



Fed Administered Economic Flu Shots; Will they work?

February 2020
KPMG Economics

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The global economy in precarious place for a demand shock

Real GDP Growth Rates %				
Top 10 Countries by GDP		2017	2018	2019 or YTD
1	U.S.	2.4	2.9	→ 2.3
2	China	6.9	6.7	→ 6.1
3	Japan	2.2	0.3	→ 2.2
4	Germany	2.8	1.5	→ 0.4
5	U.K.	1.9	1.3	→ 1.1
6	France	2.4	1.7	→ 1.2
7	India	6.9	7.4	→ 3.8
8	Italy	1.8	0.7	→ 0.2
9	Brazil	1.3	1.3	→ 1.4
10	Canada	3.2	2.0	→ 1.9

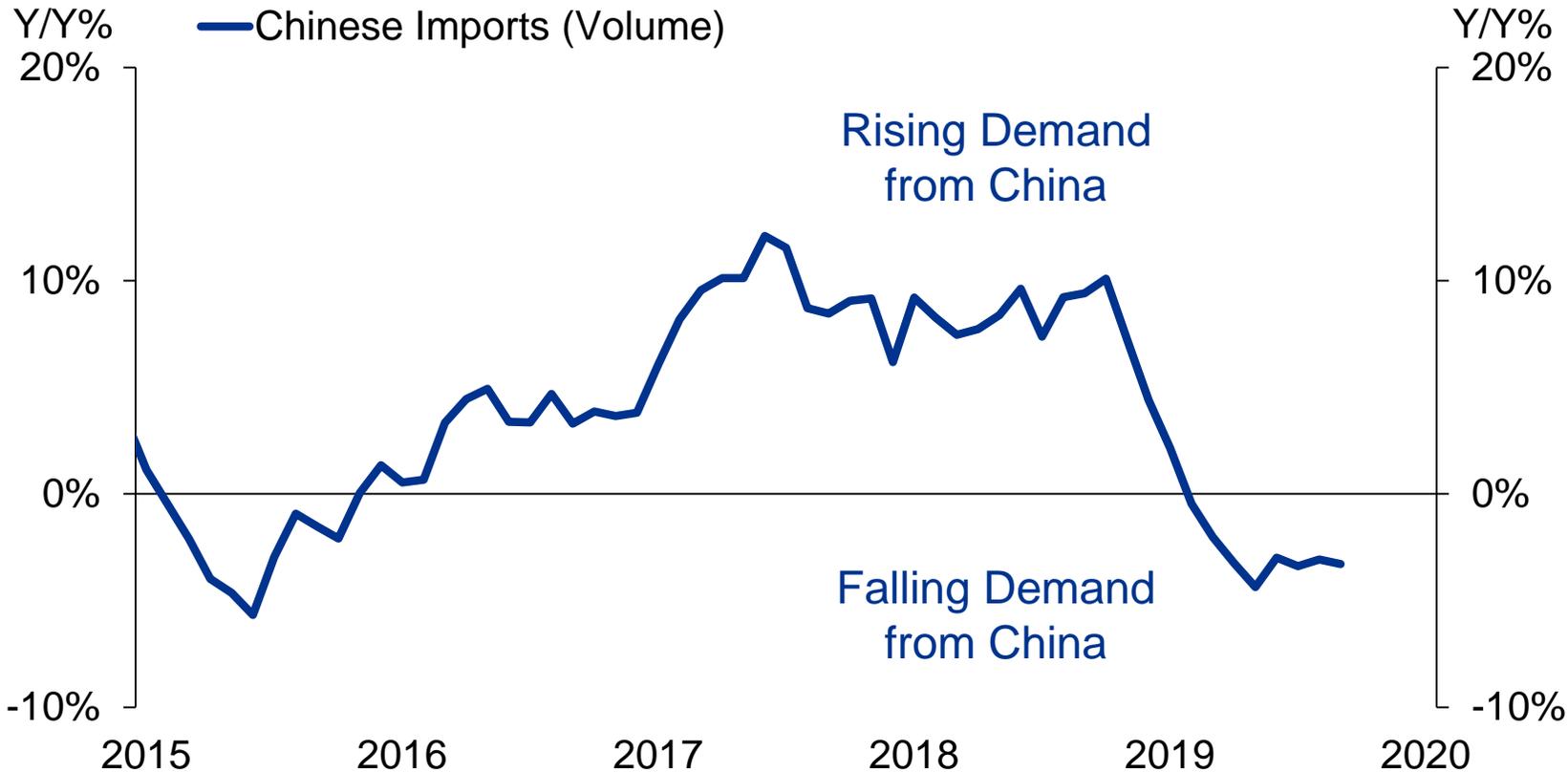
- Slowing growth in 2019 prompted Fed action to minimize spillovers to U.S. economy.
- German economic woes from a manufacturing and demand slump are still cause for concern.
- The UK exit from the EU is now underway but uncertainty will remain until the process is completed.
- Covid-19 is a significant demand shock for Q1 GDP in China and globally. An economic rebound once the virus has been contained will depend on how long the shutdown of China's economy goes on and to what extent it interacts with high debt levels.

Notes: Annual growth rate y/y%; 2019 growth for US, China, France and Italy; Q1 to Q3 2019 SAAR % for all other countries
 Source: KPMG Economics, Respective Countries' National Statistics Office, Haver Analytics



