CaixaBank

United Kingdom

Outlook

	Average 10-14	2015	2016	2017	2018	2019	2020	Forecasts 2021	Forecasts 2022
GDP growth (%)	2.0	2.4	1.7	1.7	1.3	1.4	-11.0	6.2	4.1
CPI inflation (%)*	2.9	0.0	0.7	2.7	2.5	1.8	0.9	1.5	1.2
Fiscal balance (% of GDP)	-7.1	-4.6	-3.3	-2.5	-2.3	-2.2	-16.5(e)	-9.2	-7.1
Public debt (% of GDP)	81.6	86.9	86.8	86.2	85.7	85.4	108.0(e)	111.5	113.4
Reference rate (%)*	0.5	0.5	0.4	0.3	0.6	0.8	0.2	0.1	0.2
Exchange rate (GBP/USD)*	0.6	0.7	0.7	0.8	0.7	0.8	0.8	0.8	0.7
Current account balance (% of GDP)	-3.6	-4.9	-5.2	-3.5	-3.9	-4.0	-2.0 (e)	-3.8	-3.6
External debt (% of GDP)	339.1	287.0	303.5	307.8	309.3	301.1	-341.2(e)	349.0	349.9

Notes: * Annual average. (e) estimation.
Source: CaixaBank Research, based on data from national statistical agencies and the IMF.

- **The health and economic impact of COVID-19 has been particularly strong in the United Kingdom, compared with other advanced countries**. The recovery will be hampered by restrictions on activity, which will continue to be imposed to control the virus throughout the vaccination process, until significant herd immunity is achieved. It will also be hindered by the frictions caused by Brexit. In fact, these two factors – the pandemic and post-Brexit economic performance, which in itself entails uncertainty about the future economic and trade relationship with the EU and the new economic model – are generating a significant level of uncertainty. Regarding Brexit, there are two notable elements of economic and political risk: i) the future of the British financial services sector after losing the unfettered access to the European market that it had enjoyed when it belonged to the EU and ii) the rising territorial tensions (in Scotland and Northern Ireland).

- **Real shock of COVID-19.** Being one of the advanced countries that has been most badly affected by COVID-19 from a healthcare and human perspective (the number of deaths relative to the population is higher than the European average), the United Kingdom had to implement a number of measures from March 2020 that had a notable impact on the economy. Following the upswing that occurred after some of the measures were relaxed in the summer, it is likely that the tightening of the restrictions towards the end of last year will have led to further weakening. However, this should be short-lived. Looking ahead to 2021, the process of vaccinating the population, which has been notably quicker and more effective than in other advanced countries, will aid the gradual recovery of the economy in the second half of the year, supported by maintaining the fiscal and monetary measures implemented during the crisis. However, further trade and financial frictions caused by Brexit and the possible extension of restrictions on movement to control the pandemic may have an impact on short-term growth.

- **Economic policy response**
  - **Fiscal policy.** Britain's fiscal response has been quick and emphatic, leading to a decline in the fiscal balance of 14 pp of GDP in 2020. Direct spending (and the fall in revenues) has been greater in the United Kingdom than in the main European countries, while there has been less support through loan and guarantee facilities. The most notable measures are the furlough scheme, the employment incentive package and the measures to support businesses, including direct support for small businesses, tax deferrals, purchases of corporate debt and government-backed loans.

Closing date of this edition: 3 February 2021

***Outlook** (continued)*

- **Monetary policy.** The Bank of England has also taken decisive actions to tackle the economic crisis caused by COVID-19. The Central Bank lowered its official interest rate twice in March, from 0.75% to 0.1%, and, among other measures, it repeatedly increased its public debt purchasing programme in March, June and November, doubling the existing amount before the crisis.

Macrofinancial imbalances

- **Low productivity and high regional disparity.** The UK economy was already suffering from a low rate of productivity growth prior to the COVID-19 crisis. Since the 2008 financial crisis, the rate of growth of labour productivity has fluctuated around 0%, a rate that can partly be explained by persistent issues related to the crisis, but also other factors such as the existence of regulatory barriers. Moreover, there is also high regional income disparity in the United Kingdom associated with notably low levels of productivity in certain parts of the country.
- **Public debt.** The sharp increase in the fiscal deficit will continue to exert pressure on the bloated and growing public debt. Although this should not represent a problem in the short term, given the low financing costs, in the medium term there is still a need to establish a fiscal adjustment strategy to achieve a more sustainable path, as the burden of debt to GDP is not expected to stabilise until 2025. Moreover, the guarantee facilities provided to support the liquidity of British businesses represent a fiscal risk if there is a sharp rise in bankruptcies.

