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Family Office Service: Global Economics and Markets Newsletter

Data Beginning to Show the Extent of the Economic Fallout

April 2020

This Month's Big Themes

IMF World Economic Outlook

Every April and October the International Monetary Fund (IMF) release their flagship report the World Economic Outlook which provides economic forecasts for every country in the world as well as producing a global forecast. The April report comes at a time when the COVID-19 (novel coronavirus) pandemic is inflicting high and rising human costs worldwide, and the necessary protection measures are severely impacting economic activity. As a result of the pandemic, the IMF forecasts the global economy will contract sharply by –3% in 2020, much worse than during the 2008–09 Global Financial Crisis. The IMF's baseline scenario assumes that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound. The global economy is projected to grow by 5.8% in 2021 as economic activity normalizes, helped by policy support. However, the IMF notes the risks for even more severe outcomes remain substantial.

Source: https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020

Global Manufacturing and Services

One of the first key economic indicators that points to the extent of the economic decline are the Purchasing Manager Indexes (PMIs). PMIs are forward looking indicators meant to signal the direction of economic activity. They are based on sub-indices such as output, new orders, employment, pricing, pipelines, and sentiment. A reading above 50 indicates growing activity; the higher the number the faster the growth – and vice versa.

Starting with manufacturing, the performance of the global manufacturing index rose in March 2020, from February 2020 due to the revival of economic activity on China and Taiwan but elsewhere around the world, PMIs fell, suggesting economic activity declined to rates last seen during the Global Financial Crisis in 2008-09. It should be noted though that these surveys are taken in the early stages of each month and so miss some of the worst shutdowns and lockdowns imposed by some countries which may suggest the PMIs may fall further in April 2020.

In North America, the manufacturing PMI for the US fell modestly, indicating that there was not yet a dramatic impact on manufacturing from the virus outbreak but in Europe there was a more significant deceleration in manufacturing activity, likely reflecting the fact that Europe faced a serious virus outbreak a bit earlier than the US except for in the cases of Italy and Spain, both of which have endured strict lockdowns. As a result Italy's PMI fell very sharply while that of Germany fell somewhat less in March 2020.

In Asia, outside of China and Taiwan who experienced some rebound in economic activity in March 2020 but other Asian countries Japan, South Korea, and especially the ASEAN countries of Southeast Asia experienced a decline.

Source: https://www.investopedia.com/global-manufacturing-data-paints-grim-picture-4801699

As the table overleaf shows, the service sectors has encountered severe declines in activity. The services sector is defined as most non-construction and non-manufacturing economic activities including finance, telecoms, transportation and distribution, retailing and wholesaling, professional and business services, utilities, healthcare, and education.

The global PMI fell sharply from 47.1 in February to 37.0 in March 2020. The PMI for consumer-related services fell much more than the PMIs for business services or financial services reflecting the shutdown of many consumer-facing industries such as restaurants, hotels, retail stores, and entertainment venues across the US and Europe. The sharp decline is disproportionately due to extreme weakness in Europe followed by the US and Japan. The PMIs in Europe fell to a record low. In China, on the other hand, the PMI bounced back, but remained well below 50.

Of particular note is Italy with a reading of 17.4. This steep decline will act as a sign of things to come for other countries that have implemented strict lockdowns since March 2020 such as Germany, the UK and the US for example suggesting that data in Pail will also show signs of a considerable decline.

[Table] Selected Manufacturing and Service Activity from Purchasing Manager Indexes

	Manufacturing		Services	
	February 2020	March 2020	February 2020	March 2020
Global	47.1	47.6	47.1	37.0
USA	50.7	48.5	49.4	39.8
Mexico	50.3	46.9		
Canada	51.8	46.1		
Brazil	52.3	47.8	50.4	34.5
UK	51.7	47.8	53.2	34.5
Eurozone	49.2	44.5	52.6	26.4
Germany	48.0	45.4	52.5	31.7
France	49.8	43.2	52.5	27.4
Italy	48.7	40.3	52.1	17.4
Spain	50.4	45.7	52.1	23.0
China	40.3	50.1	26.5	43.0
Taiwan	49.9	50.4		
ASEAN	50.2	43.4		
Japan	47.8	44.8	46.8	37.8
South Korea	48.7	44.2		
Hong Kong	34.9	33.1	33.1	34.9
Singapore	48.7	45.4	47.0	33.3
Australia	53.7	44.3	49.0	38.5

Source: IHS Markit. Note: Some PMIs are not produced for some countries by IHS Markit as displayed on tradingeconomics.com.

