BEA 東亞銀行

Economic Research

April 2021

Market Monitor – United Kingdom

Vaccination and Easing of Lockdown Brightens Economic Outlook

Economic performance remains subdued in the first quarter, but is expected to pick up from the second quarter

The economic impact of the third nationwide lockdown imposed since January is feeding into the economy. GDP dropped 2.9% in January from the previous month. The service sector – especially accommodation, food services, and education – has been hit severely by social restrictions and registered a 3.5% monthly drop.

While lockdown measures have been partly eased under the four-stage plan since 8th March, 2021, people's mobility is not yet back at the level seen in November, according to Google's COVID-19 Community Mobility Report. Mobility in retail and recreation dropped 51.9% between in the recent month when compared to the situation during 3rd January to 6th February, 2020. This was more severe than the 49.5% drop seen in the November lockdown, while the number of people travelling to workplaces was down 36.5% in the recent period compared to a 34.4% drop in the November lockdown. Subdued activity is weighing on consumption and business revenue, dragging on the economic performance in the first quarter of 2021.

With vaccinations on track, the government is likely to lift restrictions on schedule and the economy is expected to pick up. As of 28th March, over 30 million UK citizens have received their first dose of vaccine, accounting for 45.6% of the population. Coupled with national lockdowns, the daily 7-day rolling average of newly confirmed infections dropped significantly to less than 6,000 since mid-March, down from the peak of nearly 60,000 in mid-January. The government now plans to lift all restrictions by late-June, with actual dates depending on vaccination progress and infection rates. Improvement is being seen across all areas of mobility after the relaxation of restrictions on 8th March, and further improvement is expected as restrictions are eased in phases in the coming months.

- **Nationwide lockdown will drag on economic growth in the first quarter. Following the re-opening of the economy, economic growth will pick up from the second quarter.**
- **Housing prices will be supported by the extension of the stamp duty holiday and a mortgage guarantee scheme.**
- **The financial market is expected to be supported by the UK's vaccination progress and brighter economic outlook. Downside risks include any adverse impact of vaccines and high US Treasury yields.**

Monetary and fiscal support continues

In view of the vaccination progress, the Bank of England (BoE) has become more optimistic about the economic outlook. It now expects the economy to be back to the 2019 level by the end of 2021, faster than its February expectation of the first quarter of 2022. It also considers the rise in interest rates to be in line with a more positive outlook. Nevertheless, the BoE is expected to maintain a supportive monetary policy to foster economic recovery. With inflationary pressure accumulating in the year amid rising oil prices and an economic pickup from the second quarter, the BoE is expected to keep its Bank Rate at 0.1% and the scale of quantitative easing unchanged this year.

Meanwhile, the government has continued to support the economy, including with fiscal measures worth GBP 65 billion in the 2021 budget. Some coronavirus relief measures which were set to end in March or April have been extended. The Job Retention Scheme and the value-added tax reduction for the tourism and hospitality sector are now extended to end-September. The personal allowance for income tax is being increased to GBP 12,570 from April 2021. These policies are expected to provide some support to investment and consumption growth.

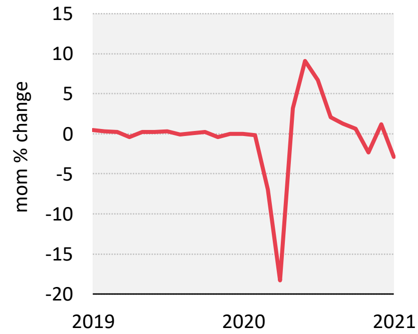
That said, as the economy rebounds, the manner in which the government withdraws the stimulus is becoming another concern. Any aggressive withdrawal of the policies may draw market attention and cause volatility in the economy and financial markets. This will be a major challenge for the government in its November budget. In addition, the government is also expected to borrow a record amount of GBP 355 billion for the financial year 2020-2021, the highest since WWII. To bring public finances back into balance, from April 2023 the government plans to raise the corporate tax rate on profits over GBP 250,000 from 19% to 25%. Additionally, the personal allowance of income tax will be frozen until April 2026 following this year's rise.

Disagreements with the EU after Brexit are another downside risk. Despite the UK and the EU agreeing to a Memorandum of Understanding (MOU) on a financial services cooperation framework and having reached a fishery deal together with Norway, the clash between the EU and the UK over the Northern Ireland issue has weighed on market sentiment. The EU has taken legal action against the UK on actions related to trading arrangements in Northern Ireland.

Budget supports the housing market

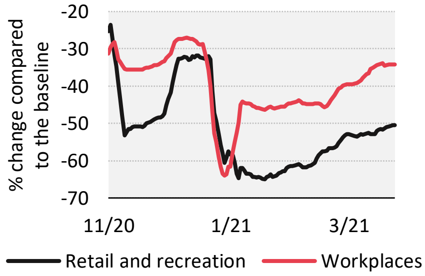
In contrast to the economic contraction over the past few months, the housing market has recovered quickly. After decreasing 0.2% monthly in January, the Nationwide Housing Price Index rebounded with a 0.7% growth in February, beating the market expectation of a 0.3% drop. The market was boosted by low interest rates and an increased preference for more spacious housing.

