

**FOR
INFORMATION**

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November 8, 2018

To: Members of the Executive Board

From: The Acting Secretary

Subject: **United Kingdom—Statement by the European Central Bank Representative**

Board Action: Executive Directors' **information**

Additional Information: For the Executive Board discussion on the United Kingdom to be held on Monday, November 12, 2018.

8 November 2018

**Statement by Rasmus Ruffer (ECB Representative) and Aidan Meyler on
the United Kingdom – Article IV Consultation**

(Preliminary)

IMF Executive Board Meeting

12 November 2018

We would like to thank Staff for their informative report and Ms. Riach and Mr. Haydon for their clear Buff statement. We associate ourselves with the statement by Mr. De Lannoy.

We appreciate Staff's comprehensive assessment on the UK economy where they emphasize the high degree of uncertainty caused by the ongoing Brexit negotiations and its pervasive impact on economic outcomes over the past two years. In addition, Staff note the difficulty of providing confident predictions for the outlook – other than the widely-held view that the outlook for the UK economy is likely to be less dynamic than in pre-Referendum years. Staff projections are predicated on the assumption that the UK will exit the EU in an orderly manner, following a negotiated transition period lasting to at least the end of 2020 and culminating in a free trade agreement covering most goods, with a modest increase in non-tariff barriers for most services.

Given they are predicated on the outcome of a range of FTA impacts [including a range of “softer” Brexit FTA scenarios, such as those extended to Norway or Switzerland], Staff's medium-term growth projections may be somewhat optimistic. To cater for the uncertainties about the ultimate FTA arrangement Staff uses a range of possible outcomes for the calibration of the projections. Some of these outcomes are however conditional on the adoption of the fundamental “four freedoms” (including free movement of labor) and many of the “soft Brexit” Single Market options cannot be applicable in view of stated positions on these four freedoms. As publicly stated by the EU's Chief Brexit negotiator, Michel Barnier, under these circumstances, the best outcome that is open to negotiation is one close to a Canadian-style Comprehensive Economy and Trade Agreement (CETA), covering trade in goods only. This should be emphasized in the report and the consequences of these less inclusive trading arrangements on projections for business investment, productivity and potential output growth made clear. The Report emphasizes the strong downside risks to growth, inflation and the UK's future trading arrangements from “disorderly Brexit” *[whereby the UK leaves the EU in March 2019 without any deal in place]*, although Staff do not see this as the most likely outcome at this point. In addition, we would also note the marked slowdown in investment (particularly business investment) over recent years, which may not rebound as strongly as Staff anticipate, is likely to weigh negatively on the UK's potential growth outlook in the coming years. *[Do more recent National Accounts releases from the UK's Office for National Statistics, which included some significant revisions to trade and investment data, change Staff's assessments in any material way?]*

We broadly agree with Staff's assessment on fiscal policy, in particular that steady fiscal consolidation is essential to set the public debt ratio on a sustainable downward path and thus rebuild fiscal buffers against future shocks. This is especially important in view of the uncertainty surrounding the challenges arising from Brexit. We also agree with the emphasis that both the Report and the Selected Issues Papers put on the long-term spending pressures arising from population ageing. The report correctly highlights the need to identify fiscal savings and sources of increased revenues to cover these costs. In this respect intensifying efforts towards achieving a more growth-friendly composition of public finances is also important. *[Are there any changes in Staff's fiscal assessment considering the Budget presentation in Parliament by the Chancellor of the Exchequer on 29 October 2018?]*

In view of the important shifts in the structure of the UK economy likely to be wrought by Brexit we welcome the emphasis also on longer-term structural issues. Staff notes that productivity levels have long been lower in the UK than in many advanced economies, and that “sustained policy efforts are needed to support growth, improve competitiveness, and help reduce income inequality and regional disparities”. In terms of policy recommendations, we broadly agree with the wide-ranging list of measures suggested. These currently include recommendations aimed at: maintaining macroeconomic stability; boosting productivity; steady fiscal consolidation and tax reform; careful oversight and remedy of high private sector indebtedness; and structural reforms to housing supply, infrastructure and to education and training systems so as to improve workforce skills and raise UK productivity. Furthermore, we fully support the Staff’s view that labor market reforms should continue to enhance employment by supporting workers’ skills and reallocation, rather than to support particular jobs or sectors. Lastly, we also support Staff’s regard for UK authorities’ ongoing efforts to improve corporate transparency and enforcement against foreign bribery.

Regarding financial sector policies, we have certain concerns regarding the staff assessment of potential Brexit-related financial stability risks. In Paragraph 33 and in the staff appraisal in Paragraph 55 the emphasis put on regulatory and supervisory cooperation to “maintain the integrity of financial transactions” after Brexit can be misleading. Firstly, we do not think this general reference to financial transactions is appropriate, since the potential impact and their possible solutions can be very different for each of the different types of financial transactions currently taking place. While some financial transactions, like derivatives cleared by means of CCPs, may be affected, the impact on many others [such as non-centrally cleared derivatives or insurance contracts] is expected to be minor or, in some cases, even inexistent. Therefore, we consider that at the very least, the statement should just refer to “some” financial transactions, not to financial transactions in general. Secondly, this statement overlooks the actions that the private sector, including financial institutions, can undertake to pre-emptively address any potential issues. In many instances, a regulatory intervention may not be needed. For example, in the area of non-centrally cleared derivatives, a wide array of actions can be taken by the involved private sector counterparties to manage the potential consequences of Brexit. Conversely, advocating for a regulatory solution can reduce private sector agents’ incentives to properly address potential issues in a timely manner.

With respect to clearing, we believe the Staff statement on euro clearing in Paragraph 33 should be clarified.¹ Cliff-edge risks for EU access to UK CCPs have been identified and, as stated by the Commission, can be mitigated by granting UK CCPs temporary recognition subject to strict conditionality. The Commission has made recent statements pointing that this is likely to happen, and this should be mentioned to provide a balanced picture of risks. Paragraph 33 also refers to “changes in the regulation and oversight arrangements for euro-denominated derivatives” (i.e. the future EMIR 2 regime on clearing). A specific withdrawal of recognition for euro-denominated derivatives under EMIR 2, which is considered a last-resort measure, would be a separate issue from the current concerns around a no-deal Brexit, and would consider the balance of risks for EU financial stability. Furthermore, it would not create short-term financial stability risks, as it would be subject to an adaptation period. We fully agree with Staff on the need for a continued commitment to high regulatory standards, which would be supported by the EMIR 2 legislative proposal by ensuring that systemically important UK CCPs continue to comply with EU prudential standards. We however think the reference to future legislative regimes is out place in this Paragraph.

¹ Paragraph 33 states: “the potential loss of euro-dominated derivatives clearing for EU banks on UK-based CCPs could generate short-term financial stability risks related to the continuity of existing contracts, as well as netting efficiency losses related to the fragmentation of derivatives clearing.”