

# Economic crisis only because of the Corona pandemic?

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This contribution is part of the Exploring Economics Dossier "The Next Great Recession?" on the economic fallout of the COVID-19 pandemic and the structural crisis of globalization.

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*With the onset of an economic crisis that has been universally acknowledged since the end of March, two main questions arise: To what extent is the corona pandemic the starting point (or even the cause) of this crisis? And secondly: can the aid programmes that have been adopted prevent a deep and prolonged recession?*

Jakob Schäfer | March 30, 2020

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Although sufficient data on the economic development has been available for months (at least since mid-2019), even today (end of March/beginning of April 2020) various economists – and even more so the major media – are still trying to keep up the myth of the 'black swan'. According to them, it is due to the "non-economic" and above all "unforeseeable" event of the Corona crisis that the global economy "slides" into recession.

Before we go into the causes of the ongoing crisis, let's first look at some evidence of the crisis-prone development already in 2018/19.

On July 5, 2019, the German business newspaper "Finanzmarktwelt" wrote: "Incoming orders for German industry: Catastrophic downturn!" However, this development in incoming orders already began at the beginning of 2018. There was only a small interim high in January 2020, but only in relation to the previous month, i.e. Dec. 2019, which had performed particularly badly at -2.08% compared to Nov. 2019.

Incoming orders are the harbingers of a trend that continued throughout 2019 in Germany and in most eurozone countries – but also in large parts of the global economy. Real growth continued to decline and, in some cases, slid into recession. However, a capitalist economy needs economic growth of two, or better three percent to function "normally" (i.e. to maintain the average profit rate and avoid increased bankruptcies). In 2019, global economic growth was already very close to the 2.5% that the IMF calls the "stall speed", i.e. the minimum growth rate that prevents a crash.

Elsewhere, I wrote: "The crisis began in 2018/2019. Internationally, the beginnings of the crisis-like development go back to 2017, which was and still is, by the way, one of the decisive factors in the trade war, unleashed mainly by the US administration ('America first'). This crisis-prone development then spread to large parts of the global economy in 2018 and especially 2019. There were sharp declines in GDP growth, especially in China,

but also in Japan, France, Germany, etc. For example, automobile production in Germany fell by 14 percent from October 2018 to October 2019 (Financial Times 6/7 Dec. 2019). In the last quarter of 2019 alone, sales in Germany's mechanical and plant engineering sector also declined by 4.4%".

In the overall economy of the Federal Republic of Germany, the production of intermediate goods and investments declined by 3.6% from October 2018 to October 2019. (From September 2019 to October 2019 alone, total production fell by 1.7%). And it didn't stop there: even before the extent of the corona crisis in Italy was visible, the Purchasing Managers Index (data collection was completed before 21 Feb. 2020) in Italy fell by 0.2 to 48.7 (anything under 50 is a clear sign of a crisis). In France, the index also fell during this period, by 1.3 points to 49.8, and even worse in South Africa, where the index fell from 45.2 to 44.3 points between January and February, the seventh consecutive drop.

This overall trend continued unabated in early 2020 (even before the "corona crisis"). In January 2020, exports in the Federal Republic of Germany fell by 2.1% year-on-year, imports by 1.8%. The International Institute of Finance (IIF, the research institute of the major international banks) predicts a decline in economic output for the first half of 2020 of almost 10% in the USA, almost 15% in Europe and 2.8% in Japan. After that, the economy will pick up again. However, the institute does not provide any real evidence to support the bold forecast for the second half of the year.

## Interest-led forecasts

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The extent to which international institutions are still lagging behind even after the obvious outbreak of the crisis is shown by an analysis of the IIF on 23 March 2020, but even statista still painted a rather rosy picture (at least until 20 March) and predicts a world GDP of 90.52 trillion euros for 2020. dollars. A growth rate of 4.5% this year (in 2019 the world GDP was only 86.6 trillion dollars) is completely illusory.