China faced GDP challenges before Covid-19 outbreak

Chinese Imports Bellwether for Underlying Weakness



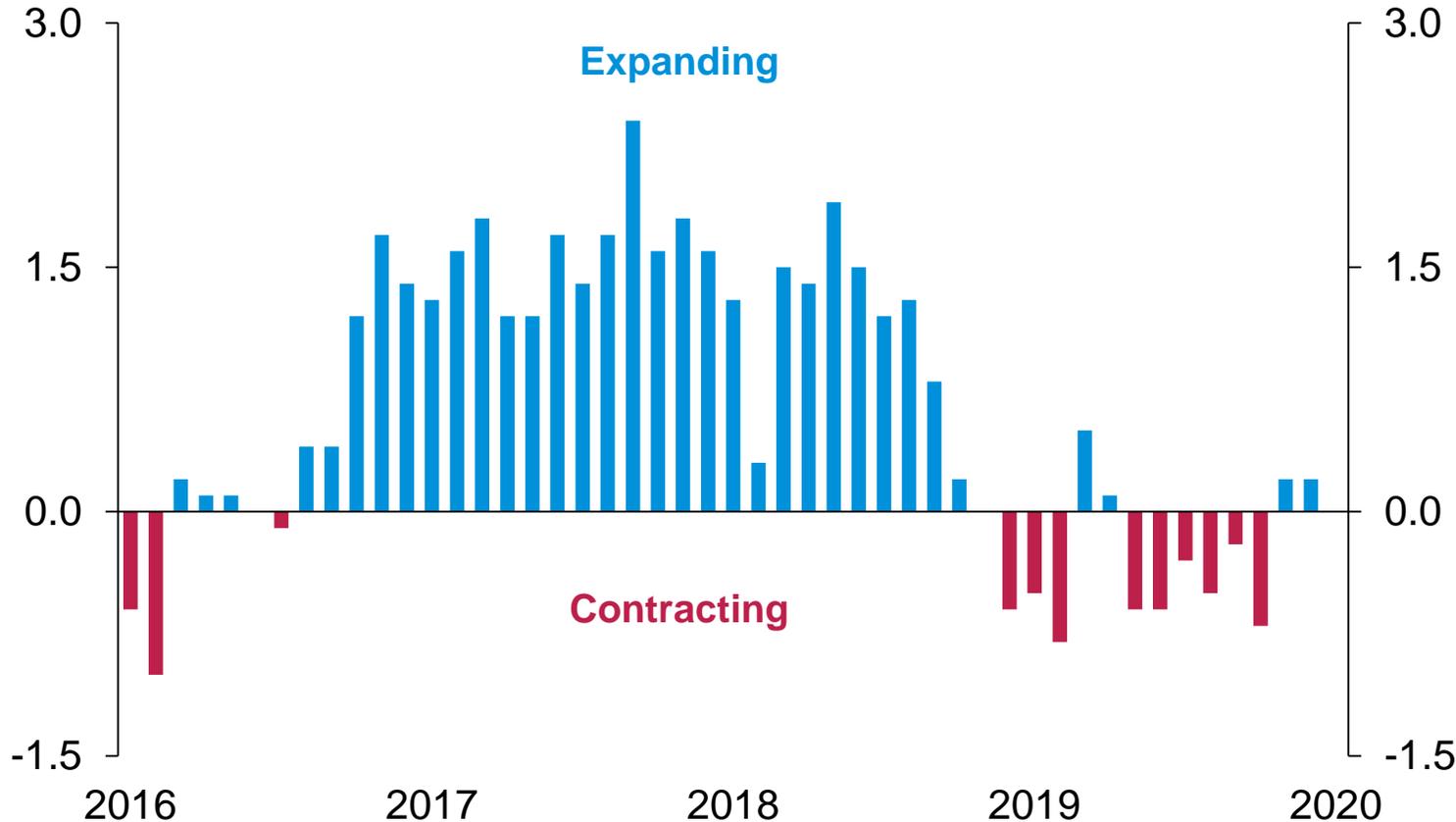
- Because Chinese GDP statistics are subject to biases, most economists look for proxy statistics to interpret conditions in the Chinese economy.
- Import volume is a reliable proxy as it is verifiable with trading partners and it is a good barometer of Chinese domestic demand.
- The current slowdown is household rather than business led.
- But due to large levels of corporate debt, businesses are vulnerable to a slowdown in consumption.

Source: KPMG Economics, China Customs (September 2019), Haver Analytics



Manufacturing sector mostly in the red despite gov't stimulus

China: Manufacturing PMI
Deviation from 50, SA



- Government financial tightening had an impact on the manufacturing sector.
- With the Chinese economy slowing from tight financial conditions, the government reversed course and loosened policy.
- The manufacturing sector showed only modest improvement going into 2020.
- With nearly a one-month shutdown so far it is not clear what the medium term ramifications will be.

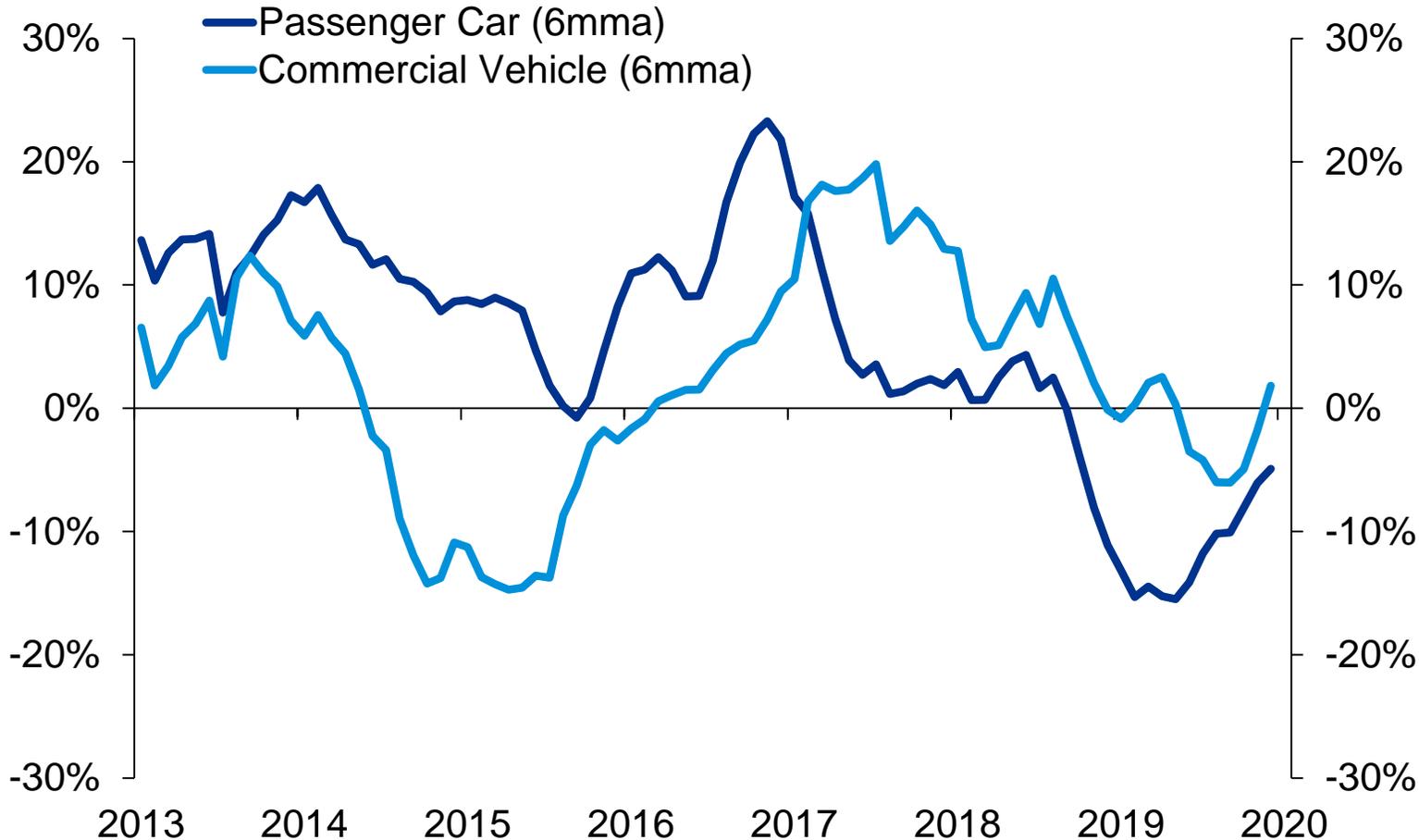
Source: KPMG Economics, China Federation of Logistics & Purchasing (Jan 2020 = no chg), Haver Analytics





Chinese consumer auto sales still in negative territory

China Car Sales: Household vs. Business



- Vehicle purchases provide a look into the strength of Chinese consumers and industry.
- Both commercial and passenger car sales declined in 2019. The sharp fall in passenger car sales is indicative of weaker household consumption.
- Globally, the auto industry is in a slump.
- Demand for passenger cars has recovered somewhat in the second half of 2019 but sales remain down from the previous year.

