The Immediate Economic Outlook for the UK

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Financial Planning

UK Outlook

Though subject to some revision in the weeks and months ahead, we now have a realistic impression of how our economy performed during the first half of this extraordinary year.

Following a decline of 2.2 percent over the course of Q1, the Office for National Statistics (ONS) estimates that gross domestic product (GDP) fell a whopping 20.4 percent during Q2.

To put the Q2 figure in some context, note that our economy shrank by no more than 2.1 percent in any of the five quarters of consecutive decline during the 2008/09 crisis; a crisis which has come to be known as the Great Recession. Before we even get to Q2, the Q1 2.2 percent fall during the current crisis is remarkable enough; it is tied with Q3 in 1979 as the 4th worst decline in the modern record.

Needless to say that Q2's 20.4 percent contraction occupies the top spot, with Q1 in 1974 in second place at 2.7 percent.

That's right, hitherto the worst quarterly decline was just 2.7 percent.

The more you look at the Q2 result, the more incredible it is. The ONS is one of the few national statistics bodies from across the world that publishes a monthly estimate for GDP. That data set indicates that Q2's 20.4 percent decline was rooted in a more severe decline that occurred during the month of April. The ONS estimate reveals that the British economy actually grew during May and June, increasing by 2.4 percent and 8.7 percent respectively.

Of course, the record will show that the UK economy was in recession during Q1 and Q2 in 2020 and that it is the worst recession in modern British history. What will be lost is that almost all of the damage was done in a period no longer than 61 days, during March and April.

Now, you might have noticed that I have gone out on a limb there and suggested that the record will show a recession during just the first half of this year (Q1 and Q2). I expect the data, when it is available in mid-November, to reveal an expanded economy during Q3. That will bring an end to the run of consecutive quarterly declines that usually characterise a recession.

And I'm not expecting a small increase during Q3, I'm expecting a big one: the biggest on record, in fact.

Thus far, the largest quarterly increase occurred during Q1 in 1973 with a jump of 5.0 percent.

I've got my sights on something like 13.0 percent for Q3 this year, give or take a percent or two in either direction.

I could be wrong, of course. 13.0 percent represents little more than a guess and it is made on the proviso that we do not see another nation-wide lockdown during September.

Actually, I'm conscious that I am one of only a few commentators emphasising the potential for improvement in the outlook.

Having said that, my forecast for Q3 growth is quite reasonable in the context of other, third-party forecasts. Indeed, if you think I'm being overly optimistic you might want to steer clear of economists at NatWest Markets, Morgan Stanley and Bloomberg. I haven't checked with them directly but from what I gather they are calling for an increase of 19.6 percent, 18.0 percent and 17.0 percent respectively. As a matter of fact, the lowest updated and credible Q3 forecast I can find is provided by Goldman Sachs. And even that, at 6.1 percent, comfortably beats the current highest logged gain of 5.0 percent.

Broadly speaking, my expectations accord with those at the Bank of England.

Mind you, the dusty boffins from Threadneedle Street haven't had it easy. Back in May, with the release of the Bank's quarterly Monetary Policy Report, I suggested that their 'illustrative scenario' – which incorporated a decline in Q2 of 25.0 percent and a full year decline of 14.4 percent – was a reasonable framework for decision-making. But that's not how it was received by the press; it was almost universally criticized as being excessively hopeful. It was too V-shaped, apparently.

Three turbulent months later, the August Monetary Policy Report notes that the subsequent…

'…recovery in UK output has been somewhat more rapid than was assumed in the [Monetary Policy Committee's] illustrative scenario in the May Report. That partly reflects lockdown measures being eased earlier than had been assumed. It also reflects activity having been stronger than assumed under lockdown, partly due to greater online spending'.

You will recall that there was an almighty degree of uncertainty back in May when the Bank compiled that report. In the light of the criticism it has attracted, and in a field of endeavor notorious for inaccurate forecasts, I think the Bank of England is due a little credit.

And not just for that report. In my view, the Bank's interventions in the money market and the capital markets – not something I generally favour – have helped to avert a much deeper, much more damaging set of circumstances. Had those markets ceased to function effectively – and for a few days in March I think that was a very real possibility – we would likely be caught in the horrid embrace of a depression today.

Dysfunctional markets are an impediment to a full and vigorous recovery, functional markets are the opposite; they're a boon.

But I digress.

As optimistic as I am, my outlook is not without an appreciation of considerable risks to the downside. Even with a historically high rate of expansion in Q3 and further strong gains in Q4, that incredible period of decline during March and April leaves us still with a sizable hole in GDP for 2020. My estimate suggests that economic output could be as much as 10.0 percent lower at the end of this year compared with the end of last year.

There are many twists and turns and bumps in the road ahead of us. And for a while we will remain vulnerable to further shocks.

Nevertheless, the recovery is already underway.

NOTES.

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www.townclosefp.co.uk

Suite 2, 258a High Road

Loughton

IG10 1RB

Tel: 020 7993 4898

Email: advice@townclosefp.co.uk