The forecasts are constantly being overtaken. On 12.3.2020 Finanznet wrote: "The ifo business climate index fell to 86.1 (February: 96.0) points, as the ifo institute announced in its second publication. This was the lowest level since July 2009, when economists surveyed by Dow Jones Newswires had forecast a level of 87.4 points.

It is not yet possible to estimate how large the declines will actually be. The huge aid programmes that have now been launched will mitigate some of the effects, but essentially only temporarily. There are serious doubts as to whether economic activity will pick up from the middle of the year. There are deeper causes for this, which are not included in the IIF's calculations, because this institution also wants to pursue policy with confidence forecasts, not least in order to support the bank's share prices.

## Corona pandemic as trigger for the crash

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Yves Lamoureux, the president of the macroeconomic research company Lamoureux & Co. had warned, months earlier, against too much optimism for stocks. The expert had already started talking about what he called the 'global financial crisis 2.0' since October 2019. He himself had already started to sell most of his shares in December before the big corona panic hit the markets. [...] 'I think after 10 years with steroids I would say that this market is very fragile. I was looking for something that could shut down the bull market. The virus was the needle that burst the bubble,' says MarketWatch Lamoureux."

There is no doubt that the corona pandemic has thwarted the deniers of the crisis-prone development and has now let the crisis break out openly. It is already clear today that the production restrictions caused by the corona pandemic are contributing to a considerable worsening of the crisis. The ILO expects the corona crisis to result in the loss of up to 25 million jobs this year. But even that is still a very conservative estimate.

How nervous investors have become in the meantime is shown by the development of the VIX, i.e. the extent of price fluctuations on the stock exchanges. The S&P 500 Volatility (as the VIX is officially called) jumped to over 80 at the beginning of March (peak value 82.69), but even more important than the nervousness expressed in the huge increase in share purchases and sales is the persistence of this uncertainty. This contradicts all conspiracy theories that attribute these fluctuations only to the targeted intervention of large institutional investors for the purpose of manipulating stocks. And yet another piece of evidence: since the end of February, a conspicuous repatriation of assets to the home countries of the security owners has been taking place. In February and March 2020 alone, 55 billion dollars were withdrawn from the emerging markets in this way, twice the amount that was returned to the US in the crisis of 2008/09 (Adam Tooze elaborated on this, as well).

## On the causes of the crisis

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The capitalist economy moves in waves. In other words, it follows a cyclical movement of demand for goods, interest and commercial credit. There are regular phases of calm, revival, prosperity, overproduction, crash, decline, stagnation, revival...

The reason: It is in the nature of the capitalist mode of production that, due to a lack of overall societal planning – the principle of competition per se does not permit this – production capacities are built up at more or less regular intervals, which can no longer be used to a sufficient extent by society as a whole. The crises of overproduction are thus primarily crises of capital valorization. Investments in plant and equipment can no longer be used profitably and must be written off – at least in part – which generally leads to a sharp increase in the structural unemployment that exists anyway.

The crises have been going deeper for some time than was the case until the mid-1970s. The background: Since the beginning of the 1980s, the return on capital has been declining significantly, and it has only been possible to achieve a small upswing for a good two decades as part of the implementation of neoliberal policies – mainly at the

expense of the standard of living of the majority of the wage-dependent population. But the remedies of wage cuts and precarisation to restore profits have since reached their limits. The first major slump then came with the bursting of the so-called Dot.com bubble (from 2001 onwards); it was even more dramatic during the crisis that began in 2007 and led in 2008/2009 to the biggest global recession since the early 1930s.

The conditions for capital appreciation have not improved since then, as is evident from several key figures: In the metropolitan areas, the industrial profit rate (the "net return on capital" there is the basis for all other profit rates) fell to almost 12% in the 1980s and 1990s and has been moving towards 10% and below for years. Related to this is the fact that since the late 1970s the ratio of net capital investment to gross domestic product (GDP) has been declining. Since the beginning of this millennium, the average age of industrial fixed assets in Germany (excluding land assets) has been between 8 and 15 years, depending on the sector; in the USA it is now 15 to 20 years, in some cases even more. To a considerable extent, these low rates of investment are also related to the significant decline in government investment.

