UK faces £14bn shortfall in public finances, warns IFS

theguardian.com/business/2016/oct/21/uk-faces-14bn-shortfall-in-public-finances-warns-ifs

Phillip Inman 10/21/2016

Higher borrowing costs and lower tax receipts could deprive Philip Hammond of up to £14bn when he presents his autumn statement next month, denying him vital funds to boost the economy after the Brexit vote, a leading tax and spending thinktank has warned.

The Institute for Fiscal Studies (IFS) said that an unexpected downturn in the public finances in September was likely to be repeated in the next few months and bust the government's annual borrowing limits set earlier this year.

Thomas Pope, an economist at the IFS, said the Treasury's room for manoeuvre would be tight after figures for the first six months of the financial year showed tax receipts had failed to match projections by the Office for Budget Responsibility (OBR).

He said: "Borrowing looks set to be higher than the OBR forecast in March, possibly by a reasonable margin. The trend so far suggests that over the year as a whole receipts could undershoot by £14bn."

Pope said income from other sources could limit the hole in the Treasury's budget to £8bn, but it could nevertheless act as a brake on plans to support a wide range of infrastructure projects and provide incentives for businesses to invest.

The IFS report followed a collapse in corporation tax receipts to the lowest level since 2009 that helped widen the budget deficit in September to £10.6bn.

A slowdown in the growth of VAT receipts was also blamed for pushing the deficit £1.3bn higher, or 14.5%, than the same month last year and above the £10.5bn recorded in August.

City analysts, who had expected an £8.5bn shortfall, said the OBR would need to rip up its pre-Brexit vote forecasts after a run of projections from all the major economic institutions showing GDP growth and tax receipts slowing next year.

In recent months Hammond has sent conflicting signals about the likely size and scope of extra spending to compensate for the uncertainty surrounding the Brexit negotiations and forecasts of growth for next year that have halved from around 2.2% to nearer 1%.

Immediately after the vote he ripped up George Osborne's fiscal rule of achieving a budget surplus by the end of the parliament, and talked about the need for extra spending to create jobs and improve the country's infrastructure.

But he has sought to dampen expectations by emphasising that he is constrained by volatile international money markets, which could drive up the government's borrowing costs if he is seen to be reckless.

Hammond said on Friday: "We have already made significant progress in bringing the public finances under control, reducing the deficit by almost two-thirds since 2010, but our debt and deficit remain too high. We remain committed to fiscal discipline and will return the budget to balance over a sensible period of time, in a way that allows us the space to support the economy as needed."

The weak September figures took the budget deficit to £45bn for the first six months of the year, down nearly 5% from the same period in 2015. The Office for National Statistics could not offer a reason for the dive in corporation tax receipts.

Paul Hollingsworth, a UK economist at Capital Economics, said if the public finances continued on the current trend, borrowing would overshoot the OBR's forecast of £55.5bn for the financial year by about £17bn.

He said: “Even before the vote to leave the EU, the OBR’s fiscal forecasts were looking optimistic. But the weaker economic prospects over the next few years as a result means that these forecasts are likely to be revised substantially in the autumn statement next month.”

Budget deficit

Collapse in corporation tax receipts pushes budget deficit to £10.6bn

Shock figure seen as setback for Philip Hammond as he prepares to boost public spending in autumn statement

The chancellor has an even tougher job cushioning the economy against an expected slowdown. Photograph: David Hartley/Rex

Phillip Inman Economics correspondent
Friday 21 October 2016 13.14 BST

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Britain's public finances suffered a shock setback in September after a collapse in corporation tax receipts to the lowest level since 2009 widened the budget deficit to £10.6bn.

A slowdown in the growth of VAT receipts was also blamed for pushing the deficit £1.3bn, or 14.5%, higher than September last year and higher than the £10.5bn recorded in August.

City analysts, who had expected an £8.5bn shortfall, warned that the figures were a setback for Philip Hammond as he prepares to boost public spending in his autumn statement next month. The chancellor is seeking ways to boost growth next year to cushion the economy against a widely expected slowdown following the Brexit vote.

