دراسات
DERASAT
مركز البحرين للدراسات الاستراتيجية والدولية والطاقة
Bahrain Center for Strategic, International and Energy Studies

Derasat Reports
April, 2020

Implications of the Coronavirus Crisis:

An Economic Outlook

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1. Introduction and Summary

The coronavirus crisis has caused grave economic damage that surpasses the direct health implications of the virus. This report monitors and analyzes the main economic developments, with a separate report detailing the implications related to oil markets. The main conclusions are:

1. The global economy will be significantly damaged by the coronavirus pandemic, in both growth rates and living standards, and some consequences will have a lasting impact, such as fundamental changes to the world trade system.
2. Currently, due to the crisis's complexity, and the uncertainty around the policies governments will adopt, the accuracy of economic models that can be used to assess the expected impact of the crisis will diminish. However, the most accurate forecasts at present indicate as significant fall of 2.6% in the average economic growth in the United States and the European Union.
3. There are a large selection of monetary and fiscal policies to help counter this crisis. Fiscal policies are considered more effective than monetary policies, but are more difficult and slower to implement. However, all these policies come with their own significant long-term economic risks.

2. Economic Implication

2.1 The Difficulty of Financially Assessing the Size of the Economic Damage

For some developments that harm the economy, economic experts can assess the size of negative economic impact on a financial basis. For example, when oil prices fall sharply, or one country imposes tariffs on another country's exports, then the impact assessment process requires creating advanced economic and statistical models, and significant time to collect data and develop models.

In the case of the coronavirus crisis, the time necessary for these requirements has increased, due to the size and complexity of this crisis, the lack of data, the difficulty of creating models, and the fact that the crisis continues to develop in an unpredictable manner. Therefore, it is essential to be circumspect when dealing with any media-circulated estimates, experts can only be sure that the economic damage will be large.

2.2 Short-term Economic Costs: The Health Sector

1. The cost of healthcare procedures, including quarantine and tests, special equipment, and overtime hours for specialized workers.
2. Health-related preventative measures, including sanitizers, masks and vaccines (when available).
3. Non-health-related preventative measures, including security arrangements at borders and public facilities, and implementing a general quarantine and curfew.
4. Lost work hours for those infected and practicing prophylactic absence, and absence to care for children during suspended schooling.

2.3 Short-term Economic Costs: Other Sectors

All sectors will bear costs, but five sectors will bear the brunt of the pandemic's direct impact, and the effects of preventative health procedures:

1- Tourism.

2- Aviation, such as KLM's plan to lay-off 2000 employees.

3- Retail.

4- Restaurants.

5- Point-to-point transport, such as taxi cabs and buses.

The effect of these developments on the GCC countries will be amplified, because these sectors make a significant contribution to their economies: religious tourism -especially Hajj- plays an important role in the Saudi economy, and the economy of Dubai revolves around tourism, retail, restaurants and civil aviation.

Additionally, production chains will witness large disruptions, due to the closure of transit points and factories as a preventative measure. Therefore, countries that depend on international trade, among them the GCC countries, will see more damage than countries with a minimal levels of self-sufficiency, because demand for their exports will contract, and the cost of their imports will rise.

The greatest economic damage will appear in countries most reliant on the economies of China, South Korea and Italy (currently; this might change with the virus spreading), as these economies are the most damaged by the virus. GCC countries fall within this category, since China and South Korea are among the most important oil consumers in the world, especially Gulf oil. This has been reflected the large decline in oil prices, exceeding 50%, which affects all sectors of the Gulf economies.

In the event that central banks do not provide monetary assistance, the coronavirus crisis will cause a financial crisis due to the liquidity crunch, originating in the banks that serve the aforementioned five sectors. Share prices have largely dropped during 2020, wiping away earnings from three or more years, and resulting in huge budgetary pressures on banks, families and pension funds.

According to estimates from the latest economic and statistical models, US and European economic growth in 2020 will fall by 2.6% due to the coronavirus fallout, along with a decline in commercial dividends by 25-28% in both economies.

2.4 Long-term Economic Implications

Due to the short amount time elapsed since the beginning of the crisis, the long-term economic implications are yet to materialize, but in in the absence of fiscal and monetary policies countermeasures, the global economy is expected to face the following:

1- The bankruptcy of companies unable to meet their financial obligations, as part of a vicious contractionary economic cycle.