In 2009, in the wake of the crisis that started in 2007 and broke out openly in 2008, the consequences of the crisis were mitigated in many countries (especially in Germany) through government aid programmes. In the USA, for example, the central bank had to intervene with huge financial injections to prevent the system from collapsing. Because of the 2008/2009 crisis alone, it still has more than \$1.3 trillion in bad loans in its vaults.

However, one effect of the state aid measures was that one of the regular consequences of a crisis - namely capital adjustment (destruction of capital) - was largely eliminated by bringing the debt back into the national budgets. Since then, however, this has put a strain on the ability of most states to act.

In the perception of the broader public, the crisis that has now come to light was seen as the end of a long boom phase. What is generally overlooked is that we already had a slump in 2015/16, even if it did not have such a major impact in Germany.

## The special feature of the current crisis

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The concrete course of the crisis in recent weeks suggests that it will not be short-lived, because it has a special feature that clearly distinguishes it from almost all other crises. This time, overproduction is not the cause that overshadows everything else. Rather, we have a pincer development:

On the one hand, in the years since 2018 an overproduction crisis had developed, which is now assuming enormous proportions, especially in the steel sector and even more so in the automotive sector. In the automotive industry, the saturation of important sales markets is compounded by technical conversion difficulties due to political requirements. (For example, there is a lack of charging stations and, above all, sufficient "clean" electricity generation to enable the switch to electric cars, which is erroneously declared to be a contribution to the fight against climate change).

On the other hand, supply will be lacking in many places for the foreseeable future because important supply chains have been interrupted or will be for a long time to come due to production restrictions. This slump came suddenly, affecting most sectors and all over the world simultaneously! The US Treasury Secretary fears that the unemployment rate will rise to 20% within a few months. Stanley Morgan forecasts (as of 23.3.) a 14% decline in US GDP between April and June, and Goldman Sachs estimates the decline at 24%. Some economists expect a decline of 5% for Germany (although this is still an optimistic estimate) and 10% for the UK.

"Never before in the world has there been such a synchronised economic standstill" (Maurice Obstfeld, 2015-2018 Chief Economist at the IMF). Mohamed A. El-Erian, Chief Economist of Allianz, fears nothing more than a simultaneous insolvency (due to overindebtedness) of several major banks and industrial companies.

## Where do we stand today in the global economic crisis?

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This time, China is being eliminated to compensate for sales markets that have collapsed elsewhere. As Winfried Wolf already explained very plausibly in Lunapark21 issue 47 of autumn 2019, "China will not judge this time". China's economic growth had already weakened considerably in recent years. Added to this are the problems in the automotive industry, which have grown enormously in the last two years, and now also the collapse in production with the corona crisis since the beginning of February 2020 at the latest. The IIF predicts economic growth of only 3.5 % for China, which should still be at least 5 to 6 % in view of the specific structure of the industrial capacities built up there (as the workbench of the global economy).

The Chinese economy is additionally at risk for two reasons, firstly because of the still significant real estate bubble and secondly because of the huge size of the shadow banks, which in 2018 had an estimated \$8 trillion balance sheet total. The decisive factor, however, is and remains the collapse in material production and its extreme interdependence with the global economy. In addition: in France, too - and to a lesser extent in Germany - a real estate bubble has developed that could become a major accelerator if the recession persists.

According to the WTO, industrial production in China fell by 30% in Feb. 2020 (twice as much as in 2008/2009). Large parts of the international value chains cannot function without mass production in China today, not least in the area of information and communication technology (see the World Trade Organization, WTO, Global Value Chain Development Report ). For some years now (even before the outbreak of the open trade wars) the importance of international value chains (GVC) has been declining somewhat (world trade is growing less rapidly than world GDP), but their importance is outstanding, especially for the Federal Republic of Germany. 9.4% of German imports come from China. Germany is extremely dependent on exports: 47% of German GDP goes into exports, while 41% of imports go into GDP.

