

## UK in 2021: Another year of tough decisions

The end of the post-Brexit transition period poses a fresh challenge for the economic recovery, although we're unlikely to see a Covid-style GDP collapse. Instead, the timing and way in which government support for jobs and businesses is unwound could have a bigger bearing on how far the UK economy recovers through 2021



**James Smith: The UK and Brexit in 2021**

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### Three main themes for 2021

1. Brexit to add pressure to the jobs market, but it's unlikely to trigger a Covid-style GDP collapse in early-2021. We expect GDP to rise by roughly 4.5% in 2021, but this is mainly a reflection of the sharper and more-prolonged lockdown in 1H20.
2. Unemployment set to rise further, potentially to high-single-digits if government support schemes are unwound before social distancing rules are meaningfully eased.
3. Bank of England to steer clear of negative rates, although it's a close call.

2020 has been a comparatively bad year for the UK economy. Not only are Covid-19 mortality figures worse than many other developed economies, but the longer lockdown has also resulted in a slower recovery. And while subsequently reversed, the initial decision to end wage support earlier than many other European governments means unemployment is likely to have risen further over the course of the year.

Prospects for a vaccine and mass-testing means that, on paper, 2021 should be a better year for the UK economy. But given the risks surrounding Brexit, and the uncertainty of how government support will be unwound means the economy is unlikely to return to pre-virus levels next year.

## 1 Brexit to add unemployment pressure, but not like Covid-19

At the time of writing, we still don't know whether the UK and EU will be able to sign-off a free-trade agreement before the end of 2020. But what we do know is that, compared to the current position of single market and customs union membership, all roads lead to a sharp change in trade-terms at the start of 2021.

With Covid-19 restrictions likely to remain relatively tight both in the UK and across the channel in January, the timing arguably couldn't be worse. England will still be emerging from lockdown, which we expect to hit UK-wide GDP by 6-7% in November.

The hope is that assuming there is a deal, both sides will be able to agree on some sideline measures to help reduce the scale of the early disruption - mitigations to ease the congestion at ports from day one, alongside EU decisions on financial services equivalence and data-adequacy, among other things.

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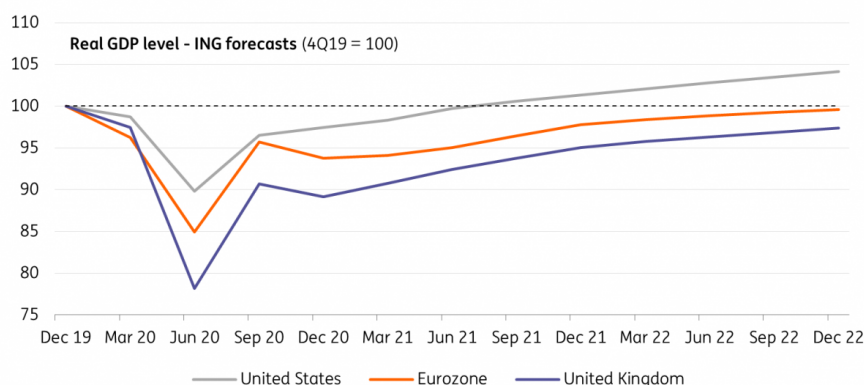
*All roads lead to a sharp change in trade-terms at the start of 2021*

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Even so, some initial disruption is to be expected, but importantly this is unlikely to trigger a Covid-19 style GDP hit early next year. In fact, barring another lockdown later in the winter, the first quarter will almost certainly record a positive growth figure, reflecting the technical bounce-back from the current shutdowns.

Instead, the impact may show through more clearly in the jobs market. The costs of new customs processes will put pressure on industries so far unscathed by the pandemic (eg agriculture). For other sectors, those already hit-hard by Covid-19 (eg carmakers), the new cost burden is likely to compound the damage already done by the pandemic.

## UK still set to underperform Europe and US



Source: ING

### 2 Unwinding government support could bring new challenges

An equally, if not more important, question for 2021 is how the government will extricate itself from the unprecedented support it has offered the economy through 2020.

Take the furlough scheme, which helps to pay workers 80% of their normal salaries. The policy, which was originally set to be replaced by a less generous scheme from the start of November, has been extended to March given the return to lockdown. That will undoubtedly help limit the rise in unemployment, although admittedly the policy announcement will have come a little too late to save some jobs.

Further extensions to this policy are possible, but at some point in 2021, the government faces the tough decision over how and when to unwind this, and other similar crisis policies. At stake are potentially around 1.7 million jobs (roughly 6% of employees) - the number of people we estimate were still 'fully furloughed' in October before the latest restrictions came in. Many of these jobs will be in sectors that were never allowed to fully reopen after the first lockdown.

If social distancing rules are still a heavy feature when the furlough scheme is scaled back, then potentially we could still see the unemployment rate rise into the high single digits at some point in 2021, as redundancies build in sectors that are still heavily constrained by Covid-19 rules.

### 3 Negative rates still far from guaranteed

Elsewhere, the Bank of England also faces a tough decision in 2021, when the debate on negative interest rates is likely to come to a head.

We think policymakers will more likely avoid rate cuts if they can next year, focussing instead on quantitative easing, but it's a close call. You can read more about this debate in our 2021 outlook for central banks.

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