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UNITED KINGDOM 2021-2022 OUTLOOK

THE RECOVERY IS LOSING SIGNIFICANT MOMENTUM

14 October 2021

**WORKING EVERY DAY
IN YOUR INTEREST**



GROUP ECONOMIC RESEARCH

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SUMMARY OF OUR SCENARIO

THE RECOVERY SLOWS DUE TO COVID AND BREXIT RELATED SUPPLY-SIDE ISSUES

Growth is on course to slow sharply in H221. The loss of momentum seems to reflect constraints on activity in relation with supply-side issues in the goods sector and the labour market. There are acute recruitment difficulties across sectors, locations and occupations, which are due to an weakness in labour supply and shifts in demand in relation with Covid across sectors (goods vs services) and regions (rural areas vs cities). **Brexit, the full impact of which remains to be felt, amplifies the already strong effects of Covid on global supply chains and labour shortages through heightened trade frictions with the EU and the new restrictive migration policy for Europeans.** In industry, the disrupted supply chain is creating shortages of goods amid already high demand and is fuelling price pressures (the CPI goods index rose by 3.3 YoY% in August, exceeding services inflation for the fourth consecutive month).

Actual GDP data at the beginning of Q3 was weaker than expected, prompting us to revise our growth forecasts to the downside (from 2.9% QoQ to 1.8% QoQ for Q3 and from 7.4% to 7.2% for annual 2021 growth). A loss of momentum was already expected in our previous scenario given the fact that key government support measures, such as the Job Retention Scheme (JRS) and the Self-Employment Income Support Scheme (SEISS) were coming to an end. However, the slowdown seems more

pronounced than expected, partly due to rising Covid cases during the summer. The so-called 'pingdemic' caused significant disruption in July (causing GDP to almost stall over the month), with rising Covid cases triggering a surge in the number of people asked to self-isolate.

The outlook for household consumption is getting more challenging due to rising energy prices and inflation more generally, planned increases in taxes, a likely rebound in the unemployment rate and greater cautionary behaviour in the consumer-facing industries in relation with Covid during the winter season. Growth in real disposable incomes is likely to become negative as inflation will likely exceed 4% in Q4 and possibly reach 4.4% in Q1. Consequently, even though household consumption is still 6.3% below its Q419 level and the savings ratio is still relatively high, growth of household consumption will likely moderate going forward.

Since the reopening of the economy, the labour market has been recovering rapidly, even though its situation is far from normal. Ahead of the expiration of the furlough scheme at the end of September, the number of employees on furlough, albeit falling, was still elevated (1.3m at the end of August). The unemployment rate declined to 4.4% in July (according to the single-month measure), still 0.5ppt above the pre-crisis

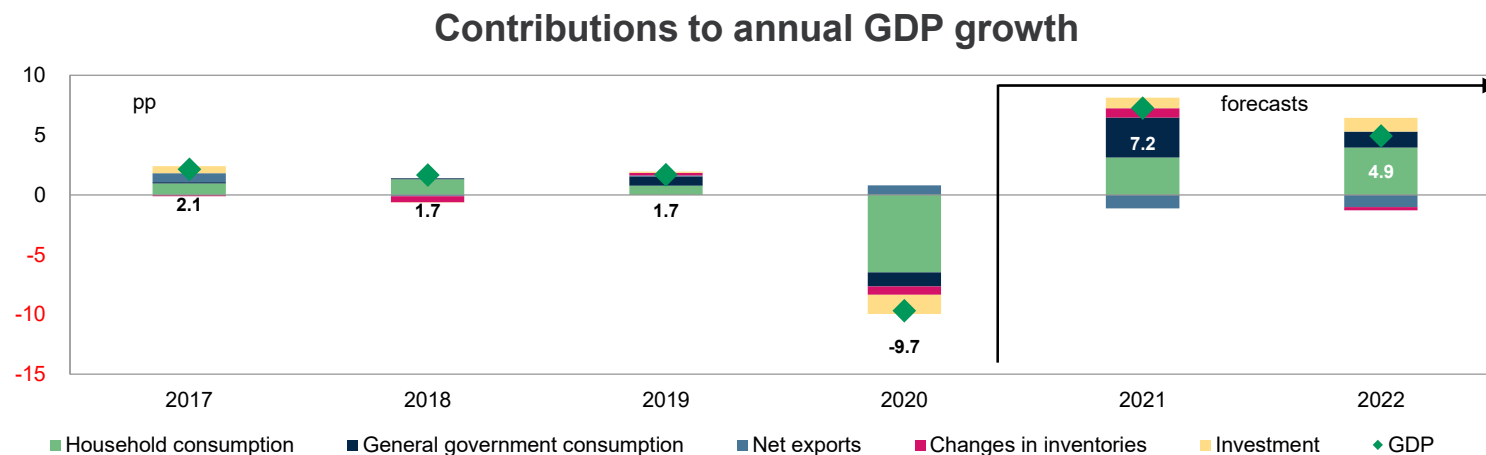
level though. Vacancies have reached a record high (exceeding 1m in June-August). Strong demand for labour lowers the risk of a large increase in unemployment when the JRS expires.

We expect the unemployment rate to increase in Q4, although by less than previously expected and to a level not exceeding the Q420 rate of 5.1%. The fall in furloughed rates has slowed in recent months, despite rising employer contributions since July. Furlough rates are elevated in sectors such as passenger air transport and travel agency, but also in retail sales, creative and entertainment activities, which are more at risk of operating at persistently lower capacity rates. Also, there is likely to be another fall in the economically active population (thereby lifting the unemployment rate all else equal), as some people might exit the labour market at the expiry of furlough (eg, employees over 65 who have now become the group with the highest furlough rate).

Labour market tightening prompted the BoE to signal willingness to start monetary policy normalisation via rate hikes in 2022. We have brought forward our forecast for the first rate hike to Q422 from early 2023 previously, which would bring its level from 0.1% to 0.25% at the end of 2022.

SUMMARY OF OUR SCENARIO

FORECASTS: DOWNWARD REVISIONS TO NEAR-TERM GROWTH



Sources: ONS, Crédit Agricole SA / ECO

United Kingdom	2019	2020	2021	2022	2020				2021				2022			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP (%)	1.7	-9.7	7.2	4.9	-2.7	-19.6	17.4	1.1	-1.4	5.5	1.8	1.3	0.9	0.5	0.5	0.4
household consumption	1.2	-10.5	5.1	6.6	-2.6	-20.3	19.9	-1.8	-4.4	7.2	4.0	2.0	0.6	0.5	0.5	0.3
public consumption	4.2	-6.3	17.1	6.4	-3.0	-17.7	17.0	4.8	2.0	8.1	3.0	1.0	1.0	1.0	0.5	0.5
investment	0.5	-9.1	4.9	6.6	-2.6	-19.3	18.9	4.4	-3.0	0.8	1.0	2.0	2.0	1.5	1.5	1.5
change in inventories*	0.2	-0.7	0.8	-0.3	0.1	-1.4	0.7	1.4	0.3	-0.2	-0.6	0.1	0.0	0.0	0.0	0.0
net exports*	0.1	0.8	-1.1	-1.0	-2.6	3.6	-4.5	-2.2	1.3	1.0	-0.8	-0.6	0.0	-0.3	-0.2	-0.2
Unemployment rate (ILO)	3.8	4.6	4.8	4.7	4.0	4.3	5.0	5.1	4.8	4.7	4.6	5.1	4.9	4.7	4.6	4.5
Inflation (CPI, YoY%)	1.8	0.9	2.4	3.5	1.7	0.6	0.6	0.5	0.6	2.1	2.8	4.2	4.4	4.1	3.3	2.4
Core CPI (YoY%)	1.7	1.4	2.3	3.3	1.6	1.4	1.3	1.3	1.1	1.9	2.7	3.5	3.9	3.9	3.0	2.4
Current account (% GDP)	-2.7	-2.6	-1.5	-3.7	-2.6	-1.3	-1.7	-4.6	-1.6	-1.5	na	na	na	na	na	na
General gov. balance, % GDP	-2.3	-12.3	-6.5	-2.0	na	na	na	na	na	na	na	na	na	na	na	na
Public debt % GDP	85.2	102.1	99.0	93.2	na	na	na	na	na	na	na	na	na	na	na	na
Bank rate**	0.75	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.25
Target of BoE's asset purchases (bn £) **	435	895	895	895	645	745	745	895	895	895	895	895	895	895	895	895

* Contributions to GDP growth

** End of period

Source: ONS, BoE, Crédit Agricole S.A.

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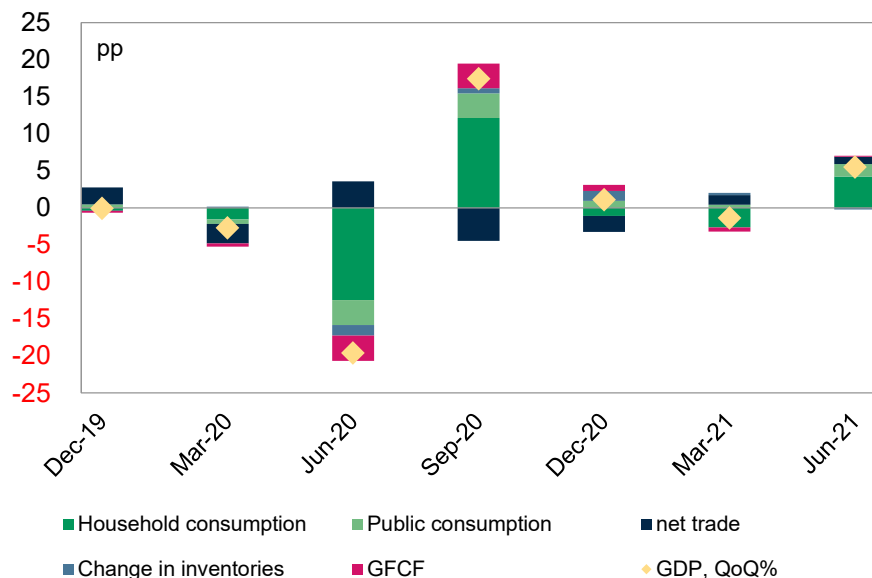
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LATEST ECONOMIC TRENDS

