Family Office Service: Global Economics and Markets Newsletter
The Worst Economic Contraction since the Great Depression

May 2020

This Month’s Big Themes

Global PMIs

The first meaningful global economic data for Q2 2020 are the IHS Markit Purchasing Manager Indexes (PMIs) for April which show catastrophic the decline in real economic activity has been. For the US and Europe, it was the first month in which there was a lockdown for the entire period examined. The result was that activity in both the manufacturing and service sectors declined rapidly. The services sector, which encompasses such industries as transportation, retailing, and hospitality, declined at an especially rapid pace. The reason being, in many locations these industries were forced to completely shut down or suffered a nearly complete loss of customers. Many service PMIs fell to historical lows. The PMIs are forward looking indicators meant to signal the direction of activity in the manufacturing and services sectors. A reading above 50 indicates growing activity and a reading below 50 indicates decline. The lower the number below 50, the faster the decline.

Global Manufacturing and Service PMI Release for April 2020

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<tr>
<th>Country</th>
<th>Manufacturing PMIs</th>
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Source: IHS Markit, tradingeconomics.com

Source: [https://www.markiteconomics.com/Public/Release/PressReleases](https://www.markiteconomics.com/Public/Release/PressReleases)
Implications of COVID-19 on global real estate

Although it is too early to receive data on the state of real estate markets globally, real estate company Jones Lang Lasalle (JLL) has offered its view on how COVID-19 and its effects on the economy as well as the change in people’s lifestyles as a result of COVID-19 will reshape the real estate market.

In the medium- to long-term, demand for flexible office space will remain as many corporates will be anxious not to commit to big capex projects or make any firm employee headcount forecasts, which will strengthen demand for preconfigured space on flexible terms. The experience of homeworking will reinforce the need for corporates to adopt agile portfolios and adapt the physical office to deliver collaboration.

The trajectory of the office market will be shaped not only by the ability of governments to manage the ongoing crisis, but also the potential emergence of structural changes to how space is used and incorporation of lower employee density and deployment of remote-working options.

For retailers, the primary focus in the short-term remains on preserving cash. Some retailers and leisure operators are assessing options to offset the loss of revenue from their physical store portfolios. For example, some gym operators have offered subscription services to stream online workout sessions while high-end restaurants are offering meals for delivery or collection. Social responsibility is being closely monitored by customers. In addition to generous donations and the manufacture of masks and hand-sanitizers, various cosmetics and luxury brands have embraced live streaming for sharing make-up and fashion tips. For retailers to stay relevant and to be socially responsible as consumers temporarily reign in their spending.

Over the long-term, retailers will have to rethink their operations and supply chains. Having the right infrastructure for the fulfilment of online orders continues to be crucial for trading. As the structural change in the retail market accelerates, greater emphasis will be placed on the shift toward a flexible omni-channel retail model and sustainable fulfilment; strengthened partnerships between landlords and retailers will need to emerge to achieve this.

In the logistics sector supply chain risk mitigation and resilience will likely become a key focus for operators. Companies will increasingly look at re-shoring or near sourcing of manufacturing. A renewed emphasis on domestic supply chain independence will accelerate this re-shoring trend; greater diversification in terms of sourcing. Distribution networks will become less reliant on any one country in order to de-risk the production or distribution processes. This will lead to more multi-facility/multi-location strategies; and diversification of transport modes, including the development of port diversification strategies and investing in locations that provide multi-modal transport options.

This is likely to result in additional regional demand for manufacturing facilities and associated logistics, but potentially lead to weaker world trade growth and container flows at gateway ports. Companies with very lean supply chains (with low inventory cover) may seek to increase their inventory levels.

The pandemic will accelerate trends already in evidence across the sector such as increased online penetration rates, expansion of online grocery, omni-channel retailing and the integration of technology into warehousing. Industrial and logistics fundamentals were very strong prior to the COVID-19 crisis. Occupier demand had been exceptionally robust and vacancy rates were at near record lows. The pandemic is highlighting the critical importance of supply chains and logistics real estate, and the sector is well placed to respond to the post COVID-19 recovery.

Once the travel industry starts to recover, travel patterns are expected to shift toward drive-to-resort destinations and less dense markets where travelers can be in open spaces and avoid large groups of people. The types of lodging people will gravitate to may also change. People have become more self-conscious of being in close proximity to others and are fearful of contracting the disease in public places with questionable standards of cleanliness. Non-professional lodging options, largely comprised of alternative accommodations, are likely to face increasing scrutiny and pressure from guests who are concerned with their health and well-being.

JLL has identified 5 mega-trends impacting the real estate sector – the growth of corporate outsourcing; rising capital allocations to real estate; rapid urbanization and city building; the adoption of new technologies; and the imperative to build a more sustainable future and to take urgent action to combat climate change.

