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The World Tipped In 2020. What's Next?

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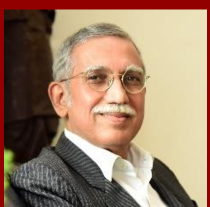
By **Mr. Raj Nair,** Chairman, Avalon Consulting

ABOUT THE AUTHOR



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"There is something in the wind that we cannot get into", said Antipholus of Ephesus, in the Comedy of Errors. *"There is something in the wind that I know will just go away"*, said Donald Trump in the "Tragedy of Errors", which is still playing to packed houses in the US even today. To be fair, many countries misjudged.

Given that many people I met in December, felt that the biggest surprise in 2021 will be that there will be no surprise, I wondered what I could predict about the world in 2021. I therefore thought it might be worthwhile to reconnect with Cyrus the Virus, whom I had introduced in my last year's annual note, Tipping Point. Cyrus, named after the famous Persian Emperor Cyrus, who conquered the world in 2020, had told me in advance about the dire straits that we would find ourselves in 2020. We kept in touch regularly ever since. Here is what he told me, even as I was still nursing my first peg today, on New Year's Eve:

"You humans have made commendable strides in trying to understand me in the last year but there is very much more that you don't know. It will take you more than a lifetime to understand most of the virus families, but in less than half a decade, you could understand enough to deal with Corona viruses, the family to which I belong. Our fight is not over. We are mutating so rapidly that solutions which might have worked eight months ago will not work as effectively anymore."

I was nonplussed when Cyrus went on to explain that species evolve over several generations, but what takes humankind 2000 years, takes a mere hour for some types of viruses. *"Unless you are able to wipe out an entire population of my variant cousins very quickly, we will produce several more virus serotypes and you may need vaccine modifications. I know that you cannot wipe us out quickly because for every ten humans who get vaccinated early, there are probably five who will either completely avoid or delay vaccination. Prize idiots like Trump help us. Add to that your inability to manufacture enough affordable vaccines quickly enough."*

I took a close look at him, only to realise that he looked a bit different and that I was probably talking to a different Cyrus the Virus, each time I spoke to him over the past year. I asked him about the South African variant. The latest Cyrus avatar told me, *"My South African cousins (B.1.351 or 501Y.V2) differ significantly from the UK cousins (B.1.1.7) in ways that may reduce your vaccines' effectiveness.*

"Even if the South African variant spreads fast to become more dominant, the mRNA (Pfizer-BioNTech and Moderna) and adenovirus-vectored (Oxford-AstraZeneca) vaccines can be modified to be more close-fitting and effective against this variant in a few months."

Oh my God, I realised, he was saying something not just about 2021 but about that year and beyond! There could be future outbreaks and more valiant efforts needed to modify the vaccine. If the virus is going to be around and will spill over to CY2022, what will life and work be in CY 2021? Not the same as it was before the pandemic, although much of the World's GDP could get back close to the 2019-20 level at the end of 21-22. More on that later. I therefore did more research and connected the visible dots as is my wont.

The immediate impact of this would be:

- There will be a shortage of vaccine in Q1 CY 2021 despite the best laid plans, even in the US. There may be more lockdowns in some parts of the world and ugly elbowing amongst nations to corner a share of the vaccines, leading to a shortage of vaccines being acutely felt in many countries through the year. India will face a vaccine shortage in H1 CY 2021.
- Social distancing and masks will not go away any time in 2021. Stock up stylish ones, guys - they are available. Those who have already contracted Covid19 and those who get vaccinated can get reinfected by a new variant, but they may face less problems. International travel will, sooner than later, probably require a certified proof of vaccination in addition to a visa.
- WFH (Work from home) could at best become WFH&O (partly home, partly office) but offices buzzing with activity like before will become a distant memory. That will be safe and good for employees and employers, very good for traffic management and the environment, but bad for all vendors who served offices in multifarious ways.
- New housing complexes in crowded cities may have shared work areas within the complex for those who miss working away from their apartments.
- Patients and doctors will continue to prefer teleconsultation, so much so that, it will become the preferred mode for many in the future too. In 2021, more physicians will get onto integrated platforms which offer not just video connectivity with patients but also a patient record system, into which diagnostic reports will be input automatically; even in rural areas in Emerging Markets, hardy pathology machines to do quick analysis and connecting its data with other systems using IoT, will gain traction.
- The health and wellness business, which was growing faster than the core pharma industry will shift to the next higher gear to touch $5 billion in 2021.
- Pharmaceutical detailing to physicians will also systematically shift online. Software will be used to track such calls, evaluate, and improve the effectiveness of detailing, analyse doctor reactions, classify doctors by likelihood to prescribe, correlate with purchases from shops (and increasingly, from online pharmacies), etc. using speech and video analytics, and AI. Eventually, medical reps will be replaced by bots which will do the job more efficiently and reliably. Pharma companies too will find this the preferred mode because nearly 50% of the marketing costs can be saved in many countries, especially India.
- Significant investment (industry and VC) will flow into developing biopharmaceuticals, biomedical solutions, bioengineered products, and devices which were mostly in the labs up until now in India. The prospects of an order of magnitude impact on patient outcomes and consequently of profits, will be the driver. The not-so-new mRNA technique, used by Moderna and Pfizer-BioNTech vaccine, will give a boost to translational research to cure many other non-communicable diseases, including cancer.

