POLICY OUTLOOK

TRT WORLD research centre

Covid-19 and the US Economy: Global Ramifications

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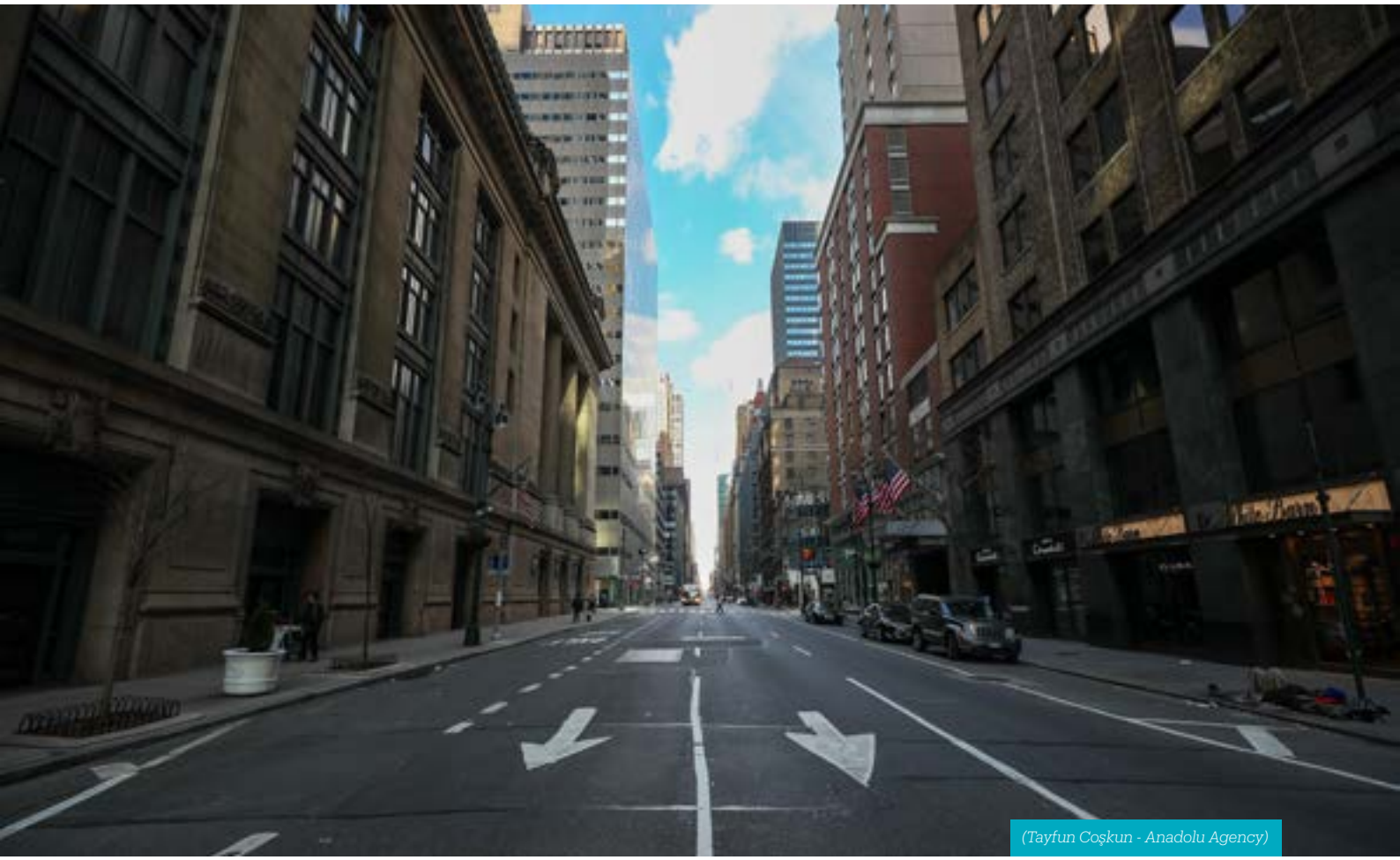

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Governments across the world are taking very strong measures to slow the pandemic, including curfews, travel restrictions, and closing down businesses. This extraordinary environment is tipping the American economy into an unprecedented economic crisis and will most probably lead to a global recession. The American administration is deploying its entire economic arsenal in order to mitigate the economic impact and help businesses and households survive. Obviously, the most critical determinant of the full economic cost is how fast the pandemic can be controlled. Regardless, the American economy will be smaller at the end of 2020, and full recovery will require considerable time and a comprehensive government program after the pandemic is over.

