Covid-19 and the global economy

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June 2020

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Coronavirus and trade war dragging growth lower

Activity in the first half of 2020 will be terrible

Corona crisis

Global economy shutdown only two of the G20 economies stand a chance of growth in 2020

Second-round effects unemployment and unrest, sovereign debt defaults

Opportunity in the rebound economic structure and market share up for grabs, reskilling of workforce vs labour hysteresis

Don’t forget...

US-China trade war and broader tensions still here

Brexit still poses a big risk in Europe at the end of 2020

US presidential election crises usually help incumbents, but is Trump fumbling it?

China challenges: debt overhang, ageing, trade conflict, productivity

Crises bring change

Rollback of civil liberties: ok during corona, but what happens after?

Big state is back, factories requisitioned, companies nationalised, contracts ripped up: does this get unwound?

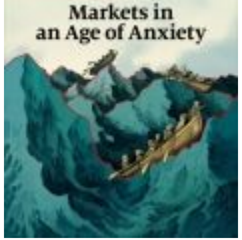
Nationalism reinforced, negative political trends get magnified

Is growth good? Norms for business and leisure rewritten

Source: The EIU

Growth numbers in 2020 looking meaningless

FWIW current global growth forecast -4.5%



Slowdown in the US and China was offset by stronger growth in some EMs, but coronavirus has taken away this recovery

Source: The EIU

(Real GDP growth rate)

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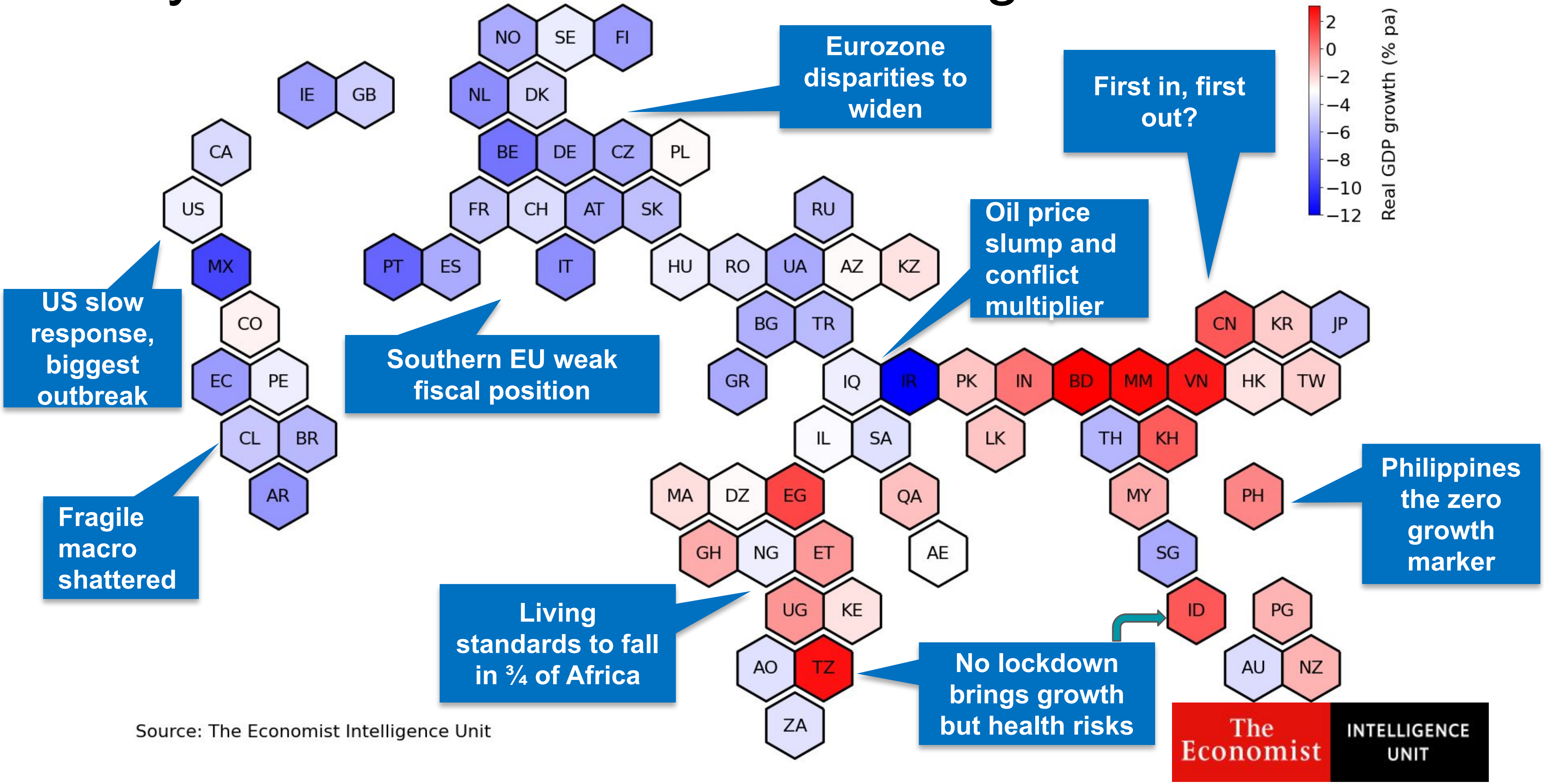
Only 2 of the G20 economies will grow in 2020



