CoVid-19: the infection that put Globalization in «Intensive Care»
The need for Crisis Managers NOW to prepare the return to "Normal"

The global economy is in a long growth cycle since the 2009 financial crisis. The end of the bull-run was already in the cards. The SARS-CoV-2 virus put the world economy in a tailspin, whereby linked CoVid-19 infection set ¾ of global GDP in quarantine. The consequences are a deep crisis in both health- and financial systems and like in 2008, the epicenter is in New York...
Will we still have a globalized economy and integrated supply chains, once this crisis is over?
The need for experienced Crisis Managers tomorrow is as high as for Virologists today…!

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End of the Cycle! End of an Era?

It all started with a June 2015 campaign for the election of a new president in the largest democratic economy of an integrated world.

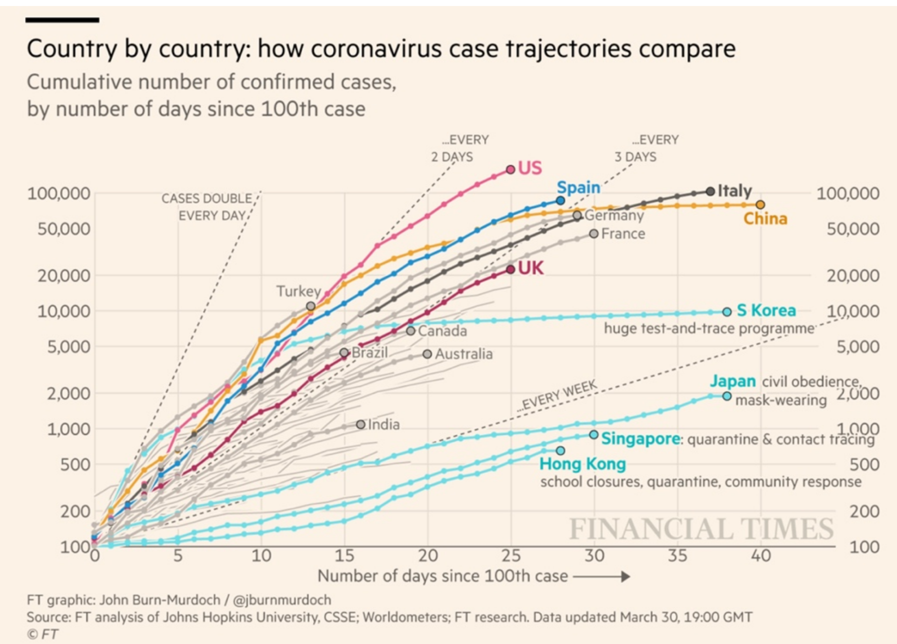
The campaign slogan of the winning candidate has started a chain of events that now threatens globalization and multinational integration as we know it.

The 3½ years under the current US administration are characterized by reducing international cooperation, dismantling multilateralism, the imposition of tariffs on global trade, and attacks on ethnic and economic structures.

For the first time since the 2nd world war, policies are introduced to reduce international cooperation, and limit the free movement of people. A scary change.

This political positioning triggered "the beginning of the end" i.e. the final phase for the longest economic expansion cycle that began after the 2008-09 financial crisis.

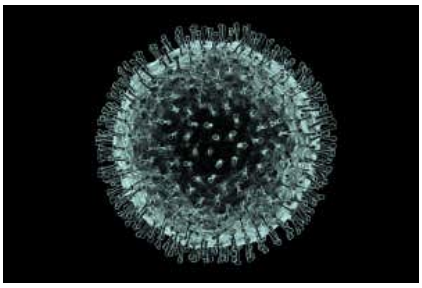
Indeed, 12 years continued high economic growth, good corporate profits and high stock exchange gains is exceptional, a first since the golden age in the 1950's and 60's.



Whilst the dust seemed to have settled by the end of 2019 both on trade tensions (mainly US-China), and on agony over migration in the US's (focused on Latinos) and on the European southern borders (focused on Muslims), a totally new crisis emerged.

