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COVID-19: Global Economic Tsunami

Introduction

COVID-19 has created a worldwide economic tsunami. The global economy is engulfed in a serious downturn. The virus has caused significant parts of the Asian and now European and U.S. economies to all but shut down. More financial pain is quickly coming as layoffs mount, businesses curtail investment, and retirement nest eggs evaporate. Central banks have responded aggressively but are running out of room to maneuver as interest rates hit the zero lower bound. The onus is now on governments to quickly provide substantial financial support to hard-pressed households and businesses. How much economic damage COVID-19 ultimately does will depend on the trajectory of the virus—and how governments respond.

COVID-19: Global Economic Tsunami

BY MARK ZANDI

COVID-19 has created a worldwide economic tsunami. The global economy is engulfed in a serious downturn. The virus has caused significant parts of the Asian and now European and U.S. economies to all but shut down. More financial pain is quickly coming as layoffs mount, businesses curtail investment, and retirement nest eggs evaporate. Central banks have responded aggressively but are running out of room to maneuver as interest rates hit the zero lower bound. The onus is now on governments to quickly provide substantial financial support to hard-pressed households and businesses. How much economic damage COVID-19 ultimately does will depend on the trajectory of the virus—and how governments respond.

For the global economy, we are updating our baseline scenario (the middle of the distribution of possible outcomes) given how rapidly the virus has undermined the economy. It is unprecedented for us to update our forecasts between our monthly forecast updates. We will also be updating our alternative, more severe, scenarios in coming days. It is not difficult to construct substantially darker scenarios for the global economy.

Economic tsunami

The economic tsunami that hit China and much of Asia earlier in the year and hit Europe a few weeks ago is now slamming the U.S. economy as more parts of the country require nonessential businesses to shut down. In the U.S., a fifth of the workforce is on some degree of lockdown. This sudden stop in the economy is unprecedented. The only analogue is the 9/11 terrorist attack. But that lasted for a day or two, and except for airlines, businesses continued to operate. China's experience with COVID-19 demonstrates the economic devastation the disease brings to an economy. Chinese GDP is on track to decline by 27% at an annualized rate in the first quarter.

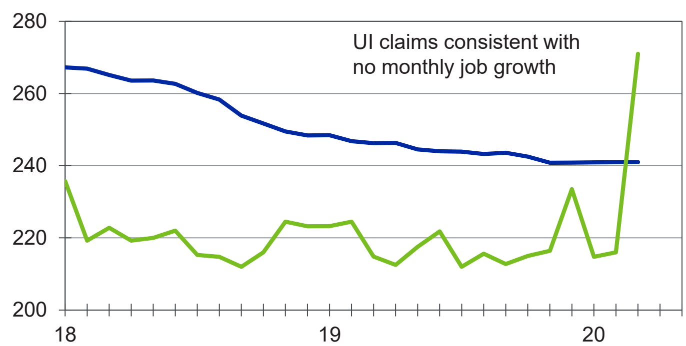
U.S. businesses immediately laid off workers. Initial claims for unemployment insurance spiked last week (the week of March 8) to over 280,000 from about 210,000 the week before (see Chart 1). U.S. claims of over 240,000 per week are consistent with no job growth. This suggests jobs will decline in March. There are numerous reports of laid-off workers unable to file for UI because so many people are trying to file at the same time. Millions of job losses are likely in coming weeks, particularly for households that live paycheck to paycheck. A survey conducted by the Federal Reserve last year found that almost half of Americans effectively live paycheck to paycheck.

The second wave of the economic tsunami will hit when the other half of households come to terms with their much-diminished wealth. Losses in the U.S. stock market are more than $10 trillion, depending on the day and hour, down about one-third from the peak in stock values just a few weeks ago. The negative wealth effects—the change in consumer spending in response to a loss of wealth—will be substantial. The baby boom cohort, now in its 50s and 60s and owning more than half of all stocks, will turn particularly cautious. If sustained, the loss of stock wealth will by itself reduce GDP over the coming year by an estimated 2%.

