

# A SILVER LINING

## The bumpy road of a post-pandemic green recovery

By Bart Le Blanc

***“Was I deceived, or did a sable cloud,  
Turn forth her silver lining on the night”***

*From a poem by 17<sup>th</sup> century political commentator/writer John Milton*

- *The short-term economic forecasts look dreadful with slow and uneven recoveries predicted by the IMF*
- *In the meantime, financial markets seem to be on steroids, fuelled by cheap money*
- *Three trends could have a major impact on the New Normal:*
  - *Post-pandemic Consumer Spending catch-up complemented by redistributive policies to fight growing inequalities*
  - *Transformation of COVID-hit sectors supported by investors and governments (and cheap money)*
  - *Green investing driven by corporates **and** investors with the help of BIG data*
- *Will it work?*

*YES, provided that*

  - *The pandemic comes under control and lockdown measures can be relaxed*
  - *Central Banks do not withdraw the monetary support too early*
  - *Governments and investors help restructuring of hard-hit businesses*
  - *Governments address grown inequality issues*
  - *Business and Investors drive investment in green recovery*
- *Sable cloud, silver lining and hopefully a bright green future ahead*

*Finally, good news, Hooray!*

### **1. When ‘SCARRING’ entered the economic vocabulary.**

Economists prefer to look forward and not dwell too much on the past particularly when it is bad. The year 2020 is easily forgotten and generally written off and ignored or left for economic historians.

The recent IMF World Economic Outlook Update illustrates this approach in its short-term economic forecast. Not many words are spent on the analysis of the devastating effects of the COVID19 pandemic. It focusses on the painful road ahead with many uncertainties around the timing of the relaxation of COVID restrictions being the main determinant for a gradual and slow path to recovery.

Travelling on that path there will be major cross-roads and many potholes and bumps ahead, in some countries and sectors more than in others.

**Table 1. Overview of the World Economic Outlook Projections**  
(Percent change, unless noted otherwise)

	Year over Year								
	Estimate		Projections		Difference from October 2020 WEO Projections 1/		Q4 over Q4 2/		
	2019	2020	2021	2022	2021	2022	Estimate 2020	Projections 2021	Projections 2022
<b>World Output</b>	2.8	-3.5	5.5	4.2	0.3	0.0	-1.4	4.2	3.7
<b>Advanced Economies</b>	1.6	-4.9	4.3	3.1	0.4	0.2	-3.9	4.6	1.9
United States	2.2	-3.4	5.1	2.5	2.0	-0.4	-2.1	4.0	2.0
Euro Area	1.3	-7.2	4.2	3.6	-1.0	0.5	-6.8	5.8	2.0
Germany	0.6	-5.4	3.5	3.1	-0.7	0.0	-5.3	5.2	1.7
France	1.5	-9.0	5.5	4.1	-0.5	1.2	-8.2	7.4	2.0
Italy	0.3	-9.2	3.0	3.6	-2.2	1.0	-8.3	4.2	2.3
Spain	2.0	-11.1	5.9	4.7	-1.3	0.2	-9.8	7.1	2.0
Japan	0.3	-5.1	3.1	2.4	0.8	0.7	-2.3	2.7	1.6
United Kingdom	1.4	-10.0	4.5	5.0	-1.4	1.8	-8.3	6.0	1.9
Canada	1.9	-5.5	3.6	4.1	-1.6	0.7	-4.0	3.7	2.7
Other Advanced Economies 3/	1.8	-2.5	3.6	3.1	0.0	0.0	-2.2	4.5	1.9
<b>Emerging Market and Developing Economies</b>	3.6	-2.4	6.3	5.0	0.3	-0.1	0.9	3.7	5.4
Emerging and Developing Asia	5.4	-1.1	8.3	5.9	0.3	-0.4	3.2	3.8	6.4
China	6.0	2.3	8.1	5.6	-0.1	-0.2	6.2	4.2	6.0
India 4/	4.2	-8.0	11.5	6.8	2.7	-1.2	0.6	1.7	7.8
ASEAN-5 5/	4.9	-3.7	5.2	6.0	-1.0	0.3	-3.2	5.2	6.1
Emerging and Developing Europe	2.2	-2.8	4.0	3.9	0.1	0.5	-2.7	4.8	3.0
Russia	1.3	-3.6	3.0	3.9	0.2	1.6	-4.6	5.3	2.6
Latin America and the Caribbean	0.2	-7.4	4.1	2.9	0.5	0.2	-4.8	2.3	2.8
Brazil	1.4	-4.5	3.6	2.6	0.8	0.3	-1.9	1.6	2.6
Mexico	-0.1	-8.5	4.3	2.5	0.8	0.2	-5.4	2.2	2.4
Middle East and Central Asia	1.4	-3.2	3.0	4.2	0.0	0.2	...	...	...
Saudi Arabia	0.3	-3.9	2.6	4.0	-0.5	0.6	-3.1	3.5	4.0
Sub-Saharan Africa	3.2	-2.6	3.2	3.9	0.1	-0.1	...	...	...
Nigeria	2.2	-3.2	1.5	2.5	-0.2	0.0	...	...	...
South Africa	0.2	-7.5	2.8	1.4	-0.2	-0.1	-6.2	2.8	0.6
<i>Memorandum</i>									
Low-income Developing Countries	5.3	-0.8	5.1	5.5	0.2	0.0	...	...	...
World Growth Based on Market Exchange Rates	2.4	-3.8	5.1	3.8	0.3	0.0	-2.0	4.3	3.1

