



BANK OF ENGLAND

Monetary Policy Committee



# Monetary Policy Report

November 2020





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## Monetary policy at the Bank of England

### The objectives of monetary policy

The Bank's Monetary Policy Committee (MPC) sets monetary policy to keep inflation low and stable, which supports growth and jobs. Subject to maintaining price stability, the MPC is also required to support the Government's economic policy.

The Government has set the MPC a target for the 12-month increase in the Consumer Prices Index of 2%.

The 2% inflation target is symmetric and applies at all times.

The MPC's remit recognises, however, that the actual inflation rate will depart from its target as a result of shocks and disturbances, and that attempts to keep inflation at target in these circumstances may cause undesirable volatility in output. In exceptional circumstances, the appropriate horizon for returning inflation to target can vary. The MPC will communicate how and when it intends to return inflation to the target.

### The instruments of monetary policy

The MPC currently uses two main monetary policy tools. First, we set the interest rate that banks and building societies earn on deposits, or 'reserves', placed with the Bank of England — this is Bank Rate. Second, we can buy government and corporate bonds, financed by the issuance of central bank reserves — this is asset purchases or quantitative easing.

### The *Monetary Policy Report*

The MPC is committed to clear, transparent communication. The *Monetary Policy Report (MPR)* is a key part of that. It allows the MPC to share its thinking and explain the reasons for its decisions.

The *Report* is produced quarterly by Bank staff under the guidance of the members of the MPC.

This *Report* has been prepared and published by the Bank of England in accordance with section 18 of the Bank of England Act 1998.

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# Monetary Policy Summary

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The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. In that context, its challenge at present is to respond to the economic and financial impact of the Covid pandemic. At its meeting ending on 4 November 2020, the MPC voted unanimously to maintain Bank Rate at 0.1%. The Committee voted unanimously for the Bank of England to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £20 billion. The Committee voted unanimously for the Bank of England to continue with the existing programme of £100 billion of UK government bond purchases, financed by the issuance of central bank reserves, and also for the Bank of England to increase the target stock of purchased UK government bonds by an additional £150 billion, financed by the issuance of central bank reserves, to take the total stock of government bond purchases to £875 billion.

Since the Committee's previous meeting, there has been a rapid rise in rates of Covid infection. The UK Government and devolved administrations have responded by increasing the severity of Covid restrictions. All restrictions announced up to and including 31 October have been reflected in the Committee's judgements.

There are signs that consumer spending has softened across a range of high-frequency indicators, while investment intentions have remained weak. The Committee's latest projections for activity and inflation are set out in the accompanying November 2020 *Monetary Policy Report*. These assume that developments related to Covid will weigh on near-term spending to a greater extent than projected in the August 2020 *Report*, leading to a decline in GDP in 2020 Q4.

Household spending and GDP are expected to pick up in 2021 Q1, as restrictions loosen. The level of activity in the first quarter is expected to remain materially lower than in 2019 Q4. UK trade and GDP are also likely to be affected during an initial period of adjustment, over the first half of next year, as the United Kingdom leaves the Single Market and Customs Union on 1 January and is assumed to move immediately to a free trade agreement with the European Union.

Over the remainder of the forecast period, GDP is projected to recover further as the direct impact of Covid on the economy is assumed to wane. Activity is also supported by the substantial fiscal policies already announced and accommodative monetary policy. The recovery takes time, however, and the risks around the GDP projection are judged to be skewed to the downside.

The fall in activity over 2020 has reflected a decline in both demand and supply. Overall, there is judged to be a material amount of spare capacity in the economy. The LFS unemployment rate rose to 4.5% in the three months to August, but it is likely that labour market slack has increased by more than implied by this measure. The extended Coronavirus Job Retention Scheme and new Job Support Scheme will mitigate significantly the impact of weaker economic activity on the labour market. The unemployment rate is expected to peak at around 7¼% in 2021 Q2. Beyond that point, spare capacity is expected to be eroded as activity picks up, and a small degree of excess demand emerges over the second half of the forecast period.

Twelve-month CPI inflation increased to 0.5% in September, but remained well below the MPC's 2% target, largely reflecting the direct and indirect effects of Covid on the economy. These include the temporary impact of lower

energy prices and the reduction in VAT, as well as some downward pressure from spare capacity. CPI inflation is expected to remain at, or just above,  $\frac{1}{2}\%$  during most of the winter, before rising quite sharply towards the target as the effects of lower energy prices and VAT dissipate. In the central projection, conditioned on prevailing asset prices, inflation is projected to be 2% in two years' time.

The outlook for the economy remains unusually uncertain. It depends on the evolution of the pandemic and measures taken to protect public health, as well as the nature of, and transition to, the new trading arrangements between the European Union and the United Kingdom. It also depends on the responses of households, businesses and financial markets to these developments.

At this meeting, the MPC judges that a further easing of monetary policy is warranted. The Committee agreed to increase the target stock of purchased UK government bonds by an additional £150 billion in order to meet the inflation target in the medium term, taking the total stock of government bond purchases to £875 billion. The Committee will keep the asset purchase programme under review.

The MPC will continue to monitor the situation closely. If the outlook for inflation weakens, the Committee stands ready to take whatever additional action is necessary to achieve its remit. The Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

# 1 The economic outlook

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Covid-19 and the actions to contain it have continued to have a dramatic and rapidly changing impact on the UK and countries around the world. Global activity fell sharply during the first half of 2020, reflecting the impact of the pandemic and the social distancing needed to contain its spread. As Covid cases fell, global activity recovered materially in Q3 from low levels. Recently, however, cases have risen again in many countries.

The outlook remains unusually uncertain. It will depend on the evolution of the pandemic and measures taken to protect public health around the world, as well as the nature of, and transition to, the new trading arrangements between the European Union and the United Kingdom. It will also depend on the responses of households, businesses and financial markets to these developments.

The Monetary Policy Committee's (MPC's) projections assume that developments related to Covid will weigh on spending in the near term, although to a lesser extent than earlier in the year. UK activity in the first half of 2021 is also judged likely to be affected by lower trade as firms adjust to the UK and EU's new trading relationship. Over the forecast period, GDP is projected to recover as the direct impact of Covid-19 on the economy is assumed to wane. Activity is also supported by substantial fiscal and monetary policy actions. The recovery takes time, however, and the risks around the projection are judged to be skewed to the downside.

The fall in activity over 2020 has reflected a decline in both demand and supply. Overall, there is judged to be a material amount of spare capacity in the economy. Spare capacity is eroded as activity picks up and a small degree of excess demand is projected to emerge over the second half of the forecast period.

CPI inflation is below the MPC's 2% target, largely reflecting the direct and indirect effects of Covid-19 on the economy. These include the temporary impact of lower energy prices and the cut in VAT, as well as some downward pressure from spare capacity. As these effects wane, inflation rises. In the central projection, inflation is projected to be 2% in two years' time.

## 1.1 Recent developments

*Global and UK GDP picked up materially in Q3, although activity remains below levels in 2019 Q4.*

After falling sharply during the first half of 2020, global GDP rose materially in Q3, as the impact of Covid-19 on activity lessened. Some social distancing measures were relaxed, and consumers continued to adjust spending habits, for example spending more than previously on available goods and services, and by doing more shopping online. Activity remains below pre-Covid levels in most countries, however. Bank staff estimate that, in Q3, UK-weighted world GDP was around 4% lower than in 2019 Q4 — somewhat stronger than had been expected in August — and that UK GDP was around 9% lower, broadly in line with the August projection.

### *The recovery has slowed in Q4 as Covid cases have accelerated in many countries, including the UK.*

Cases of Covid have accelerated in many countries. As a consequence, measures intended to slow its spread have been reintroduced, and some indicators of global activity have fallen (Section 2.1). As a result, world GDP growth is expected to weaken in 2020 Q4.

In the UK, the rise in Covid cases has led to the reintroduction of restrictions to suppress the spread of the virus. Some high-frequency indicators of economic activity — for example, motor vehicle traffic and the number of train journeys, as well as retail footfall and the number of people eating in restaurants — have declined (Section 2.3). UK GDP is expected to fall in Q4 reflecting the impact of stricter measures.

### *The fall in UK activity over 2020 has reflected a decline in both demand and supply; overall there is judged to be a material amount of spare capacity in the economy.*

The reduction in UK activity over 2020 reflects lower demand as well as a fall in supply, as some businesses have closed temporarily and others have had to reduce capacity in order to make themselves Covid-secure. Overall, the MPC judges that there is a material amount of spare capacity in the economy.

At present, spare capacity is likely to reflect a combination of underemployment and higher unemployment. Average hours worked are well below their level in 2019 Q4. A large part of the fall in average hours will reflect the impact of government schemes, which have supported the employment and incomes of eligible workers. As many furloughed employees are unlikely to seek other jobs, those schemes effectively lower labour supply in the short term. But some of the fall in average hours will also reflect spare capacity. Government job retention schemes have attenuated the number of job losses substantially, although unemployment has still risen somewhat, which will also contribute to labour market slack (Section 2.4).

### *Inflation has been below the MPC's 2% target, reflecting the influence of temporary factors, as well as the impact of spare capacity.*

Spare capacity in the labour market has weighed on wage growth, with recent pay settlements weak. That is likely to have exerted some downward pressure on inflation. Inflation has also been materially affected by previous falls in energy prices and the impact of the Government's cut to VAT for certain services (Section 2.4). While there appears to have been lower pass-through from the VAT cut to consumer prices than had been assumed in the *August 2020 Report*, CPI inflation has been well below the MPC's target, and is expected to remain below 2% in coming months.

## 1.2 The MPC's projections

**Table 1.A:** Forecast summary<sup>(a)(b)</sup>

|  | Projections |             |             |         |
|--|-------------|-------------|-------------|---------|
|  | 2020 Q4     | 2021 Q4     | 2022 Q4     | 2023 Q4 |
| GDP <sup>(c)</sup>                         | -11 (-5.4)  | 11 (6.2)    | 3.1 (2.3)   | 1.6     |
| CPI inflation <sup>(d)</sup>               | 0.6 (0.3)   | 2.1 (1.8)   | 2.0 (2.1)   | 2.1     |
| LFS unemployment rate                      | 6.3 (7.5)   | 6.7 (5.9)   | 4.9 (4.5)   | 4.3     |
| Excess supply/Excess demand <sup>(e)</sup> | -2¼ (-2¼)   | -¼ (0)      | +¼ (+¾)     | +¼      |
| Bank Rate <sup>(f)</sup>                   | 0.1 (0.0)   | -0.1 (-0.1) | -0.1 (-0.1) | 0.0     |

(a) Modal projections for GDP, CPI inflation, LFS unemployment and excess supply/excess demand. Figures in parentheses show the corresponding projections in the August 2020 *Monetary Policy Report*.

(b) Unless otherwise stated, the projections shown in this section are conditioned on: Bank Rate following a path implied by market yields; the Term Funding Scheme and Term Funding Scheme with additional incentives for Small and Medium-sized Enterprises; the Recommendations of the Financial Policy Committee and the current regulatory plans of the Prudential Regulation Authority; the Government's policy announcements up to and including 31 October; commodity prices following market paths for two quarters, then held flat; the sterling exchange rate remaining broadly flat; and the prevailing prices of a broad range of other assets, which embody market expectations of the future stocks of purchased gilts and corporate bonds. The main assumptions are set out in the 'Download the chart slides and data' link at [www.bankofengland.co.uk/monetary-policy-report/2020/november-2020](http://www.bankofengland.co.uk/monetary-policy-report/2020/november-2020).

(c) Four-quarter growth in real GDP. The growth rates reported in the table exclude the backcast for GDP. Including the backcast 2020 Q4 growth is -11.0%, 2021 Q4 growth is 11.0%, 2022 Q4 growth is 3.1% and 2023 Q4 growth is 1.6%.

(d) Four-quarter inflation rate.

(e) Per cent of potential GDP. A negative figure implies output is below potential and a positive figure that it is above.

(f) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on overnight index swap rates.

### *The MPC's projections assume that Covid-19 weighs on spending in the near term.*

The outlook for the economy remains highly uncertain. It is dependent on the evolution of the pandemic and the measures taken to protect public health. It will also depend on how governments, households, businesses and financial markets respond to those developments.

The MPC's projections are conditioned on an assumption that Covid restrictions weigh materially on UK and global activity in the near term. The forecast includes UK restrictions announced up to and including 31 October. Those restrictions include heightened England-wide measures for the period 5 November to 2 December, following an intensification of regional and subregional tiered restrictions; the five-level system of restrictions announced by the Scottish Government that came in on 2 November; the firebreak lockdown in Wales scheduled to end on 9 November, after just over two weeks; and a four-week period of additional restrictions in Northern Ireland ending on 13 November. Subsequently, restrictions are assumed to loosen somewhat. For the UK as a whole, the average level of restrictions that was prevailing in mid-October is assumed to take effect, and remain in place until the end of 2021 Q1. For the rest of the world, currently announced restrictions are generally assumed to remain in place, on average, over the rest of Q4 and Q1. Although some countries are assumed to be subject to some time-limited restrictions in line with recent announcements, for example, France and Germany.

*The direct impact of the pandemic on the economy is assumed to fade over time, as elevated uncertainty about the outlook for health dissipates gradually.*

Beyond 2021 Q1, restrictions are assumed to be loosened. But Covid continues to affect the economy through heightened health concerns and uncertainty about the outlook. For example, in an ONS survey in October, 37% of households said that they would feel uncomfortable or very uncomfortable eating indoors in a restaurant. And almost three quarters of businesses responding to the Decision Maker Panel Survey reported that overall uncertainty was high or very high in October, much higher than the start of the year, with Covid-19 being one of the top three sources of uncertainty for around 80% of businesses. Over time, those concerns and uncertainty are assumed to wane gradually. That path is consistent with improved treatments or other health interventions becoming available. As a result, over the forecast period, the direct effects of the pandemic on the economy are assumed to fade and spending recovers. Nonetheless, through its effects on household and business spending, the pandemic has a persistent indirect impact on the economy (Section 3).

*Government measures support employment and incomes in the near term...*

Government support measures are assumed to evolve in line with announced government policy. Employment and incomes will be supported by the extension of the Coronavirus Job Retention Scheme (CJRS) until December, and the recently announced Job Support Scheme (JSS) beyond that.<sup>(1)</sup> In November, around 5½ million employees are assumed to be furloughed; over December to the end of April 2021, a little under 2½ million employees are assumed to be supported by these government schemes, on average. As the JSS is unwound, and as activity recovers, most workers are judged likely to return to work, although some jobs are likely to be lost. Self-employed workers are also assumed to be supported by the Self-Employment Income Support Scheme.

*...and spending over the forecast period.*

Over the past three months, the Government has also announced other policy measures, including an extension to the VAT cut for the hospitality and tourism sectors and additional public services spending in the *Winter Economy Plan*, as well as business grants for companies required to close. Alongside the other policies announced since the start of the year, these measures boost activity over the forecast period.

*The MPC's central projections are conditioned on the assumption that there is an immediate move to a free trade agreement with the EU on 1 January 2021.*

Consistent with government policy, the MPC's central projections assume that, on 1 January 2021, the UK leaves the EU's Single Market and Customs Union and there is an immediate move to a free trade agreement (FTA) between the UK and the EU. As in previous *Reports*, that FTA is assumed to be of a similar scale and depth to the Comprehensive Economic and Trade Agreement in place between Canada and the EU (see Box 1 of the [November 2019 Report](#) for more detail).

As the UK leaves the EU's Single Market and Customs Union, some restrictions on trade between the UK and EU are assumed to come into place. Over time, trade in both goods and services is likely to be lower as a result. In line with empirical evidence, this reduction in trade with the EU is expected to weigh on productivity and GDP over the forecast period.

(1) The Government has announced that the CJRS will remain open until December, with employees receiving 80% of their current salary for hours not worked, up to a maximum of £2,500. It has also announced two types of JSS support which will be introduced following the end of the CJRS: the JSS Open, which supports employers facing reduced demand by giving them the option of keeping their employees in a job on shorter hours rather than making them redundant; and the JSS Closed, which supports the wage costs of employees who have been instructed to cease work in closed premises.

*Trade and activity are assumed to be lower temporarily in the near term as businesses adjust to the new trading arrangements.*

In addition, adjustment by businesses to the new arrangements is assumed to lead to a further, temporary, effect on trade in the near term. Recent evidence from the Bank's Agents and a range of business surveys and intelligence suggests that while some businesses feel prepared for the change in trading arrangements, others — particularly smaller firms — reported that they were not fully prepared, with Covid having hampered some preparations (Section 4). In particular, while the UK will phase in checks at the border, the EU has stated it will apply full border controls from 1 January 2021, which some businesses are initially unlikely to be fully prepared for. Reflecting this evidence, in its central forecast, the MPC assumes that traders representing around 70% of goods exports to the EU are prepared for customs and documentation checks at the border by the end of the year.

This is assumed to weigh further on UK exports in the near term. Due to the integrated nature of cross-border supply chains and logistics, imports are also likely to be affected, albeit to a lesser degree. In the central projection, the expected reduction in exports, and the impact on domestic supply chains, reduces projected GDP directly by around 1% in 2021 Q1. That is assumed to reflect a reduction in supply as well as demand. These effects on trade are assumed to be temporary and to unwind over the course of six months, as businesses adjust.

*Monetary policy boosts demand over the forecast period.*

The MPC's projections are conditioned on the market path for interest rates, which averages zero over the forecast period (Table 1.A). They are also conditioned on the prevailing prices of a broad range of assets, which embody market expectations of the future stocks of purchased assets.

*Developments in UK asset prices have been mixed since August; new mortgage interest rates have increased further.*

Since the August 2020 Report, the sterling exchange rate has appreciated a little. UK equity prices have fallen. But corporate bond spreads are lower. Government-backed loan schemes have generally continued to support bank credit conditions for companies. Interest rates on new mortgages have continued to increase, however, partly reflecting the response of lenders to the recent surge in demand for mortgages, as well as concerns about the economic outlook (Section 2.2). Credit conditions are assumed to remain tighter over the forecast period than they were projected to in August.

## Global GDP growth

*Global GDP growth is projected to slow in the near term.*

In part reflecting the recent rises in Covid cases, and the associated renewed restrictions, global GDP growth is expected to slow in Q4. In the euro area, Covid cases have increased relatively rapidly in some countries, and some restrictions have been tightened quite substantially. As a result, euro-area GDP is expected to fall in Q4. US GDP growth eases. In Q1, Covid restrictions are assumed to remain in place and continue to weigh on global activity, though to a slightly smaller extent than in Q4.

*Global GDP picks up as Covid effects dissipate over time, supported by policy measures.*

Over the forecast period, global activity rises, supported by the assumed dissipation of uncertainty, and the substantial policy responses that have been put in place. Some longer-lasting effects dampen output over the forecast period, however. Weaker business investment is likely to weigh on the growth of the capital stock and reduce productivity growth. Moreover, unemployment is expected to remain elevated relative to levels before the pandemic.

In the central forecast, UK-weighted world growth is -5¼% in 2020, before recovering to 5½% in 2021. It is 3¾% in 2022 and 2½% in 2023 (Table 1.B).

## UK GDP growth

*UK GDP falls in Q4...*

UK GDP growth in the near term is also affected by recent developments related to the pandemic. Informed by recent movements in high-frequency indicators of activity and announcements about Covid-related restrictions, UK GDP is projected to fall in Q4 (Chart 1.1). That largely reflects lower consumer spending on social activities, which is assumed to be partially offset by higher spending on other goods and services. While the Government's support schemes mean that the unemployment rate increases by less than its previous relationship with output would suggest, it is projected to rise in the near term.

...before growth resumes as the impact of the pandemic wanes.

In Q1, the easing in Covid-related restrictions relative to Q4 leads to a recovery in activity. The initial adjustment to the UK and EU’s new trading relationship temporarily reduces trade and activity somewhat, however (Key Judgement 1).

Over the rest of 2021, activity picks up (Chart 1.1) as Covid restrictions are eased further and as the adjustment to new trading arrangements occurs. Over the forecast period, spending is supported by the fiscal policies already announced, accommodative monetary policy, and by the assumption that heightened uncertainty about the outlook wanes gradually over time (Key Judgement 2). The decline in uncertainty leads to rising consumer spending, especially on social activities. Business investment also recovers, albeit more slowly than consumer spending. Government spending also contributes to growth over the forecast period, while net trade tends to drag on growth somewhat.

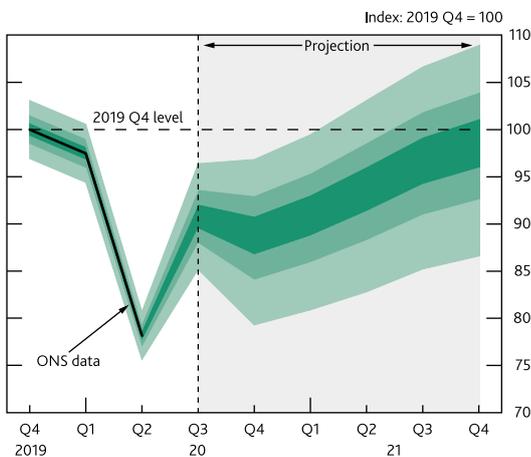
The recovery takes time, however (Chart 1.2). In the MPC’s central projection, GDP does not exceed its level in 2019 Q4 until 2022 Q1. As a result, unemployment is elevated. The unemployment rate is projected to peak at around 7¾% in 2021 Q2, before declining gradually over the forecast period as GDP picks up (Chart 1.3).

*The supply capacity of the economy is affected by Covid and the adjustment to new trade arrangements in the near term, as well as some longer-lasting scarring effects.*

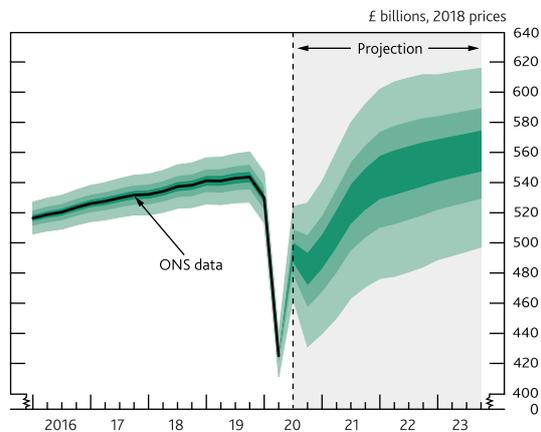
In the near term, the supply side of the economy will be affected by Covid measures, as some businesses are required to close or to reduce capacity. Moreover, the adjustment to the UK’s new trading arrangements with the EU will affect the ability of some companies to supply goods and services. Both of those effects are assumed to be temporary.

Covid and the UK’s withdrawal from the EU are judged to be likely to have persistent effects on output too, however (Key Judgement 3). The pandemic and the measures taken to control its spread have affected sectors differently, and some labour and capital are likely to need to move between them as a result. That might result in some temporary mismatch between the skills of those looking for jobs and the sectors with vacancies, which is likely to reduce the downward pressure unemployment puts on wages. Capital might also be less efficiently allocated across the economy, in part reflecting the impact of credit conditions. In addition, lower investment could reduce innovation and weigh on the productive capacity of the economy over time. Taken together, these effects are projected to reduce the supply capacity of the economy by around 1¾% by the end of the forecast period, relative to what it would have been in the absence of Covid-19. The UK’s withdrawal from the EU is also likely to have a more persistent effect on supply, as cross-border trade is lower over the forecast period and weighs on productivity growth.

