The pandemic and its aftermath: Implications for the UK economy

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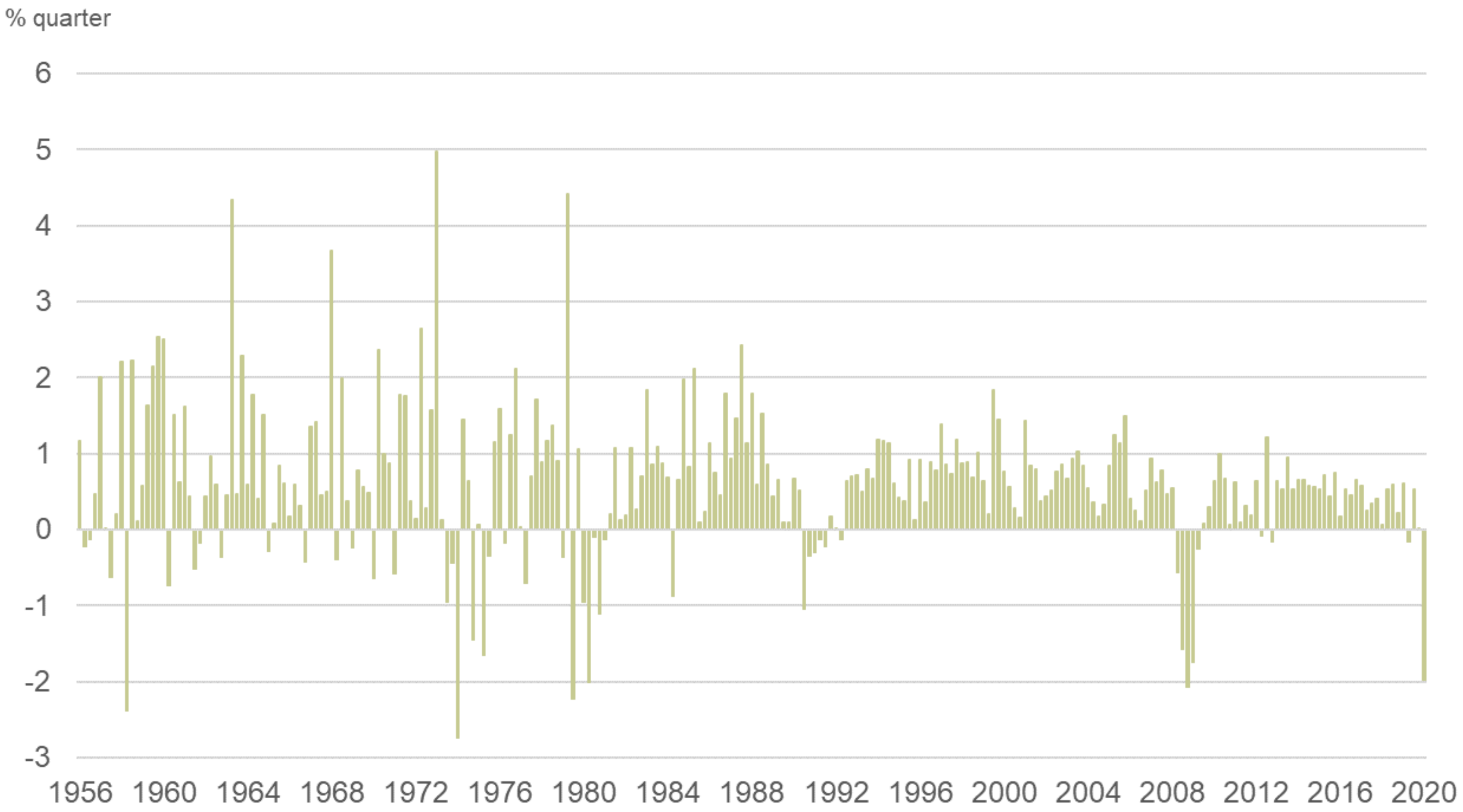
The macro-economy: four questions

1. How bad will the downturn be?
2. How strong a rebound can we expect?
3. What are the risks to the forecast?
4. What could be the longer-term implications of the pandemic?

Coronavirus and the public health response have pushed the economy into a deep contraction

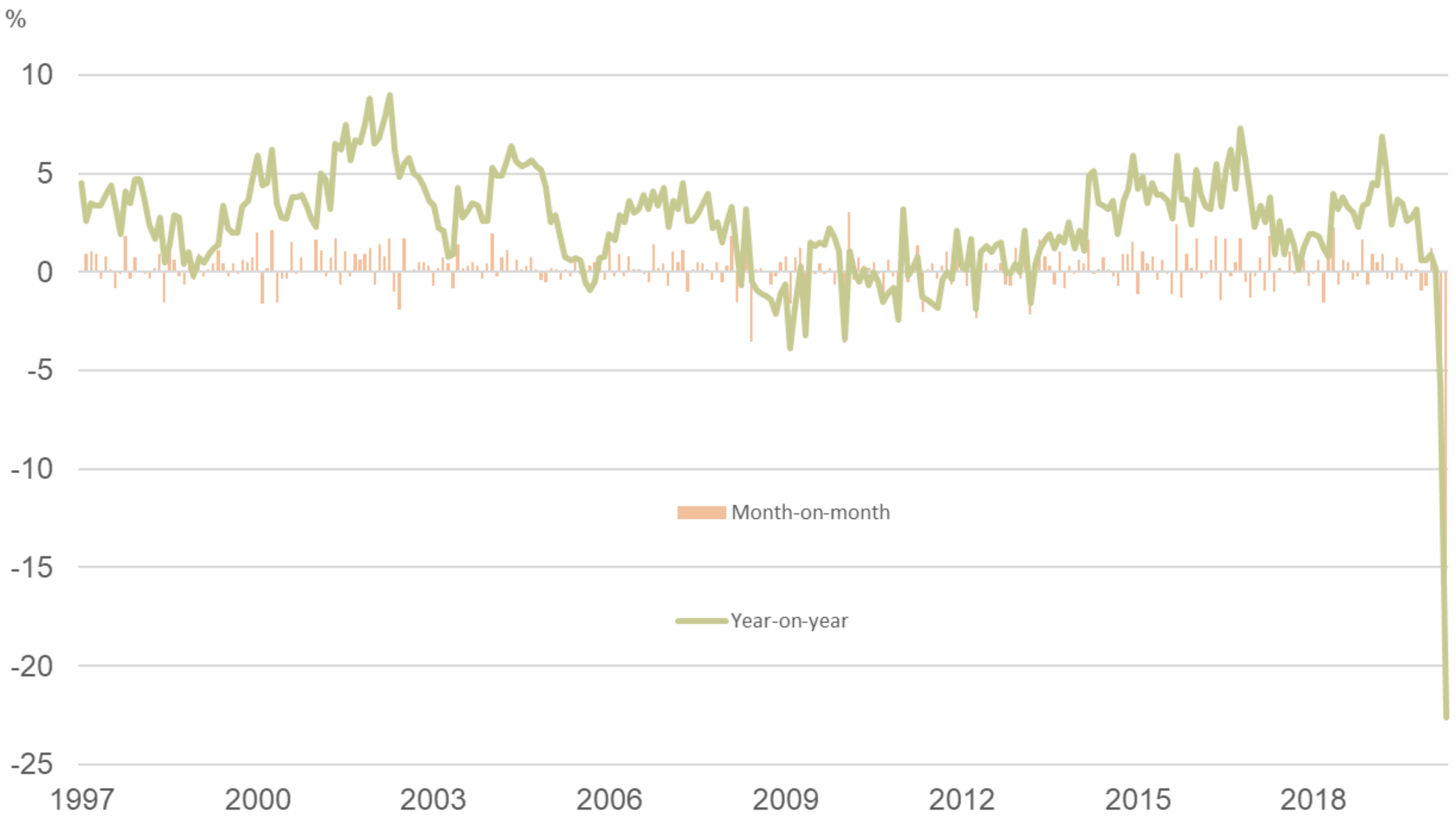
UK: ONS data on change in GDP – 3m on 3m



