Lonnie Frisby: Welcome back to Navigating Business. I'm Lonnie Frisby, Head of Communication for Commercial Banking in Asia-Pacific. And this week I'm joined again by Frederic Neumann, Co-head of Asian Economics with HSBC Global Research. In this episode, we'll again be discussing the medium and long-term economic outlook across the selection of sectors hardest hit in the current environment including tourism, apparel textile and manufacturing with a focus on automotive.

In the last episode, we examined three sectors; technology, healthcare and education. And today's like to be a slightly less positive story. Starting first with tourism & hospitality. Now it's been months since most people traveled for work or holidays and this is at a severe impact on the tourism sector. Fred, once those restrictions are lifted, when can we expect traveler's confidence to return? And do you think there's going to be a strong rebound and when it does happen, which markets are likely to recover most quickly?

Frederic Neumann: So you're right I think to say that tourism & hospitality is one of the most impacted sectors certain in the global scale. In terms of the prospects for rebound, you might see kind of the initial bounce as their first wave of pent-up travel is being digested, people have seen their loved ones across the world, urgent business travel that needs to be done.

But beyond that, it's probably a sector comes back more slowly because firstly, because of confidence among travelers about worries about perhaps contracting the disease and in different countries, but also because of the risk of lingering regulations, so likely countries will lift inward quarantine restrictions to last before they lift other lockdown restrictions. So travel within countries might actually come back much earlier before international travel, just because of the restrictions that will likely remain in place.

Now there are also some requirements I think to really get confidence back up and one would be a very efficient testing regime, for example tracing regime or testing, particularly when you get on the flights knowing that you have tested negative that your fellow passengers are negative and also at the arriving end when you get to countries to convince them that two-week quarantine is not necessary, all these things probably have to be in place. And it's probably very difficult to scale that up, that ability to the mass travel that we've seen in the past.

So the initial wave is going to be a more limited number of people you can really squeeze through these testing operations to the airports before you get back to millions of passengers coming through airports. So it's going to be more of a domestic story first and then international travel, one of the last legs to fully recover.

Lonnie Frisby: So have you seen any signs of recovery for the hospitality industry in any markets in Asia?

Frederic Neumann: So when it comes to local hospitality, you do see that and you see after months of being locked up for many people, there's a natural desire to go out to have a drink, to go to restaurants again. So in areas where you see lockdowns being removed after considerable time, there is actually a natural snapback, if you will first I have to get it out of my system. The problem a little bit is that in different countries, you have different levels of confidence in terms of whether the disease has been contained and so in places in East Asia in particular where there's been very efficient testing and tracing regimes, the government's been very proactive where the share of the infections as a share of population is extremely low relative to the West. Confidence is likely to come back very quickly. You see that in Hong Kong for example, but I would include Australia, New Zealand in there, Japan, Korea, China, Vietnam has done an outstanding job. Thailand, Malaysia, Philippines, all these economies have done actually quite well.

Where you might see that confidence to be much slower to return is in places where the government response has been less sufficient and where the penetration rate of the virus within the population and so its reservoir is much higher and that includes actually most of Europe, the US, and parts of Latin American and South Asia.

Lonnie Frisby: So looking to the outlook for the future, do you see any fundamental changes that are going to reshape the industry?

Frederic Neumann: So on the travel side, I do think there is an innate desire among all of us to explore the world and so I wouldn't expect those desired for international travel to have this as a permanent feature of the future. It may take some time to get confidence back up maybe a couple of years and then much depends on our ability to develop vaccines and treatments for this. But I would say in five years, we're probably back to a pretty busy travel season because that's the way you know the world works.

So that’s certainly a prospect medium-term prospect, is still relatively promising, where it changes the industry in some ways, is probably a greater emphasis on perhaps social distancing, reliability of hygiene standards making sure that certain minimum standards are met, that includes for example, cruise ships where you could see that comeback but possibly with slightly different protocols on board, maybe for your passengers, maybe different types of cabins, may be different just procedures, in general that would not just only prevent the spread of the virus, but also it still the confidence among the travellers that actually they're in safe hands.

Lonnie Frisby: So it's quite a complex picture ahead.

What about the textiles and ready-made garments sector? As sourcing countries slowly resume operations, the uptick in demand is obviously going to take longer. How has COVID-19 impacted the economic growth and output for these countries?

Frederic Neumann: So garments and apparel probably is among the top two or three sectors being hit. The collapse in clothing sales has been astonishing. Just to give you a sense in the US on some measures, we have a clothing sales fell to a 40 year low in the US, which is you know given population growth and the growth economies an astonishing number. What happens then after lockdown ends, you get a very strong bounce because there is pent up demand. People do want to refresh their looks, they want to go out and spend a little bit. And so in the US, you saw a 180% increase in clothing sales in the month after that lockdown, that's enormous jump but even that puts us about 30 years, that's the 30-year low. We moved from 40-year low to a 30-year low.

So that shows you really the challenge of getting back. Now we will obviously recoup the losses that will take some time. That's one thing. The other two things I would say about the garment industry in particular, one is that the type of garments being demanded is changing. So there is a change in the type of clothing that people buy. Leisurewear is much more in demand right now than formal wear and that might actually be a lasting feature because the office life as we know it is no longer really present. Another thing that has changed is that the channels of purchases are changing. So a lot of people have become more comfortable with online shopping and very likely there'll be a permanent effect on a bigger proportion of garments being bought through online channels rather than physical channels.

