Coronavirus Causing Major Economic Shock to the Global Economy

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ABSTRACT

The ongoing corona pandemic is causing a major shock to the global economy. In the coming months, many countries are expected to suffer severe economic downturns. Sealing off entire regions disrupts supply chains, resulting in production losses and falls in consumption. The global economy is expected to grow by as little as 2.5 percent this year instead of by the 3.7 percent forecasted previously. If the situation normalizes again in the course of the year, however, 3.5 percent growth will, in all likelihood, be achieved in the next year.

The impact of the coronavirus (COVID-19) will weaken the global economy considerably in the months ahead (see Figure). Production losses in China and the increasing spread of the virus will lead to substantial contractions in many economies, both in the production of goods and services, and in the demand for capital and consumer goods. At 2.5 percent, growth in global economic output is likely to be significantly weaker this year; in 2019, production increased by 3.5 percent. The global economy is expected to return to normal in the coming year.

The coronavirus crisis is intensifying the slowdown in growth. The pace of expansion has slowed, especially in the emerging markets. Towards the end of 2019, sluggish growth in the advanced economies also contributed to the slowdown in global economic development. In Europe, in particular, production lost noticeable momentum. Additionally, Japan’s economic output collapsed after the VAT rate hike in October. Only the US economy expanded at rates similar to those seen in previous quarters.

At the start of 2020, the economic outlook initially brightened somewhat, most likely as a result of the settlement of the trade dispute between China and the US. In some emerging markets, such as India and Brazil, monetary policy was eased again considerably at the end of 2019, most probably making companies there more optimistic. With most labor markets still in good shape, consumer confidence also continued to rise in January 2020.

However, the indicators do not yet reflect the supply and demand shocks caused by the spread of the novel coronavirus. The impact is most evident in the tumbling share prices at most of the world’s trading centers, suggesting that an economic slump is imminent. The increased volatility also signals huge uncertainty on financial markets.

The underlying assumption of this forecast is that the spread of COVID-19 will be similar to previous pandemics.This means the number of infections is initially expected to rise significantly.

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Table

Real GDP, consumer price inflation, and unemployment rate in the world economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Change over previous year in percent											
	2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
Euro area	1.9	1.2	−0.2	1.5	1.7	1.3	1.2	1.4	8.1	7.5	7.7	7.5
without Germany	2.0	1.4	−0.1	1.4	1.7	1.2	1.3	1.3	10.3	9.5	9.7	9.5
France	1.7	1.2	−0.1	1.7	1.9	1.1	1.5	1.2	9.1	8.5	8.4	8.3
Italy	0.7	0.2	−0.8	0.8	1.2	0.7	0.8	1.1	10.6	10.0	10.3	10.3
Spain	2.4	2.0	0.3	1.7	1.7	0.7	1.0	1.5	15.3	14.1	14.5	13.9
Netherlands	2.5	1.7	0.4	1.6	1.6	2.7	1.5	1.4	3.8	3.4	3.8	4.0
United Kingdom	1.3	1.4	0.8	1.4	2.4	1.8	1.9	2.2	4.2	3.9	4.1	4.2
USA	2.9	2.3	0.8	1.7	2.4	1.8	2.0	2.0	3.9	3.7	3.7	3.6
Japan	0.3	0.8	−0.3	0.6	0.8	0.6	0.3	0.6	2.5	2.4	2.4	2.4
South Korea	2.7	2.0	1.1	1.6	1.6	0.5	0.9	1.0	3.8	3.7	3.7	3.6
Central and Eastern Europe	4.6	4.0	2.9	3.3	2.2	2.7	2.9	3.0	3.7	3.3	3.3	3.3
Turkey	2.9	0.1	1.5	1.6	16.3	15.2	12.8	12.1	11.0	13.9	13.7	13.5
Russia	2.2	1.3	1.1	1.6	2.9	4.5	3.7	4.2	4.8	4.6	4.5	4.4
China	6.7	6.2	4.6	5.8	2.5	3.3	3.6	3.6	4.1	4.1	4.1	4.1
India	6.7	5.1	5.0	5.7	3.9	3.7	4.3	4.0				
Brazil	1.3	1.1	1.0	1.3	3.8	3.8	3.4	3.7	12.3	12.1	11.8	11.7
Mexico	2.1	−0.1	0.1	0.9	4.9	3.4	2.7	2.9	3.4	3.5	3.4	3.3
Advanced economies	2.2	1.8	0.4	1.5	2.0	1.5	1.5	1.6	4.8	4.5	4.6	4.5
Emerging markets	5.5	4.6	3.8	4.7	3.6	4.1	4.2	4.2	5.1	5.2	5.2	5.1
World	4.2	3.5	2.5	3.5	3.0	3.0	3.1	3.2	5.0	4.9	4.9	4.9

Sources: National statistical offices; DIW Berlin Spring Projections 2020.

