INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/203

UNITED KINGDOM

July 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR 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 2024 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 July 1, 2024 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 July 1, 2024, following discussions that ended on May 21, 2024, 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 June 14, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the United Kingdom.

The documents listed below have been or will be separately released.

Selected Issues

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 2024 Article IV Consultation with the United Kingdom

FOR IMMEDIATE RELEASE

Washington, DC – July 1, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the United Kingdom.

The economy is approaching a soft landing, with growth recovering faster than expected after a mild technical recession in 2023. Inflation has fallen rapidly to near-target from last year's double-digit levels, due to the reversal of the energy price shock and the demand impact of tight monetary policy. Growth is projected at a modest 0.7 percent in 2024, strengthening to 1.5 percent in 2025, as disinflation buoys real incomes, monetary policy starts easing, and financial conditions become more accommodative. Fiscal policy has remained tight, continuing to target medium-term debt stabilization, although the last two budgets did include tax cuts aimed at boosting investment and labor supply. Inflation is forecast to temporarily rise from around 2 percent presently to 2.5 percent by end-2024, due to regulated energy price base effects, before returning durably to 2 percent in early 2025.

Longer-term growth prospects remain subdued, due to weak labor productivity growth, population aging and somewhat higher than expected inactivity levels due to long term illness, only partly offset by higher migration numbers. Elevated pressures on public services, notably in health, amidst ongoing industrial action over pay, imply additional headwinds. A number of well-conceived measures to boost weak productivity have also been implemented, but these will not be sufficient to lift productivity to close to pre-GFC levels. Post-Brexit uncertainty has continued to ease, in the context of progress on Irish border arrangements, a careful review of retained EU laws, and resilience in UK services exports. However, UK firms trading with the EU are still adapting to the post-Brexit arrangement.

Risks to growth and inflation are balanced. In the short term, growth could be lower if the anticipated pick-up in consumption from current weak levels does not materialize, or higher in the event of stronger-than-expected second round effects from falling energy prices (this also represents a downside risk to inflation). Alternatively, stronger wage pressures could lend greater persistence to services inflation, with possible repercussions for growth as monetary policy adjusts. The key downside risk to medium-term growth is that productivity and labor supply disappoint relative to expectations. But bold implementation of ambitious structural reforms and AI adoption similarly present an upside risk to growth.

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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.

Executive Board Assessment[2]

Executive Directors recognized that the economy is approaching a soft landing, with growth recovering after a mild technical recession last year and set to accelerate further in 2025, as disinflation boosts real incomes and financial conditions ease. Directors welcomed the rapid decline in inflation since last summer due to easing energy and goods prices, although noted that wage growth and services inflation pressures remain elevated. They agreed that risks to the outlook are balanced.

Directors agreed that with the monetary policy stance reaching a turning point, the risks of premature versus delayed easing should be appropriately balanced. They welcomed the Monetary Policy Committee's meeting-by-meeting approach to adjusting rates, which remains appropriate given prevailing uncertainty. Pointing to the importance of communication of monetary policy decisions, particularly in a context of divergence from the path of US interest rates, Directors noted that a press conference after each rate decision could be beneficial. They concurred with the importance of articulating a clear rationale for future Quantitative Tightening (QT) plans, as the BoE's balance sheet approaches its steady-state size. A few Directors supported the high-level principles proposed by staff for BoE capital policies in future rounds of Quantitative Easing/QT. Directors also welcomed the BoE's commitment to act on the recommendations of the Bernanke Review.

Directors agreed that the main medium-term challenge for fiscal policy will be to better account for public spending needs, while assuredly stabilizing public debt. They observed that, absent a substantial boost to potential growth, stabilizing public debt will require difficult tax and spending choices. Directors recognized that possible revenue-raising measures include stronger carbon taxation and road-usage taxation, broadening the base of VAT and inheritance tax, while reforming capital gains and property taxation. On the spending side, Directors saw scope for savings from reforms to the state pension and noted that any expansion or increase in user charging for public services should effectively protect the vulnerable. They encouraged the authorities to strengthen the United Kingdom's fiscal framework.

Directors emphasized that more ambitious structural reforms to boost potential growth are needed. They supported staff's recommendation on the adoption of a stable, long-term growth strategy, backed by an independent growth commission. Directors agreed that particular focus is needed on easing planning restrictions, upskilling the workforce, and improving health outcomes, in order to boost weak productivity growth. They also encouraged the authorities to continue their cautious approach to industrial policy and constructive participation in the WTO. Directors welcomed the United Kingdom's ongoing progress in reducing carbon emissions and urged the authorities to stay the course on climate policy. They recognized the need for adequate public investment to support the green transition, while

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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 summing up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

recommending stronger feebates to hasten the transition to heat pumps and electric vehicles, as well as a strengthening of emissions trading to support the carbon price.

Directors noted the continued resilience of the financial sector. While agreeing that financial stability risks appear well contained at this time, Directors noted that careful monitoring is warranted, with ongoing strong supervision of banks and NBFIs. Directors welcomed the important initiatives undertaken by the BoE to mitigate risks from NBFIs, including the system-wide exploratory scenario exercise and the design of a backstop lending tool, while encouraging continued progress in closing data gaps. Directors welcomed the preservation thus far in the Edinburgh reforms of the primacy of financial stability objectives but urged continued vigilance. Enhancing the effectiveness of the AML/CFT supervisory regime remains important.

United Kingdom: Selected Economic Indicators

Population (million): 68.1
Key export markets:Euro area (36%); US(21%)

Per capita GDP (US$): 49,049

	2023	2024	2025	2026
	Est.	Projections		
Output				
Real GDP growth (%)	0.1	0.7	1.5	1.7
Unemployment				
Unemployment (%)	4.0	4.2	4.1	4.0
Prices				
Inflation, annual average (%)	7.3	2.7	2.1	2.0
Inflation, end-of-period (%)	4.0	2.5	2.0	2.0
Public sector finances (fiscal year)				
Revenue (% GDP)	40.6	40.3	40.3	40.5
Expenditure (% GDP)	44.8	43.7	43.5	43.4
Public sector overall balance (% GDP)	-4.2	-3.4	-3.2	-2.9
Public sector cyclically adjusted primary balance (staff estimates)	-1.0	-0.7	-0.1	0.1
Public sector net debt (excl. BoE) 2/	89.2	91.6	93.1	94.5
Money and Credit				
Broad money (% change)	-0.9	...	...	...
Credit to the private sector (% change)	0.2	...	...	...
3-month interbank rate (%)	5.0	...	...	...
Balance of Payments				
Current account balance (% GDP)	-3.3	-3.2	-3.5	-3.3
Net FDI (% GDP)	2.7	0.2	0.2	0.2
Reserves (end-of-period, billions of US dollars)	190.5	...	...	...
Net international investment position (% GDP)	-30.7	...	...	...
Exchange Rates				
REER (% change) 1/	2.5	...	...	...

Sources: Bank of England; HM Treasury; IFS; INS; ONS; and IMF staff estimates.

1/ Based on relative consumer prices. An increase denotes an appreciation.

2/ Public sector net debt is defined as public sector gross debt minus liquid assets held by general government and non-financial public corporations. It excludes Bank of England operations. The fiscal year begins in April.

INTERNATIONAL MONETARY FUND

UNITED KINGDOM

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

June 14, 2024

KEY ISSUES

Context and Outlook. The UK economy is approaching a soft landing, following a mild technical recession in 2023. A modest recovery is projected, with 0.7 percent growth in 2024, strengthening to 1.5 percent in 2025. Inflation has fallen rapidly from double digit levels last year in the context of easing energy prices and tight policies. Assuming wage and services inflation continue to moderate from their current elevated levels, inflation should return durably to target in the first half of 2025. The medium-term outlook is affected by significant public spending pressures, notably in healthcare, and the downshift in labor productivity growth post-GFC, exacerbated by recent adverse shocks (Brexit, COVID, energy price surge). Risks to the outlook are balanced. A general election is scheduled on July 4.

Policy Recommendations. The overarching policy objective is to maintain price and financial stability, durably lift per capita growth, and address pressing public spending needs while credibly stabilizing debt.

- As **monetary policy** reaches an inflection point, the timing and pace of rate cuts must carefully balance the risks of premature and delayed easing. In this context, the Quantitative Tightening strategy may need further recalibration as reserves approach the BoE's steady-state balance sheet size. Moreover, possible divergence from the US Fed's rate path will place a premium on effective Monetary Policy Committee communication with markets.

- The main **fiscal policy** challenge is how to address pressing service delivery and investment needs, including for the green transition, while assuredly stabilizing debt in the medium-term. Staff's analysis suggests that, absent a major boost to potential growth, significant additional fiscal effort and, accordingly, difficult tax and spending choices, will be required. There is also a scope to strengthen the fiscal framework by making the fiscal rules more robust, moving to a single fiscal event per year, and introducing a rolling 4–5-year expenditure framework, updated every two years.

- To durably lift **potential growth** and living standards, staff recommends: (i) *easing planning restrictions* to make the current highly localized and discretionary system of decision-making more streamlined and predictable, reducing construction delays and costs, and enhancing labor mobility; (ii) *upskilling the workforce* to address skill gaps, particularly in future growth areas such as digital and software, manufacturing, medicine and life sciences, teaching, and construction; and (iii) improving health outcomes in the face of elevated service delivery pressures, through capital and workforce investment in the National Health Service, as well as efficient resource allocation, to ensure inactivity and long term sickness do not scar labor supply. Staff also emphasizes the importance of a clear and stable long-term growth strategy, backed by an independent growth commission.

- Continued vigilance of **financial stability** risks, notably from the non-bank financial institutions (NBFIs) is warranted. Macroprudential settings are appropriate but continued close monitoring of credit conditions and financial stability risks, including stringent stress tests, is merited in future calibrations. In this context, the BoE's initiatives in the NBFI space—a system-wide stress test including banks and non-banks, and a backstop lending tool for NBFIs—are welcome.

- Finally, staff supports a redoubling of policy efforts to credibly achieve the UK **green transition** targets and maintaining a cautious approach toward industrial policy interventions.

Approved By
Helge Berger (EUR) and Daria Zakharova (SPR)

The mission took place in London during May 7–21, 2024. The staff team comprised S. A. Abbas (head), A. Carella, R. Chen, P. Deb, A. Hodge (all EUR), and E. Kemp (MCM). The mission met Chancellor Hunt, BoE Governor Bailey, FCA Chief Executive Rathi, senior HMT and BoE officials, analysts and think tanks, trade union representatives, and business groups. A wrap-up meeting involving the Managing Director, Chancellor Hunt, and Governor Bailey took place on May 21, followed by a press conference. M. Evio, G. Li (both EUR), K. Chuah (STA), R. Lama, R. Meeks, P. Zabczyk (all MCM), Y. Deng, and L. Malcherek (both LEG) supported the mission. UK Executive Director Ms. Poon and Mr. Obeney (OED) participated in the discussions.

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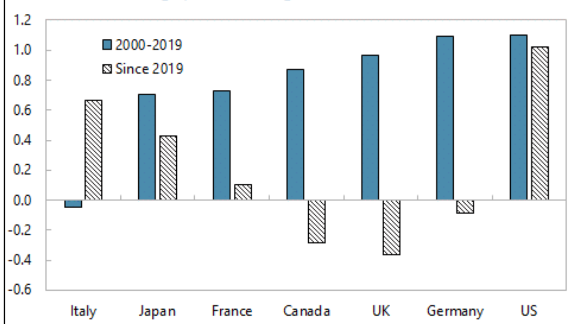
TABLES

ANNEXES

BACKDROP

1. **Weak labor productivity, headwinds to labor supply, and pressures on public services paint a challenging landscape for living standards.** Per capita real GDP growth in the UK was above the median for the G7 before the pandemic but has clearly underperformed since then. The policy response to this has included some desirable measures, notably permanent tax incentives for investment and reforms to boost labor supply, but more ambitious reforms to address key bottlenecks to growth—such as planning restrictions and skills shortages, have eluded. Attitudes toward immigration, which was the main source of growth post-GFC and could attenuate skills gaps, are hardening. Meanwhile, there are mounting pressures on public services, notably health and social care, following a period of low public investment, and given an uptick in long-term illness, elevated levels of disability, and population aging.



Source: IMF WEO.

2. **The UK is still adjusting to the post-Brexit environment**. A careful review of retained European Union (EU) laws is underway. There has been progress on Irish border arrangements, under the Windsor Framework, after the Northern Ireland Assembly was reconvened in February after two years of stalemate. The feared mass relocation of financial services activity from London to the EU has not yet materialized, with the recent EU decision on clearing rules[1] (which will alleviate uncertainty around recognition of UK central counterparties) and the Berne Financial Services Agreement with Switzerland providing further reassurance. At the same time, UK firms exporting to the EU are facing challenges in adapting to new EU rules applying to non-EU countries, while importing firms face additional fees that may lead to higher food prices.[2] Without access to price-responsive EU workers, the UK labor market is less flexible, with non-EU immigration only partially compensating. Moreover, while the share of EU trade has returned to levels before January 2021 (when the EU-UK Trade and Cooperation Agreement took effect), aggregate trade volumes have barely risen from 2019 levels (with weaker goods trade and stronger services trade, mainly with the US, largely offsetting each other). The UK has now ratified its accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) moving it closer to entering into force, however major bilateral trade agreements (e.g., with India and the US) are not yet in sight.

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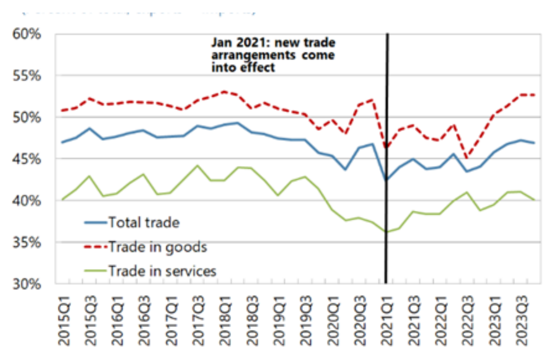
[1] The decision allows most EU trading entities to have clearing done outside of the EU once they have "active accounts" at EU-based clearing houses and, for large EU traders, to also clear a small number of their trades inside the EU.

[2] New border controls on imports of animal and plant products from the EU, which had been postponed since 2021, are now kicking in and have led to complaints by importers about additional charges (phased implementation of inspections and declarations started in January 2024, with full implementation expected from October 2024).

3. On May 22, one day after the Article IV mission conclusion, it was announced that UK general elections would take place on July 4.

Share of EU Trade

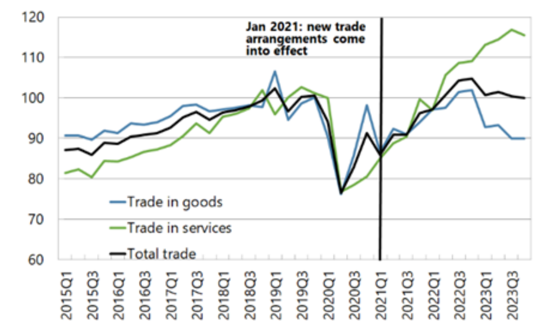
(Percent of total, exports+imports)



Sources: Haver Analytics, ONS, and IMF staff calculations.

Trade Volume

(2019 averages=100, exports+imports)



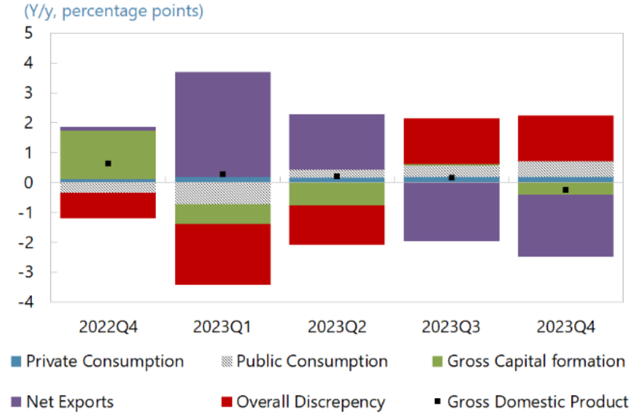
Sources: Haver Analytics, ONS, and IMF staff calculations.

RECENT ECONOMIC DEVELOPMENTS

4. The economy is approaching a soft landing, with growth recovering faster than expected following a mild technical recession in 2023. Growth was 0.6 percent q/q in 2024Q1, marking a stronger-than-expected exit from the technical recession in the second half of 2023, which left full-year growth at 0.1 percent (0.4 ppt. below January WEO). The slowdown in 2023 was driven by weakness in household consumption as higher interest rates and cost of living pressures took their toll, partially offset by somewhat stronger government spending and business investment. High-frequency indicators (PMIs, consumer and business confidence, retail sales, housing market etc.) have been pointing to a recovery and suggest that private consumption should pick up in the coming quarters, allowing the economy to durably return to a growth path.

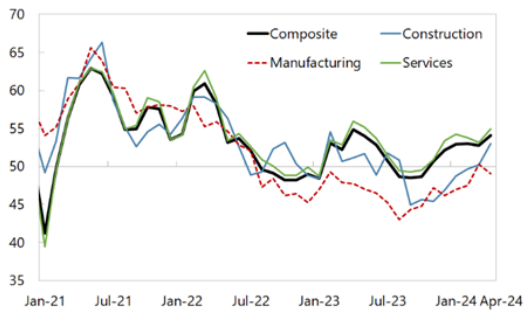
Contributions to GDP Growth

(Y/y, percentage points)



Sources: ONS; and IMF Staff Calculations.

PMI by Sector
(SA, 50+=expansion)



Sources: CPS/IHSM and Haver Analytics.

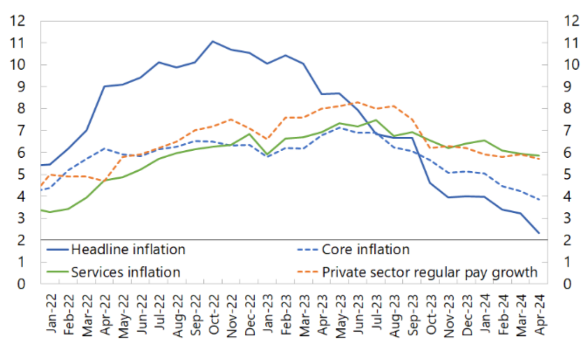
Consumer and Business Confidence
(Percent balance)

Sources: Haver Analytics.

5. Disinflation has advanced faster than expected, though wage and services inflation pressures remain elevated. Headline and core inflation stood at 2.3 percent and 3.9 percent y/y, respectively, in April, after falling rapidly due to stronger energy and imported goods price deflation, and weaker demand from restrictive monetary policy. This said, wage growth and services inflation remain elevated at 5.7 and 5.9 percent (April y/y) respectively, and momentum in both has edged up recently to above 5 percent, but the May DMP survey suggests a meaningful slowing in expected pay growth to 4.1 percent (from 4.6 percent in April). Meanwhile, the vacancy-to-unemployment ratio (a measure of labor market tightness) fell from a peak of 1.4 in 2022 to 0.6 percent in December 2023 and has broadly stabilized at that level. This is still above the 2012–2019 average of 0.4, possibly reflecting the impact of Brexit on labor market flexibility. Rent inflation, at 9 percent in April, remains quite elevated, reflecting a range of factors, including the impact of high interest rates (reduced demand for home purchase; landlords passing higher mortgage costs to tenants; and constrained supply of rental properties).

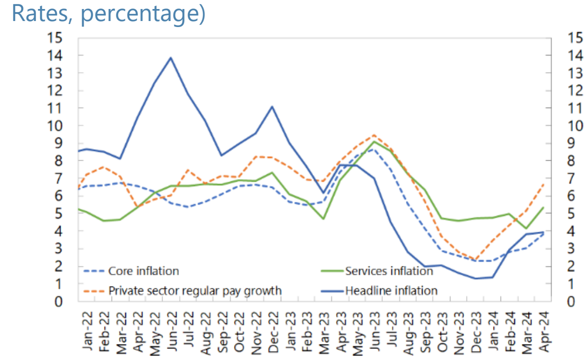
Figure 1. United Kingdom: Price and Labor Market Developments

Inflation and Pay Growth
(Seasonally adjusted, yoy, percentage)



Sources: ONS and IMF staff calculations.

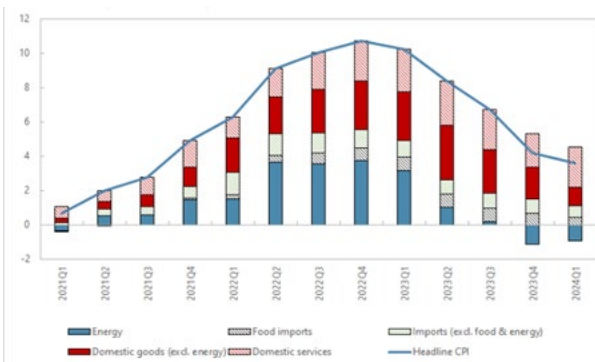
Inflation and Pay Growth Momentum 3m/3m
(Seasonally adjusted, annualized 3m/3m CPI inflation Rates, percentage)



Sources: ONS and IMF staff calculations.

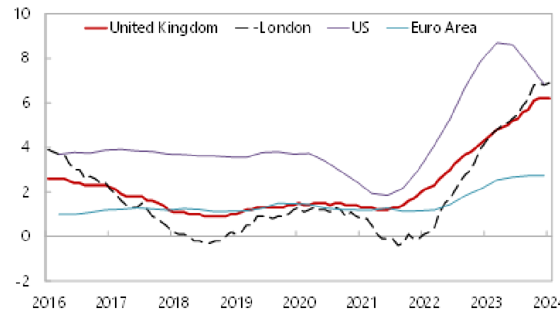
Figure 1. United Kingdom: Price and Labor Market Developments (Concluded)

Headline CPI and its Components
(Year-on-year, percentage points)



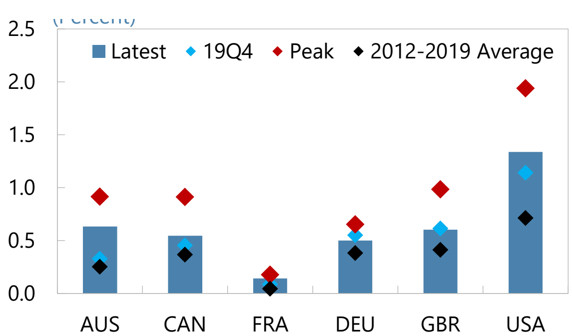
Source: ONS and IMF staff calculations

Private Rental Price
(Percentage change over 12 months)



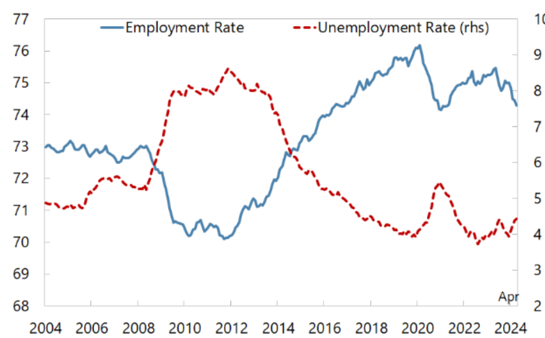
Sources: ONS Index of Private Housing Rental Prices; OCED; and IMF staff calculations.

Vacancy to Unemployment Ratios
(Percent)



Source: Haver Analytics; and IMF staff calculations.

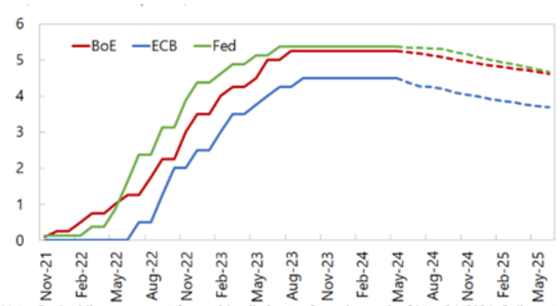
Employment and Unemployment Rates
(Y-o-y, 3-month average, percentage, aged 16-64)



Source: ONS; and Haver Analytics.

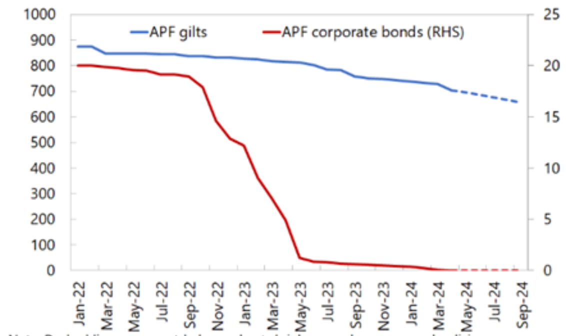
6. **Bank Rate has been left unchanged at the last six Monetary Policy Committee (MPC) meetings and the MPC shifted to a neutral forward guidance in February.** As inflation began to fall sharply, the BoE paused rate hikes in September, leaving the rate at 5¼ percent. The BoE also moved toward neutral forward guidance ("we will adjust rates as economic data warrants") in February. In its most recent meetings in March and May, no MPC member voted for a rate hike, signaling a move toward rate cuts. Market pricing (as of late May) suggests a first 25 bps rate cut in November, and a total of 40 bps cuts in 2024. Meanwhile, the BoE has broadly maintained its current pace of quantitative tightening (QT) at about £100 billion a year (once account is taken of the offloading of the BoE's corporate bond holdings) for the 12 months starting October 1, 2023. In December, the BoE decided to adjust the QT auction sizes such that there would be a more balanced amount of short-, medium-, and long-term gilts supplied in initial proceeds terms.

Forward Implied Policy Rates
(Percent, end-of-period)



Note: Dashed lines represent forward-implied rates from the week of May 24, 2024. Policy rate refers to the Bank Rate for the BoE, the Main Refinancing Rate for the ECB and the Federal Funds Target Rate for the Federal Reserve.
Sources: Bank of England, Bloomberg Finance L.P., and Haver Analytics.

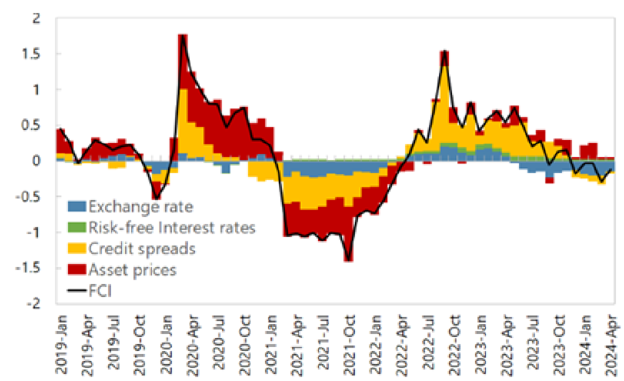
Balance Sheet Path Under Announced QT Policies
(Billion £, end of period)



Note: Dashed lines represent balance sheet shrinkage under announced policies.
Sources: Bank of England and Haver Analytics.

7. **Financial conditions have eased since May 2023.** This primarily reflects the effective appreciation of the exchange rate, an easing in credit spreads on high-yield and investment-grade corporate bonds and, to a lesser extent, a recovery in equity and house prices. Private credit has grown in nominal terms, mostly driven by non-bank lending to corporates (for example, through private equity and credit markets), but credit to GDP has continued to decline and the credit gap has remained negative.[3] However, the recent bank lending survey points to a recovery in credit supply. Staff views these credit developments as broadly consistent with the evolution of the monetary stance as well as of credit demand in the aftermath of successive adverse economic shocks. Although rate hikes have paused, the full impact of the monetary tightening still lies ahead; in particular, the transmission through mortgages has been slower than in previous cycles due to a higher share of fixed-rate mortgages (see the SIP on monetary policy issues). While the BoE projects that the aggregate mortgage debt service ratio and the share of households with high debt service ratios (after adjusting for cost of living) would continue to increase throughout 2024, the levels are expected to remain well below the GFC peak and have improved compared with their previous estimates in 2023.[4]

Financial Conditions Index
(Higher index value -> tighter financial conditions)

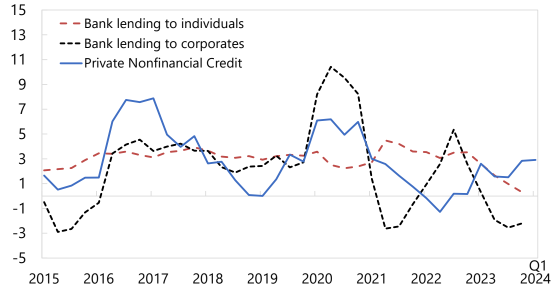


Sources: Bank of England, Bloomberg, IMF staff calculations

[3] The still large negative credit gap may be because the sample period includes the buoyant credit growth of the early 2000s.
[4] See "Financial Policy Summary and Record - March 2024". In addition, mortgage arrears reached a 7-year high in 2023Q4 (more than half were originated before 2008) but remain well below the GFC peak.

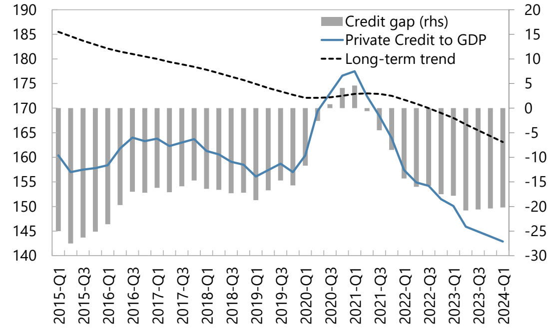
Figure 2. United Kingdom: Credit Developments

Private Credit Growth
(Percent, y-o-y growth)



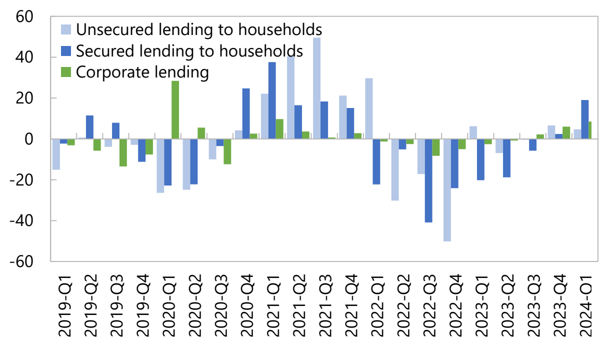
Note: Bank lending to individuals do not include student loans and credit card loans.
Sources: BoE; and BIS.

Private Credit Gap
(Percent of GDP, EOP)



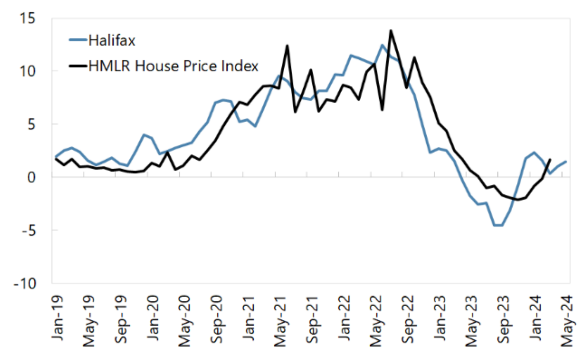
Source: BIS.

Credit Availability
(Net percentage balances)



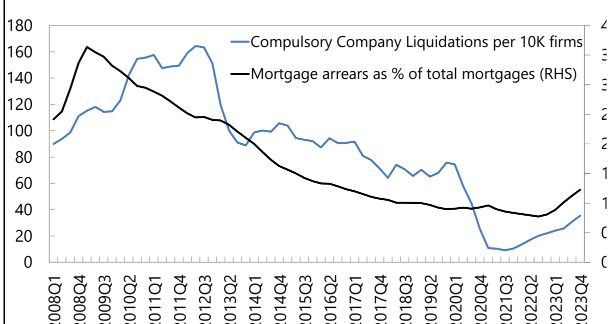
Source: BoE Credit Conditions Survey.
Note: A positive balance indicates that more credit is expected in the next three months.

Nominal House Price Index
(Y-o-y growth rates)



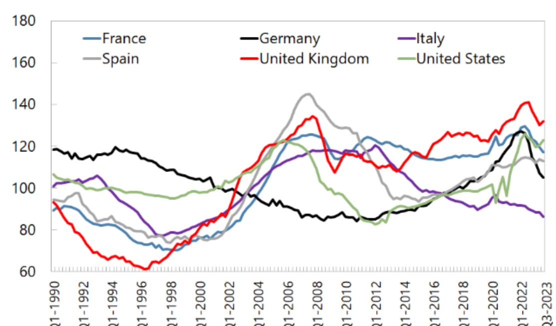
Source: Haver Analytics.

Mortgage Arrears and Company Liquidations
(Mortgage: percent; company liquidations: England & Wales, Number per 10000 companies)



Source: Mortgage lending statistics (FCA); and The Insolvency Service.
Note: Arrears are defined as instances when any contractual payments, of capital, interest fees or other charges, are overdue at the reporting date.

House-Price-to-Income Ratio Relative to Long-Run Average

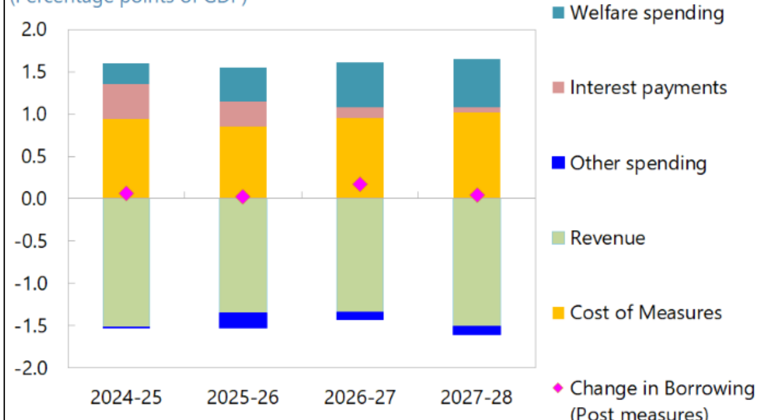


Source: OECD and IMF calculations.
The long-run average is calculated over the period 1990Q1-2019Q4.

8. The real estate market has been broadly resilient in the face of high interest rates thus far. Concerns about a major residential house price correction in the context of tight monetary policy and weak demand have not materialized. Indicators such as the house price-to-income ratio remain above their long-term average and relative to peer countries. Notwithstanding the attendant affordability concerns, a major downward correction looks unlikely at this time, given limited supply and prevailing market expectations of rising house prices in all regions (house price growth has turned positive since December).[5] Moreover, net mortgage approvals are rising from low levels as rates have eased from summer highs. Separately, the commercial real estate (CRE) sector, which already experienced significant price adjustment in 2022 (falling by over 13 percent), appears to have bottomed out in 2023 and is showing signs of recovery in 2024Q1.[6] The direct exposure of UK banks and non-bank financial institutions (NBFIs) to the CRE sector remains relatively limited (see Annex VIII, 2023 Article IV Consultation Staff Report).

9. Fiscal policy remains restrictive, with modest windfalls used mainly for tax cuts over the past year. In the 2023 Autumn Statement, the Office for Budget Responsibility's (OBR's) medium-term revenue/GDP ratio was upgraded by 2 ppts. on account of higher inflation-induced fiscal drag (in the context of income tax thresholds being frozen till FY 2028/29). After accounting for higher interest payments and increases in indexed welfare spending, this windfall was spent on making permanent the full expensing of plant and machinery investment (in line with staff advice) and a 2 ppts. cut to the main rate of National Insurance Contributions (NICs). In the 2024 Spring Budget, the revenue yield from a set of well-conceived revenue raising measures (including reform of the 'non-dom' regime) was more than fully offset by a further 2 ppts. cut to the main NIC rate. The overall fiscal stance in 2024 and 2025 nonetheless remains restrictive, including due to tight spending limits through FY2024/25.

Public Sector Net Borrowing Impact of Nov. '23 & Mar. '24 Budgets
(Percentage points of GDP)



Source: Office for Budget Responsibility.

10. The external position has deteriorated slightly in the context of a worse income balance, and an appreciation of the exchange rate. The current account deficit widened marginally from 3.1 percent of GDP in 2022 to 3.3 percent in 2023. This masked a sizable 1.6 ppts. of

[5] According to the March 24 UK Residential Market Survey, respondents anticipate house prices will return to growth over the next twelve months. All regions of the UK are expected to experience rising house prices, with particularly strong sentiment in Northern Ireland, London, and Scotland.

[6] Tenant demand increased by 4 percent in 2024Q1, up from negative 7 percent at end-2023.

GDP worsening in the income balance (due to higher net interest payments), which was largely offset by a 1.4 ppts. of GDP improvement in the trade balance (mainly due to lower energy prices). Meanwhile, the exchange rate appreciated by about 2½ percent in real effective terms in 2023, as markets expected the policy rate to stay higher for longer in the UK than in other major jurisdictions. Preliminary estimates suggest that the external position in 2023 was weaker than the level implied by medium-term fundamentals and desirable policies (ESR Annex I).[7] Separately, while gross external debt remains high, low net debt and exchange rate flexibility are major risk mitigants (External DSA Annex II).

11. ***Authorities' Views.*** The authorities reiterated that their own models tend to have smaller current account and exchange rate gaps and emphasized the significant role of the UK's recent terms of trade shock as a factor. They also pointed out uncertainties associated with the balance of payments data due to the pause in FDI statistics. That said, the authorities generally agreed with the policy responses on implementing structural reforms to boost UK international competitiveness.

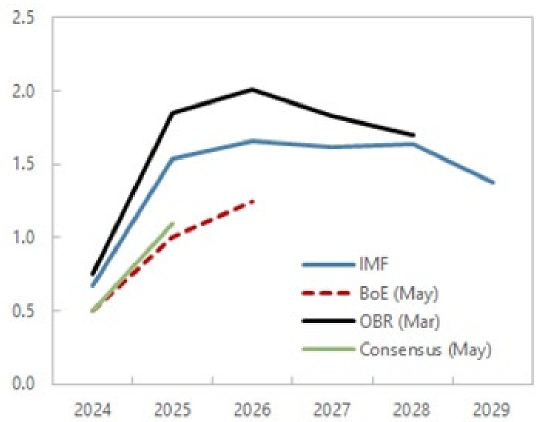
OUTLOOK AND RISKS

12. Growth is projected to recover on the back of a pickup in domestic demand. Real GDP growth is forecast to accelerate from 0.1 percent in 2023 to 0.7 percent in 2024, before rising further to 1.5 percent in 2025 as disinflation buoys real incomes and financial conditions ease. This represents an upgrade to staff's 2024 growth forecast in the April WEO (0.5 percent), in light of the significant upside surprise in 2024Q1 GDP. The broadly unchanged growth forecast for outer years reflects the fact that the underlying weakness in private consumption that weighed on 2023 growth is still there in the Q1 data.[8] Longer-term growth prospects remain subdued, with staff estimating long-term potential growth at 1.3 percent (see Potential Growth Annex III), reflecting: (i) the uptick in inactivity related to long term illness; (ii) population aging; (iii) a diminishing contribution from migration (as tighter immigration policies take effect); and (iv) a relatively weak recovery in labor productivity growth (staying well below pre-GFC levels), given low total factor productivity (TFP) growth and an extended period of chronic under-investment (partly driven by policy uncertainty, including in the context of Brexit). Although a cyclical recovery is expected over the next few years, labor productivity is not likely to reach the high levels seen in the decades before the GFC without significant and ambitious growth enhancing structural reforms or upside surprises—for example, a bigger-than-expected payoff from AI adoption, although there remains high uncertainty surrounding its impact on productivity.

[7] The final external sector assessment will be presented in the 2024 External Sector Report.

[8] Staff's projections include the growth impact of recent NIC rate cuts, while also accounting for Ricardian effects (expectations of future tax increases in light of significant public spending needs, and the imperative of stabilizing debt). The OBR and BoE both abstract from Ricardian effects, assessing that the NIC rate cut will boost labor supply by around 0.2–0.3 percent by 2029, mostly in the form of existing workers choosing to work longer hours.

Real GDP Growth
(Percent)



CPI Inflation
(Year-on-year, period average)

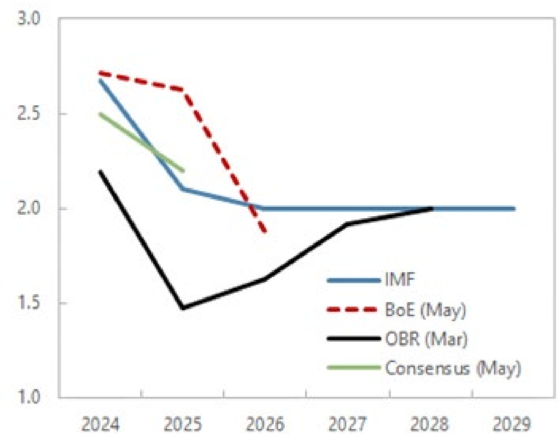


Table 1. United Kingdom: Conditioning Assumptions Underlying Staff's Baseline Forecast

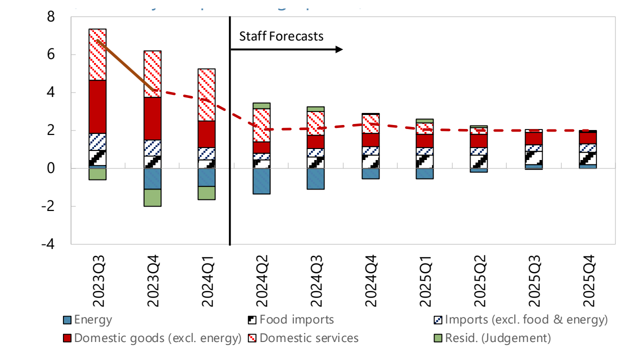
Energy prices	Conditioned on futures-implied paths for natural gas that indicate a decline in electricity prices through 2024 (24 percent annual average decline), followed by stabilization. Retail energy prices are projected to remain below the cap implied by the Energy Price Guarantee (EPG) until the EPG's expiration at end-March 2024. Oil prices are expected to decline moderately in 2024 and beyond.
Monetary policy	Bank Rate to remain at 5¼ percent until 2024Q2 and decline by 50 bps in 2024H2, followed by gradual convergence to the estimated neutral rate of around 3 percent. Financial conditions are projected to ease in line with Bank Rate, facilitating economic recovery.
Macroprudential policy	The countercyclical capital buffer (CCyB) rate to remain at 2 percent throughout the forecast period.
Fiscal policy	The fiscal impulse is assumed to be contractionary in 2024 (around -0.25 percent[1]), and to gradually converge to neutral over the forecast horizon. Revenue is close to the OBR's projections accompanying the Spring 2024 Budget, but with fuel duty uprating excluded. Non-interest expenditure is assumed to be around 1½ ppts. of GDP above the OBR's projection by FY2028/29, to account for some of the critical spending needs (for service delivery and growth-enhancing investments) not in the OBR's projections.

[1] The fiscal impulse is defined as the change in the cyclically adjusted primary balance (in ppts of GDP), multiplied by an impact multiplier of 0.4.

