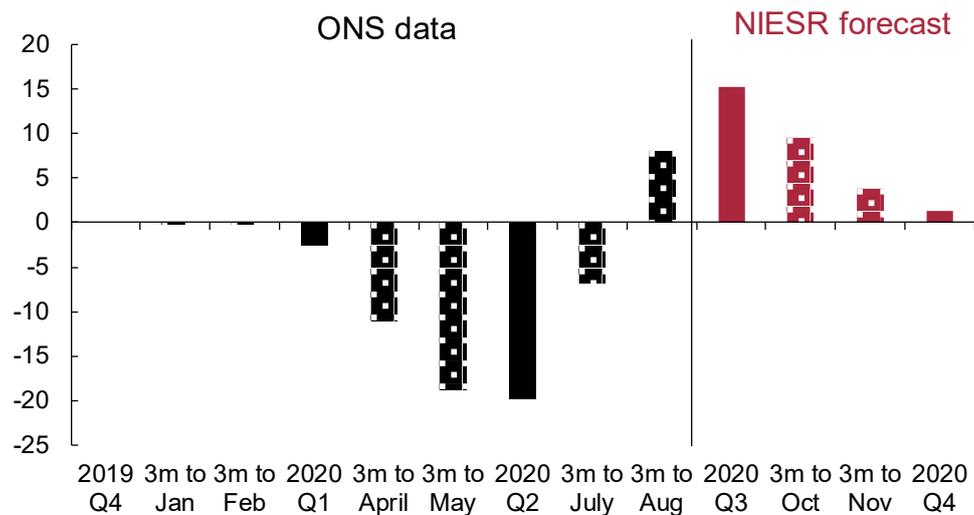


Recovery to stall due to heightened Covid-19 uncertainty

Figure 1 - UK GDP growth (3 months on previous 3 months, per cent)



Main points

- Latest ONS estimates published this morning suggest that the UK economy grew by 8.0 per cent in the three months to August, broadly in line with our forecast last month (figure 1).
- All major sectors remain below their February 2020 level. Services remain 9.6 per cent below, while manufacturing and construction are 8.5 per cent and 10.8 per cent below, respectively.
- The ONS estimates suggest that the economy grew by 2.1 per cent in August itself, marking a fourth consecutive monthly increase, but at a significantly lower rate compared to June and July as we had expected (table 1).
- We now expect growth to stop in September and project 0.0 per cent. Taking account of the latest ONS estimate for August and our September forecast, we expect to see growth of around 15 per cent in the third quarter of 2020.
- However, against the background of a likely widening of lockdown restrictions, a winding down of government support schemes, and the return of extensive Brexit-related uncertainty, we expect a significantly slower pace of recovery in the fourth quarter of 2020. Our initial forecast for the final quarter of the year is for growth of 1.3 per cent.
- We expect the economy to be about 8.5 per cent below its end-2019 level by the end of this year.

"Today's ONS estimates suggest that GDP grew by 8 per cent in the three months to August. Although the latest estimates also signal a fourth consecutive monthly increase, with growth of 2.1 per cent in August itself, output is still about 9 per cent below the levels seen in February. These numbers would suggest that the UK could grow by about 15 per cent in the third quarter of 2020. However, there is further cause for concern ahead with the likely re-imposition of lockdown measures, the winding down of government support measures, and Brexit uncertainty. We expect the economy at the end of this year to be some 8.5 per cent below its level at the end of 2019."

Dr Kemar Whyte

**Senior Economist - Macroeconomic Modelling and
Forecasting**

Economic setting

There is significant and chronic uncertainty around the path and pace of recovery in the UK economy. The initial lockdown had effectively reduced the number of cases during the second quarter of 2020. However, the lifting of restrictions and more extensive testing has led to a pronounced rise in the number of new cases. This has prompted the re-imposition of lockdowns at a localised level. The full economic cost of the pandemic is likely to rise further with the re-introduction of these restrictions. The stringency and duration of further measures to combat the rise in new cases will significantly alter the economic trajectory. At the same time, government support schemes are winding down, which means there is less job security, as well reduced firm-level dynamism and job creation. Brexit has also started to loom on the horizon causing hesitancy in spending and investment decisions. So, while the third quarter is expected to see an encouraging economic rebound, the outlook for the fourth quarter is far more pessimistic.

News in latest ONS data

The latest monthly ONS data were largely in line with what we had anticipated last month, with data confirming GDP grew by 8.0 per cent in the three months to August. Figure 2 shows how our short-term forecasts for recent quarters have changed as new information has become available.

