UUEPC

Economic consequences of COVID-19 in Northern Ireland

A provisional discussion paper on the potential impact

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THE FINDINGS IN THIS REPORT ARE PROVISIONAL

Due to the unprecedented nature of the Coronavirus outbreak and the associated health and economic fallout, **the findings in this report are provisional in nature**. It is the intention of the UUEPC research team to provide updated commentary on the impact as more information becomes available.

1. Introduction

Introduction

1. One common feature of all superlatives is that they are significantly over-used. In recent times, many events have been described as unprecedented, but the current COVID-19 pandemic and the economic fallout is truly unparalleled in economic experience. This presents a significant challenge for policy makers because there simply is no policy playbook to follow. In many respects we are flying blind.

2. We have dealt with wars, recessions and financial crises before and through painful experience we have developed policy responses to mitigate against the worst of the economic impacts. The world has also experienced pandemics before, in this current century, we have experienced SARS in 2002-04, Avian Flu in 2009 and Ebola in 2014-16. Going further back, a century ago 'Spanish Flu' killed an estimated 50-100 million world-wide.

3. Whilst the steps taken to date alongside the search for a cure and vaccine will almost certainly keep deaths significantly lower than the worst of previous pandemics, from an economic perspective, this time is different. **Never before have the governments of all major economies told their populations to stay at home and in doing so shut down a significant proportion of global economic capacity**.

The L-U-V story

4. Politicians are faced with a trade-off between public health and economic activity. The greater the emphasis given to one priority, the greater the negative impact on the other. The global priority is quite correctly public health, but as has been reported, the longer society remains in 'lock-down' the greater the economic impact will be experienced[1].

5. The period of lock down is critical for a number of reasons, firstly the immediate impact in terms of contraction in 2020 (i.e. the temporary impact), but secondly the longer a lock down is in place, the greater the probability of permanent damage being done to the economy. Typically, there are three scenarios the economy could follow:

    - V-shaped recovery – the best-case scenario, the recession is relatively deep but is short-term in nature and is followed by a strong recovery and lost economic output is quickly made up with no permanent damage;

[1] OECD suggest a loss in annual GDP of 2% for every month in lockdown. See OECD, Economic Outlook, Interim Report (20 March 2020)

- U-shaped recovery – the recession is deep and prolonged and whilst growth recovers to previous levels, economic activity remains permanently below the pre-recession trend[2]; and

- L-shaped recovery – the most pernicious scenario, where the recession is deep, long lasting and growth does not return to levels attained before the recession. The damage done is permanent. The Greece economy after the 2008 financial crisis is an example of an L-shaped recovery.

6. The scenario national economies will follow is currently highly uncertain and may vary depending on underlying economic characteristics of each country, the policy responses enacted by governments and the speed with which the threat of the virus can be eliminated.

Historical context

7. For comparison, the scale of the most serious UK recessions over the last century is set out below. Data for Northern Ireland are more limited.

Table 1: Scale of previous UK and NI recessions (% decline in GDP)

	1920-21	1930-32	1943-47	1973-75	1979-81	2008-09
UK	-23.0%	-7.6%	-13.7%	-5.0%	-5.3%	-6.0%
NI						-7.2%

Source: NIESR, Bank of England, ONS[3]

8. It is also noteworthy, that from a Northern Ireland perspective, after 2008 it took much longer for the local economy to move from peak to trough and through recovery than the rest of the UK.

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[2] A variant of the U-shaped recovery is the 'W-shaped' recovery, where the economy recovers quite quickly, but a second wave outbreak then pushes the economy back into recession. This is considered less likely because it is assumed that a second wave (if it is to happen) would occur a relatively short number of months after the lifting of restrictions and therefore before an economic recovery could materialise.

