DOI: 10.19422/j.cnki.cn10-1398/d.2021.01.003

COVID-19 AND WORLD ECONOMIC SITUATION

ZHANG YUYAN
Member, Chinese Academy of Social Sciences (CASS)
Chief Expert, National Institute for Global Strategy, CASS

The global spread of the COVID-19 pandemic has severely impacted the world economy in 2020, and there are evident regional differences in degree of the impact, as governments or economies have all taken unprecedented countermeasures but produced results varying in degree. At the same time as fragile and unbalanced recovery happens to the global economy, post-financial crisis issues such as low growth, low interest rates, low inflation and high debts, and high assets prices and high income gap have been exacerbated further. Uncertainties conceived in the epidemic evolution, tenacity and policy trend of major economies and their spillover effect, and the development trend of global and regional economic governance, and competition and cooperation between major powers will, to a certain extent, decide on the fundamentals of the world economy in 2021.

The Global Economy under the Impact of the COVID-19 Pandemic

The COVID-19 outbreak has brought about gigantic impact on the world economy, which boils down to the following aspects.

First, economic growth of various economies precipitates. *The World Economic Outlook* released in October 2020 by the International Monetary Fund (IMF) noted that the global economic growth of 2020 is estimated to be -4.4%, being the lowest one since World War II and consisting of a huge fall from the estimate of economic growth of 2020 standing at 3.0% made by the IMF a year before. Meanwhile, the impact of the COVID-19 pandemic has varied on various economies, the growth rate of developed economies as a whole being -5.8% , among which that of the US is -4.3% and that of the Euro zone is -8.3% whereas the growth rate of emerging markets and developing economies being -3.3%. At present, the Asia-Pacific regional economy has begun to recover, though the speed of recovery varies between countries. India contracts by more than 10% this year, and China has begun strong recovery since late second season and become the only one among major economies to maintain positive growth with an estimated growth rate of 1.9%. The new round of coronavirus spikes that accelerate in many countries has led to slowdown in global economic recovery, especially in that of developed economies.

Second, prices are on the fall whereas unemployment rate is on the rise. The Consumer Price Index (CPI) of the US was 2.5% in January 2020, which fell to 0.1% in May and rose again to 1.2% in November. Things are more or less the same in Europe and Japan, as deflation has occurred already to the Euro zone and Japan is hovering over the verge of deflation. Inflation of major emerging economies has been on the same track. Compared to fluctuation of price level, fluctuation of unemployment of major economies is still greater. In February 2020, the unemployment rate in the US was only 3.5%, by April the figure rose to 14.7%, and then it fell to 6.9% in November. The unemployment fluctuation of the Euro zone and Japan is similar to that of the US. There are considerable differences in impact on different industries and groups of people in various countries, among which low income earners, young people and women are the hardest hit, and the conditions of poverty stricken population deteriorate further. According to the estimates of the Economic Commission for Latin America and the Caribbean (ECLAC), the extremely poor people of the Latin American region will increase by 16 million, reaching 83 million in 2020.

Third, trade and cross-border investment are on the decrease whereas commodity prices change abnormally. According to the *Trade and Development Report 2020* released in September 2020

(C)1994-2021 China Academic Journal Electronic Publishing House. All rights reserved. http://www.cnki.net

by the United Nations Conference on Trade and Development (UNCTAD), global merchandise trade in 2020 would decrease by a fifth against the figure for the first half of the year, and global direct investment of 2020 would decrease by 40% against that of the first half of the year. In utilizing inward investment, China's actual utilization of inward investment between January and November 2020 grew by 6.3% year on year (4.1% priced in US dollars), outshining all other major economies. On top of the impact of the COVID-19 pandemic, unilateralism and protectionist policies pursued by some of the countries have also produced continued negative effects on trade and investment. Just as economic growth has stopped falling and rallied, commodity prices have fallen and risen like sitting on a roller-coaster. In November 2019, the Brent Crude was US$63 a barrel, by April 2020 it fell to US$19 a barrel, and then it climbed up oscillation to US$49 a barrel by the middle of December. Among mineral products, the price for iron ore soared in the second half of the year, the main contract price making a new historic height since iron ore futures and options were listed in 2013.

