose between turnover decreasing/increasing by more than 50%, between 20 and 50%, by up to 20% or turnover unaffected. For all except the highest band (for which we assume 50% change) we take the mid-point.

6. Labour market data released earlier this week are less directly informative about the assumptions in our reference scenario, as some of those effects are likely to build more slowly. The headline measure of unemployment rose much less than assumed, but this may simply reflect the difficulty of 'actively seeking work' during the lockdown (a requirement of the ILO definition of unemployment). The claimant count has, though, risen sharply and broadly in line with the unemployment assumptions we made in April. And average hours worked fell by 23 per cent between mid-March and the end of April.
7. The official measure of average weekly earnings (AWE) in April fell 0.9 per cent on a year earlier. That was much less sharp than the fall embodied in our reference scenario. However, to aid fiscal forecasting we use an implied measure obtained by dividing the National Accounts measure of wages and salaries by the number of employees and we had also assumed that CJRS payments would be recorded as transfer payments from government to households. The ONS has subsequently decided they should be recorded as a subsidy to companies with the associated payments to employees entering wages and salaries. That would imply a less steep fall in our measure of average earnings this year and a smaller rebound next year. We will update our earnings assumptions in next month's FSR.

The public finances in May 2020

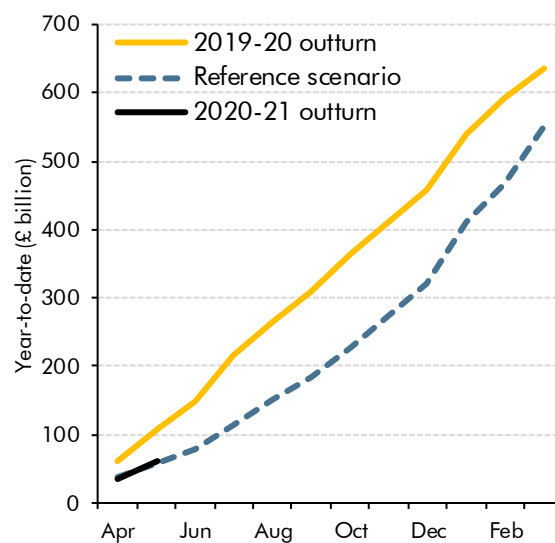
8. The first estimate of public sector net borrowing (PSNB) in May 2020 was £55.2 billion, up £49.6 billion on May last year and £5.2 billion higher than market expectations. This is the largest deficit in any month on record and was close to the deficit for 2019-20 as a whole. The sharp rise reflected a £30.6 billion rise in central government spending, compounded by a £16.2 billion fall in central government receipts. Local government borrowing was up £3.0 billion on last year while public corporations' net borrowing was little changed.
9. Over the first two months of the year, PSNB totalled £103.7 billion, up £87.0 billion on the same period in last year and higher than full-year borrowing in any year since 2013-14. That was despite PSNB in April being revised down by £13.6 billion in this month's release, largely thanks to higher accrued tax receipts. Accrued income tax and NICs receipts were revised up by £5.3 billion, in part because the ONS has assumed that more of the weakness in cash receipts reflects delays in companies paying off their employees' liabilities. VAT receipts were revised up by £2.8 billion, reflecting higher cash receipts in May. Central government spending was revised down by £3.2 billion, largely due the cost of the CJRS being lowered.
10. PSNB over the first two months of 2020-21 is now £13.8 billion (11.7 per cent) below our reference scenario. Higher central government receipts more than explain the difference – in particular PAYE income tax and NICs have performed less badly than assumed – possibly reflecting more resilience in the underlying tax base, but also because the wedge between accrued and cash receipts associated with non-payment of tax liabilities that will be made up in future is larger in these latest ONS estimates than our scenario assumes. It also reflects our assumption that smaller receipts lines would fall in proportion to the fall in nominal GDP, which has not yet been fully borne out – although this could reflect information lags.
11. As we set out last month, and as illustrated by the revisions to April 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 reference scenario profiles or other forecasts, reflecting the often significant lag between the underlying economic activity and corresponding cash payments. 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 in the data, such as adjusting the accrued tax data for non-payment of tax liabilities. If the economy and cash receipts continue to perform less badly than our reference scenario assumed, we might expect favourable revisions to accrued tax receipts in the coming months. But there is huge uncertainty around that and across other components of the public finances too.