[3] Source: For UK: 1920-21 and 1930-32: J. Mitchel, S. Solomou and M. Weale 2011, "Monthly GDP estimates for inter-war Britain", *NIESR.* For UK 1943-47: Bank of England, "A millennium of macroeconomic data for the UK". For UK 1973-75 and onwards ONS 11 February 2020, "GDP chained volume measures".
For NI: ONS 19 December 2019, "Regional GVA balanced by industry". Other estimates of the scale of economic contraction of the NI economy following the financial crisis have been more significant.

Other COVID-19 impact estimates

9. Estimating the economic impact of COVID-19 is a moveable feast at present, as forecasters assess the potential impact based on very limited economic data. By way of example, the Bank of England's March 2020 consensus of independent economic forecasts[4] presented UK economic growth forecasts for 2020 ranging from -1% to 1.9%. A few short weeks later and those forecasts have been revised down very significantly and are being updated on an almost daily basis.

10. Initial estimates of the potential economic impact caused by the COVID-19 pandemic is set out below. Given the high levels of uncertainty, these estimates tend to be confined to the impact on Q2 growth only and/ or assume a relatively swift recovery in Q3.

Table 2: Other COVID-19 Economic impact estimates

Country	Equivalent annual % decline in GDP	Peak unemployment	Source
UK	6%	-	Deutsche Bank
	5%	-	Morgan Stanley
	4% - 8%	-	PwC
US	8.25%	20%	Goldman Sachs
Germany	2% - 5%		IfO Institut
RoI	7.1%	18%	ESRI
	7.3%	-	EY
	8.3%	-	Central Bank of Ireland
NI	6.7%	78k job losses	EY

11. A consensus in terms of the immediate impact seems to be emerging around an annual contraction in economic activity of 5% to 8% in 2020 (based on the lockdown being restricted to Q2 only).

[4] Source: Bank of England March 2020, "Forecasts for the UK economy: a comparison of independent forecasts".

2. The impact in Northern Ireland

Introduction

1. Economists in Ulster University considered a range of methodological approaches to estimate the impact of COVID-19 in Northern Ireland and settled on an analysis of the demand-side impacts.

2. It is important to recognise that given the extreme uncertainty, this analysis should not be considered as an economic forecast but rather **an order of magnitude estimate of the impact of a lock-down for Q2 only** (i.e April to June 2020). The extent of either prolonged lower economic activity or compensatory additional economic activity in Q3 and beyond has not been considered[5].

3. The assumptions used in this analysis are based on evidence wherever available and informed judgement.

Impact on economic activity (GVA)

4. The level of economic output is determined by aggregate demand and the components of aggregate demand are set out in the equation below:

Economic Output = C + I + G + X – M

C=Consumption; I=Investment; G=Government expenditure on final goods and services[6]; X=Exports; M=Imports

Table 3: Summary of estimated impact on Economic Output

Demand component	Implied annual % reduction
Consumption	-8.1%
Investment	-2.5%
Government	+1.0%
Exports minus Imports (Net Trade)	0%
TOTAL	**-9.6%**

5. This estimate is at the upper end of estimates provided by other economic forecasters and it is likely that all estimates will change significantly as reliable data becomes available over time. However, **this research team has noted that estimates of**

[5] With the exception of a small compensatory increase in Investment spending in Q3.
[6] Importantly, this *excludes* government spending on welfare benefits.

the economic impact have tended to increase over the course of the last two weeks.

Consumption

6. Consumption represents the single largest component (estimated at 65%[7]) of the Northern Ireland economy. Given an almost complete lockdown in 'non-essential' areas of the economy, it is assumed that spending would be limited to essential items only. This would equate to a 50% reduction in 'C' – consumption spending.

Table 4: Basis for Consumption spending assumption

50% reduction in Consumption spending
• The *Living Costs and Food Survey* provides a detailed breakdown of consumer spending – essential items include: Food and non-alcoholic drinks 14%; housing (net) fuel and power 12%; household goods and services 8%; communications 5%; alcohol and tobacco 5%; health and education 4%; and other items such as transport will fall significantly but not to 0%. • By way of contrast, NIESR have assumed a 40% decline in consumption in Quarter 2. (NIESR 27 March 2020, "A preliminary assessment of the possible economic impact of the coronavirus outbreak: Update".)

