UNITED KINGDOM
2021-2023 OUTLOOK

ANOTHER CHALLENGING YEAR

January 2022

Slavena Nazarova

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

CONTENTS

SUMMARY OF OUR SCENARIO

ANOTHER CHALLENGING YEAR WITH COVID STILL THERE AND COST OF LIVING ON THE RISE

The recovery slows as pandemic support is withdrawn, vaccines appear less effective than initially thought against new variants and costs of living rise

A new and much more infectious variant, Omicron, has been spreading at a rapid pace across the UK since early December. Hence, one of the key downside risks to our scenario has materialised, prompting downward revisions to our already cautious near-term outlook. After a disappointing Q3, we expect a further slight slowdown in Q4 and still weak growth in Q1.

The government has so far contented itself by implementing precautionary measures, the so-called plan B (including the mandatory use of face coverings indoors, working from home when possible, the use of Covid pass for large events from 15 December and testing before visiting a vulnerable person or entering a high-risk setting), and is not planning further restrictions for the time being. The direct impact of those restrictions on growth should be relatively limited. Consumers and businesses have demonstrated their ability to adapt to restrictions and associated working conditions. Still, the highly infectious nature of the variant poses challenges for businesses to maintain activity due to job absences as millions of people have had to self-isolate at the same time, while face-to-face consumer services likely took another hit. As a consequence, GDP likely contracted in December and will probably do so again in January.

Omicron also brings negative news for the prospects of inflation as the rebalancing of spending from goods to services is likely to shift into reverse until contaminations are significantly reduced. The renewed increase in demand for goods (as suggested by the rebound in retail sales) alongside worse staff shortages is likely to exacerbate the already elevated inflationary pressures in the industrial sectors.

Beyond winter and supposing that the Omicron wave abates in the coming weeks, an acceleration of GDP growth is likely in Q2. Nevertheless, households still face difficult months ahead. They will have to deal with the looming squeeze in their living costs as inflation will continue rising in the near term and especially in April when a substantial jump is expected in energy prices. Also in April, the government will increase national insurance contributions and freeze income tax thresholds and allowances. The greater fiscal burden and rising living costs will weigh on household consumption, but we continue to expect relatively strong growth this year. The improvement in the labour market remains a key tailwind, underpinning consumer confidence. As a whole, households benefit from significant savings accumulated during the crisis and the savings ratio remains above pre-crisis levels.

Fiscal stance turning sharply contractionary, despite greater planned public spending

The fiscal stance is characterised by a sharp tightening between 2021 and 2024 as pandemic-related support is withdrawn (the structural deficit is expected to decrease from 8.3% to 1.8% over the next three years). In October, the government eased that stance significantly through an unexpected increase in spending, partially offset by a greater tax burden. As a result, the fiscal tightening will be cut sharply for fiscal year 2022-23 (by 0.8% of GDP). The OBR estimates that this lesser degree of tightening will boost GDP by 0.4% over the 2022-23 fiscal year.

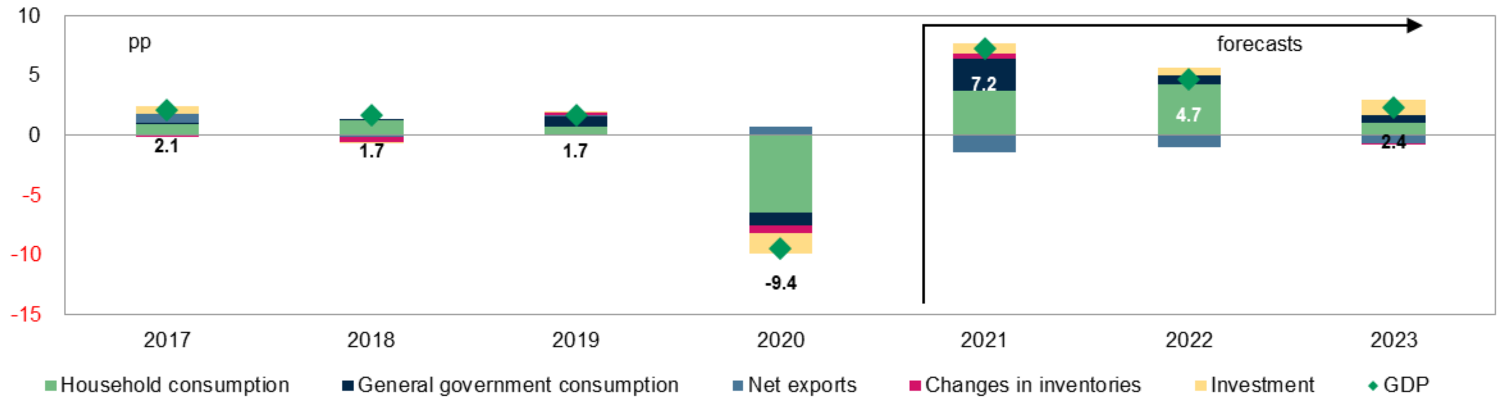
BoE's monetary policy tightening supposed to be modest

In December, the BoE increased its key interest rate by 15bp to 0.25% and reiterated that "modest" tightening is likely to be necessary in order to sustainably bring inflation back down to its 2% target. We are forecasting two rate hikes in 2022 and one in 2023 (of 25bp each). QE will likely be a complementary tool for tightening. In line with its forward guidance announced last August, the BoE will likely stop reinvesting maturing assets once the Bank rate reaches 0.50% (probably next February). Furthermore, it may begin to actively sell these assets once the Bank rate reaches 1.00% (early 2023 in our scenario), but only if economic conditions warrant it.

SUMMARY OF OUR SCENARIO

FORECASTS: DOWNWARD REVISIONS TO NEAR-TERM GROWTH

Contributions to annual GDP growth



Sources: ONS, Crédit Agricole SA / ECO

United Kingdom	2021	2022	2023	2021				2022				2023			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP (%)	7.2	4.7	2.4	-1.3	5.4	1.1	0.9	0.8	1.1	0.6	0.6	0.5	0.6	0.5	0.5
household consumption	6.0	7.0	1.7	-3.7	8.2	2.7	2.0	1.0	1.0	0.5	0.4	0.4	0.4	0.3	0.3
public consumption	13.9	3.5	3.0	1.8	8.3	-0.5	-1.0	1.0	1.0	1.0	1.0	0.6	0.6	0.6	0.6
investment	4.9	3.9	7.4	-1.1	2.3	-0.9	-0.8	1.5	2.0	1.8	1.8	1.8	1.8	1.8	1.8
change in inventories*	0.5	0.0	0.0	-0.4	-0.8	0.5	-0.2	0.0	0.2	-0.1	0.0	0.0	0.0	0.0	0.0
net exports*	-1.4	-1.0	-0.6	1.3	0.4	-1.3	0.2	-0.3	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Unemployment rate (ILO)	4.5	3.9	3.8	4.8	4.6	4.2	4.2	4.1	3.9	3.9	3.8	3.9	3.8	3.9	3.8
Inflation (CPI, YoY%)	2.6	5.3	2.6	0.6	2.1	2.8	4.9	5.4	6.1	5.5	4.2	3.7	2.4	2.2	2.0
Core CPI (YoY%)	2.4	4.2	2.5	1.1	1.9	2.6	3.8	4.6	4.8	4.2	3.5	3.1	2.6	2.3	2.0
Current account (% GDP)	-3.9	-4.6	-4.8	-1.6	-1.5	na	na	na	na	na	na	na	na	na	na
General gov. balance, % GDP	-10.1	-5.8	-4.5	na	na	na	na	na	na	na	na	na	na	na	na
Public debt % GDP	102.4	103.0	103.4	na	na	na	na	na	na	na	na	na	na	na	na
Bank rate**	0.1	0.75	1.00	0.1	0.1	0.1	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
Stock of purchased gilts (bn £) **	875	875	805	875	875	875	875	847	847	838	838	838	838	803	803

** Contributions to GDP growth*

*** End of period*

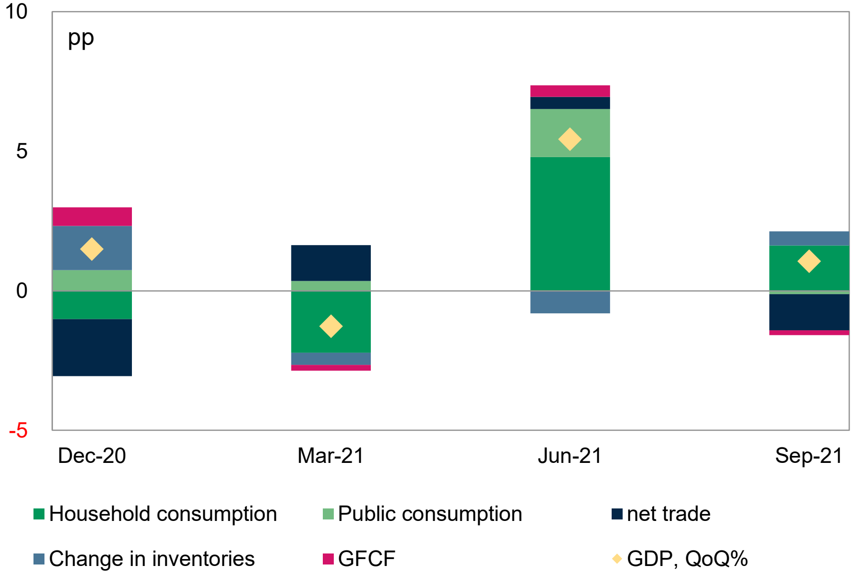
Source: ONS, BoE, Crédit Agricole S.A.

