THE IMPACT OF COVID-19
ON THE UK HAULAGE SECTOR

SECTION 1: Economic Crisis, Recession & Recovery Scenarios

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Section 1: ECONOMIC CRISIS, RECESSION & RECOVERY SCENARIOS

The COVID-19 Pandemic's impact on the economy is unique from all economic crises in the last 60 years in that it stems from restrictions on both supply and demand; meaning it can't simply be solved by pumping more liquidity into the economy to encourage more spending. As such, our best reference point may be to look at the years following WWII.

At that time, as will soon be the case for us, the government was massively indebted due to its enormous investment in the war effort. The difference is that this time we're waging war on a microbe, a deadly virus, and our challenge is to prevent mass deaths while propping up the economy to make sure it survives the crisis. No-one has ever had to do this in modern times.

The important thing for us in the UK Haulage Sector is how it will affect us and, from our own interest as a temporary driver supplier, how it will impact employment numbers in the logistics market. If it's anything like the Great Recession of 2008, the effect on the Haulage Sector will be exaggerated compared to other sectors. The effect of COVID-19 has been to force the closure of many manufacturers which in turn disrupts supply chains and delays the ability of business to resume operations. This has far-reaching consequences across all sectors.

In this first instalment in our three-part analysis on the impact of COVID-19 on the UK Haulage Sector, we explore the current coronavirus Pandemic and the consequent social and economic crisis that we face. Towards the end of this section, we'll also look at how this is likely to evolve over time and develop a number of possible recovery scenarios and the lingering impact each of them will have in the years to come.

Our Report **COVID-19 & Its Impact on the UK Haulage Sector** is structured into 3 sections:

SECTION 1: Economic Crisis, Recession & Recovery Scenarios

We explore the current COVID-19 Pandemic and the consequent social and economic crisis. We look at how this is likely to evolve over time and we develop a number of possible recovery scenarios.

SECTION 2: The Effects of Recession on the UK Haulage Sector

We look at lessons from the 2008 Great Recession. We interpret how this affected the UK haulage industry and in particular employment numbers within the Transport and Storage Sector then, more granularly, the UK LGV driver workforce.

SECTION 3: What is the Future for the UK Haulage Sector after COVID-19?

In the third part we combine the key conclusions from the previous two sections to predict how the UK Haulage Sector and the LGV driver market will be affected by the COVID-19 Pandemic crisis, the subsequent recession and recovery.

We are in an extremely volatile period, with significant developments occurring daily and a prolific amount of new data regularly being disseminated. This means that this report will need continuous maintenance to keep it current. We nevertheless hope that it will provide a useful basis for understanding our current circumstances, how these are likely to evolve and help hauliers decide what to do now to maximise their chances of survival to eventually come out with increased competitive advantage.

Section 1: ECONOMIC CRISIS, RECESSION & RECOVERY SCENARIOS

The COVID-19 Pandemic is unprecedented in modern history. Economists are drawing similarities between current circumstances and those that followed World War II. Their reasoning is that the COVID-19 Pandemic impact on the economy is unique from all economic crises in the last 60 years in that it stems from restrictions on both supply and demand. In modern times all recessions have been due to a lack of demand, which was traditionally resolved by pumping more liquidity (money) into the economy to encourage more spending and hence growth of the economy. That won't necessarily work in this case.

So, what do we mean by a supply and demand driven economic crisis? A pandemic has the effect of forcing us to avoid the disease threat and isolate ourselves within our homes. This causes a supply constraint because factories and offices reduce output or even totally shut down, thereby restricting supply of goods and services. At the same time demand drops because consumers stay at home, unable to visit service providers, (hairdressers, restaurants, gyms etc.), while businesses mothball investment plans and cease manufacturing with all the supply chain ramifications. This is not cyclical unemployment, it is enforced "quarantine unemployment". Pumping money into the economy will help maintain incomes of those forced to stay at home and their demand for products, but it won't resolve the supply constraint until the restrictions are lifted. The question therefore is how can we predict the economic impact in the short term and the longer term?

As an aside, the similarity to World War II comes from the fact that, at the time, there was massive spend on the war effort but not on consumer products or luxuries; this constrained supply of all but the essential goods needed to survive. Luxury goods were non-existent while basic goods were rationed.

