COVID 19, Contagion, Economic Consequences and Risks. 2020 03.

Contagion

At the time of writing, the COVID 19 pandemic is well underway. At the end of January, there were almost 12 thousand cases, mostly in China. Now, just two months later, there are over 150 thousand cases, with the highest growth rates outside China.

After China, Europe has become the new focus of contagion. This is probably because they were complacent, and also because of poor detection in Africa and Central Asia where COVID 19 is likely to have already taken root and may be more widespread than Europe. That said, containment measures in Europe should slow the virus in the next month, perhaps less.

The situation in the US is less predictable. There is remarkable complacency and data is noisy.

The infection rate has been about 60 in a million in China with similar numbers in Europe. In China the number has stabilized but in Europe it continues to grow. Given the differences in containment, the number in Europe is likely to rise faster than in China. Infection rates in both countries will rise over time. In the US the number is 8 in a million.

COVID 19 is different from the flu. It is deadlier, as data attest, killing between 1% to 4% of the infected. It may be more contagious given that it is infectious 2 to 3 weeks before symptoms show.

Economic consequences

Our response to COVID 19 is also different from our response to the flu. China was in lockdown for several weeks and is only just restarting its economy, and only gingerly. Europe has begun to undertake serious measures at containment. The US will soon accelerate efforts to prevent the spread of the virus. These containment measures have an economic cost.

More countries will impose travel restrictions, more people will avoid travel. Events such as cinema, theatre, concerts, spectator sports, conventions, et al have been postponed or cancelled. Lockdowns and restrictions on movements will impair retail, food and beverage industries. Manufacturing supply chains will be impaired as workers are quarantined, isolated or their mobility curtailed.

Industry is not a perfectly frictionless process. Shutting down production may not be instantaneous but require safety checks and phased shut downs. Re starting is even more difficult and may require longer periods to achieve capacity. Complex supply chains will require coordination further delaying full capacity.

The economic impact of COVID 19 has become evident. Recession risk has risen substantially and financial markets have begun to attempt to price this risk. The current volatility in markets is indicative of the uncertainty surrounding this pricing.

Policy responses

Central banks have begun monetary stimulus. The People’s Bank of China has cut reserve requirements and interest rates while providing loans to the economy. The Fed has made 2 inter FOMC meeting rate cuts of 50 and 100 basis points and has resumed bond buying to the tune of 700 billion dollars as well as making loans to the economy. Central banks across the globe will be resuming the stimulus policies of a decade ago to fight the economic slowdown.

Fiscal policy will be engaged to shore up demand. China and Britain have already announced large spending programs to boost the economy.

What happens now?

The hopeful scenario is that the virus becomes contained and burns itself out, or we find a vaccine or a cure.

At the same time countries reopen their borders and restart their economies. There is a sharp recovery in activity and the world reverts to the condition it was in before COVID 19.

Even under this scenario, some things will be different. The economy and industry will no longer be run purely for efficiency but for robustness as well, for stability. This means more redundancy and in supply chains, more slack in the system, a greater consideration for safety. ESG factors will become more important. The result will be a slightly less efficient world, but one more resilient against unexpected set backs.

The bad scenario is that no lasting solution to the virus is found and our lives become permanently disrupted. Life will adjust to the new reality but we end up losing some of the conveniences and freedoms we took for granted.

The policies we deploy such as monetary easing may be ineffective. They either pump up asset prices once again without material impact on the real economy, on employment or incomes, or, they don’t even shore up asset prices.

In our pivot from efficiency to robustness, the long term equilibrium levels of investment and consumption are lower and growth settles at a lower rate. At the same time inflation rises as supply chains lose efficiency.

Risks

QE exacerbates inequality. In 2019 there were over 20 instances of civil unrest, potentially driven directly or tangentially by inequality, of wealth, income, access, influence or power. The application of more QE could be a tipping point.

Inequality also manifests as a healthcare apartheid. The rich have access to quality healthcare, the poor do not.

Debt levels in the world are high. The leverage has built up in the corporate and sovereign sectors. A contraction in demand could lead to serious deterioration of corporate balance sheets. Even if policies to help alleviate corporate stress are deployed, businesses may decide to reduce debt which would mean slower investment and employment growth.

In a crisis, the strong are co-opted to aid the weak. The banking system, the private commercial banks were strengthened by force of regulation over the last decade. While the risk of financial contagion is now low, a de facto nationalisation could be effected to co-opt the banks into rescuing the economy.