Source: Oxford Economics/Haver Analytics

Given the nature of the lockdown, retailers have been hard hit

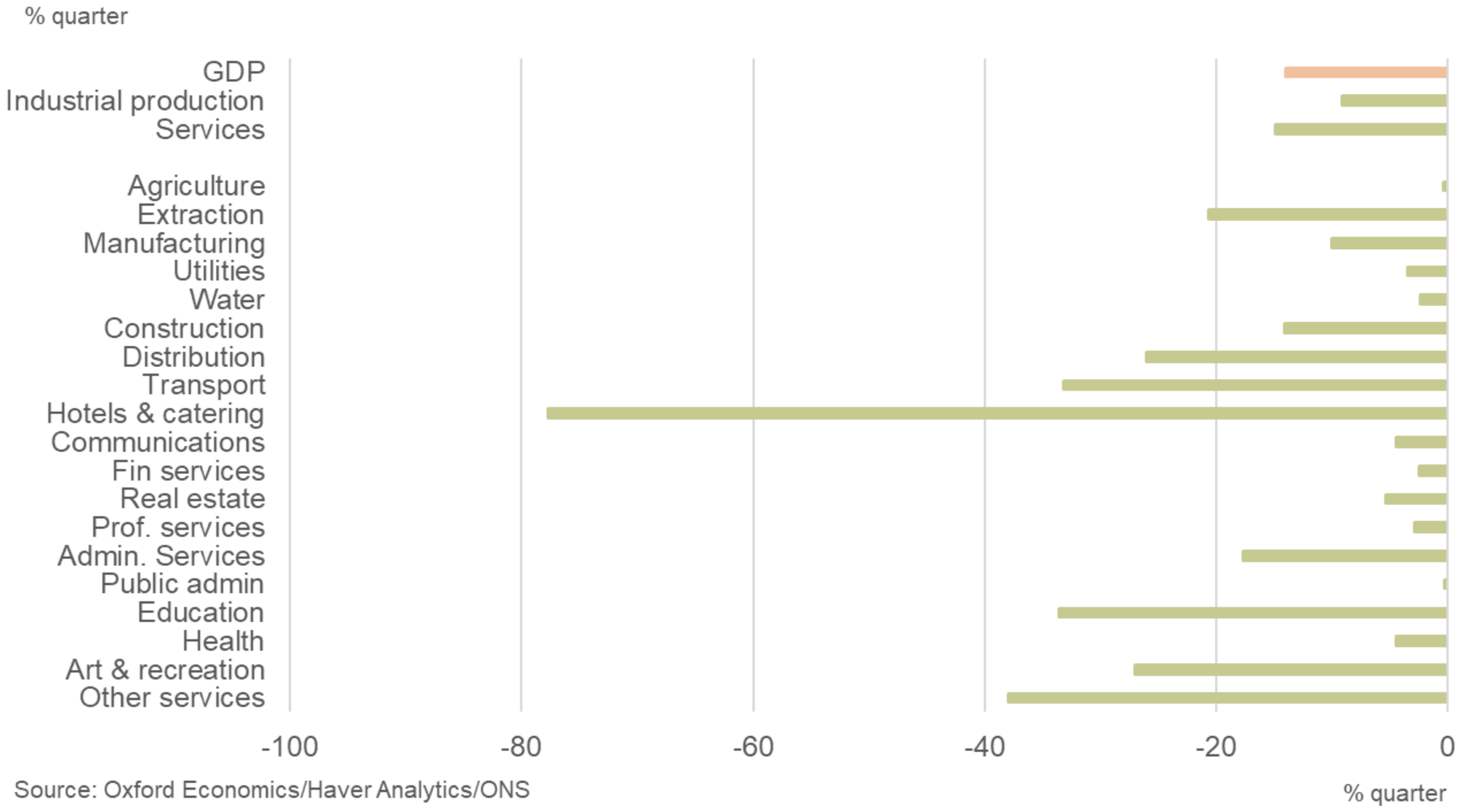
UK: ONS data in retail sales volumes – m on m and y on y



