

UK: Recovery momentum set to stall after sharp July bounce

The UK economy rebounded strongly for the second month in July, although this mainly reflects the reopening of various social-sectors. We're likely to see the pace of expansion slow in August/September and stall as we head into the winter as the 'mechanical rebound' ends and unemployment rises



Source: iStock

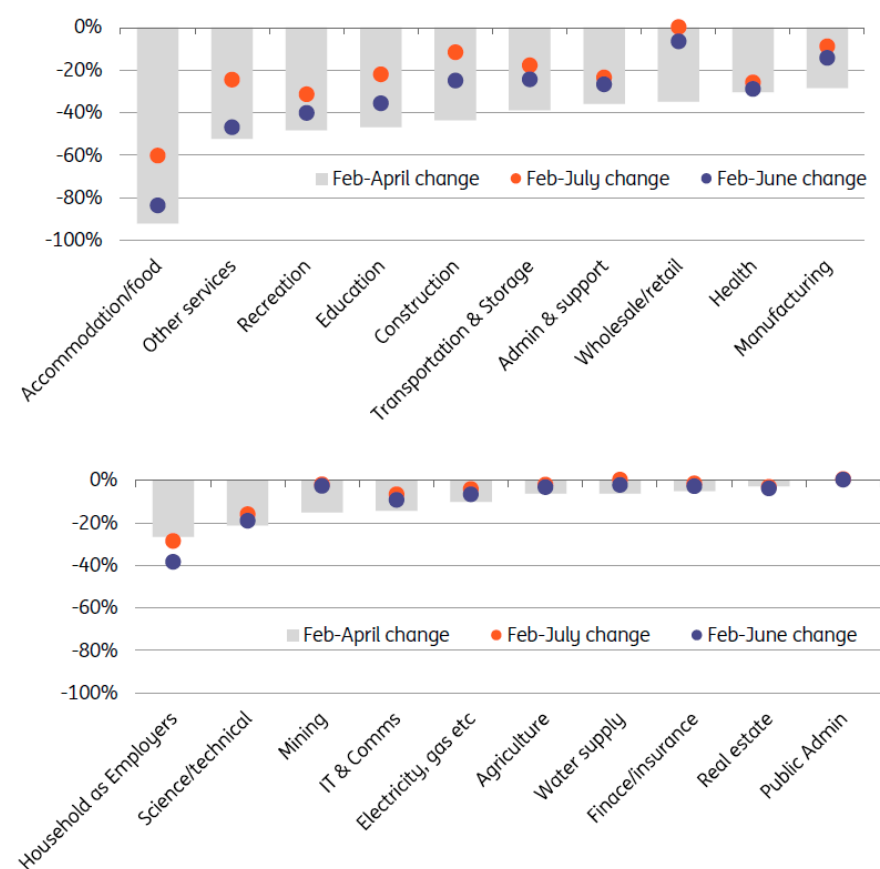
The fact that the UK economy has bounced for the second month in a row should come as little surprise.

The 6.6% increase in GDP through July really just reflects the reopening of a wider number of sectors, including of course the food and accommodation sectors (see chart).

This 'mechanical rebound' process should see a further increase in August, perhaps in the region of 3%, and a subsequent bounce in September to reflect the reopening of education venues (this part of the national accounts is as we understand it heavily dependent on the volume of people attending them). All in, we think the third quarter will register around 17% growth.

Of course, that would still leave the size of the UK economy about 8% lower than it was before the virus hit, and there are big questions surrounding where the economy will go from there.

Change in UK GDP by sector compared to February levels



Source: Macrobond, ING

In all likelihood, we're likely to see growth stall as we head into autumn.

Unemployment looks set to rise over the coming months, albeit perhaps it's still too early to see major signs of it in next week's jobs report. However, we think it's likely that the jobless rate will exceed the Bank of England's 7.5% forecast, towards the end of the year or early next.

The fireworks surrounding UK-EU negotiations also serve as a reminder that the forthcoming end to the transition carries a further risk to the recovery. While we don't expect another Covid-19 style collapse in GDP early next year (at least, not as a direct result of Brexit), the increased cost burden on firms comes at an already difficult time for cashflow.

It's important to remember that in some cases, the sectors likely to be hit hardest by the forthcoming change in trade terms (whether there's a deal or not) have not been as severely impacted by the pandemic so far. Agriculture is one such example (where tariffs can exceed 30% and border checks tend to be the most intrusive).

In the short-term though, a lot will depend on the way the virus spreads. As we've also seen in Europe, the UK government is likely to prioritise limiting gatherings over re-closing chunks of the economy. However, the risk is undoubtedly that, if transmission were to increase as people spend more time indoors over winter, then we could see the recovery process reverse to a certain extent if certain social venues are forced to close nationally once again.

We think the overall size of the UK economy is unlikely to return to pre-virus levels until late 2022, or perhaps later. This in turn will increase the pressure on the Bank of England to increase their stimulus package at the November meeting.

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