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Real-time updates on the UK economy: trends, expectations and implications from business survey data

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THE LONDON SCHOOL
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**Real-time updates on the UK economy trends, expectations and
implications from business survey data**

CEP COVID-19 ANALYSIS

Josh De Lyon and Swati Dhingra

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Executive summary

- Covid-19 has caused substantial shocks to the UK economy. Global supply chains have been disrupted by factory closures, fractured transport networks, labour disruptions and rising energy prices.
- Meanwhile, the Brexit agreement has been implemented, causing a rise in barriers to trade, investment, and migration with the UK's largest economic partner.
- The economy is changing rapidly, highlighting a need for real-time data to analyse trends. We use monthly business survey data from the Confederation of British Industry (CBI) to document recent trends and future expectations on multiple measures of firms' activity.
- The majority of firms have increased their volume of business every month since April 2021. However, this trend is weakening and in October the shares of firms increasing and decreasing their business volumes were roughly equal. The decline is mirrored in expectations which have also become less optimistic.
- Firms' average prices have grown reflecting the average growth in wages, and firms expect these price increases to persist, alongside rising wages. There is a narrowing gap between wage growth and price growth, pointing to a period of lower real wage growth.
- Across sectors, it continues to be firms providing consumer and personal services that are more likely to be experiencing downward trends in business volume and employment.
- Firms in all sectors of the economy report "labour shortages" at the pay rates that they are offering, with at least half of all businesses in each sector experiencing a shortage of workers.
- Approximately half of firms report difficulty recruiting new workers while around one in five firms report issues retaining existing staff. One in ten firms report that the UK's point-based immigration regime is causing labour shortages.
- Policymakers have an important role to play in supporting adjustments to these shocks. Policies to incentivise human capital investments will support job transitions across sectors, occupations, and firms. Migration policy could be helpful for localised labour shortages in the short-term. In the long term, both migration and trade policy should be incorporated into a broader economic strategy.

Introduction

The UK economy is experiencing turbulence. A wide range of complex factors – some global and some specific to the UK – could be driving these rapid economic changes.

Economic activity has been on the rise as vaccines have been rolled out across the developed world. Yet the recovery has been restricted. Global supply chains have been disrupted by factory closures, fractured transport networks, labour disruptions and rising energy prices. The experience of the UK in dealing with these issues has been made harder by Brexit, which significantly increased barriers to trade, investment, and migration with its closest and largest economic partner.

UK total output remains 2.1 per cent below its pre-pandemic level and the growth rate of the recovery appears to be stalling. Employment has returned to pre-pandemic levels and businesses in many sectors are facing shortages of labour at the wages that they are offering. The annual rate of inflation is hovering at around 3 per cent, with warnings by the Bank of England that it could rise to [5 per cent](#).

The economy is changing rapidly, highlighting a need for real-time data to analyse trends. Recent research suggests that business expectations are predictive of future unemployment patterns and recessions beyond standard measures of the economy (Blanchflower and Bryson, 2021). Increasing efforts are being made to collect less conventional, more timely measures of economic activity to measure real-time developments (for example, see: ONS 2021a, ONS 2021b, and Bank of England 2021).

We use monthly business survey data from the Confederation of British Industry (CBI) to document recent trends and future expectations on a wide range of measures on firms' activity. The CBI is the UK's largest business organisation and collects monthly surveys of its members and non-members. The data covers most sectors of the economy, though manufacturing is oversampled in the results presented below. Importantly, the data is already available up to October 2021 and asks firms about factors affecting their performance, including labour shortages, and expectations of future trends.

The economy has been growing but it appears to be slowing and expectations are dipping

