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RAPID VACCINE ROLLOUT WILL ENABLE A REBOUND FROM Q2...

...BUT THE MALAISE UNTIL THEN WILL CAUSE LASTING DAMAGE

U.K. ECONOMIC CHARTBOOK, JANUARY 2021

DATA AS AT JANUARY 21 | SAMUEL TOMBS, CHIEF U.K. ECONOMIST
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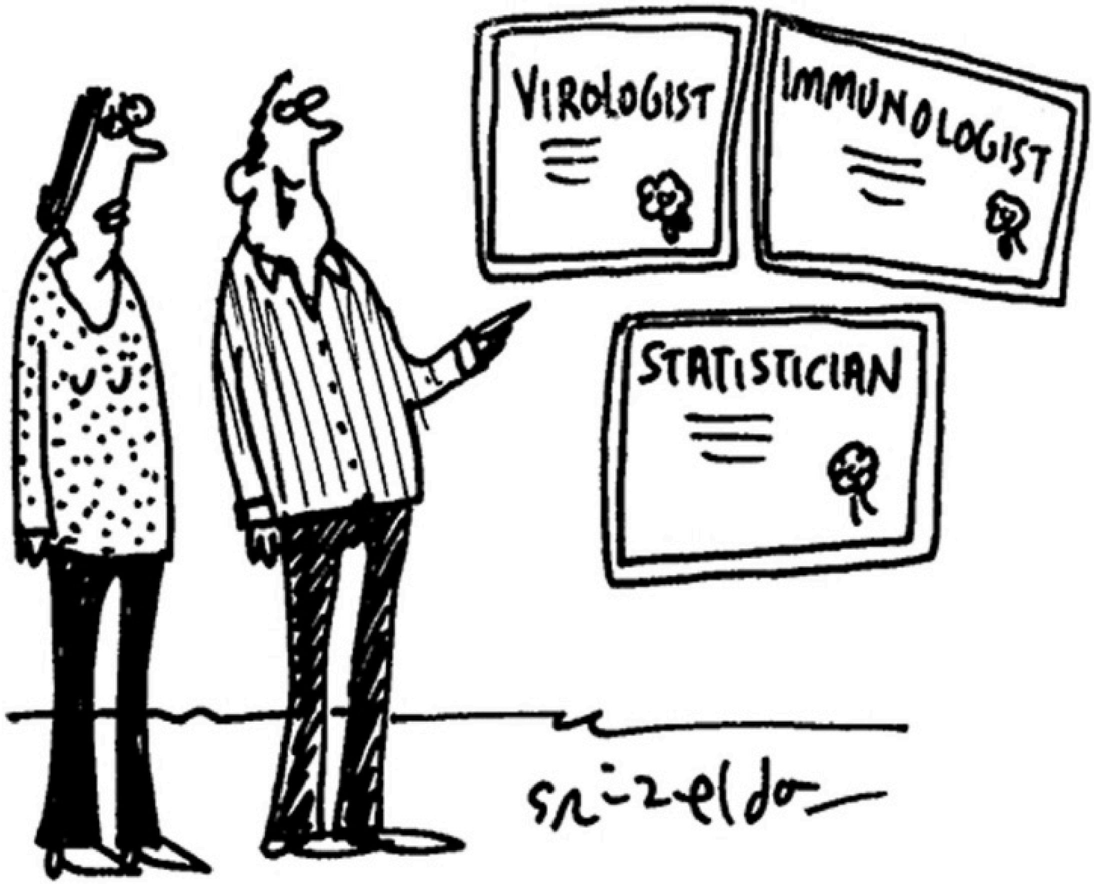

'I studied them all on Twitter.'

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Summary

- **The U.K. economy was the hardest hit by Covid-19 in the G7 last year, with GDP around 10% lower than in 2019.** The underperformance chiefly reflected a huge fall in households' expenditure, even though aggregate incomes were not greatly affected by the pandemic. Government policies largely have focussed on supporting incomes, not expenditure. In addition, the government's repeated mistake in waiting too long to bring in initial restrictions on economic activity enabled the virus to spread more widely than in other developed economies, eventually necessitating long damaging lockdowns. U.K. households also have been able to work from home more readily than those where the manufacturing sector is more dominant, enabling them to cut back on travel and discretionary services expenditure.

- GDP in January likely will be about 12.5% below its pre-Covid January 2020 level, exceeding the 8.9% shortfall seen in November. The current lockdown is more severe than November's, with schools shut for most pupils and stronger advice to stay at home. Transport indicators show that public compliance remains high.

- The good news, however, is that the lockdown is working, with the seven-day rolling average of cases now 30% below its January 4 peak. By mid-February, cases should have fallen back to their late-October level. The U.K. government also is rolling out Covid-19 vaccines much faster than in other countries, and looks set broadly to meet its target of offering a vaccination appointment to the top four priority groups—about 15 million people across the U.K., which currently account for 98% of all fatalities—by mid-February. Accordingly, we expect the government to let schools reopen on February 22, before permitting non-essential retailers to reopen in mid-March, followed by the consumer services sector in mid-April. This staggered timetable would enable the government to ascertain that each step has not lifted the R rate too high. **These assumptions lead us to conclude that GDP will drop by about 3.5% quarter-on-quarter in Q1, before rebounding by about 6% in Q2.**

- **GDP, however, probably will take until Q3 2022 to return to its pre-Covid peak.** The number of people receiving a first vaccine dose likely will slow in Q2, as more vulnerable people needing a second dose for lasting immunity take precedence. The majority of the population likely will not have received a first dose until mid-summer. People, therefore, likely will continue to act cautiously, keeping demand in the consumer services sector subdued.

- In addition, the end of the furlough scheme at the end of March likely will trigger a second wave of redundancies, especially in the retail and hospitality sectors. At the same time, grants to self-employed people, business rates relief, and the temporary VAT cut for hospitality and recreation businesses, all are due to come to an end. With many businesses' finances already strained by several months of mandated closures, we expect insolvencies to surge in Q2 and Q3.

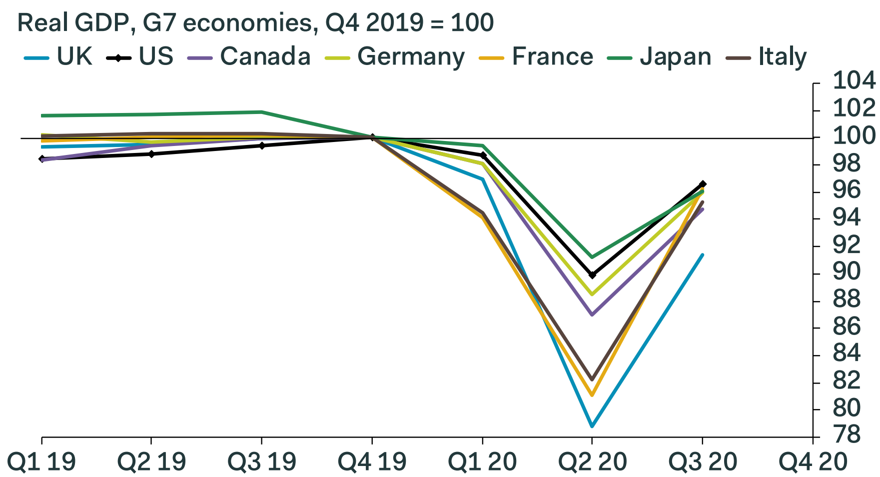
- Admittedly, households' spending will recover quickly to pre-Covid levels, if they return the proportion of their incomes that they save to pre-Covid levels and spend the cash they accumulated in 2020. The value of the stock of households' savings rose by an amount equal to 10% of annual GDP in the first three quarters of 2020. **But we expect households to spend down their accumulated savings gradually.** A BoE survey in September found that only 10% of households that had saved more intended to spend the proceeds, with the much larger group stating that they intend to deleverage or maintain a larger financial buffer. Recent money and credit data show that households have paid off unsecured debt and are starting to make higher-than-usual ad-hoc mortgage repayments. Furthermore, savings largely have been amassed by high-income households, who have a relatively low marginal propensity to spend their wealth and who likely will be targeted for tax rises. Big recessions also usually have a long-lasting effect on desired savings. Finally, much of this cash will be spent on imports, such as foreign holidays or cars, which will not lift GDP.

- **Accordingly, we expect GDP to be 1.5% below its pre-Covid level in Q4 2021.** And thereafter, we expect GDP growth to slow sharply, averaging just 0.6% in 2022. Next year looks set to be the peak year of tax rises to heal the public finances, so that the pain will be felt well before the next general election, in May 2024.

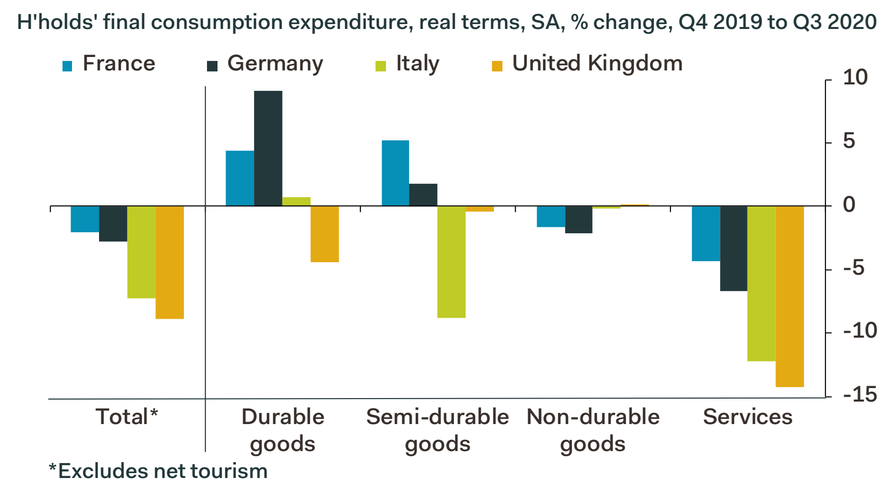
- **CPI inflation will rise over the course of 2021 and probably will slightly exceed the 2% target by the end of this year. But this pick-up chiefly will reflect rebounds in food and energy prices; core inflation will rise only modestly this year.** Granted, prices for transport, accommodation and catering services will rebound, as consumer demand recovers. But at the same time, core goods inflation will ease. The latter tracked a higher path than producer output prices last year, reflecting retailers widening their margins during a period of strong consumer demand. Any rotation by consumers towards services spending, therefore, likely will result in renewed margin pressure for goods. Furthermore, the weights of the services components in the CPI will decline, when they are updated in January for recent shifts in consumption patterns. This re-weighting will dampen the boost to the headline rate from services inflation and amplify the drag from falling goods prices.

- **The MPC, therefore, will continue to think of ways of making its monetary stance more stimulative.** We expect it to conclude in Q2 that providing banks with funding carrying a *negative* interest rate from the Term Funding Scheme is a better option than taking Bank Rate below zero. This duel interest rate structure would directly incentivise banks to make new loans, without imposing costs on those that rely heavily on households' deposits. We also expect the MPC to raise its end-year target for the Asset Purchase Facility by £50B in Q2, to avoid a sharp slowdown in the pace of its weekly gilt purchases.

