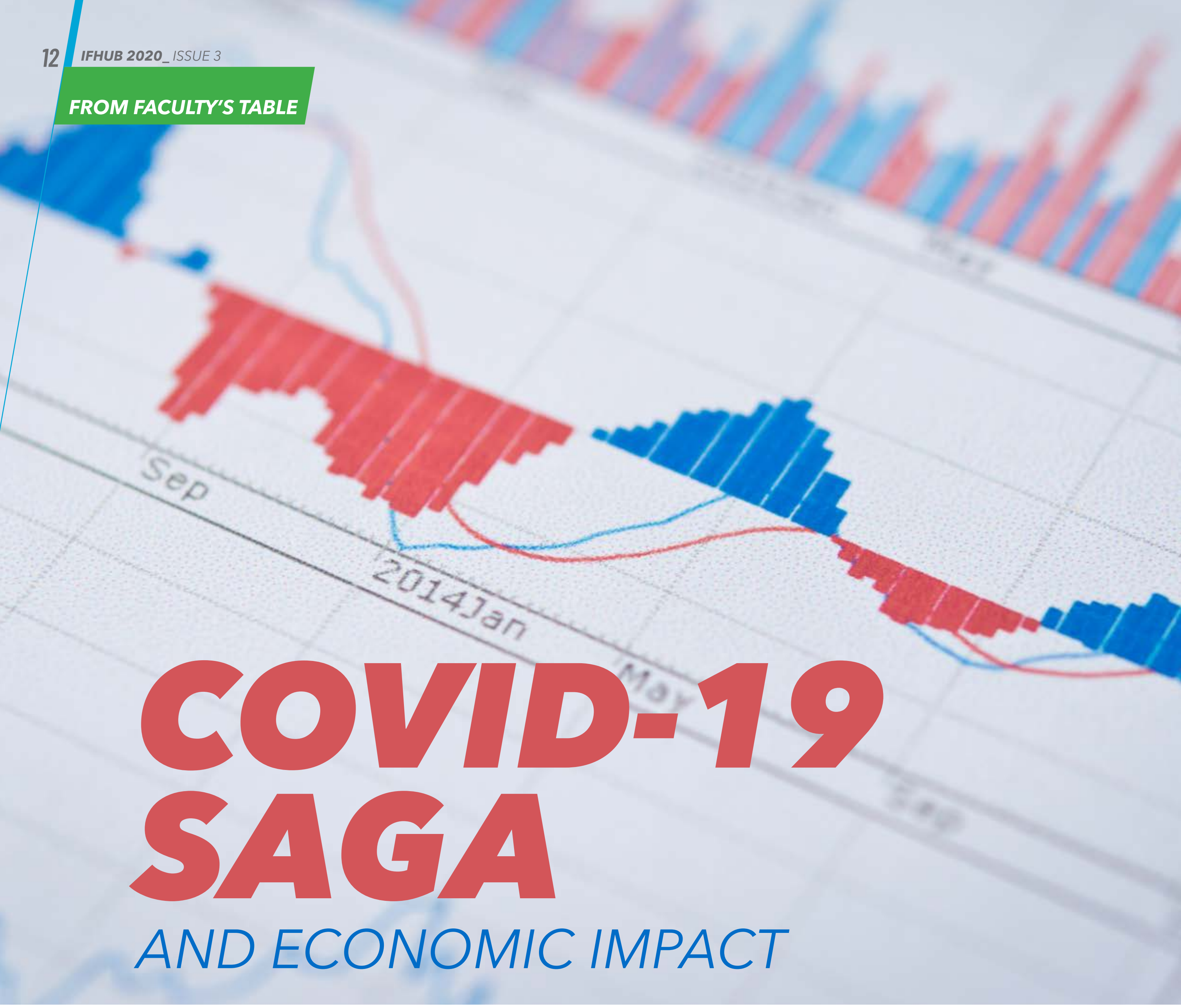
FROM FACULTY'S TABLE



COVID-19 SAGA

AND ECONOMIC IMPACT

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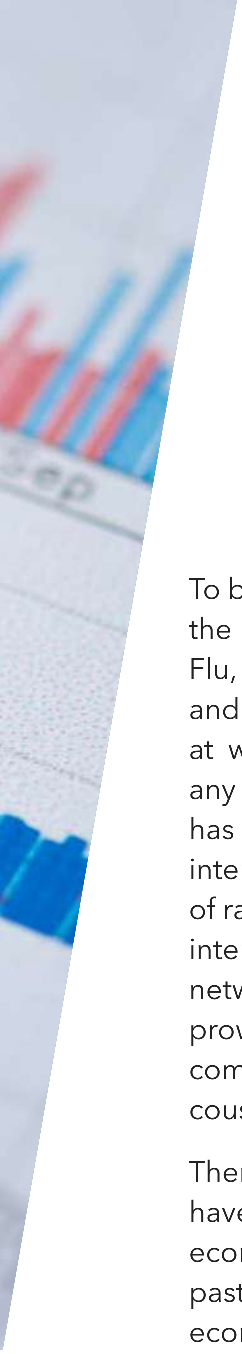
INCEIF

INTRODUCTION

The Covid-19 outbreak hit the fan in December 2019 in Wuhan, China. There is much controversy over the genesis of this new pandemic which is haunting the humanity the world over. Contradictory, if not competing, conspiracy theories have emerged, with China and the US blaming each other. Some have described Covid-19 as a Black Swan which took the world completely unawares, while others contend it was not unforeseen, as people like Bill Gates have been talking about an impending pandemic of Biblical proportions, for nearly five years.



To be sure, there were similar pandemics in the past, e.g. cholera, plague, and Spanish Flu, but what makes Covid-19 so distinctly and dangerously different is the speed at which it has spread globally, which in any case is not surprising as the world has shrunk into a global village, intimately interconnected, thanks to modern modes of rapid transportation and ever-expanding intercontinental commercial linkages and networks, not to mention the extraordinary prowess of the Novel Coronavirus in comparison with its other coronavirus cousins.

There is much evidence that such pandemics have had huge negative impacts on the economies in some parts of the world in the past. This time around, the toll on the global economy emanating from Covid-19 could well be unimaginably out of the ordinary. Much would, however, depend not only on the speed, geographical spread, and intensity, but also, more importantly, on the societal reactions and policy responses to the coronavirus spectre. We need to take a closer look at all these before we can arrive at some sensible or meaningful assessment of the economic impact of Covid-19.

WHAT WE DO KNOW

In China, where it all apparently began, the death toll is slightly more than 4,600 out of over 84,000 confirmed cases. It is the US the hardest-hit, with nearly 1.8 million confirmed cases and more than 100,000 fatalities.

