MAGNA *Focus* • FRIDAY, 6 March 2020

CORONAVIRUS CRISIS: IMPACTS ON THE US ECONOMY AND THE ADVERTISING MARKET

There have been many questions circling around the potential effects to the ad market if there is a serious outbreak of Coronavirus here in the US. How will this affect supply chains across different sectors of the market? Will clients need to pull back spending? How long could supply chain interruptions have an impact on ad spending? Will the Summer Olympics be canceled?

With major conferences getting canceled and large partner presentations postponed, we are all feeling the effects of what a pandemic can do to a market due to both an over-abundance of caution and a bit of fear. And while it is a rapidly evolving situation, we have consolidated our thinking here on the potential impacts to the ad market and consumer behavior.

The biggest question mark right now is the US economy. As we reach the end of an economic cycle, it is more vulnerable to events that may trigger a recession. Like the dot-com bust and housing bubble before it, a pandemic could certainly be such a catalyst.

The latest news from China are encouraging, showing a slowdown in the epidemic, and the number of cases is still low in the US. Nevertheless, MAGNA will continue to monitor the situation and provide regular updates.

KEY TAKEAWAYS

- *Even if the US remains relatively unscathed from the COVID-19 contagion, **US firms and the US economy will be affected** in various ways: financial losses from APAC operations, supply chain issues, reduced consumption and marketing activity caused by safety measures.*
- ***Some industries are likely to be more severely affected**, among them travel/tourism, brick-and-mortar retail, restaurants, and movie releases. Some brands in those sectors are likely to reduce marketing and advertising budgets, at least temporarily if faced with struggling sales or supply chain issues.*

- *Because this virus situation arrives following a long growth cycle for the global and US economy the impact on consumer and corporate confidence could be the self-fulfilling trigger that could precipitate a recession this year.*
- *At this point, however, **macro-economists are still predicting economic growth in the US this year** (+2.0% in real GDP growth) and the risk of a recession at just 20%. In that environment, MAGNA expects advertising spend to grow by approximately 3% (excluding cyclical events), which would be a slowdown from 2018-2019.*
- *Nevertheless, if personal consumption was to stall this year as a result of a viral outbreak, **the MAGNA statistical model** suggests ad spend might shrink to various degrees. A cancellation of the Olympic Games would reduce ad spend further. Luckily for some media channels, political ad spend - expected to be the highest ever - would not be affected by either the virus situation or an economic recession and would help stabilize ad revenues.*
- *MAGNA will publish its Q1 ad spend forecast update around March 20. In the meantime, colleagues and clients are invited to refer to the latest update, published on December '19.*
- *The big winners in a self or mandated quarantine scenario will be the streaming services, as it is ideal for binge viewing, and the influx of new services means there is more content on offer than ever.*
- *With connected TV activity already on the rise, we could see **an additional acceleration of 8-10%** among adults in the event of a severe outbreak.*
- *Linear TV will not benefit as much, but **a 2-3% increase in usage among all adults seems plausible**, and we'd anticipate **news to be a major beneficiary (+10% for cable news)**.*
- *If the Summer Olympics are cancelled, **NBC would go from seeing its primetime ratings grow by 35% compared to last year (adults 18+) to declining by around 20%,** assuming a typical programming slate.*

IMPACT ON THE OVERALL ECONOMY

The precautionary measures taken by citizens, firms, and government have already started to **slow down economic activity**; consumption and production are all slowing down in Asia. Supply chains are being disrupted due to the reliance of many US industries on Chinese imports or raw materials.

On February 22, The International Monetary Fund (IMF) released a revision to its 2020 global GDP growth forecast published just weeks before in January. China's real GDP growth, which was expected to be +6.0% this year (a moderate slowdown from previous years), is now forecast to be +5.6%. The IMF also revised its global GDP growth forecast from 3.3% to 3.2%, which basically assumes a very moderate impact in every other country at this stage (the -0.4% revision on China alone is almost enough to trigger a -0.1% revision globally, given the weight of the Chinese economy).

Meanwhile, the Survey of Professional Forecasters (SPF)—a quarterly survey of macro economists by the Philadelphia Fed—published solid forecasts in its February 14 update. According to the surveyed economists, 2020's real GDP growth will reach +2.0% (up from +1.8% in the previous survey) and 2021's expected growth stays at +2.0%. We should keep in mind that the survey was conducted in early February, when the contagion in China and Europe was still relatively subdued. Some private financial institutions and economic think tanks have already expressed bigger doubts on the economic impact, and of course, stock market indexes have fallen by -10 to -15% in an adjustment that was perhaps overdue anyway.

