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The COVID-19 Pandemic

By Bert Hofman

In his March 2015 Ted Talk on a future global flu epidemic, Bill Gates, the philanthropist, probably wanted to mention a really big number for the costs that such a pandemic could impose onto the world. So he quoted an astronomical US$3 trillion. The extraordinary G-20 leaders meeting on the COVID-19 virus pledged US$5 trillion in policy measures to fight the virus and the economic impact of the measures to control it (see the concluding statement). Even this may not be enough.

The good news is that, unlike 2008/9, there is little disagreement on the need for a massive economic policy response. Driven by collapsing stock and bonds markets, the "whatever it takes" moment took weeks rather than months, or even years to arrive, as it did after the Global Financial Crisis (GFC). Indeed, the G-20 leaders meeting came within two weeks of the World Health Organisation's (WHO) declaration of a pandemic. In the middle of diplomatic spats and blame shifting in the weeks before the (virtual) meeting, it was remarkable that the G-20 could come up with a joint and forceful statement at all.

Unlike at the time of the GFC, few if any are asking the question of who will foot the bill. The US congress, which back in 2008 had to think twice about a US$700 billion "TARP" programme to save the financial system, and later short-changed the Obama government on its fiscal stimulus, is now about to approve US$2 trillion, some 10% of gross domestic product (GDP). Even for Germany, the 'black zero" is no longer the holy grail for fiscal policy and the government has announced a EUR750 billion package in new spending and lending from KfW, a development bank.

Of course, if not now, when? Interest rates on government bonds are at record lows in the wake of a flight to safety. Those on German Bunds are negative and the yield on 10-year US Treasuries is below 0.5%. It does not take "Modern Monetary Theory" to figure out that the time to spend is now. Helpful also was that monetary authorities did not need to reinvent the wheel: they could simply restart their asset purchase programme and further open existing

emergency discount facilities. Thus, the response was swift when it came and central banks are no longer the only game in town.

The bad news is that in most countries the delay in response to the epidemic will make fighting it much more expensive. First was the delay in China, detailed in an article by the respected Caixin Magazine. The epidemic might just have been contained in the city of Wuhan, if the authorities had acted on the information available by end-December 2019. Instead, politics got in the way (in this case the rather insignificant political meetings in Wuhan municipality and Hubei province) and by the time serious action was taken on 23 January, the virus was already all over China and had started to spread internationally. It took extraordinary measures to contain the virus in China: basically, the government shut down the economy—an exceptional move in a year that was meant to deliver 5.6% GDP growth to meet the Communist Party's "Centennial Goal" of a moderately prosperous society. In all likelihood, this goal will have to wait another year.

The second delay came from the slow response in countries around the world. From denial to trivialisation of the numbers, to mistaken beliefs on the viability of "herd immunity" and to logistical challenges to get virus testing in place, all held up policy responses in most of the West. The United States, in an election year, was particularly lethargic in its response at the federal level, led as it is by a president who seems more concerned that a forceful reaction to the virus would lower "his" stock market numbers. As a result, precious time was lost. A redeeming feature for the United States was the swifter actions at the State and community levels. The United States has now overtaken China in terms of the number of infected people, though doubts remain at this stage how accurate these numbers are (see for excellent data the site of the Johns Hopkins University. Equally impressive is the site of Our World in Data).

Contrast this with some of China's Asian neighbours: the SARS and MERS epidemics are still a vivid memory that has inoculated authorities in those countries with a strong dose of common sense in addressing a virus threat. The governments of Taiwan, Korea, Singapore, Hong Kong and Japan, in their own specific way, reacted early and forcefully, and stepped up efforts as the storm outside their borders intensified. Measures to enforce "social distancing" and change behaviour to a varying degree were complemented with extraordinary efforts to monitor, test, identify and isolate the infected, trace their contacts and follow up. It is important to learn from these examples—as Western countries will need similar measures, now, and after they come out of the phase of extreme social distancing and lock-down that they only now enter into to stop the uncontrolled spread of the virus.

Timeliness of the international response was not aided by the WHO's belated declaration of human-to-human transmission, which is key for a virus to evolve from a local matter to a potential epidemic. The warning came three weeks after eight courageous doctors in Wuhan and Taiwanese authorities had already warned against it. The organisation was also reluctant to call the epidemic a pandemic—a sign that the virus had spread to many countries in the world. To be fair, there is no hard science to tell whether there is a pandemic or not, and the WHO had abandoned its own system for doing so after the H1N1 episode. Yet, declaring a pandemic obviously works as a wake-up call and when the WHO did so on 11 March, most countries put their response into high gear.