ACTIVITY REBOUNDED STRONGLY IN Q2, AS THE PANDEMIC RESTRICTIONS WERE LIFTED

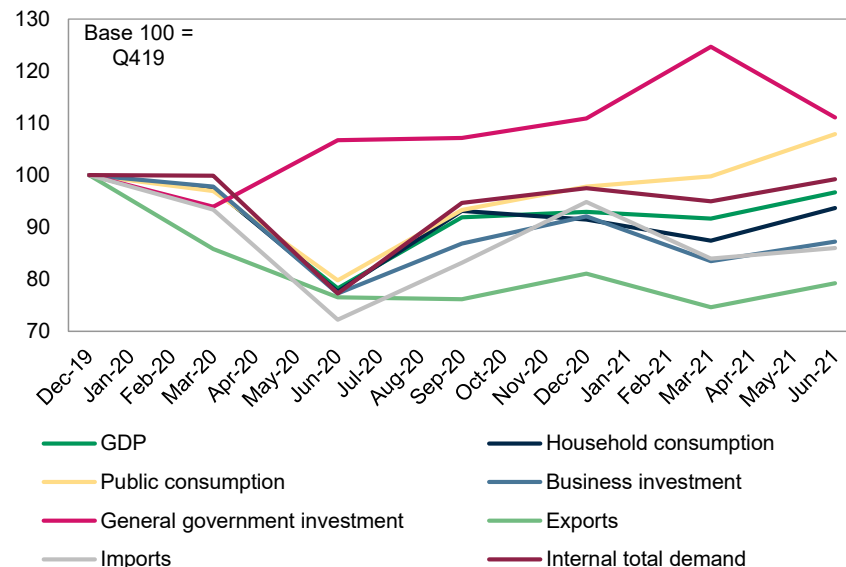
Contributions to quarterly GDP growth:
expenditure breakdown



Sources: ONS, Crédit Agricole SA / ECO

The re-opening of the economy in Q221 resulted in a strong rebound of the consumer-facing service industries (including wholesale and retail, accommodation and food services). GDP expanded by 5.5% QoQ after a downwardly revised contraction in Q1 of 1.4% QoQ and is down 3.3% relative to its Q419 level. Household consumption contributed the most to GDP growth recording a rebound of 7.2% QoQ and adding 4.2 percentage points (pp) to QoQ growth. Consumption of durable goods rose by 10.4% QoQ with 44% rebound in purchases of vehicles, while spending in non-durable goods contracted (-3.3% QoQ). Household consumption of services rose (11% QoQ) after two quarters of contraction. While household consumption has been the major driver to growth, it still remains 6.3% below its Q419 level. The savings

Only public consumption and public investment
have surpassed their pre-crisis peak



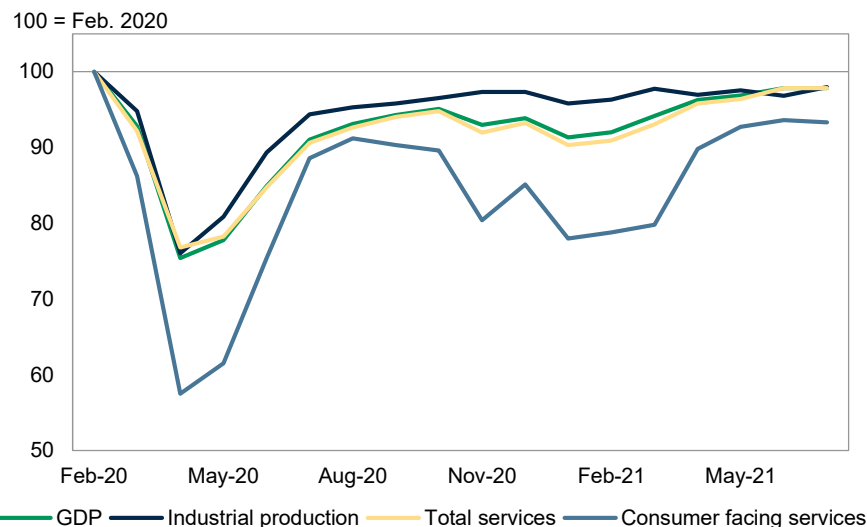
Sources: ONS, Crédit Agricole SA / ECO

ratio has fallen, but still remains well above its pre-pandemic level (at 11.7% in Q2, down from 18.4% in Q1). Public spending has been a key supportive factor to growth (both consumption and investment have grown massively since the pandemic), but its contribution is likely to diminish going forward as the pandemic-related measures are coming to an end. Net trade also contributed positively to QoQ GDP growth (by 1 pp) thanks to a rebound in exports (6.2% QoQ) which exceeded the increase in imports (2.4% QoQ). Exports remain the weakest component of growth, with almost no recovery at all standing more than 20% below their pre-crisis level. UK business investment is following closely, with a shortfall of almost 13% relative to its Q419 level.

LATEST ECONOMIC TRENDS

STAGNATION IN JULY

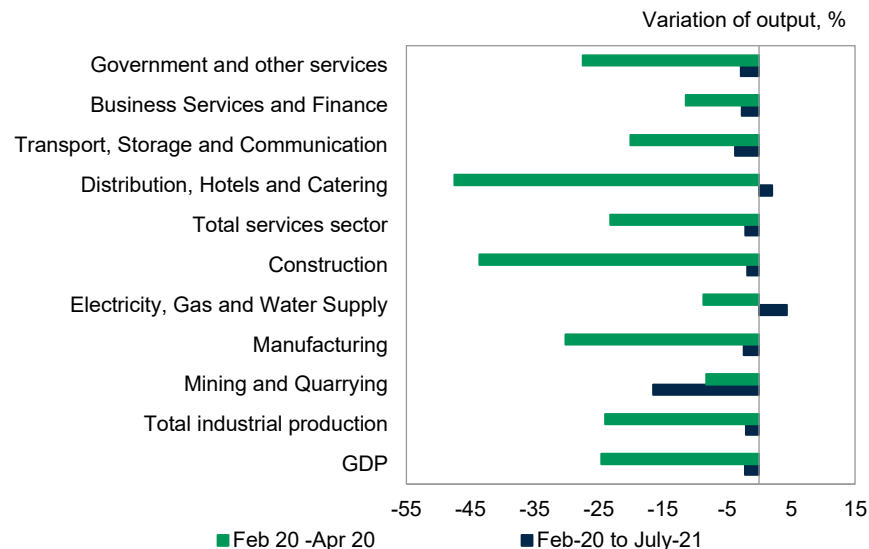
In July GDP was 2.1% below the Feb. 2020 level, with zero growth in services



Sources: ONS, Crédit Agricole SA / ECO

Monthly GDP data shows that the peak of growth occurred in April, when non-essential shops and outdoor food services reopened. At the start of Q3, growth slowed significantly with only 0.1% expansion in GDP recorded in July. A rise in coronavirus infections likely weighed on activity, as people who were infected by the virus were asked to self-isolate. Growth in the consumer-facing services industries retracted slightly (-0.3% MoM) as retail sales fell (-2.8% MoM). Growth in food and accommodation services slowed. Meanwhile, the end of the Stamp Duty holiday period in England and Northern Ireland from 1 July 2021 resulted in a drop in legal activities and real estate activities. **A major factor weighing on activity were supply constraints, particularly in the manufacturing and construction industries.** The manufacturing sector was broadly flat in July after five

The distribution, hotels and catering sector is among the few to have recovered its losses



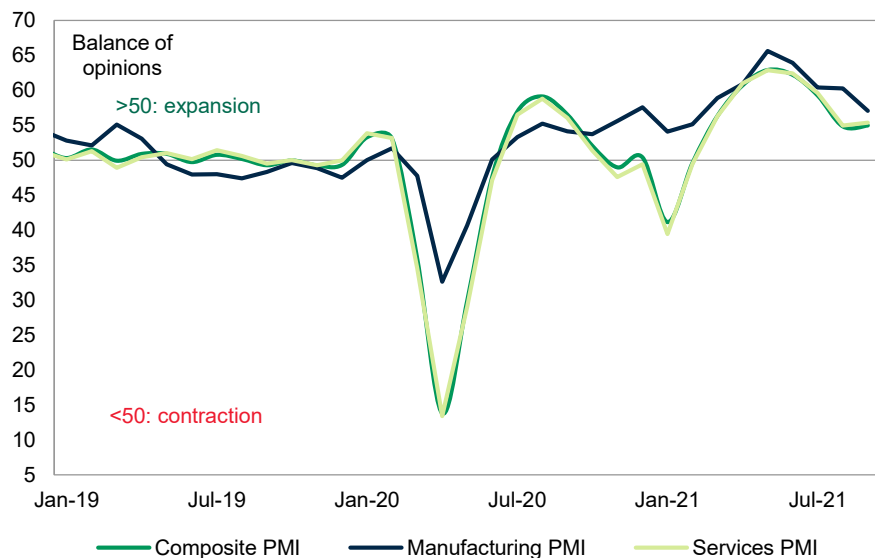
Sources: ONS, Crédit Agricole SA / ECO

consecutive months of growth, with anecdotal evidence from business surveys suggesting that staff shortages (including Covid-19 self-isolation requirements) as a challenge to production. The Business Insights and Conditions Survey (BICS) suggest that “the most common challenge, reported by manufacturing firms, to filling vacancies in July were a lack of suitable applicants for the roles on offer, followed by a reduced number of EU applicants”. Finally, the construction sector accelerated its decline for the fourth consecutive month (-1.6% MoM). According to the ONS, price increases, caused by delays in the availability and sourcing of construction products (notably steel, concrete, timber and glass) were the main reason for the decline.

