Article

Quarterly economic commentary: April to June 2020

Economic commentary for the latest quarterly national accounts, prices and labour market indicators.

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Table of contents

1 . Main points

- UK gross domestic product (GDP) contracted by a record 19.8% in Quarter 2 (Apr to June) 2020, following a decline of 2.5% in the previous quarter, as a result of the coronavirus (COVID-19) pandemic and the restrictions subsequently applied in the UK.

- The households saving ratio hit a record high of 29.1% in Quarter 2, reflecting an increase in voluntary and involuntary savings; the households net lending position was primarily financed by increasing the amount of currency and deposits placed with financial institutions.

- There have been pronounced cross-border financial flows in the first half of this year as part of the response of financial markets around the start of the coronavirus pandemic; there appears to have been some unwinding of these effects, as the UK reduced its gross external assets and gross external liabilities in loans and deposits in the most recent quarter.

- Total hours worked remains considerably lower than levels before restrictions were applied, as the volume in the three-month period of May to July was 9.8% lower than the three-month period February to April.

- The annual Consumer Prices Index including owner occupiers' housing costs (CPIH) inflation rate fell to 0.5% in August 2020, reflecting the impact of the Eat Out to Help Out Scheme and the reduced rate of Value Added Tax (VAT) applicable to firms in the hospitality industry.

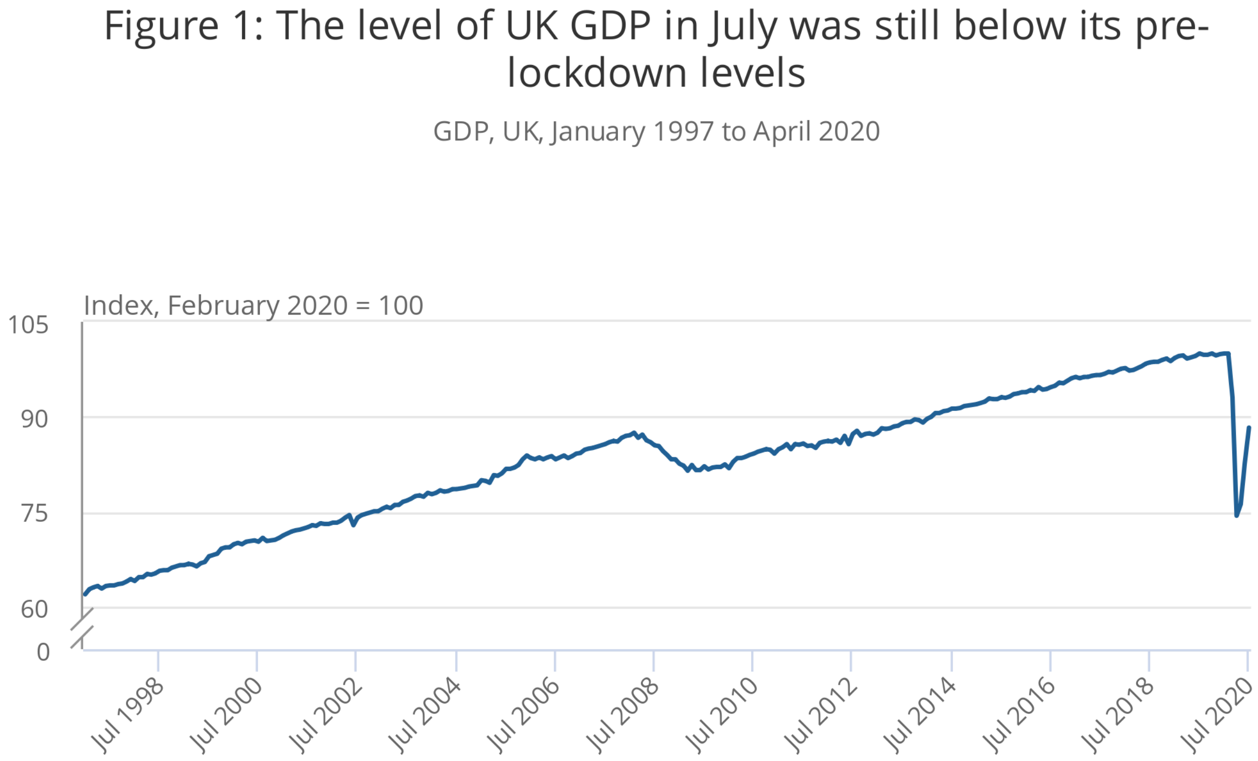
2 . Gross domestic product

UK gross domestic product (GDP) contracted by a record 19.8% in Quarter 2 (Apr to June) 2020, following a decline of 2.5% in the previous quarter, as a result of the coronavirus (COVID-19) pandemic and restrictions subsequently applied in the UK. These include the mandatory closures of non-essential businesses and voluntary social distancing to protect public health. This has been reflected in widespread falls in output produced by services, production, and construction industries, as well as by sharp reductions in spending by households and businesses in the UK and the rest of the world.

More timely estimates[1] show the extent to which the UK economy has recovered the cumulative 25.6% contraction in GDP through March and April 2020 (Figure 1). Despite the increase in activity in recent months, the level of GDP is still considerably lower than it was in February. GDP increased by a further 6.6% in July, following monthly increases in May and June, as some of the restrictions imposed to contain the spread of the coronavirus were lifted over this period. The coronavirus pandemic has also had an impact on the labour market, specifically the large decline in total weekly hours worked, which remains relatively low, although there have been some signs of recovery in the three months to July 2020.

Figure 1: The level of UK GDP in July was still below its pre-lockdown levels

GDP, UK, January 1997 to April 2020



Source: Office for National Statistics – GDP Monthly Estimate, UK: July 2020

Notes:

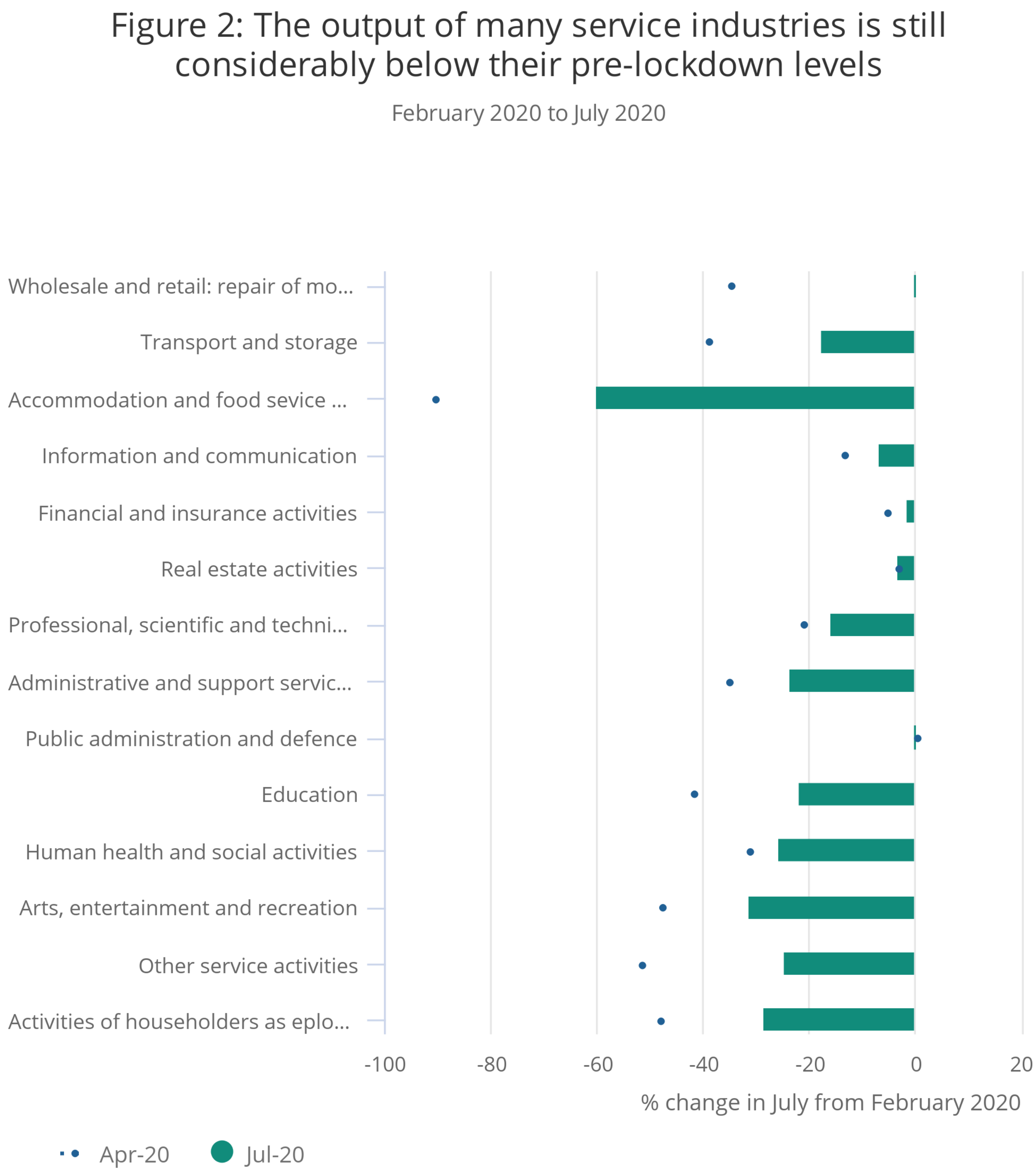
1. The latest official estimates of monthly GDP do not reflect the revisions that have been incorporated as part of the latest Quarterly National Accounts, released 30 September 2020. As such, these monthly figures are not fully consistent with the latest quarterly estimates.

