The Prospects Service

LEADING ECONOMIC ANALYSIS, FORECASTS AND DATA

Global Prospects, March 2020

Making Business Sense

The worst economic crisis since the 1930s

Toplines

- The world economy is in its greatest economic crisis since the 1930s Great Depression as a result of the global coronavirus pandemic with many world economies in shutdown.
- Governments and central banks have responded with unprecedented peacetime fiscal and monetary injections in a bid to stop the recessions turning into a 1930s-style rout.
- In this report we focus on the short-term consequences for world GDP, look at what happened in the 1930s and consider whether and how the authorities can prevent a repeat.
- We also look separately at the implications of the oil price war which has been started by the Saudi authorities.

Forecast summary

- We have severely downgraded our forecasts for virtually all economies covered by our analysis. Given that only very little hard data is available showing the impact of the virus on world economies, the forecasts largely reflect our estimates of the economic effects of partial shutdowns of countries for a limited amount of time, mostly focused on Q2 2020.
- One exception here is China, which has seen the largest impact in the first quarter and can expect to slowly return to more normal economic activity in Q2.
- The Chinese example, however, also shows that it won't be easy to just switch back to 'normal' production mode as businesses will continued to implement strict public health measures to prevent a new outbreak.
- We estimate that Chinese GDP will have contracted by 10% YoY in the first quarter. Over 2020 as a whole, GDP could fall by 2.0%.
- In the Eurozone, the effect will be even larger as countries are predicted to need to maintain longer shutdowns. Italy is especially hard-hit with the country's more prosperous north counting the most fatalities. Overall, we expect Eurozone GDP to contract by 9.0% YoY in the second and third quarter, leading to an overall reduction of GDP in 2020 of 6.0%.
- In the US, the worst impact on the economy is also yet to come in Q2, with a reduction of 8.0% expected. Our 2020 forecast sees GDP contract by 5.0%.
- Global GDP is predicted to shrink by at least 4.0% over 2020 before rebounding to growth of 3-4% in 2021.

The spread of the disease – assumptions for 2020

- Obviously Cebr are not epidemiologists and so we are reliant on assumptions from other authorities about the likely progress of the disease. Under current expectations of the spread of the virus, we interpret this will roughly have the following economic impacts:
- Asia – peak decline in GDP YoY in Q1; Q2 strong bounceback but still well below the previous year; Q3 slightly up YoY and Q4 strongly up (circa 5%) year on year.
- Europe – Q1 GDP flat or only slightly down, Q2 and Q3 sharply down, Q4 higher than Q3 but still significantly down year on year.
- North America – slightly up in Q1 compared to a year earlier, and a similar trend to Europe for rest of year.
- Provided that the authorities staunch the knock on effects of the disease, even though we expect it to linger into 2021, we expect growth for that year to show a rapid bounce back (+3% - 4% yoy).

What happened in the 1930s

- The Great Depression which took place at the beginning of the 1930s is considered the worst purely economic crisis worldwide for which reasonably accurate data is available. Peak-to-trough GDP per capita fell by 31% in the US (1929-32); 18% in Germany (1928-32); 16% in France (1929-32) and remarkably only 6.7% in the UK (1929-32).[1]
- Industrial production fell by rather more in most countries – 46% in the US; 41% in Germany, 24% in the UK and 23% in France.
- The rise in unemployment during the Great Depression was the most dramatic signal: in the US unemployment was 3.2% in 1929 and rose to 25.2% by 1933. In Germany the rise was from 8.9% in 1929 to 29.9% in 1932. In France by contrast, which was a much more agricultural society and where the labour force had been badly reduced by WW1, the official unemployment rate rose from 1.1% to 3.7% over this period[2], though industrial unemployment rose to over 20%. In the UK, interwar unemployment bottomed out at 9.7% in 1927 and rose to 22.1% by 1932.[3] These sharp rises in unemployment produced the characteristic images of the 1930s of people queuing for work and food.
- Meanwhile, collapsing demand and growing autarky led to a sharp decline in world trade. The most widely quoted figures[4] suggest a fall of 65%, though these appear to relate to the US's international trade alone. Figures for the world as a whole seem to indicate a fall of around 30%[5]
- While there are conflicting views about the original cause of the fall in economic activity, there are two strong and generally accepted messages about why the scale of the fall in the 1930s

