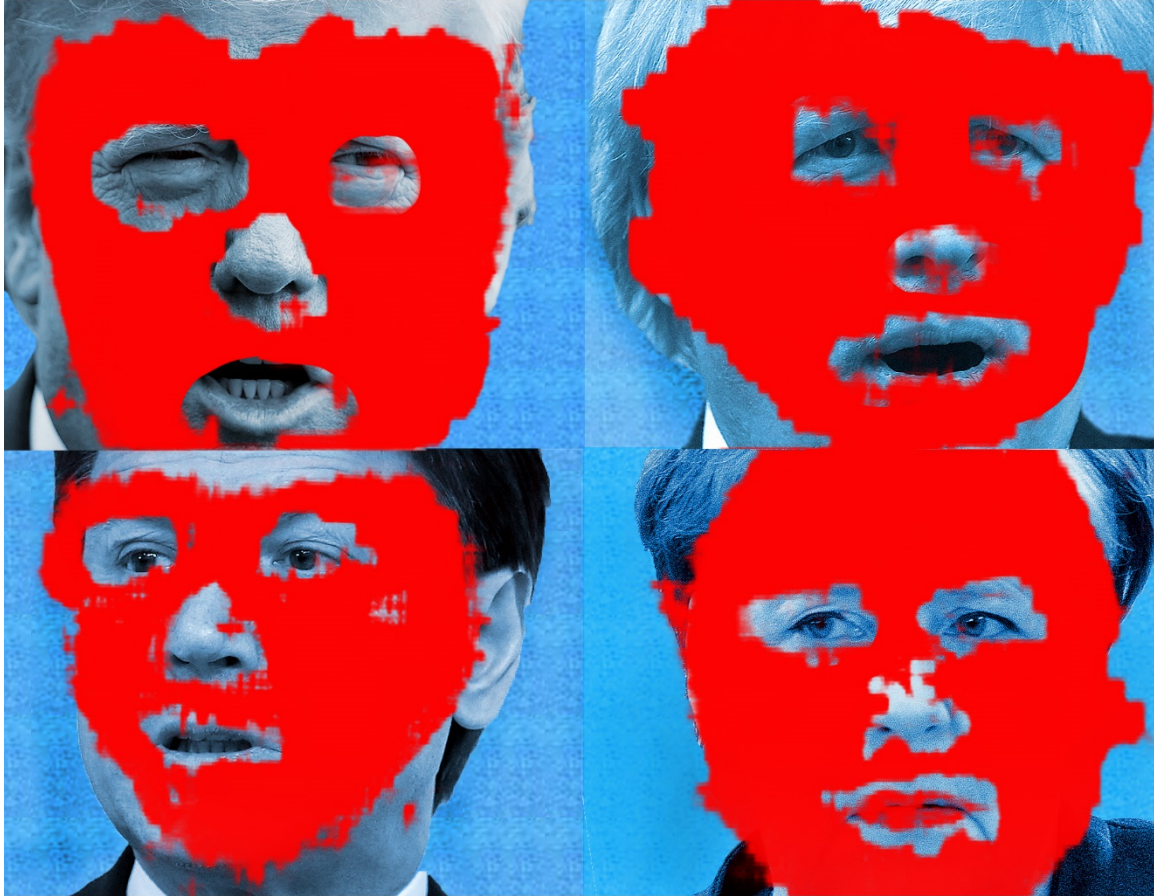


# BREAKINGVIEWS



**ONCE IN A LIFETIME?**

**What will change after the coronavirus pandemic has wrought its damage**



REUTERS BREAKINGVIEWS

# Contents

- Preface..... 4**
- The flat curve: Life and work .....6**
  - Offices will get roomier when the virus passes..... 6
  - Big Elevator faces a cable-free race to the top..... 7
  - Icky cash gets shove towards eventual obsolescence ..... 9
  - Hotels can ride out a cleaner, more vacant future.....10
  - Mall-to-retailer relationships will get creative .....11
  - Handshake will be relic of a more trusting time.....12
  - Cities exodus will be more fringe than fashion..... 13
- Not burning down the house: Staying at home..... 15**
  - U.S. moviegoers will never again fill theaters .....15
  - Vacant arenas fortify TV’s financial grip on sport.....16
  - Cable networks risk post-virus vicious cycle .....19
  - China virus may fast-track drone flight .....20
  - Telemedicine may be U.S. healthcare’s new normal.....21
  - Will casual sex get shafted by the pandemic?..... 22
  - M&A bankers should consider going back to college..... 23
- Life during plague time: New boundaries.....25**
  - Supply chains’ tectonic shift will get viral jolt..... 25
  - It’s a long jump back onto the travel bandwagon ..... 26
  - Silicon Valley gears up to leave Silicon Valley..... 28
  - Phones will restore freedom at the cost of privacy..... 29
  - Economic distancing is sad sequel to social kind..... 30
  - African debt holiday choices open new divisions ..... 31
- Crosseyed and painful: Market forces on hold .....33**
  - Chancellor: Big is beautiful will also be ugly ..... 33
  - Big Tech will emerge from virus too big to fail ..... 35
  - Cox: Brace for America’s version of Saudi Aramco..... 37
  - Central bankers have more cards up their sleeves ..... 39
  - Why 150% is the new 100% for public debt/GDP.....41
  - Fed’s credit market duct tape will come unstuck ..... 42

**Worry about the government: The role of the state..... 44**  
Fringe taxes will go mainstream when lockdowns end..... 44  
Critical workers hold keys to higher minimum pay..... 46  
Hadas: Welfare states will be big Covid-19 winners ..... 48  
Virus bailouts will be messier than past rescues ..... 50  
Pandemic protection will be a governmental affair ..... 51  
Cox: Virus-ebbed tide exposes the better leaders ..... 52

**Take me to the recovery: Returning to growth..... 55**  
Regulators will owe banks a favour post-pandemic ..... 55  
Stock-pickers will join endangered species list ..... 57  
Emerging markets will see less index, more Rolodex ..... 58  
New normal will demand new gold-standard portfolio ..... 59  
Activist curve will get flattened by the pandemic..... 61  
Buyout barons will keep getting cake and eating it ..... 61

**Road to somewhere: A better world?.....63**  
Energy’s titans will experience a dead cat bounce ..... 63  
Climate fight will survive pandemic’s mixed legacy ..... 64  
Carmakers’ green future gets revved up by Covid-19 ..... 65  
China’s soft power will be hardened by the virus ..... 67  
One odd U.S. healthcare habit to get a viral cure..... 68  
Dixon: Bailouts will store up lots more trouble ..... 69

**About us.....73**

## Preface

Forty years ago, two things happened. Talking Heads released “Remain in Light,” an album including the breakout single “Once in a Lifetime”. And in the Wooster School production of an episode of “The Twilight Zone”, I played the role of Charlie Farnsworth. Both provide perspective on the impact the Covid-19 crisis and ensuing Great Lockdown will have on the world.

Humanity is arguably at an inflection point. As the worst of the ongoing pandemic passes, we will either learn important lessons, correct course and become a more resilient species. Or we will tear ourselves further apart and expand the divisions between rich and poor, north and south, haves and have-nots. If we fix our flawed healthcare systems, make companies more resilient, improve safety nets and prepare better for future outbreaks, the coronavirus and its dramatic economic impact will be, as David Byrne sang, a once-in-a-lifetime event.

The alternative is more like that Twilight Zone episode, entitled “The Monsters Are Due on Maple Street”. The neighbours of Maple Street turn against each other violently after aliens come to town and make their presence known by turning off the power grid. “Their world is full of Maple Streets – and we’ll go from one to the other and let them destroy themselves,” one interstellar invader says to another at the conclusion of the show. Financial, political and geographical divides, obvious before the coronavirus hit, could just get deeper.

At Breakingviews, we have chosen Talking Heads over Rod Serling as the inspiration for our new book of columns on what will change after the disease has wrought its physical, emotional and financial damage on society. We hope this moment galvanises all of us – including policymakers, executives, investors, innovators and scientists – to recognise the interconnectedness of people, societies, economies and finance.

In the spirit of our annual “Predictions” book, which (full disclosure) did not foresee a coming pandemic in 2020, Breakingviews columnists around the world have laid out how the decision by governments to temporarily shutter their economies might change global supply chains, taxes, labour, technology, the balance sheets of corporations and governments, mergers and acquisitions, and shareholder activism.

The 44 commentaries in “Once in a Lifetime” explore how trends like reduced travel, less socialising and working from home will affect companies, workers, asset prices and investors even after economies reopen. The views identify some winners and losers in the healthcare, entertainment, energy and automotive spaces. And they look at the longer-term effects of the pandemic on globalisation, emerging markets and the drive for greater sustainability to fight climate change.

Our columnists are more than just, well, talking heads. Their overarching conclusion is that the virus will, more than anything, accelerate megatrends that investors have been anticipating, and which our journalists have been writing about for years. The

drive to create more sustainable businesses, where the interests of employees, communities and the environment will assume greater weight. Stay-at-home orders have hastened the move towards online work, shopping and more, benefitting companies like Amazon.com and Zoom Video Communications. Lockdown restrictions are furthering the automation of manufacturing and even service businesses like hotels, where electronic check-ins limit potentially infectious human contact. They have also exposed the grotesque inequalities of wealth and income, access to decent healthcare and economic opportunities for many citizens in some of the world's richest nations.

Looking back years from now, for some, the pandemic and Great Lockdown will be a heartbreaking time in which loved ones were struck down and laid to rest without dignified formalities. For others lucky enough to avoid tragedy, it will be a formative experience in ways of living or understanding better how society works. Some may find fortune, whether through family, creating art, a clean break from bad habits or – in the literal financial sense – establishing new businesses.

Old human habits, like hanging out together, will surely return, if not the same as it ever was. But the sharp and tragic consequences of the coronavirus have the power to reshape industries, redefine the role of governments, and alter the way people interact. It is our hope that the world emerges smarter and more equitable: The alternative is too dismal to contemplate. To that end, this is Breakingviews' contribution of ideas. We wish you happy reading and continued good health.

Rob Cox  
Reuters Breakingviews  
June 2, 2020

## The flat curve: Life and work



Traders work on the trading floor of Barclays Bank at Canary Wharf in London, Britain, Dec. 7, 2018. REUTERS/Simon Dawson

### Offices will get roomier when the virus passes

By Aimee Donnellan

Property barons like Blackstone and Brookfield Asset Management could be surprise winners when the Great Lockdown ends. Although conventional wisdom suggests that the success of remote working will allow companies to abandon city-centre offices, there's an emerging counterargument. Cooped-up workers will put a premium on social contact. And far from scaling back, the offices of the future may look more like law firms than telemarketing call-centre beehives.

Cramming ever more workers into tighter spaces was the prevailing strategy for companies before the pandemic. JPMorgan, Hewlett-Packard and Unilever all turned to so-called hot-desking to bring down their property bills. The savings were immediate. In 2016, Barclays boss Jes Staley managed to close an entire building in London's financial district and disperse 3,300 staff between two offices. He said the move saved \$50 million in annual real-estate charges.



The reality was less rosy for workers. Many had to rub elbows with colleagues in more cramped quarters. Property agent Knight Frank reckons the optimum 100 square feet per desk space – meaning workers need to be at least three metres apart – was whittled down to just 30 square feet in extreme cases. WeWork also benefitted from this craze. The shared-office provider became the biggest office tenant in New York and London as companies scrambled to fill trendy offices where leases could be cancelled with a month's notice.

China's reopening suggests such strategies are no longer viable. Employees are demanding extra space between desks and expect technological advances like touch-free electric doors to avoid close contact with some colleagues. Telecoms giants and banks have already taken note. Some are redesigning call centres and trading floors to keep workers safe. This could mean extra income for landlords who charge more for additional services.

Some tenants will go bust just the same. Others are cautiously looking to the future and what their office needs will be. Around a third of global companies renewing leases are asking for an extra 12 to 18 months before committing to a building, property experts reckon. But offices are still one of the few investments that provide inflation-busting returns. When 10-year U.S. government bonds are offering a mere 0.6%, taking a punt that workers will still want to fill offices yielding 4% a year looks attractive.

*First published May 4, 2020*

### **Big Elevator faces a cable-free race to the top**

By Ed Cropley

Eat your heart out, Roald Dahl. To the relief of frustrated post-pandemic office workers waiting in lift lines in corporate basements, cable-less elevators – great, glass or otherwise – are no figment of the British author's imagination. Powered by magnets, the elevator cars of the future will whizz round vertical circuits rather than shuttle laboriously up and down single shafts. That saves landlords space and makes it easier to add capacity should another pandemic strike.

With their towering skyscrapers, financial centres like New York, London and Hong Kong are particularly exposed to vertical bottlenecks caused by social distancing. The problem is that lifts' basic design has changed little since U.S. industrialist Elisha Otis – founder of \$23 billion global leader Otis Worldwide – took them mainstream in the 1850s. With cabins designed for 20 people now limited to just three, systems are grinding to a halt. Making top execs take the stairs to the C-suite is a downer, even if it does trim some corporate fat.

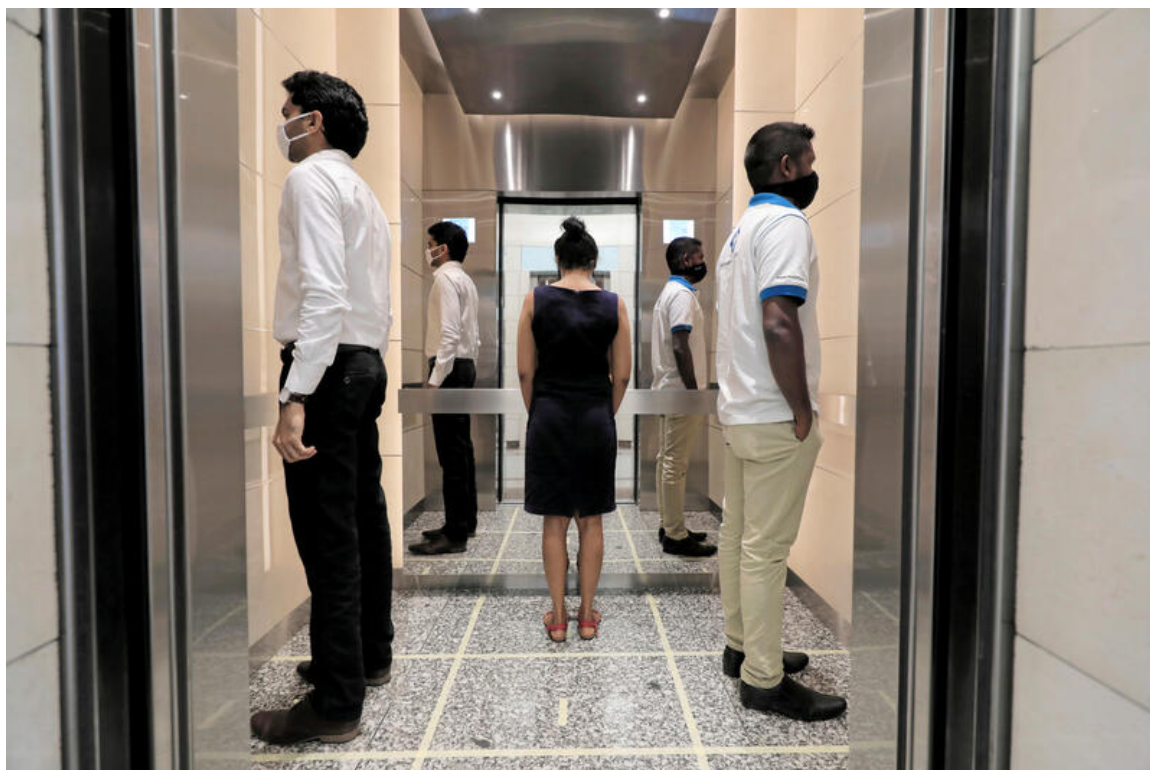
In the short term, basic gizmos can protect lift riders from Covid-19. Face or voice recognition software eliminates button-pushing, as do floor-level, kickable control

panels. Thermal cameras can spot high temperatures and weight sensors can block an ascent if boisterous foreign-exchange traders ignore Friday lunchtime loading limits.

Longer-term, however, technology offers a far smarter solution. Based on magnetic levitation similar to Japan's bullet trains, cable-free lifts will have multiple cars zipping up a single shaft, looping round the top and zooming down another. Germany's Thyssenkrupp Elevator Technology, sold in a February buyout to Advent International and Cinven for 17 billion euros, already has a setup in testing and reckons the absence of a bulky bank of central cable lifts could create up to 40% more floor space in ultra-tall buildings. That's a huge plus for landlords.

Social distancing brings added benefits for users. Unlike cable-driven lifts, a maglev-based circuit could add more cabins when the next virus strikes, reducing choke points. Thyssenkrupp reckons it's ahead of the pack thanks to the knowledge gained building Shanghai airport's maglev rail link. Otis, along with Swiss and Finnish rivals Schindler and Kone, are doubtless working on their own versions. Covid-19 just doubled the prize for the first to the top.

*First published May 26, 2020*



People practice social distancing inside an elevator prior to arriving to their workplaces at World Trade Center amidst concerns about the spread of coronavirus disease (Covid-19) in Colombo, Sri Lanka, May 11, 2020. REUTERS/Dinuka Liyanawatte



## Icky cash gets shove towards eventual obsolescence

By Lisa Jucca

Cash was already unhygienic before Covid-19. Now in addition to being icky, it's also irrelevant for many. Quarantined shoppers around the world have ditched grubby bills for more practical contactless purchases. Central banks won't want to see traditional cash walk the plank altogether, but this may accelerate their consideration of a digital alternative.

When consumer habits change, they often stick. Nearly 90% of Chinese shoppers say they will continue to buy necessities online even after the pandemic, says Nielsen. Widespread adoption of such digital purchases will increasingly marginalise physical cash.