The pickup in GDP in July reflected the increase in services output, particularly in education, wholesale and retail, and accommodation and food services. Recent analysis shows a timeline of the easing of lockdown restrictions in the UK, which had significant impacts on the monthly profiles of education, motor trades, pubs and restaurants, personal services, and hotels and accommodation. Figure 2 shows the relative performance of the service industries, showing the initial decline between February and April and how much of that fall has been recovered by July.

The output levels of most of these industries are still considerably below levels before restrictions were applied, most notably in the accommodation and food services, and arts, entertainment and recreation industries. In contrast, wholesale and retail has recovered much of its loss and is now broadly in line with levels before restrictions were applied. More timely figures show that the volume of retail sales in August is now 4.0% higher than February's level, much of which reflects the move to non-store retailing in recent months.

Figure 2: The output of many service industries is still considerably below their pre-lockdown levels

February 2020 to July 2020



Source: Office for National Statistics – GDP Monthly Estimate, UK: July 2020

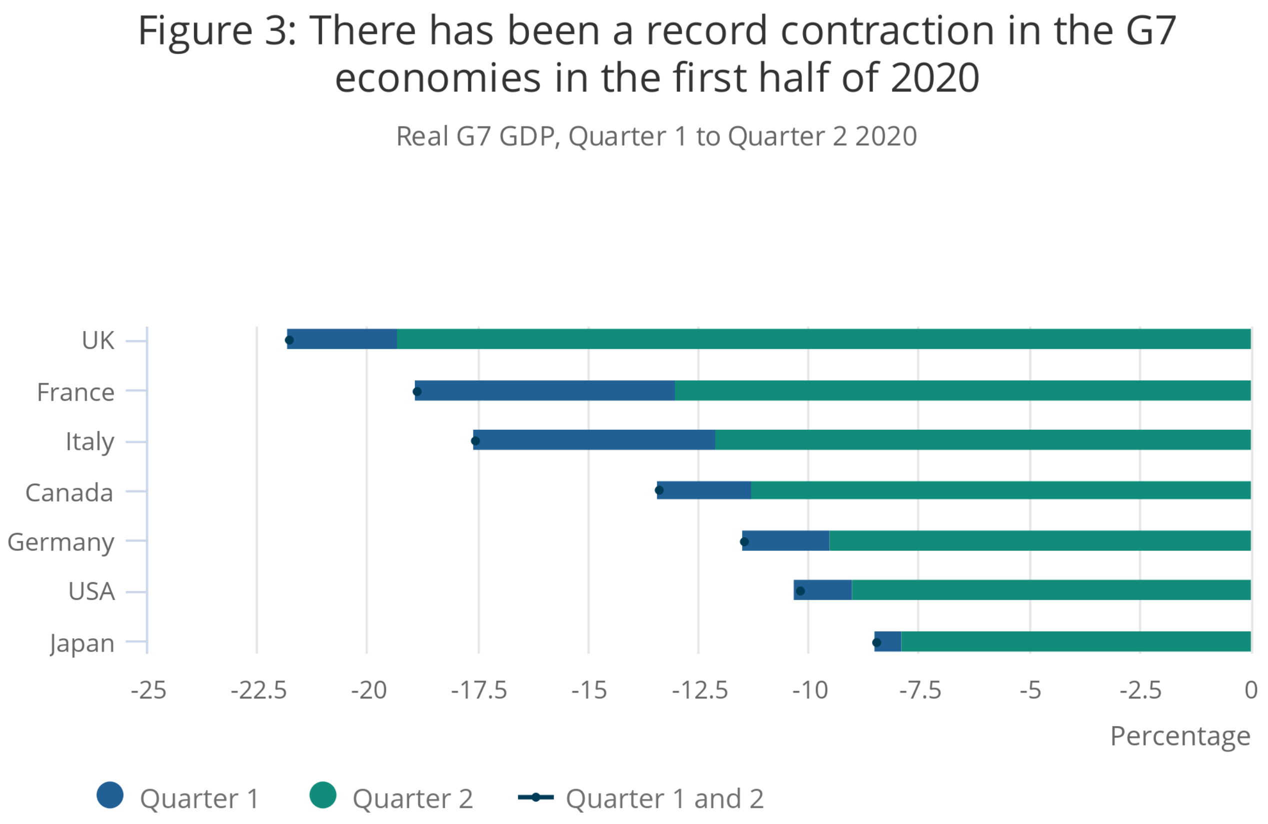
Timelier insights from the latest Business Impact of Coronavirus (COVID-19) Survey[2] (BICS) finds that 47% of all businesses currently trading experienced a decrease in their turnover compared with what is normally expected for this time of year. This was the case for more than half of businesses in the arts, entertainment and recreation, education, accommodation and food service activities industry, and the administrative and support service activities industries. The flash Composite Purchasing Managers' Index (PMI) points to a loss in momentum towards the end of the third quarter. There was a marked slowing in the rate of expansion in September from the six-year high recorded in the previous month, underpinned by "a lack of consumer confidence and persistent disruptions to business operations due to the pandemic".

International

Figure 3 shows that each of the G7 economies experienced a sharp contraction in GDP in the first half of this year. Double-digit declines in output have been experienced in most of these advanced economies, as restrictions on activity have been imposed in all countries. The timing and extent of the falls in GDP has varied across the global economy, which in part reflects the spread of the virus and the stringency of lockdown restrictions that have been in effect in each country over this period. The coronavirus pandemic has also had an impact on certain industries more than others, such as those activities that involve interactions with other people, so the structural composition of each country also helps explain how these figures compare. Additionally, it might also reflect differences in how non-market output is measured in different countries, specifically the extent to which volume indicators are in place and how these have been affected by the pandemic[3]. The UK has experienced the largest contraction of all the G7 economies so far, with a cumulative fall of 21.8% compared with the end of 2019.

Figure 3: There has been a record contraction in the G7 economies in the first half of 2020

Real G7 GDP, Quarter 1 to Quarter 2 2020



Source: Organisation for Economic Co-operation and Development, Office for National Statistics

Notes:

1. All international figures correct as of 22 September 2020.

The Bank of England (PDF, 335KB) cites how the most recent indicators imply an increase in UK-weighted world GDP of around 4.75% in the next quarter. However, the outlook for the global economy remains highly uncertain. The Organisation for Economic Co-Operation and Development (OECD) highlights that the recovery will depend on "the magnitude and duration of new COVID-19 outbreaks, the degree to which current containment measures are maintained or reinforced and feed through to confidence, the time until an effective treatment or vaccine is deployed, and the extent to which significant fiscal and monetary policy actions support demand". Their latest forecasts are for global GDP to contract by 4.5% this year, before picking up by 5.0% next year. The UK economy is forecast to decline by 10.1% this year - only Italy of the G7 economies is expected to experience a larger contraction in its economy. It also expects that the level of output at the end of 2021 to be lower than at the end of 2019, and much weaker than those that were forecast before the coronavirus pandemic.

