



## recession

### the local impact

This brief guide to the recession is intended to provide some background and contextual information to help councils consider the impact of the recession on their area and formulate their response to it. It draws on a number of sources which are referred to in the text.

This guide:

- Summarises the debate about the causes of the recession;
- Draws on recent commentary and analysis of the current position;
- Summarises some work on likely trends over the next two years.

It should be stressed that it is very much a “rough and ready” guide.

## How did it start?

There are many different interpretations of what caused the recession.

In essence the Government's view – best expressed in the recent Pre-Budget Report – is that the recession started in the United States and spread through the UK's financial institutions and banking sectors, leading to the withdrawal of credit and the contraction of the financial services sectors.

The Opposition view is that the cause lies in an over-reliance on cheap credit in the UK combined with ineffective regulation of the banking sector.

Many commentators have pointed to the convergence of the credit crisis, that began in the sub-prime mortgage market, with significant rises in commodity prices (linked to petrol prices of around \$150 per barrel at the start of the downturn).

## The position today

Many commentators and economists argue that the impact of this recession will be broader – affecting a wider range of sectors – and longer-lasting than previous recessions.

This section outlines some of the key impacts of the economic downturn since it began last year. We begin with housing. Trends here pre-date the “recession”, but continue to underpin key elements of the crisis, including the severe contraction of the house building, construction and property sectors.



### Housing

Prior to the spread of the sub-prime crisis, the UK already faced a ‘housing bubble’ that was fuelled by cheap lending from mortgage providers. Over-inflated house prices put many homes out of reach of new home buyers and also spread concerns of negative equity. Alongside this, the sub-prime crisis spread from the United States leading mortgage providers to curtail the availability of credit. As house sales declined, so did house prices, in turn making it difficult for private developers to finance the construction of new housing. Housing starts and completions reduced in turn and consequently, the construction industry was severely hit. A combination of overpricing, tightening credit conditions and – more latterly – a deteriorating macro-economic situation have led the housing boom to collapse in many areas.<sup>1</sup> The worst affected areas have been Northern Ireland and Greater London.

There are widely divergent analyses of the seriousness of the housing crisis. Department for Communities and Local Government figures show a drop in house prices of 2.5% in October, raising the year-on-year rate of decline to 7.4% and bringing the average price of a home in the UK down to £203,539.<sup>2</sup> However, the figures from recent surveys by Nationwide and Halifax tell a much more serious story, with annual price falls in double-digits for both October and November. Halifax’s monthly survey of the housing market showed the average cost of a home fell by over £4,300 in November – leaving the average house price at £163,605, down 16.2% from last November’s figure of £195,092.<sup>3</sup> The lender’s annual change figure, which compares the past three months with the same period last year, shows prices are down 14.9% year-on-year. Both the decline in average house price and decline in annual change are “the highest ever recorded by Halifax”.<sup>4</sup> Despite the steep recent price falls, Halifax’s index showed the cost of a home is only back to levels seen in July 2005 and is still 124% higher than in November 1998, when the average cost of a home in the UK was £73,129.

Halifax’s price index for the third quarter of 2008 shows the most dramatic annual change in Northern Ireland (-22.6%), Wales (-16.6%) and London (16.5%) with Yorkshire and Humberside, East Anglia, the South East, South West and North West all registering decreases of over 10%.

The fall prices has been accompanied by dramatic falls in sales – which have now fallen to a 30-year low, with agents selling an average of less than 11 homes each in the three months to November.<sup>5</sup> Mortgage approvals on October, were also down by 52% o October 2007 according to figures from the Council of Mortgage Lenders (CML).<sup>6</sup>

Many are concerned that government targets to build 3 million homes by 2020 will fail without further government intervention in the housing market. In a report published 9th September, the National Housing Federation warned that, without immediate action, only about 1.6m will be delivered by the deadline and that it could take until 2029 for the rest to be built.<sup>7</sup>

## Construction and Property

With the housing and credit crises, the construction and property industries have been severely hit. The industry has suffered its biggest fall in activity since records began in 1997, a survey showed in November. The Chartered Institute of Purchasing and Supply/Markit latest monthly construction index fell to 35.1 in October from 38.8 the month before; a number above 50 denotes expansion while a figure below this signifies contraction.<sup>8</sup> Recent business insolvencies figures paint a similarly gloomy picture.<sup>9</sup> Construction and property service companies together accounted for more than one third of insolvencies in September and October according to Ministry of Justice Figures quoted in the Financial Times.<sup>10</sup> Property services companies, including estate agents, were 13 per cent of corporate insolvencies in these two months. Business insolvencies in the UK construction sector in these two months represents 21 per cent of business insolvencies, despite representing only 5 per cent of the UK workforce.<sup>11</sup> Redundancies – high across the board – are rising fastest in the construction sector.