That's good in several ways. Paper money is a scourge for governments, like Italy or India, that must become more serious about fighting tax evasion and fraud. The risk is that private enterprises take the driving seat. Increasingly popular digital wallets are offered by firms such as PayPal, Venmo or the Alipay service run by China's Ant Financial, which glean valuable information on shoppers' habits.

Money stored with these services tends not to be covered by national deposit insurances, exposing customers to losses if the provider fails. And payment services involve fees. Cash, on the other hand, is backed by the state, offers stability, privacy and is freely exchangeable.

The conundrum is likely to accelerate something many central banks were already ruminating over: digital sovereign money that customers can store on mobile phones, cards or smart devices for everyday shopping. Some four-fifths of global central banks are already working on such projects. Sweden, which could go cashless as early as 2023, in February launched a pilot for an e-krona. And China could roll out the first sovereign digital currency later this year.

Consumers seem ready to accept state digital money. About 54% of those polled by the Economist Intelligence Unit in April said they would use state e-cash. Only a quarter trusted private cryptocurrencies like bitcoin or ethereum. In March, the U.S. Congress floated the idea of using digital dollars stored on mobile wallets to distribute Covid-19 aid to millions of unbanked citizens.

Cash won't disappear overnight. Central banks will want to make sure the digitally unsavvy are not left behind. And people still value physical money for storage value, especially in emerging markets. But the pandemic will give coins and notes another firm shove towards eventual obsolescence.

*First published May 20, 2020*

## Hotels can ride out a cleaner, more vacant future

By Aimee Donnellan

There's room at the inn. Lots of it. U.S. hotels say they bled \$1.4 billion a week during the Great Lockdown. A wind-down of travel restrictions and social distancing will ease some pain. But hoteliers globally need to prepare for a year or more of radically reduced occupancy – and losses. This will benefit well-known brands with big balance sheets like Accor and Hilton Worldwide. Pity the little guy.



A porter passes a sign for the InterContinental Hotel, Park Lane in London, Aug. 11, 2008. REUTERS/Luke MacGregor

New York's Four Seasons hotel gives a glimpse into the \$600 billion industry's woes. The iconic hotel owned by Bill Gates and Saudi Arabia's Prince Alwaleed bin Talal opened its doors to medical personnel but luxuries like minibars are gone, its restaurant replaced by a lobby fridge with box meals. Even when business customers return, some new habits will continue, such as enhanced hygiene protocols that require a 24-hour delay between guests to deep-clean rooms. Hotels will be lucky to run at half occupancy.

That will wipe out profits. Take InterContinental Hotels, owner of the Holiday Inn and Crowne Plaza brands. Like many big chains, it derives most of its revenue from royalties paid by an army of hoteliers using its brands. If these asset owners see a 50% fall in their typical occupancy, they may struggle to pay. In such a scenario, even if the \$8 billion group manages to trim costs, its \$386 million 2019 profit could sink to a loss. Accor would take a similar hit. If the French owner of the Savoy in London and the Novotel chain's 4 billion euro revenue halves, the bottom line would likely slip into the red.

These depressed results should be temporary. Unlike the increased security measures introduced in airports after the Sept. 11, 2001 attacks, only some of the higher standards of hygiene may remain once a vaccine is found. InterContinental saw a slight recovery in China with occupancy levels running in the mid-20% range in April, compared to 5% in mid-February.

All of this benefits the bigger, well-capitalised chains. Hilton, for example, hatched a deal with Reckitt Benckiser, the maker of Lysol, and the Mayo Clinic to create new room-cleaning protocols. Accor has 2.5 billion euros of cash thanks to some well-timed asset sales. But as the American Hotel and Lodging Association reckons, hotels could close if occupancy lingers at 35%. That leaves the industry's minnows particularly exposed.

*First published May 12, 2020*

## Mall-to-retailer relationships will get creative

By Jennifer Saba

Who knew mall owners could be so creative? Brookfield Asset Management, one of the largest in the United States, is launching a fund that will invest directly in challenged retailers. As more store chains and department stores hurtle towards bankruptcy, the \$50 billion Canadian firm's plans provide a blueprint for how property owners such as Simon Property and Macerich can navigate their way through retail's ructions.

The sector was already in a heap of trouble before the coronavirus hit and forced stores to shutter doors. The pandemic merely accelerated those woes. Restrictions brought some retailers' revenue to zero. Moody's reckons that clothing and footwear peddlers' recovery won't take shape until next year, and even then, earnings will be 15% to 35% below pre-pandemic results.

That directly affects the real-estate owners that have retailers as tenants. Now more than one third, or roughly 400 U.S. malls out of 1,200, are at risk of closing, forecasts Cowen. That is because rent is one of retailers' top expense, and when big tenants like Neiman Marcus, J. Crew, and J.C. Penney go bankrupt, lease payments will come under pressure.

Rent deferrals provided some aid. But Brookfield has another tack that mall owners may follow. It launched a \$5 billion fund that takes equity stakes in, and offers loans to, retail customers. This ensures tenants can cough up rent, and positions the firm to cherry-pick certain assets, say warehouses, for collateral. The idea predated Covid-19: Brookfield was part of a consortium of buyers alongside Simon Property that bought fast-fashion chain Forever 21 after it went belly up.

Landlords will have more incentive to give customers like department stores more flexible terms. Leases tied to sales – as opposed to set amounts – will become more common. Mall owners and retailers will work together to capture the benefits of the surge in e-commerce shopping, by dedicating parts of the physical space to processing in-person returns, for example, and curbside pickups. That could help reduce shipping costs, boosting margins. If Brookfield and others use this to their advantage, better bottom lines will trickle up.

*First published May 29, 2020*

## Handshake will be relic of a more trusting time

By John Foley



U.S. Surgeon General Jerome Adams elbow bumps with U.S. International Development Finance Corporation CEO Adam Boehler during a coronavirus disease pandemic response event in the White House in Washington on May 15, 2020. REUTERS/Kevin Lamarque

Finance will be different after Covid-19, and not just because the economy will be in the doldrums. Social shifts that outlast the pandemic – things as simple as a reduced willingness to shake hands – will make trust a scarcer commodity. That is the last thing an already misanthropic Wall Street needs.

Handshakes bring people closer, both literally and figuratively. Sure, the five-finger salute is likely to be a pretty effective way of transmitting the coronavirus, compared with an elbow-bump, foot-tap, bow, or any number of similar greetings. But pressing the flesh instills trust. Assyrian King Shalmaneser III seems to have been an early adopter, judging by a three-millennia-old carving. Clasp digits is, if nothing else, a good way to check for daggers concealed up sleeves.

What worked for Shalmaneser III then works just as well today. A study at University of California, Berkeley's Haas School of Business in 2018 found that when negotiators shook hands before talking turkey, they reached a more mutually beneficial outcome. In a simulated house-selling negotiation, buyers and sellers who shook hands tended

to end up unwittingly splitting the profit 50-50, compared with 80-20 otherwise. Fewer handshakes, it seems, directly resulted in less goodwill.

The financial community starts at a low base. In surveys asking people how they feel about the general public, finance professionals are less trusting than the population overall, researchers at the University of Cologne found by analyzing U.S. data. Their trust has fallen significantly – around 40 years ago, financiers were more trusting than the population in general.

Wall Street's employers might not mind a world with less trust. It is in their best interest to get the upper hand in any negotiation. If fewer warm feelings mean more alpha, that's progress. Indeed, deal-loving President Donald Trump – a self-described clean freak – in a 1997 book called the handshake "one of the curses of American society." The pandemic might give him and other hard-nosed dealmakers something they wished for all along.

*First published May 19, 2020*

### Cities exodus will be more fringe than fashion

By Lauren Silva Laughlin

The coronavirus lockdowns dragging on in the world's densest cities have many urban dwellers yearning for more space. That makes a surge in people deciding to decamp to the suburbs and beyond appear likely. But at least one problem will give them pause: inadequate infrastructure.

Covid-19 is hardly the first crisis to descend on cities. The Black Death wiped out half of Paris in the 1300s, while the Spanish Flu a century ago killed some 50 million people globally, hitting crowded metropolises like Philadelphia hardest. Yet populations returned to prior levels and then some. Cities were necessary for business, commerce and, importantly, jobs. Planners also found ways to make them resilient using innovation – think of the sewer systems built in London, Paris and elsewhere following cholera outbreaks in the 1800s.

Technology has changed at least part of that equation. Investments in Wi-Fi and 5G – a 21st-century equivalent to building highways – have allowed apps like Zoom Video Communications to make many face-to-face meetings less necessary. The more companies who join Twitter, Facebook and others with work-from-home mandates, the easier it becomes for employees to ditch city life.

But there are drawbacks to mass exodus. Consider medical care. In Italy, hospitals in remote areas quickly became overcrowded and overwhelmed. Some 120 U.S. healthcare facilities have closed due to financial concerns over the past decade, according to the Chartis Center for Rural Health. And those living in the back of beyond are one-and-a-half times more likely to die from avoidable issues as those who



in major cities, a 2018 report from the Australian Institute of Health and Welfare showed.

Other essential services might struggle with a big influx. Schools have limited space. Runoff from big farms can leave rural water with high nitrate levels. Some 16 million Europeans still lack access to clean drinking water, according to the World Health Organization, with countryside communities the most disadvantaged. Power supply can be less reliable and more expensive, the American Council for an Energy-Efficient Economy says.

Many of these issues could, with good planning and funding, be addressed – but would take years. In the meantime, quitting the city is likely to remain an option for the wealthier. For most, dreams of a view of the mountains from the home office may have to wait.

*First published June 1, 2020*

## Not burning down the house: Staying at home

### U.S. moviegoers will never again fill theaters

By Jennifer Saba

Dark movie theaters may just be a taste of the near future. Even before Covid-19 completely shut down projectors at venues offered by the likes of AMC Entertainment, attendance was in decline and streaming services like Netflix on the rise. AMC is fighting back, but the notion that America's cinemas will fill up again may be as quaint as a silent film.

With everyone stuck at home, Hollywood has time to figure out more ways to cut out the exhibitors. Comcast's NBC Universal released "Trolls World Tour" on April 10 directly to people's homes and made several other movies already showing on big screens available to rent for \$20.

There are incentives to wiggle around theaters. In general box-office ticket sales are split 50-50 between exhibitors and studios. With streaming services like Netflix or Amazon.com or through traditional cable, studios keep about 80% of the take.

The "Trolls" sequel broke first-day and opening-weekend records for Universal's home-entertainment unit, racking up some 10 times the previous record receipts for a digital release. It has now brought in nearly \$100 million in rentals, the Wall Street Journal reported on April 28. In terms of revenue for Comcast, that makes it more



Closed signs are seen on an AMC Theatre during the outbreak of the coronavirus disease (Covid-19), in New York City April 29, 2020. REUTERS/Brendan McDermid

lucrative than the original's \$154 million in gross domestic U.S. box-office receipts to date.

Netflix has changed the game too. The firm led by Reed Hastings mostly bypasses theaters for its original movies, instead choosing to use releases like "Roma" as a way to hook potential subscribers. Lockdown has accelerated the company's subscriber growth. Many of the largest studios' parent companies, notably Walt Disney, Comcast and AT&T, now have streaming services. Disney pushed its upcoming flick "Artemis Fowl" to its online Disney+ platform for a June release rather than wait until theaters reopen.

The number of Americans trekking to box offices is in long-term decline from a peak in 2002 with 1.6 billion tickets sold. From lockdown AMC, which bills itself as the largest exhibitor in America, Europe and the world, is resisting: On April 28 it said it would boycott Universal's films in light of the studio parent's comments about digital releases. AMC's stock jumped more than 20% the next day, but its market value is still only about a quarter of the \$2 billion it was worth shortly after going public in 2013. The fresh damage from the pandemic may never be reversed.

*First published April 29, 2020*

### **Vacant arenas fortify TV's financial grip on sport**

By Christopher Thompson and Anna Szymanski

Empty sports stadiums could turn into Covid-19's most abiding cultural legacy. Since the World Health Organization declared a global pandemic in March, virtually all sporting events have been cancelled, including this summer's Olympic Games in Tokyo and Europe's flagship soccer tournament, Euro 2020. Even those which have tentatively restarted, like South Korea's KBO baseball league and Germany's Bundesliga soccer division, have plied their trade in eerily vacant arenas. America's National Hockey League on May 26 said it would complete the season, but probably without fans.

The immediate financial damage is considerable. Tickets and sponsorship account for over half of the \$71 billion annual revenue earned by North American sports, according to PwC, and around two-fifths of sales among Europe's richest soccer leagues. But the fact that bars across the United States are televising Seoul's Doosan Bears baseball team while Premier League soccer fans are watching Bayern Munich suggests broadcasters could win even as stadiums lose. If fans needing their fix of, say, basketball superstar LeBron James or Barcelona forward Lionel Messi have no option but to tune in then more valuable media rights could cushion lower sales elsewhere.

Competitions that already have an established TV following will benefit most. If England's Premier League could increase its 2018 broadcasting revenue by 24%, or 757 million pounds, it would offset ticket sales entirely.

The timing of the pandemic could benefit major North American sports that have rights deals expiring in the next five years, like the National Football League. In an April report, researchers at MoffettNathanson estimated that when the NFL renegotiates its broadcasting deals, the total annual cash costs could increase to almost \$9 billion – with the average price for Sunday games spiking by a whopping 75%. This would make regular season ticket sales – which made up around 15.5% of the NFL's \$14.5 billion in total revenue in 2018, according to Statista – even less meaningful.

For less popular leagues, the opposite is true. Lower European soccer teams often rely on gate receipts for over half of their income, raising the prospect of hefty wage cuts for players. One way to bridge that gap would be for wealthier clubs to establish a “solidarity fund”. Novak Djokovic, the 17 times tennis Grand Slam champion who has earned some \$144 million in career prize money, has called on the sport's governing bodies to establish a hardship fund for lower-ranked players.

Extra TV cash isn't a slam dunk though. Contact sports such as ice hockey, basketball and soccer all rely on live crowds to generate the excitement vicariously enjoyed by fans at home. Even assuming higher ratings, broadcasters may be reluctant to stump up more money for matches played in front of empty bleachers.

That could allow sports which rely less on crowd-generated frisson – like auto racing or golf – to lure new viewers. Still, the excitement can be hard to maintain. Over 33 million Americans, on average, tuned in to NBC to watch U.S. gymnast Simone Biles win a gold medal with her team in 2016. But a U.S. Gymnastics Championships event featuring her in a non-Olympic year brought in less than one tenth of that audience.

More couchbound viewing will also blur the line between real and virtual games. Formula 1 passed a historic milestone in March when Guanyu Zhou became the first Chinese driver to win a Grand Prix race. That was because Bahrain had turned its annual contest into a virtual contest, attracting an estimated 3.2 million viewers.

Watching others play video games may seem bizarre for older sports fans. But e-sports events, which Deloitte reckons generated an estimated \$1 billion in sponsorship and advertising globally in 2019, already attract vast audiences. The 2019 World Championship Finals for League of Legends – a wildly popular multiplayer game – hit a peak of 44 million concurrent views. For comparison, an average of around 16.5 million people watch a regular season NFL game.

Even when stadiums reopen, it may be difficult to lure fans back. Social distancing rules will mean fewer seats and, eventually, higher prices – not to mention longer queues. That would turn watching live sports into a niche pursuit, dominated by corporate hospitality and a hardcore group of well-heeled season ticket holders. Such staid crowds would hardly make games more compelling to watch at home. But giving fans better access to team sidelines or enhanced in-game statistics could compensate for the lack of pitchside enthusiasm.

## Once in a lifetime?

Covid-19 might have hammered live sports and increased broadcasters' financial grip. The challenge will be persuading viewers at home to pay up for the privilege of tuning in.

*First published May 28, 2020*



Despite most sports being cancelled around the world the local league starts behind closed doors due to the spread of the coronavirus disease (Covid-19) REUTERS/Kim Hong-Ji



## Cable networks risk post-virus vicious cycle

By Jennifer Saba

Sports are at the heart of America's expensive pay-TV packages. The absence of live games, thanks to the coronavirus, provides consumers the perfect excuse to cut the cord. Yet the National Football League and others will want more for broadcast rights to make up for empty stadium seats. That could push prices for cable even higher and alienate even more users.

For media firms touting TV bundles, first-quarter results are frightening considering cancellations of marquee tournaments like basketball championship games didn't start until mid-March. AT&T and peers comprising 70% of the sector between them have reported a loss of 1.6 million subscribers for the three months ending March, versus a loss of about 1 million in the prior year, according to Bernstein's tally. Verizon Communications and Comcast had record declines; the latter blamed price hikes for the more than 400,000 customers who bailed in the quarter.

That's an ominous sign since the sports leagues are under pressure too. Walt Disney network ESPN commissioned an economic analysis from Washington University which found the lack of sports, from the professional leagues down, will cost nearly \$12 billion in lost revenue, and that's assuming baseball and soccer miss only half of their seasons.

Pent-up demand to watch something other than Korean baseball and old hoops games puts NFL Commissioner Roger Goodell and his peers in the driver's seat when media contracts come up for renewal. Broadcasters CBS, NBC and Fox may see a 75% increase in the price for football rights when negotiations get going over the next few years, reckons MoffettNathanson. For example, Rupert Murdoch's network could cough up as much as \$1.9 billion annually to air Sunday daytime games versus \$1.1 billion.

It's not just football. The Professional Golfers' Association enjoyed a bump of 70% to an annual \$700 million combined for NBC and CBS in March, according to CNBC.

To cover the costs, which will only partly be offset by advertising revenue, networks will charge distributors more to carry channels. That will ultimately be passed on to consumers. Rising cable bills coupled with better alternatives for less sports-addicted viewers, like Netflix and Disney+, will only accelerate cord cutting. It sets cable networks up for a post-pandemic vicious cycle.

