HOUSE OF COMMONS LIBRARY

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Coronavirus: Economic impact

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Summary

This briefing was last updated on 22 October. This is a fast-moving crisis, so please be aware that information may have changed since the date of publication. The Library intends to update this briefing.

The coronavirus outbreak has impacted the economy in many ways. From the lockdown restrictions shutting down many businesses to limits on mobility, voluntary and enforced, the economic impact has been severe.

Economic impact

The magnitude of the recession caused by the coronavirus outbreak is unprecedented in modern times. UK GDP was 25% lower during the depth of the crisis in April than it was only two months earlier in February.

Economic activity picked up over the spring and summer, reflecting the opening up of the economy and pent-up demand from the lockdown period. Overall, GDP was 9% lower in August than before the pandemic.

The economy faces a less supportive environment in the autumn and winter. Coronavirus case numbers increased in September and October and measures to stop the spread of the virus have become tighter and move restrictive. Some sectors, such as hospitality, face particularly difficult trading conditions.

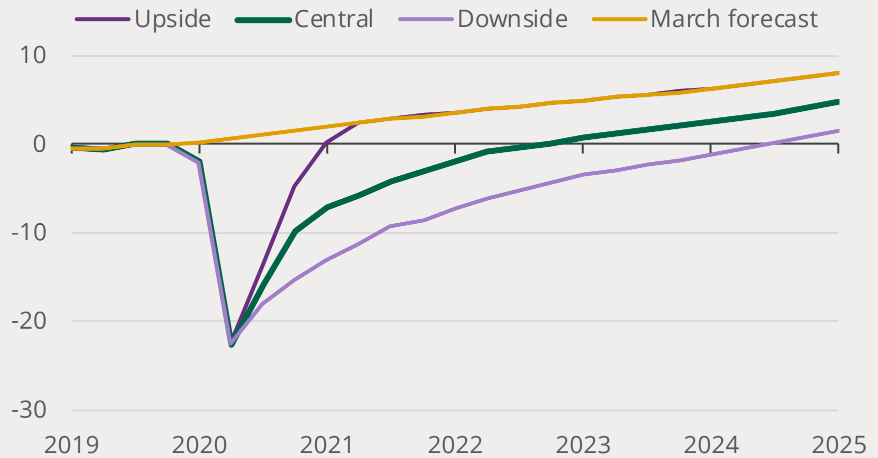
The reaction of consumers and businesses to the uncertainty is also an important factor in determining the economy's future path.

Consumers may be reluctant to return to 'normal' spending patterns. This may be due to health concerns but also perhaps due to concerns over their income. For instance, unemployment levels are expected to rise. Uncertainty may also dampen businesses' inclination to invest.

In July the Office for Budget Responsibility (OBR) presented estimates of how the economy would perform under three scenarios (relating to how long Covid-19 remains prevalent). In its central scenario, GDP declines by 12.4% in 2020, with the unemployment rate peaking at 12% by the end of 2020.

OBR scenarios for GDP vary greatly

% change with GDP level of Q4 2019 under three OBR scenarios



A survey of economists in the first part of October, showed their average forecast for 2020 GDP growth was -10.2% (compared with 2019) and +6.3% for 2021.

Even when the economic shock of coronavirus does eventually dissipate, the crisis may result in lasting damage to, and/or structural shifts in, the economy.

Policy response

Governments and central banks around the world introduced policies designed to mitigate at least some of the negative economic impacts from the coronavirus outbreak.

In the UK, several policies have been announced by the Government and the Bank of England in order to support businesses and workers.

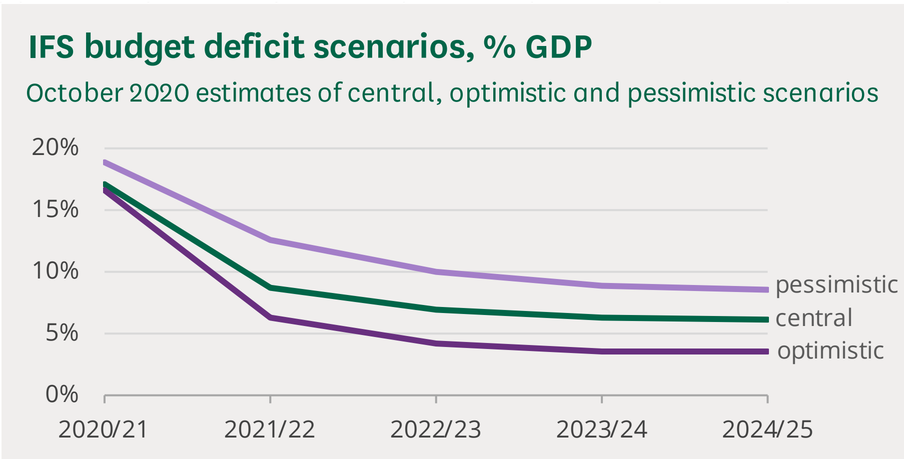
The intention of these measures is to keep businesses afloat and, in turn, as many people as possible employed. The measures seek to financially support businesses, workers and the wider public during the outbreak, as well as attempting to reduce the economic uncertainty.

Public finances

The coronavirus outbreak is significantly affecting the public finances. Government is borrowing historically large amounts as tax revenues fall and government spending increases. Government debt – the stock of its past borrowing – is, therefore, increasing.

The measures the Government has taken to support businesses, workers and household incomes may cost over £200 billion this year. The longer the crisis continues, the more the cost to government will rise. The budget deficit in 2020/21 is likely to reach a level last seen during World War II.

The outlook for the public finances in the coming years depends on the strength of the economic recovery. As the economy recovers the Government's budget deficit will decrease. Tax receipts will recover and spending on support to individuals, workers and businesses will fall. The extent to which the economy recovers will depend on how much permanent damage – or scarring – there has been.



Note: estimates were produced before the Chancellor's statement on 22 October 2020

1. Background

The UK economy prior to the coronavirus outbreak was characterised by modest GDP growth of around 1% per year and high rates of employment.

1.1 GDP growth

Heading into 2020, the UK economy was growing modestly, with GDP growth of 1.3% in 2019.[1]

The decisive General Election outcome in December 2019 and subsequent reduction in political uncertainty led to improvements in business confidence in early 2020.[2]

The improvement in sentiment, however, was not reflected in GDP data for January and February 2020 (the last period before the coronavirus outbreak really began to impact the UK economy).

GDP fell by 0.1% in the three months to February compared with the previous three-month period. Compared with a year ago, GDP was 0.6% higher.[3]

Before the spread of coronavirus took hold in the UK, forecasts for UK GDP growth in 2020 were generally around 1%.[4]

1.2 Labour market

The labour market began 2020 with the highest employment rate (76.6%) since comparable records began in 1971. The total number of employed people in the UK was 33.1 million. Both figures are for the three months to February 2020, before coronavirus social distancing measures began.[5]

The number of people in employment and the employment rate – the proportion of those aged 16-64 in work – had been rising since 2012.[6]

Similarly, the unemployment rate fell from a cyclical peak of 8.5% at the end of 2011 to around 4% by 2018, where it remained. The unemployment rate was 4.0% in the three months to February 2020, with 1.4 million people unemployed.

The annual growth rate of average earnings was 2.9% in Great Britain in the three months to February 2020.[7]

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1 ONS, series IHYP [accessed 13 October 2020]
2 See, for example: Library Insight, Economic update: Optimism on the up, 26 February 2020
3 ONS series ED3H (3 month on 3 month % change) and ONS series ED9T (year on year % change) [accessed 13 October 2020]
4 HM Treasury, Forecasts for the UK economy: a comparison of independent forecasts, 19 February 2020
5 ONS, Labour market overview, UK: April 2020, 21 April 2020
6 Data available at Commons Library, The UK economy: a dashboard
7 More information on the labour market can be found in the Commons Library briefing paper, People claiming unemployment benefits by constituency

1.3 Public finances pre-pandemic

Budget deficit

In 2019 the Government's budget deficit (the difference between its spending and taxes) was relatively small. The deficit was 2.1% of GDP in 2019 and had fallen from over 10% of GDP following the 2007-2009 financial crisis.

The Government borrows to cover its budget deficit. The Government was planing on increasing borrowing in the coming years. It aimed to take advantage of historically low borrowing costs to increase investment spending on areas such as infrastructure.[8]

Government borrowing had fallen since 2010

Budget deficit, rolling four quarters, % GDP, 1997-2019

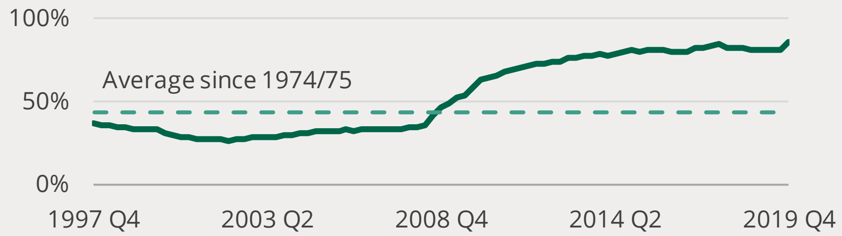
Source: ONS series J5II

Government debt

The Government's debt – broadly speaking, the stock of borrowing arising from past budget deficits – has been relatively high since the financial crisis. The debt-to-GDP ratio was a little over 80% of GDP in the autumn of 2019.[9] Debt was last consistently higher than 80% of GDP in the mid-to-late 1960s, when it was still recovering from reaching over 200% of GDP during World War II.[10,11,12]

Government debt is higher than post 1974/75 average

Public sector net debt, % GDP



Source: ONS series HF6X

[8] See Library briefing paper, Spring Budget 2020: a summary, for more
[9] We use autumn as after this period the debt-to-GDP ratio begins to be affected by the fall in GDP caused by coronavirus. This is because when measuring the debt-to-GDP ratio the GDP denominator is calculated so that it represents the 12 months centred round the debt observation (the 6 months before it and 6 months after it).
[10] OBR, Public finances databank, February 2020
[11] The OBR has produced a summary of post-World War II debt reduction
[12] See Library briefing paper, The public finances: a historical overview, March 2018

2. How coronavirus has affected the economy

The Covid-19 outbreak has impacted the UK economy in several ways. The initial disruption was to supply chains (particularly from China, the origin of the outbreak). As the outbreak spread around the world and into the UK, public health measures to slow its progress meant fewer people working and businesses in some sectors shutting down entirely.

In addition to these supply shocks, there are also shocks to demand in the economy. As the virus spread rapidly throughout the country in March, people voluntarily restricted their movements and their spending. Due to the national lockdown and government advice, consumers' opportunity to spend was restricted. With some businesses struggling to survive or facing revenue shortfalls, the number of people out of work is rising.

Furthermore, the great uncertainty associated with the crisis and how long it will last – closely linked to how successful virus containment measures are – could result in consumers being more cautious in their spending decisions. The two main factors underlying this are health concerns and/or a deterioration in their financial situation (perhaps because they have lost their job or fear that they might).

Businesses, already facing a squeeze on their cash reserves, may reduce their planned investments due to the uncertain economic outlook.

2.1 Supply shocks

The initial focus of the economic impact of coronavirus was on China, the source of the outbreak. China plays a big role in the global economy, being a large source of demand for goods and services of other countries. It's also heavily integrated into global supply chains.[13]

As the outbreak spread across the globe, the scope for economic damage widened considerably. Public health measures were introduced in many countries in order to limit the spread of the virus.

Some of the ways the coronavirus outbreak and the public health measures affected the capacity of the UK economy include:

- **Supply chain disruption** – the globalised and complex nature of some businesses' supply chains meant some found it difficult to source the parts (car makers, for example), or inventories (retailers, for example) they needed. For instance, all major UK and European car plants were closed in late March and early April.[14]
- **Workers being off sick** – many workers have taken time off work due to Covid-19. This may have limited the amount of work businesses were able to conduct.

[13] OECD Interim Economic Assessment, Coronavirus: The world economy at risk, 2 March 2020

[14] "Every major UK and European carmaker to stop or cut production", Guardian, 20 March 2020

- **Closing schools** – the enforced closure of schools for most pupils during the summer term meant many parents had additional childcare responsibilities. As a result, many may not have been able to work as much or as productively as normal.[15]
- **Shutting down businesses** – unprecedented measures to close businesses entirely, either by government direction or by their own initiative.

In summary, the combination of supply chain disruption, some workers not being able to work and the closure of businesses in some sectors, restricted how much the economy could produce and sell. These pressures were most acute in April and began to ease as many restrictions were relaxed from mid-May.

2.2 Demand shocks

The coronavirus outbreak has also affected the demand for goods and services in the economy. This was first felt in the travel and tourism sectors and they remain some of the worst-hit parts of the economy. As the virus spread rapidly throughout the country in March, people voluntarily restricted their movements and their spending. Public health measures to contain the virus led to further reductions in demand.

Many businesses have seen declines in revenues, but still have fixed costs such as rents and staff wages. While some businesses have a sufficiently large amount of cash reserves to make these payments, or the ability to borrow what is necessary, some may not. This has led to some firms facing cash flow issues.

As a result, some companies risk going out of business and others will lay off staff to cut costs. To combat this, during the initial wave of Covid-19 cases, the Government and Bank of England introduced policies to support affected businesses and workers (see section 4). A second wave of cases during the autumn and rising unemployment could once again lead to reduced consumer demand in the economy.

Uncertainty

There is a huge amount of uncertainty over how long this crisis lasts. From an economic perspective, will the damage already done be temporary, leading to a full recovery maybe later in 2020 or 2021 – what some call a 'V' shaped recovery? Or will it take longer? And will there be permanent damage done to the economy?

How will the second wave of Covid-19 cases in the autumn affect the economy? Will consumers and businesses react differently than they did in the first wave? How strict will restrictions be and how will this affect the economy? There are clearly many questions.

The uncertainty in and of itself will affect consumer and business confidence and behaviour. Consumers may be more cautious in their spending, perhaps due to concerns over the virus and/or due to financial pressures (such as losing their jobs or fears that they might). Businesses,

[15] Simon Wren-Lewis, mainly macro blog, "The economic effects of a pandemic", 2 March 2020

already facing a squeeze on their cash reserves, may reduce their planned investments due to the uncertain economic outlook.

The behavioural responses by consumers and businesses will play a large role in the speed of the economic recovery (as discussed in section 3.6).