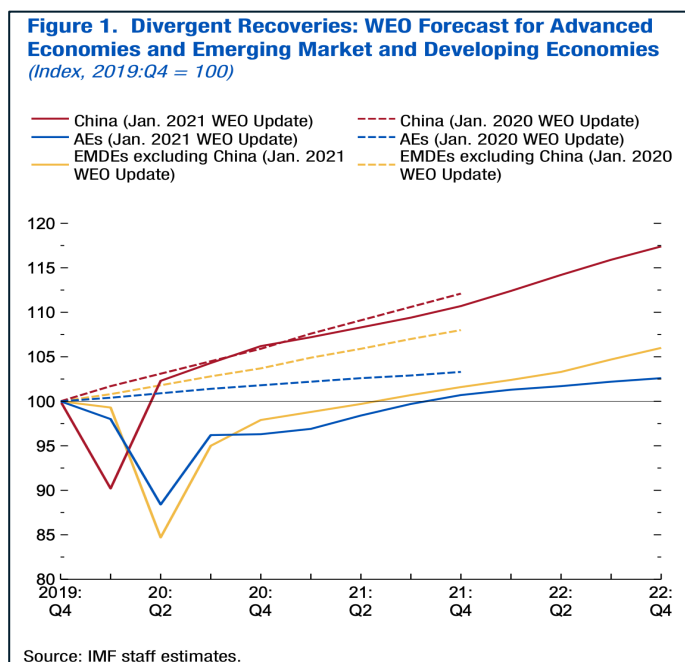
Source: IMF World Economic Outlook Update January 2021.

The table above illustrates this.

Against a background of a global economic growth of -3.5% in 2020, the divergence between countries is astonishing, even within homogeneous economic regions such as in the European Union where significant differences exist: Spain (2020 GDP -11.1%), Italy (-9.2%), France (-9.0%), while Germany's GDP loss was 'only' -5.4% (NB the contraction in post Brexit UK was -10%).

In the emerging economies group, Mexico, India and South Africa suffer most (between -8.5% and -7.5%), while in contrast, the Chinese economy is the unique frontrunner with a positive GDP growth in 2020 (+2.3%).

The outlook for post-pandemic recovery in the advanced economies is far from uplifting: no return to previous GDP levels for some years for most with again the notable exception of the Chinese locomotive thundering on.



The IMF advocates pro-active policies addressing traditional bankruptcy frameworks, targeted government support combined with fiscal stimulus and monetary support, addressing inequalities and where necessary support for debt restructuring. Equally after decades of underinvestment in critical public services, new approaches need to be developed for a post-pandemic public health and education system. The effectiveness of these combined policies will impact the shape of the recovery to come. Various possible recovery scenarios have been developed. The impact of what IMF sees as a downside scenario with continuing negative growth for some years to come could be dramatic and is bound to trigger social unrest in many parts of the world. No wonder that the IMF points at the risks of 'persistent economic damage' particularly on the supply side of the economy.

*'Country-specific labour market circumstances vary, implying different degrees of **scarring**. Economies that rely heavily on contact-intensive industries, commodity exporters, and those where school closures have inflicted large setbacks to human capital accumulation are particularly exposed to persistent damages to supply potential.'*

Eye catching is the introduction of the word '**scarring**', which has now entered the dictionary and is easy to visualise, even for an economist.

