

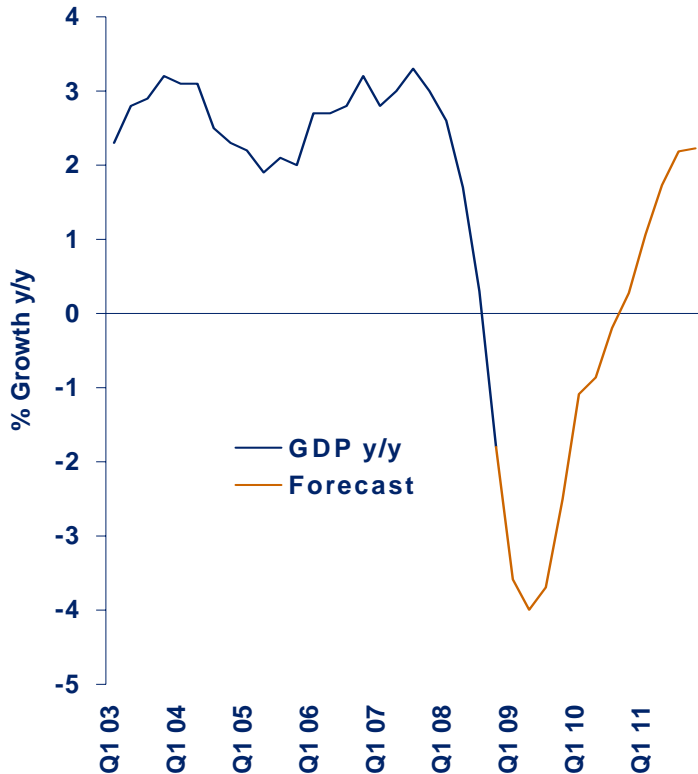
Sectors through the downturn – who's first out?

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Key Messages

- **Sectors facing non-discretionary demand will recover quickest, according to our analysis of previous UK recessions and recent equity market performance. This includes both primary producers and public sector suppliers.**
- **We expect manufacturing & industrials to recover more quickly than in previous recessions. Financial & business services is likely to perform relatively poorly, reflecting the presence of structural as well as cyclical headwinds.**

Background



Source: RBS Group Economics

- GDP is expected to contract until late 2010 (see chart). Even then, the recovery will be muted.
- The downturn will not be felt evenly across the economy – either in depth or duration. These slides focus on the latter and ask: what sectors will emerge from the recession first?
- To answer this, we look at two data sources:
 - Business activity in previous UK recessions
 - Equity market performance

Business activity in previous recessions

	Recessions		
	1970s	1980s	1990s
Agriculture	0	0	0
Health & Social Work	0	0	0
Education	0	0	0
Other services	NA	NA	1
Wholesale & Retail	3	4	4
Electricity, Gas & Water	1	4	0
Mining & Quarrying	4	3	1
Public Admin	7	1	0
Transport & Comm	6	3	3
Hotels & Rest.	3	3	7
Manufacturing	5	5	5
Fin. Intermediation	NA	NA	7
Real Estate	NA	NA	7
Construction	7	8	13
Total Economy (GVA)	3	5	5