Receipts

Cash receipts collected by HMRC

HMRC collects around 90 per cent of all central government cash receipts. Receipts in May were down by £19.4 billion (43 per cent) on last year. That represented a £7.3 billion surplus relative to our reference scenario.

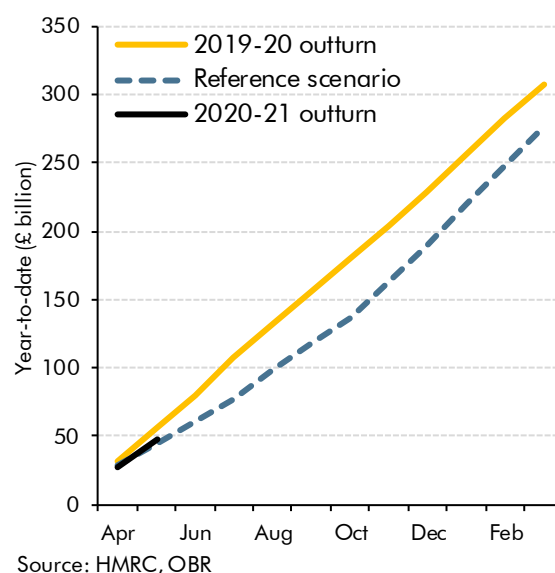
Upside surprises were recorded across income tax, NICs and VAT, whereas corporation tax fell short of our scenario profile. These surpluses broadly fit with the fall in GDP in April having been smaller than expected, but also with the corporate sector being hit much harder than the household sector.



PAYE income tax and National Insurance contributions (cash basis)

May cash receipts for PAYE income tax and NICs relate to April liabilities. HMRC's 'real-time information' (RTI) shows that total pay fell 1.6 per cent on a year earlier in April. Cash receipts in May were down £3.3 billion (13.6 per cent) on last year. The surplus of £4.9 billion relative to our reference scenario probably reflects earnings holding up better than we had assumed. The faster fall in cash receipts than in RTI total pay points to some liabilities not being paid by employers.

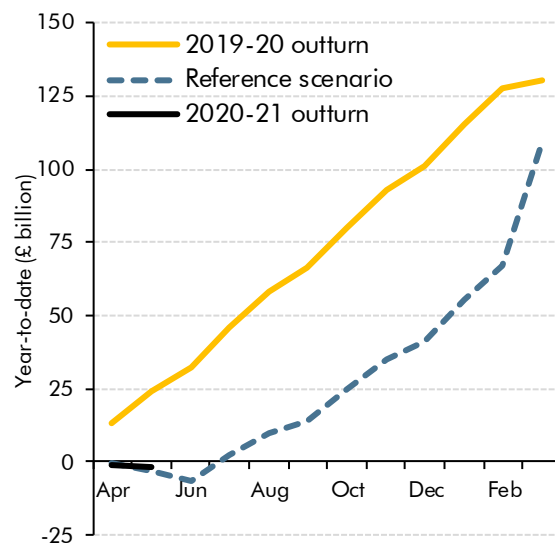
Provisional RTI for May points to a 1.7 per cent fall in employee numbers on last year. Information on total pay in May is not yet available, but median pay was down 1.8 per cent. The associated drop in May PAYE liabilities will hit June cash receipts.



VAT receipts (cash basis)

In cash terms, VAT repayments again exceeded payments in May, so receipts were negative at minus £0.6 billion. This largely reflects the deferral of most VAT payments since the end of March thanks to the deferral policy.

