Finanzgruppe
Deutscher Sparkassen- und Giroverband

Fighting Covid-19 worldwide - facing the future with full capacity to act

CORONA - NEWSLETTER

The tally of new Covid-19 infections has been sigificantly reduced thanks to the drastic measures accompanying the long second lockdown, the progressive vaccination rollout and the more favourable climatic conditions brought by early summer. This is creating scope for comprehensive easing of the economic restrictions imposed. If this positive development continues, the economy in Germany, and in Europe in general, could move up onto a higher trajectory again from the third quarter onwards. Another question that is of essential importance for the shape of the future economic constellation is the question of whether, when and how the high savings surplus of private households will be scaled back by being converted into consumption.

- Despite the current successes in the fight against the pandemic, economies - like society in general - are going to have to adjust to living with the coronavirus in the long term. Virus mutations will continue to necessitate further vaccine developments going forward. Global herd immunity is currently still a long way off. The coronavirus therefore remains a challenge for the world economy. It needs to be met with increased international cooperation.
- The coronavirus is changing society in a permanent way. Drastically altered processes and lifestyles over the course of a whole year - and the Covid-19 clock is still ticking - are leaving their mark. There can be no "business as usual". The structural paradigm shift in the world of work that already kicked in before the outbreak of the coronavirus crisis has been further intensified by the pandemic. Shifts in the direction of more sustainable and digital working practices have progressed further. The innovative talents of companies are now required to let go of outdated structures and to actively tackle structural change.
- With our *Corona Newsletters*, we have been seeking to provide information on the current situation and its economic-policy implications over the past few months. We hope that the low toll of new cases will continue to stabilise and that structural changes will enable a mode of living with a coronavirus kept in check to become possible. We are now therefore discontinuing our *Corona Newsletter* and trust it will not need to be resuscitated. To conclude the series, we would like to take a detailed look at the economic impact of the pandemic and at the challenges that are now lying ahead.

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The light at the end of the tunnel is becoming clearer

More and more commentators are now claiming that at least the major industrialised countries are slowly moving closer to the exit of the long dark coronavirus tunnel. Vaccination campaigns in the USA and Europe are making good progress by now. The clutch of vaccines developed at record speed are so far proving effective. The phase of negative surprises seems to be over, and more and more players in business, politics and the financial sector are turning their attention to the post-pandemic era.

However, enough risks still remain. The availability of vaccines currently varies widely, even in the economically more highly developed world, as the extent of the vaccination rollout by country shows. In Israel and the UK, a share over two-thirds and a shade under two-thirds of the respective populations have already received at least one vaccine dose; in the USA the figure is just over half, and in Germany it is just under half. Other wealthy countries have made less headway on this front: less than half of French citizens and only just over a third of their Swiss counterparts have already had their first jabs. The figures for Australia, South Korea and Japan are significantly lower still. Europe has now caught up with North America. This is partly due to the increased pace of the vaccination campaign in the euro area, but also because Mexico, with 127 million inhabitants yet a low vaccination rate, is classified as part of North America. In absolute terms, China is coming up with very impressive figures, with 10-15 million vaccinations per day at last count.

The vaccination rollout is proceeding at very different

With vaccine production set to become significantly higher in the foreseeable future, vaccine availability is improving and more and more people will accordingly be able to receive vaccinations. For example, the EU is expecting 530 million vaccine doses to be delivered by suppliers in the third quarter and another 450 million doses in the fourth quarter. By the end of July, 70 percent of all adult EU citizens should have been vaccinated, according to European Commission targets. This means that the willingness of citizens in the EU as well as in other industrialised countries to be vaccinated is progressively gaining in importance, and will indeed morph into one of the most crucial factors further down the road.

... An improvement is in sight thanks to accelerating vaccine

Prominent problem cases - especially the USA and France - are emerging on this score. In the United States, Democratic voters are significantly more interested in vaccination than Republicans, with their elected representatives leading the way here. If this trend continues, it will be increasingly difficult for the USA to achieve herd immunity. In France, polls show that about one-third of the overall population opposes vaccination, but this ratio has at least dropped massively in recent months.