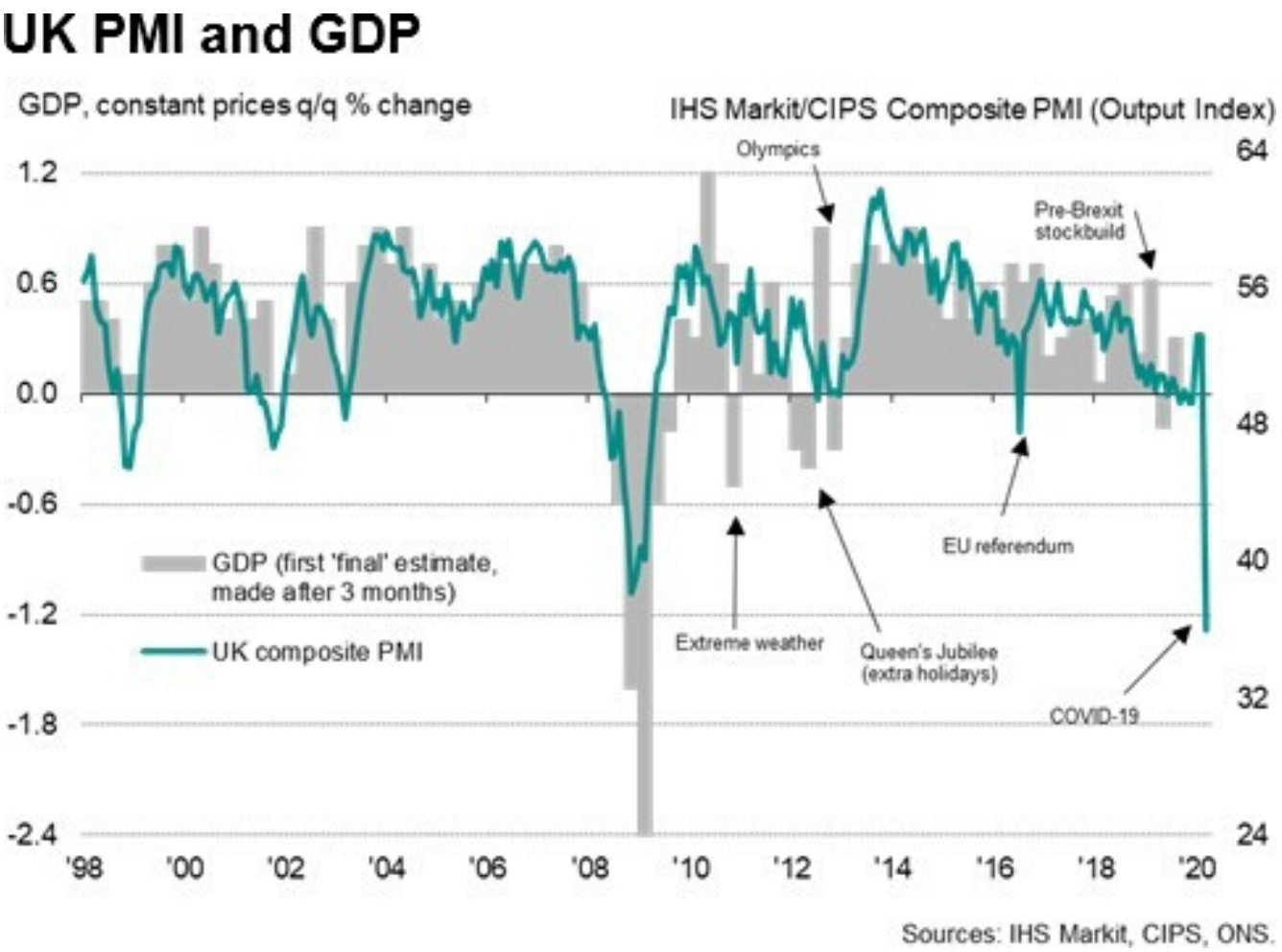
Wages were suppressed and therefore consumption was simultaneously constrained, hence the comparison with today's situation. At that time, as will soon be the case for us, the government was massively indebted due to its enormous investment in the war effort. The result was rationing of basic commodities, including clothing, until the economy could return to "normal operation", this being in 1954, nine years after the end of the war. We aren't saying that rationing will be necessary today, but it gives some idea of the severity of the measures needed to control and drive economic performance under such extraordinary conditions.

Our position is that we are waging war on a microbe, a deadly virus, and our challenge is to prevent mass deaths, while propping up the economy to make sure it survives the crisis. No-one has ever had to do this in modern times.

