

Teneo Insights

Coronavirus Update: A Strained Global Economy

A discussion between Andrea Calise, Dr. Jerome Hauer, Kevin Kajiwara,
Oscar Wang and Gabriel Wildau.

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Kevin Kajiwara (KK): I'm Kevin Kajiwara, Co-President of Teneo's Political Risk Advisory business and the topic of today's call is the coronavirus (actually now designated COVID-19 by the World Health Organization) which has severely shaken global trade and supply chains.

Governments are also imposing worldwide travel restrictions and what we're seeing now is the International Energy Agency (IEA) analysis suggesting we will see a decline in oil demand this year for the first time in a decade. Thinking even further into the future, with the Olympics set to begin this summer, this is a very big concern for countries like Japan.

With that, I'd like to introduce my four colleagues who are going to be joining us on today's call. First, is my colleague Dr. Jerome Hauer; Jerry is a Senior Advisor with Teneo's Risk Advisory business segment. He's a leading expert in emergency response, emergency management and crisis planning.

We're also joined today by Oscar Wang; Oscar is a Managing Director with Teneo, and he is also the head of Teneo's Shanghai office. While most of our expat personnel have left China in anticipation of the Lunar New Year and are still unable to get back into

the country, Oscar is still on the ground in Shanghai.

We're also joined by Gabe Wildau; Gabe is the senior China analyst for Teneo's Political Risk Advisory business and formerly was the Shanghai bureau chief of *The Financial Times*.

Finally, we're joined by Andrea Calise; Andrea is a Senior Managing Director and the head of the investor relations division within Teneo.

I want to start with Jerry and I want to start with where we are, what we know, what we don't know, and the latest data. I'd also like to talk about the changes to methodology that we're seeing out of China and whether that makes sense to you.

Dr. Jerome Hauer (JH): Let me start by giving you the latest data; as of this morning, there's about 60,000 cases, roughly 59,000 of those are in Mainland China and 48,200 cases are in the Hubei Province.

Right now, they're estimating that of the 1,360 deaths, 1,310 of those are in Hubei. They're also looking at about 2,500 severe cases, and about 6,000 recovered – of the recovered 3,400 are in Hubei. Unfortunately, Japan with 28 cases, reported its first death overnight.



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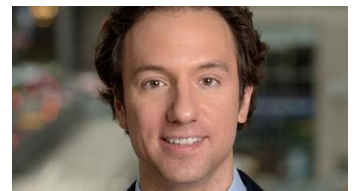
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Let me give you a little perspective on what these numbers mean: Clearly, there's been no drop-off in cases. The number of cases continues to grow, and we really don't understand the scope of the outbreak at this point in time. The Chinese are overwhelmed, and data collection is an issue.

The change in the counts for cases and deaths overnight were a result of the Chinese deciding to use clinical data definitions for confirmation instead of confirming every case by laboratory. So, they're looking at patients clinically and identifying them as a case rather than confirming by laboratory. So that's part of the reason we've seen this significant jump (about 15,000) in the number of cases.

Part of the problem is we don't have a great handle on the number of cases, the case fatality rate, or the number of deaths because the Chinese are overwhelmed. We don't know at this point in time what the potential for continued spread is. We don't understand at this point whether the quarantine is working. We simply don't know because the information coming out of China is not very accurate.

There has never been a quarantine in history of 50 million people, so it's going to be extremely hard to determine if this quarantine is in fact working. Further, the jump in the number of deaths is confounding our ability to really get a sense as to what the numbers are.

I think that the measures put in place by other countries need to be stringent, and I think they are working aggressively to put those measures in place. There should really be a policy of 'no regrets' and I'll talk about that when I get to the U.S.

'No regrets' means you over respond rather than under respond. You will never be criticized for over responding, but criticism will be significant if you choose to ignore it. If

you under respond, you're not prepared with the information we have at hand.

Let me talk a little about the U.S. response; at this point in time, the U.S. response is being led by The Department of Health and Human Services, where I worked some years ago. The Centers for Disease Control and Prevention (CDC) is involved in overseeing a good part of the response and the National Institutes of Health are working on identifying or sequencing the virus and trying to develop a vaccine. The U.S. has taken an aggressive attitude that has allowed the government to coordinate a proactive response and, at this point in time, minimize the potential infections here in the U.S.