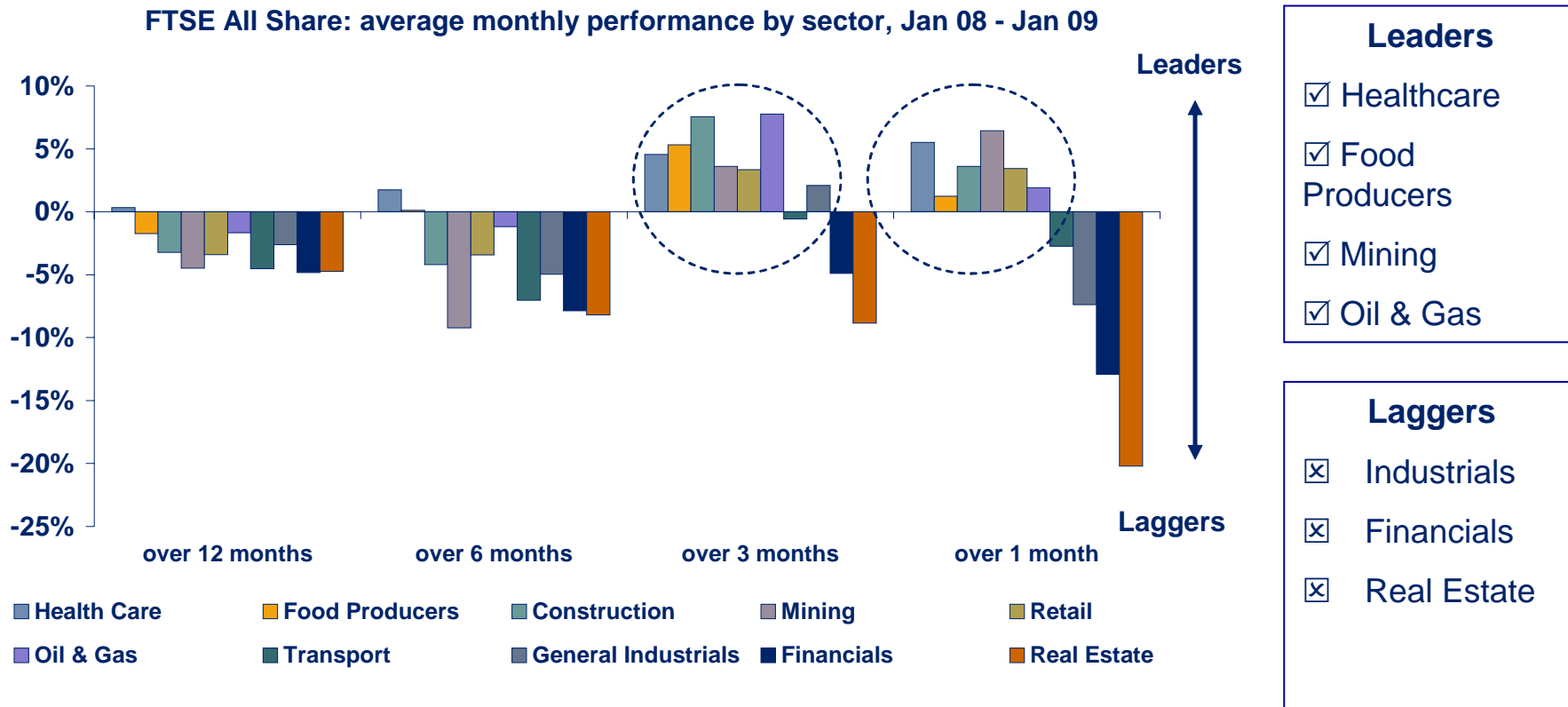
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- Primary producers and public sector industries tend to experience the shortest downturns, often avoiding them altogether.
- Manufacturing and construction are consistently hit hard, as have discretionary parts of the service sector (e.g. hotels & restaurants)

Note:

Chart shows length of contraction experienced by each sector (where data are available), in quarters, for the UK's three post-war recessions.

Equity market performance



On 12 month and 6 month performance measures, all FTSE sectors are down, with the (marginal) exception of healthcare. However, on 3 month and 1 month measures, a wide divergence between sectors emerges. We interpret those sectors whose performance has improved recently as reflecting equity market picks for those sectors likely to recover quickest, while those whose performance has continued to deteriorate as the likely laggards.

Putting it all together: who will be first out?

First Out....

- Agriculture / Food Producers
- Natural Resources / Oil & Gas
- Mining & Quarrying
- Public Administration, Education & Healthcare

Last out...

- Real Estate
- Financial Services
- Construction
- Manufacturing
- General Industrials

➤ Previous recessionary experience and current equity market trends are in broad agreement about the sectors that are likely to emerge first from the downturn.

➤ Those sectors that face non-discretionary demand experience the mildest downturn, and recover quickest. Differentiation within sectors is therefore important – e.g. in agriculture, basic producers are more insulated and quicker to recover than organic/luxury producers.

➤ Equity markets also agree with historical evidence on the likely laggards – with the notable exception of construction, whose shares have possibly been buoyed by the prospect of large government infrastructure projects.

➤ However, structural trends are different in this downturn – we expect manufacturing and industrials recover more quickly relative to the 1980s and 1990s.

Structural trends are different in this downturn

- In the 1980s and 1990s recessions, communications recovered quickly, and financial intermediation experienced a very mild, albeit protracted contraction. This was partly thanks to a long-term period of expansion driven by rapid technical innovation and deregulation.
- We think it unlikely that the regulatory environment will be favourable to a rapid rebound in financial services. A speedy recovery for communications would depend on a new round of technical innovation.
- By contrast, manufacturing experienced a very slow recovery in the 1970s and the severest contraction in all three recessions. This was partly due to the process of de-industrialisation, as activities where comparative advantage in production had been lost ceased, or were moved overseas.
- As the UK economy rebalances towards export and investment-led growth, and away from consumer spending, this long-term decline may not continue, and might even reverse. Sterling weakness will help. This may drive a speedier recovery in the manufacturing and general industrial sectors once recovery starts.

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