

UK: What the Chancellor's announcement means for the economy and sterling

The Chancellor's announcements are innovative but unlikely to completely change the game for either the UK economic outlook or the pound. We think the ongoing uncertainty surrounding UK-EU trade negotiations will dominate the story for sterling, and could push EUR/GBP to 0.92 over coming months



Source: Shutterstock

Chancellor unveils new job support amid rising unemployment

Ahead of Chancellor Rishi Sunak's summer economic update today, [we set out four key challenges he faces](#) as we enter the Covid-19 recovery phase. And by far, the biggest out of the four is linked to jobs. Unemployment is on the rise as firms grapple with the challenging new, socially-distanced operating environment.

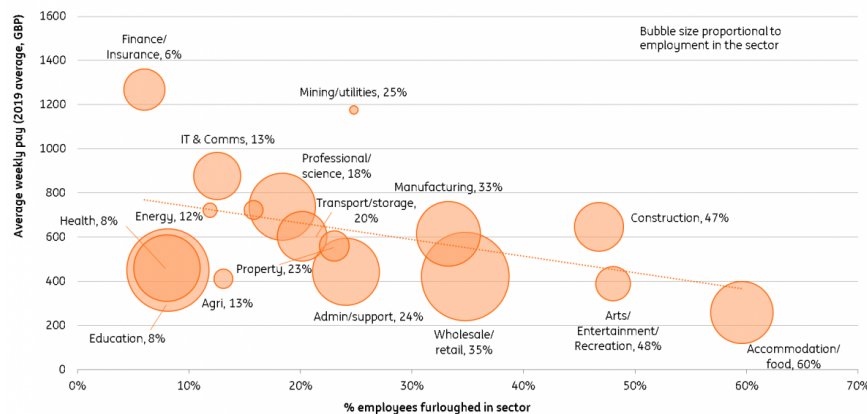
The Chancellor has opted against extending the flagship Job Retention scheme beyond October, and don't forget that the state's contribution to wage bills will be gradually reduced until then. Clearly, removing such unprecedented government intervention in the labour market is going to bring about job losses. But the big announcement today is that the government will pay a £1000

bonus per employee that is brought back from furlough, and kept employed until January.

On the face of it this is a fairly generous policy. In the accommodation/food sector, one of the heaviest users of the furlough scheme, that would be enough to pay around a month of earnings, based on the average of 2019 weekly pay. Anecdotally, it also seems that those staff members being furloughed were often towards the lower end of pay brackets.

Will this change the course of the jobs market? Not entirely - clearly if you are a business that has either had capacity significantly reduced by the new safety measures, or have seen demand collapse due to changing consumer habits, it's unlikely to save jobs when the furlough scheme is unwound. But nevertheless this scheme should at face value help cushion some of the blow for firms more widely, and it's also worth noting that companies will get the bonus even if they've already brought staff back from furlough.

The job retention scheme by sector



Source: UK Government, ONS

Property/VAT tax cuts unlikely to significantly move the needle

The other key takeaway from the statement is that by-and-large, tax cuts were avoided. As we noted in our previous piece, involuntary savings will have dramatically increased for many who have been more fortunate to continue earning through the crisis. If demand remains low now that the economy has largely reopened, then it is therefore more likely motivated by safety concerns rather than financial constraints.

Admittedly, the government has opted to cut VAT for selected industries, and more interestingly the government will cover 50% of restaurant bills through August (Mon-Wed) up to a maximum of £10 per person. This seems to be an evolution of the voucher scheme proposed over the weekend, and probably stands a better chance of luring people back out to hospitality businesses, as it eliminates the risk of the equivalent cash injection being saved rather than spent. That said, the size of this measure is, in reality, fairly small.

There was also a fairly sizable change to stamp duty (a property tax), although our feeling is that the housing market will continue to be dominated by concerns surrounding job security, despite this new government support.

Controlling the virus much more critical for UK growth

In short then, there are some innovative policies in the Chancellor's latest statement, although for markets this is not a huge intervention, at least compared to the big numbers everybody has become accustomed to. It's unlikely the schemes announced will cost nearly as much as the £30bn (or roughly 1.5% of GDP) estimated by the Treasury.

It should though, at least at the margin, help cushion some of the turbulence in the jobs market over coming months. But more importantly, no amount of fiscal support can mask the fact that the UK recovery hinges almost solely on avoiding a return to repeated, widespread lockdowns.

Not only is it important to businesses, which will be looking for an operating environment that is as stable as possible until a vaccine or similar treatment is available. But consumer confidence in the safety measures is going to be absolutely key, and in many cases will probably be a bigger driver of spending over coming months than financial health.

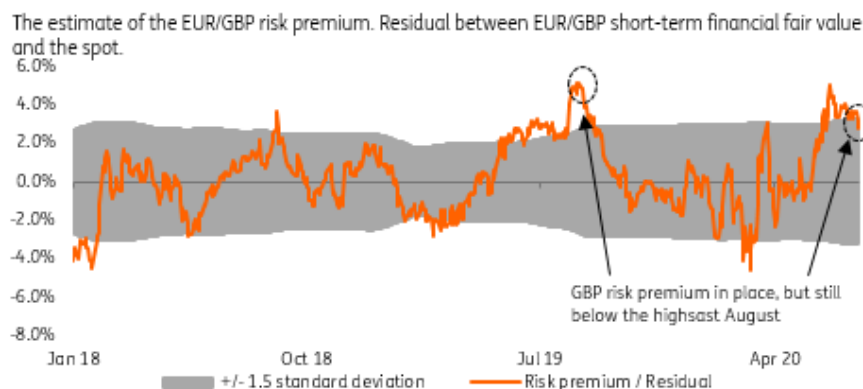
GBP: New announcements are no game changer, and will only provide short-term respite

The pound's reaction to Chancellor Sunak's fiscal announcement was fairly muted, given that sterling had already front-run the event yesterday (in terms of gains) after policy details started to emerge ahead of the announcement today.

While the size of the stimulus announced is modestly larger than expected, in our view it is not significant enough to prompt further GBP gains. The announced measures today do not significantly alter our UK growth outlook, and with the overriding GBP driver (UK-EU trade negotiations) still looking fairly uncertain, more gains in GBP are unlikely.

We see EUR/GBP moving towards 0.92 within three months as the lack of anticipated progress in UK-EU trade negotiations should translate into further risk premium being built into the currency. Based on our estimates, and following the recent GBP rebound, less than a 3% risk premium is currently built into GBP vs EUR (Figure 1). We think it's likely that the risk premium will increase above 5% ([read GBP: The ongoing disappointment](#)) if no meaningful progress in negotiations occurs this summer – which is our base case.

Figure 1: GBP risk premium



Source: Bloomberg, ING

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.