## Financial services

Investment banks have already cut thousands of jobs since September, with daily reports adding to the total since the credit crisis emerged. Recent figures have been particularly dramatic, for instance 6,800 more job losses announced in a single day on 4th December as details emerged of redundancy plans in Nomura, Credit Suisse and Commerzbank amongst others. Recent projections suggest significant further job losses up to 2010.

## Manufacturing

Initially, manufacturing wasn't associated with the credit crunch, but as the problems in the financial sector and rising fuel prices hit the 'real economy' – both in the UK and abroad – the manufacturing sector has suffered. In fact, it has been very hard hit over the last few months, with evidence of a steep contraction in November.

The Office for National Statistics said manufacturing output tumbled by 1.4% in October from the month before, and was 4.9% down from a year earlier, the biggest drop since June 2002. Output has fallen for eight consecutive months - worse than during the early 1990s and the longest run of contraction since 1980, when the economy was in a deep slump. (Manufacturing output falls for eighth month running Ashley Seager and Julia Kollwe, The Guardian, Wednesday December 10 2008)

Falling car production was found to be one of the main reasons for the fall in output – with figures last week showing new car sales in November were 37% down on a year ago.<sup>12</sup> Figures compiled by Markit/ CIPS also show an increasingly severe contraction in output – to 34.4, down sharply on October's figure of 40.7 and the lowest since the survey was launched in 1992. Any figure below 50 indicates a contraction.<sup>13</sup> The decline equates to a contraction in manufacturing output of 9 per cent in the three months to the end of November compared to the previous quarter. This is severe compared to previous recessions according to Malcolm Barr, who said that in previous recessions "contractions of 5 to 6 per cent were more typical".<sup>14</sup> New orders too fell to a record low of 29.7, implying that next month's figures may be weaker still.

Companies reported that the onset of the global economic downturn, credit restrictions and the crises in the auto, construction, consumer and financial sectors were leading many clients to cancel orders, according to Markit/CIPS.



## Retail

Until recently it appeared that the retail sector had yet to be severely hit by the recession. But recent developments, in relation to, for example, Woolworths, reinforce the view of many commentators who expect the retail sector to struggle as consumers cut back on their spending.<sup>15</sup>

## Unemployment

Unemployment increased by 5% over the summer, with redundancies rising fastest in the construction and services sectors (particularly finance, transport and restaurants). In September 2008 vacancies were 9.3% down on the previous year, with falls of 15% in

construction, transport and communications and financial services. There are signs that the current recession is hitting workers under 50 far harder than the previous downturn in the 1980s which affected older workers.

In short, the current recession:

- Appears to be having a wider, cross-sectoral impact compared with previous recessions;
- Is hitting younger rather than older workers;
- Is hitting high value-added industries and high skilled jobs, leading to a likely “glut” in people with high level skills (and high expectations) on the labour market.

## What next?

There are two linked questions to be explored here. How will this play out in the short to medium term? And when will the economy recover?

The Government's view – expressed in the Pre-Budget Report<sup>16</sup> – is that the recession will last only 12 months. Their assessment is that GDP will decline in the second half of 2008 will continue into the first half of 2009, with GDP contracting by -1 ¼% to ¾% in the year as a whole. “Thereafter growth is forecast to recover to 1½ to 2 per cent in 2010 and 2¾ to 3¼ per cent in 2011 as the lagged effects of monetary and fiscal stimulus, lower commodity prices and sterling's depreciation feed through, credit conditions normalise and the UK's flexible markets adjust and bring spare capacity back into productive use”.

However, a number of independent forecasting houses believe the downturn will last longer than that. For instance, Capital Economics saying they expect real GDP to fall by about 1.5 per cent next year and to fall by around a further 1 per cent in 2010.<sup>17</sup> National Institute of Economic and Social Research too have predicted a deeper recession than the government: “The Government faces the real risk that, despite the [stimulus] measures it took in last month's Budget, output will fall more

sharply than it expected to the end of next year,” it said.

According to Oxford Economics, the housing correction has some way to go. Prices will probably fall everywhere in 2009 and the current weak spots will suffer more than most. Northern Ireland, the Southern regions and the North West face double digit declines and the UK as whole could see prices fall about 11 per cent. Overall Oxford Economics believes that house prices fall in the current slowdown may be greater than occurred in the last recession in the 1990s. Some commentators have suggested that the housing market will not return to today's level of pricing for another 10 years. And the FT has reported that the outlook is particularly bleak for house building in housing renewal areas (FT 4 December 2008).