## 2. Financial markets on steroids: a world awash with money looking for investment.

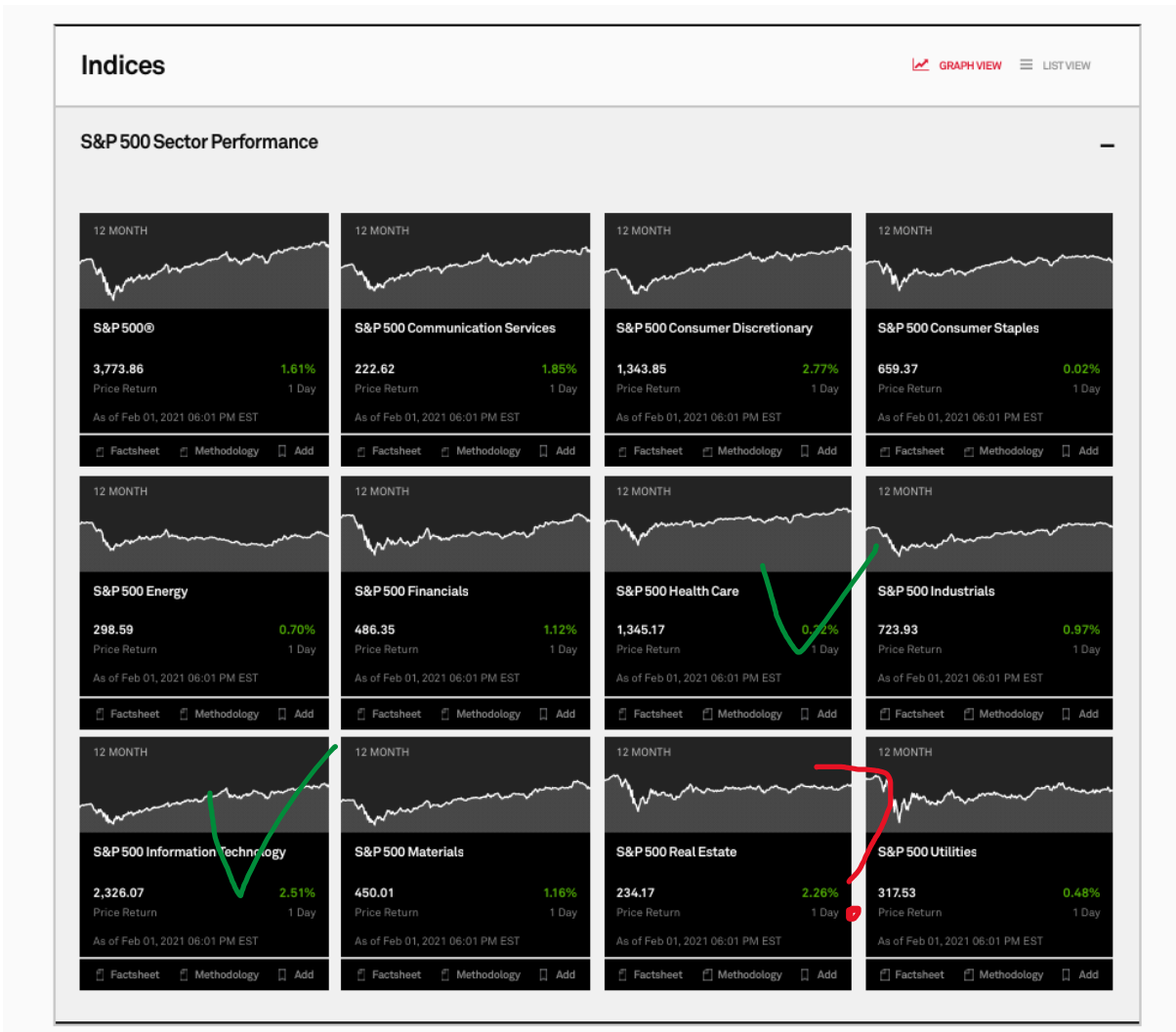
What impact has this gloomy economic forecast had on financial markets?

After the first frightening experience of the pandemic and the lockdown measures in early 2020, financial markets have recovered from a sharp drop in the first quarter, when share prices dropped with double digit percentages. The table below summarises the stock market development on the world's biggest exchanges. It shows that in the end all relevant indices recovered after the first quarter and ultimately delivered positive investment returns for the year 2020. An amazing feat!

### Index Performance:

US Indices	2020 %	Q4 %	Q3 %	Q2 %	Q1 %	vs. 52-week Low
Nasdaq 100	49%	13%	13%	30%	-10%	90%
Nasdaq Composite	45%	16%	11%	31%	-14%	94%
Russell 1000 Growth	38%	11%	13%	28%	-14%	89%
Russell Microcap	21%	32%	4%	31%	-32%	114%
Russell 3000	21%	14%	9%	22%	-21%	79%
Russell 2000	20%	32%	5%	25%	-31%	105%
S&P 500	18%	11%	9%	21%	-20%	71%
S&P Midcap 400	14%	24%	5%	24%	-30%	96%
Dow Jones Industrials	10%	10%	8%	19%	-23%	68%
Russell 1000 Value	3%	15%	6%	14%	-27%	63%

However, the overview graphs of the S&P 500 sector performance over the last 12 months since February 2020 below reveal an even more remarkable story!