Among the badly affected European countries are the UK, Italy, Spain, and France, each recording more than 25,000 deaths.

Collectively, these four European countries have roughly 900,000 known cases, with about 126,000 fatalities. In the Middle-East, Iran has reported nearly150,000 cases, which include over 10,000 infected medics. In the Arab Gulf states, the tally hangs around 200,000 cases. Meanwhile, the battleground is shifting to Latin America as the newest epicentre, where Brazil with nearly 500,000 infections and close to 30,000 deaths has overtaken Russia's 400,000 cases and 4,700 fatalities, to become the second-worst, while Peru surges past 155,000 cases and 4,000 deaths. Closer to our shores, India has reported about 180,000 confirmed cases with more than 5,000 deaths. The known cases in Indonesia exceed 25,000, with more than 1,500 deaths, trailed by the Philippines, where confirmed cases exceed 17,000, with 950 fatalities. Malaysia pales in comparison, with less than 8,000 known cases and 115 deaths. Singapore's confirmed cases are disproportionately large at nearly 35,000, albeit with low 23 fatalities. Globally, the total number of known cases in 188 countries exceeds six million, with more than 365,000 deaths. To be sure, all these numbers (as of May 3, 2020) will keep rising in the near term.

WHAT WE DO NOT KNOW

There are compelling reasons to doubt if the reported numbers do tell the true story, not so much because some countries tend to underreport their known cases and deaths, but more importantly because they are blissfully oblivious to the realities on the ground. For starters, the numbers we get to see on confirmed cases and fatalities understate the magnitude of the problem the world faces. Countries that do less testing tend to report less numbers than countries that do more testing. Many in rural South Asia maybe infected with Covid-19 without knowing and recover without any treatment, as they reportedly have better natural immunity, thanks to their tough life style, huge exposure to bacterias and viruses of sorts, and their diet which is laced with spices of sorts.

