

The Coronavirus Recession of 2020

May 13, 2020

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Outline

- I. Historical severity of the crisis
- II. The rapid sequence of events so far
- III. Policy response by governments
- IV. Forecast of GDP growth
- V. Shape of the recovery: “V”, “U”, or “W”?
- VI. Debt sustainability

I. Historical severity of the crisis

The developments of 2020 are worse than

- pandemics like the “Hong Kong flu” of 1968,
- or recessions like the 2007-09 Global Financial Crisis.

For adequate precedents we have to go back to the first half of the 20th century:

- the global influenza pandemic of 1918-19 (“Spanish flu”)
- and the Great Depression of the 1930s.

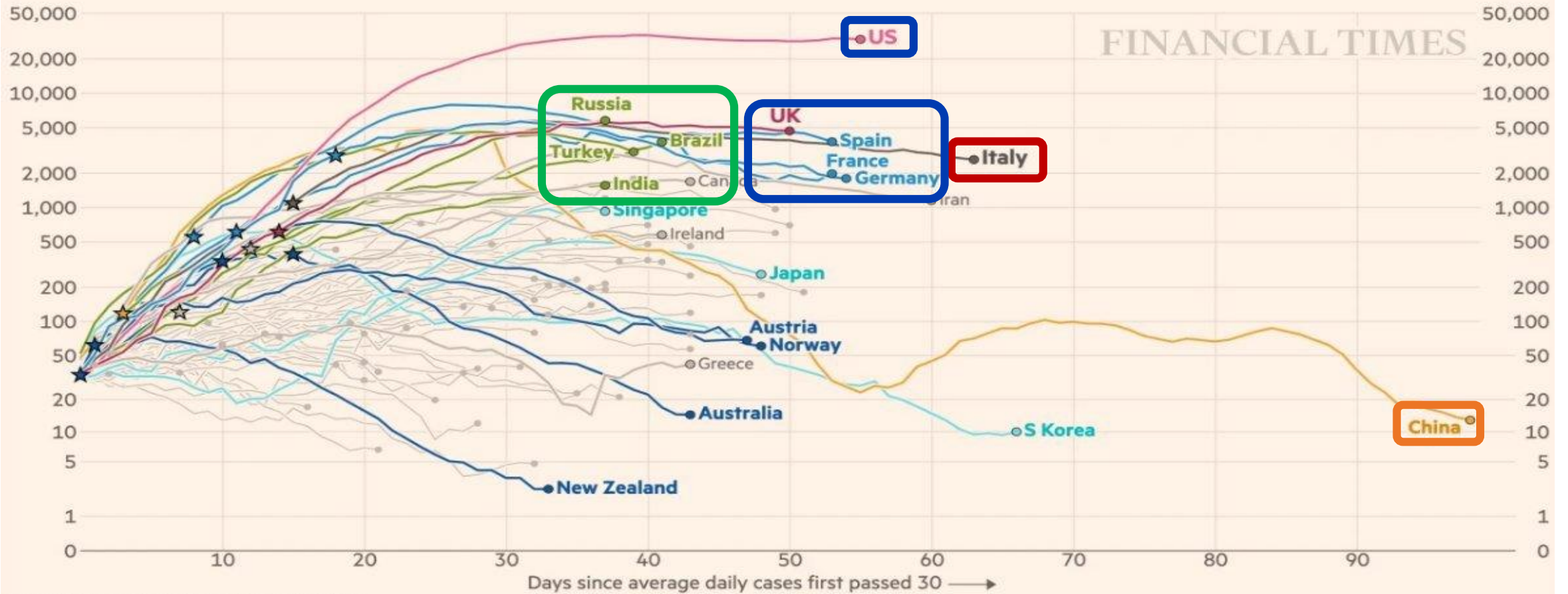
II. The rapid sequence of events so far

1. Spread of virus (Jan.-Feb., 2020).
2. “Risk off” in global financial markets (Feb. 24)
3. Collapse of oil prices (Feb. 26)
4. Onset of global recession (March-April)
5. The rush to re-open (May)

1. Spread of the virus

Several countries have turned the corner, with numbers of new cases now in decline

Daily confirmed cases (7-day rolling average), by number of days since 30 daily cases first recorded
Stars represent national lockdowns ★



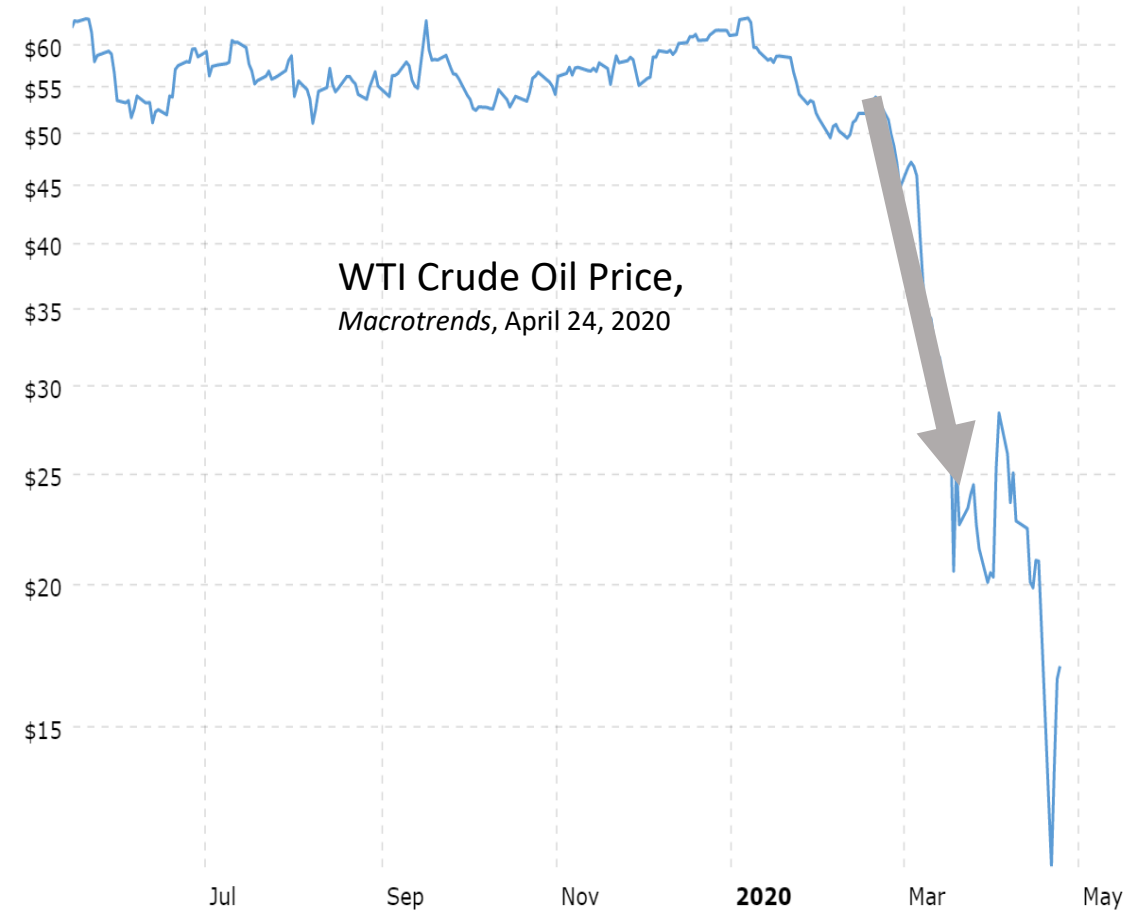
FT graphic: John Burn-Murdoch / @jburnmurdoch
Source: FT analysis of European Centre for Disease Prevention and Control; FT research. Data updated April 28, 17:12 BST

2. “Risk off” in global financial markets

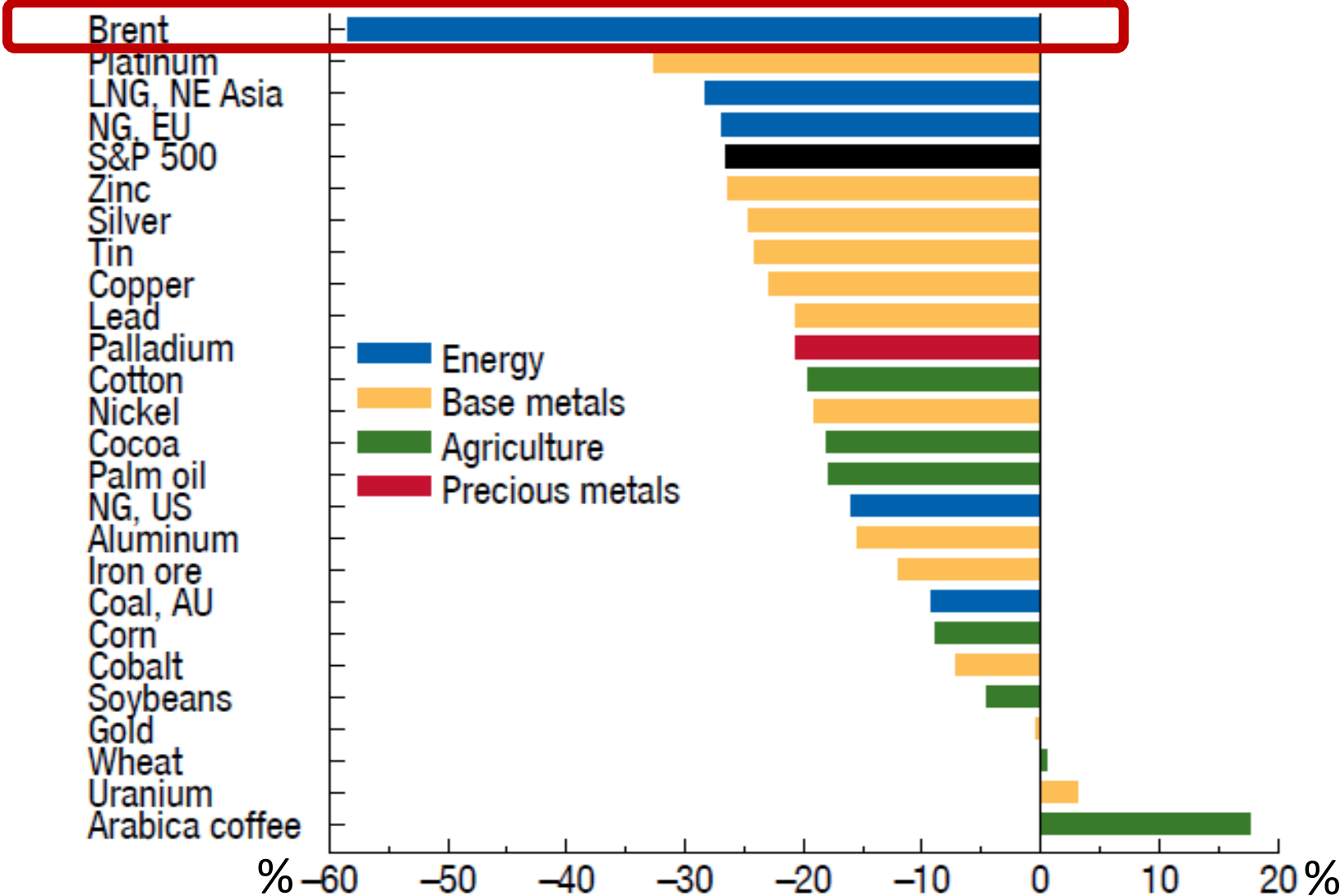
- Perceived risk, as measured by the VIX (Volatility Index) was below 14.0 as late as Feb. 14, but then rose, to 70 in mid-March.
- => Investors turned risk-averse:
 - pulled out of equities (Feb. 24-March 23),
 - then corporate bonds, esp. junk bonds (March 10-23)
 - & EM securities.
 - (See Appendix 1 for “Risk off” charts.)
- Investors moved from EM currencies to safe-havens,
 - particularly the US \$.