All these trends look set to continue, although with some new characteristics and points of focus:

1) **Growth in corporate outsourcing.** The ongoing health crisis should accelerate the trend of outsourcing over the long-term. Occupiers will increasingly seek third-party real estate services to sustain business continuity. There will be increased demand for new workplace design, including more digital, flexible and health-oriented working solutions.
2) **Rising capital allocations to real estate.** The low interest rate environment and financial asset price volatility will support the case for portfolio diversification. 'Flight to safety' in real estate, which continues to offer better relative returns in comparison to other asset classes, looks set to increase.

3) **Urbanization.** The pandemic is unlikely to slow the long-term trend in growing urbanization, but will prompt a rethink in urban design, increasing the imperative to develop truly scalable smart city solutions, to put a much greater focus on public health and safety, and to deliver greater investment in public infrastructure.

4) **Technology.** The mass adoption of remote-working technology through the pandemic phase will likely increase the pace of the Fourth Industrial Revolution, including even more emphasis on robotics, the Internet of Things (IoT), Big Data, and unmanned vehicles.

5) **Sustainability.** There will be an increased spotlight on corporate social responsibility, and through this, greater awareness of the fragility of our society and ecosystem.


### Country/Regional Updates

**1. Japan**

The Japanese economy slipped into technical recession in Q1 2020 after two consecutive quarters of negative quarter-on-quarter growth. In Q1 2020 the economy contracted 0.9% q/q and at an annualized rate of -3.4%. The Q1 2020 data follows a contraction of 1.9% q/q in Q4 2019. The cause of the Q1 2020 contraction from private demand was led by a 0.7% q/q contraction in private consumption, a 0.5% contraction in private non-residential investment and a 4.5% q/q contraction in private residential investment. From the external sector, exports of goods and services contracted 6% q/q or -21.8% annualized and imports fell 4.9% q/q (-18.4% annualized). The weakness in the external sector shows how important the Chinese economy and other international markets are to the growth of the Japanese economy. This recession has been long-expected mostly because of the effects of the consumption tax hike from October 2019 which curtailed spending. The effects of COVID-19 on the economy were likely to have happened in the second half of the first quarter. Data supporting this comes from the Japan Centre for Economic Research which publishes a monthly estimate of real GDP which shows a fall in GDP in March 2020 by 3.5% month-on-month as a result of COVID-19 and its effects on demand and supply chains.

The more stringent measures taken by the government to minimize the spread of the virus, such as the temporary closure of business happened in Q2 so it is likely that the biggest effects of COVID are likely to be felt in Q2 2020.


At its monetary policy meeting on 27 April 2020 the Bank of Japan (BOJ) stated it would no longer have a target limit on asset purchased under its quantitative easing program. Rather, it will engage in asset purchases as needed which are being undertaken in order to maintain a properly functioning credit market. Moreover, the BOJ will not only purchase government bond. It will also purchase corporate bonds and commercial paper as well as provide targeted support for small businesses, all in an effort to ease credit market conditions at a time when the government has imposed new restrictions on economic activity. Japan was already likely to have been in a recession even before covid-19 crisis due to a slowdown in global trade and investment as well as the after effects of the consumption tax hike in October 2019 which stymied household consumption.


In Japan, household spending declined 6% in March year-on-year, the sharpest decline in five years and the sixth consecutive month of declining spending. This came as household income rose 0.1% in March y/y. However, income from bonuses fell. As for spending, certain categories saw an especially sharp decline. For example, spending on clothing and shoes fell 26.1%, culture and recreation fell 20.6%, and spending on education fell 17.4%. On the other hand, spending on food fell only 2.4% and spending on housing was up 1.8%. It is likely that the decline in spending will accelerate in April given that the Japanese government only recently imposed a state of emergency.
2. United States

The US economy contracted at an annualized rate of 4.8% in Q1 2020, the sharpest decline since the global financial crisis more than a decade ago. The degree of decline for the entire quarter masks what happened at the end of the quarter. It is likely that the economy grew at a healthy rate in January, perhaps less so in February due to the impact of the disruption of Chinese supply chains, and then contracted sharply in March – but mostly in the second half of March. Moreover, much of the data gathered by the government in March came in the first half which may explain why the actual decline was less than expected by economists. A helpful comparison might come from examining data from neighboring Canada, where the economy often tends to mirror that of the US. Unlike the US, Canada compiles monthly GDP data. The latest Canadian data indicates that real GDP fell 9% from February 2020 to March 2020. Thus, we can reasonably infer that the decline in Q1 US GDP reflected what happened in March. Moreover, the number probably underestimates what happened because the lion’s share of the US decline took place near the end of March. That is when many state governments ordered lockdowns. As such, it remains reasonable to expect a catastrophic decline in US GDP in Q2 2020.