Source: The Economist Intelligence Unit

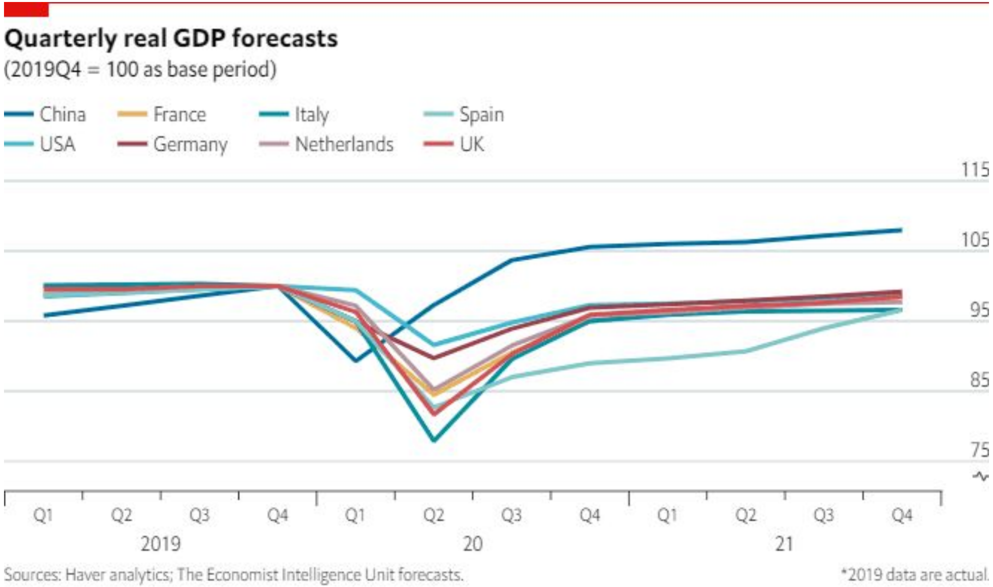
Recovery in US and China will beat Europe

In most countries GDP will not reach Q4 2019 levels until 2022 or later

Pay attention to data in levels and expressed in quarter-on-quarter terms: the usual annual figures will be hard to interpret

Factors that will affect recovery

- fiscal space and commitment
- monetary policy flexibility
- sectoral composition (distancing compatibility, pent-up demand industrial v services)
- timing of initial and subsequent lockdown measures
- export market exposure
- demographics
- Was lockdown time used to prepare the health system?



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US GDP will shrink by 4% in 2020 (Q2 -8%!)

Administration prioritising ending the shutdown rather than minimising deaths

Crisis often works to the benefit of incumbents, but Trump's re-election chances are reducing both with recession and poor handling of the crisis

Impact on different retail sectors

	Pre-pandemic health	Footfall* in April	Market demand estimates in 2020	Years to regain 2019 levels
Food and beverages	Fair	2%	-1%	1
Home improvement	Fair	8%	-3%	2
Household textiles	Poor	-94%	-8%	3
Consumer electronics	Good	-81%	-5%	2
Clothing	Bad	-98%	-12%	4

*Average of data in previous graph.
Sources: Placer.ai; The Economist Intelligence Unit.

US has around ⅓ of global deaths (high obesity, mobility, lot of big cities)

Existing trends of trade policy uncertainty and slowing global growth

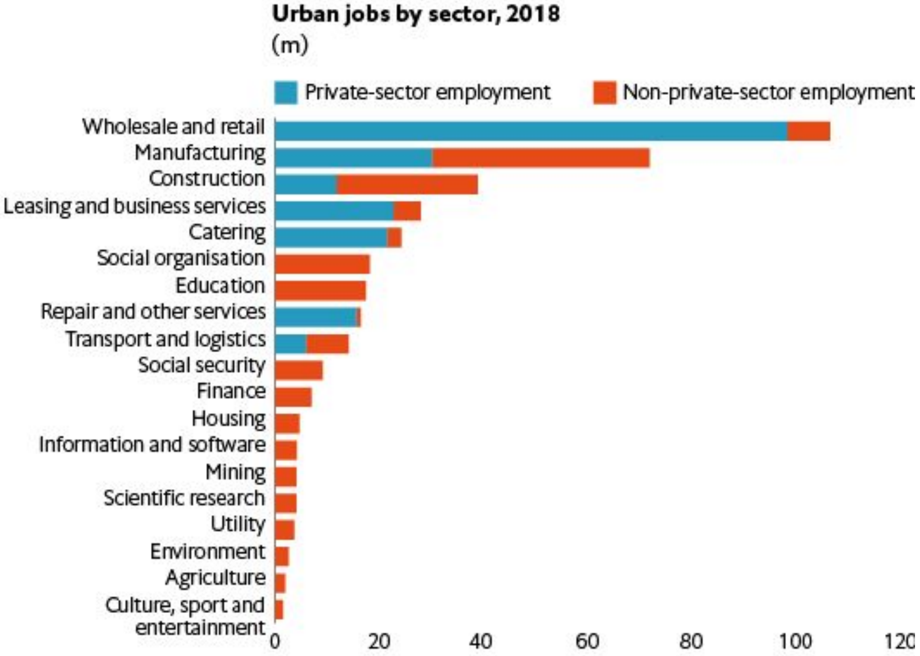
Investment boom was fading after tax cuts, now corona has pushed over a cliff, but stimulus has been agreed

US-China trade war or Iran/Korea tensions could come back as distraction for Trump's campaign

China slowly getting back to work

Unemployment is likely to hit 10%+, as migrant worker challenges intensify

Growth of even 1% will be a great outcome for China, could plausibly be below 0%



Note. Private sectors include businesses owned by individuals and self-employed; non-private sectors include state-owned, collectively owned, jointly owned, joint-stock, foreign-invested (including Hong Kong, Macau and Taiwan) companies.

