INTERNATIONAL MONETARY FUND

IMF Country Report No. 20/320

UNITED KINGDOM

December 2020

2020 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE UNITED KINGDOM

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2020 Article IV consultation with the United Kingdom, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 16, 2020 consideration of the staff report that concluded the Article IV consultation with the United Kingdom.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 16, 2020, following discussions that ended on October 29, 2020, with the officials of the United Kingdom on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 3, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for the United Kingdom.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2020 Article IV Consultation with United Kingdom

FOR IMMEDIATE RELEASE

Washington, DC – **December 18, 2020:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with United Kingdom.

The UK economy entered 2020 with some challenges but also with some strengths. Key challenges included agreeing to a post-Brexit trade deal with the EU, weak productivity growth, large regional disparities in income, population aging (and its impact on pension spending), and the need to strengthen climate policies. At the same time, the economy was operating at full employment, inflation was close to target, household and corporate debt burdens had fallen substantially since 2009, the banking system was well-capitalized and liquid, and fiscal adjustment had set debt on a declining trajectory, with fiscal space available.

The pandemic has taken a significant human and economic toll, mitigated somewhat by an aggressive policy response. An even more tragic health impact was averted by a spring lockdown, subsequent restrictions, and a second lockdown announced in early November. These health restrictions hit economic activity hard, with a sharp decline in GDP in Q2. Nonetheless, a coordinated fiscal, monetary, and financial sector policy response has helped to hold down unemployment and insolvencies. Despite a rebound as the economy re-opened in the summer, growth for 2020 will likely be around -11 percent, with core inflation below target, and the current account deficit subdued at about 2½ percent.

The outlook is challenging. The second lockdown has already dampened activity. Prolonged social distancing in its aftermath and frictions associated with implementation of the new Brexit trade regime are expected to generate strong headwinds through mid-2021 (and for even longer if a free trade agreement cannot be reached). Still, as full re-opening occurs helped by vaccines, GDP is projected to rebound and grow by 5.7 percent in 2021 and about 4.5 percent in 2022. A faster recovery would be held back by corporate and household stress as exceptional fiscal support abates and the economy adjusts structurally to the new landscape once the immediate impact of Covid and Brexit recedes. By 2025, the level of output is projected to recover to about 5 percent below the pre-Covid trend, reflecting weaker investment and higher unemployment in the interim. Risks to the outlook are to the downside, centering on the pace at which the impact of the pandemic fades and the degree of balance

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

sheet damage sustained by households and small and medium enterprises. Faster vaccine deployment could mitigate risks.

Executive Board Assessment[2]

Directors noted that the pandemic has taken a significant human and economic toll in the U.K. economy already facing strains from Brexit and long-term challenges. They commended the authorities' strong and coordinated policy response, which has helped mitigate the damage. With uncertainties remaining high, Directors stressed that policy support will remain essential to see the economy through the pandemic and the transition to the post-Brexit trade regime.

Directors stressed that fiscal policy should continue to fully fund targeted pandemic support programs. They underscored the need to be prepared to respond in case further downside risks materialize and welcomed the authorities' flexibility in this regard. As the pandemic subsides, targeted fiscal support using available space could help invigorate growth. Directors welcomed the authorities' plans to expand public investment and recommended assessing the adequacy of the public investment management framework.

Directors emphasized that a gradual fiscal consolidation, necessary to contain the debt burden over the medium term, should only start once the private sector is durably leading the recovery. They saw merit in a full expenditure review to prepare for consolidation. A number of Directors also suggested being open to consider some adjustment to major tax rates and exploring fiscal measures in support of the climate agenda. In this context, Directors took positive note of the U.K.'s ambitious climate plans.

Directors considered that monetary policy should remain accommodative and welcomed the Bank of England's commitment to increase government bond purchases. They generally noted that a negative policy rate could be part of the toolkit but recommended further study on how best to deploy it. Directors stressed the role of the financial system in funding the recovery. While recognizing banks' sizable buffers, they cautioned that uncertainty related to SME stress and commercial property prices calls for continued close supervision.

Directors underscored that adjustment to the pandemic and Brexit will require some reallocation of labor and capital. They saw room to further strengthen the social safety net, enhance active labor market policies, streamline insolvency procedures, and unlock equity finance.

Directors commended the enviable track record of the U.K.'s policy frameworks. They suggested considering updates to the fiscal framework where needed once uncertainty

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

abates. Whether the monetary framework may need adjustment to address the risk of persistent low inflation also merits consideration. The 2021 FSAP will also be an opportunity to consider emerging financial sector challenges.

Directors emphasized that agreement on a new post-Brexit trade regime would benefit both the U.K. and the EU and reduce outward spillovers. They welcomed steps taken to eliminate systemic financial sector risks and urged the U.K. authorities to complete trade infrastructure preparations. Contingency plans will be needed in case no agreement is reached. In such a scenario, it will be important to keep expectations anchored and pursue stronger policy support.

United Kingdom: Selected Economic Indicators, 2015–21

	2015	2016	2017	2018	2019	2020	2021
						Projections	
Real Economy (change in percent)							
Real GDP	2.4	1.7	1.7	1.3	1.3	-11.2	5.7
Private final domestic demand	3.7	3.7	1.4	1.2	0.9	-14.8	4.5
CPI, end-period	0.1	1.2	3.0	2.3	1.4	0.7	1.7
Unemployment rate (in percent) 1/	5.4	4.9	4.4	4.1	3.8	4.8	7.3
Gross national saving (percent of GDP)	12.7	12.4	14.4	14.1	14.0	14.4	12.5
Gross domestic investment (percent of GDP)	17.7	17.8	18.2	17.8	18.3	17.0	16.8
Public Finance (fiscal year, percent of GDP)							
Public sector overall balance	-4.2	-2.6	-2.6	-1.8	-2.5	-19.1	-7.6
Public sector cyclically adjusted primary balance (staff estimates)	-2.4	-1.1	-0.9	-0.5	-0.9	-13.9	-4.0
Public sector net debt 2/	78.7	77.6	81.1	79.9	84.6	106.4	109.9
Money and Credit (end-period, 12-month percent change)							
M4	0.3	6.3	3.8	2.1	3.8	...	...
Net lending to private sector	2.8	3.8	3.7	3.6	3.2	...	...
Interest rates (percent; year average)							
Three-month interbank rate	0.6	0.5	0.4	0.7	0.8	...	...
Ten-year government bond yield	1.9	1.3	1.2	1.5	0.9	...	...
Balance of Payments (percent of GDP)							
Current account balance	-5.0	-5.4	-3.8	-3.7	-4.3	-2.6	-4.2
Trade balance	-1.5	-1.8	-1.4	-1.2	-1.4	0.8	-1.7
Net exports of oil	-0.3	-0.2	0.0	0.0	-0.3	-0.2	-0.2
Exports of goods and services (volume change in percent)	2.8	2.7	5.4	3.0	2.8	-13.5	4.4
Imports of goods and services (volume change in percent)	5.4	3.9	2.6	2.7	3.3	-20.2	12.8
Terms of trade (percent change)	2.6	0.2	-1.1	0.6	-0.1	-0.7	-1.1
FDI net	-3.6	-11.0	1.7	-0.8	-3.1	-1.6	1.0
Reserves (end of period, billions of US dollars)	130.5	136.6	158.6	176.6	182.7	...	...
Fund Position (as of May 31, 2016)							
Holdings of currency (in percent of quota)				82.5	82.5	82.5	82.5
Holdings of SDRs (in percent of allocation)				70.2	70.2	70.2	70.2
Quota (in millions of SDRs)				20,155	20,155	20,155	20,155
Exchange Rates							
Exchange rate regime							Floating
Bilateral rate (September 8, 2020)							US$1 = £0.7679
Nominal effective rate (2010=100, year average) 3/	113.4	102.3	96.3	97.9	97.7	...	...
Real effective rate (2010=100, year average) 3/	113.7	102.4	97.1	98.8	98.3	...	...

Sources: Bank of England; IMF's Information Notice System; HM Treasury; Office for National Statistics; and IMF staff estimates.

1/ ILO unemployment; based on Labor Force Survey data.

2/ The fiscal year begins in April. Debt stock data refers to the end of the fiscal year using centered-GDP as a denominator.

3/ As of September 2020.

INTERNATIONAL MONETARY FUND

UNITED KINGDOM

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

December 2, 2020

KEY ISSUES

Context and Outlook. The UK entered 2020 negotiating a new economic relationship with the EU and facing other challenges, including meeting climate targets, dealing with an aging population, and reinvigorating tepid productivity growth. Growth and investment had been weak since the 2016 referendum, and the current account deficit elevated, but unemployment was low, inflation on target, and balance sheets strong. The global pandemic hit the UK hard in March, and the country now faces a second wave. The economic impact has been severe, but helped by an aggressive policy response, jobs have been preserved, businesses kept afloat, and banking sector losses contained. Still, the outlook for the near term is weak, as the economy works through the second wave, Brexit, rising unemployment, and corporate distress. Risks are overall to the downside, centering on the degree of balance sheet damage sustained by households and small and medium enterprises. The pace at which vaccines are able to bring the pandemic under control could be an important mitigating factor.

Policies. The pandemic itself will be temporary but is of uncertain depth and duration. Some of its economic effects will likely be permanent and will add to the structural shifts from Brexit. The UK has some fiscal and monetary space that can be used to cushion impacts during the containment phase, spur the recovery, help the economy adjust to the structural shifts, and mitigate long-term "scarring." In this context, pandemic support measures need to be carefully targeted and fully funded until effects abate, while higher public investment is needed to help restart the economy. Monetary policy should remain accommodative, through further QE if needed and even negative interest rates once their side effects are better understood. Steps can be taken now to prepare for structural change, including adapting the social safety net, simplifying insolvency procedures for SMEs, and opening channels for new sources of equity finance. Policy rotation towards restoring fiscal sustainability should only come when private demand is durably stronger. Effective macroeconomic policy frameworks will continue to be important for policy credibility, and care needs to be taken to adapt these frameworks to meet the challenges created by the crisis. Contingency plans are also needed in the event that a new post-Brexit trade arrangement cannot be agreed with the EU.

Approved By
Enrica Detragiache (EUR) and Sanjaya Panth (SPR)

The virtual mission took place during October 19–29, 2020. The staff team comprised M. Flanagan (head), D. Garcia-Macia, A. Hajdenberg (all EUR), and J. Sole (MCM). J. Chen (SPR) contributed to the report. H. Park and R. Vega (all EUR) supported the mission. The mission met the Chancellor of the Exchequer, the Governor of the BoE, senior HMT and BoE officials, the Financial Conduct Authority, bank analysts, think tanks, and the Confederation of British Industry. A wrap-up meeting involving the Managing Director, Chancellor and Governor took place on the 29th, followed by a press conference.

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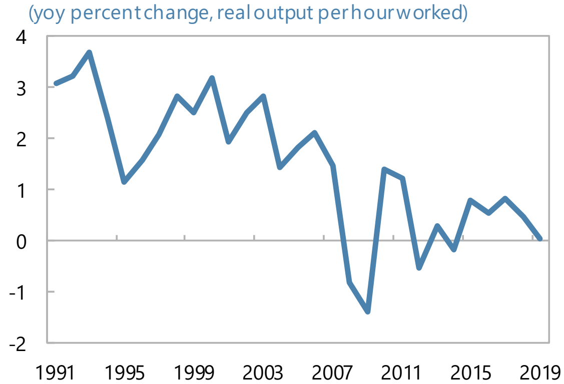
ANNEXES

BACKGROUND

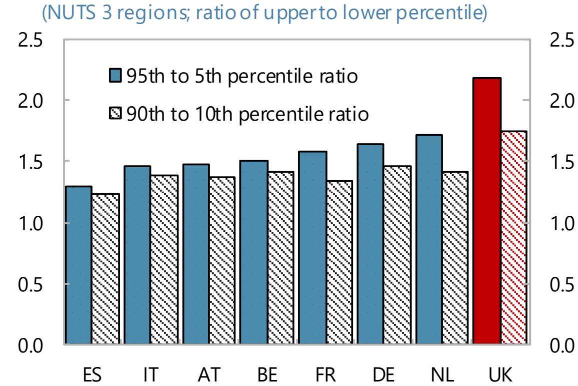
1. **Heading into 2020, Brexit considerations dominated the UK policy discourse, but the country faced other challenges as well**. In January 2020, the UK Parliament approved a Withdrawal Agreement from the EU with a transition period until December 31, 2020 while a new economic relationship would be negotiated. From a longer-term perspective, the UK economy also faced challenges related to weak productivity growth, large regional disparities in income, population aging (and its pension and health spending impact), and the need to strengthen policies to comply with targeted greenhouse gas emissions.[1]

Labor Productivity Growth
(yoy percent change, real output per hour worked)



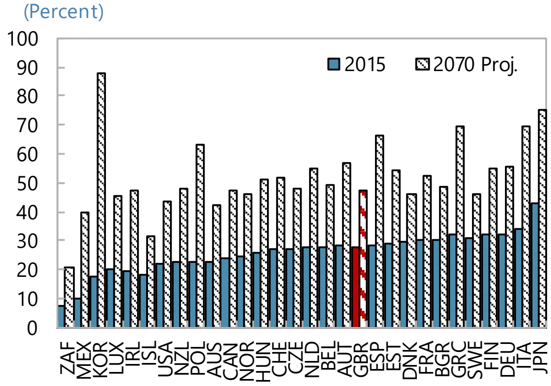
Sources: Haver Analytics; and IMF staff calculations.

Regional Disparities in Labor Productivity
(NUTS 3 regions; ratio of upper to lower percentile)



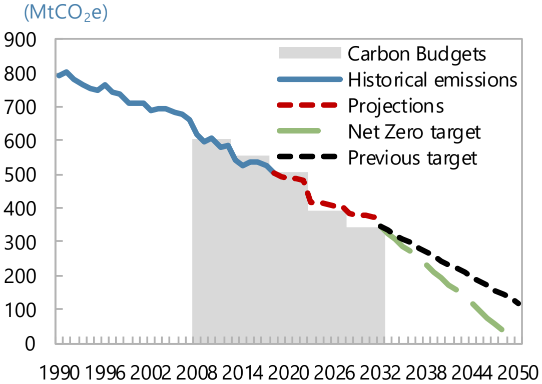
Sources: Eurostat; and IMF staff calculations.

Old Age Dependency Ratio
(Percent)



Sources: United Nations; and IMF staff calculations.

Projected Performance Against Carbon Budgets
($MtCO_2e$)

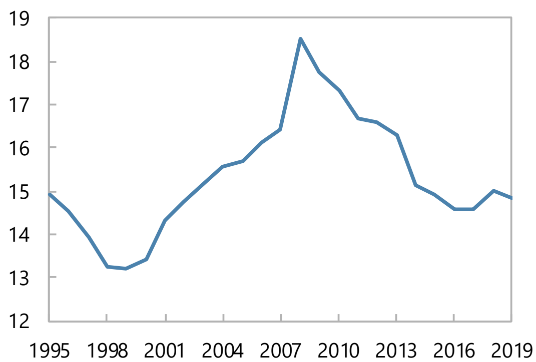


Sources: Arregui and Parry (forthcoming); BEIS.
Note: Chart shows government projections until 2032. Linear paths to a net-zero target for 2050 and previous target of 80 percent reduction (modified to include the CCC's allowance for international aviation and shipping - not currently part of carbon budgets).

[1] Committee on Climate Change, "Reducing UK Emissions Progress Report to Parliament," June 2020.

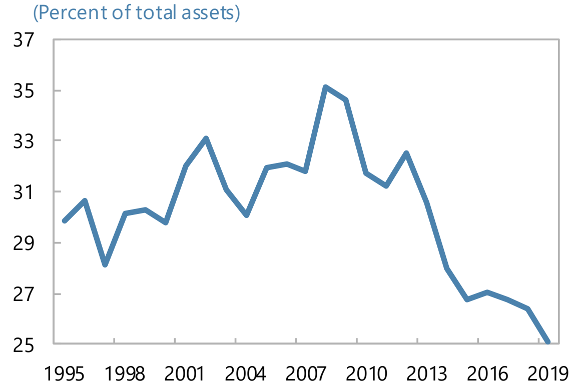
2. In early 2020, the economy was operating at full employment, with balance sheets substantially stronger than the post-GFC period. Growth had moderated to an average of about 1½ percent after the Brexit referendum of June 2016. As uncertainty restrained investment, and productivity remained stagnant, the output expansion was driven mainly by increased employment, and the unemployment rate declined below 4 percent. Inflation, which had pushed upwards after the Brexit referendum, sat comfortably beneath the BoE's 2 percent target. Households, non-financial corporations, and banks had all improved their balance sheets since 2008, and while government debt had climbed above 80 percent of GDP by 2016, it had started to edge downwards since. The current account deficit, at 4.3 percent of GDP in 2019, was larger than consistent with fundamentals, but the net international investment position was only mildly negative (and benefitted from exchange rate depreciations).

Household Debt Ratio
(Percent of total assets)



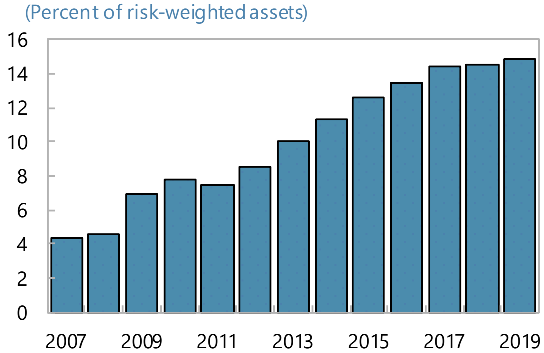
Source: Bank of England Financial Stability Report.

Non-Financial Corporations Debt
(Percent of total assets)



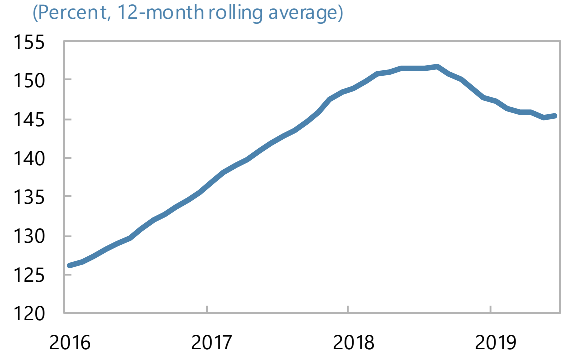
Source: Bank of England Financial Stability Report.

Aggregate CET1 Capital Ratio of Major UK banks 1/
(Percent of risk-weighted assets)



Source: Bank of England Financial Stability Report.
1/ Major UK banks include Barclays, HSBC, Lloyds Banking Group, Nationwide, The Royal Bank of Scotland, Santander UK and Standard Chartered.

Liquidity Coverage Ratio of Major UK Banks 1/
(Percent, 12-month rolling average)



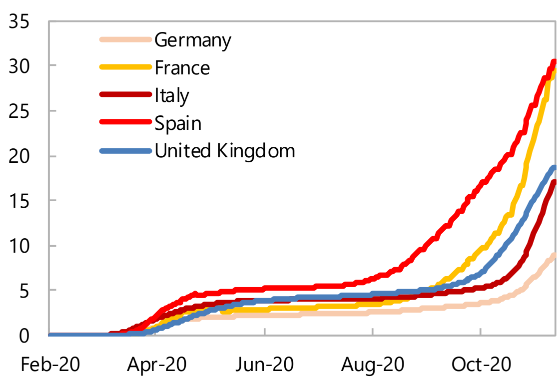
Source: Bank of England Financial Stability Report.
1/ UK major banks including Barclays, HSBC, Lloyds, Nationwide, RBS, Santander UK and Standard Chartered.

3. The authorities were pursuing an ambitious policy agenda. Beyond negotiation with the EU on the future of their economic relationship, the UK government was also negotiating free trade agreements (FTA) with countries outside the EU and had committed to increase infrastructure spending to stimulate economic growth and reduce regional inequalities (Table 1 covers previous IMF policy advice).

RECENT DEVELOPMENTS

4. **The pandemic reached the UK in March progressing to a second wave now underway, and has taken a significant human toll**. The impact as measured by deaths relative to population size exceeds the average of advanced European peers. To contain the spread, the government implemented a range of measures in late March, including travel restrictions, social distancing measures, closures of entertainment, hospitality, non-essential shops and indoor premises, and increased testing. This first lockdown was eased during the summer, but the rising number of infections prompted a re-tightening of restrictions starting in September. Initially this entailed a geographic three-tier system, but as cases continued to surge it was soon followed by a second one-month England-wide lockdown during November (with construction, manufacturing and schools remaining open). These developments were mirrored by the dynamics of mobility indicators, and these have edged down recently.

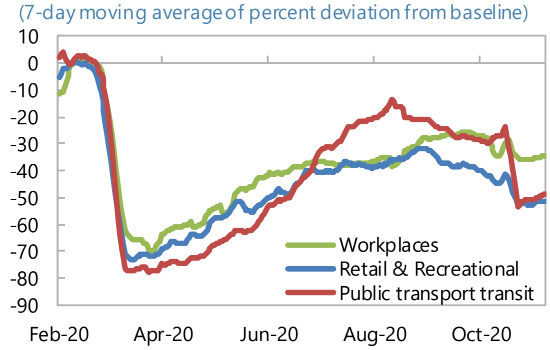
Confirmed COVID-19 Cases per 1,000,000 Population



Sources: Bloomberg; IMF staff calculations.

Google Mobility Indicators

(7-day moving average of percent deviation from baseline)



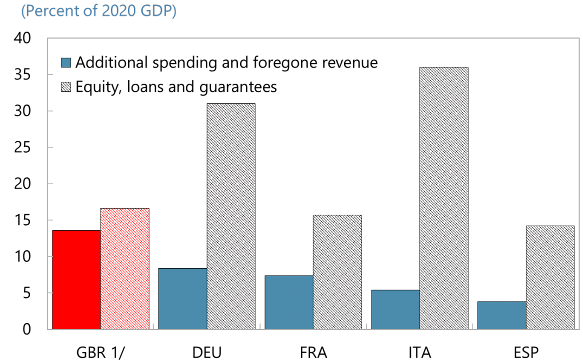
Source: Haver Analytics.

Notes: A baseline day represents a normal value for that day of the week. The baseline day is the median value from the 5-week period Jan 3 – Feb 6, 2020.

5. **The authorities met the pandemic with an aggressive policy response**. The authorities undertook well-coordinated actions involving fiscal policy (with the aim to protect jobs and companies and buttress the safety net); monetary policy (with a policy rate cut and substantial quantitative easing); and macroprudential measures to bolster financial firms' ability to support the economy (e.g., removing requirements for additional capital buffers)(Annex I).

Fiscal Response to Covid-19

(Percent of 2020 GDP)



Source: Fiscal Monitor database.

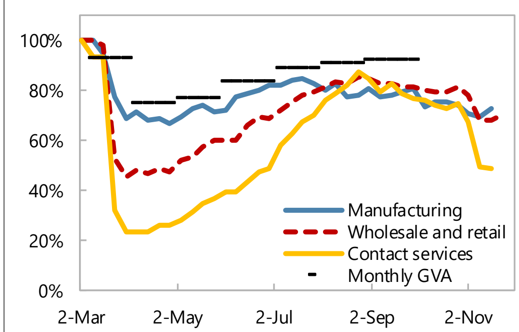
1/ FY2020-21.

6. **The set of policies has evolved in response to developments** (Annex I). The initial calibration of measures was designed to phase out through October to facilitate adjustment as pandemic-related supply constraints faded. Reopening and recovery was to be helped by the Job

Support Scheme launched in September to provide incentives to employers to retain viable jobs, and by an "eat out to help out" program, designed to help restore pre-pandemic levels of consumption in the heavily affected hospitality sector. With the intensification of Covid starting in late September, the approach in England was reset to a three-tiered system, with support to firms linked to the type of restriction an enterprise would face, and a revenue test. The early-November lockdown saw eligible businesses moved back to the original scheme, with a sunset anticipated at the end of the fiscal year (end-March 2021). Parallel measures in early-November provided an extension for 2 months to apply for government-guaranteed loans and for 6 months of the deferral for mortgages and consumer credit and overdrafts.

7. The economic impact of the pandemic has nonetheless been severe, and the second Covid wave has now truncated a nascent summer recovery. The economy cratered in 2020Q2, with output 22 percent below the 2019Q4 level and activity in consumer-facing services suffering outsized declines (Text Figure).[2] The subsequent re-opening of the economy led to a strong recovery, with GDP growing by 15.5 percent in Q3, and by October the economy had probably recovered to about 10 percent below its January level. However, the new restrictions accompanying the second wave have truncated the recovery, with high frequency indicators showing gradually weakening activity since September. Core inflation, which continued to fall through Q2 and Q3, stood at 1.5 percent in October.

High Frequency Indicator Averages
(level relative to March 2nd 2020)



Sources: Haver Analytics; Barclays Research; and IMF staff calculations.
Notes: the contact services series includes indicators on the hospitality, transport, and recreation sectors, as well as overall mobility.

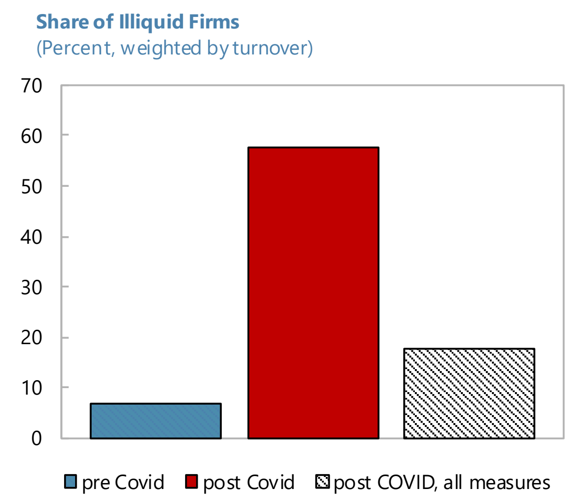
8. Government intervention has been effective at preserving economic relationships, but evidence is accumulating that structural shifts are underway. The pandemic support schemes initially covered the wages of almost a third of employees, while almost 1.5 million SMEs drew on government guaranteed loans. The official unemployment rate, which stood at 3.9 percent in March, was held down in Q2 but has since risen to 4.8 percent in Q3. Other measures point to larger slack in the labor market (e.g., the number of employees not receiving pay or away from work, Figure 6). Corporate insolvencies have fallen from a quarterly average of 4,200 during 2019 to 2,676 in Q3, though there is some backlog. At the same time, the pandemic has accelerated the trend towards digitalization, including in online retail (up 50 percent since February) and work from home (up from 5 percent of workers in 2019 to about 40 percent in June). Notably, the sectors that have relied more on job subsidies during the pandemic, hospitality and leisure, tend to employ less qualified and lower-paid workers, which risks widening inequality as support sunsets.

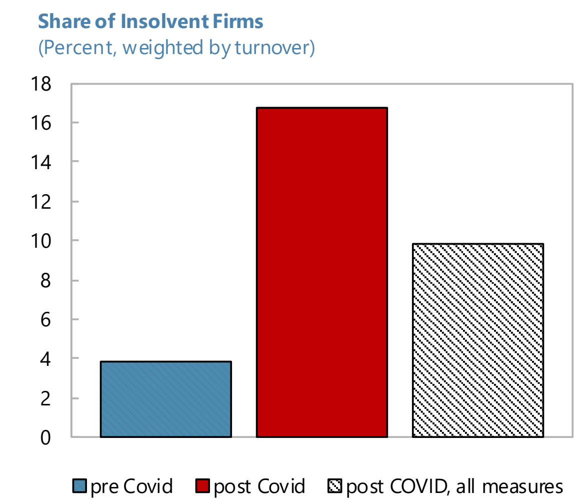
[2] The UK measures real public consumption based on effective output, as opposed to spending (as in other European economies). Thus school and health system closures (with pay) generate sharp declines in real public consumption and equally sharp rises in the public consumption deflator. Public consumption declines calculated in this way explain about one-quarter of the UK's 2019Q4–2020Q2 decline.

9. Government intervention has also mitigated the crisis impact on private sector balance sheets to date, but potential problems lie beneath the surface:

- For **households**, saving rates soared in 2020Q2 to produce an overall saving rate of 28 percent of GDP (although mainly for higher income quintiles). Government income support schemes have mitigated the impact on lower income quintiles and spending by lower income households has held up relatively well. Loan arrears have remained stable, while moratoria on overdue mortgage and consumer credits have provided a temporary measure of protection to those falling behind on payment. However, rising unemployment along with the expiration of the stamp duty holiday in H12021 is weakening the outlook for housing prices (with some pointing to a possible decline of about 10 percent or more in downside scenarios, CEBR, OBR).

- **Corporate sector** financing needs and debt surged as cashflows dried up (total additional debt taken on during Q1–Q2 amounted to £70 billion, or 3¼ percent of GDP). Government-guarantee schemes provided £65 billion in new financing, while the joint HMT-BoE Covid Corporate Financing Facility (CCFF) purchased commercial paper worth £20 billion. Altogether, government programs are estimated to have significantly reduced the share of companies experiencing liquidity and solvency stress. Still, this share is expected to rise (Text Figure). Expectations about future corporate debt distress sit in a broad range of £19 billion to £100 billion (1–5 percent of GDP).[3]





Sources: Orbis; IMF staff calculations.
Note: Figure illustrates the size of liquidity and equity gaps as a share of GDP and the share of illiquid and insolvent firms where firms can rollover trade credit but need to repay any maturing financial debt. Liquidity gap is calculated as liquid assets (cash and financial investments) minus operational net cash outflows and debt repayments. Equity gap is the book value of debt over the value of assets. The COVID-19-induced stress on corporates' turnover is consistent with the October 2020 WEO. The analysis illustrates the policy measures announced as of end-August which were designed to dampen liquidity and solvency risks. See IMF, Regional Economic Outlook, Europe, October 2020 for further information.

- Meanwhile, in the **financial sector**, post-GFC reforms left banks with strong buffers at the beginning of the pandemic. CET1 ratios now stand at 15.7 percent, up 0.7 percent since early-

[3] National Audit Office, "Investigation into the Bounce Back Loan Scheme," October 2020; TheCityUK, "Supporting UK Economic Recovery: Recapitalising Businesses Post Covid-19," July 2020.

2020, helped by policy measures taken (mainly the restriction on dividends). The countercyclical capital buffer, originally set to increase, was reset to zero, freeing additional capital. Banks also maintained significant liquidity buffers through Q2. Stress tests by the authorities suggest that systemic banks have ample room to absorb problem loans. However, residential and commercial real estate exposures may pose important risks for some types of banks (e.g., building societies), and clear procedures are not yet in place for handling increased defaults on government guaranteed SME loans (such loans jumped 28 percent since end-2019, and are concentrated in the 5 largest banks). Non-banks survived a "dash-for-cash" stress episode in March with the help of massive BoE intervention, an episode revealing an underlying vulnerability in their procyclical positioning.