Now we understand the nature of the challenge let's return to how we can forecast the outcomes.

The short-term predictor of GDP direction has recently been the Composite Purchase Managers' Index ("PMI"). The correlation has been accurate over the past 20 years or so, and many pundits are therefore watching the various PMI indices to predict what may happen to the economic output (GDP) at a local, regional and global level. In the UK, the latest PMI score for March 2020 dropped massively from 53 in February to a score of 36. A PMI score of 50 represents "business as usual"; over 50 indicates improving market conditions (growing consumption and production) and below 50 indicates a contracting market.

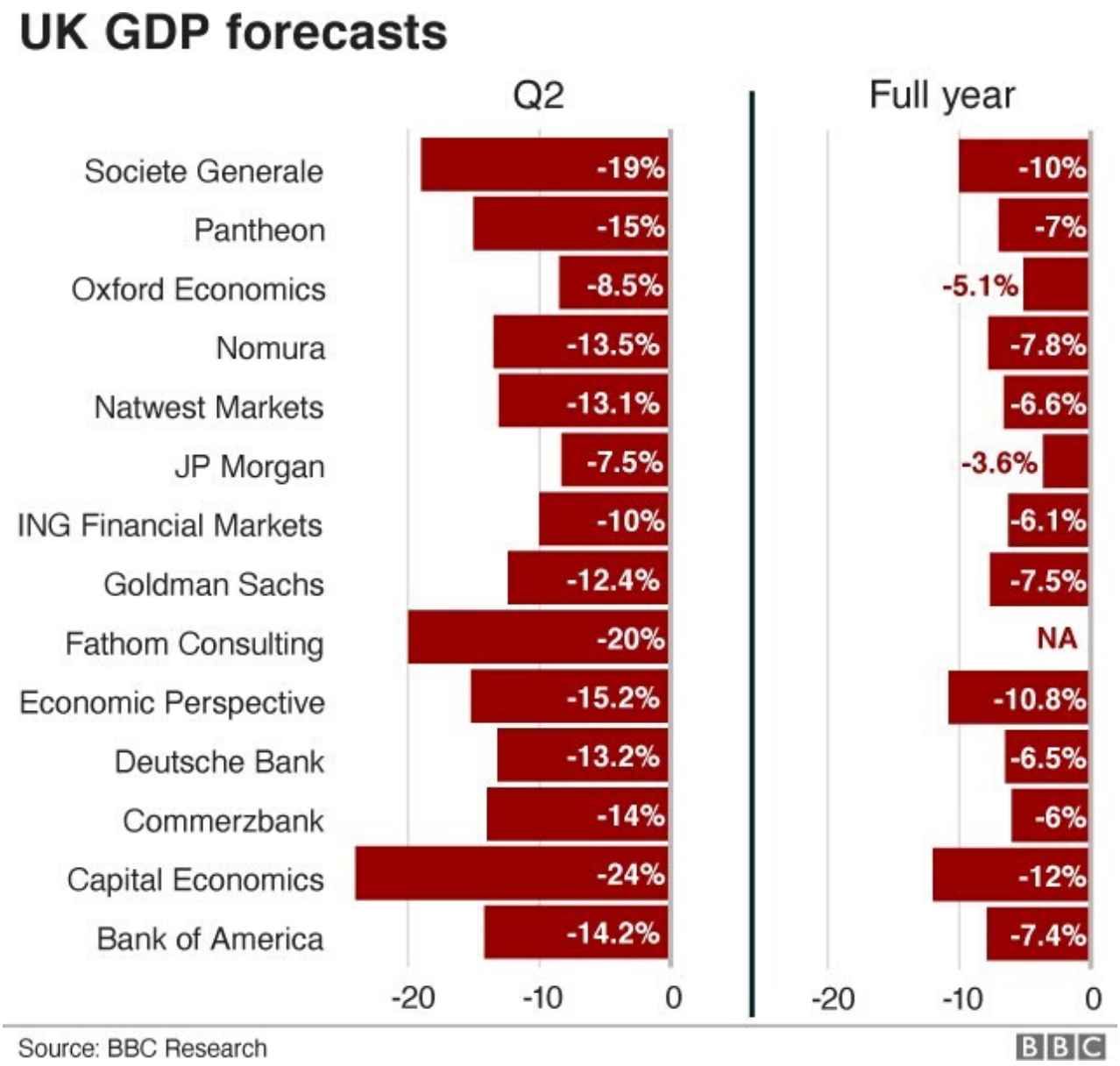
A drop of this magnitude is something that has never been seen before since the PMI index was launched in July 1996. The previous lowest UK PMI score was, unsurprisingly, in 2008 as the Credit Crunch took hold and had a very consistent correlation with the fall in GDP. At that time the PMI fell to 38.1 in November 2008. That means that we are already below the 2008 score and all indications are that it will worsen in April and until we can come out of lockdown. To add further weight to this point, the Eurozone PMI has dropped from 52 to 30 in the same period, which implies at least a -2% drop in Eurozone GDP per quarter.