Sources: National Bureau of Statistics; The Economist Intelligence Unit.

Fiscal deficit up by US$700bn to ~5.5% GDP, but this is only ~½ of fiscal boost in '08-09

Growth in Q1 was -11%, expect a +9% bounceback in Q2 but momentum will then fade towards year-end

If was China only, then rebound would have been strong in H2, but now demand impact from rest of the world looming

Exports have plummeted more than imports: smallest goods trade surplus in years in Q1 (oil price crash will reverse this in Q2)

Financial tensions as need for foreign capital growing, yet so is nationalism and state control

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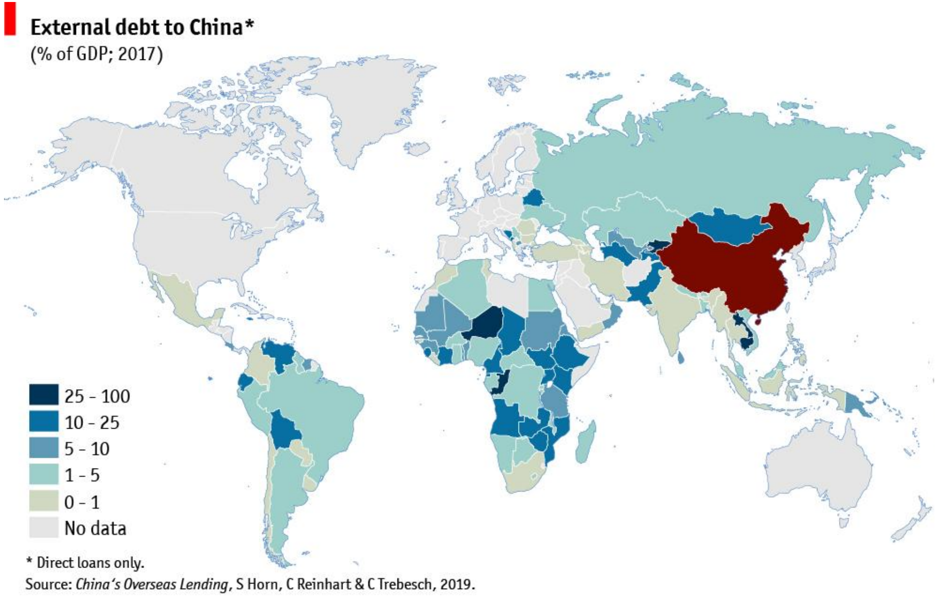
Eastern shift of power accelerates

Fear of and dependency on China will cause rising tensions and impose costs

US standing severely undermined, and managing China becomes its key challenge, and US-China decoupling intensifying



Imbalances of economic and political power generate tension: eg Russia, Iran cf EU, Japan, China

China on a reputational campaign but facing a backlash, esp in Europe and ANZ

More protectionism and trade restrictions, incl in services, supply chain moves

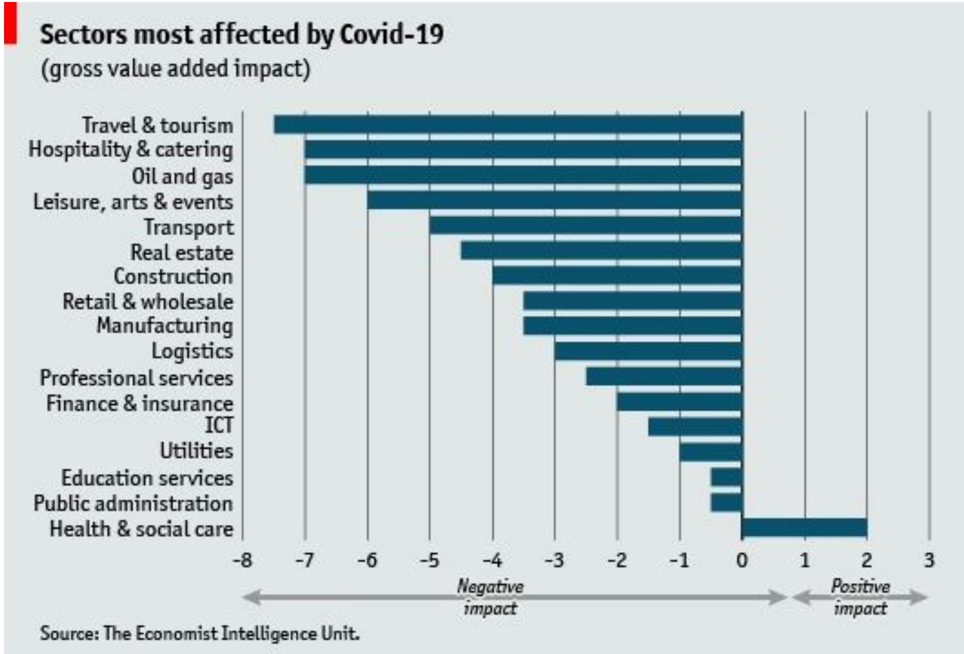
China learning that geopolitical reach comes with costs and it has institutional weakness+tricky domestic social contract