10. Protecting economic relationships and private balance sheets, while appropriate, has taken a toll on government finances. Public sector net debt is projected to rise to 106 percent of GDP at end-FY2020 (from 85 percent at end-FY2019), and the overall balance to around 19 percent of GDP, reflecting the cost of the aggressive policy response and the sharp contraction of the economy. Public net worth is now more exposed to explicit contingent liabilities tied to government-guaranteed loans (which are not large, at around 3¼ percent of GDP), while changes in asset prices due to Covid-19 raise the potential for large valuation effects (assets and liabilities of the public sector represented 94 and 205 percent of GDP respectively in FY2018).[4]

Main Fiscal Measures in Response to the Covid-19 Outbreak in FY2020–21

Measures	Amount (Percent of FY2020 GDP)
Measures with impact on the fiscal balance 1/	**13.6**
Health sector	**4.3**
Employment support	**3.8**
of which:	
Coronavirus Job Retention Scheme	2.7
Self-Employment Income Support Scheme	0.8
Boosting job searches, training, and apprenticeships, and job subsidies	0.3
Support to households	**0.4**
Support to businesses	**2.9**
of which:	
Business grant schemes	0.6
Business rates (commercial property tax) relief	0.5
Estimated losses under guaranteed loan schemes	1.5
Other	**2.1**
Measures without impact on the fiscal balance	
Deferral of VAT and self-assessment of income tax	-
Guaranteed loan schemes 2/	16.0
Trade credit reinsurance scheme	0.5

Sources: Office for Budget and Responsibility, Coronavirus Policy Monitoring, July 2020, IMF staff estimates.
1/ Excludes spending on public works brought forward from future years.
2/ Includes the BBLS, CBILS, CLBILS, and the CCFF operated by the Bank of England.

11. Against this backdrop, in early December negotiations remained underway on a post-Brexit trade deal. Key outstanding issues included level playing field provisions, governance and access for EU fishermen to UK waters. Issues related to Northern Ireland were being discussed separately. Preparations for the transition have been underway since the 2016 referendum. However,

[4] HM Treasury, Whole of Government Accounts, 2020.

while financial sector preparations are well advanced, border preparations appear to be lagging.[5] On the importation side this had been handled by allowing a 3-stage, 6-month transition period to full declaration. According to the Bank of England's October Decision Maker Panel survey, 4 percent of businesses report that they are fully prepared for potential extra trading requirements with the EU, 41 percent are "as ready as can be," and 33 percent said that they were partially prepared.

<table>
<tr><th colspan="2">Brexit: End of Transition Period Preparations</th></tr>
<tr><td>Behind the Border</td><td>

Funding (£9.5bn to date) made available for, inter alia:

Investment in border infrastructure to build port and inland infrastructure for UK-EU trade.
Investment in staffing and new IT systems.
Upscaling the customs intermediary sector.
Training more customs agents to process up to 215 million additional customs declarations each year.
Public information campaign to help citizens and businesses prepare.

Customs requirements on the UK side will be introduced in progressive phases over the first half of 2021.

</td></tr>
<tr><td>Financial Sector</td><td>

Measures include:

Legislating to ensure that there continues to be a fully functioning and effective legal and regulatory regime for financial services at the end of the transition period, which included:

Legislating for temporary permissions and recognition regimes that will allow European Economic Area (EEA) firms to continue operating in the UK and servicing UK users for a limited period of time after the end of the transition period, while they seek full authorization.
Legislating for a temporary transitional power, to allow the UK financial regulators to phase in regulatory changes occurring at the end of the transition period in an orderly way.
Legislating to ensure that firms that do not enter the temporary permission regimes can run-off their UK business in an orderly fashion.

Granting a package of 17 equivalence decisions to EEA States, that cover a range of areas including capital requirements, insurance and re-insurance activities, and central counterparties (CCPs).[1] Equivalence decisions will come into effect on January 1, 2021. These decisions are in addition to those made in April 2019 concerning central bank exemptions, prospectus regulation and transparency requirements.
The FCA under its temporary transitional powers will allow UK firms to continue trading all shares on EU trading venues, where the latter are legally able to do business with UK firms.

</td></tr>
<tr><td colspan="2">[1] The European Commission has granted time-limited equivalence for UK-based CCPs, lasting for 18 months from January 1, 2021. The European Securities and Markets Authority (ESMA) has also recognized all three UK-based CCPs and clearing in the recognized UK-based CCPs remains allowed. At the same time, ESMA reaffirmed in late-November 2020 its current rules on the trading obligations for selected derivatives like interest rate swaps (which require trading in recognized jurisdictions, as distinct from clearing).</td></tr>
</table>

[5] National Audit Office Report, "The UK Border: Preparedness for the End of the Transition Period," November 2020.

Brexit: End of Transition Period Preparations (concluded)	
	o The financial services sector has also made extensive preparations: UK banks and insurers have been building out EEA entities and are advanced in the process of restructuring their activity and migrating EEA clients where necessary. Firms have also taken action to minimize disruptions in other areas, for example with regard to payments and personal data. o UK and EU regulators have robust and comprehensive supervisory cooperation arrangements in place for the end of the transition period.

OUTLOOK AND RISKS

12. The UK is confronting the combination of a temporary health shock (Covid) and a longer lasting trade shock (Brexit). In the baseline forecast, staff assumes that the second Covid lockdown ending on December 2 will be followed by some temporary localized lockdowns. Reduced mobility would gradually unwind over 2021 (starting from a level similar to October 2020, when partial lockdowns were in place). In addition, the baseline forecast assumes that the UK and EU will reach a last-minute free trade agreement and that this will be implemented with some frictions during the first half of 2021 (in light of lagging preparations by SMEs). As regards policies, staff assumes that pandemic fiscal support measures are funded per the November 2020 Spending Review, and sunset as the pandemic subsides in 2021. Plans for higher public investment over the next three fiscal years are assumed implemented, alongside announced plans for higher labor market support. Monetary policy is assumed to support a gradual move of inflation back to target. Finally, it is assumed that no systemic financial sector risks materialize (e.g., from SME stress or falling property prices) and the current stance of macroprudential policies is preserved in the short run and only tightened over the medium term.

Policy Area	Assumptions
Fiscal	The end of Covid-related support measures per the current schedule reduces government spending by about 11 percent of GDP from FY2020 to FY2021. No additional fiscal support (relative to the situation as of end-November 2020) is assumed. Gradual consolidation with measures of 0.5 percent of GDP per year starts in FY 2023, with the goal to reach the debt-stabilizing primary balance by FY2025.
Monetary	Consistent with market expectations, policy remains accommodative over the next two years to support the recovery. Gradual normalization of the central bank balance sheet and rates is undertaken only when inflation is forecast to reach the target durably.
Structural	Public investment rises to begin to address infrastructure gaps and climate targets. Job support measures (wage subsidies, retraining, apprenticeships, and job search assistance) mitigate the unemployment spike.
Financial	Required capital ratios are maintained at 0 percent until March 2022 for the Countercyclical Capital Buffer; and for the Systemic Risk Buffer at the rates determined for each bank in December 2019 until December 2021. Limits on loan-to-value, debt-to-income, and interest coverage ratios remain at present levels.

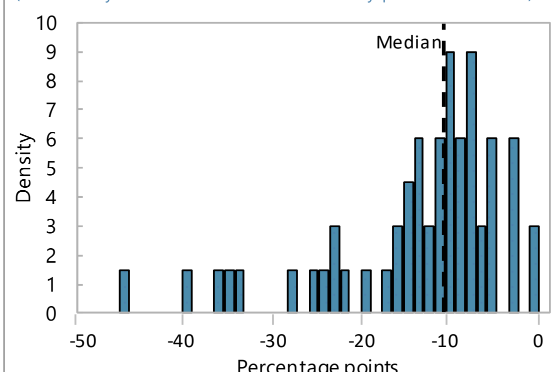
13. While the government's policy actions will mitigate the shocks, near-term pressures are expected to continue, giving way to a muted recovery:

- The economy is expected to contract again in 2020Q4 given the second lockdown. Annual growth would be at about -11.2 percent in 2020. GDP would partially recover in 2021, with reopening pushing annual growth up to 5.7 percent, notwithstanding a weak Q1 as second wave and Brexit disruptions are worked out. Unemployment would inch up gradually and climb above 7 percent in H1 as support sunsets for all employees. Corporate stress would build up as demand stays weak, presenting a headwind to higher quarter-over-quarter growth within 2021.

- Inflation is expected to gradually rise back to the 2 percent target reaching it by late 2022. Weak demand is holding core inflation down notwithstanding cost push pressures created by the pandemic. The stronger influence of demand factors on core inflation is expected to continue going forward with restrained wages (as unemployment rises) tempering inflationary effects of the pandemic and Brexit. Headline inflation may nonetheless show some upward volatility in 2021, as VAT holidays end and energy prices rise. Policy support, including the monetary expansion announced in November, would help the recovery of inflation back to target.

14. The medium-term outlook has deteriorated. While the pandemic itself is expected to be temporary, it will likely have longer-lasting economic effects as corporate failures and sectoral shifts in production (e.g., away from contact-intensive services) create both frictional and structural unemployment and some stranded capital. The BoE estimates that Covid will require less labor reallocation than the structural shocks of the 1980s, but reallocation could be more difficult this time as workers may need to transition to higher-skill occupations.[6] In staff's forecast, a period of corporate balance sheet repair is expected to suppress investment and innovation (survey data shows R&D investment has fallen by 15 percent due to Covid).[7] Average capital stock growth would be 1.2 percent during 2020–25, down from 2 percent for 2015–19, but slightly higher than in the aftermath of the global financial crisis. All factors considered, the pre-Covid level of output would only be reached by 2023 and output would remain about 5 percent below the pre-Covid trend by 2025. This outcome would be better than the average advanced economy recession, since this episode was not marked by a financial boom-bust and has been met with a strong countercyclical policy reaction. However, scarring is projected to be larger than in other large European economies, which are less specialized in contact-intensive services.

Scarring of output after recessions, AEs, 1972-2018
(GDP loss 5 years after a recession relative to 5y pre-recession trend)



Sources: OECD; IMF staff calculations.

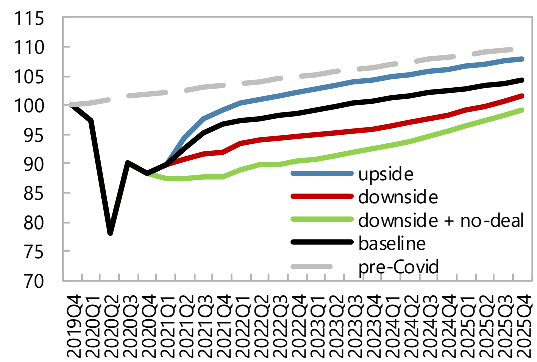
[6] Bank of England, Monetary Policy Report, November 2020.

[7] Bank of England Decision Maker Panel, September 2020.

15. Overall risks are tilted to the downside, but unusual uncertainty surrounds the baseline. Developments with Covid and Brexit could drive significantly different degrees of structural shifts and macro-financial feedbacks (via weaker firm balance sheets and the impact of declining property prices on banks) (see Annex II for a discussion of other risks):

- In an upside scenario, rapid deployment of one of the new and apparently effective vaccines (for which the UK has arranged supplies) ends contagion risk earlier than expected. This would boost confidence, ease the constraints on economic activity, put a floor under property price declines (mitigating financial system impacts), and accelerate the recovery of consumption and investment, limiting scarring. However, given the pandemic impacts to date, a full return to the pre-Covid trend would be highly unlikely.

Real GDP: alternative scenarios



Source: IMF staff calculations.
Note: the projected impact of a no-deal Brexit is based on the April 2019 World Economic Outlook, Scenario Box 1, scenario B.

- In a downside scenario, the UK would experience prolonged or intensified social distancing and/or damage to consumer confidence due to Covid (including due to a longer-than-expected second wave and delayed vaccine deployment) and deeper impacts on the tradables sector due to a no-deal Brexit. This would entail a challenging landscape of deeper structural transformation accompanied by higher corporate bankruptcies and unemployment, triggering sharper macro-financial feedbacks (as more agents are pushed into distress, property prices fall, and banks protect their balance sheets). Persistent economic weakness would be the result, as balance sheets are restored and industries leading the recovery take time to scale up.

16. While the macroeconomic outlook is challenging, the overall risk to the public sector appears contained, while external vulnerabilities are partially mitigated by the structure of net liabilities:

- **Public debt is sustainable and some fiscal space exists** (Annexes III and IV). Debt-and GFN-to-GDP ratios are elevated and above the MAC DSA high risk thresholds in the baseline. However, additional analysis of the gross financing needs profile taking into account announced quantitative easing by the BoE suggests moderate risk of stress. That is, even under a generalized stress scenario, the large domestic financial sector appears to have capacity to absorb the shock (especially through banks which have limited government exposure). These results continue to hold for scenarios in which fiscal policy is temporarily loosened in response to the shocks, suggesting the existence of some fiscal space. However, there are risks related to combined macro-fiscal shocks and contingent liabilities, highlighting the importance of managing Brexit well and of preserving strong management of the country's public sector balance sheet.

- **The external position is weaker than the level implied by medium-term fundamentals and desirable policies** (Annex V). The current account improvement projected for 2020 is due to a temporary collapse in domestic demand related to the relatively larger impact of Covid in the UK. Net external debt remains relatively low, and while high gross liabilities present a vulnerability (Annex VI), exchange rate depreciation would lead to an improvement in the NIIP, partially mitigating this vulnerability.

17. Authorities' views. The Office for Budget and Responsibility (OBR)'s near term outlook is similar to staff's. In the November *Monetary Policy Report*, the Bank of England projected a slightly faster recovery, with a stronger investment pickup and a short-lived effect on trade and GDP from a period of adjustment associated with implementation of a new UK-EU trading arrangement in 2021. Uncertainty would dissipate from 2021Q2 onwards. In the medium term the BoE and OBR anticipate less long-term scarring in their central scenarios (1¾ and 3 percent respectively). The BoE expects less labor reallocation and more fungible production factors than in previous recessions and see potential for some structural adjustments to increase productivity after Covid. However, they emphasize that the outlook hinges on the resolution of the pandemic and responses of households, businesses, and financial markets, making it subject to an abnormal degree of uncertainty. Like staff, they see risks to the downside. In addition to Covid, other sources of uncertainty relate to the nature of and transition to the UK's new post-Brexit trading arrangements with the EU. They agree that the external sector balance is qualitatively unchanged since last year, but emphasize the wide uncertainty around equilibrium REER and current account estimates.

KEY POLICY PRIORITIES

18. The over-arching priority is to contain the pandemic and return the UK to full employment on a sustainable and inclusive growth path as quickly as possible. Fiscal and external vulnerability analyses suggest that the government has space to deploy policies to this end. The authorities face the key question of how to absorb the temporary economic components of the Covid shock (preserving viable job matches and firm-specific capital to allow the economy to restart more quickly and with fewer costs), while encouraging adjustment to its permanent economic aspects, and at the same time helping the adjustment to the post-Brexit trade environment. And this must be done with the depth and duration of the shock unknown, and potentially greater permanent impacts the longer the pandemic lasts (e.g., persistent behavioral changes affecting key sectors, like deeper on-line retail penetration). This motivated four topics for the consultation:

- **Policies to contain the health and economic impacts of the pandemic**. While the pandemic is still weighing on activity, there is a strong risk management argument for an aggressive policy response to eliminate downside risks and for clear forward guidance about all policies, to maximize their impact.

- **Policies to facilitate adjustment**. Once the immediate emergency subsides, policies should focus on efforts to facilitate labor reallocation and balance sheet repair; and once the recovery is firmly entrenched, fiscal adjustment should begin to engineer a reversal of debt dynamics.

- **Securing strong policy frameworks**. To sustain an aggressive policy response, the authorities must ensure that policies remain well-anchored in clear frameworks, adapting them where necessary to address issues revealed or created by the new economic landscape.

- **Contingency plans for a no-deal Brexit**. The deeper shock associated with this would tend to amplify policy needs but could pose some constraints.

19. Authorities' views. The authorities saw the priorities and strategy in broadly the same way as staff. They also saw the same risk management considerations that staff did and emphasized that the Chancellor has committed to do "whatever it takes" to continue supporting the economy. They noted that their current focus is on containing the pandemic, and that given the unusual level of uncertainty about its evolution, they saw value in waiting until there is more clarity before committing to future specific actions, but were eager to stress their commitment to eventual adjustment and debt stabilization. They agreed that strong policy frameworks had been crucial to their response to date, and saw this credibility continuing going forward, expressing caution about framework adaptation. The Treasury agreed that the end of the transition period with the EU would create challenges, but also new opportunities for businesses. They emphasized the government's determination to reach a deal, albeit not at any cost.

A. Containing the Impact of the Shock and Igniting a Recovery

20. In the present conjuncture, there is a need for continuing policy support and the space exists to deliver it. The pandemic has continued to constrain productive capacity, with ¼ of firms earning revenues more than 20 percent below normal levels as of October (ONS). Moreover, beyond the effects of the second lockdown, the economy is expected to be close to stalled until 2021Q2, with cautious consumers and uncertain investors weighing on domestic demand (consumer confidence indicators are close to all-time lows and business confidence has plunged again in October). There is space for both further fiscal and monetary support, and room for the financial sector to support the recovery.

21. Concerning fiscal policy, fully funded and well-calibrated pandemic support policies will remain essential until pandemic impacts abate. The decision in the November spending review to further enhance health spending will help underpin continued track-and-trace efforts along with a 2021 vaccination campaign. Other November decisions to extend various job and firm support measures into 2021 (e.g., the Job Retention Scheme; see Annex I) provide important "forward guidance" to the population about the commitment of the government to continue funding a response. The authorities' intention to review policies in January and March and adapt them further as necessary provides scope to ensure they remain fit to purpose. At the next review at the latest, the government will want to consider several issues:

- **The support for the self-employed and firms**. One present gap to fill concerns coverage of the self-employed (the Self-Employment Support Scheme left around 500,000 people ineligible). As regards firms, guaranteed lending, direct grants, and other subsidies have helped them manage the burden of fixed costs, but the guaranteed lending programs are set to expire in

January. There could be a case to continue them—to the extent the impact of the pandemic on firm productivity continues—but some recalibration should also be considered (with reduced guarantee coverage as impacts fade, and with more emphasis on grants, incentives to build up equity, and other tax incentives for viable companies, in light of the debt build-up in SMEs).

- **The targeting built into the furlough scheme**. The Job Retention Scheme is geared very well to a lockdown environment with deep and uniform impacts on company revenues, but less so to other environments (e.g., temporary localized lockdowns or gradually declining social distancing). Consistent with the government's announced approach prior to the second lockdown, lower wage replacement rates and/or a greater employer contribution to employee pay could be re-instituted once the degree of damage to the firm due to lockdowns or social distancing restrictions has declined. In this context, sectoral or regional targeting could make sense to improve the cost-benefit trade-off, but could create higher administrative burdens (i.e., in establishing eligibility). Since this would mainly be a problem for larger companies which are better resourced, these companies could be made to bear more of the burden of establishing their eligibility.

- **Ensuring continued transparency and accountability**. The UK has a strong track record of reporting and public financial management to help it achieve value for money, and these have been enhanced with additional Covid-specific processes (e.g., by establishing a dedicated team at the Treasury to track Covid-related spending by departments). Still the National Audit Office[8] has raised concerns about some contracts, underscoring that the scale-up of spending and rapidly shifting programs call for careful attention (especially allowing public access to procurement contracts related to Covid, making available information on beneficial owners of contract recipients, and continuing with publication of ex-post audits).

22. The economy would benefit from additional fiscal stimulus in FY21 to invigorate the recovery. In staff's baseline scenario, the pandemic is brought under control in the course of FY21 and, therefore, direct support policies tied to the pandemic would be phased out. However, additional discretionary fiscal support, which could reach 1–2 percent of GDP beyond current plans, would be useful to supplement domestic demand while private consumption and investment remain weak. This temporary stimulus should be achieved through targeted measures with potentially high multipliers. One key element could be public investment beyond the authorities' current plans (Text Table). The expansionary impact of this could be reinforced by:

Budget 2020: Selected Public Investment Projects
Digital Connectivity
• £5bn for full fiber
Transport
• £27.4bn for roads
• £4.2bn for intra-city transport
Floods and water
• £5.2bn for flood defenses
Climate change
• £1bn for decarbonization of public buildings (announced summer 2020 in the Plan for Jobs)

[8] National Audit Office Report, "Investigation into Government Procurement during the COVID-19 Pandemic," November 2020.

(i) committing not to cut public investment in the fiscal adjustment phase (to encourage a supply-response from industry); and (ii) accelerating preparations now so that a big construction push can take place when the pandemic ends and domestic demand is still subdued. Still achieving high multipliers would require careful identification and efficient implementation of projects. In this context, a recent Resolution Foundation assessment found multiple issues with investment management, including opaqueness in selection and lack of ex-post assessment.[9] The government is considering reforms to public investment management (PIM), and staff recommended undertaking an externally-validated assessment of the revised PIM approach based on the Fund's PIMA framework to identify and address any lingering problems. Importantly, a scaled-up investment program, if appropriately designed, could help address regional inequality[10] and help meet the UK's legally prescribed climate targets, in the context of the strategy announced by the government on November 18.[11]

23. While fiscal policy is the key economic tool at present, there is a role for continued accommodative monetary policy. With inflation not projected to return to target soon and fiscal stimulus requiring more time to have an impact, the BoE appropriately extended QE by £150 billion in early November and reiterated forward guidance that policy will not be tightened at least until inflation is durably back to target and significant progress is made in eliminating spare capacity. Going forward, policy will need to be data dependent, with a bias towards loosening. That is, risks remain to the downside, and there is uncertainty about the net impact of policy changes since March (given a simultaneous decline in the neutral rate; text panel). Staff views QE as a still-available channel, noting that it would help contain a potential rise in rates and spreads in an environment of continued heavy fiscal borrowing. However, with the BoE set to raise its holdings to some 40 percent of the total gilt stock, space for further expansion could be limited by the need for financial intermediaries to hold domestic-currency long-term safe assets. Thus, other policy measures may soon need to be deployed. The BoE sees negative policy rates as part of its toolkit, and a negative yield curve has at times pointed to market expectations that this tool could be deployed. They could be the next step, but a fuller assessment should first be completed, covering their impact on the UK financial system and potential mitigating measures. Other instruments either do not fit the UK context well or are more fiscal in nature and would require coordination with the Treasury (Box 1).

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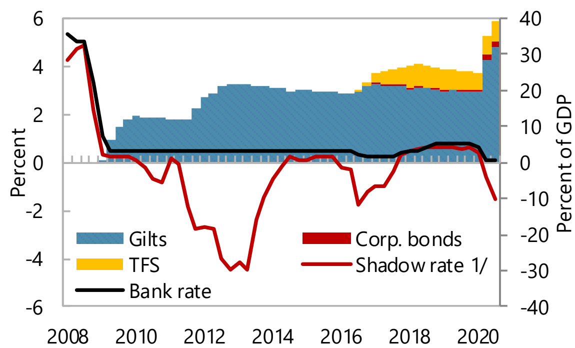
[9] Bailey et al., "Euston we have a problem," Resolution Foundation, 2020.

[10] United Kingdom: Selected Issues, IMF Country Report No. 18/43, 2018.

[11] The announced strategy lays out a ten-point plan for actions in the areas of clean energy, transport, nature, and innovative technologies. Specific measures to implement this blueprint have not been designed or costed yet. For more information see "Ten Point Plan for a Green Industrial Revolution for 250,000 jobs."

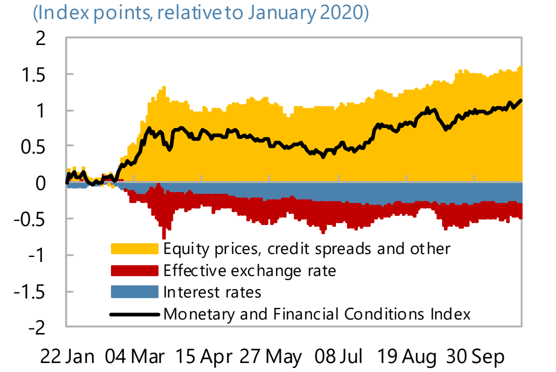
Figure 1. United Kingdom: Monetary Policy

Monetary Instruments



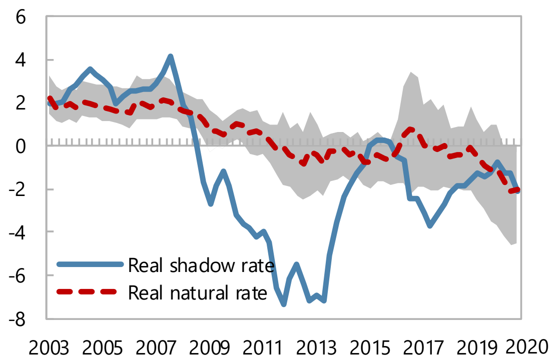
Sources: Haver Analytics; IMF staff calculations.
1/ LJK Limited (via Haver Analytics).

Monetary and Financial Conditions Index
(Index points, relative to January 2020)



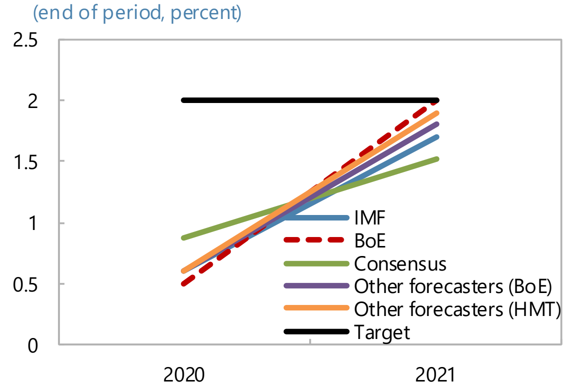
Source: Bank of England.
Notes: An increase signals tighter conditions. The series weights are based on the estimated impact of each variable on UK GDP.

Real Shadow and Natural Rates
(Percent)

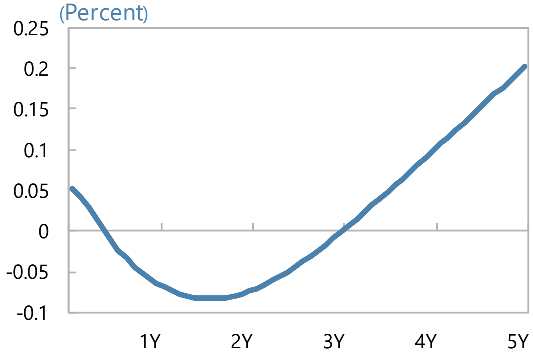


Sources: LJK Limited (via Haver Analytics); Pescatori and Turunen (2015, IMF WP); and IMF staff calculations.
Note: 20-80% confidence band. The estimation techniques may smooth out the decline of both rates at the end of the sample.

Headline CPI projections
(end of period, percent)

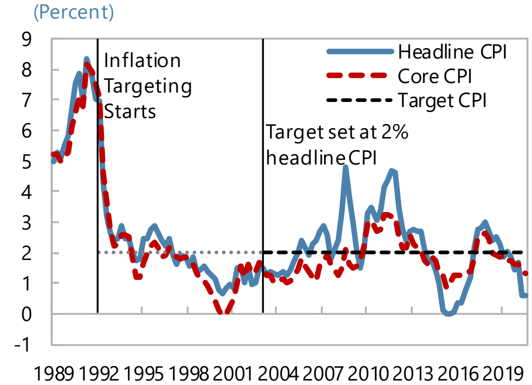


Yield Curve
(Percent)



Source: Bank of England (as of November 9 2020).
Note: Based on instantaneous nominal overnight index swaps.

Inflation
(Percent)



Sources: Haver Analytics; IMF staff Calculation.

Box 1. Monetary Tools to Loosen the Stance

Negative rates are an option in the UK but require further study to determine when they would be most effective. The effective lower bound (ELB) for the policy rate is in general thought to be slightly negative, due to credit and cash hoarding channels.[1] However, these perverse channels could be mitigated by tiering of reserves and by encouraging banks to apply negative rates to large deposits.[2] In any event, empirical studies find no evidence of a deleterious impact of negative rates on aggregate bank profits.[3] Still, UK smaller banks and building societies could be particularly exposed to the interest margin channel, especially at a time when bank balance sheets are expected to become strained by pervasive corporate defaults and given the larger share of retail depositors in the UK than in other countries using negative rates.[4] The effects of negative rates on non-bank financial intermediaries, which are particularly relevant in the UK, also need to be better studied.

Other tools used by central banks to lift inflation at the effective lower bound could face some impediments:

- **Yield curve control**: This essentially makes QE price dependent instead of committing to a specific quantity of asset purchases. It has been adopted by Australia and Japan, targeting 3- and 10-year government bonds respectively.[5] Like other forward guidance strategies, it crucially relies on credibility, the more so the farther the horizon of yield curve control; to affect long-run rates, the central bank would need to commit to keep purchasing the relevant asset as needed. While this may allow the central bank to achieve the same objective as QE by purchasing fewer assets, it might prevent balance sheet normalization for a longer period. At the current juncture, promising unconditional continued accommodation in the UK could be risky if either an accelerated recovery from Covid or Brexit push up inflation down the road. In any event, room to influence expectations would likely be limited since the yield curve is already close to zero in the medium run.
- **Quantitative easing (QE) again extended to assets beyond government bonds**: In principle this would work by compressing risk premia and improving funding conditions. However, purchases of lower-risk assets seem not to have translated into a direct boost to bank lending or corporate investment in the past in the UK or Europe.[6] In any event, funding conditions are currently easy in the UK for the relatively large

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[1] The ELB is typically thought of as a point where lower rates start having a negative impact on credit due to the reduction of bank net interest margins, which erodes their capital (estimated at about -1 percent by Brunnermeier and Koby, 2018 and Darracq Pariès and others, 2020) and/or where cash is hoarded (estimated between -0.5 and -1.5 for European countries by Rostagno and others, 2016).

[2] Lilley, A., and K. Rogoff, "The Case for Implementing Effective Negative Interest Rate Policy," Hoover Monetary Conference, 2019.

[3] Dell'Ariccia, G., Haksar, V., Mancini-Griffoli, T., Eckhold, K., Gray, S., Han, F., Hong, G.H., Lundback, E., Oura, H., Poirson, H. and Rabanal, P. "Negative Interest Rate Policies—Initial Experiences and Assessments." IMF Policy Paper, 2017; Altavilla, C., L. Burlon, M. Giannetti, and S. Holton "Is there a Zero Lower Bound? The Effects of Negative Policy Rates on Banks and Firms." ECB Working Paper No. 2289, 2019; and, Lopez, J. A., A. K. Rose, and M. M. Spiegel. "Why Have Negative Nominal Interest Rates had such a Small Effect on Bank Performance? Cross country evidence." *European Economic Review* 124 (2020): 103402.

[4] Bank of England, Monetary Policy Report, August 2020.

[5] https://www.brookings.edu/blog/up-front/2020/06/05/what-is-yield-curve-control/.

[6] Borio, C., and A. Zabai. "Unconventional Monetary Policies: A Re-Appraisal." *Research Handbook on Central Banking*, 2018; Giansante, S., M. Fatouh and S. Ongena. "Does Quantitative Easing Boost Bank Lending to the Real Economy or Cause other Bank Asset Reallocation? The Case of the UK." Bank of England Staff Working Paper No. 883, 2020; and, Todorov, K. "Quantify the Quantitative easing: Impact on Bonds and Corporate Debt Issuance." *Journal of Financial Economics*, 135 (2). 340–358, 2020.