Scientists say that the coronavirus is not a living thing, which means that it cannot be killed, and that it can only self-destruct, which makes treatment extremely hazardous. At present, hospitals can only treat the symptoms and not the disease. What makes this crisis all the more complex is the fact that this virus tends to mutate rapidly. It is reported that the strains of coronavirus vary across continents, more deadly in the temperate zones than in the tropical zones, given its sensitivity to temperature. The chances are that cases and fatalities in North America and Western Europe will diminish significantly as summer approaches. However, there are also growing fears that there could be a second wave of Covid-19 lurking around the corner, come autumn and winter, later in the year. It is instructive to note that the Spanish Flu of 1918, the most severe pandemic in history, lasted two years and came in three waves, with 500 million infections and 50 million fatalities, most of which happened in the second wave. The world can never be safe from Covid-19 until a vaccine is found.

CURE WORSE THAN DISEASE?

Many countries across the globe have resorted to full or partial lockdowns in an attempt to contain the spread of Covid-19. More than one half of the world's population or over 4.5 billion people have come under social distancing measures. However, severe restrictions have turned out to be too costly. The impact of shutdowns or lockdowns on the global economy is so huge that the IMF has warned that the world is gravitating towards the worst recession since the Depression of the 1930s. The UN World Food Programme has also warned that the pandemic could double the number of people with acute hunger.

Covid-19 has caused the supply chains to be disrupted and businesses to be derailed, with massive job and income losses. To ease the pain, nearly all countries have come up with stimulus packages of sorts, which could only do so much but not enough to compensate. There have been protests against lockdown in some parts of the world, notably Italy, Spain, Germany and the US, not to mention isolated incidents of even armed protests, staged by people who could not take it anymore. It is a mega dilemma for the jurisdictions which are in the eye of a perfect storm, whether to tighten up or loosen the restrictions, similar to a catch-22 situation. This has led to some relaxation of restrictions prematurely in some countries. Scaling down the lockdown in Germany, for instance, has led to a hike in infections and fatalities in late April.

Not all countries, however, have adopted the so-called lockdown approach. An example of countries which chose a different path is Sweden, which opted to keep the economy open in a 'business as usual' mode, with mere advisories on personal hygiene, in sharp contrast to other Scandinavian countries.

> *Taiwan could beat the pandemic with sheer social discipline with no need for any economic shutdown, limiting the coronavirus fallout to 442 cases and 7 deaths, followed by zero cases thereafter*

The results are telling: Sweden could save its economy, but only at the expense of a greater exposure to Covid-19, with close to 36,500 infections and more than 4,300 deaths, while Norway, Denmark and Finland have reported much smaller numbers, with deaths at three-digit and infections at four-digit levels. Taiwan could beat the pandemic with sheer social discipline with no need for any economic shutdown, limiting the coronavirus fallout to 442 cases and 7 deaths, followed by zero cases thereafter. What is so unique about Taiwan was that the Taiwanese took Covid-19 very seriously from day one, unlike others who are now in deep distress.

TAMING THE PANDEMIC

Some countries are still seeing their daily case numbers increase, while others in Asia and Europe have managed to bend the curve, slowing the transmission of Covid-19. The number to watch is what epidemiologist call the "effective reproduction number", or 'R', which gauges how many people the average infected person infects in turn. If 'R' is more than 1, the outbreak is on the rise; if 'R' is less than 1, it is under control. If R is 1, it means that each infected person, on average, infects one other person, in which case the number of new cases will remain steady. Ideally, 'R' will be zero, when the pandemic is over.

France, Italy, and Spain are reporting steadily declining fatalities (record lows, albeit still at 3-digit). Italy, with about 33,000 fatalities, has been in lockdown since March 10, while Spain has seen deaths exceed 27,000, trailed by France's 28,000 deaths. Spain has been under lockdown since March 14, whereas France has declared a state of emergency until July 24. Germany announced a relaxation of restrictions on April 20, as the reproduction rate of the virus 'R' fell below 1 to 0.7 which subsequently rose to 0.9, too close to the manageable level. In Hokkaido, Japan, after its 3-week lockdown was lifted, the number of infections surged, forcing the authorities to reimpose the lockdown 26 days after lifting it. Recently, in the last week of May, Spain has extended its state of emergency for the fifth time.