Global Trade

The World Trade Organization (WTO) announced that they expected world trade to fall between 13% and 32% in 2020 as COVID-19 disrupts normal economic activity and life around the world. The wide range of possibilities for the predicted decline in global trade depends on the scenario, which are explained by the unprecedented nature of this health crisis and the uncertainty around its precise economic impact. But WTO economists believe the decline will likely exceed the trade slump brought on by the Global Financial Crisis. Also the estimates of the expected recovery of global trade in 2021 also remains uncertain depending on the duration of the outbreak and the effectiveness of the policy responses.

Global trade was already slowing in 2019 because of trade tensions and slowing global growth, with merchandise trade volumes declining -0.1% year-on-year after growing 2.9% in 2018. World commercial services grew 2% y/y in 2019 but grew 9% in 2018.

The economic consultancy Oxford Economics has estimated that the volume of global trade declined by 4% y/y in Q1 2020. Furth more, Oxford Economics estimate that trade in automobiles, textiles, and electronics are declining rapidly. The decline in demand and supply of traded goods does not reflect weak income or poor credit conditions. Rather, it is due to fear as well as government-imposed restrictions on economic activity. Once restrictions are removed and fear abates, there will be plenty of consumer money available for a revival in demand.

Owing to the expected size of the decline in economic activity, the economic shock of the COVID-19 pandemic invites comparisons to the Global Financial Crisis. These crises are similar in certain respects but very different in others. As in 2008-09, governments have again intervened with monetary and fiscal policy to counter the downturn and provide temporary income support to businesses and households. But restrictions on movement and social distancing to slow the spread of COVID mean that labor supply, transport and travel are today directly affected in ways they were not during the financial crisis. Whole sectors of national economies have been shut down, including hotels, restaurants, non-essential retail trade, tourism and significant shares of manufacturing.

Source: https://www.wto.org/english/news_e/pres20_e/pr855_e.htm

Deloitte survey of European CFOs

Between 28 February and 2 April 2020, nearly 1,000 Chief Financial Officers (CFOs) were surveyed in 18 countries regarding their views of COVID-19 on their businesses and the wider European economy.

The key takeaways were as follows: almost 80% of respondents expect the pandemic to have a negative effect on their company's revenues well into the autumn; and one in three expect a double digit decline in the next six months. Perhaps unsurprisingly, CFOs in the tourism and travel industry are particularly pessimistic regarding the impact of the pandemic in the short-term, whereas financial executives in the life science and health care industry have slightly more positive views – although even in this sector more than 50% of respondents expect some decline in their revenues over the next six months.

Longer-term expectations are only slightly more positive: 10% of respondents foresee a strong decrease in revenues well into next year and almost 30% think that revenues will be at the same level as forecast before the outbreak, more than half still expect the negative effects of the pandemic to stretch into 2021. Thus, rather than a quick and sharp rebound, European companies seem to be preparing for a quite gradual recovery in their business, spread over a longer time horizon.

Subdued business expectations mean companies are downgrading their investment and hiring plans. 41% of CFOs plan to reduce their capital expenditures, twice as many as the 20% who plan to increase them. Similarly, 38% of respondents foresee a decrease in the number of their employees over the next 12 months, against 21% expecting an increase. Looking at the data based on when CFOs responded throughout March it is apparent that the outlook deteriorated substantially as the month progressed. Among the CFOs answering the questionnaire in the last week of March, 51% reported a likely decrease in the number of employees over the next 12 month.

To steer their companies in these troubling times, companies are prioritizing short-term reactive measures – in particular cutting spending. On average, one in ten executives report that they are prioritizing the establishment of new credit lines, although the number quadrupled during the data collection phase, from 4% in the weeks before 8 March 2020, to 18% among the CFOs who answered the survey after 22 March 2020. As the crisis extends over a prolonged period of time, measures to guarantee and facilitate access to credit will become increasingly relevant.

Source: https://www2.deloitte.com/global/en/pages/finance/articles/european-cfo-survey.html?id=gb:2bl:3bl:4ecfo20s:5awa:6fin:ik1

Country/Regional Updates

1. Japan

Japanese Prime Minister Shinzo Abe said direct fiscal spending under the government's stimulus package to combat the coronavirus pandemic will total 39 trillion yen ($357 billion). Abe pledged on Monday 6 April 2020 to roll out an unprecedented economic stimulus package worth 108 trillion yen - equal to 20% of economic output - as his government vowed to take "all steps" to battle deepening fallout from the coronavirus.

