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Economic Consequences

COVID-19: Economic Consequences and Recovery Measures

By Hallam Chow & Austin Lu on August 14, 2020

COVID-19 has significantly impaired the global economy. In the Global Economic Prospects Report of June 2020, the World Bank forecasted that the global GDP in 2020 will contract by 5.2%, creating the worst recession in 80 years. More than 90% of the global economies are contracting, a percentage higher than that of the Great Depression of 1930-32. While the US equity market has seen a modest recovery due to its alternative, the debt market, producing meager return rates, the outlook for the real economy is far from optimistic. In spite of expecting a rebound in the second half of 2020 and in 2021, researchers predict that it will be limited and that the prospect of a V-shaped recovery is hopeful at best.

Notwithstanding current active government fiscal interventions, the pandemic has exposed weaknesses in various economies that could impede a speedy global recovery. For example:

1. Participants in informal economies have limited safety nets and access to finance, which hurts their ability to continue operation under pressure. Informal work constitutes approximately 70% of emerging markets' total employment and a third of their GDP.
2. Persistently low oil prices could harm economies which rely heavily on oil export, as the current prices are below the fiscal break-even level for many producers. Where government resources are limited, low oil prices could also limit fiscal support or stimulus.
3. Global debt has risen to 230% of GDP. And in 40% of emerging markets, the debt-to-GDP ratio is at least 20% more than it was in 2007. Increasing sovereign debt levels will impede growth in the long term, as governments will eventually need to repay the debt through higher taxes, additional borrowing or cutting expenses.

Here is how major market regions[1] are expected to contract given certain risks according to the World Bank report:

Regions	**Expected Contraction**	**Major Risks**
East Asia and Pacific	-0.5% (+6.6% in 2021) (including PRC); -1.2% (+5.4% in 2021) (excluding PRC)	• Extended outbreak putting pressure on healthcare system • Global value chain disruption • Tighter financing conditions • PRC being the only economy expected to see growth, but it will be small
Europe and Central Asia	-4.7%(+3.6% in 2021)	• Increased debt-service costs and default triggering • Intensification of outbreak • Decaying confidence in investment
Latin America and Caribbean	-7.2% (+2.8% in 2021)	• Deterioration due to outbreak • Widespread informal economy • Government debt levels already vulnerable to financial stress (e.g., Argentina) • Delayed rebound in oil price • Hurricane season in Caribbean
Middle East and North Africa	-4.2%	• Continued low oil price • Further spread of outbreak • Spillovers from trading partners • Limited fiscal space • Military conflicts
South Asia	-2.7% (+3% in 2021)	• Widespread informal economy • Underdeveloped healthcare • High debt and deficits by government and corporations • Spillover from trading partners • Oil price volatility
Sub-Saharan Africa	-2.8% (+3.1% in 2021)	• Underdeveloped healthcare • Extended outbreak • High debt level • Limited government resources • Food shortage • Conflicts and social unrest

In response to the pandemic, central banks across the globe have provided much greater fiscal support than in previous financial crises. And policies have been introduced to promote lending, such as relaxing capital and liquidity coverage requirements and allowing temporary loan repayment delays. But a robust recovery would require more.

The immediate need is to have coordinated global policies alleviating solvency strains to prevent bankruptcies of firms possibly viable in the longer run without endangering private ownership. Promoting investment and restoring investors' confidence require a more concerted strategy among governments. In addition, governments need to expand the social security coverage for the informal sector participants to avoid mass unemployment. Emerging market and developing economies, which are particularly vulnerable, should strengthen public health systems, address the challenges posed by informality and limited safety nets, and enact reforms to generate strong and sustainable growth once the crisis passes. Aggressive fiscal policies should be accompanied by realistic measures to help restore medium-term fiscal sustainability, including actions that strengthen fiscal frameworks, increase domestic revenue mobilization and spending efficiency, and raise fiscal and debt transparency.

Source: The World Bank, Global Economic Prospects Report (June 2020)

[1] For information regarding the impact of COVID on the United States economy, please see "What to know about the report on America's COVID-hit GDP," The World Economic Forum COVID Action Platform, July 31, 2020 (https://www.weforum.org/agenda/2020/07/covid-19-coronavirus-usa-united-states-econamy-gdp-decline/).

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