13. Inflation is expected to moderate, with a durable return to target expected in the first half of 2025. Inflation is forecast to fall to around 2 percent in 2024Q2 due to regulated energy price base effects, before rising slightly later in the year to around 2½ percent and falling durably to 2 percent in 2025Q2. This decline assumes that services inflation, currently above historical levels, will moderate sufficiently to offset the abatement of the negative drag to headline from falling energy and import goods prices. Core inflation is projected to decline more slowly than headline, falling to 2 percent levels only in the second half of 2025.

Headline CPI Projections and its Components

(Year-on-year, percentage points)

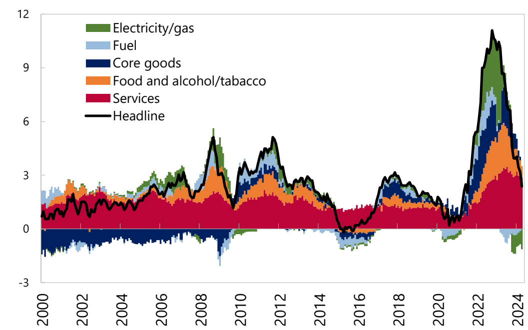


Note: Model estimated using data until 2023Q2. Sources: ONS, IMF staff calculations.

Sources: ONS, IMF staff calculations

Contributions to UK Inflation

(Y-o-y percent change)

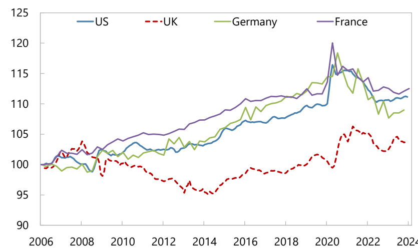


Source: Haver Analytics; and IMF staff calculations.

14. Risks to growth and inflation are balanced. Inflation could be higher or lower depending on the persistence of wage and services inflation, with possible repercussions for growth as monetary policy adjusts.[9] Growth could be lower if the anticipated pick-up in consumption from current weak levels does not materialize, or higher in the event of stronger-than-expected second round effects from falling energy prices (this also represents a downside risk to inflation). Moreover, growth could be lower and inflation higher in the event of deepening geoeconomic fragmentation and/or an intensification of regional conflicts, like in the Middle East. As a global financial center, the UK also continues to have high exposure to cyberthreats, and to global financial stability shocks. The key downside risk to medium-term growth is that investment and total factor productivity do not pick up as forecast, and labor supply disappoints relative to the baseline due to higher inactivity, lower immigration, and/or stronger aging effects. Bold implementation of ambitious structural reforms (see Policies to Boost Growth section) and AI adoption (see Box 3.3 of April 2024 WEO) present upside risks to labor productivity and growth (see RAM Annex V).

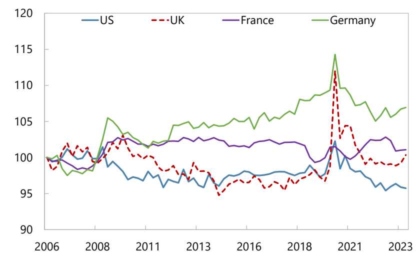
[9] Although real wages are now above their pre-pandemic level, their dismal growth in the post-GFC period (relative to other countries) could be a source of real wage pressure going forward. This said, unit labor costs in the UK have evolved broadly in line with peers since the GFC, implying that real wage growth has merely reflected very weak productivity growth. Moreover, there is a risk that the 10 percent increase National Living Wage in April slows the pace of wage moderation beyond the targeted group.

Real Wage Growth
(Index, 2006Q1=100 (Germany, France) or 2006Mar=100, 3mma (UK, US)



Sources: Haver Analytics, and IMF staff calculations.

Real Unit Labor Cost
(Index, 2006Q1=100)



Sources: Haver Analytics; WEO; and IMF staff calculations.

15. ***Authorities' Views.*** The authorities highlighted that the economy was turning a corner, and noted staff's forecasts, including the size of the upward revision to 2024 growth as a result of the stronger than expected 2024Q1 outturn. They cautioned against reading too much into the demand composition of the first estimates of Q1 GDP expenditure data, noting this often gets revised, and that underlying growth could be stronger. They pointed out that staff's medium-term growth forecasts were in the middle of OBR and BoE projections, but that staff's longer-term potential growth estimate was lower than both OBR and BoE estimates. In this context, Treasury officials were hopeful that productivity could rebound faster, supporting growth, as the effects of recent negative shocks wane. They also noted that recent measures, including the NIC rate cuts and working age benefits reforms, could provide a larger boost to labor supply and growth over the medium term than OBR costings suggested. The authorities' 2024 inflation forecasts are similar to those of staff, with considerable uncertainty in 2024H2 on the magnitude of favorable second round effects from falling energy prices, as well as the broader degree of persistence in wage growth and services CPI inflation. The authorities concurred with staff's assessment of risks but saw healthy household balance sheets and precautionary savings as an upside for consumption in the near term, and greater benefits from AI adoption as an upside for growth over the medium term given the UK's robust technology ecosystem.

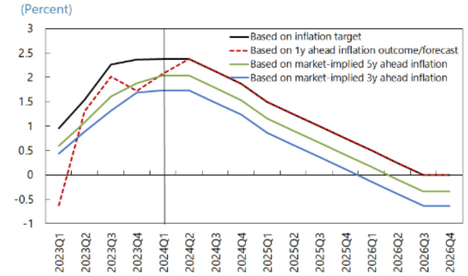
POLICY DISCUSSIONS

The overarching policy objective remains sustainably lifting potential growth and living standards while maintaining price and financial stability and strengthening fiscal buffers. Monetary policy is on track to bring inflation back to target, but some recalibration of the QT strategy and BoE communications may be needed. The main medium-term fiscal challenge will be to stabilize public debt, while managing mounting pressures on public services, which will require difficult choices about the level of taxation and public spending priorities. Bold reforms in the areas of planning, skills, and healthcare to boost labor productivity and ensure adequate labor supply can unlock growth. Macroprudential policy remains appropriate, and continued vigilance of financial stability risks, notably from the non-bank sector, is warranted. Moreover, it is recommended that the UK maintains its open trade orientation, and a cautious approach to industrial policy. Finally, the authorities should redouble policy efforts to credibly achieve their green transition targets, which are at greater risk following the September loosening of some climate policies.

A. Monetary Policy

16. Monetary policy has reached an inflection point. While wage and services inflation remain high at around 6 percent and the upper tails of survey- and market-based inflation expectations still exceed historical averages, wage and price-setting expectations for the next 12 months have eased notably (to 4.1 and 3.8 percent, respectively, in May), and core inflation momentum (3m/3m) has moderated. In this context, staff's baseline foresees headline inflation to already reach 2 percent this quarter; inflation will then rise to around 2½ percent in Q4. The current real shadow rate using staff's 1-year ahead inflation projection (2 percent in 2025Q2) is 325 bps, which, given an estimated real neutral rate of around 100 bps, implies a significantly restrictive monetary stance.[10] Therefore, the next phase of monetary policy is to ease.

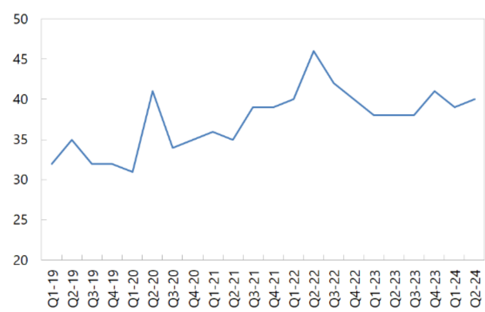
Monetary Stance
(Percent)



Notes: Monetary stance is calculated as the difference between the real interest rate (the Bank Rate plus QT impact and minus different reference rates on inflation) and the real natural rate at 1 percent. The forecast of the Bank Rate is based on the team's baseline conditioning assumption.
Sources: Haver analytics and IMF staff calculations.

Figure 3. United Kingdom: Inflation Expectations and Monetary Stance

Upper Tail of 5-Year Inflation Expectations
(Percent of responses indicating expectations of up 3 percent or more in 5 years)

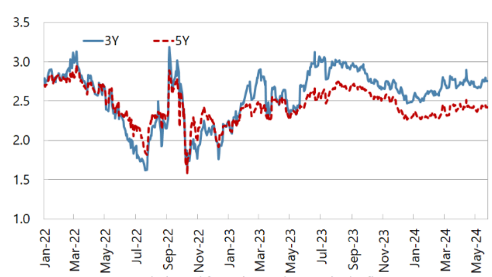


Sources: BoE/Ipsos Inflation Survey; and Haver Analytics.

Firms' Price and Wage-Setting Expectations
(Percentage point over the past year, May 2024)

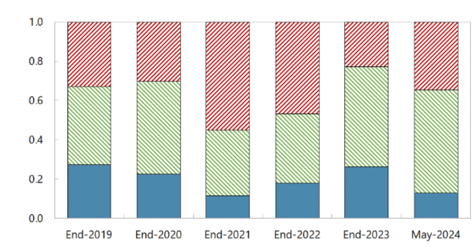
Source: BoE Decision Maker Panel.

Market Implied Inflation Expectation
(Percent)



Note: one percent is deducted from the market-implied inflation expectations to adjust for the wedge between the Retail Price Index (RPI) and CPI-based inflation. Sources: BoE and Haver Analytics.

Market-Implied Probability of Inflation Outcomes
(RPI inflation, y/y percentage over 5 years)



Notes: Probabilities are derived from inflation caps and floors, which reference the Retail Price Index (RPI). RPI inflation has historically exceeded CPI inflation by about 1 percentage points on average.
Source: Bloomberg Finance L.P. and IMF staff calculations.

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[10] The real shadow rate is 245 bps using the 12-month ahead survey-based inflation expectations, which came out at 2.8 percent in May. Based on market-implied inflation expectations, the real shadow rate ranges from 205 bps (using 1-year ahead expectations) to 291 bps (using 5-year ahead expectations).

17. In deciding when and how fast to cut rates, the MPC will need to balance the risks of premature vs. delayed easing. The MPC has highlighted the need to see-through regulated energy price base effects and wait for clearer signs of receding inflation persistence to guard against the risk of premature easing.[11] At the same time, there is a risk of delayed easing. Keeping Bank Rate constant as inflation and inflation expectations fall would raise ex-post real rates, which could stall or even reverse the recovery, and lead to an extended undershooting of the inflation target. Staff sees that 50–75 bps rate cuts in 2024 would appropriately balance these risks.

18. Still, a "meeting by meeting approach" is warranted given significant uncertainties. Since the start of the year the market has lowered its expectations of rate cuts in 2024 (to about 40 bps since late May), in light of the higher-than-expected inflation data both in the US and in the UK. Should inflation deviate notably from the baseline path on the upside or downside, monetary policy will need to be adjusted accordingly. Moreover, model-based policy rate paths (see SIP on monetary policy issues) show, intuitively, that concerns about below-potential growth could justify earlier cuts than the path staff recommended, while concerns about a prolonged period of above target inflation leading to de-anchoring of inflation expectations could call for a more cautious approach.

19. The possible divergence from the US Fed's rate path will place a premium on effective MPC communication with markets. Our empirical work shows that Fed announcements were largely supportive of UK monetary policy transmission during the pre-COVID period, given that market reactions were largely reinforcing (see SIP on monetary policy issues). However, staff also finds that, in the current tightening cycle, market reactions to Fed and MPC decisions sometimes went in opposite directions (as in December 2023). Looking ahead to a period where the BoE could diverge from the Fed (including by cutting rates earlier), there is a risk of spillovers from Fed announcements working against MPC objectives. In this context, staff proposes that the BoE enhance the frequency of its monetary policy communications with markets, including by holding a press conference after each MPC decision, akin to the approach taken by other major central banks.[12] This will enable the BoE to elaborate or caveat MPC views when the market's reaction to Fed decisions is inconsistent with the direction the MPC's policy decision would lead the market toward.

20. The MPC's QT strategy has been implemented well thus far but may need recalibration going forward. According to the current pace of QT (£100 billion gilt reduction per 12 months) and the expected maturities of the Term Funding Scheme with additional incentives for SMEs (TFSME), the level of reserves may approach the estimated range for the BoE's steady-state balance sheet size as soon as the second half of 2025.[13] Therefore, a clear rationale for future QT plans, including how

[11] Reliable data on inactivity and unemployment are a pre-requisite for economic analysis and policymaking, underscoring the importance of ongoing efforts by the Office of National Statistics to improve the quality of its Labour Force Survey (see Annex VI).

[12] At present a press conference is only held after the February, May, August, and November decisions accompanying a Monetary Policy Report publication.

[13] The BoE's survey of banks' reserve demand indicates that the preferred minimum range of reserves (PMRR) lies in the range of £345 to £490 billion, similar to the BoE's model-based estimates. The sum of LCR requirement based on the stock of sterling deposit liabilities amounts to £570 billion (as of Summer 2023).

it will help the BoE converge to a steady-state balance sheet, will be critical. The QT strategy should continue to be guided by the MPC's key principles, which include leaving Bank Rate as the active monetary policy instrument and not disrupting smooth market functioning. At the same time, the BoE should continue to monitor undue pressure on short-term money market rates and gilt markets and adjust QT implementation as needed. In this context, staff supports the BoE's adjustment on QT auction sizes to smooth gilt supply across maturities. Moreover, staff stresses that the steady-state composition of the BoE's balance sheet (gilts vs. short-term repos) should ensure that money market rates remain aligned with the policy rate (i.e., minimizing wedges),[14] while taking into consideration various aspects of demand for reserves, including banks' needs for high-quality liquid assets.

21. For future cycles of Quantitative Easing (QE)/QT, consideration could be given to adjusting the treatment of QE/QT profits and losses. QE programs have been employed to underpin the economy at times of financial crisis and to avoid sustained periods of below target inflation. Staff's analysis indicates that QE/QT could be neutral or even beneficial to the fiscal position over the cycle, with direct profit transfers and indirect fiscal benefits via higher tax revenue and lower interest payments during the QE phase outweighing the losses arising during the QT phase (Annex VII). Moreover, the full ex-ante backstop guarantee from the Treasury was intended to protect central bank independence. That said, the fiscal implications of large APF losses during the current tightening cycle have led some stakeholders to suggest that QE/QT decisions pass a narrow value-for-money test, which could potentially affect the BoE's ability to independently carry out its mandate.[15] While this is still an evolving issue for many central banks implementing QT, staff suggests some high-level principles for capital policies governing future QE/QT rounds: (i) the treatment of profits/losses should be fully transparent, ex-ante, and symmetric (as is currently the case); (ii) the size and frequency of transfers between the Treasury and the BoE arising as a result of QE/QT profits/losses should be reduced, to insulate the BoE from any political pressure associated with the fiscal implications of the transfers; and (iii) the profits/losses should be included in the debt definition used for the fiscal rule, as is currently the case, but there would be a case to exclude the profits/losses from any annually-applying deficit rule.

22. The Bernanke review provides a timely opportunity to strengthen the BoE's data and forecasting infrastructures, and communications. The Review found, *inter alia*, that (i) the BoE's forecasting performance has worsened in recent years but is not worse than that of other central banks and other UK forecasters; (ii) there were significant shortcomings in the BoE's central forecasting model (COMPASS) and data platforms; and (iii) the central forecast, used as a communication device, may not fully reflect MPC's view of the economy as the central forecast is conditioned on a set of standard assumptions, which "may not always accurately represent the views of the MPC" (see Annex VIII). The Review made 12 recommendations on improving forecasting infrastructure, publishing alternative scenarios, and retiring the inflation fan chart, but stopped short of formally recommending that the MPC publish its own policy rate path(s); the Review left it as a

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[14] Gilt holdings are longer-term and thus imply interest rate risk, while reverse repos raise the issue of encumbrance of collateral i.e., the use of assets serving as collateral in the repo transaction is restricted until the repo is repaid.
[15] Importantly, the BoE, via PRA, is also the banking supervisor and insurance supervisor, and an erosion of BoE independence could compromise the delivery of these mandates.

possible solution to issue (iii) above for the BoE to consider later. Staff welcomes the BoE's commitment to act on the recommendations. Staff advises that in designing the proposed "alternative scenarios", consideration should be given to including scenario-specific monetary policy paths generated by BoE staff, to better support MPC decision-making and communications. Accordingly, allocating adequate resources to enhance and maintain the required modeling infrastructure is also critical.

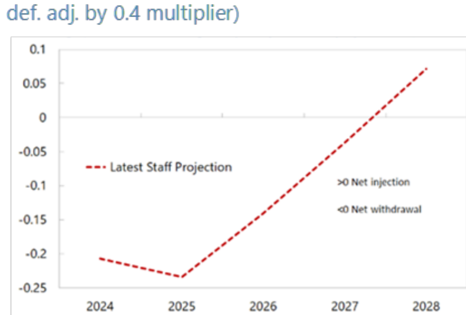
23. *Authorities' Views.* The MPC voted to maintain Bank Rate at 5.25 percent in May and stated that it would: "continue to monitor closely indications of persistent inflationary pressures and resilience in the economy as a whole". There is still a range of views among MPC members on the role second-round effects are playing in the persistence of domestic inflationary pressures. While MPC members did not seem overly concerned about immediate spillovers from Fed decision announcements to UK markets (including in a context of divergence between BoE and Fed rate paths) and, therefore, did not see a case for major changes to the MPC's communication plan, the BoE said they would consider staff's suggestion for a press conference after every rate decision in the context of implementing recommendations from the Bernanke Review. On other recommendations of the Review, the BoE said they will consider the pros and cons of including more scenarios, and accompanying them, as staff suggests, by scenario-specific monetary policy paths generated by BoE staff. In particular, the BoE agrees on the importance of ensuring adequate resources to durably enhance the required data and modeling infrastructure, and work is already underway. The BoE noted that QT has been operating in the background as intended, leaving Bank Rate as the active policy tool. The BoE will conduct its annual QT review this summer, which will inform the MPC's decision on the pace of QT for the next 12 months. At the same time, ongoing work at the Bank on the size and composition of the steady-state balance sheet (SSBS) is progressing. The availability of the Short-Term Repo (STR) facility (launched in 2022) means the MPC can continue to make independent decisions on the path of QT, even as the balance of the APF reduces reserve supply towards the estimated size of SSBS. The BoE views the current indemnification arrangement on the APF as clear and transparent but noted the Fund staff's high-level principles on capital policies for future QE/QT rounds.

B. Fiscal Policy

24. The fiscal consolidation strategy pursued since November 2022 has delivered an appropriately restrictive near-term fiscal stance that should be maintained to rebuild fiscal buffers. The consolidation helped bring the primary deficit from 3.6 percent of GDP in FY2021/22 to 1.3 percent of GDP in FY2023/24 (broadly its pre-pandemic level), while stabilizing debt in year 5 in the OBR's forecast (one of two fiscal rules introduced in the Autumn 2022 statement; the other being that the public sector borrowing requirement be below 3 percent of GDP in

Fiscal Impulse

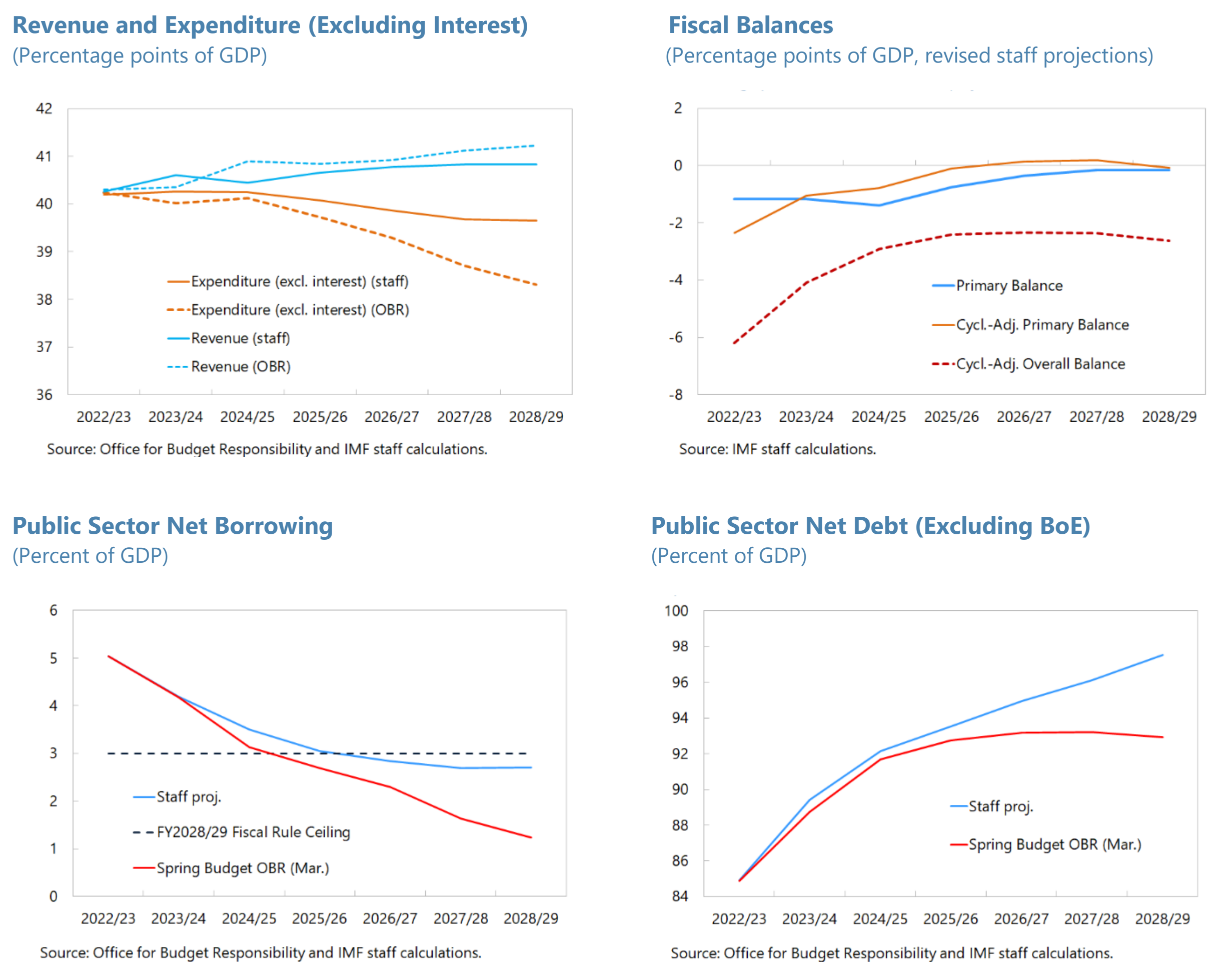
(Percentage points of GDP; change in cyc.-adj. pr. def. adj. by 0.4 multiplier)



Source: IMF staff calculations.

year 5). The consolidation was the net result of a number of measures. The 6 ppts. increase in the corporation tax rate, freezing of personal income tax thresholds, and tight limits on spending were deficit-reducing. At the same time, as noted earlier, the government included tax cuts in the last two budgets. Although the fiscal stance remains restrictive, staff would have recommended against the NIC rate cuts, given their significant cost (½ percent of GDP per year) in a context of significant medium-term spending pressures, described below. But staff does recognize the potential labor supply benefits of the NIC cuts and that they were accompanied by well-conceived measures (e.g., reform of the 'non-dom' regime, consistent with staff's recommendations to close loopholes (see Annex IX)) that will partially offset their fiscal cost over the medium-term.

Figure 4. United Kingdom: Fiscal Projections



25. The main fiscal challenge, also identified in the 2023 Article IV consultation, is the unrealistically-low medium-term spending path in official budget projections, given mounting spending pressures (See Selected Issues Paper on Spending Pressures). The current official plans assume limited growth of Departmental Expenditure Limits (DEL) (around two fifths of total public spending), with recurrent DEL spending rising by one percent per year in real terms from

FY2025/26, with flat nominal capital spending. The OBR has assessed these plans as lacking detail, with similar sentiments echoed by both business groups and leading think tanks. The assumed pace of spending growth is likely inadequate to accommodate widely reported pressures on public services, particularly health, education, and social care, as well as critical growth-enhancing investments, including for the green transition. Some of the announced sectoral spending commitments, such as the NHS long-term workforce plan, the 'triple lock' policy (likely implying above-inflation pension increases), and the aspiration to increase defense spending to 2½ percent of GDP, would require significant real cuts (as yet unidentified) to other spending areas, to be consistent with the announced pace of aggregate spending growth.

26. Accounting for some of this spending pressure, debt continues to increase over the 5-year projection horizon under staff's baseline. Staff's projections assume real growth of DEL spending will be around two percent per year over the medium term, accommodating critical spending needs in public services (particularly the NHS Long-Term Workforce Plan, meeting demand for social care, pension spending under the 'triple lock' and higher defense spending), as well as real growth of public investment, which is presently very low, and spending for the green transition. Non-interest Annually Managed Expenditure (AME) (mostly non-discretionary, including welfare) is assumed to rise with inflation and the rate of population growth. On a net basis, staff's projections imply that non-interest spending declines by only ¾ ppt. of GDP between FY2023/24 by FY2028/29, compared with a 1.7 ppts. decline in the OBR forecast, so that public sector net borrowing will be 1½ ppts. above the OBR forecast by FY2028/29. Under staff's more realistic forecast, public sector net debt (excl. BoE) continues to rise over the medium-term to reach about 97½ percent of GDP by FY2028/29 (OBR projects about 93 percent of GDP), an 8 ppts. of GDP increase from end-FY2023/24 levels (see Figure 4). Although the risk of sovereign stress is still assessed as low (see Annex X) and the UK still retains some fiscal space, the non-stabilization of the debt/GDP ratio over five years is a deterioration from the last Article IV, where debt just stabilized in year 5; it is also consistent with the observed deterioration in the SRDSF's medium-term mechanical risk signals.

27. Absent a major boost to potential growth, additional consolidation will be needed for debt to stabilize with high probability. The amount of fiscal effort required will depend on (i) the target probability by which debt must stabilize (higher probability will imply larger effort); (ii) the horizon over which debt is to be stabilized; and (iii) the extent to which spending pressures are accommodated. As shown in the table below, relative to staff's baseline, the annual primary balance would need to be higher by 0.8 ppt. of GDP on average during FY2025/26–FY2029/30 to stabilize debt in year 5 (FY2029/30) with 50 percent probability. In order to reduce fiscal sustainability risks, staff recommends an adjustment path such that debt is projected to stabilize with a higher probability (e.g., 75 percent) over five years (using the SRDSF debt fanchart methodology), requiring keeping the annual primary balance on average at least 1.2 ppts. of GDP above staff's current baseline.[16]

[16] The required adjustment also depends on a range of factors including the underlying growth assumptions and their impact on the budget. In the recommended scenarios, fiscal adjustment is estimated to reduce the level of real

(continued)

Text Table 2. United Kingdom: Fiscal Effort to achieve Debt Stabilization: Adjustment Scenarios (ppts. of GDP)			
	Scen. 1 (50% prob. over 5-yr horizon)	*Scen. 2 (**75%** prob. over 5-yr horizon)*	*Scen. 3 (**75%** prob. over **10**-yr horizon)*
Average annual excess public sector **primary balance** *relative to staff's baseline*	**0.8**	**1.2**	**1.4**
Debt level at end of horizon *relative to staff's baseline*	**-3.9**	**-5.9**	**-11.1**
For further details, see Selected Issues Paper on Spending Pressures.			

28. High-quality consolidation measures will be required to realize the additional effort required.

- On the **revenue side**, there is considerable scope to raise revenues, including through (i) aligning the rates of capital gains tax with the equivalent rates of personal income tax (around ½ percent of GDP), to treat capital and labor income equally; (ii) removing unnecessary VAT exemptions (around ½ percent GDP), to broaden the consumption tax base; (iii) reforming property taxation (replacing Council Tax with a broad-based property tax) (around ¼ percent of GDP); and (iv) broad-based wealth taxation (around ½ percent of GDP), or reforms to inheritance taxation, by removing unnecessary reliefs. Stronger carbon taxation (use of feebates) could be a further source of revenue, while supporting the green transition.[17] These measures should be implemented as part of a broader pro-growth structural reform agenda (see below) and will support the climate transition while making the tax system more efficient and fairer.[18]

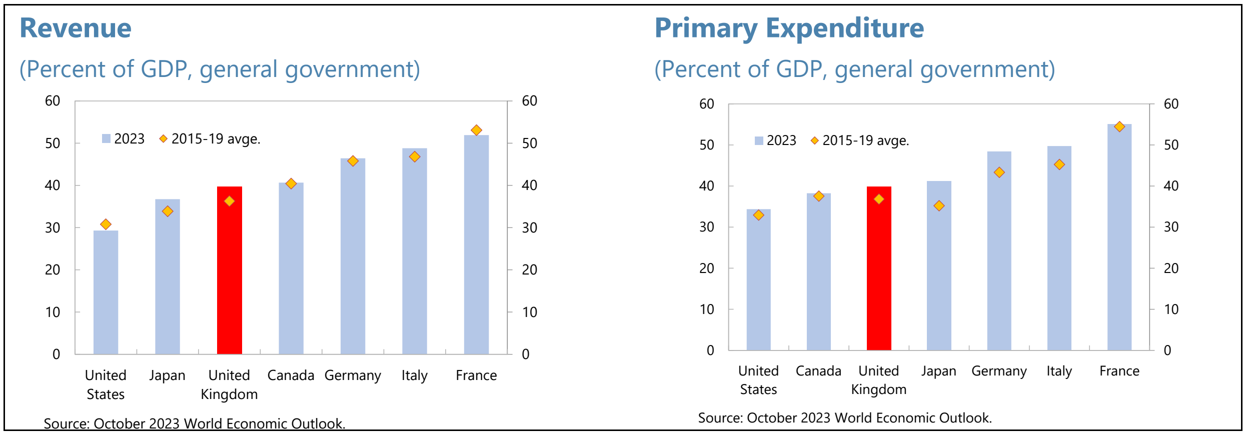
- On the **spending side**, the overly-generous pensions 'triple lock', under which the state pension will likely grow above the rate of inflation, should be abolished, saving around 0.1 percent of GDP per year. Other options could include expanded or enhanced charging for public services, while taking care to protect the vulnerable, as well as pursuing productivity gains, such as from the government's announced investment in digitalization and AI within the public sector (including the NHS), although the savings associated with these initiatives are difficult to quantify at this time.

GDP by the end of the adjustment horizon by 1.7–2.1 ppts., relative to staff's baseline; incorporating the effect of this on revenues and on the GDP denominator for the debt ratio, would raise the annual required effort by 0.2–0.4 ppts. of GDP. If potential growth could be increased, this would reduce the required fiscal effort.

[17] Detailed options for capital gains tax reform are discussed by the Office for Tax Simplification (2020). VAT exemptions or reduced rates relating to fuel, transport services, water and sewerage could be eliminated, while taking care to compensate low-income households through the welfare system. On property tax reform see the Institute for Fiscal Studies (2020) for further details. There is a potential to use some of the revenue gains from property tax reform to reduce stamp duties. For inheritance tax reform options see Institute for Fiscal Studies (2023), while the UK Wealth Tax Commission discusses both one-off and recurring wealth taxes.

[18] It is also time to take action to plan for the eventual loss of fuel duty revenue, once the transition to zero emission vehicles is completed, by implementing a road usage tax based on mileage, the administration of which may require some degree of electronic monitoring of vehicle use.

29. Against the backdrop of these challenges, as a general principle, staff advises against additional tax cuts. The UK's revenue/GDP ratio is well below the level in G7 European peers but its welfare state is, in some ways (e.g., healthcare), similarly expansive as in those peers. In this context, the bar for further tax cuts needs to be set very high: specifically, staff advises that tax cuts be eschewed unless they are credibly growth-enhancing and appropriately offset by high-quality deficit-reducing measures. Of course, in the event that growth disappoints, automatic stabilizers should be allowed to operate, but, again, considering the fiscal challenge at hand, any discretionary stimulus should be well targeted, including, to protect the vulnerable, and with strong regard to debt sustainability risks.



30. There is also a need for broader reforms to fiscal institutions and processes.

- ***Fiscal Rules.*** The current rules under which PSND (excl. BoE) must fall by the fifth year and PSNB must fall below three percent of GDP are insufficiently constraining in the near-term and encourage unrealistic assumptions further out. Staff proposes a probabilistic approach (which takes better account of uncertainty) for the debt rule under which debt must decline in the fifth year with a high probability (the "additional effort" table above shows results with 75 percent); this will increase the likelihood that debt does eventually decline.[19] This approach could be nested within a higher-level fiscal standard that sets a bar for "responsible" fiscal policy (see Annex VI, 2023 Article IV Consultation Staff Report). Separately, as noted in the monetary policy section, staff does not support the exclusion of QE/QT profits/losses from the fiscal aggregates used to assess compliance with the debt rule, since net losses of QE/QT are liabilities of the public sector. However, staff could support exclusion from flow aggregates in a future fiscal rule, such as an annually-applying deficit rule, subject to the principles discussed in the monetary policy section.

[19] This approach is a variation of what the OBR already does. The OBR is required by the government to report if there is an even chance of the fiscal rules being met. In March 2024, the OBR assessed—based on a debt fanchart—that there was a 54 percent probability of debt falling in year 5 (this result obtains because the OBR uses the government's unrealistically low spending projections after end-March 2025) (see paras 1.25–1.26 and paras 5.17 onward in the March 2024 Economic and Fiscal Outlook (https://obr.uk/efo/economic-and-fiscal-outlook-march-2024/#foreword). The change that would be needed to the fiscal rules is to raise the even chance to a high probability, like 75 percent or 95 percent.

- ***Enhanced OBR Role.*** The OBR, while empowered to produce the economic and fiscal forecasts underlying the two fiscal events a year, should be required to provide an updated forecast whenever there is a major fiscal policy change (such as that surrounding the 'mini-budget'). Extending the OBR's forecast horizon in the Economic and Fiscal Outlooks to ten years is also recommended to better-capture longer-term spending pressures, as well as dividends from growth-enhancing investments, which will help provide a more complete picture of the sustainability of public finances. Furthermore, the OBR's public views should be sought on any changes to fiscal rules at the time of their consideration, while the recommended addition of escape clauses to the fiscal rules should be accompanied by a role for the OBR to determine when they are triggered.

- ***Budget Process.*** Transitioning from semi-annual to annual budgets is also recommended to streamline the budget process and reduce political pressure for fiscal loosening, which seems to manifest itself in revenue windfalls being mostly spent, but adverse revenue shocks being fully accommodated. There is also scope to improve the credibility of the medium-term fiscal framework, by providing visibility on spending plans for at least three years ahead. This can be done by producing medium-term (four or five-year) spending ceilings, updated every 2 years based on detailed assumptions and policies. This new framework would replace the current system of periodic spending reviews, which fix limits on DEL (i.e., excluding pensions, welfare and interest payments) for three-years, providing progressively less guidance about the medium term as the end of the three-year period is approached, as is the case presently. The medium-term framework would also provide greater certainty for capital spending projects, as found by the 2022 PIMA.

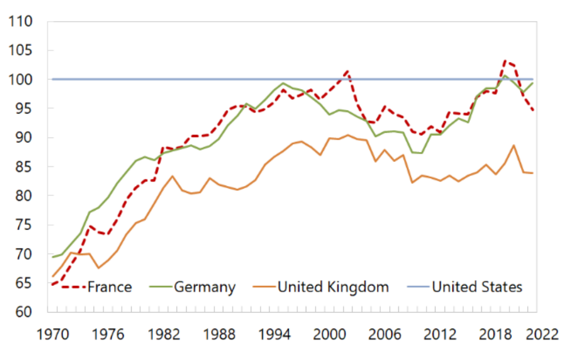
31. ***Authorities' Views.*** While acknowledging the uncertainty over expenditure allocations pending the next spending review, the authorities noted that the fiscal rules were being met under the OBR's independent forecast. They also explained that the NIC rate cuts and disability benefit reforms were designed to incentivize work in the context of a notable rise in inactivity and a high share of people with disabilities. The authorities acknowledged pressures on public services but felt recent funding increases for the NHS, social care and schools should help address immediate challenges, while longer term needs are being addressed via implementation of the NHS Long-Term Workforce Plan and other strategies. In terms of public investment, the authorities expect to set future plans at the time of the next spending review, to be held after the upcoming general election. Regarding the fiscal framework, the authorities noted its strength and underscored the important role of the OBR. The authorities saw some merit in exploring the role that the probability of debt stabilization could play in any future review of fiscal rules. Staff's recommendations to have a single fiscal event each year and replace spending reviews with rolling four or five-year spending frameworks updated twice a year were noted. The authorities concurred with staff's assessment of sovereign risks and underlying assumptions, as well as the extent of fiscal space.

C. Reforms to Boost Growth

32. Like other European peers, the UK has faced a major trend growth and productivity slowdown since the GFC. This, combined with a series of subsequent adverse shocks (Brexit, COVID, energy price surge), and longer-term trends (such as aging), has left the level of UK GDP at around a quarter below the level implied by the trend in the decades before the GFC, accompanied by worsening income, inter-generational,[20] and spatial equality.[21] Although the UK has done better than peers in terms of total hours worked, the drop in labor productivity growth, the key driver of living standards – from around 2 percent pre-GFC to around ½ percent thereafter—has been noticeably bigger than in other advanced economies. Most of this drop was due to the loss of pre-GFC growth engines such as North Sea Oil and a leverage-driven boom in the financial sector, which was then exacerbated by reduced firm dynamism post-GFC and the recent shocks mentioned above (see Annex IV). Moreover, the impact of a prolonged period of relatively low rates of TFP-supporting investment and high service delivery pressures, notably in health, on economic potential, is beginning to show (e.g., via an uptick in long-term illness-induced inactivity). Finally, aging and policies to rein in immigration will constrain total hours worked going forward, creating additional headwinds to growth.

Productivity: GDP Per Hour Worked

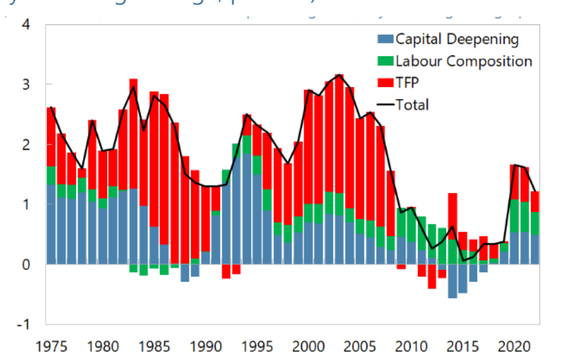
(Ratio of GDP per hour worked compared to the US, current PPP)



Sources: OECD.

Drivers of Labor Productivity Growth

(Market sector, contribution to GVA per hour growth, 5-year rolling average, percent)



Source: ONS.

33. The authorities have responded to this slowdown via a series of initiatives, but further ambitious reforms are needed to boost potential growth. The authorities adopted the "levelling up agenda" in 2022; the "4Es' strategy" ("enterprise, education, employment, everywhere") in January 2023; and "110 reforms to boost growth" in Autumn 2023. They have also delivered, since Autumn 2022, a number of helpful measures, most notably, permanent investment tax reliefs for businesses,

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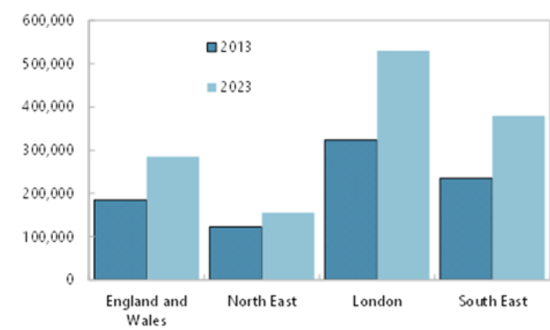
[20] Increasing house prices, in part due to planning restrictions discussed below, represent a transfer of wealth form the young (who need to buy) to the old (who typically own houses), often forcing young people to delay independent living. In the 1950s, 70 percent of UK residents owned house by age 34. This ratio has fallen to less than 34 percent today.

[21] Spatial inequality has continued to increase in the UK. While income per head in London was around 22 percent higher in 1997 than the UK as a whole, this figure increased to 37 percent just before the GFC (2008) and reached 43 percent in 2021. In contrast, the figures for Northeast stood at 86 percent in 1997, falling to 81 percent by 2008 and remaining at that level in 2021.

and strengthened the incentives and capacity to work (in the form of tax cuts, changes in working age benefits, and expansion of childcare support).[22] They have also initiated reforms to unlock pension savings for higher-return investments. While supporting the medium-term outlook, these measures are unlikely to sufficiently lift the UK's long-term potential growth to the 2 percent level seen in the UK in the decades before the GFC, or in US at present. Leveraging the wide body of work by UK academics and thinktanks on impediments to growth, staff has identified three key areas that need the most urgent attention, including by building on past efforts. These key reforms also have the benefit of being relatively less costly in fiscal terms. If implemented, these reforms will also improve competitiveness and the UK's external position.

- **Easing planning restrictions.** The current regime for planning is excessively stringent and has severely inhibited the construction of new housing and infrastructure projects, thus constraining labor mobility (workers are forced into sub-optimal jobs as they are unable to move to more expensive areas with better jobs due to unaffordable housing).[23] Cheshire (2015) estimates the attendant TFP effect at a massive 32 percent for some businesses. This has resulted in high and increasing prices overall, and widening disparities between high and low growth regions, given inelastic housing supply. ***Key reforms***: (i) establish up-to-date, binding plans at the local level to streamline the decision-making and avoid the "not in my backyard" problem in designated growth areas, with incentives and additional resources to local authorities to overcome opposition and increase efficiency; (ii) digitalize and standardize planning process to help reduce delays and increase transparency; (iii) institute broader geographic and rules based decision-making for business developments to decrease uncertainty and provide more clarity and predictability to investors; (iv) introduce targeted incentives (to overcome new builds resistance) and resources for local authorities (including skilled staff to facilitate compliance with new environmental requirements); (v) carefully review the scope to release Green Belt land of little environmental or amenity value near stations with easy access to major cities; (vi) ensure better housing standards and higher-quality housing across all income groups, particularly in the private rented sector, alongside flexible land use

Variation in Median House Price Across Regions
(Select regions, GBP)



Source: Office of National Statistics

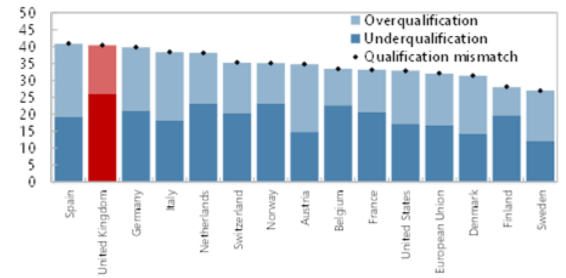
[22] Although UK female labor force participation is higher than in G7 peers (following significant improvements in the past decades), there is still room to raise participation to Scandinavian levels. See 2023 IMF selected issues paper for details.