In March 2020, *US stock market was visited by four circuit breakers, financial scare spreading fast. In the wake of the circuit breakers, central banks of the US and other major economies immediately put forward super conventional, and especially non-conventional quantitative easing monetary policies to bailout the market. Photo shows that on March 18, 2020, a trader works at the New York Stock Exchange, which was visited by the fourth circuit breaker in a month on the very day.*

Fourth, assets prices of developed economies have stopped falling and come rally, as the US Dollar falls and debts of various countries expand fast. In March 2020, the US stock market witnessed four circuit breakers, financial panic spreading quickly. The US Federal Reserve Board (the Fed) and the central banks of other major economies immediately adopted super strong conventional and especially unconventional quantitative easing policies to bailout the market. With gushing provision of liquidity, US stock prices have shocked and risen all the way and continued to make new heights in history, the gap between the high and low points within a year yawning to about two thirds. Though not returning to the position at the beginning of the year, major European indexes in the same period have also rebounded to a large extent and entered into a period of high congestion. In contrast to the rallying of assets prices, the US Dollar Index makes reverse movement. In the early period of the epidemic outbreak, after a brief rise, the US Dollar Index slid all the way and broke 90 by December 17, a new low since April 2018. Accompanying the downward slide of the US Dollar Index, gold price fluctuated and rose, breaking US$2000 per ounce and though falling somehow, it has hovered around a high point in history. Besides, in face of sudden outbreak of the pandemic, various countries have taken varying emergency measures and thereby increased the proportion of global government debts against the GDP from 83.3% in 2019 to 96.4% in 2020. By the beginning of December 2020, outstanding U.S. Treasury Securities reached US$27.4 trillion, about 130% against the GDP. According to the data of the Institute of International Finance, global corporate debts and resident debts have kept climbing and, in addition to government debts, totaled US$277 trillion, about 365% against the GDP, breaking another record in history.

Major Economies Adopting Different Policies to Cope with COVID-19 Impact

In face of the COVID-19 impact, various governments have adopted varying forms of temporary fiscal and monetary policies. In regard to fiscal policy, taking the US for instance, the US Congress passed *Coronavirus Aid, Relief, and Economic Security Act (CARES ACT)* valuing US$2 trillion in March 2020. As the second wave of COVID-19 outbreak began to rage in North America and Europe, making it necessary for concerned economies to further strengthen bailout efforts, the US Senate and House of Representatives successively passed a US$900 billion coronavirus aid act and a US$1.4 trillion spending bill, mainly on cash distribution and relief measures for unemployment, small businesses, schools and colleges, childcare, transportation and family rental support. Meanwhile, China announced to issue 1 trillion yuan of special central government bonds to mitigate the COVID-19

(C)1994-2021 China Academic Journal Electronic Publishing House. All rights reserved. http://www.cnki.net

epidemic effect in May 2020. Though there are mixed opinions and judgments in the international community on timing, size, force of the implementation and the long-term effect of bailout policies of concerned governments, taking as a whole, the fiscal bailout policies adopted by various economies have played a direct and outstanding role in sustaining the operation of economic and social life.

In regard to monetary policy, in the first 11 months of 2020, central banks of various economies the world over cut interest rates for 205 times, and central banks of major developed economies carried on with super low interest rates policies, the US Federal Funds Rate for example keeping in the range between 0% and 0.25%. Besides cutting interest rates and maintaining low interest rates, regular monetary policy also includes keeping an eye on inflation targeting. At an annual conference of global central banks held in Kansas City of the US in late August 2020, the Fed announced to renew its statement on long-term goals and monetary policy strategy, changing the statement on its commitment from realizing inflation rate around "symmetrical target of 2%" to seeking to realize a long-term goal of "targeting 2% average inflation". Targeting average inflation means that the Fed may use future inflation "surplus" to make up for past "deficits", providing extra space for monetary policy in the limited space for cutting rates by increasing tolerance for inflation in order to cope with increasing deflation risks. However, it is still questionable if such a new monetary policy framework can achieve the expected effect, and it may even have some side effects.