3. Collapse of oil prices

- started February 26.
- On April 20, price of WTI < 0.
- The losers: Middle East & Russia and some in Latin America & Africa.



Impact of the Covid-19 outbreak on oil & commodity prices

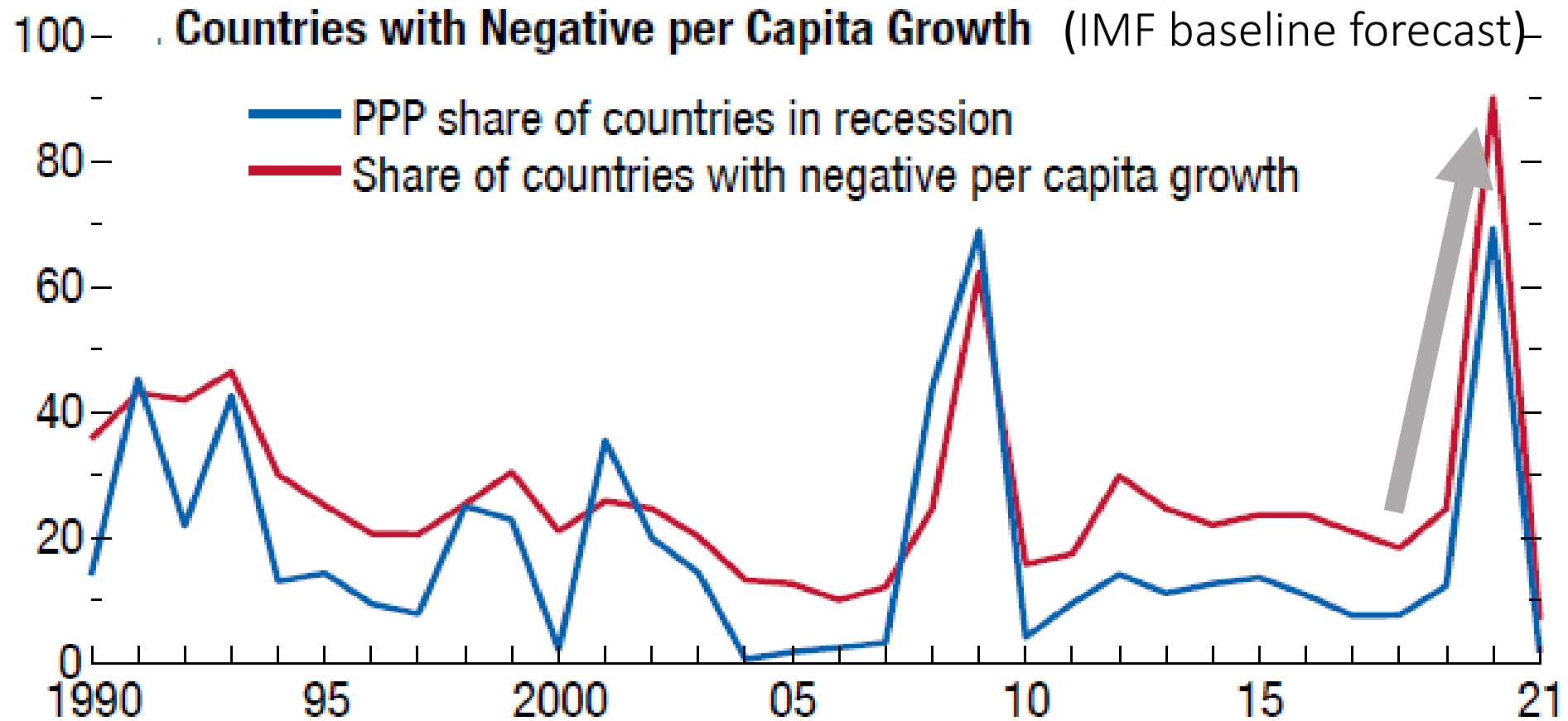


IMF WEO, April 2020. Figure 1.SF.1

For many developing countries,

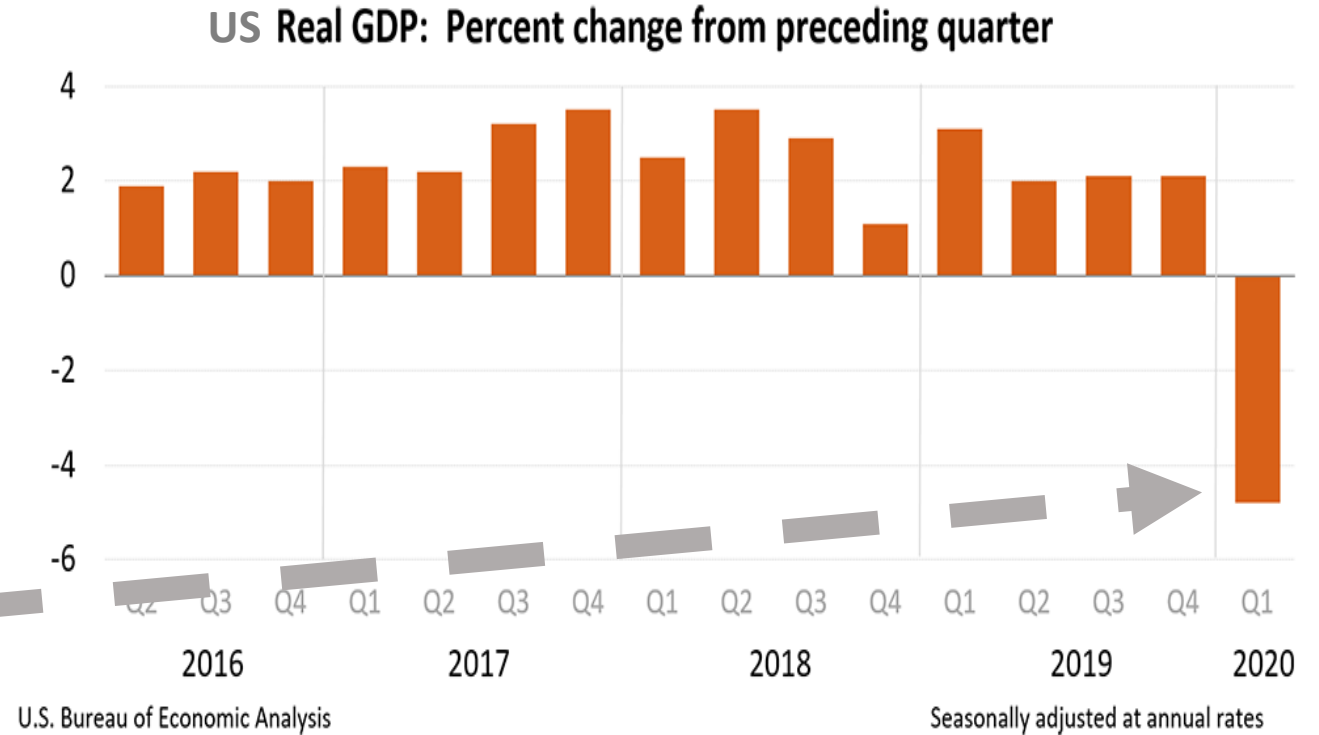
- a fall in commodity export prices comes on top of:
 - the sudden stop to capital inflows,
 - declining remittances,
 - and the terrible challenges of Covid-19 itself spreading where health care systems are inadequate even at the best of times.
- The recession will hit almost everyone.
 - Not concentrated among Advanced Countries, as in 2008-2010,
 - nor just among EM countries, as in 1997-98.

4. It is rare that one can predict recession before the numbers are in. But this time one could. A recession worse than 2008-09.



GDP already down in Q1 of 2020 (annualized & s.a.)...

- China's growth = -36.6 %.
- Korea's = -5.5 %.
- In Europe,
 - -21.3 % in France,
 - -19.2 % in Spain,
 - & -17.5 % in Italy.
- US growth = -4.8%.



- All will be much worse in the 2nd quarter.
 - US unemployment already at 14.7% in April, as measured.