**Chart 1.1:** Near-term GDP projection based on market interest rate expectations, other policy measures as announced

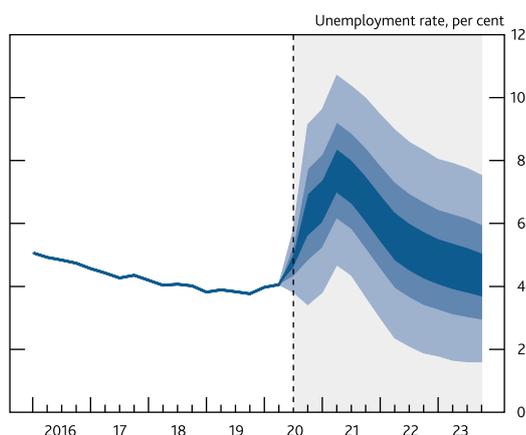


**Chart 1.2:** GDP projection based on market interest rate expectations, other policy measures as announced



The fan charts depict the probability of various outcomes for GDP. They have been conditioned on the assumptions in Table 1.A footnote (b). To the left of the vertical dashed line, the distribution reflects uncertainty around revisions to the data over the past. To aid comparability with the official data, it does not include the backcast for expected revisions, which is available from the 'Download the chart slides and data' link at [www.bankofengland.co.uk/monetary-policy-report/2020/november-2020](http://www.bankofengland.co.uk/monetary-policy-report/2020/november-2020). To the right of the vertical line, the distribution reflects uncertainty over the evolution of GDP in the future. If economic circumstances identical to today's were to prevail on 100 occasions, the MPC's best collective judgement is that the mature estimate of GDP would lie within the darkest central band on only 30 of those occasions. The fan chart is constructed so that outcomes are also expected to lie within each pair of the lighter green areas on 30 occasions. In any particular quarter of the forecast period, GDP is therefore expected to lie somewhere within the fan on 90 out of 100 occasions. And on the remaining 10 out of 100 occasions GDP can fall anywhere outside the green area of the fan chart. Over the forecast period, this has been depicted by the light grey background. See the box on page 39 of the November 2007 *Inflation Report* for a fuller description of the fan chart and what it represents.

**Chart 1.3: Unemployment projection based on market interest rate expectations, other policy measures as announced**



The fan chart depicts the probability of various outcomes for LFS unemployment. It has been conditioned on the assumptions in Table 1.A footnote (b). The coloured bands have the same interpretation as in Charts 1.1 and 1.2, and portray 90% of the probability distribution. The calibration of this fan chart takes account of the likely path dependency of the economy, where, for example, it is judged that shocks to unemployment in one quarter will continue to have some effect on unemployment in successive quarters. The fan begins in 2020 Q3, a quarter earlier than for CPI inflation. That is because Q3 is a staff projection for the unemployment rate, based in part on data for July and August. The unemployment rate was 4.5% in the three months to August, and is projected to be 4.8% in Q3 as a whole. A significant proportion of this distribution lies below Bank staff's current estimate of the long-term equilibrium unemployment rate. There is therefore uncertainty about the precise calibration of this fan chart.

### Excess supply/demand

*The MPC judges that there is a material degree of spare capacity in the economy, which is eroded as demand recovers.*

Overall, the MPC judges that there is likely to be a material amount of slack in the economy (Key judgement 4), as demand has declined by more than supply. Spare capacity persists while unemployment is elevated. It is eroded as demand recovers and unemployment declines gradually. A small degree of excess demand emerges over the second half of the forecast period.

### CPI inflation

*CPI inflation is projected to remain low in the near term, but to return to the 2% target as temporary effects fade and slack is eroded.*

Previous falls in energy prices and the impact of the cut to VAT for certain services have accounted for much of the fall in inflation over 2020, and will continue to weigh on CPI inflation in the near term. As those effects drop out of the annual calculation in the second half of 2021, inflation is projected to rise quite sharply towards the target (Chart 1.4).

Over the first half of the forecast period, slack in the economy dampens domestic price pressures. In the near term, the MPC continues to judge that the impact of spare capacity on inflation will be a little less than usual while activity is particularly weak. That judgement partly reflects research on price-setting which finds that firms are less able to increase demand for their goods and services by reducing prices when demand is low (see Section 4 of the [August 2020 Report](#)). As slack is eroded, and excess demand emerges, domestic price pressures pick up.

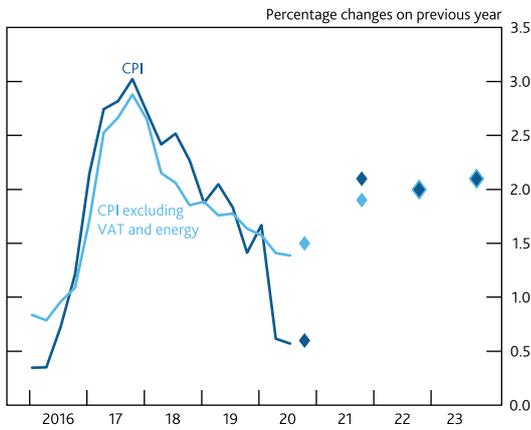
In 2022 Q4, CPI inflation is 2.0%. It is then projected to rise slightly above the target (Chart 1.5).

### Policy decision

At its meeting ending on 4 November 2020, the MPC judged that a further easing of monetary policy was warranted. The Committee voted to maintain Bank Rate at 0.1%. The Committee voted for the Bank of England to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £20 billion. The Committee voted for the Bank of England to continue with the existing programme of £100 billion of UK government bond purchases, financed by the issuance of central bank reserves, and also for the Bank of England to increase the target stock of purchased UK government bonds by an additional £150 billion, financed by the issuance of central bank reserves, to take the total stock of government bond purchases to £875 billion. The factors behind that decision are set out in the Monetary Policy Summary on pages i–ii of this *Report* and in more detail in the Minutes of the meeting.

**Chart 1.4:** In the central projection, CPI inflation picks up sharply in 2021 as temporary factors drop out of the annual calculation

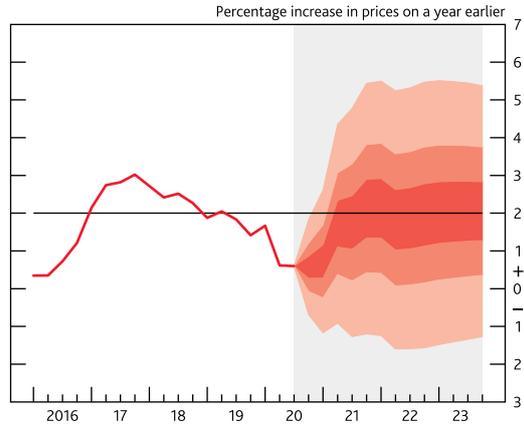
CPI and CPI excluding VAT and energy<sup>(a)</sup>



Sources: ONS and Bank calculations.

(a) CPI excluding VAT and energy excludes the estimated impact of changes in VAT and fuels and lubricants, electricity, gas and other fuels. Where Bank staff have adjusted for changes in the rate of VAT there is uncertainty around the precise impact of those changes.

**Chart 1.5:** CPI inflation projection based on market interest rate expectations, other policy measures as announced



The fan chart depicts the probability of various outcomes for CPI inflation in the future. It has been conditioned on the assumptions in Table 1.A footnote (b). If economic circumstances identical to today's were to prevail on 100 occasions, the MPC's best collective judgement is that inflation in any particular quarter would lie within the darkest central band on only 30 of those occasions. The fan chart is constructed so that outturns of inflation are also expected to lie within each pair of the lighter red areas on 30 occasions. In any particular quarter of the forecast period, inflation is therefore expected to lie somewhere within the fans on 90 out of 100 occasions. And on the remaining 10 out of 100 occasions inflation can fall anywhere outside the red area of the fan chart. Over the forecast period, this has been depicted by the light grey background. See the box on pages 48–49 of the May 2002 *Inflation Report* for a fuller description of the fan chart and what it represents.

### 1.3 Key judgements and risks

#### *Uncertainty around the MPC's central projections is unusually high...*

The MPC judges that the outlooks for the UK and global economies are unusually uncertain at the moment. Reflecting that, the MPC's forecast fan charts remain wider than usual.

#### *...and the risks to activity are judged to be skewed to the downside.*

That judgement is consistent with the MPC's conditioning assumption that the current shock has resulted in elevated uncertainty, as well as heightened health concerns, for households and businesses. Uncertainty declines over the forecast, and the MPC judges that the risks around that are skewed towards the downside for activity. Those could affect demand — for example, greater, persistent, health concerns in the UK and elsewhere would be likely to result in less spending by households — and could also have greater long-lasting effects on the supply side of the economy.

#### **Key judgement 1: in the near term, activity is dampened by Covid developments and temporarily lower trade as businesses adjust to new arrangements with the EU.**

#### *There are risks around the extent to which Covid restrictions weigh on spending in the near term.*

The MPC's central case projections are conditioned on an assumption that Covid restrictions are in place until the end of 2021 Q1. In the very near term, restrictions are consistent with recent announcements, before loosening somewhat subsequently. The uncertainty around how the pandemic evolves, and how restrictions and government support measures change in response, is very substantial. Different developments could have material effects on the path of activity over the coming months.

In the central case, these restrictions weigh on consumer spending, although the response of spending to the restrictions in place is assumed to be smaller than occurred in early 2020. That partly reflects recent developments, in which consumers have altered how they spend — away from social activities and towards other things, such as goods bought online. Consumers might be more willing to continue to switch their spending in this way in the near term, particularly given government measures which will support incomes. Set against that, some of the recent substitution into other goods and services might be less likely to happen in future if past purchases reflected pent-up demand.

*There is uncertainty around the extent to which the initial adjustment to new trading arrangements with the EU will affect activity.*

The MPC's projections are also conditioned on the assumption that cross-border trade falls temporarily in the first half of 2021 as businesses adjust to the new trading arrangements with the EU. Recent evidence suggests that while some businesses are prepared for the change in trading arrangements that will come into place, some UK businesses do not feel fully ready (Section 4). There is considerable uncertainty about how prepared businesses will be, however. For example, the Agents' most recent survey suggests that almost all respondents think that they will be either 'fully prepared' or 'as ready as can be' by the end of 2020. That might point to more readiness among companies. But other surveys and evidence suggest that the degree of preparedness is lower among those who trade most frequently with the EU, and that it will be difficult for all firms, in particular small and medium-sized enterprises, to be fully prepared by the end of the transition period. There is also uncertainty over how controls on the EU side of the border will be applied in practice. Consequently, there are two-sided risks around the impact that the initial adjustment to the new trading arrangements will have on trade and activity, and its duration. Any implications for slack and inflation are judged likely to be small, however, as the process of adjustment should be temporary and will probably affect both demand and supply.

*On balance, the MPC judges the risks to activity in the near term to be to the downside.*

Taken together, while highly uncertain, the risks to the near-term outlook for activity are judged to be skewed to the downside. The skew is somewhat smaller than was judged to be the case in August, however, as recent developments are consistent with some of the downside risks previously identified materialising.

**Key judgement 2: over time, uncertainty dissipates gradually and spending recovers.**

*Spending could recover more rapidly if some households choose to run down previously accumulated savings...*

In the near term, the saving rate is likely to rise as spending is affected by the pandemic and incomes are supported by government measures. Beyond that, the saving rate is projected to decline. The outlook for consumer spending and saving will be affected by households' health concerns, as well as their perceptions about what is likely to happen to the economy. In particular, household saving tends to be influenced by the outlook for unemployment. The decline in the saving rate in the MPC's central case is broadly consistent with the dissipation of uncertainty and decline in unemployment that is projected over the forecast period. However, some of the recent accumulation of savings — and that projected to occur in the near term — is likely to be a result of Covid-related restrictions constraining spending by some households. As a result, spending could pick up more materially if those 'involuntary' savings are run down, posing an upside risk to activity.

*...although how savings are distributed across households might pose a downside risk to spending.*

The recent rise in savings has not been equally distributed across households, however. In particular, survey evidence suggests that higher savings appear to have been concentrated in high-income households (see Box 3 in the [August 2020 Report](#)). As a result, lower and middle-income households that have not accumulated a buffer of savings might aim to do so. That is judged to pose a downside risk to UK consumer spending over 2021.

While these risks to consumer spending are two-sided, the MPC judges that the overall risks around the world and UK demand projections are skewed somewhat to the downside.

**Key judgement 3: there is some long-lasting scarring of the economy's supply capacity.**

*There are risks to the degree of scarring arising from the persistence of the shift in the mix of demand.*

Covid has affected sectors of the economy differently as consumer spending patterns have changed, and that takes time to unwind in the MPC's central projection. The change in the mix of spending over the forecast period might require some changes in the pattern of production in the economy, which in turn would require a reallocation of labour and capital between sectors.

The MPC's central forecast embodies a judgement that the rate of reallocation of labour between sectors is reduced by a degree of skills mismatch. That slows the pace of decline of unemployment and leads to some rise in the medium-term equilibrium rate of unemployment. The MPC judges that the risks around this judgement are two-sided. While the assumed degree of mismatch is smaller than occurred in some previous downturns, such as the 1980s and

early 1990s, those were accompanied by more significant structural change than is embodied in the MPC's forecast (Section 3). Any reallocation should also be aided by the flexibility of the UK labour market, with many job seekers moving between industries during normal times.

*Higher capital scrapping could reduce supply, but sectoral reallocation effects could boost supply through their impact on productivity.*

The MPC's central forecast also includes effects on the supply capacity of the economy through lower investment, which reduces capital accumulation. There is a risk that the capital stock is lowered further if some is scrapped prematurely, which might happen if the capital needed in the sectors that are expanding is different to those sectors declining. That poses a downside risk to the MPC's central projection for supply.

An upside risk to supply is judged to result from the sectoral mix of recent changes in demand. The sectors most affected by Covid-19, such as accommodation and food, tend to have lower productivity than those less affected. As a result, productivity could be boosted somewhat by a compositional effect if the mix of demand shifted more persistently.

*There are also judged to be two-sided risks from innovation and remote working.*

Since the start of the year, there have been significant changes in how many sectors have delivered their products and how their staff have worked. Some of those might persist. For example, many expect working from home to remain more common after the pandemic. Increased remote working could raise working hours and labour market participation, increasing labour supply. The evidence on the effect of remote working on productivity is mixed, however. Some studies suggest that working from home can increase worker output. But others suggest that some tasks become more difficult when colleagues are physically separated. For example, collaboration could be negatively affected by more remote working.

**Key judgement 4: spare capacity in the economy is currently weighing on inflation, but it is eroded over time and inflation returns to the target.**

*There are risks around the extent of spare capacity in the economy...*

The MPC judges that there is currently a material degree of spare capacity in the economy. Total hours worked have fallen, with at least some of that fall likely to reflect a shortfall of demand, and pay pressures are muted, with average pay settlements having decreased sharply (Section 2.4). The precise extent of spare capacity is difficult to judge, however. While demand for goods and services has fallen sharply during the pandemic, so has firms' ability to supply them. And while demand is expected to weaken over coming months, some firms' supply capacity will also be constrained as a result of measures to reduce the risk of virus transmission. The MPC expects spare capacity in the economy to persist over much of the first half of the forecast period, but there are risks around that projection.

*...and the impact of spare capacity on inflation.*

Even if it was possible to measure the degree of spare capacity with precision, risks would remain around its impact on inflation. As discussed in the [August 2020 Report](#), there are reasons why any spare capacity may be having a smaller downward effect on CPI inflation at present. The hit to output arising from Covid-19 has been concentrated in consumer-facing services, which tend to exhibit higher price stickiness than other components of the CPI basket. In addition, the economic outlook remains unusually uncertain, and such uncertainty can discourage firms from changing prices.

Inflation could also be affected by Covid-related cost pressures. Some sectors will face higher costs as a result of measures to limit the risks of virus transmission. Acting in the opposite direction, however, business rates relief for the retail, hospitality and leisure sectors should ease cost pressures in these consumer-facing sectors to some extent. There may also be some further downward pressure on rents in the retail sector, if the number of vacant properties rises.

*The outlook will also depend on the nature of the UK's withdrawal from the EU.*

The outlook will also be sensitive to the nature of the trading arrangements in place between the UK and the EU from 1 January 2021. The UK Government has stated that it would be willing to trade with the EU without a free trade agreement, should such an agreement not be reached. This would involve the introduction of tariffs on some goods

traded with the EU and, relative to the central case, greater non-tariff barriers to trade, such as more onerous border checks or higher regulatory barriers. Those could be expected to weigh on trade and activity, and as a result, could present a downside risk to GDP over the forecast period. Lower GDP would probably reflect weaker demand and supply, so have limited implications for the degree of slack in the economy, and hence inflation. The introduction of import tariffs would pose an upside risk to inflation in the first half of the forecast period, however. The impact of new trading arrangements on activity and inflation will also depend importantly on how the exchange rate moves in response.

*The risks around CPI inflation are judged to be broadly balanced.*

Overall, the risks to the MPC's inflation projection are judged to be broadly balanced. Measures of inflation expectations remain well anchored.

## 1.4 Constant rate projections

In the MPC's projections conditioned on the alternative assumption of constant interest rates at 0.1%,<sup>(2)</sup> activity is projected to be slightly weaker and CPI inflation is projected to be a little lower.

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(2) The assumption is that Bank Rate remains at 0.1% throughout the three years of the forecast period, before moving towards the market path over the subsequent three years.

**Table 1.B:** Indicative projections consistent with the MPC's forecast<sup>(a)(b)</sup>

|   | Averages  |            | Projections      |                 |                |           |
|---|-----------|------------|------------------|-----------------|----------------|-----------|
|   | 1998–2007 | 2010–18    | 2020             | 2021            | 2022           | 2023      |
| <b>World GDP (UK-weighted)<sup>(c)</sup></b>  | <b>3</b>  | <b>2½</b>  | <b>-5¼ (-6¼)</b> | <b>5½ (6)</b>   | <b>3¾ (4¼)</b> | <b>2½</b> |
| World GDP (PPP-weighted) <sup>(d)</sup>   | 4         | 3¾         | -4½ (-5)         | 7 (7½)          | 4¾ (5)         | 3¾        |
| Euro-area GDP <sup>(e)</sup>  | 2¼        | 1½         | -6¾ (-8)         | 6 (6¼)          | 3¼ (4)         | 2         |
| US GDP <sup>(f)</sup>   | 3         | 2¼         | -3¾ (-5¾)        | 4 (5¼)          | 3¾ (4¾)        | 2¼        |
| Emerging market GDP (PPP-weighted) <sup>(g)</sup><br>of which, China GDP <sup>(h)</sup> | 5½        | 5          | -4 (-4¼)         | 8¼ (8½)         | 5½ (5¾)        | 4¾        |
| <b>UK GDP<sup>(i)</sup></b>   | <b>3</b>  | <b>2</b>   | <b>-11 (-9½)</b> | <b>7¼ (9)</b>   | <b>6¼ (3½)</b> | <b>1¾</b> |
| Household consumption <sup>(j)</sup>  | 3¼        | 1¾         | -11¼ (-9¼)       | 8¼ (8)          | 4¼ (3)         | 2         |
| Business investment <sup>(k)</sup>  | 2¾        | 4          | -18¾ (-19)       | 5¾ (10½)        | 13¼ (9¼)       | 4¼        |
| Housing investment <sup>(l)</sup>   | 3¼        | 4          | -19¼ (-21¾)      | 13¼ (26½)       | 12½ (11¼)      | 5¾        |
| Exports <sup>(m)</sup>  | 4¼        | 3¼         | -11¾ (-10½)      | -1¼ (4½)        | 3¼ (¾)         | 3         |
| Imports <sup>(n)</sup>  | 5¾        | 3¾         | -18¼ (-11¼)      | 7¾ (7½)         | 6 (1¼)         | 3         |
| Contribution of net trade to GDP <sup>(o)</sup>   | -¼        | -¼         | 2¼ (¾)           | -2¾ (-1)        | -1 (-¼)        | 0         |
| Real post-tax labour income <sup>(p)</sup>  | 3¼        | 1¾         | 0 (3)            | ¼ (-4¼)         | 2¼ (4)         | 2         |
| Household saving ratio <sup>(q)</sup>   | 8         | 8¾         | 15¼ (14¼)        | 10¾ (7¼)        | 8½ (8¾)        | 8         |
| Credit spreads <sup>(r)</sup>   | ¾         | 2½         | 2¼ (2½)          | 2¼ (2)          | 2¼ (2)         | 2         |
| <b>Excess Supply/Excess Demand<sup>(s)</sup></b>  | <b>0</b>  | <b>-1¾</b> | <b>-2 (-2¼)</b>  | <b>-1¼ (-¾)</b> | <b>¼ (½)</b>   | <b>¼</b>  |
| Hourly labour productivity <sup>(t)</sup>   | 2¼        | ½          | 1¾ (-¼)          | -2¼ (¾)         | 1¾ (¾)         | ½         |
| Employment <sup>(u)</sup>   | 1         | 1¼         | -3 (-3¾)         | ¾ (2½)          | 2¾ (2)         | 1¼        |
| Average weekly hours worked <sup>(v)</sup>  | 32¼       | 32         | 29½ (31¾)        | 32 (32)         | 32 (32)        | 32        |
| Unemployment rate <sup>(w)</sup>  | 5¼        | 6¼         | 6¼ (7½)          | 6¾ (6)          | 5 (4½)         | 4¼        |
| Participation rate <sup>(x)</sup>   | 63        | 63½        | 63½ (63¾)        | 64 (64)         | 64 (64)        | 64        |
| <b>CPI inflation<sup>(y)</sup></b>  | <b>1½</b> | <b>2¼</b>  | <b>½ (¼)</b>     | <b>2 (1¾)</b>   | <b>2 (2)</b>   | <b>2</b>  |
| UK import prices <sup>(z)</sup>   | 0         | 1½         | 1¼ (-¾)          | -¼ (¼)          | ¼ (¼)          | ¼         |
| Energy prices — direct contribution to CPI inflation <sup>(aa)</sup>                    | ¼         | ¼          | -½ (-¾)          | ¼ (0)           | 0 (0)          | 0         |
| Average weekly earnings <sup>(ab)</sup>   | 4¼        | 2          | 1 (-1¼)          | 2¼ (3)          | 2½ (3¾)        | 3¼        |
| Unit labour costs <sup>(ac)</sup>   | 3         | 1½         | 11 (1¼)          | -7 (-¾)         | 2¼ (3½)        | 2¾        |
| Private sector regular pay based unit wage costs <sup>(ad)</sup>                        | 1¾        | 1½         | 10¾ (4¾)         | -5¼ (-¾)        | 3¼ (3¾)        | 3¼        |

Sources: Bank of England, Bloomberg Finance L.P., Department for Business, Energy and Industrial Strategy, Eurostat, IMF *World Economic Outlook (WEO)*, National Bureau of Statistics of China, ONS, US Bureau of Economic Analysis and Bank calculations.

(a) The profiles in this table should be viewed as broadly consistent with the MPC's projections for GDP growth, CPI inflation and unemployment (as presented in the fan charts).