Wave three will be a sharp pullback in business investment. Businesses were already on edge from the trade war between the U.S. and China, Brexit, and a long list of other geopolitical concerns. But the virus will be too much to bear. Investment in the energy industry is already falling because of the collapse in oil prices. That collapse is due in part to the global recession as well as the brinkmanship between Saudi Arabia and Russia that has prompted the Saudis to

Chart 1: Layoffs Spike

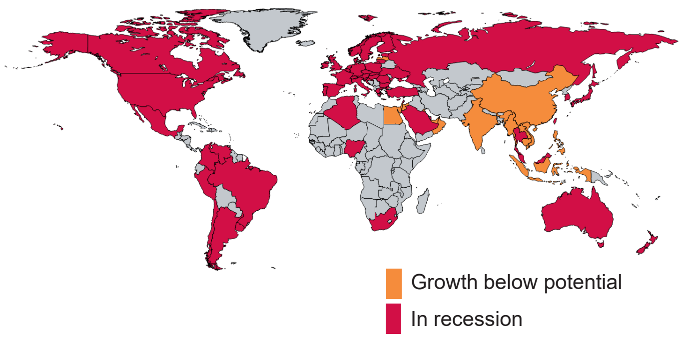
Initial claims for unemployment insurance benefits, ths



Sources: BLS, Moody's Analytics

Chart 2: Global Downturn

Business cycle status, Mar 2020



Source: Moody's Analytics

ramp up oil production. A surge in business bankruptcies and failures is surely coming. It will further exacerbate the investment decline and be an impediment to the future economic recovery.

Dark global outlook

Our darkening outlook for the global economy is struggling to keep up with the growing magnitude of the crisis. We have long been wary of the economy's growth prospects this year and the threats to that growth, but COVID-19 has resulted in consistent substantial downgrades to the outlook. In January, prior to the virus, we expected global real GDP growth of 2.6% in 2020 (see Table 1). This is close to the global economy's estimated growth potential, and thus unemployment was expected to remain low and stable. With the virus now shutting down travel, trade and many businesses, the global economy is expected to suffer with real GDP falling by 0.4% (see Chart 2).

Europe will be especially hard-hit since it has been unable to contain the spread of the virus. Italy has had the most serious outbreak so far, but all of Europe's major economies have closed borders and schools and quarantined large parts of their populations. The European economy was fragile before the virus hit—it returned only recently to full employment after a decade-long struggle in the wake of the financial crisis. Europe is also struggling to muster an economic policy response. The Bank of England recently lowered rates to the zero lower bound and the European Central Bank has maintained negative rates since the crisis. Germany and the U.K. are implementing large fiscal stimulus packages, but the rest of Europe has little fiscal space to respond. Euro zone real GDP is expected to decline by nearly 3% in 2020.

Emerging economies will be hammered given the collapse in oil and other commodity prices, which are staples for many Latin American, Middle Eastern and African economies. The price of a barrel of West Texas Intermediate has slumped to below $25 on weaker global demand and the recent brinkmanship between Saudi Arabia and Russia over who should bear the brunt of necessary oil production cuts. EM economies are also struggling with the flight-to-quality and the appreciating U.S. dollar. This is especially problematic for countries such as Hong Kong and Saudi Arabia that peg their currencies to the dollar. Real GDP is expected to decline by anywhere from 1% to 4% this year, depending on the EM economy.

The U.S. economy will also suffer significantly. Lockdowns have already cost the economy nearly a percentage point in GDP, and the losses are mounting rapidly. U.S. real GDP is expected to decline by nearly half a percentage point this year. A massive and mounting monetary and fiscal policy response will limit the economic damage compared with much of the rest of the world. The Federal Reserve's aggressive actions should stabilize credit and equity markets, and we expect lawmakers to ultimately provide $1.65 trillion in discretionary fiscal stimulus—deficit-financed increases in government spending and tax cuts—equal to nearly 8% of GDP. Even so, U.S. real GDP will decline.

