Six challenges of restarting the UK economy

Social distancing, consumer caution, business restructuring, and of course Brexit, all pose challenges for the UK economy. The road to recovery will be slow and we don't expect the economy to reach its pre-virus size until 2022 at the earliest

Woman passes parked buses near Oxford Street in London

Source: Shutterstock

A long road to recovery

After almost seven weeks of lockdown, the UK government will on Sunday outline a road-map for reopening.

But getting the economy back to full health will be no easy task, and hopes of a sharp 'V-shape' recovery have long-since faded.

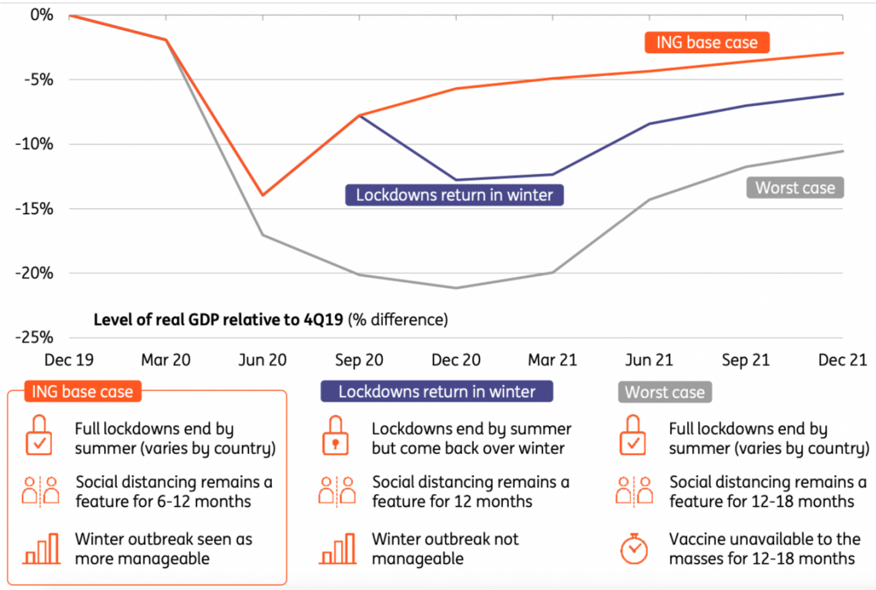
There's still a big question mark over how far the economy has shrunk so far. Our own forecasts assume at the end of the second quarter, the economy will be close-to 15% smaller than it was at the turn of the year. Clearly the risk is that the damage proves to have been greater - particularly when measured at the height of the lockdown in April. The Bank of England reckons the damage will be closer to 30%.

Either way, we think the economy is unlikely to fully regain the lost ground until 2022 at the earliest - and potentially not until much later.

Here are six key challenges, we think the economy will face over the next few weeks and months:

Read about our latest forecasts - Covid-19 pandemic: Entering the next phase

Three scenarios for the UK economy



Source: ING

1 Social distancing is here to stay

In the absence of a vaccine, it's clear social distancing is here to stay for the foreseeable future. And this is clearly key - not just for health reasons, but also for the economy. Don't forget that one of the biggest economic risks now is a second-wave of the virus that forces renewed lockdowns - more on that later.

Even so, social distancing means the reality for many businesses returning to normal levels of operation is quite distant.

> *One of the biggest economic risks now is a second-wave of the virus that forces renewed lockdowns*

Recreation is a clear example - and the lessons from other countries' plans is that operations will be very restrictive for some time.

The US State of Georgia for instance, which controversially was one of the first areas in America to reopen, is limiting restaurants to serving 10 people per 500sq ft. Our US economist James Knightley notes that by comparison, a fine dining restaurant may typically have around 20 customers in that same space. For fast-food or higher density restaurant, it's closer to 50.

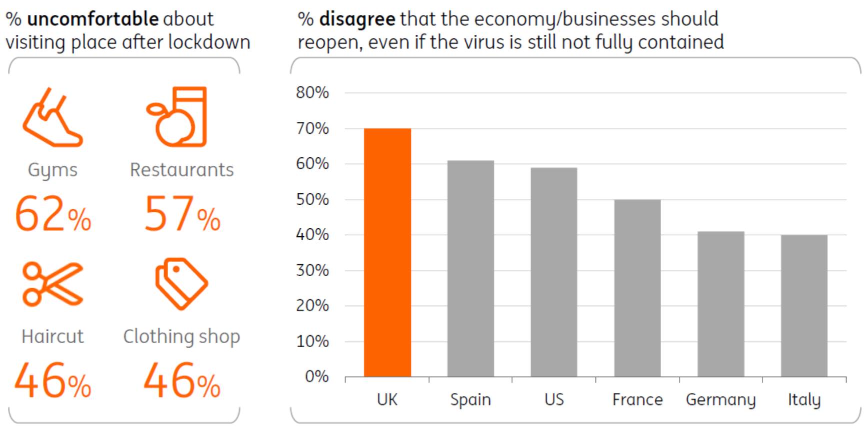
We don't know yet how the UK's plans will compare, but for those in the recreation sector that rely on high volumes and thin margins, maintaining a profitable operation in this environment will be very challenging.

