

# OCM Asset Management

Discretionary Asset Managers | Stockbrokers

## **Market Update: 12<sup>th</sup> August 2020**

### **The UK Stages A Recovery**

After sounding a relatively upbeat tone in the MPC meeting last week, a surge in eating out inspired by government incentives, a run of upbeat activity surveys and a return to growth in car sales all delivered further evidence of an economy moving steadily out of a lockdown induced hibernation.

### ***Eat Out To Help Out***

It was hoped that the economy would recover strongly from the massive hit to GDP suffered during the Covid lockdown. Last week offered some hope in this direction. Among all the support measures put in place, probably none has had quite as dramatic and speedy effect as the 'Eat Out to Help Out' scheme launched at the start of the month. Under the scheme, customers receive 50% off bills for non-takeaway food and non-alcoholic drinks Monday to Wednesday throughout the month, with the government contributing up to a limit of £10 per person. Before the scheme, restaurant reservations were running at around half of the level of a year earlier. But Monday 3<sup>rd</sup> August saw reservations 10% higher year on year. Admittedly, restaurants only account for 7% of consumer spending, and how much the scheme will displace demand from later in the week remains to be seen, however with consumers having the confidence to go out and spend being a key to getting the economy back to its pre-Covid state, the voucher scheme appears to be helping.

### ***A Brightening UK Outlook***

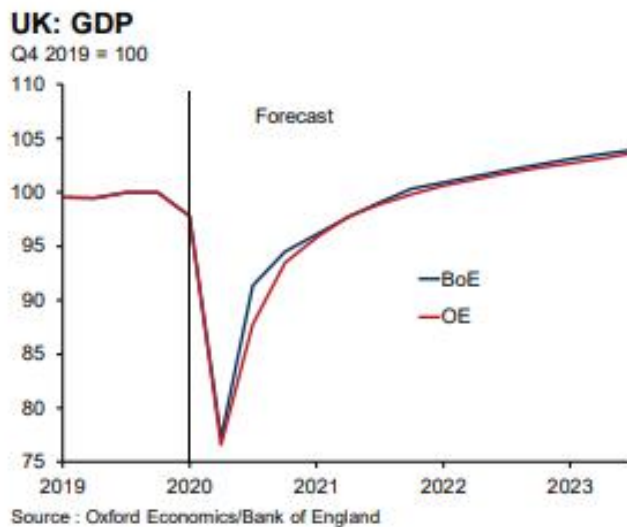
Earlier today, data confirmed expectations that UK GDP declined significantly during second quarter of the year, with today's figures officially pushing Britain into its first recession since 2009. Although this is significant in showing the extent of the damage of the lockdown on the UK economy during the period, leading indicators suggest that a recovery is now underway as restrictions have been eased in recent months.

Recent activity surveys offered a more comprehensive view of how the economy is doing, with the news remaining positive overall. Manufacturing and construction PMIs moved further into expansionary territory, while a headline services activity increased to its strongest reading since July 2015. It should be noted that these surveys do not show how far the economy is away from its Pre-Covid state. However, on that note, a recovery in car registrations in July left sales 11.3% higher than a year earlier, offering hope that an important part of the consumer durables sector is getting back to normal. July's growth, spurred by the re-opening of showrooms, was the first year on year increase since December. At the same time, while consumer spending remains below pre-pandemic levels, recent data suggests that a recovery in the key metric is underway.

Last week, the Bank of England updated its forecast for GDP growth on the back of recent movements. It now expects the peak to trough contraction in GDP to have been smaller, leaving its forecast for GDP growth in 2020 at -9.5% compared to -14% in May. Reflecting the impact of government support

schemes, the committee also reigned back its prediction for how high the jobless rate will rise, paring back forecasts from 9% to 7.5% in Q2 and improving the near-term outlook for the UK economy.

**Figure 1: Oxford Economics and BoE expectations for UK GDP**



### ***Recovery in Retail Sales***

According to research from Barclaycard, consumer spending in July fell the least since March as more people bought takeaway food and visited local shops, helping overall spending compared with a year earlier decline the least since March when lockdown measures were first put in place. The figures confirm that the economy is rebounding with Staycations, or vacationing close to home being a key theme, boosting sales for the hospitality industry. Spending is expected to experience a further boost this month by the government's Eat out incentive, with a third of people planning to spend more in restaurants and pubs according to the research. A separate report by the British Retail Consortium and KPMG indicates that retail sales increased by 4.3% in July on a like for like basis from last year.

### ***All Eyes on the Labour Market***

The LFS unemployment rate remained unchanged at 3.9% over the three months to June, however with the government's labour support schemes due to wind down in October, joblessness is likely to pick up towards the end of the year. While the overall impact of the coronavirus pandemic on the UK labour market remains largely unknown while government support remains in place, the rise in unemployment is unlikely to be as dramatic as first thought, with the bank of England reducing its expectations for unemployment to 7.5% last week. Despite the headline figure remaining unchanged over the period, looking under the hood, a rise in inactivity may have disguised an increase in unemployment, with workers not necessarily looking for work due to continued uncertainty and ongoing lockdown restrictions. Average pay in the April-June period declined by 1.2% year on year, the biggest drop since 2009, a consequence of many workers being furloughed.

As it stands, while the phasing out of the furlough scheme is likely to increase unemployment over the next few months, scarring on the economy is likely to be limited, with current consensus of 7.9% unemployment over the year appearing unduly pessimistic. For unemployment to rise to the consensus would require unemployment to grow at more than twice the pace of the early 1980's recession, a period which saw the fastest rise in joblessness since records began in 1971. But in terms of the duration of the economic shock and the scale of policy support, the present day looks far less unfavourable, particularly given the recovery we are currently seeing in the leading economic indicators.

Should we start to see signs of longer lasting issues in the labour market, it is likely that we will see further support from the central bank and the government where required to provide a further boost to the economy on the recovery, with the BoE monitoring employment as part of its ongoing strategy.

### **Our View**

While the UK's progress towards recovery is encouraging so far, it faces a more gradual challenge to return to pre-pandemic activity levels. Localised lockdown restrictions have increased concerns over more shutdowns, while government labour market support is being phased out, which is likely to result in an increase in the unemployment rate. This means that volatility is likely to remain high in the near term, however moving forward, the UK economy is recovering, and although the extent of the damage to the labour market remains to be seen, it is our view that consensus is overly pessimistic, and that longer lasting scarring to the UK economy will be relatively limited as a result of government support. That being said, should we start to see further challenges ahead, we remain content that the Bank of England and the Government will take further steps to support the economy and the labour market, keeping the medium to long term outlook intact. Looking ahead, we remain optimistic on the outlook as the UK economy recovers, with the expectation of strong growth over the coming years. Although our base line assumption is that a vaccine is not available until mid-2021 at the earliest, should an effective vaccine be found, it is likely that a recovery would be stronger, providing further support to risk assets.

### **Important Information**

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