As we can see from the graph above, a UK Composite PMI score of 38.1 correlated with a drop in GDP of -1.6% in Q3 2008 followed by a further drop of -2.2% in Q4 2008. Over the 5 quarters spanning Q2 2008 to Q2 2009, GDP dropped in total by -6.3%. No wonder economists are forecasting large drops in GDP for Q2 2020 and the rest of the year.

To summarise, the biggest issue we are facing is that we don't have a model for how to tackle this crisis, nor do we know how it will unfold; economists are trained and accustomed to forecasting GDP growth to within a 0.2% accuracy, yet we are receiving forecasts from acknowledged experts that vary by tens of percentage points. We are into unchartered territory, where epidemiologists may be better positioned to predict the economic outcomes than economists.

Consequently, economic forecasts for Q2 2020 vary significantly, however the common conclusion is that "this is grave". The best academic and financial analytical minds in the world are focused on how the COVID-19 Pandemic will affect their local economy, their regional economy and ultimately the global economy. They are all coming up with widely differing estimates. The BBC collated the forecasts for the UK, and these are shown in the table below:



The current forecasts for Q2 2020 UK GDP are a decline of between -7.5% and -24%, with an average of -14%. The same experts are forecasting a GDP drop of between -3.6% and -12% for the entire year 2020, averaging -7%. This is more than the Great Recession drop of -6.3%. and in half the time.

We note the recent analysis released by the Office for Budget Responsibility (OBR) on 14th April, which predicts a -35% drop in GDP in Q2 2020 rising quickly back up to result in a -13% fall in annual GDP in 2020. This is at the top end of previous predictions, which is not surprising as it assumes a 3-month lock-down with a 3-month recovery phase, this being more severe than the assumptions in the other forecasts. The OBR emphasises that this is not a "forecast" but a "reference" scenario, to be used "as a reference point against which to monitor incoming data and other information." The OBR states that

the “scenario should not be taken as our view of the most likely path for the economy…”. This makes sense as it omits to include the possibility of a global recession, international trade disruption and international supply chain dislocation, so offering an unrealistically optimistic view of the post crisis period.

OK, so we now have a prediction of what might happen in the next 9 months, but what about the longer term?

This requires an understanding of the larger perspective, i.e. a regional and global viewpoint. The UK recovery will depend on how quickly we can recover locally, but, because we depend very much on imports and exports to fuel our economy, it will also be determined by what happens in the European region and furthermore in the global arena. If we recover quickly but the rest of Europe or the World goes into recession, we cannot avoid following them along the same path.

Economists have defined various types of recession:

V

V-shaped recession:
This begins with a steep fall but quickly bottoms out, turns back round and immediately returns to previous levels or similar. This is a best-case scenario. The assumptions are that government intervention is successful, virus propagation is controlled, we return to business as usual (BAU), except for those aged over 60 or 70 who remain in isolation until the vaccine is deployed. There is no resurgence of a more virulent form of the virus and we quickly recover from the economic shock with little lasting damage to production capability.

W

W-shaped recession:

This begins like a V-shaped recession but then turns back down again after showing false signs of recovery. These are sometimes called “double-dip recessions” because the economy dips twice before full recovery is achieved. To apply this model to current circumstances, initial government intervention is successful, virus propagation is controlled, we return to BAU, except for those aged over 60 or 70 who remain in isolation until the vaccine is deployed. We quickly recover from the economic shock but then a more virulent mutation of the virus returns in around 6 months to a year’s time and forces us all back into lock-down. We repeat the current cycle, further depleting our nation’s capital reserves and lengthening any recovery.