The outcome for some of the winning sectors such as IT, (digital) health care and internet shopping may not be a big surprise. Though what about the real estate sector having almost recuperated its initial losses of the first quarter of 2020?

How to explain that result with empty shops in town centres across the world, and reduced demand for office space due to new Working-From-Home practices?

It is without any doubt that generous monetary policy since the financial crisis 10 years ago have pushed interest rates to zero and sometimes into negative territory. Even today the 30 years government bond yields in Japan and many core Eurozone countries are below zero, and many private savings accounts have negative interest rates.

There is a significant body of academic research on the asset inflation following aggressive monetary policies. Already in the 18<sup>th</sup> century, the Irish banker and economist Richard Cantillon argued that new money entering the economy could distort the real conditions of supply and demand for certain goods and inflate the prices for these goods relative to other assets.

More recently French economists Blot, Hubert and Labondance published a study on *“Monetary Policy and Asset Price Bubbles”* (Sciences Po - OFCE December 2017). They conclude that overly generous and prolonged monetary easing could have seriously distort the pricing of risk in financial markets, today still known as the *Cantillon effect*

That investors keep looking for yield on their portfolios is logical. While initially it was mainly retail and private investors climbing the credit risk ladder to gain some positive yield and have increased their

allocation to risk assets, in recent years many institutional investors have followed and repositioned their portfolios.

However, the key question remains: is this financial market behaviour sustainable?

Thomas Friedman wrote in a column in the New York Times: " We're *in the middle of a pandemic that has crushed jobs and small businesses — but the stock market is soaring. That's not right. That's elephants flying. I always get worried watching elephants fly. It usually doesn't end well.*" (NYT, 26 January 2021)

However, one might argue that financial markets participants rely on significant analytical research capabilities and importantly also take the long view.

Let's take a further look at this 'Long View' and step beyond the short-term IMF forecasts and financial markets valuations of recent months.

### **3. The Long View: 3 major trends to the New Normal.**

Let us assume that the pandemic is under control and restrictions are something of the past.

What would the New Normal look like?

There may be 3 distinct trends which each could have a major impact on the future shape of the economy and in combination will be leading the way:

- Post-pandemic consumer spending catch-up complemented by redistributive government policies to fight inequalities
- Transformation of COVID-hit sectors supported by governments and investors (and cheap money)
- Green investing driven by corporates and investors with help of BIG data

Let me try to broad-brush sketch the shape of each of these trends.

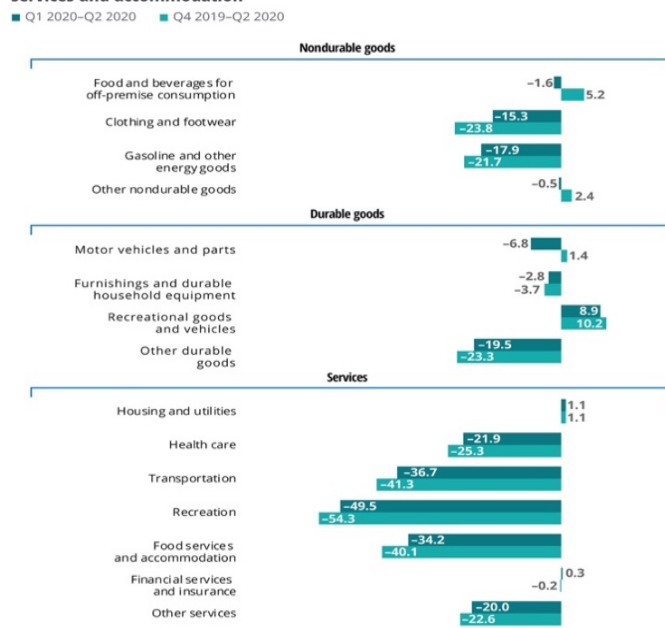
#### **3.1 Post-pandemic consumer spending catch-up complemented by re-distributive government measures in the fight against inequalities**

The pandemic and the public health restrictive measures have had a major impact on the behaviour of consumers. Logically with many shops closed and people confined to their homes, the level of spending abruptly plummeted, and savings ratios went through the roof all over the world.

The consumer was hibernating during lockdown.

As shown in the graph below, consumers cut back spending during successive pandemic waves and lockdowns on massive scale.

FIGURE 1  
**Consumers have cut back on recreation, transportation, and food services and accommodation**



Sources: United State Department of Commerce (sourced through Haver Analytics); Deloitte Services LP economic analysis.  
 Deloitte Insights | deloitte.com/insights

In analysing the patterns of consumer withdrawal under lockdowns, one can formulate some reasonable assumptions of what the post-pandemic consumption rebound could look like. It seems very likely that there might be a significant catching-up of consumption as and when lockdown measures will be relaxed, and the general feeling of infection fear and anxiety is reduced.