(b) Figures show annual average growth rates unless otherwise stated. Figures in parentheses show the corresponding projections in the August 2020 *Monetary Policy Report*. Calculations for back data based on ONS data are shown using ONS series identifiers.

(c) Chained-volume measure. Constructed using real GDP growth rates of 188 countries weighted according to their shares in UK exports.

(d) Chained-volume measure. Constructed using real GDP growth rates of 189 countries weighted according to their shares in world GDP using the IMF's purchasing power parity (PPP) weights.

(e) Chained-volume measure.

(f) Chained-volume measure.

(g) Chained-volume measure. Constructed using real GDP growth rates of 155 EME countries, as defined by the IMF *WEO*, weighted according to their relative shares in world GDP using the IMF's PPP weights.

(h) Chained-volume measure.

(i) Excludes the backcast for GDP.

(j) Chained-volume measure. Includes non-profit institutions serving households. Based on ABJR+HAYO.

(k) Chained-volume measure. Based on CAN8.

(l) Chained-volume measure. Whole-economy measure. Includes new dwellings, improvements and spending on services associated with the sale and purchase of property. Based on DFEG+L635+L637.

(m) Chained-volume measure. The historical data exclude the impact of missing trader intra-community (MTIC) fraud. Since 1998 based on IKBK-OFNNI/(BOKH/BQKO). Prior to 1998 based on IKBK.

(n) Chained-volume measure. The historical data exclude the impact of MTIC fraud. Since 1998 based on IKBL-OFNNI/(BOKH/BQKO). Prior to 1998 based on IKBL.

(o) Chained-volume measure. Exports less imports. GDP data based on the mode of the MPC's GDP backcast.

(p) Wages and salaries plus mixed income and general government benefits less income taxes and employees' National Insurance contributions, deflated by the consumer expenditure deflator. Based on [ROY]+ROYH-(RPHS+AIV-CUCT)+GZVX)/[(AB)Q+HAYE]/(ABJR+HAYO)].

(q) Annual average. Percentage of total available household resources. Based on NRJS.

(r) Level in Q4. Percentage point spread over reference rates. Based on a weighted average of household and corporate loan and deposit spreads over appropriate risk-free rates. Indexed to equal zero in 2007 Q3.

(s) Annual average. Per cent of potential GDP. A negative figure implies output is below potential and a positive figure that it is above.

(t) GDP per hour worked. GDP data based on the mode of the MPC's GDP backcast. Hours worked based on YBUS.

(u) Four-quarter growth in LFS employment in Q4. Based on MGRZ.

(v) Level in Q4. Average weekly hours worked, in main job and second job. Based on YBUS/MGRZ.

(w) LFS unemployment rate in Q4. Based on MGSX.

(x) Level in Q4. Percentage of the 16+ population. Based on MCGW.

(y) Four-quarter inflation rate in Q4.

(z) Four-quarter inflation rate in Q4 excluding fuel and the impact of MTIC fraud.

(aa) Contribution of fuels and lubricants and gas and electricity prices to four-quarter CPI inflation in Q4.

(ab) Four-quarter growth in whole-economy total pay in Q4. Growth rate since 2001 based on KAB9. Prior to 2001, growth rates are based on historical estimates of AWE, with ONS series identifier MD9M.

(ac) Four-quarter growth in unit labour costs in Q4. Whole-economy total labour costs divided by GDP at constant prices, based on the mode of the MPC's GDP backcast. Total labour costs comprise compensation of employees and the labour share multiplied by mixed income.

(ad) Four-quarter growth in private sector regular pay based unit wage costs in Q4. Private sector wage costs divided by private sector output at constant prices, based on the mode of the MPC's GDP backcast. Private sector wage costs are average weekly earnings (excluding bonuses) multiplied by private sector employment.

## Box 1

### Monetary policy since the August 2020 Report

At its meeting ending on 16 September 2020, the MPC voted unanimously to maintain Bank Rate at 0.1%. The Committee voted unanimously for the Bank of England to continue with its existing programmes of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, maintaining the target for the total stock of these purchases at £745 billion.

Indicators of global activity had been broadly in line with the Committee's expectations at the time of the August MPC meeting. The sterling exchange rate index had fallen by around 2%, in part reflecting recent Brexit developments.

UK GDP in July was around 18½% above its trough in April and around 11½% below its 2019 Q4 level. High-frequency payments data suggested that consumption had continued to recover during the summer and was at around its start-of-year level in aggregate, stronger than expected in the *August 2020 Report*. Investment intentions had remained very weak and uncertainties among businesses were elevated. For 2020 Q3 as a whole, Bank staff expected GDP to be around 7% below its 2019 Q4 level, less weak than had been expected in the *August 2020 Report*. Administrative data suggested that the number of paid employees had fallen by around 700,000 between February and August. The number of furloughed workers had continued to decline; considerable uncertainty remained around the labour market after the government job support schemes unwind.

Twelve-month CPI inflation fell from 1.0% in July to 0.2% in August, consistent with temporary impacts on inflation from the Government's Eat Out to Help Out scheme and the cut in VAT for hospitality, holiday accommodation and attractions. This triggered an exchange of open letters between the Governor and the Chancellor. CPI inflation was expected to remain below 1% until early 2021, albeit slightly higher than expected at the time of the *August 2020 Report*.

Recent domestic economic data had been a little stronger than the Committee expected at the time of the *August 2020 Report*, although, given the risks, it was unclear how informative they were about how the economy would perform further out. The recent increases in Covid-19 cases in some parts of the world, including the United Kingdom, had the potential to weigh further on economic activity, albeit probably on a lesser scale than seen earlier in the year. As in the *August 2020 Report*, there remained a risk of a more persistent period of elevated unemployment than in the central projection.

At this meeting, the Committee judged that the existing stance of monetary policy remained appropriate.

## 2 Current economic conditions

Global growth picked up in Q3, although the level of GDP remained around 4% lower than in 2019 Q4. Global growth is expected to slow in Q4, as rising Covid cases and associated restrictions weigh on activity. Movements in UK asset prices have been mixed since August, while interest rates on new mortgages have picked up.

UK activity recovered as lockdown measures eased in Q3, leaving it around 9% below its 2019 Q4 level. The recent rise in the number of Covid cases and associated social distancing measures will weigh on activity in the near term, with GDP expected to decline by around 2% in Q4. While the fall in UK activity over 2020 has reflected a decline in both demand and supply, overall there is judged to be a material amount of spare capacity in the economy. Unemployment is expected to rise to around 6.3% by the end of the year. This is a smaller rise than expected in August, largely reflecting the impact of government support schemes. The outlook for the economy remains unusually uncertain.

Inflation was 0.6% in Q3, below the MPC’s 2% target. That largely reflected the temporary impact of lower energy prices and the cut in VAT, as well as some downward pressure from spare capacity. Inflation remains below target in the near term.

**Chart 2.1:** GDP recovered in Q3, but remains around 9% below its 2019 Q4 level. Unemployment is expected to rise over the coming months. Inflation is expected to remain below the MPC’s target

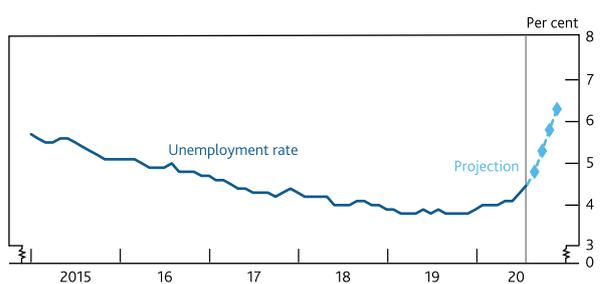
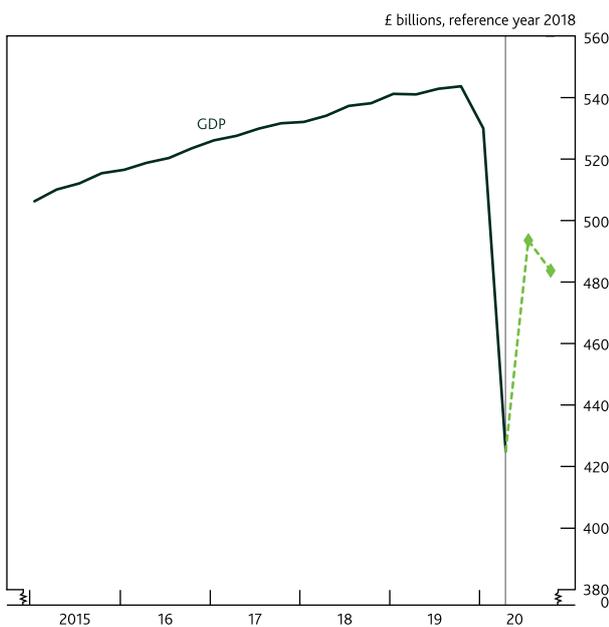
Near-term projections

2020 Q3<sup>(a)</sup>: **+16.1%**

2020 Q4: **-2.0%**

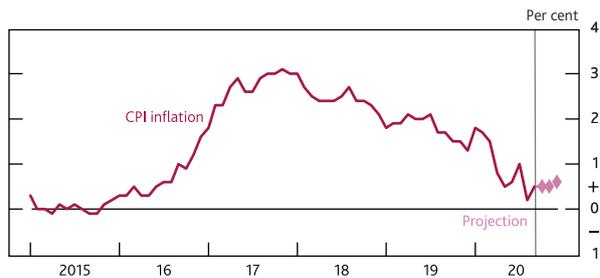
2020 Q3<sup>(a)</sup>: **4.8%**

2020 Q4: **6.3%**



2020 Q3<sup>(a)</sup>: **0.6%**

2020 Q4: **0.6%**



Sources: ONS and Bank calculations.

(a) GDP and unemployment projections are based on official data to August. CPI inflation figure is an outturn.

## 2.1 The global economy

*Global growth recovered in Q3, although activity remains 4% below its level at the end of 2019.*

The recovery in global activity, which began in May and June, continued in Q3. Bank staff estimate that UK-weighted world GDP increased by around 8% in Q3 (**Table 2.A**), stronger than expected in the *August Report*. This left the level of global GDP around 4% lower than in 2019 Q4, given the substantial falls in activity in the first half of the year. Those falls reflected the impact of the Covid-19 pandemic and the social distancing measures imposed to contain its spread.

**Table 2.A:** After a sharp fall in world GDP over Q2, activity recovered across regions in Q3

GDP in selected countries and regions<sup>(a)</sup>

|   | Percentage changes on a quarter earlier |         |         |      |       |       |      |
|---|---|---------|---------|------|-------|-------|------|
|   | Quarterly averages                      |         |         |      | 2020  |       |      |
|   | 1998–2007                               | 2008–09 | 2010–18 | 2019 | Q1    | Q2    | Q3   |
| United Kingdom <sup>(b)</sup>           | 0.7                                     | -0.6    | 0.5     | 0.3  | -2.5  | -19.8 | 16.1 |
| Euro area (40%)                         | 0.6                                     | -0.6    | 0.3     | 0.2  | -3.7  | -11.8 | 12.7 |
| United States (19%)                     | 0.7                                     | -0.3    | 0.6     | 0.6  | -1.3  | -9.0  | 7.4  |
| China (4%) <sup>(c)</sup>               | 2.5                                     | 2.3     | 1.9     | 1.5  | -10.0 | 11.7  | 2.7  |
| UK-weighted world GDP <sup>(b)(d)</sup> | 0.7                                     | -0.2    | 0.6     | 0.4  | -2.6  | -9.3  | 8.3  |

Sources: Eikon from Refinitiv, IMF *World Economic Outlook (WEO)*, National Bureau of Statistics of China, OECD, ONS and Bank calculations.

(a) Figures in parentheses are shares in UK exports in 2018.

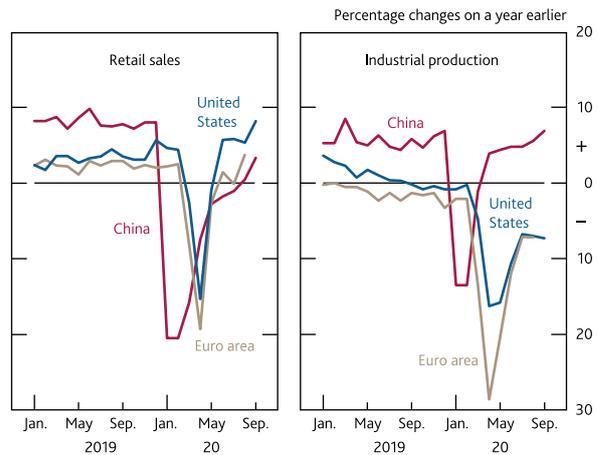
(b) Figures for 2020 Q3 are Bank staff projections.

(c) Estimates from 2010 Q4 onwards are from the National Bureau of Statistics of China.

(d) See footnote (c) of **Table 1.B**.

**Chart 2.2:** Retail sales rebounded quickly in the US and euro area, while industrial production recovered faster in China

Retail sales and industrial production in selected economies<sup>(a)</sup>



Sources: Eikon from Refinitiv, Eurostat, Federal Reserve, National Bureau of Statistics of China, US Census Bureau and Bank calculations.

(a) Retail sales are measured in current prices for China and the US, and in constant prices for the euro area. Food services are excluded from the US headline retail trade measure for comparability. Industrial production is measured in constant prices. January and February data for China are published as a combined figure, held constant for both months in the chart, due to the effects of the Lunar New Year. Data for the euro area and China are not seasonally adjusted. Data are only available to August for the euro area.

*In the US and euro area, the recovery was largely driven by higher consumer spending...*

Consumer spending has picked up markedly in the US and the euro area, underpinning the rebound in GDP in Q3. By June, annual growth in retail sales had returned to positive territory, and there was further growth subsequently (**Chart 2.2**), although these measures do not fully capture some types of consumer spending which have been worst hit, for example in restaurants and hotels. Spending recovered as some of the most widespread and stringent social distancing measures were relaxed.

Government support for incomes and employment has also helped the recovery in spending. In the euro area, the unemployment rate was only around a percentage point higher in September than at the start of the year, as many countries introduced employment support schemes. In the US, where the September unemployment rate was just over 4 percentage points higher than in January, direct payments to households and enhanced unemployment benefits earlier in the year supported incomes.

*... while, by contrast, the recovery in China has been led by industrial production.*

In China, GDP rose by 2.7% in Q3, and was a little above its 2019 Q4 level. In contrast to the euro area and the US, the recovery in China was led by investment and exports. Industrial production was 4% higher than a year earlier by April 2020, whereas retail sales were slower to recover (**Chart 2.2**). The balance of the recovery in China reflects the focus of policy support measures on businesses, and also the strong global demand for Chinese exports of medical supplies and technology products.

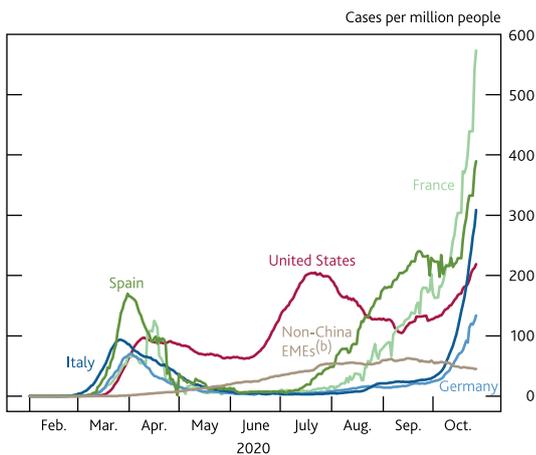
Although experiences have varied across countries, PPP-weighted GDP in other emerging market economies (EMEs) is estimated to have recovered by around 7% in Q3. This is a little stronger than expected in the *August Report*.

### Global growth is expected to slow in Q4, as Covid cases rise and restrictions are tightened.

Bank staff expect growth in UK-weighted world GDP to slow to below 1% in Q4. In part, that slowing reflects growing Covid-19 cases in a number of major economies (**Chart 2.3**) and an associated tightening in restrictions to help curb the transmission of the virus. Mobility indices — which are one indicator of the impact of Covid-19 on activity — have trended down over the past few months, although they remain much higher than earlier in the pandemic (**Chart 2.4**). The euro-area services purchasing managers' index also suggests that activity weakened in September and October. At the end of October, France and Germany announced new nationwide restrictions set to be in place for several weeks, which are likely to slow activity further.

**Chart 2.3: Covid cases are rising again in the US and large European countries**

Daily new confirmed Covid-19 cases in selected countries<sup>(a)</sup>



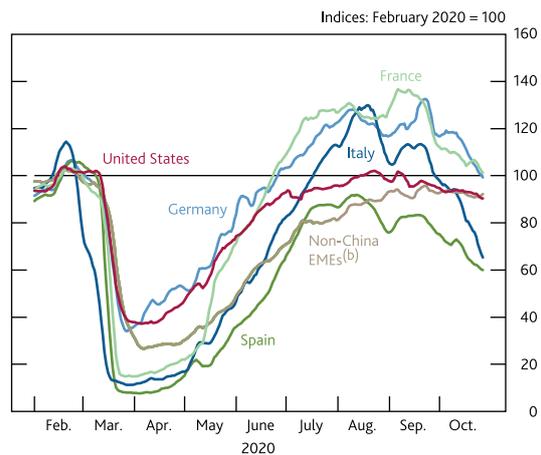
Sources: COVID-19 Data Repository by the Centre for Systems Science and Engineering (CSSE) at Johns Hopkins University, World Bank and Bank calculations.

(a) Seven-day moving averages, scaled by 2019 population. Data are shown to 27 October and are not seasonally adjusted. Cases in overseas departments are included in line with World Bank definitions of population.

(b) Series includes Brazil, India, Indonesia, Mexico, Russia, South Africa and Turkey.

**Chart 2.4: Mobility indices have fallen in some countries, but they remain higher than earlier in the pandemic**

Apple mobility indices<sup>(a)</sup>



Sources: Apple Mobility Index, IMF WEO and Bank calculations.

(a) Level of requests for directions in Apple Maps. Mobility is assumed to stay constant where data are missing. Seven-day moving averages to 27 October. Data are not seasonally adjusted.

(b) The PPP-weighted average of indices for Brazil, India, Indonesia, Mexico, Russia, South Africa and Turkey.

### Substantial fiscal support and continued accommodative monetary policy have supported spending.

Activity continues to be supported by substantial stimulus from fiscal and monetary policy. Government net borrowing in advanced economies increased sharply in 2020 Q2. Since then, labour market support has been extended in the largest euro-area countries. In the US, a new fiscal support package has yet to be agreed after the expiry of extended enhanced unemployment insurance. The scale of fiscal support has led to advanced-economy governments borrowing on a far greater scale than during the financial crisis (**Chart 2.5**).

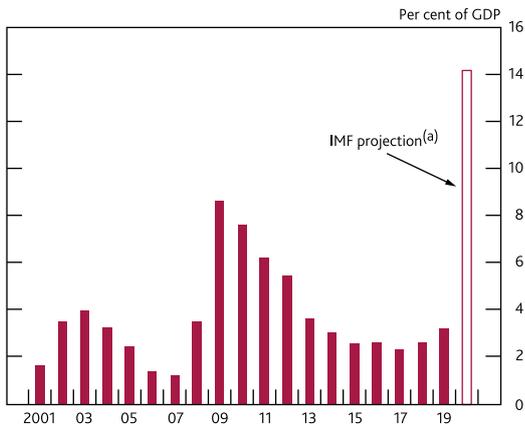
The Federal Open Market Committee and the ECB Governing Council left monetary policy unchanged at their recent meetings. Market-implied paths for policy rates in advanced economies have been broadly unchanged since the *August Report*, suggesting policy rates will remain at very low levels for several years (**Chart 2.6**).

### Inflation remains low across advanced economies...

Inflation across advanced economies remains low. Headline consumer price inflation was -0.3% in the euro area and 1.4% in the US in September (**Table 2.B**). Some of that weakness reflects lower oil prices, but core inflation is also subdued, particularly in the euro area. Low core inflation probably reflects the impact of Covid-19 on demand, as well as policy responses such as VAT cuts.

**Chart 2.5: Governments have provided substantial fiscal support to their economies**

Advanced-economy general government net borrowing

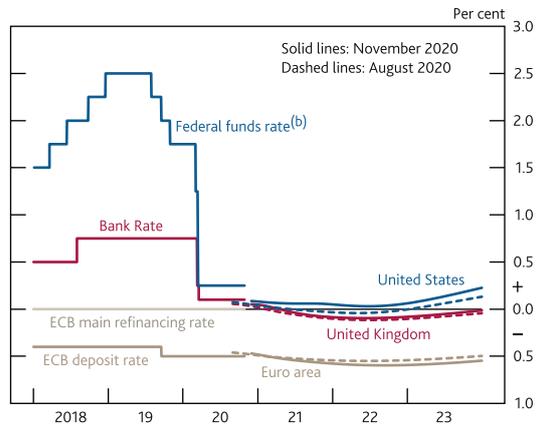


Source: IMF WEO.

(a) Hollow bar shows the IMF projection for 2020 from the October 2020 WEO.

**Chart 2.6: Market-implied paths for policy rates are broadly unchanged since August**

International forward interest rates<sup>(a)</sup>



Sources: Bloomberg Finance L.P. and Bank calculations.

(a) All data as of 28 October 2020. The November and August curves are estimated using instantaneous forward overnight index swap rates in the 15 working days to 28 October and 29 July respectively.  
(b) Upper bound of the target range.

*...although measures of inflation expectations have risen, after falling sharply in Q1.*

Measures of longer-term inflation compensation have picked up across advanced economies after falling sharply in March (Chart 2.7). The move has been particularly marked in the US since the August Report. Some of that rise is likely to reflect the Federal Reserve’s announced move to a form of average inflation targeting. Under that approach, monetary policy will aim to achieve periods of inflation moderately above target to offset periods of below-target inflation. While measures of longer-term inflation expectations have recovered to their levels at the start of the year in the US and UK, they remain around 20 basis points lower in the euro area.

**Table 2.B: Inflation remains subdued across advanced economies**

Inflation in selected advanced economies

Per cent

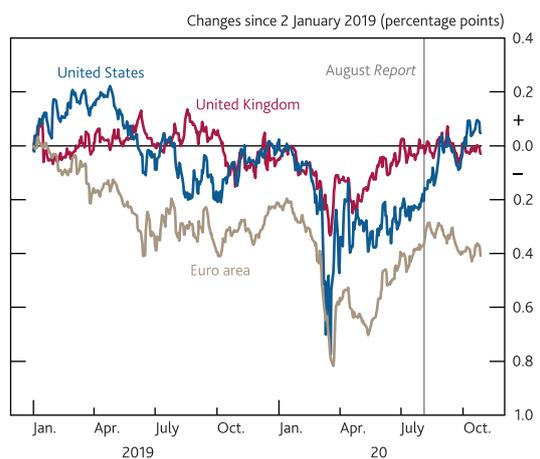
|   | Monthly averages |         | 2020 |     |      |      |      |      |
|---|------------------|---------|------|-----|------|------|------|------|
|   | 1998–2007        | 2010–19 | Jan. | May | June | July | Aug. | Sep. |
| <b>Annual headline consumer price inflation</b>                                       |                  |         |      |     |      |      |      |      |
| United Kingdom  | 1.6              | 2.2     | 1.8  | 0.5 | 0.6  | 1.0  | 0.2  | 0.5  |
| Euro area   | 2.0              | 1.4     | 1.4  | 0.1 | 0.3  | 0.4  | -0.2 | -0.3 |
| United States <sup>(a)</sup>  | 2.1              | 1.6     | 1.9  | 0.5 | 0.9  | 1.0  | 1.3  | 1.4  |
| <b>Annual core consumer price inflation (excluding food and energy)<sup>(b)</sup></b> |                  |         |      |     |      |      |      |      |
| United Kingdom  | 1.2              | 2.1     | 1.6  | 1.2 | 1.4  | 1.8  | 0.9  | 1.3  |
| Euro area   | 1.6              | 1.1     | 1.1  | 0.9 | 0.8  | 1.2  | 0.4  | 0.2  |
| United States <sup>(a)</sup>  | 1.8              | 1.6     | 1.8  | 1.0 | 1.1  | 1.3  | 1.4  | 1.5  |

Sources: Eikon from Refinitiv, Eurostat, ONS, US Bureau of Economic Analysis and Bank calculations.