Figure 2 - Evolution of the NIESR quarterly GDP forecast (3 months on previous 3 months, per cent)

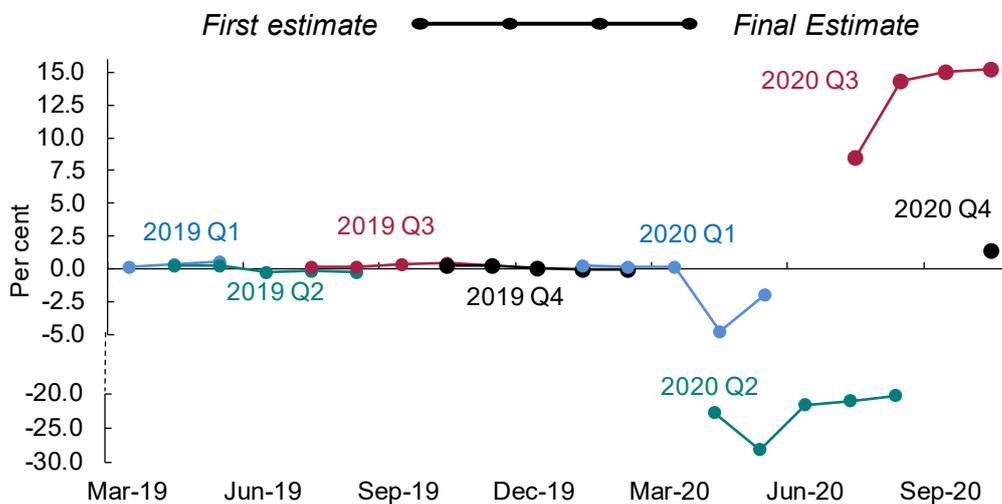
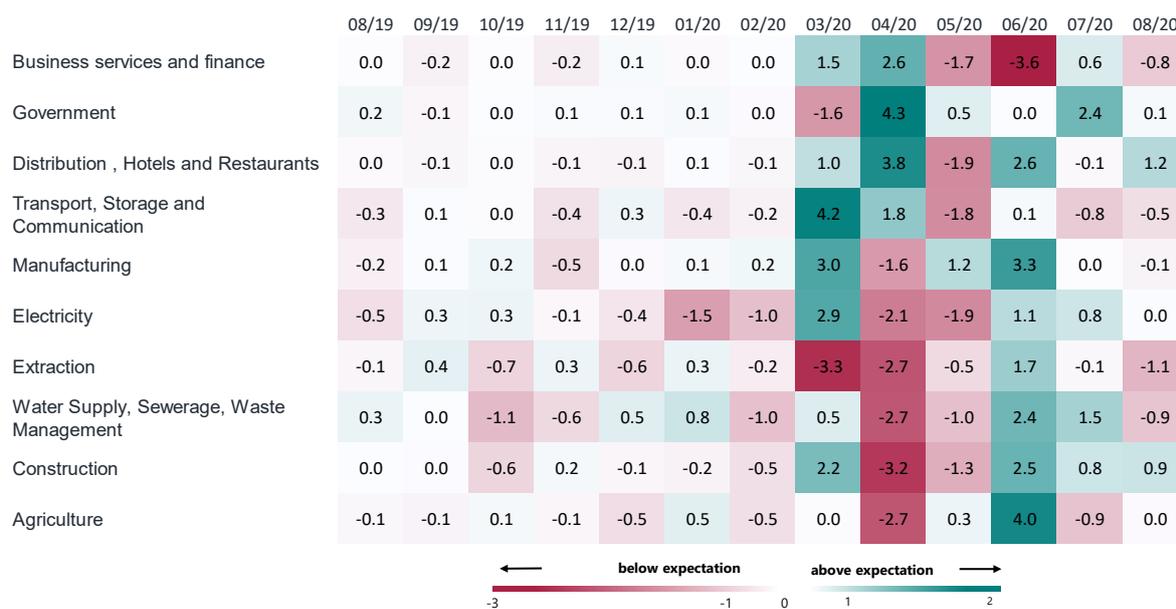


Figure 3 shows a heat map of the data surprises across sectors in the monthly data, relative to last month's GDP Tracker, highlighting the sectors where the surprises are large relative to the volatility of the output data. This month, positive surprises were seen in distribution and hotels and government. At the same time, negative surprises were seen in extraction, water supply, business services, and transport, storage and communication.