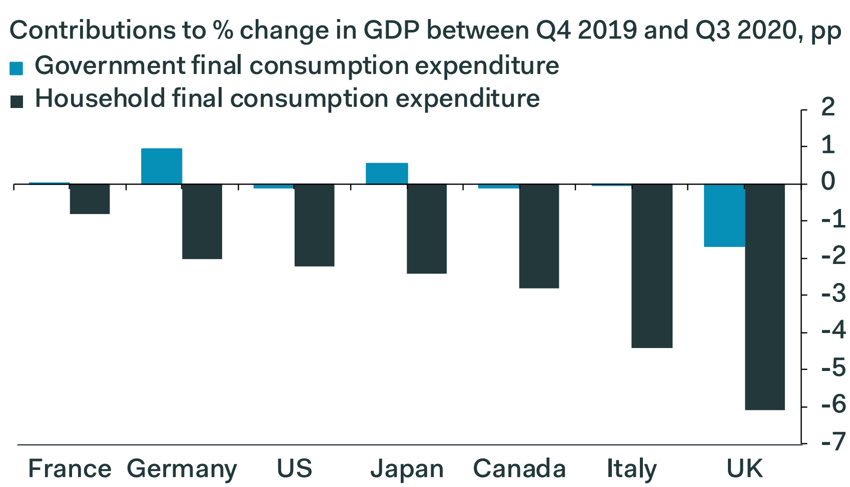
1. THE U.K. ECONOMY WAS HIT HARDER THAN MOST BY COVID-19



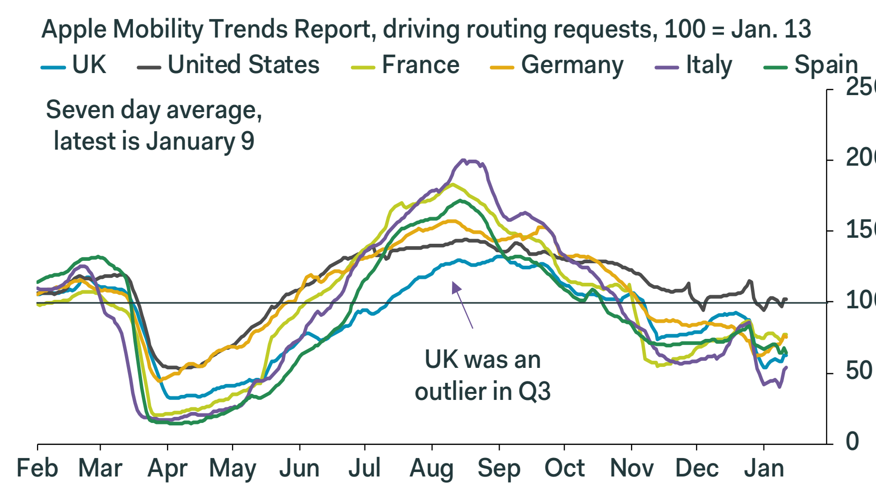
3. FISCAL POLICY SUPPORTED SPENDING MORE ACTIVELY ABROAD



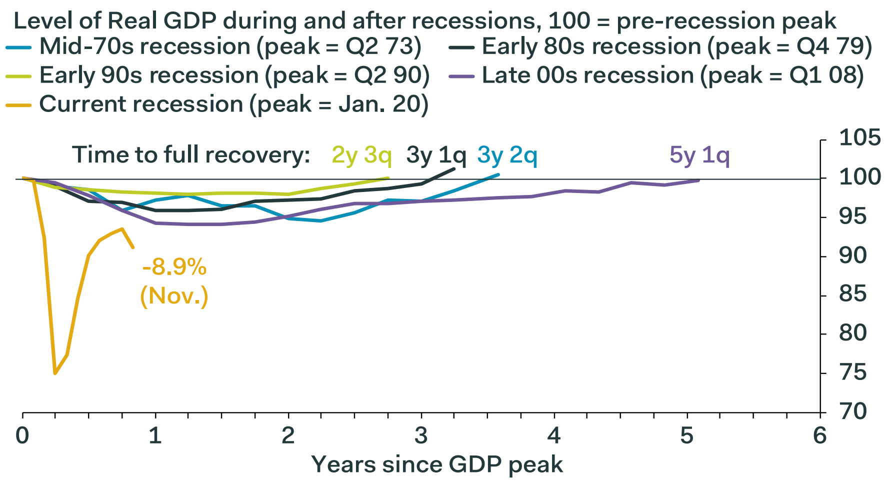
2. A GENUINE SLUMP IN HOUSEHOLDS' SPENDING WAS AT THE ROOT



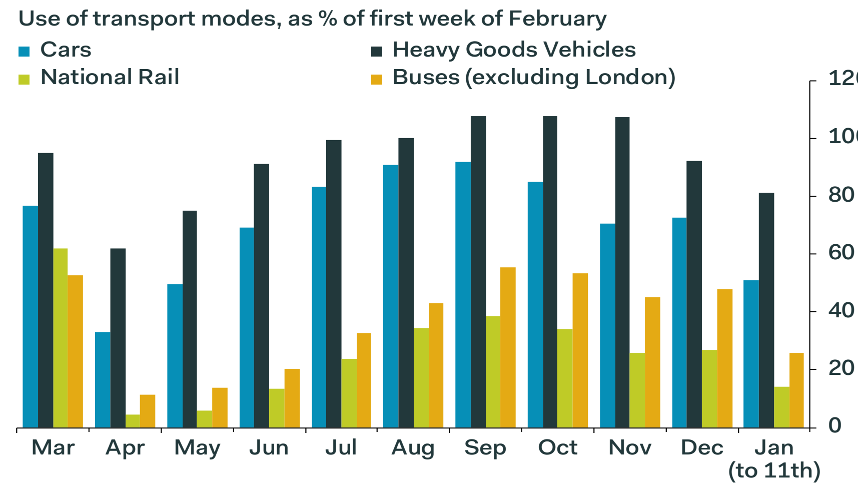
4. SERVICES SPENDING WAS HIT HARD BY A HUGE RISE IN HOME-WORKING



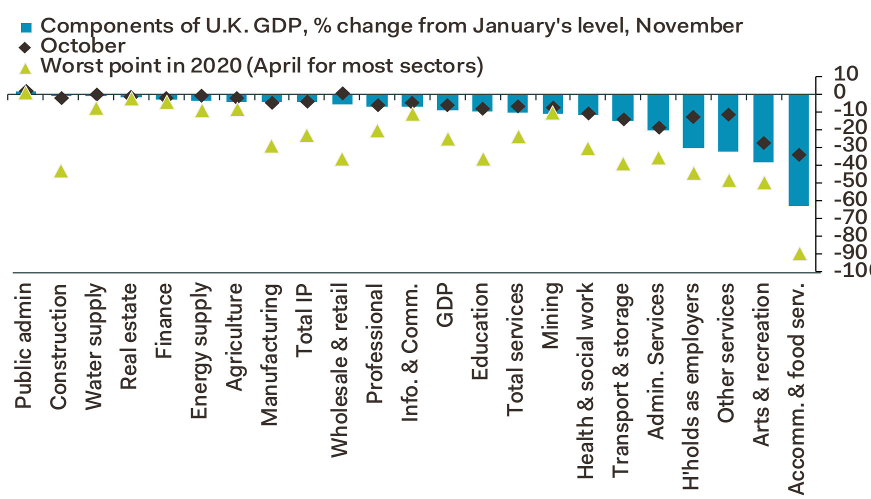
5. NOVEMBER'S LOCKDOWN DIDN'T DAMAGE GDP MUCH...



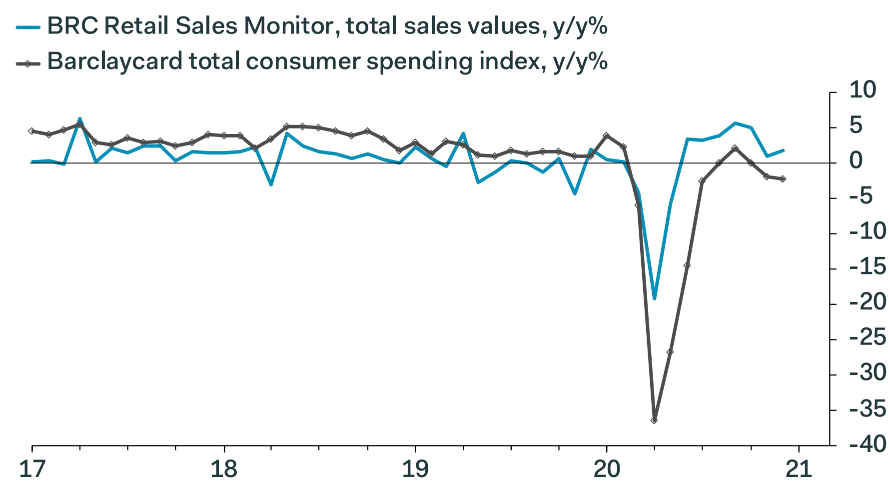
7. BUT ACTIVITY FAILED TO RECOVER MUCH IN DECEMBER



6. ...MANY BUSINESSES HAVE ADAPTED WELL TO LOCKDOWN CONDITIONS



8. SPENDING DIDN'T REBOUND, DESPITE SHOPS AND HOSPITALITY REOPENING



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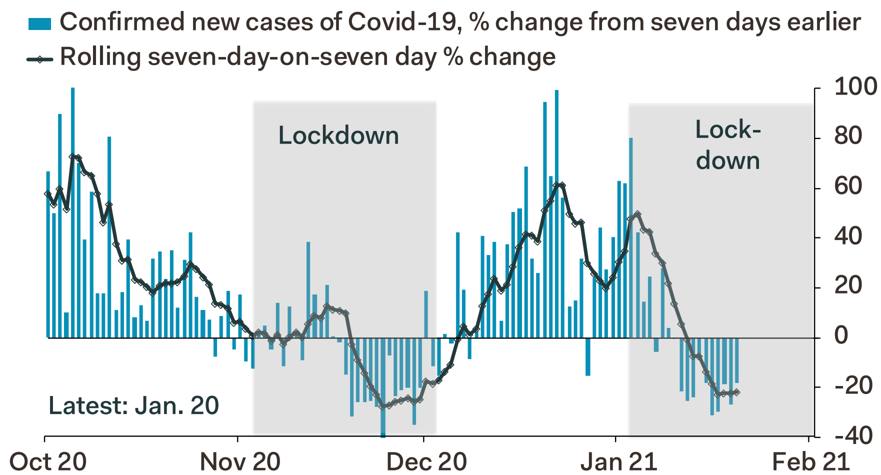
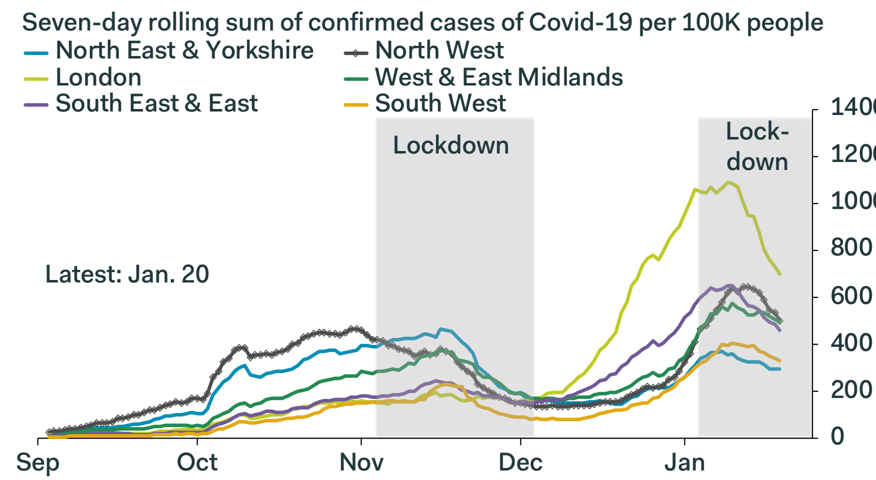
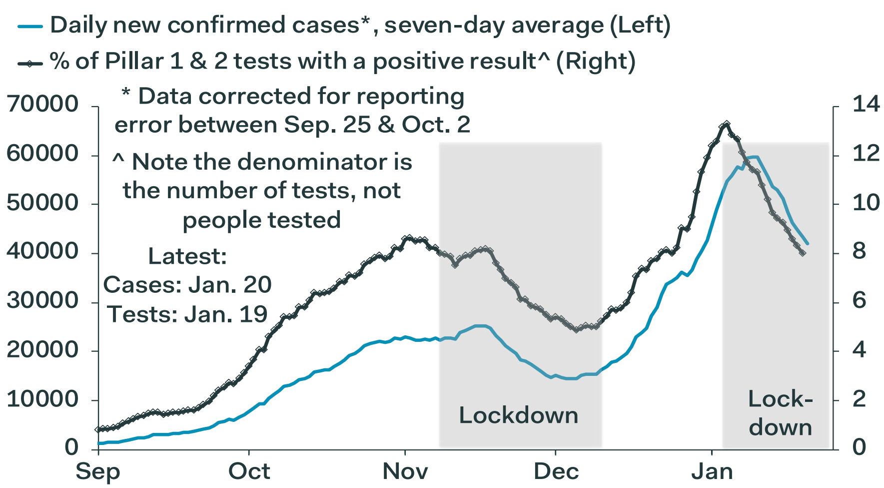
9. THE CURRENT LOCKDOWN IS WORKING; NO NEED FOR TOUGHER RULES



