

COVID-19

UK Economic Update

For more information on the potential business impact of COVID-19, please visit www.pwc.co.uk/covid19

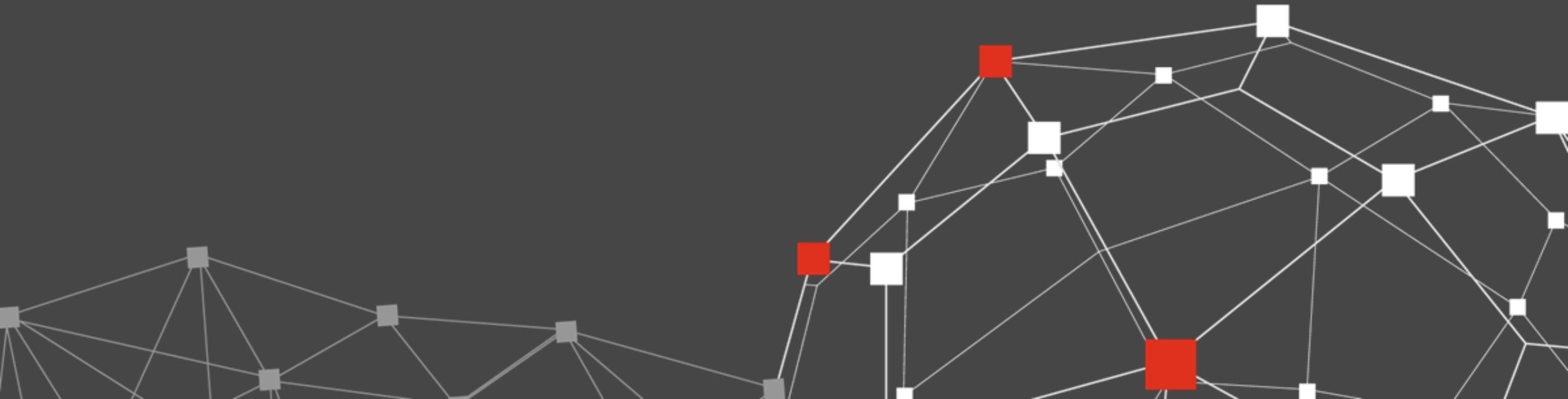


Summary

The essential public health measures taken to counter COVID-19 will inevitably have a significant short term economic cost. Our illustrative scenarios suggest UK GDP growth in 2020 could range between around -3% and -7%, depending on how quickly the outbreak is brought under control. But growth should rebound in 2021 and beyond.

- From 24 March 2020, the UK imposed stricter social distancing measures to reduce the spread of COVID-19 for an initial period of three weeks, after which this will be reviewed. Our analysis suggests **at least 11% of the economy will be directly impacted by these measures, but more will be hit by the general reduction in demand.** The aviation, non-food retail, hospitality and leisure sectors are most immediately affected, but a broader reduction in demand will adversely impact many other sectors including manufacturing, construction, real estate, land travel, employment services and motor trades.
- The latest UK economic data indicates a **significant weakening in business activity and employment in March**, with a decline in the private services sector purchasing managers' index (PMI) even greater than that experienced during the 2008-9 financial crisis.
- **The loss to output and labour supply will partly be mitigated by home-working.** Our research shows **up to around 50% of UK workers surveyed thought they would be able to work from home**, particularly in the financial and business services sectors. However, this is a less viable option for sectors requiring a physical presence, such as the construction, transport and distribution, hospitality and non-food high street retail sectors - the latter sectors also being affected by UK government policies requiring the closure of most hospitality, leisure and non-food retail outlets.
- **We present two illustrative COVID-19 scenarios with varying degrees of severity and duration. The estimates of the one year impact on UK GDP range between around -4% and -8%. Since we had previously projected 1% growth in 2020 before COVID-19, this suggests 2020 GDP growth could range from around -3% to -7% in these two scenarios. We would expect a rebound in 2021 and beyond, though it is too soon to judge the speed of this recovery.** Our analysis is driven by a set of informed assumptions but uncertainty is very high and, as a result, these should not be taken as precise estimates. Rather they give broad indications of the order of magnitude of the potential impacts in different scenarios based on information available at the time of writing.