During the summer (USA, UK) and in late summer/fall (euro area), more and more industrialised countries are likely to arrive at a "new normal". The coronavirus crisis looks like fading more and more into the background - as long as no vaccine-resistant mutant rears its head. Restrictions will be lifted as far as possible, and it will be normal to show your proof of vaccination on certain occasions, such as at the airport. Scientists and the pharmaceutical/ biotech industry will mount a pitched battle against the virus and will continue to adapt and optimise their vaccines in order to keep efficacy high despite continual mutations. Currently, vaccine efficiency is indeed high: according to the WHO, the coronavirus vaccines approved to date are effective against all currently rampant Covid-19 variants. Some studies show almost 100 percent efficacy in terms of preventing hospitalisations and fatalities.

The "new normal" this year in industrialised countries...

Things could become critical for the economy, society and financial markets from October onwards, when the weather starts to grow colder again in Europe and the USA, with people spending more time indoors. The occurrence of regional hotspots (possibly with low vaccination rates) could lead to new restrictions. Proof of vaccination or negative tests will then play a greater role regarding participation in economic and social life.

Most emerging markets can only dream of such “luxury” problems. In less developed parts of the world, it will take until next year or even the year after next before sufficient proportions of the population are protected against serious illness. And even that scenario will only materialise if help arrives. It is up to the wealthy countries and companies in the rich world to ensure that production is ramped up, in their own interests too, in order to reduce the risk of mutations.

… but not for another year or two in emerging markets

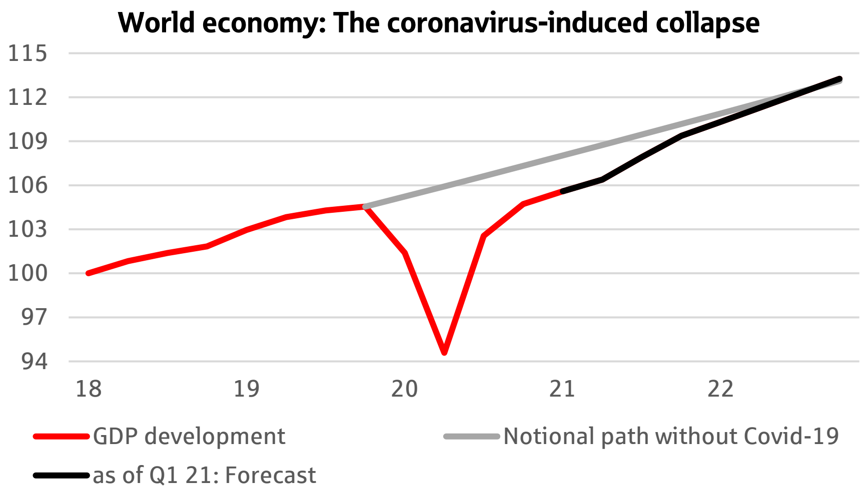
The trail of damage left by the pandemic

The coronavirus crisis has left deep scars on the economic development of almost all countries. According to our calculations, global aggregate economic output collapsed by no less than 9.5 percent in the first half of 2020, making the slump more than three times as pronounced as during the winter half year of 2008/09 under the sway of the financial crisis. Although the pandemic originated in China, the economic fallout in the Middle Kingdom was limited thanks to determined countermeasures, and the People’s Republic was already in recovery mode when many other countries were going into lockdown for the first time. The global restriction indicator hit its all-time high on April 1, 2020, and if global GDP were computed on a daily basis, the economy can be assumed to have touched bottom at around that date.

Comparing developed and emerging markets, it quickly became clear that the economic slump would be much more pronounced in advanced economies than in threshold countries. This was especially down to the "special case" of China, but there was also a correlation with the infection trajectories in the USA and Europe, in particular. In addition, not only China benefited from the experience of previous epidemics (SARS, MERS), but also neighbouring Asian countries that were also affected at the time, most of which are counted among the emerging economies.

