

Strategy & Corporate Finance Practice

# An instant economic crisis: How deep and how long?

Analysis of a range of economic data tracks the worsening effects of the pandemic in the West—and the cautious reopening of social and economic life in China.

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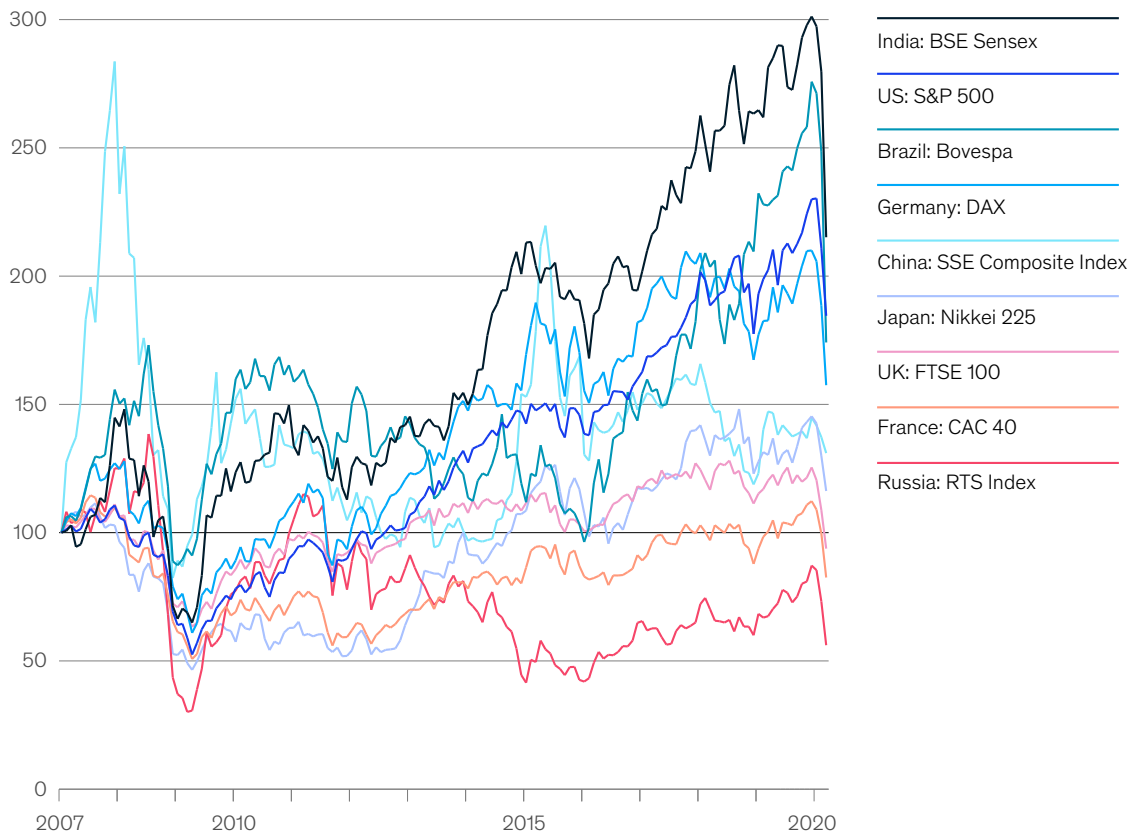
**The human tragedy of the COVID-19 pandemic** continues to deepen, with the heaviest toll now seen in Europe and the United States. Although testing remains limited, the number of confirmed cases of the virus worldwide has exceeded 1 million, and more than 70,000 have died. The United States, Italy, and Spain have the most confirmed cases and highest death tolls. Hundreds have died in each of the past several days in Britain and France. Healthcare systems in these relatively wealthy countries are strained beyond capacities, with shortages of protective equipment for health workers and ventilators for afflicted patients contributing to infection and mortality rates. Data from China suggest that the outbreak has been largely contained there; the government is cautiously reopening economic activity but is wary of the potential for new cases.