Looking at the data in the table above, it is to be expected that increased mobility and allowed social contact will trigger new spending in clothing and footwear, (although with continued working from home maybe not to the same 'dress codes' as before).

Some extra spending on gasoline/petrol for increased private travel (not business) may happen and probably also some return of car purchases, but at an overall smaller aggregated level of car ownership. Local entertainment and foodservices may see a strong come-back, but maybe not in the same places and same venues. The changed practices of working from home will have an impact on commuting, business travel and accommodation, and thus on intercity entertainment and hospitality venues. Cities will in any case need to adapt their traditional set-up as shopping habits will have structurally changed (see also next section).

Although a re-bounce in consumer spending may deliver a welcome push for a recovery, it may also be short lived in itself and uneven.

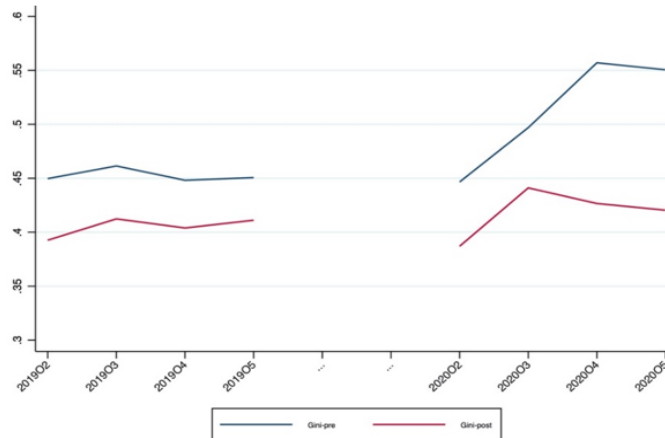
However, the good news is that a further and more structural, longer-term impulse in consumer spending may emerge from a series of redistributive measures that may be strengthened in the coming years. Many political economists have been writing about the fact that the less advantaged groups in society seemed to have been harder hit by the negative consequence of the pandemic and the lockdown measures.

Cramped housing situations have led to relatively higher rates of COVID infections. Lower skilled jobs are less susceptible to the relative ease of working from home options and have thus exposed these workers more to the virus and spreading infections. Home schooling requires sufficient and up to date digital equipment which may not be available to all and could thus result in unfair disadvantages for groups of children.

On a global scale it is undisputable that people in developing countries were generally disadvantaged compared to people living in developed and rich economies.

In a recent study on the impact of the COVID pandemic on income inequality in Spain, it was concluded that – even in a country with a developed welfare system – the inequality increased due to COVID triggered unemployment, income losses or wage cuts.

**Figure 3** Evolution of the Gini index for pre-transfer and post-transfer incomes in Spain (February-May 2019 and 2020)



Source: Aspachs, O, R Durante, J García Montalvo, A Graziano, J Mestres and M Reynal-Querol (2020), [“Real-Time Inequality and the Welfare State in Motion: Evidence from COVID-19 in Spain”](#), CEPR Discussion Paper n. 15118.

The pandemic induced increase in the income gap (as measured by the ‘Gini index’ shown in the graph above) was significant. It illustrates that re-distributive welfare state policies are essential in reducing unwanted inequality increases (see impact of income transfers on inequality gaps) but even so further policy measures seem very much needed.

The macro-economic view is that re-distributive measures will have a positive impact on the level of consumer spending, as the consumption/income ratios of lower income groups are higher than those of higher income categories (so called ‘Lorenz Curve’ effect).

As there is a growing consensus (now again with the US as active participant) that increased inequalities, particularly as they have been brought to the fore by the pandemic, require coordinated policy action both on a national and a global level.

