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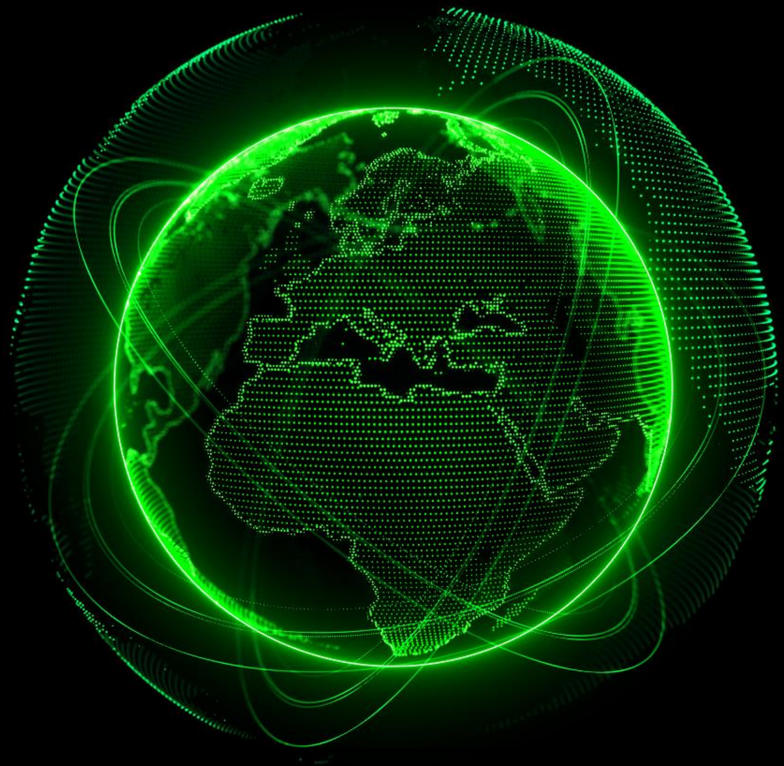
The global economic consequences of COVID-19

Deloitte Digital Dialogue - April 2020



This insights summary is based on a Deloitte's Digital Dialogue on ***The global economic consequences of COVID-19*** which was held with business leaders and Economists across the globe including **Dr Yuwa Hedrick-Wong,** Visiting Scholar, Lee Kuan Yew School of Public Policy, National University of Singapore and Chief Economics Commentator, Forbes Asia; **Dr Thabi Leoka,** Economist; **Dr Ira Kalish,** Chief Global Economist, Deloitte Touche Tohmatsu; **Ian Stewart,** Chief Economist, Deloitte UK. Moderated by Dr Martyn Davies, MD, Emerging Markets & Africa, Deloitte Africa.

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The global economic consequences of COVID-19

During these extraordinary times, Deloitte is hosting a series of digital dialogues on behalf of our clients. The series seeks to provide insights that are intended to inform decision-makers both within business and government and assist them to navigate through a world facing dramatic change.

> *“The world may begin to see stabilisation in the second half of 2020 depending on the progress made to contain the virus.”*

The global outbreak of COVID-19 is indisputably causing significant turbulence in the global economy. According to projections published by the International Monetary Fund in April 2020, global GDP growth is expected to contract sharply by -3%, a larger contraction than what was seen during the global financial crisis.[1]

In the first half of 2020, the severe impact of COVID-19 is likely to be seen especially in advanced economies, with most of these economies expected to record a contraction in 2020 GDP ranging from -5.9% to around -9%.

Despite this already negative outlook, the global economic growth outlook faces many more uncertainties due to the COVID-19 crisis. The world may begin to see stabilisation in the second half of 2020 depending on the progress made to contain the virus.

Although many organisations have developed multiple scenarios[2] to think through how the crisis may unfold, based on this digital dialogue, there are two scenarios that are likely to emerge from the crisis: the optimistic and the pessimistic scenario.

The pessimistic scenario would be a case where the pandemic will continue until at least mid-2021. Assuming a pessimistic scenario, global output could shrink by 15-30%, the global trading system could collapse and fiscal debt would rise significantly. If this scenario persists, at some point, governments will have to open up their economies, accept the trade-off of living with COVID-19 and restart their economies, even though COVID-19 is not under control.