## The oil price war harbours further dangers

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Normally a falling oil price has a positive effect on a weakening global economy. However, in the meantime the crisis has progressed so far and the oil price is so low that a sinking of the oil price at a level of \$30/barrel (and at times even lower) will cause great distress to some economies. The American fracturing industry alone, in which more than \$230 billion is invested, can only survive for a few months. It will be worse for countries like Mexico and Brazil, but also for Russia (whose budget is based on an oil price not permanently below \$35) or Saudi Arabia. This country has the lowest production costs, but is aiming for a price above \$80 to rebuild its economy. Russia did not want to agree to a reduction in the production quota (or was unable to do so because of the costs of the Syrian war), so there was no compromise between OPEC and Russia.

In the meantime, due to the global economic crisis, demand has fallen so much that even the reduction in production quotas that was aimed at a few months ago is no longer of any use. Now prices are at rock bottom and production is at its lowest level for decades. The discount battle that Saudi Arabia announced on 7th March with its 20% price reductions for deliveries to Asia, Europe and the USA also contributed to this.

Similarly devastating, by the way, is the development of other commodity prices (especially energy, ores and food), which will hit countries in Africa and South America particularly hard, as a turnaround in the coming weeks is completely unrealistic. And on top of all this, the rich in these countries are now increasingly moving money out of the country.

## Financial sector and adventurous price-earnings ratios

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The delusion of betting on rising stock market values prompted many companies to buy back their own shares on the stock market, which further boosted stock market values. US companies listed on the S&P 500 Index, for example, spent no less than 5.1 trillion dollars to buy back their shares between 2010 and 2019. In the banking sector alone, shares worth a total of 863.3 billion dollars were bought back between 2017 and 2019. The main beneficiaries of these measures are the major shareholders, not least the banks.

Falling interest rates have motivated many companies to take on further debt for such maneuvers. At the same time, investment funds have also taken on debt in order to buy more (industrial) companies.

Both together contributed considerably to the fact that in a growing number of cases the price-earnings ratios (P/E ratios) no longer reflected the real company values. Thus, a bubble developed on the stock markets which sooner or later had to burst. In other words: this development of share values is not an expression of economic developments (i.e. massively increasing profits), but is based on short-term rip-offs.



# Debt

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At the end of 2019, the total debt of states and companies amounted to 253 trillion (!) dollars, which corresponds to 322% of the world's GDP! To take just one example: If in this crisis only half as many companies get into financial difficulties as in 2009, then debts of up to 19 trillion dollars are at stake. By comparison, this is more than the total GDP of the EU in 2019 (which was 17.17 trillion dollars including GB).

Given the depth of the crisis, the states (and the central banks, insofar as they can still play an effective role here at all) have no other option than to follow the maxim of Mario Draghi at the height of the euro crisis in July 2012 ("Whatever it takes"), namely to churn in everything they can, completely independently of Maastricht guidelines or the debt brake. The US Fed, for example, expanded its package of measures four times in the space of a week, ultimately leading to the unlimited purchase of securities ("quantitative easing").

The German government wants to provide up to 500 billion euros, primarily on a credit basis, and the EU is also constantly expanding its aid program. Italy: 300 billion euros, GBP 300 billion British pounds, etc. The ECB wants to buy bonds for 750 billion euros, possibly more will be issued. The question is: how much will these measures achieve?

The resources of capitalist policies for crisis management can be quickly exhausted today (in 2020). Because we are not just dealing with a disruption of supply chains or sales opportunities, of which it is not even clear how long these failures and restrictions will last. Bridging loans can only achieve limited results in the current crisis. At least three serious factors come together, the extent of which goes far beyond the circumstances of the 2008/09 crisis:

First, governments want to spend vast sums of money they don't have. The US government, for example, is expecting to spend up to 2 trillion dollars. Such a huge expansion of national debt adds to the debt that was still being accumulated in the 2008/09 crisis and doubles the national debt. Trump's reduction in corporate taxes (2018) from 35 % to 21 % had already further narrowed the leeway.