Unravelling of pre-1990 order creating tensions in the western camp, allies reducing US reliance

Industry struggles

Almost everyone is having it tough, but big differences between sectors exist

Pre-existing trends accelerated: industry and supply chains now a national security as well as an economic issue



Need to distinguish between

transitory disruption:

- Supply chain woes
- Demand collapse
- Temporary behavior change

and structural factors:

- Social change
- Behavioral innovation

Covid will mean big changes for business

Get used to it! We don't expect a vaccine until the end of 2021

Firms will have to live with distancing measures for at least 2 years, and these will be periodically tightened with further waves of infection

Space it out Automation and e-business will accelerate, high-contact business will have to adapt to personal spacing, remote working to continue with => on tech spend and office space

Mental preparation Employees will need new skills (tech/automation)

Masked crusaders Masks and other PPE will need to be normalised, demand will grow, and health context will be key for employee retention

Resilience Just-in-time supply chains will be re-optimised to account for risk

Cash is king Severe cashflow recession, credit lines and government financing key to survival for many

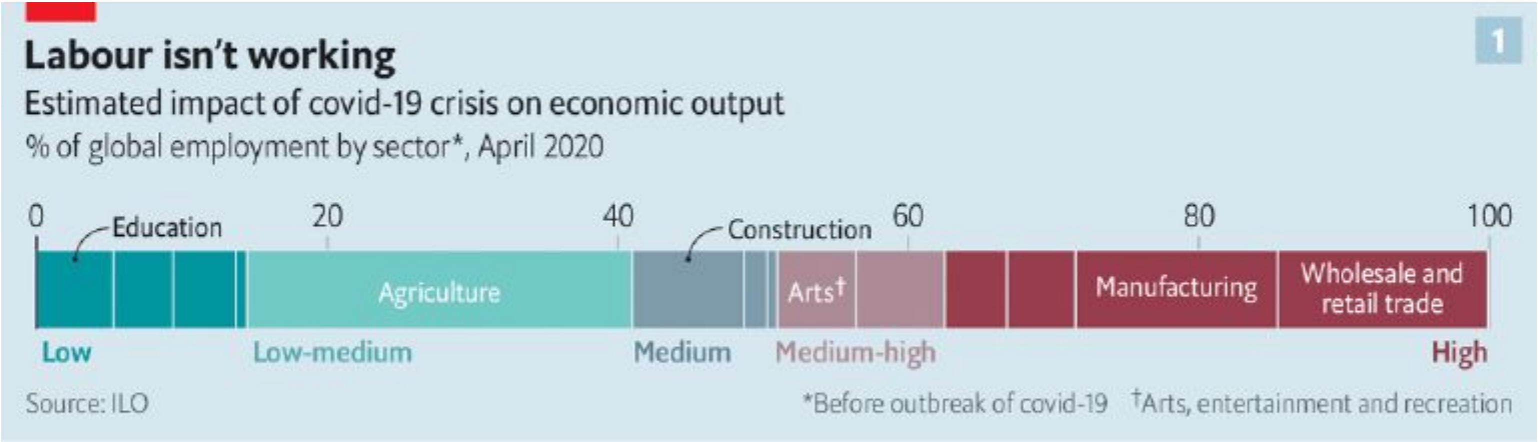
The payback With so much government money going to firms, the state will take and the public will expect more control

Surveillance will be a difficult balance: govts will demand data-sharing and tracking, employees will want to feel safe, but customers might object with privacy concerns

Jobs are going and will only come back slowly

Automation and distancing measures to cut labour-intensity across the board

Instability risk if fiscal capacity weak and sectoral exposure high (eg tourism, garments)



Emerging economies cannot lockdown as completely as no way to support informal workers: for the young and poor, getting covid-19 seems better than indefinite income loss, hence weak lockdown in eg ID, TZ

The young in rich countries will stay in education for longer, and re-skilling will also be needed for places reliant on tourism and other hard-hit industries