Our scenario assumed minus £3.1 billion for VAT receipts in May. The smaller fall in outturn could reflect lower-than-assumed take-up of the deferral scheme, weaker VAT repayments or higher-than-expected consumer spending boosting liabilities.

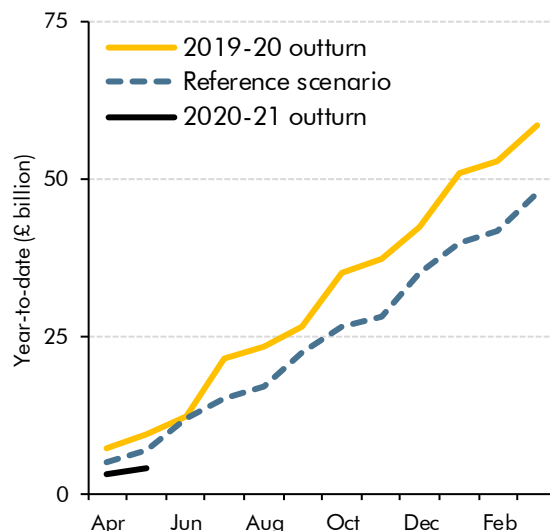


Source: HMRC, OBR

Onshore corporation tax receipts (cash basis)

On a cash basis, onshore corporation tax receipts were down £1.4 billion (62 per cent) on last May, a shortfall of £1.0 billion relative to our reference scenario. This could reflect liabilities being hit sooner than the scenario assumes or cash flow problems causing firms not to pay tax that is due.

The fall relative to last May will in part reflect companies' revised estimates of their total liabilities for the year, but this effect should be clearer next month when larger companies with calendar-year accounting periods make quarterly instalments.

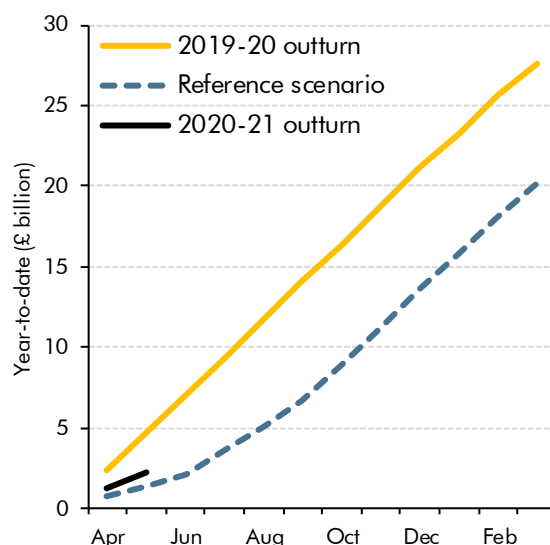


Source: HMRC, OBR

Fuel duty receipts (cash basis)

Fuel duty receipts in May were down £1.3 billion (57 per cent) on last year, but they exceeded our reference scenario by £0.3 billion. The Department for Transport's daily data suggest that motor vehicle use was down to around half its normal level in May, so the fall in receipts was broadly in line with what this might suggest.

The surplus relative to our scenario is likely to reflect both the easing of the lockdown and the composition of vehicle use, with use of HGVs and LGVs having fallen less than use of cars.

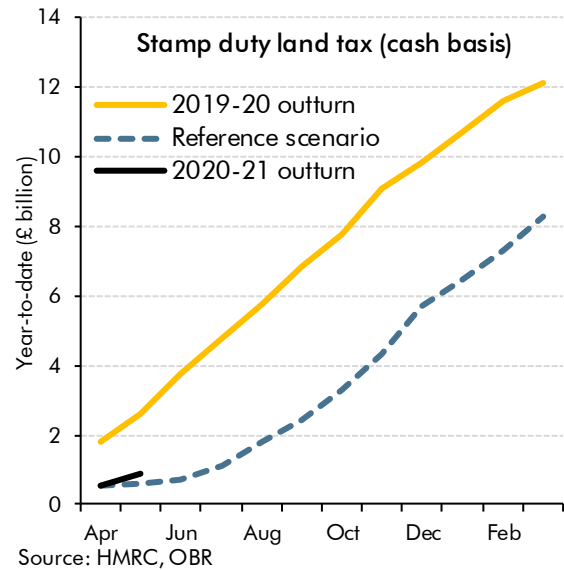


Source: HMRC, OBR

Selected other HMRC cash receipts

Other notable movements in cash receipts include:

