Government debt costs rocket to nearly £9bn a month

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HE government paid nearly £9 billion in interest on the national debt last month, a record, increasing fears that the cost of Covid is spiralling out of control.

Public sector net borrowing – the deficit – was £22.8 billion in June. That is far lower than official forecasts as the economy bounces back faster than expected and £5.5 billion lower than the same month a year ago as the pandemic raged.

But the £8.7 billion cost of just servicing the national debt, up from £2.7 billion a year ago, raised eyebrows in the City. The figure is the highest since records began in 1997.

The increase was caused by a rise in the retail price index, triggering a surge in interest payments on inflation-linked debt.

The RPI surged to 3.9% in June from a year ago in June, up from 0.5% in the summer of last year. While the Bank of England targets the consumer price index, which has showed lower increases, some government debt along with student loans and rail fares track the RPI.

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UK debt is at £2.2 trillion, just below 100% of GDP. Around a quarter of that is linked to inflation indices.

Michal Stelmach, senior economist at KPMG UK, said: “The volatility of debt interest spending underscores its sensitivity not just to inflation but also to interest rates, which can rapidly change the path of fiscal sustainability.”

Tax rises now seem inevitable.

Samuel Tombs, at Macroeconomics, said: “The Government will need to hike corporation tax and to increase the effective income tax rate by freezing existing thresholds.”

Interest payments on debt are unlikely to fall, with inflation rising and interest rates bound to go up at some point.

Ruth Gregory at Capital Economics said: “While debt service costs will probably stay higher than the OBR estimated over next few years, the public finances should continue to reap the benefits of a faster and fuller recovery in GDP than the OBR expects, meaning that the deficit should still fall faster. That said, we suspect the Chancellor will “bank” any improvement in the deficit rather than scale back the planned tax hikes and spending cuts set to hit the economy. At least by 2022/23, the economy should be strong enough to cope with it.”

Chancellor Rishi Sunak said: “I’m proud of the unprecedented package of support we put in place to protect jobs and help thousands of businesses survive the pandemic, and that we are continuing to support those who need it.

“However, it’s also right that we ensure debt remains under control in the medium term, and that’s why I made some tough choices at the last Budget to put the public finances on a sustainable path.”

The Institute for Fiscal Studies estimates the Treasury’s borrowing could come in £30 billion lower in the current fiscal year than the £234 billion pounds forecast in the budget in March.

That windfall won’t persist because of permanent damage done to the economy by the pandemic and rising debt interest costs. It also estimates that health, education and transport need at least £10 billion pounds extra in each of the next three years.

Isabel Stockton at the IFS said: “Borrowing remains very high, and the extent to which lower borrowing this year will translate into lower borrowing further forwards is highly uncertain.”