2.3 Global nature of crisis

The global nature of the crisis exacerbates domestic economic downturns and makes it more difficult for any individual country to buck the trend.

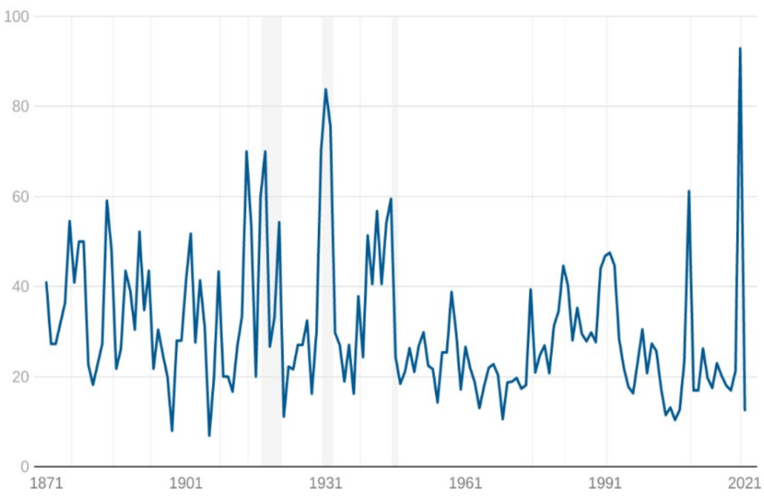
Early in the crisis, the Secretary-General of the Organisation for Economic Co-operation and Development (OECD) warned that the pandemic has caused, "a major economic crisis that will burden our societies for years to come."[16] Also in March, the IMF Managing Director, Kristalina Georgieva, similarly highlighted the severe economic cost: "the outlook for global growth: for 2020 it is negative—a recession at least as bad as during the global financial crisis or worse."[17] On 15 May, she said it could take until 2023 for the global economy to return to its pre-coronavirus levels.[18]

The global depth and reach of the economic crisis are unprecedented in modern times. In June, the IMF chief economist said this is the "worst recession since the Great Depression [of the 1930s]".[19] In October, the IMF estimated that the cumulative loss of output to the global economy, compared to pre-pandemic expectations, will be severe: around $11 trillion (£8 trillion) over 2020-21, growing to $28 trillion (£22 trillion) over 2020-25.[20]

In addition, the World Bank has estimated that this global recession will see the largest proportion of countries around the world experience falls in GDP per capita since at least 1870.[21]

Most countries are expected to face recessions in 2020

Share of economies in recession, 1871-2021



The proportion of economies with an annual contraction in per capita GDP. Shaded areas refer to global recessions. Data for 2020-21 are forecasts.

Source: Taken from World Bank, Global economic outlook press release, June 2020

[16] Angel Gurria, OECD Secretary-General, "COVID-19: Joint actions to win the war", OECD, 23 March 2020

[17] IMF press release, "IMF Managing Director Kristalina Georgieva's Statement Following a G20 Ministerial Call on the Coronavirus Emergency", 23 March 2020

[18] Interview with Politico website, Global Translations Interview with Kristalina Georgieva of the International Monetary Fund May 15, 2020

[19] IMF blog, Reopening from the Great Lockdown: Uneven and Uncertain Recovery, 24 June 2020

[20] IMF blog, A Long, Uneven and Uncertain Ascent, 13 October 2020

[21] World Bank, Global economic outlook press release, June 2020

3. Economic impact

The magnitude of the recession caused by the coronavirus outbreak is unprecedented in modern times. UK GDP was 25% lower during the depth of the crisis in April than it was only two months earlier in February.

Economic activity picked up over the spring and summer, reflecting the opening up of the economy and pent-up demand from the lockdown period. Overall, GDP was 9% lower in August than before the pandemic.

The economy faces a less supportive environment in the autumn and winter. Coronavirus case numbers increased in September and October and measures to stop the spread of the virus have become tighter and move restrictive. Some sectors, such as hospitality, face particularly difficult trading conditions.

The reaction of consumers and businesses to the uncertainty is also an important factor in determining the economy's future path.

Consumers may be reluctant to return to 'normal' spending patterns. This may be due to health concerns but also perhaps due to concerns over their income. For instance, unemployment levels are expected to rise. Uncertainty may also dampen businesses' inclination to invest.

Forecasts for GDP point towards a large decline in 2020. The consensus forecast among economists surveyed in October is for UK GDP growth of -10.2% in 2020 and +6.3% in 2021.

In July, the OBR presented estimates of how the economy would perform under three scenarios (relating to how long Covid-19 remains prevalent). In its central scenario, GDP declines by 12.4% in 2020, with the unemployment rate peaking at 12% by the end of 2020.

3.1 Unprecedented recession

The combined impact of supply and demand shocks, the large degree of uncertainty and the acute public health considerations make this an unprecedented economic shock in modern times.[22] On 19 May, the Chancellor, Rishi Sunak, said that the UK economy was facing a "severe recession, the likes of which we have not seen".[23] Subsequent data releases supported this interpretation of economic conditions.

Record fall in GDP

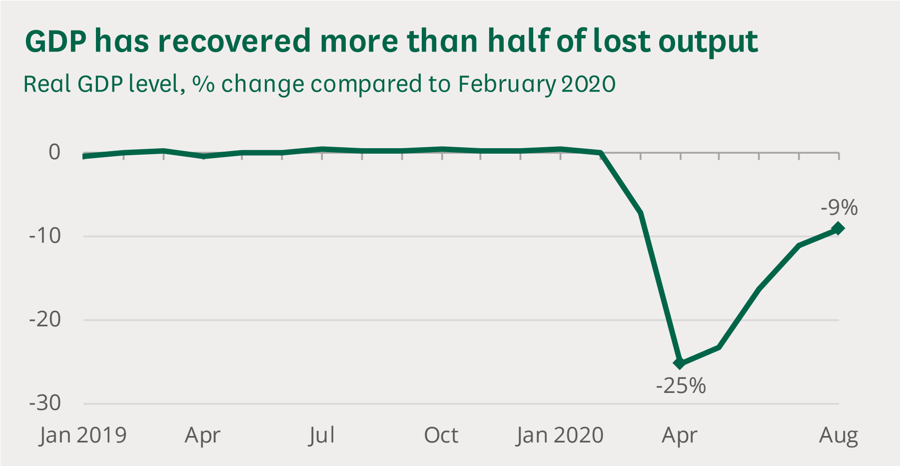
The first serious impact of coronavirus on the UK economy was evident in March. During March, Covid-19 spread rapidly. In response, social

[22] For analysis of the economic impact of past viral outbreaks see Resolution Foundation, Safeguarding governments' financial health during coronavirus, 25 March 2020

[23] Oral evidence from the Chancellor to the Lords Economic Affairs Committee, 19 May 2020; Summarised in "Chancellor plays down hopes of quick economic recovery", Guardian, 19 May 2020

distancing measures were introduced prior to the full lockdown introduced on 23 March.[24]

GDP, which is the total value of all goods produced and services provided in the UK, was 25% lower in April compared to February.[25] This offers a rough measure of the impact of Covid-19 given that lockdown measures were at their most stringent in April. For some context, this is over three times the 7% decline in GDP recorded during the financial crisis in 2008/09.[26]



Source: ONS, Monthly GDP, series ECY2

From February to March, GDP fell by 7.3%. From March to April, GDP fell a further 19.5%. This is by far the biggest decline in the official monthly GDP data series (available from 1997). It is also very likely the largest fall in the post-Second World War era.[27]

In May, GDP recorded relatively modest growth of 2.7% compared with April, as some loosening of lockdown restrictions were introduced.[28] Faster growth was recorded in June and July (more on this below).

Please note that calculating GDP is difficult even in benign conditions. In the current environment, with many businesses temporarily shut and many staff working from home, the work of statisticians is made even more difficult. Therefore, these initial estimates are subject to more uncertainty than usual and may be revised.[29]

3.2 Summery recovery

From mid-May, the Government announced relaxations of lockdown measures.[30] For example, most non-essential retailers in England were allowed to reopen from 15 June, with further easing of restrictions on

[24] HM Government, PM address to the nation on coronavirus: 23 March 2020
[25] ONS, GDP monthly estimate, UK: August 2020, 9 October 2020
[26] ONS, Coronavirus and the impact on output in the UK economy: April 2020, 12 June
[27] Economic Statistics Centre of Excellence, Historical National Accounts
[28] ONS, GDP monthly estimate, UK: May 2020, 14 July 2020
[29] ONS, Coronavirus and the effects on UK GDP, 6 May 2020
[30] Cabinet Office guidance, Our plan to rebuild: The UK Government's COVID-19 recovery strategy, 11 May 2020

many other businesses such as restaurants following in July.[31] As a result, economic activity picked up over the late spring and summer from April's low point.

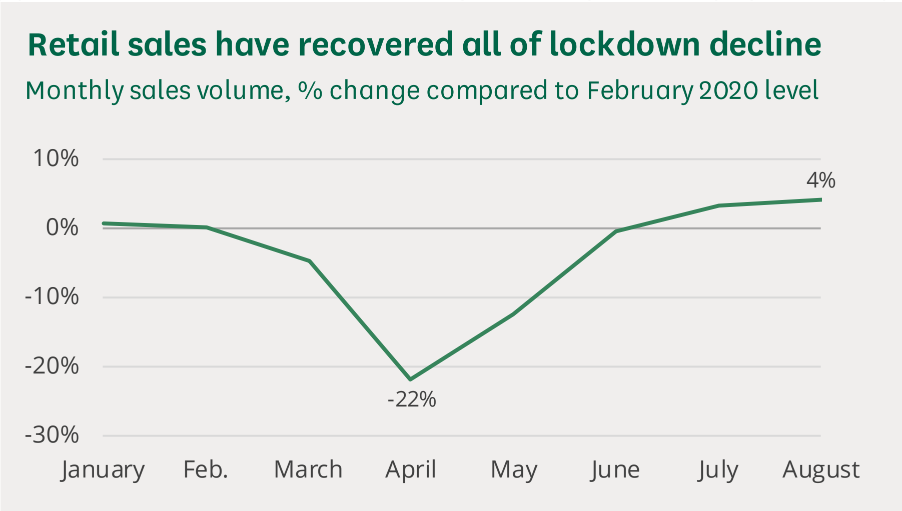
After the 25% cumulative decline in GDP in March and April, growth returned in May, with a 2.7% monthly increase. Faster growth then followed as GDP grew by 9.1% in June and by 6.4% in July. Growth slowed in August, to 2.1%.[32]

Overall, GDP was 9% lower in August than before the pandemic's full impact on the UK economy was felt.

This initial recovery phase, at least in part, derived from the opening up of the economy and reflects some pent-up demand from the lockdown period. For example, consumers could buy goods and services they were unable to when strict national lockdown measures were in place.[33]

There was a particularly strong rebound in retail sales. The volume of sales initially fell by 22% from February to April. This was followed by a 12% rise in May, followed by a further 14% increase in June.[34] Sales continued to grow in July and August, although at a slower pace.

The strength of the recovery is reflected in retail sales volumes in August being 4.0% above their pre-coronavirus levels of February.



Source: ONS, Retail sales, Great Britain: August 2020, 18 September 2020

This overall picture masks some wide variation between different types of retailer. In general, food stores have seen some growth and DIY stores have fared well, while sales in clothes and other non-food stores are still well below pre-Covid 19 levels.[35] There has also been a surge in

[31] Devolved nations reopened at different speeds. For example, most non-essential retailers in Scotland could reopen on 29 June. For more detail see Library briefing paper, Coronavirus: Business re-opening, and Institute for Government, Coronavirus lockdown rules in each part of the UK [accessed 3 July]
[32] ONS, GDP monthly estimate, UK: August 2020, 9 October 2020
[33] For more on the impact of pent-up demand on the recovery see, Bank of England, Assessing the health of the economy - speech by Gertjan Vlieghe, 20 October 2020
[34] ONS, Retail sales, Great Britain: August 2020, 18 September 2020
[35] ONS, Dataset: Retail Sales Index, tables KPSA3 and table 1A [accessed 24 Sep 2020]

online sales, which accounted for 28% of total retail spending in August, up from 20% in February.[36]

3.3 Autumn wave of Covid-19 cases

Ben Broadbent, a member of the Bank of England's Monetary Policy Committee, said in a September speech that June to August was a "sweet spot" for the economy.[37]

As already noted, this period saw the reopening of 'non-essential' stores, the easing of the strict lockdown restrictions, increases in consumer spending and the full impact of the Government's support measures (such as payments from the furlough scheme).

There are some indications that the summer momentum began to ease in September. For example, the IHS Markit Purchasing Managers' Index showed growth in business activity slowed in September. This was particularly the case in the services sector, though growth was still strong.[38]

More importantly, with coronavirus case numbers increasing in September and October, tighter localised measures and more restrictive national measures, the economy faces a less supportive environment in the autumn and winter (see also section 3.6 below).[39]

3.4 Labour market impact

As of mid-October, the official unemployment and employment rates do not show the dramatic changes that one might expect given the scale of the recession. This may be at least partly due to the Coronavirus Job Retention Scheme, as furloughed workers are classed as employed in official statistics.

Estimates for June-August 2020 show that compared with the (largely) pre-pandemic period of January-March 2020:[40]

- **Employment** levels are lower by 415,000, concentrated among young people (a fall of 256,000 employed 16-24 year olds).
- **Unemployment** levels are up by 157,000.
- The number of 16-64 year olds who are economically **inactive** (out of work and not looking for work) is up by 168,000.

A number of other indicators point to the labour market being more seriously impacted:[41]

- Early indicators for September suggest a reduction in **employee payrolls** of around 673,000 (or -2.3%) compared to March 2020, based on experimental HMRC data.