Background

A month ago, the Coronavirus Outbreak was thought of as a Chinese problem. Today, it is wreaking havoc across the globe. While it took 3 months to reach 100,000 cases of sick people globally, it took only 12 days to reach 200,000 and 4 days to reach 300,000. This is a warning for what we should expect in the coming days. Governments around the world are taking extraordinary measures in an attempt to slow the spread of the virus and relieve their overburdened health systems. Millions of people have been asked to stay home and limit their social contact. Many governments have closed borders and locked down entire cities. However, according to health official, we are still far from the peak and the situation is expected to worsen.

This extraordinary environment is tipping the American economy into what will probably become one of its worst economic crises since the Great Depression and will almost certainly lead to a global recession. Demand for goods and services has dropped significantly, forcing many businesses to cease operations entirely while others are barely active. Small and medium-sized businesses are already, willingly or not, closing, and big businesses are cutting employment. According to some estimates, half of all American jobs may be lost in the very near future, which will cut demand even further, creating a vicious cycle which economists are familiar with from depressions. Financial markets are in free fall everywhere and investors cannot see the light at the end of the tunnel. Some analysts expect a V-type recovery in the US after the virus is contained, however, this depends on economic response of the government as much as the efforts of health officials.

The American administration is deploying its entire economic arsenal in order to curb the economic impact of the outbreak. The US Federal Reserve will feed the financial market with unlimited liquidity while the government is working on plans to provide financial assistance to all segments of American society as well as key businesses. The ongoing situation seems to be unprecedented not only in terms of the depth of the economic crisis it is creating but also in terms of the state response to rescue the economy. Plans to distribute cash to all households represent unprecedented policy applications. It remains to be seen if these measures will be enough to stabilize the economy.

This paper first discusses the impact of the Coronavirus Outbreak on the US economy thus far and provides a trajectory about what to expect in terms of economic damage in the short to medium term. It then discusses American policy-makers' response to the ongoing crisis via monetary and fiscal channels, which aims to mitigate the economic consequences. Finally, it discusses the global ramifications of the Coronavirus Outbreak. The paper concludes that most of the economic damage can be short-lived and global economy will probably bounce back towards the end of this year, but country-level effect depends on governments' effectiveness in supressing the spread of the disease and use of measures to support the economy in the meantime.

An Unprecedented Crisis

The Coronavirus Outbreak is already affecting economies around the world in a number of ways. Firstly, spending. Even in this age of online spending, if you are unable to leave your house, it is a bit difficult to consume. So far, more than 80 million Americans in various states, including California, New York and Illinois, three of the largest states of the US, have been 'ordered' to stay home except to buy food and medicine. Moreover, employees are being asked to work from home and many more are in self-imposed isolation in line with government advice. Consequently, demand for vast economic activities including transportation, fast-food, hospitality, and leisure activities have drastically declined.

This lack of demand strains businesses. As people are spending much less, small shops struggle to pay the rents and wages and many are looking at the prospect of closing if they have not already. In some place, they are being forced to close by government decree. The governor of Pennsylvania, for instance, ordered the closure of all non-essential businesses, which means shop owners and chain stores will lose tremendous income for an uncertain period of time. As expected, this also feeds into unemployment, which will suppress demand even further. Therefore, there will be a broad-based loss of income and employment across the American economy.

Last week, applications for unemployment assistance in the US jumped by 33 per cent from the week before, surging to 281,000. This week, it reached 3,3 million. To put this into perspective, this is four times the record level in the American history, which was set in the 1982 recession. However, according to analysts, this is still the tip of an iceberg. There are 14 million jobs in the leisure and hospitality sectors alone in the US and a considerable share of these jobs will most probably be lost within a few weeks. Moody's Analytics reports that in total, 27 million jobs are at high risk due to the virus in the US. Along with leisure and hospitality, this includes jobs in transportation and travel, temporary help services and the oil industry. 52 million jobs are at moderate risk in sectors such as retail, manufacturing, construction and education. It is increasingly likely that approximately 10 million of these jobs will be affected either via layoffs or wage reductions.