III. Policy response by governments

1. In most countries, officials did not take Covid-19 seriously enough,
 - especially those with insufficient awareness of past history of pandemics.
 - China released the genetic code for the new coronavirus in early January.
 - WHO declared Public Health Emergency of International Concern Jan. 30.
 - But countries like the US & UK did not use the time to prepare.
 - They should have launched testing campaigns & ordered equipment.
 - President Trump was in denial. E.g., Feb. 26: “...when you have 15 people, and the 15 within a couple of days is going to be down to close to zero, that’s a pretty good job we’ve done.”

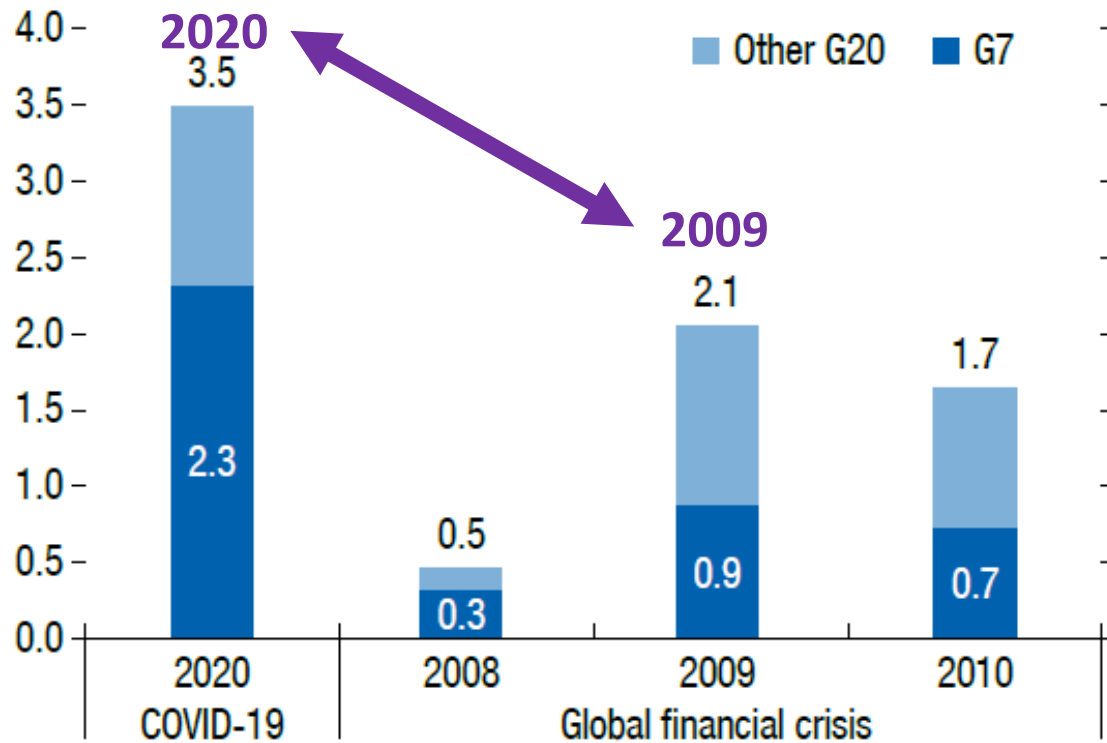
- 2. By now, however, most countries have responded with:
 - shutdowns & other public health measures
 - and appropriate macroeconomic stimulus:
 - fiscal relief & stimulus measures (in US, March 27)
 - and monetary expansion
 - going even beyond the Unconventional Monetary Policies of 2008-09:
 - Central banks buying corporate securities.

2020 fiscal response exceeds 2009, esp. in G7 countries.

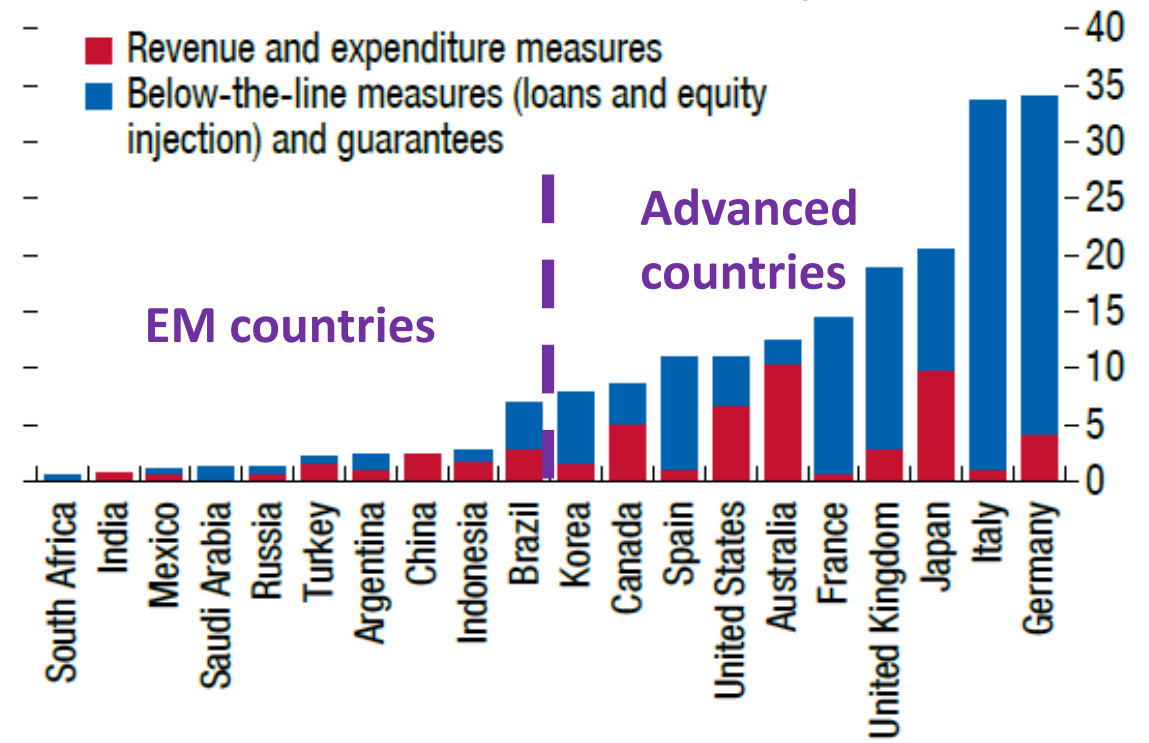
Figure 1.1. G20 Fiscal Response to the COVID-19 Pandemic and the Global Financial Crisis
(Percent of G20 GDP, left panel; percent of national GDP, right panel)

Countries are providing sizable fiscal support in response to the COVID-19 pandemic.

1. Above-the-Line Measures



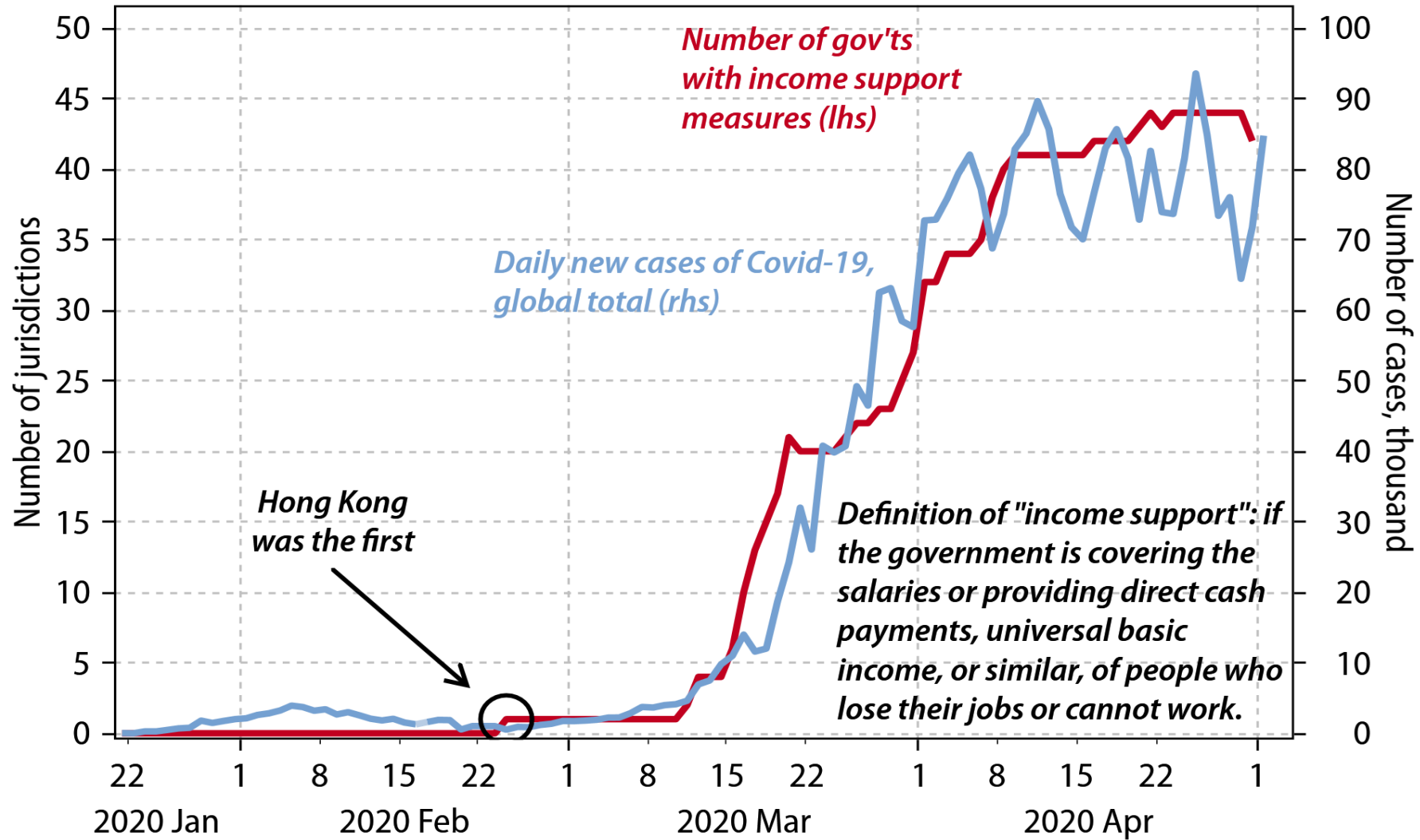
2. Above-the-Line and Below-the-Line Measures, and Guarantees



FISCAL MONITOR: POLICIES TO SUPPORT PEOPLE DURING THE COVID-19 PANDEMIC, IMF, May 2020

Data sources: IMF 2009a; IMF 2009b; national authorities; and IMF staff estimates as of April 8, 2020. Panel 1 includes above-the-line spending and revenue measures only, weighted by GDP in PPP-adjusted current US dollars. Panel 2 adds below-the-line measures (loans, equity injections) and government guarantees to revenue and expenditure measures adopted in 2020. These are presented in the same panel for ease of reference but are not additive. The decomposition between loans and guarantees is based on available information as of April 8, 2020..

