Two million could lose jobs in the coronavirus lockdown

Economy may shrink by a third, watchdog warns

Oliver Wright, Philip Aldrick, Gurpreet Narwan
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Britain should prepare for tough times ahead, the chancellor warned yesterday as the financial watchdog predicted that the lockdown could leave more than two million people unemployed and shrink the economy by 35 per cent.

In a bleak forecast, the Office for Budget Responsibility (OBR), said that net public-sector borrowing would reach £273 billion, the largest single-year deficit since the Second World War.

However, economists suggested that the damage could be even worse. They said the OBR's prediction that the economy would bounce back quickly as soon as restrictions were lifted, resulting in an annual reduction in GDP of up to 13 per cent, was too optimistic.

The OBR forecast came as the International Monetary Fund (IMF) said coronavirus would exact the biggest toll on the global economy since the 1930s Great Depression. It predicted that the British economy would shrink by 6.5 per cent, the biggest fall in a year since the mid-1920s, and more than the entire 6 per cent decline over 18 months in the 2008-09 financial crisis.

The Resolution Foundation said that Britain would suffer its worst recession for 300 years if the OBR prediction proved to be accurate.

The pre-coronavirus unemployment rate was just under 4 per cent. The OBR predicts that joblessness will rise to 10 per cent before falling quickly to just under 6 per cent at the end of next year. It would then return almost to the original level by 2023.

Speaking at the government's daily briefing, Rishi Sunak admitted that he was "deeply troubled" by the warnings.

"These are tough times and there will be more to come," the chancellor said. "We can't protect every business and every household. This is going to be hard and our economy is going to take this significant hit. That's not an abstract thing, people are going to feel that in their jobs and in their household incomes."

Mr Sunak insisted that the lockdown was the right plan and without the government's economic interventions the long-term effects on businesses and individuals would have been much worse.

He refused to rule out tax rises or further austerity to deal with the deficit but insisted that boosting the economy and improving productivity would be the key to recovery.

“When we come out of this in terms of righting the ship, we’ll have to look at it then,” he said. “Obviously this has cost a lot. But the best way out of this for all of us is to just grow the economy, which is why trying to keep as much of it as intact as possible at this moment allows that bounce-back when we come out of it and allows us to hopefully snap back to normal as quickly as possible.”

In its report, the OBR said it had based its economic modelling on the assumption that the lockdown continued for three months, after which restrictions were slowly lifted over the following three months.

It warned that the longer the period of economic disruption, the more likely it was that the economy’s future output would be “scarred”.

This could lead to business failures, cancelled investment and the unemployed finding it increasingly hard to get back into the labour market. If that happened, the OBR said, the government would be forced to confront a long-term structural deficit heralding many years of austerity or higher taxes.

The OBR said its prediction did not amount to a forecast as it had no way of knowing how long the most stringent public health restrictions might last.

Paul Johnson, director of the Institute for Fiscal Studies (IFS), described the OBR modelling as “very optimistic”, adding that it did not feel like anyone else’s “central scenario”.

“They are not only suggesting that there will be no long-term scarring on the UK economy but also that there will be no disturbance affecting us from the rest of the world either and that trade will pick up where it left off,” he said.

Torsten Bell, director of the economic think tank the Resolution Foundation, believed the bounce back would be slower: “Policy-makers should not treat this as the worst-case scenario.”

The budget deficit forecast by the OBR is significantly higher than the £158 billion that was recorded after the 2008 crash. The £273 billion has ballooned from estimates made only weeks ago by the IFS, which projected a deficit of £200 billion or more next year. The watchdog said the most profound effect would be on unemployment, which would rise in the second quarter to 3.4 million, 10 per cent of working age people. This was despite the furlough scheme by the government where wages are guaranteed at 80 per cent, up to £2,500 a month.

The OBR said that persistent economic weakness meant that interest rates were likely to remain at record lows in the coming years. Although the base rate will climb from its present level of 0.1 per cent, it will only go so far as 0.34 per cent by 2025, it predicted.

In its March outlook, the OBR said the base rate would be at 0.75 per cent by this point. It said that stock markets would remain subdued, with equity prices 15 per cent lower in 2020-21 than assumed in its March forecast.