United Kingdom

Put to the test

Now a global phenomenon, the Covid-19 pandemic reached the United Kingdom relatively late and did not give rise to immediate protective measures. Having initially opted for a 'herd immunity' strategy, Boris Johnson's government finally decided, on 24 March, to introduce a national lockdown. As in Italy, France and indeed generally across continental Europe, people's movements and interactions are now limited in the UK. The disease, meanwhile, has spread rapidly, on a trajectory similar to that seen in the worst affected countries. Faced with the health and economic threats created by the pandemic, the government and the monetary policy authorities have introduced an exceptional package of support.

The population of the United Kingdom and its economy are faring no better than elsewhere in the face of the coronavirus pandemic. Its relatively late arrival in Britain – on 29 February 2020 there were 23 confirmed cases, compared to a hundred or so in France and more than a thousand in Italy – did not trigger immediate protective measures. Boris Johnson's government initially adopted a 'herd immunity' strategy, before pivoting to a national lockdown from 24 March. At the time of writing (2 April 2020) most public places (schools, restaurants, pubs, sports clubs, etc.) and non-essential shops had been ordered to close, and restrictions had been placed on the population's movements. The disease, meanwhile, has rapidly taken hold with around 6,000 new cases per day and the loss of 4,300 lives due to Covid-19.

The economy is now showing the initial effects of the crisis. The March PMI fell to 37.1, a level never before seen, not even during the financial crisis of 2008. Back then, UK GDP showed a sharper drop than in France or in Europe as a whole[1], which could be explained both by the limited scale of the automatic stabilisers (public transfers) and the significance of wealth effects, in a country that remains a leading financial services centre.

A substantial fiscal commitment, mainly in the form of loan guarantees

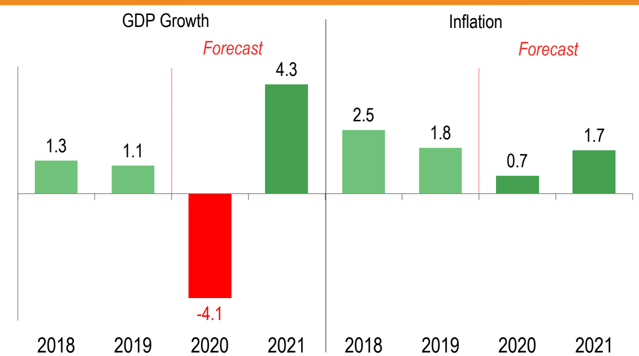
Viewed as of high quality and considered a 'national treasure', the UK's National Health Service (NHS) has nevertheless gone into the pandemic crisis in a weakened state. Although free care has been maintained to date, government spending on the service, and in particular capital spending, has been tightly constrained over the last decade. As a share of GDP spending fell regularly up until 2017, when Theresa May changed course[2]. Today the country is far from being well placed in terms of healthcare staff and capacity (2.57 hospital beds per 1,000 inhabitants, a level at the bottom end of the OECD range, Figure 2).

Fiscal measures to tackle the effects of the pandemic presented on 11 March by Rishi Sunak, Chancellor of the Exchequer, included an additional GBP5 billion for the NHS (4% of its annual budget) which might look puny given the scale of the crisis. In reality, the bulk of the government's commitments relate to guaranteed cash flow loans

[1]Between the first quarter of 2008 and the second quarter of 2009, UK GDP fell by 6%, compared to 3.9% in France and an average of 5.6% in the European Union. Source: Eurostat.

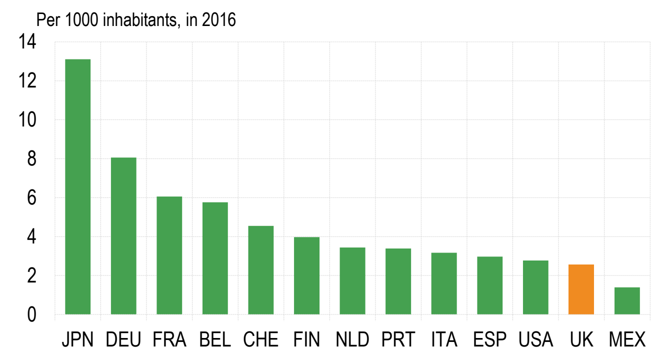
[2] See Office for Budget Responsibility, *Fiscal sustainability and public spending on health*, September 2016.

