Features of the COVID-19 Crisis – Reflections of Economic and Financial Indicators

Adina Criste
Iulia Lupu
"Victor Slăvescu" Centre for Financial and Monetary Research, Romania
criste.adina@gmail.com
iulia_lupu@icfm.ro

Abstract

Recently, the world economy has been under strong pressure from several major events, with the COVID-19 crisis being one of them. Usually, the economic crises are specific to the financial environment, but the COVID-19 crisis is exogenous to the financial system, being induced by the political decision taken by the states of the world to quarantine the economy because of the pandemic. The article aims to highlight the main features that define the COVID-19 pandemic crisis, in economic and financial terms, analysing the development of specific indicators during the crisis, at the level of several countries, both developed and emerging. The financial sector has played a double role: on the one hand as the channel of transmission to the real economy of the reaction to the initial shock, and on the other hand, as a factor in shaping the initial conditions that have increased the sensitivity of the economy to shock.

Key words: global crisis, political decisions, stock market indices, global economy, deep uncertainty
J.E.L. classification: E61, E66, F60, G01, G19

1. Introduction

The last few years have been marked by a succession of major crises and events, with the COVID-19 crisis being one of the worst in the world. Unlike other crises, more or less recent, specific to the financial environment, and intrinsically related to it, the COVID-19 crisis is not endogenous to the financial system but was induced by the political decision taken by authorities of countries worldwide to quarantine the economy because of the pandemic. The forced and deliberate shutdown of the global economy (the lockdown) automatically and immediately caused an economic crisis, extended in financial terms, and this phenomenon, with its particularities and generated effects, takes the form of a global crisis - the COVID-19 crisis.

The article aims to highlight the main features that define the COVID-19 pandemic crisis, starting from a brief description of the COVID-19 pandemic, compared to other epidemics that marked the history of the last century and continuing with a general description of the COVID-19 crisis. Achieving the proposed objective is based on the analysis of the evolution of the economic and financial indicators, at the level of several countries, both in the category of developed and emerging, during the manifestation of this crisis.

2. Theoretical background

Throughout history, the world has faced epidemics and diseases that have devastated it. The COVID-19 pandemic has certain characteristics that differentiate it from epidemics in the last century (see Table 1). The economic and financial environment in which today's economies operate is very different, globalized, with complex and interdependent relations between countries, which makes a global epidemic more likely and destructive. (Rungcharoenkitkul, 2021).

Less than a month after statements by the Chinese authorities about the first cases of pneumonia of unknown origin, later called COVID-19 (December 31, 2019), economic forecasters began to slightly change their predictions based on locally produced effects in China. Since the end of February, however, the situation has become a worldwide concern, with the number of cases registered in European countries and the USA increasing (Busch, 2020).

The main feature that distinguishes it from previous epidemics is the quarantine measure on a global scale, introduced by policymakers.

The duration of the economic constraints is closely linked to the evolution of the pandemic, and this is uncertain and very non-linear: fine-grained adjustments in public policy could have an impact on the spread of COVID-19 cases, either contributing to its stabilization or failing. . As Table 1 shows, the January-March, April and October episodes are very different, as the situation has deteriorated rapidly, despite strong political responses.

Table no. 1 Comparative features of some epidemics of the last century

Epidemics	Containment measures	Financial effects	Economic effects	Context
Influenza pandemic (1918)	Physical distancing	Minor	Minor	First World War; high share of manufacturing in GDP in advanced economies
SARS (2003)	Physical distancing	Minor	Minor	Chinese growth accelerating
COVID-19, January-March 2020	Local lockdowns (Wuhan, China; Lombardy, Italy)	Market selloff	Supply chain disruptions	Globalised economies; Integrated supply/credit chains; High share of services in GDP; High leverage in parts of the real sector
COVID-19, April 2020	Global lockdown	Tightening financial conditions	Supply chain disruptions; Sudden stop in demand	
COVID-19, October 2020	Global lockdown eased	Stable financial markets, but banks under pressure	Constraints on the balance sheets of households and companies	

Source: Rungcharoenkitkul (2021), p.4

The COVID-19 crisis is unprecedented due to its rapid spread, the global quarantine measure, and, implicitly, the complex effects generated since its inception, but also the uncertainty about the time horizon in which it manifests itself.