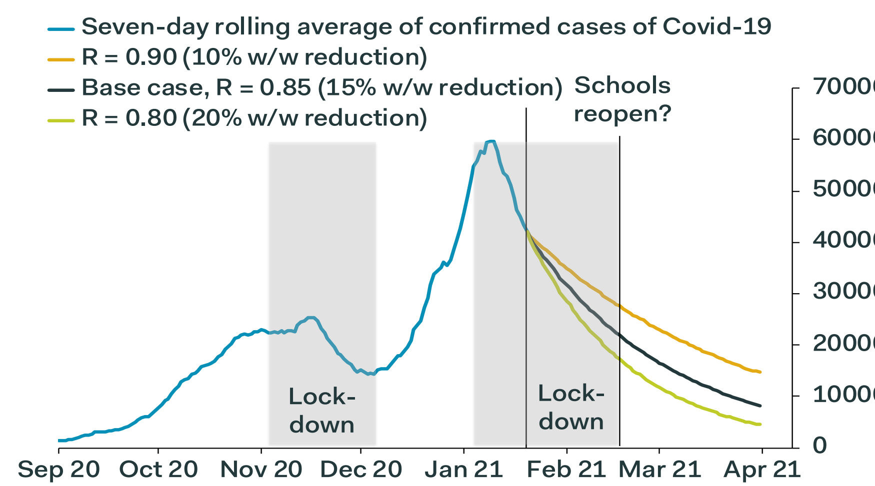
11. CASES FALLING EVEN IN LONDON, WHERE THE NEW STRAIN DOMINATES



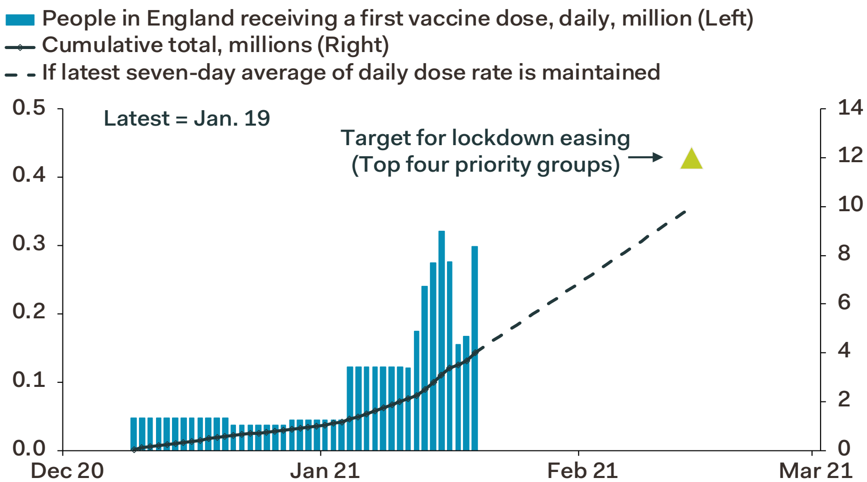
10. THE POSITIVE TEST RATE HAS FALLEN SHARPLY



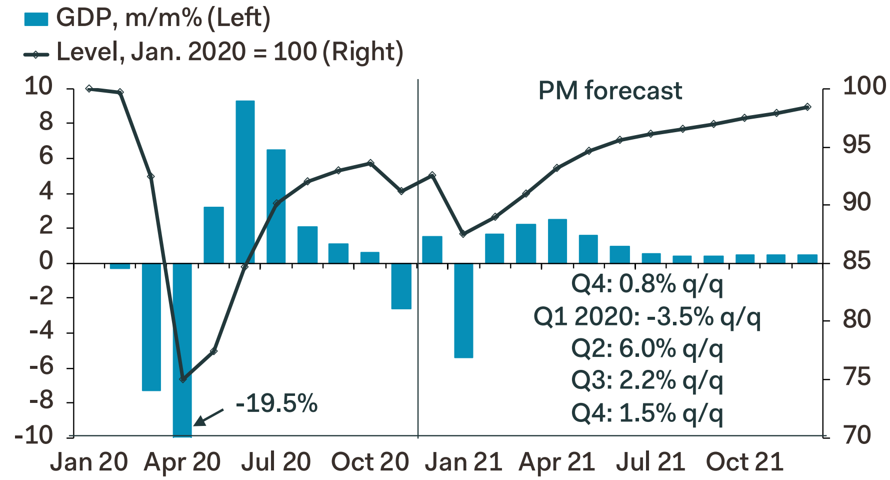
12. BY MID-FEBRUARY, CASES SHOULD BE BACK TO LATE OCTOBER LEVELS



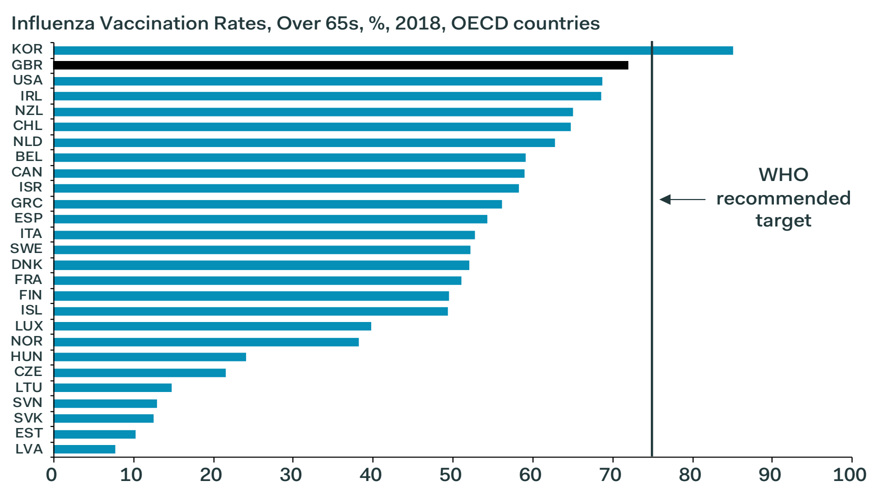
13. VACCINATION NEEDS TO SPEED UP TO MEET THE GOVERNMENT'S TARGET



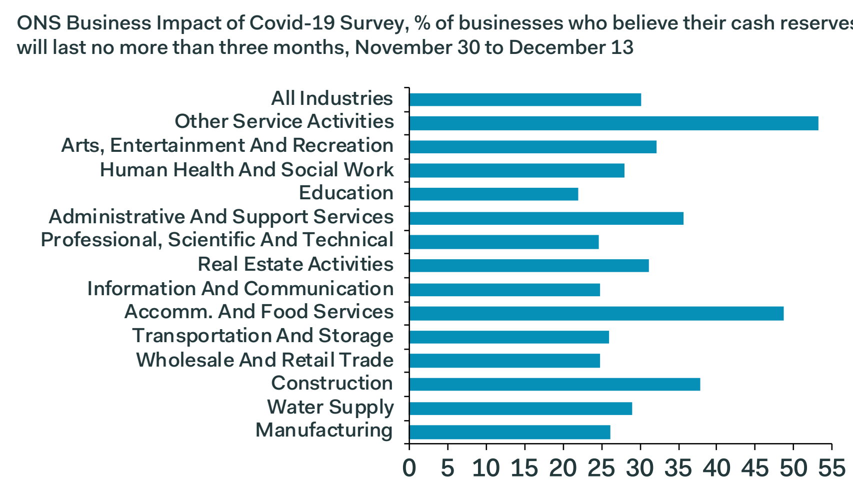
15. THE LOCKDOWN LIKELY WILL BE EASED FROM MID-FEBRUARY, SLOWLY...



