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UNITED KINGDOM

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2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE UNITED KINGDOM

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 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 6, 2023 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 6, 2023, following discussions that ended on May 23, 2023, 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 20, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for 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.

PRESS RELEASE

PR23/259

IMF Executive Board Concludes 2023 Article IV Consultation with the United Kingdom

FOR IMMEDIATE RELEASE

Washington, DC – July 11, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the United Kingdom.

The post-pandemic recovery was disrupted by the sharp energy price shock due to Russia's war in Ukraine; labor force participation has declined, mainly on account of rising long-term illness; and large policy rate increases—needed to arrest high and sticky inflation—have tightened financial conditions. Market stress following the September 2022 'mini-budget' has dissipated in the context of a successful financial stability intervention by the Bank of England and two prudent budgets. Post-Brexit uncertainty has declined thanks to the Windsor Framework.

The outlook for growth remains subdued. Staff forecasts growth to slow to 0.4 percent in 2023, held back by tighter monetary and fiscal policies needed to curb inflation, and lingering impacts of the terms-of-trade shock. Growth is projected to rise gradually to 1 percent in 2024, as disinflation softens the hit to real incomes, and to average around 2 percent in 2025 and 2026, mainly on the back of a projected easing in monetary and financial conditions. Thereafter, growth is projected to settle at the trend growth of 1½ percent. Declining energy prices and widening economic slack are expected to substantially reduce inflation to around 5¼ percent by end-2023; and below the 2 percent target by mid-2025.

Risks are considerable in the period ahead. The major near- to medium-term risk is greater-than-anticipated persistence in price- and wage-settings, leading to higher inflation for longer. Should such upside risks to inflation materialize, headwinds to growth would likely be intensified by tighter demand-management policies needed to combat inflation; and/or a drift-up in inflation expectations, which could lead to a re-pricing of long-term financial assets, with adverse macro-financial spillovers. Downside risks also include a further tightening in global financial conditions that restrains credit and trading partner demand. The impact on growth would be amplified if there is contagion to the UK financial sector and/or if adverse macro-financial feedback loops, such as a housing market correction, are triggered.

Executive Board Assessment[2]

Directors noted that the post-pandemic recovery was held back by the energy price shock, labor supply constraints, and tightening financial conditions. They commended the authorities on their decisive response to the September 2022 liability-driven investment (LDI) crisis and for their management of the fallout from the recent global banking stress. While the United

[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.

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

Kingdom is expected to avoid a recession in 2023, Directors noted the high uncertainty associated with the economic outlook and agreed that risks are tilted to the downside for growth and that high and persistent inflation remains the key near-term policy challenge.

Directors welcomed the Bank of England's (BoE) policy response to arrest inflation pressures, including the 50 bps policy rate increase on June 22. Given risks and uncertainty about the outlook and inflation persistence, Directors concurred that a continuous review of the pace and magnitude of monetary tightening is warranted. Should inflationary pressures show signs of further persistence, the policy rate may have to be raised further and would need to remain higher for longer to durably lower inflation and keep inflation expectations anchored. Directors supported the BoE's incremental approach to reducing its balance sheet via quantitative tightening. They underscored the importance of clear communication of monetary policy decisions, including in situations where markets perceive tensions between price and financial stability objectives.

Directors concurred that fiscal policy should support monetary policy in the fight against inflation. They welcomed the authorities' fiscal consolidation plan, which will help to rebuild fiscal buffers, and encouraged the authorities to save any near-term fiscal overperformance. Directors noted that preserving high-quality public services and undertaking critical public investments will imply increased spending needs over the medium term. Accommodating these needs while stabilizing the debt path will require additional high-quality revenue measures—such as strengthening carbon and property taxes and eliminating loopholes in wealth and income taxation—and reforming pensions. Directors encouraged the authorities to consider further strengthening the fiscal framework.

Directors noted that the financial system has shown resilience to shocks, and emphasized the need for continued vigilance of financial stability risks, including in the mortgage and real estate markets. They encouraged continued close monitoring of liquidity positions of all banks, and an in-depth study of depositor behavior to support policy work on the liquidity coverage ratio. Directors also supported ongoing efforts to better understand and reduce non-bank financial institutions' (NBFIs) vulnerabilities, including through a system-wide exploratory scenario, and closing of NBFI data gaps in collaboration with other jurisdictions. They noted the authorities' ongoing consideration of options to improve depositor outcomes in resolution and recommended that ongoing financial regulatory reforms preserve the primacy of financial stability. Enhancing the effectiveness of the AML/CFT supervisory regime remains important.

Directors emphasized the importance of structural reforms to strengthen the labor supply, boost business investment, and enhance productivity, and welcomed the authorities' initiatives in this regard, including the Chancellor's 4Es strategy for Enterprise, Education, Employment and Everywhere, the Spring Budget, and the Windsor Framework agreement with the EU. They underscored, however, the need for further measures, including to improve health outcomes, fine-tune immigration arrangements to address labor and skills shortages and enhance labor market flexibility, increase critical public investment, provide permanent incentives for investment, and ease planning restrictions. Investing in education and skills and R&D support would also enhance productivity. Directors welcomed the United Kingdom's leadership in decarbonization and their ambitious Net Zero climate agenda. They encouraged the authorities to accelerate the green transition in support of their climate targets and to enhance energy security.

United Kingdom: Selected Economic Indicators

Population (million): 67.8

Key export markets: Euro area (36%) US (21%)

Per capita GDP (US$): 45,461

	2020	2021	2022	2023	2024
			Est.	Projections	
Output					
Real GDP growth (%)	-11.0	7.6	4.1	0.4	1.0
Unemployment					
Unemployment (%)	4.6	4.5	3.7	3.9	4.2
Prices					
Inflation, annual average (%)	0.9	2.6	9.1	7.9	3.7
Inflation, end-of-period (%)	0.6	5.4	10.5	5.2	2.6
Public Sector Finances (fiscal year)					
Revenue (% GDP)	38.0	39.2	40.4	40.8	39.9
Expenditure (% GDP)	53.3	44.4	46.6	45.7	43.7
Public sector overall balance (% GDP)	-15.2	-5.2	-6.2	-4.9	-3.8
Public sector cyclically adjusted primary	-11.7	-3.6	-2.7	-1.6	-1.2
Public sector net debt (excl. BoE) 2/	90.1	83.9	89.0	92.2	94.4
Money and Credit					
Broad money (% change)	13.4	6.2	1.6	…	…
Credit to the private sector (% change)	3.7	3.0	3.3	…	…
3-month interbank rate (%)	0.3	0.1	2.0	…	…
Balance of Payments					
Current account balance (% GDP)	-3.2	-1.5	-3.8	-3.8	-3.7
Net FDI (% GDP)	-5.0	5.0	3.8	0.2	0.2
Reserves (end-of-period, billions of US	186.7	203.7	185.6	…	…
Net international investment position (% GDP)	-18.2	-15.3	-10.9	…	…
Exchange Rates					
REER (% change) 1/	0.2	3.9	-1.4	…	…

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 includes 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.

UNITED KINGDOM

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

June 20, 2023

KEY ISSUES

Context and Outlook. Market stress following the September 2022 'mini-budget' has dissipated, in the context of a successful financial stability intervention by the Bank of England (BoE) and two prudent budgets. Post-Brexit uncertainty has declined somewhat due to the Windsor Framework agreement to resolve disputes around the Northern Ireland Protocol. Still, the economy faces several challenges. The post-pandemic recovery was disrupted by the sharp energy price shock due to Russia's war in Ukraine; labor force participation has declined, mainly on account of rising long-term illness; and large policy rate increases—needed to arrest high and sticky inflation—have tightened financial conditions. Accordingly, and despite recent upgrades, GDP growth is forecast at a modest 0.4 percent for 2023, followed by 1 percent growth in 2024. Lower energy prices and emerging economic slack is projected to help reduce headline inflation to around 5¼ percent by end-2023 and to the 2 percent target by mid-2025. Risks are tilted to the downside for growth and to the upside for inflation. Tighter-than-expected global financial conditions present the key downside risk to growth, while robust wage growth and greater inflation persistence pose upside risks to inflation.

Policy Recommendations. The overarching policy objectives are price and financial stability, while reforming the fiscal and financial frameworks, and boosting sustainable, medium-term growth.

- **Monetary Policy** will need to be tightened further to arrest inflationary pressures, which have shown greater-than-expected persistence, and durably bring inflation to the 2 percent target. The BoE should continue to focus on services inflation and wage growth and see through declines in headline inflation due to falling energy or food prices. Should inflationary pressures show further persistence, Bank Rate will also need to remain higher for longer. Quantitative Tightening (QT) should continue as planned.

- **Fiscal Policy** should remain aligned with monetary policy in the fight against inflation and account for very significant medium-term pressures related to service delivery (especially healthcare), and needed investments in skills, innovation, infrastructure, and the green transition. Doing this while rebuilding fiscal buffers will require generating fiscal savings from, inter alia, strengthening carbon, property, and wealth taxation; closing loopholes in the income and social security tax systems; and reforming pensions. There is scope to improve the fiscal framework, by better defining escape clauses and strengthening the role of the Office for Budget Responsibility (OBR). Consideration could also be given to moving from point estimate-based rules toward a stabler framework that is based on the probability of debt stabilization that allows somewhat greater flexibility, while maintaining discipline.

- **Financial Sector Policies** are appropriately calibrated for now but should: (i) continue to consider both credit conditions and financial stability risks in setting the countercyclical capital buffer (CCyB); (ii) maintain focus on preserving adequate capital and liquidity buffers across all UK banks and consider whether liquidity requirements might benefit from refinements in light of the observed speed of deposit outflows in recent bank stress episodes; (iii) better identify and mitigate risks stemming from non-bank financial institutions (NBFIs) by closing data gaps, strengthening NBFI liquidity, and extending BoE liquidity backstops to adequately supervised and systemically important NBFIs; (iv) seek to strengthen the resolution framework in light of the recent SVB UK experience; and (v) give clear primacy to UK financial stability in ongoing financial regulatory reforms.

- **Structural and Transformation Policies** should focus on: (i) boosting anemic *business investment* by reducing policy and regulatory uncertainty, easing planning restrictions, enhancing R&D support for firms, and expediting needed public infrastructure projects; (ii) increasing *labor supply and productivity* by addressing longstanding recurrent and infrastructure needs in healthcare, investing in education and skills (especially for younger cohorts) and fine-tuning immigration arrangements; and (iii) advancing the *Net Zero Strategy*, including by increasing carbon pricing, by expanding the programs for heat pump installations and home insulation, and by removing existing supply bottlenecks, including by setting out longer-term plans to attract private investment.

Approved By
Laura Papi (EUR) and Daria Zakharova (SPR)

The mission took place in London during May 9–23, 2023. The staff team comprised S. A. Abbas (head), A. Ari, A. Carella, R. Chen, C. Mulas Granados (all EUR), and E. Kemp (MCM). The mission met the Chancellor of the Exchequer, the Governor of the BoE, the Chief Executive of the FCA, senior HMT and BoE officials, analysts and thinktanks, trade union representatives, and business groups. A wrap-up meeting involving the Managing Director, the Prime Minister, and the Chancellor took place on May 23, followed by a press conference. M. Evio, N. Kumar, G. Li, and R. Vega (all EUR) and V. Mylonas (external consultant) supported the mission.
UK Executive Director Ms. Riach, Alternate Executive Director Mr. Trott, and Mr. Chrimes (OED) participated in the discussions.

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TABLES

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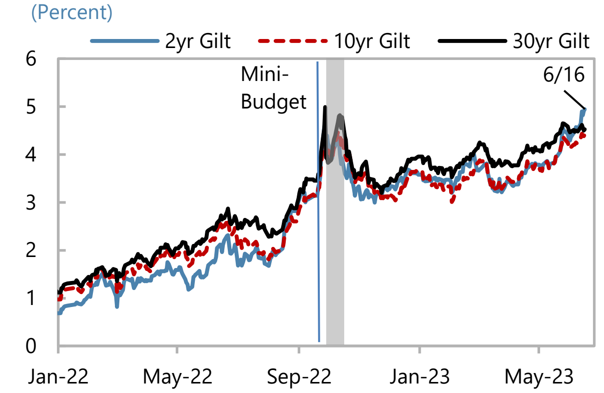
CONTEXT

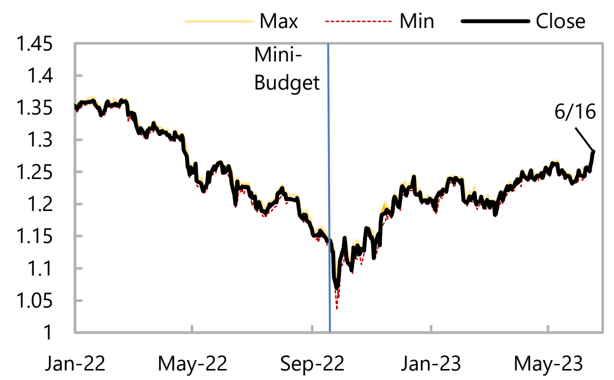
1. Economic stability and growth have been key goals of the government that took charge in October 2022 in the context of heightened market volatility. A prudent Autumn 2022 budget, prepared with full OBR input, helped to align fiscal with monetary policy in the fight against inflation and, alongside the BoE's financial stability interventions, assuaged market stress that had emerged after the September 2022 'mini-budget'. At the start of 2023, the PM promised actions to tackle the challenges of high inflation, high public debt, low economic growth, and long National Health Service (NHS) waiting lists. In February, the Chancellor announced his "4Es" economic strategy (Enterprise, Education, Employment, and Everywhere). These priorities, as well as reaching an agreement on pay with public sector workers who have staged rolling strikes, will likely dominate the government's policy agenda till the next general elections, due by January 2025.

Gilt Yields
(Percent)



Note: Shaded area indicates duration of BoE intervention.
Source: Bloomberg Finance L.P.

Pound to USD Exchange Rate



Source: Bloomberg Finance L.P.

2. The new Windsor Framework will help resolve the disputes around the Northern Ireland Protocol (NIP), and uncertainty around retained EU laws has abated somewhat. In March, the UK and EU adopted a new post-Brexit deal on Northern Ireland, the Windsor Framework, paving the way for renewed cooperation between the two sides. While a vote on the Framework is not required, new UK legislation will be needed to implement some of the Framework.[1] The proposed regulations in areas like medicines, checks on animals and plants, and medicines have been adopted by the European Parliament and the Council of the EU. Separately, the government has adopted a more measured approach for retained EU laws, reviewing about 600 instead of over 3,800 pieces by end-2023. For financial services, the UK and EU Commission published the joint text of the draft memorandum of understanding (MoU) on regulatory cooperation in financial services in May, with an intention to sign the MoU soon. A long-term decision is still awaited regarding equivalence and recognition for UK central counterparties (CCPs) in the EU beyond mid-2025.

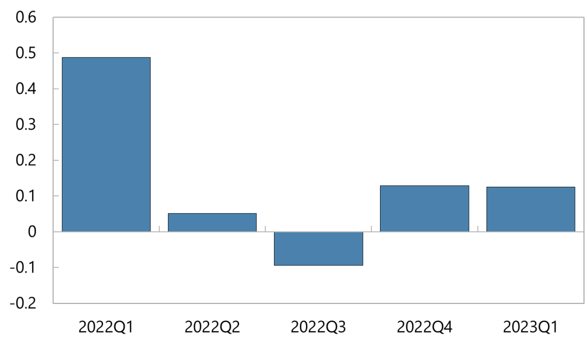
[1] The Framework will be implemented through a series of legal instruments which will be tabled to parliament in the coming months. Secondary legislation to implement the Stormont Brake (which gives the Northern Ireland Assembly powers to object to changes in new EU legislation that apply in Northern Ireland) was passed with bipartisan support by the House of Commons on March 22.

RECENT DEVELOPMENTS

3. **The post-pandemic recovery was disrupted by the energy price shock.** GDP growth slowed in the first half of 2022, as the recovery from the pandemic collided with labor supply constraints, and as Russia's war in Ukraine inflicted a sharp terms-of-trade (TOT) shock on the UK economy (Figures 7 and 8).[2] The economy contracted in 2022Q3 as financial conditions tightened and high inflation—especially in energy prices—weighed on household balance sheets.[3] GDP resumed growing, albeit at a subdued rate, in 2022Q4 and 2023Q1, as demand recovered amid declining energy prices and still-tight labor markets. High frequency indicators point to further resilience in demand in 2023Q2.

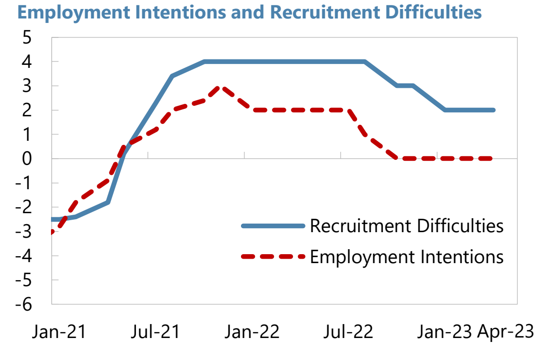
Figure 1. United Kingdom: Real Sector Developments

Real GDP Growth
(quarter-on-quarter; percentage points)



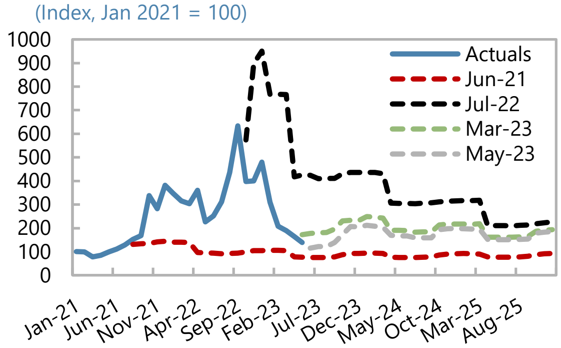
Sources: ONS and IMF staff calculations.

Employment Intentions and Recruitment Difficulties



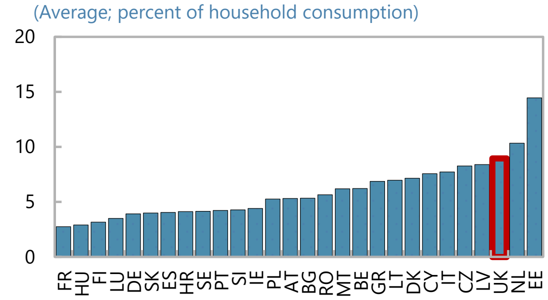
Note: Survey scores range from -5 (rapidly falling) to +5 (rapid growth).
Source: BoE Agents' Scores; Haver Analytics.

Actual and Futures-Implied Wholesale Natural Gas Prices
(Index, Jan 2021 = 100)



Note: Dashed lines correspond to different vintages of futures-implied prices. May-23 refers to futures-implied prices as of 5/23/2023, while the other lines correspond to end-month values.
Sources: Bloomberg Finance L.P.

Households' Burdens From Higher Energy Prices In 2022
(Average; percent of household consumption)



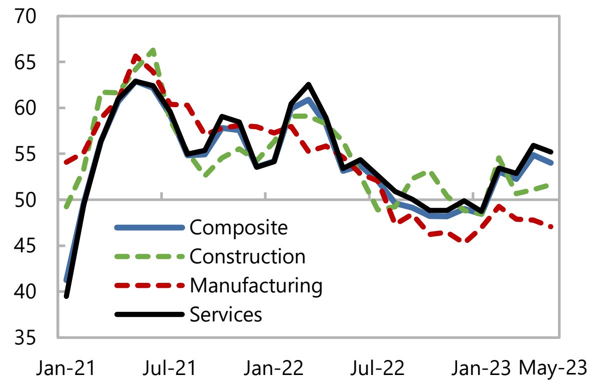
Notes: See Annex 1 in Arregui et al. (2022) for further information on methodology.
Sources: Ari et al. (2022) "Surging Energy Prices in Europe in the Aftermath of the War: How to Support the Vulnerable and Speed up the Transition Away from Fossil Fuels" and Arregui et al. (2022) "Targeted, Implementable, and Practical Energy Relief Measures for Households in Europe."

[2] See the accompanying selected issues paper for further analysis on the impact of high energy prices on the UK economy.

[3] Real wages and real household disposable incomes declined respectively by 1.7 and 0.2 percent in 2022.

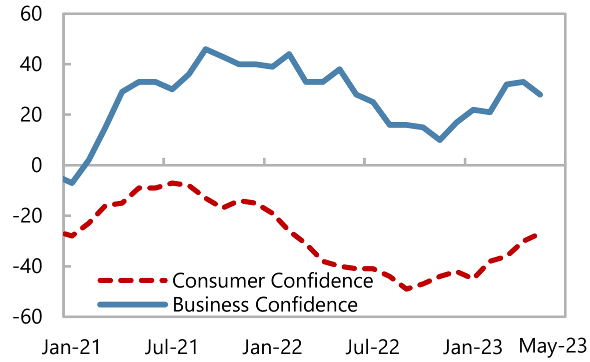
Figure 1. United Kingdom: Real Sector Developments (concluded)

PMI by Sector
(SA, 50+=Expansion)



Sources: CPS/IHSM and Haver Analytics.

Consumer and Business Confidence
(Percent Balance)

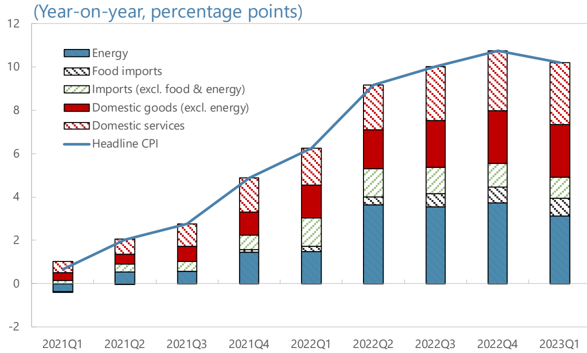


Sources: GfK/NOP European Comission; Llyods Bank; and Haver Analytics.

4. **Inflation remains elevated after surging in 2022.** Headline and core inflation—averaging 9.1 and 5.9 percent y/y, respectively, in 2022—reflected soaring energy prices, as well as demand-supply imbalances, and sterling depreciation. After peaking at 11.1 percent y/y in October, headline inflation stabilized slightly above 10 percent in 2023Q1 and started to recede in 2023Q2 as the April 2022 energy price increases shifted into the base, and notwithstanding higher food price inflation. But underlying price pressures have persisted, with core inflation rising to 6.8 percent y/y in April 2023, as firms attempted to preserve their profit margins in the face of cost-push impacts, including from strong wage growth.

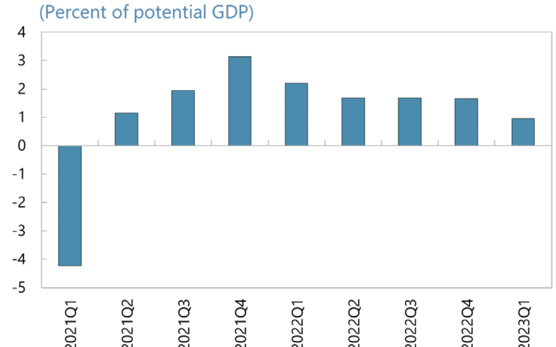
Figure 2. United Kingdom: Inflation and Its Drivers

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



Sources: ONS, IMF staff calculations

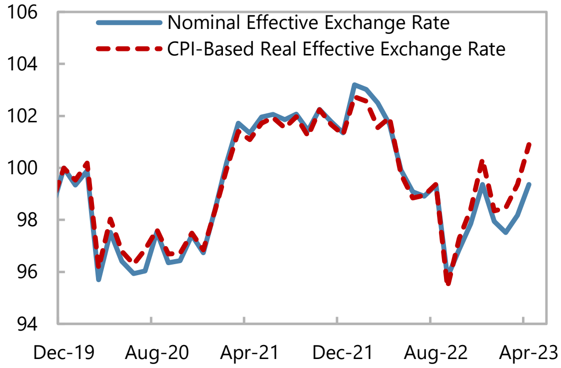
Output gap
(Percent of potential GDP)



Sources: ONS and IMF staff calculations

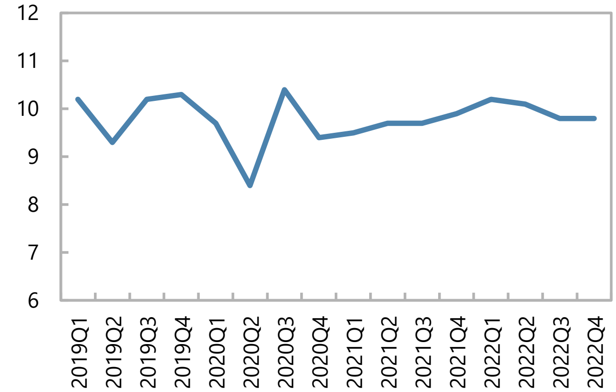
Figure 2. United Kingdom: Inflation and Its Drivers (concluded)

NEER and REER
(Index, Dec-2019 = 100)



Sources: IMF International Financial Statistics.

Private Non-Financial Corporations' Net Rate of Return
(Percent)

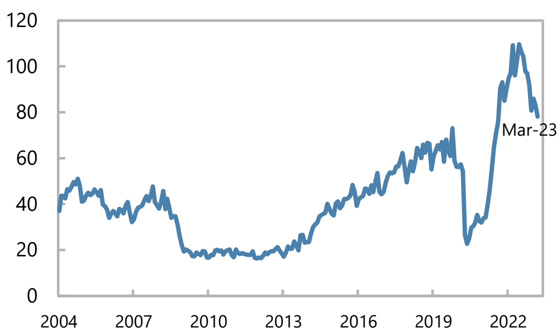


Sources: ONS

5. Exceptionally tight labor markets have led to robust wage growth. Elevated inactivity rates—reflecting increased long-term sickness after the pandemic—have held back labor supply, contributing to a historically high vacancy-to-unemployment ratio and robust private sector wage growth. Public sector wage growth, which was restrained through 2022, also accelerated after several strikes. However, labor market tightness has started to unwind in recent months as economic activity slowed and an influx of (non-EU) foreign workers entered the labor force.[4]

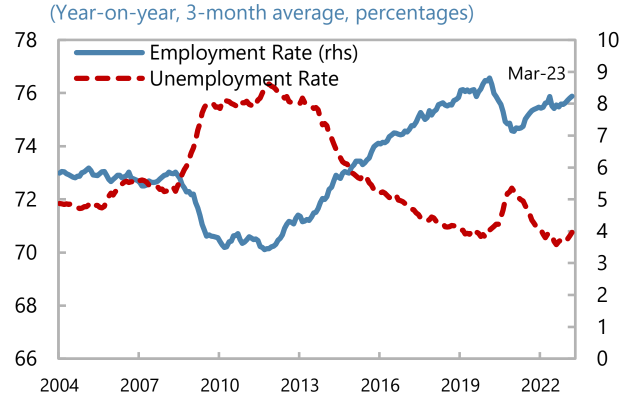
Figure 3. United Kingdom: Labor Market Developments

Vacancy to Unemployment Ratio
(Percent)



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

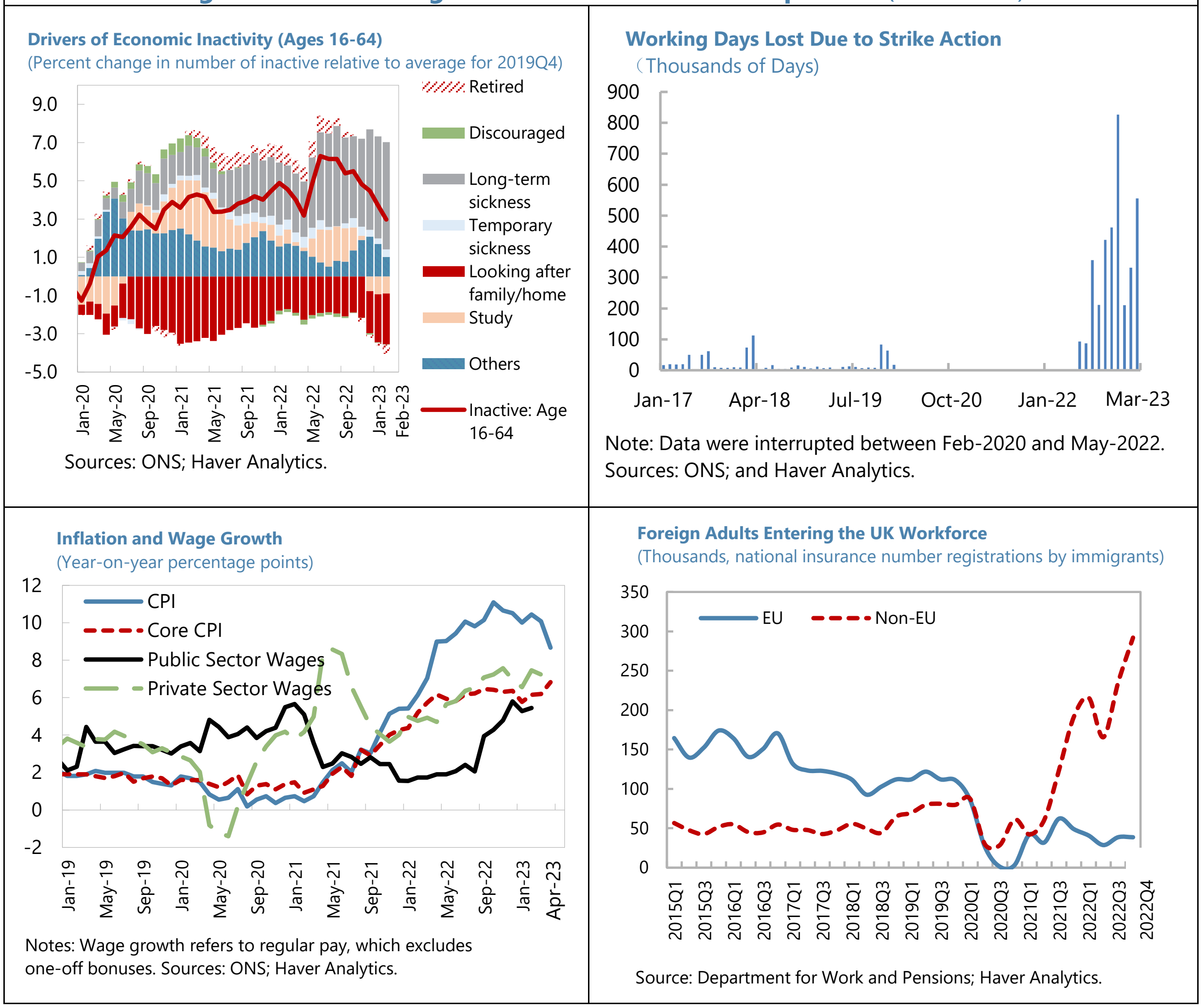
Employment and Unemployment Rates
(Year-on-year, 3-month average, percentages)



Source: ONS; Haver Analytics.

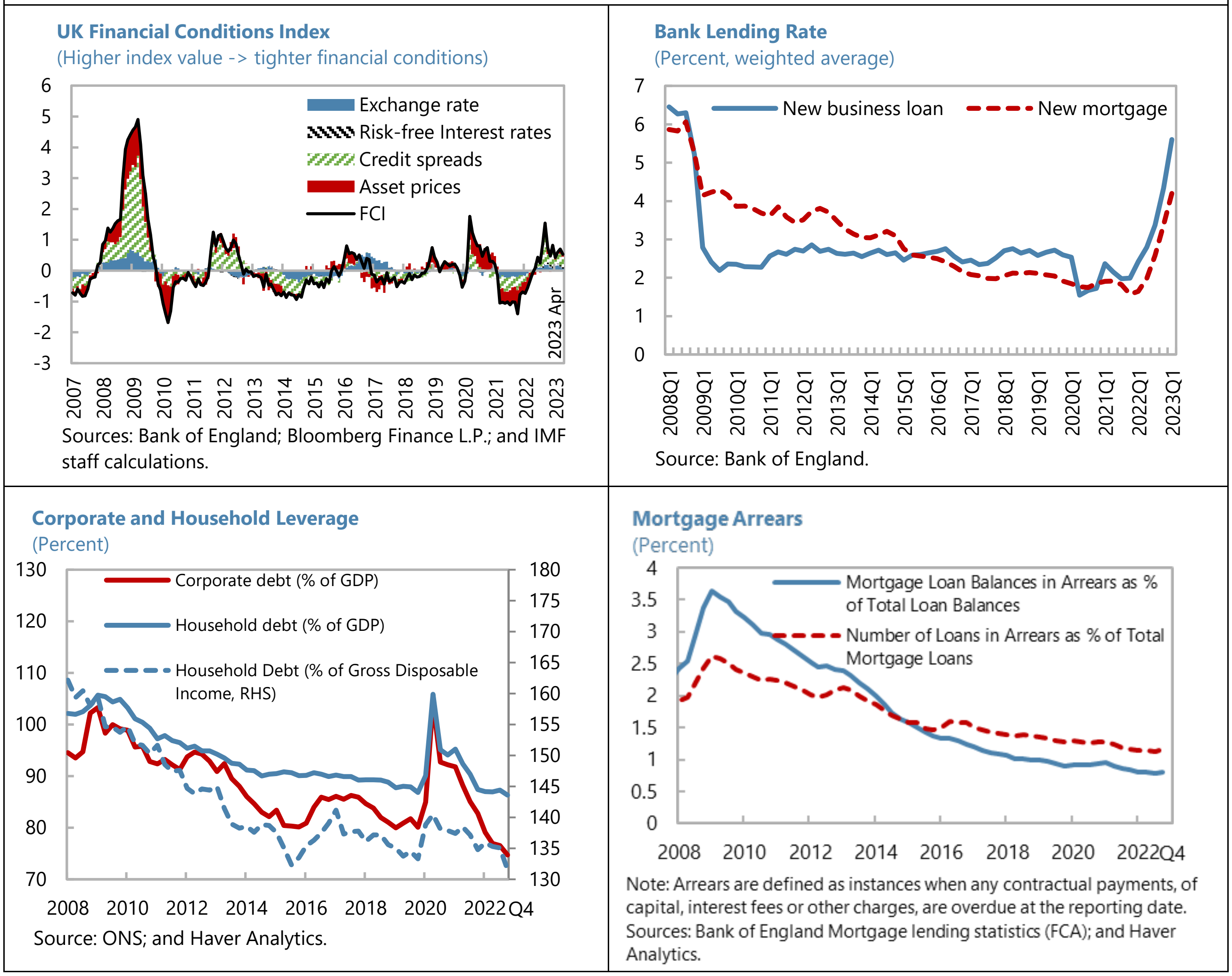
[4] The composition of long-term sponsored worker visas granted in 2022 was tilted towards skilled and healthcare sector workers.