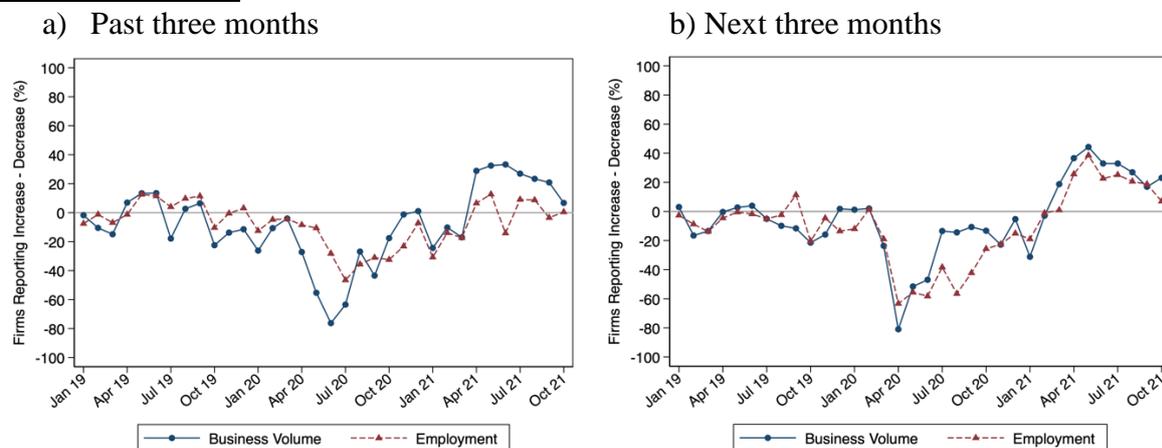
The UK economy experienced its fastest rebound since the onset of Covid-19 in the summer of 2021. Figure 1a shows that the majority of firms have been increasing their volume of business every month since April 2021. However, this trend is in decline and in October the shares of firms increasing and decreasing their business volumes are roughly equal. The decline is mirrored in expectations, shown in Figure 1b, which are also becoming less optimistic.

Figure 2a shows that the average growth in firms' prices has moved together with their average wage growth, and Figure 2b shows that firms are expecting these price increases to persist, alongside rising wages. As the Office for National Statistics (ONS) has pointed out, rising wages reflect the low base that wages are recovering from and the drop in employment experienced by lower wage workers. The narrowing gap between wage growth and price growth over the year points to a period of declining real wage growth.

Looking at variation across sectors, it continues to be firms providing consumer and personal services, which includes restaurants and hairdressers, that are more likely to be experiencing downward trends in business volume and employment, as shown in Figure 3. Their expectations on future trends also remain notably lower than other sectors of the economy. Figure 4a further shows that price increases have been highest in consumer and personal

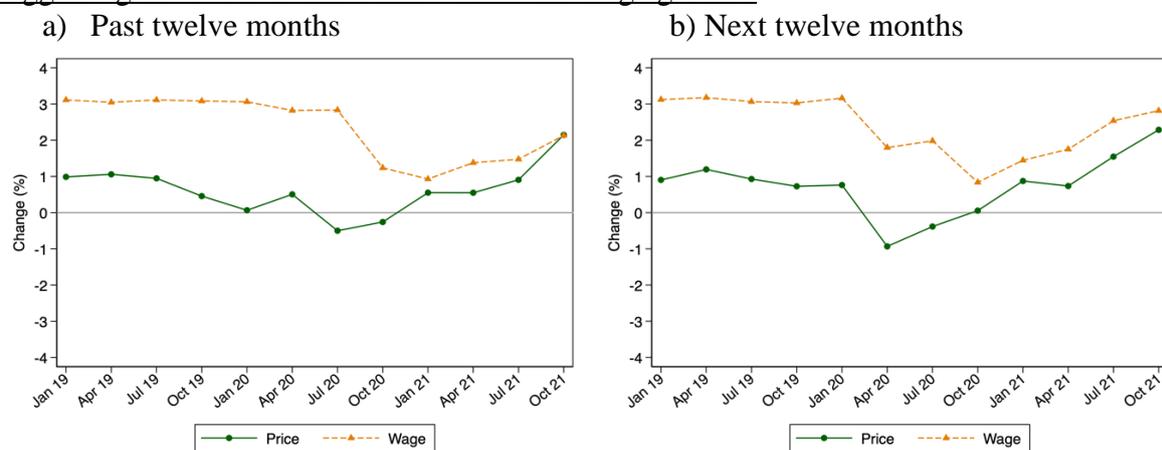
services, primarily caused by recovery from exceptionally low prices resulting from the UK government's [Eat Out to Help Out](#) discount scheme in summer 2020.

Figure 1: A high share of firms reported increased business volumes throughout the summer but this has slowed



Notes: The charts plot the share of businesses reporting an increase in business volume or employment minus the share reporting a decrease relative to the past three months. The measures are weighted by employment. Trends on past manufacturing employment are only available quarterly.