CONTENTS

LATEST ECONOMIC TRENDS

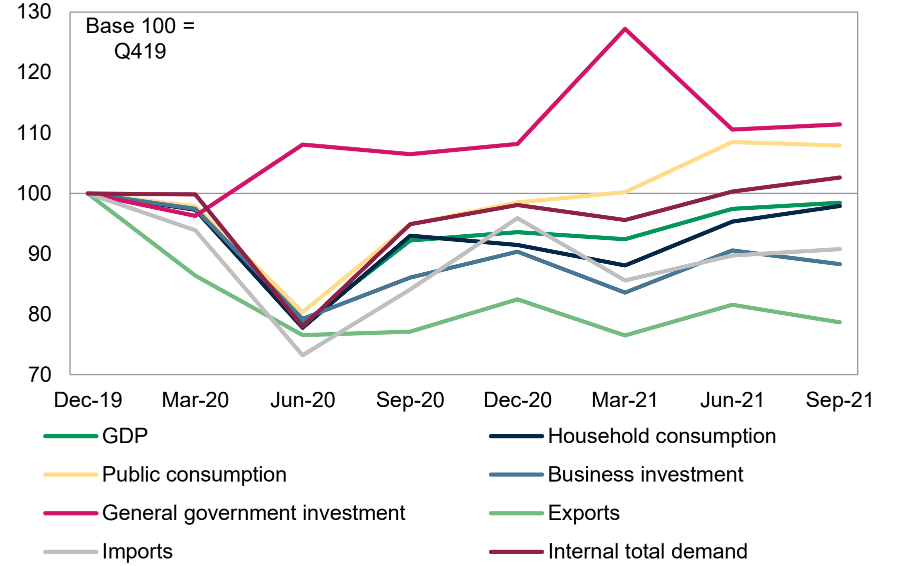
ACTIVITY IN Q3 WAS DRIVEN BY PRIVATE CONSUMPTION IN SERVICES AND LITTLE ELSE

Quarterly GDP growth: expenditure breakdown



Sources: ONS, Crédit Agricole SA / ECO

The recovery since Q419: driven by the public sector

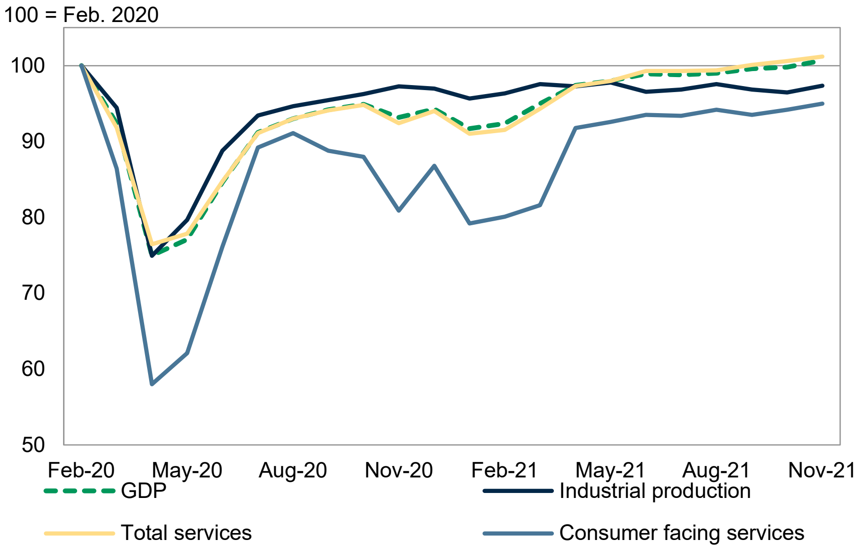


Sources: ONS, Crédit Agricole SA / ECO

On 22 December, the ONS published significant revisions to the national accounts. GDP is estimated to have expanded by 1.1% QoQ in Q321, down from 1.3% QoQ in the first estimate. Also, 2020 annual GDP growth was revised to the upside, from -9.7% to -9.4%. As a result, GDP now stands 1.5% below its Q419 level (compared to -2.1% in the first estimate). In Q3, household consumption slowed to 2.7% QoQ after 8.2% QoQ in Q2, as consumers reined in spending in goods (0.9% QoQ), notably vehicles, while sustaining consumption in services (11% QoQ). After upward revisions to actual data, the gap of household consumption relative to Q419 level is currently estimated at -2.1% vs -4.4% in the first estimate, due to a significant revision to household consumption in restaurants. The savings ratio is estimated to have fallen to 8.3%, still somewhat above its pre-crisis level (4.6% on average in 2019). Public spending has grown massively since the pandemic, as the government implemented an exceptional amount of pandemic-related stimulus. This has now come to an end. Already in Q3, both public consumption and investment brought zero contribution to the rebound of activity. Business investment contracted unexpectedly in Q3 (-2.5% QoQ), remaining 11.7% below its Q419 level. Net trade also weighed on growth in Q3 (-1.3 pp), as exports fell and imports rose. Exports have not shown any revival since the crisis, stuck at more than 20% below their Q419 level.

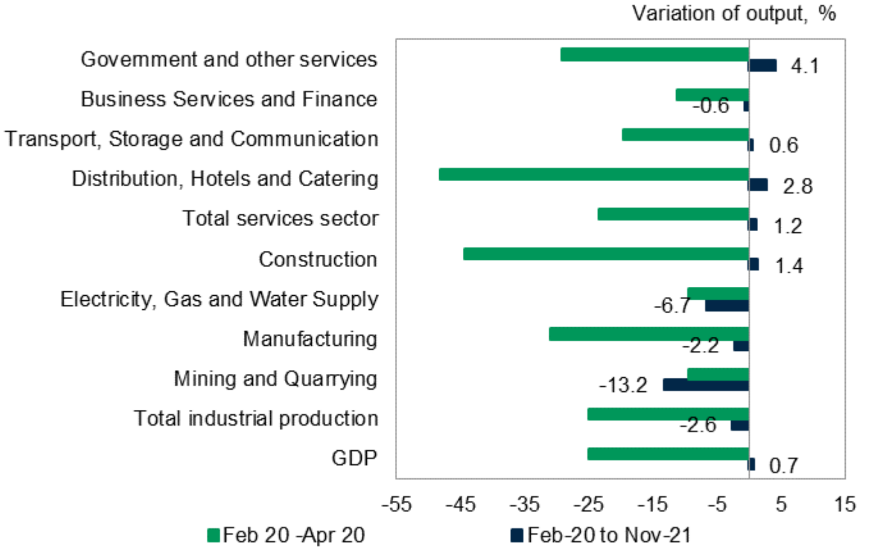
NOVEMBER SAW ACTIVITY EXCEEDING ITS FEBRUARY 2020 LEVEL FOR THE FIRST TIME

Growth remains sluggish in consumer-facing services



Sources: ONS, Crédit Agricole SA / ECO

Uneven recovery across sectors Manufacturing is still below its Feb-2020 level



Sources: ONS, Crédit Agricole SA / ECO

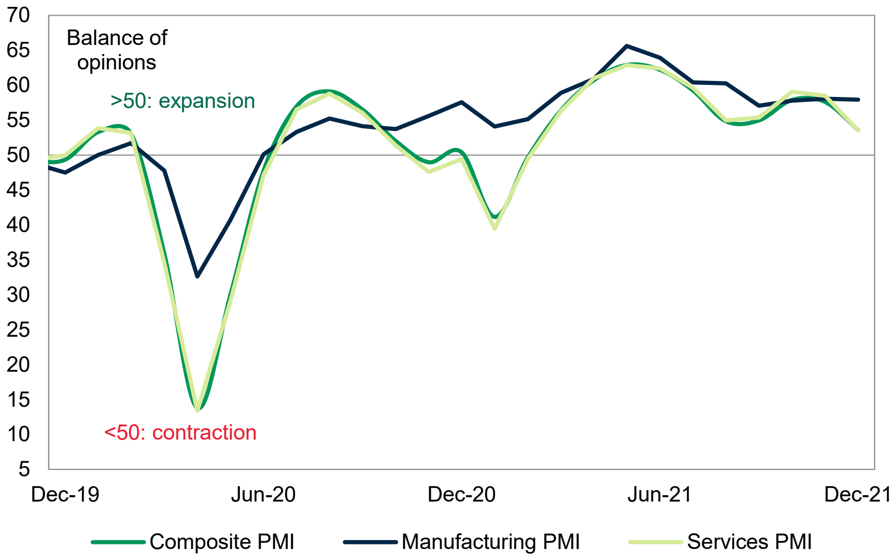
After disappointing growth in Q321 and a weak start to Q4 (activity rose by 0.2% MoM in October revised from 0.1% MoM in the initial estimate), activity strengthened in November (0.9% MoM). As a result, GDP increased for the first time above its pre-coronavirus pandemic level (Feb-2020), by 0.7%. The main contributors to the recovery since February 2020 have been human health and social activities, wholesale and retail trade, arts and recreation. Services and construction are now 1.3% above their pre-coronavirus level, while industry is still below (-2.6% MoM). Consumer-facing services (retail trade, restauration, travel and transport, entertainment and recreation) are still 5% below their pre-crisis levels, while other services are 2.9% above.

In November, all four main sectors posted positive growth but the services sector (0.7% MoM) was the main contributor thanks to a rebound in professional and scientific activities. Within industry (up 1% MoM in November), the manufacturing sector rebounded strongly (1.1% MoM) but still remains 2.2% below its pre-coronavirus level. The unexpectedly strong rebound of activity in November leaves a better-than-expected carry-over effect for GDP quarterly variation of 1.3% in Q4 (QoQ growth assuming flat activity December). However, we expect the spread of Omicron to have triggered a contraction in activity in December, partially offsetting that effect, due to staff absences and renewed weakness in the social services sectors.