In recent months he has sent conflicting signals about the likely size and scope of extra spending to compensate for the uncertainty surrounding the Brexit negotiations and forecasts of growth for next year that have halved from around 2.2% to nearer 1%.

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He said: "Even before the vote to leave the EU, the OBR's fiscal forecasts were looking optimistic. But the weaker economic prospects over the next few years as a result means that these forecasts are likely to be revised substantially in the autumn statement next month."

Government expenditure since April has been kept in check, rising by £5.9bn or 1.7%, to £348.7bn while tax receipts from the biggest sources of income – income tax and national insurance – increased at a faster pace. National insurance was 7% higher at £59.3bn and income tax rose 2.7% to £78.7bn.

These improvements were undermined when the usually strong September corporation tax receipts proved much weaker, limiting the tax take to £21bn in the first half of the year. The interest bill on the government's debts caused another headache for the Treasury after it increased by £800m, or 9%.

The OBR said the rise in debt interest payments and a change in the monthly profile of contributions to the EU budget opened up a gap between central government expenditure and income to 4.5% from the first six months last year.

Suren Thiru, head of economics at the British Chambers of Commerce, said the rise in government borrowing underscored the weakness of the UK economy.

"The UK's ability to generate tax revenue has diminished following the financial crisis, and this underlying weakness is likely to be exacerbated further if the UK economy slows as we predict," he said, adding it was vital the chancellor offered incentives to "invest, create jobs, and support growth".

Hammond said: "We have already made significant progress in bringing the public finances under control, reducing the deficit by almost two-thirds since 2010, but our debt and deficit remain too high. We remain committed to fiscal discipline and will return the budget to balance over a sensible period of time, in a way that allows us the space to support the economy as needed."

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Government borrowing higher than expected at £10.5bn, figures show

Philip Hammond likely to scale back deficit targets in autumn statement as Office for National Statistics says there is no sign of negative impact from Brexit vote

Chancellor Philip Hammond has already signalled he's ready to 'reset' the public finances. Photograph: Ben Stansall/AFP/Getty Images

Angela Monaghan

Wednesday 21 September 2016 10.35 BST

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This article is **1 month old**

Government borrowing was a touch higher than expected in August as the chancellor prepares to blow deficit targets further off course in his maiden autumn statement in November.

Borrowing was £10.5bn last month, higher than the £10bn predicted by City economists but £900m lower than the same month a year ago according to the Office for National Statistics.

It helped to reduce the deficit for the financial year, from April to August, to £33.8bn, which was £4.9bn lower than at the same point last year.

In order to meet the full-year target set out at the time of the March budget, borrowing would have to fall by £21bn over the next seven months.

In March, George Osborne was still in Number 11 and set an ambitious plan to swing the public finances back into a surplus of £10.4bn by 2019-20, with unspecified spending cuts and tax rises.

Economists, however, say that Osborne's successor, Philip Hammond, was likely to row back on some of the old targets, having already signalled he is ready to "reset" the public finances to support the economy.

Scott Bowman, UK economist at Capital Economics, said: "The improvement in the public finances in August is unlikely to continue as the post- referendum economic slowdown begins to bite and chancellor Hammond probably eases the fiscal squeeze in the autumn statement."

John Hawksworth, chief economist at PwC, said Hammond was likely to announce measures to boost spending in areas such as housing and transport in order to offset a potential slowdown in private investment.

"We would also expect him to push back by a couple of years the date by which he aims to eliminate the budget deficit," Hawksworth said. "But we would still expect him to pursue this objective in the longer term as economic conditions permit."

In a separate assessment of the state of the UK economy following the referendum, the ONS said that while the post referendum picture was still emerging, there had been no sharp collapse in confidence as some had feared. It could take months, quarters and years for the full picture to emerge.

Chief economist Joe Grice said: "As the available information grows, the referendum result appears, so far, not to have had a major effect on the UK economy. So it hasn't fallen at the first fence but longer-term effects remain to be seen."