U

U-shaped recession:

This begins with a slightly less pronounced decline but then remains at the bottom for an extended period of time before eventually turning around and rising to previous levels. In today’s circumstances this would be:

- Government intervention is not as successful as we would like.
- The lock-down continues for several months as we struggle to control propagation of the virus.
- Permanent damage is inflicted on our production capacity, with many companies going into liquidation.
- The nation’s capital reserves are severely depleted, reducing our capability to invest our way out of the recession.
- There is mass unemployment.
- It takes 3-5 years for the economy to recover.

L

L-shaped recession:

This is the most pessimistic scenario. Here it begins with a quick decline in economic output and then a failure to recover; it is essentially a more severe version of the U-shaped scenario. There is permanent damage to the economy. The post COVID-19 environment is the new “now”. It is to all intents and purposes a “post-COVID-19 winter” that endures for decades while the country, region and the world as a whole recover slowly to previous levels.

So, which will it be? V, W, U or L?

Optimists have been insisting that it will be a V-shaped recession on the assumption that we can quickly eliminate the virus and get back to normal life, avoiding any material or lasting damage to our economy. This is naturally the initial political viewpoint, as any other outcome is extremely unattractive to the voting population and a PR disaster to say the least. Eventually, even the politicians must come to terms with the reality that a quick recovery may not be a realistic scenario. So why might it not be a V-shaped recession?

Ultimately it comes down to the fact that we are dealing with a challenge that is part conventional recession and part natural disaster. Until the restrictions can be lifted, our economy will be constrained and this depends on whether we can control the virus. Even if the number of cases starts to fall in the next 2-3 months, we will still be far away from the end of the crisis, perhaps years.

Closing down large parts of society is not sustainable in the long-term. What we need is an epidemiological exit roadmap because the coronavirus is most likely to return again and again in different mutations. If we lift the restrictions that are holding COVID-19 back then the virus will come back in force, the real problem being that this is not just a UK issue, we are depending on all countries to achieve the same goals in the same timeframe. This is a massive scientific and societal challenge.

Any thoughts that we can avoid a recurrence after lockdown restrictions are lifted have just been put in doubt by Singapore, which has seen a rapid increase in new infections after lifting its restrictions. Also the belief that the virus could not thrive in hot conditions has been undermined by news that the port of Guayaquil, Ecuador's largest city, has emerged as a COVID-19 hotspot in South America with local authorities seemingly overwhelmed by the crisis; here the virus has spread rapidly in weather conditions where the temperatures have remained consistently above 30°C.

There are essentially three ways to thwart the COVID-19 threat:

Prevention or cure:
Vaccination is the obvious prevention mechanism, but this is at least 12- 18 months away, assuming everything goes to plan, and even then, the UK will probably be at the back of the queue because we have no UK-based vaccine production facilities planned until 2022; until then will have to rely on foreign manufacturers.

In parallel, drugs could be developed to successfully treat COVID-19 infection. These could be used at an early stage to prevent transmission and also to make the disease less deadly, reducing pressure on intensive care facilities, meaning that nations could cope with larger infection levels before needing to resort to lock-downs. The problem is that no such drugs have yet been identified.

Natural immunity:
We need to be cautious regarding the “herd immunity” strategy. Three European countries, the Netherlands, the UK and Sweden, started out believing that herd immunity was the way to go but quickly abandoned this strategy in the face of mounting infections and a realisation it would overwhelm their healthcare facilities.

However, by very careful relaxing of restrictions and protection of vulnerable individuals it might eventually be possible to achieve “herd immunity” but this could take years to build up. Experts believe it would take at least 2 years to achieve a sufficient herd immunity to suppress transmission enough to be able to control the virus, but the problem remains that immunity may degrade over time and the virus may mutate, undermining any such strategy. Remember that the Spanish Flu epidemic had three waves with the second being the most lethal, killing over 50 million worldwide.

Behavioural:
A third approach is to effect permanent changes in our behaviour that allow us to control transmission of the virus, such as keeping some of the current measures, including social distancing, coupled with extensive testing and tracing of infected individuals.

Ultimately it will be through a combination of all the above measures that we eventually control the virus. The fundamental issue we are facing now is when can we end the lock-down and resume "business as usual". Ending the lock-down will require careful judgement of when the health imperatives need to give way to economic concerns. Health is, quite rightly, highest priority today, but we will get to a point where the social and economic consequences of a prolonged recession become the greatest concern.

This will be no easy decision for politicians who require popular support to keep them in power in the short term but realise the need to sustain the economy to remain in power in the medium term.