Figure 3. United Kingdom: Labor Market Developments (concluded)

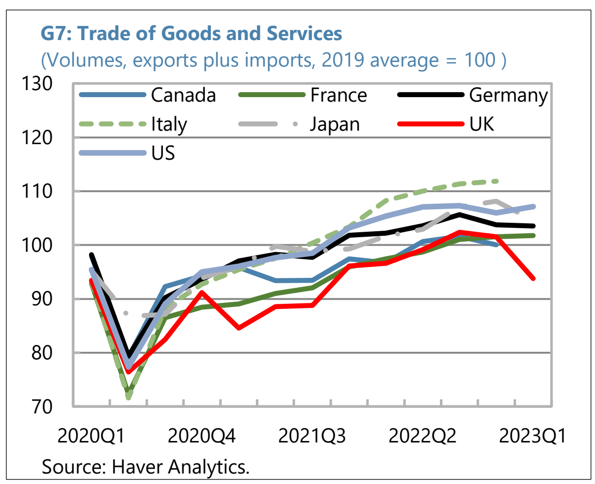


6. **Financial conditions have tightened since late 2021, in line with monetary policy tightening.** All underlying financial conditions indicators have broadly co-moved with the Bank Rate, with sharp, but temporary, movements around the 'mini-budget' episode. Lending rates had risen significantly by early 2023 (to more than double their end-2021 level), adding to household and corporate debt burdens, which, however, remain significantly below their pre-GFC peaks. Mortgage arrears remain low. House prices have fallen since reaching their all-time peak in 2022Q3 (Figure 13), although recently-surveyed market specialists do not expect a major correction (median expectation in May was for a fall by 3 percent in 2023 but a rise by 1 percent in 2024). The recent global banking stress and inflation surprises have further tightened financial conditions, and gilt market liquidity remains a concern in line with global trends.

Figure 4. United Kingdom: Financial Conditions



7. **The current account deficit widened sharply to 3.8 percent of GDP in 2022, while the volume of foreign trade declined.** The current account deterioration was driven by rising energy imports and slowing exports due to anemic trading partner demand. Excluding cyclical factors, the CA gap worsened moderately from 0 in 2021 to -0.8 percent of GDP in 2022, implying an external position broadly in line with fundamentals and desirable policies (Annex I). While gross external debt remains high, low net debt and exchange rate flexibility are major risk mitigation channels (Annex II). The UK has lagged other G7 countries in the post-COVID trade recovery with goods trade with the EU in 2023Q1 still about 7 percent lower than 2019 averages, as the Trade and Cooperation Agreement (TCA)



implementation, particularly non-tariff barriers, have brought challenges, especially for SMEs.[5] Separately, in March 2023, the UK completed negotiations to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), aiming to broaden trading relationships.

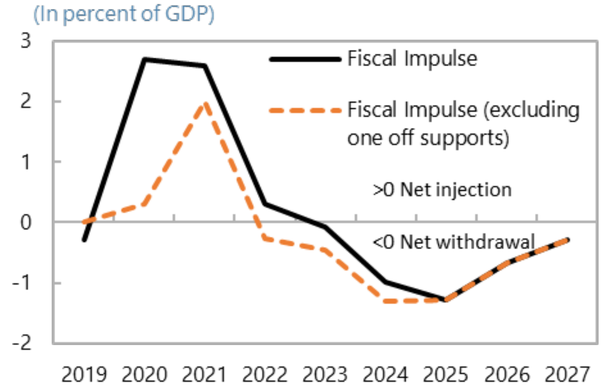
8. ***Authorities' Views.*** The authorities broadly agreed with staff's assessment and policy recommendations for the external sector in 2022. They indicated that their own models show both the current account and the exchange rate to be within staff's range, though with a central estimate somewhat closer to balance. They pointed out that goods imports might be overestimated due to some double counting, which would likely be adjusted in later releases of official statistics.

OUTLOOK AND RISKS

9. Growth is projected to be subdued in 2023, rising thereafter, while inflation is expected to ease gradually, returning to target by mid-2025.

- **Near-term growth.** Growth is forecast to slow to 0.4 percent in 2023 from 4.1 percent in 2022, as tighter monetary policy and financial conditions weigh on demand, while the fiscal impulse is expected to be broadly neutral (see Text Table). This slowdown is projected to open a negative output gap of 1 percent by end-2023, aided by a rise in potential supply as energy prices decline. With labor market tightness unwinding gradually, only a mild increase in unemployment is expected, enabling some persistence in wage-setting. Growth would then pick-up to 1 percent in 2024, as disinflation softens the hit to real incomes.

Fiscal Impulse
(In percent of GDP)



Note: Fiscal impulse calculated as the y-o-y change in CAPB, times historical multipliers. Excluded one-off measures are: Covid-support schemes (e.g. furlough) and energy support programs (e.g. EPG)
Sources: HM Treasury; OBR; and IMF Staff calculations.

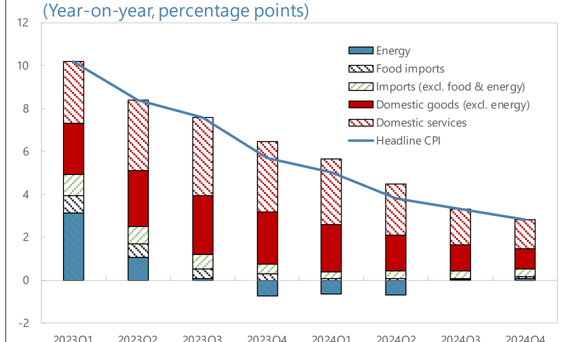
[5] See ONS - Business insights and impact on the UK economy - 6 April 2023.

Conditioning Assumptions Underlying Staff's Baseline Forecasts	
Energy prices	Conditioned on futures-implied paths, which indicate declining natural gas and electricity prices through 2023, but only a partial reversal of the increase since mid-2021. Retail energy prices projected to decline below the cap implied by the Energy Price Guarantee (EPG) in July 2023 and remain so until the EPG's expiration at end-March 2024.
Monetary policy	Bank Rate to increase by another 50–100 bps (in line with market expectations), followed by a sustained tight monetary stance through end-2024 and gradual loosening thereafter.
Financial conditions	Projected to evolve in line with the Bank Rate.
Macroprudential policy	The countercyclical capital buffer (CCyB) rate will increase to 2 percent in July 2023 and stay at that level throughout the forecast period.
Fiscal policy	OBR's fiscal projections accompanying the Spring 2023 budget, but with revenues adjusted for staff's macroeconomic forecast, and excluding fuel duty uprate and expiration of capital investment allowance. Moreover, annual current expenditures are about 0.8 percent of GDP higher to account for pressures related to public pay and service delivery; while public investment falls more slowly after 2025 (0.7 ppts. of GDP higher than in the Spring budget by the end of the forecast period). The fiscal impulse is assumed to be neutral in 2023 and negative thereafter.

- **Medium-term growth.** As the monetary policy stance and financial conditions ease, an upswing in private consumption and investment would boost demand in 2025–26, aided also by reduced uncertainty regarding post-Brexit trading arrangements and despite a negative fiscal impulse. Growth would average 2.1 percent during this period. Thereafter, real GDP would gradually converge to its pre-pandemic potential growth rate of about 1½ percent, with output in 2028 about 5 percent below its pre-pandemic trajectory. This substantial scarring results from: (a) the impact of higher inactivity rates on labor supply; (b) weak investment growth since 2016; and (c) total factor productivity (TFP) scarring from human capital and knowledge spillover losses during the pandemic, as well as elevated energy input costs relative to the pre-war path.

- **Inflation.** Declining energy prices, widening economic slack, and lagged impacts of sterling re-appreciation are expected to reduce headline and core inflation to 5.2 and 5.8 percent y/y by end-2023, with the latter showing more persistence due to cost-push impacts from robust wage growth. Thereafter, disinflation is expected to continue at a more gradual pace as economic activity and demand pick up, and wage growth outpaces inflation. Headline inflation is forecast to return to the 2 percent target by mid-2025, while core inflation remains above target until end-2025.

Headline CPI Forecasts And Their Decomposition
(Year-on-year, percentage points)



Note: Projections (after 2023Q1) are based on a bottom-up model which combines Phillips curve estimates for domestic goods and services with retail energy price projections based on the EPG and Ofgem's energy price cap, and imported inflation estimates based on historical pass-through coefficients from the exchange rate, trade partner inflation and global commodity and industrial input prices.
Sources: ONS, IMF staff calculations

10. Uncertainty associated with this outlook is high, with risks tilted to the downside for growth and upside for inflation. There are several risk scenarios around staff's baseline (see Box. 1 and Annex III):

- **Global financial conditions could tighten more substantially,** restraining credit and trading partner demand, and lowering economic activity relative to staff's baseline. The impact on growth would be amplified if there is contagion to the UK financial sector and/or adverse macro-financial feedback loops (such as a housing market correction) are activated. Materialization of these risks would also curtail inflation by widening the output gap and reducing global commodity prices.
- **Price and wage-setting mechanisms could exhibit greater persistence, leading to higher inflation for longer.** Should these upside risks to inflation materialize, headwinds to growth would likely be intensified by tighter demand-management policies to combat inflation and/or a drift up in inflation expectations, which could in turn lead to a re-pricing of long-term financial assets with adverse macro-financial spillovers.
- **Intensification of spillovers from Russia's war in Ukraine and deepening geo-economic fragmentation could weigh on the supply side.** In the near term, a resurgence in energy prices and/or global supply chain disruptions would raise inflation and lower growth. In the medium term, potential growth could be impacted by a reconfiguration of trade and financial flows.

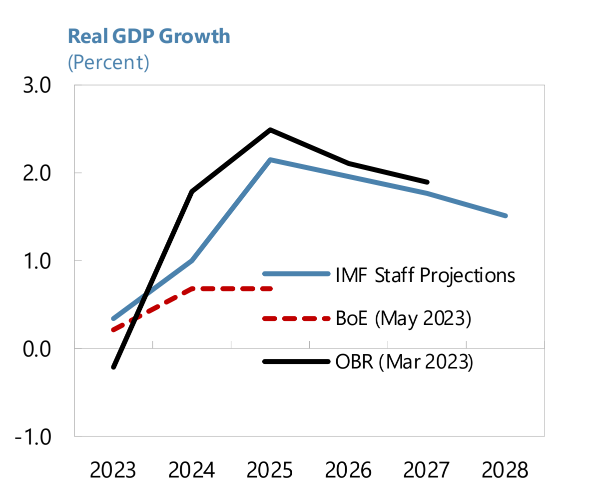
Box 1. A Global Severe Downside Scenario: Implications for the UK Economy

The Scenario. A severe tightening in global financial conditions could expose fragilities in bank and NBFI balance sheets in advanced economies, including the UK. In such a scenario,[1] financial spillovers would affect the UK via a sharp decline in credit and by depressing equity and real estate prices. This would, in turn, have a sizable contractionary impact on aggregate demand and economic activity, amplified by a deterioration in household and business confidence, and a decline in trading partner demand. Tighter financial conditions would also weigh on corporate and household debt vulnerabilities and increase credit losses. At the same time, asset repricing and changes in risk premia would lead to higher mark-to-market losses and increase funding costs for banks. Both would deteriorate their capital ratios and lead to credit tightening. The shock could also have sizable exchange rate effects, with the extent of sterling depreciation depending on flight to safety effects towards the US dollar, market perceptions of the UK's country risk profile and the monetary policy stance relative to other advanced economies.

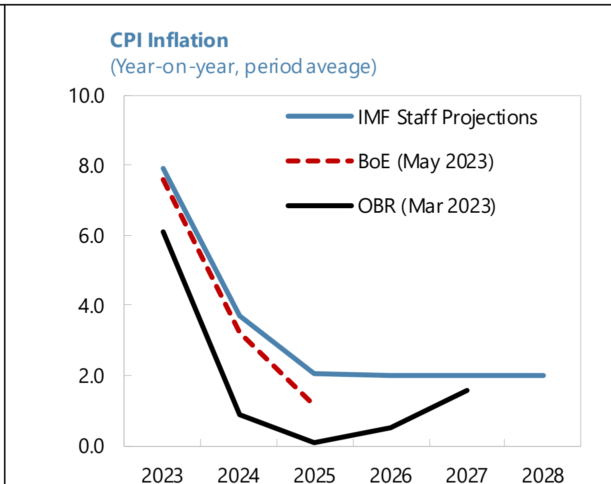
Policy Response. The authorities could consider easing *macroprudential policy* (for example, releasing the CCyB) to avoid exacerbating the credit downturn, accompanied with targeted liquidity provisions to address financial stress in core markets. In addition, very targeted support to households on their debt obligations, as recommended by the FCA recently and still-high household savings could further mitigate potential negative macroeconomic and financial stability implications. *Monetary policy* tightening may have to pause (and there may even have to be some easing) if demand and expected inflation weaken substantially. However, should inflationary pressures persist, for example because of sterling depreciation, the authorities may need to keep monetary policy tight enough to anchor inflation expectations and would have to carefully communicate the different objectives of their policy tools, as was done during the LDI crisis. *Fiscal policy* should allow automatic stabilizers to operate, but discretionary stimulus should only be deployed if monetary policy is unable to ease at the pace and magnitude necessitated by the deterioration in demand (i.e., due to transmission lags in the face of a rapid deterioration or a return to the effective lower bound); and remain mindful of fiscal space and potential risk premium increases.

[1] For further details on this scenario, see IMF WEO, April 2023, Chapter 1: Global Prospects and Policies.

11. ***Authorities' Views.*** The BoE has upgraded its 2023 growth forecast to 0.2 percent in May (from -0.6 percent in February) to account for greater-than-expected resilience in demand. The revised BoE forecast is just below staff's forecast of 0.4 percent growth in 2023. While the OBR's March forecast of -0.2 percent appears to be lower, it is also close to staff's contemporaneous April WEO forecast of -0.3 percent. The BoE foresees anemic growth through 2025, while the OBR foresees an acceleration in growth in 2024 on the back of a rebound in private consumption and investment. On inflation, the BoE has raised its inflation forecasts in response to higher expected food price inflation and a narrower projected output gap. Nevertheless, both the BoE and OBR expect less persistence in wage setting (as labor market tightness continues to unwind) and more sizable second-round effects from declining energy prices than staff, leading to a sharper decline in inflation and an undershoot of the inflation target in the outer years of their forecasts. The BoE instead captures risks of higher wage and inflation persistence in an upward skew to its baseline (modal) forecast. Like staff, the BoE and OBR see only a mild rise in unemployment rates (with unemployment rates peaking at about 4½ percent, slightly above staff's forecast at 4¼ percent). Furthermore, the OBR estimates that measures aimed at raising the labor supply in the Spring Budget will raise employment by 0.3 percent by 2027–28. Staff's forecast of medium-term potential growth (1½ percent) is similar to the BoE's forecast, but lower than the OBR/s 1¾ percent. In discussions about the event of an adverse scenario with tightening global financial conditions, the authorities indicated that policy responses would be tailored to specific circumstances, but could potentially include relaxation of macroprudential policies, while automatic stabilizers would be allowed to operate.



Sources: BoE, OBR, and IMF staff calculations.



Sources: BoE, OBR, and IMF staff calculations.

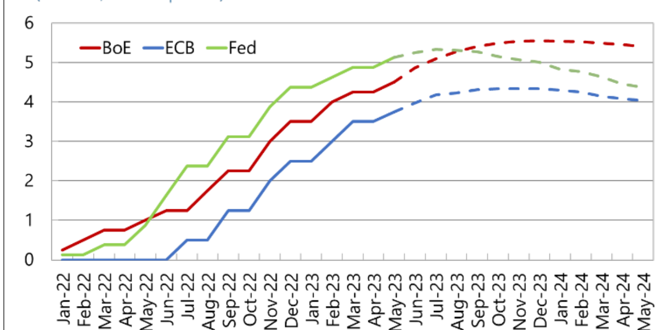
POLICY DISCUSSIONS

The overarching policy objectives are price and financial stability, while reforming the fiscal and financial frameworks, and boosting sustainable medium-term growth. Monetary policy will need to be tightened further to arrest high inflation and may need to stay tight for longer to keep inflation expectations well-anchored, especially if inflationary pressures persist. Fiscal policy should support monetary policy in the fight against inflation, safeguard key public services and the vulnerable, and create space for infrastructure and transformational spending while rebuilding buffers, underpinned by a stabler fiscal framework. Financial sector policies need to continue to focus on preserving *stability and building resilience in a more uncertain global conjuncture, with adjustments to bank resolution and regulatory frameworks. Structural policies to promote long-term growth should be focused on reducing policy and regulatory uncertainty, easing planning restrictions, boosting firms' access to finance and R&D support, raising labor force participation and productivity, fine-tuning immigration to alleviate labor shortages, and enhancing public investment and transformational spending to boost productivity and accelerate the green transition.*

A. Monetary Policy Needs to Be Tightened Further to Arrest Inflationary Pressures

12. Since December 2021, the BoE has raised Bank Rate by 440 basis points, with a notable increase in the pace of tightening after July 2022. The BoE was the first G7 central bank to lift its policy rate in December 2021 and raised it 12 times in a row to 4.5 percent in May. The pace of rate hikes was notably accelerated in August 2022. During its latest meeting in May, the Monetary Policy Committee (MPC) stated that risks to inflation were skewed significantly to the upside and further tightening in monetary policy would be required in the event of persistent inflationary pressures. Markets have priced in additional 100 bps rate hikes by end-2023, gradually easing to about 5 percent by end-2024. Staff estimates the real shadow rate will increase from 150 bps in 2023Q1 to about 340 bps in 2024 (relative to an estimated real neutral rate of 70 bps), implying a fairly tight monetary stance.[6,7]

Policy Rates
(Percent, end-of-period)



Note: Dashed lines represent forward-implied rates from the week of May 26, 2023. 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.

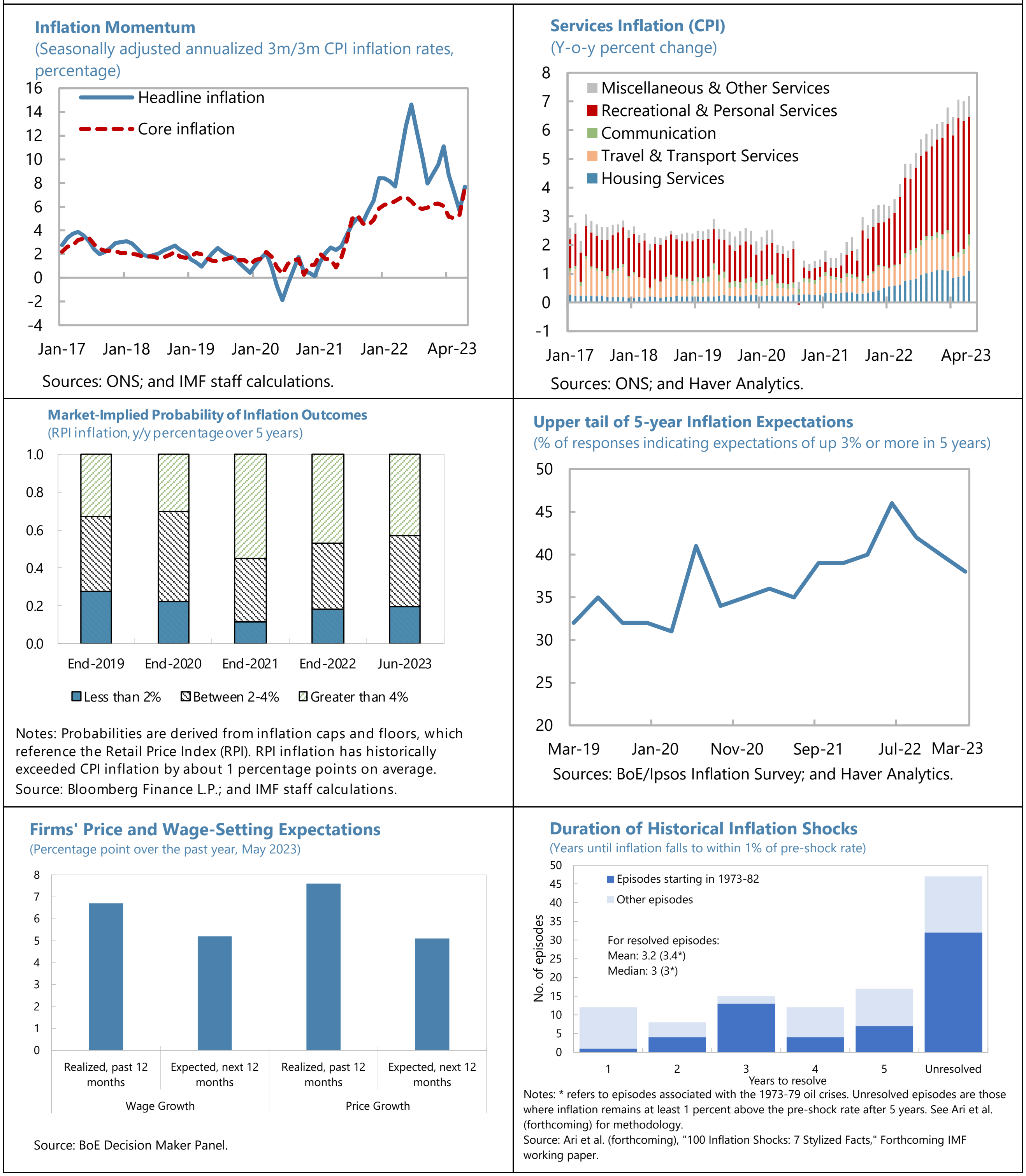
13. Still, inflation has significant momentum, implying risks of stronger inflation persistence. Survey and market-implied measures indicate that de-anchoring risks have somewhat diminished in recent months. However, inflation momentum, measured with annualized 3m/3m inflation rates, was strong at 7¾ percent for both headline and core inflation in April. Measures of underlying inflation—such as services inflation and firms' price and wage-setting expectations (at around 5 percent in 2024)—also remain well-above the BoE's 2 percent target. Staff's cross-country analysis of historical inflation shocks indicates that high inflation is often persistent, especially in the aftermath of

[6] The estimates for the real shadow rate for the first quarter of 2023 are based on an average Bank Rate of 385bps, market-implied inflation expectations (3- and 5-year forward) at about 2.5 percent, and actual and announced QT, with £20bn in portfolio shrinkage (within a quarter) assumed to raise the shadow rate by 10 bps and vice versa. The 2024 average real shadow rate is estimated using the market-implied path for Bank Rate. Staff assessments of the real neutral rate are based on the framework of Pescatori & Turunen (2015). There is considerable uncertainty around estimates of the real neutral rate and the impact of QT on the shadow rate.

[7] A Bank Rate of 4.5 percent (at present) implies an ex-ante real rate of 0.8 percent based on staff's projection of one-year ahead inflation (3.7 percent average in 2024). The ex-ante real rate would increase to around 3 percent next year, implying a restrictive monetary stance.

large TOT shocks, and suggests high prevalence of "premature celebrations," characterized by a decline in inflation as the initial TOT shock dissipates, only to reemerge or plateau at an elevated rate.

Figure 5. United Kingdom: Price Pressures and Inflation Expectations



14. Monetary policy will need to be tightened further to keep inflation expectations well-anchored and bring inflation back to target, while a continuous review of the pace and

magnitude of tightening is warranted. Further interest rate increases are warranted in response to increased persistence in underlying inflationary pressures. In quantifying such pressures, the BoE should continue to focus on services inflation and wage growth and see through declines in headline inflation due to falling energy or food prices. Should inflation show even greater persistence, the Bank Rate will need to remain higher for longer. Nevertheless, given the substantial tightening already in train (which is expected to have a peak impact on demand in late-2023, early 2024), and high uncertainty around the growth and inflation outlook, the Bank should continue to review the pace and magnitude of monetary tightening, focusing on measures of inflation persistence as well as the impact of monetary tightening on financial conditions and the economy.

15. The QT strategy should continue as envisaged. The BoE commenced QT in March 2022 by ceasing to re-invest maturing gilts and, in November, with active gilt sales.[8] During November 2022 to May 2023, the BoE reduced its gilt portfolio (excluding the unwinding of its financial stability interventions around the LDI crisis) by £26.9bn, roughly in line with the announced annual reduction target of £80bn (for the 12 months ending October 31, 2023). Shrinking the BoE's balance sheet would help reduce its footprint in financial markets and preserve headroom for future asset purchases in case adverse shocks materialize. As the medium-term target range for the BoE's balance sheet hinges on considerations about the required level of system-wide reserves (and the attendant need for banks to hold adequate high-quality liquid assets), which are subject to uncertainty and can change over time, staff sees advantages in the BoE's incremental approach to shrinking its balance sheet while keeping Bank Rate as the key monetary policy instrument. In addition, the slow-moving nature of QT decision-making helps ensure its predictability. Still, the BoE should pay attention to pressures in the gilt market, where yields and bid-ask spreads remain elevated, and be ready to provide liquidity support through its short-term Open Market Operations.

16. Clear communication will remain critical, in particular, in situations where markets perceive tensions between price and financial stability objectives. A trade-off between price and financial stability generally does not arise in normal times, as monetary policy and macroprudential policy make use of their separate tools to pursue their respective objectives. Nor should there be a trade-off in the immediacy of a financial crisis, as the accompanying weakness in demand would typically lower inflation, requiring less monetary tightening.[9] Tensions could conceivably arise in situations where there are rising risks and high uncertainty around whether monetary tightening could be leading to a buildup of serious financial stress.[10] Such tensions can be reduced if financial

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[8] The start of active gilt sales was postponed by one month due to gilt market dysfunction following the LDI crisis but plans to reduce its gilt holdings by £80bn over the next 12 months were unchanged. The BoE also fully offloaded its financial stability gilt purchases, amounting to £19.2bn between September 28 and October 14, by January 2023.

[9] The nature of market stress that emerged around the LDI crisis was different from the typical advanced economy financial crisis, in that inflation expectations did not fall but rose (in the context of a major sterling depreciation). To the extent this implied a de-anchoring of inflation expectations and rupturing of monetary transmission, the BoE's financial stability interventions were consistent with price stability objectives.

[10] See Box 1 of the April 2023 WEO on potential macro-financial feedback loops from policy rate increases to mortgages and other sources of stress.

policies can quickly and effectively address potential financial stress (e.g., via liquidity provision complemented by the release of the CCyB). Well-understood regulatory guidance on banks' ability to sufficiently run down their liquidity buffers to avert liquidity-induced financial market stress and expectations on the subsequent replenishment of those buffers can also be helpful. But insofar as "tool overlap" becomes necessary, clear communication on the nature of such interventions and their temporary and targeted nature (as was successfully done by the BoE during the LDI crisis) would be critical.

17. ***Authorities' Views.*** The BoE emphasized the importance of returning inflation to the 2 percent target and having it stay there. They highlighted the risk that inflationary pressures remain more persistent, reflecting the strength in domestic wage- and price-settings. In its May meeting, the MPC voted to address this risk by raising Bank Rate by 25 bps. The BoE noted that the size of the external cost shock is unprecedented in the inflation-targeting period, and so while models estimated over that period suggest that inflation will fall back quickly, the MPC was taking a more cautious approach in its assessment of the outlook and judges that there are significant upside risks. Views within the MPC diverged on the need for further tightening, with the majority judging that it was important to address the upside risks to the inflation outlook, while some highlighted the large tightening already in train. The BoE viewed that QT had progressed as planned as a balance sheet reduction tool, and that the start delay from October to November last year was consistent with the core principle of avoiding selling into stressed market conditions (next year's QT target will be reviewed this summer). Although the BoE's steady-state balance sheet size and composition remained yet to be determined, it would be informed by banks' assessed need for BoE reserves and liquidity regulations. The BoE stressed that while monetary policy always considers financial conditions, a shock that threatens financial stability would not impede monetary policy action. Well-designed tools, such as central bank purchases with reserve pricing as used for the financial stability intervention during the LDI crisis, can effectively contain risks and mitigate market dysfunction.

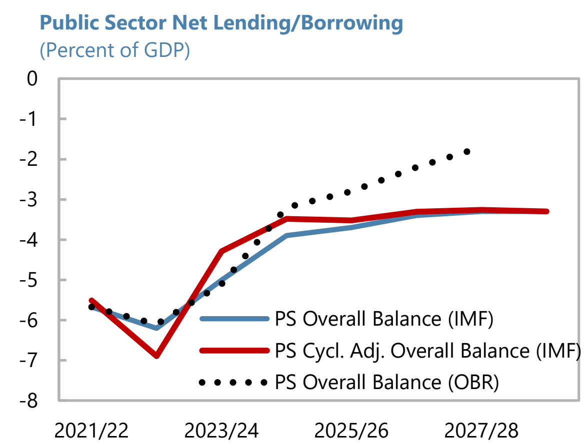
B. Implementing Fiscal Consolidation while Accommodating Key Spending Needs

18. The Autumn and Spring budgets have aligned fiscal policy with monetary policy in the fight against inflation and set out a consolidation path that should stabilize debt over the medium term. The 2023 Spring budget affirmed the gradual fiscal consolidation announced in the 2022 Autumn Statement, with windfalls mostly spent on supply side measures.[11] Although the Spring budget relaxed the 2023 fiscal stance by about 0.5 ppts. of GDP, it still implied a close-to-neutral stance for 2023 and maintained a contractionary stance thereafter. Notwithstanding the availability of some fiscal space, staff assesses this fiscal stance to be broadly appropriate as it keeps

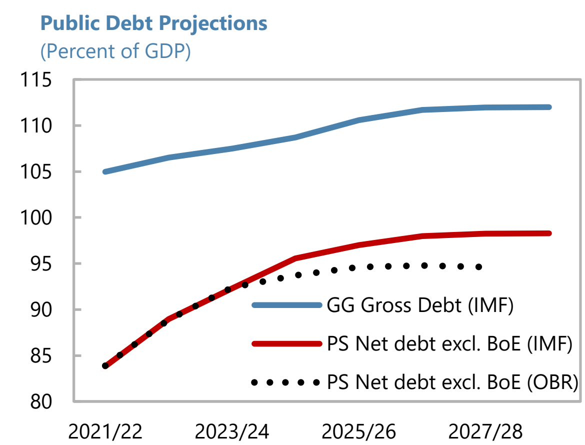
[11] For details on the main measures included in the 2022 Autumn Statement and the 2023 Spring Budget, see Annex IV.

fiscal policy aligned with monetary policy in the fight against inflation.[12] The composition and phasing of the planned medium-term consolidation, with revenue and expenditures contributing equally, but expenditure reductions (which come with larger multipliers) backloaded, could also help soften the impact on growth while reducing fiscal imbalances.

19. At the same time, the risk of sovereign stress has risen since the last Article IV. Under staff's macroeconomic forecast and conditioning assumptions, public sector net borrowing is projected to decline from 6.2 percent of GDP in FY2022/23 to 3.2 percent of GDP in FY2027/28 and public sector net debt (excl. BoE) to rise from 89 to 97 percent of GDP, where it would stabilize. General government gross debt should also stabilize in 2028 at 110 percent of GDP, third lowest among G7 economies. Notwithstanding this consolidation, the risk of medium-term sovereign stress is now assessed as moderate, rather than low as in the 2021 Article IV (Annex V), reflecting the impact of the energy price shock and the policy response to mitigate its impact on households and firms. However, there are several mitigating factors, including: a very long maturity of general government debt (of about 14 years on average) that lowers 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.



Sources: IMF staff calculations.



Sources: IMF Staff calculations.

20. Accordingly, staff recommends that any near-term fiscal overperformance be saved to avoid complicating the task for monetary policy and to rebuild fiscal buffers. Given the upgrade to 2023 growth relative to the assumptions underpinning the Spring budget, a small cyclical fiscal overperformance is likely to emerge by the time of the Autumn budget. Because this would likely reflect more resilient demand and inflation persistence, it would be appropriate to save the entirety of this overperformance to avoid adding to inflationary pressures and to rebuild fiscal

[12] The fiscal impulse is calculated in two steps. First, the fiscal stance is obtained from the change in the cyclically adjusted primary balance, and then by applying multipliers to the fiscal stance every year, we obtain the fiscal impulse over the forecast period.

buffers which have been eroded after the pandemic and energy price shocks. Moreover, there is a strong case for saving all non-cyclical revenue windfalls as well. For 2024, it would be important that targets are strictly adhered to and further loosening is eschewed. In this context, given the recent easing in energy prices, it would be important to ensure that the EPG scheme expires as planned, and that any future support—in the event of resurgent energy prices—is well-targeted. To this end, investing now in data and IT systems—which have been key impediments to better targeting—could help the authorities reach vulnerable households outside the welfare system in the future.

21. There are fiscal risks around the authorities' medium-term forecast. First, supply-side policies could take time to raise growth, and the impact might not be as large as envisaged. For instance, full rollout of the new childcare provisions, and thus its impact on labor force participation, will depend on overcoming capacity constraints in the childcare sector. Second, while the new three-year capital allowance regime is likely to be (and appropriately so) made permanent to provide more certainty to businesses, it is costed as temporary, and its revenue generating profile could be thinner over a longer period of time. Third, despite a stated intention to increase the fuel duty with inflation each year, successive chancellors, since 2011, have eschewed it, implying a potential gap in revenue going forward.[13] In addition, the green transition may lead to a decline in public revenues from existing emissions-related taxes (especially fuel duty), unless the government compensates them by raising other climate-friendly revenues. Finally, higher inflation and interest rates could imply higher debt service and bigger transfers to the BoE to cover losses arising from higher remuneration of BoE reserves and capital losses on QT.

22. The medium-term fiscal plan should better incorporate spending needs to protect key public services and enhance potential growth. The Spring budget maintains largely unchanged departments' nominal expenditure plans from the 2021 spending review, effectively lowering real expenditure until 2025, and grows them at a modest 1 percent in real terms thereafter, with the public investment/GDP ratio falling. But without measures to back these announced spending cuts, the latter raise questions about realism and consistency with maintaining adequate service delivery. For example, the authorities will have to accommodate pay agreements in the context of ongoing industrial action (amid the biggest public sector strikes in a decade). Solving well-known problems in the NHS and the social care system are also likely to require additional funding, with some experts' estimates ranging between at least 0.5 and 1 percent of GDP annually. Moreover, for public investment to approach the OECD average, as envisaged in the last spending review, investment in skills, innovation, and infrastructure would have to increase by 0.8 percent of GDP. Finally, additional public investment needed to meet the Net Zero targets by 2050 has been estimated by the Climate Change Committee to be around 0.7 percent of GDP per year.[14]

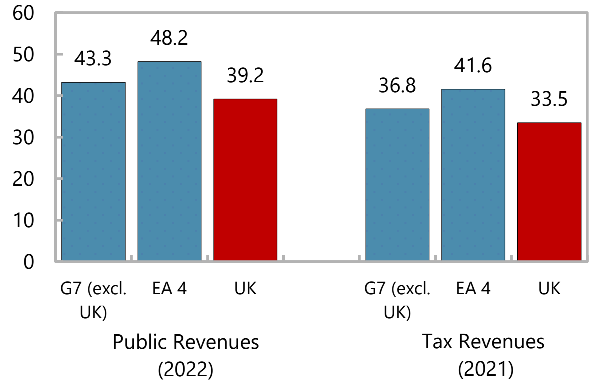
[13] Staff's macroeconomic and fiscal forecasts already seek to account for these three risks.