(a) Personal consumption expenditure price index inflation.  
(b) For the euro area and the UK, excludes energy, food, alcoholic beverages and tobacco. For the US, excludes food and energy.

**Chart 2.7: Implied inflation expectations have picked up since March**

Changes in five-year, five-year forward inflation compensation<sup>(a)</sup>



Sources: Bloomberg Finance L.P. and Bank calculations.

(a) Derived from swaps. The instruments are linked to the UK RPI, US CPI and euro-area HICP measures of inflation respectively.

## 2.2 Financial markets and credit conditions

*Equity price moves have been mixed since August, while corporate bond spreads have fallen a little further.*

In the run-up to the *November Report*, the US S&P 500 index was a little higher than in the *August Report*, while the Euro Stoxx index has fallen a little. In the last few days of October, a number of equity indices fell markedly (**Chart 2.8**).<sup>(1)</sup>

Across advanced economies, non-financial corporate bond spreads have fallen materially since March, with further small declines since the *August Report* (**Chart 2.9**). Nevertheless, high-yield spreads remain over 100 basis points higher than in February.

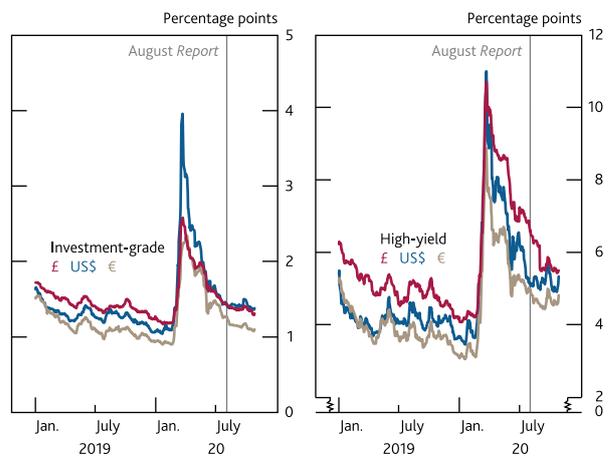
**Chart 2.8: Movements in equity prices have been mixed since the August Report**  
International equity prices<sup>(a)</sup>



Sources: Eikon by Refinitiv, MSCI and Bank calculations.

- (a) In local currency terms, except for MSCI Emerging Markets which is in US dollar terms.  
(b) The MSCI Inc. disclaimer of liability, which applies to the data provided, is available from the [November 2020 Monetary Policy Report](#).

**Chart 2.9: Investment-grade corporate bond spreads have recovered most of the way to pre-Covid levels**  
International non-financial corporate bond spreads<sup>(a)</sup>



Sources: Eikon from Refinitiv, ICE/BoAML Global Research and Bank calculations.

- (a) Option-adjusted spreads on government bond yields. Investment-grade corporate bond yields are calculated using an index of bonds with a rating of BBB3 or above. High-yield corporate bond yields are calculated using aggregate indices of bonds rated lower than BBB3. Due to monthly index rebalancing, movements in yields at the end of each month might reflect changes in the population of securities within the indices.

*UK-specific factors, such as Brexit, have affected UK asset prices.*

The FTSE All-Share index rebounded less strongly from Covid-19 lows than other equity indices (**Chart 2.8**) and has fallen by 4% since the run-up to the *August Report*. The muted recovery can be explained, in part, by the composition of the index: sectors which have been hardest hit by the pandemic feature more prominently in the FTSE than in other indices. Economic activity has been somewhat lower in the UK relative to other advanced economies, which may have also played a role. Market contacts indicate that Brexit developments have also weighed on UK asset prices.

News reports about the terms on which the UK and EU will trade from 1 January 2021 has been an important factor driving moves in sterling since August. Sterling fell by 4% in early September, but it has subsequently recovered to a little above its level in the run-up to the *August Report* (**Chart 2.10**). Market pricing suggests that the outlook for sterling is uncertain: market-implied sterling volatilities have increased since August and risk reversals suggest that market participants place more weight on a large depreciation than a large appreciation.

The market-implied path for Bank Rate has changed little since the *August Report* (**Chart 2.6**). The path moves below zero during 2021, as was the case in August. This suggests that market participants attach some weight to the possibility of a negative Bank Rate.

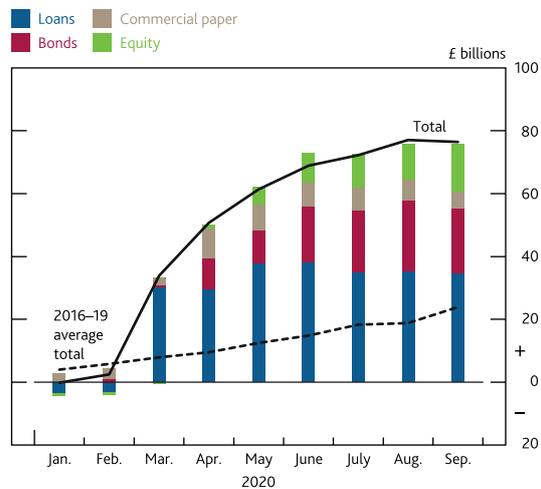
(1) All financial market data shown in charts within this section are to 28 October 2020.

**Chart 2.10: Sterling has appreciated a little overall since the run-up to the August Report**  
Sterling ERI



**Chart 2.11: Corporates have raised more finance in 2020 so far than in previous years**

Cumulative net finance raised by private non-financial corporations since January<sup>(a)</sup>



Sources: Bank of England and Bank calculations.

(a) Components may not sum to total as a result of seasonal adjustment. Data are for UK-resident PNFCs.

### *Corporate credit conditions have been supported by government-backed loan schemes...*

Corporates have raised almost £80 billion of net finance since the beginning of the year, around three times higher than that raised over the same period on average over the past four years (Chart 2.11). Government-backed loan schemes have helped many businesses access credit: just over £60 billion has been approved in total under the Bounce Back Loan Scheme (BBLs), the Coronavirus Business Interruption Loan Scheme (CBILs) and the Coronavirus Large Business Interruption Loan Scheme. In addition, as of 28 October, large companies had outstanding drawings of around £15 billion under the Covid Corporate Financing Facility. The 12-month interest-free period for firms borrowing through the BBLs and CBILs has contributed to a fall in corporate interest rates, especially for SMEs (Table 2.C). In the absence of government guarantees, the cost of credit probably would have increased and its availability may have been reduced as banks factored in increased credit risk.

### *...which have been extended since the August Report...*

Government-backed lending schemes have been extended to allow applications until the end of January 2021. The maximum length of the loans through the BBLs and CBILs has also been extended from six to ten years. The Bank announced that TFSME participants would be able to extend the term of some of their funding to align with the term of loans made through the BBLs. These changes will support credit conditions for corporates.

### *...although some firms in the hardest hit sectors have reported tighter credit conditions.*

Many corporates that have wanted credit have been able to borrow what they needed already, but some firms have found it harder to access credit. Reports to the Bank's Agents suggest there has been some further tightening in conditions since August for firms in the sectors most exposed to the impact of the pandemic (Box 2).

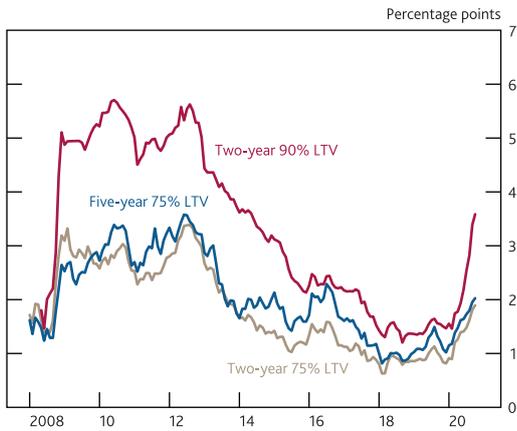
### *Interest rates on new mortgages have increased...*

Advertised rates on new mortgages have increased further since the August Report. Interest rates are now almost 50 basis points higher than in April for mortgages with a 75% loan to value (LTV) ratio and 165 basis points higher for those with a 90% LTV (Table 2.C). Rates for 90% LTV mortgages are at their highest level since 2015.

Mortgage rates have increased as risk-free rates have fallen over 2020, meaning that mortgage spreads have widened. The widening has been most pronounced at higher LTVs (Chart 2.12). Despite the recent rise, spreads remain lower than in the years after the financial crisis. Spreads declined substantially from 2013 as bank funding costs fell and banks competed for customers (see Box 2 of the [May 2019 Report](#)).

**Chart 2.12: Mortgage spreads have increased, particularly at high LTVs**

Spreads on selected fixed-rate mortgages<sup>(a)</sup>

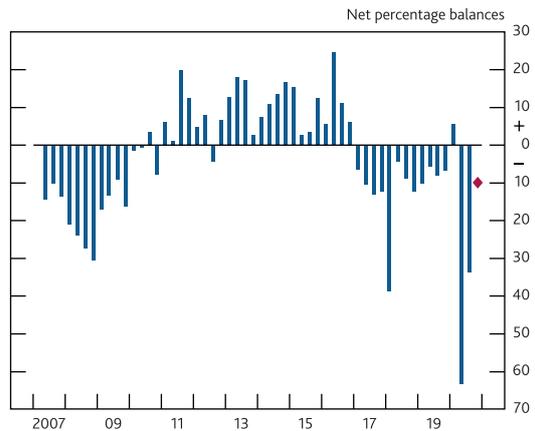


Sources: Bank of England, Bloomberg Finance L.P. and Bank calculations.

(a) Spreads over swap rates of equivalent maturity. Data are not seasonally adjusted. October 2020 quoted rates data are flash estimates using data to 28 October and are subject to change until publication on 6 November. See footnote (a) of Table 2.C for more detail on the Bank's quoted rates series.

**Chart 2.13: Lenders reported further reductions in the availability of unsecured credit in Q3**

Household unsecured credit availability<sup>(a)</sup>



Source: Bank of England Credit Conditions Survey.

(a) Lender responses are weighted by market shares. A positive balance indicates an increase in availability. The red diamond shows the expected change over the next three months, as reported in the Q3 Survey.

*...and product availability remains constrained, especially at higher LTVs.*

The number of advertised mortgage products has continued to fall in recent months and is materially lower than earlier in the year. In the early stages of the pandemic, some lenders pulled back from the market due to operational constraints, such as staff shortages and constraints on physical property valuations. While some lenders have reintroduced products since, others have withdrawn further, especially at higher LTVs. This has contributed to the rise in average high LTV rates, as several of the largest lenders, which tended to charge lower rates than others, have withdrawn their products.

*This has occurred partly in response to very strong demand for mortgages...*

Demand for mortgages has been very high, reflecting the strength in housing demand since May (Section 2.3). Intelligence from the Bank's Agents suggests that the high volume of applications has led to operational difficulties for lenders, lengthening processing times. As a result, lenders may have increased spreads and reduced product availability. Intelligence from lenders suggests that these operational constraints have been the primary driver of changes in spreads at lower LTVs.

*...but may also reflect reduced risk appetite from lenders due to the riskier economic outlook.*

Higher spreads and reduced availability may also reflect lender concerns over the economic outlook, particularly for high LTV loans. When the economic outlook worsens or becomes more uncertain, lenders tend to charge higher interest rates to compensate for additional risk.

The reported willingness of lenders to lend to borrowers with LTVs of more than 90% was broadly unchanged in the latest *Credit Conditions Survey (CCS)*, but that followed a sharp fall in availability in Q2. Lenders cited expectations for house prices and the economic outlook as important factors behind the recent falls in availability. Lenders also reported that credit scoring criteria had tightened further.

*There are also signs of tighter conditions for consumer credit.*

There are also signs of tighter credit conditions for unsecured lending such as personal loans and credit cards. A further material tightening was reported in unsecured credit availability in the Q3 CCS (Chart 2.13). Tighter conditions could have contributed to lower lending volumes: gross consumer credit lending has continued to recover but remains over 15% lower than at the start of the year. A sharp fall in the demand for credit, as household spending contracted, will also have contributed to the reduction.

*Apart from the widening in mortgage spreads, UK financial conditions are little changed since August.*

A summary measure of UK financial conditions points to a tightening since the August Report (Chart 2.14). This has been driven almost entirely by the increases in mortgage spreads, which, in part, reflects strong borrower demand. Apart from that, financial conditions are little changed.

**Table 2.C: Advertised interest rates have increased for new mortgages**

Selected household and corporate interest rates<sup>(a)</sup>

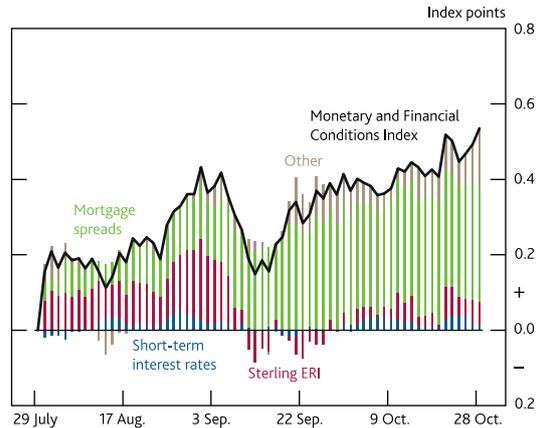
|   | Latest<br>(per cent) | Changes since (basis points) |              |              |              |
|---|----------------------|------------------------------|--------------|--------------|--------------|
|   |                      | July<br>2020                 | Apr.<br>2020 | Jan.<br>2020 | Jan.<br>2016 |
| <b>Quoted rates on new lending and deposits</b> |                      |                              |              |              |              |
| <b>Mortgages</b>                                |                      |                              |              |              |              |
| Two-year fixed rate, 75% LTV                    | 1.85                 | 41                           | 47           | 44           | -8           |
| Two-year fixed rate, 90% LTV                    | 3.54                 | 104                          | 165          | 149          | 69           |
| <b>Consumer credit</b>                          |                      |                              |              |              |              |
| £10,000 personal loan                           | 3.44                 | 1                            | 0            | -14          | -85          |
| Credit card                                     | 20.92                | 36                           | 29           | 15           | 296          |
| <b>Deposits</b>                                 |                      |                              |              |              |              |
| Instant access                                  | 0.08                 | -1                           | -20          | -33          | -39          |
| One-year fixed-rate bond                        | 0.36                 | -9                           | -33          | -61          | -72          |
| <b>Effective rates<sup>(b)</sup></b>            |                      |                              |              |              |              |
| <b>Mortgages<sup>(c)</sup></b>                  |                      |                              |              |              |              |
| Fixed-rate mortgage                             | 2.09                 | -2                           | -5           | -7           | -95          |
| Floating-rate mortgage                          | 2.27                 | -2                           | -12          | -67          | -61          |
| <b>PNFCs</b>                                    |                      |                              |              |              |              |
| New loans                                       | 1.65                 | -9                           | -61          | -103         | -100         |
| <i>of which to SMEs</i>                         | 1.72                 | 7                            | -77          | -165         | -160         |

(a) The Bank's quoted rates series are weighted monthly average rates advertised by all UK banks and building societies with products meeting the specific criteria. In February 2019 the method used to calculate these data was changed. More information is available on the [Bank's website](#). The Bank's effective rate series are weighted monthly averages of rates from a sample of banks and building societies with products meeting the specific criteria. Data are not seasonally adjusted. Latest quoted rates data are flash estimates for October using data to 28 October and are subject to change until publication on 6 November. Latest effective rates data are for September.

(b) Effective rates on the outstanding stock of loans, unless otherwise stated.

(c) Mortgages to individuals and individual trusts.

**Chart 2.14: Widening mortgage spreads have pushed up a measure of UK financial conditions since the August Report**  
Contributions to changes in the UK Monetary and Financial Conditions Index since the August 2020 Report<sup>(a)</sup>



Sources: Bloomberg Finance L.P., Eikon from Refinitiv, ICE/BoAML Global Research and Bank calculations.

(a) The UK Monetary and Financial Conditions Index (MFCI) summarises information from the following series: short-term interest rates, the sterling ERI, corporate bond spreads, equity prices, and household and corporate bank lending spreads. The series weights are based on the estimated impact of each variable on UK GDP. The chart shows changes in the MFCI from the average level over the 15 working days to 29 July 2020. An increase in the MFCI signals tighter financial conditions and a decrease signals looser conditions. For more information, see ['How can we measure UK financial conditions?'](#).

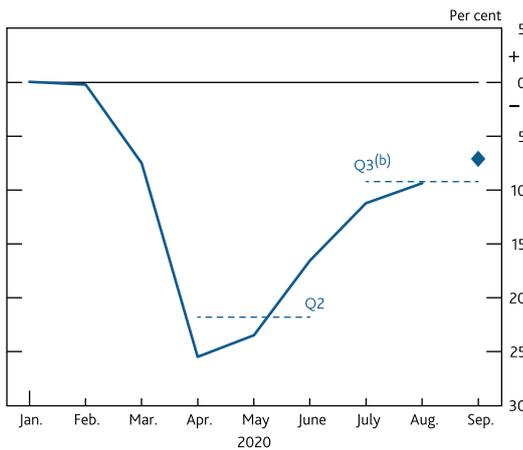
## 2.3 Demand and output

*Output has recovered since April, although it remained 9% below its 2019 Q4 level in August.*

Output fell sharply during March and April as the outbreak of Covid-19 and the interventions taken to contain its spread led to a sharp contraction in economic activity. GDP fell by around a quarter between February and April. Activity recovered somewhat thereafter, as lockdown restrictions were eased. GDP was 9% below its 2019 Q4 level in August, and is expected to be 9% lower over Q3 as a whole (Chart 2.15). That is around 50% larger than the peak-to-trough fall in GDP during the financial crisis.

**Chart 2.15: Output recovered after falling sharply in March and April**

Change in GDP relative to 2019 Q4<sup>(a)</sup>

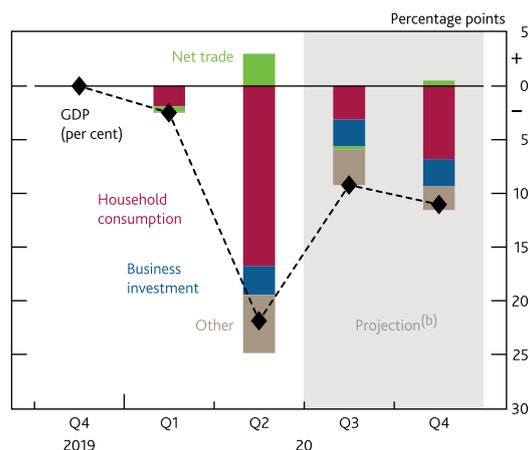


Sources: ONS and Bank calculations.

- (a) Diamond is a Bank staff projection for September.  
 (b) Bank staff projection.

**Chart 2.16: The recovery was driven by a sharp pickup in consumption**

Contributions to change in GDP since 2019 Q4<sup>(a)</sup>



Sources: ONS and Bank calculations.

- (a) Household consumption data include non-profit institutions serving households (NPISH) and net trade data exclude the impact of missing trader intra-community (MTIC) fraud.  
 (b) Bank staff projection.

*Consumer spending picked up markedly...*

Various indicators suggest that consumption has increased sharply since April, and this expenditure component is expected to have driven much of the recovery in GDP in Q3 (Chart 2.16). Retail sales rose to above their level in February. This may overstate the strength of aggregate consumption, however. For example, retail sales exclude some forms of social spending, which remained weaker than other categories of consumption (Chart 3.1). Other indicators suggest that spending has picked up sharply, but to a lesser extent than retail sales. Overall, consumption is expected to have risen by around 30% in Q3, but to have been around 5% below its level in 2019 Q4.

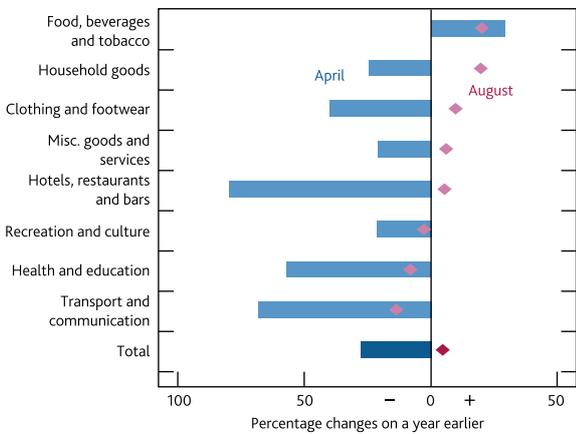
Some forms of social spending nonetheless picked up markedly in Q3. Having fallen sharply in April, Visa data suggest that spending in hotels and restaurants was around 5% higher in August than the same time last year (Chart 2.17). The Government's Eat Out to Help Out (EOTHO) scheme will have accounted for some of this strength. It is also possible that the pickup reflected perceptions of reduced health risks at that time.

The pickup in consumption also reflects increased spending on household furnishings, clothing and other big-ticket items. Card spending data suggest that spending on household goods in August was around 20% higher than the same time last year (Chart 2.17). This probably reflects some pent-up demand. Despite the shift to online retailing during the pandemic (Section 3), the closure of non-essential shops made it less convenient to purchase some of these goods during lockdown. As a result, some of the rise in spending reflects those purchases subsequently being made. In addition, it is likely to reflect some substitution away from spending on social and work-related consumption.

The household saving rate spiked in Q2 (Chart 2.18), as some consumers were unable to spend as they might have liked. That rise in saving was not evenly distributed across households however, with those on lower incomes reporting a fall in savings, on average (see Box 3 of the *August 2020 Report*). As spending recovered, the saving rate is expected to have fallen back to around 10% in Q3.

**Chart 2.17: The recovery in spending was driven by household goods and a pickup in some forms of social consumption**

Consumer spending by sector<sup>(a)</sup>

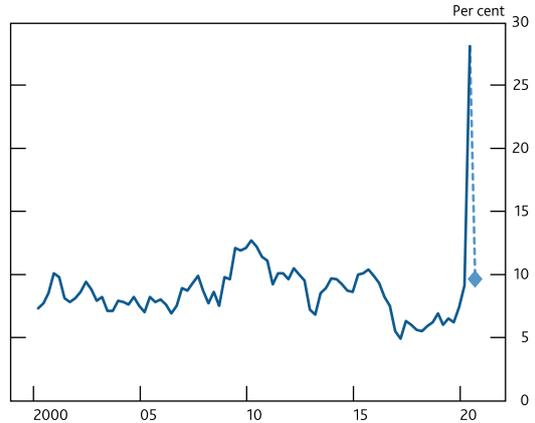


Source: Visa.