The black swan: SARS-CoV-2

CoVid-19 is caused by a new variation on a known virus: Corona, significantly the same protein sequence as the 2002 SARS epidemic, but with a twist…. the virus



is highly contagious 2-3 days *before* any symptoms are visible.

The virus that causes CoVid-19, began its voyage as a very localized new issue in Wuhan (where conspiracy-theorists point out there is also a large Chinese military complex).

Due to the invisible transmission mechanism SARS-CoV-2 spreads exponentially. Asian countries fell back on their 2002 SARS experience, and even though CoVid-19 caused over 3200 deaths in China alone, the curve of new infections flattened a month after the initial outbreak (see graph).

Unfortunately, pandora was out of the box, and corona started to spread in Northern Italy. Thanks to "the ski season" in the Alps, it spread throughout Europe and the Western world in 3 weeks.

By early April, the number of global "confirmed" infections reaches 1 mln, and from the graphs it is obvious that the peak has not been reached.

The epicenter of the Corona crisis moved from Wuhan (China) to Bergamo (Italy) and now to New York (USA), where the 2008-09 financial crisis was also centered.

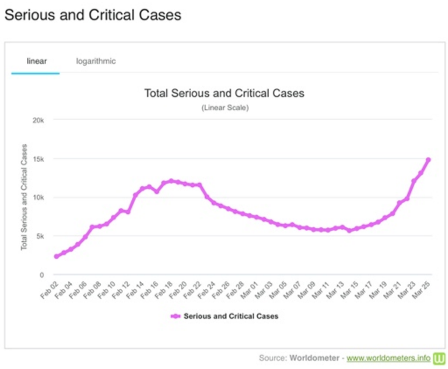
The virus is highly infectious but has a rather low mortality rate (around 3% of confirmed cases overall), provided that sufficient medical support structures are available. Over 5% of infected patients need ICU-care with Oxygen ventilators.

AGE	DEATH RATE confirmed cases	DEATH RATE all cases
80+ years old	21.9%	14.8%
70-79 years old		8.0%
60-69 years old		3.6%
50-59 years old		1.3%
40-49 years old		0.4%
30-39 years old		0.2%
20-29 years old		0.2%
10-19 years old		0.2%
0-9 years old		no fatalities

But when these medical facilities collapse (as it happened in Northern Italy and Spain), the mortality shoots to 10%.

Based on the demographic disaster in Norther Italy (a whole generation died in 2 weeks), on Friday 13th march (!?!), European countries (but not the UK) started to implement lock-down measures, and US banned travelers from the Europe (but not from UK).

Individual freedom has been taken away in an unprecedented way, without much protest. How-



ever, the stock market collapsed.

Late March, very few people are focusing on infection rates in Emerging markets (Latin America and Africa), where the disciplined respect of isolation protocols is not obvious, and where medical facilities are absent or scarce…

A series of new "Bergamo's" are in the making. Imagine Mexico City with 25 mln of habitants and 300 ICU beds, …

The next victim: global trade…

Most Asian and Western countries have now implemented more-or-less strict local-down protocols, from cancellation of large-scale public events, to social distancing and closure of retail spaces to slow down the spread of the virus.

Some countries delayed the lock-down (i.e. choosing to reduce economic cost over containment) and followed a strategy of group immunity. This choice was reversed 10 days later as the medical system became strained (UK, Netherlands, and more recently USA).

The economic cost: a 3-stage shock

1. <u>Supply shock</u>

Economists estimate that each month of lock-down in EU, USA and China would cost USD 320 bn in reduced international trade. The lock-down protocols in China in December 2019 sent an immediate supply side shock wave through world trade in 1Q2020.

By end March 2020, US trade and travel is quarantined. Estimates of lost international trade teach USD750bn for 2Q2020.

