Rosa & Roubini
ASSOCIATES

MAKING SENSE OF *THIS* WORLD — *20 April 2020*

R&R Weekly Column
By Brunello Rosa

Some Collateral Effects Of COVID Could Mark A Turning Point In History

We have lately been discussing four fundamental dimensions of COVID: *healthcare, economics, policy, and market implications.* On the *healthcare* front, advancements have been made that increase intensive-care capacity (with field hospitals and other logistical arrangements) as well as testing, treatment and progress towards a vaccine. On the *economics* front, we have just released our latest estimates of the macroeconomic impact of lockdowns around the world. We have often also discussed the *policy reaction* (fiscal, monetary and regulatory) that will be needed to mitigate the effects of the macroeconomic impact and market implications of all these factors.

Besides these four fundamental dimensions of COVID, we have also analysed what could be the long-term geopolitical implications of this crisis. Namely, China is set to gain the most from a strategic perspective, at the expense of the US, while the EU faces yet another existential crisis.

In this column, we want to discuss some of the events that are now occurring which risk being overlooked because of the pervasiveness of the news regarding the main dimensions of the crisis discussed above. We might call these the collateral effects of COVID. They too could have serious consequences, and perhaps even represent a turning point in the world's history.

On the one hand, as we have recently discussed in our in-depth analysis, there is the progress that is still being made by various countries in technologies such as artificial intelligence, which could provide a massive geo-strategic advantage to those who master them first. Russia, for example, is certainly using this period to make gains vis-a-vis its international competitors, by making large use of AI, and not just to find a cure for COVID-19. Russia is certainly not alone in this game, but it has a historical head-start over most other countries where cyberwarfare is concerned.

On the other hand, the US is about to enter one of its more turbulent periods in recent history. The US is already the country in the world with the largest number of confirmed cases and deaths, and yet partisanship regarding how to face this pandemic still prevails, with science being regularly questioned by populist political leaders and media. The US will soon have to face an election in a time of the pandemic, the result of which (as we discussed in our recent analysis) is now too-close-to call. There are those who suggest that if Trump were to lose by a small margin and the vote were to be contested, he would not accept the verdict of the Supreme Court, like Al Gore did when he run and lost against George W. Bush in 2000. The requests on Twitter made by President Trump to "LIBERATE" a number of states that are being governed by Democratic governors who are imposing COVID-related restrictions, and the gathering of armed militias to protest those restrictions, do not bode well for the future.

Around the world, authoritarian leaders are using the excuse of lockdowns to increase their grip on power and leave even less freedom to opposition parties and the press. This is happening even in Europe, within the European Union, ostensibly the most advanced defender of civil and political liberties in the world, where Hungary's PM Victor Orban has created a de-facto dictatorship.

On a larger scale, the fight against climate change has gone incredibly silent in the last few weeks. Clearly there is an even more imminent threat to deal with, but at the same time, the arguments made by those fighting against climate change have been made even stronger by the COVID crisis. The virus, if natural and not man made, is certainly a reaction of overpopulation and pollution. With lockdowns imposed in most countries, the world has just carried out its largest natural experiment as to how pollution can be greatly contained if human activities are drastically reduced. At the same time, the opponents of those advocating against climate change will say that the top priority now is re-starting the world's economic engine, rather than worrying about the side effects such as pollution and climate change.

All these example show that even as we follow the news about the COVID crisis, we should not lose sight of what else is happening in the world, which could have long-lasting consequences that will become apparent only when the current emergency is ended.

Looking Ahead

The Week Ahead: Manufacturing Services PMI Likely To Drop Further in US, EZ and Japan

In the *US, EZ,* and *Japan,* manufacturing and services PMIs are likely to drop further, well below the 50-benchmark; the 'prices' and 'employment' components are expected to fall sharply.

In the US, jobless claims are likely to remain high (April 18, *c:* 4000; *p:* 5245k), given the sudden nature of layoffs.

In South Korea, strict lockdown measures were avoided with: *i)* early, large-scale testing; and *ii)* contact tracing; as a result, in Q1 the economy is likely to contract only by -1.5% q-o-q (*p:* 1.3).

