

UK Budget

Key themes for Charities

The 2011 Budget marked a departure from the June emergency Budget, delivering downgrades to growth and upward revisions to levels of public borrowing (excluding the current fiscal year). The government also intend to issue more debt than we expected over 2011/12, but this is mainly due to the rebuilding of foreign reserves. Overall, the measures introduced on tax and spending were fiscally neutral, and therefore the Chancellor stuck to the message that deficit reduction is the first and foremost objective of the coalition.

For charities, some innovative changes to the rules on giving, particularly from estates, are progressive in attempting to widen the scope and scale of charitable donations. In particular, the Chancellor announced that charities could claim gift aid on up to £5,000 worth of small donations, without the need for lengthy form filling, the cap on the value of presents given to donors by charities rose to £2,500 from £500, and plans to reduce the rate of inheritance tax by 10% for those who leave 10% or more of their estates to charitable causes were also introduced (those donations can be cash or assets). These moves were welcomed by charities and could be worth as much as £540m to charities if fully taken up. The government's aim is to encourage charitable giving across a broader spectrum of society and to encourage the well-off to contribute a larger proportion of their income and estates. These measures will certainly help that goal and mitigate against the effects of weaker growth and higher unemployment on charitable giving.

What the figures say

- **GDP.** OBR cuts forecasts for economic growth in 2011 (1.7% from 2.1%) and 2012 (2.5% from 2.6%) – the former by more than expected. The 2013 GDP projection is unaltered at 2.9%. Projections for both 2014 (2.9%) and 2015 (2.8%) were nudged up by 0.1pp. The key point is that the *level* of GDP is around ¾pp lower throughout the forecast period and this accounts for the upward revisions to borrowing (see below). The government is still reliant on solid medium-term GDP projections (expansion at close to 3% in 2013 and beyond) but, overall, the revisions leave the OBR more in line with consensus expectations (and further below the MPC's near-term forecasts).
- **Borrowing.** The 2010-11 full-year PSNB outturn was lowered by £2.6bn (a little less than we had expected). In each subsequent year PSNB estimates were raised: by £5bn in 2011-12 and then c.£10bn a year out to 2015-16. PSNB is now forecast to stand at £29bn (1.5% of GDP) in 2015-16, up from £18bn (1.0% of GDP) estimated by the OBR in November 2010. The CGNCR data – the borrowing aggregate which forms the basis for gilt issuance – shows a similar pattern: an up-front £3bn deficit reduction in 2010-11 followed by upward revisions to borrowing from 2012-13. On a cumulative basis, the Budget 2011 forecasts unveiled an additional £34bn of CGNCR (and, by implication, gilt issuance) in the period to 2015-16 – not a dramatic change over a 5 year period and one that remains sensitive to the GDP outlook.

Neil Parker
Market Strategist, RBS
+44 20 7085 3254
neil.parker@rbs.com
135 Bishopsgate
London EC2M 3UR

■ **2011 Budget policy measures.** The 2011 Budget was fiscally neutral. There were several eye-catching tax breaks (corporation tax, income tax allowances and fuel duties) but these were offset by increases elsewhere (North Sea taxation, national insurance rebates and a host of anti-avoidance/evasion measures). The policy mix reflects the government’s priority of lowering corporation tax to support investment and job creation and to provide some relief to hard-pressed households. Doubts will linger about the extent to which the anti-avoidance measures yield the projected revenue increases.

The change in the cyclically-adjusted deficit (a top-down proxy for the fiscal policy stance) shows a 2.1% of GDP reduction in 2011-12, a significant step up in the pace of tightening vs 2010-11 (1.5% of GDP) but a marginally less rapid shift than previous envisaged. By 2015-16, the government is forecasting a small cyclically-adjusted PSNB of 0.5% of GDP.

The fiscal big issue

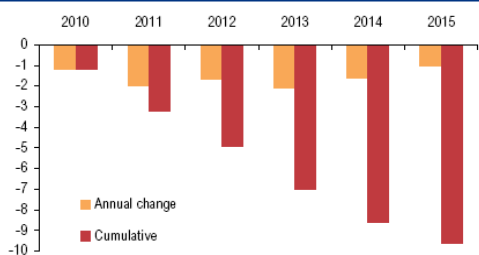
The fiscal big-picture remains much as it was: a substantial consolidation over the next 5 years with a significant step-up in the pace of deficit reduction in the coming year. The terrain has become tougher, with a lower level of economic activity throughout the forecast period. Nevertheless, the policy mix shifts increasingly towards public expenditure cuts and this is where the government’s real challenge lies: reining-in public spending as set out in the detail of the Budget 2011 numbers. This is as much about political will as it is about the economic cycle.

In summary

The 2011-12 financial year will continue to present the first significant test of the Coalition government’s ability to *deliver* spending cuts (the challenge a year ago was to put in place a credible *plan*). The Coalition’s medium-term fiscal route map has succeeded in winning market credibility and the government has made modest inroads to reducing the deficit (thus far principally via tax hikes). We now progress to the next stage. Risks of a dilution of fiscal consolidation remain – either as a result of a deliberate policy change or via a failure to implement spending cuts – but these risks pertain primarily to 2013 and beyond, once the next general election appears on the horizon (the election must be held by May 2015).

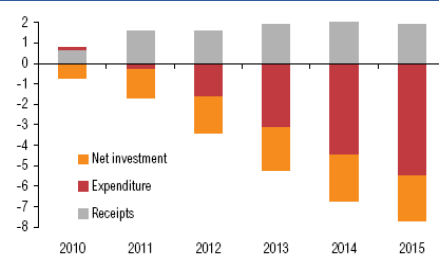
The overall UK fiscal policy stance remains restrictive, with declines in cyclically-adjusted PSNB of 2.1% of GDP in 2011-12, 1.6% of GDP in 2012-13 and 1.7% of GDP in 2013-14. Over the period to 2015-16, the average projected annual reduction in cyclically-adjusted PSNB is 1.4% of GDP. An alternative gauge of the expected impact of fiscal tightening is the contribution of real government consumption expenditure to GDP. Whereas buoyant government consumption growth during the 1997-2006 cycle averaged 2.3% y/y, contributing on average 0.43pp to GDP growth, the outlook over the next few years is for government consumption to exert a significant drag on GDP growth. The OBR projects government consumption to fall, on average, by 1.3% a year between 2011 and 2015, subtracting an average 0.27pp from GDP growth.

Chart 1: Projected change in UK public deficit
% of GDP, annual & cumulative



Source: OBR, RBS

Chart 2: Fiscal policy mix
Cumulative change, % of GDP



Source: OBR, RBS

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