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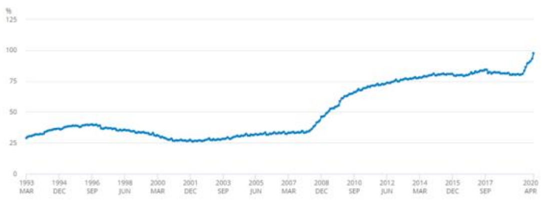
Market Insight | Business Investment Outlook: June 2020

Home truths for business in a post-COVID economy

As the nation emerges from its Covid-19 induced lockdown, business owners and their financial backers face several home truths about the fragile nature of the UK economy. David McClelland, Director of Carlton Strategy Advisors examines the business outlook:

ONS: Net Debt as a % of GDP (March'93 – April'20)



OBR: Export Market Share to Q4'23 (1998 = 100)

The UK's public sector debt level broke through its 15-year ceiling of 50% of GDP in May 2009, as a mark of the government's response to the financial crisis. In the following years – despite ultra-low interest rates, quantitative easing and austere public sector budgeting – debt went on to exceed 84% of GDP in Oct'17 before gently easing back to 80% in Feb'19. That the national debt burden took so long to stabilise, and witnessed such modest reduction, exemplifies the government's difficulty and response to the present CD19 crisis. Having promised to 'do what it takes' to increase demand with further monetary financing and business and salary support schemes, net debt is on course to breach 100% of GDP.

Rock bottom interest rates and low inflation ameliorate national indebtedness for now. However, should the global financial markets start to question the government's commitment to debt reduction – and QE programmes look to become permanent – international investors may refrain from keeping funds in sterling and inflation will become the greater concern.

The government faces something of a political 'cross-fire hurricane'; seeking to protect the demand side of the economic equation, but risking letting the inflationary 'rabbit out of the hat' – necessitating further doses of the brakes by way of publicly unpopular fiscal austerity and wealth taxation. All of which might be considered a 'normal day at the office', were it not for Brexit and the possibility of Britain reverting to WTO trade rules a time in world politics of rising international trade tensions and nation state protectionism.

This economic maelstrom risks creating deep, and potentially lasting, structural change in markets and across supply chains to which business leaders will have to adapt, if they are to survive and continue to prosper. Former assumptions about who and where – in what segments – their customer is will have to be revisited; vendor selection and procurement criteria will need to be re-evaluated and product/services pricing models will need to be re-set in order to appeal to a new customer pipeline.

Some business and market trends already appear most probable:

Economic outlook: As private sector investment remains stymied in the absence of returning market confidence, the UK economy is likely to experience prolonged depression and may face levels of permanent structural damage in its production capacity.

Inflation: For the time being, the financial markets will substantially endorse the government's commitment to debt stability, thus avoiding over reliance on central bank borrowing. Inflation will remain low as the crisis creates substantial spare capacity in the economy and consumer demand is subdued. However, as with 2008 QE, inflation may again manifest itself in asset prices rather than consumer prices.

Business investment: The UK corporate investment outlook will remain pessimistic, inhibiting discretionary capital expenditure intentions. Business revenues generated from sales of primary (major capex) goods and services will be replaced by revenues from secondary, operational items of expenditure (opex) such as spares, repairs and maintenance services.

Business re-engineering: Dislocated routes-to-market for goods and services will be slow to coalesce, as social physical distancing continues to disrupt transportation and logistics and new rules of trade are introduced. The trend towards the greater use of process automation and robotics within industry supply chains will accelerate.

Retail expenditure: Private sector unemployment will increase significantly as the government withdraws furlough and businesses reintroduce redundancy measures. Consumers will defer or postpone discretionary purchases over worries about job security. Expenditure on 'big ticket' items will fall in favour of value-item purchases. High street retail will see an accelerated loss of market share to online and out-of-town (safe-zone) click-and-collect.

UK demography: Almost one-third of the UK population lives in London and the southeast, which is predominantly urban and suburban. The historical population drift from rural to urban areas will slow. As the national market economy rebalances in line with an altered geographical footprint, this will impact patterns of demand in a wide range of business sectors ranging from the building and construction industry to the commuter transport sector as well as sectors which rely on high discretionary consumer spend which are traditionally more typical in urban areas.

Patterns of employment: Recruitment demand for permanent workers increases during periods of business stability; temporary recruitment fares better in times of uncertainty. In a wider economic recession, temporary agencies and their placements tend to be first hit and then first to recover. Public opinion will support increased spending on public services and infrastructure, including increased pay for public sector workers. A new, broader class of 'essential workers' amongst carers, cleaners and other personnel will be defined. National minimum wage levels may inflate. Remote, from home, working will become an accepted norm where possible – probably with a blend of onsite and home working becoming a common pattern.

Trade balance: The UK risks becoming economically insular. Sterling's decline in the aftermath of the 2016 Brexit vote raised import costs, but did little for overall export growth. UK exporters' share in the growth of trade within the markets to which it exports is forecast to continue to fall. Foreign direct investment is likely to decline as a consequence of the nation's reduced appeal as an EU portal. Although the CD19 induced disruption to cross-border 'just-in-time' supply chains may make 'reshoring' a more attractive option for indigenous business, the reverse outlook may be more relevant if foreign business owners and investors withdraw to non-UK landscapes; particularly in circumstances where markets are in over-supply and the consequent forces of industry consolidation combine with protective sovereign policies.

Ecology: Lockdown and the lack of economic activity caused by CD19 has led to reduced pollution, re-emerging wildlife and lower oil prices. It has also shown the size of the environmental challenge facing humanity. As the world returns to some form of normality after the pandemic new opportunities and markets will undoubtedly open and accelerate, with 'green' business investors finding themselves in possession of an 'extra string to their investment bow'.

For information about how Carlton Strategy Advisors can help you to assess business and market opportunity and attractiveness, please contact: David McClelland via carlton-advisors.co.uk

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