MONTHLY ECONOMIC INSIGHT

UK FINANCE

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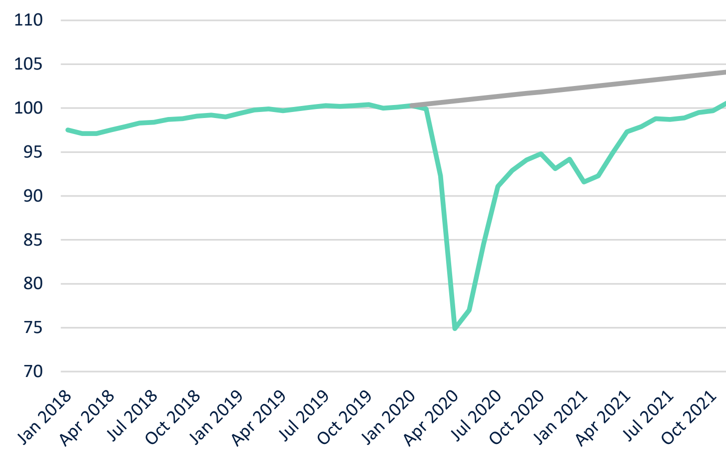
The latest ONS data for the UK economy reveal that GDP surpassed its pre-pandemic peak in November 2021. This month's economic review takes a look at some of the detail underneath the headline to see which sectors have helped to close the gap and which continue to have ground to make up.

BACK TO PRE-PANDEMIC OUTPUT

The UK economy posted its fourth consecutive month of expansion last November, with output up 0.9 per cent compared with October. After 21 long months of living with Covid-19, growth in November finally pushed output back above the levels seen prior to the pandemic and GDP was 0.7 per cent higher than the February 2020 peak.

Chart 1: Monthly GDP index, 2019=100



Source: ONS

All three broad sectors (services, production and construction) posted growth in November, the first month across the board growth has been recorded since public health restrictions began to ease last spring. The service sector was the largest contributor to the increase in GDP in November, accounting for more than half of the rise.

Despite the broad-based increase in November and the return of overall GDP levels to pre-pandemic level, this is not yet the case for all components of output. Services and construction output have recovered their Covid-19 losses, but production output (which includes manufacturing, mining and utilities) remains 2.6 per cent below.

As we indicated in **January's review**, surveys and other data were pointing to a solid start to 2021 Q4, but the arrival of the Omicron variant looked set to depress activity in December with new public health measures, increased voluntary social distancing, and staff absences due to high Covid-19 infection rates. However, the impact is widely expected to be short-lived and ONS notes that GDP data for the Q4 will reach or surpass pre-coronavirus levels (2019 Q4), provided the fall in December's GDP is no more than 0.2 per cent.

While the return to pre-pandemic levels is to be cheered, Chart 1 also shows what might have been if growth had continued on its pre-Covid-19 path. The next section will look at the sector components of GDP in more detail.

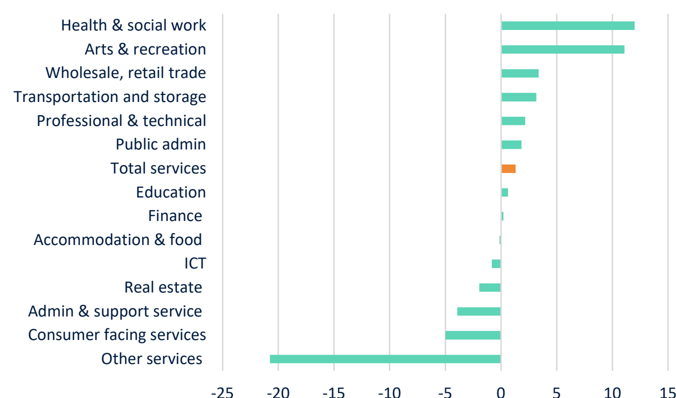
MIXED PICTURE ON SERVICES

As already noted, November was a good month for services activity, with the sector posting month-on-month growth of 0.7 per cent. Almost all sub-sectors saw output increase in the month with scientific and technical activities and transport and storage the strongest performers on the month, with the latter noting particularly strong demand around black Friday sales (which we noted back in **December**). Overall, November's growth pushed total services output higher than pre-pandemic levels.