He added that the first estimate of gross domestic growth for the third quarter, to be published on 27 October, would provide a clearer picture.

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The August figures were boosted by a 7.1% increase in tax receipts, with a 12% rise in income tax payments.

Martin Beck at the EY Item Club said the Office for Budget Responsibility was likely to cut its UK growth forecasts when it revises them at the time of the autumn statement in November.

He said: "The OBR is likely to cut its growth forecast, which combined with a possible fiscal stimulus, could push up annual borrowing by the tens of billions of pounds."

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How worried should we be about national debt?

Robert Skidelsky

The argument for fiscal austerity, coupled with concerns about budget deficits in the UK and US, is gaining traction, but invalid

There is a website showing the UK's national debt, which stands at £1.7tn, growing by £5,170 a second.
Photograph: Paul Ellis/AFP/Getty Images

Thursday 25 August 2016 08.36 BST

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Most people are more worried by government debt than taxation. "But it's trillions", a friend of mine recently expostulated about the UK's national debt. He exaggerated a bit: it is £1.7tn. One website features a clock showing the debt growing at a rate of £5,170 a second. Although the tax take is far less, the UK government still collected a hefty £750bn in taxes in the last fiscal year. The tax base grows by the second, too, but no clock shows that.

Many people think that, however depressing heavy taxes are, it is more honest for governments to raise them to pay for their spending than it is to incur debt. Borrowing strikes them as a way of taxing by stealth. "How are they going to pay it back?" my friend asked. "Think of the burden on our children and grandchildren."

I should say that my friend is extremely old. Horror of debt is particularly marked in the elderly, perhaps out of an ancient feeling that one should not meet one's maker with a negative balance sheet. I should also add that my friend is extremely well educated and had played a prominent role in public life. But public finance is a mystery to him: he just had the gut feeling that a national debt in the trillions and growing by £5,170 a second was a very bad thing.

One should not attribute this gut feeling to financial illiteracy. It has been receiving strong support from those supposedly well versed in public finance, particularly since the financial crisis of 2008. Britain's national debt currently stands at 84% of GDP. This is dangerously near the threshold of 90% identified by the Harvard economist Kenneth Rogoff, together with Carmen and Vincent Reinhart, beyond which economic growth stalls.

In the face of criticism of the data underlying this threshold, Rogoff has held firm and he now gives a reason for his alarm. With US government debt running at 82% of GDP, the danger is of a fast upward shift in interest rates, he says. The "potentially massive" fiscal costs of this could well require significant tax and spending adjustments – economist code for increasing taxes and reducing public spending – which would increase unemployment.

This is the financial leg of the familiar crowding out argument. The higher the national debt, according to this view, the greater the risk of government default and therefore the higher the cost of fresh government borrowing. This in turn will raise the cost of new private sector borrowing, which is why Rogoff wants the US government to lock in currently low rates by issuing much longer-term debt to fund public infrastructure. Maintaining low interest rates for private bank loans has been one of the main arguments for reducing budget deficits.

But this argument, or set of arguments – there are different strands – for fiscal austerity is invalid. A government that can issue debt in its own currency can easily keep interest rates low. The rates are bounded by concerns about inflation, overexpansion of the state sector and the central bank's independence, but with relatively low levels of debt – Japan's debt amounts to more than 230% of its GDP – and depressed output and inflation, these limits are quite distant in the UK and the US. As the record shows, continuous increases in both countries' national debt since 2008 have been accompanied by a fall in the cost of government borrowing to near zero.

The other leg of the argument for reducing national debt has to do with the burden on future generations. The then US president Dwight Eisenhower expressed this thought succinctly in his State of the Union message in 1960: generating a surplus to pay back debt was a necessary "reduction on our children's inherited mortgage". The idea is that future generations would need to reduce their consumption in order to pay the taxes required to retire the outstanding debt – government deficits today crowd out the next generation's consumption.

