PISM | POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

BULLETIN

No. 84 (1514), 20 April 2020 © PISM

The Great Lockdown: Impact of the COVID-19 Pandemic on the Global Economy

Marek Wąsiński, Damian Wnukowski

The coronavirus pandemic and efforts to suppress it (the Great Lockdown) will lead to the collapse of the global economy. In the short term, the reduction in production and consumption in the countries most affected by the pandemic will lead to a global recession. In the long run, the crisis may result in a partial retreat from globalisation, higher indebtedness, and narrowing the differences in economic potential between the EU and the U.S., and China. A positive side effect may be the acceleration of the development of the digital economy, including the services market.

Short-Term Effects. In connection with the pandemic, many governments have introduced radical restrictions on social and economic activity, as well as travel barriers. These have affected about half of the world's population and have harmed the global economy. Consumption has fallen (except, for example, food purchases), and the most affected sector is services, including tourism, transport, and gastronomy. Also, the absence of employees from factories has disrupted global value chains (GVC, which spread production processes across the world, both within one company and among many suppliers), making it difficult to maintain production even where restrictions were not yet in force. The economic crisis is seen both in demand and supply. This makes it difficult to stave it off and, at the same time, increases the scale. A prolonged pandemic will lead to recession, including in the U.S. and the euro area, as well as the entire global economy. According to the International Monetary Fund (IMF), in 2020, instead of the previously projected 3.3% growth, global GDP may fall by 3%. The crisis will also slow GDP growth in emerging markets, including China (the IMF predicts it may be 1.2%, the least since the 1970s). However, if the pandemic weakens in the second half of the year and the actions to mitigate its results are effective, the IMF predicts global growth in 2021 at 5.8%.

The pandemic also is affecting financial markets. In the first quarter of 2020, stock exchanges around the world lost a total of more than 20% in value, recording the worst results since the global financial crisis of 2007–2009. Fluctuations are also visible in the currency market where the dollar has mainly gained. Emerging markets have suffered the most, with more than $80 billion withdrawn in recent weeks, which could threaten the stability of their economies, such as debt service.

Countermeasures. The burden of countering the effects of the pandemic lies mainly on governments, which are introducing stimulus packages (e.g., the U.S. is spending $2.2 trillion, Germany, €1.1 trillion) and central banks (e.g. the U.S. Fed has announced unlimited purchases of bonds and the European Central Bank has prepared a programme to buy assets worth €750 billion, which can be extended if needed). The EU is supporting the Member States, including by allocating funds from the EU cohesion policy budget. The IMF and the World Bank offer developing countries easier access to financing (they already announced

support worth $50 billion and $160 billion, respectively) and call on developed countries to suspend debt payments by the poorest countries.

Cooperation within the G20 to overcome the effects of the pandemic is limited. On 26 March, G20 leaders announced they would spend $5 trillion to combat the economic effects of the pandemic (including the national measures being introduced), and on 31 March, finance ministers and the heads of central banks announced only the preparation of a joint action plan. Cooperation that would enable, for example, an effective flow of goods to fight the pandemic to the most affected regions, is hindered by mutual accusations between the U.S. and China of responsibility for the crisis and the uncoordinated efforts of each group member to secure as many resources as possible. Governments have introduced restrictions on trade in medical products, such as India, which partially suspended exports of an anti-malaria drug used in COVID-19 treatment. This threatens local shortages and may make it difficult to suppress the pandemic or, in this example, treat malaria on a global scale. Trade in other products may also be restricted, such as personal hygiene products or food (e.g., Vietnam has limited rice exports). Also, President Donald Trump's announcement on 14 April that the U.S. would suspend funding for the World Health Organisation (WHO), will further hamper crisis management at the international level.

Long-Term Effects. The pandemic is likely to permanently change the world economy, resulting in a partial retreat from globalisation. The functioning of the current GVC model has allowed minimising production costs. However, the U.S.-China trade war and the pandemic-fuelled economic crisis have revealed several threats inherent in this system. The first, concentrating production in China, has turned out to be risky, so there will be a greater geographical diversification of investment in manufacturing plants (which has happened before, among others, due to rising labour costs in China). Second, the process of moving production closer to final destination markets will be strengthened to reduce risk in a broader sense, which mainly affects Asia. Third, companies will probably return to stockpiling parts to be able to continue production despite interruptions in supply chains. Avoiding the need for storage has so far reduced costs. Also, if restrictions on the movement of people or goods are maintained, a decline in turnover in international trade and its share in global GDP can be expected. The importance of digital services in the economy, which now are more frequently used for work and shopping during the period of social restrictions, will increase. People also may limit travel.

The pandemic will increase government spending on healthcare and medical products around the world, which will affect other budget lines. Western countries are likely to cut military spending. Funding to fight future epidemics and economic stimulus packages, along with reduced corporate revenues due to the recession will lead to increased state interventionism and a significant increase in global debt, both public and private. Extraordinary actions by central banks, including large interest-rate cuts, will reduce debt-servicing costs, for example, on commercial loans, but also limit the range of possible activities of these institutions and increase the risk of a financial crisis through, for example, speculative bubbles. The treasury bond purchase programmes mean the role of central banks in financing fiscal policy will increase; however, easing debt service will only apply to large countries, not to developing ones, where investors lose confidence during a crisis, causing capital outflow. There is also a risk that the stimulus measures are insufficient and the economic rebound slower than expected, which will increase the social costs of the collapse.

The recession in the EU and the U.S. also opens up opportunities for China to bridge the gap in economic potential faster. Although the current crisis, unlike in 2007–2009, will slow the Chinese economy considerably, the relatively quick lifting of restrictions and the launch of production plants may reduce such damage. At the same time, China will try to turn the collapse of world trade to its favour by emphasizing its global role in goods production, which has slowed down in other countries, and, on the other, trying to make its economy more independent of exports due to the instability of foreign demand. The latter, however, will be difficult to achieve in the short run. Concurrently, Chinese investors may be willing to buy out foreign technologically advanced enterprises that have been weakened by the crisis

Conclusions. International cooperation will be key to reducing the long-term collapse of the world economy. This, however, is made more difficult, among others, by the U.S.-China rivalry and trade restrictions. Although the narrowing differences in economic potential increase the propensity of the U.S. to escalate trade and technology disputes with China, the recession in America will prevent such activities in the short term because of the high economic costs. Concurrently, it should also de-escalate the EU-U.S. trade dispute.

In the short term, Poland's economy will slow down, not only as a result of the decrease in domestic consumption but also the disruption in GVCs, which will reduce the demand for Polish semi-finished products. This means that, unlike the financial crisis of more than a decade ago, Poland will experience a recession. In the long run, the reorganisation of GVCs should be beneficial for Poland because companies that sell goods in the EU will bring back even more of their investments to Europe, including Poland.