Although the period of development remains questionable, the characteristics of the pandemic crisis can be identified in the two stages covered so far, with the conventional delimitation being May 2020.

The initial phase, the beginning, considered the period February-April 2020, is one of deep uncertainty related to the evolution and gravity of the situation, to which the authorities reacted through measures to close the activities (economic, social, cultural, etc.) – the lockdown stage.

At first, uncertainty severely affected the functioning of markets, both commodity markets (especially oil) and financial markets (foreign exchange market and financial assets market). It is noteworthy that the authorities responded promptly with swift and significant action. The central banks were the first to react by countering financial panic, followed by other interventions by political authorities, actions to limit the spread of the virus (sanitary), and measures to support economic activities. Monetary and fiscal measures, which played a key role in stabilizing the financial system, were complemented by decisive actions related to the regulatory/supervisory framework, to increase the resilience of the financial system in the face of this strong and unexpected pressure.

The second phase of the crisis, that of the gradual reopening of some activities and adaptation to the new situation, is ongoing from mid-May 2020, given that at one point it overlaps with another global crisis that has been fuelled by the pandemic crisis – the global energy crisis.

Beyond the onset of the crisis, the most serious challenge is the long-term economic and financial impact of the pandemic because it depends in particular on the ability of decision-makers to support the resumption and recovery of economic activity, while limiting risks. on the health of the population. In addition, the global energy crisis of the summer of 2021, amid a host of factors, including the COVID-19 pandemic, is increasing uncertainty about the economic recovery.

3. Research methodology

In order to highlight features of the COVID-19 crisis, we look at some representative economic and financial indicators, giving a picture of their developments during 2019-2021. There are considered Purchasing Managers Index, as the main indicators of economic activity at the global level, GDP growth, and GDP growth forecasts, output losses indicator, stock market indices, and long-term government bonds yield. Data are extracted from the IMF database, and also from IMF World Economic Outlook.

4. Results

4.1. Economic developments

The COVID-19 crisis has several features that set it apart from recent ones, especially the global financial crisis.

Not being caused by the accumulation of financial imbalances, as was the case with the global financial crisis, but also with other crises after the 1980s, the COVID-19 crisis is exogenous to the financial system. It is the result of a politically induced recession through the measures taken by the authorities.

The financial crisis of 2007-2008 began with a severe shock to the financial markets and later to the real economy by disturbing the confidence and tightening lending conditions for households and businesses (Criste and Lupu, 2017). Instead, the current crisis has shifted from the real economy to the financial sector, triggered by the severe isolation measures imposed, which have hampered the normal functioning of the economy. As mentioned in the Annual Economic Report 2020 of the Bank for International Settlements (BIS, 2020), non-financial companies were the first victims of the crisis, with the effects amplifying and extending into the real economy.