Asia appears past the worst of the virus, and while there is still considerable economic fallout to come, the region's economy should be able to eke out a small

Table 1: Moody's Analytics Baseline Outlook Downgrades

Real GDP growth, % change annualized rate

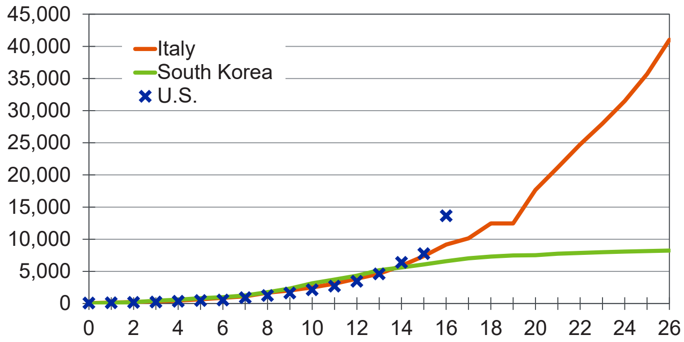
		2020Q1	2020Q2	2020Q3	2020Q4	2019	2020
World	Jan baseline	2.7	2.9	2.7	2.6	2.5	2.6
	Mar baseline	0.7	1.6	3.5	2.8	2.4	1.9
	Current baseline	-6.5	-0.1	3.6	3.2	2.4	-0.4
United States	Jan baseline	1.5	2.2	1.5	1.2	2.3	1.8
	Mar baseline	1.1	-0.4	1.7	2.4	2.3	1.3
	Current baseline	-1.3	-4.9	-0.3	1.3	2.3	-0.5
China	Jan baseline	7.2	6.6	5.5	5.8	6.1	6.2
	Mar baseline	-0.9	5.1	11.4	5.8	6.1	4.4
	Current baseline	-27.2	21.4	28.9	12.7	6.1	1.7
Brazil	Jan baseline	2.0	2.4	2.5	2.6	1.1	2.2
	Mar baseline	1.3	2.0	2.5	2.6	1.1	2.0
	Current baseline	-5.0	-5.9	-1.4	2.9	1.1	-1.6
United Kingdom	Jan baseline	1.2	1.1	1.1	1.1	1.3	1.0
	Mar baseline	0.6	0.5	1.2	1.1	1.4	0.7
	Current baseline	0.0	-3.9	-5.1	-2.5	1.4	-1.3
Euro zone	Jan baseline	1.4	1.5	1.8	1.4	1.2	1.3
	Mar baseline	0.7	0.8	1.2	1.3	1.2	0.8
	Current baseline	-5.7	-7.4	-0.8	1.6	1.2	-2.7

Note: Current baseline is the COVID-19 Critical Pandemic scenario.

Source: Moody's Analytics

Chart 3: Critical Turn in U.S. Trajectory

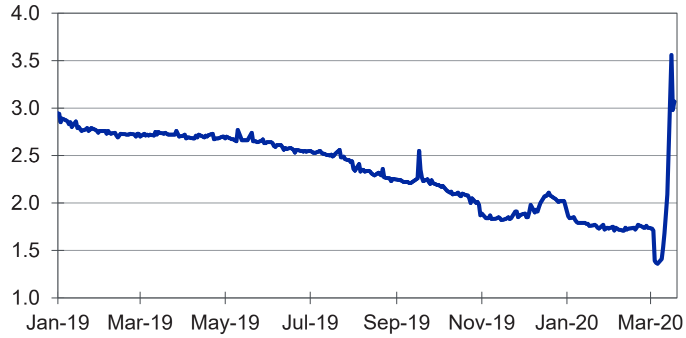
of COVID-19 cases, days since 100 confirmed cases



Sources: Johns Hopkins CSSE COVID-19 Data Repository, Moody's Analytics

Chart 4: Freeze Threatens Credit Markets

Commercial paper discount rates, A2/P2 nonfinancial, 30-day, %



Sources: Federal Reserve, Moody's Analytics

gain in GDP this year. After cratering in the first quarter, China's economy is staging a strong comeback. Barring a return of the virus, China should be fully up and running later this year. Of course, with global travel still largely shut down and the global economy struggling to revive, the Asian economy will not get into full gear until next year. The ability of Asian governments to quickly and effectively lock down their infected populations has allowed them to restart their economies more quickly and to limit the damage to the region's longer-term growth prospects.

Epidemiological assumptions

Our baseline outlook for the global economy is increasingly pessimistic. Still, given how quickly events are moving and the high degree of uncertainty around the virus' path, it may not be pessimistic enough. There are three critical known unknowns: the trajectory of the virus, the policy response, and what other problems may develop due to the extraordinary pressure on the economy and financial system. Numerous and far darker economic scenarios are possible depending on how these—and other unknown unknowns—play out.