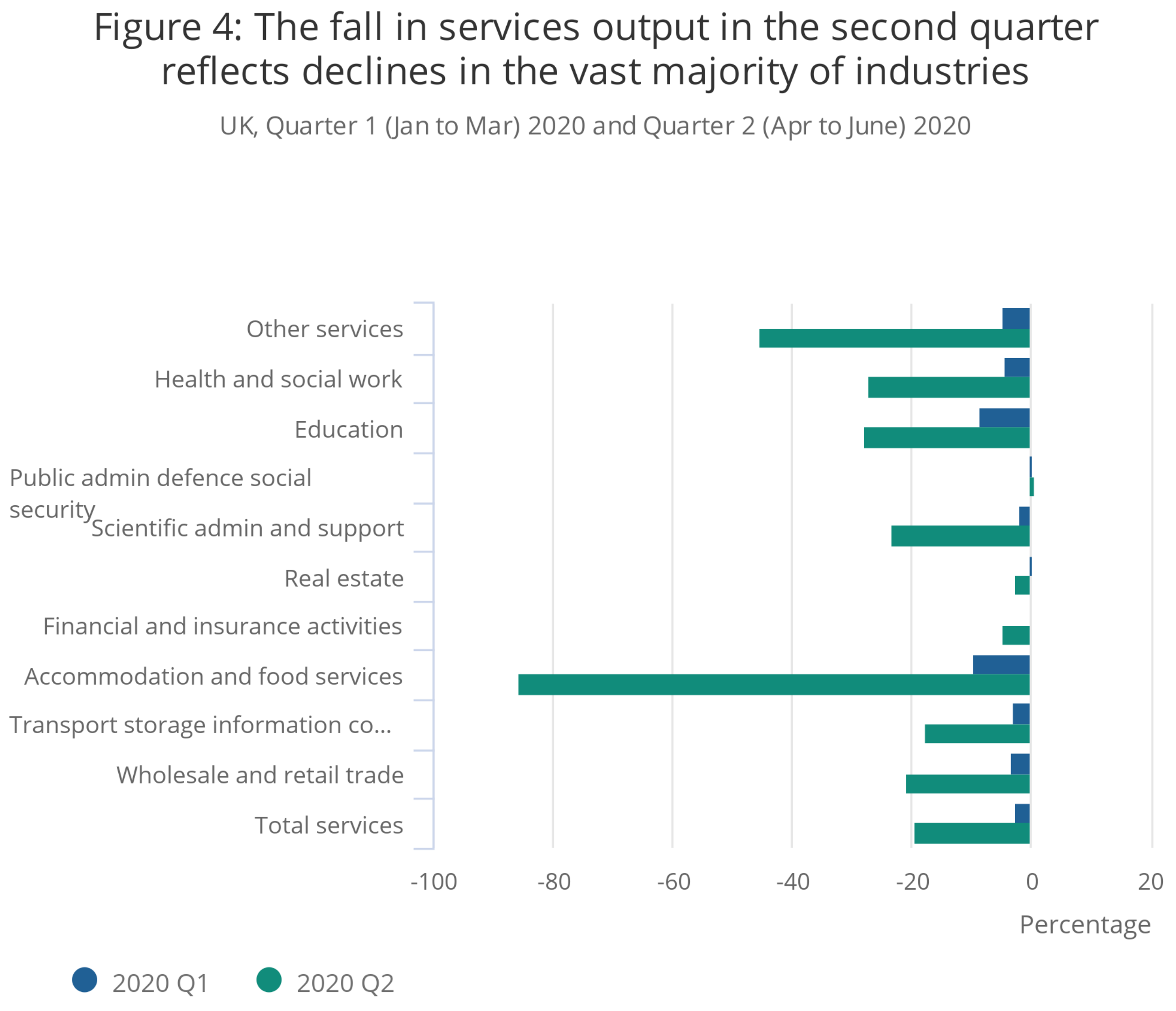
Output

There was a contraction of 19.2% in services output in Quarter 2, reflecting the sharp contraction in April 2020 as government restrictions were introduced at the end of March. There were declines in most service industries, most notably in accommodation and food services, wholesale and retail trade and repair of motor vehicles, human health and social work activities, and administrative and support service activities. These industries comprised almost half of the total decline in services output in the second quarter (Figure 4), as these were particularly affected by the public health policy response to contain the spread of the coronavirus.

The latest Decision Maker Panel survey reports that businesses expected that measures to control the spread of the coronavirus were not only expected to increase the cost of running a business over the next year, but that these would also reduce their production capacity. In particular, businesses in the recreational services and accommodation and food industries expected to the most adversely impacted.

Figure 4: The fall in services output in the second quarter reflects declines in the vast majority of industries

UK, Quarter 1 (Jan to Mar) 2020 and Quarter 2 (Apr to June) 2020



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: April to June 2020

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar) and Q2 refers to Quarter 2 (Apr to June).

2. Chart shows percentage quarter-on-quarter growth rates.

There was a decline in production output of 16.3% in Quarter 2 2020, as manufacturing output fell by 21.1%. There were widespread falls in most manufacturing industries, particularly in that of transport equipment following widespread factory shutdowns during the lockdown period. The latest Agents' Summary of Business Conditions finds that while the majority had restarted their production of manufacturing output, "many were operating below capacity in order to maintain social distancing and demand remained subdued".

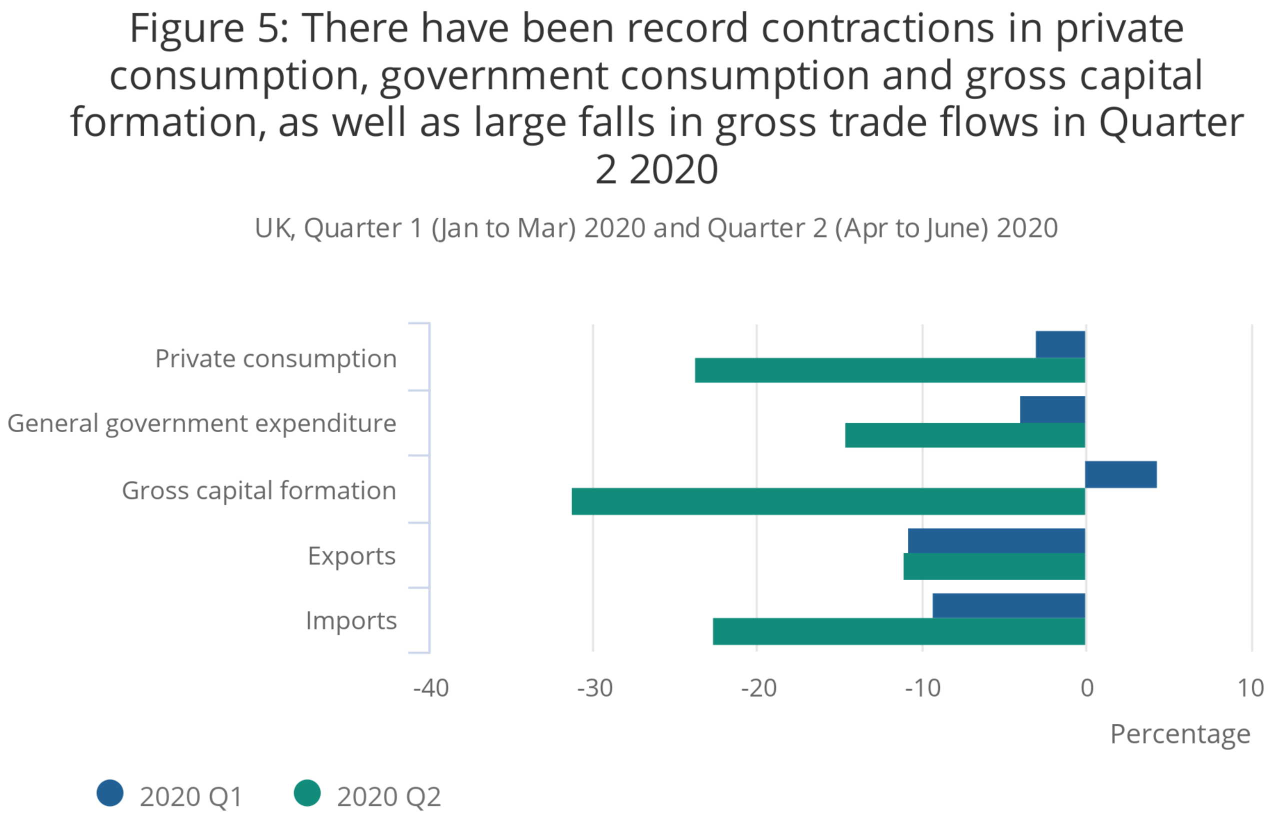
Expenditure

There have been large movements in all types of expenditure in Quarter 2 2020. There was a sharp contraction of 23.6% in household consumption, reflecting how lockdown restrictions have had particularly pronounced effects on social consumption involving spending that is more reliant on physical interaction with other people (Figure 5). The decline was driven by falls in spending on restaurants and hotels, transport, and recreation and culture as households have been unable to spend on these types of social consumption. This also likely reflects the effects of the increase in remote working, which has led to a decline in work-related consumption, such as spending on travel.

That said, recent analysis highlights that "some areas of consumption were less constrained than expected during the lockdown, with a marked shift to online sales and some substitution among popular areas of spending", as shown in the official retail sales figures in recent months. The Bank of England (PDF, 335KB) highlights how work-related and social consumption had picked up much more of late, although these levels remain below the levels in early 2020 before restrictions were applied. It cites that there were signs that the Eat Out to Help Out Scheme had led to increased restaurant spending in August.

Figure 5: There have been record contractions in private consumption, government consumption and gross capital formation, as well as large falls in gross trade flows in Quarter 2 2020

UK, Quarter 1 (Jan to Mar) 2020 and Quarter 2 (Apr to June) 2020



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: April to June 2020

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar) and Q2 refers to Quarter 2 (Apr to June).

2. Private consumption is household final consumption expenditure and non-profit institutions serving households.

The coronavirus pandemic has had a significant impact on current price and volume estimates of government consumption in the second quarter. In current prices, government expenditure increased by 15.6%, reflecting higher spending related to the coronavirus as well as planned increases in spending. However, the volume of government expenditure fell by 14.6%. This reflects direct volume indicators underpinning the measurement of some areas of non-market output. Non-market services consumed primarily by individuals, such as health and education, are measured directly by measuring the change in the volume of activity.

Government healthcare consumption fell by 30.4%, reflecting the postponement or cancellation of healthcare treatments as the NHS increased its critical care capacity in its response to dealing with the pandemic. The volume of government education spending fell by 24.5%, as schools were closed to all except for vulnerable pupils or those whose parents or guardians are critical workers. That said, teaching staff continued to support children learning at home.

Gross fixed capital formation (GFCF) fell by 21.6% in the second quarter of 2020, as businesses faced an elevated level of uncertainty. The UK's Economic Policy Uncertainty Index was five times higher in the second quarter compared with the same period a year ago. The latest Decision Maker Panelfinds that capital investment is expected to be one-third lower than it would have otherwise been because of the pandemic in Quarter 3 (July to Sept). Over half of businesses reported that the pandemic was the largest source of uncertainty.

The adverse impact of the coronavirus on cash flows for businesses may have also played a role. The latest Business Impact of Coronavirus (COVID-19) Survey finds that over two-fifths of businesses continuing to trade during the period from 24 August to 6 September 2020 had less than six months or no cash reserves.

The impact of the coronavirus pandemic on the global economy has led to large falls in gross trade flows in and out of the UK, reflecting a marked fall in global trade demand as well as how restrictions have disrupted international supply chains. The latest World Trade Monitor estimates that world trade fell by 12.5% in the second quarter of 2020, though there was a monthly 7.6% rebound in June. Travel restrictions have also significantly reduced the flow of tourists to and from the UK. Trade in services exports fell by 16.4% because of falls in travel, other business services, air transport and financial services, though the exports of education-related travel have not been affected as significantly. Services imports fell by 28.7%, particularly those of travel services, air transport and other business services.

