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Beyond the Brexit noise – five other things the IMF said about the UK

Blog post by Adviser Leo Ringer, 13 May 2016

The IMF's 'Article IV' assessment of the UK economy is dominating headlines for its roundly negative assessment of a vote to leave the EU - but beyond its Brexit judgments, the report is a telling insight into the IMF's current outlook on some key policy questions.

1. **The IMF's reservations about the pace of fiscal consolidation linger**. Having accused the Chancellor of "playing with fire" with his deficit reduction plans in 2013, the IMF later backtracked and has largely fallen into line behind the strategy. But today's assessment sounds a lingering note of caution – that deficit reduction should be "gradual", "responsive" and must avoid "overburdening monetary policy" as the lever of economic growth. The Fund is straightforwardly reserving the right to tell Osborne to ease off if growth does not pick up. But it is also an implicit recognition that the UK – exemplifying a much broader phenomenon – may be approaching the limits of monetary policy as a growth lever.

2. **The Fund takes a contrarian view of UK monetary policy.** Noting weak inflationary pressure in the UK and the "headwinds" of fiscal consolidation, the IMF states that monetary policy "may need to be eased via some combination of policy rate cuts and quantitative easing". With a base rate of 0.5%, rate cuts would quickly take the UK towards zero or negative rates territory – something, by extension, that the Fund would appear to be comfortable with. This sharply contrasts with the narrative of the UK Monetary Policy Committee, which still regards a rise as the next rate move, stating yesterday that "it is more likely than not that Bank Rate will need to be higher … than at present".

3. **The IMF is as short of ideas on productivity as everyone else.** The Fund mentions productivity – seen as the UK's most fundamental economic challenge – only in passing. Cynics may argue that this is a political favour to Osborne, who will appreciate the lack of focus on productivity as the UK's performance continues to decline. But in reality, it seems to reflect a lack of ideas on the IMF's part – its brief reference to housing supply, vocational training and childcare support as productivity-enhancing measures has the feel of a barrel-scraping exercise.

4. **The Fund is bullish in its advice on macroprudential policy.** The Fund's robust approach – including a predication that the countercyclical capital buffer (a core part of the toolkit) "may well need to be increased later this year" – is somewhat surprising. First, the CCB was only raised in March of this year, to take effect in March 2017 – casting doubt on whether the IMF is referring to an additional increase, or simply the implementation of this hike. Second, the call for intervention in the buy-to-let market front-runs the decision-making of both the UK Treasury and the Bank of England, which will make decisions about the granting

and use of additional powers over the buy to let market later this year.

5. **The IMF treads lightly into the debate on bank “de-risking”.** The Fund laments the decline in correspondent banking relationships entered into by UK banks and calls for a “clarifying of regulatory expectations” as part of the solution. Written between the lines, but not made explicit, is the enforcement stance of the US, which has been cited by UK and other non-US banks as a reason for not re-engaging with the financing of transactions involving Iran. Only yesterday, Secretary of State John Kerry and UK Foreign Secretary Philip Hammond met with UK banks with the aim of providing reassurance. However, without key constituents from the US Treasury in the room, and with a US election looming, it is unlikely that non-US banks will see the merit in dialling up their involvement – irrespective of the IMF’s entreaties.

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