Potential COVID-19 (Coronavirus) Economic and Construction Impacts

UK Economy

It is expected that the UK economy will contract sharply in the first half of 2020. The key impacts on UK growth will only be clear after it is known if coronavirus is a temporary issue primarily affecting the first half of 2020, if it continues to persist beyond the Summer or whether UK infections fall away in the Summer 2020 but rise sharply again in Winter 2020/21. Until 16 March, the UK government’s strategy was based on allowing coronavirus to spread at a rate slow enough not to overwhelm the NHS (flattening the curve) but fast enough that 60% population gets ‘herd immunity’ (mitigation).

Government has changed its strategy due to research from Imperial College London (16 March 2020) and moved more towards suppression, used in China and more in line with strategies in Italy, Spain and France. The UK Chief Scientific Adviser stated on 12 March that the UK is around 4 weeks behind Italy in terms of exposure and peak may be in around 10 weeks. However, a suppression strategy would have to be implemented until a vaccine has been tested and used widely, which may be up to 12-18 months.

Initial concerns were for manufacturing supply chains but extensive disruption has not been reported as yet. The earliest impacts have been in services, particularly affecting conferences, in-store retail, tourism, airlines, restaurants, bars, concerts etc. However, manufacturing sectors focused on export demand or requiring an international supply chains such the automotive sector have also been badly affected and manufacturers have already implemented shutdowns. Speaking to firms across the construction supply chain, activity has not fallen away as yet but expectations are that demand will fall away sharply as the numbers of infections rises and, in particular, when government announces social distancing restrictions.

The largest impacts from government restrictions on the UK economy will be due to:

- Schools closing (from Friday 20 March except for key workers)
- If/when London, the coronavirus hotspot in the UK, is placed under lockdown. This may occur in the next few days. In countries where lockdowns have been implemented, people have been restricted to their homes and have only been permitted to leave to buy food, visit a pharmacy or go to their job if they are unable to work from home

Policy Makers’ Responses

The Bank of England – 11 March 2020:

1) Lowered interest rates to 0.25%
2) Reintroduced the near-term funding scheme that allows banks to borrow at similar rates to the Bank of England for up to four years with additional incentives to encourage lending to small and medium-sized firms
3) Reduced the countercyclical buffer that UK banks need in reserve from 1% to 0%

Expected Bank of England Response: The bank is likely to reduce interest rates further, to 0.0%, at the next meeting, on 26 March 2020, and reintroduce Quantitative Easing.
The key concern is for households and small firms given that their key costs are labour, rent, leases, mortgages, energy, water, loans etc. The Bank of England reductions in interest rates and improving lending facilities for banks are unlikely to help considerably given that a current lack of funding for banks is not the key issue. The key issue is a sharp fall in demand for firms in many sectors and it is difficult to see a substantial increase in lending to small firms that are currently enduring a sharp fall in revenue that may last for 2-3 months at least.

**Policy Makers’ Response (Government – 11 March 2020):** Government announced a £30 billion stimulus package in Budget 2020 although £12 billion of this is ‘new money’ for Coronavirus measures; £5 billion in extra funding for the NHS and other public services and £7 billion extra funding to support SMEs (to help cash flow) and individuals (particularly those on temporary or zero-hours contracts).

1) Extensions to statutory sick pay including refunds for two weeks per employee for firms with fewer than 250 employees
2) Relief on (and for some firms eliminating) business rates for one year for small firms
3) Increasing grant funding for small firms
4) Expanding ‘time to pay’ to allow firms to delay tax payments
5) Introduction of a ‘Coronavirus Business Interruption Loan Scheme’ giving lenders guarantees of up to 80% on business loans up to £1.2 million

**Policy Makers’ Response (Government – 17 March 2020):** Measures taken at the Budget were quickly seen as insufficient in the light of government’s change in its Coronavirus strategy and, as a result, the Chancellor announced further measures less than a week after Budget 2020.

1) £330 billion loan guarantees (not grants)
2) Grants of £25,000 per company
3) Delaying the introduction of IR35 for one year, until April 2021
4) Three month mortgage holiday for homeowners

The success of the government policies such as loans guarantees and grants will be dependent on the detail of how focused the policies are on firms in need, the measurement criteria for assessing firms in need and, in particular, the speed of getting loans and grants through to eligible firms given the volume of administration involved. These issues occurred with loan guarantees in 2008 as the financial crisis unfolded but this is a far quicker shock.

