Profimex Market Research Update – May 6, 2020

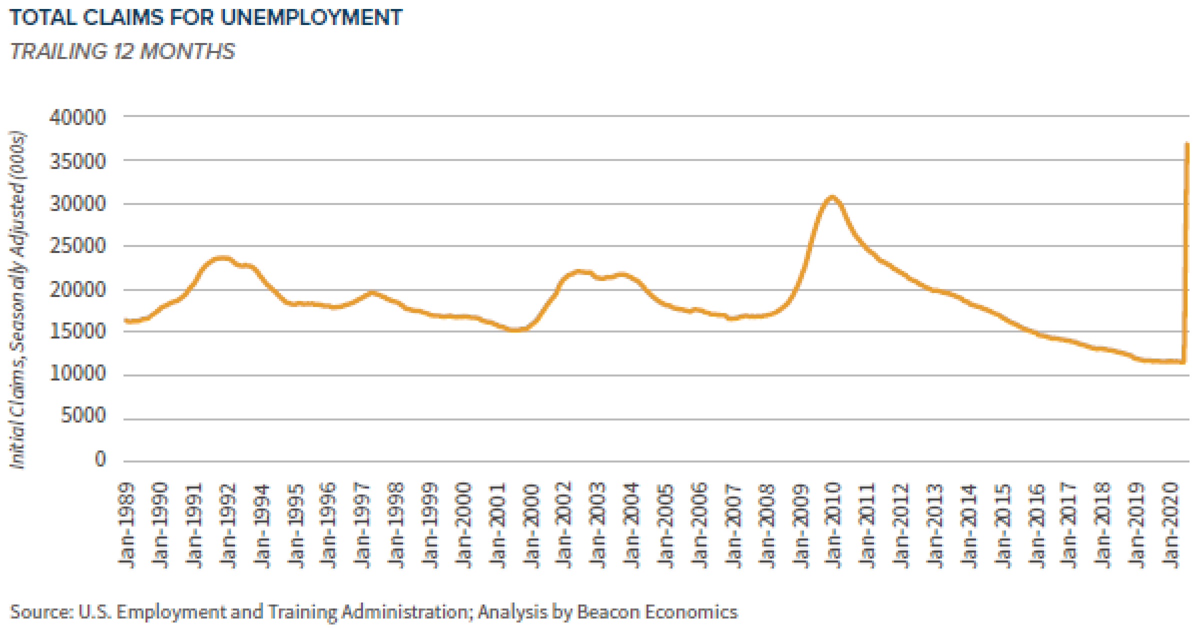
The Post Covid-19 Economy

Economists share very different opinions on the extent of the economic decline in the US and the time it will take for the economy to recover. As economic statistics significantly lag those of public health, the full extent of the downturn is not quantifiable at this time. Current estimates from a variety of forecasting organizations however suggest second quarter growth could run from -20% to -40%. Those numbers are reported on a yearly base, which makes them sounds much worse. Second quarter output will contract by "only" -5% to -10%, which is still a historical record high.

Moving forward, we are interested in the time it will take for the economy to recover. Economists refer to "V", "U", "W" and even "L" shaped recoveries. The "U" camp suggests a business cycle, comparable to the one of the Great Recession. This conclusion however has according to Beacon Economics ("BE"), an independent research firm and publisher of this article, very little basis. BE believes that there are few reasons to believe that the US economy will not be able to have a fast recovery – possibly even so fast that we might debate over whether this was in fact a true recession.

BE sees GDP growth as follows: 0% in Q1, -30% in Q2, 25% in Q3, and 5% in Q4.
When addressing this recession, it is very questionable to compare it to any historic recession. The last financial crisis was caused by a collapse of the inflated sub-prime lending industry and ultimately led to the permanent loss of millions of jobs. This recession however was triggered by an external factor in a period of economic health and not underlying fractures in the financial industry.

One argument of "U" shape supporters are the 30 million Americans, who claimed for unemployment in less than 6 weeks, compared to "only" 22 million that were lost in 2008. While the jobs that were lost during the last financial crisis were simply unsustainable, the jobs that are lost today come from profitable, viable businesses that have been impacted temporarily by public health mandates.