Source: KPMG Economics, China Association of Automobile Manufacturers (Dec 2019), Haver Analytics

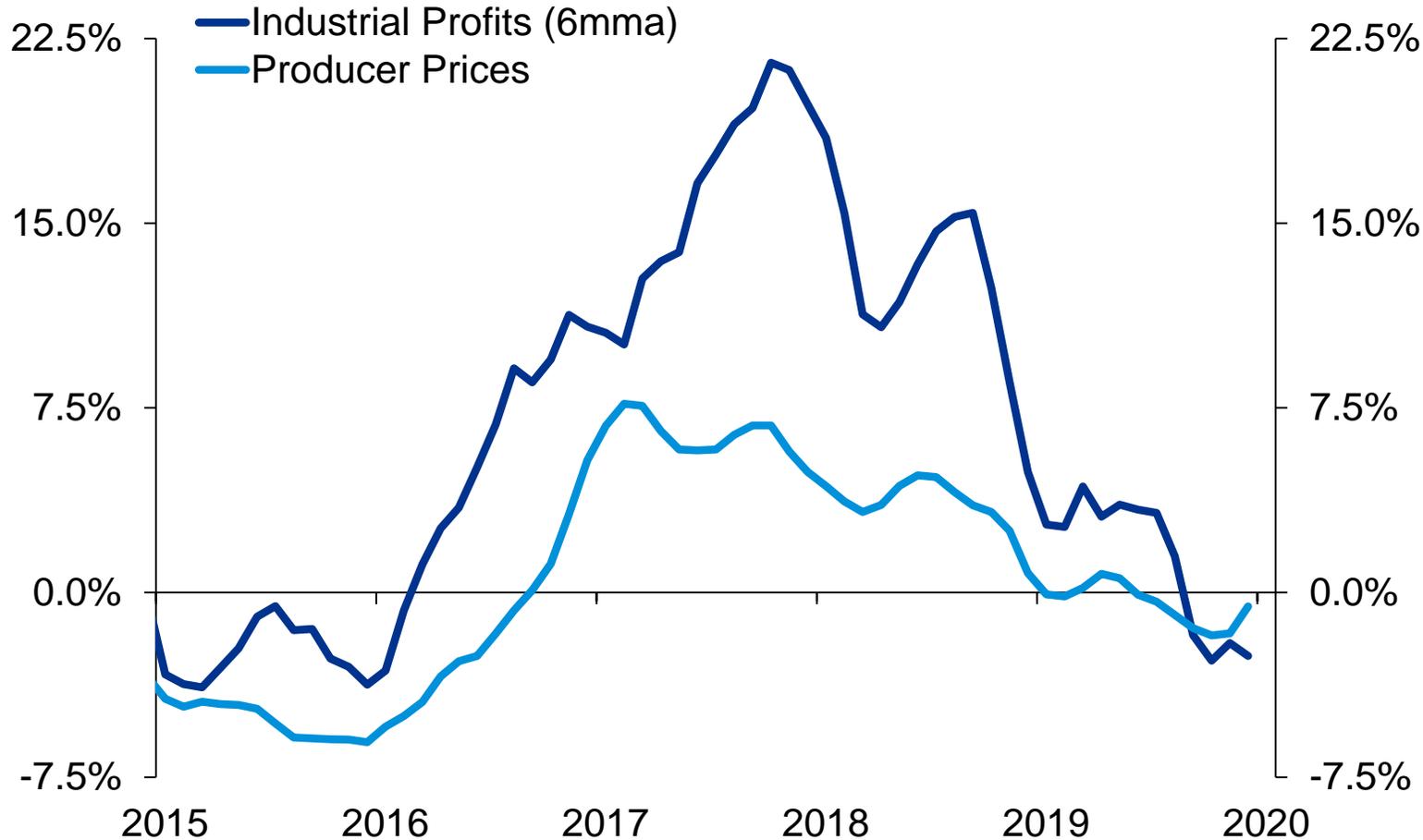


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Industrial profits faced pricing pressure before Covid-19

Falling Producer Prices Strain Industrial Profits



- The annual change in producer prices fell in 2019 for the first time since 2016.
- The decline in producer prices indicates that firms have little pricing power, resulting in an erosion of profits.
- In 2019, profits have followed prices into negative territory.
- In December 2019, industrial profits declined by 6.3% from a year ago, the largest decline over the last eight years since 2011.
- On a smoothed basis (6mma), profits were down 2.6% in December 2019.

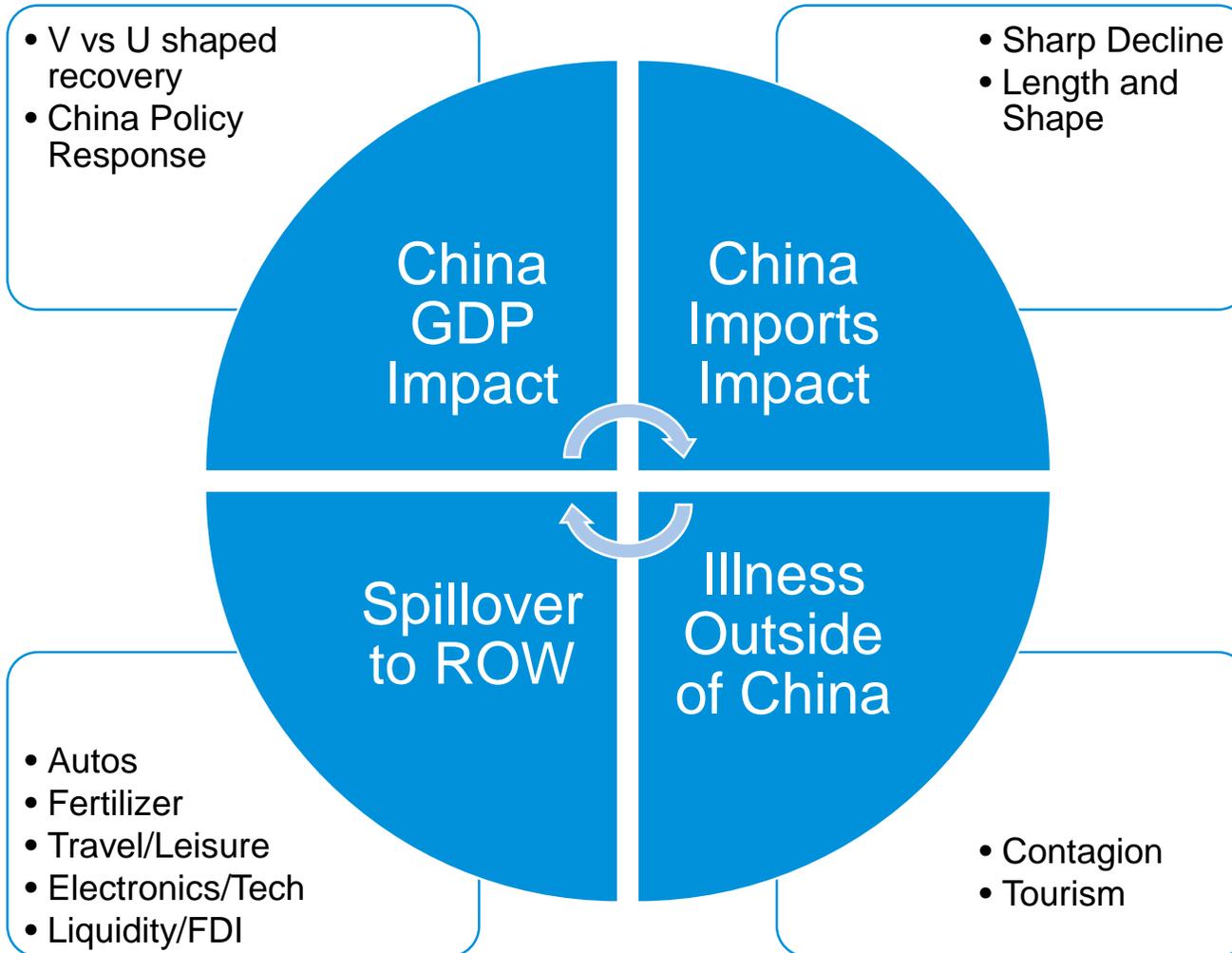
Source: KPMG Economics, China National Bureau of Statistics (Dec 2019), Haver Analytics



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Coronavirus analysis road map



- Common disaster response is fall in output with “V” shaped recovery.
- Case for “U” shaped recovery given debt complications.
- Now China and the Euro Area together make up 31% of global GDP with the possibility to exert material influence on U.S. domestic economic conditions.
- Both European and Chinese growth have downshifted over the past year.
- China will aim to ease liquidity constraints but this will add debt onto an already heavily indebted economy.



