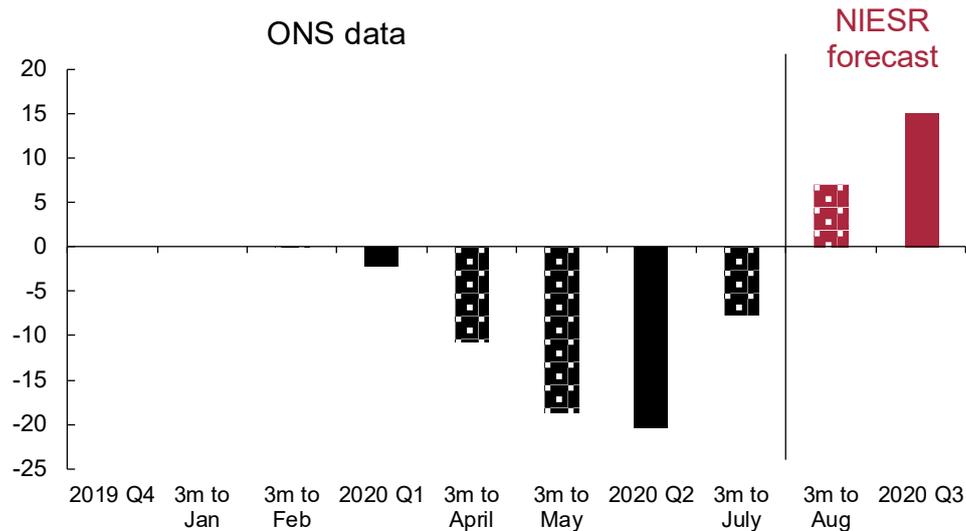


UK economy on rocky road to recovery with growth forecast of around 2 per cent in August

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



Main points

- Latest ONS estimates published this morning show that the UK economy contracted by 7.6 per cent in the three months to July, largely in line with what we had forecast last month (figure 1).
- The estimates also suggest that the economy grew by 6.6 per cent in July itself, marking a third consecutive monthly increase.
- Despite this recovery, the economy has still only recovered just over half of the lost output caused by the national lockdown.
- All the main sectors of the economy remain below pre-crisis levels. However, improvements have been seen in manufacturing and agriculture, but services and production remain sluggish.
- Taking account of the latest ONS estimates, we forecast GDP to grow by about 7 per cent in the three months to August and expect to see growth of around 15 per cent in the third quarter of 2020.

“There has been a welcome resumption of economic growth in the third quarter as the lockdown eased, signalling the end of a short, yet severe, recession in the first half of the year. The latest ONS estimates suggest that GDP grew by 6.6 per cent in July, a third consecutive monthly increase and is now 18.6 per cent higher than its April level. However, despite this recovery, we have still only recovered just over half of the output lost due to the Covid-19 pandemic. The evolution of the pandemic and the scale of expected withdrawals of government support pose downside risks on the pace of the recovery as we move to the end of this terrible year.”

Dr Kemar Whyte

**Senior Economist - Macroeconomic Modelling and
Forecasting**

Economic setting

The gradual reopening of the economy in the third quarter has led to a sharp rise in activity and signalled the end of a short, but severe, technical recession in the first half of the year due to the Covid-19 pandemic and the resulting national lockdown. Nonetheless, there are still challenges ahead as there is continued uncertainty about the evolution of the pandemic. In addition, the expected withdrawal of government support schemes such as the CJRS poses a major challenge in sustaining this recovery.

The important question is how well the economy will cope as these support measures are withdrawn. The impact of the Covid-19 recession has been felt more in some sectors than others. The most significantly hit sectors are those linked to travel, hospitality and recreation. These sectors are expected to see continued weakness for the remainder of the year, even as the overall economy begins to recover. Worryingly, many firms within the services sector have been doing further job cutting, in anticipation of the tougher times ahead. The impact on the labour market will become clearer as we approach the end of the year. While the economy continues to be affected by the pandemic and its associated containment measures, the headline rate of unemployment remained reasonably low over the summer, largely due to unprecedented government support. However, with labour intensive industries being more severely affected by the pandemic, it is to be expected that the impact on unemployment will be larger than the fall in GDP would suggest.