In the U.S., an increasingly tenuous assumption is that, while the virus will not play out nearly as well as in South Korea, it will not be as bad as in Italy. The Korean government and healthcare system have managed the crisis well, while the Italians have been overwhelmed. To date, the U.S. federal government's crisis management efforts have been poor—the lack of testing kits is symptomatic—suggesting the virus will be more widespread and result in more hospitalizations and deaths than we are currently assuming. Indeed, the recent spike in new infections in the U.S. suggests that the trajectory of the virus may be even more serious than in Italy (see Chart 3).

Policymakers break glass

Global central banks and governments are rapidly ramping up their response to the health and economic crisis. Central banks are slashing interest rates, engaging in substantially more quantitative easing, providing substantial liquidity to financial markets, and reducing capital requirements for their banks. Governments are declaring states of emergency, appropriating funds to address the health crisis and providing discretionary fiscal stimulus that includes more government spending and tax cuts.

In the U.S., the Fed has reduced the federal funds rate to the zero lower bound, restarted quantitative easing, lowered reserve requirements for banks, and is providing substantial liquidity to credit markets via a number of financial-crisis-era credit facilities resurrected in recent days. We assume that a new, much larger credit facility will soon be established to support lending to businesses via the banking system, and potentially to certain non-bank financial institutions that are critical to credit flows to businesses.

Discretionary fiscal stimulus in the U.S. is assumed to ultimately total at least $1.65 trillion. Already appropriated is more than $8 billion via the first tranche of stimulus, $90 billion in the second tranche, and $50 billion freed up with President Trump's emergency declaration. Another $1.5 trillion in stimulus is likely to come imminently in a third tranche of stimulus. This one will include direct payments to individuals, loans and loan guarantees to small businesses, and support for a bailout fund for airlines and other hard-pressed companies. These measures are in addition to the so-called automatic stabilizers built into the tax code and government programs. Even more fiscal stimulus is increasingly likely.

Financial fault lines

Our baseline outlook also depends on credit markets functioning reasonably well, albeit with significant support from the Federal Reserve. Liquidity in credit markets has become increasingly impaired, including the repo and commercial paper markets (see Chart 4). If liquidity dries up, and short-term funding markets effectively close to large corporates that issue short-term debt and financial institutions that raise funds necessary for their own lending, the impact on the economy will be severe and immediate.

The high level of corporate debt is another threat. There are many large multinationals with strong balance sheets and little debt, but there are also many highly leveraged companies that will likely face a Hobson's choice: make their debt payments in a timely way or cut payrolls and investment. Either way the economy will suffer. We assume these financial fault lines are not severe or persistent enough to materially weaken the economy. However, this is an increasingly tough assumption to make.

Dark scenarios

COVID-19 is an unprecedented global pandemic and economic shock. Economies around the globe are shutting down, and the sudden halt to business is resulting in serious economic and financial damage. It is not difficult to construct very dark scenarios—each darker than the last. With the epidemiology of the virus all but impossible to gauge, these dark scenarios cannot be ruled out, and we consider them in the various alternative scenarios that we will continue to construct and update. Yet, while our baseline outlook has also turned quickly more pessimistic, the recession that now engulfs the world ultimately should not be as severe as the financial crisis nor, certainly, as terrible as the 1930s' Great Depression. However, the scenario that comes to pass will depend critically on how effective global policymakers are in containing the virus and responding to the economic fallout.

About the Author

Mark Zandi is chief economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of Economy.com, which Moody's purchased in 2005.

Dr. Zandi's broad research interests encompass macroeconomics, financial markets and public policy. His recent research has focused on mortgage finance reform and the determinants of mortgage foreclosure and personal bankruptcy. He has analyzed the economic impact of various tax and government spending policies and assessed the appropriate monetary policy response to bubbles in asset markets.

A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation's daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation.

Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation's largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs.

Dr. Zandi is the author of *Paying the Price: Ending the Great Recession and Beginning a New American Century*, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, *Financial Shock: A 360º Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis*, is described by The New York Times as the "clearest guide" to the financial crisis.

Dr. Zandi earned his BS from the Wharton School at the University of Pennsylvania and his PhD at the University of Pennsylvania. He lives with his wife and three children in the suburbs of Philadelphia.

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