

ARTICLE FOR THE EDGE

AFTER COVID: A NEW WORLD TAKES SHAPE

Across the globe, lockdowns are easing and economic activity is gradually resuming. But with the pandemic likely to be with us for a long time, the world is not going to back to the old ways. Typically, deep and widespread crises such as this pandemic tend to accelerate existing trends while also setting in train new ones. What shape the “new normal” will take is still uncertain but the patterns emerging in a few important areas point to challenging times ahead: Existing political frictions have worsened to a point where there could be economic damage; there is a greater likelihood that the world economy will be less vibrant; the chances of damaging financial turbulence have increased; and countries as well as companies will have to adapt, sometimes painfully, to structural changes that the crisis has accelerated.

Political changes will be a drag on economies

Three sets of political forces that were already underway before the crisis are likely to accelerate because of the pandemic – the US–China tussle, the backlash against widening inequality and the growing attraction of inward-looking economic policies. The consequences will certainly be adverse for the world economy.

Of these forces, the fraying relationship between the two most important countries in the world is the most worrying. Prior to the pandemic, the US and China were already getting more testy with each other but mature voices were still able to prevail, which is why a deal to resolve trade disputes could still be inked earlier this year. But the pandemic has instigated a turn for the worse. The American political class is furious that China had initially suppressed news about the pandemic. Unable to coherently manage their pandemic, American leaders have found it expedient to slam China for a whole host of evils. The Trump Administration is moving against China in many areas – restrictions on technology, threats to delist Chinese companies from American exchanges, and placing limits on visas for Chinese students seeking to study in the US. Separately, the US Congress has also passed legislation to punish Chinese officials implementing policies on Hong Kong, Xinjiang and Tibet. A lot more is in store.

China, on its part, has adopted a harsher tone in foreign policy, not just towards the US but towards anyone who dares to offend it. China’s leaders seem to believe that their successful containment of the pandemic proves that their ascendancy is unstoppable, they do not see any need to genuflect to the US or anyone else. China will retaliate against American measures targeting it while also sanctioning US allies or others who annoy it – as Australia found to its cost when it sponsored a resolution in the World Health Assembly that angered China.

In essence, the pandemic has caused the relationship to pass the point of no return. This trend goes beyond simple election year China-bashing in the US or Chinese leaders playing to their nationalist gallery. Recent events have crystallised a struggle for ascendancy between

China and the US which will last for a long time – even a new president in the US will not change this.

This region will be a big loser. As the primary arena for that tussle, East and Southeast Asia will see military tensions grow. One of the casualties will be trade – there will be acrimonious exchanges over whether China is fulfilling its commitments under the January trade deal which will lead to more American trade restrictions on China, some of which could spill over and hurt Asian exporters. The US will almost certainly succeed in mobilising more of its allies to restrict Chinese investments and acquisition of technology in strategic areas. The risk of the technological arena being split into two – a western one and a Chinese one – is now higher.

The pandemic has also made it more likely that a backlash against widening inequality will produce a more difficult environment for businesses. Across the developed world, the economic losses caused by the pandemic have been borne disproportionately by lower income groups while the asset price inflation generated by policy responses to the crisis have boosted the wealth of the already-rich. This has given more momentum to political groups advocating a decisive shift in policies in favour of the disadvantaged segments of society. Post-crisis, we will see a stronger commitment to expanded social safety nets which will have to be funded by higher taxes. Not only will income tax rates rise, but wealth taxes and estate duties are likely to make a return. Tighter regulations governing fair trading and competition policies will increasingly limit the room for manoeuvre that corporations now enjoy.

Another emerging trend is towards more inward-looking economic policies. The US, together with other developed countries, is now questioning the decades-long trend of manufacturing capacity relocating towards lower-cost countries. New laws are virtually certain to be passed to mandate domestic production of strategic items, including medical equipment and pharmaceuticals as well as items needed for military defence such as electronics components.

This tendency to favour home-grown production is becoming evident elsewhere as geo-political tensions and rising protectionism persuade more countries to reduce dependence on foreign markets or overseas sources of vital items. In China, policy makers are increasing their emphasis on domestic demand over export-oriented economic development. It is telling that Wang Jian, the economic thinker whose seminal article in 1988 laid the basis for China's export-oriented development model, has now called for a reversal in favour of domestic orientation. In India, Prime Minister Modi has embarked on a new wave of economic reforms called "Aatmanirbharata" which roughly translates into "self-reliant India".