7. **The implied reduction in annual GDP arising from reduced consumption in Quarter 2 is therefore 8.1%.**

Investment

8. Levels of investment in the NI economy (and UK more generally) has been a long-term issue and were already at low levels before the COVID-19 outbreak, which might suggest that scope for further significant reduction would be relatively limited.

9. Investment[8] represents approximately 15% of NI economic output.[9] Given the very limited data available on components of Investment for NI, we applied UK data relating to the proportional composition of investment and were informed by the assumptions made by ESRI (19 March 2020) on the change in estimated levels of investment spending.

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[7] Source: NISRA 19 December 2019, "Structure and performance of the NI economy in 2015 and 2016".

[8] The investment component of economic output is defined as Grass Capital Formation (GCF). GCF in turn consists of Gross Fixed Capital Formation (GFCF) plus change in Inventories and Acquisitions minus Disposals of Valuables (e.g. precious metals). In practice the difference between GCF and GFCF is very small and the difference has not been included in the modelling. This analysis focuses on GFCF.

[9] Actual figure 14.4% NISRA 19 December 2019, *op.cit.*

Table 5: Estimating the decline in main components of Investment (GFCF)

Components of Investment	% share of GFCF total	Assumed % Q2 decline[10]	Assumed % recovery in Q3[11]	Contribution to % decline GFCF
Dwellings	24.3%	100%	110%	5.5%
Other buildings	27.9%	100%	110%	6.3%
Equipment & intellectual property products	47.8%	50%	110%	4.8%
Total assumed reduction in Investment spending				**16.6%**
Implied reduction in overall GDP				**2.5%**

Source: ONS 31 October 2019, "National Accounts: The Blue Book- Supplementary Tables".

Government expenditure on final goods and services

10. Government spending contributes approximately 25% to overall economic output. Given information available, it is difficult to estimate how far an increase in government spending on final goods and services might add to output in 2020. As of 31 March 2020, the NI Executive had received a Barnett consequential of £912m[12]. It is assumed that half of that will be used to fund increased spending on final goods and services (as opposed to spending on welfare benefits), i.e. £456m[13].

11. Such an increase in spending **could be equivalent to an approximate 1% boost to economic output**[14].

12. It is worth noting that there are challenges in estimating GDP/GVA during the crisis given the huge amount of Government support payments (often to retain employment). This research team considered such subsidies should be treated as "transfer payments" and therefore not contributing directly to the measured level of economic output. However, they would contribute in an indirect way, as wage

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[10] The same as the % declines assumed in ESRI 19 March 2020.
[11] A modest rebound is assumed in the UUEPC analysis and below that assumed in ESRI 19 March 2020. This is obviously very dependent on consumer and business confidence levels when restrictions on economic activity are lifted. Assumed Q4 returns to Q1 levels.
[12] Minster of Finance 31 March 2020, "Budget 2020-21", *Statement to the Northern Ireland Assembly*.
[13] It could be argued that £456m is generous. The Minister of Finance's 2020 Budget statement indicated that of the £912m allocated via Barnett about £490m was being spent in the form of grants to businesses or forms of Rating relief. That would imply increased spending on goods and services of no more than £422m, however, there will almost certainly be further increases in funding for NI public spending during 2020-21.
[14] Assumes a government spending to GDP multiplier of 1.0

support payments sustain household disposable income and hence consumption levels.

