

# Economic Outlook Briefing

## 11 December 2019

### INTRODUCTION

The two most significant concerns for the British economy are political. On the one hand, the issue of Brexit continues to dominate political discussions and whatever is ultimately decided, it will have long lasting impacts on most aspects of the British Economy.

These include but are not limited to; our future trade, foreign direct investment, the value of the pound, migration, regulation, and productivity. In addition to Brexit, we are also in the midst of a General Election campaign, where the major parties are signing up to sizeable spending commitments.

Rather than speculate on who will be in No.10 on the 13 December, it is prudent to consider the potential impacts that these different commitments might have on your charity.

If wages make a large percentage of your expenditure, then you will want to monitor any pledges to increase the National Living Wage (NLW). If you rely on grants from local authorities for your income, then proposals to increase funding to local government will be of great interest.

We will explore some of the issues which will affect most charities in this briefing, but we'd recommend looking for anything that might be specific to your charity.

It is also worth noting that a number of the useful forecasts we would look to for help in gaining an understanding of the economy and the public finances have been postponed due to the impending election, most notably the Office for Budgetary Responsibilities (OBR) forecasts which would ordinarily accompany the budget, and the Bank of England's Financial Stability Report. So we will likely have to re-evaluate many of our assumptions in the new-year.

With these caveats in mind, we hope this briefing provides a useful overview of the key economic issues to be aware of, and helps your charity prepare and strategize for the short to medium term. We hope it proves a useful resource for trustees and charity boards to make strategic decisions about their finances.

## KEY STATISTICS

Measure	Figure	Notes
<b>UK Growth Q3 2019</b>	<b>0.3%</b>	With rolling three-month GDP showing no growth in October 2019 (August to October), due to a fall in manufacturing and a decline in construction.
<b>Unemployment</b>	<b>3.8%</b>	Aged 16 and over, seasonally adjusted)
<b>Employment</b>	<b>76%</b>	The highest rate of employment since records began
<b>Earnings</b>	<b>3.6%</b>	Increase of average earnings excluding bonuses
<b>Interest rates</b>	<b>0.75%</b>	Interest rates have remained stable for some time, but there has been speculation that rates will be cut following low levels of inflation
<b>Inflation</b>	<b>1.5% CPIH</b>	This is slightly below the BoE target of 2%

## BIG PICTURE

Following volatility in the first half of 2019, UK GDP growth has slowed over the last two quarters, with the UK narrowly avoiding a recession. The Office for National Statistics (ONS) estimates that GDP has grown by only 0.3% in Q3, and when compared to a year ago GDP has only increased by 1%, which is the slowest rate of quarter-on-year growth since Q1 2010.<sup>1</sup>

There are further causes for concern with the ONS commenting that the underlying momentum in the UK economy shows signs of slowing,<sup>2</sup> with GDP growth having actually fallen by 0.1% in September 2019 and remained stagnant in October.<sup>3</sup> Ongoing uncertainty with Brexit has persisted and is likely a contributor to the lack of business investment and household consumption that has taken place over the last few quarters, and it has been known for some time that there is a close relationship

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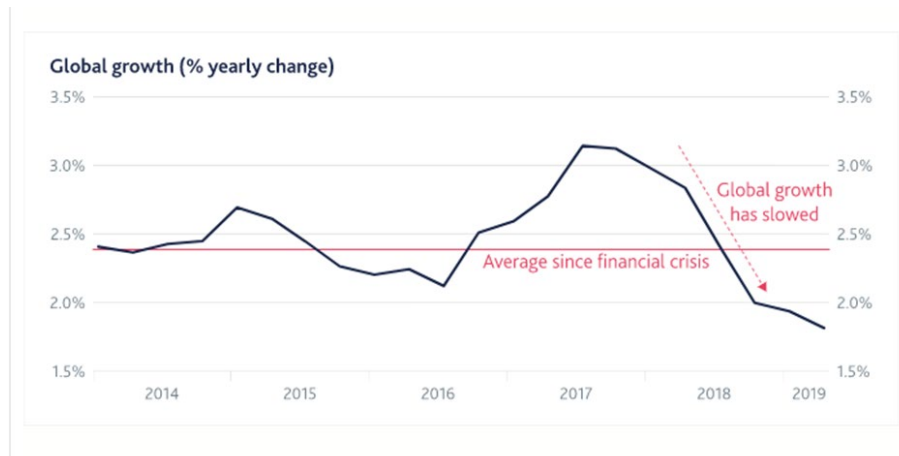
<sup>1</sup> A key reason for this is gross capital formation (GCF) falling (net capital expenditure, or public and business investment), although net trade did make a positive contribution to GDP growth.

<sup>2</sup> <https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/september2019>

<sup>3</sup> However, the monthly growth rate in GDP is volatile, so shouldn't be relied upon in isolation.

between uncertainty and spending. There has also been a notable increase in the number of organisations that cite Brexit as an important source of uncertainty.