LATEST ECONOMIC TRENDS

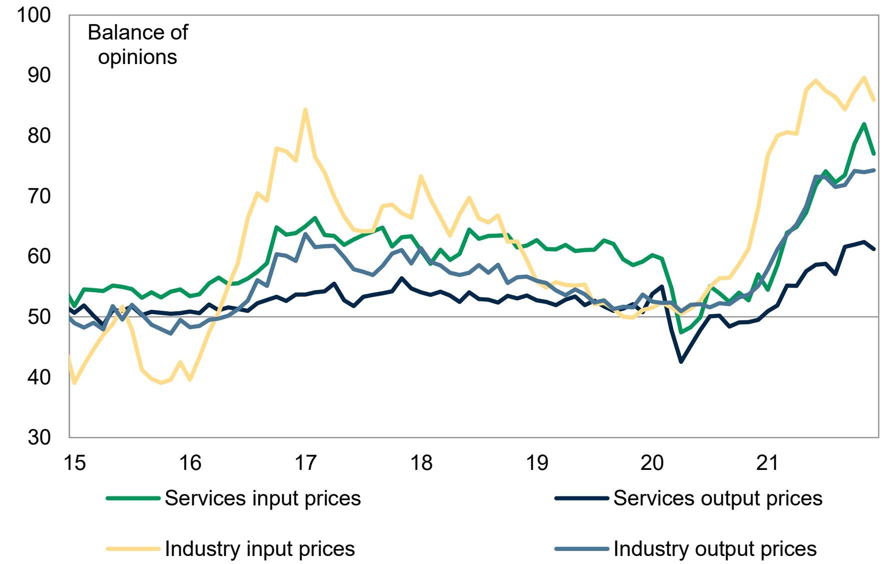
COMPANIES REMAIN OPTIMISTIC DESPITE CHALLENGES

PMI surveys comfortably in expansion territory despite Omicron



Sources: IHS Markit, Crédit Agricole SA / ECO

PMI price components: timid signs of stabilisation



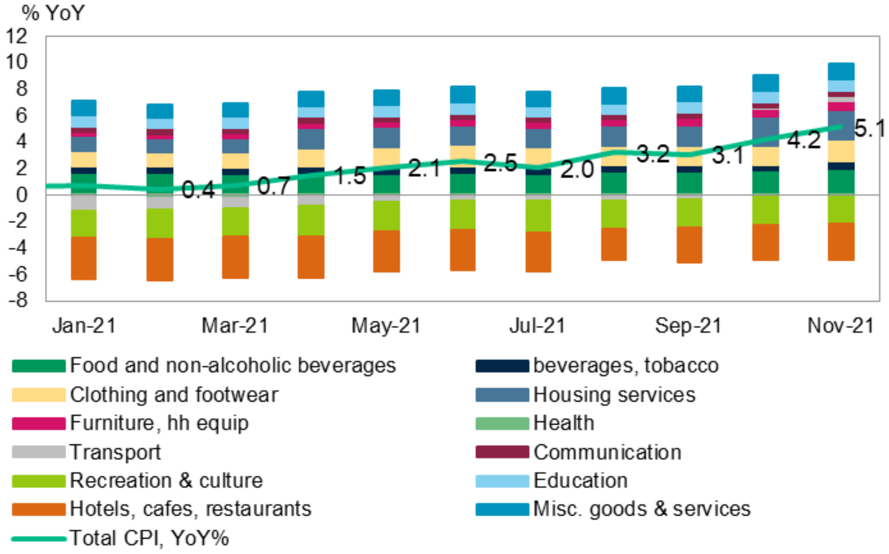
Sources: IHS Markit, Crédit Agricole SA / ECO

PMI surveys show “a considerable reversal of fortunes during December” due to Omicron. While the indusial sector held up relatively well, the PMI services was down to 53.6 from 58.5 in November indicating the weakest pace of expansion since the lockdown in February. Businesses reported falling spending on face-to-face consumer services and disruptions due to staff absences. There was a severe loss of momentum in new orders in December (53.6 from 59, also the weakest since February) as travel, leisure and hospitality businesses suffered from cancelled events during the festive period and renewed travel restrictions. Consistent with the weaker demand for services, capacity pressures eased somewhat. On the brighter side, employment growth remained relatively strong, despite shortages of available candidates, reflecting upbeat confidence in future prospects for activity. Cost pressures remained high, but the pace of inflation decelerated slightly for the first time since August. Overall, the PMI services has remained comfortably above the 50 threshold, signalling continued expansion, although temporarily hampered by Omicron. In industry, the December PMI showed stronger output growth, new orders (to the highest since August) and employment. However, while domestic demand strengthened, export demand has continued to fall. This reflected Brexit difficulties, logistic issues and further Covid restrictions. Supply-chain constraints and staff shortages remained strong, although easing slightly.

LATEST ECONOMIC TRENDS

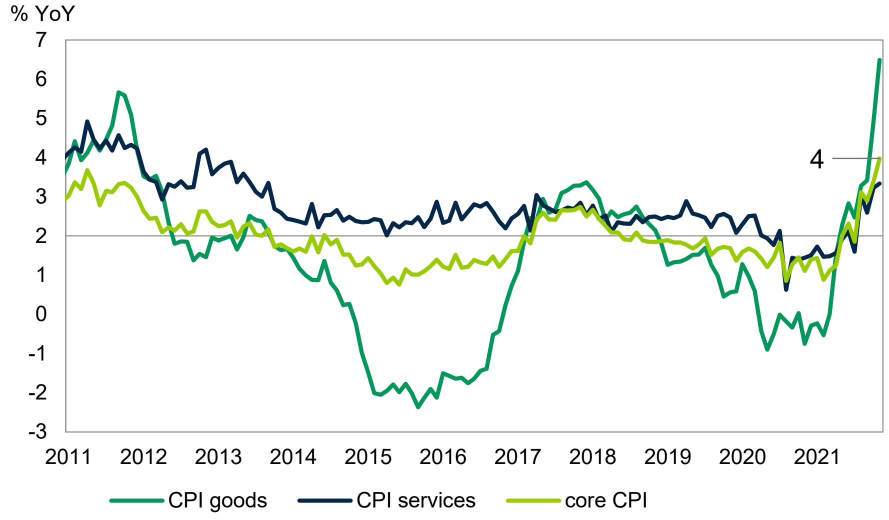
INFLATION HAS CONTINUED ITS UPWARD TREND

CPI inflation: pressures are relatively broad-based, but temporary factors remain at play



Sources: ONS, Crédit Agricole SA / ECO

CPI goods inflation has continued to surge, surpassing its 2011 high. CPI services inflation more contained



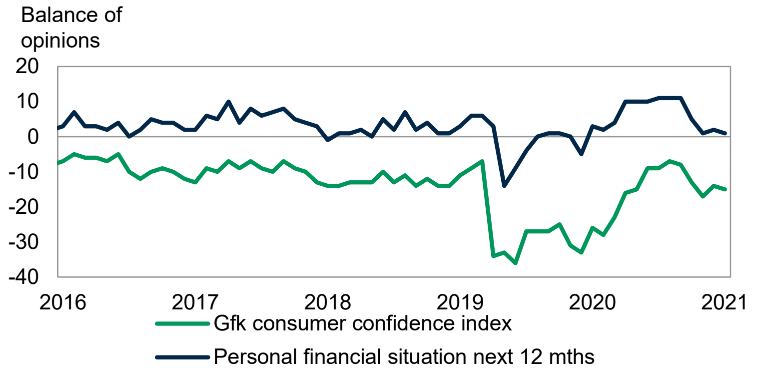
Sources: ONS, Crédit Agricole SA / ECO

CPI inflation reached 5.1% YoY, its highest pace in ten years. Core inflation rose to 4% YoY, a record high since the beginning of the series in 1997. Monthly variations for both indices (0.7% MoM and 0.5% MoM respectively) significantly exceeded their past averages for this period of the year. The upward contributions to CPI inflation were broad-based, with the largest coming from transport (especially motor fuels and second-hand cars) and housing and household services (as a result of prices rises for gas and electricity). Prices of motor fuels are up 28.5% YoY with average petrol prices reaching an all-time high at 145.8 pence per litre. Regarding second-hand cars (27% YoY), the sharp increase in prices is due to increased demand of vehicles as people avoid public transport coupled with supply-side issues in the production of new cars amid the global semiconductor shortage. Housing and household services also contributed substantially to inflation due to the increase in the cap on energy prices by the energy regulator (Ofgem). The cap was raised twice this year (in April and October), in order to reflect increases of wholesale prices of gas and electricity. Other sectors contributing positively to inflation were clothing and footwear (mostly due to base effects), food, alcohol and tobacco prices (the largest effect coming from tobacco due to an increase in duty rates), recreation and culture. Those positive contributions were partially offset by negative contributions from restaurants and hotels where prices decelerated in November. Despite the relatively broad-based contributions to inflation, the analysis shows that temporary factors are still at play.

LATEST ECONOMIC TRENDS

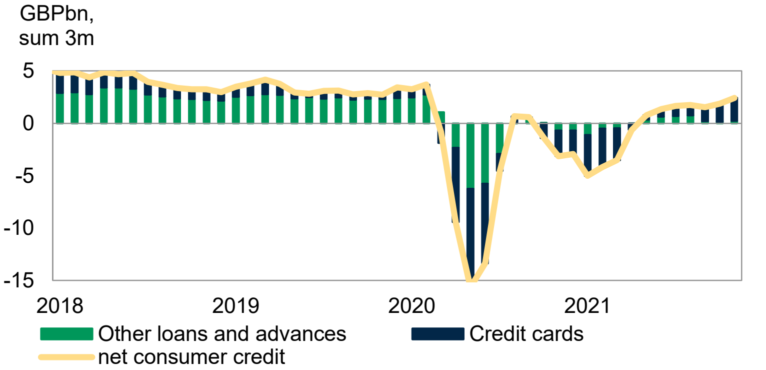
CONSUMERS REMAIN RELATIVELY CONFIDENT AND KEEP ON SPENDING

Consumer confidence is levelling off, but not collapsing



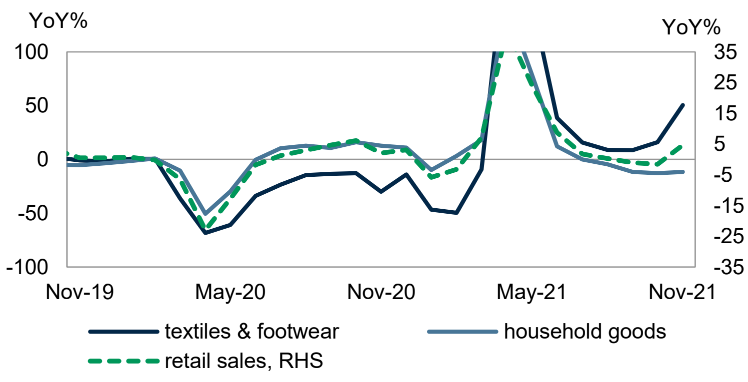
Sources: Gfk, Crédit Agricole SA / ECO

Households are increasing their consumer credit holdings



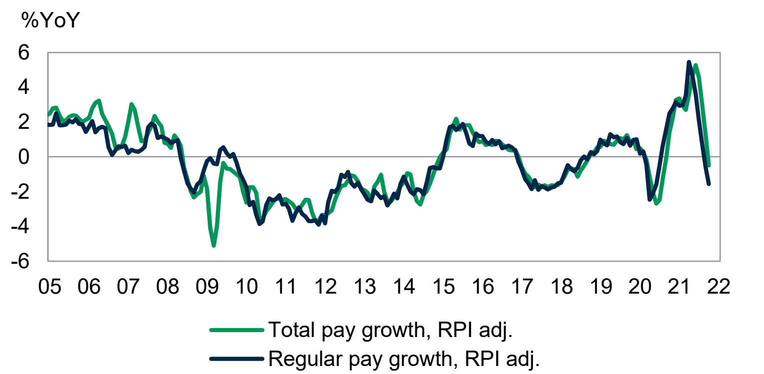
Sources: BoE, Crédit Agricole SA / ECO

Retail sales are surging again (volumes)