The government has provided a [factsheet](#) to help individuals and small firms but the majority of small firms and those who are self-employed or on temporary contracts may not be aware of the assistance and even for those that do the admin will take time to process. Small firms dependent on cash flow and with few assets may not have this time available.

**Further Policy Maker Response: UK Government** will announce detail of measures to help renters in line with its policies to help homeowners with mortgages later this week and over the next week it will also announce measures to counter criticism that the measures so far have focused on companies at risk rather than individuals. It will also announce measures to help sustain companies in sectors where demand has fallen sharply such as airlines.
Impacts of Coronavirus on Demand and Supply by UK Sector

The negative impacts on the UK economy are likely to occur across most sectors. Demands on the health sector are increasing whilst supply restrictions and shortages of inputs have pushed up input costs although lower oil prices have helped to reduce energy and transportation costs.

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<th>Sector</th>
<th>Demand</th>
<th>Input costs</th>
<th>Supply</th>
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<tr>
<td>Agriculture</td>
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<td>-</td>
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<tr>
<td>Construction</td>
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<td>Retail</td>
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<td>Tourism &amp; hospitality</td>
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<td>Manufacturing</td>
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<td>Transportation</td>
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<td>Business services</td>
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<tr>
<td>Health</td>
<td>+</td>
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- = Negative effect  
+ = “Positive” effect  
+/− = Both “positive” and negative effects

Resilience by UK Sector

Professional services are largely able to work from home but this is not an option for most workers in other sectors except for management level and above. Where staff are employed on temporary or zero-hours contracts, sectors can reduce their staffing costs whilst demand is falling but in many cases temporary employees are a small proportion of costs. Assuming that the impacts of the coronavirus are temporary, affecting primarily 2020 H1, once a recovery gets underway in 2020 H2, industrial production and wholesale trade may be able to catch up some lost ground and some non-essential retail trade that was postponed will return but a significant proportion of the activity may have just been pushed back. In addition, consumer confidence may take time to recover, especially for big-ticket items and as savings may have been used to sustain regular spending. In the construction and health sectors, supply capacity will limit how much of the pent-up demand can be met during recovery.
UK Forecasts

At the time of writing, key macroeconomic forecasters are still assuming the impact will be a sharp temporary disruption, a ‘V’ shaped recession; a decline in economic activity during Q1 and, in particular, a sharp fall in activity during Q2 whilst economic activity recovers in the second half of 2020. As a result, the most recent forecasts from key forecasters anticipate a fall in UK GDP of between 0.6% and 2.5% for 2020 overall before recovery in 2021 of between 2.0% and 3.5%. However, the likelihood is that these forecasts are on the optimistic side as they do not account for the economic impact of schools closing and a lockdown of key hotspots of the coronavirus such as London. According to research on pandemics from the University of Oxford, UK GDP during 2020 could fall by between 3.0% and 5.0% if schools were closed for a substantial period as workers deal with working and childcare issues simultaneously. If households constrain spending further, to essential items only, this could deteriorate.

Many commentators have highlighted comparisons with the financial crisis of 2008/09 given the potential extent of impact on the UK economy (6.0% fall in UK GDP between 2008 Q2 and 2009 Q2) but it is worth noting that in 2008 it was issues in the financial sector that led to a lack of credit and, consequently, led to cash flow issues. On this occasion, the concerns are that with sections of the services sector (so far) suffering from sharp falls in demand and with other sectors potentially following, cash flow issues may lead to a lack of credit availability.

1) UK Economic Impacts: Households
   - Stockpiling impact boosts short-term sales of a few general retail items
   - Confidence shock leads to a sharp decline in footfall for services as well as purchases of non-essential items and big-ticket purchases
   - Rise in saving due to increased risk and uncertainty
   - Best case scenario: primary impact on spending in Q1 & Q2 before spending growth in H2
   - Worst case scenario: sharp rise in unemployment and real wage falls

2) UK Economic Impacts: Financial Markets
   - Share price falls impact corporate balance sheets and firms focus on cash and reducing costs
   - Less liquidity in the markets leads to tighter lending conditions
   - Rise in the difference between lending rates and Bank of England interest rate
   - Best case scenario: share prices fall in March and April before the impacts of policy intervention lead to a stabilisation during Q2 and a recovery in balance sheets in line with growth from Q3
   - Worst case scenario: panic from global financial markets heightens and leads to financial crisis