The longer the lock-down continues the worse and the longer the recession is likely to be. Any recovery will be constrained by how well the virus is controlled, which, as we have discussed above, is likely to take years rather than months. Even if we do end the lock-down, it will have to be gradual, starting with key sectors, such as manufacturing and vital services, then progressing to small businesses and ultimately recreational services, such as restaurants, theatres and gyms. Either way it will be a slow process.

Once we start lifting the lock-down restrictions, the next factor will be the cumulative effect on the population and on businesses, and how long it will take them to recover. If the government cannot sustain the financial support for the community and for businesses due to an extended lock-down, then there will be catastrophic levels of unemployment and business closures, meaning it will take months if not years for the labour market to recover.

Even with continued government financial support, it will not be easy to get businesses back up and running, as they will be dependent on all links in their supply chain being operational. This will be far from the case, especially considering that many of their international suppliers will be in regions that are at different stages of the war against COVID-19 and may not yet be able to supply critical parts or services. Consumers will have depleted their nest eggs or expanded their debts, while surviving businesses will have lost profit and also will have increased their debt burden. This means that those projects and investments planned before the crisis will be abandoned or postponed, leading to a drop in overall business activity. Finally, banks will be more risk averse and will constrain lending or at least take longer to approve loans.

This pretty much counts out the possibility of a V-shaped recession, which requires a quick rebound. The same applies to a W-shaped recession, which again would require a quick rebound after the second dip.

Then we come to the larger economic consequences of the global Pandemic. Kristalina Georgieva, Head of the International Monetary Fund, said on 9th April, that the coronavirus Pandemic will turn global economic growth "sharply negative" this year and that 2021 would see only a partial recovery. She warned that emerging markets and developing countries would be hardest hit, requiring hundreds of billions of dollars in foreign aid. Ms Georgieva said that just 3 months ago predictions were that 160 of the 189 IMF member nations expected positive per capita income growth in 2020, but now this had been "turned on its head" with over 170 expected to experience negative per capita income growth this year. Earlier in the same week a UN study said that 81% of the world's workforce of 3.3. billion people had had their place of work fully or partly closed because of the outbreak.

There are also macro-factors such as the oil price, which has plummeted following Russia and OPEC's delayed negotiations to cut production. Even now that they have agreed a 13.4% cut in production it is unlikely to be enough, given the 25% drop in demand. Sustained low oil prices will inflict serious damage on countries such as Iraq and Iran, which rely on their oil revenues to sustain their economy. Add to this that the Arab states are predicted to be one of the worst hit regions with an 8.1% decline in working hours (equivalent to 5 million full time workers being unemployed) and we get a tinder box in the Middle East.

Looking at other regions, in the Eurozone, the north/south divide is reopening, with conflicts over who will absorb the main burden for rescuing the southern countries more severely afflicted by the pandemic. Could we be looking at a collapse of the Eurozone?

In the USA, though Trump doesn't want to admit it, all indications are that they too will be heading into recession as a result of COVID-19. Remember that when the USA sneezes, the world catches a cold; just imagine what will happen if the USA catches flu!

