Spotlight: Econ Op-eds in Summary

Week ended 18th March '20

In Summary

The underneath contains summaries of the articles given above, including key extracts from these articles.

1. How bad might the coronavirus recession be in 2020
By: Ganeshan Wignaraja

- The global economy had been showing fragility even before the virus outbreak. Trade wars and geopolitical tensions had slowed down global trade while developing economies suffered from rising debt and fiscal problems. The unexpected spread of Covid-19 further disrupted global markets and supply chains, subduing business confidence and consumer activity, increasing risk of unemployment and poverty across the world.

- If the outbreak is contained within a few months, the global economy could recover by 2021. If not, a lengthy recessionary period is likely. Therefore, a coordinated global response, backed by national efforts, is critical. The current global response and fiscal measures introduced are still not on par with what we saw during the 2008 global financial crisis.

- For Sri Lanka, the virus is expected to impact the economy through reduced tourist arrivals, capital outflows, waning business confidence and falling exports. While the public health response to the outbreak is encouraging, a similar initiative in consultation with international agencies is needed to boost the economy and protect vulnerable households.

At the dawn of 2020, experts thought that the world economy had finally bottomed out from the 2008 global financial crisis. In January 2020, the IMF projected that global growth would rise from 2.9% in 2019 to 3.3% in 2020. However, the scenario has changed with the fast spread of COVID-19 in February 2020. Global growth in 2020 will be less than the IMF projection. But whether it will trigger a global recession and what it means for Sri Lanka are the key policy questions today.

From health emergency to global economic crisis?

The world economy was fragile even before COVID-19. The trade war between the US and China, coupled with rising geopolitical tensions, had taken a toll on global trade which had hitherto driven globalisation.

China, the world's factory, was seeing a hollowing out of manufacturing and off-shoring of manufacturing production in the wake of the trade war and rising wages. Europe was hampered by uncertainties in the Brexit process and weak business investment. Japan, at the frontier of a super aging population and a consumption tax hike, was confronting sluggish growth. All of these were happening when India was slowing with distress in rural areas, weighed down by the lingering effects of demonetarisation and the general sales tax. Other developing economies, with rising debt levels and limited fiscal space, were experiencing a bout of risk aversion by investors.

Then came the unexpected global spread of COVID-19 – a rapidly-moving highly contagious infection originating in China. It has been rightly declared a pandemic by the

World Health Organization (WHO) having affected 146 countries, infecting over 150,000 people and causing more than 6000 deaths (16 March 2020). The rapid transmission of the disease is linked to globalisation of the world economy, the advent of truly global travel and human mobility particularly between airports. It is putting an enormous strain on health care systems and disaster risk management.

The COVID-19 is not just a public health emergency but it is also an economic shock which has caused global economic disruptions through finance, trade and people channels. It has hit global financial markets, reduced valuations, tumbled stock markets and caused volatile capital flows. It has disturbed global supply chains, forcing multinational companies to reduce or temporarily close assembly and factories. In turn, this is affecting second-tier suppliers, demand for goods and services and global trade.

Urban shut downs and international travel restrictions are halting people movement on an unprecedented scale. Business confidence, consumer activity and daily life have altered. The risk of significant unemployment, income inequality and poverty, both within and between economies, is looming large on the horizon.

Scenarios for global growth in 2020-2021

It is still too early to assess the full economic impact of COVID-19. Data is inadequate and existing forecasting models are not adequately specified to analyse the disruption from the pandemic. The IMF will update its global economic forecasts during the Spring Meetings in mid-April 2020, which are being held virtually for the first time.

Nonetheless, there is a growing consensus among economists that global growth in 2020 will be lower than the figure for 2019. Two scenarios are possible at this stage with the depth of economic downturn depending on the effectiveness in containing the pandemic:

• Scenario 1: a short outbreak and a limited global economic impact. The global spread of COVID-19 is checked within a few months through measures such as large-scale virus testing, social distancing, quarantine procedures and medical treatment. Ultimately, a vaccine is successfully developed and readily made available. Under scenario 1, global growth in 2020 may be in the range of 2.3-2.5%. Some upturn in global growth may also be expected in 2021. Nonetheless, this scenario will fall within the practical definition of a recession by economists as two consecutive quarters of fall in a country's real (inflation adjusted) gross domestic product (GDP).

• Scenario 2: A long outbreak and a prolonged global economic impact. COVID-19 continues to spread internationally at a rapid pace, the measures are partially successful in containing the disease and it takes longer than expected to develop a vaccine. Under scenario 2, global growth in 2020 could slip to a range of 1.0-1.5% and remain subdued in 2021. According to the suggested definition, this would constitute a lengthy recession.