Not a moment too soon, as people were losing confidence in their governments. An extremely timely and large-scale survey done last week by a group of researchers from 12 different institutions, including Harvard, Cambridge, IESE and Warwick University, sheds more light on this. The findings suggest that many people around the world have little confidence in the words and actions of their government in response to the virus (Figure 1; see all the results here). Among OECD countries, the United States particularly stands out: the vast majority of people felt that the government had been untruthful and done too little. Opinions in Japan were also less favourable than most would have expected, perhaps because until recently, the government was still seen to be weighing measures to contain the virus against the chances of holding the Olympics this summer. These have now been postponed. In contrast, most people in the smaller Asian countries have high confidence in the actions and words of their government. The survey also reveals a sharp change in personal behaviour (social distancing, stay home, washing hands, cough in your tissue or elbow) around the world, which gives hope for turning the tide on the pandemic.

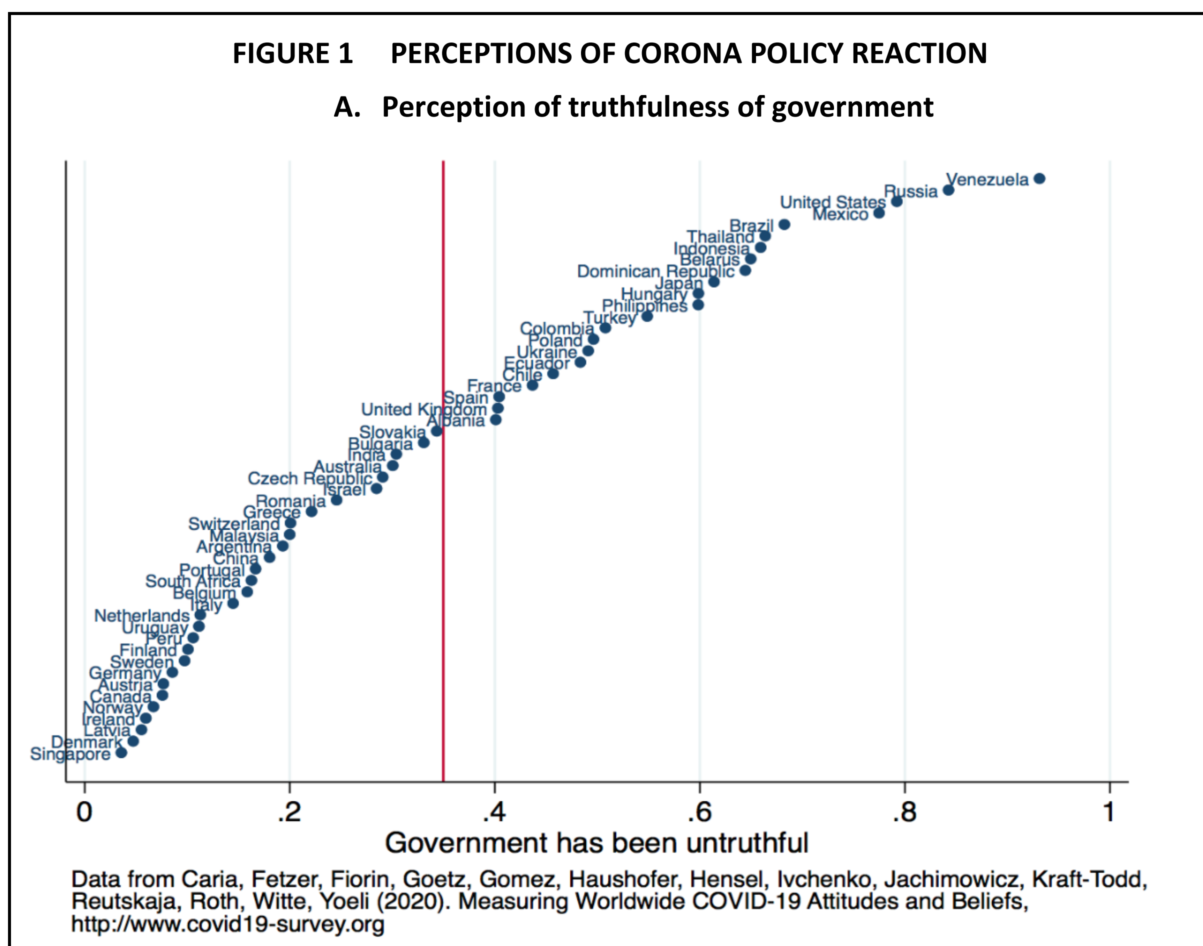


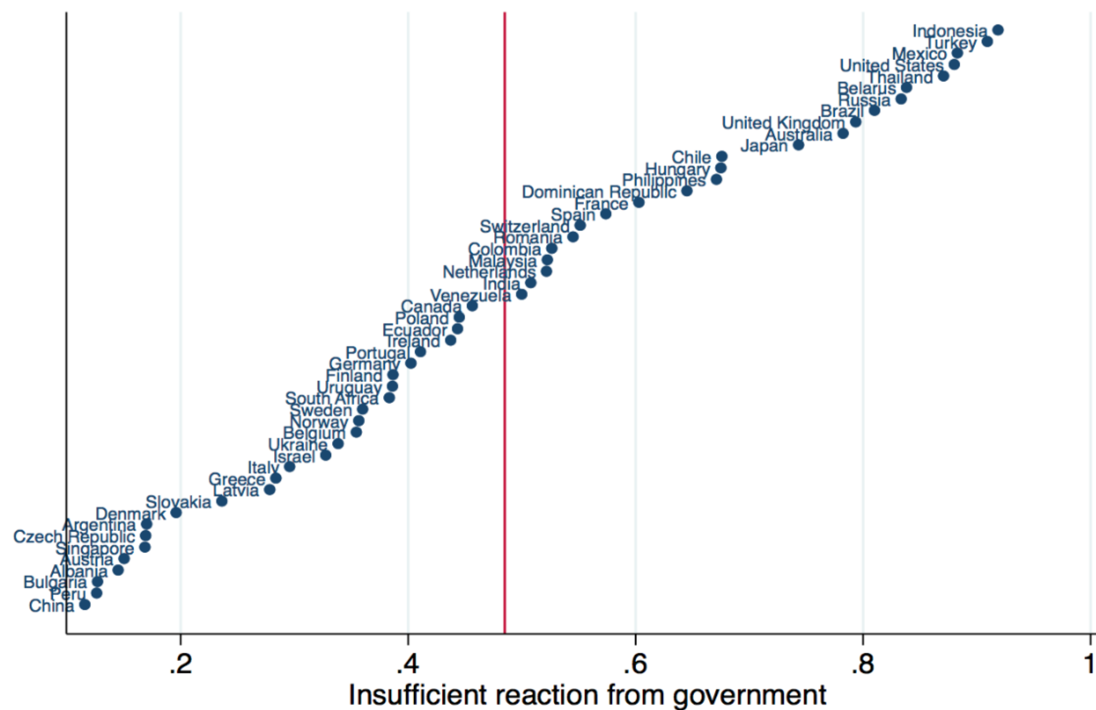
FIGURE 1 PERCEPTIONS OF CORONA POLICY REACTION

A. Perception of truthfulness of government

Data from Caria, Fetzer, Fiorin, Goetz, Gomez, Haushofer, Hensel, Ivchenko, Jachimowicz, Kraft-Todd, Reutskaja, Roth, Witte, Yoeli (2020). Measuring Worldwide COVID-19 Attitudes and Beliefs, http://www.covid19-survey.org