Consumer facing services (which includes retail, restaurants, travel agents and sports activities) have faced some of the toughest trading conditions over the past two years. Solid growth has returned with the easing of restrictions, including in the most recent data for November, which shows a monthly expansion of 0.8 per cent. Nevertheless, output in the sector remains some five per cent lower than in February 2020 (Chart 2). Short term prospects for these sectors look challenging. The recent 'flash PMI', for example, notes consumer-facing businesses were hit hard by Omicron, pushing activity down in December and January. Despite the robust expansion seen in sectors such as accommodation and food services in recent months (output was up some 75 per cent in the six months to November compared with the same period in 2021), the return to pre-pandemic levels looks to be some months away.

In contrast, the health and social work sub-sector has so far seen the biggest output gains relative to February 2020. The vaccine rollout, test and trace activities and more recently, the return of face-to-face GP appointments has spurred activity.

Chart 2: Output of service industries, percentage change compared with February 2020



Source: ONS

£100 IS THE LIMIT

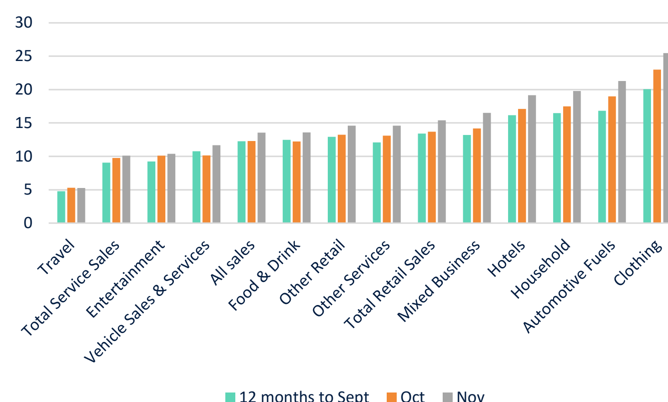
On a slight tangent from recent growth trends, new UK Finance data on consumer payments points to the ongoing evolution of payment trends following the increase in the contactless spending limit to £100, in October 2021.

Chart 3 shows the average transaction value (ATV) across contactless credit and debit cards by broad sector. It illustrates the ATV in the 12 months leading up to the change and in subsequent months as retailers phased in the increase.

Across all sectors the ATV has been around £12.30 since the last limit increase in April 2020. It increased to £13.60 in November as contactless payments of up to £100 became more widely accepted. More notably ATV increases are seen in clothing stores, automotive fuels and household sector (DIY, furniture and garden centre stores), as more transactions were covered by the new limit. In addition, the ATV at supermarkets also increased by over £2 as more customers are able to access contactless payments for the weekly shop.

At the other end of the spectrum there has been little movement in contactless ATV for travel, where purchases of flights or train bookings may be more likely to be made online and other payments for public transport will be unaffected by the limit increase.

Chart 3: Average spend on contactless by sector, £



Source: UK Finance

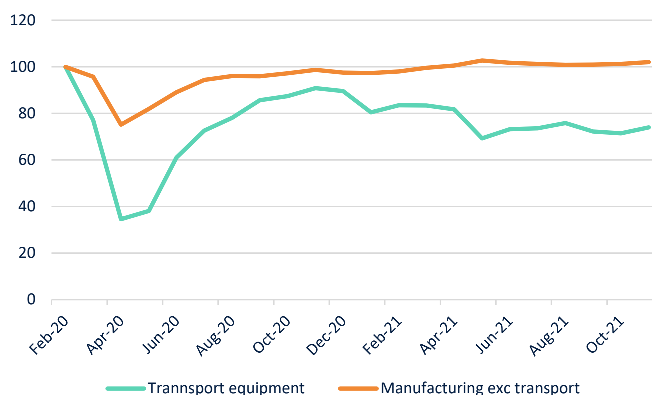
Also interesting to note (not shown) is the impact on the ATV of other forms of payment. For example, we have seen the ATV for chip and pin rise above that for online payments in the last few months as to lower value transactions now being predominantly contactless.

PLANES, TRAINS, AND AUTOMOBILES

Back to recent growth trends. Similar to services, it is difficult to generalise about the performance of manufacturing, which includes everything from meat packaging to machine tools. Total manufacturing growth of 1.1 per cent in November comes after a bumpy ride for the sector. In part, a consequence of the widely reported global supply chain disruptions that plagued industry through much of 2021. Output across the sector remains 2.2 per cent below its pre-coronavirus peak and more or less where it was a year ago.

However, there is significant sub-sector variation within this. The transport sector has played a large part in the sector's wobbles over the past 12 months (it accounts for around 15 per cent of manufacturing output). Problems with electronic chip production and shipping have caused significant production problems for the auto sector, in the UK and globally. Restrictions on foreign travel will also have impacted on the aerospace sector.