---

[1] Source Maddison Project Database 2018, Groningen Growth and Development Centre https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2018

[2] http://www.cepii.fr/PDF_PUB/wp/1996/wp1996-06.pdf France in the Early Depression of the Thirties Pierre Villa, Centre des Etudes Perspectives et des Informations Internationales, Paris June 1996

[3] https://www.irle.berkeley.edu/files/1988/Unemployment-In-Inter-War-Britain.pdf Unemployment In Inter-War Britain, Barry Eichengreen IRLE WORKING PAPER #13-88 November 1988, Berkeley, US

[4] https://www.history.com/news/trade-war-great-depression-trump-smoot-hawley

[5] Trade Barriers and the Collapse of World Trade During the Great Depression, Jakob B Madsen, Southern Economic Journal, 2001 67 (4) pps 848-868

was so great. First, the initial falls in activity were compounded by the resultant falls in income, leading to a further contraction in spending. Second, autarkic behaviour in world trade led to beggar-thy-neighbour policies compounding the effects of the contraction.

Preventing a repeat of the 1930s

- The authorities are unlikely to be able to prevent a short-term sharp decline in activity as major parts of the world economy go into lockdown. Cebr's own study of the impact in London shows that a London lockdown could reduce London GDP by 31% on a weekly basis.[6] Though the same study points out that the loss of economic activity could have been of a far greater magnitude, had this crisis occurred at at time when remote working was less possible. But it is important that this initial blow is cushioned and that knock on effects are prevented to the extent possible.
- The first most important lesson for now is that even at the risk of huge rises in debt, the fiscal and monetary authorities need to cushion the blows of falling activity and, in particular, prevent them from generating a further round of contraction, as falling activity leads to falling incomes, leading to further falling spending. This means that preventing corporate collapse and limiting the falls in disposable incomes is of the upmost importance.
- The second lesson is that, to the extent possible, autarkic trade and exchange rate practices should be avoided.
- Our modelling suggests that, if the scale of the reduction in real disposable incomes in economies emerging from the effects of the virus can be kept below 5%, it ought to be possible for the built in bounceback, as pent up supplies and demand come on stream to overcome the impact of reduced spending power. The aim of the authorities should be to enable people to spend when they are able to.
- We have been encouraged by the degree of coordination by some authorities and the extent to which governments have realised the need to take action. This gives us hope that by 2021 the main macroeconomic impacts of the crisis will be over.

[6] https://cebr.com/reports/a-coronavirus-lockdown-in-london-could-cost-the-uk-half-a-billion-pounds-per-day/ Forecasting Eye 2 March 2020 by Owen Good and Daryn Park