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 declined by 7.6 per cent in the three months to July. 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)

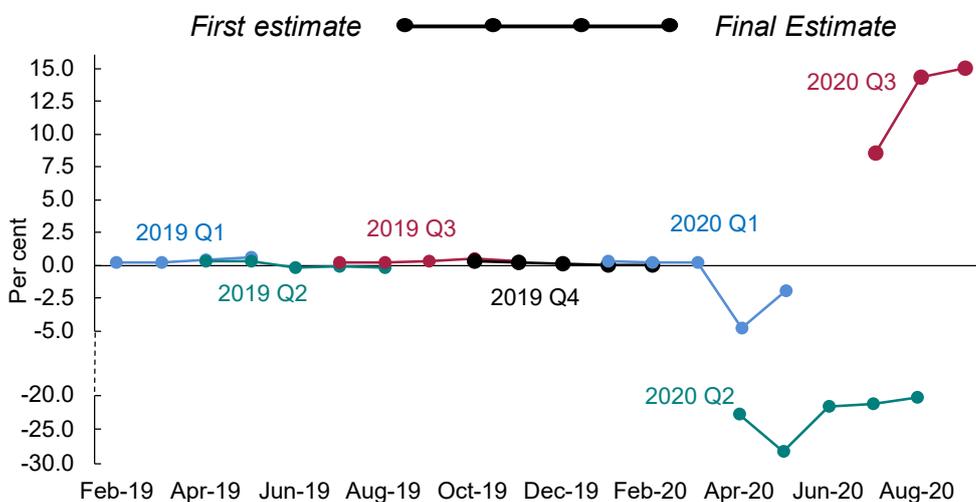
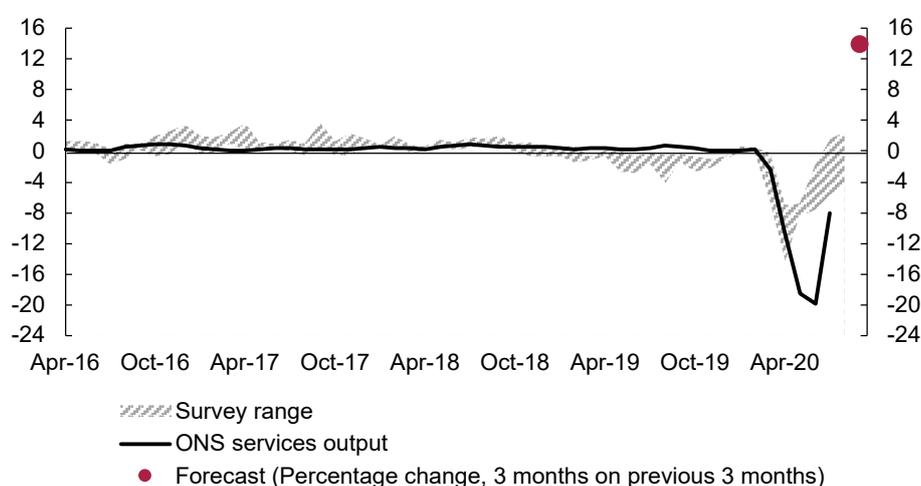


Figure 3 shows a heat map of the data surprises across sectors in the monthly data, relative to last month's GDP Tracker, highlighting the sectors where the surprises are large relative to the volatility of the output data. This month, positive surprises were seen in all sectors except transport, storage and communication and agriculture.

Services (80 per cent of GDP)

According to the latest ONS data, the services sector fell by 8.1 per cent in the three months to July, broadly consistent with what we predicted last month. The fall in the services sector was driven by declines in nearly all industries, most notably in education which fell by 14.3 per cent due to school closures, health which fell by 23.6 per cent largely because of reduced activity in elective operations, food and beverage services which fell by 60.1 per cent. There was also a large contraction in accommodation which fell by 69.2 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 rebound 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 58.8 in August, up from 56.5 in July. The higher volumes of business activity were strongly linked to a rebound in business and consumer spending during August, following the phased reopening. Globally, Services Activity Index registered at 51.9 in August, up from 50.5 in July, signally a second consecutive expansion of output.