Dozens of governments are directly supporting household income



Oxford COVID-19 Government Response Tracker, Gavekal Data/Macrobond

IV. Forecast of GDP growth:

IMF's *World Economic Outlook*, April 14

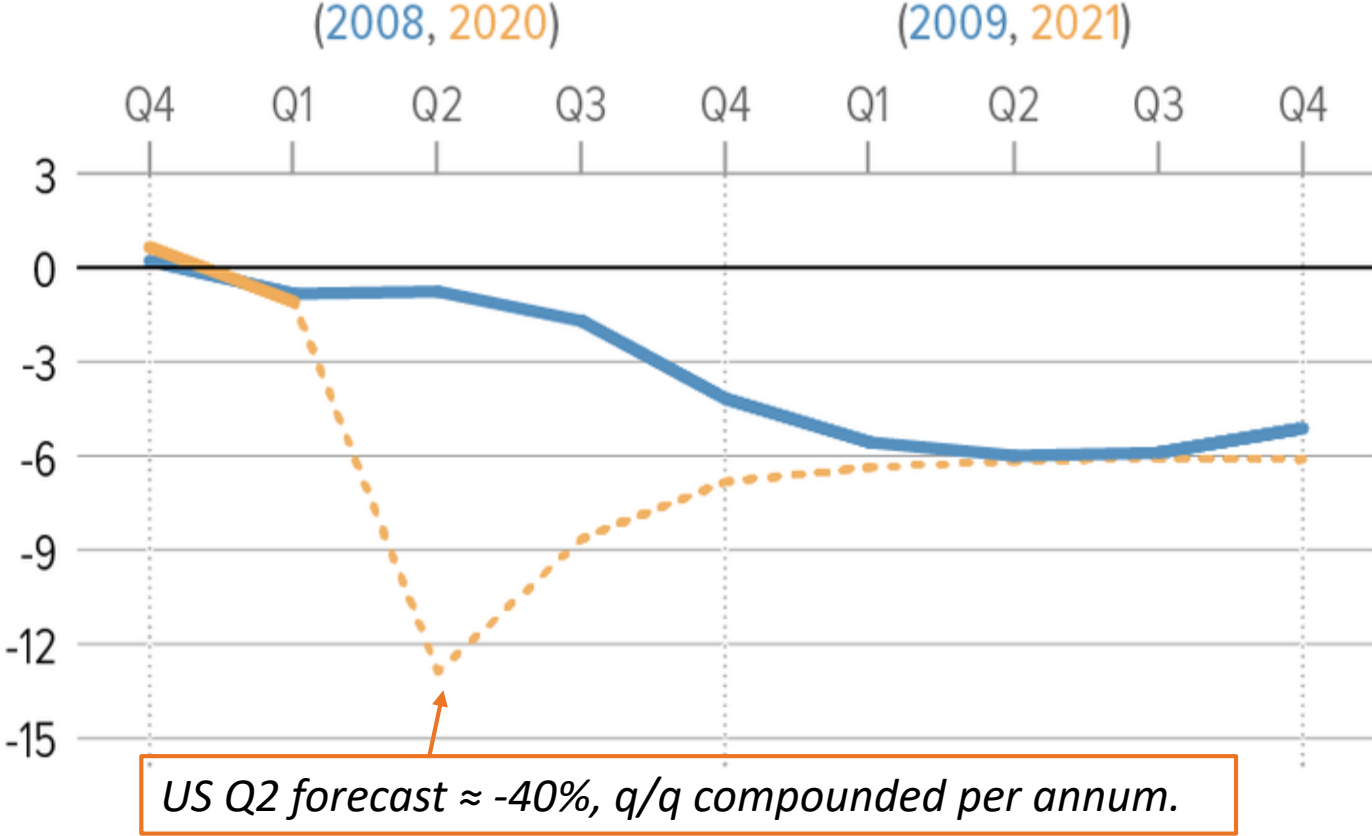
- lowered its forecast for global growth in 2020 sharply,
 - by 6.3% pts. from the January forecast,
 - to an unprecedented **-3.0% worldwide.**
- That averages **-1.0 % in EM & developing countries**
- and **-6.1% in advanced economies.**
- (See Appendix 2 for *WEO* tables.)
- It is already clear that the IMF forecasts were too optimistic,
 - especially for developing countries,
 - as it has now said.

Lost US Output

Projected GDP Losses Due to COVID-19 Far Larger Than Losses in Great Recession

Percentage difference between potential and actual GDP

- Great Recession: GDP loss after the end of 2007
- Pandemic: Actual GDP loss after end of 2019
- - - Pandemic: Projected GDP loss



US Q2 forecast $\approx -40\%$, q/q compounded per annum.

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

“Putting the Size of the Needed COVID-19 Fiscal Response in Perspective,” CBPP, May 4, 2020

V. What shape of recovery: “V”, “U”, or “W”?

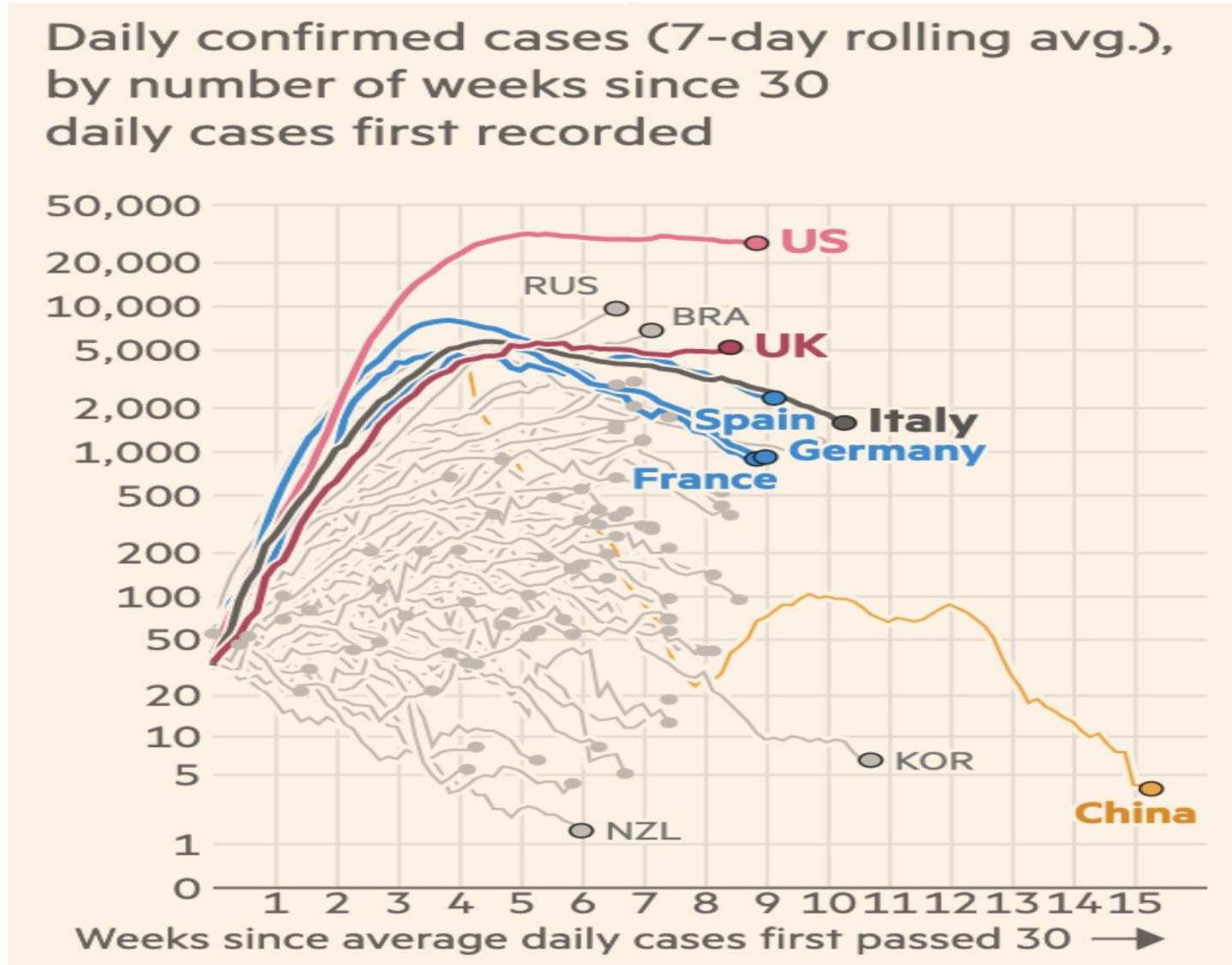
1. V-shaped recovery in the global economy is not likely.