Box 1. Monetary Tools to Loosen the Stance (concluded)

firms that would qualify for corporate QE.[7] Purchasing riskier debt securities could be more powerful, but also could sow the seeds of financial instability (in the form of asset price bubbles or underpricing of risk) and increase inequality, as it would create a windfall gain for asset holders. Similarly, equity purchases might be more effective in a context of corporate debt overhang but would raise governance issues.

- **Subsidized loans to banks**: The BoE currently provides loans to banks (conditional on lending targets) at rates as low as the policy rate through term funding schemes. Other central banks have gone further, providing loans below the policy rate, such as the ECB's TLTRO III program. This could further encourage bank lending, mitigate any damage to bank profitability if negative rates are introduced, and ensure the availability of cheap bank funding in the event markets dry-up. However, such a measure would have fiscal implications and require coordination with the Treasury.

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[7] IMF Global Financial Stability Report, October 2020, Chapter 3.

24. While keeping systemic risks well-contained the authorities need to make sure the banking system provides the intermediation necessary to finance the recovery:

- **Managing systemic risks**. In view of continuing uncertainty about the depth and duration of the pandemic, staff recommended that dividend payment restrictions be extended to ensure that capital remains ample after losses start to materialize. A potential systemic concern relates to the impact of falling property prices (especially in the retail and office segments, which may experience lasting impacts from the crisis). Close supervision of banks should thus continue (with particular attention to mid-cap and smaller banks with narrower business models and higher exposures to areas of risk like property prices). Limits on loan-to-value, debt-to-income, and interest coverage ratios should be preserved given uncertainty over the evolution of housing prices, and risks in this area need to be kept under review.

- **Supporting intermediation**. Large banks have reasonably strong capital positions, per BoE stress tests, and with the release of counter-cyclical capital buffers even more of total buffers are usable. The issue now is for banks to put these buffers to use to provide funding for the recovery. The authorities could help in this respect by: (i) clarifying the terms and procedures for banks to access state loan-guarantees (to avoid tying up bank resources); (ii) committing to provide ample forward notice on any potential changes to regulatory buffers (as the recovery gains traction); and (iii) for stress testing, resuming the now-suspended Annual Cyclical Scenarios and using the new results to identify weak institutions (the ACS are by design counter-cyclical, and it would be important to calibrate them carefully to this end and deploy judgment carefully, to reduce the risk of imposing unnecessary procyclical capital increases).

25. Authorities' views. The discussions took place at a very active point in the policy process, and right ahead of decisions by the authorities to extend and adapt pandemic support policies and to loosen monetary policy:

- **Fiscal policy**. The fiscal authorities emphasized their strong agreement on doing whatever it takes on pandemic support, noting the recent extensions and enhancements implemented. They placed somewhat more emphasis than staff on adapting policies on an ongoing basis as opposed to commitment/forward guidance and noted legal constraints to the latter (i.e., the budget year). They saw a strong role for public investment, emphasizing that they remained committed to their announced March program, and pointing to the expanding focus on climate change mitigation measures. In principle they were open to scaling up further but consideration would need to be given to the capacity to do so to ensure it could be done in line with processes to maintain value for money. They welcomed the recommendation for an externally validated assessment of their public investment management systems.

- On **monetary policy**, in the wake of the November loosening, the BoE views the stance as accommodative and expects inflation to return to target in around two years' time under the baseline scenario. It believes that it has sufficient room to maneuver and an array of tools available should the outlook call for further loosening, although some tools may be less effective close to the lower bound. Negative rates are part of the toolbox, but would require preparatory operational work and further analysis, including on their transmission through the banking sector.

- Finally, regarding the **financial sector**, the BoE takes the views that, reflecting the resilience that has been built up since the global financial crisis, and, alongside the extraordinary policy responses of the Government and BoE, the financial system has so far been able to provide support to UK households and businesses. The UK banking system remains resilient to a very wide range of possible outcomes, and has the capacity to continue to support households and businesses. They emphasized that banks' buffers of capital exist to be drawn down in stress and were confident that all elements of capital buffers would be able to be used as necessary. The BoE indicated that it would continue to monitor the use of capital buffers and assess the extent to which temporary changes to the capital framework may be necessary. A decision on dividends beyond 2020 will be taken in Q4 2020, based on the current and projected capital positions of the banks, taking into account the level of uncertainty on the future path of the economy, market conditions, and capital trajectories.

B. Policies to Facilitate Macroeconomic and Fiscal Adjustment

26. The authorities need to also design and implement policies to facilitate macroeconomic adjustment. There will be a significant shift in the pattern of production and employment due to both Covid and Brexit. The Covid and Brexit shocks generally impact different sectors—contact-intensive industries are likely to shrink due to Covid, while some manufacturing industries and financial services could experience losses of about 15 percent due to Brexit, with variation also across regions.[12] Staff analysis suggests that post-Brexit labor reallocation across sectors will likely take several years, notwithstanding the UK's flexible labor markets. During the transition, the NAIRU could increase above the long-term equilibrium unemployment rate. In addition, the scale of corporate restructuring could be very significant. Some analysts estimate that

[12] United Kingdom: Selected Issues, IMF Country Report No. 18/317, 2018.

by March 2021 around £70 bn of corporate debt (3½ percent of GDP) could be in distress, affecting over 640,000 small and medium sized businesses.[13]

27. Several policy changes could help smooth the adjustment. The UK has among the most flexible labor and product markets in Europe, and the insolvency regime has low barriers to corporate restructuring and inexpensive personal cost associated with entrepreneurial failure (Figure 6). Nevertheless, gains could be realized by:

- **Strengthening the social safety net**. The system in the UK at present leans towards incentives to return to work, with the level of benefits provided by the Universal Credit (UC) below the OECD average for out-of-work replacement ratios. While this has helped keep unemployment low and reduced fiscal costs, the projected post-pandemic shift in the landscape towards higher structural unemployment calls for some review of the approach. If it does indeed become harder to exit unemployment because jobs are scarce, incentives would be less of a concern, and more emphasis should be placed on cushioning the impact. The government could consider: (i) extending temporary UC (introduced in March) to the post-pandemic phase; (ii) an adjustment to the level of earnings at which UC starts to be withdrawn and the speed at which UC is withdrawn as earnings rise (which could allow greater generosity for in-work recipients while protecting incentives;[14] and (iii) improving the fairness of housing support under UC by making permanent the link between the level of benefits and rents in the recipient's area. Making these changes could cost around 0.5 percent of GDP per year and could be financed initially within staff's proposed envelope for additional fiscal stimulus. Since low-income households tend to have higher propensity to consume, this would be a particularly effective way to help stimulate the economy.

- **Enhancing active labor market policies (ALMPs)**. As the economy begins to recover the right modalities need to be in place to support sectoral labor reallocation. In the post-GFC period, spending on ALMPs was cut back in the UK, leaving spending on activation policies per unemployed at low levels by international standards.[15] The authorities have launched several initiatives to boost job search assistance, expand training and apprenticeships, and subsidize jobs. Further enhancements to ALMPs could focus on several approaches, including support for the National Retraining Scheme, which could help facilitate the adjustment for women, low-income and highly vulnerable workers (Box 2). The cost of such enhancements could come to around 0.1–0.2 percent of GDP per year, which could again be financed initially within staff's proposed envelope for additional fiscal stimulus.

[13] Recapitalisation Group, "The Demand for Recapitalisation," TheCityUK, September 2020.

[14] P. Bourquin and T. Waters, "The Temporary Benefit Increases Beyond 2020–21," Institute for Fiscal Studies, Green Budget 2020: Chapter 8.

[15] OECD Economic Surveys: United Kingdom, October 2020.

Box 2. Policies to Facilitate Adjustment in the UK Labor Market

The literature suggests support for displaced workers should be tailored by type of recipients. Active labor market programs (ALMPs) tend to be more effective for women, lower-income and vulnerable groups; work-first programs focused on placement are more successful for disadvantaged participants, while human capital programs are more effective for the long-term unemployed. However, ALMPs tend to be less effective for placing young and old workers. Intensive training should be the policy priority for young displaced workers even if the training programs might take time to payoff.

There are a number of interventions that could strengthen the UK's activation policies:

- JobCentre Plus (JCP)(the UK's public employment service provider) offers a range of training programs, but the total size of these programs is small, hence expanding them should be considered.
- To improve the selection of type of support provided by the JCP (e.g., specific training programs) a statistical-based profiling tool should be developed to complement the existing, discretionary-based, approach. To target training programs to sectors or skills in most demand the JCP should seek guidance on the future skill needs from the government and engage with the private sector.
- The UK has the lowest numeric and literacy skills among young workers in the OECD. Thus, training for basic skills for claimants that fail the basic skills tests should be made mandatory.
- It will be important to make financing available for those who want to take self-financed training courses. The government could also consider expanding the size of the existing financing programs (e.g., the advanced learner program, the learner support program and the grants and bursaries programs for adult learners) as well as increasing awareness of these programs.
- Alternative career paths should be explored for older displaced workers. In many countries, subsidies (either in the form of social benefits or direct wage subsidies) have been considered to help displaced older workers getting back to work. Alternatively, older workers could seek the opportunity to be self-employed, allowing them to continue working in areas of their expertise. The government could help older workers by providing the necessary funding and guidance on how to become self-employed.
- Drawing from successful international experiences, other types of training programs could be introduced in the UK. One option is the job-rotation program in Denmark, which provides unemployed persons placement in a firm in which a regular employed worker is seeking vocational training. An agency modelled along the lines of the US' National Association of State Workers Agencies (NASWA) could be established to share good practices among district level offices of JCP.

Type of Support	Government Initiatives to Support Jobs	Staff's Additional Proposals
Public employment services	Funding to increase number of career advisers and for Job Centres Plus (JCP) to help Universal Credit recipients find jobs, including through the new Restart program. Support for those unemployed for three months to find employment (JETS program).	Introduce statistical profiling to assist career guidance provided by JCPs. Improve coordination among JCP offices.
Institutional training	Funding for more training courses in high demand sectors.	Expand size of training programs offered by JCPs, including on basic skills. Provide funds for self-financed training courses.
Workplace training	Subsidies for traineeships and apprenticeships.	Consider introducing a job rotation program.
Employment incentives	Subsidies for jobs for 16 to 24-year-olds at risk of long-term unemployment (Kickstart scheme).	Explore alternatives to help older displaced workers.

- **Facilitating corporate restructuring**. As support schemes sunset, significant numbers of SMEs may face some form of balance sheet distress (as almost 1.5 million sought help under government lending schemes). Cases may range from viable firms that need to adjust their capital structure to non-viable firms that need to be wound down (with viability understood to include the future value generated by intangibles). Drawn out case-by-case deleveraging—a significant risk if there will be high numbers to process—can create macroeconomic headwinds. Facilitating a speedier process is a matter of having the right insolvency framework, and ensuring companies have access to equity finance. The UK has recently introduced a new corporate insolvency and restructuring regime which provides greater flexibility, but the new regime still entails significant court involvement, which could become challenging given the potential large number of firms involved. There are options to further streamline the insolvency and restructuring regime and foster new equity investments in viable SMEs (Box 3).

Box 3. Policies to Facilitate the Reallocation of Capital

The corporate insolvency and restructuring regime could be further strengthened:

- A more standardized and simple out-of-court approach could be introduced to expedite the process given the potentially large number of firms in need of debt restructuring.[1]
- The government could also consider taking a larger haircut on its claims than private creditors take on theirs (the government has built exposures through deferred tax payments while called guarantees for some creditors will also give it residual claims). The motivation would be to reflect the broader social value of keeping a viable firm in business.[2]
- Well defined procedures on how defaults in the presence of government guarantees should be treated by lenders, regulators, and the courts could help banks to provision against losses and continue financing the recovery.

The UK could consider several options to help enterprises rebuild equity:

- **Temporary conversion of government-guaranteed loans into equity**: Loans to struggling firms could convert to non-voting equity for a period of time. The government would obtain a dividend from only those companies able to pay. This measure would give time for companies to get back on their feet and avoid arrears to other debtors and suppliers. At the end of the "equity" period, government shares would convert back to debt at a discounted rate depending on the dividends paid and the remaining value of the company. This scheme could be managed by the British Business Bank.
- **Conversion of government-guaranteed debt into future tax liabilities**: Under this option, debt to the government would convert into future tax liabilities (i.e., only companies that return to profitability would repay the money owed but as a tax—that is, proportional to profits—rather than as debt). Such a strategy would increase pre-tax profits and reduce debt overhang, thus enabling companies to attract more equity investors. However, the pros and cons for public finances and the design of the debt-to-tax conversion mechanisms need to be carefully assessed.

[1] Liu, Y., J. Garrido, and C. DeLong, 2020, "Private Debt Resolution Measures in the Wake of the Pandemic," IMF Special Series on Covid-19; J. Garrido et al., 2019, "The Use of Data in Assessing and Designing Insolvency Systems," IMF Working Paper 19/27. Blanchard et al., 2020, "A New Policy Toolkit is Needed as Countries Exit COVID-19 Lockdowns," PIIE Policy Brief 20-8.

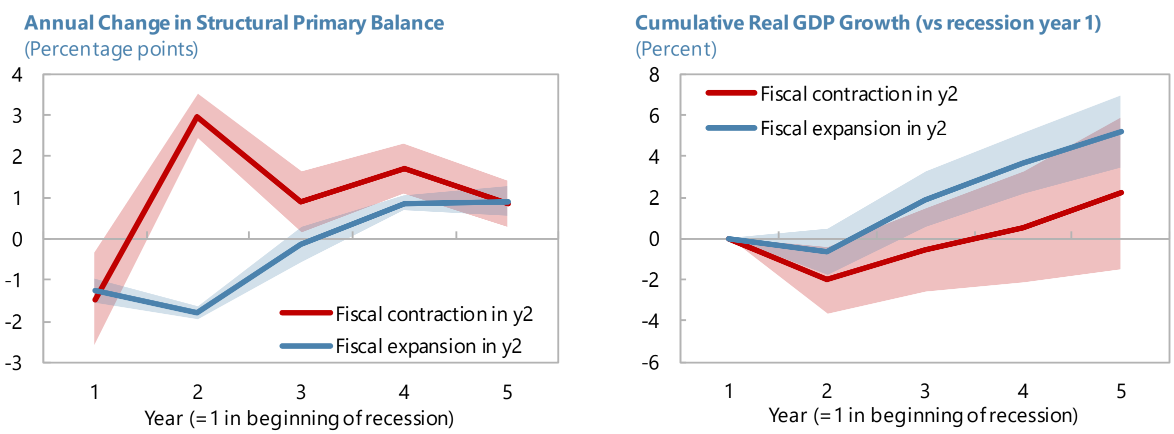
[2] Olivier Blanchard, Thomas Philippon, and Jean Pisani-Ferry, "A New Policy Toolkit Is Needed as Countries Exit COVID-19 Lockdowns," Policy Brief, Peterson Institute for International Economics, June 2020.

Box 3. Policies to Facilitate the Reallocation of Capital (concluded)

- **Risk pooling of viable companies' distressed debt**: The government, via the British Business Bank, could pool the debt of struggling but viable firms into a portfolio (developing metrics to determine viability). Such debt could be converted into equity and sold in tranches to venture capitalists, private equity firms, and other investors seeking high-yield/high-return opportunities.
- **Expansion of the Future Fund**: This scheme already exists and provides loans to match new private investments. The debt converts to equity at the end of the loan's life under certain conditions. This scheme is small compared to the UK's large population of firms and aggregate investment, but could play some role in assisting distressed firms.
- **Pooled asset vehicles**: New pools of equity assets that diversify risk sufficiently and meet the regulatory requirements of institutional investors (e.g., insurers and pension funds) could be considered. In addition, some of the requirements limiting insurers and pension funds access to equity investments could be partially relaxed.

28. For fiscal policy, the adjustment and rotation phase—essential for restoring debt dynamics—should start when the private sector begins to durably lead the recovery. Past experience in advanced economies shows considerably better subsequent economic performance when fiscal stimulus is not withdrawn too soon (text charts).

Fiscal Response and Post-Recession Growth, Advanced Economies, 1990–2019



Sources: World Economic Outlook; IMF staff calculations.
Note: Straight lines show averages (across countries and recession episodes) and shaded areas +/-1 standard deviations of the average. A recession is defined as starting with a year of negative annual real GDP growth and a cycle has a minimum length of 5 years. Country-recession episodes are classified as experiencing a fiscal contraction during the recovery if the change in the structural primary balance in year 2 of the recession is more than 1 percent, and as an expansion if it is less than -1 percent. There is no significant difference in the debt-to-GDP ratio between the two groups the year before a recession starts.

29. Nonetheless, it is not too soon to prepare the groundwork for the fiscal adjustment process. Staff considers the key components of an adjustment stratsegy to include:

- **Gradual adjustment** to achieve a debt stabilizing primary balance by FY25–26 (the end of a normal 5-year horizon for the UK's fiscal forecast). On current estimates, a pace of 0.5 percent of

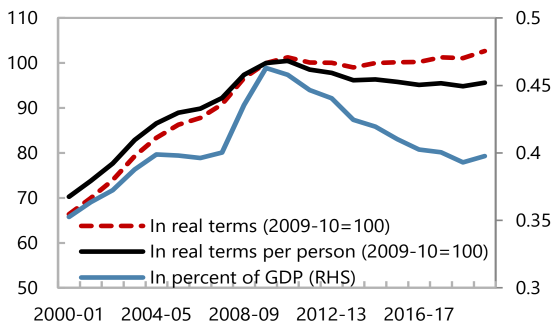
GDP per year starting from FY23–24 would be required to reach the debt-stabilizing primary deficit of about 2½ percent of GDP. This would not create too much of a headwind to recovery. A faster-than-expected cyclical recovery should be used to accelerate fiscal deficit improvements towards faster debt stabilization.

- **A full expenditure review in 2021**. Given the compression of spending in the last decade (in most areas other than health) and the 0.5 percent of GDP in departmental spending cuts relative to the previous budget introduced in the November 2020 spending review (in the near-term largely delivered by a public wage freeze and temporary cuts to foreign aid), there will likely be limited further room to act on the expenditure front. The 2021 review can however be useful to identify and contain spending pressures and to protect even higher public investment and social safety net spending (per staff recommendations). One option that needs to be considered, though, is removing the expensive "triple-lock" in the pension system, whereby pensions are adjusted by the largest of 2.5 percent, CPI inflation or growth in earnings.

Figure 2. United Kingdom: Tax and Expenditure Indicators

Public spending was significantly compressed following the GFC.

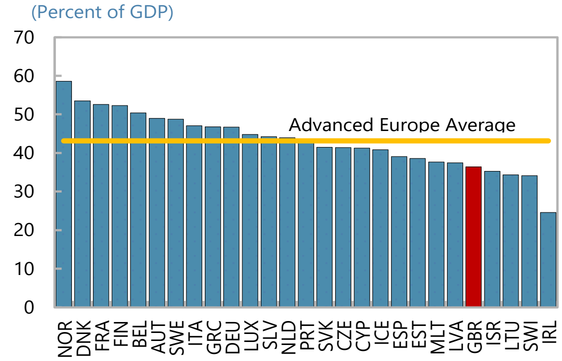
Central Government Spending 1/



Source: Office for Budget and Responsibility.
1/ Total managed expenditure.

Tax revenue in the UK is relatively low compared to peer countries.

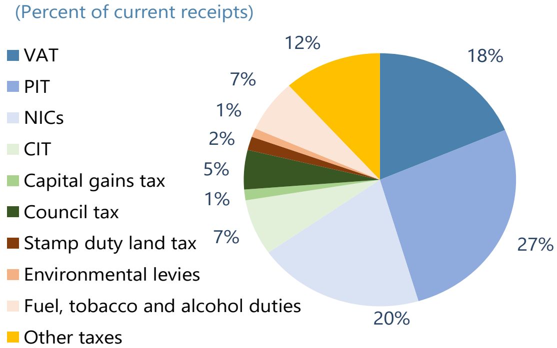
General Government Tax Revenue
(Percent of GDP)



Source: World Economic Outlook.

Income taxes, VAT and social contributions account for two-thirds of tax revenue.

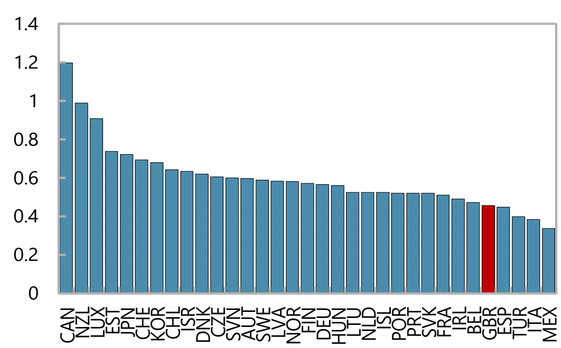
Tax Revenue Compositions
(Percent of current receipts)



Source: Office for Budget and Responsibility.

VAT collections are relatively low measured against the potential revenue base.

VAT Revenue Ratio in OECD Countries

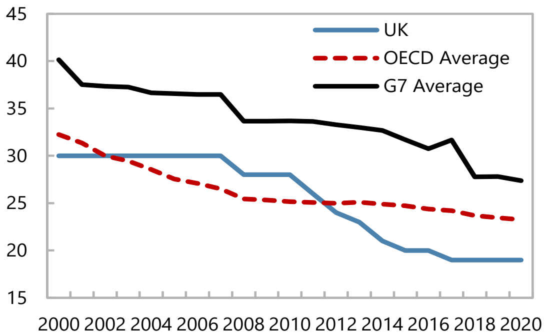


Sources: OECD; and IMF staff calculations.

Figure 2. United Kingdom: Tax and Expenditure Indicators (concluded)

The corporate tax rate has declined more rapidly than in peer countries.

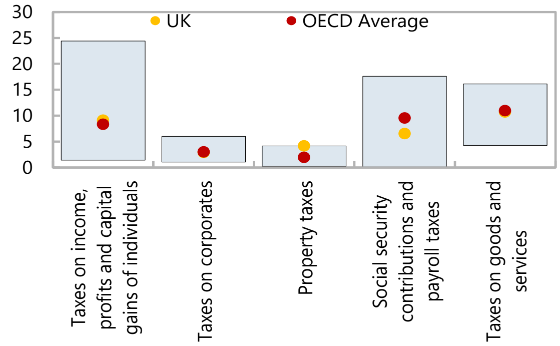
Corporate Tax Rates
(Percent)



Source: OECD.

Lower tax collections relative to peers derive from several revenue sources.

Sources of Tax Revenue in OECD Countries



Sources: OECD; and IMF staff calculations.
Note: Missing data in 2018 for Australia, Greece, Japan, Mexico was replaced with 2017 values.

- **Targeted revenue measures**. Steps to raise additional revenue should prioritize taxes with lower fiscal multipliers, with a focus on income tax exemptions, property taxes and the capital gains tax (all of which can address a need for progressivity). Tax measures can also support the climate agenda by introducing a carbon price of at least £60 per ton of CO2, implemented either through a carbon tax or an Emissions Trading System (ideally linked to the EU ETS to maximize efficiency).[16] Given the magnitude of the adjustment needed, the structure of the tax system, and the limitations for spending cuts discussed above, there will almost certainly be a need to raise the rate of one or more of the three main revenue sources (VAT, income tax, national insurance contributions), which account for two thirds of collections (Text Table).

Possible Fiscal Measures

Measures	Fiscal Impact
Fiscal Stimulus	
• Public investment in infrastructure, including on green projects. • Strengthen social safety net. • Further expansion of active labor market policies.	• 1–1.5 percent of GDP. • 0.5 percent of GDP. • 0.1–0.2 percent of GDP.
Fiscal Consolidation	
• Replace pension triple lock by CPI indexation after retirement. • Carbon tax or Emissions Trading System. • Tax property on values (not transactions), lower council tax discounts for single-occupant properties.	• CPI indexation of pensions could save 0.2 percent of GDP in 2024–25 (OBR 2020). • A carbon price of £60 could generate revenues of 0.7 percent of GDP in 2030.

[16] Arregui, N., and I. Parry, "Reconsidering Climate Change Mitigation Policy in the UK," IMF Working Paper 20/268, December 2020.

Possible Fiscal Measures (concluded)	
Fiscal Consolidation	
• Raise rate of: ○ Personal Income tax ○ Corporate income tax ○ VAT ○ NICs • Harmonize taxation of income across employees, self-employed, and business owner-managers. • Broaden VAT base (reduce preferential rates).	• A 1% rise in the basic rate would yield 0.2 % of GDP, and a 1% rise in the higher rate, 0.05 %. A 1% rise in the corporation income tax would yield 0.1% of GDP. A 1% rise in the standard rate would raise 0.3% of GDP.
Source: HM Revenue & Customs, IMF staff estimates.	

30. Authorities' views:

- The authorities agreed that **policies to facilitate adjustment** need to be carefully considered. They were open to doing more on ALMPs and to reviewing the safety net but emphasized the need for a comprehensive review to preserve incentives to seek work, and saw scope to maintain the relative cost-effectiveness of their previous approach. Concerning enterprise restructuring, they noted that some companies may struggle because they were highly leveraged or unprofitable prior to March and others faced pressure due to structural changes in the economy. They would monitor closely the evolution of corporate credit conditions. They saw the policies in place, particularly the recalibrated guarantee schemes (to allow a "pay-as-you-grow" element of debt service deferral), as sufficient to head off problems.

- On **fiscal rotation** they emphasized the importance of adjusting to restore sustainability, when the economic recovery is secured. They were focused on a one-year spending review (with some multi-year limits to support continued investment) and saw consolidation design as something for later on. They were more confident in finding some efficiencies through the forthcoming spending review, and emphasized that on the tax side they had recently seen success with base-broadening measures (for instance, a cap on reliefs for wealthy taxpayers). They reiterated government policy commitments to preserve the pension triple-lock and avoid tax rate increases. They acknowledged that they would have a choice to make on carbon taxation.

C. Anchoring the Response within a Strong Policy Framework

31. The UK's macroeconomic policy framework has served it very well, and its stabilizing properties need to be preserved. The authorities' forceful response to the pandemic has been possible thanks to the robust and credible fiscal, monetary and financial sector policy frameworks and the strong institutions that support them. The economy's performance over time has also benefitted from an open and rules-based trading regime. Policies need to remain anchored in strong frameworks (and the belief that they will be fully preserved and successfully adhered to once the crisis has passed). This may require some adaptations in light of the current crisis.

32. The UK's fiscal framework, now under review, confronts some challenges. Over the last 20 years, fiscal rules have generally steered policies in the right direction, albeit with targets that may have been too tight post-GFC, and with more frequent revisions to targets of late. The expiring rules—which focus on the headline budget balance, the structural deficit, and net public debt—do raise some questions. As structured, it can be difficult to determine a level of net debt to anchor on given uncertainty about future real interest rates and fiscal multipliers; meeting debt targets may create an incentive to sell assets at a discount; and the near-term targets may not be controllable enough (because of cyclical revenue variations). Some have pointed to a need for broader rules entirely, linked to climate targets.[17] Guiding and anchoring policy while making allowances for uncertainty, which is extremely high at present, also poses a challenge.

33. Staff sees several key elements to a new fiscal framework to address gaps and uncertainty (with different emphasis than other proposals put forward; Text Table):

- **Distinguish between core (necessary) targets and other guiding principles**. There is room for broader objectives to guide fiscal policy (e.g., climate), however ensuring that the government remains sustainable with a high likelihood of meeting its gross financing needs is a necessary condition for any framework, and thus at the core. This motivates a role for a net debt target, with the precise calibration informed by measures of financing pressure to account for potential drift in real interest rates (e.g., gross financing needs to GDP or debt service to revenues) and also by careful consideration of fiscal multipliers.

- **Focus on a controllable near-term aggregate**. A good year-to-year target should be tightly controllable and capable of delivering the medium-term anchor. This points to public expenditure. Since net debt forecasts will on occasion drift away from the target (e.g., due to deviations in revenues from forecasts, without compensating revenue action), an automatic correction mechanism for public spending could also be considered.

- **Some accounting for public net worth**. The impact of asset sales and contingent liabilities need to be taken into account (e.g., by using a benchmark on public (financial) net worth to evaluate below-the-line transactions). Wider use of public net worth as a target would, however, suffer from data gaps and valuation issues.

- **Adequate allowance for uncertainty**. An escape clause tied to a signal from a sufficiently high frequency indicator could allow for discretionary policy in the face of a shock too large for automatic stabilizers to effectively handle. To this end, utilizing a moving average of monthly GDP could be helpful (with sufficient account for movement in estimates of potential GDP). Importantly, any new framework should only enter into force only when the recovery from the pandemic is firmly in place and fiscal consolidation begins.

[17] A. Stirling et al, "Changing the Fiscal Rules: Unlocking Public Investment for a Green New Deal," New Economics Foundation, July 2019.

Alternative Proposed Fiscal Frameworks				
Proponent	**Medium Term Anchor**	**Operational Target**	**Complementary Rules**	**Escape Clause**
Rules in the 2017 Charter for Fiscal Responsibility (legally in effect)	Balanced budget in the middle of the 2020s. Public sector net debt falls as a percentage of GDP in 2020–21.	Structural deficit below 2 percent of GDP in 2020–21.	Spending in 2022–23 capped at 3 percent above November 2017 forecast of £135 billion.	
Rules in the Conservative Party Manifesto	Debt interest costs below 6 percent of tax revenues.	Current budget balance in the third year of the forecast.	Net public sector investment below 3 percent of GDP.	
IMF	Public sector net debt (calibrated with reference to GFNs or debt service to revenue).	Public expenditure.	Public (financial) net worth.	Tied to a high frequency indicator (e.g., a moving average of monthly GDP relative to potential).
Resolution Foundation	Increasing public sector net worth as a share of GDP over a fixed five-year term.	Cyclically adjusted public sector current balance of 1 per cent of GDP and no less than -1 per cent of GDP in outturn by the end of a fixed five-year period.	Debt service to revenue below 10 per cent at any time.	Output gap in excess of 1 per cent and Bank Rate below 1.5 per cent.
New Economics Foundation	**Operational target**: A rolling forecast of the range of the optimal primary balance over the medium term estimated by the OBR (or a new independent body) based on an assessment of fiscal space and macroeconomic dynamics.			
Word Wild Fund (WWF)	**Fiscal objective**: Public spending aligned with building a sustainable, resilient and fair economy in the long term, by directing adequate and appropriate investment to mitigate future pressures and risks to the UK economy and to the public finances. **Fiscal rule**: Net borrowing will be permitted over the next five years to support spending that is aligned with improving fiscal resilience by 2025 including by: • Reducing risk by supporting spending aligned with meeting climate and environment goals (e.g., the low-carbon transition to net zero emissions), • Other priority objectives that contribute to improved fiscal resilience, as determined by the government and the Treasury (e.g., additional investment in flood risk management, early years education, electric vehicles, cycling and improving diets).			

34. **The UK's monetary framework has been working well but deserves more frequent review given the evolving global context**. The inflation targeting regime has provided stability and has kept inflation close to target and expectations well anchored.[18] In 2013, the Treasury made explicit that, in exceptional circumstances, inflation could deviate from target temporarily in order to stabilize output,[19] which provided some additional flexibility that has helped the BoE to manage the

[18] Carney, M., "A Framework for All Seasons?" Speech by the Governor of the Bank of England, January 2020.

