MONTHLY ECONOMIC INSIGHT

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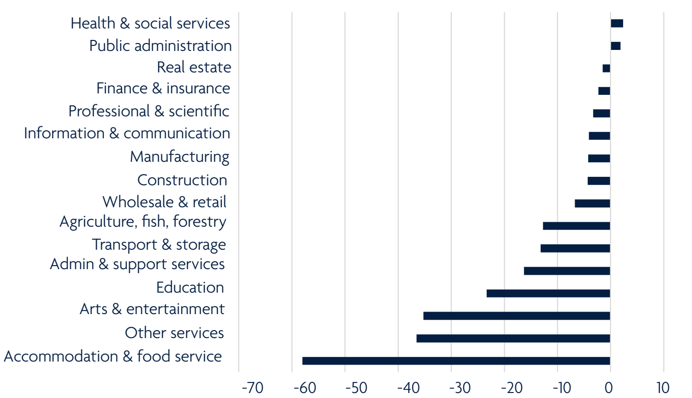
In the first of a new series of monthly economic bulletins we review some of the latest developments in the UK economy. As the nations of the UK move through the next phases of lifting restrictions that have been in place to manage the Covid-19 pandemic, this month's update looks at where the UK economy currently stands and the near-term outlook.

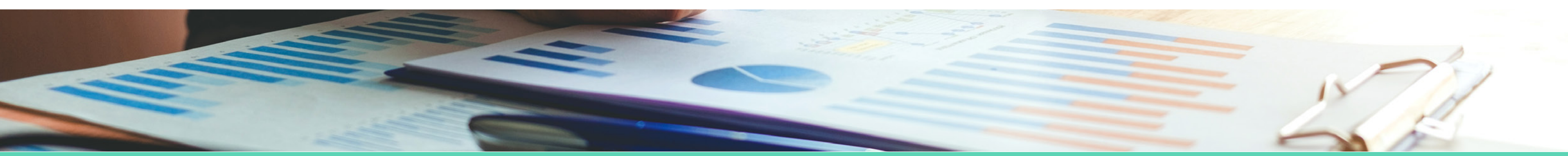
STATE OF THE SECTORS

The UK economy exhibited some welcome signs of life in February with GDP expanding by 0.4 per cent on the month, despite the continuation of public health restrictions. There was a modest 0.2 per cent growth in the service sector, but production and construction sectors were more positive contributors to the better-than-expected performance. Nevertheless, GDP remained 7.8 per cent lower than a year ago – the pre-pandemic peak. As the chart above illustrates, there is a large degree of variation across sectors over the past year. While all parts of the economy experienced a significant hit to growth at the onset of the public health crisis, contact-intensive services, such as accommodation and food service and arts and recreation have lost the most ground, with output 58 per cent and 35 per cent lower than a year ago respectively. In contrast, sectors where greater levels of social distancing or homeworking is possible, such as construction and information and communication, mounted a recovery from 2020 Q2 lows in the second half of last year, leaving output some four per cent below the pre-Covid-19 peak.

Chart 1: Percentage change in output in February compared with pre-Covid-19 peak



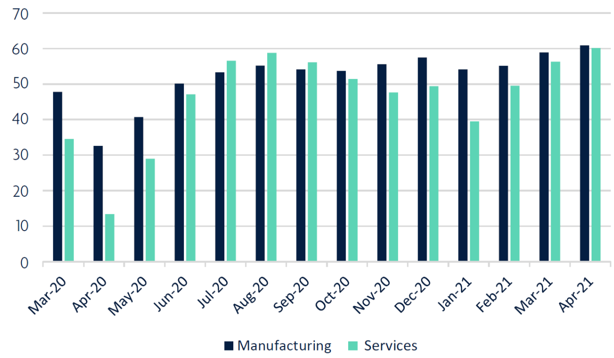
Source: ONS



SENTIMENT IS ON THE INCREASE

Many businesses will have faced significant challenges over the past year as restrictions have been turned on and off to control the virus. However, activity indicators have been strengthening in both services and manufacturing since the start of the year. The latest manufacturing activity index accelerated again in April to stand at the highest level since 1994. The improvement is underpinned by strengthening domestic demand and improved global trading conditions. However, ongoing supply chain challenges are contributing to rising costs. Nevertheless, the improved outlook is supporting employment growth in the sector. The picture for services has inevitably been more volatile over the past six months, but the flash estimate for April also pointed to increased activity as parts of the economy reopened in April. In addition, the survey notes higher levels of confidence amongst services firms that recovery will be sustained in the coming months.

Chart 2: Purchasing managers' index, 50 = no change

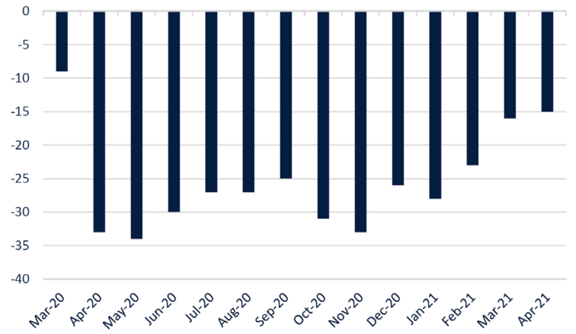


Source: HIS Markit

CONSUMER CONFIDENCE ON THE RISE TOO

Consumer sentiment has also gained ground since the start of the year. While not yet back to pre-pandemic levels, households are becoming somewhat less pessimistic about the economic outlook, with the current vaccine roll out and roadmap to reopening the economy contributing to the improving sentiment. Consumers' confidence about their own financial situation in the next 12 months has also held firm in positive territory. Both the major purchase and savings component of the index are significantly higher than last April's lows.

