United Kingdom

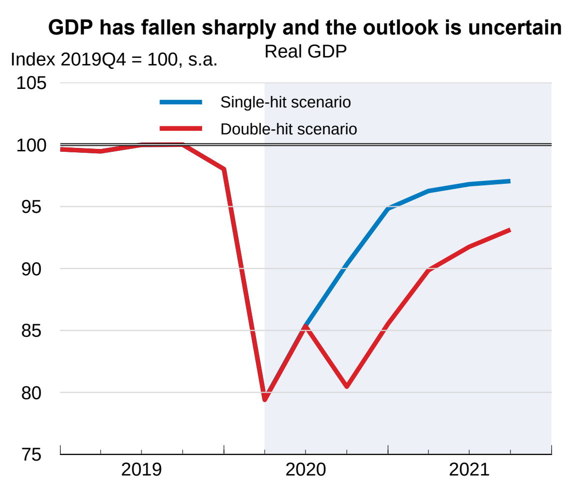
The COVID-19 crisis has led to a severe economic contraction. GDP is projected to fall by 14% in 2020 if there is a second virus outbreak later in the year (the double-hit scenario). An equally likely single-hit scenario would still see GDP fall sharply by 11.5%. In the double-hit scenario, the unemployment rate is set to more than double to 10% and remain elevated throughout 2021, despite widespread use of furloughing. Measures to limit the effects of the crisis in that scenario would push the fiscal deficit up to at least 14% of GDP in 2020.

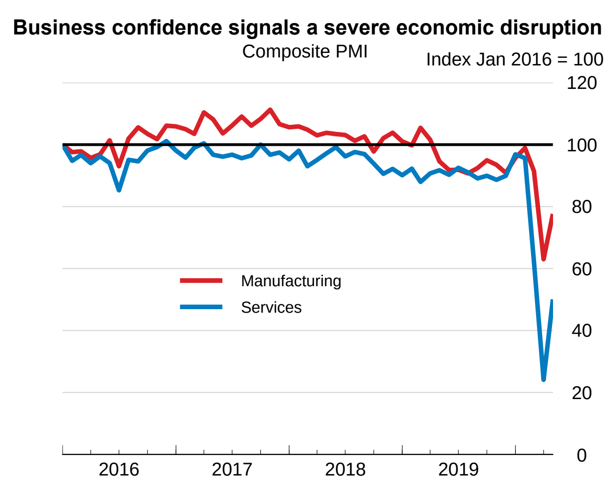
The government swiftly put in place a comprehensive economic support package. Fiscal measures include income support for workers and self-employed, around GBP 330 billion in state loan guarantees to keep firms in business, tax deferrals, and an improved dispute resolution mechanism as an alternative to bankruptcy. Moving forward, these measures should be kept in place as long as they are needed and fiscal policy should remain supportive. Higher unemployment benefits should be extended beyond the fiscal year 2020-21 to help support demand during the recovery. Given the economic disruption caused by COVID-19, a temporary extension of existing trading relationships with the EU beyond the end of 2020 would help reduce uncertainty. Public investment supporting the recovery should underpin progress in digitalisation, sustainability and inclusiveness.

Containment measures have helped to slow the spread of COVID-19

The United Kingdom has been relatively hard hit by the COVID-19 crisis. Transmission within the United Kingdom was first documented on 28 February, and the virus has spread rapidly. Among the most affected were people in nursing homes. Since strict containment measures were implemented, the health situation remains under control and the number of daily confirmed deaths peaked in mid-April. The government announced a GBP 6 billion emergency response fund for the National Health Service. The health system scaled up rapidly, doubling the number of critical care beds within a month and rapidly expanding its testing and tracing capacity, which has helped keep the heath crisis under control.

United Kingdom 1





Source: OECD Economic Outlook 107 database; and Markit.

