NAME: OGBAJE DAVID

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 QUESTION

The COVID-19 pandemic continues to ravage the world. Briefly assess the pandemic’s impacts on the global economy between December 2019 and April 2020. Basically both the intended and unintended consequences of the shutdowns, looking at the statistics of global financial institutions, for example, the IMF.

 IMPACT OF COVID-19 ON THE GLOBAL ECONOMY

 The current coronavirus situation is profoundly impacting all types of businesses. With temporary cessation of some businesses and activities slowing down for many, the consequences of the pandemic are even worse for the global economy than the ones following the Great Financial Crisis in 2007-2008.

 The first country to suffer from the impact of Covid-19 is China, the second largest economy worldwide. The drastic lockdown, which required a number of significant manufacturing companies and retail businesses to close or reduce their activities, has dreadfully slowed down the Chinese economy. According to the report by the China Enterprise Confederation (CEC) on March 6th, over 95 percent of the 299 large manufacturers surveyed have seen a revenue drop. In terms of consumption, compared to 2019, retail sales in January and February went down 20.5 per cent. Even though the consumption started to be impacted by the pandemic in January, all retail sales apart from necessities were frozen as of February for almost the full month.

 Fortunately, as China has been able to stop the spread of the virus, Chinese manufacturers have returned to full capacity. However, with the rest of the world going through a similar form of lockdown, the country's economy is undergoing a second hit with overseas market shutting down. Based on a paper from IMF economists, China will suffer from the cutback in global demand which accounts for 20 percent of the Chinese's economy.

 According to Fan Gang, one of China's top economists, we can expect a progressive recovery for China. Indeed, based on [a study from Cefuture](https://www.weibo.com/ttarticle/p/show?id=2309404481706731110481), a Chinese logistics and transportation consulting firm, 41 percent of citizens aim to reduce their spending as a precautionary measure for future unexpected events whereas only 8 per cent plan on shopping more after the outbreak. Although this could be worrying for businesses, the recovery of China still brings hope and optimism to the rest of the world where the situation is rapidly evolving, especially in Europe and the United States.

 In the United States for instance, with the quarantine measures continuously reducing economic activities, the economists of Morgan Stanley have predicted a drop of 30 per cent in consumption and a level of unemployment reaching approximately 12.8 per cent in the second quarter. Indeed, the impact of the pandemic cannot be taken lightly as it affects everyone. The travel industry is among the sectors suffering the hardest risks due to the travel restrictions implemented by governments worldwide.

 With the uncertainty lying behind COVID-19, we can expect the global market to be quite volatile with no global growth this year. According to the Organization for Economic Cooperation and Development (OECD), 2020 can see an estimated 2.4 per cent decline for the global economy before a growth of 3.3 per cent next year. Tom Rafferty, main economist for China at The Economist Intelligence Unit, suggests that, by next year, the global demand and supply should be back to normality. Indeed, to achieve this result, policymakers have been obliged to review policies

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in order to mitigate the severity of the impact, but the virus remains the last factor which will decide when each country can get back to its ordinariness. The pandemic will continue to disturb the global market therefore it is essential that we all work together to successfully get through this challenging time.

 THE CONSEQUENCES OF COVID-19 ON FINANCIAL INSTITUTIONS

 The COVID-19 pandemic has caused an unprecedented human and health crisis. The measures necessary to contain the virus have triggered an economic downturn. At this point, there is great uncertainty about its severity and length. The latest [Global Financial Stability Report](https://www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020) shows that the financial system has already felt a dramatic impact, and a further intensification of the crisis could affect global financial stability.

 Since the pandemic’s outbreak, prices of risk assets have fallen sharply. At the worst point of the recent selloff, risk assets suffered half or more of the declines they experienced in 2008 and 2009. For example, many equity markets in economies large and small have endured declines of 30 percent or more at the trough. Credit spreads have jumped, especially for lower-rated firms. Signs of stress have also emerged in major short-term funding markets, including the global market for U.S. dollars.

**Market strain**

 Volatility has spiked, in some cases to levels last seen during the global financial crisis, amid the uncertainty about the economic impact of the pandemic. With the spike in volatility, market liquidity has deteriorated significantly, including in markets traditionally seen as deep, like the U.S. Treasury market, contributing to abrupt asset price moves.

 To preserve the stability of the global financial system and support the global economy, central banks across the globe have been the first line of defense. Firstly, they have significantly eased monetary policy by cutting policy rates in the case of advanced economies to historic lows. And half of the central banks in emerging markets and lower income countries have also cut policy rates. The effects of rate cuts will be reinforced through central banks’ guidance about the future path of monetary policy and expanded asset purchase programs. Secondly, central banks have provided additional liquidity to the financial system, including through open market operations. Thirdly, a number of central banks have agreed to enhance the provision of U.S. dollar liquidity through swap line arrangements.

 And finally, central banks have reactivated programs used during the global financial crisis as well as launched a range of new broad-based programs, including to purchase riskier assets such as corporate bonds. By effectively stepping in as “buyers of last resort” in these markets and helping contain upward pressures on the cost of credit, central banks are ensuring that households and firms continue to have access to credit at an affordable price.

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 To date, central banks have announced plans to expand their provision of liquidity including through loans and asset purchases by at least $6 trillion and have indicated a readiness to do more if conditions warrant.

As a result of these actions aimed at containing the fallout from the pandemic, investor sentiment has stabilized in recent weeks. Strains in some markets have abated somewhat and risk asset prices have recovered a portion of their earlier declines. Sentiment continues to be fragile, however, and global financial conditions remain much tighter compared to the beginning of the year. The global spread of COVID-19 may require the imposition of tougher and longer-lasting containment measures actions that may lead to a further tightening of global financial conditions should they result in a more severe and prolonged downturn. Such a tightening may, in turn, expose financial vulnerabilities that have built in recent years in the environment of extremely low interest rates. This would further exacerbate the COVID-19 shock. For example, asset managers facing large outflows may be forced to sell into falling markets thus intensifying downward price moves. In addition, levered investors may face further margin calls and may be forced to unwind their portfolios; such financial deleveraging may aggravate selling pressures.

As firms become distressed and default rates climb higher, credit markets may come to a sudden stop, especially in risky segments like high yield, leveraged loan, and private debt markets. These markets have expanded rapidly since the global financial crisis, reaching $9 trillion globally, while borrowers’ credit quality, underwriting standards, and investor protections have weakened. Since early March, high-yield spreads have skyrocketed notwithstanding recent declines, particularly in the sectors most affected by the pandemic like air travel and energy. Similarly, leveraged loan prices have fallen sharply about half the drop seen during the global financial crisis at one point. As a result, ratings agencies have revised upward their speculative-grade default forecasts to recessionary levels, and market-implied defaults have also risen sharply.

Central banks will remain crucial to safeguarding the stability of global financial markets and maintaining the flow of credit to the economy. But this crisis is not simply about liquidity. It is primarily about solvency at a time when large segments of the global economy have come to a complete stop. As a result, fiscal policy has a vital role to play.

Together, monetary, fiscal, and financial policies should aim to cushion the impact of the COVID-19 shock and to ensure a steady, sustainable recovery once the pandemic is under control. Close, continuous international coordination will be essential to support vulnerable countries, to restore market confidence, and to contain financial stability risks. The IMF is ready to assert the full weight of its resources first, to help protect the world’s most vulnerable economies, and, for the long term, to strengthen the eventual recovery.

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