

Global Economic Research

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British Parallels

The U.K. is facing familiar inflation and labor market problems.

By Vaibhav Tandon



George Bernard Shaw once observed that “The British and the Americans are two great peoples divided by a common tongue.” But in the present day, the United States and the United Kingdom have economies that appear to be on a common trajectory.

Both nations were among the first to stress vaccination as a means of controlling COVID-19. Rising coverage allowed both to reopen aggressively in recent months; indices of economic

restrictiveness for the two countries are among the lowest in the developed world. Both have had caseload increases recently, but both waves have receded.

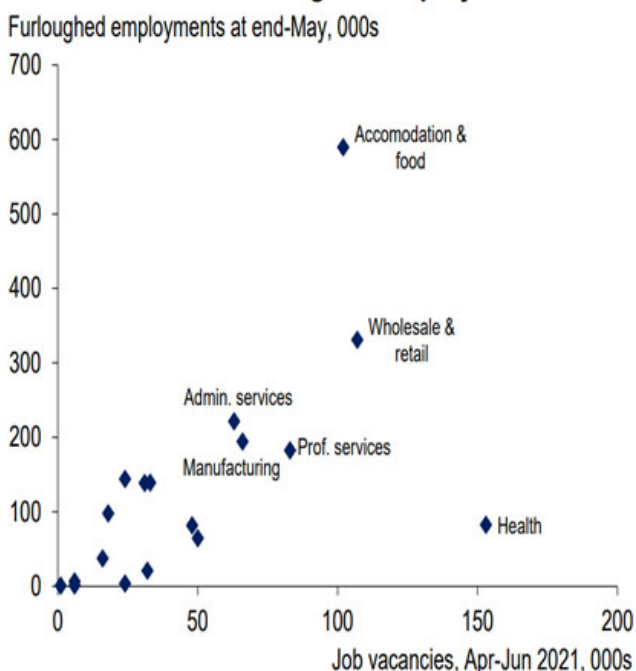
As a result, both countries have enjoyed an outpouring of demand which has outstripped supply, which has led inflation to surprise to the upside. In Britain, the increase in the overall consumer price index (CPI) climbed to 2.5% year-over-year in June from just below 1.0% in March; inflation could peak at around 4% towards year-end, according to the Bank of England (BoE).

The same details that led to a surge in **consumer prices** in the U.S. are in play in Great Britain. Large positive base effects, demand for used cars amid semiconductor shortages, and consumers eager to return to reopened restaurants and hotels are the key drivers behind higher inflation prints. Delays at ports in China and other major exporting hubs have created a shortage of both imported raw materials and finished products, adding to cost pressures. Just like the case of the U.S., most of these factors are idiosyncratic, pandemic-induced disruptions.

UK: BoE forecast for CPI inflation*



UK: Vacancies & furloughed employments



Source: Oxford Economics

Another striking **resemblance** between the U.S. and the U.K. can be seen in their labor markets. In Britain, job vacancies reached a three-year high of 862,000 in the second quarter, with a large number concentrated in sectors most affected by the pandemic (like hospitality and retail). Many employees in these sectors continue to remain on **flexi-furlough**. The 'pingdemic' has also kept workers away. Over 600,000 people were pinged by the COVID-19 contact tracing app in mid-July, triggering mass self-isolation.

As is the case in the U.S., labor supply in the U.K. has been slow to normalize.

Lack of staff is proving to be a major hurdle for British businesses, causing delays, disruptions and increased price pressures. The food supply chain, in particular, has been impacted by a shortage of truck drivers (**about 90,000** are needed to fill the gap). Shortages are forcing firms to offer higher wages to retain and attract employees. Though hard to isolate the shock of the pandemic from the simultaneous stress of **Brexit**, there is little doubt that the latter has added to delays, shortages of both goods and labor, and increased costs for businesses.

Many positions will likely be filled as the economic reopening continues in the U.K., but with the government likely to let the furlough scheme sunset at the end of September, some workers are likely to lose jobs that had been protected. With sectors like tourism, particularly **international arrivals**, still disrupted, businesses will likely find it difficult to retain workers without support from the government.

The economic recovery remains incomplete in the U.K., as its gross domestic product has not yet climbed back to its pre-pandemic level. On that basis, the Fed might begin tapering before the BoE, but statements from officials of both banks suggest that they are preparing for this outcome. The two countries will therefore serve as interesting test cases of how markets will perform as policy becomes somewhat less supportive.

The economic developments on the west side of the Atlantic are therefore providing some color on what lies ahead for the U.K. The two will be centers of attention for other countries heading in the same direction of travel.

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