[14] Staff has incorporated some of the needs above in its baseline (as noted earlier in the conditioning assumptions), consistent with aspirations and indications set out in official speeches and pronouncements. However, the needs are sizable and are likely to significantly exceed the amount assumed by staff.

23. In light of these fiscal risks and spending needs, staff suggests additional high-quality revenue and expenditure measures to more assuredly deliver debt stabilization over the medium term (Annex IV):

- **Revenue measures.** The UK's public revenues and tax-to-GDP ratios are still more than 3 percentage points below the G7 average and more than 8 points below the four largest euro area economies. Given this, there is scope to mobilize additional revenues in a manner that improves the efficiency of the tax system, is progressive, and greens the economy. First, additional revenue can be raised by closing well-documented income, capital gains, and social security tax loopholes. Second, existing pockets of tax-related inequality could be addressed by reforming inheritance and property taxation. Third, moving toward a comprehensive, predictable, uniform, and higher carbon price (including by more rapidly extending the UK's Emissions Trading System) could more assuredly deliver the authorities' ambitious Net Zero targets.

Public Revenues and Taxes
(Percent of GDP)



Sources: IMF (2022) and OECD (2021).

- **Expenditure measures.** Reforming the state pension, which according to the OBR accounts for 42 percent of the total welfare bill, can also yield savings. While increasing state pensions with inflation is best practice and should be maintained, the wage and floor components of the 'triple lock' are excessively generous and should be eliminated. Ending the triple lock or increasing the state pension retirement age from 67 to 68 earlier than planned could cumulatively generate significant savings.

24. The fiscal framework could be further strengthened, leveraging the lessons from the 'mini-budget' episode and the UK's strong fiscal institutions. As noted in Annex VI, there is scope to enhance the stability and flexibility of the UK's fiscal rules which have been changed multiple times in the past two decades, and, at the same time, have constrained optimal fiscal policy. In this context, staff recommends that the authorities: (i) strengthen the role of the OBR by requiring it to produce a forecast to accompany all major discretionary fiscal policy changes; and provide an early analysis of the impact of any changes in rules before these are voted upon in parliament (as recommended in the last Art. IV consultation, see Annex VII); (ii) better define escape clauses to the current rules (with clear conditions under which the rules could be suspended and reactivated); and (iii) consider, building on the UK's strong fiscal institutions, adopting a framework anchored in the probability of debt stabilization (and possibly nested in higher-level "fiscal standards") that has the potential to be stabler, and would provide somewhat greater flexibility, while maintaining fiscal discipline.[15]

25. ***Authorities' Views.*** The authorities affirmed their commitment to keep fiscal policy aligned with monetary policy in the fight against inflation. The authorities agreed with the principle of targeting of any future energy support and noted that there is ongoing work to consider the form that such consumer protection should take from April 2024. The independent OBR forecast shows the authorities are delivering a declining debt-to-GDP ratio by FY2027/28 and the deficit firmly landing below the 3 percent of GDP ceiling set in the fiscal rules. With regard to pressures on public services, they felt the additional funding approved for the NHS, social care and schools was sufficient to address immediate challenges. In terms of public investment, the authorities expect to reassess future needs at the time of the next Spending Review, due by end of FY2024/25. Regarding the fiscal framework, the authorities noted its strength and underscored the important role of the OBR. However, they did not favor substituting numerical fiscal rules with fiscal standards, which they felt would be complicated to interpret and could lead to a loss in fiscal discipline. They did, however, see merit in exploring the role that the probability of debt stabilization could play in any future review of fiscal rules. The authorities concurred with staff's assessment of sovereign risks and underlying assumptions; and agreed that some scenarios considered in staff's analysis could generate pressures but noted that they were monitoring risks closely.

C. Financial Sector Policies to Enhance Resilience

26. The UK financial sector appears resilient to potential substantial macrofinancial shocks, but continued vigilance is needed, especially in the non-bank sector. Macroprudential policies are appropriately calibrated for now. Still, the authorities should remain watchful of credit conditions (for any unwarranted tightening) and (excessive buildup) of financial stability risks, especially in the real estate sector, and adjust macroprudential policy settings as needed. Bank capital and liquidity buffers are above prudential requirements, but strong regulation and supervision needs to continue for all banks, large and small. As stressed by the 2022 Financial Sector Assessment Program (FSAP), there is greater uncertainty in the NBFI segment, where data gaps hinder a comprehensive risk assessment. Therefore, staff supports the authorities' continued efforts, including with relevant foreign authorities, to enhance the monitoring and resilience of NBFIs.

Calibrating Macroprudential Policies to Preserve Financial Stability

27. The authorities have kept the CCyB level in line with standard risk settings. The CCyB rate rose from 0 to 1 percent in December 2022 and is set to rise to 2 percent in July 2023, following the Financial Policy Committee's (FPC) July 2022 decision. During its March meeting, the FPC maintained the CCyB at 2 percent, which it considers the neutral risk setting, while affirming that financial vulnerabilities remain. At 2 percent, the CCyB will not be binding for major UK banks,

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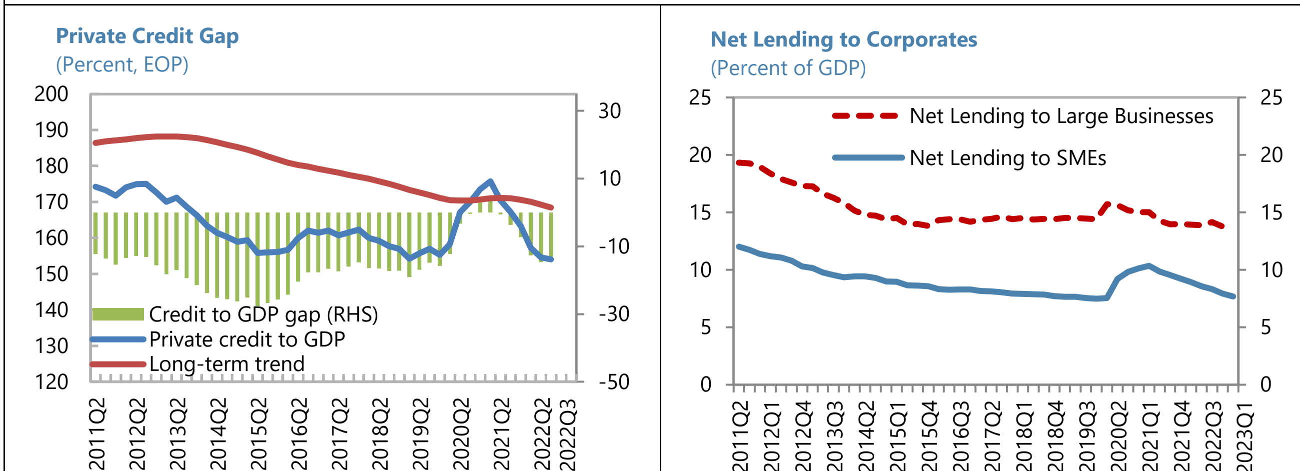
[15] It is also helpful to reiterate here that whether under numerical rules or within a fiscal standards framework, the underlying debt path needs to be underpinned by concrete and credible fiscal measures.

as their aggregate common equity tier 1 (CET1) ratio stands at 14.6 percent in 2023Q1, 3.6 ppts. above the 2 percent CCyB-inclusive 11 percent average minimum requirement at which dividend distribution restrictions are triggered. Accordingly, the FPC judged that UK banks would be able to absorb shocks and continue to support economic activity under a wide range of adverse scenarios. The FPC also maintained its only active borrower-based measure, a 15 percent limit on new mortgage lending with a loan-to-income (LTI) ratio at or higher than 4.5. The FPC continued to view it as an effective structural, not cyclical, measure to limit the build-up of mortgage vulnerabilities.

28. The calibration of macroprudential policies is finely balanced. A credit downturn—reflected in a decline in bank lending to firms (notably SMEs) and households (notably mortgages), and in market financing—is showing some signs of bottoming out, while house prices continue to fall since September 2022. At the same time, macrofinancial risks have emerged in the mortgage market (with a large share of household mortgages being repriced this year), commercial real estate (with the pandemic hit being reinforced by the ongoing economic slowdown), and heightened susceptibility of firms (especially SMEs) to rising interest rates and disruptions in market finance (see Annex VIII). Against this backdrop:

- Staff supports keeping the CCyB at 2 percent for now but encourages continued close monitoring of credit conditions and financial stability risks to calibrate the buffer going forward.
- Should annual cyclical scenario (ACS) stress test results indicate that major banks could face larger than expected losses, a further increase of CCyB may be needed, provided that it does not unduly dampen credit growth and economic activity.
- However, if financial conditions tighten more substantially, the authorities could consider releasing the CCyB to possibly help avoid exacerbating an undue tightening in credit.

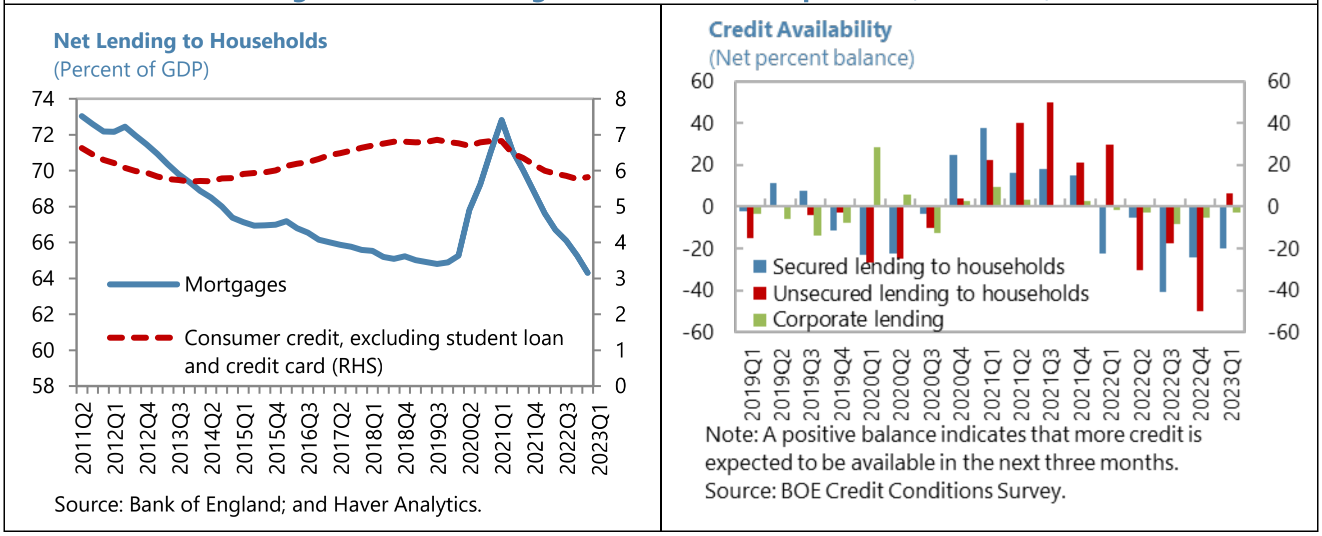
Figure 6. United Kingdom: Credit Developments



Source: Bank of England.

Source: Bank of England; and Haver Analytics.

Figure 6. United Kingdom: Credit Developments (concluded)



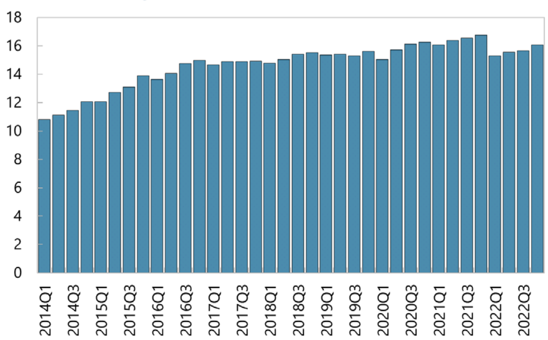
29. The authorities are on track to implement most of the key 2022 FSAP recommendations but are facing challenges in closing NBFI data gaps (see Annex IX). They have been working towards better understanding and monitoring system-wide risks in various sectors and their interconnections. The BoE is developing a top-down modeling toolkit to enable more timely assessments of new risks and the spillover of stress to major banks. The BoE has launched a "system-wide exploratory scenario" (SWES) to better understand NBFIs' behavior and its implications during stress and is developing in-house models to support this exercise. Building on the LDI crisis experience, where the BoE was able to provide backstops for the functioning of gilt markets, the authorities are developing a repo tool for NBFIs. The Financial Conduct Authority (FCA), BoE, and HMT are participating in multiple international workstreams on common approaches to closing information and data gaps in NBFI activities. However, progress has been limited, largely due to differences in supervisory and regulatory approaches across different jurisdictions. Still, the authorities are collecting data on sterling asset holdings to support their SWES exercise.

30. *Authorities' Views.* FPC members considered the current macroprudential settings as appropriate, and that the FPC was closely monitoring credit risks and conditions. An increase in the CCyB rate could be needed if vulnerabilities that could amplify future economic shocks were to increase to elevated levels, while a lower CCyB rate could be considered if conditions were to deteriorate by significantly more than expected, in a manner that might otherwise lead banks to restrict lending to defend their capital ratios. While a wide range of macroprudential measures are potentially available within the FPC's toolkit, the tools that are currently active (the CCyB and the LTI flow limit) are seen as sufficient. Moreover, FPC powers of recommendation remain an effective tool, as demonstrated by the recent recommendations to enhance the resilience of pension funds' LDI strategies.

Preserving Healthy Capital and Liquidity Buffers Across all UK Banks

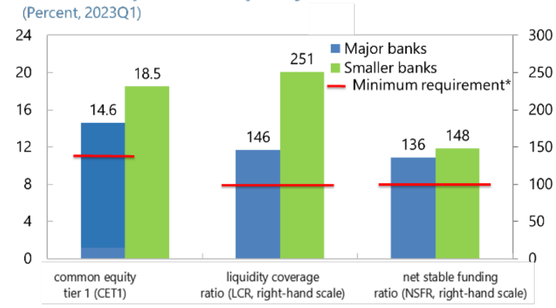
31. UK banks remain healthy, but recent bank failures in the US underscore the importance of continued strong regulation and supervision of all banks. UK banks maintain capital and liquidity buffers that are well above prudential requirements. UK global systemically important banks (G-SIBs) have strong capital and liquidity positions compared with other G-SIBs in the EU and US. BoE's stress tests have confirmed the resilience of the banking system to a wide range of severe economic outcomes, including in a period of higher interest rates. In addition, the Pillar 2A capital requirement, which applies to all banks, includes an explicit capital charge on interest rate risks in the banking book. The authorities are currently considering proposals for a new Strong and Simple Framework, under which the PRA could seek to simplify the prudential framework for non-systemic domestic banks and building societies, while maintaining their resilience (see Annex X). Staff reiterates that—as recommended in the FSAP—the PRA should carefully weigh the pros and cons of amending supervisory requirements for smaller banks. A series of failures of smaller banks could prove systemic, and even an isolated failure could dent the PRA's reputation.

Aggregate CET1 Ratio
(Percent of risk-weighted assets)



Source: Bank of England.

UK Bank Capital and Liquidity Ratios
(Percent, 2023Q1)



Note: The major banks are Barclays, HSBC, Lloyds Banking Group, Nationwide, NatWest, Santander UK, Standard Chartered, and Virgin Money. *For CET1 ratio, this is the minimum requirements and buffers level at which distribution restrictions are triggered. This is only available on an aggregate basis for major UK banks and assumes a 2 percent UK CCyB rate and current CCyB rates in relevant jurisdictions. Source: Bank of England.

32. The authorities should gather data on the behavior of UK depositors to inform future policy work. A new feature of recent banking stress is that deposit runs happened much faster than the 30-day period on which the prudential liquidity coverage ratio (LCR) is calibrated, reflecting the impact of electronic banking as well as the use of social media as a news-transmission vehicle. Staff encourages the authorities to deepen their understanding of depositor behavior via expanded data collection and analysis to inform future international policy deliberations on the LCR, as well as potential adjustments to domestic stress testing with a view to re-evaluate liquidity risk assessments. Moreover, staff supports clearer regulatory guidance on tolerable LCR declines and the timeframe to rebuild high-quality liquid assets (HQLA) during market-wide stress, ideally coordinated internationally. The BoE's ongoing discussion on this issue is welcome.

33. *Authorities' Views.* FPC members reiterated that the UK banking system is well-regulated and subject to robust prudential supervision. The PRA's supervisory work on UK banks, including small banks, was intended to ensure they held sufficient capital and liquidity to withstand severe but plausible stresses, including a significant rise in interest rates. Regarding the Strong and Simple regime being developed, the PRA assured on delivering the "strong" aspect of the regime, the importance of which was emphasized by the recent US global banking stress in smaller banks. The BoE agreed that the rapid deposit runs seen in recent global banking stress called for further policy work on liquidity regulation at the international level and showed the importance of robust supervision of banks' liquidity positions, including the ability to undertake intensified liquidity monitoring. The BoE will conduct analyses on depositor behavior to support international work and inform domestic liquidity risk assessments. Moreover, the BoE has extensively analyzed banks' reluctance to draw on HQLA during market stress and will draw on that knowledge in future policy work and in managing stress situations, both domestically and in contributions to international discussions.

Enhancing Resilience of the Non-Bank Financial Institution (NBFI) Sector

34. The BoE's financial stability intervention during the LDI crisis helped restore orderly market conditions, and the authorities have taken further actions to strengthen the sector's resilience.[16] Several factors contributed to the success of the intervention, notably, timely market intelligence; close coordination among key stakeholders, including overseas regulators; the use of reserve pricing for gilt purchases, which helped distinguish the operation from quantitative easing (QE); and firm public communication on the temporary/targeted nature of the intervention, which reinforced the needed swift actions from pension funds to recapitalize their LDI strategies, and curtailed moral hazard. Following this episode, the FPC recommended that the Pensions Regulator (TPR), in coordination with the FCA and overseas regulators, ensure that pension trustees can only invest in LDI funds that hold liquidity buffers that can withstand at least 250 bps rise in bond yields, substantially higher than the 140 bps increase during the LDI crisis. The FPC also recommended that TPR's remit take into account financial stability considerations. The FCA and TPR recently set out further guidance on enhancing resilience in LDI funds, including realistic contingency planning, applying appropriately designed stress tests, and ensuring clients can deliver collateral within five days.

35. Staff supports the above measures, and advises additional actions to identify and tackle vulnerabilities in the wider NBFI sector:

- **Strengthening NBFIs' liquidity regulation and management.** Leverage, liquidity mismatches, and concentrated positions were at the core of the LDI crisis, as well as other NBFI-related market stress episodes (such as the 2020 "dash for cash"). Thus, enhancing liquidity regulation of NBFIs holding leveraged exposures in core markets, ensuring preparedness in the face of margin calls, and work with the Financial Stability Board (FSB) to strengthen the resilience of the open-ended fund sector are priority areas.[17] Vulnerabilities in the money market fund (MMF) and hedge fund sectors bear close monitoring; the forthcoming BoE/FCA consultation on resilience-enhancing measures for MMFs is timely.[18] Staff also welcomes the authorities' efforts to secure enhanced cooperation from other major jurisdictions to strengthen NBFI liquidity regulation in coordination with the FSB, given the high degree of interconnectedness and cross-border activities undertaken by NBFIs.

[16] See the accompanying selected issues paper on the lessons from the LDI crisis as well as staff's forthcoming working paper, "Putting Out the *NBFi*re: Lessons from the UK's Liability Driven Investment Crisis" for a more detailed discussion of the LDI crisis and lessons therefrom.

[17] The BoE is developing specific policy proposals this year to address vulnerabilities arising from pro-cyclicality in margin models, as well as insufficient predictability, transparency, and preparedness to meet margin calls.

[18] Such measures could include reducing MMFs' liquidity transformation; mechanisms to ensure that the cost of redemption falls on redeeming investors; eliminating the cliff effect of liquid-asset thresholds; and policies to absorb losses.

- **Better understanding risks posed by NBFIs, including AML/CFT risks.** Staff supports the authorities' SWES for NBFIs—the first of its kind in the world for its wide reach—results of which will be available by mid-2024. The focus will be on both key entities (banks and NBFIs, including those domiciled abroad) and core markets. This exercise, which is voluntary, but intended to cover most NBFIs important in UK financial markets and their links to banks, should help identify and possibly quantify the various risks, including hidden leverage, and channels of systemic risk propagation. The exercise should also help close some NBFI data gaps. Separately, as stressed by the FSAP, effective and risk-based AML/CFT supervision remains important, given the UK's position as an international financial center.

- **Strengthening liquidity backstops for systemically important NBFIs.** As recommended by the FSAP, allowing appropriately regulated and systemically interconnected NBFIs access to at least some of the BoE's liquidity facilities would widen the policy options to counteract future market-wide stresses. The design of such backstops should ensure that lending remains at BoE's discretion, after other liquidity support options have been exhausted, only to solvent firms at a penal rate, fully collateralized and with more intrusive supervisory oversight. Moreover, conditions could be imposed on the NBFI borrower, including that the measures taken should have a clear timeline to reestablish the NBFI's liquidity.[19]

36. ***Authorities' Views.*** The authorities highlighted that there remained vulnerabilities in the NBFI sector, which could crystalize in the event of greater market volatility or tighter financing conditions. As such, the authorities underlined the urgent need to develop and adopt policy reforms to increase resilience across the NBFI sector, ideally through internationally coordinated reforms led by the FSB. In this context, the BoE, the FCA and HM Treasury have been closely involved in international work programs on increasing the resilience of MMFs and OEFs, improving margin practices, and understanding drivers of illiquidity (such as NBFI leverage) in core funding markets. Alongside this international work, the BoE continues to work to reduce NBFI vulnerabilities domestically where it is effective and practical (including, for example, the FPC's recent recommendations on LDI resilience). In this context, the BoE considers its SWES exercise focused on NBFI risks and their interconnections with banks and core markets to be an important pioneering initiative.

Further Strengthening the Bank Resolution Regime to Minimize Potential Disruptions

37. Post-GFC reforms on banking resolution have proven helpful, but there may be opportunities to strengthen the resolution regime further. The Banking Act 2009 empowers the BoE to submit a failing bank to insolvency procedures or to partially or fully transfer it to a private party. In SVB UK's case, a full sale was made to HSBC Bank UK plc, which protected all depositors without use of public funds (see Annex XI). Still, the experience highlighted that the current 7-day period to pay insured depositors could be disruptive for business customers that have placed a large share of their cash with a single bank. Another issue is some smaller banks' inability to issue loss-absorbing capital such as Additional Tier (AT) 1 or 2 bonds which could mean significant losses for

[19] See Global Financial Stability Review, April 2023, Chapter 2 for more detail.

uninsured depositors in a resolution; this could render smaller banks more susceptible to a run ex-ante, and the system more vulnerable ex-post. In this context, staff supports the authorities' consideration of options to improve depositor outcomes in case of bank failure; and notes that broader reforms may also be broached in this context. Work in this area should be supported by careful analysis of depositor data. Moreover, as recommended in the FSAP, the Financial Services Compensation Scheme (FSCS) should build up a prefunded deposit insurance fund with an appropriate target level, to expand its financial firepower with sufficient funds under its direct control and investment.[20]

38. ***Authorities' Views.*** The BoE agreed that the rapid deposit runs seen in recent global banking stress and the experience with the resolution of SVB UK called for further work on resolution arrangements, both domestically and internationally. One area of focus (that was already identified before the failure of SVB UK) is to improve depositor outcomes in the event of a bank or building society insolvency. The UK authorities have identified three initial reform areas to support more timely payout of eligible deposits: (i) an online portal to enable depositors to provide alternative account details so that the FSCS can make electronic transfers, (ii) improved continuity of bank services through potentially utilizing the existing infrastructure for transferring of information on, and redirection of, payments to a new bank; and (iii) better operational support and capacity at receiving banks.

Securing Regulatory Safeguards for Financial Stability and Integrity

39. Regulatory reforms for the financial sector should preserve the primacy of financial stability, prudential safety, and soundness objectives. The government's proposals for financial regulatory reforms are ambitious (see Annex XII). While many details on the reforms are still pending, staff stresses that any reforms should: (i) in line with FSAP recommendations safeguard the primacy of the FPC's financial stability objective and strengthen its focus on global financial standards and cross-border surveillance; and (ii) allow for adequate time for consultation and consideration of proposed changes, to produce balanced outcomes on stability vs. innovation, with competition and innovation mandates subordinate to that of financial stability. In this regard, any adjustment to the ring-fencing regime for banks should be carefully weighed[21]; and the review of the Senior Managers and Certification Regime (SMCR) should maintain its robustness.

40. ***Authorities' Views.*** The authorities reiterated their commitment to high financial regulatory standards both domestically and internationally. The PRA and FCA have launched a discussion paper to collect information on the effectiveness, scope, and proportionality of the SMCR, and also seek views on potential improvements and reforms. Separately, the government broadly accepted the conclusions of the independent statutory review of ring-fencing in 2022. In line with the recommendations, the government issued a Call for Evidence on aligning the ring-fencing regime and the resolution regime considering developments in the wider regulatory framework. The

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[20] The FSCS collects levies from the industry on a pay-as-you-go basis, making it in certain cases dependent on HMT loans.

[21] The government currently plans to increase the deposit threshold (to trigger ringfencing requirements) from £25 billion to £35 billion in light of the growth in banking system assets since 2015. They also intend to explore options for aligning the ring-fencing and resolution regimes through a call for evidence. This will inform their decisions on the long-term future of the ring-fencing regime. See the policy paper on ring-fencing reforms.

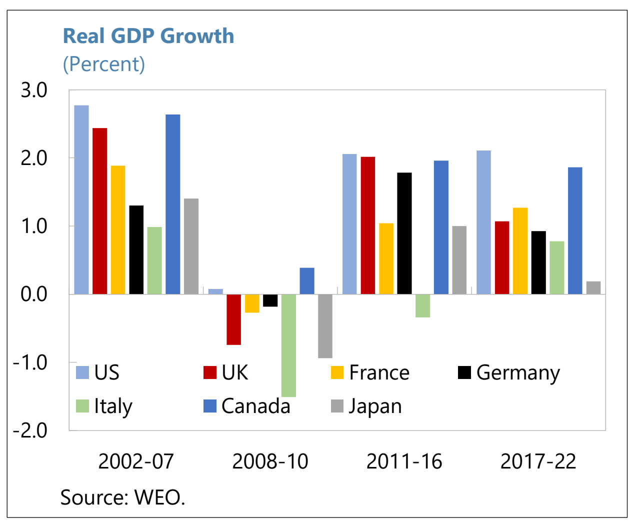
authorities also intend to take forward a package of short-term changes to the ringfencing regime to address some of its unintended consequences whilst maintaining financial stability safeguards.

Transnational Aspects of Corruption

41. Staff supports the authorities' continued efforts to prevent the laundering of foreign proceeds of corruption and the bribery of foreign public officials. The key objectives outlined in the Economic Crime Plan 2 are to safeguard the integrity of the UK financial system, including limiting the abuse of UK corporate structures, increasing the effectiveness of the AML/CFT supervisory regime, and combating criminal use of crypto assets. The authorities are addressing the remaining recommendations of the OECD Working Group to combat bribery of foreign public officials and will submit updates on progress made in June. The UK's financial and institutional resilience in mitigating supply and facilitation of corruption will be strengthened by the publication of a new anti-corruption strategy, effective implementation of its global anti-corruption sanctions regime, and addressing professional enablers of corruption (see Table 8).

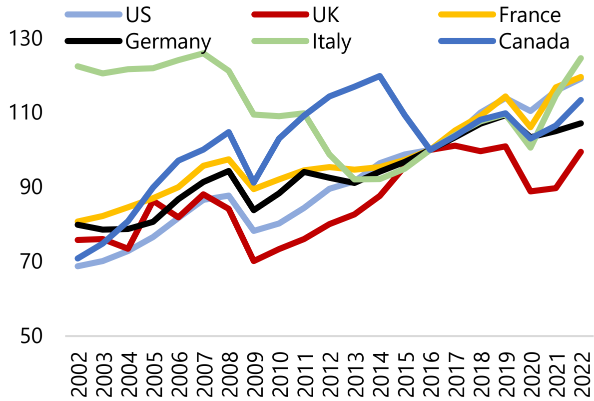
D. Policies to Boost Potential Growth and Advance the Green Transformation

42. The UK's growth performance has been somewhat weak in recent years. The UK had been a strong performer among G7 countries in the years preceding the GFC (thanks to strong capital accumulation) and during the subsequent rebound (due to a sharp increase in working hours). However, this momentum was lost in the middle of the last decade. By 2022, real business investment was still slightly lower than in 2016, in contrast to the 14 percent increase observed among other G7 economies. Labor supply, which has just reached its pre-pandemic level, has also been weaker than peers, which have on average surpassed pre-pandemic levels. Moreover, as in other advanced economies, productivity growth has been anemic since the GFC, reflecting a slower pace of innovation and technological diffusion amid declining business dynamism (especially due to uncertainty in international trade relationship since 2016). This is despite the UK remaining a leader in innovation and ranking high in economic complexity.[22]



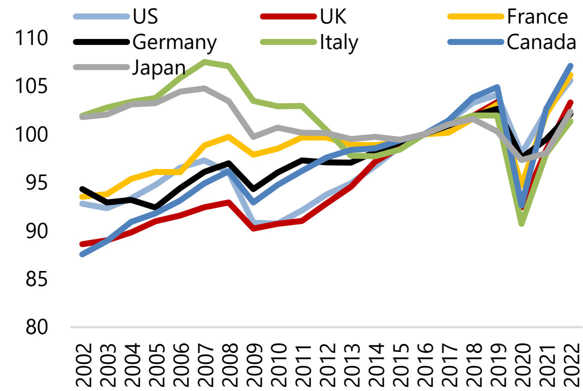
[22] As of 2020, the UK ranks 4th in terms of innovation performance and 10th in terms of accumulation of productive knowledge.

Real Business Investment
(2016=100)



Sources: ONS; and WEO.

Total Annual Hours Worked
(2016=100)



Source: The Conference Board.

43. The authorities are alert to these challenges and are taking important measures to boost potential growth. The childcare support and capital investment allowance measures introduced in the Spring budget may enhance labor participation and business investment, respectively, over the medium term. The "Windsor Framework" agreement with the EU and the more measured approach to reviewing retained EU laws have reduced Brexit-related uncertainty. The Chancellor's 4Es strategy appropriately targets high-productivity growth areas, such as advanced manufacturing, life sciences, and clean energy (Annex XIII). Finally, the government's 'returnships' program, and—to a lesser extent—pension tax reliefs should help keep older workers in the workforce, while the measures in the education sector (extending early childcare, making math compulsory until age 18) should strengthen educational attainment and labor productivity.

44. To give momentum to these efforts, further ambitious, evidence-based reforms are needed to lift business investment, labor supply, and productivity.

- **Bolstering business investment.** Staff's analysis suggests that Brexit-related uncertainty has had a significant negative effect on investment spending, corroborating other research.[23] Outlining a permanent set of incentives for capital, as part of a stable, long-term tax strategy to promote investment, would help bolster investor confidence. Moreover, public infrastructure investment, including through the Net Zero Growth Plan, could crowd-in private investment. Liberalization of the planning system and streamlined approval requirements would also reduce barriers to investment in new industries and accelerate the delivery of critical infrastructures (network and healthcare).

[23] See the accompanying selected issues paper for further analysis on enhancing business investment in the UK. In addition, a recent study by Bloom et al. (2019) also shows that Brexit has brought more persistent and larger, although slower-to-materialize, effects on investment and productivity.

- **Increasing labor supply.** Long-term sickness and, to a lesser extent, early retirement, are the main drivers of the post-pandemic surge in labor inactivity.[24] More significant outlays for the health sector will likely be needed to improve health outcomes and possibly reduce inactivity. Moreover, given high unemployment rates and inactivity among younger cohorts, including due to mental health problems, the authorities should consider additional targeted healthcare interventions for the mentally ill, scaling-up investment in high-quality apprenticeships, and devoting resources to career counseling in schools to help students transition into the labor market. Flexible working schemes and coaching services could also enhance female labor participation, complementing the recently announced expansion in childcare support. Finally, fine-tuning immigration arrangements could ameliorate labor and skills shortages while promoting labor market flexibility.

- **Reviving productivity growth.** Higher investment in the education and training of young adults and promoting upskilling and knowledge development is needed to strengthen human capital and boost productivity. The funding of recurrent and infrastructure needs in healthcare could also improve health outcomes and workforce productivity. With regard to physical capital, the authorities could consider unlocking pension and insurance savings for investment in higher-growth projects, while being mindful of potential financial stability implications. Staff sees potential for increasing R&D support for firms to bring them to international standards, including in the context of a possible rejoining of the EU's Horizon Europe Program.

45. Further actions are needed to secure Net Zero objectives. While the Spring budget did not include any major new costed financial commitments to accelerate the Net zero Strategy, some notable measures included the extension of the Boiler Upgrade Scheme to 2028, timelines for the next stage of the Carbon Capture, Usage and Storage scheme, and support for the development of port infrastructure to deliver floating wind. In response to a High Court ruling, the government later published a set of documents detailing how it intended to meet the Net zero targets. Despite better spelling out how existing and forthcoming plans would be able to curb emissions, quantifiable measures included in those documents only added up to 92 per cent of the emission reductions needed to meet the UK's 2030 Paris Agreement goal, rising to 97 per cent of the emission reductions needed to meet the UK's 6th Carbon Budget, a key milestone on the path to net zero by 2050.[25] Going forward, the authorities should continue with the process of increasing carbon taxation and widen the coverage of the Emission Trading Scheme (ETS) to more sectors (e.g., heat and buildings, road transport, and agriculture). The authorities should also provide more incentives for the green transition (e.g., by expanding the grant program for low-income households' heat pump installations and home insulation) and remove existing supply bottlenecks, including by setting out longer-term plans to attract private investment. Moreover, the US Inflation Reduction Act and the EU's green deal strengthen the motivation for policies that more effectively address

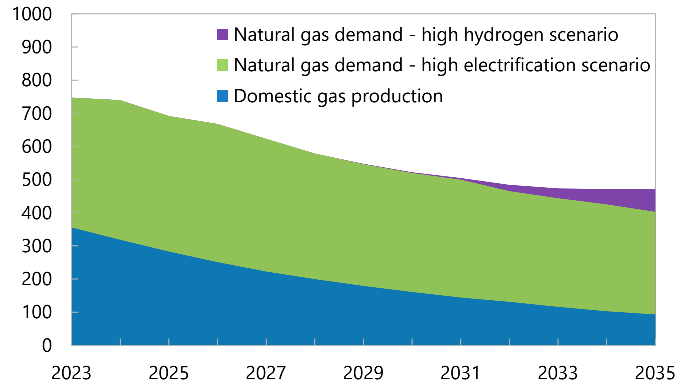
[24] See the accompanying selected issues paper for further analysis of the recent decline in UK labor force participation.