Sources: ONS, Crédit Agricole SA / ECO

The squeeze in real earnings growth has only just begun

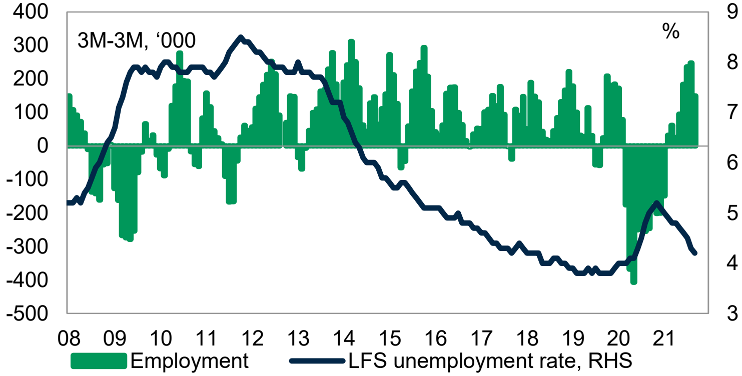


Sources: ONS, Crédit Agricole SA / ECO

LATEST ECONOMIC TRENDS

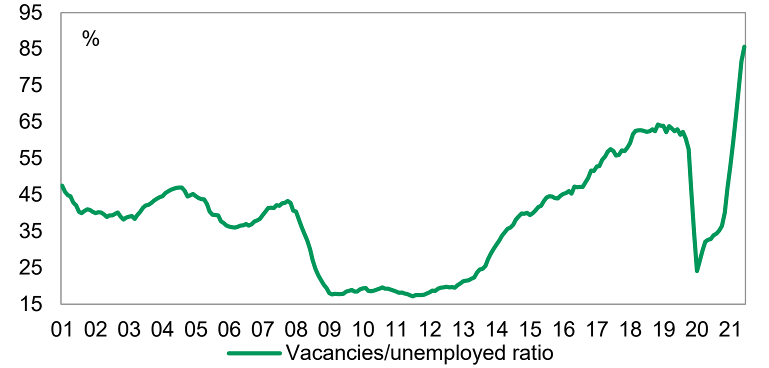
THE LABOUR MARKET HAS TIGHTENED FURTHER

Unemployment rate down to 4.2% amidst still low participation rate (63.3%)



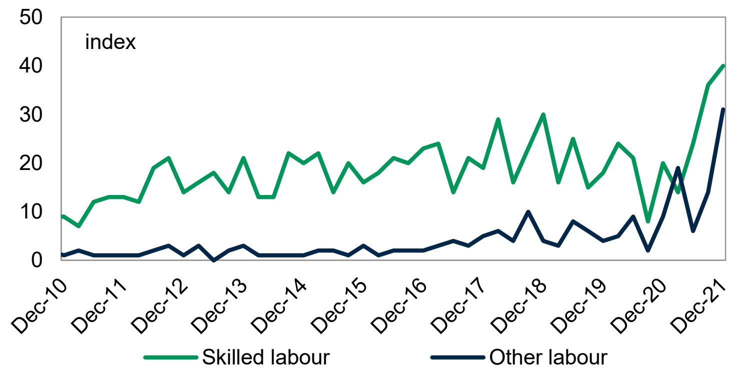
Sources: ONS, Crédit Agricole SA / ECO

Vacancies are up to new record highs



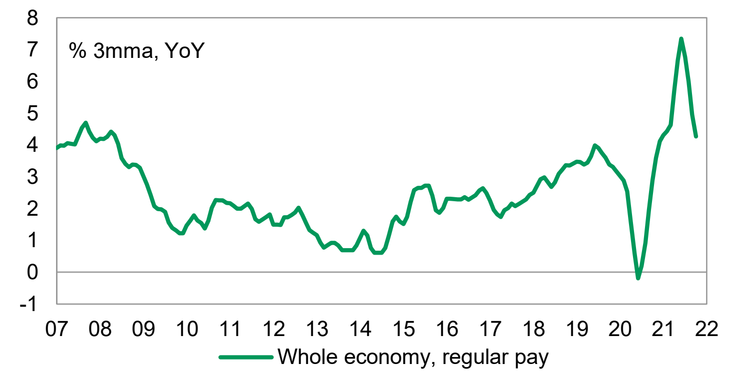
Sources: ONS, Crédit Agricole SA / ECO

Recruitment difficulties have strengthened and broadened, owing to the pandemic and Brexit



Sources: CBI, Crédit Agricole SA / ECO

Wage growth has fallen as base and compositional effects have largely been phased out



