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Coronavirus:
The Economy Holds Its Breath

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Overview

- The pandemic we are dealing with now may change the global economy. Due to its unprecedented magnitude, it is a source of a macroeconomic shock.

- Its scope and power of influence can cause changes in the market structure, competition rules, and the system of law. One might have an impression that the world is holding its breath.

- As the example of Italy demonstrates, predictive models are not effective under conditions of the pandemic.

- Coronavirus is an external factor. Therefore, with the decline of the coronavirus pandemic models will return to their stability in the long-term perspective. However, the way they will reach this stability depends on the way the virus will retreat. It can either happen rapidly (as it was with the Spanish flu) or as a result of a process that could last several months.

- Both scenarios imply an introduction of some rescue packages in the process of pandemic, as well as stimulus packages after its ending (such packages have been already announced by many countries). It is difficult to imagine a recovery of economy without an introduction of such packages.

Introduction

As a society, today we face a great challenge. COVID-19 is a first pandemic of modern times, which has spread over the whole world in such a short period of time. The virus affected almost hundreds of thousands people and brings itself as a threat particularly to the old and chronically ill people. Such an exceptional situation requires solidarity, social distancing and putting millions of people under quarantine. This is a challenge for the medical staff. This situation is new in many aspects, and the economic perspective proves this point. However, as the following paper outlines, the economic slowdown provoked by the pandemic should not be the major reason of concern if the relevant rescue packages will be implemented. Undertaking collaborative efforts to decrease the scope of the pandemic, we must first think how the global economy would look like after the COVID-19 pandemic.

The pandemic we deal with today may transform the global economy. **Its scope and power of influence cause changes in the market structure, competition rules, and the system of law. It affects not only the trade and price levels but also informal institutions such as shopping or greetings. Simultaneously, an interruption of several economic processes is observed, ie the production and distribution of goods as well as freezing of transactions and credibility. One may have an impression that the world is holding its breath.**

The following analysis recalls past epidemics and pandemics as well as previous forecasts concerning economic outcomes of the spread of coronavirus. We have attempted to interpret current events in a qualitative form in the context of the growth theory and institutional economics. This report is the first part of the series about economy under conditions of epidemiological threat and the impact of pandemic.

1. Historical pandemics and epidemics and COVID-19

Over the course of following centuries epidemics and pandemics decimated the population of Europe and the globe quite regularly. These include Justinian's Plague (541-542), the cocoliztli epidemic (1576-1577) and the consecutive outbreaks of cholera and typhus. The last case of pandemic immersing tens of millions of victims was the H1N1 influenza virus of 1918-1919. The Spanish flu killed at least 50 million of its victims worldwide, though probably the number is underestimated. In Europe, at least 2.3 million deaths were caused by the pandemic - that is 4.8 percent of the European population then ((Johnson, Mueller 2002: 115). Researches indicate that the Spanish influenza has worsened health of the children born in 1918-1919, thus resulting in indirect cases of pandemic that occured years after its ending (Almond 2006). What is more, the Spanish flu evoked substantial economic effects. After 1919 there were no cases of pandemic that would cause such a drastic macroeconomic shock. Other epidemics of the 20th century resulted in deaths of thousands of people all over the whole world but did not lead to structural modifications in economy. Such examples are the pandemics of H2N2 and H3N2 flu (also called as "Asian Flu" and "Hong Kong Flu"). The economic growth of United States kept stable at 3 percent on average after the H3N2 pandemic.

During the SARS pandemic of 2002-2003 8096 people were infected. In this case preventive measures were effective as patients were immediately reported

to the hospitals at the very early stage of the infection. As for the so-called Bird Flu that occurred in 2005 a number of analyses forecasted that the GDP growth was would fall by 12 percentage points (Jonung & Roeger 2006: 18). But it didn't happen.

Due to the nature of COVID-19 (numerous mild cases that may be confused with an ordinary head cold), violation of sanitary procedures and restricted availability testing for COVID it is too late for the scenario of containment to happen in Europe. Due to the high mobility of European society, it is difficult to create a fully effective system of combating the epidemic there. Some sources report that tens of percentages of global population may be infected by the SARS-CoV-2 virus. The chancellor of Germany Angela Merkel claimed that approximately 70 percent of German citizens can be affected. Therefore, the principal objective of governments and sanitation services now is flattening the curve of infections due to a limited number of beds in hospitals. Good news is coming from the scientific world: in an optimistic scenario, the vaccine should be ready in 12 to 18 months. It may prevent a consecutive return of the virus in following surges of the pandemic.