Source: https://www.reuters.com/article/us-health-coronavirus-japan-stimulus/japan-pm-abe-says-fiscal-spending-under-stimulus-plan-to-total-39-trillion-yen-jiji-idUSKBN21O36D

Japan's retail sales in February 2020 rose 1.7% y/y to JPY 11.2 trillion, according to the Ministry of Economy, Trade and Industry. Drugstore sales surged 18.9%, as consumers scrambled to buy face masks, toilet paper and other health and hygiene products in response to the new coronavirus outbreak. The February figures are the first year-on-year increase in retail sales in Japan since September 2019, when there was a last-minute rise in demand before the consumption tax increase. Supermarket sales climbed 6% led by consumer goods. Convenience stores rose 3.4%, with a significant increase in sales of processed food. Department store sales dropped 11.8%, as the number of overseas visitors to Japan plummeted as a result of the epidemic.

Source: https://asia.nikkei.com/Economy/Panic-buying-in-Japan-lifts-February-retail-sales

In Japan, land price data is released on an annual basis and the most recent data is for 2019 which show Japanese land prices grew for the fifth year in a row. The catalyst for this continuous growth has been driven by foreign tourism and low interest rates. For example, areas popular with foreign tourists such as Hokkaido, Okinawa and Kyoto. The price rise of 1.4% y/y is the fast gain since 2008. An increase in foreign tourists boosted demand for hotel properties and retail space while low interest rates supported strong office demand.

Commercial land prices in areas other than Tokyo, Osaka and Nagoya rose 0.3%, up for the first time since the asset bubble burst 28 years ago. Residential land prices in those areas also stopped falling for the first time since 1996.

However, with the risk of Japan going into recession and the obvious decline in demand and the lack of foreign tourists, retail land prices would be expected to decline and there is less likely to be demand for commercial land as investment dries up, so there is a risk that land prices along with real estate prices will fall in 2020 as the economy readjusts to the change in demand.

Source: https://www.reuters.com/article/japan-economy-landprices/japans-2019-land-prices-power-higher-but-virus-clouds-outlook-idUSL4N2B42VV

2. United States

In the week up to 28 March 2020 the US government reported there had been 3.3 million new claims for unemployment insurance – a new historical record. Prior to that week, the record had been less than 700,000 in one week. In the weeks ending 4 April and 11 April an additional 6.6 million people made a claim for unemployment insurance a week and in the week ending 18 April 5.2 million people filled for unemployment bringing the total number of Americans filling for unemployment insurance to just over 22 million people in just a four week period. This implies that, when the April job market reports come out in early May, it will likely show an unemployment rate of more than 15%. This would be, by far, the highest rate since the early 1930s.

Source: https://www.investing.com/news/economic-indicators/us-weekly-jobless-claims-seen-at-record-high-again-2128548

Source: https://www.dol.gov/sites/dolgov/files/OPA/newsreleases/ui-claims/20200592.pdf (PDF)

Retail sales fell 8.7% from February to March 2020, by far the steepest decline on record. Sales were down 6.2% y/y. Yet as shocking as the overall number was, the details were especially notable. For the month, sales at automotive dealerships were down 27.1%. Sales were down 50.5% at clothing stores, down 26.8% at furniture stores, down 19.7% at department stores, and down 26.5% at restaurants. Also, it is important to note that this report is for all of March. Yet we know that most of the state lockdowns took place in the second half of the month, some toward the end of the month. Therefore, it is reasonable to expect that the retail sales numbers for April will see a sharp decline once again.

Meanwhile, the government also reported about the industrial sector of the economy. Industrial production fell 5.4% from February to March 2020, the largest monthly decline since January 1946 when the economy was adjusting to the end of the Second World War.

Source: https://www.reuters.com/article/us-usa-economy/coronavirus-seen-knocking-u-s-retail-sales-in-march-idUSKCN21X0EL

As expected with a decline in economic demand, inflation in March 2020 slowed in both the US and China. In the US, consumer prices were down 0.4% month-on-month from February to March 2020, the largest monthly decline since early 2015. The decline was largely due to a very sharp drop in energy prices, including a 10.4% decline in the price of gasoline. Overall, consumer prices were up only 1.5% y/y. When volatile food and energy prices are excluded, core prices were down 0.1% m/m, the first monthly decline in three years. Plus, core prices were up 2.1% y/y. The monthly decline in core prices included a decline in the prices of new automobiles (-0.4%), apparel (-2.0%), and transportation services (-1.9%).