The situation is only gradually different in the other countries. No region in the world can pull the cart out of the mire as an additional supplier or sales market. So this pumping only shifts the problems into the future, which significantly increases the risk of an even bigger crash in the not too distant future. What's more, depending on how the crisis develops, this massive currency devaluation increases the risk that confidence in the affected currency will dwindle, which could lead to a rush on the banks. This, in turn, would immediately mean the collapse of payment traffic.

Second: Today, there are still several hundred billion dollars worth of bad loans in private and partially nationalised banks worldwide. Under the title "Coronavirus becomes a stress test for the banking sector: Is there a threat of a new financial crisis?" finanzen.net wrote on 24 March: "On the stock market the effects of the coronavirus have already

reached the banks: The share prices of numerous major European banks have plummeted sharply since mid-February, and some shares have even halved. The Stoxx Europe 600 Banks, which includes the largest financial institutions in Europe, closed on 18th March at 83 points, its lowest level since February 1988 according to 'Wolf Street', when the months of selling after Black Monday in October 1987 sent stock markets into a tailspin. Even at the height of the financial crisis in March 2009, the index of European banks had not fallen as deeply as it is now. Since mid-February alone, the stock market barometer for the sector has fallen by more than 40 percent". "The crash of the American markets is now worse than the crash of 1929," according to a study by the Bank of America in late March. And let's not forget: in Italy, where the Covid-19 virus is particularly raging and the economy has been paralysed for months as a result, with GDP plummeting sharply, the banking sector is particularly badly hit (not to mention the high level of public debt).

Thirdly, manufacturing companies (and to some extent also trade and logistics companies) are now also heavily indebted, not least because in recent years loans were extremely cheap to obtain.

"According to the latest data from the Organisation for Economic Cooperation and Development (OECD), corporate bond debt has doubled since 2008 to 13.5 trillion US dollars by the end of 2019. [...] The companies downgraded in their credit rating would then have hardly any alternative sources of financing and would have to accept considerably higher credit costs. Both effects, in turn, further increase the probability of bond default and can lead to a dangerous domino effect. (19. Feb. 2020) The loss of confidence in the market is also a result of the huge increase in corporate debt.