LATEST ECONOMIC TRENDS

PMI SURVEYS FALL FROM RECORD HIGHS AS HEADWINDS INCREASE

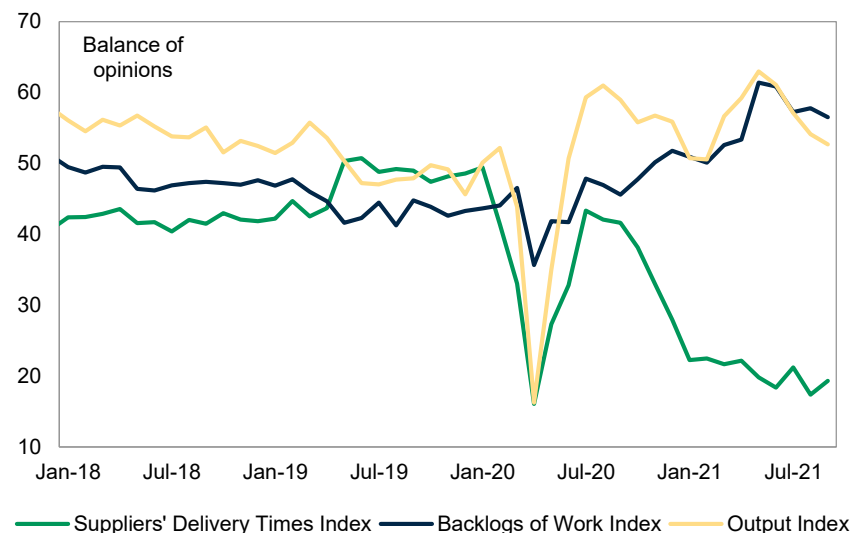
PMI surveys point to more moderate though still positive growth ahead



Sources: IHS Markit, Crédit Agricole SA / ECO

While PMI surveys remain firmly in positive territory, they suggest a pace of growth that is slowing significantly. In the manufacturing sector, the rate of expansion eased for the fourth month in a row and reached its weakest level since February. Firms are facing a growing list of headwinds which include declining new export orders, supply chain delays in air, land and sea freight, rising material and labour shortages with difficulties recruiting required skills, Brexit disruptions, sharply rising costs and more recently fuel shortages. Furthermore, demand is slowing: in September, new orders increased at their weakest pace of growth since February while new export orders fell for the first time in eight months reflecting shipping issues and cancellations due to long lead times. Job growth was still positive in September, albeit at the weakest rate since January, as, according to IHS Markit, small firms saw cuts in

Manufacturing sector suffers from acute supply chain delays, material and labour shortages



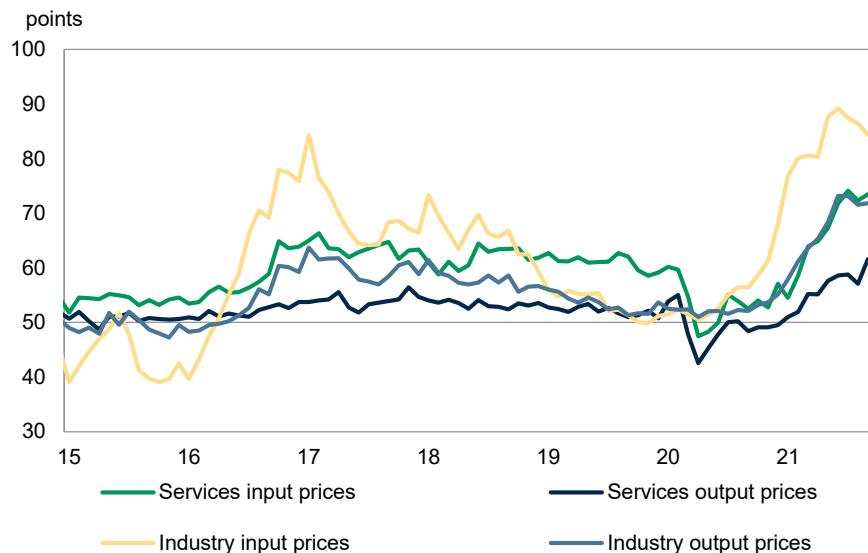
Sources: IHS Markit, Crédit Agricole SA / ECO

employment for the first time in eight months. In the services sector, the PMI slightly increased in September (to 55.4 from 55 in August), but the rate of expansion was much weaker than the peak seen in May (62.9). **New order growth weakened for the fourth month running in September.** Staff shortages, supply issues and the end of the stamp duty holiday were among the most commonly cited reasons for softer demand. Employment growth eased from its August record high reflecting a lack of candidates to fill vacancies but also some redundancies following the end of the furlough scheme. Constrained supply, higher transport costs and rising salary payments pushed up inflationary pressures. The rate of output inflation rose to the highest since the survey began in July 1996.

LATEST ECONOMIC TRENDS

INFLATION SHARPLY UP, STILL LARGELY ON ACCOUNT OF BASE EFFECTS

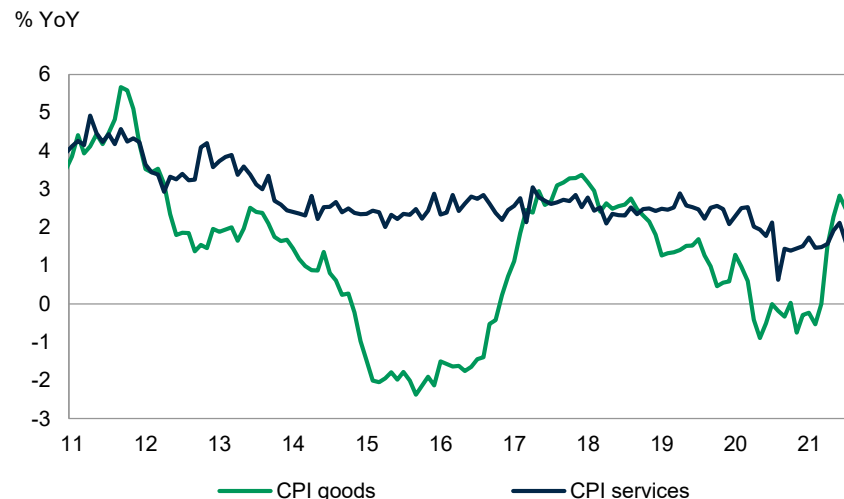
Cost pressures: still very high



Sources: IHS Markit PMI indices, Crédit Agricole SA / ECO

CPI inflation rose from 2% YoY in July to 3.2% YoY in August (0.2 pp above our forecast) with core inflation rising to 3.1% YoY, the highest since November 2011. **Base effects accounted for the majority of the increase of the CPI inflation rate between July and August.** They were particularly strong in the food and accommodation services due to the 'Eat Out to Help Out' scheme which dragged on prices last year and the temporarily reduced VAT rate for hospitality. **Global cost pressures have continued to push upwards UK consumer goods prices**, which have now exceeded the growth rate of services prices for the first time in three years. Energy inflation reached 10% YoY and is likely to rise further with the planned increase in administered energy prices in October 2021 (by 10%). Non-energy industrial goods' inflation

CPI goods inflation has risen, but so did services inflation as the economy reopened



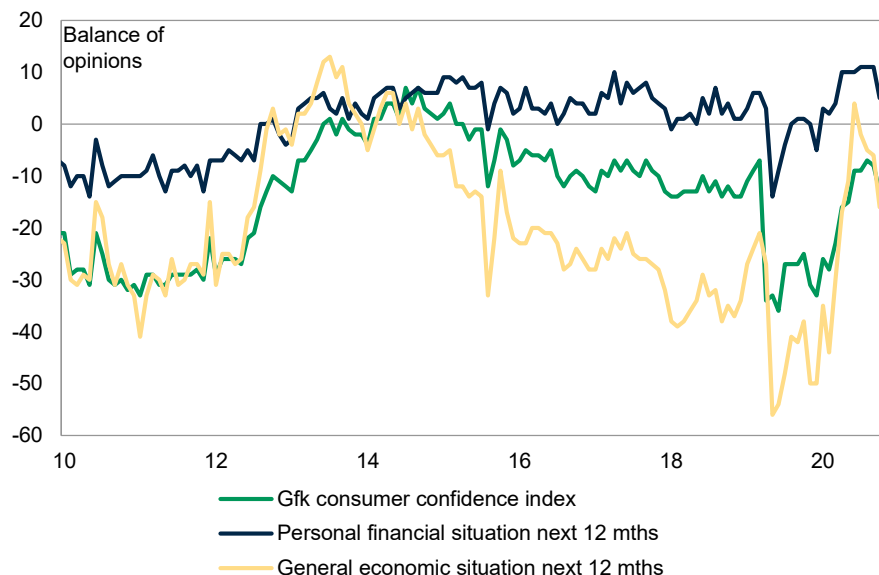
Sources: ONS, Crédit Agricole SA / ECO

was also sharply up (3.3% YoY, highest since 2011). For instance, continuing semiconductor shortages which had disrupted new car production, have led to an increase in demand in the used car market and a surge in prices for used cars (+18% YoY in August). **The reopening of the economy has driven an increase in prices of some consumer services.** Monthly increases of prices in some sectors which were affected by the pandemic restrictions (such as transport, food and accommodation, recreation and culture) were particularly pronounced relative to historical averages. As a result, the monthly increase posted by the CPI and core CPI indices was among the highest on record for the month of August (0.7% MoM) and almost double the monthly variations of the CPI index in the month of August since 1997.