Figure 2: Firms report that average price growth is catching up with average wage growth, suggesting current and future declines in real wage growth.

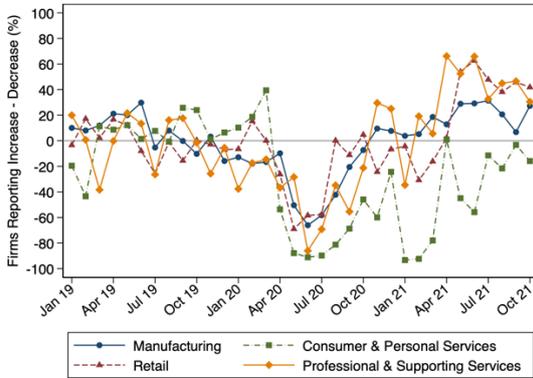


Notes: The chart plots the mean of firms' average change in selling price and wage rate over the past twelve months and next twelve months. The measures are weighted by firm employment.

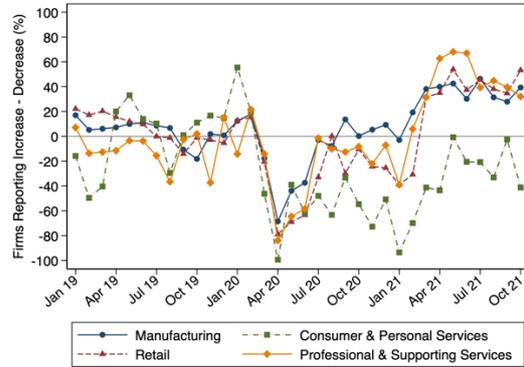
Figure 3: Consumer and personal services continues to lag behind other sectors.

Business Volume:

a) Past three months

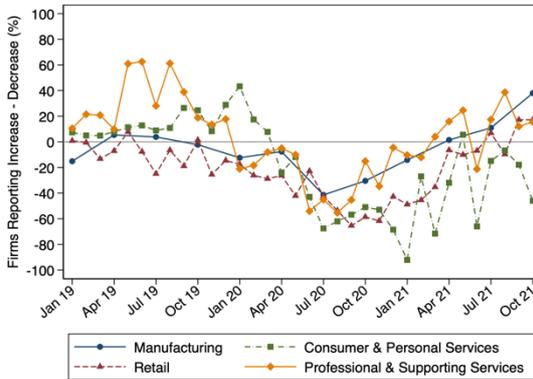


b) Next three months

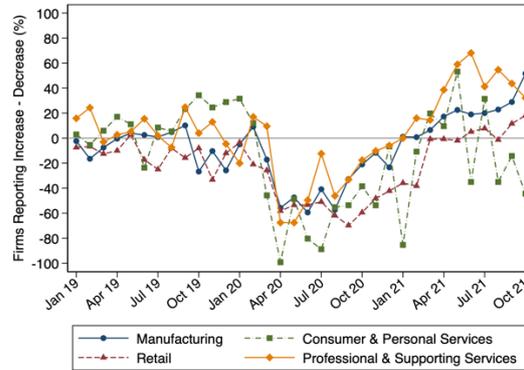


Employment:

c) Past three months



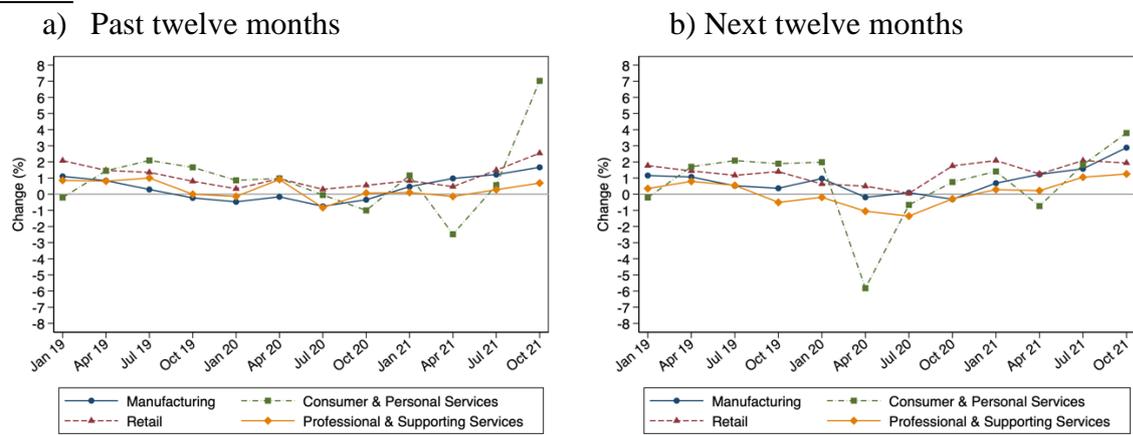
d) Next three months



Notes: The charts plot the share of businesses reporting an increase in business volume or employment minus the share reporting a decrease relative to the past three months. The measures are weighted by employment. Trends on past manufacturing employment are only available quarterly.

Figure 4: Average prices are growing in all sectors, with price growth greatest in consumer and personal services

Prices



Notes: The chart plots the mean of firms’ average change in selling price and wage rate over the past twelve months and next twelve months. The measures are weighted by firm employment.

The necessary lockdowns in 2020 and 2021 caused a sharp temporary reduction in economic activity as many workers and firms did not operate as normal and demand was suppressed. As these restrictions were relaxed, economic activity began to rebound. Yet there are signs that this rebound is slowing, with the economy [still 2.1 per cent smaller](#) than before the pandemic. Our metrics suggest that firms are less optimistic about future growth than they were over the summer, alongside the prospect of persistent inflation. In the next two sections, we present evidence on some of the factors affecting firms and the economic recovery.

Firms are responding differentially to labour disruptions

Labour shortages have been well documented, particularly in sectors that are fundamental to broader supply chains such as transportation (BBC News, 2021). Firms report facing difficulties in recruiting workers, which is restricting the growth of total output and putting upward pressure on prices.

The survey data suggests that firms across all sectors of the economy are reporting labour shortages at the pay rates that they are offering, with at least half of all businesses experiencing a shortage of workers in each sector (Figure 5a). Figure 5b shows that businesses, small or big, are experiencing labour shortages. Large and medium size firms are more likely to have reported a shortage of labour, but small firms are also affected.

Figure 6 shows that approximately half of firms were having difficulty recruiting new workers while around one in five firms are having issues retaining existing staff. One reason for these labour shortages is simply that the pandemic and, in part, Brexit have caused a major restructuring of economic activity. The shocks hitting the economy have been substantial and rapid, and labour markets are still adjusting to them.

Changes in migration have also played a role. In 2020, the number of migrants fell by around 10 per cent, although there is some uncertainty about the exact figures (Sumption, 2021, and Manning 2021). The fall was for both EU and non-EU migrants. For some sectors, particularly those that rely on short term or seasonal migrant workers, Brexit appears to be having an effect.

Government data shows that the proportion of short-term migrant visas given to workers from the EU is now close to 0 per cent. Before Brexit, almost all short-term workers came from the EU. But overall, migration is unlikely to be the main cause of labour shortages. Approximately one in ten firms in our sample are reporting that the UK's point-based immigration regime is causing labour shortages.

The furlough scheme is unlikely to have contributed significantly to labour shortages. At the end of September, approximately four per cent of the workforce was on furlough. The majority of those who leave furlough return to their previous jobs (Tomlinson, 2021). If these firms had been experiencing labour shortages for the occupations of their furloughed workers, then they would have already asked them to return to work.

Around a third of firms say that they have responded to labour shortages by raising wages, though this has come after a prolonged period of rising prices and reduced employment, especially among lower wage workers. The wage growth therefore reflects a long period of weak labour market responses and a change in composition as low wage workers have suffered more during the pandemic.

Around 20 per cent of firms have responded to labour shortages by investing in new technologies. Previous evidence suggested that the majority of firms had adopted new technologies throughout the pandemic, but only 10-15 per cent cited that the new technologies will reduce their need for employees (Riom and Valero, 2021). As firms adjust their technologies in response to labour shortages, it is more likely that there will be impacts on the long-term structure of the labour market. One in five firms report that they have adjusted their operations in response to shortages, perhaps to less labour-intensive production or to areas without shortages.