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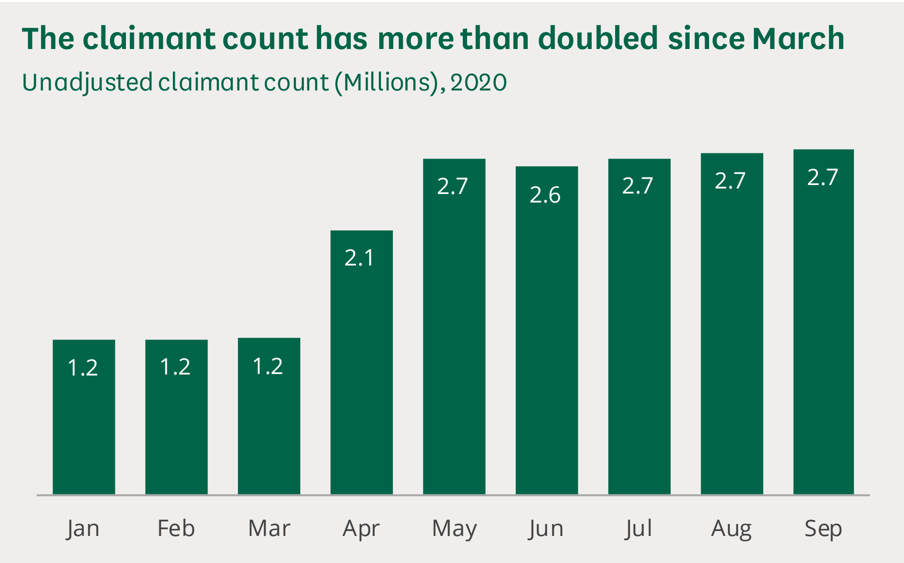
36 ONS, series MS6Y [accessed 20 October 2020]; this peaked at 34% in May 2020
37 Bank of England, Government debt and inflation - speech by Ben Broadbent, 2 September 2020
38 Markit, IHS Markit / CIPS UK Services PMI: September 2020, 5 October 2020
39 For example, UK Govt Guidance, Local COVID alert levels: what you need to know [accessed 20 October 2020]
40 ONS, Labour market overview, UK: October 2020, 13 October 2020
41 ONS, Labour market overview, UK: October 2020, 13 October 2020

- The total number of weekly **hours worked** in the three months to August 2020 was still 15% lower than a year before, compared to the 20% fall seen in April-June.
- **Job vacancies** were over 40% lower than a year ago during July-September, after being a record 59% lower than the year before during the three months to June.
- **Average wages** were unchanged in the three months to August 2020 compared with a year earlier. Before the pandemic, average wages were rising by around 3% per year. This change is likely partly due to many employees receiving lower wages while being furloughed.
- On 10 September 2020, 2.7 million people were claiming **unemployment-related benefits**. Between March and September there has been an increase of 1.5 million claimants, though most of this net increase happened by May.[42] Not all people on these benefits will be out of work; some low-paid workers falling below Universal Credit income thresholds will also be eligible.[43]



Source: ONS, CLA01: Claimant Count

In addition, the **number of furloughed workers** has declined substantially since the spring but remains large. Throughout April and May, over 8 million jobs were on furlough, with a peak of 8.9 million jobs furloughed on 8 May. This number declined steadily to 4.8 million as of the end of July (roughly 16% of eligible jobs).[44]

A more recent survey of businesses by the ONS suggest around 9% of employees were on furlough in the two-week period ending 4 October.[45]

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[42] ONS, CLA01: Claimant Count, 13 October 2020

[43] In their report "The truth will out" (July 2020) the Resolution Foundation estimated that around half of the Claimant Count rise relates to those newly out of work

[44] HMRC, Coronavirus Job Retention Scheme statistics: September, 8 October 2020

[45] ONS, Wave 15 of BICS survey, 22 October 2020

Further information and detail is available in the Library briefing paper, Coronavirus: Impact on the labour market. This includes data showing the number of employees furloughed by parliamentary constituency.

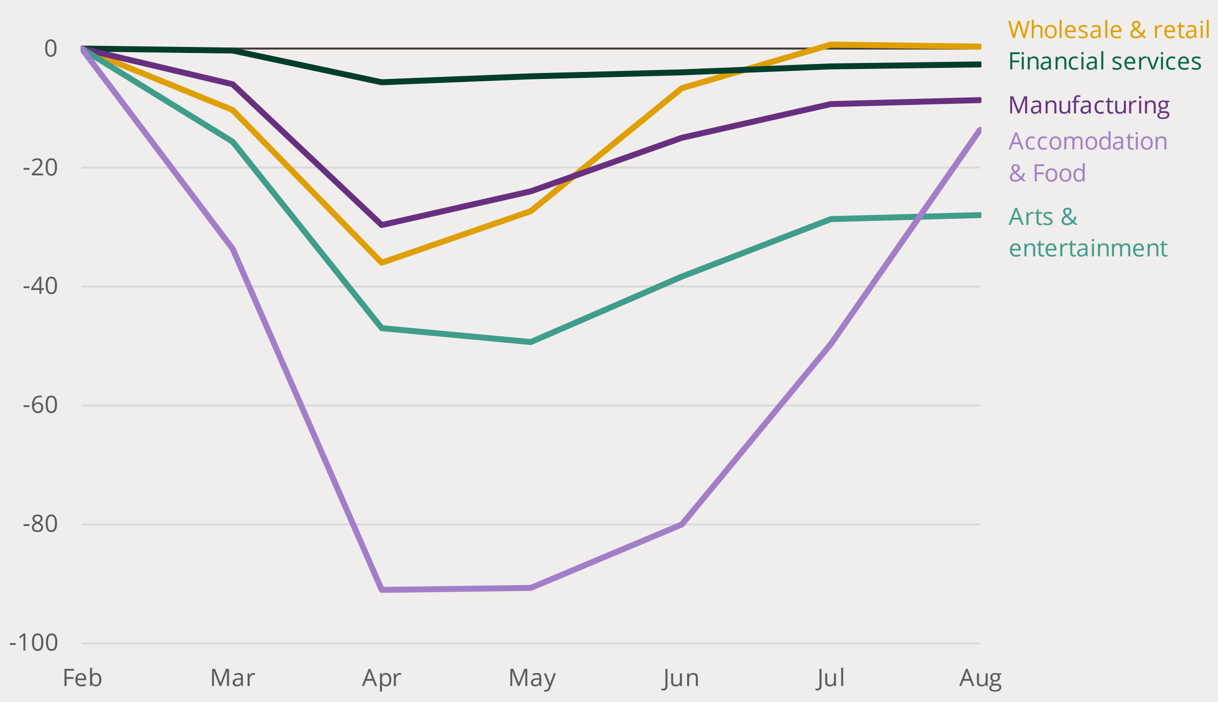
3.5 Uneven impact by economic sector

Most parts of the economy saw big declines in output during the national lockdown. Data for May showed some improvement for certain sectors compared with April (when the 'full lockdown' was in effect), but not all. A broad-based recovery began in June, as the economy gradually re-opened.

Some industries were especially badly affected. The largest declines have been in the accommodation and food sector, with output 91% lower in April compared with February.[46] Output in the arts and entertainment sector was 49% lower in May than in February. Some sectors experienced smaller falls. Output in the information and communication sector saw a maximum fall of 12% and financial services saw a 6% decline.

Huge differences in how badly sectors have been affected by the pandemic

% change in output (GVA) compared with Feb 2020 level, selected sectors



Note: Data subject to volatility and a large degree of uncertainty due to Covid-19
Source: ONS, Monthly gross domestic product by gross value added, 9 October 2020

The table below provides more detail on all sectors of the economy. Monthly output in each sector is shown relative to February 2020, taken to be the pre-pandemic level. Figures are shown up to August 2020 (the latest available as of mid-October).[47] Also shown is the contribution of

[46] ONS, Monthly gross domestic product by gross value added [accessed 30 Sep 2020]
[47] ONS, Monthly GDP by gross value added dataset (9 Oct)

each sector to total UK economic output in 2019, i.e. the size of each sector.[48]

In August, output in the arts and entertainment sector had recovered from its April low but was still 28% below its February level. The wholesale and retail sector saw a strong rebound and by August had a (slightly) higher level of output than before the pandemic began. Overall, the value of UK economic output in August was 9% below its February level.

Coronavirus impact varies a lot by economic sector

% change in output of sector compared with its pre-coronavirus level of February 2020

	% of UK economic output (2019)	Sector's output compared with February 2020 level (% ch.)							
		Monthly vs. Feb	Feb	Mar	Apr	May	Jun	Jul	Aug
Agriculture	0.7%		0.0	-1.8	-7.7	-7.0	-4.0	-3.9	-4.3
Mining & quarrying	1.0%		0.0	-5.7	-7.2	-4.8	+2.2	+0.7	-3.4
Manufacturing	9.7%		0.0	-6.1	-29.7	-24.1	-15.0	-9.1	-8.5
Energy supply	1.4%		0.0	-0.1	-7.0	-6.6	-2.6	+0.8	+2.3
Water supply	1.2%		0.0	+2.0	-5.5	-4.1	+0.1	+1.4	+1.3
Construction	6.6%		0.0	-5.5	-44.4	-39.4	-26.1	-13.5	-10.9
Wholesale & retail trade	10.4%		0.0	-10.4	-35.8	-27.2	-6.5	+0.6	+0.4
Transportation & storage	4.1%		0.0	-13.0	-39.1	-34.7	-23.0	-18.4	-16.4
Accommodation & food	3.0%		0.0	-33.7	-91.1	-90.8	-80.2	-49.7	-13.7
Information & communication	6.9%		0.0	-1.2	-11.9	-13.6	-8.5	-6.0	-6.4
Financial services	6.4%		0.0	-0.4	-5.6	-4.6	-4.0	-3.0	-2.7
Real estate activities*	13.4%*		0.0	-0.3	-2.5	-3.0	-3.1	-2.4	-2.3
Professional activities	7.8%		0.0	-1.5	-19.4	-21.2	-15.1	-12.1	-11.4
Business admin & support	5.3%		0.0	-10.5	-35.0	-35.7	-26.6	-23.4	-22.4
Public administration	5.0%		0.0	+0.1	+0.4	+0.6	+0.7	+0.9	+1.0
Education	5.9%		0.0	-24.2	-37.9	-33.6	-27.8	-19.7	-14.5
Health	7.5%		0.0	-12.1	-31.1	-30.2	-28.7	-25.5	-23.9
Arts & entertainment	1.6%		0.0	-15.5	-46.9	-49.5	-38.3	-28.5	-28.1
Other service activities	1.7%		0.0	-15.4	-53.0	-51.4	-48.1	-25.7	-27.0
Households as employers	0.3%		0.0	-4.2	-43.9	-45.4	-38.9	-29.4	-23.0
Total services	*79.4%*		*0.0*	*-7.9*	*-24.4*	*-23.0*	*-16.6*	*-11.7*	*-9.6*
Whole economy	**100%**		**0.0**	**-7.3**	**-25.3**	**-23.4**	**-16.4**	**-11.0**	**-9.2**

*Real estate activities includes 'imputed rents' - estimates of hypothetical rental value of homes that owner-occupiers live in. This is an attempt to include the value of housing services going to owner-occupiers.

Note: Economic output is Gross Value Added (GVA)

Sources: ONS, Monthly GDP by gross value added dataset (9 Oct); ONS, GDP – low-level aggregates (30 Sep)

[48] ONS, GDP output approach – low-level aggregates (30 Sep)

3.6 Key issues for the outlook

Economic prospects over the near term will greatly depend on the spread of Covid-19 over the coming months, including the severity of restrictions introduced. The reactions of consumers and businesses will also play an important role.

In addition, a key factor for the economic outlook will be how high unemployment levels will rise. Particularly important is how many employees who were furloughed will ultimately return to work and how many will become unemployed.

Spread of the virus

The most important issue for the economic outlook is the prevalence of Covid-19 cases. The higher the number of cases, and the faster the spread, the greater the likely harm to the economy.

As coronavirus case numbers increased in September and October, tighter localised measures and more restrictive national measures were introduced. New national restrictions were announced by the Prime Minister for England on 22 September, with a localised tiered system of measures being introduced in October.[49]

Restrictions such as these may be in place for several months, with the possibility of further restrictions. Indeed, stricter restrictions are in place in Wales, Northern Ireland and much of Scotland (as of late October).[50]

In short, the economy faces a less supportive environment in the autumn and winter. Some sectors, such as hospitality, face particularly difficult conditions.

Consumer spending

Accounting for nearly two-thirds of GDP, consumer spending – totalling £1.4 trillion in 2019 – is a crucial factor determining the economy's performance.[51] This encompasses the purchase of goods and services, including retail products, entertainment, restaurants, transport and utility bills among many other items.

A large reduction in spending during the lockdown

During the national lockdown, the opportunity for consumers to spend money was limited by the combination of many businesses being closed and limits – voluntary and enforced – on mobility.

Consumer spending fell sharply during this period. In Q2 (April-June) 2020, it fell by 23.6% compared with Q1 2020 (January-March). Consumer spending had already fallen by 3.0% in Q1 2020. The decline

[49] Gov.uk, Coronavirus (COVID-19): What has changed – 22 September; Gov.uk, Local COVID alert levels: what you need to know [accessed 22 October 2020]
[50] For up to date information on the restrictions in place see the Library's interactive map displaying the areas where coronavirus restrictions apply
[51] ONS, GDP quarterly national accounts, UK: April to June 2020, 30 September 2020

were driven by falls in expenditure on hospitality, transport and recreational activities.[52]

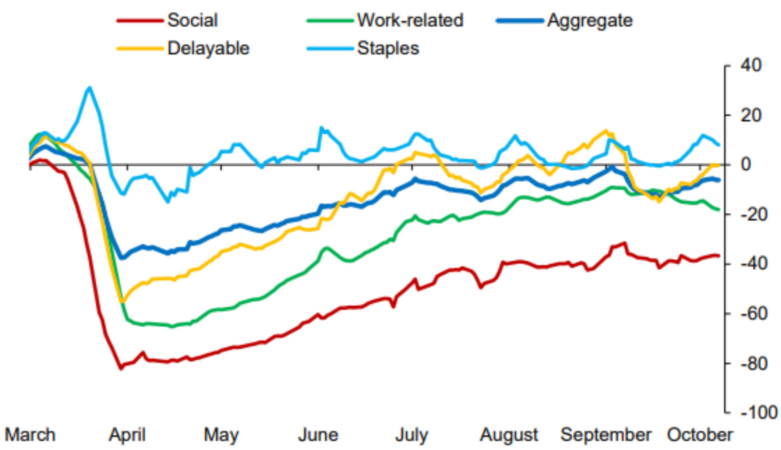
The other side of this coin was that consumers, in aggregate, saved money during the lockdown. The savings rate of households rose from 6.6% in Q4 2019 to 29.1% in Q2 2020.[53] This is the highest, by far, since the series began in 1963; the previous high was 14.4% in Q2 1993.