LATEST ECONOMIC TRENDS

CONSUMER EUPHORIA NOW APPEARS TO BE BEHIND US

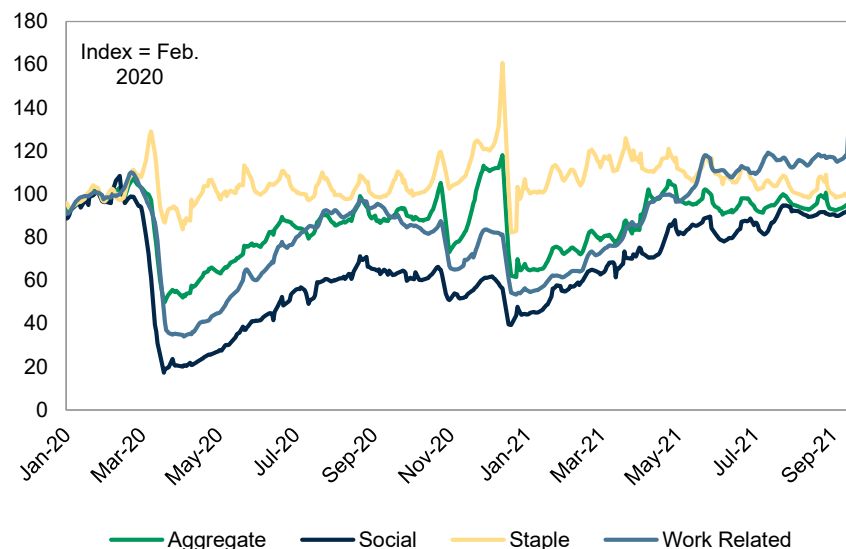
Consumer confidence falls to lowest since April



Sources: ONS, Crédit Agricole SA / ECO

Consumer confidence measured by the GfK consumer confidence index fell more sharply in September to -13 points, its lowest level since April. Consumers are more cautious about the general economic outlook for the next 12 months, but still quite confident in the outlook for their personal financial situation. The climate for major purchases has deteriorated slightly, but is still better than in May when shops were reopened in full. **The volume of retail sales fell in August for the fourth month in a row and is now 5% under its peak in April, but still 8.2% higher than in February 2020, before the impact of the coronavirus.** This may suggest that consumers have continued

Spending on credit and debit cards rose in September driven by work-related items



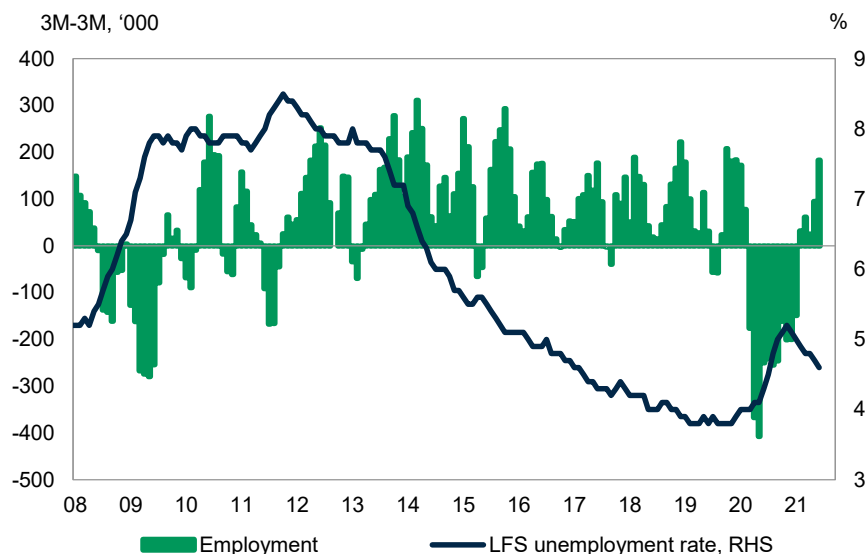
Sources: ONS, Crédit Agricole SA / ECO

to increase services consumption at the expense of goods. The fall in retail sales is broad-based: consumers are purchasing less in food shops (-1.6% 3M/3M), in non-specialised stores (-6.7% 3m/3m), in household goods stores (-4.6% 3M/3M) as well as online (-9.7% 3M/3M). In September, the high-frequency data of credit and debit cards spending shows an improvement, albeit a small one (+0.6% MoM relative to August). Therefore, indicators do not signal a collapse in consumer spending, but rather point to a moderation in growth and possibly a continuing rebalancing towards spending in services.

LATEST ECONOMIC TRENDS

LABOUR MARKET HAS TIGHTENED FURTHER AHEAD OF THE END OF FURLOUGH SCHEME

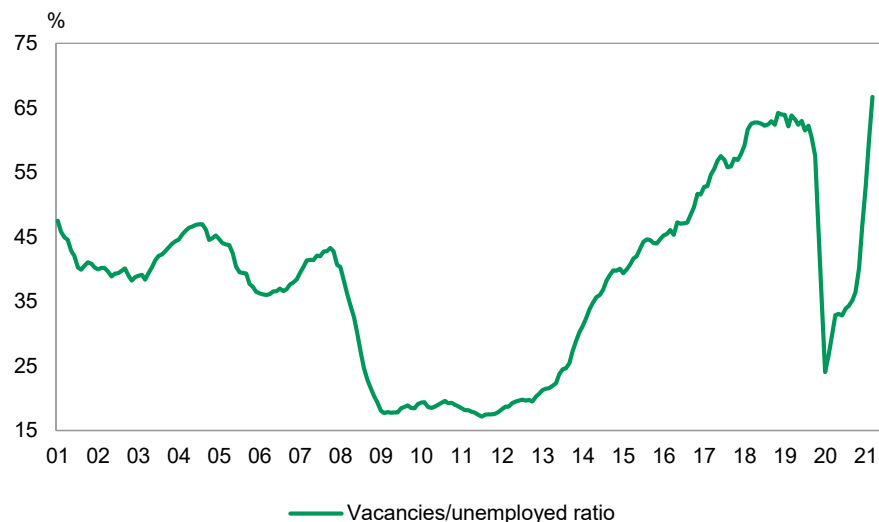
The unemployment rate fell to 4.6% in May-July



Sources: ONS, Crédit Agricole SA / ECO

The unemployment rate has been on a downward trajectory since the beginning of the year. It has fallen from 5.2% in Q420 to 4.6% in the three months to July. Businesses have been recruiting at a rapid pace. Vacancies reached a record high in August at more than 1 million and around 250k above their pre-crisis level. This recruitment frenzy concerns all sectors: the number of positions to be filled has reached records in most sectors. The largest increase concerns restaurant and hotel services (+57,600 over three months), followed by transport (+20,300). There were only 1.5 unemployed people per vacant position, a record low, suggesting significant tensions in the market.

Vacancies-to-unemployed ratio rose to a record high with vacancies hitting 1 million in August



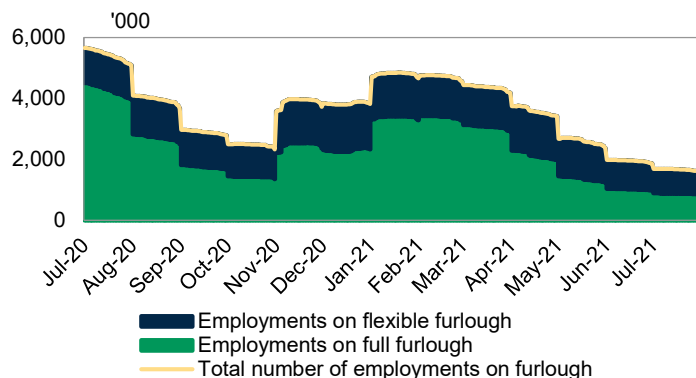
Sources: ONS, Crédit Agricole SA / ECO

Surveys, in particular those of the CBI, show significant recruitment difficulties across both the services and industrial sectors, regardless of the level of qualification. **Tighter labour market has already started to push upwards pay growth, although official figures of earnings growth remain difficult to interpret due to base and compositional effects.** Average total pay accelerated to 8.3% (9.6% in the private sector) while regular pay growth reached 6.8% in the three months to July. According to the ONS, underlying regular pay growth (adjusted for the base and compositional effects) is estimated at between 3.6% and 5.1%, which is above its pre-crisis level.

LATEST ECONOMIC TRENDS

THERE IS STILL MORE THAN ONE MILLION EMPLOYMENTS ON FURLOUGH

Number of employments on furlough by full and flexible furlough (end of August)

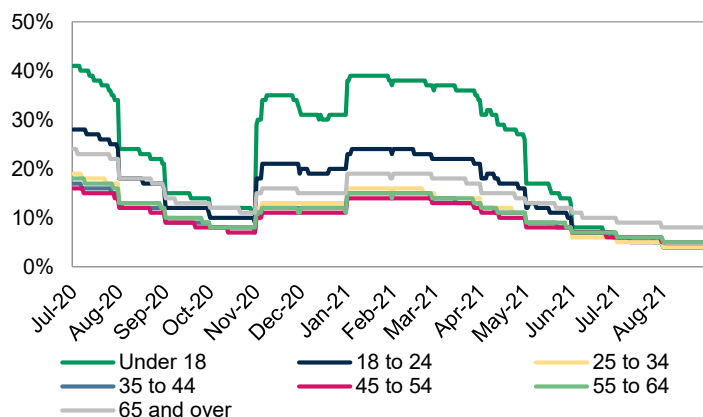


According to the official statistics of the HM Revenue and Customs (HMRC), **there were 1.3 million people on furlough at the end of August** (down from 1.6 million at the end of July and from 5.4 million one year before). The furlough rate fell further in September according to the ONS' BICS survey reaching 5.3% of the workforce (representing around 1.1 million). There were 730k employees on full furlough and 600k on flexible furlough at the end of August.

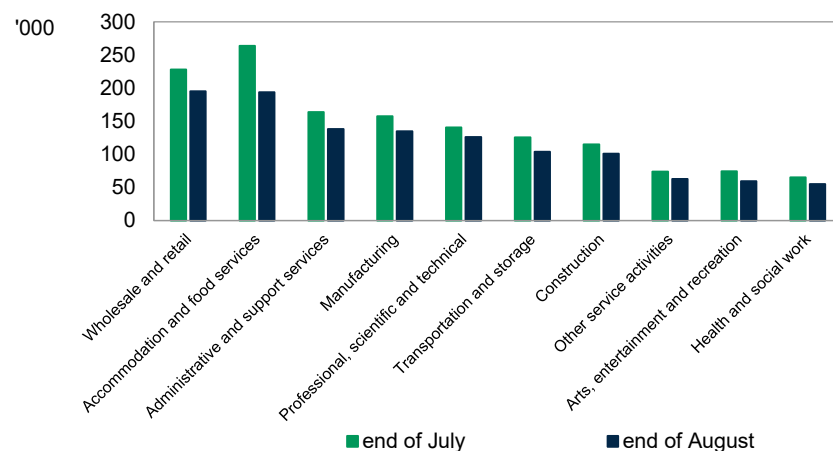
Furlough rates are the highest in sectors such as passenger air transport (44%) and travel agency (40%), but also in retail sales via stalls and markets (21%), creative and entertainment activities (24%), which are more at risk of operating at persistently lower capacity rates.

Over-65s have become the group with the highest furlough rate (most at risk of losing their job).

