THE CURRENT CORONAVIRUS CRISIS: LESSONS FOR ECONOMIC DEVELOPERS FROM THE 2009 RECESSION

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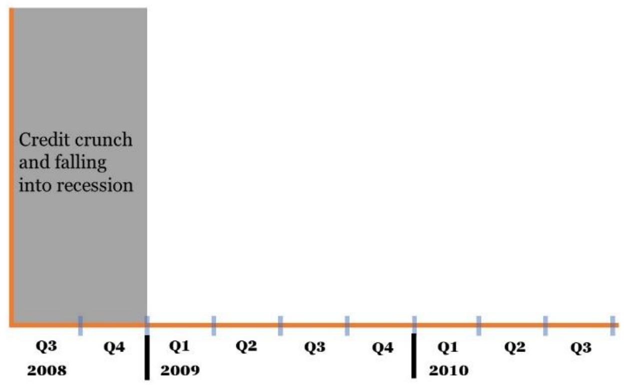
Introduction – learning from experience

We are being hit hard and fast by the Covid-19 virus, the closing of borders, lockdown and the onset of recession. This article summarises what I went through as an economist working at a Regional Development Agency during the last credit crunch and recession between 2008 and 2011. At the time, each region in England had a crack team of economists and researchers to analyse what was happening in their economies, share notes, and present analysis to central government. We worked together on this, and it would be really great to get insights from other economists and economic developers who went through these times.

The news is full of speculation at the moment. It useful to recall what actually happened at the time, and some of our responses. Here's some of the big observations over the five phases from early disbelief that we were in a recession, to the beginnings of recovery. These are some of the events, changes and challenges that cropped up**. It is useful to help prepare for the next few months to come.**

I. EARLY RECESSION… WE WERE ONLY JUST REALISING (Q3/Q4 2008)



At the time, our leading indicators were telling is that the economy was in trouble, but we didn't know how deep this trouble was or how it would play out. Given the lag in official data on GVA and industries at the time, it was difficult to get official confirmation of recession. The PMIs (Purchasing Managers Indices) were very prescient, we were later to find, in terms of identifying when the recession started. Also there was data on public transport and traffic flows which was noticeably dropping off… the signs were there.

The housing market was pretty quick to react – transactions slowed down markedly. Jobs were being lost in house construction and housing market services such as estate agents and conveyancy.

At this stage – consumer caution and retrenchment was also a blow to retail sales: particularly home improvement, furniture and homewares (linked to the housing market). Consumers also switch to cheaper goods, services and forms of recreation.

For SMEs – they were finding that their business customers are taking longer to pay, even negotiating payment terms to 90 days. Financial and cashflow issues were affecting businesses. Trade insurance was one of the first difficulties – businesses with less than stellar financials or track record were unable to access it, or the premiums went up.

As yet – the corporate sector was largely unaffected, although it was evident that some businesses had cash to invest in acquisitions, and were waiting for opportunities to arise. We were also hearing that many medium-sized and large businesses had good cash reserves and were wary of further bank lending, having been burnt in previous downturns and recessions by reliance on bank finance.

Unemployment was just starting to increase. Other signs, such as the flight of migrant workers back home, and less of an influx. Applications for FE colleges and universities spiked as young people deferred job entry. This reduced the economic activity rate in many localities. (falls)

The public sector was just starting to react. Measures were put in place for public sector organisations to pay suppliers within 10 days to help with cashflow. Grant assistance to SMEs was quickly oversubscribed and drawn down. There was lots of talk about tax reliefs – VAT and council tax payment deferments, cuts in the VAT rate and so on.

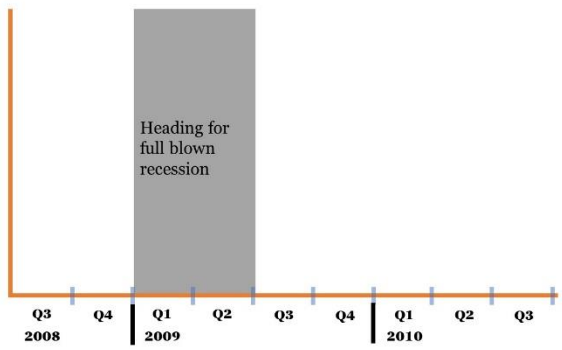
The early signs: what can we learn for the current Covid-19 crisis?