First, in comparison to the original framework, the readjustment this time around has neither introduced new monetary policy tools nor directly adjusted interest rates, but rather attempted to achieve policy goals by guiding inflation expectations. Since the beginning of the last circle of economic expansion, the inflation rate of the US has for most of the time been lower than the 2% inflation rate target set by the Fed, which to a degree reduces the market expectations for the Fed to overshoot in the future and its confidence in the Fed's inflation control capacity. Second, though the Fed clearly introduced the concept of targeting average inflation in its statement the time around, it has not revealed relevant details of the target system such as concrete calculation formula. This means that the Fed may subjectively select a given period of time for making an estimate, "technically" adjusting the level of average inflation in line with its expectations, and thus replacing the original clear-cut Taylor's Rule with a new rule that is subjectively adjustable. This new way of doing things increases the unpredictability of the Fed's policy, decreases transparency of the operation of monetary policy within the new framework, and ultimately weakens the Fed's credibility. Finally, in order to release adequate liquidity to the market, post-COVID-19 underlying assets for purchasing set by the Fed will further expand to corporate debts and commercial paper, which necessarily make the Fed's conduct exceed the scope of its function as "the lender of last resort". At the same time, in order to secure funds for fiscal bailout measures, the Fed needs to buy a large sum of US Treasury Securities on one hand and on the other, to reduce the cost of debts by keeping low interest rates. By doing so, monetary policy and fiscal policy are deeply bound, thus reducing the independence and market regulating capacity of the Fed's monetary policy, and ultimately making it difficult to achieve its goal of recovering endogenous growth of the US economy.

Since the international financial crisis of 2008, the space has been very narrow for major developed economies like the US, Europe and Japan to implement conventional money policy. In face of the pandemic impact, the Fed announced to adopt an infinite and unlimited quantitative easing policy and continue to increase its holding of all grades of bonds including US Treasury Securities, mortgage-backed securities and other junk bonds at least at current pace, resulting in the fact that its balance sheet soared from US$4.2 trillion in the week of January 6, 2020 to US$7.1 trillion by the end of June. At this rate, its scale of assets and liabilities will have expanded to US$10 trillion by the end of 2021. At the same time, influenced by the central banks of Europe, the United Kingdom (UK) and Japan that further expand the scope of quantitative easing, still more emerging markets have followed suit, targeting to control government bond yield to zero, thereby to supplement quantitative easing policy, and to reduce borrowing cost at the issuance of more bonds. So far, as nominal interest rates of the Fed and the central bank of the UK stand at or approach 0%, it is not impossible for central banks of concerned countries to return to negative interest rates policy. Besides, some of the unconventional policies are being conceived. For instance, making use of the theoretic middle ground in the mingling of monetary policy and fiscal policy, concerned industry insiders propose that as long as low inflation rate and low interest rates keep borrowing costs low for central banks, governments can have a free hand in spending on medical care, education and infrastructure projects free from worrying about debt level. This proposal may encourage still more economic stimulus measures to be put forward.

Effect of Unconventional Policies of Major Economies on the Future World Economy

At the same time as varying kinds of unconventional policies adopted by various major economies of the world produce positive effects, they also bring about uncertainties of the long-term growth to the world economy. From a global perspective, though recovery of actual economy and easy monetary policy will be of some support to the formation of asset prices, the phenomenon remains that risk asset prices become divorced from economic prospect and deteriorating credit quality. According to the Bloomberg Barclays Global Aggregate Index, by December 10, 2020, global negative yield bonds totaled

(C)1994-2021 China Academic Journal Electronic Publishing House. All rights reserved. http://www.cnki.net

US$18.04 trillion and made another historical record, the figure standing for 27% of global investment grade bonds and approaching the last peak of 30% happening in August 2008. It can be predicted that in order to seek the highest possible rate of return, many investors will take all risks in buying a large sum of risk assets, which is fully illustrated by the boom of the US stock market with soaring Price-to-Earnings Ratio. At the same time, the overlay of COVID-19 impact and super quantitative easing monetary policy gives a big boost to US real estate prices. Economic contraction going hand in hand with rapid hike of asset prices means that huge fluctuations happening to global capital market one year or more down the road will not be a small probability event. Large fluctuations in capital markets of major economies will necessarily produce negative spillover effects on other countries and regions and therefore arouse negative feedback.

