Covid-19 and the Greater Manchester Economy - Implications for the GMSF

Nicol Economics, August 2020

Introduction

1.1 This note responds to a request by the Greater Manchester Combined Authority (GMCA) to review the implications of the potential economic impacts of Covid-19 on the growth options for the Greater Manchester (GM) economy.

1.2 The specific question this note addresses is whether there is **sufficient certainty/evidence currently available in respect of the impacts of Covid-19** to enable the GMCA to **define a "reasonable alternative" growth option** to those that are currently being used for assessment against the Greater Manchester Strategic Framework (GMSF) vision and objectives.

1.3 The GMSF is a 17 year plan that looks forward from 2020 to 2037. The three growth options that are being used for assessment at present are:

- Growth Option 1: "*Business as usual*" which is based on growth that is consistent with the assessed 2019 baseline housing and employment land supply. The rate of housing growth is assessed by the GMCA as 165,550 over the Plan period, which is 7% below that of Option 2.
- Growth Option 2: "*Meeting assessed needs*", namely GM's Local Housing Need[1] and the assessed need for employment land (based on the employment forecasts and an allowance for replacement demand[2]). This is the Objectively Assessed Need (OAN) option. The relationship between housing, population and employment growth is broadly consistent under this growth option.
- Growth Option 3: "*Higher than OAN Growth*". This scenario is for 227,000 homes in GM over the Plan period (or a rate of growth for housing of some 27% above the Option 2) plus the assessed concomitant extra employment land needed[3].

1.4 The assumed economic growth that underpinned Growth Option 2 was derived from an Accelerated Growth Scenario developed in 2019 (AGS 2019) using the Greater Manchester Forecasting Model (GMFM). This scenario was of course developed pre-Covid 19 and was also produced at a time of uncertainty over the impacts of Brexit. This is a deliberately ambitious scenario for the future path of the GM economy in terms of both jobs and GVA growth that aimed for economic growth above the baseline forecast produced by the GMFM[4].

[1] Based on the standard methodology which gives a figure of 178,092 dwellings over the 17 year Plan period or an average of 10,476 dwellings per annum

[2] Producing an assessed figure of 2,500,000 sqm of space for offices and 4,100,000 for industrial and warehousing uses

[3] This has been assessed by Nicol Economics as some 10% extra employment land compared to Option 2 for office uses and 7% for industrial and warehousing uses

[4] The rates of growth of employment for GM in the AGS 2019 scenario are slightly below that over that last 15 years prior to Covid-19; however GVA growth is forecast to be stronger than that historically.

Assessing the potential impacts of Covid-19

1.5 The economic impacts to date of Covid-19 have been of an unprecedented speed and severity. The causes of the economic impacts of the shock are complex, but are rooted in the way government and society have responded to the pandemic. It is therefore a **health-driven economic crisis** which makes it different in nature from all previous recessions certainly since the Second World War.

1.6 At the heart of questions addressed by this note is the question of uncertainty. It is difficult at present to derive a robust alternative growth scenario for the future path of the GM economy, its housing and employment land needs because there are at least five levels of uncertainty:

- Uncertainty 1: the medium term (1 to 4 years) path of the UK's economic recovery from Covid-19.
- Uncertainty 2: the longer term implications of Covid-19 (if any) for the growth path and potential of the UK economy as a whole.
- Uncertainty 3: the ensuing implications for the overall GM economy over the next 17 years.
- Uncertainty 4: the sectoral and land-use implications, particularly for sectors that drive demand for employment land in GM.
- Uncertainty 5: the potential implications for housing need and population change.

1.7 We review in brief the emerging evidence of each of these forms of uncertainty below.

Uncertainty 1: the medium term path of the UK's economic recovery from Covid-19

1.8 As of August 2020, there remains a high degree of uncertainty about the speed and pace of the economic recovery from Covid-19, let alone what the final impact in 2020 will be. There have been a succession of assessments of the likely impact of Covid-19 on the UK economy by a range of private forecasting consultancy, research firms and think tanks such as the IFS and NIESR, and by the Bank of England[5] and by the OBR.

