THE WEEKLY **U.K.** ECONOMIC MONITOR

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SAMUEL TOMBS, CHIEF U.K. ECONOMIST

The PMI fell less sharply in the U.K. than in Europe only because restrictions were imposed later.

Even the dismal PMI likely understates the damage; we look for a 20% hit to GDP during the lockdown.

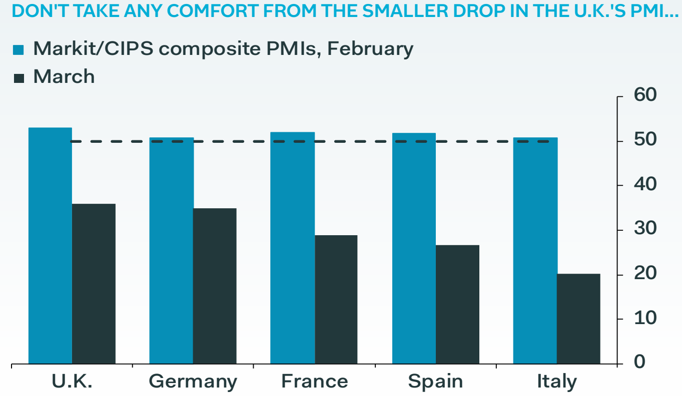
The virus still will circulate in H2, but greater medical and testing capacity will help to lift restrictions.

Britain Won't Fare Better than the Rest of Europe in Q2

The U.K. services sector has vanished overnight, following the introduction of tough restrictions on everyday life to stem the spread of Covid-19. The services PMI fell to 34.5 in March, from 53.2 in February, undershooting its prior record low— 40.1 in September 2008—with room to spare. With services output accounting for 80% of GDP in normal times, the composite PMI also collapsed to an unprecedented low of 36.0, from 53.3.

Admittedly, the composite PMI for the other major European economies fell even more. Our first chart shows that the German, French, Spanish and Italian PMIs came in at 35.0, 28.9, 26.7 and 20.2, respectively. *But it would be a mistake to expect the U.K.'s relative outperformance to be sustained*. The government introduced restrictions on everyday life much later in March than governments in Europe. For instance, U.K. schools were required to close for all but the children of essential workers on March 21, one week later than in Germany, Spain and France, and over two weeks later than in Italy.

DON'T TAKE ANY COMFORT FROM THE SMALLER DROP IN THE U.K.'S PMI...



...THE U.K. INTRODUCED CURBS ON EVERYDAY LIFE MUCH LATER

Date in March measures designed to slow Covid-19 were announced
Last country among five largest European economies to announce measure in **bold**

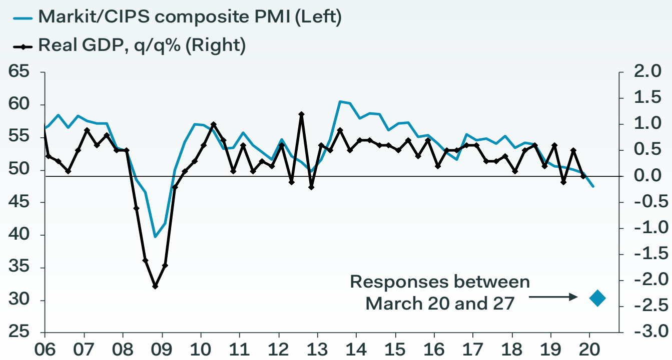
	UK	IT	DE	ES	FR
School closures	**21**	5	14	13	14
Public events banned	**24**	9	22	14	13
Lockdown ordered	**24**	11	22	14	17
Social distancing encouraged	**16**	9	12	9	**16**
Self-isolation advised if symptomatic	12	9	6	17	**16**

Source: Imperial College COVID-19 Response team

Markit conducted all its surveys in Western Europe between March 12 and 26. Unlike across the Channel then, the vast majority of firms in the U.K. reported on business conditions before the most serious measures to contain the virus were introduced. Indeed, we know that 84% of responses to Markit's U.K. survey were received before March 20, in time for the "flash" estimate published on March 24. The 1.2-point gap between the flash and final PMIs for the U.K. in March implies that responses received between March 20 and 26—when most containment measures were in place—were consistent with a PMI of 30.5, much closer to the European numbers.