The optimistic scenario would see the pandemic “under control” by end-2020, with easing of the lockdowns from May 2020. In this case, over the medium to long term, the global economy will stabilise and begin to recover in 2022.

Populism could increase in the West, as numerous economies would begin to switch to a more technologically intensive mode of production to reduce dependency on global supply chains and human workers. In turn, this will create a severe impact on Organisation for Economic Co-operation and Development (OECD) countries and emerging markets, specifically

[1] IMF, 2020. World Economic Outlook database. April 2020. Available [Online]. https://www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx
[2] For Deloitte’s scenarios please see Deloitte, 2020. Recovering from COVID-19: Considering economic scenarios for resilient leaders. Available [Online]. https://www2.deloitte.com/za/en/pages/about-deloitte/articles/deloitte-africa-economic-scenarios-for-resilient-leaders.html

"With governments making financial commitments to provide support for companies, workers and also increase healthcare spending and social welfare, debt levels may increase even further."

medium-skilled and low-skilled workers – pushing more of them into low-end services or even into poverty.

As populism increases, capital-labour substitution is likely to accelerate post COVID-19 and create higher unemployment globally, as seen with the United States (US) Department of Labour's announcement that 30 million US citizens applied for unemployment benefits since the pandemic started.[3]

The global economy is becoming more technologically intensive and this will somewhat lead to a shortage of skilled workers and will likely affect the level of economic growth expected in countries post COVID-19. Going forward, OECD countries and emerging markets will experience weakened growth momentum, mainly resulting from the debt burden by governments, corporates and even households. With governments making financial commitments to provide support for companies, workers and also increased healthcare spending and social welfare, debt levels may increase even further.

A vacuum in global leadership

The COVID-19 crisis is somewhat intensifying the decoupling of China and the US, which has been on-going even before the crisis began. In the US, there is a wide consensus regarding the rise of China as a threat to the US.

Within China, domestic priorities never seemed to have succumbed to any kind of foreign domination, thus giving the country a level of independence.

Post COVID-19, the US is expected to take a protectionist approach and exert bilateral control to protect the country's interests. China is expected to continue pursuing an approach that is beneficial for the country and utilise a multilateral system where necessary.

The decoupling between China and the US also exists in terms of technology, already visible prior to the COVID-19 spread. For example, this was seen with the attempt to ban ZTE operations by the US[4] and export controls on Huawei.[5]

[3] Bloomberg, 2020. Job Losses Deepen in Pandemic With U.S. Tally Topping 30 Million. Available [Online]. https://www.bloomberg.com/news/articles/2020-04-30/another-3-8-million-in-u-s-filed-for-jobless-benefits-last-week

[4] Reuters, 2020. China's ZTE says main business operations cease due to U.S. ban. Available [Online]. https://www.reuters.com/article/us-zte-ban/chinas-zte-corp-says-main-business-operations-have-ceased-due-to-u-s-ban-idUSKBN1IA1XF

[5] Financial Times, 2020. Fears rise that US-China economic 'decoupling' is irreversible. Available [Online]. https://www.ft.com/content/c920bce2-360e-11ea-a6d3-9a26f8c3cba4

“Future relations between the US and China will be determined by the outcome of the upcoming US presidential elections in November 2020.”

Post COVID-19, other areas of decoupling between China and the US beyond the above-mentioned ones, are likely to become visible and as a result exert pressure on the world to reduce its reliance on China-centric supply chains.

A rapid shift in Fortune 500 headquarter locations

China has rapidly become one of the top headquarter locations for Fortune Global 500 companies. The number of Fortune Global 500 companies headquartered in the US fell from 179 to 121 between 2000 and 2019. While in 2000, only 10 of the Fortune Global 500 companies had their headquarters in China, this has now increased to 119 in 2019 – almost the same as in the US last year.[6] Locating headquarters to China seems to largely be influenced by China’s global economic performance.

Before the COVID-19 crisis, China’s footprint in the global economy was rising inevitably and this trend will continue, more so as China contributed 35% to total global economic growth over the 2017-19 period. This is much higher compared to the US and the EU’s contributions to global growth (18% and 8%, respectively over the same period), and gives China a lot of economic power in addition to technological power.