Millions of jobs across western economies are at risk. A record 10 mln Americans filed for unemployment support in the 2 weens- between 16th and end-March.

A quarter of the workforce in Belgium is in "technical unemployment", meaning that they are not able to reach their workplace or that the business they work has been forced to lock down. Other European countries have similar numbers.

2. <u>Financial Shock</u>

The MSCI world index of equities lost 30% of its value in 90 days, the biggest value destruction since the 2008-09 subprime crisis.

This destruction of wealth creates a liquidity issue in the both financial sector (investments) and at household level (saving and pension funds) and depending on the recuperation curve after the lifting of all measures, this may take years to be restored.

3. Demand shock

The necessary decision to confine households and the forced closure of non-essential businesses is creating a confinement-based shock.

Private consumption and investment decisions are put on hold, as ¾ of the global GDP is under some sort of lock-down.

This is creating 2nd and 3rd level side-effects, as the reactions to the confinement are collective and exponential.

Exceptional times need new measures

As the strength of multilateral institutions had already been weakened by previous crisis (2008-09, the EU debt- and migration crisis, and the distancing of the US administration), taking mitigating measures to reduce the triple shock waves has fallen on individual countries. Even the EU has not been able to come up with a coordinated approach of the health crisis.

Table 1: Cost of fiscal stimulus measures, impact on GDP growth and fiscal deficit

	Fiscal stimulus (EURbn)	Share of GDP	Impact on GDP growth (in pp)	Impact on fiscal balance (in pp)
Germany	150	5.0%	1.5	-3.9
France	45	2.0%	0.8	-1.3
Italy	25	1.4%	0.7	-0.9
Spain	18	1.4%	0.5	-1.1
UK	30	1.4%	0.6	-0.9
US	1000	4.6%	1.2	-4.1

Sources: Euler Hermes, Allianz Research

In China, authorities have been quick to reach with massive policy support initially totaling RMB 2.2Tn.

In Europe, the different governments have rolled out public guarantees, fiscal measures and emergency liquidity programs totaling around EUR 2Tn. The ECB enlarged the scope of its debt purchase program. In US, the White House announced a USD2Tn fiscal package.

But the US faces an unprecedented health crisis with its purchasing-power dependent structure of the health sector.

SARS-CoV-2 seems not to care whether someone has medical insurance…

Rebound?

2020 recession & 2021 recovery? U-shape or L-shape?

Wuhan had a 3-month head-start in dealing with CoVid-19. Looking back at the November-march economic data for China, the 3 months partial confinement created a 13% reduction in consumer spending, a 20% reduction in investments and a 16% reduction in exports.

Depending on the modeling, and confirmed by the fresh Singapore GDP data, each month of lock-down could create an approx. 10% reduction in quarterly GDP.

Suppose isolation works…

In the most optimistic scenario, the current lock-down that started half march could be lifted after the Easter holidays (mid-April), meaning a one month lock down.

However, given the fact that the CoVid-19 cases have not yet peaked in Europe (neither in number of infections and nor the number of deceased), it seems unlikely that the measures can be lifted.

Table 2: Growth elasticity to confinement

Real GDP growth	1 month of confinement	2 months of confinement
Eurozone	-1.8%	-4.4%
Germany	-1.8%	-5.0%
France	-1.3%	-3.1%
Italy	-3.5%	-6.0%
Spain	-0.8%	-3.8%

Source: Euler Hermes, Allianz Research

Realistically we can expect the current social- and economic lockdown to remain in full force to end-April, and a gradual recuperation of activity from May onwards, with an expected 80-90% normalization by June 2020.

The situation in USA could be worse, as the real spread of the virus is not clear at this stage, and the depth of the health crisis is just starting to unfold.

In this scenario, the trough could be reached in the 2Q2020 and real European GDP could be down -2% to -3% q/q.

The world economy is set for a violent recession in 1H2020 and the full-year world GDP growth could be between 0% and 1% (down from a previous estimate of 2.4% growth).