Source: https://www.reuters.com/article/us-usa-economy-economy/u-s-consumer-prices-post-largest-drop-in-five-years-amid-coronavirus-disruptions-idUSKCN21S1B7

3. China

On 16 April 2020, the Chinese government released their estimate of Q1 2020 GDP. Real GDP contracted 6.8% y/y, the first decline in more than 40 years. It is worth noting that prior to the crisis, the consensus expectation that the economy would grow approximately 6% y/y. Therefore the report suggests that economic activity was about 13% lower than if the crisis had not happened. Moreover, real GDP fell from Q1 2019 to Q1 2020 at an annualized rate of approximately 36%. This number is not to dissimilar to forecasts offered by economists at banks for economic growth in Q2 2020 in the US. The Chinese figure thus confirms the scale of the impact of the lockdowns that have taken place in numerous countries around the world.

Meanwhile, other indicators point to the nature of the downturn in China. Retail sales fell 15.8% y/y in March 2020. This follows a 20.5% decline for January and February 2020 combined. There was a sharp decline in most categories, although spending on food and household products grew as did spending for online purchases. Spending was down especially sharply for apparel, jeweler, appliances, furniture, and automobiles which is similar to other country reports.

Fixed asset investment was also down 16.1% y/y in Q1 2020. This follows growth in 2019 of 5.4%. Private sector investment fell 18.8% while public sector investment fell 12.8%. In addition, industrial production appears to have rebounded in 2020 after a sharp decline in January and February. In the first two months of the year, industrial production was down 13.5% y/y down only 1.1% y/y in March 2020. Thus, it is clear that the industrial side of China's economy began to recover in March.

Source: https://uk.reuters.com/article/us-china-economy-gdp/hobbled-by-coronavirus-chinas-first-quarter-gdp-shrinks-for-first-time-on-record-idUKKBN21Z08Q

Although China's economy is starting to recover from the shock of a near complete shutdown in February 2020, the damage done by that shutdown is beginning to become apparent. It is reported that roughly 460,000 small businesses in China closed permanently in Q1 2020, mostly due to the coronavirus. Roughly 26,000 of these were in the export sector. In addition, there was a slowdown in the pace of new business formations. Specifically, 3.2 million new businesses were established, a 29% y/y decline. It now appears that the virus has been contained in China and there are indications of a modest revival in economic activity. However, the destruction of existing businesses and the slow pace of new business formation demonstrate the obstacles to rebooting a dormant economy.

Source: https://www.forbes.com/sites/kenrapoza/2020/04/06/coronavirus-emergency-hits-japan-and-460000-chinese-companies-go-bust/#355828502ac7

4. European Union

Finance ministers from across the European Union agreed to an aid package worth 540 billion €. This will include a 100 billion euro employment insurance fund; the creation of a 200 billion euro facility to be used by the European Investment Bank (EIB) to provide liquidity to companies; and a 240 billion euro credit line provided through the European Stability Mechanism (ESM), which is a bailout fund created during the last crisis.

German Chancellor Merkel stated, the coronavirus crisis represents the biggest threat to Europe since the Second World War. Europe accounts for over 60% of all deaths attributed to the virus. With governments in Europe imposing strict lockdowns which have caused economic activity to plummet as indicated by the PMI surveys. Given this, in order to protect households and businesses from disruption the governments of the European Union have passed such a large aid package. A European-wide approach was needed to pull together the aid package as some countries such as Italy would be unable to finance the package themselves. One reason, would be the increase in the risk premium that investors would demand on the extra debt issuance.

Source: https://www.france24.com/en/20200409-eu-finance-ministers-reach-agreement-on-coronavirus-rescue-deal

Capital Markets

1. Equities

Despite the bad economic data prints and the gloomy growth forecasts, financial markets around the started to rebound in part due to policy Reponses such as those by the Federal Reserve and the European Union and on some of the news that some of the lockdown restrictions are being eased in the likes of Italy, Spain and Germany as the number of new cases has moved beyond the peak for some time now. For example the S&P 500 was up more than 9%, the German DAX is up more than 7.3%.

