UK: Four challenges facing the Chancellor

As UK Chancellor Rishi Sunak gears up to present his 'summer economic update' later today, he'll be acutely aware that many of the classic policy levers ordinarily designed to boost demand may not be much use in the current economic crisis. Here are four challenges we think he faces

1 Rising unemployment

Preserving jobs has become by far the most pressing challenge for the Treasury, amid renewed signs that unemployment is increasing.

While the majority of sectors are now able to reopen or will be, over the coming days (outside of England), it's clear that social distancing measures will make operating profitably challenging for various sectors. The pandemic is also changing habits, which is causing dramatic differences in where people are spending. More home-working, for instance, has seen footfall evaporate in some city centres and office districts.

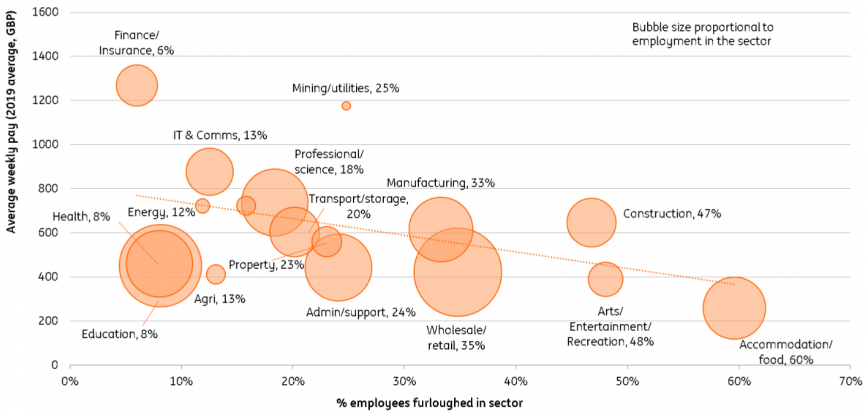
Up until now, the government's job retention (furlough) scheme has been successful in preventing job losses. But the scheme will be adjusted in coming weeks to require firms to make a large contribution to furlough pay - and this is being seen as a potential catalyst for businesses to begin making redundancy decisions. Polling by Opinium suggests fewer than half firms intend to keep on all of their furloughed staff.

Preserving jobs has become by far the most pressing challenge

Unsurprisingly the problem is most acute in hospitality, recreation and retail. These industries have been the heaviest users of the job retention scheme, but more importantly, tend to have lower rates of average pay. Food/hospitality, in particular, is also a sector that has historically led the rest of the jobs market in the recovery phase after downturns, helping to offset slower rebounds in other corners of the economy. As things stand, that's unlikely to be the case this time around.

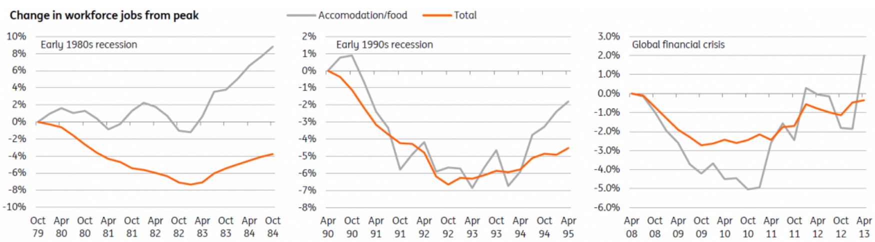
As a result, there's growing pressure to target support to these industries. The Treasury has thus far been reluctant to adapt the job retention scheme for certain sectors, but we are likely to hear more about apprenticeship funds and possibly other wage policies designed to keep people employed.

Sectors with higher furlough rates tend to have lower average pay



Source: UK Government, ONS

Accommodation and food has tended to lead jobs recovery in previous downturns



Source: Macrobond, ING

Local lockdowns

The Chancellor will also be under increasing pressure to announce how he will cushion the blow of local lockdowns, the first of which is currently underway in Leicester.

This localised strategy is being employed across Europe and is likely to be the go-to mechanism to control the virus over the coming months. In the case of Leicester, the government has allowed businesses to re-furlough staff providing they have used the scheme before.

This will presumably be extended to apply in future local lockdowns, but what's less clear is whether firms will still be able to claim the current 80% wage subsidy, even when the government's contribution to the job retention scheme begins to decrease from August.

3 Consumer reluctance

The outlook for unemployment is also intrinsically linked to how those who have been more fortunate to continue earning alter their spending habits as the economy reopens.

And while the government has launched a range of marketing campaigns to try and lure consumers out to the high street and restaurants once again, early evidence suggests that people are still wary. Retail footfall is still down considerably in comparison to a year ago. At the same time, OpenTable reservation data suggests there wasn't the anticipated rush to visit pubs/restaurants as they reopened in England over the weekend. Almost two-thirds of those polled by YouGov last Friday said they either wouldn't visit a pub until later in the year, or not all.