Wuhan is a significant producer of high value added goods

2018 Output	Share of National Output
Sulfuric Acid	13.7%
Yarn (2017)	12.2%
Industrial Products, Hydropower Electricity	12.1%
Chemical Fertilizers	11.8%
Plain Glass	10.8%
Air Conditioners	9.3%
Cloth	8.9%
Motor Vehicles	8.9%
Cars	8.6%
Chemical Pesticides	8.2%
Salt	7.4%
Home Refrigerators	6.2%
Cigarettes	5.6%
Soda Ash	5.2%
Cement	5.0%
Ethylene	4.8%
Beer	4.6%
Power Generation	4.1%
Micro Computer Equipment	3.6%
Crude Steel	3.4%
Rolled Steel	3.4%
Pig Iron	3.4%

- Wuhan is a major industrial hub, and an integral part of the global supplying chain.
- Analyzing the impact, the Fukushima earthquake and nuclear disaster may be a better predictor of supply chain impacts.

Source: KPMG Economics, China National Bureau of Statistics

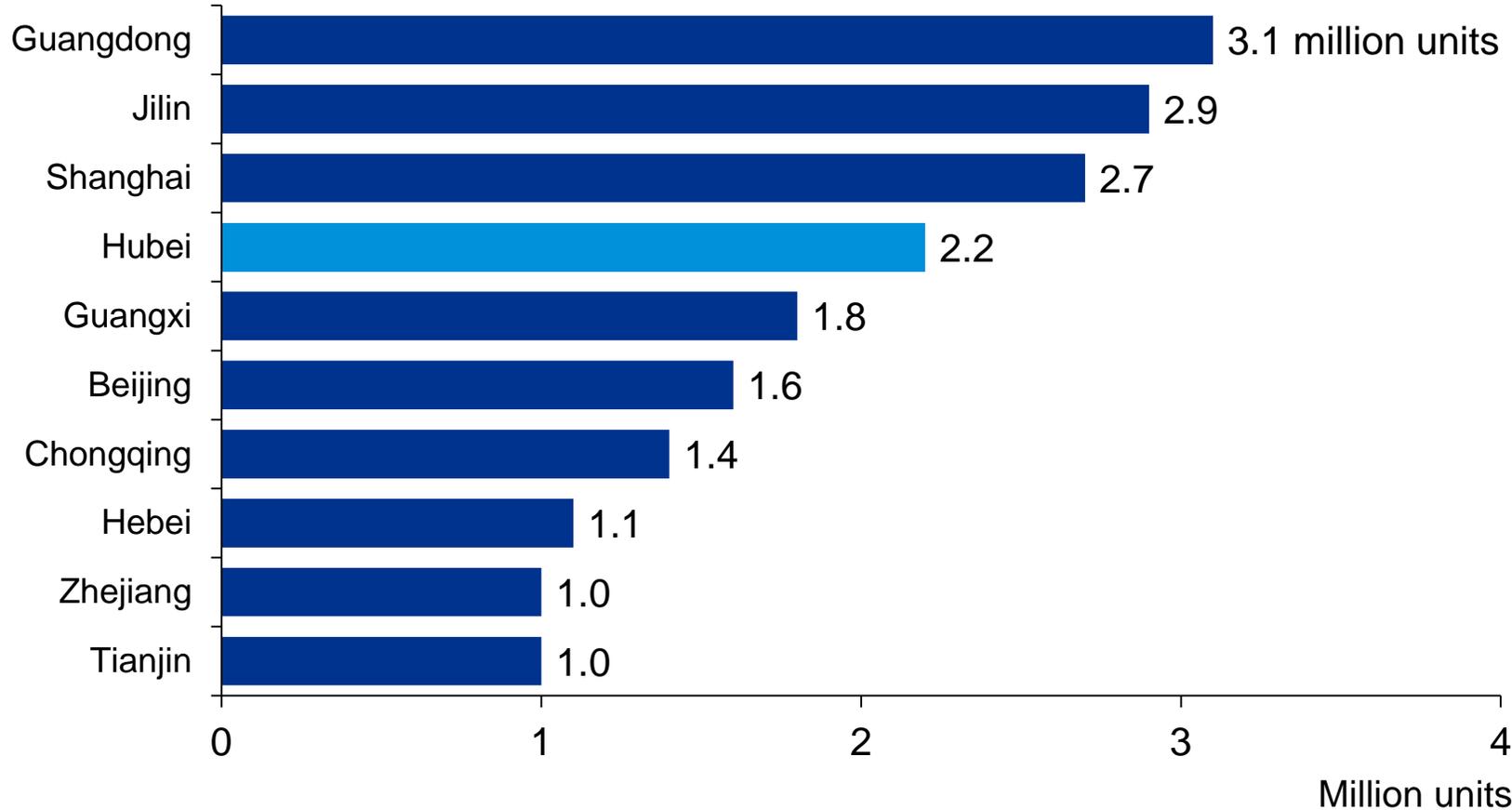




Hubei province is the fourth largest motor vehicle producer

Largest Motor Vehicle Producers by Province

Million units produced, 2019



- Hubei province, which contains Wuhan, produced 2.2 million motor vehicles in 2019, the fourth most of any Chinese province.
- Quarantine measures barring most travel in and out of the region are disrupting supply chains and delaying factory re-openings following the New Year holiday.
- More than 57 million people in Hubei's cities remain under travel restrictions.