The past relationship between the composite PMI and GDP implies that a 30 reading is consistent with output falling at a 2.5% quarter-on-quarter rate, but we're bracing for a *much* bigger decline. For a start, Markit's survey does not include retailers, most of whom have been forced to shut their stores. In addition, the PMI is a diffusion index, capturing the proportion of firms reporting that output is rising, less

LATE RESPONSES TO MARKIT'S SURVEY WERE VERY WEAK



GDP LOOKS SET TO BE DOWN ABOUT 20% DURING THE LOCKDOWN

	Assumed change from baseline, %	GDP weight, %	GDP impact, pp
Food store retail sales	20	2.0	0.4
Healthcare	30	7.5	2.3
Non-food store retail sales	-50	3.3	-1.7
Food service activities	-90	2.0	-1.8
Arts, entertainment and recreation	-80	1.6	-1.3
Transport services	-70	4.1	-2.9
Education	-80	5.8	-4.6
Real estate buying and selling	-80	3.8	-3.0
Hit to rest of the economy	-10	69.9	-7.0
Hit to GDP during lockdown			**-20.0**

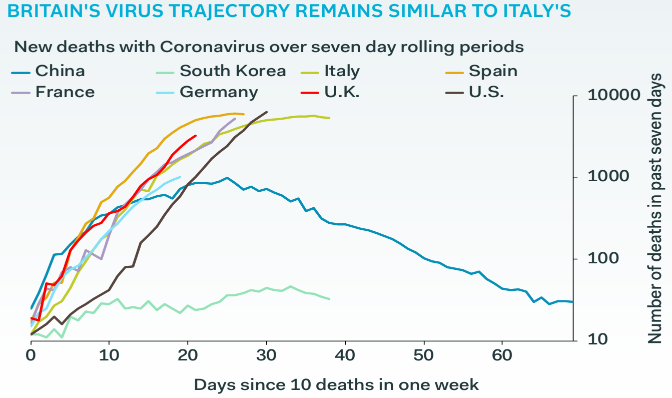
those reporting declines. A firm reporting an 80% drop in activity has the same influence on the PMI as one reporting a 2% drop. In normal recessions, many businesses report relatively small incremental declines in output. By contrast, many firms now likely are reporting huge declines in activity. The PMI fails to make any distinction between the two cases, even though the latter entails a much bigger decline in GDP. As a result, any GDP forecast based simply on its past relationship with the PMI likely will be far too upbeat.

The slump likely will worsen in early April. Firms in certain sectors—such as online retail and construction— initially appear to have attempted to continue operating as normal, only then to meet with resistance from their workers. Labour shortages also will emerge as infections continue to grow, forcing those with the virus and their family members to isolate. The lockdown also might get stricter, depending upon how well the NHS is coping.

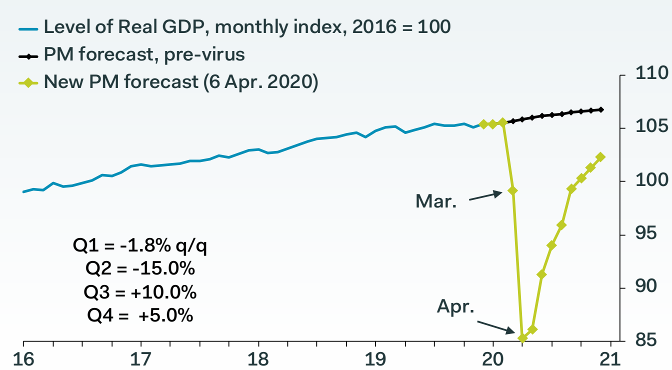
Our best guess now is that GDP will be about 20% below its pre-virus level during lockdown weeks. The assumptions underpinning this estimate can be seen in our table above. This is slightly worse than our prior estimate of a 17% hit, as we have revised our assessment of the damage to the real estate and transport services sectors.

As a result, we now look for a 15% quarter-on-quarter drop in GDP in Q2, followed by a 10% rebound in Q3. This assumes that anti-virus measures are incrementally relaxed from the beginning of June, but schools remain shut until September. The virus still will be circulating in the second half of this year, but hospital and testing capacity will have been scaled up, while herd immunity will have been partly achieved, enabling something resembling normal life to resume. Even so, with lasting labour market damage likely and inflation set to rise next year in the wake of sterling's depreciation, GDP probably won't return to its pre-virus level until the second half of 2021.