[25] The climate activists that are behind the legal challenge are Friends of the Earth, Client Earth and the Good Law Project. See: https://www.ft.com/content/c70d8e9e-e815-400b-a059-bbb78795f711.

market failures (such as underinvestment in green R&D and energy efficiency), thus helping to maintain the UK's attractiveness as a destination for investors in the climate transition, but in a manner that does not burden public finances.

46. Enhancing gas storage capabilities would help ensure energy security. The UK is a leading liquefied natural gas (LNG) hub, and electricity interconnections with neighboring countries bolster energy security. However, the UK remains vulnerable to a "twin shock" of unforeseen supply shortfalls (e.g., due to disruptions to electricity or pipeline gas inflows, or adverse weather conditions) and tight LNG markets (which would make it difficult to expedite additional gas imports). While measures to raise energy efficiency and increase renewable and nuclear energy generation would help limit this vulnerability, the UK is expected to become more dependent on natural gas imports (with the share of imports rising to over 80 percent of natural gas consumption by 2035 from about half currently) as domestic gas production declines with the depletion of the North Sea basin. Enhancing the UK's natural gas storage capabilities, which are currently among the lowest in Europe, would help enhance energy security.

Indicative Pathways for Gas Supply and Demand
(Twh)



Notes: The scenarios refer to alternative pathways towards achieving Net Zero objectives.
Source: Department for Business, Energy and Industrial Strategy.

Authorities' Views

47. The authorities acknowledged the importance of further ambitious, evidence-based structural reforms to boost investment, productivity, and labor supply. They felt the Chancellor's 4Es strategy, the "Windsor Framework" agreement, and measures announced in the Spring Budget to increase labor supply and business investment will help expand UK potential and provide a strong basis for further measures. They recognized the important challenge facing labor market participation from the recent rise in long-term illness. They emphasized their commitment to facilitating innovation for companies operating in key growth sectors, alongside delivering a competitive business taxation regime to unlock productive capital. On planning restrictions, despite this being a longstanding issue, which has proven challenging to address, the authorities agreed that absent serious reforms, it will inhibit business dynamism. In this context, they noted the package of planning reforms announced for renewable energy as set out in the Energy Security Plan, publication of the action plan for Nationally Significant Infrastructure Projects (which sets out a range of reforms to the process for consenting to major infrastructure projects), and reforms to allow the allocation of additional research space around a major University hub.

48. The authorities explained that the UK's climate policy and targets are underpinned by a strong legal framework, and they see the recent High Court ruling—requesting the government to set out more details on the Net Zero strategy—in that context. The plans that have been spelled out —including in the March 2023 Net Zero Growth Plan and Energy Security Plan—give the authorities confidence that they will fully achieve the Net Zero targets. The authorities agreed with staff's recommendations in relation to the rationale for carbon pricing in new sectors, which is currently subject to consultation, and agreed that investment in the green transition will need to increase in the medium term, but warned about supply constraints as factors limiting the speed of policy adjustments in some areas. On energy security, the authorities emphasized that the UK has a secure and diverse energy system, as confirmed by its resilience during spells of cold weather which coincided with unusually tight energy markets in the winter of 2022–23. The authorities are currently undertaking a cost-benefit analysis regarding the future role of gas storage and other sources of flexibility, and plan to issue an update by the Autumn.

STAFF APPRAISAL

49. The UK's near-term growth outlook is subdued while inflation remains elevated. With higher-than-expected resilience in both demand and supply, growth is expected to remain positive but subdued in 2023 and 2024 as tighter monetary policy and financial conditions weigh on demand. Activity should be stronger in 2025–26, as the output gap closes, before converging to trend. Declining energy prices and tight fiscal and monetary policies should lower inflation to target by mid-2025. However, there are significant upside risks to inflation, reflecting the possibility that persistence in wage- and price-setting may turn out to be greater than in baseline projections. Tighter-than-expected global financial conditions present the key downside risk to growth. The 2022 external position was broadly in line with fundamentals and desirable policies.

50. Monetary policy will need to be tightened further to keep inflation expectations well-anchored and bring inflation back to target. Given still-robust inflation momentum and signs of persistence, further monetary tightening will be needed, and rates may have to remain high for longer to bring down inflation more assuredly. This said, elevated uncertainty about inflation persistence and the macroeconomic outlook merits continuous review of the pace and magnitude of monetary tightening. The BoE should continue to focus on underlying measures of inflation—such as wage growth and services inflation—and see through base effects in headline inflation. The QT strategy should continue as envisaged. As the medium-term target range for the BoE's balance sheet hinges on system-wide reserve needs, which remain uncertain, the BoE's incremental approach to shrinking its balance sheet while relying on Bank Rate as the key monetary policy instrument is appropriate.

51. Fiscal policy should continue to support monetary policy in the fight against inflation in the near term, and address critical spending needs over the medium term. With a close-to-neutral stance for 2023 and contractionary stance thereafter, staff assesses the authorities' planned consolidation to be broadly appropriate as it keeps fiscal policy aligned with monetary policy in the fight against inflation. In the near term, the authorities should save any fiscal overperformance (including non-cyclical revenue windfalls), which will also help rebuild fiscal buffers after successive shocks. And it will be crucial to adhere to targets and avoid any further loosening in 2024 and beyond. In this context, it is also important that existing energy support programs expire as planned, and that any future support—in the event of resurgent energy prices—is well-targeted. Over the medium term, the government needs to allocate significant additional resources to ensure high-quality public services, especially health and social care, and undertake public investments in skills, innovation, infrastructure, and the green transition to boost economic potential. Accommodating these needs within the authorities' announced debt path will require additional measures, notably pension reforms, and strengthening of carbon, property, and wealth taxation, as well as closing tax loopholes.

52. **Enhancing the fiscal framework could bring greater stability as well as flexibility, while preserving discipline.** The OBR should be requested to produce a forecast at every major discretionary fiscal event and mandated to provide an analysis of the impact of any proposed changes to fiscal rules. Well-defined escape clauses can also reduce the need to repeatedly change fiscal rules. Looking ahead, the authorities could also leverage their strong institutions to adopt a framework anchored in the probability of debt stabilization that can better account for uncertainty and reduce the need for frequent changes to point-based rules.

53. **The financial sector appears resilient to shocks, but continued vigilance to financial stability risks and strong oversight of banks and NBFIs is warranted.** Household and corporate balance sheets have been resilient thus far, but the authorities should remain alert to financial stability risks arising from the corporate and real estate sectors. The UK banking system appears healthy, but the speed of deposit outflows in recent bank stress episodes warrants continued close monitoring of liquidity positions of all banks, large and small, and an in-depth study of depositor behavior to support policy work on the LCR both internationally and domestically. At the same time, efforts to better understand and reduce NBFI vulnerabilities (including risks related to money laundering), including globally, should continue, with policy actions focusing on closing data gaps, strengthening NBFI liquidity, and considering allowing the extension of BoE liquidity backstops to systemically important and adequately supervised NBFIs.

54. **Bank resolution frameworks could be further strengthened, and ongoing financial regulatory reforms should preserve the primacy of financial stability.** As part of the options to improve depositor outcomes in case of bank failure, the FSCS could build up a prefunded deposit insurance fund. Also, in-train financial regulatory reforms should preserve the primacy of financial stability, safety and soundness, and market integrity objectives (including addressing transnational drivers of corruption and illicit finance). The authorities should give adequate time for careful consideration of any proposed modifications to existing rules, especially in relation to ring-fencing and the SMCR.

55. **Further ambitious, evidence-based reforms are needed to address the UK's long-term challenges of weak labor supply, investment, and productivity growth.** The Chancellor's 4Es strategy, the Spring budget's childcare support and capital investment allowance measures, and reduced post-Brexit uncertainty should raise medium-term growth. These efforts should be complemented by further measures to improve skills and education outcomes, alongside better health and social care, permanent and wider capital investment allowances, easing planning

restrictions, and accelerating catalytic public investments for the green transition and the delivery of critical network and healthcare infrastructures. The authorities could also consider fine-tuning the immigration system to alleviate labor and skill shortages and promote labor market flexibility.

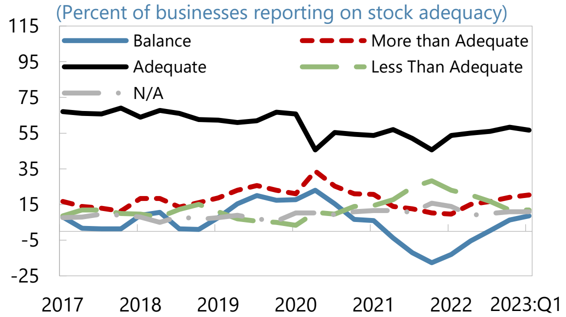
56. The green transition should be expedited to meet Net Zero objectives and enhance energy security. There is scope for more ambitious and consistent carbon pricing, including by more rapidly extending the UK's ETS and legally clarifying the phase-in of regulations. It would also be desirable to provide more incentives for the green transition and remove existing bottlenecks, including by setting out longer-term plans to attract private investment. The transition to a greener energy mix also offers opportunities to lower energy input costs and increase energy security.

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

Figure 7. United Kingdom: Output and Supply-Side Developments

Supply chain disruptions have abated…

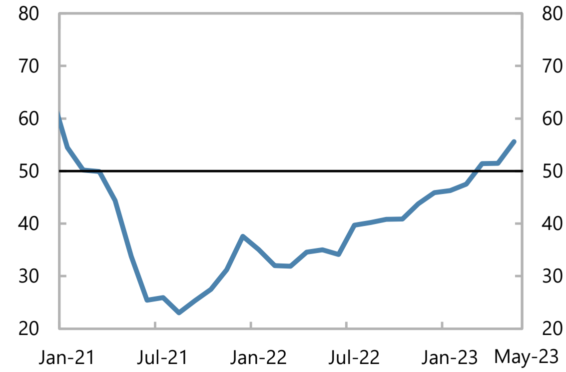
CBI Industrial Trends Survey: Stocks of Finished Goods
(Percent of businesses reporting on stock adequacy)



Note: Balance refers to % of businesses reporting "more than adequate" net of % of businesses reporting "less than adequate."
Sources: CBI and Haver Analytics.

…and labor shortages are gradually unwinding…

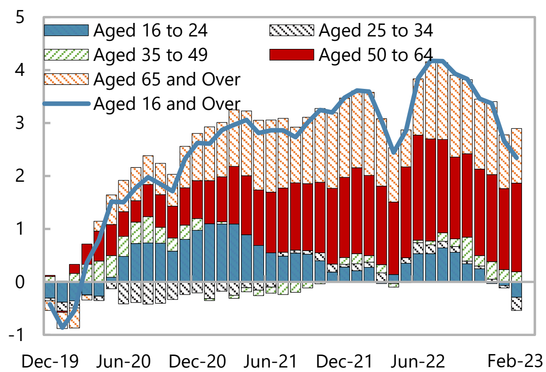
Overall Staff Availability
(Seasonally adjusted, 50+ = increase)



Sources: S&P Global.

…despite still high inactivity rates among older workers…

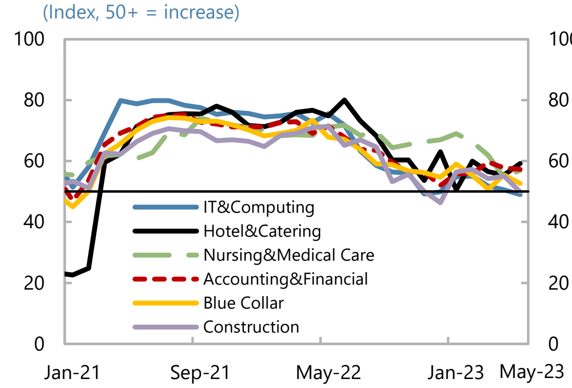
Economic Inactivity Decomposition by Age Group
(Percent change relative to 2019Q4 Average)



Sources: ONS; and Haver Analytics.

…as demand for labor moderates.

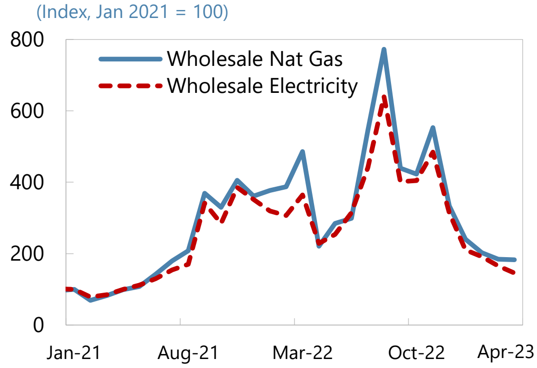
Permanent Staff Placements by Sector
(Index, 50+ = increase)



Sources: S&P Global.

Energy input costs have come down after surging due to Russia's war in Ukraine…

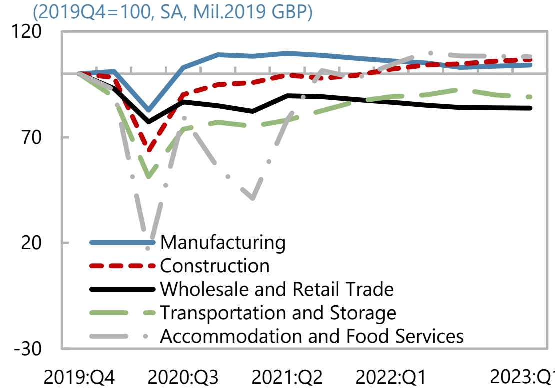
UK Wholesale Natural Gas and Electricity Prices
(Index, Jan 2021 = 100)



Source: Bloomberg Finance L.P.

…but the recovery of transportation and distributive sectors remains incomplete.

Gross Value Added By Sector
(2019Q4=100, SA, Mil.2019 GBP)

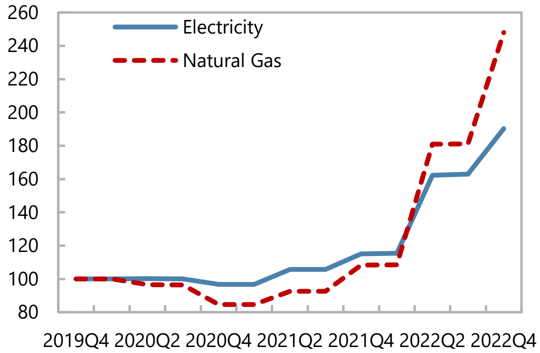


Sources: ONS; and Haver Analytics.

Figure 8. United Kingdom: Demand Outlook

As rising energy bills weighed on household balance sheets…

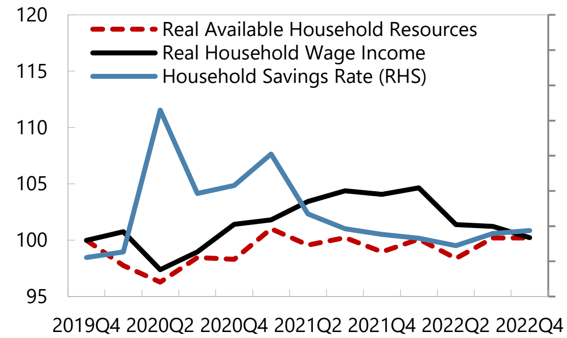
Retail Natural Gas and Electricity Prices
(Index, 2019 Q4 = 100)



Sources: International Energy Agency.

…government transfers and pandemic-era savings provided a buffer…

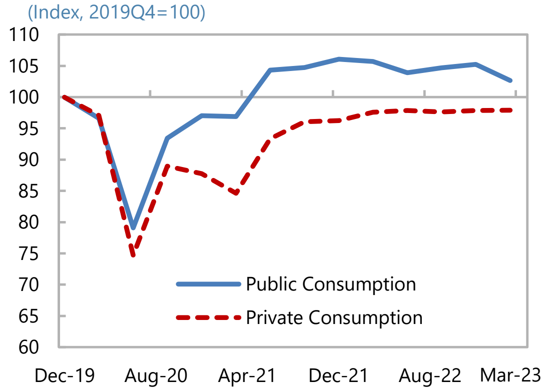
Household Income, Balance Sheet and Savings Rate
(LHS: Index, 2019Q4 = 100, RHS: Percent)



Sources: ONS; and IMF Staff Calculations.

…that helped maintain real consumption.

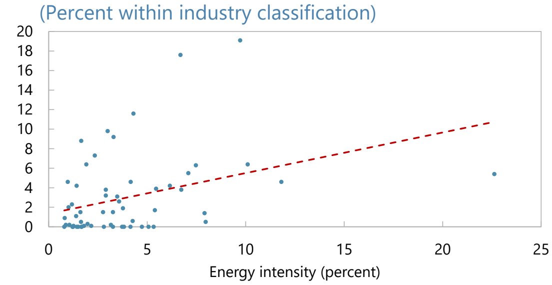
Real Consumption
(Index, 2019Q4=100)



Source: Haver Analytics.

Energy costs also weighed on firms' balance sheets…

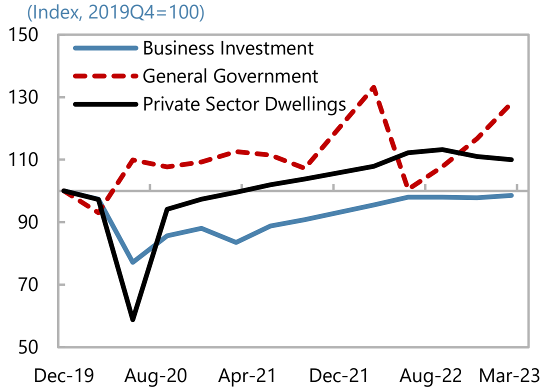
Share Of Businesses Not Fully Trading
(Percent within industry classification)



Note: Dashed line shows an OLS line of best fit. Energy intensity is energy purchases divided by total purchases of energy, materials, goods and services, excluding purchases for direct resale. Businesses are grouped by the two-digit Standard Industrial Classification. Based on responses to the question "Which of the following statements best describes your business's trading status?" in the June/July 2022 BICS.
Source: ONS

…holding back business investment…

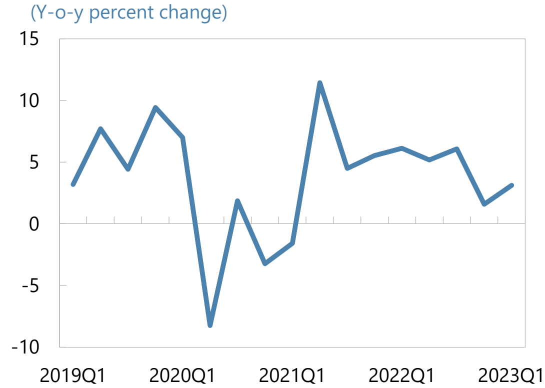
Real Fixed Investment
(Index, 2019Q4=100)



Source: Haver Analytics.

…amidst weakening trade partner demand

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

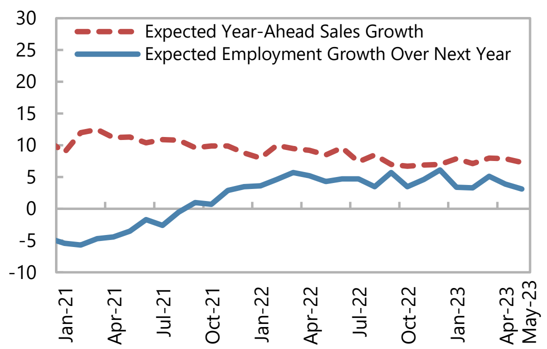


Source: IMF staff calculations.

Figure 9. United Kingdom: High Frequency Indicators of Economic Activity

Firms expect continued resilience in demand…

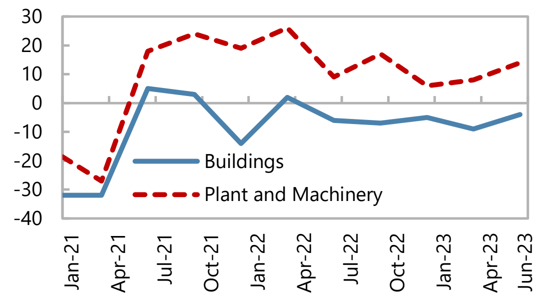
Firms' Sales and Employment Expectations
(Percentage growth rate)



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

…but Bank Rate hikes have started to weigh on planned investments…

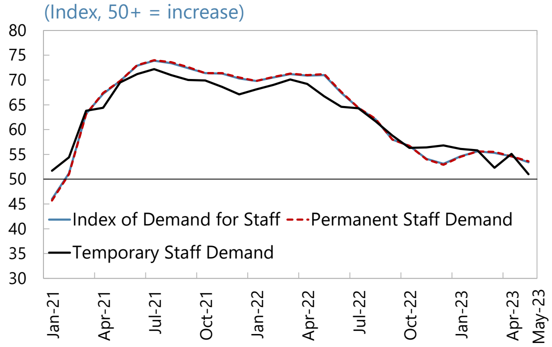
Expectation of Capital Expenditure Authorizations
(Percent Balance, Over Next Year Vs. Last Year)



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.

…and labor demand is softening…

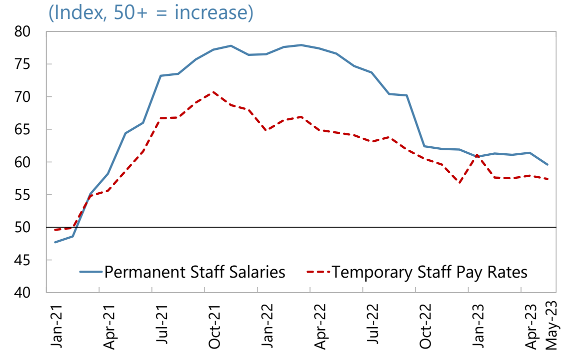
Labor Demand
(Index, 50+ = increase)



Sources: S&P Global.

…with some impact on wage settlements.

Permanent Staff Salaries and Temp Staff Pay Rates
(Index, 50+ = increase)

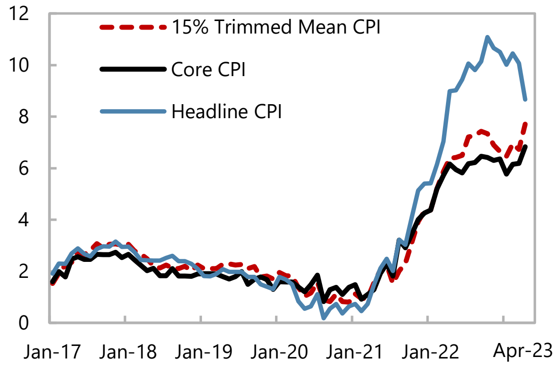


Sources: S&P Global.

Figure 10. United Kingdom: Inflation

Headline and core inflation remain high…

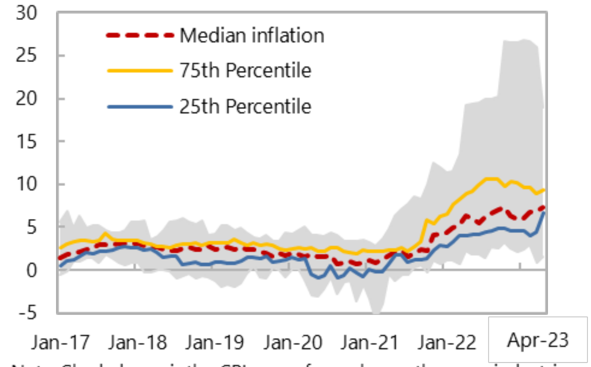
CPI Trimmed Mean
(Y-o-y percent change)



Sources: ONS; and Haver Analytics.

and price pressures are broad-based.

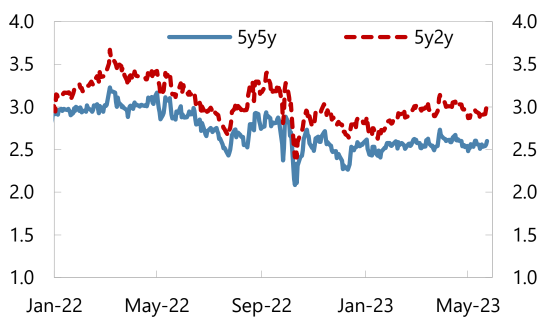
CPI Dispersion
(Y-o-y percent change, SA)



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

Nevertheless, inflation expectations remain anchored

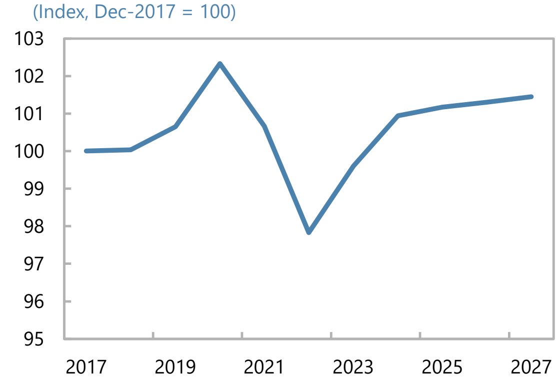
Inflation Expectations
(Percent)



Note: Derived from swaps linked to UK RPI and adjusted for the difference between RPI and CPI.
Source: Bloomberg Finance L.P. and IMF staff calculations.

…and the terms-of-trade shock has started to ease.

Terms of Trade
(Index, Dec-2017 = 100)

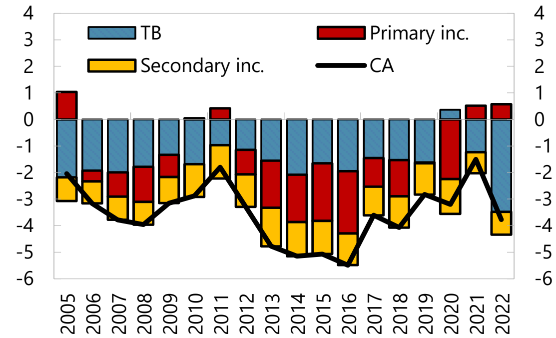


Sources: World Economic Outlook.

Figure 11. United Kingdom: External Sector Developments

The current account deteriorated in 2022, …

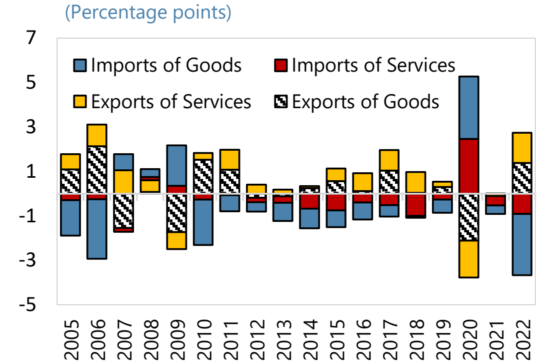
Current Account Balance
(Percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.

… driven by goods imports.

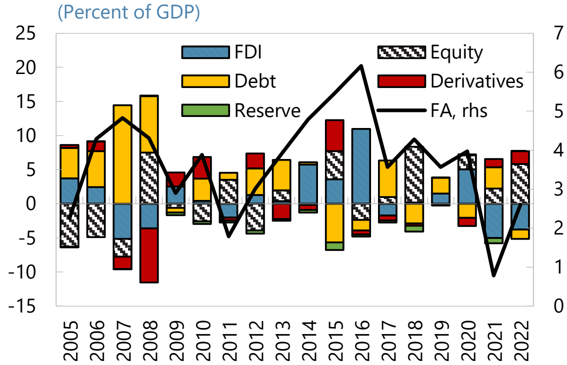
Contributions to Growth from Trade
(Percentage points)



Sources: Haver Analytics; and IMF staff calculations.

The CA was financed by portfolio investment instead of FDI, which was the main financing source in the past.

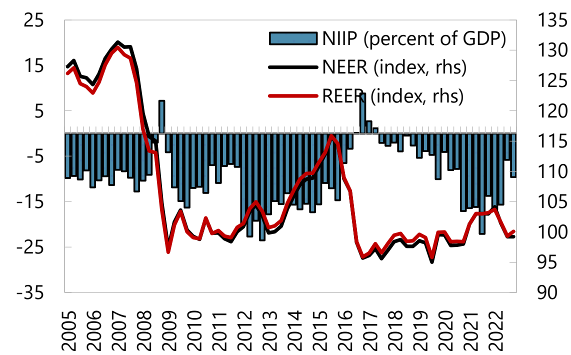
Financial Account
(Percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.

The NIIP has improved, however, driven by valuation effects, including exchange rate depreciation.

NIIP and Effective Exchange Rates

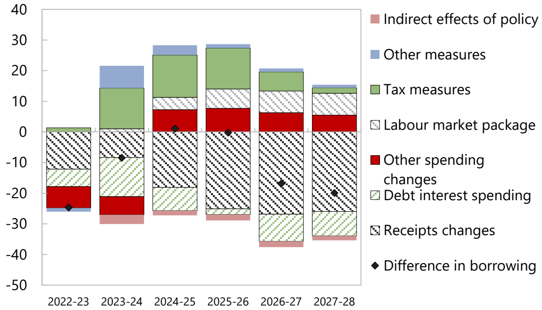


Sources: Haver Analytics; INS; and IMF staff calculations.

Figure 12. United Kingdom: Fiscal Developments

Most of the additional fiscal space due to [inflation] has been spent in a new labor activation package…

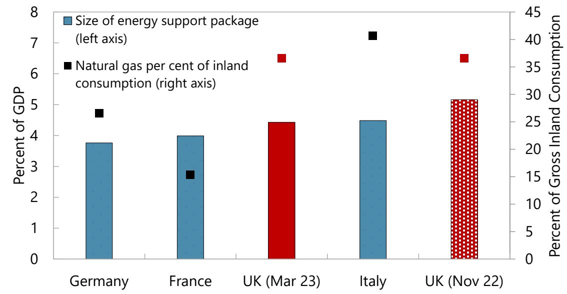
Public Sector Net Borrowing: Changes Since November
(Percent)



Sources: ONS; OBR Economic and Fiscal Outlook.

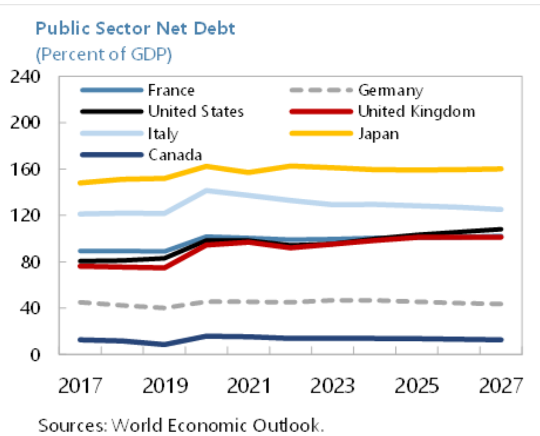
…and in the extension of energy support, which remains the largest package amongst peers.

European Countries' Size of Energy Support Package and the Share of Natural Gas in Final Energy Consumption



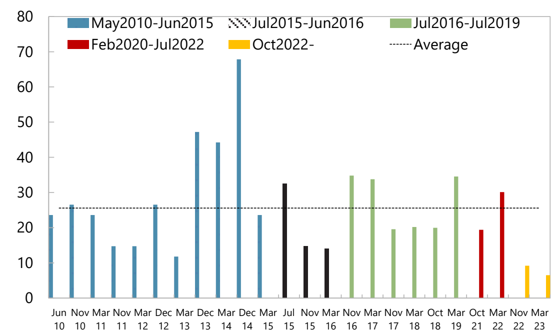
Notes: UK includes the cost of the health and social levy reversal and the increase in the NIC's thresholds to ensure comparability with IMF. Loan guarantee commitments excluded from costs.
Sources: OBR Economic and Fiscal Outlook, Mar 2023.

The UK's public debt is below the median for G7 economies …



…but headroom vis-à-vis fiscal rules (deficit and debt targets) keeps shrinking…

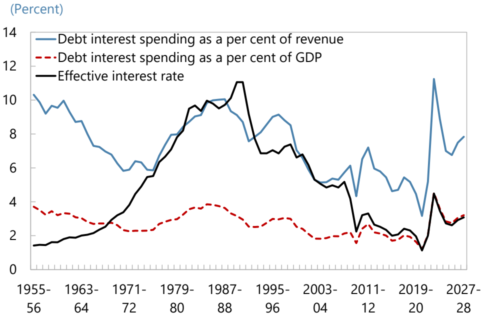
Successive Forecasts for Headrooms Against Fiscal Targets
(£ Billion)



Sources: OBR.

Debt service ratios have risen since COVID, reflecting a high share of inflation-indexed bonds and remunerated reserves…

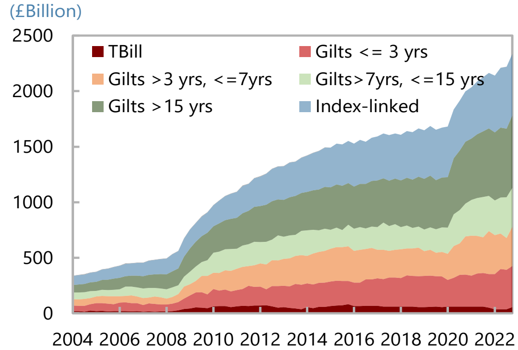
Debt Interest Spending Relative to GDP and Revenues
(Percent)



Sources: ONS;OBR Economic and Fiscal Outlook, Mar 2023.

Debt levels have also gone up, as has the medium-term risk of sovereign stress

Composition of Central Government Wholesale Debt Stock
(£Billion)

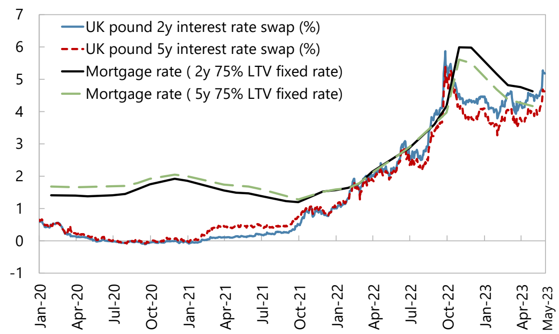


Sources: DMO.

Figure 13. United Kingdom: Residential Real Estate Developments

Mortgage rates have declined since the peak after the 'mini-budget', yet they are about 100 bps above average 2022 levels.