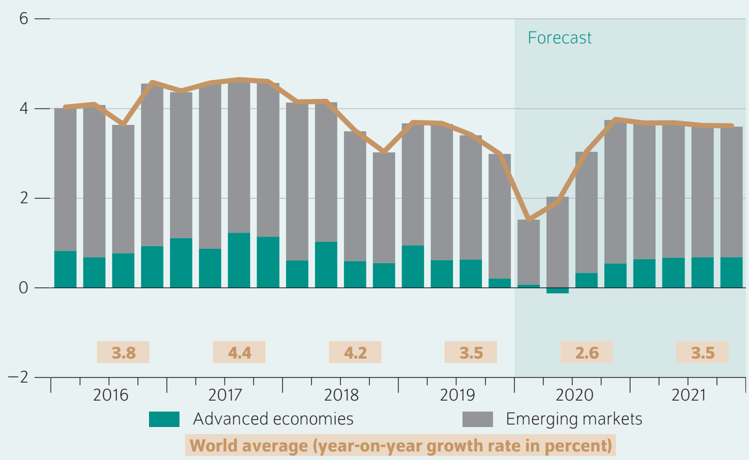
The quarantine measures, travel restrictions, and loss of working hours are likely to massively limit global production and existing supply chains this year, particularly for industry. The service sector, especially transport, tourism, and the financial sector, are also likely to suffer heavily. The downturn in industrial production which began already in 2018 will initially worsen and then further curb investment activity, which has been declining in recent years anyway. The production-side impact of COVID-19 will further exacerbate this year's already weak global trade. The restrictions imposed on the public in many places as well as the uncertainty arising from the spread of the virus are also expected to result in weaker private consumption, despite the temporary increase in retail sales from panic buying. Following the economic downturn in the first half of the year, precautionary measures will eventually be relaxed, gradually reducing production-side frictions and easing the various restrictions in place. The global economy is expected to normalize from the second half of 2020.

Fiscal policy, which was already mildly expansionary even before the corona crisis, and the numerous public support packages, in particular, are likely to cushion the effects of the coronavirus on production.

In addition, there were clear monetary policy stimuli, some coordinated between central banks. For example, some important central banks have already lowered interest rates and expanded or relaunched bond purchasing programs. It

Figure

World real GDP growth
Quarter-on-quarter, in percent



Sources: National statistical offices; DIW Berlin Spring Projections 2020.

The spread of the coronavirus will lead to significant economic dislocations, especially in 2020.

can be assumed that further measures will follow. The measures will go some way towards offsetting worsening financing conditions and provide some support for the global economy.

Given the tense economic situation, further monetary policy easing is likely to increase consumer prices only gradually. The strong position of the labor markets and the recent rises in wages in many places, coupled with continued moderate inflation, can be expected to support real disposable income and thus private consumption.

Conflicts within OPEC+[1] and the resulting expansion of the crude oil supply by Saudi Arabia have led to a considerable drop in oil prices. Although likely to support manufacturing production and private consumption, this will also hamper growth in oil-exporting economies such as Russia and the US.

Overall, global economic growth will be noticeably weaker, particularly this year, due to the effects of the coronavirus. Throughout the remainder of the forecast period, the global economy should pick up speed again and production gains will make up for some of the earlier losses. Private consumption is likely to remain the main driver of global expansion. The global economy is expected to grow by 2.5 percent this year and by 3.5 percent next year (see Table). Compared to its winter economic outlook, DIW Berlin is lowering its forecast for 2020 significantly, by 1,2 percentage points, and slightly for 2021.

Downside risks have increased significantly since the beginning of the year. Thus, the forecast scenario, which presumes the current pandemic will play out similarly to previous pandemics, is becoming increasingly unlikely. The comprehensive restrictions on public life in many economies will noticeably increase the downward trend, causing serious recessions in some countries. The extent of the economic crisis depends on the economic policy responses. In addition, further trade conflicts could occur, for example between the United States and the European Union. Last but not least, there is still the possibility of a hard Brexit at the end of the year if the EU and the United Kingdom do not agree on a trade agreement before then.

1 OPEC+ consists of the original OPEC member states plus ten other oil-producing countries, including Russia.

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