

**EXECUTIVE
BOARD
MEETING**

SM/22/24
Supplement 2

February 11, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **United Kingdom—Staff Report for the 2021 Article IV Consultation—
Supplementary Information**

Board Action:	Executive Directors' consideration (Formal)
Tentative Board Date:	Wednesday, February 16, 2022
Publication:	Yes*
Questions:	Mr. Flanagan, EUR (ext. 36724) Ms. Chen, EUR (ext. 37917) Mr. Mulas Granados, EUR (ext. 35910) Mr. Ari, EUR (ext. 37396) Mr. Bouis, MCM (ext. 39097)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	Forthwith—European Central Bank, European Commission After Board Consideration—Caribbean Development Bank, Food and Agriculture Organization, Organisation for Economic Cooperation and Development, World Food Programme, World Trade Organization

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**



UNITED KINGDOM

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

February 10, 2022

Prepared By European Department

This statement provides information that has become available since the staff report was issued to the Executive Board on February 2, 2022 and updates the staff appraisal.

1. The BoE's Monetary Policy Committee (MPC) raised the Bank Rate by 25 bps to 0.5 percent on February 3. In the press conference, the Bank pushed back against expectations of a long rate hike cycle with a high terminal rate. The MPC also extended its previous guidance on the quantitative tightening strategy, reaffirming that the Bank would cease reinvestments of maturing gilts going forward and announcing the initiation of corporate bond sales (aimed at unloading all of the BoE's corporate bond holdings by late 2023 at the earliest). The BoE downgraded its 2022 growth forecast from 5 to 3¾ percent, anticipating a sharper and earlier consumption slowdown than staff (and less wage catch-up to inflation). It lifted its near-term inflation forecast to reflect a peak of 7¼ percent in April 2022 (but still returning to the target in 2024). The combination of hawkish near-term guidance but restraining forward guidance is consistent with the dilemma the BoE now faces (i.e., signs of inflation de-anchoring leading to growing expectations in the market of a policy rate overshooting, but with forecasts of a sharp slowdown ahead).

Medium-Term Forecast Comparison (Percentage change, unless otherwise indicated)									
	2022			2023			2024		
	IMF	BoE (Feb)	BoE (Nov)	IMF	BoE (Feb)	BoE (Nov)	IMF	BoE (Feb)	BoE (Nov)
Real GDP	4.7	3.8	5.0	2.3	1.3	1.5	1.3	1.0	1.0
CPI Inflation, Q4/Q4	5.4	5.8	3.5	2.4	2.5	2.3	2.0	1.8	2.0
Output gap 1/	0.4	0.0	0.3	0.2	-0.5	0.3	-0.1	-0.8	-0.3

Sources: Office for National Statistics; Bank of England and IMF staff estimates.
1/ In percent of potential GDP.

2. The energy regulator in the UK (Ofgem) announced an increase of the energy price cap on February 3. The price cap will increase by 54 percent to £1,971 per year starting on April 1. The price cap is updated twice a year, allowing the

pass-through of energy costs to customers.¹ The last price cap was set in August 2021 and thus did not reflect the record increase in wholesale gas prices over the previous six months. The revision of the price cap to cost-reflective levels is a welcome development, which will help preserve well-functioning energy markets and avoid price distortions in energy consumption and domestic energy production.

3. On the same day, the Treasury announced a support package to help households with the increasing energy bills. The package costs £9.1 billion (0.35 percent of GDP) in 2022–23, and includes universal, targeted, and discretionary elements as follows: i) a repayable discount on energy bills from October 2022, ii) an additional non-repayable rebate in council tax from April 2022, and iii) discretionary funding for households not eligible for the council tax rebate (text table). The authorities also confirmed plans to expand eligibility for the Warm Home Discount by almost a third so that an additional half a million vulnerable households would get a £150 discount in their energy bills from October 2022 (to an amount of £450 million or 0.03 percent of GDP). The authorities' effort to protect households from the cost-of-living increases is broadly in line with staff advice. However, reducing the scope and/or automaticity of the loan program (e.g., for households with above median income), and further increasing the targeted component could be considered.

Energy Bills Rebate		
Measure	Details	Budget Cost
Repayable discount	A £200 discount on energy bills per electricity customer from October, with automatic equal £40 installments over five years from 2023.	£5 billion (0.2 percent of GDP) upfront
Non-repayable rebate	An additional £150 rebate in council tax in April, covering about 80 percent of households in England.	£4 billion (0.14 percent of GDP)
Discretionary funding	For local governments to support vulnerable households not eligible for the council tax rebate.	£144 million (0.01 percent of GDP)
Warm Homes Discount	Increase in the eligibility criteria so that the scheme will now cover 3 million low-income households. The discount will be increased from £140 to £150.	£450 million (0.03 percent of GDP)

4. The authorities also presented the “Levelling-up” White Paper, a long-term plan to address regional disparities across the country. The document provides valuable evidence of regional differences in economic outcomes and life chances (e.g., a child on free school meals in London has over twice the chance of going to university than one outside London). It further fleshes out the Build Back Better Strategy defining twelve national targets in important areas such as employment, skills, R&D, health, and transport or connectivity. The document covers the resources needed to meet those targets by 2030, and the resulting budgetary estimates are largely consistent with the allocations of the Spending Review. Staff welcomes the plan but continues to see

¹ The energy price cap is adjusted to reflect changes in underlying costs, such as wholesale energy prices, network and operating costs, and taxes. For further details, please see: <https://www.ofgem.gov.uk/information-consumers/energy-advice-households/check-if-energy-price-cap-affects-you>.

opportunities to be more ambitious in spending, especially in public investment, education, and training programs.

5. On February 8, the European Commission adopted the decision to extend the temporary equivalence for the UK central counterparties (CCPs) until the end-June 2025.

While the 3-year extension alleviates short-term market stability concerns, the status of UK CCPs in the long run remains uncertain. As noted in the FSSA, fragmentation could ultimately lead to increased costs to clear derivatives.

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6. The upcoming period, when fiscal performance and the outlook will be reviewed, will present an opportunity to refine the announced energy compensation scheme to support broader government objectives. It could be adjusted to focus the support on low-income households and to better support climate objectives (e.g., by transforming the repayment of the energy bill discount into subsidies for those households willing to invest in green home renovations). To pay for this, and again consistent with the net zero strategy, the authorities could consider raising carbon taxation and/or fuel duties at the time when energy prices start to decline.

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