COVID-19: A Bumpy Road Ahead

Dr. Jérôme Haegeli

Group Chief Economist, Swiss Re

None of us have ever experienced anything remotely similar to the ongoing situation, not even post-war generations. We are not in the midst of a «simple» financial market crash, but rather a real economic and humanitarian crisis. Many governments globally are facing a unique health crisis which has seen no borders. Combatting it has meant taking into account a deliberate, difficult and delicate trade-off between public health and economic growth. The strict containment measures have put companies under strain through severely stressed cash flows as well as mounting levels of debt.

Historically, periods of instability and disruption have brought nations together. The 1944 Bretton Woods system, created at the height of the Second World War, was a big step for globalisation by preventing competitive devaluations of currencies and by promoting international economic growth. Another more recent example was the coordination between the Group of 20 in the face of uncertainty after the Global Financial Crisis (GFC). The ongoing cost of climate change as well as the looming intensification in the absence of strict measures resulted in an increase of global cooperation. This includes the Sustainable Development Goals that were adopted by all UN member states and the Paris Agreement which sees nearly every nation stand together against climate change. More recently, however, the rise of protectionism is threatening such global agreements. Last year's official announcement about the US pulling out of the Paris Agreement a day after the 2020 presidential elections casts a large shadow on wide-scale cooperation. Climate change, however, is more than a temporary threat to the environment, the economy, and society. Climate change is here to stay and continues to intensify. The 1.5°C goal under the Paris Agreement is rapidly slipping out of reach, with emissions still on the rise.[1] Despite this, it remains our common responsibility to increase our efforts in preventing further damage and to adapt to the already changing environment.

Virus outbreaks and natural disasters have been recurring themes since long before our civilisation became what it is today, but times are changing. Virus outbreaks are turning into pandemics more quickly as a result of urbanisation and globalisation.

1 In 2018, emissions have risen to a new high of 55.3 gigatonnes of CO2 equivalent. Emissions Gap Report 2019, UN environment programme, November 2019

The frequency of natural disasters, assuming we can still call them «natural», is increasing as a result of the changing climate due to the interactions humans have (had) with our planet. If we want to prevent future pandemics and other environmental and social catastrophes, we need to revise how our society is set up. Doing so would take decades if not centuries. This is a matter of urgency though, and a more immediate solution is needed. One such solution is for the world to become more resilient which will only be achieved if nations, institutions and corporations come together and work towards to a common goal: to reduce risks and minimise their impact across all players of the economy. A retreat away from globalisation is by no means a solution. Thanks to the medical advances seen in the last century, COVID-19 will end up being a temporary, albeit painful disruption. However, other themes such as climate change will remain at the forefront of global dialogues on a continuous basis and will not be resolved anytime soon. As the links between climate change, the business world and the economy are becoming increasingly evident, climate governance practices should assume a prominent role in corporate and investment planning as well as in economic policy. The World Economic Forum (WEF) released a set of eight guiding principles to help Boards navigate the complex issue that climate change represents. The phenomenon is already present in discussions surrounding risks and opportunities (especially within the re/insurance industry), however, the associated scientific, macroeconomic and policy uncertainties that come with it are not adequately addressed by general governance guidance.[2]

Global stability is also under threat from the extremely high levels of debt. Debt accumulation has demonstrated cyclicality over the last 50 years with the latest debt accumulation underway since the end of the GFC. The global debt-to-GDP ratio reached 322 percent in 2019, with much of the rise attributable to emerging market countries.[3] However, unlike in the lead up to the GFC, risks are now present across the private and public sectors with the latter largely a legacy of the response to the GFC. Government debt rose by more than 30 percentage points since the GFC to roughly 89 percent.