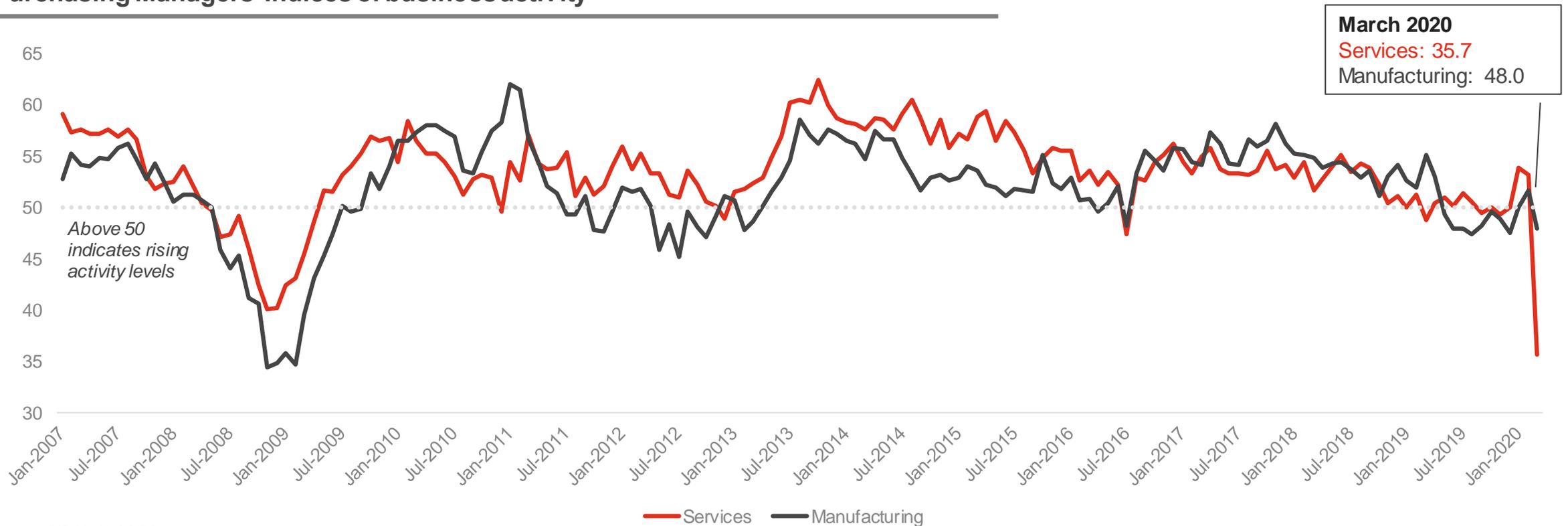
Latest data on UK economic impact of COVID-19



UK services business activity falls sharply in March

Last week's flash purchasing managers' index (PMI) data for March suggested the COVID-19 outbreak has already had a significant broad-based impact on business activity, with an observed decline for the private services sector even greater than that experienced during the 2008-9 financial crisis. The manufacturing sector was also hit, but less severely so far.