*First published May 7, 2020*

## China virus may fast-track drone flight

By Robyn Mak



A drone is seen during a demonstration for the media before a news conference by Chinese food delivery company Ele.me on its drone delivery service, in Shanghai on May 29, 2018. REUTERS/Aly Song

China's epidemic could give rise to the drones. Contagion fears and quarantines have made deliveries costly and tricky for Alibaba, and others. Reducing human contact might help. Just as past crises have spurred technological developments, the latest outbreak should give automation a boost.

Millions in China have been stuck at home since the Lunar New Year holiday in late-January. Efforts to contain a deadly new coronavirus, which has killed more than 560 people, have triggered unprecedented city-wide shutdowns, travel restrictions and self-seclusion. With retailers from Apple to Starbucks closing shops across the country, food delivery, e-commerce and grocery apps in theory stand to benefit. During the holiday week, postal deliveries were up substantially from last year's festival period, Bernstein analysts note.

Even so, dispatching people to drop off prepared and unprepared food amid an epidemic poses huge challenges. To ease customer fears of contracting the virus from potentially infected drivers, takeout apps run by Alibaba and rival Meituan Dianping are offering "contactless delivery", where couriers leave food in designated pickup spots. Moreover, with fewer people willing or available to deliver, labour costs are bound to rise. Investors are worried. Meituan shares, for example, are down 11% since Jan. 15.

Drones may be one solution. As early as 2013, Amazon boss Jeff Bezos unveiled ambitious plans to use unmanned aerial vehicles to bring down costs and cut delivery times. In China, drone-makers from DJI, the upstart last valued at \$15 billion in 2018, to the recently listed EHang are growing fast. Alibaba and rival JD.com are also experimenting with aerial deliveries. Both are rolling out high-tech upgrades across their logistics networks, including automated warehouses.

Technical and regulatory hurdles have hampered progress for drone deliveries. Companies and governments may now be prepared to invest more and accelerate approvals. Consumer habits could change, too. The 2003 SARS outbreak hastened the adoption of online shopping in China. JD founder Richard Liu has said the virus forced him to close his brick-and-mortar shops and pivot online. Likewise, Japan's most popular chat app, Line, was inspired by the Fukushima nuclear accident in 2011. Drones could be next to be nudged by a crisis.

*First published Feb. 6, 2020*

### **Telemedicine may be U.S. healthcare's new normal**

By Robert Cyran

The doctor's office is increasingly in everyone's home. Online visits in the United States are surging during the pandemic, as it's safer, insurers are waving carrots to use them, and restrictive rules are easing. While virtual visits are cheaper, though, increased uptake could push up total healthcare spending.

Teladoc Health, a virtual healthcare specialist worth \$13 billion, saw visits grow by more than 90% in the first quarter to 2 million. UnitedHealth, the nation's largest health insurer, said virtual visits by customers doubled in the first quarter.

It's easy to see why. Patients are reluctant to be in a waiting room with people potentially suffering from Covid-19. Doctors' practices need to replace lost revenue. Meanwhile, insurers are waiving co-pays, and the government is encouraging virtual visits. It has broadened services that can be offered and bumped up the amount doctors can charge Medicare patients. And some states are easing rules restricting healthcare workers from practicing across state lines.

It's more than just Covid-19. Online visits are more convenient. Rural patients particularly benefit, as doctors tend to cluster in urban areas. According to a 2017 study in Health Affairs, a telehealth session for a respiratory infection cost \$79 compared to \$146 for a doctor's office and \$1,734 for an emergency room visit.

There are limitations, of course. Patients need to be present for procedures such as biopsies. Online care may not be as good as an in-person consultation if symptoms are missed. Cross-border license restrictions still exist. And wrinkles such as hacked connections and recorded sessions introduce legal issues.

The biggest drawback might be an increase in overall medical spending. The 2017 study found nearly 90% of visits were new utilization – in other words, instead of just using an online session as a substitute for an office visit, patients were seeing doctors much more often because of the convenience. While the cost per visit went down, net costs went up. That may not be all bad. More patients may get needed care, and fewer missed visits may yield better outcomes for conditions such as depression or diabetes where patient compliance is notoriously low.

U.S. healthcare spending, now at 18% of GDP, has proved resilient against any efforts to curtail its growth. It shouldn't surprise anyone if telemedicine adheres to the pattern.

*First published May 21, 2020*

### Will casual sex get shafted by the pandemic?

By Dasha Afanasieva

Tinder cofounder Sean Rad once joked the dating app was borne from fear of open spaces. If true, his service, along with Match, Bumble and others, is tailor-made for a world in lockdown. The truth is more complicated. The rise of online dating has accompanied an increase in casual sex, which the coronavirus may have temporarily shafted. But if that means more engagement, albeit fewer physical hookups, the matchmaker model is still safe.

Covid-19 isn't the first disease to change intimacy patterns. The free love associated with the introduction of the birth control pill in 1960 became a distant memory with the onset of AIDS. Hookup culture has flared up again. According to a study in the *Journal of Sex Research*, 45% of people interviewed between 2004 and 2012 had sex with a casual date over the prior year versus 35% between 1988 and 1996 – and with more partners.

These trends stimulated demand for Tinder, which favours casual encounters, and its many digital competitors. But the highly contagious coronavirus threatens that. In April, Anthony Fauci, the head of the U.S. National Institute of Allergy and Infectious Diseases, warned that using dating apps could help spread the virus.

As a result, casual encounters will likely take a backseat to more traditional courtship, at least until a vaccine arrives. That means Tinder's trademark right swipe – a digital expression of interest for a potential tryst – is likely to suffer. Tinder is \$24 billion Match's biggest app, with 6 million paying members comprising more than half its revenue.

Investors seem confident Match can pivot with new social norms. After reporting a 17% rise in first-quarter sales on May 5, the stock rose above the price at which it began 2020. Chief Executive Shar Dubey is rolling out more features like video that enhance the more traditional Match app, whose business had been cannibalized by Tinder.

Video is already becoming a thing: Bumble said such calls rose 56% globally in the week ending March 27 compared with the week ending March 13.

Video allows for more time-efficient filtering of potential partners and makes users reliant on the app for longer. Covid-19 has kept people physically apart, but more engaged digitally. For businesses that benefit from the nuance between long-term love and short-term flirtation, the pandemic's pause could be a sweet match.

*First published May 9, 2020*

### **M&A bankers should consider going back to college**

By Lauren Silva Laughlin

Wall Street bankers fretting about the deal lull may want to head back to college. Not for the keg parties, but to advise their alma maters on strategic options. Universities, especially in the United States, will need to close, go digital or merge to survive.

Even before Covid-19 shut down campuses, higher education was troubled. Pressure to grow enrollment forced schools from Australia to Britain to California to seek students abroad. The pandemic-inspired switch to online learning has exposed the folly of soaring tuition. Public and private funding are being crunched by the Great Lockdown's economic fallout.

International students will now stay home. Strapped parents will question the value of leveraging up for the "college experience," which costs some \$100,000 over four years in the United States, the National Center for Education Statistics says. The virus will double the number of colleges failing over the next decade, compared to the previous one, to 700, predicts AGB senior fellow Rick Beyer.

Some, like Boston University, which charges more than \$74,000 annually, are cutting costs. Others will justify expenses by offering online courses for specialty degrees, like a diploma in finance. That's sensible if a lecture hall for 250 students can accommodate another 5,000 via Zoom. Paying more for the live experience may bring perks like office hours. While universities can build this, any good consigliere would suggest buying established businesses and reaching for "revenue synergies."

Oxbridge and the Ivies won't want to dilute pedigrees or miss offering a bachelor's in Shakespeare for \$250,000 to the well-heeled. Partnerships will emerge for the next tier. Faith-based universities, for instance the big four in Texas, could roll up front offices. Rather than four finance vice presidents, "the Colleges of the Christians" could have one.

Merger advice will be welcomed by trustees. A 2012 deal between Georgia Health Sciences University and Augusta State University offers a blueprint. That union helped Georgia Health bring Augusta's margins in line with its own, like any successful deal, according to educational advisor TIAA Institute.



## Once in a lifetime?

Shacking up with for-profit outfits like Strategic Education, whose shares have surged 30% since late March, might work for some. But more universities will need to simply embrace the business school playbook – with some help from finance alums. If that doesn't work, they'll call in the grads who went to McKinsey's restructuring practice.

*First published May 8, 2020*



Students study in the law library at the University of Michigan in Ann Arbor, Michigan on Sept. 20, 2018. REUTERS/Rebecca Cook

## Life during plague time: New boundaries

### Supply chains' tectonic shift will get viral jolt

By George Hay and Ed Cropley

Most people pay no attention to a machine's inner workings until it breaks down. Empty supermarket shelves and shortages of vital coronavirus-fighting products focused attention on international supply chains. In a United States election year, it could well accelerate a rethink of globalisation.

That may sound economically sacrilegious. Between 2004 and 2017 globalisation's ability to cut corporate taxes and other costs increased net margins for S&P 500 Index companies by 2.2 percentage points, according to Bank of America research. Even so, the bank's February survey of 3,000 companies found that bosses at more than 80% of firms in 12 sectors with international supply chains planned to shift at least some of their operations from current locations.

There were already plenty of reasons to. President Donald Trump's many trade fights had prompted industries from tech to carmakers to ponder moving some factories or changing suppliers. Automation could reduce the difference between emerging- and developed-market labour costs. Climate change is playing a larger role, too: The carbon footprint of a U.S.-made bicycle, for example, is 90% lower than one made in Taiwan and exported, BofA reckons.

Trump administration officials now talk of "turbocharging" the unpicking of industrial supply chains from China, home of a quarter of global manufacturing's value-added. That could be an effective populist gambit with Americans who blame Beijing for its handling of Covid-19. It could spell trouble for so-called just-in-time manufacturers, which maintain low inventory to control costs.

Meanwhile supply chains that already had more padding, like supermarkets, may get more. Consider two countries which import half their food. In one, the United Kingdom, most retail supply chains store up to a month's worth of stock. The coronavirus has shown how much that leaves the country exposed to broken global supply chains. Landlocked Switzerland, meanwhile, charges its citizens 12 Swiss francs



A truck driver wears a vest with a labour union logo as truckers stage a blockade in Carquefou near Nantes Jan. 19, 2015. REUTERS/Stephane Mahe

a year to subsidise companies to create three-month stockpiles of fuel, fertilisers and basic foodstuffs like rice and wheat.

Throwing sand in the wheels of global trade might sound excessive were the virus a one-off. But it's just a nastier version of a slew of epidemics over the past two decades. And there may be worse to come, along with other challenges like increasingly extreme and changing weather patterns. These will put greater onus on security of supplies, relegating cost to an important but secondary consideration.

*First published May 7, 2020*

### **It's a long jump back onto the travel bandwagon**

By Sharon Lam

It has never been truer that the journey is the destination. Travelling has proven resilient after previous crises, which suggests that once a Covid-19 vaccine, treatment or other solution is found, antsy globetrotters will pack their Samsonites in nearly full force again. Notable changes are likely to be in health checks and corporate flyers.

The pandemic's effects will undoubtedly linger. Count Warren Buffett, whose investment horizon is longer than most, among those worried that some changes to travel habits will endure. The billionaire's Berkshire Hathaway conglomerate dumped its big stakes in four U.S. airlines amid the crisis.

There's reason for concern. It took nearly two years for North American flight demand to return following the 9/11 attacks, according to Morgan Stanley research. Overnight stays abroad this year are expected to fall by 20% to 30% from 2019, according to the World Tourism Organization, which would amount to a loss of up to \$450 billion in receipts. After the global financial crisis in 2009, the comparable decline was a mere 4%.

Travellers probably will stay closer to home at first. Domestic driving vacations, for example, make more sense in many places while flights are grounded, and national borders closed. Before bigger vacations get planned, popular destination spots will have to reopen. With most of Walt Disney's theme parks and other major attractions unavailable, there's less incentive to embark on a journey anytime soon. Eventually, though, airlines, hoteliers and online booking sites should be able to start luring confined consumers back with tantalising discounts.

Costs will ultimately be on the rise, however. Airlines can expect lasting changes to their expense structures. Just as a single bomb threat forced passengers to remove their shoes before boarding, the virus is likely to usher in a mask-wearing era. Temperature checks, deeper cleaning of planes and new boarding protocols all will be more time-consuming and chew up money. Many middle seats also will be empty for a while, as Southwest Airlines boss Gary Kelly noted for his \$16 billion discount carrier, forcing further financial recalibration. Roughly 77% of seats need to be filled for

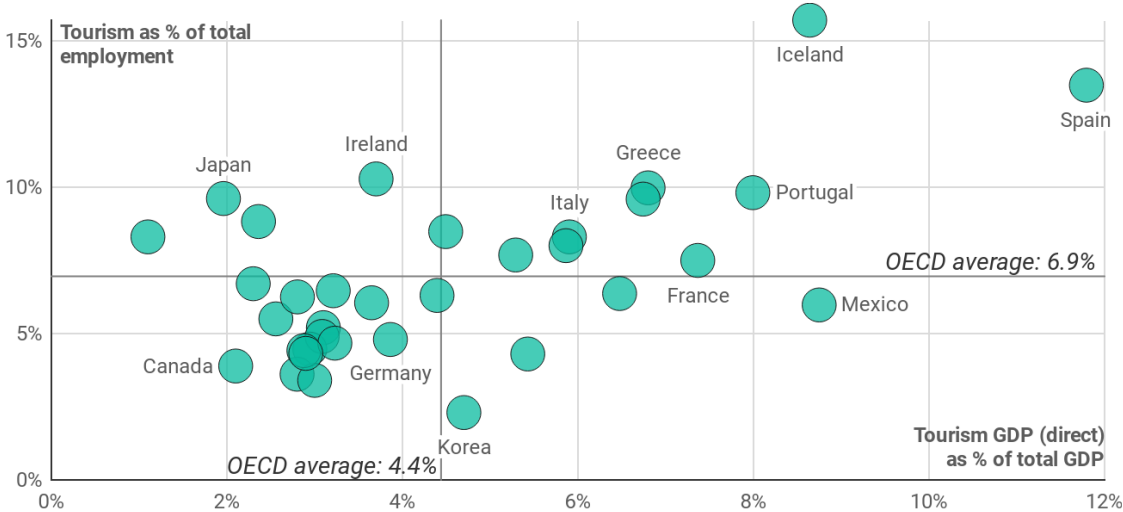
## Once in a lifetime?

airlines to break even on an operating basis, according to the International Air Transportation Association trade group.

Some destinations also may fare better than others. Countries with better-developed healthcare systems, such as Switzerland and New Zealand, will be more appealing, providing even greater incentive to channel government stimulus funds into improving them now. At least some tourists are already thinking about their next itinerary. Embattled cruise operator Carnival, for one, said nearly half its passengers had opted for future credit instead of refunds on cancelled trips. The company is planning to restart some voyages in August.

### Hit the road

Tourism makes up a sizeable portion of GDP and employment for some OECD countries



Note: 2018 data or latest year available  
Source: OECD Tourism Trends and Policies 2020 report  
Vincent Flasseur | Breakingviews

There is other mildly encouraging evidence for the industry even though Expedia and others have withdrawn financial forecasts and Delta Air Lines boss Ed Bastian expects a recovery to take two to three years. Domestic bookings for China’s largest online travel agency, Trip.com, are on a rapid rise. Travellers in their teens and twenties are powering the \$15 billion company’s first stage of a rebound in May, signalling that less risk-averse generations will help lead a post-pandemic age of tourism. Certain carriers, such as Ireland’s Ryanair, with more flexible cost structures also may be better able to navigate the crisis. More consolidation could be necessary and allowed.

Mobility will be more difficult, however. Countries wary of future contagion may tighten their borders and widen the scope of what constitutes non-essential travel. Leisure trips are also apt to become onerous. Health immunisation documents could become as vital as passports. Global air traffic, meanwhile, is expected to slow to a

compound annual growth rate of 4.6% through 2028, from an estimated 5.1% before the crisis, according to UBS.

Business travel looks especially vulnerable. Such spending had been projected to reach \$1.7 trillion worldwide by 2022, according to industry estimates. Serious concerns are evidenced, however, by two investors recently backing out of a proposed deal to buy a stake in a corporate airfare and hotel booking enterprise half-owned by American Express at a \$5 billion valuation.

By the time the pandemic blows over, companies also will be more accustomed to remote working, and happy to keep costs down by using videoconferencing to meet with clients over first-class tickets and conference boondoggles. Even a modest 5% long-term hit to this segment of the market would upend many business strategies. For the beaten-up travel complex, this area will leave the most lasting scars.

*First published May 19, 2020*

### Silicon Valley gears up to leave Silicon Valley

By Gina Chon

Silicon Valley will soon be more of an idea than a place. Some startups are closing San Francisco offices; giants like Facebook were already expanding their national footprint. Covid-19 will hasten the planting of tech flags across America.

The pandemic has shown location isn't everything. Twitter boss Jack Dorsey on May 12 told employees that most of them could permanently work from home, according to BuzzFeed. Facebook and Google parent Alphabet told workers in early May they probably won't be back in the office this year.

Enforced home working has made firms realize they aren't tethered. Ryan Johnson, co-founder of Culdesac, a startup building car-free neighborhoods, said on Twitter on May 8 that his company is giving up its San Francisco office while keeping its Tempe, Arizona location. A venture capitalist told Breakingviews he recently set up several startup founders in Boise, Idaho.

Population was already declining in some parts of the Bay Area. From July 2018 to July 2019, San Francisco county had a net loss of 88 residents, while Santa Clara county, home to Apple and Alphabet, lost more than 5,800, according to the California Department of Finance.

High costs are a big factor. The median home value in San Francisco costs more than \$1.4 million while median monthly rent is \$4,500, according to Zillow. The equivalent home price in Tempe is \$320,000 and rent is \$1,695 a month.



Commercial real estate is also expensive. An area in Google's hometown of Mountain View was the most expensive U.S. office submarket in 2019, averaging \$1,554 per square foot of space, according to PropertyShark.