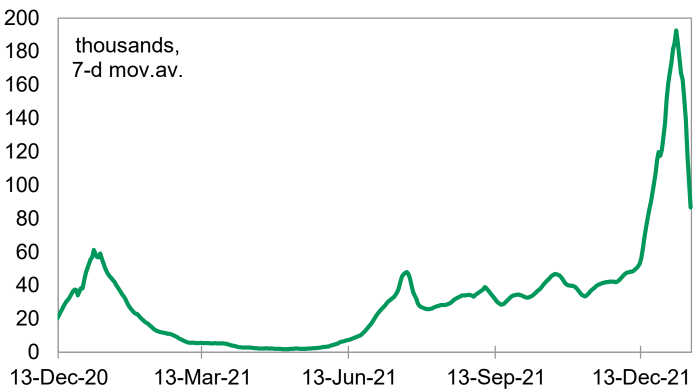
Sources: ONS, Crédit Agricole SA / ECO

CONTENTS

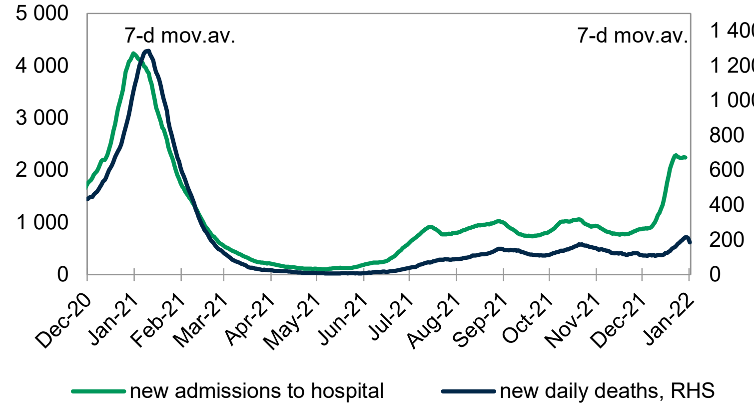
THE BASIS OF OUR SCENARIO

THE OMICRON WAVE WILL HOPEFULLY RECEDE IN THE COMING WEEKS

Covid-19 new infections in the UK

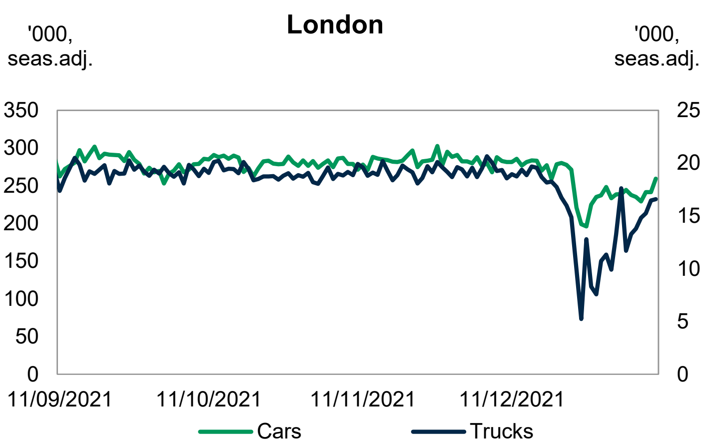


Hospitalisations and deaths

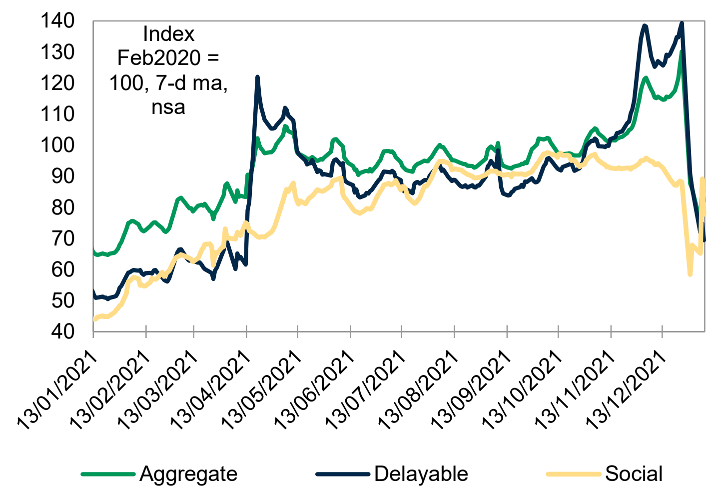


Sources: gov.uk, data as of 13 January 2022, Crédit Agricole SA / ECO

Traffic camera activity



Spending on credit and debit cards

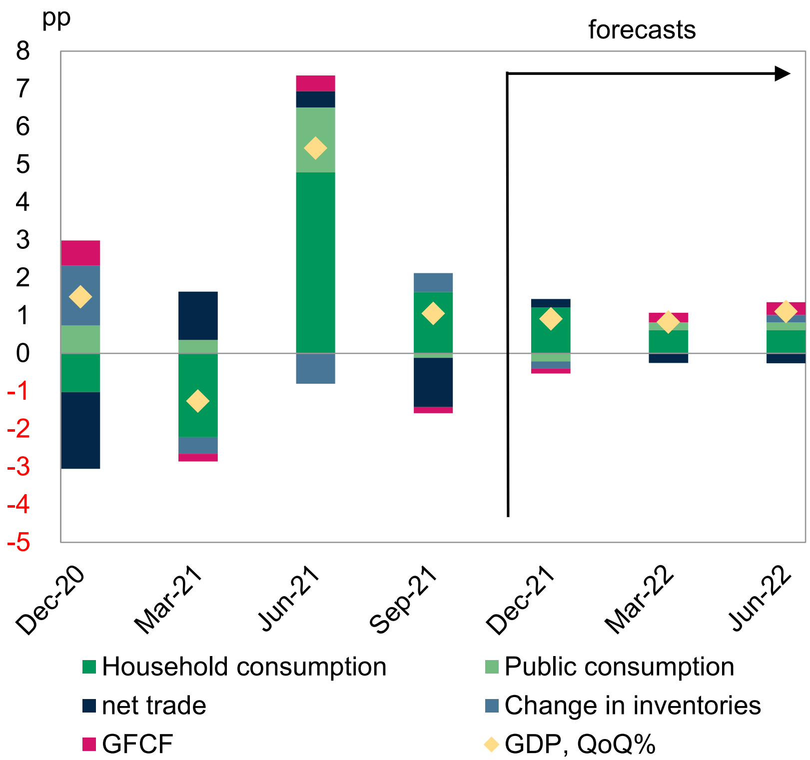


Sources: ONS

THE BASIS OF OUR SCENARIO

THE RECOVERY SLOWS AS PANDEMIC SUPPORT IS WITHDRAWN AND COST OF LIVING RISES

Contributions to quarterly GDP growth: expenditure breakdown



Sources: ONS, Crédit Agricole SA / ECO

We expect the quarterly growth rate to continue slowing slightly in Q421 to 0.9% QoQ after 1.1% QoQ in Q3 and 5.4% QoQ in Q2, due to the spread of Omicron and the persistent supply-side constraints on output. We expect growth to remain weak in Q122 before some acceleration in spring as the spread of Omicron is brought under control and supply-side issues ease.

Household consumption is likely to remain the key driver to growth. There are still significant tailwinds to household consumption such as the improvement of the labour market, the accumulated savings during the pandemic and a still high savings ratio, but the near-term outlook is challenging due to rising living costs with energy prices up significantly and planned tax increases (national insurance, income tax, corporation tax). Inflation is expected to rise above 6% in Q222 due to another expected sharp increase in gas and electricity prices in April. Inflation is likely to stay above target this year and next, but to fall towards the 2% target in the medium term.

We expect a rebound in business investment growth this year 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. However, we do expect some improvement there as global growth strengthens in the coming months, logistic issues ease and the UK government implements the remaining custom controls on its imports from the EU.

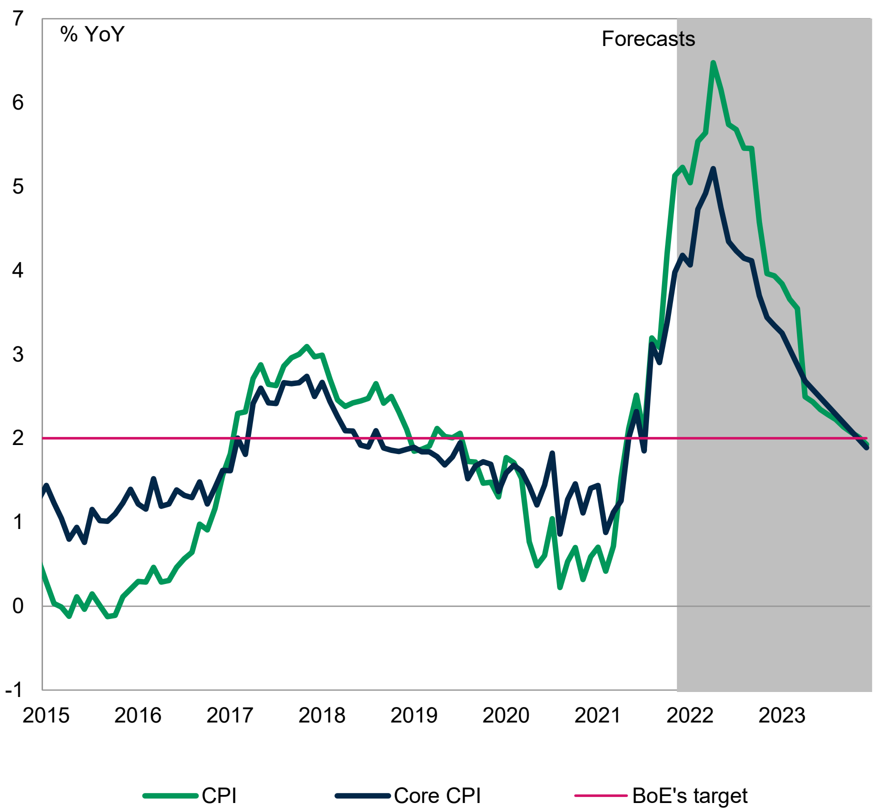
Crucially, policy mix will be less accommodating in the coming months as the BoE has started its monetary policy normalisation and fiscal policy is tightening.

Risks to the scenario remain tilted to the downside. Unfortunately, the UK case highlights the fact that available vaccines are less effective against new variants than thought previously. 'Polyvalent' vaccines against Covid are not foreseeable before 2025-26 meaning that the pandemic could persist for years to come. This has implications for inflation as the pandemic is likely to continue to disturb global supply-chains, pushing up costs and prices. Rising and persistent inflation in turn poses risks of political crisis and social unrest.

THE BASIS OF OUR SCENARIO

A BIG INFLATION BOOST TO COME IN APRIL 2022 FROM ENERGY PRICES

CPI inflation expected above 6% in April due to a big jump in retail gas and electricity prices



Sources: ONS, Crédit Agricole SA / ECO

CPI inflation reached 5.1% YoY in November 2021 (core at 4%). Although contributions were broad-based, chief factors were energy prices and rising prices of second-hand cars. As such, **the elevated inflation still appears driven to a large extent by temporary factors**.

Retail energy prices are set to rise sharply in April 2022. Reflecting the sharp rise energy prices in the first half of 2021, the UK's energy regulator Ofgem increased the tariff caps on retail gas and electricity prices by around 17% and 9% respectively from October. Ofgem will update its tariff caps again in April and the recent moves in wholesale energy prices suggest that retail gas prices may increase by around 50% in April. This is expected to push CPI inflation above 6% in April and core inflation above 5%.

The rise in energy prices has put the government under mounting pressure to ease the cost of living and several measures are currently under discussion including a VAT cut on energy bills from 5% to 0%, expanding the warm homes discount scheme, targeted-funded payments to poorer households and more recently a one-off windfall tax on North Sea oil and gas production companies pledged by Labour and Liberal Democrats.

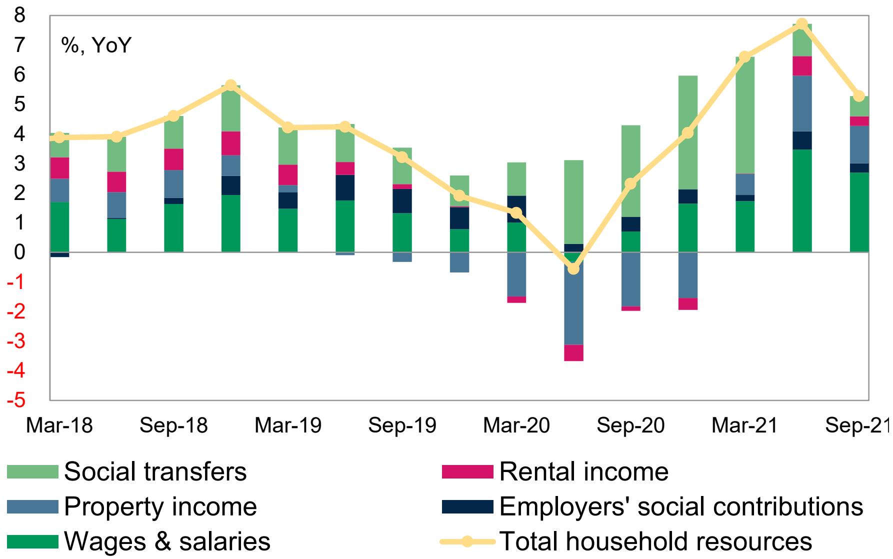
Inflation is expected to gradually fall in the medium term assuming that wholesale energy prices fall as suggested by future prices. They will put downward pressure on retail energy price inflation from 2023, thereby reversing the impact on real incomes. We expect CPI inflation to remain high this year but to fall toward target by the end of 2023.

Risks now appear more balanced than before. To the upside, wholesale energy prices may increase further and supply-side tensions may appear more persistent. To the downside, household consumption may weaken more than expected due to weaker income growth and rising living costs.