Purchasing Managers' Indices of business activity

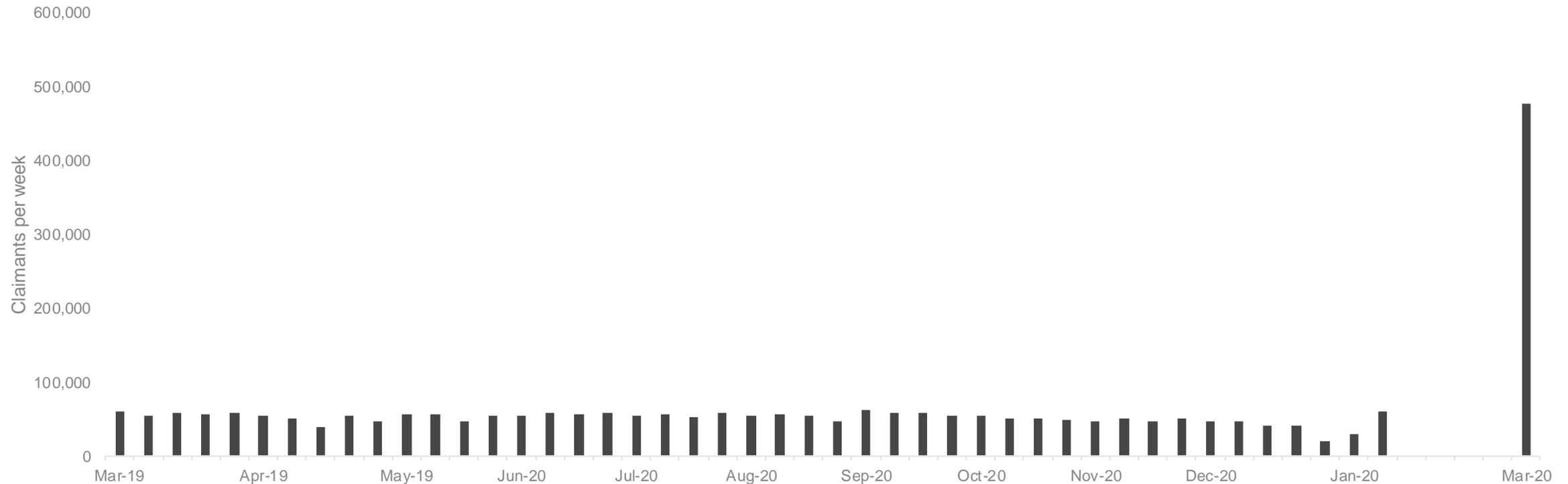


Source: IHS Markit / CIPS

UK labour market – benefit claims rise sharply

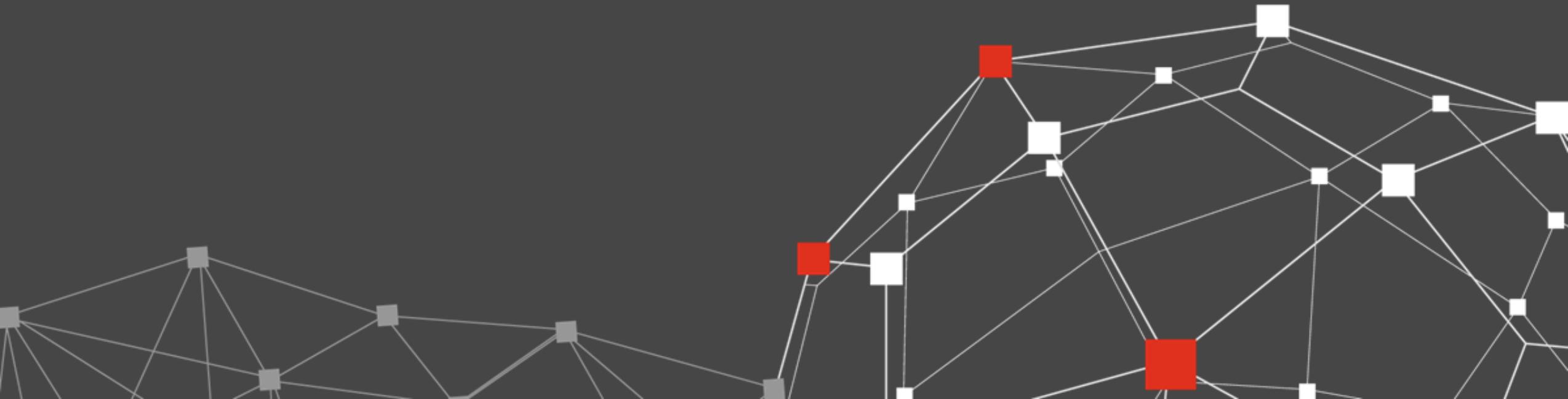
The UK jobs market remained relatively strong earlier in 2020, but last week's DWP data indicated a significant weakening in performance, with the number of new Universal Credit claimants reaching 477,000 people in the previous nine days, compared to around 55,000 on average in a normal week.

Universal Credit – number of new claimants per week (9 days for last data point)



Source: DWP

Illustrative scenarios for UK economic impact of COVID-19



COVID-19 economic impact transmission channels

We have modelled five main transmission channels through which COVID-19 can impact the UK economy (first four negative, with offsetting positive effect from monetary and fiscal policy reactions). Other reinforcing and mitigating impacts are possible, so this is not an exhaustive list.



1. Supply chain disruption

- Major disruption reduces demand throughout the supply chain, affecting suppliers. Businesses scale back production or adapt supply chains to alternative sources.
- Significant proportion of the workforce becomes unavailable for work and production facilities can't maintain output of basic materials and unfinished goods.



2. Labour supply reduction

- Social distancing measures see non-essential workers working from home for an extended period, or workers staying at home to care for children or other dependents.
- Focus on maintaining workforce in essential roles only.



3. Uncertainty impacts

- Consumers defer major purchase decisions and defer discretionary spend.
- Significantly reduced levels of business and consumer confidence results in a sharp and sustained downturn in business investment.
- Investment focuses on infrastructure and facilities to counter the pandemic and investment in digital ways of working (or new delivery models).



4. Sector partial or full lockdowns

- Significant periods of travel disruption, closures of most retail outlets (except grocery and pharmacy), leisure; hospitality; sports and entertainment venues.