Furlough take-up rate by employee age



Sectors with the highest number of furloughed jobs

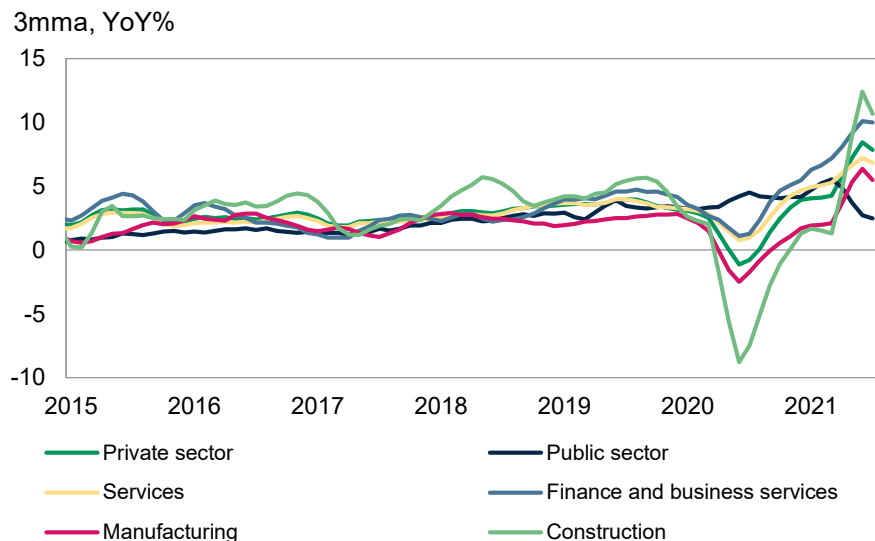


Sources: HMRC CJRS and PAYE data

LATEST ECONOMIC TRENDS

WAGE GROWTH RISES, BOOSTED BY SECTOR-SPECIFIC LABOUR SHORTAGES

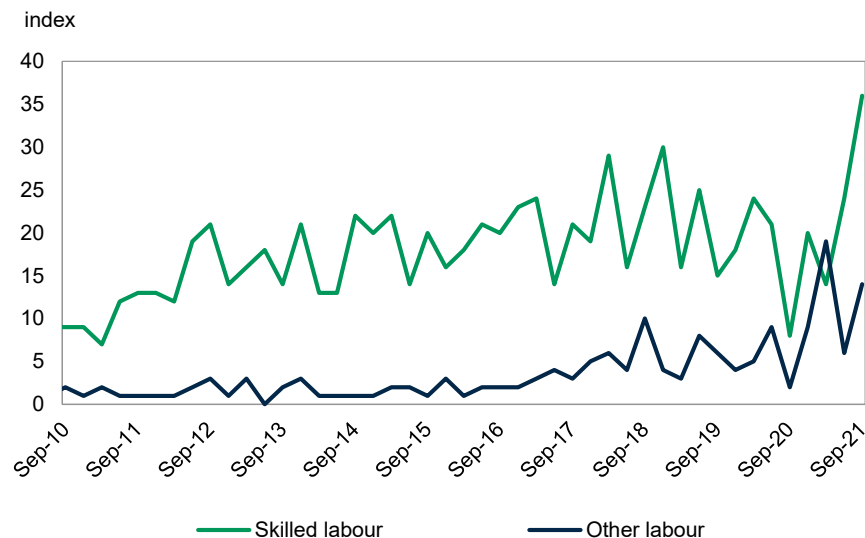
Regular pay growth rises to all times' high



Sources: ONS, Crédit Agricole SA / ECO

Pay growth has risen sharply recently: average total pay reached 8.3% (9.6% in the private sector) while regular pay growth was 6.8% in the three months to July. Official figures of earnings growth remain difficult to interpret due to base and compositional effects. Still, according to the ONS, underlying regular pay growth (adjusted for the base and compositional effects) is estimated at between 3.6% and 5.1%, exceeding its pre-crisis level. Several factors are at play, both cyclical and structural. First, there is the weakness in the supply of labour which reflects the extension of the furlough scheme until the end of September, the departure of EU workers not returning due to the more restrictive immigration policy post-Brexit and the exit from the workforce of some categories of employees due to Covid. Second, there were large and sudden shifts in demand

Recruitment difficulties are aggravated by the new immigration policy post-Brexit



Sources: CBI, Crédit Agricole SA / ECO

across sectors during the Covid crisis (goods vs services) and across regions (rural areas versus cities). **Sector-specific labour shortages seem to be further contributing to the increase in recent wage growth.** Consistent with the record high number of vacancies, business surveys have evidenced rising recruitment difficulties, especially acute in some specific and well-commented sectors. For instance, labour shortages in transport and food processing have led to double-digit wage settlements. However, overall pay settlements remain broadly in line with their pre-pandemic range, suggesting a lack of economy-wide wage pressures for the time being. Going forward, the need of post-Brexit adjustment in the labour market and revaluation of skills within the spare capacity will likely continue to exert some persistent pressures on wage growth.

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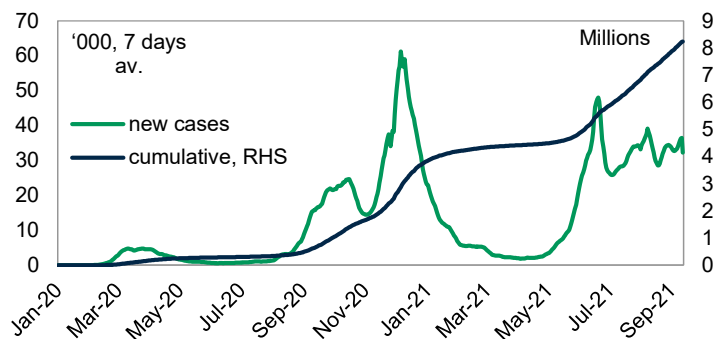
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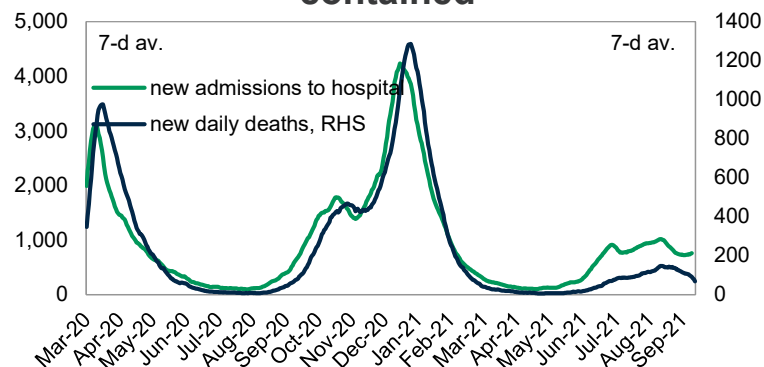
THE BASIS OF OUR SCENARIO

THE PUBLIC HEALTH OUTLOOK REMAINS CONSTRUCTIVE AS THE VACCINATION CAMPAIGN HELPS AVOID ANOTHER DEADLY COVID-19 WAVE IN THE WINTER

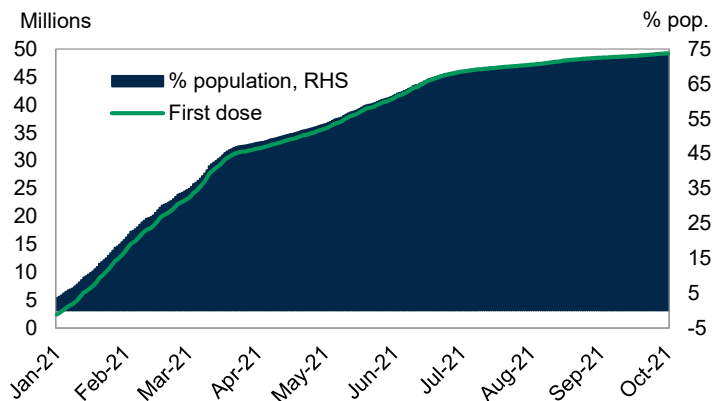
New Covid-19 infections relatively stable



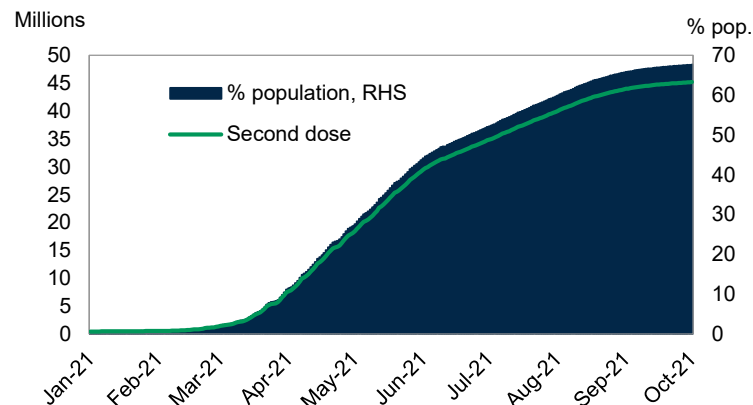
Hospitalisations and deaths are contained