Oxford Economics has provided an early analysis of ‘Which sectors and boroughs are most vulnerable to the “credit crunch”’ in July 2008. This provides some helpful pointers on the way in which the credit crunch will hit specific sectors and in what order. They make the following key points:

- The economy is being hit by the twin pressures of the credit crunch, which is restricting the supply of finance (particularly

for house purchase) and a squeeze on disposable incomes resulting from high and rising energy and food prices.

- The resulting slowdown will have a wide-reaching impact across the country, not just on London and the greater South East. This reflects the importance of financial services to a wide range of centres and the way that local economies of the UK have changed in light of globalization
- The industries most likely to be initially affected by the credit crunch and squeeze on disposable incomes are financial services, real estate, other business services, construction and retail and other consumer related industries. Heading into 2009, the sectoral and thus geographic pattern of impact will change as the wider economy begins to slow.
- Central London – the City, Tower Hamlets and Westminster - has the country's biggest concentration of financial & business services and real estate jobs, and is the most vulnerable part of Great Britain (GB) to any resultant job losses.
- Outside of central London, a number of smaller centres show up as being particularly vulnerable. These include Chester, Bournemouth, Calderdale and Macclesfield. These tend to be relatively prosperous areas, all of which have high concentrations of jobs in banking and auxiliary services.
- Within London area, Barnet, Elmbridge and Richmond show up as being vulnerable because of concentrations of jobs in real estate, while Watford and Kingston have a general exposure to a range of the vulnerable sectors, not just financial services.
- Cities are generally more exposed than rural areas but there is a considerable range in level of exposure, with Leeds,

Edinburgh and Bristol more exposed than more industrial and public sector-focussed cities, such as, Sheffield and Liverpool.

(Which sectors and boroughs are most vulnerable to the "credit crunch"? Research by Oxford Economics (July 2008))

## Unemployment

Paul Dales, an economist at Capital Economics, said the pace of job losses had accelerated in the UK and was likely to continue to do so as the recession is deeper and longer than many had anticipated. He said British unemployment rates could see some of the steepest rises among western economies. "We think unemployment in the UK will rise by 1.7 million to just over 3 million in 2010 ... with a little more than one in 10 members of the workforce out of work."

Capital Economics predicts job losses in financial services will reach 100,000 by the end of 2010, with at least half of them in the City. Construction layoffs are forecast to reach 500,000 and a similar number is penciled in for high street retailers, hotels, bars and restaurants.

## FOOTNOTES

<sup>1</sup>How the UK downturn hurts, November 24th 2009, Jeremy Lemer Financial Times

<sup>2</sup>House Price Index, Department for Communities and Local Government, October 2008

<sup>3</sup>House prices fall £12,000 in six months, Hilary Osborne, The Guardian, Tuesday December 9 2008

<sup>4</sup>House prices suffer largest fall for 16 years, Hilary Osborne, The Guardian, December 4 2008

<sup>5</sup>Sales hit a new low but expectations of a recovery increase, RICS UK housing market survey, October 2008, Royal Institution of Chartered Surveyors (Rics) figures, November 11 2008

<sup>6</sup>House prices fall £12,000 in six months, Hilary Osborne, The Guardian, December 9 2008

<sup>7</sup>Global credit crunch could delay 2020 housing target by up to nine years, National Housing Federation, September 19 2008

<sup>8</sup>The Chartered Institute of Purchasing and Supply/Markit monthly construction index tumbled to 35.1 in October from 38.8 the month before, Alice Brock, The Guardian, Tuesday November 4 2008

<sup>9</sup>How the UK downturn hurts, Financial Times, November 24 2008

<sup>10</sup>Ibid

<sup>11</sup>Construction and property services companies account for over a third of all corporate insolvencies in September and October, Wilkins Kennedy accountants, November 6 2008

<sup>12</sup>Manufacturing output falls for eighth month running, Ashley Seager and Julia Kollwe, The Guardian, December 10 2008

<sup>13</sup>Gloom deepens as output plunges rapidly, Norma Cohen, December 1 2008

<sup>14</sup>Quoted in: Gloom deepens as output plunges rapidly, Norma Cohen, December 1 2008

<sup>15</sup>How the UK downturn hurts, Financial Times, November 2008,

<sup>16</sup>Pre-Budget Report

<sup>17</sup>Quoted in: Steep falls add to fears of deep recession, Dave Shellock and David Oakley December 1 2008