How quickly the savings rate subsequently falls is one factor that will determine the path of consumer spending over the rest of 2020 and beyond. This will depend a great deal on the spread of the virus, associated restrictions, and the response of consumers. For example, will people, where possible, want to have more precautionary savings than they did prior to the pandemic?

Spending recovered over the summer

Data held by the Bank of England indicates that households did increase their spending after April's low point. The chart below is from a speech by one of the Bank's Monetary Policy Committee members (this is the only publicly-available source of these figures).[54] It shows expenditure recorded on the Bank's CHAPS payments system, broken down into different categories. Notably, the upward trend in aggregate spending since April seems to come to an end in September and early October (figures are up to 7 October).[55]

Chart 6: High-frequency spending indicators



Source: Bank of England and Bank calculations. Notes: Based on the CHAPS payments that a sample of around 90 UK companies receive from their merchant acquirers on a daily basis. These payments reflect the sales that companies make through debit and credit card purchases, which are summed to estimate rolling seven-day revenues. Latest observation: 07 October 2020.

Library note: Although not explicitly stated, the chart refers to spending compared with the start of the year (pre-pandemic). In previous versions of this chart that was the Jan-Feb level.

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[52] ONS, GDP quarterly national accounts, UK: April to June 2020, 30 September 2020

[53] The savings rate is the difference between aggregate household after-tax incomes and expenditures, shown as a percentage of after-tax incomes; ONS series DGD8

[54] For more on the impact of pent-up demand on the recovery see, Bank of England, Assessing the health of the economy - speech by Gertjan Vlieghe, 20 October 2020

[55] Some definitions from the chart on spending: STAPLES: housing, food and health; DELAYABLE: household goods, clothing, cars; WORK-RELATED: travel and fuel; SOCIAL: air travel, hotels, restaurants, cultural events

It should also be noted that while retail sales have shown strong growth, they only account for around one-third of overall consumer spending.[56] Crucially, they do not include social consumption (cinemas, restaurants, pubs, entertainment), nor does it include spending on transport. These are some of the sectors of the economy hardest hit.

How will consumers react?

Most businesses are open, but with social distancing measures in place. How will consumers' react to these conditions? Will people be more hesitant to go out and spend money – maybe due to health concerns but also perhaps due to concerns over their income? Does the continued uncertainty lead to households, in aggregate, deciding to maintain a larger amount of savings than they did before the virus?

As of mid-October, tighter local restrictions, including the forced closure of businesses in certain sectors, have been implemented in many parts of the country.[57] "Firebreak" measures, more akin to the latter stages of the UK lockdown of March-May, have been introduced in Wales.[58] (For up to date information on the restrictions in place see the Library's interactive map displaying the areas where local coronavirus restrictions apply.)

In short, consumers may be reluctant or unable to return to 'normal' spending patterns.

Jonathan Haskel, a member of the Bank of England's Monetary Policy Committee, observed in July that consumers' fear of infection will be determined by the effectiveness of both public and private sector health measures:

> The path of recovery crucially depends therefore on the fear of infection, which in turn depends on the mix of public (e.g. track and trace) and private (e.g. screens in shops) health measures undertaken.[59]

How high will unemployment rise?

The number of employees on payrolls has declined, hours worked fallen and job vacancies declined. Nevertheless, the Government's interventions in the economy, via its business and employment support schemes, have mitigated the full impact of the recession on the labour market.

The furlough scheme is scheduled to run until the end of October. The Jobs Support Scheme is then available from the beginning of November, although this is less generous than the furlough scheme. Employees working for businesses forced to shut under local restrictions will also be eligible for some support (see section 4.3 for more on these measures).

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[56] Library calculations based on 2019 data on the value of retail sales and household final consumption expenditure (from the national accounts)

[57] House of Commons Library briefing paper, Coronavirus: the lockdown laws

[58] Welsh Government, Coronavirus firebreak: frequently asked questions [accessed 22 October 2020]

[59] Bank of England, From lockdown to recovery - the economic effects of COVID-19 - speech by Jonathan Haskel, 23 July 2020

A key issue for the economic outlook is how many employees currently furloughed will return to work, move onto the new schemes, or become unemployed.

Most economists expect that unemployment to rise by the end of 2020.[60] The average forecast from economists is for the unemployment rate to reach 7.7% by the end of 2020, nearly double its pre-virus rate of 4%.[61]

Should the economy recover at a faster pace over the next few months than most economists expect more businesses may be able to bring back a greater number of furloughed workers. A less optimistic scenario involves rising unemployment levels squeezing household budgets, leading to weaker economic growth.

Business investment

The reduction in revenues many businesses are experiencing will result in business investment falling. The high degree of uncertainty over the outlook may also dampen businesses' inclination to invest.

Official statistics show business investment fell by 26.5% in Q2 (April-June) of 2020, compared with Q1 2020. For context, the largest quarterly fall during the peak of the global financial crisis in 2008 was 10%.[62]

There is additional uncertainty about what the UK's trading relationship with the EU will look like next year.

Business surveys suggest many companies are delaying or cancelling investment plans. For example, a Bank of England survey of chief financial officers in the first half of September showed that businesses expect investment to be 21% lower in Q3 2020 than would otherwise have been the case due to Covid-19. Investment was still expected to be 7% lower in Q2 2021.[63]

3.7 Forecasts

Forecasts for GDP, while clearly and understandably subject to major uncertainty, point towards a large decline in 2020.

In the first half of October, HM Treasury surveyed investment banks, economic research organisations and other institutions for their GDP forecasts. The **average forecast for 2020 GDP growth was -10.2%** (compared with 2019).[64] To provide some context, GDP fell by 4.1% in 2009 during the recession caused by the financial crisis (the largest post-War recession).[65]

[60] For example, see NIESR, Prospects for the UK Economy, 28 July 2020
[61] HM Treasury, Survey of independent forecasts for the UK economy: October 2020, 21 October 2020 [to be clear, these are not forecasts from the Treasury themselves]
[62] ONS, GDP quarterly national accounts, UK: April to June 2020, 30 September 2020
[63] Bank of England, Monthly Decision Maker Panel data - September 2020, 1 Oct 2020
[64] HM Treasury, Survey of independent forecasts for the UK economy: October 2020, 21 October 2020 [to be clear, these are not forecasts from the Treasury themselves]
[65] ONS, series IHYP [accessed 21 October 2020]

The **average forecast for GDP growth in 2021 was +6.3%**, suggesting a relatively strong recovery is expected, though not enough to recover the lost ground of 2020.

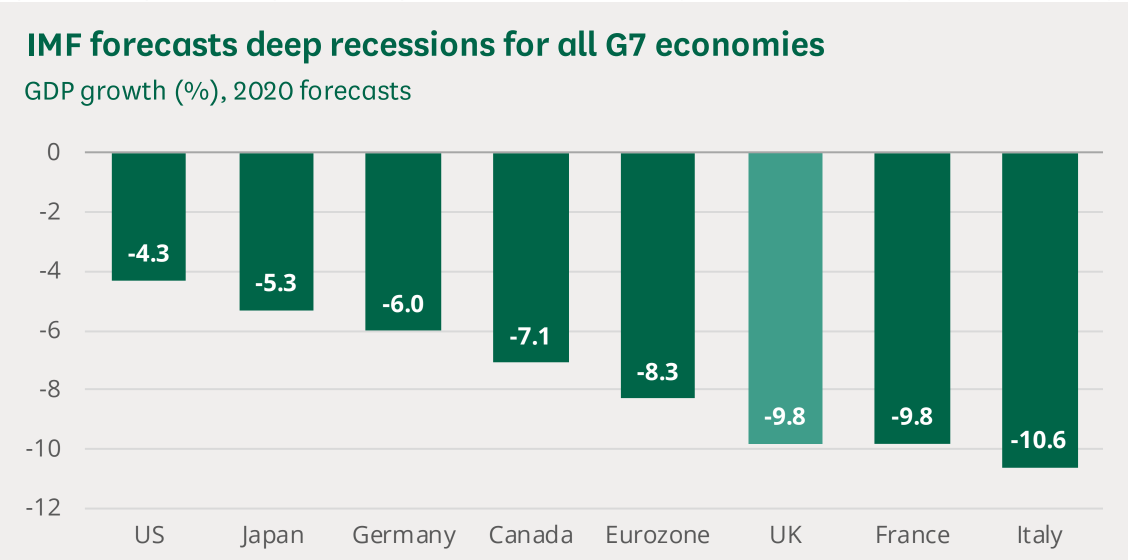
For quarterly GDP growth, the average forecast was for +15.6% in Q3 (July-September). In other words, GDP would be 15.6% higher in Q3 than in Q2 2020 (April-June). This would be a strong recovery from the 19.8% decline in quarterly GDP recorded in Q2. It would, however, still leave GDP around 10% below its end 2019 level.

Forecasts for Q4 2020 are more muted, with an average forecast of 1.7% quarterly growth expected.

Box 1: International outlook

On 13 October, the International Monetary Fund (IMF) released its latest set of forecasts.[66] It expects UK GDP to fall by 9.8% in 2020 (compared to 2019). This is a larger decline than the US (-4.3%), Germany (-6.0%) and the Eurozone (-8.3%). The French economy is expected to contract by the same amount as the UK, while Italy is forecast to see a larger decline of 10.6%.

While a return to growth is expected in 2021 – the UK is forecast to see growth of 7.6% in 2021 – most advanced economies would still be smaller by the end of 2021 than they were before the coronavirus outbreak.



Source: IMF, World Economic Outlook, 13 October 2020

For international comparisons of latest quarterly GDP data and OECD forecasts see the Library briefing, GDP – International Comparisons: Key Economic Indicators.

Under the **Bank of England's** central projection, in its *Monetary Policy Report* published in early August, GDP will decline by 9.5%in 2020, followed by growth of 9% in 2021.[67] The economy would return to its pre-pandemic level of GDP by the end of 2021 under this projection. The next economic forecasts from the Bank of England are scheduled to be released in their *Monetary Policy Report* on 5 November.

[66] IMF, World Economic Outlook, 13 October 2020
[67] Bank of England, Monetary Policy Report, 6 August 2020, table 1.C, p11

The **National Institute for Economic and Social Research** (NIESR), in late July, forecast GDP growth of -10.1% in 2020 and +6.1% in 2021.[68] They don't expect GDP to return to its pre-coronavirus level until the second half of 2023.

Since these figures were published, additional economic data has been released (as summarised earlier in this section).

OBR

On 14 July, the Office for Budget Responsibility (OBR) published three scenarios for the economy, including for many key economic indicators in each scenario, up to early 2025.[69] None of the scenarios include the impact of the measures including in the Chancellor's summer economic update of July nor, of course, subsequent announcements such as the winter economy plan.[70]

The three economic scenarios can be summarised as follows:[71]

- **UPSIDE**: A fast recovery. GDP returns to pre-virus levels by the first quarter of 2021. GDP growth is -10.6% in 2020. There is no long-term damage to the economy. Requires "rapid resolution of the threat from the virus".
- **CENTRAL**: A slower recovery. GDP returns to pre-virus levels by the end of 2022. GDP growth is -12.4% in 2020. Unemployment and business failures "remain elevated". Might be consistent with an effective vaccine or treatment being delivered by mid-2021 but with the health threat being resolved quicker than that.
- **DOWNSIDE**: Very slow recovery. GDP returns to pre-virus levels only by mid-2024. GDP growth is -14.3% in 2020. Significant loss of business investment and persistently high unemployment. Might be consistent with virus becoming endemic without effective treatment.

All scenarios assume the UK agrees a "conventional" free trade agreement with the EU, to be implemented in an orderly way after the current transition period expires at the end of 2020.[72]

The table below summarises some key economic indicators under the OBR's three scenarios.

[68] NIESR, Prospects for the UK Economy, 28 July 2020, main-case forecast scenario
[69] OBR, Fiscal Sustainability Report, 14 July 2020
[70] The OBR's press notice of the report provides some brief analysis of the possible impact of the Chancellor's summer update
[71] OBR, Fiscal Sustainability Report, 14 July 2020, p24 and elsewhere
[72] OBR, Fiscal Sustainability Report, 14 July 2020, p27, para 2.13

OBR estimates of key economic indicators under three scenarios
% change on previous year, unless otherwise indicated

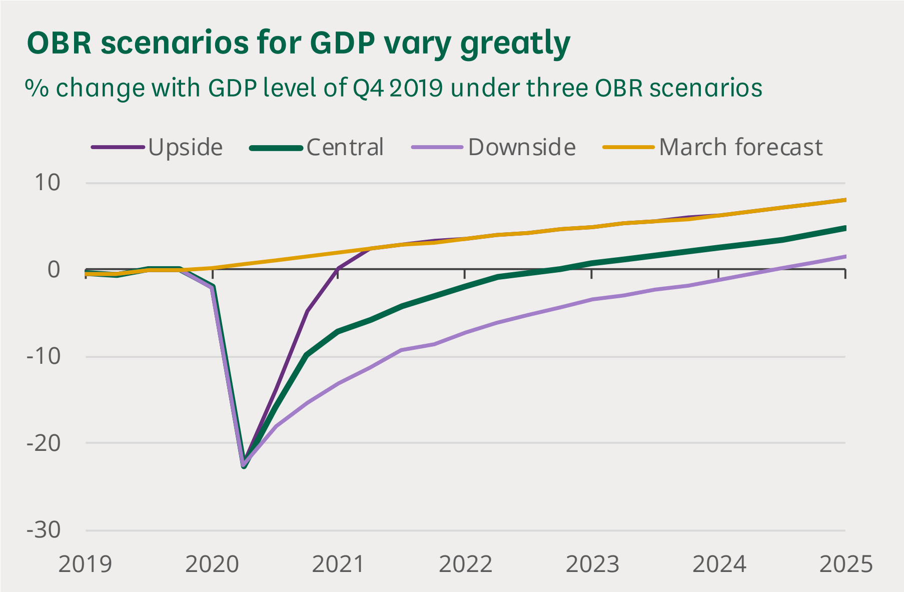
	2019	2020	2021	2022	2023	2024
Central Scenario						
GDP growth	1.4	-12.4	8.7	4.5	2.1	1.9
GDP level, 2019=100	100.0	87.6	95.2	99.5	101.6	103.5
Consumer spending*	1.1	-13.9	7.7	3.3	1.4	1.5
Business investment	0.6	-24.4	11.6	17.7	9.7	6.1
CPI inflation	1.8	0.7	1.3	1.9	2.0	2.0
Unemployment rate (%)	3.8	8.8	10.1	6.9	5.9	5.3
Average wages**	2.8	0.2	3.7	2.7	3.0	3.1
Productivity (per hour)	0.0	5.0	-2.1	-0.5	0.3	0.8
Upside Scenario						
GDP growth	1.4	-10.6	14.5	1.9	1.3	1.4
GDP level, 2019=100	100.0	89.4	102.4	104.4	105.7	107.2
Consumer spending*	1.1	-11.1	12.5	1.6	1.8	2.1
Business investment	0.6	-20.5	29.2	8.1	0.9	1.4
CPI inflation	1.8	0.7	1.3	1.9	2.0	2.0
Unemployment rate (%)	3.8	7.9	5.6	4.0	4.0	4.1
Average wages**	2.8	1.2	5.2	3.6	3.1	3.2
Productivity (per hour)	0.0	5.7	-0.4	-1.2	0.6	1.0
Downside scenario						
GDP growth	1.4	-14.3	4.6	5.4	3.3	2.5
GDP level, 2019=100	100.0	85.7	89.7	94.5	97.6	100.1
Consumer spending*	1.1	-15.9	2.4	3.1	3.1	2.9
Business investment	0.6	-25.9	7.8	17.5	7.9	5.6
CPI inflation	1.8	0.7	1.3	1.9	2.0	2.0
Unemployment rate (%)	3.8	9.1	11.6	8.1	6.9	6.3
Average wages**	2.8	-1.6	1.1	2.6	3.0	3.6
Productivity (per hour)	0.0	4.3	-5.6	0.0	1.2	1.3

*Consumer spending is consumption of households and non-profit institutions serving households **Average wages are a national accounts based estimate (wages & salaries divided by employees)
Note: These estimates do not include the impact of the Chancellor's summer economic update or subsequent policy announcements
Source: OBR, Fiscal sustainability report, July 2020, tables 2.2-2.4

The impact on the public finances of these three scenarios is examined and summarised in section 5.