Source: Oxford Economics/Haver Analytics/ONS

March's GDP numbers give us a handle on the likely cost of the lockdown

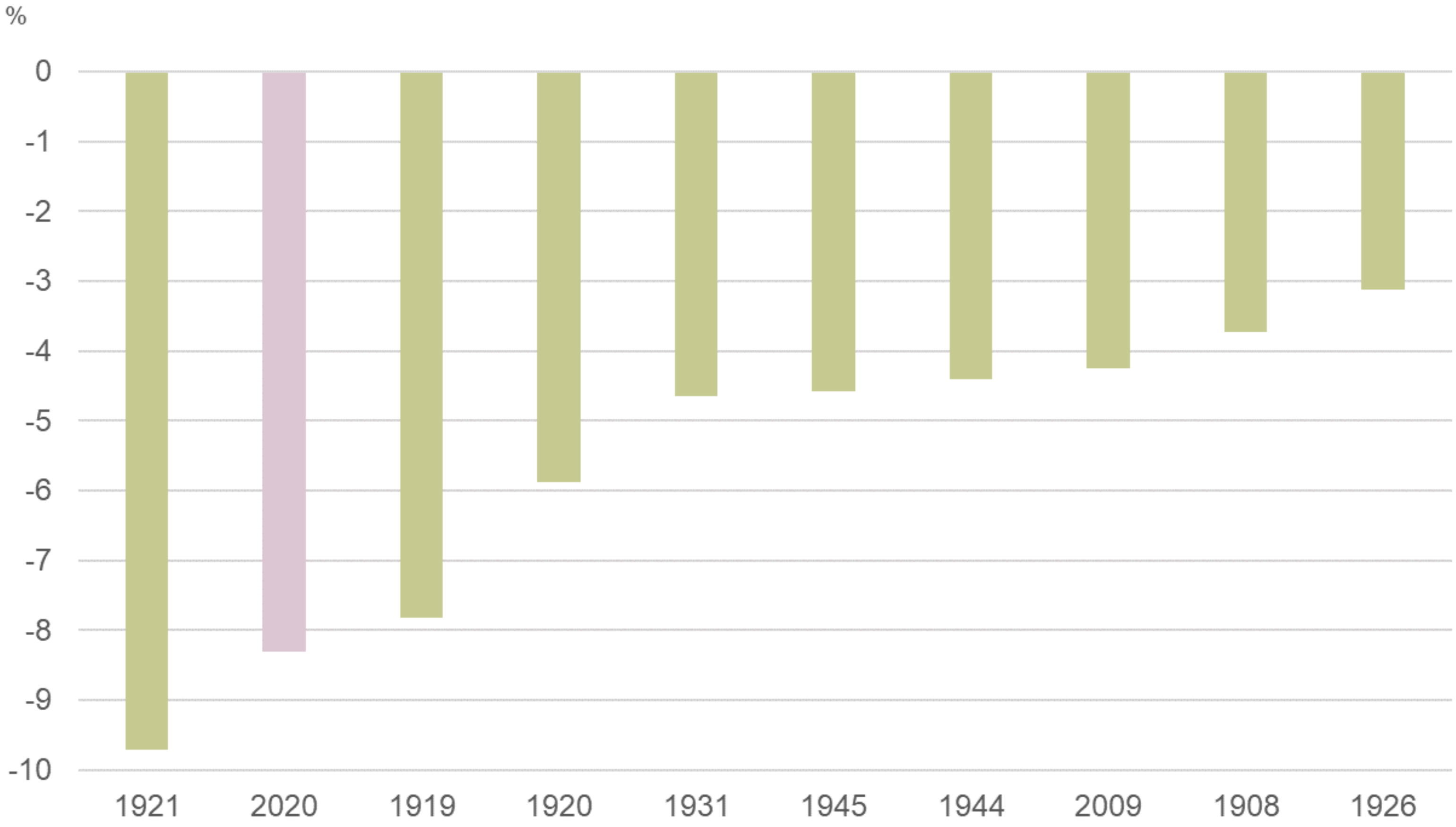
UK: GVA growth, Oxford Economics forecast for Q2



Source: Oxford Economics/Haver Analytics/ONS

Even allowing for a rebound, 2020 is on course for a once-in-century recession

UK: Annual GDP growth, Oxford Economics forecast for 2020
****10 largest declines since 1900. Forecast for 2020.***



Source: Oxford Economics/Bank of England/Haver Analytics

Reasons for optimism

1. **Economy has contracted because of planned, partial, shutdown. Not a 'recession' in the normal sense of the word**

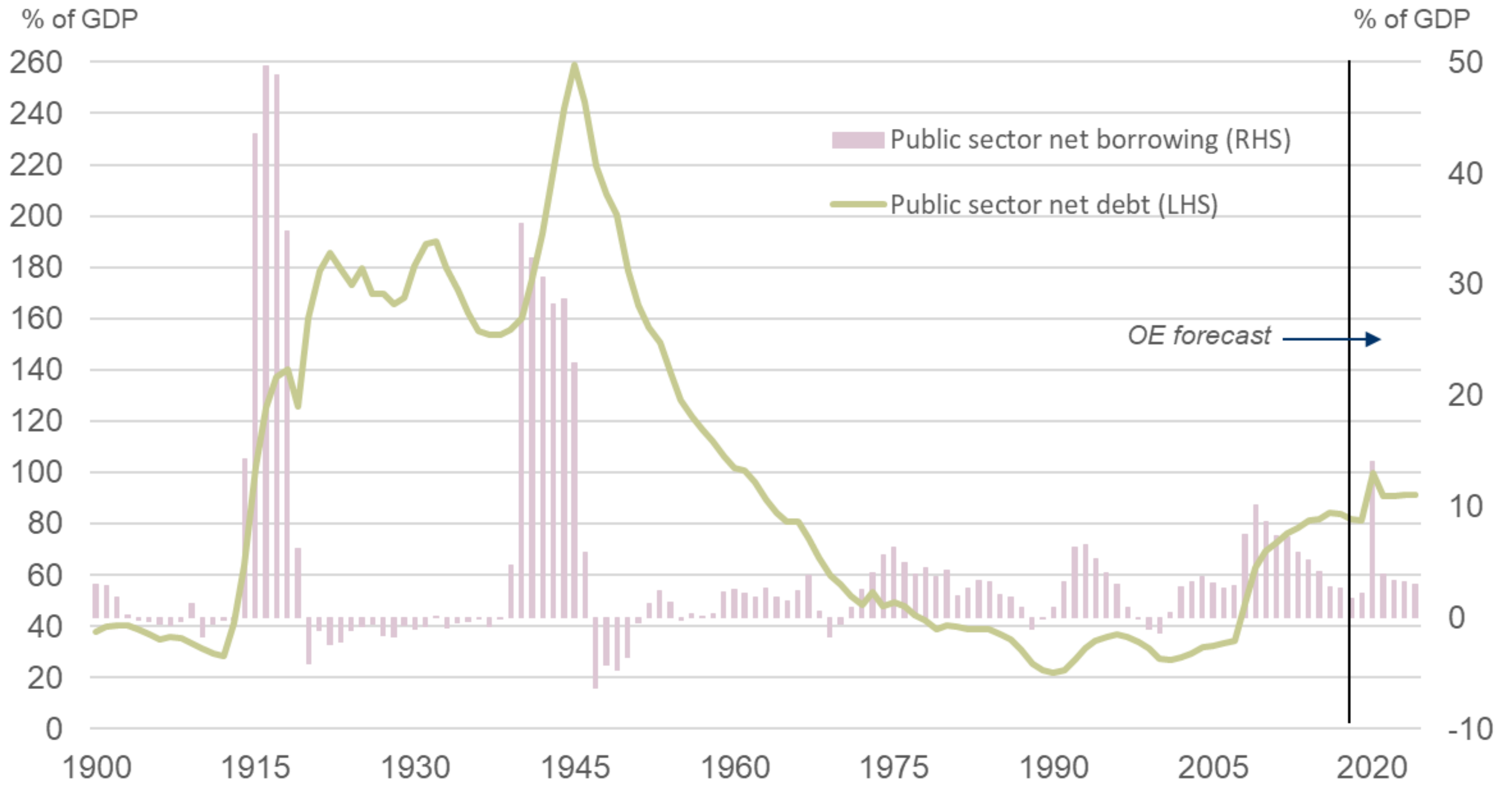
2. **Physical capital – buildings, infrastructure etc. – is unscathed**