Global roundup

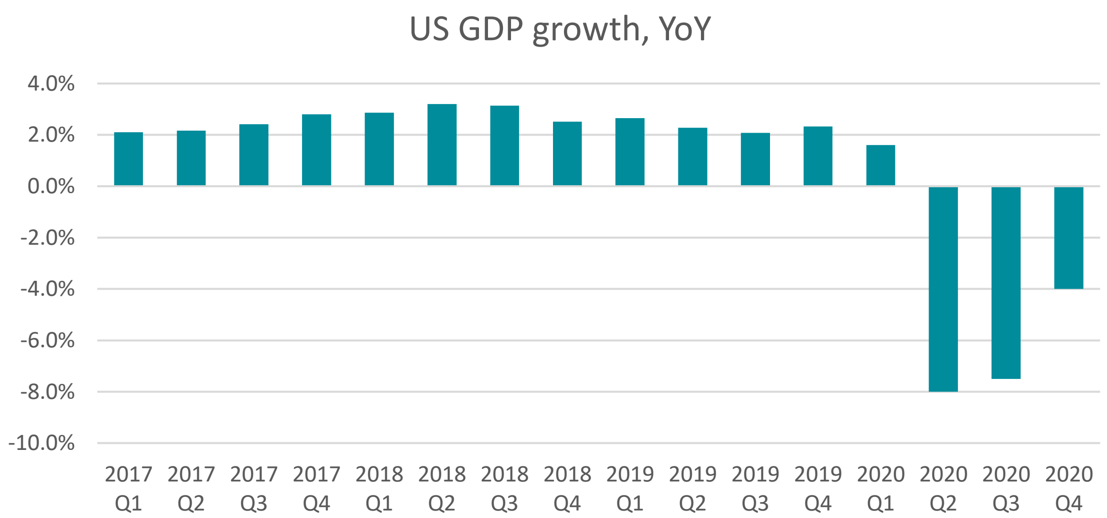
Europe

- Europe has become the worst affected region by coronavirus in early March. As Asian countries started to gain some control over the illness, the outbreak started to wreak havock on European economies, starting in Italy.
- Italy was the first European country to enact firstly a partial and then a full lockdown. Other heavily affected countries include Spain, France and Germany.
- At the time of writing, it is still unclear for how long the containment measures will need to stay in place. Schools and shops have closed in many countries and authorities have started to limit the extent to which citizens are allowed to leave their homes.
- The economic effects will be concentrated in the second and third quarters of 2020, although we assume that some of the measures to limit the spread of the virus can be relaxed in second half of the year.
- Both the services and production industries will be affected heavily.
- The already struggling car sector will be hard hit and many manufacturers have announced they will be halting production in a number of European factories.
- European banks have also been hit hard, with shares down by around 50% since February.
- The European Central Bank has reacted by announcing a €750 billion package and announced it would remove its issuer limits, if necessary, which prevents the central bank from buying more than 33% of any single country's outstanding debt, and no more than 33% of a particular bond issue. Italian and Greek bond yields plunged in response to the announcement.

Source: IMF, Cebr analysis

North America

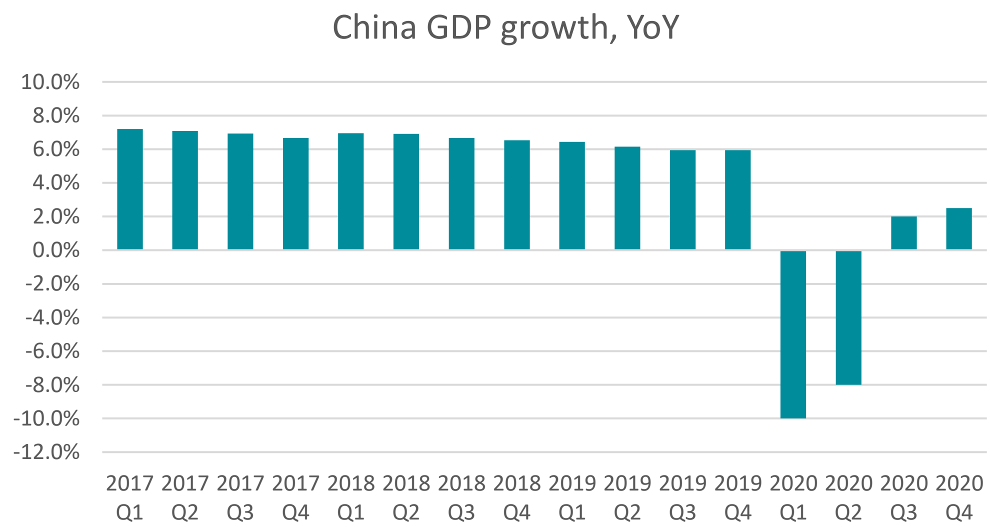
- The first case of Covid-19 in the United States was confirmed on 21 January in a patient near Seattle.
- The response of the Trump administration to the crisis has been slow, especially in early weeks of the crisis. More drastic measures have been put into place in the second half of March, including a travel ban from European countries to the US, which sent stock markets reeling.
- The governor of California has ordered the state's residents into lockdown. All non-essential businesses have been ordered to close and residents have been told to avoid all non-essential social contact, with groups of more than 10 people prohibited. People are ordered to stay at home unless for buying food, going to pharmacies and getting petrol.
- These drastic measures show that the scale of the crisis in the US has reached a level comparable to that of the most affected regions of the world, such as in Europe.
- As a reaction to the crisis, the Fed has cut interest rates twice, bringing the range of the federal funds rate to 0.00% - 0.25%. Asset purchases to the tune of US$700 billion have been restarted.
- There has been some progress on a fiscal stimulus measure as well. Republicans have proposed a US$1 trillion spending package – the largest in history – to address the economic fall-out. The focus of the package will be on protecting household incomes and lending support to small businesses to keep the economy afloat.
- Previously unheard of measures, such as direct cash transfers to Americans, are also being discussed.
- Any deal, however, will need to be approved by the Democrats and Republicans meaning both parties will need to collaborate to find a consensus.