Vaccinated people with one dose represent 70% of UK population



More than half of UK population has now received its second dose

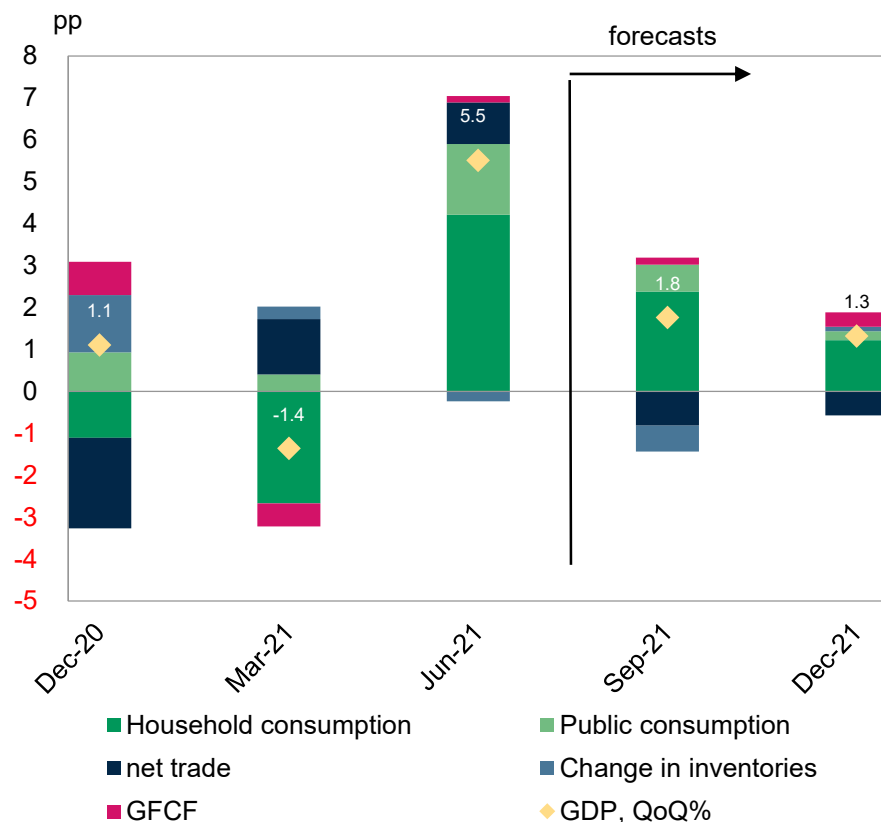


Sources all charts: gov.uk, data as of 10 October, Crédit Agricole SA / ECO

THE BASIS OF OUR SCENARIO

EASY GAINS ARE NOW BEHIND US, THE RECOVERY ENTERS A TOUGHER PHASE

Contributions to quarterly GDP growth: expenditure breakdown



Sources: ONS, Crédit Agricole SA / ECO

We expect the quarterly growth rate to slow sharply in Q3 to 1.8% QoQ after 5.5% QoQ in Q2, a slowdown which is greater than expected before due to the emergence of supply-side constraints on output.

Household consumption is likely to remain the key driver to growth.

There are still significant tailwinds to household consumption such the improvement of the labour market, the accumulated savings during the pandemic and a still high savings ratio, but the near-term outlook is getting more challenging due to rising energy prices and planned tax increases (national insurance, income tax, corporation tax). Inflation is expected to rise above 4% in Q421 and stay above 4% in H122.

We expect a rebound in business investment growth as the worst of the pandemic is now behind us and companies benefit from the temporary uplift in capital allowances announced in the March Budget. However, with supply-side issues expected to last another year or so, **its contribution to growth is likely to remain modest**. Growth in general government investment and dwellings investment have also likely passed their peak.

Net trade would remain a drag to growth due to headwinds to exports such as slowing external demand, distortions in supply chains, Brexit barriers on trade with the EU while Import growth stays more resilient in line with domestic demand. Trade with the EU is currently undergoing a period of acute structural adjustment post-Brexit. Brexit uncertainty remains high due to the persistent tensions around the Northern Ireland protocol ([see page 23](#)).

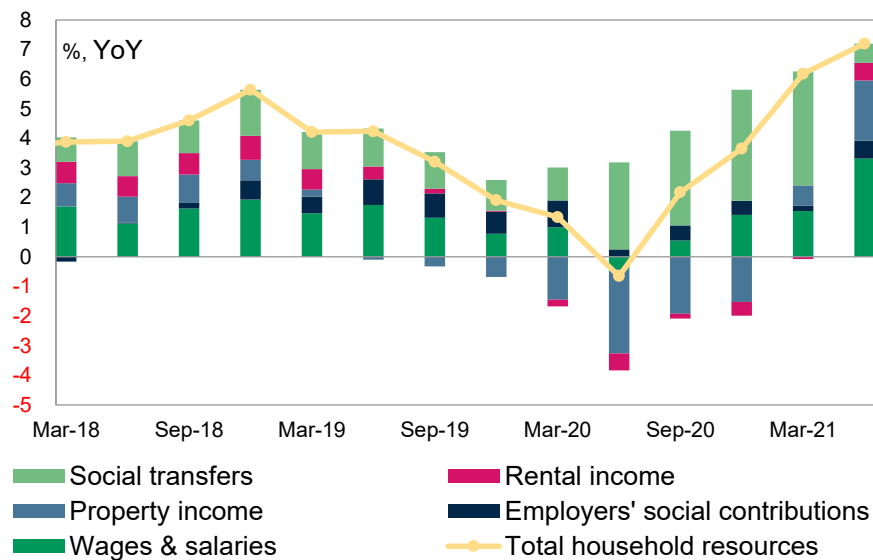
Risks to the scenario have shifted to the downside in recent weeks.

Rising inflation may hit consumer confidence leading consumers to rein in spending and boost precautionary savings. Moreover, Covid-19 risks have not disappeared, especially now that we enter the winter. One can not rule out the emergence of vaccine-resistant variants of the virus which could trigger a renewed rise in infections and another period of restrictions on economic activity.

THE BASIS OF OUR SCENARIO

HOUSEHOLD CONSUMPTION OUTLOOK: A MODERATE SLOWDOWN

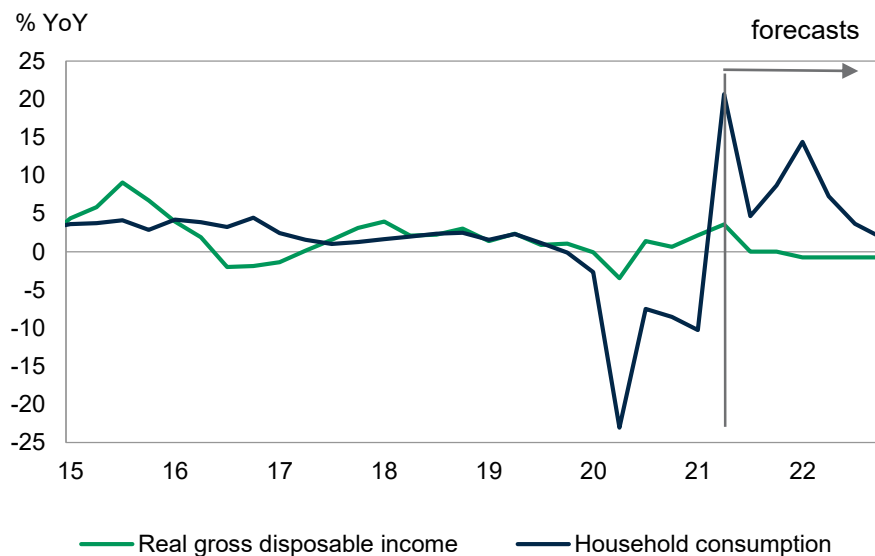
Wage acceleration has underpinned growth in household resources



Sources: ONS, Crédit Agricole SA / ECO

Household consumption rebounded sharply as the economy reopened in Q2 and real gross disposable income accelerated (to 3.6% YoY in Q2) thanks to the sharp increase in earnings' growth (7.4% YoY). Household consumption is still 6.3% below its Q419 level suggesting that there is still a potential for a recovery, especially in services consumption (down 13.4% relative to Q419 level). **However, the growth rate is likely to moderate going forward due to several headwinds.** The end of the government support in the labour market will likely lead to a rebound in the unemployment rate (expected at 5.1% QoQ in Q4) as there were still close to 1 million furloughed employments at the end of August. Inflation is rising fast (expected at 4.2% YoY in Q421, with upside risks) which will weigh on consumer purchasing power. Consumer

Growth in real gross disposable income to become negative and private consumption to slow down



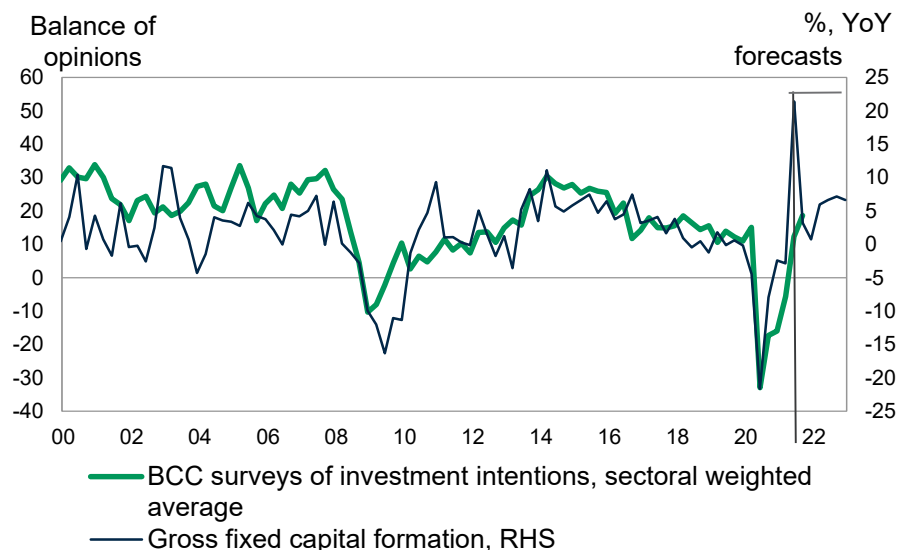
Sources: ONS, Crédit Agricole SA / ECO

confidence has fallen off from its recent highs and we expect the deterioration to continue. In 2022, the fiscal burden is set to increase as the government plans to freeze the income tax thresholds in April, which will further weigh on consumer spending. **Still, household consumption would be underpinned by the accumulated savings during the pandemic.** Some of them were used by households in Q221 in order to support consumption. Although the household saving ratio fell from 18.4% in Q2 to 11.7% in Q3, it remains far above its pre-crisis level (4.6% on average in 2019). We do not expect the household saving ratio to return to its pre-crisis level anytime soon, as households are likely to maintain a cautionary behaviour.