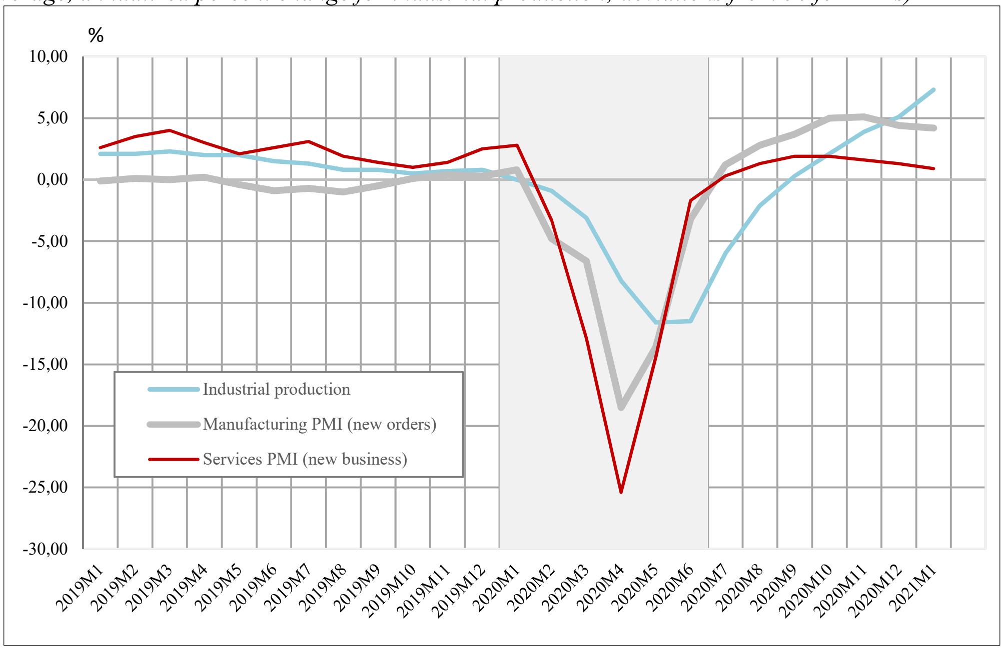
The sudden stop of global economic activity in March 2020 meant a collapse, sharper than during the Great Depression, and deeper than in the case of the global financial crisis (Borio, 2020).

Within a few weeks, the stage of moderate expansion that had been going on for several years in most economic regions came to an abrupt halt and turned into a deep, large-scale recession of economic activity and demand. The PMI (Purchasing Managers Index) indicators, often considered to be key indicators of economic activity, calculated globally, have fallen dramatically, as shown in the chart below (Figure no.1).

The policy of closing some business activities, including the travel restriction to mitigate the spread of the virus, has disrupted the supply chain - which has indirectly blocked global economic growth. Recent estimates (Ahmed & Sarkodie, 2021) show that since the outbreak of the COVID-19 crisis, the world economy and commodity markets have declined much more than during the global financial crisis.

Another feature of the COVID-19 crisis concerns the degree of uncertainty and unpredictability concerning the development of factors outside the economic field. Uncertainty is a feature specific to any economic and financial crisis. However, in the case of a pandemic crisis, it has a much deeper meaning, given the existence of unpredictable factors outward the economy, whose influence and action can determine a wide range of scenarios. This feature can also be seen in the fact that the time horizon in which the crisis is unfolding remains unknown.

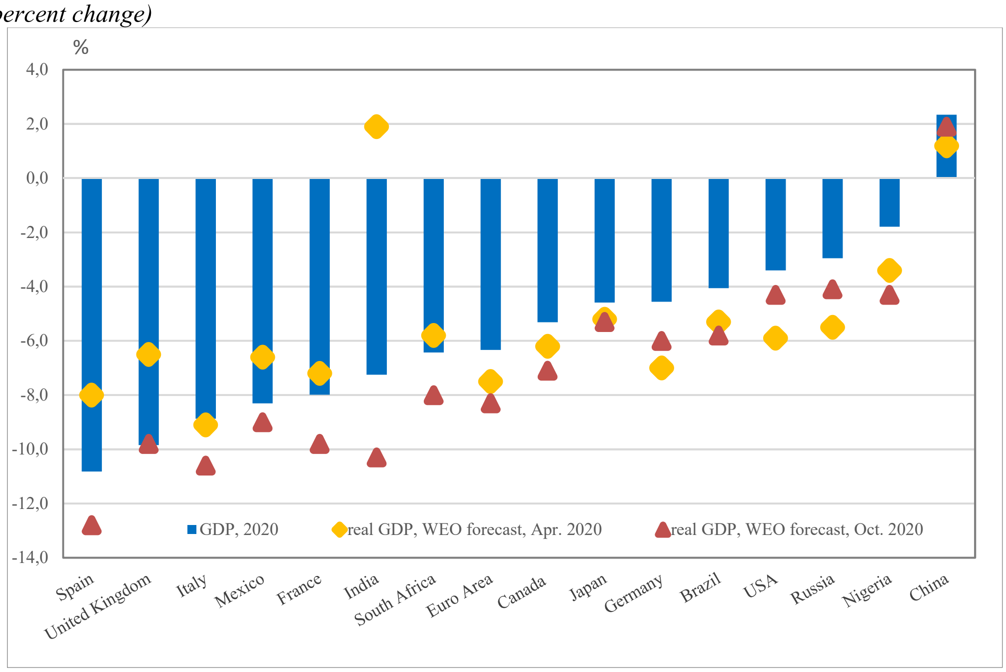
Figure no. 1. The dynamic of the global activity during the COVID-19 crisis (three-month moving average, annualized percent change for industrial production; deviations from 50 for PMIs)