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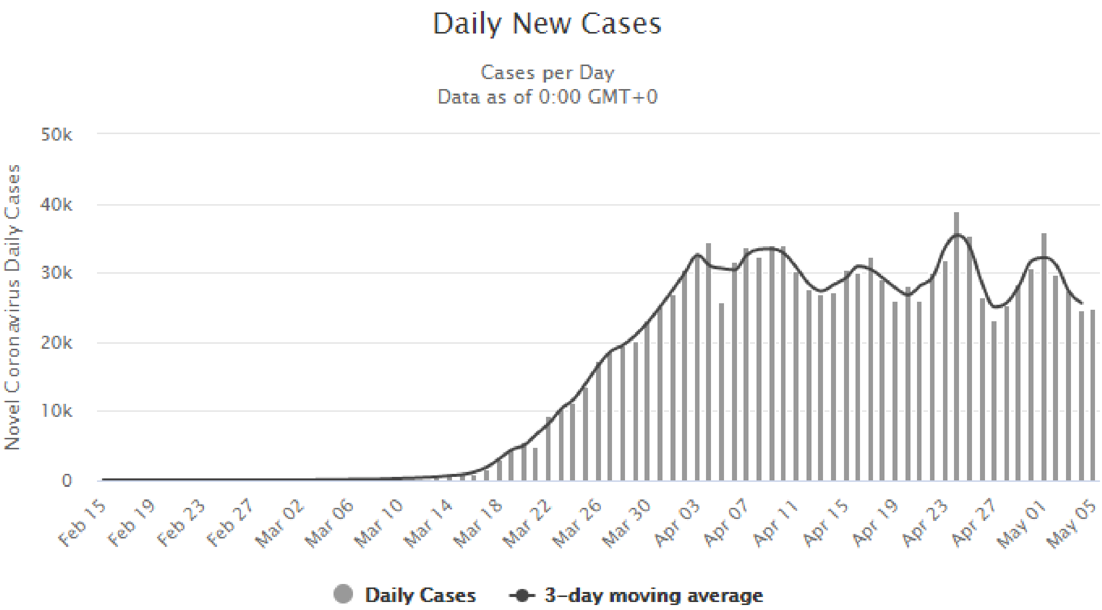
BE's opinion of a "V" shape recovery is supported by the short analysis of 5 major questions:

1. How long until the public health mandates are lifted?
2. How deep is the current shock to the economy?
3. What is government doing in the meantime to soften the blow?
4. How fragile/healthy was the economy when the pandemic first hit?
5. Will there be permanent significant changes in consumer behaviour?

1. How long until the public health mandates are lifted?

The number of new Coronavirus cases seems to have peaked in US and many other hard-hit nations and first relaxations of public health mandates are experienced in states, such as California. If the US follows roughly the same path as China, which leads the world in its post-shutdown surge and its control efforts, citizens can expect the government to start lifting measurements later this month (May). While the world waits for the Coronavirus to be contained to the point where it is safe to lift the public health mandates, businesses are losing revenues and families are losing income.