THE BASIS OF OUR SCENARIO

BUSINESS INVESTMENT: LACKLUSTRE GROWTH

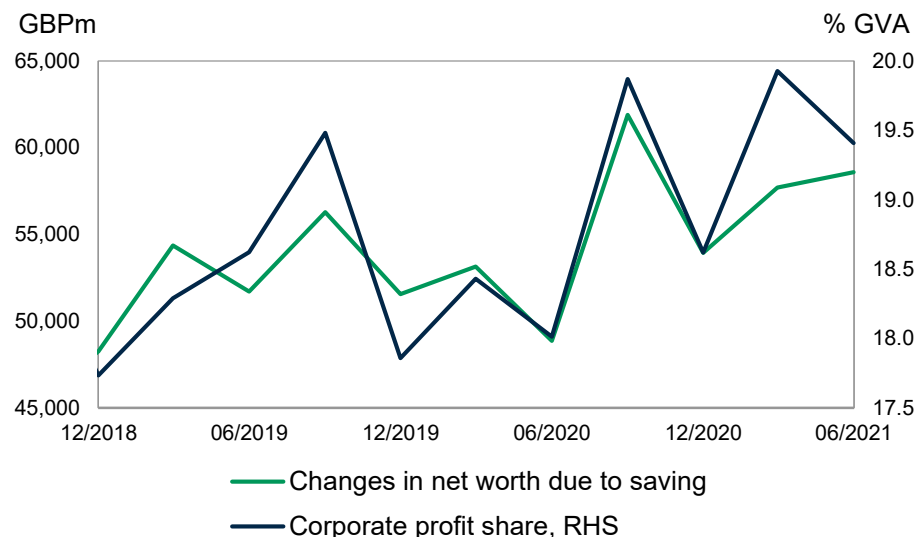
Investment intentions have recovered to pre-crisis levels



Sources: BCC, ONS, Crédit Agricole SA / ECO

Business investment has remained a laggard in the UK recovery. In Q2 it was still almost 13% below its Q419 level. **Surveys of investment intentions have improved, but do not point to a full-blown recovery in investment.** In the consumer services, the outlook has brightened indeed. Strong demand since social distancing restrictions were lifted had indeed encouraged businesses to resume investment plans that had been put on hold during the pandemic. However, businesses that continued to be adversely affected by Covid continued to limit investment. Some are even scaling back investment after having invested during lockdown periods. Investment intentions have remained low in the transport services due to weak demand and high costs. In the manufacturing, labour and material shortages and the associated costs are causing delays and revisions in investment projects. Gross fixed capital formation represents a smaller shortfall than business investment relative to

Businesses have accumulated savings on an aggregate basis since Q419



Sources: ONS, Crédit Agricole SA / ECO

Q419 (-4.5%) thanks to the fast recovery in dwelling investment (+4.3%) and in general government investment (+12.8%) growth of which seems to have past its peak. **We continue to expect the generous temporary uplift in capital allowances announced in the March Budget** (a 130% 'super deduction' available on most types of investment in plant and machinery) to boost business investment this year and next as companies are encouraged to bring forward investment from future periods. However, the impact is likely to be less than initially expected (in March the OBR had estimated that the measure could potentially raise the level of business investment by around 10% at its peak in the financial year 2022-23). In the long term, the reversal of the impact of the capital allowances and the substantial increase in the main rate of corporation tax in April 2023 will likely further weigh on business investment.

THE BASIS OF OUR SCENARIO

LARGE TAX RISES COMPOUND THE SQUEEZE IN HOUSEHOLD INCOMES

Key fiscal policy measures announced since the beginning of the pandemic until March 2021

Fiscal year starting in April	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Virus related policy	250	93	0	1	0	0
of which:						
Public services	106	53	0	0	0	0
Support for households	82	28	0	1	0	0
Support for businesses	62	13	0	0	0	0
Economic recovery measures	6	16	15	5	1	0
of which:						
Capital allowances super deduction	2	12	13	2	-2	-3
Fiscal consolidation measures			-8	-20	-28	-32
of which:						
Corporation tax rate increase			-2	-12	-16	-17
Income tax threshold freezes			-2	-4	-6	-8

* A negative sign indicates a fiscal tightening.

Sources: OBR March 2021, Crédit Agricole SA / ECO

The government is progressively putting an end to its pandemic-related support.

- **The job support schemes and Universal credit.** Both the Job Retention Scheme (JRS) and the Self-Employment Income Support Scheme (SEISS) expired at the end of September. Also, the GBP20 per week uplift in the Universal Credit and the extra GBP500 payment to Working Tax Credit claimants came to an end on 30 September.
- **VAT hike.** Last summer, the VAT in the hospitality sector was reduced to 5%. It rose back to 12.5% on 1 October and will be restored to its normal level on 1 April 2022.
- **Stamp duty.** The threshold above which one has to pay a tax on residential property transactions was back to its normal level of GBP125K on 1 October.
- **Business rate relief.** Eligible properties in the retail, hospitality and leisure sectors in England were fully exempt from paying business rates during Q2, as an extension of the 100% relief available in 2020/21. In July, this relief was reduced to 66% and will end on 31 March 2022.

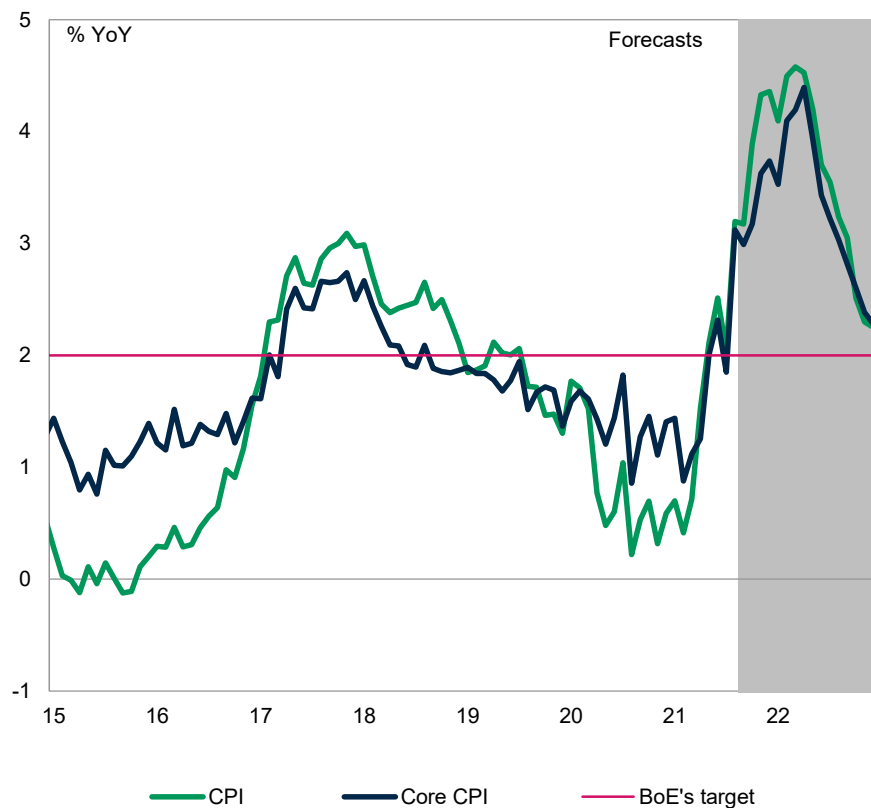
In March and September 2021, the government announced large tax increases:

- **Income tax threshold freezes from April 2022** announced in the March 2021 Budget
- **Corporation tax rate increase from April 2023**
- **A new, Health and Social Care Levy from April 2022** (announced alongside the launch of *Spending Review 2021* on 7 September). This would be based on an increase in National Insurance Contributions for all working adults and a rise in dividend tax rates. The proceeds would be used for spending on health and social care. The government also announced that the state pension 'triple lock' would be suspended for fiscal year 2022-23.

THE BASIS OF OUR SCENARIO

STRONG UPWARD REVISIONS TO NEAR-TERM INFLATION FORECASTS

CPI inflation expected close to rise above 4% in Q4 and H122 as global cost pressures persist



Sources: ONS, Crédit Agricole SA / ECO

After having reached 3.2% YoY in August, CPI inflation is expected to rise further in the near term (to 4.2% YoY in Q421 and 4.4% YoY in Q121) largely due to higher oil prices and more persistent global cost pressures.

UK-specific factors are also expected to contribute to inflation:

- **VAT rate hikes.** In October, VAT in the tourism and accommodation sectors was raised to 12.5% (and then to the normal 20% rate in April 2022).
- **Higher gas and electricity prices.** Also in October, regulated energy bills are set to jump by 10%, for the second time this year.
- **Brexit barriers to trade add to imported inflation well into 2022.** The UK government has yet to implement a range of custom controls on its imports from the EU. Brexit-related labour and goods shortages are set to persist adding upward pressures to prices and earnings in some specific sectors.

Inflation still expected to moderate in the second half of 2022. While inflation is still likely to fall sharply in the course of 2022 as base effects drop from the 12-month comparison, our forecast is slightly above target at the end of 2022 (2.4% YoY in Q422)

Risks remain to the upside. The material rise in wholesale gas prices recently adds upside risk to our forecasts for 2022.

