G20 and COVID-19

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Michael Roberts, February 23, 2020

The finance ministers and central bankers of the top 20 economies in the world met this weekend in Riyadh, Saudi Arabia. The G20 finance summit had a lot to ponder. First, there was the coronavirus epidemic. Would it turn into a pandemic? Would the impact of global growth, trade and investment be so severe as to tip the world economy into recession in 2020? Also, what is to be done about curbing and reducing greenhouse gas emissions with the world's temperatures continuing to rise towards an increase above that set by the last international climate change agreement? Finally, is there nothing to be done about high and rising inequality of wealth and income and continued shift of profits by multi-nationals and rich oligarchs into 'tax havens'?

The Saudi Arabia G20 communique provided no answers to any of these questions. At Riyadh, IMF managing director, Kristalina Georgieva, having previously announced a reduction in IMF forecasts for global growth to just 2.9%, now added a further reduction due to COVID-19. She reckoned that the epidemic will likely cut 0.1% from global economic growth to 2.8%, the lowest rate since the end of the Great Recession over ten years ago. And it would drag down growth for China's economy to 5.6% this year from 6.0% previously forecast. *"In our current baseline scenario, announced policies are implemented and China's economy would return to normal in the second quarter. As a result, the impact on the world economy would be relatively minor and short-lived,"* she said. But even that could be optimistic. *"But we are also looking at more dire scenarios where the spread of the virus continues for longer and more globally, and the growth consequences are more protracted,"*

French Finance Minister Bruno Le Maire said in Riyadh. *"The question remains open whether it will be a V-shape with a quick recovery of the world economy, or whether it would lead to an L-shape with a persistent slowdown in world growth."* He said the V-shaped scenario was more likely.

As the ministers met, the latest data on COVID-19 suggested that China was getting the epidemic under control. It reported a sharp fall in new deaths and cases of the coronavirus, but world health officials warned it was too early to make predictions about the outbreak as new infections continued to rise in other countries. *"Our biggest concern continues to be the potential for COVID-19 to spread in countries with weaker health systems,"* WHO chief Tedros Adhanom Ghebreyesus said. The U.N. agency is calling for $675 million to support most vulnerable countries, he said, adding 13 countries in Africa are seen as a priority because of their links to China.

The Chinese authorities put on an optimistic air. Chen Yulu, a deputy governor of the People's Bank of China, said policymakers had plenty of tools to support the economy, and were confident of winning the war against the epidemic. *"We believe that after this epidemic is over, pent-up demand for consumption and investment will be fully released, and China's economy will rebound swiftly,"* Chen told state TV.

Other commentators are less convinced that China can recover quickly from shutting down industry, stopping tourism and keeping millions at home. Zhu Min, a former deputy managing director of the International Monetary Fund, reckoned that COVID-19 could slash US$185 billion off China's economy in January and February. Dips in tourism and consumer spending could reduce first-quarter growth by three or four percentage points, according to Zhu Min, While online spending – particularly on education and entertainment services – would offset some of the losses, the total drain on the economy over the period could be as much as 1.38 trillion yuan, said Zhu. Based on figures from China's National Bureau of Statistics, that would represent about 3.3 per cent of the country's total retail sales in 2019.

Car sales, fell by 20.5 per cent year on year in January, their largest monthly dip in 15 years, according to figures from the China Passenger Car Association. And sales in the first two weeks of February fell 92 per cent from the same period of 2019, mainly due to showroom closures. Over the whole of 2020, the coronavirus epidemic could cost China 1 million car sales, or about 5 per cent of its annual total, the industry group said. *"The falling consumption in the first quarter could knock down growth by three or four percentage points,"* Zhu said. "*We need a strong rebound, and that needs 10 times as much effort."*

Chen Wenling, chief economist at the China Centre for International Economic Exchanges, a Beijing-based think tank, said this week that even if national production returned to 80 per cent by the end of February, first-quarter growth would still be less than 4.5 per cent. By comparison, China's economy grew by 6.4 per cent in the first three months of 2019.