Chart 3: Consumer confidence index

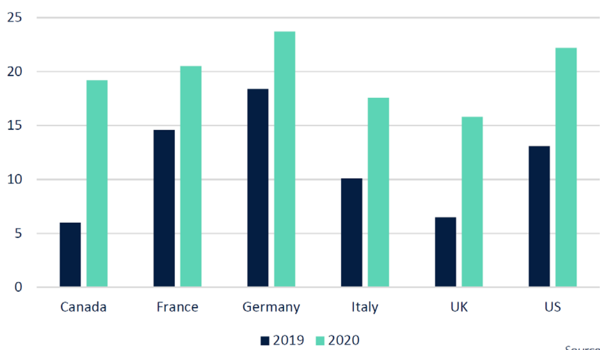


Source: GfK

SAVINGS HAVE BUILT UP

Consumer spending has been curtailed through the shuttering of non-essential retail and services. Additionally, incomes have fallen by less than output, in large part a consequence of the government's furlough scheme. The result has been a large increase in households' savings. According to the ONS, the UK's savings ratio rose to nearly 16 per cent last year, more than double the rate in 2019. This is not a UK phenomenon, with the same factors driving similar growth in savings across developed economies. However, surveys from the ONS also reveal that the trend towards greater saving is uneven across the economy, with homeowners, the over-30s and those with incomes over £20,000 more likely to have greater capacity to save through the past year. However, these excess savings should contribute to a robust recovery in consumer spending in the second half of this year, if the economy continues to open up in line with the government's road map.

Chart 4: Households gross savings ratio, percentage

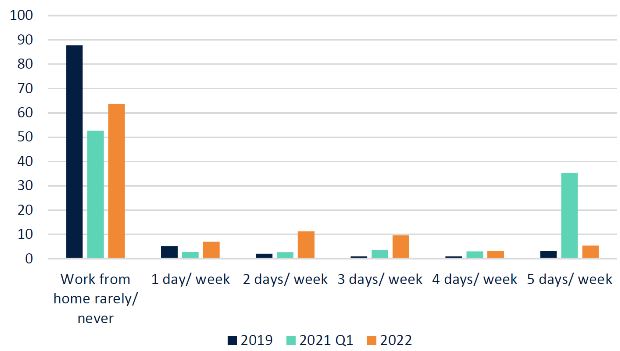


Source: ONS

EXPECTATIONS FOR A RETURN TO THE OFFICE

With non-essential retail closed and more employees working from home or on furlough, spending on hospitality and transport services has greatly reduced. This has been a particular drag on activity in cities and the extent of a 'return to normal' will inform the strength of the rebound in spending. New evidence from the Bank's regular Decision Maker Panel survey confirms the extent of the shift in working patterns over the past year. In Q1 2021 over a third of full-time employees were permanently working from home; this compares with nearly nine in ten never or rarely working from home prior to the start of the pandemic. As restrictions are lifted, employers are predicting some change in working patterns, but not a reversion to that seen in 2019. Over a third of employees are expected to spend at least part of the week at home in 2022.

Chart 5: Expected proportion of full-time workers working from home, per cent



Source: Bank of England Decision Makers' Panel

ROUND UP

A whole gamut of activity and sentiment indicators have been on the rise since the start of this year and are markedly improved from the lows recorded a year ago, when households and businesses were adjusting to the first lockdown. Initial signs from the first tentative steps to lifting restrictions across the UK suggest strong growth in footfall on high streets and increased activity levels in some hard-hit service sectors.

Production related sectors, such as manufacturing, have proved to be more resilient, with some additional boost coming from stockpiling activity at the end of last year, ahead of the UK's exit from the European Union.

The successful roll out of the vaccine in the UK has undoubtedly contributed to improved levels of confidence. And as such, forecasters have put the red pens away and have been revising up the outlook for growth in the latter part of this year. HM Treasury reports that the average independent forecast for GDP growth this year has been revised up to 5.3 per cent in April, from 4.7 per cent in March. Private consumption and investment are both expected to make positive contributions to the growth outlook this year, with momentum predicted to carry through to 2022. Prospects for growth this year continue to be supported by fiscal support announced earlier in the year, through the extension of the furlough scheme and incentives for business investment. The upgraded outlook has also fed through to a slightly brighter labour market picture. While unemployment is expected to rise through this year, joblessness is forecast to peak at lower levels than previously predicted.

These forecasts hinge on continued progress on the vaccine roll out and easing of restrictions – not just in the UK, but internationally. Assuming this is successfully navigated, recovery should take root this year, but after a near ten per cent fall in output last year, pre-pandemic levels of GDP still won't be reached until next year.

Indicator	Period	Value	Change	2021 Forecast*
GDP	Q4 2020	1.3%	↓	5.3%
CPIH inflation	Mar 2021	1.0%	↑	2.1%
Unemployment rate	Feb 2021	4.9%	↓	6.3%
Average earnings	Feb 2021	4.5%	↓	3.8%
Brent crude	Apr 2021	$64.2	↓	-
$ Exchange rate	Apr 2021	$1.38	↓	-
PSNB	Mar 2021	£28 bn	↑	£219.9 bn