MEASURING THE DAMAGE

It is extremely difficult, if not impossible, to measure the depth of the decline in the economies affected by Covid-19. We will not know the extent of damage for years until after the dusts have settled. What bedevils our analysis is the fact that the story is still unfolding and rapidly evolving. Obviously, we cannot zoom into all the coronavirus-hit countries, not only due to space constraints by also data constraints. Nor can we cover all the sectors of the global economy even with broad-brush strokes.

> *British Airways is set to slash up to 12,000 jobs from its 42,000-strong workforce. The airline's parent company IAG has reported that the group revenues fell 13% to €4.6 billion in 1Q20*

Photo: Stuart Bailey

In what follows, we can only manage to scratch the surface, in our search for answers to umpteen questions.

For starters, the International Labour Organisation (ILO) has warned of the severe impacts of Covid-19 pandemic on people in work. According to the ILO, 1.6 billion people's livelihoods are threatened, equivalent to one-half of the global workforce. The ILO expects that the total working hours will be 10.5% lower, equivalent to 305 million full-time jobs.

The ILO estimates show that the workers' income worldwide has dropped by 60% in 1Q20, while the impact is much larger across the continents: 81% in Africa and Americas, 70% in Europe and Central Asia, and 20% in Asia and the Pacific region. More than 400 million enterprises worldwide are at the risk of serious disruptions. For example, nearly 4.1 million Bangladesh garment factory workers face a bleak future in the near term as global brands are ditching clothing contracts worth $3.7 billion amid the coronavirus pandemic.

This is too huge a loss to the Bangladesh economy, where garments generated more than $30 billion income which translated to roughly 80% of Bangladesh's exports or 16% of GDP, in2019. In India, 122 million people lost their job In April alone, with Indian unemployment rate surging from 8.7% in March to 23.5% in April and 27.1% in May. In the US, 20.5 million jobs were lost in April, the highest on record, pushing up the unemployment rate to 14.7%.

The aerospace industry faces the gravest crisis in history. Covid-19 has caused a collapse in air travel.

Airbus reported a €481 million loss in 1Q20 compared to €40 million profit a year ago in 1Q19. Boeing has reported a $1.5 billion loss in 1Q20, compared to $2.3 billion profit in 1Q19. Boeing plans to cut 10% of its 150,000 jobs. GE is slashing up to 13,000 jobs at its jet engine division. British Airways is set to slash up to 12,000 jobs from its 42,000-strong workforce. The airline's parent company IAG has reported that the group revenues fell 13% to €4.6 billion in 1Q20. Lufthansa, which has reported €1.2 billion loss in 1Q20, plans to trim its fleet by 13%, with 10,000 job cuts. All indications are that 2Q20 will be much worse. In the UK, Easy Jet has laid off up to 4,000 cabin crew. Virgin Atlantic is seeking a £500 million loan from the government as bailout. Elsewhere, Qantas has put its 20,000 staff on leave, while Air Canada has done the same for its 15,200 employees. Norwegian Air has declared that it could run out of cash by mid-May. At American Airlines, about 4,800 pilots are taking short-term leave on reduced pay, and another 700 are taking early retirement. Thai Airways has filed for bankruptcy. The aviation industry is evidently in the throes of an unprecedented crisis.

Oil prices have plunged down to 20-year lows. US oil prices have fallen off the cliff by three-quarters, since early January, to just $15 a barrel. BP's profit in 1Q20 has dived by two-thirds. Oil industry is hit by both supply and demand shocks like never before. People are not filling their cars and airlines are not refuelling their planes. Oil prices were already under pressure before the pandemic due to in-fighting among oil producers.