2. The economic impact

The dynamics of global economic growth is predicted to slow down. In February, a rating agency S&P announced that the world GDP growth would decrease by 0.3 p.p. For China that would be – 0.7 p.p., for United States and for Europe – 0.1-0.2 p.p. (EPRS 2020). At the beginning of March, they reexamined their estimations of the COVID-19 effects and published a new forecast of the world GDP growth; the growth will be by 0.5 p.p. less than expected before. For China that would be - 0,9 p.p., 0.5 p.p. for Eurozone (including 0.7 p.p. for Italy), and 0.3 p.p. for United States (S&P Global 2020). This means that in 2020 the

global economic growth may fall below the level forecasted in December (3.3 percent of GDP) to no more than 2.8 percent of GDP.

In China, the pessimistic scenario assumed the economic growth of 2.8 percent of GDP - the same level as the global average. And that would appear to be the worst rate for China since 1976 (Roache 2020). Thus, the new S&P's forecast seems significant.

At the beginning of March, forecasts indicated the growth level of 0.5 percent for the Euro area, and 0.8 percent for Great Britain (Broyer 2020). Due to the growing number of coronavirus cases in Europe, there is an increased risk of recession in the region.

The predictions of OECD were even more pessimistic as they have foreseen a fall in GDP growth at the level of 1.3 p.p. in the Euro zone (OECD 2020: 6). On this basis, analysts from BNP Paribas estimated that the GDP growth in Poland will be 0.6 p.p. lower than predicted and that it will amount to 2.0-2.5 percent of GDP (BNP 2020: 7). Analysts from mBank indicated an even greater decline – to 1.6 percent of GDP (mBank 2020: 2).

Industry forecasts indicate the following domains that are at greatest risk due to the pandemic:

- Transportation
- Tourism
- Gastronomy
- Hotel business
- Retail sale of selected products
- Selected products production

That's almost 2 million employees and entrepreneurs. The average decrease in turnover was estimated to be at least 20 percent. Today such a forecast may be of a use for most industries except for pharmacy, the production

of medical equipment, and - at the short-term time span – food production and production of selected items for personal hygiene.

Forecasts of individual centers differ. However, they do not differ due to the adoption of different methods, but due to the time of their publication. The economic situation is dynamic and the analyses are verified daily. The report uses the forecasts from the end of February and the beginning of March, though in the middle of March, when the article is being written, these analyses have already been outdated. The Managing Director of the International Monetary Fund, Kristalina Georgieva, announced on March 13th, 2020: "Global growth will dip below last year's levels, but how far it will fall and how long the impact will be is still difficult to predict" (WEF 2020). The data concerning the social reactions to the pandemic lead not only to the quantitative but also qualitative conclusions about the impact of COVID-2019 on the society worldwide.

As the example of Italy demonstrates, the predictive models do not work under the conditions of pandemic. Models do not foresee – and they do not have to – the disappearance of 26 percent of population from the market (as now observed in Italy, where 16 million people are quarantined). Moreover, they do not consider the interruption in the Euro-Atlantic communication, and the potential infection of 58 million citizens of the most populated country in the European Union.

There is no variable in a model that could represent the effect of the closures of schools and other public institutions. The nature of models is simple – they display a simplified representation of reality in conditions of ordinary economic turnover.

In Poland, school closure is one of the first struggles. If their offspring is younger than 15, parents have the responsibility of staying at home or provide them with some other form of care. And as there are almost 6 million children

younger than 15 in Poland, the quarantine on massive scale means that in this particular moment the majority of the labor force will not be performing their full economic activity.

Due to the possibility of introduction of the state of emergency, and the now-existing common recommendations to #stayathome, the scenario that was perceived as a pessimistic one in 2005 may now be considered optimistic. This would mean the suspension of economic activity of all of the market participants that could result in the decrease of the GDP growth dynamics and, probably, in a recession with a magnitude that is difficult to estimate. Even the record-breaking consumption of food and cleaning products could not compensate the fall in the industrial production and the service sector. However, the drastic recession in the 2nd and 3rd quarters should not be a reason to panic. In these special circumstances, statistics do not display a proper image of the economy. The process of getting out of the epidemic, preparing effective vaccines and the probability of new waves of virus emergence - these are the current priorities.

