MACRO PERSPECTIVE

Impact of Covid-19 on the World Economy

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The Covid-19 pandemic is wreaking havoc on the world economy. The global economic outlook was already fragile prior to the outbreak of the coronavirus crisis. Initially, when the outbreak emerged in China, it was thought that the negative impact on the global economy would be small —mainly limited to the output contraction in China and its knock-on effect on global supply chains, tourism, and commodity markets. However, with the rapid spread of Covid-19 across the world and the consequent imposition of containment measures and restrictions, all countries are experiencing severe supply and demand shocks that are independent of their links to global supply networks. In every country, the containment measures have adversely impacted all sectors of the economy to varying degrees. Production has plummeted, investment plans are being shelved, consumer spending has fallen sharply, and job losses have surged. Financial market sentiment has deteriorated, foreign direct investment inflows are dropping, and emerging market countries are experiencing large capital outflows. The global economy is now entering in a recession which is likely to be far deeper than during the Global Financial Crisis in 2009.

The imposition of containment measures has been a game changer for global economic performance and outlook. Reflecting the immediate impact of these measures on production, consumption and confidence, the composite Purchasing Mangers' Indices (PMI) of manufacturing and services in major economies dropped below 50 to their lowest ever levels in March, suggesting that a severe economic contraction is underway. Based on an analysis of sectoral output and consumption patterns across

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advanced economies and major emerging market economies, the OECD has estimated that the initial direct impact of the containment measures could be a decline in the *level* of output ranging from 15 per cent to 30 per cent (slightly below 20 per cent for India and around 25 per cent for G7 countries).[1] The variations in the impact across economies reflect differences in the composition of output.[2] Further, the OECD estimates that for each month that the containment measures continue, the drop in output is equivalent to a decline in *annual GDP growth* of up to 2 percentage points.[3] Thus, if the containment measures were in place for three months - a reasonable assumption if one takes into account that in Wuhan (China) the lockdown lasted for 76 days - annual GDP growth could be between 4-6 percentage points lower than it otherwise might have been (the OECD's projection in early March for world GDP growth was 2.4 per cent). On this basis, global output could likely contract between 1.6 per cent and 3.6 per cent in 2020. The latest projections of the International Monetary Fund and Economic Intelligence Unit for world GDP growth in 2020 (–2.9 percent and –2.5 per cent, respectively) fall within this range.

Rating agencies, investment banks and multilateral agencies have revised downward the growth outlook for India substantially following the imposition of the lockdown measures. Apart from the resilience of agriculture and allied activities, most of other sectors of the economy are adversely impacted by the containment measures. The latest projections of GDP growth for the Indian economy in FY21 range from –0.5 per cent (Nomura) to 2.5 per cent (Moody's). The Economic Intelligence Unit projects a quarter-on-quarter growth of –9.3 per cent in Q2, 2020. If the social distancing measures remain in place for a relatively extended period and it takes time for business and consumer confidence to return and normal business operations to resume, then GDP growth in FY21 might well be toward the lower end of the range.

The containment measures in response to the Covid-19 pandemic has contributed to a severe decline in employment in both developed and developing countries. Almost 10 million people in the United States filed initial jobless claims in the last two weeks of March, and the numbers have increased significantly since then. The number of new claims also increased many fold in Europe in the same period. Data released by the Center for Monitoring the Indian Economy show a three-fold increase in the unemployment rate since the imposition of lockdown: from 8.4 per cent in week ending March 22 to 23.4 per cent in the week ending April 25, with the increase being higher for urban areas than for rural areas. Much of this spike happened within a week of the imposition of the lockdown. Workers in the informal sector, including self-employed persons, have been affected particularly hard from the containment measures.

The International Labour Office (ILO) estimates that containment measures will likely result in a reduction in working hours worldwide by about 6.7 per cent (equivalent to a loss of 195 million full-time workers) in Q2, 2020 compared with Q1, 2020, reflecting both lay-offs and other temporary reductions in working time. The ILO projects the decline in working hours to be highest in the Arab states and Asia-Pacific region, and concentrated in sectors such as accommodation and food services, manufacturing, retail, and business and administrative activities.[4]

Countries have already initiated measures to contain the fallout from the Covid-19 pandemic. The measures are summarised in the Covid-19 policy trackers that have been launched by both the IMF and OECD.[5] These measures include increasing resources to the health care sector, providing support to businesses and workers (including self-employed persons) most affected by the decline in economic activity, expanding liquidity to banks and easing monetary policy stance to facilitate lending to the non-financial sector. The IMF and World Bank are also providing support through their various lending facilities to financially constrained countries facing health and funding shocks, and with weak health systems.

Strong multilateral policy coordination and cooperation will also be required to overcome the effects of the Covid-19 pandemic and facilitate a swift rebound in economic activity. But, progress on this front may be protracted. Financially constrained countries will need continued multilateral assistance, including access to concessionary financing, grants, and debt relief. At the recent G20 Extraordinary Trade and Investment Ministers Virtual Meeting, the Secretary-General of UNCTAD highlighted the sharp decline in foreign trade and foreign direct investment, and emphasised the need to avoid lasting damage to global production networks and supply chains.[6] In this context, most G20 countries underlined the importance of a rules-based multilateral trading system with a reformed WTO at its center. However, the meeting did not lead to any specific commitments to de-escalate trade tensions or avoid introducing additional trade barriers.

The timing of the resumption of growth and the speed of recovery are uncertain. Much will depend on the duration of the containment measures, the exit strategy from the lockdown, and the success of the policy responses in restoring business and consumer confidence. Even if the lockdown measures are successful in containing the spread of infected cases, there may be continued fear about the resurgence of infection until a safe and effective vaccine is developed and made available widely. This could increase precautionary savings among households and delay business investment, and thereby hinder growth.[7]

Endnotes

1 See https://read.oecd-ilibrary.org/view/?ref=126_126496-evgsi2gmqj&title=Evaluating_the_initial_impact_of_COVID-19_containment_measures_on_economic_activity Full shutdowns are assumed in transport, manufacturing and personal services; declines of one-half are assumed for output in construction and professional service activities; and declines of three-quarters are assumed in all the other output categories directly affected by shutdowns.

2 For example, countries in which tourism is relatively important potentially could be affected severely by the containment measures, while countries with relatively sizeable agricultural sector would be affected less.

3 Banque de France estimates the negative impact of containment measures on GDP growth in France to be higher. For every two weeks that the lockdown continues, annual GDP growth would decrease by 1.5 percentage points.

4 See https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_740877.pdf

5 See https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19 and http://www.oecd.org/coronavirus/en/#country-tracker

6 https://unctad.org/en/pages/SGStatementDetails.aspx?OriginalVersionID=250)

7 The IMF projects that the global economy could contract by as much as 6 percent in 2020 if containment measures continue in the second half of the year and the direct domestic economic impact from Covid-19 disruptions are broadly similar across countries.