1.9 All those attempting any assessment of likely economy effects emphasise the **extraordinary level of uncertainty at present**. The normal forecasting tools and models are not well designed to assess a shock like Covid-19. This stems from the fact that this is health-driven economic shock which is unlike previous economic shocks (such as the 2008 Great Financial Crisis) so that we cannot simply apply the lessons from previous recessions. The OBR[6] summarises these uncertainties as being:

- The **course of the pandemic** and the development of effective vaccines and treatments
- The speed and consistency with which the Government can **lift public health restrictions** (ie "lockdown" measures)
- The response of **individuals and businesses** as it does so (in terms of consumer confidence etc), and
- The **effectiveness of the policy measures** put in place to protect viable businesses, foster new opportunities and sustain employment.

[5] See "*Monetary Policy Report*", Bank of England, August 2020

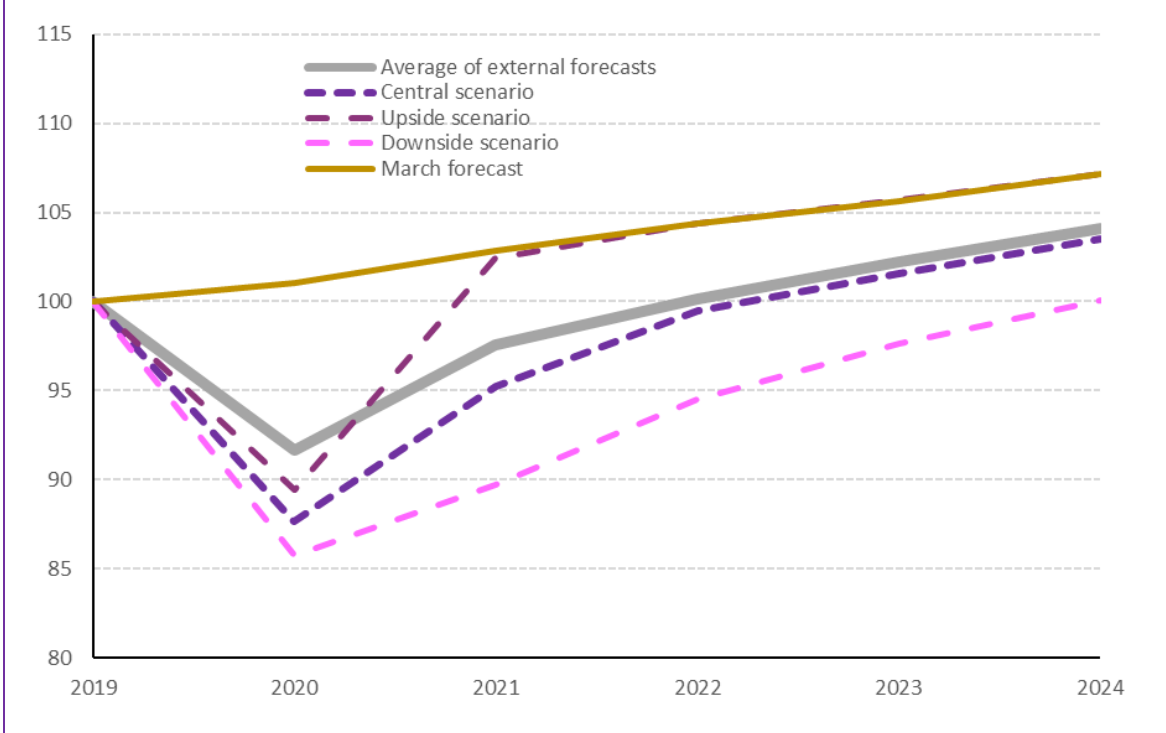
[6] See the "*Fiscal Sustainability Report*", Office for Budget Responsibility (OBR), July 2020

1.10 The OBR's July 2020 Fiscal Sustainability Report developed three scenarios for what the path of UK economic recovery might look like (upside, central and downside). They however noted: ""*these scenarios are intended to provide a plausible range of outcomes … but there is no good basis for forming a judgement as to their relative likelihood. In particular, we would not claim that the central scenario is the most likely of all possible outcomes. The upside scenario is probably about the best that can be hoped for, but even worse outcomes than the downside scenario are certainly possible*". The scenarios suggested that the overall fall in the UK's GDP in 2020 compared to 2019 could range from 11% to 14% and that the UK economy could take between 1 to 3 years to recover to 2019 levels (see Figure 1).

1.11 It is important to note that **data is emerging all the time** as to how consumers, business and the economy is responding, so forecasts and assessments are being constantly updated. The August 2020 Monetary Policy Report by the Bank of England had a central estimate that the UK economy will contract by 9.5% in 2020. This forecast fall is less than even the OBR's upside scenario and also considerably lower than the Bank's earlier "illustrative scenario" of a 14% fall produced in May 2020[7]. This shows how assessments are changing as data and evidence change whilst the impacts of Covid-19 unfold.