Source: IMF (2021a)

Although statistics show an improvement in economic activity compared to 2020, the pace of global GDP growth remains in the negative zone and the future remains uncertain (see Figure no. 2). In June 2020, in the IMF's baseline scenario, the decline in economic activity for 2020 was forecasted at -4.9%, but according to the latest information (IMF, 2021b), the pace of global GDP growth is -3.1 %.

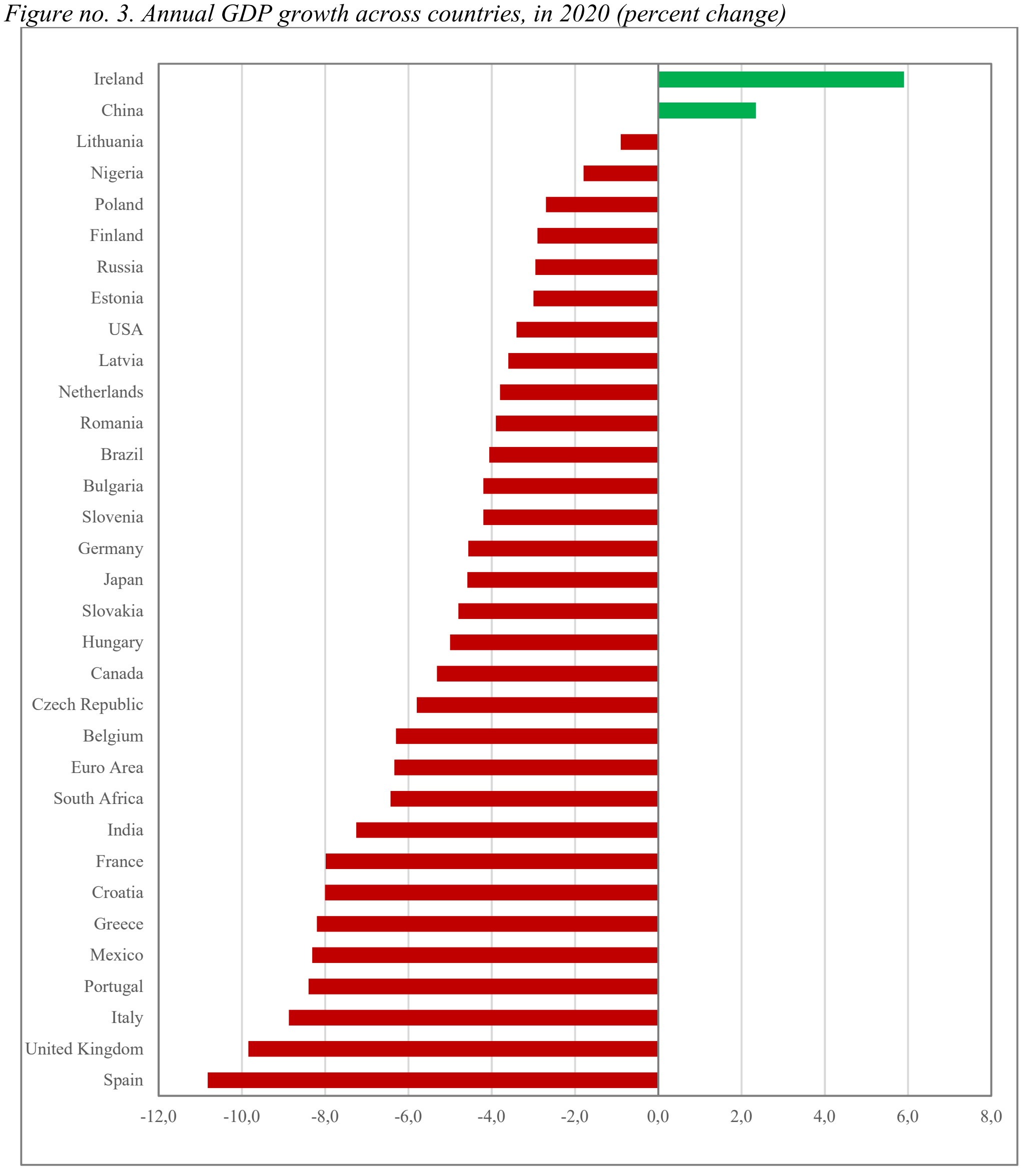
Figure no. 2. The dynamic of economic activity during 2020. Real and projected GDP growths (annual percent change)



