



## ECONOMICS

# A Whole New World? Looking Past the Pandemic

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The world will never be the same. Historically, that's been an overused phrase. A century ago, the "war to end all wars" was followed by still more wars. Russia didn't become a friendly democracy after the Berlin Wall crumbled. They built tall buildings and people returned to flying after 9/11.

So the idea that the global economy will never be the same again after Covid-19 is vanquished by a vaccine or a cure, should also be viewed with a critical eye. To be clear, we're not describing the coming year. Economically, after a huge Q2 contraction, we expect only a partial recovery given the need to maintain social distancing restraints, and a continuation of near-zero policy rates through 2020. Many will be working from home or not at all, large gatherings will be off limits, and masks won't be just for Halloween.

When Covid-19 has been left to the history books, interest rates will no doubt climb, quantitative easing will be put on the back shelf, and people will get back to work. But will their work and home life look radically different in, say, 2025, than they did in 2019? Fortunately, there are ways to think systematically about where those differences are likely to emerge, and some historical precedents that can guide us.

### Revealed Preference as a Clue

Life has been anything but normal during the pandemic. Behaviours that were

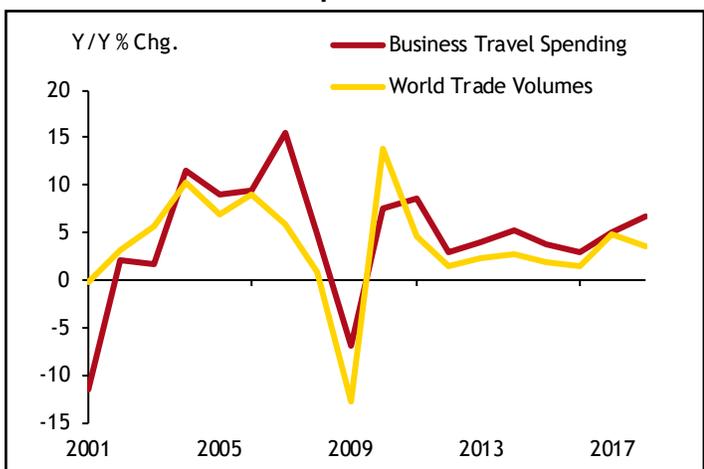
possible, but not common or growing prior to the virus are unlikely to remain when it's over, given what economists call "revealed preference." Simply put, your choices among alternatives tell a lot about what you will do when those options are again available.

You could have always stood six feet away from your friends, or met with your neighbours online. The fact that you chose not to is evidence that these behaviours will disappear when Covid-19 does. But changes that were already afoot pre-virus, and accelerated by its presence, are more likely to hold on to some of their 2020 gains, as the virus pushed more people to experiment with what early adopters had been doing.

Leisure travel was expanding before this crisis and should one day fully return, albeit only gradually due to the recession's losses in income and wealth. Cruises might be permanently dented by their negative PR, but winter will still motivate snowbirds and skiers, and we'll always have Paris to look forward to. Although it will compete with online gaming, the rest of what happens in Vegas should return to Vegas.

Many airlines and hotels garnered much of their profit off business travel. Now that we're zooming to meetings on Zoom, will road warriors ever venture back out again? For internal meetings, the use of video conferencing had been creeping up before the crisis, and it could retain some added market share.

Chart 1  
**Business Travel Had Kept Pace with World Trade**



Source: Global Business Travel Association, CPB, CIBC

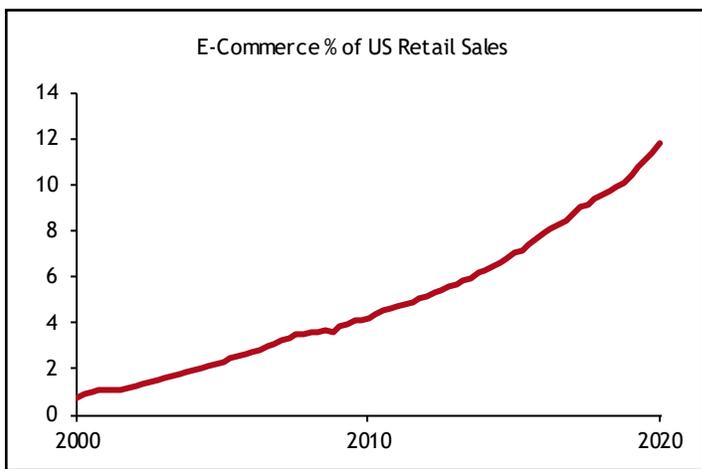
But business travel had still been growing in sync with global trade (Chart 1). That revealed preference suggests that conferences and in-person meetings will still be used to build business-to-client relationships. Zoom had been around for nearly a decade before the virus hit, and there was no momentum towards large conferences being conducted virtually. The 9/11 attacks of 2001 as well as the recession of that year weighed on travel for the subsequent year but it subsequently accelerated sharply.