Exports minus imports (Net Trade)

13. In line with the UK in general, Northern Ireland has a trade deficit. Northern Ireland's total external sales/exports (i.e. sales to both GB and the rest of the world) were £21.6bn and total external imports (i.e. purchases from both GB and the rest of the world) were £24.6bn.[15]

14. The Coronavirus will lead to a very significant reduction in international trade, i.e. a fall in both imports and exports. In terms of goods, NI may experience an increase in food sales to GB (although this may be a longer term response than simply in Q2). In addition, the local economy could also experience a boost from increased sales in health and pharmaceutical related products. However, there is also likely to be an increase in imports in products related to dealing with the current pandemic.

15. In respect of services, the thriving local tourism sector is in total lock-down (a loss in exports), but similarly NI residents are unable to take their overseas holidays (a reduction in imports).

16. In the absence of any data and given there is likely to be only a relatively negligible impact on the **net** trade position, it is assumed that there is no impact on output.[16]

[15] NISRA 19 December 2019, *ibid.*
[16] ESRI 19 March 2020, *op.cit.*, estimated that RoI exports would decline by more than imports (which would imply a negative impact on growth) but their economy is more export orientated than the NI economy and more susceptible to a slowdown in global trade.

3. Labour market implications

Introduction

1. The impact on the labour market is likely to be very significant, firstly in terms of those working in sectors which have been placed in lock-down by the Government, but then secondly in terms of those who may lose their jobs in the immediate post-lockdown period as a result of a potential significant demand shock to the economy.

2. This initial analysis sets out the likely change in claimant numbers in the last few weeks and provides a high level overview of the sectors most likely to be immediately impacted.

Change in claimant numbers

3. The UK Department of Work and Pensions (DWP) reported on 1 April 2020, that approximately 950k successful applications had been made for Universal Credit from 16th to 31st March 2020. They indicated that typically they would expect approximately 100k applications in a two-week period, which represents an almost 10-fold increase.

4. The UUEPC research team has made a data request to Department for Communities (DfC) but at the time of publishing, the data has not been released. However, the BBC reported[17] 10,000 new claims on week commencing 16th March and a further 9,000 part-way through the following week (this is against a baseline of 1,600 per week). It is reasonable to conclude that the final figures for week commencing 23rd March were in excess of the previous week. This would have **resulted in over 20,000 successful claimant applications in Northern in the last two weeks of March**.

5. As employers continue to experience significant challenges, job losses will continue. Whilst numbers of new claimants may start to reduce from their exceptionally high levels in the coming weeks, they will most likely remain much higher than pre-crisis levels.

[17] Source: https://www.bbc.co.uk/news/uk-northern-ireland-52044168

Impact across sectors

6. All sectors are being impacted by the Coronavirus lock-down, but the table below sets out the total employment levels in the sectors likely to be most significantly impacted, at least in the short term. These sectors alone represent over 40% of the total NI labour market.

Table 6: Sectors most impacted: Total Employment levels (2019)

Sector	Employment
Wholesale & Retail	145k
Manufacturing	96k
Construction	59k
Hospitality	55k
Arts & Leisure	20k
Real Estate	10k
TOTAL	**385k**

Source: UUEPC

7. Importantly, **this does not represent the number of jobs which will be lost**. For example, food retailers have been seeking to recruit additional staff to meet increased demand, and many companies have taken advantage of the Government's Job Retention Scheme and furloughed staff.

8. Data on the extent of furloughing in Northern Ireland is not available but national surveys suggest employers are taking advantage of the scheme in greater numbers than anticipated by HM Treasury. A British Chambers of Commerce survey indicated approximately 44% of companies would pay at least half their staff through the scheme, and 32% indicated they were planning to furlough more than 75% of their workforce.

9. Locally, the NI Chamber of Commerce[18] members survey highlighted the significance of the impact on local (mainly smaller) firms:

- 36% have closed their operations temporarily;
- 30% intend to furlough all their employees (80% intend to furlough at least some in the next week); and
- 38% have seen a significant decrease in their workforce.