1.12 This uncertainty, if anything, worsens when considering the **medium term growth path** of the UK economy to 2024. The August 2020 Bank of England central forecast is that the level of output in the UK economy will not reach its pre-Covid-19 peak (in Q4 2019) until around the beginning of 2022. However their "fan charts" also show the high level of uncertainty about these estimates (see Figure 2) . The OBR scenarios suggest the UK could reach its pre Covid-19 peak in 2021 (upside), 2022 (central) and 2024 (downside). A similar pattern is apparent in the assessments by independent forecasters which vary widely at present.

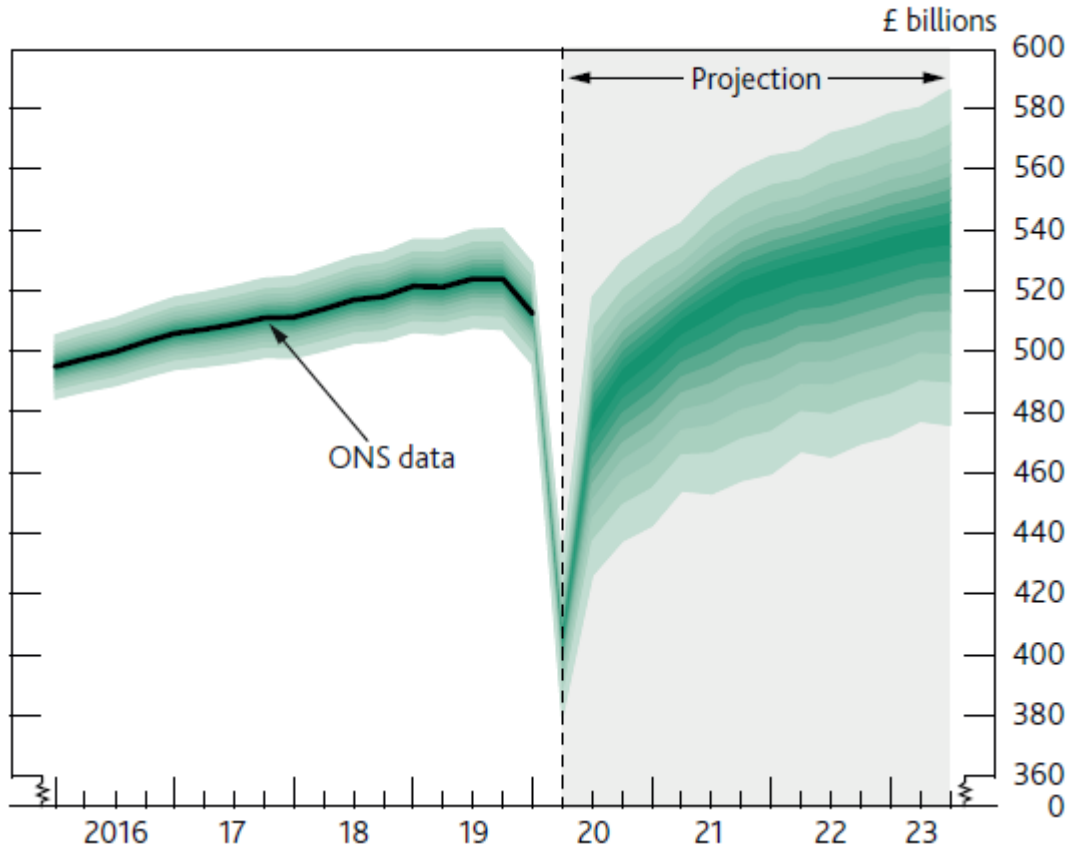
Figure 1: Scenarios for medium term path of UK economic output to 2024, 2019=100



Source: Fiscal Sustainability Report, OBR, July 2020

[7] "*Monetary Policy Report*", Bank of England, May 2020

Figure 2: Bank of England Forecasts for path of UK economic output, August 2020



Source: Monetary Policy Report, Bank of England, August 2020. Note: projection of the real level of quarterly UK GDP. The "fan chart" shows for instance that there is an assessed 1 in 4 probability is that by Q3 2023 actual real GDP is 4% of more below the central projection of £540 billion and a 1 in 4 probability that actual GDP is 4% higher than the central projection.