These concerns with the UK economy have been exacerbated by a rise in global uncertainty due to trade protectionism and some weakness in a number of large emerging markets.



<https://www.bankofengland.co.uk/monetary-policy-report/2019/november-2019>

## FORECAST

Ordinarily we would rely on the Office for Budgetary Responsibility (OBR) forecast to offer the independent outlook for the of the UK economy. But with their forecast of the public finances having not taken place since March 2019 due to a cancelled budget and the imminent general election, we will rely primarily on the Bank of England's ( BoE) economic outlook from their November 2019 monetary policy report for our forecast.<sup>4</sup>

It's important to note that the Bank of England's' forecast presumes that we will have a 'deep-free trade agreement with the EU' in place following our departure, something which at the moment is far from certain. So as always, one should take these forecasts with the proverbial pinch of salt.

The BoE forecasts that 2019 Q4 will see growth of 1%, meaning that the UK economy will grow at roughly half the rate it did in 2018. The median projection for 2020 is 1.6%, and for 2021 1.8%, increasing further to 2.1% in 2022.<sup>5</sup>

If true, this could be quite significant for charities, as we will go on to explain in the sections on income from individuals and from government in this briefing.

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<sup>4</sup> <https://www.bankofengland.co.uk/monetary-policy-report/2019/november-2019>

<sup>5</sup> <https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2019/november/monetary-policy-report-november-2019.pdf>

## INCOME

The top line data show that there has been an overall growth in income for the charity sector, with the sector worth over £50bn for the first time.

The most up to date data from the NCVO almanac<sup>6</sup> indicates an interesting change in the way charities are generating income. While the public remains the single largest source of income for charities, closely followed by government, the amount of income from these sources has declined slightly (by c.1%). There has been a marked increase from the voluntary sector and investments, increasing by 13% and 17% respectively. A trend which has continued for some time is the increase in the share of income going to bigger organisations.

If we break these figures down further, we can see that different sizes of organisation tend to rely on different income sources. With micro to small charities overwhelmingly dependent on money from the public (making up 57% of their income), whereas super-major charities depend on money from the government and national lottery far more (making up c.43% of their income as opposed to 22% for smaller charities). This data can provide a useful benchmark for your charity to see how you compare to other organisations of a similar size.

It is worth reiterating evidence from the CAF Giving Report<sup>7</sup> that volatility in the wider economy and the stock market does not correlate to fundamental changes in the amount of donations from the public, with the amount remaining fairly stable at £10bn since 2005/06. However, their most recent edition has indicated that fewer people are giving, but that the amount that individuals with a higher net-worth are donating is increasing to offset this, but nonetheless this a trend we should continue to monitor.

A trend which has continued for some time is that the rate of return on fundraising investment is continuing to decline.<sup>8</sup> This means that every penny spent to raise funds is generating less in return. This is of course not to say that money invested in fundraising is no longer worthwhile, far from it, but that due to the increasing cost of regulation and the introduction of GDPR, margins are likely to be tighter than before.

### Income from Government

While individual donations aren't significantly affected by external political and economic shocks, this is not true of income derived from government, as income from government is far more dependent on external economic factors, as the introduction of austerity since 2010 has shown. This has led to a decline in funding for local authorities, and a corresponding reduction in grant funding for charities. There have been notable increases in funding for local government at the most recent budget, both via a direct funding of over a £ billion, but also via the social care

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<sup>6</sup> <https://data.ncvo.org.uk/>

<sup>7</sup> <https://www.cafonline.org/about-us/publications/2019-publications/uk-giving-2019>

<sup>8</sup> While the survey hasn't been done since 2015, anecdotal evidence from sector bodies in the fundraising have indicated that this trend is still true.

precept, which allows local authorities to raise additional revenue to pay for social care.

Even after the most recent increase, it has still meant a 17% fall in council spending on local public services since 2009-10, which corresponds to about £300 per person.<sup>9</sup> Another trend to be aware of is that council spending is increasingly dedicated on social care services, with over half of all service budgets spend on social care provisions. Not only has this meant a marked increase in demand for social care, but there has been a corresponding cut to what local authorities have spent on many sectors of direct relevance to the charities, including housing, leisure and cultural services.

Importantly this has led to the number of potential beneficiaries for charities to increase, with no corresponding increase in resources for the charities who deliver frontline services, which has placed a further squeeze on charity resources.

Many charities will hope for some respite following the upcoming election. While all major parties have commented on the need to invest more in local government, and particularly adult social care, we will have to wait for the new government's first budget, and later the long anticipated multi-year Spending Review for clarity on whether local government will be put on a sustainable footing.

Asking for further central government funding for local government, and to consider the longer-term financial sustainability of councils at the upcoming Spending Review, is one of the primary asks of our 'Charity Finance Manifesto' which has been co-signed by a wide range of charity infrastructure bodies.