Income

Nominal GDP fell by 14.5% in Quarter 2 2020. Taxes less subsidies fell by 95.2% in Quarter 2 2020, reflecting a decrease in tax revenue from Value Added Tax (VAT) as well as from fuel, tobacco, stamp, and air passenger duties. There was also an increase in subsidies that primarily relates to the Coronavirus Job Retention Scheme (CJRS) and Self Employment Income Support Scheme (SEISS), as well as an increase in transport subsidies granted to rail and bus services and a local government subsidy providing financial support to small businesses affected by the coronavirus pandemic.

Compensation of employees (CoE) fell by 2.2% in Quarter 2 2020, the largest quarterly fall since the 2008 economic downturn. However, the impact of the Coronavirus Job Retention Scheme (CJRS) is one reason why the fall in wages and salaries has been less marked than other types of income. Gross operating surplus (GOS) of corporations fell by 12.5%, as private non-financial corporations (PNFC) GOS is estimated to have fallen by 9.6% in the second quarter. Meanwhile, financial corporations' GOS declined by 30.3%.

According to the Quarter 2 2020 EY UK profit warnings report (PDF, 1.314MB), UK companies issued 165 profit warnings in Quarter 2 2020, a 139% increase from the previous year. The report stated that 84% of profit warnings cited the impact of the coronavirus pandemic, adding that coronavirus stresses were spreading from "the lockdown-impacted sectors of the first quarter to sectors exposed to the knock-on impacts of changing corporate and consumer behaviour".

Notes for: Gross domestic product

1. The latest official estimates of monthly GDP do not reflect the revisions that have been incorporated as part of the latest Quarterly National Accounts, released 30 September 2020. Fully consistent figures will be released on 9 October 2020. An indicative monthly path for Quarter 2 2020 has been made available.

2. Businesses were asked for their experiences for the reference period 24 August to 6 September 2020. However, for questions regarding the last two weeks, businesses may respond from the point of completion of the questionnaire (7 September to 20 September 2020).

3. Consistent with international guidance, the Office for National Statistics (ONS) uses direct measures of the volume of activity to estimate the volume of non-market output, such as health and education. As such, international comparisons should be made with care if the estimates being compared are based on different approaches to measuring the volume of non-market output.

3 . Institutional sector accounts

The coronavirus (COVID-19) pandemic has led to large movements in the non-financial and financial transactions of households[1], corporations, the government and the rest of the world[2]. Non-financial transactions have been significantly affected by the policy response to the pandemic, including those of mandatory business closures as part of lockdown restrictions, voluntary and involuntary social distancing that has been in place and the fiscal policy response. Heightened uncertainty is likely to have also had an impact on the behaviours of households and corporations. Financial transactions will likely be responsive to the uncertainty and volatility experienced in financial markets during the coronavirus pandemic.

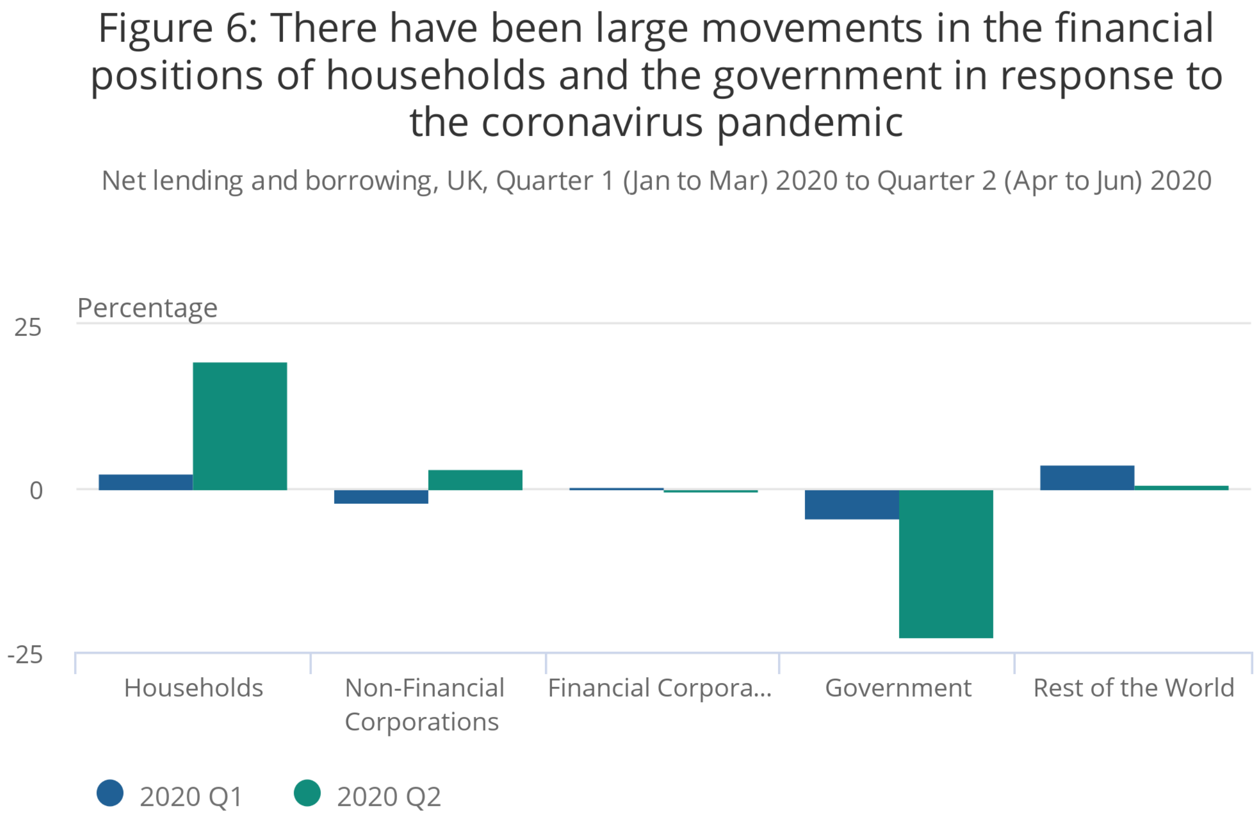
The paths of sectoral income and expenditure determine whether households, corporations, the government and the rest of the world are net lenders or borrowers[3]. A net borrowing position must be funded by taking on further financial liabilities and/or reducing financial assets, while a net lending position is reflected in a net increase in financial assets and/or decrease in financial liabilities.

Figure 6 shows that there have been unprecedented movements in the sectoral net lending or borrowing positions in Quarter 2 (Apr to June) 2020. There was a sharp increase in the net lending position of households to 19.5% of gross domestic product (GDP) in the latest quarter, reflecting the record contraction in consumption expenditure. There was also a less marked improvement in the financial position of private non-financial corporations (PNFCs), who became net lenders in Quarter 2. The last time that this was the case was in the years that followed the 2008 to 2009 economic downturn. Recent analysis explains that "households and non-financial businesses are likely to want to hold higher levels of liquidity as a buffer against the very high levels of uncertainty over incomes, profits and the future availability of credit".

As households and non-financial corporations have improved their financial position through record increases in the holdings of currency and deposits and higher loan repayments, this is then reflected in the position of financial corporations in Quarter 2. The household position is primarily the counterpart to the government position, in which the effects of the fiscal policy response and the impact of lockdown restrictions on receipts and expenditure have led to a record-high government net borrowing position of 22.6%.

Figure 6: There have been large movements in the financial positions of households and the government in response to the coronavirus pandemic

Net lending and borrowing, UK, Quarter 1 (Jan to Mar) 2020 to Quarter 2 (Apr to Jun) 2020



Source: Office for National Statistics – Quarterly Sector Accounts, UK: April to June 2020

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

2. Net lending or borrowing positions may not sum to zero in later years because of unbalanced supply and use tables in the compilation of gross domestic product (GDP).