3) UK Economic Impacts: Private Sector
   - Lower company revenues due to slower household spending
   - Lower corporate profits; fixed costs are maintained whilst additional contingency costs rise
   - Cash flow problems for smaller firms and increase in administrations and liquidations
   - Likely additional policy response: Central banks lower interest rates further and increase Quantitative Easing to inject liquidity into financial markets
   - Best case scenario: smaller firms’ cash flow is badly affected during H1 although this is partially mitigated by early policy intervention to stimulate lending and bridge the cash flow gap
   - Worst case scenario: panic from the financial markets constrains lending to the extent that there is a sharp increase in small and medium-sized firms going into administration and liquidation as policy maker interventions are insufficient or take time to have an impact
Construction

At the point of writing, there remains little indication that house building, construction activity on site and manufacturing activity in factories has been significantly affected although some medium-size sites have moved to skeleton staff (trades) only on site and moved management to working from home. Major issues will arise either if/when the government enacts changes in social distancing or if/when someone tests positive on a high-profile construction site or manufacturing facility and that site or factory has to be shut down. Then, the issue will become whether it has a domino effect and other sites or factories will shut regardless. Any social distancing measures imposed may impact disproportionately on major projects with large numbers of people on site in addition to sectors that are dependent on household spending decisions, where all but the most essential spending is likely to be on hold.

Construction activity has a strong correlation with UK economic growth but is three times more volatile on average and tends to lag the overall economy. As a result, a 0.6%-2.5% fall in UK GDP during 2020 would generally imply a fall of around 1.8%-7.5% over the next 12-18 months. However, the impact depends upon if/when construction shuts down, how long the shutdown lasts and what policies the government puts in place to mitigate the shutdown. In previous recessions, construction activity has fallen in line with the general economy whilst, currently, activity appears to still be continuing in general. The essential problem for construction, if it is subject to a sharp decline in demand such as parts of the services sector, is that 86% of construction employment is SMEs and 41% is self-employment in an industry that employs 2.1 million people so the majority of industry business models are based almost entirely on cash flow and a lack of assets, which means that a sharp fall in demand inevitably would lead to a sharp rise in administrations and liquidations, particularly following on from the slowdown in construction activity at the end of 2019. If the harshest macroeconomic forecasts prove to be more accurate (between -3.0% and -5.0% change in UK GDP in 2020), then this would imply a fall of between -9.0% and -15.0%) in construction output.

The concerns over impacts on construction have been reflected in share price falls across the construction supply chain (e.g. major house builder share prices have fallen 52% between peak and 18 March) as well as share prices of investors who are also highly risk averse to investment in new projects.
The CPA is also monitoring share prices of major contractors, product manufacturers and builders merchants. It is worth noting, that the largest falls in the share price of contractors between peak and 18 March are for firms that also have internal issues at the company; Kier (-94.3%) and Costain (-92.0).

4) UK Construction Impacts: Private Sector Demand
- The largest impacts of the uncertainty so far are likely to be in areas requiring either high investment upfront for a long-term rate of return or where the demand is dependent on spending by risk-averse households, particularly on services activities
- Negative impacts on demand are likely to occur primarily in commercial offices, retail & leisure, industrial factories, private new housing and private housing rm&i

5) UK Construction Impacts: Public Sector Demand
- Government is likely to announce policy intervention to stimulate economic activity in addition to its existing announcements of increased investment in infrastructure although it is doubtful that these stimuli would impact on construction output this year

6) UK Construction Impacts: Supply Issues
- Labour: Over 50% of contractors already report difficulties recruiting key trades, site managers, planners and engineers. An absence of a considerable proportion of construction workers due to a significant increase in the spread of COVID-19 illness would exacerbate issues, hindering recovery after the fall in demand, raising labour cost inflation and delaying project progress
- Labour: A potential shut down for a prolonged period (initially 2 weeks but then extended) would lead to delayed work and it is likely that, at best, only 60% of this work would be subject to ‘catch-up’ and at least 40% of work on delayed projects would be merely pushed back
• Products supply-chains: ¼ of products used in UK construction are imported. 16% of these imports are directly from China but the indirect impacts will be greater as, firstly, many UK construction products imports go via Europe’s largest port in Rotterdam (Netherlands is 5th in the chart) and, secondly, UK imports from other countries may also rely on China for materials.

• The direct imports from China are primarily paints & varnishes, electrical wiring, HVAC, ironmongery, plywood & lino. There here has been little disruption to products supply reported so far. This is likely to be as shipping (and admin) times from China are between 28 and 42 days so impacts on supply chains since February are likely to impact from the end of March.

• 6% of the UK’s imports of construction products come from Italy

• 5% of the UK’s imports of construction products come from Spain