The chart below shows the path of GDP under the OBR's three scenarios together with its early March forecasts (which only included a minimal impact from the coronavirus outbreak on the economy).[73]

[73] OBR, Economic and fiscal outlook: March 2020; forecasts were finalised in February



Source: OBR, Fiscal sustainability report, July 2020, tables 2.2-2.4

The next official forecasts from the OBR are due in November.[74]

3.8 Long-term impact

Even when the economic shock of coronavirus does eventually dissipate, the crisis may result in lasting damage to, and/or structural shifts in, the economy.[75] There is, of course, a great deal of uncertainty associated with what may, or may not, occur in many years' time, but some possible effects are explored in this section.

Potential damage

In May, the Chancellor, Rishi Sunak, noted the importance of how much damage – or 'scarring' – the coronavirus-related recession will have on the economy's longer-term prospects:

> …the question that occupies my mind and in the long term is probably more relevant is: what is the degree of long-term scarring of the economy as a result of this recession? What is the loss of productive capacity?
>
> Ultimately, once we recover from this crisis—by the nature of it, I believe it will be temporary, and we will suppress the virus and progressively lift the restrictions—the question is: what do we return to? [76]

Damage to an economy's supply capacity of goods and services over the long term could come from different sources. One may be the impact of relatively low business investment levels during the crisis on productivity. Another could be the loss of skills among some workers, usually due to prolonged periods of high unemployment.

[74] Richard Hughes, chairman OBR, in evidence to the Treasury Committee (7 Oct), Q144
[75] For a discussion on possible longer-term damage of the crisis on economic growth, see the discussion in Box 1 (pp27-30) in Resolution Foundation, Doing more of what it takes: Next steps in the economic response to coronavirus, April 2020
[76] Oral evidence from the Chancellor to the Lords Economic Affairs Committee, 19 May 2020

In July, the Bank of England's chief economist, Andy Haldane, said that some long-term scarring due to the pandemic is "inevitable" and highlighted two key avenues for scarring to occur:

> There will inevitably be some long-term scarring of the economy as a result of the Covid crisis. One of the aims of public policy in the current environment, including monetary policy, is to limit the extent of that scarring. This is best done by measures which shorten the duration, and limit the depth, of the downturn. Indeed, this explains the speed and scale of the monetary and fiscal response to the Covid crisis.
>
> The two key channels through which scarring of the economy's longer-term potential might arise is through reduced business investment and dynamism, hitting the stock of physical capital, and through high unemployment depleting the skills of the workforce and shrinking the stock of human capital.[77]

The OBR in its July presentation of three economic scenarios (see section 3.7 for more) explained the ways in which the pandemic could impair the economy's long-term performance:

> 2.20 Economic shocks can sometimes permanently impair the level or rate of growth of potential output. This 'scarring' (or 'hysteresis') can come about through a variety of channels, including reduced investment, the loss of firm-specific or human capital due to business failures or sustained unemployment, or the dragging effect of higher debt on productivity growth. The degree of scarring on this occasion will be affected by how quickly the virus can be brought under control, the pace of the economic recovery, and the effectiveness of policy measures in keeping workers attached to firms and viable firms in business. Many of the Government's measures have been designed expressly to minimise avoidable scarring.
>
> 2.21 […] Broadly, this is the result of three factors: a longer-lasting rise in unemployment; permanently forgone business investment, which reduces capital deepening and productivity growth; and business failures that result in capital scrapping and the loss of intangible capital. The size of the scarring effect is highly uncertain given the difficulties in predicting how the economic disruption in any given scenario would feed through these various channels. Nevertheless, they are in line with external estimates, and it seems reasonable to believe that the longer output remains below its pre-crisis level, the greater such effects are likely to prove.[78]

In October 2020, the OECD published an assessment of the UK economy in which it discussed the possible long-term effects of the pandemic:

> The COVID-19 crisis is likely to reduce productivity and employment for several years, although the extent is hard to gauge. Scarring effects are likely to affect long-term output significantly, as job losses have been massive, firms have held back investment and many will exit the crisis with a debt overhang (Demmou et al., 2020). Demand in some sectors, such as tourism, may be lower for a long time. An unwinding of global value

[77] Treasury Committee, Reappointment Questionnaire, Andy Haldane, Chief Economist at Monetary Policy Committee, Bank of England, published 20 July, Q9

[78] OBR, Fiscal Sustainability Report, 14 July 2020, p30, paras 2.20 and 2.21

> chains would further hamper efficient resource reallocation. However, the crisis may also trigger shifts in production process and working arrangements towards more teleworking. Consumer preferences could also change permanently, accentuating the transition in retail towards greater use of e-commerce and the digital delivery of services.[79]

Structural shifts in the economy?

Regardless of whether or not there is a long-term impact on the productive capacity of the economy, there may also be structural changes to the economy. Some possible changes could include:

- An increase in the prevalence of working from home
- Economic sectors such as hospitality, travel and international tourism seeing lower growth compared to pre-virus expectations
- An acceleration of online commerce growth

Further information on economic impact

- Library, The UK economy: a dashboard
- Library briefing paper, Coronavirus: Impact on the labour market
- OBR, Fiscal Sustainability Report, 14 July 2020
- Bank of England, Monetary Policy Report, 6 Aug 2020
- HM Treasury, Monthly survey of independent forecasts for the UK economy

[79] OECD, OECD Economic Surveys: United Kingdom 2020, 14 October 2020, p23

4. Policy response

Governments and central banks around the world introduced policies designed to mitigate at least some of the negative economic impacts from the coronavirus pandemic.

In the UK, several policies have been announced by the Government and the Bank of England in order to support businesses and workers.

The intention of these measures is to keep businesses afloat and, in turn, as many people as possible employed. The measures seek to financially support businesses, workers and the wider public during the outbreak, as well as attempting to reduce the economic uncertainty.

4.1 Broad goals

The nature of the economic crisis means that for many firms, revenues have fallen sharply. Many have found it difficult to pay some of their costs, such as rents and wages.

The policy response was largely designed to address these cashflow issues, offering a bridge over the shortfall.

If businesses can be kept afloat, they either will not have to reduce their workforce by as much or be in a better position to get going again following the crisis. If successful, such policies will minimise the amount of long-term damage that this crisis will have on the economy.

Financially supporting workers who face unemployment, or the loss of income following a reduction in working hours, may also help to reduce the impact of lower consumer spending on the economy.

This may also help with public health. If people are faced with a large reduction in income if they adhere to public health advice, some may choose to ignore it and continue to work.

Intervention by the authorities may also help to reduce the economic uncertainty associated with the outbreak.

Nevertheless, these interventions will have an impact on the public finances (as is discussed later in this briefing) and will not be able to completely alleviate the economic downturn.

4.2 Monetary policy and the financial system

In response to the coronavirus outbreak and its impact on the economy, the Bank of England and its Monetary Policy Committee (MPC) announced a series of emergency measures.

Heading into the coronavirus outbreak, interest rates were at 0.75%. The MPC's quantitative easing (QE) programme – where the Bank of England creates additional money and uses it to buy financial assets – stood at £445 billion. Of this, the Bank owned £435 billion in UK government bonds (these are essentially loans to government), with a further £10 billion in corporate bonds. The QE programme had been unchanged since the aftermath of the EU referendum in summer 2016.

Rate cuts and £300 billion of additional QE

Interest rates were cut in two stages to 0.1% - the lowest they have ever been. On 11 March they were cut from 0.75% to 0.25% and then again to 0.1% on 19 March.[80,81] They have remained at 0.1% since then. Both cuts were made after unscheduled emergency meetings of the Bank's Monetary Policy Committee (MPC).

On 19 March, the MPC also **expanded its quantitative easing (QE) programme by £200 billion**, taking the total value of assets it can own to £645 billion. This round of QE was completed by mid-July.[82] The MPC said this measure was to support the economy and the functioning of the bond market, which had shown some signs of stress.[83]

QE consists of the Bank creating new money electronically (as central bank reserves) and then using it to purchase financial assets, mostly government bonds.

On 18 June, the MPC **expanded QE by a further £100 billion**, taking the total value of assets it can own to £745 billion.[84] With this second round of QE the Bank slowed the pace of its government bond purchases, expecting to complete them around the turn of the year.[85]

This additional capacity to buy government debt makes it easier for the government to borrow. The Bank of England does not buy these bonds directly from government when they are issued. Rather, the Bank purchases them from others, such as asset managers, in the so-called secondary market. For more on the impact of the Bank's QE programme on the public finances and government borrowing costs see section 5.

Other measures to support lending

The MPC also introduced a number of schemes designed to provide cheap loans to banks, so they have additional capacity to lend to businesses.[86]

This includes a new **Term Funding Scheme** designed to ensure banks pass on the interest rate cuts to businesses and consumers by giving them access to cheap loans from the Bank of England.[87] The amount they can borrow is linked to the amount they lend to households and firms (especially small- and medium-sized ones).

80 Bank of England, Bank of England measures to respond to the economic shock from Covid-19, 11 March 2020
81 Bank of England, Monetary Policy Summary for the special Monetary Policy Committee meeting on 19 March 2020, 19 March 2020
82 Bank of England, Bank Rate maintained at 0.1% - May 2020, 7 May 2020; BoE data series RPWZ4TM [weekly outstanding amounts of QE]
83 Bank of England, Monetary Policy Summary for the special Monetary Policy Committee meeting on 19 March 2020, 19 March 2020
84 Bank of England, Bank Rate maintained at 0.1% - June 2020, 18 June 2020
85 Bank of England, Asset Purchase Facility: Gilt Purchases - Market Notice 6 August 2020, 6 August 2020
86 Bank of England, Bank of England measures to respond to the economic shock from Covid-19, 11 March 2020
87 The scheme is formally called the Term Funding Scheme with additional incentives for lending to SMEs (TFSME)

The Bank of England's Financial Policy Committee (FPC) **lowered the amount of reserves banks are required to hold**, in order to free up this money for lending to businesses. On 11 March, the FPC reduced the UK countercyclical capital buffer rate to 0% of banks' exposures to UK borrowers. The rate had been 1% and was due to reach 2% by December 2020.[88] The FPC expects the rate the remain at 0% until at least March 2021 and any subsequent increase would not take effect until March 2022 at the earliest.[89]

In addition, there was **coordinated action from world's leading central banks** at the beginning of the crisis to ensure the smooth functioning of the global financial system. This was undertaken to increase the amount of US dollars – which had been in high demand – in circulation across the world.[90]

Further information is contained in the Bank of England's Monetary Policy Report of May 2020 [PDF], Box 2 on pages 14-18 and in August's Report [PDF] in Box 2 on page 16.[91] Also see the regularly updated Library economic indicator page, Interest Rates and Monetary Policy.

4.3 Government measures

Government measures are designed to support businesses, workers and individuals during the coronavirus pandemic. Rishi Sunak, the Chancellor, committed to do "whatever it takes" to get through the crisis.[92]

Over £200 billion of direct tax, welfare and spending measures have been announced. Government is also providing support to businesses through guaranteed loans.

Below we summarise the most significant schemes. More detail is available in the Library briefings collated at the end of this section.

Employment support schemes

The most significant policy, in terms of cost, is the **Coronavirus Job Retention Scheme** (CJRS). The scheme – often described as the furlough scheme – aims to keep workers attached to their employers. When introduced, in April 2020, workers of any employer placed on the scheme could keep their job, with the Government paying 80% of their wage up to £2,500 per month. The Government also paid employer National insurance and minimum auto-enrolment pension contributions. From 1 July, employers have been able to bring furloughed workers back on reduced hours with the Government covering the costs of furloughed hours. From 1 August, employers have met the cost of

[88] Bank of England, Bank of England measures to respond to the economic shock from Covid-19, 11 March 2020
[89] Bank of England Financial Policy Committee, Financial Policy Summary and Record - October 2020, 8 October 2020, paras 29-34
[90] Bank of England, Coordinated central bank action to further enhance the provision of global US dollar liquidity, 20 March 2020
[91] Bank of England, Monetary Policy Report and Interim Financial Stability Report - May 2020, 7 May 2020
[92] HM Treasury, Speech, "Chancellor of the Exchequer, Rishi Sunak on COVID19 response", 17 March 2020

employer National Insurance and pension costs. Employers have covered 10% of gross pay from 1 September and 20% of gross pay from 1 October. The CJRS is scheduled to close on 31 October 2020.