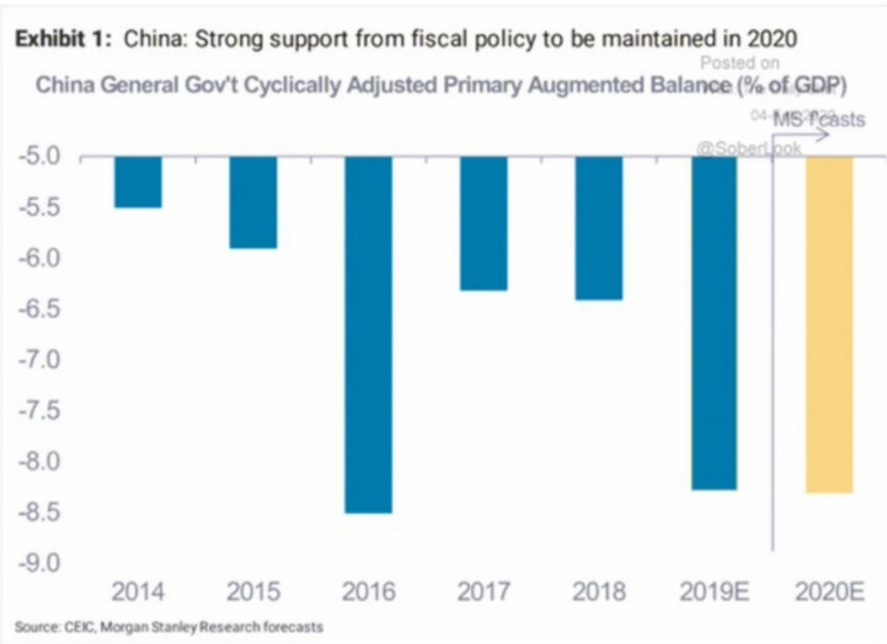
What to do? At Riyadh, Japan's answer was to call for increased government spending. Finance Minister Taro Aso called on G20 countries with 'fiscal space' (like Germany) to ramp up spending to help the global economy. *"I told the G20 ministers that the spread of the coronavirus epidemic … could have a serious effect on the global economy,"* Aso pointed out that Japan has deployed fiscal spending quite a bit, so wants other countries with fiscal room to do the same. This is ironic when it is realised that Japan's permanent annual budget deficits do not appear to have saved the economy from dropping into recession, even before the effects of COVID-19 epidemic hit.

But don't worry. Aso claimed that Japan continued to recovery moderately as a tight job market and rising household income offset some of the weaknesses in exports and output. "*At this stage, I don't think risks to Japan's economy have suddenly heightened sharply."* That *is* wishful thinking.

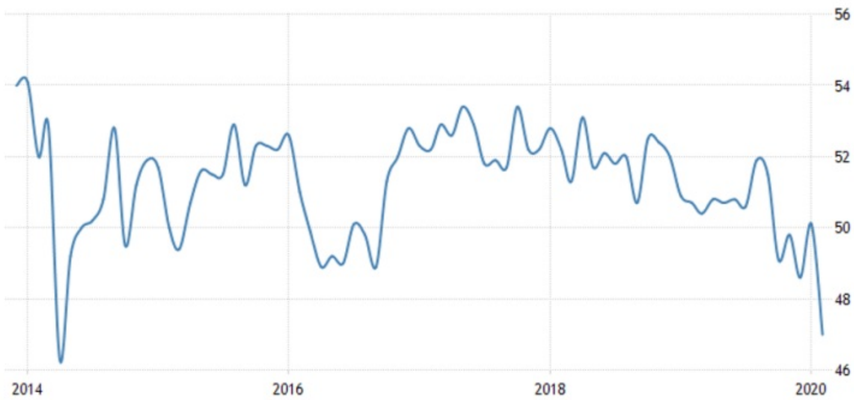
As I have argued in many posts before, fiscal stimulus is likely to have a negligible effect on achieving economic recovery once a slump sets in and the capitalist sector stops investing and consumers stop spending (as much). That's because government spending outside of welfare transfers is no more than 10% of most economies' GDP and government investment (as opposed to spending on public services) is no more than 3% of GDP compared to 15-20% of GDP invested by the capitalist sector. It will take a huge increase in government investment to have an effect.

Moreover, the ability and willingness of governments to resort to such huge fiscal injections are limited. Gavyn Davies in the FT is sceptical: *"the next global recession may result in a merging of what has traditionally been viewed as the two separate wings of macro policy, fiscal and monetary. It is a difficult question of political economy whether the central bank or the treasury is better placed to lead the design of an effective policy response in this environment. Japan has been in this position for several years and has so far failed to cut the Gordian knot. Policymakers in the US and Europe should be thinking well in advance about how they can co-operate both internationally and domestically to produce a better outcome. There is no sign of this happening yet."*

Perhaps only one country is capable to doing that. Given the size of the state sector and government control in China, a fiscal boost can have much more effect, as it did during the 2008-9 Great Recession, when China continued to grow while virtually every other economy went into a slump or slowed drastically. The Chinese government is ready to spend and invest big time to turn things round once the virus epidemic fades.



