

Review of the UK economy in 2021

In this article **Steven Proud** looks at the performance of the UK economy in 2021 and the return of high inflation levels

The economy in 2021 continued to be dominated by the impacts of Covid-19 along with, towards the end of the year, the re-emergence of inflation as a serious threat to the cost of living.

Covid-19 caused significant economic damage in 2020, both through imposed public health measures (including lockdowns), and through individual changes in behaviour, leading to the biggest reduction in UK GDP in history. The end of 2020 heralded a new hope, with the development of vaccines from Astra-Zeneca, Pfizer, Moderna and others as a potential route to protect lives and health, and allow the economy to fully reopen.

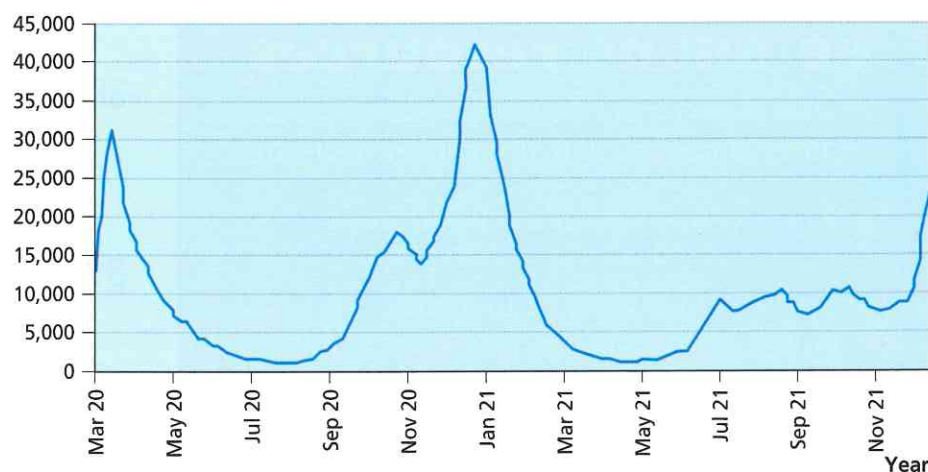
A return to lockdown

However, in late 2020, a much more transmissible variant of Covid-19, the Delta variant, became the dominant strain in the UK, leading to a rapid increase in both case numbers and hospitalisations (see Figure 1).

This led the UK government to re-implement a full UK-wide lockdown from the 6 January 2021 to help save lives and protect the NHS.

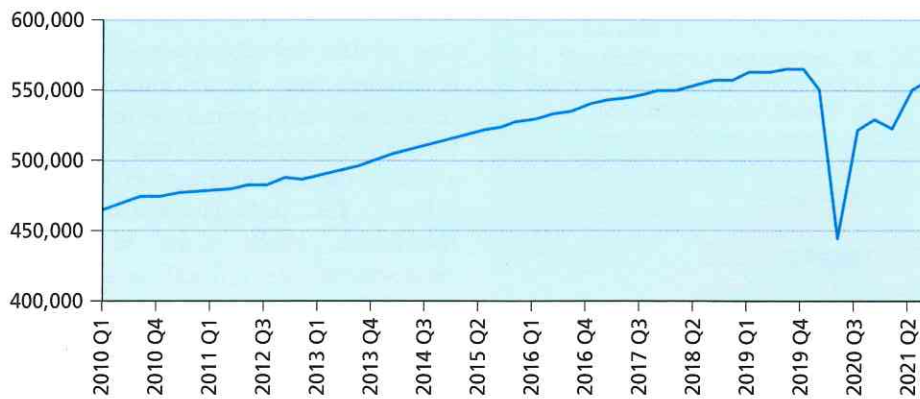
The onset of the Covid-19 pandemic in 2020 saw significant reductions in

expenditure, in part due to protective measures, such as lockdowns, but also due to (voluntary) changes in behaviour resulting from a fear of the virus. This led to a 20% reduction in quarterly GDP.