The **Self-Employed Income Support Scheme** (SEIS) aimed to provide similar support to the CJRS but for the self-employed with average annual profits of £50,000 or less.[93] Two rounds of payments have been made. In the first, the SEIS paid taxable grants worth 80% of someone's average monthly trading profit, for a three-month period, worth up to £7,500 in total. In the second round, those eligible could claim a second grant, worth 70% of their average monthly trading profit, for a further three months, capped at £6,570

Both schemes have been widely used since their inception, as the tables below show. Over 9 million jobs have been supported by the Coronavirus Job Retention Scheme (the furlough scheme), with 2.7 million self-employed workers also receiving financial support in the SEIS's first phase.[94] 78% of businesses surveyed by the Office for National Statistics say they have applied to use the furlough scheme.[95]

Coronavirus Job Retention Scheme (CJRS)
By midnight 18 October 2020

Total jobs furloughed	9.6 million
Total employers furloughing	1.2 million
Total claimed (£)	£41.4 billion

Notes: 'Jobs furloughed' is calculated as the sum of the maximum number of employees furloughed by each PAYE scheme that has made a claim. 'Employers furloughing' is calculated as the number of distinct PAYE schemes that have made a claim.

Source: HMRC, HMRC coronavirus (COVID-19) statistics, accessed 22 October 2020

Coronavirus Self-Employment Income Support Scheme (SEISS)

Round 1 (closed 13 July)	
Claims up to 19 July	
Total number of claims	2.7 million
Total amount claimed (£)	£7.8 billion
Round 2 (opened 17 August)	
Claims up to 18 October	
Total number of claims	2.3 million
Total amount claimed (£)	£5.9 billion

Source: HMRC, HMRC coronavirus (COVID-19) statistics, accessed 20 October 2020

93 HM Treasury, Chancellor gives support to millions of self-employed individuals, 26 March 2020
94 HMRC, HMRC coronavirus (COVID-19) statistics [accessed 24 July 2020]
95 ONS, Business Impact of Coronavirus Survey (BICS) Wave 13, 24 September

For additional information on the number of jobs that have been furloughed by sector and also by parliamentary constituency, see the Library briefing paper Coronavirus: Impact on the labour market.

The Chancellor originally announced the **Job Support Scheme (JRS)** on 24 September, in the Winter Economic Plan. The JRS was revised on 22 October to make it more generous.[96] It's seen as the successor to the CJRS. The scheme aims to "protect viable jobs in businesses who are facing lower demand over the winter months due to Covid-19, to help keep their employees attached to the workforce".[97]

Under the JRS, the Government will contribute towards the pay of workers who are working at least 20% of their normal hours. Specifically, the Government will pay towards the hours that the employee isn't working. The Government will pay 61.67% of hours not worked up to a cap (£1,541.75 a month) and the employer will pay 5%.[98] The employee's wage will be lowered to cover the final third. The employer will pay for the hours that the employee is working.

The scheme will be open from 1 November 2020 to 30 April 2021. Large businesses can only access the scheme if coronavirus has lowered their turnover. This rule doesn't apply to SMEs.[99]

The **SEISS Grant extension** was also announced in the Winter Economic Plan and made more generous on 22 October. The eligible self-employed will receive two grants each covering a three-month period, from November 2020 to April 2021. The first grant will cover 40% of average monthly profits, paid out in one instalment covering three months' profits. The grant is capped at £3,750. The Government hasn't yet set the level of the second grant, which will cover February to April 2021.[100]

Business support schemes

There are four main Government-backed financial loan schemes for businesses of different sizes affected by coronavirus:

1. The **Bounce Back Loans Scheme (BBLS)** offers all businesses loans of up to £50,000 or 25% of turnover. The scheme offers streamlined application procedures and loans will be 100% backed by the Government.
2. The **Coronavirus Business Interruption Loan Scheme (CBILS)** offers loans of up to £5 million for businesses with a turnover under £45 million. The loans are 80% backed by the Government.
3. The **Coronavirus Larger Business Interruption Loan Scheme (CLBILS)** extends the standard CBILS approach to larger businesses with turnover over £45 million.

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96 HM Treasury. Plan for Jobs: Chancellor increases financial support for businesses and workers, 22 October 2020

97 HM Treasury. Job Support Scheme, 24 September 2020

98 HM Treasury. Job Support Scheme Open Factsheet, 22 October 2020

99 HM Treasury. Job Support Scheme Factsheet, 24 September 2020

100 HM Treasury. Plan for Jobs: Chancellor increases financial support for businesses and workers, 22 October 2020

4 The **Future Fund** provides convertible loans up to £5 million to UK-based companies that are unable to access other government support programmes because they rely on equity investment and are pre-revenue or pre-profit. Government support is subject to companies having at least equal match funding from private investors.

The loans themselves are provided by commercial lenders, except for the Future Fund which is being delivered by the government-owned British Business Bank. Applications can be made up to 30 November 2020.

In total, loans of £62.7 billion have been approved across all four schemes as of 18 October 2020, to over 1.4 million businesses.

Coronavirus business loan statistics

As at 18 October 2020

	Total value of loans (billion)	Number of loans approved
Coronavirus Business Interruption Loan Scheme (CBILS)	17.2	73,094
Coronavirus Large Business Interruption Loan Scheme (CLBILS)	4.6	623
Bounce Back Loan Scheme (BBLS)	40.2	1,336,320
Future fund	0.8	745
TOTAL	**62.7**	**1,410,782**

Notes: The total number of applications includes approved applications, those applications that are still to be processed, applications that have been declined and those applications that may turn out not to be eligible or cases where customers will decide not to proceed. For CBILS, this number will also include a number of applications that have subsequently been converted to applications for the BBLS scheme

Source: HM Treasury, HM Treasury coronavirus (COVID-19) business loan scheme statistics, data for close of business, 20 September 2020, accessed 24 September 2020.

Repayments to the **BBLS** were made more flexible in the Winter Economic Plan under the banner of **'Pay as you Grow'**. Businesses borrowing through the BBLS will be able to extend the period over which they will repay their loan to ten years, reducing their monthly repayments. Businesses will also be able to temporarily move to interest-only payments for periods of up to six months (which they can do three times) or pause payments for six months (which they can do once).

A **CBILS loan extension** was also announced in the Winter Economic Plan. Businesses that borrowed through the CBILS will be able to extend the term of their loan up to ten years.

The **Covid Corporate Financing Facility (CCFF)** has also been introduced. The CCFF is a joint Bank of England and HM Treasuring lending facility for larger firms to access finance to support cash flow during the coronavirus outbreak.[101] Under the CCFF, the Bank of

[101] Bank of England, Covid Corporate Financing Facility (CCFF): information for those seeking to participate in the scheme [accessed 24 July 2020]

England buys short-term unsecured debt from large companies in the form of a commercial paper of up to 1-year maturity.

As of 14 October 2020, a total of £16 billion of commercial paper had been purchased through the CCFF (less redemptions).[102] A total of 62 businesses had outstanding commercial papers held by the CCFF. Details of all businesses using the scheme and the amount they have borrowed is also available.[103]

Additional business support measures

Businesses in the **retail, hospitality, childcare nurseries or leisure sector** in England will not pay business rates in 2020/21.[104] Those operating in smaller properties[105] will also receive grants of £25,000. **Small businesses** are receiving cash grants of £10,000.[106]

The Government is also allowing payments for taxes including **VAT and self-assessment income tax** to be **deferred** until 2021. Businesses who deferred their VAT payment to 2021 will be able to spread their payment across 2021/22 in 11 instalments. Some of those deferring self-assessment income tax are also being given more time to pay in 2021, following the Winter Economic Plan. [107]

The **HMRC Time To Pay** service has been scaled up, allowing businesses and the self-employed to defer tax payments over an agreed period.

The Library briefing Coronavirus business support schemes: statistics is updated regularly with statistics on employment support and business support schemes.

Wider support for jobs and industries

The Chancellor announced several schemes to support jobs and protect industries in the summer economic update. The original package of measures was set out in the Plan for Jobs, in July 2020.[108]

A **Job Retention Bonus** of £1,000 will be paid for every furloughed employee who remains continuously employed to the end of January 2021.

The **Kickstart Scheme** aims to create 6-month work placements for those aged 16-24 who are on Universal Credit and are deemed to be at risk of long-term unemployment.

A range of measures to **boost work search, skills and apprenticeships,** including more funding for the National Careers Service and traineeships. Employers will receive a payment of £2,000 for

[102] Bank of England, Results and usage data: Covid corporate financing facility [accessed 29 September 2020]; data is updated weekly on Thursdays at 3pm
[103] Library briefing paper, Coronavirus business support schemes: statistics, section 3
[104] Information on business rate relief schemes in Wales, Scotland and Northern Ireland are available in section 4 of Library briefing paper, Coronavirus business support schemes: statistics.
[105] With a rateable value over £15,000 and below £51,000
[106] Those in receipt of either small business rates relief or rural rates relief
[107] HM Treasury. Winter Economic Plan, 24 September 2020, 24 September 2020, paras 2.12-2.13
[108] HM Treasury, A Plan for Jobs 2020, 8 July 2020

each new apprentice they hire aged under 25 and £1,500 for each aged over 25. The number of work coaches in Jobcentre Plus will be doubled before the end of 2020/21 to enhance work search support.[109]

VAT for hospitality, accommodation and attractions has temporarily been reduced to 5% from 20%. The reduction was initially set to apply from 15 July 2020 to 12 January 2021 but was extended to 31 March 2021 in the Winter Economic Plan.[110]

The **Eat Out to Help Out scheme** offered discount to diners to encourage them to eat out Monday-Wednesday during August. A 50% discount of up to £10 per head to those eating in was available at any participating restaurant, café etc.

The nil-rate band for **residential stamp duty transactions** has been increased from £125,000 to £500,000 from 8 July to 31 March 2021.[111]

Green Homes Grants are being made available to homeowners and landlords to make their homes more energy efficient.

Several **infrastructure projects** have been brought forward, reprofiling spending over the medium term. Projects include improving schools' building and estates; modernising courts; funding local infrastructure; road maintenance; and, improving town centres.[112]

Grants, repayable finance and capital investment are being provided to **national cultural institutions and organisations, and heritage sites.**

On 29 September the Prime Minister set out plans for the training and skills system, including the **Lifetime Skills Guarantee** (LSG).[113] Through the LSG, adults without an A-Level or equivalent qualification will be offered a free, fully-funded college course, from April 2021. The funded courses will be limited to those "valued by employers". Higher education loans will also be made more flexible.[114] The PM also said that apprenticeship opportunities would increase, with more funding for SMEs taking on apprentices, and greater flexibility in how their training is structured.[115]

Extra support will be offered to those out of work for three months through **Job Entry Targeted Support (JETS)**, including CV and interview coaching.[116]

[109] For more on Government employment support measures see the Library briefing, Coronavirus: Getting people back into work
[110] HM Treasury. Winter Economic Plan, 24 September 2020, 24 September 2020, para 2.7
[111] See the Library's landing page on Stamp Duty Land Tax (Temporary Relief) Bill 2019-21 for more
[112] HM Treasury. Plan for jobs, July 2020, paras 2.59 – 2.71
[113] PM's skills speech: 29 September 2020
[114] 29 September 2020; HC Deb 01 October 2020 [Lifetime Skills Guarantee and Post-16 Education]
[115] Press release Prime Minister's Office. Major expansion of post-18 education and training to level up and prepare workers for post-COVID economy,
[116] Press release DWP. Nation's job hunt JETS off, 5 October 2020

Public services and welfare

The Government is providing additional **funding for health services** to cover the cost of treating patients including the purchasing of personal protective equipment. **Local authorities** have received funding to support social care services and deal with wider issues arising from the lockdown. Other public services, such as **rail**, and the **devolved administrations** are receiving **more funding.**

The Government has temporarily increased the **availability and generosity** of some parts of the **welfare system**.[117] For example:

- the standard rate in Universal credit and Tax Credits has been increased;
- the self-employed can access Universal Credit at the same rate as Statutory Sick Pay for employees;
- it is quicker and easier for individuals who can't claim statutory sick pay – such as the self-employed – to access other benefits.

Support for businesses affected by local restrictions

To simplify its approach to slowing the spread of coronavirus the Government introduced 3 local COVID alert levels in October 2020: medium, high and very high.[118] Businesses – particularly those in hospitality – face restrictions based on the level of alert in the area in which they are located.

During October, the Chancellor announced support for businesses adversely affected by local restrictions. Additional support was first announced for businesses forced to shut in very high alert areas. Support for those businesses adversely affected (but not forced to close) in high alert and very high alert areas followed later.

Businesses in tier 3 (Very High alert)

On 9 October, the Chancellor announced support for businesses forced to close by local restrictions designed to slow the spread of coronavirus.[119] The **Job Support Scheme** will be **expanded** for businesses whose premises are legally required to shut. For eligible businesses, the Government will pay two thirds of each employees' salary, up to a maximum of £2,100 a month. The **Local Restrictions Support Grant** will also be more generous. The grant – originally introduced in September[120] – will be available to businesses after two weeks of closure. A grant of up to £3,000 a month will be paid, depending on the rateable value of the business' premises.

Support is also to be provided to businesses in very high alert areas who aren't forced to close but are adversely affected by restrictions. Local

[117] See Library briefing paper, Coronavirus: Support for household finances
[118] HM Government. Local COVID alert levels: what you need to know, 12 October 2020
[119] Press release HM Treasury. Job Support Scheme expanded to firms required to close due to Covid Restrictions, 9 October 2020
[120] Press release HM Treasury. Ministers announce new grants for businesses affected by local lockdowns, 9 September 2020

authorities are receiving business support packages when they move into very high alert.[121]

Businesses in tier 2 (High alert)

The **Local Restrictions Support Grant (Tier 2)** is being introduced for businesses impacted by restrictions on socialising. Local authorities will determine which businesses receive the grants and how much each will receive. The Government is providing funding to local authorities for the grants based on the number of hospitality, hotel, B&B, and leisure businesses in their area. Local authorities will be provided with up to £2,100 a month for each property, depending on the rateable value of the business' premises.[122]

Some areas were subject to restrictions on socialising before the 3 tier system was introduced. Funding for these areas will be backdated until the point at which these restrictions began.