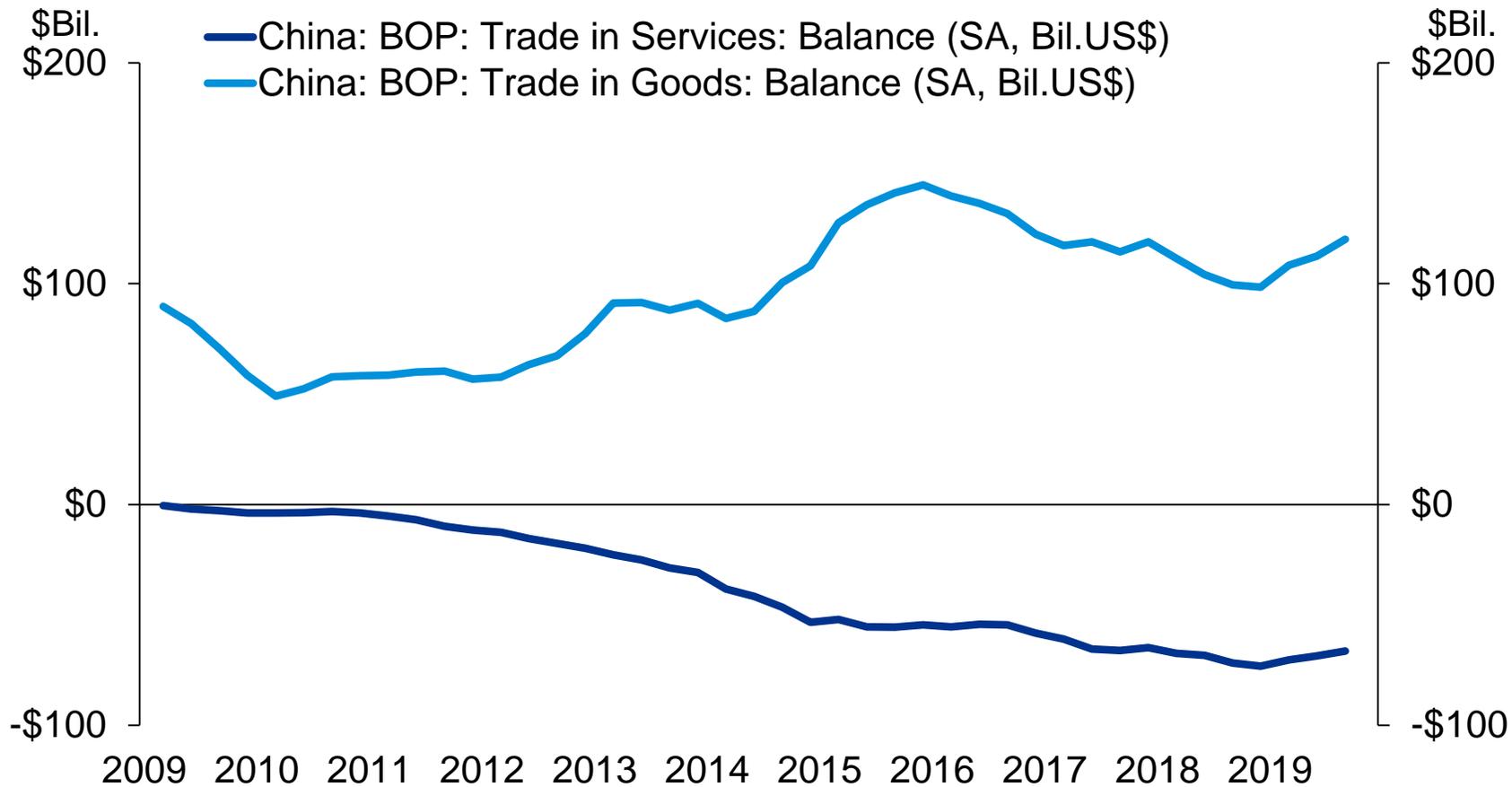
Source: Bloomberg, China National Bureau of Statistics



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Absence of Chinese tourism will be felt globally

Travel Comprises over 80% of China's Imports of Services



Note: 4-Quarter moving average

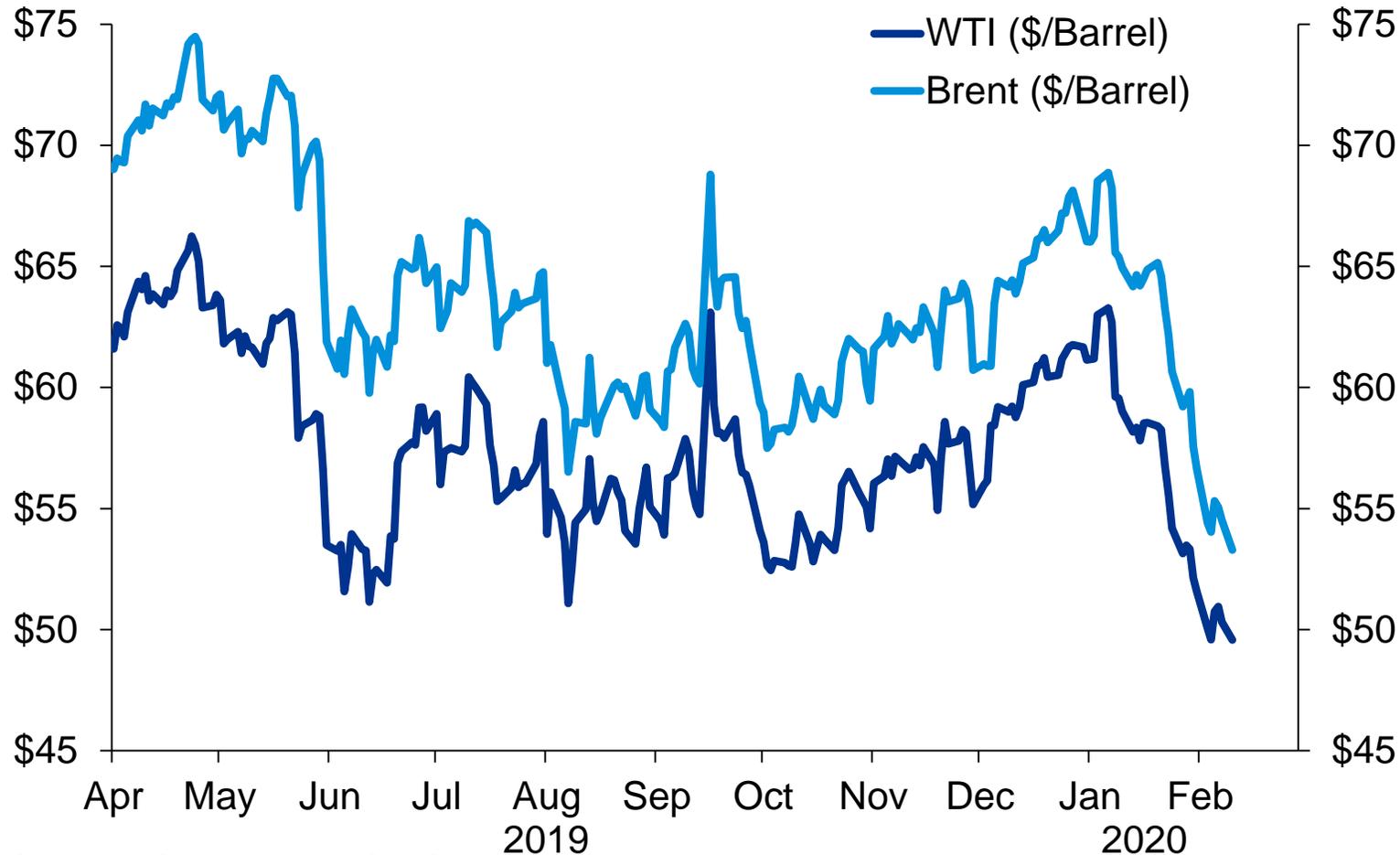
Source: KPMG Economics, State Administration of Foreign Exchange (Q3 2019), Haver Analytics

- Chinese imports of travel services totaled \$251 billion in 2019.
- This will be a loss of between \$50-70bn to the global economy in Q1.
- Halted flight routes, closed borders and quarantine are all reducing the movement of people from China to the rest of the world.



Oil prices decline challenging the profitability of some firms

Oil Prices



Source: KPMG Economics, EIA, CME Group, Financial Times, Haver Analytics

- Oil prices have fallen 20% from their recent peak in early January.
- WTI has dipped below \$50 per barrel.
- Sustained oil prices below \$50/barrel will impact oil exporters.
- Major oil exporters depend on high oil prices to fund domestic budgets.