Early April, OPEC countries and allies agreed to cut global production by 10% which is unlikely to match the fall in demand. The UK oil and gas industry has warned of 30,000 job losses due to the pandemic and depressed oil prices. According to Fitch Ratings, more than $43 billion of high-yield bonds and leveraged loans in the energy sector are at the risk of default. Nonetheless, oil prices are expected to rebound in the second half of this year. Even so, Moody's Investors Service believes that oil prices will average just $30 a barrel in 2020, which is too low for any US shale oil company to make a profit. In May, however, oil prices jumped on the hopes for vaccine and recovery, with Brent and crude rising to $35 and $32, respectively.

The pandemic has caused huge dents into the tourism sector across the globe, under the lockdowns, with nearly all airlines being grounded. The toll on the hospitality industry, in particular, is enormous, with many hotels reporting extremely poor occupancy rates, while many others are closing down operations indefinitely to minimise losses, as keeping them open would add more to their costs than to their revenues. Economies that are overwhelmingly dependent on tourism are knocked out totally. The pandemic has also delivered a body blow to international trade flows by disrupting the global supply chains.

Photo: New York National Guard

Research houses and think-tanks around the globe are busy revising their GDP forecasts downward frequently. Small open economies with a small domestic sector are particularly vulnerable. Regardless, the chances are that many countries will report a double-digit contraction in 2Q20. Japan, the third largest economy, is already in recession, with two consecutive quarters of contraction in 4Q19 and 1Q20.

MANAGING THE CRISIS

The Covid-19 pandemic crisis appears to be second only to the 1918 Spanish Flu crisis on the scale of infections and fatalities. In economic terms, the current crisis is the worst the world has ever seen since the 1929-1932 Great Depression. In this 2020 pandemic crisis, the US plays the lead role not only because it is the largest economy in the world with most extensive international connections, but also because it is the hardest-hit by the coronavirus pandemic.

THE UNITED STATES

The US economy was poised to grow 2% this year, which is now derailed by Covid-19. The US economy has been growing non-stop for 23 quarters in a row, nearly six straight years of uninterrupted growth. Covid-19 ended that streak in the first quarter of this year (1Q20), even though the pandemic did not disrupt businesses until mid-March. By mid-April, about 95% of the country was in some form of lockdown. Although some states have started to remove the orders, others remain locked down, including New York and California, the twin mega engines of growth in the US economy. Consequently, consumer spending which accounts for two-thirds of the US economy, has dropped 7.6% in 1Q20.

The US Federal Reserve (Fed) has unfolded a stimulus package of nearly $3 trillion, which unquestionably is a big deal. The Fed's slew of emergency measures includes direct payments to many families, lowering interest rates close to zero, relaxing banking rules and dramatically expanding its own lending to save the economy under its 'Main Street Program', which is open to companies up to 15,000 employees or up to $5 billion in revenue. This Fed initiative is also open to small companies. The loan size will range from $1 million to $25 million.

All these moves by the Fed, however, could cause problems later on, including the swelling of the Fed's balance sheet.

Huge job losses since March have lifted the US unemployment rate from a 50-year low of 3.5% in February to 4.4% in March and 14.7% in April. White House economist Kevin Hassett has cautioned that unemployment could rise to 20% by June, which is not too far from the historic high of an estimated 25% in the 1930s. From mid-March till May 21, 38.6 million Americans have filed for unemployment benefits, which corresponds to 23.7% of the US labour force. Big businesses are experiencing body blows. Disney's profit dived 91% in 1Q20. US household debt has risen to $14.3 trillion, which is $1.6 trillion higher than the previous peak of $12.7 trillion in 2008. In 1Q20, corporate profits shrank nearly 14% from the prior quarter, while financial corporations logged a 17% profit drop.

The US economy has contracted by an annualised rate of 5.0% in 1Q20, marking the worst quarter since the Great Depression. Growth in January and February this year, if any, has apparently been more than washed off by the severe contraction in March. The annualised 5.0% contraction in 1Q20 was shocking to the US economy which had registered a 2.1% growth in 4Q19.

The first quarterly contraction since 1Q14 is the worst drop since the 1Q09, when the economy contracted by an annualised 4.4% in the midst of the global financial crisis. According to the Fed, the US economy is likely to contract 20-30% in 2Q20.