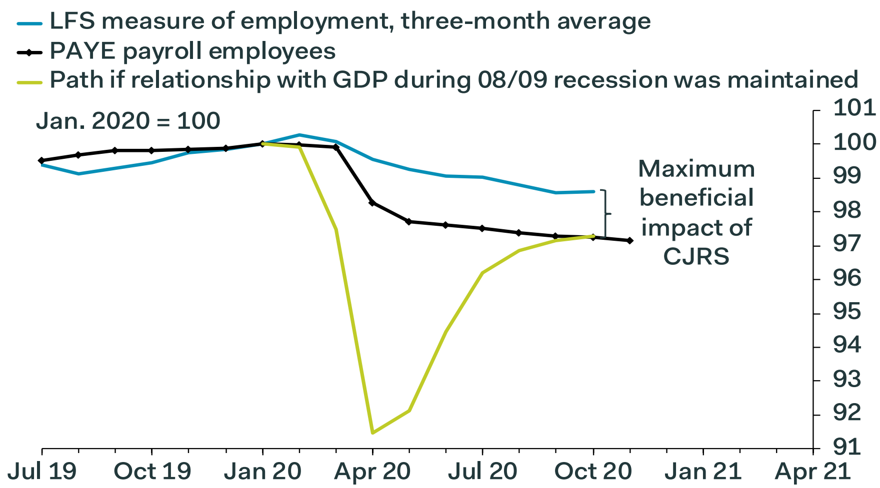
14. BRITS AREN'T AFRAID OF NEEDLES; VACCINE TAKE-UP WILL BE HIGH



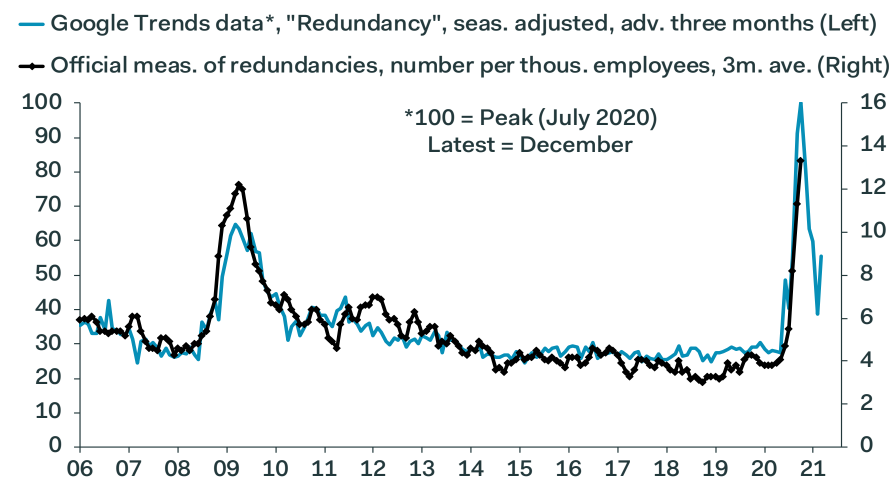
16. ...BUT HOSPITALITY WILL HAVE TO WAIT TILL APRIL; TOO LONG FOR MANY



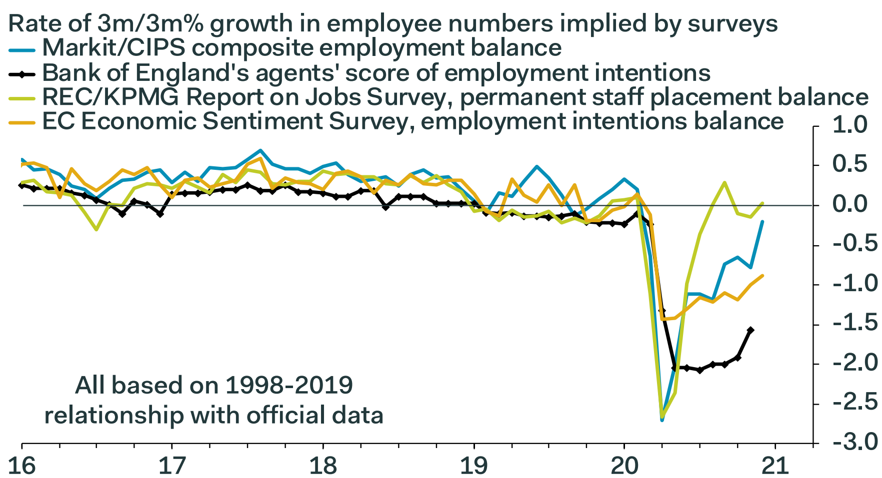
17. THE FURLOUGH SCHEME HAS WEAKENED THE GDP—EMPLOYMENT LINK



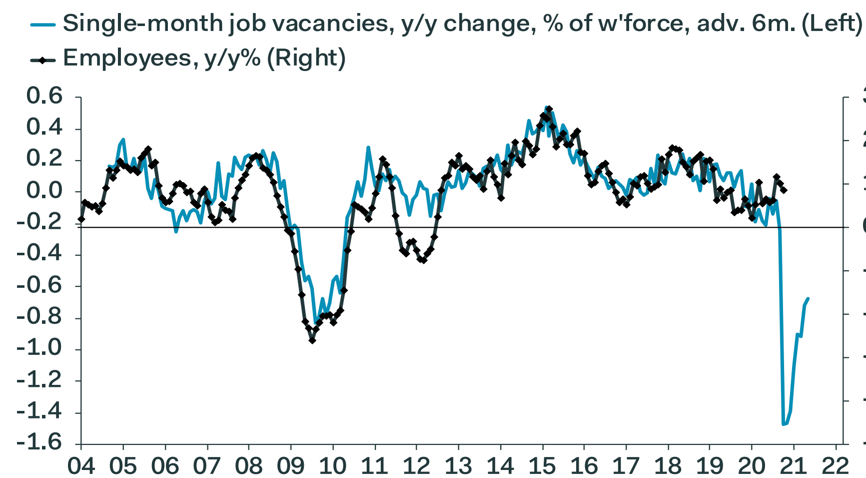
19. LAYOFFS HAVE PEAKED, BUT WILL RISE IN APRIL AFTER THE CJRS ENDS



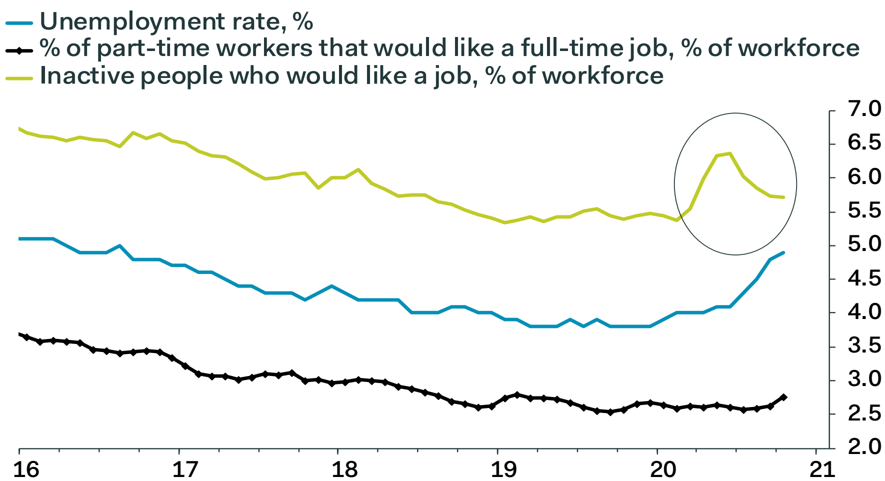
18. FIRMS STILL ARE CUTTING HEADCOUNTS, BUT AT A SLOW PACE



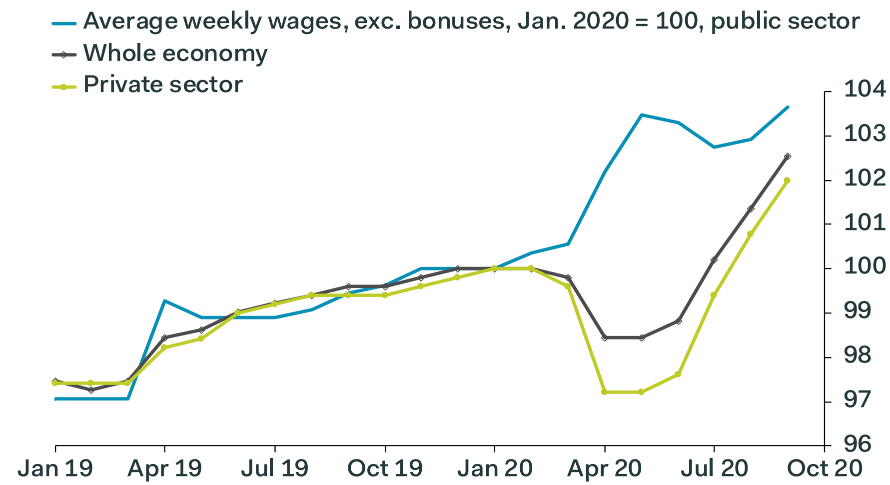
20. JOB POSTINGS REMAIN FAR BELOW LAST YEAR'S LEVELS



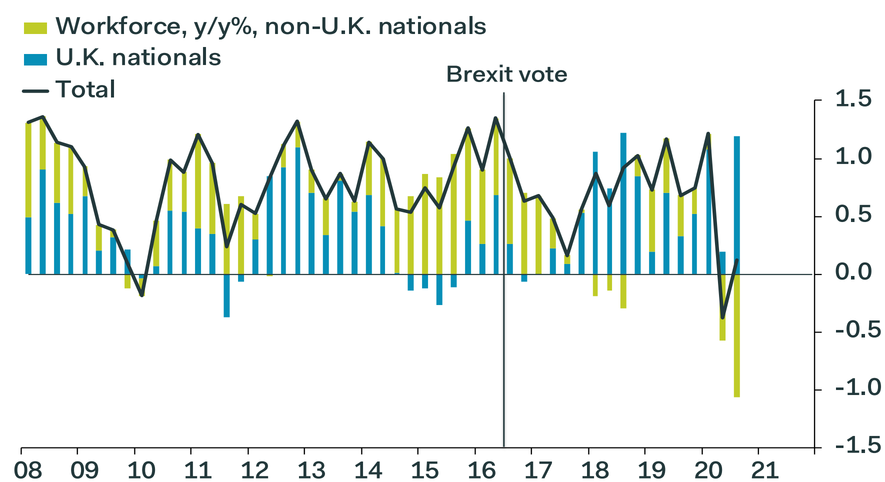
21. THE UNEMPLOYMENT RATE STILL UNDERSTATES THE AMOUNT OF SLACK



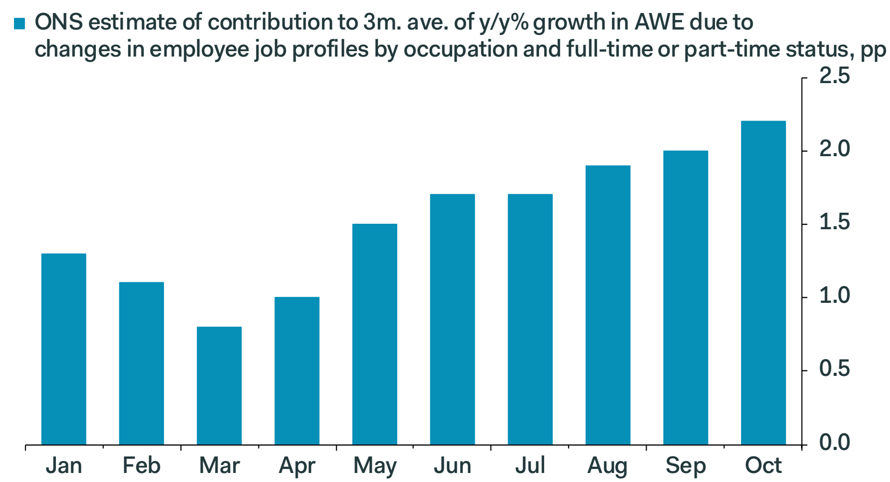
23. THE REBOUND IN THE LEVEL OF AVERAGE WEEKLY WAGES...