People also ask me if this will become pandemic. First of all, let me talk about what a pandemic is versus an epidemic. An epidemic tends to be an outbreak that's very localized. It's localized in one country or small region. A pandemic is when an outbreak or a disease spreads to multiple regions. The World Health Organization's (WHO) definition of a pandemic is an epidemic with worldwide spread. The CDC here in the U.S. is a lot more aggressive in their definition of a pandemic and they look at it as a spread throughout different regions.

Let me turn now to the case fatality rate. First, the incubation period appears to be about five days. The case fatality rate, meaning the number of cases that dies as a result of the disease, is roughly 2.3% to 2.7%. I'll put that in perspective; for Severe Acute Respiratory Syndrome (SARS) it was 10% and for the current Middle Eastern respiratory virus, it's about 34%. Again, part of the problem we've got is that the denominator is really not known at this point. It could be 50,000, it could be 60,000, it could be 80,000.

Because the Chinese are overwhelmed, the reporting

is not accurate. The greater the denominator, the more the case fatality rate is going to go down. So, at this point in time there's a lot we don't know. What we do know, and this is very clear at this point, is that the potential for human to human transmission is very clear. We've seen that overseas, and we're seeing it clearly in China and the regions around China.

A potential vaccine is probably still 10 to 18 months out. Vaccines are not easy to develop. There is some indication that it could be sooner, but we're being very conservative in the estimate. There are antivirals such as Tamiflu used for everyday flu; there is currently a different antiviral being tested in China and they're testing it to see if it can reduce the severity of the disease or reduce the number of deaths, but we may not have an answer to that for quite some time.

KK: You mentioned the recoveries and from your perspective, is there a standard by which we're defining someone who has recovered?

JH: I don't think we have a good answer to that. I don't know whether it's people that they've seen that have had the virus with mild symptoms that wind up recovering, so to speak, or if it's people discharged from hospitals. It's really not clear what a recovered patient is at this point in time.

KK: Now, you've also given us a lot of the top line numbers here. However, the picture looks significantly different if you isolate Hubei Province and Wuhan. You mentioned we've had over 1,300 deaths at this point and over 1,000 of those are in the Hubei Province. The next largest province by death rate in China has had 8 deaths so far. So, is there any understanding that the response may have been slow and inadequate at the start of this outbreak? Is it fair to say that China has actually been effective at walling off Hubei Province?

JH: It's quite possible Kevin, but it's really too early to tell.

KK: I know that a lot of our listeners today are confounded by all of this conflicting information. They are having to make corporate decisions. They are having to make decisions on personnel travel, on their supply chain, etc. So, what are you really watching to indicate whether things are improving, or whether they're deteriorating? And who should our clients and listeners be listening to out there with all the noise? Who do you think are the voices that they really ought to be paying attention to as they as they contemplate their decision-making process?

JH: First of all, when I look at the data, what I'm watching for is a kind of levelling off. The confusion overnight though, with this artificial jump in cases, has really affected our ability to try to understand the trajectory of this outbreak.

So, what I'm going to be looking for is to see some kind of levelling off, and then hoping for a reduction in number of cases. Some of these viruses are weather-warmed and they tend to drop off. At this point in time, we're not seeing anything that indicates this virus is going to drop off. In fact, there is concern about a continued escalation. One of the questions I've been asked is the potential for something here in the United States. Tony Fauci, who leads The National Institute of Allergy and Infectious Diseases feels that this is going to turn into a pandemic. So, while there's no reason for alarm in the United States, the possibility of additional cases is real.

KK: I know you've known Tony Fauci for a very long time and it's important to note that that he does not speak in a hyperbolic manner.

One last question I want to ask you before we move on; what are the key protocols that ought to be followed for companies?

JH: The most important thing is to seek medical care, but we recommend calling ahead before you go into a hospital or a health care setting. Put a mask on so you don't spread it. Seek medical care, and they will then report it to the public health doctors.