For a long time, the consensus among economists was that the subsequent economic recovery would not take shape without lasting damage to the global economy having been caused. A wide variety of letters of the alphabet were mobilised to plot the possible course of recovery (L-shaped, U-shaped, V-shaped recovery). In the meantime, the weight of evidence has shifted to the argument that, following the series of slumps, the global economy can probably return to the original production path that would have been on the cards without the coronavirus crisis. The term "V-shaped upswing" is used to describe such a trajectory. That such a V-shaped upswing could be taking shape at all is the biggest surprise sprung by the pandemic from an economic point of view.

A "V-shaped recovery" could ensure that the world economy follows its original production path

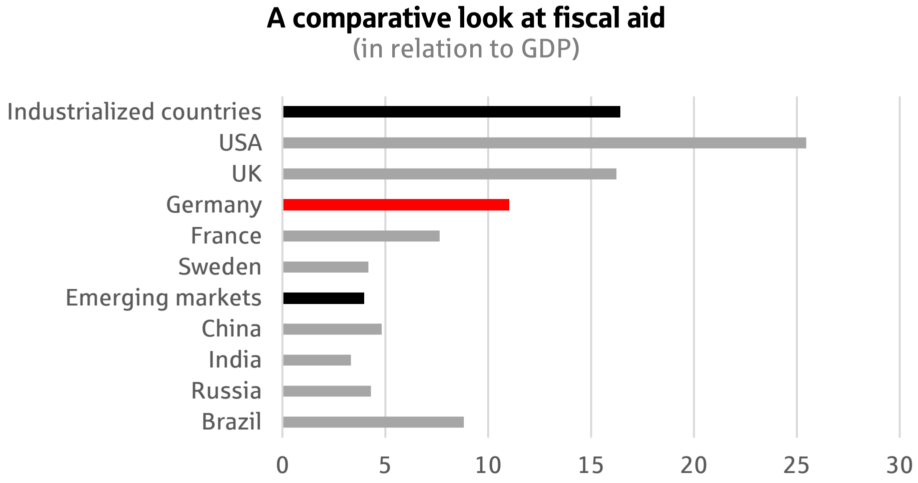


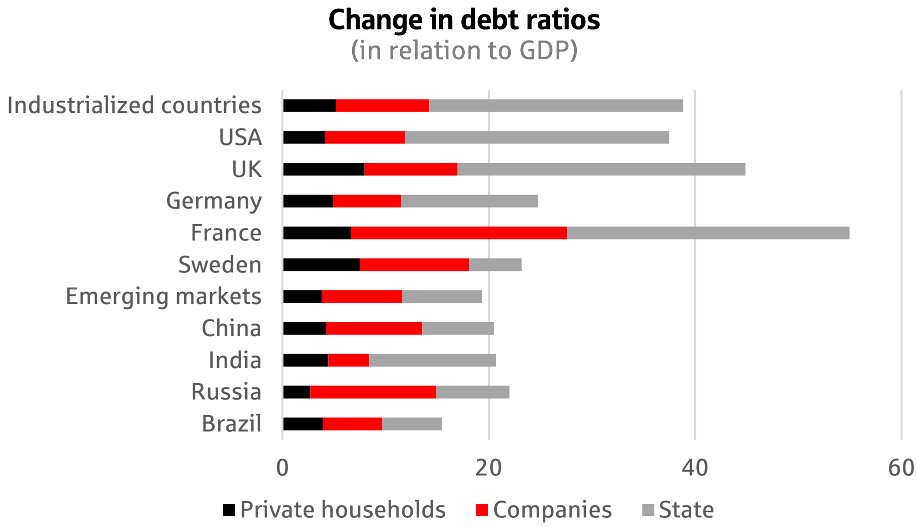
Sources: National statistical offices, DekaBank

So far, the "V-shaped recovery" is still incomplete - after all, the global restriction indicator has only fallen by a little over 18 percent from its all-time high. The global gross domestic product (GDP) was still 2.4 percentage points lower at the end of 2020 than it would have been under a notional scenario editing out the coronavirus crisis. However, this gap is likely to close in response to a further reduction in the remaining restrictions over the coming quarters. This means that dismantling restrictions is the essential precondition for an ongoing catch-up process. However, the prerequisite for a presumably almost complete recovery was created by the government aid measures adopted at the outset of the crisis.

