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Disruption—The New Normal

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Dictionary definitions of "disruption" cast the term in a negative light, while the late Harvard Business School professor Clayton Christensen, in his seminal work *The Innovator's Dilemma*, applies "disruption" to the creation of new markets and value networks, shaking up the existing order. Airbnb's challenges to the hotel industry and Uber's and Lyft's to the taxi industry are prime examples.

As the world contends with the galloping spread of COVID-19, one is hard-pressed to identify which regions, communities, sectors, firms, and peoples have *not* been slammed by this plague. While there have been, and will continue to be, many major and far-reaching impacts of the Coronavirus worldwide, several merit special attention, as they are directly related to post-pandemic economic recovery.

First is the issue of globalization. In truth, COVID-19 is the very embodiment of globalization. But while the virus will dissipate, the worldwide movement of goods, services, capital and people will continue unabated despite economic contraction. (Global trade contraction in 2019 was less than 1%.). China's Belt and Road Initiative, post-Brexit cross-border investment within the EU, a revitalized North American trade agreement (USMCA), and ongoing intra-regional trade in Latin America and Asia are manifestations of the resilience of globalization.

Second, is the potential impact of globalization on the global financial system. Markets are likely to remain volatile in the near term, as the pandemic's ravaging effects continue to spread across regions. In the U.S. alone, the private sector appears to have shed more than 20 million jobs in April, bringing the unemployment rate to 15% or more from 3.5% only two months earlier.

Faced with such dire conditions, governments are going to be injecting record amounts of liquidity into the system, the U.S. Congressional Budget Office is already projecting that the annual budget deficit will quadruple by September, pushing debt to more than 100% of GDP.

The sharp increase in liquidity is going to generate significant distortions for the markets as investors are forced towards increased risk exposures to preserve their income targets. At the same time bankruptcies risk spiraling out of control, which means that we will be seeing bailouts that will be reviving the "too big to fail /moral hazard" debates of a decade earlier.

For equities it's going to be volatile for some time because revenue streams and, therefore, earnings are going to be upended as a result of the new normal environment. "Defensive" sectors like staples and utilities will be less affected, and tech will bounce back after a short period of turbulence. The

transportation and financial sectors are going to be hurting and in need of bailouts for some time to come. Surprisingly housing appears to be showing resilience, but that is likely because housing starts have tumbled much faster than the drop in demand.

For the bonds, the damage will, of course, be in the high-yield and junk markets, as defaults accelerate, widening the spread against treasuries. As for merger and acquisition activity, this will likely take off again after a period of "sit and wait" as the "variant" new normal change pushes firms to recalibrate and reposition themselves.

Next, there is the question of how companies will do business post-pandemic. While governments at all levels will need to reassess their policies on strategic stockpiling, a number of companies in critical sectors such as health care will need to diversify their supply chains. According to APQC (American Productivity & Quality Center), only thirty-one percent of companies have developed alternate sources of supply for 70% or more of their Tier 1 suppliers. There will be far greater reliance on contract workers and outsourcing and other measures to reduce overhead (for example, Zoom and WebEx in lieu of travel); and automation and wider use of technology will accelerate. To illustrate, many forwarders are leveraging technology to navigate the buying and selling terms between manufacturers and importers. The Israel-based software company All Forward launched in 2020, is a good example. They call themselves "the Zoom of freight forwarding" for their capability to bring quick visibility and interaction to worldwide partners. Regarding their customers, we can expect companies to prioritize areas of very profitable growth, adopt tactical pricing, segment markets, discount more than previously, and alter the product mix to reflect affordability—the value proposition will rule for the near future.

Finally, there is the issue of consumer behavior. When the pandemic dissipates one can expect surge in recreational activities, such as dining out and visiting shopping malls. Recreational activities will be enjoyed less frequently than pre-pandemic and be more affordable as well. There will be less leisure travel and far more likely to be domestic than international (shorter stays at lower hotel prices will be the norm). In terms of consumer finance, borrower priorities will center on paying down credit card debt and getting up to date on mortgage payments. Homeowners will opt for fixing up their existing dwellings rather than buying new ones. In higher education, students will increasingly opt for public vs. private universities and studying and living close to home, with online classes substituting more face- to-face ones.

Disruption is, indeed, the new normal. Therapeutics and vaccines are indispensable for mitigation and treatment of COVID-19, but they are not the most important catalysts and drivers of economic recovery and growth. Only governments--working both individually and collaboratively--and private enterprise can create a *newer* normal that will achieve that goal.

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