StatLink https://doi.org/10.1787/888934140012

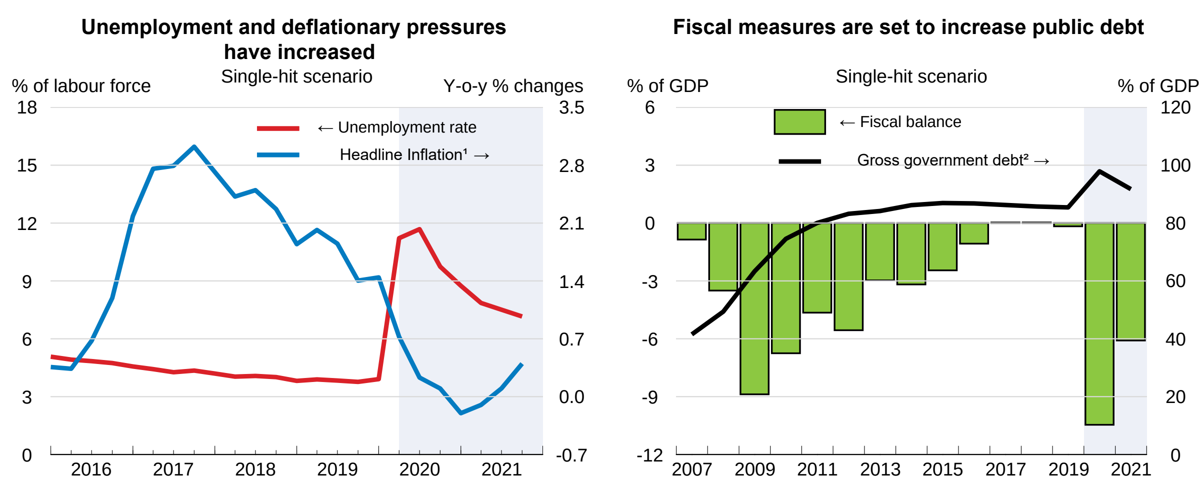
United Kingdom: Demand, output and prices (double-hit scenario)

United Kingdom: double-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices GBP billion	Percentage changes, volume (2016 prices)				
GDP at market prices	1 995.5	1.9	1.3	1.4	-14.0	5.0
Private consumption	1 299.1	2.2	1.6	1.1	-18.5	5.2
Government consumption	381.5	0.3	0.4	3.5	11.2	4.0
Gross fixed capital formation	343.7	1.6	-0.2	0.6	-23.6	4.8
Final domestic demand	2 024.3	1.7	1.1	1.4	-13.6	4.8
Stockbuilding[1]	3.5	-0.6	0.3	0.2	-0.7	0.1
Total domestic demand	2 027.8	1.2	1.3	1.7	-14.3	4.9
Exports of goods and services	567.5	6.1	1.2	4.8	-16.9	-2.9
Imports of goods and services	599.8	3.5	2.0	4.6	-18.1	-2.8
Net exports[1]	- 32.3	0.7	-0.3	0.0	0.6	0.0
Memorandum items						
GDP deflator	_	1.9	2.1	1.9	1.5	0.5
Harmonised index of consumer prices	_	2.7	2.5	1.8	0.6	0.0
Harmonised index of core inflation[2]	_	2.3	2.1	1.7	0.8	0.3
Unemployment rate (% of labour force)	_	4.4	4.1	3.8	10.4	10.0
General government financial balance (% of GDP)	_	-2.4	-2.2	-2.1	-14.2	-12.1
General government gross debt (% of GDP)	_	119.9	116.6	116.1	142.2	148.6
General government debt, Maastricht definition (% of GDP)	_	86.2	85.7	85.4	100.7	98.3
Current account balance (% of GDP)	_	-3.5	-3.9	-3.8	-3.6	-3.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934138891

United Kingdom 2



1. Harmonised consumer price index (HICP). Projection from 2020Q1.
2. Maastricht definition.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934140031