The restrictions applied to populations to stop the spread of the virus—including quarantines, stay-at-home orders, business closures, and travel prohibitions—have produced massive fallout for the world economy. The data to measure these effects are still arriving; available indicators reveal conditions have dramatically darkened since February. An early arresting statistic was that 3.3 million Americans applied for unemployment benefits in the week ending on March 21. The following week, 6.6 million applied. Until these two shocking totals were triggered by this crisis, the highest number of unemployment applications ever received in one week was 695,000 (in 1982). Around the world, stock markets lost approximately one-third of their values between February 20 and the end of March (Exhibits 1 and 2).

Exhibit 1

## **Equity markets plunged in March as fear of recession drove investors to safe havens; most exchanges lost around one-third of their values.**

**Equity markets by country, index (2007 = 100)**

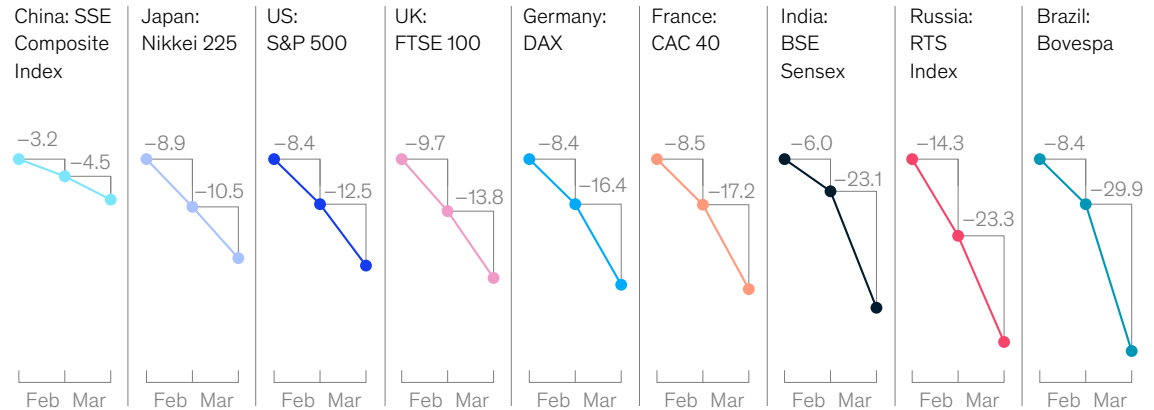


Source: Haver Analytics; McKinsey analysis

## Exhibit 2

### In China, where the pandemic has subsided, equity markets have suffered less in recent weeks.

Equity market in Feb and Mar 2020 by country, % change



Source: Haver Analytics; McKinsey analysis

### East and West—yesterday and today

The reality today is that the Chinese economy has begun to reopen as the West shuts down. The most recent edition of McKinsey's Global Economics Intelligence (GEI), released to subscribers on March 31, reveals the damage the Chinese economy experienced in January and February, when it was at the center of the outbreak.<sup>1</sup> Forward-looking indicators for manufacturing and services fell to unprecedented lows; exports contracted 17 percent compared with those in 2019. For Europe and the United States, the data were still largely positive in advance of the coming storm. In Europe, a moderate pickup in growth experienced early in 2020 has since been stopped in its tracks, as large employers curtail operations and lay off workers. Indicators for India presented in the GEI report were largely positive as well, but they are set to fall steeply, as the entire nation has been under a stay-at-home order since March 25.

Alongside the steps taken to stop the spread of the virus, governments and central banks intervened in economic life with mitigating measures of increasing force. The financial markets responded