(a) Volume measure. Data are not adjusted for seasonality or trading days.

**Chart 2.18: The household saving rate is expected to have fallen back in Q3**

Saving ratio<sup>(a)</sup>



Sources: ONS and Bank calculations.

(a) Saving as a percentage of household post-tax income. Includes NPISH. Diamond is a Bank staff projection for Q3.

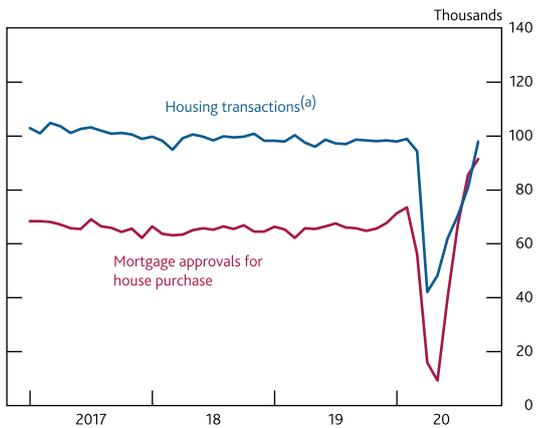
*... and demand was strong in the housing market.*

The housing market has also strengthened. There were around 91,000 mortgage approvals for house purchase in September (**Chart 2.19**) — the largest number of approvals recorded in a single month since 2007. As with some consumer spending, the rise is likely to reflect some pent-up demand: the housing market was effectively closed for seven weeks between March and May. The temporary increase in the threshold at which homebuyers start paying stamp duty in England and Northern Ireland has also provided some support to activity. As a result of higher demand, house price inflation picked up notably in recent months (**Chart 2.20**).

While transactions and house prices have risen, housing starts — a leading indicator of dwellings investment — remained weak. Companies that build houses may not expect the strength in housing demand to persist — contacts of the Bank’s Agents expect demand to ease over the next six months, as the stamp duty cut and the current form of the Help to Buy equity loan scheme come to an end.

**Chart 2.19: Housing transactions and mortgage approvals recovered strongly**

Mortgage approvals and housing transactions

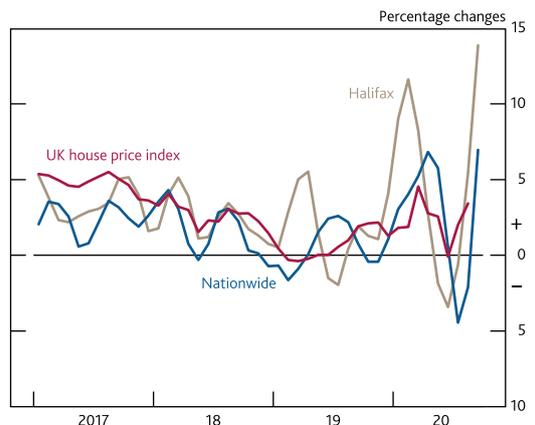


Sources: Bank of England, Her Majesty’s Revenue and Customs (HMRC) and Bank calculations.

(a) Residential property transactions for values £40,000 or above.

**Chart 2.20: House price inflation picked up**

Three-month on three-month annualised house price growth



Sources: Halifax house price index by IHS Markit, HM Land Registry, Nationwide and Bank calculations.

*The recovery in business investment is expected to have been much weaker than that of consumption.*

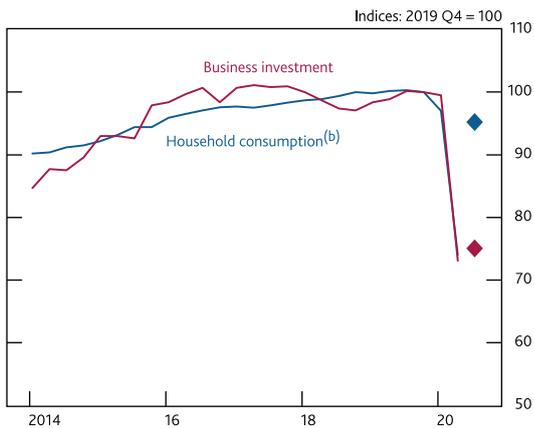
The recovery in business investment is expected to have been much weaker than consumption (**Chart 2.21**), as Covid-related uncertainty weighed on spending. Uncertainty about the future level and pattern of demand, including

whether recent changes in the composition of spending will be sustained (Section 3), may have discouraged businesses from making new investments. Despite the pickup in demand in Q3, businesses' expectations for sales next year declined in the latest Decision Maker Panel (DMP) Survey. Measures of investment intentions remain subdued (Chart 2.22).

Brexit-related uncertainty is also likely to have weighed on firms' plans for investment. The percentage of firms that reported Brexit as one of their top three sources of uncertainty fell back a little to 47% in the October DMP Survey, but it still remains higher than levels recorded at the start of this year. Section 4 discusses business preparedness for the UK's new trading relationship with the EU and its impact on the near-term outlook.

**Chart 2.21: Business investment is expected to have recovered by much less than consumption in Q3**

Business investment and household consumption<sup>(a)</sup>

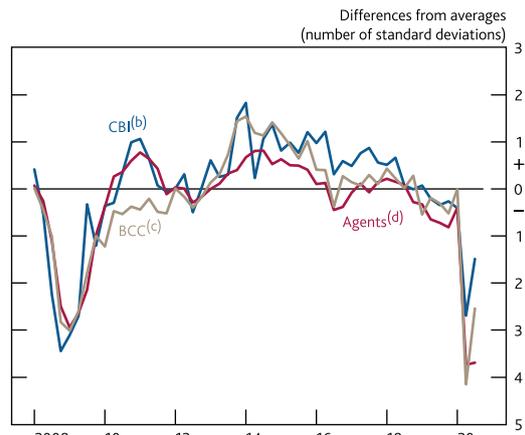


Sources: ONS and Bank calculations.

- (a) Diamonds are Bank staff projections for Q3.  
 (b) Household consumption data include NPIISH.

**Chart 2.22: Investment intentions remained subdued**

Selected survey indicators of investment intentions<sup>(a)</sup>



Sources: Bank of England, BCC, CBI and Bank calculations.

- (a) Difference from averages since 2000.  
 (b) Planned investment in plant and machinery over the following year relative to the previous year. Sectors within CBI (manufacturing, distribution, financial services and business/consumer/professional services) are weighted together using shares in real business investment.  
 (c) Based on reported changes to planned investment in plant and machinery over the past three months. Weighted average of the manufacturing and services sectors based on shares in real business investment.  
 (d) Planned expenditure on tangible non-financial assets over the following 12 months.

### *Economic activity has been supported by government spending.*

The Government has increased spending materially to support the economy, through measures such as the Coronavirus Job Retention Scheme (CJRS) that supported households' and firms' incomes. In September, the Government announced additional measures in its *Winter Economy Plan*. The package included a new Job Support Scheme (JSS) that will succeed the CJRS, an extension to the Self-Employment Income Support Scheme (SEISS) and an extension of the 15 percentage point VAT cut for the hospitality and tourism sectors until March 2021. Further support measures have been announced since then. The CJRS has been extended to early December, while the level of support offered under the JSS, which will support incomes once the CJRS expires, has also been increased.

### *Net trade provided a small boost to growth in Q2, but that is expected to have unwound in Q3.*

UK gross trade flows fell materially following the outbreak of Covid-19. Both imports and exports recovered since their troughs earlier in the year but remained somewhat below their 2019 Q4 levels. Net trade provided a boost to GDP growth in Q2 (Chart 2.16) as imports fell by more than exports, in part reflecting the steeper falls in UK GDP relative to its major trading partners (Table 2.A). Imports are expected to have risen faster than exports in Q3 as UK spending recovered, and net trade is expected to drag somewhat on GDP growth.

### *The recovery in output slowed in August, and the rise in Covid cases and the associated social distancing measures appear to have weighed on activity since then.*

The recovery in activity slowed in August, with output increasing by 2.1% on the month, a much smaller rise than in June and July (Chart 2.15).

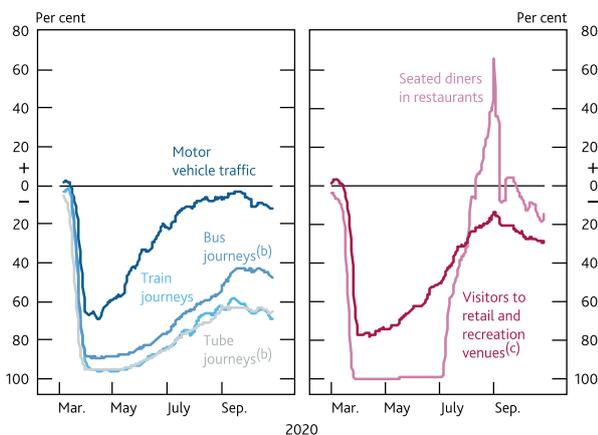
Since then, the number of Covid cases in the UK has risen and restrictions intended to slow the spread of the virus have been introduced. Over September and October, stricter measures were implemented on a local basis in areas where transmission rates were highest. Heightened England-wide Covid restrictions have been announced for the

period 5 November to 2 December. The Scottish Government implemented a new five-level system from 2 November. A firebreak was introduced in Wales on 23 October and is due to end on 9 November, and heightened restrictions in Northern Ireland are due to end on 13 November.

Even before the most recent announcements, the rise in Covid cases and associated social distancing measures had been accompanied by a fall in some of the high-frequency indicators of economic activity that the MPC has been monitoring since the start of the pandemic (**Chart 2.23**). For example, motor vehicle traffic and the number of train journeys began to decline in September. The number of visitors to retail and recreation venues, such as shopping centres, cinemas and restaurants also fell back, although the latter will in part reflect the end of the EOTHO scheme in August. Consumer confidence declined in October to around levels last recorded in May (**Chart 2.24**).

**Chart 2.23: Some high-frequency indicators show a decline in activity since September**

High-frequency indicators of economic activity<sup>(a)</sup>

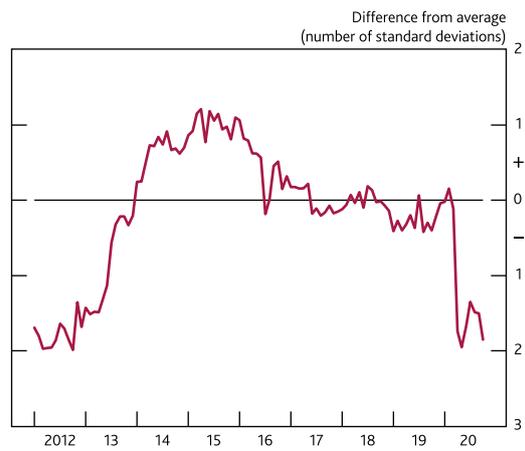


Sources: Department for Transport, Google Covid-19 Mobility Reports, OpenTable and Bank calculations.

- (a) Seven-day moving averages to 26 October. Data are not seasonally adjusted. Road, rail travel and visitors to retail and recreation venues are shown relative to normal levels. All other data are shown relative to a year earlier.  
 (b) The number of tube journeys is based on Transport for London data and the number of bus journeys do not include London buses.  
 (c) Numbers of visitors to places such as restaurants, cafes, shopping centres, theme parks, museums, libraries and cinemas.

**Chart 2.24: Consumer confidence declined in October**

Consumer confidence<sup>(a)</sup>



Sources: GfK (research carried out on behalf of the European Commission) and Bank calculations.

- (a) Difference from average since 1997. Based on the average of five survey balances: general macroeconomic situation over the past 12 months and expectations for the next 12 months, personal financial situation over the past 12 months and expectations for the next 12 months, and major purchases at present.

### Output is expected to decline in Q4.

The near-term growth outlook is unusually uncertain, and it will depend on the progression of the virus, associated social distancing measures and how households and businesses respond.

The new restrictions and consumer caution are expected to weigh on social spending. Households already appear to be more cautious about social interactions. For example, in an ONS survey, 37% of respondents said they would feel uncomfortable eating indoors in a restaurant in mid-October, up from 26% in late August. The most recent Government announcements will reduce social spending further. As in the summer, the fall in social spending is expected to be offset slightly by some substitution towards spending on other goods. Taken together, consumption is expected to fall in Q4. Business investment is expected to be broadly flat in Q4, but remain significantly below its 2019 Q4 level as uncertainty continues to weigh on spending.

Overall, GDP is expected to fall by around 2% in 2020 Q4 (**Chart 2.1**). That is around 6 percentage points weaker than expected in the *August Report*, reflecting the reimposition of social distancing measures and increased consumer caution in response to the rise in Covid cases.

## 2.4 The labour market, supply, and costs and prices

### *Despite the sharp fall in output, the official measure of unemployment has increased only modestly...*

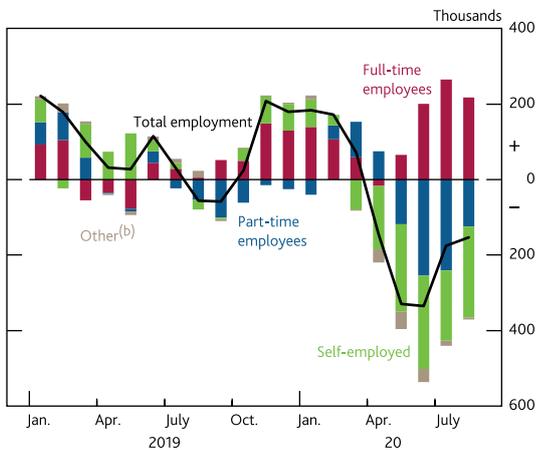
The sharp reduction in activity this year has lowered the demand for labour. Unemployment rose to 4.5% in the three months to August according to the latest Labour Force Survey (LFS) data (**Chart 2.1**). This rise is significantly less than would be suggested by the sharp fall in output, however.

The official unemployment data are difficult to interpret at present. The ONS published new estimates back to 2020 Q1 in its October release, following the introduction of new weights to help mitigate the effects from the fall in survey response rates among households in rented accommodation. The ONS has noted the challenges associated with collecting labour market statistics at this time, and an article accompanying its most recent release raises the possibility of further revisions in the future as its methodology continues to be refined.

According to the newly revised LFS data, total employment has fallen by around 500,000 since February. That has been driven by a decline in the number of self-employed workers; the number of employees has been broadly flat, with an increase in full-time employees broadly offsetting a fall in those working part time (Chart 2.25). The ONS suggests that HMRC income tax data are the best estimate of the number of employees at present, however.<sup>(2)</sup> Those data point to a significant fall (Chart 2.26), and would be consistent with a larger drop in employment than currently indicated by the LFS data.

**Chart 2.25: The fall in the LFS measure of employment has been driven by part-time workers and the self-employed**

Decomposition of changes in employment<sup>(a)</sup>

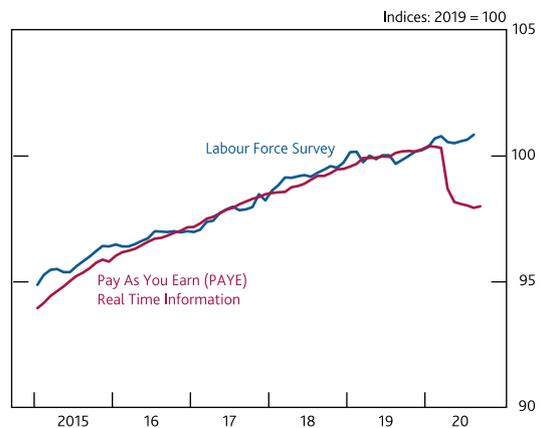


Sources: ONS and Bank calculations.

- (a) Three months on previous non-overlapping three months.
- (b) Unpaid family workers and those on government-supported training and employment programmes classified as being in employment.

**Chart 2.26: Income tax data suggest that there has been a significant fall in the number of paid employees**

Number of employees



Sources: HMRC, ONS and Bank calculations.

*...reflecting support from government schemes and an increase in the number of people who are not actively searching for work.*

The Government’s job retention scheme, the CJRS, has helped many businesses retain their staff. The number of jobs supported by the CJRS peaked in May, when an estimated 30% of the eligible workforce — equivalent to around 9 million jobs — were furloughed. The income of a further 2.7 million self-employed workers was supported by the first tranche of the SEISS. The number of workers on furlough has fallen since then as parts of the economy have reopened and the Government reduced the level of support offered by the scheme. According to the latest preliminary ONS Business Impact of Coronavirus Survey, the number of private sector employees continuing to use the CJRS had fallen to around 1¾ million in the first half of October.

An increase in the number of people not actively searching for work also helps to explain why the unemployment rate has not risen further. During lockdown, restrictions such as school closures and other social distancing measures, made it difficult for people to look for jobs. LFS data show a record proportion of people moving out of unemployment and into inactivity in Q2.

*The unemployment rate is projected to pick up over the latter part of the year.*

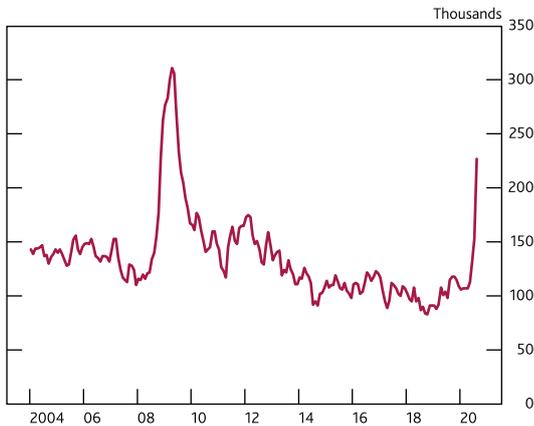
The LFS unemployment rate is expected to rise further to around 6.3% in 2020 Q4. The extension of the CJRS over the next month is expected to support employment, with around 5½ million employees assumed to be furloughed in November. But unemployment is still expected to rise as firms continue to adjust to the lower level of demand.

(2) See ‘Measuring the labour market during the pandemic’ for more details.

Redundancies picked up over the summer (**Chart 2.27**), and some of those who became inactive during the pandemic are expected to resume their search for work, pushing up the unemployment rate. This process may have already started; the ‘marginal attachment ratio’ — the proportion of people who are not currently in or seeking work, but who report they would like a job — has fallen back from its peak in June (**Chart 2.28**).

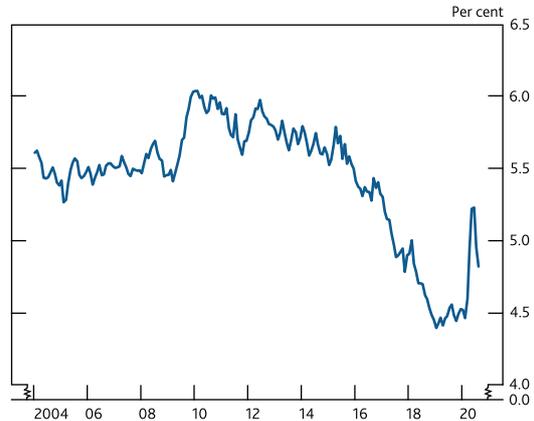
**Chart 2.27: There has been a sharp rise in the number of redundancies**

Redundancies



**Chart 2.28: The marginal attachment ratio fell back in August as individuals resumed their search for work**

Marginal attachment ratio<sup>(a)</sup>



Sources: ONS and Bank calculations.

(a) Number of those aged 16–64 who say they are not in work or not actively looking for work but would like a job, as a percentage of the 16–64 population.

The level of unemployment in 2020 Q4 is expected to be lower than projected in the *August Report*. This largely reflects the extension of the CJRS and the announcement of the JSS, whereby the Government pays a proportion of the wage costs for firms that remain open but face reduced demand (JSS Open) and firms legally required to close under coronavirus regulations (JSS Closed). The scheme, which runs until April 2021, means that direct government support to employment will last longer than previously expected.

Beyond Q4, the unemployment rate is expected to peak at around 7¾% in 2021 Q2 (Section 1). This is broadly consistent with the historical relationship between output and unemployment, adjusted to account for the sectoral pattern of output and, in particular, that labour-intensive sectors have been hard hit (see Section 3 of the *August 2020 Report*).

### *Pay pressures are muted.*

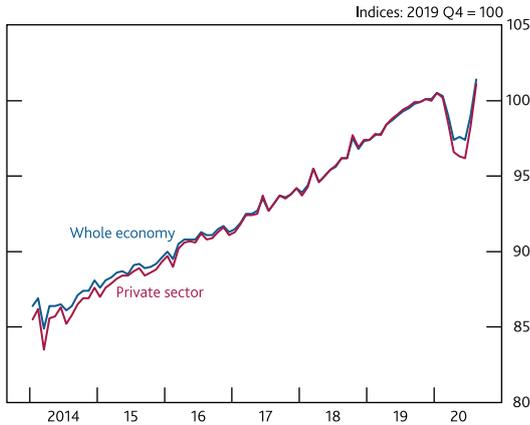
Pay growth has been volatile since the start of the year. In large part that reflects workers moving onto the CJRS — which provided them with up to 80% of their usual wage while furloughed — and then coming off. Pay fell sharply in March and April (**Chart 2.29**), then picked up as the number of furloughed employees decreased.

Smoothing through this volatility, pay pressures are muted. Agency intelligence suggests that the pay of non-furloughed workers stayed broadly flat during the pandemic, and median pay settlements fell to zero in Q3 (**Chart 2.30**). The weakness in underlying pay growth is likely to reflect slack in the labour market; it may also reflect some cash constraints within firms. With unemployment likely to rise further in the near term, underlying pay growth is expected to remain subdued.

While pay pressures appear muted, the actual cost to business of producing a unit of output is likely to have increased because the productivity of the workforce fell by more than wages during the pandemic. Recent data on productivity and unit labour costs have been very volatile, partly reflecting the impact of government furlough schemes. As a result, it will take some time for the underlying trends in the data to become clear.

**Chart 2.29: Pay has been volatile as workers have been furloughed**

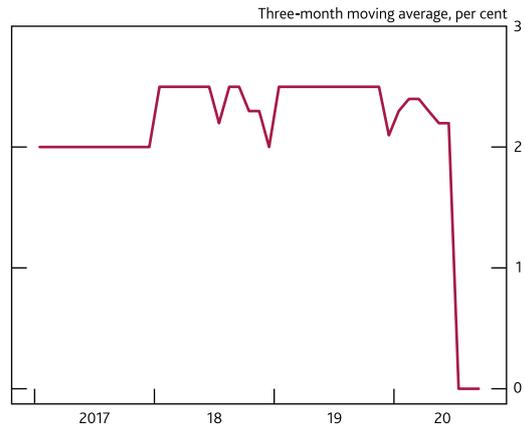
Measures of total pay



Sources: ONS and Bank calculations.

**Chart 2.30: Median pay settlements have fallen to zero**

Median pay settlements<sup>(a)</sup>



Source: XpertHR.

(a) Median basic pay rise awarded in the sample of pay reviews conducted in each three-month period. Data are not seasonally adjusted. The XpertHR disclaimer of liability, which applies to the data provided, is available from the [November 2020 Monetary Policy Report](#).