THE BASIS OF OUR SCENARIO

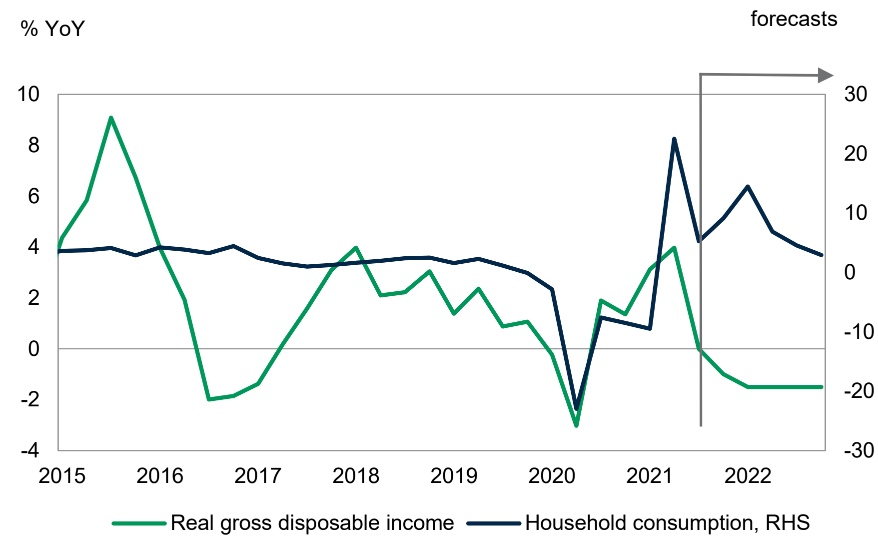
HOUSEHOLDS BRACE FOR A DIFFICULT SPRING: A BIG INCOME SQUEEZE COMES IN APRIL

Household resources should continue to decelerate as wage growth moderates and social transfers weaken



Sources: ONS, Crédit Agricole SA / ECO

Growth in real gross disposable income to become negative in 2022, weighing on consumption



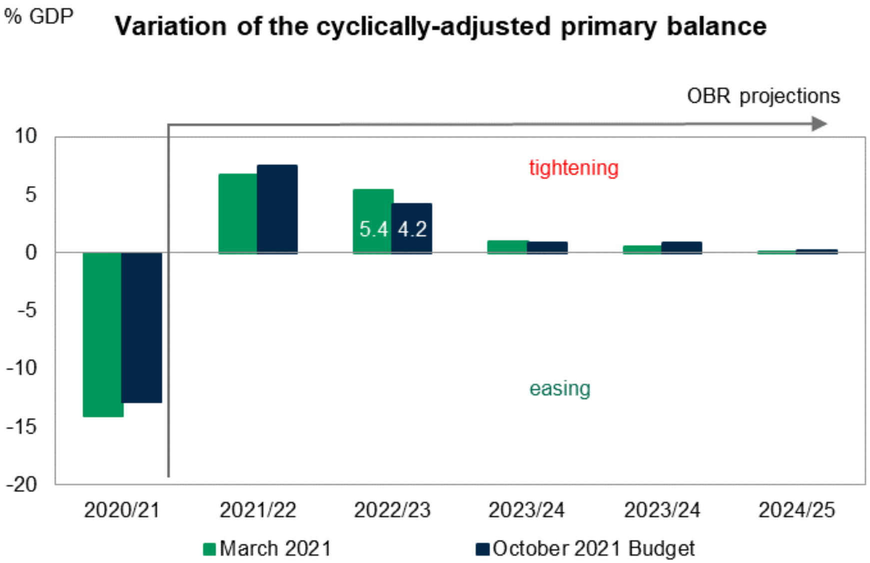
Sources: ONS, Crédit Agricole SA / ECO

Moderating wage growth, rising energy prices and significant tax increases planned for April 2022 are expected to significantly hit real household disposable income. Household balance sheets are no longer protected by the large fiscal transfers seen during the pandemic and liquidity support. The furlough scheme ended at the beginning of October, VAT rates in hospitality and accommodation were raised (from 5% to 12.5%) and the GBP20 a week boost in universal credit was removed. Households will face further significant rises in taxes in April 2022. The VAT rate for hospitality and accommodation is set to return to the standard 20%. Most importantly, national insurance contributions will rise by 1.25%. April also marks the start of a four-year freeze in the income thresholds and allowances. The Resolution Foundation estimates that alongside soaring energy bills, those tax changes will result in an average extra cost of GBP1200 in April per household, ie, a huge squeeze in living standards. The budget on 27 October included some welcomed offsetting supports – including a 6.6% increase in the National Living Wage from April 2022 and changes to the universal credit (through higher work allowances and reduced taper). While those changes are expected to boost incomes for the poorest people, they are far from offsetting the other rises in taxes. What is more, the main corporation tax is planned to increase substantially in April 2023 (from 19% to 25%) and its burden is likely to be partially borne by workers. On the bright side, the labour market should remain resilient and underpin consumer confidence. High savings accumulated during the crisis will also allow households to support consumption compensating for the fall in real incomes.

THE BASIS OF OUR SCENARIO

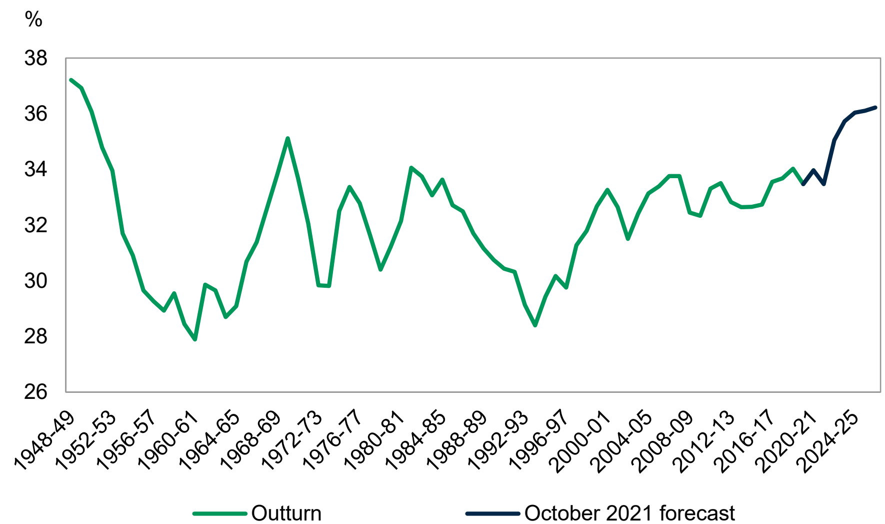
FISCAL STANCE TURNING CONTRACTIONARY

UK planned fiscal tightening has been eased next year though still remains substantial



Sources: OBR, Crédit Agricole SA / ECO

Tax-to-GDP ratio to rise to record high since the 1950s



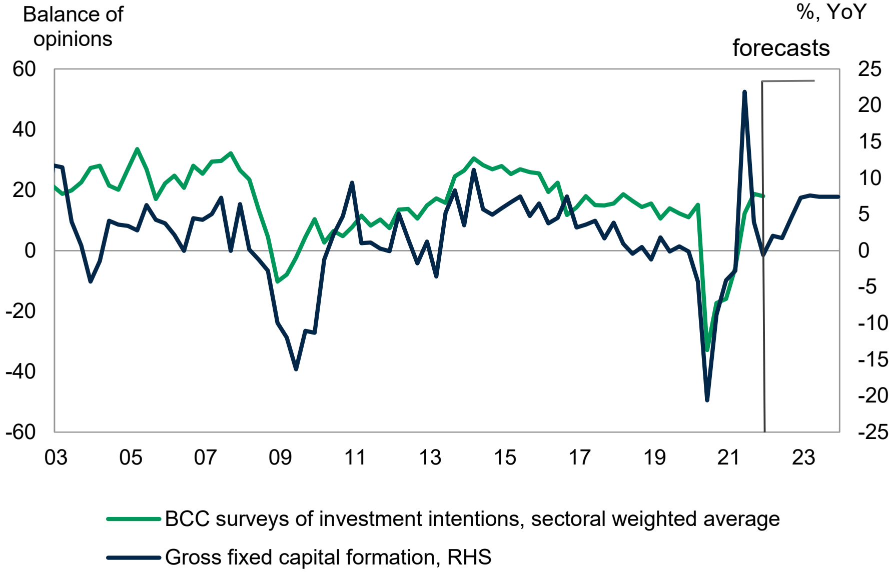
Sources: OBR

In the October Budget and Spending Review the government announced a significant and unanticipated discretionary increase in both the size of the post-pandemic state and the tax burden. In particular, it delivered a large and sustained increase in public spending (GBP23bn a year until 2026-27) which, according to the OBR, is expected to take public spending from 40% of GDP before the pandemic to 42% of GDP in FY 2026-27, the largest since the late 1970s. This is partially financed by a further net tax rise (GBP17bn a year) in the form of the introduction of a health and social care levy of 1.25% on employees, employers and self-employed. Alongside tax rises announced by the Chancellor in March 2021 (to the main corporation tax and to income tax personal allowance and thresholds), this implies that the tax burden as a share of GDP is now expected to increase from 34% pre-pandemic to 36% in FY 2025/26 – its highest level since 1950. The large rises in public spending announced in the October budget imply a significant cut to the planned fiscal tightening in 2022-23 (by 0.8% of GDP). The OBR estimates that this lesser degree of tightening will boost GDP by 0.4% over the 2022-23 fiscal year. Even so, the UK remains on course for a relatively rapid fiscal consolidation with a structural primary fiscal deficit set to fall to from an expected 6.7% of GDP in the current fiscal year (ending in March 2022) to 1.6% of GDP in FY 2023-24.

THE BASIS OF OUR SCENARIO

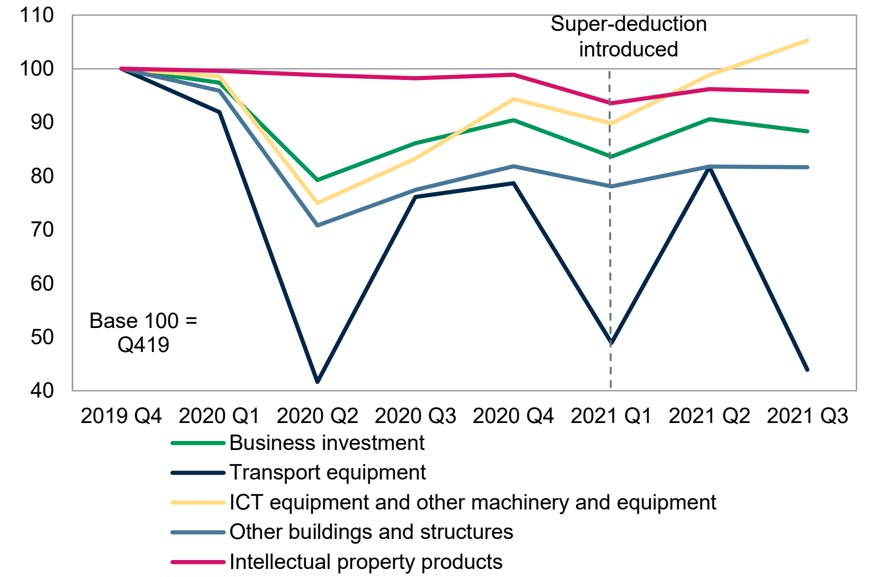
UNCERTAINTIES HELD BACK BUSINESS INVESTMENT PROSPECTS

Investment intentions have recovered to pre-crisis levels



Sources: BCC, ONS, Crédit Agricole SA / ECO

The "super deduction" has probably had an effect in the IT sector



Sources: ONS, Crédit Agricole SA / ECO

Business investment has remained a laggard in the UK recovery. In Q321, it was still almost 12% below its Q419 level after having fallen by 2.5% QoQ, while dwellings investment and general government investment have largely recovered. However, surveys of investment intentions have been improving steadily since their trough in Q220 and business confidence as a whole has remained relatively strong despite the challenges. Therefore, and given the gap that remains to be recovered, we continue to anticipate recovery in investment in our scenario, but due to Omicron it will probably wait until Q122 or Q2 to manifest itself. Businesses that continued to be adversely affected by Covid likely continued to limit investment. Investment performance was held back by investment in transport equipment (it remains 56% below its pre-crisis level) and other buildings and structures (-19%). On the contrary, investment in IT equipment and other machines and equipment has grown strongly and in Q3 stood 5% above its pre-crisis level. The introduction in April 2021 of a generous temporary uplift in capital allowances (a 130% 'super deduction' available for two years on most types of investment in plant and machinery) is likely to boost business investment in 2022 as companies are encouraged to bring forward investment from future periods. However, the impact is likely to be less than initially expected due to the persistent uncertainties stemming from Covid and Brexit and the prospects of rising interest rates. 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.