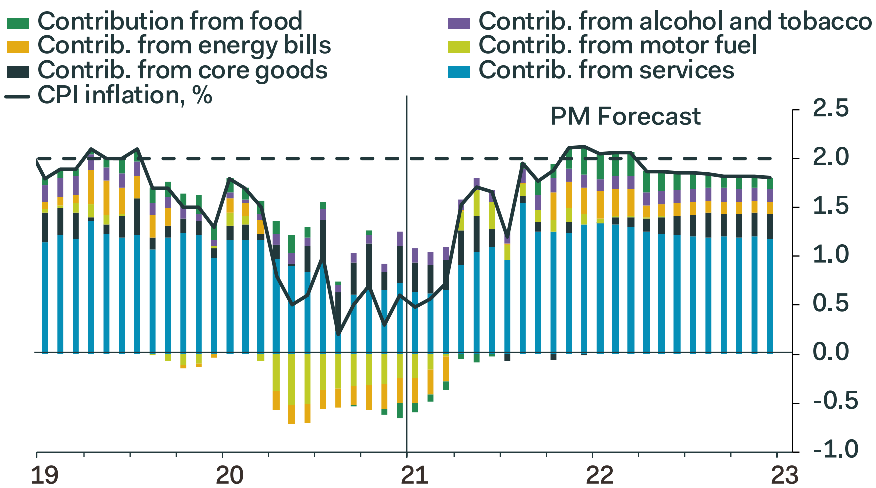
22. IT WILL RISE FURTHER, IF FOREIGN NATIONALS RETURN TO BRITAIN



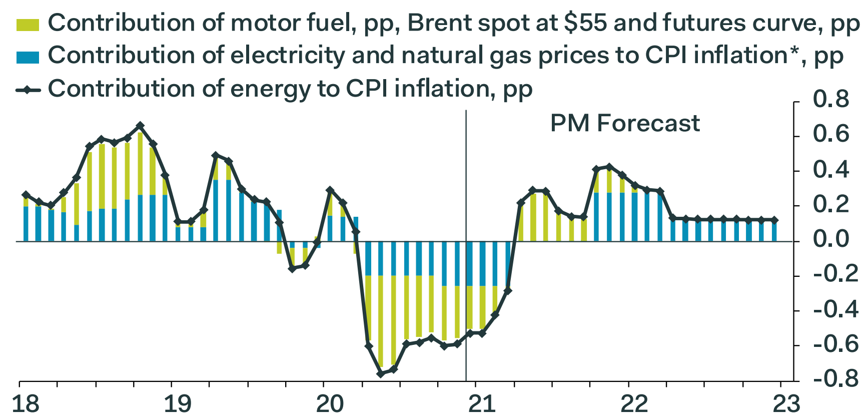
24. ...MAINLY REFLECTS LOW-PAID STAFF BEARING THE BRUNT OF LAYOFFS



25. AT LEAST HOUSEHOLDS CAN LOOK FORWARD TO LOW CPI INFLATION

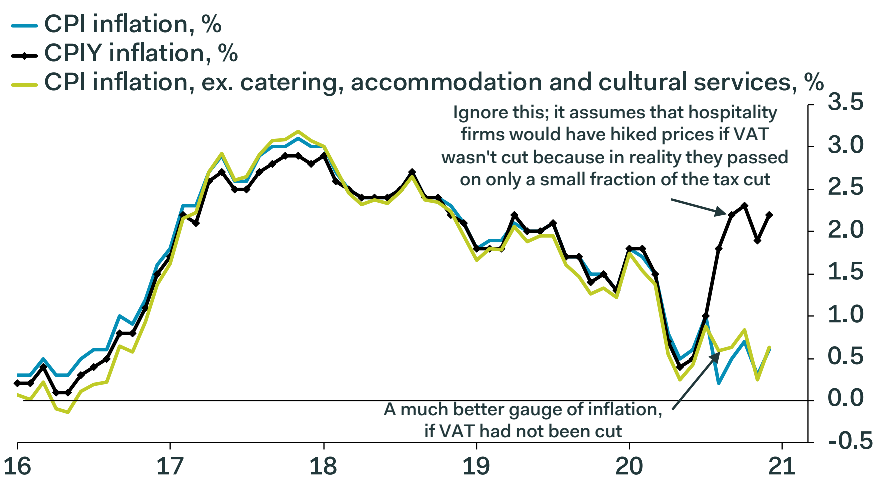


27. THE NEGATIVE CONTRIBUTION FROM ENERGY PRICES WILL DISAPPEAR...

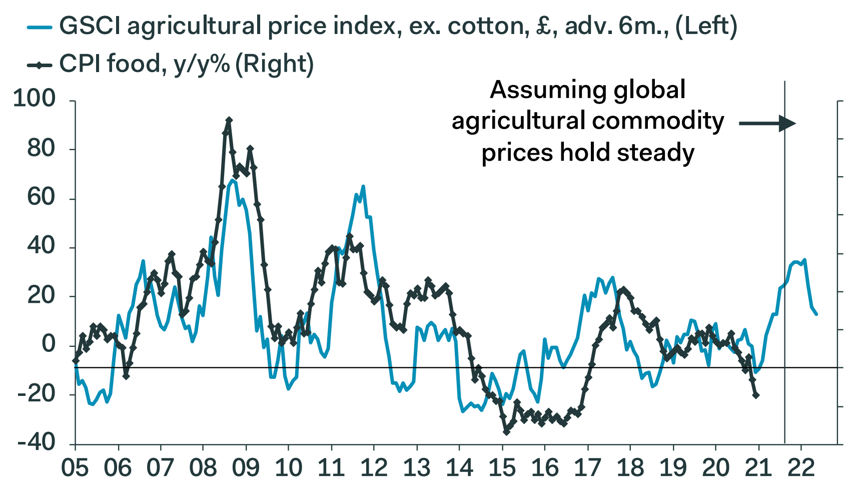


* The default tariff price cap fell by 7.5% in Oct. 20. We assume it then rises by 7% in Apr. 21, 2% in Oct. 21, 2% in Apr. 22 and 2% in Oct. 22