According to JP Morgan analysts, the unemployment rate is expected to multiply in the coming weeks and reach 20 per cent from the current 3.5 per cent. This figure is on par with the Great Depression of 1929 and 2008 Global Financial cri-

sis, and marks an ironic turn of events since late January, when President Trump's Commerce Secretary Wilbur Ross said the outbreak in China may "*help to accelerate the return of jobs to North America, some to the U.S...*" The American labour market is highly flexible, which contributes to the deepening of the effect on unemployment compared to European economies. In the US, employers are often not obliged to pay severance pay and most workers are on zero-hour contracts, meaning the number of hours they work is flexible and can be reduced by the employers as they will. In other words, in times of crisis there are no breaks on layoffs which can limits the loss in employment.

The effects of the outbreak have extended to manufacturing as well. Honda North America became the first to announce that it is suspending production in its four US-based factories. Shortly thereafter, Ford closed one factory in Michigan after a worker tested positive for Covid-19. Most recently, several major car producers, including Ford, General Motors, and Fiat-Chrysler have declared that they will be partially shutting down their plants, in line with their agreement with the United Auto Workers union, which had asked car producers to suspend production to protect their workers from the spread of the disease. This mean 150,000 workers will now remain at home. This number is likely to increase as the virus spreads to different corners of the country. Already other producers, such as Tesla, are under pressure. Moreover, business activity in other segments of manufacturing is also on the decline.

All in all, the US economy is bracing for a major recession in the second quarter of 2020. Some estimates reach as low as a 30 per cent reduction in output compared to the same period last year. JP Morgan expects a more moderate reduction of around 14%. It should be said, however, that it is a little too early to make such estimates because we do not know how long and deep this trend is going to last and will largely depend on how successful countries can be in containing the virus. Most analysts seem to be optimistic and expect a V-type recession. In other words, they foresee a sharp recovery after the outbreak is taken under control. However, this may also turn out to be an L-type depression, similar the Great Depression of 1929, which means slow growth may last for some time.

President Trump seems overly optimistic about a swift recovery. Recently, he said he wants the US economy to be 'opened up' by Easter. Certain segments of business may go back to work at least partially, and some others may even continue to be fully operative, however, a return to complete normalcy by mid-April is not only improbable but, according to health officials, may also end up with a healthcare disaster and even larger economic costs in the long run. In the unlikely event of the Trump administration resuming businesses as normal, the spread of the virus will accelerate, causing mass hospitalization and high mortality rates, which may also lead to panic and social disturbances. Furthermore, even if they do not attempt to reopen businesses earlier, such remarks signal to the markets that the Trump administration is taking the issue lightly. In all likelihood, a complete reopening will not happen until mid-summer at the earliest.

The timing of the recovery is important because US elections are scheduled to take place in the last quarter of 2020. Perceptions of American voters may have significant implications for the prospects for a second-term Trump presidency. If voters are convinced that recession was nothing more a short-term divergence from the long run trend, and the government handled the situation well, this may benefit President Trump in his re-election bid. However, if the slow down continues after the pandemic is contained, Trump may face unexpected challenges in his bid for re-election. Regardless, by the end of 2020, we will see a smaller US economy and unemployment will be considerably higher.

Rescue Plan: A Comprehensive Government Response

The size and scope of the government response has to match the size and scope of the crisis. Some have made analogies with the 1929 Great Depression and the famous New Deal which followed it. After the 1929 Great Depression, millions of Americans lost their jobs and economic growth lagged for years to come. It took an extensive and deep government spending program, named the 'New Deal', between 1933 and 1939 for the American economy to recover. President Franklin D. Roosevelt injected massive government funds to boost economic activities and break the vicious cycle between low demand and unemployment described above. The depth of the depression may indeed be comparable with the Great Depression, and having realized this, American policymakers seem ready to respond with a substantial economic package. The Government and the Fed have already acted to stabilize economic activity.

The first responder to the prospective crisis was the Fed. In an emergency meeting, the Fed lowered interest rates to near zero levels and announced the purchase of $700 billion worth of Treasury Bonds. These steps are critical because over the next few months, most businesses will need to borrow in order to survive and continue making their payments. Banks will need liquidity to provide credit to these organizations. Accordingly, the Fed is making it cheaper to borrow and pump money into the economy so the financial system can function as a cushion and provide the necessary support for real businesses to continue their operations after the pandemic is over. This is one big exception to the New Deal analogy because in 1937, the Fed did the exact opposite and increased interest rates, which axed Roosevelts efforts and led to the extension of the crisis

until the end of 1930s.
Lowering interest rates and pumping liquidity will help, however, it is nowhere near sufficient for countering the economic recession the US will be facing. In the global financial crisis of 2008, these monetary measures were, to some extent, effective because at the time interest rates were high and Fed had enough space to lower interest rates to create a substantial effect. However, after ten years of quantitative easing and low interest rates, erasing what is left of its benchmark interest rate will not be enough. The Fed went one step further and also enacted an emergency lending program, which was last used during the 2008 crisis. The Fed will use its emergency authority to provide direct loans - which may reach trillions of dollars of liquidity - to mutual funds to keep the money market operational.