Under the impact of COVID-19 pandemic, accelerated adjustment of global supply chain becomes an important issue on the world economic entity level. On corporate level, under the dual pressure of principal factors such as technological progress and its proliferation, digitalization of production, the narrowing of labor arbitrage space and environmental factors like trade tension between major economies, near penalization of multilateral trading system, occurrences of climate and natural calamities and frequent cyberattacks, high concentration of key trade goods enables enterprises to seek greater profit by reappraising and investing in a more elastic supply chain. On national level, some of the countries have planned or launched a series of policy measures aiming at raising self-sufficiency or localization, encouraging manufacturing to come home or diversifying supply chain. Although the focus of discussion on supply chain and the principal target of "decoupling" is China, since the country has been successful with its efforts in controlling the pandemic and taking the lead to resume work, China stands on a historical high in 2020 both in exports and in attracting inward investment.

Furthermore, the "abnormal change" of the US Dollar exchange rate in the global economy of 2020 is particularly worth noting. Different from the international financial crisis of 2008 when US Dollar assets played the role of global safe assets, between March and September 2020 the sum of foreign central banks' total holding of US Treasury Securities was reduced by US$155.2 billion net, and the Fed rather than international investors or American funds became principal buyers of US Treasury Securities, whose prices plummeted in March 2020 and kept low later on together with the downward slide of the US Dollar Index. This abnormity is attributable to, besides the US unprecedentedly injecting infinite and unlimited liquidity, the weakening position of the country in the world economic pattern. Since the beginning of the 21st century, the proportion of US Treasury Securities against the global GDP has continued to increase whereas that of US economic output against the global GDP has continued to decrease. Such a situation is similar to the "Triffin Dilemma" faced by the Bretton Woods system in the 1960s: on the one hand there were fixed rate and free exchange between US dollars and gold, and on the other mass amount of US dollars circulated beyond the US. By the early 1970s, the Bretton Woods system collapsed, which may be a precursor of the future trend of the US Dollar. Furthermore, leaders of the member states of the European Union (EU) reached a historic agreement on €750 billion temporary recovery instrument (dubbed "Next Generation EU"), making complete the three pillars of European economic and monetary union, the policy commitment for a unified currency, a central bank and a credible, unified fiscal policy. "Next Generation EU" will receive key support from the issuance of a sizable Pan-Europe sovereignty bonds and ultimately make Europe a new supporter of non-risk assets beyond the US, giving the Euro the role as a strong competitor of the Dollar in the international monetary system.

Outlook of World Economic Prospect 2021

It will directly affect the trend of global economy if the COVID-19 pandemic can be successfully controlled or not. It is likely that major developed economies will again contract in the first season and quicken the pace of recovery afterward in the second and third seasons, and the global recovery will turn from a V shape to an irregular W shape, with factors like employment, consumer price, trade, capital and foreign currency market, commodity price changing in correspondence to the development of the pandemic. Relatively speaking, it is difficult to determine the degree of world economic recovery and the constraint of recovery by non-pandemic disturbances. It would be worth noting that the completion of the *Regional Comprehensive Economic Partnership* (RCEP) led to the creation of the largest free trade area in the world in November 2020. Meanwhile, the IMF's External Sector Report assessing the currency and imbalance of top 30 global economies indicated that the proportion of net surplus on global current account against the global GDP continued to drop and stood at 2.9% in 2019, underscoring continued increase of balance in the world economy, among which China's surplus on current account in 2020 is about 1.3%, in line with its economic fundamentals. To sum up the above assessments, the global economic growth for 2021 may reach 4.5% as calculated by purchasing power parity.