In the 7 weeks leading up to 9 May 2020 a little over 33 million Americans had filed for unemployment insurance. Non-farm payrolls from March to April 2020, which measures the number of employed persons fell by 20.5 million. This was, by far, the largest decline in history, bringing the number of jobs down to a level last seen in 2011 when the economy was still recovering from the global financial crisis. By industry, the biggest decline was in leisure and hospitality, with 7.6 million jobs lost. Other sectors faced large job cuts such as a decline of 975,000 in construction, 1.3 million in manufacturing, 2.1 million in retailing, 2.1 million in professional and business services, and 2.1 million in healthcare. The latter might come as a surprise given that the virus has boosted the demand for medical services. But the reality is that most non-Covid and non-emergency medical services have been put on hold. People are not visiting doctor’s offices and not undertaking non-essential procedures. The unemployment rate rose from 4.4% in March 2020 to 14.7% in April – the highest level since the Great Depression in the early 1930s.

Source: https://www.bls.gov/news.release/empsit.nr0.htm

Inflation in the US declined dramatically in April, with overall prices falling the most since the global financial crisis of 2008-09. This was largely due to a sharp drop in energy prices. Core inflation which excludes the volatile effects of food and energy prices fell by the most since records began in 1957. In April 2020, consumer prices fell 0.8% month-on-month, the steepest decline since December 2008. This was the second consecutive month of declining prices. In addition, prices were up only 0.3% y/y. The weakness of prices was due primarily to the sharp decline in energy prices. The gasoline component of the consumer price index (CPI) was down 20.6% m/m from the previous month and down 32% y/y. Excluding the impact of volatile food and energy prices, core prices were down 0.4% m/m the biggest decline since records began in 1957. This was also the second consecutive month of declining core prices. In addition, core prices were up 1.4% y/y. Among the other interesting aspects of the government’s inflation report were a 2.6% increase m/m in the price of food at home, reflecting increased demand for groceries as consumers shun restaurants. Indeed, this was the biggest increase in the price of food at home since 1974. There was a 4.7% decline in the price of transportation services such as airlines, reflecting the extreme weakness of demand.

Source: https://www.bls.gov/news.release/cpi.nr0.htm

3. China

Even though China experienced a very sharp decline in retail sales, spending through online retail vendors has increased. In Q1 2020, retail sales at store-based retailers fell 24% y/y whereas online spending was up 6% of course, it should be noted that, in the first quarter of 2019, online retail sales were up 24% y/y. Thus, overall online spending has decelerated due to the decline in income. Still, the net impact of what happened in Q1 2020 is that online sales increased to 25.5% of total spending, up 5% from before. Interestingly, online spending on groceries was up 33% y/y in Q1 as shoppers met their basic needs online rather than by trips to stores. Similarly, online retailing gained market share in other countries including the US and Italy. Yet online retailing in the US and Europe has evidently involved substantial delays and
inefficiencies that are not as prevalent in China. This may be due to the fact that China was already well along in developing an online retail infrastructure. Even before this pandemic, about 400 million Chinese had already engaged in online purchases of groceries. Going forward, there is speculation as to whether what has happened during this crisis will translate into a permanent change in China’s retail environment.

Source: https://www.piie.com/blogs/china-economic-watch/chinas-economic-shock-online-retail-sales-are-prospering

4. European Union and the Eurozone
The European Union (EU) reported Q1 2020 numbers. For the EU overall, real GDP fell 3.5% q/q, or at an an annualized rate of 13.3%. In the 19 member Eurozone, real GDP fell 3.8%, or at an annualized rate of 14.4%. Compared to the GDP print in the US, Europe’s economy shrank three times as fast as that of the US, reflecting an earlier effort to suppress social interaction in order to stifle the spread of the virus. The European numbers are the worst since the EU started compiling such data in 1995. In addition, three major European economies reported their growth figures. In France, real GDP fell 5.8% q/q, or at an annualized rate of 21.3%. This was the sharpest decline in the French economy since 1949 driven by a 17.9% decline in consumer spending, or an annualized rate of 54.6%. In Spain, GDP fell 5.2% q/q, or at an annualized rate of 19.2%. And in Italy, GDP fell 4.7%, or at an annualized rate of 17.5%. The German economy fell into technical recession in Q1 2020 as the economy contracted 2.2% q/q following a contraction of 0.1% q/q in Q4 2019.