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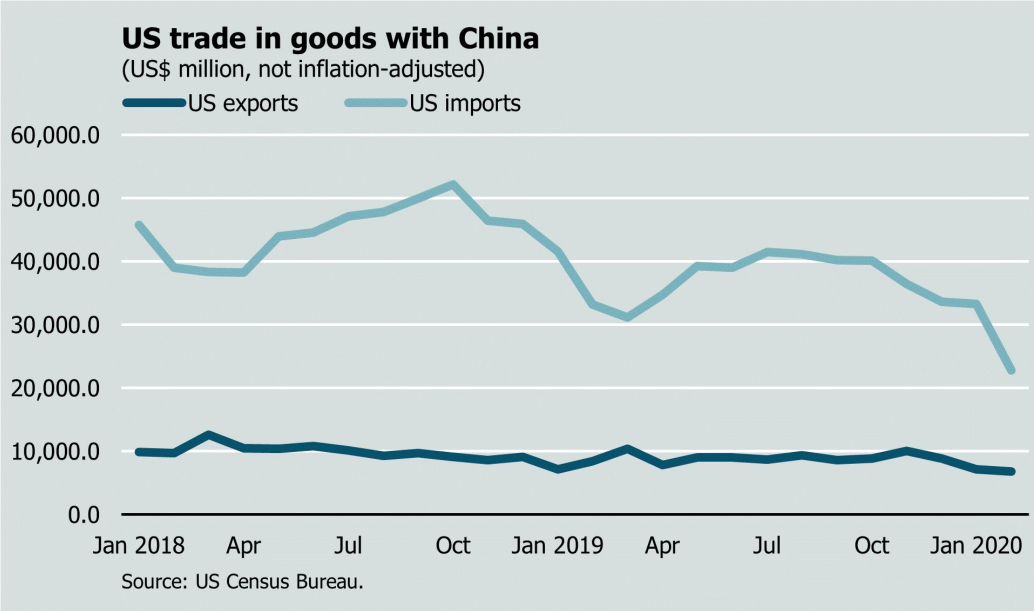
Global trade to shrink by almost 25% this year

Covid-19 will exacerbate existing protectionist trends and trade tensions

China won’t meet its trade deal purchase target, but its trade surplus with the US will fall



Trade financing has become more expensive, and cargo capacity has reduced

Further supply shocks could occur eg south-east Asia which initially saw increased trade from China diversion

Oil exporters facing huge adjustment but others lower import bills and transport costs

China’s weak imports mean it won’t save the world this time

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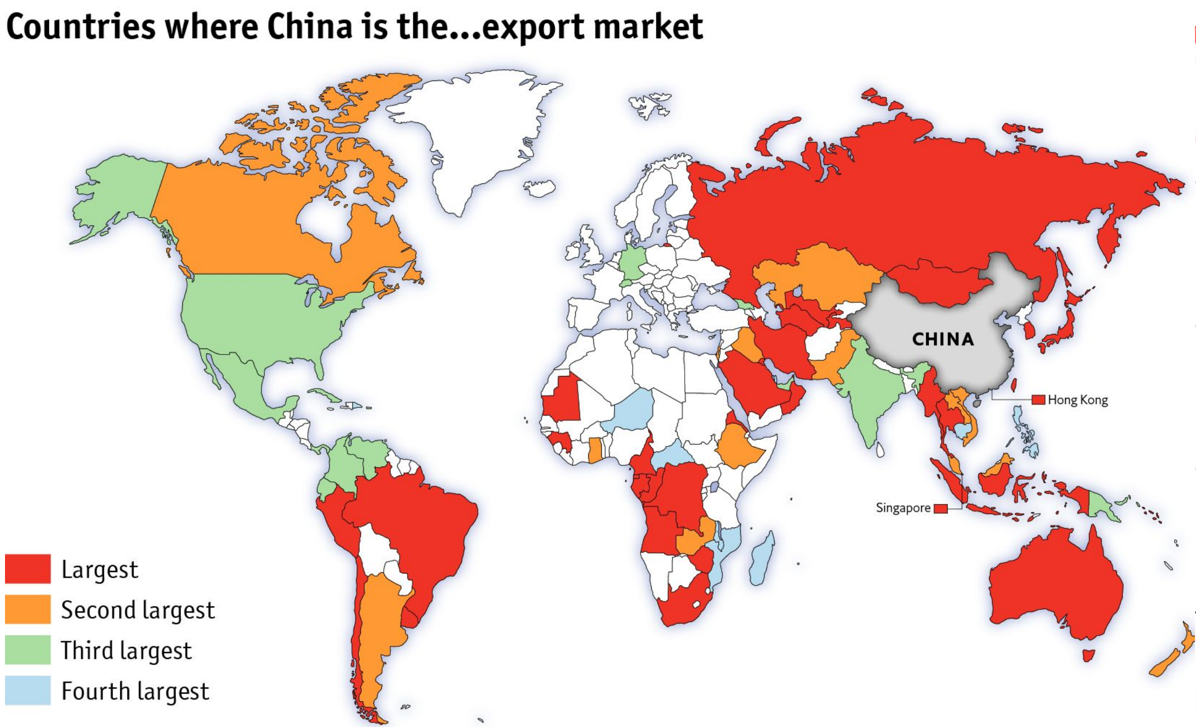
China's trade dominance is extending

This huge market brings opportunities, but concentration carries risks



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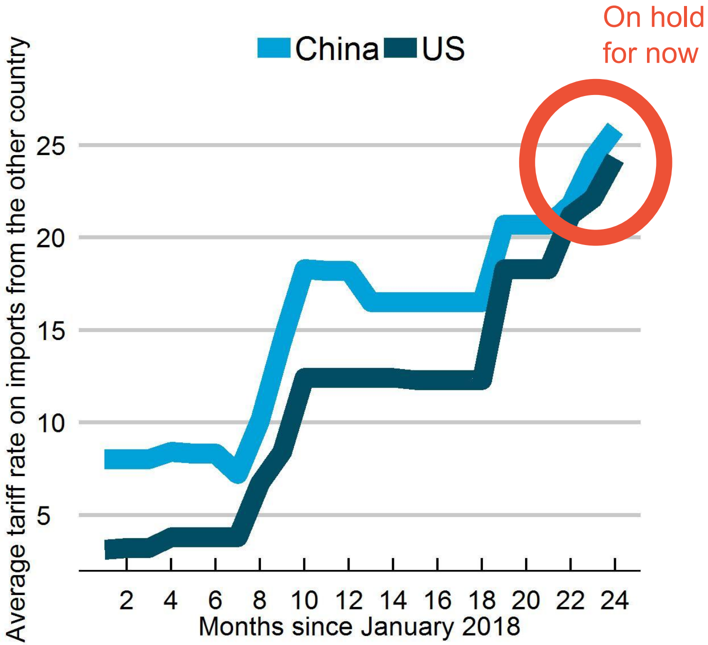
US-China average tariffs heading towards 25%