A coordinated global response, backed by national efforts, is crucial to tackle the pandemic. Addressing public health needs is the first priority. The WHO urgently needs increased financial resources to support economies engulfed by COVID-19 and modernisation of the institution over time.

With a severe downturn likely, a complementary priority is for economies to spend notable sums to protect vulnerable households. They should also prepare fiscal measures including transfers and backstops to financial institutions. The US Federal Research has cut interest rates back to zero and reintroduced the bond-buying program it used to tackle the 2008 global financial crisis. The Trump Administration and Congress are in the process of negotiating an economic stimulus package. The European Central Bank introduced a modest stimulus package including new cheap loans to banks but did not cut interest rates.

These efforts are laudable but much below the spending levels and close international coordinated action undertaken to tackle the 2008 global financial crisis.

Implications for Sri Lankan growth

At the time of the IMF Mission visit to Sri Lanka in January 2020, the country was on a recovery trajectory from the Easter Sunday attacks and the IMF projected better GDP growth of 3.7% in 2020. A part of that growth was attributed to change of political regime. Business confidence and investment along with public infrastructure investment were thought likely to boost growth. Some commentators also felt that the new tax measures and financial support to SMEs were useful at least in the short-term. And the world economy appeared to be looking up offering the prospect of export growth, more inward investment into Sri Lanka and higher tourist arrivals. Parliamentary Elections were announced for 25 April with the SLPP looking to gain a majority of seats.

However, since then COVID-19 has emerged as a public health and macroeconomic risk for Sri Lanka. While some 28 cases have been recorded to date, there are signs of the adverse economic impact in terms of reduced numbers of tourists, capital outflows, waning business confidence and falling export orders. A temporary COVID-19 outbreak would have a modest impact on Sri Lanka's growth in 2020. Forecasting growth in a small open economy like Sri Lanka is a difficult exercise.

An educated guess suggests that a temporary outbreak might lower Sri Lankan growth to 2019 levels, which is expected to be 2.7% or thereabouts. But a prolonged outbreak obviously creates more stress for the Sri Lankan economy and would mean lower growth than the temporary outbreak. It is encouraging that Sri Lanka has launched a strong public health emergency response and is supportive of a SAARC initiative to contain COVID-19. A similar initiative to bolster the macroeconomy and protect vulnerable households is also needed in consultation with international agencies and aid donors.

For the full article – Refer Daily FT

2. Sri Lanka's economic recovery suffers amid COVID-19 threat
By: Shihar Aneez

- Last week, Sri Lanka started to gradually realize the grim reality facing the economic recovery this year due to the fears of the coronavirus' impacts, both internationally and locally. One main impact is felt in remittances as Middle East closes down, and the oil prices drop resulting in many workers losing their jobs or having to shift to lower wage jobs.

- The tourism industry which had just been recovering from last year's Easter Sunday attack would also be hit. Along with it, other related industries such as hotel, food and beverage, and transport sectors would be affected significantly. This is especially problematic since even the locals refrain from travelling, unlike after the Easter Sunday attack.

- China's economic woes due to the virus also mean that we would have less imports of raw materials and intermediates. This means in order to maintain exports we would need to look for alternative sources which could result in delays and higher prices. The governments could also find it hard to refinance, given the grim economic conditions both locally and in major lending nations like China.

Sri Lanka last week started to gradually realize the grim reality of the economic recovery this year due to the fears of the impact of coronavirus both internationally and locally.

Stock market trading was halted three times within four days last week to prevent a steep fall. The main All Share Price Index (ASPI) plummeted 4.1% last Tuesday after the world risky asset markets plunged a day before due to fresh COVID-19 threats. It also fell 3.6% on Thursday after the detection of the first Sri Lankan national with COVID-19 positive, and nearly 3% on Friday.

This week all the schools and universities are closed. The Government declared Monday as a Public and Mercantile holiday in a response to prevent the novel coronavirus spread throughout the country. The Health Ministry has ordered to not hold any mass gathering. Religious ceremonies and sermons are shortened. Even film theatres are ordered to be closed. All these measures come in the wake of fears of a coronavirus outbreak in the country.

The business confidence gained from the election of President Gotabaya Rajapaksa is slowly eroding amid fear of economic slowdown after the COVID-19 threats and Sri Lanka's mounting debts.

The grim reality is the outbreak of coronavirus across the world is likely to hit Sri Lanka's key foreign revenue earners like garments, tourism, and remittances harder while easy foreign borrowing from China could be constrained as the world's second largest economy itself is struggling with the highest fatalities from the pandemic disease.