The 2008 financial crisis, however, is dwarfed by the COVID-19-induced recession which has brought many aspects of our social and economic system to its knees. The much needed and sizeable fiscal support in the face of the pandemic will therefore result in very large fiscal deficits raising once again the question of debt sustainability. Advanced economies are in a better position relative to emerging ones to absorb these fiscal costs. We estimate that over the next decade, two-thirds of global GDP growth will come from emerging economies, however, this is conditional on investments in infrastructure. Sustainable infrastructure is the crux of human well-being and productive activity: It enables sustainable economic growth all the while allowing countries to transition away from carbon-intensive infrastructure. This becomes even more important under the weak global economic backdrop we expect to see given the protracted recovery. The COVID-19 outbreak, however, has and is further constraining public budgets across emerging market countries leaving the opportunity for private capital to play an important role, especially from institutional investors given the long-term nature of their liabilities.[4]

The COVID-19 outbreak has represented an especially large hurdle for the European Union with numerous headlines questioning its sole existence. We forecast a global cumulative output loss of roughly USD 12 trillion by end-2021 relative to pre-COVID-19 trend growth, roughly 23% of which will be lost from the Eurozone's economy and a further 4% will be lost from the UK. If the European Union wants to maintain its place in the world, it must adapt and evolve. COVID-19 may be the much-needed catalyst to spark cooperation and solidarity across member countries. The European Recovery Fund is a great demonstration of how the immense challenge exposing the global economy can be turned into an opportunity. For the first time since its creation, the European Union is allowed to run up debt on a large scale. Even though disbursement is unlikely before 2021, we see this as positive for growth, especially when coupled with the recent and significant increase in Germany's fiscal stimulus. Funding of the Recovery Fund through debt issuance at the European Commission level would be a significant step forward towards integration across the currency union.

2 How to Set Up Effective Climate Governance on Corporate Boards, World Economic Forum, Jan 2019

3 Institute of International Finance Global Debt Monitor database as of April 2020

4 Sigma 3/20, Power up: investing in infrastructure to drive sustainable growth in emerging markets, Swiss Re Institute, June 2020

The EU should not ignore perpetual bonds issuance either to have funds for quick deployment and be «debt-burden» friendly at the same time.

In our view, Europe's future lies in the services sector and is green. Europe has increasingly grown into a service economy, with the sector amounting to nearly three-quarters of EU GDP. This challenges the notion of a single market, which was originally devised for goods, as lifting barriers to trade in services is much harder. The part of the economy covered by the single market is shrinking, putting in question its purpose considering the rising protectionism. European companies focused on the sale of goods can make use of the single market, reaching scale and so profitability quickly. But service companies tend to be more productive than goods producing firms, resulting in higher living standards. Given the slowing productivity of the Eurozone in recent years, the services sector must be a focus point on policy makers' agendas. Furthermore, with global efforts towards transitioning to a carbon-neutral economy, the services sector in Europe comes with a lower carbon footprint at around 7%[5,6] of direct carbon emissions. The Eurozone could really kill two birds with one stone.

Increasingly, the success of nations will be defined by a wider spectrum of factors than economic growth alone. Sustainability and resilience will be key competitive advantages, especially in a world where the risk landscape is growing more complex. This in turn has repercussions for companies as they are increasingly required to navigate emerging issues but also need to address the changing societal demands. The time for action is therefore now. This applies not only to governments but also to private sector companies, and the first step could be to incorporate a resilience officer into the governance structure. Chief Executive Officers, like policy makers, are forced to contemplate some difficult choices whether to focus on riding out the storm that COVID-19 has brought on or to take decisive action to make sure they emerge stronger from the crisis. Those acting with a «through-the-cycle» mindset and taking a proactive approach will be best positioned to accelerate out of the downturn and secure higher resiliency going forward.

We propose the following to help companies achieve / maintain a competitive edge:[7]

1. **Green innovation** – focus on low-carbon technologies and energies in order to support the global climate change objectives.

2. **Digital expansion** – COVID-19 will significantly accelerate the shift to digital with companies having to revise their business model.

3. **Swift and early adaptability to supply chain changes** – end-to-end visibility across supply chains is very important, however, given the evolving nature of today's global landscape, companies will need to identify supply chain changes early on.

This, however, is only the tip of the iceberg, and more opportunities and challenges will emerge as the future unfolds. Even as uncertainty remains extremely high, economic systems will continue to change with governments and are likely to play a more prominent role for some time to come. For the private sector, adapting to the macro trends enforced by COVID-19 will be key: the pandemic has an «expiry date», but the macro trends are likely to last much longer.

5 Transport, construction, and real estate services are accounted for separately
6 Eurostat on «Greenhouse gas emission statistics – carbon footprints», Feb 2020

7 The proposal here is very broad and much more can be done at an individual company level which will vary according to the industry