*The weakness in demand has been accompanied by a reduction in supply...*

While demand from consumers remains below pre-Covid levels (Section 2.3), the supply of goods and services has also been restricted. Some businesses closed earlier in the year, and while many of those reopened over the summer, some have had to reduce capacity in order to make themselves Covid-secure. For example, some shops and restaurants have limited customer numbers to allow for social distancing, and some businesses such as dentists and barbers have had to do extra cleaning between customers. In addition, some firms may be experiencing reduced productivity as they adapt business practices to accommodate widespread working from home or because of disruption to their supply chains.

*...but overall, there is judged to be a material amount of spare capacity in the economy.*

While a reduction in supply accounts for a large part of the fall in GDP, the MPC judges that there is a material amount of spare capacity in the economy. At present, spare capacity is likely to reflect a combination of underemployment and higher unemployment. Average hours worked are well below their 2019 Q4 level. A large part of the fall in average hours will reflect employees being furloughed. As many furloughed employees are unlikely to seek other jobs, those schemes temporarily lower labour supply. But some of the fall in average hours will reflect spare capacity. The rise in unemployment will also contribute to spare capacity.

*Spare capacity is judged likely to be weighing on inflation...*

Slack in the economy is likely to account for some of the weakness in CPI inflation, which was 0.6% in Q3. The relationship between spare capacity and inflation may be weaker than usual at present, however. For example, uncertainty about the outlook might cause some firms to hold off changing their prices (see Section 4 of the [August 2020 Report](#)).

*...which has also been affected by temporary factors.*

Some temporary factors have also weighed on inflation. Domestic energy prices have fallen, reflecting the decrease in oil prices and wholesale gas and electricity prices over the past year. The impact of the Government's EOTHO scheme also weighed on inflation in August. CPI inflation fell to 0.2% in August from 1% in July, before rising to 0.5% in September ([Chart 2.31](#)) as the EOTHO scheme ended.

The cut to VAT for the hospitality sector has dragged on inflation. However, there appears to have been lower pass-through from the VAT cut to consumer prices than had been assumed in the [August Report](#). Intelligence from the Bank's Agents suggests that some firms have not fully passed through the VAT cut into prices in order to cover increasing Covid-related costs, such as the cost of making their premises Covid-secure, or to help them cover revenues lost during lockdown.

*CPI inflation is expected to rise a little in the near term, but remain below the MPC's 2% target.*

In the near term, inflation is expected to rise slightly, reaching 0.9% in March 2021 (Chart 2.31), below the MPC's target. The near-term projection is a little higher than in the August Report. That partly reflects continuing lower pass-through from the VAT cut, as well as higher fuel and import prices. The Government's announcement to extend the VAT cut until March offsets part of this news in Q1.

*Movements in measures of inflation expectations have been mixed.*

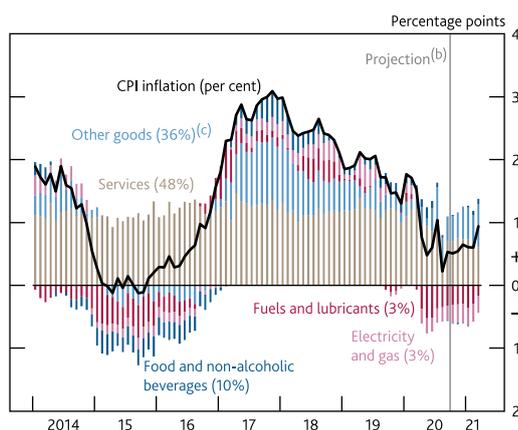
There has been relatively little change in the medium-term inflation expectations of financial markets and professional forecasters since the August Report (Table 2.D). Financial market measures for the medium term are at similar levels to 2019 (Chart 2.7). Professional forecasters continue to expect inflation to be close to the target in two years.

There has been a pickup in some measures of household and company inflation expectations. The YouGov/Citigroup survey suggests that households' long-term inflation expectations rose to above their post-financial crisis average in Q3. The Bank/Kantar survey estimate rose by less, but a change in this survey's methodology may have affected recent estimates.<sup>(3)</sup> Companies' price expectations in the distribution sector picked up in Q3, although expected price changes were close to 2% over the next couple of years.

Overall, the MPC judges that inflation expectations remain well anchored.

**Chart 2.31: Inflation is expected to remain below the MPC's 2% target in the near term**

Contributions to CPI inflation<sup>(a)</sup>



Sources: Bloomberg Finance L.P., Department for Business, Energy and Industrial Strategy, ONS and Bank calculations.

- (a) Contributions to annual CPI inflation. Figures in parentheses are CPI basket weights in 2020.  
 (b) Bank staff's projection. Fuels and lubricants estimates use Department for Business, Energy and Industrial Strategy petrol price data for October 2020 and are then based on the sterling oil futures curve.  
 (c) The difference between CPI inflation and the other contributions identified in the chart.

**Table 2.D: Recent movements in measures of inflation expectations have been mixed**

Measures of inflation expectations<sup>(a)</sup>

| Per cent                                     | 2000–             | 2010– | 2019 | 2020 |     |     |
|--|-------------------|-------|------|------|-----|-----|
|  | 07 <sup>(b)</sup> | 18    |      | Q1   | Q2  | Q3  |
| <b>One year ahead inflation expectations</b> |                   |       |      |      |     |     |
| <b>Households<sup>(c)</sup></b>              |                   |       |      |      |     |     |
| Bank/Kantar                                  | 2.4               | 3.0   | 3.2  | 3.0  | 2.9 | 2.8 |
| YouGov/Citigroup                             | 2.5               | 2.4   | 2.7  | 2.7  | 3.1 | 3.1 |
| <b>Companies<sup>(d)</sup></b>               |                   |       |      |      |     |     |
|  | n.a.              | 1.7   | 0.9  | 0.0  | 0.4 | 2.1 |
| <b>Financial markets<sup>(e)</sup></b>       |                   |       |      |      |     |     |
|  | 2.6               | 2.9   | 3.4  | 3.1  | 2.8 | 3.1 |
| <b>Two to three year ahead expectations</b>  |                   |       |      |      |     |     |
| <b>Households<sup>(c)</sup></b>              |                   |       |      |      |     |     |
| Bank/Kantar                                  | n.a.              | 2.8   | 3.0  | 2.9  | 1.9 | 2.2 |
| <b>Companies<sup>(d)</sup></b>               |                   |       |      |      |     |     |
|  | n.a.              | n.a.  | 0.8  | 1.3  | 1.0 | 1.9 |
| <b>External forecasters<sup>(f)</sup></b>    |                   |       |      |      |     |     |
|  | 2.0               | 2.1   | 2.0  | 2.0  | 2.0 | 1.9 |
| <b>Financial markets<sup>(e)</sup></b>       |                   |       |      |      |     |     |
|  | 2.8               | 3.1   | 3.6  | 3.5  | 3.4 | 3.6 |
| <b>Five to ten year ahead expectations</b>   |                   |       |      |      |     |     |
| <b>Households<sup>(c)</sup></b>              |                   |       |      |      |     |     |
| Bank/Kantar                                  | n.a.              | 3.3   | 3.5  | 3.4  | 2.6 | 2.8 |
| YouGov/Citigroup                             | 3.5               | 3.2   | 3.1  | 3.1  | 3.0 | 3.4 |
| <b>Financial markets<sup>(e)</sup></b>       |                   |       |      |      |     |     |
|  | 3.0               | 3.3   | 3.5  | 3.4  | 3.4 | 3.5 |
| <b>Memo: CPI inflation</b>                   |                   |       |      |      |     |     |
|  | 1.6               | 2.3   | 1.8  | 1.7  | 0.6 | 0.6 |

Sources: Bank of England, Bloomberg Finance L.P., CBI, Citigroup, Kantar, ONS, YouGov and Bank calculations.

- (a) Data are not seasonally adjusted.  
 (b) Averages from 2000, or start of series, to 2007. Financial market data start in October 2004, YouGov/Citigroup data start in November 2005 and external forecasters' data start in 2006 Q2.  
 (c) The household surveys ask about expected changes in prices but do not reference a specific price index.  
 (d) CBI data for the distributive trades sector. Companies are asked about the expected percentage price change over the coming 12 months and the following 12 months in the markets in which they compete.  
 (e) Instantaneous RPI inflation one and three years ahead and five-year RPI inflation five years ahead, derived from swaps.  
 (f) Bank's survey of external forecasters, CPI inflation rate three years ahead.

(3) This survey was previously called the Bank of England/TNS Inflation Attitudes Survey. See 'Bank of England/TNS Inflation Attitudes Survey — May 2020' for more details of the change in methodology.

## Box 2

### Agents' update on business conditions

The key information from Agents' contacts considered by the Monetary Policy Committee at its November meeting is highlighted in this box.<sup>(4)</sup> The information was gathered before the most recent announcements of Covid-related restrictions and government support. Overall, contacts reported some improvement in activity in recent months, particularly in retail and business services. However, activity levels continue to be lower than a year ago, and the outlook for employment and investment remains weak.

#### *Retail sales had picked up markedly, but spending on consumer services remained substantially weaker than a year ago following renewed social distancing restrictions.*

In recent months, retailers have reported a strong improvement in demand across a range of goods, partly due to some Christmas shopping being brought forward. Contacts said sales of household and electrical goods, technology and furniture remained significantly higher than a year ago, reflecting some consumers spending accumulated savings and some expecting to work from home for some time to come. Online sales continued to strengthen and contacts said they expected growth in this area to be maintained.

Spending on consumer services remained significantly lower than a year ago, in part reflecting renewed social distancing restrictions around the UK which have impacted on the hospitality, leisure, travel and tourism sectors. Restaurant trade was reported to have weakened after the Eat Out to Help Out scheme ended, and following the imposition of the 10pm curfew and local social distancing restrictions. Hotels said that revenues were depressed by a combination of weak demand, particularly in city locations, and limits on customer numbers in order to meet social distancing rules. Tour operators and airports were pessimistic about the near-term outlook and did not expect passenger volumes to recover to pre-Covid levels next year.

#### *Activity in business services, manufacturing and construction increased a little, though output levels remain very subdued.*

Contacts reported a modest improvement in business services activity over the past two months, though turnover was still well below 2019 levels. Companies in IT, telecoms, employment law, audit, corporate restructuring, insolvency and Covid-19-related advice reported strong activity. Demand for advice ahead of the UK's new trading relationship with the EU coming into effect was also reported to have picked up. Firms offering marketing, advertising and recruitment services also saw increased demand, though revenues remained well below normal levels. By contrast, demand for business travel, conferences and corporate entertainment remained weak.

In manufacturing, activity also picked up slightly but remained weaker than a year ago. Pharmaceutical and medical companies reported increased output, as did food producers supplying supermarkets. However, output in the aviation, automotive, steel, and oil and gas sectors remained significantly lower than a year ago. A number of contacts expressed concern about the outlook for the first few months of next year, when the transition period for UK withdrawal from the EU ends (Section 4).

Construction output increased a little as companies caught up on projects that were delayed by lockdown earlier in the year, but was still lower than a year ago. Contacts reported stronger activity on publicly funded projects than on commercial projects, and said the pipeline of commercial projects remained subdued. Housing repair and maintenance work was strong, as was housebuilding activity, though this was mostly to complete existing projects rather than start new ones. Contacts said they expected new-build construction to soften in the coming months.

Housing market activity remained strong in most parts of the UK, but contacts reported a modest softening in areas where tighter social distancing rules had been introduced. An anticipated rise in unemployment, tighter mortgage availability, and a rise in Covid-19 infection rates were expected to weigh on activity over the coming months. Demand for rented accommodation was weak in major cities, due to the sharp fall in numbers of overseas students and foreign tourists. Contacts said that the increase in remote working during the pandemic had encouraged some

(4) A comprehensive quarterly report on business conditions from the Agents is published alongside the MPC decision in non-Monetary Policy Report months. The next report will be published on 17 December 2020.

people to move out of cities to seek larger homes, pushing up demand for rented property and leading to higher rents in some areas.

In commercial real estate, contacts said investor demand remained subdued, though there were some signs of increased interest among overseas investors. Rental income for retail property remained significantly lower than a year ago, though it was slightly higher than in the second quarter. Some landlords were reported to be considering repurposing retail premises. Office rental returns were reported to be only slightly below normal. However, contacts said there was significant uncertainty about the outlook, as many businesses expect more people to continue to work from home. Demand for industrial, distribution and logistics premises remained high.

*Uncertainty continues to weigh on investment intentions; credit availability tightening for certain sectors.*

Many contacts have cancelled or postponed investment, citing concerns about the strength of the recovery, their cash positions and uncertainty about the outlook. Investment intentions were particularly weak in the automotive, aviation and oil and gas sectors. Contacts also reported postponing projects such as office moves, workplace expansion and replacement of machinery in order to preserve cash. However, contacts in sectors experiencing strong growth, such as food production, renewable energy, warehousing and distribution, reported investing to increase capacity. Investment in IT and digital services remained strong as companies invested in remote working and online services. And there were a few reports of paused investment projects being reinstated.

Credit demand among small and medium-sized enterprises (SMEs) was reported to have increased a little in recent weeks, in part due to renewed social distancing restrictions in some areas, and ahead of the closure of the Government lending schemes which had previously been due to finish at the end of November. Contacts thought credit demand could rise further in the coming quarters as deferred payments, such as rent and tax, come due. However, high levels of debt among SMEs could constrain the appetite of many to take on new debt. Demand for bank credit from large corporates remained subdued, as companies were able to raise credit in capital markets or elsewhere.

Although the Government schemes are supporting credit availability, especially for the smallest companies, there have been some reports of bank credit conditions tightening, particularly in sectors that had been most affected by the pandemic, and where insolvencies were expected to rise.

*Companies continue to reduce headcount in response to weaker demand; widespread pay freezes imposed.*

Some companies have made redundancies, mainly those in sectors most severely affected by the pandemic, such as hospitality, retail, travel, leisure, automotive, aviation and oil and gas. Other companies have reported that changes to working practices as a result of lockdown had enabled them to review processes and make modest reductions to headcount to cut costs. However, a few contacts who thought demand might recover next year said they planned to reduce hours rather than cut jobs, in order to retain skilled staff. Employment intentions remained very weak overall, though contacts in some sectors reported taking on staff to meet increased demand.

Pay freezes were widespread, and there were some reports of temporary pay cuts, though these were usually at management level.

*Retailers plan discounts to boost demand, while pricing strategies for consumer services vary.*

Supermarkets said discounts on food were now back at their usual levels, driven by competition in the sector. And some retailers expected to have to offer large discounts to help clear stock in the Black Friday sales, particularly on clothing and footwear and consumer electronics.

In general, contacts in the hospitality sector felt that cutting prices would do little to encourage demand among those who are concerned about the risk of infection. However, city-centre hotels and other venues that cater for events and business travellers were reported to be offering significant discounts, with further downward pressure on prices expected. A few contacts in hospitality and tourism reported increasing prices, for example where demand outpaced capacity due to social distancing measures.

# 3 In focus The potential long-term economic effects of Covid

Covid-19 has affected the UK economy in many different ways. Some of the changes to what we buy, what we make, and how we work are likely to take some time to unwind. Some might persist. Although there could be some positive economic effects from new working practices and innovations, these are likely to be outweighed over the MPC’s forecast period by the negative economic effects associated with a period of reallocation and reduced investment.

Covid-19 and the public health measures to contain it have changed everyday life dramatically in just a few months. Although many of these changes will prove temporary, some may persist. This *In focus* considers how persistent changes could affect the UK economy. In some cases, the MPC’s central projections are likely to be consistent with some of these effects. In other cases, the potential for longer-lasting change or material economic consequences poses a risk to the projections.

Section 3.1 covers how **what we buy** has changed, including the rise of online shopping. If expenditure patterns are changed persistently, the goods and services the UK economy produces — **what we make** — may also need to change, requiring a period of costly reallocation. This is covered in Section 3.2. Finally, the pandemic has changed **how we work** — in particular, many people have gone from working in offices to working at home. Section 3.3 covers the potential economic effects of this change, as well as the prospects for wider innovation as a result of Covid. Section 3.4 covers the implications for the MPC’s forecast.

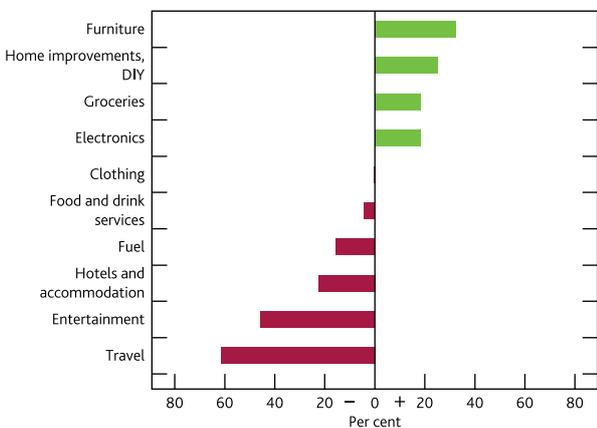
## 3.1 What we buy

*Consumers are spending less on services — particularly those consumed socially — but more on goods.*

The pandemic has resulted in a material change to consumer spending patterns. Spending on travel, entertainment and hospitality has fallen sharply (**Chart 3.1**) as a result of mandated closures and reduced capacity in some sectors, as well as a general increase in precautionary behaviour by consumers. Some work-related spending has also fallen, including spending on transport and fuel, as more people work from home (Section 3.3).

**Chart 3.1: Spending on services has been lower recently, but spending on some goods has been higher**

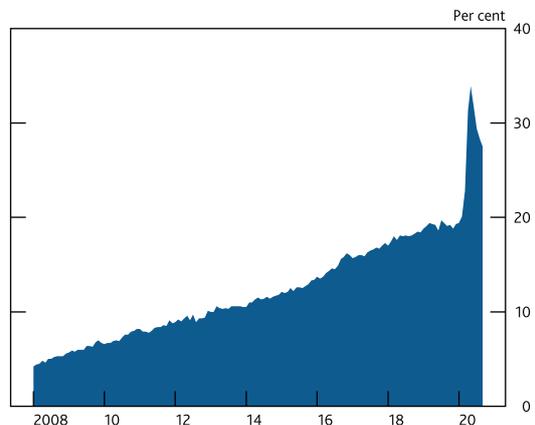
Annual growth in spending in selected categories, 2020 Q3



Sources: Barclays and Bank calculations.

**Chart 3.2: The share of online retail sales has surged during the pandemic, accelerating a pre-existing trend**

Internet sales as a proportion of all retail sales<sup>(a)</sup>



(a) All retailing excluding automotive fuel. Latest observation is for September 2020.

Consumers appear to have replaced some spending on services with spending on goods. In particular, spending on household goods and groceries has increased sharply (Chart 3.1). Agency contacts report that the demand for furniture, electronics and DIY supplies has been strong as consumers have devoted more resources to improving their homes.

*This pattern may persist if concerns about the virus linger, or consumer tastes change.*

Spending patterns should move back towards normal as concerns about the virus and the associated consumer caution dissipate. However, that process could take a long time, especially if progress on treatments and other health interventions is only gradual. In that case, the changed pattern of spending could persist over the MPC’s three-year forecast period. And some of the changes may persist for much longer if consumer tastes are changed. For example, people may prefer to travel for work or tourism less often in the future.

*Online shopping has surged during the pandemic, accelerating a pre-existing trend.*

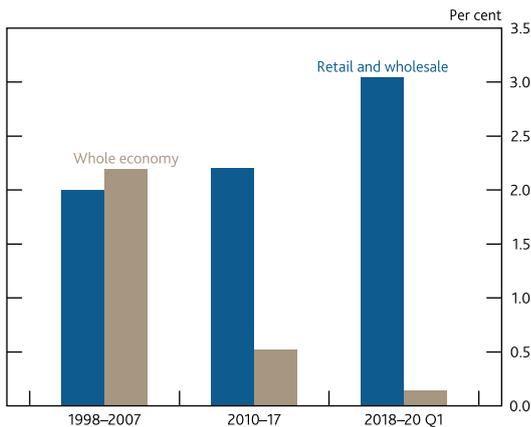
There has also been a change in how consumers buy goods. In May, around a third of all retail purchases were made online, up from 20% in February (Chart 3.2). Although physical stores had mostly reopened by September, the share of sales made online remained high, at 28%. That share has been increasing steadily for many years, but the recent shift is a marked acceleration of the trend. At least some of this increase is likely to be maintained as more consumers have become familiar with the process and firms have invested in their online capabilities.

*The rise of e-commerce may already have been a factor weighing on consumer price inflation.*

Online retailing has the potential to be more productive than through physical stores (Cox et al (2016)), so as the share of online grows, the productivity of the sector may increase. There is some evidence of this already: labour productivity in retail has been growing faster than in the wider economy since 2010 (Chart 3.3). Higher productivity growth has not been fully matched by higher wage growth, so unit labour cost growth has also been lower in consumer-facing sectors than the whole economy (Chart 2.35 in the May 2020 Report). And because the retail sector accounts for a larger share of the input content of household spending than overall spending, its unit costs may be more important for consumer prices than its share of the economy would imply (Tenreyro (2020)). This may have contributed to the relative weakness of domestic consumer price pressures in recent years even as average wage growth picked up (Chart 3.4).

**Chart 3.3: Over the past decade, productivity has grown faster in the retail sector than in the wider economy...**

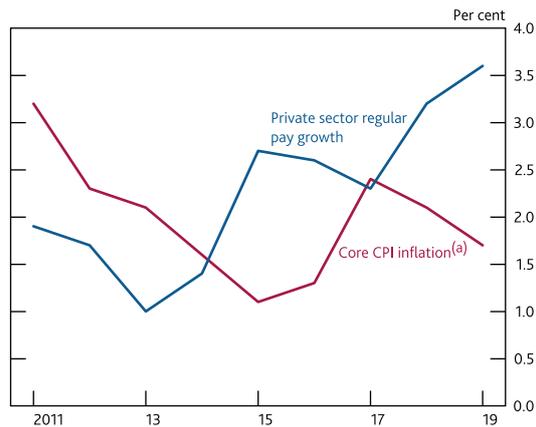
Average annual hourly productivity growth



Sources: ONS and Bank calculations.

**Chart 3.4: ...which may help explain relatively weak domestic consumer price pressures in recent years**

Core CPI inflation and private sector regular pay growth



Sources: ONS and Bank calculations.

(a) CPI inflation excluding food, energy, alcohol, tobacco and non-alcoholic beverages.

The rise of online shopping could also have affected prices via the level of competition. Online prices are typically easier to compare, as it is easier to visit multiple websites than multiple shops. The internet also allows smaller firms to sell their products more widely. As a result, retailers may feel increased competitive pressures. In response, they may invest in new technologies and processes to increase their efficiency. Both increased price transparency and greater efficiency might put some downward pressure on inflation going forward.