The underlying battle over technology will move to the forefront

Slight easing in tensions, but a substantive agreement still out of reach



Source: Chad Bown, PIIE

China moves: unreliable entity list, currency depreciation, offload Treasuries, make life tougher for US firms

US moves: International Emergency Economic Powers Act, financial sanctions (i) on investment (ii) on Chinese banks, Huawei ban

The USMCA: still not ratified, autos from EU and Japan at risk: auto tariffs would signal a global trade war, but likely just a negotiation tactic for free-trade agreements

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Supply chains are stressed and (slowly) changing

Risk-resilience calculation is altered, but there are limits to diversification

Things change fast: exposure to China has switched from risk to protection

Internationalisation of supply chains has bought huge efficiency gains and rising living standards, and profits, and this won’t unwind

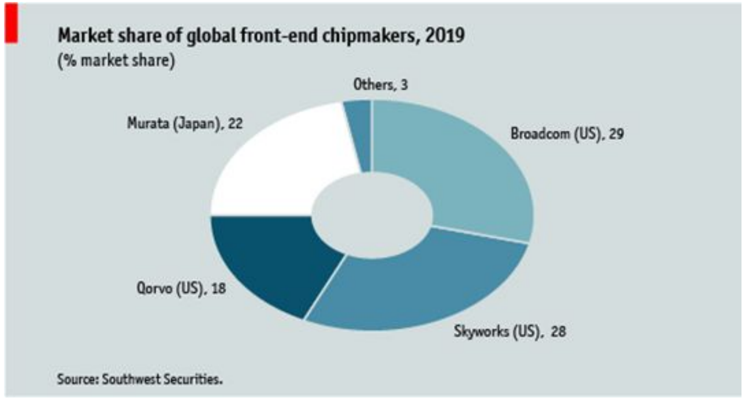
But internationalisation was already slowing, and covid-19 will accelerate that

Tech illustrates the complexity and fragility of supply chains: specialisation cannot be easily unwound and labour:capital ratios differ hugely by production stage

Hole blown in India’s plan to be manufacturing hub by supply chain collapse, strength of Singapore and China emphasised

Huawei Mate 20 5G Parts Breakdown

Country	Components	Component types
China	7	Power chips, WiFi module, chipset
US	4	Semiconductors, DRAM
Japan	2	Camera, Flash memory
South Korea	2	OLED display, DRAM
Taiwan	2	Printed circuit board, body panel
Hong Kong	1	Battery
Netherlands	1	Near-field communication (NFC, contactless) controller



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The big foreign investors have been hit hard

M&A opps likely to come in hard-hit countries with weak fiscal position

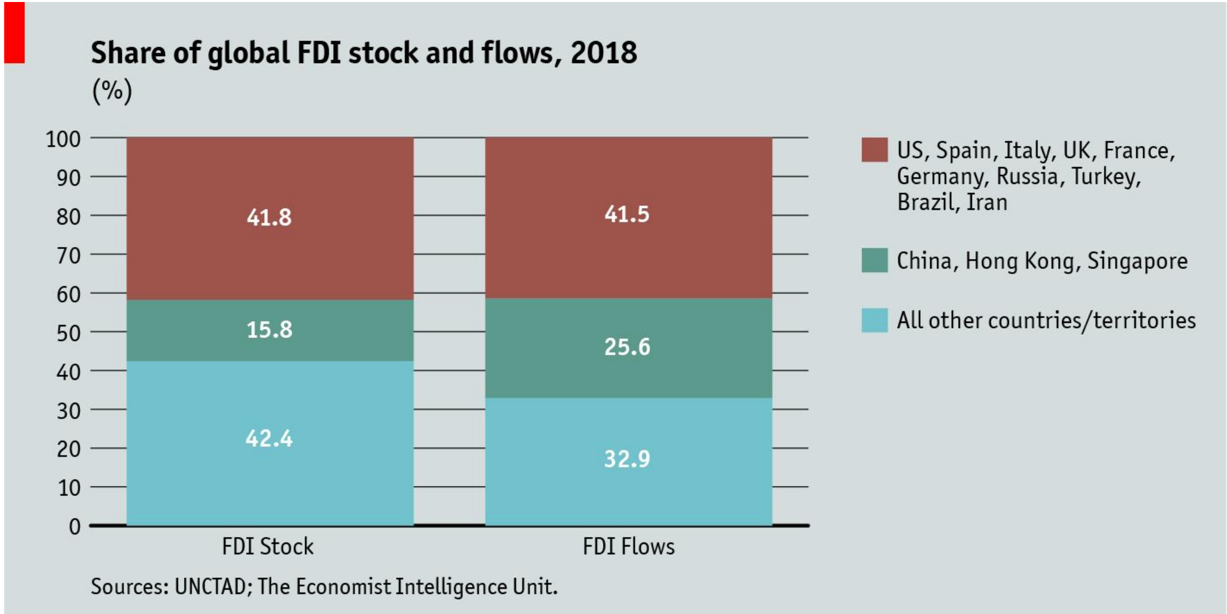
FDI has high upfront costs and a narrow window for exit, so uncertainty bites hard