Production (14 per cent of GDP)

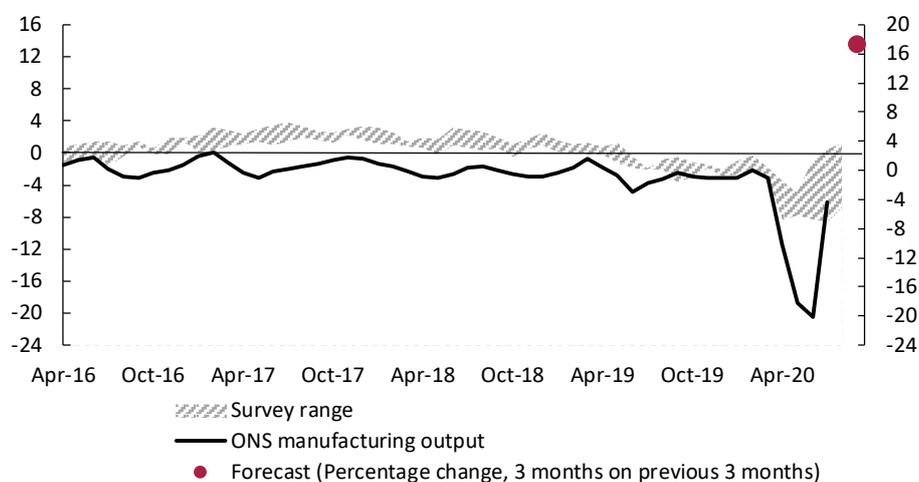
Production output fell by 3.5 per cent in the three months to July, in line with what we anticipated last month. The decline in production was driven by falls in manufacturing, electricity and gas supply, and water supply. We estimate that production will grow by 14.4 per cent in the third quarter of 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 fell by 4.4 per cent in the three months to July. Manufacturing industries experienced widespread decline over the last three-month period, with 10 out of 13 sub-sector experiencing contraction. The most notable was the manufacture of transport equipment, which fell by 19.1 per cent. Our forecast for the third quarter is for manufacturing to grow by 17.2 per cent, revised downwards 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 rose at its fastest pace since May 2014. The index increased to 55.2 in August, up from 53.3 in July, recording a third consecutive above neutral mark posting. Manufacturers accredited the expansion to the reopening and loosening of other restrictions in place to combat Covid-19.

The J.P.Morgan Global Manufacturing Output rose to 51.8 in August, up from 50.6 in July, and back above the neutral mark for the second consecutive month. The improvement was mainly linked to the restarting of production and reopening of clients following lockdowns in response to the pandemic.

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 2.8 per cent in the three months to July, due to a recovery in quarrying. We now forecast growth of 8.9 per cent in the third quarter of 2020.

Construction (6 per cent of GDP)

Output in the construction sector fell by 10.6 per cent in the three months to July, broadly consistent with what we had forecast last month. The main contributors to this decline were private new housing and private housing repair and maintenance, which fell by 17.0 per cent and 17.9 per cent, respectively. We anticipate growth of around 36.8 per cent in the third quarter of 2020.

The IHS Markit/CIPS construction PMI survey fell to 54.6 in August, down from 58.1 in July, reflecting the weakest expansion in the last three months. All three broad categories of construction provided a weaker contribution to the headline index relative to those seen in July. Survey respondents pointed to the lack of new work to replace completed contracts as a brake on the speed of expansion.