- **Alcohol duty** fell just 13 per cent on last year, which is less than our scenario assumes. Relative to our assumptions, the boost to receipts from higher supermarket sales has been greater than the loss from pubs closing.
- **Stamp duty land tax** fell 56 per cent on last year – much less than our scenario assumed, indicating that transactions held up more than we had anticipated. **Stamp duty on shares** rose 15 per cent on a year earlier, well above the scenario, due to higher turnover in equity markets (not captured in the scenario).
- **Air passenger duty** was extremely weak again (down 98 per cent on last year) as the number of flights in May remained very low. The fall is even larger than we assumed.

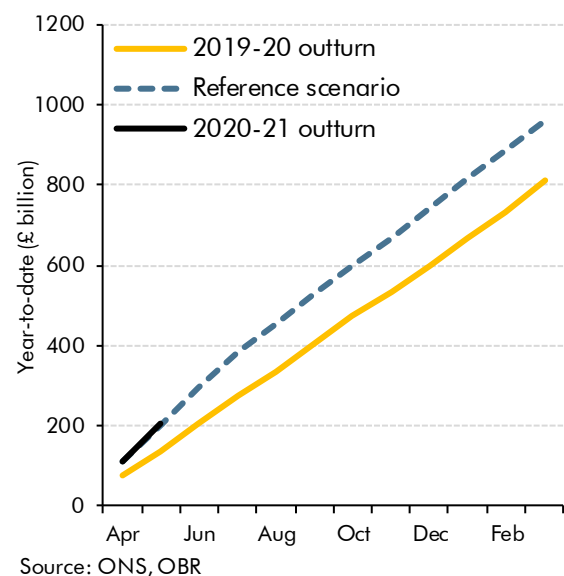


Public spending

Central government spending (accruals basis)

Total CG spending in May was up £30.6 billion (48 per cent) on last year, but very close to our reference scenario. So far this year it is up £65.8 billion on last year, but only £1.8 billion (0.9 per cent) higher than our scenario. This reflects offsetting differences, with CJRS spending revised down to match our most latest estimate, but other spending coming in higher than assumed (in part due to a timing effect related to SEISS payments).

At this stage of the year, even in normal circumstances, expenditure data are highly provisional. The current situation has further increased the potential for substantial revisions.

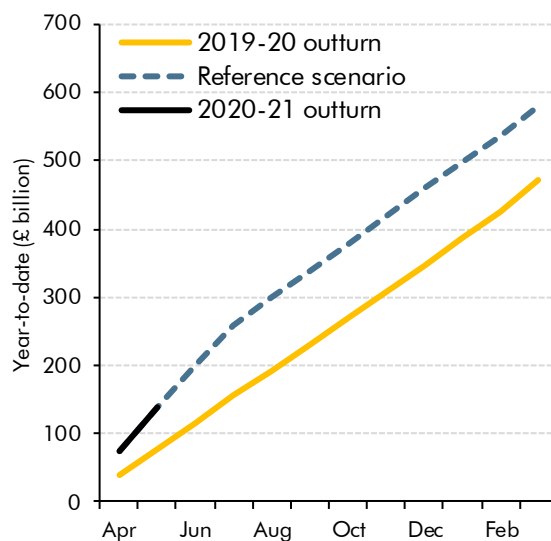


'Other current expenditure' (largely departmental spending)

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

Spending in May is up £27.5 billion (74 per cent) on last year and £2.9 billion higher than our scenario assumes. The jump relative to last year is largely explained by the CJRS (with £10.5 billion assumed to accrue to May) and the SEISS (with £6.8 billion accrued to May); current grants to local authorities being brought forward, amounting to around £1.6 billion; and around £4 billion in additional public services spending, most of which is likely to be coronavirus-related.

