The global war against the coronavirus

COVID-19, the disease caused by the new coronavirus that emerged in the Chinese city of Wuhan, started out as a distant threat for the western world. In the last few weeks it has become a reality. As of today, there are at least 100 cases in more than 30 countries in Europe, which now accounts for 75% of all new daily cases in the world. On 26 March, the US surpassed China in the number of confirmed cases.

Faced with this health emergency, a large number of countries have taken drastic containment measures to curb the spread of the virus and ease pressure on national health systems. Schools and non-essential businesses have been closed, large concentrations of people have been banned and, in many cases, citizens have been urged to stay at home.

The economic impact of the containment measures

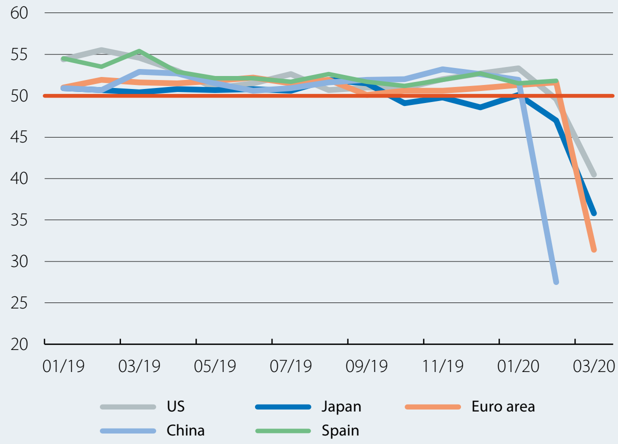
These measures, which are absolutely necessary to contain the virus and save thousands of lives, will result in a huge and inevitable drop in economic activity. Tourism, leisure, catering and hospitality, trade and transport will be severely affected during the confinement. The manufacturing sector will not be spared either, as there is expected to be a widespread decline in consumption, construction, investment and international trade.

This situation constitutes a very peculiar kind of shock, as it has a detrimental impact on both supply and demand. On the one hand, supply will be affected by the closure of factories, the disruption of global supply chains and the logistical and financial difficulties that the containment of the pandemic will entail for companies. On the other hand, the containment and the reduction in international trade will cause a sharp decline in demand, both domestic and foreign.[1]

The first economic indicators that we have, such as the PMI (a measure of economic sentiment), have plummeted to all-time lows and point towards a significant contraction of GDP in Q1 2020 in the euro area, which no doubt will be repeated in Q2. In China, where radical containment measures have been in place since January, in the first two months of 2020 industrial production and retail sales were 20% lower than in January and February 2019. Investment plummeted by 25%. Overall, it is estimated that the country's GDP has fallen by 10% in Q1 compared to the previous quarter.

The new macroeconomic scenarios forecast by CaixaBank Research, which assume that the containment measures will be lifted in the second half of the year, predict growth

Composite PMI



Source: *CaixaBank Research, based on data from IHS Markit.*

in 2020 of –3.1% in the euro area, –1.7% in the US and 2.5% in China. These annual figures mask significant declines in economic activity at the quarterly level: in the euro area, GDP is likely to fall by more than 10% in Q2 compared to Q1. At the global level, we estimate that GDP growth will be –0.4% in 2020, which places the impact of the coronavirus on this year's growth at slightly over 3.5 pps, a figure comparable to that of the Great Recession of 2008-2009. For 2021, we expect a rebound in the global economy and growth in excess of 5%. It is important to emphasise the high degree of uncertainty surrounding these forecasts, since we are dealing with a shock of an unprecedented nature and we do not yet know how effective the containment measures adopted around the world to fight the virus will prove to be, nor whether they will be extended beyond the first half of the year. Each additional month of confinement and reduced economic activity would result in a greater drop in annual GDP.

Governments respond to the crisis

Such significant declines in demand and economic activity will pose major difficulties for many companies, which will have to deal with drastic reductions in their income, at the same time as having to repay loans and cover wage payments. If they do not receive public support, they will inevitably have to reduce their workforce and experience financial difficulties. In the US, there has already been an unprecedented increase in the number of people applying for unemployment benefits for the first time (over 3 million in the third week of March and 6 million in the last, compared with the peak of 665,000 during the Great Recession).

To counteract these devastating effects of the crisis, and to prevent them from having a lasting impact, many countries have announced a series of measures intended to cushion the impact of the crisis on firms and households.

1. For these same reasons, the impact on inflation is highly uncertain. On the one hand, the drop in demand will apply downward pressure on prices. On the other, lower supply should affect inflation in the opposite direction. To complicate things further, the dramatic fall in the price of oil will also have an impact on prices.