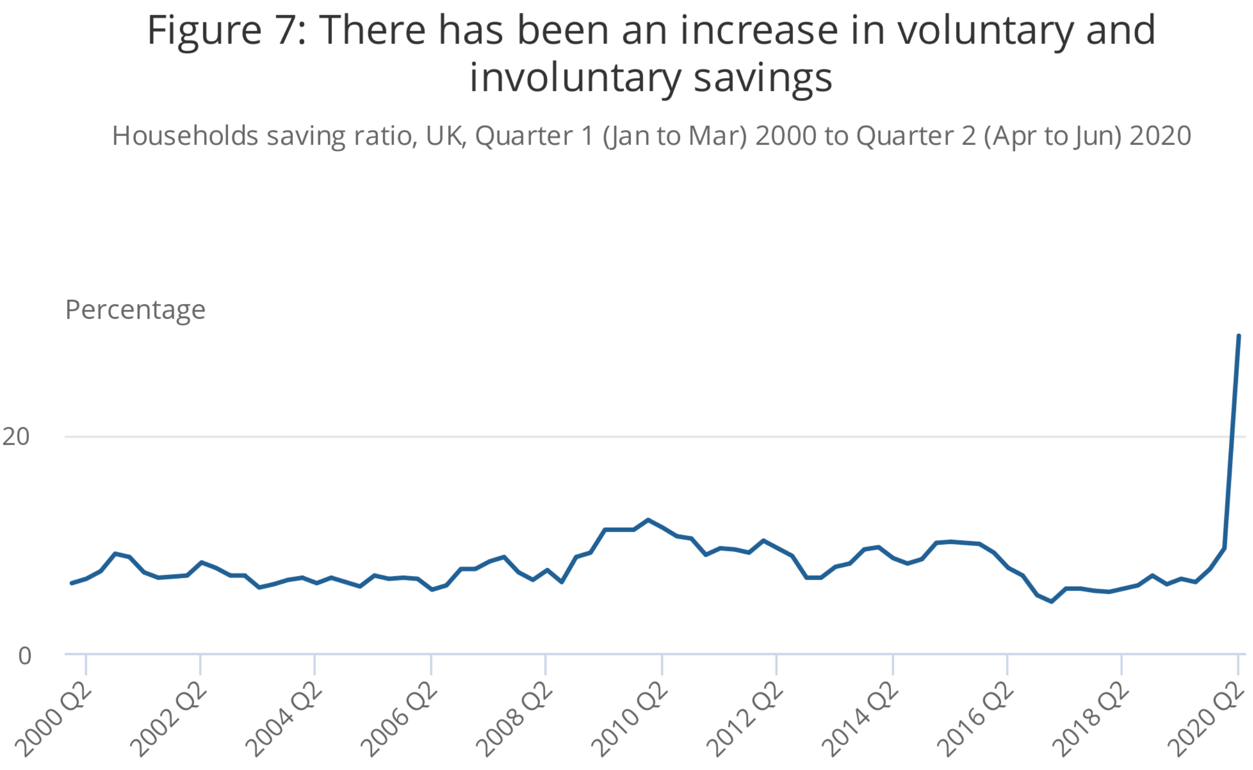
There was a record increase in net lending by households in Quarter 1 (Jan to Mar) 2020, largely reflecting the unprecedented decline in final consumption expenditure. In response to the coronavirus pandemic, lockdown restrictions were imposed, which led to a very sharp contraction in non-essential spending. Mandatory business closures were in effect, while forms of social distancing affected those transactions that require direct contact between consumers and businesses. There were particularly large falls in consumer spending on restaurants, transport and recreation and culture, which include forms of social consumption.

Households primarily financed the higher levels of net lending by increasing the amount of currency and deposits placed with financial institutions, as well as reducing their loan liabilities in Quarter 2 2020. More timely indicators show that household deposits was still a little stronger in July 2020 than in the period leading up to the lockdown restrictions, although the value of deposits was lower than that recorded in the period of March to June.

The households saving ratio hit a record high of 29.1% in the same period, which is likely to reflect voluntary and involuntary savings (Figure 7). Recent analysis has highlighted how households have been reducing their spending on social and work-related consumption, but that incomes have been relatively maintained. This reflects an increase in the ability of individuals to work from home, or that there has been a large number of individuals who have been furloughed. It is also possible that households have chosen to increase their savings in response to the higher levels of uncertainty around their future employment prospects.

Figure 7: There has been an increase in voluntary and involuntary savings

Households saving ratio, UK, Quarter 1 (Jan to Mar) 2000 to Quarter 2 (Apr to Jun) 2020



Source: Office for National Statistics – Quarterly Sector Accounts, UK: April to June 2020

There was a marked improvement in the financial position of non-financial corporations who became net lenders in Quarter 2 2020, as there was a large fall in capital investment amidst increased uncertainty over demand and a marked reduction in the distributed income that was paid out to shareholders. The Bank of England (PDF, 11.9MB) estimates that UK companies could face a cash-flow deficit of up to around £200 billion this financial year, as the coronavirus pandemic has led to lower levels of production and demand. The latest Decision Maker Panel survey reports that 30% of businesses estimated their sales to be lower than would have otherwise been the case in Quarter 2 (Apr to June) 2020. The latest Business Impacts of Coronavirus (COVID-19) Survey reports that "47% experienced a decrease in their turnover compared with what is normally expected for this time of year". Enforced restrictions help explain the reduction in gross operating surplus (GOS) in the latest quarter and why non-financial corporations have looked to improve their financial position of late.

This improved financial position was reflected in a rise in currency and deposits and an increase in loan repayments. There is evidence that deposits remain higher than the period prior to lockdown. Recent analysis explains that "the crisis has lifted the demand for money - the amount of deposits that households and businesses would like to hold", in response to the desire to hold higher levels of liquid assets in these conditions. The latest Agents' Summary of Business Conditions finds that there is high demand for credit by small- and medium-sized enterprises to "cover working capital and cash-flow needs".

The coronavirus pandemic has not only had a profound impact on the economy, but it has also had large consequences for the UK's fiscal position. General government was a net borrower in Quarter 2 2020 of 22.6% of gross domestic product (GDP). While initial estimates of accrued spending, receipts and borrowing are expected to be prone to revision, the latest figures show that the coronavirus pandemic has had significant consequences for the UK's public finances. Public sector net borrowing (PSNB) stands at £173.7 billion over the first five months of this financial year. This is not only more than the three times higher than was recorded in the previous financial year in total, but it is also higher than the net borrowing in financial year ending (FYE) 2010 following the economic downturn.

HMRC cash receipts over the first five months of FYE 2021 were around a quarter lower than last year, primarily reflecting the lower Value Added Tax (VAT) receipts on the year that captures the contraction in consumer spending in this period. These lower cash receipts would also capture the effects of the VAT deferral scheme, which allows those liabilities that were due from 20 March to 30 June 2020 to be paid at a later point in time. However, from a UK National Accounts perspective, the falls in cash resulting from the deferral scheme are not captured in the PSNB figures that are recorded following the accruals principle.

In the year-to-date, central government spending is one-third higher than a year earlier, which captures the fiscal cost of the Coronavirus Job Retention Scheme (CJRS) and the Self-Employment Income Support Scheme (SEISS). These subsidy payments are reflected in the financial positions of non-financial corporations and households respectively in Quarter 2.

In its Fiscal Sustainability Report, the Office for Budget Responsibility (OBR) constructs a central scenario in which the budget deficit would increase from 2.6% of GDP in FYE 2020 to 16.4% of GDP in FYE 2021[4]. This reflects relatively higher expenditure, which captures the fiscal policy response as well as higher welfare spending. Tax revenues are then expected to be lower because of the lower levels of income and spending taking place this financial year in response to the lockdown restrictions in place. These effects are partially offset by lower debt interest spending. In this scenario, public sector net debt (PSND) rises to 104.1% of GDP in this financial year, primarily reflecting the effects of higher cumulative borrowing. The level of PSND is 101.9% of GDP as at the end of August 2020, which is the highest it has relatively been since the early 1960s.

Notes for: Institutional sector accounts

1. For the purposes here, households include non-profit institutions serving households (NPISH), unless otherwise stated.

2. Non-financial transactions are those that relate to production, income, consumption and capital investment. Financial transactions are those that capture the change of ownership in financial claims.

3. Total borrowing must be matched by total lending, so these financial positions must sum to zero across the institutional sectors in any period.

4. The figures that refer to the Fiscal Sustainability Report are those that were published on 14 July 2020 and do not incorporate any further information that has been updated thereafter, including the fiscal impacts of the Summer Economic Update and the subsequent outturns that have been produced. More information is available in the Office for Budget Responsibility's Coronavirus analysis.

4 . Balance of payments

The International Monetary Fund highlights how the coronavirus (COVID-19) pandemic has led to "a sharp decline in global trade, lower commodity prices, and tighter external financing conditions", which will have an impact on countries' external positions this year. There have been record contractions in the global economy in the first half of this year. The Organisation for Economic Co-operation and Development (OECD) finds that global output was over 10% lower in Quarter 2 (Apr to June) 2020 than it was at the end of 2019, while global trade fell by over 15% in the first half of 2020.

The UK has experienced a larger contraction in the first half of this year of the G7 economies than its main trading partners, primarily reflecting the timing of the lockdown policies in place and the structural composition of the UK economy. These effects are all having an impact on the UK's international transactions with the rest of the world, including the gross and net positions.

Figure 8 shows that there was a sharp narrowing in the current account deficit in Quarter 2 2020. Net lending from the rest of the world stood at 0.6% of GDP in the latest quarter, which is the lowest recorded since Quarter 2 2011. This reflects a marked improvement in the trade balance which recorded a surplus of 3.6% of gross domestic product (GDP), underpinned by large gross movements of trade this year. Some of this reflects pronounced trade movements in unspecified goods, which reflects the unwinding of previous volatile trade in non-monetary gold. There have been large declines in the exports and imports of finished manufactured goods.

