Market Update: 24th June 2020

The UK Emerges from Lockdown as Signs of Economic Recovery Materialise

In an attempt to rescue the economy from a prolonged and painful recession brought about by the pandemic, this week Boris Johnson announced a dramatic lifting of lockdown measures starting next month. From the 4th July, pubs, restaurants, and hotels in England can reopen, with the 2-metre guidance being revised to 1 metre to facilitate the openings. Scotland, Wales and Northern Ireland will make their own decisions about when to ease lockdown, with further relaxations expected to follow.

The reopening of the economy remains a controversial decision, with the government facing the challenging act of balancing the potential harm of increased virus spread with the damage being done to Britain's economy during the lockdown. In his announcement yesterday, the Prime Minister was clear that he took full responsibility for the decision, emphasising the economic importance of getting the UK back to work and back to some form of normality. The scientists flanking him were clear about the dangers, warning that the virus is likely to be with the UK into 2021 and of the need to remain vigilant to avoid complacency in following updated government guidelines.

With the virus now under control within the UK, the Prime Minister encouraged the public to go out and spend to support an economic recovery in the summer months, while also urging caution and reiterating new guidance. If the virus surges again, he warned that restrictions could be re-imposed, however we see this as unlikely given the potentially negative economic impact of a second lockdown alongside the lessons learnt on more efficient methods to stamp out any clusters of reinfection.

The Risk of a Second Wave

Although the risk of infection remains, the Prime Minister's drive to return to normality is based on the UK being much better placed now to face a rise in cases, with testing capacity expanded, more ventilators and greater understanding of the treatment of Covid-19. It is clear that the UK economy has a long route to recovery, however as restrictions are relaxed while the health situation remains under control, we are likely to continue to see a gradual pickup in activity and recovery in the coming months. In the event that we see an increase in cases as the economy reopens, we are now in a better place to stamp out reinfection clusters via increased testing and tracking capabilities alongside greater treatment capacity across the country.

Boosting Consumer Confidence

Although we are moving forward with the return to normality, things will still feel very different in July. Pubs will apply table service and ordered queues, churches will open but without singing and weddings will go ahead, but with a maximum of 30 guests. The fear is that consumers will be too nervous to come out and spend, therefore we are expecting a more gradual return to normality. According to a YouGov poll, only 26% of people surveyed would be comfortable visiting a pub, though twice as much said that they would be happy to visit a pub garden. In an effort to boost confidence and get people out spending, ministers have been encouraging the public to get out and about via social media, with the pace of recovery becoming more evident over the next month.

Economic Data

Looking to the data, a rise in the flash PMIs in June reflected the recent relaxation in lockdown measures. The services gauge stayed below the 50 mark (with a score of 50+ indicating expansion), and the manufacturing index was barely above, suggesting that the surveys are underplaying the recovery. With a further easing of social distancing now due in early July, PMIs should continue to rebound into more 'normal' territory in the coming months, helped by a release of pent-up demand. That being said, risks to the recovery remain as we take steps to relax restrictions further. From here, it appears that the data bottomed in April, before rebounding in May and June, evidenced by the PMI data.

A 12% month on month rebound in retail sales volumes in May also reflected the fruits of the relaxation in social distancing measures which began that month, with sales starting to come back from a 18% drop in April as lockdown restrictions took their toll on the UK retail sector. The reopening of non-essential shops earlier this month should prompt a further recovery in June data. Longer term, any scarring effect on the economy will influence the extent of retail's return to normality, with any longer term impact on unemployment and consumption likely to play a part in the performance. Admittedly, May's growth still leaves the level of retail volumes 13.1% below that of pre-coronavirus in February, however the further relaxation in restrictions in June should see the gap close further in the coming months.

Unemployment

In terms of unemployment, we expect to see further weakness in the data to come as the pandemic's job cost becomes clearer. To date, the government's employment support programmes have propped up employment rates, however as the schemes start to wind down, we could start to see a surge in unemployment. The degree of this will depend on how quickly the UK can get back to normality, providing much needed demand for products and services and keeping the economy moving. As it stands, the government's Coronavirus Jobs Retention Scheme (CJRS) is now helping to pay the wages of 8.9m people, 27% of those in work, avoiding a far worse outcome. Under the current plans, employers will be required to contribute towards the cost of the CJRS from July, and the scheme will come to an end on 31st October. A rebound in consumers' appetite to spend, facilitated by the further easing of social distancing restrictions will be essential to ensuring a relatively smooth transition as public support is removed to not result in more embedded higher levels of unemployment. The Prime Minister's drive to reopen the economy is hoped to save as many jobs as possible within small businesses.

The Housing Market

The UK housing market appears to have bounced back from the coronavirus lockdown, as resurgent demand and tight supply pushed house prices up by 2.4% in May from a year earlier, faster than the pace seen at the beginning of the year, according to a report on Wednesday from Zoopla. Agreed sales are also higher than before the government-imposed lockdown. Prices are expected to grow by as much as 3% through the third quarter before cooling toward the end of the year as the economic impact of the virus intensifies, with unemployment expected to rise and lenders imposing stricter mortgage requirements according to the report.

Brexit

While the UK economy recovers from the coronavirus lockdown measures, Brexit looms on the horizon, with the deadline for an extension request set at the end of the month. The government has already stated it will not ask for another delay, which leaves negotiators until 26th November to reach an agreement with the EU in a manner that will leave enough time to ratify a deal before the end of the transition period on 30th December. The base case for most economists is that the EU and the UK will strike a "thin" free trade agreement by the end of the year, avoiding WTO tariffs. We are likely to see further volatility in sterling as negotiations continue, however we have started to see hints from both sides that there may be room for compromise in recent weeks, providing optimism that a deal may still be made.

Positioning

Overall, although risks remain in the near term, with economic activity beginning to rebound as lockdown restrictions are relaxed, we are becoming more optimistic on our UK outlook. UK assets were harshly punished in the March selloff, while economic and political uncertainty has weighed heavily on the recovery in comparison to US markets, leaving a significant opportunity on the recovery of UK markets for long term investors. Brexit remains on the horizon, however we view risks as being more weighted towards the end of the year as negotiations continue, while we are encouraged by indications from both sides that a compromise may be reached.