Living with COVID-19: the economic outlook

18th September 2020

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Agenda:

- Global economic outlook
- UK economic outlook

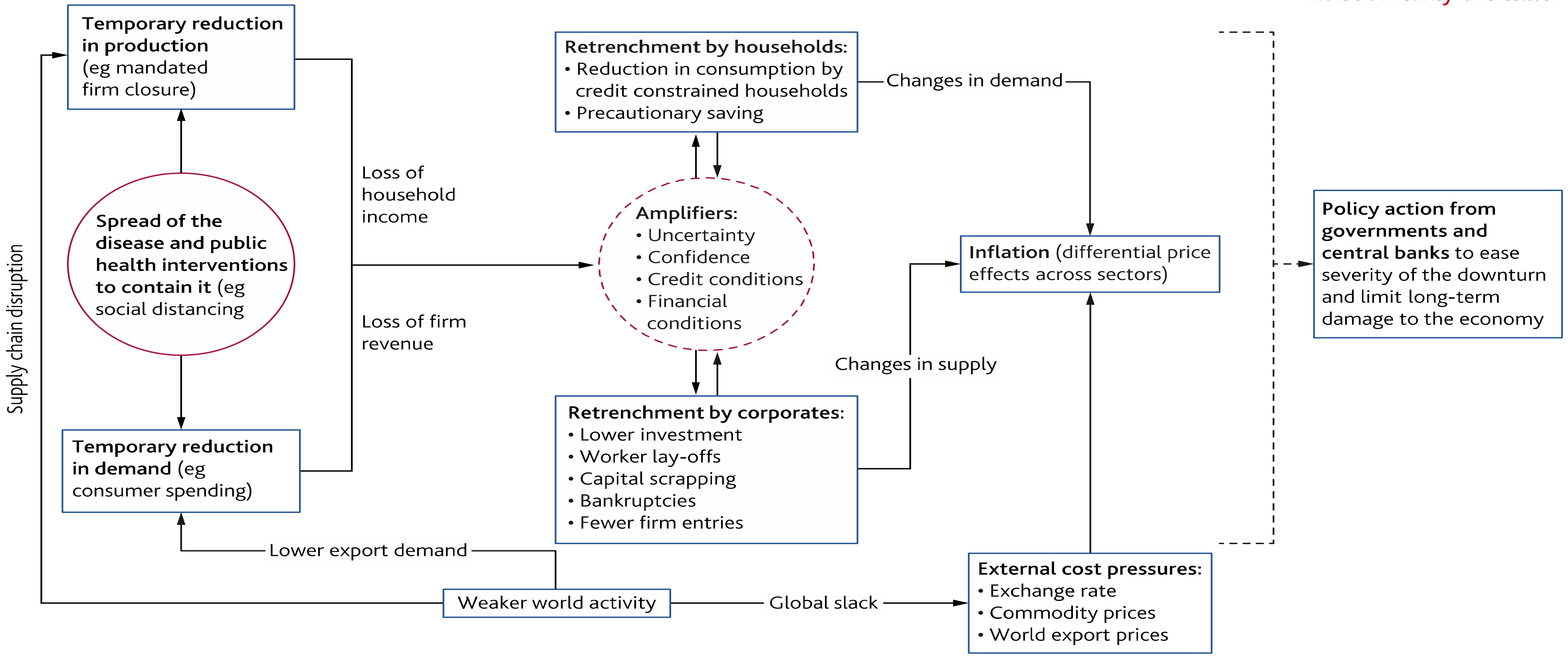
UK overview

- Negative global growth induced by a health scare. Worst global pandemic since 1918 ‘Spanish’ flu. UK one of the worst hit economies.
- UK faces double whammy with Brexit and Covid-19 likely interacting in 2021, but economically it will be hard to distinguish one effect from the other (apart from, perhaps, the occasional lorry in Kent!).
- Sharp cuts in interest rates and further monetary loosening - more is possible.
- Sharp rises in public sector debt as fiscal policy is loosened and growth slows.
- However, lower long-term bond yields and negative or inverted gilt yields…
- …make it easier for governments to finance deficits and for households and firms to recover.
- Tech, internet and health related sectors seem to be the winners. Travel and hospitality seem to be the losers. Future growth is key: driverless cars, carbon reduction technologies, digitalization
- Requires global openness to trade and ideas and people, less regulation, decentralization, innovation.

Covid-19 acts through several economic channels as shutdown ordered

Government induced shutdown:

A demand and supply side hit but mainly the latter



Source: Bank of England, May MPR

Global activity falls sharply…

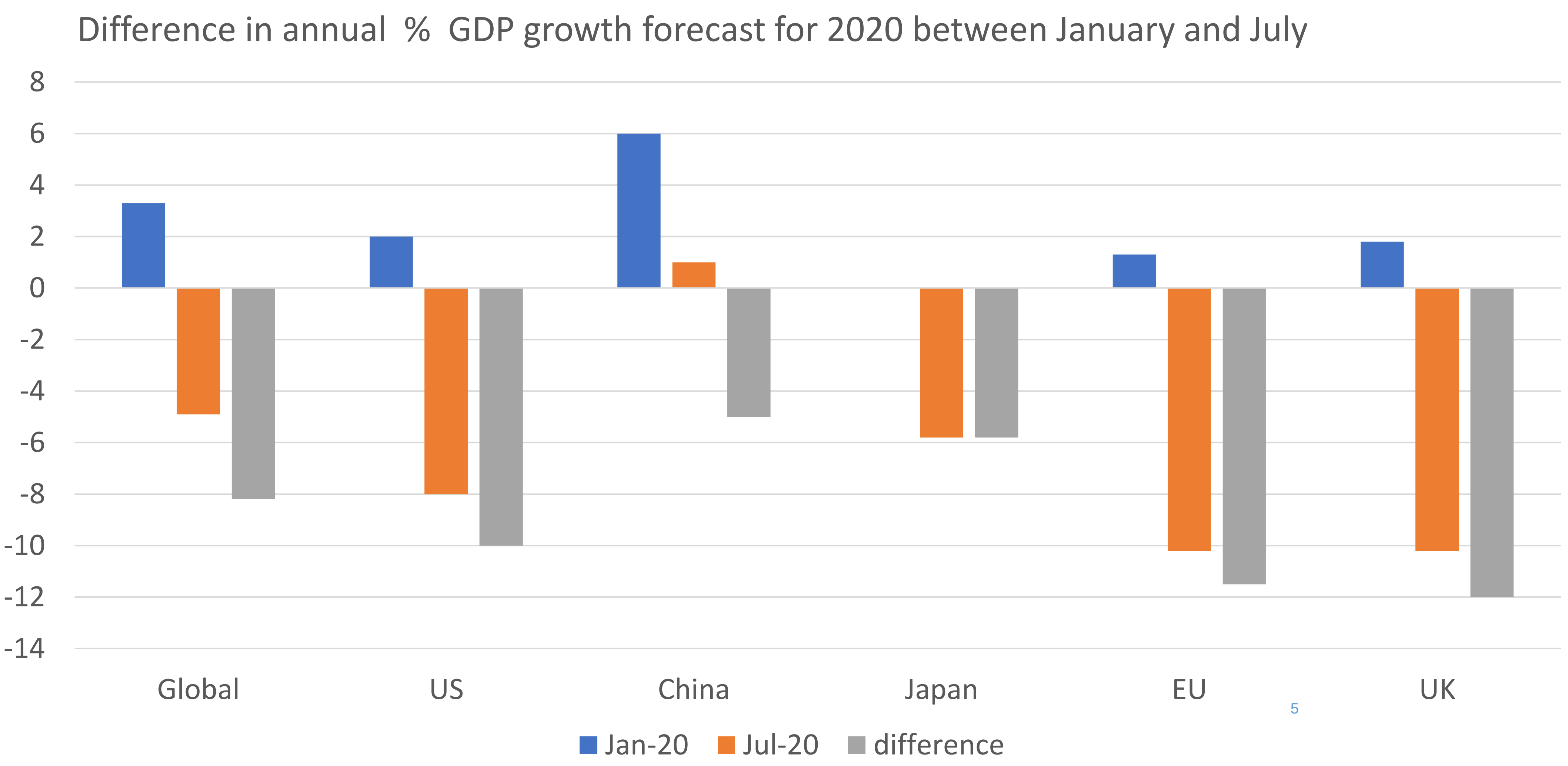
% change in selected period

	Quarterly averages					2020	
	1998–2007	2008	2009	2010–18	2019	Q1	Q2
United Kingdom[b]	0.7	-0.9	-0.4	0.5	0.3	-2.2	-21.0
Euro area (40%)	0.6	-0.5	-0.6	0.3	0.2	-3.6	-12.1
United States (19%)	0.7	-0.7	0.0	0.6	0.6	-1.3	-9.5
China (4%)[c]	2.5	1.8	2.7	1.9	1.5	-10.0	11.5
UK-weighted world GDP[b][d]	0.7	-0.3	-0.1	0.6	0.4	-2.6	-9.2

Sources: Eikon from Refinitiv, IMF *World Economic Outlook (WEO),* National Bureau of Statistics of China, OECD, ONS and Bank calculations.

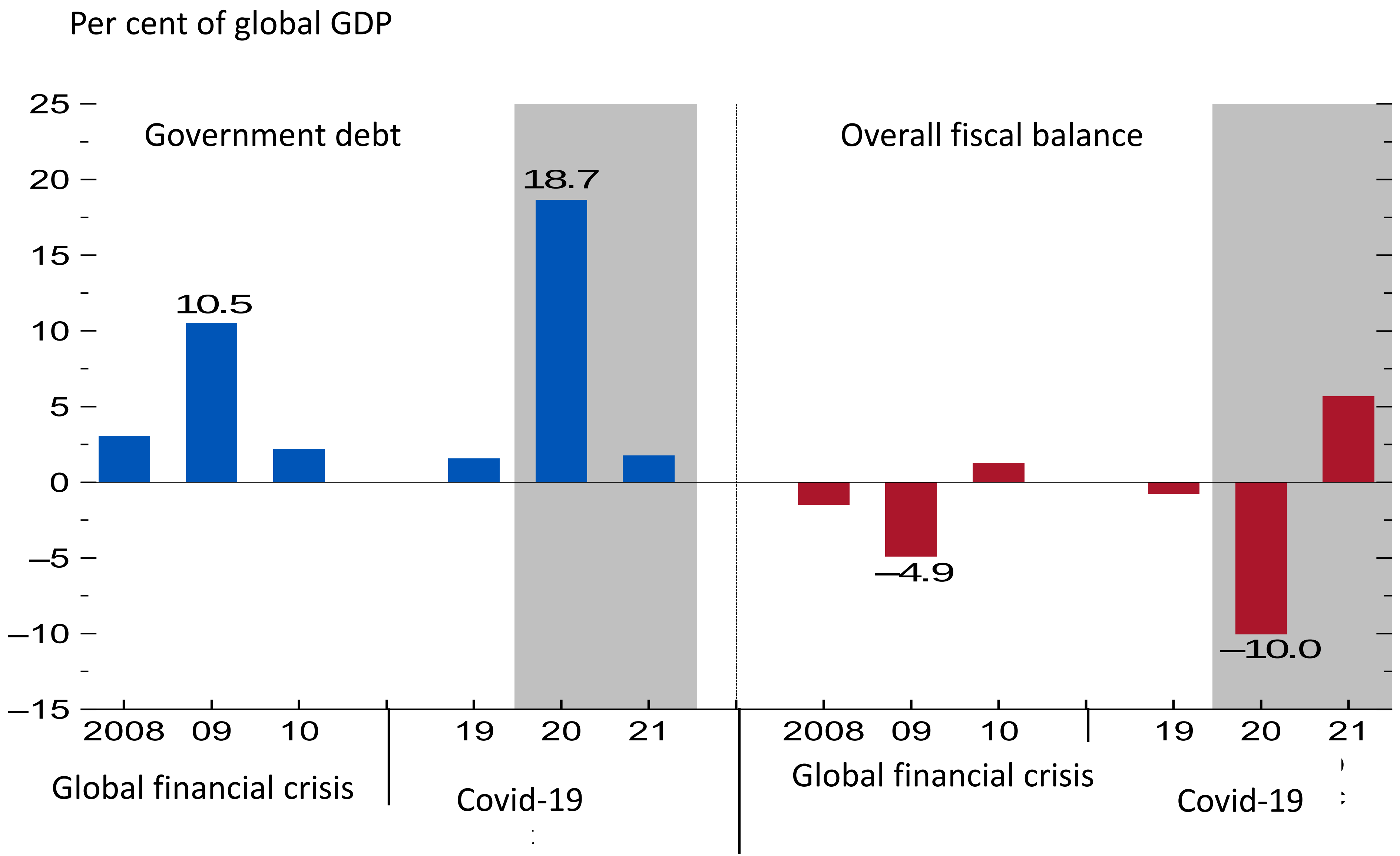
(a) Figures in parentheses are shares in UK exports in 2018.
(b) Figures for 2020 Q2 are Bank staff projections.
(c) Estimates from 2010 Q4 onwards are from the National Bureau of Statistics of China.
(d) See footnote (c) of **Table 1.B**.