- At first, V bounce-backs seemed plausible.
- Natural disasters usually follow that pattern.
- E.g., China’s 2003 SARS is estimated to have cost 2% growth in Q2, but didn’t show up in the year’s overall GDP.
- But a V is too optimistic, for the aggregate world economy.

2. More likely, at best, is a U-shaped recovery:

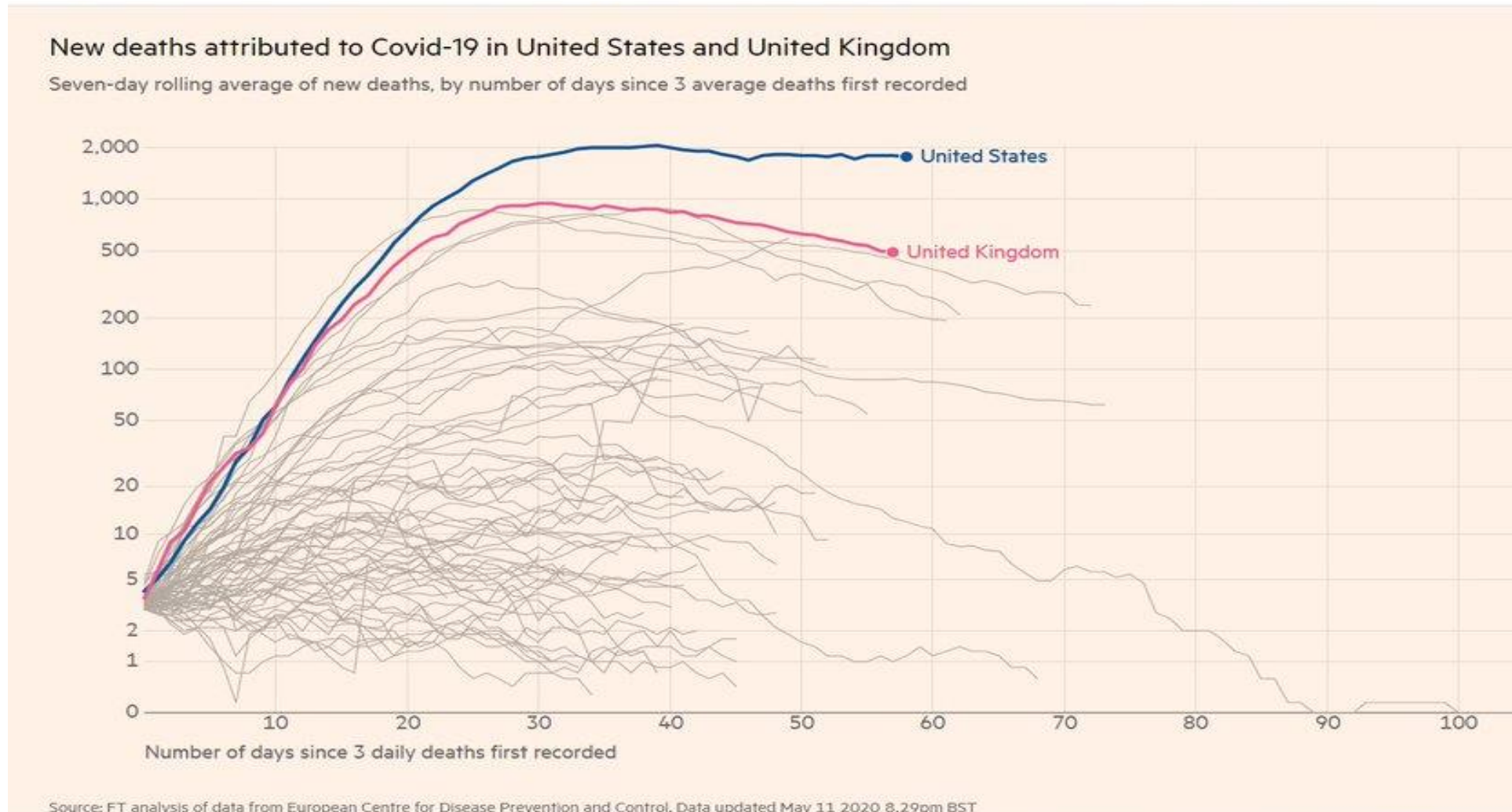
- 60% of business leaders expect “U” shape
 - -- World Ec. Forum, April 24.
- Certain segments of the economy go back to work,
 - perhaps in shifts,
- while others should remain shut down longer...
 - including, I would think, tattoo parlors & night clubs!
- at least until we achieve massive, frequent, convenient, free testing
 - + contact-tracing
 - + reliable tests for anti-bodies.
- A full recovery will wait until a vaccine is available, which we are told will take at least 1 year,
 - or an effective treatment.

Reported cases have peaked in China, France, Italy & Spain.
Not yet in US, Russia, Brazil or UK.



R. Baldwin
May 9, 2020

The death rate has not yet peaked in the US.



Note: Excess mortality in 14 countries runs about 60% above reported Covid19 death tolls.

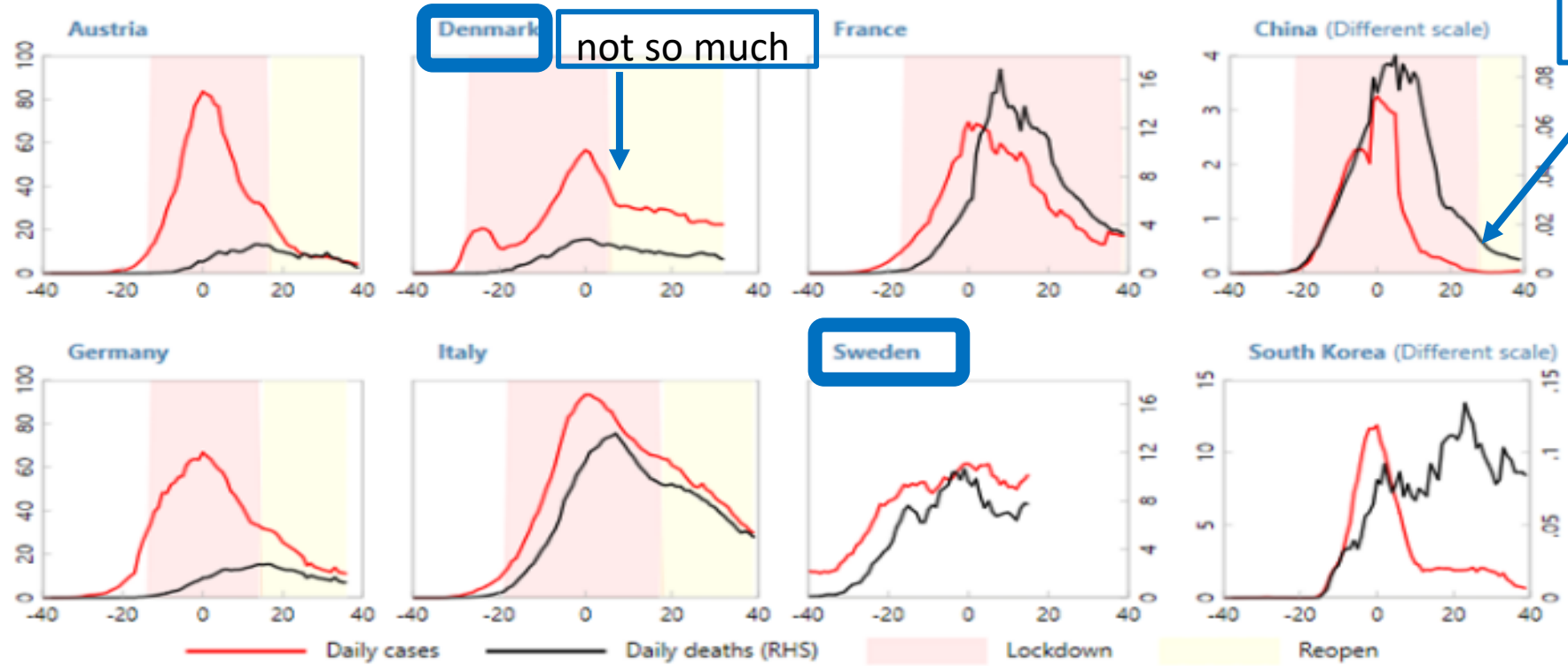
3. I worry about a W-shaped recovery, arising from policy mistakes.

Two possible mistakes are illustrated by events of the inter-war period.

- **Mistake #1: Leaders sound the “all-clear” signal on contagion too soon.**
 - Some politicians have shown an excessive bias towards optimism,
 - Which has already done harm by delaying action.
 - It can do more harm if they try to re-open the economy prematurely.
 - It is not enough for the numbers to have peaked. They need to show a sustained decline.
 - The 1918-19 global influenza pandemic is an informative precedent.
 - American cities instituted public health interventions in 1918.
 - Those cities that let up early suffered a 2nd or 3rd wave of flu, with more deaths.

Europe is reopening at an earlier point on the infection curve than Asia, which could pose higher risks.

(COVID-19 daily cases and deaths per million during lockdown/reopening)



China re-opened after cases were way down.

Sources: OWID; ECDC; and staff calculations.

Note: X-axis shows days since peak in daily new cases. Daily new cases/deaths denote moving average over 7 days.

Changyong Rhee and Poul M. Thomsen, May 12, 2020, IMF

Strategies vary widely from country to country

On reopening, Asia leads, and Europe follows, with strategies differing across countries.

May 12, 2020, IMF.