Uncertainty 2: the longer term implications for the growth path and potential of the UK economy as a whole

1.13 The GMSF is a long term plan. Therefore the growth of the UK economy to 2037, once it has recovered from Covid-19, is particularly important in providing a context to the GMSF. Inevitably there are fewer assessments of the longer term economic effects of Covid-19. There are potential downsides on the longer term growth performance which economists describe as "scarring" that arise from any sustained recession[8]. At present, the extent to which these scarring effects will occur and it what ways is very unclear (in part because they depend on the success of government counter measures to offset such effects).

[8] See the discussion in Bank of England, May 2020, Monetary Policy Report, in Section 3 "In focus the economic effects of Covid-19". These scarring effects could include: (1) reductions in business R&D and other investment (eg in workforce development) which is not recovered; (2) reductions in the rate of formation of new firms; (3) firm failures; (4) labour market effects as workers that are laid off could lose skills and become detached from the labour market.

1.14 The OBR, as part of their July 2020 Fiscal Sustainability report, considered the long term trajectory of productivity and the workforce for the UK (as this affects public finances). However, in July 2020 the OBR's long term assumptions about average UK productivity growth remained as it was pre-Covid (in March 2020[9]) at 1.5% with just 0.05% pa workforce growth contributing to an overall 1.5% pa real GDP growth.

Uncertainty 3: the ensuring implications for the overall GM economy over the next 17 years

1.15 As noted earlier, the AGS-2019 scenario for GM's economic growth was deliberately set at a level of growth that was stretching and ambitious for the economy. It aligned with growth ambitions for the North articulated in the NPIER refresh of 2019[10]. The strength of the AGS 2019 growth scenario reflected GM's strong contribution to this overall Northern Powerhouse growth. Such growth is of course consistent with the current government's stated ambition to "level up" across the UK. AGS 2019 was broadly in line with GM's historic rates of employment growth (but had more ambitious increases in productivity and so GVA growth see Table 1). The path for GM's jobs and productivity growth in AGS 2019 both exceeded the then baseline for the UK as a whole over the Plan period.

Table 1: GM's AGS 2019 growth path in context, annual average growth rates

Basis of forecast	2004-2018		2018-2037***		2020-2037***	
	Jobs	GVA	Jobs	GVA	Jobs	GVA
GM historic*	0.8%	1.5%				
GM AGS 2019-forecast			0.7%	2.4%	0.6%	2.4%
UK historic*	0.9%	1.6%				
UK baseline forecast 2019*			0.4%	1.5%	0.3%	1.3%
OBR long term UK assumptions**					0.05%	1.5%

*Notes: * sourced from GMFM provided by the GMCA; ** covers a period beyond 2024; *** two period shown as the period from 2018 was the period from when most data was forecasts, 2020 to 2037 in the Plan period*

[9] "*March 2020 Economic and fiscal outlook*", OBR

[10] The 2019 Northern Powerhouse Independent Economic Review transformational growth scenario (NPIER 2019)

1.16 Clearly, the wider UK and global economic context can and will impact on the growth path of the GM economy. The less positive are the prospects of UK economic growth to 2037, generally the less positive will be the prospects for the GM economy. The impact of Covid-19 will be to contract GM's economy and number of jobs during 2020 and lead to increase in unemployment during the latter half of 2020 and during 2021. However, given the wide range of uncertainty around the path of UK growth in the short, medium and longer term, there is no robust basis to develop an alternative growth scenario for the economy that is more likely than either of the current three growth scenarios.

1.17 We have considered whether it would be possible to, in effect, adjust the first few years of the AGS 2019 growth scenario (from 2020 to 2023 or 2024) to provide a revised starting point for the period of economic growth of the GM economy. This would have implications for the overall scale of growth over the whole Plan period. However, as the analysis above has shown, getting a reliable "fix" on this revised starting point for growth is nigh on impossible at present and would be guesswork.

1.18 Furthermore, the government has announced that it is committed to the levelling up agenda and to see substantial infrastructure investment continue and indeed accelerate to help this process. Such investment and actions by partners in GM may work to offset at a local level the potentially damaging impacts of Covid-19 on longer term economic growth.