[23] People need to move to areas with greater job opportunities, typically cities. But strict land use regulation in countries like United States, Canada and the United Kingdom have made housing supply in cities less elastic, resulting in higher costs and hindering geographical mobility. See Sutherland 2020; Hsieh & Moretti (2019); Erdmann, Furth, Hamilton 2019; Stutts 2021; Rothwell & Massey 2015. Hilber & Vermeulen (2016) estimate that in the absence of regulatory constraints (i.e., refusal of proposed development by Local Planning Authorities), prices would have been 35 percent lower in the 2000s than they actually were.

policies to adapt to changing economic needs and environmental considerations; and (vii) lower stamp duty for both residential and non-residential properties (alongside a reform of the council tax to ensure net revenue gain) to stimulate high-growth firm activity and facilitate workforce mobility (see Planning SIP).

- **Upskilling the workforce.** There is an urgent need to upgrade the skills of UK workers, given larger observed skills gaps than in peer countries, and surveys reporting widespread recruitment difficulties that are limiting output, particularly in high skill sectors like digital and software, manufacturing, medicine and life sciences, teaching, and construction. Despite an increase in public funding for primary and post-secondary education since 2019 (reversing earlier cuts), outcomes, particularly science scores, have declined over the past two decades, accompanied by a decline in workplace training and apprenticeship. Since Brexit, there has been an increase in non-EU migrants, but they have not directly offset the loss of EU-workers given different skillsets and hurdles (especially for small firms, in sponsoring skilled worker visas). ***Key reform*:** (i) more and better-quality training and apprenticeships to develop skills in high-demand, including via higher government support; (ii) ambitious targets consistent with a reversal of the recent decline in STEM outcomes; (iii) schemes to further encourage younger workers to enter future growth sectors and improve retention; and (iv) a simplified worker visa regime to facilitate smaller employers (who were large employers of skilled EU-labor pre-Brexit) hire non-EU workers (see Skills SIP).

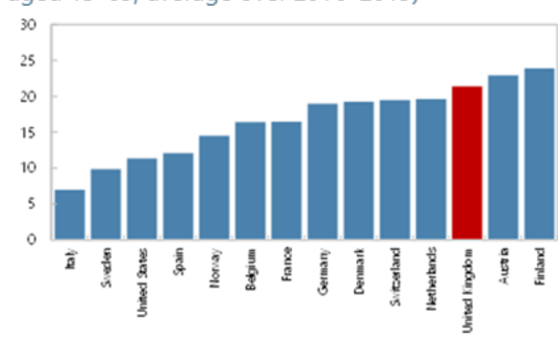
Qualification Mismatch
(Percentage)



Note: Qualification mismatch is defined by the discrepancy between the highest qualification held by a worker and the qualification required by their job. Over (under) qualification that is above (below) their job's requirements.
Sources: OECD Skills for Jobs Database

- **Improving health outcomes.** The UK has done well to boost labor supply in the past (including through immigration), but this could be at risk going forward from rising inactivity (in the context of weak health outcomes) and an aging population. The post-pandemic decline in UK labor force participation is largely attributable to elevated rates of long-term sickness and disability, with more than 20 percent of the population recorded as having disabilities (above G7 peers). Moreover, illness is a major drag, not just on labor supply but also on labor productivity—for the segment of the population who remain in the workforce but

Disability Prevalence
(People with disability as a share of the population aged 15–69, average over 2016–2019)



Sources: OECD calculations based on European Union Statistics on Income and Living Conditions (EU-SILC) for European countries are not healthy. Given that the number of hospital beds, doctors, and nurses per capita are lower than the OECD average, the authorities have responded by committing additional resources to the health system, including through the NHS Long-Term Workforce Plan, which aims to increase NHS staff numbers by around 800,000 over the next ten years, while also announcing £3.4 billion (0.1 percent of GDP) in the Spring Budget to support efficiency improvements using digitalization and AI. The authorities have also announced reforms to the benefit system to incentivize work, including by increasing the stringency of the Work Capability Assessment (WCA), which determines access to incapacity benefits.[24] ***Key reforms:*** (i) full implementation of the NHS Long-Term Workforce Plan, accompanied by real increases in capital spending, to create a better-resourced and more productive health service;[25] (ii) pursue a forward-looking and integrated approach to NHS resource allocation and strategic decision making that is focused on system-wide performance (e.g., integrated and digitalized patient records); (iii) increased funding for social care commensurate with demand over the medium-term; and (iv) improved health services for those with disabilities (including mental health), while ensuring that those capable of work are incentivized to do so and are adequately assisted through training, coaching, and integrated health support, building on recent reforms.

34. In this context, staff proposes that the authorities adopt a clear and stable long-term growth strategy, potentially anchored in the advice of an independent growth commission. While progress on post-Brexit arrangements has reduced uncertainty, recurrent and piecemeal policy changes, including at semi-annual fiscal events, have arguably made it harder for businesses and workers to plan. With only one fiscal event a year and a longer horizon for official projections, the government might be better incentivized to articulate and follow through on a stable growth agenda which includes reforms with payoffs going well beyond the electoral cycle. In this context, consideration could be given to establishing an independent growth commission, similar, for example, to the productivity commission in Australia (see Growth Commission Annex XI). Such a body can take a longer-term view of reform priorities (making policy more strategic and focused); better coordinate across different levels of government; and track and report on implementation, serving as a disciplining and communication device (akin to the Climate Change Committee).

35. The authorities should continue their cautious approach to industrial policy. Relative to some G7 peers, the UK has been cautious in deploying vertical industrial policies, instead favoring broad-based tax incentives for business investment and R&D. Direct support to industry has been limited, with the UK government announcing an Advanced Manufacturing Plan in November 2023,

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[24] Other recently announced measures include the launch of a consultation to see whether some cash payments (including, notably, the non-means-tested personal independence payment or PIP) to claimants with mental health conditions could be replaced by treatment or access to services. Other steps included: (i) shifting responsibility for issuing “fit notes” away from General Practitioners (GPs) to other “work and health professionals”; (ii) plans to close benefit claims for anyone who has been claiming for 12 months but is not complying with conditions on accepting available work; and (iii) asking more people on universal credit working part-time to look for more work.

[25] The Institute of Fiscal Studies estimates that health spending may need to rise by 2 percentage points of GDP by the FY2036/37 to fund the NHS Long-Term Workforce Plan, which seeks to avoid a labor shortfall of between 260,000–360,000 staff emerging by the mid-2030’s.

together with a Battery Strategy. Under the plan, £4.5 billion (0.2 percent of GDP) will be invested strategically in high technology sectors, including the aerospace, automotive and life sciences, mainly in the form of grant funding for R&D and investment. Around £1 billion each (0.1 percent of GDP) has also been committed to a Green Industries Growth Accelerator, and for creative industries, while 13 investment zones and 12 free ports have been announced, which will offer tax concessions and other targeted support. Staff encourages the authorities to keep these plans and future policies narrowly targeted toward removing obstacles to investment and improving the business environment, focusing on industries and firms where externalities or market failures prevent effective market solutions, while minimizing trade and investment distortions, as well as adverse international spillover effects. Meanwhile, the UK's active and constructive participation in the WTO is welcome.

36. ***Authorities' Views.*** The authorities' acknowledged the importance of further ambitious, evidence-based structural reforms to boost investment, productivity and labor supply and noted that this was their preferred means of building fiscal buffers while addressing spending needs. They agreed with staff on key reform priorities and noted recently implemented reforms in these areas. In particular, they highlighted planning reforms and full expensing (for qualifying plant and machinery business investments), and the cuts in the NIC rate, which should support labor supply. While agreeing that rising inactivity due to long term sickness was a challenge, they highlighted reforms to working age benefits, with the view of ensuring that people who are capable of work are incentivized to do so but agreed with the importance of adequately supporting such people through training and coaching; and to ensure that those who need healthcare receive it. The authorities opined that the main issue in healthcare was efficiency but acknowledged the need for capital investment, including in digital infrastructure, which was announced during the Spring Budget. The authorities also noted that addressing skills gaps was a priority with an emphasis on future growth areas such as digital and AI, STEM, life sciences and the creative arts, particularly for the young, but also for older workers through lifelong learning. The authorities explained that they have put in place measures to improve the quality of apprenticeship programs, and this in part explains the decline in total numbers. Recent efforts have also been made to grow apprenticeship numbers in key sectors and incentivise SMEs to create opportunities for young people. They were receptive in principle to the idea of a growth commission.

D. Financial Sector Policies

37. The overall level of systemic risk is assessed as broadly similar to that in the previous Article IV consultation, with the focus shifting somewhat from households to corporations. Household debt vulnerabilities have reduced somewhat, supported by strong wage growth and a lower expected policy rate path, while corporate vulnerabilities have edged up, mainly for firms exposed to some segments of market finance (see below). The banking sector is healthy, while vulnerabilities in the more complex NBFI sector, including high leverage and liquidity mismatch, and lack of data for a comprehensive assessment remain a source of concern (see Annex XII on FSAP recommendations). Moreover, in line with staff's assessments the recent Financial Policy Committee (FPC) meeting summary highlighted that risk premia have decreased further below historical averages across several asset classes and a sharp correction in a broad range of asset prices could crystalize long-standing vulnerabilities in market-based finance. Moreover, global risks remain elevated, including from heightened geopolitical tensions, corrections in CRE markets globally, as well as the property market in China, which could spill over to the UK financial system.

38. Macroprudential settings are appropriate but continued close monitoring of credit conditions and financial stability risks is merited in future calibrations. Reflective of the macroeconomic development, credit conditions remain muted, particularly for smaller businesses and certain sectors, Moreover, the latest results from the IMF global stress testing showed that in an adverse scenario, UK banks remain resilient, echoing the BoE's 2022/23 stress testing results. Against this backdrop, staff supports the FPC's decision to maintain the countercyclical capital buffer (CCyB) at its two percent neutral level. Should tighter financial conditions weigh on corporate and household debt vulnerabilities and increase credit losses materially, the authorities should consider easing prudential policy (for example, releasing the CCyB) to avoid exacerbating the credit downturn. In light of potential valuation risks in several asset markets, continued monitoring and appropriately stringent stress tests would be important.

39. While major UK banks remain healthy, continued strong supervision of all UK banks is warranted. The capital and liquidity positions of major UK banks remain robust (with CET1 ratio at 14.7 percent and LCR at 147 percent in 2023Q4), but the diverse business models of smaller banks merit continued close monitoring as stress in this segment has been idiosyncratic. Staff supports the BoE's decision to conduct desk-based top-down stress testing this year, which would provide more flexibility to test multiple stress scenarios, and views this as a helpful complement to the bottom-up approach. Staff also encourages further utilization of stress testing tools to identify potential risks in smaller banks. Separately, the Prudential Regulation Authority (PRA) has made careful progress on a new Strong and Simple Framework to simplify the prudential framework for non-systemic domestic banks and building societies, while maintaining their resilience.

40. Ongoing initiatives to enhance risk monitoring and crisis response readiness with regard to NBFIs have gained momentum but challenges remain.

- Staff welcomes the progress thus far on the ***System-Wide Exploratory Scenario*** (SWES) and looks forward to important insights generated on the level of resilience of participants, their reaction functions to stressed financial market conditions, and potential propagation channels. Moreover, staff encourages considering making some data collection permanent for continued risk monitoring to build an ongoing capacity for system-wide stress testing.

- Staff also welcomes progress on the design of the ***NBFI lending tool***, which, in line with FSAP recommendations, aims to act as a backstop to core markets in the event of systemic stress by providing liquidity to appropriately regulated and systemically interconnected NBFIs, while avoiding moral hazard. The first step is to have the facility accessible for pension funds, insurance companies, and LDI funds.[26] Staff urges that the design of the tool ensure an appropriate balance between signaling BoE readiness to provide sufficient support during stress episodes, and preserving incentives for NBFIs to enhance their resilience in normal times and encourages continued regulatory coordination to ensure the resilience of non-UK domiciled funds.

- Staff supports continued work to enhance the resilience of different segments of the NBFI sector, such as ***money market funds (MMFs) and pension funds***. Staff welcomes the regulatory changes proposed by the Financial Conduct Authority (FCA) for MMFs and stresses that work should continue internationally given the large number of non-UK domiciled sterling MMFs.[27]

- Reforms to unlock ***pension savings for higher-return investments***, which could provide better outcomes for savers, are welcome, but should not undermine financial stability (see Pensions Annex XII). While investment reallocation could potentially improve returns, the asset allocation of pension funds should not be mandated, and any reforms should not hinder the ability of pension funds to fulfill fiduciary responsibilities effectively and achieve the best possible outcomes for their beneficiaries. Given the ongoing defined benefit (DB) pension fund buy-outs and potential concentration risk created in the insurance industry from these concurrent changes, monitoring possible financial stability implications, including the longer-term structural impact of these developments on gilt demand, will be important. In this context, staff continues recommending that The Pensions Regulator (TPR) be given an explicit financial stability remit, accompanied by a reinforcement of its staffing to achieve this mandate. Finally, staff encourages continued work to ensure adequate pensions for UK employees, including the consideration of expanding auto-enrollment efforts and raising the minimum pension contribution in the medium term.

- Progress on ***closing data gaps*** has been slower than expected, such as data on all Sterling asset holdings and data needed to improve the management of liquidity demands by fund managers and flow-of-funds data, including all cross-border NBFI exposures (see Data Issues Annex XIV). Therefore, it is important to maintain both domestic and international momentum to close NBFI data gaps and to better understand and take action to address the financial stability implications of NBFI leverage. In this context, staff welcomes the FPC's continued evaluation of risks from

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[26] The Bank has recently announced some preferred design features (e.g., a contingent—rather than, standing—facility, which would limit its use to systemic liquidity events; and a prudent level of haircuts to protect BoE capital). Staff views a contingent facility would provide a powerful signal to market once it is triggered. While firms indicate a preference for a standing facility to ensure operational readiness, the Bank has indicated that challenges regarding operational readiness will be addressed via the onboarding process and a program of regular test trades.

[27] There are two recommended changes: (i) a significant increase in the liquidity requirements for all MMFs; and (ii) the removal of the regulatory link between liquidity levels and the need for the manager to impose tools for certain types of MMFs (so-called' stable NAV MMFs', i.e., MMFs that can offer subscriptions and redemptions at a constant net asset value (NAV)).

private equity and interconnected markets and looks forward to the assessment to be published in the June 2024 FSR.[28]

41. Structural financial sector reforms are progressing cautiously. The Edinburgh Reforms package (see Annex XV) in December 2022 and the Chancellor's Mansion House speech on pension reforms in July 2023 have listed some government priorities on regulatory changes in the financial service sector. The government has taken steps on the 31 initiatives in the Edinburgh Reforms and has preserved the primacy of financial stability objectives. Moreover, the authorities are working on enhancements to the special resolution regime, including a proposal to allow the Financial Services Compensation Scheme (FSCS) to provide funds to the BoE to recapitalize and secure operational continuity of a failing small bank through resolution, and then recoup costs through industry levies. While this would help minimize disruptions from small bank failures, staff encourages prefunding the FSCS to an appropriate level to avoid moral hazard.

42. The authorities continue to strengthen the effectiveness of AML/CFT risk-based supervision, considering the UK's high exposure to the laundering of proceeds of foreign crimes. To mitigate misuse of the financial and professional services sectors and UK-registered corporate structures, the authorities should continue to implement measures under Economic Crime Plan 2023–26 to improve the effectiveness and coordination of the AML/CFT supervisory regime. These include HMT's consultations on potential changes to the Money Laundering Regulations and the implementation of a data framework to measure the effectiveness of supervisors. The FCA continues implementing a proactive, data-driven supervisory strategy to cover systemically important entities more frequently. To prevent the criminal use of virtual assets, the FCA pursues a stringent risk-based approach to the registration and supervision of virtual asset service providers. Additionally, the Economic Crime and Corporate Transparency Act passed in October 2023 provides broadened powers for law enforcement for quicker seizure and recovery of virtual assets which are the proceeds of crime.

Voluntary Assessment of Transnational Aspects of Corruption

43. The authorities continue to address transnational aspects of corruption, including combatting foreign bribery and preventing laundering of foreign corruption proceeds, but more efforts are needed (Box 1).

[28] Recent high interest rates have put pressure on private equity funds to raise investment, weighing down asset valuations. A sharp reduction in asset prices could reduce the value of collateral securing existing loans and increase the demand for liquidation at a discount. These could trigger losses for both NBFIs with direct exposures and also banks indirectly and tighten financial conditions. However, FPC highlighted that lack of transparency around asset valuations, leverage, and interconnectedness made assessing financial stability risks difficult.

Box 1. United Kingdom: Transnational Aspects of Corruption[1]

While facing significant foreign bribery risks, the authorities have continued to undertake mitigation efforts.[2] Several factors contribute to such risks, including the UK's size and number of multinational enterprises, scale of outward FDI, its leading position as a global financial center, diverse business sector and exports to high-risk jurisdictions and industries.[3] The OECD Phase 4 evaluation of the UK acknowledges the consistent efforts of the authorities as one of the major enforcers among Working Group on Bribery (WGB) members, including enhancing independence of investigation and prosecution, providing training to ensure sanctions through public procurement measures, improving case management system, and strengthening tax-related
measures. In the 2023 written follow-up report, the authorities provided clarifications on its legal system in ensuring independence of investigation and prosecution and reported measures to collaborate with the Crown Dependencies (CDs) and British Overseas Territories (BOTs) in their efforts to fight foreign bribery. The authorities should continue to implement the OECD Phase 4 recommendations, including reviewing and raising awareness of its whistleblower protection framework, further ensuring adequate resources for foreign bribery enforcement, independence of investigation and prosecution, and transparency of court decisions, as well as engaging with the CDs and BOTs to extend application of the OECD Anti-Bribery Convention and enhance enforcement.

The authorities should continue their efforts to improve the effectiveness of the AML/CFT supervisory regime, given exposures of ML risks. The UK's banking, high-end real estate, and TCSP[4] sectors are at the highest risk of laundering proceeds of overseas corruption. In response, the Economic Crime and Corporate Transparency Act 2023 introduces key reforms to strengthen beneficial ownership transparency, including new powers for Companies House to verify ownership filings, share information with law enforcement, remove fraudulent companies, and impose financial penalties. The reforms also target high-risk limited partnerships (including Scottish limited partnerships) and expand the scope of trustees and nominee beneficial owners under the UK's Register of Overseas Entities. The authorities continue to engage with UK Overseas Territories and Crown Dependencies on their commitments to provide publicly accessible beneficial ownership registers (see Table 9). In order to address deficiencies in the effectiveness of the risk-based supervision of the legal and accountancy sector, the authorities have undertaken a public consultation and are assessing reform options. The Home Office, the Office for Professional Body Anti-Money Laundering Supervision (OPBAS), and the National Economic Crime Centre also developed a professional enablers strategy to improve intelligence sharing between the private sector, supervisors, and law enforcement. The Economic Crime Plan 2023–26 and the 2023 International Development White Paper outline measures to strengthen the UK's international response to foreign illicit finance threats. These include a renewed commitment to law enforcement capabilities, strengthening of cross-border asset recovery outcomes and cooperation with global financial centers, and continuing participation in relevant multilateral fora. The authorities should continue these welcome efforts to strengthen entity transparency and effective supervision of high-risk sectors to counter the risk of laundering of foreign proceeds of corruption in the UK.

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[1] The United Kingdom volunteered to have its legal and institutional frameworks assessed in the context of bilateral surveillance for purposes of determining whether it: (a) criminalizes and prosecutes the bribery of foreign public officials and (b) has an effective AML/CFT system that is designed to prevent foreign officials from concealing the proceeds of corruption.

[2] Information relating to supply-side corruption in this Box is based on information and data provided by the UK authorities. IMF staff has provided additional views and information. The information in this Box has not been verified by the OECD Working Group on Bribery (WGB) or the OECD Secretariat and does not prejudice the WGB's monitoring of the implementation of the OECD Anti-Bribery Convention.

[3] Out of the 500 largest multinational enterprises (MNE) in the world, 20 are headquartered in the UK, with some operating in high-risk sectors and jurisdictions, according to the OECD- UNSD Multinational Enterprise Information Platform.

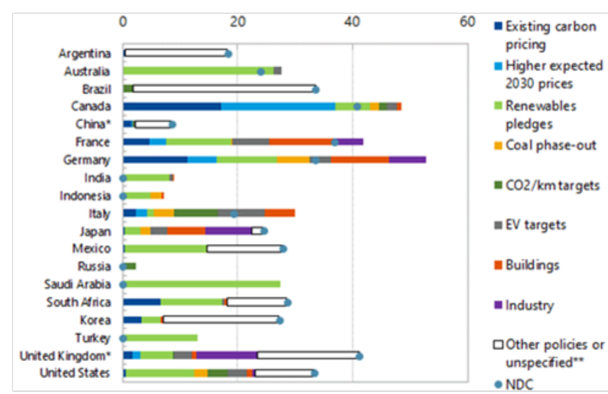
[4] Trust and Company Service Providers.

44. *Authorities' Views.* The authorities noted that the financial stability environment was somewhat calmer than last year. While idiosyncratic risks and the exposure of large banks globally to CRE—especially to the US and China—are closely monitored, the FPC reiterated that the UK banking system was resilient, and subject to robust prudential supervision. Regarding the Strong and Simple regime, the PRA noted that careful progress has been made. The FPC viewed macroprudential settings as appropriate and noted that credit conditions overall reflect changes in the macroeconomic outlook rather than defensive actions by banks. Regarding NBFI initiatives, the BoE has completed the first round of the system-wide exploratory scenario (SWES). Final results are expected to be published in 2024Q4. The BoE also plans to launch a new NBFI repo facility, noting that work is underway to determine key design features. The FCA described industry feedback on the consultation on enhancing liquidity management of UK-domiciled sterling money market funds (MMFs) as broadly positive and believed that the market could adjust to the proposed requirements. The authorities noted that work was underway both domestically and internationally to close NBFI data gaps.

E. Climate Policies

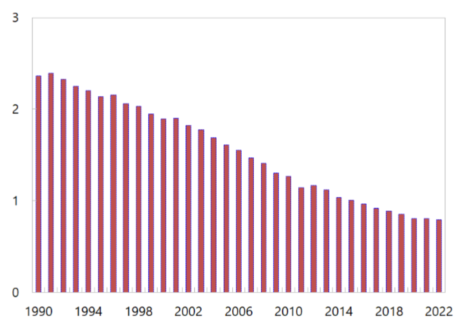
45. The recent relaxation of climate policies and decline in the UK carbon price will put the UK's ambitious climate targets further off track. The UK hosted COP26 in 2021 and adopted an Nationally Determined Contribution (NDC) to reduce emissions by 68 percent by 2030, having already reduced emissions by 50 percent below 1990 levels, mainly due to phasing out coal-fired power stations, so that the UK now accounts for around 1 percent of global emissions. In September 2023, the government softened climate policy by announcing an exemption for 20 percent of homes from the requirement to transition to electric heat pumps, while the transition deadline for homes off the gas grid was delayed from 2026 to 2035, despite a welcome increase of the boiler upgrade grant. In the transport sector, the requirement that 80 percent of new vehicles sold in the UK be 'zero emission' by 2030 (100 percent by 2035) has been enshrined in legislation, but the ban on purchasing internal combustion engine vehicles has been delayed from 2030 to 2035 (as in some EU countries). Despite announcing an emissions cap under the Emission Trading Scheme for 2035 that is consistent with the UK's climate goals, the UK carbon price has declined to around 50 percent of its level in early 2023, to be well below the corresponding EU price, which, if it persists, will make some of the UK's exports subject to the EU Carbon Border Adjustment Mechanism (CBAM) from 2026. The announcement of a UK CBAM, to be implemented from 2027, is welcome. Overall, however, the net impact of recent policy adjustments and announcements is that existing policies are only sufficient to achieve 57 percent of the UK's NDC emissions reduction target by 2030 (see chart).

Percent Reduction Below No-Climate Policy Counterfactual in 2030



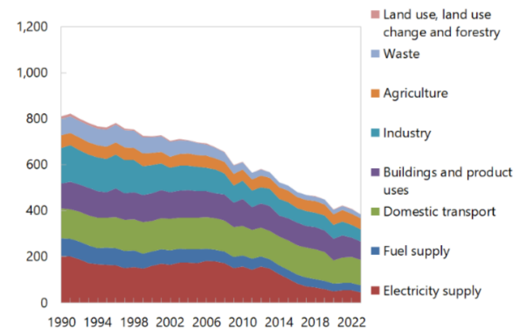
Source: IMF staff calculations.

UK Greenhouse Gas Emissions
(Percent of Global Emissions)



Source: EU Emissions Database for Global Atmospheric Research.

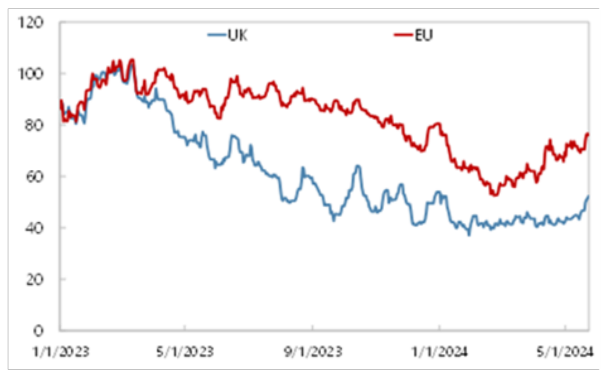
UK Greenhouse Gas Emissions by Sector
(Million Tonnes of CO_2 Equivalent)



Source: EU Emissions Database for Global Atmospheric Research.

46. The UK should stay the course on climate policy, to maintain its status as a climate leader and to realize the benefits of the green transition. Whole-of-economy investment in the green transition should increase to £50 billion pounds per year by 2030 (from £20 billion in 2020), as the Climate Change Committee has recommended, with a public contribution of around one third. Public support to households for the transition from gas heating to electric heat pumps is a priority for the government's contribution, given that the buildings sector is among the largest contributors to UK emissions, along with the transport and industrial sectors. The recently-announced exemption for certain homes from the requirement to transition to electric heat pumps should be narrowly defined, and the relaxation of energy efficiency requirements for rental properties should be reversed. Strengthening feebates on heating options for non-exempt homes in the near-term (with taxes on new fossil fuel heating funding subsidies for heat pumps) should be considered to accelerate the transition away from gas heating. Given the government's decision to delay the ban on purchases of internal combustion engine vehicles to 2035, the government should instead consider stronger price-based incentives for zero-emission vehicles in the form of larger feebates, with higher taxes on internal combustion engine vehicles supporting non-discriminatory consumption subsidies for electric vehicles, consistent with WTO rules and without favoring local manufacturers. The CBAM can help to address carbon leakage concerns and encourage trading partners to make more ambitious mitigation efforts, but should be implemented in line with WTO rules including basing charges on actual carbon content in traded products, rather than benchmarks. In line with 2023 Article IV recommendations, consideration could be given to widening the coverage of the ETS to include road transport and buildings (or consider upstream carbon taxes in these sectors), supported by a fixed carbon price floor that rises over time, in order to achieve a more comprehensive, predictable, and uniform carbon price. The

Carbon Prices
(12-month futures, euros)



Source: Bloomberg Finance L.P.

authorities should also pursue long overdue action on agricultural emissions, by implementing a self-reporting regime for farmers, with emissions subject to a fee.

47. ***Authorities' Views.*** The authorities explained the UK's strong performance in reducing emissions, noting that emissions have been halved relative to 1990 levels and that the first three carbon budgets have been met, subject to the UK's strong legal framework for climate policy. The authorities pointed out that recent changes to climate policy (e.g., delaying the ban on purchase of internal combustion engine vehicles) bring the UK more into line with peer countries. The authorities noted the legislative passage of the Electric Vehicles (EV) mandate, requiring 80 percent of new vehicles sold in the UK to be fully electric by 2030, and observed that the uptake of EVs is progressing well. The number of conversions to heat pumps for home heating has also accelerated, albeit from a low base, since the Boiler Upgrade Grant was increased. The authorities explained that a net-zero consistent cap on emission trading scheme allowances has been implemented and believe that this will be sufficient to support an appropriate carbon price in the UK. The authorities note the important role of public investment in the green transition, as well as public-private cooperation, particularly in the power sector. As with all areas, future public spending levels will be set at the next Spending Review.

STAFF APPRAISAL

48. The UK economy is approaching a soft landing. Real GDP growth is forecast at 0.7 percent in 2024 before rising to 1.5 percent in 2025 as disinflation buoys real incomes and financial conditions ease. However, longer-term growth prospects remain subdued due to weak labor productivity and somewhat higher-than-expected inactivity levels, only partly offset by higher migration numbers. Disinflation has advanced faster than expected, and a durable return to the target is forecast by early 2025, although this rests on wage growth and services inflation pressures abating from current elevated levels. Risks to growth and inflation are balanced. The 2023 external position was weaker than the level in line with fundamentals and desirable policies.

49. Monetary policy will need to balance the risks of premature vs. delayed easing, and be supported by strong communications, including around QT. With Bank Rate more than 2 ppts. higher than staff's estimate of the neutral rate, the next phase of monetary policy is to ease. Rate cuts of 50–75 bps in 2024 would balance the risks of premature and delayed easing, but a meeting-by-meeting approach remains appropriate, given uncertainties. Given a possible divergence from the Fed, there will be a premium on effective MPC communications, and a press conference after each rate decision would be beneficial. The reduction in the APF's gilt holdings through QT and the redemption of TFSME could lead the level of reserves to approach the estimated range for the BoE's steady-state balance sheet size as soon as 2025H2. Therefore, articulating a clear rationale for future QT plans will be important. In the context of implementing recommendations from the Bernanke review, consideration should be given to including, in any "alternative scenarios", scenario-specific monetary policy paths generated by BoE staff, and adequate resources should be allocated to enhance and maintain the required modeling infrastructure.

50. Fiscal plans will need to take better account of pressing spending needs, while assuredly stabilizing debt—this will involve difficult choices. Staff's analysis suggests that accommodating pressures in key public services and critical growth-enhancing investment needs, including for the green transition, will imply a non-stabilizing public debt to GDP ratio over the five-year projection horizon. Debt stabilization will require the primary balance to be, on average, around 0.8 ppt. GDP higher per year (relative to staff's baseline) which, absent a major boost to potential growth, will necessitate some difficult tax and spending choices. Possible measures include, on the revenue side, raising additional revenue from higher carbon and road-usage taxation, broadening the VAT and inheritance tax bases, and reforming capital gains and property taxation; and, on the spending side, indexing the state pension (only) to increase the cost of living, and expanded/enhanced charging for public services, while taking care to protect the vulnerable.

51. There is scope to further improve the UK's sophisticated fiscal framework. First, staff recommends strengthening the debt rule with the requirement that debt be falling by the fifth year with a high probability (e.g., 75 percent), to increase fiscal buffers against adverse shocks. Second, the credibility of fiscal plans should be enhanced by producing 4–5 year expenditure frameworks every two years, replacing the non-rolling 3-year spending reviews; requiring that an OBR forecast accompany each fiscal event; and extending the OBR's forecast horizon for its Economic and Fiscal Outlooks to ten years to better capture longer-term spending pressures, as well as dividends from growth-enhancing measures, which will help provide a more complete picture of the sustainability of public finances. Third, staff recommends moving to one fiscal event per year to steady decision making and reduce political pressure points for fiscal loosening. Finally, there is scope to adjust the treatment of QE/QT profits and losses in future cycles with a view to protecting the BoE from political pressures.

52. Further ambitious reforms are needed to boost potential growth. The authorities have delivered several helpful measures over the last three budgets, e.g., investment tax reliefs for businesses to boost investment, an expansion of childcare, and active labor market policies, but they are unlikely to sufficiently lift the UK's long-term potential growth towards pre-GFC levels. Additional ambitious reforms in (i) easing planning restrictions; (ii) upskilling the workforce; and (iii) improving health outcomes are needed, including building on past efforts. These reforms should ideally be nested within a stable, long-term growth strategy, backed by an independent growth commission. Such a body can take a longer-term view of reform priorities, better coordinate across different levels of government; and track and report on implementation, serving as a disciplining and communication device (akin to the Climate Change Committee). Moreover, the UK should continue its cautious approach to industrial policy, while maintaining its open trade orientation.

53. The UK authorities should stay the course on climate policy. The UK has halved emissions relative to 1990 levels, but current policies and spending allocations are insufficient to meet the 2030 target. It is important that the UK stays the course on climate policies to achieve the country's ambitious emission reduction goals and continues to build on its successes. Key priorities are: (i) ensuring the needed level of investment for the green transition; (ii) enhancing incentives for conversion to electric vehicles and heat pumps, through the use of feebates; and (iii) strengthening the UK's emission trading system and eliminating the shortfall of the UK carbon price below the EU price, while implementing the UK's CBAM in a way that minimizes administrative burdens on importing firms.

54. Financial stability risks have been contained thus far, and continued strong supervision of all banks and NBFIs is warranted. Households and corporates have been resilient, supported by strong wage growth and enhanced regulatory measures. Other financial stability risks, for example, globally stretched valuations across asset classes (notably private equity), as well as spillovers from CRE stress in other jurisdictions warrant continued close monitoring. The capital and liquidity positions of major UK banks remain robust, but the diverse business models of smaller banks merit continued close monitoring, including through stringent stress tests. The BoE is taking important initiatives in the NBFI space, notably the system-wide exploratory scenario exercise and the design of a BoE backstop lending tool for non-banks. While data is adequate for surveillance, staff continues to emphasize the importance of maintaining both domestic and international momentum to close data gaps and reduce NBFI vulnerabilities.

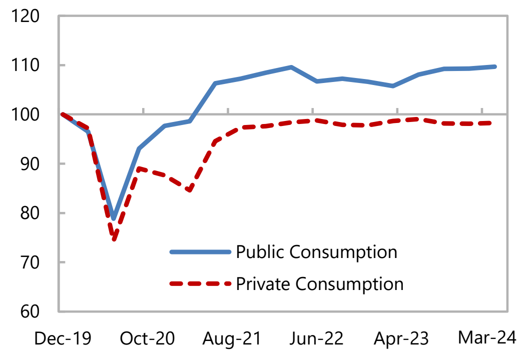
55. Structural financial sector reforms should continue to progress cautiously. The Edinburgh reforms have, so far, proceeded carefully and have preserved the primacy of financial stability objectives. While supporting the government's plan to reform the special resolution regime to minimize disruptions from small bank failures, staff encourage prefunding the FSCS to an appropriate level to avoid moral hazard. Moreover, caution is warranted around possible financial stability implications of the pension reforms, particularly given the context of ongoing DB pension fund buy-outs and potential concentration risk created in the insurance industry from these concurrent changes. In addition, staff encourages expanding auto-enrollment efforts and raising the minimum contribution to ensure adequate pensions for employees. Finally, the authorities should continue to strengthen the effectiveness of AML/CFT risk-based supervision.

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

Figure 5. United Kingdom: Real Sector Developments

Real private consumption remains subdued

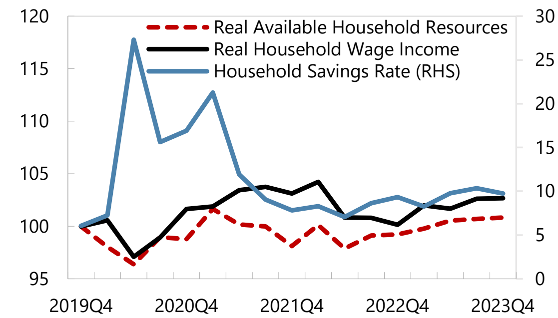
Real Consumption
(Index, 2019Q4=100)



Source: Haver Analytics.

HH savings rate is still high relative to pre-COVID level

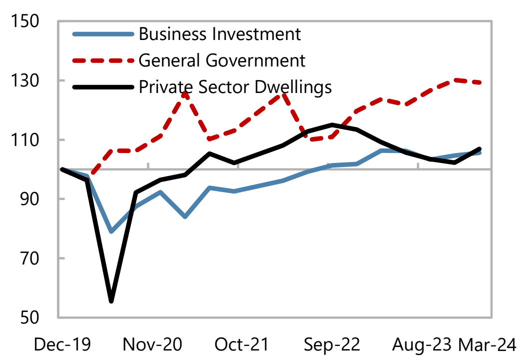
Household Income, Balance Sheet and Savings Rate
(LHS: Index, 2019Q4=100, RHS: percent)



Sources: ONS; and IMF Staff Calculations.

Private investment has been weak

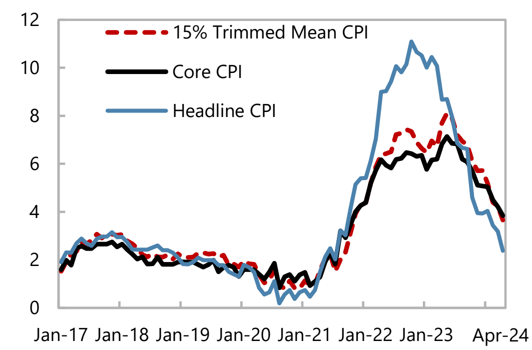
Real Fixed Investment
(Index, 2019Q4=100)



Source: Haver Analytics.

Price pressures have declined faster than expected…

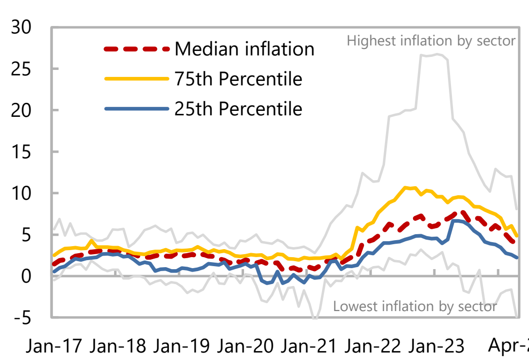
CPI Trimmed Mean
(Y-o-y percent change)



Sources: ONS; and Haver Analytics.

…but there is still a wide dispersion across sectors

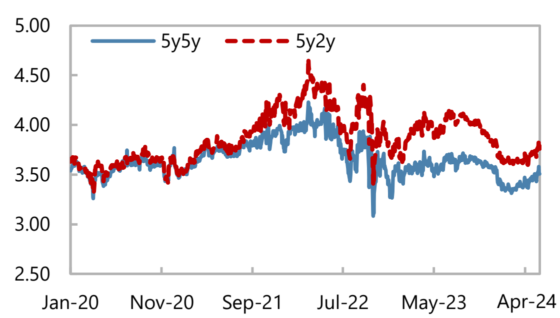
CPI Dispersion
(Y-o-y percent change, SA)



Note: Shaded area is the CPI range for each month across industries.
Sources: ONS and Haver Analytics.

Inflation expectations have eased since mid-2023.

Inflation Expectations
(Percentage points)



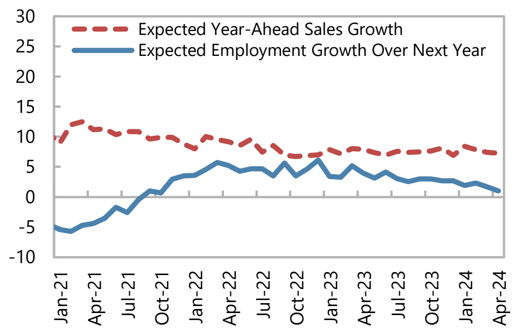
Note: Inflation expectations are derived from RPI based swaps. Historically, RPI is 1 ppt higher than CPI.
Sources: Bloomberg Finance L.P.; and IMF staff calculations.

Figure 6. United Kingdom: Labor Market Indicators

Firms' employment expectations suggest cooling

Firms' Sales and Employment Expectations

(Percent growth rate)

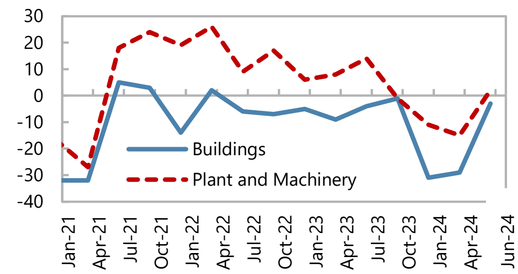


Sources: Bank of England Decision Making Panel; Haver Analytics.

Firms' expectation of capital expenditure has declined

Expectation of Capital Expenditure Authorizations

(Percent balance, over next year vs. last year)

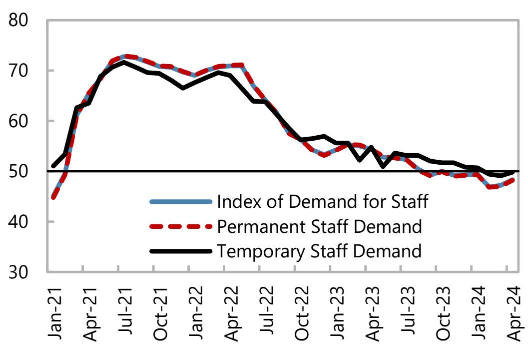


Note: The percent balance of opinion equals percent of respondents reporting more capital expenditure authorizations minus those reporting less over next 12 months versus last 12 months.
Sources: CBI; and Haver Analytics.

Labor demand has cooled…

Labor Demand

(Index, 50+ = increase)

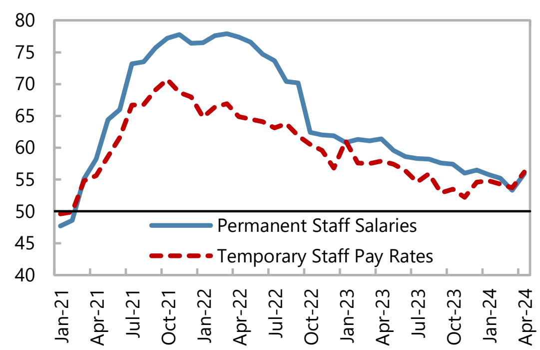


Sources: S&P Global.

…and staff pay rates are moderating.

Permanent Staff Salaries and Temp Staff Pay Rates

(Index, 50+ = increase)

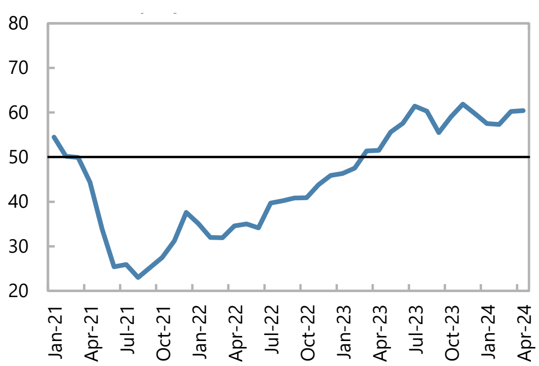


Sources: S&P Global.