### 3.2 What we make

*If new expenditure patterns persist, production patterns are also likely to change.*

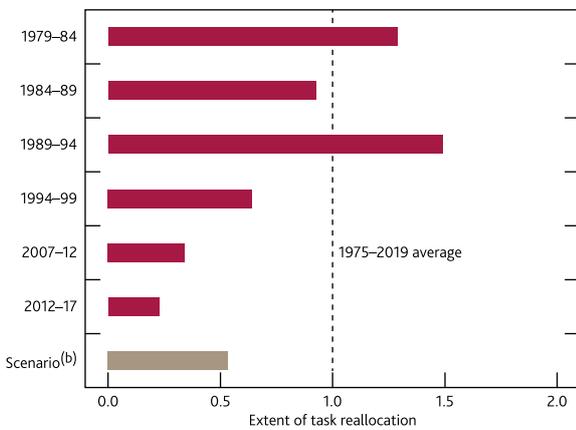
If some changes to consumer spending habits persist — possibly because Covid prevents some social activities for a prolonged period, or because consumer tastes change — the pattern of production in the economy is also likely to change. But this shift will take time, as labour and capital are often specialised. During this period of reallocation, productivity and output may be reduced as workers retrain and capital is repurposed or replaced. The period of reallocation will be shorter the easier it is for workers and capital to move between firms and sectors.

*The labour market tends to adjust quickly, although some workers may need to gain new skills.*

The UK labour market has adjusted relatively quickly to large shocks in the past (Broadbent (2012)). Even in normal times, around 9% of workers change jobs every year. Nevertheless, there can be some mismatch between the skills of job seekers and those required by hiring firms. Some of the sectors hardest hit by the pandemic employ lots of young and low-skilled workers who may find it difficult to move between sectors (Henehan (2020)). And it is hard for any worker to move between sectors if the jobs involve different tasks. Bank staff have analysed the task content of different jobs to quantify the extent of ‘task reallocation’ required in various scenarios. In a relatively extreme scenario where the pattern of consumer spending is unchanged from 2020 Q3, staff estimate that the extent of task reallocation over the forecast period would be somewhat higher than in recent years. However, even that extreme scenario would require much less task reallocation than occurred during the 1980s and early 1990s (Chart 3.5). That was a period of significant structural change during which the share of employees working in the manufacturing sector fell from 26% to 16%.

**Chart 3.5: Even in a relatively extreme scenario there would be less task reallocation than in the 1980s**

Task reallocation over selected five-year periods and in a scenario based on the pattern of consumer spending in 2020 Q3<sup>(a)</sup>

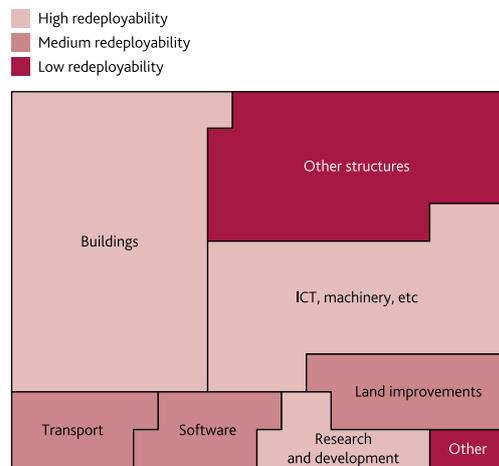


Sources: O\*NET, ONS and Bank calculations.

- (a) Estimates of the task content of jobs are based on the O\*NET Content Model. UK jobs data are based on the ONS Annual Survey of Hours and Earnings. This work was produced using statistical data from ONS. The use of ONS statistical data in this work does not imply the endorsement of the ONS in relation to the interpretation or analysis of the statistical data. This work uses research data sets which may not exactly reproduce National Statistics aggregates.
- (b) Extent of task reallocation between 2019 and a scenario in which the pattern of consumer spending remains unchanged from 2020 Q2.

**Chart 3.6: Some forms of capital can be more easily redeployed than others**

Net capital stock by asset redeployability<sup>(a)</sup>



Sources: ONS and Bank calculations.

- (a) Net capital stock by asset in 2018, excluding dwellings. Areas correspond to asset shares of the total. ‘Other’ includes artistic originals, cultivated biological resources, and mineral exploration and evaluation. Redeployability scores are Bank staff estimates using an approach similar to that outlined in Kim and Kung (2017).

*Capital can often be redeployed, although there is a risk some may be prematurely scrapped.*

Just as workers are often specialised, capital such as plant and machinery can be specialised for specific tasks. The more specialised capital is, the harder it is to sell to a new owner to ‘redeploy’ it. Bank staff have estimated capital ‘redeployability’ scores for different types of assets using a similar approach to Kim and Kung (2017). Information and communications technology, machinery and buildings are highly redeployable (Chart 3.6) as they are used across many industries. Other structures, for example infrastructure used in the mining and energy sectors, have lower redeployability scores.

Some of the sectors hit hardest by the pandemic use very specialised assets. One example is the airline industry: there are very few alternative uses for aircraft and the associated infrastructure. Many recreational events also rely on

specialised structures, such as stadia or concert halls. If output in these sectors does not recover, some of these assets could be mothballed or scrapped before the end of their usual lifespan.

*Capital may be in the wrong place if economic activity moves away from city centres.*

Even if the economy produces a similar pattern of output, the pandemic may result in that production happening elsewhere. The number of workers working from home has increased sharply (Section 3.3). This has led to many office buildings being underutilised and reduced demand in the shops and restaurants that cater to office workers. Although buildings can generally be redeployed for different uses, they cannot usually be moved. This may lead to buildings remaining vacant, which would also be an effective reduction of the capital stock. A sharp reduction in commercial real estate prices could also have wider consequences for the economy, for example by reducing the collateral available for firms to borrow against for investment.<sup>(1)</sup>

*Investment in new capital is expected to be weak, which will also lower productivity growth...*

The sectors which are growing in response to the pandemic may invest in new capital. However, surveys of existing businesses suggest investment will remain low in the near term (**Chart 2.22**), possibly because of uncertainty over which changes in demand will prove temporary and which will persist (Vlieghe (2020)). As well as increasing the stock of capital per worker, business investment — particularly intangible investment — often increases 'total factor productivity' (TFP) — the efficiency with which labour and capital are combined — by implementing new ideas and innovations. Lower business investment will therefore also lower the growth rate of TFP. Although there may be aspects of the Covid shock that affect the pace of innovation more positively, these effects are much more uncertain (Section 3.3).

*...although there is a possibility that compositional effects offset some of this.*

Going in the other direction, there could be a positive compositional effect on aggregate productivity as sectors which tend to be more productive grow faster than others. Some of the sectors negatively affected by Covid, such as accommodation and food services, have lower productivity than average (Chart 3.4 in the *August 2020 Report*). Aggregate productivity was boosted in Q2 as a result, although it is unclear to what extent this will persist.

*New trading arrangements with the EU may also prompt some reallocation.*

These potential changes to the pattern of production come on top of those prompted by EU withdrawal. On 1 January 2021, the UK will leave the EU Single Market and Customs Union and new trading arrangements will come into effect (Section 4). This is also expected to prompt some changes in production patterns which affect the productivity and supply capacity of the economy (see Box 1 in the *November 2019 Report*).

Some firms have identified alternative suppliers in anticipation of new trading arrangements (**Chart 4.3**), and the experience of the pandemic may encourage further adjustment of supply chains. In the US, sectors with a greater reliance on intermediate goods produced overseas saw larger falls in output than other sectors earlier this year (Meier and Pinto (2020)). However, the Bank's Agents have heard relatively few reports of reorganisation prompted by Covid. That may be because more localised supply chains are not necessarily more resilient (Miroudot (2020)).

*Overall, reduced investment and a period of reallocation are expected to weigh on supply growth.*

The MPC expects the combination of a period of lower investment and a process of reallocation to lower the economy's supply capacity relative to what it would have been in the absence of Covid (Section 1.2). Elevated uncertainty and tighter credit conditions are expected to reduce investment, leading to a persistently lower capital stock and productivity. A degree of skills mismatch in the labour market is also expected to reduce the effective supply of labour via an increase in the medium-term equilibrium rate of unemployment. But there are risks around the magnitude of these effects. The possibility of premature capital scrapping — which would further lower supply growth — and the possibility of a positive compositional effect on productivity — which would raise it — are also risks to the central projection (Section 1.3).

(1) More information on the risks from open-ended funds that trade in commercial real estate can be found in the *December 2019 Financial Stability Report*. A wider discussion of the risks stemming from the market can be found in the *July 2016 Financial Stability Report*.

### 3.3 How we work

As well as what we produce, the way things are produced has also changed over the past few months. Remote working has become much more common and businesses have delivered services in new ways, often using technology to reduce personal contact. If these changes persist, they could affect employment, productivity and growth.

*Economic downturns and crises have tended to have negative long-term effects on growth in the past...*

Investment, innovation and productivity have tended to be procyclical in the past, meaning they fall alongside output in recessions. Although there is some evidence that past recessions led to productivity-enhancing reallocation as less productive firms fail and more productive firms survive (Foster *et al* (2016)), this has tended to be offset by falls in the productivity of surviving firms. Natural disasters are also generally found to have negative long-term effects on growth (eg World Bank (2020) and Hsiang and Jina (2014)) as a result of a prolonged period of low investment, labour dislocation, and disrupted supply chains.

*...but the pandemic has prompted firms to innovate, which may have some positive effects.*

The pandemic has forced many firms to adopt new working practices in a way unlike any other recent episode, however. This could have some positive economic effects in the long run, although these effects are highly uncertain.

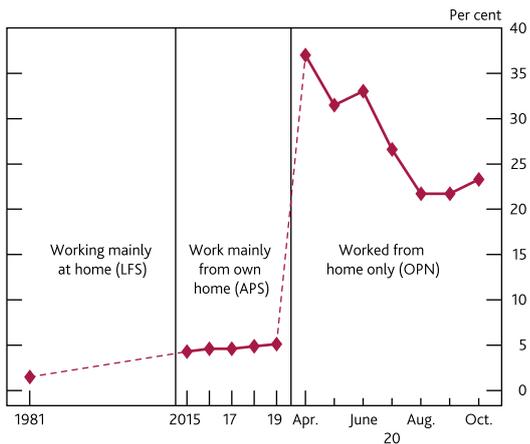
*Working from home is expected to be more widespread after the pandemic.*

One of the most dramatic changes to working practices over the past few months has been the sharp increase in the number of people working from home (Haldane (2020)). According to the ONS, 37% of people in employment worked entirely from home in April, and 23% were still working remotely in October (Chart 3.7). Prior to the pandemic, only 5% worked mainly from home.

Many people expect working from home to remain more common after the pandemic. Half of new remote workers say they would like to continue to work from home all or most of the time even when restrictions permit a return to normal working patterns (Felstead and Reuschke (2020)). Employers expect the proportion of staff that regularly work from home to more than double (CIPD (2020)); many Agency contacts expect a hybrid model of two to three days a week spent in the workplace to become the 'new normal' for office workers.

**Chart 3.7: Working from home has become much more widespread as a result of Covid**

Proportion of workers working from home<sup>(a)</sup>

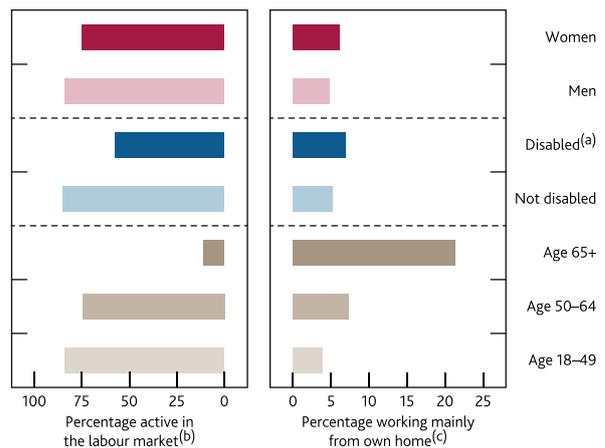


Sources: ONS and Bank calculations.

(a) Data for 1981 are from Felstead and Reuschke (2020) analysis of the Labour Force Survey (LFS). Data for 2015–19 are from Coronavirus and homeworking in the UK labour market: 2019, based on the Annual Population Survey (APS). Data for 2020 are from Coronavirus and the social impacts on Great Britain, based on the Opinions and Lifestyle Survey (OPN). Data are not seasonally adjusted.

**Chart 3.8: Groups that work from home more have been less likely to participate in the labour market in the past**

Participation rates and percentages of homeworkers in 2019



Sources: Labour Force Survey, ONS and Bank calculations.

(a) People with a long-term health problem or disability in accordance with the core definition in the 2010 Equality Act. Data are for Great Britain only.  
 (b) Women/men and disabled/not disabled participation rates are from the 16–64 population.  
 (c) Based on Bank staff analysis of LFS data.

*Increased remote working could lead to higher working hours and labour market participation.*

More widespread remote working could increase the average number of hours employees spend working. Bank staff analysis of LFS data suggests full-time remote workers tend to work longer hours than those based in the workplace. That may be because homeworkers do not spend time commuting. In 2018, the average UK worker spent 59 minutes

travelling to and from work every day (TUC (2019)). Evidence from the US — where the average commute time is similar — suggests workers sent home due to the pandemic have devoted about a third of the time saved by not commuting to their primary jobs (Barrero *et al* (2020)).

Increased remote working could also increase participation in the workforce, further increasing the total number of hours worked in the economy. Women, older workers, and people with disabilities were more likely to work from home in the past and were also less likely to participate in the labour force (Chart 3.8). Labour market participation may be boosted if greater availability of remote working helps overcome barriers to work, such as mobility issues. Participation could also be boosted if taking a job no longer meant living in a certain part of the country. Some people are reluctant or unable to move for jobs, resulting in geographic mismatch between workers and vacancies.

#### *Studies suggest working from home can boost productivity in specific settings...*

Some studies have shown that working from home can improve productivity in jobs involving certain tasks. In one well-known study of Chinese call centre workers, working from home for four days a week increased worker output by 13% (Bloom *et al* (2015)). This was partly because the employees spent more time on work, although there was also an improvement in productivity attributed to a quieter and more convenient working environment. Even if workers only maintain their levels of personal productivity while at home, a firm's overall productivity can be increased if remote working allows them to use less office space.

#### *...but it's unlikely to be appropriate for all workers and all tasks.*

However, some tasks appear to become more difficult when colleagues are physically separated. One study involving emergency call handlers in Manchester found that productivity was 2% higher when colleagues were in the same room, with the effect larger for more urgent and complex tasks (Battiston *et al* (2017)). This suggests collaboration — which is also crucial for innovation (Bloom *et al* (2020)) — can be harder when working remotely. Densely populated urban areas also tend to have higher productivity (Glaeser and Gottlieb (2009)). Although the reasons for these 'agglomeration' advantages are not fully understood, a more widely distributed workforce might lose them. It may also be harder to train less-experienced employees in roles that rely on 'on-the-job' training.

#### *Many of those working from home during the pandemic have reported lower productivity.*

A survey of Japanese workers who recently worked remotely as a result of the pandemic found that a majority reported being less productive at home (Morikawa (2020)). A smaller UK survey reported that the share of people who found they did more work was similar to the share that did less (Felstead and Reuschke (2020)). However, just as it is not always possible to generalise the results of experiments in specific settings, the impact of changes introduced this year may not apply in normal times. Many remote workers are new to the practice, so might become more productive as they get used to it. The pandemic has also resulted in a much lower demand for labour, so some workers may have had less work than normal recently. And some homeworkers have had greater childcare responsibilities as a result of the reduced availability of schooling and childcare (Andrew *et al* (2020)).

#### *The pandemic has led to other changes in working practices...*

The experience of the pandemic may lead to firms changing their working practices in other ways as well, particularly those in the most affected sectors. The accommodation and food services sector is one of those sectors, with output in August remaining 11% lower than a year earlier. Historically, firms in this sector have tended to innovate less, with only 23% of businesses introducing new products or processes<sup>(2)</sup> between 2016 and 2018 (Chart 3.9), compared with 38% across the whole economy. Some studies suggest that could rise in coming years, however — the ONS estimates that workers in the accommodation and food services sectors do a relatively high number of tasks that could be automated (Chart 3.10).

There has also been a significant change in how many public services are delivered. Both the healthcare and education sectors have made greater use of technology to reduce personal contact. In the four weeks to mid-April, 71% of routine GP appointments were done remotely, up from 25% a year earlier; the NHS aims to make some of this change permanent. Similarly, schools and universities moved a large amount of teaching online at the end of the last academic year. Although some in-person teaching has resumed, some higher education establishments expect to continue with hybrid models of in-person and remote learning. These innovations have the potential to increase

(2) The UK definition of a business which is 'innovation active' is based on an OECD and Eurostat definition and can be found on page 4 of the 'UK Innovation Survey 2019: Main Report'.

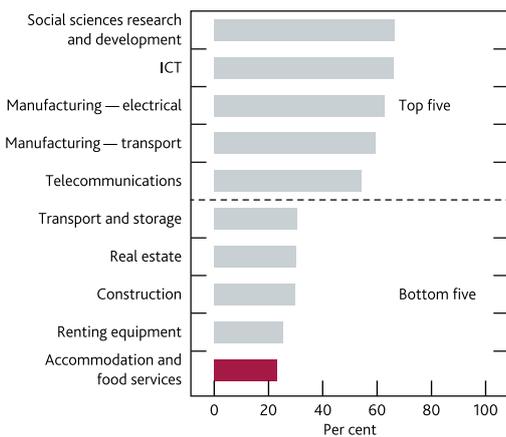
productivity growth in sectors where it has historically been relatively low. For example, GPs may be able to see more patients a day, and lecturers may be able to teach more students at once.

*...although some changes reflect increased costs of doing business.*

In some cases, changes to business processes have been necessary to mitigate the new threat of Covid. For example, many consumer-facing businesses have installed plastic screens, increased the regularity of cleaning, and reduced the number of customers they can serve at any one time to reduce the risk of viral transmission. Some of these innovations reflect a new cost of doing business, so they actually reduce, rather than increase, productivity. They may also lead to higher prices (Section 2.4).

**Chart 3.9: Working practices in hard-hit sectors such as hospitality have not changed much in recent years...**

Percentage of 'innovation active' businesses by sector<sup>(a)</sup>

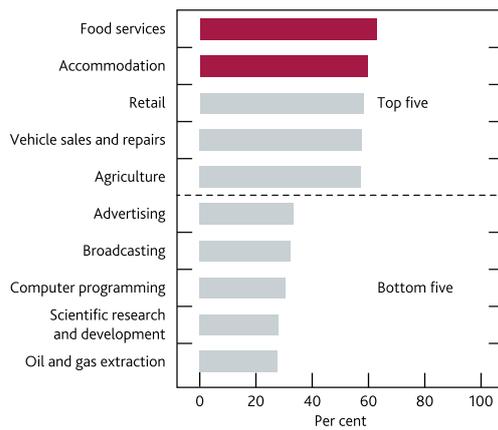


Sources: UK Innovation Survey and Bank calculations.

(a) Estimates are based on data from 2016–18 across 25 sectors. The definition of a business which is 'innovation active' and full descriptions of the different sectors can be found in [UK Innovation Survey 2019](#).

**Chart 3.10: ...but there may be opportunities for innovation in coming years**

Average probability of job automation by sector<sup>(a)</sup>



Sources: ONS and Bank calculations.

(a) Estimates are based on data from 2017 across 86 sectors. The ONS estimates use a task-based approach to assess the suitability of jobs for automation, building on work by [Frey and Osborne \(2013\)](#) and [OECD \(2016\)](#). See ['The probability of automation in England: 2011 and 2017'](#) for more information.

### 3.4 The MPC's projections and risks

The MPC expects some effects of the Covid shock to take some time to unwind. As a result, changes to what we buy and what we make are likely to lead to some reallocation over the forecast period. The medium-term equilibrium rate of unemployment is expected to increase, in part because some workers need to retrain to move between sectors. Although the sectors which are growing may require new capital, elevated uncertainty and tighter credit conditions are expected to reduce investment, weighing on capital stock growth and productivity growth. Together, these effects contribute to the supply capacity of the economy being around 1¼% lower than it otherwise would have been in the absence of Covid by the end of the forecast period (Section 1.2). There are two-sided risks around the size of these effects. Moreover, the possibility of more persistent large shifts in the mix of demand and any resulting supply effects from reallocation, such as premature capital scrapping or sectoral compositional effects, are also risks to MPC's central projections (Section 1.3).

The impact of the changes to how we work are very uncertain, so the MPC has not incorporated any impacts in its projections as yet. For example, it is still unclear to what extent remote working will persist, and what, if any, macroeconomic effects it will have. And it is not yet clear if the Covid shock will have a lasting effect on the pace of productivity-enhancing innovation, where the risks appear two-sided. The MPC will be closely monitoring the evidence on these issues.

# 4 In focus The transition to a new UK-EU trading relationship

Recent evidence suggests that while some businesses are prepared for the change in trading arrangements when the UK leaves the EU Single Market and Customs Union at the start of 2021, others do not feel fully ready. The MPC's central projections assume that a free trade agreement is reached between the UK and EU before the end of 2020, but that trade and GDP are temporarily lower in the near term as firms adjust to the new arrangements.

While negotiations on the exact nature of the new trading relationship between the UK and EU are continuing, the Government has stated that the UK will leave the EU's Single Market and Customs Union on 1 January 2021. As a result, customs and some regulatory requirements will be introduced on goods trade at that point. The UK Government will phase in the enforcement of full border controls over six months, but controls on UK exports to the EU are expected to be enforced with immediate effect.<sup>(1)</sup> Cross-border trade in some services will also change.

In February 2020, the Government set out its approach to negotiations with the EU. That stated that a free trade agreement (FTA) should be at the core of the future relationship, supplemented by a range of other agreements, including over fisheries, law enforcement and judicial co-operation in criminal matters, transport and energy. Some outcomes will result in closer trade links between the UK and EU than others. The Government has stated that if an FTA cannot be agreed, then the UK and EU would move to a trading relationship that is largely based on World Trade Organisation (WTO) rules.

In line with the Political Declaration of October 2019, the MPC's central projections assume that an FTA is agreed, which is of similar scale and depth to the Comprehensive Economic and Trade Agreement in place between Canada and the EU (see Box 1 of the [November 2019 Report](#) for more detail).

The speed and ease with which businesses adjust to the new trading arrangements will affect the near-term economic outlook. In turn, the nature of that adjustment will be in part determined by the extent to which businesses are prepared. This *In focus* presents the latest evidence on business preparedness, drawing on evidence from the Decision Maker Panel (DMP) Survey and a recent survey on preparations for EU withdrawal by the Bank's Agents.<sup>(2)</sup> It also discusses the implications for the MPC's forecast.

## 4.1 Evidence on business preparedness

### *Businesses can take a range of actions to prepare for the new trading relationship.*

There are a range of measures that businesses need to take to be fully ready for the new trading relationship between the UK and EU.<sup>(3)</sup> Firms will need to have the right customs documentation for EU border controls, as well as updated product certifications, for example. Some parts of the new arrangements remain subject to UK-EU negotiations and in those cases it is difficult for firms to prepare for specific outcomes.

### *While most firms have taken some actions, a number of firms report that they are not fully prepared...*

According to the October DMP Survey, most firms have undertaken some preparation for new trading arrangements. Some businesses report that they are fully prepared. Around a third say they are only partially prepared, however, while 19% of firms report that they do not trade with the EU (**Chart 4.1**).

(1) See the European Commission webpage on [Getting ready for the end of the transition period](#) for details of the EU approach.

(2) The DMP Survey has asked firms about Brexit preparedness on a number of occasions since February 2020. The October Survey received responses from around 2,800 businesses and was conducted between 2 and 16 October. The Agents' survey on preparations for EU withdrawal received responses from around 350 businesses with a combined headcount of around 850,000. The survey was conducted between 15 September and 13 October.