That's what we're recommending here in the U.S. We're recommending people in the U.S. call an ER or call a health care facility. Let them know you're coming in, put a mask on, get to the facility, and they will notify the local health department in the U.S.

KK: Now, let me move on to Oscar Wang on the line from Shanghai. Oscar, my question is how life is going on in China. What are the direct consequences of the measures that have been implemented by the Chinese government, not just on business life, but also in terms of access to food and medicine? And what is the current general public sentiment?

Oscar Wang (OW): I think that the situation in Wuhan and the Hubei Province is quite different from the situation in the rest of the country. In places like Beijing and Shenzhen there have been some harsh times for everyone, but not to the extremes that we are seeing in the Wuhan and Hubei Province.

As an individual living in Shanghai, most of the direct impacts are coming from measures and restrictions imposed by the local governments to control the spread of the virus in residential areas and in office buildings.

For example, the residential community I live in has checkpoints with guards taking and recording your

temperature and the office buildings are quite the same. Our office building reopened earlier this week and you cannot get into the building unless you apply for permission beforehand and report your itinerary over the past fourteen days.

I was actually trying to get back to the office on Monday to pick up some stuff and I was kicked out of the building by the guards because I didn't get permission. So, there's a lot of disruption of daily life and you can see that the government has conducted a series of aggressive measures in a short period of time. To a certain level it does work, and the people here are very proactive in taking protective initiatives, and there is a high demand for information and updates from the different channels on virus control.

There are definitely less people on the street for sure (even on working days) but you can really see that the economic disruption is caused by these measures and peoples' anxieties. The service industry took the biggest hit - transportation and hospitality for example. You cannot, for example, find any fine dining restaurants open, as probably 8 out of 10 of them are closed in Shanghai. Secondary industries, like industrial construction, were also hit very hard.

The supply of food and medicine is quite sufficient. So that is the situations with us here in Shanghai, and it's probably very similar in Beijing and Shenzhen.

KK: I think a lot of companies are in a situation similar to Teneo, in that their expat personnel within China had left on holiday in anticipation of the Lunar New Year and now are having trouble getting back in, or haven't been given the green light to go back in. Nonetheless, we still have large numbers of Chinese nationals employees who are working even if they're working from home. What is the proper response for

multinationals if their employees are infected in China right now?

OW: So, I think this is especially important for multinationals if their employees get infections that have been identified. Most of the companies that I see have encouraged their employees to work from home and go see a doctor right away. That is the basic response taken by most of these multinationals.

KK: Gabe, I want to turn to you now. There was a lot of anticipation coming into this week, particularly since the quarantine of Hubei Province had begun. What was the trajectory of infections?

And the other thing was that the economy was supposed to be jump-started this week. Now, we've seen the national policy, but there have been regional and local policies that are somewhat different, and on top of that, there's just the simple logistics of getting people back to their homes, and therefore being able to go back to work.

What's your assessment right now of the state of economic activity in China? I know it's different around the country so it's difficult to give a definitive response here, but what are you seeing?

Gabriel Wildau (GW): Well, as you mentioned, Monday was officially the first return to workday after this extended holiday where we had 11 missed workdays on top of the usual Lunar New Year. But what we're seeing is that in reality, the return to work is going to take some time, and it's going to be quite gradual. This is related in large part to the issue of migrant workers who, in many cases, are not able to return to the cities where they work because of transport bottlenecks, or if they have returned, they are subject to quarantine.

We've really seen a kind of lurching from what was arguably an under reaction initially with Wuhan officials, who were perhaps not taking the situation seriously enough, to what may now be an overreaction, where you have the full surveillance mechanisms of the Communist Party mobilized towards tracking migrant workers who've returned to big cities from anywhere, particularly if they've been to Hubei Province.

So, workers are in some cases locked in their homes and unable to return to work. The economic impact of that is that factories that maybe have permission to restart are still not able to do so because they lack the workers. We're also seeing local governments imposing kind of a phased return to work schedule, where local employees (that is people that are local to that city and never left during the holidays) are able to restart work, but migratory workers are not there. They have to wait for fourteen days after coming back.