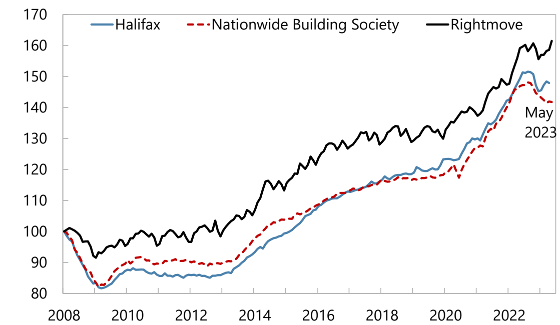
Mortgage Rates
(Percent)



Sources: Bank of England; and Haver Analytics.

House prices have fallen since September 2022.

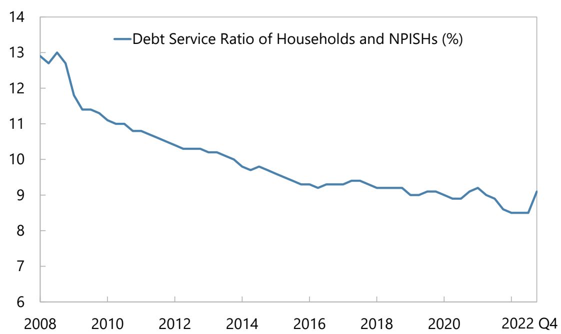
House Price Indices
(Index, Jan 2008 = 100)



Source: Haver Analytics.

Higher interest rates have contributed to rising debt service burdens.

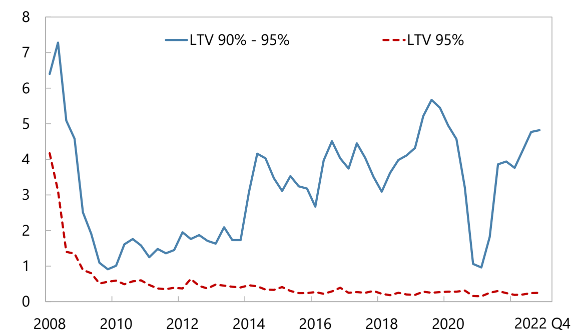
Housing Affordability
(Percent)



Sources: BIS; and Haver Analytics.

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

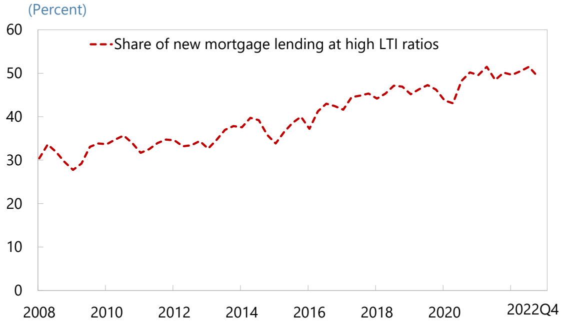
New Mortgage Loans as % of Gross Advances: Loan to Value
(Percent)



Sources: Bank of England; Haver Analytics.

... but lending at high LTI ratios has been stable.

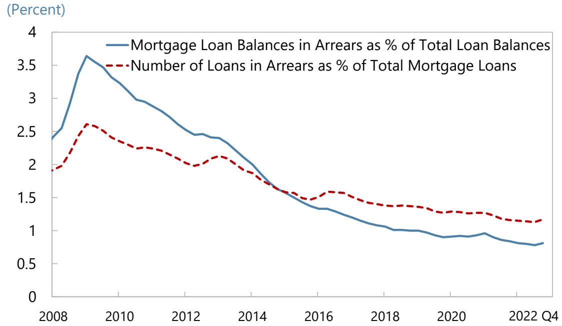
New Lending to High-LTI Borrowers
(Percent)



Note: High LTV ratio refers to Single Income Multiple Over 4.00% and Joint Income Multiple Over 3.00%.
Sources: Haver Analytics and Mortgage Lending and Administration Return (MLAR).

Mortgage arrears remained low.

Mortgage Arrears
(Percent)



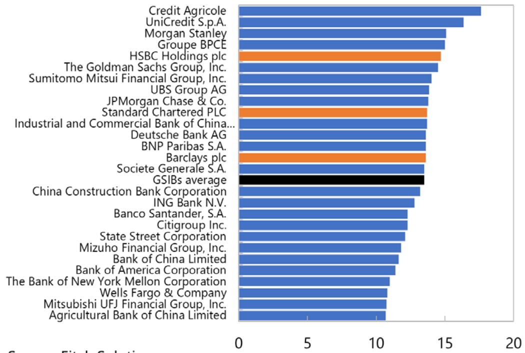
Note: Arrears are defined as instances when any contractual payments, of capital, interest fees or other charges, are overdue at the reporting date.
Sources: Haver Analytics and Mortgage Lending and Administration Return (MLAR).

Figure 14. United Kingdom: Banking Sector

UK GSIBs have strong capital and …

Selected GSIBs - CET1

(Percent of RWA, 2023Q1)

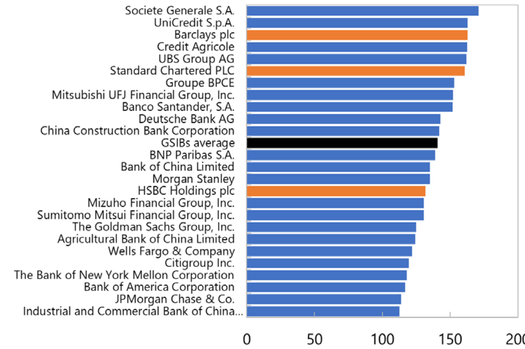


Source: Fitch Solutions.

… liquidity positions compared with other GSIBs in the EU and US.

Selected GSIBs & Major UK Banks - LCR

(Percent of 30d net cash outflows, 2023Q1)

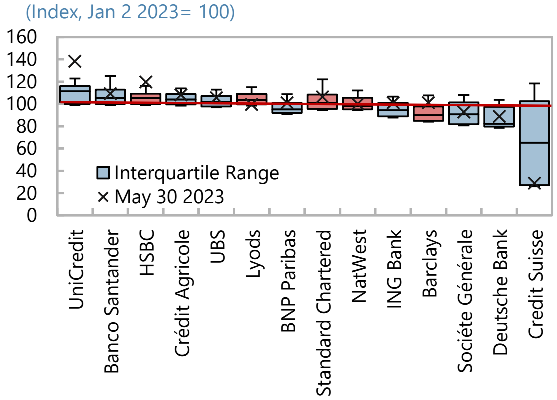


Source: Fitch Solutions.

Bank equity prices have been stabilized, …

Selected G-SIBs Equity Market Indices

(Index, Jan 2 2023= 100)

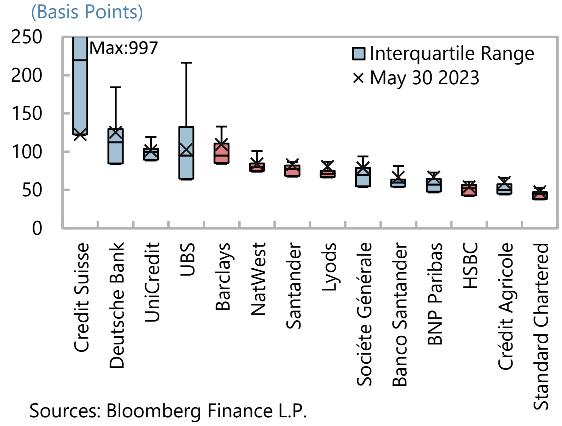


Sources: Bloomberg Finance L.P.

… and so have CDS, but CDS for some GSIBs remain elevated.

Selected G-SIBs CDS Spreads

(Basis Points)



Sources: Bloomberg Finance L.P.

Table 1. United Kingdom: Selected Economic Indicators, 2020–28

(Percentage change, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
						Projections			
Real Economy (change in percent)									
Real GDP	-11.0	7.6	4.1	0.4	1.0	2.2	2.0	1.8	1.5
Private final domestic demand	-13.2	6.2	6.4	-0.8	0.1	2.5	2.1	1.9	1.6
CPI, period average	0.9	2.6	9.1	7.9	3.7	2.1	2.0	2.0	2.0
CPI, end-period	0.6	5.4	10.5	5.2	2.6	2.0	2.0	2.0	2.0
Unemployment rate (in percent) 1/	4.6	4.5	3.7	3.9	4.2	4.2	4.2	4.2	4.2
Gross national saving (percent of GDP)	14.0	16.4	15.8	13.9	13.7	14.2	14.4	14.3	14.3
Gross domestic investment (percent of GDP)	17.2	17.9	19.6	17.7	17.4	17.7	17.9	17.9	17.8
Public Finance (fiscal year, percent of GDP)									
Public sector overall balance	-15.2	-5.2	-6.2	-4.9	-3.8	-3.7	-3.4	-3.3	-3.2
Public sector cyclically adjusted primary balance (staff estimates)	-11.7	-3.6	-2.7	-1.6	-1.2	-1.4	-1.8	-1.9	-1.9
Public sector net debt 2/	82.8	80.3	86.6	89.9	92.5	96.0	96.8	97.1	97.2
Money and Credit (end-period, 12-month percent change)									
M4	13.4	6.2	1.6	…	…	…	…	…	…
Net lending to private sector	3.7	3.0	3.3	…	…	…	…	…	…
Interest Rates (percent; year average)									
Three-month interbank rate	0.3	0.1	2.0	…	…	…	…	…	…
Ten-year government bond yield	0.4	0.8	2.4	…	…	…	…	…	…
Balance of Payments (percent of GDP)									
Current account balance	-3.2	-1.5	-3.8	-3.8	-3.7	-3.5	-3.5	-3.5	-3.5
Trade balance	0.4	-1.2	-3.5	-3.4	-2.6	-2.1	-2.0	-1.9	-1.9
Net exports of oil	0.0	0.0	-0.6	-0.5	-0.4	-0.4	-0.3	-0.3	-0.3
Exports of goods and services (volume change in percent)	-12.1	2.2	9.9	-2.0	3.8	2.4	1.8	1.6	1.5
Imports of goods and services (volume change in percent)	-16.0	6.2	13.3	-0.8	2.6	1.1	1.5	1.5	1.5
Terms of trade (percent change)	1.7	-1.6	-2.8	1.8	1.2	0.1	0.1	0.1	0.1
FDI net	-5.0	5.0	3.8	0.2	0.2	0.2	0.2	0.2	0.2
Reserves (end of period, billions of US dollars)	186.7	203.7	185.6	…	…	…	…	…	…
Exchange Rates									
Exchange rate regime		Floating							
Bilateral rate (Apr 25, 2023)	US$1 = £ 0.81								
Nominal effective rate (2010=100, year average)	98.3	102.6	101.0	…	…	…	…	…	…
Real effective rate (2010=100, year average)	98.8	102.6	101.2	…	…	…	…	…	…
Memorandum Items:									
Nominal GDP (billions GBP)	2,110	2,270	2,491	2,635	2,765	2,883	2,997	3,112	3,222
Nominal GDP (billions USD)	2,707	3,123	3,082	3,201	3,448	3,654	3,874	4,102	4,335

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 includes 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.

Table 2. United Kingdom: Medium-Term Scenario, 2020–28

(Percentage change, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections					
Real GDP	-11.0	7.6	4.1	0.4	1.0	2.2	2.0	1.8	1.5
Q4/Q4 1/	-9.2	8.9	0.6	0.5	1.3	2.4	1.8	1.8	1.6
Real domestic demand	-12.3	8.8	4.4	0.6	0.7	1.8	1.9	1.8	1.6
Private consumption	-13.2	6.2	5.6	0.1	0.3	1.6	1.7	1.8	1.6
Government consumption	-7.3	12.5	1.8	2.6	1.6	1.2	1.5	1.9	1.9
Fixed investment	-10.5	6.1	8.6	-1.7	-0.9	4.3	3.1	1.6	1.0
Public	4.8	5.3	3.6	10.8	0.4	-3.3	-1.1	-1.4	-1.4
Residential	-16.0	18.1	8.2	-4.2	-1.0	5.2	4.4	2.0	1.5
Business	-11.9	0.9	10.8	-3.2	-1.5	7.0	4.2	2.5	1.5
Stocks 2/	-0.6	1.0	0.3	-0.5	0.0	0.0	0.0	0.0	0.0
Gross national saving (percent of GDP)	14.0	16.4	15.8	13.9	13.7	14.2	14.4	14.3	14.3
Gross domestic investment (percent of GDP)	17.2	17.9	19.6	17.7	17.4	17.7	17.9	17.9	17.8
External balance 2/	1.5	-1.2	-1.2	-0.3	0.3	0.4	0.1	0.0	0.0
Exports of Goods and Services	-12.1	2.2	9.9	-2.0	3.8	2.4	1.8	1.6	1.5
Imports of Goods and Services	-16.0	6.2	13.3	-0.8	2.6	1.1	1.5	1.5	1.5
Current account 3/	-3.2	-1.5	-3.8	-3.8	-3.7	-3.5	-3.5	-3.5	-3.5
CPI Inflation, period average	0.9	2.6	9.1	7.9	3.7	2.1	2.0	2.0	2.0
CPI Inflation, end period	0.6	5.4	10.5	5.2	2.6	2.0	2.0	2.0	2.0
GDP deflator, period average	5.9	0.0	5.4	5.4	3.9	2.1	2.0	2.0	2.0
Output gap 4/	-3.6	0.5	1.8	-0.1	-0.7	-0.3	-0.1	0.0	0.0
Potential output	-8.4	3.2	2.8	2.2	1.7	1.7	1.7	1.7	1.5
Employment and productivity									
Employment	-0.9	-0.3	1.0	0.2	0.2	1.1	1.0	0.9	0.8
Unemployment rate 5/	4.6	4.5	3.7	3.9	4.2	4.2	4.2	4.2	4.2
Productivity 6/	-10.2	7.9	3.0	0.1	0.8	1.1	0.9	0.9	0.7
Memorandum items:									
Private final domestic demand	-13.2	6.2	6.4	-0.8	0.1	2.5	2.1	1.9	1.6
Household saving rate 7/	15.9	12.6	8.5	8.9	9.0	7.9	6.9	5.8	5.0
Private saving rate	21.9	20.3	17.2	25.7	24.6	24.5	24.2	23.6	23.0
Credit to the private sector	3.7	3.0	3.3	…	…	…	…	…	…
Population growth	0.4	0.3	0.8	0.5	0.5	0.4	0.4	0.3	0.3
GDP per capita growth	-11.4	7.3	3.3	-0.1	0.6	1.7	1.6	1.4	1.2

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

Table 3. United Kingdom: Statement of Public Sector Operations, FY2020/21–2028/29

(Percent of GDP, unless otherwise indicated)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
				Projections					
Revenue	38.0	39.3	40.6	41.2	40.7	40.7	40.7	40.9	41.1
Taxes	27.0	28.5	29.5	30.1	30.0	30.1	30.3	30.5	30.5
Social contributions	6.9	6.9	7.1	7.0	6.7	6.8	6.7	6.6	6.8
Other revenue	4.2	3.9	3.9	4.1	4.0	3.8	3.7	3.8	3.8
Of which: Interest income	1.1	1.0	1.3	1.5	1.4	1.2	1.2	1.3	1.3
Expenditure	53.3	44.5	46.8	46.1	44.5	44.4	44.4	44.3	44.3
Expense	52.1	43.5	45.3	43.5	42.4	42.3	42.3	42.1	42.1
Consumption of fixed capital	2.6	2.4	2.3	2.2	2.2	2.2	2.2	2.2	2.1
Interest	2.0	3.1	5.5	4.1	3.9	3.8	3.6	3.2	3.2
Other	47.5	38.0	37.6	37.2	36.3	36.2	36.4	36.7	36.8
Net acquisition of nonfinancial assets	1.2	1.1	1.5	2.6	2.1	2.1	2.1	2.2	2.2
Gross operating balance	-14.1	-4.2	-4.7	-2.4	-1.7	-1.6	-1.5	-1.3	-1.0
Net lending/borrowing (overall balance)	-15.2	-5.2	-6.2	-4.9	-3.8	-3.7	-3.6	-3.4	-3.2
Current balance 1/	-11.8	-3.1	-3.7	-1.0	-0.4	-0.4	-0.5	-0.2	0.1
Primary balance 2/	-14.3	-3.1	-2.0	-2.3	-1.3	-1.1	-1.2	-1.5	-1.3
General government gross debt	105.7	105.2	103.8	106.7	108.5	109.4	110.5	110.2	110.2
Public sector net debt 3/	104.9	96.9	100.7	102.9	103.1	100.5	99.8	99.4	99.4
Public sector net debt excl. BoE schemes	90.1	83.9	89.0	92.2	94.4	96.0	97.0	97.1	97.1

Sources: HM Treasury; Office for National Statistics; and IMF staff calculations.

1/ Includes depreciation.

2/ Excludes both interest revenues and interest expenditures

3/ Public sector is defined as consolidated public sector. Public sector net debt is defined as public sector gross debt minus liquid assets held by general government and non-financial public corporations.

Table 4. United Kingdom: Balance of Payments, 2020–28
(Percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections					
Current account	-3.2	-1.5	-3.8	-3.8	-3.7	-3.5	-3.5	-3.5	-3.5
Balance on goods and services	0.36	-1.24	-3.5	-3.4	-2.6	-2.1	-2.0	-1.9	-1.9
Trade in goods	-6.3	-7.5	-9.3	-9.2	-8.9	-8.6	-8.5	-8.4	-8.4
Exports	14.6	14.3	16.6	17.7	17.9	17.9	17.8	17.6	17.6
Imports	-20.9	-21.7	-25.9	-26.9	-26.8	-26.5	-26.2	-26.1	-26.0
Trade in services	6.7	6.2	5.8	5.8	6.3	6.5	6.5	6.5	6.5
Exports	14.7	14.6	16.1	16.3	16.6	16.7	16.7	16.7	16.7
Imports	-8.0	-8.3	-10.3	-10.4	-10.3	-10.3	-10.2	-10.2	-10.2
Primary income balance	-2.2	0.5	0.6	0.4	-0.2	-0.5	-0.6	-0.7	-0.8
Receipts	6.5	9.4	11.4	10.5	10.0	9.8	9.8	9.8	9.8
Payments	8.7	8.9	10.9	10.1	10.2	10.3	10.4	10.5	10.6
Secondary income balance	-1.3	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-1.0	-0.9
Capital and financial account	-3.8	-0.7	-2.5	-3.8	-3.7	-3.5	-3.5	-3.5	-3.5
Capital account	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial account	-4.0	-0.8	-2.6	-3.9	-3.8	-3.6	-3.6	-3.6	-3.6
Direct investment	-5.0	5.0	3.8	0.2	0.2	0.2	0.2	0.2	0.2
Abroad	-0.1	5.2	5.1	3.0	3.0	3.0	3.0	3.0	3.0
Domestic	4.9	0.2	1.4	2.8	2.8	2.8	2.8	2.8	2.8
Portfolio investment	1.2	-8.5	-3.5	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4
Abroad	4.2	-2.3	-4.5	1.8	1.8	1.8	1.8	1.8	1.8
Domestic	3.0	6.2	-1.0	7.2	7.2	7.2	7.2	7.2	7.2
Financial derivatives	1.2	-1.2	-1.9	0.2	0.2	0.2	0.2	0.2	0.2
Other investment	-1.2	3.1	-0.9	1.1	1.3	1.4	1.5	1.4	1.4
Abroad	17.8	13.1	4.4	1.0	1.0	1.0	1.0	1.0	1.0
Domestic	19.1	10.0	5.3	-0.1	-0.3	-0.4	-0.5	-0.4	-0.4
Change in reserve assets	-0.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.6	0.8	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Terms of trade (y/y percent change)	1.7	-1.6	-2.8	1.8	1.2	0.1	0.1	0.1	0.1

Sources: Office for National Statistics; and IMF staff estimates.
Note: a negative sign on the financial account indicates financial inflows.

Table 5. United Kingdom: Net Investment Position, 2020–28

(Percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections					
Net investment position	-18.2	-15.3	-10.9	-11.5	-12.0	-12.4	-12.8	-13.2	-13.6
Assets	613	573	563	548	537	529	522	516	511
Liabilities	631	588	574	560	549	541	535	529	525
Net direct investment	-15.4	-10.3	-16.5	-15.4	-14.5	-13.7	-12.9	-12.3	-11.6
Direct investment abroad	94.3	96.4	86.9	85.1	84.1	83.7	83.5	83.4	83.6
Direct investment in the UK	109.6	106.6	103.4	100.5	98.6	97.4	96.4	95.7	95.2
Net Portfolio investment	-16.2	-17.4	-10.5	-12.6	-14.7	-16.8	-18.8	-20.8	-22.8
Portfolio investment abroad	149.5	149.6	121.6	119.5	118.4	118.0	118.0	118.2	118.7
Portfolio investment in the UK	165.7	167.0	132.1	132.1	133.1	134.8	136.9	139.0	141.5
Net financial derivatives	-1.6	-3.1	-3.7	-3.4	-3.0	-2.7	-2.5	-2.2	-1.9
Assets	142.0	104.2	128.4	128.4	128.4	128.4	128.4	128.4	128.4
Liabilities	143.6	107.3	132.1	131.7	131.4	131.1	130.8	130.6	130.3
Net other investment	8.7	9.2	13.9	14.3	14.9	15.7	16.6	17.4	18.2
Other investment abroad	221.3	216.5	220.8	209.7	200.8	193.6	187.2	181.4	176.1
Other investment in the UK	212.6	207.3	206.8	195.4	186.0	178.0	170.7	164.0	157.9
Reserve assets	6.2	6.3	5.9	5.6	5.3	5.1	4.9	4.7	4.6
Memorandum items:									
Change in the net investment position	-6.9	1.7	3.0	-1.2	-1.1	-0.9	-0.8	-0.9	-0.9
Current account balance	-3.2	-1.5	-3.8	-3.8	-3.7	-3.5	-3.5	-3.5	-3.5

Source: Office for National Statistics.

Table 6. United Kingdom: Monetary Survey, 2016–2022

(Billion GDP)

	2016	2017	2018	2019	2020	2021	2022
Net foreign assets	372	399	393	279	215	220	296
Foreign assets	3582	3748	3856	3693	3971	4094	4433
Foreign liabilities	3210	3349	3463	3414	3756	3874	4137
Net domestic assets	1879	1960	2020	2227	2606	2781	2751
M4 lending to the private sector	2258	2381	2457	2576	2655	2700	2728
Net foreign currency lending to the private sector	-164	-190	-238	-168	-160	-185	-203
Net lending to the public sector	605	625	575	598	892	969	711
Other items, net	-821	-855	-774	-779	-781	-703	-485
M4 1/	2251	2360	2414	2506	2821	3000	3047
Memorandum item: 2/							
M4 growth, percent	6.2	4.8	2.3	3.8	12.6	6.4	1.6
M4 lending to the private sector growth, percent	4.2	5.5	3.2	4.8	3.1	1.7	1.0

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 7. United Kingdom: Financial Soundness Indicators, 2016–22

	2016	2017	2018	2019	2020	2021	2022
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	20.6	20.7	21.4	21.3	21.6	22.1	21.4
Regulatory Tier 1 Capital to Risk-Weighted Assets	16.5	17.1	17.9	17.9	18.5	19.1	18.4
Capital to Assets	5.5	5.4	5.6	5.5	5.5	5.3	6.4
Credit Risk							
Non-performing Loans Net of Provisions to Capital	3.8	3.1	4.9	4.3	3.1	4.4	4.3
Non-performing Loans to Total Gross Loans	1.7	1.4	1.1	1.0	1.0	1.0	1.0
Foreign-Currency-Denominated Loans to Total Loans	79.5	78.7	67.4	60.1	54.9	60.8	64.8
Profitability							
Return on Assets	0.3	0.3	0.5	0.3	0.2	0.5	0.5
Return on Equity	2.3	2.8	5.2	3.7	2.7	6.5	7.6
Interest Margin to Gross Income	54.8	53.5	50.5	43.3	49.2	44.3	66.7
Non-interest Expenses to Gross Income	81.9	75.7	72.5	78.0	80.7	75.0	63.7
Trading Income to Total Income	4.7	7.8	12.9	16.8	13.4	11.1	0.5
Personnel Expenses to Non-interest Expenses	46.4	41.6	41.7	45.1	48.6	43.6	45.4
Liquidity							
Liquid Assets to Total Assets (Liquid Asset Ratio)	26.4	30.7	34.5	31.3	30.9	37.5	34.0
Liquid Assets to Short Term Liabilities	40.5	44.1	51.0	44.2	46.6	47.6	35.4
Customer Deposits to Total (Non-interbank) Loans	...	...	...	...	...	...	...
Foreign-Currency-Denominated Liabilities to Total Liabilities	40.2	42.0	41.3	39.1	37.4	40.2	44.2
Fx, Equity, and Derivative Risk							
Net Open Position in Foreign Exchange to Capital	-7.3	-8.6	-8.4	-15.1	-13.3	-8.4	...
Gross Asset Position in Financial Derivatives to Capital	337.6	274.7	254.8	293.3	355.4	260.7	349.8
Gross Liability Position in Financial Derivatives to Capital	331.4	273.0	251.0	292.1	356.5	257.9	343.6

Source: IMF FSI database.

Table 8. United Kingdom: Anti-Corruption Efforts (Authorities' Self-Assessment)
Corporate Transparency
The UK Economic Crime and Corporate Transparency Bill, currently before Parliament, will reform the role of Companies House and improve transparency in relation to UK companies and partnerships.
In August 2022 the UK launched the Register of Overseas Entities, which requires overseas companies owning or buying property in the UK to reveal the real identities of their owners (including where a trust is part of the structure) to Companies House.
The UK helped to organize, and participated in, Beneficial Ownership Leadership Group-led events at both political and technical levels (in December 2021, July 2022 and December 2022) to promote publicly accessible beneficial ownership registers.
In March 2023 the UK published the Economic Crime Plan 2, which includes a number of commitments in relation to enhancing domestic and international corporate transparency.
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 in June 2021. UK has fully or partially implemented 37 out of its 44 recommendations overall. The UK will be reporting back on implementation of a small number of its remaining recommendations in June 2023.
International Anti-Corruption
The UK is currently developing a new Anti-Corruption Strategy with publication expected in 2023. 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.
The UK agreed precedent setting anti-corruption provisions in its trade agreements with Australia and New Zealand. These included provisions on anti-money laundering (UK-NZ), confiscation of the proceeds of corruption (UK-NZ), measures to restrict the entry of corruption actors (UK-Australia).
As a founding and current member of the Open Government Partnership, the UK remains committed to improving government transparency. The UK published its Fifth National Action Plan for Open Government 2021–23 (NAP5), which sets out the UK's current commitments to detect and tackle corruption and illicit finance, building on commitments in the UK's G7 presidency. The process for developing the Sixth National Action Plan 2024–2025 is currently underway.
The UK has continued to use its sanctions powers, including the Global Anti-Corruption sanctions regime, to combat serious corruption internationally. On 9 December 2022 the Foreign Secretary announced a new wave of sanctions that targets corrupt actors. This package was coordinated with international partners to mark International Anti-Corruption Day. On 10 February the UK, alongside the US, used its Global Anti-Corruption sanctions regime to designate three influential Bulgarian individuals involved in serious corruption, bribery, and abuse of power.
The UK supported the G7 2022 commitment to establish 15 Beneficial Ownership registers in Africa 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 fora. This included attending the UN Convention Against Corruption Working Groups on Prevention and Asset Recovery to engage with technical experts to share knowledge and best practice in fighting corruption.
The second US-led Summit for Democracy (S4D) took place on 29–30 March 2023. All the UK's anti-corruption commitments from the first summit are on track or have been exceeded. The UK was actively involved in the US-led Financial Transparency and Integrity Cohort, leading and delivering an event on the professional enablers of corruption. We are continuing to engage with this work to drive international action on the transnational drivers of corruption and illicit finance.

Annex I. Preliminary External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: The external position in 2022 was preliminarily assessed broadly in line with the level implied by medium-term fundamentals and desirable policies.[1] The CA deficit deteriorated in 2022, reflecting a sharp terms-of-trade shock triggered by Russia's war in Ukraine. The CA deficit could temporarily stay high in 2023–24 due to the adjustment of income flows, before gradually narrowing over the medium term as the trade balance improves. Uncertainty around this assessment remains significant, due to measurement issues, the evolving effects of the EU-UK Trade and Cooperation Agreement, and the impact on capital flows of any final agreement between the EU and the UK on financial services.[2]

Potential Policy Responses: Gradual fiscal consolidation, while preserving the quality of key public services and protecting the vulnerable, should improve net public savings and help offset the decline in net private savings as private investment slowly recovers. This will help maintain the CA broadly in line with fundamentals and desirable policies. Over the medium term, implementing structural reforms to boost the UK's international competitiveness (including via upgrading the labor skills base to support labor reallocation to fast-growing sectors) would bolster national savings which, in turn, will help to finance the increased investment needs, including in support of the climate transition.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. The NIIP improved to –11 percent of GDP in 2022 from –15 percent of GDP in 2021. A positive valuation effect led to an improvement of the NIIP despite the wider CA deficit.[3] About three-fifth of gross assets and liabilities is accounted for by other investment (221 percent of GDP in assets and 207 percent in liabilities) and portfolio investment (128 percent of GDP in assets and 132 percent in liabilities). Similarly, three-fourth of gross assets and liabilities are accounted for by the United States, other European countries, and Japan. External liabilities have a larger share denominated in pounds than do external assets.[4] IMF staff project that the NIIP will moderately decrease over the medium term, in line with the projected (small) CA deficits. However, large, and volatile valuation effects make these estimates particularly uncertain.

Assessment. Since 2016, CA flows (which were negative) have not been able to explain changes in the NIIP (which have been largely positive), mainly due to valuation gains from the pound's depreciation, and two types of positive flows not recorded in the income balance of the CA: retained earnings on portfolio equity, and inflation compensation on debt interest. Fluctuations in large gross stock positions could be a potential source of vulnerability (both gross assets and gross liabilities exceed 500 percent of GDP). Also, the large short-term debt liability positions are sensitive to changes in market sentiment. However, the combination of exchange rate flexibility and a net liability position in domestic currency offer some insurance against external crises.</td></tr>
<tr><td>2022 (% GDP)</td><td>NIIP: -11</td><td>Gross Assets: 563</td><td>Debt Assets: 283</td><td>Gross Liab.: 574</td><td colspan="3">Debt Liab.: 293</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The CA deficit deteriorated from 1.5 percent of GDP in 2021 to 3.8 percent in 2022, reflecting a widening in the trade deficit due to the negative terms-of-trade shock from surging energy prices following the war in Ukraine. Net private savings declined from 6.8 percent in 2021 to 2.5 percent in 2022, more than offsetting lower net public borrowing from 8.3 percent in 2021 to 6.2 percent in 2022; gross savings also declined, while investment increased. IMF staff project that CA will moderately decrease to – 3½ percent of GDP over the medium term.

Assessment. The EBA CA model estimates a norm of –1.0 percent of GDP and a CA gap of –1.2 percent of GDP. Adjustments to the EBA estimates include the lingering COVID-19 impact, totaling (–0.3 percent of GDP): travel services (–0.4 percent of GDP) and transport balances (+0.1 percent of GDP). As in previous years, unrecorded income – retained earnings on portfolio equity (0.2 percent of GDP), and inflation compensation on debt interest (0.5 percent of GDP) – contributed to an underestimation of the underlying CA. Overall, the IMF staff assesses the CA gap in the range of –1.8 to 0.2 percent of GDP, with a midpoint of –0.8 percent of GDP.</td></tr>
<tr><td>2022 (% GDP)</td><td>CA: -3.8</td><td>Cycl. Adj. CA: -2.2</td><td>EBA Norm: -1.0</td><td>EBA Gap: -1.2</td><td>COVID-19 Adj.: -0.3</td><td>Other Adj.: 0.7</td><td>Staff Gap: -0.8</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. The pound, on average, depreciated in real effective terms in 2022 by 1.4 percent relative to its average level in 2021, driven entirely by nominal depreciation, largely due to the surge in the dollar. Overall, the pound has depreciated in real terms by about 3.4 percentage points since mid-2016, reflecting market expectations of more restricted access to the EU market under post-Brexit trade arrangements. As of the end of April 2023, the REER had appreciated by 1.1 percent compared to the 2022 average.

Assessment. The IMF staff CA gap implies a REER gap of about 2.9 percent in 2022 (applying an estimated elasticity of 0.28). The EBA REER level and index approaches suggest a gap of 2.3 and –8.4 percent, respectively, for 2022. Consistent with the staff CA gap, the IMF staff assess the REER gap to be about 2.9 percent, in a range of –0.7 to 6.4 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and</td><td colspan="7">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 2022, the 3.8 percent of GDP CA deficit was financed by net portfolio investment of 3.5 percent of GDP, financial derivatives and other investment of 2.8 percent of GDP, offsetting by FDI of -3.8 percent of GDP and errors and omissions of 1.3 percent of GDP.</td></tr>
</table>

Policy Measures	**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 sound financial regulation and supervision and a healthy financial sector. An additional risk is that financial account flows may decelerate, driven by the change in the trade relationship with the European Union and the shift of some financial services to the European Union.
FX Intervention and Reserves Level	**Background.** The pound has the status of a global reserve currency. Sterling's share of global reserves has not changed materially since 2015 and stands at about 4.6 percent. **Assessment.** Reserves held by the United Kingdom are typically low relative to standard metrics, and the currency is freely floating.

[1] The final assessment will be presented in the 2023 External Sector Report.
[2] For example, long-term access of EU clearing members (such as banks and asset managers) to the UK central counterparties (CCPs) remains uncertain. The EU only extended the equivalence for UK CCPs until end-June 2025.
[3] The official NIIP data may understate the true position—estimates of FDI stocks at market values imply a much higher NIIP, close to +100 percent of GDP, as reported in the Bank of England's December 2022 Financial Stability Report.
[4] Estimates in Bénétrix and others (2019) suggest that, in 2017, about 94 percent of external assets were denominated in foreign currency, compared with 56 percent for external liabilities.

Annex II. External Debt Sustainability Analysis

The external debt sustainability analysis complements the External Sector Assessment (Annex II). Under the baseline scenario, external debt is projected to decline from the 2020 peak of 334 percent of GDP in 2020—on account of the contraction in nominal GDP during the Covid crisis—to about 268 percent over the medium term. In historical scenarios, including the Covid crisis, 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 of 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 policy frameworks would help contain external vulnerabilities as the country continues to adjust to the post-Brexit trade regime.

1. Background. External debt peaked at 334 percent of GDP in 2020, mainly due to denominator effects as the pandemic depressed nominal GDP. Before the pandemic, external debt had stayed at around 300 percent of GDP since 2013. Almost half of external debt comprises short-term bank liabilities, while public debt accounts for a tenth. 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 offset current account deficits.

