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BLOG

Reignite – Preparing for a post-pandemic world

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Except for consumers, no one knows when and how the economic effects of the pandemic will end

Two weeks after stopping consumption of green leafy vegetables, as two major vegetable markets in New Delhi reported COVID-19 cases, my wife commented, "Let's start eating green vegetables. For how long are we not to?"

We acknowledge this is not a scholarly or well-researched statement made by a renowned economist, but a behavioural observation affecting a basic unit of consumption, i.e., a family, that incrementally builds demand to spur economic growth. It is significant, however, as we wonder when economies will be kick-started.

Finding a solution begins with understanding the problem

To do this, we need to determine (1) what happened due to the pandemic and (2) how pandemics and their impacts end.

Pandemics lead to fear of outdoor activities and contact, leading to suppression of demand. The degree of fear is directly proportionate to the (a) spread, (b) intensity and (c) lethality of a disease. In the case of communicable diseases, such fear leads to stopping contact and social activity. The COVID-19 pandemic poses significant risk, being "unprecedented in the combination of its easy transmissibility, a range of symptoms going from none at all to deadly", according to magazine Scientific American.

As a result, demand dropped across industries, bringing economic activity to a standstill. Something feared during the 2018-09 financial crisis actually occurred from March to May. However, cessation of activity was not universal, and the pandemic's impact on the different sectors varied.

What happened from March to May?

Standstill eroded demand – from lifestyle products to essential goods

As the world feared contact and, by extension, movement and socialising, demand for lifestyle products and services eroded with repercussions on many other industries. For example, MarineTraffic showed ships stalled at sea, and Flightradar24 showed skies bare of aircraft. Acuity

Knowledge Partners (Acuity) has analysed these repercussions in previous blogs, e.g., the disruption in global energy transition and the impact on the energy and hospitality sectors.

Even food demand in the US declined in April 2020, after a likely stockpiling in March 2020. In addition, food consumption patterns changed, due to the loss of school and other meal assistance programmes. Food prices increased sharply (flour up 1%), especially of meat products (beef up 4.4%) due to supply constraints as meat-producing units faced closure and mass euthanasia, milk was dumped,and vegetables rotted. Notably, only 8% of food produced was consumed locally.

On the other hand, the technology sector seemed to be flourishing. Amazon WorkSpaces registered 155% growth in March 2020 alone and reported its first USD10bn in revenue in the first quarter.

Investors are less affected than industries and corporates

M&A transactions were almost halted in March, and deal volumes fell 72% y/y in April. Some deals did not come through, the most notable example being the Xerox-HP deal. On the other hand, many deals seem to be progressing as planned, as their status has not changed. However, deal volumes are expected to remain subdued for the remainder of 2020.

Besides, banks now have better structures and risk-management systems after strengthening themselves after the 2008-09 crisis. Similarly, asset managers, especially private equity firms, have significant dry powder, as we have ascertained, boosting confidence that they have sufficient capital in addition to benefiting from government stimulus measures.

Dusty Philip, co-head of global M&A at Goldman Sachs expects to see deals in the healthiest of sectors—think tech and healthcare—and the least viable sectors, like energy. In healthy sectors, M&A will strive for growth, while in the latter, it's all about survival

What drives an economic revival?

Unlike extreme economic events, pandemics have not been studied well from an economic point of view. A November 2007 study by the Federal Reserve Bank of St. Louis, for example, suggests that the economic impact of the 1918 Spanish flu pandemic was short-term in nature. Companies in the service and entertainment sectors suffered losses, while those in healthcare thrived. The pandemic 'caused a shortage of labour, giving rise to higher wages' in the short term, ***but the resulting 'reduction in human capital' had 'implications for economic activities occurring decades after the pandemic'.***

The race is on to end the pandemic – medically and psychologically

The race for a cure is on. However, we do not know when one will be universally available. Besides, the UK's and Italy's experiences indicate that herd immunity works, and countries would typically take just a few months to cross the deadliest phases.