Figure 3 - Surprises in monthly data

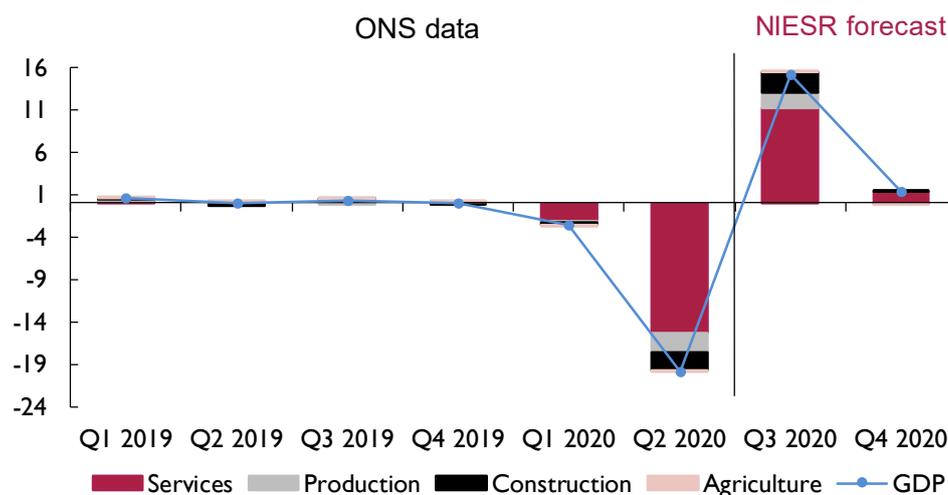


Note: Cells show forecast errors as a fraction of the standard deviation of errors for each series. Green cells are greater than expected, red cells are less than expected.

Sectoral detail

The economy grew by 8.0 per cent in the three months to August. Growth in the last three months was underpinned by positive contributions across all the headline sectors of the economy. Our forecast for the third quarter of 2020 is for growth of about 15 per cent.

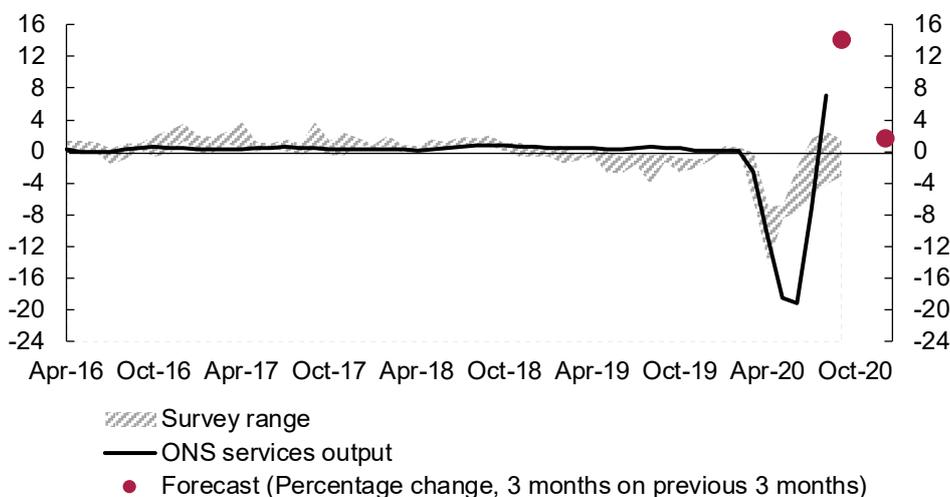
Figure 4 - Contributions to quarterly GDP growth (percentage points)



Services (80 per cent of GDP)

According to the latest ONS data, the services sector grew by 7.1 per cent in the three months to August, a stronger outturn than what we predicted last month. The growth in the services sector was driven by increases in nearly all industries, most notably in wholesale and retail trade, which has recovered to above its February 2020 level; retail trade, which grew by 17.9 per cent; and education, which grew by 16.4 per cent. Based on recent developments we expect service sector growth to be around 14 per cent in the third quarter of 2020 (figure 5).

Figure 5 - ONS service sector growth (3 months on previous 3 months, per cent) compared with swathe of business survey balances (standardised)



Note: The shaded swathe shows the highest and lowest values each month of a range of business survey balances that have been standardised so that they have the same mean and standard deviation as the quarterly growth of the ONS series.
Source: ONS, CBI, Markit, Bank of England Agents, EC, NIESR calculations.