[19] HM Treasury Policy Paper, "Review of the Monetary Policy Framework," March 2013.

response to shocks like Brexit. Going forward, low-for-longer interest rates could constrain monetary space, raising risks of lingering inflation undershoots and downward de-anchoring of inflation expectations if shocks occur. Other major central banks have examined options to address this of late, although the UK's situation involves important differences (e.g., a stronger exchange rate channel of monetary policy)(Table 8). Whether the current framework may need adjustment to address the potential problem of prolonged deflationary pressures nonetheless merits consideration. Introducing a calendar-based schedule of framework reviews, in line with the practice in some peers, might be helpful in this regard, as it would avoid sending unintended signals about the likelihood of potential changes.

35. The UK's financial sector regulatory and supervisory framework has been stable and first rate, but several challenges need to be worked through. The UK's bank regulatory framework was strengthened substantially after 2008. The authorities have implemented several measures to address issues identified in the 2016 FSAP (Table 9), although AML/CFT risks need to be mitigated with robust compliance in the financial sector and improved transparency of beneficial ownership information.[20] Key new challenges to be considered, including in the context of the forthcoming 2021 FSAP, cover:

- **Establishing robust and stable equivalence regimes with the EU, where possible**. Any new equivalence arrangement between the UK and the EU should aim to be as stable as possible. The two sides should consider a phase-out approach to revocation of equivalence (e.g., 3 to 6 months prior notice) enshrined in new agreements, thus granting enough time for: (i) the relevant jurisdiction to take remedial action, if desired, and (ii) private entities to adjust to forthcoming changes. Even if few or no equivalence arrangements can be reached with the EU, the UK 's role as a global financial center will remain, reflecting London's key advantages (e.g., preeminence of English law in financial contracts, first-class reputation of its financial regulators, deep pools of human capital, and high existing financial services trade with the U.S.).

- **Addressing weaknesses in the non-bank financial system**. The recurrence of the dash-for-cash dynamic during stress episodes suggests that: (i) investors treat certain financial vehicles as perfectly liquid whereas the underlying assets are illiquid; and (ii) markets expect the central bank to provide a backstop ("central bank put") when liquidity dries out suddenly. Addressing these would require some re-think of regulation of non-banks, and/or introduction of a potential formal BoE liquidity facility for non-banks. These issues are not unique to the UK and can be considered by the authorities alongside ongoing FSB work.

- **The role of bank buffers**. The initial pandemic stages and ongoing response will offer insights into the effectiveness of bank buffers and the degree to which they will continue to prove usable (i.e., to allow banks to continue providing credit for the recovery). Weak usage of buffers may point to concerns that using buffers will lead to restrictions on payouts, including of AT1

[20] Such efforts will also benefit the authorities' voluntary commitment to assess the UK's framework for dealing with bribery of foreign officials, as part of the IMF's 2018 Enhanced Framework on Governance. Table 10 provides the authorities' self-assessment of progress in this area since the last AIV consultation.

coupons (notwithstanding some flexibility in the framework), which may be viewed negatively by markets; could reflect precautionary motives; or could point to a failure to countercyclically increase buffers enough prior to the crisis. Again, these issues are not unique to the UK, and can be pursued by the authorities within the Basel process.

36. The UK's open international trade regime has been a source of strength, but confronts two challenges:

- **Managing the Brexit transition effectively to help minimize disruptive feedback**. Above all, the authorities need to accelerate the implementation of their plan to invest in border administration. Stronger communications and simplified custom processes would help to guide business' plans. Targeted support for the least prepared businesses such as SMEs is also warranted (e.g., providing information on how to fill out customs declaration forms and how to register as a visa sponsor to recruit foreign workers). Notwithstanding progress in the financial sector, there remain a few issues for the two sides to work through, including: avoiding fragmentation of derivative trading; possible repapering of about £17 trillion worth of uncleared derivatives contracts; completing contractual clauses allowing the transfer of personal data from the EEA to the UK; and ensuring that low-value cross-border direct debit payments under the Single European Payments Area (SEPA) can continue post-Brexit. Completing work in these areas would be important to mitigate potential outward spillovers from Brexit.

- **Completing trade agreements with other partners**. The UK had signed or agreed roll-overs on 22 out of 41 existing trade agreements with non-EU countries, as of October 21st, which combined with recent agreements with Canada and Japan account for 14 percent of total UK trade (26 percent of non-EU trade). The authorities are focused on agreements with the U.S. and 14 countries with which the EU has trade deals (e.g., Mexico), as well as other countries (e.g., Australia). It will also be important for the UK to preserve its strong role in the WTO and provide leadership in negotiating new WTO-based agreements in services (where the UK is a large global player).

37. Authorities' views.

- The authorities see their **monetary and fiscal frameworks** as having performed well. The Treasury noted that the fiscal framework is under review, but uncertainty argues against early re-imposition of fiscal rules. Whilst acknowledging the merits of calendar-based monetary framework reviews, they see no urgent need to review the framework now, given well-anchored inflation expectations and the flexibility to address shocks (incorporated in the 2013 reform of the MPC remit).

- On the **financial sector framework** side, they noted that their key aims are to support an open, globally integrated UK financial sector, fostering common high standards of international regulatory and supervisory cooperation, and promoting the interests of consumers and market participants. Irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibilities, the BoE would remain committed to the implementation of robust prudential standards in the UK. They noted that it would be important after the pandemic to review experience and distill lessons working in concert with international standard setting bodies.

- On the **trade side** they emphasized their commitment to complete end-of-transition-period implementation preparations and progress to date. They emphasized that businesses and citizens now need to take action to prepare as some changes will be inevitable when the UK leaves the EU's single market and customs union, even if a free trade agreement is reached. They would work to finalize trade deals with remaining partners and described their overall philosophy as aimed at liberalizing and simplifying tariffs.

D. Contingency Plans: In the Absence of an FTA Between the UK and EU

38. A no-deal Brexit would likely require similar but perhaps more ambitious policy responses. With the outlook in this instance tending towards the staff's downside scenario and embedding a longer period of deeper structural transformation and weak demand, there would be a greater need for fiscal policy to cushion those facing hardship and to support rebuilding the economy with public investment. With inflation likely held down in the medium term, monetary policy would face a need to remain accommodative, raising the likelihood that other tools would need to be deployed to loosen further (like a negative policy rate). For the financial sector, securing its ability to intermediate might mean action to rebuild capital for some banks (as the deeper shock would raise losses). The same key structural policy needs would apply (to facilitate the movement of labor and capital across sectors), but the depth of the shock would argue for introducing them more aggressively and upfront.

39. The key potential constraint would be a loss of policy space. The UK's strong and credible frameworks would be expected to continue to anchor a response, but their credibility cannot be taken for granted (e.g., in September, Moody's expressed concern about policy frameworks in the wake of the proposed Internal Market Bill, which threatened to overwrite an aspect of the Withdrawal Agreement). Moreover, the staff's DSA assessment does highlight higher risks in the event of a combined macro-fiscal shock. It is possible that, in the market turbulence that would follow an unexpected no-deal Brexit, financing options for the authorities could become tighter, limiting the government's ability to immediately loosen fiscal policy. It is also possible that the short-run impact of a no-deal Brexit on inflation (through currency depreciation and supply disruptions) increases medium-term inflation expectations, limiting the BoE's ability to immediately respond within its inflation-targeting mandate. It would accordingly be critical to: (i) stabilize any immediate market turbulence (by reassuring about the BoE's ability to provide market liquidity in major currencies if needed, and about the sufficiency of system-wide liquidity buffers); and (ii) anchor expectations firmly with appropriate guidance and if necessary actions, before launching the desirable policy response. These actions would help to mitigate near-term outward spillovers from such an unexpected reversion to WTO trading terms with the EU on January 1.

40. Authorities' views. The authorities reiterated their intention to reach an agreement, albeit on terms that are of interest to both sides, and acknowledged that in the absence of an agreement there would be some short-run macroeconomic policy issues to work through. They were confident in maintaining the credibility of their frameworks. They reiterated that preparations are ongoing to help businesses meet the challenges and opportunities at the end of the transition period, irrespective of the outcome.

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41. The pandemic has taken a significant human and economic toll in the UK. It hit an economy already facing strains from Brexit and longer-term challenges (e.g., low productivity growth), but which had rebuilt fiscal and private sector buffers post 2008. GDP has dropped dramatically. A sharp initial economic rebound is now in reverse due to a second Covid-19 wave. The outlook is for a muted recovery with risks to the downside, as the lingering pandemic lifts unemployment and creates stress on corporate balance sheets. Uncertainty remains high, but an early deployment of an effective vaccine could offer upside potential.

42. The authorities' aggressive policy response—an excellent example of well-coordinated action—has helped mitigate the damage. The unprecedented and coordinated package of fiscal, monetary, and financial sector measures has supported incomes, kept unemployment down and curbed bankruptcies. The cost of this response has been a sharp deterioration of the public sector's balance sheet, although borrowing costs have fallen and there remains fiscal space. Private debt levels are also rising sharply, but the banking system remains well-capitalized and liquid, reflecting reforms post-2008 and crisis measures taken.

43. Continued policy support is essential to see the economy through the pandemic and the transition to the post-Brexit trade regime. This will boost expectations and confidence and will help the economy work through the temporary economic effects of the pandemic. The skewed distribution of risk argues for an aggressive approach, to rule out a sharper and more extended period of deleveraging. Forward guidance about continuing policy support—along fiscal, monetary, and financial sector dimensions—is critical to maximize impact.

44. Fiscal policy should continue to accommodate the ongoing costs of pandemic health, job, and small business support schemes. These have proven to be an essential extension of the safety net. Recent policy adjustments are important enhancements and the programs should be kept under review to ensure their continued effectiveness. In this context, it will be particularly important to correctly calibrate the balance of loan versus grant support to firms and to adjust the parameters of the job support program to reduce the effective subsidy as pandemic impacts decline. The various schemes should be phased out fully as the direct impact of the pandemic on the economy disappears.

45. Invigorating growth as the pandemic subsides will require an additional fiscal policy push, and this should take advantage of opportunities to "build forward better." The planned expansion of the public investment program could help raise productivity, address regional inequalities, and reduce carbon emissions. There is a case to go even further, provided projects can be well targeted and managed. An externally validated assessment of the oversight framework, using the IMF's PIMA methodology, could help identify any gaps.

46. Monetary policy should remain accommodative to guard against the risk that projected inflation remains below target. Staff welcomes the BoE's commitment to further government bond purchases. Other tools like negative policy rates could be brought in incrementally if and when needed. To this end, it will be important to complete an assessment about how the net impact of such an approach could be maximized.

47. Financial sector policies should stay alert to the emergence of stress and continue to buttress the system's ability to fund the recovery. The strong position of the banking system suggests that releasing regulatory buffers was appropriate, and banks can put these buffers to use to provide funding for the recovery. However, in view of uncertainty related to SME stress and property prices, close supervision of banks should continue and dividend payment restrictions should be extended. It will be important to better define the trigger points and procedures for the activation of government guarantees to avoid tying up bank resources.

48. To support macroeconomic adjustment in the medium term, impediments to factor reallocation will need to be tackled. The pandemic and Brexit, in their specific ways, will likely cause some industries to shrink and others to expand. Unemployment might rise persistently, especially among the low skilled, and corporate financial distress will likely increase. The UK economy is relatively flexible but some adjustments to policies could prove helpful, including measures to strengthen the social safety net, higher ALMP spending, a more streamlined out-of-court insolvency approach, and unlocking new sources of equity for SMEs.

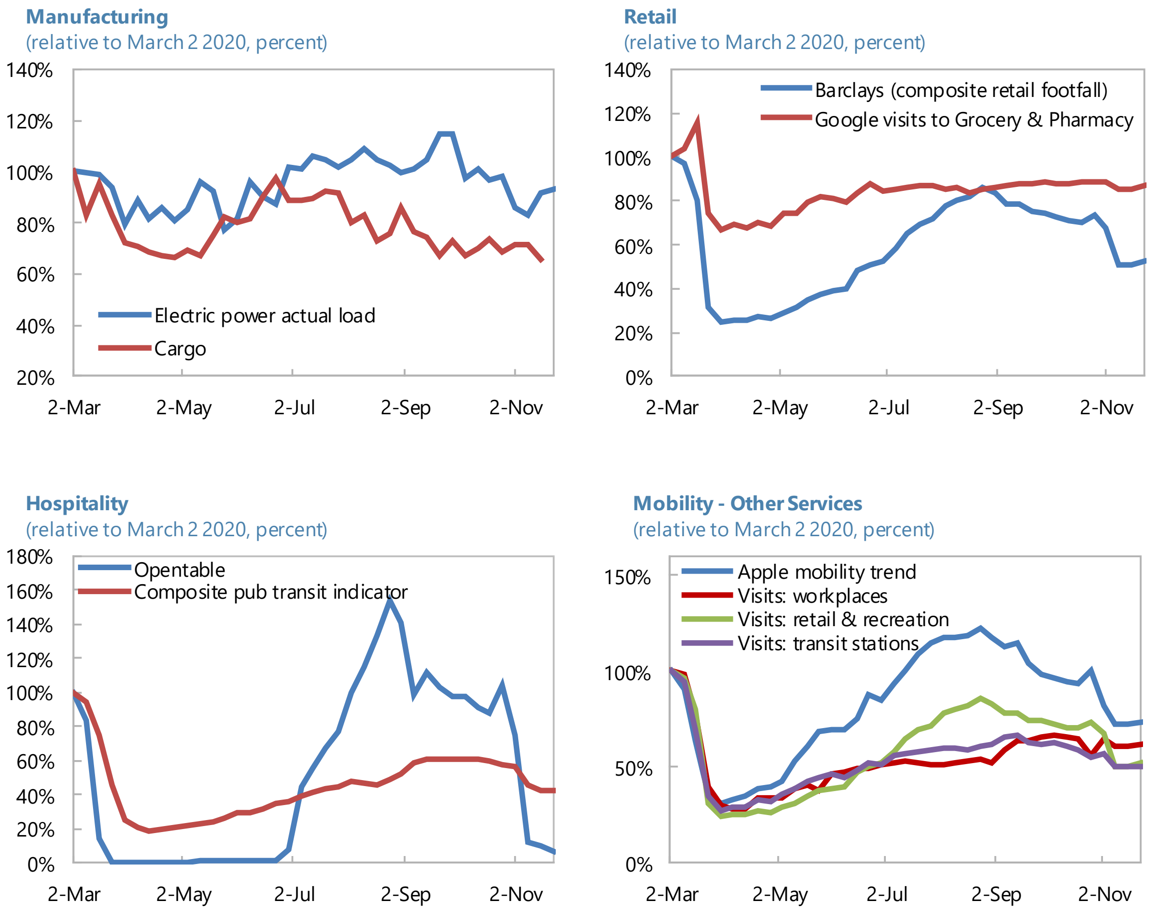
49. Policy rotation toward fiscal adjustment in the medium term will be essential to reverse the rise in public debt ratios. Rotation should only come when the private sector begins to durably lead the recovery, and consolidation should be gradual to reduce headwinds. There are advantages to considering the difficult choices soon, including to cement expectations that public investment will be protected, thereby enhancing its impact now. Re-launching a full spending review in 2021 and re-examining the expensive pension triple lock appear necessary. However, some adjustment of major tax rates also appears inevitable.

50. Policies should remain anchored within robust frameworks. The UK's policy frameworks have an enviable track record and should be adapted where needed to continue to deliver their objectives. In the fiscal area, rules are under review, and a new medium-term anchor and annual targets will be needed to support fiscal sustainability. Whether the current monetary framework may need adjustment to address the risk of persistent low inflation merits consideration, but within a calendar-based schedule of reviews. Finally, it will be important for the authorities to use the ongoing FSB review of non-banks and the IMF FSAP in 2021 to address weaknesses uncovered by the crisis.

51. Agreement on a new post-Brexit trade regime would be beneficial for both the UK and EU, and alongside the joint efforts to achieve this it will be important to finalize preparations for implementation. On the UK side, the government needs to deliver on its plan for investment in border infrastructure, staff, and technology, and the customs intermediary sector to avoid disruptions. With non-financial corporations lagging in their preparations, stronger communications and direct assistance for SMEs would be particularly helpful. While a deal would offer benefits to both sides, in the event one cannot be reached and the two sides move on to trade on WTO terms, it will be critical for the UK authorities to keep expectations anchored and, subject to this, pursue more aggressive demand support while more rapidly implementing policies to facilitate structural transformation.

52. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 3. United Kingdom: High-Frequency Activity Indicators

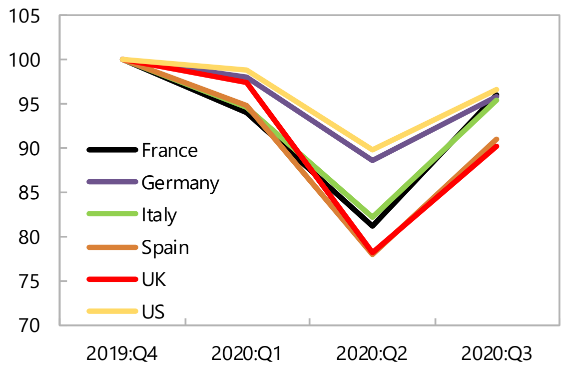


Sources: Haver Analytics, Barclays Research, IMF staff calculations.

Figure 4. United Kingdom: Recent Macroeconomic Developments

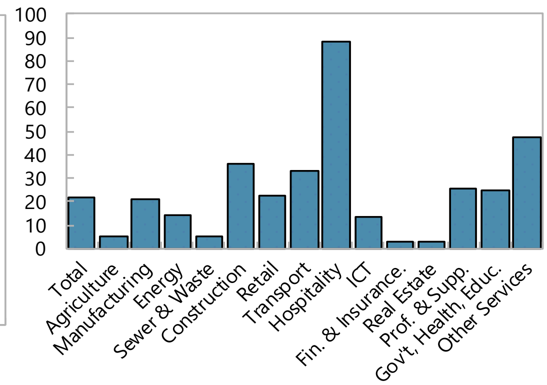
The pandemic led to a relatively large contraction in the UK.

Real GDP (Index, 2019:Q4=100)



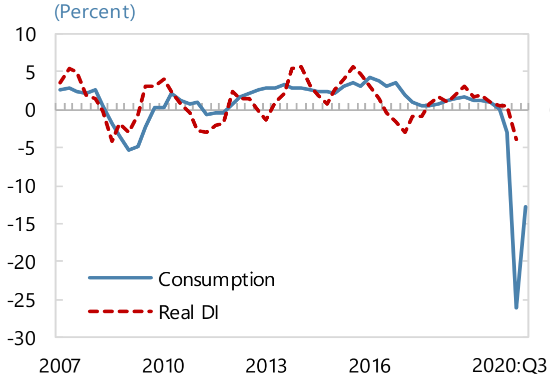
With high-contact services being harder hit.

GVA Losses by Sector, 2019:Q4-2020:Q2



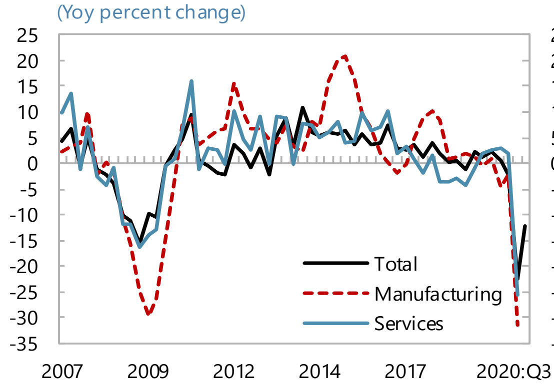
Consumption plummeted due to social distancing...

Real Income and Consumption Growth
(Percent)



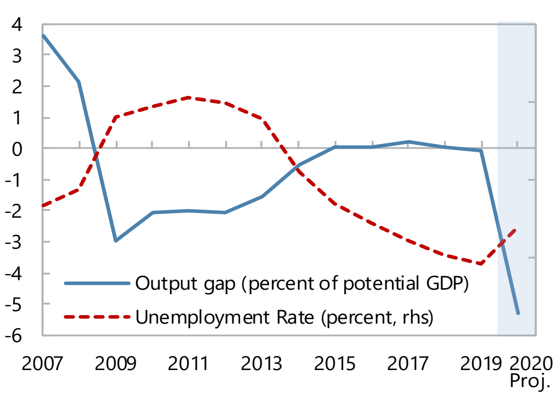
...and so did investment amidst high uncertainty.

Investment Growth
(Yoy percent change)



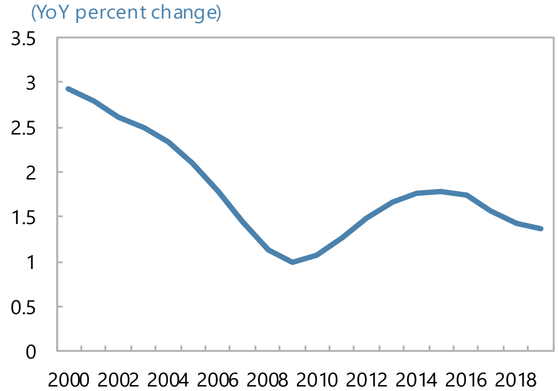
The furlough scheme muted the unemployment hike, but substantial slack is estimated.

Output Gap and Unemployment Rate



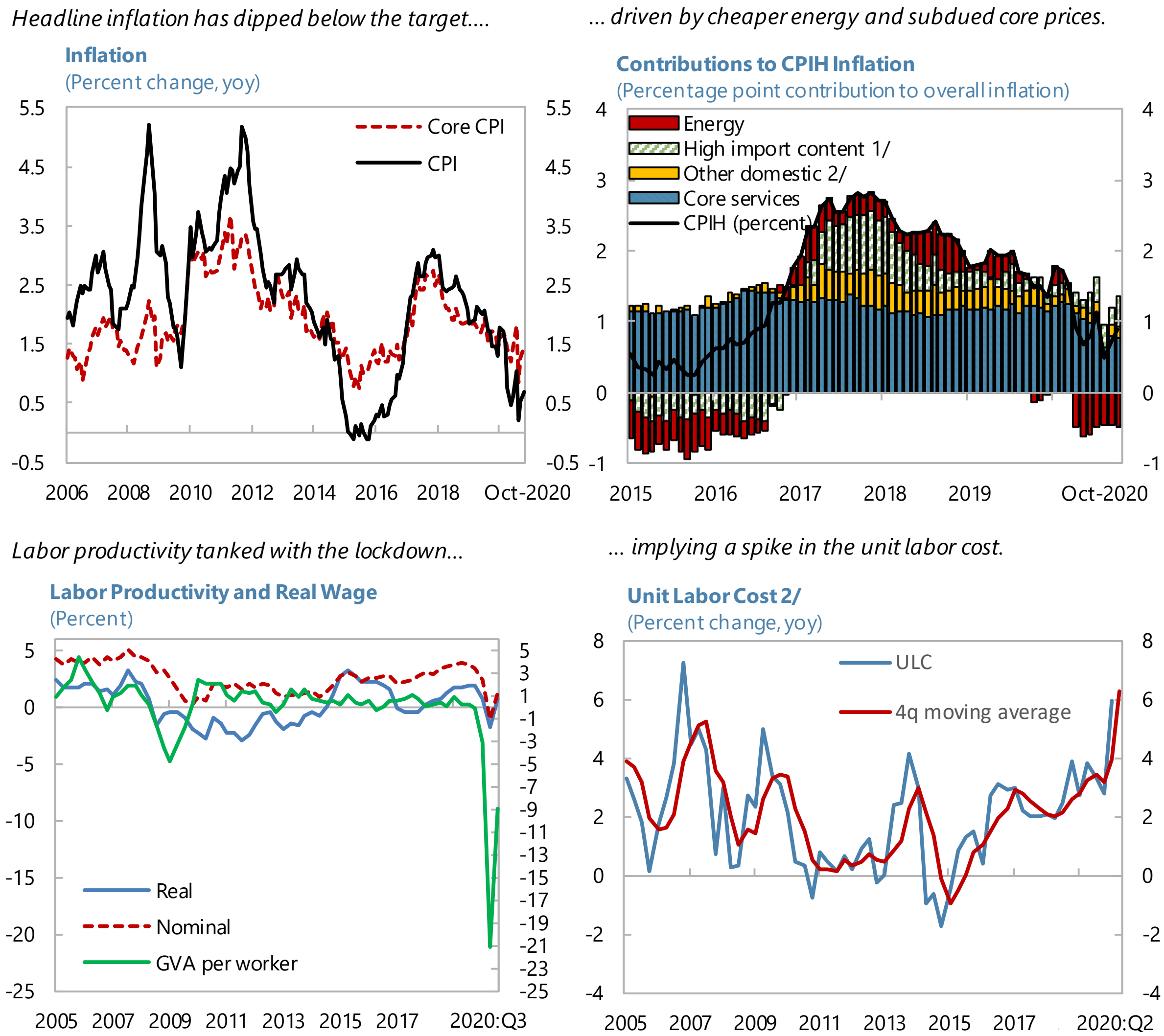
Potential growth had already been slowing down before Covid.

Potential Output Growth
(YoY percent change)



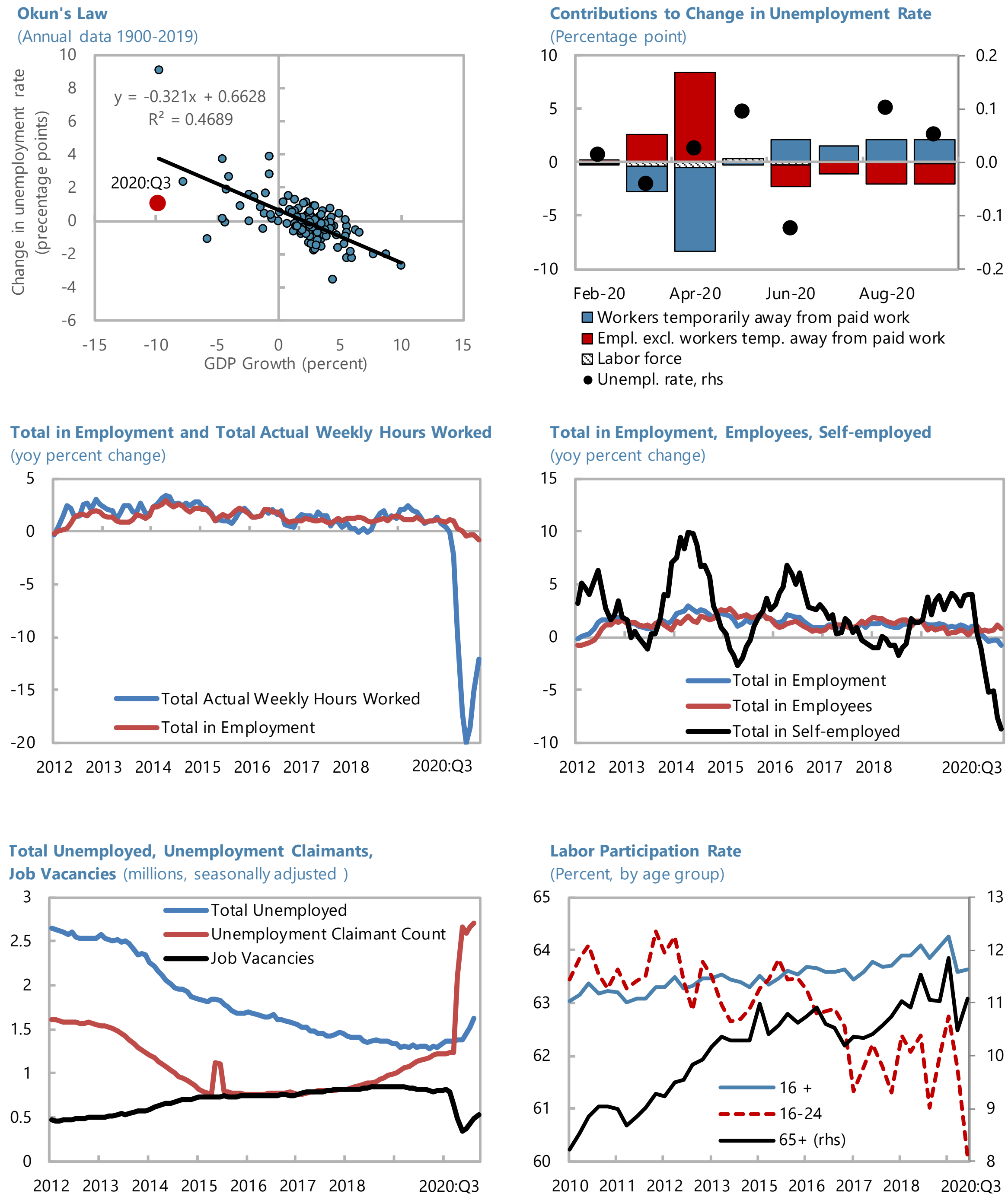
Sources: Haver; and IMF staff calculations.

Figure 5. United Kingdom: Inflation



Sources: Haver; Bank of England; IMF WEO database; and IMF staff calculations.
1/ Derived from government securities, assuming RPI inflation exceeds CPI inflation by 1 percentage point.
2/ Labor cost (per worker) over productivity.

Figure 6. United Kingdom: Labor Market Developments

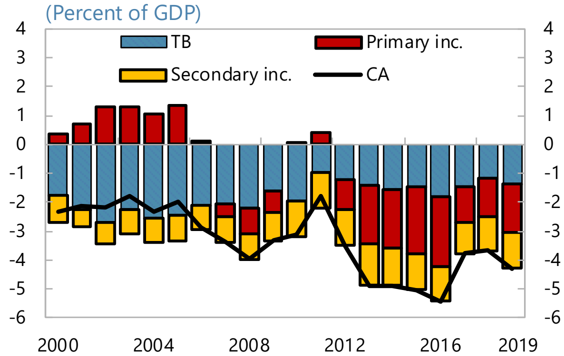


Source: Bank of England Research Database; Haver; IMF staff calculations.

Figure 7. United Kingdom: External Sector

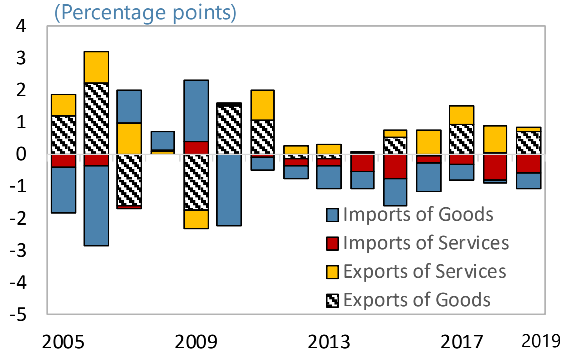
The current account was broadly unchanged in 2019...

Current Account Balance
(Percent of GDP)



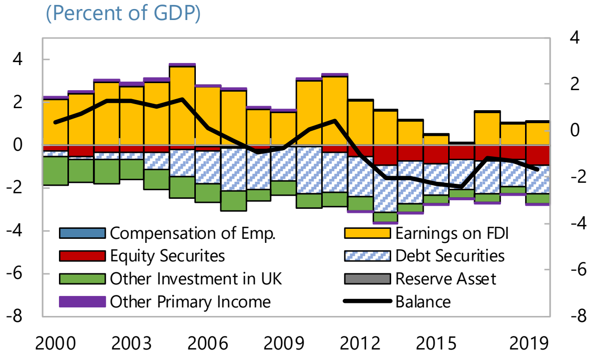
... with net exports having a neutral contribution to growth.