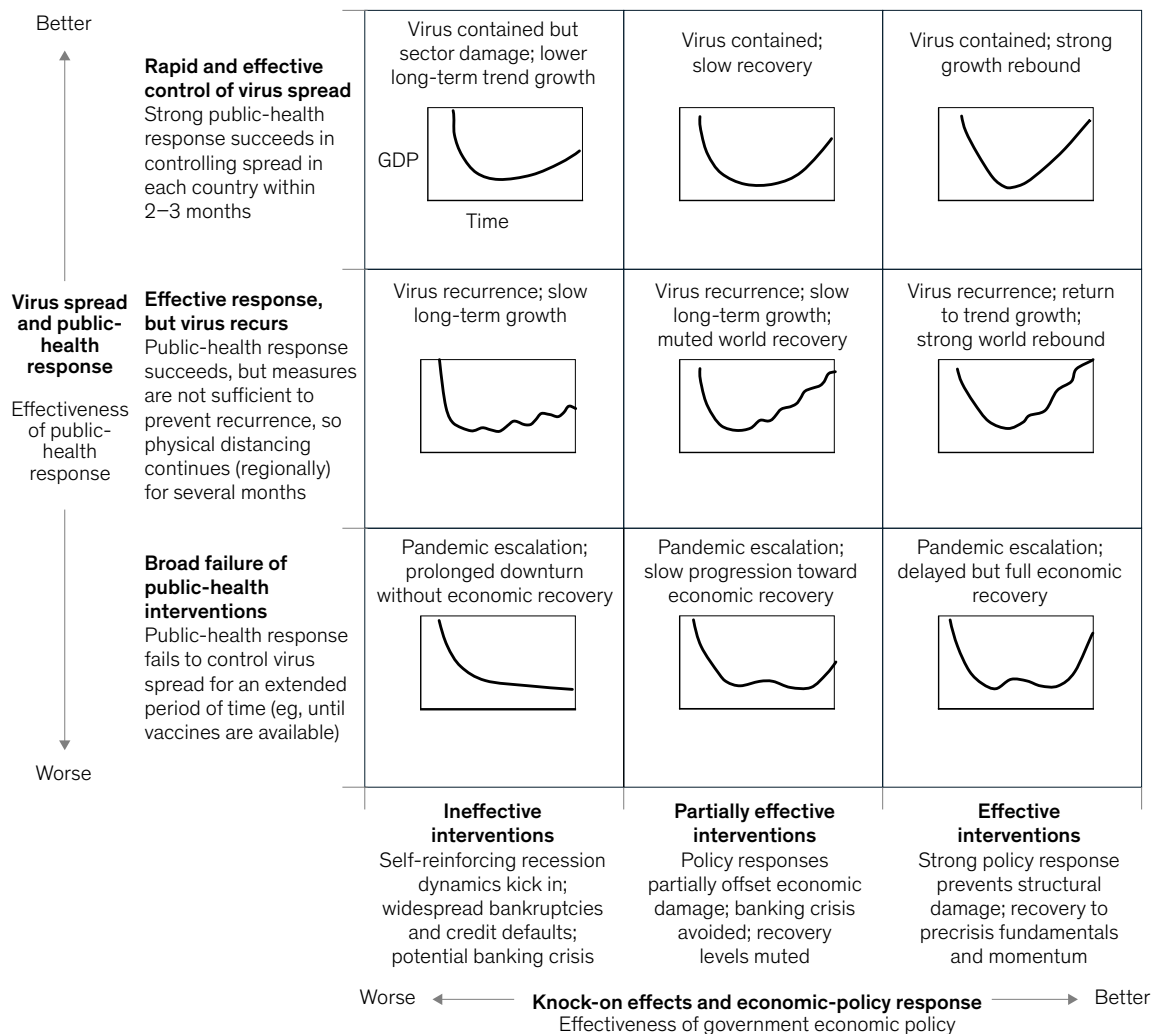
positively but remain unusually sensitive to fluctuating medical and political developments. Among the enormous relief programs being enacted to sustain companies and citizens during the lockdowns, the largest of the large is the US stimulus package, valued at more than \$2 trillion. The European Central Bank (ECB) announced €870 billion in quantitative easing; in an effort to forestall a credit crunch, ECB has also prohibited eurozone banks from paying dividends to investors or buying back shares until later in 2020. The European Parliament released €37 billion to support small and medium-size enterprises (SMEs) and the healthcare sector. The People's Bank of China has taken steps to supply the banking system with an additional 550 billion renminbi (around \$78 billion) in liquidity. The US Federal Reserve Board brought its policy rate near zero (0.00 to 0.25 percent) and announced \$700 billion in quantitative easing.