Source: based on IMF data from IMF (2021a, 2020a, 2020b, and 2021b)

The pandemic crisis is a global crisis because it has afflicted all regions and states of the world, unlike the financial crisis of 2007-2008 which, although it is called global, did not directly affect all countries. Its economic impact is highly differentiated between countries, reflected not only by the real pace of economic growth in 2020 (see Figure no. 3) but also by the estimated losses in terms of production, as shown in Figure no. 4.

Figure no. 3. Annual GDP growth across countries, in 2020 (percent change)

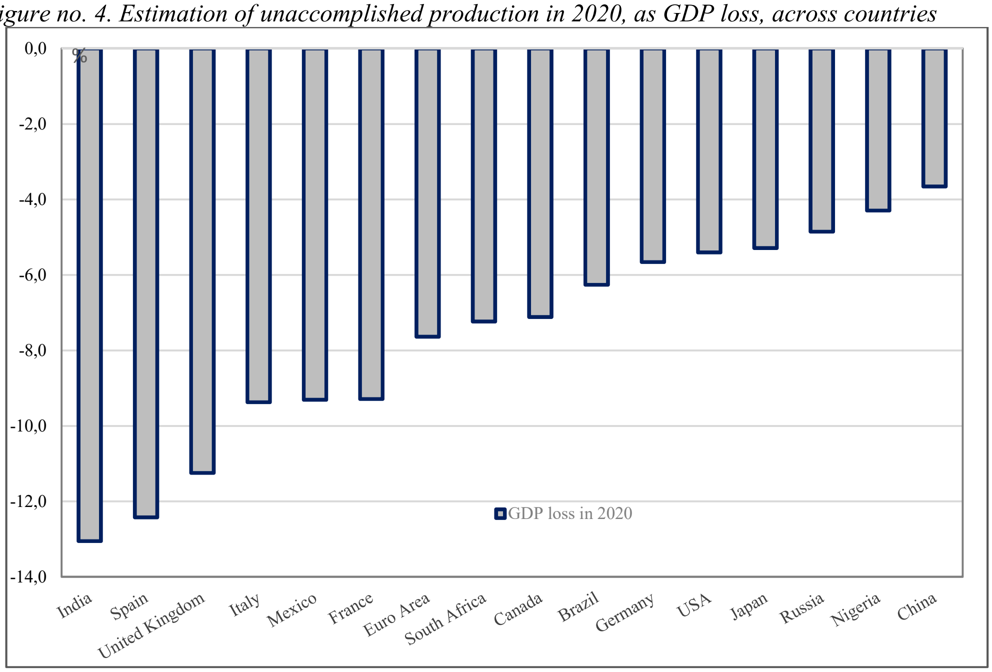


Source: IMF data 2021

The variation range of production losses is quite high, from -13% (in the case of India) to almost -4% (in China), if we consider only a few countries (see Figure no. 4). This heterogeneity partly reflects a different efficiency both in addressing the pandemic (for example, Korea and China have managed to control the spread of the virus in 2020, without resorting to prolonged and widespread shutdowns) and in responding to policy measures, and the importance given to economic and health objectives. Countries are also different in their economic and social structure (dependence on tourism and service industries, population density, etc.), which makes them more or less vulnerable to the pandemic.