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											
Latest weights			339	217	133	108	136	102	15	6	13	61	7
Sep-18	104.1	104.2	102.8	102.2	106.1	109.9	102.5	103.0	94.9	108.0	104.3	107.2	102.4
Oct-18	104.4	104.5	103.4	102.4	106.8	109.5	102.4	102.5	96.2	111.4	103.7	107.7	103.0
Nov-18	104.6	104.8	103.4	102.4	107.7	110.0	102.2	102.6	95.7	107.9	103.2	107.3	103.0
Dec-18	104.2	104.5	103.0	102.6	106.7	110.6	101.6	102.1	94.6	107.3	102.9	105.2	102.0
Jan-19	104.7	104.8	102.8	102.7	108.1	111.5	102.5	103.2	96.7	105.2	102.1	107.4	101.7
Feb-19	105.0	105.1	103.1	103.0	108.3	111.7	102.6	103.7	93.1	107.8	102.1	109.6	101.4
Mar-19	105.1	105.1	103.1	103.1	108.4	111.3	103.7	105.0	92.4	113.1	102.5	108.4	101.3
April-19	104.6	105.0	102.8	102.9	108.3	112.2	100.5	100.4	95.4	108.1	102.9	108.4	101.2
May-19	104.8	105.1	103.0	103.1	108.4	111.7	101.5	101.3	95.9	108.6	105.3	108.5	101.2
Jun-19	105.0	105.5	103.4	103.6	108.5	112.6	101.4	101.2	96.3	108.0	105.0	106.8	101.3
Jul-19	105.4	105.9	103.9	103.7	108.7	113.7	101.2	101.4	94.9	107.3	104.2	108.3	101.4
Aug-19	105.3	105.9	103.9	104.0	108.7	112.3	100.5	100.6	93.1	107.6	105.3	108.2	101.5
Sep-19	105.3	105.8	103.8	104.0	108.4	112.8	100.5	100.1	92.7	114.6	105.5	108.8	101.4
Oct-19	105.5	106.2	104.2	104.1	108.9	113.1	100.9	100.7	96.3	106.8	104.7	106.6	101.3
Nov-19	105.1	105.8	103.9	104.5	108.2	111.4	100.0	99.1	97.6	108.8	105.2	107.9	101.3
Dec-19	105.3	106.1	104.3	104.6	108.0	112.3	99.8	99.2	95.7	106.5	105.6	107.5	101.4
Jan-20	105.5	106.2	104.4	104.9	108.9	110.9	100.0	99.8	92.0	107.7	106.7	108.8	101.5
Feb-20	105.5	106.2	104.7	104.8	108.4	111.3	100.3	100.7	91.1	107.4	104.7	106.8	101.6
Mar-20	98.2	98.2	102.2	92.1	92.7	105.2	96.0	95.4	89.8	100.1	105.4	101.0	100.7
Apr-20	78.5	80.1	91.1	73.3	57.9	86.1	76.4	71.9	81.9	91.0	98.0	60.4	94.9
May-20	80.4	81.2	90.3	74.1	65.4	86.5	81.1	77.9	81.8	96.6	98.5	65.0	95.8
Jun-20	87.3	87.5	93.2	77.2	83.9	95.0	88.7	86.4	85.2	104.7	102.5	80.3	98.4
Jul-20	93.1	92.8	95.1	84.8	94.9	99.5	93.3	91.9	87.4	105.4	105.0	94.4	99.5
Aug-20	94.6	94.7	97.0	86.7	96.8	101.5	94.5	92.9	88.6	106.5	106.0	92.8	99.2
Sep-20	95.5	95.8	97.1	88.3	98.8	103.7	94.0	91.9	89.8	106.4	106.1	94.1	98.1