The survey balances point to a decline in growth in the private service sector, as shown by the swathe of survey indicators in figure 5. The headline business activity balance in the IHS Markit/CIPS UK services came in at 56.1 in September, down from 58.8 in August. Despite the fall, which represents the lowest reading since June, the index nevertheless pointed to a marked rate of growth. Activity was mainly supported by a further increase in the levels of new work. However, the withdrawal of the government’s Eat Out to Help Out scheme, coupled with in introduction of tighter restrictions on activity in September, meant growth in new business was slightly weaker than in August. On the global front, Services Activity Index registered at 51.6 in September, relatively unchanged form 52.0 August. Output was largely boosted by improved inflows of new business.

Production (14 per cent of GDP)

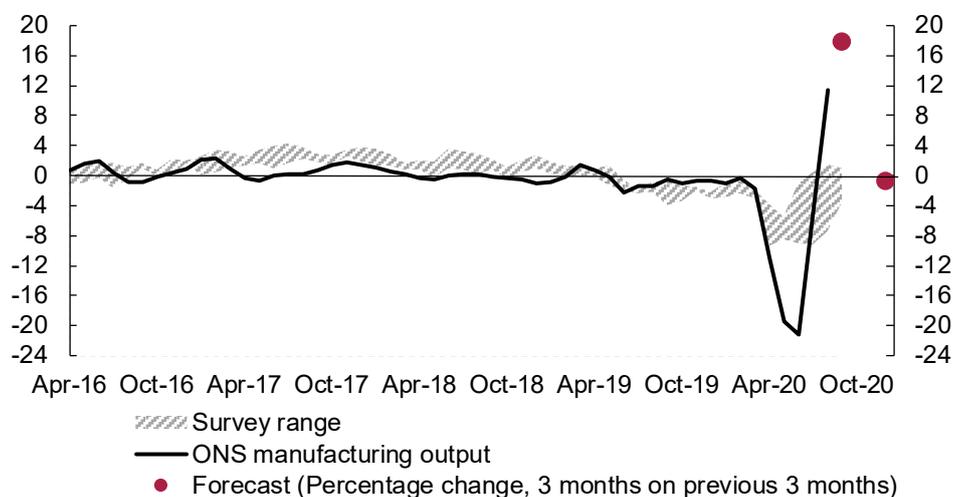
Production output grew by 9.3 per cent in the three months to August, in line with what we anticipated last month. The growth in production was driven by increases in manufacturing, electricity and gas supply, water supply, and mining and quarrying. We estimate that production will grow by 13.7 per cent in the third quarter of 2020, though output in this sector is volatile and difficult to predict on a quarterly basis with any accuracy.

The production sector comprises manufacturing; mining and quarrying; electricity gas, steam and air conditioning; water supply and sewerage; and oil and gas extraction. The largest of these sectors is manufacturing, worth 10 per cent of GDP.

Manufacturing (10 per cent of GDP)

Within production, output in the manufacturing sector grew by 11.3 per cent in the three months to August. Manufacturing industries experienced widespread increases over the last three-month period, with 12 out of 13 sub-sector experiencing growth. The most notable was the manufacture of transport equipment, which grew by 25.6 per cent. Our forecast for the third quarter is for manufacturing to grow by 17.8 per cent, revised upwards marginally from last month.

Figure 6 - ONS manufacturing sector growth (3 months on previous 3 months, per cent) compared with swathe of business survey balances (standardised)



Note: The shaded swathe shows the highest and lowest values each month of a range of business survey balances that have been standardised so that they have the same mean and standard deviation as the quarterly growth of the ONS series.
Source: ONS, CBI, Markit, Bank of England Agents, EC, NIESR calculations.

The IHS Markit/CIPS UK manufacturing PMI fell marginally to 54.1 in September, down from 55.2 in August, and recording a fourth consecutive above neutral mark posting. The increased production was due to higher inflows of new work, companies resuming operation and staff returning to work. Within the industry, larger manufacturers saw the fastest growth and smaller firms recorded the slowest.

The J.P.Morgan Global Manufacturing Output rose to 52.3 in September, up from 51.8 in August, signalling an expansion for the third consecutive month. The improvement was largely underpinned by further improvements in new business.

Mining and quarrying (1 per cent of GDP)

Mining and quarrying is a small but erratic component of industrial production that can have an influence on overall GDP growth. Output grew by 6.0 per cent in the three months to August, due to a recovery in quarrying. We now forecast growth of 1.5 per cent in the third quarter of 2020.

