Kallum Pickering, Senior Economist | Kallum.pickering@berenberg.com | +44 203 465 2672

UK: PART 3 OF THE BIG STIMULUS – THE BUDGET

Berenberg Macro Flash

Opening the taps: Rising to the challenge, new Chancellor Rishi Sunak announced a fiscal stimulus worth £30bn, equal to 1.3% of GDP, for 2020. It combines a short-term emergency package to counteract the COVID-19 disruptions worth £12bn plus a pre-planned discretionary stimulus of nearly £18bn. This was the first of three fiscal announcements for 2020 (Spending Round in July and Autumn Budget to come). Next year, the Chancellor plans to add a further £18bn in stimulus – equivalent to 0.7% of our 2021 GDP estimate. The announcements were broadly in line with our expectations. Combined with the aggressive stimulus package announced earlier today by the BoE worth 1% of GDP (see below), the coordinated monetary and fiscal response to COVID-19 is sizeable and will make a difference as the UK is hit by the COVID-19 disruptions.

COVID-19: The £12bn of emergency support the economy includes £5bn in extra funding for the NHS and other public services and £8bn in extra funding to support small and medium-sized enterprises (SMEs) and individuals. The £7bn package includes: 1) extensions to statutory sick pay – including refunds for two weeks per employee for firms with fewer than 250 employees; 2) relief on, or fully eliminating, business rates (taxes on business properties) for one year for small firms; 3) increasing grant funding for small businesses; 4) expanding 'time to pay' which allows firms to delay tax payments; and 5) the introduction of a 'Coronavirus Business Interruption Loan Scheme' which will give lenders guarantees of up to 80% on business loans up to £1.2 million. The package is designed to support SMEs and the most vulnerable workers (temporary and zero hours contracts) through the next few months in case they run into cash flow problems. The Chancellor emphasised that the UK's fiscal response to COVID-19 would be proportional to its economic impact. With the risks to the outlook tilted heavily to the downside, we would not be surprised if the final cost came in materially higher than the Chancellor's £12bn estimate.

Big stimulus over the next two years: The budget includes roughly £18bn of extra stimulus for this year compared to the March 2019 budget and an additional £18bn for 2021 (Table 1). Table 1 estimates do not include the COVID-19 response. By 2024 the plans entail a projected £42.5bn total fiscal expansion. Much of this rise in current spending was set out already in the September Spending Round 2019. The total size of the additional public sector capital investment was in line with our expectations (c£80bn to 2024 – implied £100bn to 2025). However, the budget sets out a more gradual rise than we had expected in the near-term. Instead of rising to 2.8% of GDP this year, the OBR projects that public investment will hit 2.4% in 2020 before rising sharply to 3.0% next year as spending is stepped up. Discretionary measures, which increase the projected tax yield, come from several small adjustments and one major change, namely the decision to maintain corporation tax at 19% rather than to reduce it to 17% as previously planned. The chancellor also announced that, from April 2020, the threshold for having to pay National Insurance contributions would rise to £9,500 from £8,632. This will lift real household incomes at the margin.

For a full breakdown of the tax and spending decisions announced today see the March 2020 budget document and the OBR's updated projections.

Big disclaimer: Due to the evolving nature of the COVID-19 risk and the total policy response to it, the economic and fiscal projections by the OBR should be taken with a large dose of salt. The forecasts and policy announcements are up to date as of 28 February. Therefore they do not fully reflect the current government/OBR/BoE consensus view on the likely negative impact of COVID-19 which has obviously worsened in recent days. The OBR notes that 'under the circumstances, the precise forecasts for the economy and public finances in this EFO can no longer be regarded as central'. The COVID-19 impact is likely to be more severe than the conditioning assumptions used by the OBR for the official budget projections. That will likely lead to higher borrowing in 2020 due to higher expenditure and lower revenues. Whereas the OBR estimates that the headline deficit will rise from 2.1% in 2019 to 2.4% in 2020 and to 2.8% in 2021, we see it rising to 3.1% this year before falling back a little to 2.8% in 2021. Please see Table 2 for a comparison of our budget projections – which reflect a large near-term impact from COVID-19 - versus the official projections published today. See Table 3 for the OBR's pre-COVID-19 forecasts.