That has benefited places like Austin, Texas, where Facebook has a music room for employees to hold jam sessions. The city's tax revenue jumped nearly 25% from the 2016-17 fiscal year to the current one. In the same period, San Francisco's revenue increased about 18% but the growth rate has slowed. It's projected to fall to 2% in 2021-22.

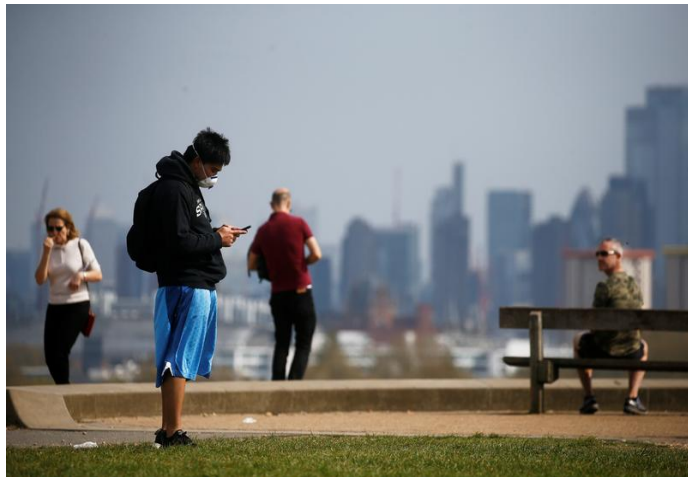
Tech ecosystems aren't solely about cost. The number of computer science graduates at Boise State University has quadrupled since 2014 after investments in that program. It will take a lot more to match Silicon Valley's mix of entrepreneurs, capital, talent and academic excellence. Still, the pandemic is spreading versions of the region across the United States.

*First published May 13, 2020*

### Phones will restore freedom at the cost of privacy

By Ed Cropley

Without a universal coronavirus vaccine, people will have to accept a little slice of Big Brother in their mobile phones. Contact-tracing apps, including ones spawned from a rare alliance between Apple and Alphabet's Google, will be key to containing future viral flare-ups. Besides less privacy, such systems demand participation levels rarely seen in democracies. The benefits of increased mobility, however, will outweigh the Orwellian overtones of mass compliance.



A man wearing a face mask looks at his phone on Primrose Hill in London as the spread of the coronavirus disease (Covid-19) continues, London, April 11, 2020. REUTERS/Henry Nicholls

South Korea's early success in cornering the virus leaned heavily on location-tracking via smartphones. But victory came at the cost of intrusion into private lives. While every country is free to choose how its citizens' liberty should be curtailed, the need for common standards across integrated regions like Europe means the South Korean model won't fly.

Fortunately, there is a less intrusive alternative based on Bluetooth, the radio technology that lets mobile phones communicate over a few metres – about as far as a coronavirus particle travels on a sneeze droplet. If everybody has an app recording who they have been near, the moment an individual is diagnosed with Covid-19, their recent ‘contacts’ can be alerted.

The beauty is that there is no central database or controlling authority, bar the health worker who enters a person’s status after a test. The snag is that without widespread and quick testing, the system breaks – few will sign on if an infection alert means a schlepp to a distant lab or, worse, two weeks of self-isolation.

And to work, 60% of a population need to be on board, according to University of Oxford’s Big Data Institute. That’s the limit of achievability – in developed societies, smartphone penetration is roughly 80% but only three-quarters of handsets have the super-efficient microchips that let Bluetooth run constantly without flattening the battery.

Mandating apps is a bad look in any free society. Hence why democracies’ sticks will look carrot-shaped: tech giants and phone firms may ‘push’ apps onto handsets automatically, with users consciously having to opt out; awareness campaigns will remind the public that usage involves less personal data than millions submit willingly to Facebook daily; bars and restaurants may demand contact-tracing apps for employees’ health and safety. As ‘1984’ aficionados will recall, at the end of George Orwell’s totalitarian masterpiece, even protagonist Winston Smith learns to love Big Brother.

*First published April 30, 2020*

### **Economic distancing is sad sequel to social kind**

By John Foley

Social distancing today will lead to greater economic distancing tomorrow. Covid-19 is a disease that looks to have disproportionately targeted the poor. Its legacy will be to drive a wedge between communities already far apart, despite fairy tales of the leveling effect of past pandemics.

New York City, with almost 17,000 deaths as of May 26, is a grim illustration. A Manhattanite is roughly half as likely to be hospitalized and half as likely to die compared with someone from the Bronx, based on city government data. Lower prosperity increases the chances of contracting a potentially fatal, crowd-borne disease. The average Bronx household has 35% more occupants than its Manhattan counterpart, half the median income, and a 40% longer commute to work, according to U.S. Census Bureau data.

The division could play out in other places too. Italy’s north is where the coronavirus wreaked most havoc, but the south has worse healthcare, poorer living conditions, and

more people working outside of the formal economy. Or think of Paris and its banlieues. Wealth, health and racial gaps are unhappily aligned. A black African British person is 3.7 times more likely to die of Covid-19 than a white Briton, after adjusting for age and geography, the Institute for Fiscal Studies has shown.

True, one rosy view is that the coronavirus will be a turning point. The 1918 influenza led to a rise in wages; the Black Death, six centuries earlier, sped the death of the feudal system. But this disease will almost certainly be different. Spanish influenza killed the young; coronavirus mostly leaves them alive, but jobless. Dominant enterprises from Amazon.com to Walmart have their pick of the labor market, without having to drastically raise wages. And there's a grim political dimension. Of the 44 hardest-hit congressional districts in the United States, 41 are Democrat-voting, according to Pew Research Center.

After social and economic distancing, expect the geographic kind, for those wealthy enough to pursue it. Previous crises, from the 1918 pandemic to the Sept. 11 attacks, didn't lead to the feared emptying out of cities, or acceleration of so-called white flight. This one might though – and it's white-collar flight that's most likely to define any urban exodus. Covid-19 has united the world in fear, and splintered it in almost every other way.

*First published May 27, 2020*

### **African debt holiday choices open new divisions**

By Ed Cropley

Coronavirus will accentuate the divide between Africa's haves and have-nots. Kenya, which views itself in the former camp, is declining the offer of a debt holiday extended by the Group of 20 major economies because it doesn't want to hurt its standing with private creditors. Others that have no choice but to accept will look worse by comparison.

Indebtedness was also a problem for African countries during the global financial crisis a decade ago. But two things have changed. First, foreign capital has fled faster. Second, Africa is now more reliant on private funding and thus more exposed to its departure. Since 2010, more than 20 sub-Saharan countries have raised dollar-denominated debt. Private creditors are owed a third of total Eurobond issuance, which topped \$100 billion last year.

That causes big problems when it comes to sensible ideas, like the one punted by the G20, for official and private creditors to forgo payments for a year or so. Even if ratings agencies can be persuaded to look the other way – and that's a big if – markets will take a dim view of such a manoeuvre and drive up borrowing costs in the future. Given

the hefty future financing requirements of hammered petro-economies like Nigeria, that's a worry.

Take Rwanda. Since making a coupon payment on May 2 and flagging its intent to eschew debt relief, the yield on its 2023 Eurobond has dropped 150 basis points. Were Nigeria to roll over its \$11 billion of external debt, such a decline in borrowing costs would translate into a reduction of \$165 million in interest payments a year.

In one sense, Kenya could afford to be picky – it already had a \$1 billion World Bank loan in the works with an interest rate of at most 2%. But that's a reward for its foresight, past handling of the economy, and willingness to embrace economic reform. Angola and Zambia – both over-indebted and over-reliant on commodity exports – were probably already on track for default regardless of the coronavirus and will have to take whatever help is on offer. Others like Ghana, Senegal or Ivory Coast sit in the middle and have to choose between pain now or pain later.

*First published May 20, 2020*



A woman walks past a wall painted with a slogan calling for action against the coronavirus disease (Covid-19) in the Kibera slum of Nairobi, Kenya on May 18, 2020. REUTERS/Baz Ratner



## Crosseyed and painful: Market forces on hold

**Chancellor: Big is beautiful will also be ugly**

By Edward Chancellor



A worker gathers items for delivery from the warehouse floor at Amazon's distribution center in Phoenix on Nov. 22, 2013. REUTERS/Ralph D. Fresno

It's hard to rustle up a hearty breakfast in the coronavirus era. Eggs are in short supply at UK shops. Across the pond, bacon is disappearing from supermarket shelves. These shortages have a common origin. The food industry on both sides of the Atlantic has become highly concentrated, making supply vulnerable to the Covid-19 shock. Many other industries are in a similar spot. Ideally, now is the time for antitrust regulation and fiscal measures to make business more competitive and less concentrated. Yet when the lockdown ends, Big Business will probably emerge in an even more dominant position.

The Great British Egg Shortage resulted from a lack of containers. There are only three egg-carton manufacturers in Europe and one of them, located in Denmark, went offline. America's meatpacking industry is dominated by a handful of giant operators. One of them, Smithfield Foods, closed two large processing plants in mid-April after employees tested positive for the coronavirus. In April, pork production fell by nearly 15% and beef production by even more. The White House ordered abattoirs to remain

open under the Defense Production Act, which allows the president to control critical supplies, including the supply of hot dogs and hamburgers to kitchen tables.

For more than three decades, the pursuit of shareholder value has encouraged managers to cut costs and merge in the name of efficiency. Antitrust regulators have given the nod to the consolidation of industry behemoths, providing consumers didn't suffer. Now the true costs of all this cost-cutting are becoming apparent. It's not just that concentrated industries tend to invest and innovate less, create barriers to entry and pay their workers less and executives more. The relentless pursuit of efficiency has created heretofore-hidden vulnerabilities.

Bottlenecks have appeared in strange places – such as Europe's egg-box manufacturers – creating a domino-like effect across whole supply chains. The effect is reminiscent of the cascade of financial failures following Lehman Brothers' collapse. Most seriously, excessive industry concentration has contributed to shortages of critical medical supplies – of ventilators, face masks and other personal protective equipment. Amazingly, there are only two major manufacturers of Food and Drug Administration-approved hospital swabs, one of which, Copan, is based in locked-down northern Italy. Local private hospital monopolies in the United States tend to operate with a minimum number of spare beds. Group purchasing organisations – buying cartels operated on behalf of healthcare providers – have squeezed suppliers of medical equipment and drugs and driven manufacturing to cheaper offshore locations.

In an ideal world, policymakers would respond to the failings exposed by the crisis by tightening the enforcement of competition rules. The laissez-faire approach to mergers, favoured by neoliberal types, has considered the impact of mergers only on consumer welfare. Antitrust watchdogs need to ensure that industries are more resilient, which means operating with greater slack, even if that means higher prices. Nobel laureate economist Paul Romer suggests that antitrust rules could be supplemented with progressive taxes that target corporate size, such as taxes on sales or the number of employees. Romer believes that such fiscal measures would encourage companies to shrink in size.

In the real world, such an assault on Big Business is unlikely. One of the more depressing aspects of the Great Lockdown is how much kinder it has been to the Goliaths than to the Davids. On the stock market, the S&P 500 Index of large-cap firms has crushed the Russell 2000 Index of smaller companies. Amazon's sales are soaring while small retailers remain closed. In the UK, garden centres are shuttered while liquor stores are free to sell alcohol manufactured by a handful of multinational brands.

Most U.S. small businesses operate with just two weeks of cash reserves, according to the JPMorgan Chase Institute. The chances of firm survival are correlated with size. When the lockdown ends, expect a surge of bankruptcies of small and medium enterprises. Although governments are providing loans to small businesses, monetary



policy favours large ones with access to capital markets. The Federal Reserve is providing up to \$750 billion to buy corporate bonds, including non-investment grade ones. The U.S. central bank has taken interest rates to zero for the first time in history. Ever-lower interest rates will drive more industry concentration.

As Jonathan Tepper observes in his book, “The Myth of Capitalism”, business cartels are more likely to hold together during periods when money is cheap – as was the case in the late 19th century, when U.S. Steel and other monopolistic “trusts” were formed. It was during the trust era that American economist and Princeton University President Arthur Hadley defined interest as “the price paid for the control of industry”. The lower the rate, argued Hadley, the easier it is for a dominant business to take over its weaker competitors. That’s how natural selection works in the corporate world, he thought.

This suggests another merger boom is coming, financed on even-easier terms than during the last cycle. The large will devour firms fatally weakened by the pandemic. Expect a wave of takeovers in stricken sectors: airlines, travel and leisure, energy and oil services, food distribution and retail. Trustbusters, of course, will be up in arms. But they will find little political support in Washington or Brussels. There are no Teddy Roosevelts or Woodrow Wilsons in the Republican Party to challenge the corporate giants. Elizabeth Warren and Bernie Sanders would have led the battle, but both failed to progress in the Democratic primaries.

In the cratered economy that emerges from the lockdown, acquisitive firms will argue that mergers save jobs. Furthermore, as the tide of globalisation recedes, pressure is building on other countries to follow China’s example of fostering national champions in strategic industries. Big is beautiful will be the new corporate mantra. In the long run, it will be ugly.

*First published May 4, 2020*

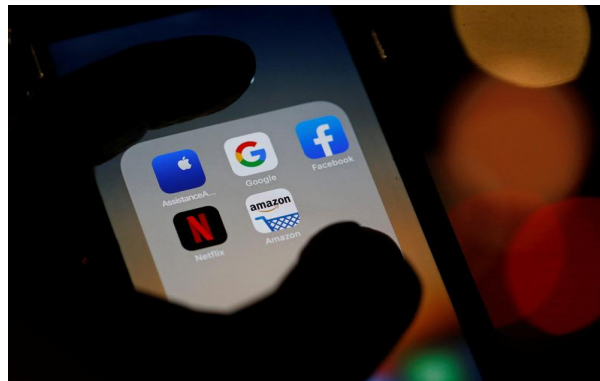
### **Big Tech will emerge from virus too big to fail**

By Gina Chon

Big Tech has become too big to fail, thanks to the coronavirus. Amazon.com has been an essential service keeping households supplied during the pandemic. The alliance between Apple and Alphabet’s Google on contact tracing is seen as key to reopening economies. Facebook’s reach has disrupted virus disinformation. The size and scale of these companies has proven to be an asset in a crisis – and will mute arguments to break them up.

Before the outbreak, political pressure in the United States and Europe was mounting on these firms. The U.S. Justice Department launched antitrust probes, Congress has held multiple hearings and Brussels dug into business practices after imposing billions in fines.

Yet Silicon Valley's giants have been a lifeline during unprecedented economic shutdowns. Amazon has become the go-to place to get baby wipes, freezers and face masks delivered to doorsteps. In March, the group run by Jeff Bezos sought 100,000 more employees to meet demand. The pressure has sparked worker protests regarding warehouse conditions and pay.



The logos of mobile apps, Google, Amazon, Facebook, Apple and Netflix, are displayed on a screen in this illustration picture taken Dec. 3, 2019. REUTERS/Regis Duvignau

Its cloud-computing unit has also been vital for businesses and governments managing remote work. The Small Business Administration enlisted Amazon to help set up an emergency loan program for firms struggling to survive. Microsoft's Azure cloud-services arm has played similar roles.

Apple-Google launched an interface to alert people who have been in contact with someone who tested positive for Covid-19. Such data will be useful to containing the spread of the virus as businesses reopen. It raises privacy concerns, which the companies have tried to mitigate through an opt-in system using randomized identities. But the app is being embraced by Germany and other European countries.

The outbreak also reminded many of Facebook's utility. The social network whose traffic has surged also used its reach to direct more than 2 billion people to coronavirus factual health resources and started flagging Covid-19 misinformation to people who have liked or commented on it.

Collectively these big tech firms have a market value of more than \$5 trillion. Their scale has been a plus for governments trying to reach constituents quarantined at home. They've been thanked by politicians from California Governor Gavin Newsom to President Donald Trump. Silicon Valley firms will make sure that's remembered the next time regulators complain about their size.

*First published April 28, 2020*

## Cox: Brace for America's version of Saudi Aramco

By Rob Cox

Calamity creates opportunity. That has always been true when it comes to corporate consolidation. Recall how a series of mega-mergers and acquisitions transformed the banking industry after the 2008 financial panic. Wells Fargo snagged Wachovia. Bank of America scooped up Merrill Lynch. Lloyds TSB bought HBOS. BNP Paribas grabbed Fortis. JPMorgan got Washington Mutual and Bear Stearns. And so on. Before the coronavirus has taken its full physical and economic toll, expect more of the same.



The U.S. flag is displayed at Tesoro's Los Angeles oil refinery in Los Angeles, California on Oct. 10, 2014. REUTERS/Lucy Nicholson

Strong banks ate the weak, and they were chivvied along by federal and state governments and regulators worried about the sustainability of their financial systems. Governments will play a central role now, too. Even before the Great Lockdown, leaders were calling for relaxation of antitrust restrictions as a response to the emergence of stronger Chinese competitors. France and Germany railed against the European Commission blocking the merger between the rail businesses of Siemens and Alstom, complaining it would give Chinese giant CRRC free reign. President Donald Trump has tried to encourage telecom mergers to combat Huawei. These concerns have only become more pronounced as China appears to have rebounded from the virus more rapidly than the rest of the world.

The political logic of protecting domestic companies through strategic alliances will apply after the pandemic and across a broad range of industries. Governments will come away from Covid-19 with new priorities, ranging from safer, more domestic, manufacturing and supply chains to less risky balance sheets. If history rhymes, then pre-virus views about competition may take a back seat. As Edward Chancellor argued, this will lead to an unhealthy concentration of power.

For the M&A business it opens all sorts of possibilities once considered taboo. Take the oil patch. Sliding demand has combined with efforts by the world's largest producer, Saudi Arabia, to flood the market and nudge U.S. drillers toward bankruptcy. As the price of a barrel of West Texas Intermediate crude has fallen below \$20 a barrel from \$60 at the start of the year, producers have been lobbying Trump for a rescue.