Amid the fast-moving pandemic and the policy responses, economic forecasting has become an unusually uncertain enterprise. The Organisation for Economic Co-operation and Development, for example, canceled the March release of its forward-

<sup>1</sup> McKinsey's Global Economics Intelligence (GEI) is a joint project of the firm's Strategy & Corporate Finance Practice and the McKinsey Global Institute. GEI provides free monthly macroeconomic data and analysis of the world economy to email subscribers. To add a name to the subscriber list, go to [Broadcast.McKinsey.com/51/1043/landing-pages/gei.asp](https://Broadcast.McKinsey.com/51/1043/landing-pages/gei.asp). The authors wish to thank Richard Bucci, Samuel Cudre, Debadrita Dhara, Eduardo Doryan, Adrian Grad, Ryan Luby, Tomasz Matczynski, Moira Pierce, Raye Qin, Jose Maria Quiros, Erik Rong, and Maricruz Vargas for their contributions to making GEI possible.

## Scenarios for the economic impact of the COVID-19 crisis

### GDP impact of COVID-19 spread, public-health response, and economic policies



looking composite leading indicator. Forecasts in this period must be looked upon with robust skepticism. Moody's Investors Service, one of the most respected forecasting agencies, cut its 2020 GDP-growth estimate for India to 5.3 percent on March 17 because of the expected effects of the pandemic. Ten days later, it cut the estimate to 2.5 percent.<sup>2</sup> The McKinsey Global Institute has taken a different approach, developing scenarios that help conceptualize the course of the pandemic and potential paths to public-health and economic recovery (Exhibit 3). The scenarios consolidate assumptions into a range

of estimates of the GDP impact of lockdowns on consumption and economic activity.

### From expansion to contraction and back again?

The logarithmic progressions of new COVID-19 cases indicate that the curves in the East (China and South Korea) are now essentially flat. The curves are flattening in Iran, reaching an apex in Western Europe, and yet climbing in the United States.<sup>3</sup> The course of the pandemic and the human tragedy it is

<sup>2</sup> McKinsey's own cautiously advanced estimates of the effect of the coronavirus on GDP growth, undertaken with Oxford Economics, suggest a global slowdown (from a preoutbreak consensus of 2.5 percent) to 2.0 percent growth in a quick-recovery scenario and 1.0 to 1.5 percent growth in a global-slowdown scenario. In 2020, growth could slow to 1.34 or 0.45 percent (from 1.75 percent) in the United States, to 1.68 or 0.75 percent (from 1.84 percent) in Europe, and to 4.68 or 3.82 percent (from 6.00 percent) in China. Matt Craven, Linda Liu, Mihir Mysore, Shubham Singhal, Sven Smit, and Matt Wilson, "COVID-19: Implications for business," March 2020, McKinsey.com.

<sup>3</sup> "COVID-19 coronavirus pandemic," Worldometer, April 3, 2020, worldometers.info.

# Measures to limit the pandemic's deadliness will remain in effect in many countries for weeks to come. Economic recovery can only follow the recovery of public health.

causing are far from exhausted. Measures to limit its deadliness will remain in effect in many countries, including in Europe and North America, for weeks to come. Economic recovery can only follow the recovery of public health. The March GEI report, coupled with subsequently released economic data, does, however, suggest a pattern—yet embryonic and fragile—toward that recovery.

The global Purchasing Managers Indexes (PMIs) for February (released in March) mainly reflected the preoutbreak economy. PMI readings above 50 indicate expanding manufacturing or services activity; those below 50 indicate contraction. February PMIs in China revealed dramatic contractions. Services are especially hard hit by quarantines and physical-distancing measures. In China, an expansionary reading in the Caixin Global services PMI of 51.8 in January went into free fall, bottoming out at 26.5 in February—the lowest reading in the history of that indicator.

Readings for March in China's official PMIs (a different index) show, however, a significant recovery in both manufacturing (52.0 in March, from 35.7 in February) and services (52.3 in March, from 29.6 in February). As the Chinese economy hopefully climbs out of the COVID-19 hole, the US and eurozone economies are still descending into it. Recently released IHS Markit PMIs for the United States show a moderate contraction in manufacturing (48.5) and a historic fall in services, to 39.1 (from 49.5 in February). A similar pattern is observed in the eurozone, with the manufacturing PMI retreating from 49.2 in February to 44.5 in March and the services PMI falling disastrously, from 52.6 in February to a never-before-seen 28.4 in March.