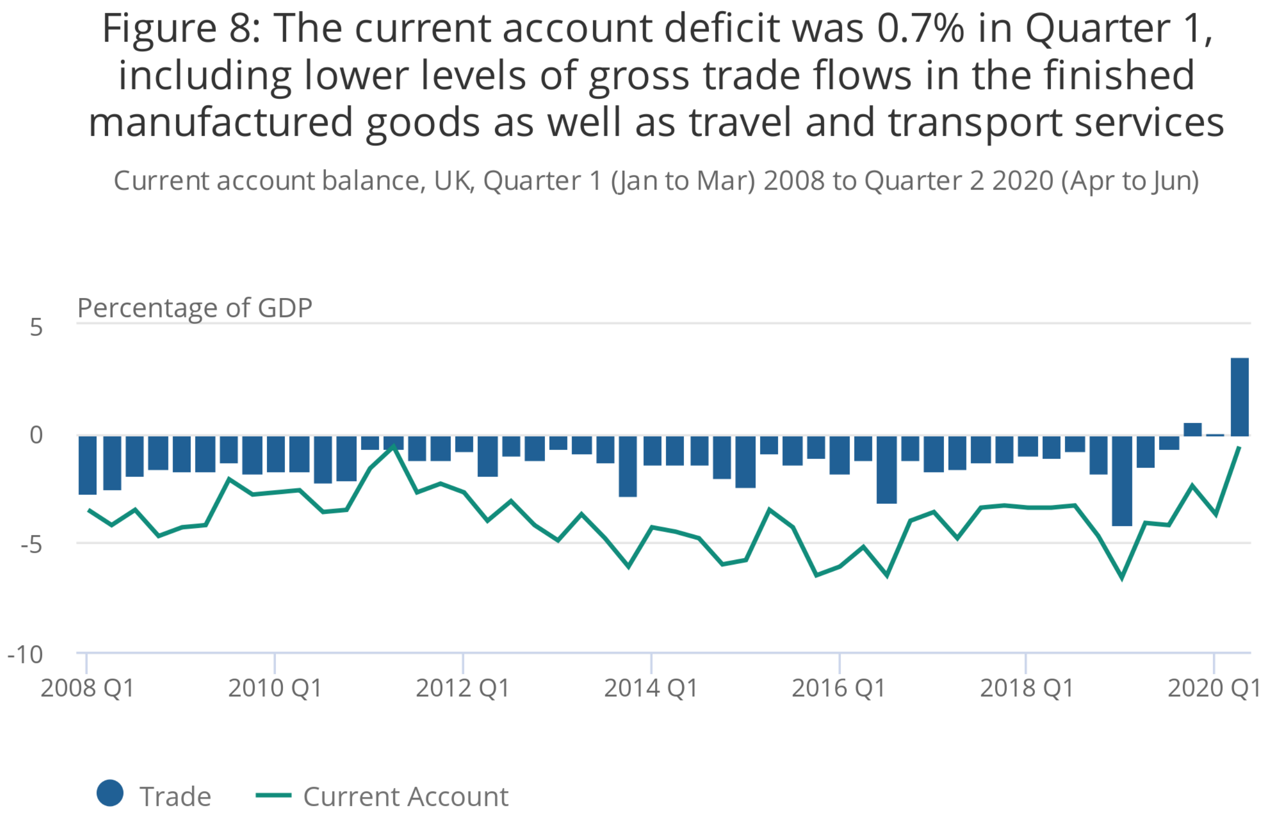
The latest Confederation of British Industry (CBI) Industrial Trends Survey found that there was a slight pickup in export order books in the three months to September 2020, but that the rate of decline was still high by historical standards.

The UK has historically been a net importer of oil and other fuels, but this net trade position also improved in Quarter 2 2020. The movements in gross trade flows largely reflect the reduced demand in response to the restrictions on mobility, as well as the lower price of oil. There have also been notable impacts on the gross trade flows in travel and transport services, reflecting the imposition of physical restrictions have reduced such international activity. Higher-frequency indicators (PDF, 5.9MB) provide some further insight around the extent to which international travel has fallen over this period.

There has also been a decline in the UK's investment income of late on its external assets and liabilities, most notably on foreign direct investment (FDI). However, net investment income has improved in the latest quarter as there was a larger fall in foreign earnings on FDI that is held in the UK. It is possible that these lower flows in inward and outward flows of earnings reflect the lower interest rates that were imposed in many countries. There is also some evidence that businesses may be responding by retaining a higher level of earnings, reducing and/or cancelling dividend payments, which would have an impact on investment income.

Figure 8: The current account deficit was 0.7% in Quarter 1, including lower levels of gross trade flows in the finished manufactured goods as well as travel and transport services

Current account balance, UK, Quarter 1 (Jan to Mar) 2008 to Quarter 2 2020 (Apr to Jun)



Source: Office for National Statistics – Balance of Payments, UK: April to June 2020

Notes:

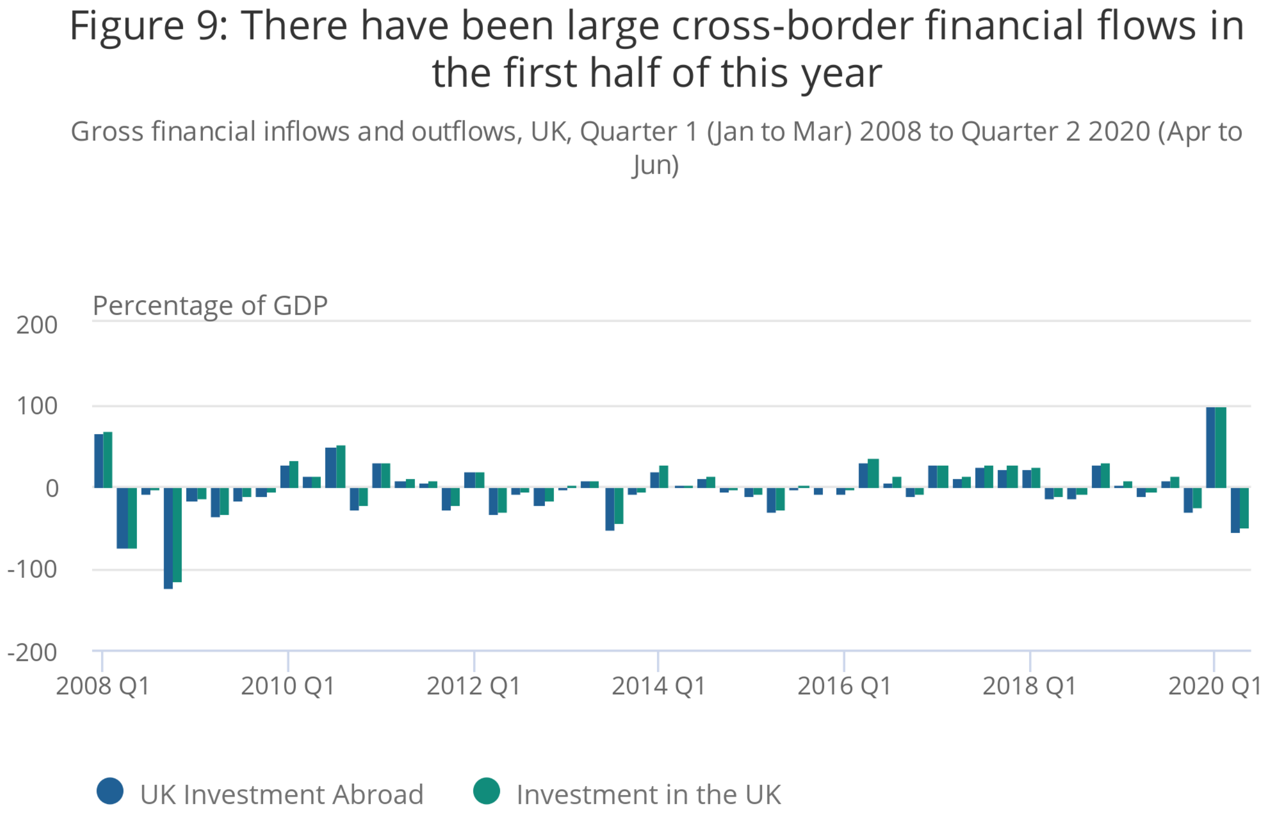
1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

A current account deficit must be financed by net financial inflows. This can be achieved by increasing external liabilities to the rest of the world and/or disinvesting in previously owned external assets. A reliance on net foreign capital inflows can leave a country vulnerable to a reduction in international investor appetite for those assets, particularly given the heightened economic uncertainty around the coronavirus pandemic, and if there is a fall in the confidence of foreign investors and/or there is a shift in the global risk environment. These cross-border capital flows are prone to large swings, particularly for the more mobile forms of capital such as loans and deposits. This has been particularly marked in the first half of this year, where there were particularly large flows of other investment in Quarter 1 (Jan to Mar) (Figure 9).

It is likely that these financial flows have reflected the response of financial markets around the start of the coronavirus pandemic, leading to a shift in the risk appetite of investors. The latest [Financial Stability Report (PDF, 11.9MB)] explains how "precautionary demand for liquidity and the need for a dramatic redistribution of cash around the financial system resulted in an abrupt and extreme 'dash for cash' in mid-March", which likely played a role in the gross financial flows recorded earlier this year. However, there appears to have been some unwinding of these effects, as the UK reduced its gross external assets and gross external liabilities in loans and deposits in the most recent quarter.

Figure 9: There have been large cross-border financial flows in the first half of this year

Gross financial inflows and outflows, UK, Quarter 1 (Jan to Mar) 2008 to Quarter 2 2020 (Apr to Jun)



Source: Office for National Statistics – Balance of Payments, UK: April to June 2020

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

5 . Labour market

The impacts of the coronavirus (COVID-19) pandemic on the UK labour market are most evident in how total hours worked and vacancies are still considerably below their pre-lockdown levels. In contrast, the headline employment and unemployment figures have been relatively stable over the same period, though this largely reflects how individuals who have been furloughed through the Coronavirus Job Retention Scheme (CJRS) or the Self-Employment Income Support Scheme (SEISS) are classified as in employment[1]. Also, it might reflect the response to the pandemic, if people are unable and/or unwilling to take up a new role because of the impact of the coronavirus on home and work. This might explain the record-high flow from unemployment to economic inactivity in Quarter 2 (Apr to June) 2020.

The number of people who are in employment but have been temporarily away from paid work, which includes those who have been furloughed, has fallen from its peak in late April 2020. However, there are still almost 5.5 million such people, including around 2.5 million who had been away from paid work for three months or more. While there is evidence that employers had brought back some furloughed workers, the latest Agents' Summary of Business Conditions reports that some companies had intended to "reduce headcount, particularly in the second half of this year as the CJRS unwinds", particularly in the hospitality, retail, aviation, automotive and oil and gas industries.

