Global economic slump accelerating

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As the coronavirus spreads, taking more lives at an escalating rate, its effects are penetrating ever deeper into the global economy.

Goldman Sachs warned last week that US gross domestic product (GDP) would contract by 24 percent in the second quarter. There are forecasts that up to 5 million jobs will be lost in the American economy this year, with the fall in economic output to total as much as $1.5 trillion.

Goldman expects, at this stage, that US output will contract 3.1 percent this year and the unemployment rate will rise to 9 percent from the current level of 3.5 percent. This is on a par with the jobless rate of 10 percent in October 2009, following the financial meltdown of 2008.

But just as the health impact of the virus was significantly underestimated, the same may apply to the current economic forecasts.

“Things look so gloomy right now that perhaps we should be grateful if we can get out of this health crisis with a brief recession,” Bernard Baumohl of the Economic Outlook Group told the *Wall Street Journal*.

“You just cannot rule out the prospect of a longer, more destructive depression,” he said.

In other words, a relatively short but deep recession is now the “best case” scenario.

The eurozone is expected to experience a fall of around 10 percent of GDP. But this forecast could well be exceeded. There is no end in sight to the spread of the virus and no clear assessment of the economic effect of the shutdowns being implemented to try to combat it.

In an interview with the *Financial Times*, the chief economist of the European Union, Paolo Gentiloni, indicated that officials were working on new measures.

“The consensus is growing day by day that we need to face an extraordinary crisis with extraordinary tools,” he said.

“This idea of a V-shape [recovery] that you can see in the first semester of 2020 is now completely impossible. We have no previous analysis of the impact of such a widespread lockdown in major economies.”

Gentolini conducted the interview as part of a political battle inside the EU over the economic and financial measures, bringing further into the open the widening rifts between leading member states.

Powerful forces in Germany and the Netherlands are opposed to all-European action, regarding this as a bailout for weaker economies such as Italy.

On the other side, the French Finance Minister Bruno Le Maire last week warned that failure to act in a unified manner meant the eurozone was in danger of disappearing.

European *Financial Times* columnist Wolfgang Münchau wrote yesterday that the situation facing the eurozone was “far worse” than the sovereign debt crisis of 2012.

“The coronavirus will prove to be an economic shock, a corporate solvency crisis and a political crisis all folded into one,” he said.

Münchau noted that European countries had fiscal stabilisers such as unemployment insurance, but these “shock absorbers” were designed to deal with “normal fluctuations.” They were not “big enough or strong enough for emergencies like this one.”

Pointing to the deepening divisions in Europe, Münchau wrote that not everyone would want to be in a monetary union with countries like the Netherlands where the prime minister was “ideologically opposed” to all-European measures. “This sort of unwilling partnership is not sustainable.”

In the absence of data on overall output, the *Financial Times* conducted a survey, particularly covering retail and services, to give some indication of what to expect.

It showed that vehicular traffic had halved in many of the world’s largest cities, while spending in restaurants and cinemas had collapsed.

Greg Daco, the chief US economist at Oxford Economics, said: "Looking at the data across various sectors of the US economy, it appears we could be heading for the most severe contraction in consumer spending on record."

The rapid shrinkage in the real economy will further escalate the already severe crisis in the financial system, and extend from the stock and credit markets to the banks.

In a *Financial Times* comment, Sheila Bair, the former chief of the US Federal Deposit Insurance Corporation, wrote: "Big banks throughout the world are substantially exposed to the pandemic, particularly as it hurts corporate borrowers."

Around the world, non-financial corporations covering every industry, including the hard-hit energy, transport, retail and hospitality sectors, had racked up debts to the tune of $70 trillion, she wrote.

"To survive, they are increasingly hoarding cash and tapping into their massive back-up lines of credit, placing additional strain on the banking system," Bair wrote, noting that as bond markets "seize up," bank credit may be their only source of cash.

But the ability to supply credit, she wrote, had been considerably weakened by the $325 billion paid out by the major global banks last year on dividends and share buybacks, some $155 billion of which was laid out by the eight largest banks in the US.

Meanwhile, fears are growing that the enormous pile of debt around the world could start to collapse as the economic effects of the coronavirus deepen and widen.

According to the Institute of International Finance, in a report published last November, total global corporate, government, finance sector and household debt had reached $253 trillion, equivalent to 322 percent of global GDP.

The unravelling could start in so-called emerging market economies where there is $72.5 trillion of debt, much of it denominated in US dollars. The growing dollar shortage in international markets, which has seen national currencies fall against the greenback, means obligations on interest and principal payments are rapidly rising.

This increase in the debt burden is occurring as all economies drop into recession, or something worse, and have less cash to meet their commitments.

It is not just emerging market economies that are affected. The Australian dollar, one of the most traded in the world, saw its rate against the US dollar drop to as low as 55 cents last week, compared to just under 70 cents a few months ago.

This means that the debt burden of a company or financial institution that had raised $100 million, when the Australian dollar traded at 70 cents to the US currency, would rise in Australian dollar terms from $A143 million to more than $A180 million when the Australian dollar fell to 55 cents, placing it under enormous strain as revenues drop.

The cash flow crisis is striking at the heart of the major economies as well.

In the UK, the Tory government is considering a plan to take out equity holdings in airlines and other companies because the economic stimulus packages announced so far are not sufficient to prevent collapses.

In the US, the *Wall Street Journal* has reported that "scores of US companies," from the aircraft maker Boeing to the telecommunications Verizon, are "furiously lobbying" to be included in the bailout packages being prepared by the Trump administration that could run as high as $2 trillion.

For more than a century, the semi-official religion in the US has been the denunciation of socialism, which Trump had planned to make the centre of his re-election campaign.

Now the universal cry is: the state must intervene; once again billions must be handed to the corporations on an even larger scale than in the crisis of 2008.

The calls will only get louder. According to a *Wall Street Journal* report yesterday, investors and analysts say the more than 30 percent drop in the share market over the past month is not over, despite extraordinary actions by the Fed involving trillions of dollars.

Summing up the voracious outlook in corporate and financial circles, a representative of the global investment and banking firm State Street, told the *Journal*: "Market participants need to feel they are backstopped without question."