Moreover, the exposure to financial factors, and the vulnerable elements in the structure of the economy, are also different between countries. Countries with emerging economies are usually more vulnerable (Criste and Lupu, 2021), being affected on several levels in terms of abrupt cessation of activities - domestic economic activity, capital flows, and exports of products or remittances from abroad.

Figure no. 4. Estimation of unaccomplished production in 2020, as GDP loss, across countries



Source: based on IMF data, 2021.

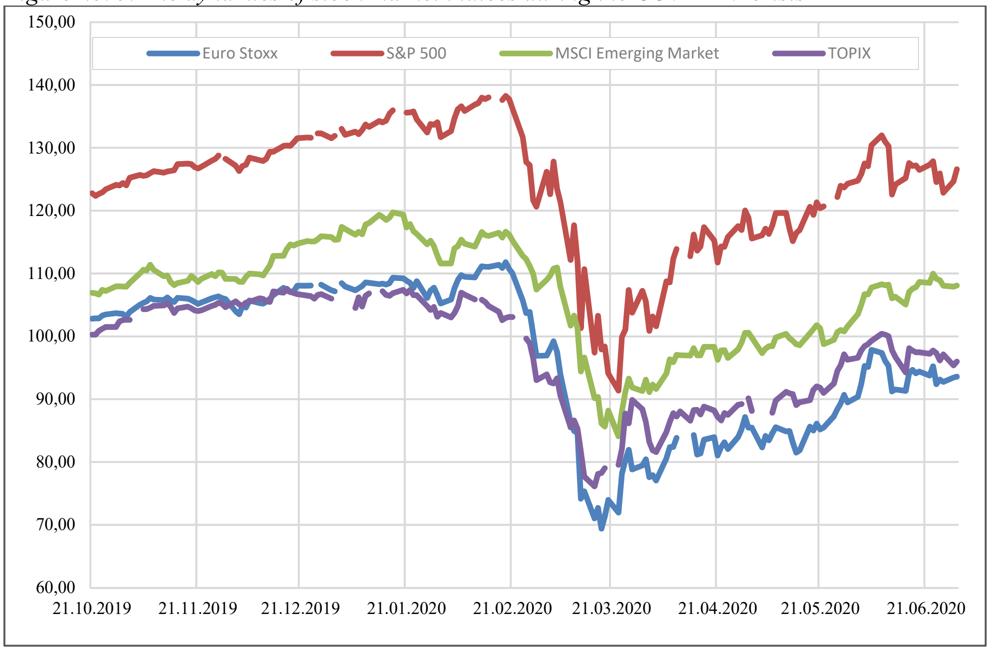
Guerrieri et al. (2020) draw attention to the fact that this crisis, which started with the temporary cessation of many activities in the service sector (tourism, travel, entertainment, etc., even "non-COVID" medical services, etc.), has led to very large differences between economic sectors, and the unusual combination of demand-side and supply-side shocks is likely to have major long-term implications for the structure of the economy and growth. Such consequences will be challenges for economic policies.

4.2. Financial developments

Although not at the root of the shock, the financial sector has played a dual role: on the one hand as a channel of transmission to the real economy of the reaction to the initial shock, and on the other hand as a factor in shaping the initial conditions that have increased sensitivity of the economy to shock.