1.19 We have also carried out a review of the available data that measures the relative impacts of Covid-19 on the GM as opposed to the UK economy. This is primarily from data on unemployment/claimant data and proportion of workers on the Covid Job Retention Scheme that was available by the end of July. This evidence suggests that, as would be expected given its size and diversity, that GM has fared broadly in line with the UK economy so far as the impacts of Covid-19 have unfolded.

Uncertainty 4: the sectoral and land-use implications for GM

1.20 The overall size of the GM economy and the number of jobs is one factor in driving demand for employment land. However, the demand for property and space is a derived demand that links to the scale, type and function of different economic activities and sectors of the economy.

1.21 During 2020, as the impacts of Covid-19 have unfolded, there have been some immediate short term trends that have emerged (or have been accelerated) that have been much noted and discussed[11]. These include:

- The acceleration of the previous trends that had seen a **major squeeze on physical retail (**whether high street or out of town). This is primarily as result of the acceleration of the use of internet shopping, a previously well-established trend.
- The associated increase in **demand for warehousing and logistics space**, which have also seen changes as a result of the need to increase supply chain resilience.

[11] See for instance: (1) **McKinsey Consulting** https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/a-global-view-of-how-consumer-behavior-is-changing-amid-covid-19; (2) Accenture "*How COVID-19 will permanently change consumer behavior Fast-changing consumer behaviors influence the **future** of the CPG industry*", April 2020; (3) "*The Future of Global Real Estate, Tipping Points, How climate, politics, demographics and technology are transforming real estate, The impact of Covid-19 on real estate*", **Savills** May 2020

- The potential **change in demand for office space,** or at least offices as configured today, as fewer people may travel in to work every day and more work from home in a flexible way. However, there is a complex relationship between different factors whose net effects are difficult to predict[12].
- The possible future increase **in re-shoring of manufacturing** activity as a result of concerns about excessive reliance on global supply chains with their inherent potential for disruption.

1.22 These factors are likely to change the relation between economic activity and the need for property and the location of property. However, it is still really early days into the pandemic. Although there have been widely reported comments on factors such as the future of the office, it is too early to be able to develop a robust basis for understanding what future patterns of remote working will be and their impact on office needs. Similarly, at a UK level the current effect of Covid-19 appears to have boosted demand for warehousing and logistics space, but it is not clear if this a temporary effect or will reflect a longer term growth trend[13].

Uncertainty 5: the implications for housing need and population change

1.23 The effects of Covid-19 on housing need, in contrast to the research on immediate economic effects, have not been subject to much consideration. Many of the underpinning demographic changes that drive housing need and demand are likely to remain unchanged and are driven by long term trends. Covid-19 may impact on household formation rates as a result of changes in household incomes and economic opportunities in the short term (associated with the rise in unemployed expected in 2021). However, equally the impact of Covid-19 may be to reduce somewhat house prices and so improve affordability levels.

1.24 As far as we are aware, there is no robust research on these possible implications. Furthermore most methods of projecting housing need are based on some extrapolation of past trends and data. There is certainly no data on any impacts of Covid-19 demographic effects (such as migration) and household formation. It will be some time before the actual effects of Covid 19 on household formation is apparent that will feed into household modelling tools (possible only after the 2021 Census data can be analysed in 2022).

Conclusions

1.25 At this moment in time, given the high degree of uncertainty that exists about future events and their implications for GM, we can only conclude that there is **quite clearly not sufficient certainty/evidence currently available** to inform a robust "reasonable alternative" growth option for purposes of the GMSF. We draw this conclusion due to the following factors:

- As of early August 2020, we are only five months into the period of intense economic and social impacts from Covid-19.
- Events continue to unfold and data to emerge on how the UK and GM economy is performing and what are the health, social and economic consequences of Covid-19.

[12] See for instance the assessment of the impact of remote working on overall office demand "*Remote Working The Potential Impact on Office Demand*", CBRE Econometric Advisors, July 2020

[13] As reported in "Big Shed Briefing" **Savills**, July 2020 and "UK Logistics & Industrial Regional Outlook, Summer 2020" **Cushman & Wakefield**

- There is an unusually wide range of uncertainty about the short to medium economic effects at a UK level and its recovery and growth path. It is also unclear whether Covid-19 will impact on the long term growth path of the UK and so the GM economy.
- There are also unfolding impacts on the relationship between the economy, consumer and business behaviour and property needs that will have land-use implications. However, it is not clear at present what the net effects will be and to what extent very recent effects will prove long lasting.
- Finally, the longer term implications of Covid-19, if any, on future housing need are not clear.