FIGURE 1 PERCEPTIONS OF CORONA POLICY REACTION

B. Perception of actions taken by government



Data from Caria, Fetzer, Fiorin, Goetz, Gomez, Haushofer, Hensel, Ivchenko, Jachimowicz, Kraft-Todd, Reutskaja, Roth, Witte, Yoeli (2020). Measuring Worldwide COVID-19 Attitudes and Beliefs, http://www.covid19-survey.org

Economists were almost as slow as politicians in accepting the economic consequences of the epidemic. True, this economic impact is not independent from the policy response to the virus, but at least for China, it was clear early on that the massive lock-down would have serious economic consequences. At the time of my last newsletter end-February, the outlook for China of most financial institutions had remained surprisingly rosy, though, and our own projections for Quarter 1 GDP growth (then minus 6.5% year on year) stood out (Figure 2).

Things have changed since then and rapidly so. The National Bureau of Statistics has released initial numbers for January and February, which all point towards a sharp decline in first quarter GDP. Many now project a fall in Q1 GDP and very modest growth for the year as a whole. Our own projection for Q1 has become even more negative as newly available data revealed that March saw less of a return to normal than we originally thought. We now foresee a drop in GDP by 10% (yoy) for Q1 and a growth between 1% and 3.3% for the year. It would take on average a 10.2% (yoy) growth rate for Q2-4 for China to reach 5.6% growth. The state of the economy suggests that the recovery will spill in the second quarter and achieving 5.6% growth for the year is now nigh impossible.