Now of course, anyone from Hubei Province is going to be subjected to even heavier restrictions. It is hard to quantify the extent of economic disruption, but there are a few big data type of analyses that I've seen that are an attempt to do this.

The so-called Baidu Migration Index is drawn from the Baidu Map app, and it allows a comparison between this same day last year and this year in terms of how many people have returned from their Lunar New Year holiday. By February 9th last year, more than 70% of people had returned from the Lunar New Year Holiday. On February 9th of this year, only 18% of employees had returned. So that data gives us a sense of the disruption.

There's another analysis from another map app that attempts to measure traffic on streets and how much activity there is on the streets, where a higher number means that there's a lot of traffic and a lower number means there's a free-flow traffic.

Normally for an index of a group of hundred cities at this time, you see at 1.5 to 1.6, but now we're sitting at about 1.1. All of that means that there's very little traffic on the streets. These ratings were from February 10th, but we're now starting to see that the government is getting concerned about the economic disruption. The President told the Politburo Standing Committee meeting on February 3rd that some of the containment efforts had gone too far and that there was a threat to the economy. He asked leaders to ease up on some of the most restrictive measures. So now we're starting to see that order filter down to local governments.

But the big picture is that the return to work is going to take time, and even companies that are allowed to return to work are suffering from not only labor shortage, but also supply shortages upstream. Their suppliers can't give them the goods they need to start work again. There's also this issue of the mask requirements, where factories are allowed to reopen, but only if they have two masks per worker, per day. Obviously, there's a shortage of mask and so companies are constrained by that.

Then there are the logistical bottlenecks. So, even if you have supplies and you're able to produce your own goods, you can't ship those goods to your customers. So, it's a bit of a mess, and the situation is different in every province, but the big picture is that we're very far from a return to normalcy at this point. And as you mentioned at the very beginning, these issues are now starting to take effect outside of China, with one of the most dramatic examples of this being

the cancellation of the Mobile World Congress, which was mainly because they were expecting a huge inflow of Chinese participants to that conference. There could have been a political issue there, with other attendees being uncomfortable with Chinese people coming in, even if these were people who probably had no contact with the virus. We can probably expect to see a bit more of this type of reaction in terms of international events.

KK: I want to get to the politics here in just a second, but first a couple of quick questions. I think one thing that has gotten hidden in all of this top line economic news that you're talking about, is that certain industries, particularly those that are mission critical, have not been shut down. In the semiconductor space for example, we've seen many of these factories, even factories within Hubei Province, continue to operate throughout the crisis. We've seen these reports from Reuters, but are you seeing that as well?

GW: The factories that are part of strategic objectives in terms of technology have been given special permission to basically operate straight through or to return to work early. Tesla has said that they've been able to reopen, Foxconn, the contract supplier for Apple, has also been able to reopen, although they are still facing labor shortages.

But it really is the small and medium sized enterprises that are taking it the worst. If we think about something like semiconductors, it is not a labor-intensive industry.

It's really the labor-intensive industries that are getting hit the worst. What we've traditionally thought of as the 'made in China' industry is the kind of apparel, footwear, toys, furniture and consumer goods that are most labor intensive and are therefore getting hit the hardest.

KK: What about the impact with regard to China's ability to comply with the phase one trade deal? Is there accommodative noise coming out of Washington with regards to the purchases or other trade commitments, or the deferral thereof, of the trade deal?

GW: Well, it's very early to say. Here's the way I'm looking at it. Officially, the trade deal only took effect within the last 10 days, so there's a chance things could return to normal before there's any significant impact. In terms of Washington's willingness to be flexible, what I'm hearing is that President Trump mostly cares about the bilateral trade deficit.

Therefore, if we see a slowdown in Chinese exports to the U.S., then I think the Trump administration will be willing to accept fewer U.S. imports to China. However, if Chinese exports to the U.S. continue to be very strong, then Trump will not consider the virus to be an excuse for China slowing down imports of U.S. goods.