Lofty oil price forecasts underpin many producer budgets

IMF Fiscal Breakeven Oil Prices in \$/bbl			
Country	2018	Projections	
		2019	2020
Iran	\$82	\$156	\$195
Iraq	\$45	\$62	\$60
Kuwait	\$54	\$54	\$55
Saudi Arabia	\$89	\$86	\$84
United Arab Emirates	\$67	\$70	\$70

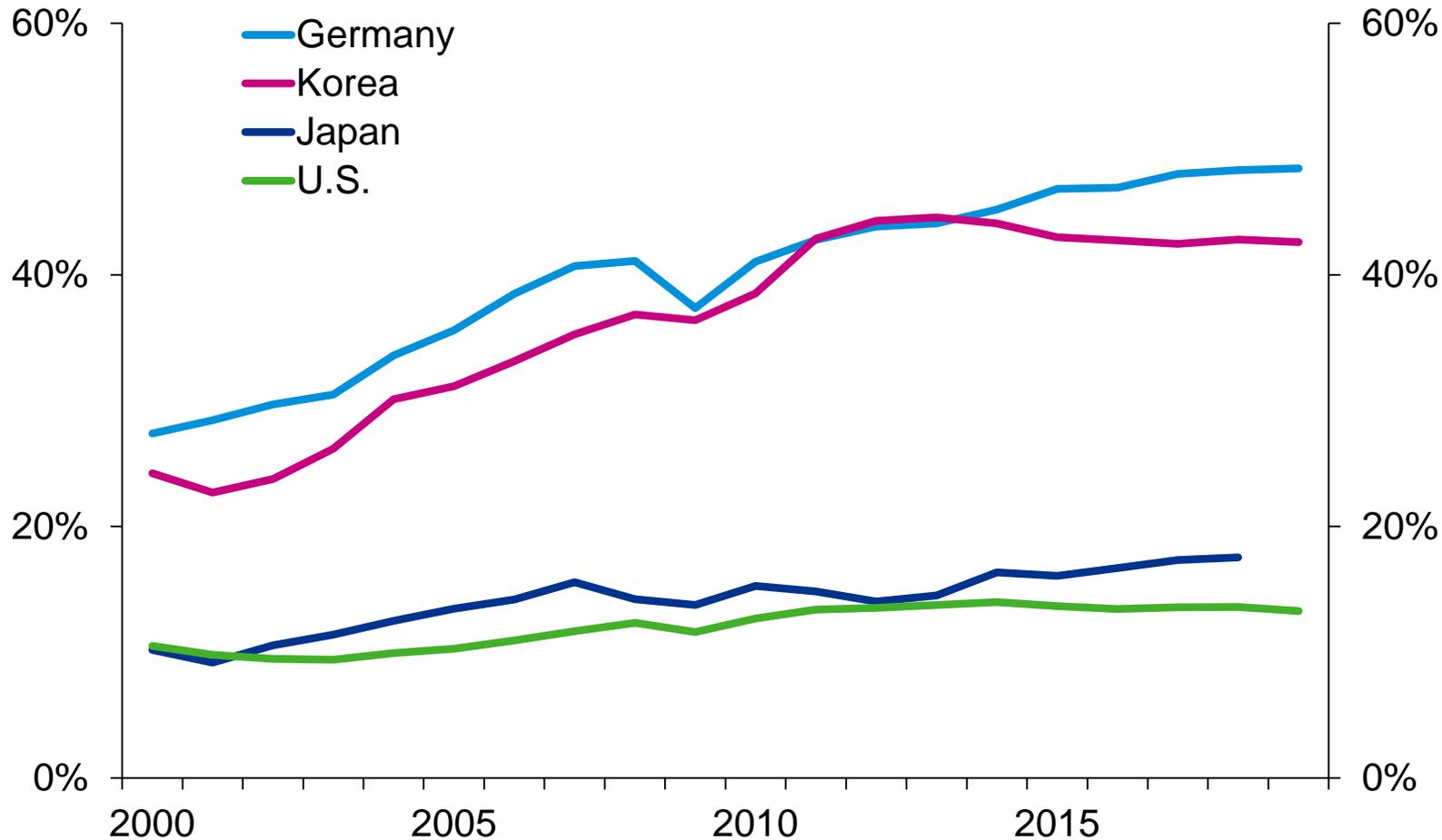
Source: KPMG Economics, IMF “Regional Economic Outlook: Middle East and Central Asia”, Statistical Appendix Table 6

- IMF analysis of federal budget’s assumptions and breakeven prices suggest continued downward pressure on prices could cause the need for reduced spending or increased debt issuance from impacted countries.



Export dependent countries biggest losers in trade drought

Exports of Goods and Services as a % of GDP



- The heavily export-dependent countries of Germany and South Korea have been deeply impacted by the slowing in trade volumes.
- They are likely to be the most impacted by disruption to their supply chains.

Source: KPMG Economics, National Sources (FSO, BEA, BoK, COJ), Haver Analytics

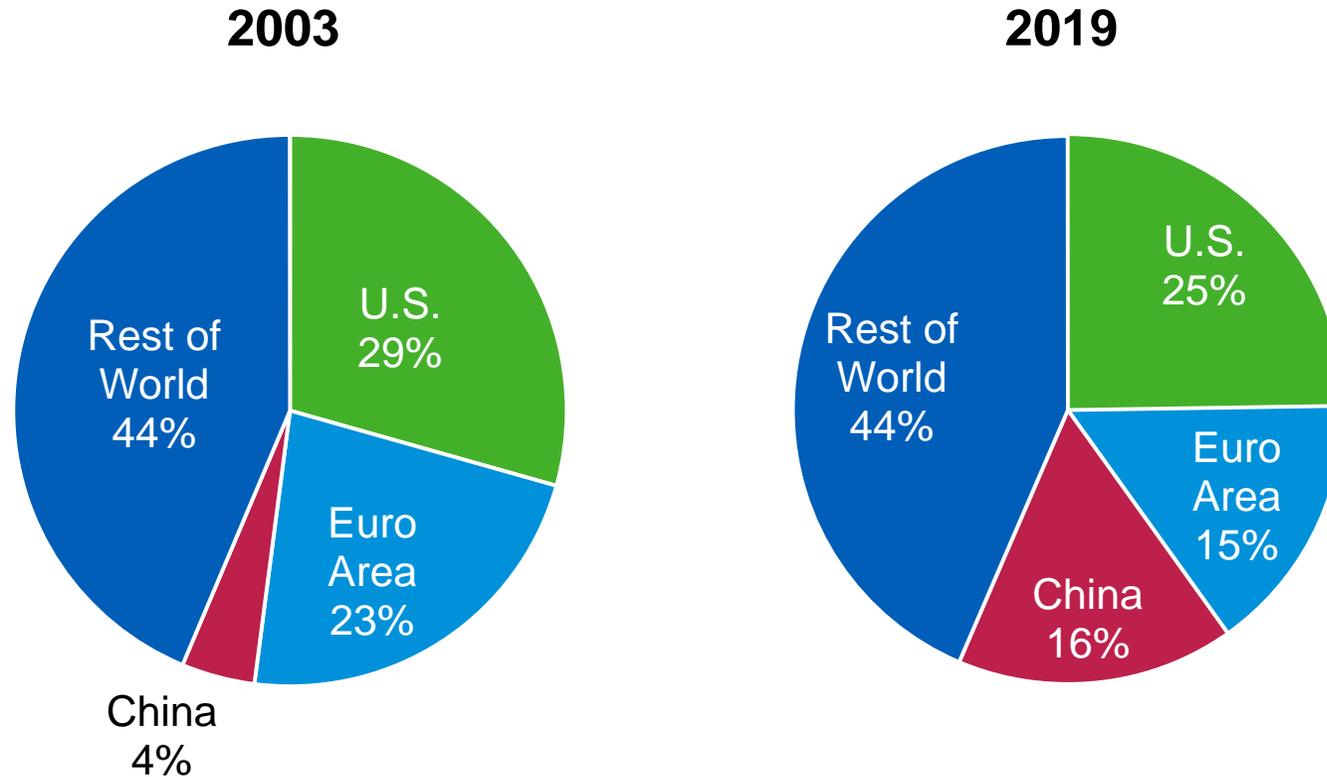


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Global economy is different than during the SARS outbreak