United Kingdom: Demand, output and prices (single-hit scenario)

United Kingdom: single-hit scenario	2016 Current prices GBP billion	2017	2018	2019	2020	2021
		Percentage changes, volume (2016 prices)				
GDP at market prices	1 995.5	1.9	1.3	1.4	-11.5	9.0
Private consumption	1 299.1	2.2	1.6	1.1	-15.2	12.2
Government consumption	381.5	0.3	0.4	3.5	10.1	1.3
Gross fixed capital formation	343.7	1.6	-0.2	0.6	-20.3	7.2
Final domestic demand	2 024.3	1.7	1.1	1.4	-11.2	8.8
Stockbuilding[1]	3.5	-0.6	0.3	0.2	-0.7	0.1
Total domestic demand	2 027.8	1.2	1.3	1.7	-11.8	8.9
Exports of goods and services	567.5	6.1	1.2	4.8	-15.8	-1.1
Imports of goods and services	599.8	3.5	2.0	4.6	-17.0	-1.0
Net exports[1]	- 32.3	0.7	-0.3	0.0	0.6	0.0
Memorandum items						
GDP deflator	_	1.9	2.1	1.9	1.5	0.8
Harmonised index of consumer prices	_	2.7	2.5	1.8	0.7	0.6
Harmonised index of core inflation[2]	_	2.3	2.1	1.7	0.8	0.8
Unemployment rate (% of labour force)	_	4.4	4.1	3.8	9.1	7.8
General government financial balance (% of GDP)	_	-2.4	-2.2	-2.1	-12.4	-7.8
General government gross debt (% of GDP)	_	119.9	116.6	116.1	137.7	136.2
General government debt, Maastricht definition (% of GDP)	_	86.2	85.7	85.4	97.9	91.7
Current account balance (% of GDP)	_	-3.5	-3.9	-3.8	-3.5	-3.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 107 database.

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An economy-wide lockdown was introduced on 23 March, somewhat later than in neighbouring countries. Since then, all social events and gatherings have been banned, and all shops selling non-essential goods closed. The government announced a gradual easing of restrictions in England on 13 May, starting with the opening of manufacturing and construction sectors. If the health situation remains under control, a second phase would see the reopening of non-essential retail stores on 15 June, followed by the hospitality and entertainment sectors in July.

The economy is contracting sharply

As a service-based economy, the United Kingdom is heavily affected by the crisis. Trade, tourism, real estate and hospitality are all hard hit by confinement restrictions. Sectoral estimates indicate that stay-at-home measures could reduce output directly by one-third. Business and consumer confidence fell to all-time lows in April, before stabilising in the wake of the easing of confinement measures in May. 856 thousand new unemployment benefit claims (2.5% of the labour force) were registered in April, and 8.4 million workers (24.4% of the labour force) were furloughed by the end of May. Financial market uncertainty reached high levels. The FTSE 100 equity index has declined by 20% between mid-February and the end of May, and the volatility of government bonds and the sterling exchange rate have increased.

A prompt policy response supports the economy

The government reacted promptly to the crisis and put in place a substantial set of economic support measures, including 5% of GDP in discretionary spending, to support business and households. The Coronavirus Job Retention Scheme provides companies with 80% of furloughed workers' salaries. In addition, self-employed receive a taxable grant of up to 80% of their previous earnings over the past three years. The government also increased basic unemployment support, raising the levels of net income that a worker maintains when falling out of work from 56% to 63%. Nonetheless, unemployment benefits remain below levels in other advanced European economies. Furthermore, it set aside GBP 40 billion of tax deferrals. The GBP 330 billion Covid Corporate Financing Facility, run jointly with the Bank of England, and the Coronavirus Business Interruption Loan Scheme provide state loans and guarantees for businesses affected by the crisis. However, co-financing requirements of 20% limit the take-up among smaller businesses.