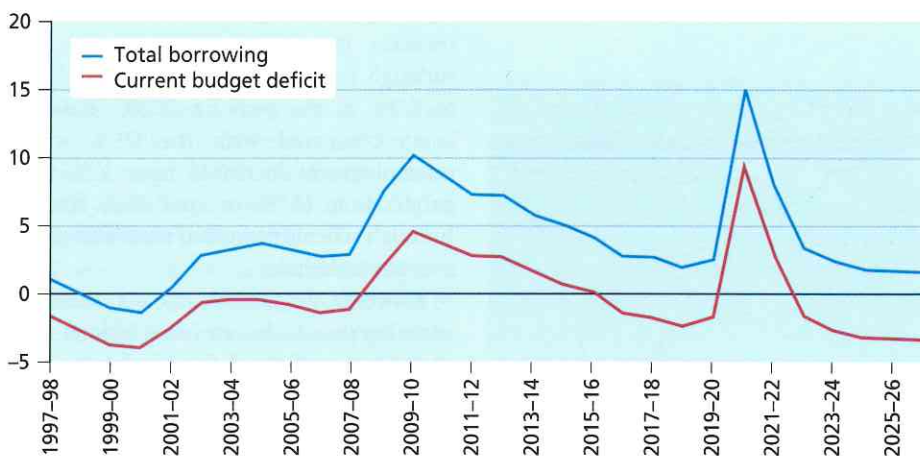
Source: coronavirus.data.gov.uk

Figure 1 Seven-day moving average of hospital admissions due to COVID-19



Source: ONS

Figure 2 Quarterly GDP



Source: OBR

Figure 3 Government deficit

Table 1 Summary statistics for the UK economy

	GDP growth (annual % change)	CPI inflation (annual % change)	Unemployment (% of labour force)	Government debt (% of GDP)
2010	2.13	3.31	8.0	68.6
2011	1.46	4.64	8.6	74.4
2012	1.47	2.75	8.0	80.3
2013	1.89	2.06	7.4	82.1
2014	2.99	0.91	5.8	83.7
2015	2.62	0.10	5.2	84.9
2016	2.26	1.20	4.9	84.5
2017	2.13	3.05	4.4	84.3
2018	1.65	2.20	4.1	83.5
2019	1.67	1.50	3.8	82.8
2020	-9.40	0.46	5.3	83.0
2021 Q1	-5.09	0.65	5.0	103.6
2021 Q2	24.23	2.03	4.8	
2021 Q3	6.79	2.75	4.3	

Source: ONS

In early 2021, despite the re-introduction of strict lockdown measures, with shops, restaurants and hospitality closed, the overall reduction in output was relatively small (see Figure 2).

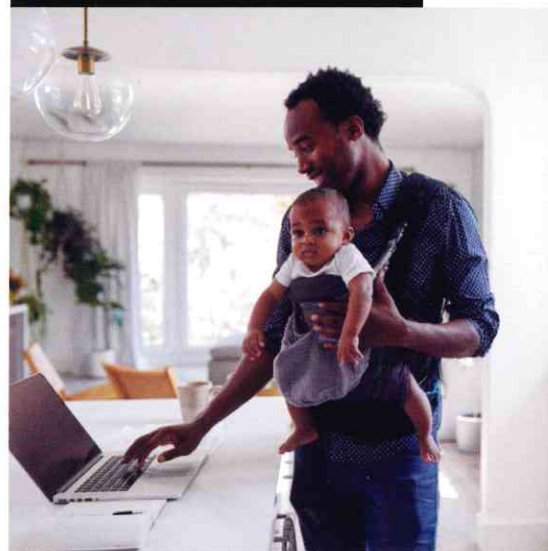
Through 2021, partly due to the benefits of high levels of vaccination in the UK, the economy could open up, and rebounded significantly through the year, but even at Q3 of 2021, the overall size of the economy was still smaller than the pre-pandemic peak.