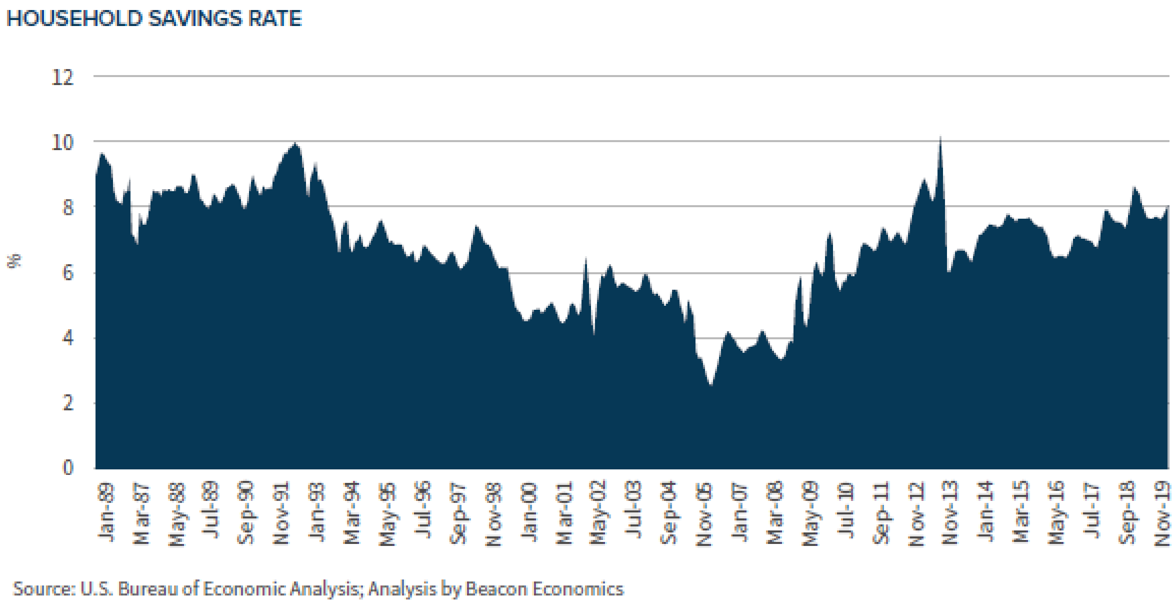
Source: Worldometers as of May 6, 2020

2. How deep is the current shock to the economy?

The impact on families and businesses will cause them to fall behind on financial obligations, which can lead to other difficulties such as bankruptcies, defaults, and business failures. Moreover, the lack of consumer and business spending is sending shock waves through supply chains, leading to additional lost income and revenues. As this continues, true structural damage will begin to build within the economy—harm that in theory could slow an otherwise rapid return to normalcy. How much damage will ultimately determine whether the economic trajectory looks like a sharp V or a protracted U. Overall, BE anticipates a contraction of up to 10% in the second quarter, which is unquestionable enormous, but may be offset by more demand and increased spending during the second half of 2020.

3. What is government doing in the meantime to soften the blow?
During this crisis, there has been an unprecedented degree of government support. The current government stimulus is more than $2 trillion, compared to the whole US economy, which is $22 trillion in size. Small businesses are receiving forgivable loans, households are getting $1,200 per person and billions more are going to social programs and local governments. Much of the total stimulus is flows straight into the financial markets, which are notably performing much better today than last month. The S&P 500, for example, increased by 27.3% between March 23, 2020 and May 6, 2020.

4. How fragile/healthy was the economy when the pandemic first hit?
Overall, the economy was in a much better shape before the coronavirus started to spread than it was prior to 2008, for example. Unemployment rate was at a 50-year low, there is no sign of excess inventories or residential and commercial real estate, business investment was at a moderate level and consumers had money to spend on luxury and leisure.
Today, the economy is still solid with a household savings rate at a 30-year high and very low delinquencies of commercial banks.



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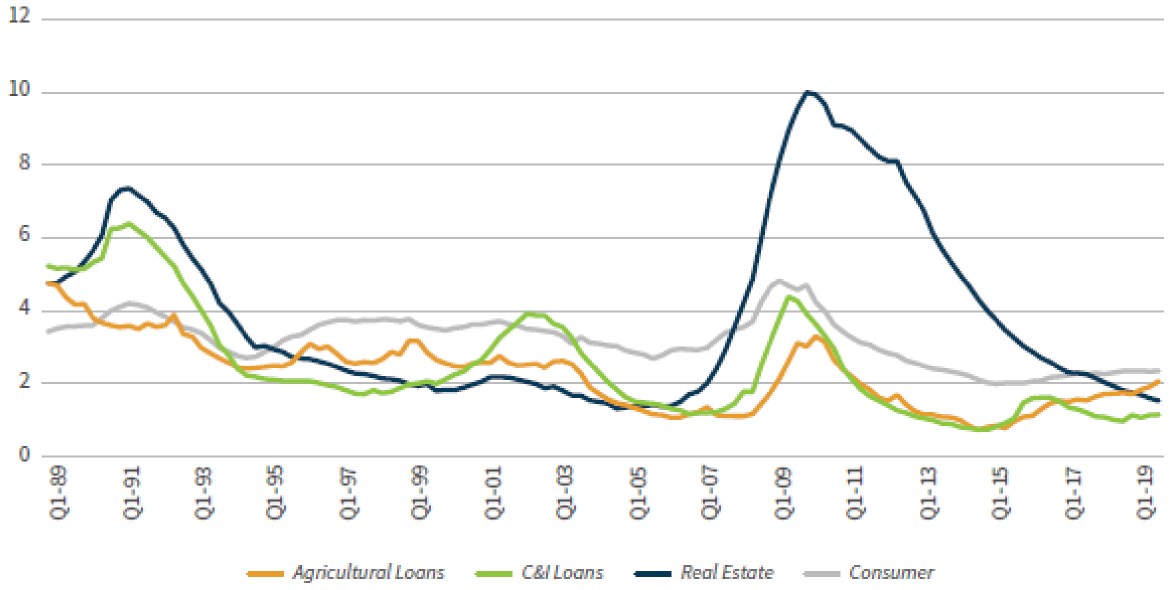
COMMERCIAL BANK DELINQUENCIES



Source: Board of Governors of the Federal Reserve System; Analysis by Beacon Economics

<u>5. Will there be permanent significant changes in consumer behaviour?</u>

There will be some changes in general behaviour, such as washing hands more often and not shaking hands with others, but overall, there is little evidence to believe that people won't return to the pre-corona life they had. After 9/11 and even during wartime, people do not allow low odds to influence their life. Some even believe that there will be an increased spending on goods, such as cars with the money that was or will not be spend on international travel.