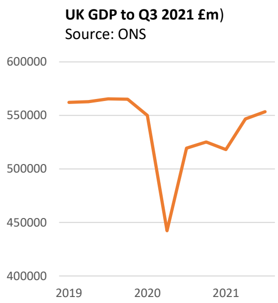
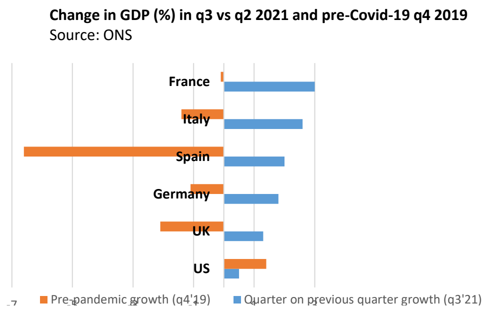
Market Insight | Business Economic Outlook: November 2021

2022 – What next for business managers and their financial backers?

The government's autumn budget was positioned to lay the foundations for a strong UK economy; turning the page on austerity, while presiding over an unprecedented expansion of state spending to generate an economy grounded in higher wages, skills, investment and productivity. In this light, CSA examines the UK's economic situation and asks, "What next for business managers and their financial backers?"

UK outlook: battling economic headwinds



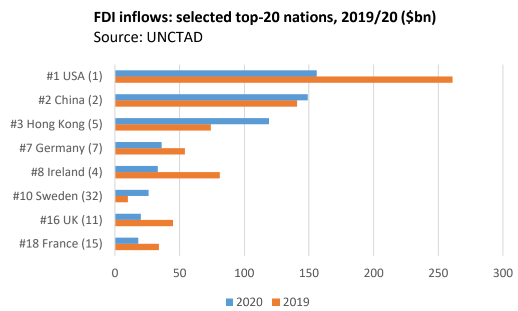


Social distancing, restricted travel and business closures under Covid-19 have severed many of the accepted commercial channels that hitherto linked willing consumers with willing suppliers and, on which, the economy depends. But as many key economic sectors have struggled to survive, new segments have also gained evolutionary traction and uptake, revising the pattern of winners and losers (summarised below) across the UK economic landscape.

With increasing population vaccination and easing of the national lockdown through the summer months, GDP has recovered some of its lost ground, increasing by an estimated 1.3% in Q3 2021 - although this is still 2.1% lower than before the pandemic in Q4 2019. Furthermore, the momentum appears to be losing strength compared to the increase of 5.5% in the previous quarter, with uncertainty over the risk of future restrictions also dampening activity.

Internationally, the UK's economic performance lags France, Italy, Spain and Germany which are all closer to their pre-Covid level of GDP. Only the USA amongst the G7 economies has recovered to now exceed its pre-pandemic level. However, the UK also has to live with Brexit.

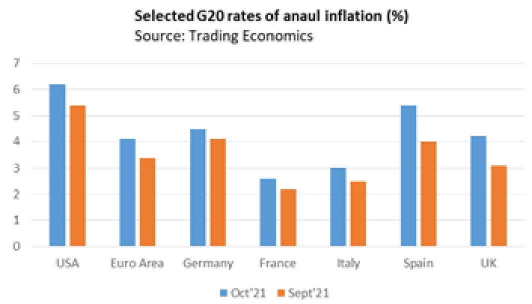
Business investment: lost home ground and foreign attractiveness



The social and economic impact of Covid captures the political mood of the day and dominates the UK's media but, potentially, masks the very real business and economic implications of Brexit. Business investment in the UK flatlined after the EU referendum in mid-2016, reversing several years of growth out of recession following the 2008/09 financial crisis. Investment nosedived sharply again after the UK formally left the EU on 31 January 2020, although the picture of cause and consequence is muddied by the almost simultaneous arrival of Covid to the UK's shores in February.

In addition to the UK's reduced level of indigenous business investment, it is clear that the country has become less attractive to overseas investors. Most leading economies experienced lower foreign direct investment (FDI) in 2019/20 - bar China, including Hong Kong. However, in a list of the top-20 FDI inflow nations in 2020, the UK sits at #16, five places lower than 12 months previously.

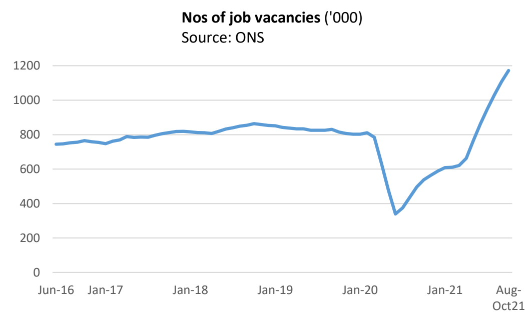
Inflation: more than a short-term conundrum

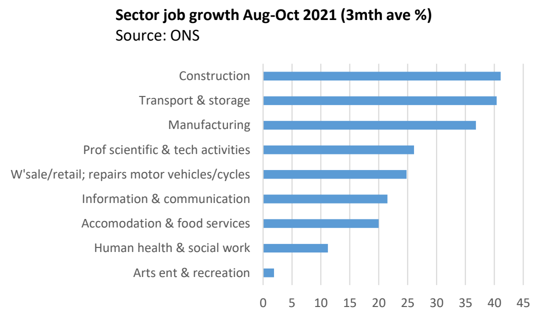


The UK's Consumer Prices Index rose this year to 4.2% in the 12 months to October, compared to 3.1% in September. This is slightly ahead of the Euro-area, although significantly lower than the USA given the vastness of the $1.9tn Biden stimulus package, in some contrast to the European situation.