## EXPENDITURE

### Inflation

Inflation has fallen to 1.5% over the last quarter, it has shrunk because of falling energy prices and water bills. However, the BoE still forecasts a rise in inflation towards the 2% target in a years' time, with it rising further in 2021 slightly above 2%.<sup>10</sup>

All things considered, these figures should not be a major concern for most charities, but it should be a reminder to charities that are sitting on large amounts of cash, that you should consider alternatives, as even though inflation is relatively low, and is likely to be in the short to medium term, it will still slowly eat away at your reserves.

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<https://www.ifs.org.uk/uploads/English-local-government-funding-trends-and-challenges-in-2019-and-beyond-IFS-Report-166.pdf><sup>9</sup>

<sup>10</sup> <https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2019/november/monetary-policy-report-november-2019.pdf>

## OPERATING COSTS

### Staffing

The overall workforce in the sector has declined slightly since 2017, but has grown over the last eight years, and still employs around 3% of the UK workforce, and according to data from the NCVO Almanac, the majority of employees within the sector work in organisations with less than 50 paid staff.

The UK jobs market had remained remarkably robust, with record low unemployment, and with the UK economic inactivity rate at only 20.8%, we are at what most would consider full employment. As of yet this has not yet led to significantly higher wages, in fact a lack of wage growth has been a feature of the past decade. The Resolution Foundation have argued that this is because collectively we're a lot poorer than we thought we would be, i.e. the labour supply by households has increased in response to a recession and a slow recovery in earnings <sup>11</sup>. This would explain why wages have remained stagnant, while unemployment is so low, and would suggest that there will be little reason to suppose an increase in earnings, without more sizeable growth in the economy.

The one pressure on wages that certain kinds of charities are likely to be affected by is the increase to the National Living Wage and National Minimum Wage. It last increased in April 2019, so regardless of who is in No.10 Downing Street during 2020, we would expect to see this increase. The key question will be by how much, and this will be very much dependent on the outcome of the election.

### Tax

The most recent figures from HMRC show that charity tax reliefs that applied to charities themselves equated to £3.7bn. The three largest of which were Gift Aid, business rates relief and VAT relief. <sup>12</sup>

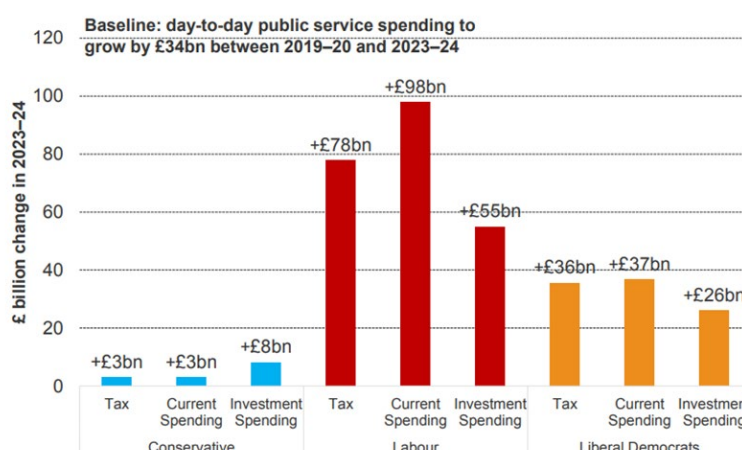
The outlook for tax for charities, and more broadly, depends greatly on who will form the next government. All major parties have published their manifestos which outline their proposals, and there has not been a time when the difference in tax proposals and in spending plans has been greater.

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<sup>11</sup> <https://www.resolutionfoundation.org/publications/feel-poor-work-more/>

<sup>12</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/811710/UK\\_Charity\\_Tax\\_Relief\\_Statistics\\_Commentary.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/811710/UK_Charity_Tax_Relief_Statistics_Commentary.pdf)



The graph above from the Institute for Fiscal Studies (IFS) analysis of the party manifesto makes this clear. With the Conservative party proposing relatively modest changes to tax and spend, with the Labour party proposing significant increases to both, and the liberal Democrats somewhere in the middle. Again, we are not proposing that one of these options is preferable to another, but merely that they change the outlook charity operating costs quite significantly.

CFG will be able to provide more detailed analysis shortly after the first budget of the new government, the Queen's Speech and the upcoming Spending Review which will take place later in 2020.

## Business Rates

There has been renewed interest in business rate reliefs for charities, with the Scottish government publishing their proposals to implement of the recommendations of the Barclay Review, which reviewed non-domestic tax rates in Scotland.

It proposed removing business rate relief for independent schools with charitable status, which would in effect create a two-tier charity system with some receiving business rate relief and some who won't. Similar proposals have been discussed by the Welsh Assembly, and some of the major political parties have also suggested such an idea in their manifesto. A number of parties including the Liberal Democrats and the Labour party have proposed the idea of replacing Business Rates entirely with a Land Value Tax.

The exact impact this would have on charities is unknown at this stage, but were such proposals to be enacted, we would advocate strongly that charities should be exempt, in-keeping with the long-held principle that money donated for public benefit should not be subject to tax.