…and big turnaround has occurred because of the lockdown



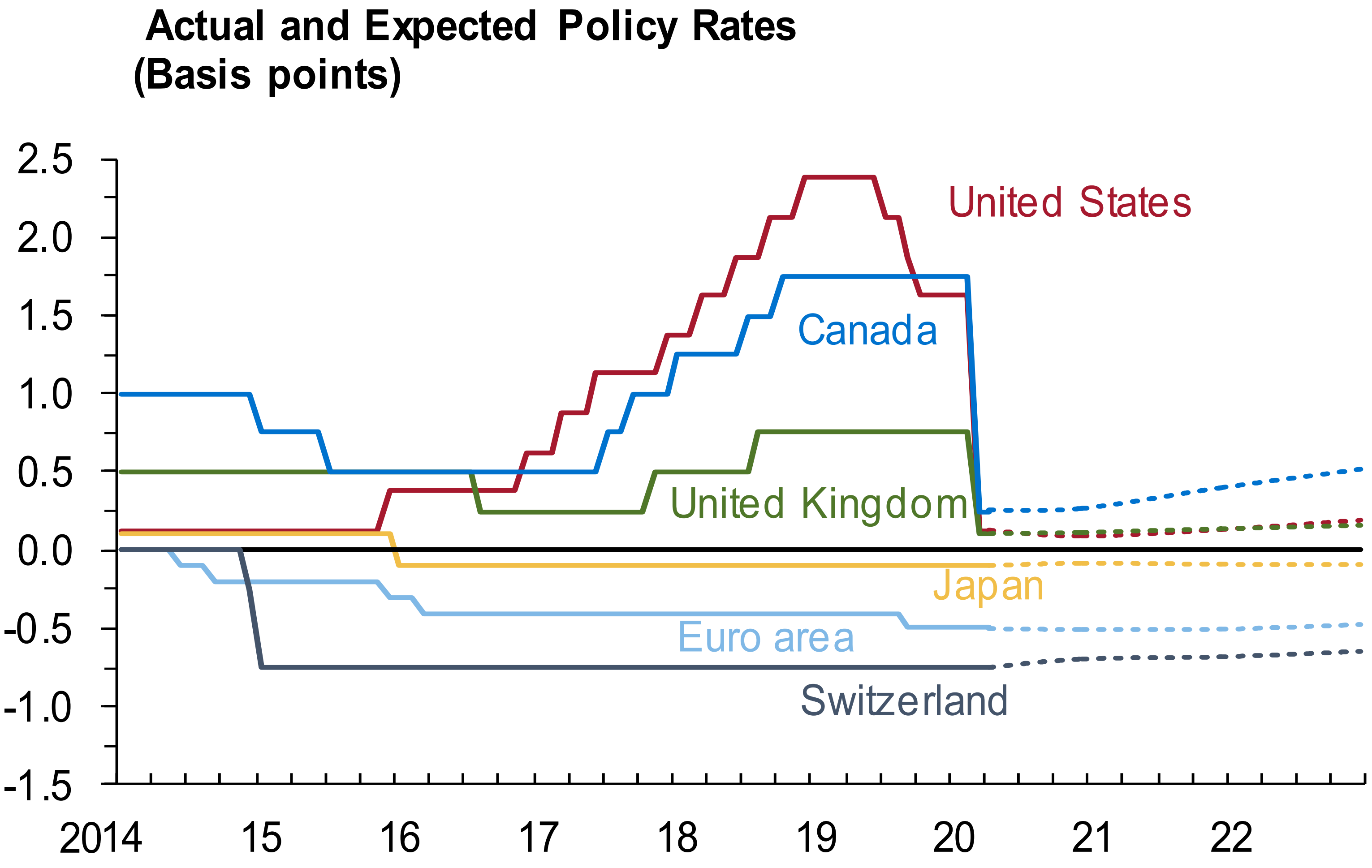
Source: TW calculation, using IMF data

So, the extent of fiscal easing is much greater than in the 2008 / 9 crisis



Source: IMF

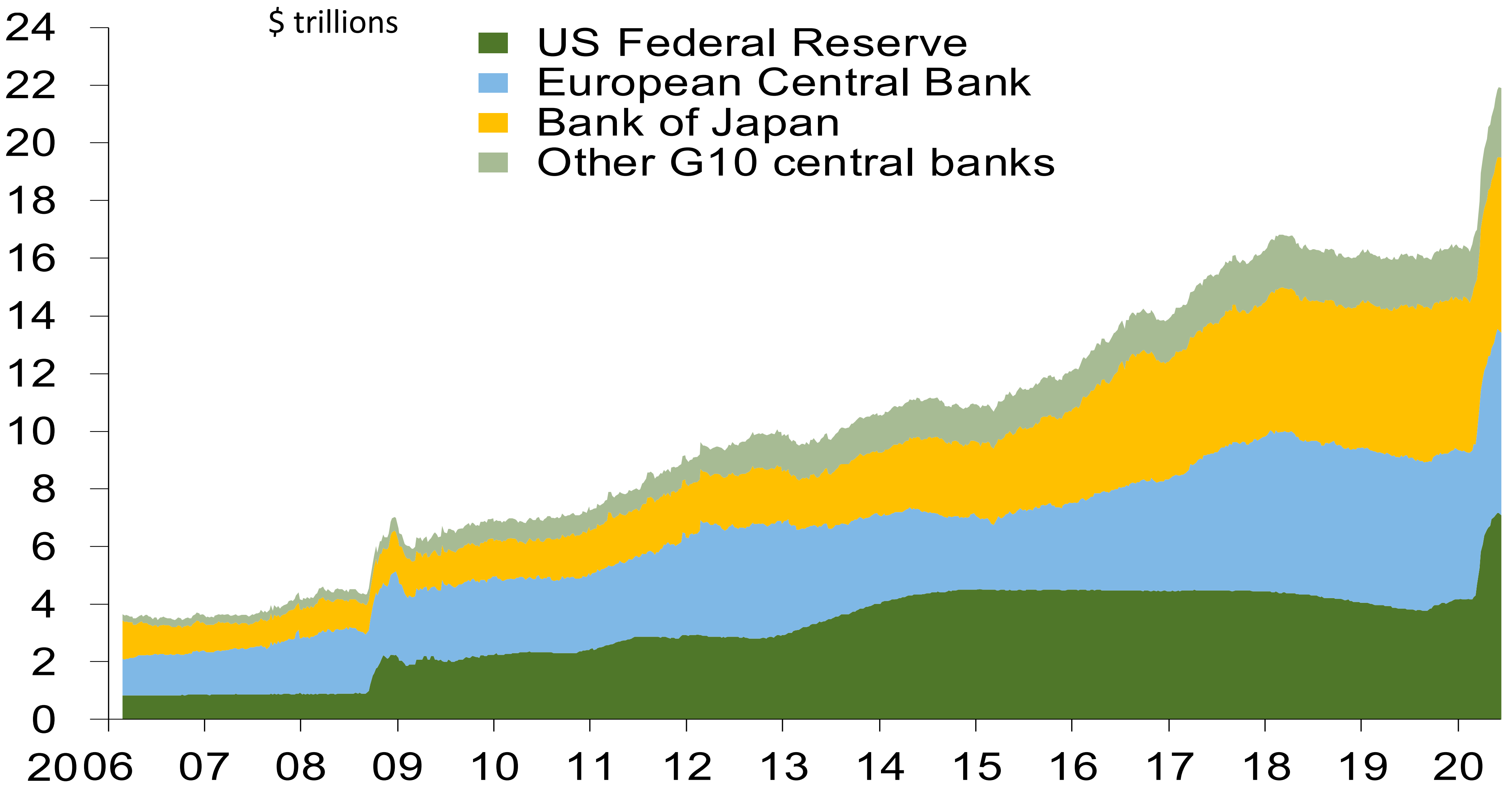
Monetary policy has also been loosened aggressively



- Because they were cut to such low levels in the last recession…
- …and have not been raised much since then…
- …in some countries / jurisdictions policy rates were still negative and are now even more so.
- Central banks have significantly eased monetary policy, have provided additional liquidity to banking systems and enhanced US dollar liquidity is available through swap lines.

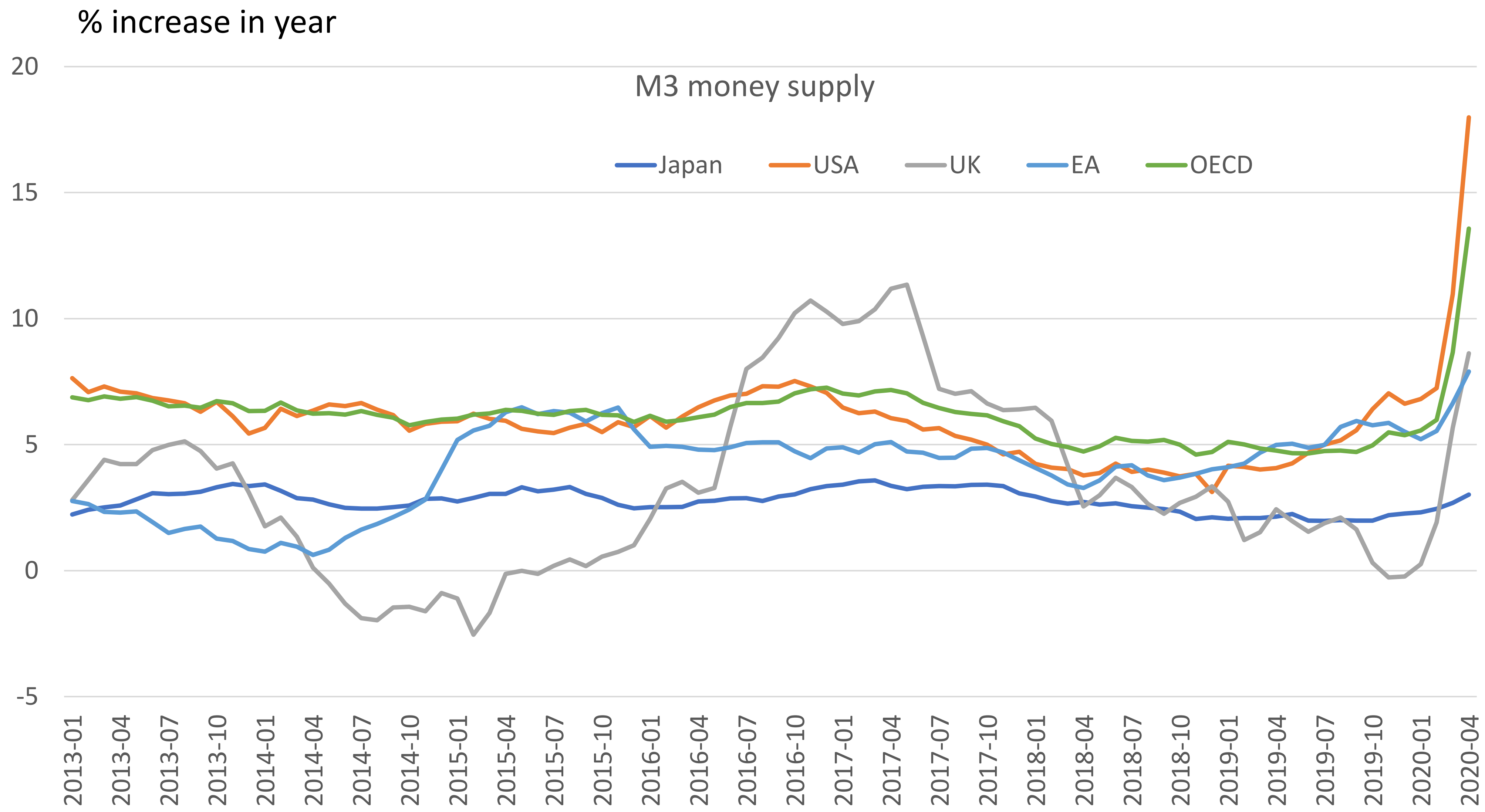
Sources: Bloomberg Finance L.P.; and IMF staff calculations.

With Quantitative Easing on a massive scale…



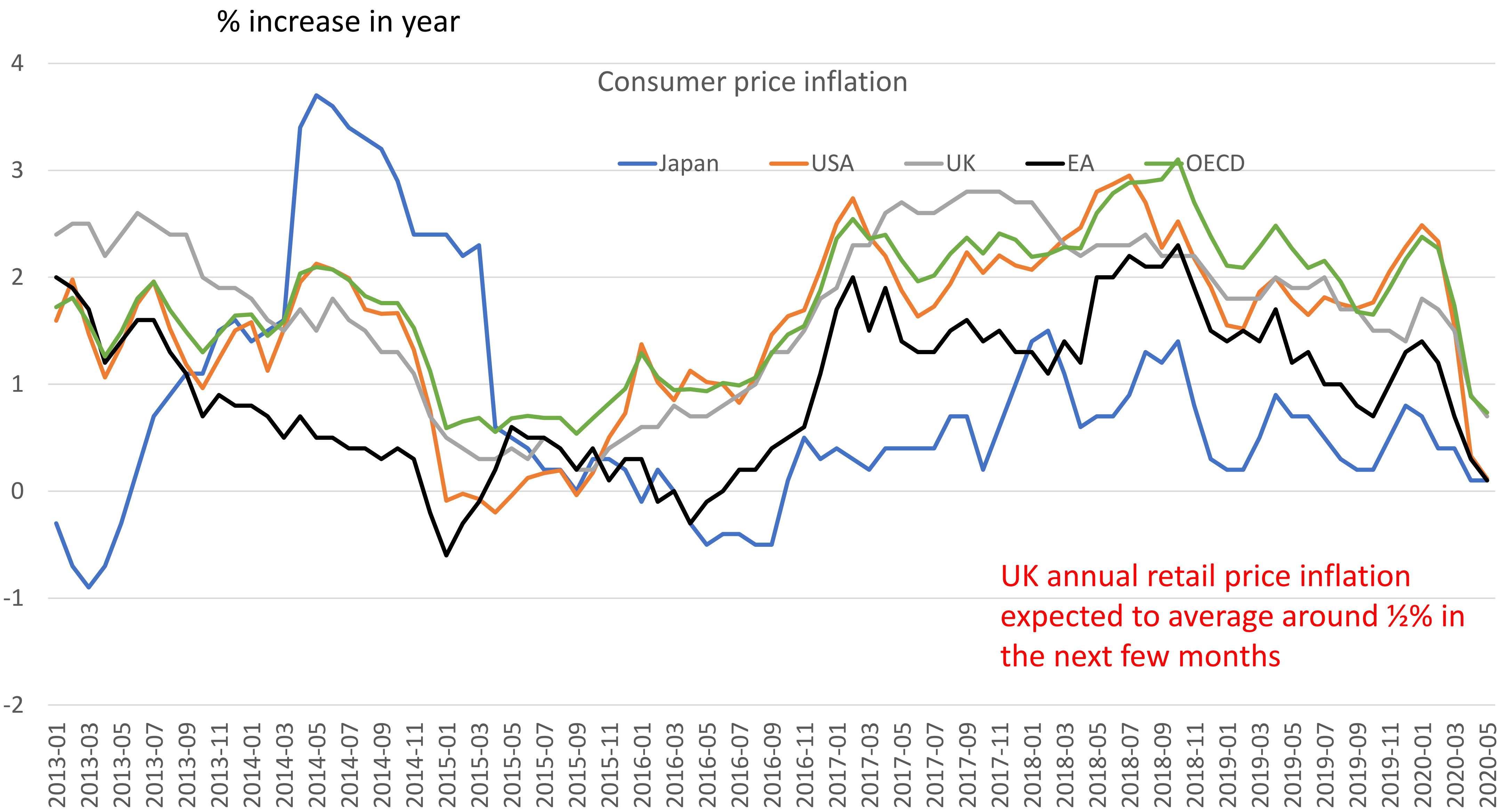
Sources: Bloomberg Finance L.P; and IMF staff calculations. Note: G10 = Group of Ten; other G10 central banks = central banks of Canada, Sweden, Switzerland, and the United Kingdom.