A less vibrant global economy

A world beset with technological bifurcation, growing protectionism, higher taxation and more inward policies will tend to be less efficient, constraining economic dynamism. In addition, the shock of the pandemic will create other pressures on economic growth.

For one, so deep and widespread has been the shock of the loss of jobs and incomes, that

individuals will almost certainly seek to put aside higher cash buffers in case there are more such shocks in future. Consumer spending will therefore tend to slow.

In addition, companies will face great uncertainty over the strength of economic recovery and the direction of policies and political risks. They will become more cautious about investment while also increasing their own cash buffers by reining in spending and hiring.

Moreover, the post-crisis world is likely to see higher spending in non-economic areas. Rising geo-political tensions almost certainly mean that countries will have to raise defence spending. Rectifying the stark rise in inequality is politically and socially necessary – but the higher taxes and greater spending on welfare could initially mean slower economic growth – albeit with rewards in the future such as a healthier and more productive work force, reduced crime and higher social mobility.

Higher risks of financial turbulence

Global central banks had barely exited from the ultra-easy monetary policies employed during the global financial crisis before they were hit by the pandemic. Another round of massive monetary easing is now underway. The speed and scale of expansion of central banks' balance sheets has been quite extreme.

This has helped stabilise the global economy but one wonders about the longer term consequences. Asset prices have soared from their lows in late March, with US equities now trading close to pre-crisis levels – it's almost as if the crisis did not happen, that economies have not crashed and millions of jobs have not been destroyed. Interest rates are back at historic lows and there are even serious discussions in countries which have resisted negative rates whether they should change course.

The longer term consequences are murky but it strikes us that when capital and risk are priced at such cheap levels, investors and speculators tend to make risky bets that create financial imbalances. And eventually those imbalances cause markets to tumble.

Supply chains will be reconfigured

Just as governments are now more concerned about resilience and will require more domestic production, companies have also learnt a hard lesson that resilience requires them to be more diversified in sourcing of components and locations of their production bases. Some profitability and efficiency will now be sacrificed in order to ensure that future crises do not cause the dislocations this pandemic induced. However, the reconfiguration of supply chains will be a complex process.

First, because so much manufacturing activity (almost a third of global production) is now concentrated in China, diversification of production must mean a significant amount of manufacturing out of China. Although some surveys of foreign investors already in China show very few wanting to move out, the actual actions of large companies suggest that many

will shift the export-oriented parts of their production out while still committing new investment for production meant for the Chinese market. Apple, for instance, has moved about 30% of the manufacture of its popular AirPods from China to Vietnam.

Second, China will not be the only loser from relocation. Look at how Panasonic is planning to shut down its appliance production facility in Thailand so as to consolidate production in a new facility in Vietnam which being larger than the existing Thai one, also promises greater cost efficiencies.

Third, India and Indonesia are promising significant labour and other reforms which could be game-changing in making these two countries with huge work forces and low production costs more attractive to foreign investors. If the reforms are really carried through, we could see more production shifting to these two Asian giants.

Fourth, because of likely new laws in developed countries, some production will also shift to richer countries. TSMC has already shown the way with its USD12 billion investment in a new semiconductor facility in the US. European policy makers are also pressing companies to commit to more production of essential items in Europe.

The bottom line

This discussion has touched on just the main shifts in trends that will make up the new normal. But they give a flavour of the challenges ahead, for policy makers as well as for businesses.

One major consequence of these changes is that, for some time to come, the expansion of global demand will proceed at a slower pace. Export-oriented Asian economies will have to adjust to that and find new engines of growth.

Another challenge will be a more turbulent environment as a result of the political ructions that will follow as well as the higher chances of financial market volatility.

Finally, both countries as well as companies will have to adapt to new supply chain configurations: they may no longer be so competitive as before in some areas and will need to find new niches where they can prosper.

Whatever the case, there is no room for complacency or business as usual. Whether for policy makers or for corporate leaders, this is no longer the time for tweaks and incremental changes, it is the age when the bold will be rewarded and the timid penalised.

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