Politics will impact economics in 2021

- The Biden Administration's biggest challenge may not be the likely but unpredictable shenanigans of his disgraceful predecessor in the three weeks before Biden is slated to assume office, though I don't put anything beyond Trump. Biden's challenge will be to right the wrongs done to America's traditional allies. Besides Covid-19 and the sagging economy, he will have big new challenges on the international front. He would have wanted to get the EU on his side before resuming trade negotiations with China in a different but firm manner. Sadly, the news trickling in today suggests that China has checkmated him by arriving at an in principle agreement on all terms of the Comprehensive Agreement on Investment (CAI) with the EU during a call with Merkel on the eve of Germany giving up charge of the EU and before the Biden administration could mend fences with the EU. This was supported by Charles Michel of the EU and Macron, who were also on the call. The big concessions thrown in by Xi were just too tempting for the EU to give up and in any case, Angela Merkel was only too happy to lob a grenade at Trump before his term ends. Now China will not only become a big consumer of goods from all over the world in the 2021-25 period but will also see huge investments from the EU in high technology. In many cases, EU companies will no longer need a Chinese JV partner nor will they have to disclose critical IP. In fact, EU companies may leverage China's strides in e-mobility, solar technology, etc. China has already started work on supply side reforms to boost domestic consumption even in the interiors, in place of the stimulus measures of 2020. Structural reforms had become urgent in the light of the poor manner in which the food shortage was handled recently. Reforms would cover distortions in income distribution, providing a social safety net, and land-use and ownership. The 14Th FYP (2021-25) would also focus on three other pillars viz. growth in exports despite jump in domestic consumption, industrial growth through high technology and commitment to technology-led green manufacturing.

- The weakness in the strength of the world's most powerful economy is the dependence of US economy on the dollar remaining the reserve currency for the world. China seems intent on dislodging the dollar. A few years ago, Sino-Russian trade, started moving away from the dollar. The energy deal is itself worth $25 billion. That's just the start. As 2021 progresses there will be serious moves from China. A tit-for-tat on the stock exchange, for delisting Chinese shares in the US exchanges, may be a potential start. Since the dollar is losing value, this could be the time for China to strike. I had pointed to another likely development at a Banking Conference in February 2019. Many countries, including China, were working on what is called Central Bank Digital Currency which will mirror fiat currencies. Since the Chinese strategy needs to be understood more carefully, Biden's attention may be on Europe and on reviving the Iran deal, while his expert team works on the multifaceted China problem.

- Washington will signal to the world that Biden is serious about restoring America's old image of being a reliable partner and that he is serious about returning to the Paris Accord, probably in his commencement speech. It seems logical to expect Biden to take a leaf out of Franklin Delano Roosevelt's book, to broadly define his vision on how to revive the US economy and follow it up with a flurry of policy announcements over the next weeks which could radically change the situation in public health, domestic investments, job creation, upliftment of the middle class and the poor even if it means taxing the rich, climate change, etc. The Biden Deal is unlikely to kill fracking in a hurry because the US oil output will have to tactically offset the OPEC production cuts. Revival of the TPP may have to wait.