Countermeasures

Dire as the economic slump was, without the fiscal countermeasures taken by the industrialised countries in particular, the decline would probably have been much deeper and longer, while the recovery would have proved flatter. According to IMF calculations from April of this year, the coronavirus crisis resulted in global aid packages corresponding to a full 9.2 percent of world gross domestic product. Here, too, a dichotomy opens up: the more severely affected industrialised countries put together aid packages amounting to 16.4 percent of their GDP, while the stimulus measures adopted by the whole group of emerging economies came to "only" 4 percent of their aggregate economic output.





Sources: IMF, DekaBank

However, the difference cannot only be explained by the lower burden. The ability to borrow on a large scale is also likely to have contributed to the lower borrowing ratio. A further breakdown, zooming in on low-income emerging markets, reveals that government aid packages in this set of countries accounted for just 1.6 percent of GDP. In the industrialised countries, the effect of "normal" automatic stabilisers brought into play by social-security systems must also be added in on top of the special programmes. As these automatic stabilisers have a less pronounced effect in countries such as the USA or the UK, “discretionary” corona packages had the greatest impact here, especially in the form of additional unemployment benefits. Conversely, the Scandinavian countries needed remarkably few government support measures.

These calculations do not factor in government guarantees and credit assistance, which accounted for a further 6.1 percent of GDP. While the spending programmes helped to prevent GDP from tumbling even more sharply, the guarantees and credit assistance helped to prevent insolvent companies from having to declare bankruptcy. In the USA and many European countries, these aid measures even went so far that 2020 turned out to be a year with a strikingly low number of corporate insolvencies. The low number of insolvencies is, in turn, the basic prerequisite for the economies in question to be able to move back onto their previous economic trajectories once the restrictions have been scaled back. In a nutshell: without guarantees and credit assistance, a V-shaped recovery would be unthinkable.

Guarantees and credit assistance are buttressing the "V-shaped recovery”

In addition to fiscal policy, monetary policy has also contributed to economic stabilisation. In the first hours of the pandemic, it was necessary to keep financial flows coursing round the system because they were threatening to dry up in mid-March of last year. Without intervention by central banks around the world, a new financial crisis would probably have ensued. The absence of a renewed flare-up is also a basic prerequisite for the V-shaped recovery that is still to be completed.

However, the monetary-policy measures implemented have not only ensured that the global financial system continued to exist and function, but also had the effect of pushing down yields on government bonds. This later development, in turn, made it easier for the states concerned to grant such an extraordinarily high degree of fiscal aid.

States are now the main debtors coming out of the coronavirus crisis

One of the economic clean-up tasks facing us in the coming years will be how to deal with now sharply steeper debt ratios. At the global level, the collective debt ratio of households, companies and governments has risen from 242.4 percent of gross domestic product to 273.9 percent, an increase of 31.5 percentage points. By way of comparison, the collective global debt ratio climbed by 18.0 percentage points of GDP between the end of 2007 and mid-2009 as the financial crisis was unfolding. At that time, governments accounted for a little over half of the increase in debt, with the rest deriving almost entirely from corporations. During the coronavirus crisis, the increase in the corporate debt ratio has been comparable to the trend at the time of the financial crisis, while the increase in sovereign debt ratios has been almost twice as high. Private households too have expanded their debt commitments relatively significantly. As a result, the coronavirus crisis has led to a situation in which the main debtors worldwide are no longer companies but states.