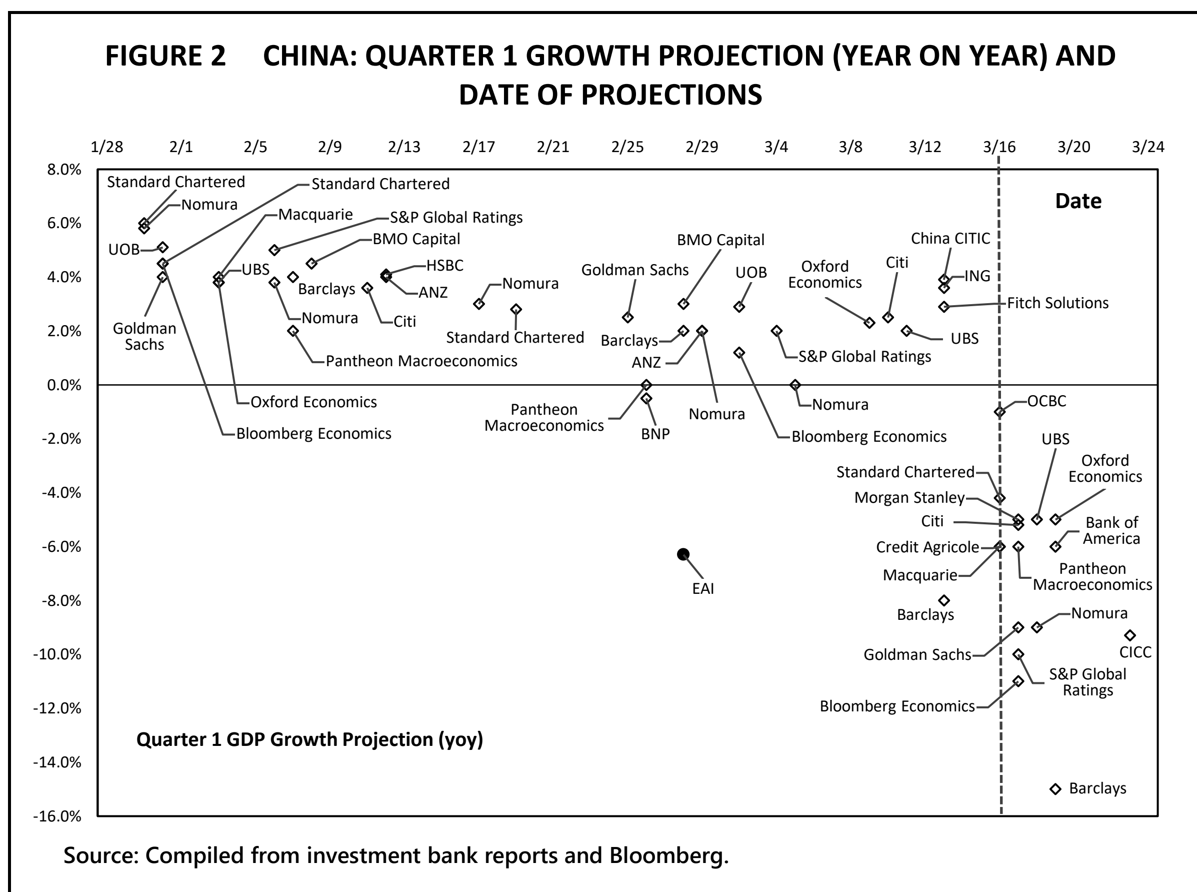


FIGURE 2 CHINA: QUARTER 1 GROWTH PROJECTION (YEAR ON YEAR) AND DATE OF PROJECTIONS

Source: Compiled from investment bank reports and Bloomberg.

Thus far, China has only been staging a relatively modest economic stimulus, at least compared to the massive one it unleashed in 2008. The strategy seems to be to keep enterprises and banks alive through the shutdown and only boost spending after a return to normal. Measures taken or announced by the central government thus far included tax exemptions and tax rate cuts, deferral of social security and health insurance premium payments, and special lending facilities managed by PBC and state banks. This adds up to some RMB3 trillion, some US$400 billion, or a little less than 3% of GDP. China also announced the release of RMB1.8 trillion in local government bonds quota, the right of local governments to issue bonds. This is done ahead of the National People's Congress meeting, which normally approves the cap on the amount local governments can issue, but it is less than last year's RMB3 trillion.