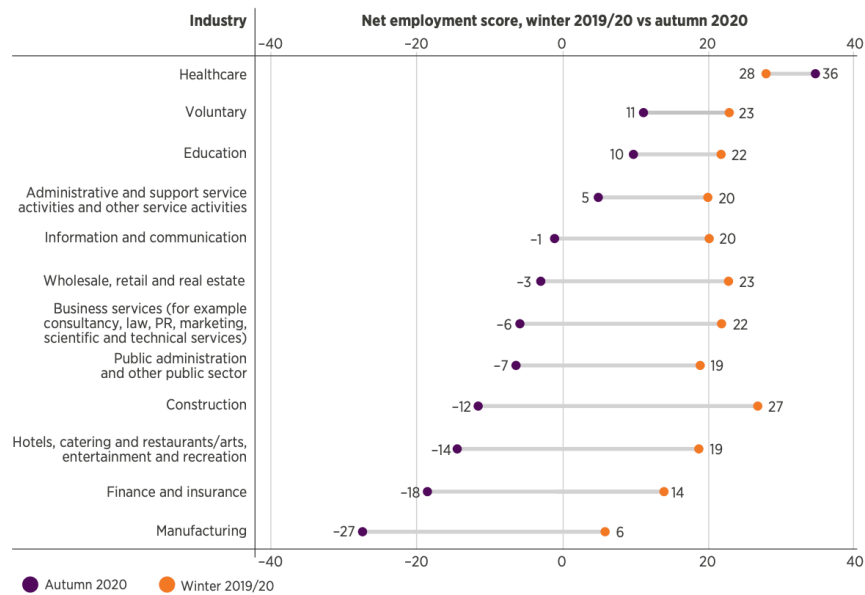
It provides in my view a further support for a consumer pushed recovery through post-pandemic consumer spending, thus helping the longer-term post-pandemic recovery.

### **3.2 Transformation of COVID-hit sectors supported by governments and investors (any cheap money)**

As the consumer spending data implied, the pandemic has hit different business sectors very unevenly. The economic pain has been dramatic for many businesses, particularly small and medium sized ones. Governments have introduced programmes of bridging support for businesses which has led to relatively low levels of bankruptcies in a crisis situation. However a longer term view may see the need for restructuring and transformation of businesses.

Some indication of the economic pain in different sectors may be found in the periodic net employment score, which is published quarterly in the UK and can provide some illustrative evidence.

Figure 5: Net employment score, by industry, winter 2019/20 and autumn 2020 (%)



Source: CIPD Labour Market Outlook Autumn 2020

It is thus not surprising that the business outlook varies significantly per sector. Some sectors are terribly hard hit, such as air travel and holiday sectors, leisure and entertainment, restaurants and hotels, traditional retail and commercial property/real estate (offices and shops). The employment perspective in these hard-hit sectors is bad (see chart).

Some of the suffering sectors may recover once the pandemic comes under control and consumer spending is on the rise again. Temporary government support, cheap debt and lenient banks and investors may support the bridging towards a better future.

For other sectors fundamental restructuring may be unavoidable and development of new business models may be the only way to survival. Governments may wish to avoid steep increases in unemployment in the immediate aftermath of the pandemic. They will particularly try to avoid massive layoffs in delicate sectors such as the hospitality sector, which in many countries can employ up to 9% of the overall workforce with many young and female workers. However, governments will need the support of businesses and investors to succeed in this endeavour.

Luckily the attitude of many portfolio investors towards major corporate transformation programmes seems to have changed significantly in recent times.

In the past, many investors were not keen on getting involved in restructurings. They generally preferred a "cut-your-losses" approach over long term involvement in business transformation processes.

Today I detect a different attitude.

Investors today are far more likely to stay the course and provide support for restructuring. Rather than accepting capital losses and turning the page on an investment in difficulties, the investor community seems to have moved to a pro-active involvement with companies which require financial support for the transformation of their business models and the restructuring of their assets and liabilities.

This is of course much facilitated by the generous monetary policies of central banks which make money very cheap and alternative attractive investment opportunities hard to find. Therein lies a risk of reconsideration of this investor support when central bank's monetary policies may face calls for tightening.

For the coming years such withdrawal of monetary generosity seems very unlikely, even when inflation rates may start to rise from the morose levels of the last decade.

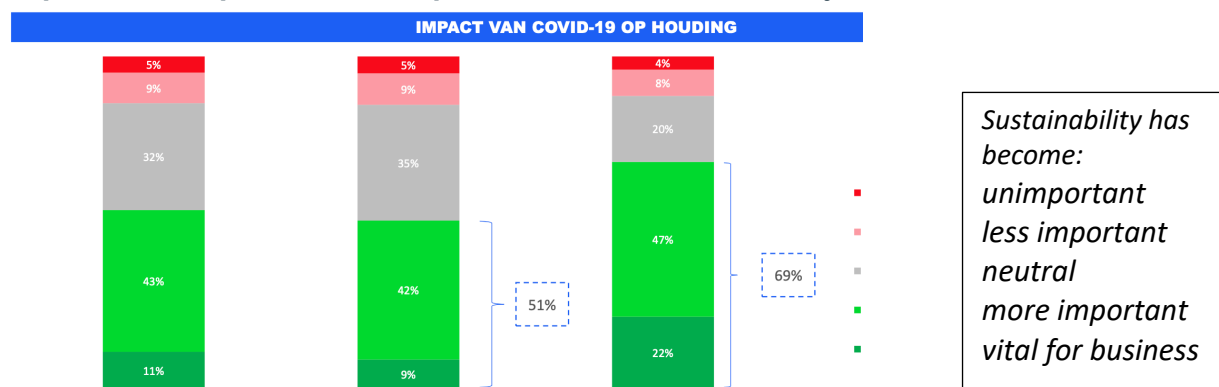


### 3.3 Green investing driven by businesses and investors with help of BIG data

A recent study published by the Dutch bank ING revealed that the pandemic has increased the focus of major businesses on sustainability ('Greening of companies under the pandemic', DVJ Insights, 27 January 2021).

