Global Alumni Town Hall

COVID Recovery Expectations, Geopolitics and Impact on Trade & Business, and the Power of Purpose

November 19th, 2020
Welcome to BCG's Global Alumni Town Hall

- Thank you for joining us from a community of 26k people worldwide.
- This is our monthly global live session after starting a series of successful webinars in April. We're glad to make this happen again!
- This challenging time has brought us together, but we wanted to connect with all of you as unique and valuable members of the BCG community.
- Since the beginning of COVID we have published 400 new pieces on bcg.com, an 80% growth in articles and reports that reflects our collective commitment to publish and share how COVID is impacting our clients across industries and sectors on a range of capabilities.
- Before we begin, some housekeeping items:
  - You're all muted for a better audio experience
  - In case of tech issues, write to Alumni_relations@bcg.com
  - We'll share these slides with you along with the recording!
Welcome to our speakers

Philipp Carlsson-Szlezak
BCG’s Chief Economist

Michael McAdoo
Partner & Director, Global Trade & Investment

Ashley Grice
CEO Brighthouse
What we'll cover

- Why the Covid Recovery Beats Expectations - and Can It Last?
- How Geopolitics Will Impact Global Trade & Business
- The Power of Purpose
A few notes before we begin

• When you are not speaking, please stay on mute via the toolbar (far left side) to avoid background noise
  You can Unmute yourselves at the end of the session for Q&A

• For Zoom participants on their computers:
  - If you would like to ask a question at any time, please use the Q&A or Chat function
  - You can also click on the Raise Hand icon beside your name in the participant list to indicate that you need something from the host

• How do I know who’s speaking? The person speaking will have a yellow frame around them
Philipp Carlsson-Szlezak
This material draws on the recent article *Why the Global Economy is Recovering Faster Than Expected* published in Harvard Business Review on November 3, 2020.

The articles and others in the series can be accessed on hbr.org
Recovery beat expectations

Where the virus spread widely the expectation was that bad economic news would continue. But relative to those expectations the data surprised to the upside (U.S., Europe, and global).

For China, which largely contained the virus early on, expectations were never set that negatively and thus we have not seen big upside surprises in Chinese data.

Source: Citi, Bloomberg, BCG Center for Macroeconomics
Three engines of consumption – two fully back online, one not yet

Total consumption (100%)

Sectors unaffected by lockdown or social distancing (46% of consumption)

Sectors affected by lockdown but not by social distancing (15%)

Sectors dependent on vaccine (affected by lockdown and social distancing (38%)

The shock had little or no impact on food or housing consumption.
The lockdown had a meaningful impact but once past lockdowns, see full recovery. Each groups is a goods sector.

Lockdown had a large impact and recovery still hampered by social distancing – mostly services.

Latest (September)

Trough (month)

Dot fill for “Goods”

Dash fill for “Services”

Main opportunity post-vaccine

Source: BEA, BCG Center for Macroeconomics
## 2008 vs. 2020: COVID drivers primed for strong recovery – can it last?

### GFC (2008/09):
Less drawdown but a more pernicious recession

<table>
<thead>
<tr>
<th>Nature of recession</th>
<th>Concentration of decline</th>
<th>Primary driver</th>
<th>Policy or structural damage</th>
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<td>Policy error</td>
<td>Services</td>
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### COVID-19 (2020):
Bigger drawdown but a less pernicious recession

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### Design

<table>
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<tr>
<th>Policy response</th>
<th>Magnitude</th>
<th>Timing</th>
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<tbody>
<tr>
<td></td>
<td>Ineffective</td>
<td>Poor</td>
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<tr>
<td></td>
<td>Too small</td>
<td>Meaningful</td>
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<tr>
<td></td>
<td>Far too late</td>
<td>Late but impactful</td>
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</table>

### Type/Channel

<table>
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<th>Structural Damage</th>
<th>Magnitude</th>
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<tbody>
<tr>
<td>Capital stock investment</td>
<td>Significant</td>
</tr>
<tr>
<td>Labor growth participation</td>
<td>Moderate</td>
</tr>
<tr>
<td>Productivity</td>
<td>Little to none</td>
</tr>
<tr>
<td>Bankruptcies Firm &amp; IH</td>
<td></td>
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<tr>
<td>B.S. damage</td>
<td></td>
</tr>
</tbody>
</table>