3. World after the pandemic

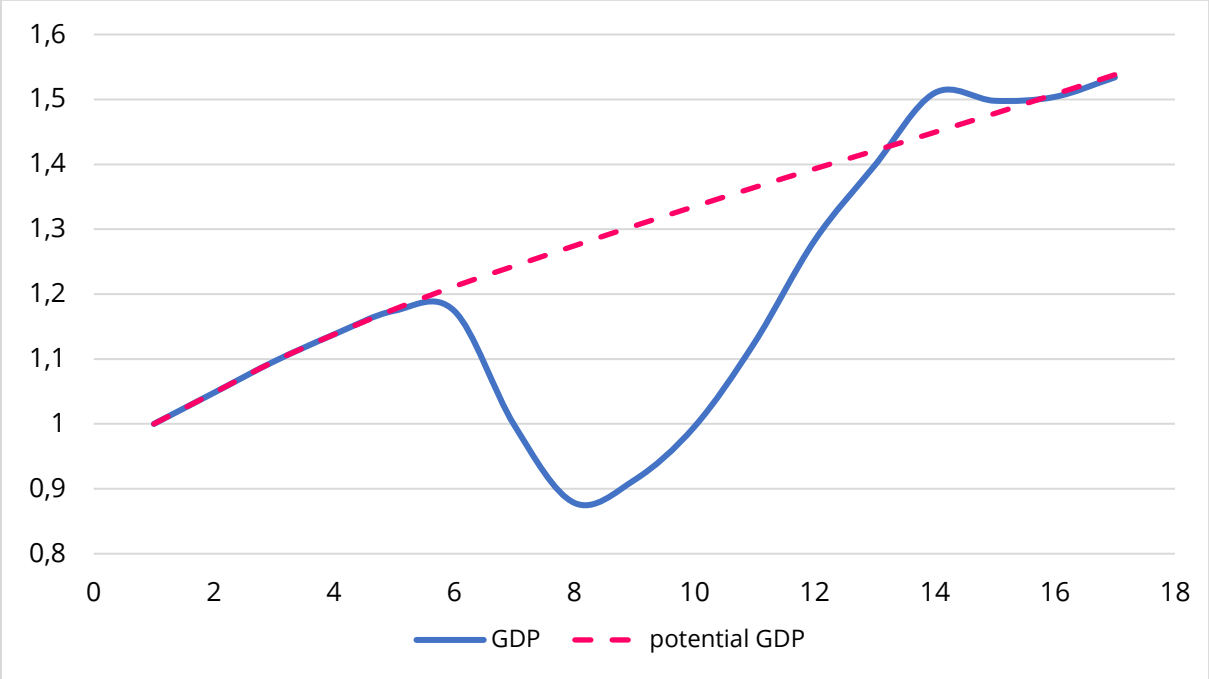
As mentioned before, COVID-2019 pandemic is an exceptional situation; its consequences are already being experienced in all of the branches of the economy by each and every citizen worldwide. Due to its scale, the pandemic may lead to the transformation of the global economy.

As coronavirus is an external factor, in a long term perspective models should return to their equilibrium. However, the way they will reach this equilibrium depends on the way the virus will be eliminated: abruptly – as it happened with the Spanish flu – or as a result of a process that could last for months.

Simulations based on the theory of economic growth are presented below. The long-term benchmark was determined by relying on historical data and “Guidelines on the application of common macroeconomic indicators" published

by the Ministry of Finance. Two factors were identified as uncertain parameters: time (t) and GDP. Even though the lack of necessary data prevents detailed prediction in this time span, it still allows to identify the mechanism.