The time delay for trade data is longer than for the PMIs. The most recent readings from some indicators are based on data for January, when trade momentum (imports plus exports) was slowing moderately in most surveyed economies. The CPB World Trade Monitor showed that trade volumes shrank in January (–1.2 percent), after rising in December (+0.4 percent). The Container Throughput Index, which measures traffic in most major ports globally, fell 10 percent in February (to 102.5, from 113.4 in January). The reading aligns with reports of subdued activity in US Pacific ports and suggests the disruption in US–China trade caused by COVID-19.

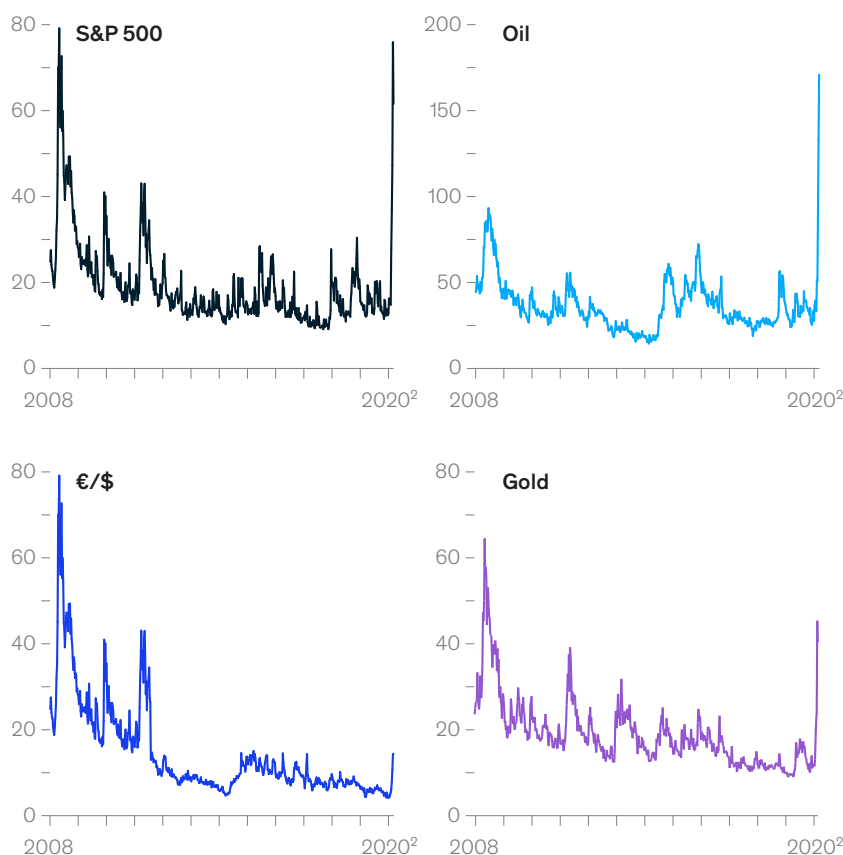
Preoutbreak inflation indicators (for February) showed easing prices for both consumers and producers in advanced and developing economies. Commodity price indexes provide more recent data, showing prices falling in March, especially in the energy sector. Oil prices have plunged below \$25 (Brent). The steep fall was precipitated by two coinciding events: Russian–Saudi competition ramped up production just as pandemic-fighting restrictions on movement depressed demand. Inflation expectations, as expressed in the yield spread between US Treasury inflation-protected securities (TIPs) and Treasury bills of the same maturity, have fallen because of the falling commodity prices and rising fears of recession. The euro and the yen gained in March against the US dollar, while other major currencies depreciated significantly.

