State of play

13 August 2020

Our Investment Specialist Simon Durling shares his thoughts in our latest update. After this edition, Simon (and the weekly update) are taking a well-deserved summer break - see you again in September!

Future unemployment levels may hold the key to the economic recovery

It is 140 days since the lockdown was announced on 23 March forcing millions of employees to work from home and millions more onto a furlough scheme aimed at maintaining a connection between employer and employee to protect jobs. The support offered by the UK Government has been an unprecedented financial intervention costing the tax payer many billions in borrowings which at some point in the future will have to be repaid, probably by the next generation or potentially even the generation yet to be born.

We are fast approaching the crucial stage at which we learn how effective this scheme has been and how many employees will have been saved from almost certain redundancy and how many unlucky ones who, although supported through the worst of this crisis, will be looking for a new job at the end of the scheme on 31 October. Crucially the knock-on effect of mass job losses doesn't just impact the individuals unfortunate enough to have been made unemployed. It creates a shift in mindset for millions who have held onto their jobs, but fear they may be next.

Job uncertainty can be as devastating for the economy as the job losses themselves. Long-term financial decisions about buying or moving home are put on hold. Upgrading your car or phone along with home improvements may be put back onto the wish list. The type of holiday you book and the location may be downgraded, assuming you are able to go at all. Consumer behaviour moves from spending to

saving - which has already been witnessed on an unprecedented scale during the lockdown.

The UK economy has been recognised as a 'job making machine' since the financial crisis and especially in the last four years since the European Union (EU) Referendum result in 2016, with the joint highest employment level of 76.4% recorded in March by the Office for National Statistics (ONS). They announced that 730,000 jobs were lost between March and July which is the largest fall since 2009, following the financial crisis. Whilst this data would point to an unemployment rate rise, this remained flat at 3.9%.

'The relative flatness of the unemployment figures may seem surprising. However, to be unemployed someone has to say that they do not have a job and that they are currently actively seeking and available for work' the ONS said. Thousands of individuals have become economically inactive over this period. Economic inactivity increased by 82,000 to 8.44 million during the quarter.

The furlough scheme is masking how the economy is performing. When you assess the number of hours worked, a different perspective reveals itself. People still count as employed if they are furloughed or temporarily away from a job and receiving no pay. The ONS said that 7.5 million people, or 27% of employees, currently fell into these categories. This caused the number of hours worked in the economy to fall to a record low of 25.8 hours a week. The quarterly fall of 18.4% of hours worked each week on average was a record and is now at its lowest level since 1994.

Many parents who would have ordinarily worked part time had to stop because their children have been at home due to school closures. They are unable to work and are not currently seeking work until perhaps their children return to school in September. In addition many who are very young and still living with parents and those who are older and perhaps semi-retired working part-time have simply stopped working. While unemployment has barely risen so far, the Bank of England expects the jobless rate to almost double to 7.5% by the end of 2020, whilst the Office for Budget Responsibility (OBR) has predicted a gloomier rate of 11.9%.

One thing for certain is the jobs market will become very competitive, with the power moving from employees to employers as individuals compete with dozens of other applicants for the same job. Businesses will probably be able to cherry pick with job vacancies being oversubscribed and this is likely to keep a lid on wage rises in the short-term, as evidenced by the latest Average Earnings Data (including bonuses) showing earnings falling by 1.2%, which is in stark contrast to the positive growth rate of 3.1% recorded back in March.

Another factor to consider is the behaviour of businesses and how they prepare to bounce back from the current economic shock. Many companies have some difficult decisions to make and will find it hard to predict what the future holds over the next 6-12 months and beyond. One argument that followed the EU Referendum result was whether companies hired workers to keep up with meeting the demands of their customers during the period of Brexit uncertainty, when they might typically

have invested in plant, machinery and other efficiency-boosting technology to meet that demand during more normal times. People are easier to hire and fire when companies are reluctant to invest for the longer term. This has led to record employment, albeit more fragile than a few decades ago, when the UK economy was structured very differently. The economy is now dominated by the service sector which is fast moving and changeable.