Source: IMF, Cebr analysis

Asia-Pacific

- Coronavirus started in Asia and, in the early parts of 2020, the hit on Asian economies will hav been larger than anywhere else. Chinese GDP in Q1 looks to be down around 25% compared to Q4 2019.
- But most Asian economies have addressed their problems earlier than elsewhere and, as a result, production is likely to start to rise in Q2, although being still well below that a year earlier.
- In addition, many of the key Asian economies (China, Japan, South Korea, Taiwan and Singapore especially) have been much more aggressive than Western countries at enforcing separation of those likely to be infected from others and preventing the spread of the disease and this has reduced the scale of infection.
- We expect a strong bounceback in most Asian economies in the second half of this year, though not enough to produce year on year economic growth for 2020.
- The bounceback is expected to continue into 2021, even though most government stimulus measures should be phased out during the year.



Source: IMF, Cebr analysis

The oil price war

- The past month has seen turmoil in the oil market. Saudi Arabia, either in cahoots with Russia, or at least with the same intention, has taken advantage of the coronavirus pandemic to launch an attack on the US tight oil industry.
- Increased supply had been enough to keep prices around $50 / bbl, a level that discouraged new exploration, but left existing wells in production. The collapse in demand due to coronavirus provided the opportunity to drive prices much lower; currently to a level around $25 / bbl. This looks set to decimate highly leveraged US fracking companies, and put other high cost producers, such as UK's North Sea fields, under pressure.
- Saudi Arabia needs to keep the oil price around $30 /bbl for two to three years to drive US frackers out of business. Whether they can do this depends on a range of factors, including whether the US can apply sufficient political pressure on OPEC to cut supplies.
- It is questionable whether Russia can survive for this long without devastating its economy and its own oil industry. Even if OPEC applied stringent cuts to production now, the drop-off in demand and long road to recovery is likely to see low prices for some time, and in the near-term prices could fall further as storage facilities fill and there is no market for the glut of oil.
- The impact of coronavirus on gas prices is more nuanced. Henry Hub prices have been over $3 /MMBtu for the past four years but, since January, have been falling due to a supply surplus caused by fracking, including associated gas, and growing LNG capacity. In the near-term the price seems likely to remain in the $1.50 to $2.00 / MMBtu range.
- In the longer term the coupling between oil and natural gas prices is likely to decrease further. Fuel substitution (switch between oil and gas depending on energy cost) is decreasing, as oil use for electricity generation declines, and gas becomes a cleaner substitute for coal fired generation. In the longer-term, electrification of transport and heating will reduce oil demand further, while some of the additional electricity will be fuelled by gas. Prices look to be heading back towards $3 / MMBtu by mid-decade or earlier and perhaps $4 / MMBtu by the end of the decade.

Forecast tables – GDP growth, major economies

Cebr-Growth forecast-%	2019	2020	2021	2022
Australia	2.2%	-6.0%	4.5%	2.7%
Brazil	1.2%	-8.0%	4.4%	2.4%
Canada	1.7%	-4.0%	3.5%	1.8%
China	6.1%	-2.0%	5.2%	5.7%
France	1.2%	-7.0%	2.9%	1.4%
Germany	0.6%	-8.0%	1.5%	1.3%
India	5.9%	-3.0%	8.0%	7.0%
Indonesia	5.0%	-4.0%	5.2%	5.3%
Italy	0.2%	-11.0%	2.5%	0.7%
Japan	0.8%	-4.0%	1.7%	0.5%
Mexico	-0.1%	-3.0%	3.7%	2.1%
Russia	1.3%	-4.0%	1.5%	2.0%
Spain	2.0%	-7.0%	2.2%	1.7%
Turkey	0.6%	-5.0%	6.0%	3.5%
United States	2.3%	-5.0%	3.0%	1.6%
World	2.8%	-4.0%	3.4%	3.0%
Oil prices**	61	30	35	40

Source: IMF, Cebr analysis

*IMF non-fuel commodity index, 2005 = 100
**Average of Brent & WTI, in USD

Contact:

Douglas McWilliams dmcwilliams@cebr.com 0207 324 2860 or +44 7710 085 652

Kay Neufeld kneufeld@cebr.com 0207 324 2841

For any questions related to our oil price forecasts and the energy sector, please contact:

Mike McWilliams mmcwilliams@cebr.com +44 1580 763 009