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REPORT FROM THE COMMISSION

United Kingdom

**Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of
the European Union**

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1. INTRODUCTION

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows countries to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

According to the Commission 2020 spring forecast, the general government deficit in the United Kingdom¹ is expected to have been 2.5% of GDP in the financial year 2019-20, while general government debt is expected to have been 85.2%. However, final outturn data on the 2019-20 general government deficit and debt will only be available in autumn 2020. According to the Commission forecast, the United Kingdom's deficit is expected to be 10.7% of GDP in 2020-21, while debt is expected to be 102.5% of GDP. All available evidence, including statements by the national authorities about the extent of the reaction of budgetary policy to the severe economic downturn associated with the COVID-19 pandemic, points to a deficit significantly in excess of the 3% of GDP threshold in 2020-21 and in 2021-22. In its letter of 7 May 2020, the Commission asked the UK to provide updated information on the

¹ The United Kingdom withdrew from the European Union as of 1 February 2020. The Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and European Atomic Energy Community (OJ L 29, 31.1.2020, p. 7) entered into force on 1 February 2020, when the United Kingdom withdrew from the EU. It provides for a transition period during which Union law, with a few exceptions, is applicable to and in the United Kingdom. As defined by Union law applicable to it during the transition period, the United Kingdom is treated as an EU Member State, but will not participate in EU decision-making and decision-shaping.

estimated size of the deficit in 2020-21. The UK however did not provide the requested clarification, but referenced the COVID-19 scenario from the Office for Budget Responsibility, which expects a deficit significantly above 3% in 2020-21. Taking those factors into account, the Commission considers its current forecast of a deficit of 10.7% of GDP in 2020-21 as sufficiently compelling prima facie evidence of an excessive deficit as defined by Article 126(2)(a) of the Treaty.

Against this background, the Commission has therefore prepared this report, which analyses the United Kingdom's compliance with the deficit and debt criteria of the Treaty. It takes into account all relevant factors and gives due consideration to the major economic shock linked to the COVID-19 pandemic.

Table 1. General government deficit and debt (% of GDP)

		2016-17	2017-18	2018-19	2019-20 COM	2020-21 COM	2021-22 COM
Deficit criterion	General government balance	-2.8	-2.7	-1.8	-2.5	-10.7	-6.2
Debt criterion	General government gross debt	85.2	84.6	84.2	85.2	102.5	100.2

Note: Source: Eurostat, Commission 2020 spring forecast

2. DEFICIT CRITERION

Based on the Commission 2020 spring forecast the United Kingdom's general government deficit in 2020-21 is expected to reach 10.7% of GDP, above and not close to the Treaty reference value of 3% of GDP. The forecast excess over the Treaty reference value in 2020-21 is exceptional, as it results from a severe economic downturn. Taking into account the impact of the COVID-19 pandemic, the Commission 2020 spring forecast projects a contraction of real GDP in 2020 by 8.3%.

The forecast excess over the Treaty reference value is not temporary, based on the Commission 2020 spring forecast, which projects the deficit to remain above 3% of GDP in 2021-22.

In sum, the forecast deficit for 2020-21 is above and not close to the 3% of GDP Treaty reference value. The forecast excess is considered to be exceptional and not temporary as defined by the Treaty and the Stability and Growth Pact. All available evidence, including statements by the national authorities about the extent of the reaction of budgetary policy to the severe economic downturn associated with the COVID-19 pandemic, points to a deficit significantly in excess of the 3% of GDP threshold in 2020-21 and in 2021-22. In its letter of 7 May 2020, the Commission asked the UK to provide updated information on the estimated size of the deficit in 2020-21. The United Kingdom however did not provide the requested clarification, but referenced the COVID-19 scenario from the Office for Budget Responsibility, which expects a deficit significantly above 3% in 2020-21. Taking those factors into account, the Commission considers its current forecast of a deficit of 10.7% of GDP in 2020-21 as sufficiently compelling prima facie evidence of an excessive deficit as

defined by Article 126(2)(a) of the Treaty. Hence, the analysis suggests that *prima facie* the deficit criterion as defined by the Treaty and Regulation (EC) No 1467/97 is not fulfilled.