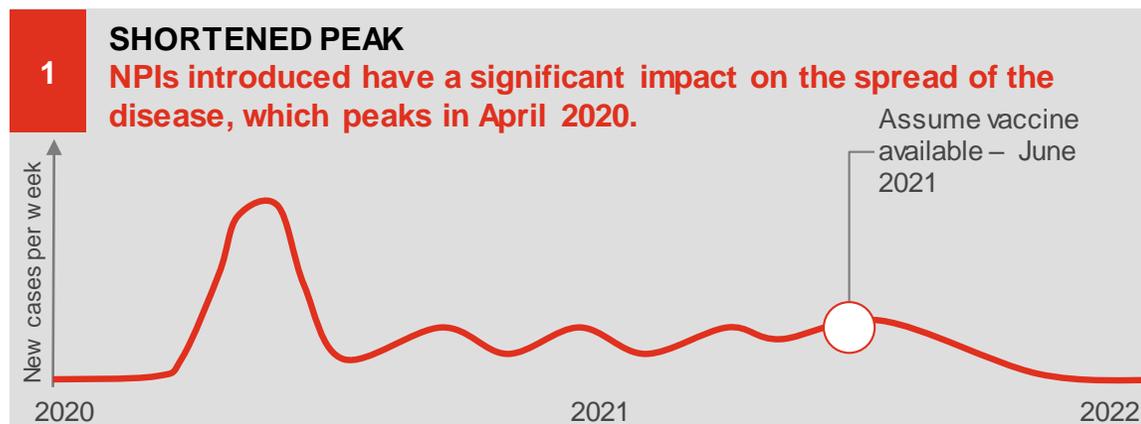


5. Policy reactions

- Extensive working capital / cashflow support to businesses through tax / payment holidays and loan guarantees.
- Fiscal support for healthcare service.
- Looser monetary policy stance through interest rate cuts combined with additional quantitative easing (QE) and other measures to boost credit flows to business.

Potential COVID-19 scenarios to inform crisis planning

Following the introduction of non-pharmaceutical interventions (NPIs) such as social distancing and sector lockdowns in March 2020, an ongoing rise in cases is expected for several more weeks as these measures take effect. The subsequent trajectory of the disease is dependent on the success of the implementation of these NPIs, how long they are sustained for and the introduction of other NPIs or pharmaceutical interventions at a later date (i.e. treatment drugs or vaccines).

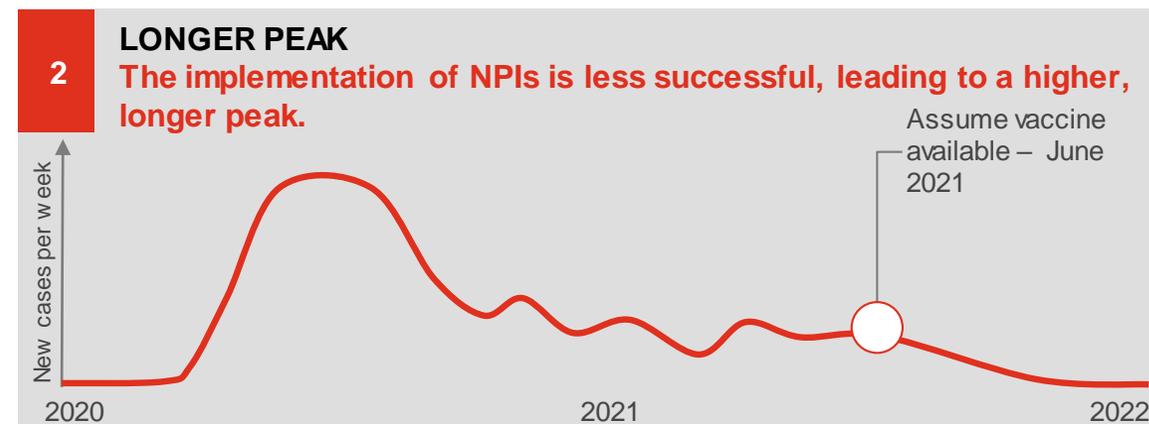


Assumptions:

- Following an initial peak in April 2020, successful implementation of NPIs including testing, contact tracing, quarantine of cases and social distancing prevent an ongoing rapid increase.
- Ongoing implementation of NPIs is required to prevent a significant recurrence of the disease as pre-symptomatic and mild cases prevent complete containment of the virus until a vaccine becomes available. Some NPIs may be introduced and reversed in a cyclical way to limit the number of cases.
- Antibody testing may enable a proportion of the population with immunity to return to work.

Timeframe:

- **Peak:** April 2020
- **Total duration:** 12 to 18 months (until a vaccine is available).



Assumptions:

- Weaker adoption of NPIs leads to a more prolonged peak in cases over summer 2020.
- Variability in success of implementation of NPIs leads to ongoing but smaller peaks in the disease until the development of a vaccine. Seasonality of the virus is currently unknown, but may contribute to the timing and scale of these subsequent peaks.
- Antibody testing may enable a proportion of the population with immunity to return to work.

Timeframe:

- **Peak:** May-June 2020
- **Total duration:** 12 to 18 months (until a vaccine is available).