To complement the monetary channel, notable economists have advised an aggressive fiscal policy response from the government, one that is similar to the New Deal. Kenneth Rogoff, for instance, who is an expert on government default and known as a defender fiscal conservatism in normal times, agrees that governments should spend enormously to avoid a complete economic shut-down. According to Rogoff, World War II is a better analogy for the current situation than the Great Depression, and just like in war, the government can and should spend without limit. He claims that an unemployment surge and growth slowdown will probably be worse than the 2008 crisis at least in the short run and, considering that the US is a 23 trillion-dollar economy, it will require the American government to commit trillions of dollars to help the economy survive a 2-3 month shut down.

Senate leaders and the White House have most recently finalized a 2 trillion-dollar package to rescue businesses and help workers during the epidemic. The legislation includes direct one-time cash payments of $1,200 to all adult Americans and $500 to children, which amounts to a check of $3,400 for a family of four. Furthermore, the package will provide $850 billion in loans and grants to small businesses and corporations, including airline companies and cruise lines, that have been affected by the pandemic, $150 billion in aid to local governments, and increased funding for an enhanced unemployment assistance program for workers who lost their jobs due to the pandemic. It also includes an $100 billion spending program on the health-care system and health workers so that they can build capacity for the epidemic as much as possible.

This is indeed a massive fiscal stimulus, surpassing anything we have seen in the past. However, it is highly likely that we will see more coming in the near future. Millions of private sector workers in the US do not have paid-leave and they will not have medical coverage once they are unemployment. Most recently, congress has finally made Coronavirus tests free for all, but this does not help those who get sick because treatment is very expensive for those who are uninsured. Unless drastic action is taken, the current state of America's extremely market-based health care system and fragile labour regulations will probably multiply the suffering of the American people, financially and health-wise.

It may sound too early to talk about what will happen after the epidemic, considering that the US is still preparing for the perfect storm ahead of it, but there are already discussions of how to prevent the ongoing recession turning into a long-term depression. This would be a repeat of the Great Depression, when it took 10 years for the US economy to turn back to its pre-crisis levels in terms of economic size. The fact that the US has already had 10 years of low growth since 2008 makes this scenario even grimmer. Even before the pandemic, there were already calls for a paradigm shift in policy making to improve the economic outlook. Now, the case for a more proactive government which dares to use aggressive fiscal policies is stronger than ever. In fact, it is plausible to say that we have already entered an era where everyone expects governments, instead of central banks, to act in order to solve economic grievances.

Global Ramifications

As the US and Europe are heading towards a major recession, China is barely recovering from its own recession. In the first two months of 2020, Chinese industrial output fell by 13.5% compared to the same period a year earlier. In fact, even before the Coronavirus epidemic, China had already been experiencing a growth slow-down for a few years. Particularly following the escalation of trade disputes with the US, 2019 marked the lowest industrial expansion in China for last 18 years and lowest economic growth in 29 years. The Chinese economy was expected to make a comeback in 2020. Now, this is impossible. The Chinese economy is expected to grow around 1 per cent, which was previously estimated at 6 per cent prior to the outbreak.

The effects of a pause in Chinese manufacturing is obviously not limited to the Chinese economy. China is at the centre of global supply chains and accounts for 20% of global production, producing crucial inputs for major global companies and using high amounts of primary products mostly from developing countries. The disruption in the last three months in the Chinese economy, in and of itself, is a reason for a global slowdown with important consequences for both developing and developed economies. Even without the pandemic, global producers were under stress due to supply chain disruptions. Some critical intermediate goods are still in low supply and we don't know how long it will take for Chinese manufacturing to once again work in full capacity.