The report shows that two thirds of the major corporates participating in the survey indicated that sustainability has become the dominant factor in new business strategies (up from around 50% pre-pandemic).

#### Impact of COVID pandemic on Corporate Attitude to Sustainability



Source: ING/DVJ Insights: Onderzoek verduurzaming bedrijven 2-meting corona-jaar, January 2021

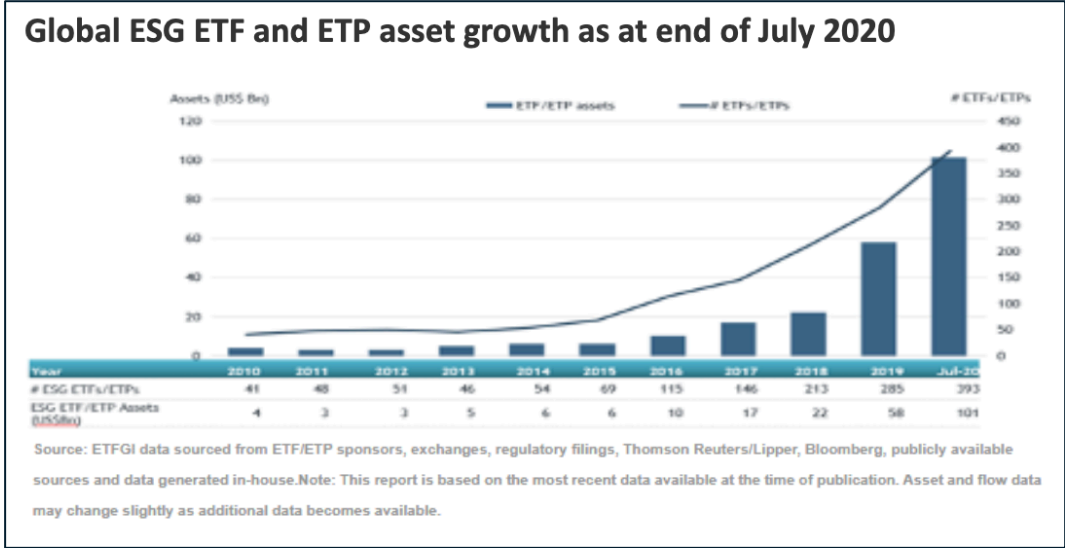
Sustainability has become:  
 unimportant  
 less important  
 neutral  
 more important  
 vital for business

Another interesting phenomenon was that the increased focus on sustainability was driven by a significant motivational shift: from reduction of waste (energy, recycling, increased efficiency of manufacturing input) and resulting cost savings towards a more strategic objective such as enhancing the competitive advantage through development of greener products and a greener corporate image (see also table below).

The surveyed companies expected that post-pandemic sustainability investment would be significantly higher with 15% of the companies reporting that these green investments would be brought forward and 22% adding that the overall investment levels would be brought to a higher level. Those are very encouraging numbers!

It is probably reasonable to assume that this survey reflects broader shared views in the international corporate world and is not exclusively a Netherlands picture.

In addition to the increased corporate focus on sustainability, the international investor community has played an important role in advancing the issue of ESG or green investing. Pension funds and life insurance companies have led the way as they have per definition a longer-term investment horizon. The graph from a report by ETFGI, a London based ETF consultancy, show the enormous flight investing in ETFs with ESG screened companies (Environmental, Social and Governance factors)) has taken in the last decade and particularly the recent years.

