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V, U or L; what the recovery would look like? And beyond?

The global financial crisis (GFC) of 2008-09 landed the 'too big to fail' corporations seeking bail outs from the governments, the COVID-19 induced recession – I call it Great Economic Suspension crisis (GESC) – has all the making to test the resilience and fail-safe status of sovereigns.

Definitely, there is no price to save lives. To this end and to maintain the economic/financial architect functional, all developed countries have announced massive revenue and spending packages. However, the sum of costs coming from economic contraction and fiscal stimulus –in a period of approximately three months – is too high to be sustainable even for the developed economies, see Table 1. By the end of May 2020 (not the full economic cost of the [first phase] COVID-19 pandemic) the economic cost for the US is already amounting 2.9 trillion USD or 14.3% of their 2018 GDP figure. Largest stimulus deployment is seen in Japan i.e. 37.2% of the GDP, which is followed by France, Italy, Spain and the UK. For all of them the economic costs are above 18% of their respective GDP values.

The wide design, large outlay and fast interjections are aimed to protect the most-affected households, SMEs and sectors where economic activity was/is at halt so that economic contraction may not swamp people and firms that are central to the global recovery. With an optimistic expectation that coronavirus outbreak(s) are contained in the latter part of 2020, for having an effective vaccine in the earlier part of 2021, these fiscal stimulus are expected to keep financial markets stable and economies on a lifeline facilitating a rapid 'V-shaped' recovery in 2021. In this scenario, IMF financial monitor estimates that global outputs to rebound in 2021 at the rate of 5.8% lead by the growth in developed economies, see Figure 1.

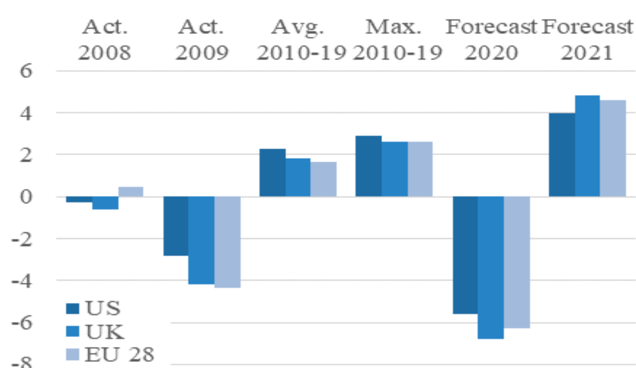
Table 1 Economic costs of lock down by April 2020 (in $bn.)

Country	*Gross figures*	*Percentage of GDP*
France	764	27.5%
Germany	138	3.5%
Greece	7	3.4%
Italy	531	25.5%
Japan	1,850	37.2%
Spain	*259*	*18.2%*
United Kingdom	*508*	*17.8%*
United States	*2,945*	*14.3%*

Source: Oxford University's coronavirus government response tracker and The World Banks database for GDP figures

Is this a likely scenario? The chances for such a scenario take a hit when World Health Organization's chief scientist cautions that it may take four to five years that COVID-19 pandemic is under control. This assessment requires no guessing about the increasing costliness of the GESC and its impact on global growth. Furthermore, there is historical baggage of debt overhang that may prove an additional drag on public finances and fast recovery. The stalled global growth has been a lingering issue. Only six months prior to the COVID-19 pandemic declaration by the WHO, European quantitative easing measures were reinstated, along with deposit rate cuts into negative territory, to stimulate the flagging Eurozone economy.

***Figure 1** Change in Real GDP (YoY%)*

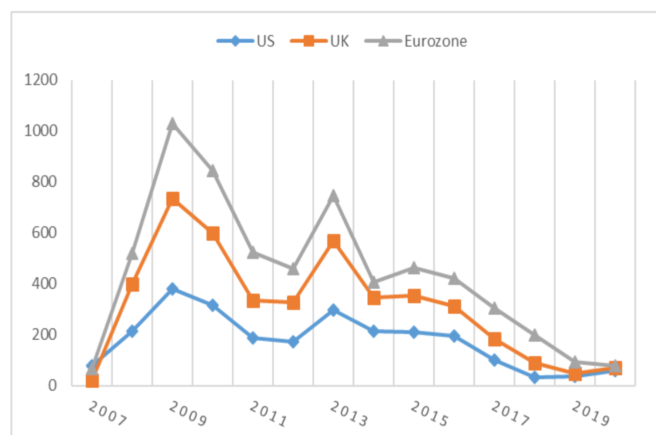


With the continuing tradition that recessions require monetary policy adjustments, the substantial interest rates cuts during GESC ring no bells. For the large expenses involved, central banks have slashed interest rates. As shown in Table 2, the expected interest rate levels for the EU-27, the UK and the US in 2020 are

estimated to be lower than what we witnessed during Global financial crisis (GFC) of 2008 and 2009. A similar story emerges, in Figure 2, when the yield spread of these economies are analysed.

Source: IMF fiscal monitor

Figure 2 Sovereign debt yield spread (10Y-3M)



Source: Bloomberg

The likely impact of continual in sub-zero or negative interest rates – in the worst case scenario – is reduced public spending and increased public savings. For long-term assessment, see here and in the ongoing episode see here.