- There has been hectic activity in many capitals as 2020 draws to a close. Many are unsure about where they will stand in Biden's priorities. In Riyadh, after tactically deciding to cut oil production further and pushing the OPEC for a monthly, production-setting meetings in 2021 to secure better prices for his Arab neighbours, Mohammed bin Salman (MbS) was busy trying to arrange a meeting next week of all Gulf Arabs to unite against Iran. He was sure that the US under Biden, would want Qatar to be included, thus ending the three year boycott. Who better than Qatar as an interlocutor with Iran? His next step would be to have a joint Arab axis rather than bilateral discussions with Israel, to escape criticism from religious groups in his own country. Egypt is trying to bring Syria into the Arab fold and away from Iran, given that it has a Sunni majority despite there being at least 12 ethnic groups. Whenever that happens, one can expect more peace in the region which will increase intra ME trade & investments and allow the Arab leaders to draft US help to fight terrorism at home, keep Iran at bay and to prevent another Arab spring. It appears that the Palestinians will get shafted if they don't compromise with Israel. Some of this could start even before Biden takes charge. But this script will not suit Iran, which will need something to bring the US scurrying quickly for a negotiation on the sunken agreement. Something like a threatened attack in retaliation for killing General Soleimani starting with some controlled skirmish, defiantly stepping up uranium enrichment, etc. is required as a negotiating point. Pakistan is now stuck between a rock and a hard place. It messed up with Saudi Arabia and had to repay the $3 billion aid received in 2018. Then it drifted into the lap of the Turkey-Iran-Malaysia group which is disliked by the Arabs. Earlier it kept a distance from Israel to please the Muslim world which has now made friends with Israel. Even the Turks have resumed diplomatic relationship with Israel of late. All this has helped India get friendly with the Muslim world without losing Israel.
- In the meanwhile, with the Brexit deal behind it, EU will continue its easy money policy and focus on export trade, especially with China.
- Where does this place India vis-a-vis the US and the EU? On the slow burner. There are other urgent priorities for the US and the EU. This may seem worrisome given the situation in Pakistan, Afghanistan, and on the border with China but the relationship with the US, is unlikely to reverse despite Modi having openly supported Trump not long ago, and the concern about Kashmir vented by Biden's team. The US will want to use India and the Quad as pressure points against China. The Quad may get strengthened if anything. The S400 purchase matter may not be escalated but it will be used to extract concessions for imports of various items from the US, military and otherwise. The mini trade deal with India being negotiated by the Trump Administration will likely be docked and be reviewed only towards the end of 2021. The US has bigger fish to fry now. India will continue to try to balance with the US and Russia.
- All this suggests that the political stage has been set for more international trade and investment than in the recent past.

The economic rebound in 2021 from the depths of 2020:

- The World's GDP could get back close to the 2019 level at the end of 2021. Two lost years but it is not as simple as that. We are entering a different world in many respects- new opportunities and new risks that cannot be ignored. The new jobs created will not go to the people who lost old jobs.
- Rising hope with vaccination starting from Q1 onwards, and the trillions of dollars going to be pumped into the system in the US, EU and elsewhere, will favour global economic growth. The US and countries which have been affected by the third wave, will grow too, as they get over the temporary hurdle of rising infections and lockdowns. See Chart 1.

Chart 1: Expected real GDP growth (% YoY)

Geography	2021*	2020**
World	4.0/4.5	-4.0/-4.9
USA	3.0/4.0	-3.8
EU	3.2/3.5	-7.5
Japan	2.3/2.8	-5
China	8.0/9.0	1.8
India	8.2/9.5	-7.5/-8.0*

*Source: *My estimates but political policies could alter them, **OECD estimates*