	School		Retail		Industry	Services			Events, Large Gathering	Travel (International)	Contact Tracing*	Social Distancing/Masks	Targeted Isolation	Testing Expansion
	Primary	Higher	Small	Large		Small	Large	Cafes						
Austria	Yellow	Yellow	Green	Yellow	Yellow	Green	Red	Red	Red	Red	Green	Green		Green
Czech Republic	Red	Yellow	Green	Green	Yellow	Yellow	Red	Yellow	Red	Yellow	Green	Green		Green
Denmark	Green	Red	Green	Green	Yellow	Green	Red	Red	Red	Red	Green	Green		Green
France	Yellow	Red	Yellow	Yellow	Yellow	Yellow	Red	Yellow	Red	Red	Green	Green	Green	Green
Germany	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Red	Yellow	Red	Red	Green	Green	Green	Green
Italy	Red	Red	Yellow	Red	Green	Red	Red	Red	Red	Red	Green	Green		Green
Norway	Green	Yellow	Green	Green	Green	Green	Green	Yellow	Red	Red	Green	Green	Green	Green
Poland	Red	Red	Green	Green	Green	Yellow	Yellow	Red	Red	Red	Green	Green		Green
Spain	Red	Red	Yellow	Red	Yellow	Yellow	Red	Yellow	Red	Red	Green	Green		Green
Sweden	Green	Red	Green	Green	Green	Green	Green	Green	Red	Yellow	Green	Green	Green	Green
China	Yellow	Yellow	Green	Green	Green	Green	Green	Green	Yellow	Red	Green	Green	Green	Green
New Zealand	Yellow	Red	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Red	Red	Green	Green	Green	Green
South Korea	Red	Red	Green	Green	Green	Green	Green	Green	Red	Green	Green	Green	Green	Green

Note: Estimated status of opening as of May 12 (except for New Zealand whose status is as of May 14), based on announcements by authorities. Cafes refers to dine-in restaurants and cafes. Travel (international) refers to non-essential international travel. *At this stage, contact tracing apps in Europe are mainly on a voluntary basis with decentralized data-protection/sharing approach.

Scale of Opening: green = open with restrictions/guidelines, yellow = partially open, red = closed.

Most economists: A health/economy tradeoff is illusory.



From *The Economist*,
May 7, 2020

www.economist.com/the-world-this-week/2020/05/07/kals-cartoon

Lasting growth cannot be restored, without first defeating the virus.

- Mistake #2: Abandoning economic stimulus too soon,
 - resulting in a renewed downturn.
 - The best precedent in the US is 1936.
 - The Roosevelt Treasury prematurely curbed federal spending
 - & raised taxes to restore a balanced budget.
 - The Fed too tightened in 1936,
 - Doubling bank reserve requirements
 - And starting to sterilize gold inflows.
 - As a result, the US went back into severe recession in 1937-38.
 - This could easily happen again,
 - perhaps as the result of partisan politics.
- Conclusion:
A W-shaped pattern, i.e., relapses in health & the economy,
 - could result from premature withdrawal
 - either of public health measures or of economic stimulus.

VI. Is all this additional debt sustainable?



From *The Economist*,
April 30, 2020

www.economist.com/the-world-this-week/2020/04/30/kals-cartoon

Those of us recommending sustained fiscal stimulus must address whether the implied debt path is sustainable.

Divide countries in 3 categories:

- 1) US seems still able to borrow as much as it wants,
 - at low i & high \$,
 - \leq exorbitant privilege, despite past abuse of it,
 - e.g., 2017-19, when we incurred a \$ 1 trillion budget deficit at the cyclical peak.
 - CBO, April 24: US budget deficit \approx \$3.7 trillion & Debt/GDP \approx 101% by end-2020.
- 2) Many EM & developing countries are on unsustainable debt paths,
 - defined as ever-rising Debt/GDP ratios.
 - They may require standstills & some restructuring.
- 3) In between are countries like UK & France.

The debt sustainability question is open.

- But perhaps Larry Summers is right about secular stagnation & the near-permanence of low r .
 - If so, that applies not just to US but also to Europe
 - => countries can afford to borrow.
- Just as growth cannot be lastingly restored without defeat of the virus, so debt sustainability cannot come without lastingly restored growth.

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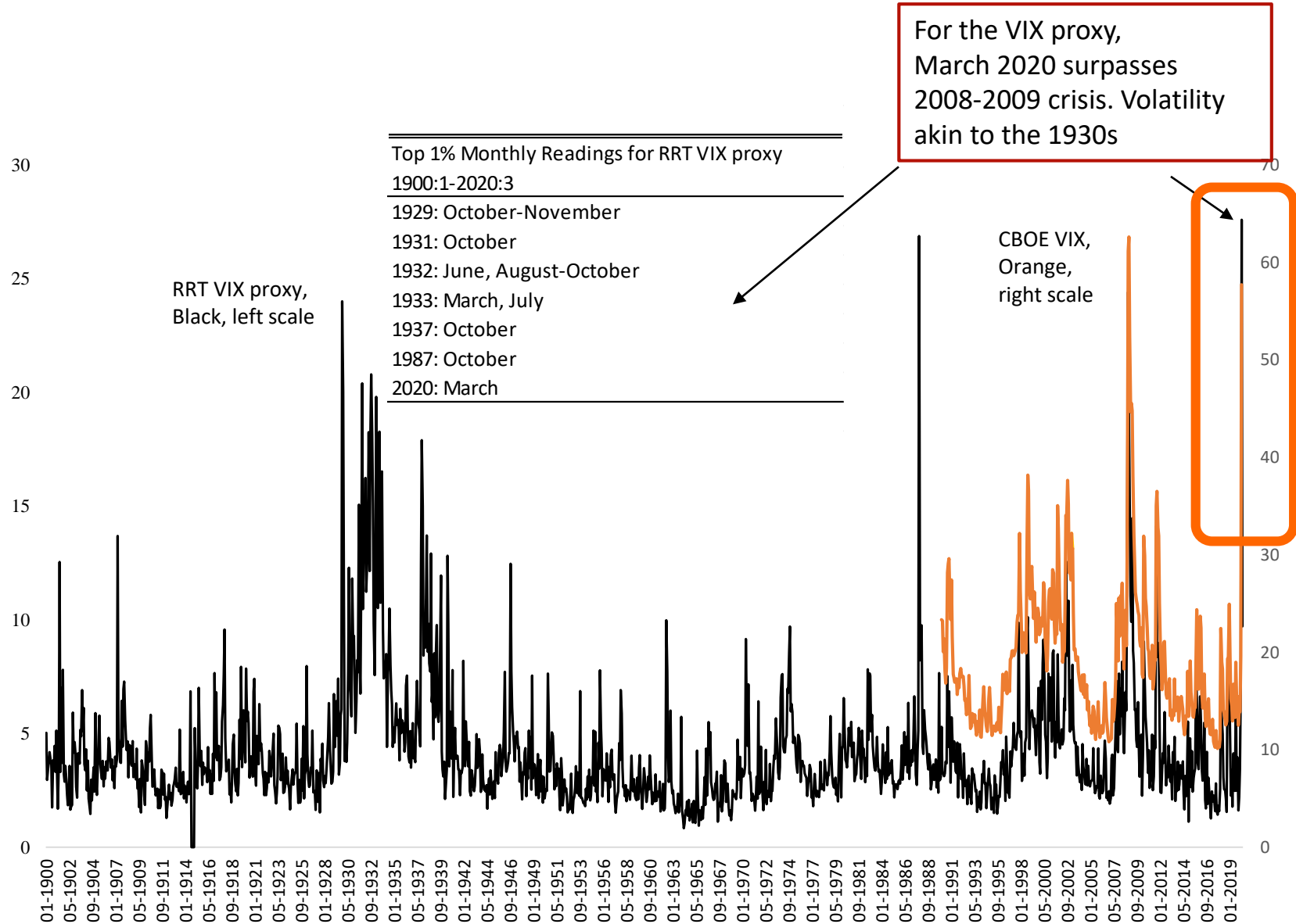
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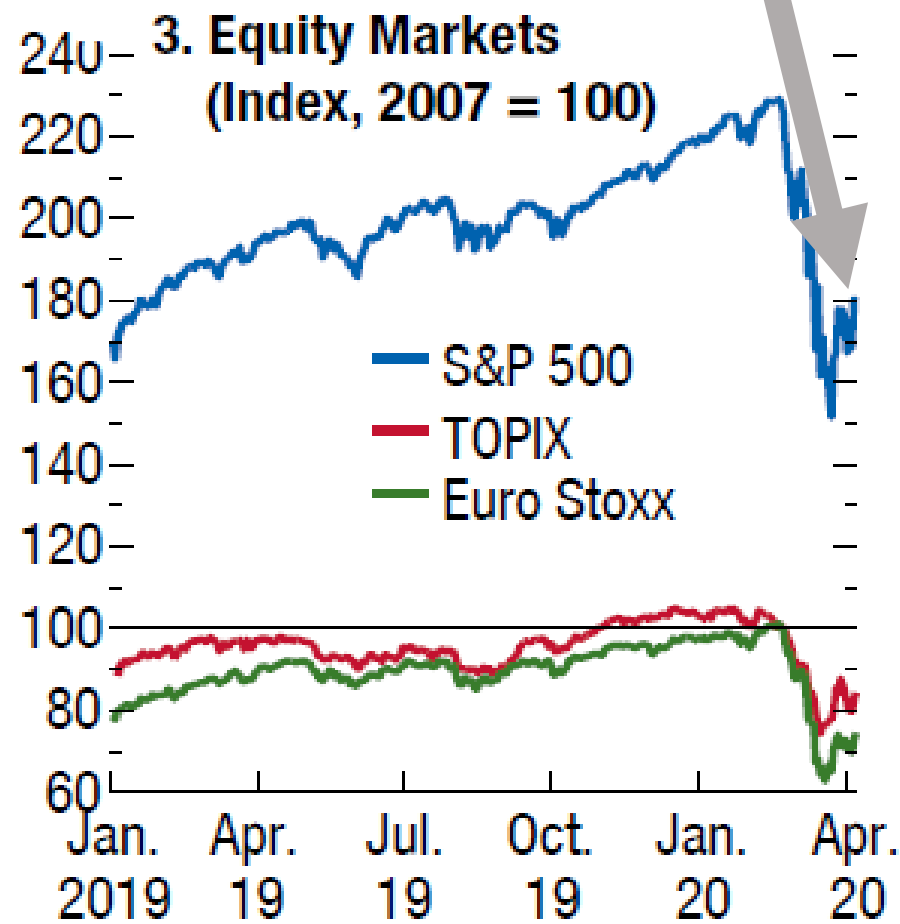
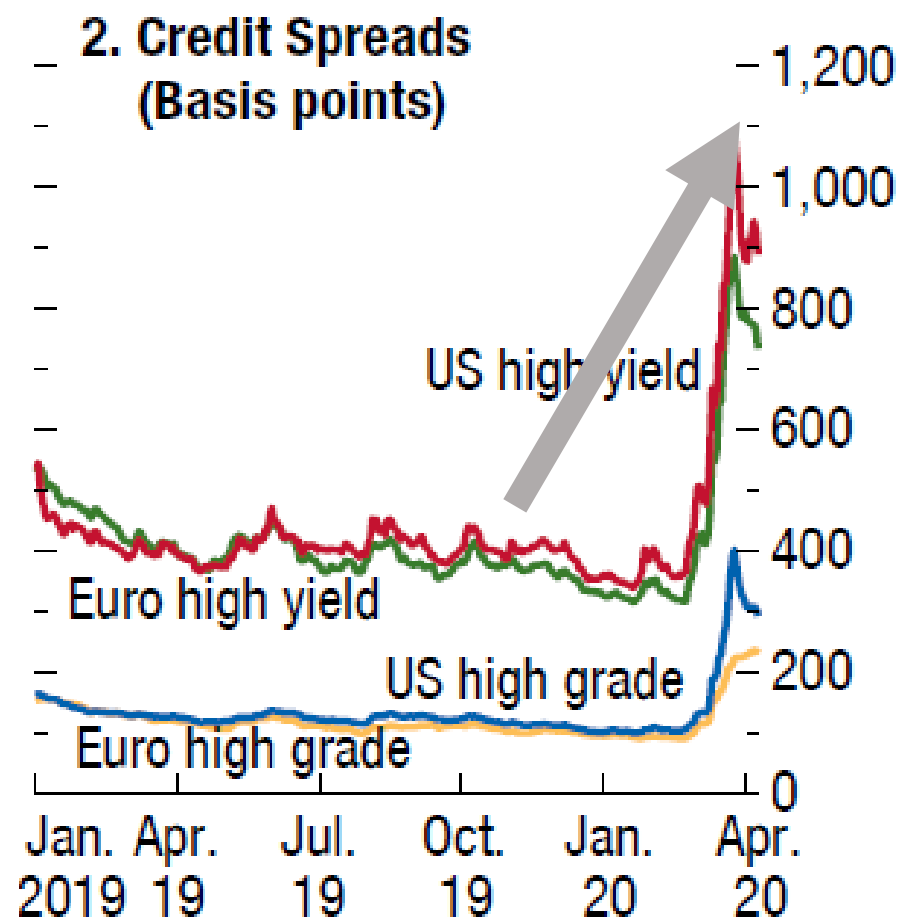
Appendix