Construction (6 per cent of GDP)

Output in the construction sector grew by 18.5 per cent in the three months to August, in line with what we had forecast last month. The main contributor to this increase was private new housing, which grew by a record 34.9 per cent. We anticipate growth of around 39 per cent in the third quarter of 2020.

The IHS Markit/CIPS construction PMI survey rose sharply to 56.8 in September, up from 54.6 in August. Underlying data suggested that home building and commercial projects rose strongly, whilst civil engineering activity fell for a second month. Further evidence suggested that expansion in overall activity was driven by improvement in demand conditions during September.

Table 1 - Summary Table of GDP growth (2016=100)

2016=100	GDP index	Index of Services	Index of Services - Components				Index of Production	Index of Production - Components				Index of Construction	Agriculture
			Business services and finance	Government and other services	Distribution, Hotels and Restaurants	Transport, Storage and Communications		Manufacturing	Electricity, gas, steam and air conditioning	Mining and Quarrying	Water Supply, Sewerage and Waste Management		
	1000	796	339	217	133	108	136	102	15	6	13	61	7
Latest weights	1000	796	339	217	133	108	136	102	15	6	13	61	7
Dec-18	100.5	100.9	100.2	100.5	100.7	104.0	98.9	98.9	98.5	99.0	99.2	98.9	103.1
Jan-19	100.9	101.1	100.1	100.6	102.0	104.4	99.4	99.6	100.8	97.1	98.4	101.0	103.3
Feb-19	101.3	101.4	100.3	101.0	102.2	104.4	99.8	100.2	97.6	99.3	98.8	103.4	103.1
Mar-19	101.5	101.4	100.3	101.1	102.4	104.4	101.3	101.7	98.4	103.7	98.9	102.3	103.6
Apr-19	101.0	101.4	100.0	101.1	102.5	105.1	98.1	97.7	101.2	97.3	98.8	102.2	104.4
May-19	101.3	101.5	100.1	101.2	102.4	105.1	99.3	98.7	102.2	100.3	100.8	102.5	105.3
Jun-19	101.4	101.8	100.5	101.7	102.5	105.4	98.9	98.2	103.1	97.8	100.5	101.1	105.9
Jul-19	101.7	102.1	100.9	101.8	102.8	105.9	98.7	98.4	100.5	97.3	100.0	102.1	106.8
Aug-19	101.5	102.1	101.0	102.0	102.7	105.0	97.9	97.3	99.7	98.3	100.7	102.0	107.8
Sep-19	101.6	102.0	100.7	102.0	102.5	105.5	98.3	97.2	99.4	104.5	100.7	102.5	108.4
Oct-19	101.8	102.4	101.1	102.2	102.9	106.0	98.8	97.9	103.7	98.5	99.9	100.6	108.8
Nov-19	101.5	102.0	100.7	102.6	102.3	104.6	97.8	96.5	103.8	99.6	100.0	101.7	108.9
Dec-19	101.6	102.3	101.0	102.8	102.3	105.4	97.3	96.4	101.8	96.5	100.4	100.6	108.7
Jan-20	101.7	102.4	101.1	102.9	103.4	104.4	97.2	96.6	98.9	96.8	100.4	100.8	108.3
Feb-20	101.4	102.2	101.1	102.2	102.9	104.4	97.6	97.4	98.2	96.7	99.4	99.5	107.4
Mar-20	94.0	94.1	98.8	89.0	86.9	98.6	93.1	91.5	98.1	91.2	101.4	94.0	105.5
Apr-20	75.7	77.3	88.7	72.8	53.3	81.5	74.9	68.5	91.3	89.7	93.9	55.3	99.1
May-20	77.7	78.7	88.1	74.2	60.2	82.1	79.1	73.9	91.7	92.1	95.3	60.3	99.9
Jun-20	84.8	85.2	91.2	77.5	79.2	90.0	86.9	82.8	95.6	98.8	99.5	73.5	103.1
Jul-20	90.2	90.2	92.9	83.5	92.0	93.4	91.4	88.5	99.0	97.4	100.8	86.1	103.2
Aug-20	92.1	92.4	93.3	85.5	100.1	93.9	91.7	89.1	100.5	93.4	100.7	88.7	102.8
Sep-20	92.1	92.5	93.3	87.0	97.2	95.6	90.8	87.7	100.8	94.1	100.7	88.1	102.3
Oct-20	92.4	92.9	93.4	88.7	96.0	96.2	90.9	87.8	101.3	94.1	101.0	88.3	101.9
Nov-20	92.6	93.2	93.5	89.3	96.0	96.5	90.9	87.7	102.3	93.2	101.1	88.3	101.9
Dec-20	93.0	93.6	93.7	89.8	97.0	97.1	90.8	87.5	102.4	92.9	101.3	88.4	102.0