[18] NI Chamber & BDO, 8 April 2020, "Quarterly Economic Survey and COVID-19 Business Impact Tracker"

10. A CIPD survey found that more than half of employers expected to furlough staff using the government's scheme.

11. Unfortunately, the published information does not provide a sectoral breakdown in terms of uptake, but the table below provides a provisional estimate of potential numbers of staff temporarily laid off or furloughed across broad sectors of the economy.

Table 7: Initial estimate of staff nos. temporarily laid-off or furloughed

Sector	
Production & Manufacturing	33k
Construction	15k
Private sector services	187k
TOTAL	**235k**

Source: UUEPC

12. This represents approximately 44% of total private sector employees. As further information becomes available, the assumptions used in this analysis can be refined and improved upon to provide more detailed estimates.

Investment in mental health

13. A final point in terms of the impact on the labour market is the focus on mental health. Prior to the COVID-19 outbreak, there had been calls for increased investment in mental health services. With the heightened anxiety associated with this crisis alongside the increased sense of isolation for many, demands on mental health services are likely to increase further. This is an economic as well as broader social issue as a healthy labour force is critical to a recovering economy.

4. Fiscal considerations

Introduction

1. At a national level, the UK Government has significantly more fiscal levers than regional governments and assemblies, but the UK fiscal position is highly relevant in a Northern Ireland context as it determines the level of spending in the current year and the likely direction of both spending and taxes in the longer term.

2. Firstly, a brief consideration of the likely fiscal decisions facing the NI Executive in the next few years.

Will the NI Executive consider additional revenue raising?

3. The NI Executive has very limited tax raising powers, but there is scope to introduce a range of charges which would bring NI into line with other parts of the UK. These have been discussed at length before and include: the introduction of domestic water charges and prescription charges; and increasing university tuition fees. Pre-crisis these were resisted by the Executive, but the economic and political landscapes have fundamentally changed in the last few weeks.

4. The following reasons suggest this is more likely:

   - HM Treasury will have a greater over-sight role in the management of NI public finances;
   - The introduction of a new Independent Fiscal Council; and
   - The aspirations set out in the New Decade, New Approach far exceeded resources available[19].

5. One counter-argument is the understandable reluctance to squeeze household disposable incomes further, particularly at a time when consumer spending will already be under pressure.

Reduced revenue raising capacity and higher borrowing

6. The Institute for Fiscal Studies (IFS) have estimated that if UK GDP declines by 5% in 2020, as a general rule of thumb, the budget deficit would widen by approximately £70bn, as tax receipts decline and welfare payments increase. Pre-crisis the Office for Budget Responsibility (OBR) forecast a £55bn deficit in 2020-21 and government responses announced up to 28 March 2020 imply further borrowing of £50bn. Taken together, this suggests a deficit in the region of £187bn, with the prospect of it

[19] The priorities set out in the NDNA document could be subject to significant revision in a post-COVID-19 environment.

increasing further[20]. This is broadly similar to the scale of the deficit in the aftermath of the global financial crisis.

7. The longer term fiscal outlook also gives cause for concern as economic growth rates may be reduced due to a range of behavioural changes which the Coronavirus pandemic may cause. For example, reduced international movement of labour and lower levels of international trade as companies consolidate their supply chains in their domestic economies. Over time this would have a negative impact on global productivity growth.

8. The Harvard Business Review argued there is a significant risk of permanent damage to national economies in the wake of this crisis and we could experience an "L-shaped" recovery, where the economy settles on a new, lower growth path below its previous trend (referenced further above).[21]

Long term effects of the increase in borrowing

9. There is no precise threshold in terms of the level of public debt, which once passed, negatively impacts future economic growth. However, typically if a nation's debt to GDP ratio rises above 100% (the pre-COVID-19 ratio for the UK was approx.. 80%) concerns are raised[22]. As a consequence there is likely to be a view in the coming years that either reductions in public expenditure will be necessary and/ or be prepared to accept higher taxes.