For the Treasury, this is a tricky nut to crack. One of the many unusual characteristics of this crisis is that savings have risen involuntarily for many individuals, particularly at the higher end of the income spectrum. That suggests that for many, the unwillingness to engage with retail or hospitality is down to safety rather than financial reasons.

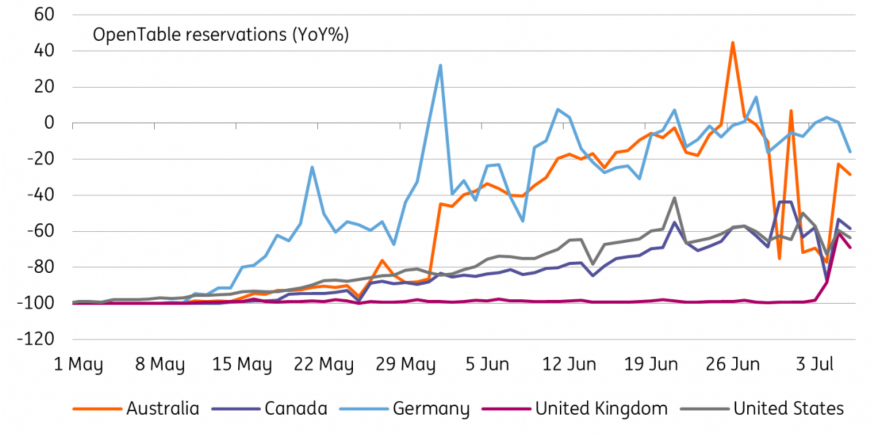
That implies that cutting taxes may not be particularly beneficial at the moment, and despite reports that the Chancellor is considering a cut in the rate of VAT, the risk is that this is simply saved rather than spent. Equally, those more heavily affected by the current crisis may be better served by more direct forms of income/employment support.

> *The unwillingness to engage with retail or hospitality is down to safety rather than financial reasons*

Perhaps for that reason, the Chancellor is reportedly mulling an alternative approach, which would involve giving consumers time-limited vouchers, redeemable in heavily-affected sectors (e.g. restaurants and physical retail).

This proposal, initially put forward by the Resolution Foundation, has been tried in countries over recent months, and its targeted nature could, in theory, prevent the vouchers simply being used to offset spending that would have happened anyway. That was a principal concern when Japan used a coupon scheme back in 1999.

OpenTable dining reservations



Source: OpenTable

4 Housing market uncertainty

The housing market remains something of a wildcard in the current economic outlook.

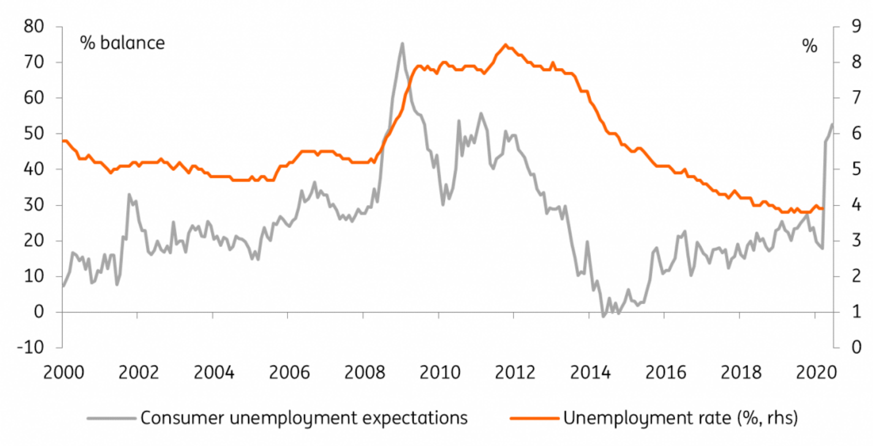
While rising unemployment points to a fall in prices, there appears to have been renewed activity over recent weeks as the market has reopened. And in the US - admittedly quite a different market to the UK - we've seen a dramatic rise in mortgage applications, reflecting the fact that the average homebuyer is less likely to have been profoundly affected in the current crisis.

Still, the lingering uncertainty has seen increased discussion about a possible time-limited cut in stamp duty (a tax on those buying a property). In fact, given it has been floated in public, it could become hard not to announce it this week, to avoid potentially paralysing the market further (if buyers hold out for a stamp duty cut later in the year).

However, similar to other forms of tax cuts, a stamp duty cut could turn out to be less effective than hoped.

Despite the recent pickup in activity, we suspect that transaction volumes in the housing market will begin to tail-off towards the autumn, once those sales that were agreed pre-lockdown have gone through. That's mainly because unemployment expectations have risen considerably over recent weeks, which is a reminder that those that have kept their jobs so far will be reluctant to make significant financial decisions until the risks surrounding the virus fade away.

Unemployment expectations have risen



Source: Macrobond

Unemployment expectations taken from European Commission consumer confidence survey

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