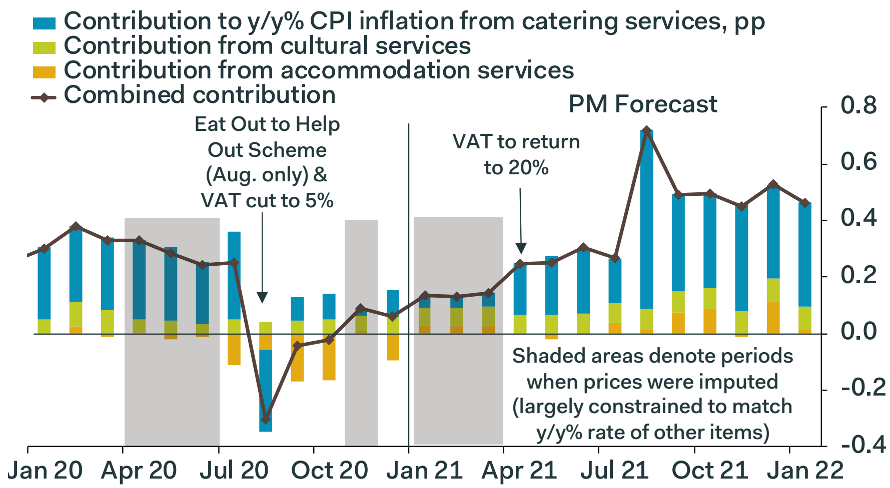
26. INFLATION IS LOW NOT JUST DUE TO THE HOSPITALITY VAT CUT



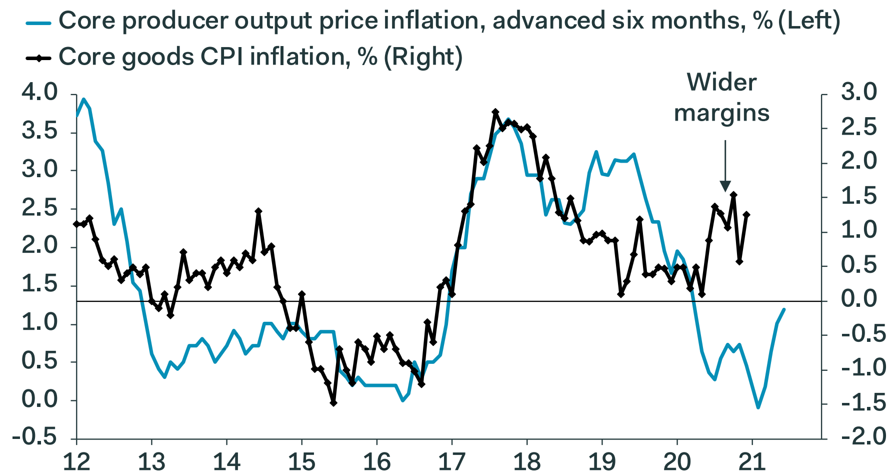
28. ...AND FOOD INFLATION WILL RESPOND TO HIGHER COMMODITY PRICES



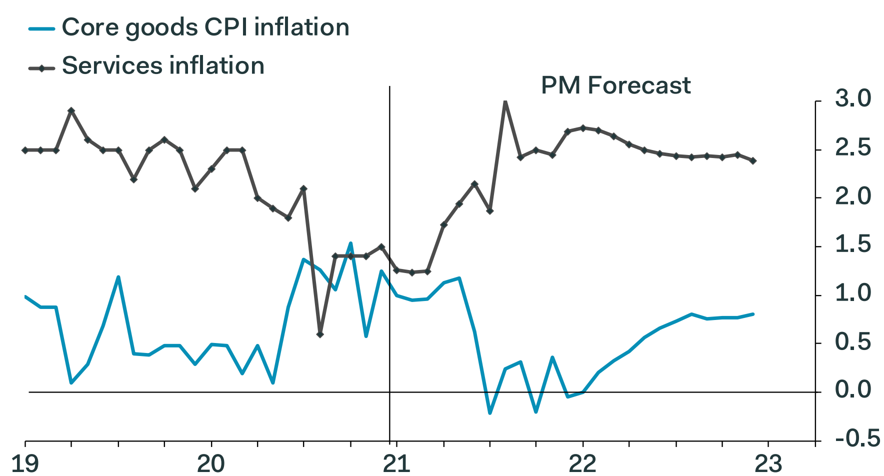
29. PRICE IMPUTATION ALSO WILL LIFT CPI INFLATION IN Q1, MODESTLY



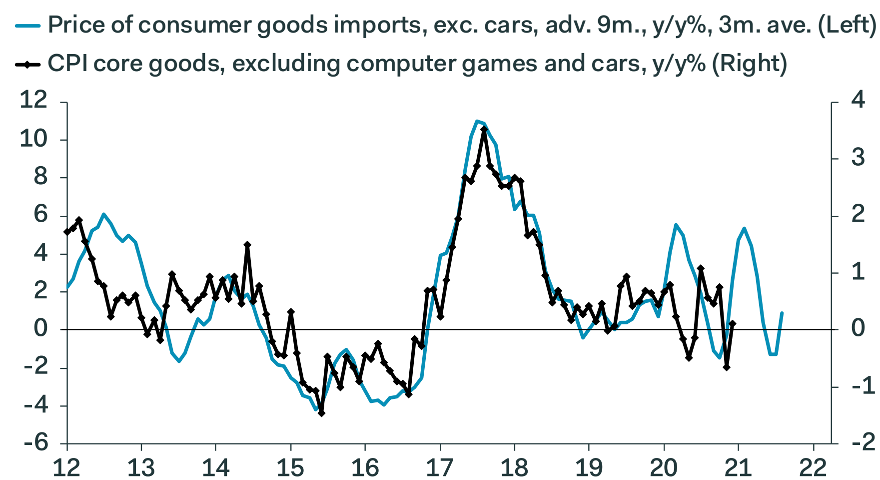
31. GOODS MARGINS HAVE ROOM TO TIGHTEN IN 2021, AS DEMAND EASES



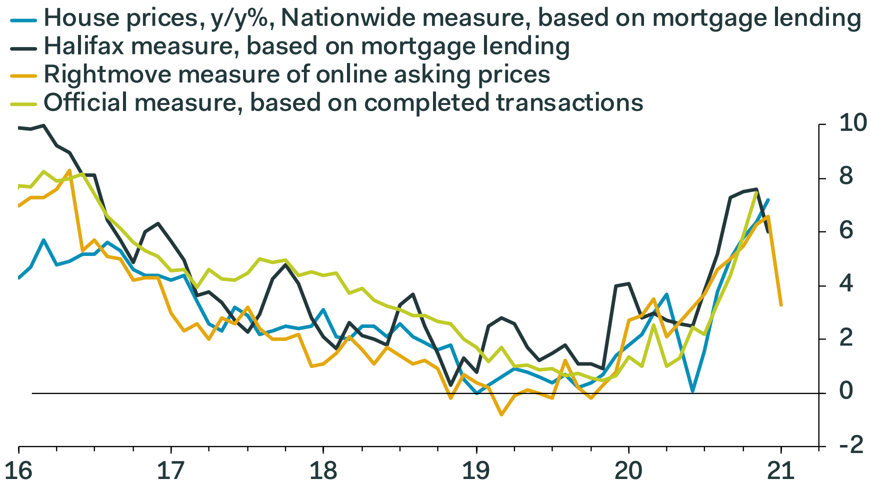
30. BUT FALLING GOODS INFLATION WILL DAMPEN ANY SERVICES SURGE



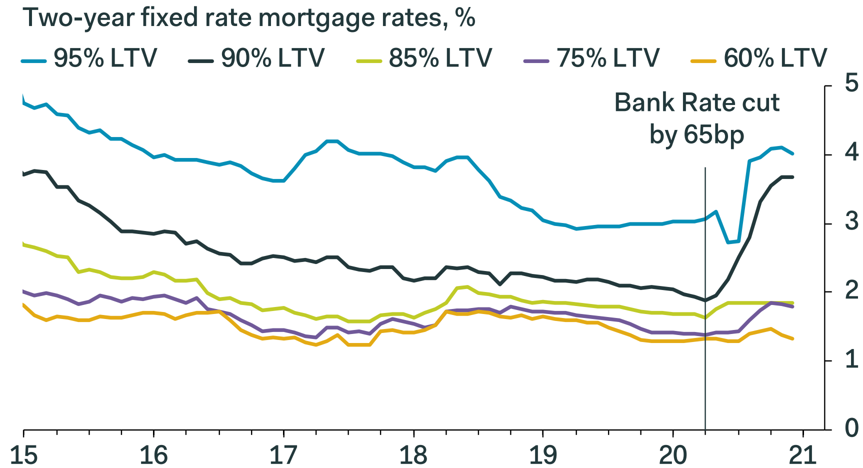
32. NO SIGN OF HIGHER SHIPPING COSTS LIFTING IMPORT PRICES YET



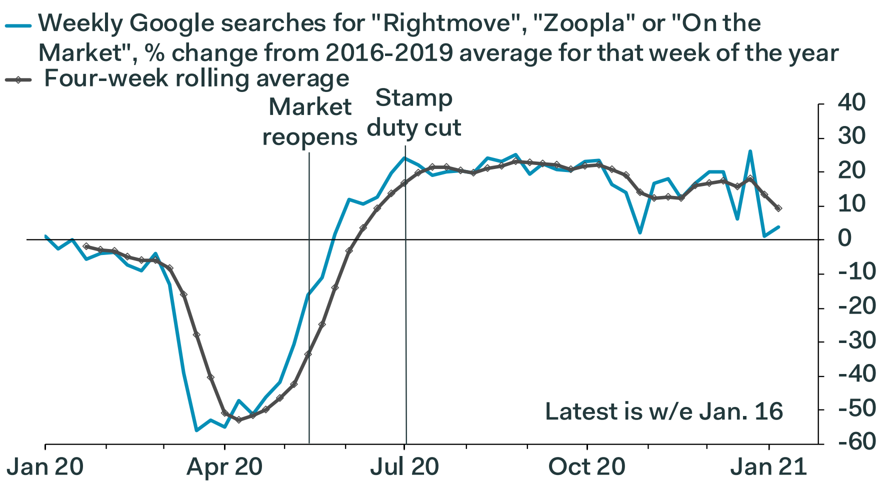
33. HOUSE PRICE GROWTH PROBABLY NOW HAS PEAKED



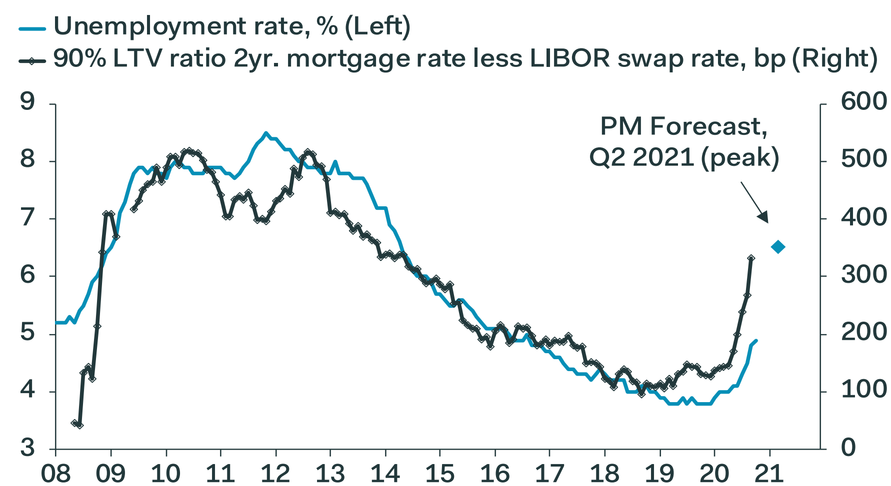
35. ONCE THE STAMP DUTY CUT ENDS, MORTGAGE RATES WILL BE A PROBLEM



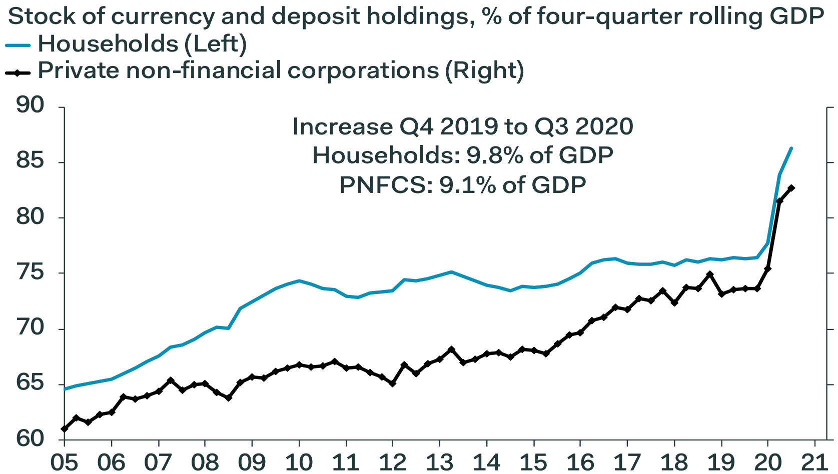
34. DEMAND HAS REVERTED TO SEASONAL NORMS THIS YEAR



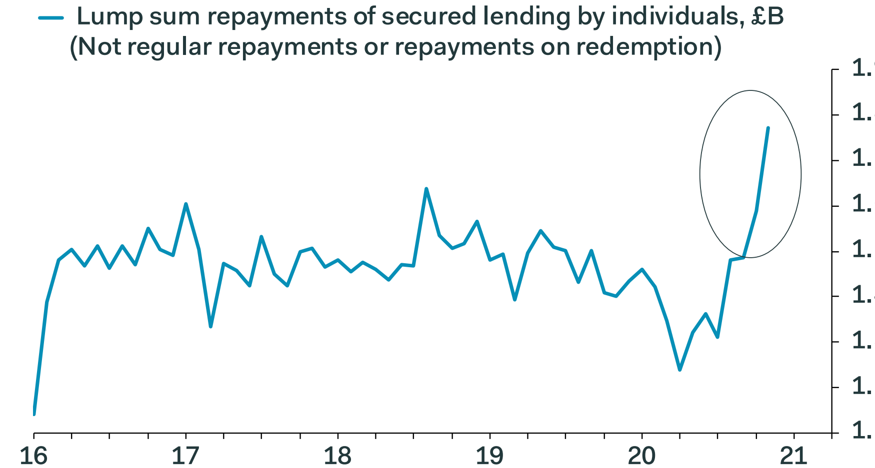
36. THE LABOUR MARKET OUTLOOK SUGGESTS SPREADS WON'T TIGHTEN



37. GDP WILL ROCKET, *IF* HOUSEHOLDS QUICKLY SPEND THEIR SAVINGS...



39. SOME HOUSEHOLDS ARE USING EXCESS CASH TO REDUCE THEIR DEBTS



38. ...BUT WE EXPECT THIS CASH TO BE DRIP-FED BACK INTO THE ECONOMY

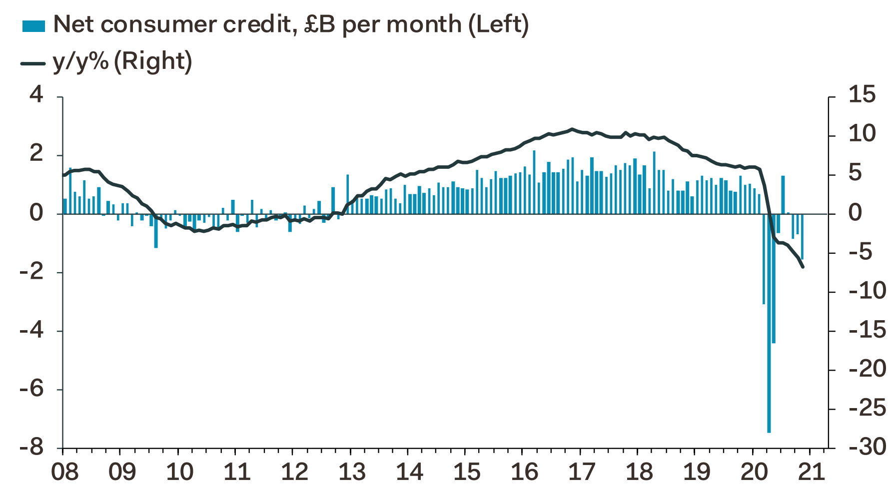
* Households have accumulated savings partly because they avoided foreign travel this year. Much of this extra cash likely will be spent abroad in 2021, or on imported goods.

* High-income households have accounted for most of the surge in savings. They have a lower propensity to spend than low-income households. Indeed, a BoE/NMG survey of households in September found that just 10% of those that had increased their savings said that they plan to spend the money they have saved.

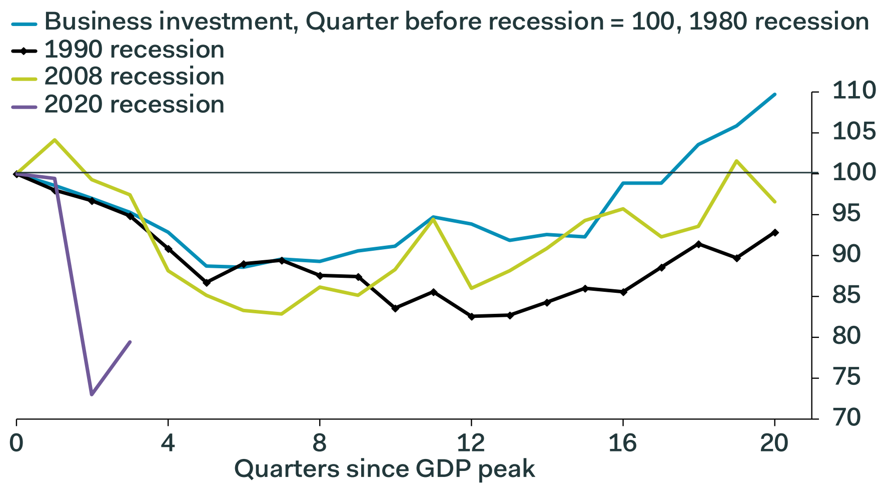
* High-income households also likely will be burdened by tax rises next year and in 2022.

* Households' and firms' desired level of precautionary savings likely will be higher over the coming years than before Covid-19. Financial crises leave scars.

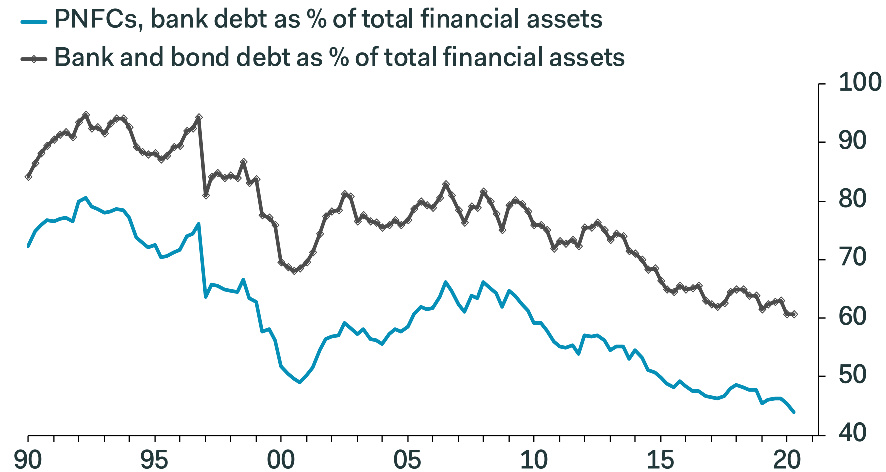
40. FALLING UNSECURED DEBTS ALSO ILLUSTRATE CONSUMERS' CAUTION



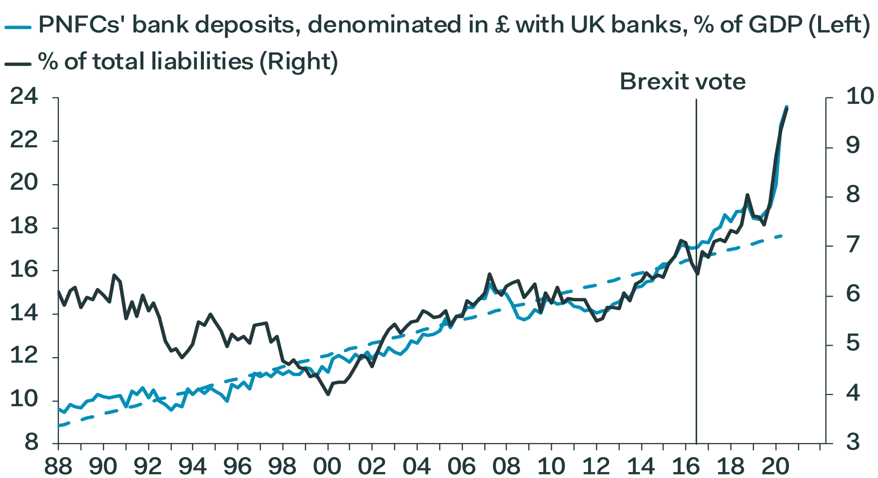
41. THE DOWNTURN IN BUSINESS INVESTMENT LAST YEAR WAS SEVERE



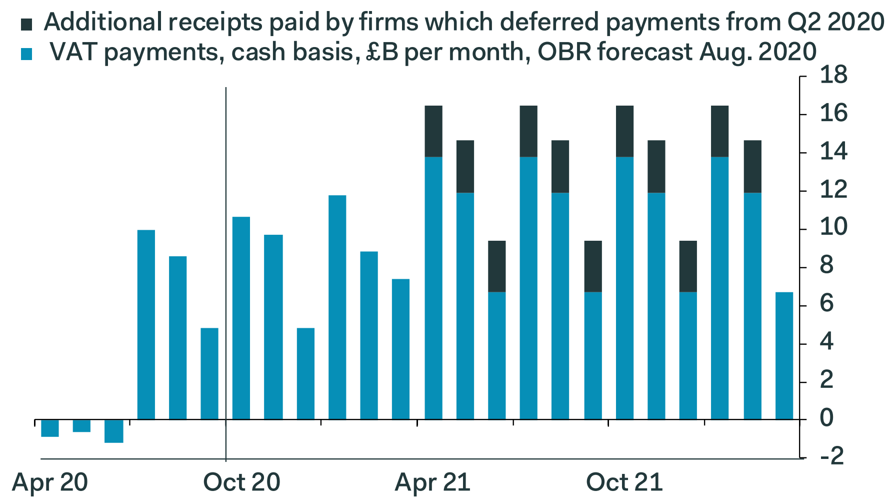
43. ...AND LEVELS OF LEVERAGE ARE LOW...



