THE ECONOMIC IMPACT OF CORONAVIRUS ON THE RECESSION OF THE GLOBAL ECONOMY AND FUTURE ECONOMIC POLICY CHALLENGES

Msc. Elvis XHORI

Kolegji Universitar LOGOS
elvisxhori@gmail.com

Abstract
Pandemics are the inevitable attendants of economic progress. Interconnected trade networks and teeming cities have made societies both richer and more vulnerable, from the empires of antiquity to the integrated global economy of the present. The effects of covid-19 will be very different from those of past pathogens, which struck populations far poorer than people today, and with less knowledge of things like viruses and bacteria. The toll should be on a different scale than that exacted by the Black Death or Spanish flu. Even so, the ravages of the past offer some guide as to how the global economy may change as a result of the coronavirus.
How long the COVID-19 crisis will last, and what its immediate economic costs will be, is anyone's guess. But even if the pandemic's economic impact is contained, it may have already set the stage for a debt meltdown long in the making, starting in many of the Asian emerging and developing economies on the front lines of the outbreak.
The COVID-19 outbreak seems to have raised the odds of a global recession dramatically. But even if no downturn materializes in the near term, the outbreak, together with US President Donald Trump's trade policy, may herald the end of the era when steadily rising international trade buttressed global peace and prosperity.
With the COVID-19 pandemic still spiraling out of control, the best economic outcome that anyone can hope for is a recession deeper than that following the 2008 financial crisis. But given the flailing policy response so far, the chances of a far worse outcome are increasing by the day

Key words: Coronavirus, recession, accumulation of debt, financial crisis

JEL Classification Codes: H63, H31, H32, E 61

INTRODUCTION

Long-run economic effects are not always dreadful

Though the human costs of pandemics are dreadful, the long-run economic effects are not always so. The Black Death carried off an astounding one-third to two-thirds of the population of Europe, leaving lasting scars. But in the wake of the plague there was far more arable acreage than workers to farm it. The sudden scarcity of workers raised labourers' bargaining power relative to landlords and contributed to the breakdown of the feudal economy. It seems also to have ushered parts of north-west Europe onto a more promising growth path.

Real incomes of European workers rose sharply following the pandemic, which struck the continent from 1347 to 1351. In pre-industrial times, higher incomes usually enabled faster population growth, which eventually squeezed incomes back to subsistence levels (as observed by Thomas Malthus). But in parts of Europe, Malthusian rules did not reassert themselves after the pandemic receded. Nico Voigtländer, of the University of California, Los Angeles, and Hans-Joachim Voth, now of the University of Zurich, argue that the high incomes induced by plague led to more spending on manufactured goods produced in cities, and thus to higher rates of urbanisation. The plague effectively shoved parts of Europe from a low-wage, less urbanised equilibrium on a path more congenial to the development of a commercial, and then an industrial, economy[1].

Something similar occurred in the aftermath of the Spanish flu, which killed between 20m and 100m people from 1918 to 1920. The industrial economies of the early 20th century were no longer bound by Malthusian constraints. Even so, reckon Elizabeth Brainerd, now at Brandeis University, and Mark Siegler, of California State University, American states harder hit by the disease grew faster in its aftermath. After controlling for a range of economic and demographic factors, they find that one additional death per thousand people was associated with an increase in average annual growth of real income per person over the next decade of at least 0.15 percentage points. Though the toll of covid-19 is likely to be too low to boost real wages, it may force firms to embrace new technologies in order to operate while warehouses and offices are empty, with lasting effects on growth and productivity. More often, though, a pandemic's economic consequences are unambiguously negative. Trade links which spread a pathogen can themselves be undone by its effects. During the Roman Empire, a high degree of specialisation and trade lifted incomes to levels that would not be reached again for more than a millennium. Alas, the same links facilitated the spread of disease. The Roman economy was dealt a blow in the late second century ad, when an outbreak of what is thought to have been smallpox ravaged the empire. A century later, the Plague of Cyprian, which may have been a haemorrhagic fever, emptied many Roman cities and coincided with a sharp and permanent decline in economic activity, as measured by numbers of shipwrecks (a proxy for trade volumes) and levels of lead pollution (generated by mining activity). Reduced trade fed a cycle of falling incomes and weakened state capacity from which the western empire never recovered. More recently, trade may well have tumbled as a result of Spanish flu, had the first world war not already brought a curtain down on the industrialised world's first great era of globalisation. Covid-19 also strikes at what may be the tail end of a long period of rapid global integration, which is likewise threatened by great-power competition. The circumstances are not identical, and trade is unlikely to suffer as badly as it did in the 1910s. Still, it would not be surprising if historians identify the pandemic as one of several consequences of globalisation that eventually precipitated a new era in global trade.

