Rathbones
Look forward

Review of the Week

18 May 2020

The most important resource

Our kids are going to lead us out of lockdown, as the government makes some tough decisions. Chief investment officer Julian Chillingworth looks at the tracking programme that will accompany the back-to-school drive.

A phased reopening of schools is due to start next month. This is bound to be an emotive move. Children are our most precious resource and also the least able to avoid hugging long-lost friends on sight.

Yet data shows youngsters are least susceptible to the virus and potentially spread it less than their elders (the data gets a bit thinner here though). Finally, and perhaps most importantly, the damage to their development from enforced isolation and reduced education is real and backed up by stacks of data. Fears of the virus today are completely valid, yet those concerns should be weighed against the real and insidious damage that each month of lockdown does to our children's brains and emotional health. Unfortunately, there are no easy decisions in a pandemic.

The government is dovetailing the reopening of schools with a new virus-tracking system. Centred on the NHS's track and trace app, which is being trialed on the Isle of Wight, the system will allow Brits to log their symptoms and notify anyone they've come into contact with that they may have been infected. It works by registering when one phone comes close to another by using the Bluetooth network technology on mobiles. The app works anonymously to prevent privacy complications, i.e. every phone is known only as a number, rather than connecting to an identity. This system has two main requirements to be successful: first, most people in the UK will need to download the app; second, there needs to be a strong contingent of tracers to follow up on the data that the app will provide.

Cabinet Office Minister Michael Gove says the government is on course to enlist 18,000 tracers by the end of May and they will be working alongside the army. Yet with the NHS's app preparing to go live Nationwide in the coming weeks, just 1,500 tracers have been signed on so far. All that contact and tracing data will be useless if there aren't enough staff to act on it.

Meanwhile, more than 100 vaccines are currently in development around the world. Just shy of a tenth of them have started human testing. With a spot of luck, one of them will prove successful. If so, then it's on to the next herculean challenge: making enough of the vaccine for the entire world. Typically, this is a chokepoint for pharmaceutical companies. You've already sunk a lot of money into researching a vaccine with a high chance of coming to nothing. And, to ensure that you can manufacture enough of the vaccine in the quickest possible time, you have to start building massive production facilities *before you even know if it will work*. You can understand why companies would typically balk at this. However, many pharma companies have banded together and agreed to use the laboratories to scale up partners' vaccines should they work. This sharing of risk allows companies to invest more in vaccine production – and, crucially, earlier. UK-based drugs giant AstraZeneca is poised to churn out 30 million doses by September if its trial in Oxford is successful.

Plus ça change

Chinese industrial production bounced back in April. Iron ore price jumps back to $90 a tonne on Chinese demand, a welcome ray of good news.

There are still concerns that relations between the US and China will worsen and upend the two nations' recoveries. Yet, the two countries have been bickering for years now without going completely down the tubes. Are the

chances of them doing severe and mutual damage to each other really any higher now they have bigger problems battling the pandemic? Sure, President Donald Trump may shoot for political points ahead of November's election by asking China to pay reparations for the virus fallout or some such thing, but that's a precarious road. It could end up taking the American economy down along with the Sino-US trade relationship.

US Federal Reserve (Fed) Chair Jay Powell gave a sombre assessment of the US economy as lockdowns were eased across a number of states. He expects the recovery to be slower than many optimistic forecasters have been touting. Given the sheer number of unemployed, it will take some time to get people back to work, he warns. He urged Congress to agree even greater fiscal stimulus, giving impetus to a $3 trillion package the Democrat-controlled House of Representatives has passed. It is now before the Republican-led Senate. Mr Powell's downbeat speech dampened stock market enthusiasm and sent American and European indices lower. As did very weak US economic data: American retail sales fell 16% in April, a larger drop than analysts had expected.

As breathtaking as such drops in economic data are, it was no secret that the US had shuttered its main streets. Essentially proscribing face-to-face commerce is unprecedented. Economists' forecasts were always going to be shots in the dark. Economic data was always going to be phenomenally bad during the pandemic lockdown. You have to keep in your mind that this drop in commerce is the *intention* of government responses. They are trying to shut down society to stop the spread of the virus. Lower GDP and retail sales and industrial output simply show that this is working. Rather than focusing on these numbers, we think you should be focusing on the efficacy of governments' pandemic support programmes for households and businesses, and the reduction in the rates of virus infection and deaths.

There is of course another thing to keep in mind during these strange times: the strain on government finances. The longer the lockdowns and restrictions go on for, the less taxes governments will collect and the more cheques that they have to mail out to the hard-up. This means much higher government borrowing. We have explained why higher debt isn't necessarily a bad thing for a nation. As long as the debt is productive, a country can typically keep jacking up its debt. That means the money is used to improve infrastructure, increasing the amount of GDP that can be turned out for every £1 of capital invested and every person put to work. Money spent keeping households and businesses above water may also be considered productive borrowing, if it prevents people from falling into long bouts of unemployment that blunt their skills (economists call this wasted human capital). Such investments would mean that when the debts come due, the economy is larger relative to the debt, making the borrowing sustainable rather than crippling.

But these calculations can get very complex when you take into account expectations of inflation and the cost of borrowing. Those calculations must also include the effects of Brexit, which is virtually guaranteed to increase the cost of imports for people and companies, make UK businesses less efficient, and therefore decrease the productivity of the UK. With the June-end deadline for extending Brexit beyond the end of the year looming, debt issued today is looking less sustainable in five and 10 years' time. So investors are selling British assets, thereby sending the pound sinking. Over the past month, sterling was the worst-performing currency of the G10 group of large developed nations. The pound has lost about 10% of its value against the dollar and the yen since the beginning of the year. At one point in mid-March, it had fallen almost 15%. Will the government charge on with Brexit regardless of the terrible economic situation?

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