Although governments have endlessly repeated this argument in the past eight years as a justification for fiscal tightening, the economist AP Lerner pointed out its fallacy years ago. The burden of reduced consumption to pay for state spending is borne by the generation that lends the government the money in the first place. This is crystal clear if the government simply raises the money it needs for spending through taxes rather than borrowing it.

Furthermore, the idea that additional government spending, whether financed by taxation or borrowing, is bound to reduce private consumption by the same amount, assumes that no flow of additional income results from extra government spending. In other words, that the economy is already at full capacity. This has not been true of most countries since 2008.

But in the face of such weighty, if fallacious, testimony to the contrary, who am I to persuade my elderly friend to ignore his gut when it comes to thinking about the national debt?

Robert Skidelsky is an emeritus professor of political economy at Warwick University, a fellow of the British Academy in history and economics, and a member of the House of Lords.

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KENNETH ROGOFF

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Kenneth Rogoff, Professor of Economics and Public Policy at Harvard University and recipient of the 2011 Deutsche Bank Prize in Financial Economics, was the chief economist of the International Monetary Fund from 2001 to 2003. The co-author of *This Time is Different: Eight Centuries of Financial Fol…* READ MORE

America’s Looming Debt Decision

BOGOTÁ – Should the US government lock in today’s ultra-low borrowing costs by issuing longer-term debt? It’s a tough call, but with overall debt levels already high (not to mention unfunded pension and medical insurance liabilities, which are both likely to rise), perhaps the time has come.

Until now, the US Treasury and the Federal Reserve Board, acting in combination, have worked to keep down long-term government debt, in order to reduce interest rates for the private sector. Indeed, at this point, the average duration of US debt (integrating the Fed’s balance sheet) is now under three years, well below that of most European countries, even taking into account their own central banks’ massive quantitative-easing (QE) programs.

The tilt toward short-term borrowing as a way to try to stimulate the economy has made sense until now. Given that the interest rate on 30-year US debt is roughly 200 basis points higher than on one-year debt, short-term borrowing has saved the government money as well.

But the government should not operate like a bank or a hedge fund, loading up on short-term debt to fund long-term projects. It is too risky. With net US government debt already running at 82% of national income, the potential fiscal costs of a fast upward shift in interest rates could be massive.

No one is saying that such a shift is likely or imminent, but the odds aren't as trivial as some might like to believe. For starters, interest rates could spike in the event of a war or some other catastrophic event. Less dramatic but more likely is that the Fed will someday find a way to push up inflation expectations, which, as in most advanced economies, have been drifting inexorably downward. If inflation expectations do start rising, this will push up rates.

A rise in borrowing rates could also come from self-inflicted damage. Suppose, for example, that US voters elect as their president an unpredictable and incompetent businessman, who views bankruptcy as just business as usual. Alternatively, it is not difficult to imagine a sequence of highly populist leaders who embrace the quack idea that the level of government debt is basically irrelevant and should never be an obstacle to maximizing public spending.

Unfortunately, if the US ever did face an abrupt normalization of interest rates, it could require significant tax and spending adjustments. And the overall burden, including unemployment, would almost surely fall disproportionately on the poor, a fact that populists who believe that debt is a free lunch conveniently ignore.

Mind you, lengthening borrowing maturities does not have to imply borrowing less. Most economists agree that larger deficits make sense if used to pay for necessary infrastructure and education improvements, not to mention enhancing domestic physical and cyber security. There is a significant backlog of worthy projects, and real (inflation-adjusted) interest rates are low (though, properly measured, real rates may be significantly higher than official measures suggest, mainly because the government's inability to account properly for the benefits of new goods causes it to overstate inflation). One hopes that the next president will create an infrastructure task force with substantial independence and technocratic expertise to help curate project proposals, as the United Kingdom's pre-Brexit government did.

With control of the global reserve currency, the US has room to borrow; nonetheless, it should structure its borrowing wisely. Several years ago, it still made sense for the Fed to do cartwheels to bring down long-term borrowing costs. Today, with the economy normalizing, the case for creative policies like QE, which effectively shortens government debt by sucking long-term bonds out of the market, seems much weaker.

