

IN THE **moment**

How the COVID-19 crisis is different

The COVID-19 crisis is different to some of the other economic crises we've experienced in living memory for three key reasons, particularly when compared to the global financial crisis (GFC).

During the GFC, many developed economies, because of the financial services aspect of the crisis, were significantly affected. This time around, with Covid-19, we've also seen emerging markets facing a lot of pain and, in some instances, emerging markets contracted by even more.

Manufacturing sectors came under pressure during the GFC, but there was a spillover into the services sectors during the COVID-19 crisis. This has largely been on the back of government imposing stricter lockdown regulations and restrictions.

Thirdly, this is the first time where such a large part of the global economy was, or is, under some form of lockdown. We've never really had an experience where such a large part of the global economy has been largely frozen.

During the first quarter of the year, markets were in turmoil as COVID-19 hit. However, during the second quarter, risky asset classes rallied and volatility measures started to recede.

One of the reasons for this is that policymakers acted swiftly with measures and stimulus responses, which boosted riskier asset classes.

The rally in investments sits at odds with what is happening in the real economy.

Economic surprises are still tilting to the downside and policy uncertainty measures are at an extreme high, which raises a couple of red flags. Volatility has come back so sharply and risky asset classes have rallied, but the real economy is still showing some form of economic pain.

Will the extraordinary amount of fiscal and monetary stimulus injected in the global economy in response to COVID-19 end up being inflationary?

We don't think this is going to result in higher levels of inflation, just like during the GFC. This time, we are expecting a similar experience, where financial markets get the benefit, asset price inflation picks up, but the real economy doesn't see the benefit of that liquidity coming through.

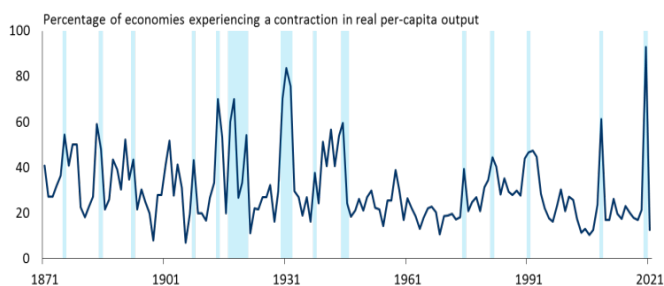
Most countries to fall into recession

The likely economic contraction is not the largest we've ever seen. Since the 1870s, there have been three periods in history where the economic contraction was greater than what the world is experiencing now - World War I, World War II and the Great Depression.

But, where this recession stands out is that this is likely to be the most far-reaching that we've seen in a long time.

In fact, the World Bank suggests that about 93% of the world's economies are likely to experience a contraction in gross domestic product (GDP) per capita this year. The only other experience in history that comes close is the Great Depression, where 84% of economies experienced a contraction in real per capita GDP growth.

Broadest global recession in history: Highest proportion of countries to fall into recession since 1870



Source: World Bank, Momentum Investments

The COVID-19 pandemic will also have a lingering damaging effect on the global economy. We often speak of the U-, the V-, or the W-shaped recovery, but there will still be some elements that will take much longer to recover in the global economy.

We are anticipating bankruptcies to go up, levels of unemployment to stay high for longer, inequality to spike and levels of poverty to pick up. Therefore, even though we are expecting some sort of recovery going into next year, there will be some scars left on the global economy, and these will likely persist for some time.

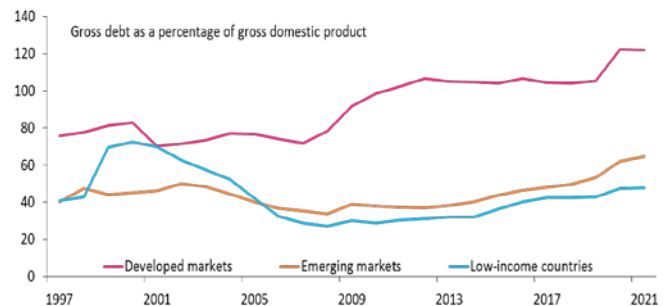
Initially, governments were slow to act, but when COVID-19 became a global pandemic, policymakers acted swiftly, and the monetary policy response, as well as government stimulus measures, have outweighed the stimulus efforts during the GFC.

Fiscal interventions lead to mounting public debt

Governments entered the COVID-19 pandemic with elevated levels of debt, and more government stimulus means this will only be exacerbated.

We are expecting debt levels worldwide, and not just developed markets, but also emerging markets and some low-income countries, to soar to even higher levels.

Growth in the shadow of COVID-19 debt: Unprecedented fiscal interventions by governments worldwide imply a substantial rise in public debt



Source: International Monetary Fund, Momentum Investments

This implies that interest rates around the world are likely to remain at reasonably low levels for a longer period of time. However, this means that the debt-can continually get kicked down the road.

Headwinds to globalisation

One of the main negative consequences as a result of the COVID-19-pandemic is a continued deceleration of globalisation trends. Unfortunately, this is not good news for emerging markets that have been reliant on globalisation trends and the transfer of skills, knowledge and ideas to prop up their economies.

After the GFC, globalisation trends started to decline and contributed increasingly less to emerging markets. This trend will be exacerbated. Firms will be more hesitant to deploy capital in an environment that is largely uncertain, higher levels of unemployment will detract from labour productivity, and a continued deceleration in globalisation trends will take away from total factor productivity. This will all be quite harmful for emerging markets, which in the past have been very reliant on traded goods and services and technology and ideas floating |between countries.

South Africa already on the back foot

South Africa entered the COVID-19-pandemic on the back foot.

For the past decade or so, the country has essentially lived beyond its means and more so than many of SA's emerging market peers. It's going to take South Africa a much longer time to claw itself out of this economic hole.

Policy buffers are eroded and countries need to start turning to structural reform measures, particularly in emerging markets such as South Africa, to reignite and promote sustainable growth.

These reform measures could include labour market reform, product market reform, boosting infrastructure and ensuring we have a clear regulatory path to attract foreign investment back into the country.

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