

POLICY NOTE: AN UPDATE TO OUR REVIEW FORECAST FOR THE NOVEMBER LOCKDOWN

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Summary

We estimate that the November lockdown will contribute to a fourth quarter contraction in GDP in the region of 3 per cent and reduce year-on-year growth from our November Review main case forecast of -10.5% to between -11.5 and -12%.

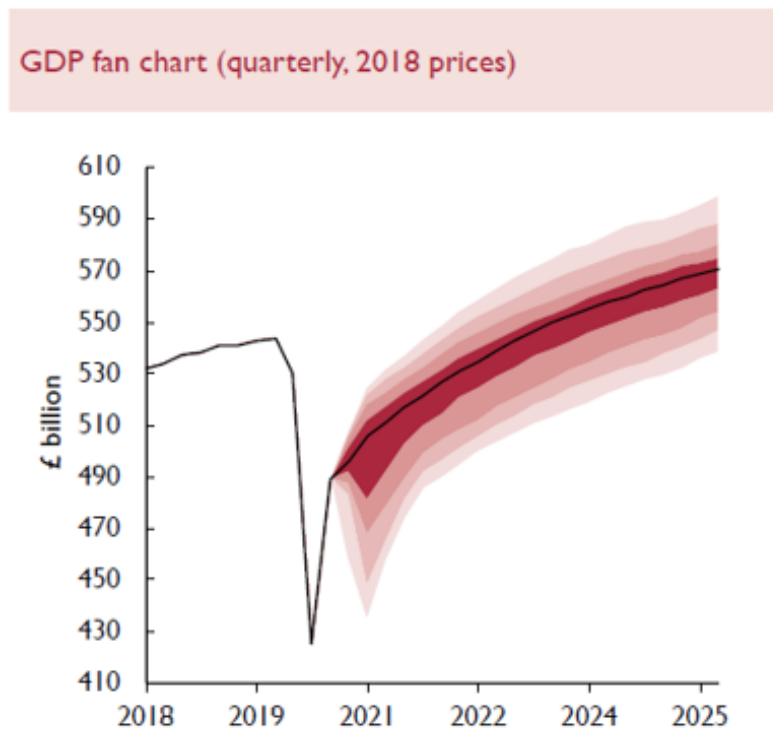
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Background

Our main case forecast scenario for November was for a fall in UK GDP of 10.5 per cent in 2020, which is shown by the black line in Figure 1, and which is subject to a number of risks, illustrated by a density forecast with 10% probability bands. These risks were weighted to the downside as they incorporated the possibility of further health-related interventions on the economy. In our original forecast, prior to the announcement by the Prime Minister on 31 October of a one-month lockdown, we expected with a 50% probability that GDP would return to its pre-Covid level by 2023Q2. In this policy paper we illustrate how we have adjusted our central case in light of the November lockdown.

Figure 1



Source: NIESR forecast and judgement. In addition to usual uncertainty the fan chart incorporates a 20 per cent chance of a second wave leading to a national lockdown in the first quarter of 2021.

