INVESTMENT TRENDS MONITOR

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UNCTAD

IMPACT OF THE CORONAVIRUS OUTBREAK ON GLOBAL FDI

HIGHLIGHTS

- *The outbreak and spread of Coronavirus (Covid-19) will negatively affect global foreign direct investment (FDI) flows.* With scenarios of the spread of the epidemic ranging from short-term stabilization to continuation throughout the year, the downward pressure on FDI will be -5% to -15% (compared to previous forecasts projecting marginal growth in the FDI trend for 2020-2021).

- The impact on FDI will be concentrated in those countries that are most severely hit by the epidemic, although negative demand shocks and the economic impact of supply chain disruptions will affect investment prospects in other countries.

- *More than two thirds of the multinational enterprises (MNEs) in UNCTAD's Top 100, a bellwether of overall investment trends, have issued statements on the impact of Covid-19 on their business.* Many are slowing down capital expenditures in affected areas. In addition, lower profits – to date, 41 have issued profit alerts – will translate into lower reinvested earnings (a major component of FDI).

- *On average, the top 5000 MNEs, which account for a significant share of global FDI, have seen downward revisions of 2020 earnings estimates of 9% due to Covid-19.* Hardest hit are the automotive industry (-44%), airlines (-42%) and energy and basic materials industries (-13%). Profits of MNEs based in emerging economies are more at risk than those of developed country MNEs: developing country MNE profit guidance has been revised downwards by 16%.

Expected impact on global FDI flows in 2020 -2021

Scenario	Downward pressure on global FDI flows
1 Covid-19 controlled in H1 2020	-5%
2 Covid-19 continued impact through 2020	-15%

Earnings losses and potential relevance for reinvested earnings

	Average earnings revisions due to Covid-19 *to date* for the Top 5000 MNEs	Share of reinvested earnings in FDI
World	-9%	**52%**
Developed	-6%	**61%**
Developing	-16%	**40%**
Africa	-1%	27%
Asia	-18%	41%
Latin America/Caribbean	-6%	43%
Transition economies	-10%	93%

How will Covid-19 affect FDI

The *economic* impact of Covid-19 will be uneven, with the effects caused by negative demand shocks concentrated in those economies most severely hit by the epidemic, and effects caused by production stoppages and supply chain disruptions felt especially in economies that are closely integrated in global value chains centered around China, the Republic of Korea and Japan, as well as South-East Asian economies.

The *investment* impact will be even more concentrated. It will be strongest in those countries that have been forced to take the most drastic measures to contain the spread of the virus.

The outbreak of Covid-19 will slow down capital expenditures of MNEs and their foreign affiliates. Production locations that are closed or that operate at lower capacity will temporarily halt new investment in physical assets and delay expansions.

Greenfield investment projects that are already ongoing will also be affected by this. However, as new investment projects have a long gestation period and a lifecycle that can span decades, the immediate impact on existing investments and investment projects under construction is likely to be limited.

Announcements of new greenfield projects (normally reported in UNCTAD's data for the purpose of projecting future trends) could be delayed. Similarly, mergers and acquisitions (M&As) could see a slowdown. Like greenfield projects, M&As are generally long-term commitments to overseas markets. Nevertheless, data for February show a significant drop in the completion rate of cross-border acquisitions, to below $10 billion from normal monthly values of $40-50 billion.

Covid-19 will affect market-, efficiency- and resource-seeking investment alike. Market-seeking investment and FDI projects in extractive industries could be delayed worldwide as a result of negative demand shocks. For now, the demand shock is most serious in China; for example, Toyota reported a 70% drop in sales in China in February. But the impact is already visible in major markets beyond China as well, especially in consumer-facing industries such as travel and tourism, retail and wholesale, and other consumer cyclicals.

The negative effect on efficiency-seeking investment – in production facilities that are closely integrated in global value chains (GVCs) – will be concentrated primarily in China and East and South-East Asia at first. However, they could rapidly spread outside the region through GVC linkages. The transmission will concern both economies that feed intermediate goods and services into China's exports, and those that rely on inputs of intermediates from China. For example, Fiat Chrysler Automobiles has temporarily stopped production of its Fiat 500L model at a plant in Serbia due to disruption in the supply of audio system components from China.

Lower MNE profits, lower reinvested earnings

Apart from the primary effect on FDI of MNEs concretely delaying capital expenditures, a further (indirect) mechanism through which FDI flows could be affected in the coming period is through lower profits in foreign affiliates leading to lower reinvested earnings, a component of FDI. In the economies most affected by Covid-19, reinvested earnings make up about 40% of total FDI inflows. (About 50% of profits in foreign affiliates, on average, are retained in the host country.)

The MNEs in UNCTAD's Top 100 – the largest MNEs worldwide based on their foreign assets, foreign sales and foreign employees published annually in the *World Investment Report* – are indicative of the impact that Covid-19 could have on investment trends.

Of the (2019) Top 100, 69 have already made a statement regarding the impact of Covid-19 on their business. Of those, 41 have issued profit alerts or signaled increased risks, with 10 anticipating lower sales, 12 expecting negative effects on production or supply chain disruptions, and 19 expecting to be affected by both.

The automotive MNEs in the Top 100 appear to be most affected, with all 12 signaling negative implications (8 out of 12 due to production or supply chain disruptions). Nine out of 13 MNEs in the electronic components and equipment sectors have done the same. Most of the extractive industry and basic materials and chemicals MNEs, as well as the consumer goods firms in the top 100, have issued warnings about negative demand shocks.

