

ECONOMICS FOR ALL

SG Economic and Sector Research

How will the recovery from Covid-19 shape up?

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The game? Choose a letter: V, U, W, L, or the Nike swoosh. The goal? Describe the shape the economic recovery will take once the COVID-19 pandemic is under control. Will it be rapid, delayed, bumpy, slow, or nearly non-existent? Will the economy return to its pre-pandemic levels of activity and if so, how long will it take? Clearly, prospects remain marked by major uncertainties given that the evolution of the health crisis will largely determine the profile of the economic recovery. But we must consider the long-term negative effects of the crisis (bankruptcies, structural unemployment, record debt levels, etc.).

The COVID-19 pandemic and the measures taken to contain it have plunged the global economy into a recession without precedent in modern economic history, in terms of its intensity and suddenness, as well as its global dimension. Which leads to the question now on everyone's lips: what shape will the economic recover take once the health crisis has passed?

Possible recovery scenarios for the economy

We can imagine several possible recovery scenarios based on two key parameters: 1) the duration of the pandemic and 2) the nature of the recovery:

- The most optimistic economists are betting on a “V-shaped” recovery, a rapid upswing after the collapse of the economy, with a return to a near pre-crisis level of activity once the lockdown measures are lifted.
- Some are betting on the “U-shaped” scenario in which GDP would remain very low for a certain period (prolongation of social distancing rules, difficulties of deeply impacted sectors such as tourism to resume activity) before recovery.
- Others see a “W” or a double-dip recession: after an upswing amid lockdown relaxation, a second wave of infections intervenes, imposing a new tightening of restrictions and a new blow to the economy.
- The most pessimistic anticipate an “L-shaped” scenario: a nearly non-existent recovery after the headlong collapse of the economy, which will then enter a period of secular stagnation.
- Yet others think that the recovery will take on the shape of the Nike brand's famous inverted comma logo, representing a gradual improvement in the economy that will take several years to return to its pre-pandemic levels.

Long-term damage to growth prospects

As the last leading economic indicators show, **wherever lockdown measures have been lifted or eased, the historic plunge in economic activity has given way to a sharp slowdown in economic contraction**, helped by massive public aid, the enormous expansion of liquidity injected by central banks and the release of deferred demand accumulated during the lockdown (“pent-up demand”). This would seem to point in favour of a V-shaped scenario.

However, **many arguments do not support a lasting upturn and a rapid return to pre-crisis activity levels:**

- **The unusually high degree of uncertainty in the current crisis.** Uncertainties remain high concerning the evolution of this pandemic and the capacity of researchers to develop a treatment or vaccine. However, the evolution of the health situation around the world will determine the profile of the economic recovery.
- **The global dimension of the crisis.** The crisis is affecting all countries at the same time, including the leading global economies, notably the United States and China which remain the world's economic engines.
- **Cascading bankruptcies.** For thousands of companies, the shutdown of production sites and the loss of income mean that their debt levels will become unsustainable, especially since too many of them have based their recent growth on the recourse to debt.
- **The restructuring of global supply chains.** To guard against supply disruptions, many companies in advanced countries will relocate their supplies, accentuating a trend that was already visible in the industry, at the cost, however, of increasing their production costs. The relocation trend will accelerate the pace of automation, putting downward pressure on wages.
- **The degradation of human capital.** Workers who find themselves unemployed during a recession may be impacted for life. They gradually lose their expertise, and their skills can quickly become obsolete, especially at a time when new information and communication technologies are rapidly developing. Their productivity, and therefore their employability, declines. And a cyclical rise in the unemployment rate then turns into structural unemployment (hysteresis effects). Moreover, a high unemployment rate can discourage unemployed people from seeking new jobs and encourage them to leave the workforce.
- **The likely increase in the risk aversion of both households and companies, and the resulting shock to demand.** In a situation of radical uncertainty, saving and investment behaviours may be marked by greater caution, with a rise in precautionary savings and the downward revision of consumption prospects for households and, in a context of sluggish demand, the cancellation or the postponement of investment projects for companies, especially if they have to deleverage. This threatens to translate into insufficient global demand.
- **The sharp rise in public debt to levels never before seen.**

Entering the “New Normal”?

History has taught us that severe recessions leave deep scars on the economy, having lasting effects on the level and rate of growth of potential production. After a temporary upswing thanks to the relaxation of restrictions, a string of bankruptcies, mass unemployment, hysteresis effects and record debt foreshadow sluggish and bumpy growth. **COVID-19 could well foster a New Normal for the world economy, with a prolonged period of low growth.**

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