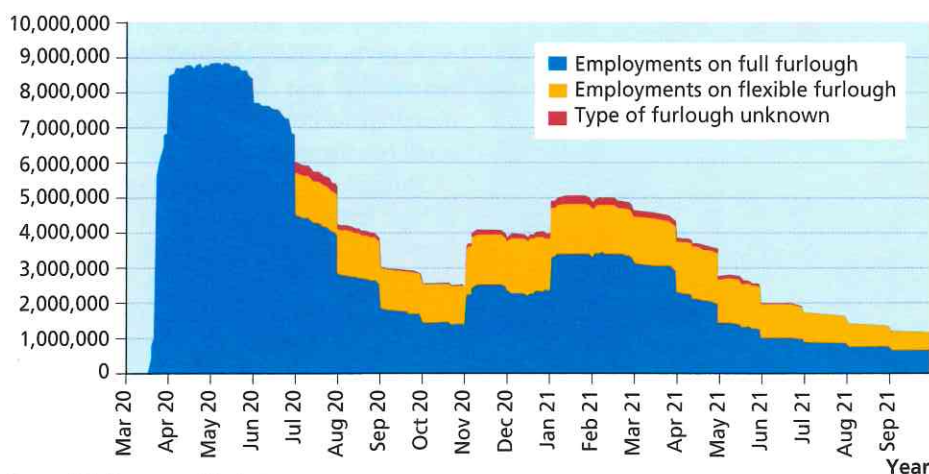
Fiscal impacts of Covid-19

Covid-19 has affected both government spending and the economy as a whole through a number of routes. The government had to increase direct spending to fund the furlough scheme to support businesses affected by lockdown, and pay for direct, health-related interventions relating to Covid-19. Second, due to the reduction in economic output, government income through taxation was also reduced. This led to a rise in government borrowing to over 15% of GDP in 2020/21, largely driven by an increase in the current budget deficit.

The years from 2010 to 2020 had been characterised by a slow reduction of current deficits through a policy of austerity, leading to a current budget surplus from 2016/17 to 2020, and a moderate reduction in overall government debt (as a proportion of GDP), but the overall fiscal impact of Covid-19 has dwarfed these reductions.

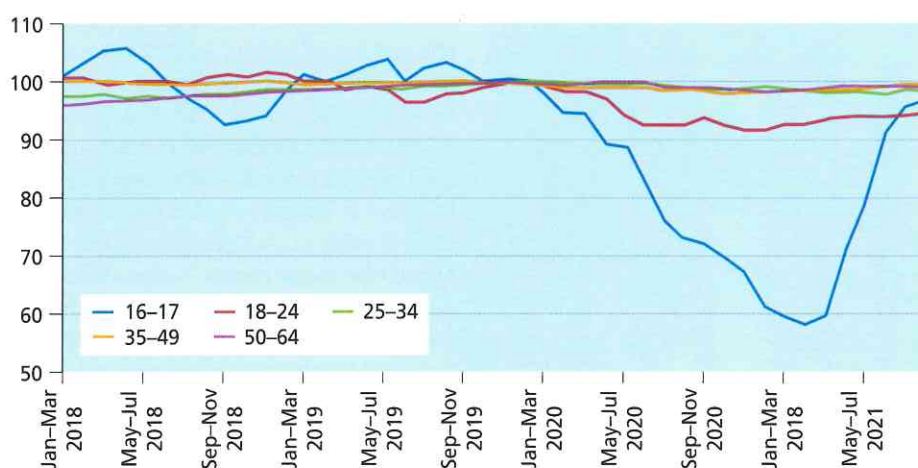
Unemployment is measured as the proportion of economically active individuals who are not in employment, but are actively looking for work





Source: HM Revenue and Customs

Figure 4 Workers on furlough



Source: ONS

Figure 5 UK employment (seasonally adjusted), standardised in Dec 2019–Feb 2020

The UK furlough scheme

One of the key objectives of the UK government following the introduction of restrictions was to protect the relationship between employers and employees. As a result, the Coronavirus Job Retention Scheme (or furlough scheme) was introduced, which acted to protect employment. The furlough scheme was one of the key drivers of the increase in government spending, costing a total of £69 billion, and protecting almost 9 million workers at its peak.

In terms of the main aim of furlough — protecting the relationship between employer and employees — the scheme was very successful. There was a modest increase in unemployment during the furlough period, from 3.8% pre-pandemic to 5.3% at the peak in 2020. However, when compared with the USA, where unemployment increased from 3.5% pre-pandemic to 14.7% in April 2020, the UK furlough scheme prevented mass movement into unemployment.