Percentage change, 3 months on previous 3 months

Mar-19	0.5	0.4	-0.3	0.5	1.1	1.3	0.8	1.5	-1.5	-0.2	-1.0	1.6	-1.2
April-19	0.4	0.4	-0.1	0.4	0.8	0.9	0.2	0.4	-2.1	2.7	-0.2	2.0	-0.9
May-19	0.2	0.3	0.0	0.3	0.6	0.4	-0.3	-0.7	-0.2	3.0	1.2	1.0	-0.5
Jun-19	-0.1	0.2	0.1	0.3	0.1	0.6	-1.7	-2.9	1.9	-0.4	2.1	-0.5	-0.2
Jul-19	0.2	0.4	0.4	0.5	0.2	0.8	-0.9	-1.7	2.2	-1.6	2.3	-0.9	0.0
Aug-19	0.4	0.7	0.7	0.7	0.2	1.0	-0.9	-1.1	0.2	-2.1	1.2	-0.6	0.2
Sep-19	0.5	0.6	0.8	0.7	0.2	0.7	-0.4	-0.3	-2.4	1.5	0.6	0.5	0.2
Oct-19	0.3	0.4	0.5	0.5	0.1	0.1	-0.7	-0.8	-1.7	1.6	0.3	0.0	0.1
Nov-19	0.1	0.2	0.2	0.4	-0.1	-0.4	-0.6	-1.1	0.8	2.3	0.3	0.0	-0.1
Dec-19	0.0	0.2	0.3	0.5	-0.2	-0.6	-0.5	-1.0	3.2	-2.2	0.2	-1.0	-0.1
Jan-20	-0.1	0.1	0.2	0.6	-0.3	-1.1	-0.7	-1.1	1.1	-1.8	0.6	0.2	0.0
Feb-20	0.1	0.2	0.5	0.5	-0.1	-0.8	-0.4	-0.1	-2.7	-2.6	0.5	-0.1	0.2
Mar-20	-2.1	-2.4	-0.4	-3.6	-4.6	-2.8	-1.5	-1.0	-5.8	-2.1	0.4	-1.7	-0.1
Apr-20	-10.7	-10.6	-4.7	-13.9	-20.3	-9.6	-9.0	-10.1	-7.9	-7.6	-3.0	-17.3	-2.3
May-20	-18.7	-18.5	-9.5	-23.8	-33.6	-17.0	-15.5	-18.2	-9.1	-10.5	-4.8	-29.9	-4.3
Jun-20	-20.4	-19.9	-11.8	-25.6	-33.2	-18.3	-16.9	-20.2	-8.8	-7.3	-5.6	-35.0	-4.8
Jul-20	-7.6	-8.1	-6.5	-12.6	-5.7	-7.1	-3.5	-4.4	-3.2	2.7	-0.7	-10.6	-1.2
Aug-20	7.0	6.0	0.6	3.8	27.6	6.6	9.1	10.6	3.0	10.0	3.8	18.2	1.9
Sep-20	15.0	13.9	5.3	15.7	40.2	13.8	14.4	17.2	6.8	8.9	6.1	36.8	2.7

Percentage change, month on same month in previous year

Mar-19	2.3	2.3	0.7	1.6	5.2	5.6	0.9	1.8	-10.7	13.7	1.4	5.1	-1.4
April-19	1.5	1.8	0.1	1.3	4.0	5.9	-1.8	-2.2	-3.3	-0.1	2.5	3.7	-1.3
May-19	1.4	1.5	0.3	1.4	2.5	4.8	-0.4	-1.7	4.6	2.0	3.3	2.6	-1.2
Jun-19	1.3	1.8	0.6	1.7	2.5	5.2	-1.5	-2.5	2.1	1.5	0.4	0.2	-0.6
Jul-19	1.3	1.9	0.9	1.8	1.7	6.1	-1.9	-2.0	-2.4	-3.4	-0.1	1.5	-0.3
Aug-19	1.2	1.7	1.0	1.9	2.0	3.0	-2.5	-2.6	-4.0	-4.0	1.3	1.8	-0.3
Sep-19	1.2	1.5	1.0	1.8	2.2	2.6	-2.0	-2.8	-2.3	6.1	1.2	1.5	-1.0
Oct-19	1.1	1.6	0.8	1.7	2.0	3.3	-1.5	-1.8	0.1	-4.1	1.0	-1.0	-1.7
Nov-19	0.5	1.0	0.5	2.1	0.5	1.3	-2.2	-3.4	2.0	0.8	1.9	0.6	-1.7
Dec-19	1.1	1.5	1.3	1.9	1.2	1.5	-1.8	-2.8	1.2	-0.7	2.6	2.2	-0.6
Jan-20	0.8	1.3	1.6	2.1	0.7	0.5	-2.4	-3.3	-4.9	2.4	4.5	1.3	-0.2
Feb-20	0.5	1.0	1.6	1.7	0.1	-0.4	-2.2	-2.9	-2.1	-0.4	2.5	-2.6	0.2
Mar-20	-6.6	-6.6	-0.9	-10.7	-14.5	-5.5	-7.4	-9.1	-2.8	-11.5	2.8	-6.8	-0.6
Apr-20	-25.0	-23.7	-11.4	-28.8	-46.5	-23.3	-24.0	-28.4	-14.2	-15.8	-4.8	-44.3	-6.2
May-20	-23.3	-22.7	-12.3	-28.1	-39.7	-22.6	-20.1	-23.1	-14.7	-11.0	-6.5	-40.1	-5.3
Jun-20	-16.9	-17.1	-9.9	-25.5	-22.7	-15.6	-15.6	-14.6	-11.5	-3.1	-2.4	-24.8	-2.9
Jul-20	-11.7	-12.4	-8.5	-18.2	-12.7	-12.5	-7.8	-9.4	-7.9	-1.8	0.8	-12.8	-1.9
Aug-20	-10.2	-10.6	-6.6	-16.6	-10.9	-9.6	-6.0	-7.7	-4.8	-1.0	0.7	-14.2	-2.3
Sep-20	-9.3	-9.4	-6.4	-15.1	-8.9	-8.1	-6.5	-8.1	-3.2	-7.1	0.6	-13.5	-3.3