Overall staff availability has also improved…

Overall Staff Availability

(Seasonally adjusted, 50+ = increase)

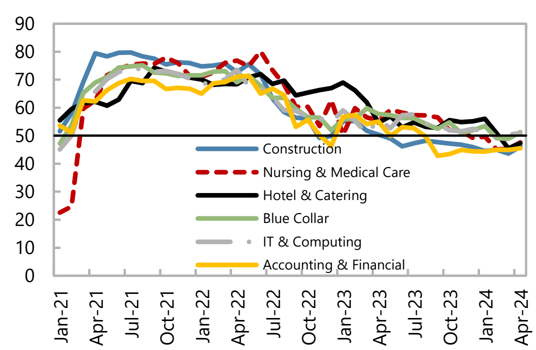


Sources: S&P Global

…while placements have declined.

Permanent Staff Placements by Sector

(Index, 50+ = increase)

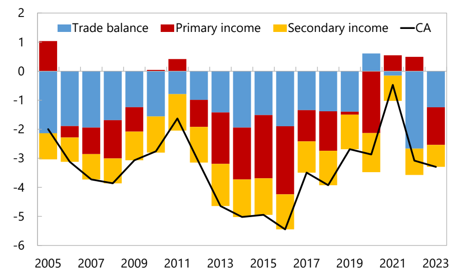


Sources: S&P Global.

Figure 7. United Kingdom: External Sector Developments

The current account deficit widened marginally in 2023, …

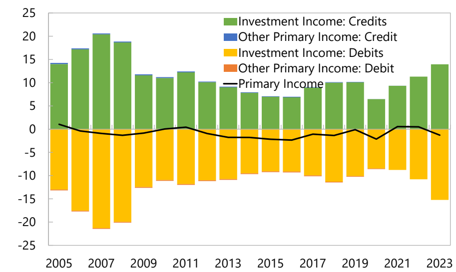
Current Account Balance
(Percent of GDP)



Sources: Haver Analytics, ONS, and IMF staff calculations.

… driven by a worsening in the income balance.

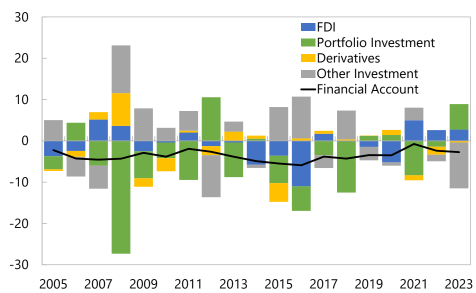
Primary Income Balance
(Percent of GDP)



Sources: Haver Analytics, ONS, and IMF staff calculations.

The financial account remains very volatile, reflecting large stock positions.

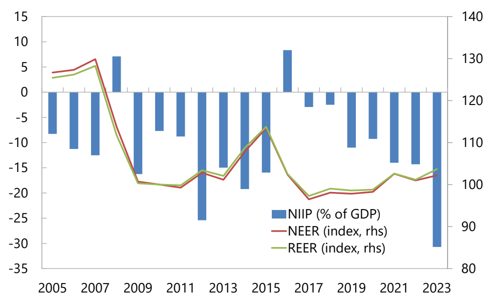
Financial Account Balance
(Percent of GDP)



Sources: Haver Analytics, ONS, and IMF staff calculations.

The NIIP worsened, largely driven by valuation effects, including exchange rate appreciation.

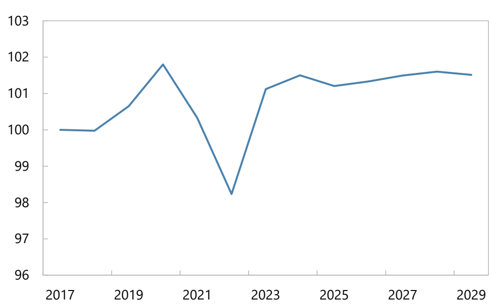
NIIP and Effective Exchange Rate



Sources: Haver Analytics, ONS, and IMF staff calculations.

Terms of trade improved sharply in 2023, reflecting lower energy prices, …

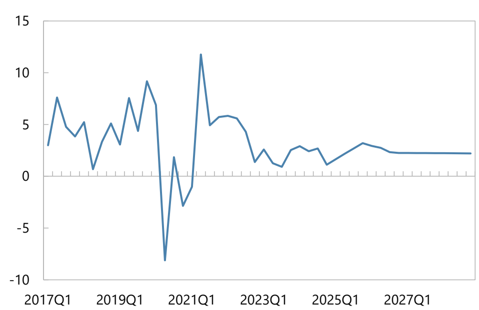
Terms of Trade
(Index, 2017 = 100)



Sources: World Economic Outlook; and IMF staff calculations.

… but trading partner demand was weak.

Trade Partner Demand Weighted by Exports
(Y-o-y percent change)



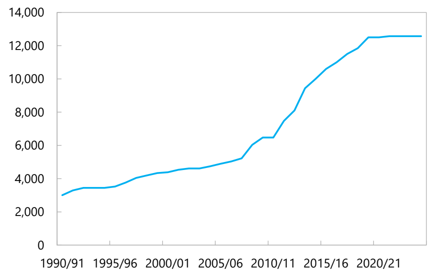
Source: IMF staff calculations.

Figure 8. United Kingdom: Fiscal Developments

Frozen personal income tax thresholds are causing fiscal drag and boosting revenue

Bottom Marginal Tax Threshold (Personal Allowance)

(GBP)

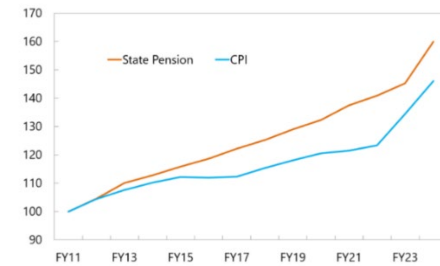


Source: HM Revenue and Customs.

Spending pressures are mounting including from ageing, with the Triple Lock policy increasing the state pension above inflation

State Pension

(FY11 = 100)

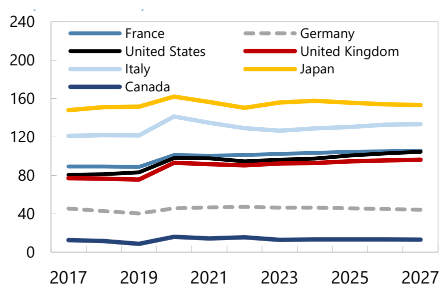


Sources: UK Department for Work and Pensions.

Public debt/GDP is lower than the median for the G7

Public Sector Net Debt

(Percent of GDP)

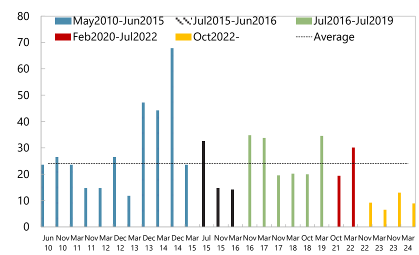


Sources: World Economic Outlook.

..but headroom vis-à-vis fiscal rules (deficit and debt targets) has shrunk.

Successive Forecasts for Headrooms Against Fiscal Targets

(£ Billion)

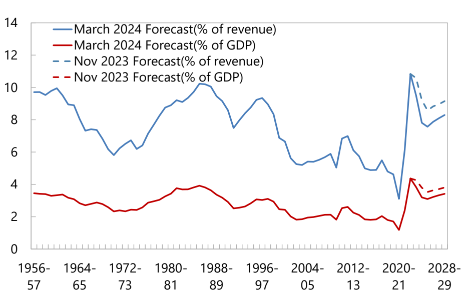


Sources: OBR.

Debt interest has surged, reflecting tight financing conditions and a high share of inflation-indexed bonds and remunerated reserves …

Debt Interest Spending Relative to GDP and Revenues

(Percent)

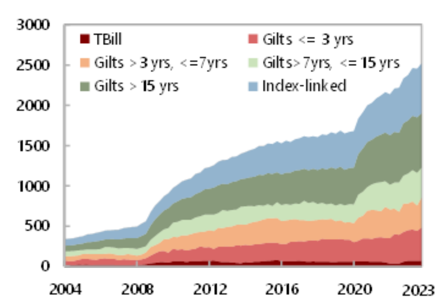


Sources: ONS;OBR Economic and Fiscal Outlook, Mar 2024.

Debt levels have risen, but the medium-term risk of sovereign stress remains moderate, mitigated by a relatively long average maturity of GG debt

Composition of Central Government Wholesale Debt Stock

(£ Billion)

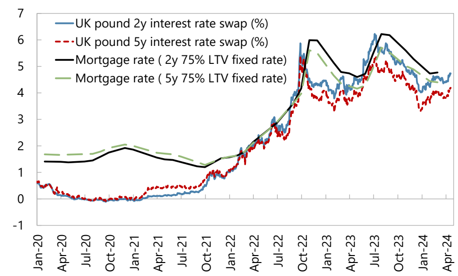


Sources: DMO.

Figure 9. United Kingdom: Residential Real Estate Developments

Mortgage rates have declined since the peak after the 'mini-budget.'

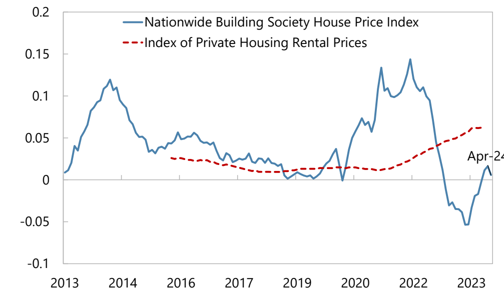
Mortgage Rates
(Percent)



Sources: Bank of England; and Haver Analytics.

UK rental prices rose at a new record in the year to March

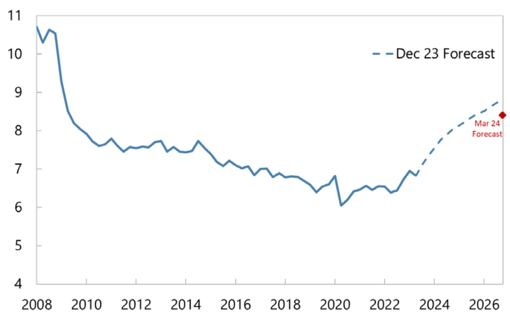
House Prices and Rental Prices
(Y-o-y percentage change)



Sources: ONS; National Building Society.

High interest rates continue to put pressure on debt servicing obligations, which are projected to increase.

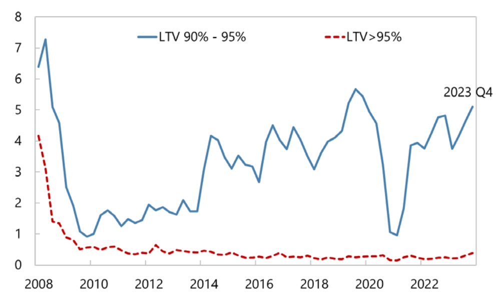
Aggregate UK Household Mortgage Debt-Service Ratio
(Percent)



Sources: BoE Financial Stability Report 2023 and BoE forecast.

While mortgage lending in the highest LTV category remains low, lending at LTVs between 90 to 95 percent has increased…

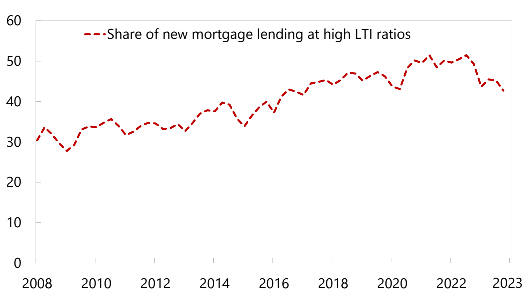
New Mortgage Loans as Percent of Gross Advances: Loan to Value
(Percent)



Sources: Bank of England; Haver Analytics.

but lending at high LTI ratios has been contained

New Lending to High-LTI Borrowers
(Percent)

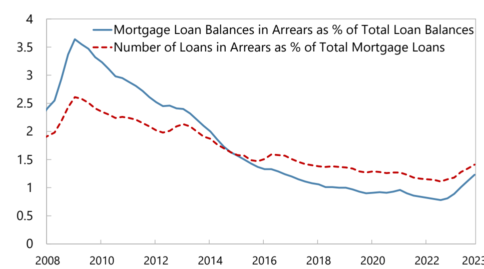


Note: High LTI ratio refers to Single Income Multiple Over 400% and Joint Income Multiple Over 300%

Sources: Haver Analytics and Mortgage Lending Administration Return (MLAR)

Mortgage arrears peaked in Q4 2023 but remain low compared with pre-GFC levels

Mortgage Arrears
(Percent)



Note: Arrears are defined as instances when any contractual payments, of capital, interest fees or other charges, are overdue at the reporting date.

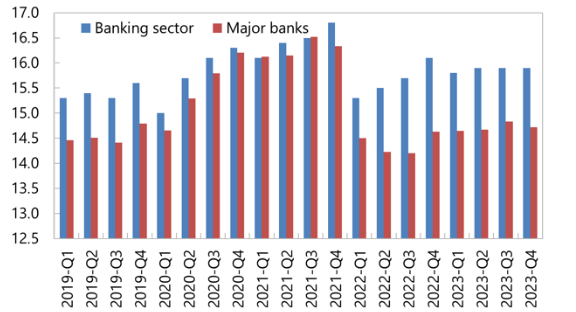
Sources: Haver Analytics and Mortgage Lending and Administration Return (MLAR).

Figure 10. United Kingdom: Financial Sector

The banking sector continues to maintain a comfortable level of capital buffers.

Aggregate CET1 Capital Ratio

(Percent)

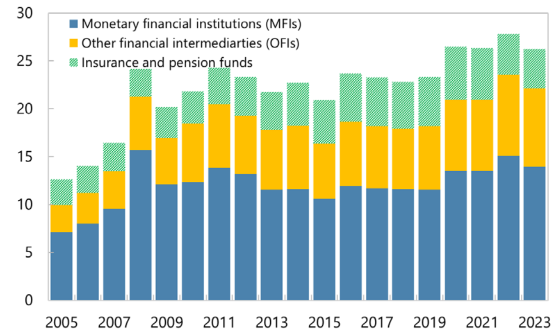


Source: Bank of England.
Note: Major UK banks are Barclays, Lloyds Bank, HSBC, NatWest, Standard Chartered, and, from end-2020, Virgin Money UK.

NBFIs are growing as an equally important sector, ...

Financial Sector – Financial Assets

(Trillion £)

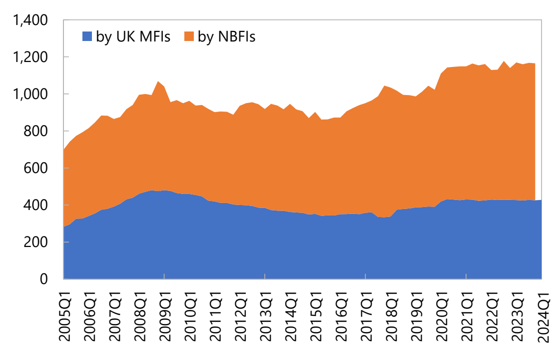


Source: ONS.

... with growing shares in corporate lending ...

Loans to UK NFCs

(In billion £)

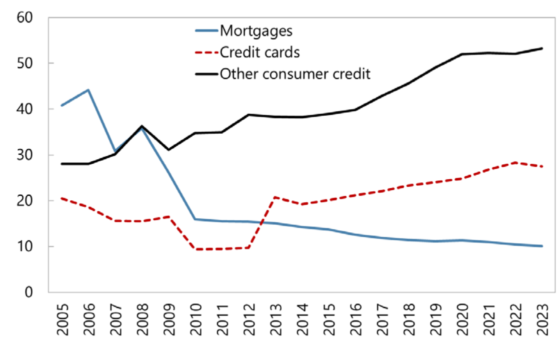


Sources: ONS, BoE, BIS

... and in consumer credit.

NBFI Share in Outstanding Household Credit

(Percent)



Sources: ONS and BOE.

Table 2. United Kingdom: Selected Economic Indicators, 2019–29

(Percentage change, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
Real Economy (change in percent)											
Real GDP	1.6	-10.4	8.7	4.3	0.1	0.7	1.5	1.7	1.6	1.6	1.4
Domestic demand	1.8	-11.9	9.1	4.8	0.0	0.5	1.8	1.4	1.6	1.6	1.3
Private final domestic demand	1.3	-13.3	7.3	5.9	0.4	-0.1	0.9	1.2	1.7	1.7	1.3
CPI, period average	1.8	0.9	2.6	9.1	7.3	2.7	2.1	2.0	2.0	2.0	2.0
CPI, end-period	1.3	0.6	5.4	10.5	4.0	2.5	2.0	2.0	2.0	2.0	2.0
Unemployment rate (in percent) 1/	3.9	4.7	4.6	3.9	4.0	4.2	4.1	4.0	4.0	4.0	4.0
Gross national saving (percent of GDP)	15.6	14.7	17.1	16.2	15.0	14.2	13.9	14.3	14.3	14.3	14.4
Gross domestic investment (percent of GDP)	18.2	17.5	17.5	19.3	18.3	17.4	17.4	17.6	17.5	17.4	17.4
Public Finance (fiscal year, percent of GDP)											
Public sector overall balance	-2.7	-14.9	-5.3	-5.1	-4.3	-3.7	-3.2	-3.0	-2.8	-2.9	-2.8
Public sector cyclically adjusted primary balance	-0.8	-11.5	-3.6	-2.4	-1.2	-0.9	-0.2	0.0	0.0	-0.2	-0.2
Public sector net debt (excl. BoE) 2/	85.2	85.1	83.5	84.8	89.4	92.2	93.5	94.9	96.1	97.5	98.6
Public sector primary balance 3/	-0.4	-1.3	-14.1	-3.6	-1.2	-1.2	-1.4	-0.7	-0.4	-0.1	-0.2
Money and Credit (12-month percent change)											
M4 (end-period)	3.8	13.5	6.3	1.6	-0.9	...	...	...	...	...	...
Net lending to private sector (end-period)	2.8	3.6	2.8	2.9	7.2	2.6	3.3	3.6	3.7	3.7	3.5
House Price Index (HMLR, end-period)	0.9	7.0	7.3	7.6	-2.0	...	...	...	...	...	...
Interest Rates (percent; year average)											
Short Term Interest Rate	0.8	0.3	0.1	2.0	4.7	5.1	4.1	3.2	3.0	3.0	3.0
Long Term Interest Rate	0.9	0.4	0.8	2.4	4.1	4.3	4.2	4.2	4.2	4.1	4.1
Bank Rate	0.8	0.2	0.1	1.5	4.7	5.1	4.1	3.2	3.0	3.0	3.0
2y mortage rate (75% LTV fixed rate,average)	1.6	1.6	1.4	3.5	5.3	...	...	...	...	...	...
5y mortage rate (75% LTV fixed rate,average)	1.9	1.8	1.6	3.4	4.8	...	...	...	...	...	...
Balance of Payments (percent of GDP)											
Current account balance	-2.7	-2.9	-0.5	-3.1	-3.3	-3.2	-3.5	-3.3	-3.2	-3.1	-3.0
Trade balance	-1.4	0.6	-0.2	-2.7	-1.2	-1.0	-1.3	-1.1	-1.0	-0.9	-0.8
Net exports of oil	-0.2	0.1	0.0	-0.6	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3
Exports of G&S (volume change in percent)	2.0	-11.5	4.9	9.0	-0.5	-0.4	0.8	0.6	1.6	1.6	1.5
Imports of G&S (volume change in percent)	2.7	-16.0	6.1	14.6	-1.5	-1.0	1.6	-0.2	1.6	1.5	1.2
Terms of trade (percent change)	0.7	1.1	-1.4	-2.1	2.9	0.2	-0.3	-0.2	0.2	0.2	-0.1
FDI net	-1.5	-5.2	5.0	2.6	2.7	0.2	0.2	0.2	0.2	0.2	0.2
Reserves (end of period, billions of US dollars)	168.0	169.0	197.2	181.5	173.6	176.4	178.7	182.5	186.0	189.3	193.3
Exchange Rates											
Exchange rate regime			Floating								
Bilateral rate (May 29, 2024)			US$1 = £ 0.8								
Nominal effective rate (2010=100, year average)	97.8	98.3	102.6	101.0	102.2	...	...	...	...	...	...
Real effective rate (2010=100, year average)	98.6	98.8	102.6	101.2	103.7	...	...	...	...	...	...
Memorandum Items:											
Nominal GDP (billions GBP)	2,234	2,104	2,284	2,506	2,687	2,756	2,848	2,950	3,059	3,173	3,283
Nominal GDP (billions USD)	2,853	2,700	3,142	3,100	3,341	...	...	...	...	...	...

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

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

2/ Public sector net debt is defined as public sector gross debt minus liquid assets held by general government and non-financial public corporations. It excludes operations from Bank of England. The fiscal year begins in April. Debt stock reported in this table has been transformed into calendar year by using end-of-fiscal year information on debt and centered-GDP as a denominator.

3/ Corresponds to fiscal year ending in 2019, 2020, etc.

Table 3. United Kingdom: Medium-Term Scenario, 2019–29

(Percentage change, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
Real GDP	1.6	-10.4	8.7	4.3	0.1	0.7	1.5	1.7	1.6	1.6	1.4
Q4/Q4 1/	1.8	-8.3	9.7	0.6	-0.2	1.5	1.6	1.7	1.6	1.7	1.1
Real domestic demand	1.8	-11.9	9.1	4.8	0.0	0.5	1.8	1.4	1.6	1.6	1.3
Private consumption	1.1	-13.2	7.4	5.0	0.3	0.4	1.0	0.8	1.6	1.8	1.3
Government consumption	4.0	-7.9	14.9	2.3	0.5	4.0	2.2	1.7	1.9	1.6	1.6
Fixed investment	2.2	-10.8	7.4	8.0	2.2	-2.4	0.0	1.8	1.3	1.1	1.1
Public	2.7	3.6	10.0	0.9	7.7	-2.1	-4.2	-1.4	-1.6	-1.1	-1.1
Residential	3.1	-17.1	19.6	10.3	-6.4	-4.1	0.6	3.2	1.1	1.5	1.5
Business	2.1	-10.6	2.0	9.6	5.5	-2.0	0.8	2.1	2.2	1.6	1.4
Stocks 2/	0.0	0.1	-0.2	1.0	-0.9	-0.4	0.3	0.1	0.0	0.0	0.0
Gross national saving (percent of GDP)	15.6	14.7	17.1	16.2	15.0	14.2	13.9	14.3	14.3	14.3	14.4
Gross domestic investment (percent of GDP)	18.2	17.5	17.5	19.3	18.3	17.4	17.4	17.6	17.5	17.4	17.4
External balance 2/	-0.3	1.7	-0.4	-1.7	0.3	0.2	-0.3	0.2	0.0	0.0	0.1
Exports of Goods and Services	2.0	-11.5	4.9	9.0	-0.5	-0.4	0.8	0.6	1.6	1.6	1.5
Imports of Goods and Services	2.7	-16.0	6.1	14.6	-1.5	-1.0	1.6	-0.2	1.6	1.5	1.2
Current account 3/	-2.7	-2.9	-0.5	-3.1	-3.3	-3.2	-3.5	-3.3	-3.2	-3.1	-3.0
CPI Inflation, period average	1.8	0.9	2.6	9.1	7.3	2.7	2.1	2.0	2.0	2.0	2.0
CPI Inflation, end period	1.3	0.6	5.4	10.5	4.0	2.5	2.0	2.0	2.0	2.0	2.0
GDP deflator, period average	2.1	5.1	-0.1	5.1	7.1	1.9	1.7	1.9	2.0	2.1	2.1
Output gap 4/	0.0	-3.6	0.5	1.8	-0.3	-1.0	-0.9	-0.7	-0.5	-0.1	0.0
Potential output	1.4	-7.1	4.2	3.0	2.2	1.4	1.5	1.5	1.4	1.3	1.3
Employment and productivity											
Employment	1.1	-0.9	-0.1	1.3	0.7	0.2	1.3	1.1	1.0	0.8	0.7
Unemployment rate 5/	3.9	4.7	4.6	3.9	4.0	4.2	4.1	4.0	4.0	4.0	4.0
Productivity 6/	0.5	-9.6	8.8	3.0	-0.6	0.5	0.2	0.5	0.6	0.8	0.7
Memorandum items:											
Private final domestic demand	1.3	-13.3	7.3	5.9	0.4	-0.1	0.9	1.2	1.7	1.7	1.3
Household saving rate 7/	5.5	16.8	12.5	8.4	9.5	9.2	7.9	7.3	6.5	6.2	5.6

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, 2019/20–2028/29 1/

	2019/20	2020/21	2021/22	2022/23	2023/24		2024/25		2025/26		2026/27		2027/28		2028/29	
					Proj.	OBR	Proj.	OBR	Proj.	OBR	Proj.	OBR	Proj.	OBR	Proj.	OBR
Revenue	36.9	38.0	39.1	40.3	40.6	*40.4*	40.4	*40.9*	40.7	*40.8*	40.8	*40.9*	40.8	*41.1*	40.8	*41.2*
Personal income tax	8.6	9.5	9.6	9.8	10.3	*10.2*	10.6	*10.9*	11.1	*11.0*	11.3	*11.1*	11.3	*11.3*	11.3	*11.3*
National insurance contributions	6.5	6.9	6.8	6.9	6.6	*6.6*	6.1	*6.0*	6.0	*6.0*	6.0	*6.0*	6.0	*6.0*	6.0	*6.0*
Corporate income tax	2.2	2.5	2.8	3.1	3.5	*3.5*	3.5	*3.6*	3.5	*3.6*	3.5	*3.6*	3.5	*3.6*	3.5	*3.6*
VAT	6.0	5.7	6.1	6.3	6.3	*6.3*	6.3	*6.3*	6.3	*6.3*	6.3	*6.4*	6.3	*6.4*	6.3	*6.4*
Interest income	1.0	1.1	1.0	1.2	1.5	*1.5*	1.6	*1.6*	1.3	*1.3*	1.3	*1.3*	1.3	*1.3*	1.3	*1.3*
Other	12.6	12.3	12.9	12.8	12.4	*12.3*	12.4	*12.5*	12.4	*12.6*	12.4	*12.6*	12.4	*12.6*	12.4	*12.6*
Expenditure	39.6	53.1	44.3	45.3	44.8	*44.5*	44.0	*44.0*	43.7	*43.5*	43.6	*43.2*	43.5	*42.8*	43.5	*42.5*
Departmental Expenditure Limits (DEL)	16.9	24.3	20.8	19.5	19.1	*19.0*	19.1	*19.0*	19.1	*18.7*	19.2	*18.4*	19.3	*18.2*	19.3	*18.0*
-Recurrent (RDEL)	14.3	20.8	17.6	15.9	15.6	*15.5*	15.5	*15.4*	15.6	*15.3*	15.6	*15.2*	15.7	*15.0*	15.7	*14.9*
-Capital (CDEL)	2.6	3.5	3.3	3.5	3.5	*3.5*	3.6	*3.6*	3.6	*3.4*	3.6	*3.3*	3.6	*3.2*	3.6	*3.0*
Non-Discretionary (incl. Welfare)	20.3	26.6	20.4	20.7	21.2	*21.0*	21.2	*21.1*	20.9	*21.0*	20.7	*20.8*	20.4	*20.5*	20.3	*20.3*
Interest expense	2.4	2.2	3.1	5.1	4.5	*4.5*	3.7	*3.9*	3.6	*3.8*	3.7	*3.9*	3.8	*4.1*	3.9	*4.1*
Net lending/borrowing (overall balance)	-2.6	-15.1	-5.2	-5.0	-4.2	*-4.2*	-3.5	*-3.1*	-3.0	*-2.7*	-2.8	*-2.3*	-2.7	*-1.6*	-2.7	*-1.2*
Primary balance	-1.3	-14.1	-3.2	-1.2	-1.2	*-1.2*	-1.4	*-0.8*	-0.7	*-0.2*	-0.4	*0.4*	-0.1	*1.1*	-0.2	*1.6*
Cyclically adjusted overall balance	-2.6	-13.0	-5.5	-6.2	-4.1	*-4.3*	-2.9	*-2.7*	-2.4	*-2.3*	-2.3	*-2.1*	-2.4	*-1.6*	-2.7	*-1.2*
Cyclically adjusted primary balance (CAPB)	-1.3	-12.0	-3.5	-2.3	-1.1	*-1.3*	-0.8	*-0.4*	-0.1	*0.2*	0.1	*0.6*	0.2	*1.2*	-0.2	*1.6*
General government gross debt 2/	84.6	107.6	101.0	99.3	99.6	*98.6*	103.1	*101.9*	104.7	*103.4*	105.7	*103.8*	106	*104*	107	*103.1*
Public sector net debt excl. BoE schemes /3	77.1	86.5	83.2	84.9	89.4	*88.8*	92.2	*91.7*	93.5	*92.8*	94.9	*93.2*	96.1	*93.2*	97.5	*92.9*
Memorandum items:																
Output gap (percent of potential)	-0.8	-3.9	2.1	1.5	-0.8	*-0.2*	-0.9	*-0.8*	-0.9	*-0.5*	-0.6	*-0.2*	-0.4	*0.0*	0.0	*0.0*
Deflator growth (Percent)	2.4	5.3	-0.7	6.7	6.1	*6.5*	1.3	*0.8*	1.8	*1.3*	2.0	*1.7*	2.0	*1.9*	2.0	*1.9*
Real GDP growth (percent)	0.9	-11.6	13.6	1.7	0.1	*0.2*	0.9	*1.2*	1.6	*1.9*	1.7	*2.0*	1.6	*1.8*	1.6	*1.7*
Nominal GDP growth (percent)	3.2	-6.9	12.9	8.5	6.2	*7.0*	2.3	*2.0*	3.5	*3.2*	3.6	*3.8*	3.7	*3.7*	3.7	*3.7*
Nominal GDP (in billions of pounds)	2,241	2,086	2,354	2,555	2,715	*2,731*	2,777	*2,786*	2,873	*2,875*	2,978	*2,985*	3,087	*3,094*	3,202	*3,207*
Potential GDP growth (percent)	1.4	-8.8	7.0	2.3	2.4	*na*	1.0	*na*	1.7	*na*	1.3	*na*	1.4	*na*	1.2	*na*

Sources: HM Treasury; Office for National Statistics; and IMF staff estimates.
1/ Fiscal year ends March 30.
2/ On a Maastricht treaty basis. Includes temporary effects of financial sector intervention.
3/ End of fiscal year using centered-GDP as the denominator.

Table 5. United Kingdom: Balance of Payments, 2019–29

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
Current account	-2.7	-2.9	-0.5	-3.1	-3.3	-3.2	-3.5	-3.3	-3.2	-3.1	-3.0
Balance on goods and services	-1.4	0.61	-0.15	-2.7	-1.2	-1.0	-1.3	-1.1	-1.0	-0.9	-0.8
Trade in goods	-6.5	-6.1	-7.2	-8.7	-6.9	-6.9	-7.5	-7.4	-7.2	-7.1	-7.0
Exports	16.5	14.9	14.5	17.0	14.7	13.9	13.6	13.2	13.0	12.9	12.8
Imports	-23.0	-21.0	-21.7	-25.6	-21.6	-20.8	-21.1	-20.6	-20.3	-20.0	-19.7
Trade in services	5.1	6.7	7.0	6.0	5.7	5.9	6.2	6.3	6.2	6.2	6.2
Exports	15.2	14.8	15.1	16.5	17.5	17.6	17.3	17.1	16.9	16.7	16.5
Imports	-10.1	-8.1	-8.1	-10.5	-11.8	-11.6	-11.1	-10.8	-10.6	-10.5	-10.4
Primary income balance	-0.1	-2.1	0.5	0.5	-1.3	-1.3	-1.3	-1.2	-1.2	-1.2	-1.2
Receipts	10.2	6.5	9.4	11.4	14.0	13.2	12.4	11.7	10.9	10.1	9.3
Payments	10.3	8.6	8.8	10.9	15.3	14.5	13.7	12.9	12.1	11.3	10.5
Secondary income balance	-1.2	-1.3	-0.9	-0.9	-0.8	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0
Capital and financial account	-3.4	-3.4	-0.7	-2.3	-2.5	-3.2	-3.5	-3.3	-3.2	-3.1	-3.0
Capital account	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial account	-3.5	-3.5	-0.8	-2.4	-2.7	-3.3	-3.7	-3.5	-3.3	-3.3	-3.1
Direct investment	-1.5	-5.2	5.0	2.6	2.7	0.2	0.2	0.2	0.2	0.2	0.2
Abroad	-0.7	0.6	5.1	4.0	1.3	3.0	3.0	3.0	3.0	3.0	3.0
Domestic	0.8	5.8	0.2	1.4	-1.5	2.8	2.8	2.8	2.8	2.8	2.8
Portfolio investment	1.2	1.4	-8.4	-1.4	6.2	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4
Abroad	3.5	3.9	-2.3	-2.8	9.1	1.8	1.8	1.8	1.8	1.8	1.8
Domestic	2.3	2.5	6.1	-1.3	2.9	7.2	7.2	7.2	7.2	7.2	7.2
Financial derivatives	0.1	1.2	-1.2	-1.9	-0.4	0.2	0.2	0.2	0.2	0.2	0.2
Other investment	-3.2	-0.8	3.1	-1.6	-11.1	1.7	1.4	1.6	1.7	1.8	1.9
Abroad	-12.1	17.9	13.0	4.2	2.7	1.0	1.0	1.0	1.0	1.0	1.0
Domestic	-8.8	18.7	10.0	5.8	13.8	-0.7	-0.4	-0.6	-0.7	-0.8	-0.9
Change in reserve assets	0.0	-0.1	0.8	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.7	-0.5	-0.2	0.8	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Terms of trade (y/y percent change)	0.7	1.1	-1.4	-2.1	2.9	0.2	-0.3	-0.2	0.2	0.2	-0.1

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, 2019–29

(Percent of GDP)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
Net investment position	-11.0	-9.3	-14.0	-14.3	-30.7	-30.6	-30.6	-30.3	-29.8	-29.3	-28.8
Assets	517	622	570	559	503	502	498	492	487	482	477
Liabilities	528	631	584	573	534	532	528	523	517	511	506
Net direct investment	0.5	-7.9	-10.2	-18.2	-27.0	-26.1	-25.1	-24.0	-23.0	-22.0	-21.0
Direct investment abroad	86.2	100.6	95.8	85.2	76.0	77.1	77.6	77.9	78.2	78.4	78.7
Direct investment in the UK	85.8	108.5	106.0	103.4	103.0	103.3	102.8	102.0	101.2	100.3	99.7
Net Portfolio investment	-25.9	-15.8	-17.0	-12.2	-7.5	-10.1	-12.5	-14.8	-17.0	-19.1	-21.2
Portfolio investment abroad	129.7	151.0	149.0	119.2	122.8	124.2	124.7	124.8	124.8	124.8	125.1
Portfolio investment in the UK	155.6	166.8	166.0	131.4	130.3	134.3	137.2	139.6	141.8	143.9	146.3
Net financial derivatives	-1.2	-1.6	-3.2	-3.1	-3.3	-3.0	-2.7	-2.5	-2.2	-2.0	-1.7
Assets	103.2	142.3	103.6	130.2	103.1	103.1	103.1	103.1	103.1	103.1	103.1
Liabilities	104.3	143.9	106.8	133.3	106.3	106.1	105.8	105.5	105.3	105.0	104.8
Net other investment	9.6	9.8	10.1	13.4	1.9	3.6	4.9	6.3	7.8	9.3	10.9
Other investment abroad	192.0	222.0	215.2	218.4	196.4	192.5	187.3	181.8	176.3	171.0	166.2
Other investment in the UK	182.3	212.3	205.1	205.0	194.5	188.9	182.4	175.5	168.6	161.7	155.3
Reserve assets	5.9	6.3	6.3	5.9	5.2	5.1	4.9	4.7	4.6	4.4	4.3
Memorandum items:											
Change in the net investment position	-8.6	2.4	-5.5	-1.5	-17.4	-0.6	-1.0	-0.8	-0.7	-0.6	-0.4
Current account balance	-2.7	-2.9	-0.5	-3.1	-3.3	-3.2	-3.5	-3.3	-3.2	-3.1	-3.0

Source: Office for National Statistics.

Table 7. United Kingdom: Monetary Survey, 2016–23

(Billions GBP)

	2016	2017	2018	2019	2020	2021	2022	2023
Net foreign assets	372	399	393	279	215	220	296	342
Foreign assets	3582	3748	3856	3693	3971	4094	4433	4387
Foreign liabilities	3210	3349	3463	3414	3756	3874	4138	4045
Net domestic assets	1879	1960	2020	2227	2606	2781	2751	2669
M4 lending to the private sector	2258	2381	2457	2576	2655	2700	2728	2695
Net foreign currency lending to the private sector	-164	-190	-238	-168	-160	-185	-203	-163
Net lending to the public sector	605	625	575	598	892	969	711	678
Other items, net	-821	-855	-774	-779	-781	-703	-485	-541
M4 1/	2251	2360	2414	2506	2821	3000	3047	3011
Memorandum item: 2/								
M4 growth, percent	6.2	4.8	2.3	3.8	12.6	6.4	1.6	-1.2
M4 lending to the private sector growth, percent	4.2	5.5	3.2	4.8	3.1	1.7	1.0	-1.2

Source: Bank of England.

1/ M4 includes the private sector's holdings of sterling notes and coins; sterling deposits, including certificates of deposits; commercial paper, bonds, floating rate notes, and other instruments of up to and including 5 years' original maturity issued by UK monetary financial institutions; claims on UK MFIs arising from repos; estimated holdings of sterling bank bills; and 95% of the domestic sterling interbank difference (the remaining 5% being allocated to transits).
2/ Computed as the ratio of the change in the stock divided by last period's stock and therefore includes valuation changes.

Table 8. United Kingdom: Financial Soundness Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
Capital Adequacy								
Regulatory Capital to Risk-Weighted Assets	20.6	20.7	21.4	21.3	21.6	22.1	21.4	21.2
Regulatory Tier 1 Capital to Risk-Weighted Assets	16.5	17.1	17.9	17.9	18.5	19.1	18.5	18.3
Capital to Assets	5.5	5.4	5.6	5.5	5.5	5.3	6.5	6.1
Credit Risk								
Non-performing Loans Net of Provisions to Capital	3.8	3.1	4.9	4.3	3.1	4.4	4.3	4.6
Non-performing Loans to Total Gross Loans	1.7	1.4	1.1	1.0	1.0	1.0	0.9	1.0
Foreign-Currency-Denominated Loans to Total Loans	79.5	78.7	67.4	60.1	54.9	60.8	62.9	62.6
Profitability								
Return on Assets	0.2	0.3	0.5	0.3	0.2	0.5	0.6	0.7
Return on Equity	1.1	2.8	5.2	3.6	2.6	6.5	7.9	9.0
Interest Margin to Gross Income	53.8	52.3	46.1	44.7	43.9	43.1	45.0	45.5
Non-interest Expenses to Gross Income	68.3	66.8	65.7	66.6	68.0	68.6	62.8	60.6
Trading Income to Total Income	12.3	12.8	16.5	17.3	21.1	16.1	21.2	22.2
Personnel Expenses to Non-interest Expenses	49.8	47.4	46.2	47.1	47.2	46.5	45.9	45.5
Liquidity								
Liquidity Coverage Ratio	149.3	159.2	172.2	163.6	160.7	164.9	159.9	166.8
Foreign-Currency-Denominated Liabilities to Total Liabilities	40.2	42.0	41.3	39.1	37.4	40.2	42.9	43.8
Fx, Equity, and Derivative Risk								
Gross Asset Position in Financial Derivatives to Capital	337.6	274.7	254.8	293.3	355.4	260.7	381.7	322.9
Gross Liability Position in Financial Derivatives to Capital	331.4	273.0	251.0	292.1	356.5	257.9	375.7	316.1

Source: IMF FSI database.

Table 9. United Kingdom: Anti-Corruption Efforts (Authorities' Self-Assessment)

Corporate Transparency
The UK passed the Economic Crime and Corporate Transparency Act 2023 ("the Act") gained Royal Assent on 26 October last year. Among other things, it includes measures to reform the role of Companies House and improve transparency over UK companies and other legal entities. The reforms include: • Introducing identity verification for all new and existing registered company directors, People with Significant Control, and those delivering documents to the Registrar. This will improve the accuracy of Companies House data, to support business decisions and law enforcement investigations. • Broadening the Registrar of Companies House's powers so that the Registrar can become a more active gatekeeper over company creation and custodian of more reliable data, including new powers to check, remove or decline information submitted to, or already on, the companies register. • Improving the financial information on the register so that the register is more reliable, complete and accurate, reflects the latest advancements in digital technology, and enables better business decisions. • Providing Companies House with more effective investigation and enforcement powers and introducing better cross-checking of data with other public and private sector bodies. Companies House will be able to proactively share information with law enforcement bodies where they have evidence of anomalous filings or suspicious behaviour. • Enhancing the protection of personal information provided to Companies House to protect individuals from fraud and other harms. • Broader reforms to clamp down on misuse of corporate entities
The Act also introduced measures to tackle the misuse of limited partnerships, including Scottish limited partnerships, while modernising the law governing them. The Act will tighten registration requirements; requires limited partnerships to maintain a connection with the UK; increase transparency requirements; and enable the Registrar to deregister limited partnerships which are dissolved, no longer carrying on business, or where a court orders that it is in the public interest to do so.
The UK has worked with the Overseas Territories (OTs) to identify how to improve beneficial ownership transparency. Gibraltar introduced a fully publicly accessible register in 2020, with some expected to follow suit in 2024. Most remaining inhabited OTs have agreed to introduce publicly accessible registers with a legitimate interest access filter, and UK Government has stated its expectation that this will include civil society and the media and be an interim step to full public accessibility. The UK is providing technical and financial assistance to these OTs to expedite implementation.
The UK Government is also engaging with the Crown Dependencies (CDs) on their commitments to improve transparency in their registers of beneficial ownership. In December 2023, the CDs published their updated commitments on beneficial ownership transparency which stated they will deliver obliged entity access (to include groups such as auditors, accountants, legal services) during 2024 and will develop and work towards delivering legitimate interest access, for groups including media and civil society organisations. The CDs will present their proposals for a definition of LIA in their relevant Parliament by Q4 2024 and the UK government continues to work closely with the Crown Dependencies to support progress.
OECD Working Group Recommendations to Strengthen the Effectiveness of Enforcement
The UK last reported its progress on implementing outstanding recommendations from its Phase 4 Evaluation by the OECD Working Group on Bribery (WGB) in June 2023. Due to updated procedures, the WGB was unable to consider changes to the UK's implementation ratings. The Working Group did, however, agree not to ask for further updates from the UK on the six recommendations which had been identified as a priority by the WGB,
Anti-Corruption Strategy
Development of a new UK Anti-Corruption Strategy is well underway with publication expected shortly. The new Strategy will build on the progress made by the UK Anti-Corruption Strategy 2017–2022 and outline the UK response to strengthen resilience against corruption and illicit finance in the UK and internationally.