Source: https://www.destatis.de/EN/Themes/Economy/National-Accounts-Domestic-Product/Tables/gdp-bubbles.html;jsessionid=5B7B957BF8AFF9DD39751A456A905B94.internet8731

5. Mexico
According to Instituto Nacional de Estadística y Geografía (INEGI), Mexican economic activity fell 2.4% y/y Q1 2020, the worst contraction since the third quarter of 2009. Mexico’s economic performance had already been weak in the first two months of the year, but worsened at the end of the quarter, as containment efforts were scaled up to halt the spread of the virus.

The biggest downturn was in industry which contract 3.8% y/y, as it was the first to be hit, considering the supply chain disruptions during January and February, as China and other Asian economies were under lockdown.

Source: https://jp.reuters.com/article/mexico-economy-gdp-idINL1N2CI0BM

Capital Markets
Throughout May 2020 financial markets, particularly risk assets such as oil prices and equity markets prices have risen compared to the levels of April 2020, but as would be expected, there is considerable volatility as investors try to balance the negative economic news against the hope of re-opening the economy, extraordinary fiscal and monetary policy support and the hope of finding the vaccine, which when combined would lead to a sudden turnaround in what is potentially the worst economic crisis since the great depression.


1. Equities
As countries around the world gradually ease restrictions in an effort to restart their economies, investors are becoming anxious about a second wave of infections as evidenced in Asia after the Chinese city where the pandemic originated reported its first new cases since its lockdown was lifted as well as a fresh outbreak in night clubs in South Korea.


The Dow Jones Industrial Average dropped more than 500 points Wednesday 13 May after Federal Reserve Chairman Jerome Powell said further stimulus could be needed to support the economy’s recovery from the coronavirus-induced contraction. During the speech, Mr. Powell revealed growing alarm about the path ahead, describing the outlook as “highly uncertain and subject to significant downside risks… There is a growing sense that the recovery may come more slowly than we would like…and that may mean that it’s necessary for us to do more,” he said, urging the White House and Congress to spend more money to ensure the economy’s rebound.
2. Interest Rates

While much of the attention on fiscal policy during this crisis as centered on the US and Europe because of the strict cross-country lockdowns, Asia-Pacific has seen a significant shift in policy as well. Many governments in the region are boosting fiscal deficits through increased emergency spending. Japan has pledged to spend an additional 20% of GDP. South Korea will spend 13% of GDP. Even in Southeast Asia governments are going all out. In Malaysia this will entail 15% of GDP, in Singapore 13%, in Thailand 12%, in the Philippines 7.8%, and in Indonesia 3.9%. With the exception of Japan these countries had relatively modest levels of sovereign debt prior to the crisis. Thus, investors needn't necessarily be alarmed. Still, while ratings agencies have not downgraded any country’s bonds, they have downgraded some credit outlooks, expressing concern about how added debt might be financed going forward. In addition, the concern is that, not only are countries increasing spending, but these countries are also facing a sharp decline in revenue owing to the decline in GDP. In the first quarter of this year, real GDP declined at an annualized rate of 7.1% in Japan, 10.6% in Singapore, 5.5% in South Korea, 5.9% in Taiwan, 18.9% in the Philippines, and increased at a rate of 1.0% in Thailand. In any event, the added sovereign debt could constrain the ability of some of these governments to spend on public investment in the near future and could force them to raise taxes. Some might subordinate monetary policy to the needs of governments, thereby fueling inflation. Yet that would lead to currency depreciation and possible debt servicing problems which will ultimately lead to higher interest rates, which makes financing the deficits and debt service even more expensive which may lead to a continued rise in national debt levels, further constraining these governments when the next economic crisis arises.

3. Commodities

In commodity markets, oil prices rose after OPEC’s de facto leader, Saudi Arabia, said it would increase supply curbs in June 2020, while other members of the oil-producing group said they want to extend the deep cuts reached in April for a longer period than originally agreed but very quickly these were offset by the possibility of a second wave of coronavirus cases in countries starting to ease lockdowns, while industry data showed a rise in U.S. crude inventories. Related to the aforementioned speech given by Chair Powell overshadowed a further call by Saudi Arabia for larger production cuts to balance the market following a virus-induced demand slump, after OPEC’s biggest producer said earlier this week it planned to add to cut output again.


Useful Resources

| Investing.com | United States: Bureau of Economic Analysis | Deloitte Insights: Economics |
| Yahoo! Finance | Cabinet Office of Japan | International Monetary Fund |
| Federal Reserve Board | European Commission: Eurostat | Project Syndicate |
| Bank of Japan | United Kingdom: Office for National Statistics | Organization of Economic Cooperation and Development |
| Bank of England | Federal Reserve Economic Database | Aon: Political Risk Heatmap |
| People’s Bank of China | Reuters | |

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