Percentage change, month on previous month

Mar-19	0.1	0.0	0.0	0.1	0.1	-0.4	1.1	1.3	-0.8	4.9	0.4	-1.1	-0.1
April-19	-0.5	-0.1	-0.3	-0.2	-0.1	0.8	-3.1	-4.4	3.2	-4.4	0.4	0.0	-0.1
May-19	0.2	0.1	0.2	0.2	0.1	-0.4	1.0	0.9	0.5	0.5	2.3	0.1	0.0
Jun-19	0.2	0.4	0.4	0.5	0.1	0.8	-0.1	-0.1	0.4	-0.6	-0.3	-1.6	0.1
Jul-19	0.4	0.4	0.5	0.1	0.2	1.0	-0.2	0.2	-1.5	-0.6	-0.8	1.4	0.1
Aug-19	-0.1	0.0	0.0	0.3	0.0	-1.2	-0.7	-0.8	-1.9	0.3	1.1	-0.1	0.1
Sep-19	0.0	-0.1	-0.1	0.0	-0.3	0.4	0.0	-0.5	-0.4	6.5	0.2	0.6	-0.1
Oct-19	0.2	0.4	0.4	0.1	0.5	0.3	0.4	0.6	3.9	-6.8	-0.8	-2.0	-0.1
Nov-19	-0.4	-0.4	-0.3	0.4	-0.6	-1.5	-0.9	-1.6	1.3	1.9	0.5	1.2	0.0
Dec-19	0.2	0.3	0.4	0.1	-0.2	0.8	-0.2	0.1	-1.9	-2.1	0.4	-0.4	0.1
Jan-20	0.2	0.1	0.1	0.3	0.8	-1.2	0.2	0.6	-3.9	1.1	1.0	1.2	0.1
Feb-20	0.0	0.0	0.3	-0.1	-0.5	0.4	0.3	0.9	-1.0	-0.3	-1.9	-1.8	0.1
Mar-20	-6.9	-7.5	-2.4	-12.1	-14.5	-5.5	-4.3	-5.3	-1.4	-6.8	0.7	-5.4	-0.9
Apr-20	-20.1	-18.4	-10.9	-20.4	-37.5	-18.2	-20.4	-24.6	-8.8	-9.1	-7.0	-40.2	-5.8
May-20	2.4	1.4	-0.9	1.1	13.0	0.5	6.2	8.3	-0.1	6.2	0.5	7.6	0.9
Jun-20	8.6	7.8	3.2	4.2	28.3	9.8	9.4	10.9	4.2	8.4	4.1	23.5	2.7
Jul-20	6.6	6.1	2.0	9.8	13.1	4.7	5.2	6.4	2.6	0.7	2.4	17.6	1.1
Aug-20	1.6	2.0	2.0	2.2	2.0	2.0	1.3	1.1	1.4	1.0	1.0	-1.7	-0.3

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

For further information please contact the NIESR Press Office press@niesr.ac.uk or Chloe Ridyard / Luca Pieri on c.ridyard@niesr.ac.uk / l.pieri@niesr.ac.uk / 07930 544 631

National Institute of Economic and Social Research

2 Dean Trench Street
Smith Square
London, SW1P 3HE
United Kingdom

Switchboard Telephone Number: 020 7222 7665

Website: <http://www.niesr.ac.uk>