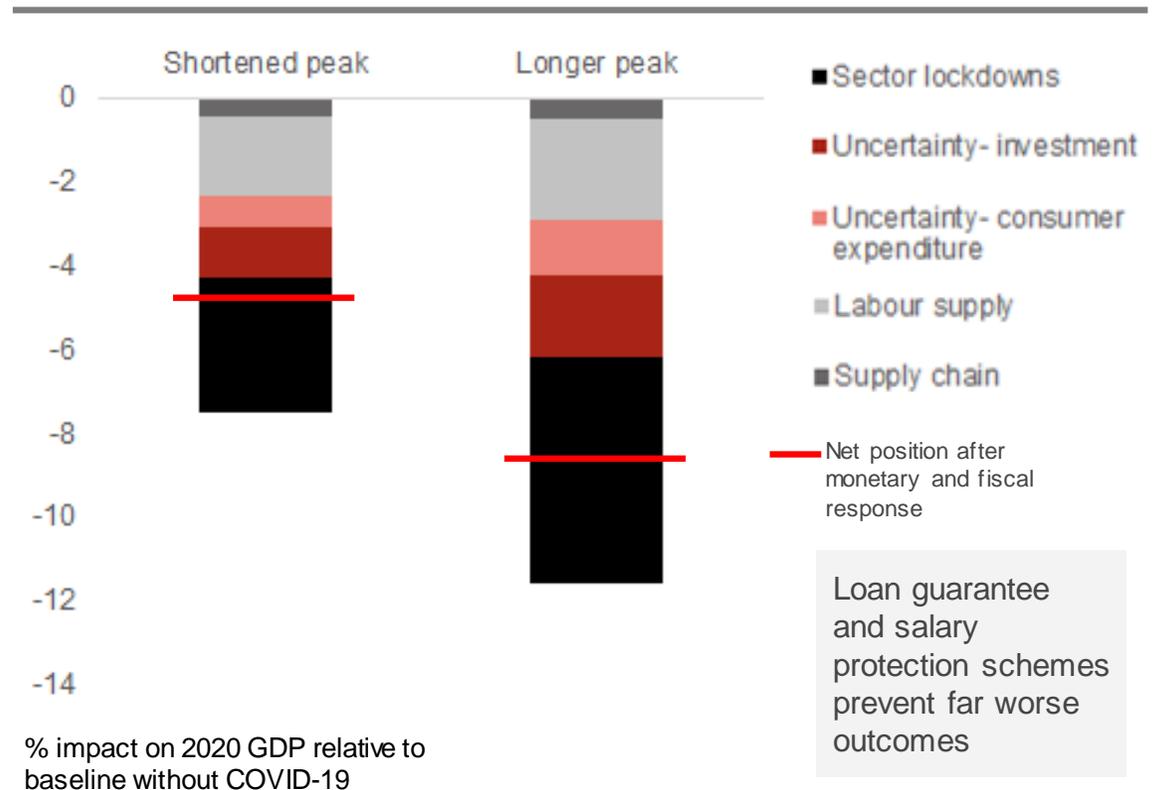
Illustrative scenarios for UK short term economic impact

The combination of supply chain disruption, reduced labour supply, uncertainty effects and full or partial lockdown in some sectors could reduce UK GDP by around 4-8% in 2020, relative to a baseline case of 1% growth without COVID-19

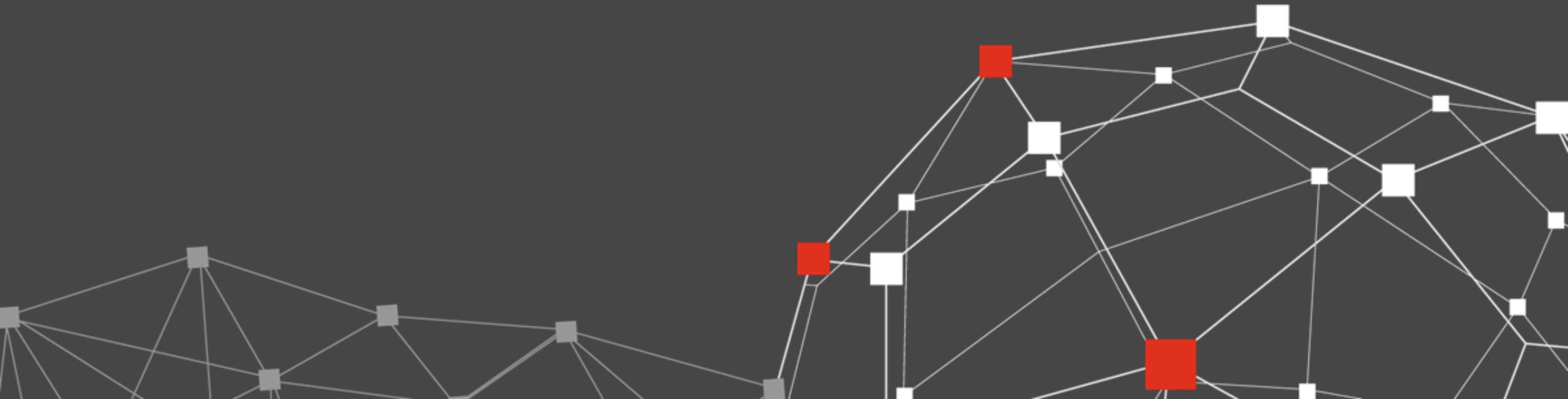
Our illustrative scenario analysis suggests UK GDP growth could range between around -3% and -7% in 2020, given we expected growth of around 1% before COVID-19 and the estimated impacts of the outbreak in the table below, which are around -4% to -8% in the first year. We would expect growth to rebound in 2021 and beyond, but it is too soon to put numbers on that. Figures below are only illustrative of broad orders of magnitude and should not be taken as forecasts or predictions. See technical annex for more detail on assumptions.