Table 9. United Kingdom: Anti-Corruption Efforts (Authorities' Self-Assessment) (Concluded)
International Anti-Corruption
The UK unveiled an International Development White Paper in November 2023 which includes 8 commitments aimed at tackling international corruption and illicit finance.
The 10th Conference of State Parties (COSP) to the UN Convention against Corruption (UNCAC), was held in December 2023. The UK's delegation played an active role in the COSP's programme and co-chaired a side event aimed at encouraging the transparency and impact of the UNCAC's Implementation Review Mechanism. On the latter, the UK garnered signatures from 60 geographically and economically diverse countries in support of the UK's statement promoting transparency and civil society inclusion in the UNCAC Implementation Review.
The UK has continued to use its sanctions powers, including the Global Anti-Corruption sanctions regime, to combat serious corruption internationally. The UK has made 7 delegations since the publication of the last report, including 4 individuals connected to corruption in Lebanon in conjunction with the United States and Canada. On 30 April the UK sanctioned 3 Ugandan Parliamentarians involved in serious corruption.
The UK announced a Global Call to Action for greater transparency on company ownership to tackle global illicit flows and announced £2m of funding to World Bank and IMF Trust Funds in support of the Global Call to Action. The UK has continued to support the G7 2022 commitment to establish 15 Beneficial Ownership registers in Africa through the co-creation of the Africa Beneficial Ownership Transparency Network with the African Development Bank and assisted the Presidency in broadening the discussions from the G7 to include the International Financial Institutions.
The UK actively participates in a range of multilateral anti-corruption and integrity related forums, including at the G7, OECD, G20, and Council of Europe.

Annex I. Preliminary External Sector Assessment

<table>
<tr><td colspan="6">Overall Assessment: The external position in 2023 was weaker than the level implied by medium-term fundamentals and desirable policies. The CA deficit deteriorated marginally in 2023, reflecting a higher income deficit largely offset by improved trade balances due to lower energy prices and a negative public imbalance. The CA deficit is projected to gradually narrow as trade balances recover. The uncertainty around this assessment remains significant, reflecting measurement issues and the evolving impact on trade and capital flows of the new EU-UK Trade and Cooperation Agreement.
Potential Policy Responses: Gradual fiscal consolidation, while preserving key public services and protecting the vulnerable, should help close the CA gap. In the medium term, implementing structural reforms to boost UK international competitiveness (including via upgrading the labor skill base to support labor reallocation to fast-growing sectors) would help improve CA balance while accommodating a need for rising public investment in support of the climate transition. The UK should continue to support an open trade environment, including addressing remaining barriers to trade with the EU, while industrial policies should continue to be deployed cautiously and remain targeted to specific objectives where externalities or market failures prevent effective market solutions.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="5">Background. The NIIP deteriorated to –31 percent of GDP in 2023 from –14 percent of GDP in 2022. A negative valuation effect (including sterling appreciation) led to this sizable worsening of the NIIP in 2023 in addition to the CA deficit.[1] Other investment—which is mainly cross-border bank loans—(196 percent of GDP in assets and 194 percent in liabilities), and portfolio investment (123 percent of GDP in assets and 130 percent in liabilities) constitute a large part of gross assets and liabilities. Other European countries, Japan, and the United States account for about three-quarters percent of total UK external assets and liabilities, and external liabilities have a larger share denominated in pounds than do external assets.[2] IMF staff project the NIIP will moderately improve over the medium term, although large and volatile valuation effects make these estimates particularly uncertain.
Assessment. Despite the large valuation losses in 2023 (mainly driven by valuation losses on other investment assets), total valuation gains since 2016 (including the unrecorded impact of inflation differentials and the retained earnings bias on portfolio investment, as well as sterling depreciation) have more than offset the negative CA flows on the NIIP. Fluctuations in large gross stock positions could be a potential source of vulnerability (gross assets and liabilities exceed 500 percent of GDP). However, the UK's net liability position in domestic currency and exchange rate flexibility would offer some insurance against external crises.</td></tr>
<tr><td>2023 (% GDP)</td><td>NIIP: –31</td><td>Gross Assets: 503</td><td>Debt Assets: 257</td><td>Gross Liab.: 534</td><td>Debt Liab.: 282</td></tr>
<tr><td>Current Account</td><td colspan="5">Background. The CA deficit increased marginally from 3.1 percent of GDP in 2022 to 3.3 percent in 2023, driven by a larger income deficit largely offset by an improved trade balance with a positive terms-of-trade shock. This CA deficit was higher than the average of 2.5 percent over the past five years (2019–23). While the income balance has been volatile historically, the deterioration in 2023 (which is also high compared with the average over the past five years) was likely due to higher interest payments on pound-denominated external debt. The decline in investment was slightly lower than the decline in gross savings, which was driven by the fact that public dissaving (6 percent of GDP) exceeded private saving (2.7 percent of GDP).
Assessment. The EBA CA model estimates a norm of –0.4 percent of GDP; thus, with the cyclically adjusted 2023 CA of -3.3 percent of GDP, the CA gap is –2.9 percent of GDP. As in previous years, the unrecorded impact of inflation differential-related valuation effects on debt stocks (which would otherwise improve the 2023 CA by 0.6 percent of GDP) and retained earnings on portfolio equity assets (which would otherwise worsen the 2023 CA by -0.1 percent of GDP) together underestimate the underlying CA by 0.5 percent of GDP.[3] Adjusting for this, the IMF staff assesses the CA gap at –2.4 percent of GDP, within a range of –1.4 to –3.4 percent of GDP.</td></tr>
<tr><td>2023 (% GDP)</td><td>CA: –3.3</td><td>Cycl. Adj. CA: –3.3</td><td>EBA Norm: –0.4</td><td>EBA Gap: –2.9</td><td>Staff Adj: 0.5   Staff Gap: –2.4</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="5">Background. The pound appreciated in real effective terms in 2023 by 2.5 percent relative to its average level in 2022, driven partly by nominal appreciation, with higher for longer policy rates expected in the UK. Overall, the pound has depreciated by about 3.7 percent since mid-2016, reflecting market expectations of more restricted access to the EU market under post-Brexit trade arrangements. As of April 2024, the REER had further appreciated by 2.8 percent compared to the 2023 average.
Assessment. The EBA REER level and index approaches suggest a gap of 4 and –6 percent, respectively, for 2023. Consistent with the staff CA gap, the staff assessed the REER gap to be in the range of 5.4 to 13 percent with a midpoint of 9.2 percent (applying an estimated elasticity of 0.26).</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="5">Background. Given the UK'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 deficit was mainly financed in 2023 by net other investment of 11.1 percent of GDP, while net portfolio investment and FDI declined by 6.2 and 2.7 percent of GDP, respectively.
Assessment. Large fluctuations in capital flows are inherent in countries with a large financial sector. This volatility is a potential source of vulnerability, although it is mitigated by a robust financial stability framework.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="5">Background. The pound has the status of a global reserve currency. The share of global reserves in sterling has not changed materially since 2015, at about 4.6 percent.
Assessment. Reserves held by the UK are typically low relative to standard metrics, and the currency is free floating.</td></tr>
<tr><td colspan="6">[1] Official NIIP data do not record FDI assets and liabilities at market value. The Bank of England's December 2022 Financial Stability Report estimates that if the UK's FDI assets and liabilities were also marked-to-market, then the UK's NIIP would rise from negative territory to close to +100 percent of GDP.
[2] Estimates in Allen and others (2023) suggest that, in 2020, about 93 percent of external assets were denominated in foreign currency compared with 53 percent for external liabilities.
[3] These measurement issues arise primarily because of differences between the statistical definition of income and the relevant economic concept. Both would lead to NIIP valuation changes but are not recorded in the income balance.</td></tr>
</table>

Annex II. External Debt Sustainability Analysis

The external debt sustainability analysis complements the External Sector Assessment (Annex I). Under the baseline scenario, gross external debt is projected to decline from 282 percent in 2023 to about 271 percent over the medium term. In historical scenarios, including the pandemic, external debt would increase significantly. In addition, with more than ¼ of external debt denominated in foreign currency, a real depreciation would also lead to a sizable increase in external debt. Still, a net asset position in foreign currency suggests that external debt is sustainable. Structural reforms to increase productivity and preservation of the strong frameworks (for monetary, fiscal, and financial sector policies) would help contain external vulnerabilities as the country continues to adjust to the post-Brexit trade and immigration regime.

1. Background. External debt peaked at 336 percent of GDP in 2020, mainly due to denominator effects as the pandemic depressed nominal GDP. In the period from 2013–19, external debt had averaged around 300 percent of GDP. About half of external debt comprises short-term bank liabilities of the private sector, while public external debt accounts for a tenth.[1] Despite the sizable external debt, the net international investment position has been at an average of about -10 percent of GDP since 2000, as positive valuation gains have tended to largely offset current account deficits.

2. Assessment. In the baseline, external debt is projected to gradually decline to 271 percent of GDP by 2029, on the back of the baselined economic recovery and improving non-interest current account. The historical scenario has a significant impact, with debt climbing to 306 percent of GDP by the end of the forecast horizon. This scenario is based on an average of the past ten years (from 2014–23), including a significant pandemic-induced growth shock and a sizeable pound depreciation. Similarly, in the growth shock scenario, one of the standardized shocks (calibrated to ½ standard deviation for interest rates, growth, and the current account), external debt would rise to 306 percent of GDP. A depreciation shock has the largest impact, leaving external debt somewhat higher at 315 percent of GDP. Yet, gross debt assets at about 257 percent of GDP and a net assets position in foreign currency would offer some insurance against such shock. Although external debt is sustainable in the baseline, the large liability positions at twice the value of GDP make the UK sensitive to market sentiment. Upholding robust policy frameworks and implementing appropriate structural reforms would be vital to preserving sustainability going forward.

[1] The size of public external debt might be overestimated, given that some government bonds held by UK pension funds via liability-driven investment (LDI) asset managers domiciled outside the UK are recorded as external debt.

Table II.1. UK: External Debt Sustainability Framework, 2019-2029

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2019	2020	2021	2022	2023	10-Year Historical Average	10-Year Standard Deviation	2024	2025	2026	2027	2028	2029	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	290	336	318	291	282			**282**	**280**	**278**	**276**	**273**	**271**	**-6.3**
Change in external debt	-10.2	46.0	-17.9	-27.0	-8.9			0.2	-1.5	-2.2	-2.4	-2.7	-2.1	
Identified external debt-creating flows (4+8+9)	-5.0	13.2	-26.3	-13.1	-13.7			1.7	-0.4	-0.6	-0.6	-0.8	-0.2	
Current account deficit, excluding interest payments	-3.0	-1.2	-3.1	-2.9	-7.5			-1.9	1.3	1.1	-0.4	-0.8	-0.9	
Deficit in balance of goods and services	1.4	-0.6	0.2	2.7	1.2			1.0	1.3	1.1	1.0	0.9	0.8	
Exports	31.6	29.7	29.6	33.4	32.2			31.5	30.9	30.3	29.9	29.6	29.3	
Imports	33.0	29.1	29.8	36.1	33.4			32.5	32.2	31.4	30.9	30.5	30.1	
Net non-debt creating capital inflows (negative)	-0.5	-7.0	5.1	3.7	3.0			0.3	0.2	0.5	0.5	0.4	0.4	
Automatic debt dynamics 1/	-1.4	21.4	-28.3	-13.9	-9.2			3.2	-1.9	-2.2	-0.6	-0.3	0.4	
Contribution from nominal interest rate	5.7	4.0	3.5	6.0	10.8			5.1	2.2	2.2	3.6	4.0	3.9	
Contribution from real GDP growth	-5.0	31.7	-25.0	-14.0	-0.3			-1.8	-4.1	-4.4	-4.3	-4.3	-3.6	
Contribution from price and exchange rate changes 2/	-2.2	-14.4	-6.8	-5.9	-19.7			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-5.2	32.8	8.4	-13.9	4.7			-1.5	-1.1	-1.6	-1.9	-1.9	-1.9	
External debt-to-exports ratio (in percent)	916	1130	1074	870	876			896	907	920	922	923	925	
Gross external financing need (in billions of US dollars) 4/	6206	5900	6332	6972	6969			7193	7514	7819	8205	8590	8981	
in percent of GDP	218	219	202	225	209			207	206	203	201	200	198	
Scenario with key variables at their historical averages 5/								**282**	**285**	**290**	**295**	**300**	**306**	**2.0**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	1.6	-10.4	8.7	4.3	0.1	1.6	4.8	0.7	1.5	1.7	1.6	1.6	1.4	
GDP deflator in US dollars (change in percent)	-2.4	5.6	7.1	-5.4	7.7	0.6	6.6	3.5	3.1	4.1	4.0	3.9	4.2	
Nominal external interest rate (in percent)	1.9	1.3	1.2	1.9	4.0	1.8	0.8	1.9	0.8	0.8	1.4	1.5	1.5	
Growth of exports (US dollar terms, in percent)	-0.6	-11.2	16.0	11.4	3.7	2.8	8.6	2.0	2.7	3.6	4.5	4.5	4.6	
Growth of imports (US dollar terms, in percent)	-0.6	-16.7	19.1	19.7	-0.2	2.9	11.4	1.3	3.8	3.0	4.2	4.2	4.3	
Current account balance, excluding interest payments	3.0	1.2	3.1	2.9	7.5	1.9	2.5	1.9	-1.3	-1.1	0.4	0.8	0.9	
Net non-debt creating capital inflows	0.5	7.0	-5.1	-3.7	-3.0	1.9	4.7	-0.3	-0.2	-0.5	-0.5	-0.4	-0.4	

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.

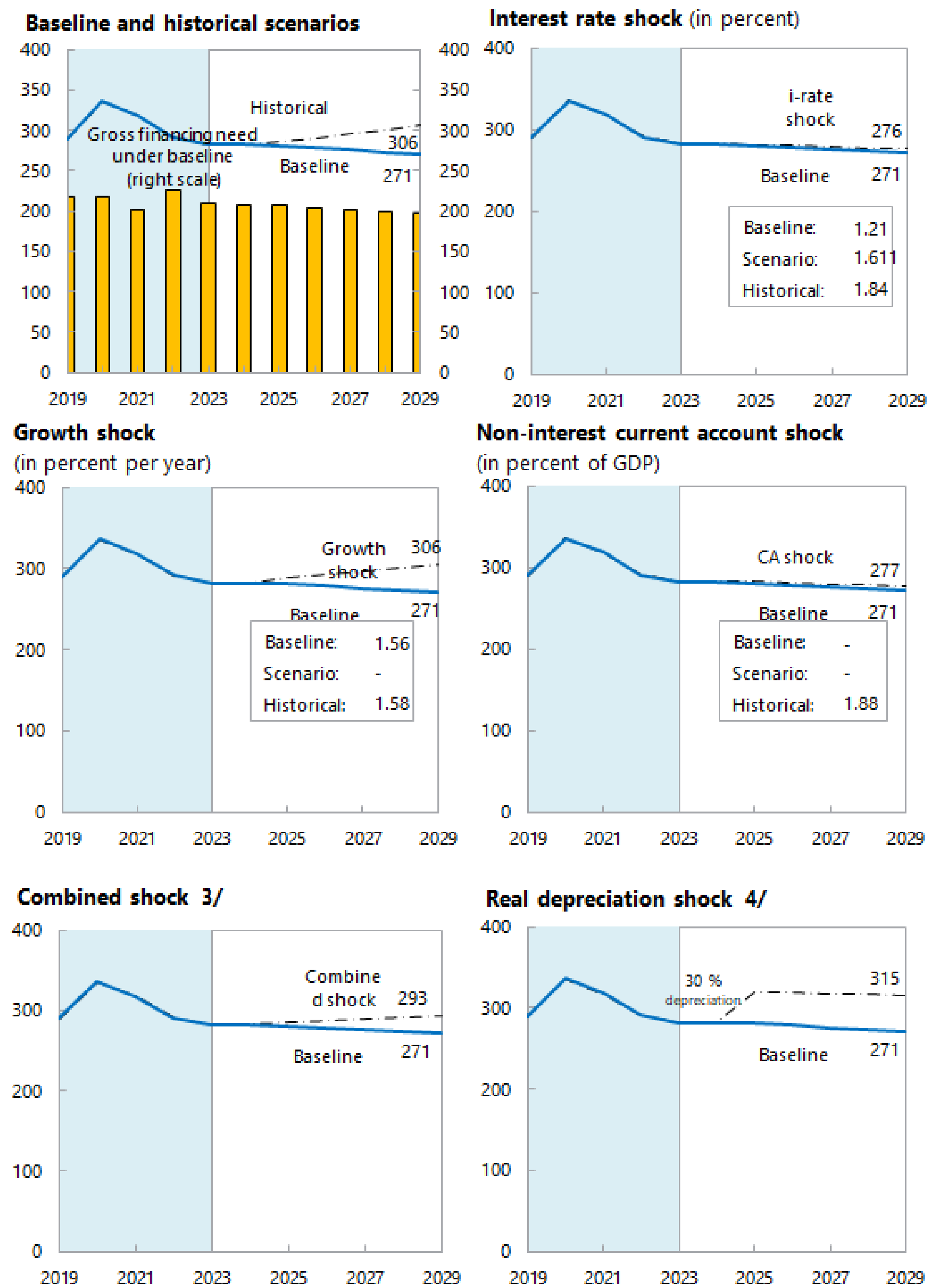
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Figure II.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.

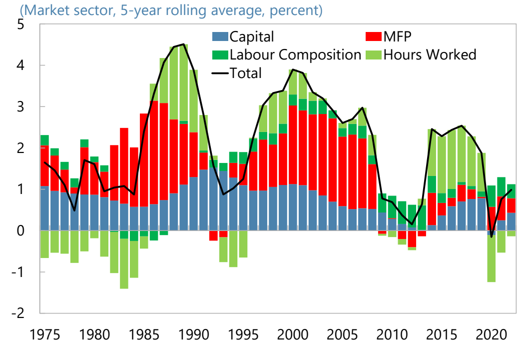
4/ One-time real depreciation of 30 percent occurs in 2021.

Annex III. Growth Accounting and Potential Growth

Past Evolution of Drivers of Supply

1. **Growth accounting can be used to decompose UK output into contribution from multi-factor productivity (MFP), labor, and capital inputs and shed light on expected potential growth.** The growth accounting used here follows standard neoclassical framework where changes in the volume of inputs (capital, and quality-adjusted labor) are weighted by the output elasticities of labor (α) and capital (1-α) and an unobserved residual, which captures MFP.[1] This allows us to quantify how different assumptions about the evolution of the various components over time will translate into potential growth.

Contribution to GVA Growth
(Market sector, 5-year rolling average, percent)



Source: ONS.

2. **A key observation from the growth accounting exercise for the UK (chart above) is the significant decline in MFP growth and capital growth (or investment).** The former is captured by the red bars which noticeably shrink from about 2 percent in the pre-GFC period to ¼ percent in the period after. The weakness in investment (blue bars) is more evident when compared with the 1990s (when it averaged around 1¼ percent); since the mid-2000s, it has averaged around ½ percent, and fell to virtually zero in the immediate post-GFC period, and the Brexit vote. The decline in MFP growth and investment has been partially offset by a rise in hours worked (notably during the 2012–19 period), but this too has fallen off in recent years.

3. **The decline in MFP growth and investment have meant exceptionally weak growth in labor productivity (i.e., output per hour), when seen in a cross-country context.**[2] During the two decades before the GFC, output per hour in the UK increased at around 2 percent (1996–2007 average), close to the pace witnessed in the United States, with the Euro Area increasing only at around 1¼ percent. While labor productivity growth has declined in all advanced economies since the GFC, the UK has performed worse that the others. The pace of growth in the UK has slowed down to a mere 0.4 percent (2008–2022 average), compared with 1.2 percent in the United States and 0.7 percent for the Euro Area. While the average pre-GFC labor productivity growth in the Euro Area was only around 60 percent of the UK's pace, the situation reversed post-GFC, with the pace of growth in the UK now only 60 percent of the growth seen in the Euro Area. Fortunately, as noted in

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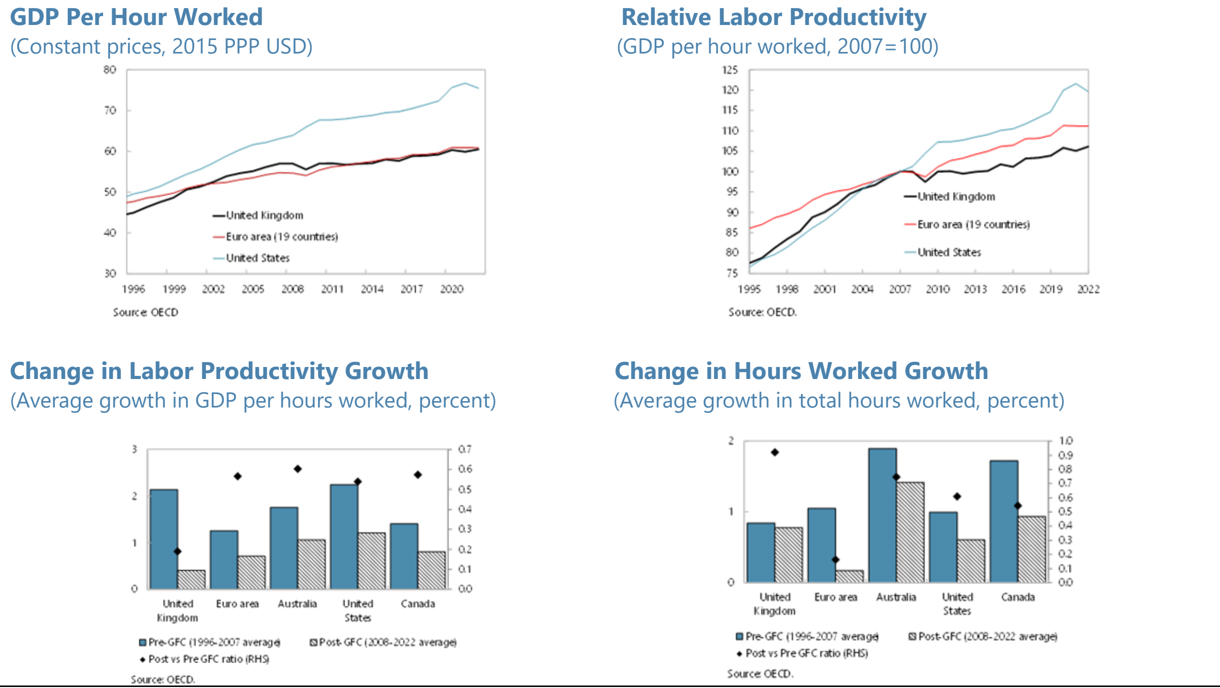
[1] More formally, ONS calculates $\Delta lnGVA = \alpha\Delta\ln QALI + (1-\alpha)\Delta\ln VICS + \Delta\ln MFP$, where GVA is the gross value added of the UK market sector, QALI is the labor input, which incorporates both the volume of labor (hours worked, HW) and its quality (labor composition, LQ), VICS measures volume of capital. With GVA, QALI and VICS given, MFP then obtains as the residual. α is the elasticity of output with respect to QALI, and varies over time, but averages around 0.6 percent over the entire sample.

[2] The growth accounting framework can be rearranged to provide a decomposition of output per hour to measure labor productivity. Formally, $\Delta\ln\left(\frac{GVA}{HW}\right) = \alpha\Delta\ln LQ + (1-\alpha)\Delta\ln\left(\frac{VICS}{HW}\right) + \Delta\ln MFP$, where $\Delta\ln\left(\frac{GVA}{HW}\right)$ captures labor productivity growth, while $\Delta\ln\left(\frac{VICS}{HW}\right)$ measures changes in capital per hour worked (capital deepening).

earlier, the UK has been more successful at maintaining the pace of growth in total hours worked, and more broadly the size of its economically active population, unlike in the Euro Area where it declined significantly post-GFC. This allowed the UK to partially offset the larger productivity decline and maintain overall economic growth. These trends in labor productivity and supply are elaborated further in Annex IV.

Figure III.1. United Kingdom: Headline Productivity Trends



Estimating Potential Growth

4. The growth accounting framework can be used to estimate potential output and its drivers based on bottom-up assumptions. Growth can be broken down into labor productivity growth and labor supply growth (hours worked), and these can be further broken down into subcomponents.

$$\Delta lnGVA = \Delta \ln\left(\frac{GVA}{HW}\right) + \Delta \ln HW$$

$$= \underbrace{(1-\alpha)\Delta \ln(\frac{VICS}{HW}) + \Delta \ln MFP + \alpha\Delta \ln LQ}_{Labor\ Productivity\ Growth} + \underbrace{\Delta \ln(Pop\ x\ LFP\ x\ Average\ Hours)}_{Labor\ Supply\ Growth}$$

5. Labor productivity growth over the medium term is expected to around be around <u>1 percent</u>, gradually picking up from its current low level as the economy normalizes and investment picks up. This incorporates the impact of growth measures already announced and in train, such the full tax-expensing of business investment (that was made permanent in the 2023

Autumn Statement). It is also underpinned by staff's somewhat higher path (than the OBR's) for public investments (in infrastructure and the green transition). Bolder reforms (esp. in the areas of planning and skills), faster implementation, better service delivery (e.g., in health and education which affect the quality of labor) or larger investment envelopes would present an upside risk for both labor productivity and potential output. Given these conditioning assumptions, here are our projections for the underlying components of labor productivity, based on past, current and expected trends, and staff and comparators (BoE, OBR and private sector analysts) assessment of drivers behind these trends.

- **MFP growth** is expected to contribute **0.3 percentage points**, but there is high degree of uncertainty around this assumption. This represents a pickup from current levels and is higher than the "post-GFC pre-pandemic (2013–19) average of 0.2 percentage points but is significantly below the 1.8 percentage points in the decade before the GFC (1998–2007) and the 0.9 percentage point long term average (1975–2022) given the pre-GFC engines of growth are unlikely to be repeated (North Sea oil, financial services, and the information technology boom). That said, AI adoption could provide a new source of MFP growth, akin to the IT boom in the 1990s, and present an upside risk, though there is high uncertainty about potential impact on productivity (see Acemoglu (2024); Box 3.3 of April 2024 WEO).

- **Capital deepening** is expected to contribute **0.4 percentage points** to potential output in the medium term, with a gradual pickup as Brexit related headwinds on investment abate and the benefits of a favorable tax regime are realized. However, higher depreciation rates due to an increasing share of shorter-lived IT and intangible capital, and prolonged underinvestment since the GFC, that has resulted in a falling capital-output ratio and an ageing and degraded capital stock, limit the scope for a more significant contribution of capital services to growth. Lingering uncertainty regarding post-Brexit trading arrangements, reduced participation in the global value chain, as well as potential geo-economic fragmentation could be hindrances to investment.

- **Labor composition** accounts for **0.3 percentage points**, driven by a post-Brexit skill-selective migration regime that favors higher skilled workers, and a continuing improvement in the share of graduates and higher skilled workers in the labor force, assisted by favorable reforms to the education and skills sector.

6. Labor supply is estimated to grow at 0.3 percentage points over the longer term. This is primarily driven by ONS population projections, with offsetting effects from aging (participation and average hours worked) and policies to incentivize work. While the focus is on the longer term, population growth is expected to be temporarily higher for the next few years (until 2027) due to strong migration inflows. But its effects on labor supply, and therefore potential growth, are tempered by continued challenges with long-term illness dampening activity rates.

- **Population growth** assumption is primarily driven by ONS 2021-based population projections for the working age population (16–64 years) of 0.28 percent (2028–2037 average). However, the total 16 and over population grows at a faster rate of 0.58 percent given the effects of population ageing. Since some people over the state pension age, which is expected to rise over time, continue to work, our overall labor supply assumption assumes a growth rate of **0.5 percent** in the long term. But given strong migration seen in 2023, and which is expected to continue over the next couple of years, the contribution of labor supply to potential growth is higher until 2027.

- **Labor force participation** is assumed to remain largely unchanged over the long term, given already high activity levels in the UK compared to peers, except for the impact due to an ageing population (increase in share of workers who typically have lower activity rates). Although rising inactivity due to long term illness is a challenge in the short run, decreasing potential labor supply by as much as **0.1 percentage point**, particularly in the near term.

- **Hours worked** are again to be driven by adverse demographics (older workers put in less hours) being offset by policy actions (including cuts to the NIC rate) to boost supply. Overall, the impact on hours worked is expected to decrease labor supply by **0.1 percentage point**, with an even larger negative impact expected in the long term as population ageing accelerates.

7. In line with the above, long-term potential output growth for the UK is estimated at 1.3 percent. This represents a slight markdown from 1.5 percent assumed in recent Article IV consultations and is primarily driven by reassessment of labor productivity growth due to weaker MFP and capital deepening assumptions. However, given strong migration, potential growth is likely to be higher (closer to 1.5 percent) over the next few years.[3] The new path for potential growth is lower than the OBR's assumptions, particularly in 2028 and beyond, given lower labor productivity and labor supply growth assumptions. The estimates are however stronger than private sector estimates which range from 1 to 1.3 percent and the BoE's supply side stock-take in February, although those do not reflect latest ONS population projections. Staff's estimate is also in line with the Euro Area (1.2 percent) and other large European economies (Germany 0.7 percent, France 1.3 percent, Italy 0.8 percent and Spain 1.6 percent), but lower than Australia (2.3 percent), Canada (1.7 percent), and the US (2.1 percent).

Table III.1. United Kingdom: Potential Growth

	2024	2025	2026	2027	2028	2029
IMF	**1.4**	**1.5**	**1.5**	**1.4**	**1.3**	**1.3**
WEO (Jan)	1.6	1.5	1.5	1.5	1.5	1.5
OBR (Mar)	1.6	1.7	1.6	1.6	1.6	
BoE (Feb) /1	1.0	1.2	1.3			

1/ The ONS's updated population projections were not reflected in the MPC's February supply-side stock take. BoEs May MPR projections are conditioned on the most recent ONS population projections with gives an average supply growth of 1½ percent over the next three years.

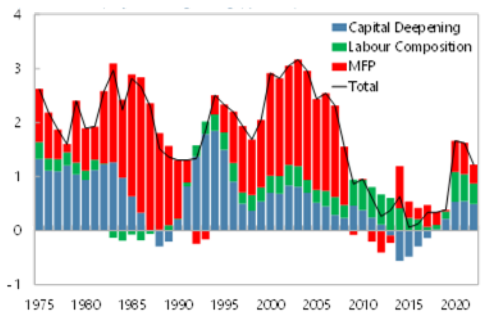
[3] The larger markdown in 2024 is because the previous figure already incorporated the effect of post-COVID normalization and stronger migration in 2023-2024 (and hence was larger than earlier the long-term average of 1.5 percent) but did not incorporate the negative surprise from still high and increasing inactivity levels due to long term illness.

Annex IV. Drivers of Labor Productivity and Supply in UK

1. Some of the strong performance in UK Total or Multi-Factor Productivity (MFP) in the pre-GFC period was driven by unique factors. First, the faster growth in manufacturing, while in part due to rising import competition and offshoring, was also a result of expanding North Sea oil production in the mid-2000s. Second, the pre-GFC period witnessed a large expansion in financial services, driven by "leverage", which was unsustainable and the post-GFC decline represents deleveraging and the long process of normalization. And third, MFP for information and communication was elevated during the tech-boom of the early 2000s. Nevertheless, MFP growth in the UK has remained weak over the past decade, in part due to declining firm dynamism, and while this is true globally, the UK still stands out from its counterparts.

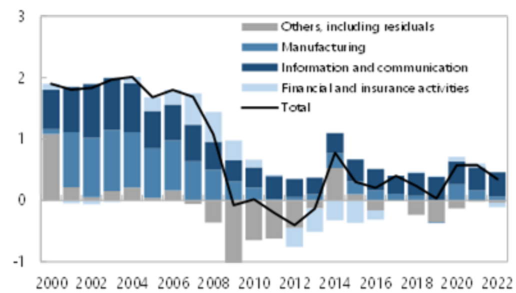
Figure IV.1. United Kingdom: Drivers of Labor Productivity and MFP

Contributions to GVA per Hour Growth
(Market sector, 5-year rolling average, percent)



Source: ONS.

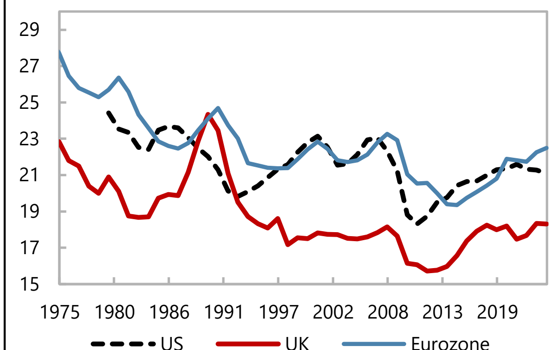
Contributions of MFP to GVA Growth by Sectors
(Market sector, 5-year rolling average, percent)



Sources: ONS; and IMF staff calculations.

2. The post-GFC decline in MFP has been accompanied by weak business and public investment. Capital accumulation in the UK was robust in the years preceding the GFC, but the rate almost halved in 2008–2010, and has since struggled, with the capital stock growing slower than hours worked. Business investment has remained subdued until recently, in part due to headwinds and higher uncertainty since the Brexit referendum in 2016, with the pandemic adding to the drag. And given a more austere fiscal environment, public investment has not picked up the slack (see 2023 SIP for a detailed discussion of drivers of weak investment and policy options).

Gross Fixed Capital Formation
(Percent of GDP)

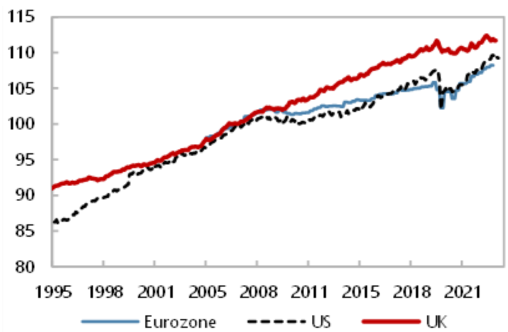


Source: WEO.

3. The UK labor force has grown faster than in peers, but recent trends suggest this may be at its end. Some of the historical growth in hours worked reflects strong gains via higher participation rate among women and older workers, and also high rates of worker migration, particularly from Central and Eastern Europe. Furthermore, the labor force has moved towards higher skill on average, with a higher share of workers with an advanced degree, contributing to labor composition gains. However, the growth in labor supply seen during the 2010s has now plateaued, with increasing inactivity level due to an increase in long-term sickness (see 2023 SIP). While a pickup in migration in the short term should support growth, longer term, population ageing, an increasing dependency ratio, and shifts in the age structure towards age groups who work shorter hours on average, is likely to be a drag on labor supply.

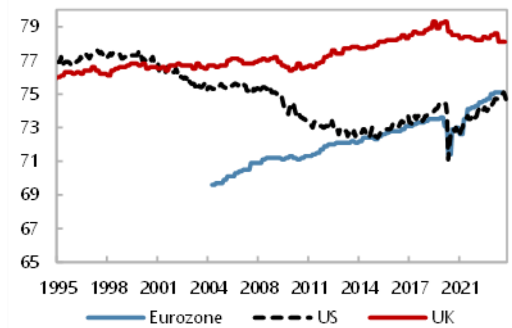
Figure IV.2 United Kingdom: Labor Market Trends

Economically Active Population
(Index, 2007 Jan=100)



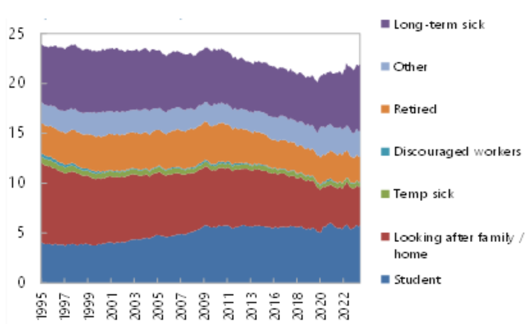
Source: Haver Analytics.

Labor Force Activity Rate
(Percent aged 16–64)

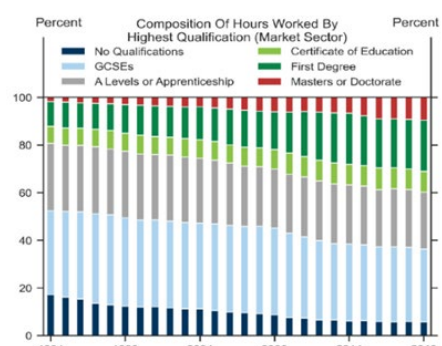


Source: Haver Analytics.

Breakdown of Inactivity by Reasons
(Percent of labor force)



Source: Haver Analytics.



Annex V. Risk Assessment Matrix[1]

Source of Risk and Relative Likelihood	Expected Impact of Risk	Policy Recommendations
	Global risks	
High **Intensification of regional conflict(s).** Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	**High** Surging energy prices impose an adverse terms of trade shock, raising inflation while worsening the growth outlook. Export competitiveness of UK firms is adversely affected, which slows down activity. High energy prices have an adverse impact on already stretched vulnerable households, leading to lower domestic demand.	Consider targeted energy support for households (and, possibly, some highly affected firms), with a clear timetable for sunsetting. Monetary policy might need to tighten to keep inflation expectations well-anchored and return inflation to target in a reasonable timeframe. Accelerate the green transition and, in that context, diversify toward more renewable energy sources.
High **Deepening geo-economic fragmentation.** Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High** Trade barriers and supply disruptions lead to shortages in crucial inputs, higher inflation and production bottlenecks that reduce economic activity—albeit with uneven sectoral effects—and weaker confidence. These amount to an adverse supply shock in the near-term and lower potential growth over the medium-term.	Diversify energy production and secure supply chains to avoid shortages of critical raw materials. Adjust monetary policy as needed to anchor inflation expectations and return inflation to target in a reasonable timeframe. Fiscal policy should let automatic stabilizers operate, and provide targeted support to affected segments of the economy, while avoiding a stance that conflicts with monetary policy objectives or undermines debt sustainability.
Medium **Abrupt global slowdown.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation. Amid tight labor markets, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in more abrupt financial, housing, and commercial real estate market correction	**Medium** Lower trading partner growth weigh on net exports and growth and inflation, pushing the latter below target (although a pound depreciation may partly offset).	Ease monetary policy, consistent with returning inflation to target in a reasonable timeframe, accounting for changes in the outlook for demand and inflation. Fiscal policy should let automatic stabilizers operate, while avoiding a stance that conflicts with monetary policy objectives or undermines debt sustainability.

[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.

Source of Risk and Relative Likelihood	Expected Impact of Risk	Policy Recommendations
Medium **Systemic financial instability.** High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	**High** Higher funding costs and a shift in risk sentiment lead to bond repricing and financial tightening, a reduction of credit growth and strains on leveraged corporates and households. Insolvencies increase, resulting in rapid deterioration of bank balance sheets and profitability. Tightening of financial conditions lead to housing market corrections. Growth declines sharply, while the sterling depreciates.	Ease macroprudential policy (for example, releasing the CCyB rate) to avoid exacerbating the credit downturn, accompanied with targeted liquidity provisions to address financial stress in core markets. Monetary policy may have to ease if demand and expected inflation weaken substantially. However, should inflationary pressures persist, for example because of sterling depreciation, monetary policy would need to remain tight enough to anchor inflation expectations and would need to carefully communicate the different objectives of their policy tools. Fiscal policy should allow automatic stabilizers operate, but discretionary stimulus should only be deployed if monetary policy is unable to loosen at the pace and magnitude necessitated by the deterioration in demand, and remain mindful of debt sustainability
	Domestic Risks	
High **Second round effects from falling energy prices.** The fall in energy prices results in stronger than expected second round effects, particularly on services inflation, resulting in a faster than expected decline in inflation.	**High** Lower inflation could permit earlier and larger rate cuts, boosting growth while keeping inflation expectations anchored.	Adjust monetary policy based on incoming data to avoid excessively tight policies while avoiding the risk of premature easing
High **Failure of demand to pick up and monetary policy miscalibration.** Amid high economic uncertainty, the BoE and/or major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	**High** Delayed easing may lead to tighter than warranted financial conditions, resulting in a failure of domestic demand to pick up as expected. On the other hand, inflation could remain high, in part due to wage persistence and high services inflation, prompting the BoE to tighten monetary policy to re-anchor inflation expectations and return inflation to target. A period of below trend growth and potentially a recession would follow.	Adjust monetary policy as needed to anchor inflation expectations and return inflation to target in a reasonable timeframe, while avoiding excessively tight policies. Fiscal policy should let automatic stabilizers operate, while avoiding a stance that conflicts with monetary policy objectives or undermines debt sustainability.

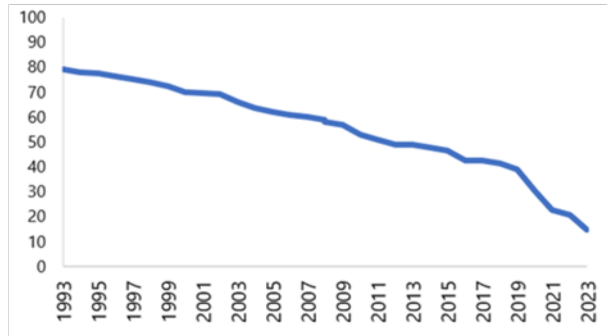
Source of Risk and Relative Likelihood	Expected Impact of Risk	Policy Recommendations
Low **Problems with the Brexit transition**. Lack of equivalence decisions for financial services by the EU, and more importantly, lack of clarity about the path forward with the EU on financial services. Lack of clear and feasible plan on retained EU laws.	Medium Market fragmentation increases the cost of financial services and the continuing uncertainty about the adjustment path and future regulatory framework leads to a decrease in business investment and weighs on potential growth. London's financial center status could be undermined.	Re-engage with the EU to complete the framework for cooperation on financial regulatory issues. Clarify the plan for retained EU laws.
Medium **Cyberthreats.** Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	High As a global financial center, UK is at a high risk of cyberattacks, which can be financially and legally devastating, disrupting and upsetting both people and businesses, undermining economic stability.	Build resilience, including through better regulation and stronger guidelines. Ensure large companies have detailed policies and plans in place to respond and recover from potential cyber incidents.
Low **Social discontent**. High inflation, real income loss, spillovers from conflicts (including migration), and worsening inequality cause social unrest and detrimental populist policies. This exacerbates imbalances, slows growth, and leads to policy uncertainty and market repricing.	High Social tensions around economic adjustments cause disruptions and erode trust in policy makers. The resulting political instability complicates reaching political consensus on policies, including to fight inflation. Public sector strikes over pay escalate, further complicating challenges with public service delivery and impacting economic activity.	Expand support to most vulnerable households. Urgently address public service delivery challenges (especially in healthcare).

Annex VI. Response Rate of the UK's Labor Force Survey[1]

1. **While the quality of surveys depends on many factors, this note focuses on the "response rate", which was identified as the main problem in discussions on the UK Labor Force Survey (LFS) over the last years.** The response rates for surveys are affected by many different elements in the collection method and survey design. For example, mandatory versus voluntary participation, sample design, fieldwork, length of interviews, incentives to respond, response burdens, as well as public communications and sentiments all affect response rates. The data collection method came to the center of attention when the pandemic required a shift to more remote data collection. Beyond the response rates, sampling variability also affect survey quality.[2]

Response Rate

(Percent)



Sources: ONS, and IMF Staff estimates.