In the worst-case scenario, the US economy may suffer an unprecedented 40% in contraction in 2Q20. Against this gloom, however, Treasury Secretary Steven Mnuchin is optimistic that the US economy will rebound this summer (3Q20). The Wall Street is also betting on a quick recovery. The S&P 500 has spiked above 3000 points since the low on March 23, a stunning rebound reflecting optimism based on the Fed's aggressive stimulus measures. However, consumer confidence index has dropped to 85.7, its lowest level in nearly six years. Meanwhile, some states, including Texas and Georgia, have begun to slowly reopen their economies, albeit with health restrictions and social distancing in place. The US Congressional Budget Office projects a strong rebound in the second half of the year. Other estimates also point to GDP surging by 23.5% in 3Q20 and 10.5% in 4Q20.

Much will, however, depend on how people will respond to the reopening of the economy, while coronavirus is still lurking. It is unlikely that Americans will return to crowded places like theme parks and sport arenas after social distancing restrictions are relaxed.

Americans are nervous about the state of the economy, stashing cash at a rate that may not augur well for any hope of a quick recovery. American consumers are tightening their belts and hoarding cash. JCPenney, 118-year old retail giant with 85,000 employees, has filed for bankruptcy on May 15. The US government's Bureau of Economic Analysis (BEA) has reported that the savings rate has surged from 8% in February to 13.1% in March, the highest savings rate since November 1981, despite near-zero interest rates. In addition, there is also the risk of a second wave of coronavirus infections leading to another round of lockdowns, in which case a severe harm to the economy, escalating into a deep financial crisis, cannot be ruled out. For the US, which is apparently not winning the war on Covid-19 thus far, the worst has yet to come.

Photo: Ejército del Aire Ministerio de Defensa

EUROPE

The European story line is somewhat similar to that of the US, with lockdowns and economic disruptions in many countries taking a huge toll on employment, incomes, businesses, and industries. European countries in great distress include the UK, Italy, and Spain which are likely to register double-digit negative annualised GDP growth in the second and third quarters. An uptick, if any, may show up in 4Q20 for these countries on the assumption that the pandemic is reigned in, but it cannot redress the contractions in the preceding quarters, which means that these economies are likely to register a sharp decline this year with negative growth.

Even Germany, the strongest in Europe, is forecast to see its GDP shrink by 6.8 % in 2020, the worst in its history.

Like many other central banks, the ECB has taken several measures to lessen the impact of the pandemic on the Euro Zone economy. Unlike others, ECB is taking a boldly unprecedented move, directing the banks not to pay dividends in the financial years 2019 and 2020 or buy back shares during the pandemic, in order that the conserved capital can be used to support households, small businesses and corporate borrowers and/or to absorb losses on existing exposures to such borrowers.

Photo: Gauthier Delecroix

Photo: Universiti Malaysia Sarawak

CHINA

The Chinese economy shrank by 6.8% in 1Q20, its first quarterly contraction since 1992. Unemployment is on the rise in China, with roughly 80 million job losses, according to some estimates. Coronavirus was reported in mid-Dec 2019 in Wuhan (capital of Hubei province), a metropolis with over 11 million population, which went through a historic 76-day lockdown starting on January 23. Many restrictions were lifted on April 8, but the city is experiencing an uphill battle in restoring normalcy. It is not going to be easy. Consumer spending is sluggish, as many are reluctant to venture out.

It is likely that production will recover first and consumption will follow. Wuhan, a manufacturing and transportation hub for the rest of the country, may take a while before it can fully recover from the severe lockdown. The takeaway from Wuhan's experience is that an early action could save lives, but could be costly to the economy.

Hubei province's GDP shrank almost 40% in 1Q20 year-on-year. The fear in China is that the turnaround felt in 2Q20 can be fleeting and that a new wave of infections may be waiting in the horizon. For the first time in decades, China has no annual growth target for this year.

MALAYSIA

The pandemic situation in Malaysia fortunately pales in comparison with many other countries in the region and elsewhere. Nonetheless, the impact on the economy is by no means mild. The economy has been in some form of lockdown since March 18, with a lifting of restrictions delayed till June 9. In the first five weeks of the lockdown, 7,159 workers were retrenched. In Johore, 398 employers have applied to carry out retrenchment and wage cut exercises which involved 15,597 workers during the lockdown. Unemployment rate has surged from 3.2% in January to 3.9% in April, and it is likely to hit 5.5% by June. The hospitality industry is badly bruised, with tourism taking a knock-out blow.

