EXECUTIVE BOARD MEETING

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December 14, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **United Kingdom—Staff Report for the 2020 Article IV Consultation—Supplementary Information**

Board Action:	Executive Directors' **consideration** (Formal)
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Questions:	Mr. Flanagan, EUR (ext. 36724) Mr. Hajdenberg, EUR (ext. 38619) Mr. Garcia-Macia, EUR (ext. 30141)
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***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

INTERNATIONAL MONETARY FUND

UNITED KINGDOM

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

December 14, 2020

Prepared By | European Department

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

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

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

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

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

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

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

Staff Appraisal

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

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