UK Economics

Acute Crisis to Tricky Recovery: The Key Questions

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures

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Prepared for Benjamin Nabarro

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A marked rebound, but key uncertainties remain

Most expect restrictions to hit the UK economy hard in Q1. A rebound in the latter three quarters of 2021 is likely. The key question is how ‘complete’ the recovery will prove. The outlook here remains highly uncertain.

Why the recovery may prove incomplete

A complete economic recovery requires a rapid return to pre-Covid ‘normality.’ We think this is unlikely. While the vaccination effort should remove the risk of national lockdown, some Covid-related effects are likely to persist.

● **Vaccine: No magic bullet**
  – The vaccines seem to offer protection against severe disease for most. But they will not 1) protect health capacity alone nor 2) keep $r$ below 1.

● **A rebound to come…** - the vaccine will reduce the risks to UK health system. This should mean the end of lockdowns.

● **… But some social distancing to remain** to reduce the risk of potential mutations. Early evidence suggests precautionary behaviour should also be expected to continue.

Source: ONS and Citi Research. See: UK Economics View - From Acute Crisis to Tricky Recovery: The Five Key Questions; UK Economics View: Why the UK may emerge from COVID-19 an underperformer; UK economic outlook: the long road to recovery; European Economics Weekly: The UK’s Economic Recovery From Covid: A Tragedy in Three Parts
Why the UK economy is more at risk of ‘long-Covid’

We expect the lingering effects to weigh more heavily on UK output than elsewhere. This is a function of a higher share of social consumption and an urbanised economic geography.
Accumulated savings: Don’t get carried away

Households have accumulated around £125bn during the pandemic. We expect only a relatively small portion of this to boost consumption in 2021. Instead a large portion of this money seems to be flowing into housing.

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**Household Saving and Major Purchase Intentions, Q3 2020**

(% Bal.)

<table>
<thead>
<tr>
<th>Savings</th>
<th>Major Purchases</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;£20,000</td>
<td>-20%</td>
</tr>
<tr>
<td>£20,000 - £34,999</td>
<td>-15%</td>
</tr>
<tr>
<td>£35,000 - £54,999</td>
<td>-10%</td>
</tr>
<tr>
<td>£55,000+</td>
<td>-5%</td>
</tr>
</tbody>
</table>

**New Gross Mortgage Lending and Housing Transactions Value**

(% YY)

- New Mortgage Lending
- Value of Housing Transactions

Brexit: Still hitting hard

Since 2016 the UK has enjoyed the benefits of weak sterling, without of the actual costs of Brexit. These dynamics are now reversing. Early evidence points to acute trade disruption owing to both Covid and Brexit. We expect some of these effects to persist.

GDP Deviation to ‘No Brexit’ Scenario

Source: OBR, ONS and Citi Research. See: UK Economics View - From Acute Crisis to Tricky Recovery: The Five Key Questions; UK Economics View: Why the UK may emerge from COVID-19 an underperformer; UK Economics View: Brexit: A deal done, but significant pain still to come

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Investment: Lagging not leading the recovery

The near term outlook remains challenged. We expect both Covid and Brexit to drive write downs. 1) Higher debt, 2) marking down of assets and 3) fewer high growth firms are also likely to weigh in the medium-term.

Labour market vulnerability remains

Redundancies spiked in 2020 as the government planned to wind down the furlough scheme. The effect abated as support was extended. However we expect a marked pick up again in 2021, weighing on the recovery.

- The underlying picture is likely worse than the headline data suggests
- Many redundancies have been deferred, but not prevented. Reconfiguration poses additional challenges.
- Weak demand is likely to be reinforced by growing redundancies, slowing the recovery

Source: HMRC, ONS BICS and Citi Research See: UK Economics View - From Acute Crisis to Tricky Recovery: The Five Key Questions; UK Economics View - When the tide recedes: Emerging risks to the UK labour market
Inflation through Covid: Expectations the key risk

Inflation through Covid has been characterised by 1) headline resilience and 2) growing dispersion. We expect these themes to continue into 2021. The key risk remains a further increase in household inflation expectations.
Policy: Stuck in the 1990s?

Having proven generous in 2020, we expect UK fiscal support to be dialled down quickly in 2021. If the recovery lags, this will leave the Bank of England trying to more alone – most likely via negative rates.

- **Fiscal policy: Carrying the mantle** – Fiscal policy has so far carried the primary burden for economic support during the pandemic.

- **Three roles** – Fiscal policy has to replace incomes during the pandemic, stimulate the economy out of the downturn and also facilitate reconfiguration thereafter. Policy in the latter two cases is particularly important now. We expect disappointment.

- **The Bank will have to react** – The Bank is likely to react to higher unemployment, most likely with negative interest rates. More may be possible with further asset purchases, but if fiscal policy is tight these would likely do little.

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Note: APF Purchases and changes in net debt expressed as a share of GDP. Bank rate expressed as an annual rate. Note: Figures calculated using OBR estimates of fiscal multipliers. Sources: OBR, ONS, Bank of England and Citi Research See: From Acute Crisis to Tricky Recovery: The Five Key Questions; The Long Fiscal Shadow of COVID-19

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Conclusion: 3 Scenarios for 2021

The economic outlook remains unusually uncertain. On the upside, the recovery in private consumption could prove more complete, and the labour market robust. On the downside, the vaccinations may not do enough to obviate the need for further lockdowns next winter – especially given the ongoing risk of mutation.

UK – Real GDP, 3 Scenarios
(£ 2018 bn)

Source: ONS and Citi Research. See: UK Economics View - From Acute Crisis to Tricky Recovery: The Five Key Questions; European Economics Weekly: The UK’s Economic Recovery From Covid: A Tragedy in Three Parts

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Appendix A-1

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