It remains to be seen how severe the contagion will be in the US, but even if the US was to be moderately impacted by the virus, and for a short period of time, **many large firms will be hit by revenue losses on their overseas activities and/or supply chain issues** and some might decide on cuts in marketing expenditure in order to protect bottom line profitability.

Beyond the direct effect of the virus and the indirect impacts of the precautionary measures, the full impact of the situation should be looked at in relation to its **timing within the economic cycle**. If the global economy was in a phase of acceleration, the cost of a pandemic could be relatively easy to absorb (as was the case with SARS in 2002). However, the global economy has been slowing down for months. The US is still in the longest growth cycle ever recorded (ten years) and many economists believe it's not a question of "if" but "when" the next recession episode is likely to hit. US economists still predict a "soft landing" in the short term, with +2% in GDP growth in 2020-2021, but history suggests that, at that stage in the cycle, any negative news or concern (a local war, a financial bubble) can trigger a confidence crisis that would bring on a recession sooner than anticipated.

SOME SECTORS WILL BE HIT HARDER THAN OTHERS BY THE CORONAVIRUS CONCERN

- ***Travel/Tourism:*** US citizens will be less likely to travel, internationally or domestically, out of fear of infection, or fear of flight cancellations.
- ***Retail:*** The sector may face a combination of US consumers reducing trips to supermarkets and department stores and the lack of three million Chinese tourists who normally visit the US every year and spend about $20 billion on hotels, luxury shops and department stores. Retail sales may also suffer from a shortage of products in some segments (e.g. affordable clothing brands). Department stores like Macy's have already published profit warnings. E-commerce may benefit from consumers staying away from shops in the next few weeks or months, but e-commerce giants may also suffer from supply chain issues and the overall impact on retail sales will remain negative.
- ***Restaurants:*** Traffic might be affected in all types of restaurants, especially QSRs.
- ***Movies:*** Theaters are among the confined spaces that are likely to make a consumer nervous in coming months. This, and the closure of tens of thousands of theaters in China, may lead Hollywood studios to postpone the release of their spring blockbusters, thus aggravating the impact on box office in the short term. The global release of the next James Bond movie, scheduled early April, has already been postponed to November, and Disney's *Mulan*, scheduled on March 27 might be next in line.
- ***Technology:*** This sector is less likely than others to suffer lower domestic sales in the US but it faces supply chain disruption. Apple warned that, although its Chinese manufacturing partners are gradually re-opening, extreme precautionary measures in factories will slow down production in the weeks and months to come.
- ***Pharmaceuticals:*** Drug giants have warned that they may face supply chain issues as a significant share of drug ingredients are sourced from China.

- ***Food/Drinks:*** Soft drink brands reported a risk of shortage on artificial sweetener. Some brands are also facing reduced sales from China.
- ***Automotive:*** There are some supply chain issues here as well, and the largest manufacturers all have significant exposure to Asian markets. GM, for instance, is one of largest brands in China and expects shrinking sales this year.

IMPACT ON THE ADVERTISING MARKET

Marketing activity may be hit harder than the overall economy for a couple of reasons. Advertising activity relies on a number of business events and trade fairs that are at risk of cancellation; and marketing and advertising spend is partly linked to **tentpole events, (mainly sports)**, that are also at risk. Many sports events have been cancelled or postponed in Asia and Europe already, including the Ireland-Italy rugby game and several soccer games from Italy's top league Serie A, including Juventus-Milan.

The biggest one, of course, is the **Olympic Games** scheduled to start on July 24 in Tokyo, Japan. Recently, the Olympic minister Seiko Hashimoto said Japan's government and Tokyo were still committed to hosting the event, but didn't rule out a postponement. The Olympics have been cancelled only three times in the past (World War I and twice during World War II) and both the International Olympic Committee and the US Olympic Committee are telling the athletes to continue to train as if the Games will commence in July. Moving the Olympics to another city (past or future sites) or later in the year is difficult at this point due to many logistics (hotels, Olympian housing, transportation, International TV rights and schedules, etc.). Despite what the London and LA Olympic committees have been saying in the press, the IOC has indicated that moving the Games is not an option. As the IOC has a two-month window for canceling the games, any decisions will have to be made in May.