This time around, in 2020 we know we're in recession already. There's no debate and delayed reactions for 6 months. If there's one current benefit, we're not sitting around wondering if we are actually in a recession yet for months. There is no energy being spent on speculation, and the natural optimism bias of people and businesses were trying to deny that we were in a crisis. To some extend this was the government and Bank of England trying to maintain confidence in markets, and not trying to make things worse than they are. Last time round, businesses were in the same boat – they were hoping for the best, and not making any rash decisions, partly because they were not clear whether we were in recession or what the path ahead looked like.

In 2020, we know we're in a recession and that the downturn is real. Businesses and industries will respond more quickly. There may be restructuring plans, redundancies, and new investments.

People will also make rational decisions in the face of uncertainty such as cutting back consumer spending, reducing exposure to risk, making do with existing capital goods and housing. Also more young people will choose to remain in education rather than enter a jobs market which is in recession.

II. ARE WE HEADING FOR A FULL BLOWN RECESSION? (YES, WE JUST DON'T KNOW IT YET) (Q1 2009)



Consumer behaviour led the early signs of recession, and was now in full-blown retrenchment, hitting the retail sector hard. Retailers were responding with significant promotions, but middle-tier retail outfits were struggling.

The worst hit sectors at this stage were: manufacturing, construction, property and financial services. One of the features of the 2009 recession was the over exposure of banks and financial institutions to bad debt, and this saw a lot of disposal of property assets, and an aversion to any new property investment.

Previously healthy sectors were starting to suffer – such as telecommunications and utilities. It was now evident that new car sales had plummeted, and automotive manufacturers were talking about suspending production. There were calls for a scrappage scheme for older, more polluting cars – to give a discount towards the purchase of a new car.

The pound had depreciated markedly in 2008 – there was a lot of expectation of a boost to export sales. But what we found is that most firms negotiated export sales 6+ months in advance and priced to local markets. And we found that imported supplies were, of course, more expensive due to the pound being worth less – which would more than offset any boost to exports. Also, credit and trade insurance are increasingly putting pressure on firms, in many cases offsetting the benefits of sterling's depreciation where companies have international supply chains.

The banks' reputations were not so great. Reports were coming in of banks withdrawing finance to whole sectors due to perceptions of risk, leaving sound businesses stranded.

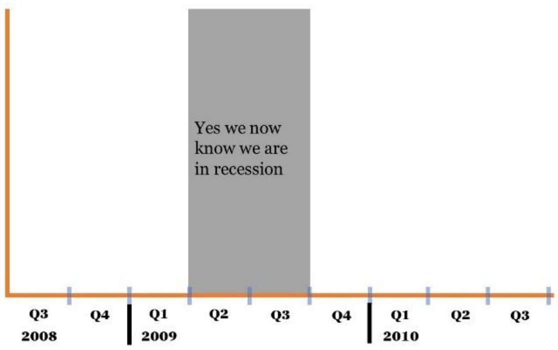
Many of the SMEs in major difficulties were the ones with poor business planning and poor financial controls, information and management. Business Link – which operated regionally in England and employed a few hundred advisors – was coming up short in terms of capacity to deal with enquiries. Applications for grants and loans were proving difficult for businesses who did not have the management and financial information to fill out the forms.

In the labour market, major closures and layoffs were now occurring. There was evidence of employers striving to retain skilled workers through reduced working hours, pay cuts, and innovative approaches such as 'time-banking' (where workers are on full pay but will owe hours to the company when they return to work).

We were also starting to see a strong pattern to business investment throughout the recession (and which continued well beyond it) – the preference to hire in temporary staff to fulfil business orders and services rather than make capital investments.

Locally – concerns were emerging over the impact of job and business losses on rural areas and small towns, where the impact was greater, and sources of alternative jobs and incomes smaller.