Other job losses are likely to be affected by a tidal shift in consumer behaviour. The last 10 years has seen a significant move to online shopping hit high streets and bricks and mortar retailers hard. The lockdown turbo charged this move to another level, with many who had previously avoided the internet altogether now being forced to go online, perhaps because they are in the shielded vulnerable population who were advised not to go out to the shops unless absolutely necessary. This portion of consumers may never go back to their previous habits and many, if my elderly parents are anything to go by, have been surprised by the ease of shopping online. The proportion of food shopping carried out online rose from 12% to 25% during the restrictions. An example of the behavioural buying shift could be seen in the performance of technology companies, with their earnings growth and subsequent share price rises over the last 6 months.

One thing is for sure, the next few months leading into winter will reveal an economic period like no other in history which may reshape our economy and jobs market for decades to come. The success of the measures put in place to protect jobs and livelihoods arguably remains the most important weapon used by the Chancellor of the Exchequer, Rishi Sunak, during this crisis. Whether this buys enough time for individuals and businesses to find the necessary answers to help them emerge into the new normal remains to be seen.

Latest economic news

It came as no surprise that the ONS announced yesterday morning (12 August) that the UK economy is officially in recession. As I have said in previous updates, this is where an economy has two negative quarters back to back. The UK economy contracted 20.4% between April and June, following the 2.2% decline in the first quarter of 2020. One bright spot amongst the data release from the ONS was that as lockdown measures eased and businesses restarted, output in June recorded a healthy rebound of 8.7% following a small increase in May of 2.4%. March and April were so severe they wiped out nearly 17 years of growth bringing the size of the UK economy back to where it was in the second quarter of 2003. The UK has suffered more than any other leading economy during the second quarter, in part caused by locking down their economy a few weeks later than the rest of Europe. However, even on a year-to-date basis only Spain has recorded a contraction which is bigger.

As I mentioned earlier the UK economy is dominated by the service sector which itself relies on consumer spending which fell an unprecedented 30-40% during lockdown, according to the Bank of England. No sector came through unscathed, with services down 19.9%, manufacturing down 20.2% and construction

contracting 35%. In addition, business investment fell by a record 31.4% as any spending plans were scrapped. Among the worst affected industries were accommodation and food services, in which output shrank 86.7% as hospitality closed.

In the first week of the 'eat out to help out' scheme diners used the meal discount more than 10.5 million times at an average of close to £5, costing the UK Government around £50m so far. The scheme designed to lure shoppers and diners back to restaurants and the shops has been deemed a success so far with footfall increasing to retail shops and outlets by 18.9% between Monday and Wednesday, when the scheme discount is available, according to Springboard who measure such data. The UK Government had budgeted £500m for August when the discount is available, but at this run rate it will only cost £225m.

Market update

Over the last month global shares have broadly rallied on the hopes of a successful vaccine development and on additional stimulus by central banks and governments if required. On Tuesday, following a stalemate between Democrats and Republicans on an additional $1 trillion stimulus package in the US, stocks retreated. The Dow Jones Industrial Average fell 104.53 basis points, or 0.4%, to 27,686.91. The NASDAQ Index lost 1.7% at 10,782.82 although this has been the top performer so far this year up 20.2% since the start of 2020.

The yield on 10 year US treasuries climbed significantly ahead of a record $38bn auction yesterday (Wednesday). The 15 basis point rise in yields was driven by repositioning before yesterday's auction and a sense that the US recovery is looking more robust following a decline in individuals going to hospital due to the virus as the pandemic appears to be coming back under control.

As I covered in last week's update Gold has been on a stellar run over the last 12 months, but especially since the pandemic crisis began, reaching a high of $2,089 per ounce. Following the steep rise in US treasury yields, investors appeared to take some profits as the price fell 5% to $1,845 per ounce, before rallying slightly to $1,938 at the time of writing. Rising inflation expectations amid massive monetary and fiscal stimuli remain supportive of Gold in the medium to long-term.

Find out more

Read our latest **A Month in the Markets** by Portfolio Manager John Mullins, for his full review and his outlook for markets **here**.

Note: Data as at 12 August 2020.

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