Until a vaccine and/or a medication is developed, though, restrictions may be eased, marking an end to "fearing" the pandemic, simply because countries need to restart their economies. Many are also willing to face the risk of infection, wanting to reclaim a part of their past lifestyles. Besides, many have been struggling financially, depleting savings, hoping for the pandemic to end so they can begin earning a livelihood. This is especially the case with those on the dole in emerging markets.

Again, a lot depends on how we look at the pandemic. Healthline Media reports that COVID-19 has a 3-4% fatality rate, less deadly than the Ebola virus, which has a 50% fatality rate. On the other hand, with very delayed symptoms, COVID-19 has spread far wider and emerged as a more deadly type of flu. Our behaviour, therefore, is likely to be directly impacted by the number of reported cases and community responses.

Working with levers of revival

Asset prices may help build confidence more than measuring underlying economic activity

As discussed before, the lack of relevant economic thought hinders our understanding of the current crisis. Hence, we borrow pointers from recent events such as the global financial crisis (GFC) of 2008-09. During the GFC, governments and industries worked together to restore asset prices irrespective of how inflated and unaffordable they had become in the years leading to the crisis. This was primarily because a significant amount of savings – including pensions – was invested in assets worldwide, including in speculative assets.

We see a similar situation now as asset prices rebound from their lows in March-April 2020; in many cases, they are just a fraction away from their January highs. Although the forecast is bleak, in terms of a drop in GDP growth and an impeding recession, the markets seem to be oblivious. In the three months that it became a pandemic, COVID-19 has been factored in, meaning that no more surprises are expected, leading to a stabilisation of indices.

In favourable scenarios, we may see significant growth in 2021 because (1) the expected 2020 base will be sharply lower and (2) people have amassed significant savings amid the lockdown, which should lead to a rebound in spending.

Businesses on a war path to stay afloat by reinventing and canvassing for safety

Restaurants in particular are evolving, making notable changes in the way they operate – from providing isolated seating to takeaway and home delivery. Even hotel chain Marriott is opting for home delivery. Besides, delivery services have been changing from a less critical and outsourced function to a key function. For example, Behrouz, a biryani delivery platform, has recently been advertising the health and fitness of its “own” delivery staff.

Even car sales may move online – with more personalised services. Airports are creating models to facilitate contact-less journeys.

Governments may pledge the usual packages

Governments usually tend to inject confidence and stimulus through increasing liquidity and non-financial policy measures. Governments globally have taken measures, but they are working with interest rates and liquidity infusion – tools that have been spent since the GFC of 2008-09. The effect of government stimulus, therefore, will be interesting to see.

Besides, governments in economically distressed countries have limited choices and have started implementing measures to build confidence. For example, in mid-June, Italy opened its entertainment venues and its tourist attractions in Venice, and Greece’s prime minister visited Santorini in efforts to attract tourists.

The instability may force innovation

On the constructive side, this may speed up adoption of technology in a plethora of businesses, leading to the emergence of new business models. On the challenging side, the current disruption may call for readjusting supply chains and supplier relations, and making significant investment in new facilities, partnerships and redesigning.

Besides, a pandemic usually does not have a definite ending. There may be a second wave, as China is experiencing in Beijing.

Do we revert to the old normal or find a new normal?

Answers to this question are as speculative as ever. As noted earlier, those with a long-term view and businesses that directly address the COVID-19-related constraints are in operation. However, consumers' fears will likely reshape consumer behaviour and business models.

Rebuilding consumer confidence in labour- and contact-intensive businesses (e.g., travel, hospitality and entertainment) may take time. However, as philosopher and bestselling author Yuval Harari noted, millennials are fuelling the "experience economy" by spending more on experiences than on decorating their homes. This may provide the necessary boost to revive these businesses.

Whether the impact will be long-term or short-term would ***depend on the virulence of the virus and the waves of the pandemic,*** if any. In addition, as a community, we are too deeply invested in our assets to lose their valuation. Hence, certain concerns will likely remain until the dust settles:

- How well has a country tackled the pandemic?
- How will consumer behaviour evolve?
- Will distrust and anger cause socio-political-economic upheaval like they did after the GFC?
- Are other risks likely to emerge?
- Will environmental, social, and governance (ESG) themes in business and investing emerge stronger?

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