Changing rules…again…maybe: The current provisional fiscal rules set out in the Conservative Party 2019 election manifesto are as follows: 1) to have the current budget in balance no later than the third year of the forecast period; 2) to limit public sector net investment to 3% of GDP; 3) to adjust fiscal plans if debt interest payments reach 6 per cent of tax revenue. While the OBR's current projections show that Sunak will manage to stick to all three rules – notwithstanding the COVID-19 impact - the Chancellor announced that he would review the fiscal rules later this year. We would not be surprised if these rules, like those before, were to be honoured only loosely in the next few years.

Table 1: Budget 2020 policy decisions – impact on budget balance

£ (millions)	2019	2020	2021	2022	2023	2024
Total policy decisions	605	-17,900	-36,430	-38,530	-41,150	-41,920
Total spending policy decisions	-355	-19,255	-40,185	-45,640	-48,780	-49,440
of which current	-2,545	-13,765	-24,910	-27,860	-27,680	-27,660
of which capital	2,190	-5,490	-15,275	-17,780	-21,100	-21,780
Total tax policy decisions	960	1,355	3,755	7,110	7,630	7,520

Source: HM Treasury

Table 2: Budget projections Berenberg vs. OBR projections March 2020 projections

% GDP	2019	2020	2021	2022	2023	2024
Current receipts						
OBR (Mar 20)	37.7	37.9	38.0	38.3	38.4	38.5
Berenberg		37.7	37.9			
Difference (ppt)		*-0.2*	*-0.1*			
Total expenditure						
OBR (Mar 20)	39.8	40.3	40.8	40.8	40.8	40.7
Difference (ppt)		*0.5*	*-0.3*			
Current expenditure						
OBR (Mar 20)	35.3	35.4	35.7	35.6	35.5	35.4
Berenberg		35.7	35.0			
Difference (ppt)		*0.3*	*-0.7*			
Gross investment						
OBR (Mar 20)	4.4	4.9	5.2	5.3	5.3	5.3
Berenberg		5.0	5.5			
Difference (ppt)		*0.1*	*0.3*			
Net investment						
OBR (Mar 20)	2.2	2.6	2.9	3.0	3.0	3.0
Berenberg		2.8	3.2			
Difference (ppt)		*0.2*	*0.3*			
Depreciation						
OBR (Mar 20)	2.2	2.3	2.3	2.3	2.3	2.3
Public sector total balance						
OBR (Mar 20)	-2.1	-2.4	-2.8	-2.5	-2.4	-2.2
Berenberg		-3.1	-2.7			
Difference (ppt)		*-0.7*	*0.1*			
Public sector current balance						
OBR (Mar 20)	0.1	0.2	0.1	0.5	0.7	0.8
Berenberg		-0.3	0.6			
Difference (ppt)		*-0.5*	*0.5*			
Berenberg nominal GDP (% yoy)	3.3	2.6	4.0			

Annual data. Source: OBR, Berenberg calculations

Table 3: OBR economic forecasts

Table 1.1: Overview of the economy forecast

	Percentage change on a year earlier, unless otherwise stated						
	Outturn	Forecast					
	2018	2019	2020	2021	2022	2023	2024
Output at constant market prices							
Gross domestic product (GDP)	1.3	1.4	1.1	1.8	1.5	1.3	1.4
GDP per capita	0.7	0.8	0.5	1.3	1.1	0.9	1.1
GDP levels (2018=100)	100.0	101.4	102.5	104.3	105.8	107.1	108.6
Output gap	0.2	0.1	-0.1	0.4	0.4	0.2	0.0
Expenditure components of real GDP							
Household consumption	1.6	1.3	1.1	1.2	1.2	1.4	1.4
General government consumption	0.4	3.6	3.7	2.8	2.1	1.9	2.2
Business investment	-1.5	0.3	0.0	1.8	3.0	2.4	2.3
General government investment	1.3	2.1	1.9	10.9	4.6	1.8	1.2
Net trade[1]	-0.2	0.0	-0.1	-0.3	-0.2	-0.4	-0.3
Inflation							
CPI	2.5	1.8	1.4	1.8	2.1	2.1	2.0
Labour market							
Employment (millions)	32.4	32.8	33.0	33.1	33.2	33.3	33.4
Average earnings	3.3	2.8	3.3	3.6	3.4	3.1	3.1
LFS unemployment (rate, per cent)	4.1	3.8	3.8	3.8	3.9	4.0	4.1

Source: OBR

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3465 2672
www.berenberg.com
kallum.pickering@berenberg.com