Percentage change, 3 months on previous 3 months

Jun-19	0.0	0.3	0.0	0.4	0.3	0.8	-1.4	-2.3	3.3	-1.6	1.4	-0.3	1.8
Jul-19	0.2	0.4	0.3	0.5	0.2	0.8	-0.8	-1.4	2.9	-1.6	1.6	-0.7	2.2
Aug-19	0.3	0.6	0.7	0.7	0.2	0.5	-1.1	-1.4	0.5	-2.6	0.9	-0.6	2.3
Sep-19	0.4	0.5	0.7	0.6	0.2	0.3	-0.5	-0.6	-2.3	1.6	0.4	0.3	2.3
Oct-19	0.2	0.4	0.4	0.5	0.1	0.0	-0.6	-1.0	-1.0	2.0	0.0	-0.2	2.2
Nov-19	0.1	0.1	0.0	0.4	-0.1	-0.1	-0.2	-0.8	1.2	3.1	-0.2	-0.1	1.7
Dec-19	0.0	0.2	0.1	0.6	-0.2	-0.1	-0.3	-0.7	3.2	-1.8	-0.4	-1.2	1.1
Jan-20	0.0	0.1	0.0	0.7	0.0	-0.7	-0.9	-1.0	0.6	-2.8	-0.2	-0.7	0.3
Feb-20	-0.1	0.2	0.2	0.4	0.3	-0.6	-0.9	-0.4	-2.6	-4.2	-0.1	-1.3	-0.5
Mar-20	-2.6	-2.6	-0.6	-4.4	-4.7	-2.7	-2.0	-1.8	-4.6	-3.4	0.3	-2.8	-1.6
Apr-20	-11.1	-10.8	-4.7	-14.4	-21.1	-9.5	-9.1	-11.1	-5.6	-5.2	-2.0	-17.9	-4.3
May-20	-18.8	-18.5	-9.1	-23.4	-35.1	-16.5	-15.4	-19.5	-6.0	-5.9	-3.2	-30.3	-6.1
Jun-20	-19.8	-19.3	-11.0	-23.7	-34.3	-17.5	-16.3	-21.1	-5.6	-1.4	-4.2	-35.7	-5.9
Jul-20	-6.8	-7.1	-5.7	-10.9	-4.8	-6.7	-3.1	-4.7	-0.5	3.9	0.3	-11.6	-1.9
Aug-20	8.0	7.1	0.7	4.4	35.4	5.8	9.3	11.3	5.0	6.1	3.6	18.5	1.5
Sep-20	15.2	14.1	4.3	14.0	50.1	11.6	13.7	17.8	7.8	1.5	4.7	39.0	2.0
Oct-20	9.5	9.3	2.9	11.0	26.8	7.6	6.2	7.9	5.7	-2.3	2.3	20.6	0.3
Nov-20	3.8	4.0	1.0	7.5	6.6	4.0	1.0	1.1	3.2	-2.8	0.6	6.6	-1.0
Dec-20	1.3	1.7	0.4	4.6	-0.1	2.5	-0.4	-0.8	1.9	-1.7	0.4	0.8	-0.8