The government may well plan for more to come, and a 25 March meeting of the Standing Committee of the Politburo on "New Infrastructure" suggests as much. However, the situation now is very different from 2008 and the world should not expect China to once again become the global engine of growth through a debt-fuelled infrastructure and real estate construction. Much infrastructure has been built in the past decade and a half, and debt levels of local governments, enterprises and households are now relatively high. Moreover, the tax base of local governments has been cut recently and thus too much stimulus may risk the financial stability of local governments. As for households, real estate, which was a big factor in the 2008 stimulus, has been hit hard by the crisis; households are heavily indebted and the housing market seems saturated. If the central government deems a larger stimulus necessary, it will

likely need to pay for it itself, either by means of larger transfers to local government, or to households, and targeted at consumption rather than investment.

One big opportunity for China to stimulate the economy is to extend a stronger safety net to migrants and rural citizens. While unemployment numbers only increased modestly to 6.2%, this by and large excludes migrants, of which nearly 100 million had yet to return to work by mid-March, in part because there is no work to return to. Providing support for them, and increasing the support for people in rural areas through more generous pensions and *dibao* or welfare payments will not only boost consumption, but also contribute to meeting the goal of eradicating extreme poverty by the end of the year.

The rest of the world will fare worse than China. Though the International Monetary Fund (IMF) has yet to publish new estimates, in a statement released after last week's G20 its managing director has already said that the world will enter a recession this year. The Institute of International Finance, in quick succession, downgraded its global economic growth for 2020 from 2.6% earlier this year to *minus* 1.5% now. It now projects GDP to decline for the United States (-2.8), the Eurozone (-4.7) and Japan (-2.6), whereas emerging markets are expected to eke out a meagre 1% growth. Most investment banks now project similar orders of decline in the world economy. The underlying assumption for most projections is that there will be one really bad quarter—the second for most of the West—and then a recovery, which will extend into 2021. This assumption may well be too optimistic, as if one bad quarter turns into two, growth rates will further decline.

Low-income countries are particularly at risk even if their growth rates are for now projected to remain positive. The virus is likely to hit them hard for several reasons. First, their health systems are far less developed than that of OECD countries or those of China, and the rich East Asian economies currently affected. Second, a large part of the population works in the informal sector without a social safety net or health insurance. Thus they are far more vulnerable to a downturn than workers in the formal sector. While informality has increased across the board and now affects some two thirds of the global labour force, it will strongly drop as income rises, according to this ILO Report. Finally, unlike rich countries, the flight to safety increased interest rates for them and thus their governments will find it harder to spend the money needed to contain the virus and counter the economic impact.

To tackle the lack of funds in developing economies, IMF, the World Bank and other development organisations have pledged huge support. World Bank Group President Malpass also called on creditors to reschedule debt service due. This is a good initiative, and if implemented, will free up cash for health and economic policies in those countries. What is good for the goose is good for the gander, they say, so the World Bank (and IMF) could set a good example by rescheduling the debt service due to them. Over time, for the next pandemic, this could be institutionalised—at little to no costs to the World Bank: their financing also benefits from the flight to safety and is now cheaper than ever. Such a rescheduling facility will undoubtedly work better than the existing pandemic facility that was created in the wake of Ebola. That is an insurance facility, with high interest for investors and highly specific conditions for disbursement. It has yet to be disbursed.

One of the real downside risks for economic projections is that measures to suppress the virus are relaxed too early and that a renewed round of infection would cause a second economic downturn. Even without this, the measures may need to be in place for longer than they have been in China and other parts of Asia. This is in part because many countries implement less extreme measures, and in part because implementation is less consistent than in East Asia. A final risk is that the mechanisms for enduring control of the virus—detection, isolation and tracking—are not in place to take over after initial suppression. History suggests that these risks are real: the famous Spanish flu at the end of World War I came in three waves. Only a vaccine or a cure—both yet to be discovered—will ultimately stop the COVID-19 epidemic. The alternative, letting the virus run its course and aim for herd immunity to stop it from further spreading, is simply unacceptable.

A final, long-term risk is that the pandemic will feed protectionism around the world. Diversification from China, the China+1 strategy, which was already on the drawing board in the wake of the US-China trade tensions, will be reinforced by the disruptions caused by COVID-19. Some trade hawks in the United States, though, want to take the opportunity to go further, and use the epidemic as a further argument to decouple. Even within free trade blocs such as the EU, tensions have arisen on trade in medical supplies and reinstatement of controls at the border to protect against the spread of the virus. Finally, restrictions on food exports, which aggravated the impact of the GFC in 2008/9, is rearing its head again, which could be particularly damaging for developing countries. Thus, the epidemic is increasingly a risk for free trade, which could bring long-term damage to the world economy and slow the recovery from COVID-19.

The markets seem to believe that the worse will be over soon, and that public health measures and large economic stimulus packages are enough to get through this. They may yet be disappointed in the months ahead.

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