3. **Both fiscal and monetary policy have been loosened:.**

- Government is paying 80% of salaries, up to £2,500 per month, for 8m workers
- Support for the self-employed, extra welfare spending, grants, tax holidays and subsidised loans for businesses, and more spending on the NHS
- Monetary policy – cut in official interest rate to its effective floor of 0.1%
- £200bn of asset purchases
- Various schemes to ease credit conditions for businesses

Government borrowing is set to rise to wartime proportions

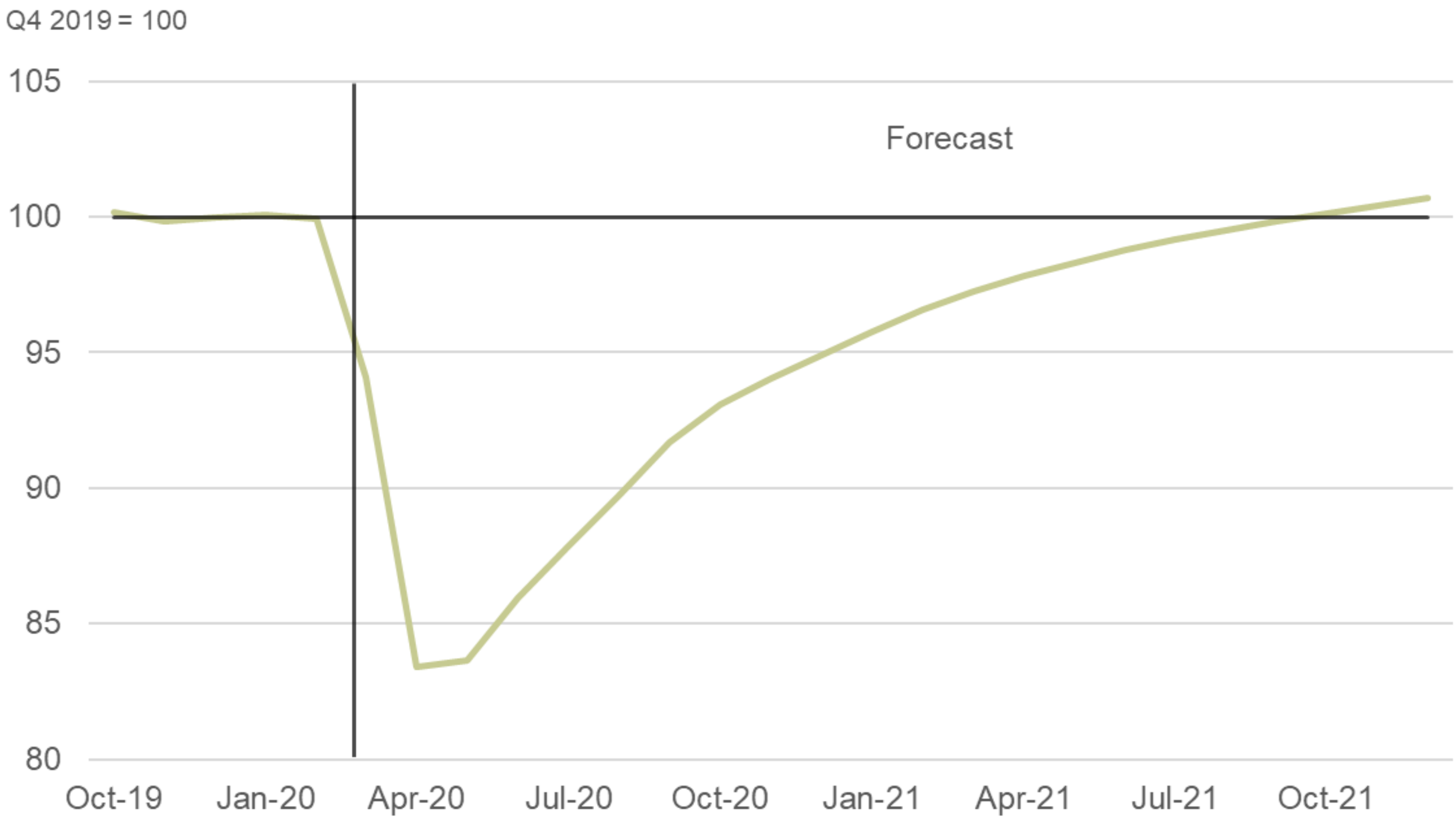
UK: Fiscal aggregates



Source: Oxford Economics/OBR

We expect a strong rebound in growth, but some time before economy regains its pre-pandemic size

UK: Level of GDP



Source: Oxford Economics/Haver Analytics

Economic forecasts are subject to big risks

1. **Coronavirus becomes more virulent and the lockdown period is extended**. The UK economy would suffer a deeper recession in 2020 and the subsequent recovery would be slower.

2. **The virus strikes again later this year and the lockdown is repeated**. A second wave of coronavirus would generate a 'W-shaped' path for the economy, as activity initially rebounded before being hit again.

3. **Long-term damage to the UK economy proves more significant than expected.** Studies have shown that individuals who experience sharp recessions are more cautious in making economic decisions over their lifetimes, and tend to save more.