…global money supply growth is rising, fast…



Source: OECD

But weak consumer price inflation supports loose monetary policy…

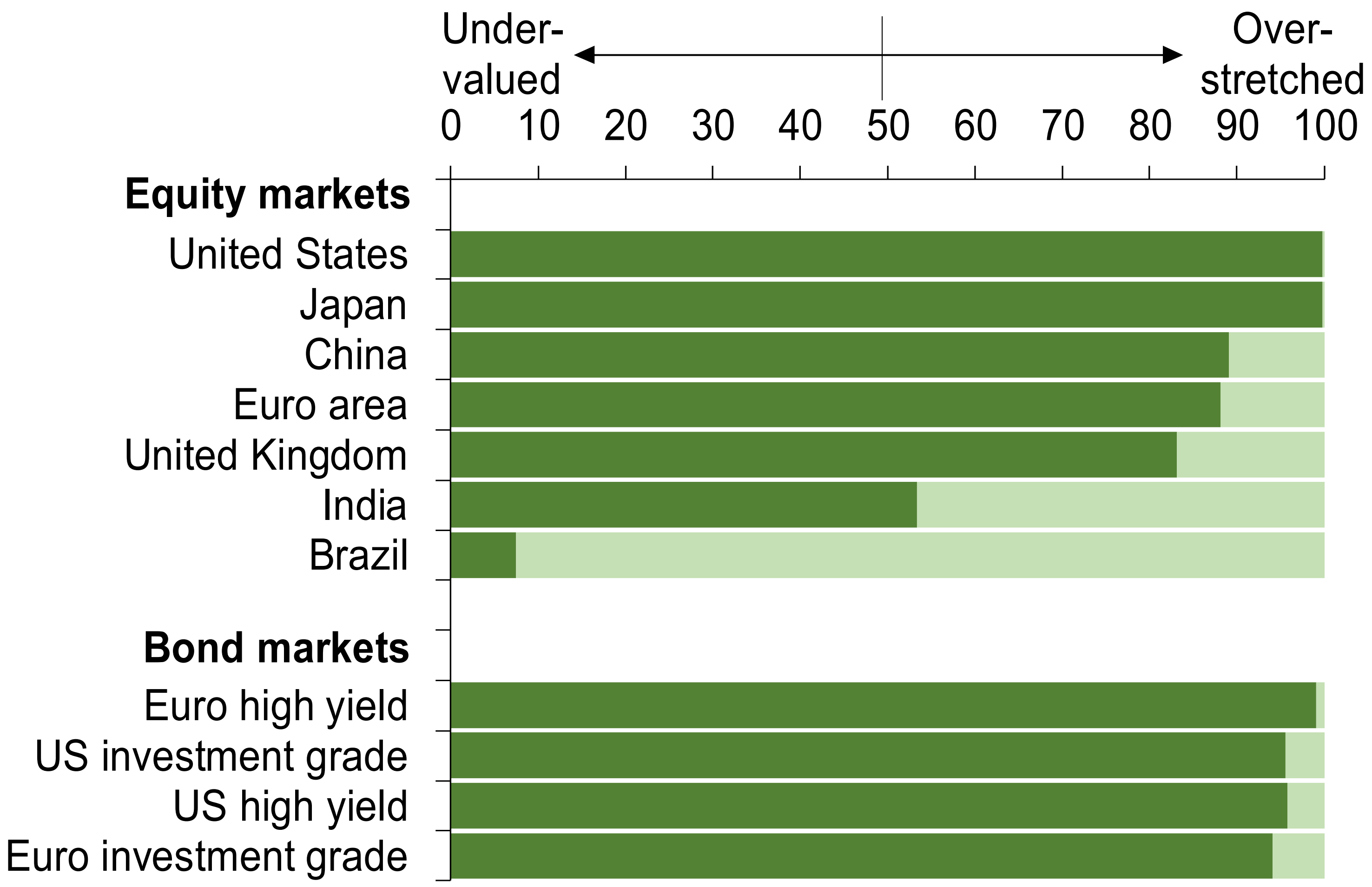


UK annual retail price inflation expected to average around ½% in the next few months

Source: OECD

…meaning that asset price misalignment is rising…

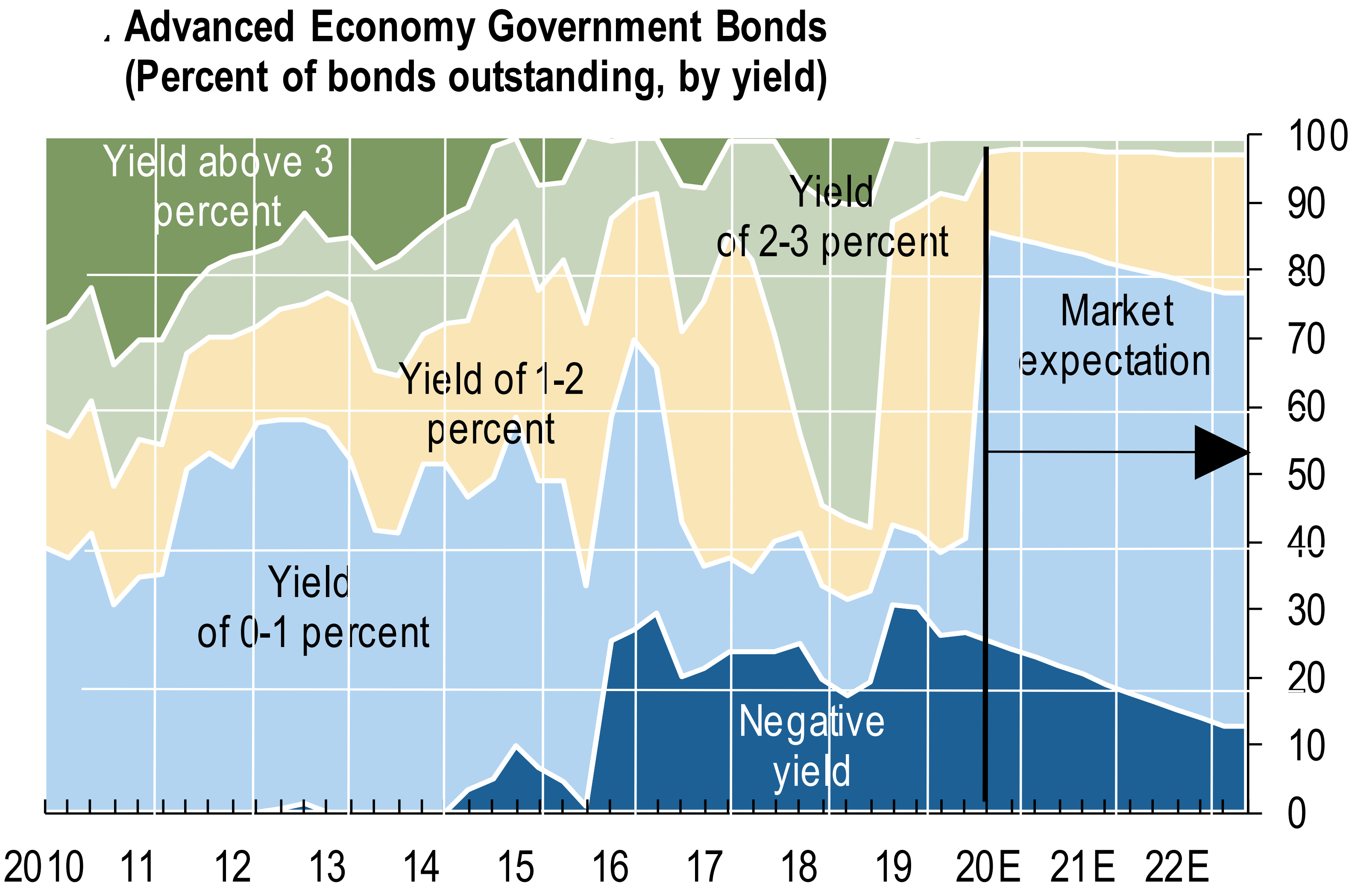
(Percentile during 1990–2020)



- Asset prices increasingly unmoored from real economy
- Feeding wealth inequality at a time when income is constrained.
- Weight of money from QE is not boosting real economy but leading to asset price inflation.
- No good will come of it.
- Undermines talk that we are all in it together and worse creates conditions for next financial crisis when politics could prevent central banks from acting.

Source: IMF staff calculations.

…partly driven by the prevalence of negative yielding bonds



Sources: Bloomberg Finance L.P.; and IMF staff calculations.

- This will surely lead to problems at some point in the future
- Can inflation really stay low once this is over?
- What about pension fund returns, savers, insurance companies?
- Inequality will rise, as in 2007/8, as those with access to capital once again benefit from the policy reaction, while those reliant on income will struggle. Plus la change?

UK focus

Key details of UK forecast

FSR 2020 scenarios (14 July)	Upside scenario	Central scenario	Downside scenario
Real GDP in 2020 (percentage change on previous period)	-10.6	-12.4	-14.3
Peak unemployment rate (per cent)	9.7 (Q3 2020)	11.9 (Q4 2020)	13.2 (Q1 2021)
PSNB in 2020-21 (£ billion)	263.4	322.0	391.2
PSND in 2020-21 (Per cent of GDP)	94.8	104.1	113.2

Source: OBR

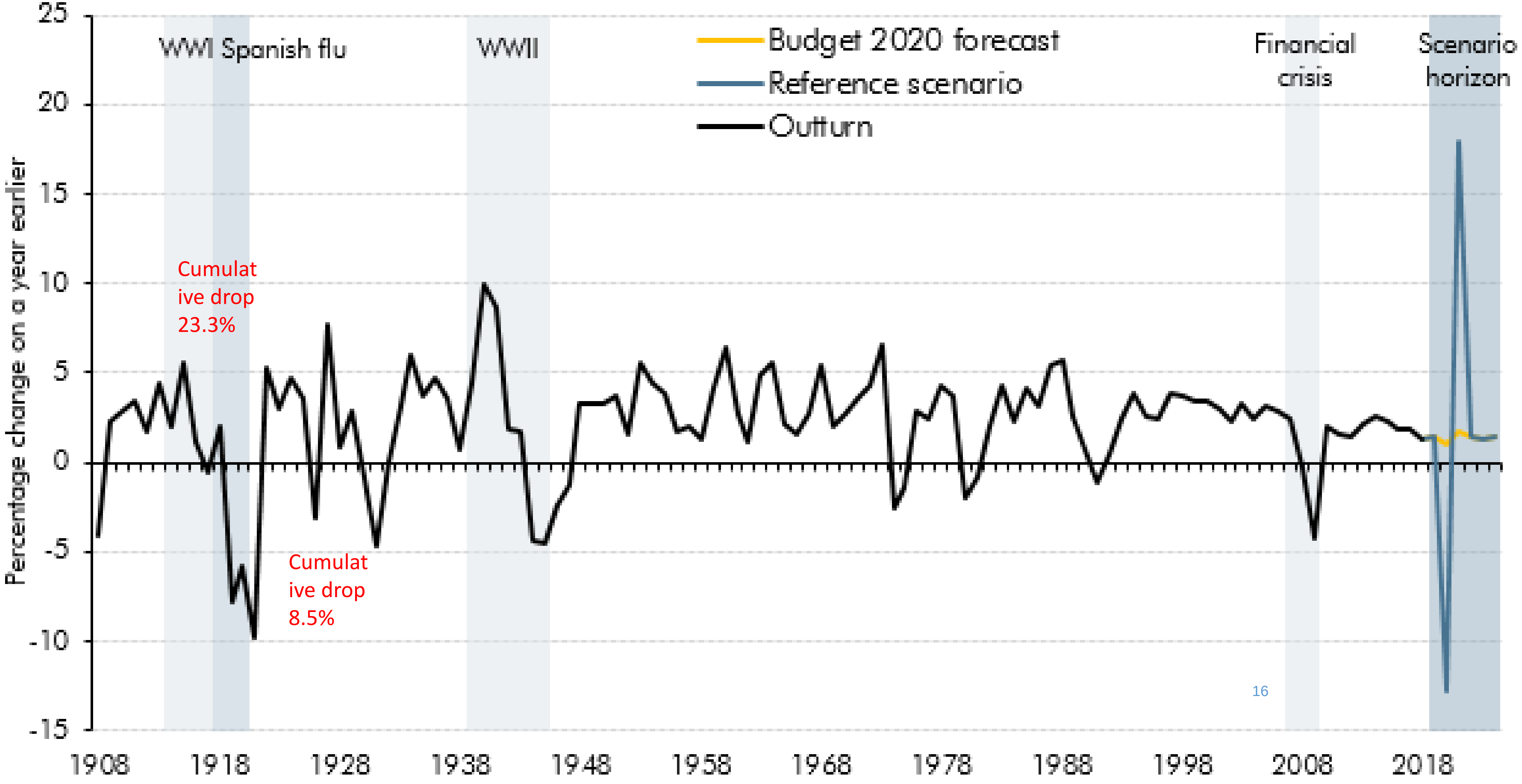
The winners and losers

	US	Canada	France	Germany	Italy	UK
	Per cent of GDP					
Transport manufacturing	-1.5	-1.4	-1.4	-5.5	-1.6	-1.5
Construction	-1.8	-3.7	-2.8	-2.2	-2.1	-3.0
Retail and wholesale trade	-8.1	-8.4	-8.2	-7.4	-9.0	-7.8
Hotels, restaurants and air travel	-2.3	-2.1	-2.3	-1.3	-2.9	-2.6
Professional and real estate services	-9.2	-5.9	-8.6	-9.2	-7.6	-7.9
Other personal services	-2.4	-1.8	-2.7	-3.5	-3.0	-3.6
Total	**-25.3**	**-23.2**	**-25.9**	**-29.2**	**-26.3**	**-26.4**
Per cent of private consumption						
Clothing & footwear	-3.0	-3.9	-3.6	-4.6	-6.0	-5.0
Household equipment	-4.2	-5.3	-4.8	-6.4	-6.2	-4.9
Transport expenditure	-6.5	-10.9	-8.8	-9.3	-8.0	-8.8
Arts and recreation	-7.1	-6.4	-6.2	-7.0	-4.9	-9.3
Hotels, restaurants and package holidays	-5.5	-5.3	-5.9	-6.3	-8.3	-7.0
Other personal services	-2.1	-2.2	-2.5	-2.1	-2.4	-2.3
Total	**-28.4**	**-34.1**	**-31.8**	**-35.6**	**-35.7**	**-37.2**