No bright spot even in medical industries due to rising nationalism, everything now ‘strategic’

For companies with cash (eg Japan) could be M&A opps, but valuations still fairly high (inc. for Buffett)

Political scrutiny of foreign deals will increase, but fall for domestic M&A

Some tailwind from need to diversify supply chains but results in higher costs



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Monetary and fiscal measures are huge

But this is different from previous crises

Spending can put a floor under most economies for now

Interest rates are already at zero and the financial system is in pretty good shape, so monetary policy largely for liquidity

Short-term: more demand doesn't help if you can't spend and supply is disrupted

Medium term: huge drag from persistent unemployment will contain inflation but demand recovery will depend on fiscal strength

Debt burdens can be manageable with productivity growth, workforce growth and (for local currency debt) inflation; asset sales or capital levies may be another option

Sovereign debt crises already happening (Ecuador, Lebanon), but not yet in systemic countries...worry about Italy and Turkey

Markets are funding fiscal deficits for now, this mostly comes from Japan and Germany so watch attitudes there

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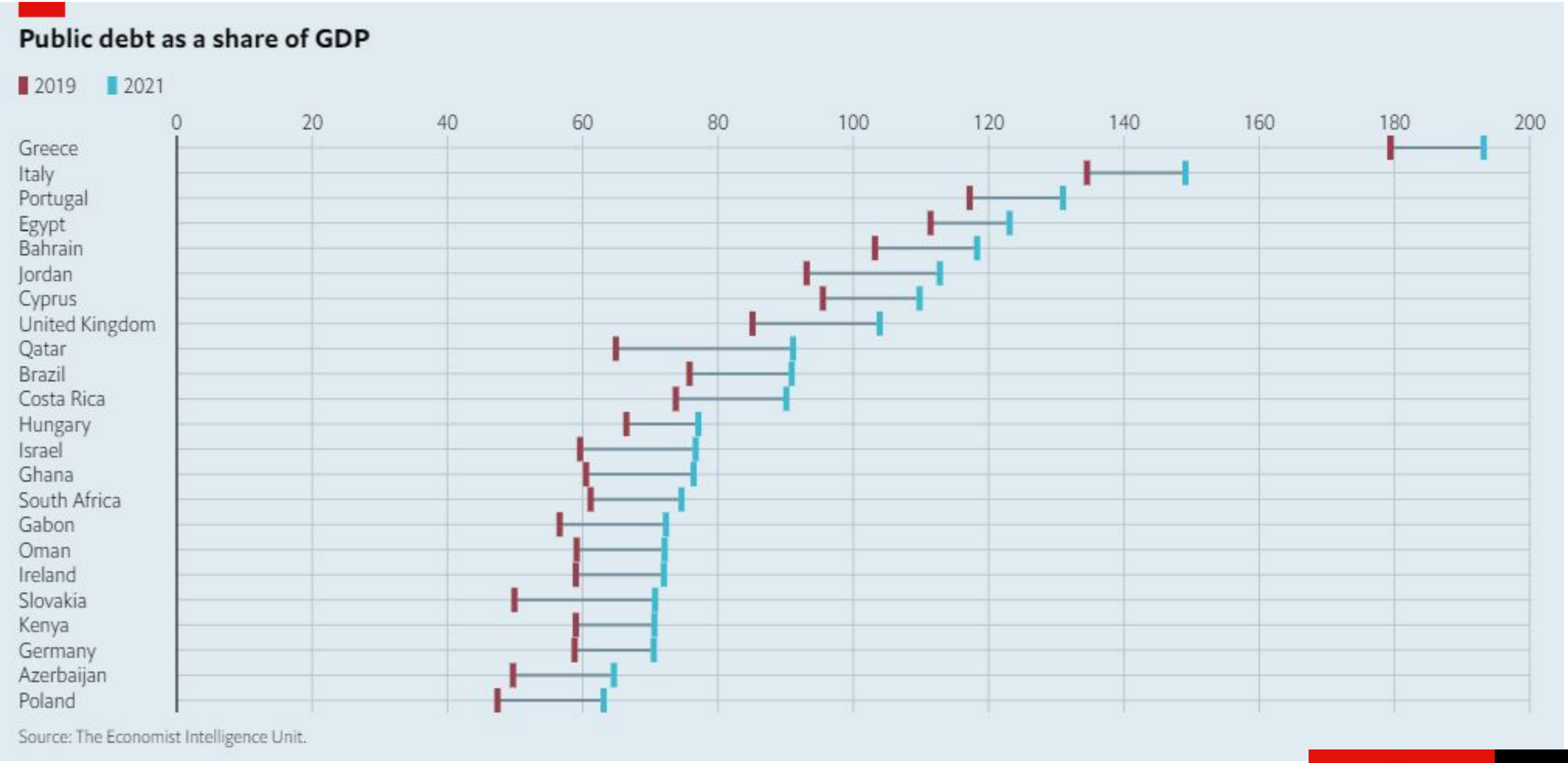
Debt levels will increase markedly