### Source:
BCG Center for Macroeconomics (CME)
Capex/investment: Structural damage contained

Fears of bankruptcies haven't come true (Business bankruptcies)

Despite shock investment orders rebounded very quickly – leave narrow gap

Few bankruptcies and investment recovers rapidly – containing overall loss

This was the largest drop in GDP in nearly a century stoking fears of waves of bankruptcies and collapsing investment, but the bankruptcies haven't come, and investment recovered rapidly.

When thinking about the loss in the capital stock one can consider the width of the gap that opens in investment – today's gap appears much smaller than those of prior recessions.

Source: Administrative Office of the U.S. Courts, NBER, U.S. Census, BCG Center for Macroeconomics (CME)
Policy: Fast and very potent (contrast to 2008)

Real personal income growth *rose* during the crisis as wage growth *fell*.

Household income derived from wages and salary fell at its fastest pace on record as employment collapsed...

... yet personal income grew at the fastest pace on record as stimulus checks and other transfer payments (e.g., unemployment insurance) more than filled in the gap.

Note: Current recession length assumes it ended when unemployment starts falling – the official length has yet to be determined.

Source: NBER, BEA, BCG Center for Macroeconomics analysis
### The Risk Profile (How it could go all wrong from here)

#### Structural Risks: Drivers

<table>
<thead>
<tr>
<th>Nature of recession</th>
<th>Unlikely, but residual risk of &quot;systemic&quot; contagion (e.g. real economy collapse infecting banking system) can change the &quot;nature&quot; of Covid recession into a financial recession</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy response</td>
<td>As the crisis ages, risk of stimulus fatigue raises. Young crisis catalyzes political willingness, aged crisis enters a politicized environment and struggles to pass stimulus. Policy is likely to be less than ideal, but not insufficient</td>
</tr>
<tr>
<td>Structural Damage</td>
<td>Less likely, but structural damage of economic potential could still emerge in a negative scenario where capex collapses and labor market shows structural damage</td>
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#### Tactical Risks: Idiosyncratic

<table>
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<tr>
<th>Health policy restrictions</th>
<th>Steepening case and death curves trigger renewed strict and broad lockdowns, forcing activity of already recovered sectors to retreat</th>
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<tbody>
<tr>
<td>Vaccine timelines and efficacy</td>
<td>Despite strong upside surprises, remaining hurdles could prove difficult (roll-outs and distribution, efficacy) and negative surprises remain possible (side-effects, virus resistance and/or mutations, etc.)</td>
</tr>
<tr>
<td>Non-Covid risks</td>
<td>Other risks have been largely forgotten during the pandemic, but they still weigh in a judicious accounting of the risk profile (geopolitical shocks, financial conditions shock, etc.)</td>
</tr>
</tbody>
</table>

Source: BCG Center for Macroeconomics (CME)
Tactical risks (I) – Return of the lockdown

New lockdowns pose a material headwind in Q4

New lockdowns pose a real risk to economic activity as sectors that had re-engaged take a step back.

However the prospects for economic impact on par with what was seen in the 2Q is unlikely both as lockdowns can be more targeted, are less of a shock (already restricted), and occur when more areas of the economy are ready to operate in a social distanced way.

Covid-19 response stringency index show restrictions tightening

Source: Oxford University/Blavatnik, BCG Center for Macroeconomics
Tactical risks (II) – Tailwind from accelerated vaccines

Good Judgement Project ("Superforecasters") suggest vax sooner

In the depth of the crisis (April) the expectation was that it would be well in 2022 before a vaccine was wildly distributed (purple line).

Here too the surprise has been positive – now expectations are for a vaccine to be meaningfully distributed by the end of the first quarter of 2021.

Yet if the vaccine is distributed slowly it will be a headwind to 2021 growth expectations.