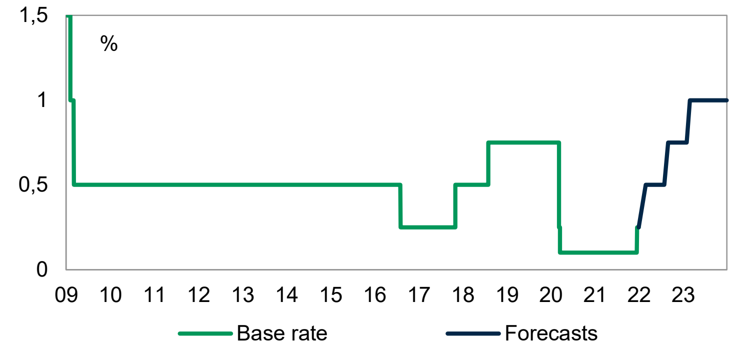
BANK OF ENGLAND: MONETARY POLICY TIGHTENING SUPPOSED TO BE "MODEST"

The BoE has become increasingly difficult to anticipate. Despite Omicron and after having left rates unchanged in November against consensus expectations for a lift-off, the MPC changed course in December and raised the base rate by 15bp to 0.25%. This was a surprise for most of the consensus – us included – which was expecting the initial rate hike to be postponed until February 2022 considering the Omicron-related uncertainty. This hike confirms the BoE as the most hawkish of the major central banks in the advanced economies, even though its economy has been recovering more slowly from the Covid crisis.

Rate hike justified by a solid labour market and rising inflation expectations. The BoE had indicated that any rate hike would be contingent on reassuring labour market progress following the end of the furlough scheme. The labour market continued to tighten, with unemployment falling and vacancies and hiring difficulties hitting new record highs. Households' and financial markets' medium- to long-term inflation expectations have increased. The BoE fears that not acting promptly may lead to more persistent inflation and a continued rise in inflation expectations, which would force it to raise rates more aggressively later on.

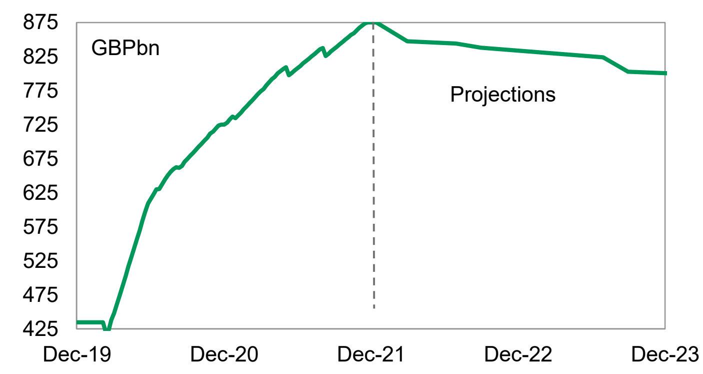
What pace of tightening ahead? According to the BoE, "modest" tightening is likely to be necessary in order to sustainably bring inflation back down to its 2% target. Its November inflation projections, suggest that the tightening priced in by the markets at that time (Bank rate at 1% at the end of 2022) is compatible with its inflation target. We are forecasting a slightly slower pace of tightening, with the Bank rate reaching 1% in 2023 only. Rate hikes will probably be accompanied by quantitative tightening. According to its new forward guidance regarding the QE, the BoE will probably stop reinvesting maturing assets once the Bank rate reaches 0.50% (likely in February). "Provided that economic conditions warrant it", it may begin to actively sell these assets once the Bank rate reaches 1.00%.

Key policy rate



Sources: Thomson Reuters, Crédit Agricole SA / ECO

Stock of holdings of gilts at the BoE's APF if maturing gilts are not reinvested



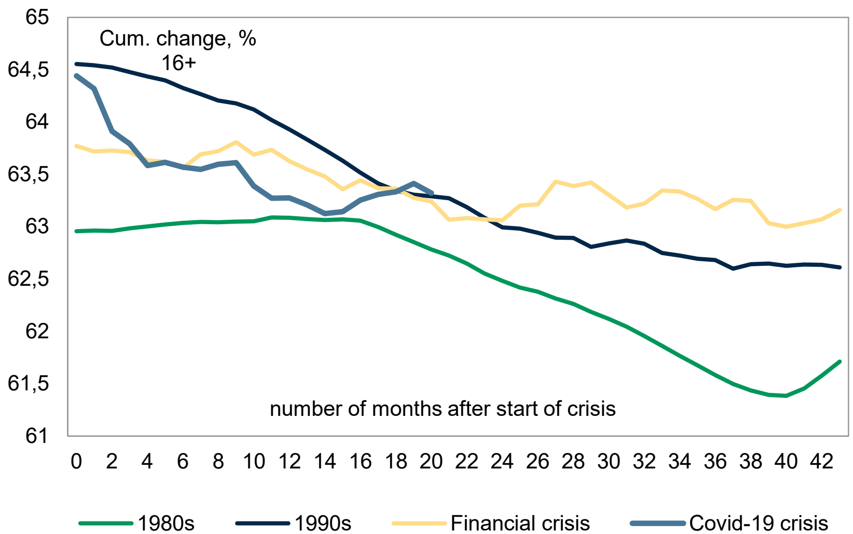
Source: BoE, Bloomberg, Crédit Agricole SA / ECO

CONTENTS

FOCUS ON LABOUR FORCE PARTICIPATION

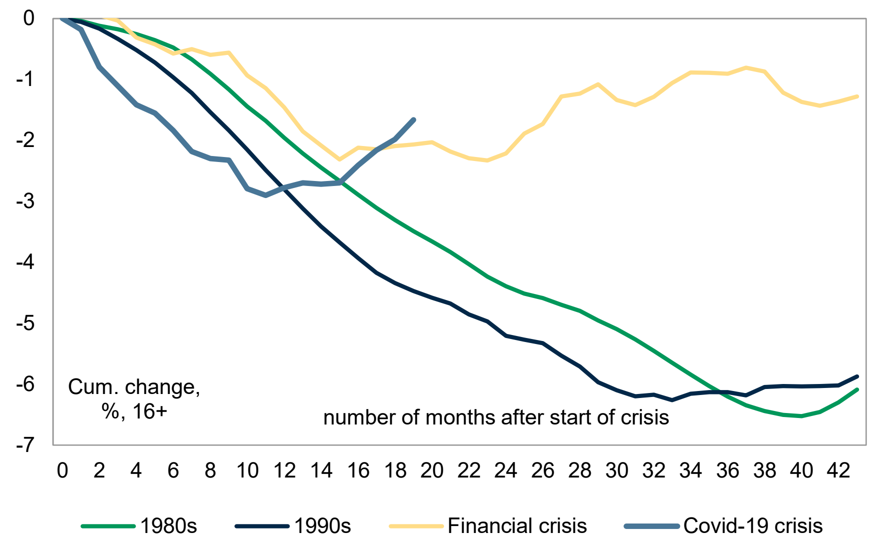
THE PARTICIPATION RATE REMAINS WEAK

The participation rate has fallen more rapidly during this crisis than in previous recessions …



Sources: ONS, Crédit Agricole SA / ECO

Employment has been relatively preserved during the pandemic, but still fell significantly



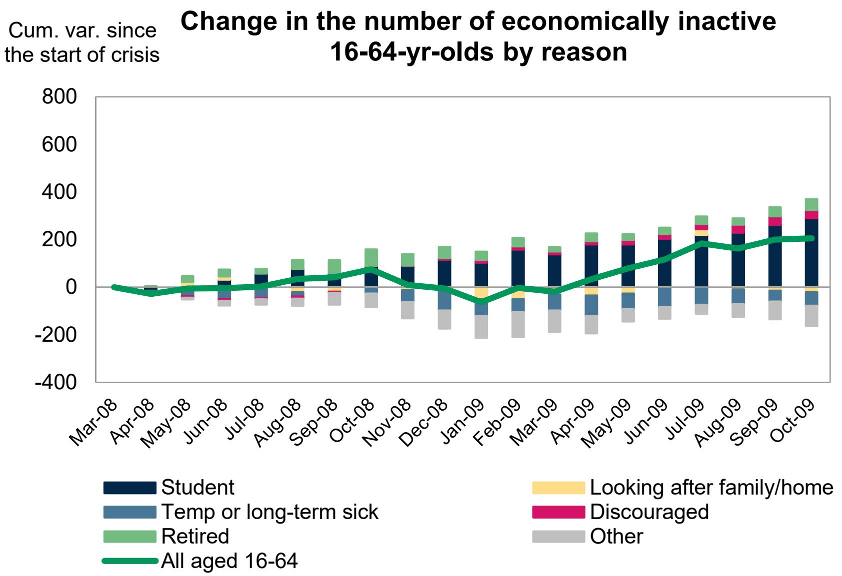
Sources: ONS, Crédit Agricole SA / ECO

As unemployment has continued to surprise positively, it has become increasingly evident that it will likely not be the primary lasting challenge for the labour market post-pandemic. Another form of worklessness, namely elevated inactivity (people not working or not looking for a work) may instead be a bigger challenge as the longer it persists, the greater the scarring effects of pandemic are on potential growth. Inactivity rose significantly during the Covid-19 crisis and has stayed relatively high during the economic recovery that has followed. The government's furlough scheme has been successful in holding down the unemployment rate, as employers could keep people in jobs that otherwise might have been made redundant. However, not all people that leave their job become unemployed, many choose to become inactive, thereby contributing to a decline in the participation rate. During the first year of the Covid-19 crisis, the participation rate fell sharply (-1.2pp) and more rapidly than during past recessions (-0.7pp in the 1990s recession, -0.2 pp in the equivalent period of the global financial crisis. Despite some tentative signs of recovery recently, there were still more than 8.75m people aged between 16 and 64 years that were inactive in the three months to October, vs 8.37m at the onset of the pandemic, representing a rise of 376k people among this age group. This results in an inactivity rate (number of people aged 16 to 64 divided by the population aged 16-64) of 21.2%, 1 pp higher than before the crisis. Compared to the fall in activity, the fall in net migration during the pandemic (-170k according to OBR's estimates) appears a much less significant factor explaining the labour shortages reported by business surveys.

