17th August 2020

THE UK IN RECESSION COMMENTARY

After suffering its deepest contraction on record in terms of economic output during Q2 2020, the UK economy has officially entered a recession, which is defined as two consecutive quarters of negative growth. We have seen a decline of 2.2% in Q1 and a 20.4% fall during Q2[1].

Although the definition of recession is unique, no two recessions are the same and there may be many different causes, such as those highlighted in the following link:
https://www.bbc.co.uk/news/av/53736958/coronavirus-what-is-a-recession

However, the cause of this recession is obvious: the almost complete shutdown of the economy imposed by the government enforced lockdown, initiated to fight the spread of Covid-19. The side effect of such measures caused private consumption, i.e. spending on goods and services by households, to fall by 23.1% overall in Q2 2020, coupled with a notable fall in business investment[2].

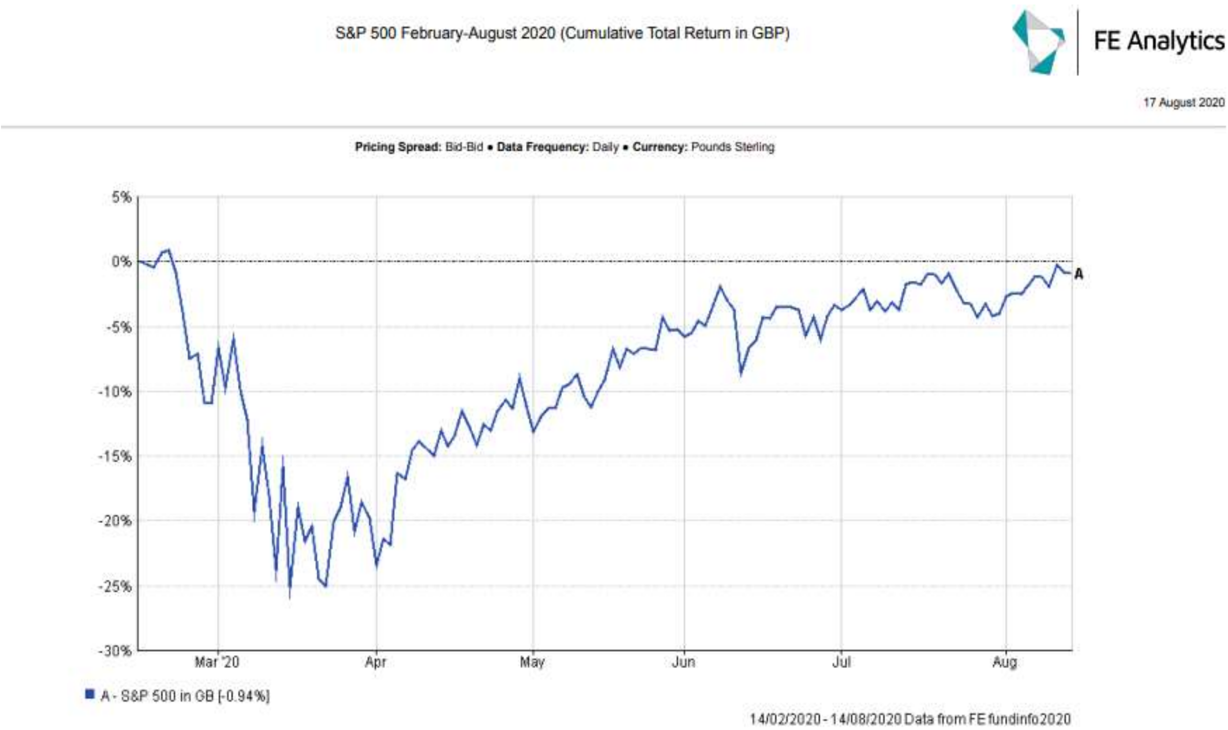
Tom Stevenson, investment director at Fidelity International, warns that the UK faces a 'slow crawl' back to recovery from the worst recession ever: "No-one knows exactly what the recovery from coronavirus will look like - particularly with the potential for a second wave of infections and further local lockdowns - but it is likely that it will be a slow crawl towards pre-Covid levels with further government stimulus needed to restore sustained growth"[3].

Dean Turner, economist at UBS Global Wealth Management**,** says June's growth shows that the worst is behind us, but it could take another 18 months to return to pre-Covid levels: "GDP numbers for June

[1] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/apriltojune2020
[2] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/apriltojune2020
[3] https://www.theguardian.com/business/live/2020/aug/12/uk-gdp-slump-recession-covid-19-q2-june-business-live?page=with:block-5f338fcd8f08fd092ae78882#block-5f338fcd8f08fd092ae78882