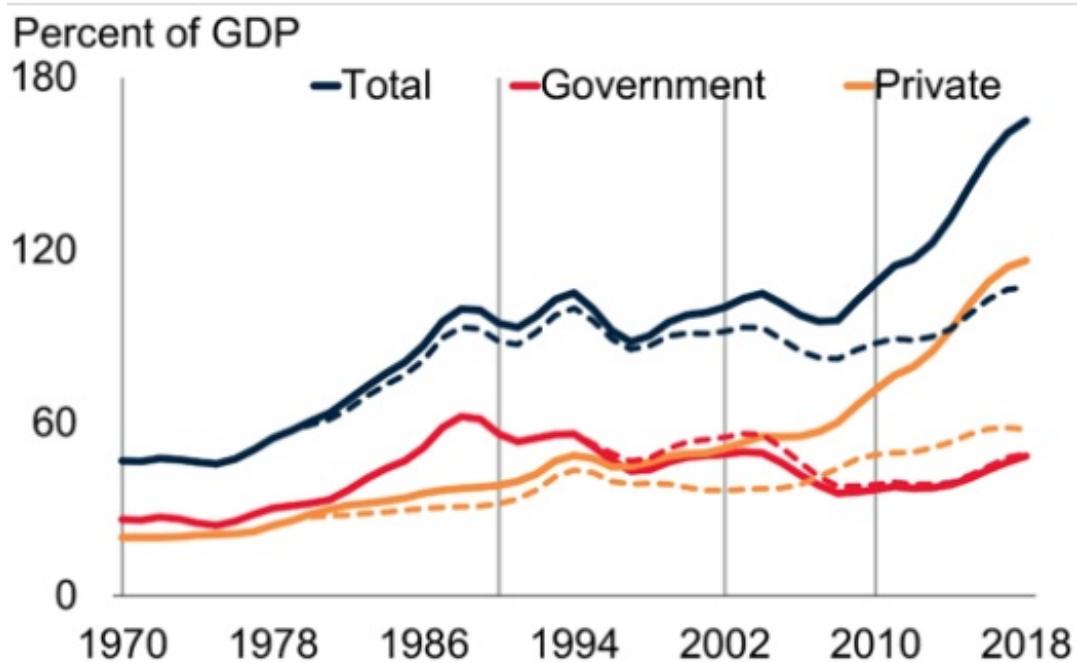
## Debt of emerging markets

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The debt of the emerging markets in particular was already a ticking time bomb before the Corona crisis. With the open outbreak of the global economic crisis (i.e. since the end of February 2020 at the latest), this has now possibly become the greatest source of danger for a massive "meltdown", i.e. a deep recession such as has not been seen since the early 1930s (including 2008/09).

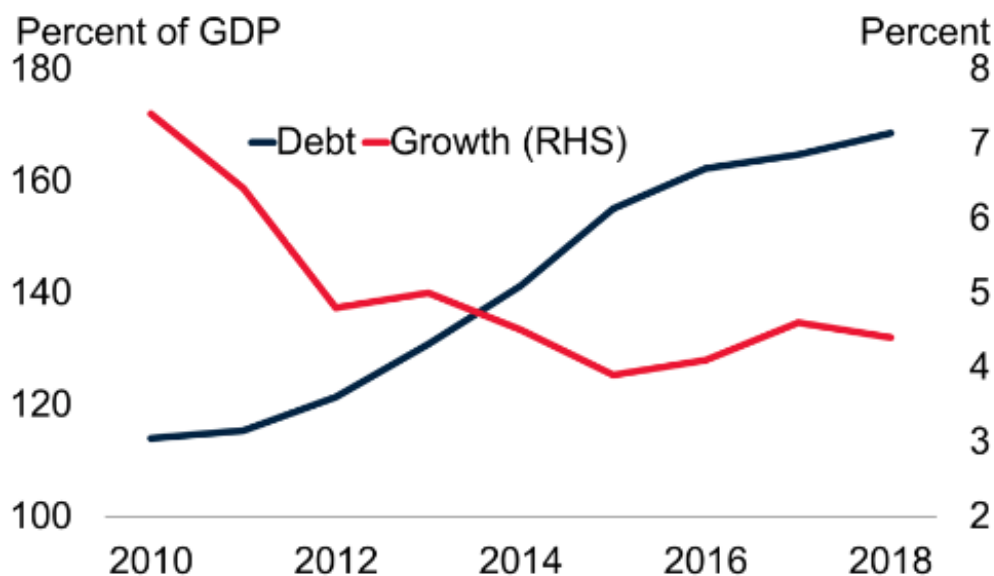
As World Bank economists point out, "most of the debt increase since 2010 has been in the Emerging and Developing Countries (EMDEs), whose debt increased by 54 percentage points of GDP to a record high of about 170 % of GDP in 2018. This increase was broad-based and affected around 80% of EMDEs". (EMDEs = emerging market and developing economies).





