A BELATED AND UNCERTAIN ECONOMIC RECOVERY

Due to the late implementation of lockdown measures, the UK was hit hard by the Covid-19 pandemic. Consequently, the country is reopening after its European neighbours, and its economy has been particularly affected. The return to pre-crisis levels will therefore be long and difficult. What's more, the risk of a protracted crisis is all the greater due to two major threats looming on the horizon: a second wave of the pandemic requiring lockdown measures to be imposed again; and failure to negotiate a free-trade agreement with the European Union before the end of the year.

Because the government waited before implementing lockdown measures, the Covid-19 pandemic spread rapidly throughout the UK. With close to 45,000 deaths, it is the world's third hardest-hit country and Europe's most affected country. Consequently, the lockdown – which was finally imposed on 23 March – has been particularly long. While they reopened in early May in France and Germany, non-essential businesses only started welcoming customers again in mid-June in the UK, while bars and restaurants had to wait until early July. That said, although the authorities were slow to introduce lockdown measures, they were quicker when it came to economic support packages.

THE STATE TO THE RESCUE...

To counter the coronavirus health crisis, the UK government first allocated about GBP 15 bn for public services – with a particular focus on the healthcare sector.

Faced with a looming economic crisis, the government then took measures to support companies and households. Rishi Sunak, the Chancellor of the Exchequer, promised GBP 330 bn in guarantees for loans to companies, and added that the amount would be increased as needed. So far, these programmes have provided more than GBP 40 bn in financing (see table 1). What's more, the chancellor announced on 8 July a plan for jobs worth GBP 30 bn.

As far as households are concerned, the government launched the Coronavirus Job Retention Scheme (CJRS) and the Self-Employed Income Support Scheme (SEISS), which should mobilise funds of about GBP 80 bn. The job retention scheme has been extended until October, although the percentage of wages covered by the government, as well as the maximum amount of compensation, will gradually diminish.

...WITH SUPPORT FROM THE BANK OF ENGLAND

The Bank of England (BoE) has taken action on all fronts. It has cut its key rate by 65 basis points (bp) to an all-time low of 0.10%. It has also significantly expanded its quantitative easing programme. While before the crisis the central bank was targeting a stock of GBP 435 bn in bond purchases – primarily sovereign bonds – it has since raised this figure to GBP 745 bn. At the same time, it has created funding schemes for banks and building societies (Term Funding Scheme with additional incentives for SMEs – TFSME) as well as for companies (Covid Corporate Financing Facility – CCFF) and launched a liquidity support facility for market participants (Contingent Term Repo Facility – CTRF) (see table 2). Lastly, the BoE negotiated swap agreements with the US Federal Reserve and extended the use of the Ways and Means Facility, which allows the government to directly seek short-term financing from it.

Although the bank and corporate financing schemes (TFSME and CCFF) will last a few more months, the BoE has already begun to withdraw its support from other segments. The liquidity support programme (CTRF) was discontinued on 26 June, and the frequency of USD-liquidity providing operations was reduced from daily to only three times a week since July.

GROWTH AND INFLATION (%)

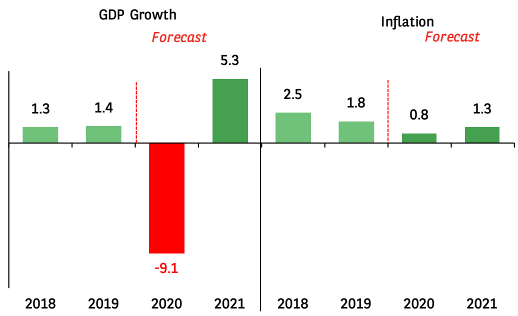

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

FISCAL SUPPORT PACKAGES (AT 28 JUNE, GBP BN)

• **Guarantees on corporate loans**	
- *Bounce Back Loan Scheme (BBLS)*	29.5
- *Coronavirus Business Interruption Loan Scheme (CBILS)*	11.1
- *Coronavirus Large Business Interruption Loan Scheme (CBILS)*	2.3
- *Future Fund*	0.3
• **Job retention scheme and support for the self-employed**	
- *Coronavirus Job Retention Scheme (CJRS)*	25.5
- *Self-employed Income Support Scheme (SEISS)*	7.7
• **Payment deferrals**	
- *VAT payments deferral scheme* (outstanding at 7 June)	27.5

TABLE 1 SOURCE: GOVERNMENT

MONETARY SUPPORT PROGRAMMES (AT 24 JUNE, GBP BN)

• **Refinancing for banks and building societies**	
- *Term Funding Scheme with additional incentives for SMEs* (TFSME)	14.2
• **Corporate financing facility**	
- *Covid Corporate Financing Facility* (CCFF)	18.6
• **Liquidity support for market players**	
- *Contingent Term Repo Facility* (CTRF)	11.4
• **Swap agreements with the US Federal Reserve**	
- USD repo operations	7.7

TABLE 2 SOURCE: BANK OF ENGLAND

A SLOW RECONSTRUCTION PROCESS

The UK economy was hit hard by the protracted lockdown, as illustrated by figures released by the Office for National Statistics (ONS). After declining by nearly 6% in March, GDP plummeted by more than 20% in April, the first full month of lockdown. That is the biggest monthly decline since the series began in 1997 (see chart 2).