2 People are reluctant to get back out-and-about

But for the high street as a whole, there is a more immediate challenge - persuading consumers to come and visit them at all.

Polling by Ipsos Mori indicated that Brits are the wariest about reopening the economy out of any country surveyed. People are very wary about returning to the high street once lockdown ends, according to separate YouGov surveys. Even for hairdressers - which will presumably be in high demand after seven weeks of hair growth - 46% of people said they would be uncomfortable visiting.

Surveys show Brits wary about returning to everyday life



Source: Ipsos Mori, YouGov

3 Business mindsets are likely to change

The combination of social distancing constraints, and consumer reluctance, means the economy is now entering another high-risk phase.

Up until now, the clear objective among businesses, but also the government's support measures, has been to weather the storm and this has been broadly successful. Around a quarter of employees are now being covered by the government's job retention (furlough) scheme.

Despite some teething issues with some other policies - notably government-guaranteed loans - the overall package of measures has limited the number of firms having to permanently cease trading. Less than 1% have shuttered their businesses for good, according to a recent ONS survey.

But now the eye of the storm has passed, and it is becoming clearer that the landscape has changed for the foreseeable future, the risk is that businesses begin to make longer-lasting changes to their operations. Airlines have been the most visible example of this so far, announcing wide-scale redundancies. Unfortunately, the risk is that we see more examples across other sectors too.

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Of course, how the government's support package evolves will be key. We wouldn't be surprised to see the job retention scheme adapted to incentivise businesses to phase staff back into the work, even if only on a part-time basis. This could perhaps see support gradually reduced as the number of hours an employee is able to work increases.

Alternatively, a number of other countries structure their own schemes based on the revenue loss a firm is encountering compared to pre-virus levels. That could see greater support offered to the likes of hospitality and parts of retail where trading is likely to be most constrained.

4 The fear of a second-wave

As we alluded to earlier, probably the biggest risk to the economy now is a return to severe lockdowns later in the year.

If that materialises, we'd expect a second dip in GDP, and the recovery to become even more protracted. There's a real risk that those businesses that have managed to weather the storm so far are unable to ride out a second lockdown.

With that in mind, both firms and consumers alike are likely to remain very cautious until the situation has passed entirely. Even those businesses with the capacity to expand are likely to stay cautious. And consumers, including those that still have their jobs or who are continued to be paid via the job retention scheme, will remain nervous. Don't forget savings rates are already lower in the UK than other parts of Europe.

5 Supply chains remain sensitive to global containment measures

Of course, it's not just the success of the UK in managing future coronavirus outbreaks that matters. Supply chains have been severely disrupted by the global pandemic. And don't forget many goods move multiple times across borders before hitting the market as a finished item.

Restarting these supply chains will be no easy task - not least because, as our trade team has highlighted, shipping will take time to readjust. There were reports back in March of a container shortage in Europe, owing to a lack of deliveries from China earlier in the pandemic.

The message is that if we get further supply interruptions again overseas, owing to new coronavirus containment measures outside of the UK, there could be ongoing volatility for businesses to contend with when sourcing materials and products.

6 Risk of a change of UK-EU trading terms in 2021

That brings us neatly to the final challenge for the UK - Brexit. This story is coming back to the fore again as negotiations continue, and both sides have until the end of June to decide whether to extend the transition period. The UK government has so far insisted it doesn't want an extension, which would imply that there will be big changes for the way Britain trades with Europe from the start of next year.

Even if a free-trade deal is agreed, there will still be considerable new frictions for both goods and services.

With firms unlikely to have the capacity to fully prepare for such changes this year, there could inevitably be disruption. The risk is that this combines with a second outbreak of the virus over the winter, further interrupting supply chains.

The UK's view may still change towards an extension when the June deadline draws nearer. But if not, then according to EU legal experts, this deadline cannot be pushed back, even if the political will exists to do so.

Put simply, if there has been no agreement on extending the transition period by July, then businesses will need to work on the assumption that there will be big changes in UK-EU trade terms at the beginning of 2021.

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com

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