KK: I want to move on now to the big political picture. You know Xi Jinping has sort of disappeared from public view for a while. I know he re-emerged earlier this week, and there has been considerable (and unusual for China) social media outcry, particularly centered around the now martyred doctor who had given the initial alert on this outbreak. Do you see any building risks to the Chinese government?

GW: In the short term, I don't see much risk. There has been speculation in the media about the impact on the Communist Party's legitimacy, and I would just highlight that this is a very serious issue. There's been a highly unusual outpouring of politicized anger on social media that the sensors have struggled to deal with.

But this isn't the first incident like this. We can think

about the Sichuan earthquake in 2008, where there was a lot of anger about the shoddy construction of schools. And also, with the 2011 high-speed train derailment, and the 2015 the chemical plant explosion, there were similar reactions and similar speculation after those disasters that they would erode legitimacy. We didn't see a major impact in terms of Xi personally, and I think Xi's also safe in the short term. However, this virus is the latest in a string of challenges that Xi has faced, adding on to the trade war, the slowing economy, protests in Hong Kong and the elections in Taiwan.

In the medium term, especially if virus gets a lot worse, and the depth and disruption spreads significantly beyond Hubei, then you could imagine that this could hurt Xi's ability to secure a third term as General Secretary beginning in 2022. His opponents would have the ammunition to try to challenge him.

So, while I certainly don't see any prospect of him being unseated in the near term, this could weaken him in the medium term. There are already people who Xi's alienated through his anti-corruption campaign who are looking for an excuse to try to weaken him.

KK: I want to turn now to Andrea Calise here in New York because we've heard a lot of analysis and commentary from our other colleagues, but obviously where the rubber hits the road as far as the people on our call today are concerned is, in addition to corporate action, is corporate communication around those actions.

So, Andrea, can you give us a sense of not only what you're hearing, but also what you are generally advising, understanding that different industries and different companies have different types of exposure to China and to the ripple effect economically around the world? But in general, what are best practices for C-suite members

addressing this issue on earnings calls and the like?

Andrea Calise (AC): We've been working with dozens of CEOs on their tailored communications plans regarding coronavirus and I think the first communications priority for our clients has been to serve and support the health and safety of their employees, and let stakeholders know that they're working with their customers to avoid this business disruption whenever possible. For many clients, this has included implementing travel bans on non-critical travel; for consumer-facing clients, shutting down businesses in the region as needed. Many companies are also highlighting their giving efforts and what they're doing to help the area.

For our clients in the middle of earnings season here, it's been a little bit easier for those that reported earlier and is becoming increasingly complex as the outbreak escalate in how they communicate and as information comes in. The key is really to be transparent regarding the impact when they have little information.

It's also really critical to not let coronavirus completely consume your narrative, and your investor sentiment. We certainly recommend that companies proactively address coronavirus in their prepared remarks and be prepared to manage detail questions on their Q&A, but the key again is to not let it overtake completely your narrative and your long-term message.

In terms of messaging, I think in the beginning people were able to not say too much other than that they're monitoring it closely. But at this point, companies need to be transparent in terms of the impact on their supply chain, on their production, and logistics. It's also important that companies explain the size and

scale of their business in the region and what their business continuity and mitigation plans are. Diversification and highlighting the diversification of their businesses is also proving to be an important element.

We're seeing some companies refer to SARS and the impact that SARS had on their business. How these companies were able to recover from the financial crisis is another example that people are using to lend assurance that their company can manage a major crisis and bounce back.

An important element of communication for some companies includes talking about how they're ramping up production of products that actually address the outbreak and this is an important element of telling the investor story as well. Increasingly we're seeing people put numbers and attribute numbers to what they're saying. This includes specific numbers on Q1, and what to expect. We're seeing a lot of companies beginning to widen their fiscal year forecast and I think for most companies that have the visibility, this level of transparency really does help build their credibility.

Question - Caller 1: This question goes to Dr. Hauer. You mentioned before that there is no sign yet of a reduction in the number of cases. Can you elaborate on that a little bit? Because if we follow the official data respective of this jump we had today because of the new methodology, then there actually already seems to a slowdown happening.