Scenario no. 1. Pandemic ends in several weeks after its peak

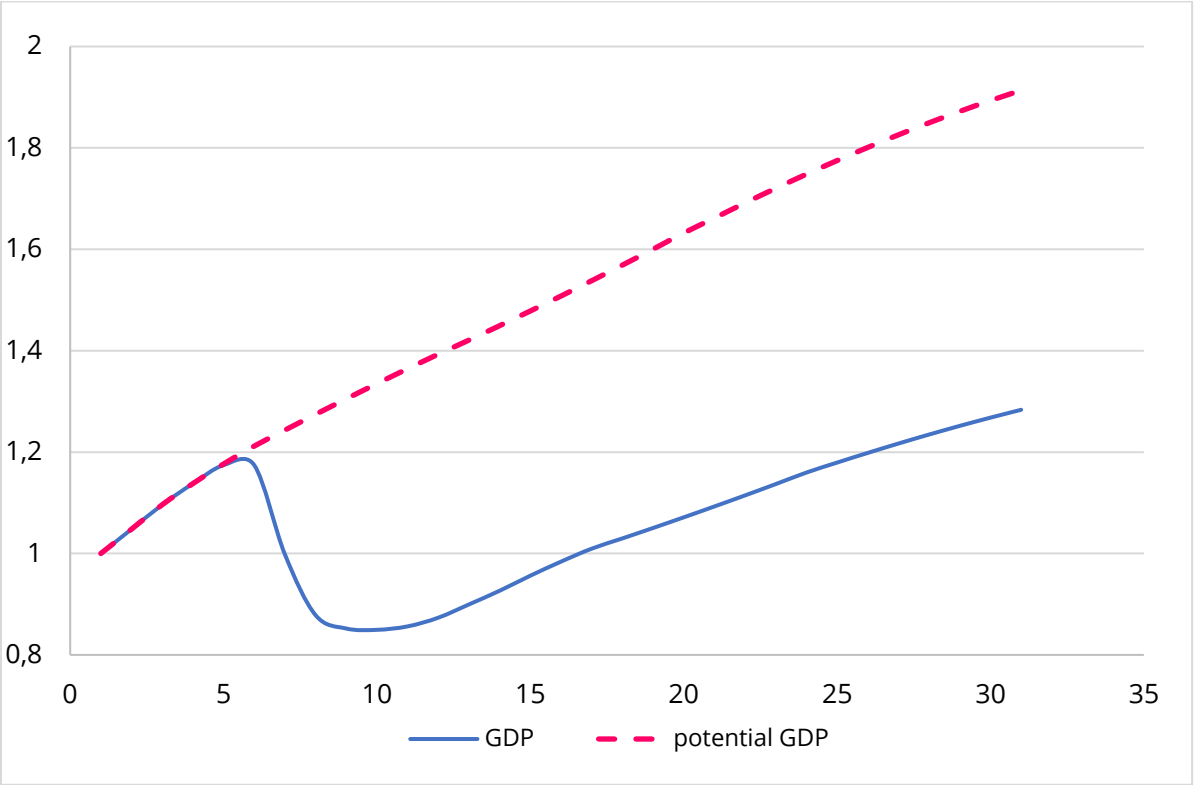


In this scenario it would be possible to observe the process of return to the natural rate of growth. The acceleration of economic growth would then be much faster than previously expected. Such pace will be caused by the disappearance of component that is solely responsible for the crisis. What should be taken into consideration is that before the pandemic the global economy has been in the stage of a slowdown but none of the industry sectors has been experiencing a crisis that could have affected other industries. Thus, after rapid disappearance of the coronavirus, the demand will be released at a level significantly higher than the one prior to the pandemic. The companies that have not lost their financial liquidity due to the protecting measures introduced by the government will be responsible for this demand: **in order to increase liquidity and cover losses,**

entrepreneurs and investors will boost their activity. In such situation we would observe an eruption of enthusiasm on the markets. That would happen due to an increase in innovation, as quarantining healthy people would have an additional effect as the means of free time increase. This, combined with a decline in general economic activity, is a special example of Schumpeter's creative destruction (Schumpeter 1942). Stimulation of innovation will depend on the accumulated social capital, while its implementation will depend on the levels and structure of this capital. The force of Gershenkron effect (1962) and technological gaps' completion will depend on the effectiveness of individual governments' actions to a large extent.

Such a fast growth and quick return to the long-term path of development is conditioned by the stimulus packages. We should notice that the problems of shortages in capital are not only reported by the individual businesses, but the industries and entire economies. Therefore, the governmental intervention is required and necessary. Stimulus packages have been already planned in Italy, Indonesia and Australia. According to the theory, growth will be faster than the potential and after the correction it will return to the long-term perspective at t=14 outlined in this case.

Scenario no. 2. Pandemic ends gradually and unevenly.



The 2nd scenario assumes slow expiration of the coronavirus from the subsequent countries and regions. If the governments do not introduce any protective packages for enterprises and employees, they will all lose the financial liquidity and eventually announce bankruptcy. Structural changes – caused, inter alia, by exit of many firms out of the market – will prolong the period of recession. Economy will return to the rate of growth but the new market structure and extending impact of coronavirus may cause the change in the long term growth rate. **GDP will grow at a previous rate but below the potential level: to put it briefly, we will not observe any enthusiasm on the market - contrary to the 1st scenario. The return to the level of GDP that was expected before the outbreak of the pandemic would happen later than in the first scenario. Furthermore, the second scenario growth will be more sensitive to the external factors.**

Both scenarios assume an introduction of the rescue packages during the pandemic or packages stimulating the economy after the pandemic's end (in a lot of countries such packages are being implemented already). Without them, it would be difficult to imagine the economy recovering to its pre-pandemic level of growth. Nowadays, the human population faces a problem that is impossible to be solved without an active role of the states' institutions. Protective and stimulating packages involve increased government expenditures from the budget. However, they are essential in order to avoid an abrupt recession and, afterwards, a long stagnation.

We do not know which of the scenarios will come true. However, COVID-2019 pandemic is a phenomenon that will result in the transformation of the global economy. Transport, production, and trade will return to their pre-pandemic levels but with a modified structure. Stock market companies will reinstate their earlier capitalization but in a different market structure and with different investors. Therefore, it is necessary to create the best possible conditions for the development in the new market structure. Such actions should be met with the inter-party agreement – just like the current fight with the spread of the virus.

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Other publications from the author:

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