Further information on policy measures

All of the Library's coronavirus (Covid-19) research and analysis is available from our coronavirus hub. The following give further details about the policies discussed above:

- Library briefing paper, Coronavirus: Support for businesses
- Library briefing paper, Coronavirus business support schemes: statistics
- Library briefing paper, FAQs: Coronavirus Job Retention Scheme
- Library briefing paper, Coronavirus: Self-Employment Income Support Scheme
- Library briefing paper, Coronavirus: Support for household finances
- Library briefing, Coronavirus: Getting people back into work
- Library briefing paper, Coronavirus Bill: Overview
- Library Insight, Coronavirus: Employment rights and sick pay (update)
- Library Insight, Coronavirus Bill: Statutory Sick Pay & National Insurance Contributions
- Library briefing paper, Coronavirus: Support for economies by European and other states

[121] HM Treasury. Job Support Scheme Open Factsheet, 22 October 2020
[122] HM Government. Business Grants Factsheet, 22 October 2020

5. Public finances

The economic shock of the coronavirus outbreak has had a significant effect on the public finances. The Government's budget deficit is increasing as tax revenues fall and government spending increases. The Government is spending significant amounts, through the measures discussed in section 4, to limit the permanent economic damage arising from the pandemic.

The outlook for the public finances in the coming years depends on the strength and speed of the economic recovery. As the economy recovers tax receipts will grow and spending on support to individuals, workers and businesses will fall, bringing the deficit down. The extent to which the economy recovers will depend on how much permanent damage – or scarring – there has been.

5.1 The budget deficit

The 2020/21 budget deficit (the difference between government spending and income) is expected to be larger than at any time since World War II. The budget deficit may exceed £350 billion in 2020/21, over 17% of GDP.[123] Only weeks before lockdown measures were introduced the Office for Budget Responsibility (OBR) forecast a deficit of around £55 billion in 2020/21.

Two factors are increasing the deficit. First, the measures the Government has introduced (discussed in the previous section) come at a significant cost. Second, while these measures aim to prevent long term economic damage, they can't prevent the immediate significant slowdown in the UK economy. Less economic activity means falling taxes and increasing government spending on areas such as unemployment benefits.

Government measures

It's hard to put a definitive cost to the Government's package of tax and spending measures. The cost will depend on duration and take-up.

The Government's package of measures may add around £215 billion to the government's deficit in 2020/21. This is based on a central scenario the OBR published in July 2020 (see section 3.7 for more) and also includes measures the Chancellor announced in the summer economic update and public spending announced up to September 2020.[124] The £215 billion does not include measures announced in the Winter Economic Plan, such as the Job Support Scheme, or support for businesses closed or adversely affected by local restrictions. Official costs of these schemes will come in the OBR's November 2020 forecasts.

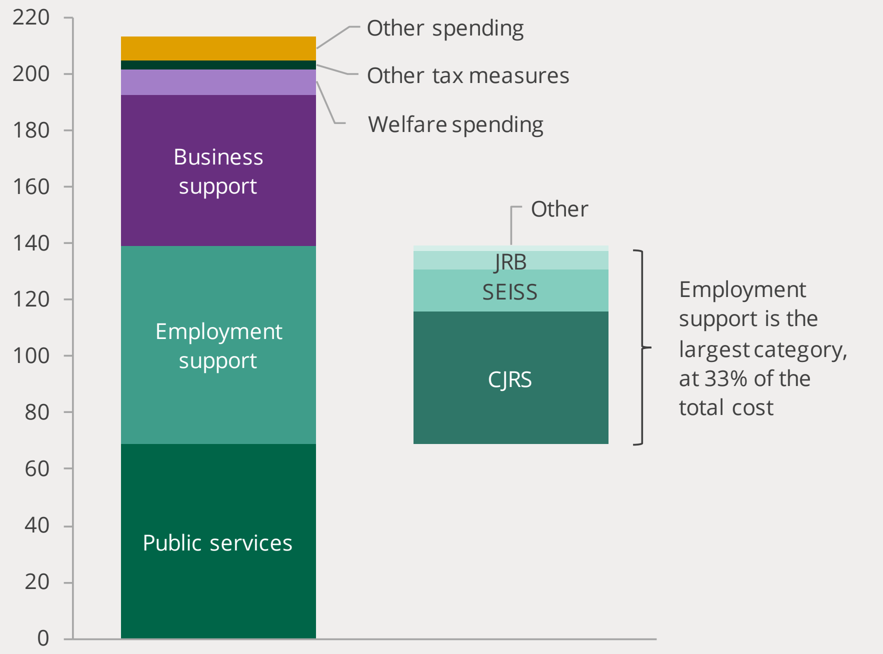
The OBR say that the economic outlook would "have been much worse without the measures the Government has taken."[125] The Institute for

[123] IFS. Green Budget 2020: Chapter 4, October 2020
[124] OBR, Fiscal Sustainability Report – July 2020 ; OBR Coronavirus policy monitoring database – July 2014; HM Treasury. Winter Economic Plan, para 2.14
[125] OBR, Fiscal Sustainability Report – July 2020, para 3

Fiscal Studies believe that the low cost of borrowing (see section 5.2) makes additional spending that helps "to deliver a more complete recovery would almost certainly be worth doing."[126]

Illustrative cost of coronavirus measures

£ billions, 2020-21, OBR policy monitoring estimate (14 July) and WEP figures



Source: OBR, [Coronavirus policy monitoring database](), 14 July 2020, and HM Treasury, [Winter Economy Plan]() (WEP), 24 September 2020

About a third of the total cost of Government measures comes from schemes to support employment and self-employment. The OBR estimates that the Coronavirus Job Retention Scheme (CJRS) alone has a net cost of nearly £50 billion. The self-employed income support scheme (SEIS) is forecast to cost around £15 billion, while the Job Retention Bonus (JRB), announced as part of the Plan for Jobs, is forecast to cost over £6 billion. The final cost for all three of these schemes will depend on take up and their duration.

Commenting on the CJRS, the Resolution Foundation – a think tank – say that "the long-term economic, fiscal, and social benefits of keeping workers attached to their employers and the labour market, and avoiding unprecedented levels of unemployment, almost certainly exceed the temporary costs of the scheme".[127]

The Institute for Fiscal Studies (IFS) say that the SEIS is "very generous support for the self-employed".[128]

Additional spending on public services contributes a little under a third of the total cost of Government measures. As of the Plan for Jobs announcement in July, an additional £48 billion was going to health services, local authorities and on measures to support vulnerable

126 IFS. Green Budget 2020: Chapter 4, page 3
127 Resolution Foundation, Doing more of what it takes, 16 April 2020, Box 2
128 IFS, Help is coming for (most of) the self-employed, 26 March 2020

individuals, rail services and funding for the devolved administrations. £15 billion of this is for procuring Personal Protective Equipment (PPE) for frontline staff and £10 billion is for the Test, Trace, Contain and Enable programme.

In September, the Government announced that it had also added another £24.3 billion in public services spending since July. This included an extra £16.4 billion in support for health services, over £2 billion for local government, and £5.8 billion across other public services.[129]

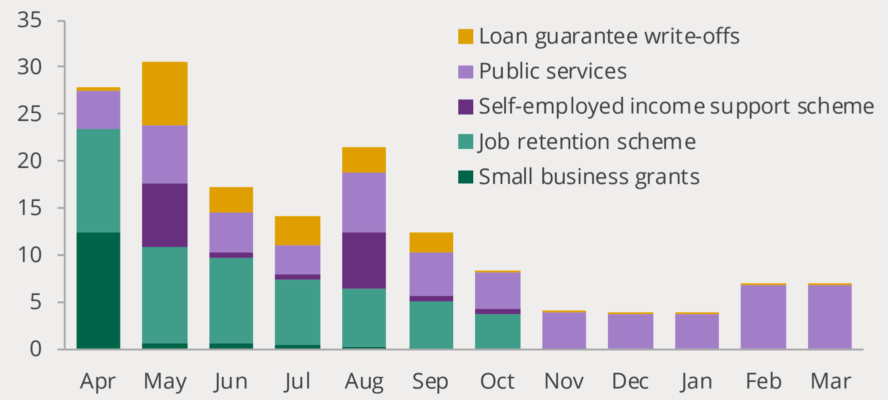
The Government is also providing roughly £30 billion to businesses through business rates holidays (around £12 billion) and grants (around £15 billion). These figures include funding going to the devolved administrations in Scotland, Wales and Northern Ireland from the Barnett formula.[130]

Temporarily increasing the availability and generosity of some parts of the welfare system is set to cost around £9 billion.

As the chart below indicates, the OBR estimates that most of the government's extra spending on the main coronavirus measures took place before August 2020. The OBR's monthly profile doesn't include the cost of tax measures or increased welfare spending, or any of the extra spending announced in the Winter Economy Plan.

Most extra Covid-19 spending happened before August

£ billions, main items of additional spending, OBR estimates



Notes: Tax measures, welfare measures and some smaller policy interventions aren't included.
Source: OBR, Coronavirus analysis: monthly profiling, 21 August 2020

On 4 May, the Government published the Main Supply Estimates for 2020-21.[131] These list the amount of money that each Government department is requesting from Parliament for the current financial year. Many departments' Estimates specified extra money that they were requesting to deal with coronavirus; the total came to £122.5 billion, with the largest contributors to the total being the CJRS (£42.0 billion), changes to Universal Credit (£15.2 billion) and business support in the form of Coronavirus Business Interruption Loans (£12.9 billion) and

129 HM Treasury, Winter Economy Plan, section 3.3, 24 September 2020
130 The Library briefing paper, The Barnett formula, discusses how the formula operates
131 See also the Library's briefing paper on the Estimates.

business support grants (£12.4 billion). Many of these figures are rough estimates and are likely to be amended in the Supplementary Estimates early in 2021.

Box 2: Funding government spending during the crisis

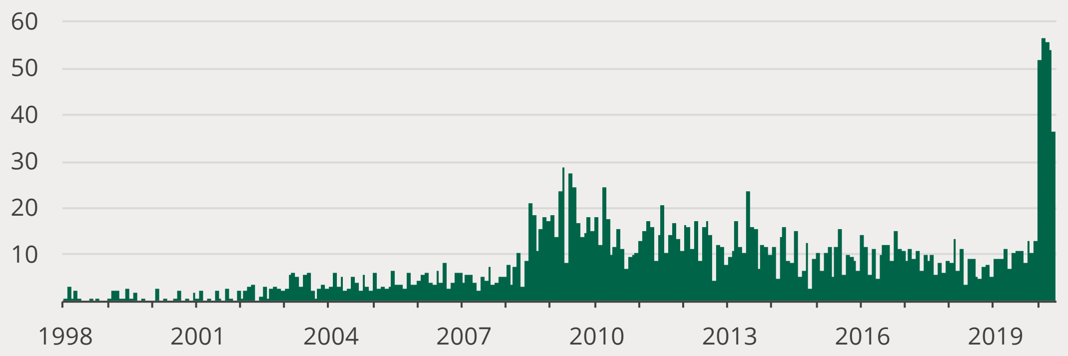
When the Government spends more than it receives in taxes and other revenues it borrows. The Government mainly borrows by selling gilts and bills to financial markets. The Library Insight Coronavirus: Government debt, an explainer explains this further.

Before the coronavirus outbreak, the UK Government planned to borrow around £160 billion through gilts in 2020/21: £60 billion to finance the cash difference between its annual spending and tax receipts and nearly £100 billion to roll over previous debt (ie payback old debt that is maturing). The Government may need to borrow over £300 billion more in response to the coronavirus pandemic.[132]

With more borrowing required, the Debt Management Office (DMO) – the Government's debt management agency – has been selling more gilts more often. The DMO has issued more debt in recent months that during any month of the 2007-2009 financial crisis. [133] During April to November 2020, the DMO plans to raise £385 billion.[134]

Record amounts of debt have been issued in April - August 2020

Nominal amount issued, £ billion, monthly



Source: DMO. Debt issuance calendar [accessed on 23 September 2020]

As discussed in section 4.2, the Bank of England is purchasing gilts on secondary markets as part of its expanded quantitative easing (QE) programme. While this isn't the primary aim of QE the purchases have made it easier and cheaper for the Government to borrow, as has been recognised by the Bank of England Governor, Andrew Bailey.[135]

The Government can also access money directly from the Bank of England, through the 'Ways and Means Facility', which is its overdraft at the Bank. The overdraft has been temporarily extended from £370 million to an unlimited amount. The facility allows the Government to meet short-term spending commitments without needing to immediately sell gilts. Any use of the facility will be "temporary and short-term" and borrowing from it will be repaid before the end of the year.[136] This means that eventually all additional funding will be met by additional borrowing, even if in the short-term some comes directly from the Bank of England. As of 16 September 2020, the Treasury has not made use of the Way and Means facility.[137]

[132] OBR, Fiscal Sustainability Report – July 2020, Chart 5.4
[133] IFS, For sale: £45 billion of gilts, 8 April 2020
[134] DMO Press Release, Revision to the DMO's 2020/21 financing remit for September to November 2020, 16 July 2020
[135] "BoE is financing UK's coronavirus measures, Bailey acknowledges", Financial Times, 14 May 2020
[136] Bank of England, HM Treasury and Bank of England announce temporary extension to Ways and Means facility, 9 April 2020
[137] Bank of England, Data series RPWB72A

Box 3: Government guarantees on loans

Businesses can access loans guaranteed by the Government through the Coronavirus business interruption loan scheme (CBILS), the Coronavirus large business interruption loan scheme (CLBILS), and the Bounce Back Loan Scheme (BBLS). The loans are being provided by commercial lenders. 80% of loans from the CBILS and CLBILS schemes are guaranteed by the Government. Loans from the BBLS have a 100% Government guarantee. The Government is covering the first 12 months of interest payments for CBILS and BBLS. For more on the schemes see section 4.3.

The loans themselves do not add to the Government's deficit, but the write-off costs of borrowers defaulting do. The write-off costs are classed as government spending and an estimate of their value is added to the deficit when the loans are most.

The write-off cost depends on several factors: "the volume of lending; the proportion of loans that default; amounts recovered by lenders in those cases; and the proportion of the remaining loss that is guaranteed by government."[138] The OBR suggests that write-offs could cost around £18 billion in 2020/21.[139] Nearly all the potential cost comes from the BBLS, which has provided most of the lending and is expected to have the highest default rate.[140]

Wider impact on the budget deficit

It was inevitable that the pandemic would cause the economy to slow, whatever steps the Government took. The Government's measures aim to help ensure that the negative effects on the economy are temporary, rather than permanent. For instance, they aim to stop businesses failing and people falling out of the labour market.