Table 2 Yearly Central Bank Rate (%)

Country	*Act. 2008*	*Act. 2009*	*Avg. 2010-19*	*Max. 2010-19*	*Forecast 2020*
US	0.3	0.3	0.8	2.5	0.3
UK	2.0	0.5	0.5	0.8	0.1
EU 28	2.7	1.1	0.5	1.2	0.1

Source: Bloomberg

Table 3 Government Debt as percentage of GDP

Country	*Act. 2008*	*Act. 2009*	*Avg. 2010-19*	*Max. 2010-19*	*Forecast 2020*
France	68.8	83.0	93.1	98.5	115.4
Germany	65.5	73.0	72.6	82.4	68.7
Greece	109.4	126.7	170.3	184.8	200.8
Italy	106.14	116.59	129.4	135.35	155.54
Japan	183.28	200.88	227.56	237.38	251.91
Portugal	75.643	87.799	120.37	132.94	134.95
Spain	39.712	53.261	86.955	100.7	113.42
United Kingdom	49.371	63.312	82.053	86.923	95.727
United States	73.701	86.744	102.56	108.98	131.07
Advanced G-20	84.703	99.058	110.43	114.21	131.77
Emerging G-20	35.631	40.558	43.468	54.179	63.26

Source: IMF database

Protracted fiscal spending and reduced demand amid ebbing consumer confidence and spending will weigh heavily on government finances. To the extent that there might be impending solvency issues and unemployment rates might stay high for an extended period leaving profound economic marks.

On the top of this, other impending issue has been the increasing indebtedness of the global economies. Table 3 shows that the debt accumulation (as % of their GDP) in the developed economies have only increased since GFC. In most cases the forecast for 2020 is substantially higher than what has been recorded for was witnessed in 2008 and 2009. Resorting back to Figure 1, in more ways, the debt overhang has contributed to the anaemic global growth post GFC: the average (maximum) GDP growth remained around 2% (3%) for the EU-28, the UK and the US.

To cater the increasing public expenditure, as interest rates are expected to remain low, developed economies debt accumulation is larger and faster relative to the unprecedented debt accumulation during the period of 2010-19. For all the countries the sovereign issues in the first five months of 2020 have approached or exceeded the average issues during 2010-19, see Table 4. In the case of Japan and the US, the new debt issues are already

1.5x and 3.5x more than the last 10 year average issues. This is an ominous situation: in the absence of growth and increasing public debts, if the COVID-19 risk goes beyond 2020, there will be further ballooning of public finances and debt/GDP ratios.

Therefore, the continuation of fiscal stimulus with debt overhang only exacerbates the potential risks for the desired fast recovery after the economic shutdown.

Table 4 Government bond issues 2007-2020 (in $bn.)

Country	*Act. 2008*	*Act. 2009*	*Avg. 2010-19*	*Max. 2010-19*	*May 2020*
France	29.7	65.2	207.9	267.4	197.1
Germany	34.0	0.3	166.5	267.2	211.4
Greece	0.0	0.0	22.4	170.9	16.9
Italy	41.5	85.4	187.2	350.5	202.5
Japan	181.9	272.1	912.0	1296.5	1360.6
Spain	24.9	31.0	103.7	156.2	132.4
United Kingdom	59.9	222.1	149.2	191.3	142.7
United States	70.9	178.1	1548.7	5072.5	5451.2

In current circumstances when interest rates hover around zero and global growth is anaemic, there is a strong possibility that a debt spiral in the developed markets is in the making: loans offered to businesses during the ongoing pandemic crisis are mainly state-guaranteed credit. This only asks an in-the-face type of question: is the ongoing humongous debt shopping spree is making of a profounder debt crisis – in scale and depth – in the developed economies? Whether, the rampant sovereign debt issues are preparation for a persisting lockdown scenarios or are only to fortify to not to let the system fall apart, the answers do not change: how to retire/service prior debts amid falling revenues and how much of the fiscal support will be sustainable for the sovereigns while ravishing on low cost of debt. That is, the fiscal challenges for the developed economies are here to stay. Implying that the anticipated V-recovery would at best be U-shaped if not L.

To resolve the ever increasing globe debt issues, there might be a déjà vu solution: increased state presence in the corporations by replacing debt by equity stakes. This will be only part of the full resolution of the problem. The full answer to deal with increasing sovereign debt levels has two paths. The German way or the Japanese way.

The German debt are still manageable (see Table 3), however, there has been ample evidence that austerity measures compromise growth. Nonetheless, rationale is simple and directed. We need to ask, do we want to limit increasing debt levels or can pile up debt levels to usher growth –at precisely the time when it is most needed. For the latter, Japan's substantial debt levels – the largest in the developed world – can help introspection if it is not the right answer when their debt levels have been on the rise for more than two decades. The bond yields on Japanese debt have been negative for long and growth in this model have been quashed by deflation. Not to mention ageing and reduced savings have been other issues in this pathway.

Both roads are tricky when after more than a decade of austerity measures, masses will have little interest and patience of another long haul of it. Whereas the spending route has its fault lines – persisting with an increased global indebtedness will only a ticking bomb to explode and may land us into an even deeper recession. In that scenario even U may be an optimistic possibility and the recovery may look like an L – a Japanese recovery. Paving a way forward from the cross-roads of these two pathways is needed for a global reset. Obviously, when the latest expensive round of fiscal spending is not to boost demand or growth, there is a limit to accumulating debt and with inflating debt overhang the risk levels will be on the rise as the government providing relief is no free money and is essentially a heavy borrowing from the future.

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