2. **The long-term downward trend in the response rate for the UK's LFS accelerated significantly during the pandemic.** The declining trend has been a problem since the 1990s,[3] but the deterioration accelerated when face-to-face data collection was suspended during the pandemic (Figure 1). In October 2023, with the response rate at a historical low of 12.7 percent,[4] the Office for National Statistics (ONS) took the unprecedented step to suspend the publication of official labor market statistics derived from the LFS due to quality concerns. In response, the ONS has been implementing a recovery plan[5] for the LFS to boost the number of respondents, which has shown some impact on the response rate. Since publication of LFS data resumed in February 2024, the ONS has transparently disclosed that LFS data

Revisions in Labor Data

(Percentage point)

Note: Revisions defined as the difference between first and latest estimate of the labor data, which are affected by several factors other than higher sampling variability due to low response rate.
Source: ONS and IMF staff estimates.

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[1] Prepared by Kue-Peng Chuah.

[2] See quality reports for the LFS by Eurostat and ONS, which cover a list of factors such as accuracy, timeliness, comparability, and coherence. Indicators used to measure accuracy include the response rate and size of sampling variability. The assessment here will focus on the response rate due to the significant deterioration.

[3] See Barnes *et al.*, "Making Sense of Labor Force Survey Response Rates", Economic and Labor Market Review Vol. 2 No. 12, 2008 and the quality reviews such as National Statistics Quality Review: Review of LFS, 2014 and Quality of LFS Estimates Produced by the ONS, 2017.

[4] Between July and September 2023, 14,180 households responded from a total of 111,281. Source: ONS website, article, LFS Quality Report: July to September 2023.

[5] See progress and plans published by the ONS in Labor Market Transformation, April 2024 and improvements of the response rate between January and March 2024 in LFS Quality Report: January to March 2024.

should be treated as "official statistics in development[6]" until further review and accreditation. While falling response rates have also been an issue in other countries, the drop has not been as persistent and steep as in the UK (Box 1).

3. **An alarmingly low response rate could make labor market data unreliable as data becomes more susceptible to higher uncertainty[7] (more volatile) and subject to self-selection bias[8] (less accurate).** As the LFS and LFS data undergo changes, including the regular reweighting exercise to incorporate the latest estimates of the size and composition of the UK population, there is likely more data revisions taking place (Figure 2). These issues pose challenges for macro-critical analyses that are reliant on LFS data, such as gauging inflationary pressures to inform monetary policy decisions, warranting additional caution due to heightened concerns about data quality.

4. **The introduction of a new LFS is under way**. This significant action reinforces earlier efforts to improve the declining long-term trend of the response rate such as enhancing the quality of interviews, better and more fieldwork resources, and offering monetary incentives. ONS took measures to mitigate the impact of low response rates on data quality, including regular monitoring of biases and reweighting LFS data to reduce biases when the sample becomes unrepresentative. The ONS also recommends supplementing LFS data by using other data sources such as the Pay As You Earn Real Time Information (PAYE RTI). The ONS decided to replace the LFS with the Transformed LFS (TLFS) which has been in development since before the pandemic and run in parallel with the LFS since 2023. The improvements include a larger sample size and the use of additional collection methods to cover online data collection. The TLFS is expected to replace the LFS in September 2024, subject to quality criteria being met.

5. **While the TLFS has the potential to address the shortcomings of the LFS over the medium term, we would recommend the following points for ONS's consideration:**

- Launching the new TFLS is a major modernization step and requires more dedicated resources to prevent further delays experienced since 2023.
- Offer transparent and timely communication[9] when managing the rising scrutiny of users and reviewers as the LFS undergoes major changes and face heightened quality concerns.
- Independent reviews[10] have recommended making the LFS participation mandatory to improve the UK's long-run response rate, which require a change in the legislation. Although not directly comparable, the average response rate in countries with compulsory participation exceeded the average with voluntary participation. In some cases, a voluntary survey can achieve a higher response rate by incurring a higher cost.

[6] See monthly reports from the ONS on Labor Market Overview.
[7] A lower response rate in the survey can cause volatility in LFS data due to sampling variability, especially at granular breakdowns. See monthly data in Table A11 from the ONS on LFS Sampling Variability.
[8] The LFS data can suffer from bias if LFS respondents have different characteristics from the non-respondents.
[9] See recent examples in 2024 when the ONS was explaining LFS changes such as the TLFS and reweighting exercise.
[10] See Eurostat Task Force on Quality of LFS, 2009, and Independent Review of the UK Statistics Authority, 2024.

Box VI.1. United Kingdom: LFS in Selected Countries

A cross-country comparison among other advanced economies in Europe and North America, which publish comprehensive information about the quality of the LFS, adds perspective to the challenges of UK's LFS, even though LFS response rates have methodological differences in the definitions.

While the US, Canada, Ireland, Netherlands, and Sweden faced a substantial drop in LFS response rates between 2013 and 2019 (just before the pandemic), none started as low as the UK in 2013 and none has dropped as low in 2019.

Comparing 2019 and 2020, the impact of the pandemic showed a wide variety of experience across countries. Germany was particularly hard hit with the response rate dropping from 98 percent to just over 50 percent, which could be related to the low share of remote collection. Meanwhile, countries with a high share of remote collection experienced a limited drop in the response rate during the pandemic (Netherlands, Sweden, Italy, and Spain).

A simple estimate between 2013 and 2023 showed that the response rate for voluntary and compulsory participation averaged close to 60 percent and 80 percent, respectively, indicating that mandatory participation may have a positive effect on participation rates.

<table>
<tr><th rowspan="2"></th><th rowspan="2">Participation</th><th colspan="2">Remote data collection (Percent share of total)</th><th colspan="4">Response rate for the LFS (Percent)</th></tr>
<tr><th>2019</th><th>2020</th><th>2013</th><th>2019</th><th>2020</th><th>2023</th></tr>
<tr><td>UK</td><td rowspan="6">Voluntary</td><td>53</td><td>100</td><td>49</td><td>39</td><td>30</td><td>15</td></tr>
<tr><td>US</td><td colspan="2">Not available (NA)</td><td>90</td><td>83</td><td>74</td><td>70</td></tr>
<tr><td>Czech Republic</td><td>19</td><td>25</td><td>80</td><td>78</td><td>74</td><td rowspan="3">NA</td></tr>
<tr><td>Ireland</td><td>39</td><td>50</td><td>77</td><td>49</td><td>42</td></tr>
<tr><td>Netherlands</td><td>94</td><td>96</td><td>79</td><td>49</td><td>48</td></tr>
<tr><td>Sweden</td><td>100</td><td>100</td><td>69</td><td>50</td><td>51</td><td>43</td></tr>
<tr><td>Germany</td><td rowspan="6">Compulsory</td><td>10</td><td>63</td><td>98</td><td>94</td><td>53</td><td rowspan="5">NA</td></tr>
<tr><td>France</td><td>56</td><td>81</td><td>80</td><td>79</td><td>73</td></tr>
<tr><td>Italy</td><td>37</td><td>100</td><td>88</td><td>83</td><td>80</td></tr>
<tr><td>Spain</td><td>74</td><td>72</td><td>85</td><td>84</td><td>85</td></tr>
<tr><td>Portugal</td><td>69</td><td>93</td><td>86</td><td>81</td><td>62</td></tr>
<tr><td>Canada</td><td>80</td><td>NA</td><td>90</td><td>87</td><td>72</td><td>71</td></tr>
</table>

Note: For the US, the response rate is taken from the current population survey (CPS), the primary source of labor statistics. Remote data collection refers to online, telephone and post.
Sources: ONS, US Bureau Labor Statistics, Statistics Canada, Statistics Sweden, Eurostat, and IMF staff estimates.

Annex VII. Fiscal Implications of Post-Pandemic Large-Scale Asset Purchases by the Bank of England[1]

1. It is well understood that conventional monetary easing has a favorable impact on the fiscal position. This is because easier monetary conditions reduce debt servicing costs, boost aggregate demand, and increase tax revenues. In contrast, fiscal implications of large-scale asset purchases (LSAP) are less clear as they may adversely affect central bank profits. This can be particularly true if the monetary authority ends up normalizing policy earlier than expected when launching LSAP.

2. These considerations are highly relevant for countries like the United Kingdom, which relied heavily on LSAPs to mitigate adverse macroeconomic effects of the Covid-19 pandemic. The monetary easing by the BOE involved keeping the policy rate at close to zero and purchases of assets worth around 17.5 percent of annual GDP, which came on top of post-GFC purchases cumulatively worth around 20 percent of annual GDP. Global supply chain disruptions and spike in energy prices due to Russia's invasion of Ukraine called for faster monetary normalization, with the policy rate quickly rising and eventually exceeding 5 percent.

3. To assess the fiscal effects of post-pandemic LSAP by the BOE, we use a two-country New Keynesian model with bond market segmentation.[2] The model is augmented to include a rich account of fiscal policy and government debt dynamics, and is calibrated to reflect the key features, initial conditions, and recent developments in the UK economy. We start with the interest rate at the ELB and use a large, negative demand shock to simulate a severe fall in global economic activity, which keeps the interest rate low for a prolonged period. We subsequently use the model to assess macroeconomic developments depending on whether the BOE undertook extra LSAPs or not.

4. By lowering long-term rates, LSAPs helped mitigate the contraction in economic activity and deflationary pressures, and created room for a slightly earlier policy lift-off (see Figure 1). Had the economic recovery proceeded as forecasted at the time of the additional LSAP, its impact on the fiscal stance would have been clearly favorable, implying a reduction in government debt of around 2 percent of annual GDP at the 8-year horizon. This positive fiscal outcome is mainly due to increased tax revenues and lower debt service costs, which more than offset the effect of lower central bank profits that cumulate to around 4 percent of annual GDP.

5. However, LSAPs make the central bank balance sheet more vulnerable to earlier policy normalization. Indeed, this risk materialized as the BOE policy rate needed to be increased much earlier and more drastically than projected at the onset of the Covid-19 crisis. We simulate this scenario in the model by assuming that, about 1.5 years after the LSAPs, positive demand and

[1] Prepared by Marcin Kolasa, Jesper Linde and Pawel Zabczyk.

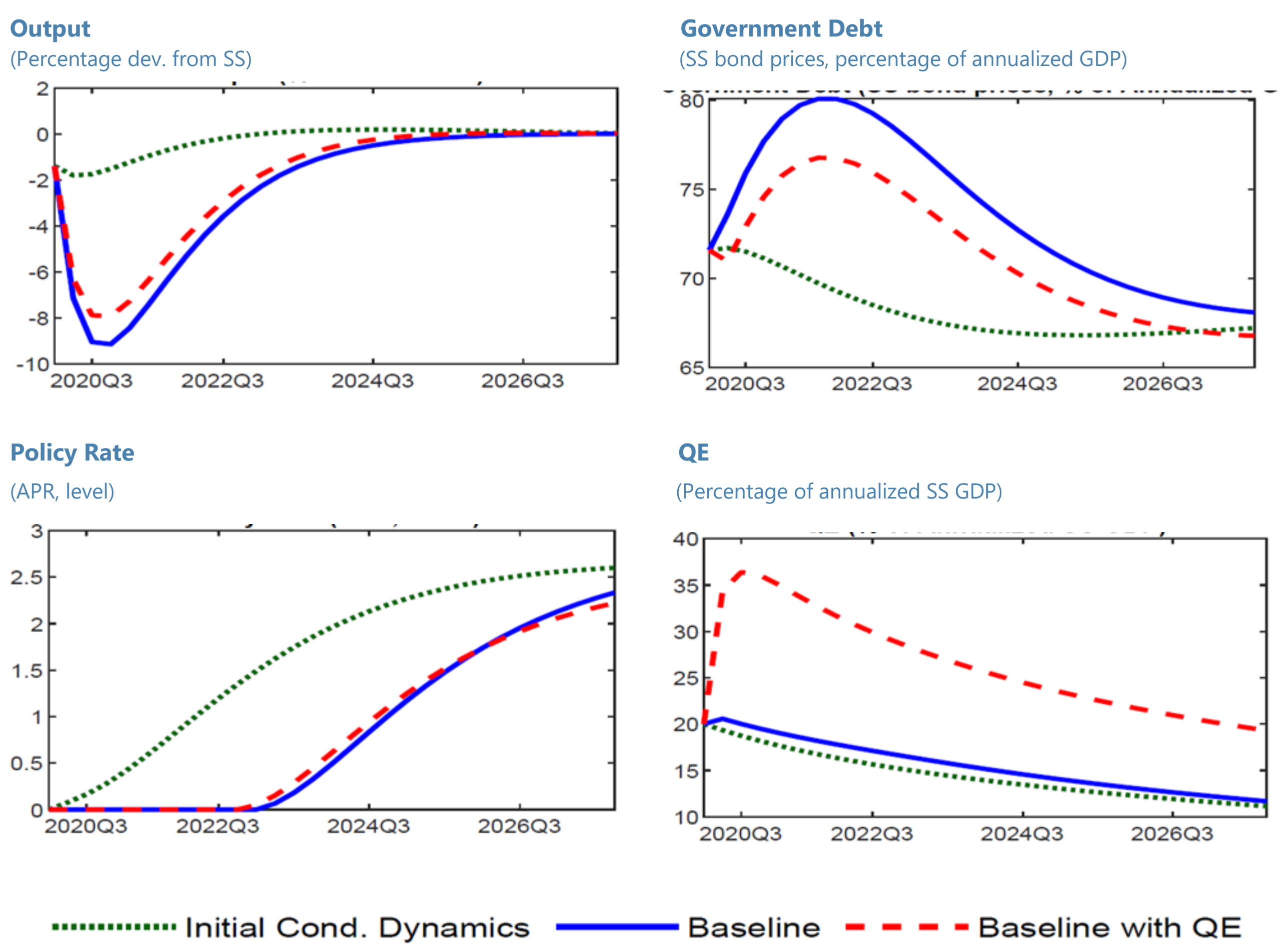
[2] Erceg, C., Kolasa, M., Linde, J., and P. Zabczyk (2024). Central Bank Exit Strategies: Domestic Transmission and International Spillovers. IMF Working Paper 24/73.

negative supply shocks trigger a faster global recovery. These shocks are aimed to capture the post-pandemic recovery and sharp increase in energy prices, both contributing to a sharp rise in inflation.

6. In this scenario with earlier monetary tightening, the cumulative decrease in central bank profits due to LSAPs amounted to about 6 percent of annual GDP (see Figure 2). In consequence, ex post fiscal gains from LSAPs were significantly reduced. Even so, according to our simulations, the overall impact of these pandemic interventions on the medium-run level of public debt was still likely to remain favorable, though small.

7. Overall, the last wave of LSAP by the BOE had favorable effects on the fiscal stance, even if we take into account the earlier than expected monetary policy normalization. These outcomes can be contrasted with the consequences of a fiscal stimulus which, if used to provide a similar boost to economic activity, would clearly increase the medium-run level of government debt, at least for realistic values of fiscal multipliers.

Figure VII.1. United Kingdom: Covid-19 Recession With and Without LSAP

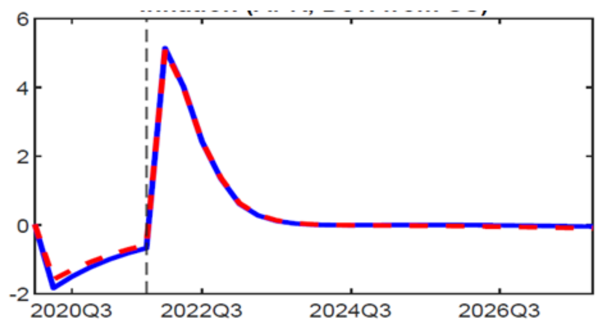


Source: IMF staff calculations.

Figure VII.2. United Kingdom: Covid-19 Recession With Earlier Policy Tightening

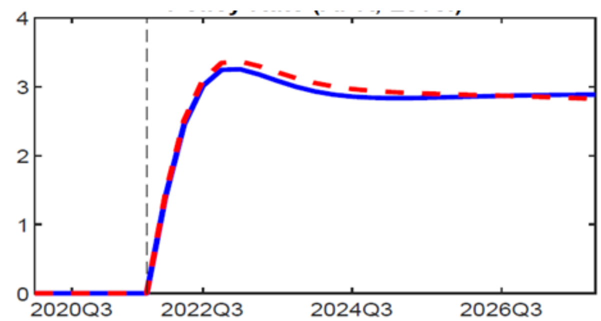
Inflation

(APR, dev. from SS)



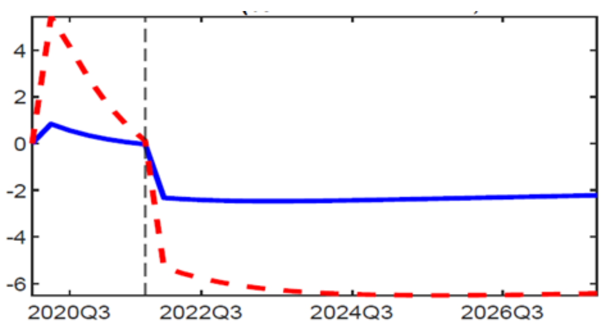
Policy Rate

(APR, level)



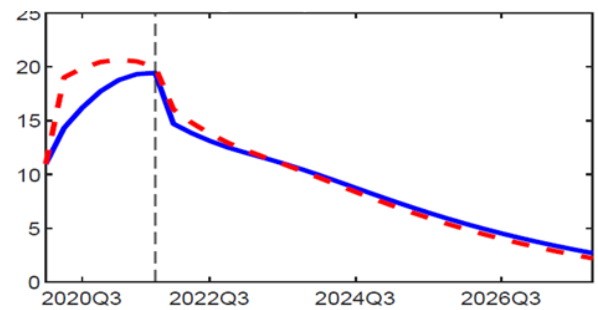
Central Bank Profit

(Percentage of ann. SS GDP, cumulative)



Chane in Outstanding Debt

(Percentage of ann. SS GDP, cumulative)



Baseline + Earlier Tightening   Baseline with QE + Earlier Tightening

Sources: IMF staff calculations.

Annex VIII. Bernanke Review of BoE Forecasting & Communications

The Bernanke Review made 12 recommendations on improving forecasting infrastructure, publishing alternative scenarios, and retiring the inflation fan chart, but he stopped short of formally recommending that the MPC publish its own policy rate path (although he did float this as a possibility). The BoE stated it is "committed to action" on each recommendation but indicated it would take time to develop and implement responses, with an update on proposed changes to be published by year-end.

1. The **Review found** that the BoE's forecasting performance has worsened in recent years, but is no worse than for other central banks and other UK forecasters. Bernanke pointed out significant shortcomings in the BoE's official central forecasting model, COMPASS: e.g., it does not include much modeling of the financial sector, the monetary transmission mechanism, or energy prices, and it has been subject to "a variety of makeshift fixes." Hence, the model itself plays a much-diminished role in the forecast process. He also pointed out that this model and similar models have failed to capture wage and price persistence in recent years.

2. Bernanke pointed out that, compared with other central banks, the BoE heavily relies on its central forecast as a **communication** device, but this central forecast may not fully reflect MPC's view of the economy. This is because the central forecast is conditioned on a set of standard assumptions, which "may not always accurately represent the views of the MPC." In addition, he described the BoE's inflation fan charts as having "weak conceptual foundations" and conveying "little useful information" to the general public.

3. Against this backdrop, Bernanke made 12 **recommendations**, covering three main areas:

- Investing in forecasting infrastructure and human resources to improve and maintain a high-quality forecasting framework (recommendations 1 to 4);
- Enhancing the support to MPC's decision-making by providing alternative scenarios, highlighting significant forecast errors, and incentivizing qualified staff to improve forecast quality (recommendations 5 to 7); and
- Better utilizing the forecast to communicate MPC's outlook and policy rationale by clarifying MPC's views around the conditioning assumptions, dropping the fan charts, and deemphasizing the central forecast (recommendations 8 to 11). [The last recommendation discusses the order of reforms and stresses that improving forecasting infrastructure should be prioritized.]

4. Contrary to staff's expectation, Bernanke did not push for producing an in-house interest rate path, which he said would be "a more aggressive approach" to tackling the problem of publishing a central forecast based on what can be unrealistic assumptions and left it open to the Bank, saying it would be a matter for "future deliberations." Bernanke told reporters that if the Bank decided to publish in-house rate projections, it should "not be the Fed dot plots" but something akin to the collective rate path used by the Riksbank and others.

BoE Response:

In its response to the Review, the BoE committed to taking action on all recommendations, noting that "it will take some time to develop detailed plans as well as to manage their implementation." In particular, the Bank said that scenarios could better describe the risks around the forecast and illustrate differences of opinion between Committee members but suggested that internal processes would need to adapt to ensure that these worked effectively. So, no immediate decisions are expected.

Annex IX. Staff Policy Advice from the 2023 Article IV Consultation[1]

IMF 2023 Article IV Selected Recommendations	Policy Actions Between 2023 Article IV and May 2024
Monetary Policy	
Monetary Policy will need to be tightened further to arrest inflationary pressures and durably bring inflation to the 2 percent target.	The MPC further increased Bank Rate to 5.25 percent by August 2023 and has held it at that rate since then.
Quantitative Tightening (QT) should continue as planned.	QT implementation has gone smoothly, guided by the MPC's key principles, which include using Bank Rate as the active monetary policy instrument and not disrupting smooth market functioning.
Fiscal Policy	
Adopt a restrictive stance of fiscal policy in 2024, to align with monetary policy in the fight against inflation.	In the November 2023 and March 2024 budgets, the authorities have broadly followed the path of fiscal consolidation set out in November 2022, implying a restrictive fiscal stance in 2024.
Any near-term fiscal over-performance should be saved, while the energy price support programs should be allowed to expire as planned.	There was some fiscal loosening in the form of tax cuts in the Autumn 2023 and Spring 2024 budgets. The decision to make permanent full expensing of business investment in plant and machinery was in line with staff's recommendations. The 4 ppts. of cuts to the main rate of National Insurance Contributions (NIC) (with a full-year fiscal cost of 0.6 percent of GDP) were additional; although staff would have advised against these cuts, their labor favorable supply impacts and partial offset from well-conceived deficit-reducing measures (see below) are acknowledged. Energy price support is set to expire as planned.
Over the medium-term, allocate significant additional resources to high-quality public services, especially health and social care and undertake public investment in skills, innovation, infrastructure, and the green transition.	The authorities have announced plans for increasing resources for health and social care, including the NHS Long-Term Workforce Plan (published June 2023), with an additional £2.5 billion committed in the March 2024 budget for NHS recurrent spending in FY2024/25, on top of the £3.4 billion capital investment to improve productivity through digitalization. An additional £500 million was announced in the March 2024 Budget in grants to local government for social care this fiscal year. Funding allocated to schools in FY2024/25 also implies a real increase over the past five years. Beyond FY2024/25, only one percent annual real growth of resource Departmental Expenditure Limits (DEL) is assumed, with flat nominal Capital DEL spending. It will be challenging to accommodate the required spending on public services and make needed investments, including in the green transition, within this envelope.
Adopt additional deficit-reducing measures to accommodate spending pressures over the medium term, including pension reform and strengthening of carbon, property and wealth taxation, as well as closing tax loopholes.	The authorities announced a series of revenue-raising measures in the Spring Budget 2024, worth around 0.3 percent of GDP, including reform of the 'non dom' regime, increased taxation of tobacco and vapes, an extension of the oil and gas profits levy, a UK Carbon Border Adjustment Mechanism', less generous stamp duty for purchasers of multiple dwellings and less preferential tax treatment for those leasing furnished property to holidaymakers. More ambitious tax reforms have not been pursued.

[1] The 2023 Article IV Consultation was concluded in July 2023.

IMF 2023 Article IV Selected Recommendations	Policy Actions Between 2023 Article IV and May 2024
Monetary Policy	
Adopt the following enhancements to the fiscal framework: (i) require an OBR forecast to accompany every major discretionary fiscal event; (ii) require the OBR to analyze the impact of any changes to fiscal rules; (iii) better define escape clauses for the fiscal rules; and (iv) adopt a fiscal framework anchored in the probability of debt stabilization.	An OBR forecast has accompanied the November 2023 and March 2024 budgets, but no formal changes to the fiscal framework have been made. A Spending Review is expected after the general election.
Structural Policy	
Further ambitious, evidence-based reforms are needed to lift business investment, labor supply, and productivity. This includes: (i) permanent and wider capital investment allowances; (ii) easing planning restrictions; (iii) and accelerating catalytic public investments for delivery of critical network and healthcare infrastructures; and (iv) measures to improve skills and education outcomes, alongside better health and social care. The authorities could also consider fine-tuning the immigration system to alleviate labor and skill shortages and promote labor market flexibility.	Key overarching challenge is to raise UK potential growth. The authorities announced "110 reforms to boost growth" in Autumn 2023, including in the area of planning. In line with staff recommendations, full expensing (of qualifying plant and machinery business investment) has been made permanent. Work is ongoing in the skills space, including to improve the quality of apprenticeship programs, however the immigration system has been tightened in response to a surge in migration, which could exacerbate labor market shortages.
The green transition should be supported by (i) expanding the sectoral coverage of the Emission Trading Scheme (ETS) to heat and buildings, road transport and agriculture; (ii) strengthening incentives for adoption of green technology, including through expansion of fiscal support to households for converting gas heating to electric heat pumps; and (iii) clarifying investment plans to attract private participation, while providing regulatory certainty and easing investment bottlenecks. Energy security should be bolstered by increasing the UK's natural gas storage capabilities.	Public consultations are ongoing to expand the ETS to energy from waste, waste incineration and greenhouse gas removals (GGRs). A consultation on incorporating the domestic maritime sector will take place in due course. Expansion to heat and buildings and transport is not planned. Incentives for households to convert to electric heat pumps have been strengthened via an increase in the Boiler Upgrade Grant to £7500 per household. The level of future public spending to support the green transition is expected to be set at the next spending review, which will be after the general election.

Annex X. Sovereign Risk and Debt Sustainability Analysis[1]

Under the baseline scenario, the primary fiscal deficit declines to 0.5 percent of GDP by FY2029/30 on the back of a gradual fiscal consolidation (including a revenue boost from inflation-induced fiscal drag, and some spending restraint). General government gross debt nonetheless increases each year over the medium term to 108 percent of GDP in FY2029/30 (well-above pre-crisis projections), mainly reflecting less favorable automatic debt dynamics, due to higher interest rates and lower growth, as well as net losses related to quantitative tightening. Gross financing needs (GFNs) average 12 percent of GDP over FY2024/25–FY2029/30 (compared to pre-pandemic levels of around 10 percent), consistent with the higher debt levels and debt interest costs. Moderate risk from debt non-stabilization and high gross financing needs are mitigated by the UK's long maturity of GG debt, lack of foreign currency debt and substantial market absorption capacity for gilts (once NBFI demand is accounted for) aided by the UK's large institutional investor base and the sterling's status as a global reserve currency.

1. Background. The UK economy experienced a mild technical recession in 2023, but has rebounded in 2024 Q1, while CPI inflation has fallen faster than expected, from double digits in 2022 to 2.3 percent in April 2024. Interest rates remain well-above pre-pandemic levels. Meanwhile, the medium-term fiscal consolidation plan set out in the Autumn Statement of November 2022 has been broadly followed, with the overall fiscal deficit declining by 1 ppt. between FY2021/22 and FY2023/24, as revenue increased due to tax increases (including a 6 ppt. increase in the corporate rate) and fiscal drag, while tight limits on spending have been maintained, and the interest bill has begun to decline in percent of GDP. The debt-to-GDP ratio declined by 8 ppts of GDP between the end of FY2020/21 and FY2023/24.

2. Baseline fiscal assumptions. Staff's baseline is informed by the medium-term fiscal framework contained in Spring Budget 2024, overlayed with adjustments based on staff's judgment, including that medium-term expenditure (notably discretionary recurrent and capital spending after FY2024/25) will be significantly higher than in the authorities' plans, due to pressures on public services and critical investment needs (including for the green transition). The primary deficit is nonetheless projected to improve by 1½ ppts of GDP between FY2024/25 and FY2029/30, due to a combination of a ½ ppt of GDP boost to revenue from fiscal drag (reflecting frozen nominal personal income tax thresholds) and a 1 percentage point decline in expenditure as non-discretionary spending (including welfare) declines in percent of GDP as the economy recovers, outweighing faster-than-nominal GDP growth of discretionary recurrent and capital spending (Figure 4).[2]

1 The data are presented on fiscal year basis (April–March) with ratios calculated using fiscal year GDP (not centered-fiscal year GDP). For more information on the methodology, see IMF (2021), Review of the Debt Sustainability Framework for Market Access Countries, IMF Policy Paper 2021/003.
2 The primary deficit in 2024–26 is higher than projected in the 2023 Article IV, given less fiscal drag related revenue due to faster disinflation. In contrast, primary deficits are projected to be lower by the end of the five-year horizon than projected in the 2023 Article IV, given that the 2021 spending review limits restrain spending growth until 2025 and provide a low base for future growth.

3. Realism of baseline projections. Forecast errors point to some optimism in staff's projections for medium-term primary balances and cyclical conditions, given substantial fiscal support measures and a large output gap during the pandemic that weighed on public finances (Figure 5). The projected medium-term fiscal adjustment and debt reduction paths are nonetheless within the normal historical range observed in peer countries.

4. Risks and mitigating factors. The Debt Fanchart and GFN Financeability modules both signal moderate risk (Figure 6). For the fanchart, this reflects high uncertainty (as indicated by the fanchart width), a high probability of debt non-stabilization but more moderate end-projection debt levels when adjusted for institutional quality. Moderate GFN Financeability risk reflects moderately high average GFNs under the baseline projections, which exceed 20 percent of GDP in a generalized stress scenario with increased deficits, inflation, lower growth, and a shortening of debt maturities. In this scenario, the needed (residual) absorption of government debt by domestic banks is further increased by limited rollover of external private financing and continued QT by the BoE. Nevertheless, it only cumulates to 18 percent of sterling-denominated bank assets by end-horizon, owing to the current very low level of government exposure of the banking sector (at about 2¾ percent of sterling-denominated assets). While combining the debt fanchart and GFN indices yields a moderate medium-term risk signal (Figure 1), there are several mitigating factors, including: a very long maturity of general government debt (of about 14 years on average) that smoothes GFNs and limits the pass-through from higher yields to effective interest rates; lack of foreign currency debt that mitigates FX risks; and substantial market absorption capacity for gilts aided by the UK's large institutional investor base and the sterling's status as a global reserve currency, which mitigate liquidity risks. Staff therefore assesses overall risks of sovereign stress to be low.

Figure X.1. United Kingdom: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	**Low**	Staff's assessment of the overall risk of sovereign stress is low, reflecting moderate levels of vulnerability in the medium-, and long-term horizons. Mitigating factors include exceptionally long debt maturity, lack of foreign currency debt and large market absorption capacity for gilts aided by the UK's large institutional investor base and the sterling's status as a global reserve currency.
Near term 1/			
Medium term	**Moderate**	**Moderate**	Staff's assessment of the medium-term risk of sovereign stress is moderate, consistent with the mechanical signal. Risks resulting from a high probability of debt non-stabilization and large financing needs are mitigated by the quality of the UK's institutions and the low sovereign exposure of UK banks.
Fanchart	**Moderate**	...	
GFN	**Moderate**	...	
Stress test		...	
Long term	...	**Moderate**	Long-term risks are moderate as aging-related expenditures on health and social security and investment needs associated with the Net Zero Strategy feed into debt dynamics.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: The UK is at a low overall risk of sovereign stress. The large response to successive shocks and permanent output losses have raised debt levels, with large financing needs and a sizable probability of debt non-stabilization reflected in a moderate medium-term risk score. Long-term risks are also judged as moderate in view of spending needs associated with an aging population and climate objectives. Over the projection horizon, the key debt drivers are primary deficits and interest costs. Risks to the debt path include downside risks to growth, upside risks to inflation which could raise interest costs (including costs of inflation-indexed gilts), and unanticipated spending needs (e.g., due to labor strikes generating pressures for more substantial public sector wage rises in the near-term, and needs related to an aging population and climate objectives in the medium and long-term). Nevertheless, there are several mitigating factors including: a very long debt maturity that smoothes GFNs and limits the pass-through from higher yields to effective interest rates; lack of foreign currency debt that mitigates FX risks; and substantial market absorption capacity for gilts aided by the UK's large institutional investor base and the sterling's status as a global reserve currency, which mitigate liquidity risks.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure X.2. United Kingdom: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						
Subsectors captured in the baseline					Inclusion	
1 Budgetary central government					Yes	
2 Extra budgetary funds (EBFs)					No	Not applicable
3 Social security funds (SSFs)					Yes	
4 State governments					Yes	
5 Local governments					Yes	
6 Public nonfinancial corporations					No	
7 Central bank					No	
8 Other public financial corporations					No	
3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	
4. Accounting principles:	Basis of recording		Valuation of debt stock			
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	
5. Debt consolidation across sectors:		Consolidated		Non-consolidated		

Rows 1–8 are grouped as: CG (1–2), GG: expected (1–5), NFPS (1–6), CPS (1–8).

Color code: chosen coverage (green); Missing from recommended coverage (red); Not applicable (grey)

Reporting on Intra-Government Debt Holdings

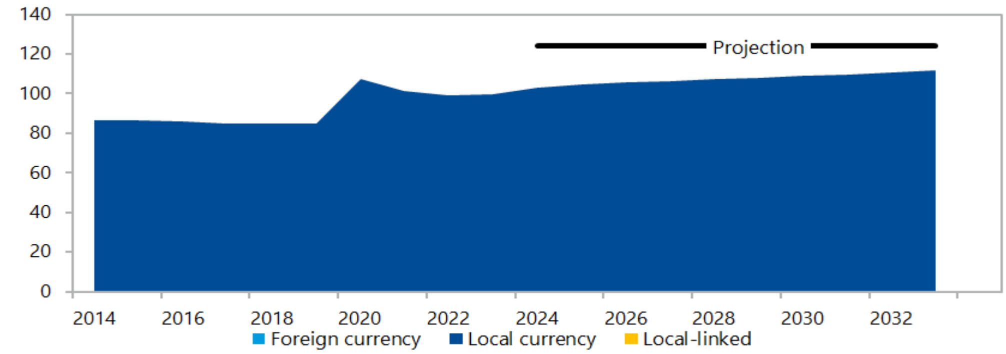
Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt									0
2 Extra-budget. funds									0
3 Social security funds									0
4 State govt.									0
5 Local govt.									0
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The coverage in this SRDSA is general government, with most debt issued by the central government. This reflects the preferred concept in the new SRDSA.

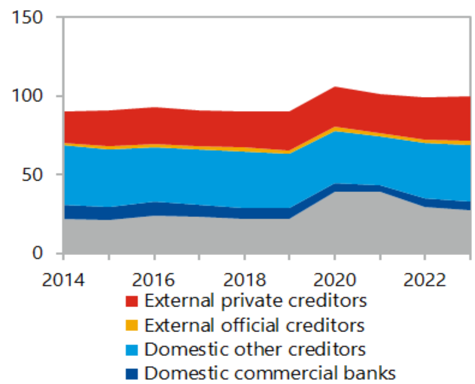
Figure X.3. United Kingdom: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



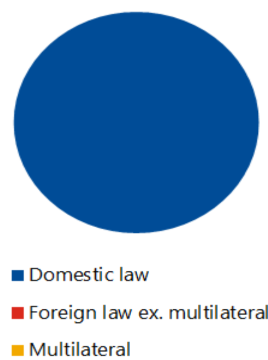
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



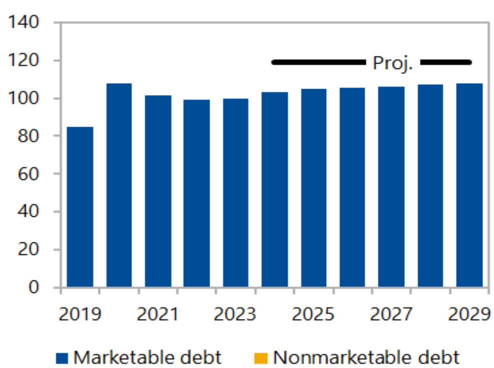
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



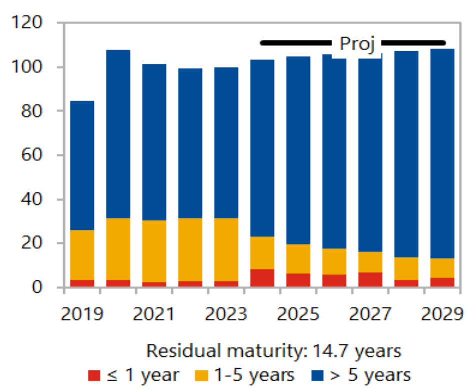
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

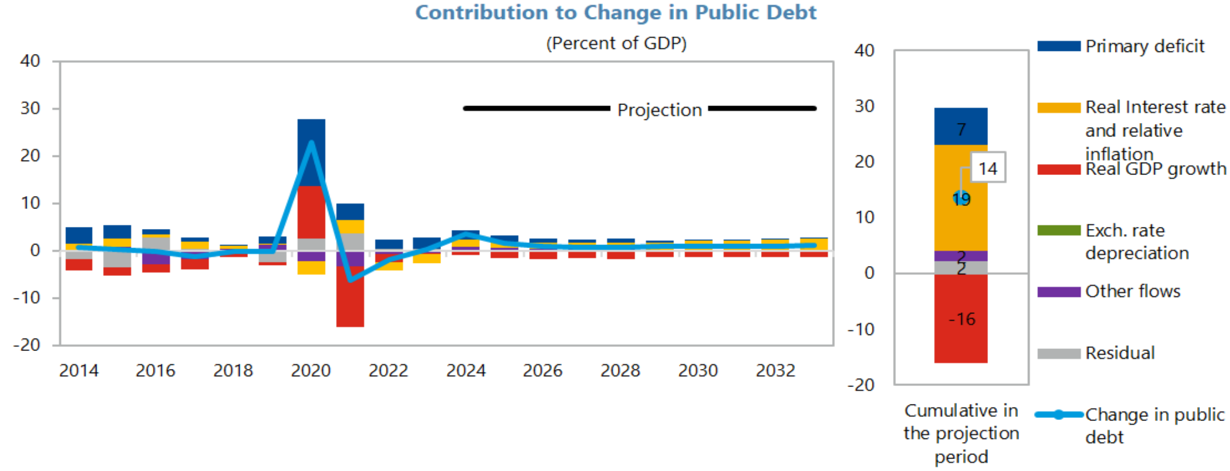
Commentary: Debt is predominantly in domestic currency and marketable. All public debt is governed by domestic law. Debt is mostly long-term, with its residual maturity one of the highest among advanced economy peers. The share of debt held by the central bank, which had risen with successive rounds of QE, has started to decline with QT in 2022. The remainder of the debt is predominantly held by NBFIs and external private creditors, with the domestic banking sector estimated to hold only about 6 percent of public debt.

Figure X.4. United Kingdom: Baseline Scenario 1/

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	99.6	103.1	104.7	105.7	106.4	107.2	108.0	108.9	109.8	110.8	112.0
Change in public debt	0.3	3.5	1.7	0.9	0.7	0.8	0.9	0.8	1.0	1.0	1.2
Contribution of identified flows	-0.1	3.2	1.5	0.7	0.6	0.6	0.7	0.6	0.7	0.8	0.9
Primary deficit	2.5	2.0	1.5	1.0	0.7	0.7	0.5	0.2	0.1	0.0	0.0
Noninterest revenues	39.1	38.9	39.1	39.3	39.4	39.3	39.3	39.3	39.3	39.3	39.3
Noninterest expenditures	41.6	40.8	40.6	40.3	40.1	40.0	39.8	39.5	39.5	39.4	39.4
Automatic debt dynamics	-2.0	0.8	-0.5	-0.5	-0.4	-0.3	0.2	0.4	0.6	0.7	0.9
Real interest rate and relative inflation	-1.9	1.7	1.2	1.2	1.3	1.4	1.5	1.8	2.0	2.2	2.3
Real interest rate	-1.9	1.7	1.2	1.2	1.3	1.4	1.5	1.8	2.0	2.2	2.3
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-0.1	-0.9	-1.6	-1.7	-1.7	-1.7	-1.3	-1.4	-1.4	-1.4	-1.4
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	-0.6	0.5	0.4	0.2	0.3	0.2	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	1.1	0.9	0.7	0.8	0.7	0.5	0.5	0.5	0.5	0.5
Contribution of residual	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Gross financing needs	11.4	11.6	12.4	11.1	11.1	12.8	10.2	11.6	12.6	12.8	13.5
of which: debt service	9.4	10.2	11.4	10.5	10.9	12.5	10.2	11.9	12.9	13.3	13.9
Local currency	9.4	10.2	11.4	10.5	10.9	12.5	10.2	11.9	12.9	13.3	13.9
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	0.1	0.9	1.6	1.7	1.6	1.6	1.2	1.3	1.3	1.3	1.3
Inflation (GDP deflator; percent)	6.1	1.3	1.8	2.0	2.0	2.0	2.1	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	6.2	2.3	3.5	3.6	3.7	3.7	3.4	3.3	3.3	3.3	3.3
Effective interest rate (percent)	4.1	3.1	3.0	3.2	3.3	3.4	3.6	3.7	3.9	4.0	4.2

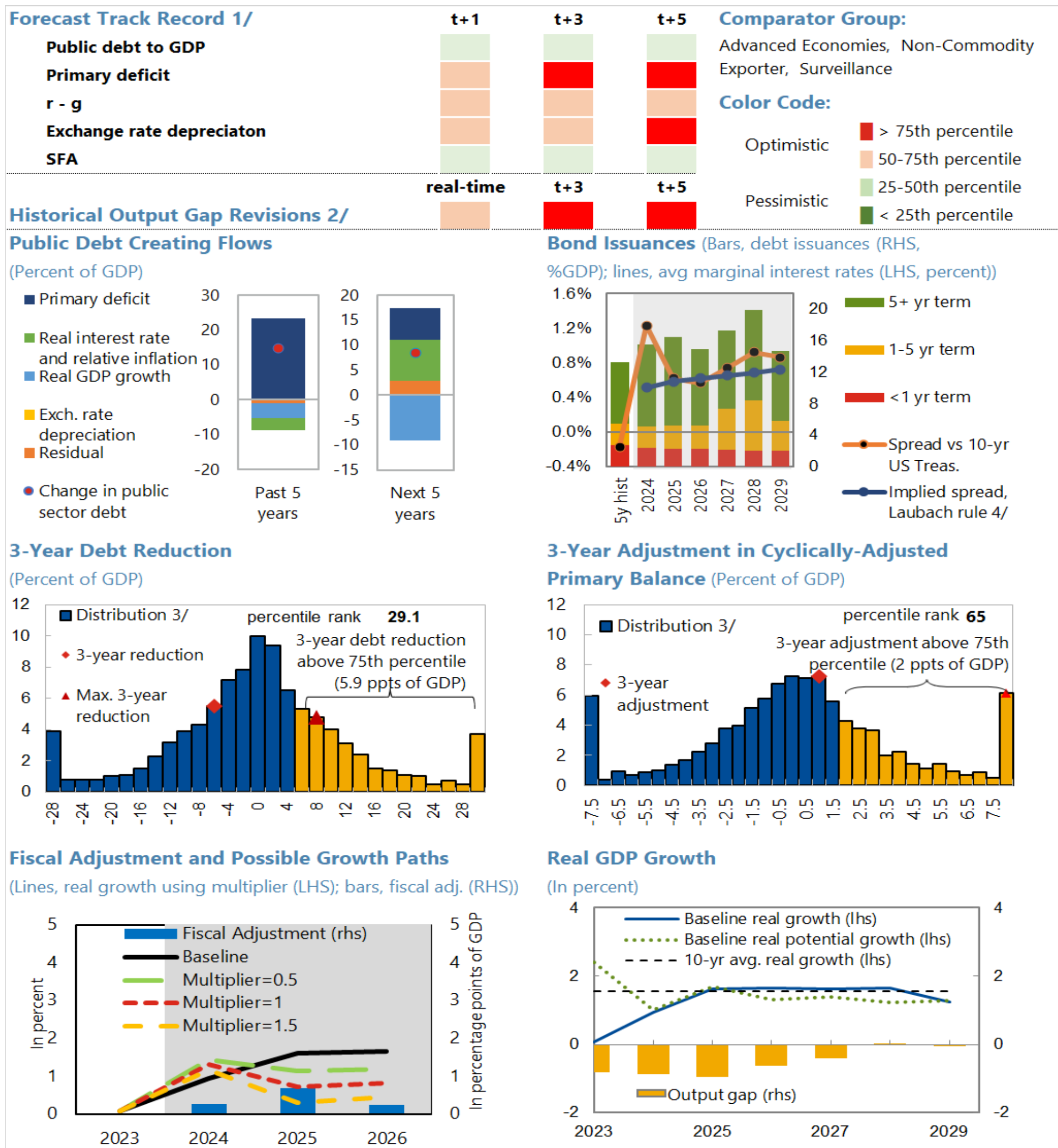
Contribution to Change in Public Debt



Staff commentary: Public debt does not stabilize over medium-term or extended projection horizon, due to ongoing primary deficits and deterioriating automatic debt dynamics, partly reflecting a mark down in staff's estimate of potential growth (to 1.3 percent), as well as an increase in debt due to the impact of other transactions. These include the stock flow adjustment implicit in OBR general government debt projections until 2028.