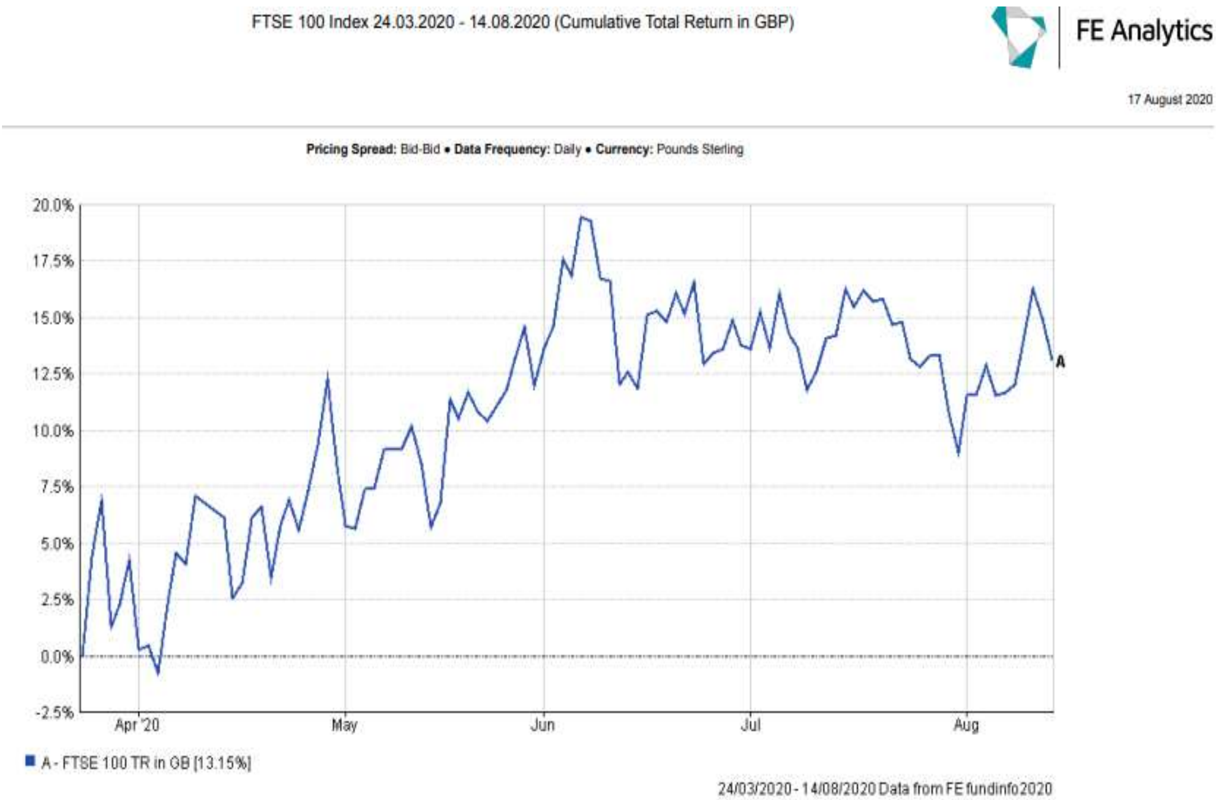
show a strong bounce in activity as the economy emerged from lockdown. We expect pent-up consumer demand to drive a strong recovery in the third quarter, although this momentum will gradually fade as the outlook for the labour market deteriorates. The UK economy is unlikely to return to its pre-crisis level before the end of next year"[4].

Equity markets are by their very nature forward looking and they priced in the imminence of the recession once it was clear the economy would grind to a halt due to the lockdown measures imposed by governments worldwide. The equity markets decline, in the UK and abroad, was sharp and painful, from about mid-February to the last week in March 2020. However, markets then started to price-in a potential economic recovery in the second part of 2020 and early 2021, bouncing back strongly on the back of expansionary fiscal and monetary policy measures. This is the most evident in the US market, led by technology stocks, featuring a V-shaped rebound, taking back the index almost to unchanged over the last 6 months (-0.94%)[5]:



[4] https://www.theguardian.com/business/live/2020/aug/12/uk-gdp-slump-recession-covid-19-q2-june-business-live?page=with:block-5f338fcd8f08fd092ae78882#block-5f338fcd8f08fd092ae78882
[5] Source; FE Analytics, data as of 17th of August 2020, Cumulative Total Return in GBP.

In the UK, the FTSE 100 Index, heavily weighted towards cyclical sectors such as energy, basic materials and financials, had been heavily impacted by the recession. However, it has also rebounded from the trough in March[6]:



In general, the lengthier a recession, the deepest the decline in equity markets tend to be. The swiftness of recovery from this recession will probably be dictated by the speed at which a vaccine and/or a cure for the Covid-19 virus will become available in the coming months, as this would enable the economy to come back to full life. In this regard, there are many encouraging signs, with research centres and university labs worldwide working 24/7 on trying to find a vaccine and/or a cure for the disease.

[6] Source; FE Analytics, data as of 17th of August 2020, Cumulative Total Return in GBP

In the meantime, unprecedented expansionary fiscal and monetary policies implemented by governments worldwide have reinforced financial markets. This, coupled with interest rates at historic lows, and likely to remain so for the next few years, means equity markets are poised for a sustained long-term growth trajectory, albeit with far more volatility ahead and with the ever present tail risk of a “second wave” of the virus disrupting the economy in the absence of a vaccine or cure for it.

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