1- GDP Growth and inflation
(Y/Y, %)



Source: BNPP, Interim Forecasts (Before Global Markets updated scenario)

2- Hospital beds



Source: OECD

3- Fiscal support measures (GBP billion)

Loan guarantees	**330**
- To major companies (CCFF*)	n.s.
- To SMEs (BILS**)	n.s.
Direct transfers, contribution reductions and deferrals	**39**
- To companies	27
- To social organisations (including NHS)	12
TOTAL	**370**

* *Covid Corporate Financing Facility* ***Business Interruption Loan Scheme*

Source: Government, IMF, Press

to companies suffering from a loss of business (Table 3). On 17 March, Mr Sunak announced that their total value could reach GBP330 billion, or 15% of GDP. Although the precise split has not been spelt out (it will depend on the scale and spread of the crisis), the bulk of the allocation will go to large companies through the Covid Corporate Financing Facility (CCFF), a programme of buying commercial paper that will be open for 12 months and run by the Bank of England (BoE). Eligible securities (for a minimum amount of GBP1 million and for maturities ranging from 1 week to 12 months) must be issued by companies "making a significant contribution to the economy" with an investment grade credit rating on 1 March 2020[3].

Small and medium-sized companies, with annual revenue of up to GBP41 million, will be covered by the Business Interruption Loan Scheme (BILS), a system of loans made by banks for an amount of up to GBP5 million. The UK Treasury will guarantee 80% of the loan value and cover the first six months of interest payments.

To complete the picture, the government is planning direct cash grants to companies and offering deferral of contribution payments for a total of at least GBP 20 billion (GBP 27 bn on the IMF's reckoning).

Substantial monetary support

As is the case around the world, the fiscal effort has been backed by an unprecedented monetary stimulus. Since 11 March, the BoE's policy rates have been close to zero, the financial system has received exceptional injections of liquidity, in both sterling and dollars, and the pace of quantitative easing has increased (see box). At the latest regular meeting of its Monetary Policy Committee (MPC), on 25 March 2020, the BoE did not take any new measures but indicated its readiness to increase asset purchases if necessary and emphasised its vigilance over the application of the measures introduced, to guarantee their correct transmission into the real economy.

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4- The BoE has deployed substantial resources

Mark Carney's term as the Governor of the Bank of England ended on 16 March, having been extended to help deal with possible Brexit-related complications. At the time of his departure, the BoE had pursued a more or less unchanged monetary policy for several months with an asset purchasing programme, launched in 2009, capped at GBP445 billion, and a policy rate that was raised to 0.75% in August 2018 and held at that level despite the repeated votes, since November 2019, by two MPC members to cut it to 0.5%.

Faced with the Covid-19 crisis, the BoE reacted relatively quickly and strongly at the extraordinary MPC meetings on 11 and 19 March. The policy rate was cut first to 0.25%, then to 0.10%. The asset purchasing programme was increased by GBP200 billion, including GBP10 billion in private securities. The long-term refinancing programme was relaunched as the Term Funding Scheme Small and Medium Enterprises (TFSME), which as its name suggests has a particular focus on SMEs. Planned to last 12 months, the TFSME is designed to make available 4-year funding equivalent to 10% of participants' real economy lending at preferential rates. The counter-cyclical buffer applicable to UK lending was cut from 1% to 0% for 12 months with immediate effect, freeing up the equivalent of up to GBP190 billion of potential financing according to BoE estimates.

An agreement was also reached with the Fed to improve liquidity supply through US dollar liquidity swaps. In practice, the effective rate on this type of financing fell by 25 basis points on 16 March. On 18 March, the BoE announced that it had already allocated GBP12 billion of this type of funding. On 24 March, it also triggered the Contingent Term Repo Facility (CTRF), temporarily enhances its capacity to provide sterling liquidity.

Lastly, the BoE plans to adjust the timetable and application of certain prudential measures. The stress tests due to be carried out in 2020 have been cancelled – the 2019 round of tests having been judged satisfactory by the BoE – and the Biennial Exploratory Scenario looking at liquidity and climate change delayed. The BoE has also expressed its support for a flexible application of the rules for classifying loans under IFRS 9 such that, should the authorities impose or encourage repayment holidays, this does not automatically feed through into the recognition of cases under Stage 2 – which would require an increase in bank provisions. The BoE has also decided to delay by one year the implementation of proposals relating to the definition of default, probability of default and loss given default and the move to 'hybrid IRB' models as part of the finalisation of Basel III measures. Since this decision, the Basel Committee has made a similar recommendation.

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[3] It is worth noting that the BoE will have some flexibility on these criteria, particularly if they prove to be too selective. See: Financial Times, *Loan guarantees: what funding will be available to UK businesses?* March 20, 2020.