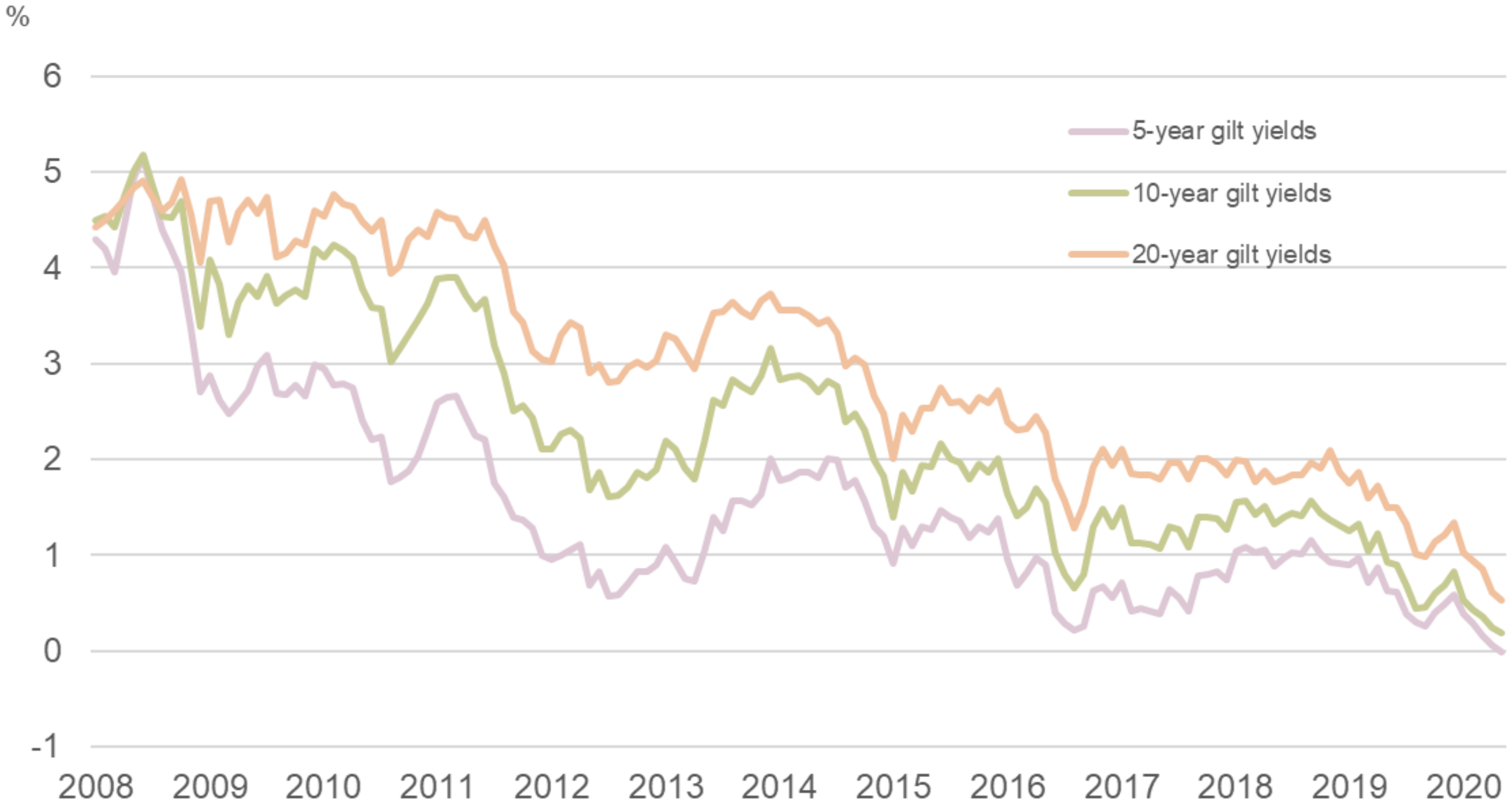
4. **Policy support is withdrawn prematurely.** Given the scale of public borrowing in response to the current crisis, politicians may try to cut the deficit too quickly. Or fears of inflation may prompt the BoE to over-hastily tighten monetary policy.

Longer-term implications

1. Temporary rise in deficit financed at near-zero interest rates does not imply need for future austerity. Interest cost of extra borrowing is near-zero.

At some maturities, the government is being paid to borrow money

UK: Interest rate on UK Government bonds



Source: Oxford Economics/Haver Analytics

Longer-term implications

1. **Temporary rise in deficit financed at near-zero interest rates does not imply need for future austerity. Interest cost of extra borrowing is near-zero.**

2. **A bigger government seems likely post-pandemic, financed by a combination of higher borrowing and higher taxes:**

    - Governments, aided by the support of central banks, have more fiscal space than some previously believed.

    - Borrowing costs are likely to stay low as the economy recovers – no urgency to cut the deficit quickly.

    - Increased demand for redistribution? Support for the creation of the post-war welfare state was founded, in part, upon memories of the economic slump of the 1930s.

    - Crisis has demonstrated the need for more spare capacity in the NHS.

    - Has static ‘efficiency’ in the provision of health care been prioritised too much at the expense of resilience?