- Global GDP growth could hit the higher end of the forecast range if global politics plays out as above. Whilst more waves of the pandemic alongside sloppy vaccination drives will send the global GDP growth down to even a tad below 4%.
- Taiwan clocked approximately 2.7% GDP growth, Vietnam about 2.4% and China 1.8 in CY 2020 by controlling the pandemic with strict measures, resulting in economic growth momentum in H2 of 2020. They had a strategy to contain the pandemic without killing the economy and they implemented it well. By contrast, India which went from being amongst the fastest growing economies in the world in 2019 to being at the bottom of the pile in 2020 (-7.5% to -8%) but will get back to being amongst the fastest growing economies in 2021 (8.2 to 9.5% range). This is not surprising because the dip experienced in India in 2020 was caused by one of the severest and longest lockdowns in the world.
- The bull run in the stock markets around the globe will continue unabated driven by the liquidity-induced momentum till interest rates rise in response to higher than target inflation or the economy has stabilised. The higher they go, the steeper the fall. In India, the P/E multiple is nearly 34X! When the money tap is shut, and interest rates on debt rises, there will be less appetite for investing in equity and crypto currencies. Prices will fall. The Fed has declared its intention to remain sanguine at least until 2022 but the risk looms large in 2021.
- A major debt crisis is approaching with global debt close to $277 trillion which is a scary 3.65 times the global GDP. It's like a trap because neither repaying a large part of debt nor achieving high economic growth seem feasible. Unless interest rates are close to zero, a large chunk of the Governments' revenue will be eaten up by interest payments. Swelling global debt will cause serious economic crises,

especially in some highly indebted poor countries in 2021 (there are at least 39, with most being in Africa and a few in Central, S America and Asia) and the pain will continue to be felt for years to come. Poor countries will get poorer. Even the rich countries will not be able to restore their debt/GDP ratio for another decade at least. Effectively, the current generation is surviving by borrowing from the unborn generations. This pandemic has also shifted wealth from non-tech businesses to tech business and from the poor to the rich people. Global solutions will have to be found if social unrest has to be prevented but they will take time because every country which is capable of helping, will be busy with its own problems.

- US debt, reportedly 1.4 times its GDP, will mount as the new Administration is likely to spend trillions to not just deal with the economy which has started faltering again due to the new Covid wave but also to prevent jabs from the previous administration.

- Many countries which went overboard with stimulus packages without commensurate increase in the supply of goods and services could face inflation. Germany did well on that score, but the US did not. Hence the dollar could weaken, and precious metals could rally. Food inflation is expected.

- Debris of over a million dead small businesses globally will show up as big write downs by banks around the world. In India, the impact on banks will be evident before June 2021. Right now, the stock market seems oblivious to even this threat, due to liquidity sloshing around from the world.

- Oil prices started firming up from Nov 2020 (Brent rose to $43/b) on the back of positive news about the vaccine and kept zig-zagging till it was a whisker below $50 on Dec 30. OPEC Plus's efforts seem to have paid off after it had hit a low of $9 in April 2020 when the global economy was locked down. With expectations of global economic revival in 2021 thanks to generous stimulus in OECD countries, vaccine deployment starting in the new year, the oil demand is expected to rise by 5.8 million b/d to an average of 98.2 million b/d in 2021. Saudi Arabia seems to have convinced the cartel not to get over-enthusiastic about production and to calibrate their output to the US output every month depending upon the Biden Government's Oil policy. The price will creep past $50 per barrel and test $65, but ease after summer, leaving the average for the year at about $49. This $ 6 increase will not hurt Europe as the dollar will weaken but India will get hurt unless the Rupee is allowed to naturally strengthen against the dollar.

- Retail therapy will drive growth. Consumers, sitting on savings over $1.5 trillion, will loosen their purse strings. This can boost the GDP very significantly in countries like the US where consumer spending accounts for 70% of the nominal GDP, also UK (64.8%), India (59.7%) and EU (53.9%). Great for consumer durables, automobiles, etc. and discretionary spending which were postponed., etc. While most of those countries have stepped up their spending to boost the economy, the Govt of India did not in 2020 (good social schemes were funded by diverting from other account heads). It remains to be seen on Feb 1 whether India will spend more in FY 21-22 to stimulate the economy.

- Suburban home purchases will rise, because people will want bigger apartments and houses because WFO&H will be a trend hereafter. A few days in the Office and a few days at Home. Remote employment far away from the office city is here to stay.