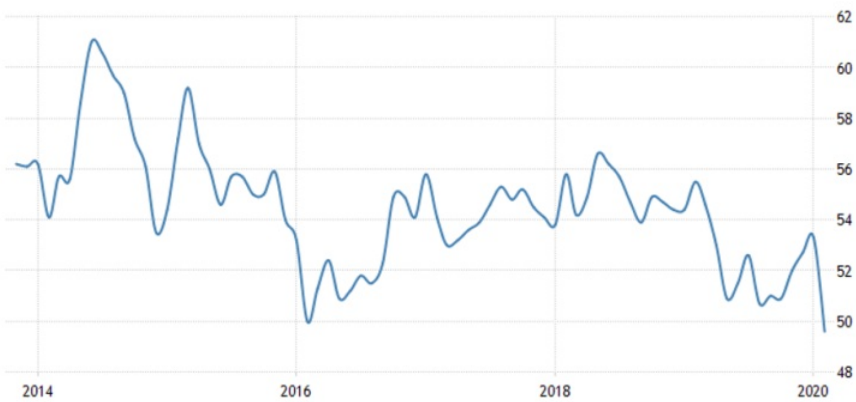
Even so, if China's growth slows sharply for a couple of quarters, that will only add to the woes of the major economies. The latest economic activity indexes for the major advanced capitalist economies make sombre reading. Japan's business activity indexes in February showed a significant fall below the stasis level of 50. Japan's manufacturing PMI dropped to 47.6 in February 2020 from 48.8 in the previous month. The latest reading was the steepest pace of contraction in the manufacturing sector since December 2012. And the services PMI declined to 46.7 in February from 51.0 in the previous month. This was the steepest contraction in the service sector since April 2014, So the overall index fell to 47.0 from 50.1 in January. Again, this was the steepest contraction in private sector activity since April 2014. Japan is clearly in a slump.



Eurozone private sector activity showed a slight improvement in February. The overall 'composite' PMI in the Euro Area increased to 51.6 in February from 51.3 in January. This slight improvement was due mainly to German manufacturing, which is still contracting – but at a slower pace. The Eurozone is still growing, but at a snail's pace.

The UK's manufacturing activity in February jumped into mildly positive territory, up to 51.9 from 50.0 in January. This was a ten-month high, which is not saying much as the index was over 55 three years ago. The services sector index weakened a little in February but still showed modest growth at 53.3. So the overall 'composite' index was unchanged at 53.3. That means the UK economy is growing but very modestly in the first quarter of 2020.

But the big shocker was the US. The US economic activity indicator went below 50, signalling a contraction in the economy for the first time since the PMI survey began in 2014. The overall 'composite' indicator fell to 49.6 in February from 53.3 in January. The manufacturing index also fell to 50.8 from 51.5 in January. But the real bad news was the fall in the larger services sector, which dropped to 49.4 from 53.4. It seems that the US is joining Japan and the Eurozone in stagnating or even contracting in Q1 2020, and China has yet to report on the full economic impact of the coronavirus outbreak.



Other G20 economies are also on the cusp. Australia's index was below 50 in February; South Africa too. We await data on the others.

In my last post on the nature and impact of COVID-19, I commented: *"it could be a trigger for a new economic slump because the world capitalist economy has slowed to near 'stall speed'. The US is growing at just 2% a year, Europe and Japan at just 1%; and the major so-called emerging economies of Brazil, Mexico, Turkey, Argentina, South Africa, and Russia are basically static. The huge economies of India and China have also slowed significantly in the last year and if China takes an economic hit from the disruption caused by 2019-nCoV, that could be a tipping point."*

Up to now, the world's stock markets have ignored this risk, convinced that zero or negative interest rates for borrowing and speculating would continue, thanks to the US Federal Reserve, and also in expecting the epidemic to dissipate by the end of this current quarter, so the 'business as usual' can be resumed. But with the outbreak picking up outside China and the likely slow economic recovery by China, the stock fantasists may be overoptimistic. And remember, global corporate profits are stagnant along with business investment, the main cause of the global slowdown.

As for the other issues discussed by the G20 ministers: climate change, inequality and tax havens, forget it. Nothing was agreed. For the first time, the final G20 communique included a reference to climate change *"to examine the implications of climate change on financial stability".* It was ok to worry about the impact on financial assets and stock markets, but the US vetoed any mention of the impact on the world economy and people.

Nothing happened on inequality because the European countries could not agree on a common tax strategy on global tax avoidance.