Even if the pandemic is put under effective control or the present coronavirus evolves to be more ordinary, the world economic recovery in 2021 will still face disturbances of non-pandemic factors. The internationally authoritative financial analyzing institution Standard & Poor's observed in its report of mid-November 2020 that compared with 2009, though global banking as a whole is healthier, it still holds negative outlook for a third of the global banks. 2021 may be the toughest year for

(C)1994-2021 China Academic Journal Electronic Publishing House. All rights reserved. http://www.cnki.net

global banking since the international financial crisis of 2008. In the short and middle terms, the risks of global banking including credit rating may be on the fall, increasing growth of corporate debts and more defaults may put huge pressure on the quality of bank assets and bank profitability, and latent problems of real estate market may increase but may be seriously underestimated.

It is very likely that the rise of policy risks will become another disturbing factor for the global economic recovery in 2021. One point of view believes that the world will enter into a period of inflation, the main reasons of which include that first, the injection of astronomical liquidity into the economy leads to fast increase of money supply; second, all major central banks pursue a super easy monetary policy; third, massive relief packages push up family wealth which in turn ultimately becomes household consumption; fourth, the impact of COVID-19 on supply chain is likely to result in supply shortage; and fifth, increasing supply of labor that used to result in deflation in the past thirty years has reversed to acceleration of aging and rising wage level. If the level of inflation rate in major developed economies exceeds 5% and even approaches 10%, then concerned central banks will have to take action to intervene. Either to increase interest rates or withdraw from quantitative easing, should deviation happen to the strength and timing of the central banks' policies, then the process of slow, uncertain and unbalanced economic recovery may be disrupted. Another point of view believes that consumer prices will fall in a post-COVID-19 era, the main reasons for which include that first, though global currency circulation greatly increased, currency velocity has slowed down considerably; secondly, impacted by the pandemic, residents' fear for the future increases, resulting in conservative tendency of household consumption; third, rise of unemployment leads to an eased labor market and lowered utilization of equipment, which creates conditions for supply expansion; fourth, the quantitative easing policy in the wake of the global financial crisis of 2008 did not lead to inflation as had been generally expected. This is repudiated by yet another point of view which points out that what the post-global financial crisis of 2008 quantitative easing policy pushed up were asset prices whereas accompanying the crisis this time were rising wages, one being different in nature from the other. As such, to make accurate judgment on inflation or deflation is an important challenge facing makers of monetary policy of all countries.

Besides risks on micro level, risks residing in global capital market and currency market should not be underrated. Although the probability rate is more than 30% for more than 20% fluctuations to happen to stock market and real estate market, one may give discount to the effect of the fluctuations in capital market as correlation between asset prices and actual economy now is not what it used to be. More worrying is the trend of the US Dollar exchange rate. Although the variables for the rise and fall of the dollar are too numerous to make accurate assessment, there is no suspension that the US will continue its monetary policy, and to a degree the Fed has no other options but to release a flood of liquidity, increasing the possibility of the Dollar sliding. Besides the US, serious currency crises may happen to a small number of countries. At the same time, one can not exclude the possibility of chain reaction of sovereignty debt crisis triggered off by defaults of a few emerging markets and developing countries. In regard to global and regional economic governance, centering on the reform of the World Trade Organization (WTO), the relationship of cooperation and competition between major economies will continue to intensify, the reform prospect being difficult to predict. On December 30, leaders of China and EU countries jointly declared that the negotiations for a *China-EU Comprehensive Agreement on Investment* had been concluded as scheduled, which in addition to the implementation of the RECP gives more sunshine to the dawn of a world economic recovery, at least in trade and investment area.

The conclusion of negotiations *for the Regional Comprehensive Economic Partnership (RCEP) led to the formal establishment of the world's largest free trade area in November 2020, which will greatly heighten the level of trade and investment liberalization and facilitation in the region and improve its attraction and competitiveness. Photo taken on August 17, 2020 shows the Pasir Panjang Container Terminal of the Port of Singapore.*

(C)1994-2021 China Academic Journal Electronic Publishing House. All rights reserved. http://www.cnki.net