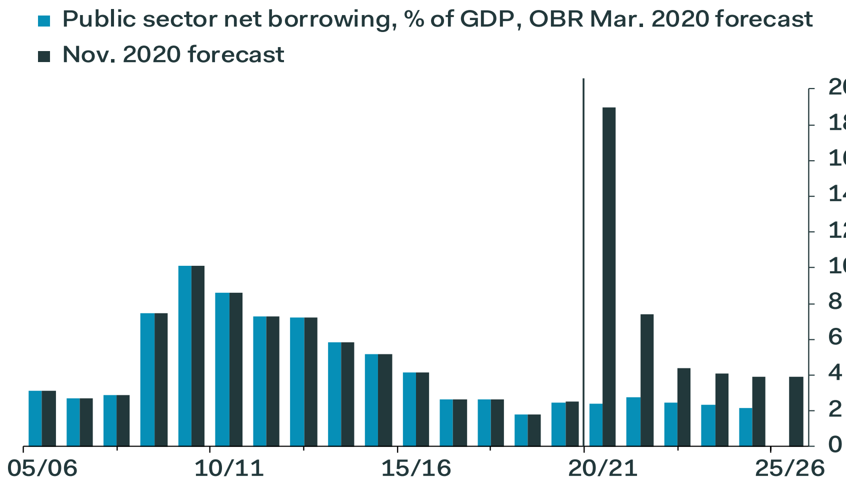
42. LIKE HOUSEHOLDS, CORPORATES HAVE AMASSED EXCESS CASH...



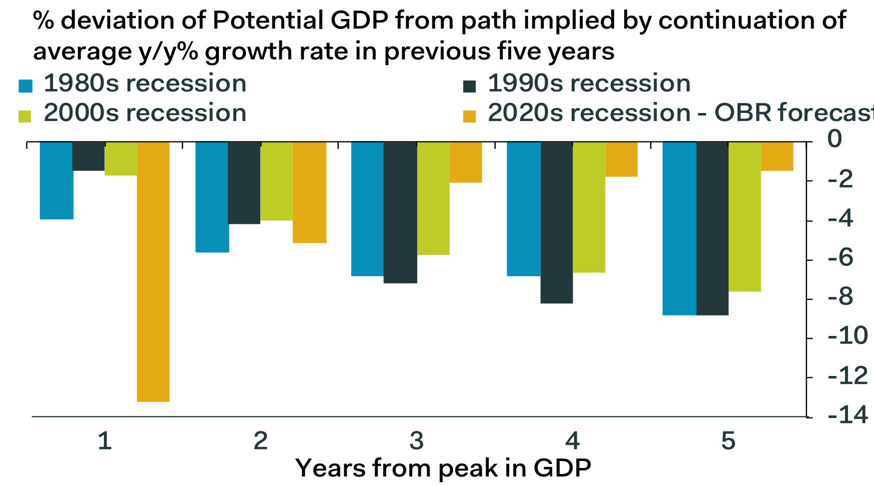
44. ...BUT TAX, RENT AND LOAN REPAYMENTS WILL ALL JUMP NEXT YEAR



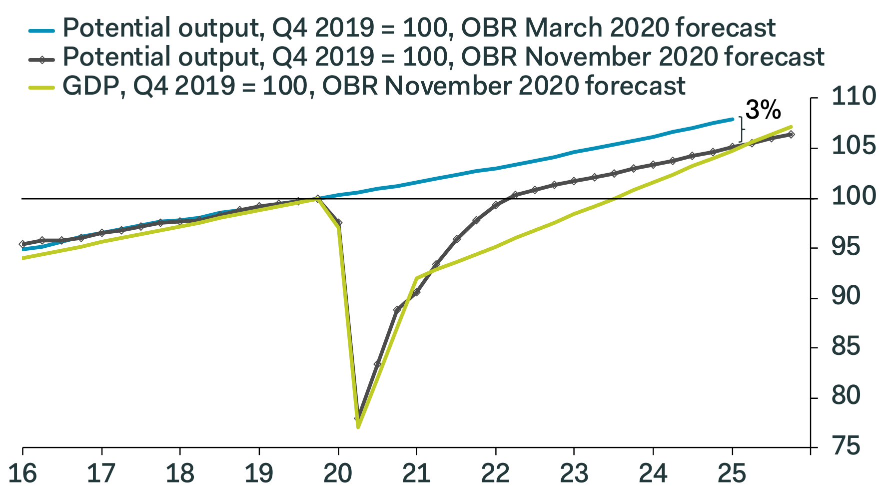
45. PUBLIC BORROWING STILL WILL BE VERY HIGH NEXT YEAR



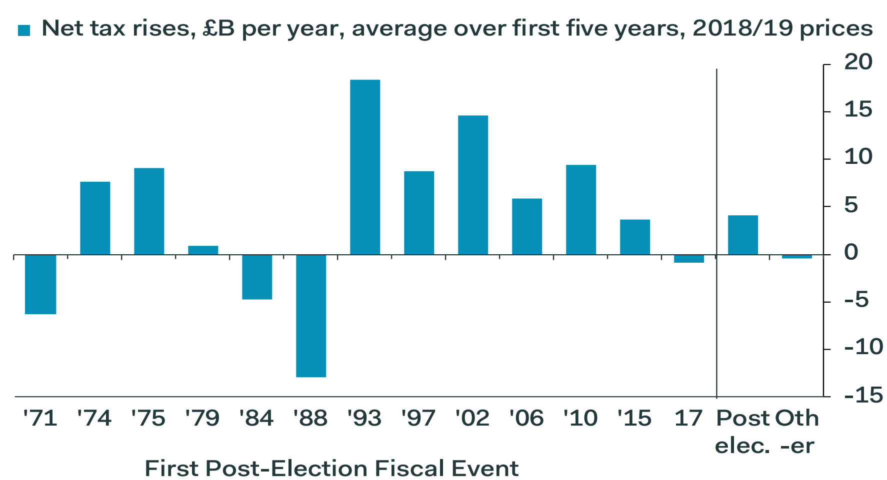
47. ...PREVIOUS RECESSIONS, HOWEVER, HAVE BEEN FAR MORE DAMAGING



46. THE OBR ASSUMES LITTLE "SCARRING" TO POTENTIAL OUTPUT...



48. BIG TAX RISES ARE COMING, WELL IN ADVANCE OF THE 2024 ELECTION



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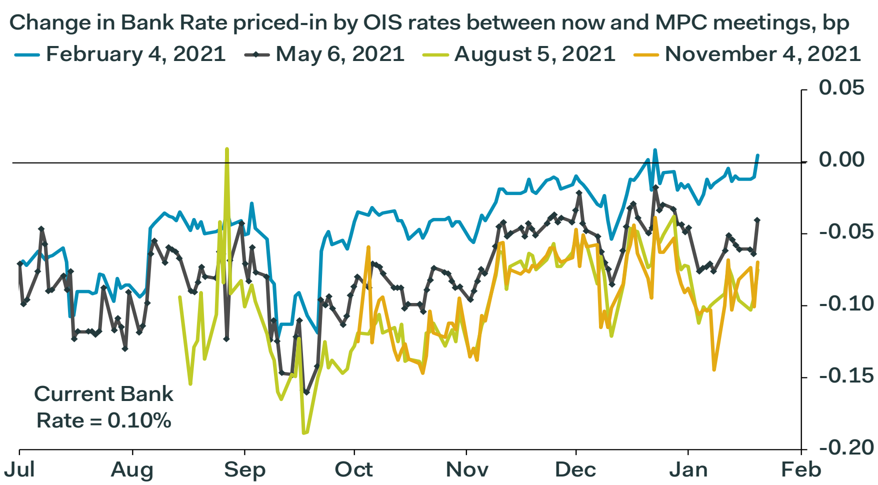
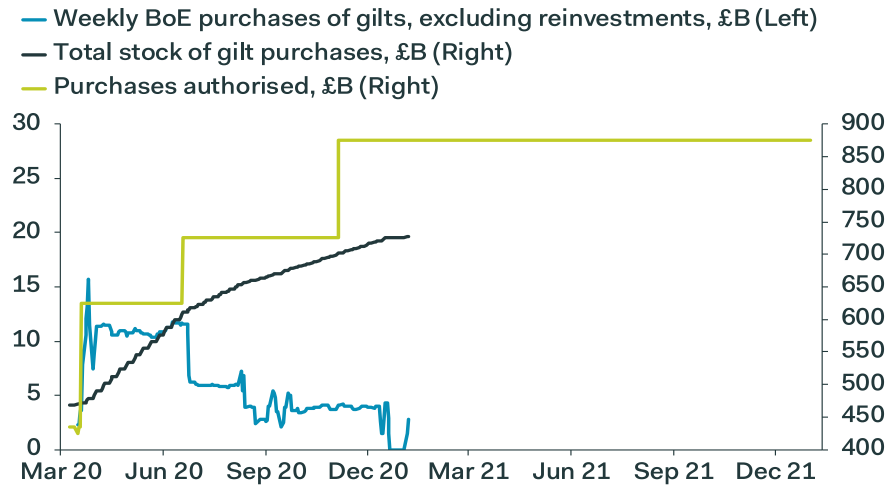
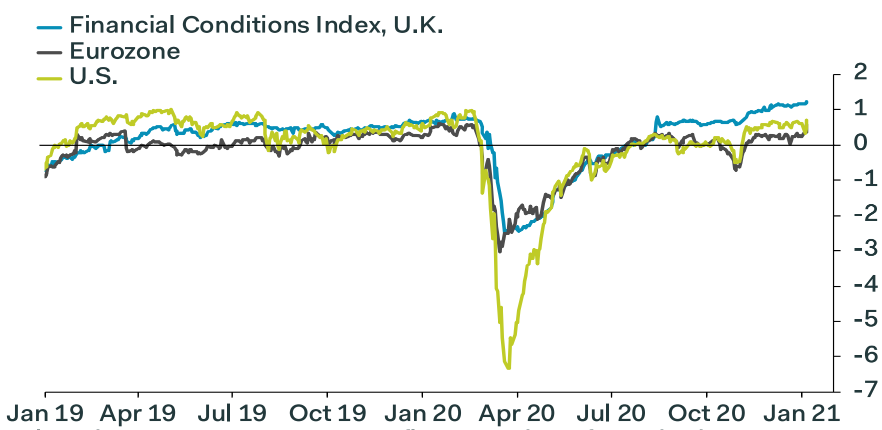
49. MARKETS SEE AROUND A 50:50 CHANCE OF NEGATIVE RATES BY AUGUST