Even though China currently seems to have got the first wave of the disease under control, this does not mean that Chinese manufacturing is back on track. A big recession in the US and other Western economies will significantly re-

duce the demand for Chinese manufacturing products. In other words, Chinese manufacturing going back to normal does not mean anything if there is no one to buy the output. If anything, the problems of the Chinese economy are expected to deepen in the coming months. Unfortunately, this is true for other emerging markets as well. There will be a serious drop in global demand, especially for primary products, for at least two quarters. Of course, apart from this lack of demand, most emerging market economies are preparing to, or are already going through, their own epidemic crisis. Since the start of the crisis, $83 billion has already flown out of emerging market economies.

According to JP Morgan, the Euro zone will experience an even deeper contraction than the US economy. Their estimates show that in the first and the second quarters of 2020, GDP will shrink by 15% and 22% respectively. However, unemployment will not rise as much as it will in the US. This is because European labour market, especially in countries like France and Germany, is stricter compared to the American labour market. Similar to the Fed, the European Central Bank has launched an $820 billion loan fund to finance government and corporate debt across the Eurozone. After the announcement, addressing criticism for weak action, ECB President said in a tweet, *'Extraordinary times require extraordinary action. There are no limits to our commitment to the euro. We are determined to use the full potential of our tools, within our mandate'.*

In the meantime, almost all European governments have already committed gigantic fiscal stimulus packages to help their economies. One extreme example is the British government, which announced a £350 billion bailout package for businesses as well as pledging to pay 80 per cent all wages up to a maximum of £2,500 so employers do not lay off workers. Underlining the conditions, Prime Minister Boris Johnson said, *"We must act like any wartime government and do whatever it takes to support our economy."* Germany has also announced a €822 billion package to rescue businesses and help workers and the self-employed during the crisis.

Despite massive spending packages, rescue plans, cash distribution, and unprecedented government intervention across the world, the global economy is expected to grow minimally in 2020. The IMF predicts that the global economy will probably contract in 2020 for the first time since 2009 and the recession will be as bad as the 2008 financial crisis. The IMF's Director, Kristalina Georgieva, while praising government efforts to contain the epidemic and stabilize their economies, pointed that more will probably be needed "*especially on the fiscal front*." Georgieva also said the IMF is ready to support government action in a substantial way and 80 countries have already applied for financial aid. The IMF has $1 trillion of lending capacity. The IMF also predicts that recovery at the global scale will start in 2021.

Outlook

The Coronavirus continues to spread, collapsing healthcare systems across countries, rich and poor. Health officials agree that we are far from the end of this pandemic, and in the coming days and weeks, we will see more health systems failing to provide enough hospital beds and intensive care units for the sick. Consequently, hundreds of thousands of more people will get sick and death toll will exponentially rise. This obliges governments to take extraordinary actions to supress the spread of the disease and protect their citizens. Some countries are already in complete lockdown; others will follow suit without doubt.

The American economy is at a relatively earlier phase of the epidemic. If the epidemic follows the current trajectory, it will get substantially worse. One way or another, millions of Americans are cut off from the economy and will be so for some time. People will stay home, which means they will not be able to produce economic value, and neither can they spend as much as they used to. Consequently, the US economy is bracing for one of its worst ever economic depressions. National output will fall, unemployment will rise, and most Americans will suffer economically. This will be an unprecedented crisis not only in size but also in nature. Unlike other economic crises, the government does not try to incentivize people to go back to work and businesses to invest. On the contrary, it is ordering them to be home and stay safe.

There is still a lot government can and should do. In this warlike situation, the Fed will provide unlimited liquidity to banks, local governments, and diverse businesses so as to keep them alive until the storm passes. It remains to be seen how successful this will be. The government will also provide direct cash support to all households and enhance the unemployment assistance. This will not only help them survive as long as they are not able to go to work but also incentivize them to stay home and slow the epidemic. The Senate has also enacted a massive fiscal stimulus plan to prepare the health system to build capacity for the coming crisis.

In the best-case scenario, the epidemic will be controlled and supressed sooner rather than later, and economic life will go back to normal after a swift recovery. Strong and timely economic interventions by the American state are crucial for this scenario to materialize. If the economic interventions are effective, this will help both the disease to be taken under control as quickly as possible and businesses to survive the shut-down so that they can be ready to hire people back when it is over. However, it is more likely that when the epidemic is over, full recovery of the American economy will require considerable time and a comprehensive government program. We will see more discussions of what governments should do and less talk of free-markets self-correcting without government intervention. There will arguably be more proactive, Keynesian governments everywhere, trying to improve national economic potential.