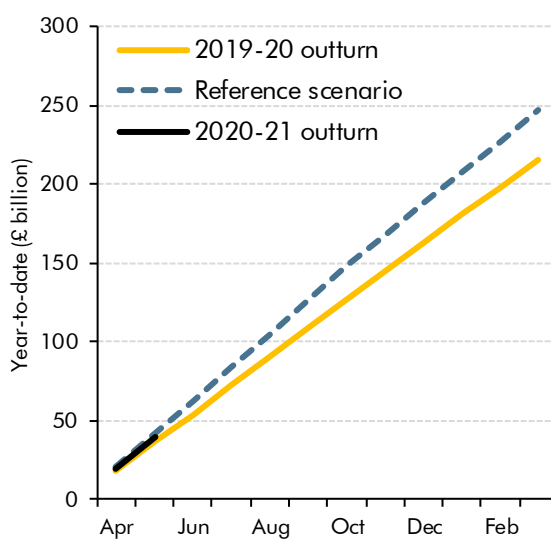
The difference relative to our scenario is largely related to SEISS payments, which have been scored on a cash basis whereas we assumed they would be accrued equally across three months.



Source: ONS, OBR

Net social benefits spending

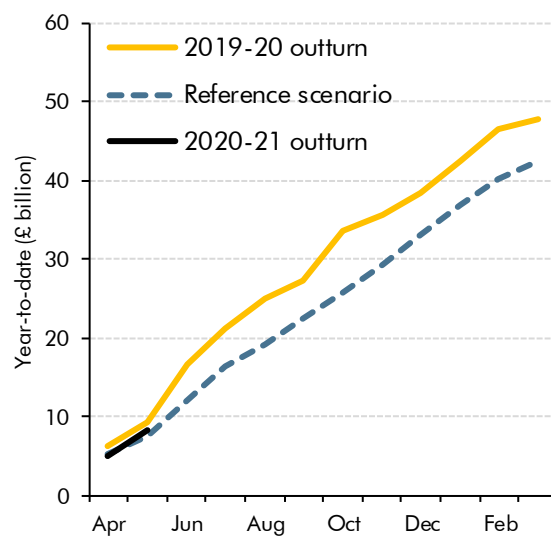
This category includes both welfare spending and net public service pension payments. CG net social benefits spending in May was up £1.6 billion (8.7 per cent) on last year, but was £1.5 billion lower than our scenario assumes. Despite the sharp rise in the claimant count measure of unemployment, it is possible that the scenario overstates the extent or pace of the rise in unemployment taking place, or the speed with which that will hit benefits spending.



Source: ONS, OBR

Central government debt interest spending

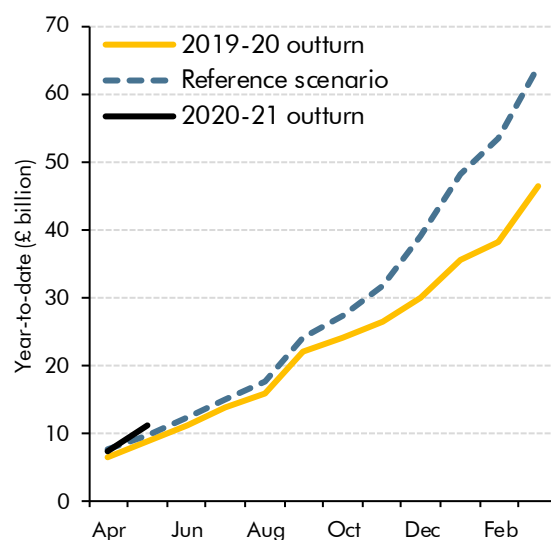
Debt interest spending in May was up £0.2 billion on last year and £1.1 billion higher than our scenario assumes. This was mostly due to higher-than-expected RPI inflation, which raised spending on index-linked gilts relative to our scenario.