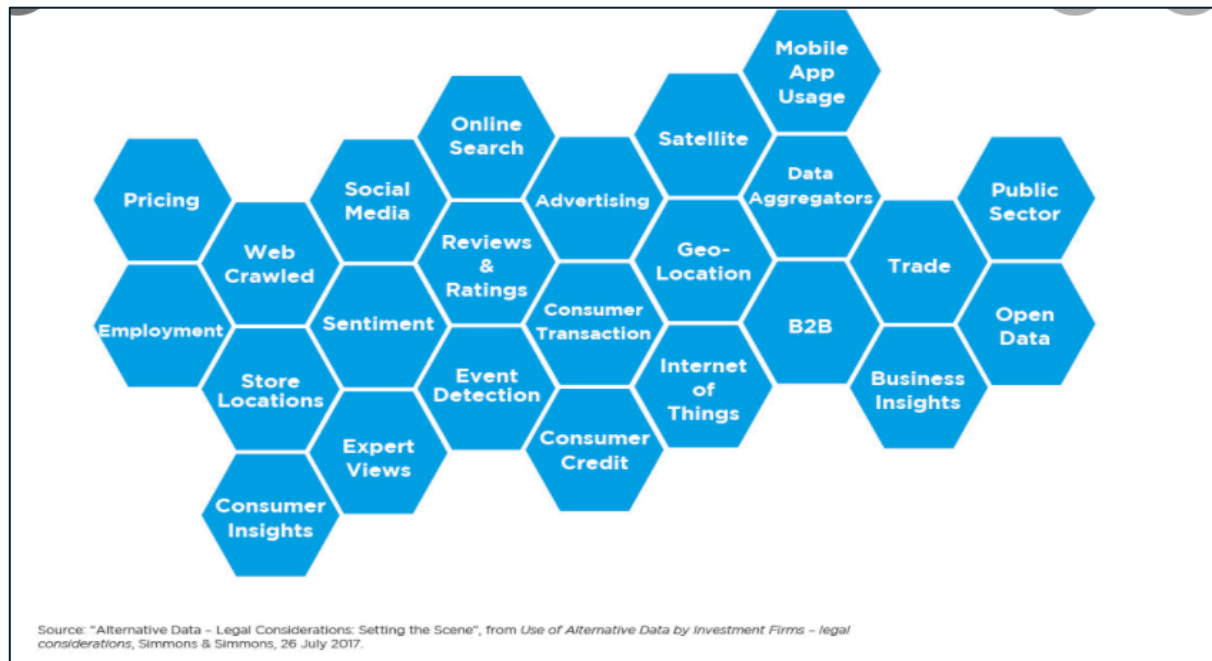


Knut Kjaer (the founding CEO of Norges Investment Management and a colleague at APG Asset Management) has been on the barricades for a pro-active investor approach for a decade or more. In a recent lecture at the Norwegian University of Life Sciences (NMBU) in early 2020 Knut confronted his audience with dramatic facts: *'The last time the atmosphere's concentration has reached today's mark; the global sea level was as much as 20 meters higher than it is now. China is moving backward on climate change, opening a new coal-fuelled power plant every second week. Some estimates suggest there may be 200 million climate change refugees by 2050, and the damage could cost \$54 trillion. I have seen the maps of the planet in 30 years' time, and there are places you cannot live any more. Looking into the eyes of my grandchildren, I ask myself "What future are they going to inherit from us?"*. A very pertinent question for a long-term investor.

Helped with significant support of the growing BIG DATA and AI companies, major institutional investors in Europe have pioneered very active investment policies in the environmental investing area. These investment policies are frequently built on extensive research which goes far beyond the traditional financial information companies provide to stock markets investors. In many cases this research uses information stemming from so called 'alternative data'.

These 'alternative data' (not to be confused with "fake news") are provided from external independent sources and regard information on consumption choices and frequencies, mobility patterns, regional differences, cultural habits, etc. these data are collected by financial institutions, credit cards companies, mobile phone companies, satellite observations, public records, etc. (see schedule below). From these information sources investors can derive large numbers of consumer (behavioural) data which could complement any financial analysis and guide long term investment decisions. As a result, they can direct investment decisions towards enhanced value creation over the longer term.

## Schematic overview of some alternative data sources



It is thus without any doubt, that the active use of alternative data by investors will deliver an extra push towards investing in a more sustainable future.

This type of data driven investment approaches is already prominent among major institutional investors and growing, particularly in Europe where a strong ESG bias is visible in their investment policies.

Companies choosing a more sustainable path and investors pushing them in in that direction creates the silver lining behind the dark pandemic cloud.

In the push for a greener future, the availability of investment money will not be the blocking issue.

### **4. Towards a greener future, provided that....**

As any economist will do, I need to conclude with words of caution.

Is it possible that regardless the gloomy short term economic outlook and the fact that financial markets seem to ignore the downside risk fuelled by a wall of money, there is logic in longer term, sustainable growth?

My answer is YES, provided that:

- the pandemic comes under control and lockdown measures are relaxed.
- Central Banks do not withdraw the monetary support too early.
- Governments supported by investors and financial institutions pro-actively assist hard-hit businesses to restructure.
- Governments address growing inequalities and develop a broad-based consensus for re-distributive policies.
- Investors keep driving change and investments in a green recovery.

With a bit of luck and a lot of dedication to each and everybody's role, a brighter, greener future lies ahead.

Good news, finally. Hoorah!

Bart Le Blanc, February 2021.

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