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State of Play

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Our Investment Specialist, Simon Durling, shares his thoughts in our latest update. Last year's first lockdown painted a gloomy picture with predictions of mass unemployment - have support schemes worked or painted over the cracks?

What do the latest employment reports tell us about the role of support schemes and the outlook for the economy?

According to the Collins Dictionary, the word furlough has two main meanings: a leave of absence from military duty or the temporary laying-off of employees usually because there is insufficient work to occupy them. Certain industries, like car manufacturing, have in the past used the latter definition to great effect in order to maintain the link between employee and employer. The employee is normally laid off for a short period with a proportion of their normal pay. Rarely is it unpaid as the employer wants to incentivise the worker to remain with them and not seek alternative employment. Trying to attract, recruit, and train new employees is very costly for businesses, especially if there is a shortage of candidates for specific skilled roles.

When the pandemic struck towards the end of the first quarter in 2020, governments, central banks and many economists globally were warning of mass unemployment and the impacts of lockdowns lasting for many years. Whilst it was impossible to predict the future none would have expected the outcome thus far. Clearly each country around the world made different choices about what, and when, interventions were necessary to avoid an economic and jobs catastrophe, but some, such as the UK, chose furlough as their main solution. The theory given was that, whilst the cost to the taxpayer

was very high, with UK Government borrowing available at very low interest rates the initial cost was worth it in the long run if it protected the economy from mass unemployment and the long-term cost this would have on the economy as a whole.

The UK furlough scheme was launched on 20 April 2020 paying up to 80% of people's wages, up to a maximum of £2,500 per month. Separate arrangements were also put in place to support those who are self-employed. The scheme was only supposed to last for a few months but, due to the additional lockdowns, the current scheme will finish at the end of September this year, with employers now being asked to contribute towards employees' wages as the support is tapered off. Companies are unlikely to be hoarding staff now that it costs them up to £625 a month to keep someone on furlough, as the support is tapered away by October. At its peak nearly 10 million people were being paid under the scheme whilst retail, hospitality, construction and manufacturing all shutdown during the first lockdown. At this point, despite this support, the Bank of England (BoE) predicted more than 10% unemployment at the peak and at least two years for this figure to reduce significantly.

As businesses adjusted to a safer environment for some staff to return to work the number on the scheme fell significantly. Fast forward over a year since its implementation as at the end of June (according to the Office for National Statistics (ONS)) 1.9 million people are still on furlough. However, 880,000 of these are on flexible furlough or working part-time leaving approximately 970,00 on full furlough with the vast majority in hospitality, construction, manufacturing and health services.

The latest unemployment figures confirm that unemployment has fallen from a peak in March 2021 of 5% down to 4.8%, still 1% shy of the record low, just prior to the start of the crisis and I am certain that even the most optimistic politician or central banker would not have believed how effective the furlough scheme would be.

Vacancies now point to a completely different problem which may not have crossed the mind of those in charge throughout this unprecedented period in our history. Andrew Bailey, Governor of the Bank of England, said last Thursday; 'The challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs'.

So, how has one expected outcome been replaced with almost the absolute opposite? Well, firstly you need to dig a little deeper into the data to uncover some of the factors influencing the jobs market over the last 18 months. Vacancies at the end of June 2021 reached a record high of nearly one million. Many sectors are desperate to recruit people but are struggling to find enough applicants. It is

becoming common place for new jobs to offer a signing on bonus and pay packages have skyrocketed as businesses compete with one another to secure the right recruit. In health care and social services the challenges are enormous as many foreign workers from the European Union (EU), who prior to the pandemic and Brexit would have applied for many of the vacancies, have been avoiding travel due to restrictions and the additional visa paperwork required following the UK's departure from the EU.

Another important factor is how many students have chosen to remain in full time education which has risen sharply over the last year. Nearly 400,000 young people have left the labour market which most economists expect during economic downturns and the pandemic appears to be no different, despite many students faced with paying for courses that predominantly remain online and remote. Additionally, many older workers who were part-time but forced to stop working during lockdowns have decided not to return.

If you combine travel restrictions, Brexit, student decisions and many early retirements, the UK jobs market has now rotated almost 360 degrees in a very short space of time. Consequently, the economic outlook has changed beyond all recognition from those dark forecasts a year ago. The BoE now predicts that the permanent economic scarring will be 1% of gross domestic product - only a third of what they initially thought, leaving the UK Government with a much bigger tax take and thus enabling them to start the long process of repaying the unprecedented cost of this crisis.

Tony Wilson, Director of the Institute for Employment Studies is concerned the jobs market may be too tight. He thinks it may be a secular shift when you compare one era with another. Twenty years ago, a mere 20% of people aged between 16 and 25 were in education. This number jumped after the 2008 financial crisis and just before the pandemic it was 30% but has now risen to a record 36%. 'After every crisis you get a stepped increase' he said. The rise in the minimum wage over the last decade may be influencing workers decisions as in many parts of the country beyond London, it is a living wage. This means for many, low-wage, low-stress jobs are more attractive in relative terms than marginally better-paid but gruelling ones. Wages will no doubt need to adjust to reflect this change in mindset for many, which the UK Government seems to be relaxed about, though the BoE may not be if inflation picks up.

On the UK Government's to-do list for jobs will be trying to get more older workers, women and long-term unemployed into work, which can be driven as much by flexible working conditions and childcare or occupational health support, as what wages they are paid. Why is this subject so important for investment markets and investors? The

economic recovery has always been about how quickly businesses can bounce back from such a dramatic financial shock to their system. Private businesses are the main employer of the UK workforce and, without the support packages of the past year, then this remarkable turnaround would not have happened. Whilst we are not out of the woods by any means, the future looks much rosier than it did last summer - even if the weather doesn't!

Find out more!

Click **here** to read our latest A Month in the Markets, where our Head of Multi-Asset Solutions Stefano Amato looks at how key themes impacted markets in July.

Note: Data as at 10 August 2021.

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