For consumers, revealed preferences give clues about which changes seen in the pandemic might partially stick around. At-home simulators like stationary bikes were a pre-virus fad, and could permanently steal some additional market share from gyms. In contrast, long hair for men wasn't a fashion trend, so barbers can expect a full return.

More broadly, e-commerce was already an established trend (Chart 2), showing that it was becoming a preferred mode for early adopters. It now has boomed during the early months of the pandemic. Some will have tried home delivery and faced long delays and half-filled orders, and will happily return to in-store shopping. But a portion of consumers who tried and liked an online vendor will no doubt stick with that approach after the pandemic, adding to the challenges that were already growing for related commercial real estate, but boosting industrial property demand for the required distribution centres.

Hundreds of millions around the world have tried working from home for the first time. In the US, nearly a third of all workers had the ability to do so, and we suspect that

Chart 2  
**Gains For Online Retailing: A Long Established Trend**

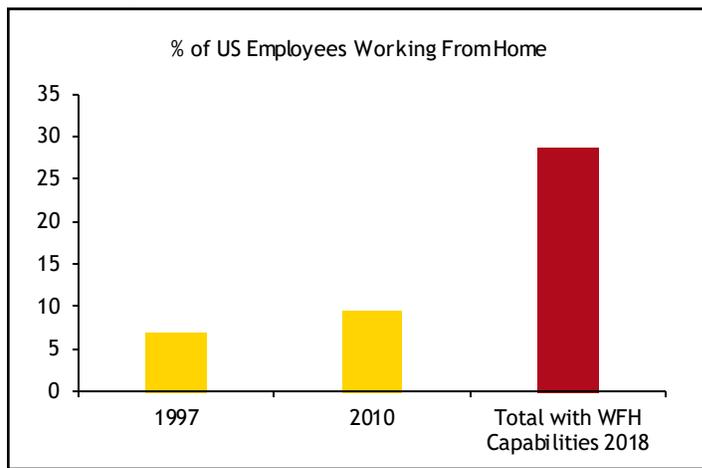


Source: US Census Bureau, CIBC

the current WFH employment share is close to that mark. Again, that's a trend that was already in evidence before the virus hit (Chart 3), so it's reasonable to expect it to end up with a higher share of jobs in the long run than it had pre-virus. Occasional days working from home will also be more acceptable.

But remember that the vast majority of employers/employees were revealing their preference to work at the employer's premises. The technology to work at home has been in place for decades, but that's not what was preferred. Co-working facilities like WeWork were in fact aimed at those who could have hunkered down at their kitchen tables but chose not to.

Chart 3  
**Only Gradual Trend To Work From Home, But Many More Could Do So Now**



Source: US Census Bureau, BLS, CIBC

As a result, once we no longer need to social distance, expect office space to be as much in demand as it had been. If there's a lingering impact, it could be to have a slightly higher percentage of work-from-home, but an offsetting need for floor space per worker if we remain even slightly cautious about future pandemics.

Similarly, once we're comfortable being on crowded elevators again, we won't all flee condos and dense cities for the "safety" of suburbia and small-town living. The Spanish flu didn't end the growth of cities, and the revealed preference trend has been towards more, not less density. The coronavirus has not proven more deadly per capita in such areas as a rule: some suburbs like New Rochelle, New York were as hard hit as NYC, there were large outbreaks in Mississauga Ontario, and major cities like Rome, Hong Kong and Beijing fared better than much less dense centres like Bergamo and Wuhan.

Getting back to the office, and to leisure activities, also means that the demand for oil as a transportation fuel isn't nearly as dead as it looks today. Traffic has already returned to Beijing streets. That said, demand for hybrids and electric vehicles will also return once gasoline is no longer this cheap.

### An Era of Big Government?

The Covid-19 crisis has brought with it, for obvious reasons, a year of Big Government across the developed world. Will a year turn into an era of greater spending on poverty or tighter regulations, or will we see a counter trend of spending restraint to address the recent buildup of debt and deficits?

There is a tendency for economic crises to increase the hand of government on the regulatory front. The Great Depression's legacy included deposit insurance, the 1970s OPEC oil price shock gave birth to the US strategic petroleum reserve, and the 2008 financial crisis sparked new banking regulations. This time, governments will take action to add a layer of resiliency to the health care system, and pandemic preparedness more specifically.

But on the spending side, history's lessons are mixed. The Depression permanently expanded the US government under FDR's New Deal, and Canada launched employment insurance in its wake. But a huge fiscal stimulus effort in Obama's first term was followed by significant restraint, particularly at the state and local level, which created a drag on growth in the 2011-2014 period. We saw much the same with austerity measures in the EU and UK.