GDP



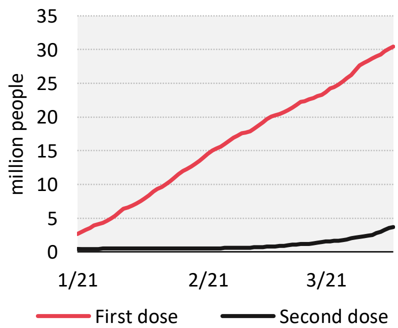
Source: Bloomberg, data as of 30/3/2021

7-day rolling average of community mobility



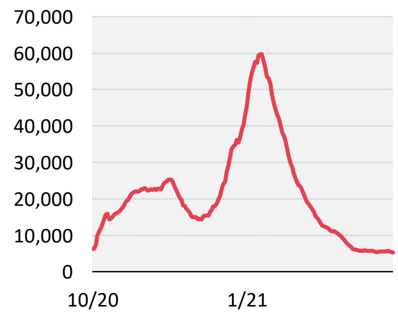
Note: The baseline is the median value, for the corresponding day of the week, during 11/3/2020 to 6/2/2020.
Source: Google COVID-19 Community Mobility Report, as of 30/3/2021

Number of people vaccinated



Source: UK Government, data as of 30/3/2021

7-day rolling average of daily new cases



Source: UK Government, data as of 30/3/2021

Meanwhile, the government continued to support the housing market. The stamp duty holiday was extended in the March budget, meaning that properties with selling prices of GBP 500,000 or less will continue to enjoy a tax holiday until end-June, while those worth under GBP 250,000 are eligible for zero taxes until end-September. In addition, the government has launched a mortgage guarantee scheme where it provides a guarantee on mortgages for home buyers who can only afford a 5% deposit. These policies are expected to fuel the housing market, but risk overheating housing demand.

Financial markets supported by the easing of lockdown measures and vaccination progress, but hit by high US treasury yields

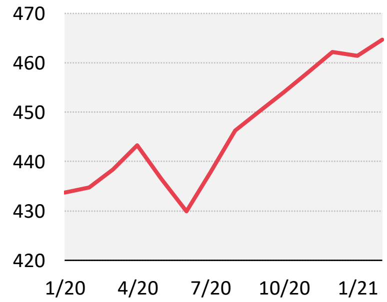
In the stock market, the UK's vaccination progress and a brighter economic outlook continue to support market sentiment. Global stimulus measures, such as the UK's March budget and the USD 1.9 trillion stimulus package in the US, are also lifting market sentiment. Despite the concerns over side-effects of the AstraZeneca vaccine and the high US Treasury yields, the FTSE 100 Index rose 3.9% between end-February and 29th March.

Despite uplifted market sentiment and higher US Treasury yields, the BoE play down the market concern over inflation. This dragged the bond yields, with the 10-year UK government bond yield dropped by 320 basis points.

In the foreign exchange market, the US dollar gained strength due to high US Treasury yields, dragging the pound to depreciate 1.2% against the US dollar. On a contrary, due to market optimism about the UK economic recovery, the pound rose 1.4% against the euro. The EU's sluggish vaccination progress and the European Central Bank's decision to accelerate bond buying fueled the pound appreciation as well.

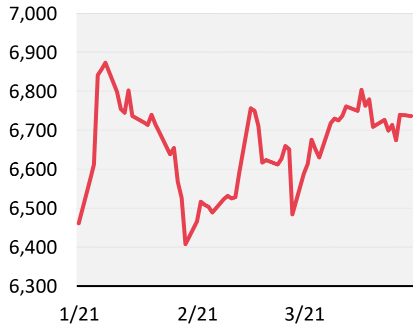
Looking ahead, the UK's rapid vaccination progress and the relaxation of lockdown measures will continue to boost its financial market performance. However, the country's rapid vaccination pace is only for one dose, while the number of people having received two doses is low. The souring relationship with the EU, including lingering post-Brexit talks and threatened legal actions, is also expected to dampen market sentiment.

Nationwide housing price index



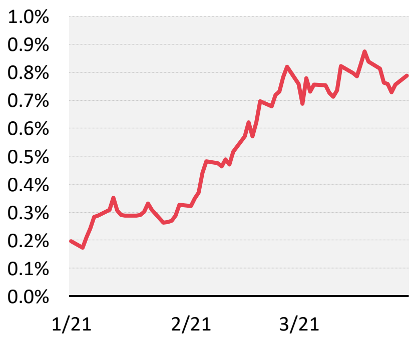
Source: Nationwide Building Society, data as of 30/3/2021

FTSE 100 Index



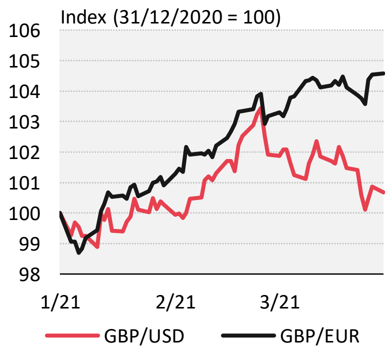
Source: Bloomberg, data as of 30/3/2021

UK 10-year Government Bond Yield



Source: Bloomberg, data as of 30/3/2021

British Pound Exchange Rate



Source: Bloomberg, data as of 30/3/2021

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