Assuming that the containment measures in Europe and in US are maintained and are successful in slowing the spread of the virus, a rebound of the economic activity could be expected in 2H2020, and a U-shaped recovery with a +1% q/q GDP correction in Europe becomes possible in 3Q.

However, the exit from the unavoidable recession will pose serious challenges for a wide range of companies. Overly indebted or poorly capitalized groups will suffer, as the losses in turnover in the trough of the crisis (-20% y/y) will be hard to compensate by year end.

Suppose isolation does not work…

In case the current lock-down protocols are not working, either because the people don't follow the instructions, or because the protocols are not strict enough, a darker scenario emerges: a 12-18 months sanitary crisis with possible reinfection.

This could mean that borders stay closed, and an intermittent domestic confinement would prevail.

Then an L-shaped recovery emerges: International Trade and supply lines disrupted, Equity/Debt markets would remain dysfunctional and policymakers would disrupt market roles for years to come.

Sharp downward price movements of products and equity markets would generate liquidity stress and credit events and maintain the global economy in a tail-spin similar to the 2008-09 financial crisis.

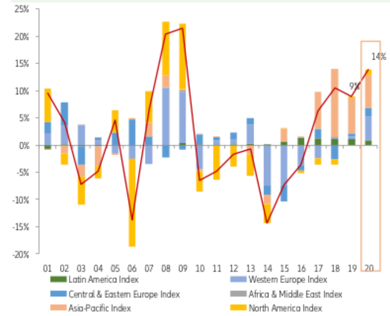
In this scenario the Eurozone contraction would exceed -4% y/y and the global GDP could contract -1.5% (Source Euler Hermes). If the situation remains critical for over 12 months, global trade could drop -10%...

For companies: a delayed wave of defaults on its way

Looking at the first months of the current CoVid-19 crisis, and the Chinese experience, hardly any sectors will be spared of the fall-out.

The first stage of the crisis is a supply shock hitting all B2C segments, caused by disrupted supply chains and intuitive collective hoarding of supplies. This stage is already visible in the European heartland, and in New York.

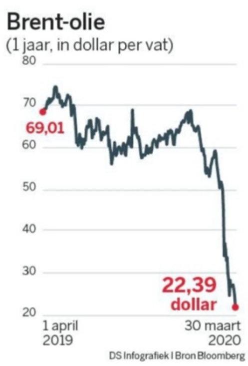
Figure 7: Global and Regional Insolvency Indices (yearly changes in %)



Sources: National statistics, Euler Hermes, Allianz Research

This is quickly followed by B2B segments, given the interconnectivity of the economies, with both a lack of consumer confidence and liquidity (demand shock) and supply chains (supply shock).

This second wave will hit sectors with the most vulnerable companies due to their exposure to liquidity risks, based on their leverage and weak levels of profitability: automotive, transportation, energy, metals, electronics and non-food retail (source Coface, Euler Hermes). People are not spending for lack of liquidity or by lack of confidence.



Global insolvencies are likely to increase +14% (based on U-shape recovery – source ICISA), but large bankruptcies are likely to be avoided through state interventionism. In a prolonged crisis (L-shape), insolvencies can increase +25%

This state support for companies that are deemed "too big to fail" would avoid an additional 4-6% increase in business collapses for 2020.

The consequences 2021 and beyond…

This global crisis is a clear double whammy, an accelerated end-of cycle through weakened multilateral organizations and integrated markets, followed by a worldwide sanitary crisis, with a feedback loop into the real economy that destroys value (markets), collapses weak companies, and destroys employment.

Does it start looking like a depression?

1. Healthcare

There will be a need to rethink investments in healthcare and their funding, and the ways to pay for the cost of healthcare.

The divergent results in China (1st epicenter), Europe (2nd) and USA (3rd epicenter) will undoubtedly create new structures and models of healthcare.

2. Balance of power

The soft power China and its status as superpower will probably be strengthened as the country that was first out of the deep crisis helped others generously.