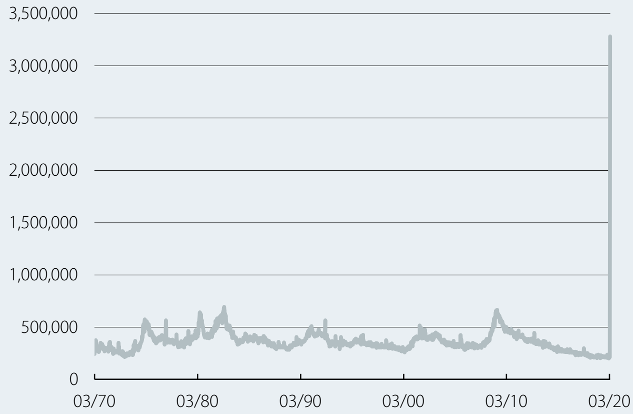
Among the wide variety of measures taken throughout the world, some of the most noteworthy include programmes of guarantees for bank loans and lines of credit through national development banks, aimed at avoiding a significant contraction in credit and boosting access to liquidity for all players; temporary workforce reduction measures (such as temporary staff lay-offs – or «ERTEs» as they are known – in Spain, or the scheme of subsidies for reduced working hours – or *Kurzarbeitgeld* – in Germany) that seek to ensure employees do not lose the connection with their employers that are experiencing difficulties; the deferment of tax payments and, in some cases, direct payments to citizens (such as in the US) and direct subsidies to companies (such as in France and Germany).

In Germany, the government will provide 822 billion (24% of GDP) in lines of guarantees through KfW, a national development bank, and in a new Economic Stabilisation Fund, which will also provide 50 billion euros in direct subsidies to small businesses with fewer than 10 employees. In addition, the authorities have expanded access to – and the generosity of – the *Kurzarbeitgeld*. Although it is often compared with ERTEs in Spain, the *Kurzarbeit* system is different in some important ways, as it allows for a reduction in working hours (not just lay-offs) and because the government pays a percentage of the wages of affected workers. Given that these measures entail a significant increase in the deficit, the government requested from Parliament the suspension of the so-called «debt brake» through an emergency clause. The amount and the public coverage of the lines of guarantees announced by Germany (aptly referred to by the government as a *bazooka*) is vast and will provide much welcomed aid for its companies. Although the measures have focused on providing liquidity to firms for the time being, it will be necessary to increase investment and spending in order to support the recovery when the containment measures are relaxed.

In France, of particular note is an ambitious plan of subsidies for reduced working hours, which is automatic and involves 70% of wages being fully borne by the state, and a compensation fund for companies with a turnover of less than 1 million euros that suffer declines of more than 70% in their turnover. The postponement of the pension reform has also been announced. In addition, the government announced a package of 300 billion euros of guarantees for loans to SMEs (up to 70% of the loan).

Italy, the European country hardest hit by the coronavirus to date, has prohibited objective staff dismissals over the next two months and has announced a total package of 25 billion euros (1.4% of GDP) in the form of subsidies for households, businesses, the health system and civil protection. Italy's measures have been somewhat restrained, perhaps due to fears over the sustainability of the country's debt and due to speculative attacks on the sovereign bond market. More support will need to be provided to the Italian economy to prevent it from being permanently damaged by this crisis. The programme of

US: initial jobless claims



Source: *CaixaBank Research, based on data from the US Unemployment and Training Administration.*

bond purchases announced by the ECB should help to alleviate these fears, but more support may be necessary at the European level.

In the US, an unprecedented economic package of loans, guarantees and subsidies for businesses was approved. In addition, the package will include direct payments to households, up to a maximum of 1,200 dollars per person and 500 per child. It is estimated that the fiscal measures could exceed 1.2 trillion dollars (6% of GDP).

In China, the measures have been more cautious. For the time being, the government has reduced company social security contributions, cut VAT and electricity rates and granted subsidies to firms in order to maintain employment. All these measures will lead to significant increases in public debt in these countries. However, as the former ECB president Mario Draghi said in an opinion article in the *Financial Times*, we face a war against the coronavirus, and these measures (which no doubt will be expanded during the course of the crisis) are necessary. It is the appropriate role of the state to protect citizens and the economy from shocks for which the private sector is not responsible and which it cannot absorb. Thus, it is important not only to increase aid for those who will lose their jobs, but to do everything possible to prevent them from losing them in the first place. In this regard, the lines of guarantees established for firms and banks are very appropriate. The direct fiscal measures (such as direct payments to citizens in the US, and benefits for unemployment and reduced working hours) also help to prevent a complete collapse in demand, in addition to directly helping citizens who are experiencing financial difficulties. Increased spending and public investment will, most likely, also be crucial in order to relaunch the economy once the containment measures have come to an end.