3. RELEVANT FACTORS

Article 126(3) of the Treaty provides that, if a Member State does not fulfil the requirements under one or both of those criteria, the Commission has to prepare a report. That report must also “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.

Those factors are further clarified in Article 2(3) of Regulation (EC) No 1467/97, which also provides that “any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission” need to be given due consideration. As specified in Article 4 of Regulation (EC) No 1467/97, as regards the deficit criterion, since the government debt-to-GDP ratio exceeds the 60% reference value and the double condition is not met – i.e. that the deficit remains close to the reference value and that its excess over the reference value is temporary – those relevant factors cannot be taken into account in the steps leading to the decision on the existence of an excessive deficit on the basis of the deficit criterion for the United Kingdom.

In the current situation, a key additional factor to take into consideration regarding 2020 is the economic impact of the COVID-19 pandemic, which has a very substantial impact on the budgetary situation and results in a highly uncertain outlook. The pandemic has also led to the activation of the general escape clause.

3.1. COVID-19 pandemic

The COVID-19 pandemic has led to a major economic shock that is having a significant negative impact throughout the European Union. The consequences for GDP growth will depend on the duration of both the pandemic and of the measures taken by national authorities and at European and global level to slow its spread, protect production capacities and support aggregate demand. Countries have already adopted or are adopting budgetary measures to increase the capacity of health systems and provide relief to those individuals and sectors that are particularly affected. Significant liquidity support measures and other guarantees have also been adopted. Subject to more detailed information, the competent statistical authorities are to examine whether those measures entail an immediate impact on the general government balance or not. Together with the fall in economic activity, those measures will contribute to substantially higher government deficit and debt positions.

3.2 Medium-term economic position

According to the Commission 2020 spring forecast, the United Kingdom’s real GDP is expected to fall steeply in the first half of 2020. The lockdown measures that were implemented in late March to contain the spread of COVID-19 have led to a sharp fall in economic activity across many sectors of the economy. As the containment measures are eased, the economy should start to recover. Overall, the United Kingdom’s real GDP is

expected to fall by 8.3% in 2020. This is a mitigating factor in the assessment of the United Kingdom's compliance with the deficit criterion in 2020.

There is an exceptional high degree of uncertainty surrounding the macroeconomic outlook. Changes to the assumptions about the length of the COVID-19 pandemic and related lockdown measures would significantly change the forecast outlook.

3.3 Medium-term budgetary position

The United Kingdom was recommended on 13 July 2018 to ensure that the nominal growth rate of primary government expenditure, net of discretionary revenue measures and one-offs, did not exceed 1.6% in 2019-20 ('the expenditure benchmark'), corresponding to a structural adjustment of 0.6% of GDP². The overall assessment points to a risk of significant deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019-20 and over 2018-19 and 2019-20 taken together. A final assessment can, however, only be made in autumn 2020 when outturn data for 2019-20 have become available.

Over the medium-term, according to the Commission 2020 spring forecast, the general government deficit is expected to increase significantly. This is due to the expected economic downturn in combination with several fiscal measures announced by the UK government to deal with the consequences of COVID-19, such as support for employees and self-employed workers, support for businesses and an increase in welfare spending. The general government deficit is expected to increase to 10.7% in 2020-21, before falling to 6.2% in 2021-22. The general government debt is expected to increase from 85.2% in 2019-20 to 102.5% of GDP in 2020-21, before falling slightly to 100.2% of GDP in 2021-22.

Those forecast numbers are subject to a high degree of uncertainty. For instance, the costs of the fiscal measures are dependent on levels of take-up and the duration of the lockdown measures. Changes to the macroeconomic outlook would also significantly affect the fiscal outlook.