Year one impact (%) on UK GDP relative to baseline without COVID-19	Scenarios	
	Shortened Peak	Longer Peak
1. Supply chain	- 0.5	- 0.5
2. Labour supply	- 1.9	- 2.4
3a. Uncertainty – consumer expenditure	- 0.7	- 1.3
3b. Uncertainty – business investment	- 1.2	- 1.9
4. Policy response	Fiscal: 2.1 Monetary: 1.0	Fiscal: 2.1 Monetary: 1.3
5. Sector partial lockdowns	-3.2	-5.4
Overall UK economic impact	- 4.4	-8.1

UK one year economic impact across COVID-19 scenarios



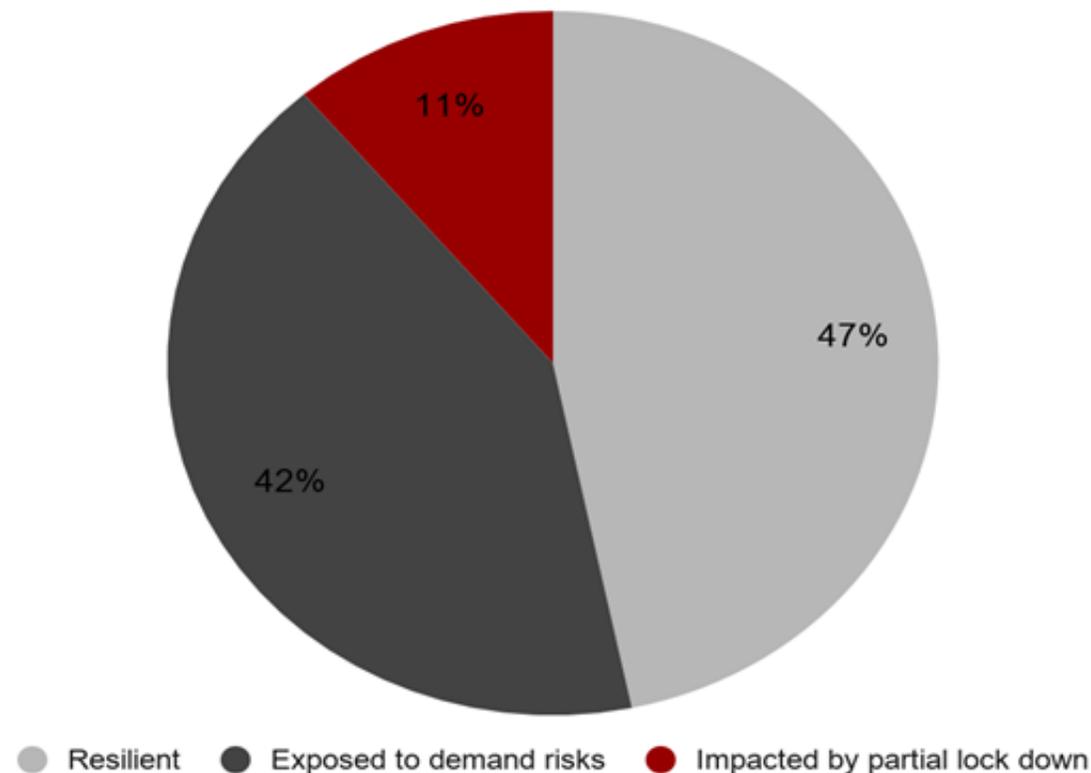
Sector impact analysis of COVID-19



Sectoral exposure to COVID-19 lockdowns and wider demand effects

At least 11% of the UK economy will be directly impacted by full or partial sector lockdowns, but much wider effects will be seen from the general reduction in demand, potentially impacting over half of UK output.