This will likely change the balance of power in the US-China struggle with 2 different government systems, and their respective spheres of influence.

3. End of global supply lines

CoVid-19 will be a serious and ongoing blow to globalization and international trade. The USA was already pushing to reduce its reliance on Chinese production centers, and even the EU may look seriously at re-shoring. The free movement of people throughout the world will remain disrupted for quite a while.

The western world is likely to onshore production, with a reduction in wealth creation in emerging markets.

4. Dealing with global Crisis'

As a planet, an integrated ecosystem, we will need to look at a different way to deal with exponential large-scale emerging issues such as climate change.

There may be a need to increase supranational authorities, against the current tendency to promote nationalism.

5. Savings and pensions

The value destruction in savings and pension funds through the stock exchange meltdown may also change the way we save for the future.

2020 isn't the first time that people lost a large chunk of their Life-savings. Only now many people lose their life too

What to do now? Activate Crisis Management…!

Large corporates all have business continuity plans, that have been activated when WHO declared the CoVid-19 crisis as a pandemic. For smaller companies, the forced lock down will have reduced the activities by now to a 'work-from-home' or low level of activity.

Instructions from governments aim to flatten the curve of new infections that should start to work, and that aims mainly to avoid the collapse of the health system. Experience where this didn't work (Northern Italy and Spain as a whole) indicates a social drama, with a whole generation of parents and grandparents deceased…

Support from government and monetary authorities help to soften the equally threatening curve of bankruptcies and job losses.

But companies will be facing a range of serious challenges over the next months, from disrupted supply chains to bankruptcies in their distribution. All Corporates will need to adjust their cost structure and look to re-establish a market position. Financial institutions will need to provide for the cost of insolvencies and insurance companies will need to look at their devaluated reserves and the cost of the health and financial crisis.

Today the Crisis Managers look at the end of the quarantine, and to get the company back in "business as normal" as quickly as possible. Unwinding the protective measures gradually and re-establishing customer relations or alienated supply chains are now the priorities.

Be ready, get an experienced crisis manager on board…!

Sources: Financial Times, Allianz Research, Coface, Euler Hermes, WHO, worldometer.com, DS Graphics

Figure 1: Real GDP growth (%, y/y)

	2017	2018	2019	2020	2021
World GDP growth	**3.3**	**3.1**	**2.5**	**0.8**	**3.0**
United States	2.4	2.9	2.3	0.5	2.7
Latin America	**0.9**	**1.0**	**0.0**	**-1.2**	**1.6**
Brazil	1.1	1.3	1.1	-0.7	1.6
United Kingdom	1.8	1.3	1.4	-0.7	1.2
Eurozone members	**2.7**	**1.9**	**1.2**	**-1.8**	**2.1**
Germany	2.8	1.5	0.6	-1.8	2.2
France	2.4	1.7	1.3	-1.3	2.2
Italy	1.7	0.7	0.3	-3.5	1.7
Spain	2.9	2.4	2.0	-0.8	2.0
Russia	1.6	2.3	1.3	1.2	1.8
Turkey	7.5	2.8	0.9	2.5	4.0
Asia	**5.4**	**4.9**	**4.4**	**3.0**	**4.4**
China	6.9	6.7	6.1	4.0	5.8
Japan	2.2	0.3	0.7	-0.5	1.0
India	7.3	6.2	5.0	5.5	5.8
Middle East	**1.2**	**1.1**	**0.6**	**0.2**	**2.3**
Saudi Arabia	-0.7	2.4	0.2	1.2	2.0
Africa	**3.1**	**2.7**	**1.9**	**0.8**	**2.4**
South Africa	1.4	0.8	0.3	-0.5	0.7

** Weights in global GDP at market price, 2019*

NB: The revisions refer to the changes in our forecasts since the last quarter

Fiscal year for India

Sources: Euler Hermes, Allianz Research