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MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
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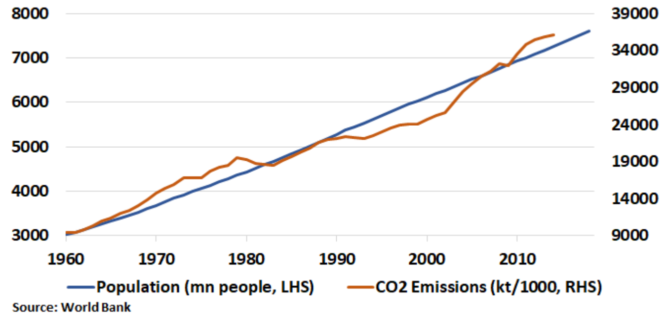

Covid "Proved" The Human Origin of Global Warming, But It Won't Stop Climate Change

Last week, we analysed some of the ongoing issues that risk being overlooked as a result of the Covid-induced crisis. One of these issues was the impact of the crisis on carbon emissions. According to recent estimates, with 28 countries in the world having adopted full or partial lockdowns, the movements of a third of the world population are now enduring some form of restriction as a result of social distancing. Economic activity has been severely reduced because of this; the IMF is estimating a contraction of real GDP in 2020 of approximately 3% (but we expect it to be closer to 4%). Some sectors have completely shut down, and international travel, especially via planes, has collapsed. Statistics show that commercial air traffic has shrunk 41% below 2019 levels in the last two weeks of March. The situation since then has likely worsened even more, as more countries have adopted some form of lockdown.

As a result of this collapse in economic and travel activity, air pollution has collapsed, and greenhouse gas emissions have been dramatically reduced. According to the United Nations, since lockdowns and shutdowns begun, CO_2 emissions have dropped by 6%. By the time the year ends, there will be an estimated 0.5%-2.2% reduction in CO_2 emissions due to Covid (or even 5%, according to some experts), depending on the model adopted to predict the pick-up in economic activity in Q3 and Q4 2020. This could be the first reduction in global emissions since the 2008-2009 Global Financial Crisis.

To some extent, the Covid-induced lockdowns have provided an unexpected, yet welcome, massive natural experiment as to the impact that a reduction on human economic activity can have on greenhouse gas emissions that are responsible for global warming (the rise in the earth's temperature, estimated to be around 0.2˚ C every decade). This hopefully will resolve once and for all the *vexata quaestio* of whether global warming is caused by human activity or other unrelated factors. However, the UN warns, this temporary reduction in emissions will not stop climate change, which derives from the accumulation of the effects of many decades of human activity. Especially if the solution to this crisis will be the implementation of public infrastructure projects that have a significant environmental impact.

While having gone silent in the last couple of months, climate change activists have gained a number of arguments in their favour. Not just on the impact that a reduction of economic activity might have on pollution and global warming, but also on the need for international coordination and cooperation to achieve that result. There is, however, another argument that will likely get traction. As the chart above shows, carbon emissions have increased in tandem with world population, which has risen from the 3 billion people of 1960 to the 7.6bn of 2018 (more than doubling in two generations). The UN estimates that there will be 11.2bn people in 2100, and if greenhouse gas emissions continue to be correlated with world population, the world's temperature will rise well above any target being discussed in the various Conferences of The Parties (COP) rounds.

Pandemics, if the virus is natural and not man made, may be partly a reaction to overpopulation (and therefore pollution). It is a clear signal the planet is sending that it may not have enough natural resources for all its inhabitants, at least not if resources are so unequally distributed. If the world does keep on increasing its human population without significantly changing its development model, pandemics will become more frequent and deadly in the future.

If, then, we want to learn some lessons from the immense tragedy represented by Covid, they might include the following: 1) human beings are for the most part responsible for the catastrophes that befall them; 2) if the world's development model does not radically change in favour of sustainability and renewable resources, extreme weather events will continue to affect the planet and pandemics will plague its human (and more generally, animal) population; and 3) only a coordinated and cooperative international approach can provide the solution to these historical issues.

Looking Ahead

The Week Ahead: US And EZ GDP To Contracts; Major Central Banks Will Remain On Hold

In the *US*, Q1-2020 annualized GDP is expected to contract by -4.0% (p: 2.1%), hit by the global economic slowdown and lower domestic consumption. The PCE – an index of prices of goods and services purchased by US consumers - is likely to soften to 1.6% y-o-y (p: 1.8%), and core-PCE to 1.7% y-o-y (p: 1.8%). The 'ISM Manufacturing PMI' is expected to fall deeper, to 36.7 (p: 49.1).

In *the EZ*, Q1-2020 GDP is projected to contract by -2.8% y-o-y (p: 1.0%), and CPI inflation to decline to 0.0% y-o-y (p: 0.7%).

The Fed (0.25%), ***ECB*** (0.0%), ***BoJ*** (-0.1%), and ***Riksbank*** (0.0%) are expected to keep their policy rates unchanged.