2. Interest Rates

To ensure the monetary policy transmission mechanism continues to function without friction the Federal Reserve has cut the Federal Funds rate to lows not seen since the Global Financial Crisis, restarted quantitative easing, pledging to buy government bonds, mortgage backed securities, investment grade corporate bonds, and bank loans, and providing direct loans to banks. On 9 April, 2020 the Fed announced it will also provide USD 2.3 trillion in credit to the market for high yield (junk) bonds. High yield investors have been shaken by fears of default, especially on the part of highly leveraged energy companies that have been hurt by much lower oil prices. Federal Reserve Chairman Jay Powell stated "we are deploying these lending powers to an unprecedented extent, enabled in large part by the financial backing of Congress and the Treasury. We will continue to use these powers forcefully, proactively, and aggressively until we are confident that we are solidly on the road to recovery." He added that these "emergency tools" would be "put away" when the economy recovers and when "private markets and institutions are once again able to perform their vital functions of channeling credit and supporting economic growth." The speed and volume of measures taken by the Fed during this crisis dwarfs what happened during the global financial crisis more than a decade ago. There are two reasons. First, this crisis is much bigger in terms of the decline in economic activity. Second, in the last crisis, the Fed struggled to stay ahead of the curve. As a result, credit markets seized up and credit activity shrank rapidly. Trade finance, for example, nearly dried up. Through its actions to date it is clear the Fed is determined to keep credit markets open and properly functioning as it is imperative to ensure companies are able to survive the lockdown of the economy.

Source: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm

3. Commodities

By 17 April 2020 WTI crude fell below USD 18 per barrel which was the lowest price in 17 years. The reason for the fall in prices has been related to a fall in demand as economies around the world entered lockdowns, effectively closing the economics. Other reasons for falling prices include a report from the International Energy Agency, which reports that global demand for crude could fall by as much as 20% in 2020. Oil demand may fall by as much as 30 million barrels per day, more than the combined output of the US, Russia and Saudi Arabia.

Source: https://www.reuters.com/article/uk-global-oil-demand-trafigura/global-oil-demand-could-fall-around-a-third-next-month-trafigura-idUSKBN21H2WX

Whilst demand for oil was declining, supply rose when Russia refused a Saudi request to join OPEC in another round of production cuts. After that refusal, the Saudis boosted production in order to put pressure on Russia. The end result was a precipitous decline in the price of oil. Still, even if the Saudis and Russians were to suddenly restore their economic friendship, it is likely that prices would remain relatively suppressed because of the sharp decline in demand.

But in the middle of April 2020, the two sides negotiated and reached an agreement to attempt to cut production by 10 million barrels per day. In anticipation of the deal, traders had pushed oil prices up considerably. However, once the deal was announced, prices actually fell as traders determined that the deal will not do enough to support prices. That is because, as the global economy continues to shut down, demand for oil is collapsing. Only a rebound in demand, which will happen when the virus is suppressed and lockdowns end, will significantly boost oil prices. Under the deal, half of the 10 million barrel decline in output will be undertaken by Saudi Arabia and Russia. The rest of the decline will be allocated among OPEC members. One major oil exporter that refused to cooperate was Mexico. The agreement to cut global oil production was finalized when OPEC and Russia allowed Mexico to cut production by a smaller percentage than other countries. The result is that production is meant to decline by 9.7 million barrels per day which triggered further downward price action.

In addition, the US and Canada, which are significant exporters, are not likely to cooperate, despite pressure from OPEC. Some analysts said that, by cutting production without an agreement with the US, OPEC will cause US shale producers to boost output, thereby undercutting OPEC market share. On the other hand, if the deal does not result in significantly higher prices, US shale producers will remain at risk financially.

Source: https://www.investing.com/news/commodities-news/oil-up-on-back-of-historic-production-cuts-2139149

On Monday 20 April, the price of WTI Crude oil fell below USD 0 per barrel for the first time on history at one point falling to USD -40 per barrel. The reason for this was on Tuesday 21 April, future contracts were expiring and because of the fall in demand, the supply glut meant that companies who were expected to take delivery had nowhere to store the oil and so investors were willing to pay others to take possession of the oil.

Source: https://www.reuters.com/article/us-global-oil-crash-explainer/explainer-what-is-a-negative-crude-future-and-does-it-mean-anything-for-consumers-idUSKBN22301M

Useful Resources

Investing	Economic Data	Economic Analysis
• investing.com	• United States: Bureau of Economic Analysis	• Deloitte Insights: Economics
• MarketWatch	• United States: Bureau of Labor Statistics	• Deloitte Weekly Global Economic Update
• Yahoo! Finance	• Cabinet Office of Japan	• International Monetary Fund
Central Banks	• European Commission: Eurostat	• Project Syndicate
• Federal Reserve Board	• United Kingdom: Office for National Statistics	• Organization of Economic Cooperation and Development
• Bank of Japan	• National Bureau of Statistics of China	• Central Intelligence Agency: The World Factbook
• European Central Bank	• Federal Reserve Economic Database	• Aon: Political Risk Heatmap
• Bank of England	**News**	
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