Summary of NIESR Business Conditions Forum January 2021

National Institute of Economic and Social Research (NIESR) hosted the Business Conditions Forum (BCF) on 13 January 2021. The aim of the BCF is to have informed and analytical discussions of data and surveys to better understand the current state of the UK economy. The discussions are held the Chatham House Rule to encourage free and open discussion. *NIESR is grateful to the ESRC and the Impact Accelerator Award (IAA) for funding the BCF.*

Agenda

The discussion at this meeting was centred around the economic impacts in the short and medium term of Covid-19 and Brexit. The discussion ended with a poll where participants were asked to provide forecasts for unemployment, inflation and GDP.

Main discussion points

Fallout from COVID-19

The latest Deloitte Chief Financial Officer survey shows that business optimism in the UK was at a record high in December. This survey sample is dominated by large corporates, so worth noting that optimism may not be shared among small and medium enterprises (SME). The survey was also completed before the announcement of a new lockdown in England and so the optimism may not carry over to January.

Despite the rapid roll-out of vaccines to the population, CFOs do not expect COVID-19 related restrictions to be permanently lifted until the second half of this year. COVID-19 has had a profound and likely-lasting impact on the economy. The number of people working from home has dramatically increased, as have the number of remote GP consultations and online sales. Even in manufacturing where it is traditionally difficult to work from home, the number of people working from home has increased significantly. Businesses are focusing on reducing costs in order to preserve their cash flows, and are trying to adapt to the situation by increasing their efforts in automation, streamlining of processes and IT at the expense of lower R&D, machinery and infrastructure investments.

One of the contributors noted that the pandemic has not led to a homogeneous increase in corporate debt. Somewhat surprisingly, the latest Bank of England data shows that the outstanding longer maturity debt of the larger corporate sector is actually lower than a year ago. Large businesses drew down on revolving capital facilities, took short term finance including from the Government sponsored schemes and then paid it back using their cash flows. On the contrary, SME borrowing is about a quarter higher than a year ago. There seem to be few concerns about liquidity at the moment.

Compared to the first national lockdown, the lockdown started in January is expected to have a smaller economic impact because businesses are better prepared, flexible working arrangements are in place and click-and-collect is allowed. The reduction in hours worked during the lockdown is expected to be lower than in the first lockdown, but redundancies are rising faster.

Labour market and pay

The latest Incomes Data Research survey shows that there has only been a moderate decrease in median pay growth in 2020 despite the pandemic: median pay growth decreased from 2.5 to 2.3%. However the stable median masks a large heterogeneity in pay awards, with the lower quartile seeing a high proportion of pay freezes. In the third quarter, up to one third of pay settlements included a pay freeze. There are important sectoral differences. The private services sector had the largest number of pay freezes, but it also had the largest number of pay awards that are worth 4% or more. Air transport was badly hit by the pandemic but food retail has been holding up very well. The outlook for 2021 is a further moderate slowdown in median pay.

Despite pay settlements holding up during the pandemic, household earnings growth declined significantly in 2020 because a significant part of the workforce lost income while on furlough or working part-time. According to the latest NIESR Wage Tracker, Average Weekly Earnings growth will decline from 3½ % in 2019 to slightly lower than 1% in 2020, making it the worst year for earnings growth since 2009.

The pandemic also triggered a change in the structure of the labour market with a record number of self-employed changing their status to employees according to the latest Labour Force Survey. This could be because workers are attracted to the security of the employee status in an economic downturn, or because the Coronavirus Job Retention Scheme is seen as more favourable than the Self-Employed Income Support Scheme. There may also have been an anticipation of change in legislation designed to bring in alignment on and off payroll working due to enter into force in April 2021.

Unemployment is clearly on the rise and is likely to increase sharply from the 4.9% from August to October 2020. The number of advertised online job ads is at about a third below last year's level, and often at lower proposed pay. The furlough scheme may have to be extended beyond April to limit the rise in unemployment. In the last recession, unemployment increased to 8½ per cent in 2011. The poll of the participants shows that two third of participants expect unemployment to rise to 5-7% at the end of this year while one third expect it to rise to 7-9%.

Brexit

The announcement of a Free Trade Agreement (FTA) with the EU has been generally well received by the business community because it avoided a damaging no-deal, but there are of course some caveats. The Deloitte survey shows that CFOs tend to be more positive about the impact of Brexit on their own business than the economy as a whole.

The completion of a Brexit deal may lead to a rebound in investment that had been kept on hold by the uncertainty around the new trade arrangement with the EU and the risk of a no-deal. But the increased level of debt that some companies had to take on to survive the pandemic may however act as a drag on investment, and Brexit remains a concern for businesses. For example, there are some questions about the ability to attract international talent and the additional administrative burden for selling products and services into EU markets.

There is anecdotal evidence of disruptions because of the new FTA, for example in supermarkets in Northern Ireland. There are fewer disruptions in Dover at the moment, but that may change because of seasonal patterns and some stock building that occurred in December 2020. We will need to wait longer to evaluate the full extent of disruptions from Brexit.

Poll results

Question 1: What do you expect inflation to be at the end of 2021?

Above 2% (6%)
1.5-2% (39%)
1-1.5% (33%)
0.5-1.0% (17%)
Below 0.5% (6%)

Question 2:

What do you expect unemployment to be at the end of 2021?

Below 5% (0%)
5-7% (67%)
7-9% (33%)
Above 9% (0%)

Question 3:

When do you expect the UK economy to return to its pre-pandemic level?

21Q3 or before (0%)
21Q4 (5%)
22Q1 (26%)
22Q2 (32%)
22Q3 or beyond (37%)