Source: ONS, OBR

Central government net investment

CG net investment in May was up £1.2 billion on last year and £1.6 billion above our scenario profile. 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. Capital grants to local authorities were higher than last May as a result of some delayed payments from last month. Our scenario assumes that the disruption to construction activity will weigh on capital spending in the initial months of 2020-21, but to date that is not apparent in the provisional data, although April's initial estimate was revised down this month.



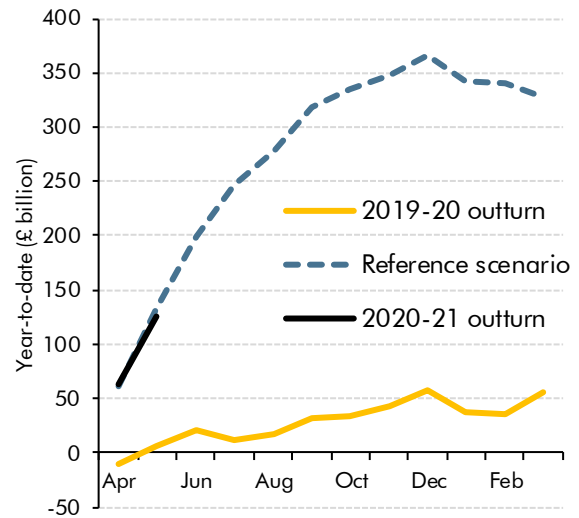
Source: ONS, OBR

Fiscal aggregates

Central government net cash requirement (CGNCR)

Central government cash borrowing reached £62.7 billion in May, up £46.1 billion on last May and exceeding the total in 2019-20 as a whole.

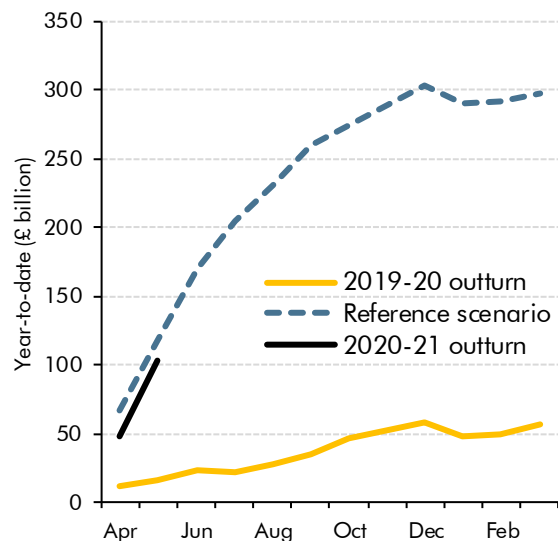
To a large extent this reflects a sharp rise in outlays, including the initial CJRS and SEISS cash outlays, as well as spending on grants and public services. The sharp fall in HMRC cash receipts also played a part, with other receipts also down on last year.



Source: ONS, OBR

Public sector net borrowing (PSNB)

Public sector net borrowing in April totalled £55.2 billion, up £49.6 billion on last year and a little higher than our reference scenario assumes, reflecting slightly higher CG spending. But PSNB in April 2020 was revised down by £13.6 billion, with the bulk of the revision explained by tax receipts, taking it below our scenario. Despite that, borrowing topped £100 billion in just two months.



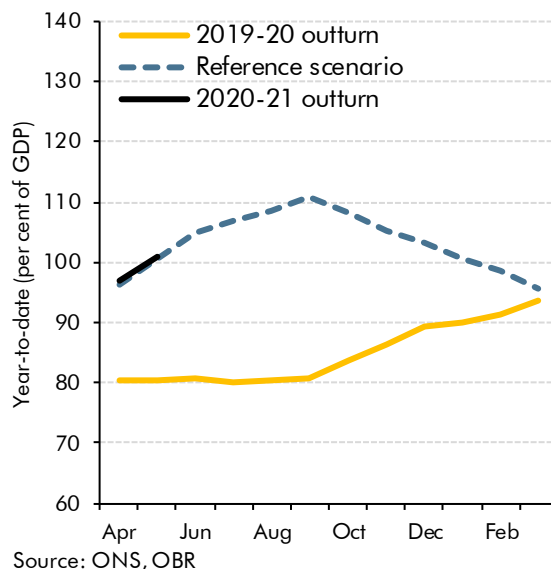
Source: ONS, OBR

Public sector net debt (PSND)

PSND in May rose 20.5 per cent of GDP on a year earlier to reach 100.9 per cent – the first time it has exceeded 100 per cent of GDP since the early 1960s.