(3) The [Government's website](#) sets out how trading arrangements will change and the actions that businesses need to take.

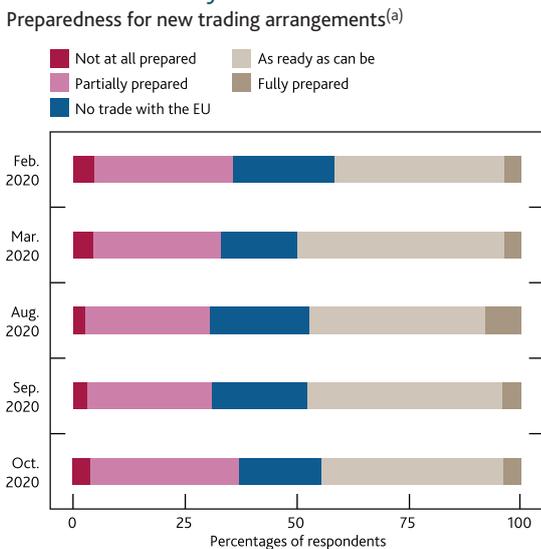
Around 40% of firms in the DMP Survey report that they are currently ‘as ready as can be’. Results from the Agents’ survey are also consistent with this finding. It is quite difficult to judge the extent of preparedness among these firms, who have generally made some preparations, but do not feel fully prepared. The Agents report that this response partly reflects the full details of the new trading relationship not yet being known. In addition, firms may feel there are things, such as how consumer and business confidence are affected by the transition to the new trading relationship, that it is not possible to fully prepare for.

Other business surveys also suggest that some firms have not taken some of the actions needed to fully prepare. In a survey by the BCC in September, around half of firms surveyed had not taken any of the steps recommended by the Government to prepare for changes in the movement of goods between the UK and EU. Evidence from the Agents suggests that around 80% of manufacturers that export to the EU have undertaken preparations for border checks, but that number falls to around 50% for small and medium-sized enterprises (SMEs).

*...including a number of manufacturers, as well as providers of some types of services.*

According to the DMP Survey, businesses that expect the move to new trading arrangements to have a large impact on their sales report being less prepared for the end of the transition period on average. Consistent with that, the share of partially prepared firms tends to be higher in sectors where a relatively large proportion of firms trades directly with the EU. For example, over 40% of businesses in the wholesale and retail, manufacturing, and transport and storage sectors report that they are partially prepared for the end of the transition period, or not at all (Chart 4.2). Fewer businesses report that they are partially prepared in the accommodation and food services and construction sectors, where a higher share of firms do not trade with the EU.

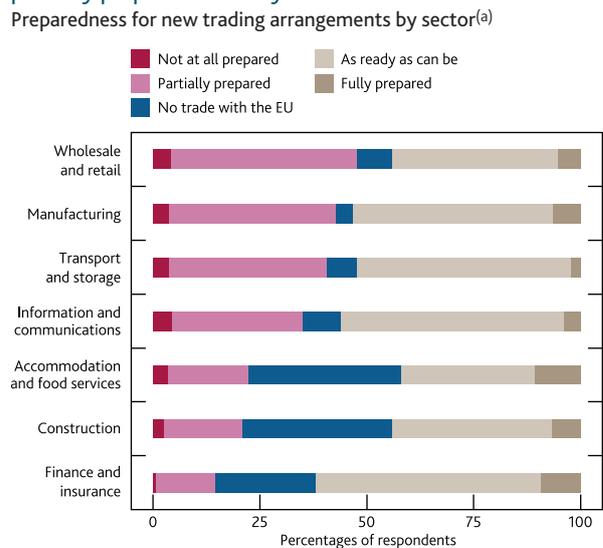
**Chart 4.1: Around a third of respondents were partially prepared for new UK-EU trading arrangements in the October DMP Survey**



Sources: DMP Survey and Bank calculations.

(a) Question: ‘Do you think your business is prepared for the potential extra requirements for trading with the EU once the current transition period comes to an end?’.

**Chart 4.2: The share of firms reporting that they are partially prepared varies by sector**



Sources: DMP Survey and Bank calculations.

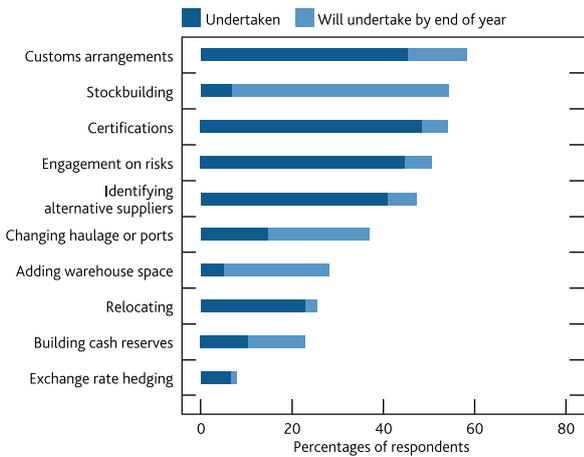
(a) Question: ‘Do you think your business is prepared for the potential extra requirements for trading with the EU once the current transition period comes to an end?’. Based on average shares across the August, September and October Surveys.

*Some businesses expect to undertake further preparatory steps in the coming weeks...*

A survey by the Bank’s Agents suggests that some firms intend to boost their level of preparedness before the end of 2020 (Chart 4.3). That is consistent with past evidence, where certain types of preparation, such as stockbuilding, took place close to previous Brexit deadlines. Manufacturers increased their stock levels materially in March 2019, for example, although the boost to GDP was smaller as a large share was imported. At the same time, EU firms also built stocks of UK-produced goods, which boosted UK exports temporarily. Stockbuilding is costly, and firms can reduce those costs by minimising the period for which goods are stored. Consistent with that, relatively few firms have already begun to increase their inventory levels, but over half the respondents said they expect to have done so by the end of the year. Of the respondents that hold stocks, almost half expect to hold inventories that would support more than five weeks of business activity at the end of 2020. Normally at year-end, that share would be around a quarter (Chart 4.4). Companies also intend to change haulage or ports arrangements, add warehouse space, and build cash reserves over the remainder of the year. These responses were provided before the latest Covid-related restrictions and government support measures were announced and firms’ plans may therefore have changed since.

**Chart 4.3: Businesses have taken, and plan to take, a range of actions to prepare for EU withdrawal**

Types of preparation for EU withdrawal undertaken<sup>(a)</sup>

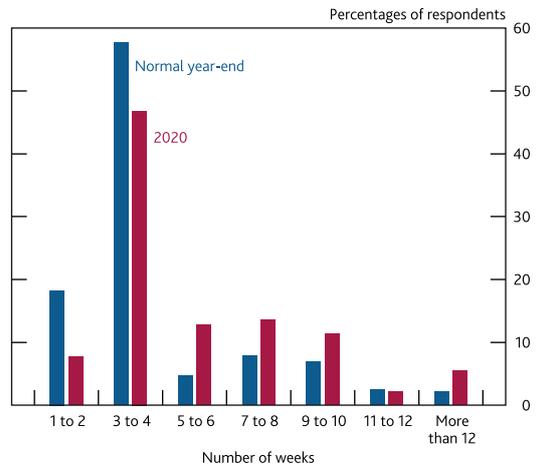


Source: Agents' survey on preparations for EU withdrawal.

(a) Question: 'If applicable, what type of preparations has your company undertaken, or will have done by the end of the year?'

**Chart 4.4: Some businesses plan to increase their stock holdings relative to normal**

Number of weeks of stock holdings at year-end<sup>(a)</sup>



Source: Agents' survey on preparations for EU withdrawal.

(a) Question: 'If you hold stocks, how many weeks of normal business activity would be supported by stock holdings?'

*...but surveys and other evidence suggest some firms will still not be fully prepared at the end of the year.*

Although firms will make further preparations, surveys suggest that some firms will not be fully prepared by the end of the year. In a survey conducted by the Institute of Directors in September, for example, only around 60% of businesses that expected to be affected by the end of the transition period thought they would be fully prepared by the end of 2020. In the Agents' survey, a third of firms that trade with the EU said they would be fully prepared by the end of the year, with two thirds 'as ready as they can be'.

Discussions with firms suggest that Covid-19 and associated restrictions might have hindered some companies' preparations for the new UK-EU trading relationship. During 2020, many businesses have had to divert resources to dealing with the impact of the pandemic. While Brexit-related uncertainty has increased compared with earlier in the year, Covid-19 continues to be viewed as a more important source of uncertainty by many firms (Chart 4.5). Almost half of firms surveyed by the CBI in September said the impact of dealing with Covid-19 had negatively affected their preparations for moving to new trading arrangements.

Trade bodies have reported that some preparations can only be undertaken once further details of the new UK-EU trade relationship are known. Logistics groups have also raised concerns that there will be limited time to familiarise themselves with new border procedures before the end of the transition period.

*Some small businesses are expected to face particular challenges.*

Some smaller firms may find it particularly difficult to carry out the necessary preparations for a new UK-EU trading relationship and could face challenges when the relationship changes as a result. The fixed cost of preparations may be high relative to their turnover and these firms are more likely to have had little experience of customs arrangements to date.

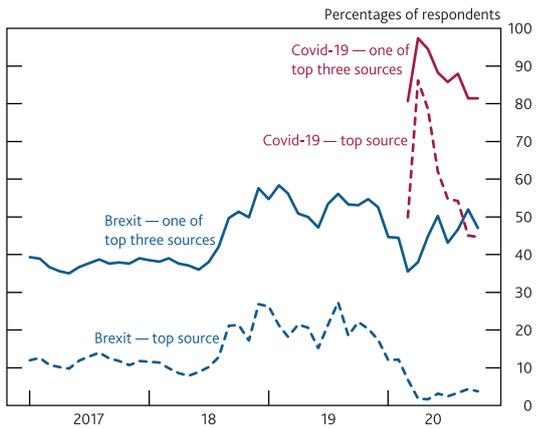
## 4.2 The impact of moving to a new UK-EU trading relationship

*The outcome of UK-EU negotiations will have an impact on a range of businesses...*

Changes to trading arrangements will influence the way importers and exporters obtain their inputs or sell their products in the EU market. But other firms are also likely to be affected. Firms that source their inputs domestically may rely on suppliers that use imported goods in their own supply chains, for example.

Respondents to the Agents’ survey suggest that there are various channels by which the transition to the new relationship with the EU will affect their business (Chart 4.6). Some firms expect weaker consumer and business confidence to have a negative impact on them, although a relatively small share of those believe the effect would be significant. Around 40% of respondents report that they expect to be negatively affected by border delays. On average, respondents to the survey believe that growth in their output, employment and investment spending in 2021 would be lower if there is no deal between the UK and EU, relative to what would happen if a comprehensive FTA is agreed.

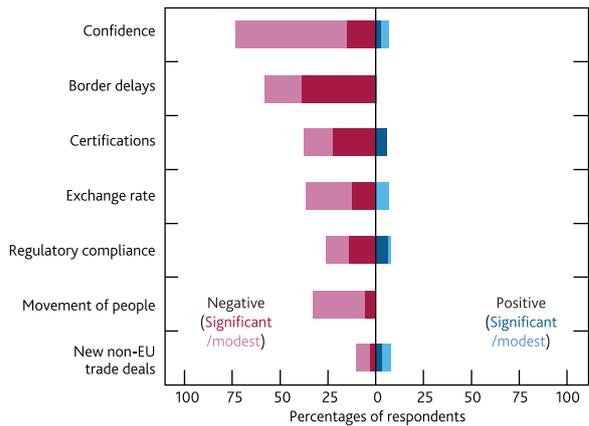
**Chart 4.5: Covid-19 has been the main source of uncertainty for many businesses since March, although Brexit is also cited as a key uncertainty**  
Brexit and Covid-19 as sources of uncertainty<sup>(a)</sup>



Sources: DMP Survey and Bank calculations.

(a) Based on the survey questions: 'How much has the result of the EU referendum affected the level of uncertainty affecting your business?' and 'How important is the spread of coronavirus (Covid-19) as a source of uncertainty for your business?'.

**Chart 4.6: Moving to a new trading relationship with the EU will affect businesses via a number of channels**  
Expected channels by which EU exit will affect businesses<sup>(a)</sup>



Source: Agents’ survey on preparations for EU withdrawal.

(a) Question: 'What are the main channels for any impact of EU exit on your company?'.

*...and is expected to weigh on UK-EU trade.*

Since November 2019, the MPC’s central forecast has been conditioned on the assumption that the UK and EU will agree an FTA which is of similar scale and depth to the Comprehensive Economic and Trade Agreement in place between Canada and the EU. The move to such an FTA would mean that customs, rules of origin and some regulatory checks on goods trade would be introduced between the UK and EU. Some cross-border provision of services is also likely to be affected by new barriers to trade. The Bank’s framework for analysing different EU withdrawal scenarios was set out in November 2018.<sup>(4)</sup> Consistent with that approach, trade in both goods and services are expected to be lower.

In line with empirical evidence that suggests greater openness supports productivity, this reduction in trade with the EU, as well as lower foreign direct investment, is expected to weigh on UK output over the forecast period.

*In addition, the MPC judges that trade and activity will be temporarily lower in the near term as firms adjust to the new trading arrangements.*

The range of surveys and other available evidence suggests that although preparedness will continue to improve over the coming months, it is likely that some businesses, particularly SMEs, will not be ready to continue trading with the EU at the end of the transition period. The most significant impact is likely to arise from a lack of preparedness for new customs and border controls, which the EU intends to apply in full from 1 January 2021.

The MPC therefore judges that trade and activity will be temporarily lower in the near term as firms adjust to new arrangements. In its central forecasts, the MPC assumes a greater proportion of large businesses are prepared than smaller companies and that overall, traders representing around 70% of goods exports to the EU are prepared for customs and documentation checks at the border by the end of the year. That is consistent with a further improvement in preparedness from current levels set out in Section 4.1, but some businesses, particularly SMEs, not

(4) EU withdrawal scenarios and monetary and financial stability, Bank of England response to the House of Commons Treasury Committee, published 28 November 2018.

being fully ready by that point. This weighs on UK exports in 2021 Q1 as most goods without the correct documentation are assumed to be turned back at the border. Due to the integrated nature of cross-border supply chains and logistics, imports are assumed to be affected too, but to a lesser degree.

The expected reduction in exports, and the impact on domestic supply chains, reduces projected GDP directly by around 1% in 2021 Q1. These effects are expected to dissipate by the end of 2021 Q2 as more businesses adjust to the new arrangements.

There is considerable uncertainty around the impact that the initial adjustment to the new trading relationship will have on trade and activity, and its duration. Any implications for slack and inflation are judged likely to be small, however, as the process of adjustment should be temporary and will probably affect both demand and supply.

## Annex

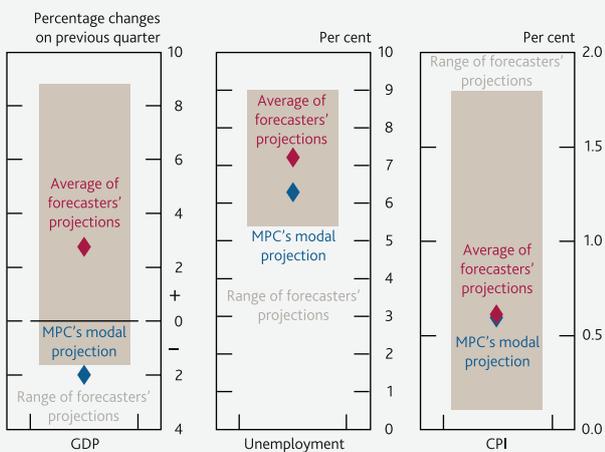
### Other forecasters' expectations

This annex reports the results of the Bank's most recent survey of external forecasters. Expectations for the near term are summarised in **Chart A**, and those for further out are shown in **Table 1** and **Chart B**.<sup>(1)</sup> Survey responses were collected in the week to 23 October, before the latest announcements about Covid-19, associated restrictions and government support measures.

On average, external forecasters expected quarterly GDP growth of 2.8% in 2020 Q4 (**Chart A**). The unemployment rate was expected to rise to 7.2% and CPI inflation was expected to be 0.6%. The range of projections is wide.

**Chart A: External forecasters expect stronger GDP growth in 2020 Q4 than in the MPC's modal projection, but higher unemployment**

Other forecasters' central projections for GDP, the unemployment rate and CPI inflation in 2020 Q4



**Table 1: Averages of other forecasters' central projections**

|  | 2021 Q4 | 2022 Q4 | 2023 Q4 |
|--|---------|---------|---------|
| GDP growth <sup>(a)</sup>                                      | 3.7     | 2.6     | 1.8     |
| CPI inflation <sup>(b)</sup>                                   | 1.8     | 1.9     | 1.9     |
| LFS unemployment rate (per cent)                               | 6.7     | 5.9     | 5.3     |
| Bank Rate (per cent)   | 0.2     | 0.5     | 0.7     |
| Stock of purchased gilts (£ billions) <sup>(c)</sup>           | 837     | 867     | 869     |
| Stock of purchased corporate bonds (£ billions) <sup>(c)</sup> | 23      | 25      | 26      |
| Sterling ERI <sup>(d)</sup>                                    | 78.8    | 79.5    | 80.5    |

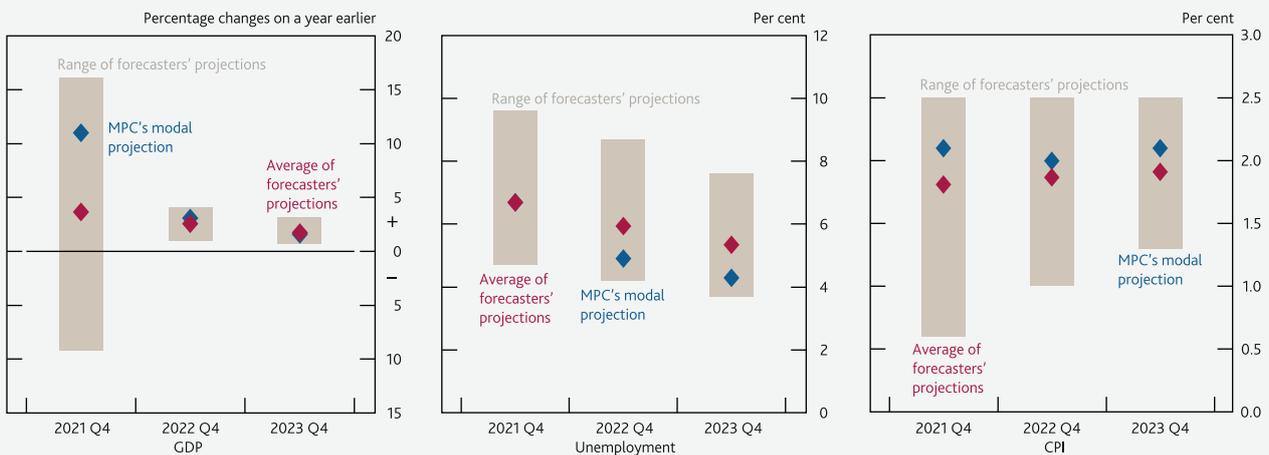
(a) Four-quarter percentage change.  
 (b) Twelve-month rate.  
 (c) Original purchase value. Purchased via the creation of central bank reserves.  
 (d) Index: January 2005 = 100.

On average, respondents expected GDP growth of 3.7% in the four quarters to 2021 Q4. Four-quarter GDP growth is then expected to fall back gradually to just under 2% by 2023 Q4 (left panel, **Chart B**). The unemployment rate is expected to fall steadily, reaching 5.3% by 2023 Q4 (middle panel, **Chart B**). CPI inflation is expected to rise towards the target, but remains slightly below 2% throughout the forecast period (right panel, **Chart B**).

On average, external forecasters expected an increase in the stock of purchased assets of about £150 billion over the next three years, on top of the £745 billion announced by the MPC at the time of the survey (**Table 1**).

**Chart B: At the three-year horizon, external forecasters expect GDP growth to be just under 2%, the unemployment rate to be around 5¼%, and inflation to be marginally below the MPC's 2% target**

Projections for GDP, the unemployment rate and CPI inflation



(1) For detailed distributions, see 'Other forecasters' expectations'.

# Glossary and other information

## Glossary of selected data and instruments

**AWE** – average weekly earnings.  
**CPI** – consumer prices index.  
**CPI inflation** – inflation measured by the consumer prices index.  
**DMP** – Decision Maker Panel.  
**ERI** – exchange rate index.  
**GDP** – gross domestic product.  
**HICP** – harmonised index of consumer prices.  
**LFS** – Labour Force Survey.  
**MFCI** – Monetary and Financial Conditions Index.  
**RPI** – retail prices index.  
**RPI inflation** – inflation measured by the retail prices index.

## Abbreviations

**BBLs** – Bounce Back Loan Scheme.  
**BCC** – British Chambers of Commerce.  
**CBI** – Confederation of British Industry.  
**CBILS** – Coronavirus Business Interruption Loan Scheme.  
**CCS** – Credit Conditions Survey.  
**CIPD** – Chartered Institute of Personnel and Development.  
**CJRS** – Coronavirus Job Retention Scheme.  
**CLBILS** – Coronavirus Large Business Interruption Loan Scheme.  
**CSSE** – Centre for Systems Science and Engineering.  
**ECB** – European Central Bank.  
**EME** – emerging market economy.  
**EOTHO** – Eat Out to Help Out.  
**EU** – European Union.  
**FTA** – free trade agreement.  
**FTSE** – Financial Times Stock Exchange.  
**GfK** – Gesellschaft für Konsumforschung, Great Britain Ltd.  
**HMRC** – Her Majesty’s Revenue and Customs.  
**ICE/BoAML** – Intercontinental Exchange/Bank of America Merrill Lynch.  
**ICT** – information and communications technology.  
**IMF** – International Monetary Fund.  
**JSS** – Job Support Scheme.  
**LTV** – loan to value.  
**MPC** – Monetary Policy Committee.  
**MSCI** – Morgan Stanley Capital International Inc.  
**MTIC** – missing trader intra-community.  
**NHS** – National Health Service.  
**NPISH** – non-profit institutions serving households.

**OECD** – Organisation for Economic Co-operation and Development.  
**ONS** – Office for National Statistics.  
**PNFC** – private non-financial corporation.  
**PPP** – purchasing power parity.  
**S&P** – Standard & Poor’s.  
**SEISS** – Self-Employment Income Support Scheme.  
**SME** – small and medium-sized enterprise.  
**TFP** – total factor productivity.  
**TFSME** – Term Funding scheme with additional incentives for Small and Medium-sized Enterprises.  
**TUC** – Trades Union Congress.  
**VAT** – Value Added Tax.  
**WEO** – IMF *World Economic Outlook*.  
**WTO** – World Trade Organisation

## Symbols and conventions

Except where otherwise stated, the source of the data used in charts and tables is the Bank of England or the Office for National Statistics (ONS) and all data, apart from financial markets data and results from the Decision Maker Panel (DMP) Survey, are seasonally adjusted.

n.a. = not available.

Because of rounding, the sum of the separate items may sometimes differ from the total shown.

On the horizontal axes of graphs, larger ticks denote the first observation within the relevant period, eg data for the first quarter of the year.