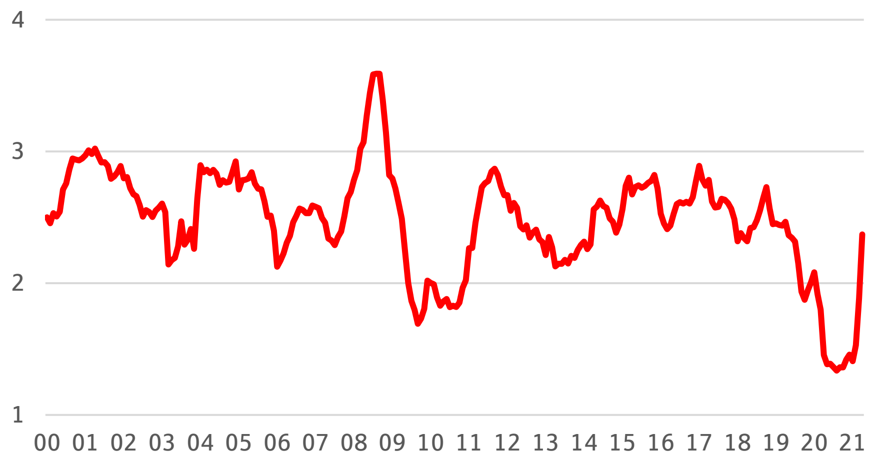
Prices

The coronavirus crisis has not only involved an economic shock but also a price shock: underlying global inflation (i.e. excluding food and energy) initially plummeted even more sharply than it did as a result of the financial crisis. What followed, however, was also unusual: the inflation rate has rebounded massively, especially since the beginning of this year.

Strong price increases are in evidence this year

Over the course of the crisis, initially habituation effects and, as the crisis progressed, cautious easing measures led to an increase in economic activity. In this context, it became apparent that the government-ordained, and globally relatively synchronous, shutdown was easier for some companies to handle than the subsequent resumption of their own business operations. In view of the major uncertainties swirling around in 2020, capacity planning at many companies was rather cautious. By the fall at the latest, reports of supply bottlenecks at companies became more widespread. These supply-side constraints caused prices to rise, first for raw materials and then for intermediate products. Since the beginning of this year, this price pressure has also been feeding through to consumer prices. The global inflation rate rose by around one percentage point between January and April of this year - such an increase in such a short period has not been seen since the mid-1990s.

World: Consumer prices
(excluding food and energy, inflation rates in %)



Sources: National statistical offices, DekaBank

So far, most central banks have been assuming that this price pressure is of a temporary nature. This is because it is apparently the current mismatch between supply and demand which is responsible for the spike in inflation rather than levels of capacity utilisation: individual intermediate inputs are not in sufficient supply, but production resources in the economies as a whole are not overutilised. The unemployment rate serves as a measure of such overutilisation: although this metric has already fallen significantly again, particularly in the industrialised countries, pre-crisis levels are still a long way off.

Prior to the coronavirus crisis, issues such as the trade dispute, protectionism and the low-inflation environment were in the economic spotlight. Due to the change of government in the USA, the systemic conflict with China now seems to be being fought out by other means, and the developments on the inflation front suggest, at least for the moment, that the phase of inflation is over. That said, we are not anticipating permanently higher inflation rates.

Economic policy after the corona crisis

The experience of the coronavirus crisis so far points to a resounding success of Keynesian stabilisation policies. The coronavirus crisis is an exogenous shock that does indeed reveal structural weaknesses but nevertheless does not have its origins in structural disequilibria. In keeping with this, Keynesian stabilization policy tools were the right means of choice.

But one must be able to afford such a choice. Such a crisis response is only possible if states have sufficient resources. Moreover, the resources expended must be replenished in the foreseeable future so that a successful crisis response is not followed up by a structural crisis. Such a structural crisis would then be "home-made" - an endogenous rather than exogenous shock - and could no longer be resolved by dishing out a neo-Keynesian cornucopia of measures.

Understandably, resources are looking significantly diminished after the crisis. Elevated debt levels and high money-supply growth point to this. However, the logic of large-scale stabilisation measures necessarily includes regenerating government resources between major crises. Such resource regeneration ought to become the leitmotif of macro policy in the post-coronavirus era.

Certainly, caution must be exercised when to comes to timing. But a "business as usual" philosophy regarding deficits and credit creation would definitely be the wrong path to go down.

Disclaimer

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