III. IN A FULL BLOWN RECESSION (Q2-Q3 2009)



What was now clear from the statistics and official estimates was that we were *officially* in recession... essentially 6 months after (we later found out) it started. Curiously, consumers were starting to recover confidence and the pace of decline in industries was beginning to slow. Footfall in retail centres and stores was beginning to recover.

Wider implications began to bite, that had taken longer to impact. When international air travel is reduced due to recession – airlines order fewer new planes, and the aerospace industry's order book contracts. Government intervention, in the automotive industry through the scrappage scheme – acted to reverse the decline in car sales and kept the car factories running.

Big companies, of course, have been getting their heads around the changes in the economy and planning for the future. This is why lots of major layoffs and redundancies began to be notified.

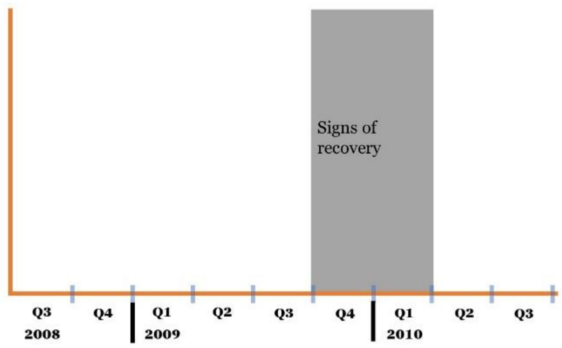
The debate now started over whether the evident upturn in manufacturing was due to stocks running low and restocking, or a genuine recover underway. This debate over temporary vs permanent restocking will rumble on for the rest of the year.

Businesses and banks were now starting to work better together. Better clarity over support, a more supportive banking sector. However, it is reported that individual banks are making national policies not to invest in certain sectors.

Unemployment and redundancies were continuing to rise across the UK, although the rates of increase were slowing. Redundant workers from 2008 or early 2009 who would have been ineligible initially for benefits, or who declined to apply for them, were now amongst the new claimants – showing that there can be incredible lags in the labour market in terms of flows between employment, inactivity and unemployment.

We were now seeing the signs of impacts of public expenditure cuts, which have been announced and made to shore up expenditure in other parts of government. RDAs are asked to cut their capital budgets by 10%, and the Citizen's Advice Bureau sees a massive increase in inquiries and requests for assistance as other sources of advice have been cut.

IV. SIGNS OF RECOVERY – RATE OF DECLINE EASING OFF (Q4 2009)



Going into Q4 2009, the suspicion was that the recession was over and recovery underway, particularly as PMI values had now gone above 50 – signalling expansion – but still we were not certain. Although consumer spending activity had now recovered significantly, investment intentions remained low in the private sector. While activity across the economy had increased, there was still a large amount of spare capacity.

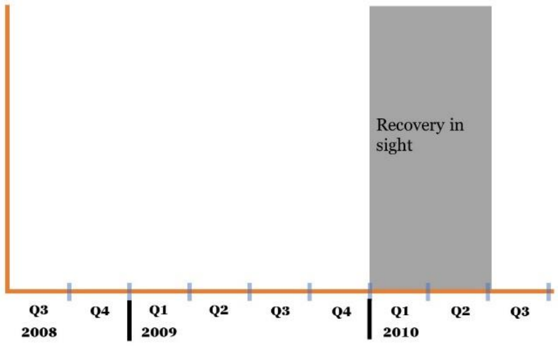
Only now were we beginning to see the signs of an exporting dividend from the devaluation of sterling over 12 months ago.

Investment intentions remain low in most regions. This seems to be mainly due to firms seeking to reduce debt and build cash reserves, rather than investing significantly for growth. Meanwhile, it was not a case of returning to business as usual. Firms profit margins were being affected by increased competition, price conscious consumers, and increasing input costs.

In the labour market, unemployment and claimant counts continued to rise, but the rates of increase had eased off. The new pool of graduates appear to be entering into more informal employment, with evidence of some freezes on graduate recruitment. Redundancies continued, and making themselves known in sectors with longer order lead times, such as steel production.

