The Impact of COVID-19 on World Economy and China's Role

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***Abstract*:** Recent years have seen more countries to experience "three lows and three highs" problems. The pandemic triggered the exposure of these accumulated risks, leading to a slump in world economic growth. Given the developing trend of world economy amid the ongoing pandemic, the world may face a range of challenges for a long time to go, e.g. insufficient momentum for economic growth, increased resistance for market opening and rising debt risks. As the world economy suffers a major hit, China has been active in providing the international community with the assistance needed to combat the COVID-19 and recover the economy, while China's economy itself has shown strong resilience and stability. In the long run, the pandemic will not change the sound momentum of China's economic development; rather, it will provide an opportunity for China to play a significant role in the world economy.

***Keywords*:** COVID-19; World economy; China's economy

1. The COVID-19 Outbreak Deals a Heavy Blow to the World Economy

As COVID-19 continues to spread throughout the world, it is difficult to accurately predict when it will end and how much it will impact and change the world economy. The impact of the pandemic on the world economy, however, has been complicated by the risks accumulated over the years. If the pandemic continues, the world economy may be caught up in a prolonged downturn. Therefore, international agencies have successively substantially lowered their expectations for world economic growth. The OECD's 2 March 2020 report pointed out that the public health emergency will severely hurt global demand and supply, possibly making world economy growth hit a 10-year low. Even in the best-case scenario, the global growth rate in 2020 will drop by 0.5 percentage points from the prior year to 2.4%, while the continuation of the pandemic will make the world economy suffer more. The world economic growth rate is likely to drop to 1.5%, only half the expected rate before the outbreak, and the economies of Japan and the euro zone may even be caught up in a recession.1 On 23 March, the *Global Macro Views*, issued by the Institute of International Finance (IIF), reported that as the COVID-19 has led to stalled economic activities, plummeted oil price, and mounting credit stress, the world economy in 2020 will see its first negative growth since 2009, at -1.5%.2 On 14 April, the IMF released its *World Economic Outlook* report, indicating that in 2020, it is highly likely that the global economy will experience its worst recession since the Great Depression in the 1930s, and the global economic growth rate is projected to be -3%.3

The global spread of the COVID-19 has accelerated the exposure of the accumulated risks in major advanced economies, such as the United States (U.S.), over the years. After the U.S. subprime mortgage crisis in 2007, the U.S. economy embarked on a journey of recovery after a year of adjustment. Thanks to the implementation of unconventional monetary policies, the U.S. has managed to maintain a bull market for 10 consecutive years, which has led to the generation of a huge asset bubble. According to the WIND database, the total value of the U.S. stock market by the end of 2019 was approximately USD47.18 trillion, accounting for 220% of its GDP, far exceeding the 2007 level before the global financial crisis. In addition to the ultra- low interest rate, companies' stock repurchase efforts are also an important reason for the rise of stock prices. However, the performance of both the real economy and the financial market has indicated that the situation is changing, and the stock market is a barometer of the future economy. Between 9 March and 18 March 2020, the U.S. stock market has experienced four circuit breakers, unprecedented in the history of the world stock market. In the context that the U.S.'s macro policies, economic performance and asset prices are largely disconnected, it is normal for the U.S. stock market to decrease by 30%. The plunge shows that the stock market bubble, among other economic risks, of the advanced economies, such as the U.S., has reached unprecedented level that any disturbance may trigger a violent market shock. It just happens that the pandemic serves as such disturbance. In any case, the signal released by the U.S. stock market reflects the market's underlying concerns about the future of the U.S. economy.