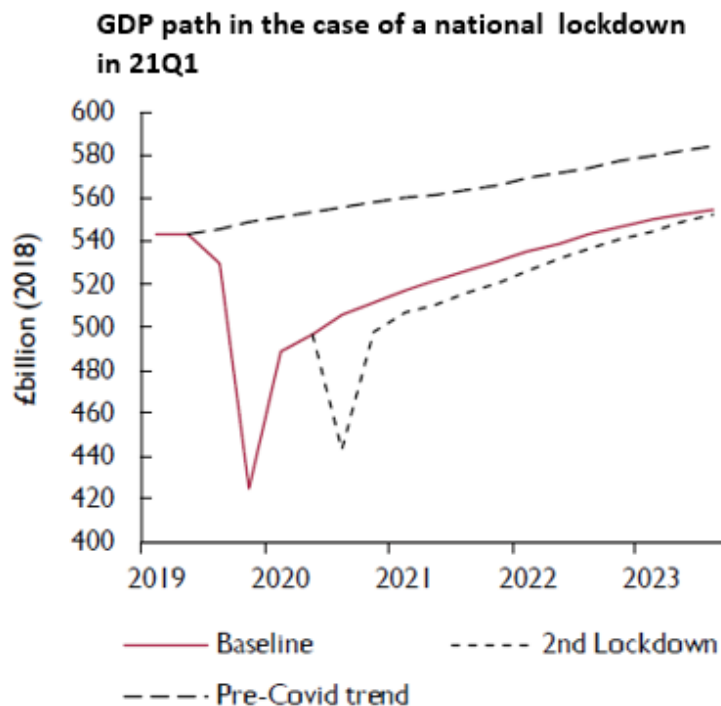
The Prime Minister's announcement

One downside risk to our main case forecast scenario has already begun to materialise, as the Government announced a second 'lockdown' to tackle Covid-19. This will begin on 5 November and will last at least until 2 December. In our November Review we had identified as one of the main risks to the UK economy that the current 'second wave' of Covid-19 could trigger new lockdowns, potentially pushing the economy back into a recession before it had recovered from the previous one. Of course, there is also the increasing probability that forward-looking agents may start to expect either a sequence of lockdowns and/or a sustained period in which normal social interactions remain proscribed.

To illustrate the potential impact of lockdowns, *sui generis*, we simulated a full second national lockdown building on work by Hurst *et al.* (2020), with a shock calibration based on the experience in the second quarter of 2020, thus assuming a lockdown of similar length and stringency. We estimated that such a lockdown would lead to an immediate drop in GDP of about 12½ per cent during the lockdown period compared to the baseline, and that it would take around four years to return to the pre-second lockdown baseline (see Figure 2). The deflationary effect coming from depressed domestic demand would lead the Bank of England to deploy further unconventional monetary policy measures and would lead to a further sequence of fiscal deficits.

While there are still some uncertainties related to the implementation of the November lockdown and how long it will last, we provide in this policy note an initial assessment of the economic impact of the second lockdown as it was announced on 31 October. The November lockdown differs from both the Spring lockdown and our 'second lockdown' simulation in several important ways, not least in that we assume it only lasts for the initial month before its 'review date', but the channels by which the lockdown affects the economy are now well-known: lower consumption and employment, business closures, reduced hours worked, lower productivity and an increase in economic and political uncertainty.

Figure 2



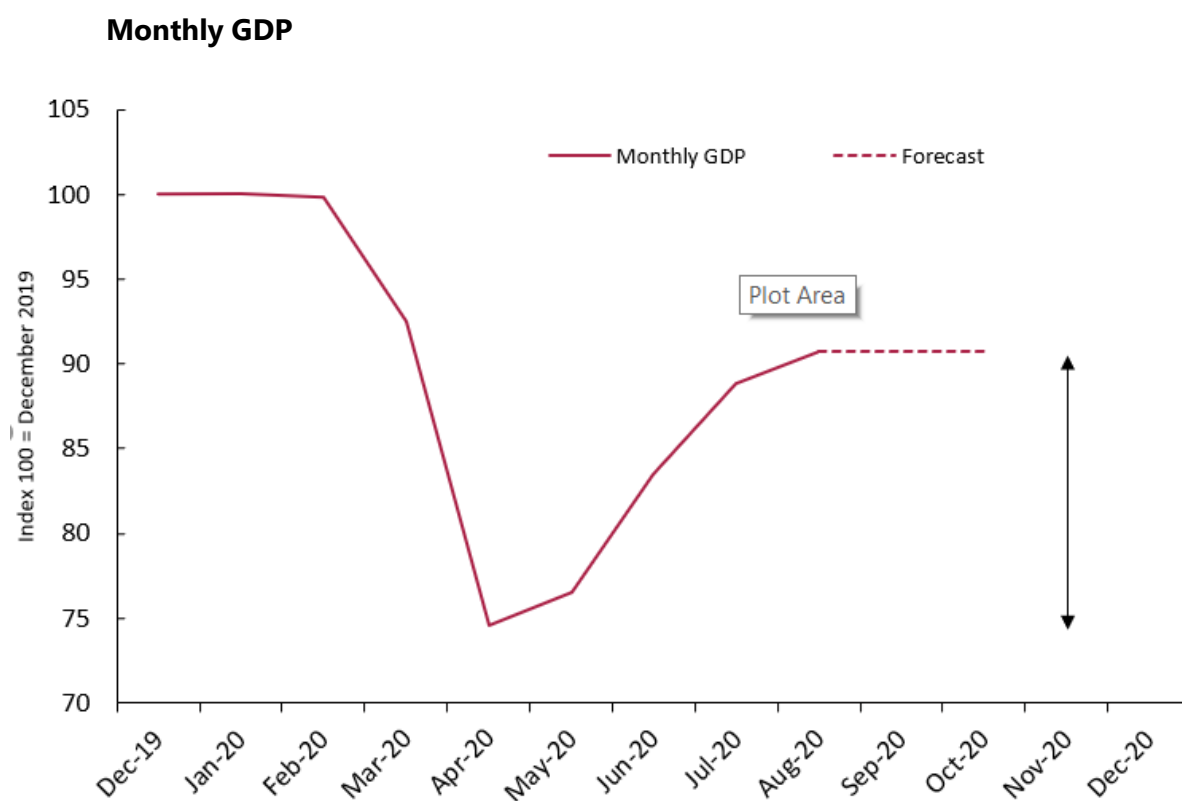
Source: ONS and NIGEM simulation. A second lockdown of similar length and stringency in 21Q1.