BRITAIN'S VIRUS TRAJECTORY REMAINS SIMILAR TO ITALY'S



A SWIFT RETURN TO PRE-VIRUS LEVELS OF GDP ISN'T LIKELY



Samuel Tombs **+44 (0)203 744 7430**
samuel@pantheonmacro.com

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, April 6

• **D: Car Registrations (3)/09:00 BST**
Cars registered in March likely were ordered earlier in the year, so we don't expect to see a Covid-19 hit in this data. Year-over-year growth in private car registrations likely recovered to about **-2.0%** in March, from -7.4% in February. **Consensus: N/A.**

• **D: Markit/CIPS Construction PMI (3)/09:30 GMT**
The construction sector eventually will be hit hard by the Covid-19 outbreak, but projects have lead times and press reports suggest that most builders have continued to go to work. As a result, we look for a comparatively small fall in the construction PMI to **47.0** in March, from 52.6 in February. **Consensus: 44.0.**

Tuesday, April 7

• **No significant data released.**

Wednesday, April 8

• **No significant data released.**

Thursday, April 9

• **D: RICS Residential Market Survey (3)/00:01 BST**
The house price balance is a three-month average and so it won't be depressed too much by any Covid-19 hit. We think that it probably dropped to about **+20** in March, from +29 in February. **Consensus: +12.**

• **D: GDP (2)/07:00 BST**
We look for a **0.1%** month-to-month rise in GDP in February. Encouragingly, the manufacturing and services PMIs were both well above their 12-month averages in February. Increases in property transactions and equity market activity point to solid increases in output in the real estate and financial services sectors. Flight numbers had not yet been affected by Covid-19, and few people had begun to adjust their behaviour in response to the virus. But we already know that retail sales volumes fell by 0.3% month-to-month. In addition, unprecedented levels of rainfall likely dampened construction activity. **Consensus: 0.1%.**

• **D: Trade (2)/07:00 BST**
The trade surplus between November and January has been due to a slump in imports, reflecting a decline in precautionary Brexit stockpiling, and a surge in exports of non-monetary gold. Neither imports or exports can be sustained at January's level, so we look for a trade deficit of about **£1.0B** in February. **Consensus: £1.0B.**

Friday, April 10

• **No significant data released.**

CHART OF THE WEEK: THE UNEMPLOYMENT RATE IS SOARING

PANTHEON'S FINANCIAL FORECASTS

	End-month:					
	5pm Fri.	Mar	Jun	Sep	Dec	Dec 21
Bank Rate	0.10	0.10	0.10	0.10	0.10	0.50
3m Libor	0.57	0.20	0.20	0.20	0.20	0.50
12m Libor	0.86	0.30	0.30	0.30	0.40	0.80
2-year Gilt	0.06	0.20	0.30	0.40	0.50	0.80
10-year Gilt	0.30	0.40	0.50	0.60	0.70	1.00
30-year Gilt	0.77	0.80	0.80	0.90	1.00	1.20
FTSE 100	5415	5800	6000	6200	6500	7000
USD/GBP	1.23	1.22	1.25	1.25	1.25	1.30
EUR/GBP	1.14	1.10	1.11	1.11	1.11	1.15

PANTHEON'S ECONOMIC FORECASTS (SUBJECT TO RAPID CHANGE IN CURRENT ENVIRONMENT)

	Period average:						
	Q1 20	Q2 20	Q3 20	Q4 20	2019	2020	2021
GDP, q/q%	-1.8	-15.0	10.0	5.0	-	-	-
GDP, y/y%	-1.4	-16.0	-8.0	-3.5	1.4	-7.0	6.0
Employment, y/y%	-0.5	-3.5	-3.9	-2.8	1.1	-2.5	2.0
Unemp. rate, %	4.8	7.5	8.0	6.5	3.8	6.7	5.0
Wkly earnings, y/y%	3.1	2.7	2.3	2.2	3.5	2.5	3.0
CPI, y/y%	1.7	0.8	0.6	1.0	1.8	1.0	1.9
RPI, y/y%	2.5	1.4	1.2	1.6	2.6	1.7	2.7
PSNB FY, % GDP	-	-	-	-	2.1	9.0	5.0
Cur. acc't., % GDP	-4.2	-4.0	-3.9	-3.9	-3.8	-4.0	-4.5
House prices, y/y%	1.5	1.5	1.5	2.0	2.0	2.0	3.0