That is why the time has come for the US Treasury to consider borrowing at longer horizons than it has in recent years. Today, the longest maturity debt issued by the US government is the 30-year bond. Yet Spain has successfully issued 50-year debt at a very low rate, while Ireland, Belgium, and even Mexico have issued 100-year debt. Sure, there is no guarantee that rates won't drop even more in the future, but the point is to have a less risky stream of future interest obligations.

Many left-leaning polemicists point to Japan, where net debt is about 140% of GDP, as proof that much higher debt is a great idea, despite the country's anemic growth record. The implication is that there is little need to worry about debt at all, much less its maturity structure. In fact, Japanese policymakers and economists are plenty worried and do not recommend that other countries emulate their country's debt position.

Europe is admittedly in a very different place, with much higher unemployment, and a much stronger argument for continuing to pursue stimulus at the risk of higher debt-service costs in the future. But with the US economy now enjoying a solid recovery, the best approach may be to move faster toward normalizing debt policy, and not to assume that foreign lenders will be patient, regardless of the direction of US politics.

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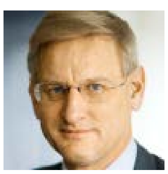

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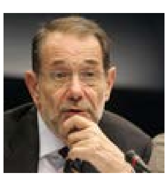

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US Interest rates

US interest rates to stay unchanged for at least two months, says Fed

This is the fifth time the Fed has decided against raising interest rates since December, when it raised interest rates for the first time in almost a decade

Specialists Dilip Patel and Glenn Carell work at a post on the floor of the New York Stock Exchange on Wednesday. Photograph: Richard Drew/AP

Jana Kasperkevic in New York
@kasperka email
Wednesday 27 July 2016 20.22 BST

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The Federal Reserve decided to hold steady and not raise US interest rates for at least another two months at its latest meeting, arguing that near-term risks to the US economy have diminished.

This is the fifth time that the Fed has decided against raising interest rates since December, when it raised interest rates for the first time in almost a decade. Federal interest rates remain unchanged at 0.25% to 0.5%.

US Federal Reserve's interest rate

Monthly

Source: Federal Reserve | Graphic: Jan Diehm/The Guardian

“We continue to expect the next tightening move to be in December. That said, the wording does not preclude a move in September; a lot can happen in eight weeks,” Jim O’Sullivan, chief US economist at High Frequency Economics, wrote in a note to investors.

The only dissenting member of the Federal Open Market Committee (FOMC), the Fed’s policy-setting committee, was Esther George, president of the Kansas City Fed. George has been advocating for higher interest rates for a some time, but voted to keep them unchanged in June after a disappointing jobs report found that just 38,000 jobs were created in May. That number was later revised to 11,000.

“Job gains were strong in June following weak growth in May. On balance, payrolls and other labor market indicators point to some increase in labor utilization in recent months,” the US central bank said in a statement.

Uncertainty over Brexit and US job market halted Fed's interest rates rise

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The news came as little surprise. Two different polls – one by Reuters and another by Wall Street Journal – found that economists expect the Fed to hold rates steady until after the election. The next rate hike is expected in December, if at all.

“Rate normalization has fallen down the Fed priority list and will remain there until the dust is well settled on the financial markets and the economy,” Jefferies economists predicted in a note last week.

But the decision to hold off on rates once more marks a dramatic shift in the Fed’s thinking from the start of the year. Originally, the Fed was expected to raise rates four times this year.

In addition to low inflation, the Fed said another reason for holding off on raising interest rates was “soft” business investment.

“Despite healthy corporate balance sheets and ample access to cash, businesses remain hesitant to invest in equipment, structures and high-wage, full-time employees. The longer this trend continues, the more difficult it will be for the US economy to expand beyond this stagnant 2% growth rate and the more challenging it will be for the Fed to justify a further adjustment to policy,” pointed out Lindsey Piegza, chief economist at investment banking firm Stifel. “After all, without business investment, job creation and by extension income growth and consumer spending will remain restrained.”