It is important to note that the estimates in this policy note constitute a like-for-like amendment to the main case baseline forecast as a result of changing information about the spread of Covid-19 and the response, which is **not** a cost-benefit analysis of the lockdown and cannot be used to substitute for one. The economic cost (not to mention the human cost) of not locking down may be far in excess of the downward revision to our forecast due to the November lockdown (see Bhattacharjee and Lisauskaite, 2020, on this point).

Calculations

Our estimates for November GDP are built up from looking at the level of GDP in April, when the first lockdown was at full effect throughout the month. As shown in Figure 3, around 15 percentage points of the 25 per cent fall between February and April had been recovered by August. Our first assumption is that the August level of GDP, and its sectoral decomposition, continues largely unchanged in September – in line with our most recent GDP tracker which forecast 0% monthly growth – and again in October as the recovery continued to stall (see Figure 3).

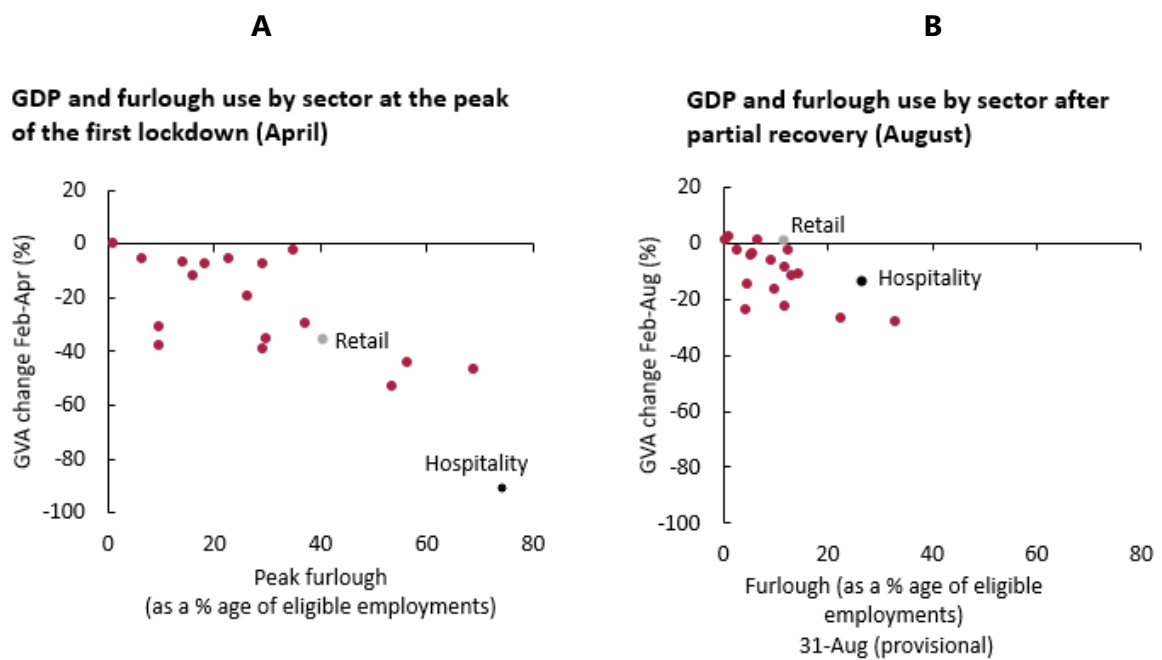
Figure 3



This gives a starting assumption that, if November’s lockdown led to an identical level of output as seen in April, we could expect an 18 per cent fall from October to November. However, we know this not to be the case because the conditions of the second lockdown are different to those prevailing in April: restrictions are less stringent, firms and households are better prepared, manufacturing and constructions are explicitly ‘encouraged’ to continue, a part-time Job Support Scheme is in place to maintain part-time work where demand is reduced and schools and universities plan to stay open. We therefore condition on these factors along with the with the insights from the Review scenario given in Figure 2. We also examine the sectoral pattern of the recovery since the first lockdown, making some assumptions to estimate an overall impact on GDP.