2. Assessment. In the baseline, external debt is projected to gradually decline to below its pre-pandemic level of about 268 percent of GDP by 2028, as the economic recovery and the non-interest current account induce positive dynamics. The historical scenario has the most significant impact, with debt climbing to 321 percent of GDP by the end of the forecast horizon. This scenario is based on an average of the past ten years, including a significant growth shock during the Covid crisis 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 302 percent of GDP. A depreciation shock has a larger impact, leaving external debt somewhat higher at 317 percent of GDP. Yet, gross debt assets at about 283 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, short-term 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.

Table 1. United Kingdom: External Debt Sustainability Framework, 2018–28

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2018	2019	2020	2021	2022			2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 6/
Baseline: External debt	300	290	334	321	293			**285**	**279**	**275**	**272**	**270**	**268**	**-6.4**
Change in external debt	0.1	-10.0	44.8	-13.7	-27.7			-8.3	-5.8	-4.1	-3.0	-2.4	-1.8	
Identified external debt-creating flows (4+8+9)	-9.0	-4.1	13.2	-22.5	-11.8			3.0	1.2	-2.1	-1.3	-0.7	-0.1	
Current account deficit, excluding interest payments	-1.3	-2.9	-0.8	-2.0	-5.8			-5.7	0.3	-0.1	0.0	0.0	-0.4	
Deficit in balance of goods and services	1.5	1.6	-0.4	1.2	3.5			3.4	2.6	2.1	2.0	1.9	1.9	
Exports	31.2	31.3	29.2	28.8	32.7			33.9	34.5	34.6	34.5	34.4	34.3	
Imports	32.8	32.9	28.9	30.1	36.2			37.3	37.1	36.7	36.4	36.2	36.1	
Net non-debt creating capital inflows (negative)	-0.1	-0.9	-7.3	5.1	4.8			0.2	0.2	0.0	0.3	0.4	0.2	
Automatic debt dynamics 1/	-7.6	-0.4	21.3	-25.5	-10.8			8.6	0.7	-2.1	-1.6	-1.0	0.0	
Contribution from nominal interest rate	5.4	5.7	4.0	3.5	9.6			9.6	3.4	3.6	3.5	3.5	3.9	
Contribution from real GDP growth	-4.8	-4.8	33.7	-22.0	-13.3			-1.0	-2.7	-5.7	-5.1	-4.6	-3.9	
Contribution from price and exchange rate changes 2/	-8.3	-1.2	-16.4	-7.1	-7.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	9.1	-5.9	31.5	8.8	-15.9			-11.3	-7.0	-2.0	-1.7	-1.7	-1.7	
External debt-to-exports ratio (in percent)	959	927	1144	1113	895			839	809	794	789	785	781	
Gross external financing need (in billions of US dollars) 4/	5741	6218	5916	6386	7014			6980	7066	7446	7778	8162	8566	
in percent of GDP	199	218	219	204	228	10-Year	10-Year	218	205	204	201	199	198	
Scenario with key variables at their historical averages 5/								**285**	**293**	**299**	**306**	**313**	**321**	**3.0**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.7	1.6	-11.0	7.6	4.1	1.6	4.8	0.4	1.0	2.2	2.0	1.8	1.5	
GDP deflator in US dollars (change in percent)	5.5	-2.4	6.4	7.2	-5.2	0.0	6.2	3.5	6.6	3.8	4.0	4.0	4.1	
Nominal external interest rate (in percent)	1.9	1.9	1.3	1.2	2.9	1.7	0.5	3.4	1.3	1.4	1.4	1.4	1.5	
Growth of exports (US dollar terms, in percent)	9.3	-0.7	-11.4	13.7	12.0	2.4	8.3	7.7	9.5	6.4	5.6	5.5	5.4	
Growth of imports (US dollar terms, in percent)	9.4	-0.5	-16.8	20.1	18.9	3.3	11.4	7.0	7.1	5.0	5.2	5.3	5.3	
Current account balance, excluding interest payments	1.3	2.9	0.8	2.0	5.8	1.3	2.0	5.7	-0.3	0.1	0.0	0.0	0.4	
Net non-debt creating capital inflows	0.1	0.9	7.3	-5.1	-4.8	2.2	4.6	-0.2	-0.2	0.0	-0.3	-0.4	-0.2	

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.

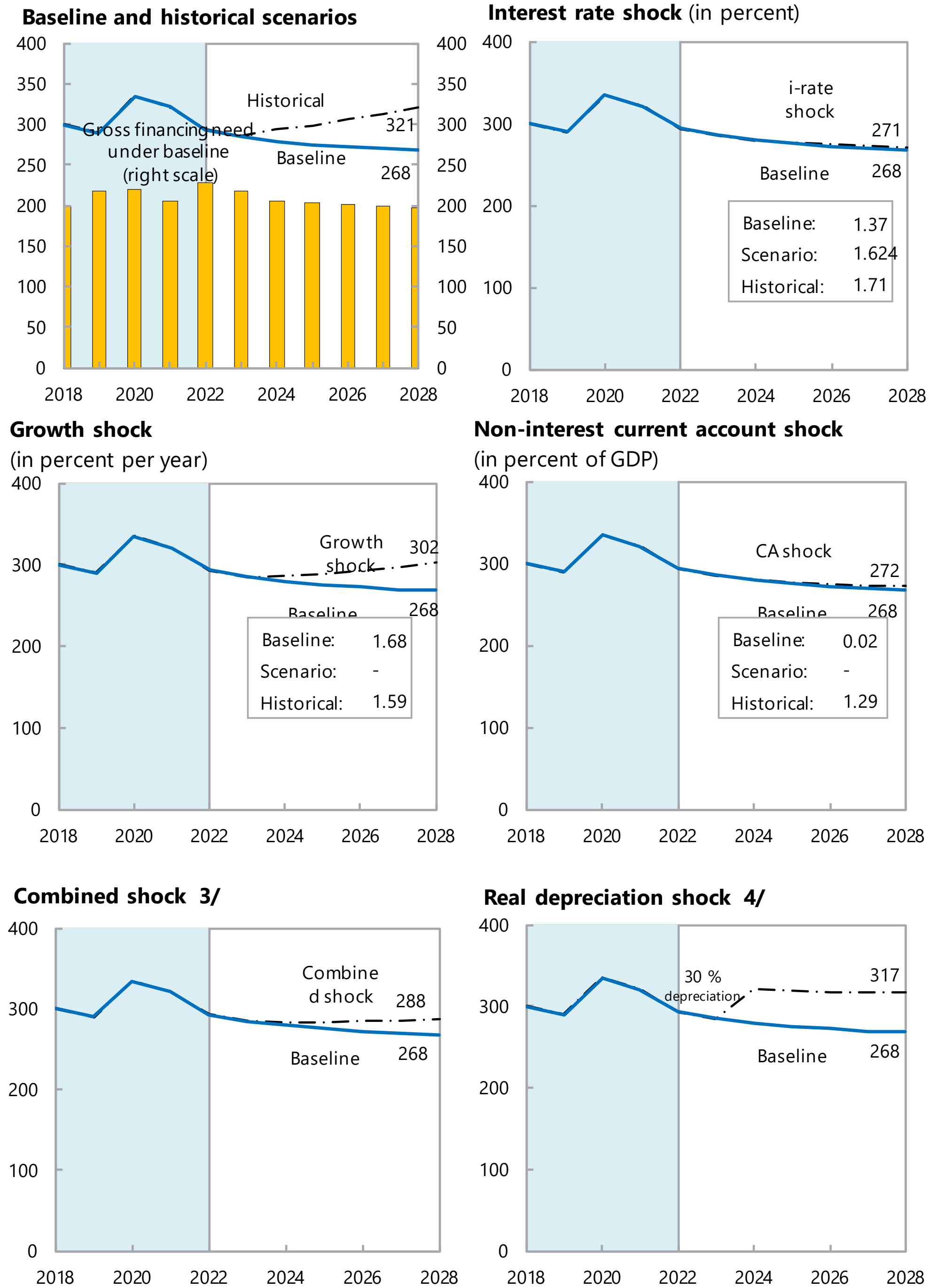
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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 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. Risk Assessment Matrix[1]

<table>
<tr><th>Source of Risk and Relative Likelihood</th><th>Expected Impact of Risk</th><th>Policy Recommendations</th></tr>
<tr><td>High

Intensification of regional conflict(s). Escalation of Russia’s war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.</td><td>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.</td><td>Accelerate the green transition.
Extend energy support schemes but improve targeting and provide a timetable for sunsetting.
Monetary policy might need to tighten to keep inflation expectations well-anchored and return inflation to target in a reasonable timeframe.</td></tr>
<tr><td>High

High inflation remains sticky, leading to de-anchoring of inflation expectations, and raising core yields and risk premia. Persistence in wage and price-setting, and supply-side constraints and shocks keep inflation at elevated levels and push medium-term expectations upwards.</td><td>High

Inflation remains higher for longer, prompting the BoE to tighten monetary policy more to return inflation to target. A period of below trend output growth and potentially a recession would follow.
Highly leveraged elements of the private sector would face refinancing and solvency problems, activating macro-financial feedback channels that would deepen the recession.</td><td>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, while avoiding a stance that conflicts with monetary policy objectives.</td></tr>
<tr><td>High

Abrupt global slowdown or recession. 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. In the U.S., amid tight labor markets, supply disruptions and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in dollar strengthening, a more abrupt financial and housing market correction, and “hard landing”. In Europe, intensifying fallout from the war in Ukraine, worsening energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns and housing market corrections.</td><td>Medium

Lower trading partner growth weigh on net exports and growth. While rising economic slack would exert downward pressure on inflation, there could also be increased price pressures if the pound depreciates due to tighter-than-anticipated Fed policies.</td><td>Adjust monetary policy as needed to keep inflation expectations anchored and return inflation to target in a reasonable timeframe, while 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.</td></tr>
</table>

[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.** Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	**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 strain some weaker financial institutions and lead to housing market corrections. Growth declines sharply, while 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 tightening may have to pause (and there may even have to be some easing) 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 to 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 exhausting fiscal space and exacerbating increases in risk premia.
Medium **Monetary policy miscalibration.** Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	**High** Inflation remains higher for longer, prompting the BoE to tighten monetary policy more to re-anchor inflation expectations and return inflation to target. A period of below trend output growth and potentially a recession would follow. Highly leveraged elements of the private sector would face refinancing and solvency problems, activating macro-financial feedback channels that would deepen the recession.	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, while avoiding a stance that conflicts with monetary policy objectives.
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 the 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 growth.	Re-engage with the EU to complete the framework for cooperation on financial regulatory issues. Clarify the plan for the retained EU laws.

Source of Risk and Relative Likelihood	Expected Impact of Risk	Policy Recommendations
High **Deepening geo-economic fragmentation.** Broader and deeper conflict(s) and weakened international cooperation lead to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential 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 the vulnerable, while avoiding a stance that conflicts with monetary policy objectives.
High **Social discontent.** Supply shocks, high inflation, real wage drops, and spillovers from crises in other countries worsen inequality, trigger social unrest, and give rise to financing pressures and damaging populist policies.	**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. Labor strikes escalate, further complicating challenges with public service delivery and impacting economic activity.	Expand support to the most vulnerable households. Re-engage with social partners to de-escalate the situation.

Annex IV. Recent Budget Measures and Possible High-Quality Measures

Autumn Statement 2022	
Selected Measures	**Comments**
-Income tax increases and businesses rate relief	See: https://lordslibrary.parliament.uk/autumn-statement-2022-key-announcements-and-analysis/
-Increase in the effective rate and coverage of windfall taxes on energy suppliers.	The Autumn Statement of November 2022 expanded the oil and gas windfall taxation scheme introduced earlier in May that year. For more information, see: https://www.gov.uk/government/publications/autumn-statement-2022-energy-taxes-factsheet/energy-taxes-factsheet
-Introduction of an energy price cap (Energy Price Guarantee Scheme)	The Autumn Statement expanded by energy price cap announced earlier in September that year. See https://commonslibrary.parliament.uk/research-briefings/cbp-9714/#:~:text=The%20Energy%20Price%20Guarantee%20set,time%20in%20around%2020%20months.
-New round of targeted energy and cost-of-living support	New targeted support was approved for recipients of means-tested and disability benefits, as well as pensioners. Also, social benefits, state pensions and the National Living Wage were to increase with inflation. See: https://www.gov.uk/government/publications/autumn-statement-2022-cost-of-living-support-factsheet/cost-of-living-support-factsheet
Spring Budget 2023	
Selected Measures	**Comments**
-Confirmation of the increase in the corporation tax rate from 19 to 25 percent and improvement to capital investment allowance	For more details, see: https://commonslibrary.parliament.uk/research-briefings/cbp-9178/; and https://www.gov.uk/government/publications/spring-budget-2023-factsheet-cutting-simplifying-tax-for-businesses-to-invest-and-grow/spring-budget-2023-media-factsheet-cutting-simplifying-tax-for-businesses-to-invest-and-grow
-Replacing the Energy Bill Relief Scheme (which had capped energy tariffs for businesses at the same level as the EPG) with better targeted and less generous subsidies to firms under the Energy Bills Discount Scheme.	According to OBR (EFO, March 2023, Page 57): "the average modelled discount of those [firms] on fixed contracts under the EBDS is around 80 percent less generous" than under the previous 6-months program. For more details see Energy SIP.
-Rollout of new childcare provisions	Working parents in England will be able to access 30 hours of free childcare per week, for 38 weeks of the year, from when their child is 9 months old to when they start school. This will be rolled out in stages: (1) From April 2024, all working parents of 2-year-olds can access 15 hours per week; (2) From September 2024, all working parents of children aged 9 months up to 3 years old can access 15 hours per week; (3) From September 2025 all working parents of children aged 9 months up to 3 years old can access 30 hours free childcare per week.
-Introduction of a 3-year capital investment allowance	For details, see: https://www.gov.uk/government/publications/full-expensing/spring-budget-2023-full-expensing

Staff Recommendations for High-Quality Measures for Forecast Period	
Selected Measures	**Comments**
-Close tax loopholes	For corporate income taxes, loopholes are related to investment allowances; for personal income taxes, they affect inheritance taxes and "non-domiciled" tax status; and for social security, they relate to the differential treatment of self-employed people. For reference, see: https://ifs.org.uk/books/top-income-inequality-and-tax-policy https://ifs.org.uk/articles/how-tax-rich
-Reform property taxation	Currently, council tax rates apply to valuation buckets that may not adequately tax the owners of properties whose valuations have increased massively within the top band. A reform that delivers a fairer council tax rate system could also provide an opportunity to rebalance away from the stamp duty on real estate transactions which constrains housing and labor mobility.
-Increase carbon taxation	See: https://www.theccc.org.uk/wp-content/uploads/2019/08/Vivid-Economics-The-Future-of-Carbon-Pricing-in-the-UK.pdf
-Reform the tax system more broadly	For carbon pricing options by the CCC, see: https://ifs.org.uk/publications/tax-reforms-needed-encourage-employment-and-investment; https://www.economist.com/britain/2023/04/11/britains-tax-take-is-getting-bigger-but-not-better For UK Emissions Trading Scheme, see: https://www.gov.uk/government/publications/participating-in-the-uk-ets/participating-in-the-uk-ets For a UK Carbon Border Approach, see https://publications.parliament.uk/pa/cm5802/cmselect/cmenvaud/737/report.html
-Ensure that resources are being deployed in the most efficient and impactful manner (including enhancing performance-budgeting and taking forward the Procurement Bill)	On Performance budgeting, see: https://www.oecd.org/gov/budgeting/43411005.pdf; https://www.oecd.org/gov/budgeting/budgeting-and-public-expenditures-2019-united-kingdom.pdf; https://www.gov.uk/government/publications/planning-and-performance-framework/the-governments-planning-and-performance-framework On Procurement Bill (May 2022): This bill establishes new measures to tackle fraud and corruption in public procurement, including a requirement to exclude a supplier that has failed to provide beneficial ownership information requesting by the contracting authority in their procurement. See: https://commonslibrary.parliament.uk/research-briefings/cbp-9402/
-Eliminate the 'triple lock' on pensions and/or bring forward the delay in state pension age	Triple lock: Under the triple lock (introduced by the Conservative/Liberal Democrat coalition government in 2010), the state pension is supposed to increase each year in line with whichever of these three measures is highest: inflation, as measured by the Consumer Prices Index (CPI) in September of the previous year, the average increase in wages across the UK, or 2.5 percent. The increase comes into effect each April. See: https://www.resolutionfoundation.org/app/uploads/2022/09/What-next-presentation-for-publications-page.pdf. State Pension age: The state pension age is due to rise from 66 to 67 by 2028. The next increase, to 68, is not due to happen until between 2044 and 2046.

-Increase in public pay spending to address ongoing public sector strikes and maintain high quality services and retain public sector workers	For details on the agreement with health sector unions, see: https://www.gov.uk/government/news/government-and-health-unions-agree-pay-deal-paving-way-for-an-end-to-strike-action For details on civil service pay, see: https://www.instituteforgovernment.org.uk/explainer/civil-service-pay For report on options to retain public sector workforce, see ("How can the government retain public sector workforce", Institute for Government, June 2023, forthcoming)
-Increase public investment for the green transition	The Climate Change Committee (CCC) estimated about £50 billion (2.1 percent of GDP) per year in additional investment is required to get to net zero by 2050, of which they expect 1/3 to be public and 2/3 private. See: https://www.theccc.org.uk/wp-content/uploads/2020/12/The-Sixth-Carbon-Budget-The-UKs-path-to-Net-Zero.pdf

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

Successive shocks over 2020–22 pushed up deficit and debt levels, reflecting fiscal response measures and economic scarring. Under the baseline scenario, the primary fiscal deficit declines below 2 percent of GDP as temporary fiscal support measures are unwound, and a gradual fiscal consolidation takes place in accordance with the medium-term fiscal plans set out in Spring Budget 2023. General government gross debt continues to rise through 2026, stabilizing at 110 percent of GDP at the end of the projection horizon (well-above pre-crisis projections), in part reflecting less favorable automatic debt dynamics. Gross financing needs (GFNs) average 13 percent of GDP over 2023–28 (compared to pre-pandemic levels at 9 percent), reflecting increased debt service costs. While high GFNs and quantitative tightening by the BoE is expected to increase the supply of gilts, domestic banks appear to have sufficient residual absorption capacity once likely NBFI demand is accounted for. Moderate risk from debt non-stabilization and high gross financing needs are mitigated by the UK's long debt maturity, lack of foreign currency debt 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.

1. Background. As the UK economy rebounded from the pandemic shock in 2021, the fiscal deficit remained high but public debt stabilized. The decline in the public debt-to-GDP ratio continued in 2022 despite the energy price shock, as high inflation lifted the denominator. As growth prospects worsened, energy support measures with high albeit temporary fiscal costs were rolled out, and borrowing costs increased in Q3 2022, with concerns about increased deficit and debt and potential changes in the fiscal framework leading to a disorderly, but temporary, increase in gilt yields and financial volatility in the NBFI sector. Credibility in the fiscal framework was restored by the Autumn Statement in November 2022, which set out medium-term fiscal consolidation plans, and returned gilt yields to levels consistent with broader monetary and financial conditions. The medium-term consolidation plans were re-affirmed by the Spring budget in March 2023, also aided by lower-than-expected outlays for energy support measures.

2. Baseline fiscal assumptions. Staff's baseline is built on the medium-term fiscal framework contained in Spring Budget 2023, which entails a decline in the fiscal deficit in 2024 as energy support measures are phased out and GDP growth picks up, and sustained structural restraint thereafter maintaining the primary deficit at less than 2 percent of GDP in FY25–28 (Figure 4).

3. Realism of baseline projections. Forecast errors point to some optimism in staff's projections for medium-term primary balances and cyclical conditions, reflecting substantial fiscal support measures and a large output gap during the pandemic (Figure 5). The projected fiscal adjustment and debt reduction paths are within the normal historical range observed in peer countries. While the maximum adjustment over any three years is an outlier, this reflects the phase out of energy support measures.

[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.

4. Risks and mitigating factors. The Debt Fanchart and GFN Financeability modules both signal moderate risk (Figure 7). For the fanchart, this reflects high uncertainty (as indicated by the fanchart width), a high probability of debt non-stabilization but 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 25 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 12 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 2½ 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 debt maturity (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 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	n.a.
Debt stabilization in the baseline			Yes

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, with strong GDP growth over 2025-2027 helping stabilize debt. 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 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:

Sectors		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting On Intra-Government Debt Holdings

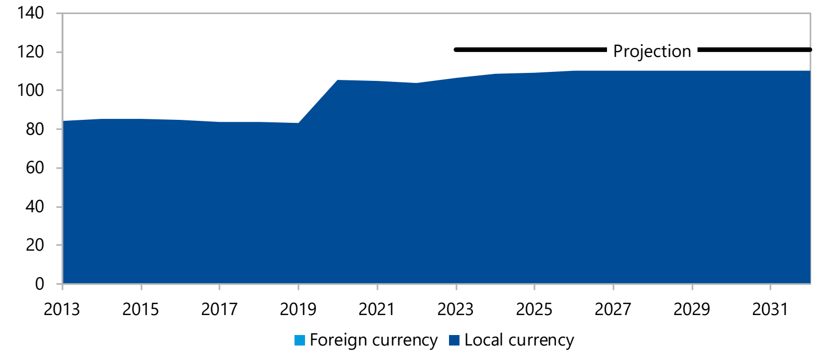
Issuer \ Holder		Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt									0
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.									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, and differs from the public sector debt concept used in the 2021 Article IV staff report.

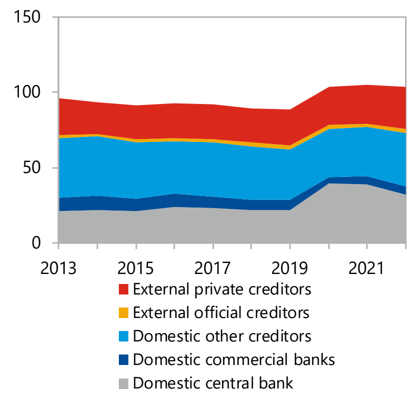
Figure 3. United Kingdom: Public Debt Structure Indicators

Debt by currency (percent of GDP)



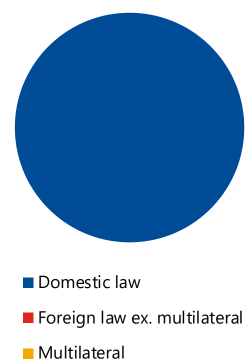
Note: The perimeter shown is general government.

Public debt by holder (percent of GDP)



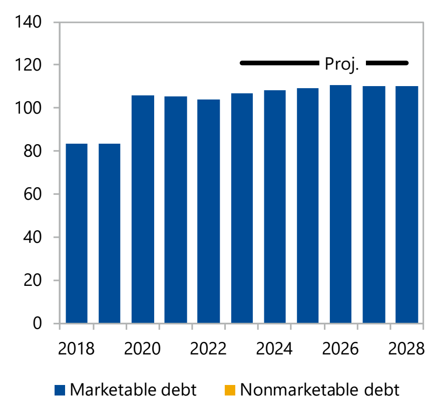
Note: The perimeter shown is general government.

Public debt by governing law, 2022 (percent)



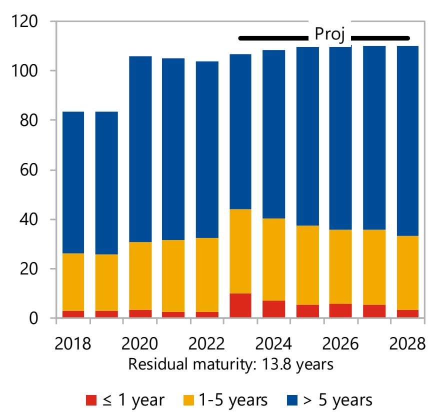
Note: The perimeter shown is general government.

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 5 percent of public debt.

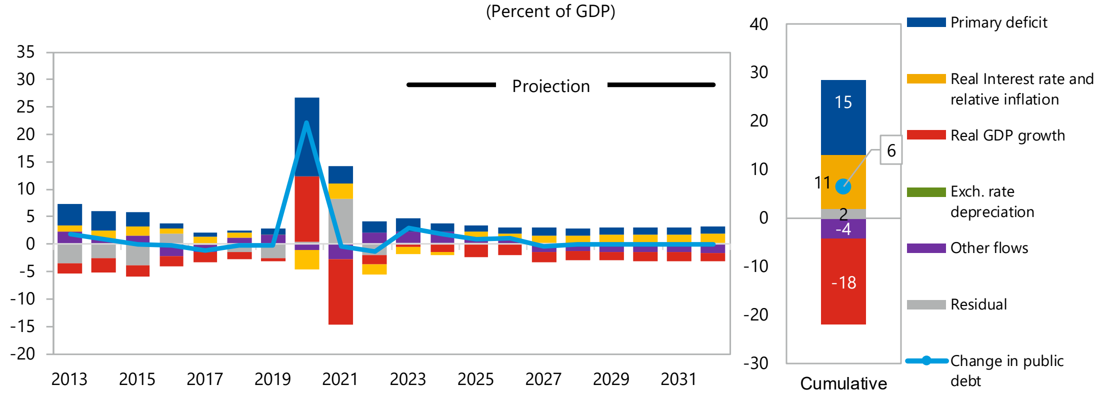
Figure 4. United Kingdom: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Est.	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	103.8	106.7	108.5	109.4	110.5	110.2	110.2	110.2	110.2	110.2	110.2
Change in public debt	-1.4	2.9	1.8	0.9	1.1	-0.3	0.0	0.0	0.0	0.0	0.0
Contribution of identified flows	0.6	2.7	1.6	0.7	1.0	-0.5	-0.1	-0.2	-0.2	-0.2	-0.2
Primary deficit	2.0	2.3	1.3	1.1	1.2	1.5	1.3	1.3	1.3	1.3	1.3
Noninterest revenues	39.3	39.6	39.3	39.4	39.5	39.6	39.8	39.8	39.8	39.8	39.8
Noninterest expenditures	41.4	42.0	40.7	40.5	40.8	41.1	41.1	41.1	41.1	41.1	41.1
Automatic debt dynamics	-3.5	-1.8	-1.9	-1.4	-0.8	-0.5	-0.2	-0.1	-0.1	0.0	0.0
Real interest rate and relative inflation	-1.8	-1.3	-0.5	1.0	1.2	1.4	1.4	1.5	1.6	1.6	1.7
Real interest rate	-1.8	-1.3	-0.5	1.0	1.2	1.4	1.4	1.5	1.6	1.6	1.7
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	-1.7	-0.5	-1.4	-2.4	-2.0	-1.9	-1.6	-1.6	-1.6	-1.6	-1.6
Real exchange rate	0.0	…	…	…	…	…	…	…	…	…	…
Other identified flows	2.1	2.1	2.1	1.1	0.6	-1.5	-1.2	-1.4	-1.4	-1.5	-1.5
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	2.1	2.1	2.1	1.1	0.6	-1.5	-1.2	-1.4	-1.4	-1.5	-1.5
Contribution of residual	-2.0	0.2	0.2	0.2	0.1	0.2	0.1	0.2	0.2	0.2	0.2
Gross financing needs	11.6	11.6	14.2	12.2	12.1	13.5	14.1	12.5	14.3	15.0	14.8
of which: debt service	10.8	9.2	12.9	11.1	10.9	12.0	12.8	11.2	12.9	13.7	13.5
Local currency	10.8	9.2	12.9	11.1	10.9	12.0	12.8	11.2	12.9	13.7	13.5
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)	1.6	0.5	1.3	2.3	1.9	1.7	1.5	1.5	1.5	1.5	1.5
Inflation (GDP deflator; percent)	6.5	4.9	3.5	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	8.2	5.3	4.8	4.2	3.9	3.7	3.6	3.5	3.5	3.5	3.5
Effective interest rate (percent)	4.6	3.6	2.9	2.8	3.1	3.2	3.3	3.4	3.5	3.5	3.6

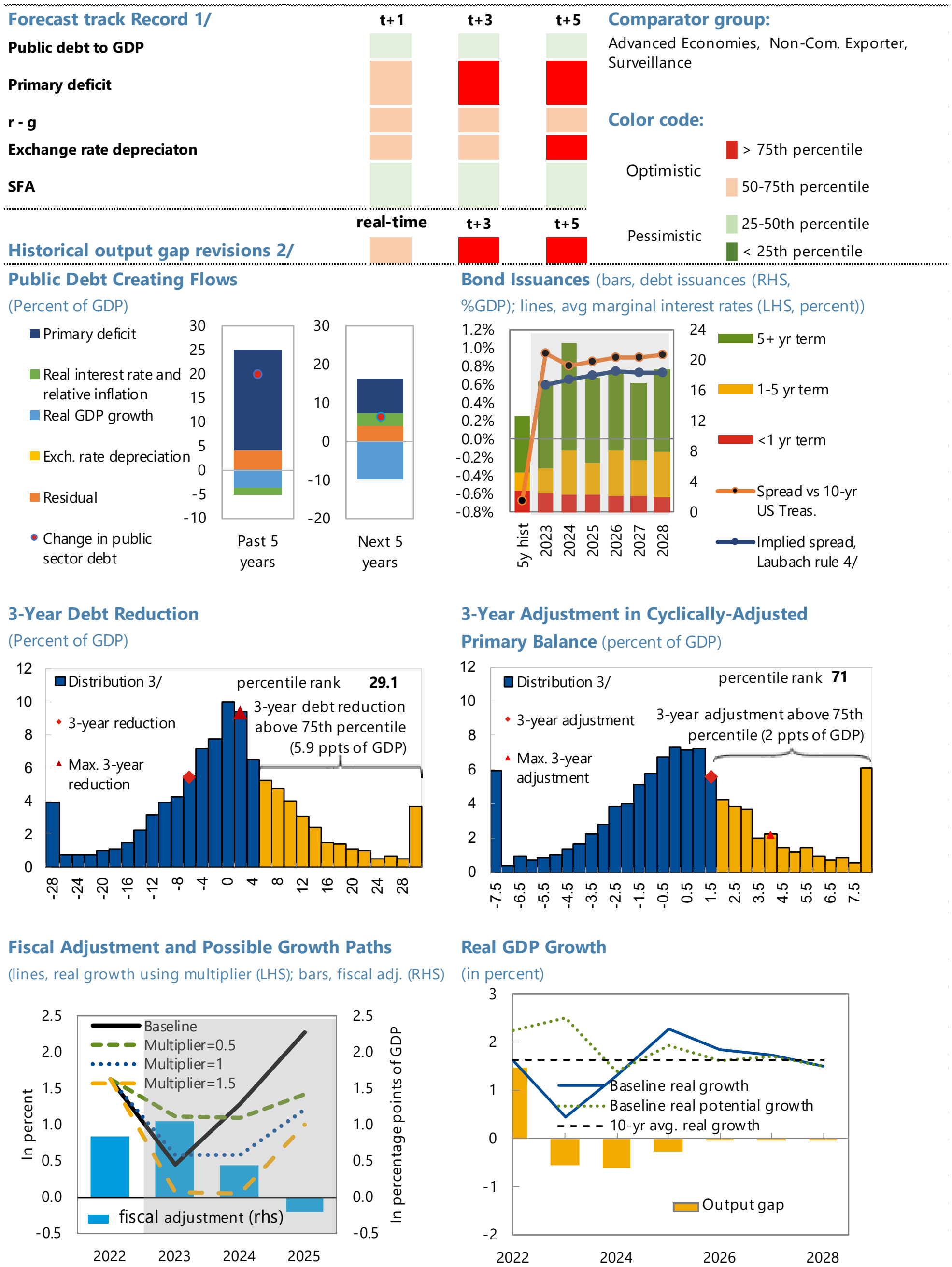
Contribution to Change In Public Debt

(Percent of GDP)



Staff commentary: Public debt will rise through 2026 but then stabilize as the economy recovers and primary deficits remain restrained. Other transactions include government interest revenues, which follow OBR projections through 2027, and grow at the same pace as nominal GDP thereafter.

Figure 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 debt reduction are within historical norms; while the maximum adjustment over any three years is above the threshold, this reflects the unwinding of energy support measures. Public debt creating flows reflect increased real interest rates as tight monetary policy brings down inflation.

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 and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

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

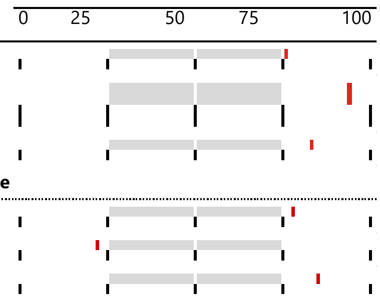
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 6. United Kingdom: Medium-Term Risk Analysis

Debt fanchart and GFN financeability indexes

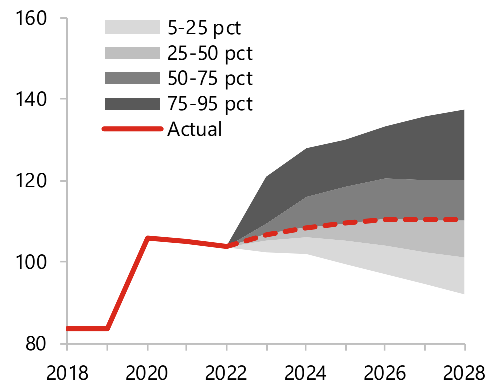
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	45.5	0.7	...
	Probability of debt not stabilizing (pct)	88.4	0.7	...
	Terminal debt level x institutions index	25.6	0.6	...
	Debt fanchart index	**...**	**2.0**	**Moderate**
GFN finance-ability module	Average GFN in baseline	12.9	4.4	...
	Bank claims on government (pct bank assets)	2.6	0.9	...
	Chg. in claims on govt. in stress (pct bank asset	11.7	3.9	...
	GFN financeability index	**...**	**9.2**	**Moderate**

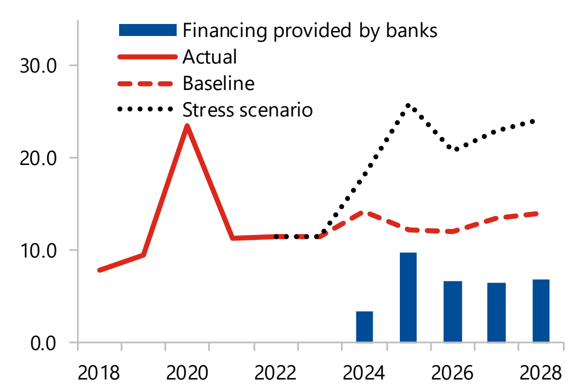


Legend: Interquartile range United Kingdom

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

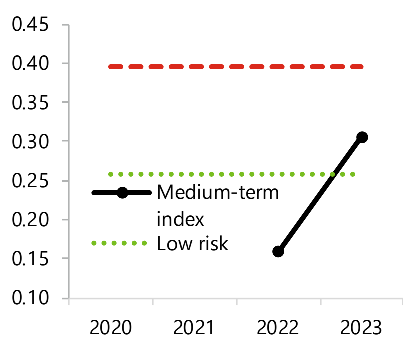


Triggered stress tests (stress tests not activated in gray)

Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-term index

(index number)



Medium-term risk analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.43
GFN finaceability index	7.6	17.9	0.5	0.18
Medium-term index (MTI)	0.26	0.40	...	0.31, Moderate

Prob. of missed crisis, 2023-2028 (if stress not predicted): 18.2 pct.