The Quarter Ahead: According To The WHO, The Key COVID Risk Is A 'Recurrence, After The Initial Wave Subsides'

Due to the pandemic-induced *'Great Shutdown'*, ***the IMF*** projects negative 2020 growth for: *a)* the global economy (-3.0%); and *b)* real GDP per capita, in 99% of the globe's countries (versus 62% during the GFC). The IMF baseline scenario leads to a 5.8% recovery in 2021, but in H2-2020 assumes: *i)* the pandemic to fade; and *ii)* gradually unwound containment measures. If downside risks materialize, many countries would face a multi-layered crisis - including: *i)* a health emergency; *ii)* domestic economic disruptions; *iii)* falling external demand; *iv)* capital flow reversals; and *v)* a collapse in commodity prices. Hence, the IMF offers three downside scenarios: *1)* if lockdowns last 50% longer, in 2020 global growth will fall by a further -3.0% (-6.0%); *2)* with a virus' second wave in 2021, global output will be 5.0% lower in 2021 (-0.5%); and *3)* if both events occur, in 2021 global output would be 8.0% lower (-3.5%). Major economies will likely suffer: *i)* higher debt, as a result of needed fiscal spending; and *ii)* lower growth potential, due to permanent output loss and structural changes to the economy.

In the US, demonstrations against *"lockdown measures that restrict civil rights"* took place in a few states; as a result, the Trump administration suggested: *"some states may ease social distancing measures within four weeks"*. In 2020, the fiscal deficit could widen by another USD 1.6tn.

Last Week's Review

Real Economy: Data Begin To Show A Deep Recession; IMF Sees A -3.0% Global Contraction

In the US, March retail sales fell by -8.7% m-o-m (*c:* -8.0; *p:* -0.4), due to record declines in discretionary spending in: *i)* durable goods (furniture: -27.0%; autos: -26.0%) and *ii)* non-durable goods (clothing: -50.0%; restaurants: -27.0%). March IP contracted by -5.4% m-o-m (*c:* -4.0; *p:* 0.5), marking the largest decline since 1946. In the week of April 5-11, 5.2m workers filed for unemployment benefits (*c:* 5.1mn; *p:* 6.6mn); since mid-March, total claims amount to 22mn workers, roughly 13% of the US labor force. Capacity utilization – a gauge of both potential output and output gap – fell to its lowest levels since 2008 (*a:* 72.7%; *c:* 74.0; *p:* 77).

In the EZ, February manufacturing activity fell into negative territories *(a:* -0.1% m-o-m; *c:* -0.2; *p:* 2.3), even before most EZ economies introduced lockdown measures.

In China, in Q1 the economy shrank by -6.8% y-o-y (*c:* -6.5; *p:* 6.0), the first ever contraction since Beijing began reporting quarterly GDP in 1992. March data showed a recovery in: *i)* industrial production (IP, *a:* -1.1% y-o-y; *c:* -7.3; *p:* -13.5); and *ii)* consumption and services (Retail sales, *a:* -15.8% y-o-y; *c:* -10.0; *p:* -20.5).

In Canada, the BoC announced: *i)* measures to increase asset purchases; *ii)* a *Provincial Bond Purchase Program* of up to USD 50bn; and *iii)* plans to buy up to USD 10 bn of investment-grade corporate bonds.

Financial Markets: Hopes Of COVID-19 Treatment And Liquidity Spur Equities, Bonds. Oil Down

Market drivers: Despite weak economic data, risky assets rallied on: *i)* treatment hopes; and *ii)* the effectiveness of the Fed's 'corporate debt backstop'.

Stocks: w-o-w, global indices rose (MSCI ACWI, +2.2%, to 480), driven by DMs (S&P 500, +3.0% to 2,875; Nikkei 225, +2.0% to 19,897) and EMs (MSCI EMs, +1.5% to 901).

Bonds: w-o-w, returns on indices rose (BAML Global, +0.5% to 291.4), as yields fell in the US (10y UST, -7bps, to 0.66%) and Germany (10y bund, -14bps, to -0.48%). The spread between Italian and Germany yields – a measure of 'EZ debt market' risk – rose over investors' concern about the sustainability of Italy's debt (10y Italian bond, +19bps to 1.79%). In US credit markets, the Fed's purchase of IG corporate debt provided support, with junk-rated debt offerings – e.g.: from carmaker Ford and others - drawing strong demand.

FX: w-o-w, as demand for the USD rose (DXY, +0.3% to 99.782), the USD strengthened against the EUR (EUR/ USD, -0.5% to 1.088) and EM FX (MSCI EM, -0.5% to 1,566).

Commodities: Despite the US-backed OPEC+ deal to reduce oil production by 9.7 mn bp/d – almost a tenth of the current output – energy prices kept falling (Brent, -10.8% to 28.1 USD/b), because the upcoming demand collapse (up to a third of consumption) is likely to be bigger than the lockdown-induced loss. Gold prices fell marginally (Gold, -0.3% to 1,684 USD/Oz).

@RosaRoubini Rosa & Roubini Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED

Farah Aladsani *contributed to this Viewsletter.*

The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*