Share of World GDP



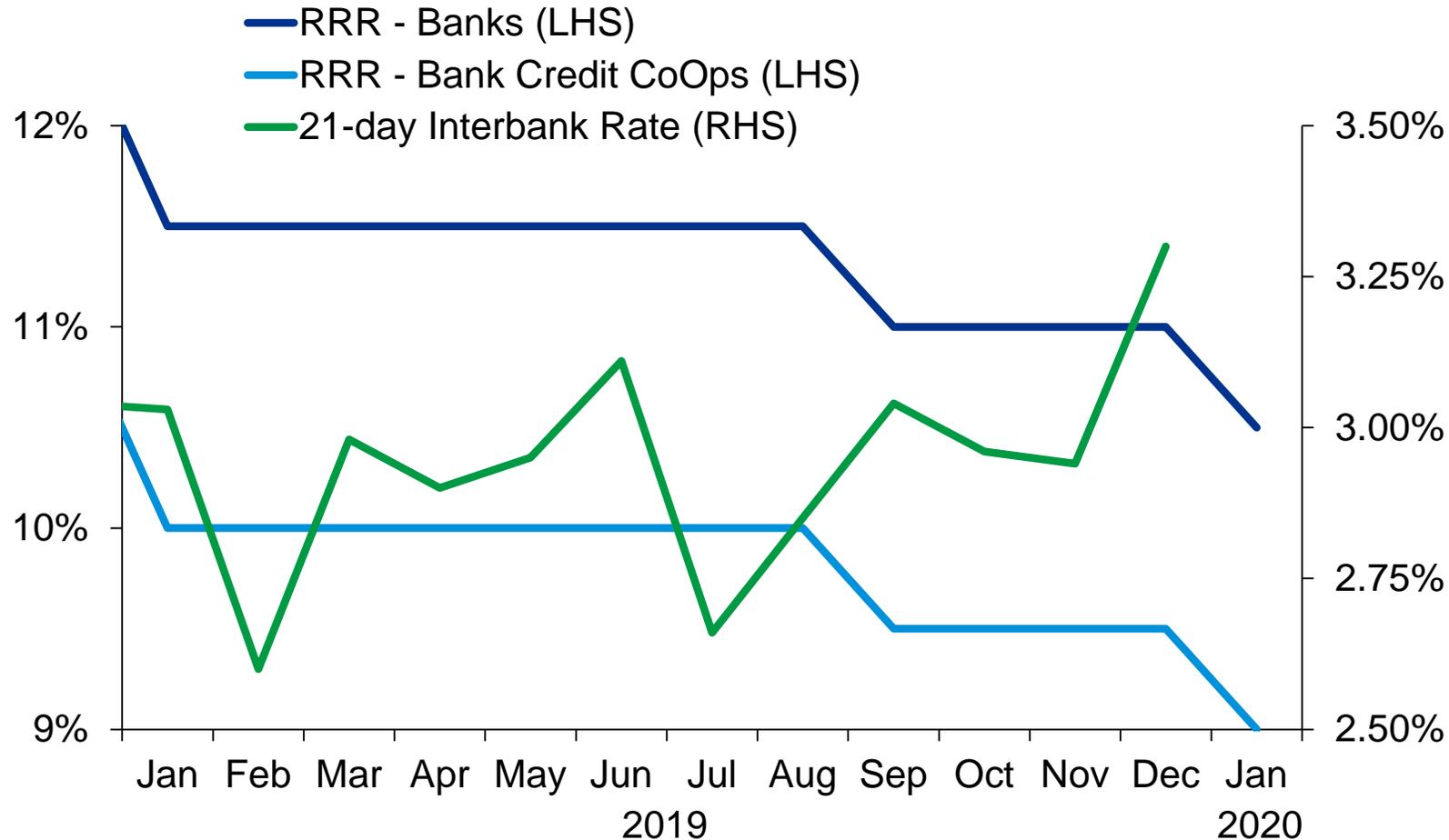
Source: KPMG Economics, IMF (2019), Haver Analytics

- China is not only larger but more integrated into the global economy than it was in 2003.
- This integration is an important differentiator.
 - China imports a greater percent of global goods.
 - China is linked in important ways to the global supply chain.