On 21 March 2020, the world-famous hedge fund Bridgewater Associates estimated that the novel coronavirus pandemic may cause U.S. companies to lose USD4 trillion. Without effective monetary and fiscal policy support, the U.S. economy would contract by more than 6% in 2020.4 It is difficult for the U.S. to launch effective policies to cope with the crisis facing the imminent economic recession. The benchmark interest rate has already been lowered to zero, and the leeway for fiscal policy is also pretty limited. Since President Donald Trump took office, the U.S.'s fiscal deficit has rebounded due to the large-scale tax cuts. The debt problem is not just a reflection of the economic challenges faced by the U.S. government, but also an important factor that drives up risks in the U.S. economy. Once these economic risks are exposed, not only would the U.S. economy be impacted, but a strong negative spillover effect would happen in other countries, thereby affecting the future of the world economy. In the medium to long term, major advanced economies are still faced with many challenges. Some European countries and Japan have already set their nominal interest rate to negative values, and now the U.S. is following their steps as the Federal Reserve has adjusted the benchmark interest rate to zero.5 Thanks to the ultra-low interest rates and different versions of the quantitative easing policies introduced by the central banks, these countries manage to maintain their GDP growth rate at about 1%. It is worth noting that negative interest rate is not something a central bank would normally adopt. But as policymakers in many countries cannot afford the political consequences of an economic recession, the promise to normalize monetary policies has not really been put into practice. Moreover, monetary policies are hardly sufficient to have a substantial impact on long-standing structural problems. They may even fortify the long-standing "three lows and three highs" problems.6

As the COVID-19 spreads to more emerging markets and developing countries, its impact on the economy of these countries will be amplified. In emerging economies where the virus is spreading rapidly or the situation is more severe, the short-term impact of the pandemic on the economy has shown up, as the normal operation of consumer services, such as tourism, air transport, hotels, catering, and foreign trade-related industries has been seriously disrupted, residents' consumption directly impacted, and corporate investment willingness undermined. In the medium to long term, stalled economic activities may lead to the reorganization and damage to the industrial, supply and value chains. These damages are not only reflected in the severe losses suffered by the real economy, but also in the turbulence of the capital market, increased capital outflows, and rising debt risks.

In short, the COVID-19 pandemic has been a tremendous blow to the world economy, making it unavoidable for the world economy to experience negative growth in 2020. Compared with previous economic crisis, this one is particularly difficult for the international community to deal with. There is even a possibility for the world economy to fall into a prolonged downturn.

2. The World Economy Is Faced with Multiple Challenges

Today, the international community is developing as a "community of shared future", where the interests of all parties are deeply intertwined. Facing the economic challenges brought by the global pandemic, no country can stand alone. Only through strengthened cooperation can the countries around the world better meet the global challenges, so as to build a better future for mankind. In particular, the major global economies must stand together in a joint effort to shoulder the responsibility of maintaining the global value chain and driving world economic recovery. It is gratifying that the G20 leaders have reached a consensus on restoring confidence, maintaining financial stability, restoring growth, or better still, achieving stronger growth. Considering that the world economy will be likely to develop against the background of a global pandemic for a long time to go, the international community is expected to encounter the following challenges.

2.1 Insufficient Momentum for Economic Growth

In the short term, countries should strengthen macroeconomic policy coordination and introduce a reasonable mix of fiscal and monetary policies to stimulate the economy. In this regard, G20 members have determined to inject USD5 trillion into the global economy during the 2020 G20 Extraordinary Virtual Leaders' Summit on COVID-19 (hereinafter referred to as "Summit"). This has released a strong signal to the international community that cooperation will be strengthened among the major economies, which is conducive to restoring market confidence and boosting the morale for world economic recovery. The fund will provide support to the global economy affected by the pandemic, and to a great extent mitigate the current downward pressure on the world economy. In the meantime, the positive results achieved through the efforts will also lay a solid foundation for further capital input and cooperation. In the long run, the key to economic growth lies in labour productivity growth. At present, whether in developed economies or in emerging markets and developing economies, the growth rate of labour productivity is on a downward slope. Therefore, countries around the world need to strengthen collaboration on technological innovation, the international division of labour, human capital accumulation, and institutional reforms to jointly create the source for world economic growth.

2.2 Increased Resistance for Market Opening

In recent years, the world economy has been heavily affected by unilateralism and protectionism. Kristalina Georgieva, IMF Managing Director, has pointed out on multiple occasions that the cumulative economic losses caused by trade conflict may reach USD700 billion. It has directly led to insufficient global demand, i.e. investment demand and consumer demand. Worse still, unilateralism and protectionism have greatly dampened the confidence and determination of countries to open up and participate in the division of labour in the global value chain, causing more countries to set reducing reliance on foreign countries as a core economic policy. Since the COVID-19 outbreak, international economic and trade activities have been severely disrupted, as cross-border flow of important medical supplies, key agricultural products and other commodities and services have been blocked, putting the global supply chain at the risk of disruption. To turn the tide, the international community needs to jointly create a free, fair, non-discriminatory, transparent, predictable, and stable trade and investment environment so that the market will stay open.