Contributions to Growth from Trade
(Percentage points)



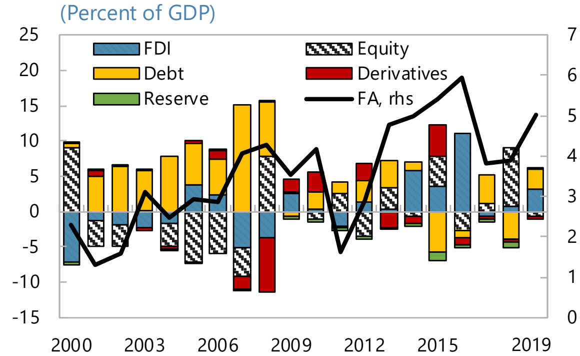
The primary income balance remained above -2 percent.

Primary Income Balance
(Percent of GDP)



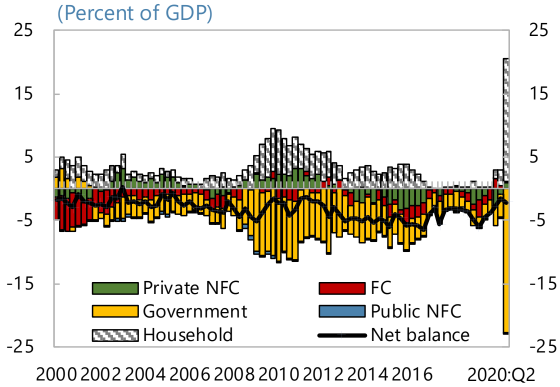
The current account deficit was financed by FDI and portfolio debt inflows.

Financing the Current Account
(Percent of GDP)



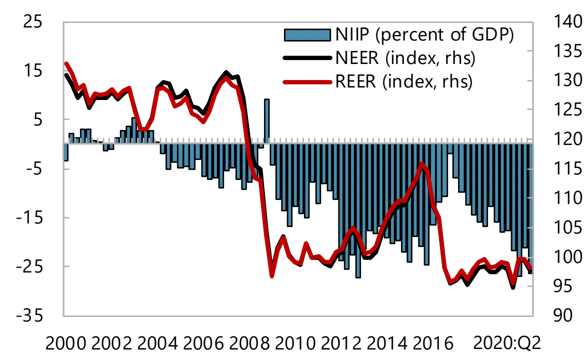
The S-I balance increased in 2020H1, with household saving absorbing government borrowing.

Saving-Investment Balance, by Sectors
(Percent of GDP)



The NIIP stayed at end-2019 levels in 2020Q2, wtih effective exchange rates at the 2019 average.

NIIP and Effective Exchange Rates



Sources: Haver; INS; and IMF staff calculations.

Table 1. United Kingdom: Implementation of Past Fund Advice	
IMF 2018 Article IV Selected Recommendations	**Actions Between 2018 Article IV and March 2020**
Monetary Policy	
A modest further tightening of monetary policy over the next two years would likely be needed to ensure that inflation converges sustainably to the target.	Policy rate was held at 0.75 percent as domestic inflation (i.e., excluding imports) gradually accelerated towards the target. In the Bank of England's pre-pandemic central forecast, interest rate was assumed to rise moderately over the medium term.
Fiscal Policy	
Steady fiscal consolidation to comply with the government's fiscal framework.	The March 2020 budget envisaged a structural deficit of 2.4 percent of GDP in 2020–21, missing the legislated fiscal mandate by 0.4 percent of GDP in part due to the changes to the accounting treatment of student loans. Public sector net borrowing was projected to remain in deficit in 2025 missing the balanced budget objective. Debt was projected to fall by 2.1 percent of GDP in 2020–21, meeting the supplementary debt target. Welfare spending was assessed by the OBR to be within the cap. The March 2020 budget, however, met all the Budget 2020 targets set out in the Conservative manifesto which include: 1, balance the current budget by the third year of the rolling five-year forecast period; 2, ensure public sector net investment does not exceed 3 percent of GDP on average over the rolling five-year period; and, 3, reduce debt to GDP ratio if debt-interest-to-revenue ratio is forecast to remain over 6 percent of a sustained period. The Chancellor had indicated in March his intention to review the fiscal framework in the Autumn 2020 budget.
Finance the higher (pre-Covid) public health spending with new revenue and/or offsetting spending cuts.	There has been limited progress in this area.
Eliminate the "triple lock" (which guarantees an annual increase in the state basic pension payment equal to the highest of 2½ percent, CPI inflation, or the rise in average earnings) on public pensions. This is an unsustainable method of indexation, poorly targeted to those most in need, and in line with international best practices.	There has been limited progress in this area.
Explore opportunities for further efficiency gains in health care provision to reduce pressures from age-related spending.	There has been limited progress in this area.
Absent a fundamental rethinking of the size and role of the public sector, revenue measures will likely need to play a more prominent role in the next phase of the fiscal consolidation.	There has been no plan for raising the three major tax rates in the medium term.

Table 1. United Kingdom: Implementation of Past Fund Advice (concluded)

IMF 2018 Article IV Selected Recommendations	Actions Between 2018 Article IV and March 2020
Structural Policies	
Increase public spending on infrastructure to close the infrastructure gap with peers.	In the March 2020 budget, the government announced £640bn of gross capital investment over 2020–2025.
Facilitate flexible work arrangements and close the gender pay gap to improve economic opportunities for women.	[.]
Facilitate the structural shift due to Brexit.	[.]
Promote housing supply by easing planning restrictions.	The government has recently proposed to reform the planning system to streamline the process.
Higher investment in research and development.	The March 2020 Budget planned to increase public R&D investment to £22bn per year by 2024–25.

Table 2. United Kingdom: Selected Economic Indicators, 2015–21

	2015	2016	2017	2018	2019	2020	2021
						Projections	
Real Economy (change in percent)							
Real GDP	2.4	1.7	1.7	1.3	1.3	-11.2	5.7
Private final domestic demand	3.7	3.7	1.4	1.2	0.9	-14.8	4.5
CPI, end-period	0.1	1.2	3.0	2.3	1.4	0.7	1.7
Unemployment rate (in percent) 1/	5.4	4.9	4.4	4.1	3.8	4.8	7.3
Gross national saving (percent of GDP)	12.7	12.4	14.4	14.1	14.0	14.4	12.5
Gross domestic investment (percent of GDP)	17.7	17.8	18.2	17.8	18.3	17.0	16.8
Public Finance (fiscal year, percent of GDP)							
Public sector overall balance	-4.2	-2.6	-2.6	-1.8	-2.5	-19.1	-7.6
Public sector cyclically adjusted primary balance (staff estimates)	-2.4	-1.1	-0.9	-0.5	-0.9	-13.9	-4.0
Public sector net debt 2/	78.7	77.6	81.1	79.9	84.6	106.4	109.9
Money and Credit (end-period, 12-month percent change)							
M4	0.3	6.3	3.8	2.1	3.8	...	...
Net lending to private sector	2.8	3.8	3.7	3.6	3.2	...	...
Interest rates (percent; year average)							
Three-month interbank rate	0.6	0.5	0.4	0.7	0.8	...	...
Ten-year government bond yield	1.9	1.3	1.2	1.5	0.9	...	...
Balance of Payments (percent of GDP)							
Current account balance	-5.0	-5.4	-3.8	-3.7	-4.3	-2.6	-4.2
Trade balance	-1.5	-1.8	-1.4	-1.2	-1.4	0.8	-1.7
Net exports of oil	-0.3	-0.2	0.0	0.0	-0.3	-0.2	-0.2
Exports of goods and services (volume change in percent)	2.8	2.7	5.4	3.0	2.8	-13.5	4.4
Imports of goods and services (volume change in percent)	5.4	3.9	2.6	2.7	3.3	-20.2	12.8
Terms of trade (percent change)	2.6	0.2	-1.1	0.6	-0.1	-0.7	-1.1
FDI net	-3.6	-11.0	1.7	-0.8	-3.1	-1.6	1.0
Reserves (end of period, billions of US dollars)	130.5	136.6	158.6	176.6	182.7	...	...
Fund Position (as of May 31, 2016)							
Holdings of currency (in percent of quota)				82.5	82.5	82.5	82.5
Holdings of SDRs (in percent of allocation)				70.2	70.2	70.2	70.2
Quota (in millions of SDRs)				20,155	20,155	20,155	20,155
Exchange Rates							
Exchange rate regime							Floating
Bilateral rate (September 8, 2020)							US$1 = £0.7679
Nominal effective rate (2010=100, year average) 3/	113.4	102.3	96.3	97.9	97.7	...	...
Real effective rate (2010=100, year average) 3/	113.7	102.4	97.1	98.8	98.3	...	...

Sources: Bank of England; IMF's Information Notice System; HM Treasury; Office for National Statistics; and IMF staff estimates.
1/ ILO unemployment; based on Labor Force Survey data.
2/ The fiscal year begins in April. Debt stock data refers to the end of the fiscal year using centered-GDP as a denominator.
3/ As of September 2020.

Table 3. United Kingdom: Medium-Term Scenario, 2015–25

(Percentage change, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Projections					
Real GDP	2.4	1.7	1.7	1.3	1.3	-11.2	5.7	4.6	2.0	1.9	1.7
Q4/Q4 1/	2.4	1.6	1.6	1.2	1.0	-11.6	9.6	1.8	2.2	1.7	1.6
Real domestic demand	3.0	3.0	1.6	0.5	1.5	-13.4	8.3	4.7	1.9	1.9	1.7
Private consumption	3.0	3.4	1.1	1.4	0.9	-14.4	5.0	7.0	2.0	1.5	1.5
Government consumption	1.8	1.0	0.7	0.6	4.1	-7.9	21.1	-3.8	1.2	2.4	2.0
Fixed investment	5.3	4.4	2.8	0.4	1.5	-12.9	2.8	5.8	3.2	2.5	1.9
Public	-1.4	0.6	3.8	1.4	4.0	7.0	5.5	6.1	2.7	1.5	1.5
Residential	6.4	4.2	10.8	11.4	0.1	-16.2	8.9	3.8	1.9	1.4	1.4
Business	7.7	5.5	1.5	-2.5	1.1	-17.2	0.1	7.2	4.1	3.3	2.4
Stocks 2/	-0.1	-0.1	0.2	-0.7	0.1	0.0	-0.2	0.3	-0.1	0.0	0.0
Gross national saving (percent of GDP)	12.7	12.4	14.4	14.1	14.0	14.4	12.5	13.4	13.8	14.1	14.2
Gross domestic investment (percent of GDP)	17.7	17.8	18.2	17.8	18.3	17.0	16.8	17.5	17.7	17.8	17.8
External balance 2/	-0.8	-0.4	0.8	0.1	-0.2	2.4	-2.4	-0.1	0.0	0.0	0.0
Exports of Goods and Services	2.8	2.7	5.4	3.0	2.8	-13.5	4.4	6.6	2.5	2.4	2.3
Imports of Goods and Services	5.4	3.9	2.6	2.7	3.3	-20.2	12.8	6.6	2.4	2.4	2.2
Current account 3/	-5.0	-5.4	-3.8	-3.7	-4.3	-2.6	-4.2	-4.1	-3.9	-3.7	-3.6
CPI Inflation, period average	0.0	0.7	2.7	2.5	1.8	0.9	1.2	1.8	2.0	2.0	2.0
CPI Inflation, end period	0.1	1.2	3.0	2.3	1.4	0.7	1.7	1.8	2.0	2.0	2.0
GDP deflator, period average	0.7	2.2	1.9	2.2	2.1	6.5	-2.1	0.4	1.8	2.1	2.2
Output gap 4/	0.0	0.0	0.2	0.0	-0.1	-5.3	-4.2	-1.8	-1.0	-0.3	-0.1
Potential output	1.8	1.7	1.6	1.4	1.4	-6.2	4.6	2.0	1.2	1.2	1.4
Employment and productivity											
Employment	1.7	1.5	1.0	1.2	1.1	-1.0	-2.7	1.7	1.1	1.0	0.7
Unemployment rate 5/	5.4	4.9	4.4	4.1	3.8	4.8	7.3	6.1	5.2	4.5	4.2
Productivity 6/	0.8	0.6	0.8	0.5	0.1	-2.9	3.0	1.1	0.6	0.9	1.0
Memorandum items:											
Private final domestic demand	3.7	3.7	1.4	1.2	0.9	-14.8	4.5	6.7	2.2	1.7	1.6
Household saving rate 7/	10.1	7.6	5.7	6.1	6.5	18.2	13.7	8.2	7.0	6.9	6.9
Private saving rate	13.9	12.5	13.4	12.8	12.8	28.5	16.6	15.6	14.7	14.2	13.5
Credit to the private sector	2.8	3.8	3.7	3.6	3.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Population growth	0.8	0.8	0.6	0.6	0.5	0.7	0.5	0.5	0.5	0.4	0.4
GDP per capita growth	1.6	0.9	1.1	0.6	0.7	-11.8	5.2	4.1	1.5	1.4	1.2

Sources: Office for National Statistics; and IMF staff estimates.
1/ Percentage change in quarterly real GDP in the fourth quarter on four quarters earlier.
2/ Contribution to the growth of GDP.
3/ In percent of GDP.
4/ In percent of potential GDP.
5/ In percent of labor force, period average; based on the Labor Force Survey.
6/ Whole economy, per hour worked.
7/ In percent of total household available resources.

Table 4. United Kingdom: Statement of Public Sector Operations, 2017/18–2025/26

(Percent of GDP, unless otherwise indicated)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
						Staff projections			
Revenue	37.3	37.5	37.1	37.6	37.5	37.6	38.3	39.0	39.5
Taxes	27.0	27.4	26.8	26.3	26.7	26.9	27.6	28.2	28.7
Social contributions	6.3	6.3	6.5	6.7	6.5	6.5	6.6	6.6	6.6
Other revenue	4.1	3.8	3.9	4.6	4.3	4.2	4.2	4.2	4.2
Of which: Interest income	1.1	1.1	1.2	1.4	1.3	1.3	1.4	1.4	1.4
Expenditure	40.1	39.4	39.7	58.9	45.4	43.9	43.5	43.3	43.3
Expense	38.6	38.5	38.7	57.1	43.7	42.5	42.1	41.8	41.8
Consumption of fixed capital	2.3	2.3	2.2	2.6	2.5	2.4	2.4	2.4	2.4
Interest	3.0	2.6	2.5	2.1	2.1	2.3	2.3	2.2	2.2
Other	33.3	33.6	34.0	52.4	39.1	37.8	37.4	37.2	37.2
Net acquisition of nonfinancial assets	1.4	0.9	1.0	1.8	1.7	1.4	1.4	1.4	1.5
Gross operating balance	-1.3	-1.0	-1.5	-19.5	-6.2	-4.9	-3.8	-2.9	-2.3
Net lending/borrowing (overall balance)	-2.7	-1.9	-2.5	-21.3	-7.9	-6.3	-5.2	-4.3	-3.8
Primary balance	-0.8	-0.4	-1.2	-20.6	-7.2	-5.4	-4.3	-3.5	-2.9
Cyclically adjusted overall balance	-2.8	-2.0	-2.2	-17.8	-4.8	-4.9	-4.6	-4.1	-3.8
Cyclically adjusted primary balance (CAPB)	-0.9	-0.4	-0.9	-17.1	-4.0	-3.9	-3.7	-3.3	-2.9
CAPB (percent of potential GDP)	-0.9	-0.4	-0.9	-16.0	-3.9	-3.9	-3.7	-3.2	-2.9
General government gross debt 1/	84.6	84.3	84.5	114.2	115.2	115.9	116.9	117.2	117.1
Public sector net debt 2/	82.4	80.7	85.0	111.5	110.7	112.4	113.6	114.1	115.0
Public sector net debt excl. BoE schemes 2/	73.5	72.3	76.7	101.4	101.6	103.9	105.3	106.0	107.2
Memorandum items:									
Output gap (percent of potential)	0.1	0.1	-0.8	-6.5	-3.7	-1.5	-0.6	-0.2	0.0
Real GDP growth (percent)	1.6	1.4	0.3	-12.8	9.9	3.8	2.1	1.7	1.5
Nominal GDP (in billions of pounds)	2,085	2,162	2,222	2,025	2,173	2,298	2,394	2,484	2,574
Potential GDP growth (percent)	1.5	1.4	1.2	-7.4	6.7	1.4	1.2	1.2	1.3

Sources: HM Treasury; Office for National Statistics; and IMF staff estimates.
1/ On a Maastricht treaty basis. Includes temporary effects of financial sector intervention.
2/ End of fiscal year using centered-GDP as the denominator.

Table 5. United Kingdom: Balance of Payments, 2016–25

(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
					Projections					
Current account	-5.4	-3.8	-3.7	-4.3	-2.6	-4.2	-4.1	-3.9	-3.7	-3.6
Balance on goods and services	-1.8	-1.4	-1.2	-1.4	0.84	-1.71	-1.6	-1.5	-1.4	-1.3
Trade in goods	-6.7	-6.5	-6.4	-5.9	-4.7	-6.2	-5.9	-5.7	-5.5	-5.4
Exports	14.9	16.3	16.4	16.9	15.0	15.3	15.6	15.6	15.7	15.7
Imports	-21.6	-22.8	-22.8	-22.8	-19.7	-21.5	-21.5	-21.3	-21.2	-21.1
Trade in services	4.8	5.1	5.2	4.5	5.5	4.5	4.2	4.2	4.1	4.1
Exports	13.3	13.9	14.5	14.3	13.2	13.1	13.4	13.3	13.1	12.9
Imports	-8.5	-8.8	-9.3	-9.8	-7.7	-8.7	-9.2	-9.1	-9.0	-8.8
Primary income balance	-2.4	-1.2	-1.3	-1.7	-2.1	-1.6	-1.6	-1.6	-1.6	-1.6
Receipts	6.9	9.1	10.2	9.4	5.9	8.9	9.4	9.4	9.4	9.4
Payments	9.4	10.3	11.5	11.1	8.0	10.5	11.0	11.0	11.0	11.0
Secondary income balance	-1.2	-1.1	-1.2	-1.2	-1.4	-0.9	-0.9	-0.8	-0.6	-0.7
Capital and financial account	-6.0	-3.2	-3.8	-4.8	-2.6	-4.2	-4.1	-3.9	-3.7	-3.6
Capital account	-0.1	-0.1	-0.2	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial account	-6.0	-3.3	-4.0	-4.9	-2.7	-4.3	-4.2	-3.9	-3.7	-3.7
Direct investment	-11.0	1.7	-0.8	-3.1	-1.6	1.0	0.8	0.2	0.2	0.2
Abroad	1.2	6.5	2.0	-2.4	0.9	3.0	3.0	3.0	3.0	3.0
Domestic	12.2	4.7	2.8	0.8	2.5	2.0	2.2	2.8	2.8	2.8
Portfolio investment	-7.5	-4.7	-12.6	1.8	-2.0	-5.4	-5.4	-5.4	-5.4	-5.4
Abroad	-8.6	3.5	-6.3	4.7	-1.0	1.8	1.8	1.8	1.8	1.8
Domestic	-1.1	8.3	6.3	2.9	1.0	7.2	7.2	7.2	7.2	7.2
Financial derivatives	1.1	0.5	0.4	0.4	0.5	0.2	0.2	0.2	0.2	0.2
Other investment	11.1	-1.1	8.2	-3.9	0.3	-0.5	-0.2	0.7	0.9	1.0
Abroad	9.2	10.1	8.2	-10.1	-2.0	-0.7	1.0	1.0	1.0	1.0
Domestic	-1.9	11.2	0.1	-6.3	-2.3	-0.2	1.2	0.3	0.1	0.0
Change in reserve assets	0.3	0.3	0.9	0.0	0.1	0.4	0.4	0.4	0.4	0.4
Net errors and omissions	-0.5	0.6	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Terms of trade (y/y percent change)	0.9	-0.9	0.2	0.7	0.3	0.0	0.3	0.2	0.2	0.2

Sources: Office for National Statistics; and IMF staff estimates.

Note: a negative sign on the financial account indicates financial inflows.

Table 6. United Kingdom: Net Investment Position, 2015–25 1/

(Percent of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Projections					
Net investment position	-25.2	-1.9	-13.9	-15.1	-26.2	-28.6	-30.2	-31.3	-32.3	-33.0	-33.7
Assets	499.6	552.8	524.8	516.6	502.4	525.1	516.8	504.7	497.6	489.9	483.2
Liabilities	524.8	554.7	538.7	531.7	528.6	553.7	547.1	536.0	529.9	522.9	516.9
Net direct investment	2.6	4.4	-1.1	-5.2	-2.5	-4.3	-3.1	-2.2	-1.9	-1.6	-1.4
Direct investment abroad	73.1	81.9	84.7	84.3	78.0	83.3	83.5	82.5	82.5	82.2	82.2
Direct investment in the UK	70.5	77.5	85.9	89.5	80.5	87.6	86.6	84.7	84.4	83.9	83.5
Net Portfolio investment	-39.2	-35.2	-36.0	-41.3	-40.4	-43.0	-45.2	-46.7	-48.6	-50.4	-52.2
Portfolio investment abroad	116.0	122.4	128.9	113.5	125.8	133.7	132.7	129.9	128.6	127.0	125.8
Portfolio investment in the UK	155.2	157.6	164.9	154.8	166.2	176.7	177.9	176.5	177.2	177.4	178.0
Net financial derivatives	1.0	2.1	2.2	2.4	1.9	2.6	2.6	2.7	2.8	2.8	2.9
Assets	125.6	132.8	98.0	96.7	99.2	99.2	99.2	99.2	99.2	99.2	99.2
Liabilities	124.6	130.7	95.8	94.3	97.3	96.7	96.6	96.6	96.5	96.4	96.3
Net other investment	5.8	21.3	15.6	22.8	8.9	9.7	8.9	8.3	8.7	9.3	9.9
Other investment abroad	180.4	210.1	207.7	215.8	193.4	202.4	194.8	186.5	180.6	174.5	169.0
Other investment in the UK	174.6	188.8	192.2	193.0	184.5	192.7	185.9	178.2	171.9	165.2	159.1
Reserve assets	4.6	5.5	5.4	6.3	5.9	6.4	6.5	6.6	6.7	6.8	6.9
Memorandum items:											
Change in the net investment position	-2.5	22.4	-12.1	-1.6	-11.5	-1.0	-2.6	-2.5	-2.2	-2.0	-1.9
Current account balance	-5.0	-5.4	-3.8	-3.7	-4.3	-2.6	-4.2	-4.1	-3.9	-3.7	-3.6

Source: Office for National Statistics.

Note: the projections assume valuation gains of 1.7 percent of GDP per year, consistent with the average of the past two decades.

1/ Data correspond to the end of the indicated period, expressed as a percent of the cumulated GDP of the four preceding quarters.

Table 7. United Kingdom: Financial Soundness Indicators, 2010–19Q3

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019Q3
Capital Adequacy										
Regulatory Capital to Risk-Weighted Assets	15.9	15.7	17.1	19.6	17.3	19.6	20.8	20.5	21.4	21.0
Regulatory Tier 1 Capital to Risk-Weighted Assets	13.2	13.3	14.5	16.1	13.6	15.7	16.9	17.1	17.9	17.6
Capital to Assets	5.4	5.1	5.5	6.3	5.6	6.8	7.0	6.8	6.8	6.2
Credit Risk										
Non-performing Loans Net of Provisions to Capital	16.9	16.1	13.9	9.5	5.4	3.9	3.4	2.9	6.8	6.5
Non-performing Loans to Total Gross Loans	4.0	4.0	3.6	3.1	1.7	1.0	0.9	0.7	1.1	1.0
Foreign-Currency-Denominated Loans to Total Loans	52.6	58.0	52.9	55.4	56.1	55.3	58.1	57.6	59.2	57.7
Spread Between Reference Lending and Deposit Rates (Basis Points)	225.0	258.0	272.0	291.2	...	...	...	...	...	...
Sectoral Distribution of Total Loans										
Residents	52.6	50.6	52.9	55.4	50.9	51.5	47.9	47.4	46.4	47.5
Deposit-takers	13.2	14.4	14.9	16.3	11.5	11.2	10.0	9.3	7.7	8.3
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	14.4	2.4	12.4	13.3	11.9	11.8	11.7	12.1	12.9	13.3
General government	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.7	0.2	0.2
Nonfinancial corporations	8.0	3.1	7.1	7.1	7.3	7.2	6.8	6.1	6.6	6.7
Other domestic sectors	16.8	30.6	18.5	18.5	20.1	21.1	19.2	19.3	19.0	19.1
Nonresidents	47.4	49.4	47.1	44.6	49.1	48.5	52.1	52.6	53.6	52.5
Geographic distribution of Total Loans										
Domestic economy	56.3	55.7	56.6	58.6	54.5	57.4	54.5	53.8	46.4	47.5
Advanced economies, excluding China	35.3	35.5	34.7	32.4	34.8	32.7	35.9	37.1	33.4	36.6
Other emerging market and developing countries, including China	8.4	8.8	8.7	9.0	10.7	9.9	9.7	9.1	20.2	15.9
Africa	1.3	1.3	1.3	1.2	1.4	1.5	1.5	0.6	0.5	0.6
Sub-Saharan Africa	1.4	1.3	1.3	1.2	1.3	1.4	1.5	0.6	0.5	0.5
Central and Eastern Europe	0.6	0.3	0.3	0.3	0.7	0.6	0.6	0.5	0.4	0.4
Commonwealth of Independent States and Mongolia	...	...	...	...	...	...	...	...	...	0.0
Developing Asia, including China	3.2	3.8	3.8	4.4	5.1	4.5	4.7	5.2	4.5	4.7
Middle East	1.4	1.3	1.3	1.3	1.6	1.7	1.8	1.7	1.5	1.6
Western Hemisphere	1.8	1.9	1.8	1.6	1.8	1.5	1.0	0.9	0.9	0.9
Profitability										
Return on Assets	0.3	0.3	0.2	0.2	0.3	0.3	0.3	0.5	0.5	0.4
Return on Equity	6.9	6.1	3.2	3.8	5.6	4.4	3.8	7.6	7.5	6.5
Interest Margin to Gross Income	50.4	44.2	49.3	50.9	48.4	51.0	46.2	45.9	48.1	43.5
Non-interest Expenses to Gross Income	69.1	61.1	76.1	81.0	64.1	71.1	76.3	70.8	75.1	63.8
Trading Income to Total Income	14.2	9.4	9.1	8.9	7.9	11.7	11.3	14.5	14.9	20.5
Personnel Expenses to Non-interest Expenses	46.7	45.1	42.3	43.9	53.2	51.2	48.2	44.8	39.8	46.8
Liquidity										
Liquid Assets to Total Assets (Liquid Asset Ratio)	21.0	20.5	22.5	22.7	21.3	19.5	19.6	22.3	25.1	23.5
Liquid Assets to Short Term Liabilities	37.9	40.9	36.8	35.7	35.7	35.9	37.9	37.8	40.7	50.0
Customer Deposits to Total (Non-interbank) Loans	106.2	108.4	101.2	115.5	117.2	114.2	119.9	126.4	129.1	122.9
Foreign-Currency-Denominated Liabilities to Total Liabilities	20.3	19.1	20.1	21.3	21.1	20.3	20.5	22.4	22.8	21.1
Net Open Position in Foreign Exchange to Capital	5.6	3.3	-6.1	-10.5	8.3	3.1	-3.4	-3.7	-3.4	-1.0
Net Open Position in Equities to Capital	82.1	158.0	123.4	120.8	73.6	133.8	125.2	143.8	125.1	142.6
Gross Asset Position in Financial Derivatives to Capital	721.9	842.8	684.1	539.1	692.7	484.7	537.5	447.3	400.5	531.0
Gross Liability Position in Financial Derivatives to Capital	717.5	842.7	683.3	536.3	639.8	478.9	530.1	441.1	393.1	523.2

Source: IMF FSI database.

Table 8. United Kingdom: Monetary Policy Frameworks

Policy	Pros and Cons	Key Issues for the UK
Price Level Targeting	A systematic form of forward guidance that relies heavily on a time inconsistent commitment, as it may require large corrections of the price level ex-post with a high cost in terms of output stabilization.[1]	In the UK, where exchange rate pass-through is large and protracted exposure to persistent terms of trade shocks is large, it could be particularly problematic.[2]
Average Inflation Targeting	Similar to price level targeting but more flexible, as past inflation realizations are forgotten at some point, putting a smaller strain on time consistency. The period to calculate the average could be specified as a fixed time window (e.g., 2–3 years) or over the business cycle.[3] Optimizing the calibration would be important: a mechanical average inflation targeting rule would delay policy loosening at the beginning of a recession, whereas a more discretionary implementation could obscure communication.[4]	Same as above. The current conjuncture of successive macroeconomic shocks does not seem propitious for measures constraining the ability of policymakers to react flexibly.
Nominal GDP Targeting	A variant of price level targeting that would put more weight on output stabilization. It would be counterproductive in the face of negative supply shocks, which should not trigger a monetary expansion according to standard models.	Supply shocks are particularly relevant for the UK as it braces for Brexit and a potential reshoring of supply chains.
Higher Inflation Target	While the optimal level of inflation targeting is highly contested in the literature, more recent studies tend to prescribe higher average inflation, since the ELB has become a more relevant constraint.[5] Increasing the target may help pull the economy out of the ELB,[6] but would require finding more effective tools to generate inflation than the ones used to date. Moreover, a small rise (e.g., to 3 percent) may be insufficient to create the monetary space needed for large shocks, while a higher rise would intensify the real costs of inflation, such as distorted relative prices under sticky pricing.	To date, the UK has largely avoided the inflation undershoots seen in other advanced economies, making an update of the inflation target less of a priority, although that could be partly due to shocks weakening the exchange rate over the last decade.

[1] Cochrane, J., "What Target Should the Fed be Shooting At?" Chicago Booth Review Article, May 2017; and Barwell, R. and T. Yates, "Four is the New Two: The Case for Raising the Inflation Target." National Institute of Economic and Social Research, Occasional Papers 58, 2019.
[2] Carney, M., "A Framework for All Seasons?" Speech by the Governor of the Bank of England, January 2020.
[3] Diwan, R., S. Leduc, and T. M. Mertens. "Average-Inflation Targeting and the Effective Lower Bound," Federal Reserve Bank of San Francisco Economic Letter, August 2020.
[4] Reifschneider, D. and D. Wilcox, "Average Inflation Targeting Would Be a Weak Tool for the Fed to Deal with Recession and Chronic Low Inflation," Peterson Institute for International Economics, Policy Brief 19–16, November 2019.
[5] Diercks, A. M., "The Reader's Guide to Optimal Monetary Policy," unpublished manuscript available at SSRN 2989237, 2019.
[6] Eberly, J., J. H. Stock, and J. H. Wright. "The Federal Reserve's Current Framework for Monetary Policy: A Review and Assessment." NBER working paper 26002, 2019.

