NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH:
PRESS CONFERENCE
Monday 10th May 2021
Opening remarks by the Director

Good morning. Welcome to the National Institute of Economic and Social Research for the release of our Spring 2021 *Global Economic Outlook* and our *UK Economic Outlooks*. Our *Global Economic Outlook* focusses on the developments in the world economy projected by our global econometric model, NiGEM as well as providing scenarios to help us understand emerging macroeconomic issues. In this case we look at the impact of the US fiscal expansion on the US economy and in the rest of the world. The *National Institute UK Economic Outlook* assesses the aggregate picture but increasingly places weight on its micro underpinnings at the sectoral, household and regional level. To that end we are developing a new National Institute Regional Economic modelling system (NiReMS), which should allow us to assess the true extent of any 'levelling up'.

The Global Economic Outlook

There are signs of a glorious Spring as we start to emerge blinking into the light. Vaccine rollout programmes have brought to an end to the most severe forms of lockdowns in many countries. But an opinion piece last spring, published as the pandemic first struck, by the *New York Times* adopted a compelling headline: This Won't End for Anyone Until It Ends for Everyone. And while we are excited by the prospect of a return to some semblance of normality, our analysis in this Outlook suggests that both the impact of the virus and the prospects for recovery differ markedly across the world. And many of the risks we face seem bound closely to the observation that we need to provide common good.

The first and most obvious risk is that the Covid-19 virus, and its expanding list of mutants, is not yet fully under control. Secondly, with over 3 million deaths accounted for by Covid-19, which is almost certainly an understatement, it has exposed both government and health care failures in many countries. These need urgent attention if economies are to recover. This relates to a third point, that there has been both an uneven impact of lockdowns on individual economies and in sectors within them. The common shock of Covid-19 has affected the common man and woman grievously but not uniformly. From a financial perspective, the response of governments, who have been so able, has been to ratchet up once again the levels of public debt and for central banks to maintain policies of easy money. Those who have been able to deploy the tools of macroeconomic stabilisation have tended to perform better than those who have limited monetary and fiscal space.

The high levels of public and private debt and an escalation in asset prices leaves many economies very vulnerable to future shocks, particular to the costs of funding. Indeed, we have seen skittishness of markets this past week in response to some fairly standard comments from a former Chair of the Federal Reserve which suggested that policy rates may need to rise if there was an inflation threat. Such a statement is hardly news and yet markets responded with a tantrum that suggests trouble may lie in store for any attempts to normalise interest rates.

In fact, the real voice in this crisis lies off the monetary stage as the microphone has been passed to fiscal policy. We think the impact of the US government's fiscal expansion will not only support growth in the US but also support the global recovery. This analysis is subject to one caveat and an obvious implication. First the caveat monetary and fiscal frameworks must not be allowed to slip and undermine the ongoing pursuit of price and financial stability. Global liquidity has supported financial markets well in this crisis and the new issuance of SDR by the IMF provides a welcome source for countries that cannot borrow at low advanced country rates. We have worked hard at promoting reforms to fiscal frameworks that will increase their connection and hence traction with people's lives.

But the lesson of the US fiscal expansion has not been absorbed by all countries with fiscal space. The European Monetary Union has not followed suit with a similarly large response. Stuck in a monetary union some countries have limited room for manoeuvre, but others could do much more. And our analysis suggests that a co-ordinated response would do much to bring countries out of the both the stupor that they have been in since the financial crisis and the sudden stop effected by this pandemic.

The UK Economic Outlook

Having suffered the largest economic contraction in modern times, the UK now looks set to grow in manner this year that will also break records. But as is so often the case, concentrating on growth rates masks the underlying level. And it is the level of income and the associated quality of life that matters in a country. In our recent Occasional Paper on fiscal frameworks, we argued for policy to be assessed against the metric of robust and inclusive economic growth as a way of re-focussing the debate away from the most recent numbers or political milestone. To be clear we do not want income to be targeted, like inflation, as it is largely the product of firm level innovation which cannot be well predicted. But we do know that institutional and government capabilities matter and so we want to focus more attention on the progress of households, regions and sectors. Indeed, policy needs to be systematically concerned with the progress of the nations and regions that comprise the UK.

This Spring we have revised up our central forecast for economic growth in 2021 to 5.7 per cent, compared to 3.4 per cent in February. The immediate economic effects of the virus, which have been concentrated in the low-waged service sector, are expected to wane, while the negative consequences of Brexit will make themselves felt over the longer run and largely in sectors less affected by Covid-19. The good news is that the third national lockdown has seen the adaptation of much of the economy to pandemic conditions, meaning that a smaller fall in first-quarter GDP than previously forecast provides a strong basis for the rest of the year. This is followed by the projected re-opening of the remaining affected sectors, thanks to the success of the vaccination programme. The principal downside risk remains a resurgence of the Covid-19 virus, through adaptation or the failure of vaccines, and as an open economy the UK will not be physically or economically protected from a failure to control the virus globally.

The immediate issues facing policymakers are how to redesign the furlough and other support measures to encourage workers who have lost their jobs to retrain or locate new careers. We note that firm birth has been strong but perhaps not in the sectors that have in the past shown high levels of productivity. And this may act to limit the development strong regional pockets of demand, which underpin the creation of good jobs. Many existing firms may be saddled with high levels of debt that will tend to crimp investment and hence productivity in the recovery. The impetus for much of the recovery will come from a household sector that undergone a period of "forced savings" and there will be positive spill-overs to the manufacturing, private traded services and construction sectors. But the tourism and hospitality sectors may continue to suffer for as long as international travel remains subdued.

As ever the aggregate can mislead on the granular. The overall improvement in the household sector net worth from higher house prices and some escalation in asset prices masks considerable levels of spatial and income inequality. Our work shows a prospective increase in household level destitution with many of the attendant social problems closely aligned. But one further implication may also follow should government policy not succeed in levelling up. We also project more jobs and higher incomes in London and the South East than in the rest of the country. If not carefully managed with a careful re-examination of our political institutions, this crisis has the propensity to further the centralisation of activity in the United Kingdom, which may ultimately question its very existence.

Jagjit S. Chadha
10th May 2021