INDUSTRY UPDATE
QUARTER 2
YEAR 2020

Coronavirus

Impact on the UK economy

The new coronavirus, SARS-CoV-2, causing the Covid-19 disease, has spread across the globe at an alarming rate.

The shock to the global economy has been devasting, drawing comparisons to the 2008 global financial crisis and even the Great Depression. Both economic downturns experienced similar shocks to the current outlook; the collapse of the stock market, high unemployment rates and contracting GDP rates. However, where before these effects were felt over a period of a few years, here in the UK these effects have been felt in only a few weeks.

Whilst the full extent of the impact is unknown, it is clear that in the short-term the pandemic will materially affect the economy, both from the impact of the illness and the measures implemented to control the spread. The long term impact on the economy is uncertain, depending on the evolution of the pandemic and the development of a vaccine. Whilst many market commentators expect the UK's economy to recover quickly once the pandemic has passed, it is likely that the consequences of increased government debt will be felt long after the public health crisis has passed.

Impact on key economic indicators

It is clear that where Brexit has in recent years been the dominant factor restricting the UK's short-term economic growth prospects, Covid-19 has now claimed this title, with even more severe consequences for the UK economy.

Quarantine measures, including the closure of all non-essential businesses and strict lockdown procedures, are expected to have significant negative effects across a range of key economic indicators.

Estimates of the economic impact vary significantly, although most recent estimates point towards short-term double-digit falls in GDP. The Office for Budget Responsibility ("OBR") recently released modelling suggesting that UK GDP could plunge by 35% in the second quarter of 2020. Whilst it is expected that the economy will largely 'bounce back' as quarantine measures are gradually lifted, full-year economic forecasts are poor, with the OBR estimating a 13% reduction in UK GDP in 2020.

The UK is by no means alone, as similar economic forecasts have been released by other nations. The French statistical institute, INSEE, and the President of the Federal Reserve Bank of St Louis, for example, have announced rough estimates of 35% and 50% reductions in economic activity in France and the US respectively. It is clear that the economic impact of the pandemic is being felt worldwide.

In the UK, the subdued economic growth will stem to a large extent from a fall in consumer confidence, which was already low due to the UK's impending departure from the EU, and its repercussions on consumer spending. As businesses have closed and consumers have obeyed warnings to stay indoors to reduce exposure to the virus, overall demand for goods and services has fallen significantly. This is likely to be accompanied by a fall in supply, as supply chains are disrupted by delayed production and reduced productive capacity.

In an effort to reduce the long-term impact of the virus, the Bank of England announced an emergency cut in the interest rate to a record low of 0.1%, a week after a previous cut to 0.25% and alongside a £200 billion quantitative bond stimulus.

These policies were introduced to encourage spending and lending in the economy, helping businesses and individuals cope with the economic damage caused by the virus.

The government has also introduced a number of policies to help protect businesses against disruption to revenue and ongoing cost. These include the Coronavirus Business Interruption Loan Scheme (CBILS), providing government backed guarantees for loan repayments, encouraging lending and providing small businesses with increased access to loans with zero interest for 12 months. Whilst these measures will provide support for most companies, with a drastic fall in demand and disruption in production it seems inevitable that these will not be sufficient for some businesses who will still be faced with bankruptcy and insolvency.

One of the main concerns surrounding the pandemic is the potential loss of thousands of jobs. In an effort to reduce the impact on unemployment, the Government has introduced an unprecedented plan to cover 80% of employee salaries of up to £2,500 a month, known as the Job Retention Scheme. This policy has also been extended to self-employed workers. These measures are expected to help the labour market cope with the virus. Initial estimates are that over nine million UK workers will be supported by the Job Retention Scheme.

Despite the support on offer, significant rises in unemployment are expected. The Financial Times reported that over half a million new unemployment benefit claims were made in the space of just nine days as of 25 March, although the precise employment status of the claimants' is not known. Current estimates are that Covid-19 will temporarily increase unemployment to 4.7% in 2020, up from 3.8% in 2019, before falling to 4.1% in 2021.

Unemployment rates from 2019-21

The Covid-19 pandemic has prompted a substantial fiscal response from the government. An economist at the Institute for Financial Studies predicts that government borrowing in 2020 could be expected to exceed £175 billion, more than 8% of national income. This amount would be more than triple the forecasted borrowing of 2.4% announced in the Chancellor's March budget. This borrowing will stem from increased welfare and NHS spending, alongside sharp falls in tax revenues as a result of reduced company profits and a sharp fall in equity markets. Whilst necessary to deal with the public health crisis and support businesses and individuals, increased government borrowing could have significant consequences, reaching beyond the end of the pandemic for years to come.

The impact of Covid-19 on the UK economy as a whole is therefore likely to be severe, although focused in the short term with economic recovery predicted in 2021. Whilst the government has introduced unprecedented policies aimed at protecting businesses and individuals and ensuring their survival in the long run, these policies will have their own consequences, with government debt expected to rise significantly. Many estimates expect economic activity to increase significantly in 2021 on the assumption that social distancing measures are relaxed towards the end of 2020, as the pandemic slows. However, KPMG prepared a pessimistic estimate in their Quarterly UK Economic Outlook in the event that the pandemic persists into the first half of 2021. In this scenario, GDP is forecast to decline by a further 1.4% in 2021, following the sharp fall in 2020. This would result in an even more severe recession than the downturn experienced in 2008-2009. It is therefore clear that the longer the disruption to business activity, the higher and longer the economic costs felt by the UK.