US and UK debt will go from ~80% of GDP in 2019 to over 100% by 2021



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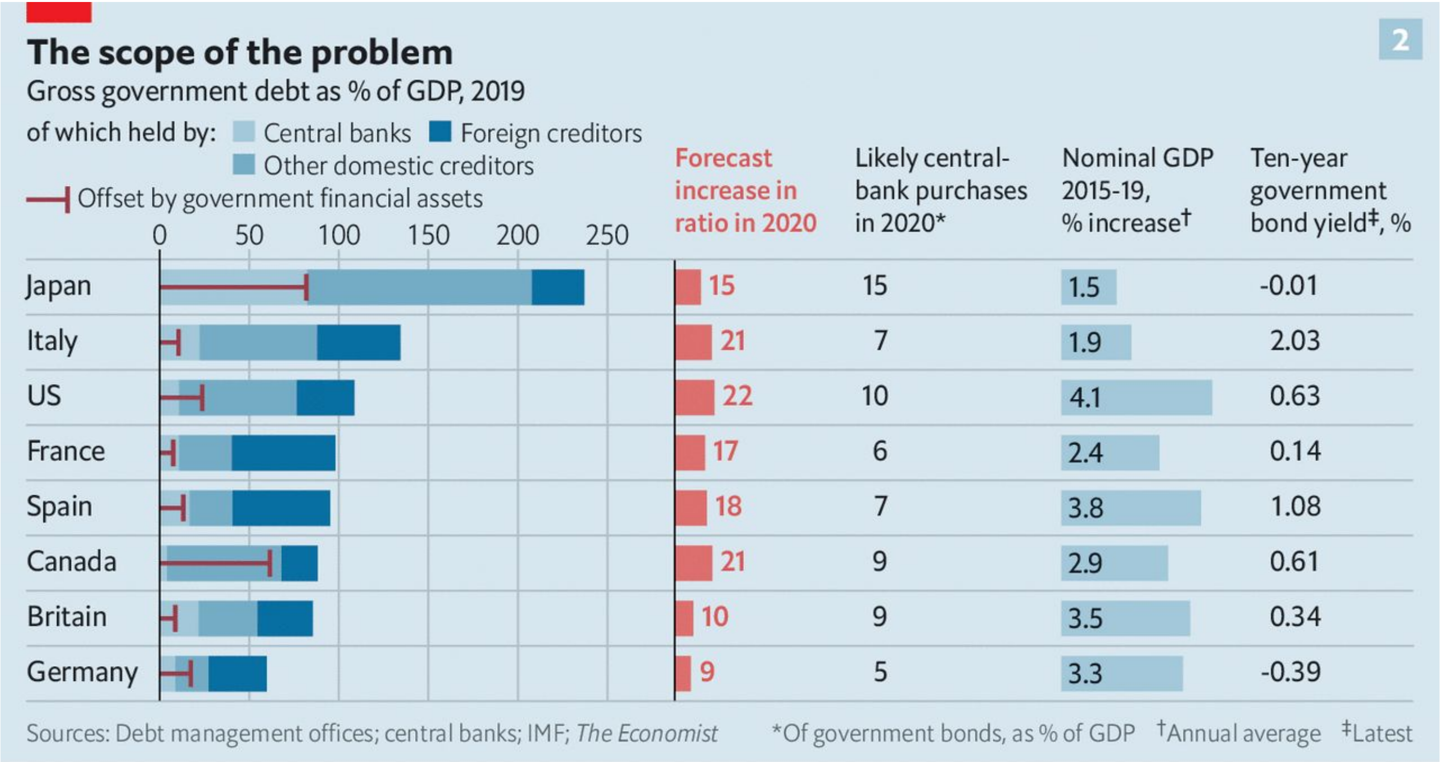
Italy the developed world's financial weak spot

Interest rates are low so, if investor confidence retained, debts are serviceable



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Higher education impact as yet unclear

Remote delivery trend will accelerate, and new research themes will emerge

Country fiscal state, domestic v foreign student balance, and sectoral mix drive impact

Negative factors

Loss of fee income as institutions close

International student movement collapse

Endowments shrink

Positive factors

Unemployment and fewer service sector jobs encourages people to stay in education

Jobs in healthcare and tech require more qualifications

Footing the bill

Distribution of public and private expenditure on educational institutions (2016)

Source: The Economist 1843 (2017)

Heat map for higher education prospects

Some initial thoughts on factors that might help or hinder the sector's recovery

	US	UK	AU	CN	IN	VN	DE	JP	CA	BR
Net international student movement (1=receiver, 0=source)	1	1	1	0	0	0	1	1	1	0
Tech readiness (EIU ranking, 1=best)	4	20	1	32	42	65	4	4	15	47
Fiscal pulse (% of GDP, 2019 to 2020)	9.4	12	7	1.2	2.4	4.1	7.6	4.3	6.6	6.1
Private consumption growth (2020 % pa)	-4.5	-12.3	-4.1	+1.2	-1.5	+3	-3.3	-4.6	-3.4	-5.4
Covid response quality (1=best)	3	3	1	2	3	1	1	2	2	4

Any questions?

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