Just as pandemics have a way of demarcating historical eras, they can also pinpoint shifts in the fortunes of some places relative to others. The Black Death lifted real incomes across Europe. But the fortunes of Europeans subsequently diverged, and disease again played a role. Plague returned to the continent in the 17th century in several deadly waves. The effects of these outbreaks varied greatly across Europe, argues Guido Alfani, of Bocconi University in Milan[2]. Though at most a tenth of the population of England and Wales was lost to plague, for example, more than 40% of Italians may have died from the disease over the course of the century. While Italy's population stagnated and rates of urbanisation tumbled, north-west Europe continued to benefit from growth and urbanisation despite the pandemic. The fiscal capacity of Italian states suffered badly, as did the textile industries of northern Italy, and northern and southern Europe embarked on quite different economic trajectories[3].

[1] https://www.economist.com/finance-and-economics/2020/03/12/throughout-history-pandemics-have-had-profound-economic-effects
[2] https://www.economist.com/finance-and-economics/2020/03/12/the-challenge-of-addressing-covid-19s-economic-effects-in-europe
[3] https://www.ft.com/content/0c13755a-6867-11ea-800d-da70cff6e4d3

Is the world moving towards a global recession?

The shock to the global economy from COVID-19 has been both faster and more severe than the 2008 global financial crisis (GFC) and even the Great Depression. In those two previous episodes, stock markets collapsed by 50% or more, credit markets froze up, massive bankruptcies followed, unemployment rates soared above 10%, and GDP contracted at an annualized rate of 10% or more. But all of this took around three years to play out. In the current crisis, similarly dire macroeconomic and financial outcomes have materialized in three weeks. Earlier this month, it took just 15 days for the US stock market to plummet into bear territory (a 20% decline from its peak) – the fastest such decline ever[4]. Now, markets are down 35%, credit markets have seized up, and credit spreads (like those for junk bonds) have spiked to 2008 levels. Even mainstream financial firms such as Goldman Sachs, JP Morgan and Morgan Stanley expect US GDP to fall by an annualized rate of 6% in the first quarter, and by 24% to 30% in the second. US Treasury Secretary Steve Mnuchin has warned that the unemployment rate could skyrocket to above 20% (twice the peak level during the GFC)[5].

In other words, every component of aggregate demand – consumption, capital spending, exports – is in unprecedented free fall. While most self-serving commentatorshave been anticipating a V-shaped downturn – with output falling sharply for one quarter and then rapidly recovering the next – it should now be clear that the COVID-19 crisis is something else entirely. The contraction that is now underway looks to be neither V- nor U- nor L-shaped (a sharp downturn followed by stagnation)[6]. Rather, it looks like an I: a vertical line representing financial markets and the real economy plummeting. Not even during the Great Depression and World War II did the bulk of economic activity literally shut down, as it has in China, the United States, and Europe today. The best-case scenario would be a downturn that is more severe than the GFC (in terms of reduced cumulative global output) but shorter-lived, allowing for a return to positive growth by the fourth quarter of this year. In that case, markets would start to recover when the light at the end of the tunnel appears[7].

But the best-case scenario assumes several conditions. First, the US, Europe, and other heavily affected economies would need to roll out widespread COVID-19 testing, tracing, and treatment measures, enforced quarantines, and a full-scale lockdown of the type that China has implemented. And, because it could take 18 months for a vaccine to be developed and produced at scale, antivirals and other therapeutics will need to be deployed on a massive scale.

Second, monetary policymakers – who have already done in less than a month what took them three years to do after the GFC – must continue to throw the kitchen sink of unconventional measures at the crisis. That means zero or negative interest rates; enhanced forward guidance; quantitative easing; and credit easing (the purchase of private assets) to backstop banks, non-banks, money market funds, and even large corporations (commercial paper and corporate bond facilities). The US Federal Reserve has expanded its cross-border swap lines to address the massive dollar liquidity shortage in global markets, but we now need more facilities to encourage banks to lend to illiquid but still-solvent small and medium-size enterprises.

[4] https://lplresearch.com/2020/03/12/the-fastest-bear-market-ever/#more-15874
[5] https://www.economist.com/finance-and-economics/2020/03/05/a-recession-is-unlikely-but-not-impossible
[6] https://www.investopedia.com/hopes-of-a-v-shaped-recovery-are-dying-4799672
[7] https://24plus.ilsole24ore.com/art/perche-sara-brutta-recessione-effetti-imprevedibili-ADvTvkE?s=sf

Third, governments need to deploy massive fiscal stimulus, including through “helicopter drops” of direct cash disbursements to households. Given the size of the economic shock, fiscal deficits in advanced economies will need to increase from 2-3% of GDP to around 10% or more. Only central governments have balance sheets large and strong enough to prevent the private sector’s collapse.