2- The bankruptcy of individuals unable to settle their debts, such as mortgages and car loans, also as part of a vicious contractionary economic cycle.

3- Redundancies by companies that can no longer pay their wages, as part of the same cycle/

4- Collapse of the financial system due to a liquidity crunch.

5- A retreat in globalization, and an increase in self-sufficiency in each country's production chains, to avoid similar future economic crises, but at the expense of the higher living standard brought about by globalization.

Due to the rapid implementation of monetary and fiscal policies (see below), these implications will only materialize in limited form. However, there are other risks related to these policies, also mentioned below.

Notably, the coronavirus crisis may lead to a decrease in global inequality, since wealthy nations and individuals are the most affected by the virus. Throughout history, diseases and epidemics usually spread more among the poor, but today we see – especially outside China – that the wealthy are more prone to disease, with those infected being people on cruise ships, politicians, entrepreneurs and celebrities. The wealthy and elite are more susceptible to contract the coronavirus, because they travel more, live in large urban centers, and interact with a lot of people.

The fortunes of the wealthy have also been the most affected by the coronavirus outbreak, as stock prices have fallen, and companies owned by the wealthy have recorded a sharp decline in profits. The combined net worth of the wealthiest 500 people in the world decreased by $500 billion due to the outbreak, with the richest three: Jeff Bezos, Bill Gates and Bernard Arnault accumulating losses of $30 billion.

3. Economic Measures to Counter the Crisis

3.1 General Principles

In economic crises, governments provide economic support packages to mitigate the negative impacts and revive the economy. However, the negative economic impacts of epidemics are substantively different from those of conventional economic crises, and require special procedures. In the case of the coronavirus crisis, governments have broadly adhered to the following principles:

First: the goal is not boosting aggregate demand in the economy, such as launching large government investment projects, nor reducing taxes, but rather providing social insurance by helping those with a reduced or lost income, whether companies or individuals. Due to the difficulty of instantly establishing a system to separate those largely affected from those with minor losses, packages should include direct unconditional money transfers to families and businesses without complications.

Second: due to the magnitude of the crisis, packages most likely will not be affected by the size or trajectory of the public debt, because economies are facing an existential threat.

Third: packages should motivate people to abide by directions to practice home quarantining and observe curfews to curb the spread of the coronavirus, due to the psychological stress these steps inflict on people, and their tendency to push people toward violating them over time.

Fourth: monetary authorities should provide enough liquidity for individuals and companies to avoid an economic meltdown. In particular, demand for credit will have experienced a sharp increase due to the fall in corporate revenues and personal earnings, and in the absence of a concomitant decrease in financial liabilities. Rising demand for credit will also represent a precautionary measure to ensure companies have sufficient liquidity. Therefore, banks' ability to respond to an increase in demand must be guaranteed. Notably, advanced economies have adopted loose monetary policies since the global financial crisis of 2008, focusing on low interest rates, thus leaving very little room for further lowering of interest rates, necessitating alternative means for enhancing liquidity. This is a problem faced by Eurozone countries, since interest rates have reached near-zero prior to the crisis.

3.2 Monetary Policies

1. Lowering interest rates to zero or near-zero, and offering collateralized credit at zero interest to all financial institutions with a very high ceiling, such as what the UAE provided at 50 billion Dirhams. This policy aims to guarantee liquidity in the financial system, and help banks avoid having to reject credit requests or liquidate their investments to satisfy demand.

2. Lower capital buffers imposed on banks that usually reduce their capacity to lend; these were previously made stricter following the 2008 global financial crisis.

3. Implementing an asset purchase program at inflated prices to provide banks with an additional liquidity channel.

4. Rescheduling loan payments, especially mortgages.

Several countries adopted these policies as a whole or partially, with different specifications according to their internal economic situation, among them the United States, United Arab Emirates, Saudi Arabia, the European Union and the United Kingdom. The International Monetary Fund also offered to provide direct financial support to affected countries through low-interest loans. In some countries, like the UAE, a ceiling was specified for certain types of financial support, while in other countries – with the US leading – central banks were explicitly keen not to cap support, to boost confidence.