51. THE MPC IS NOWHERE CLOSE YET TO FINISHING ITS QE PROGRAMME



50. FINANCIAL CONDITIONS ALREADY ARE VERY LOOSE



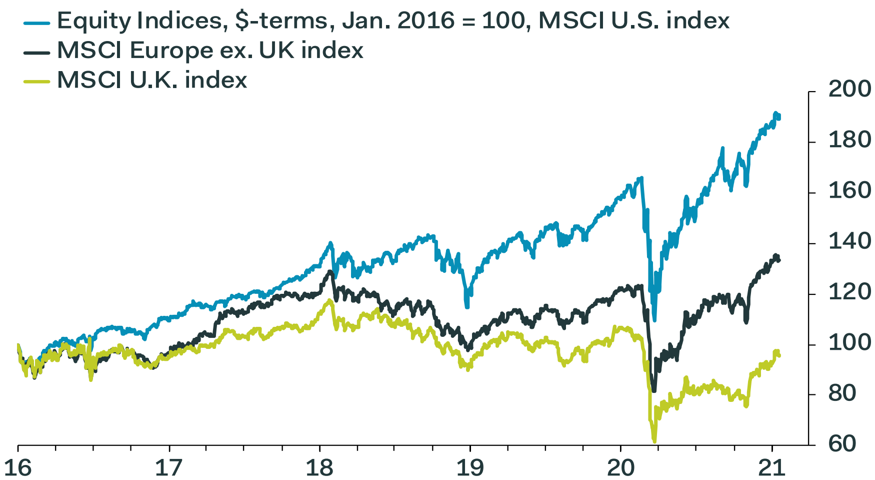
Bloomberg measures; z-score reflects number of standard deviations from 1999 to 2008 mean

52. WE EXPECT MORE QE, AND AN ENHANCED TFS, BUT NOT NEGATIVE RATES

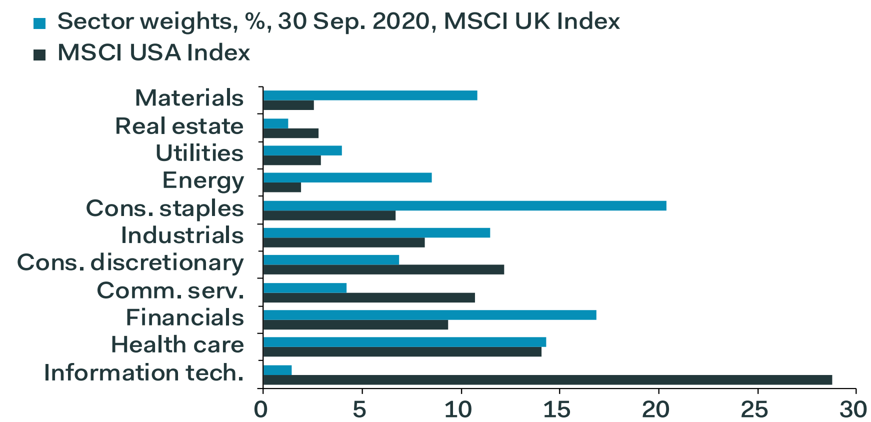
Stimulus options for the MPC

Tool	Current Stance	Possible future changes	PM Expected future changes
Bank Rate	0.10%, which is deemed to be its floor.	Reduce to or below zero.	None.
Term Funding Scheme	Banks can access four-year funds at or close to Bank Rate. Volume equal to 10% of base stock of loans, plus a multiple of 2020 net lending.	Let banks access funds at a negative interest rate. Increase banks' borrowing allowances.	Let banks access funds at a negative interest rate, in either Q1 or Q2 2021.
Forward guidance	"The Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably."	Commit to letting CPI inflation overshoot the 2% target, so that the average rate over a period of time since Covid-19 equals 2%.	None.
QE	Purchase £100B more gilts by the end of 2021, taking total purchases since Covid-19 to £390B.	Purchase more gilts. Restart corporate bond purchases. Widen scope to include asset backed securities (e.g. RMBS).	A £50B increase in the asset purhase target in May.
Yield Curve Control	The MPC only commits to purchasing a fixed value of gilts.	Commit to open-ended purchases of gilts in order to sustain the 10-year yield at a fixed percentage.	None.

53. U.K. EQUITIES HAVE RECOVERED ONLY PART OF THEIR LOST GROUND

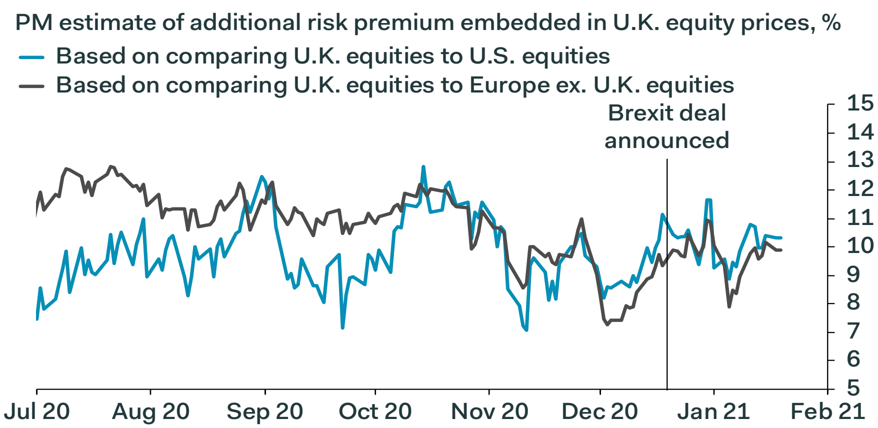


55. U.K. EQUITY INDICES ARE OVERWEIGHT FINANCIALS...



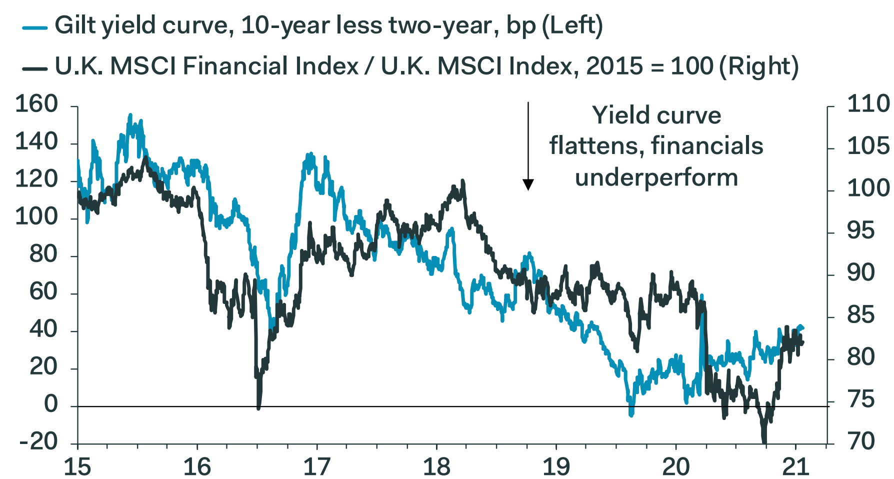
Both MSCI indices include equities that account for c.85% of the free float-adjusted market capitalisation

54. A LARGE RISK PREMIUM STILL IS WARRANTED, GIVEN TRADE RISKS



Based on comparing PE ratios of MSCI indices, adjusting for differences in sector weightings and long-standing tendency for U.K. stocks to have lower P.E. ratios

56. ...OUTPERFORMANCE ONLY LIKELY IF YIELD CURVES STEEPEN A LOT

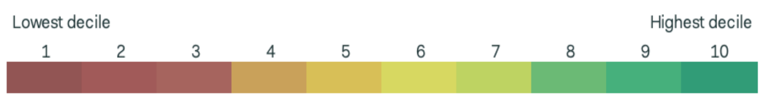


U.K. Economy Heatmap

Survey	Indicator
Economy-wide	
Markit/CIPS PMIs	Composite Index
CBI Monthly Growth Indicator	Output, past three months
Bank of England Agents' Report	Bus. services, man & cons. output scores
E.C. Business & Consumer Survey	Economic sentiment index
Lloyds Business Barometer	Confidence Index
BCC Quarterly Economics Survey	Domestic and export sales, all firms
Consumer Spending	
CBI Distributive Trades Survey	Reported sales balance
BRC Retail Sales Monitor	Total sales, adjusted by price index
Bank of England Agents' Report	Retail sales values score
Bank of England Agents' Report	Consumer services turnover score
GfK Consumer Confidence Survey	Composite index
Business Investment	
Bank of England Agents' Report	Investment intentions score
ICAEW Business Confidence Monitor	Business confidence index
BCC Quarterly Economics Survey	Investment intentions balance
CBI Industrial & Distributive Surveys	Investment intentions balances
EEF Manufacturing Outlook Survey	Investment intentions balance
Exports	
Markit/CIPS Manufacturing Survey	Export orders balance
CBI Industrial Trends Survey	Export orders balance
Bank of England Agents' Report	Export output score
BCC Quarterly Economics Survey	Export sales balance
EEF Manufacturing Outlook Survey	Export orders balance

Notes

Indicators are coloured according to their decile from all its past values between 2008 and 2019.
If the indicator is a monthly series, its average value for the quarter is used.
A weighted average is calculated where values are reported separately for sectors.



Economic Activity (y/y%, full-year average)	2017	2018	2019	2020	2021	2022
Household spending	1.0	1.3	1.1	-11.8	6.5	6.5
Fixed investment	2.8	0.4	1.5	-11.8	6.0	6.0
Government spending	0.7	0.6	4.0	-8.6	5.0	3.5
Inventories, cont. to GDP growth, % points	0.2	-0.7	0.1	0.2	-0.2	-0.1
Domestic demand	1.0	1.2	1.6	-11.7	6.4	5.7
Exports	5.4	3.0	2.7	-14.0	5.8	8.0
Imports	2.6	2.7	2.7	-20.2	9.0	9.0
GDP	1.7	1.3	1.4	-9.9	5.0	5.5
Labour Market, Costs and Prices (y/y%, full-year average, unless stated)						
Output per worker	1.0	0.0	0.2	-9.5	6.3	4.3
Employment	1.0	1.2	1.1	-0.4	-0.7	1.1
Unemployment rate (%)	4.4	4.1	3.8	4.5	5.6	4.9
Average weekly wages	2.3	2.9	3.4	1.4	2.7	1.0
Unit wage costs	1.5	3.0	3.3	11.0	-3.5	-3.3
CPI	2.7	2.5	1.8	0.9	1.5	1.9
Core CPI	2.4	2.1	1.7	1.4	1.5	1.8
RPI	3.6	3.4	2.6	1.5	2.2	2.5
House prices, Official measure	4.6	3.2	1.0	3.3	3.3	1.0
(end-year)	*4.5*	*2.0*	*0.7*	*7.6*	*-2.0*	*3.7*
Other						
Current account, % GDP	-3.5	-3.9	-3.8	-3.0	-4.0	-4.0
Budget deficit, PSNB ex., % GDP, FY	2.7	1.9	2.1	20.0	8.0	5.0
Bank Rate, December	0.50	0.75	0.75	0.10	0.10	0.10
APF Target, Gilts & Corp. Bonds, £B, end-yr	445	445	445	895	945	945
10-year gilt yields, end-year	1.19	1.28	0.80	0.20	0.60	0.80
30-year gilt yields, end-year	1.76	1.82	1.30	0.75	1.00	1.20
$ per £, end-year	1.35	1.30	1.32	1.37	1.35	1.35
€ per £, end-year	1.13	1.15	1.18	1.12	1.14	1.13
FTSE 100, end-year	7688	6728	7542	6461	7200	7500