

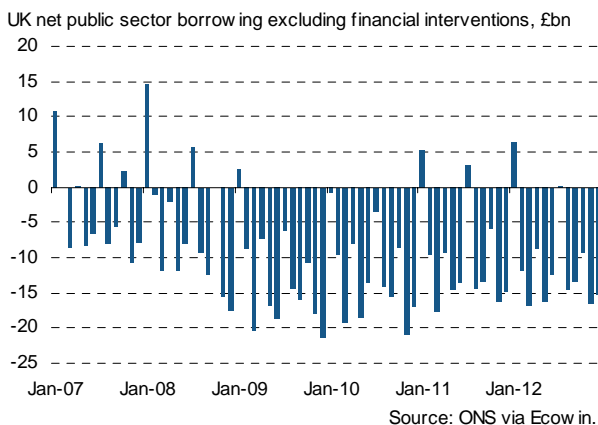
United Kingdom

Government borrowing higher than expected as weak economic growth hits tax revenues

- **Borrowing up from £14.8bn last year to £15.4bn in December, up 7% in year to date**
- **Tax revenues rise at slower rate than spending**
- **Data add to risk of credit rating downgrade**

Government borrowing appears on course to be higher than planned for the current year, as austerity measures have failed to reduce government spending and weak economic growth has resulted in disappointing tax revenues. The danger is that the data add to the risk of the UK losing its AAA credit rating, a risk that will intensify significantly if Friday's GDP report shows the UK entering a new downturn.

UK government borrowing



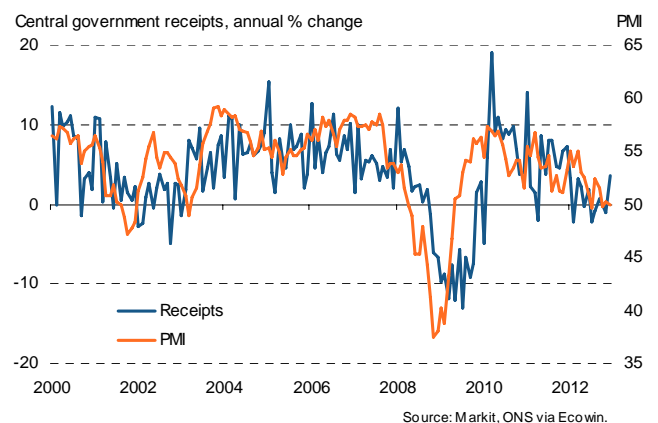
Government borrowing rose by a slightly larger than expected £15.4bn in December, up from £14.8bn last year. The government was dealt some better news in the form of revisions to back data, which meant that over the year to date, borrowing is only 7.3% higher than last year compared to the 9.9% increase that was signalled in the November data release. However, with total borrowing from the year (excluding the Royal Mail pension fund transfer) already up to £106.5bn (up from £99.3bn in the same period of last year), there is little doubt that the government's target for the whole year of £108.5bn will be breached, and possibly to quite a substantial degree.

In the final three months of the 2011-12 financial year, borrowing totalled £22.4bn. Even if the government managed somehow to match last year's performance over the three months to April, that would take borrowing for the full year up to £129bn.

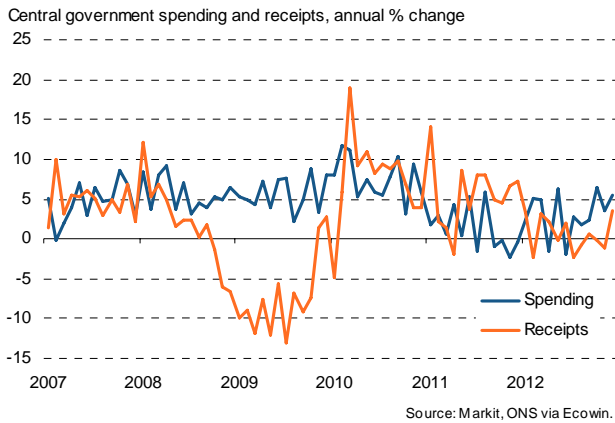
The picture is blurred, of course, by coupons from the Bank of England's asset purchases now being transferred to the government's account, and the sale of 4G licenses boosting revenues, which may limit the overshoot, but the underlying disappointing borrowing trend if such one-off factors are excluded will not be missed by the credit rating agencies.

Government spending was 5.4% up on last year in December, and 2.7% higher in the year to date, while revenues rose 3.6%, up just 0.3% over the year to date. The problem is therefore primarily one of disappointing economic growth, which has led to lower than anticipated tax revenues, with the official data and surveys such as the PMI collectively suggesting that the economy stagnated at best in the final quarter of last year. At the same time, it seems that austerity has failed to bring about a decline in the government spending.

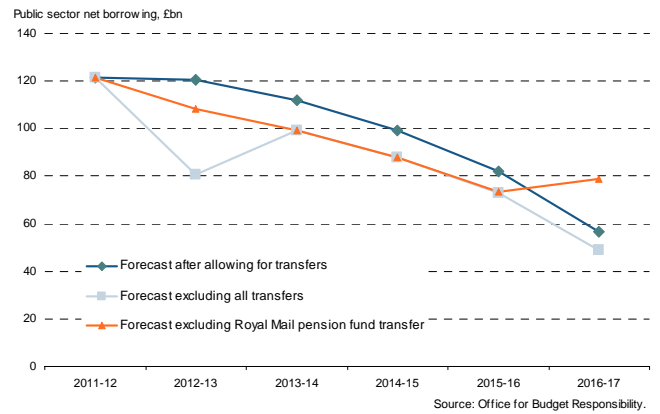
Economic growth and tax receipts



Revenues and spending



OBR deficit projections



* transfers include the coupons from the Bank of England Asset Purchase Facility, and reclassification of the Royal Mail pension fund and Bradford & Bingley and Northern Rock assets, plus an expected £3.5bn revenue from the auction of 4G mobile phone licences.

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