The changing pattern of public expenditure

10. Pre-crisis, the IFS noted how over the long term the percentage composition of UK public spending had become increasingly weighted towards healthcare. Similarly, in June 2019 the Permanent Secretary in the Northern Ireland Department of Health indicated that on current trends, within 20 years, spending on health would require almost all the funding available to the Executive. The COVID-19 crisis will most likely accelerate that trend.

11. As a result, a much tougher funding environment will face all areas of the public sector in the years ahead.

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[20] C. Emmerson and I Stockton 26 March 2020, "The economic response to coronavirus will substantially increase borrowing", *IFS Report.*

[21] *Harvard Business Review* (P. Carlsson-Szlevak, M. Reeves and P. Swartz), "Understanding the economic shock of coronavirus".

[22] By way of context, the Maastricht Treaty's Protocol on Excessive debt, obliged members to respect a debt to GDP ratio of 60%. In contrast the ratio rose above 200% during World War 2.

5. Concluding comments – developing an exit strategy

The challenging decisions ahead – public health vs the economy

1. The decisions for our political leaders are likely to become even more difficult in the weeks and months ahead. The recovery phase will begin with the decision to start to lift restrictions on people's movements and businesses ability to trade and this will be taken based on the best scientific advice available. However, there is a set of more difficult decisions that lie ahead.

2. Ultimately, society's aim is to minimise the human cost of this crisis and the strong global consensus to achieve this outcome has been to prioritise public health over the economy. Given the high levels of compliance with the restrictions in place, this decision has been implicitly supported by the public. However, this decision also has an economic cost and as experienced throughout history, major recessions and depressions also creates significant human cost.

3. Political leaders will soon have to turn their attention to creating more of a balance between public health and economic priorities in order to minimise overall human cost. Increasing funding for public services requires a strong and wealthy economy generating tax revenues. A global economy on its knees will not be able to create the jobs to fund the level of investment society would wish to see in public services.

4. Securing public buy-in around the timing of that decision will be very important.

Identifying opportunities for the longer term 'recovery' phase

5. Governments are currently implementing 'damage limitation' policies, with the aim of protecting households and businesses from the worst impacts of the shutdown. But looking to the long-term, the following 'recovery' phase opportunities are likely to be considered:

   - **Increased government investment** – if private sector investment falls below pre-crisis levels of spending, there is a role for Government to pick up the slack. This could include fast-tracking current investment plans at a time when there is spare capacity in the economy. The crisis has highlighted infrastructure weaknesses such as lack of digital connectivity in rural areas, which could be prioritised moving forward;

   - **FDI opportunities from near-shoring** – there has been significant economic commentary about the longer term implications the crisis could have on global supply chains. If businesses choose to pursue a policy of bringing their supply chains closer to home (i.e. more near-shoring), there may be an opportunity for Invest NI to re-position NI as a safer location for GB and European inward investment. It could also result in a re-balancing towards manufacturing.

- **Adapting to changing tourism patterns** – a reduced tendency towards international travel would create significant challenges for the local tourism sector and significant promotional effort will be needed to maintain the momentum achieved prior to the crisis. However, other opportunities may also emerge such as a preference towards 'staycations'.

- **Embracing new working behaviours and associated innovations** – the current crisis has created a significant impetus to push many businesses and sectors into adopting on-line working practices. The types of changes in behaviour which would ordinarily takes years to achieve, has been realised in a few short weeks. This could create the opportunities for businesses to be more efficient (e.g. in terms of accommodation costs), but could also open up new and innovative business operating models.

- **Re-skilling during "furlough**" – significant sums of public money are being committed to protect earnings during the lockdown. Rather than have people inactive at home for an extended period of time, it may be an opportunity to combine funding for re-skilling.

- **The normal business of government must continue** – focusing on addressing the immediate issues at hand will take up the entire bandwidth of government, but if the economy is to successfully recover the next Programme for Government must be carefully developed to include policy to raise, amongst many other things, productivity and competitiveness.