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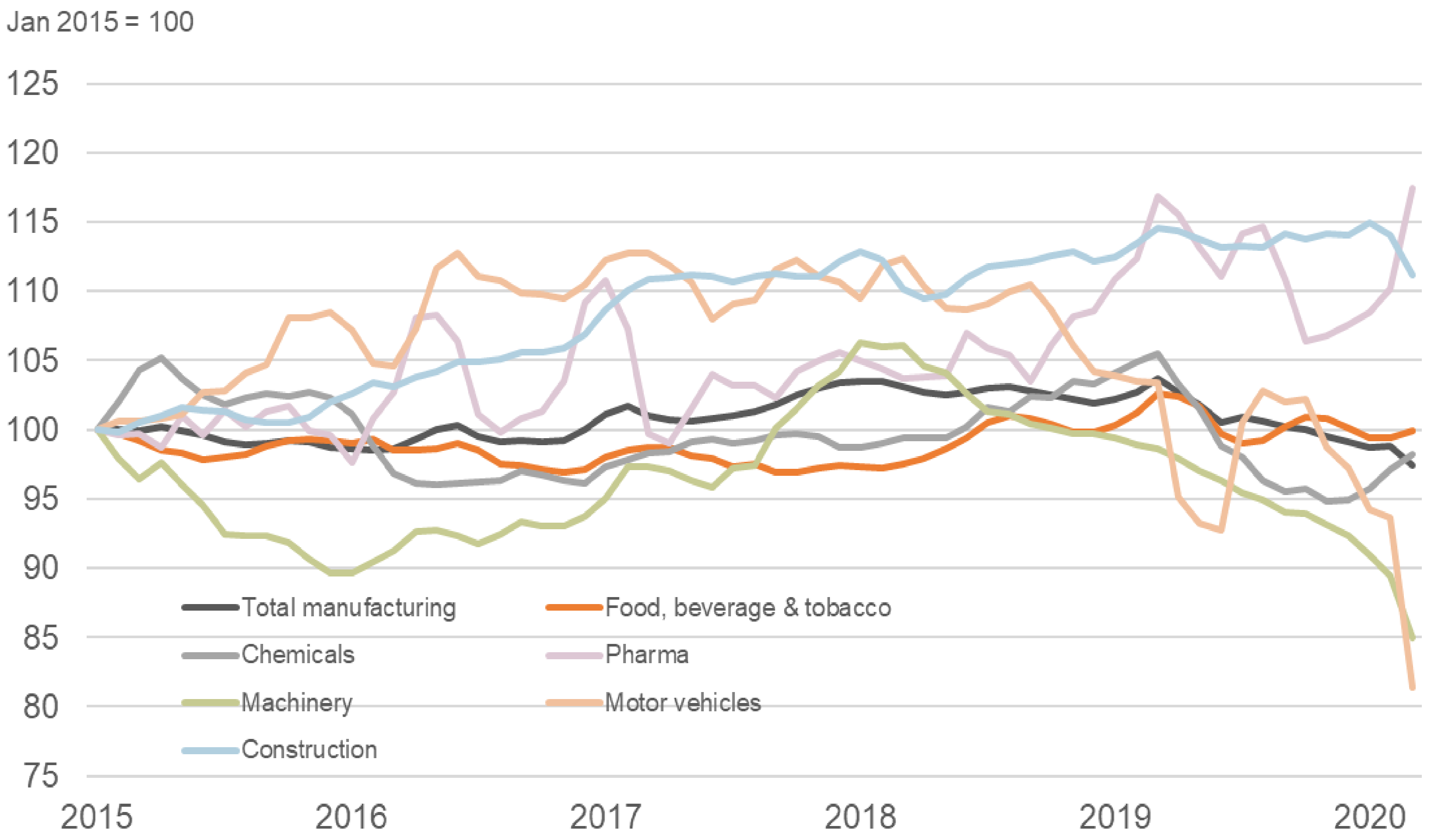
Industrial sectors: some very different experiences to date

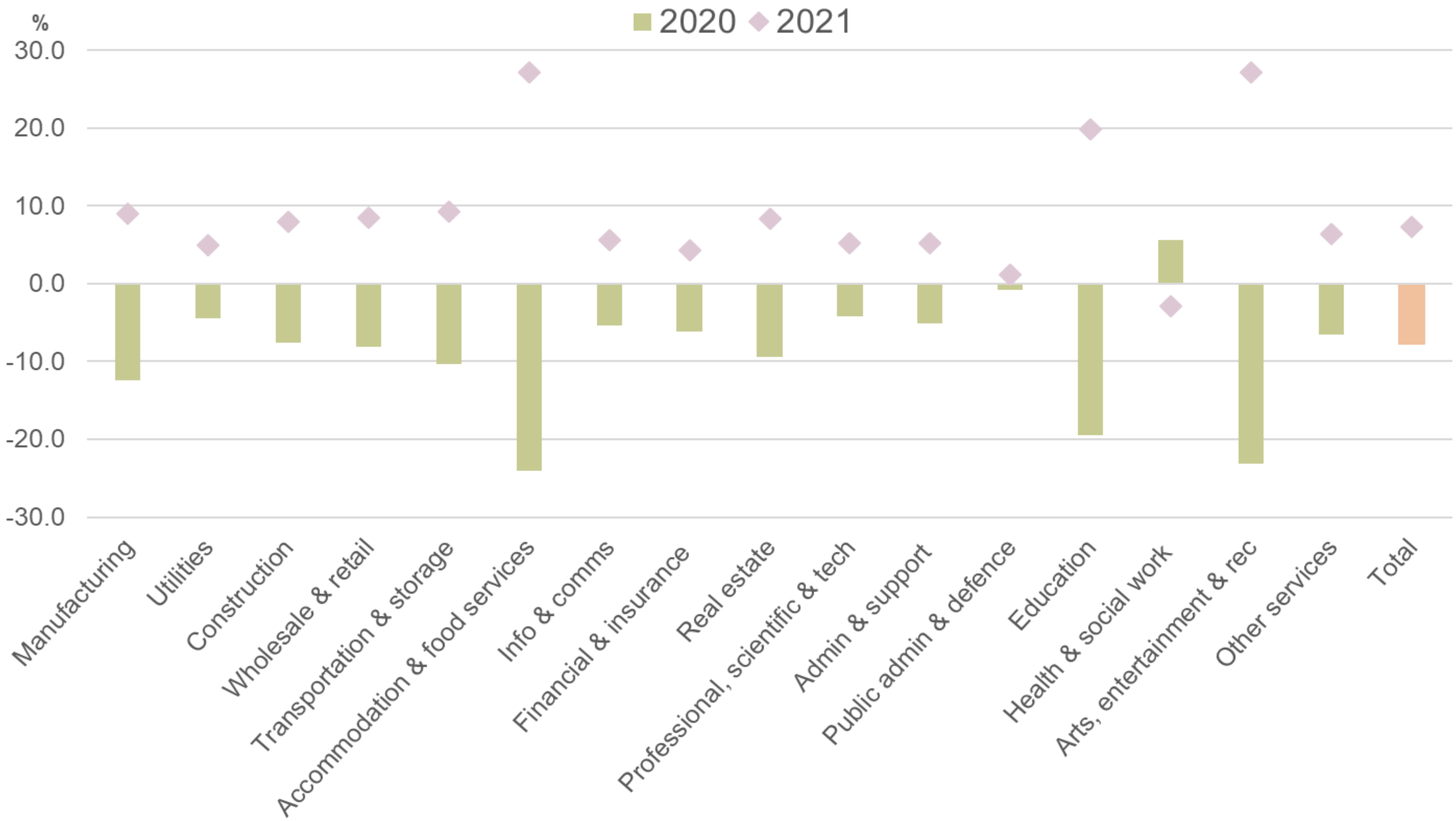
Key sectoral dynamics since 2015, industrial production