Monetary policy has appropriately further eased in the context of increased financial stress. The Bank of England cut interest rates from 0.75% to 0.10% and announced an increase of its bond-purchasing programme by GBP 200 billion (9% of GDP), to a total of GBP 645 billion. It temporarily extended the Ways and Means facility that allows the government to increase spending without the need to turn to the markets, and reduced the counter-cyclical capital buffer to preserve banks' capacity to lend to households and firms.

The recovery will be gradual

In the double-hit scenario, a second wave of the virus and new restrictions would put an abrupt halt to the pickup in economic growth in the fourth quarter this year, leading to a fall in GDP by 14% in 2020. Growth is expected to recover to 5% in 2021 as confinement measures ease. Employment will remain below pre-crisis levels and the unemployment rate will stay at around 10%. While the government's job retention scheme will preserve some jobs, it will probably not be able to fully offset lasting effects on employment. A higher unemployment rate will damp wage growth and subdue consumption, and limited unemployment benefits may encourage jobseekers to take on less qualified jobs. Investment growth is projected to remain subdued and the outlook for trade remains weak. If the United Kingdom moves to a basic free trade agreement with the European Union at the end of 2020, as assumed in the projections, trade costs will increase and exports will fall in 2021. In the equally likely single-hit scenario, where a seven-week lockdown is gradually eased from 13 May, GDP is projected to decline by 11.5% in 2020, with activity picking up from the third quarter of 2020. Weak business and consumer confidence, the rise in unemployment, and the uncertainty about ongoing restrictions slow the recovery. GDP levels will remain more than 5% below the level projected before the crisis by the end of 2021 in the single-hit scenario. Economic measures to tackle the crisis and the sharp fall in revenues will lead to a substantial fiscal deficit.

In addition to a more extended lockdown period, downside risks come from the risk of longer-term scarring of the economy due to higher unemployment and business closures. There is considerable uncertainty about how prolonged restrictions on activity or lower than expected demand would affect financial stability. A failure to provide credit to capital-weak small enterprises would result in higher business failures and unemployment, while a larger-than-expected fall in house prices might weigh on banks' capital buffers and reduce their lending capacity at a critical time. Moreover, risks around the future relationship with the European Union compound COVID-19-related uncertainty, including whether a free trade agreement can be negotiated before the end of 2020. The failure to conclude a trade deal with the European Union by the end of 2020 or put in place alternative arrangements would have a strongly negative effect on trade and jobs.

Further policy action will be needed to support the recovery

Economic measures should be kept in place as long as needed and fiscal policy should remain supportive. As stay-at-home measures are lifted, policy should gradually shift from temporary measures to preserve existing businesses and jobs towards general demand support. Extending the higher unemployment support replacement rate and the suspension of the Universal Credit minimum income floor beyond the fiscal year 2020-21 could support demand and inclusiveness during the recovery. Furthermore, the government should stand ready to extend the furloughing scheme in case of a renewed lockdown. Fast resolution of insolvent firms will be key to a speedy recovery. Streamlined debt resolution schemes may be helpful. To avoid otherwise solvent firms going bankrupt, the government could consider improving access of capital-weak SMEs to existing loan schemes by temporarily easing co-financing requirements, while keeping strict monitoring in place. The government should also consider temporarily postponing future increases in the National Living Wage to support labour demand and facilitate the reallocation of labour towards sectors that may face labour shortages, in line with current institutional arrangements and advice from the Low Pay Commission. Further ahead, the COVID-19 crisis will lead to permanent structural shifts in the economy and policy should support a more sustainable and inclusive re-adjustment. This could entail adjusting plans for public investment in line with digital, sustainable and inclusive growth targets, for example by increasing carbon taxation, reducing the tax wedge between self-employed and regular employees, and shifting funds within the National Productivity Investment Funds towards digital infrastructure. The United Kingdom should make a temporary arrangement to stay in the EU Single Market beyond 31 December 2020 given the pressures firms already face from COVID-19.

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