Summary of NIESR Business Conditions Forum October 2020

National Institute of Economic and Social Research (NIESR) hosted the Business Conditions Forum (BCF) on 07 October 2020. 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

Discussion at this meeting was centred around three broad themes – post-Brexit trade negotiations, the UK residential and commercial property markets and the UK government's job support schemes.

Participants were encouraged to participate in a poll related to the three topics discussed towards the end of the meeting.

Main discussion points

Post-Brexit trade negotiations

The outcome of the ongoing UK-EU trade negotiations is difficult to predict. On one view, there is slightly higher than a 50 per cent probability that the negotiations will lead to a free trade agreement (FTA), but the new FTA that might emerge is likely to be shallow in terms of the goods and services covered.

In its negotiations with the EU, the UK will prioritise the fisheries sector and the right to offer subsidies over a trade deal that covers the financial services and motor vehicles sectors. A trade deal along these lines will be unfavourable for the UK because of the relative importance of the financial sector and the motor vehicle sector to the UK economy.

In the less likely event that negotiations fail, the fallout between the UK-EU will be acrimonious, leading to disruption in trade between the UK and the EU and in particular between Northern Ireland and the Republic. Even if a trade deal emerges, the next 6-7 months will be 'chaotic' as governments and businesses on both sides will have to adjust to the new arrangements.

Beyond the EU, the most important trade negotiation is with the US. Here too, the outlook is highly uncertain. On that view, a Jo Biden government will not prioritise and expedite trade negotiations with the UK and the outlook remains unclear under the alternative scenario where President Trump is reelected. A US-UK trade deal is unlikely to be finalised this year regardless of the outcome of the US presidential elections.

Among other important countries, the UK has managed to finalise a trade deal with Japan. The details are not known, but it appears to be a rollover of the EU-Japan trade deal.

Business preparedness: On one survey, a balance of 47 per cent of business respondents believe that the pandemic has had a negative impact on Brexit preparedness. That message is echoed in another survey which shows that just 38 per cent of respondents had completed a Brexit risk assessment. This compares with over 50 per cent last year. One important reason cited for the lack of preparedness is the absence of clear government guidance.

In so far as firms are prepared, there is a clear split between larger and more internationally exposed companies which appear to be better prepared compared with smaller and more domestic companies. Businesses that trade directly with the EU are struggling to prepare because of uncertainty over the final outcome of the trade negotiations and those that are part of a supply chain are additionally unclear about their level of exposure to the EU. The grocery and the chemical sectors appear to be particularly vulnerable to an unfavourable outcome.

Long term impact: Looking beyond the next few months and into the long term, recent research by the UK Trade Policy Observatory suggests that a no-deal Brexit will subtract just over 5 per cent of UK value added compared with a scenario where current trading conditions persist. Under an alternative scenario where the UK and the EU manage to strike a trade deal, the value-added loss will be in the region of 4.5 per cent and the loss to the UK will be similar at around 4.5 per cent if the UK strikes an FTA with the US and Japan. In other words, this study suggests that an FTA with the US and Japan will not have a material beneficial impact to the UK in terms of value added.

The study also shows the relative impact of these scenarios on different sectors of the economy. The textile, motor vehicles and the services sectors are most exposed to trade frictions with the EU.

Housing and commercial property market

Housing market

The RICS new buyer housing market indicator is at its highest level since 2013. The survey also shows an improvement in new instructions for both new and existing homes. One potential explanation for the recovery after the lockdown restrictions were lifted is pent-up demand, but there appears to be broader and more sustained support, including from the buy-to-let investors and particularly outside London. Government policy initiatives such as the help-to-buy scheme extension, the stamp duty holiday and easy credit conditions appear to be providing support to the market.

The housing market is expected to remain buoyant over the next 3-6 months, but conditions are expected to ease over the 12-month horizon according to the survey. Several reasons were cited for the more subdued outlook, including a challenging macroeconomic backdrop and the withdrawal of temporary government support schemes.

Looking beyond the next 12 months and into the medium-term, the outlook remains positive. House prices are expected to rise by 12-15 per cent in the next 5 years and rents are also expected to rise over this period

Commercial property

RICS survey data for the third quarter is incomplete and provisional. The provisional data shows that London is slightly worse off compared with the rest of the UK and from a sector point of view, the retail sector is worse than the industrial sector.

According to a survey by CBI, more than a third of firms surveyed are evaluating the usage of office space with a view to downscale. As a result, there is downward pressure on rents.

The message from a recent survey of construction companies mirrors the demand outlook. Construction activity in the retail and commercial office segment remains subdued. Activity among housebuilders is flat and the expectation overall is for activity to remain at current levels.

UK government job support schemes

The two main job support schemes – the Coronavirus Job Retention Scheme and the Self-employment Income Support Scheme (SEISS) have been successful in limiting the rise in unemployment. This has come at a high fiscal cost which the government has funded through borrowing. On one view, this is a cost worth paying because the cost of borrowing for the government is low and the support schemes will help prevent a sharp rise in poverty and scarring from long-term unemployment. It is for these reasons that NIESR has recommended that the government extends the CJRS (furlough scheme) until mid-2021 by which time businesses are expected to recover from the Covid shock.

Demand for jobs has fallen sharply in spite of the government's job support scheme. Data by Adzuna/ONS from September shows an overall 45 per cent decline in online jobs compared with the same period last year. The data shows a wide divergence across sectors. On one side is the transport, logistics and warehousing sectors where demand is strong. These sectors are very much the exception because most other sectors are suffering a loss in labour demand with the most pronounced downturn in the charity/voluntary sector, secretarial/clerical/administration and legal jobs.

The government's new Job Support Scheme (JSS) is a step in the right direction, but it will be less successful than the existing CJRS at protecting jobs and that is because the scheme encourages firms to operate with fewer full-time jobs rather than a larger workforce where some work part-time. This is particularly the case in the construction sector where part-work working arrangements are more challenging. The new scheme will leave lower-skilled workers more exposed because they are easy to hire. On one view, the JSS is deficient because it does not specifically target sectors that will be hit hardest e.g. low skilled and consumer focused sectors.

Poll results

Q1: The governing Conservative party had pledged in its 2019 election manifesto that it will strike FTAs over the next three years with countries that account for 80% of UK trade. Will the government achieve that goal?

Yes - 8%

No - 50%

Maybe - 25%

Don't know - 17%

Q2: Over the next 12 months, do you expect UK house prices to:

Rise significantly - 8%

Remain broadly stable - 69%

Fall significantly - 15%

Don't know - 8%

Q3: Do you expect the unemployment rate to peak at:

4 to 6% - 8%

6-8% - 23%

8-10% - 69%

10% + - 0%

The meeting was chaired by Amit Kara. A total of 21 organisations were represented which covers survey organisations, academia and policy making departments/institutions.