Table 9. United Kingdom: Status of Implementation of the 2016 FSAP Recommendations (As of July 2020)[1]

Financial Stability Policy Framework	
Extend the Financial Policy Committee's (FPC) powers of direction to the buy-to-let market.	Implemented. Legislation came into force in early 2017.
Extend perimeter of concurrent stress tests to cover large foreign subsidiaries.	Not Implemented. The BoE has reviewed the perimeter of concurrent stress tests as part of work to update its approach to stress testing. The BoE does not currently include large foreign subsidiaries in the concurrent stress test, taking the view that an entity level test is most informative if done at a group level. Thus, the BoE's supervisory approach in relation to stress testing is to work with the home supervisory authorities to, among other things, assess the extent to which the parent group can support its UK operations in the event of a stress.
Complete core data template and enhance analytical infrastructure for concurrent stress tests.	In progress. A key feature of the BoE's ACS data strategy is to define a core set of stress-testing data and ensure that a higher proportion of data are within this data set. The BoE is in the final stages of a comprehensive review of the data firms should report from the 2022 stress test onwards.
Develop a set of cross-sector interconnectedness indicators using flow of funds data, cross sector exposures, market-based indicators, and information produced by thematic analyses.	In progress. The BoE collects data on systemic interconnectedness from banks that are involved in the annual concurrent stress test. This includes their borrowing and lending exposures to other financial institutions, and granular data on banks' tradeable asset holdings. To improve the UK's flow of funds data, the BoE, FCA, and Office for National Statistics (ONS) are engaged in a joint Enhanced Financial Accounts project. The BoE and FCA are represented in the FSB's mapping exercise of the critical connections in non-bank sectors in a cross-border setting. The BoE has also developed work simulating stress in the financial system, as outlined in BOEs Financial Stability Paper #42 FS Paper 42 - and Staff Working Paper 803. There is also work in progress on a more comprehensive model to simulate stress in the financial system, as described in Staff Working Paper 809. Solvency II regulatory reporting and PRA ad-hoc reporting provides insight into the connections between regulated insurers and the wider financial system. For example, the PRA has utilized SII data to identify potential for liquidity strains and wider market impacts from fire sales due to margin calls from non-banks (see Financial Stability Report June 2018).
Financial Sector Oversight	
Increase the supervisory intensity on less systemically important banks, for example through more frequent onsite inspections and greater scrutiny of asset classification and provisioning.	Implemented., The PRA has increased resources for small firms' supervision. In addition, in 2018/19 the PRA completed a thematic review of fast-growing firms (risk, credit and stress testing). In 2020, the PRA published a Consultation Paper on its supervisory approach to growing firms. Supervision of less systemically significant firms that are part of internationally headquartered groups has been bolstered with enhanced data collection (the Branch Return). Furthermore, a Financial Resources and Credit pool has been set up to conduct all of the International Banks Directorate's (IBD's) CSREP and LSREP work, lead on credit reviews and provide peer analysis on capital, liquidity and credit. Since 2017, the PRA senior leadership has met regularly to scan the horizon for emerging and evolving risks (including from less systemically important firms) and evaluate the functioning of the framework for unintended consequences.

[1] Based on a self-assessment by the UK authorities. This assessment will be updated during the forthcoming FSAP.

Table 9. United Kingdom: Status of Implementation of the 2016 FSAP Recommendations (As of July 2020) (continued)

Extend the scope of transparency reporting under the Alternative Investment Fund Managers Directive (AIFMD) to cover non-European Economic Area (EEA) managers and funds and strive for enhanced international exchange of information.	Completed. Since July 2017, the FCA has obtained information from: • Non-EEA AIFMs on their quarterly-reporting non-EEA master funds, if the corresponding feeder funds are marketed in the UK. • UK AIFMs on all their non-EEA funds not marketed in the EEA. The FCA extended the reporting requirements for Master Funds domiciled offshore, and the FCA now has a more in-depth view of funds' exposure and leverage. It has integrated this data into analytical work, providing the FCA and Bank of England with a more complete risk profile for the sector.
Ensure that Broker Crossing Networks' (BCNs) activities are sufficiently supervised and monitored.	Implemented. The FCA completed a review of the structure of the equity market in 2019. As part of this work, the FCA visited a number of firms that operate as Systematic Internalisers (SI) including investment banks that previously operated broker crossing networks (BCN). The review assessed the trading models of SIs and the systems and controls in place to meet pre-trade transparency and conflict of interest requirements. Feedback was given to all firms at the conclusion of the review, where the FCA set out its expectations for compliance with the SI regime. On an ongoing basis, the SI activities of firms are supervised according to the FCA's supervision model.
Broaden the review of bank internal models to cover a greater sample of less material models and models of smaller banks.	Implemented. Since the 2016 FSAP, the PRA has enhanced its coverage of internal models, seeking to review at least 60 percent of firms' modelled credit risk RWAs. It is further enhancing its program by starting a comprehensive cross-firm review of all IRB models to ensure firms meet the new regulatory standards set out in the Policy Statements 7/19 (definition of default) and 11/20 (PD and LGD estimation). This includes the expectation that firms reduce unwarranted variability in IRB model-driven RWAs, and in particular that all firms using IRB for mortgage exposures, whatever their size, will need to use a hybrid model by end January 2022. The program for mortgage exposures is due to be completed by 2021 and that for other asset classes by 2022.
Introduce agreements similar to those under the European Insurance and Occupational Pensions Authority (EIOPA) requirements for colleges for insurers with significant business outside the EEA.	Implemented. PRA supervisory practices are aligned to the IAIS ICP 25 requirements including ComFrame. The PRA has put in place supervisory colleges for all significant groups (regardless of whether they are EU focused or not). For small groups with limited international footprint, the PRA has established supervisory coordination arrangements setting out how engagement will take place for group supervision purposes. The PRA is an active participant in wider international co-ordination of supervision for major firms. Where invited to do so as host supervisor, it participates in supervisory colleges for all firms with significant operations in the United Kingdom, whether a legal entity or a branch. The FCA decides on its participation in colleges based on its assessment of the risks of harm posed by the firm and the topics the college is seeking to address. The FCA participates in colleges from a conduct of business perspective, and to ensure that the impacts of prudential regulation on consumer outcomes and the avoidance of harm are considered.

Table 9. United Kingdom: Status of Implementation of the 2016 FSAP Recommendations (As of July 2020) (continued)	
Financial Markets Infrastructures	
Consider alternative structures for the oversight and management of risk within the UK High Value Payments System (HVPS) and finalize the self-assessment of the Real Time Gross Settlement System (RTGS) infrastructure against the Principles for Financial Markets Infrastructures.	Implemented. In April 2017, the FPC concluded that there were financial stability risks arising from the current structure for delivery of the UK High-Value Payment System (HVPS). In November 2017, the BoE completed the transfer to direct delivery, becoming the HVPS scheme operator (previously CHAPS Co), alongside the BoE's existing responsibilities for operating the RTGS infrastructure. Direct delivery will enable a single entity to manage risks right across the system. The Bank's FMI supervisory area continues to supervise the operation of the HVPS system (CHAPS) system to the same standard as recognized payment systems, even though it was derecognized after delivery was transferred to the Bank. The self-assessment of the Real Time Gross Settlement System (RTGS) infrastructure against the Principles for Financial Markets Infrastructures has been completed and published (https://www.bankofengland.co.uk/-/media/boe/files/payments/rtgs-and-chaps-2019-pfmi-self-assessment.pdf).
Continue with the de-tiering project for payment systems and EUI and consider increasing settlement in central bank money for CCP-embedded payment system transactions by increasing the number of CCP members that are also members of the HVPS.	Partly implemented. Firm-specific actions related to promoting de-tiering and opening access to payment systems have been taken. For example, the number of CHAPS and Faster Payments Services direct participants has increased significantly between 2016 and 2020. As part of the RTGS review, the BoE has also engaged individually with CCPs and their clearing members on the benefits of direct membership of CHAPS and to ascertain what types of features and functionalities of a rebuilt RTGS would promote broader usage in a clearing context. Further work on de-tiering is now likely to be a medium-term deliverable given RTGS rebuild and new policy challenges.
Crisis Management and Resolution	
Build on current arrangements to develop operating principles for funding of firms in resolution.	Implemented. Available public backstops in the UK for firms in resolution include SMF and the Resolution Liquidity Framework. The BoE has publicly set out its operating principles for funding of firms in resolution in its Purple Book, published in October 2017. UK authorities have put in place a flexible approach for liquidity provision, with the aim to be compatible with the FSB's guidance on funding in resolution.
Work with international partners to develop an effective resolution regime for insurance firms that could be systemically significant at the point of failure.	Partly implemented. The BoE engaged with the FSB in 2016 to finalize guidance on 'Developing effective resolution strategies and plans for systemically important insurers' and has been working with firms to implement it. The BoE has also been closely involved in the FSB work to develop a Key Attributes Assessment Methodology for the insurance sector, including its review in 2020. In March 2017, the IAIS published a revised version of ICP12 (Exit from the market and resolution) for consultation, which is relevant to all insurers. ICP12 also includes the ComFrame material on resolution, which applies to Internationally Active Insurance Groups (IAIGs). IAIS adopted the Insurance Core Principles and ComFrame in November 2019. The Bank of England participates in IAIS, including through a BoE executive director acting as chair of the IAIS Executive Committee.

Table 9. United Kingdom: Status of Implementation of the 2016 FSAP Recommendations (As of July 2020) (concluded)

	The BoE has played a proactive role in the IAIS Resolution Working Group (ReWG) in developing guidance to both insurers and supervisors for recovery planning and resolution (covering both resolution tools and resolution planning) in the form of two Application Papers (AP). The recovery planning AP was published in November 2019 and the BoE continues to provide material input into the drafting of the Resolution AP.
Establish an approach for engaging with countries that are not members of CMGs but where UK banks and CCPs have a systemic presence.	Partly implemented. The UK has established CMGs for the two UK CCPs (LCH Ltd. and ICE Clear Europe) that have been identified as systemic in more than one jurisdiction. In line with the FSB Key Attributes and implementation guidance, the composition of both CMGs is broad and should capture many of the jurisdictions where the CCP has a systemic presence. Work in both CMGs is at an initial stage of resolution planning for the CCPs. Given the very wide geographic scope of LCH Ltd and ICE Clear Europe's service provision, the CMGs do not involve all other countries where participants that rely on the UK CCPs for clearing are domiciled. However, the proposed resolution strategies for UK CCPs are expected to follow the rules of the CCP when allocating losses, with the resolvability of the CCPs assessed on this basis. To this extent, the impact of resolution on participants' exposures should be predictable and transparent. The BoE's policy approach to CCP resolution is set out in the Purple Book, with an updated edition published in October 2017.

Table 10. United Kingdom: Anti-Corruption Efforts (Authorities' Self-Assessment)
Corporate Transparency
The government has announced it will introduce verification of identities of people holding certain roles in corporate entities alongside other measures to improve the accuracy and value of public information on companies.
Since the start of 2020, financial institutions and other obliged entities have been required to report discrepancies on the PSC (People with Significant Control) register.
The government legislated in 2020 to significantly expand its register of trusts beneficial ownership and published a draft Bill which will establish a register of the beneficial owners of overseas entities owning UK property.
The UK Government has proposed to make beneficial ownership information a condition of awarding contracts that involve central government procurement.
OECD Working Group Recommendations to Strengthen the Effectiveness of Enforcement
The National Economic Crime Centre (NECC) is now in existence (established October 2018) and are coordinating the relatively prompt de-confliction of foreign bribery cases amongst the UK Foreign Bribery Law Enforcement Community through the FB Clearing House.
Recommendations (i) to maintain the role of the Serious Fraud Office (SFO) in foreign bribery cases; and (ii) improving coordination of law enforcement between England, Wales, and Scotland and improving Scotland's enforcement capacity have been implemented.
Recommendations to (i) enhance the UK's AML reporting framework to improve detection of foreign bribery; (ii) strengthen engagement with the CDBOT regarding the detection and enforcement; and (iii) conduct a comprehensive review of Her Majesty's Revenues and Customs capacity to detect and report foreign bribery have been partially implemented.
There are still elements due to implement regarding the recommendation to further improve interagency cooperation and ensuring the safeguard of the independence of investigations and prosecutions.
International Anti-Corruption
The UK continued hosting the IACCC (International Anti-Corruption Coordination Centre) in support of several grand corruption cases and will improve fast-time intelligence sharing. The IACCC has new affiliate members to assist with detecting Politically Exposed Person corruption.
On anti-foreign bribery, the UK Government is continuing to implement the outstanding OECD Phase 4 recommendations and has already fully or partially implemented 34 of the 44 recommendations made, according to the OECD working group on bribery.

Annex I. Measures in Response to Covid-19 Outbreak

Initial Measures 1/		Measures in Effect at the Time of Writing 2/	
Measure	**Duration**	**Measure**	**Duration**
Fiscal			
Support for health			
Additional funds for health services.	One off	Further additions to health spending.	One off
Zero VAT rate on personal protective equipment.	May–October	Expired	
Support for households			
Increase of Universal Credit (UC), Working Tax Credit and housing allowance.	Until end-March 2021	No further changes.	
Transfers to clinically vulnerable people.	One-time payment	No further changes.	
Suspension of Minimum Income Floor for self-employed claiming UC.	Until end-November	Extended	Until end-April 2021
		Payment to low income people (and household members) that cannot work from home and told to self-isolate by NHS Test and Trace.	Until end-January 2021
Support for jobs			
Coronavirus Job Retention Scheme (furlough scheme) with coverage of non-worked hours starting at 80% of wages, declining to 60% in October.	March–October	Extended with 80% replacement for non-worked hours.	Until end-March 2021
Self-Employment Income Support Scheme in two 3-month tranches covering first 80% and later 70% of trading profits.	6 months	Two additional 3-month tranches. The first one set at 80% of trading profits (up to £7,500), second one to be defined.	Until end-April 2021
…		Kickstart scheme subsidizing wages of young employees at risk of long-term unemployment for 6 months.	Until end-June 2021
…		Payment for employers taking on trainees.	Six months
…		Payment for employers taking on apprentices.	Six months
…		Additional resources for training, career advisers, and programs to assist the unemployed find jobs, including under the Restart program.	One of. Restart program is for 3 years.
Support for firms			
Grants for small firms and firms in hospitality, retail and leisure sectors.	One-time payment	New grants for businesses closed due to restrictions, computed for 2-week periods.	While restrictions last
Business rates (local property tax) relief for firms in affected sectors.	FY2020	No further changes.	
Deferral of VAT payment for Q2 2020 until end-March 2021.	One time	Payments in installments allowed until end-March 2022.	
Deferral of July self-assessment tax payment until end-January 2021.	One time	Time to Pay payment plan allows payments in installments until end-March 2022.	
Two-week statutory sick pay support.	One-time payment	No further changes.	
Government guaranteed loan schemes:			
Bounce back loans scheme with 100% guarantee. Loans up to £50,000.	Until November 4	Application period extended. Maturity extended up to 10 years. Loan top-up allowed.	Until end-January 2021
CBILS with 80% guarantee for smaller firms. Loans up to £5 million.	Until September 23	Application period extended.	Until end-January 2021
CLBILS with 80% guarantee for large firms. Loans up to £200 million.	Until October 20	Application period extended.	Until end-January 2021
Purchase of commercial paper of investment grade firms (CCFF, operated by the BoE).	Until end-March 2021	Technical updates of firm qualifications.	
Convertible loans to support start-ups (the Future Fund).	Until end-September	Application period extended.	Until end-January 2021
Trade credit reinsurance facility.	Until end-December	No further changes.	
Commercial eviction moratorium to protect commercial tenants from risk of eviction.	Until end of 2020	No further changes.	
Measures to reinvigorate the economy			
…		Green Home grants to make homes energy efficient.	Until end-March 2021

Initial Measures 1/		Measures in Effect at the Time of Writing 2/	
Measure	**Duration**	**Measure**	**Duration**
Fiscal			
…		Additional funds to improve energy efficiency of public sector buildings.	One off
…		Temporary reduction of stamp duty on real estate transactions.	July 2020–March 2021
…		Temporary reduction of VAT from 20 to 5% on food, accommodation and attractions.	End-March 2021
…		Eat out to help out program subsidizing meals at participating businesses.	August 2020
Monetary			
Policy rate reduced by 65bps to 0.1 percent.		No further changes.	
Quantitative easing program expanded by £300bn.		Additional expansion by £150bn.	
Term Funding Scheme with additional incentives for lending, and especially SMEs.		Maturity of loans extended to up to 10 years.	
Central Bank Facilities			
Temporary extension of Ways & Means facility, yet to be used by government.	While Covid disruptions last.	No further changes.	
Activated Contingent Term Repo Facility.	While conditions last.	Discontinued	
Coordinated action with major central banks to offer dollar liquidity at more favorable terms.			
Financial 3/			
Reduced the countercyclical buffer rate to 0 from a path toward 2 percent by 12/2020, and associated reduction in the countercyclical leverage ratio buffer.	For at least 12 months.	No further changes.	
Canceled outstanding 2019 dividends; and halted cash bonuses to senior staff.	Until end-December	No further changes.	
Pillar 2A requirements to be set as a nominal amount (instead of percentage of RWA).	Expires end-2021	No further changes.	
Implementation of the Basel 3.1 leverage ratio treatment of the exposure value of regular-way purchases and sales awaiting settlement.	n/a	No further changes.	
Exclusion of BBLs from the leverage exposure measure.	n/a	No further changes.	
Maintain Systemic Risk Buffer Rates set in December 2019.	Reviewed in December 2021 to come into effect January 2023.		
Temporarily allow firms to offset the increase in risk-weighted assets due to the automatic application of a higher VaR multiplier against UK-specific modelling capital requirements.	Reviewed after 6 months.	Terminated from 30 September 2020 in light of amendments to the legislation in the EU to address the issue directly.	
Payment deferrals on mortgage and consumer credit.	Until end-October	Extended	Until end-March 2021

1/ Covers measures introduced prior to the Plan for Jobs announced on July 8, 2020.

2/ As of November 30, 2020.

3/ The measures taken by the PRA in the table above were also accompanied by measures to reduce the operational burden on firms during the crisis period and by guidance to support firms' implementation of policy, which can be found at this link: https://www.bankofengland.co.uk/coronavirus/information-for-firms.

Annex II. Risk Assessment Matrix[1]

Source of Risk and Relative Likelihood	Expected Impact of Risk	Policy Recommendations
Conjunctural Shocks and Scenario		
High **Unexpected shift in the Covid-19 pandemic**. **Downside**: The disease proves harder to eradicate (e.g., due to difficulties in distributing vaccines), requiring more containment efforts. **Upside**: Alternatively, recovery from the pandemic is faster than expected due to a rapid and effective distribution of vaccines and/or a faster-than-expected behavioral adjustment to the virus.	**High** **Downside**: Demand for contact-intensive sectors remains low for longer, prompting a costly reallocation of resources. Firms face a prolonged increase in production costs. Financial markets call into question public debt dynamics, leading to reduced policy space and creating a tradeoff between excessive inflation and costly consolidation. Markets reassess real economy risks leading to a repricing of risk assets, unmasking of debt-related vulnerabilities, and weakening banks and nonbank financial intermediaries–forcing them to reduce credit (further weighing on growth). **Upside**: Activity picks up faster than projected. Macro-financial channels and scarring are contained.	**Downside**: Intensify public health measures, such as large-scale systematic testing, contact tracing, and support for medical research. Use all available policy space by extending fiscal and monetary support, including emergency lending. Facilitate swift corporate debt restructuring to minimize debt overhang. **Upside**: Bring forward the rotation towards policies supporting adjustment once the recovery is on firm ground.
High **No-deal Brexit** The EU and the UK fail to reach a free trade agreement. They start trading under WTO terms in January 2021.	**High** A significant increase in trade barriers will lead to lower production, investment and exports. On impact, there could be widespread disruptions of production and services in various sectors. For instance, contractual and operational challenges could lead to the disruption of financial services. A loss of confidence could also trigger elevated financial volatility and asset prices declines. There is a risk of a period of	Close collaboration to ensure a smooth and predictable transition to a new economic relationship with the EU. Contingency planning for risks that may arise in the event of heightened market volatility, including liquidity support. Avoid withdrawing fiscal support until the economy stabilizes. The scope for monetary stimulus will depend on an assessment of slack in the economy and the extent to which longer-run

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risk and Relative Likelihood	Expected Impact of Risk	Policy Recommendations
	stagflation. Higher import tariffs and further sterling depreciation would depress households' real incomes and consumption. A decline in asset prices, including real estate prices, would affect the balance sheets of financial and non-financial corporations and households, reducing further investment and consumption. Negative economic consequences in the EU—due to higher trade barriers and a possible increase in the cost and availability of financial services—would have spillback effects to the UK.	inflation expectations remain well-anchored. Implement structural policies to boost productivity and competitiveness over the medium term.
High **Corporate balance sheet strains**. A period of reduced cash flows leads to widespread corporate default and bankruptcies (even in the absence of other shocks). Banks tighten lending conditions to corporates.	**High** Debt overhang and stranded capital in insolvent firms cause a more persistent investment slump. Bank balance sheets suffer from knock-on effects. Corporate restructurings and bankruptcies result in sizeable job redundancies.	Provide emergency liquidity support as needed. Facilitate swift (out-of-court) corporate debt restructuring to minimize debt overhang. Convert public loan guarantees into equity (or a claim on future tax payments in the case of SMEs).
Structural Risks		
High **Accelerating de-globalization**. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation of trade.	**Medium** Disruption to supply chains increases production costs and inflation. Permanent reshoring and less trade reduce potential output.	Continued support for the multilateral rules-based trading system. Pursue free trade agreements with a broad set of partners. Facilitate a speedy reallocation of activity towards domestic sectors if supply chains are disrupted.

Annex III. Debt Sustainability Analysis[1]

The sharp contraction of the economy and the outsized policy response in the light of the Covid-19 outbreak have led to very large increases of the fiscal deficit and public debt of the UK in 2020. Under the baseline scenario, public debt is projected to remain broadly stable in the medium-term from this year's level as the economy recovers and the emergency measures are unwound. It would land at around 118 percent of GDP (compared to 96 percent of GDP pre-Covid) once economic activity returns to trend. The surge in gross financing needs in 2020 (26 percent of GDP) was covered by a parallel rise in domestic savings. Financing needs return to lower levels thereafter as the fiscal deficit declines. Public debt is sensitive to combined macroeconomic shocks and contingent liabilities simulated in the template. Sustained fiscal restraint for a period of time will be needed to put public debt on a firm downward path.

A. Baseline and Realism of Projections

1. Baseline fiscal assumptions. The staff's baseline is built on the medium-term fiscal framework contained in the March 2020 budget, updated with the policies announced after that. In addition, it assumes the authorities implement 0.5 percent of GDP in structural fiscal consolidation in each of FY23 through FY25.

2. Debt level. Under the baseline scenario, gross public sector debt is projected to rise from 96 percent in 2019 to over 118 percent of GDP in 2020. The underlying debt continuous rising mildly throughout the forecast period and stabilizes by FY25 reflecting the recovery in economic activity. Public debt remains at 118 percent of GDP after 2025 as the primary balance reaches the debt-stabilizing level (the 5 percent of GDP decline in FY24 and FY25 reflects the unwinding of the BoE's Term Funding Scheme). Net public sector debt stabilizes at around 108 percent of centered GDP).

3. Fiscal balance and adjustment. In the baseline projection, the budget deficit worsens in FY20 as a result of the contraction in GDP and the policies in response to the Covid-19 outbreak. A large improvement takes place in FY21 as the economy rebounds and the bulk of the emergency policies dissipate. The deficit continues declining in the following years, as growth remains above potential and consolidation measures are put in place beginning in FY23. The distribution of fiscal adjustment episodes provided in the DSA template (Figure 3) indicates the projected 3-year adjustment in the cyclically-adjusted primary balance of about 11 percent of GDP is unprecedented. However, the figure is distorted by the large additional "cyclical" Covid-related spending and revenue declines, which automatically sunset as the economy recovers. The actual adjustment needed is better approximated by the structural adjustment in FY23–FY25, which at about 2 percent of GDP is well within the range of past experience.

[1] The data are presented on fiscal year basis (April–March) with ratios calculated using fiscal year GDP (not centered-fiscal year GDP). Public sector gross debt is defined as net debt plus liquid assets held by general government and non-financial public corporations.

4. Realism of baseline assumptions. The median forecast errors for key assumptions (real GDP growth, the primary balance and inflation) are mostly within the error band observed for all countries (Figure 3). There has been generally a modest upward bias in the projections.

5. Heatmap and debt profile vulnerabilities. Risks from the debt level are deemed high by DSA standards, as the level of debt exceeds the benchmark of 85 percent of GDP for advanced economies under the baseline and stress scenarios. Gross financing needs of over 26 percent of GDP in FY20 are above the benchmark of 20 percent, but return to below the threshold in the years ahead. However, the risk is mitigated by the fact that domestic creditors (especially banks) have the capacity to absorb the higher financing needs given relatively low levels of exposure to the government (see Annex IV, Table). Debt profile vulnerability indicators are below early warning thresholds. Interest rates and CDS spreads also suggest that markets view debt vulnerabilities as low.

B. Stochastic Simulations

6. The fan charts illustrate the possible evolution of the debt ratio over the medium term, under symmetric and asymmetric distributions of risk based on historical outturns. Under both distributions there is a high level of certainty that debt will remain close to end FY20 levels in the medium term, with risks to the upside. As above, the decline in debt of about 5 percent of GDP in FY24 and FY25 is the result of the unwinding of the BoE's Term Funding Scheme.

C. Stress Tests

7. The DSA suggests that medium-term debt dynamics are moderately sensitive to the macroeconomic shocks simulated by the DSA template.

- **Growth shock**. In this scenario, real output growth rates are lowered by one standard deviation in FY21 and FY22. The cumulative growth shock is 1.2 percent of GDP (reflecting stable growth over the last decade) with a small impact on debt dynamics.

- **Primary balance shock**. This scenario assumes that the government provides additional stimulus to support the economic recovery. In particular, the fiscal deficit is assumed to be 2 and 1 percent of GDP higher than in the baseline in FY21 and FY22, respectively, with gradual consolidation starting in FY23 (as in the baseline). Under these assumptions, the debt-to-GDP ratio rises more rapidly and then stabilizes at around 123 percent of GDP, just above the baseline.

- **Interest rate shock**. In this scenario, a 260-basis point increase in interest rates is assumed from FY21 on. The effective interest rate edges up to 2.1 percentage points by FY25 (about 0.9 percentage point higher than the baseline). Given the long maturity of UK's debt the impact is mild.

- **Exchange rate shock**. A shock to the exchange rate operates via its pass-through to inflation, as debt is denominated in local currency. A depreciation of 20 percent is assumed for FY21. This reduces the debt ratio as the denominator effect of higher nominal GDP is only partially offset by the debt impact of higher spending on inflation-linked payments. The scenario abstracts from the impact of inflation on other expenditures and revenues (CPI is used to uprate many direct tax thresholds, some benefits and public service pensions). The stock of index-linked gilts represents about 25 percent of debt, making debt sensitive to changes in RPI inflation (OBR Fiscal Risk Report 2017).

- **Combined macro-fiscal scenario**. This scenario aggregates shocks to real growth, the interest rate, and the primary balance. Under these assumptions, the debt-to-GDP ratio remains on an upward trend throughout the forecast period, reaching almost 128 percent of GDP in FY25. Gross financing needs would remain below the 20 percent of GDP threshold.

- **Contingent liability shock**. This scenario assumes that banking sector problems lead to a one-time bail out of the financial sector, raising non-interest expenditure by 3 percent of banking sector assets in FY21. The scenario can also be interpreted to cover the risk related to pandemic-related government guarantees (which amount to about 3 percent of GDP). Real GDP is also reduced by one standard deviation for two years. Under this scenario, the debt-to-GDP ratio would rise to about 138 percent of GDP in FY21 and continue rising modestly thereafter, reaching 133 of GDP in FY25. Gross financing needs would exceed the 20 percent of GDP threshold in FY21.

Figure 1. United Kingdom: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

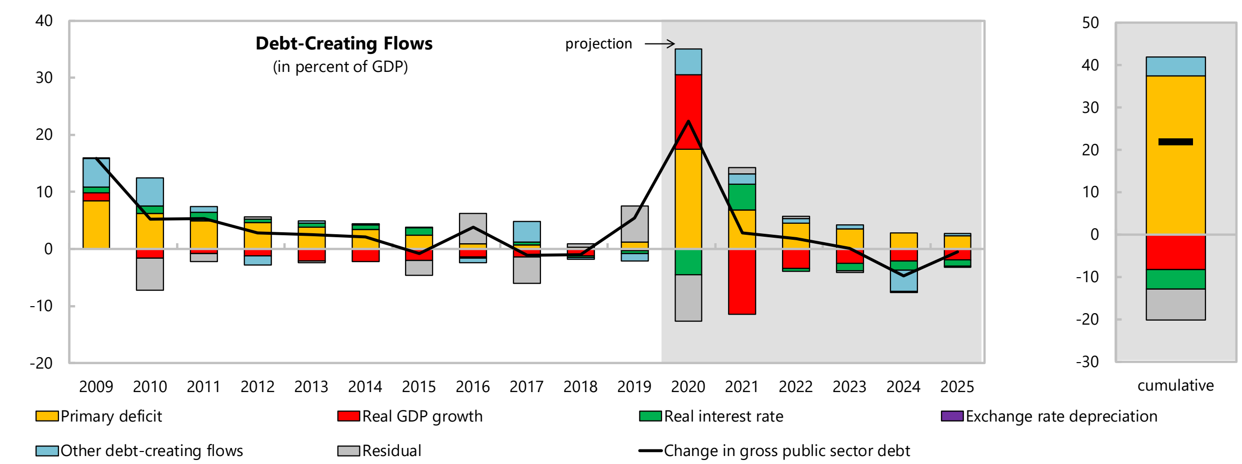
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	85.2	90.6	96.0	118.4	121.2	123.1	123.2	118.4	117.9
Public gross financing needs	11.6	9.4	9.6	26.0	15.6	14.5	13.4	13.7	14.1
Real GDP growth (in percent)	1.5	1.4	0.3	-12.6	10.3	2.9	2.1	1.8	1.6
Inflation (GDP deflator, in percent)	1.7	2.3	2.4	6.4	-3.1	1.1	1.9	2.2	2.2
Nominal GDP growth (in percent)	3.6	3.3	-3.3	0.6	5.6	3.6	4.2	3.9	3.8
Effective interest rate (in percent) [4/]	2.8	2.0	1.9	1.2	0.6	0.7	0.8	0.9	1.2

As of November 19, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		63
5Y CDS (bp)		23
Ratings	Foreign	Local
Moody's	Aa3	Aa3
S&Ps	AA	AA
Fitch	AA-	AA-

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	4.0	-1.0	5.4	22.4	2.8	1.8	0.1	-4.8	-0.5	21.9	
Identified debt-creating flows	4.9	-1.6	-0.9	30.5	1.7	1.4	0.4	-4.6	-0.3	29.1	
Primary deficit	3.9	0.3	1.3	17.5	6.8	4.5	3.5	2.8	2.4	37.5	-2.7
Primary (noninterest) revenue and grants	36.2	37.0	38.7	35.9	37.2	36.9	37.6	38.1	38.6	224.4	
Primary (noninterest) expenditure	40.2	37.3	40.0	53.4	44.0	41.4	41.1	40.9	41.0	261.9	
Automatic debt dynamics [5/]	-0.4	-1.5	-0.8	8.5	-6.9	-3.9	-3.8	-3.7	-3.0	-12.8	
Interest rate/growth differential [6/]	-0.4	-1.5	-0.8	8.5	-6.9	-3.9	-3.8	-3.7	-3.0	-12.8	
Of which: real interest rate	0.8	-0.3	-0.5	-4.5	4.5	-0.5	-1.3	-1.6	-1.2	-4.6	
Of which: real GDP growth	-1.3	-1.2	-0.3	13.1	-11.4	-3.4	-2.5	-2.1	-1.9	-8.3	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.4	-0.3	-1.4	4.5	1.8	0.8	0.8	-3.8	0.3	4.5	
Cash req. adjustments. incl. privatization (negative)	1.4	-0.3	-1.4	4.5	1.8	0.8	0.8	-3.8	0.3	4.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-1.0	0.6	6.3	-8.2	1.1	0.4	-0.3	-0.1	-0.2	-7.3	



Source: IMF staff.

