

Significant revisions leave public finances in a stronger position than initially estimated

July 2023

Revisions to net borrowing and debt put UK public finances below the OBR forecast after two months of overestimated spending. Cumulative net borrowing is now £7.5 billion below forecast, leaving some fiscal space.

Although revisions to previous estimates put UK public finances on a better heading, the Government is still borrowing at some of the highest levels seen since records began, while debt servicing continues to grow.

June saw a net borrowing level of £18.5 billion, bringing this fiscal year's cumulative borrowing to £54.4 billion - £12.2 billion more than at this point in the previous financial year. This is the third highest level of borrowing for June on record, only behind last year and 2020 in the midst of the pandemic.

Net debt-to-GDP provisionally grew to 100.8%, up from 99.9% in May (revised down from 100.1% in June's data release due to better-than-expected GDP growth). This level of debt hasn't been seen since the 1960s and presents a significant cost burden to service. June saw interest payable on debt reach £12.5 billion, with £9.3 billion coming from indexed-linked gilts and an increase of £4.7 billion from May.

Alongside the public sector finance release this month, the Office for Budget Responsibility (OBR) also released its latest report – *Fiscal Risks and Sustainability*. This report outlines longer-term areas of risk towards the UK Government's finances and areas that should be of particular focus to stabilise debt.

The sustainability of UK public finances has been shaken by successive external shocks, first the COVID-19 pandemic, and second the war in Ukraine. The resulting stress on supply chains and energy price shock has led to a cost-of-living crisis, requiring steep interest rate increases to prevent inflation becoming domestically embedded.

The OBR has identified three primary areas that may affect the long-term stability of UK public finances: health-related inactivity, energy demands and prices, and levels of national debt.

A record 2.6 million individuals are out of the labour market due to ill-health, placing significant strain on Government spending through welfare spending, health-related benefits and foregone tax revenues. Those out of the labour force due to ill-health predominately fall into four sub-groups: older individuals (50-64), those suffering from mental health conditions, relatively low-skilled and those who previously worked in lower-paid, consumer facing

occupations. Collectively, 85% of this cohort have either been out of work for more than three years or have never had a job, and just 4% have been out of work for less than a year.

UK reliance on imported gas continues to leave the economy vulnerable to foreign price shocks caused by the likes of the Russian invasion of Ukraine. Despite efforts to decarbonise, the UK remains one of the most gas-reliant economies in Europe, and has lagged behind France, Germany and Italy in renewable investment over the past year.

The OBR estimates that continuing the UK's dependence on gas at the current level could be as fiscally costly as completing the full transition to net zero. In a stylised scenario where the UK's reliance on gas persists and adverse shocks in gas prices occur every decade, gas price spikes could add 13% of GDP to public debt by 2050/51. This is approximately double the 6% of GDP estimate for public investment into a complete transition to net zero by the same date. In other words, it could be twice as expensive to do nothing than to consistently invest now.

The composition of UK debt leaves the UK more vulnerable than other countries with similar net debt levels around 100% of GDP. The average length of maturities has shortened significantly since 2008 from seven years to just two. On top of this, the UK has the highest proportion of inflation-linked debt of any major advanced economy. This means that UK public finances are very susceptible to changes in both the interest rate and the level of inflation. The UK also has a larger share of debt owned by foreign investors than most other G7 countries, leaving the UK exposed to shifts in global investor sentiments.

Public Sector Borrowing

Public sector net borrowing in June grew to £18.5 billion from May and is the third highest level of borrowing for a June on record. Despite this high level of borrowing, it is still £2.7 billion below the OBR's forecast for the month.

- Significant revisions to public finances have meant that the past two months' estimate of overspending relative to the OBR forecast has been reversed. Where last month's release put public finances cumulatively £2.1 billion ahead of projections, this latest estimate shows cumulative fiscal space of £7.5 billion.
- Cumulatively, the Government has borrowed £54.4 billion this financial year, £12.2 billion more than this time last year, and more in line with levels seen in the 2021/22 financial year.
- Total Government expenditure in June grew to £96.8 billion, a £5.9 billion increase from May, and the highest spending for June on record.
- The energy support scheme and net social benefits continue to add to expenditure with each accounting for £3.6 billion and £24.0 billion respectively. This is largely driven by inflation-linked benefits, the energy price guarantee scheme and disability cost-of-living payments.
- The budget deficit excluding public sector banks remains largely unchanged from May at £14.5 billion.

Public Sector Debt

Net debt continues to grow month-on-month (despite a downward revision) and has provisionally reached 100.8% of GDP in June. This level of debt is unseen since the 1960s.

- Net debt grew £28.5 billion between May and June of this year to a stock of £2.6 trillion. This is up £171 billion from June of last year and is a new high on record.
- The composition of national debt means the UK Government is quite exposed to changes in interest rates as the majority is made up from short-maturity index-linked gilts.
- Interest payable on debt in May came to £12.5 billion – 12.9% of total Government expenditure that month. Cumulatively, £29.8 billion has been spent on interest payable this financial year so far.
- Net investment grew to £4.0 billion in June and is two-thirds more than in June 2022.