It's not inconceivable to imagine the largest American producers banding together to squeeze out costs and take a better grip of U.S. oil supply, maybe even aided by government loans and a streamlined regulatory process, effectively creating a potential rival to Saudi Aramco. Merging Exxon Mobil with Chevron would forge a company worth some \$350 billion with 35 billion barrels of proved reserves. Heck, they might even fold in BP's 20 billion barrels of reserves and \$75 billion market cap and "ExChevBrit". It would be a shrimp compared to Aramco's \$1.6 trillion value and 270 billion barrels of proved barrels of oil – and that's how they would justify a deal.

Cars are further down the hydrocarbon food chain. The planned merger of Fiat Chrysler Automobiles and Peugeot looks prescient as sales have plummeted. The French state has to be considering a way to smush Renault together with FCA-Peugeot in a couple of years – if Nissan Motor and Mitsubishi don't do it first. Even Germany's big three automakers are sucking wind. BMW and Daimler have a combined market cap of 65 billion euros – half of Tesla's. Founder Elon Musk must be exploring options to expand Tesla's manufacturing base.

Meantime, with Chinese rivals Geely Automobile and BAIC Motor buying Daimler shares and competing for influence over the Mercedes maker, a sale to a non-Chinese buyer of Daimler, which purchased America's Chrysler two decades ago, can't be ruled out. Those fears could even push Daimler into the arms of its Bavarian rival BMW, as Breakingviews argued in its 2020 Predictions book. Similar combos such as Ford Motor-General Motors can't be entirely off the table if that were to happen.

The respiratory plague's acceleration of China fears may also drive deals in defence. Vector in the financial troubles at Boeing and General Electric and it's possible to see the two combining to create an integrated aircraft-and-jet engines monster, perhaps with government backing on national security grounds. That would make Siemens-Alstom look like an amuse-bouche.

Dread of China dominating the 5G telecommunications race was already sparking speculation of a Cisco Systems bid for \$20 billion Nokia. In a market redefined by the global threat posed by China's Huawei, rather than old-style concerns about local competition, Cisco-Nokia could fold in \$26 billion Ericsson, too. Even tacking on International Business Machines would still only create a company worth a quarter of Microsoft's \$1.32 trillion market capitalisation. Then there's 6G, where Intel, Qualcomm and Micron Technology will almost certainly face pressure to manufacture their chips onshore. Three-way anyone?

Banks started out in better shape this time around, but as economies suffer, so will their balance sheets. European banks already weathering negative interest rates will find the post-pandemic environment a challenge. Cross-border mergers – such as UBS buying Deutsche Bank – may still be hard to pull off, but more domestic combinations may not be. After two previous attempts perhaps BNP and Société Générale will create a "champion national" in French banking. Banco Santander and Barclays might find enough overlap in the UK and elsewhere to pull off something similar.

From chicken stocks to pharmaceutical supplies, companies and countries will want to ensure their product-sourcing is secure by making supply chains more resilient and less internationally dependent. Britain's resistance to concentration in the retail space may get a rethink as retailers like Marks and Spencer struggle, grocers including J Sainsbury prove their worth, and Ocado, the delivery service, crushes small shops. In April, UK antitrust watchdogs broke down and approved a big investment in food-delivery startup Deliveroo led by Amazon.

Delivery has become a piece of critical American infrastructure during lockdown. Services like Grubhub, Uber Eats and DoorDash are unlikely to remain independent. Even Amazon needs more delivery help, particularly for the last mile. While it can just hire more people, an Amazon purchase of Uber Technologies might please politicians worried about delivery bottlenecks when the second wave of the virus returns later in the year.

Similarly, shelter-at-home life may usher in new possible combinations in the entertainment and telecommunications sphere. Comcast, whose cable business is being undermined by streaming rivals like Netflix, has long coveted Walt Disney, whose own streaming business is getting off the ground. A merger of Dish Network and AT&T's DirecTV would create the country's only major satellite television provider. But as consumers increasingly use their mobile phones to consume media, would regulators blink?

Finally, the need to create more diversified companies with robust balance sheets could revive the fortunes of the conglomerate, which had been wilting under the lash of shareholder activists and investors preferring to invest in focused businesses. Not only would that blunt criticism for sprawling enterprises such as 3M and Emerson Electric to break up, it might even prod others, say Caterpillar and Deere, to run the numbers on huddling together.

*First published May 5, 2020*

### Central bankers have more cards up their sleeves

By Swaha Pattanaik

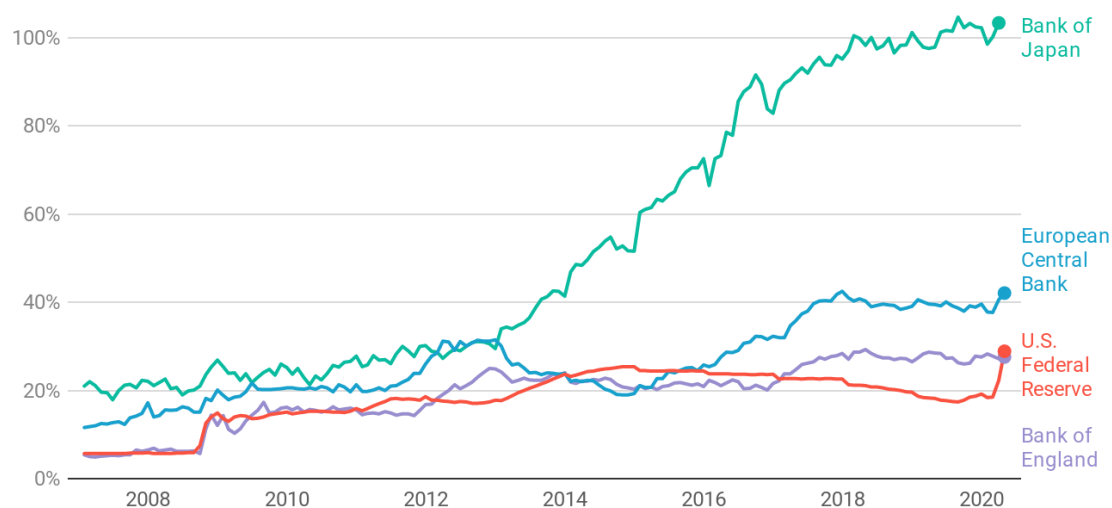
There's an end to everything except, apparently, central bankers' creativity. Virus-damaged economies will need lots of help to heal, and more downturns are inevitable in the future. The monetary-policy bigwigs will keep coming up with more new ways to stimulate growth.

Necessity may persuade Federal Reserve Chair Jerome Powell and Bank of England Governor Andrew Bailey to eventually overcome their aversion to negative interest rates, which have been part of the European Central Bank's toolkit for some time. And central bankers could copy Bank of Japan chief Haruhiko Kuroda's yield-curve control policy of targeting specific levels for 10-year government bond yields.

They also have the option to ramp up asset buying on a massive scale. The BOJ is the trailblazer: Its balance sheet is worth more than Japan's annual GDP yet Kuroda on April 27 pledged to buy unlimited amounts of debt. If central banks own too much of one asset, they can buy others. Powell has branched out into corporate debt, and is even purchasing junk bond exchange-traded funds. Buying equity ETFs, as Kuroda already does, is the next step.

### Central bank balance sheets

Total central bank assets as a % of GDP



Source: Refinitiv Datastream

Vincent Flasseur | Breakingviews

The last taboo will be directly financing governments. The ECB can buy corporate bonds when they are first issued as well as in the secondary market. But major central banks have so far eschewed buying government debt in the primary market to protect their independence and credibility.

That said, the more they do across all markets, the more the lines blur. For example, there was obvious coordination when the BoE unexpectedly cut rates on March 11, just hours before finance minister Rishi Sunak unveiled fiscal stimulus. And major central banks have embarked on huge asset purchases that will keep yields in check at a time when politicians are spending vast amounts to prop up economies. Even a full-on depression may not be enough to provoke the crossing of this final red line, but central bankers have lately shown a willingness to push boundaries.

Two things could force a retreat. Any sudden surge in price pressures would make rate-setters, particularly those with a single inflation-fighting mandate, rethink their largesse. That's not a problem now, but might be in the future. A second trigger could



## Once in a lifetime?

be overt political meddling that jeopardises central bankers' credibility. Investors' faith is hard to regain once it is lost. Asking Powell and his peers to do too much might finally make them resist.

*First published April 29, 2020*

### Why 150% is the new 100% for public debt/GDP

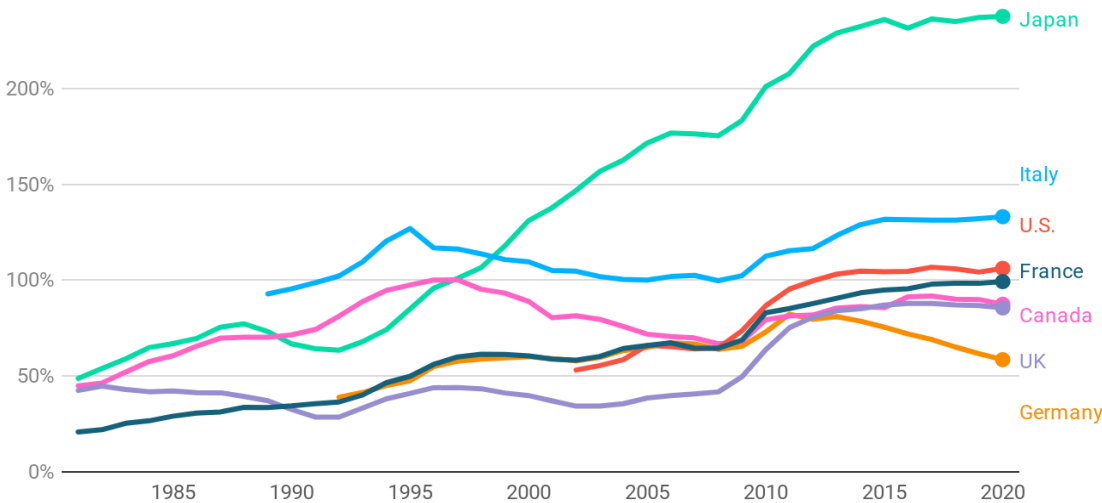
By Swaha Pattanaik

When it comes to age, 70 is supposed to be the new 50. A similar rethink is on the cards for public debt. Governments are spending freely to combat the economic havoc wrought by the coronavirus. While borrowing will inevitably jump relative to economic output, investors will have higher tolerance thresholds.

The U.S. Senate on March 25 backed a \$2 trillion bill to help the American economy. Germany has announced spending and tax plans worth 4.5% of gross domestic product, France's package is worth about 2% of GDP, and Italy has already adopted emergency measures worth 1.4% of GDP, according to the International Monetary Fund. As it's unclear how long the lockdowns will last, analysts are struggling to forecast either debt or GDP. Still, Goldman Sachs on March 24 predicted Italy's debt-to-GDP ratio, which was 137% in the third quarter of 2019, would rise to 161% this year. The investment bank expects the comparable metric for France and Spain to surpass 100% by some margin.

### G7 government debt mountain

General government gross debt as a percentage of GDP



Source: Refinitiv Datastream, IMF WEO

Vincent Flasseur | Breakingviews

Bond investors would normally look askance at government debt exceeding the value of a country's yearly output. Not in a post-virus world. First, GDP would plummet further and longer without emergency spending, so the debt burden is set to rise anyway. Second, since public debt is rising relative to GDP everywhere, the level at which bond investors get worried will change. As former European Central Bank chief Mario Draghi wrote in the Financial Times on March 25, much higher debt levels will become a permanent feature.

A third reason why public debt of around 150% of GDP might become the new 100% is that Draghi's old employer and other central banks are buying ever larger amounts of it. Federal Reserve Chairman Jay Powell has committed to buying as much as is needed and expanded the range of assets that can be acquired. Meanwhile, the ECB has dropped self-imposed limits that applied to a previous asset-buying scheme from its new 750 billion euro Pandemic Emergency Purchase Programme. That should help keep a lid on bond yields.

Some will worry that such stimulus will lead to higher inflation. But it would be counterproductive to fret about future price increases rather than the immediate threat of deflation and economic depression. Higher debt levels are here to stay.

*First published March 26, 2020*

### **Fed's credit market duct tape will come unstuck**

By Anna Szymanski

The U.S. junk bond market has had a wild year. True, Federal Reserve Chair Jerome Powell's plan to buy some high-yield debt has soothed nerves for the time being. But it could end up making the ride bumpier for investors in the coming years.

The extra yield investors demand to hold U.S. junk debt rather than U.S. government bonds roughly tripled from early January to its peak on March 23, according to an ICE Bank of America index, but has fallen by around a third since then.

That may seem odd given U.S. economic forecasts range from bad to cataclysmic. S&P Global Ratings expects the trailing 12-month default rate on high-yield debt could hit 10%, triple the forecast in December. But Powell's new scheme more than offset the gloom, even before the central bank began exchange-traded funds purchases on May 12.

Calmer conditions allowed junk-rated companies, including Ford Motor, to sell at least \$33 billion in bonds last month. That's more than double the total for April 2019. Nor is this likely to be a flash in the pan. Ultra-low interest rates and ample liquidity will fan investors' risk appetite and make it easier for companies to roll over debt.

But Powell's stimulus measures won't make business models sustainable in the long term. They may also encourage companies to take on even more debt and create

dangerous asset price bubbles. Meanwhile, inflation, which erodes bond returns, could pick up once domestic demand recovers. The forces that have kept consumer prices in check include closer global economic and trade ties, technological advances and weaker labor rights. These may be less powerful or go into reverse if crisis-scarred nations reduce trade flows and immigration, on-shore supply chains and limit capital flows.

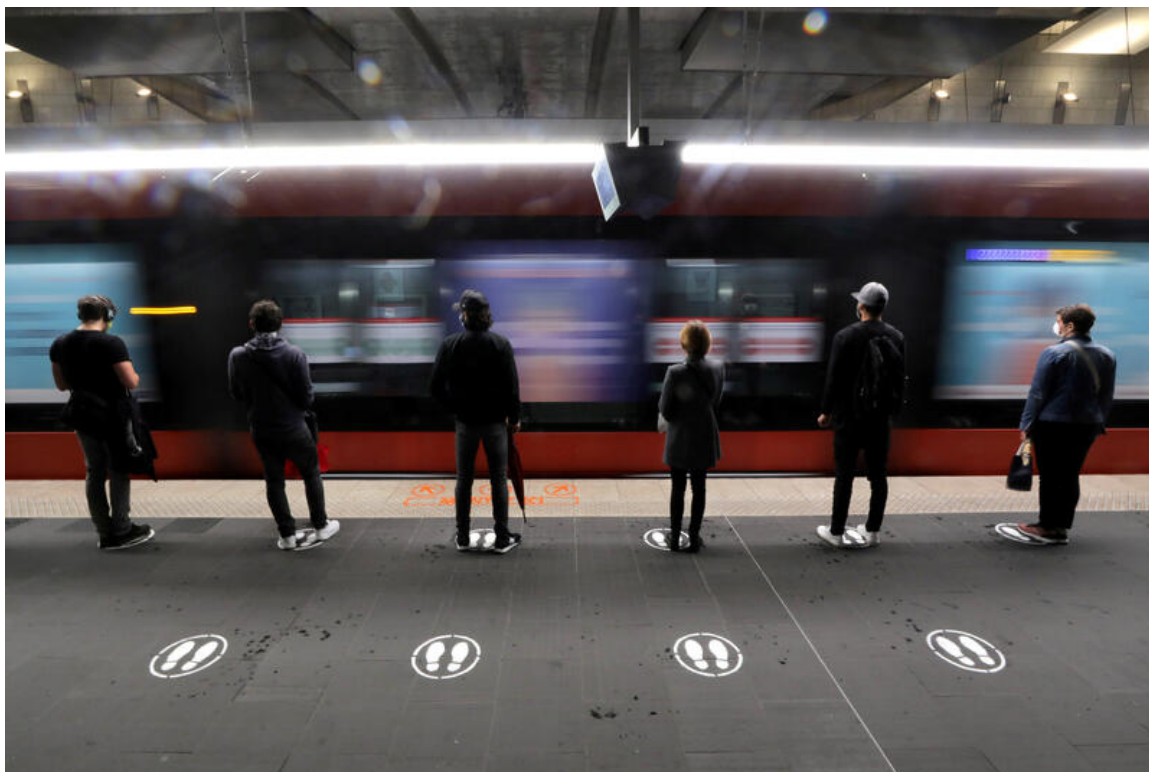
Investors may be adequately compensated for the risks right now given Powell's helping hand. But this is a temporary safeguard, and one that may not be there if inflation concerns reappear or if a market bubble bursts. At that point, investors may be out on a limb without any central banker to catch them.

*First published May 20, 2020*

## Worry about the government: The role of the state

### Fringe taxes will go mainstream when lockdowns end

By Peter Thal Larsen



People stand on signs to respect social distancing on a platform for the tramway in Nice as France began a gradual end to a nationwide lockdown due to the coronavirus disease (Covid-19) on May 11, 2020. REUTERS/Eric Gaillard

The coronavirus pandemic has upended conventional thinking about economics and finance. Previously radical ideas, such as governments paying private sector wages, have rapidly become mainstream. In the same way, the crisis looks set to push fringe tax proposals to the fore.

It's too soon to introduce any new taxes. Governments are spending freely to mitigate an economic shock from becoming a prolonged slump. When normal life resumes, most consumers and companies will probably want to save more and spend less than before. Public deficits will have to pick up the slack.

At some point, however, governments will have to repair the damage to their finances. Average sovereign debt in developed countries is set to rise above 120% of gross domestic product, according to the International Monetary Fund. Returning to the economic austerity that followed the 2008 financial crisis is impossible. Fixing the holes in public healthcare systems exposed by Covid-19 requires more spending, not

less. Politicians won't dare to rekindle the public anger caused by previous cuts that ushered in a wave of populism.