1/ Data are presented in fiscal years, so that, e.g., 2023 corresponds to FY2023/24, ending in March 2024.

Figure X.5. United Kingdom: Realism of Baseline Assumptions



Commentary: The realism analysis shows large forecast errors for medium-term primary deficit, exchange rate and output gap projections, indicating an optimistic bias, and smaller errors for the public debt to GDP ratio and r-g projections. The projected fiscal adjustment and change in debt are within historical norms; while the maximum adjustment over any three years is above the threshold, this reflects the unwinding of pandemic relief and energy support measures. Public debt creating flows reflect increased real interest rates as tight monetary policy brings down inflation, as well as weaker potential growth.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

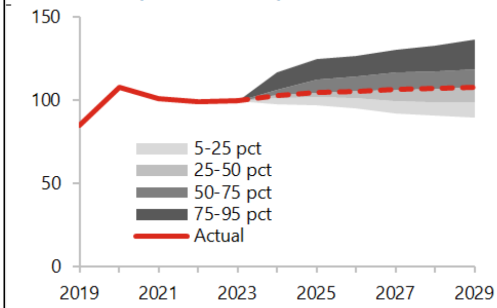
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

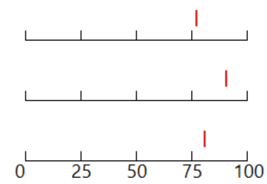
Figure X.6. United Kingdom: Medium-Term Risk Analysis

Debt fanchart module

	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	47.0	0.7	
Probability of debt non-stabilizaiton *(percent)*	74.0	0.6	
Terminal debt-to-GDP x institutions index	25.0	0.5	
Debt fanchart index (DFI)		1.8	
Risk signal: 3/		**Moderate**	

Final Fanchart (Percent of GDP)

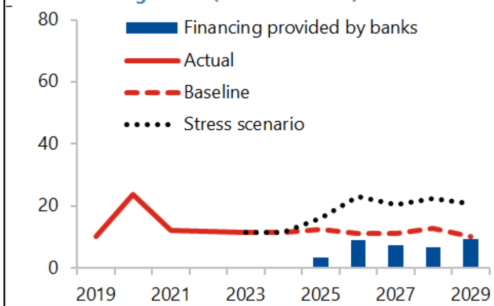


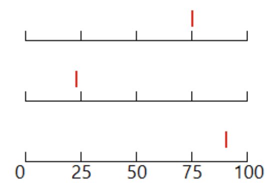


Gross financing needs (GFN) module

	Value	Contrib 1/	Percentile in peer group 2/
Average baseline GFN *(percent of GDP)*	11.5	3.9	
Initial Banks' claims on the gen. govt *(pct bank assets)*	2.7	0.9	
Chg. In banks' claims in stress *(pct banks' assets)*	17.9	6.0	
GFN financeability index (GFI)		10.8	
Risk signal: 4/		**Moderate**	

Gross Financing Needs (Percent of GDP)

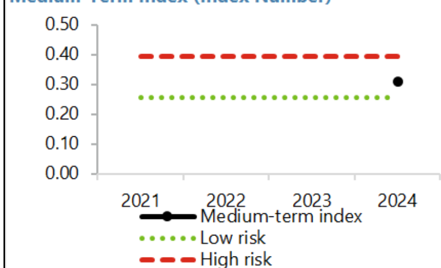




Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	(normalized)	Weight	Contribution
Debt fanchart index	1.8	0.4	0.5	0.2
GFN finaceability index	10.8	0.2	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		**Moderate**		
Final assessment:		**Moderate**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 26.1 pct.

Commentary: The Debt Fanchart and GFN Financeability modules both point to moderate risk. For the fanchart, this reflects high uncertainty (as indicated by fanchart width), a high probability of debt non-stabilization but moderate end-projection debt levels when adjusted for institutional quality. Moderate financing risk reflects moderately high average GFNs and moderate increases in sovereign exposure of domestic banks under a stress scenario with limited rollover of external private financing, increased deficits and continued QT, offset by the very low initial sovereign exposure of domestic banks.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure X.7. United Kingdom: Long-Term Risk Analysis

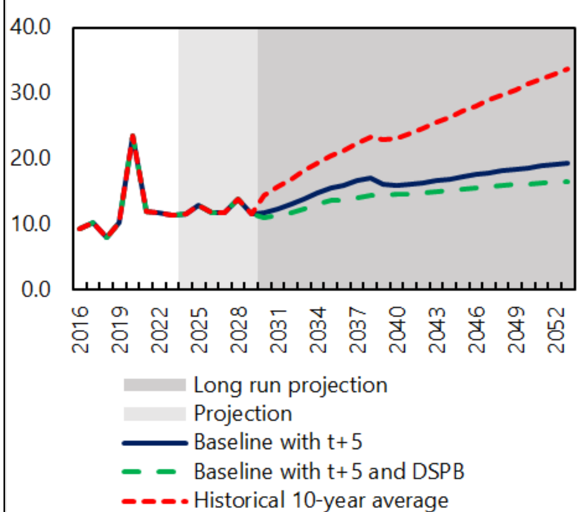
United Kingdom: Triggered Modules

Large amortizations	Pensions	Climate change: Adaptation	Natural Resources
	Health	Climate change: Mitigation	

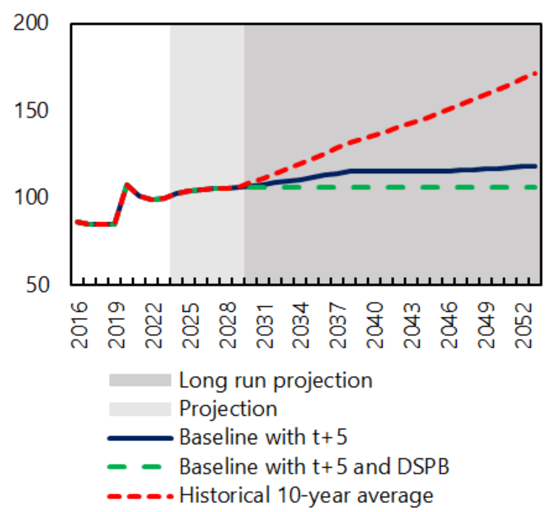
United Kingdom: Long-Term Risk Assessment: Large Amortization

Projection	**Variable**	**Risk Indication**
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP Ratio



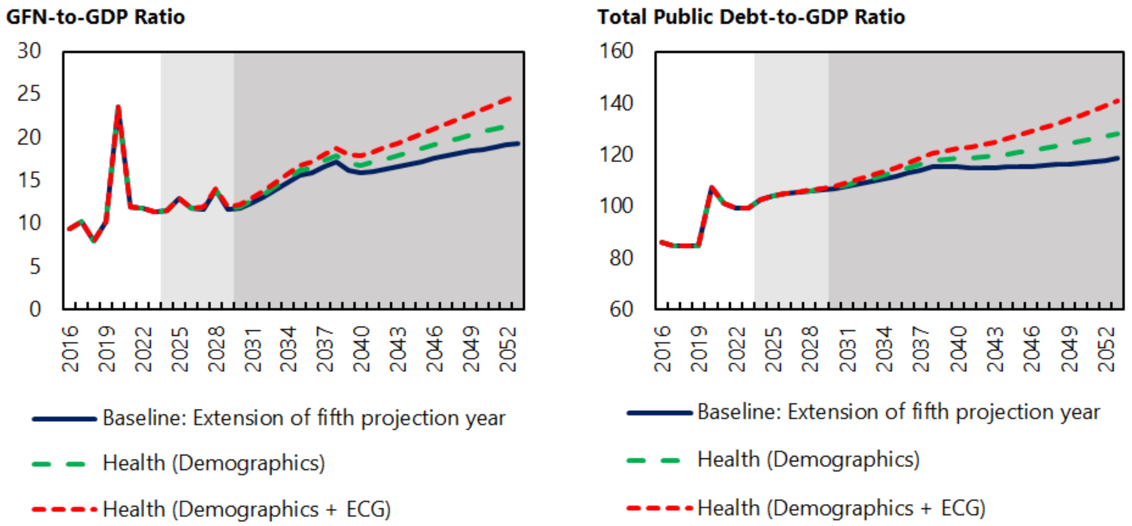
Total Public Debt-to-GDP Ratio



Staff Commentary: Long-term simulations suggest that GFN and / or amortization will exceed the 2014-2023 average by more than one std. dev. if (i) debt drivers remain at FY2028/29 levels over the LT; or (ii) the debt stabilizing primary balance prevails over the LT, while other debt drivers remain at FY2028/29 levels; or (iii) debt drivers remain at the average over the past ten years. These results illustrate the LT fiscal challenge in the UK due to high debt and spending pressures, including because of the ageing population, underscoring the need for fiscal adjustment.

Figure X.8. United Kingdom: Long-Term Risk Analysis

United Kingdom: Demographics: Health



Staff Commentary: Long-term simulations suggest that GFN and GG debt will rise more sharply if (i) current health spending (around 8 percent of GDP) rises over time due to population ageing **(Demographics)**; or (ii) current health spending (around 8 percent of GDP) rises gradually to 10 percent of GDP (as implied by NHS LT Workforce Plan) **(Demographics + Excess Cost Growth (ECG))**, relative to a baseline with health spending of araound 8 percent of GDP and debt drivers remaining at FY2028/29 levels over the LT.

Annex XI. International Experience with Growth Commissions

There is considerable experience among OECD economies of setting up growth and/or productivity commissions to advise governments on structural reforms (anchored in independent research) needed to power long-term growth. Autonomous commissions in Australia, New Zealand, Norway, and Denmark have had notable success in advancing policies that fostered innovation and productivity.

1. **The history of productivity commissions stretches well back into the past century.** Chile's Economic Development Agency (CORFO) was founded in 1939; Danish Economic Councils have been active since 1962; the Australian Productivity Commission and Norway's Productivity Commission were established in 1998; Mexico's National Productivity Commission (CONAPO) was launched in 2008; and New Zealand's Productivity Commission started in 2011 (ended 2024).

2. **Autonomy and political influence have varied across these commissions.** Although growth commissions only make recommendations and do not make policy decisions (which rest with the government), they do have varying degrees of influence on policy and decision-making, depending on the institutional setup. In Australia, New Zealand, and Norway, commissions have operated independently, drawing on expertise from academia and business to offer impartial policy advice. Similarly, Denmark's Economic Councils and Mexico's CONAPO conduct autonomous research and make policy recommendations, though they face some government oversight. In contrast, Chile's CORFO operates under the Ministry of Economy, with government officials on its board.

3. **The aforementioned commissions have been associated with some impressive growth-oriented reforms.** Australia's commission led to significant competition policy reforms, notably in telecommunications, reducing consumer prices. New Zealand's commission influenced welfare and regulatory policies, fostering innovation and job creation. In Norway, the commission’s research supported sustainable development, making the country an environmental leader. Denmark's Economic Councils shaped labor market policies and boosted industry-academia collaboration. Mexico's CONAPO successfully pushed reforms in the telecommunications and energy sectors. These commissions also often regularly reported on reform implementation and outcomes, thereby serving as an effective disciplining device.

4. **The experience above suggests that independent commissions can be helpful in advancing politically-contentious but economically-desirable reforms.** Governments can have short horizons due to the electoral cycle, which means that reforms with long payback periods are often eschewed. Moreover, governments can find it difficult to push through politically-contentious reforms, e.g., reforms that have wide benefits for the economy, but are opposed strongly by particular constituencies. An independent commission can help in these situations by allowing the government to point to the commission’s evidence-based findings. The commission can also as a disciplining device to anchor implementation, an example of which already exists in the UK in the form of the Climate Change Committee.

Annex XII. FSAP Recommendations

	Time frame	Update on Relevant Work in Progress
1: Strengthen backstops to the functioning of core markets in times of stress by considering allowing appropriately regulated and systemically interconnected NBFIs access to repo and/or Gilt purchase operations; clearly communicating the objectives, instruments, eligible participants, and the exit criteria. (BOE)	1–3 years	• Designed and carried out gilt market purchases on financial stability grounds in Autumn 2022 to address market dysfunction in long-dated gilts (see letter to TSC for more detail). More detail on operational design can be found here. The purchases were successfully exited. • Work to reflect on lessons learnt from the LDI episode is ongoing and seeks to build on other Bank analysis of the subject (see here). It is expected to be completed in 2024. • Work on developing a repo tool for NBFIs is making good progress. The Bank is taking a two-stage approach to the tool. The first phase will be for eligible insurance companies, pension funds and LDI funds. In parallel work on the second phase of the tool is exploring how access might be expanded over time to maximise policy efficacy. More details on design choices can be found here, including why the first phase will focus on the gilt market and be a contingent facility.
2: *Enhance* and further strengthen the existing stress testing framework by consolidating the internal toolkit and run independent full-fledged top-down exercises covering all systemically relevant components of the financial system. (BOE/PRA, with FCA)	3–5 years	• The Bank is running a system-wide exploratory scenario exercise to consider the behavior of banks and NBFIs in stress, and how their behaviors might interact and amplify shocks in ways that might cause adverse outcomes in UK financial markets core to UK financial stability. The Bank published the stress scenario for this exercise in November 2023, and will publish final results in Q4 2024. After the SWES concludes, the Bank will consider options to assess system wide risks going forward. • To support this, the Bank is developing models to examine the channels through which different sectors, including core non-bank intermediaries such as dealers and central counterparties, propagate stress through financial markets and impacts aggregate liquidity in the non-bank financial system. In particular: ○ The Bank is developing our "system interlinkages model". This includes improving the modelling of fundamental asset price and open-ended fund flows; refining the treatment of repo borrowing; and introducing an LDI fund. ○ The Bank is also developing model approaches that exploit new datasets on financial exposures and interlinkages. For example, the Bank is extending the capital at risk microstructural model of banking sector exposures to consider amplification and feedback effects, as well as bringing in additional data collections on insurers and funds. • The Bank is carrying out a stocktake of its approach to stress testing the UK banking system in 2024, drawing on lessons learned from its first decade of concurrent stress testing, and so ensuring it continues to support the FPC and PRC in meeting their objectives. • The Bank is investing in its desk based / top-down modelling toolkit for stress testing the banking system. This will enable us to provide timely assessments of new risks and their impact on the ACS banks, outside of the annual stress test round. For example, supporting international exercises like the FSB/BCBS global stress test. The Bank is also continuing to invest in our suite of granular models and toolkit used to understand bank portfolio-specific risks, for use in the ACS and beyond.
3. Seek additional statutory powers to review and examine the resilience of all critical services (including, but not limited to, cloud services) that third parties provide to regulated firms. (BOE/PRA, FCA, and HMT)	3–5 years	• Third parties are becoming increasingly important and relevant for the delivery of important business services (IBSs). The financial institutions that outsource key systems and processes which underpin their IBSs to third parties remain accountable for the risks to those IBSs. This means that they should establish appropriate oversight of the third party risk and ensure effective management of these risks and remediation of any vulnerabilities, including cybersecurity risks. See the Supervisory Statement (SS) 2/21 'Outsourcing and third party risk management • In addition to the responsibilities of individual financial institutions, the UK authorities are developing a framework to monitor and manage potential systemic risks posed by certain third party service providers to the UK financial sector. • In July 2022, the Bank of England, Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) jointly issued DP3/22 – Operational resilience: Critical third parties to the UK

	Time frame	Update on Relevant Work in Progress
		financial sector, which sought industry views on their initial thinking on a potential framework for CTPs. The consultation period for DP3/22 closed in December 2022. • In July 2023, the Financial Services and Markets Act 2023 (FSMA 2023) was adopted by the UK Parliament. FSMA 2023 contains the statutory building blocks of the proposed new framework for CTPs. In particular, FSMA gives (i) HM Treasury the power to designate certain third party service providers to the financial sector as critical third parties; and (ii) the regulators rulemaking powers, powers of direction, information-gathering powers and disciplinary powers over CTPs in respect of their services to the financial sector. • Following the coming into force of FSMA 2023, and building on feedback to DP3/22, the regulators published a joint consultation paper setting our proposed rules and supervisory expectations for CTPs in December 2023 (CP26/23 - Operational resilience: Critical third parties to the UK financial sector | Bank of England). The consultation period for CP26/23 closed on 15 March 2024. There were over 60 responses from a wide range of stakeholders. The regulators are currently analysing these responses, with a view to publishing the final requirements and expectations for CTPs in H2 2024. The initial designations of CTPs by HMT should follow sometime after the publication of the final rules. In parallel, the regulators are jointly developing an approach for overseeing CTPs in practice.
4. Further develop "on the ground" reviews of systemically important financial firms' exposures and risk management practices for early identification and remediation of supervisory issues, including AML/CFT risks, and to also support macroprudential surveillance. (BOE/PRA and FCA)	1–3 years	• As part of its 2021–26 strategy, the PRA strengthened its supervisory approach and its internal capabilities. For its largest firms, the supervisory approach continues to include regular 'on the ground' reviews for some topics (e.g. capital, liquidity). For its mid-sized firms, there is a new requirement to complete annual 'on site' visits. This adjusted supervisory approach has now been in place for over one year. The PRA is satisfied that it has embedded adequately. • The PRA's supervisory approach continues to include the aggregation of intelligence to inform the Bank of England's assessments of the risks and resilience of the UK banking (and insurance) system that are routinely considered by FPC. The PRA is continuing to invest in cross-firm work to enhance its macroprudential insights. The market events in spring 2023 were a good demonstration of the PRA's ability to respond quickly where a macroprudential risk necessitates it. The PRA introduced greater focus on the composition of firms' liquidity asset buffer portfolios and liquidity monitoring metrics, aggregated this information through an internal taskforce, responded to commissions from the FPC on the exposure from non-systemic firms and carried out contingency planning on a small subset of those firms. • In 2023, the PRA introduced new requirements, training and guidance to ensure greater use of Section 166 Skilled Person Reviews. The PRA is satisfied, after a year embedding, with the benefits of these changes. It is seeing sustained use of Skilled Person Reviews for its largest firms (or adequate justification when such a review is not needed). It has no plans to make any immediate changes. • The PRA has established an international platform for supervisory cooperation with overseas regulators for Lloyd's of London to facilitate the sharing of supervisory information. The first meeting took place across two days in November 2023 and was attended by over 40 representatives. Participants were selected by reviewing materiality of presence (e.g. GWP and catastrophe exposure), both in countries where Lloyd's operates regulated operations and those without physical operations, and to achieve a wide geographical spread. Engagement from attendees was good. • While the Financial Conduct Authority (FCA) remains the lead UK regulator for managing money laundering (AML) and terrorist financing (CFT), the PRA will continue to consider both topics in its prudential assessment of firms and co-operate closely and share information with the FCA and other AML/CFT authorities.
5. Enhance cyber risk technical risk reviews on technology risk management expectations for all financial firms, and by conducting additional cybersecurity control verification activities to complement CBEST security testing. (BOE/PRA, and FCA)	1–3 years	• The Bank/PRA has developed the supervisory cyber toolkit by: o introducing CQUEST which enables regulated firms of any size to benchmark their maturity in cybersecurity risk management. o jointly with the FCA publishing the Simulated Target Attack and Response for the Financial Services (STAR-FS) framework, a concept of cyber testing which is similar to CBEST but targeted on smaller and medium-sized firms o continued the CBEST programme and published a detailed summary of the key learnings from the most recent round of CBEST tests so that firms across the UK finance sector can benefit from the thematic findings. For the first time this includes analysis by the National Cyber Security Centre (NCSC).

	Time frame	Update on Relevant Work in Progress
		○ progressed piloting a new concept of pen-testing, building on CBEST, to test resilience against advanced threat actors and intended to challenge those firms with a high degree of cyber risk management maturity (pilot completion target is end H1 2024). • Alongside the cyber-security toolkit the Bank/PRA is implementing the Operational Resilience policy which requires firms to set impact tolerances for their Important Business Services against a range of relevant severe but plausible scenarios. The Bank/PRA have provided guidance to the sector on cyber risk scenarios, e.g. ransomware attacks, to ensure that firms are testing their capability to recover from a sufficiently severe attack. This work complements the cyber-security tools by assessing firms' capability to restore a business service end-to-end. • The Bank/PRA has recently started its third Cyber Stress Test. Previous tests focussed on retail payments and the current test will assess key parts of wholesale payments focussed on sterling assets. • The Bank/PRA continues to contribute to enhancing cybersecurity risk management good practice throughout the UK finance sector through a Public-Private partnership with UK Finance, and internationally through the G7 Cyber Expert Group, the European Systemic Cyber Group and in the FSB, in particular its work on cyber incident reporting. • The FCA has implemented a self-assessment tool for Operational Resilience (ORQUEST) to inform supervisory assessments, which includes questions relating to threat and vulnerability management, identity management and incident management.
6. Enhance entity transparency through improved verification of beneficial ownership information on the PSC Register and augment, as needed, ongoing support to Crown Dependencies and British Overseas Territories in operationalizing similar registers. (HMT, BEIS/Companies House, and FCDO)	1–3 years	• The Economic Crime and Corporate Transparency Act 2023 includes measures to reform the role of Companies House and improve transparency over UK companies, in order to strengthen our business environment, support our national security and combat economic crime, whilst delivering a more reliable companies register to underpin business activity. • The reforms include: ○ Introducing identity verification for new and existing directors, beneficial owners and those who file information with Companies House - helping ensure the authorities know the real people acting for and benefiting from companies; ○ Broadening the Registrar's powers so that the Registrar becomes a more active gatekeeper over company creation and custodian of more reliable data concerning companies and partnerships; ○ Improving the financial information on the Register so that the Register is more reliable, complete and accurately reflects the latest advancements in digital technology and enables better business decisions; ○ Providing Companies House with more effective investigation and enforcement powers and introducing better cross-checking of data with other public and private sector bodies. Companies House will be able to proactively share information with law enforcement bodies on higher risk corporate bodies or when there is evidence of anomalous filings or suspicious behaviour; ○ Enhancing the protection of personal information and addresses provided to Companies House to protect individuals from fraud and other harms; ○ Broader reforms to clamp down on misuse of corporate entities. • The Overseas Territories (OTs) and Crown Dependencies (CDs) are self-governing jurisdictions who are responsible for their own financial services regulation. • All CDs and OTs have committed to introducing publicly accessible registers of company beneficial ownership, Gibraltar's public register is now live. The Government welcomed this commitment, which underscores their continued contribution to the global fight to tackle illicit finance. • The UK Government is engaging with the CDs and OTs on understanding the implications of the recent Court of Justice of the European Union (CJEU) ruling. Since the ruling, the CDs and OTs have noted concerns about the legal implications of implementing a publicly accessible register of beneficial ownership if human rights provisions applicable to them were to be interpreted in a similar way. • The CDs have committed to providing publicly accessible registers of beneficial ownership to financial institutions and designated non-financial services businesses and professions by the end of 2024, and to others with a legitimate interest (media and civil society) within a reasonable timeframe. Gibraltar has implemented a public register of beneficial ownership, and

	Time frame	Update on Relevant Work in Progress
		the authorities are working with the other OTs to support implementation of publicly accessible registers of beneficial ownership with a legitimate interest access filter as an interim step. • The CDs and six OTs with global financial centres share beneficial ownership information with UK law enforcement agencies (within 24 hours, or 1 hour in urgent cases) under the Exchange on Notes arrangements, which were put in place in 2017. • All CDs and OTs with financial centres have committed to the OECD's Common Reporting Standard, under which taxpayer financial account information is automatically exchanged for tax purposes. This reciprocal, automatic exchange of financial information addresses the secrecy that facilitates offshore tax evasion and provides evidence of tax non-compliance.
7. Continue to encourage the conversion of remaining legacy LIBOR exposures of U.K. regulated firms and support foreign efforts to migrate from non-Sterling LIBOR, mindful of the needs of emerging markets users. (FCA, HMT, and BOE)	1–2 years	• 32 of the 35 LIBOR settings have now ceased permanently. The FCA has announced end dates for the remaining 1-, 3- and 6-month synthetic US dollar LIBOR settings which are due to cease at end-September 2024. • The Bank and FCA continue to facilitate public-private partnerships to allow for a market-led transition. Following the cessation of most LIBOR settings at the end of 2021, the Working Group on Sterling Risk-Free Reference Rates moved forward from 2022 with a revised objective to focus on non-sterling LIBOR transition in UK markets and active transition of any legacy contracts using synthetic sterling LIBOR. The Working Group continues to operate, with the expectation it will wind down following the cessation of the final synthetic US dollar LIBOR settings at end-September 2024. • The PRA and FCA's central LIBOR supervisory programmes have now been wound down, with ongoing monitoring handed over to individual supervisory teams. The PRA and FCA supervised firms with the largest and most complex LIBOR exposures have in aggregate less than £31 billion of exposures to synthetic US dollar LIBOR, down from £3 trillion in 2020. • The FPC Record on 27 March 2024 covered LIBOR transition. The Committee welcomed the further reduction in the stock of legacy US dollar LIBOR exposures, and consequently judged that the financial stability risk in the UK associated with US dollar LIBOR had effectively been mitigated (having previously concluded the same for sterling LIBOR in March 2023). The FPC welcomed the fact that the final synthetic GBP Libor setting would cease on 28 March. It noted that all remaining synthetic LIBOR settings have planned end dates in 2024 and encouraged participants to maintain momentum on transition efforts to minimise remaining exposures ahead of these dates. • The Bank, FCA and HMT continue to work closely with other international authorities in monitoring global use of reference rates. The FSB's Official Sector Steering Group has now been wound down, with ongoing monitoring on the use of reference rates falling to the BIS Markets Committee (escalating to the FSB's Standing Committee on Supervisory and Regulatory Cooperation as necessary). • Marking the progress of US dollar LIBOR transition in the US, the Alternative Reference Rates Committee has now been wound down. • To support a globally consistent shift away from US dollar LIBOR to robust alternatives, IOSCO published a statement following its review of alternatives to US dollar LIBOR. The review assessed how certain US dollar benchmarks align with IOSCO Principles 6, 7, and 9 relating to design, data sufficiency, and transparency, and whether such rates provide users with robust and reliable benchmarks and sufficient information to enable them to assess their suitability. The review highlighted concerns that some credit sensitive rates – marketed as potential substitutes for US dollar LIBOR – exhibit the same inherent "inverted pyramid" weaknesses as LIBOR. Furthermore, Bloomberg announced plans to cease its BSBY index in November 2024.
8. Continue preparing for diverse failure scenarios; eliminate rules that may constrain the bank resolution regime; and accelerate and expand the work on recovery and resolution planning for insurers and CCPs. (HMT, BOE/PRA, FCA, and FSCS)	3–5 years	• Banks: The UK's bank resolution regime has been in place since 2009 and has been iterated over time to ensure it continues to effectively limit risks to financial stability, depositors and public funds. As with any policy framework, the UK continues to keep the regime under review to ensure it is fit for purpose. The Bank has continued to prepare its HCF execution materials for diverse failure scenarios, including cyber, and use of multiple tools concurrently. The Bank is working with HMT as part of its updates to the Code of Practice to consider amendments relevant to the IMF's recommendations. The authorities have worked together to consider any lessons learned from SVB US / UK and CS failures to enhance our approach and engaged with relevant international work, including by the FSB, on lessons learned. A key part of this has been

	Time frame	Update on Relevant Work in Progress
		the publication by HMT of proposed enhancements to the Special Resolution Regime in January 2024. • Insurance: The new s377A of FSMA, to give the PRA an additional tool to deal with a failing insurer to facilitate continuity of cover for policyholders has been enacted and is in the process of being fully operationalized by the PRA. HMT consulted on establishing an Insurance Resolution Regime (IRR) in January 2023, and have subsequently announced that legislation to implement the new regime will be introduced when Parliamentary time allows. The proposed regime will align the UK to relevant standards, providing the Bank as resolution authority with a range of tools and powers to manage the failure of an insurer where this would have adverse systemic impacts. When IRR is implemented, it will complement the Insurance Core Principles that the PRA complies with as part of its group-wide supervision of Internationally Active Insurance Groups, by requiring resolution authority-led resolvability assessment and resolution planning for our most systemically important insurers. In addition, in January 2024 the PRA issued a Consultation Paper proposing an expansion of the requirements for all UK insurers to prepare for a solvent exit as part of their BAU activities, so that, if needed, they could cease PRA-regulated activities in a timely and orderly manner. The PRA intends to publish a Policy Statement on this subject in the second half of 2024, with Q4 2025 as the proposed implementation date for resulting changes. • CCPs: In June 2023, new primary legislation that includes an extensive enhancement of the UK's CCP resolution regime (see Schedule 11 of FSMA 2023) was passed into law. Following the putting into place of several pieces of secondary legislation required to bring the enhancements into effect, the new regime entered into effect on 31st December 2023. These enhancements made the UK regime fully consistent with FSB standards, providing the Bank with a range of tools and powers that enable it to act quickly, flexibly and decisively to handle the failure of a CCP. The Bank is progressing CCP resolution planning and enhancing our operational capacity and preparedness to execute a CCP resolution. These arrangements were subject to testing, both internally and with external partners, in 2023 and will continue to be tested in 2024. The Bank has commenced development of a CCP RAF program, and this work will continue in 2024.
9: Preserve the primacy of the FPC's financial stability objective and strengthen its focus on global financial standards and cross-border surveillance. (HMT, BOE, PRA, and FCA)	1 year	• The 2023 Remit letter from the Chancellor underscores the primacy of the FPC's financial stability objective and does not add material new responsibilities related to the FPC's secondary objective. It also recommends the FPC support international work to address vulnerabilities in the financial system. • The FPC has continued to emphasise in its external communications that UK financial stability will require levels of resilience at least as great as those put in place since the GFC and required by international baseline standards, and - recognising the importance of the UK as a global financial centre - in some cases greater. • The FPC has also publicly stressed the importance for UK financial stability of alignment with international standards within the PRA and FCA's new secondary objectives. • The PRA's September 2022 discussion paper on its approach to policy also noted it will remain at the forefront of efforts to strengthen international standards where necessary, and that the long-term competitiveness of the UK is underpinned by a robust and effective prudential regime, built around global standards, in a way that instils trust and confidence in the UK as a place to do business.
10. Preserve the primacy of PRA and FCA's objectives of safety and soundness and market integrity, in principle and in practice, over any secondary objectives and ad hoc policy priorities. (HMT and FPC)	1 year	• The Financial Services and Markets Act (FSMA) 2023, enacted by Parliament, preserves the primacy of the primary objectives to act in a way that promotes the safety and soundness of PRA-authorized persons so far as reasonably possible and to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders while providing the PRA with wider rule-making responsibilities and enhanced accountability requirements. • FSMA 2023 gives the PRA a new secondary competitiveness and growth objective. This objective is to facilitate, subject to aligning with relevant international standards, (i) the international competitiveness of the economy of the United Kingdom (including in particular the financial services sector through the contribution of PRA-authorized persons); and (ii) its growth in the medium to long term. FSMA 2023 left unchanged the existing PRA secondary objective to facilitate effective competition in the markets for services provided by PRA-authorized firms in carrying on regulated activities. The secondary objectives are engaged only when the PRA is

	Time frame	Update on Relevant Work in Progress
		proposing to perform its general functions in pursuit of the primary objectives, and do not rank above the latter. • The PRA's recent Consultation Paper (CP) 27/23 sets out the approach that the PRA proposes to take to policy under FSMA 2023. The CP makes clear that primary objectives rank above all other considerations when making policy. It also describes how maintaining trust among domestic and foreign firms in the PRA and UK prudential framework is an important part of the PRA's approach to advancing its secondary competitiveness and growth objective. The PRA maintains trust by maintaining strong prudential standards. • The FCA was also given a secondary growth and competitiveness objective by FSMA 2023, maintaining the existing clear hierarchy of objectives. • Both the FCA and the PRA are required by FSMA 2023 to report on how they are advancing their new growth and competitiveness objectives, and the first reports will be published in 2024Q2.
11. Review and estimate the expected workload in core and new financial stability and supervisory risk areas and determine how to align BOE/PRA and FCA capacity and resources accordingly. (HMT, BOE/PRA, and FCA)	1–3 years	• Over 2022/23, the PRA increased its funding, re-deployed resources and set up a flexible resource hub to help manage its expanded regulatory responsibilities. The PRA is satisfied, after more than a year embedding, with these improvements. They have enabled the organisation to better manage its expanded regulatory responsibilities. However, it recognises that its responsibilities will continue to expand (e.g. as it takes on responsibility for overseeing critical third parties that are designated by HM Treasury under the Financial Services and Markets Act 2023). Therefore, a continual focus on the resourcing model (as well as workflow) will be required to ensure the PRA can continue to regulate effectively. • The second part of the PRA 2026 strategy includes the transformation of our capabilities around solvent exit planning (complementing the capabilities the authorities have built and continue to build on resolution as outlined in KR8) for small to mid-tier firms and the use of advanced technology to support supervision. As of 2024, this transformation is ongoing. On solvent exit planning, the PRA issued two consultations papers (one for insurers, one for deposit takers) to consult on new rules and expectations. It is also considering changes to internal requirements on supervisors later in 2024. On deploying new technology, the PRA has released a number of new tools to help its supervisors extract value from existing data. Alongside, it is currently piloting more advanced tools that make use of machine learning and exploring use of automation and artificial intelligence to enhance workflow. Lastly, the PRA is continuing to consult with industry (across both banks and insurers) regarding the data it needs (and does not need) to collect in the future to ensure it can continue to supervise effectively.
12: Ensure that the final accountability and transparency mechanisms adopted under the ongoing FRF review seek to safeguard regulatory independence and pose no constraints for operational and oversight effectiveness. (HMT, PRA, FCA with other agencies)	1–3 years	• The Financial Services and Markets Act (FSMA) 2023 includes a range of measures to enhance the regulators' transparency, accountability and scrutiny. These include rule review, the establishment of a Cost Benefit (CBA) Panel as well as notifying the Treasury Select Committee (TSC) and the newly established Lords Financial Services Regulation Committee when the authorities publish a consultation and respond in writing to parliamentary committees' formal responses to consultations. Importantly, these measures also preserve the regulators' operational independence. • Some measures, such as the power for HMT to require regulators to conduct a review of specified rules, or to oblige regulators to make rules in a certain area, or to impose additional 'have regards' for rule-making, will require close ongoing cooperation between the regulators and HMT. • The Bank recognizes the importance of appropriate accountability, greater transparency, and clearly communicating the reasoning underpinning our judgements and the Bank has set this out in our consultation paper Consultation Paper (CP) 27/23. FSMA 2023 provides for the establishment of a Cost Benefit (CBA) Panel, composed of external experts. This will enhance independent scrutiny of our cost benefit analysis. The requirement for the regulators to consult the CBA Panel comes into force on 1 August 2024. In addition, the Bank has published a statement on how the PRA approaches rule reviews. • The FCA has also published (in January 2024) its Rule Review Framework and online stakeholder feedback tool to make it easier for anyone to provide evidence about how well rules are working in practice. • Alongside a new general rulemaking power for the Bank over CCPs and CSDs, new accountability and transparency mechanisms have been created for the Bank's regulation of CCPs and CSDs which the Bank has begun implementing. These include a statutory committee, a requirement to carry out cost benefit analyses when using the new rulemaking power, a secondary innovation objective and increased engagement with HM Treasury and Parliament.

	Time frame	Update on Relevant Work in Progress
		The majority of the accountability mechanisms came into force on 1 January 2024, including the new FMI Committee which will govern use of the Bank's new general rulemaking power in accordance with the FSMA 2023 accountability framework. • The National Audit Office has recommended that when appropriate, HMT should work with the regulators and other stakeholders to review the effectiveness of the new accountability arrangements. HMT intends to do this at an appropriate point, once an assessment can be made.
13: Accelerate the efforts to close data gaps on NBFI activities, including data on all Sterling asset holdings and data needed to improve the management of liquidity demands by fund managers; continue improving flow-of-funds data including all cross-border NBFI exposures. (FPC, BOE/PRA, and FCA)	3–5 years	• On the back of a comprehensive survey of the available data on banks' exposures to NBFIs, the Bank has submitted a new data request to banks to address gaps in NBFI exposures. • The ONS primarily rely on the Financial Services Survey (FSS) to collect balance sheet data from NBFIs and is updating the questionnaire to encompass a wider range of institutions and collect more granular data, including new sector counterparty data which separately identifies the rest of the world. Whilst preparing the launch of the new questionnaire and the publication of the data via Data Gap Initiative phase 2 template submissions, the ONS is simultaneously working on integrating the data from the new FSS into the National Accounts. • Lending by non-bank credit grantors accounts for around half of the total stock of consumer credit and was collected by the ONS on behalf of the Bank. The ONS will cease collection in April 2024 at which point data collection will transition to the Bank. Once the collection has been transferred in May 2024, the Bank will be reviewing the coverage of the current collection. This review will be completed in conjunction with data received from the FCA, who will be launching a loan-level consumer credit collection (Product Sales Data), currently scheduled to be received from 2025. • The Bank and ONS will host a Flow of Funds Workshop in the coming months with stakeholders from across a range of government bodies including HM Treasury, the Office for Budgetary Responsibility, and the Financial Conduct Authority. The focus of the workshop is on planned improvements, identifying data requirements for policy needs, and a broader discussion on current data initiatives. • The Bank is currently working on exploring and understanding gilt market structure further; as part of this, The Bank has collated data on gilt holdings from multiple sources the Bank has access to and have been able to form an initial view of the size of the data gap in this space. Next, the Bank is aiming to explore different avenues that could enable us to address some of the identified gaps. • The Bank is co-leading the FSB' s Open-End Fund Data Pilot project, which is considering the availability of data to monitor vulnerabilities arising from liquidity mismatch in funds. The FCA is also a member of this project, and is contributing its data towards it. • The FCA, Bank and HMT are participating in multiple other international workstreams that are considering the adequacy of existing regulatory reporting, the areas where gaps remain, and how those gaps might be addressed in a coordinated, cross-jurisdictional manner. These include recent and current FSB workstreams on data gaps and leverage. • Domestically, the FCA has been evolving its own reporting requirements under UK EMIR. Enhanced reporting requirements will become applicable from 30 September 2024. This will improve the granularity of the data, especially with regard to commodity derivatives, but will also add new risk-sensitive metrics, such as the reporting of deltas for options and swaptions. • The FCA is also starting to consider reform its AIFMD reporting framework as part of the SRF transfer of the AIFM Level 2 regulation, though the work remains in its early stages.
14. Strengthen information sharing with relevant third-country authorities, including reviewing the approach to monitor and supervise hybrid cross border transactions, private market activities, and internationally active mixed financial groups. (FPC, BOE/PRA, and FCA)	3–5 years	• Good cooperation, information sharing, and collaboration with relevant third country authorities remains a key priority for the UK authorities. Various market and supervisory events have provided opportunities to test these relationships and found them to be strong in both 'peace time' and during crises. Communication and information sharing between supervisory teams across jurisdictions remains strong. The PRA continues to look for additional opportunities to further build relationships with a large number of third country authorities. • The PRA have continued to enhance and develop our trilateral relationship with the FRB and ECB on day-to-day and long-term supervisory issues and have identified potential areas for common work, horizon scanning and information sharing on a number of financial and operational resilience issues. For example, through the Trilateral group, the authorities have developed a quantitative data collection template on NBFI exposures that seeks to consider counterparty-credit risk on a group-wide basis.