Genting Malaysia has reported a net loss of RM418 million due to business disruptions. Three landmark hotels in Penang and two in Perak are closing down. Even five-star hotels in Kuala Lumpur are not taking the blows with hands down, with some scaling down their activities or temporarily ceasing operations altogether, while some others are already up for sale.

The Malaysian Institute of Economic Research (MIER) has projected a 6.9% GDP contraction, with 2.4 million job losses, 12% fall in household incomes, and 11% drop in consumer spending in 2020. To mitigate the impact, the government has put in place a RM250 billion stimulus plan unveiled on March 27.

The stimulus package, equivalent to 16.5% of GDP, consists of loans, loan payment deferments, rental waivers, among others, in addition to handouts, to cushion economic meltdown though the multiplier effect. The direct fiscal injection (RM25 billion), which represents one-tenth of the total, will be spent on wage subsidies, one-off cash payments for frontline health workers, and handouts to e-hailing drivers, among others. However, the impact of the RM250 billion stimulus package unveiled in March plus an additional RM10 billion announced on April 6 will be muted, if the package remains under-utilised. In any case, the RM35 billion fiscal injection is likely to widen this year's budget deficit.

Fiscal injection cannot help the economy much, if the handouts translate to increased saving rather than increased spending by the recipients.

The funds for fiscal injection are to be raised through "fiscal consolidation", i.e. cutting costs or cost savings, which is easier said than done. If not, the government may have to issue bonds/sukuks, or resort to off-balance-sheet loans, to adhere to the legal limits. On the monetary front, the central bank (BNM) has reduced OPR by 50-basis points to 2% on May 5, the lowest since 2010, which translates to a 100-basis point reduction since January this year.

The economy registered a tepid 0.7% GDP growth in 1Q20, the slowest since 2009, which however translates to a 2% contraction on a seasonally adjusted basis in comparison with the preceding quarter, according to BNM. All indications are that 2Q20 will experience a steep GDP contraction, followed by lesser year-on-year contractions in the subsequent quarters. Malaysia is currently under a strong deflationary spell, with consumer price index (CPI) shrinking -2.9% in April, which does not bode well for the economy in the near term.

CONCLUSION

Recovery cannot come anytime soon. Stimulus packages can certainly help but cannot ensure recovery. There are other more important factors at play. First, the time needed to get the virus under control does matter, which is shrouded in uncertainty. The pandemic will not be under control until a vaccine is found, hopefully in 12-18 months. Second, much would also depend on how severe is the damage to the economies. If too severe, some businesses may not be able to jump start quickly, while some may quit and go out of business. Third, the impact will spill over from the real sector to the financial sector, as debts turn toxic. Fourth, as the crisis is global, foreign economies will weigh heavily on the recovery in small open economies like Malaysia's.

For example, exports and tourist arrivals will revive only when consumer demand picks up in the countries of East Asia, North America, Western Europe and the Middle East. Recovery, nearly everywhere, hinges to a large extent on recovery in the US, still the most important nodal point for the global economy. According to the Fed, the US economic downturn may drag on till late 2021. The IMF had forecast a 3% contraction for the global economy this year, which is likely to be revised further downward. Last but not least, fiscal stimulus packages will add trillions to the global debt which currently stands at $253.0 trillion, safely below global real estates valued at $280.6 trillion. The growing debt burden will weigh heavily on the economic growth down the road, as it will act as sands in the wheel.

Recovery is unlikely to be U-shaped, as the problem is neither structural nor cyclical; instead, mostly it may look more like the Nike swoosh rather than a sharp V. An arguably optimistic scenario suggests that a recovery in whatever form can come at the year-end, while a more realistic scenario points to a sustainable recovery only in the second half of next year around the third or fourth quarter, depending on the arrival of the vaccine. In the past, it took 4-5 years to develop vaccines. Hopefully, it could happen much sooner, this time around. Meanwhile, the world has to learn to live with the virus, and brace itself for a rough ride.