Second quarter earnings by companies like Starbucks, McDonald's and Chipotle have indicated a decrease in spending by US consumers. Steve Easterbrook, chief executive of McDonald's, said that consumers were spending less because they feel uncertain about their financial stability and the upcoming presidential election.

The Fed meets three more times this year – in September, November and December. The next meeting will take place on 20-21 September.

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Kenneth Rogoff

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The Curse of Cash—Data

This page contains links to data for figures and tables in *The Curse of Cash*, by Kenneth Rogoff, Princeton University Press, 2016.

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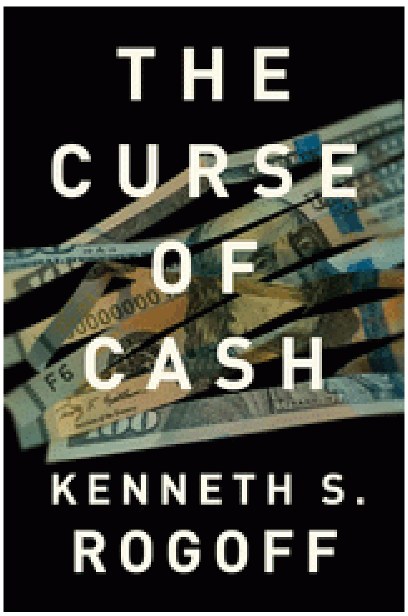

Economics

Philip Hammond rules out 'splurge' in public spending in autumn statement

Fiscal policy reset will be on modest scale with focus on small projects, chancellor says

Philip Hammond said UK will await more data on the state of post-Brexit economy before making any decisions. Photograph: Stefan Rousseau/PA

Larry Elliott in Washington
Friday 7 October 2016 17.14 BST

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Philip Hammond has ruled out a "splurge" in public spending to support the economy in next month's autumn statement and said that any help to boost demand would be on only small projects that deliver productivity improvements.

Speaking in Washington, the chancellor said he would wait for more data on the state of the post-Brexit economy before making any decisions but made it clear that the previously announced "re-set" to fiscal policy would be on a modest scale.

Hammond said it was sensible to abandon the plan announced by his predecessor, George Osborne, to run a budget surplus by the end of the current parliament in 2019-20 and that there was now an opportunity to support the economy.

"Now is a good time to invest in genuinely productivity-enhancing infrastructure, and to take advantage of low borrowing costs and our ability to borrow.

"But this is not about a fiscal splurge. It is about supporting the economy in a measured and balanced way."

The chancellor left open the option of doing nothing in the autumn statement, saying that he would make up his mind as more data came in over the next month.

But he dropped the broadest of hints that he is planning to supplement the stimulus provided by the Bank of England with "careful, considered and targeted" measures.

At the end of a week that has seen sterling fall to a fresh 31-year-low on a daily basis, Hammond was careful to do nothing to add to the downward pressure on the pound.

He dampened speculation that the government would announce some high-profile public spending initiatives in the autumn statement, pointing instead to smaller-scale projects – such as road and rail improvements – with sizeable pay offs.

Hammond said it was not sensible to stick to Osborne's plan given the expectation that there would be turbulence for the two-year period of negotiations between Britain and the other 27 EU states that will begin by next March.

But he said the state of Britain's public finances meant there was still the need for a timetable to get borrowing down.

"We have very high debt to GDP and a significant budget deficit. It is not credible to leave fiscal policy unanchored. I want to give the markets a clear set of benchmarks and will set out my plan in the autumn statement."

The chancellor said it was quite often the "modest" public infrastructure projects that had the best returns, because they could to be started quickly. "They give a short-term boost to the economy but also provide longer-term benefits."

He added: "It will not be spending in the way previous chancellors have used the word investment. It will be investment in the way a businessman would understand the word investment."

Hammond said he wanted a framework that allowed him to respond to economic conditions, stressing that if the official figures for growth in the third quarter – due out in late October – was much stronger than expected he might do nothing.