Now in terms of the countries benefiting from this to have large garment industries you know in Asia we've seen the likes of Bangladesh do extremely well, Sri Lanka, Cambodia have gained market share, Vietnam still to some extent, even though Vietnam also scanning in electronics. And that has largely come at the expense of China where labor costs have now increased quite a bit. There has been some talk in the garment industry about moving some production back into the US and back into Europe because the move to its online shopping accelerates the turnaround time that you need and so you can satisfy demand more quickly, but that may only affect a certain segment. Mass garments are likely still going to be produced in the economy as I just mentioned,

Lonnie Frisby: You mentioned online sales, but even though online apparel sales have increased. There's been a 50% decline in global clothing demand. Could the upheaval from the pandemic cause a real reshaping of this industry?

Frederic Neumann: It could, yes. So I think we've seen very far-flung producers actually. So we have perhaps on the brand side you know a few major brands but in terms of production side, it is actually fairly widely distributed across countries and different niche players. What such a big decline in demand really implies is that we have to accelerate efficiency. That's just as a natural way things work in a big recession. And one trend might be consolidation that you see industry players coming together and forming larger operations.

You might see consolidation in the sense that certain countries specialize even more in certain types of garments. So knitwear in one country, sportswear in another one, shoes in the third one, just to exploit more economies of scale. So those all consolidation is probably one way to think about the reshaping of it.

And the other one, I think is that there's going to be because of the greater digitization of the retail channel, greater demand on a much more efficient logistics supply line, a faster one, and that could conceivably give some advantage to McKinsey closer to the big consumer market. So you might think of some economies in Eastern Europe or North Africa maybe being a preferred place to supply Europe than say a far eastern one because of the proximity. So those are changes, it's very difficult to predict at this point because of the industry pro segment has been so traumatized by the collapse but probably those are some of the trends I think that will crystallize of the coming quarters.

Lonnie Frisby: Now Fred the global automotive industry has been really hard hit by the pandemic especially when China which is the world's leading source for components and car sales went into lockdown. So as China's manufacturing slowly returns, I guess a couple of things when can we expect demand to increase? And how long do you think it will take for the industry as a whole to recover?

Frederic Neumann: Well, that's right. The industry has been in a very tough spot and it has been a tough spot not just because of COVID-19 but it actually has been a bit of a tough spot before. So there were global changes afoot in the last few years that meant really we had an overcapacity in car production and a lack of demand including in China which is by far in a way the world's largest car market. But even in other economies, young people were no longer eager to buy cars.

You see car-sharing coming through, you see greater reliance on public transportation. In some countries, public transportation has been made free actually to encourage you know the use of public transportation. That has structurally reduced car demand and COVID-19 came along and it obviously decimated not just production but also sales. In terms of the production capacity, we saw a very quick ability to recoup the losses.

So despite this being one of the most integrated global industries and therefore very vulnerable from production shutdowns in some corners, the industry has been extremely resilient and quick on its feet to rectify these disruptions and is back to essentially full capacity mode now.

In terms of the demand, you have seen a bounce in some markets. So in China for example, we've now seen over last month an increase of about 6% in passenger car sales over the year. So you know we've gone from a very big hole into a sharp rebound, and that seems to be driven in part by a desire by many commuters not to use public transportation but to use cars. And that's a boom for the industry.

I do suspect though that the underlying trends that were restraining car sales will reassert themselves because there's a limit with which you can move commuters from the subway to cars. It's just a capacity issue. And once confidence returns about the public health issues, once we get maybe vaccines and then the motivation to actually stay away from subways and buses is no longer as great.

And then you have the ongoing trends which is that you know young people are less keen on cars and will just use it less and less and so broadly speaking I think there is still after a rebound a bit of a structural headwind in many markets.

Now some emerging markets like India for example, there's still very low penetration rates. That's true for Africa, that's true for Latin America. But you see a level of saturation setting in in terms of the overall size of the car market in the mature economies. China still has some room to run but even there you'll hit some saturation levels in terms of the growth numbers not coming through.

One last point on this is that the car industry is not just undergoing a structural change on the demand side but also in terms of the technology. And so when you think about the future of the car industry, one silver lining for some producers might be that if there is a wholesale shift towards automated driving or towards alternative energy vehicles then that could give you another big growth era. So we're now almost ending structurally the end of the fossil fuel-driven motor era. And I wouldn't discount therefore a technological shift actually reinvigorating the growth rates. But we may not quite be there, that's maybe two or three years or so down the road.

Lonnie Frisby: You've mentioned the key trends there that will impact the automotive industry. Do you think we can expect to see an increase in M&A activity or industry consolidation?

Frederic Neumann: Well, the experience really is from the past to set maturing industries especially around recessions, tend to see after the recession a heightened wave of consolidation. That just we see that in the steel industry for example, we see that in train makers, we see that in many industries. And so the car industry is for intents and purposes at the moment a maturing industry.

And so consolidation there from that perspective seems very likely. I would say though that there's an additional element, it is not just to reduce capacity and to become profitable through economies of scale. But there's another reason for consolidation and that is that the technological revolution that the car industry is looking at when it comes to automated driving and new energy vehicles requires enormous investments and the individual companies might not be so the committed company might not be able to stem that expenditure.

So in that sense, there is an additional driver for consolidation and that is to develop technology that can keep pace with startups and that can keep up with the technology that the bigger rivals are still able to deliver in-house.

Lonnie Frisby: In the next episode, we'll take a different view. We'll sit down with Sandeep Uppal, our Global Co-Head of International Subsidiary Banking to discuss what the next phase of globalization looks like and how this will impact the way international businesses operate into the future. In the meantime, for more insights from HSBC or to listen to the series, visit business.hsbc.com. Thank you for listening.