Source: OECD

- In terms of GDP: professional services and Retail trade are worst affected, then personal services and construction.
- In terms of private consumption spending: arts and recreation, transport, hotels, restaurant, and holidays are worst hit.

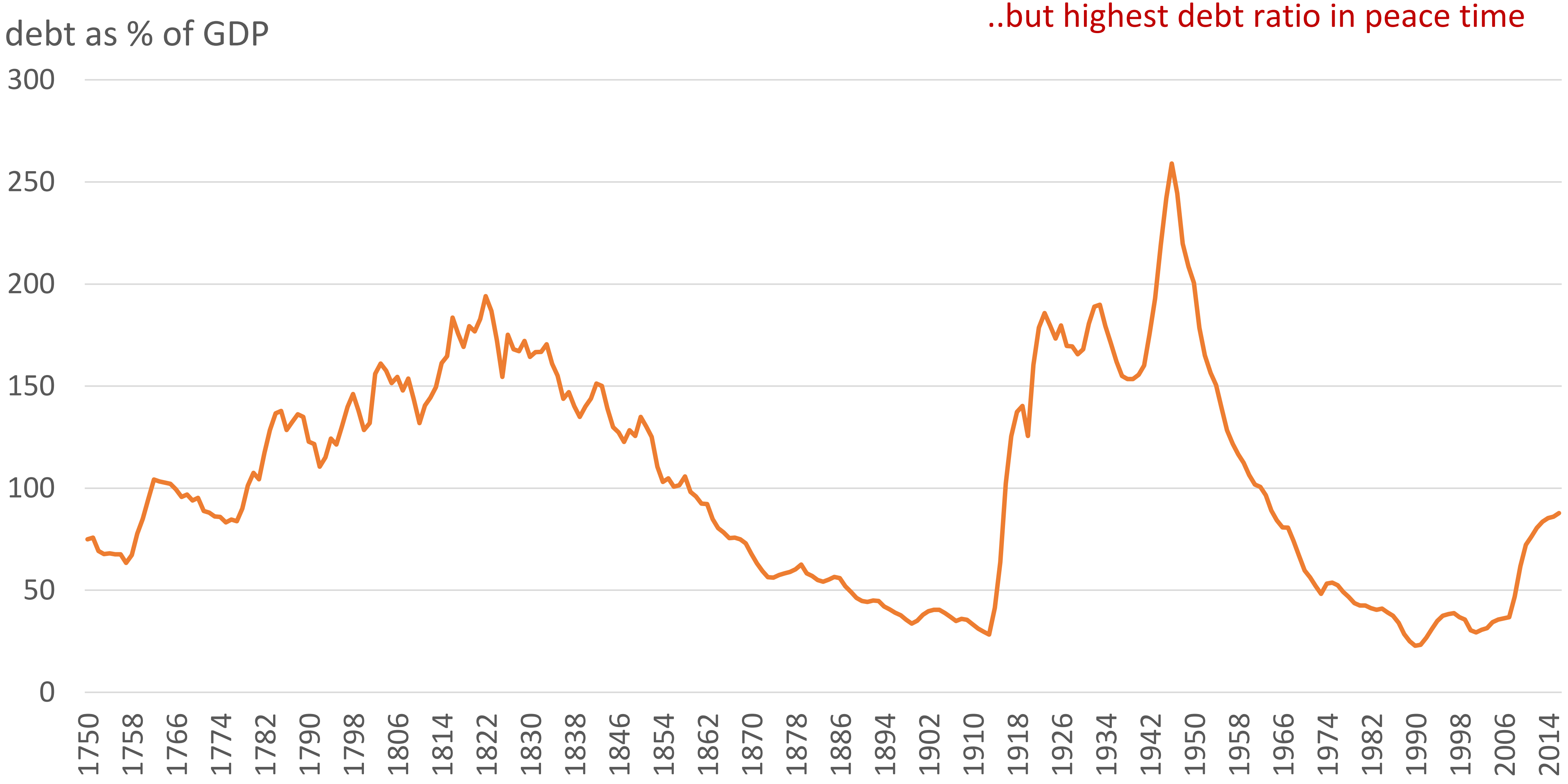
UK GDP performance in historical perspective



Source: Bank of England, ONS, OBR

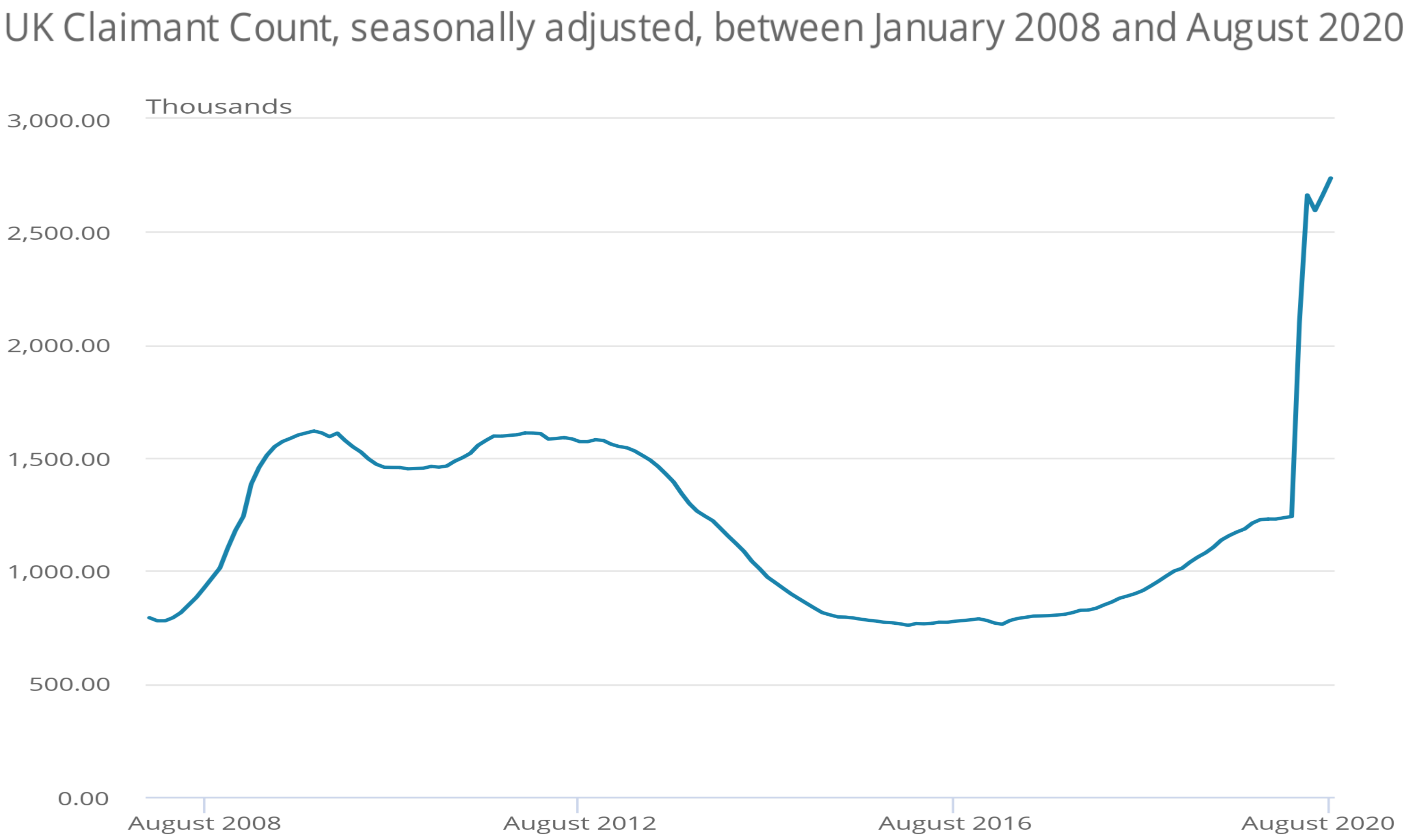
UK government debt in historical perspective – not the worst ever