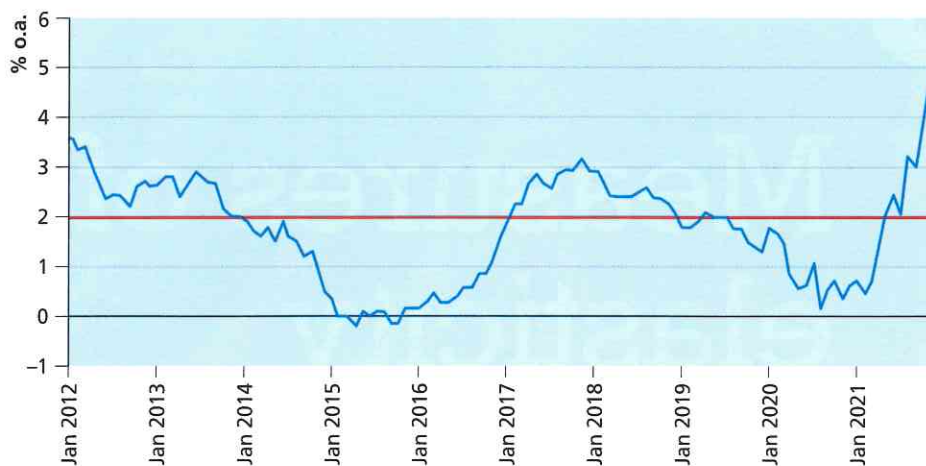
However, despite this success, there are some key details that are being hidden. One of the key impacts of the pandemic was a significant reduction in youth employment — employment of 16–17 year olds was 40% lower in January 2021 compared with January 2020, while 18–24 year olds saw an 8% reduction in the same time period. Although employment is still below the pre-pandemic levels, there has been significant recovery for youth employment.

This effect was not, however, represented in the unemployment figures. The reason for this is that unemployment is measured as the proportion of economically active individuals who are not in employment, but are actively looking for work. The pandemic saw an increase in young people who were economically inactive. This may be because they were in education, rather than entering the workforce.

The return of inflation

Through the last decade, inflation levels have been relatively benign, compared with the Bank of England's target of 2% inflation. Over this period, central bankers and commentators have been more worried about deflation rather than inflation.

High levels of inflation have emerged in the past 12 months



Source: ONS

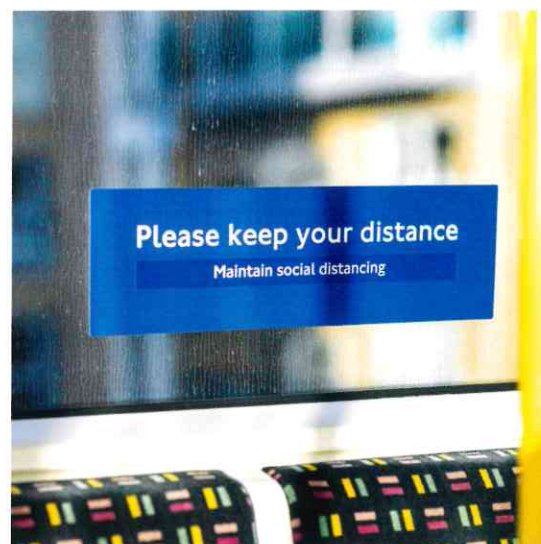
Figure 6 CPI inflation 2012–21

While the long-term story of inflation has been close to, or below, the Bank of England's target of 2%, the fourth quarter of 2021 revealed a return to much higher levels, as shown in Figure 6.

However, the source of this inflation is not monetary policy, but is instead driven by price shocks. For instance, a large part of the

inflation shock is being driven by transport costs, which in turn are being influenced by a fuel price shock.

In December 2021, due to a range of issues and partly in response to the increasing inflation figure, the Bank of England raised base rates from the historic low of 0.1% to 0.25%.



Summary

The UK economy rebounded significantly in 2021, compared with the record falls in GDP in 2020, with GDP and unemployment tending back towards the pre-pandemic levels. However, an old threat to the economy has re-emerged in the form of high levels of inflation.

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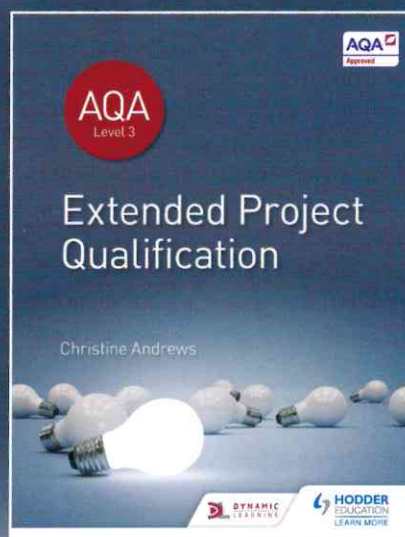
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