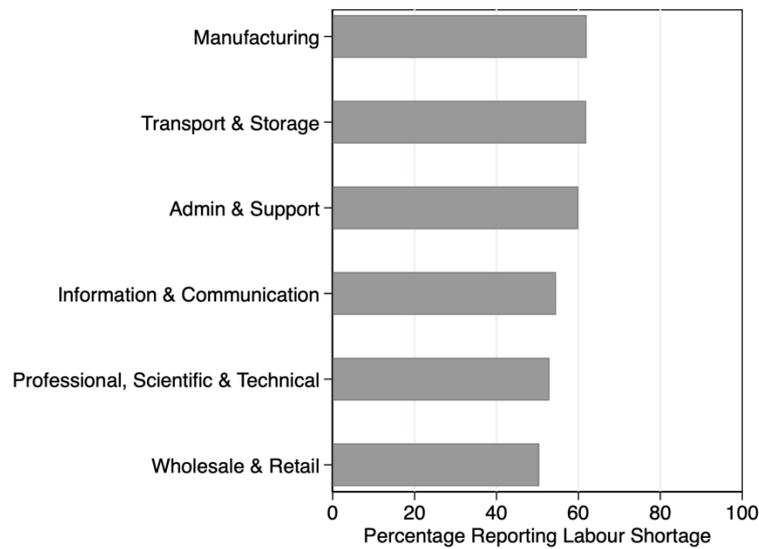
One in five businesses have also reported that long term skills gaps are affecting their ability to recruit workers. Relative to other OECD countries, a high share of the UK workforce has university degrees. Where it clearly lags is on technical and vocational skills, and the share of the workforce considered to be underqualified for work is well above the OECD average.¹

Nearly half of firms expect labour shortages to last more than one year, and 21 per cent say more than two years. Just five per cent of firms think that shortages will last less than three months. Both Covid and Brexit will continue to alter the structure of employment in the UK. We discuss the policy implications of these trends in the final section of the report.

¹ See forthcoming work as part of the Centre for Economic Performance and Resolution Foundation *Economy 2030* project.

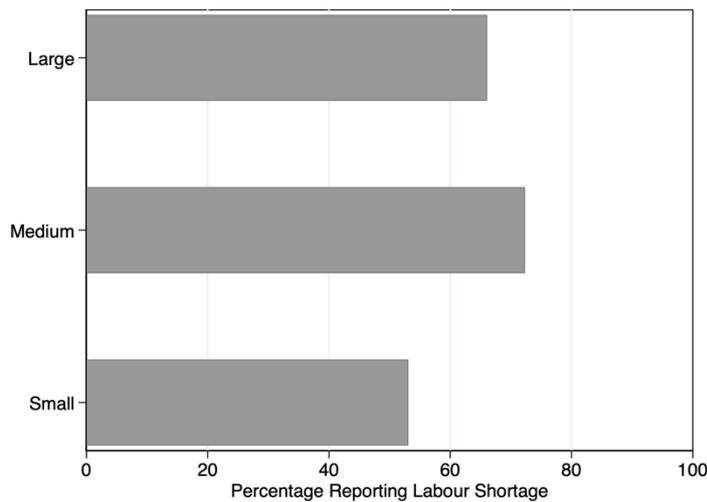
Figure 5: A high share of firms in all sectors and of all sizes are reporting labour shortages