US elections set to determine future US-China relations

Future relations between the US and China will be determined by the outcome of the upcoming US presidential elections in November 2020. Granted that President Trump is re-elected as president, the US protectionist approach will continue, including the partial breaking of the symbiotic relationship between the US and Chinese technological companies.

This may slow down the pace of innovation and may lead to two separate technological standards that the rest of the world would have to choose from. It may also result in continued diminishing growth of trade, mainly due to the trade war between the US and China that has unfolded under the Trump administration.

[6] Bloomberg, 2019. The Changing Headquarters Landscape for Fortune Global 500 Companies. Available [Online]. https://news.bloombergtax.com/daily-tax-report/insight-21

“Increasing debt burden coupled with slower growth will put strain on European institutions.”

In the event that former Vice President Joe Biden is re-elected, there may be a partial return of the policies that were seen under former President Obama’s administration. These policies are less protectionist, more globalist, and more focused on developing global trading systems and global solutions to economic problems.

Going forward, the relationship between the US and China will be determined by the 2020 US election outcome and the policy direction thereafter.

Eurozone debt crisis setting in

The Eurozone has suffered economic growth challenges resulting from the effects of the global financial crisis and resultant European debt crisis a decade ago.

The COVID-19 crisis is expected to have a similar – if not worse – impact on Europe. Already growth in the Eurozone declined sharply by 3.8% in the first quarter of 2020,[7] following the introduction of lockdowns in the area. This sharp drop in growth is worse than what the Eurozone experienced during the financial crisis.

Growth in the Eurozone is expected to contract further in the coming months, owing to reduced economic activity, global supply disruptions and increased debt.

National debt levels in the Eurozone are projected to rise steeply, particularly due to increased government borrowing to curb the spread of the virus and support areas that will be affected.

Increasing debt burdens coupled with slower growth will put strain on European institutions. These may trigger political and economic tension and will require renewed momentum from the European government.

[7] Financial Times, 2019. Eurozone economy shrinks by fastest rate on record. Available [Online].
https://www.ft.com/content/dd6cfafa-a56d-48f3-a9fd-aa71d17d49a8

> *"Oil producing countries will suffer great economic shocks, owing to a collapse in oil prices and may find it challenging to emerge from the economic effects of the commodity price collapse."*

The impact of COVID-19 in SSA

Several SSA countries have recorded strong growth rates over the years. However, the unprecedented COVID-19 crisis will destabilise some of the strong growth recorded.

Oil producing countries will suffer great economic shocks, owing to a collapse in oil prices and may find it challenging to emerge from the economic effects of the commodity price collapse. Nonetheless, other commodity-exporting countries will also be affected to some extent, owing to negative demand in the region and globally.

Economic shutdowns across the globe have resulted in global supply chain disruptions, affecting SSA trade participation, reducing inflows of foreign financing and causing economic difficulties in the region.

Some SSA countries may recover from the economic shock much faster than others. Some may struggle to ramp up their economies, notably those that are oil dependent or undiversified, such as Nigeria and Angola amongst others.

A South Africa view

South Africa has been facing economic headwinds prior to the COVID-19 pandemic. The country recorded a technical recession in the past year, has been battling with unreliable electricity supply, and mounting debt. In the 2020 Budget Review published by the National Treasury in February 2020, South Africa was forecast to record a budget deficit of -6.8% for 2020, with debt reaching unsustainable levels in the medium term.

Although the South African government has announced a stimulus injection of R500bn (10% of the country's GDP) into the economy, this may not be enough to support the most affected areas, such as the local health system, small businesses as well as other social issues that may arise due to the pandemic.

The South African government needs to reprioritise its existing budget towards health, social and economic interventions. This will likely force it to seek additional funding, thus further widening the budget deficit and raising debt-to-GDP levels.

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This insights summary is based on a webinar with the same title that was hosted by Deloitte Africa's **Dr Martyn Davies,** Managing Director of Emerging Markets and Dean of Deloitte Alchemy School of Management on 23 April 2020. Speakers included:

- **Dr Yuwa Hedrick-Wong,** Visiting Scholar, Lee Kuan Yew School of Public Policy, National University of Singapore and Chief Economics Commentator, Forbes Asia
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