Percentage change, month on same month in previous year

Jun-19	1.5	2.0	0.8	2.0	2.2	6.0	-1.3	-2.4	6.5	-1.2	-1.7	0.2	6.5
Jul-19	1.4	2.0	0.8	1.9	1.4	6.9	-1.9	-1.8	0.6	-7.1	-1.0	1.0	7.2
Aug-19	1.1	1.7	0.9	1.9	1.7	4.1	-2.3	-2.5	0.1	-6.6	-0.1	1.6	8.0
Sep-19	1.2	1.6	0.6	1.9	2.1	3.5	-2.1	-3.4	0.1	3.8	0.6	1.4	8.5
Oct-19	1.1	1.6	0.4	1.8	1.7	4.3	-0.7	-1.6	5.5	-2.8	0.0	-0.9	8.6
Nov-19	0.7	1.0	0.0	2.2	0.2	2.5	-1.1	-2.4	5.6	-0.4	0.8	0.5	7.5
Dec-19	1.1	1.4	0.8	2.3	1.6	1.3	-1.6	-2.5	3.4	-2.5	1.2	1.7	5.4
Jan-20	0.8	1.3	1.0	2.3	1.4	0.0	-2.2	-3.0	-1.9	-0.3	2.0	-0.2	4.8
Feb-20	0.1	0.8	0.8	1.2	0.7	0.0	-2.2	-2.8	0.6	-2.6	0.6	-3.8	4.2
Mar-20	-7.4	-7.2	-1.5	-12.0	-15.1	-5.6	-8.1	-10.0	-0.3	-12.1	2.5	-8.1	1.8
Apr-20	-25.0	-23.8	-11.3	-28.0	-48.0	-22.5	-23.6	-29.9	-9.8	-7.8	-5.0	-45.9	-5.1
May-20	-23.3	-22.5	-12.0	-26.7	-41.2	-21.9	-20.3	-25.1	-10.3	-8.2	-5.5	-41.2	-5.1
Jun-20	-16.4	-16.3	-9.3	-23.8	-22.7	-14.6	-12.1	-15.7	-7.3	1.0	-1.0	-27.3	-2.6
Jul-20	-11.3	-11.7	-7.9	-18.0	-10.5	-11.8	-7.4	-10.1	-1.5	0.1	0.8	-15.7	-3.4
Aug-20	-9.3	-9.5	-7.6	-16.2	-2.5	-10.6	-6.3	-8.4	0.8	-5.0	0.0	-13.0	-4.6
Sep-20	-9.4	-9.3	-7.3	-14.7	-5.2	-9.3	-7.7	-9.8	1.5	-9.9	0.0	-14.1	-5.6
Oct-20	-9.2	-9.3	-7.6	-13.2	-6.7	-9.2	-7.9	-10.3	-2.3	-4.5	1.1	-12.2	-6.3
Nov-20	-8.7	-8.6	-7.1	-13.0	-6.2	-7.7	-7.0	-9.1	-1.4	-6.5	1.1	-13.1	-6.5
Dec-20	-8.5	-8.5	-7.3	-12.6	-5.2	-7.8	-6.7	-9.2	0.6	-3.7	0.9	-12.1	-6.1

Percentage change, month on previous month

Jun-19	0.1	0.3	0.4	0.5	0.1	0.3	-0.4	-0.5	0.9	-2.5	-0.3	-1.4	0.6
Jul-19	0.3	0.3	0.4	0.1	0.3	0.5	-0.2	0.2	-2.5	-0.5	-0.5	1.0	0.8
Aug-19	-0.2	0.0	0.1	0.2	-0.1	-0.8	-0.8	-1.1	-0.8	1.0	0.7	-0.1	0.9
Sep-19	0.1	-0.1	-0.3	0.0	-0.2	0.5	0.4	-0.1	-0.3	6.3	0.0	0.5	0.6
Oct-19	0.2	0.4	0.4	0.2	0.4	0.5	0.5	0.7	4.3	-5.7	-0.8	-1.9	0.4
Nov-19	-0.3	-0.4	-0.4	0.4	-0.6	-1.3	-1.0	-1.4	0.1	1.1	0.1	1.1	0.1
Dec-19	0.1	0.3	0.3	0.2	0.0	0.8	-0.5	-0.1	-1.9	-3.1	0.4	-1.1	-0.2
Jan-20	0.1	0.1	0.1	0.1	1.1	-0.9	-0.1	0.2	-2.8	0.3	0.0	0.2	-0.4
Feb-20	-0.3	-0.2	0.0	-0.7	-0.5	0.0	0.4	0.8	-0.7	-0.1	-1.0	-1.3	-0.8
Mar-20	-7.3	-7.9	-2.3	-12.9	-15.5	-5.6	-4.6	-6.1	-0.1	-5.7	2.0	-5.5	-1.8
Apr-20	-19.5	-17.9	-10.2	-18.2	-38.7	-17.3	-19.5	-25.1	-6.9	-1.6	-7.4	-41.2	-6.1
May-20	2.6	1.8	-0.7	1.9	12.9	0.7	5.6	7.9	0.4	2.7	1.5	9.0	0.8
Jun-20	9.1	8.3	3.5	4.4	31.6	9.6	9.9	12.0	4.3	7.3	4.4	21.9	3.2
Jul-20	6.4	5.9	1.9	7.7	16.2	3.8	5.2	6.9	3.6	-1.4	1.3	17.1	0.1
Aug-20	2.1	2.4	0.4	2.4	8.8	0.5	0.3	0.7	1.5	-4.1	-0.1	3.0	-0.4
Sep-20	0.0	0.1	0.0	1.7	-2.9	1.9	-1.0	-1.6	0.3	0.8	0.0	-0.7	-0.5
Oct-20	0.4	0.4	0.1	1.9	-1.2	0.6	0.2	0.2	0.5	0.0	0.2	0.3	-0.3
Nov-20	0.2	0.3	0.1	0.7	0.0	0.3	0.0	-0.1</					