Global financial markets have reacted very quickly. If stock prices had reached an all-time high by the end of January, with the February 2020 announcements concerning the rapid spread of the virus in Europe, the stock market reacted quickly, with a sharp drop in stock prices, reflected by the dynamics of stock market indices (see Figure no. 5).

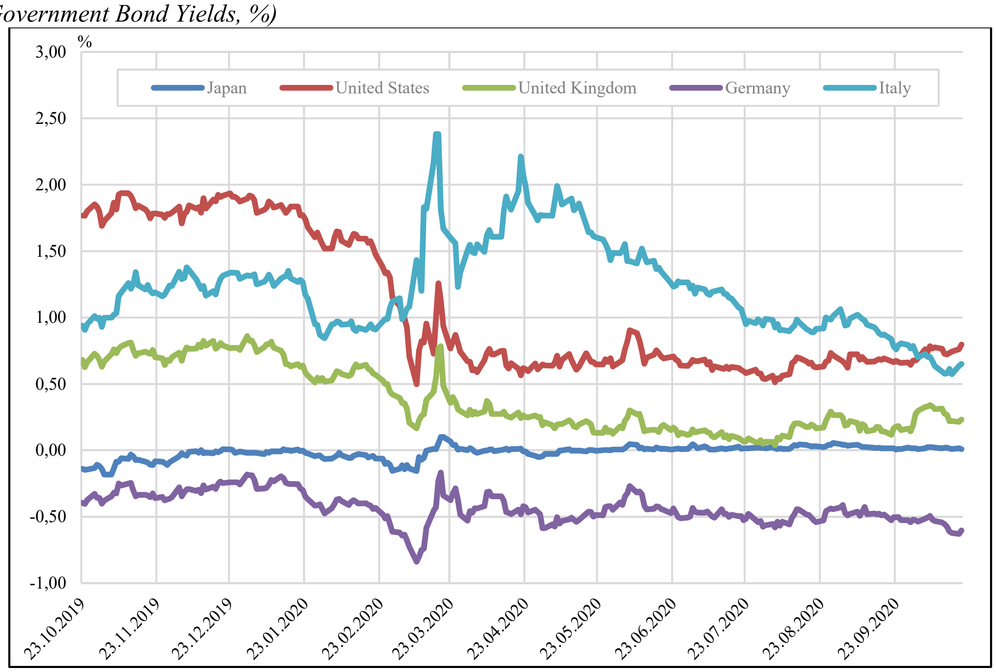
Figure no. 5. The dynamics of stock market indices during the COVID-19 crisis



Source: based on IMF data (IMF, 2021b).

In March 2020, the variation margin in the value of securities issued by corporations widened dramatically in developed countries. The markets for commercial securities, asset-backed securities, and mortgage-backed securities have frozen in many countries, and fluctuations have increased for several types of assets. The long-term bond market has been shocked by a sharp rise in 10-year government bond yields in some developed countries (Figure no. 6).

Figure no. 6. The dynamic of the long-term government bond yield, during the COVID-19 crisis (10-Year Government Bond Yields, %)



Source: based on IMF data (IMF, 2021a).

It is known that the degree of the financial development influences the economic and financial stability of a system (Criste and Lupu, 2021). In emerging countries, characterized by a lower degree of financial development, the shock of COVID-19 has triggered a sudden capital phenomenon affecting public and private external financing. The withdrawal of capital has led to a sharp of currencies' depreciation in these states and a further tightening of financial conditions. Massive and rapid sales in local currency bond markets have led to sharp increases in sovereign bond yields in several emerging countries, but the strong intervention of central banks of these countries has helped to correct such trends in the coming months.

As Borio (2020) pointed out, the financial system was quite robust at the time of the current crisis, with the world economy expanding. Moreover, the rapid and firm intervention of central banks in the first phase largely neutralized the turmoil in the financial markets, and their communication with the market restored confidence that the situation was under control. In addition to stabilizing the markets, the measures taken by the monetary authorities aimed to maintain the flow of credit to companies, households, and even public entities.