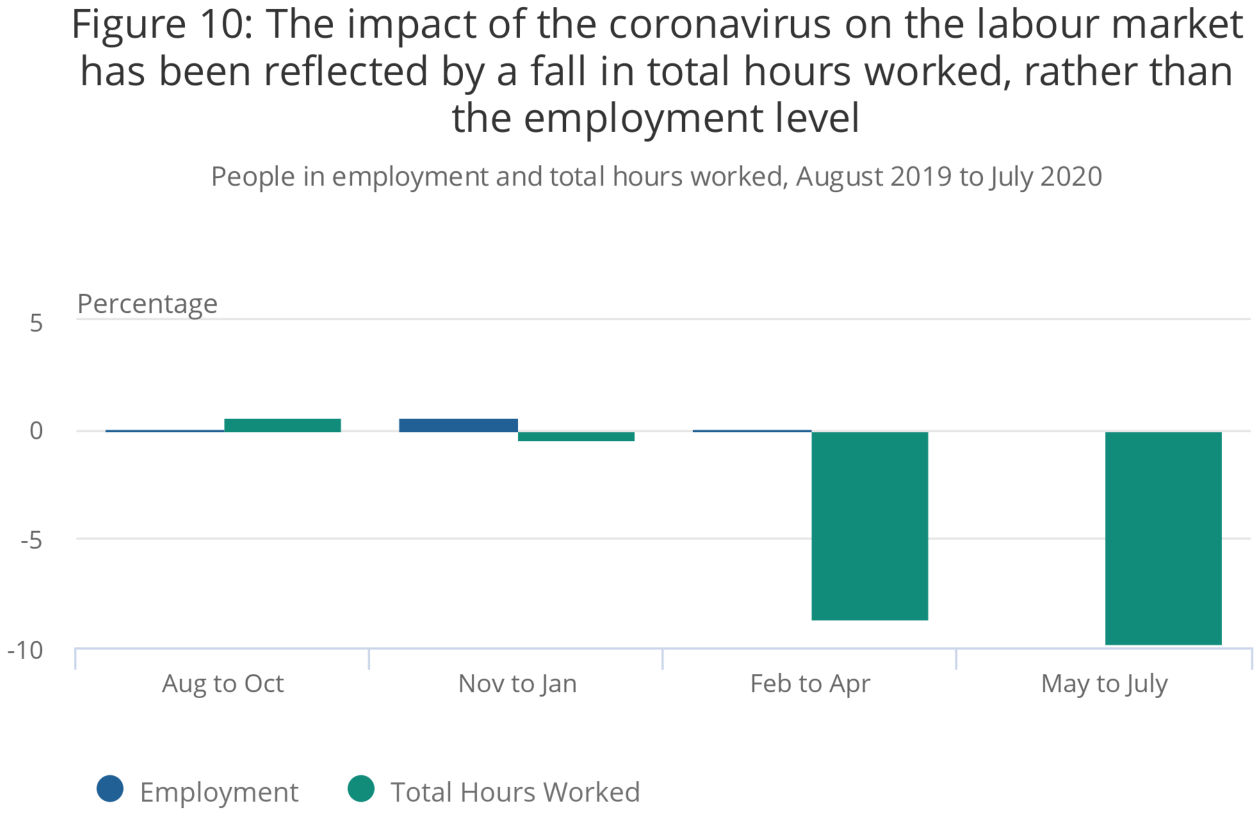
The unemployment rate increased to 4.1% in the three months to July, up from 3.9% in the previous three months. There was a quarterly increase of 62,000 in the number of unemployed people over this period, driven by a rise in short-term unemployment - those who had been unemployed for up to six months increased by 128,000 in the three months to July 2020. It is also the case that much of the increase in unemployment over this period was concentrated in those aged 16 to 24 years.

The immediate impacts on the labour market can be seen as a fall in total and average hours worked, reflecting how employers have been able to furlough individuals through the CJRS. Total hours worked remains considerably lower than pre-lockdown levels - the volume in the three-month period of May to July 2020 was 9.8% lower than the three-month period February to April.

There has been a slight recovery in hours worked, in line with the easing of lockdown experienced towards the end of that three-month period, although this has varied by industry. In contrast, there was little change in the number of people in employment over the same time period (Figure 10). Recent modelling shows that the fall in hours worked is likely to reflect the effects of voluntary and involuntary forms of social distancing, as the former captures a behavioural response in which individuals choose to reduce their labour supply.

Figure 10: The impact of the coronavirus on the labour market has been reflected by a fall in total hours worked, rather than the employment level

People in employment and total hours worked, August 2019 to July 2020



Source: Office for National Statistics – Employment in the UK: September 2020

The latest Decision Maker Panel reports that almost one-third of employees reported to have been on furlough and working no hours, which mostly explains the fall in total hours worked in Quarter 2 2020. It also found that the average number of hours worked by active employees that were not on furlough had fallen by an average 8% over the period April to June 2020.

The more timely HMRC estimates show that there was a further fall in the number of payroll employees of 36,000 in August 2020. There has now been a cumulative decline of 695,000 payroll employees since March 2020 - a total decline of 2.4%, which in recent months has reflected lower-than-usual inflows, as opposed to higher-than-usual outflows.

Recent analysis highlights that the industry patterns of workers that have been furloughed is similar to that of which industries have experienced that largest declines in gross domestic product (GDP). The latest Business Impact of Coronavirus (COVID-19) Survey finds that of businesses that had not permanently stopped trading, "the arts, entertainment and recreation industry and the accommodation and food service activities industry had the highest proportions of their workforce on partial or full furlough leave".

There are also signs that redundancies are on the rise, with the increase of 48,000 the largest quarterly rise seen since 2009. There is some evidence that redundancies will increase further. For example, the Chartered Institute of Personnel and Development (CIPD) reports a significant increase in redundancy intentions over the next three months, reflecting "the worsening economic landscape and clarity over the Government's Job Retention Scheme". Based on monthly figures of redundancies notifications, the Institute for Employment Studies (IES) estimates that redundancies may reach 450,000 in Quarter 3 (July to Sept) 2020.

The impact of a sharp contraction in output and heightened level of uncertainty is reflected in the fall in labour demand immediately following the easing of lockdown restrictions. The number of vacancies declined to their lowest level on record in the three-month period April to June 2020 (341,000). The monthly figures show there has been a steady increase in the number of vacancies in the months thereafter, as vacancies recovered further to 434,000 in the three months to August. The strongest recovery has been experienced in the construction and transport and storage industries, while vacancies continue to be low in the arts, entertainment and recreation industry, which remains subject to public health restrictions in place.

Figure 11 shows the annual change in the industry-ratio of vacancies to employee jobs. It highlights how the largest relative declines in labour demand have been in the accommodation and food services and arts, entertainment and recreation industries, in which the services provided are for social consumption.

The experimental Adzuna job adverts figures provide a timelier insight on labour demand, which had shown the volume of online job adverts had fallen as low as 35% of their the 2019 average in May 2020. The latest figures capture the extent to which labour demand has picked up in the following months, although online job adverts are still only 55% of their 2019 average as of 18 September 2020.

The latest estimates by the Recruitment and Employment Confederation show an increase in hiring following the relaxation of lockdown restrictions, although this has primarily reflected an increase in temporary placements. This might reflect how the ongoing uncertainty has led to a reluctance by employers to undertake significant hiring.

Figure 11: The largest relative declines in labour demand have been in the accommodation and food services, arts, entertainment and recreation, and mining and quarrying industries

Annual change in vacancies per 100 employee jobs, UK

Figure 11: The largest relative declines in labour demand have been in the accommodation and food services, arts, entertainment and recreation, and mining and quarrying industries

Annual change in vacancies per 100 employee jobs, UK

Source: Office for National Statistics – Vacancies and Jobs in the UK: September 2020

Total average weekly earnings fell at an annual rate of 1.0% in the three months to July 2020, while regular average weekly earnings slightly picked up by 0.2% over the same period. This can be explained by the large decline in bonus payments in response to the coronavirus pandemic, which fell by an annual rate of 21.4% in the three months to July 2020.

The recent weakness in earnings partly reflects the impact of employees that have been furloughed through the CJRS, and therefore put on lower pay. As the number of furloughed individuals reduces, this downward pressure will ease, all else the same.

Recent analysis shows that those industries that have experienced the larger losses in output tend to also be low wage industries, so these compositional effects will have an impact on the outlook for earnings. The latest Agents' Summary of Business Conditions finds that "many companies reported freezing pay, and a large proportion of contacts said they planned to delay or cancel pay settlements this year" reflecting the heightened levels of uncertainty.

Notes for: Labour market

1. The latestHer Majesty's Revenue and Customs (HMRC)figures show that 4.8 million jobs have been furloughed on the CJRS as at the end of July 2020, though this could increase to 5.3 million once all returns are received and revisions made. This has continued to fall throughout July. A further 2.0 million of the potentially eligible population had claimed a second SEISS payment by the end of August 2020.