The case for raising taxes is stronger. State and central bank bailouts helped investors by propping up equity and bond markets, while ultra-low interest rates are supporting already high property prices. Pressure to share that windfall will give new impetus for wealth taxes, like U.S. Senator Elizabeth Warren's proposal for an annual levy on Americans with net worth above \$50 million. University of California, Berkeley economists Emmanuel Saez and Gabriel Zucman estimated the scheme would raise around \$200 billion a year, equivalent to almost 1% of U.S. GDP.

That's not the only way to make the well-off pay more. Higher taxes on inherited wealth is one option; so are increased charges on profits from real estate. In the United States, classifying carried interest earned by fund managers as income, rather than lighter-taxed capital gains, would close a long-standing loophole. These measures would also tend to hit older citizens, who are most at risk from Covid-19 and therefore the main beneficiaries of widespread lockdowns. That would help address the pandemic's intergenerational inequities.

Corporate profits are another prime target. Governments from Denmark to Poland have already excluded companies located in tax havens from receiving bailout cash. When the pandemic eases, companies will face even greater public pressure to pay their fair share. Some politicians may try again to introduce a tax on financial transactions, an idea more debated than implemented since it was first proposed by the economist James Tobin in the 1970s.

The drive to tax tech companies, which was already underway in Europe, will gain new urgency after a period in which Amazon and Alphabet have become even more powerful. Such measures are unlikely to be big revenue earners. Britain's 2% tax on the revenue of social media companies, search engines and online marketplaces – which came into force in April – is expected to raise just 515 million pounds a year by 2025. But they will be popular. Companies which reaped windfall profits, such as online retailers and medical equipment makers, could become targets for one-off taxes.

The virus may also spur some overdue changes to the tax system. One idea that could be dusted off is reducing or eliminating the tax shield on debt. Charging tax on earnings after deducting interest charges gives companies – and consumers in some countries – a perverse incentive to borrow. Fixing that isn't straightforward, and probably wouldn't raise much revenue. But it would make economies less vulnerable to future debt crises.

Likewise, advocates for taxing carbon will spy an opportunity to push a measure that helps fight climate change. The sharp drop in oil prices creates a window to raise taxes without directly hurting consumers. India was the first major economy to hike fuel taxes. However, most governments will be wary of introducing levies that fall

disproportionately on poorer citizens, having seen how fuel levies sparked the “Yellow vest” protests in France two years ago. So, carbon taxes will probably have to redistribute whatever revenue they bring in.

How will politicians justify extra spending? They can earmark increased taxes for certain projects, like preparing for future pandemics. Governments tend to resist such proposals, because they remove budget flexibility and make spending dependent on unpredictable income. However, after a crisis that has demonstrated the importance of healthcare systems, such “hypothecated” taxes may be the best way to persuade voters.

Some taxes may start as temporary measures, or one-off levies. But history suggests governments don't willingly give up new sources of revenue. Britain started taxing income in 1799 as a short-term way to pay for the cost of fighting Napoleon Bonaparte. It never stopped.

*First published May 11, 2020*

### Critical workers hold keys to higher minimum pay

By Richard Beales

There's nothing like a coronavirus-induced lockdown to reveal who really matters. Everyone who cares for sick people, for starters. Yet many workers now designated “essential” by leaders such as New York Governor Andrew Cuomo make less than average U.S. wages. Any post-virus rethink of supply chains and other problems exposed by the crisis must consider who gets paid what.

Take retail sales workers keeping food on shelves with little hope of safely distancing themselves from colleagues or customers. Their average pay is under \$28,000 a year nationally, or around \$13 an hour. That's barely more than the Department of Health and Human Services' poverty guideline for a household of four, and only around half the national average wage, according to the Bureau of Labor Statistics.

Healthcare practitioners at least make a decent \$84,000 a year on average, over \$40 per hour. That's skewed by doctors and dentists, both near \$200,000, but the typical registered nurse, for example, also does fine. Yet ambulance drivers and attendants, not in the same BLS category, pull in under \$30,000 on average, or less than \$15 an hour. Emergency medical technicians do only slightly better.

As in the UK and elsewhere, home health aides are financially forgotten – and heavily exposed to Covid-19. They make less than retail workers on average, says the BLS, as do drivers for services like Uber, according to Economic Policy Institute estimates. Bus drivers and postal workers get closer to the national average. Journalists, loan officers and morticians are among the luckier ones with above-average pay.

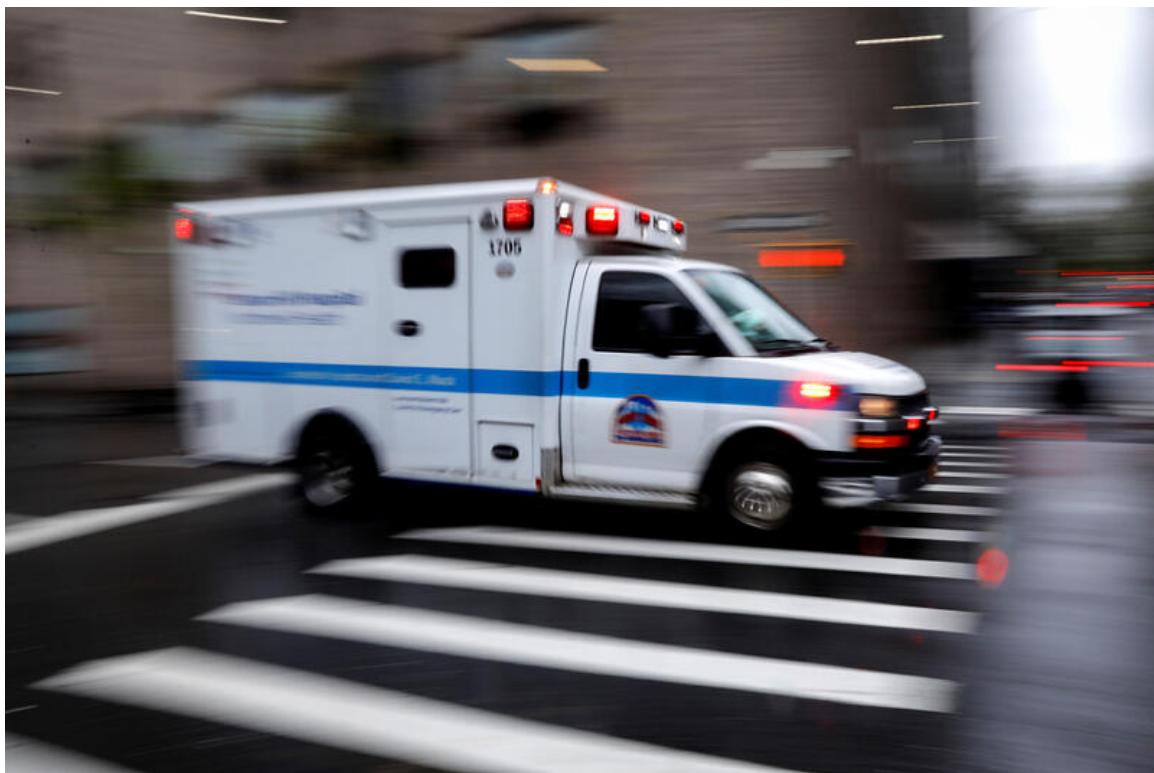


Meanwhile, there's nothing remotely essential about astronomically paid top financiers or, say, sports stars. The question is what to do about this iniquity.

Minimum wage laws are one blunt instrument. The hourly pay floor in New York City is \$15. Enforcing that nationally would fatten the wallets of a dozen of the roughly 40 BLS categories identified by Breakingviews as overlapping with Cuomo's "essential" folks – though that would require more than doubling the laughable \$7.25 federal minimum wage, a long-term victim of legislative dithering.

Other remedies include greater redistribution of wealth through taxes, including higher levies on the rich and companies, or even establishing a universal basic income. Whether lawmakers take such things seriously will depend on how quickly their lockdown memories fade – or whether their lives, like that of British leader Boris Johnson, are saved by an essential worker.

*First published May 6, 2020*



An ambulance arrives at the emergency entrance outside Mount Sinai Hospital in Manhattan during the outbreak of the coronavirus disease (Covid-19) in New York City on April 13, 2020. REUTERS/Mike Segar

## Hadas: Welfare states will be big Covid-19 winners

By Edward Hadas

Disasters often teach people what is really important. The fight against Covid-19 is showing how helpful strong welfare states are to modern economies. The lesson is unlikely to be forgotten.

Lockdowns have made many jobs impossible to perform. In the United States, where firing is easy and government support haphazard, the unemployment rate is set to rise above 20%. It was 3.5% just before the coronavirus outbreak. In Europe, the proportion of the workforce that is banned from working is similar. However, European unemployment rates are not expected to reach anything like American levels.

The main difference is taxpayer-funded programmes to keep payrolls intact so that employers face less pressure to lay off workers. While that will push up budget deficits, the return to economic normalcy will be much faster where workplaces have been kept in suspended animation, rather than smashed up.

A different arm of the welfare state, social care for the elderly, has been much less satisfactory on both sides of the Atlantic. The systems in the UK, most of the continent south of Germany, and the United States were inadequately funded and ill-equipped to deal with Covid-19. But the bitter response to the failures shows how much people in these countries count on the government to take care of them in tough times. This will shape post-Covid policies. Three trends are already starting to emerge.

First, politicians and bureaucrats will have more opportunities to do something that they know how to do: develop new arrangements to protect the most vulnerable. Unemployed voters will have more security and old people will be better cared for. There is likely to be enough political support to raise the money needed to improve nursing homes and public services right away. Employment support will mostly be contingent. Outside the United States, there is a little interest in expanding already-extensive welfare states so the goal will be to have better programmes ready for the next time.

Depending on governments means keeping them better informed. Governments will start to keep closer tabs on incomes and employment. Expect mandatory detailed reporting of the cash flows of small businesses and self-employed workers. It's the economic equivalent of permanent track and trace software.

Second, the United States will move in a generally European direction in the provision of welfare. Progress may be limited in a country that has resisted mandating paid sick leave and annual vacations. However, even conservatives mostly love prosperity more than they hate government. The shock of extraordinarily high unemployment rates encourages a partial suspension of principles, and even a willingness to pay higher taxes.

One way forward is a guaranteed universal basic income. Some libertarians are keen on UBI because it sounds unbureaucratic. In Europe, these programmes may simplify a generous but complicated system. In the United States, they increase the incomes of the people most likely to suffer in a crisis. Andrew Yang, who promoted UBI as a Democratic presidential candidate, may yet get his way.

Finally, more careful European tracking and more generous American benefits could bring more marginalised workers into the regular workforce. This would continue a two-century-old trend: the shift from casual labour that is barely taxed to highly-taxed, state-registered employment.

The recent rise of the so-called precariat, especially undocumented workers, suggested the trend was reversing. Those developments could turn out to have been just a temporary aberration. However, this change is the most tentative.

The current political mood on both sides of the Atlantic favours helping the low-paid workers who are disproportionately exposed to Covid-19, for example carers for the elderly. Justice is not the only motivation. Stronger welfare systems would benefit the prosperous by reducing the economic pressure that forces contagious workers to keep working.

Selfish reasons to be more generous will, however, disappear with the pandemic. And fulfilling promises of financial solidarity would help politically unpopular migrants. Proponents of regularising the status of all migrants and bumping up wages need to move fast.

The welfare state brings economic benefits to all, but ultimately it is always a political project. And for the moment, the politics favour more active and more generous government.

*First published May 13, 2020*

## Virus bailouts will be messier than past rescues

By Neil Unmack

Bailing out coronavirus-hit economies will be messier than the sub-prime salvage job. Governments are pumping trillions of dollars into industries from carmakers to airlines. In return they'll expect higher taxes and jobs, putting them at odds with private sector interests. And lending to smaller companies will create its own set of new headaches.



Shop owners wearing protective face masks protest in front of closed shops asking for help from the government during the coronavirus disease (Covid-19) outbreak in Rome on May 18, 2020. REUTERS/Remo Casilli

Just over a decade after rescuing banks like Citigroup and Royal Bank of Scotland, Europe and the United States are facing an even bigger cheque from Covid-19's damage. The European Commission has already approved over 2.2 trillion euros of state aid, and unveiled plans this week for a 750 billion euro fund. America's CARES Act, which includes loans and grants for small companies, totals \$2 trillion, roughly 10% of GDP. Congress is now debating another \$3 trillion.

Whereas in 2009, governments mostly pumped equity into banks, they're now rolling out a smorgasbord of loans and guarantees. More stock-based bailouts may yet happen. If the recovery is slow and infections recur, companies that took state funding like American Airlines or Deutsche Lufthansa may need to cut debt, and struggle to raise it from weary shareholders.

Governments tend to be awkward shareholders. Cutting employees at airlines or carmakers won't be politically acceptable. Instead, they'll try to rein in pay and dividends. They'll also want to preserve domestic jobs, as President Emmanuel Macron suggested after announcing an 8 billion euro aid package for France's auto industry. That may encourage companies to buy out their rescuers quickly, but weaker firms will be left with investors whose interests are out of kilter with other shareholders.

The funding support packages could be even trickier. Unlike large public banking firms, governments are now bankrolling small and medium-sized companies, which are more vulnerable to recession and have limited access to capital markets. If economies falter further, defaults will jump. And banks may have less incentive to keep companies alive, once default risk is transferred to the public purse.

Governments will struggle to step back from this new role in developed economies. Withdrawing funding could tip weak enterprises over, hurting voters and tax revenue. Already, the UK has watered down its rescue terms to make guarantees easier for borrowers and take on more risk. Ever more money on looser terms may be the only way forward.

*First published May 29, 2020*

## **Pandemic protection will be a governmental affair**

By Aimee Donnellan



A member of parliament wears gloves during the questions to the government session at the National Assembly in Paris as France softens its strict lockdown rules during the Covid-19 outbreak on May 12, 2020. REUTERS/Gonzalo Fuentes

Filling market voids is what insurers do best. Floods, terrorism and earthquakes once caused devastating losses to businesses, but cunning actuaries at groups like Allianz and American International Group quickly created lucrative products to meet rising demand for future protection. The coronavirus has shaken that model. Insurers are already facing over \$200 billion of losses stemming from the pandemic, and governments are the only entities with deep-enough pockets to cover the bill. Future viral crises will play out the same way.

Plans for dealing with the next pandemic are underway. In the UK, a steering committee is looking to create an entity dubbed Pandemic Re, a public-private enterprise that could shoulder some of the costs of another catastrophe. In the United States, where every month of the Great Lockdown could lead to as much as \$431 billion in business losses, the sector is looking at an insurance plan modelled on the federal backstop of the Terrorism Risk Insurance Act of 2002.

Insurers have been here before. In the 1990s, an Irish Republican Army bombing campaign in the UK made terrorism coverage unaffordable. Pool Re was set up to allow insurers to provide affordable coverage to companies. The reinsurer then used the government as the insurer of last resort. This is just one of the many models being explored by virtually every state member of the Organisation for Economic Co-operation and Development, according to insurance sources. But given the sector's limited resources, such ideas seem fanciful.

In the UK alone, the lockdown has put 4 trillion pounds of annual business turnover at risk. The insurance sector only has half of that amount in capital to cover losses. Similarly, U.S. insurers say they would not have the financial means to help every insured business affected by coronavirus, even if they were legally required to.

The problem boils down to pricing. Pointy-headed insurance boffins need frequency and severity to calculate the probability of a claim and how much they can cover. Pandemics don't allow for such clarity. And while Covid-19 is deemed a once-in-a-century event, there's no guarantee that there will not be another virus in 10 years that will cause just as much damage. That leaves governments to pick up the tab.

*First published May 14, 2020*

### **Cox: Virus-ebbed tide exposes the better leaders**

By Rob Cox

People don't know much about Zachary Taylor. America's 12th president lasted 16 months in office before dying of gastrointestinal distress after eating cherries on the Fourth of July in 1850. But he was the first non-politician to occupy the Oval Office, or whatever shape it took back then. Having just distinguished himself as a hero in the Mexican-American War, the Whig Party drafted Taylor as their candidate and he prevailed in an election – the first to be held on a Tuesday nationwide – marked by a divisiveness that would be familiar today.

Taylor, to whom this author is apparently a distant relation, was one of many wartime leaders to emerge from the maelstrom of American politics to become commander in chief despite having little or no prior interest in the profession. George Washington was arguably the first, but there have been others, like Ulysses Grant and Dwight Eisenhower. Andrew Jackson and Theodore Roosevelt were already politicians, but



their battlefield victories established them as full-blown stars. The point is that new and often unlikely leaders tend to emerge from wartime footings.

Which brings us to the current battle against the coronavirus. Leadership is once again being redefined. The incompetents are being exposed nakedly by the virus-ebbed tide. But so, too, are the courageous – those men and women in our communities, companies, hospitals, schools, central banks, houses of worship and, yes, elected offices, who are combatting this existential scourge with compassion, effectiveness and moral purpose. As such, the job descriptions for all manner of roles, not least the president of the United States, are being rewritten in real time.

Impressive new options are also emerging, consistent with historical precedent. The American presidency is the most obvious example. In just a week of virtual lockdown, Donald Trump's inability to manage a crisis with calming aplomb has become apparent. But not because his erstwhile rival for the presidency, former Vice President Joe Biden, has stepped up to the plate. Sure, the Democrat contender has been producing statesmanlike readings from a teleprompter at home, but he's just not relevant to the crisis response. Instead, governors like Andrew Cuomo or Gavin Newsom, in New York and California, have stepped into the breach.

This same dynamic is playing out beyond the American political horse race. In the corporate context, every employee idling at home, worried about their next paycheck or their retirement savings, is parsing company-wide messages for any hint of coming layoffs. Chief executives who show true grit by resisting the temptation to react prematurely to the downturn, and who manage to keep staff calm and productive, will be remembered. But many of them will not be up to the new challenges posed by the economic shock that Covid-19 is delivering.