..but highest debt ratio in peace time



Source: Bank of England

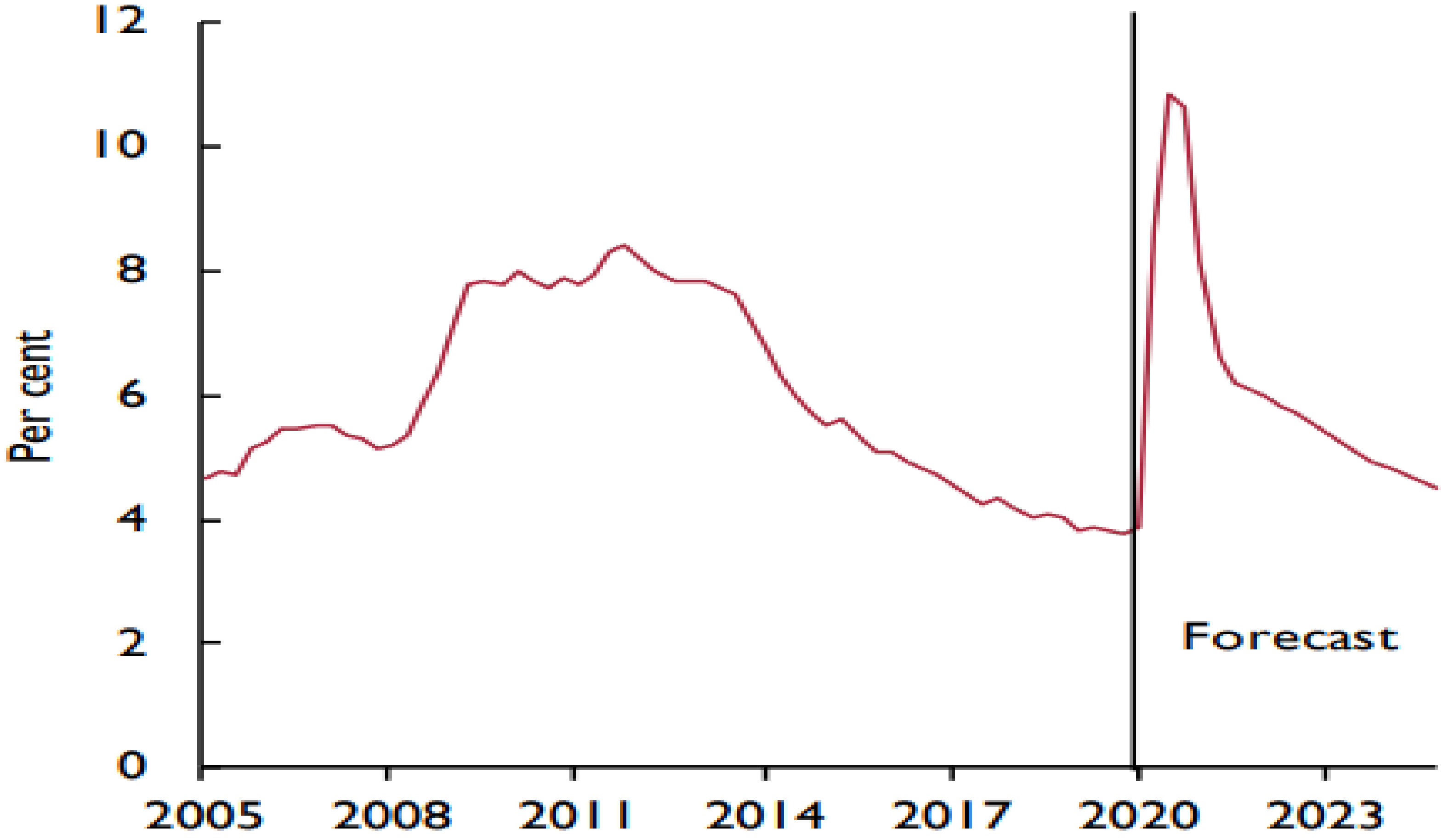
Unemployment is rising fast…



We did not see this sort of rise during the Global Financial Crisis

Source: ONS

…and is likely to reach over 10% but not perhaps this year…

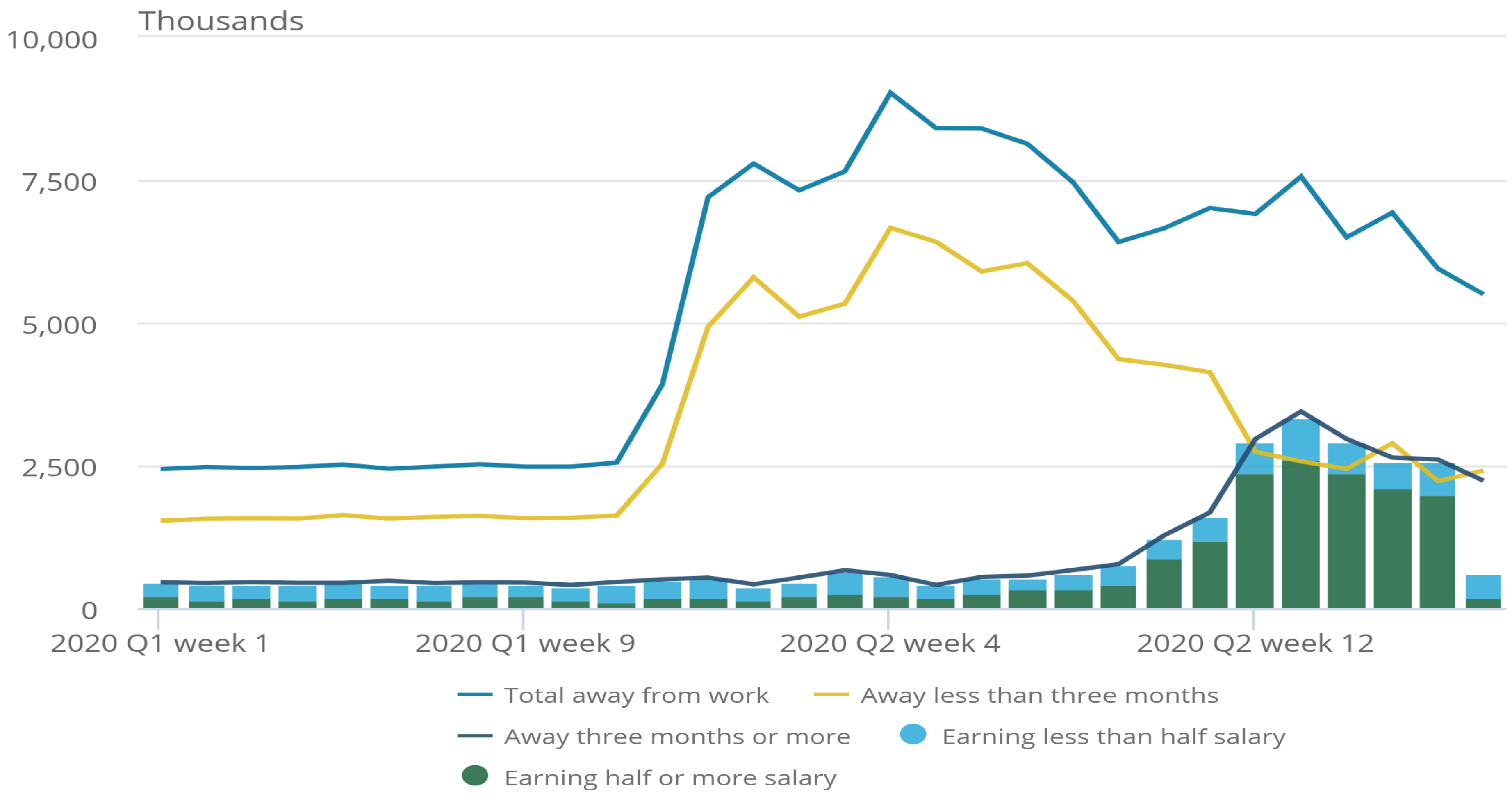


Vacancies are falling, though signs of stabilisation, hours worked has dropped and redundancies are increasing

Source: NIESR

Number on furlough are falling but still 5.2m…

Total number of people temporarily away from paid work, including their time away and amount of wage receiving if away for three months or more, seasonally adjusted, UK, Jan to July 2017 to Jan to July 2020 (1000s)



Of the more than 5 million people temporarily away from paid work in July 2020, more than 2.5 million were away for three months or more

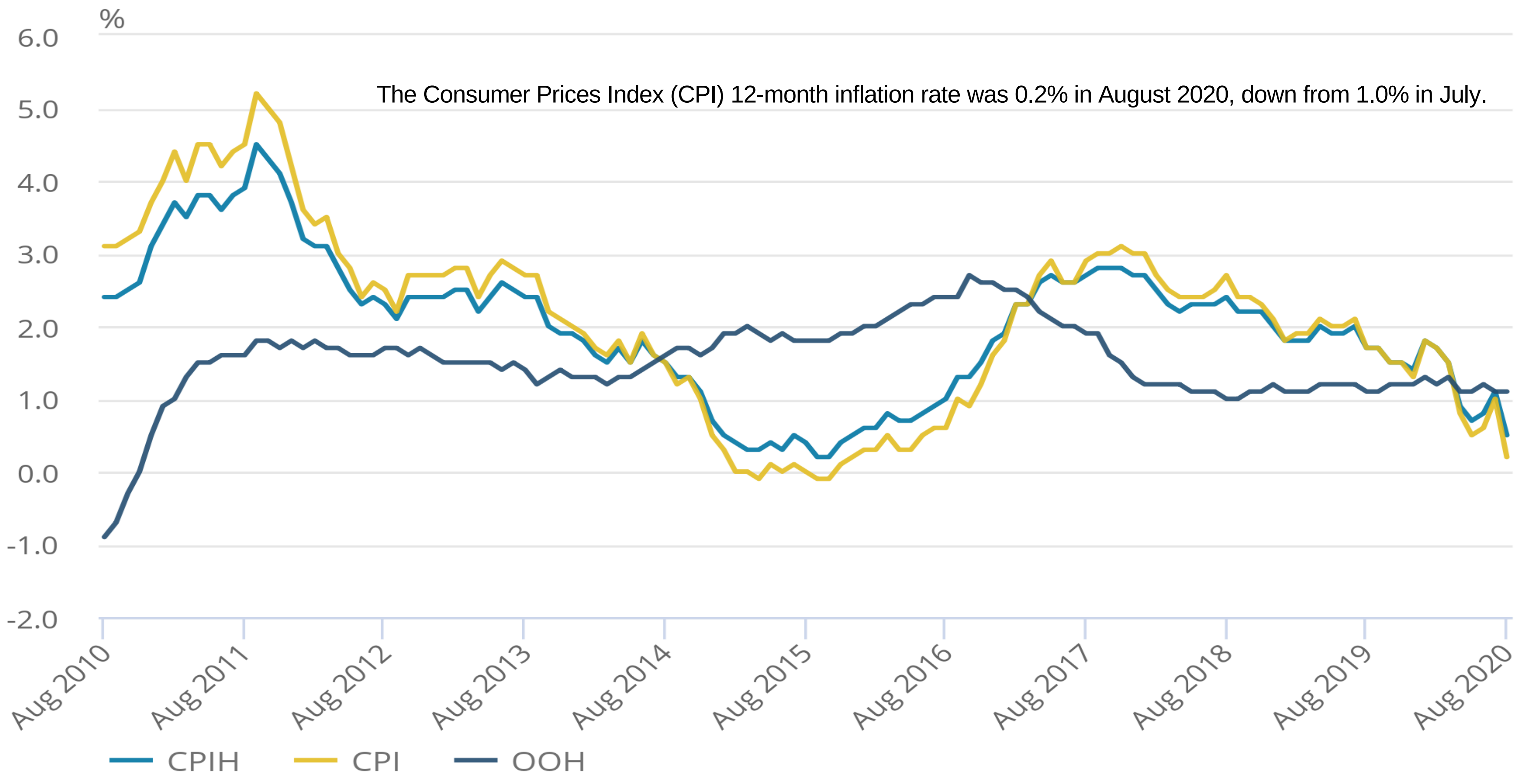
Source: Bank of England

Furlough impact om incomes partly explains why pay growth is falling…

Annual growth in employee total pay (including bonuses) is estimated to be negative 1.0%; this translates to a fall of 1.8% in real terms

Source: LFS, ONS

…as price inflation drops to weakest in 5 years



Source: LFS, ONS

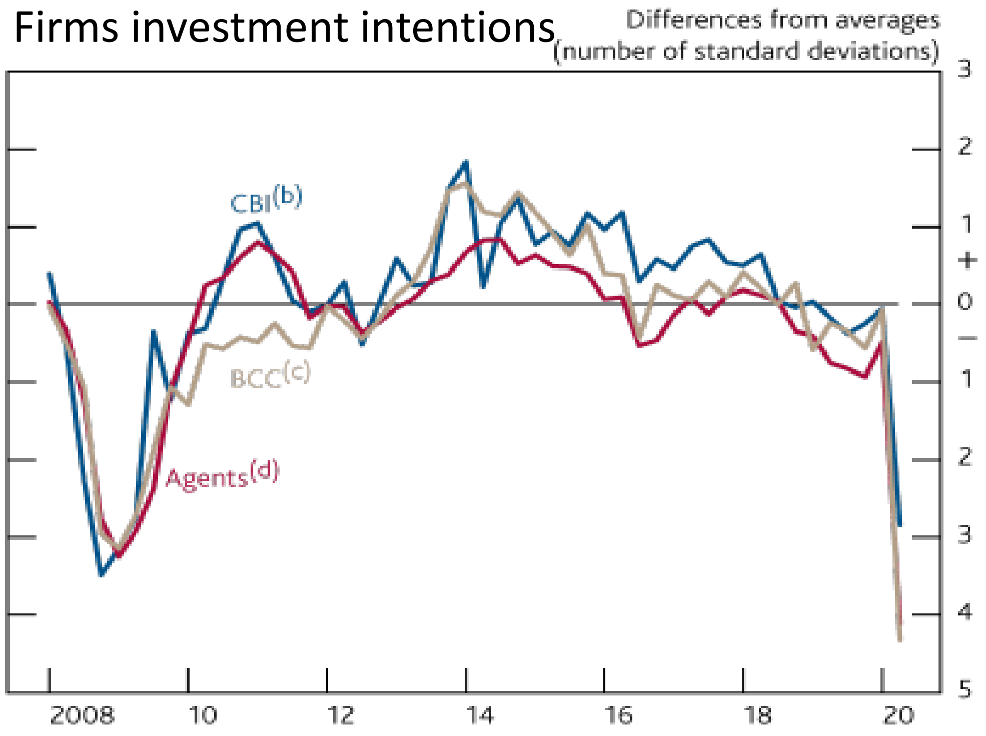
No surprise that consumer & Business confidence have been hit

Consumer confidence

Sources: GfK (research carried out on behalf of the European Commission) and Bank calculations.

(a) Difference from average since 1997. Based on the average of five survey balances: general macroeconomic situation over the past 12 months and expectations for the next 12 months, personal financial situation over the past 12 months and expectations for the next 12 months, and major purchases at present.

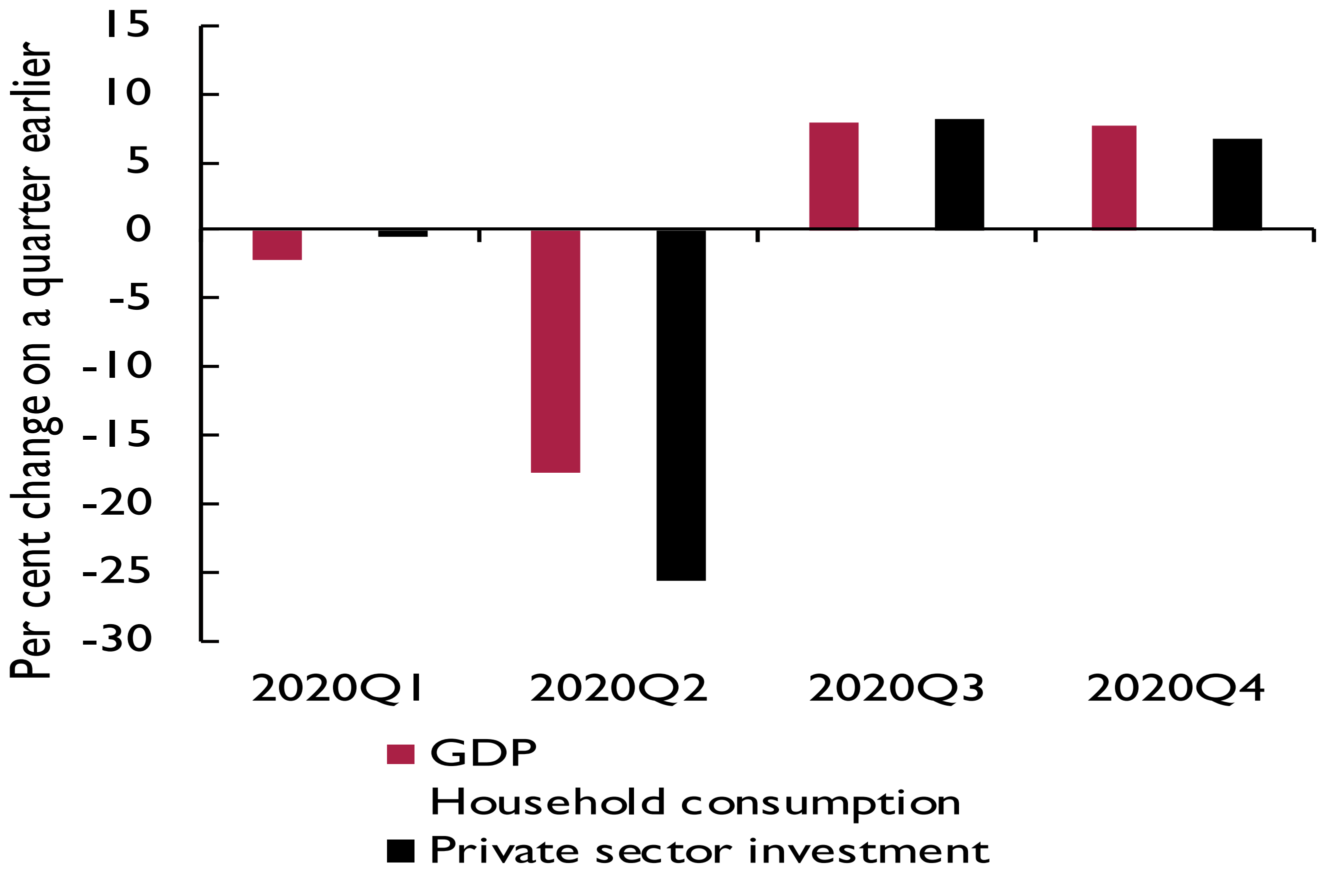
Firms investment intentions



Sources: Bank of England, BCC, CBI and Bank calculations.