But these deficit-financed interventions must be fully monetized. If they are financed through standard government debt, interest rates would rise sharply, and the recovery would be smothered in its cradle. Given the circumstances, interventions long proposed by leftists of the Modern Monetary Theory school, including helicopter drops, have become mainstream. Unfortunately for the best-case scenario, the public-health response in advanced economies has fallen far short of what is needed to contain the pandemic, and the fiscal-policy package currently being debated is neither large nor rapid enough to create the conditions for a timely recovery. As such, the risk of a new Great Depression, worse than the original – a Greater Depression – is rising by the day. Unless the pandemic is stopped, economies and markets around the world will continue their free fall. But even if the pandemic is more or less contained, overall growth still might not return by the end of 2020. After all, by then, another virus season is very likely to start with new mutations; therapeutic interventions that many are counting on may turn out to be less effective than hoped. So, economies will contract again and markets will crash again[8].

Moreover, the fiscal response could hit a wall if the monetization of massive deficits starts to produce high inflation, especially if a series of virus-related negative supply shocks reduces potential growth. And many countries simply cannot undertake such borrowing in their own currency. Who will bail out governments, corporations, banks, and households in emerging markets?

In any case, even if the pandemic and the economic fallout were brought under control, the global economy could still be subject to a number of “white swan” tail risks. With the US presidential election approaching, the COVID-19 crisis will give way to renewed conflicts between the West and at least four revisionist powers: China, Russia, Iran, and North Korea, all of which are already using asymmetric cyberwarfare to undermine the US from within. The inevitable cyber attacks on the US election process may lead to a contested final result, with charges of “rigging” and the possibility of outright violence and civil disorder. Similarly, as I have argued previously, markets are vastly underestimating the risk of a war between the US and Iran this year; the deterioration of Sino-American relations is accelerating as each side blames the other for the scale of the COVID-19 pandemic. The current crisis is likely to accelerate the ongoing balkanization and unraveling of the global economy in the months and years ahead. This trifecta of risks – uncontained pandemics, insufficient economic-policy arsenals, and geopolitical white swans – will be enough to tip the global economy into persistent depression and a runaway financial-market meltdown. After the 2008 crash, a forceful (though delayed) response pulled the global economy back from the abyss. We may not be so lucky this time.

At the start of this year, things seemed to be looking up for the global economy. True, growth had slowed a bit in 2019: from 2.9% to 2.3% in the United States, and from 3.6% to 2.9% globally. Still, there had been no recession, and as recently as January, the International Monetary Fund projected a global growth rebound in 2020. The new coronavirus, COVID-19, has changed all of that. Early predictions about COVID-19’s economic impact were reassuring. Similar epidemics – such as the 2003 outbreak of severe acute respiratory syndrome (SARS), another China-born coronavirus – did little damage globally. At the country level, GDP growth

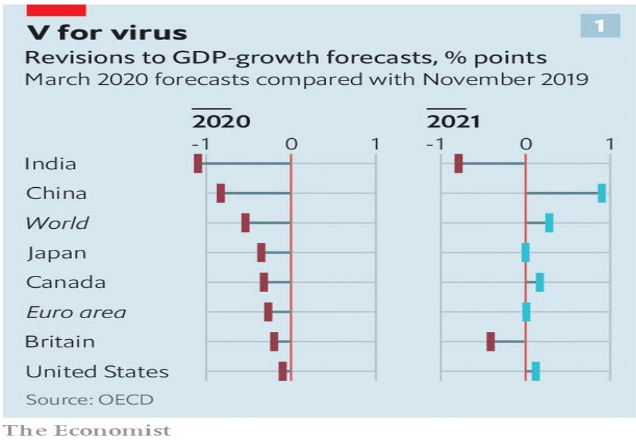
[8] https://www.project-syndicate.org/commentary/coronavirus-global-recession-prospects-by-jeffrey-frankel-2020-02.

took a hit, but quickly bounced back, as consumers released pent-up demand and firms rushed to fill back orders and re-stock inventories. It is becoming increasingly clear, however, that this new coronavirus is likely to do much more damage than SARS. Not only has COVID-19 already caused more deaths than its predecessor; its economic consequences are likely to be compounded by unfavorable conditions – beginning with China's increased economic vulnerability. China's economy has grown significantly more slowly in the last decade than it did previously. Of course, after decades of double-digit growth, that was to be expected, and China has managed to avoid a hard landing. But Chinese banks hold large amounts of non-performing loans – a source of major risks[9].