- A significant component of consumer spending will continue to be online even after fear of the virus subsides. It is now imprinted in the lifestyle of people. Even in India, right down to Tier 4 towns. However, many corporates will struggle to offer truly omnichannel distribution, e.g., to include a Direct-to-Consumer sales option, although some consumers would like to buy online. It is more a business model issue and struggle to create new processes to engage with consumers than a technology issue for these businesses which have always used traditional channels. Online dealers of automobiles and consumer durables have already shown the way. There will be more examples in 2021.
- Digitisation which would have happened over the next decade has already happened in 2020, not just in India. But it is still a partial transformation. There is much more to come in 2021 and beyond. The Banking system is today, like the gold standard in digital transformation. Many other businesses will transform in five years to the same extent as India's banking system did over two decades since it is now cost effective and imperative. This and selective adoption of Industry 4.0 is required (and may happen) in manufacturing, or else Indian manufacturing would lose its cost competitiveness to the West which designed it to offset labour cost disadvantage.
- All this (including businesses reacting to the Covid crisis) will lead to unemployment, especially at the middle management levels. In the US and EU, such unemployment has resulted in a sudden jump, from mid-2020 onwards, in new small business ventures being set up by people out of jobs seeking a permanent solution. This is possible in India too.
- Leisure travel will get a boost once vaccination takes off. It has already been on the mend in H2 of CY 2020 but still small compared with the pre-Covid times. Business travel will lag leisure travel. International travel will lag domestic and regional travel. Consequently, long distance routes for airlines will see less takers than before as long as the viral threat remains but domestic and regional air routes will be in demand. Business travel will pick up in 2022 in spite of virtual meetings becoming an established norm. Travel operators will struggle with international packages since they will be subject to periodic travel restrictions in many countries.
- Since the Government of India has realised the huge cost of the disruption caused by the pandemic, it would therefore stand to logic that the forthcoming Budget will allocate significant funds to
    - vaccine procurement and distribution because half the country may not be able to afford vaccination
    - vaccine development grants
    - healthcare to contain and mitigate Covid cases in FY21-22
    - rural healthcare in general
- The jury is out on the number of small business that have shut down forever globally and in India in 2020. Additionally, there are many which are limping. They urgently need emergency financial support from the Government of India. If the Government clears its own dues to large and medium sized companies through a creative

mechanism by which the said sum is redeployed to clear their dues to the surviving tiny and SME vendors, there could be immediate relief. Many SMEs will need management support for revival, and some for being acquired by healthier larger companies. This is an opportunity for small advisory firms.

- Recovery of the Indian economy to pre-pandemic levels, does not mean much for FY 22-23, as it was limping for a few quarters before the pandemic.
  - Private investment in manufacturing has been shying away for the past couple of years and will continue to do so in 2021 as the capacity utilisation is not high enough. The Government of India's schemes to boost investment through Production Linked Incentive Schemes will only have modest success in weaning away production from China because competing countries have made quicker and better efforts and because Chinese supply-chains' ability to bounce back quickly after the crisis has reduced the urgency for MNCs to quickly move out of China. Hence consumer demand must rise in mother industries like auto, textiles, construction & infrastructure for the Indian economy to rise. Will the budget do anything to improve demand for 2W/4W, durables, house purchase, and textiles?
  - The automobile industry in India will start picking up but may not reach the pre-pandemic levels in 2021; expect waiting lines for new releases due to pent up demand. The demand for used cars will exceed that for new cars. But it will take a couple of years for the industry to reach pre-Covid levels.
  - The textile industry and the Infrastructure sector are the other two mother sectors for job creation in India that need immediate help to revive. They may get some help in the Budget but were overlooked in Feb 2020 when India needed them to tick in order to revive the economy.
- Despite the pandemic, many corporates will show higher profits on lower revenues when the FY20-21 results are declared in 2021. Cost restructuring is here to stay, though salary cuts will be restored.

Finally, though there is a lot more to write about various industry sectors, let me point out just three things:

- The parting message from Cyrus the Virus about the end of the fight with pandemics was, *"If humankind stops interfering with nature's balance (climate, flora, and fauna), there will be fewer new viruses crossing over to humans."*
- The pandemic has widened the wealth divide and the digital divide, thereby accentuating the differences between the Haves and the Have Nots. The Government on its part may even reintroduce inheritance tax on the rich but that will be useless unless it goes to fund welfare schemes to empower the Have Nots.
- The post Pandemic world will present new opportunities because people and organisations (schools, universities, hospitals, manufacturers, advisory firms, distribution channels, etc.) have been forced to change. Innovative people will rule the roost. **If you are good, your clock starts now. Happy New Year.**

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