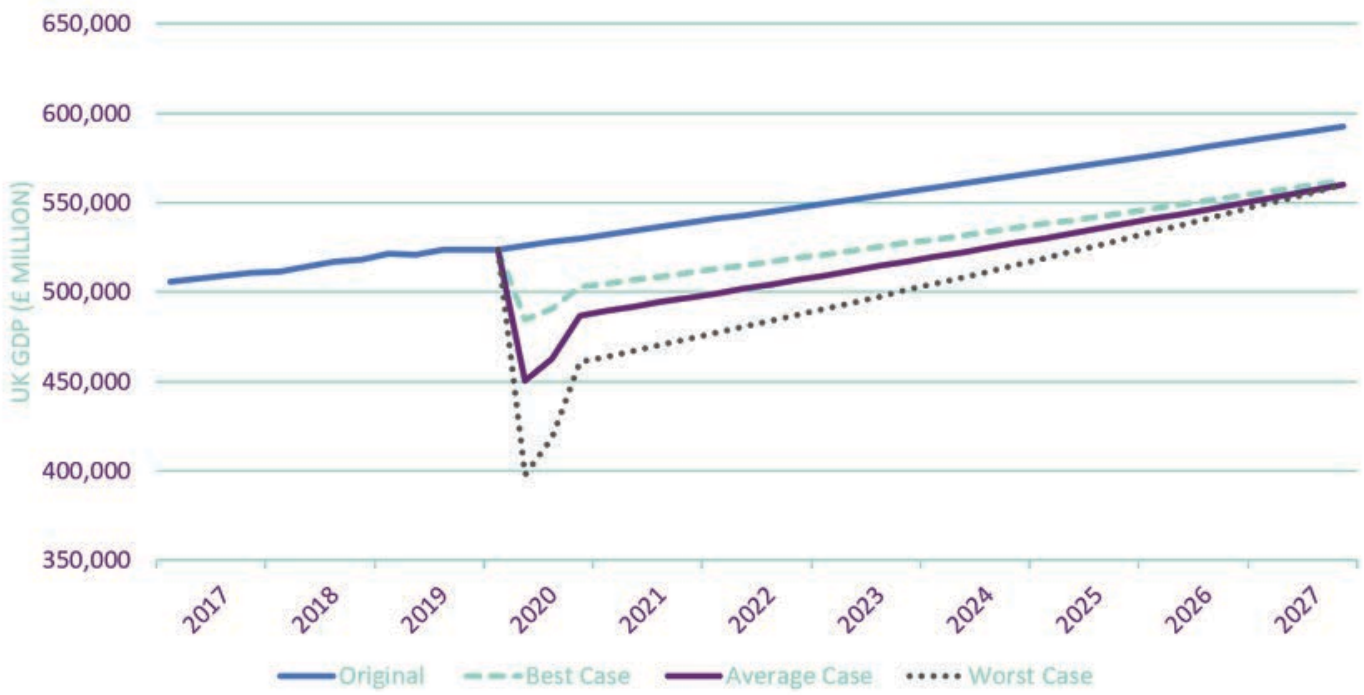
Even if most of what we are considering turns out to be a false alarm, a global recession is still looking inevitable along with all the regional and national consequences.

This leads us to the regrettable conclusion that a U-shaped recession or even an L-shaped recession are the only likely outcomes. Supporting this conclusion is a sequence of surveys conducted by Focus Economics, which found that economists from 75 institutions around the world now believe there will be a longer global recession because of the pandemic. According to their latest survey conducted on 15th April, of these economists only 20% polled V-Shape, while 65% polled U-Shape. This compares with 28% who polled V-Shape and 58% U-Shape 2 weeks earlier.

It is our belief that it will probably be a U-shaped recession in the longer term with a V-shaped partial recovery in late 2020, as we come out of full lock-down. The initial recovery will only be enough to partially offset the massive drop in GDP in Q2 and will still leave the economy operating well below pre-Q2 levels as we head into the prolonged global recession.

This will possibly look something like the graph below where GDP drops sharply in Q2 2020, partially recovers in the second half and then grows again at between 0.4 and 0.7% per quarter, i.e. between 1.6% and 2.8% per annum.

Predicted scenarios for UK GDP



- In the Best-Case scenario UK GDP drops by -7% in Q2 then rises to a total 2020 GDP fall of -3.6%. Subsequently it rises at 0.4% per quarter, which equates to 1.6% per annum

- In the Worst-Case scenario GDP drops by -24% in Q2 then rises to a total 2020 GDP fall of -12%. Subsequently it rises at 0.7% per quarter, which equates to 2.8% per annum.

- In the Average-Case scenario GDP drops by -14% in Q2 then rises to a total 2020 GDP fall of -7%. Subsequently it rises at 0.5% per quarter, which equates to 2.0% per annum.

The logic is that the further GDP falls the greater the recovery rate. This assumes that the basic infrastructure, resources and know-how remain to enable this recovery rate.

The conclusion from the above model is that GDP could return to pre-pandemic levels between 2023 and 2025, but this, in all honesty, is an educated guess.

In summary, the latest PMI scores and all other evidence is pointing towards a dramatic decline in Q2 GDP. Forecasts average a -14% drop in Q2 rising by the end of the year to an annual GDP fall of -7% for 2020. We examined the various types of recession and concluded that we are probably looking at a V-Shaped phase in mid-2020 followed by a prolonged (U-Shaped) recession. We then developed this into a COVID-19 Forecast Model, with Best, Worst and Average-Case scenarios.

In Section 2 of this report we will examine the impact of the 2008 Great Recession on employment in the UK Haulage Sector. We will draw inferences from this that we can then apply in the final Section 3, to predict how our COVID-19 Average-Case scenario might affect the UK Haulage Sector.