The European response

The measures taken to deal with the coronavirus crisis also require the support of other institutions, such as central banks and supranational bodies. Thus, the European

Economic measures adopted in Germany, France and Italy

	Germany	France	Italy
Fiscal measures	• Expansion of the *Kurzarbeitgeld*, the scheme of subsidies for reduced working hours. The government estimates that 2.35 million people will benefit from this plan, at an estimated cost of € 10 billion (0.3% of GDP). • €3.5 billion (0.1% of GDP) for healthcare (protective equipment, developing vaccines and other measures). • € 100 billion (2.9% of GDP) to recapitalise companies through the Economic Stabilisation Fund. • € 50 billion (1.5% of GDP) for direct grants to small businesses (fewer than 10 employees).	• Total cost estimated by the government: € 45 billion (1.9% of GDP). • Cancellation of taxes for companies: on a case by case basis. • Payment of temporary unemployment (*chômage partiel*, similar to temporary staff lay-offs, or «ERTEs», in Spain). Between 70% and 100% assumed by the state. Estimated cost of €8.5 billion (0.4% of GDP) in two months. • Solidarity fund for small businesses (turnover of less than € 1 million). • € 2 billion (0.1% of GDP) for the health system.	• €3.5 billion (0.2% of GDP) for the health system. • € 10.2 billion fund (0.6% of GDP) for households and companies. It includes: – Increase of funds to cover wages. – € 100 in March for workers unable to work remotely. – € 600 for the self-employed and working parents. • Tax credit of 60% of rent for small businesses. • Aid for the transport and aviation sectors (provision of € 600 million for the nationalisation of Alitalia).
Deferrals	• Tax deferrals for companies (€ 500 billion, 14.5% of GDP).	• Tax deferrals for companies (with the possibility of cancellation. Estimated cost in March: € 35 billion, 1.5% of GDP). • Deferral of gas, electricity and rent bills for companies.	• Deferral of up to € 220 billion (12.3% of GDP) of loans to SMEs and independent workers. • Deferral of up to € 10.7 billion (6.7% of GDP) of taxes and benefits for companies.
Credit lines and guarantees	• € 822 billion (24% of GDP) in guarantees for loans to companies through the public development bank KfW: – Companies with less than € 2 billion in turnover: 80% guarantee for loans up to € 200 million. – Companies with turnover of between € 2 and € 5 billion: 70% guarantee. – Companies with turnover of over € 5 billion: guarantees on a case by case basis. • € 400 billion (12% of GDP) in guarantees through the new Economic Stabilisation Fund.	• € 300 billion (12.4% of GDP) in guarantees for small and large businesses (guarantee of between 70% and 90%, depending on the size of the company).	• Up to € 120 billion (6.7% of GDP) in guarantees for small and large businesses.

Source: *CaixaBank Research, based on data from national authorities.*

Commission has decided to suspend its budgetary rules, which in normal times would not authorise such increases in spending. The Fed and the ECB also announced sovereign asset purchase programmes on an unprecedented scale (for more details on the measures taken by central banks, see the Focus «The coronavirus spreads to the markets and monetary policy takes urgent action» in this same *Monthly Report).* However, the expectation of the unavoidable increases in public debt has also given rise to new fears about the sustainability of some countries' debt (in particular that of Italy, which at the end of 2019 was as high as 135% of GDP). There has already been an increase in the risk premiums of certain European countries in recent weeks, which only receded after the ECB announced the sovereign debt purchase programme. Although the central bank has proclaimed that it is prepared to purchase large quantities of sovereign debt, it will be difficult to counteract speculative attacks on certain countries' bonds, since the monetisation of debt is not permitted by the European treaty. Furthermore, even if it has been endowed with flexibility, the ECB is limited in the total amount of debt that it can purchase from certain countries. These speculative attacks could call the integrity of the euro area into question. For this reason, there has been a resurgence of ideas that had already been proposed during the monetary area's last crisis, in order to share the cost related to the current crisis: the famous eurobonds or, in this case, «coronabonds». At the moment, the discussions among the European heads of state have focused on establishing precautionary credit lines from the European Stability Mechanism (ESM), the institution that provided loans to Greece, Ireland, Portugal and Spain in 2012. This would involve an element of mutualisation, since these credit lines would be backed by ESM capital, which is provided by all euro area countries. The agency's high credit rating allows it to provide loans at very low rates. However, this measure offers limited added value, since euro area countries can already finance themselves at very low interest rates thanks to the ECB's purchases of sovereign debt. Moreover, obtaining a loan from the ESM could be politically toxic for many countries that still have the case of Greece fresh in their memories (despite there being talk of reducing the conditions attached to these credit lines). Finally, these loans would add to the debt of the countries that obtain them, and they would not involve a real co-insurance or mutualisation mechanism, unlike a true eurobond.

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