a) By industry



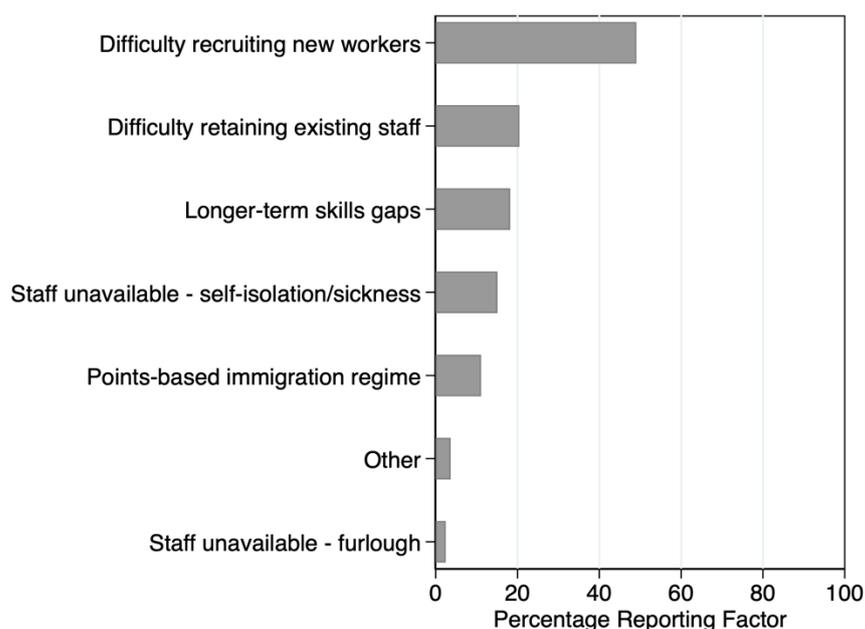
Notes: The chart shows the percentage of firms reporting labour shortages by industry. Sectors with fewer than 20 respondents are omitted.

b) By firm size



Notes: The chart shows the percentage of firms reporting labour shortages by firm size. Small firms are defined as those with less than 200 employees (or less than 100 for the distribution sector). Medium firms are those with 200-500 employees (100-500 for distribution) and large have over 500. The difference across sectors is due to differences in the bands provided in the surveys.

Figure 6: Difficulty recruiting new workers is the main reason for labour shortages



Notes: The chart shows the percentage of all firms reporting that each factor has caused their labour shortages. Note that firms could report more than one factor.

Policy

Covid-19 has caused a huge shock to the UK economy, which has hit firms and workers unevenly. Significant trade shocks, like Brexit, also have an uneven effect across the economy. There is a role for policymakers to play in supporting the economy adjust to these large shocks. Employment in the UK is back to pre-pandemic levels, yet total hours worked and output are not. The UK consistently ranks as one of the most flexible labour markets in the world (Schwab 2018), meaning that frictions from labour market institutions are not likely to be playing a big role in slow recovery.

Vacancies have been high, and a lack of specific skills can restrict the ability of firms to fill vacancies. The UK is below the OECD average on basic numeracy skills (Zwart and Baker 2019), as well as having relatively low vocational skills. Employer-provided training – which makes up 82 per cent of training expenditure in the UK – has fallen following both the Brexit referendum and Covid-19 (De Lyon and Dhingra 2020, 2021).

Policies can encourage firms to invest in training workers. There are already tax credits provided to firms who invest in physical capital but not in human capital (Costa et al 2018). Providing human capital tax credits will help to incentivise firms to hire workers and train them in-house, reducing the emphasis on other forms of training. Human capital is easier to scale up and has more positive spillovers than other forms of capital (Haskel and Westlake 2017). Furthermore, the apprenticeship scheme requires reform to target younger workers and broaden investment by the scheme more effectively (Li et al 2020). There are concerns that the current apprenticeship levy does not sufficiently incentivise firms to offer apprenticeships to younger workers, for whom the returns are higher, so the fund could be repurposed to specifically address this (Major and Machin 2020, CBI 2020). Improving skills will address labour shortages although this may be a more long-term fix, promoting productivity, wages and social mobility.

Migration policy can provide a short-term fix to labour shortages that are localised to particular sectors. Allowing short-term specific visas for particular types of work can alleviate shortages. However, when labour shortages are experienced across broad sectors of the economy, as our data suggests is the case now, migration cannot do much to address shortages as new migrants generate an increase in demand which translates to a need for more labour elsewhere. Furthermore, when sectors are provided with specific migration visas, they are essentially getting a ring-fenced supply of labour which can reduce the incentives to invest in training (Manning 2021). Migration policy, therefore, needs to be nuanced and integrated into an overall economic strategy.

On trade policy, the focus has been on negotiating new trade agreements which have mostly been with small markets, especially given that the US is currently not open to negotiating (Hale et al 2021). Trade policy can open market access to UK business, provide access to cheaper imported inputs and a wider variety of consumer goods and services, and discipline firms to be more efficient. But trade policy should be implemented as part of a broader economic strategy, and it is not yet clear what strategy the UK will pursue.

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