The empire-building CEO, accustomed to using easy credit and an ever-rising stock price to acquire rival companies and reduce their costs, may no longer be suitable. Activist investors with a penchant for sharply worded letters exhorting boards to borrow money and buy back stock will find the post-coronavirus environment hostile. Above all, bosses will need compassion as now-poorer employees recover from the virus or mourn loved ones who were less fortunate. Restructuring experts, too, will have their day, quarrelling with lenders, suppliers and lawyers for forbearance and much more.

Hospitals like Humanitas Gavazzeni in the virus-stricken city of Bergamo, in northern Italy, are already producing new leaders. While we may not yet know all of their names, the stories of doctors and nurses working around the clock, often at great personal risk to their health and that of their families, will be told. Every hour they are making triage decisions, effectively choosing who lives and who dies. Can there be a greater test of decisiveness, and nerve?

Britain's National Health Service will have its standouts to choose from, including some of the 500,000-plus people who volunteered within hours of a call for help this week. Every hospital battling the disease will see someone new step up. Ditto in schools, where teachers unaccustomed to instruction via Zoom or email will need to learn new skills. Principals used to walking the halls will need to project themselves differently. Some will fail to do so, and others will distinguish themselves to become the headmasters of tomorrow.



U.S. President Donald Trump departs after addressing the coronavirus task force daily briefing as Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases, stands by at the White House in Washington on March 26, 2020. REUTERS/Jonathan Ernst

Which brings us back to the big job of the American presidency. Trump has been upstaged by some in his cabinet. Compared to some of his remarks, which for stock market investors have been particularly anxiety-producing, those of his vice president, Mike Pence, have been more calming. The straight talk from Anthony Fauci, the nation's top infectious disease expert, and Coronavirus Response Coordinator Deborah Birx has made them pandemic celebrities on both sides of the aisle.

One thing is certain: after weeks, perhaps months, of lockdown, layoffs and lower net worth, Americans' views about what sort of leader they want at the helm won't be the same as it is today. Trump already appears to be the wrong man at the wrong time. Biden, while he may project greater compassion, may not measure up to whatever new requirements the electorate will demand of the next president. And who can say that Covid-19's deadly selection of those over 60 as its primary victims will not affect general views in a few months about the wisdom of appointing people in their seventies to the most important management positions in society?

Once the acute phase of the virus has lifted, leadership will be reassessed at every level of civilization – from the presidency and premiership to corporations, schools, hospitals and town halls. Previous notions of what a resume once required will appear antiquated. Which boss looked to be the most fun to share a beer with will hopefully be a laughable standard. Who had the most delegates in a state primary – itself a convention that can be dropped in exceptional circumstances – will be an afterthought. The only thing that will matter was who stepped up to coronavirus and won.

*First published March 26, 2020*

## Take me to the recovery: Returning to growth

### Regulators will owe banks a favour post-pandemic

By Peter Thal Larsen and Liam Proud



General view of the Canary Wharf financial district, as the spread of Covid-19 continues, London on April 6, 2020. REUTERS/Matthew Childs

The wrath of regulators is shifting away from banks. Big lenders spent the past decade atoning for the 2008 financial crisis. The coronavirus-induced meltdown has tested the resilience of a reformed industry, while revealing the fragilities of financial markets. Banks will reap the benefits.

In 2008, thinly capitalised and poorly run banks were the villains in the crisis. This time, the strain has been felt mainly by exchange-traded funds, collateralised loan obligations and other vehicles that ballooned in the past 12 years. As Covid-19 spread, those investors fled.

Banks remain remarkably unscathed by the global dash for cash. The biggest blunder to date is ABN Amro Bank's \$200 million loss after a client got into trouble. The Dutch lender's setback is tiny compared to the multi-billion dollar debacles Morgan Stanley, UBS and others suffered in 2008.

Regulators deserve much of the credit. They spent a decade making banks more resilient. The thinking was that funds and other non-bank entities were better

repositories for risky debt, because they have less leverage and don't gather public deposits. Their failure won't threaten to drag down the system.

The shift is visible in Financial Stability Board data. By the end of 2018, banks' share of financial assets had fallen below 40%, from 45% a decade earlier. Debt held by "other financial intermediaries" almost doubled to \$114 trillion over the same period, reaching more than 30% of the total.

Covid-19 has exposed the vulnerabilities of the regime. As markets tumbled, ETFs dumped their holdings, including less liquid assets such as corporate bonds and commodities. A vast edifice of corporate debt is wobbling. Bonds rated BBB – the lowest investment-grade rating – account for roughly half of all investment-grade corporate debt in the United States and Europe, according to the International Monetary Fund. Some investors were forced to sell after big borrowers like Ford Motor and Kraft Heinz lost their investment-grade ratings.

That's why central banks have rushed to prop up markets. They announced plans to buy corporate bonds worth billions of dollars and unclogged the market for commercial paper. The Federal Reserve is even buying some junk-rated debt.

Those interventions have halted the panic. But as the last crisis showed, the beneficiaries of support will pay a price. Large fund managers like BlackRock and other financial intermediaries will face greater scrutiny, and possibly tighter rules.

Banks meantime are showing other virtues. Lenders can grant payment holidays or waive debt covenants for borrowers. Bond investors, whose holdings tend to be governed by legal contracts, are less flexible. Banks are also the main conduits for distributing government-guaranteed loans, especially to small and medium-sized companies.

Acting as instruments of policy isn't risk free: Supervisors at the European Central Bank and Bank of England have instructed banks not to pay dividends or buy back shares this year. Fat bonuses will also be taboo.

The quid pro quo may be regulatory relief. The Fed, Switzerland's Finma and European Union authorities have temporarily relaxed the calculation of the leverage ratio – a key capital constraint. Meanwhile the Governors and Heads of Supervision, which oversees the Basel Committee of global banking regulators, deferred tighter capital rules by a year.

Supervisors have dulled the effect of tough new accounting standards by encouraging banks not to set aside too much cash for bad debt. European authorities could deliver a further benefit by allowing banks to include some intangible software assets in their capital calculations.

The next step might be to encourage consolidation. The most likely deals would see stronger names like Britain's Lloyds Banking Group mop up sub-scale peers such as

Virgin Money. America's scores of regional lenders could use the crisis as a spur for more dealmaking, while cash-squeezed fintechs may flee into the arms of the incumbents they hoped to disrupt.

Société Générale Chief Executive Frédéric Oudéa said he's interested in cross-border M&A. Perennial pairings like BNP Paribas and Deutsche Bank may be back on the table, pitched as regional champions to rival U.S. megabanks. The first step to making such deals plausible would be easing restrictions that stop banks from moving deposits across European borders. The pandemic may finally persuade sceptical national governments such changes are necessary.

Banks still face plenty of challenges. Lockdowns will lead to bad loans which will eat into capital. Ultra-low interest rates will further squeeze profitability. Nevertheless, the sector that helped cause the last crisis is proving itself an essential tool in fighting the current one. The prize will be more sympathetic regulators on the other side.

*First published May 21, 2020*

### Stock-pickers will join endangered species list

By Anna Szymanski

The pandemic will hammer more nails into the active investment business's coffin. Most stock-pickers failed to prove their worth as the coronavirus spread in early 2020 and roiled global financial markets. They will find it even harder to do so after the crisis passes.

Portfolio managers have long complained that a lack of volatility makes it hard to beat passive funds peddled by firms like Larry Fink's BlackRock that are meant to track stock and bond indexes. They can't any longer. The S&P 500 Index posted moves of 2% or more on over 80% of the trading days in March alone.

Yet in a review of 500 long-only U.S. equity mutual funds' first-quarter performance, fewer than half beat an exchange-traded fund tracking the S&P 500, according to Copley Fund Research, and the average underperformance marked the fourth worst quarterly showing in 10 years. Many managers held a lower percentage of large firms that proved resilient, such as Amazon.com or Microsoft, in their portfolios compared to the benchmark.

Those larger companies will only become more powerful and valuable after the crisis, as they squeeze out weaker competitors. They will represent even higher weightings in major stock indexes and be rewarded with higher valuations as investors pile into passive funds. That will make it even harder for stock-picking fund managers to outperform.

Central banks will also continue to help index-trackers by keeping interest rates low and buying bonds. That should prop up both equity and bond prices and limit future



trading swings, making security selection less useful. The Federal Reserve has even started to buy exchange-traded bond funds, boosting their appeal to investors.

Some active managers – especially those betting on fast-growing tech companies – have been performing well. Managers taking advantage of the sustainable investing fad may also thrive. But passive managers should keep gobbling up more of the world's assets. They already have a 31% share of the funds market in the United States and 16% in Europe, according to Refinitiv data.

Active funds can't completely disappear, as passive investors can't exist without them. But as index-trackers grow, the trend to slash fees and consolidate, like with Franklin Templeton's bid for Legg Mason, will accelerate. The past isn't on their side. Morningstar reckons only around 23% of them have beaten their passive rivals over a 10-year period through December. The future could be even bleaker.

*First published May 27, 2020*

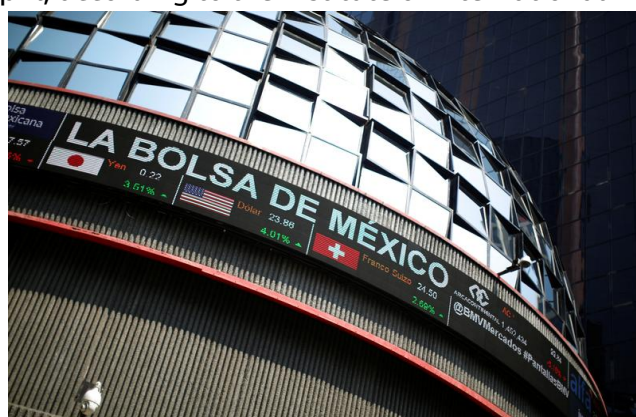
### Emerging markets will see less index, more Rolodex

By Una Galani

Investing in poorer countries will require more nuance. Ultra-loose monetary policy from the U.S. Federal Reserve, Bank of Japan and European Central Bank, and unprecedented fiscal stimulus is pushing capital out of mature markets and into developing ones. But ongoing virus concerns will require funds on the hunt for higher returns to be more discerning than they were after the global financial crisis and taper tantrum. Think less index, and more Rolodex.

The recovery in fund flows is already tracking an uneven economic recovery. After a record \$83 billion outflow from equity and debt investments in March, there were inflows of an estimated \$17 billion in April, according to the Institute of International Finance's Capital Flows Tracker. Emerging Asia, which includes virus-tackling role models like Taiwan, attracted twice the debt inflows as Latin America. Similarly, President Xi Jinping's China stood alone in securing net equity inflows, reflecting its head start on getting back to business.

That uneven trend will go beyond the initial virus shock. Countries with similar levels of macroeconomic stability and equal rates of growth may differ wildly on their crisis-



The building of Mexico's stock exchange is pictured after Latin American stocks tanked amid continued concerns over the coronavirus disease in Mexico City on March 18, 2020. REUTERS/Gustavo Graf

management capacity. Some, like Prime Minister Narendra Modi's India, with limited health resources and struggling to manage the first wave of infections, may be more prone to demand-crushing stop-start relapses until a vaccine is found. These non-financial vulnerabilities can accelerate critical ratings downgrades.

Relapse risk will also make investors more keenly value the financial depth of markets. Take Mexico. Its proximity to the United States, the peso's status as the world's most traded emerging market currency by volume, and a responsible central bank may outweigh concerns about its delicate public finances and make the country a sounder investment destination than other Latin American economies with shallower financial markets.

Beyond the destination, there could also be a shift in how capital flows. The higher cost of actively managed funds has in recent years seen business decamp to cheaper passively managed counterparts run by behemoths like Vanguard, but this means more investors automatically must hold certain weights of various emerging markets. Covid-19's inherent uncertainties may see investors prefer the stewards of their money to have the discretion and local knowledge that comes with a hands-on approach. The wall of capital coming back to developing countries will be built brick by brick.

*First published May 13, 2020*

### **New normal will demand new gold-standard portfolio**

By Swaha Pattanaik

The archetypal balanced portfolio, 60% equities and 40% fixed income, may not outlast the coronavirus crisis. The traditional mix goes off kilter if bonds are going to offer less and less income and more and more volatility. The solution may be to hold more stocks and cash, and possibly gold, too.

The problem with the old split is that bonds no longer fulfil their intended function. They are supposed to offer a steady income stream rather than high returns and act as a buffer when equities head south. That's not how it's panning out. Huge asset purchases by Federal Reserve Chairman Jerome Powell and European Central Bank President Christine Lagarde are pushing up bond prices, which move in the opposite direction to yields. Increasingly, yields are low or even negative and investors only make money if prices keep rising.

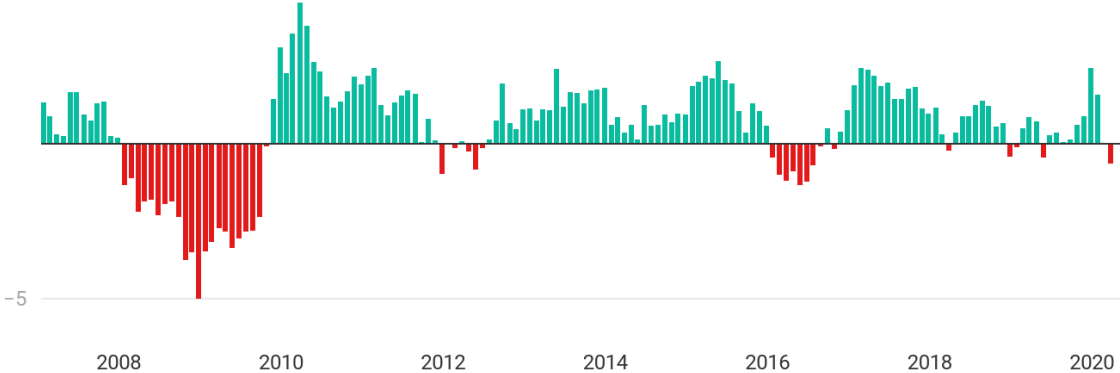
True, continuing central bank purchases mean that could happen for a while. But the second difficulty is that fixed income is no longer so stable. The yield on the benchmark 10-year U.S. Treasury note, supposedly the safest and most liquid bond, fell by two-thirds over two trading days in March before rebounding sharply on the third day, almost to where it started. Third, equity and debt prices started to fall in lockstep during the pandemic-induced market turmoil in March. Such episodes defeat the point of holding low-yielding bonds.

## Once in a lifetime?

Overall, there's a strong case for increasing allocations to stocks, say to 70%. Yet investors still need buffers in case equities sour. They can hold more cash. There's an opportunity cost since interest rates on deposits are close to or below zero in most advanced economies. But cash offers more safety these days than low- or negative-yielding debt and is always in high demand during times of financial stress.

### Finding a new balance

Difference in one-year rolling returns between 70/20/5/5 portfolio (equities/bonds/cash/gold) and 60/40 portfolio (equities/bonds), percentage points.



Note: Returns are total returns where available. Components used for calculations are MSCI World Index, FTSE World Broad Investment Grade Index, U.S. dollar index and gold bullion.

Source: Refinitiv Datastream

Swaha Pattanaik & Vincent Flasseur | Breakingviews

Gold, either in its physical form or via exchange-traded funds, is another option. The yellow metal is a hedge against both deflation and inflation, ideal when it's unclear whether cratering economies will depress prices or central bank money printing will push them up.

And the cost of storing and insuring physical gold holdings is less of a deterrent when alternative safe havens are offering zero or negative yields. A 70% stocks, 20% bonds, 5% cash and 5% gold mix outperformed the 60/40 standard over the past year. Maybe portfolios will become shinier.

First published May 6, 2020

## Activist curve will get flattened by the pandemic

By Lauren Silva Laughlin

Aggressive investors should brace for stronger counterpunches. Although the coronavirus will expose a litany of business flaws that cry out to the likes of Paul Singer's Elliott Management and Dan Loeb's Third Point, corporate balance sheets will need to become stronger, and other yellowed pages from the activist playbook will prove less effective. The returns from such funds also hardly support their cause.

Pushy approaches have slowed down since the crisis struck. The number of campaigns initiated in the first three months of 2020 fell by a quarter from a year earlier, according to research outfit Activist Insight. The board-defending legal eagles at Wachtell, Lipton, Rosen & Katz recently issued a memo saying that funds agitating for short-term changes in this environment risk being tarred "as mere profiteers" taking advantage of misfortune.

Even without the finger-wagging, harsh realities may get in the way. Thanks in part to stock buybacks, borrowing levels at U.S. companies, excluding financial institutions, have been expanding since the financial crisis. At more than \$10 trillion, total debt has ballooned 65% since the end of 2010, according to the Federal Reserve Bank of St. Louis, to a record proportion of GDP. Even before Covid-19 torpedoed global growth estimates, Moody's Investors Service was forecasting more downgrades and defaults in the next recession than the last one.

Bountiful merger activity has taken its toll, too. Companies targeted by activists were more likely to have their credit ratings affected, with twice as many getting downgraded as upgraded, according to S&P Global Ratings. More than 80% of such changes were the result of campaigns that demanded some sort of dealmaking.

Those developments suggest activists will need to show up more often with sound operational advice instead of financial engineering. If their recent performance is any reflection of such expertise, however, many lack credibility. Hedge Fund Research's Activist Index improved by 18% last year compared to a 30% uplift for the S&P 500 Index. Similarly, the brash bunch collectively lost 10.5% in 2018 while the benchmark index fell just 7%. After years of successfully barging through boardroom doors, assertive investors can expect to have more of them slammed in their faces.

*First published May 28, 2020*

## Buyout barons will keep getting cake and eating it

By Lauren Silva Laughlin and Neil Unmack

Private equity firms use debt to increase their potential rewards. It makes their investments riskier, though, and as Covid-19 has pushed thousands of businesses into oblivion, that no longer passes the smell test. Yet the cycle can continue, because the

pandemic is helping buyout groups like Blackstone and KKR and their investors, including big pension funds, even as it hurts their investee companies.