Source: Oxford Economics/Haver Analytics

How the 2020 decline and 2021 recovery vary by sector

GVA growth in 2020 and 2021, % y/y



Source: Oxford Economics

The period from 2020 to 2025: which sectors will lead the economy

GVA and employment changes, % y/y 2020-25

Source: Oxford Economics

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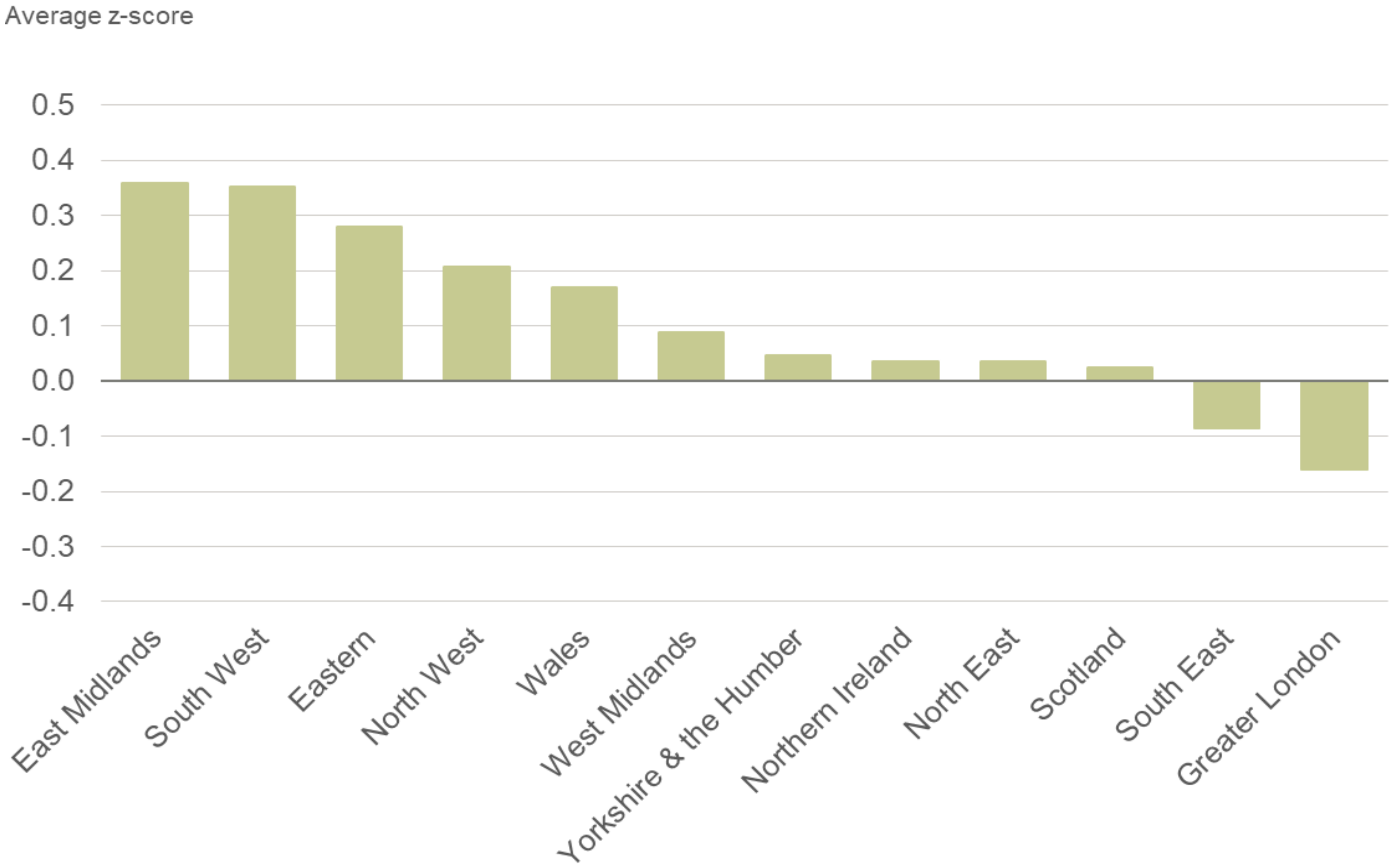
Oxford Economics' Regional Vulnerability Indicators

- Exposure to hospitality, tourism, retail, manufacturing sectors
- Trade intensity
- Share of self-employed
- Share of small firms
- Capacity for working from home (2019 evidence)
- Internet access
- Share of population aged 65+
- Hospital beds relative to population
- Population density

The Vulnerability Indicators give clues as to overall regional challenges

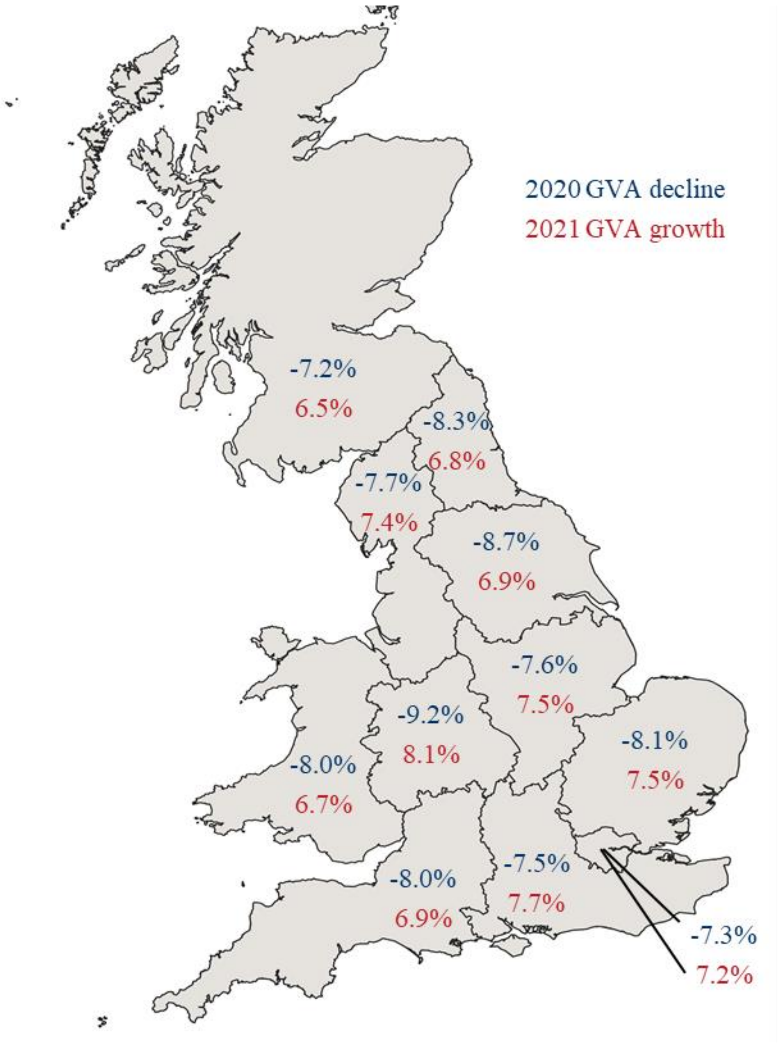
Oxford Economics' Structural Vulnerability Index
Greater than 0 is more exposed than the UK average, less than 0 is less exposed.