Cash debt rose by £173.2 billion relative to last May, largely due to higher central government cash borrowing but also in part thanks to the extension to the Bank of England's Term Funding Scheme and the expansion of its gilt purchases.

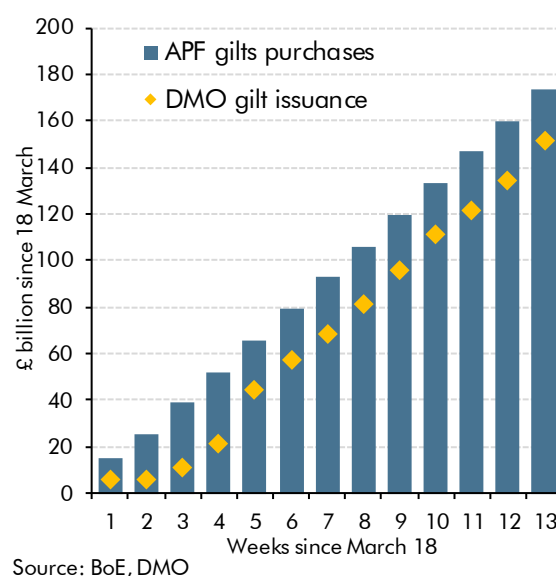
By ONS convention, the debt-to-GDP ratio in any given month is measured as the stock of cash debt in that month relative to the sum of GDP over the twelve months that straddle the end of the current month. In this release, the ONS has again used the assumed path of nominal GDP in our reference scenario to fill in the period for which GDP data are not yet available. This assumed sharp fall in nominal GDP contributed more to the recorded rise in the debt-to-GDP ratio than the rise in cash debt. The ONS has not adjusted the denominator for the smaller-than-assumed fall in April GDP, which all else equal would lower the May debt-to-GDP ratio.



Financing

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

Between 1 April and 16 June, the DMO issued £146 billion of gilts – 65 per cent of the £225 billion it plans to issue between April and July (net of redemptions, gilt issuance totalled £125 billion). In the period since 18 March, when the Bank of England commenced purchases under the initial £200 billion extension to quantitative easing, it has purchased £174 billion of gilts from the market. So in effect the Bank has purchased £28 billion more gilts from the private and overseas sectors than the DMO has issued so far in 2020-21 (and £49 billion more than net DMO issuance). To date, the Treasury has not made use of the 'Ways & Means Facility' – its overdraft at the Bank.



Issues for next month's release and beyond

12. We can expect significant data revisions over the coming months, although it is difficult to estimate the potential size and direction of these changes. Some key issues include:
- Accrued spending data on the **CJRS payments** are currently aligned to our costings. In our 4 June update to our policy costings database, we revised the cost of the CJRS scheme down by around 30 per cent, reflecting evidence that average claims are lower than assumed despite take-up being higher. This has been incorporated into the ONS figures, but they may be revised again as more data become available. **SEISS payments** have been scored on a cash basis in this release, but the ONS plans to revisit this.
 - The ONS is continuing to consider how to reflect **non-payment of liabilities** in the accruals-based receipts figures used when estimating PSNB. This month it revised its approach to non-payment of PAYE liabilities, assuming that 93 per cent of estimated non-payments will eventually be repaid and so score as accrued receipts in the month of the liability arising despite no cash payment having yet been made. The cash receipts data suggest this has been a material issue across many taxes.
 - 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.