Failed private equity investments bring extra frisson because they often leave a trail of damage.

Take J. Crew, the U.S. retailer with some 15,000 staff that filed for bankruptcy in early May. TPG and Leonard Green & Partners bought it in 2011, took some \$55

million in fees and expenses for closing the deal and then took another \$8 million annually for “monitoring” the company. They extracted nearly \$700 million in dividends too. When things got rocky, they transferred J. Crew’s trademark into a holding company, away from creditors.



Shoppers enter and leave the J.C. Penney department store in North Riverside, Illinois on Nov. 17, 2017. REUTERS/Kamil Krzaczynski

There will be more J. Crews as growth craters. But for the buyout shops themselves, things are going just fine. They raised a record \$361 billion last year, according to Bain & Company. Central banks’ backstop of credit markets has indirectly subsidized the use of leverage. Low interest rates will ensure that investors keep seeking out the high returns that private equity promises, in part enabled by all the fees and dividends that enrich their investors too. All the while, buyout firms continue to exploit a loophole that lets them treat profit as capital gains rather than income, which is taxed at higher rates.

The private equity game was under scrutiny even before Covid-19. U.S. Senator Elizabeth Warren took on buyout shops last year in her Stop Wall Street Looting Act. Europe and the United States have introduced modest regulation around adding debt to companies. And they were excluded from the Paycheck Protection Program, which offered loans to U.S. small businesses at risk of folding.

The saving grace for industry bosses like Blackstone’s Steve Schwarzman and KKR’s Henry Kravis is that politicians currently have bigger foes – notably in Silicon Valley. Seven of the top 10 American billionaires Forbes list that tracks real-time wealth are tech founders. The others are LVMH’s Bernard Arnault, Warren Buffett, and Zara empire builder Amancio Ortega. With whales like Jeff Bezos and Larry Page dominating the oceans, the smaller sharks may ply the seas unimpeded.

*First published May 18, 2020*



## Road to somewhere: A better world?

### Energy's titans will experience a dead cat bounce

By George Hay



A worker walks inside the Brazil's Petrobras P-66 oil rig in the offshore Santos Basin in Rio de Janeiro on Sept. 5, 2018. REUTERS/Pilar Olivares

Energy's big hitters are limbering up for a dead cat bounce. Despite a rally after U.S. crude futures briefly turned negative in April, oil prices are still half January's \$70-a-barrel level. For petrostates like Saudi Arabia and companies such as Royal Dutch Shell, there's good and bad news.

Even an estimated 30% year-on-year Covid-19-driven demand slump in April is manageable in a big boat. Shell, BP and other big players have enough liquidity to navigate a year of negative cash flow. Saudi, Qatar and the United Arab Emirates can use their foreign-exchange reserves and wealth-fund assets to defend dollar pegs and ease budget deficits.

Saudi Aramco and the big western oil majors have production costs well below \$20 a barrel, and relative storage flexibility. Contrast that with leveraged U.S. shale producers that bleed red below \$30 a barrel, or Nigeria, which lacks the infrastructure to store unwanted oil. Many will be stopping production altogether to avoid big losses.

Big companies and countries can snap up this market share. As of late April, 95 companies had cut 28% of their investment budgets, according to Morgan Stanley. Using the U.S. investment bank's assumption of daily global demand recovering to near its pre-slump 100 million barrels by 2021, the current glut could subside and bolster prices, with the now-larger survivors capturing an even bigger share of profit.

There's a problem with this rosy story, though. Even if draconian lockdowns don't directly sap demand longer than expected, their behavioural effects on air travel and home working could be profound. A demand snapback might not then materialise, and the ocean of stored crude could keep prices too low for companies and states alike to pay their bills. That's probably why Saudi tripled value-added tax and Shell cut its dividend.

Before Covid-19, petrostates and oil majors already struggled to balance spending and dividends with the transition away from oil. Saudi's Vision 2030 plan and BP's pledge to bring net greenhouse-gas emissions to zero by 2050 are still there, but the money to finance the pivot is not. Oil groups can borrow to maintain the status quo, but peak demand will still loom. Merging to get even bigger will delay but not deter the inevitable.

*First published May 21, 2020*

### Climate fight will survive pandemic's mixed legacy

By Antony Currie and George Hay

The coronavirus crisis leaves the fight against climate change at a pivotal point. Carbon emissions will drop by 8% in 2020 due to plummeting growth amid international lockdowns, according to the International Energy Agency. Whether this largest-ever yearly reduction proves to be good or bad for battling global warming hinges on what governments do next.

It's easy to be pessimistic. It has, after all, taken a near-global economic shutdown for emissions to fall only slightly more than the 7.6% drop required every year until 2030 to keep temperature increases to below 1.5 degrees Celsius.

Some countries may pursue climate-hostile policies to kick-start growth. U.S. President Donald Trump is relaxing environmental protections. Dramatic falls in oil



The Robert W Scherer Power Plant, a coal-fired electricity plant operated by Georgia Power, a subsidiary of the Southern Company, in Juliette, Georgia on April 1, 2017. REUTERS/Chris Aluka Berry

and coal prices could encourage China and India to increase consumption, economist Dieter Helm warns. Supply-chain disruptions and hard-up governments could hurt future low-carbon and renewable-energy projects, the IEA says.

Yet the momentum behind climate activism remains. There's now hard evidence that sustainable investing offers an advantage: Between December and the end of April, climate-focused stocks outperformed benchmark indexes by 5.1%, and those scoring highly in so-called environmental, social and governance ratings by 3.7%, according to HSBC.

Meanwhile, the Network for Greening the Financial System, a group of more than 60 central banks and other institutions, is pushing for coronavirus recovery policies to be linked to the environmental transition. Investors with more than \$100 trillion of assets in early May started lobbying for the same action from governments through nonprofit representatives at The Investor Agenda.

Economic multipliers on state investment in areas like green infrastructure can be much larger in a slump, notes research by economists including Nobel laureate Joseph Stiglitz and Nicholas Stern. Funding resilient infrastructure in emerging markets can yield a 400% return, the World Bank estimates. That's far better than doling out trillions of dollars in post-crisis emergency aid and could limit the permanent stranding of assets.

It may push credulity to assume that an increasingly splintering world can convene at the delayed COP26 conference in 2021 and set binding emissions-reduction targets. But Covid-19 has distilled into a few weeks a harsh taste of the havoc global warming will cause over years. Consequently, citizens may be less willing to accept ill-preparedness and more amenable to previous non-starters like tough carbon taxes. Course-correction is more, not less, conceivable.

*First published May 14, 2020*

### **Carmakers' green future gets revved up by Covid-19**

By Christopher Thompson

Few things would please the world's big automakers more than customers quickly returning to dealers' lots to buy new cars once pandemic-induced lockdowns are lifted. What would top that is if many were to drive away in the battery-powered cars manufacturers have devoted hundreds of billions of dollars to develop. It may take state aid to tip the balance in electric vehicles' favour.

Automakers' outlook is brutal. Assuming factories reopen in full in the second half of 2020, global vehicle production would still decline by 21% from last year, IHS Markit predicts, the worst contraction since the financial crisis. Reflecting such pain, the Refinitiv Global Automobiles & Auto Parts index has fallen by nearly one quarter.

Still, the importance of Ford Motor and General Motors in the United States, Germany's Daimler and Volkswagen and China's Dongfeng Motor to their respective country's economy should put automakers at the centre of any post-virus stimulus plans. And the International Monetary Fund has called for governments to pursue a green economic recovery.

These environmental and economic issues converge around electric vehicles, which by rights should become more appealing to drivers now. Air pollution, after all, might worsen the disease, adding to the concerns about climate change that first fuelled their adoption. Shares in Elon Musk's Tesla, which accounted for around a fifth of global electric vehicle sales last year, have nearly doubled in 2020, signalling that carmakers should flog more than the roughly 2% of total auto sales the segment accounted for in 2019.

But battery-powered cars are in general more expensive, even though the affordability gap to vehicles running on fossil fuel has halved over the past five years. Jefferies analysts reckon the recent oil-price crash has widened gas guzzlers' advantage to some \$8,000 over the average ownership period. That's a big hurdle when joblessness has skyrocketed.

Governments can help by, say, rehashing for electric vehicles the popular cash-for-clunkers programmes rolled out after 2009 in the United States, United Kingdom and Germany. Tripling the number of electric cars sold last year to 6.5 million with a \$6,500 subsidy per vehicle, roughly the upper limit of what Germany currently offers, according to Deutsche Bank, would cost some \$42 billion, or less than 1% of the combined 2019 GDP of the Organisation for Economic Co-operation and Development countries.

Pricey, yes, but hardly prohibitive. Faced with widespread economic devastation, states can afford to accelerate towards a lower-carbon future.

*First published May 18, 2020*

## China's soft power will be hardened by the virus

By Pete Sweeney



China's President Xi Jinping waves to Russian President Vladimir Putin as they talk via a video link, from the Great Hall of the People in Beijing on Dec. 2, 2019. Noel Celis/Pool via REUTERS

China's soft power is getting a lot harder thanks to Covid-19. Even before the virus first emerged in Wuhan, the nation's partners were reconsidering their economic and diplomatic ties. Foreign criticism since is only sharpening attitudes in China, while Western disarray is emboldening nationalists in Beijing. That will lead Chinese firms to take a more aggressive approach in overseas markets – and foster more trade friction.

The Chinese Communist Party has never been particularly adroit at making friends; historically its diplomatic support network has been held together by transactions, as opposed to the shared values that define soft power. President Xi Jinping's "China Dream" aspires to a racial renaissance for Chinese people. Not much scalable value there.

Now the People's Republic faces its biggest PR crisis since the CCP crushed protests with tanks in Tiananmen Square in 1989 – a comparison drawn inside Zhongnanhai, Reuters reported. Official censorship of doctors' initial reports of the outbreak has played poorly as the virus spread overseas. This has exacerbated resistance to Chinese presence in international institutions, technology networks, universities and laboratories. Entrenched suspicion has hobbled Beijing's attempts to redirect the narrative to its containment of the disease.



Yet if China emerges from recession first, as seems likely, it won't emerge humbler if the West is still floundering. Early revival will validate the "wolf warriors" inside the party that believe financial and military might make right, and the state-driven economic model is working just fine. They're sick of losing popularity contests played by foreign rules. They have the support of many ordinary citizens who believe China's time to dominate has come, to hell with its public image.

For all its bluster, the Chinese economic team has tried to rebalance trade and improve areas like intellectual property protection. The obnoxious "Made in China 2025" import substitution programme has been downplayed. This could be easily reversed as cheap stimulus credit flows from government banks to state champions.

Buttressed by a recovering home market, and encouraged by economic hardliners, companies like construction equipment maker Zoomlion or telecoms giant ZTE could tap funds to win price wars for market share abroad, or acquire strategic technology. Indeed, Chinese exports defied plunging overseas demand to rise in April. A China that's diplomatically alienated yet economically triumphant will be even harder to get along with.

*First published May 8, 2020*

### One odd U.S. healthcare habit to get a viral cure

By Robert Cyran

The U.S. healthcare system ended up broken through a series of accidents. For example, half of Americans get their health insurance through an employer, and many prefer that to sourcing it themselves, or getting it from the government. Fear of change has left workers and companies unhealthily codependent. With unemployment rates now rocketing, and an estimated 27 million losing their insurance according to the Kaiser Family Foundation, both sides may be more willing to consider alternatives.



An entrance sign to the Texas Health Presbyterian Hospital is seen in Dallas on Oct. 4, 2014. REUTERS/Jim Young

The idea of getting health coverage from an employer is rooted in World War Two. With wages frozen, employers offered insurance to compete for scarce workers. Once this became the norm, the government had less need in providing a universal alternative. While there is now a state-provided healthcare scheme for low-income or

vulnerable groups – Medicaid – the expense borne by companies has risen dramatically.

The average cost for family health insurance offered by an employer exceeded \$20,000 in 2019, according to the Kaiser Family Foundation. Companies paid about 70%, and workers the rest. The price for employers has grown over six times faster than inflation over the past two decades, and about five times faster than wages. The figures are worse for workers, who shoulder a greater chunk of the increase. Despite this, over 85% of those with employer-supplied healthcare are satisfied, according to a Commonwealth Fund survey.

This system is economically wasteful. Labor mobility is reduced, because a speculative change of job could leave an employee without insurance. The government gains by not having to pay for universal healthcare but loses something too because most premiums paid by employers and workers are exempt from taxation. This reduces tax revenue by \$260 billion a year and is the government's third-biggest expenditure, according to the National Bureau of Economic Research.

Covid-19 may change the calculus because millions of Americans will lose their jobs – and their healthcare. Some will lose insurance entirely, but about half of those losing insurance will be eligible for Medicaid, Kaiser reckons – and might discover it's not so bad. Satisfaction with the program is even higher than the 85% approval for employer healthcare. A significant obstacle to discussing universal healthcare may therefore shrink.

In theory, more Medicaid should please more people. It has fewer administrative costs than private insurance and pays substantially less for care. If it covered everyone, employers would have less reason to provide insurance or workers to demand it. It takes a pandemic to make those arguments better appreciated.

*First Published May 13, 2020*

### **Dixon: Bailouts will store up lots more trouble**

By Hugo Dixon

Struggling individuals, businesses and countries deserve financial support during the pandemic. But let's not kid ourselves. Taxpayer-funded bailouts are likely to encourage excessive risk-taking in the future and provoke new populist backlashes when the bills need to be paid.

Unlike in 2008, there's little talk of "moral hazard" as governments shower their economies with cash to cope with lockdowns designed to stop the spread of the coronavirus. After all, those receiving bailouts today were not to blame for the emergence of Covid-19 in the way banks were partly culpable for the previous financial crisis.

But the support packages are so far-reaching that many who don't meet the obvious definition of poor and deserving will get cash. What's more, if investors, companies and countries think a sugar daddy will always ride to the rescue, they will take less care to manage their finances conservatively in the future.

### **Central bank puts**

The vast central bank liquidity programmes are bailing out investors and large enterprises. How else to explain the fact that the S&P 500 Index is only around 15% below its February peak – and is still over four times higher than it was in the depths of the credit crunch – despite the fact that the global economy is receiving its worst clobbering since the Great Depression?

These central bank fire hose operations aren't cost-free. They anaesthetise investors to risk. We are seeing a new version of the Greenspan and Bernanke "puts", when previous chairs of the U.S. Federal Reserve stopped stock markets from collapsing.

Remember how the cheap money after the Asian financial crisis helped fuel the dotcom bubble? Or how measures to stop the financial system collapsing after Lehman Brothers went bankrupt let borrowing go through the roof again?

Global debt at the end of 2019 reached \$255 trillion, or 322% of gross domestic product, according to the Institute of International Finance. That was 40 percentage points higher than at the onset of the financial crisis.

Governments are the biggest source of the increase. Their debt has doubled to \$70 trillion since 2007. But non-financial corporations were not far behind, with their borrowing going up 70% to \$74 trillion. These numbers will shoot up again as a result of the pandemic, making the world even more vulnerable to the next shock.

### **Rewarding junk**

Companies are getting bailed out in three main ways. First, central banks are buying their bonds. The Fed led by Jay Powell is even buying junk bonds, while the European Central Bank, presided over by Christine Lagarde, is under pressure to follow suit.

Second, governments are bailing out high-profile companies. For example, over the weekend, the French and Dutch governments prepared an aid package of up to 11 billion euro for Air France-KLM.

Third, states are guaranteeing bank loans. Germany and Switzerland are underwriting all the new debt. The UK, which initially wanted to guarantee only 80%, this week went the whole hog for the smallest firms because banks didn't want to hold even 20% of the risk of lending to companies that could easily go bust.

While all this will stop many businesses from being wiped out, it could reward foolish behaviour. After all, private equity companies deliberately loaded up their acquisitions

with debt to take advantage of cheap money and tax breaks on interest payments – and airlines have historically relied too much on borrowing and buying back stock. With governments helping them out, they may go back to their old tricks once the crisis is over.

Meanwhile, if banks can make loans without bearing any of the risk, they will have no incentive to conduct due diligence. Zombie firms will be kept alive along with the viable ones.

What's more, if some countries are more generous than others, their companies may survive while more efficient ones in other countries may go bust. This is particularly concerning in the European Union, because most governments are not as rich as Germany and so can't match its aid programme.

### **Magic money**

These rescue packages are going to cost trillions of dollars. But since most governments' finances are in poor shape, they themselves need bailouts.

Some countries are directly supporting others. For example, the Group of 20 major economies has agreed to freeze debt service payments for the world's poorest countries until the end of the year. Meanwhile, EU leaders in April agreed a 540 billion euro package to support struggling European workers, businesses and countries – and started planning a joint recovery fund.

But the central banks are again doing the heaviest lifting, by buying trillions of dollars of government bonds from investors. This makes it possible for the governments to sell new bonds to the market at low interest rates.

All this has a cost. Populists may be tempted to turn to their central banks in the future rather than make difficult choices over how to raise money and spend it wisely. And when one country bails out another, those on the receiving end may not do enough to balance their books – and that could cause resentment in those countries which have ridden to the rescue.

## Back to normality?

But there are ways to stop economies getting crushed without storing up too much trouble. One is to ensure those who get cash share the risks. This is roughly what is happening in the EU. For example, Italy is getting most of its help via debt – and the need to pay that back means it can't throw caution to the winds.

Another solution is to make clear that these are one-off rescues. It is, of course, hard to make that sound credible given the world's recent history of mega-bailouts. But governments and central banks could promise to bring their debt to manageable levels and return monetary policy to normality after the crisis, while weaning companies off their addiction to debt.

Many policymakers argue that the current emergency is so great that we shouldn't waste time thinking about moral hazard. But if we don't prepare the ground now, we'll be in a worse position when the next crisis hits.

*First published April 28, 2020*



An empty Times Square is seen on the street following the outbreak of Covid-19, in New York City on March 18, 2020. REUTERS/Jeenah Moon



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