The government created programmes for training and recruitment, such as train to gain. These were taken up significantly, particularly with SME HR and training budgets under pressure. Often they were accompanied by business development support such as HR and workforce planning.

V. RECOVERY IN SIGHT (Q1-Q2 2010)



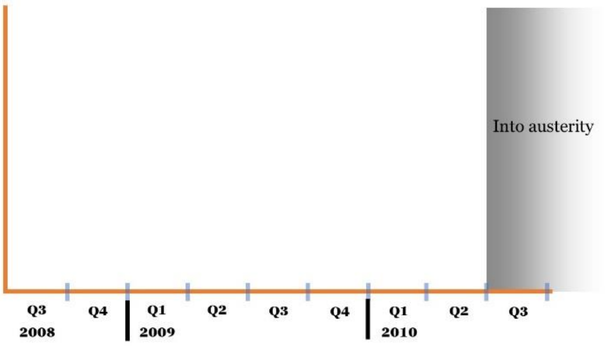
Although recovery was clearly in sight, and the statistics are showing this, business investment continued to be held back, with the announced general election in May 2010, resulting in more caution. Despite the scrappage scheme, vehicle production in the UK was at its lowest level for 50 years in January 2010. The Construction Sector was showing positive signs from a challenging position. Weak steel demand and the reduction in future orders had resulted in announced closures and redundancies. Similarly in the aerospace industry, the downturn in passenger numbers and knock-on impacts of airlines' balance sheets saw a decline in future orders.

It was a mixed picture for the SME sector. Some smaller businesses were doing well, although many SMEs were risk averse, which was now beginning to put R&D budgets at risk, and reduced the appetite for borrowing.

Meanwhile – there was much uncertainty at the time at whether recovery would take hold. Was the upturn due to restocking or genuine recovery? The lag in business confidence behind economic recovery was a definite feature. Businesses continued to be wary of new capital investment, choosing to invest instead in labour, training, and marketing.

Some forms of government support had ended – the temporary VAT cut was ended, with VAT increasing back from 15% to 17.5% in January 2010 (and further increased to 20% in January 2011). Many businesses thought this was premature, and there was also a lot of criticism about the short notice for the ending or rollover of government schemes such as VAT and car scrappage.

VI. INTO AUSTERITY (Q3 2010 ONWARDS)



The new government in power in May 2010 had promised deep cuts to public finances. But prior to the election, all parties were promising this, with the Labour government beginning to implement some cuts in late 2009 and early 2010. Going into 2011, public organisations and local councils, were making plans to manage these cuts. It was suggested by government officials that they were going to make gradual cuts. How wrong they were. Like businesses, local authorities set out their business plans and organisational models to face a future with much reduced public finances – most made redundancies and cuts in one go. The impact of austerity is now well documented – it fundamentally lengthened the impacts of the recession and pushed the timescales of economic recovery.

SO WHAT DID WE LEARN?

What should we be looking out for in the next 3-4 months from May to August?

Consumer Sector

Consumer confidence has sharply declined, and will not recover over the next few months. We may see more switching to cheaper goods and stores. This obviously causes competitive pressures as well as supply chain disruptions. And then there is the seasonal issue – summer stocks will need to be sold, when the holiday and tourism market and scope for activity are hampered. Not to mention the impact of all of this sucking out revenues from struggling retailers, and difficulties with lease payments. We can probably expect the retail sector to restructure, and for more retail chains to make redundancies or go into administration. Small and medium sized retailers might have difficulties with trade insurance and supplies.

There is a significant knock-on effect for real estate asset valuations. If the leases and rents look unaffordable and unsustainable, this means asset values will decline. In turn, this will affect investors, pension funds and asset holders. It will leave some financial institutions exposed, as well as their balance sheets.

