The COVID-19 crisis must be spelled with a V

The letter game is back. Still immersed in a fully-blown health crisis, and having only just entered into the economic crisis, the debate about what shape the terrible episode we are currently going through will take has already been reignited. Will it be a V-shaped crisis, a U-shaped one or an L-shaped one? There are those who even venture to suggest a W-shaped crisis. It is just as well that we use the Latin alphabet and not Chinese characters.

At the present juncture, one of the few certainties we have is that the measures we are taking to curb the pace at which the virus is spreading, which are essential, will have an economic impact of an unprecedented magnitude. In China, where the virus first appeared, the available indicators suggest that in Q1 2020 GDP shrank by 10% compared to the previous quarter. In addition, with a very gradual relaxation of the containment measures and the collapse in demand from the rest of the world, the recovery is expected to be slow.

The indicators available for the major developed countries are still scarce, but the few that we do have indicate that the blow to economic activity will be at least of a similar magnitude to that observed in China. These include indicators relating to the labour market, which show an unprecedented increase in unemployment. In the US, in the last two weeks of March unemployment benefits applications reached levels never seen before (3.3 million in the penultimate week and 6.6 million in the last, well above the levels registered at the height of the crisis of 2009). In Europe, the use of the temporary job suspension programmes implemented by each country has also highlighted the impact of the containment measures. In parallel, economic activity indicators are plummeting to levels never seen before.

In this situation, there is no government (at least among the major developed countries) that has not announced measures of economic support. The speed with which they are acting and the decisiveness, agility and effectiveness of the measures announced will be key for determining what shape the recovery will take. Indeed, it is essential that households and businesses are in a position to quickly return to normal once the pandemic is under control.

The actions taken by the central banks are also proving decisive, and they will continue to be so, providing liquidity to ensure the proper functioning of the payments system, taking measures to anchor interest rates at low levels and prevent a tightening of financial conditions and, above all, implementing asset purchase programmes which, implicitly, cover the surge in funding needs that the public sector will experience in the coming months.

Beyond the economic stimulus measures announced to date, there are other factors that will determine the speed of the recovery. The fear that there could be a new resurgence of the virus could slow the recovery in demand, especially in certain sectors. The recovery will also depend on the situation in which other countries find themselves. The fear of a resurgence will increase if the virus remains active in other regions, and the speed with which economic activity will return to normal will depend on the state of global demand. This shock, which affects us all, is bringing to the fore just how interconnected the world is. In this regard, there is concern that an economic crisis could be triggered in emerging countries. In these countries, the health crisis has been exacerbated by a rapid tightening of international financing conditions and a sharp fall in commodity prices. Many of them are highly dependent on exports of such goods and/or have high levels of debt denominated in dollars. In the face of these risks, economic policy, which is now focusing on measures to curb the harsh impact of the lockdowns, must also be prepared to implement fiscal stimulus plans that ensure a rapid recovery in economic activity once the onslaught of the virus has been overcome.

All this paints a highly uncertain picture of the scenario, as reflected in the performance of the financial markets. In the wake of the historic corrections experienced between February and mid-March, the major stock market indices remained highly volatile in the closing weeks of the month as new information emerged. However, they gradually recovered some of the lost ground thanks to the confidence offered by the economic measures announced by many countries. In other words, it seems that the financial markets are gradually ruling out an L-shaped scenario. Thus, the S&P 500 and the Eurostoxx 50, which by mid-March had amassed setbacks of 25% and 30%, respectively, closed the month having regained around one-third of the lost ground.

In the end, the shape of the COVID-19 crisis will depend on multiple factors. Some of them, unfortunately, cannot be predicted. But many others are relatively predictable and their outcome depends on how we act. It is in our hands to take decisive and effective action to minimise the economic impact of the COVID-19 pandemic and return to the level of activity we had just a few weeks ago as quickly as possible. We have to do everything possible to ensure that the COVID-19 crisis is spelled with a V.

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