MAGNA traditionally tracks the impact of cyclical sports events on US advertising spend. **The 2020 Games are expected to generate approximately $1.2 billion in revenue, of which $900 million is incremental** (compared to a non-Olympic year). This would be roughly the same amount as the 2016 Olympics in Rio, Brazil, and national TV would once again get the bulk of it ($750MM). If the games were to be cancelled, a large portion of that amount is likely to be refunded rather than spent against other TV programs. Irish Bookmaker Paddy Power recently raised odds on a cancelation to 4/6, meaning the event is odds-on to be called off or to be held in a country other than Japan. Even if the Games take place as scheduled in Tokyo, we should expect marketing and advertising spend to be lower this year, if only because attendance by visitors, sponsors, and advertisers is likely to be below expectations.

Based on a statistical analysis of advertising spending and economic fluctuations in the last 50 years, MAGNA has developed a predictive model that tells us what to expect from advertisers in various economic environments. For 2020, macro-economists are currently expecting personal consumption to grow by +4% and industrial production to grow by +1%. Our model suggests that, in that economic environment, advertising spending should grow by +3% across all above-the-line media channels in calendar year and the cyclical events (Olympics and political) may add +2% on top of that.

Using the same model, and assuming that a situation where personal consumption would grow by just +2% instead of +4% and industrial production shrink by -2%, normalized non-cyclical advertising spending would decline by -1% this year. The cyclical ad spending might be hit too, but, luckily for media owners, the bulk of it comes from political campaign spend that will be largely unaffected by either the virus news or an economic slowdown. The Olympic component of the cyclical boost would be reduced, but overall MAGNA would expect a total cyclical boost of +1.5% instead of +2% in the mainstream scenario, leading to a flat marketplace. Obviously the impact on ad spend would be much harsher if personal consumption was to *decrease* in 2020.

IMPACT ON CONSUMER BEHAVIOR AND AUDIENCE SUPPLY

The obvious behavioral impact of a severe outbreak here in the US is that people will travel less and stay at home more to avoid exposure. This may be exacerbated further if companies begin to recommend or mandate working from home, as is the case in China. We can reasonably assume that TV usage of all types will increase if this is the case; we see it play out each year during the winter months when people are indoors more often to avoid the cold weather.

In our opinion, **the big winners in this scenario will be the streaming services**, as a self (or mandated) quarantine situation is ideal for binge viewing, and the influx of new services means there is more content on offer than ever. We've already seen this sentiment take hold on Wall Street, as analysts seem to share our opinion, and Netflix's stock price was positively impacted.

Indeed, **the SVOD players may opt to adjust their programming strategies to take advantage of this.** For example, Netflix was likely planning to release the fourth season of *Stranger Things* around the Fourth of July holiday, but may opt to move it up a bit. Disney+ also has a number of hotly anticipated Marvel series in the queue.

With connected TV activity already on the rise, we could see an additional acceleration of 8-10% among adults in the event of a severe outbreak.

Linear television is not likely to benefit nearly as much, due in part because such a high concentration of the audience is 60 and older, more likely to be retired, and thus heavier TV users already. **That being said, a 2-3% increase in usage among all adults seems plausible, and we would anticipate news to be a major beneficiary as viewers seek information both about the virus and the presidential elections. Cable news in particular could get as much as a 10% bump.**

China has seen a meaningful increase in console gaming since its citizens began staying at home more, and there could be some impact here in the US as well, thought it would likely be minor across the full adult populace, as activity is generally stable throughout the year. It would be more pronounced among kids, teens, and young adults however, particularly if school is suspended.

Lastly, the cancellation of the 2020 Summer Games would mean a serious change in the viewing landscape this summer. **NBC would go from seeing its primetime ratings grow by 35% compared to last year (adults 18+) to declining by around 20%, assuming a typical programming slate**. Competitive networks would also benefit, and where streaming was likely to take a slight hit during the 17-day Olympic period, it would continue to grow uninterrupted.

IMPACT ON ADVERTISING COSTS

Increases in viewing and decreased demand from several economic sectors could potentially lead to lower media costs for advertisers, e.g. **lower scatter cost on television in the third quarter**. We have already heard some digital publishers seeing a slowdown in ad spend as recently the last week in February, which could be a sign that advertisers are beginning to pull back on media that is easily cancelable.

Over the next weeks we will continue to have conversations with clients and partners to assess how spending could change moving into the third quarter as well as the next broadcast year. If we continue to see a softening in demand we will re-assess pricing impacts moving forward.