Source: Oxford Economics

But the 2020 GVA decline and 2021 recovery also reflect underlying trends

UK regional GVA growth



Source: Oxford Economics

The region probably experiencing the biggest shock: the West Midlands

GVA , % y/y 2015-25

Source: ONS, Oxford Economics

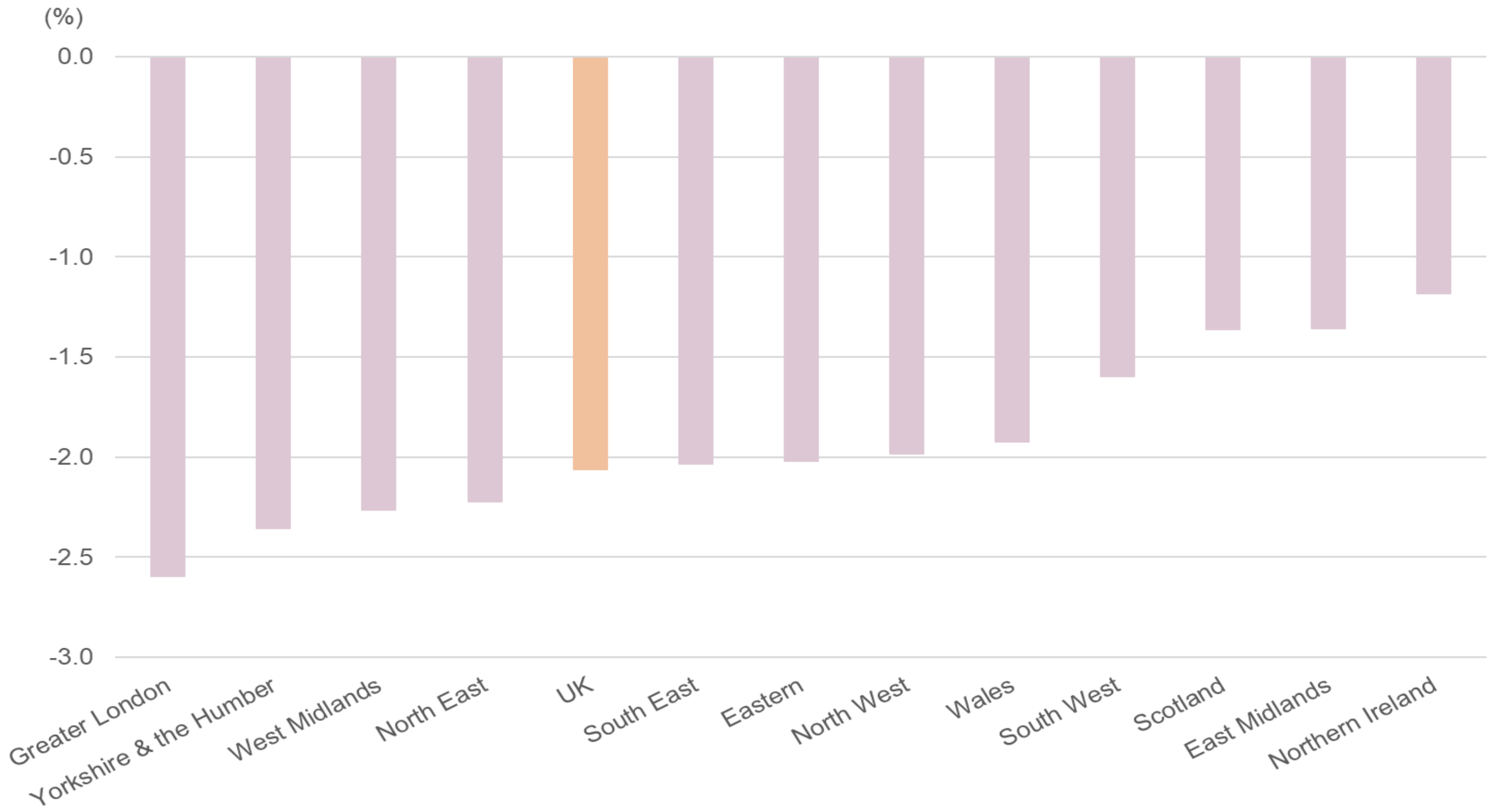
The very mixed experience of the North West in 2020 and 2021

Employment, change, 2020-21

Source: ONS, Oxford Economics

How much damage has been done to regional prospects in 2025?

Percentage difference between December 2019 and May 2020 forecast for the level of GVA in 2025.



Source: Oxford Economics

What will regional inequalities look like in 2025?

Annual average GVA growth 2020-25 and unemployment rate in 2025

Source: Oxford Economics

The North East: declining population cause and consequence of poor economic growth to 2025

Total population growth, % y/y 2015-25

Source: ONS, Oxford Economics

Key points

1. The economy is on course for a once-in-a century downturn.
2. But the nature of the shock creates conditions for a strong rebound.
3. However, unprecedented circumstances mean big risks.
4. Post-pandemic economic model is likely to see big changes.
5. Different sectors: dramatically different experiences. Hospitality, education, culture/sport, some manufacturing, some retail, very hard hit.
6. Feeds through to regional variations. West Midlands worst hit in 2020, London least hit.
7. Long established patterns of regional inequality are probably not being altered.

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