The sectoral pattern to both the initial lockdown fall and its April-August recovery was far from even: Figure 4 shows the fall in GVA per sector and the degree of furloughing at their peaks in Spring (A) and, by the summer, in August (B).

Figure 4



We therefore look at the GVA recovery which has taken place in each sector over that period and scale it by 90% in hospitality and retail, 10% in education and 60% of the rest of the economy, to estimate the likely overall impact on GDP during the second lockdown.¹ The resultant falls, shown in the right-hand column of Table 1, are then weighted by their August sectoral shares in GDP.

¹ Note that saying, for example, 90% of retail sector GVA recovered since April will be lost in November is not saying that 90% of *total* retail sector GVA will cease in November.

Table 1: Changes in Sector GVA

	Change in GVA (per cent of February)		August GVA assumed lost in November
	February - April	April - August	
Agriculture	-8%	3%	2%
Mining	-7%	4%	2%
Manufacturing	-30%	21%	14%
Electricity	-7%	9%	5%
Water	-6%	7%	4%
Construction	-44%	34%	23%
Retail	-36%	36%	32%
Transport	-39%	23%	16%
Hospitality	-91%	77%	81%
I.T.	-12%	6%	4%
Finance	-6%	3%	2%
Property	-2%	0%	0%
Professional, scientific and technical	-19%	8%	5%
Business support	-35%	13%	10%
Public admin	0%	1%	0%
Education	-38%	23%	3%
Health	-31%	7%	6%
Arts	-47%	19%	16%
Other services	-53%	26%	21%

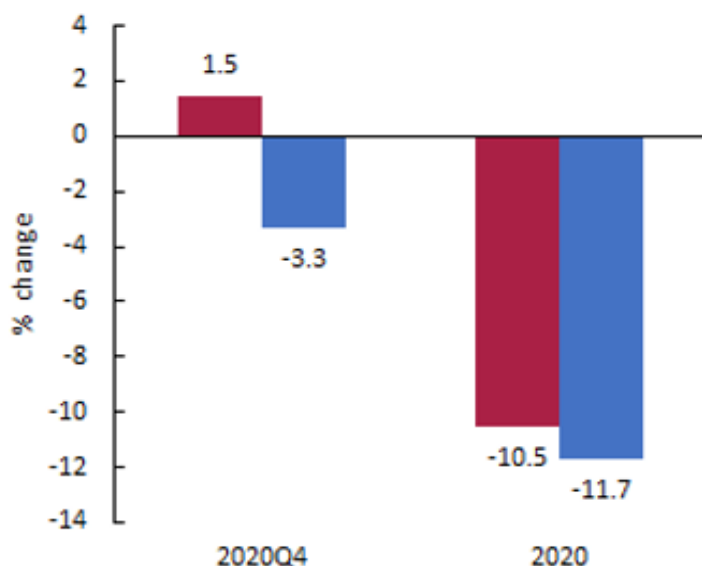
Results and risks

Applying these to the 18 per cent drop in output described in Figure 1 leads to an estimate of an 11-12 per cent monthly GDP fall in November. This would see our Review GDP forecast of 1.5 per cent growth in Q4 of 2020 revised down to -3.3 per cent, and our overall forecast for 2020 revised down from -10.5 per cent to -11.7 per cent.

There is significant uncertainty around these revisions and around fourth quarter forecasts overall. Sources of downside risk include our assumption of a full rebound in December, which is itself predicated on exit from Lockdown on 2 December and assumes no short-term scarring (or an equivalent off-setting increase in capacity elsewhere). Other restrictions on mobility may continue in December, and other countries may announce further lockdowns, reducing demand for UK exports and hampering our role as part of the global value supply chain.

Figure 5

2020 GDP growth forecasts with November lockdown



Source: ONS, NIESR forecast and judgement.

There are also upside risks. Spillover effects mean that the decision to keep schools open is likely to have a larger effect than the statistical contribution of Education the post-April recovery would imply. Much of November's retail is likely to be Christmas-related and so could be substituted with online retail or pent-up demand expressed in December figures. We do not know the impact of Covid-19 restrictions on Christmas spending overall but note that the household sector has seen a large rise in savings (with a historical record savings ratio of 28 per cent) during 2020 as a result of restrictions on normal spending.

We will continue to monitor developments carefully.

References

Bhattacharjee, A. and Lisauskaite, E. (2020), 'Covid-19 impacts on destitution in the UK', National Institute Economic Review, August.

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