FOCUS ON LABOUR FORCE PARTICIPATION

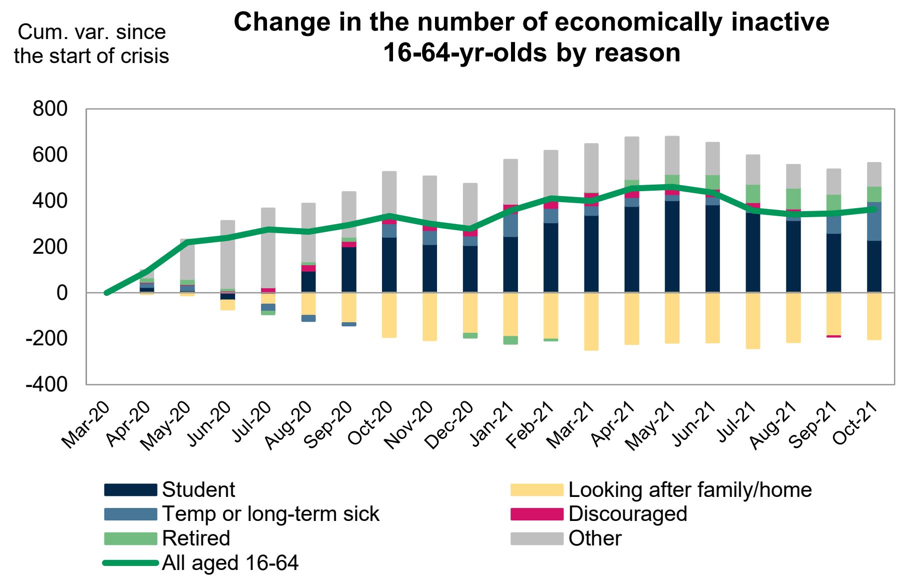
REASONS FOR INACTIVITY

Financial crisis 2008-09



Sources: ONS, Crédit Agricole SA / ECO

Covid-19 pandemic crisis



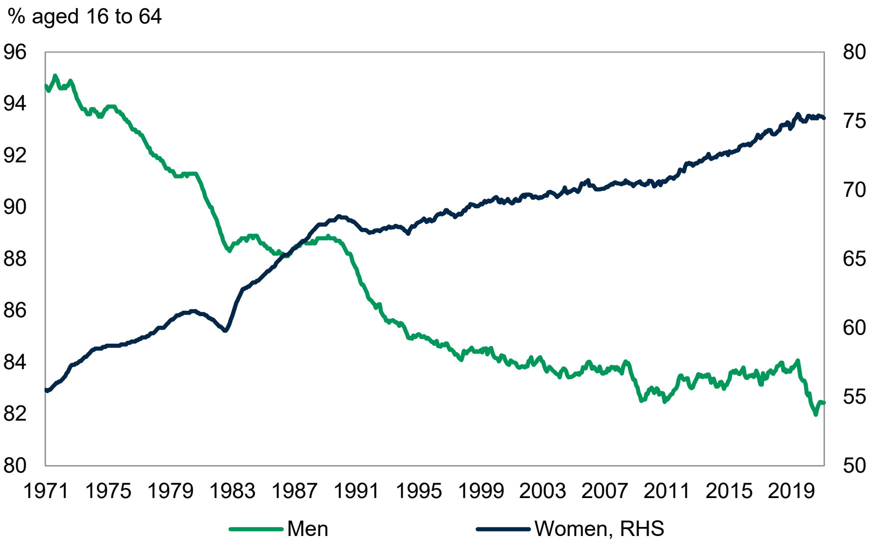
Sources: ONS, Crédit Agricole SA / ECO

We compare the reasons of inactivity with the financial crisis 2008. The ONS data shows that the rise of inactivity during the financial crisis was almost entirely explained by students. The number of students increased during the pandemic crisis (to an even bigger extent), but was not the unique driver of the rise in the inactivity rate. There were two additional drivers: (1) inactivity due to illness (the large majority being long-term illness) and (2) inactivity for "other reasons". The ONS estimates that in October 1.2m people (1.9% of the population) were still suffering from long Covid symptoms (persisting for more than four weeks after the first suspected Covid-19 infection). Regarding those people who said they were inactive for 'other reasons', they likely included, among other, those who do not want to work because of the fear of catching the virus. On the other hand, the number of people inactive for family reasons has fallen. Analysis of from the Resolution Foundation shows that labour force participation among women under 40, particularly those with children, has risen during the pandemic, in part thanks to the greater use of remote working. On aggregate, labour force participation among women has risen during the pandemic while it has fallen among men, thereby prolonging a pre-crisis of trend of increasing female participation.

FOCUS ON LABOUR FORCE PARTICIPATION

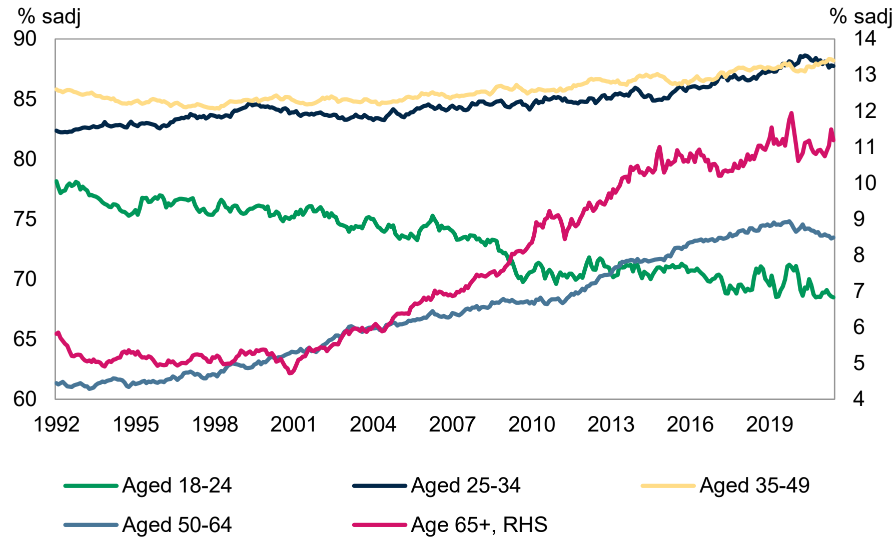
PARTICIPATION IN TERMS OF GENDER AND ACROSS AGE GROUPS

Economic activity rate of men has fallen during the pandemic contrary to women



Source: ONS

The youngest and the older have seen the biggest falls in participation



Source: ONS

The fall in the participation rate during the Covid-19 crisis has been the highest among the youngest (16-24-year-olds) and older worker-age people (50+). While the falling activity rate among the young is a well-established pattern during past crises, the shutdown of sectors like hospitality and retail has led to falls in the number of people working while studying. By contrast, the fall in participation among the older is unusual: their participation rose after the financial crisis. An analysis of The Resolution Foundation shows that while both women and men in their 50s have seen large falls in participation during the pandemic, the impact of the crisis was particularly bad for older women's employment relative to previous recessions. A complete recovery of the participation rate is highly uncertain. There are divergent views among institutions on the most likely path. Inactivity among students is likely to recover with the reopening of the economy. However, this is less certain for older people. The weakness in their participation rate could be permanent (which is the OBR's view), or it could recover if and when the perceived risks with the virus diminish significantly (which is the BoE's view). We believe that an increase in the participation rate among the aged 50+ group is likely, but it will be gradual (as it typically takes longer for older people to find a job after having left the workforce completely and often at lower pay). At the same time, the possibility of working at home could allow more people with caring responsibilities to participate in the labour market. Digitalisation is also likely to continue favouring sectors where remote working is possible.

CONSULT OUR LAST PUBLICATIONS

Date	Title	Theme
14/01/2022	Spain – 2021-2023 scenario: New year, new uncertainties	Spain
14/01/2022	France – 2021-2023 Scenario: recovery firms, despite uncertainty	France
14/01/2022	Germany – 2021-2023 scenario : Winters roll by, but each one is different…	Germany
14/01/2022	Can reindustrialisation bring freedom from dependence?	World
20/12/2021	World macro-economic scenario 2022-2023: betting on a successful double normalisation	World
16/12/2021	The risk may not be what you think it is	Inflation
09/12/2021	Country and sovereign ratings: new risks, new methods?	Rating
01/12/2021	Global economy – One Belt, One Road, new paths?	Geopolitics

ECO
ÉTUDES ÉCONOMIQUES GROUPE

Slavena Nazarova
+33 1 43 23 21 40
slavena.nazarova@credit-agricole-sa.fr

Completed on 18 January 2022

THANKS FOR YOUR ATTENTION

YOU CAN SUBSCRIBE TO OUR PUBLICATIONS ON OUR WEBSITE :
http://economic-research.credit-agricole.com/

Access and subscribe to our free online publications:
application available in App Store and in Google Play

Crédit Agricole S.A. — Group Economic Research
12 place des Etats-Unis – 92127 Montrouge Cedex

Publication Manager: Isabelle Job-Bazille - **Chief Editor:** Armelle Sarda
Information centre: Dominique Petit - **Statistics:** Robin Mourier
Editor: Fabienne Pesty
Contact: *publication.eco@credit-agricole-sa.fr*