Of course, the figures for the next few months are bound to show signs of improvement, as the economy reopens and the various fiscal and monetary support programmes start to kick in.

Nonetheless, it will probably take a long time for the UK economy to return to pre-crisis levels, and its economic hardships will not end with renewed GDP growth. Thanks to the job retention scheme (CJRS) and support for the self-employed (SEISS), which have benefited nearly 12 million people, the unemployment rate held steady at 3.9% between February and April. That said, this figure also reflects a contraction of the workforce. In addition, more than 600,000 employees lost their jobs during the lockdown. Given the scope of the economic crisis and the imminent ending of government support programmes, unemployment will inevitably rise sharply in the months to come. The Office for Budget Responsibility (OBR) is forecasting a surge in the unemployment rate to 10% in Q2 2020[1].

UNITED KINGDOM GDP (INDEX VOLUME, BASED 100 = AUGUST 2016)

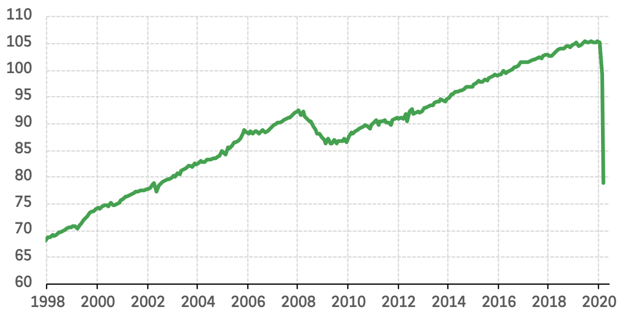

CHART 2

SOURCE: ONS

TWO MAJOR RISKS LOOM ON THE HORIZON

The size of the rebound is all the more uncertain due to two threats looming over the UK economy. The first is the risk of a second wave of the virus requiring lockdown measures to be restored – a scenario which possibility was recently reiterated by leading health professional groups[2]. According to the OECD[3], GDP growth would contract by about 14% in 2020 in that scenario, as opposed to 11.5% without a second wave of the virus.

The second risk is the failure of negotiations on a free-trade agreement between the UK and the EU. This risk is all the greater now that the UK has officially rejected the extension of the current transition period beyond the end of the year (see box).

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FOUR QUESTIONS ABOUT BREXIT

- **What is the UK's current position towards the EU?**

Although the UK officially left the European Union on 31 January 2020, it has entered a transition period through the end of the year to give the two parties time to reach an agreement on the nature of their future relationship. During the transition, the UK remains a member of the EU's single market and customs union, and the European Treaties continue to be binding. In brief, what we have seen is only a "political Brexit", while the "economic Brexit" is yet to come.

- **Where do things stand in terms of negotiations?**

After four rounds of negotiations, little progress has been made. Michel Barnier, the head of the European Commission's Task Force for Relations with the United Kingdom, has repeatedly pointed out the lack of commitment from his UK counterparts. According to him, that is particularly true in four areas: rules of economic and commercial fair play (the counterpart to the EU's proposal of a no-tariff, no-quota trade agreement), access to fishing waters and markets, police and judicial cooperation in criminal matters, and governance of the future relationship. Indeed, the British seem to be backtracking on certain commitments that were already made as part of the Political Declaration, such as the agreement to maintain the highest common standards applicable between the EU and the UK.

- **What next?**

Given the lack of progress on negotiations, a high-level meeting was held on 15 June between UK Prime Minister Boris Johnson, and Ursula von der Leyen, Charles Michel and David Sassoli, presidents of the European Commission, European Council and European Parliament, respectively. During the meeting, all parties took note of the UK's decision not to request an extension of the transition beyond 31 December 2020. As a result, they decided to intensify their talks in July and August. According to the EU, an agreement must be reached by 31 October in order for it to be ratified in time.

- **What are the possible scenarios?**

The negotiations can lead to two main outcomes, with a myriad of possibilities in between. The outcome that would create the least disruption would be a free-trade agreement with no customs duties. Yet that would still be a "hard" Brexit, as the UK would exit both the EU single market and customs union. At the other extreme, failure to reach a deal would result in the application of basic World Trade Organisation rules. This means that the hardest possible Brexit is still a very real possibility, which raises the risk of high financial market volatility and major economic difficulties towards the end of the year.

1 See https://obr.uk/coronavirus-analysis
2 See https://www.bmj.com/content/369/bmj.m2514
3 http://www.oecd.org/economic-outlook/june-2020