6 . Prices

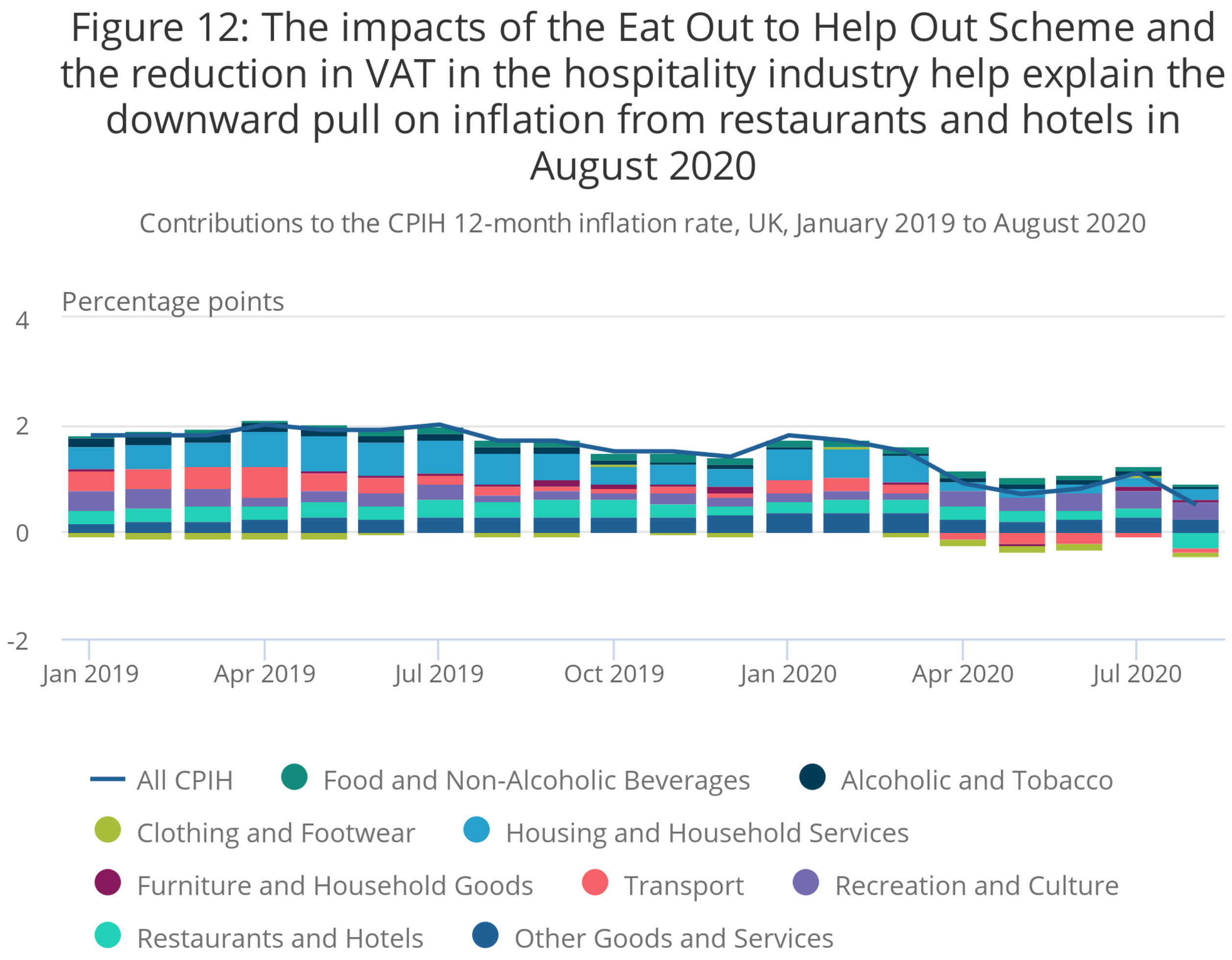
The coronavirus (COVID-19) pandemic and the policy response to containing its spread has had impacts on the supply and demand for goods and services in the UK. There is some evidence that previous pandemics have tended to lead to persistent declines in inflation, while recent analysis finds that there have been declines in the consumer prices of social consumption, work-related travel and "delayable" products in the UK.

Consumer and producer price inflation has been volatile in recent months. The 12-month rate of Consumer Prices Index including owner occupiers' housing costs (CPIH) inflation increased from 0.8% in June 2020 to 1.1% in July, before then falling back to 0.5% in August.

Figure 12 shows how restaurants and hotels were the largest driver of the decline between July and August 2020. Prices fell by around 4.7% on the month and 2.8% on the year to August 2020, largely driven by restaurants. This reflects the impact of the Eat Out to Help Out Scheme, which offered diners, in participating restaurants, a 50% discount on food and non-alcoholic beverages. This would apply up to the value of £10, when eating in on Monday to Wednesday through August 2020. It also captures the reduced rate of Value Added Tax (VAT) applicable to firms in the hospitality industry from 20% to 5%. This was introduced on 15 July 2020 for certain suppliers of hospitality, hotel and holiday accommodation, and admissions to certain attractions, which is due to run until 12 January 2021.

Figure 12: The impacts of the Eat Out to Help Out Scheme and the reduction in VAT in the hospitality industry help explain the downward pull on inflation from restaurants and hotels in August 2020

Contributions to the CPIH 12-month inflation rate, UK, January 2019 to August 2020



Source: Office for National Statistics – Consumer Prices Inflation, UK: August 2020

Notes:

1. Individual contributions may not sum to the total because of rounding.

The unusual pattern of price movements this year helps explain the recent profile of the contribution of clothing and footwear to the annual CPIH rate. Prices for clothing usually follow seasonal patterns with discounts typically being applied at certain times of year.

Figure 13 shows that typically there has been a consistent trend with prices rising gradually at the beginning of the year before falling back and reaching their lowest point in July, reflecting the summer sales. By contrast, prices fell between February and April in 2020 and have remained below their 2019 levels. Clothing retail was affected by restrictions imposed in response to the coronavirus (COVID-19) pandemic, with non-essential retailers, [including clothing stores](), being closed from 23 March.

Price falls in March and April 2020 likely reflect discounting by retailers in response to falling consumer demand for clothing during lockdown, as well as consumers' inability to go to shops. Figure 13 shows that prices for July were broadly equal in 2019 and 2020 but the usual seasonal pick-up, observed in previous years in August, has not materialised this year. As such, these timing effects have led to clothing and footwear providing a negative contribution to the annual CPIH inflation rate in August.

Figure 13: Clothing prices have been relatively flat in 2020

Clothing and footwear, UK, January 2014 to August 2020

Source: Office for National Statistics – Consumer Prices Inflation, UK: August 2020

Transport has had a downward pull on the headline inflation rate each month since April 2020. As with clothing, this largely reflects unusual market conditions during the coronavirus pandemic. Most parts of the transport component were affected during lockdown with non-essential travel being prohibited and car retailers closed to the public. Meanwhile, demand for fuels and lubricants fell sharply as many people started to work from home and avoid unnecessary journeys. Similar restrictions on travel and the transport of goods elsewhere in the world greatly reduced global demand for crude oil.

There was a sharp fall in the price of crude oil - an important component of the input Producer Price Index (PPI) - between January and April 2020, as global supplies outstripped demand, in turn feeding through to lower prices in output PPI and for consumers at the pumps. Prices began to rise slowly following output cuts from OPEC+, and a gradual increase in demand as various pandemic-related restrictions eased around the world. Price movements broadly levelled off in August 2020 but remain below their January 2019 level.

The fall in consumer demand for fuels and lubricant during lockdown also highlights one of the challenges of collecting consumer prices during this time. Typically, weights for the CPIH and CPI baskets are updated annually based on expenditure patterns and follow the reasonable assumption that consumer spending patterns are broadly stable in the short term. During the pandemic, however, consumption patterns have changed considerably. This includes some items being unavailable at different times and larger than usual changes in spending habits such as the sudden drop in fuel consumption and increased spending on food and non-alcoholic beverages.

By keeping the weight for these items unchanged in the official CPIH series, the impacts of large price changes, such as the drop in fuel prices, are exaggerated. With people driving considerably less during lockdown, and therefore buying less fuel, consumers would not have realised the benefit of falling fuel prices as it made up a smaller proportion of their spending than would otherwise be the case.

To maintain a consistent methodology and align with the international framework for producing consumer price statistics, weights were left unchanged in the official series of CPIH and CPI but this was addressed in a separate piece of analysis re-weighting the entire basket to reflect changes in consumption patterns during the pandemic.

Table 1 shows the results of this analysis for the 12-month growth rate of CPIH from April to June 2020. For each month, re-weighting the basket led to a 12-month growth rate 0.1 to 0.2 percentage points higher than the official published estimates. This broadly reflects increased demand for items that saw prices rises, and lower demand for goods and services that saw price falls.

It is also worth noting that overall consumer spending appears to have fallen during the pandemic so, while the effects of inflation may seem more pronounced once we account for changes in spending patterns, consumers may still nonetheless be spending less on average than before the pandemic. This also has the effect of amplifying some components of the basket, such as education, for which an unchanged amount of expenditure represents a higher proportion of total spending in the re-weighted basket.

Table 1: Re-weighting the CPIH basket to take into consideration the change in expenditure patterns implies a higher rate of inflation than the official published estimates
UK, April to June 2020

	April 2020	**May 2020**	**June 2020**
Official CPIH	0.9	0.7	0.8
Chain-link CPIH	0.9	0.7	0.9
Reweighted CPIH	1.0	0.8	1.0

Source: Office for National Statistics – Consumer Prices Inflation, UK: August 2020

There is some evidence that the coronavirus pandemic has led to increased costs resulting in higher prices. The latest Decision Maker's Panel reports that the average unit costs for businesses would be around 9% higher in Quarter 3 (July to Sept) 2020 because of the pandemic. The Bank of England (PDF, 336KB) cites that there have been increases in some services prices, such as for hairdressing and dentistry, reflecting the "costs of personal protective equipment and other safety measures being passed on to consumers". That said, the Monetary Policy Report (PDF, 5.9MB) explains that businesses may be more reluctant to change prices because of uncertainty around demand. It may also be that businesses are less able to generate an increase in demand by cutting prices in this environment.