2.3 Rising Debt Risks

The global economic slowdown has forced major economies to implement large-scale tax cuts, thereby leading to high government debt levels. According to IMF forecasts in October 2019, the proportion of gross government debt of developed economies to their GDP was 103.1% in 2019, 32.2 percentage points higher than that in 2007. In comparison, the figure of emerging markets and developing economies was 53.3 %, 17.6 percentage points higher than that in 2007.7 In the meantime, private debts and external debts also soared. IMF's October 2019 *Global Financial Stability Report* examined eight major economies, including the United States and Japan, in which it warned that due to ultra-low interest rates, corporate debt-atrisk could rise to USD19 trillion—or nearly 40% of total corporate debt. Such default may lead to a subprime crisis on the corporate level.8 The vulnerability of shadow banking, measured in GDP, has worsened in 80% of the economies, a recurrence of the situation in the 2008 global financial crisis.9 As global economic growth slows down amid the ongoing pandemic, debt risks are likely to surface due to the introduction of large-scale stimulus policies.

2.4 Imminent Harm Brought by Negative Interest Rate Policies

In response to the major impact of the COVID-19 pandemic on the capital market and the real economy, the U.S. Federal Reserve announced on 15 March that it had cut the lower limit of the benchmark interest rate to zero, and it is widely believed that the Federal Reserve will introduce negative interest rate in the near future. The impact of the emergence and spread of negative interest rates on the world economy is both complex and extensive, with both direct and indirect consequences. But overall, it will become a hotbed for risks to stack up, and bring forth negative effects that are difficult to deal with, such as squeezing the profitability of commercial banks, undermining the enthusiasm of enterprises to improve efficiency, weakening the ability to fight risks, and disturbing the market's basic function of resources allocation, encouraging speculators to borrow and invest in high risk assets, and exacerbating the risk of currency mismatch in developing countries and emerging economies. Moreover, negative interest rates will further narrow the space for countries to introduce other policies in response to the economic recession.

3. China Helps the International Community Combat COVID-19

To prevent and control the pandemic, China upholds the philosophy of "community of shared future for mankind" as a guideline to provide necessary assistance to the international community. Since the COVID-19 outbreak, China has been sharing the research information of the coronavirus, the relatively mature diagnosis and treatment plans, and technical routes with the international community in a timely manner, which have provided important experience and technical support for relevant countries in the control of the pandemic. On 19 February 2020, Tedros Adhanom Ghebreyesus, WHO Director General, mentioned that China's proactive efforts to contain the outbreak made it possible to prevent a broader global crisis. By far, China's virus prevention and control efforts have generated remarkable results — the number of confirmed cases of COVID-19 has dropped dramatically. As China continues to promote the resumption of production and work, the production capacity of medical supplies manufacturers has increased substantially to solve the shortage of personal protective materials, such as masks and disinfecting supplies.

Moreover, China has also played an active role in promoting the relevant parties to strengthen macro-policy coordination under the framework of the UN and the G20, thus contributing substantially to many countries' efforts to stabilize the markets, secure growth and protect livelihoods, and ensure that the global supply chain is open, stable, and safe. In the meantime, amid the epidemic, it becomes all the more relevant to fully tap into the tremendous potential of the Belt and Road Initiative (BRI) for international cooperation. By expanding third-party market cooperation, more developed and developing countries are encouraged to participate in the joint effort of the BRI to facilitate regional and global economic integration as a driving force for international economic and trade cooperation and world economic growth.

Despite the impact of the pandemic on its economy, China has not slowed its pace in opening up wider to the world. In order to unblock the global industrial chain for revived global growth, China has optimized its business environment by launching a series of new measures to promote international trade and investment, and expand the openness of the financial sector.

4. China Will Make Greater Contribution to World Economy

As the world's second largest economy, China has maintained a relatively high growth rate for a long time. In recent years, China has actively put into practice its new development philosophy, took supply-side structural reform as the main task, and focused on advancing reform and opening up, in an effort to create new momentum for high-quality development. In 2019, faced with complex and severe international environment and arduous tasks of balancing reform, development and stability, China managed to maintain its economy generally stable and ensure the quality and efficiency of growth, thereby laying a solid foundation for a decisive victory in building a moderately prosperous society in all respects and eliminating poverty. According to the preliminary results released by the National Bureau of Statistics of China on 17 January 2020, China's GDP in 2019 exceeded RMB99 trillion, ranking second in the world, an increase of 6.1% over the previous year.10 The Chinese economy drove world economic growth up by about 1 percentage point, which perfectly reflected China's remarkable contribution to the world economy.