Breakdown of UK GVA by sector risk exposure



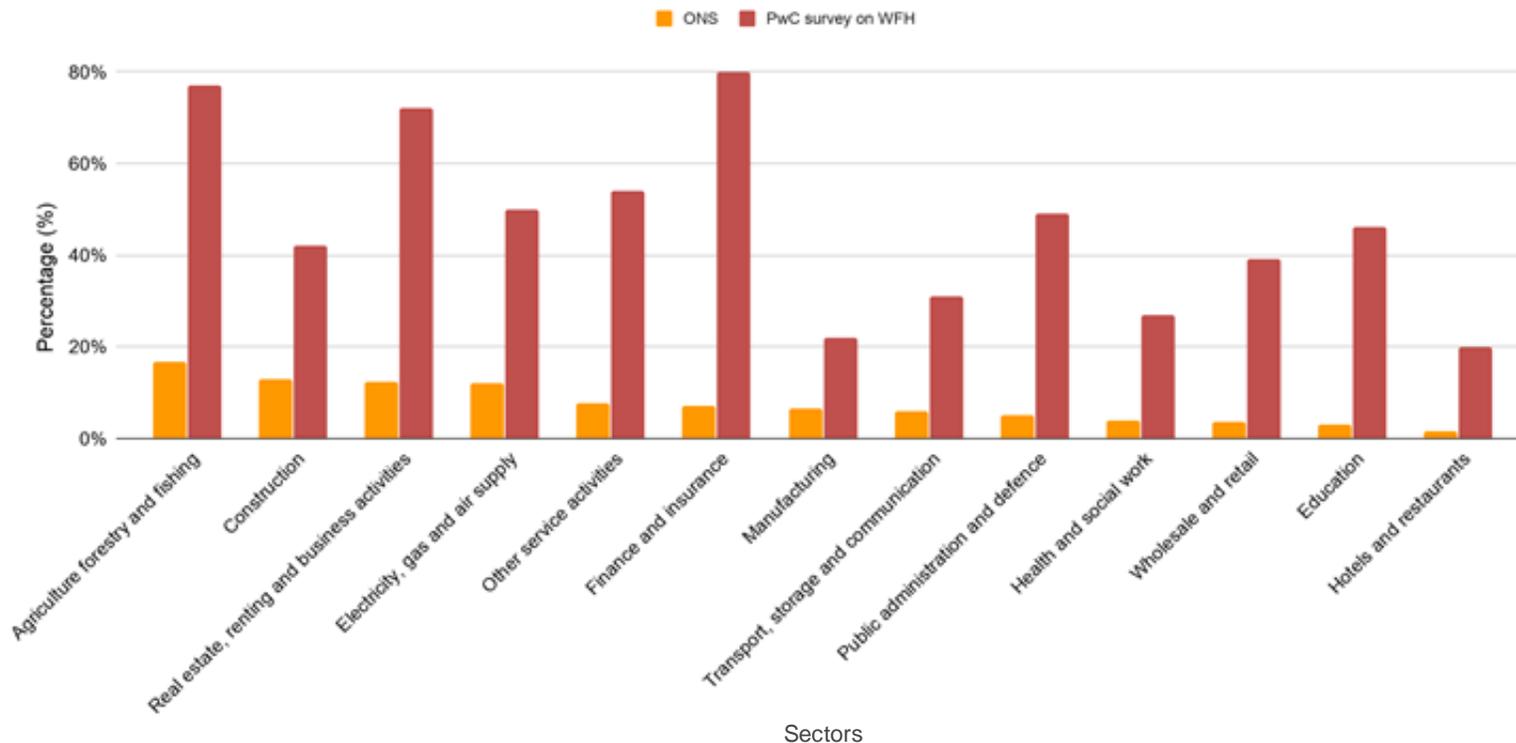
Commentary

- Key sectors most exposed to a partial or full lockdown include: air travel and travel agencies; retail (except grocery and pharmacy); leisure; hospitality; sports and entertainment.
- Key sectors most exposed to demand risks include: manufacturing; construction; real estate; land travel; employment services and motor trades.
- Key sectors likely to be more resilient (or see boosts to demand) include: health; social care; legal, accounting; advertising; publishing; telecoms; computing; energy; water supply; waste; agriculture; forestry; fishing and mining.

New PwC research shows up to half of workers could do so from home

Our new survey results contrast with actual ONS data showing much lower past rates of working from home.

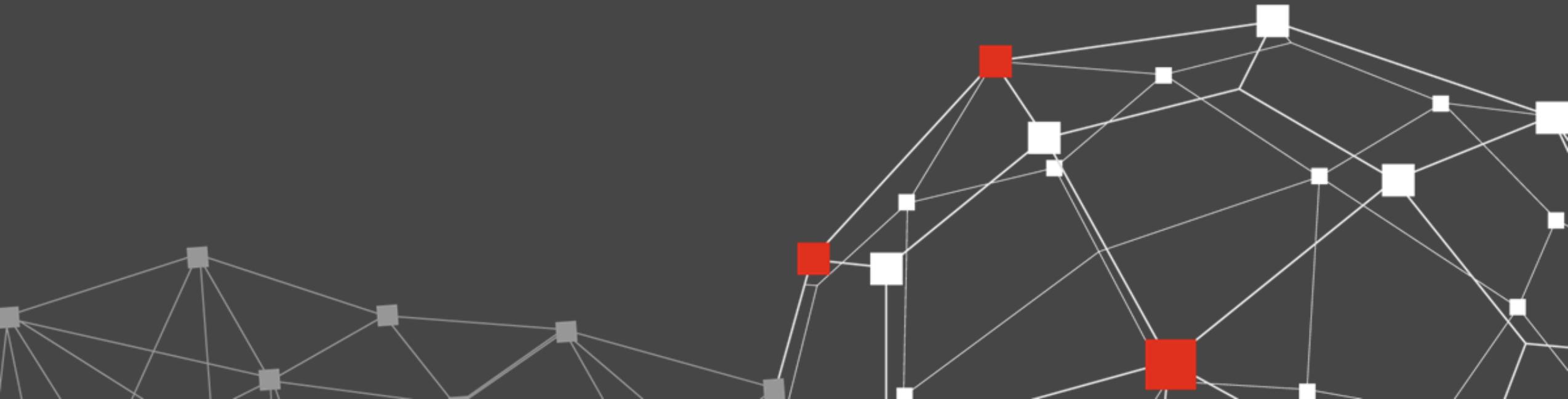
% of UK employees that regularly work from home (ONS, 2018) or could potentially work from home (PwC research, March 2020)