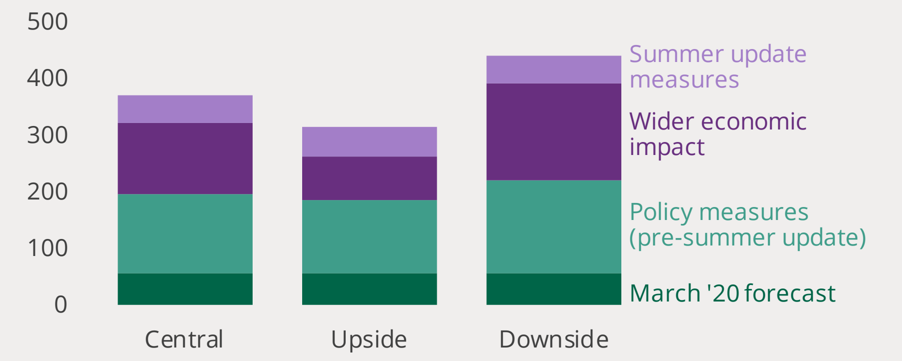
As the economy slows, the automatic stabilisers (see Box 5) take effect. Less is collected in taxes and government spending – in areas such as unemployment benefits – increases. The Government borrows more to fund its deficit, and this will add to its stock of debt.

At this stage it isn't clear how much the deficit will increase, but the increase will be significant. The slower and weaker the economic recovery the larger the Government's deficit will be.

On 11 March, only weeks before the introduction of lockdown measures, the OBR forecast that the deficit would be £55 billion in 2020/21. By July, the OBR's central scenario of the budget deficit had risen to over £370 billion. £125 billion of the additional borrowing is largely a result of tax receipts falling following the sharp decline in economic activity. £140 billion is from policy measures taken before the Chancellor's summer economic update and a further £50 billion that was added by the measures included in that update.

The OBR's July 2020 central scenario for the budget deficit was equivalent to around 19% of GDP in 2020/21. The OBR's upside scenario – where economic activity rebounds more quickly, see section 3.7 – results in a budget deficit of around 15% of GDP in 2020/21. Their downside scenario – where economic activity rebounds slowly – results in a deficit of 23% of GDP. These figures don't include the measures included in the Winter Economic Plan, nor the additional £24 billion of public spending approved between July and September.

138 OBR, Coronavirus policy monitoring database – 14 May 2020
139 OBR, Commentary on the Public Sector Finances: August 2020, para 7
140 OBR, Commentary on the Public Sector Finances: June 2020, para 6



Notes: The OBR has only produced an estimate of the cost of summer economic measures based on the central scenario. The chart above therefore uses this figure in all scenarios.
Sources: OBR. Fiscal Sustainability Report – July 2020; OBR. Coronavirus analysis

More recently, in October 2020, the Institute for Fiscal Studies (IFS) produced projections of the budget deficit. Their projections for the 2020/21 deficit range from £345 billion (16.7% of GDP) under an optimistic scenario to £376 billion (18.9% of GDP) under a pessimistic scenario. The IFS's central projection is for a budget deficit of £351 billion (17.1% of GDP) in 2020/21.[141] In the IFS's optimistic scenario fears about coronavirus dissipate more quickly than expected and the economy rebounds more quickly. In the pessimistic scenario an outbreak over winter 2020/21 forces more social distancing and sectoral and local lockdowns.[142]

Box 4: Latest estimates for the public finances

The Office for National Statistics (ONS) publishes monthly data on the public finances. The data are released with a relatively short lag. For instance, data for June 2020 were released by the Office for National Statistics (ONS) on 21 July. However, each new month of data is provisional and will remain so for several months. The provisional data should be treated with caution.

The OBR publish a commentary on the ONS's public finance data release, each month. The OBR is using their monthly commentary to provide as clear a picture as they can about how the coronavirus impact and policy response is feeding through to the data.[143]

The Library briefing Public Finances: Key Economic Indicators is updated after each release of public finances data with the key headlines.

Future deficits

It's hard to quantify how future government deficits will be affected. Much depends on the extent of persistent economic damage, such as businesses permanently closing or people losing their jobs. If the Government's policy response is successful in limiting long-term economic harm, then the impact on future government deficits will be reduced.

However, if there is long-term economic harm there will be less scope for economic activity to recover. Consequently, there will be less scope for tax receipts to recover and for welfare spending to subside. This

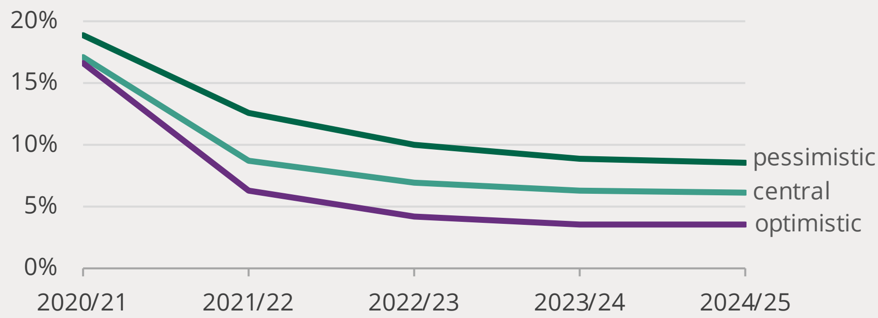
[141] IFS. IFS Green Budget 2020: Chapter 4, October 2020
[142] IFS. IFS Green Budget 2020: Chapter 2, October 2020
[143] ibid

means that the Government will be left with a bigger structural deficit. The structural deficit is the part of the deficit that remains when the economy is running at its full potential.

The potential impact of long-term economic damage can be seen in the budget deficits projected by the IFS's central, optimistic and pessimistic scenarios. In the pessimistic scenario more business failures and redundancies result in a greater long-term economic impact and a budget deficit of around 8.5% of GDP in 2024/25. In the optimistic scenario, with less significant economic scarring a smaller deficit of around 3.5% of GDP is forecast for 2024/25, although this is still larger than the OBR's forecast from March 2020.[144]

IFS budget deficit scenarios, % GDP

October 2020 estimates of central, optimistic and pessimistic scenarios



Source: IFS. Green Budget 2020: Chapter 4, 13 October 2020, Figure 4.2

> **Box 5: Automatic stabilisers**
>
> 'Automatic stabilisers' are built into the public finances. These are elements of the tax and public spending system that fluctuate over the ups and downs of the economy (the economic cycle) in a manner which, without active policy decisions, dampen fluctuations in the economy. For example, in an economic downturn, unemployment benefit payments will rise, mitigating the decline in household incomes, and moderating the slowdown. Conversely, during an upswing, tax receipts will rise as incomes increase, and this will act to mitigate the increase in disposable incomes and hence act to dampen the cycle.
>
> The automatic stabilisers are "automatic" as they do not require any policy change, such as alterations to tax rates or planned public spending.

5.2 Government debt

Government debt is the overall level of government indebtedness, built up over many years. Broadly speaking, it is the stock of borrowing arising from past budget deficits. Government debt is increasing as the Government borrows more during the pandemic.

[144] The OBR produced budget deficit estimates for a central, upside and downside scenario in their July 2020 fiscal sustainability report. These were produced before the Chancellor's Summer Economic Update or Winter Economic Plan. The OBR's scenarios differ from the IFS's. However, broadly speaking the OBR forecasts point to greater borrowing in 2020/21, than suggested by the IFS. For the rest of the forecast period the IFS projects higher borrowing. Much of the difference is a result of the IFS expecting a less severe decline in GDP this year, than the OBR, but a weaker economy in future years.

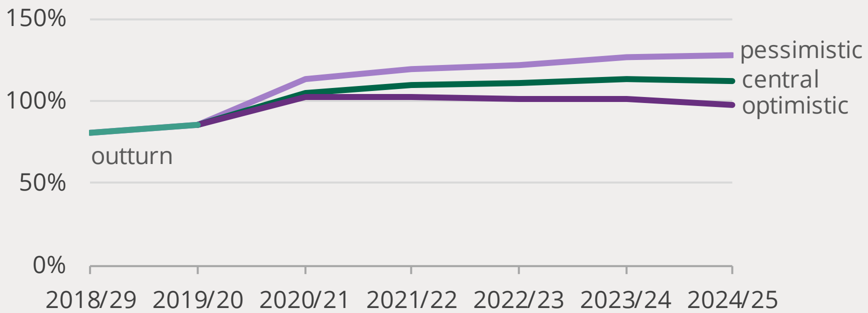
The Government will borrow to fund its deficit, and this will add to its debt. Over £300 billion may be added to government debt this way (see estimates of the deficit above).

In addition, some of the Bank of England's policy measures add to government debt. Most significantly the Term Funding Scheme adds up to £150 billion.[145] Repayments from these loans will lower government debt in the future.

The IFS's central scenario suggests that government debt may exceed 105% of GDP at the end of 2020/21.[146] Debt was around 80% of GDP going into the coronavirus pandemic.

IFS debt scenarios, % GDP

October 2020 estimates of central, optimistic and pessimistic scenarios



Source: IFS. Green Budget 2020: Chapter 4, 13 October 2020, Figure 4.9

Government's debt interest

The Government is borrowing from investors at historically low rates of interest. This was the case going into the coronavirus pandemic and has remained so since.

Low interest rates – and other factors – mean that despite the large amounts being borrowed, the Government's debt interest costs remain low. Relative to tax revenues, debt interest costs are at a 320-year low.[147]

Government can borrow at historically low rates

Ten-year government bond yields, %

Source: Bank of England. Yield curves [accessed on 23 September 2020]

[145] OBR, Fiscal sustainability report – July 2020, Table 3.29
[146] IFS. Green Budget 2020: Chapter 4, 13 October 2020
[147] IFS. Green Budget 2020: Chapter 4, 13 October 2020, Figure 4.14

Measures taken by the Bank of England to support the economy – such as buying government bonds from investors – have helped to support low government borrowing costs (see below). Between April and July, the Bank purchased more bonds from investors than the Government issued in new debt. The Bank of England has since slowed the pace of its purchases.[148]

Most economists agree that so long as borrowing costs remain low, high levels of debt aren't of immediate concern.[149] However, higher levels of debt leave the public finances more vulnerable to surprises in interest rates and inflation.[150] As the IFS points out, the government's debt interest bill "will rise sharply" if the Bank of England raises its interest rate.[151]

Bank of England measures: debt and debt interest

Some of the Bank of England's measures affect government debt but not the deficit. This is due to how the two measures are accounted for.[152] Some Bank of England measures affect the Government's debt interest costs, spending that impacts on the deficit.

Loans

As the Bank of England is in the public sector, the loans it provides to banks through the new Term Funding Scheme – to ensure they pass on interest rate cuts to businesses and consumers – will increase government debt when they are made. When the loans are repaid, they will lower the debt.

The OBR estimate that the new Term Funding Scheme will add around £90 billion to debt in 2020/21, rising to £150 billion by 2021/22.[153] The OBR expect £120 billion of the loans to be repaid by 2024/25.[154]

Purchases of government bonds

The Bank of England (BoE) is purchasing government bonds to get money into the economy and ensure financial stability in what is widely known as quantitative easing (see section 4.2). The bonds aren't bought directly from the Government, but from investors on secondary markets. The BoE Governor, Andrew Bailey, recognises that as well as getting money into the economy the purchases have supported government spending "in terms of smoothing the profile of government borrowing and the impact that might have on financial markets".[155]

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[148] Bank of England, Asset Purchase Facility: Gilt Purchases - Market Notice 18 June 2020, 18 June 2020

[149] See, for instance: IFS. The outlook for the public finances under the long shadow of COVID-19, June 2020; Resolution Foundation, Doing more of what it takes, April 2020

[150] OBR. Fiscal Sustainability Report – July 2020, para 5.47

[151] IFS. IFS Green Budget 2020: Chapter 5, October 2020

[152] Debt is measured on a cash basis, so debt changes when any cash payments take place. The deficit is an accrual measure that records when the activity takes place rather than when the payment is made.

[153] OBR, Fiscal sustainability report – July 2020, Table 3.29

[154] OBR, Fiscal sustainability report – July 2020, para 3.7

[155] "BoE is financing UK's coronavirus measures, Bailey acknowledges", Financial Times, 14 May 2020

The purchases result in the government's debt interest costs being lower than they would otherwise be. First, as is explained in Box 6, Government bonds held by the BoE are effectively refinanced at Bank Rate, which is usually a lower rate of interest. Second, the BoE's purchases support the demand for government bonds, which in turn helps to maintain the low rates that investors are prepared to lend to the Government at. The Government is issuing significant amounts of bonds to fund its deficit and without the BoE's intervention demand for these might fall.

Government debt is also affected by the purchases to the extent that the BoE pays more, or less, for the bonds (the market price) than the nominal value at which they are recorded in the public finances. Presently, this 'valuation effect' means that the official measure of government debt is increased by the bond purchases. The OBR explain the 'valuation effect' in their explainer on the consequences of unconventional monetary policies on the public finances.

Box 6: Effect of the Bank of England holding government debt

Government's debt interest costs are lower than they otherwise would have been because the Bank of England has purchased government debt, through its Asset Purchase Facility.

The Asset Purchase Facility (APF) was set up for the Bank of England (BoE) to carry out quantitative easing, which aimed to stimulate the economy. The BoE buys government bonds through the APF from private investors such as pension funds and insurance companies to get money into the economy.

While the bonds remain in the APF it means that government net debt interest is lower than it otherwise would have been. This is because the BoE is in the public sector, so when the government makes debt interest payments for the bonds held in the APF it is making them directly to another public sector body – this is a transfer within the public sector and the net effect is £0. This means that the actual cost to the public sector of holding the debt in the APF is the cost to the BoE of raising the funds used to buy the debt, which is the Bank rate and it is lower than the debt interest.

The BoE has carried out further quantitative easing in response to the coronavirus pandemic (see section 4.2).

Lowering interest rates

The Bank of England's decision to lower its main interest rate (Bank rate) lowers the effective interest rate the Government pays on the government bonds held by the Bank.

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