What can be done to support the consumer sector? We've found that our city and town centres have been seriously affected by the downturn in retail over the past decade. This will only accelerate the pace of change and the need to intervene. Towns Funds, Future High Street Funds will need to be continued – but probably within the context of worsening unemployment and poverty. We can expect some kind of stimulus to consumer spending and retail, such as a discount in the VAT rate. On the flip side, we may see some efforts to tax online retailers more to help stem to decline of physical retail. Trade insurance or supplier guarantees might also help.

Corporate sector / industries

Don't expect gradual change. Recessions cause shocks. Responses and reorganisations are made for the medium to long-term. Organisations tend to implement restructuring in one go – they take stock of how they will do business in the future, and re-engineer their organisations to do this then make the changes. This is what happened in both the public and private sector. And different businesses will restructure at different times, and they won't be coming to government organisations to inform them, they will go ahead. Communicating with key strategic employers is vital.

It is useful to understand how different industries' order books and supply chains operate, so we can understand the timelines of when orders will start to run out. In the case of the steel and aerospace industries, this can take 12+ months.

Financial services: It is important to keep an eye on the risk profiling of financial institutions. For example, if property becomes more risky, they may well deleverage away from that and dispose of assets. The may avoid new investments in certain sectors where they think they are over-exposed. In addition – all the banks are different, and they have different approaches to SME lending, and different appetites to risk. They have their own balance sheets and investment portfolios to take care of, so may not see the promotion of government loans and credit as being in their interest.

Property: Commercial property and housing markets and activity are often the first to suffer during a recession, and take a long time to recover.

SMEs: A key message is that SMEs will require short term forms of support such as loan conversions, grants, and cashflow support even, but that agencies should tie this into business improvement assistance such as management training, financial management, HR reviews and workforce planning, market diversification, and sustainable business practices and decarbonisation. Support should help businesses to be more resilient in future and better able to grow and retain and recruit staff. A big problem during the 2009 recession is that banks were reluctant to issue government backed loans. There are some fundamental conflicts of interest between the banks needs to maintain balance sheet discipline and manage risk, and the level of exposure the government expects them to take. If this is not balanced right, there will not be many government loans made to businesses who need them.

Closures / redundancies

In a recession, there are certain phases that we pass through. Initially, the weakest businesses go into administration or close first. Then there is a period of 6-9 months when businesses are assessing their options and making their best judgement of what the market will be like when the economy emerges out of recession. Then they start to make closures, transfer jobs and functions around their other facilities. Many businesses will be motivated by the need to reduce debt and build cash reserves. Saving costs and rationalising or restructuring to improve productivity or market leadership is also a motivation.

Labour market

There might be some good news for FE Colleges and Universities – applications from the UK will be up as young people decide not to enter the jobs market. This might make up for some of the loss of international students. On the flip side, apprenticeships might be down.

Labour market conditions remain tough for a considerable period of time during and after a recession, with improvements expected to lag business activity by around 12-18 months. This is because private sector employers retain some skills and spare capacity. When recovery happens, they will make the best use of their existing workforce and capital and gain more confidence that recovery is underway before hiring again. The lags between redundancy, economic activity and unemployment or re-entering the labour market are also a feature. Some people will chose to sit it out until the economy picks up. The labour market is affected at all levels, including graduates.

Transitioning out of support

In the UK, much of the support given to businesses and citizens during the recession was abruptly ended, without any real thought whether this was appropriate or the right time. The political narrative turned very quickly to austerity and paying off excessive government spending made during the tenure of the previous government and the recession. The focus was essentially on the political impact of austerity rather than the economic impact.

BUT MOST OF ALL… THE CHALLENGES WE FACED GOING INTO THE RECESSION – WILL BE THERE WHEN WE COME OUT OF IT

The economic and social challenges we were all concerned with before the Coronavirus are still with us and will continue. We mustn't lose sight of these. The current crisis adds to these immensely, but once there's a bit more clarity over the exit route and stability in the economy – we will still be looking at the fundamentals of inequality, education, skills, infrastructure, productivity, innovation and doing business internationally after Brexit.

My Local Economy is an economic development consultancy run by Glenn Athey. You can read more about it at www.mylocaleconomy.org

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