JH: Yeah, we started to see a trend of levelling off. I'm not sure what that means at this point. We've seen some leveling off early on, and then the number jumped. So, I think it's too early to tell whether we're seeing a real levelling off, or reduction in cases. I think we need a little more time for this artificial bump to

work its way through, and then we'll be able to see what's happened with leveling off.

Question - Caller 2: I just had a quick question regarding the future state of countries outside of Asia, potentially imposing similar travel restrictions, in comparison to what is being imposed in mainland China.

JH: I think there's been a very aggressive response by governments around the world. Our biggest concern is underdeveloped nations and their inability to respond because of the lack of public health infrastructure. But those countries in Europe and South America, etc. are being very aggressive with their travel restrictions and I think at this point in the outbreak, that's a very reasonable response.

Question - Caller 3: My question is in regards to the political viewpoint. How do you view the measures that the Chinese government will take to restart or recover the economy, like decrease interest rates or help the small businesses on their own?

GW: We've already seen Chinese policymakers announce stimulus measures, and I expect to see more. What we've seen so far has primarily been liquidity injections into the banking system, and also instructions to banks to provide special loans and support the affected businesses.

There was a report that there's already been about 300 billion Renminbi worth of those special requests. I think the bulk of this special support is going to go to the small and medium-sized enterprises which were the hardest hit, but among this tranche of 300 billion, it did also include some very large companies such as Didi Chuxing, the Uber equivalent to transport in China.

I expect fiscal policy to kick in at the National People's Congress in March (which could be subject to a delay). That is when the fiscal deficit target is normally announced; last year the official target was 2.8%. That could be raised to 3% or even 3.5% this year as part of the effort to respond. I think we're also going to see some targeted measures for specific industries like the medical supply chain factories and the logistics industry, which has been so, so heavily hit by the travel restrictions. They will receive some targeted help as well, I expect.

So those are some of the economic response measures that I expect to see in addition to monetary policy interest rate cuts, as well. I expect the loan prime rate, which is now the main benchmark interest rate for corporate loans, to be to be lowered by perhaps 15 basis points during the next monthly review on the 20th of this month.

Question – Caller 4: What is the social media view on how the government has been handling this crisis and the new classification methodologies being used to spot and resolve cases? Have you seen any kind of reaction to that on social media? I heard from a colleague today that it was actually greeted with a bit of a relief insofar as people thought that the reported numbers we're getting closer to the actual numbers.

GW: I haven't seen the social media that mostly would have occurred while I was asleep, overnight. But what we have seen is a lot of heart-breaking and poignant coverage out of Hubei Province over the last several weeks, including from sort of amateur citizen journalists.

So, I think everyone who was monitoring it on social media (and this showed up in my own WeChat moments quite clearly) people knew that the situation

was very severe. In particular, they knew that there weren't enough test kits and that people were being refused entry to hospitals because there just wasn't capacity.

And so, I don't think this spike will come as a shock, and it may be welcomed as an acknowledgement of reality. The fact that there were many more infections than what the official stats show will not be a surprise to anyone who's been following the reports coming to us from the Hubei Province about the overwhelmed health system.

OW: Let me just add one additional point regarding social media and the information. Overall, if you look at the social medias in China, particularly within the Weibo and WeChat platforms, there is an information overload and it will be really hard for individuals or corporations to find out what's the truth and what the key discussions are regarding the issue. It is very clear that the government is trying very hard to control the information flow.

So, there are those heart-breaking stories, and of course the government's trying to push the positive stories out at the same time. There will be a bunch of sad stories and then another set of positive stories focused on doctors who are fighting the virus, for example.

Question – Caller 5: I'm just wondering if someone's had the virus, are they susceptible to getting it again? And my second question is, if there's a five-day gestation period, why is everyone going for 14-day quarantine?

JH: One of the reasons they're going for a 14-day quarantine is we really did not have good information about the incubation period. They're being overly cautious, because there's a range in incubation

Periods. For some it might be shorter, for some it might be longer. The average is about five days at this point. The second question about getting the virus again, that's one of the big unknowns at this point.



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