- 1 “Risk off” in financial markets, Feb.-March.
- 2. IMF forecasts of April 14 (already too rosy)
- 3. Which EMs are in the most danger of debt crises?

1. Risk off (1.1) CBOE VIX, 1990:1-2020:3 & RRT VIX Proxy, 1990:1-2020:3

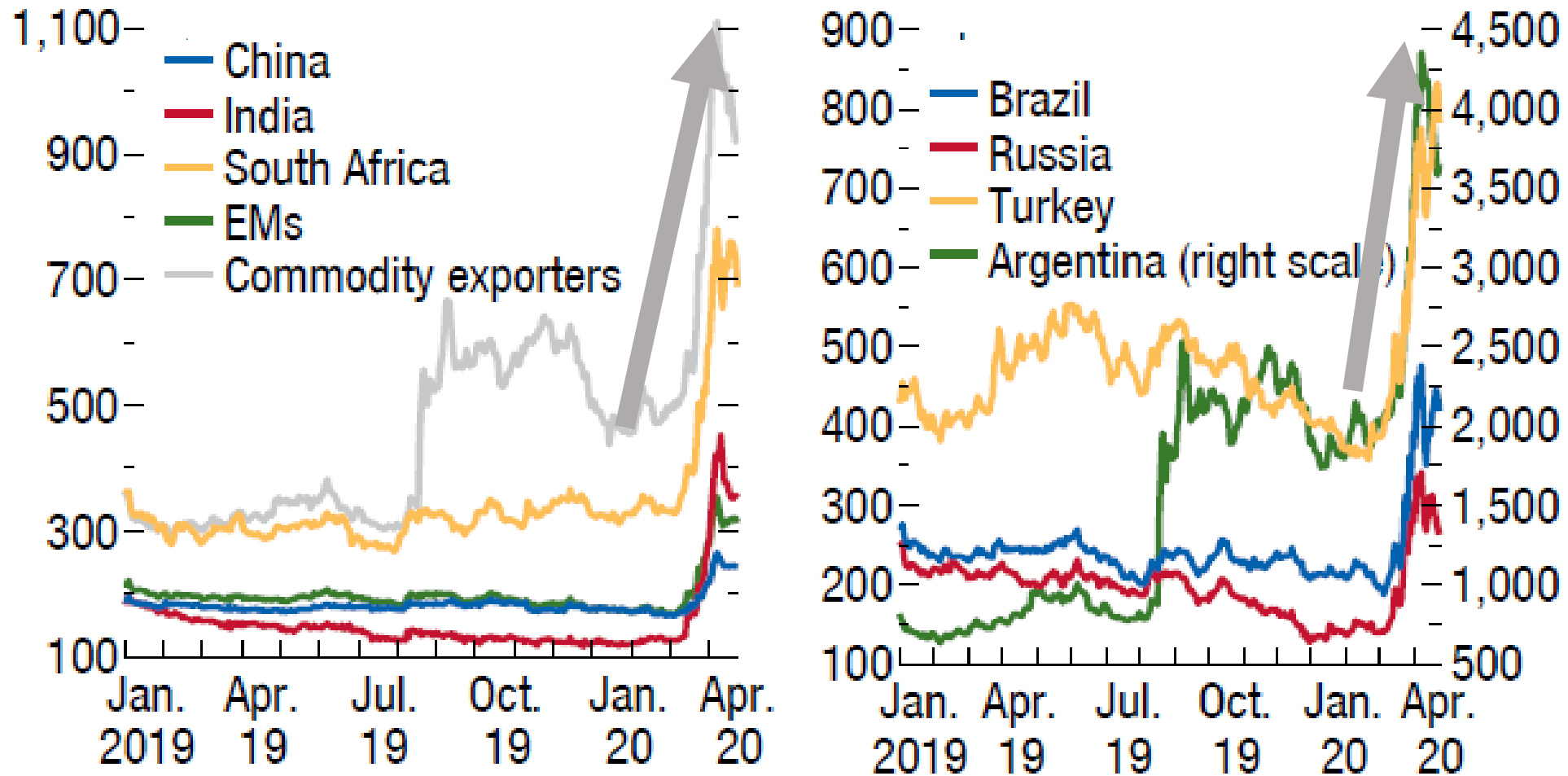


(1.2) Corporate interest rate spreads rose & equity prices fell.



(1.3) Emerging Market spreads rose.

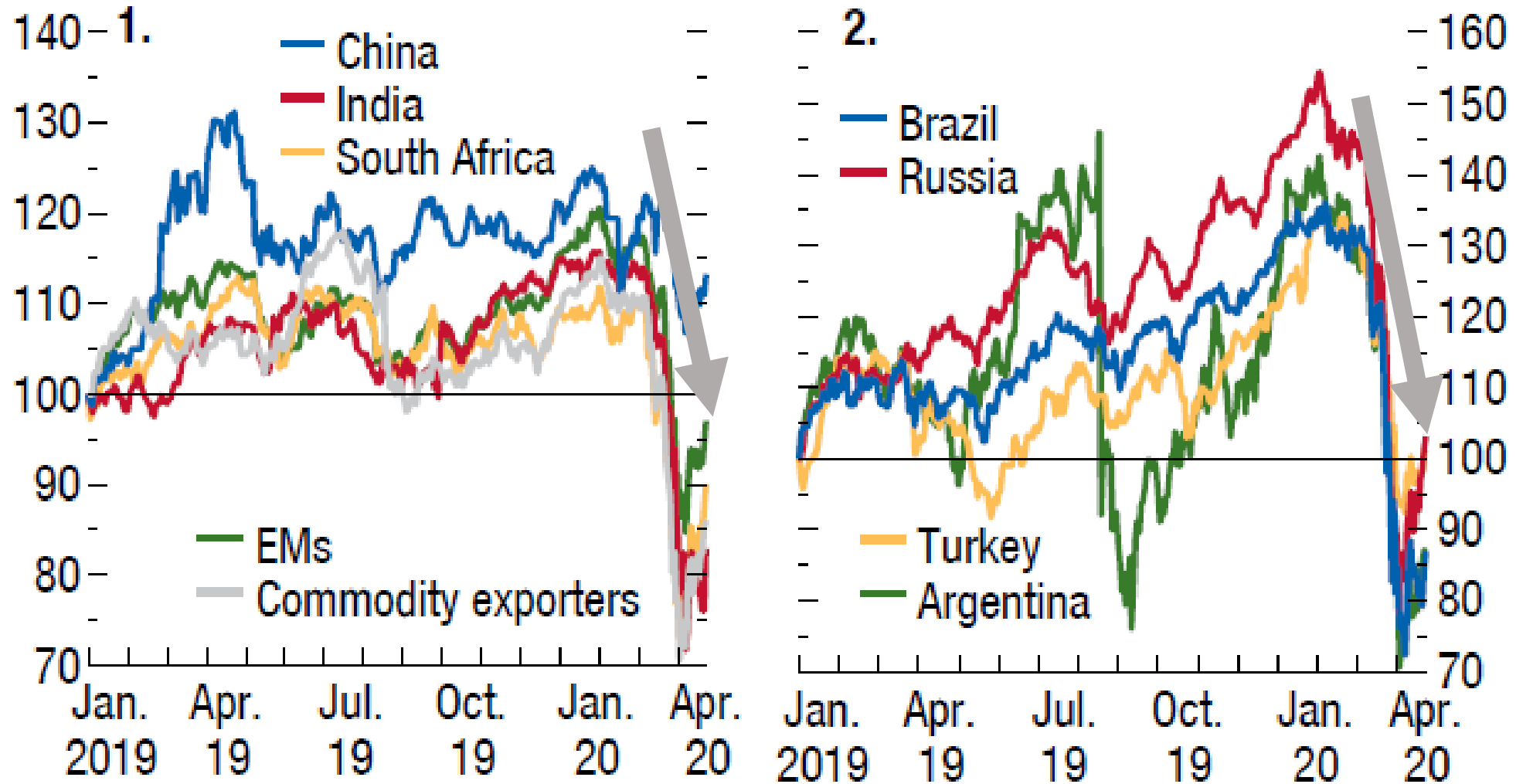
(EMBI Sovereign Spreads, basis points)



IMF WEO, April 2020.