Voters might well determine the US outcome this time, given the gap between the major parties on spending and regulatory issues. In Canada, the crisis has not swung the public in a particular party direction, with incumbent leaders in different parties gaining ground at the federal and provincial levels.

### Trade, Supply Chains and Just-in-Time

Governments will take steps to ensure that there are ample local supplies of key materials like mask, gowns, testing equipment, and medications to deal with the next health crisis. But the pandemic has exposed other supply chain vulnerabilities. Some are arguing that 2020 will put a permanent nail in the coffin for globalization as a result.

Remember, however, that globalized supply chains developed for a very good reason: they were more cost effective. So the question is, has the economics changed, or will politics intervene?

Again, looking at the pre-virus trend is instructive. Disruptions to supply chains aren't new and have been regular features during strikes, natural or man-made disasters, but it's their combination with just-in-time inventory systems that can lead to cascading shutdowns. After a two-decade trend to leaner US inventories, the ratio of stockpiles to sales had been creeping up since 2005 (Chart 4), perhaps capturing the lower financing costs of carrying such inventories in a low interest rate era. Look for that shift to a less-stringent just-in-time system to continue.

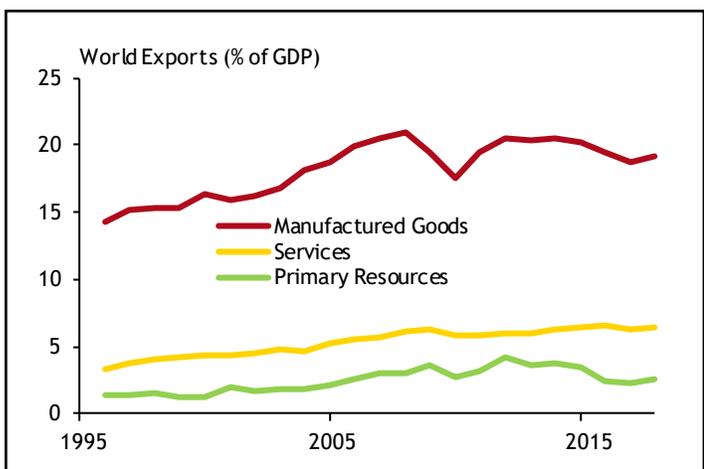
Some argue that the memories of this year's crisis will add to the caution in dealing with distant suppliers. But

Chart 4  
Trend To Lean Inventories Had Started To Reverse



Source: US Census Bureau, CIBC

Chart 5  
Globalization Had Plateaued For Good



Source: McKinsey & Company, CIBC

Chart 6  
Foreign Content in Exports Had Started To Decline



Source: OECD, CIBC

for items that can be stored and produced more cheaply abroad, higher local inventories could be more cost-effective than setting up local suppliers. As well, some of the disruptions in this crisis have been from more proximate suppliers. German automakers were shuttered when Italian parts makers, part of the EU trading bloc, got hit by Covid-19. Even before the virus hit, a US strike had furloughed production workers at GM in Canada due to the lack of key parts.

There were, however, other trends emerging prior to the virus that suggest that we may have seen the peak in globalization some time ago. Other than in services, the volume of trade had flattened out as a share of GDP since 2007 (Chart 5). And that actually reflected a movement away from disparate supply chains for OECD industries. The share of foreign value added within OECD exports has been in decline in the past few years, contributing to the deceleration in gross exports (Chart 6).

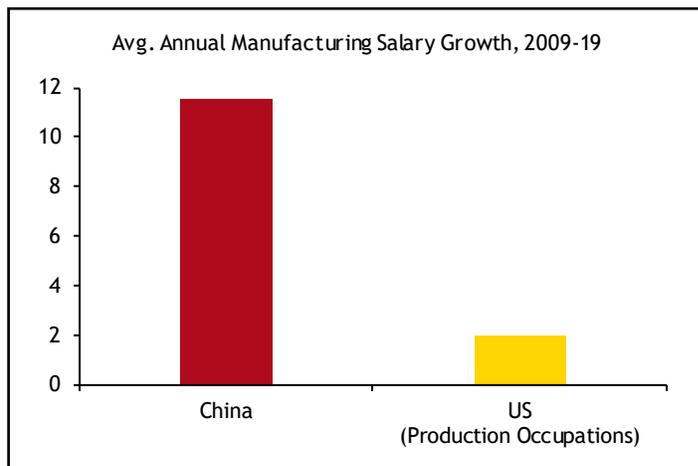
These trends could well persist in the post-virus world, and have nothing to do with the Covid-19 interregnum in world trade. They reflect increased mechanization in manufacturing, which in turn reduces the cost savings of operations in far flung low-wage countries. As well, some of globalization’s earlier winners, and specifically China, have been closing the wage gap versus more developed economies as its pay escalation has run well above that of the US in common currency terms (Chart 7).