Chart 4: Index of output, February 2020 = 100



Source: ONS

Chart 4 illustrates the path of the transport equipment sub-sector and manufacturing excluding transport over the course of the pandemic. It is clear that output fell further and faster with the onset of the pandemic in the transport sector and the initial recovery path derailed at the start of last year due to the issues discussed. Stripping that out, the rest of manufacturing has proven to be a bit more resilient through 2021 with output activity tipping above pre-Covid levels in spring 2020.

Supporting manufacturing growth have been sectors such as chemicals and pharmaceuticals, which, unsurprisingly, put in a particularly strong performance at the end of 2020 as vaccines secured approval for rollout. In addition, sectors such as food and drink tend to be less volatile, even in a downturn, due to the nature of demand.

In the short term there remains some headwinds to broader manufacturing. December and January PMI data were affected by capacity constraints and staff absences. While there were signs of some easing in supply chain pressures, survey responses continue to suggest industry is some way from normal.

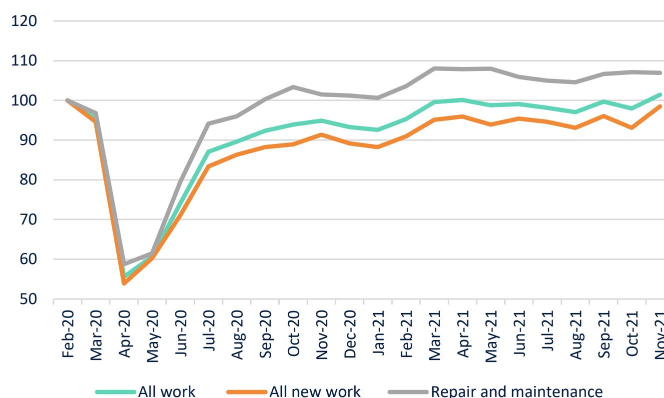
CONSTRUCTION ACTIVITY ON THE UP

The final sector in our round-up is construction. As noted, the sector's output is now larger than recorded prior to the pandemic, by 1.3 per cent (Chart 5). November's robust 3.5 per cent expansion, helped by mild weather, pushed the sector back above pre-pandemic levels after some volatility over the course of last year – again linked to availability of skills and materials.

Construction repair and maintenance has seen solid demand growth after the initial hit of the first national lockdown. Activity has been particularly strong in housing, perhaps reflecting projects to adapt to homeworking and renovations on newly purchased properties. Notably this tailed off in the most recent data.

While new work overall has been somewhat weaker through the pandemic, infrastructure new work has recorded significant expansion over the past two years, though this was not sufficient to offset falls in industrial and commercial projects.

Chart 5: Index of output, February 2020=100



Source: ONS

ROUND UP

The latest sector data from the ONS indicate that the economy was faring pretty well before the emergence of Omicron. The new Covid-19 variant looks like it has created a re-emergence of some challenges for some industries. The flash PMIs indicate wobbles in some parts of the service sector and all industries hitting capacity bumps due to staff absences.

In addition, the latest wave of the ONS Business Insights and Conditions Survey (BICS) showed around a third of businesses reporting lower than normal turnover in the two weeks straddling the new year period – the highest proportion since June. And the proportion of the workforce reported to be on sick leave or not working because of coronavirus remained at three per cent, the highest level reported since comparable estimates began in June 2020.

So, what will the Bank of England make of this when it produces its forecast update and meets to decide changes to Bank Rate in February? It is likely it will see the shaky start to 2022 as temporary, with activity recovering through Q1. The continuing concern will be prospect of a further acceleration in inflation, which stood at 5.4 per cent in December.

While the Bank has previously indicated that monetary policy can do little to address the causes of higher prices – largely driven by what's happening in energy markets – there is an argument that ultra-low rates are not appropriate given that supply constraints will take time to resolve, the labour market looks tight and inflation expectations are heading higher.

Markets are pricing in another rise in February, but they have been wrong about timing in the past. We'll have to wait and see if Bank Rate changes are like buses – you wait years for one and two come along in quick succession.

Indicator	Period	Value	Change	2022 Forecast*
GDP	Q3 2021	1.3%	↓	4.4%
CPI inflation	Dec 2021	5.4%	↑	4.0%
Unemployment rate	Nov 2021	4.1%	↓	4.1%
Average earnings	Nov 2021	4.2%	↓	3.9%
Brent crude	Dec 2021	$77.78	↓	-
$ Exchange rate	Dec 2021	$1.33	↓	-
PSNB	Nov 2021	£16.8bn	↑	£95 bn

Source: ONS, HM Treasury, Bank of England