PBOC provides liquidity to banks via tiered rates

Interbank Rate under Pressure Prior to Covid-19



Source: KPMG Economics, PBOC, Haver Analytics

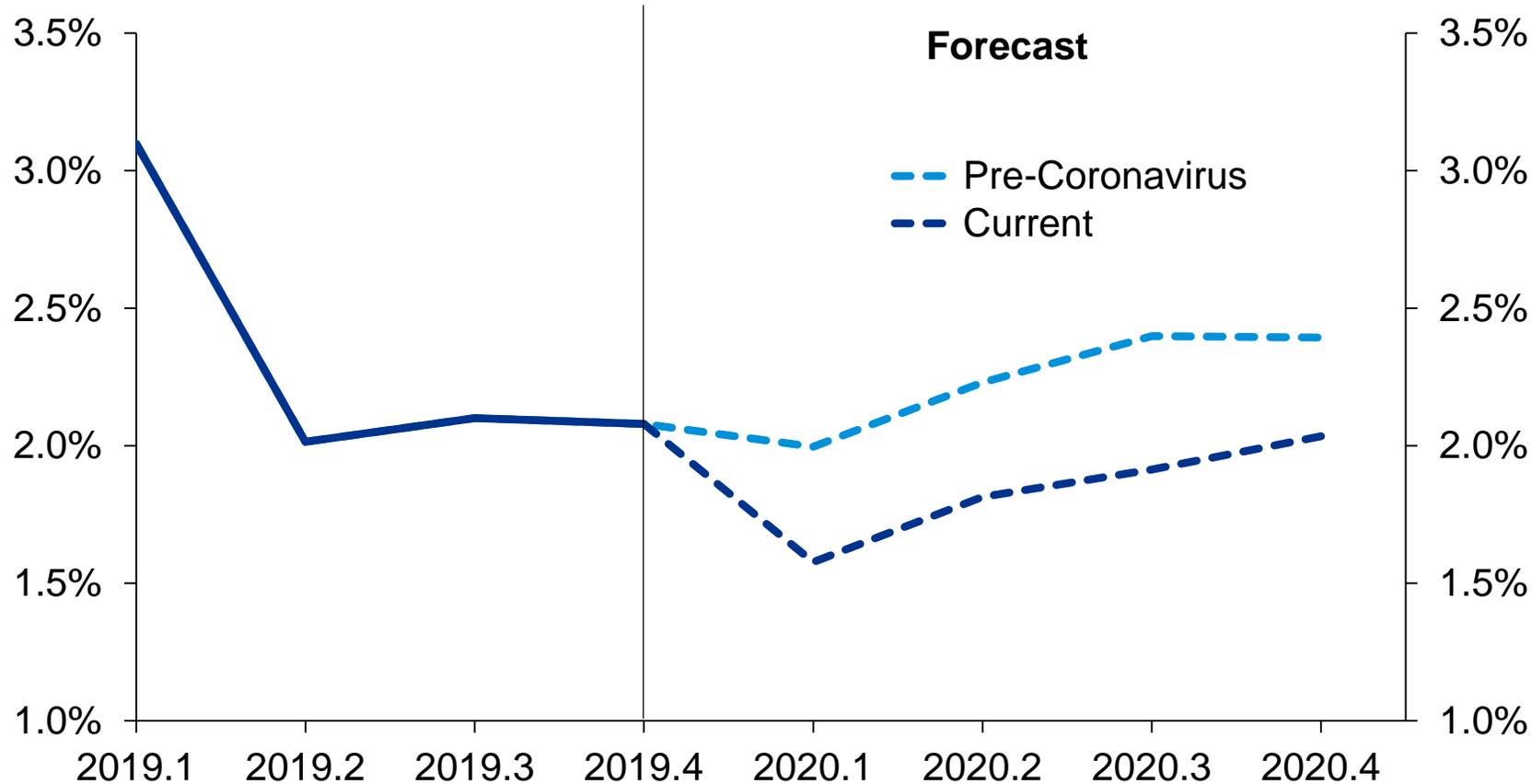
- Bloomberg has reported that as of February 11th, the PBOC issued \$43bn in loans at preferential rates to ease liquidity constraints.
- Banks can seek reimbursement from the PBOC for refinancing and extending terms up to a year.
- As of the 11th, 19 banks had applied for the special funds.
- The Ministry of Finance is subsidizing half of the rate with the remainder to come from the PBOC according to documents from the central bank.



Coronavirus headwinds knock 40-50 bps off 2020 growth

U.S. Real GDP Growth

Seasonally-adjusted Annualized Rate



Source: KPMG Economics, Macroeconomic Advisors by IHS Markit

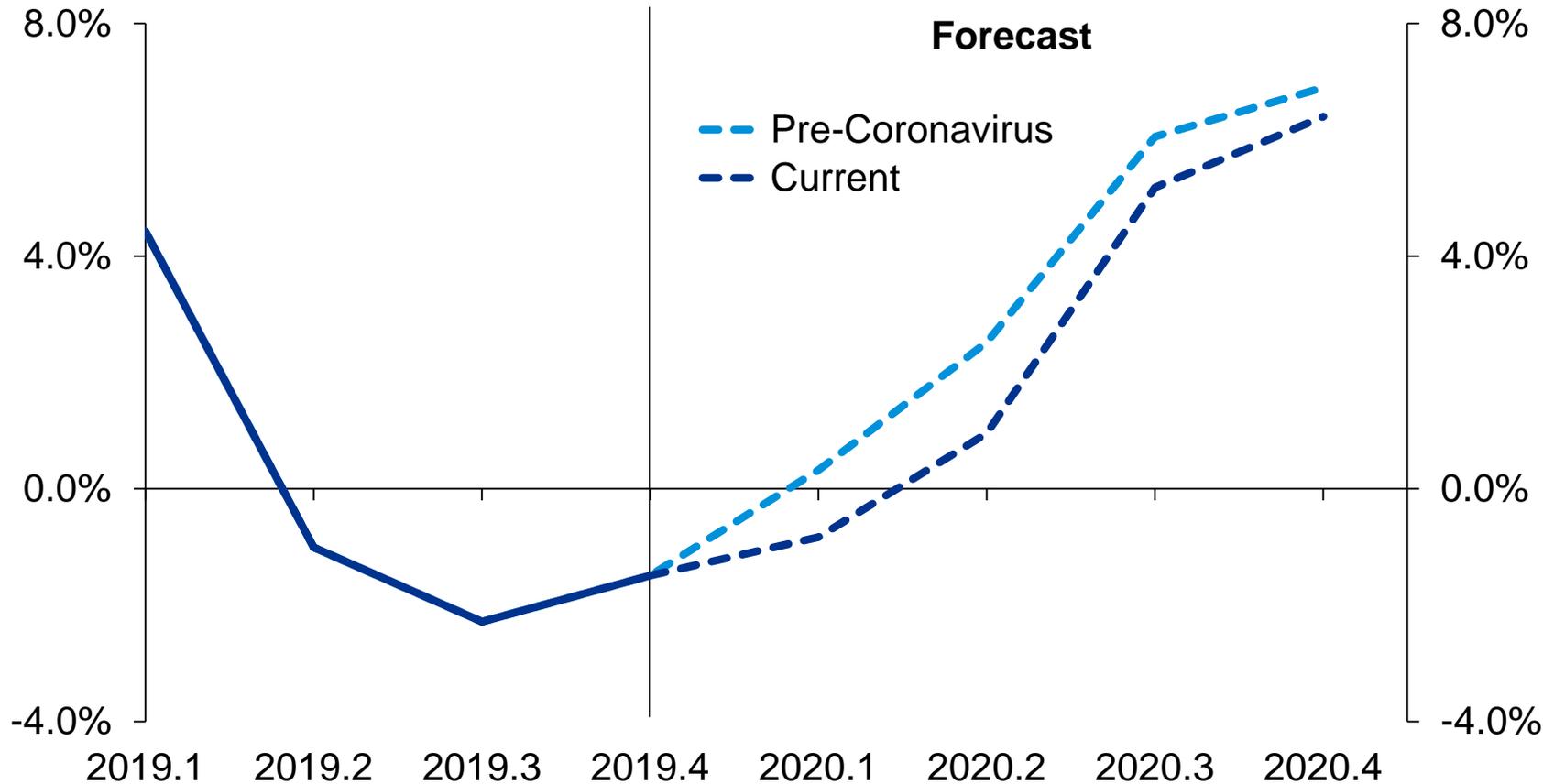
- Disruptions of supply chains, financial market volatility, and slowing Chinese demand for U.S. goods all contribute to a weaker outlook for 2020.
- Our model assumes that jobs growth and consumption is only minimally impacted.
- Our model assumes inventory behavior is normal, this is the largest wild card and could cause a percentage point swing in GDP.
- Coronavirus will make it increasingly difficult for China to fulfill its commitments in the U.S.-China “Phase One” trade deal.



Global uncertainty will slow investment recovery

U.S. Real Nonresidential Fixed Investment Growth

Seasonally-adjusted Annualized Rate



Source: KPMG Economics, Macroeconomic Advisors by IHS Markit

- One of the largest international spillovers is increased global uncertainty and financial volatility.
- Firms are hesitant to increase investment as the virus spreads and supply chain disruptions create further bottlenecks.
- Financial market volatility could wipe out significant market value and create wealth effect spillovers in China and internationally.



Potential impacts of Coronavirus on SEC issuers

**For information on
SEC guidelines
for communicating risk go to:**

<https://frv.kpmg.us/content/dam/frv/en/pdfs/2020/hot-topic-coronavirus.pdf>



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