1/ Public sector is defined as consolidated public sector.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

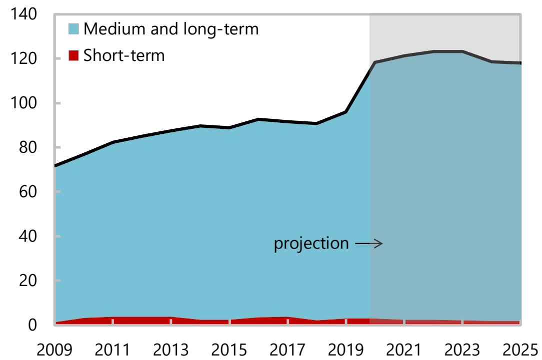
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

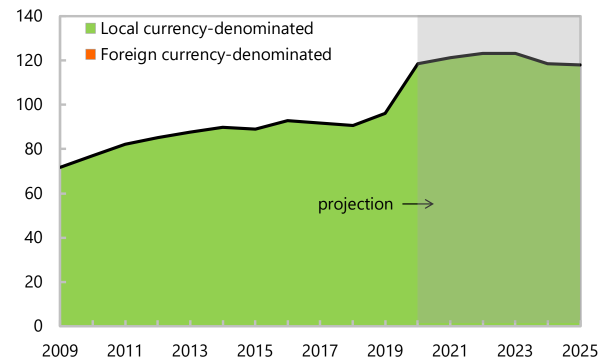
Figure 2. United Kingdom: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



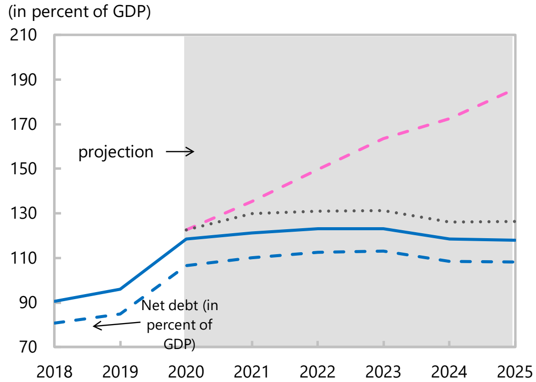
By Currency
(in percent of GDP)



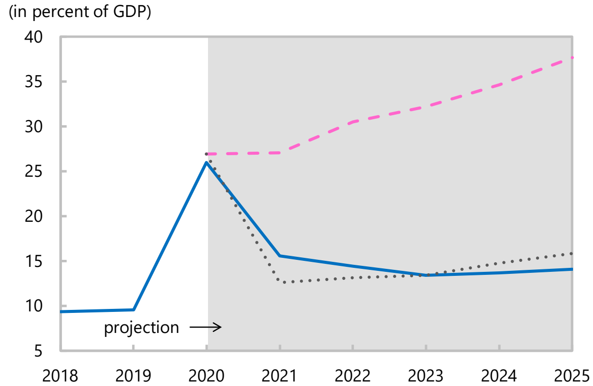
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



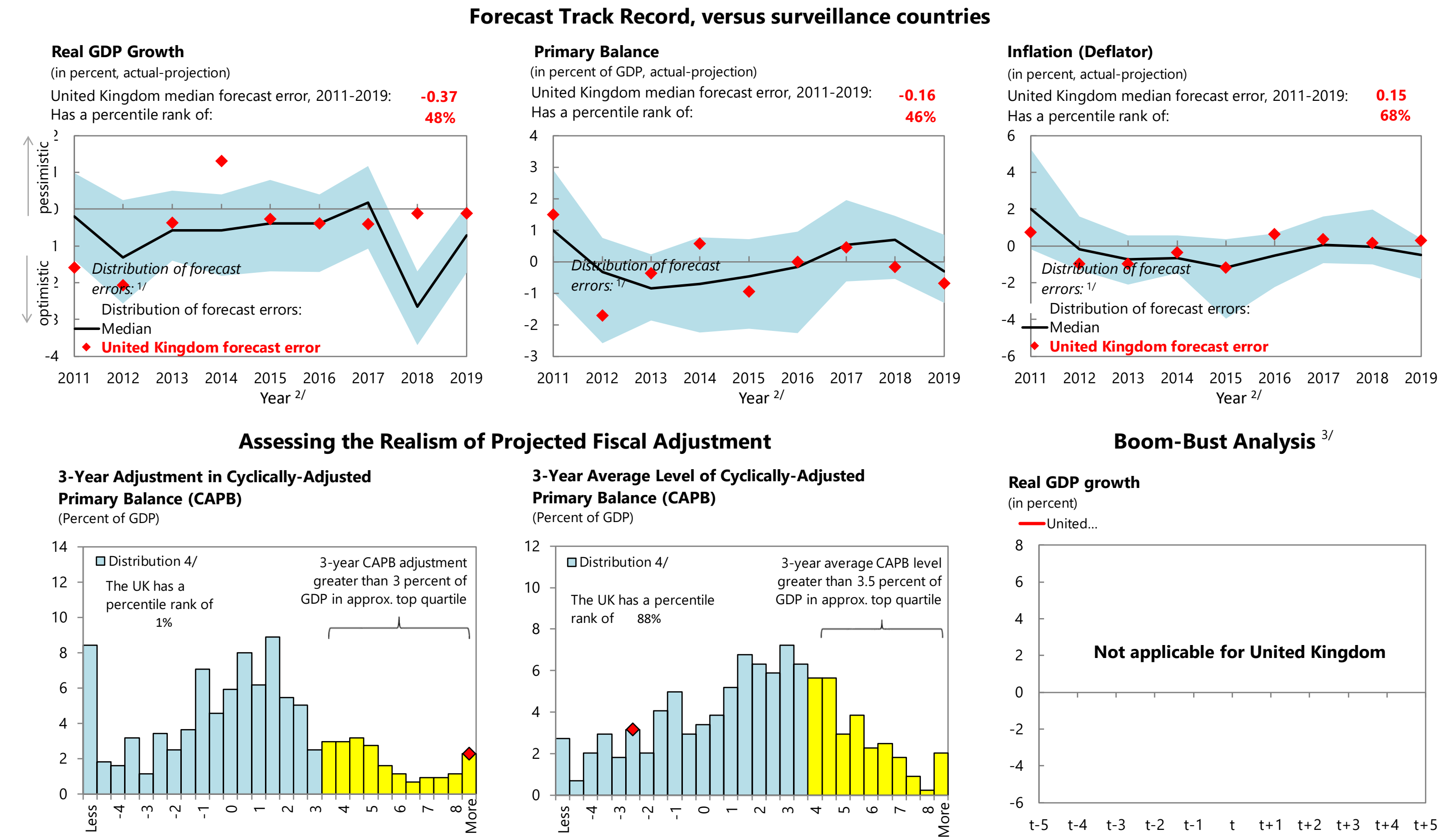
Underlying Assumptions
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-12.6	10.3	2.9	2.1	1.8	1.6
Inflation	6.4	-3.1	1.1	1.9	2.2	2.2
Primary Balance	-17.5	-6.8	-4.5	-3.5	-2.8	-2.4
Effective interest rate	1.2	0.6	0.7	0.8	0.9	1.2
Constant Primary Balance Scenario						
Real GDP growth	-12.6	10.3	2.9	2.1	1.8	1.6
Inflation	6.4	-3.1	1.1	1.9	2.2	2.2
Primary Balance	-18.1	-18.1	-18.1	-18.1	-18.1	-18.1
Effective interest rate	1.2	0.6	0.7	0.8	0.8	1.0

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-12.6	1.7	1.7	1.7	1.7	1.7
Inflation	6.4	-3.1	1.1	1.9	2.2	2.2
Primary Balance	-18.1	-2.9	-2.9	-2.9	-2.9	-2.9
Effective interest rate	1.2	0.6	0.9	1.1	1.2	1.7

Source: IMF staff.

Figure 3. United Kingdom: Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

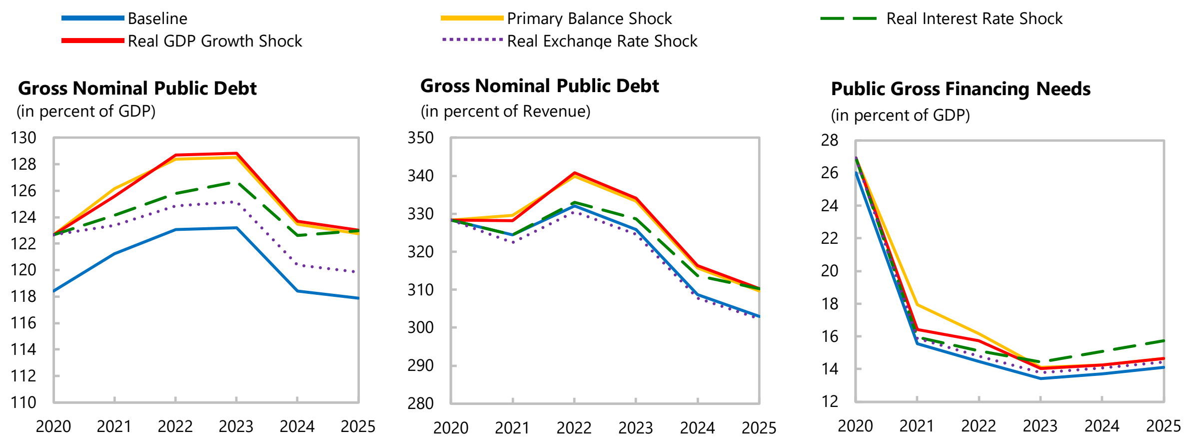
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for United Kingdom, as it meets neither the positive output gap criterion nor the private credit growth criterion.

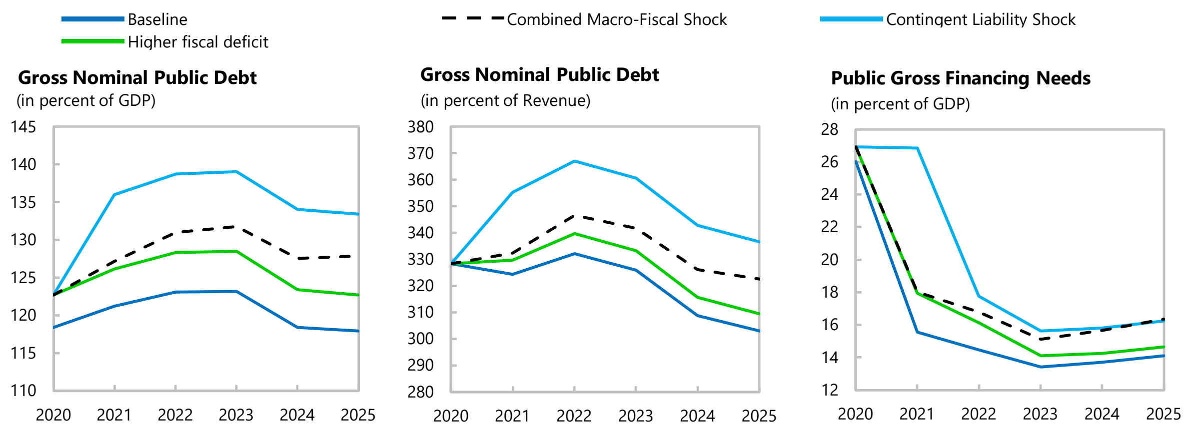
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. United Kingdom: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2020	2021	2022	2023	2024	2025
Primary Balance Shock						
Real GDP growth	-12.6	10.3	2.9	2.1	1.8	1.6
Inflation	6.4	-3.1	1.1	1.9	2.2	2.2
Primary balance	-18.1	-9.0	-5.6	-3.6	-2.9	-2.4
Effective interest rate	1.2	0.6	0.7	0.8	0.8	1.2
Real Interest Rate Shock						
Real GDP growth	-12.6	10.3	2.9	2.1	1.8	1.6
Inflation	6.4	-3.1	1.1	1.9	2.2	2.2
Primary balance	-18.1	-7.0	-4.6	-3.6	-2.9	-2.4
Effective interest rate	1.2	0.6	1.0	1.4	1.6	2.1
Combined Shock						
Real GDP growth	-12.6	9.6	2.2	2.1	1.8	1.6
Inflation	6.4	-3.3	0.9	1.9	2.2	2.2
Primary balance	-18.1	-9.0	-5.6	-3.6	-2.9	-2.4
Effective interest rate	1.2	0.6	1.1	1.4	1.6	2.1

	2020	2021	2022	2023	2024	2025
Real GDP Growth Shock						
Real GDP growth	-12.6	9.6	2.2	2.1	1.8	1.6
Inflation	6.4	-3.3	0.9	1.9	2.2	2.2
Primary balance	-18.1	-7.4	-5.4	-3.6	-2.9	-2.4
Effective interest rate	1.2	0.6	0.7	0.8	0.9	1.2
Real Exchange Rate Shock						
Real GDP growth	-12.6	10.3	2.9	2.1	1.8	1.6
Inflation	6.4	-2.5	1.1	1.9	2.2	2.2
Primary balance	-18.1	-7.0	-4.6	-3.6	-2.9	-2.4
Effective interest rate	1.2	0.6	0.8	0.9	0.9	1.3
Contingent Liability Shock						
Real GDP growth	-12.6	9.6	2.2	2.1	1.8	1.6
Inflation	6.4	-3.3	0.9	1.9	2.2	2.2
Primary balance	-18.1	-17.8	-4.6	-3.6	-2.9	-2.4
Effective interest rate	1.2	0.6	1.2	1.2	1.2	1.5

Source: IMF staff.

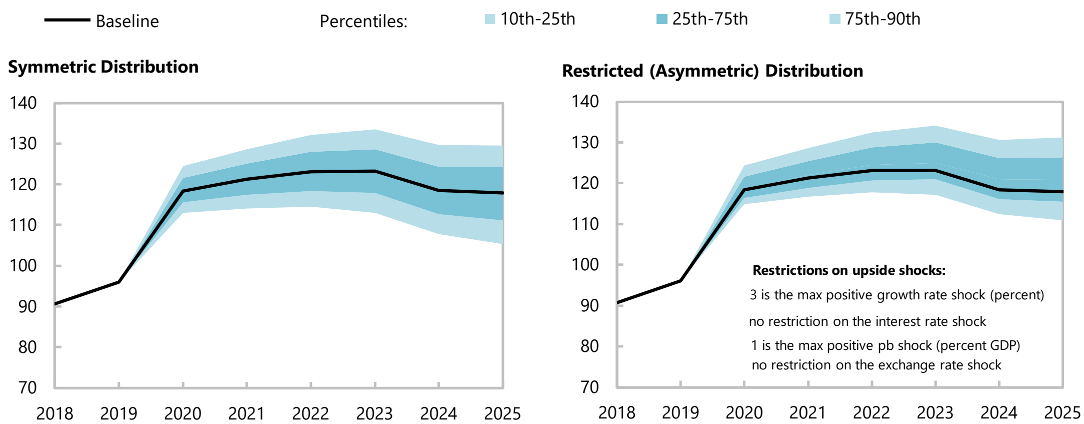
Figure 5. United Kingdom: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

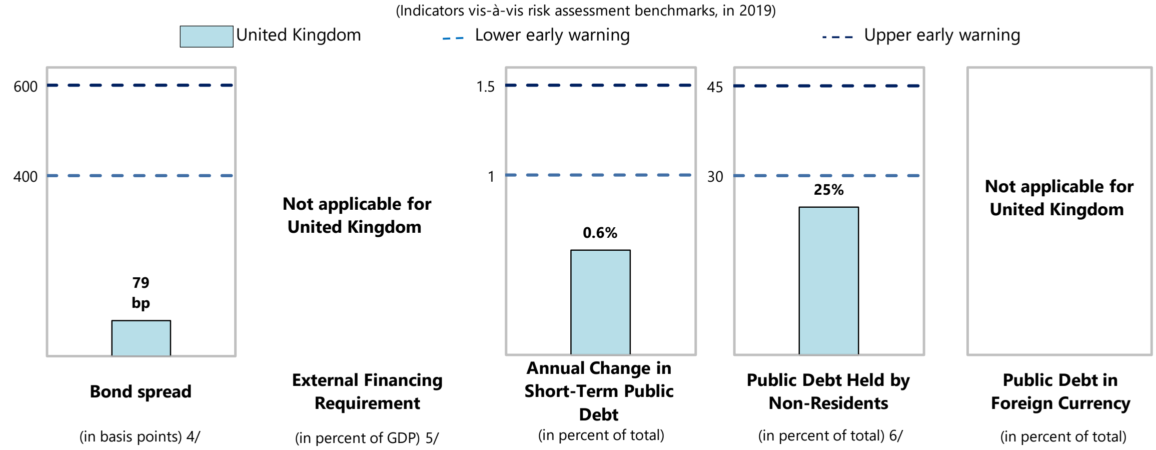
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 21-Aug-20 through 19-Nov-20.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

6/ Overseas holdings of gilts.

Annex IV. Assessment of Fiscal Space

Fiscal space is defined as the room for undertaking discretionary fiscal policy relative to existing plans without endangering market access and debt sustainability. The assessment is informed by the following considerations.

Macro-Fiscal Context

1. The economy has been severely impacted by the Covid shock and the effects are expected to persist over the medium term. Real GDP growth is projected to contract by about 11 percent in 2020, but despite the recovery expected in the coming years, GDP is projected to remain about 5 percentage points below the pre-Covid trend by 2025. Uncertainty around the growth outlook is unusually large, due to risks related to the evolution of the Covid pandemic and the impact of Brexit.

2. The sharp economic contraction and the strong fiscal response have led to a surge in the fiscal deficit and public debt. The overall balance of the public sector is projected at around 19 percent of GDP in FY2020. The deficit is expected to decline to about 7½ percent of GDP next fiscal year as the pandemic response measures are mostly phased out and fall further to about 3.3 percent of GDP in 2025 assuming gradual consolidation starting in FY2023. Net public sector debt is projected to climb from 85 percent of GDP at the end of FY2019 to over 106 percent of GDP in the current fiscal year. It is projected to stabilize at around 108 percent of GDP over the medium term (taking into account the unwinding of the TFS scheme in FY24 and FY25).

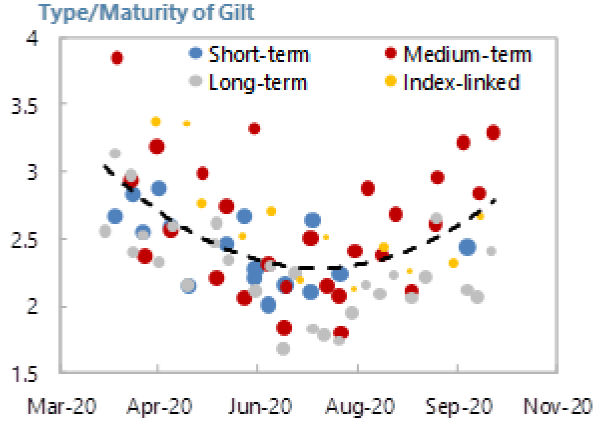
3. The current macroeconomic context provides some space for policy actions. In the current environment of low interest rates, high unemployment and potential constraints on private sector borrowing, fiscal multipliers are projected to be high.[1] This would mitigate impacts on debt and financing needs (relative to GDP).

Availability of Financing and Debt Sustainability

4. Financing availability is ample. While GFN-to-GDP ratios are elevated and above the MAC DSA high risk thresholds in the baseline (Annex II), additional analysis of the gross financing needs profile point to a moderate risk of stress, as under a generalized stress scenario, the large domestic financial sector, especially banks, which have limited government exposure, appears to have capacity to absorb the shock. Market indicators support this, with very low funding costs, strong demand for gilts in auctions, and declining CDS spreads since March. Average maturity of debt remains among the highest at 15 years, although the high volume of placements has meant more issuance at shorter maturities of late.

[1] See IMF, World Economic Outlook, April 2020, Chapter 2.

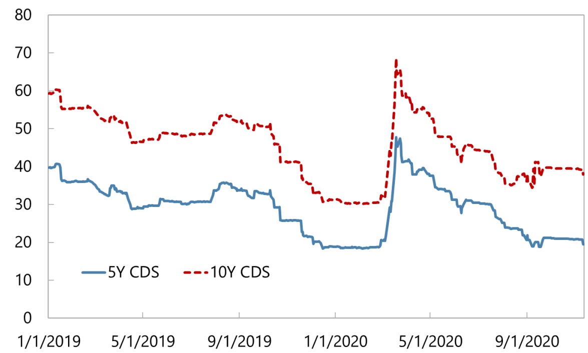
DMO Gilt Auctions 2020-21: Cover Ratio by Type/Maturity of Gilt



Sources: Debt Management Office; and IMF staff calculations.

Sovereign Credit Default Swaps

(Basis points)



Source: Refinitiv Eikon..

Assessment of Gross Financing Risks

Indicator	Weight	GFI
Average GFN/GDP, baseline projections	0.35	13.9
Initial bank claims on government/assets	0.32	3.6
Change in bank claims on govt in stress	0.33	11.1
Total index		9.7
Signal		**Moderate risk**
Thresholds:		
High-Moderate		17.9
Moderate-Low		7.6
Memo: Sterling Bank assets/GDP		187.4%

Source: Bank of England and IMF staff estimates.

Note 1: the Gross Financing Index (GFI) is a weighted average of the three indicators presented in the table. A three-zone risk signal has been established after evaluating the GFI relative to a lower and an upper threshold, which were calibrated based on a sample of GFIs and stress events in market-access countries. The lower threshold, which separates the low and moderate risk regions, corresponds to a 10 percent missed crisis rate and the upper threshold, which separates the moderate and high risk regions, corresponds to a 10 percent false alarm rate. Thresholds are still preliminary.

Note 2: The change in bank claims on government in stress is computed under a scenario similar to the combined shock presented in the DSA annex combined with the primary balance shock. In addition, these shocks are augmented by imposing a temporary shortening in the maturity of new government debt issuances and reduction in the rollover rate by foreign private creditors. It is also assumed that non-bank financial institutions maintain their purchases of government debt as a proportion of total assets at the average level of the last 25 years. The stock of BoE holdings is assumed to remain at the level announced so far. Official creditors are assumed to acquire new government debt in line with their share of debt held at end-2019. Domestic banks are the residual buyers of government debt after these assumptions are taken into account.

5. **The government is expected to preserve robust market access going forward**. The BOE's quantitative easing program projects to absorb most of net new issuance over the next 12 months. With the private financial sector ending up holding a larger stock of short-term claims on the BoE (i.e., bank reserves) there should be ample space for the Debt Management Office to pursue its strategy of issuing at long maturities. At the same time the temporary extension of the BoE's Ways and Means facility in April serves as a precautionary tool to smooth financing and

support the orderly functioning of markets (though it has not been utilized to date and there are no plans to do so in the future).

6. Debt is assessed to be sustainable, portending continued market access. This holds both under the baseline and under a scenario involving a sustained higher fiscal deficit, with later and slower adjustment (Annex II). Debt levels are projected to remain above the 85 percent of GDP benchmark for advanced economies throughout the forecast period, but risks are offset by the ample availability of financing and the expectation that interest rates will remain at low levels going forward, implying enhanced capacity to service the debt.

7. Fiscal adjustment requirements are achievable. The large reduction of the fiscal deficit envisaged for F2021 reflects the expiration of the extraordinary support provided in the current year. Further consolidation of around 2 percent of GDP in structural terms would be needed going forward to stabilize public debt (albeit at a high level), and more to start reversing the recent increase in debt. By comparison, the consolidation implemented in the UK after the GFC was 6.5 percent of GDP. This magnitude of adjustment is also not infrequent by international comparison (Figure 3 of Annex III).

Assessment

8. The UK is assessed to have some fiscal space. However, with the public debt expected to remain at high levels, expansionary fiscal policies in the near term to support the economy will need to be anchored by a credible medium-term fiscal framework and a credible fiscal consolidation plan. The UK has a number of favorable characteristics in implementing its fiscal objectives, including: a strong macroeconomic and fiscal forecasting capacity, a long-standing and a credible medium-term budget framework. The OBR provides an independent and clear assessment of whether the government is meeting its fiscal objectives, which strengthens the credibility of the framework.

Annex V. External Sector Assessment

Overall Assessment. *The external position in 2019 was weaker than the level implied by medium-term fundamentals and desirable policies.* The CA deficit remained high in 2019, reflecting low public and private saving. The uncertainty around this assessment is significant, reflecting both measurement issues and uncertainty about the future trade arrangement with the European Union and its possible effect on growth and trade flows. On a preliminary basis, and adjusting for transitory factors, recent developments suggest a broadly unchanged overall external position in 2020 compared to 2019. However, this assessment is highly uncertain given the lack of full year data for 2020 and the Covid-19 crisis, and a complete analysis will be provided in the 2021 External Sector Report. **Potential Policy Responses:** Macroeconomic policies in the short term (2020–21) should focus on supporting the economy, addressing the impact of the coronavirus, and facilitating the recovery. Structural reforms, including those focused on broadening the skill base, should be pursued to boost the United Kingdom's productivity and international competitiveness. These efforts are particularly important in light of expectations that access to the EU market will become more restricted.						
Foreign Asset and Liability Position and Trajectory	**Background.** The NIIP declined to –25.2 percent of GDP in 2019 from –12.8 percent of GDP in 2018, to a large extent due to the pound's appreciation. Over the past five years, the NIIP has declined by 2.5 percentage points, reflecting a negative CA contribution (–19.7 percentage points) largely offset by valuation and growth effects (13.7 percentage points and 3.6 percentage points, respectively).[1] The composition of assets roughly matches that of liabilities (about 86 percent of GDP in FDI, 70 percent of GDP in equity instruments, about 98 percent of GDP in derivatives—about ¾ linked to interest rates and ¼ to exchange rates—and about 183 percent of GDP in other investment), although portfolio investment liabilities (167 percent of GDP) exceed assets in portfolio investments (126 percent of GDP). The United States, other European countries, and Japan account for about 75 percent of total UK external assets and liabilities, and external liabilities have a larger share denominated in pounds than assets.[2] The IMF staff projects the NIIP to decline over the medium term, although the large and volatile valuation effects make these estimates particularly uncertain. **Assessment.** Despite some decline, the sustainability of the NIIP is not an immediate concern. Since 2000, valuation gains have offset about 40 percent of the effect of CA flows on the IIP, partially reflecting CA measurement issues and depreciation of the pound. However, fluctuations in the large gross stock positions are a potential source of vulnerability (including derivatives, gross assets and gross liabilities both exceed 500 percent of GDP).					
2019 (% GDP)	NIIP: –25.2	Gross Assets: 508.6	Debt Assets: 250.7	Gross Liab.: 533.8	Debt Liab.: 288.0	
Current Account	**Background.** The CA deficit narrowed marginally to –3.8 percent of GDP in 2019 (from –3.9 percent in 2018) and remains significantly larger than its historical average. The wider CA deficits since the global financial crisis reflect mostly weaker income balance, due in part to lower earnings on the United Kingdom's FDI abroad (especially in the euro area). In 2019, a slightly rise in the trade balance was offset by a slight fall in the income balance. The CA deficit is projected to decline to 2.6 percent of GDP in 2020 due to a narrower trade deficit, including a reduction in net tourism spending, as domestic demand is projected to fall by more than in trade partners. This reflects a sharp fall in investment combined with a slight increase in gross saving (relative to GDP). **Assessment.** The EBA CA model estimates a norm of 0.4 percent of GDP and a cyclically adjusted EBA CA gap of –4.2 percent of GDP. However, the CA is assessed to be understated due to measurement biases, which are partly reflected in the large NIIP exchange rate valuation effects and in other unidentified stock-flow adjustments. An important source of bias is retained earnings on portfolio equity assets, which are not recorded on an accrual basis—estimated at about 0.8 percent of GDP.[3] A second source is the unrecorded impact of expected inflation differentials on the CA—estimated to be about 0.5 percent of GDP. Overall, the IMF staff assesses the CA gap in the range of –0.9 to –4.9 percent of GDP. This range takes into account the uncertainty in the assessment related to the outcome of the negotiations on the future UK-EU relationship and possible measurement issues.[4]					
2019 (% GDP)	Actual CA: –3.8	Cycl. Adj. CA: –3.8	EBA CA Norm: 0.4	EBA CA Gap: –4.2	Staff Adj.: 1.3	Staff CA Gap: –2.9
Real Exchange Rate	**Background.** The pound remained unchanged in real effective terms in 2019 relative to its average level in 2018 but has depreciated since mid-2016 by about 6 percent. Sterling depreciation since 2016 may reflect an unwinding of past overvaluation as well as market expectations of more restricted access to the EU market in the future. As of October 2020, the REER is broadly unchanged relative to the 2019 average. **Assessment.** EBA REER level and index approaches suggest a gap of –5.6 and –12.6 percent, respectively, for 2019. However, given uncertainties related to the United Kingdom's new trading relationship with the European Union, these model estimates may not be entirely appropriate. The IMF staff CA gap assessment implies an REER gap of 12 percent. Overall, the staff assesses the REER to be overvalued between 0 and 15 percent, with a midpoint of 7.5 percent.[5]					

Capital and Financial Accounts: Flows and Policy Measures	**Background.** Given the United Kingdom's role as an international financial center, portfolio investment and other investment are the key components of the financial account. In net terms, the CA was financed in 2019 by broadly stable net FDI inflows of 1 percent of GDP, net other investments worth 5.7 percent of GDP (reflecting rising inflows and declining outflows), while net portfolio investments declined by 2 percent of GDP (reflecting accumulation of assets abroad by 4.9 percent of GDP and higher investments in the United Kingdom of 2.8 percent of GDP). Nonresidents' net purchases of UK debt (portfolio and direct investment) represented 2 percent of GDP. Despite some turbulence in March, access to finance has remained favorable during the Covid-19 crisis, aided by the Bank of England's liquidity support and expanded quantitative easing. **Assessment.** Large fluctuations in capital flows are inherent to financial transactions in countries with a large financial sector. This volatility is a potential source of vulnerability, although it is mitigated by sound financial regulation and supervision and a strong financial sector. An additional risk is that FDI and portfolio investment inflows may decelerate, driven by concerns about the United Kingdom's future trade relations with the European Union.
FX Intervention and Reserves Level	**Background.** The pound has the status of a global reserve currency. Despite uncertainty about the future relationship between the United Kingdom and the European Union, the share of global reserves in sterling has not changed since 2015, at about 4.5 percent. **Assessment.** Reserves held by the United Kingdom are typically low relative to standard metrics, and the currency is free floating.

[1] The official NIIP data may understate the true position—estimates of FDI stocks at market values imply a much higher NIIP. Estimates from the Bank of England suggested that the NIIP based on market values could have been close to 80 percent of GDP for mid-2017 (November 2017 inflation report). Market value estimates of FDI assets assume their valuations move in line with those of equity market indices in the United Kingdom and abroad. These estimates are highly uncertain, as actual FDI market values could evolve differently across different equity markets.