Prob. of false alarm, 2023-2028 (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.

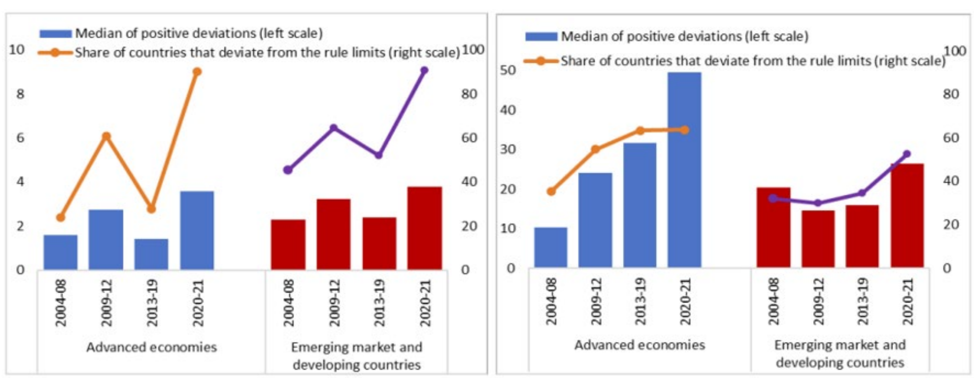
Annex VI. Reforms to Further Strengthen the UK's Fiscal Framework

1. **Countries have increasingly adopted fiscal rules and fiscal councils to help strengthen their fiscal frameworks, promote debt sustainability, and increase the credibility of fiscal policy.** Fiscal rules are long-lasting constraints on fiscal policy through numerical limits on broad budget aggregates. The optimal set of fiscal rules would be one that combines flexibility, simplicity and enforceability (IMF, 2021, 2022).[1] Flexibility is key to avoid highly inefficient or sub-optimal fiscal policy decisions ex-post at moments in which responding to unexpected economic conditions may not be compatible with meeting the fiscal targets. Fiscal rules must also be simple to understand by the broader population, and this is why many countries opted for nominal debt or deficit rules instead of cyclically adjusted measures. Finally, enforceability of the rules must be straightforward, and this is why most frameworks incorporate legal and economic sanctions and correction mechanisms, accompanied by independent fiscal councils.

2. **Compliance with the rules has been low in most countries, especially due to unexpected economic shocks.** About 90 percent of countries with Balance Budget Rules (BBR) saw their deficits exceed the rule limits in 2020, with the median positive deviation at about 4 percent of the GDP. A greater share of countries exceeded BBR limits and to a larger degree than in the global financial crisis (Figure 1). At the same time, over half of countries with Debt Rules (DR) had debt exceeding the limit or anchor levels with a median deviation of 50 percent of GDP for advanced economies and 26 percent of GDP for emerging market and developing economies. In the UK too, a

Figure 1. Deviations from Deficit (left) and Debt (right) from Fiscal Rules Limits

(In percent of GDP, left scale; percent, right scale)



[1] International Monetary Fund (2021) Fiscal Rules and Fiscal Councils: Recent Trends and Performance during the Covid-19 Pandemic, IMF Working Paper WP/22/11; International Monetary Fund (2022) The Return to Fiscal Rules, Staff Discussion Notes, SDN/2022/002.

battery of rules has not prevented growth of deficits and debt as the impact of large shocks has not been fully reversed.

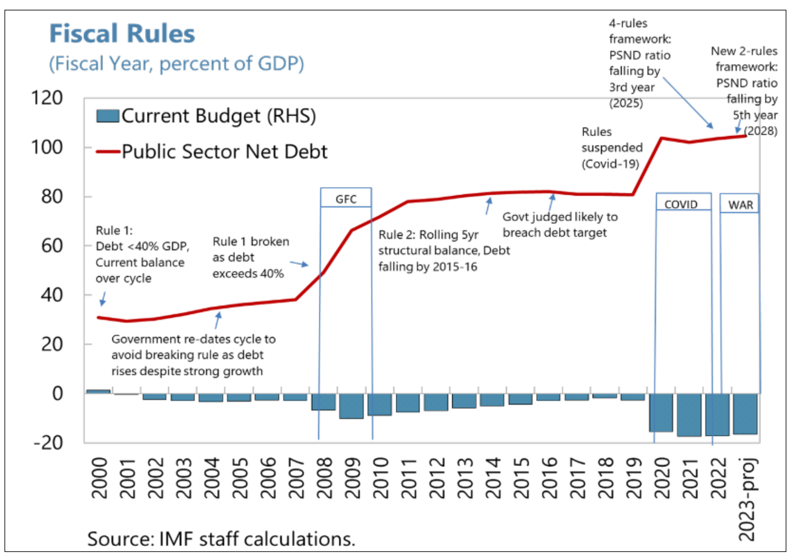
3. **The UK's fiscal framework has many strengths, most notably, its institutions:** a highly capable and powerful Treasury to advise chancellors and implement their agenda; a fiscal council (Office for Budget Responsibility) that is empowered to produce the economic and fiscal forecasts for government; a system of spending reviews that produces binding 3-year (non-rolling) nominal ceilings for departments; an independent National Audit Office; strong accountability before the parliamentary Treasury Select Committee; and a globally-recognized culture of fiscal transparency.

Box 1. The Role of the OBR

The UK has a rather unique fiscal council model in the Office for Budget Responsibility (OBR). The OBR scrutinizes and certifies costings of announced policy measures, producing the economic and fiscal forecast that the Treasury uses to produce its budget plans, and assess compliance with the existing fiscal rules – most fiscal councils do not have the expansive mandate of costing measures and producing the official economic and fiscal forecast for government. At the same time, to ensure its neutrality and independence, the OBR was not given the mandate to assess the appropriateness of policy measures or the resulting fiscal stance, which most fiscal councils have. Separately, the OBR also produces an annual fiscal risks and sustainability report, and senior staff of the OBR give on-the-record briefings to the UK parliament's Treasury Select Committee (typically after every major fiscal event).

4. **However, the UK's experience with fiscal rules over two decades, and the recent 'mini-budget' stress episode, point to some issues in the fiscal framework that deserve attention.**

- First, in the last two decades, the UK has had 10 sets of rules (including 2 changes in the last 2 years), reflecting a tendency to change rules when there is a change in leadership, and a reluctance to invoke escape clauses that could be activated when sizable shocks hit the economy. While this may reflect both the administrative ease, and low political cost of changing the rules, it undermines the perceived credibility of the rules-based framework.



Source: IMF staff calculations.

- Second, approving new rules at the 2022 Autumn Statement instead of activating the escape clause as a result of the energy shock may have been justifiable given the backdrop of market stress, but the new rules are far from optimal. In principle they seem less constraining (e.g., debt must be falling in the 5th year of the forecast -instead of the 3rd-; and the deficit should be below 3 percent of GDP -instead of a current balance budget-), but they don't take into account the level of debt thus prompting sub-optimal fiscal policy choices to meet the rules. For example, despite starting from a lower level of debt than at the time of the Autumn Statement, the 2023 Spring budget incorporated inefficient policy decisions (e.g. temporary tax reliefs for investment when they should have been permanent), and low-probability assumptions (e.g., a fuel duty uprate, despite this choice having been eschewed for several years) only to meet the rules by the smallest margin in the OBR's history.

- Third, the OBR's potential is somewhat under-tapped in that the OBR is currently not mandated to present its analysis on (i) whether shocks are sizeable enough to invoke the escape clause and suspend the application of the rules; or (ii) the pros and cons of alternative fiscal rules before these are voted upon. Given the experience of the 'mini-budget' stress episode, it seems an OBR mandate that includes pronouncing on these issues in a timely manner might have been helpful.

5. Staff sees options to strengthen the fiscal framework that would allow more space for efficient choices, avoid repeated change of rules, and fully leverage the UK's institutional strengths. Specifically, staff recommends that authorities consider three options:

- First, drawing on the experience of the 'mini-budget' stress episode, all major fiscal policy changes should be accompanied by a full set of macroeconomic and fiscal forecasts by the OBR, unless the OBR assesses that such a forecast is not necessary.

- Second, escape clauses for fiscal rules should be better fleshed out (with clear conditions under which the rules could be suspended and when they should be reactivated) to avoid the loss of credibility associated with permanent discretionary changes to the rules. The OBR could assess whether the escape clause could be invoked in response to a specific shock, with the final decision resting with the government. Also, a mechanism could be established for the OBR to provide to parliament an analysis of the impact of any proposed changes in the fiscal rules before these are voted upon. These additional functions would require minimal modifications to OBR's remit, while preserving the objectivity and neutrality of the institution.

- Finally, building on the strength of the UK's fiscal institutions, the authorities could consider the case for a framework that considers the full probability of debt stabilization, rather than rules based on point-estimate projections. The probability of debt stabilization is also a concept at the center of the new IMF Sovereign Risk and Debt Sustainability Framework (SRDSF).[2] This stochastic approach would take better account of uncertainty and could be nested within a higher-level "fiscal standard" (see Box) that is stabler than numerical fiscal rules, and provides somewhat greater flexibility while preserving fiscal discipline.

[2] See "Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for Market Access Countries" (2022): https://www.imf.org/-/media/Files/Publications/PP/2022/English/PPEA2022039.ashx.

Box 2. Fiscal Standards

In a recent paper Blanchard and others (2021) propose abandoning European fiscal rules and developing fiscal standards instead. Standards are qualitative prescriptions that leave room for judgement and therefore need to be accompanied by a strengthening of enforcement mechanisms. To illustrate the difference between rules and standards, the authors use the following example "standards lay out an objective, but without fully spelling out how it is to be met. For example, 'do not drive faster than 55 miles an hour' constitutes a pure rule, while do not drive at excessive speed' is a pure standard. What speed is considered 'excessive' depends on the situation, and will be based on judgment, social norms, and legal precedent'.

Moving to fiscal standards in the UK would require adapting some elements of the existing framework. First, fiscal policy should be guided by a higher-level objective (e.g., "debt should be sustainable with a high probability") that is seen as sensible and prudent by stakeholders and the population at large, thus making it more difficult to change. Second, assessing the compliance with the standard would require further developing specific tools that allow for judgement (e.g., debt fancharts, and risk scenarios for standard or climate related shocks) to be used in assessing the relative compliance with the standard. Finally, there should be an independent assessor to determine if the standard has been met, with the capacity to activate a corrective mechanism that could eventually include the modification of budget proposals and/or the delay of budget plans assessed as inconsistent with the standard.

Fiscal standards could work well in the UK. Moving to fiscal standards requires strong fiscal institutions and the UK is very well-placed in this respect. This, together with an established culture of fiscal transparency, could effectively support a fiscal framework anchored in higher-level standards that provide UK governments with more flexibility to apply optimal fiscal policy at each moment in time, as long as actions are considered prudent and in line with the standard. Such a framework would also provide more stability, because changing a fiscal standard based on the prudent principle of debt sustainability (for which there would be wide popular support), would be more politically costly.

References:
-Blanchard, O, Á Leandro and J Zettelmeyer (2021), "Redesigning EU Fiscal Rules: From Rules to Standards", Economic Policy, 36(106): 195–236.

Annex VII. Staff Policy Advice from the 2021 Article IV Consultations[1]

IMF 2021 Article IV Selected Recommendations	Policy Actions Between 2021 Article IV and May 2023
Monetary Policy	
Tighten monetary policy to return inflation to target; adjust monetary policy as needed to keep inflation expectations anchored.	The BoE has raised its policy rate 12 times in a row since December 2021 to 4.5 percent in May 2023. The pace of rate hikes accelerated in August 2022 and then slowed from March 2023.
Ensure that the quantitative tightening strategy is made as predictable as possible; provide short term liquidity if the tightening process reveals liquidity mismatches.	Since November, the BoE has reduced its gilt portfolio by £26.9bn, roughly in line with the announced annual reduction target of £80bn. The BoE has recently emphasized that the UK banking system maintains capital and liquidity positions above prudential requirements.
Fiscal Policy	
Set fiscal policy set to address structural issues while preserving sustainability; use available fiscal space to cushion the economy against the present conjuncture.	The September 23, 2022 'mini-budget,' with nearly £45 billion unfunded tax cuts, was delivered against the backdrop of historically high inflation and not accompanied by an assessment by the OBR. The budget unnerved the UK's core financial markets: the pound plunged to a historic low of 1.03. Acute dysfunction in the 30-year gilt market, as pension funds faced large margin calls, prompted the BoE to intervene and restore orderly market conditions. The credibility in the fiscal framework was restored by the Autumn Statement in November 2022, which set out medium-term fiscal consolidation plans, and returned gilt yields to levels consistent with broader monetary and financial conditions. The medium-term consolidation plans set out in the Autumn Statement were re-affirmed in the Spring budget in March 2023, also aided by lower-than-expected outlays for energy support measures. In the Spring budget of 2023, the government announced that it would spend most of the additional fiscal space obtained since the 2022 Autumn Statement from a better-than-expected economy in a new labor activation package (including an expansion of childcare services), tax reliefs for business investment, and the costly extension of universal energy bill support (the largest package amongst peers).
Limit the frequency of changes to the fiscal rules, framework and consider expanding the mandate of the OBR so that every time the design of fiscal rules is altered, the parliament could benefit from a structured commentary on whether the new calibration aligns with higher-order fiscal objectives (such as sustainability or any other objectives defined in law).	In the Autumn Statement of 2022, the authorities abandoned the previous set of fiscal rules (approved just a year earlier) and replaced them with two new rules, namely to have the debt-to-GDP ratio declining in the 5th year of the forecast horizon (3rd year in the previous framework), and have a budget deficit below 3 percent of GDP in the 5th year of the forecast horizon (before a current balance budget in the 3rd year)

[1] The 2021 Article IV Consultation was concluded in February 2022.

Structural Policy	
Implement structural reforms to advance the growth plan, including by scaling up public investment, allocating higher funding to active labor market policies, pursuing opportunities to strengthen education and training, and enhancing the public investment management framework. Accelerate the Net Zero Strategy by establishing clearer and earlier incentives for private sector actions, implementing earlier compensation mechanisms, and removing barriers to boost private supply and increase green public investment.	The Chancellor's 4Es strategy aims to boost business investment and productivity and support key and fast-growing sectors. The government also launched the refocused Investment Zones program to catalyze 12 growth clusters across the UK to drive growth and bring investment to the local area. The government has empowered the British Business Bank (the UK's government-owned economic development bank) via British Patient Capital to provide equity to high-growth sectors, Long-term Investment for Technology and Science (LIFTS) initiative to unlock UK institutional investment, COVID-related recovery loans, and a new generation of funds worth £1.6bn supporting financing across the regions. The government is taking forward reforms set out in the Skills for Jobs White Paper. The government commits to gigabit broadband, adopting 5G in key sectors, and £20bn direct funding for R&D by FY2024/25. While these actions demonstrate progress on the structural front, additional reforms are required to lift labor participation, productivity, and business investment. On the Net Zero Strategy, notable measures include the extension of the Boiler Upgrade Scheme to 2028, timelines for the next stage of the Carbon Capture, Usage and Storage scheme, and support for the development of port infrastructure to deliver floating wind. However, further actions are needed to secure Net Zero objectives.
Revise Brexit migration legislation to augment the labor force.	The authorities have further developed a migration system for high skilled and globally mobile talent: They have launched several new visas, including i) in April 2022 the Global Business Mobility route to streamline existing offers for overseas businesses transferring staff to the UK, ii) in May 2022 the High Potential Individual visa for those who have recently graduated from a top 50 ranked non-UK university, iii) and in August 2022 a new Scale-up Worker visa to help these fast-growing businesses bring in the talent needed to grow and drive innovation. Reforms have also been made on the Global Talent Network to attract talent in Science and Technology, and the Innovator Founder visa to make it easier for those with the skills and experience to found, and invest in, innovative businesses in the UK. The Spring Budget also announced plans to simplify and expand the UK's business visitor visa offer by expanding the range of short-term business activities that can be carried out for periods of up to 6 months and reviewing permitted paid engagements. In addition, recommendations from the Migration Advisory Committee to support businesses and tackle labor shortages were accepted, including adding five construction occupations to the Shortage Occupation List. While these efforts are helpful, additional adjustments to immigration arrangements are needed to effectively address labor and skills shortages.

Annex VIII. Pockets of Emerging Credit Risks

1. While about 80 percent of household **mortgages** have fixed rates, the durations of the fixed rates are short, mostly 2–5 years. Consequently, about half of owner-occupied mortgages will be subject to sizable increases in mortgage payments this year. While the FPC projects that the share of households with cost of living-adjusted mortgage debt service-to-income ratios of 70 percent or higher is around 2 percent, staff's analysis suggests household mortgage stress (share of mortgage arrears) could reach GFC peak levels should high inflation persist and interest rates need to stay higher for longer. In this context, the FCA has appropriately issued recommendations to banks to communicate with and provide tailored solutions to consumers in need of support to meet their contractual debt obligations; this should mitigate its impact on the health of the financial system. In addition, still-high household savings would help to limit negative effects on the real economy via a compression in household consumption.

2. The **commercial real estate** (CRE) sector could also be a source of vulnerability, as rising interest rates depress property values but push up debt service costs. UK commercial property values fell by over 13 percent in 2022, with declines seen in the industrial, retail, and office sectors. While aggregate CRE values picked up slightly in March and April 2023, declines were particularly prominent in the offices sector. Moreover, office occupancy rates are only at about 35 percent of pre-pandemic levels. From the financing perspective, it is estimated that about £150bn (6 percent of GDP) in CRE loans are due to be refinanced over the next five years. UK banks have relatively low exposures on CRE loans, less than 4 percent of their total loan books, and have an average maximum loan-to-value ratio below 60 percent. NBFIs are also exposed to the sector (about 9 percent of insurers' portfolios and 4 percent of pension funds' assets), as commercial property investors scaled down exposure, the discount at which commercial property real estate investment trusts trade increased.[1]

3. On the **corporate** side, SMEs are more vulnerable to interest rate risks than large corporations, but, as the FPC stated, a significant part of their debt is guaranteed by the government under the COVID-support schemes and carries relatively low (fixed) interest rates. Still, SME borrowing from banks (about 9 percent of total bank lending, or 36 percent of total business lending) could be crowded out by large firms if conditions for market financing deteriorate. At the same time, corporates with a heavier reliance on riskier market financing would be more vulnerable under volatile financial markets/tighter financial conditions. Corporate insolvencies have picked up, reflecting rising interest costs but also due to removal of the freeze on insolvency procedures placed during the pandemic. The BoE analysis shows that over 80 percent of insolvencies in 2022 were micro firms.

[1] According to the BoE, UK commercial real estate investment trusts were trading at a 25 percent discount at end-2022, a significantly larger discount than the average in preceding years of roughly 5 percent.

Key Recommendations

	Recommendations	Time[1]	Update on relevant work in progress	Current progress
	A. Further Bolster Management of Systemic Risks			
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)	MT	• Designed and carried out gilt market purchases on financial stability grounds 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 have now been successfully exited. • Work to reflect on lessons learnt from the episode and to embed a buy / sell facility in the Bank's FS toolkit is underway and expected to be completed in 2024. • Work on developing a repo tool for NBFIs is ongoing. Design, eligibility and operational features of the tool expected to be finalized in 2024, with potential for phased roll-out to NBFIs following that.	On track
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)	MT	• The Bank will run 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 will publish more detailed information on the exercise in Q2. • The Bank will also over coming years be developing and setting out our approach to stress testing the financial system, including how the existing sector-level exercises (for banks, insurers and CCPs) fit together and exploring options to assess system wide risks. • 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: • We are 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. • We are also developing model approaches that exploit new datasets on financial exposures and interlinkages. For example, we are extending the capital at risk microstructural model of banking	On track

			sector exposures to consider amplification and feedback effects, as well as bringing in additional data collections on insurers and NBFIs. • 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. We are 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)	MT	• 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 June 2022, HMT published a policy statement signalling its intention to give the Bank, FCA and PRA ('the regulators') new statutory powers over critical third-party service providers to the UK financial sector. The proposed powers were duly included in Part 5 of the Financial Services and Markets Bill (FS&M Bill) which is currently going through Parliament and expected to receive Royal Assent in Q3 2023. • In July 2022, the regulators jointly published DP3/22 – Operational resilience: Critical third parties to the UK financial sector, which sought industry views on their detailed, initial thinking on how they may exercise their proposed new statutory powers over CTPs. The consultation period for DP3/22 closed in December 2022. • Once the legislation receives Royal Assent, the regulators will follow-up with a Consultation Paper setting out detailed rules and expectations for CTPs, which will build on feedback to DP3/22.	On track
	B. Continue Strengthening Regulation and Supervision			
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	NT	• **As part of its 2021-26 strategy, the PRA has recently 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.** The PRA completed a full review of the supervisory activities it completes across all firms it regulates. The review led to some adjustments to internal requirements, reflecting our analysis of the risk to the PRA's objectives posed by different categories of firms (e.g. host and home, branch and subsidiary, insurance and banking). After applying these adjustments, the PRA is satisfied it will obtain sufficient information to be judgement-led, risk-based and forward-looking across the	On track

	risks, and to also support macroprudential surveillance. (BOE/PRA and FCA)		firms it regulates. The PRA understands the benefit of periodic 'on the ground' reviews and retains these, for some topics, in its minimum supervisory requirements for its largest firms. For its mid-sized firms, the PRA has introduced an annual 'on site' visit. These 'on the ground' reviews and 'on site' visits support the early identification of risks that may be outside of the PRA's tolerance and are followed by tailored workplans to mitigate those risks. Where possible, the PRA is completing more of its supervisory activities (including 'on the ground' reviews) on a cross-firm basis, allowing more insightful comparisons to be made between firms. • **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.** Our greater focus on cross-firm work through our strengthened supervisory approach should enhance our macroprudential insights. • **The PRA has introduced new requirements, training and guidance to ensure greater use of Section 166 Skilled Person Reviews.** Consistent with the FSAP 2021 report's findings, the PRA's review identified opportunities to better leverage a handful of specific tools available to supervisors. Subsequently, the PRA introduced new internal requirements, training, and guidance to: o remove the internal barriers to use of Section 166 Skilled Person Reviews o make greater use of the Senior Managers & Certification Regime for accountability of key risks; and o better influence firms in adjusting variable remuneration where supervisory priorities have not been implemented appropriately by the responsible Senior Manager. These tools will be especially prominent in supervisory workplans for the largest firms and firms with risk profiles that are out of the PRA's risk tolerance. • **The PRA is establishing an international platform for supervisory cooperation with overseas regulators for Lloyd's of London to facilitate the sharing of supervisory information.** The first meeting is planned for Q4 2023. The PRA is working with Lloyd's to identify an appropriate list of overseas regulators to invite (based on the materiality of Lloyd's presence overseas, e.g. by GWP written in different jurisdictions). • **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	NT	• In 2022, the UK Authorities (PRA/FCA/Bank) completed preliminary exploratory work assessing the need of further regulatory guidance and on expectations for cyber risk management and cyber resilience (including international gap analysis, identification of key drivers and possible proposal). A proposal will be progressed and a plan of implementation will be discussed in 2023. The UK authorities have recently extended the scope of our exploratory work to include IT and change management, which has however delayed the original timeline for implementation.	Somewhat behind

	cybersecurity control verification activities to complement CBEST security testing. (BOE/PRA, and FCA)		• In parallel to the regulatory framework review, the UK Authorities are progressing a review of the supervisory approach, where we have already addressed some of IMF recommendations. • In 2022, PRA increased number of cyber specialist and their supervisory support and, alongside the FCA, completed a review of the Cyber Questionnaire (CQUEST). • In 2023, the PRA and FCA will progress the review of their approach including confirming the adoption of new testing tools for small medium firms, exploring holistic supervisory cyber assessment and piloting a new concept of testing for advanced firms and threats. • The Bank also completed the 2022 Cyber Stress Test and we took active role in international forums on the cyber resilience topic. • Through collaborative engagement with industry (Cross Market Operational Group – CMORG), the Bank has also supported the development of a number of sector cyber resilience capabilities. These include an enhanced framework for supporting firm reconnection following a data integrity incident; a cloud control framework to support the consistent adoption of controls and practices between firms and cloud service providers (CSPs); and an initiative to support firm and sector resilience improvements following the Log4j incident.	
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)	NT	• The Economic Crime and Corporate Transparency Bill introduced in September 2022 includes measures to reform the role of Companies House and improve transparency over UK companies, in order to strengthen the business environment, support our national security and combat economic crime, whilst delivering a more reliable companies register to underpin business activity. • The reforms include: o 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. o 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 o 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. o 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; o Enhancing the protection of personal information and addresses provided to Companies House to protect individuals from fraud and other harms; o Broader reforms to clamp down on misuse of corporate entities.	On track

			• 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. • 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.	
	C. Minimize Potential Risks of Ongoing Transitions and Future Crises			
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)	NT	• 29 of the 35 LIBOR settings have now ceased permanently, and the FCA have announced end dates for all the remaining settings. Overnight and 12-month US dollar LIBOR will cease at end-June 2023, 3-month synthetic sterling LIBOR will cease at end-March 2024, and the 1-, 3- and 6-month US dollar LIBOR settings will continue on a synthetic basis from end-June 2023 to 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 PRA and FCA continue to monitor UK regulated firm exposures to LIBOR through continued supervisory engagement with the highest risk firms and regular data collection across supervised entities. The Bank now estimates that, across all asset types, less than 0.1% of the total sterling LIBOR legacy stock remains. • The FPC Record on 23 March 2023 covered LIBOR transition. The Committee welcomed the further reduction in the stock of legacy sterling LIBOR exposures, and consequently judged that the financial stability risk associated with sterling LIBOR had effectively been mitigated. The FPC noted progress with active transition of legacy USD Libor exposures, and encouraged participants to maintain momentum on transition efforts to minimise remaining exposures by end-June 2023. • The Bank, FCA and HMT work closely with international authorities in support of global LIBOR transition. The Bank and FCA are actively involved in the FSB OSSG (with the FCA being a co-chair	On track

			of the OSSG), including the production of the FSB's [Progress Report] on LIBOR and Other Benchmarks Transition Issues. The report included engagement from non-FSB respondents, incorporating insights from emerging markets and developing economies on their progress in transitioning LIBOR-linked contracts. • In support of US dollar LIBOR transition globally, the Bank and FCA work closely with US authorities and committees. They meet at least monthly with the FRB, CFTC, SEC and ARRC chair. • To support a globally consistent shift away from US dollar LIBOR to robust alternatives, IOSCO has also launched a one-time review of 'credit sensitive rates' (CSRs) and SOFR term rate alternatives to USD LIBOR that present themselves as compliant with IOSCO's Principles for Financial Benchmarks. The FCA co-chairs this review with the US SEC. The aim of the review is to assess how these 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. IOSCO's review is expected to be finalized by June 2023.	
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)	MT	• **CCPs:** In July 2022, the UK Government introduced proposed legislation to Parliament that includes an extensive enhancement of the UK's CCP resolution regime (see Schedule 11 of the Bill). These enhancements will make 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. HMT and the Bank will set out timings for full regime implementation in due course. The Bank is progressing CCP resolution planning and enhancing our operational capacity and preparedness to execute a CCP resolution. These arrangements will be subject to testing, both internally and with external partners in 2023 and 2024. The Bank has commenced development of a CCP RAF program, with intended implementation in 2024. • **Insurance:** Work on updating s377 of FSMA, to give the PRA an additional tool to deal with a failing insurer, is close to completion. HMT have now consulted on establishing an Insurance Resolution Regime (IRR), and are considering the timescale for introducing legislation to bring the regime into being. The proposed regime will align the UK to relevant standards, providing the Bank with a range of tools and powers to manage the failure of a systemic insurer. If 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, the PRA are planning a Consultation Paper towards the end of 2023, which will expand on the requirements for all insurers to plan for orderly exit. • **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	**CCPs:** On track **Insurance:** On track **Banks:** On track

			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. We also working together to considering any lessons learned from SVB US / UK and CS failures to enhance our approach – and will also be engaging with relevant international work, including by the FSB, on lessons learned.	
	D. Secure Institutional Safeguards for Financial Stability and Integrity			
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)	I	• The 2022 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 (e.g., the 2022 Q3 and Q4 Records) 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.	On track
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)	I	• The PRA's general and insurance objectives rank above all other considerations when making policy, including the current secondary competition objective and the forthcoming secondary competitiveness and growth objective. • The Financial Services and Markets Bill (FSM Bill) currently going through Parliament preserves the primacy of safety and soundness and policyholder protection, making clear that competitiveness and growth is a secondary objective. • PRA has publicly re-committed its approach to its primary and secondary objectives in its recent Discussion Paper on the PRA's future approach to policy and in a speech given by PRA's CEO in October 2022. • This approach will also apply to the new secondary objective introduced by the FSM Bill. As stated by PRA's CEO Sam Woods in his speech, 'as we make this shift (in relation to the new secondary objective) we must do it carefully and without undercutting the primacy of safety and soundness in governing our actions.' • The new secondary objective will require PRA to facilitate the UK economy's international competitiveness and its growth over the medium to long term, subject to alignment with	On track

			international standards. The secondary objectives cannot be advanced independently of the primary objective.	
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)	NT	• **The PRA has increased its funding, re-deployed resources and set up a flexible resource hub to help manage its expanded regulatory responsibilities.** As outlined in the response to recommendation 4, the PRA's strategy included a full review of the supervisory activities it completes across all firms it regulates to ensure these remained focused on the areas that matter and are deliverable with the resources available. This recognised the increasing responsibilities placed on the PRA (including climate change, operational resilience and post-Brexit responsibilities). In 2022, the PRA materially increased its funding levy (by around 8 percent) to support the recruitment of 100 additional staff (7% of staffing level). This was alongside the re-allocation of resources internally and the establishment of a flexible, resource hub to help manage rapidly changing risks and priorities on an institution-wide basis. • **The second part of the PRA 2026 strategy includes the transformation of our capabilities around solvent exit planning (complementing the capabilities we 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.** The PRA recognises that it needs to keep pace with innovation. The second phase of the PRA's strategy is focused on transforming its regulatory approach to meet this challenge. In particular and consistent with the 2021 FSAP report's findings, the PRA expects to: ○ build capability in orderly exit planning for smaller-to-mid-tier firms (following the significant focus on larger and systemically-important firms in recent years); and ○ deploy new technology – including machine learning – to support supervisory activities. • The introduction of new technology will help drive efficiencies in the PRA's resourcing that can enable more staff to be deployed to the work on orderly exit planning.	On track
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)	NT	• The FSM Bill includes a range of measures to enhance the regulators' transparency, accountability and scrutiny. Importantly, these measures 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 to ensure that exercise of these powers considers relevant operational considerations. • New accountability and transparency mechanisms are also being created for the Bank's supervision of CCPs and CSDs, including a statutory committee for FMIs. This new architecture is being introduced in tandem with new Bank rulemaking powers in this sphere.	On track

Key Recommendations (with Other Jurisdictions)				
	A. Further Bolster Management of Systemic Risks			
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)	MT	• The Bank has undertaken a comprehensive survey of the available data on banks' exposures to NBFIs, and are considering further data requests to address gaps. • The ONS are investigating if and how overseas NBFI counterparties can be captured into the who to whom data. The ONS primarily rely on the Financial Services Survey (FSS) to collect balance sheet data from NBFIs and are currently updating this survey to encompass a wider range of institutions, while simultaneously working on fully integrating data from the FSS into the National Accounts. • The Bank is currently working on exploring and understanding the gilt market structure further; as part of this, we are collating data on Sterling asset holdings from multiple sources we have access to. We will also be working closely with the system-wide exploratory stress scenario team on data collection from firms that would complement existing sources. This will help us take stock of the data we have and identify any remaining gaps that we would need to address. • The Bank is participating in the FSB Open-End Fund Assessment project, which in 2023 will include a data pilot to explore the data requirements for monitoring liquidity risks for fund managers. The FCA and Bank 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 workstreams on commodity markets; leverage in hedge funds, family offices and long-term investors; and IOSCO's FSEG. Domestically, the FCA is evolving its own reporting requirements under EMIR, for example to receive more granular information on underlying commodity types.	Somewhat behind
	B. Continue Strengthening Regulation and Supervision			
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	MT	• Good cooperation, information sharing, and collaboration with relevant third country authorities remain a key priority for the UK authorities. Over 2022 and early 2023, various market and supervisory events has both tested our working arrangements and found them to be strong in both 'peace time' and during crises: • 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 a 12–18-month agenda for common work on issues such as CTPs, climate, Crypto products, use of DLT and NBFIs. • The PRA have undertaken several joint reviews with key jurisdictions (FRB and ECB SSM in particular) over the last 12 months on both crystallised and emerging risks including in relation to Archegos, nickel, fixed income financing, crypto products and the PRA will be participating in the upcoming qualitative Federal Reserve CCAR. We have also shared workplans for 2023 and have coordinated our key areas of focus.	On track

	mixed financial groups. (FPC, BOE/PRA, and FCA)		• The PRA worked closely with key regulatory authorities (FINMA, FRB and ECB) in handling the failures of both SVB and Credit Suisse 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 we navigated the volatility post the invasion of Ukraine, the UK mini budget and the more recent SVB and Credit Suisse events we 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. We 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 we conducted through the Russia/Ukraine volatility. • In December 2022, the FPC welcomed the FSB's proposed 2023 workplan on NBFIs and announced plans for an exploratory scenario exercise focused on NBFI risks. In March 2023, the FPC confirmed its intention and indicated it would publish more information in Q2. We are also developing a quantitative data collection template on NBFI exposures alongside the ECB and FRB that would seek to consider counterparty-credit risk on a group-wide basis and form a starting point for future Trilat working group templates. In addition, and as noted under Recommendation 2, we are 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.	
	C. Minimize Potential Risks of Ongoing Transitions and Future Crises			
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)	I	• The PRA has signed and implemented 34 Memoranda of Understanding with EU institutions and member states since the beginning of 2021. • The 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 Supervisory Authorities and the National Competent Authorities. • HMT welcomes the renewed commitment to signing the financial services Memorandum of Understanding and stands ready to do so. HMT look forward to operationalising the forum as soon as possible this year. In the meantime, HMT continue to closely engage with EU authorities bilaterally and through multilateral fora. • HMT granted the EU a package of equivalence decisions in November 2020, including a decision on CCP equivalence. Recognition decisions for individual CCPs are ongoing, but EU CCPs are able to continue providing services through the Temporary recognition regime. • Equivalence and recognition are unilateral decisions, and the EU has put in place time limited decisions for UK CCPs until mid-2025. The UK continues to work with EU supervisors through regulatory Colleges, and to maintain commitments to the highest standards of FMI regulation.	On track

			The FSM Bill introduces a requirement for the Bank not to discriminate on the basis of location, and heightened rules for UK CCPs, including the Senior Managers and Certification Regime. • The enhanced CCP resolution regime (See Recommendation 8) will make the UK regime fully consistent with international FSB standards. Similarly, to the EU, 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.	