To date, concrete profit warnings have been issued by 23 of the Top 100 MNEs as a direct result of the Covid-19 outbreak. Most concern the consumer-facing firms, indicating that the demand shock, for now, is expected to have more direct effects on earnings than production or supply chain disruptions.

Very few firms in the Top 100 have given specific guidance on expected profit impacts. Hon Hai/Foxconn, the electronics contract manufacturer that supplies major technology firms worldwide and that has significant production capacity in China, has so far lowered its expectations for global sales growth in 2020 from 3-5% to 1-3%.

Looking at a wider sample of **the global top 5000 (listed) MNEs, e**arnings forecasts for fiscal year 2020 have been revised down in the last month by an average 9 per cent (table 1).

The majority of the top 5000 (by revenues) have had earnings revisions since 1 February (until 5 March); expected earnings were revised downwards especially in the energy, basic materials and consumer cyclical sectors; the automotive and the travel and tourism industries have been among the worst hit. Companies in these sectors and industries are normally important capital investors.

The revisions to date are likely to be conservative. For the moment, the most significant negative revisions in the automotive industry come from parts producers based in the most affected areas in South-East Asia, while leading carmakers in developed economies have not yet registered the shock. The negative impact of the virus is likely to spread and increase further.

Table 1. Earnings revisions and capital expenditures of the top 5000

Sector/industry	Number of companies with earnings revisions	Average earnings revision (%)	Share of capital expenditures (%)
Basic Materials	389	-13	8
Consumer Cyclicals	671	-16	16
Airlines	45	-42	2
Hotels, Restaurants & Leisure	111	-21	2
Consumer Non-Cyclicals	351	-4	6
Energy	243	-13	20
Healthcare	195	0	3
Industrials	739	-9	14
Automobiles & Auto Parts	142	-44	9
Technology	358	-3	11
Telecommunications Services	105	1	11
Utilities	175	-5	10
Grand Total	*3'226*	*-9*	*100*

Source: UNCTAD, based on data from Refinitiv SA.

Note: Top 5000 public companies that had at least one revision of earnings forecast for the fiscal year 2020 since 1 February 2020. A few outliers (5 in total) were excluded as extreme revisions of earnings were driven by idiosyncratic factors not related to Covid-19.

Across developed economies, earnings revisions have been relatively mild to date (table 2). On average, Japanese companies had a revision of earnings of about 9%, in line with the global average; this most probably underestimates the impact on Japanese MNEs given their proximity and GVC integration with emerging Asian markets. It should be noted that the numbers are changing rapidly, with revisions for large Japanese firms not yet fully reflecting the impact of Covid-19. For example, Toyota's reported sales drop in China has not been reflected in earnings forecasts.

Table 2 also lists the share of the reinvested earnings component of FDI for each region, indicative of the potential indirect effect that earnings losses could have on FDI. For example, the average -9% earnings losses projected to date for 2020 could affect 52% of FDI flows (this assumes losses are spread uniformly across MNE operations; in reality it is more likely earnings losses would be concentrated in foreign affiliates in affected areas, further augmenting the impact on reinvested earnings).

Table 2. Earnings revisions of the top 5000 and relative importance of reinvested earnings in FDI, by region

Region/economy	Number of companies with earnings revision	Average earnings revision (%)	Share of reinvested earnings in FDI, 2018 (%)
Developed	**2’334**	**-6**	**61**
Developing economies	**864**	**-16**	**40**
Africa	42	-1	27
Developing Asia	730	-18	41
Singapore	16	-30	..
China	259	-26	..
Republic of Korea	121	-20	22
Malaysia	33	-20	..
Thailand	32	-15	72
Vietnam	8	-10	..
Latin America and the Caribbean	92	-6	43
Transition economies	**28**	**-10**	**93**
Total	**3’226**	**-9**	**52**

Source: UNCTAD, based on data from Refinitiv SA.

Downward pressure on FDI: -5% to -15%

UNCTAD’s forecast for the underlying trend in the *World Investment Report 2019* (confirmed in the January 2020 Global Investment Trends Monitor) projected a stable level of global FDI inflows in 2020-2021 with a potential increase of +5% (relatively marginal for FDI).

Based on an expected GDP growth impact of -0.5% under a scenario in which Covid-19 would be brought under control in the first half of 2020, and a potential impact of -1.5% under a scenario in which the epidemic continues to affect the global economy throughout the year – in line with projections by other international organizations[1] – UNCTAD projects a negative impact on global FDI flows ranging from -5% to -15% in 2020 (with the effect of the demand shock filtering through 2021). This is based on UNCTAD’s forecasting model, early indications from monthly transaction data, and estimates of the potential impact on reinvested earnings.

Much of the impact will be driven by delayed investment as a result of the global demand shock. However, significant negative impact will result in economies and industries that are highly dependent on GVC trade. As such, the Covid-19 outbreak will potentially accelerate existing trends of decoupling (the loosening of GVC ties) and reshoring driven by the desire on the part of MNEs to make supply chains more resilient.

UNCTAD will continue to monitor the outbreak and its potential impact on FDI and GVCs.

[1] See OECD Interim Economic Outlook, 2 March 2020; IMF statement, 4 March 2020.

The next regular issue of UNCTAD's Investment Trends Monitor will be released in October 2020.

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For further information, please contact
Mr. James X. Zhan
Director
Investment and Enterprise Division UNCTAD

diaeinfo@unctad.org   +41 22 917 57 60

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