<table>
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<tr>
<th>Forecast History:</th>
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<tr>
<td>100</td>
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<tr>
<td>80</td>
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<tr>
<td>60</td>
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<tr>
<td>40</td>
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<tr>
<td>20</td>
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<tr>
<td>0</td>
</tr>
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</table>

Source: Good Judgement Project.
Recall that 2021 is about recovery of services sectors

Switching services sectors back on likely to return us to pre-Covid levels of output

The first two engines of U.S. consumption bounced back when social distancing replaced lockdowns.

However, some sectors, representing 38% of consumption, are truly vaccine dependent – mostly services.

There is credible prospect of removing the bottleneck in these services sectors as a vaccine is rolled out in 2021.

Key assumptions:
- Covid recession will continue to avoid systemic/structural downside.
- Continued policy support despite diminished prospects for outsized effort post-election.
- Current vaccine timelines hold.

Strong 2021 base case is built on removing obstacles to full recovery in services sector.

Source: BEA, BCG Center for Macroeconomics
## Scenario description – Strong 2021 base case

### Nature of recession decays
- **Downside**
  - Renewed health crisis triggers renewed economic crisis
  - Policy support fails
  - Crisis infects the financial system

- **Base case**
  - Vax success starts to end health crisis – at least enough so that even services sectors operate at prior levels of capacity.
  - Levels of economic activity surpass pre-crisis levels but not yet regain pre-crisis trend
  - Renewed policy support can help deliver an even strong recovery.

- **Upside**
  - Extraordinary renewal of policy support
  - Fast distribution of vaccine
  - Labor markets back to a tight stance

### Return to tight economy
- **Downside**
  - Extraordinary renewal of policy support
  - Fast distribution of vaccine
  - Labor markets back to a tight stance

- **Base case**
  - Foundations for a strong year due to the potential for bounce back and tailwinds of comprehensive reopenings

- **Upside**
  - Extraordinarily strong recovery
  - Tight labor markets

<table>
<thead>
<tr>
<th>Description</th>
<th>Conviction</th>
<th>What it would take</th>
<th>Outcomes</th>
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<tr>
<td><strong>Renewed health crisis triggers renewed economic crisis</strong></td>
<td><strong>Low conviction (10%)</strong></td>
<td><strong>Policy support fails</strong></td>
<td><strong>Renewed severe recessions, systemic risks</strong></td>
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<td><strong>Policy support fails</strong></td>
<td><strong>Low conviction (10%)</strong></td>
<td><strong>Banking system hobbled</strong></td>
<td><strong>Return to pre-crisis output level in mid or late 2021 (for those not already there)</strong></td>
</tr>
<tr>
<td><strong>Crisis infects the financial system</strong></td>
<td><strong>High conviction (80%)</strong></td>
<td><strong>Vaccine distribution allowing services sectors to open more fully</strong></td>
<td><strong>Distance (for most) remains to pre-crisis trends.</strong></td>
</tr>
</tbody>
</table>

**Source:** BCG Center for Macroeconomics (CME)
2021 base case: U.S., Europe, China

**United States**
*Less bounce, earlier new high*
- Q4 headwind but contraction unlikely, thus less 2021 bounce
- Back to pre-Covid level by mid-year as remaining sectors re-engage
- 2021 growth ~4.1% (4q/4q)

**Europe**
*Bigger bounce, later new high*
- Q4 challenge (W-shape) thus stronger 2021 bounce
- Plausible bounce to pre-Covid levels late in 2021
- 2021 growth ~5.9%

**China**
*Recovery already done*
- Already recovered – organic growth more difficult than bounce-growth
- China remain high potential
- 2021 growth in line with potential of ~5.3%

Return to pre-Covid levels is not same as full recovery

Return to pre-Covid is within reach in 2021, but can we return to pre-crisis trend?

Two questions to watch:
(1) When will output pass the pre-Covid high? This seems likely in the middle of 2021 (in the U.S.)

(2) How much of the gap between the old trend in output can be closed? This question will not be fully resolved in 2021 as the gap is likely to continue to narrow.