[1] I = Immediate (within one year); NT = Near Term (within 1 to 3 years); MT =Medium Term (within 3 to 5 years).

Annex X. The Strong and Simple Framework for Smaller Banks

1. **The Prudential Regulation Authority (PRA) initiated a "strong and simple" framework in 2021 to simplify the prudential framework for non-systemic domestic banks and building societies, while maintaining their resilience.** The aim is to mitigate the "complexity problem" that can arise when the same prudential requirements are applied to all firms. The development of the "strong and simple" framework has several phases. In April 2022, the PRA proposed a definition of a "Simpler-regime Firm" that would be subject to a simpler but robust set of prudential rules in the future. In November 2022, in the context of proposing the implementation of the remaining Basel III standards (so-called "Basel 3.1 standards"), the PRA modified the criteria for a "Simpler-regime Firm" and allowed firms that meet the Simpler-regime criteria to choose to follow a transitional regime or to implement Basel 3.1 standards. In February 2023, the PRA set out proposals for liquidity and disclosure requirements for Simpler-regime Firms. Future plans include proposals on capital-related prudential requirements (planned in 2024) and options for wider application of any simplifications once the simpler-regime has significantly progressed.

2. **The criteria for a simpler-regime firm are intended to capture small banks that are: (i) focused on deposit-taking and lending activities domestically; and (ii) not systemically important.**

Definition of a Simpler-Regime Firm	
Size	• Total assets ≤ £20 billion* • Calculated using a three-year average • Based on the financial reporting framework (FINREP) definition of total assets
Trading activity	• Trading book business ≤ 5 percent of total assets and ≤ £44 million* • Overall net foreign exchange position ≤ 2 percent of own funds* • No commodities positions
No IRB	• No internal ratings-based (IRB) approvals • A firm could develop and submit an IRB application while remaining a Simpler-regime Firm
Clearing & Settlement	• No provision of clearing, settlement, custody, or correspondent banking services to another bank or building society, except services provided within its group and in pound • Does not operate a payment system
Domestic activity	• ≥ 85 percent of the firm's credit exposures must be to obligors located in the UK* • Based on the common reporting framework (COREP) data
Level of application	• A firm, the consolidation group, and all firms in the group, need to meet the criteria • Firms that are part of foreign groups need to apply for a waiver or modification

* Reflecting feedback on the proposed definition of a Simpler-regime firm, the PRA revised up asset threshold from £15 billion to £20 billion and provided smooth application around several thresholds in CP16/22 – Implementation of the Basel 3.1 standards.
Source: Bank of England

Annex XI. The Resolution of SVB UK

1. A loss of confidence in Silicon Valley Bank UK (SVB UK) triggered by the failure of parent Silicon Valley Bank (SVB) saw 30 percent of SVB UK deposit outflows in one day. SVB was the 16th largest bank in the US and the largest bank failure in the US since the global financial crisis. SVB financial group announced in September 2022 that its UK branch had become a wholly owned subsidiary of SVB after SVB UK experienced rapid growth against a backdrop of significant UK innovation growth. At the point of failure, SVB UK had a total balance sheet size of approximately £8.8bn, and a deposit base of approximately £6.7bn. However, the scale of the deterioration of liquidity and confidence means that in the view of the Bank and the PRA the position was not recoverable.

2. Since the GFC, the UK has established significantly more robust regulatory standards, including for bank capital and liquidity. The UK authorities have put in place a range of robust prudential standards, designed to ensure levels of resilience which are at least as great as those required by international baseline standards. These standards are applicable to all UK banks and include a liquidity framework and capital requirements that are calibrated to the risks faced by individual firms.

3. The Banking Act 2009 created a Special Resolution Regime (SRR), equipping HMT and the BoE with tools for dealing with distressed UK banks and building societies. Presently there are more options to resolve a failing bank than policymakers had during the GFC. SRR tools include (i) placing the whole bank or building society into the bank insolvency procedure, (ii) a number of stabilization powers (including transfer to a private sector purchaser, transfer to a bridge bank, transfer to an asset management vehicle, bail-in, and temporary public ownership), (iii) a provision for a bank administration procedure for use where there has been a partial transfer of business from a failing bank. Authorities can use optimal tools separately or in combination. In contrast, only two options were available during the GFC: either allowing banks to fail and risking financial stability or using public funds to bail them out.

4. Initially the BoE announced its intention to apply to the Court to place SVB UK into an insolvency procedure, but authorities later took the decision that SVB UK would be sold to HSBC UK Bank plc. Given the emergence of a credible purchaser for SVBUK the BoE determined that using its resolution powers for stabilizing failing banks was appropriate. The decision to sell SVB UK followed a consultation between the PRA, the BoE, the FCA and HMT on the resolution conditions contained in the Banking Act 2009 - The BoE considered that the conditions for exercising stabilization powers under the Banking Act 2009 were met. While the bank was successfully sold to HSBC UK, the BoE was prepared to move ahead with insolvency in case the deal fell through at the eleventh hour.

5. The SBV UK sale necessitated some relaxation to the UK ring-fencing rules. Existing regulation already makes SVB exempt from ring-fencing rules (requiring large banks to be split between a safer retail bank and a riskier trading bank) for four years after acquisition/merger. But in this case HSBC UK requested that SVB UK be exempted from the ring-fencing permanently (as keeping the bank as one piece was a key attraction). In light of this, the Treasury agreed to make a permanent exemption for SVB UK within HSBC UK. The BoE supported the Government's decision, given the benefits of a quick private solution to protect depositors without using public funds. The BoE explained that a rather significant proportion of the book is in the form of subscription finance, i.e., a bridge to venture fund investors, and ringfenced banks cannot normally lend to them. More generally, the BoE favors the Government proceeding with reforms to the ring-fencing regime despite the turbulent backdrop, but reemphasized the need to not weaken it. The Treasury is considering the deposit threshold for ring-fencing to be raised from £25 billion to £35 billion.

6. The successful sale of SVB UK to HSBC UK reflects both strong UK supervision of smaller banks, as well as the potential of the UK's reformed bank resolution regime. UK regulations required SVB UK to subsidiarize last summer (as its assets rose above the cut-off below which branch existence is allowed). While SVB UK had suffered a 30 percent loss in deposits in one day, it had the cash buffers to meet those outflows – it was a well-capitalized subsidiary with strong liquidity, reflecting strong supervision by the PRA.

Annex XII. Financial Regulatory Reforms

1. The government's proposals for financial regulatory reforms are ambitious. The Edinburgh Reforms, announced by Chancellor Hunt in December, sets out plans to replace retained EU laws governing financial services with the aim of ensuring an open, sustainable, and technologically-advanced financial services sector. The package, which comprises more than 30 policy initiatives, includes a number of new announcements as well as some that were already in the public domain (see table below). The timelines for implementing various reforms differ, with several currently in consultation. The package takes note of the new secondary objectives of growth and competitiveness for the FCA and PRA – in light of EU laws migrating fully into regulatory rulebooks; and sets out reforms to (a) banking regulation, including changes to the ring-fencing regime; (b) improve financial services and enhance consumer and business protection; (c) the accountability regime for senior decision-makers Senior Managers and Certification Regime (SMCR); (d) Green Finance, including an updated Green Finance Strategy; (d) the regulation of crypto assets and for facilitating the digital pound; and (e) EU-era Solvency II rules for insurers, with a view to their repeal.

Table 1. United Kingdom: The Edinburgh Reforms

	Initiative/Proposal	Status/Timeline*
A Competitive Marketplace Promoting Effective use of Capital		
1	Reforming the Ring-Fencing Regime	An independent review was completed in 2022. The government published a call for evidence on aligning the ring-fencing and resolution regimes in March 2023 and will conduct a consultation on key short-term reforms. These reforms aim to address unintended consequences in the regime while maintaining financial stability safeguards.
2	New remit letters for the PRA and FCA with recommendations on growth and international competitiveness	The Chancellor sent these letters to the regulators in December 2022. The Financial Services and Markets Bill (FSMB), separately, introduces new secondary objectives for growth and international competitiveness for the PRA and the FCA.
3	Publishing the plan for repealing and reforming retained EU law	The government published a policy statement setting out its plan for repealing and replacing retained EU law for financial services, using the powers within the FSMB. This includes plans on prioritizing work program and the approach to engagement with industry.
4	Overhauling the UK's regulation of prospectuses	A consultation was conducted in 2021 and in March 2022 the government confirmed its intention to proceed as largely consulted. It published an illustrative statutory instrument and policy note in December 2022.
5	Reforming the Securitization Regulation	The government published a review in 2021, informed by a call for evidence. An illustrative statutory instrument was published, as part of the Edinburgh Reforms. The legislation will delegate the regulation of Securitizations to the FCA and PRA, so the rules can be re-stated in their rulebooks, with the reforms identified in the review. This measure relies on the powers in the FSMB to repeal and reform retained EU law.

Table 1. United Kingdom: The Edinburgh Reforms (continued)		
6	Repealing the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, and consulting on a new direction for retail disclosure	The government announced that it will repeal the PRIIPs Regulation as a priority. It also published a consultation, setting out a new direction for retail disclosure in the UK. This measure relies on the powers in the FSMB to repeal and reform retained EU law.
7	Intending to repeal EU legislation on the European Long-Term Investment Funds (ELTIF)	The government announced its intention to repeal the ELTIF Regulation as part of the Edinburgh Reforms. Work is now progressing on taking this forward. This measure relies on the powers in the FSMB to repeal and reform retained EU law.
8	Reforming the Short Selling Regulation	The government announced a review of the Short Selling Regulation as part of the Edinburgh Reforms and published a Call for Evidence. The Call for Evidence has closed, and work is ongoing to reform the Short Selling Regulation. This measure relies on the powers in the FSMB to repeal and reform retained EU law.
9	Publishing a draft Statutory Instrument to ensure that the FCA has sufficient rulemaking powers over its retained EU payments legislation	This was consulted on in the Payments Regulation and Systemic Perimeter Consultation in 2022. The government published a draft SI as part of the Edinburgh Reforms. This measure relies on the powers in the FSMB to repeal and reform retained EU law.
10	Consultation on customer information requirements in the Payment Accounts Regulations (PAR) 2015	The government launched a consultation at the Edinburgh Reforms to seek views from relevant stakeholders on the customer information requirements in the PARs, many of which are expected to be either too prescriptive or less necessary in a UK context. The consultation closed in February and next steps are under consideration. This measure relies on the powers in the FSMB to repeal and reform retained EU law.
11	Removing rules for the capital deduction of certain non-performing exposures held by banks	The PRA are leading on delivering this initiative.
12	Implementing Wholesale Markets (WMR) Review reforms	The FSMB delivers the changes that the government consulted on as part of the WMR where there was clear support for the government's proposals and where changes were most urgently needed. Other changes as a result of the WMR will be delivered using the powers in the FSMB to repeal and reform EU law.
13	Establishing an Accelerated Settlement Taskforce	The taskforce, chaired by Charlie Geffen, was launched in December 2022 to explore the potential for faster settlement of financial trades in the UK, such as moving to a 'T+1' standard settlement period. It will publish its initial findings by December 2023, with a full report and recommendations made by December 2024.
14	Committing to establish the independent Investment Research Review	Timelines and scope of the Review will be announced as soon as an independent Chair has been appointed.
15	Launching a review into reforming the Senior Managers & Certification Regime (SM&CR)	The government launched a Call for Evidence into the legislative framework of the SM&CR in March 2023. This is alongside the regulators' (FCA/PRA) joint Discussion Paper into the regulatory framework.

Table 1. United Kingdom: The Edinburgh Reforms (continued)		
16	Having a regime for a UK consolidated tape	The government committed, alongside the FCA, to have a regulatory regime for a consolidated tape in place by 2024. This measure is included in the FSMB.
17	Consulting on issuing new guidance on Local Government Pension Scheme asset pooling	A consultation on investment reform in the Local Government Pension Scheme is planned for launch in 2023.
18	Increasing the pace of consolidation in Defined Contribution pension schemes	The government (DWP) published a consultation on "Value for Money: A framework on metrics, standards, and disclosures" in January and will publish a response after the end of the consultation.
19	Improving the tax rules for Real Estate Investment Trusts	Changes will be legislated in the Finance Bill. One has effect from April 2023.
20	Announcing changes to the Building Societies Act 1986	The consultation closed in February 2022. The government's official response outlining next steps was published in December 2022, noting where the Government will legislate as well as relevant areas which the government will return to in due course. The Government plans to continue to progress this work, including further sector engagement, in 2023.
21	Delivering the outcomes of the Secondary Capital Raising Review	The government has accepted all the recommendations made to the government and has appointed Sir Douglas Flint to chair a new Taskforce to consider the digitization of shareholdings. Alongside this, the FCA and PEG have both published statements welcoming Mr. Austin's report.
22	Consulting on reform to the VAT treatment of fund management	The consultation closed in February. Next steps are under consideration.
A World Leader in Sustainable Finance		
23	Publishing an updated Green Finance Strategy	The government published an updated Green Finance Strategy in March 2023. The government is analyzing the responses to the call for evidence which closed in June 2022 and will also consider the conclusions of the review undertaken by the Rt. Hon. Member for Kingswood, Chris Skidmore, which were published in January.
24	Consulting on bringing Environmental, Social, and Governance ratings providers into the regulatory perimeter	The government launched a consultation on regulating ESG ratings providers in March 2023.
A Sector at the Forefront of Technology and Innovation		
25	Consulting on a UK retail central bank digital currency alongside the Bank of England in the coming weeks	A joint HMT and BoE consultation on a digital pound was published in February 2023. This consultation, open for four months, marks the opening of the design phase of work on a potential digital pound.
26	Expanding the Investment Manager Exemption to include crypto assets	HMRC regulations were made in December 2022 to give effect to the change.
27	Implementing a Financial Market Infrastructure Sandbox	The government intend to have an FMI Sandbox up and running in 2023. The FSMB will enable the government to set up an FMI Sandbox (or several) via SI, to test the use of new technologies and practices in FMIs .

Table 1. United Kingdom: The Edinburgh Reforms (concluded)		
28	Working with the regulators and market participants to trial a new class of wholesale market venue which would operate on an intermittent trading basis	The government, FCA, and industry are currently exploring specific regulatory changes that are needed to deliver an intermittent trading venue (ITV).
Delivering for Consumers & Businesses		
29	Consulting on Consumer Credit Act Reform	The government published a consultation in December 2022. The proposed reform seeks to modernize regulation of the UK's consumer credit market by moving much of the Consumer Credit Act into the more agile regulatory framework of the FCA.
30	Laying regulations to remove well-designed performance fees from the pensions regulatory charge cap	The government (DWP) published a consultation response in January confirming it intends to enact the regulations by Spring 2023.
31	Committing to work with the FCA to examine the boundary between regulated financial advice and financial guidance	The government and the FCA have begun work to examine the boundary between regulated financial advice and financial guidance, with the objective of improving access to helpful support, information, and advice, while maintaining strong protections for consumers.
* As of May 2023.		

Annex XIII. The Government's "4Es" Growth Plan

1. **The Chancellor has set out a 4Es strategy to deliver long-term prosperity for the UK, with a focus on enterprises, education, employment, and everywhere.** The strategy aims to attract enterprises in high-tech sectors (clean energy, life sciences, digital, creative industries, and advanced manufacturing) by creating a competitive tax system and flexible regulatory environment. This will in turn incentivize business investment and promote productivity. In addition, reforms on school and education will promote internal labor upskilling and reduce the country's dependence on migration. This includes enhancing young people's basic English and math skills and improving the opportunities for life-long learning. The plan also features key labor market policies to bring employment back to pre-pandemic levels, with a focus on addressing the inactivity of working-age adults (students and the early-retired) and re-entry barriers for people with long-term conditions or mental illness. Further measures apply to completing the leveling up agenda on delivering equal opportunities and benefits everywhere in the UK.

Pillar	Policy Proposal	Budget Allocation
Enterprises	• Tax simplification for small businesses • R&D benefits for SMEs, in particular life sciences and technology companies • Full expensing (100% FYA) permanent as soon as fiscally feasible and Annual Investment Allowance with 100% first-year deduction for investments up to £1mn p.a. • Increase public capital spending	• £500mn in tax reduction (0.02% of GDP) • £500mn in R&D benefits for SMEs (0.02% of GDP) • Full expensing represents a £27bn corporation tax cut for the three years it is in place (1% of GDP) • £600bn of planned public sector gross investment over the next five years (about 4% of GDP annually)
Education	• School funding and skills programs expansion • Expert guidance to the government in introducing maths and education to 18	• £2.3bn to enable school leaders to continue to invest in high quality teaching and tutoring, taking total funding in FY2024/25 to £58.8bn (2% of GDP).
Employment	• Increase labor supply • Reduce childcare costs and enhance wraparound childcare	• £7bn in labor market package (0.3% of GDP) • £5bn in childcare provisions (0.2% of GDP) • £0.3bn in wraparound childcare (0.01% of GDP)
Everywhere	• 12 high potential knowledge-intensive growth clusters across the UK	• £80mn over 5 years, subject to proposals meeting specific conditions (0.003% of GDP)

INTERNATIONAL MONETARY FUND

UNITED KINGDOM

June 20, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

CONTENTS

FUND RELATIONS

(Data as of May 31, 2023)

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	14,750.27	73.18
Reserve position in Fund	5,405.18	26.82
New arrangement to borrow	54.70	

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocations	29,451.96	100.00
Holdings	30,448.54	103.38

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		0.39	0.39	0.39	0.39
Total		0.39	0.39	0.39	0.39

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

Exchange Rate Arrangement:

The UK authorities maintain a free floating regime.

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

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

Article IV Consultation:

The UK is on the standard 12-month consultation cycle. The last Article IV consultation was concluded on February 16, 2022 (IMF Country Report No. 22/56).

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

STATISTICAL ISSUES

(As of June 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance.
National Accounts: The Office for National Statistics (ONS) compiles national accounts in line with the *European System of Accounts 2010 (ESA 2010)* using the production, expenditure, and income approaches. GDP volume measures are derived through annual chain-linking. Monthly GDP is released around the 10th of each month as part of the Short-term Economic Indicators (STEI) theme day; for the second calendar month of each quarter the first quarterly estimate is published alongside monthly GDP. The second quarterly estimate is published around 90 days after the reference quarter. In response to the COVID-19 pandemic, the ONS has developed a *Fortnightly Business Impact of Coronavirus Survey (BICS*) which provides more timely data on economic developments. These data allow the ONS to provide high-frequency indicators that complement the existing monthly and quarterly GDP.
Price Statistics: The official monthly consumer price index (CPI), a composite of urban and rural price data, is available on a timely basis. The reference year of the CPI and CPIH (CPI including owner occupiers' housing costs) is 2015. The Producer Price Index (PPI) is compiled monthly and is available within 6 weeks after the reference month. The index weights are annually chain-linked. The current reference period for the PPI is 2015.
Government Finance Statistics: The ONS compiles government finance statistics in line with the *System of National Accounts (SNA 2008)* and *ESA 2010*. The UK publishes detailed information on the public sector's finances, covering the entire public sector, on a monthly basis and adapts the *ESA 2010* based statistics to produce and disseminate quarterly data compliant with the *2014 Government Finance Statistics Manual (GFSM),* which are included in the IMF's Government Finance Statistics database. HMT disseminates a comprehensive, annual, IFRS based set of financial statements for the entire public sector, including a full balance sheet, in the *Whole of Government Accounts* publication.
Monetary and Financial Statistics: The Bank of England (BoE) has not yet reported to the Fund monetary statistics using the Standardized Report Forms (SRFs) for publication in *International Financial Statistics (IFS)*. Data published in *IFS* are reported by the BoE using the old forms (forms 10R and 20R) with supplementary breakdowns by currency and by type of financial instruments for some accounts in the central bank data retrieved from the BoE website. The IMF's Statistics Department receives source data from BoE for the compilation of the SRFs, although improving the mapping of the source data to the SRFs requires more information. The UK does not report data on the non-bank financial institutions (NBFIs). The BoE reports data on some key indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the U.N. to monitor Target 8.10 of the Sustainable Development Goals.

Financial Sector Surveillance: The BoE reports all core FSIs and 11 encouraged FSIs for deposit takers, and several FSIs encouraged for other sectors—including FSIs for nonfinancial corporations, households, and real estate markets. Data frequency has improved from semi-annual to quarterly, however, timeliness needs improvement. The FSI data and metadata for the UK are posted on the IMF's FSI website.
External Sector Statistics: The ONS compiles and disseminates detailed quarterly balance of payments and International Investment Position (*BPM6*) since September 2014. The UK's balance of payments statistics is compiled at the same time as the national accounts and is published quarterly on the ONS website 90 days after the end of the reference period. There are several different sources used in the production of BoP statistics, some of which are collected in the ONS's surveys and some of which are provided by external partners such as the BoE and HM Revenue and Customs (HMRC). The country participates in the Coordinated Portfolio Investment Survey, providing the encouraged data by sector of the holder. The UK reports inward and outward Coordinated Direct Investment Survey, including the breakdown of net debt instruments into gross claims and liabilities, and the data template on International Reserves and Foreign Currency Liquidity and the Currency Composition of Official Foreign Exchange Reserves.
II. Data Standards and Quality
The UK subscribes to SDDS and is working towards the eventual adherence to SDDS Plus.

Table 1. United Kingdom: Common Indicators Required for Surveillance

(As of June 9, 2023)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Same day	Same day	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 2023	06/05/2023	M	M	M
Reserve/Base Money	May 2023	06/05/2023	M	M	M
Broad Money	April 2023	06/01/2023	M	M	M
Central Bank Balance Sheet	April 2023	06/01/2023	M	M	M
Consolidated Balance Sheet of the Banking System	May 2023	06/01/2023	M	M	M
Interest Rates[2]	Same day	Same day	D	D	D
Consumer Price Index	April 2023	05/24/2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q1 2023	05/23/2023	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	April 2023	05/23/2023	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	April 2023	05/23/2023	M	M	M
External Current Account Balance	Q4 2022	03/31/2023	Q	Q	Q
International Investment Position[6]	Q4 2022	03/31/2023	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2022	03/31/2023	Q	Q	Q
GDP/GNP	Q4 2022	03/31/2023	Q	Q	Q
Gross External Debt	Q4 2022	03/31/2023	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND

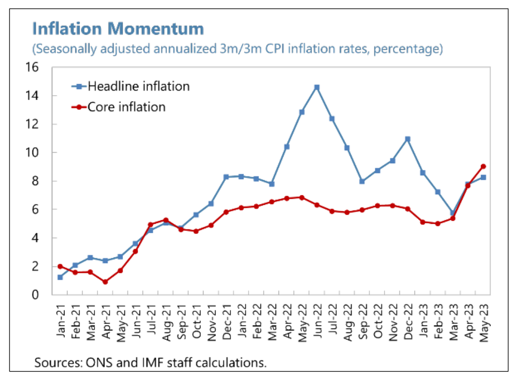
UNITED KINGDOM

June 29, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

This statement provides information that has become available since the staff report was issued to the Executive Board on June 20, 2023. The thrust of the staff report remains unchanged.

1. The May inflation outturn, released on June 21, exceeded expectations. Headline inflation remained unchanged in May (relative to April), with contributions from energy and food reduced but offset by higher services inflation (retail energy prices will fall by 17 percent in July when regulated energy prices adjust). Core inflation rose to 7.1 percent from 6.8 percent in April, and 3m/3m core inflation momentum increased to around 9 percent from 7.7 in April. The headline inflation out-turn was 0.3 ppt. higher than both the Bank of England's (BoE's) expectations at the time of the May Monetary Policy Report and the consensus forecast but was broadly in line with staff's expectations.



Inflation Momentum
(Seasonally adjusted annualized 3m/3m CPI inflation rates, percentage)
Sources: ONS and IMF staff calculations.

2. Against this backdrop, on June 22, the BoE's Monetary Policy Committee (MPC) – by a 7-2 majority – raised Bank Rate by 50 bps to 5 percent. The MPC stated that "there has been significant upside news in recent data that indicates more persistence in the inflation process, against the background of a tight labor market and continued resilience in demand", and that "the second-round effects in domestic price and wage developments generated by external cost shocks are likely to take longer to unwind than they did to emerge." The BoE's recent rate hike is consistent with the staff report's monetary policy recommendation of a 50-100 bps increase in 2023 (also staff's conditioning assumption); accordingly, there are no material implications for staff's baseline growth and inflation projections. With significant tightening already in train, a meeting-by-meeting approach for further rate hikes – as indicated by the MPC's forward guidance – is appropriate. With the May inflation out-turn clearly suggesting persistent inflationary pressures, the policy rate will need to stay higher for an extended period to durably lower inflation and keep inflation expectations anchored; this is also in line with the staff report.

3. In the context of successive upside inflation surprises, the BoE will undertake a review of its forecasting approach. In recent months, wage growth and inflation significantly exceeded the BoE's expectations, and the BoE substantially revised its forecasts for growth (up) and unemployment (down). These sizable under-predictions, notably of inflation, have led the BoE to agree to an externally-led review of its forecasting and related processes during times of significant uncertainty; the review will be supported by the BoE's Independent Evaluation Office.

4. In response to rising mortgage concerns, UK banks have agreed to give mortgage holders a 12-month grace period prior to repossession. The cumulative 490 bps policy rate increase since December 2021 is expected to have a significant impact on the mortgage market: about half of mortgages are expected to reprice significantly higher over the next 18 months. Although the repossession rate and mortgage arrears remain at historic lows, UK banks reached an agreement with the chancellor on June 23 to grant a 12-monthly delay on home repossessions. The agreement also allows mortgage holders to lock in a new rate up to six months in advance, or switch to an interest-only mortgage/extend the current term for six months without an affordability check or affecting credit scores. These measures come on top of the Financial Conduct Authority's (FCA) earlier recommendations to banks to communicate with and provide tailored solutions to consumers needing support to meet their contractual debt obligations.

Statement by Shona Riach, Executive Director for the United Kingdom,
Matt Trott, Alternate Executive Director, and
Tommy Chrimes, Advisor to the Executive Director
July 6, 2023

The outlook for the UK – as for many peers – remains challenging, but the economy continues to demonstrate resilience, with forecasters (including the IMF) making substantial upgrades to their projections for UK growth in 2023 over the last few months.

At Autumn Statement in November 2022, the UK government took difficult, necessary decisions on tax and spending to restore economic stability, support public services, protect the vulnerable, and lay the foundations for long-term growth. At Spring Budget in March 2023, the government set out further measures to build on this foundation, anchored around the Prime Minister's priorities of halving inflation on the path back to 2%, growing the economy, and getting debt falling. Meanwhile, the Bank of England's Monetary Policy Committee (MPC) will adjust Bank Rate as necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit. Separately, IMF staff note that "the UK financial system has weathered the recent global banking stress well."[1]

Inflation

Sustainably bringing down inflation is a priority for the UK authorities. Russia's unprovoked and illegal invasion of Ukraine added to global supply chain pressures, contributing to record wholesale energy prices and seeing headline UK inflation peak at just over 11% in October 2022, the highest level in 40 years. Inflation remains elevated in the UK and in many other advanced economies. Staff note that the Bank of England was the first G7 central bank to raise interest rates in December 2021, and has continued to tighten subsequently. The MPC will adjust Bank Rate as necessary to return inflation to the 2% target sustainably over the medium term, in line with its remit. Monetary policy will ensure that CPI inflation returns to the 2% target sustainably in the medium term.

As set out in the staff supplement, against the backdrop of a tight labor market and continued resilience in demand, the MPC voted to raise Bank Rate by a further 50 basis points at its meeting ending on 21 June.[2] The MPC will continue to monitor closely indications of persistent inflationary pressures in the economy as a whole, including the tightness of labor market conditions and the behavior of wage growth and services price inflation. If there were to be evidence of more persistent inflationary pressures, further tightening in monetary policy would be required.

The government has also stressed the priority of reducing inflation, recognizing that higher inflation, erodes the value of wages, and hurts economic growth. The government is addressing this by ensuring responsible fiscal decisions are taken, making active policy decisions including the Energy Price Guarantee and supporting the MPC's actions to tackle inflation. The staff report reiterates that UK fiscal policy is aligned with monetary policy in the fight against inflation. At the same time, the government has taken significant actions to support households

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[1] https://www.imf.org/en/News/Articles/2023/05/22/mcs052323-united-kingdom-staff-concluding-statement-2023-article-iv-mission
[2] https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2023/june-2023

with the cost of living, including on energy and childcare, as well as specific measures for those on benefits, pensioners and the disabled. The Prime Minister and the Chancellor are committed to taking the difficult decisions necessary to bring down inflation, with the Prime Minister noting that this is the foundation and first thing needed to build a better future.

Growth

The Chancellor has prioritized four areas to address the UK's productivity challenge and build on the economy's strengths: employment, education, enterprise and everywhere. The staff report notes "important measures" announced by the government to boost potential growth, including to enhance labor participation and to boost business investment. The independent Office for Budget Responsibility has noted that these measures should improve the strength of the economy and increase tax receipts, offsetting some of the direct costs.

A targeted package of policies has been announced to boost labor supply, focused on four key groups: the long-term sick and disabled, older workers, welfare recipients and parents. The spring budget included a suite of measures to address key causes of health-related inactivity, including tailored employment support in mental health and musculoskeletal health services. A new "Returnerships" offer aims to support the over-50s. The government is also removing one of the biggest barriers to parents working, undertaking significant investment to increase the amount of free childcare that working families can access (to 30 hours a week for children aged between nine months and four years). A range of pilots and evaluations, some innovative, are being advanced to help assess what works to address inactivity and improve labor market outcomes; the government will monitor and evaluate the effectiveness of these schemes.

Weak business investment is one factor behind the UK's modest productivity growth since the Global Financial Crisis, including since the pandemic. The government is taking actions to reduce business uncertainty and to reinvigorate enterprise and innovation. The full expensing capital allowance is a significant step; initially announced for three years, the government has indicated its intention to make this measure permanent as soon as it is economically responsible to do so.

The government recognizes that the transition to net zero is essential to long-term prosperity, in the UK and globally, and that energy security and net zero are two sides of the same coin. The UK has a world-leading track record in decarbonization, having reduced emissions faster than any G7 country between 1990 and 2021. Thanks to the 2008 Climate Change Act and the 2021 Environment Act, the UK has a strong legal framework in place for reaching net zero emissions by 2050. To keep the UK on a pathway to achieving the 2050 target, the government is required to set legally binding, five-year caps on emissions – carbon budgets – twelve years in advance and then to publish a report setting out proposals and policies for meeting that budget and those budgets previously set.[3] In March 2023 the government published a Net Zero Growth Plan and Energy Security Plan, further refining the UK's energy security and net zero plans and the government's vision for a market-led, technology-driven transition, building on the UK's strengths and early mover status.[4]

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[3]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1147369/carbon-budget-delivery-plan.pdf
[4]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1147457/powering-up-britain-net-zero-growth-plan.pdf

Debt

The government has underscored its commitment to fiscal responsibility. The fiscal rules announced in November 2022 ensure that policy puts the public finances on a sustainable path, requiring that debt falls as a share of the economy over the forecast period, while providing space for the economy to recover. In general, the UK's fiscal rules are designed to guide policy decisions for the length of a Parliament, balancing stability with fiscal policy that reflects the current macroeconomic context and the government's objectives. Together with the UK's very strong fiscal institutions and well-established system of multi-year spending settlements, the fiscal rules help the government in delivering a fiscally responsible approach to public spending and taxation in support of macroeconomic objectives.

Financial stability

The UK financial system is one of the largest and most advanced globally, and the authorities take its stewardship extremely seriously. The IMF assess UK financial stability as a global public good. The staff report highlights the strong progress made by the UK authorities in delivering on the recommendations of the 2021 Financial Sector Stability Assessment.

The IMF notes that "the UK financial system has weathered the recent global banking stress well". Amid a still-challenging global economic environment, the Financial Policy Committee judges that UK banks are resilient and are strong enough to support households and businesses. IMF staff also underscore that the Bank of England's financial stability intervention helped swiftly restore market functioning during the pension funds' liability-driven investment disruption last year, and that in March 2023, it effectively used resolution powers to facilitate the sale of Silicon Valley Bank (SVB) UK, fully protecting all SVB UK depositors and limiting risks to the taxpayer. These examples are testament to the strength and effectiveness of UK financial regulatory frameworks, which the authorities continue to refine and enhance, including via the Prudential Regulatory Authority's Strong and Simple initiative for small banks, the government's Edinburgh Reforms, and the Financial Services & Markets Bill.[5]

The UK authorities have long argued for the need to build non-bank financial institutions' (NBFIs') resilience globally, and have been taking actions to address this, both domestically and with international counterparts. As part of efforts to develop system-wide understanding, the Bank of England has launched a system-wide exploratory scenario exercise: this ambitious exercise aims to enhance understanding of the risks to and from NBFIs, and the behavior of NBFIs and banks in stress, including what drives that behavior; and to investigate how these behaviors and market dynamics can amplify shocks in markets.[6]

The authorities will continue to monitor financial sector developments closely.

[5] https://www.bankofengland.co.uk/prudential-regulation/publication/2023/february/strong-and-simple-framework; https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms; https://bills.parliament.uk/bills/3326

[6] https://www.bankofengland.co.uk/news/2023/june/boe-launches-first-system-wide-exploratory-scenario-exercise

Conclusion

The UK is a committed supporter of the rules-based international order and of multilateralism. The authorities will continue to work closely with key partners on shared economic challenges. This includes over £4.7bn in economic support for Ukraine: alongside direct bilateral assistance the UK has provided a series of guarantees through both the World Bank and the European Bank of Reconstruction and Development, enabling those institutions to provide hundreds of millions of dollars of additional support for Ukraine. At the IMF, the UK is providing significant support to the Poverty Reduction and Growth Trust and to the Resilience and Sustainability Trust.

We are grateful to the IMF Article IV team, and to IMF staff more generally, for their close engagement and constructive dialogue. **We look forward to continuing to work collaboratively with staff on addressing domestic and international macroeconomic challenges.**