Indeed, the COVID-19 outbreak has been a tremendous blow to China's economy, but it will not undermine China's significant role in the world economy. Thanks to its effective prevention and control measures, as well as policies for stabilizing economic operations, China has demonstrated strong resilience to stabilize its economy. So far, China has been progressing steadily in promoting the restoration and stabilization of employment, resuming transportation, and guaranteeing market supply. Thanks to the targeted financial and monetary policy support and adequate supply of protective materials, the number of reopened industrial enterprises above designated size has gradually increased. In terms of agricultural production, spring farming was effectively safeguarded by promoting the resumption of work for agricultural materials manufacturers and the opening of wholesale stores of agricultural materials.

In the short run, China's effort to support the resumption of production in all industries has produced remarkable results. To intensify support for the real economy, China has adopted fiscal policies by moderately increasing its deficit rate. Apart from implementing policies such as financial interest discounts, large-scale tax and fee reductions that have been issued in recent years, a special tax and fee reduction policy has been introduced to help enterprises survive the crisis. In terms of monetary policy, by cutting the statutory deposit reserve ratio of commercial banks and depository institutions, China provides targeted credit support for industries, private, small and micro enterprises that are substantially affected by the pandemic. In the long run, China will intensify its support for innovation-driven development, improve the level of industrial chain, and continuously promote new breakthroughs in supply-side structural reform, as part of an effort to facilitate high-quality economic development. As the Chinese economy turns for the better, the world economy will have a steady driving force that pushes it forward.

Looking ahead, thanks to its great development potential, China will remain the "locomotive" of global economic growth, as it has a huge market with a population of more than 1.4 billion. The people's need for a better life can create tremendous domestic demand that will enable China to maintain stable economic growth. China continues to make progress in its industrialization, informatization, urbanization, and agricultural modernization. New economic development models are taking form to facilitate sustained and healthy economic development. In the meantime, China's effort to build an open economy based on new systems is moving ahead steadily in terms of level, coverage and depth. The Belt and Road Initiative is entering a new stage of quality development, which will create conditions for better use of both international and domestic markets and resources. This means that China's economy still has a strong momentum for growth, and its significant role in the world economy will be further enhanced. Following an approach of pursuing shared benefits through consultation and collaboration, China will continue to work with other countries to build a community of shared future for mankind, and make greater contribution to promoting a strong, sustainable, balanced and inclusive growth of the world economy.

Notes:

1 OECD (2020). *Coronavirus: The World Economy at Risk*, http://www.oecd.org/economic-outlook.

2 Robin Brooks & Jonathan Fortun (2020). *Global Macroeconomic View: Global Recession*, https://www.iif.com/Publications/ID/3813/GMV-Global-Recession.

3 IMF (2020). *World Economic Outlook: The Great Lockdown*, https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020.

4 Greg Jensen, et al. (2020). *The Coronavirus's $4 Trillion Hit to US Corporations*, https://www.bridgewater.com/research-library/daily-observations/Greg-Jensen-the-coronavirus-4-trillion-hit-to-us-corporations/.

5 On 15 March, the U.S. Federal Reserve cut its benchmark interest rate by 100 basis points to 0–0.25%.

6 The "three lows and three highs" problems refer to low growth, inflation and interest rates, and high debts, income gaps and asset prices.

7 IMF (2019). *World Economic Outlook: Global Manufacturing Downturn, Rising Trade Barriers*, https://www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019.

8 IMF (2019). *Global Financial Stability Report: Lower for Longer*, https://www.imf.org/en/Publications/GFSR/Issues/2019/10/01/global-financial-stability-report-october-2019.

9 Ibid.

10 National Bureau of Statistics (2020). *National Economy Was Generally Stable in 2019 with Main Projected Targets for Development Achieved*, http://www.stats.gov.cn/tjsj/zxfb/202001/t20200117_1723383.html.

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