3.4 Medium-term government debt position

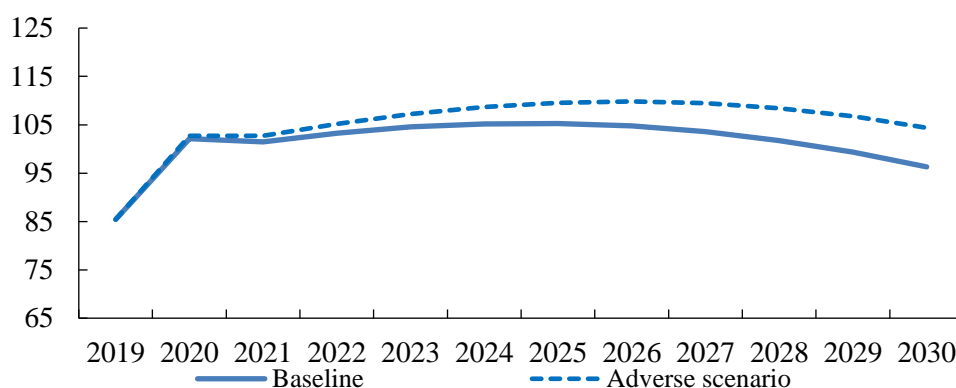
According to the Commission 2020 spring forecast, general government debt is expected to rise from 85.2% of GDP in 2019-20 to 102.5% by 2020-21.

The debt sustainability analysis has been updated with the Commission 2020 spring forecast. Overall, the debt sustainability assessment indicates that notwithstanding risks, the debt position remains sustainable over the medium-term, which takes into account important mitigating factors (including the debt profile). In particular, while the government debt position deteriorates as a result of the COVID-19 crisis, the debt-to-GDP ratio in the baseline is expected to be on a sustainable (slightly declining) trajectory over the medium term.³

² Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of the United Kingdom and delivering a Council opinion on the 2018 Convergence Programme of the United Kingdom; OJ C 320, 10.9.2018, p. 119.

³ The baseline is based on the Commission Spring 2020 forecast. Beyond 2021, a gradual adjustment of fiscal policy is assumed, consistent with the EU economic and fiscal coordination and surveillance frameworks. Real GDP growth is projected according to the so-called EPC/OGWG T+10 methodology. In particular, (real) actual GDP growth is driven by its potential growth and affected by any additional fiscal adjustment considered (through the fiscal multiplier). Inflation is assumed to converge gradually to 2%. Interest rates assumptions are

Graph 2: Government debt-to-GDP ratio, United-Kingdom, % of GDP



Source: Commission services.

3.5 Other factors put forward by the United Kingdom

On 12 May 2020, the United Kingdom authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities.

4. CONCLUSIONS

According to the Commission 2020 spring forecast the United Kingdom's general government deficit in 2020-21 is forecast to increase to 10.7% of GDP, above and not close the 3% of GDP Treaty reference value. The forecast excess over the reference value is considered to be exceptional but not temporary.

All available evidence, including statements by the national authorities about the extent of the reaction of budgetary policy to the severe economic downturn associated with the COVID-19 pandemic, points to a deficit significantly in excess of the 3% of GDP threshold in 2020-21 and in 2021-22. In its letter of 7 May 2020, the Commission asked the UK to provide updated information on the estimated size of the deficit in 2020-21. The UK however did not provide the requested clarification, but referenced the COVID-19 scenario from the Office for Budget Responsibility, which expects a deficit significantly above 3% in 2020-21. Taking those factors into account, the Commission considers its current forecast of a deficit of 10.7% of GDP in 2020-21 as sufficiently compelling prima facie evidence of an excessive deficit as defined by Article 126(2)(a) of the Treaty.

The general government gross debt is expected to have been 85.2% of GDP at the end of the financial year 2019-20, above the 60% of GDP Treaty reference value. The United Kingdom is not expected to have made sufficient progress towards meeting the debt reduction benchmark in 2019-20. Final outturn data will, however, only be available in autumn 2020.

set in line with financial market expectations. Under the adverse scenario, higher interest rates (by 500 bps.) and lower GDP growth (by -0.5 pp.), with respect to the baseline, are assumed (throughout the projection horizon).

In line with the Treaty and the Stability and Growth Pact, this report also examined relevant factors. As regards compliance with the deficit criterion in 2020-21, however since the government debt-to-GDP ratio exceeds the 60% reference value and the double condition is not met – i.e. that the deficit remains close to the reference value and that its excess over the reference value is temporary – those relevant factors cannot be taken into account in the steps leading to the decision on the existence of an excessive deficit on the basis of the deficit criterion for the United Kingdom.

Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.