The price of gold was volatile in March, lately rising above \$1,600. Volatility indexes have generally spiked, hitting readings not seen since the financial crisis of 2008–09 (Exhibit 4). Yields on government

Exhibit 4

**Volatility indexes have generally spiked, hitting readings not seen since the financial crisis of 2008–09.**

**Selection of volatility indexes<sup>1</sup>**



<sup>1</sup>S&P 500: S&P 500 Index Option Volatility Index; €/€: CBOE Euro Currency Volatility Index; oil: CBOE Crude Oil Volatility Index based on US Oil Fund option prices; gold: CBOE Gold Volatility Index based on SPDR Gold Shares options.

<sup>2</sup>Updated through Mar 24, 2020.

Source: CBOE; McKinsey analysis

bonds, meanwhile, rose significantly in March in most surveyed economies, especially those of Brazil and Italy.

### **Economic intervention**

Governments and central banks have scrambled to apply accommodative monetary policies and assemble stimulus packages to sustain businesses and individuals during lockdown periods. China's policy response was initially modest. In mid-March, the People's Bank of China released financial institutions from liquidity requirements totaling 550 billion renminbi. Reports of a March 25 Politburo meeting suggest that fiscal-deficit limits will be

lifted and national and local bond sales increased. In Europe and the United States, the policy measures have already been clearly described.

### **The United States**

The US Congress came together to pass a stimulus package of unprecedented size, with provisions to support businesses and individuals. Around \$500 billion is aimed at aiding citizens. Adult Americans making less than \$75,000 per year will receive a single payment of \$1,200. The sum will be higher for those with children and lower for those with higher incomes. The package also expands unemployment benefits, lengthening coverage for up to 39 weeks and supplementing state payments

with a weekly federal payment of \$600. Previously ineligible workers, such as part-time workers and freelancers, will become eligible. Some requirements on retirement funds and student loans are to be relaxed.

To businesses large and small, \$867 billion is to be provided. Cargo and passenger airlines will receive an additional \$58 billion support package, with the stipulation that no employees are laid off before September 30. Aircraft manufacturers could receive support under a separate national-security provision. For industries, a \$500 billion liquidity fund has been set aside. The US Small Business Administration will administer a fund of \$350 billion to provide SMEs with partly forgivable loans on favorable terms for payroll, rent, mortgage, and utilities. Hospitals are to receive \$100 billion and state and local governments \$150 billion in aid.

The stimulus came on top of attempts by the US Federal Reserve to bolster crumbling financial markets. The efforts included an announced \$700 billion quantitative-easing program and two policy-rate cuts, on March 3 and 15, which brought the effective rate to zero. A measure of investor confidence did not return, however, until the passage of the stimulus. The S&P 500, for example, climbed 15 percent in the final week of March.

### The European Union

For many weeks, Western Europe has been at the center of the crisis. In response to the economic fallout of the pandemic, ECB announced two quantitative-easing packages in succession, the first worth €120 billion and the second totaling €750 billion. Speaking of this unprecedented intervention, ECB president Christine Lagarde stated, "There are no limits to our commitment to the euro." The European Union announced the Coronavirus Response Investment Initiative, which is to provide €37 billion in liquidity relief to SMEs and

the healthcare sector. The European Commission proposed softening fiscal rules, including increasing limits for state aid to companies affected by the crisis to as much as €800,000 per undertaking in direct grants.

The European Commission also created a strategic stockpile of medical equipment, including respirators and medical masks, and launched a joint public-procurement program to alleviate the shortage of medical supplies within the European Union. Along with the response by central European Union and eurozone authorities, individual member states have also implemented their own fiscal measures in an effort to stabilize the markets and assist companies and workers in coping with the drop in the demand for work.

### Toward the return

In recent weeks, restrictions on movement and travel have been tentatively relaxed in China, as the number of new infections drops toward zero. Millions of migrant workers are returning to the country's major cities, and workplaces are restarting operations. Employees are temperature tested when they come to work and must show a green national-health-code designation. Most receive this information as a QR code on a mobile platform designed by Alipay. A green tag indicates good health; yellow and red tags require one- and two-week quarantines, respectively. Evidence indicates that these rules are strictly enforced and that life, even in Wuhan, has begun returning to a semblance of normal.

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The experience in China offers important lessons for nations still grappling with this grave public-health crisis—both in the rapid, forceful containment of the outbreak and in the careful reopening of social and economic life.

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