In GCC countries whose currencies are pegged to the US Dollar, central banks supported the economy through these steps, also with the aim of enhancing investor confidence trust concerning a fixed exchange rate, by indicating the magnitude of foreign currency reserves. Despite this, pressure has risen on GCC transactions in financial markets.

Notably, central bank governors have affirmed the secondary role that monetary policy will play in countering the crisis, and that fiscal policy will play the leading role. However, monetary policies are an important launch point because they do not require intragovernmental coordination or parliamentary approval, a time-consuming process that slows down fiscal policies compared to monetary ones. This is a problem that limits the US government's ability to implement fiscal policies, since both Republicans and Democrats have struggled to reach a consensus on any policy, due to deep and continuous political conflicts.

3.3 Fiscal Policies

1. Policies to support sick and family leave and quarantine, through legislation that permits extended holidays, as well as direct financial support to employers in the form of direct transfers to cover salaries during these periods, in addition to tax exemptions for employers. These policies partially aim to encourage people to adhere to social distancing protocols.
2. Supporting budgets for programs that raise living standards of those with limited income, such as food vouchers, subsidies to basic goods, and unemployment benefits.
3. Direct unconditional money transfers to families, and to companies in the form of exemptions from – or reductions in – taxes.
4. Supporting the budget for public health systems to ensure adequate staffing, equipment and medical supplies.
5. Nationalizing large affected corporations, such as Alitalia.

Countries around the world either adopted or will adopt different combinations of these policies, based on their specific circumstances. China, South Korea and Singapore began implementing such policies, and economic packages moved west with the virus, where European countries and the US are still in a parliamentary consultation phase regarding fiscal policies.

3.4 Other Policies

Regarding GCC countries, oil policy, under OPEC's umbrella, merits discussion. With shale oil's increasing market share and flexible production, OPEC countries are now unable to collectively raise prices without cooperation from non-OPEC countries, such as under the OPEC+ deal. Such an arrangement succeeded in supporting oil prices from December 2016 to March 2020, but Russia announced it will exit the deal, causing member countries' production to return to its normal levels.

Saudi Arabia sought cooperation under the umbrella of OPEC+ as a method to counter the coronavirus crisis, and it was joined in this vision by GCC countries like Kuwait, the UAE and Bahrain. However, Russia's withdrawal led to the end of the cooperative policy to raise oil prices, since OPEC's market share comprised less than half the market, therefore, any attempt to cut production will in turn lead to an increase in market share for shale oil at the expense of OPEC's share, leading to a huge economic loss. Russia might reconsider its position, yet for reasons mentioned in an associated report, that is unlikely to happen.

In all the world economies, the crisis has forced organizations to develop their telework systems. With investments that took and will take place in the coming months, societies could witness a fundamental change in work methods, with a notable shift to working remotely. This direction is also supported by environmental considerations, since working remotely reduces the carbon footprint. This will affect several services, especially education and retail, and will increase dependence on ecommerce companies like Amazon, which is now planning to recruit 100 thousand new employees. The changes could also motivate companies to increase their reliance on international outsourcing.

3.5 Risks

Despite the urgent need for these policies, they carry several risks. In terms of monetary policy, credit might encourage irresponsible financial decisions (moral hazard), such as perpetuating economically unfeasible commercial activities, or misusing low-interest loans, causing a future financial crisis. Restrictions had previously been applied to counter the spread of the kinds of irresponsible investments that led to past financial crises; consequently, on this occasion, there is a need for intelligent and diligent monitoring from financial authorities.

In terms of fiscal policies, there is great concern on how they will be financed over the long-term, especially with the continuing rise in public debt after the 2008 global financial crisis. In countries like the US, public debt surpassed 100% of GDP prior to the coronavirus crisis, and society will likely refuse higher taxes. Therefore, the current fiscal stimulus could help bring about a large financial crisis, such as state bankruptcy in 10 years, or a political crisis due to society's refusal to pay taxes. European and East Asian countries face similar concerns.

In GCC countries, this problem is exacerbated due to the fixed exchange rate that depends on maintaining a low public debt and the absence of large fiscal deficits.

Updated on March 29, 2020.