The Quarter Ahead: Sharp Slowdown; New US Stimulus, Fed's Balance Sheet Size Reaches ~30% Of US GDP

The world economy: 1) is on track for the steepest fall (-4.3%) in global GDP since the Second World War (global financial crisis: -0.5%); and 2) will need years to return to its pre-virus potential.

Going forward, ***Central Banks*** are likely to resort to drastic measures, while fiscal support will lead public debt to surge. Yet, over 2020 disinflationary pressures will prevail, due to weaker demand. The WHO and world leaders pledged to expedite work on effective and affordable: *i)* diagnostic tests; *ii)* therapeutic drugs; and *iii)* vaccines for COVID-19. The US is not part of the initiative.

In the US, the House of Representatives passed a USD 484bn spending bill to provide: *i)* loans to small businesses; and *ii)* further funding for COVID-19 testing and hospitals. Due to the roll out of an unprecedented amount of stimulus, the Fed's balance sheet: 1) increased to a record USD 6.62tn (about 30% of the US economy), from USD 4.29tn in the first week of March, via open-ended asset purchases; and 2) will likely expand further, to: i) contain the economic fallout of the COVID-19 outbreak; ii) lift business and household confidence; and iii) support asset prices in financial markets.

Last Week's Review

Real Economy: COVID-19 Weights On Growth, Governments' Deficit And Debt Levels To Rise

In the US, April's preliminary 'Markit composite PMI' fell to 27.4 (p: 40.9) – signaling the steepest reduction in private sector output on record. Both the service and manufacturing sectors registered contractions (services PMI, a: 27.0; c: 31.5; p: 39.8; manuf. PMI, a: 36.9; c: 38; p: 48.5). Due to business closures, durable goods orders ex. defense – a proxy of business investment – fell deeper, to -15.8% m-o-m in March (p: -0.2%) – the biggest drop since August 2014. As of April 17, initial jobless claims rose by 4.4m (c: 4.2m; p: 5.2m), reaching a total of over 26m (16% of the labor force) in just 5 weeks. In other words, the 22m jobs created during the employment boom of the last 10 years were wiped out in about a month.

In the EZ, April's preliminary 'IHS Markit composite PMI' plummeted to an all-time low of 13.5 (c: 25.7; p: 29.7), pointing to the steepest pace of contraction in the service sector in over 20 years (services PMI, c: 23.8; p: 26.4), and the biggest drop in manufacturing activity since February 2009 (manuf. PMI, c: 39.2; p: 44.5).

In Japan, the preliminary 'Jibun Bank Manufacturing PMI' declined to 43.7 in April (p: 44.8), signaling the sharpest monthly contraction since April 2009.

In South Korea, the COVID-19 pandemic took a softer-than-expected toll on the economy in Q1-2020, as GDP expanded by 1.3% y-o-y (c: 0.6%; p: 2.3%) – the weaker expansion since Q3-2009.

In EMs, central banks eased their policy stance. In China, the PBoC lowered its key policy rate by 20bps, to a record low of 3.85% (c: 3.85%; p: 4.05%). ***In Russia***, the Bank of Russia lowered its one-week repo rate by 50bps, to 5.5% (c: 5.5%; p: 6%), bringing borrowing costs to their lowest level since February 2014. ***In Turkey,*** the CBT cut the one-week repo rate deeper-than-expected, by 100bps to 8.75% (c: 9.25%; p: 9.75%).

Financial Markets: WTI Prices Turned Negative, Stocks Fell Despite US Stimuli. US Bonds Up

Market drivers: the turmoil in energy futures weighed heavily on investor sentiment.

Stocks: w-o-w, global indices fell (MSCI ACWI, -1.6%, to 473), driven by DMs (S&P 500, -1.3% to 2,837; Euro Stoxx 50, -2.7% to 2,809) and EMs (MSCI EMs, -2.4% to 879).

Bonds: w-o-w, returns on indices rose (BAML Global, +0.2% to 292.1); yields fell in the US (10y UST, -6bps, to 0.6%) and remained flat in Germany (10y bund, +1bps, to -0.47%).

FX: w-o-w, demand for USD rose (DXY, +0.6% to 100.380), hence the USD strengthened against the EUR (EUR/USD, -0.5% to 1.082) and EM FX (MSCI EM, -0.7% to 1,556).

Commodities: WTI's spot price turned negative due to: 1) the trading nature of futures market; and 2) structurally weak demand. May futures fell to a historical low of -37.63 USD/b: buyers were compensated to store barrels (Brent, -23.6% to 21.4 USD/b; WTI, -7.3% to 16.9 USD/b). Over the next months, storage constraints will depress oil prices. Gold kept its safe-haven appeal (Gold, +2.6% to 1,727 USD/Oz), but it is unlikely to continue outperforming most other asset classes, as it did in 2009.

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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*