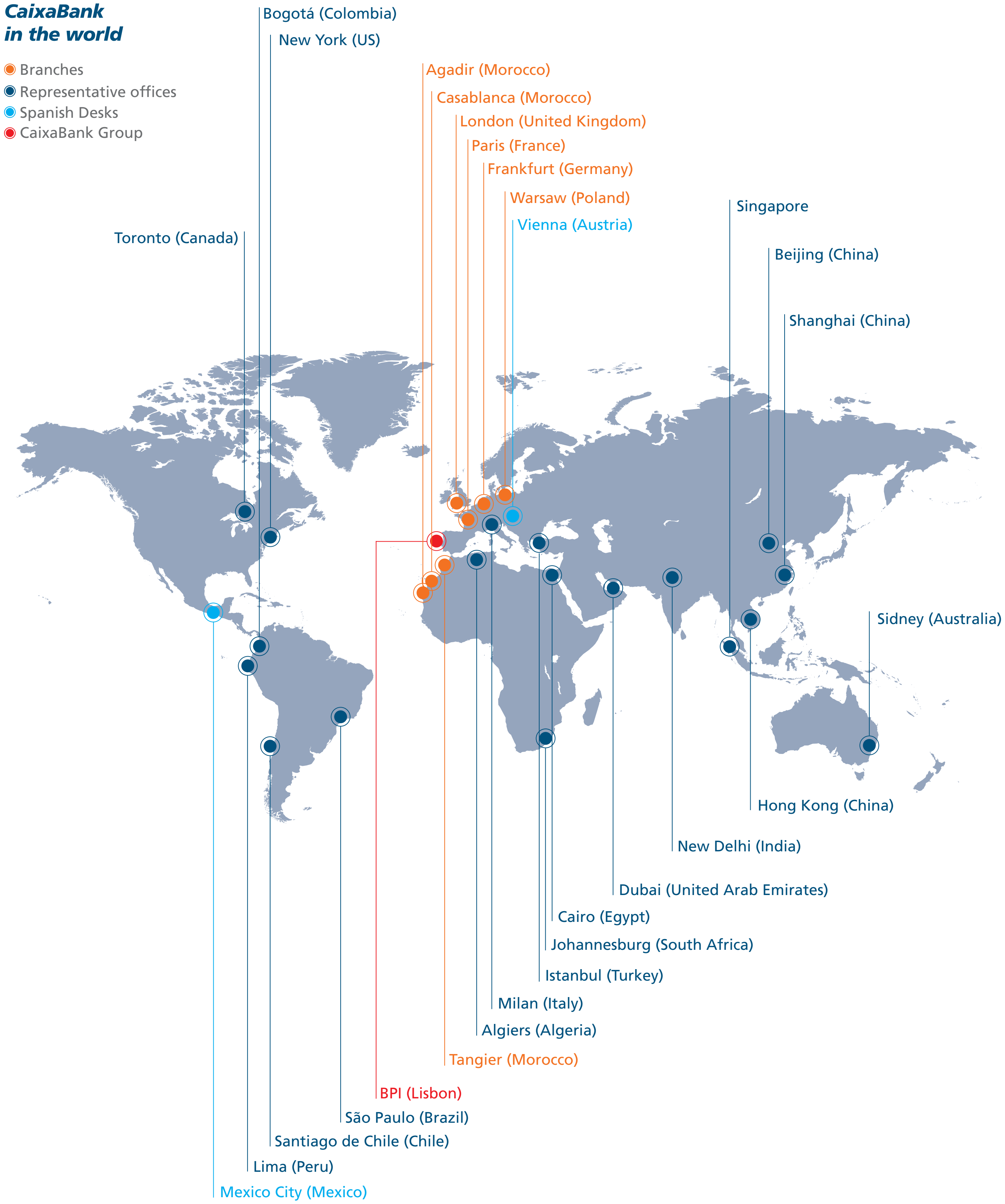
Main risks

- **Foreign sector.** Although the Brexit agreement reached at the end of 2020 has avoided any increase in trade tariffs and quotas, the United Kingdom exiting the single market involves new frictions that are significant compared to the previous trade relationship (border and regulatory controls, rules of origin, strict local content requirements, etc.) and they may possibly have a permanent economic impact on the British economy, even if it will be far more moderate than the impact that a no-deal Brexit would have had.
- **Financial sector.** The Brexit agreement has been characterised as a no-deal plus in the City with regard to financial services: the trade agreement offers nothing substantial in this regard and, as they have lost their "passporting rights", the financial institutions have also lost their unfettered access to the EU. There is an equivalence system under which the EU can grant a third country a certain level of access to its market for various financial activities if it believes that the regulatory framework is sufficiently similar in that country, but thus far temporary equivalence decisions have only been approved for two of the 39 possible activities (clearing houses and settlements). In our opinion, Brexit has not increased systemic risk in the British financial sector as most British financial institutions have been preparing for it for over three years (with measures such as capital increases). However, the loss of unfettered access to the European market may lead to a loss of competitiveness and some financial activities possibly being moved to other European countries.
- **Territorial unity.** In the medium term, Brexit may jeopardise Britain's territorial unity, especially in Scotland. The Johnson government is not currently considering holding a second referendum, but it may be difficult to maintain this position if the results of the Scottish parliamentary elections in May 2021 are highly favourable for the SNP. Managing the border between Northern Ireland and the Republic of Ireland may also be an enduring source of territorial friction.

	Rating	Last changed	Outlook	Last changed
Standard & Poor's	AA	27/06/16	Stable	17/12/19
Moody's	Aa3	16/10/20	Stable	16/10/20
FitchRatings	AA-	27/03/20	Negative	27/03/20

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".

CaixaBank in the world



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