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COVID-19's Economic Fallout: The Logic of Pump Priming

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SYNOPSIS

The COVID-19 outbreak is affecting regional economies. To cope with grim growth prospects, governments are leaning on fiscal stimulus to weather the crisis. Such policy measures will largely be determined by politics as different sectors compete for limited resources.

COMMENTARY

THE OUTBREAK of the novel Coronavirus or COVID-19 reportedly started in December 2019 in Wuhan, the capital of Hubei province, China. On 30 January 2020, the World Health Organisation (WHO) declared it as a "Public Health Emergency of International Concern."

While its fatality rate is around 2%, which is much lower than that of Severe Acute Respiratory Syndrome (SARS), COVID-19 has been more infectious than SARS. At the time of this writing, WHO reports more than 87,000 confirmed cases and almost 3,000 deaths.

Economic Fallout

The Chinese economy has been hit hard by COVID-19. One expert at the International Monetary Fund (IMF) estimated that the virus would cost China as much as $196 billion from January to February 2020.

The economic fallout has also been felt by other countries, especially those relying on foreign demand and are well-integrated into the global supply chains. For example, there is a reported 25-30% decline of tourists and business travels in Singapore. The Ministry of Trade and Industry cut Singapore's growth outlook from between 0.5 and 2.5% to minus 0.5 to 1.5%, suggesting that its economy risks heading towards a recession.

Bank of Thailand cut down this year's growth from 3.3% to 2.8% amidst the virus scare. South Korea, the country which has been experiencing a rapid surge of cases to more than 800, reported a decline in domestic consumption and exports to China.

Seoul is bracing for more impacts as the infection in the country worsens. As for Japan, the world's third-largest economy already weakened by the sales tax hike last year, several experts predicted that its GDP would plunge 0.25% this quarter, increasing the risk of a recession.

So far, no world leader or international body has issued effective reassurances. For instance, the IMF head Kristalina Georgieva remarked at the recent G-20 Meeting in Saudi Arabia that the outbreak slashed about 0.1 percentage points from the world's economic growth. Although the Fund anticipated a V-shaped recovery, the IMF chief warned governments that they should "prepare for more adverse scenarios."

Government Responses

As COVID-19 has already afflicted several economies across the globe, and the end is still unknown, one pressing economic question stands out front and centre: "How would countries cope?"

Central banks in some Asian countries are seeking to loosen their monetary policy while several governments rolled out their fiscal stimulus packages to prop up their economies. For example, the Bank of Thailand lowered the benchmark rate by 25 basis points to make the historically low rate of 1%.

Malaysia announced its fiscal stimulus on 27 February 2020 and expected to unveil a RM20 billion (US$6.6 billion) package to mitigate the adverse effects of COVID-19 on its economy.

Likewise, the Singapore authorities announced that they have set aside $4 billion to be injected into the economy to manage the impact of COVID-19 on businesses and households. As for Indonesia, Southeast Asia's biggest economy, several ministries are on their way to implementing fiscal stimulus following President Joko Widodo's earlier call to cushion the economy from the effects of COVID-19.

Political Economy of Fiscal Policymaking

Going forward, many countries will tend to rely more on fiscal policy rather than the monetary one. Although loosening monetary policy is necessary as it sends clear signals to the market that the government is striving to make the economy buoyant, such decreased interest rates alone will likely be insufficient to boost business confidence or convince companies to invest again.

It is because this global contagion has exacerbated uncertainties in the world economy, tempting investors to reassess risks and companies to adopt a wait-and-see approach.

Therefore, hopes are on the effects of fiscal stimulus on the economy. These policies can be tailored to help specific sectors such as retail, tourism, or other segments which are hard hit by the COVID-19 outbreak. In short, Asia will soon witness increased fiscal expansion. If the crisis escalates, larger such packages are most likely.

It is too soon to gauge exactly the details of these fiscal stimulus policies. Yet, the study of Political Economy can be a useful tool to help us think about how the packages will look like.

Since several ways exist to design policies to stimulate the economy, Political Economy reminds us that politics largely determine policy outcomes. As policies usually generate different impacts on different segments in the economy, such distribution effects beget losers and winners. These players in turn lobby the authorities to craft policy measures to fulfill their needs and interests.

The Logic of Fiscal Stimulus

These same logics can be applied to the fiscal stimulus packages coined or about to be coined by Asian governments. Expect fierce lobbying from different firms and sectors as they bid for limited resources.

For instance, tourism companies may press the governments to help them find other markets for tourists beyond China. Some manufacturing firms scrambling to adjust their supply chains to be less reliant on Beijing may knock on the authorities' doors and plead for their assistance.

Import-competing industries see the virus situation as an excellent opportunity for them to convince their governments to strengthen the industrial policy to support them instead of exporters. In some countries, small and medium enterprises may collectively persuade the governments to help them as they are the backbone of the economy and contribute to the significant portion of domestic employment.

Now is a crucial time to observe how the governments would respond via fiscal policies which could consequently shape the future development of international trade and investment ties. While it is too early to predict these matters in precise terms, the discipline of Political Economy can help us roughly assess how policies will likely turn out to be.

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