(a) Differences from averages since 2000.
(b) Planned investment in plant and machinery over the following year relative to the previous year. Sectors within CBI (manufacturing, distribution, financial services and business/consumer/professional services) are weighted together using shares in real busines investment.
(c) Based on reported changes to planned investment in plant and machinery over the past thre months. Weighted average of the manufacturing and services sectors based on shares in rea business investment.
(d) Planned expenditure on tangible non-financial assets over the following 12 months.

Yet the economy started to recover in Q3 as the lockdown was eased…

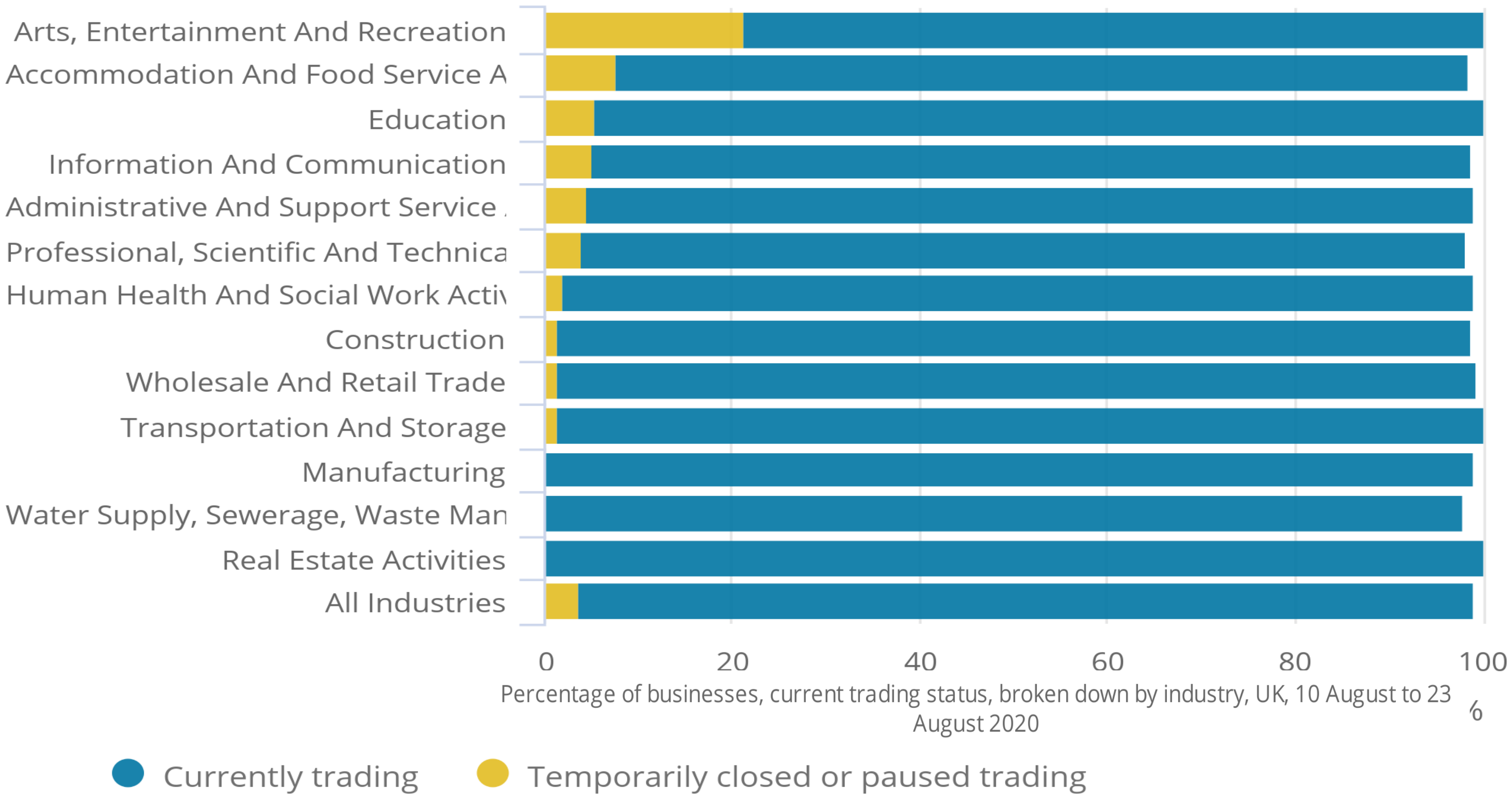


- The UK economy started to recover in May and in July output was up 6.6% after 8.7% in June, as the lockdown was eased.
- But the recovery will be long and difficult. Expect a 'U' shaped rather than a 'V'.
- The UK economy will not regain its pre-pandemic peak reached in Q4 2019 until the second half of 2023.
- It usually takes an economy around 3 to six years to regain its precrisis level.

Source: UK NIESR

Businesses are reopening…

Across all industries, 96% of responding businesses reported they were currently trading

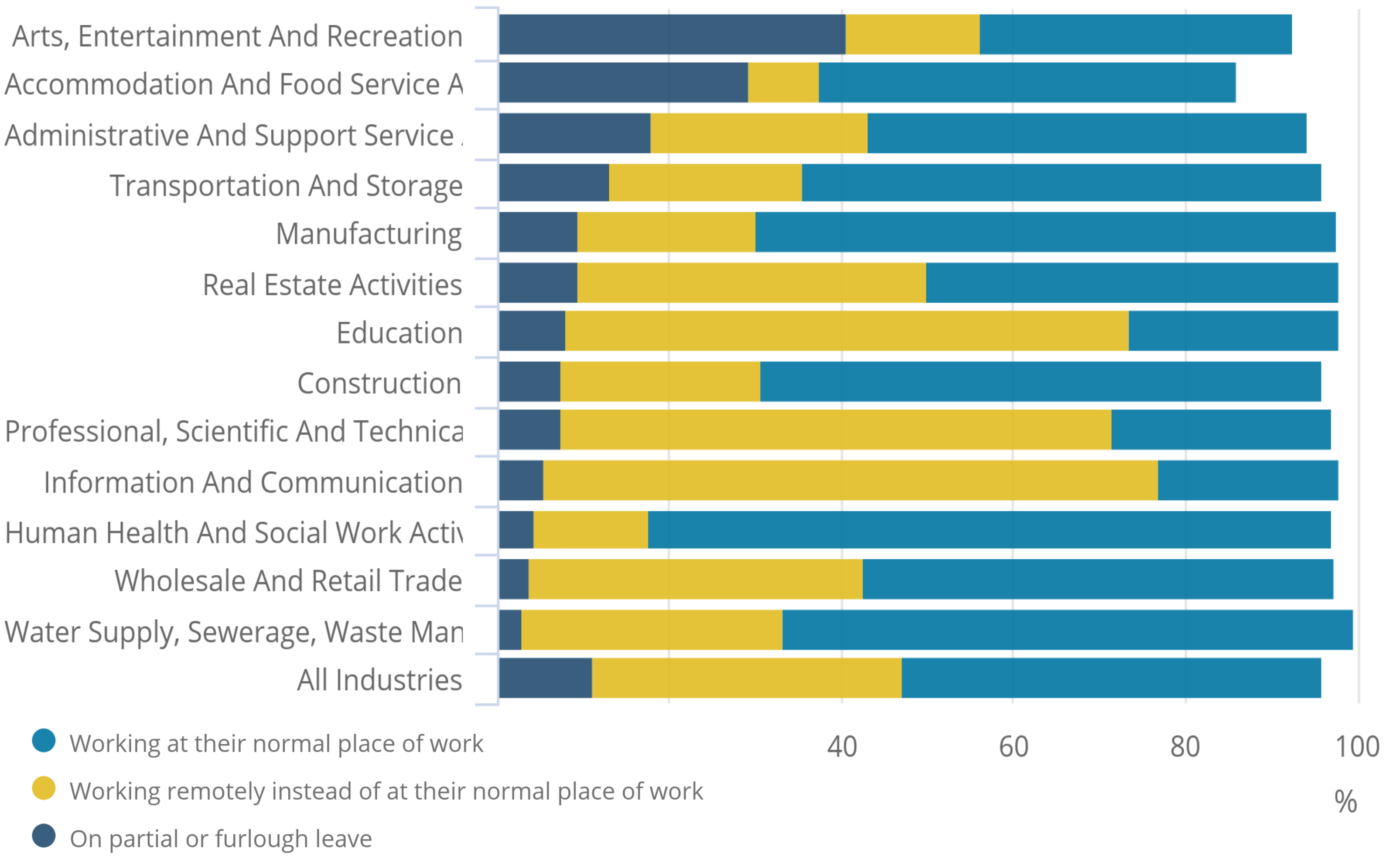


Percentage of businesses, current trading status, broken down by industry, UK, 10 August to 23 August 2020

4% on average will not reopen, but the impact is greater for arts etc and hospitality.

Source: Source: Office for National Statistics – Business Impact of Coronavirus (COVID-19) Survey

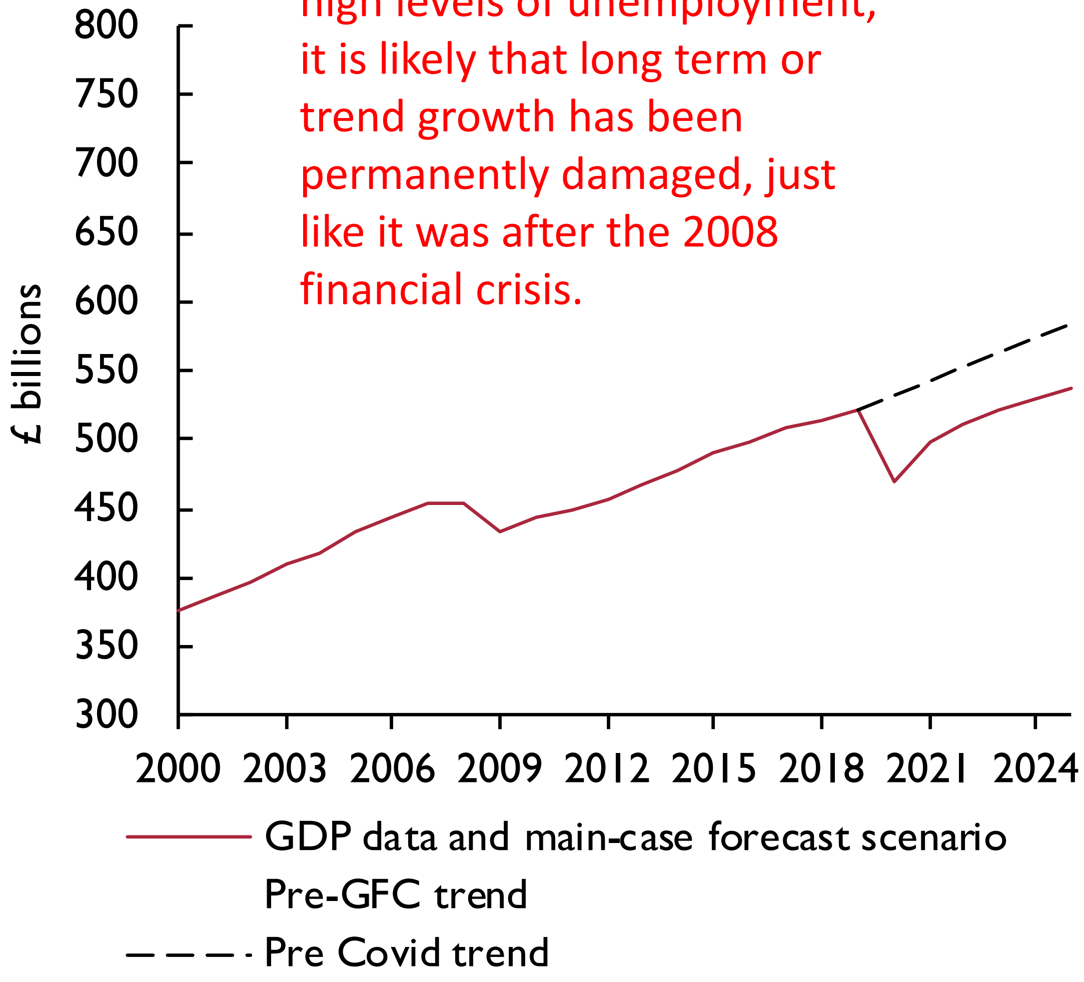
But 36% of the workforce were working remotely…