Financial markets, however, are braced for some action from the Treasury in the autumn statement given the comments made by both the chancellor and the prime minister, Theresa May, since the Brexit vote on 23 June.

Hammond said the UK was fundamentally strong. "The data for the first half of 2016 has been revised up to show that the economy going into the referendum was stronger than we thought.

“That doesn’t alter the fact that I expect there to be a period of turbulence as the economy responds to the uncertainty that the vote has created, and adjusts to the changed arrangement with the European Union.

“Although the economy has been resilient, we have to expect and plan for ups and downs that will be seen over the next 24 months as we negotiate our exit from the EU.”

Hammond said he was not surprised at the tough noises emerging from other EU countries, saying that was simply part of the negotiating process. “We will say what we want and say it is non-negotiable. They will say what they want and insist it is non-negotiable. Then we will negotiate,” he said.

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Invest in housing and broadband, business group tells chancellor

Autumn statement is Philip Hammond's opportunity to show he is serious about supporting business after Brexit, says British Chambers of Commerce

The chancellor of the exchequer, Philip Hammond, arriving in Downing Street for a cabinet meeting. Photograph: Daniel Leal-Olivas/AFP/Getty Images

Staff and agencies

Sunday 16 October 2016 23.49 BST

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The government should include a multibillion-pound package of measures in the autumn statement to support UK companies in the wake of the EU referendum, a business lobby group has urged.

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The British Chambers of Commerce (BCC) said the chancellor, Philip Hammond, should adopt measures including reform of business rates, investment in housing and broadband and more help for smaller companies. The proposals would cost £4.6bn a year, equivalent to 0.6% of government spending, the BCC said.

The BCC's director general, Adam Marshall, said: "The autumn statement gives the government a great chance to set the tone for its relationship with British business by pulling out all the stops to support investment, infrastructure improvements and business confidence.

“The chancellor made the right move when he signalled his willingness to use historically low interest rates to invest prudently to support growth and he has a golden opportunity now to use this fiscal flexibility to ‘crowd in’ business investment.”

In its submission before next month’s statement, the BCC said concern about a slowing economy had intensified after the Brexit vote. It said the chancellor should also pledge not to introduce any other significant costs on business for the rest of this parliament.

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Budget deficit

UK faces £14bn shortfall in public finances, warns IFS

Collapse in corporation tax receipts and rise in borrowing costs will cut Philip Hammond's room for manoeuvre at autumn statement, says thinktank

City analysts say the OBR must rip up its pre-Brexit vote forecasts after projections show GDP growth and tax receipts slowing. Photograph: Justin Tallis/AFP/Getty Images

Phillip Inman Economics correspondent
Friday 21 October 2016 20.06 BST

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Higher borrowing costs and lower tax receipts could deprive Philip Hammond of up to £14bn when he presents his autumn statement next month, denying him vital funds to boost the economy after the Brexit vote, a leading tax and spending thinktank has warned.

The Institute for Fiscal Studies (IFS) said that an unexpected downturn in the public finances in September was likely to be repeated in the next few months and bust the government's annual borrowing limits set earlier this year.

Thomas Pope, an economist at the IFS, said the Treasury's room for manoeuvre would be tight after figures for the first six months of the financial year showed tax receipts had failed to match projections by the Office for Budget Responsibility (OBR).

He said: "Borrowing looks set to be higher than the OBR forecast in March, possibly by a reasonable margin. The trend so far suggests that over the year as a whole receipts could undershoot by £14bn."

Pope said income from other sources could limit the hole in the Treasury's budget to £8bn, but it could nevertheless act as a brake on plans to support a wide range of infrastructure projects and provide incentives for businesses to invest.

The IFS report followed a collapse in corporation tax receipts to the lowest level since 2009 that helped widen the budget deficit in September to £10.6bn.

A slowdown in the growth of VAT receipts was also blamed for pushing the deficit £1.3bn higher, or 14.5%, than the same month last year and above the £10.5bn recorded in August.