As the COVID-19 outbreak disrupts economic activity – owing partly to the unprecedented quarantining of huge subsets of the population – there is reason to expect a sharp slowdown this year, with growth falling significantly below last year's official rate of 6.1%. During the recent meeting of G20 finance ministers, the IMF downgraded its growth forecast for China to 5.6% for 2020 – its lowest level since 1990. This could hamper global growth considerably, because the world economy is more dependent on China than ever. In 2003, China constituted only 4% of global GDP; today, that figure stands at 17% (at current exchange rates). Moreover, because China is a global supply-chain hub, disruptions there undermine output elsewhere. Commodity exporters – including Australia, and most of Africa, Latin America, and the Middle East – are likely to be affected the most, as China tends to be their largest customer. But all of China's major trading partners are vulnerable. For example, Japan's economy already contracted at an annualized rate of 6.3% in the fourth quarter of 2019, owing to last October's consumption-tax hike. Add to that the loss of trade with China, and a recession – defined as two consecutive quarters of shrinking GDP – now seems likely.

European manufacturing could also suffer considerably. Europe is more dependent on trade than, say, the United States, and is linked even more extensively to China through a web of supply chains. While Germany narrowly escaped recession last year, it might not be so lucky this year, especially if it fails to undertake some fiscal expansion. As for the United Kingdom, Brexit may finally have the long-feared economic consequences. All of this could happen even if COVID-19 does not become a full-blown pandemic. In fact, while the virus is proliferating in some countries, such as South Korea, a high infection rate is not a prerequisite for economic hardship. The specter of contagious disease tends to have a disproportionate impact on economic activity, because healthy people avoid traveling, shopping, and even going to work. Forecasters are pencilling in sharp falls in output elsewhere (see chart 1)[10]. Goldman Sachs, a bank, reckons global gdp will shrink at an annualised rate of 2.5% in the first quarter. With luck the slump will end once the virus stops spreading. But even if that happens the speed and size of the economic bounce-back also depends on the extent to which those costly spillovers are avoided. That is why central bankers and finance ministries are turning to more targeted interventions (see chart 2)[11]. These fall into three broad categories: policies to ensure that credit flows smoothly through banks and money markets; measures to help companies bear fixed costs, such as rent and tax bills; and measures to protect workers by subsidising wage costs.

[9] https://www.project-syndicate.org/commentary/coronavirus-greater-great-depression-by-nouriel-roubini-2020
[10] https://www.economist.com/finance-and-economics/2020/03/05/a-recession-is-unlikely-but-not-impossible
[11] https://www.investopedia.com/hopes-of-a-v-shaped-recovery-are-dying-4799672



This Could Be The Fastest Bear Market Ever

S&P 500 Index Quickest Bear Markets After A New All-Time High

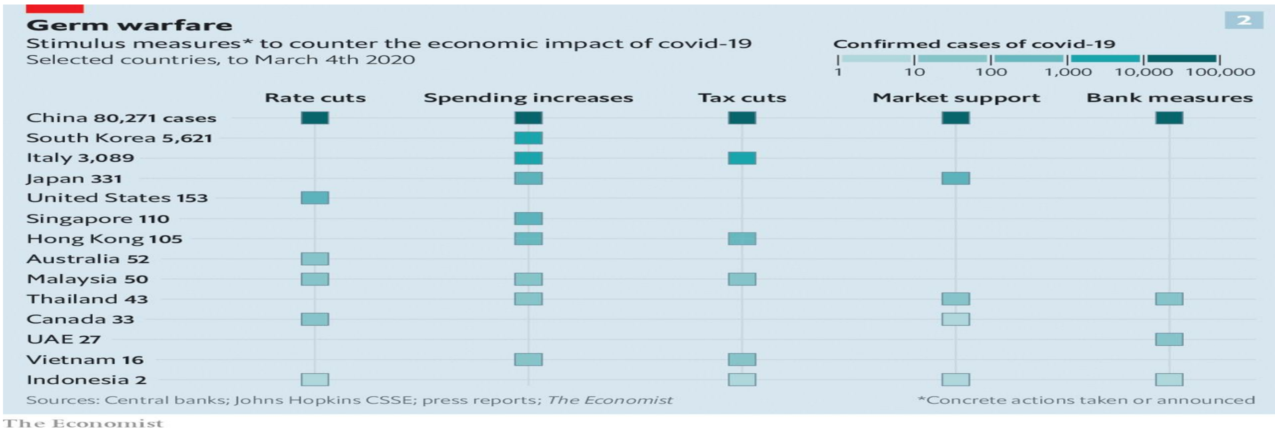
Date Of Bear Market	Trading Days To Reach New Bear Market
March 12, 2020	16*
October 28, 1929	30
October 19, 1987	38
May 28, 1962	115
August 29, 1966	139
July 9, 2008	188
November 27, 1973	221
March 12, 2001	242
January 29, 1970	288
October 21, 1957	305
February 22, 1982	310

Source: LPL Research, FactSet 3/12/20

* The S&P 500 could close down 20% today

A bear market is when a stock index or security closes 20% or more below a 52-week high.