MONETARY POLICY

BANK OF ENGLAND: BRINGING FORWARD THE FIRST RATE HIKE

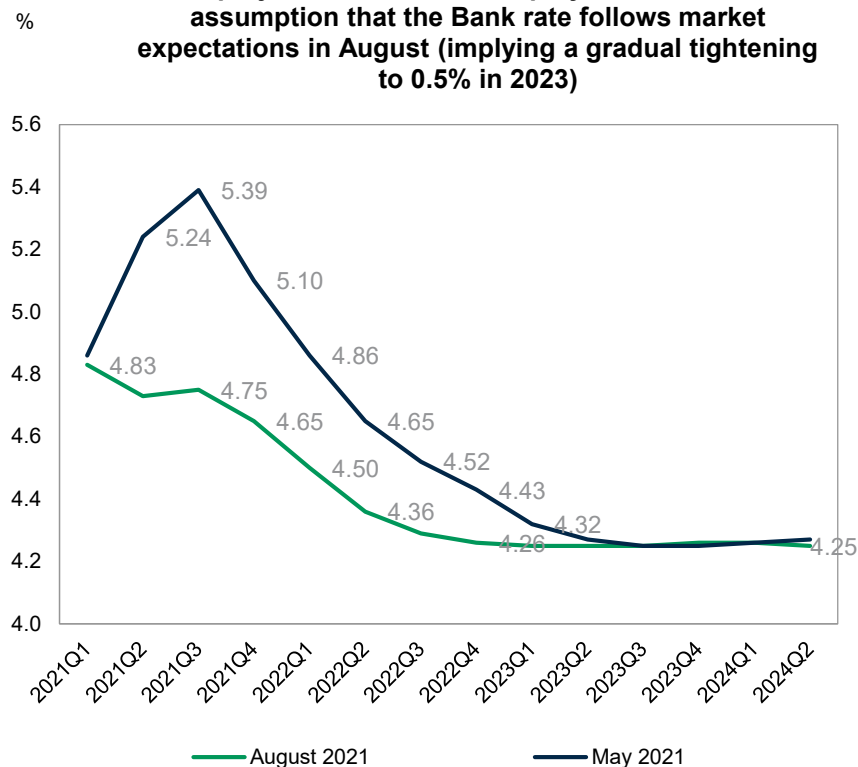
The BoE has maintained its Bank rate at a record low of 0.1%, the existing programme of UK government bond purchases at GBP875bn and the total target stock of asset purchases at GBP895bn. While the decision to keep the Bank rate on hold is still unanimous, **the MPC has become increasingly split on the QE as two members voted for a reduction of QE.** Though, the majority view of the MPC is to continue with the asset purchases as planned, meaning that the current asset purchases programme will be completed towards the end of the year.

Importantly, labour market tightening prompted the BoE to signal the start of monetary policy tightening via rate hikes in 2022. In August, the BoE endorsed market expectations for a very gradual normalisation in monetary policy starting in 2022: Bank rate lifted to 0.25% in Q3/2022 (from 0.1% currently) and to 0.5% by the middle of 2023. Then in the September minutes, the BoE even opened the door to the possibility of rate hikes in November this year. This optimism appears motivated by the positive surprises so far this year in terms of the strength of the recovery and the pace of improvement of the labour market. **The MPC no longer expects an increase in the unemployment rate once the furlough scheme comes to an end.** Several MPC members commented on the possibility of persistence of some factors of tightening of the labour market (domestic mismatches across sectors, regions and occupations). The MPC judges that spare capacity is likely to be eliminated in Q3. The BoE anticipates that small excess demand will emerge temporarily next year, before demand and supply return broadly to balance in 2023.

The BoE communicated on its strategy for the mix of monetary policy instruments to deliver tighter policy. It plans to stop re-investing maturing assets when the Bank rate reaches 0.5% but will not sell assets until the Bank rate reaches 1%. This represents a change vs the BoE's previous forward guidance: in June 2018, the MPC had stated that it intended not to reduce the stock of purchased assets until the Bank Rate reached around 1.5%. According to the Bank, the change reflects the decision early this year to include a negative Bank rate in the BoE's toolkit.

The BoE no longer expects a strong increase in the unemployment rate at the end of the furlough scheme

BoE projections for the unemployment rate, on the assumption that the Bank rate follows market expectations in August (implying a gradual tightening to 0.5% in 2023)



Sources: BoE August 2021 and May 2021 Monetary reports

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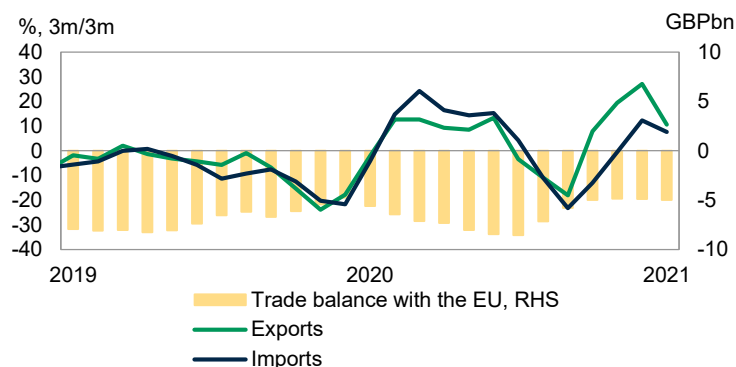
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FOCUS: BREXIT UPDATE

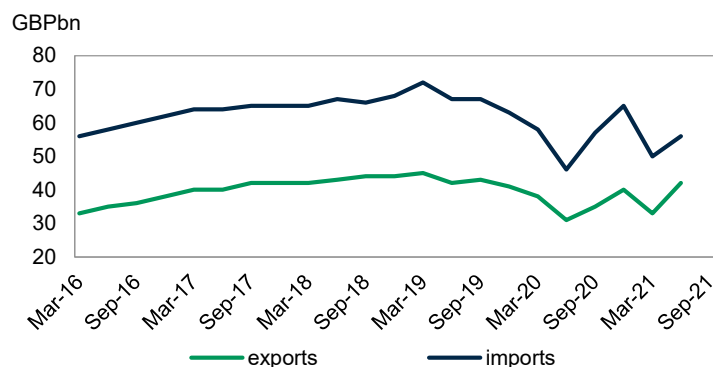
THE FULL IMPACT OF BREXIT REMAINS TO BE SEEN AS ADDITIONAL FRICTIONS ARE TO COME

UK trade deficit of goods with the EU has narrowed



Sources: ONS, Cr dit Agricole SA / ECO

Exports towards the EU have recovered to pre-crisis levels, but not imports



Sources: ONS, Cr dit Agricole SA / ECO

Brexit is a factor in the UK's current disruption. The UK left the EU single market and customs union on 1 January 2021. A Trade and Cooperation Agreement took place which introduced significant barriers to trade with the UE and put an end to the free movement of Europeans. As a consequence, Brexit has been contributing to the supply issues from which the UK economy suffers currently, even though this is of course not the only factor to blame. Brexit worsens the already immense shock of Covid on global supply chains and labour migration. It has also revealed long-standing structural labour problems in some sectors. Although the exact numbers are unclear, it appears that tens of thousands of EU citizens, especially from Central and Eastern Europe, have left the UK and have not returned due to the post-Brexit much more restrictive UK migration policy. Low-skill and low-paid sectors are suffering the most from the lack of labour, with haulage, agriculture and meat industry grabbing the headlines.

Trade burdens will grow in the coming months. Additional frictions are yet to be introduced on the UK side. On 14 September 2021, the UK government decided to delay further some elements of controls on its EU imports, especially those relating to sanitary and phytosanitary goods, to 1 January 2022 and 1 July 2022.

- 1 January 2022 (unchanged): end of current easements in relation with full customs controls and the introduction of customs checks
- 1 January 2022 (as opposed to 1 October 2021): pre-notification of agri-food imports
- 1 July 2022 (as opposed to 1 October 2021): new requirements for export health certificates
- 1 July 2022 (as opposed to 1 January 2022): phytosanitary certificates and physical checks on SPS goods at border control posts
- 1 July 2022 (as opposed to 1 January 2022): safety and security declarations on imports

FOCUS: BREXIT UPDATE

PROGRESS ON THE DISPUTE OVER NORTHERN IRELAND, BUT IT IS NOT ALL OVER YET

Grace periods were extended. Tensions between the UK and the EU over how to implement the **Northern Ireland Protocol**, the arrangements agreed as part of the Trade and Cooperation Agreement to avoid a hard border on the island of Ireland, have become more acrimonious recently. On 7 September, the UK government extended for the third time this year the so-called grace periods (initially set to last between three and six months) designed to ease the burden of the Protocol in order to allow for negotiations to continue. It did not set a date for ending the “standstill arrangement”. UK Brexit minister Lord David Frost has demanded sweeping changes to the protocol, which he has warned is “not sustainable” in its current forms because of the bureaucratic burdens that are facing British businesses sending goods to the region. The UK complains that the current situation does not respect the integrity of its own internal market and also wishes to end the oversight of the European Court of Justice (ECJ) in the Protocol.

- The **protocol** imposes checks on some goods moving between Great Britain and Northern Ireland effectively setting a border in the Irish sea in order to protect the Belfast agreement and avoid the creation of hard border on the isle of Ireland. Also, Northern Ireland is subject to a different regulatory environment to the UK, as it stays bound by the rules of the EU’s single market in specific areas, most notably food products and manufactured goods.

The threat of Article 16 is a means to obtain concessions rather than a realistic scenario.

- **What is Article 16?** Article 16 is a clause in the protocol that states that “if the application of this Protocol leads to serious economic, societal or environmental difficulties that are liable to persist, or to diversion of trade, the Union or the United Kingdom may unilaterally take appropriate safeguard measures”. Any actions taken must be “restricted with regard to their scope and duration” and limited to what is “strictly

necessary” in order to solve the problems. Those safeguards can amount to suspending parts of the deal, but not the whole deal. Article 16 is not intended to allow either party to suspend provisions of the protocol permanently or in their entirety. The other part can then take “strictly necessary” proportionate “rebalancing measures”. So, if the UK triggers Article 16, the EU can respond by setting tariffs on its imports and take further legal steps against the UK in the ECJ.

- The protocol does not define what constitutes either “serious economic, societal or environmental difficulties”, or a “diversion of trade”, so there remains ambiguity around threshold for taking unilateral measures. In a document published in July 2021, “Northern Ireland Protocol: the way forward”, the UK government extensively described the issues with the current Protocol and its profound economic, political social and commercial ramifications the UK government and argued that “the circumstances exist to justify using Article 16”. Earlier this year, the EU created a precedent in January 2021, by invoking Article 16 to block EU exports of vaccines to Northern Ireland which could subsequently enter Great Britain. The EU rapidly backtracked on its threat, but it added fuel to the tensions in Northern Ireland. Importantly, this misstep lowered the bar for calls to use unilateral measures.

Recent major break-through. On 13 October, Lord David Frost hardened the tone by threatening that “fractious” relations between the two sides would not find a new equilibrium unless the EU agreed to British demands to fundamentally rewrite the protocol. In a notable move, the EU offered to scrap 80% of checks on goods moving from Great Britain to Northern Ireland and halve the customs paperwork. Lord Frost, UK Brexit minister, insisted that any agreement must remove the European Court of Justice from its role in policing the Brexit deal in Northern Ireland, but did not call it a “red line”.

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