Health warning

The NIESR GDP Tracker provides a rolling monthly forecast for GDP growth. Our first estimate of growth for any particular quarter starts in the first month of that quarter and is then updated each month until the first official release in the second month of the following quarter. So, for example, our first estimate of growth in the first quarter of 2020 is published this month and will then be updated four times (in February, March, April and May) before the ONS publishes its first estimate for the first quarter of 2020 in May 2020. In other words, we publish four estimates of GDP for any particular quarter before the official release and change them as new evidence becomes available.

NIESR's short-term predictions of monthly GDP growth are based on bottom-up analysis of recent trends in the monthly sub-components of GDP. These predictions are constructed by aggregating statistical model forecasts of ten sub-components of GDP. The statistical models that have been developed make use of past trends in the data as well as survey evidence to build short-term predictions of the sub-components of monthly GDP. These provide a statistically-based guide to current trends based on the latest available data. Each month these predictions are updated as new ONS data and new surveys become available.

It is important to stress that the timelier NIESR guide to quarterly GDP growth is less reliable than the subsequent ONS data releases as its data content is lower, particularly for estimates of the current quarter which in some months will be based only on forecasts rather than hard data. To mitigate this issue, NIESR provides a guide to average errors based on past performance. NIESR also provides clear guidance on how the latest news has caused its estimates of GDP growth in the current and preceding quarter to change and thereby quantify how the short-term outlook is being affected by recent data releases.

As the bottom-up methodology for producing estimates of GDP growth for the current and preceding quarters is still relatively new, we do not yet have a long track record of estimates produced by this approach. To check how our methodology would work in real time we went back to late 2016 to produce judgement-free forecasts of GDP growth in future months based on the monthly data series available for the components in November 2016 (this was the earliest vintage then available on the ONS website) and in each subsequent three months. These are shown in Table 2, which has been updated to include estimates since we started producing the GDP Tracker in July 2018. We calculate the forecast quarter-on-quarter growth rates for the current quarter and compare these to the ONS first estimates of quarterly growth. The average absolute error for the quarters considered was 0.2 % points. The largest error was for 2019Q2 when our GDP tracker in May pointed to growth of 0.3 per cent, 0.5% points higher than the ONS first estimate of GDP growth. As shown in figure 2, we correctly revised our estimate of 2019Q2 growth down to -0.2 per cent in June when monthly GDP figures for April indicated a fall in output.

Table 2 Forecast Error Analysis: Quarterly GDP growth (%)

Quarter	ONS first estimate	ONS latest	NIESR nowcast*	Error in NIESR nowcast**	ONS latest – first
2016Q4	0.6	0.7	0.7	-0.1	0.1
2017Q1	0.3	0.6	0.6	-0.3	0.3
2017Q2	0.3	0.3	0.4	-0.1	0.0
2017Q3	0.4	0.3	0.4	0.0	-0.1
2017Q4	0.5	0.4	0.4	0.1	-0.1
2018Q1	0.1	0.0	0.5	-0.4	-0.1
2018Q2	0.4	0.5	0.0	0.4	0.1
2018Q3	0.6	0.6	0.5	0.1	0.0
2018Q4	0.2	0.2	0.4	-0.2	0.0
2019Q1	0.5	0.6	0.2	0.3	0.1
2019Q2	-0.2	-0.2	0.3	-0.5	0.0
2019Q3	0.3	0.4	0.2	0.1	0.1
2019Q4	0.0	0	0.2	-0.2	0.0
2020Q1	-2.0	-2.1	0.2	-2.2	-0.1
2020Q2	-20.4	-20.4	-22.8	2.4	0.0
2020Q3			15.0		
Average absolute error				0.22	0.08

Notes for editors

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