It is noteworthy that in the early stages of the crisis, despite sharp currency depreciation and massive capital outflows, central banks in emerging economies reduced monetary policy interest rates. However, the decision was motivated on the one hand by the existence of sufficient room for monetary easing, and on the other hand by the sudden easing of monetary policy by the Fed and other central banks in developed economies, which improved conditions, thus, easing the appreciation pressure on the US dollar, a risk factor for emerging economies.

Equally important was the role of financial factors in shaping the initial conditions. After accumulating gradually, partly because of persistently very low-interest rates, a specific phenomenon in the wake of the global financial crisis, the financial fragility has exacerbated the impact of the shock on economic activity. The vulnerabilities accumulated in the banking system in the post-crisis period refer to both the aggressive assumption of risks, a predominant behaviour in the financial markets, and the very high level of non-bank financial leverage (BIS, 2020). Credit risk was underestimated not only in advanced economies, but also in emerging ones, and liquidity was "fragile", given the popularity of illiquid investments with short-term financing, investment funds, etc. Following the global financial crisis, corporate debt has risen in many countries with advanced and emerging economies, while household debt has risen mainly in countries that have been less affected by the global financial crisis. In addition, sovereign debt has risen in several advanced economies, but especially in emerging economies, partly because of the political response to the global financial crisis. These factors have left their mark on the economy's initial response to the shock.

The above-mentioned characteristics, which reflect the economic and financial effects of the COVID-19 crisis, have required firm, rapid and major interventions by macroeconomic policy decision-makers. Berger & Demirgüç-Kunt (2021) emphasize that the long-term prudential policies pursued by the US authorities since the time of the global financial crisis have prepared the US banking system for a future crisis. This remark is also valid in other countries, most of which have such an approach.

Therefore, although measures to stop the pandemic have led to a deterioration in the macroeconomic environment, and an increase in financial risks for banks, the macroprudential mechanism developed in recent years and the proactive conduct of macroprudential policy, as well as the experience of the global financial crisis, which through its springs has been an exercise in increasing the resilience of the financial system to future shocks and crises, have helped reduce risk in the financial sector at the global level.

5. Conclusions

The COVID-19 crisis is unprecedented due to its rapid spread, the global quarantine measure and, implicitly, the complex effects generated since its inception, but also the uncertainty about the time horizon in which it manifests itself.

The initial stage, from February to April 2020, is one of deep uncertainty related to the evolution and gravity of the situation, to which the authorities reacted through measures to close the activities (economic, social, cultural, etc.) lockdown. Uncertainty has severely affected the functioning of markets, both commodity exchanges (especially oil) and financial markets (foreign exchange market and financial assets market).

The analysis highlights several features of the COVID-19 crisis:

- it is exogenous to the financial system, not being determined by the accumulation of financial imbalances, but by the blocking of the economy through the measures adopted by the authorities, which were reflected in the financial area;
- it has a high degree of uncertainty, generated by the unpredictability of the factors that sustain it, outside the economic environment, and therefore the time horizon in which the crisis unfolds remains unknown;
- it is a global crisis because it has covered all regions and states of the world, but its economic impact is very differentiated between countries, depending on the financial openness and the vulnerable elements in the structure of the economy;
- it bears the seeds of major long-term changes in the structure of the economy and economic growth, as a result of the production of very large differences between the fields of activity.

The financial sector played a dual role in the manifestation of the COVID-19 crisis: on the one hand, it was a channel of transmission to the real economy of the reaction to the initial shock, and on the other hand, it was a factor in shaping the initial conditions increased sensitivity of the economy to shock.

The most serious challenge is the long-term economic and financial impact of the pandemic because it depends in particular on the ability of decision-makers to support the resumption and recovery of economic activity, especially in the face of the global energy crisis and geopolitical tensions. war products in Ukraine prolong uncertainty about the future of the global economy.

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