But even if supply chains become less internationally linked, it’s worth remembering that components or raw materials used by domestic industry account for

a modest share of imports. Most of what crosses into the US and Canada are finished goods, either capital equipment or consumer products (Chart 8). There’s no reason to believe that this episode has radically changed relative competitiveness in such products. Low-end t-shirt manufacturing has about as much chance of returning to Canada as orange groves; US businesses aren’t going to abandon their assets in low-wage Mexico.

Still, as we saw in the 2019 China-US trade war, and earlier NAFTA uncertainties, politics can interfere with economics by distorting location decisions through trade barriers. While we’re not going to join into the “blame game,” there’s an evident political tide in the US, and

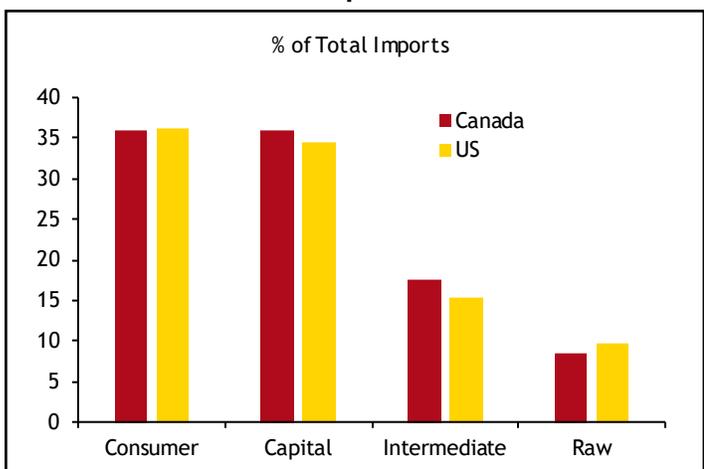
Chart 7  
Chinese Pay Rates Escalated in US Dollar Terms in The Last Decade



Source: BLS, China National Bureau of Statistics, CIBC

Chart 8

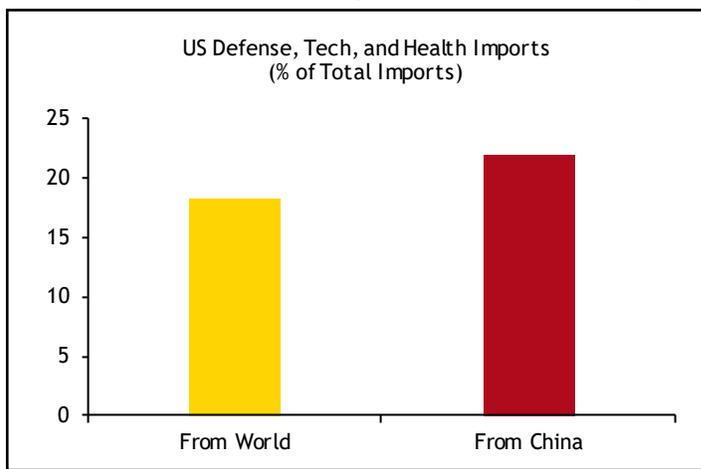
**Most Imports Are Finished Consumer or Capital Goods**



Source: WITS, CIBC

Chart 9

**Sensitive Sectors Made Up One-Fifth of US Imports**



Source: US Census Bureau, CIBC

perhaps even in the Canadian public, to blame China for not acting swiftly enough to prevent the spread of the virus beyond Hubei province. The current US administration has already threatened to rip up its newly signed trade deal with China in retaliation.

Most at risk would be items deemed to be sensitive from a national security or health perspective. Once again, this will be reinforcing a trend that had started pre-virus; in 2019 Canada and the US negotiated a pact designed to reduce their heavy reliance on China as a supplier of rare earths, some of which are used in electronics and military applications. All told, sensitive sectors like telecom equipment, military equipment and health goods account for one-fifth US imports from China (Chart 9). We expect these to be in the spotlight for goods that a future administration could seek to source elsewhere. Canada would hope to be part of a buy-North-America arrangement rather than a strict Buy-America stance in that regard.

Overall, then, by 2025, when this virus will have either run its course or been fended off by medical science, our lives, work and trade will share much more in common with how they looked in 2019 than the way they appear in 2020-21. Every major crisis, from the Great Depression, to World Wars, to the 2008 financial shock, left changes in their wake, and this one will too. But history and the concept of revealed preference suggest that these are more likely going to be in the direction of trends already underway, and perhaps not as earth shattering as those who want to write attention grabbing headlines are predicting.

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