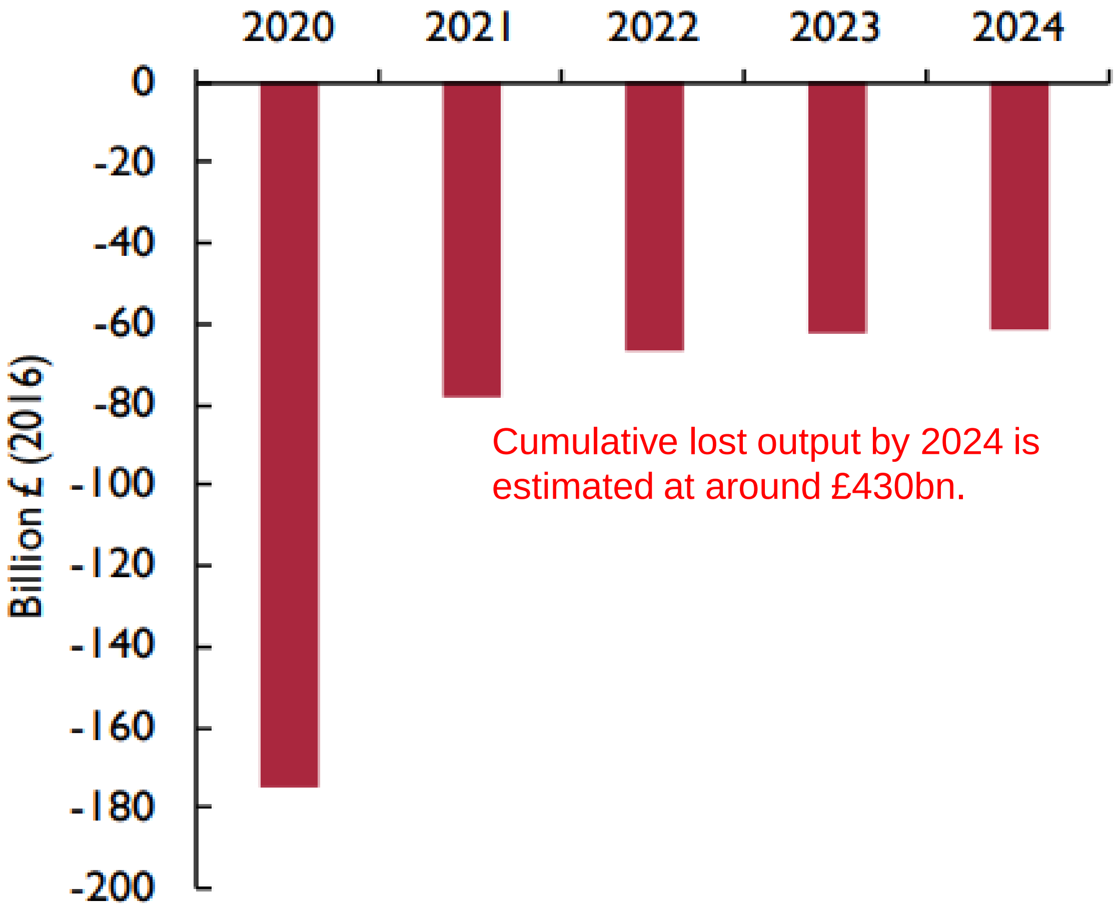


Source: Source: Office for National Statistics – Business Impact of Coronavirus (COVID-19) Survey

…due to the combination of higher unemployment and slower investment spending, long term growth may be weaker

- With lower productivity and high levels of unemployment, it is likely that long term or trend growth has been permanently damaged, just like it was after the 2008 financial crisis.





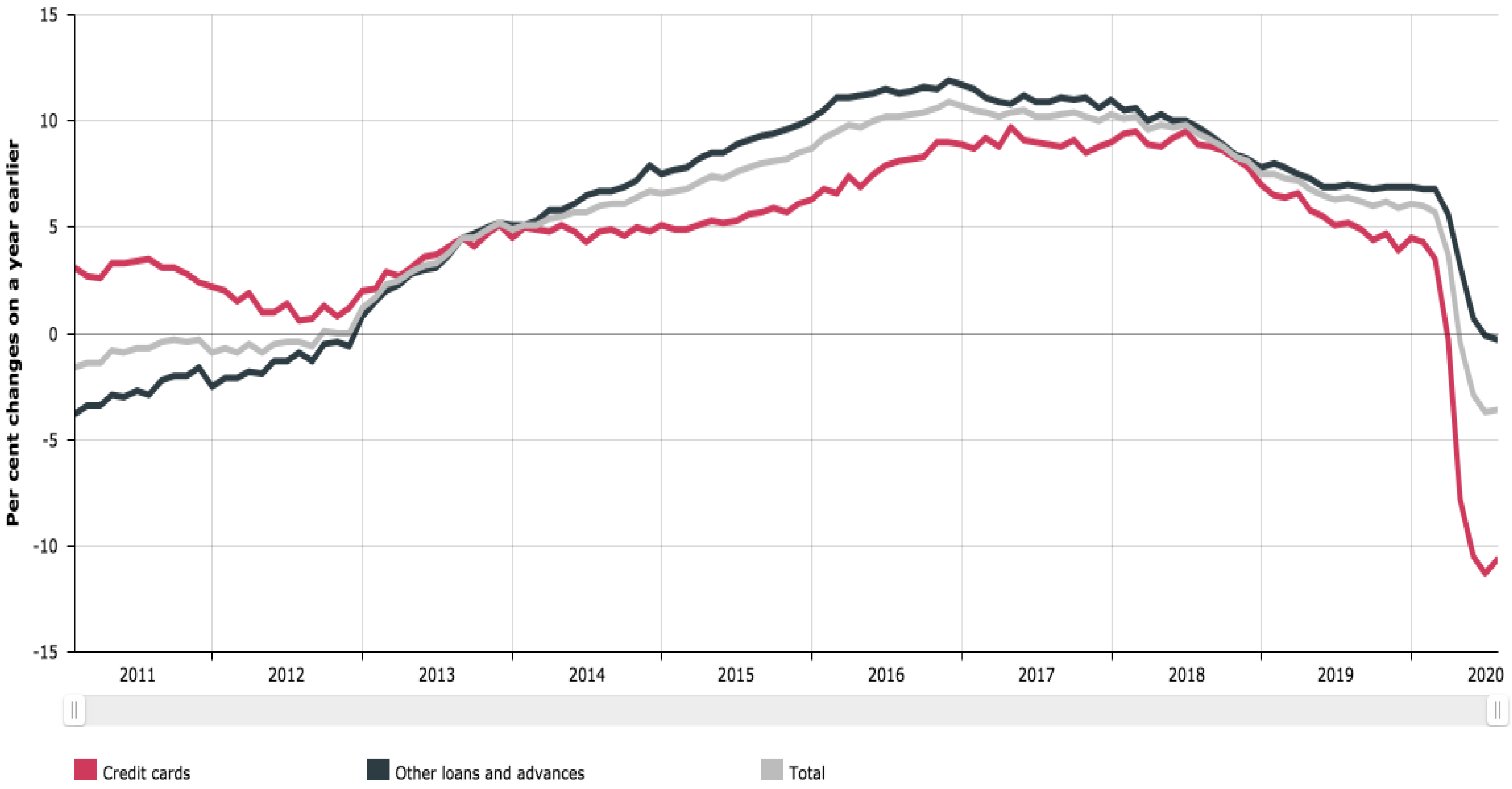
Source: UK NIESR

Even though money supply growth is rising fast…

…note that lending is not rising alongside it.. are banks not lending or consumers not borrowing?

Source: Bank of England

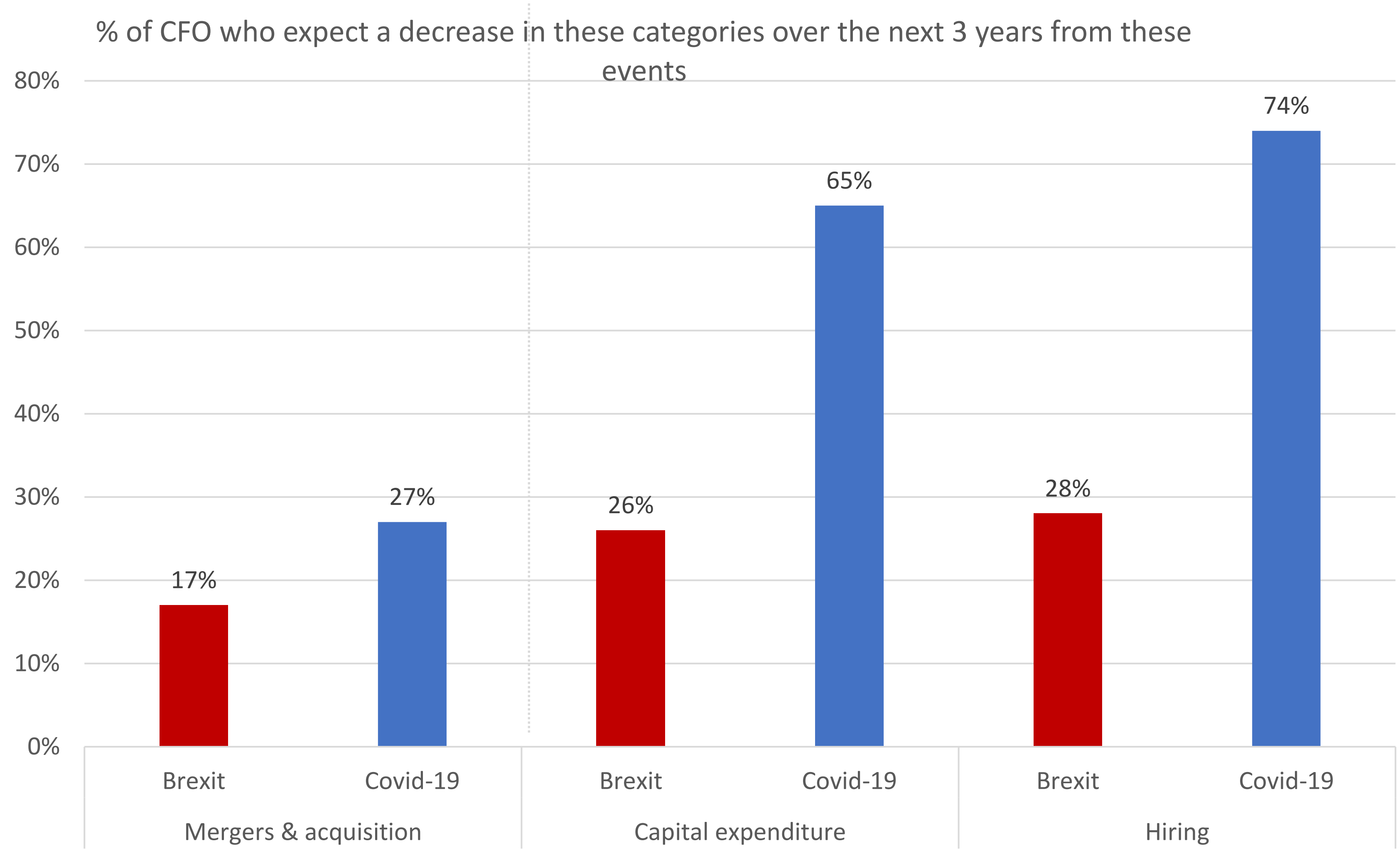
Households are repaying debt and raising their savings rate



Growth rates:
Credit cards -10.6
Other -0.3
Total – 3.3

Source: Bank of England

Too much complacency on the impact of Brexit on the economy?



- Plus the UK seem to have an economy more exposed to the negative effects of the Coronavirus – large leisure, hotels and hospitality sectors...and locked down later

Source: Deloitte CFO survey, June/July 2020

Long run effect on UK productivity of trading with EU on Free Trade Area (FTA) terms

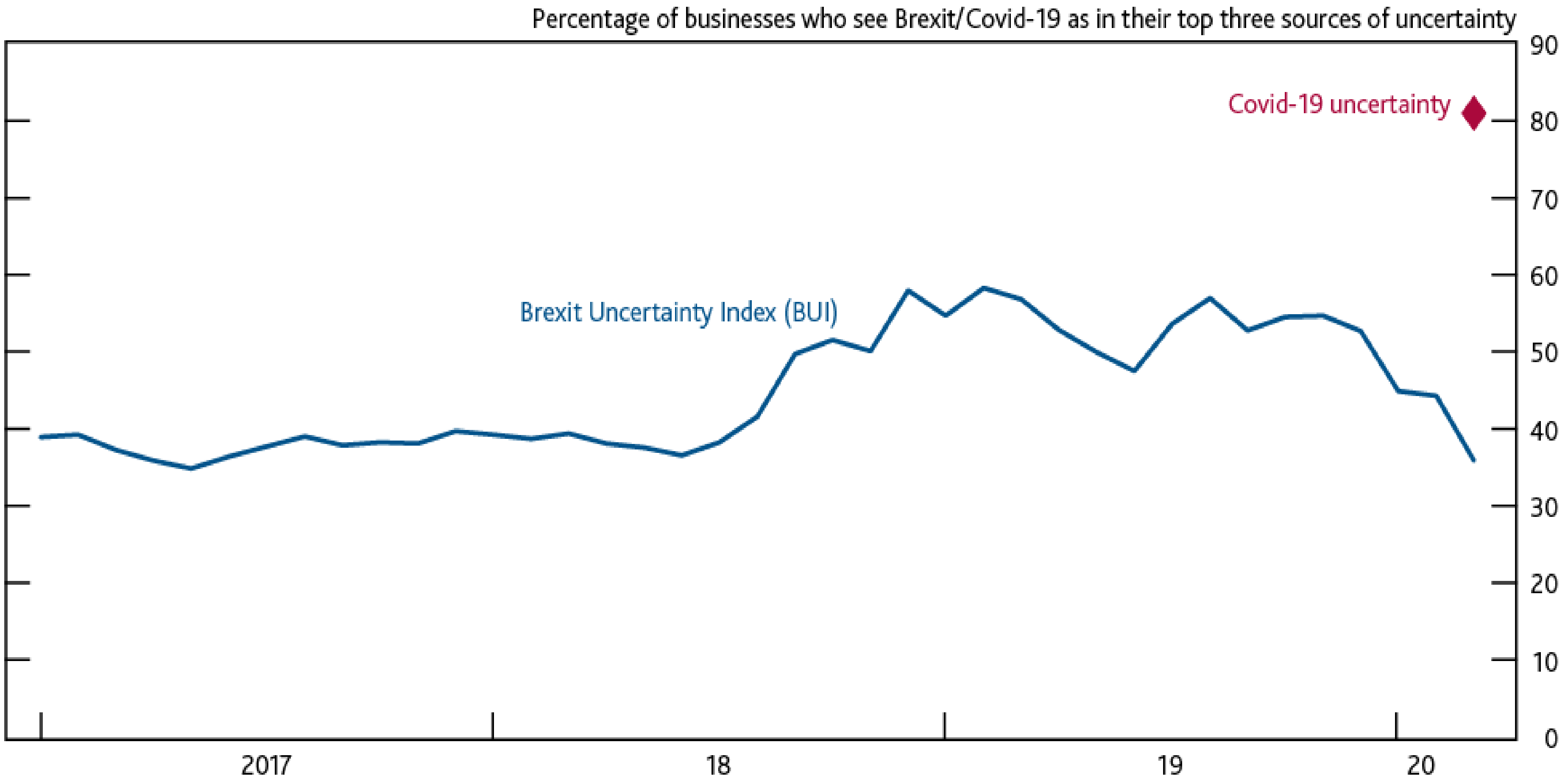
Effect on the level of UK GDP over the long term (assumed as 15 years). Will equal £80bn over that period at today's prices.