City analysts, who had expected an £8.5bn shortfall, said the OBR would need to rip up its pre-Brexit vote forecasts after a run of projections from all the major economic institutions showing GDP growth and tax receipts slowing next year.

In recent months Hammond has sent conflicting signals about the likely size and scope of extra spending to compensate for the uncertainty surrounding the Brexit negotiations and forecasts of growth for next year that have halved from around 2.2% to nearer 1%.

Immediately after the vote he ripped up George Osborne's fiscal rule of achieving a budget surplus by the end of the parliament, and talked about the need for extra spending to create jobs and improve the country's infrastructure.

But he has sought to dampen expectations by emphasising that he is constrained by volatile international money markets, which could drive up the government's borrowing costs if he is seen to be reckless.

Hammond said on Friday: "We have already made significant progress in bringing the public finances under control, reducing the deficit by almost two-thirds since 2010, but our debt and deficit remain too high. We remain committed to fiscal discipline and will return the budget to balance over a sensible period of time, in a way that allows us the space to support the economy as needed."

The weak September figures took the budget deficit to £45bn for the first six months of the year, down nearly 5% from the same period in 2015. The Office for National Statistics could not offer a reason for the dive in corporation tax receipts.

Paul Hollingsworth, a UK economist at Capital Economics, said if the public finances continued on the current trend, borrowing would overshoot the OBR's forecast of £55.5bn for the financial year by about £17bn.

He said: “Even before the vote to leave the EU, the OBR’s fiscal forecasts were looking optimistic. But the weaker economic prospects over the next few years as a result means that these forecasts are likely to be revised substantially in the autumn statement next month.”

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Budget deficit

Budget deficit will be much bigger than hoped, ONS figures show

Deficit reduction slower than predicted, despite £2.2bn borrowing drop that allows government to hail strength of economy

The new chancellor, Philip Hammond, said the economy was in a good position to deal with the aftermath of the Brexit vote. Photograph: Mark Thomas/REX/Shutterstock

Larry Elliott Economics editor
Thursday 21 July 2016 12.51 BST

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Britain's budget deficit is on course to be much higher this year than the government hoped, despite an unexpectedly large fall in public borrowing last month, official figures show.

The Office for National Statistics said public borrowing in June stood at £7.8bn, compared with £10bn in the same month last year and the £9.5bn predicted by the City.

Although the smallest June deficit for nine years allowed the new chancellor, Philip Hammond, to say the economy was in good shape to cope with the aftermath of the Brexit vote, the ONS figures show that deficit reduction in the first three months of the 2016-17 financial year was slower than forecast in George Osborne's March budget.

Osborne envisaged borrowing being cut by around a quarter in the current year. But during the first three months of the financial year, slow growth in tax receipts meant there was an improvement of just over 8%.

The ONS said public sector net borrowing – the government's preferred measure of the size of the budget deficit – stood at £25.6bn in April to June 2016, compared to £27.9bn in the same months in 2015. Assuming a similar performance for the year as a whole, the deficit would total almost £70bn, rather than the £55bn forecast by the Office for Budget Responsibility.

Analysts said the decision to leave the EU would lead to slower growth, with a knock-on effect on public finances.

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John Hawksworth, chief economist at PricewaterhouseCoopers, said: "There was some good news for the new chancellor in today's data, with public borrowing in June down by £2.2bn on a year earlier, following two months when the deficit had been stuck at around the same levels as in the previous year.

"Economic growth is likely to slow significantly after the Brexit vote, however, and this will take its toll on tax revenues. For 2016-17 as a whole, it therefore seems likely that the budget deficit will come in significantly higher than the OBR forecast back in March on the assumption of a vote to remain in the EU."

Hammond said: "These public finance figures highlight the underlying strength of the British economy. Ahead of the referendum, monthly borrowing continued to fall, with the deficit in June the lowest it has been since 2007.

"As our economy now adjusts to reflect the referendum decision, it is clear we will do so from a position of economic strength."

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