	Time frame	Update on Relevant Work in Progress
		• The PRA have undertaken a number of reviews in coordination with, or with the full participation of, regulators from key jurisdictions on both crystallised and emerging risks including in relation to Archegos, nickel, fixed income financing, crypto products and private equity. The authorities have also shared workplans and key areas of supervisory focus for the year ahead. • The PRA worked closely with key regulatory authorities (FINMA, FRB and ECB) in handling the resolution and acquisition of Silicon Valley Bank and Credit Suisse respectively, further bolstering strong bilateral and multilateral supervisory relationships and ensuring the free flow of information throughout the critical days and weekends preserving the financial stability of the UK. • As the authorities navigated the volatility post the invasion of Ukraine, the UK mini budget and the more recent SVB and Credit Suisse events the authorities held joint firm monitoring calls with the FRB and SSM, to further assess firms changes in risk profiles, counterparty exposures and overall risk appetite, on a global basis. The authorities also continue to share areas of key concerns on a regular basis with the FRB and SSM, including on a desk-based commodity stress test the authorities conducted through the Russia/Ukraine volatility.
15: Maintain the United Kingdom's commitment to mutual cooperation with the EU, post-Brexit, including intensifying regulatory dialogue to support financial stability and mitigate market fragmentation risks, including the regulatory status of the U.K. CCPs over the long term. (HMT, BOE, and FCA)	3–5 years	• The UK welcomes the signing of the Memorandum of Understanding on Financial Services Cooperation on 27 June 2023 and the establishment of the Joint EU-UK Financial Regulatory Forum, which held its first meeting in October 2023 and the second in May 2024. UK authorities will continue to closely engage with EU authorities through the semi-annual Forum meetings, as well as bilaterally and through multilateral fora. • HMT granted the EU a package of equivalence decisions in November 2020, including a decision on CCP equivalence, and announced a further decision under the UK Overseas Funds Regime in 2024. The Bank has recognized two EU CCPs—Cboe Clear Europe and Eurex Clearing—with recognition decisions for other individual CCPs are ongoing, but EU CCPs not yet recognized are able to continue providing services through the Temporary recognition regime. • The Bank has signed and implemented 13 MoUs with EU institutions and members states since the beginning of 2021 in relation to Financial Market Infrastructures. • Equivalence and recognition are unilateral decisions, and the EU has put in place time limited decisions for UK CCPs until 2025. The UK continues to work with EU supervisors through regulatory Colleges, and to maintain commitments to the highest standards of FMI regulation. The FSM Act 2023 gives the Bank rule making powers to set requirements for CCPs and CSDs within a new accountability framework set by Parliament. The Bank will use this power to set requirements through its rules and update UK domestic requirements as new international standards are developed. The new legislation requires that in any exercise of rulemaking power, the Bank must consider the effects of those rules on the financial stability of any country where a CCP or CSD provides services. • The PRA has signed and implemented 34 Memoranda of Understanding (MoU) with EU institutions and member states since the beginning of 2021. These MoUs include the PRA as signatory to the IAIS Multilateral Memorandum of Understanding which provides a formal basis for global cooperation and information exchange among insurance supervisors. The Bank has signed and implemented 13 MoUs with EU institutions and members states since the beginning of 2021 in relation to Financial Market Infrastructures. • The Bank, PRA and FCA have also strengthened its ongoing regulatory dialogues through senior-level and working-level engagement with EU institutions, including the European Commission, the European Central Bank, the European Supervisory Authorities and the National Competent Authorities. • An enhanced UK CCP resolution regime (See Recommendation 8) came into effect in December 2023, making the UK regime fully consistent with international FSB standards. Similarly, to the EU regime, the Bank is developing policy options on second skin in the game (SSITG). The Bank also continues to engage with international counterparts on international workstreams, for example through CPMI-IOSCO and FSB.

Annex XIII. Pension Reforms

The government has announced several reforms to direct pension assets toward domestic growth assets, intending to support domestic growth and improve pension outcomes. This analytical piece takes a holistic view of the UK's pension system, assesses the scope for directing pension investment, and explores additional reform options to support the authorities' objectives. Staff finds that, despite being relatively small in terms of total assets, defined contribution (DC) pension funds have greater scope to invest in UK equity provided appropriate investment vehicles are available. Moreover, increasing pension contributions (which remain low in the UK relative to peers) will boost pension income and increase pension funds' assets for high-growth investment.

1. **In the 2023 Autumn Statement, the government detailed significant pension reforms initially outlined in the chancellor's July 2023 Mansion House address.**[1] The reforms are aimed at providing better outcomes for savers, fostering a more consolidated pensions market, and facilitating diversified investment portfolios of pension funds.[2] Key initiatives include: (i) the proposal of a "pot for life" system and the merging of smaller pension pots; (ii) a critical evaluation of "master trust" DC pensions; (iii) exploration of alternatives to buyouts for defined benefit (DB) pensions along with a new approach to managing pension surpluses; (iv) pushing forward the consolidation of local government pension schemes; and (v) emphasizing the importance of cost-effectiveness in DC pensions as well as enhancing the expertise of pension trustees. Following these announcements, in the 2024 Spring Budget, the government announced further reforms as a strategic plan to boost British business and increase returns for savers. This includes requirements for DC pension funds to publicly disclose their level of investment in the UK. Alongside disclosure agreements, the government is introducing a new Value for Money framework to ensure that pension funds deliver good returns and are expected to encourage more investment into high-growth domestic companies. Moreover, the Mansion House compact encourages the largest DC pension funds to allocate at least 5 percent of their assets in unlisted equity by 2030, targeting innovative and potentially high-return domestic ventures.

2. **The UK pension system is transitioning from a DB system to a DC system, but total assets are still dominated by DB pension funds.** The UK pension fund sector is diversified and analyzing the overall size of the pensions market is difficult given there are different permutations that could be considered. Regulatory and demographic changes since the late 1990s have led many private DB pension funds to close to new members and switch to DC schemes. More recently, private sector DB scheme sponsors with schemes that are in surplus have pursued buy-outs with life insurers.[3] Still, according to ONS data the bulk of pension assets are held by private sector DB and

[1] See Autumn Statement Pensions Reform 2023 and Mansion House 2023.

[2] These measures represent the next steps of the Chancellor's Mansion House reforms and meet the three golden rules: to secure the best possible outcomes for pension savers; to prioritize a strong and diversified gilt market; and to strengthen the UK's competitive position as a leading financial center. See https://www.gov.uk/government/collections/autumn-statement-pensions-reform-2023 for more info.

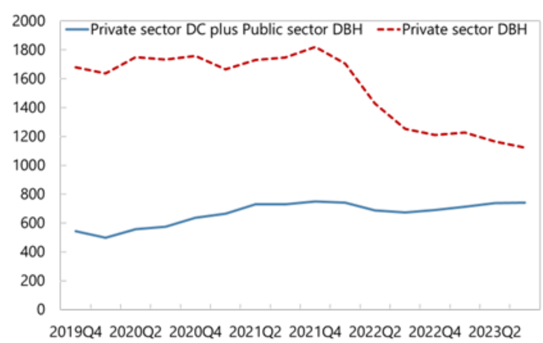
[3] The buy-out process involves sponsors with the means exiting the DB pensions business by passing both their assets and liabilities to an insurer in a bulk annuity transfer, or 'buy-out'.

hybrid funds (about £1.1 trillion), while private sector DC and public sector DB funds amount to £0.7 trillion.[4] Compared to major advanced economies, the UK pension fund assets are roughly similar in size when measured as a percentage of GDP, with pension fund assets amounting to roughly 95 percent of GDP at end-2022).[5] The US had the largest pension assets at end-2022 ($35 trillion, 103 percent of GDP), while the Netherlands' pension assets as a percentage of GDP ranked highest (roughly 180 percent of GDP, $1.8 trillion).

3. **The total pension assets generally do not include public sector pensions for government employees, teachers, and health workers which are unfunded, and typically paid out of current government revenues.** These unfunded pension schemes are similar to DB schemes, where pension payments are determined based on factors such as salary history, years of service, and age at retirement. The government's reform proposals for these unfunded pension schemes mainly focused on structural and regulatory adjustments to ensure sustainability and fairness. Experts have suggested more ambitious reforms, such as shifting to an explicitly funded model, that could alleviate government spending pressures, provide additional resources for productive investment, and improve pension outcomes.

Assets of Defined Benefit (DB) & Defined Contribution (DC) Pension Funds

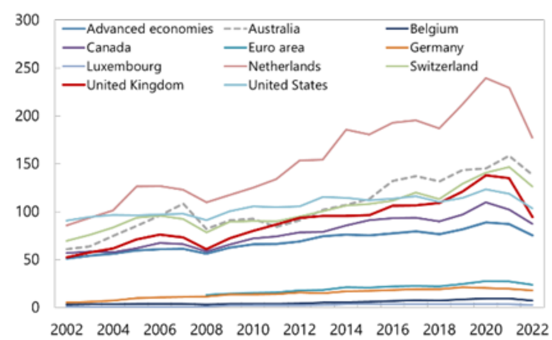
(GBP billions)



Source: ONS.

Pension Fund Assets

(Percent of GDP)



Source: Financial Stability Board.

4. **UK pension funds currently a larger proportion of their assets invested in bonds than in equities, reflecting DB pension funds' shift in recent years from equity to fixed income.** According to the OECD, UK pension funds invested 29 percent of assets in equity and 35 percent in bills and bonds in 2022, broadly comparable to the OECD averages. However, this reflects a shrinking equity exposure by DB pension funds, to overall equity but also UK equities in particular. Equity holdings of DB pension funds fell from 61 percent in 2006 to only 18 percent in 2023, with the share of UK equities declining from 30 percent to only 1 percent. Accordingly, DB pension funds

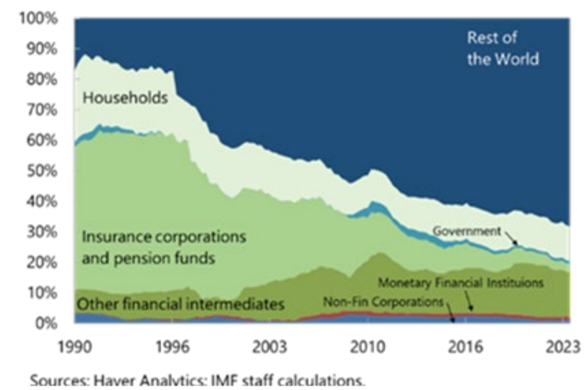
[4] As at Q3 2023. Separate data from the Pension Protector Fund, the local government pension scheme (LGPS) and TPR estimate DB fund assets of funds in the Pension Protection Fund (PPF) at £1.4 trillion as at March 2023, the market value of assets of the LGPS at £361 billion as at March 2022, and the market value the assets and the assets of occupational DC schemes at around £1.4 trillion in 2023. See The Purple book, 2023, LGPS and TPR, 2023.

[5] Based on FSB data, NBFI monitoring dataset 2023.

have gone from being the dominant investors in UK equity, to now owning almost nothing. On the other hand, asset allocation to bonds grew from 29 percent in 2006 to just under 70 percent in 2022, broken down further into index-linked bonds (primarily consisting of government bonds and amounting to 30 percent), corporate bonds (25 percent), and other government bonds (13 percent).

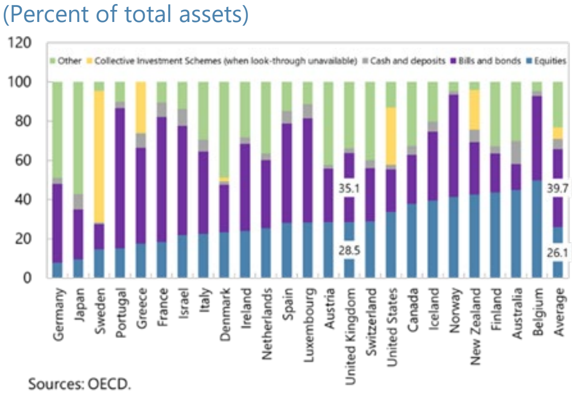
5. The shift of DB pension funds out of equity was likely due to asset-liability matching rules and a change in risk preference. Some experts have pointed out that overall regulatory reforms have created an environment in UK pensions to actively reduce risk and discourage long-term investment. Asset-liability matching rules, combined with a discount rate based on the corporate bond yield, mean that pension funds need to match their assets with their liabilities by investing in long-dated debt. Experts also note that an aging pool of pension beneficiaries—even those not being paid - may want a lower risk tilt if they are close to retirement. Accordingly, DB pension funds have increased their asset allocation to fixed income, real estate, and sometimes illiquid alternative investments that are not exposed to the mark-to-market penalty of publicly traded equity.

Equity Market Ownership
(Percent)



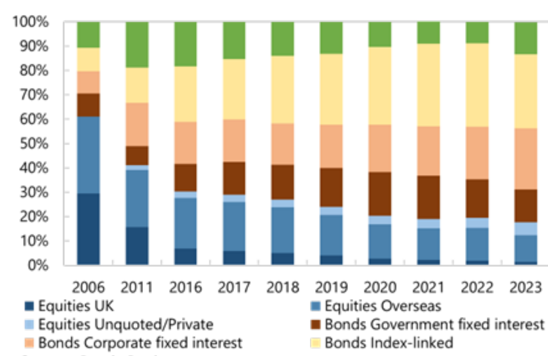
Sources: Haver Analytics; IMF staff calculations.

Pension Fund Asset Allocation – Selected Countries
(Percent of total assets)



Sources: OECD.

Defined Benefit Pension Fund Asset Allocation
(Percent of total assets)



Sources: Purple Book.

6. DC pension funds in the meantime have a larger relative proportion of their assets invested in equity but still have much smaller total assets. Analysts estimate that around half of DC funds' assets are invested in equity versus only 15 percent for private DB funds. Moreover, the flows into equity by DC funds (about £3.0 billion per quarter) are bigger than equity outflows from DB funds (£2.5 billion per quarter). Nevertheless, DC pension funds still hold much less equity because of relative size (DB pension funds are still much larger than DC funds by a factor of 7). That said, assets in DB funds are shrinking while those in DC funds are growing, and experts estimate that DC assets will be bigger by around 2032 by extrapolating the trends of the past four years.

7. While DC pension funds have better opportunities to invest in UK equity, the asset allocation of pension funds should not be mandated. Government proposals aimed at increasing pension fund allocation to domestic equity can appear logical on first glance.[6] In addition, the requirement of pension funds to publicly disclose where they invest and the returns they offer could also play a role in increasing exposure to UK equities. Growing investment in UK equity could, in turn, deepen the capital market, encourage new companies to list, and attract further investment, thus creating a virtuous circle. Nevertheless, prescribing pension fund asset allocations should not hinder their ability to fulfill fiduciary responsibilities effectively and achieve the best possible outcomes for their beneficiaries. Similarly, the proposal to consolidate small pension funds is appropriate, but caution should be exercised regarding investment limits when consolidations are made. so as to avoid creating a forced sale of those any assets or unintended market volatility.

8. In addition, the minimum pension contribution (and participation rate) could be raised in the medium term to increase the available pension assets to invest in UK equity and retirement income. Estimates show that almost 40 percent of the working age population are under-saving for retirement, with the pension income of roughly 50 percent of the population projected to fall below the Pension and Lifetime Saving Association's Moderate Retirement Living Standards.[7] Compared with other OECD countries, the minimum contribution rate of 8 percent is low. Moreover, the participation rate declined in 2022 for the first time since the introduction of automated enrollment in 2012. This is likely due to cost-of-living pressures from high inflation and interest rates and the fact that pension participation is voluntary. Staff recommends that consideration be given to increase the minimum contribution rate gradually in the medium-term, potentially via a relatively larger minimum contribution from employers,[8] while taking into consideration the impact this could have on precautionary savings of especially the lower-income groups.

9. Experts also suggest more ambitious reforms, such as shifting public unfunded pension schemes to an explicitly funded model, to alleviate government spending pressures, provide additional resources for productive investment, and improve pension outcomes. Public pension funds for government employees, teachers, and health workers are unfunded, and typically paid out of current government revenues. This sector amounts to roughly the same size as private sector DB pension schemes, and are similar to DB schemes, in the sense that pension payments are determined based on factors such as salary history, years of service, and age at retirement. The government's reform proposals for these unfunded pension schemes have mainly focused on structural and regulatory adjustments to ensure sustainability and fairness. Experts have

[6] Boost the 'Mansion House compact' in which big DC pension providers have committed to invest 5% of their assets in unlisted equities by 2030.

[7] See https://www.gov.uk/government/statistics/analysis-of-future-pension-incomes/analysis-of-future-pension-incomes.

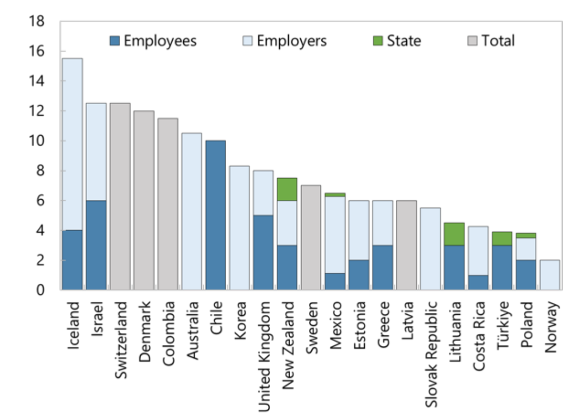
[8] Of the 8 percent, the employers minimum contribution is set at 3% and the remainder made up by the staff's contribution.

suggested more ambitious reforms, such as shifting to an explicitly funded model, that could alleviate government spending pressures, provide additional resources for productive investment, and improve pension outcomes. In this regard, experts have suggested that Canada's provision public service pension transition from unfunded schemes to a funded model, that started at the end of the 1980s, could serve as a potential example to follow.

10. Finally, the proposed pension reforms could have a non-trivial impact on gilt-market demand and financial stability, and these impacts should be carefully weighed in advance. Given the relative share of gilts held by pension funds and the buy-out of DB pension funds by insurers who have different investment preferences, together with reforms to encourage DC pension funds to increase their portfolio allocation to equities – staff recommends that authorities continue to closely monitor demand for gilts and any adverse market developments.

Minimum or Mandatory Contribution Rates for an Average Earner in Mandatory and Auto-Enrolment Plans

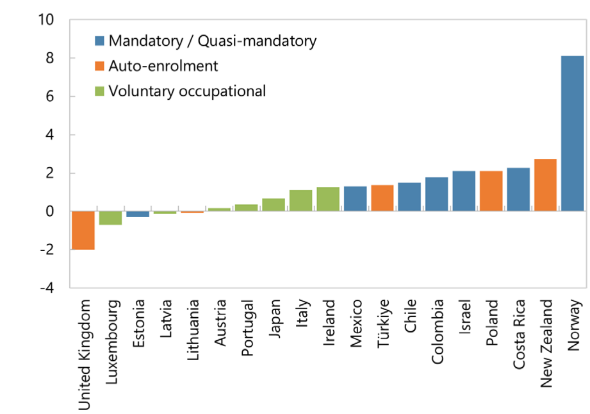
(As percentage of earnings)



Source: OECD - Pensions at a Glance 2023.

Change in the Participation Rate in Pension Plans Between 2021 and 2022, by Type of Plan and by Jurisdiction

(In percent of working age population)



Source: OECD - Pension Markets in focus 2023.

Box XIII.1. United Kingdom: Autumn Statement Pension Reform 2023

The authorities have announced a package to improve pension savers' returns and boost growth in the UK, progressing reforms set out at Mansion House.

"To provide better outcomes for savers, the Government is:

- introducing the multiple default consolidator model for defined contribution (DC) schemes, to enable a small number of authorized schemes to act as a consolidator for eligible pension pots under £1,000;
- launching a call for evidence for DC schemes on a lifetime provider model to simplify the pensions market by allowing individuals to move towards having one pension pot for life, and on a potential expanded role for Collective DC (CDC) schemes in future;
- publishing an update that proposes placing duties on DC occupational pensions trustees to offer decumulation services and products at an appropriate quality and price when savers access their pension assets, either themselves or through a partnership arrangement.

Box XIII.1. United Kingdom: Autumn Statement Pension Reform 2023 (Concluded)

To drive a more consolidated pensions market, the Government is:

- welcoming the current trend of DC pension fund consolidation and expecting to see a market in which the vast majority of savers belong to schemes of £30 billion or larger by 2030;
- welcoming the Financial Conduct Authority (FCA) and the Pensions Regulator (TPR) announcements on next steps towards implementing the Value for Money framework in the DC workplace pensions market;
- publishing a review of the Master Trusts market, 5 years after the 2018 Master Trusts regulations came into force;
- consulting this winter on how the Pension Protection Fund can act as a consolidator for defined benefit (DB) schemes unattractive to commercial providers;
- confirming a March 2025 deadline for the accelerated consolidation of Local Government Pension Scheme (England and Wales) assets, setting a direction towards fewer pools exceeding £50 billion Assets Under Management, and implementing a 10 percent allocation ambition for investments in private equity;

To enable pension funds to invest in a diverse portfolio, the Government is:

- consulting this winter on whether changes to rules around when DB scheme surpluses can be repaid, including new mechanisms to protect members, could incentivize investment by well-funded schemes in assets with higher returns;
- reducing the authorized surplus payments charge from 35 percent to 25 percent from April 6, 2024;
- welcoming TPR's announcement that they will implement a register of trustees and update the trustee toolkit;
- engaging with industry on proposals to ensure all aspects of the pensions industry are supporting best outcomes for savers, including how to shift employer incentives away from low fees towards long-term pension investment performance;
- committing £250 million to 2 successful bidders in the Long-term Investment for Technology and Science (LIFTS) initiative, subject to final agreement;
- following positive feedback from industry, confirming its intention to establish a Growth Fund within the British Business Bank (BBB);
- developing a fellowship course targeting mid-career science and technology Venture Capital (VC) investors, similar to the Kauffman Fellowship in the US, to be operational in 2024."

The Authorities' Consultations and Reviews:
Helping savers understand their pension choices: supporting individuals at the point of access (DWP)
Ending the proliferation of deferred small pension pots (DWP)
Looking to the future: greater member security and rebalancing risk (DWP)
Trends in the Defined Contribution trust-based pensions market (DWP)
Evolving the regulatory approach to Master Trusts (DWP)
Options for Defined Benefit schemes: a call for evidence (DWP)
Local Government Pension Scheme (England and Wales): Next steps on investments (Department for Levelling Up, Housing and Communities)
Pension trustee skills, capability and culture: a call for evidence (DWP, HMT)
Value for Money: A framework on metrics, standards, and disclosures (DWP, FCA, TPR)

Annex XIV. Data Issues

Table XIV.1. United Kingdom: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	B	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	A	A	B		
Granularity 3/	A		A	A	B		
			B		A		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	B		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provided by the Office for National Statistics (ONS), the Bank of England (BoE), and other national sources are adequate for surveillance. Room for improvement remains concerning data gaps in the non-bank financial institution sector, including data on all Sterling asset holdings (including government bonds), data needed to improve fund managers' management of liquidity demands, and flow-of-funds data. In addition, addressing problems with labor force survey data due to low survey response rates should be prioritized, as timely high-quality labor market data is critical for sound policy decisions.

Changes since the last Article IV consultation. The BoE has taken steps to collect data on certain segments of the NBFI sector, such as gilt exposures and private equity. ONS has been improving surveys and methodologies, including updating the population and migration estimates following the Census 2021 and bringing the PPI in line with methodological best practices by introducing the annual chain linking to correct the errors identified in late 2022.

Corrective actions and capacity development priorities. The ONS has been working on a Transformed Labour Force Survey with a plan to replace the Labour Force Survey from September 2024.

Use of data and/or estimates different from official statistics in the Article IV consultation. Staff also uses international resources (such as BIS and FSB) and commercial data (such as Bloomberg) to supplement its analysis of the financial sector and cross-country comparisons.

Other data gaps. Not relevant for the UK.

Table XIV.2. United Kingdom: Data Standards Initiatives

United Kingdom adheres to the Special Data Dissemination Standard (SDDS) Plus since August 2022 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table XIV.3. United Kingdom: Table of Common Indicators Required for Surveillance

As of June 13, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	United Kingdom[8]	Expected Timeliness[6,7]	United Kingdom[8]
Exchange Rates	Jun-24	Jun-24	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jun-24	Jun-24	W	W	M	M	1W	3D
Reserve/Base Money	Apr-24	May-24	M	M	M	M	2W	29D
Broad Money	Apr-24	May-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	Apr-24	May-24	M	M	M	M	2W	29D
Consolidated Balance Sheet of the Banking System	Apr-24	May-24	M	M	M	M	1M	1M
Interest Rates[2]	Apr-24	May-24	M	M	D	D	...	D
Consumer Price Index	Mar-24	Apr-24	M	M	M	M	1M	NLT 3W
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2023Q4	Apr-24	Q	Q	A/Q	A	2Q/12M	9M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Apr-24	May-24	M	M	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Apr-24	May-24	M	M	Q	M	1Q	NLT 6W
External Current Account Balance	2023Q4	Mar-24	Q	Q	Q	Q	1Q	NLT1Q
Exports and Imports of Goods and Services	Apr-24	Jun-24	M	M	M	M	8W	NLT 40D
GDP/GNP	2024Q1	May-24	Q	Q	Q	Q	1Q	1Q
Gross External Debt	2023Q4	Mar-24	Q	Q	Q	Q	1Q	1Q
International Investment Position	2023Q4	Mar-24	Q	Q	Q	Q	1Q	NLT1Q

[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] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex XV. The Authorities' Update on Edinburgh Reforms[1]

Commitment	Status
A competitive marketplace promoting effective use of capital	
Reforming the Ring-fencing Regime for Banks.	In progress • The Government published a draft SI for consultation on 28 September 2023 on a package of reforms to improve the ring-fencing regime. The consultation closed on 26 November 2023. • The Government also launched a Call for Evidence on aligning the ring- fencing and resolution regimes in the longer term, which concluded on 7 May 2023. The Government published a summary of responses to the Call for Evidence on 28 September.
Issuing new remit letters for the PRA and FCA with clear, targeted recommendations on growth and international competitiveness.	Delivered • The Government published the remit letters to the FCA and PRA on 9 December 2022, alongside the Edinburgh Reforms announcement. • The Government launched a call for proposals on how to measure the progress/impact of these new mandates and in December 2023 published a list of metrics that the FCA and PRA will publish from 2024.
Publishing the plan for repealing and reforming EU law using powers within FSMA 2023, building a smarter regulatory framework for the UK.	Delivered • The Government published a Policy Statement and illustrative SI on 3 December 2022.
Overhauling the UK's regulation of prospectuses.	Delivered • The Government published a draft SI in December 2022. • The Government published a near final SI in July 2023. • The Government laid the final SI on 27 November 2023. That legislation has been approved by Parliament.
Reforming the Securitisation Regulation.	Delivered • The Government laid two Statutory Instruments which implement the SRG for the Securitisation Regulation. 'The Securitisation Regulations 2024' were approved by Parliament in January 2024 and the 'The Securitisation (Amendment) Regulations 2024' were approved in May 2024. • The PRA and FCA consulted on regulations which replace the securitization legislation in summer 2024 and published the outcome of their consultation proposals in April 2024.
Repealing the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, and consulting on a new direction for retail disclosure.	In progress • As part of the Mansion House package, on 10 July 2023, the Government published its response to its consultation which sought views on the Government's plans to revoke the PRIIPs Regulation and a proposed alternative framework for retail disclosure. • The Government published a draft SI to deliver a new UK retail disclosure framework at Autumn Statement 2023.
Intending to repeal EU legislation on the European Long-Term Investment Fund (ELTIF), reflecting that the new UK Long-Term Asset Fund (LTAF) provides a better fund structure for the UK market.	Delivered • Commencement Regulations to repeal EU legislation on ELTIF were made on 10 July 2023 as part of the Mansion House package.

[1] As of May 2024.

Commitment	Status
A competitive marketplace promoting effective use of capital	
Launching a Call for Evidence on reforming the Short Selling Regulation.	Delivered • The Government published its Call for Evidence in December 2022, and its response on 11 July 2023, as part of the Mansion House package. • The Government launched its subsequent consultation on aspects of the short selling regime related to sovereign debt and credit default swaps on 11 July 2023, as part of the Mansion House package. The Government published its response at Autumn Statement 2023. • The Government published a draft SI to deliver a new UK short selling regime, for technical checks, at Autumn Statement 2023. • On 27 November 2023, the Government laid The Short Selling (Notification Threshold) Regulations 2023, which amended the notification threshold for reporting net short positions to the FCA, as announced at Mansion House 2023.
Publishing a draft SI to demonstrate how the new powers being taken forward in the FSM Bill will be used to ensure that the FCA has sufficient rulemaking powers over its retained EU payments legislation.	Delivered • The Government published the draft SI on 4 December 2022. • The Government then laid the SI on 12 July 2023, as part of the Mansion House package.
Consulting on removing burdensome customer information requirements set out in the Payment Accounts Regulations (PARs) 2015.	Delivered • The Government published its consultation on 9 December 2022 as part of the Edinburgh Reforms. The Government published its response in June 2023. • The Government published secondary legislation in July 2023, as part of the Mansion House package.
Welcoming the PRA consultation on removing rules for the capital deduction of certain non- performing exposures held by banks.	Delivered • The Government welcomed the PRA's consultation alongside the Edinburgh Reforms.
Bringing forward secondary legislation to implement Wholesale Markets Review reforms.	Delivered • The Markets in Financial Instruments (Investor Reporting) (Amendment) Regulations 2022 implement changes to the investor reporting regime that the Government consulted on as part of the Wholesale Markets Review. It was laid on 9 December 2022. • The Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 implemented changes to the regime for firms trading commodity derivatives as an ancillary activity that the Government consulted on as part of the Wholesale Markets Review. It was laid on 29 March 2023.
Establishing an Accelerated Settlement Taskforce.	Delivered • The Government established the taskforce and appointed Charlie Geffen as chair. • The Government asked Charlie Geffen to publish his initial findings by December 2023 and to make recommendations by December 2024. We now expect a report to be published in Spring 2024.
Committing to establish the independent Investment Research Review.	Delivered • Rachel Kent published the outcome of her review on 10 July 2023, making a series of recommendations to the Government, FCA and industry. The Chancellor responded at Mansion House 2023.
Commencing a review into reforming the Senior Managers & Certification Regime in Q1 2023.	Delivered • The Government launched the Call for Evidence on 30 March 2023, alongside FCA/PRA joint discussion paper.

Commitment	Status
A competitive marketplace promoting effective use of capital	
Committing to having a regime for a UK consolidated tape in place by 2024.	Delivered • On 27 November 2023, the Government laid The Data Reporting Services Regulations 2024 which will facilitate the emergence of a UK consolidated tape (CT). A consolidated tape will bring together market data from multiple platforms into one continuous feed.
Consulting in early 2023 on issuing new guidance on Local Government Pension Scheme asset pooling.	Delivered • The Government launched its consultation on 11 July 2023 as part of the Mansion House package. The consultation closed on 2 October 2023 and following analysis of responses, the Government published its response to the consultation on 22 November 2023, alongside Autumn Statement 2023. • The consultation response confirms the proposal to set a March 2025 deadline for the transition of Local Government Pension Scheme assets into pools, sets a direction towards fewer asset pools exceeding £50bn in assets under management, and sets a 10% ambition for investments in private equity.
Increasing the pace of consolidation in Defined Contribution pension schemes.	In progress • The Government, FCA and the Pensions Regulator (TPR) published their consultation response on a new Value for Money (VfM) framework for DC schemes on 11 July 2023 after Mansion House. • On 22 November 2023, alongside Autumn Statement 2023, the FCA and TPR announced next steps towards implementing the VfM framework. The FCA will consult on rules for contract-based schemes in 2024, working closely with the Government and TPR for consistency with the development of legislative requirements for trust-based schemes. In the meantime, actions from the TPR will strengthen their existing supervisory approach.
From April 2023, improving the tax rules for Real Estate Investment Trusts (REITs).	Delivered • Legislated via the Finance (No.2) Act 2023. The changes came into effect in April 2023.
Announcing changes to the Building Societies Act 1986.	In progress • The Government published its consultation response in December 2022. • The Building Societies Act 1986 (Amendment) Act 2024 received Royal Assent on 24 May 2024 and will commence in July 2024.
Delivering the outcomes of the Secondary Capital Raising Review.	In progress • Mark Austin published the outcome of his review in July 2022, making a series of recommendations to the Government, FCA and to the Pre-Emption Group (PEG). • The Government has accepted all the recommendations addressed to it, including the establishment of a new independent Digitisation Taskforce, focusing on dematerialisation of paper share certificates, led by Sir Douglas Flint. Sir Douglas' taskforce published an interim report alongside Mansion House on 10 July 2023. • The FCA has delivered a proportion of the recommendations addressed to them. The PEG published their Monitoring Report in March 2024, delivering another key recommendation of the SCRR.
Consulting on reform to the VAT treatment of fund management.	Delivered • The Government published its consultation on the VAT treatment of fund management response as part of the Edinburgh Reforms. • The summary of responses was published on 14 December 2023.
A World Leader in Sustainable Finance	
Publishing an updated Green Finance Strategy in early 2023.	Delivered • The Government published the updated Green Finance Strategy on 30 March 2023.
Consulting in Q1 2023 on bringing Environmental, Social, and Governance ratings providers into the regulatory perimeter.	Delivered • The Government launched this consultation on 30 March 2023. It closed on 30 June 2023.

Commitment	Status
A Sector at the Forefront of Technology and Innovation	
Consulting on a UK retail central bank digital currency alongside the Bank of England in the coming weeks.	Delivered • The Government launched this consultation on 7 February 2023. It closed on 30 June 2023. • The Government published its consultation response in January 2024, laying out next steps.
Publishing a response to the consultation on expanding the Investment Manager Exemption to include crypto assets.	Delivered • The Government published its response to the consultation on 9 December 2022. • The relevant HMRC regulations were made on 19 December 2022.
Implementing a Digital Securities Sandbox.	In progress • The Government launched its consultation on the first FMI Sandbox, the 'Digital Securities Sandbox' (DSS), on 11 July 2023. It closed 22 August 2023. • HMT published a response to the DSS consultation at Autumn Statement 2023. • HMT laid the SI to implement the DSS on the 18 December 2023, which came into effect 8 January. • The Bank of England and FCA are now working on setting up the DSS in the coming months, including setting out guidance and the application process.
Working with the regulators and market participants to trial a new class of wholesale market venue which would operate on an intermittent trading basis.	In progress • The Government published its consultation on the new Private Intermittent Securities and Capital Exchange System (PISCES) as part of the Spring Budget 2024 package. It closed on Wednesday 17 April 2024.
Delivering for Consumers and Businesses	
Consulting on Consumer Credit Act (CCA) Reform.	Delivered • The Government launched its consultation on 9 December 2022 as part of the Edinburgh Reforms. • The Government published its response on 11 July 2023 as part of Mansion House.
Laying regulations in early 2023 to remove well- designed performance fees from the pensions regulatory charge cap.	Delivered • The Government published a consultation response and statutory guidance on 30 January 2023 confirming it intended to enact the regulations by Spring 2023. • The Government then laid regulations which came into force on 6 April 2023.
Committing to work with the FCA to examine the boundary between regulated financial advice and financial guidance.	Delivered • The Government and the FCA continue to work together on the review. • The FCA published an update on the review on 3 August 2023, which included updated guidance to help firms move closer to the current boundary. • A joint Government and FCA policy paper was published on 8 December, outlining initial options for reform and inviting stakeholders to share their views by 28 February 2024.

UNITED KINGDOM

June 14, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

CONTENTS

FUND RELATIONS

(Data as of May 31, 2024)

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	14,883.06	73.84
Reserve position in Fund	5,272.07	26.16

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocations	29,451.96	100.00
Holdings	31,052.55	105.43

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				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest		0.22	0.22	0.22	0.22
Total		0.22	0.22	0.22	0.22

[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 December 18, 2023 (EBD/23/79).

Article IV Consultation:

The UK is on the standard 12-month consultation cycle. The last Article IV consultation was concluded on July 6, 2023 (IMF Country Report No. 23/252).

FSAP:

An FSAP was conducted in time for the 2021 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

Statement by the IMF Staff Representative
July 1, 2024

This statement provides information that has become available since the staff report was issued to the Executive Board on June 17, 2024. The thrust of the staff appraisal remains unchanged.

1. **As widely expected, inflation in May (released on June 19) fell to 2 percent, the Bank of England's (BoE's) inflation target.** Headline inflation declined from 2.3 percent y/y in April to 2 percent in May on the back of favorable energy price base effects and easing goods prices. Core inflation also fell by 0.4 ppts, but remains elevated at 3.5 percent. Services inflation—a key measure of inflation persistence—eased by less than expected, from 5.9 percent in April to a still high 5.7 percent (consensus and BoE expectations were 5.5 percent and 5.3 percent, respectively). The strength of services inflation was, however, in part driven by private rents and transport services, including airfare, which tend to be volatile. Thus, overall, the outturn remains consistent with gradually declining underlying inflationary pressures.

2. **Against this backdrop, on June 20, the BoE's Monetary Policy Committee (MPC) kept Bank Rate at 5.25 percent.** As in the May MPC meeting, seven members voted to keep the rate unchanged, while two voted for a 25 bps cut. However, the decision summary noted that for some of the seven members who voted for a hold, the decision was "finely balanced." The meeting minutes stated that the MPC will "continue to monitor closely indications of persistent inflationary pressures and resilience in the economy as a whole" and prepare to adjust monetary policy to ensure a sustainable return to the inflation target. Markets scaled up expectations for rate cuts to 50 bps in 2024 (44 bps before the meeting), with the odds of an August rate cut priced at 58 percent (34 percent before the meeting).

3. **The foregoing is broadly in line with staff's forecast and monetary policy assumptions and advice.** The May inflation outturn has narrowed the band around staff's forecast of 2.1 percent 2024Q2. While continuing to see underlying pressures ease, staff still forecasts headline inflation to rise to around 2.5 percent later this year, as favorable energy price base effects abate, before durably returning to the 2 percent target in the first half of 2025. The MPC rate decision, similarly, is consistent with staff's baseline assumption of 50 bps rate cuts in 2024. Staff continues to see rate cuts of 50–75 bps rate cuts in 2024 as appropriately balancing the risks of premature vs. delayed easing, while supporting the MPC's meeting-by-meeting approach, given uncertainties.

Statement by Veda Poon, Executive Director for the United Kingdom, Matt Trott, Alternative Executive Director, and Will Obeney, Advisor to Executive Director
July 1, 2024

On behalf of the UK authorities, we thank the IMF staff team for insightful policy discussions during the Article IV mission held May 7-21, and their comprehensive and useful report. The authorities used the mission to express appreciation for their longstanding, cooperative engagement with the Fund. The UK entered a pre-election period shortly after, with elections to be held on July 4.

Emerging data for 2024 points to a strengthening outlook for the UK economy. The successive global shocks of Covid-19 and Russia's unprovoked and illegal invasion of Ukraine slowed growth and pushed inflation to a peak of 11%. 2023 growth was 0.1%, with output falling in the second half of the year. Growth has picked up in 2024, with Q1 GDP growing by 0.6% quarter-on-quarter, with strengthened output in services and manufacturing.

Consumer Prices Index (CPI) inflation returned to the 2% target in May, although the Bank of England expect it to rise slightly later this year as last year's declines in energy prices fall out of the annual comparison. In their June meeting, the Monetary Policy Committee held Bank Rate at 5.25%. They noted a restrictive stance remains necessary to ensure that CPI inflation returns to target sustainably in the medium-term. At present, indicators of inflation persistence remain elevated, although they continue to moderate. For example, services consumer price inflation fell from 6.0% in March to 5.7% in May, and evidence remains of some labor market tightness.

The Bank of England recognizes the importance of effective communications, which was one of the drivers for requesting the Bernanke Review. The Review provides a careful and thorough assessment of the Bank's forecasting methods and the relationship between forecasts, monetary policy decisions and their communication. Considerable new investment in data and forecasting infrastructure is already underway. Dr Bernanke's other recommendations are wide ranging and interconnected, so the Bank is currently considering implementation options in depth and will provide an update on proposed changes by the end of the year. They appreciate staff's suggestions in this regard.

Staff's report notes that fiscal policy has remained restrictive, supporting disinflation. The authorities remain committed to fiscal responsibility. The primary deficit decreased from 3.6% of GDP in FY22 to 1.3% in FY24, and gross debt-to-GDP was second lowest in the G7 in FY23. The authorities are also committed to supporting long-term growth. In March 2024, the Chancellor of the Exchequer delivered a Budget with measures on both taxation and expenditure, based on forecasts by the independent Office for Budget Responsibility which confirmed that the government is on track to meet both its debt and borrowing fiscal rules.[1] As is standard practice, further decisions about spending plans across the public sector will be made in a Spending Review, to be held later this year.

The UK financial sector has shown resilience over recent years, and the authorities continue to develop cutting-edge mechanisms for understanding and ensuring the resilience of non-bank financial institutions (NBFIs). The UK banking system is well capitalized and in a strong position to support households and businesses, even if economic and financial conditions are substantially worse than expected. The Financial Policy Committee continues to maintain the countercyclical capital buffer (CCyB) at its neutral setting of 2%, helping to ensure that banks continue to have capacity to absorb unexpected future shocks without restricting lending in a counterproductive way. NBFIs play an important role in channeling finance to the UK real economy, and important steps are being taken to minimize data gaps for surveillance and ensure resilience in the sector. The authorities appreciate staff's support for the System-Wide Exploratory Scenario[2] exercise, as well as the NBFI lending tool[3] which will act as a backstop in periods of market dysfunction by providing liquidity to NBFIs in the gilt market. Given the cross-jurisdictional nature of the NBFI sector, domestic efforts are complemented by global efforts including bilateral cooperation and work at the FSB.

Authorities agreed on the importance of staying the course on climate policy, maintaining the UK's status as a global climate leader. The UK has a strong legal framework in place for reaching net zero emissions by 2050. This includes requirements on government to set legally binding five-year caps on emissions, known as 'carbon budgets', and to publish reports setting out proposals and policies for meeting those budgets. The UK has successfully delivered all three carbon budgets so far, over-delivering on the 2018-22 carbon budget by 15%, and is on track to deliver the next carbon budget covering 2023-27. In 2022, the UK became the first major economy to halve its emissions compared to 1990 levels. Leveraging private sector investment remains an important part of the authorities' strategy – since 2010, the UK has mobilized £300 billion in investment in low carbon technologies. The authorities stated during the mission that they remain committed to delivery of net zero by 2050 in line with the UK's world-leading legislation.

The UK remains a committed supporter of multilateralism, seeing it as a critical means by which to preserve the health of the global economy and address shared challenges. The UK

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[1] A full summary of taxation and expenditure measures in the Spring Budget can be found at www.gov.uk/government/topical-events/spring-budget-2024

[2] See www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise

[3] Nick Butt 'Market resilience, non-bank financial institutions and the central bank toolkit – practical next steps' www.bankofengland.co.uk/speech/2024/march/nick-butt-keynote-speech-at-isda-virtual-conference-procyclicality-and-margin-practices

seeks to play a constructive role in the global economic system, including the IMF, World Bank, G20, and WTO. In recognition of the IMF's role at the center of the global financial safety net, we remain closely engaged across the Fund's work on surveillance, lending and capacity development, including through provision of UK financial resources and expertise. In May, the UK secured legislative approval for increasing its IMF quota under the 16th General Review of Quotas. The UK provides significant support to the Poverty Reduction and Growth Trust and to the Resilience and Sustainability Trust, and we fully support efforts to deliver a bigger and self-sustaining PRGT in parallel to an ambitious IDA21 replenishment. As a key jurisdiction for sovereign debt issuance, the UK also participates in the Global Sovereign Debt Roundtable, supporting efforts to facilitate common understanding of restructuring issues amongst a diverse set of stakeholders.