[2] Estimates in Juvenal and others (2019) suggest that, in 2017, about 90 percent of external assets were denominated in foreign currency, compared with 60 percent for external liabilities.

[3] The marked shift in recent years from FDI assets to portfolio equity assets implies a greater-than-historical underestimation of the income balance.

[4] Should Brexit lead to a significant increase in trade barriers, the equilibrium exchange rate could be weaker than suggested here.

[5] These values reflect the relative weights put on the different approaches, with a higher weight on the CA gap methodology. The wide range reflects the large uncertainty as to the future of the UK-EU relationship.

Annex VI. External Debt Sustainability Analysis

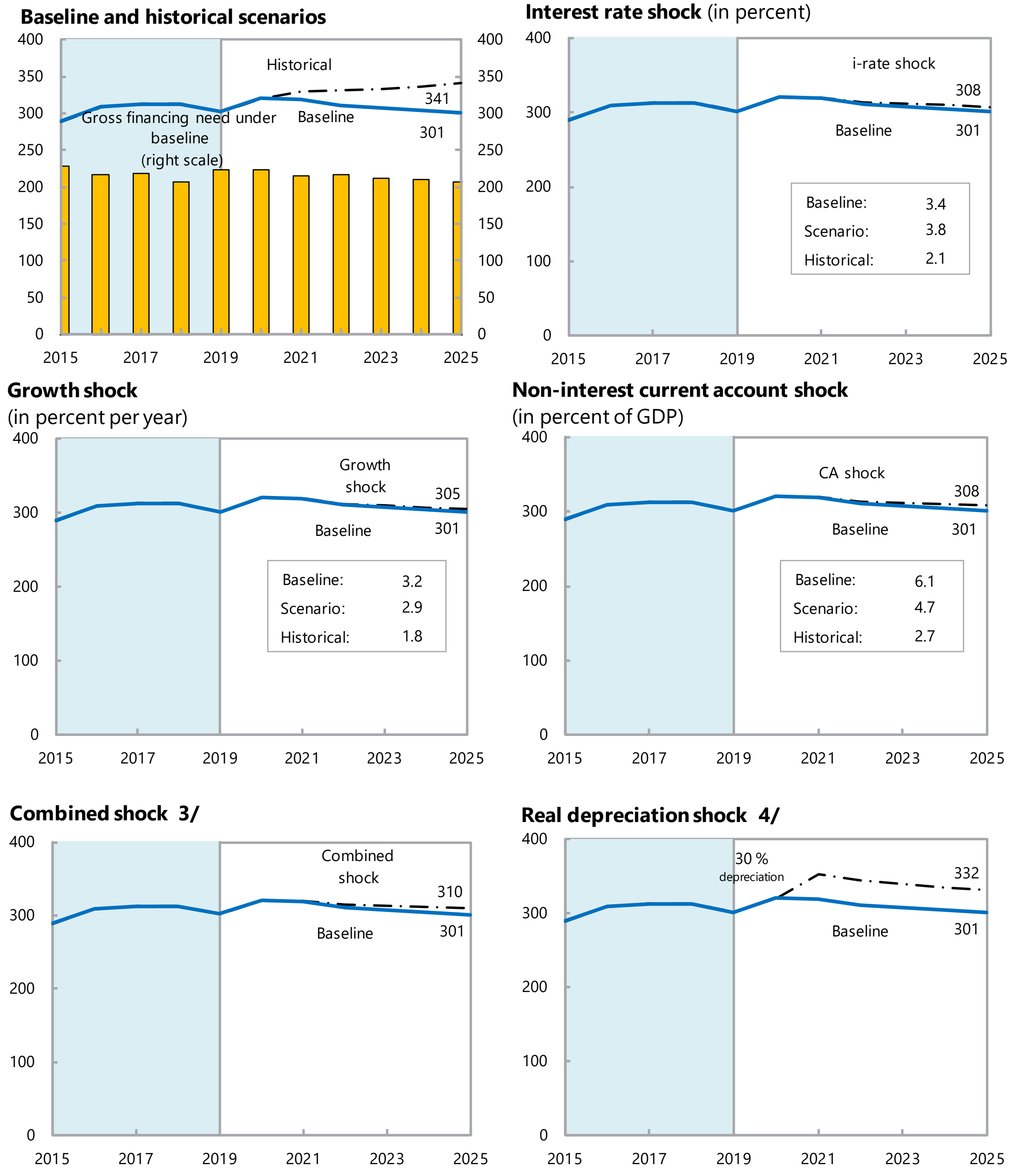
The external debt sustainability analysis complements the External Sector Assessment (Annex V). Under the baseline scenario, external debt is projected to increase from about 300 percent of GDP in 2019 to about 320 percent in the following two years—on account of the contraction in nominal GDP during the Covid crisis—and to recover thereafter. In standard shock scenarios, external debt would increase very modestly. With more than ¼ of external debt denominated in foreign currency, a real depreciation would be the most significant shock. Still, a net position long in foreign currency suggests that external debt is sustainable. Structural reforms to increase productivity and preservation of the strong policy frameworks would help contain any external vulnerabilities as the country transitions to a new trade regime with the EU.

1. **Background**. External debt peaked at 400 percent of GDP on the eve of the global financial crisis, which was followed by rapid deleveraging, leaving debt at about 300 percent since 2013. Almost half of external debt is composed of short-term bank liabilities, while public debt accounts for a tenth. The net international investment position has always stayed above -30 percent of GDP over the past decades, as positive valuation gains have tended to offset financial account deficits (Annex V).

2. **Assessment**. In the baseline, external debt is projected to grow in 2020 and 2021 due to denominator effects, as the pandemic and Brexit depress nominal GDP. Debt would reach 321 percent of GDP in 2020, but would revert to its 2019 level by 2025, as the economic recovery and non-interest current account flows induce positive dynamics. Standardized shocks are calibrated to ½ standard deviation for interest rates, growth, and the current account. In these scenarios, external debt would inch up marginally by the end of the forecast horizon. A depreciation shock has a larger impact, leaving external debt somewhat higher at 332 percent of GDP. Yet, gross debt assets at about 270 percent of GDP and a net debt position long in foreign currency would offer some insurance against such shock. The historical scenario is less favorable, with debt climbing to 340 percent of GDP, as it is based on an average of the past 10 years, which include weaker nominal growth than during the post-Covid recovery as well as a sizeable depreciation of the pound. Although external debt is sustainable in the baseline, short-term liability positions at twice the value of GDP make the UK sensitive to market sentiment. Upholding strong policy frameworks and implementing appropriate structural reforms would be key to preserving sustainability going forward.

Figure 1. United Kingdom: External Debt Sustainability—Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown. The average maturity of long-term external debt is assumed to equal 7 years.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2021.

Table 1. United Kingdom: External Debt Sustainability Framework, 2015–2025

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
Baseline: External debt	288.9	308.7	312.6	312.9	301.8			**320.6**	**318.3**	**310.7**	**307.5**	**303.8**	**300.8**	**-1.4**
Change in external debt	-19.0	19.7	4.0	0.3	-11.1			18.9	-2.4	-7.6	-3.2	-3.7	-3.0	
Identified external debt-creating flows (4+8+9)	0.3	10.4	-5.3	-9.7	-2.1			38.1	-12.7	-10.5	-2.1	-1.9	-1.3	
Current account deficit, excluding interest payments	0.3	-1.2	-5.1	-7.6	-6.1			-7.3	-5.9	-6.0	-6.2	-6.3	-6.3	
Deficit in balance of goods and services	-27.2	-28.2	-30.1	-30.9	-31.2			-28.2	-28.4	-29.0	-28.9	-28.7	-28.6	
Exports	27.3	28.2	30.1	30.9	31.2			28.2	28.4	29.0	28.9	28.8	28.6	
Imports	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Net non-debt creating capital inflows (negative)	-2.7	5.7	-3.5	-0.2	0.5			-0.1	0.4	-0.5	0.0	0.1	0.0	
Automatic debt dynamics 1/	2.7	6.0	3.3	-2.0	3.6			45.4	-7.2	-4.0	4.1	4.4	5.1	
Contribution from nominal interest rate	4.7	6.7	8.9	11.2	10.4			9.9	10.1	10.1	10.0	10.0	9.9	
Contribution from real GDP growth	-7.6	-5.4	-5.4	-3.6	-4.0			35.5	-17.4	-14.1	-6.0	-5.6	-4.8	
Contribution from price and exchange rate changes 2/	5.6	4.7	-0.1	-9.6	-2.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-19.2	9.3	9.3	10.0	-9.0			-19.3	10.3	2.9	-1.1	-1.8	-1.7	
External debt-to-exports ratio (in percent)	1059.8	1093.1	1038.3	1012.9	967.3			1136.2	1119.2	1070.0	1062.3	1056.0	1051.5	
Gross external financing need (in billions of US dollars) 4/	6717.9	5880.9	5844.6	5912.2	6326.7			6011.1	6128.2	6421.9	6539.1	6712.7	6897.8	
in percent of GDP	0.2	0.2	0.2	0.2	0.2	10-Year	10-Year	0.2	0.2	0.2	0.2	0.2	0.2	
Scenario with key variables at their historical averages 5/								**320.6**	**330.1**	**330.7**	**333.7**	**337.0**	**340.7**	**1.0**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.4	1.7	1.7	1.3	1.3	1.8	0.5	-11.2	5.7	4.6	2.0	1.9	1.7	
GDP deflator in US dollars (change in percent)	-6.6	-9.4	-3.1	6.0	-2.4	-0.1	5.5	6.8	0.1	-0.3	1.8	2.1	2.1	
Nominal external interest rate (in percent)	1.5	2.1	2.8	3.9	3.3	2.1	0.9	3.1	3.3	3.3	3.4	3.4	3.4	
Growth of exports (US dollar terms, in percent)	-7.5	-4.6	5.1	10.2	-0.2	3.5	7.3	-14.2	6.7	6.5	3.5	3.4	3.2	
Growth of imports (US dollar terms, in percent)	-7.6	-3.6	3.5	9.2	0.4	3.3	6.3	-20.0	16.1	7.2	3.1	3.1	3.0	
Current account balance, excluding interest payments	-0.3	1.2	5.1	7.6	6.1	2.7	2.9	7.3	5.9	6.0	6.2	6.3	6.3	
Net non-debt creating capital inflows	2.7	-5.7	3.5	0.2	-0.5	0.2	2.5	0.1	-0.4	0.5	0.0	-0.1	0.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

UNITED KINGDOM

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 2, 2020

Prepared By European Department

CONTENTS

FUND RELATIONS

(Data as of October 31, 2020)

Membership Status: Joined December 27, 1945; accepted Article VIII.

General Resources Account:

	SDR Million	Percent Quota
Quota	20,155.1	100.00
Fund holdings of currency	15,709,74	77.94
Reserve position in Fund	4,446.78	22.06
New arrangement to borrow	422.73	

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocations	10,134.20	100.00
Holdings	9,986,81	98.55

Outstanding Purchases and Loans: None

Financial Arrangements: None

Overdue Obligations and Projected Payments to Fund[1/]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2020	2021	2022	2023	2024
Principal					
Charges/Interest	0.01	0.28	0.28	0.28	0.28
Total	0.01	0.28	0.28	0.28	0.28

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement:

The UK authorities maintain a free floating regime.

The UK accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 15, 1961. It maintains an exchange system free of multiple currency practices and restrictions on payments and transfer for current international transactions, except for exchange restrictions imposed solely for the preservation of national or international security. The UK notifies the Fund of the maintenance of measures imposed solely for the preservation of national and international security under Executive

Board Decision No. 144–(52/51). The last of these notifications was made on January 9, 2012 (EBD/12/2).

Article IV Consultation:

The last Article IV consultation was concluded on November 12, 2018. The UK is on the standard 12-month consultation cycle.

FSAP:

A mandatory FSAP was conducted in time for the 2016 Article IV consultation, in line with the five-year cycle for members or members' territories with financial sectors that are determined to be systemically important pursuant to Decision No. 15495-(13/111), adopted December 6, 2013.

Technical Assistance: None

Resident Representatives: None

STATISTICAL ISSUES

(As of November 2020)

I. Assessment of Data Adequacy for Surveillance

General: Data provision is broadly adequate for surveillance.

National Accounts: The Office of National Statistics (ONS) compiles national accounts in line with the European System of Accounts 2010 (ESA 2010) using the production, expenditure, and income approaches. Volume estimates of GDP are compiled using a fixed base year, currently 2018. Under the new model, monthly GDP is released around the 10th of each month as part of the Short-term Economic Indicators (STEI) theme day; for the second calendar month of each quarter the first quarterly estimate is published alongside monthly GDP. The second quarterly estimate is released 12 weeks after the reference quarter. In response to the COVID-19 pandemic, the ONS has developed a *Fortnightly Business Impact of Coronavirus Survey (BICS*) which provides more timely data on economic developments. These data allow the ONS to provide high-frequency indicators that complement the existing monthly and quarterly GDP.

Price Statistics: The official monthly consumer price index (CPI), a composite of urban and rural price data, is available on a timely basis. The reference year of the CPI and CPIH (CPI including owner occupiers' housing costs) is 2015. The Producer Price Index (PPI) is compiled monthly and is available within 6 weeks after the reference month. The index weights are annually chain-linked. The current reference period for the PPI is 2015.

Government Finance Statistics: Annual GFS data are reported for publication in the Government Finance Statistics Yearbook (GFSY). The fiscal data for the Article IV consultations missions cover public sector operations and the general government and public sector boundary is in line with ESA 2010/GFSM 2014. The GFS data are compiled on an accrual basis. The UK participates in the Eurostat GFS convergence project with the IMF and thus, GFS data for general government, including government balance sheet data, are submitted in line with GFSM 2014 presentation on a quarterly and annual basis. The UK publishes detailed information on public sector finances for the entire public sector on a monthly basis, and also compiles comprehensive annual financial statements for the public sector including a full balance sheet in the Whole of Government Accounts publication. From 2010, Northern Rock Asset Management and Bradford and Bingley, formerly classified as financial corporations, are included within central government. Government revenue in 2012 is affected by the substantial one-off receipt of £28 bn from the transfer from the Royal Mail Pension Fund.

Monetary and Financial Statistics: The Bank of England (BoE) has not yet reported monetary statistics using the Standardized Report Forms (SRFs) for publication in International Financial Statistics (IFS). Data published in IFS are reported by the BOE using the old forms (forms 10R and 20R) with supplementary breakdowns by currency and by type of financial instruments for some accounts in the central bank data retrieved from the BoE's website. The IMF's Statistics Department receives source data from BOE for the compilation of the SRFs, although the mapping of the source data to the SRFs requires further clarification and information from the BoE. The BoE

reports data on some key series and indicators of the Financial Access Survey (FAS), including the two indicators of the U.N. Sustainable Development Goals.
Financial Sector Surveillance: The BoE reports all 12 core FSIs, 11 of the 13 encouraged FSIs for deposit takers, and 11 of the 15 FSIs encouraged for other sectors—two FSI for other financial corporations, four FSIs for nonfinancial corporations, one FSI for households, and four FSIs for real estate markets. Data frequency has improved from semi-annual to quarterly frequency since 2015. However, timeliness needs improvement. The FSI data and metadata for the UK are posted on the IMF's FSI website.
External Sector Statistics: The ONS compiles and disseminates detailed quarterly balance of payments and International Investment Position. *BPM6* was implemented in the UK's balance of payments accounts and IIP in September 2014. The impact on the UK's balance of payments and IIP as a result of the introduction of *BPM6* for the period 1997 to 2013 was published as annex to the UK's balance of payments, Q2 2014 edition. The UK's balance of payments statistics is compiled at the same time as the national accounts. A Balance of Payments statistical bulletin and time series dataset is published quarterly on the ONS website, 90 days after the end of the reference period. There are several different sources used in the production of BoP statistics, some of which are collected in the ONS's surveys and some of which are provided by external partners such as the BoE and HM Revenue and Customs (HMRC). The country participates in the Coordinated Portfolio Investment Survey with semiannual data reported for 2001 onwards and with encouraged data by sector of the holder. The UK also reports inward and outward Coordinated Direct Investment Survey with data for 2009 onwards, including the breakdown of net debt instruments into gross claims and liabilities. In addition, the UK reports the data template on International Reserves and Foreign Currency Liquidity and the Currency Composition of Official Foreign Exchange Reserves.
II. Data Standards and Quality
The UK subscribes to SDDS and is working towards the eventual adherence to SDDS Plus.

Table 1. United Kingdom: Common Indicators Required for Surveillance

(As of November 17, 2020)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Same day	Same day	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	October 2020	11/04/2020	M	M	M
Reserve/Base Money	October 2020	11/04/2020	M	M	M
Broad Money	Q3 2020	10/29/2020	Q	Q	Q
Central Bank Balance Sheet	November 11, 2020	11/12/2020	W	W	W
Consolidated Balance Sheet of the Banking System	September 2020	10/29/2020	M	M	M
Interest Rates[2]	Same day	Same day	D	D	D
Consumer Price Index	October 2020	11/18/2020	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3 2020	10/21/2020	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	September 2020	10/21/2020	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	September 2020	10/21/2020	M	M	M
External Current Account Balance	Q2 2020	09/30/2020	Q	Q	Q
International Investment Position[6]	Q2 2020	09/30/2020	Q	Q	Q
Exports and Imports of Goods and Services	Q3 2020	11/12/2020	Q	Q	Q
GDP/GNP	Q3 2020	11/12/2020	Q	Q	Q
Gross External Debt	Q3 2020	11/12/2020	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND

UNITED KINGDOM

December 14, 2020

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By European Department

This statement reports on developments and provides information that has become available since the staff report was issued to the Executive Board on December 3, 2020, notably about discussions on the post-Brexit framework, and updates the staff appraisal.

1. **The UK-EU negotiations towards a post-Brexit trade deal have yet to reach a conclusion.** The two sides have not yet secured understandings on the issues noted in the staff report (level playing fields provisions, a fisheries agreement on access to waters and quota shares, and governance). After reaching what appeared to be an impasse, they decided on December 13 to continue to seek solutions on these difficult issues. Meanwhile, the European Commission published contingency measures for a no-deal scenario. These cover, *inter alia*, proposed transitional provisions for continuation of EU-UK air and road connectivity for 6 months, and a proposal for continuation of fishing access and quotas for 12 months (both reciprocal in nature, requiring the UK to grant the same provisions).

2. **The UK and EU have, however, reached an understanding on how to implement the Northern Ireland Protocol.** Under the Withdrawal Agreement signed with the EU in January 2020 the UK committed to keep Northern Ireland aligned with various EU rules relating to trade in goods to eliminate the need for checks and controls between Ireland and Northern Ireland. This, in turn, creates a need for some processes between the rest of the UK and Northern Ireland. The agreement in principle reached in December 2020 covers the implementation of the NI Protocol, including the application of State aid rules and exemptions for certain goods and activities. With this deal the UK government has indicated that it will drop clauses in a draft UK Internal Market Bill that were set to be the subject of legal proceedings by the EU (i.e., for violating the Withdrawal Agreement). In parallel, the UK also published a Taxation Bill creating the legal framework for the implementation of the fiscal aspects of the Northern Ireland Protocol.

3. **The Prudential Regulation Authority (PRA) decided not to extend the exceptional and precautionary action taken in March on banks' dividend distribution and cash bonus payments, allowing banks to recommence some**

capital distributions. The decision, announced on December 10, is motivated by PRA's assessment that banks remain well capitalized and able to support the economy, based on results of two stress tests of banks' capital positions carried out by the Prudential Regulation Committee and the Financial Policy Committee. Distributions to ordinary shareholders by large UK banks should not exceed the higher of 20 basis points of risk-weighted assets as at end-2020; or of 25 percent of cumulative eight-quarter profits covering 2019 and 2020 after deducting prior shareholder distributions over that period. The PRA intends to transition back to its standard approach to capital-setting and shareholder distributions through 2021.

4. The UK started delivering a Covid-19 vaccine on December 8. The government has purchased 40 million doses of the vaccine developed by BioNTech and Pfizer, which would allow immunization of 20 million people. With priority given to the elderly, frontline health and social care workers, and individuals at risk, most vulnerable people should be vaccinated through April. The vaccine is being delivered for free, and liability lies with the government under the current emergency process, but distribution is subject to large logistical challenges. The UK has also reserved another 317 million doses of vaccine from six other providers (including 100 million from AstraZeneca/Oxford University). These options have not yet secured approval and/or completed clinical trials, but the UK government has requested that the Medicine and Healthcare Products Regulatory Agency review the AstraZeneca/Oxford vaccine for emergency use.

5. High-frequency data releases hint to stronger-than-expected GDP in 2020Q4. In October GDP grew by 0.4 percent, better than suggested by declining mobility indicators, and likely reflecting adaptation of non-contact-intensive sectors to Covid restrictions. In November, despite the impact on overall activity due to the England-wide lockdown, the manufacturing PMI points to a sizeable build-up of input inventories, amidst Brexit-related uncertainty (although this factor would probably reverse in early 2021). Finally, daily mobility and activity data are displaying a relatively quick rebound after the end of the lockdown on December 2.

Staff Appraisal

6. Considering the BoE decision to allow limited bank dividend payments, a cautious case-by-case approach to lifting them is warranted. Such an approach would ensure that banks have enough capital to absorb losses while supporting lending. In the event of a deterioration in the outlook and depending on the results of a full system-wide stress test planned for mid-2021, this process may need to be slowed or even paused. In any event, banks' medium-term capital plans including dividend distributions must remain subject to enhanced supervision.

7. In other areas, the thrust of the staff appraisal remains unchanged.

Statement by Shona Riach, Executive Director for the United Kingdom, David Paul Ronicle, Alternate Executive Director and Tommy Chrimes, Advisor to the Executive Director December 16, 2020

The UK has long valued the IMF's independent scrutiny, analysis and advice, so we are pleased to be among the first major economies to be discussed at the Board since the resumption of standard Article IV surveillance. A general election and scheduling challenges meant that there was not a UK Article IV in 2019, and efforts to hold one in the first half of 2020 were stymied by the emergence of the pandemic. We are grateful to the staff team for their efforts against a changing and challenging backdrop, and we welcome the report's focused attention on the challenges associated with COVID-19.

The pandemic has caused exceptional hardship for individuals, families and businesses across the UK, as it has across large parts of the world. The health emergency has been accompanied by unprecedented economic uncertainty and the deepest recession on record: UK GDP looks set for its biggest annual fall since the Great Frost of 1709. Output fell an estimated 25 percent between February and April as a result of restrictions needed to limit the spread of the virus. While the economy grew rapidly over the summer, the UK, like many other countries, has seen a resurgence of the virus in recent months, prompting greater restrictions to contain the spread of COVID-19. Although promising developments on vaccines since staff's virtual mission give some grounds for cautious optimism, there remains considerable uncertainty about the outlook. Under the independent Office for Budget Responsibility's (OBR) central scenario, published in late November, in which restrictive public health measures need to be kept in place until the spring, the economy is not expected to return to its pre-virus level of activity until late 2022.

The authorities have collectively taken extensive and unprecedented action to tackle the virus and mitigate impacts across all areas of the UK. Fund staff note that the economic policy response "– one of the best examples of coordinated action globally – has helped mitigate the damage, holding down unemployment and insolvencies." Significant interventions by the Bank of England and other central banks helped to address liquidity strains and calmed markets early in the crisis. Since March, government action has included helping to pay the wages of people in 9.6 million jobs which might otherwise have been lost, supporting the livelihoods of an additional 2.6 million self-employed workers, and making additional welfare support available. UK businesses have received significant support from the authorities in loans, tax deferrals, business rate reliefs, and general and sector-specific grants, with a focus on small businesses in some of the hardest-hit sectors. The Bank of England has loosened monetary policy, cutting interest rates and resuming its asset purchase program, and views the current stance as accommodative. Action taken by the authorities since the financial crisis has substantially strengthened the resilience of the financial system, and meant that UK banks entered the pandemic well-capitalized (as illustrated by the desktop stress test published in the Bank of England's Interim Financial Stability Report in May). This has enabled them to absorb the COVID-19 shock and continue lending, supported by the release of the counter cyclical capital buffer.

In late November, the government delivered a one-year spending review, prioritizing funding to support the response to COVID-19, support jobs and invest in the UK's recovery. While most aspects of the spending review set out single-year plans for 2021-22, multi-year settlements for health and schools provide additional certainty. Key infrastructure plans also provided £100bn of capital investment next year, a £27bn real-terms increase on FY19-20. This is a significant step towards achieving the government's objective of over £600bn of gross public investment over the next five years, reaching the highest sustained levels of public sector net investment as a proportion of GDP since the late 1970s. Priority welfare outcomes for the spending review included: maximizing employment across the country; improving opportunities for all through work; addressing poverty through enabling progression in the workforce and increasing financial resilience; and delivering a reliable, high quality welfare and pensions system. To help support the labor market, a new three-year Restart program will provide intensive and tailored support to help over one million unemployed people find work, alongside additional funding for work search support measures, and the Kickstart Scheme to create hundreds of thousands of new, fully-subsidized jobs for young people at risk of long-term unemployment across the country. Staff's international comparisons give a partial picture of the UK's welfare provisions, because of the nature of Universal Credit as a single payment covering working age welfare; the UK actually spends more on family benefits as a share of GDP than all but one OECD member, and is in the top quintile for social spending.

The long-term effects of COVID-19 on the economy remain unknown. Staff's estimate for economic scarring is somewhat larger than those of the OBR or the Bank of England, but all of these assessments are characterized by high uncertainty. Our authorities welcome the finding that the UK retains policy space to respond. The exact nature and scale of the challenges to come will depend on many factors, including the path of the virus and the effectiveness of vaccines and their rollout.

Looking forward, which tools the authorities choose to deploy, beyond measures announced to date, will be driven by careful consideration of developments and evidence. From the Bank of England's perspective, the Monetary Policy Committee (MPC) has already noted that if the outlook for inflation weakens, it stands ready to take whatever additional action is necessary to achieve its remit, and that it does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably. Importantly, the reverse stress test exercise considered by the Financial Policy Committee (FPC) ahead of its August report demonstrated UK banks to be resilient to a very wide range of possible outcomes, and the FPC continues to judge that banks have the capacity to continue to support businesses and households through this period.

Meanwhile, the government has pledged to continue to show flexibility and creativity in its response, building on the Chancellor's pledge to do "whatever it takes to support the UK economy through the crisis". Like staff, our authorities believe that announced increases in borrowing and debt over the near term to fund important spending are both necessary and affordable. The government also recognizes its responsibility to ensure that the next generation will inherit a strong economy backed by sustainable public finances. The extent of the government's economic package of support was made possible by work to rebuild the strength of the public finances following the Global Financial Crisis and the UK's strong institutional frameworks. Therefore, over time, and once the economic recovery is secured, the government will take the necessary steps to ensure the public finances are on a sustainable path.

The UK will continue to be a dynamic and outward-looking trading nation. Trade is at the heart of the UK's foreign policy. In under two years, the UK government has signed or agreed in principle free trade agreements with 56 countries (as of 10 December), including Canada, Japan, Singapore and Switzerland. Our authorities intend to step up international engagement, including as an independent member of the World Trade Organization, to strengthen the rules-based global trading system.

The UK left the European Union on 31 January 2020, and regardless of the outcome of negotiations, it will be leaving the Single Market and the Customs Union at the end of the transition period. Whatever the outcome of negotiations, this will bring both changes and opportunities. The UK authorities continue to put in place the measures needed to prepare for these, and to encourage businesses and citizens to prepare. Financial sector preparations have progressed well. The FPC judges that most risks to UK financial stability that could arise from disruption to the provision of cross-border financial services at the end of the transition period have been mitigated. This reflects extensive preparations made by authorities and the private sector over a number of years. However, financial stability is not the same as market stability or the avoidance of any disruption to financial services. Some market volatility and disruption to financial services, particularly to EU-based clients, could arise. Irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibilities, the FPC will remain committed to the implementation of robust prudential standards in the UK. The government has also provided certainty about the actions that businesses and individuals need to take in preparation for a successful end to the transition period.

As staff note, any new equivalence decisions should aim to be as stable as possible. The UK believes that having comprehensive, appropriate and reasonable framework for regulatory cooperation will help to provide stability to our equivalence decisions. The UK believes in adopting a proportionate approach when it comes to the withdrawal of equivalence. This includes appropriate adaptation periods to allow jurisdictions and firms time to prepare for the changing circumstances. The length and nature of any adaptation period will depend on the circumstances of withdrawal, such as the type of equivalence decision involved.

The government is pressing ahead with investing in the economic recovery, including by providing £100bn of capital spending next year, to rebuild for a stronger, greener, more equal future. Even before COVID-19, the government had begun to scale up infrastructure investment plans. A new National Infrastructure Strategy is centered around three main objectives: economic recovery; levelling up and unleashing the potential of all parts of the UK; and meeting the net zero emissions target by 2050. The government is looking to further improve the efficiency and effectiveness of infrastructure project delivery and has published a refreshed Green Book to ensure that project appraisals properly analyze how proposals deliver the government's key priorities, including levelling up, and how they will impact different parts of the country.

The UK continues to lead on tackling climate change and environmental issues, with policy ambition backed up by evidence-based reviews and legislative targets. The UK has a well-established system of carbon budgets, stepping up commitments over time. Earlier this year, the UK became the first major economy to legislate to end its contribution to global warming by 2050. The Treasury is undertaking a "Net Zero Review" to assess how the UK can maximize economic growth opportunities from its transformation to a green economy, cutting emissions without seeing them exported elsewhere, and ensuring a fair balance of contributions from all those that will benefit, including considering how to reduce costs for low income households. We welcome a new IMF working paper which offers useful insights and considerations on how the UK can meet its net zero commitments. To help accelerate progress, the Prime Minister this month announced a new target for the UK to reduce its greenhouse gas emissions by at least 68% by 2030, relative to 1990 levels. This sits alongside his ten point plan to create and support up to 250,000 British jobs through a green industrial revolution. UK financial authorities continue to set a strong example in promoting the assessment of climate-related risks to the financial sector. TCFD-aligned disclosures will be mandatory across the economy by 2025, and the Bank of England published its own disclosure for the first time earlier this year. The UK will implement a Green Taxonomy, and will also issue its first Sovereign Green Bond in 2021, subject to market conditions, following up with a series of further issuances to build a 'green curve'. Separately, a government-commissioned independent global review on the economics of biodiversity, led by Professor Sir Partha Dasgupta, aims to build a unified and comprehensive economic framework for thinking about and approaching economics and economic decision-making in a way that fully accounts for our natural assets, and the goods and services we derive from them.

The Fund has publicly recognized the UK's leadership in responding to COVID-19, and our authorities intend to continue to proactively and constructively address shared global challenges. The UK is the largest donor to the COVAX Advance Market Commitment, which aims to support developing country access to COVID-19 vaccines. It has strengthened core funding to the WHO over the next four years, with a 30 percent increase to existing funding. It remains the largest donor to Gavi, the Vaccine Alliance, helping to ensure that the pandemic does not undermine global efforts to protect against preventable diseases. And it continues to work through the Fund, the World Bank Group and other high-value international institutions to promote shared prosperity, including through large and timely replenishments to the Fund's CCRT and PRGT loan resources.