Commentary

- COVID-19 will impact sectors more where workers are less able to work from home.
- ONS data suggests working from home is least common in sectors that require more face-to-face contact (e.g. hospitality, wholesale and retail and public services)
- However, in a PwC Research survey in March 2020, when asked whether workers think they can work from home, significantly more stated they are able to work from home, particularly in finance, agriculture and business activities. On average 50% of workers thought they could work from home, aided by modern technology.
- This suggests the negative economic impact of COVID-19 may be less than otherwise expected due to modern communications technology and flexible working.

Annex – technical notes and key assumptions for UK GDP scenarios



UK GDP scenarios – technical notes and key assumptions

- **Supply chain assumptions** are taken from an academic paper by [Luo and Tsang \(2020\)](#) who estimate the indirect economic impact to the: a) domestic and b) global economy due to the Chinese supply chain disruption as a reference point. We adjust this to reflect the different composition of the UK economy (either due to the manufacturing/services mix or openness to trade compared to the global average). Finally, we also incorporate any potential adaptation effects for longer lasting scenarios from businesses which switch to alternative suppliers, dampening this effect.
- **Labour supply impacts** are assessed in five categories covering workers that are: a) self isolating; b) infected and not ill; c) infected and ill; d) caring for dependants; e) not affected by the disease. We assume the first four segments of the workforce lose between 75-100% of their working hours during absence and calculate the total number of hours worked lost. We combine this analysis with our calculation of the additional GDP produced per hour of work estimated by UK GDP and the average number of hours worked by an employee in the UK in a week. In this analysis, we don't take into account the productivity improvements that could potentially result from production levels being maintained with fewer workers, or the potential for continued home working by those with only mild symptoms.
- **Uncertainty - consumer expenditure:** We benchmark the shock to household expenditure with reference to historical crises and period of economic stress. To derive the economic impact we adjust the expenditure shock based on its duration and the relative importance of household expenditure to total GDP.
- **Uncertainty - business investment:** We use our [previous modelling work](#) to determine the relationship between UK GDP and business investment. The modelling quantified the economic impact of a risk premium shock to total investment and UK GDP using a Computable General Equilibrium modelling approach. We estimated a 16.4% drop in total investment levels led to an almost 1.9% drop in UK GDP. We apply this relationship to a drop in the business investment portion of total investment to estimate the impact on GDP. The shock to business investment was informed by benchmarking to other periods of historic stress and adjusted for its duration.
- **Policy response - fiscal:** We divide the additional amount the UK government plans to spend to combat COVID-19 into: a) day-to-day spending; b) additional spending brought forward; and c) negative tax receipts (i.e. cut in taxes). Each of these spending categories is associated with a fiscal multiplier between 0.6 and 1 which we obtain from the [Office for Budget Responsibility \(OBR\)](#). We do not explicitly model the impact of government loan guarantees, though these will help to limit downside risks to the economy relative to our two scenarios.
- **Policy response - monetary:** We estimate the sensitivity of UK real GDP growth to changes in monetary policy using [Andy Haldane's speech](#) on the impact of monetary policy during the global financial crisis. We assume the monetary policy space available to the Bank of England is consistent with the Governor's statement that "We have effectively 200 to 250 basis points of space".
- **Sector lockdown:** We use ONS data for the UK's sector and sub-sector outputs. We assume that output in certain "locked-down" sectors will be depressed for a fixed period of time.



Nick Forrest
Economics leader

T: +44 (0) 7803 617744
E: nickforrest@pwc.com



John Hawksworth
Chief economist

T: +44 (0) 7841 803 665
E: john.c.hawksworth@pwc.com



Barret Kupelian
Senior economist

T: +44 (0) 771 156 2331
E: barret.g.kupelian@pwc.com



Alex Tuckett
Senior economist

T: +44 (0) 7483 373 911
E: alexander.tuckett@pwc.com



Edmond Lee
Senior economist

T: +44 (0) 7802 660 423
E: edmond.sp.lee@pwc.com



Jing Teow
Senior economist

T: +44 (0) 7525 281 974
E: yong.jing.teow@pwc.com

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For more information on the wider business impact of COVID-19, see our website at:
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