The UK is currently experiencing its highest 12-month inflation rate since November 2011. The key question, therefore, is whether the present surge will be temporary or longer lasting. In a forward time-line characterised by stop-start economic output, the more likely scenario is one of continuing high inflation in line with Covid's lasting footprint - until vaccination and herd immunity reduce the pandemic to manageable, endemic levels of proportionality. Meanwhile, 10-year high inflation will impact public sector borrowing costs and the public sector's ability to fund its committed programmes within government funding limits – especially local authorities, health and education - as well as impacting raw material production costs and labour rates in private sector supply chains as these feed through to employers and consumers.

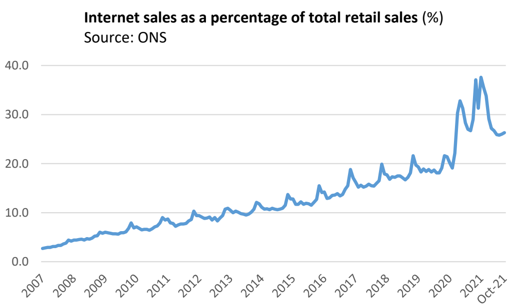
Labour market: easing into the New Year





The number of job vacancies in August to October 2021 reached a record level of nearly 1.2m. At a time when the rate of unemployment is around 4.3%, this suggests employers are struggling to fill vacancies, notably in the construction, transportation and manufacturing sectors. However, the ending on 30 September of the government's furlough scheme, protecting wages during the initial phases of the pandemic, may lead to some slackening of the labour market running into the New Year as struggling businesses cut employee numbers, serving notice of statutory redundancy in the coming few months.

Retail sales: regaining overall equilibrium with increasing online traction



Covid saw the retail sales index fall by more than 20% in February 2020. Non-food items led the decline as people stayed at home, killing shopper footfall and demand for fuel, for example. The index recovered to its pre-Covid level mid-summer last year and has remained broadly steady since then to date. The internet's share of retail sector trade during lockdown spiked at nearly 38% in January before settling back to 26% in October, as online continues to gain traction and take market share from instore, bricks and mortar establishments. It is interesting to note the month of November's increasing importance to seasonal online sales activity.

Household savings as a proportion of disposable incomes reached record levels of over 25% in Q1 2020, against a historical 10-year spread of 5-10%. The household savings ratio has since decreased; reducing to just under 12% in Q2 2021, according to ONS data for September. The key question for the retail industry is whether people will continue to spend their pandemic saving's windfall, or hold on to it because of precautionary purposes - a key driver of consumer spending behaviour - when NI and other taxation announced in the Budget increase next April.

Outlook summary: revised patterns of economic activity

Sector	Health check					Outlook 2022
Consumer goods & services						
Online sales	✓					Continuing market penetration, driven by 'hassle of going out' • Demand for volume merchandise home delivery + specialist niche retail
Social media	✓					Remains in strong growth territory across widening user age groups • Demand for social networking and influencer interaction
Small-ticket items		✓				More time-at-home benefits consumption, but slowing post-lockdown • Demand for DIY/gardening, games and pet care
Big-ticket items			✓			Headwinds from post-furlough unemployment worries • Consumer concern that wages will not keep up with inflation
Retail services			✓	✓		City centre hospitality/recreation remain stuck. Out-of-town faring better • Low demand for air/rail travel. Restaurants, leisure and sports still slow
Business services						
Digitech/telecoms	✓					Enterprises invest to improve efficiency and stay competitive • Demand for the internet-of-things, robotics and AI
Building services		✓				Active across warehousing/logistics + environmental fit out • Demand for CCTV/access control/HVAC + remote monitoring services
Employment services			✓			Permanent recruitment on hold, temp active in key segments, eg logistics • Temps hit first by the downturn, but will recover first
Prof services		✓				'Dry powder' in M&A. Strength in employment law, audit + treasury • Continued demand in Brexit planning and corporate restructuring
Advertising/PR agency		✓				Corporate marcom stymied by cash flow concerns • Digital ad spending continuing to enjoy strong tailwinds
ESG services	✓					Increased focus on regulatory + non-regulatory standards of compliance • Demand for management systems advisory, implementation + reporting
Manufacturing & production						
Pharma & healthcare		✓				Consumption is characteristically resilient and non-cyclical • Non-C19 therapies faltering as hospital procedures are postponed
Automotive			✓	✓	✓	Global production overcapacity; supply chain frailty • Demand for electric vehicle + used-vehicles/remanufactured parts
Oil & gas		✓				Demand running ahead of supply; geo-political + environmental strictures • Lasting economic dependency; no easy energy alternatives
Chemicals & plastics			✓			Cyclical in line with OEM and end-user consumption • Recovering demand, but feedstock cost inflation/extended lead times
Building & construction						
Public sector	✓					Supported by projected government infrastructure funding • Education and healthcare premises, road and rail transportation
Industrial	✓	✓				Demand held up by online order fulfilment and cloud data centre activity • Supply of data centre vacant space mostly insufficient to meet demand
House building				✓		Debottlenecking in existing projects, rather than new starts, but: • Govt support/message - energy efficiency/low-C for new builds/retrofit
Commercial sector				✓		Muted office space demand as tenants reconsidered staffing/locations • Retail structural change as landlords renegotiate rental terms or vacate

For information about how Carlton Strategy Advisors can help you to assess business and market opportunity and attractiveness, please contact: David McClelland via carlton-advisors.co.uk