Organisation	Model	Productivity assumption	Per cent Effect
Felbermayr et al (2018)	New quantitative trade model	Constant returns to scale	-1.8
IMF (2018)	Computable general equilibrium	Constant returns to scale	-2
Mayer et al (2018)	New quantitative trade model	Constant returns to scale	-2.4
UK in a Changing Europe (2019)	New quantitative trade model	Constant returns to scale	-2.5
OECD (2016)	NIGEM	Dynamic productivity	-2.7
IMF (2018)	Computable general equilibrium	Melitz-style increasing returns to scale	-3.3
Netherlands CPB (2016)	Computable general equilibrium	Krugman-style increasing returns to scale	-3.4
Bank of England (2019)	Gravity modelling	Dynamic productivity	-3.5
NIESR (2018)	Gravity modelling	Dynamic productivity	-3.8
Whitehall Study (2018)	Computable general equilibrium	Melitz-style increasing returns to scale	-4.9
UK in a Changing Europe (2019)	Gravity modelling	Dynamic productivity	-6.4
Netherlands CPB (2016)	Computable general equilibrium	Dynamic productivity	-5.9
World Bank (2017)	Gravity modelling	Dynamic productivity	-10
Average			-4.0

Source OBR, March 2020

Brexit still a concern…

Covid and Brexit uncertainty are top concerns for UK firms (a)

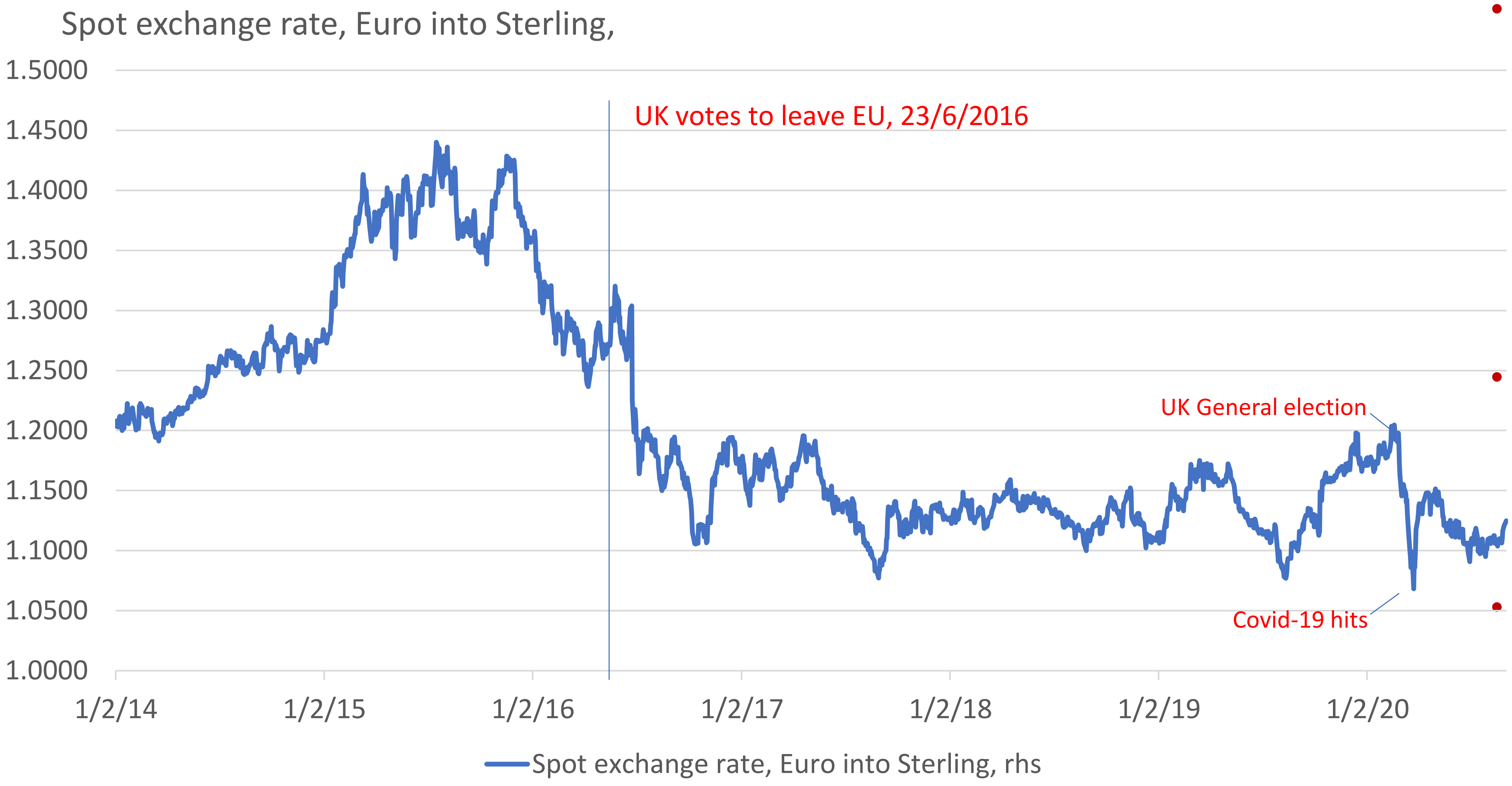


(a) Brexit outcome is based on the question: 'How much has the result of the EU referendum affected the level of uncertainty affected your business?'.

(b) Covid uncertainty is higher than Brexit worries but Brexit remains second biggest issue for firms

Source: Bank of England

…though the pound versus the euro is holding up remarkably well



- The pound has risen from a low of 1.06 versus the euro on 23 March to 1.12 last week – so much for the fact that talks have stalled with the EU on a free trade deal (FTA).
- But markets seems convinced that something will be cobbled together before the end of the year
- This may be so, but it won't be a comprehensive free trade deal.

Source: Bank of England

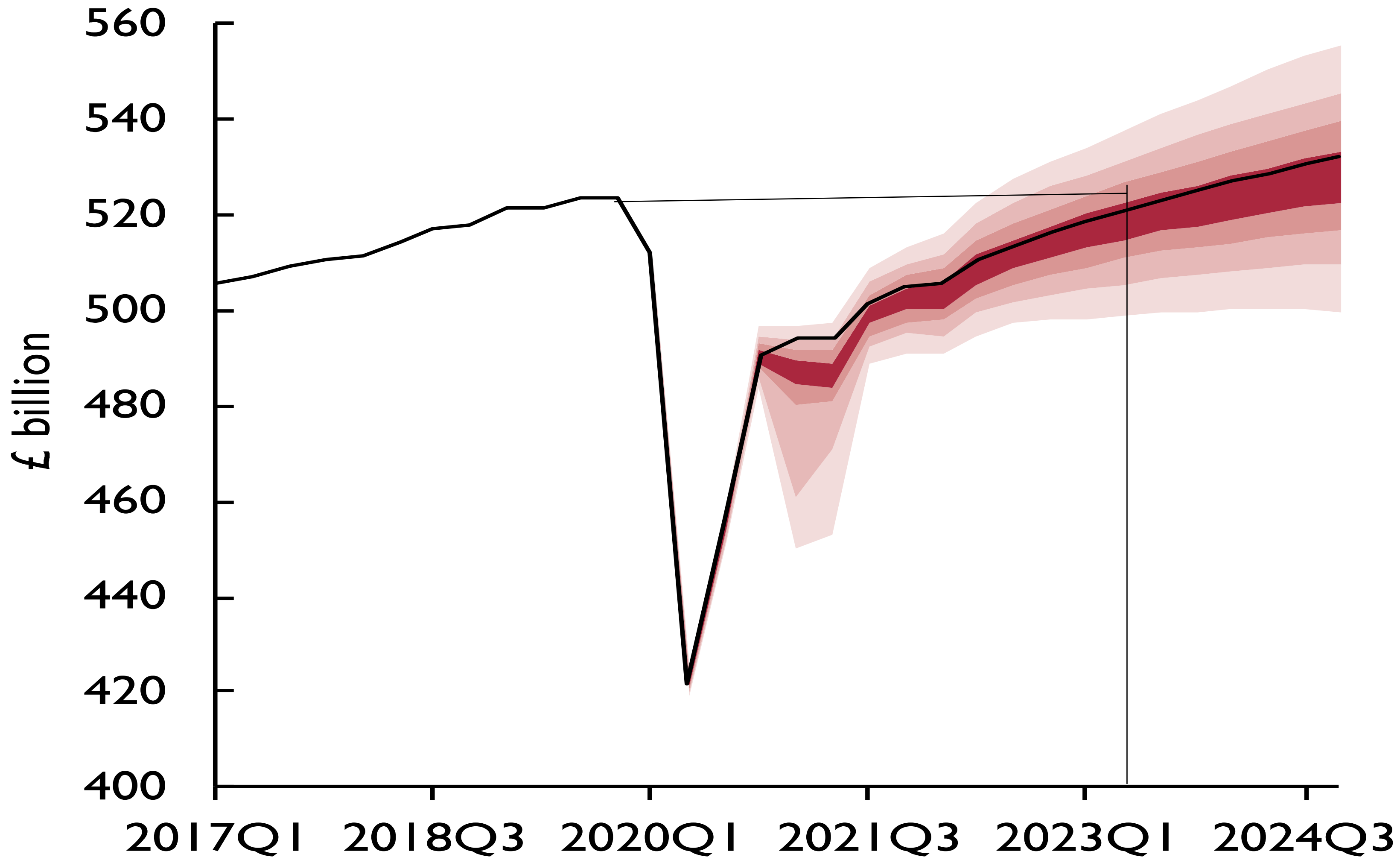
Nonetheless, UK 5 year economic forecasts show some sectors will still do well

Growth in output and employment % changes 2020-2025 average

- The best performing sectors are: Professional scientific and technical, health, Admin and support, Health and social work, information and communications. Arts and entertainment but low employment
- The worst performing sectors are: manufacturing, utilities, finance and insurance

Source: OEF

It will take many years for the level of output to regain its pre Covid-19 high of Q4 2019



- The UK economy will not regain its pre-pandemic peak reached in Q4 2019 until the second half of 2023.
- It usually takes an economy around 3 to six years to regain its precrisis level.

Source: UK NIESR

Some recommendations

- Brexit is a done deal so will have to be seen an opportunity for those UK firms that find workarounds as new deals are done, plugging gaps and innovating for new markets.

- The good news is that the pace of technological process has not slowed and will continue to accelerate. UK needs to reap its benefits to grow out of debt rather than impose tax increases and spending cuts.

- Safety nets must be maintained as needed for low-income families, to access to unemployment benefits, to broader cash and in-kind

- Invest in people—in education, health, social protection, and in preventing the sharp increase in inequality this crisis could produce.

- Support low-carbon and climate-resilient growth, including through smart allocation of public spending; and take advantage of the digital transformation, whether through greater use of e-government platforms to enhance efficiency and transparency while cutting red tape, e-learning, or remote work.

- Long run requires sound management of money and finance required but short run can diverge. Asset prices remain overvalued and caution on overly expanding monetary base is required.

Conclusion: what next?

- The societal impact – a new 'social contract' to look after more vulnerable, social housing, care homes (a link to NHS inevitable?), essential workers eg are we really all in it together?

- What about Brexit? A hard landing looks likely. WTO terms likeliest outcome other than a limited deal on goods. UK will be hit next year.

- A political fall-out – how competent were leaders? Global power grabs by some; vested interests?

- The environmental – what about climate change after this dramatic improvements occurred in lockdown, rules on food production, green solutions etc to drive future growth. Carbon pricing?

- Innovation – there is more of it about during lockdown; firms are working smarter, getting new ideas out quicker, responding to opportunities, online deliveries etc, people are crucial, more home or out of office working?

- The power of information has never been more recognized – epidemiologists, data analysis, scientists. Belief in the expert is back (US an outlier here ?). Education, education, education and lifelong learning, raising skills and productivity. Technology bias.

- The UK will have to grow itself out of debt or suffer lower livings standards, perhaps from higher inflation. With budget constraints from an aging society and high debt, global openness, to ideas, technology, investment, skills, matter more than ever. Greater risks mean greater opportunity. But crisis rewards disruptors and those that seize the opportunity. Sound management of money and finance required in long run. Asset prices remain overvalued and caution on monetary expansion is required.

- Its not all negative, change brings opportunities to do things differently, to innovate to fix the old problems and move forward with optimism and renewed vigour with new solutions to new issues.