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.



CONCLUSIONS

Lockdowns of entire cities. Panic in financial markets. Bare store shelves. Shortages of hospital beds. The world has entered a reality unknown outside wartime. By mandating that people isolate themselves at home, policymakers hope to slow, and then reverse, the rate at which COVID-19 is spreading. But a lockdown alone, or a burst of money creation, will not stop the pandemic or save our economies. The $2 trillion economic-rescue package soon to be adopted by the United States is a case in point. The US needs government spending on the scale that it envisions, but it also needs government intervention to address a deepening public-health crisis. As such, many of the "stimulus" bill's provisions appear misguided, some woefully so. Others move in the right direction, but are too piecemeal[12].

The systemic insurance that is needed demands a government-led effort in four main areas:

- Redirecting the economy's existing productive capacity to overcome the rapidly growing shortages of equipment and services required to respond effectively to the pandemic.
- Supporting firms that are not directly involved in efforts to combat the crisis, so that they can continue to supply essential goods and services.
- Ensuring that the population has sufficient means to purchase these goods and services.

[12] https://www.project-syndicate.org/bigpicture/the-post-pandemic-world

- Creating a financial facility to help those unable to pay their mortgage and meet other obligations, thereby mitigating cataclysmic risks to the financial sector.

Such systemic insurance goes well beyond current proposals to spend trillions of dollars, much of which is earmarked for policy initiatives that misdiagnose the crisis as one of deficient aggregate demand or as the result of an ordinary supply shock. Moreover, substantial sums are being dedicated to bailouts without explicitly conditioning the money on a firm's participation in the effort to combat the health crisis and its economic consequences. So, as officials around the world consider large outlays to combat the COVID-19 crisis, the most immediate questions that we face are whether the policies currently under consideration provide sufficient insurance against the systemic risks that are now mushrooming. The criteria are straightforward[13]:

- Is government spending sufficiently laser-focused on overcoming the public-health crisis?
- Is the economic rescue package adequate to sustain the population's wellbeing

What is now painfully clear is that there is a supply shortage of an unprecedented type: medical equipment and facilities. And it is equally clear that the policies under consideration in the US, which mostly rely on voluntary repurposing of existing manufacturing capacity, are woefully inadequate to close the growing gap. Re-equipping factories to produce ventilators for patients and personal protective equipment (PPE) for medical personnel, for example, takes time. So these measures must be scaled up without delay. Moreover, such retooling requires substantial financial outlays, which are hard to make in a collapsing economy[14].

In order to repurpose existing capacity, the government should condition support for any private firm on the firm's commitment to producing vital equipment (specified by a body of medical experts) and meet its payroll at reasonable wages. To avoid price-gouging, medical supplies must be priced at pre-crisis levels. What makes the systemic insurance unprecedented is that it requires not just government spending – which can be thought of as the cash part of the premium – but also large-scale government-led interventions in how our economies produce and distribute goods and services. This move toward state action is much more encompassing than the mobilization for World War II – a frequently invoked parallel – ever was.

But such a reorganization of our economies poses more than operational difficulties, especially in the US, where government has historically strictly limited its direct intervention in productive activities. Although governments' intervention in modern economies takes many forms, ingrained ideas about the balance between the state and the market are even now impeding an adequate response to this crisis. President Donald Trump and US policymakers have thus far favored piecemeal measures, especially when it comes to the state directing – indeed, reorganizing – the private sector. Their instinctive belief in the superiority of the market and private initiatives, regardless of the circumstances, leads them to recoil from the scale of government intervention needed to save our lives and livelihoods.

Lingering shibboleths about the state's proper role must not become roadblocks to mitigating the grave systemic risks that we face. Governments' poor track record on addressing another existential threat – that of climate change – does not inspire optimism.

[13] https://www.project-syndicate.org/commentary/economic-insurance-requires-massive-government-intervention-by-roman-frydman-and-edmund-s-phelps-2020

[14] https://www.project-syndicate.org/commentary/coronavirus-debt-crisis-by-jayati-ghosh-2020-03

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