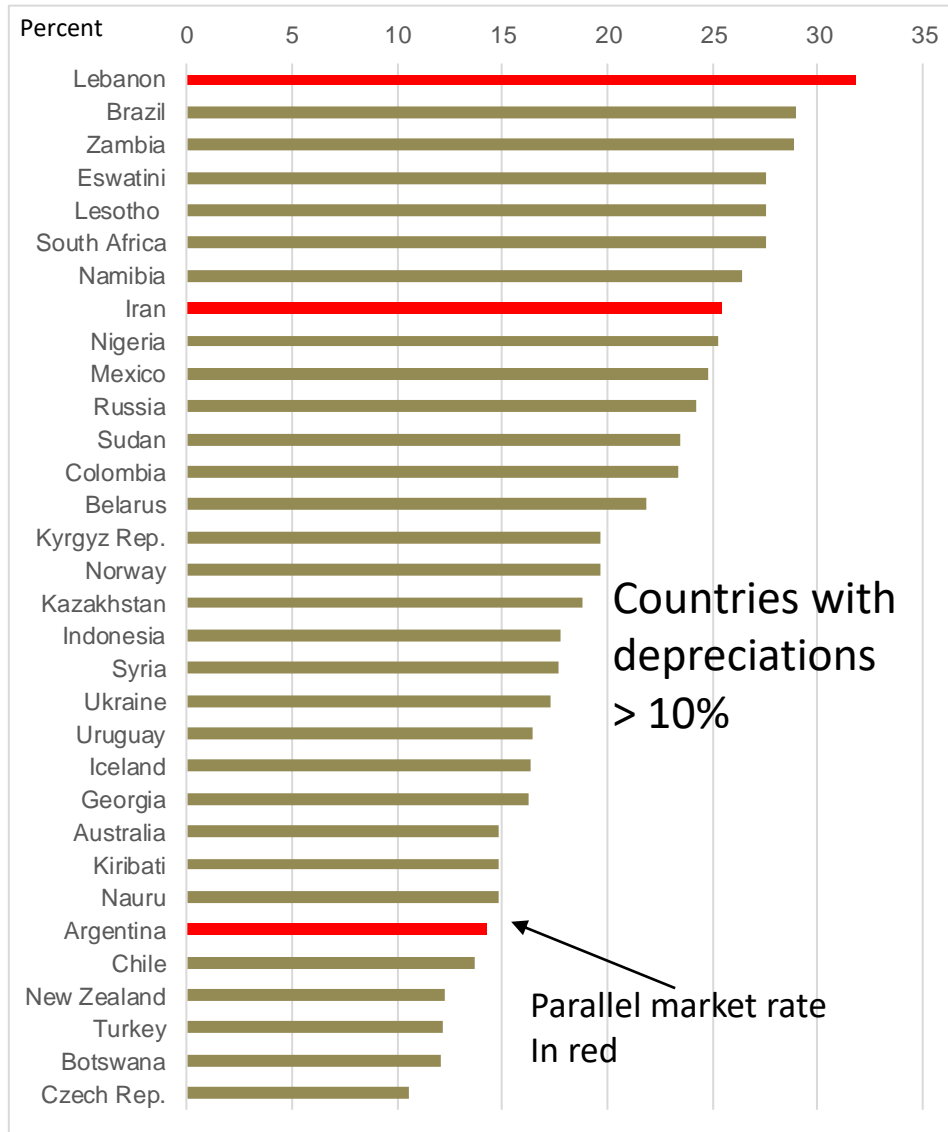
Emerging Market equities fell.

(Jan.1, 2019 = 100)

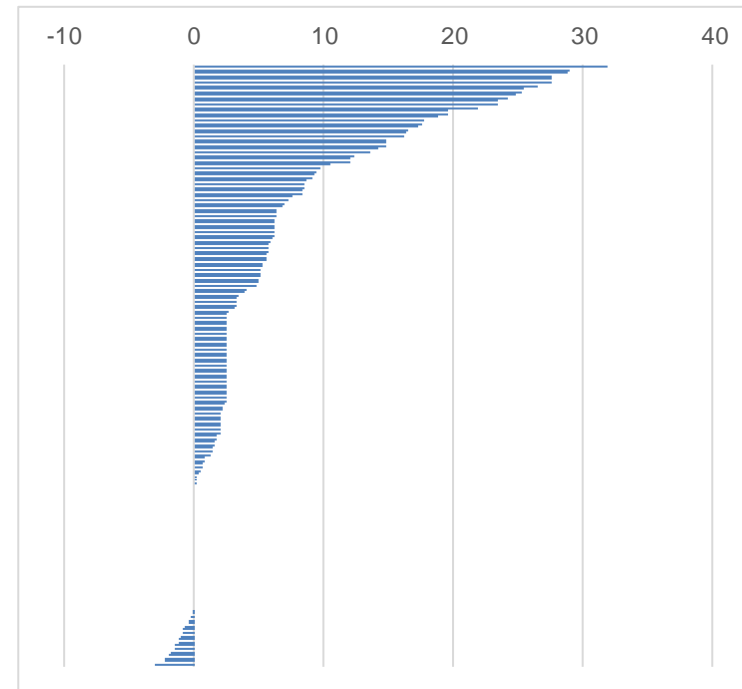


(1.4) Exchange Rate Changes versus the US Dollar

December 31, 2019-March 31, 2020, (in percent)



Snapshot of changes for 184 countries reporting to IMF



Appendix 2: *World Economic Outlook*, April

Even the IMF base case was a severe global 2020 recession.

	2019	Projections		Difference from January 2020 WEO <i>Update</i> ¹	
		2020	2021	2020	2021
World Output	2.9	-3.0	5.8	-6.3	2.4
Advanced Economies	1.7	-6.1	4.5	-7.7	2.9
United States	2.3	-5.9	4.7	-7.9	3.0
Euro Area	1.2	-7.5	4.7	-8.8	3.3
Germany	0.6	-7.0	5.2	-8.1	3.8
France	1.3	-7.2	4.5	-8.5	3.2
Italy	0.3	-9.1	4.8	-9.6	4.1
Spain	2.0	-8.0	4.3	-9.6	2.7
Japan	0.7	-5.2	3.0	-5.9	2.5
United Kingdom	1.4	-6.5	4.0	-7.9	2.5
Canada	1.6	-6.2	4.2	-8.0	2.4
Other Advanced Economies ²	1.7	-4.6	4.5	-6.5	2.1

EM & Developing Economies also show negative growth.

Emerging Market and Developing Economies

Emerging and Developing Asia

China

India³

ASEAN-5⁴

Emerging and Developing Europe

Russia

Latin America and the Caribbean

Brazil

Mexico

Middle East and Central Asia

Saudi Arabia

Sub-Saharan Africa

Nigeria

South Africa

	Projections		Difference from January 2020 WEO Update ¹	
	2019	2020	2020	2021
Emerging Market and Developing Economies	3.7	-1.0	-5.4	2.0
Emerging and Developing Asia	5.5	1.0	-4.8	2.6
China	6.1	1.2	-4.8	3.4
India ³	4.2	1.9	-3.9	0.9
ASEAN-5 ⁴	4.8	-0.6	-5.4	2.7
Emerging and Developing Europe	2.1	-5.2	-7.8	1.7
Russia	1.3	-5.5	-7.4	1.5
Latin America and the Caribbean	0.1	-5.2	-6.8	1.1
Brazil	1.1	-5.3	-7.5	0.6
Mexico	-0.1	-6.6	-7.6	1.4
Middle East and Central Asia	1.2	-2.8	-5.6	0.8
Saudi Arabia	0.3	-2.3	-4.2	0.7
Sub-Saharan Africa	3.1	-1.6	-5.1	0.6
Nigeria	2.2	-3.4	-5.9	-0.1
South Africa	0.2	-5.8	-6.6	3.0

Trade is falling even more sharply than GDP,
an intensification of post-2008 de-globalization.

	Projections		Difference from January 2020 WEO <i>Update</i>	
	2019	2020	2020	2021
World Trade Volume (goods and services)	0.9	-11.0	-13.9	4.7
Imports				
Advanced Economies	1.5	-11.5	-13.8	4.3
Emerging Market and Developing Economies	-0.8	-8.2	-12.5	4.0
Exports				
Advanced Economies	1.2	-12.8	-14.9	4.4
Emerging Market and Developing Economies	0.8	-9.6	-13.7	6.8
Commodity Prices (US dollars)				
Oil ⁶	-10.2	-42.0	-37.7	11.0

Appendix 3

“Which EMs are in most financial peril?
– *The Economist*,
May 2, 2020.

www.economist.com/briefing/2020/05/02/which-emerging-markets-are-in-most-financial-peril

Criteria include

1. Public debt
2. Foreign debt
3. Cost of borrowing
4. ForEx reserves