Source: BEA, BCG Center for Macroeconomics (CME)
Michael McAdoo
Past ~200 years were not "Normal"

% share of World GDP at PPP - selected years

Note: Includes the assumption that growth after 2019 growth will be 2% for US and Europe, 4% for Rest of World and 6% for Asia
International trade value and real GDP
Global import value ($) and real GDP (2000-2019)

From 2000-08, trade value growing ~4x GDP

Drop in Trade much more than drop in GDP

From 2011-19, trade value growing ~0.8x GDP

Source: UN Comtrade; World Bank; Economist Research Center. BCG analysis
Still, in 2019, global trade grew in all major corridors, save US-China.
Trade recovery, post-Covid, will be driven by three factors

I. GDP performance
   - Tend to decrease/shift trade
     - Economic recession
     - Uneven economic growth
   - Tend to increase trade
     - Economic expansion
     - Balanced global growth

II. Geopolitical orientation
   - Tend to decrease/shift trade
     - Increasing RTAs
     - Nationalist policies
     - Protectionism
     - Restriction on migration
   - Tend to increase trade
     - Multilateral agreements
     - Globalist policies
     - Freedom of movement

III. Supply Chain trade-offs
   - Tend to decrease/shift trade
     - Multi-Local sourcing, higher safety stocks
     - Inaccessible low-cost labor supply
     - Faster adoption automation/robotics
   - Tend to increase trade
     - Global sourcing, JIT inventory
     - Accessible low-cost labor supply
     - Slower adoption of automation/robotics

Source: BCG Analysis
Geopolitical tensions not limited to US-China

 Declining Altruism
Economic nationalism from the left and right
Fewer voices supporting the global trading system
Key trade relations restructured:
• NAFTA / Auto
• Paradigm shift in US-China Trade
• Uncertain attitude towards EU & Japan
• Backing away from WTO

Post-Brexit blues
Anti-EU sentiment drives surprise Brexit vote
Redefining relationship with EU, US, and world

On the fence
Complex geopolitics and economic stagnation
Redefining relationship with EU, US, and world

Shifting political consensus / Alliances
Anti-globalization parties on the right and left. Limited ability for Consensus on trade.
Evolving trade relations with UK, US, China

Economic Sanctions
Geopolitical Moves drive Western Sanctions
Complex Public Policy / Regulatory environment

The New Superpower
Now #2 world economy, seeking to both use global institutions and build alternatives
One Belt, One Road policy reaching into Asia, Africa, Europe
Deepening trade and political tensions with US

Trouble in the House
Saudi, UAE, & Bahrain blockading Qatar
FTA negotiations with potential partners have stalled

Source: BCG analysis
New supply chain models will emerge | Three sample models

Illustrative example for a firm traditionally manufacturing in China and selling globally

Global supply chains
Global supply chains with added redundancy, but limited footprint changes due to cost & access

Migrated supply chains
Global supply chains shifting certain steps to new geographies to reduce geopolitical risk

Multi-local supply chains
Closer to end-markets, enabled by technology, and naturally hedged against exogenous shocks

Degree of change for typical MNC

1 Sourcing
2 Manufacturing
3 Distribution
Change in trade of goods (major corridors\(^1\), base case, 2023F vs. 2019, $B)

~$18T

Global trade 2023F

Legend

- Width of arrow represents total change in trade flows 2023F Base vs 2019 Base
- Color of arrow represents change 2023F compared to 2019 Base
- Star represents biggest % volume changes 2023F compared to 2019 Base

1. Corridors in the map above represent -32% of global trade. Intra EU=-20%; NAFTA=-8%; China/Hong Kong/Taiwan=4%; ASEAN=3%, RoW=-32%

Source: BCG Trade Finance Model 2020, UN Contrade, OECD, WEF, IHS, TradeAlert, BCG Analysis
Ashley Grice
PIONEERS OF THE PURPOSE MOVEMENT
THESE UNPRECEDENTED TIMES
ABILITY TO CHANGE
SOAP & CANDLES
LIFT THE WORLD
FIND SOLUTIONS
FIRST, MOVE THE WORLD
SEE CHALLENGE AND EMBRACE OPPORTUNITY
Closing Round
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