The most affected industries

Whilst all industries will experience the impact of the virus, some industries are more vulnerable than others.

Tourism Industry

With non-essential international travel heavily discouraged, the tourist industry is expected to be one of the most affected industries from the coronavirus outbreak.

According to research published by Ibisworld, 2020 was forecast to be a record year for the UK tourist industry, with record spending and visits predicted from international tourists. Industry revenue is now set to decline, with tourist numbers expected to have fallen by 3.6% in the financial year ended April 2020 and 4.8% in 2021. Other industries affected by tourism, such as hotels and travel agents, will also experience a fall in demand as the government imposes strict travel restrictions and as a number of hotels are set to close to provide essential hospital services for coronavirus patients and healthcare workers. Although growth is expected in the medium-term, once travel bans are removed and consumer confidence increases, businesses in this industry will be vulnerable to insolvency in the short-term despite the government assistance offered.

Transport Industry

The UK transport industry, similarly to the tourist industry, has already been hard hit by government warnings against non-essential international and national travel.

Airlines have experienced a significant decline in demand, with less than 5% of passengers expected to use airlines. EasyJet has been the first airline to ground its whole fleet, with other key airlines such as British Airways, RyanAir and Virgin Atlantic running a significantly reduced timetable. UK airlines have warned the government that they are in need of between £5 billion and £7.5 billion of immediate financial aid. However, the government has announced that it will only step in as a last resort and warned airlines to look elsewhere for funding.

In response to government calls to work from home for all non-essential businesses, the Department for Transport has noted a 70% drop in rail passenger numbers, with ticket sales dropping by over two thirds. Train operators noted a significant drop in their revenue at the beginning of March, causing the government to respond by suspending all rail franchise agreements, taking on the financial risk of the network themselves, to avoid operators entering insolvency.

Retail and Leisure Industry

The forced closure of all non-essential retail and leisure stores is likely to add pressure to a struggling market, with no source of income for the foreseeable future. Whilst all restaurants and bars have been forced to close, some retailers with the infrastructure to offer e-commerce are able to continue to operate, with some experiencing a surge in demand. The demand for these products does however depend on the category they fall in, for whilst garden furniture and crafts have experienced an increase in demand, retailers offering fashion have experienced falling sales. E-commerce retailer growth is expected to be limited to the short-term with firms likely to experience issues with production, stock and supply chain due to the pandemic. There may be longer-term growth seen in this area as a result of this pandemic, though, as consumers acclimatise to the social distancing and lockdown rules and opt to do even more of their shopping online, after the rules are relaxed.

The sector expected to benefit the most from strict lockdown procedures are supermarkets and independent food stores. As consumers work from home and restaurants close, demand for groceries has experienced a surge in demand. This has been fuelled by consumer stockpiling, as people worry about the availability of essential groceries as the outbreak worsens. According to consumer analyst Kantar, supermarket sales of £10.8 billion in March were even higher than levels seen over Christmas, with year-on-year supermarket sales reportedly growing by 20.6% over the four-week period.

Morrisons are among many supermarkets creating new jobs to deal with the surge in demand for products, reportedly hiring 3,500 new workers as a direct result of the outbreak.

Healthcare Industry

The healthcare industry is naturally expected to experience a significant impact from the pandemic. The government has pledged a £5 billion response fund to help the NHS cope with the outbreak, pledging that they will “go further if necessary”. Whilst lockdown measures are in place to try to limit industry demand for hospitals and treatment, the NHS has still reported a surge in demand, with higher future demand expected as the number of cases continues to increase. Increased investment in research into a vaccine is also expected to contribute to growth in the industry. Ibisworld predicts that growth in the current financial year would increase to 4.2%, rising to 5.1% throughout 2020-21.

Commercial Property Industry

The closing of non-essential shops and community spaces has had a considerable effect for commercial property landlords. According to a study carried out by Knight Frank and the British Property Federation, only a third of the estimated £2.5 billion of quarterly retail rent due in March was received by landlords. With no date on when the closures will be lifted, tenants will be fighting for survival and landlords may be caught in a difficult position if they themselves have significant debts to service.

Going forward, we may also see some permanent changes for businesses that previously thought the idea of staff working from home was implausible. Being forced into these changes may have allowed business to realise that productivity levels have not been affected or they have made use of available software to minimise disruption. It was reported by MarketWatch that the usage of video meeting software, Zoom, increased by 300% since the end of December and businesses have continued to adapt to the difficulties faced working from home.

This could set a new precedent for certain businesses who may now feel they are able to downsize their office space or make use of serviced offices in exchange for employees to increase their time working from home once restrictions have been lifted.

Conclusion

The spread of Covid-19 will undoubtedly continue to cause significant disruption across the global economy. It is clear that until the spread of the pandemic slows, economies and markets across the world will continue to suffer.

It appears we may have reached a turning point, as lockdown measures in certain countries begin to be lifted lifted and falls in the number of new cases in the most severely affected countries in Europe are noted. However, in reality, no one will know how long the effects will last or even whether there will be a second wave of cases following the lifting of lockdown regulations.

Research predicts that UK economic growth will start to return by the end of 2020, as strict measures to control the virus are lifted, however, the full impact of the virus will be far reaching.

The government has introduced a number of financial packages aimed to ease the burden that businesses currently face including paying for employee wages and loans with interest-free periods. Please contact us if you require more information on how these may assist your business in the current climate.

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