Less foreign jobs

The Middle East, which is the main job market for over half a million Sri Lankan expatriates, has seen the reality of the deadly virus. Some of the Middle Eastern countries have imposed travel restrictions and shut down their airports while the prices of crude oil, which is the main sources of income for many Gulf countries, have plunged on lower demand after the COVID-19 outbreak. This means many Sri Lankans are likely to lose jobs in the Middle East or will be forced to seek alternative jobs, perhaps at a lower wage.

Reduction in remittances will compel rural Sri Lankans to look for other sources of income and agriculture is likely be the obvious beneficiary, though it is unlikely to happen overnight.

The IMF has already said the global spread of the novel coronavirus has crushed hopes for stronger growth this year and would hold 2020 global output gains to their slowest pace since the 2008-2009 financial crisis.

That kind of global slowdown will result in more job losses for millions of expatriates across the globe.

Tourism surge suffers

Sri Lanka's tourism industry had almost completely recovered in December after the Easter Sunday attack last year. The leisure sector was preparing for a stronger growth in 2020 before the bad news on the novel coronavirus outbreak.

Monthly tourist arrivals which were 70% down in May, the month following the Easter Sunday attacks, recovered to just 4.5% less in December compared to the same month in the previous year. The impact of the coronavirus is already seen with a 55% drop in Chinese tourist arrivals into the country. Chinese tourists ranked third in last year's top foreign visitors list after India and the United Kingdom.

The lower number has also reflected in earnings with revenue from tourism falling 18% to $ 391 mn in February from a year ago. With the State-run SriLankan Airlines cancelling as many as 36 flights per week to China and the Middle East as a response to the COVID-

19 outbreak, the tourism industry will see a further dip in earnings. Since the end of the war, tourism has become the fastest-growing foreign exchange earner with related sectors like transport and food and beverage also benefitting immensely. All these sectors came back to almost normal towards the end of the last year mainly due to a surge in local tourism after the initial plunge. But this time, local tourists are also not going to visit anywhere until normality returns from the fears of COVID-19 threats. Thus, the coronavirus fear will dent tourism in the country, which could hit hotel, food and beverage, and transport sectors significantly.

This means many people who have registered in formal transport services like Uber and PickMe will feel the pinch of settling their lease dues in the face of lower business.

Hit on import sector

China is Sri Lanka's top importer now, with 21% of our goods bought from the Far Eastern nation. The outbreak in China means many Chinese locals are unable to work in their own manufacturing plants and thus Sri Lankan importers will have look at alternative destinations. There are two risk factors associated with this: delays and higher prices.

Imports from China are considered among the cheapest in the world due to its massive production and scale of economies. Sri Lanka depends on China for raw materials for its exports like its top foreign exchange earner, garments. If Sri Lanka is not going to get imports on time, the importers will have to look at another foreign supplier and that will cause delays for sure. Furthermore, raw materials are not going to be supplied at the same price. They will be expensive. This means the price of Sri Lankan exports using Chinese raw materials will have to be revised upward to maintain sustainability. These adjustments are going to be very painful.

For instance, Sri Lanka currently imports approximately 25% of its textiles from China. Sri Lanka imported $ 218.1 mn worth of cotton and $ 132.6 mn worth of knitted/crocheted fabric from China in 2018.

Local media, quoting garment industry experts, have reported that some apparel manufacturers are exploring the option of halting operations for a few weeks as they may struggle to pay their workers who would go idle due to the non-availability of fabrics. This means indirect worker layoff or pay cuts are on the cards if things get worse.

The country earned a record $ 5.3 bn from apparel exports in 2019, a 5.1% growth compared to the previous year.

Tight finance

The Government's financing for its infrastructure drive and other projects is not going to be easy this year. President Gotabaya Rajapaksa's administration will have to allocate a significant amount of unplanned spending on COVID-19 threats and drought. This financing could make Government funding difficult, especially at a time when it has reduced taxes and State revenue is on the decline.

In the past, the Government led by Mahinda Rajapaksa had the blessings of Chinese finance mainly for infrastructure. Though some the loans were expensive, still China came up with funding options where other countries including the West overlooked the island nation. With China itself struggling to face the ongoing coronavirus outbreak, it is unlikely to lend to Sri Lanka easily, unlike in the past.

With the Government turning down $ 480 mn from the Millennium Challenge Corporation deal, other Western nations are unlikely to come up with some outright grants. So Sri Lanka will have to address its own funding constraints. But the options are limited for such financing without burdening the people or going for long-term leasing like in the Hambantota Port deal.

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