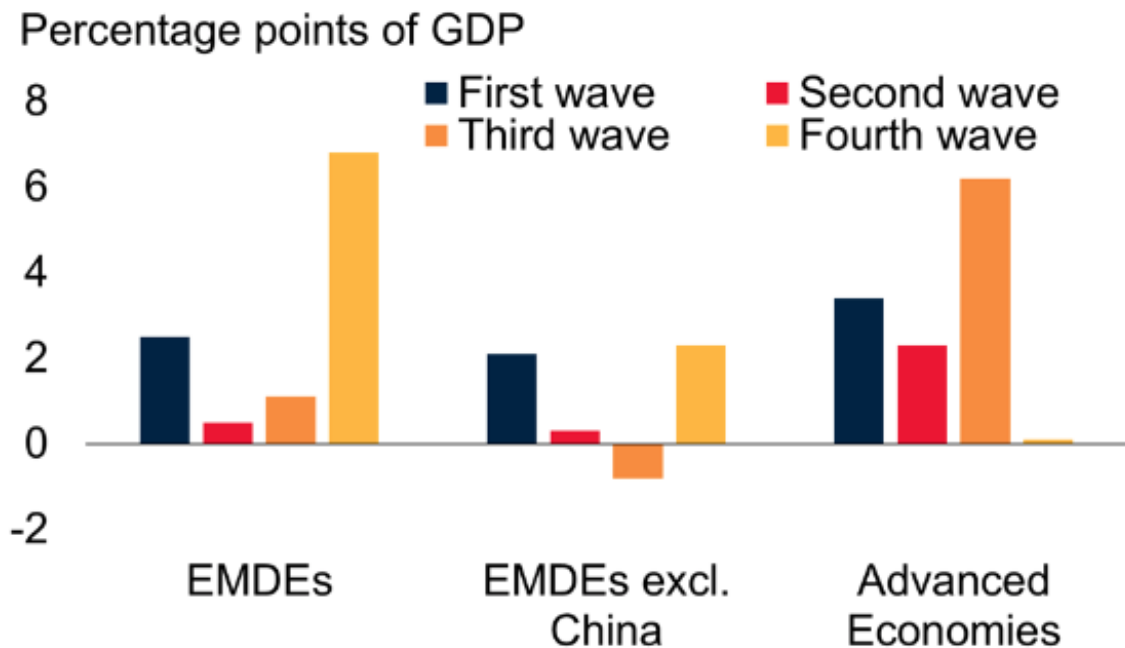
The chart shows (taken from [Debt and financial crises: Will history repeat itself?](#)) the development of emerging market debt since 1970, the dotted lines excluding China.

The same World Bank economists note: “Despite the sharp rise in debt, growth in these economies has repeatedly disappointed, and they face weaker growth prospects in a fragile global economy. In addition to their rapid debt build-up, they have accumulated other vulnerabilities, such as growing fiscal and current account deficits and a riskier composition of debt”



The blue line shows the increase in debt, the red line the decline in economic growth.

At the end of each "debt wave", the picture is as follows:



So never has the increase in debt been as great as at the end of the fourth wave. In addition, in times of "flight to safe havens" (thus also to the dollar) the debt of developing and emerging countries grows even more. Their level of debt is thus (even before the outbreak of the new crisis) significantly higher than in 2008.

Now the IMF wants to make one trillion dollars available for support measures (loans), but only 50 billion dollars of this will go to emerging markets and only 10 billion dollars to the poorest countries. At the same time, a flight of capital is taking place from these countries.

As a result of this development, the ILO (Geneva) is now (as of 18 March 2020) expecting 5.3 to 24.7 million additional unemployed (among the 188 million officially registered as unemployed in 2019). However, these calculations are based on the data base of 16 March. As the crisis is developing more dramatically than most virologists had assumed up to mid-March, the economic decline (not only in Italy) and thus the number of additional unemployed should also be significantly higher.

## Threatening transition to the monetary system?

At the level of the financial markets, the enormous expansion of the most diverse derivatives is now also taking its toll, as is the securitisation of even dubious securities in packages, not all of which could be adequately hedged. Today, the completely confusing growth of private equity is increasingly becoming a problem for credit default swaps (CDS).

Corporate loans in excess of two trillion dollars will have to be renegotiated this year. Under these conditions, who can still easily grant new loans or even at the low interest rates of recent years? High risk premiums are to be expected. Even more so: Due to the

dwindling stability of banks, insurance companies and now also many large companies (see above), the risk of the crisis turning from the credit system to the monetary system will increase significantly in the coming weeks.

So if companies stop lending to each other and only sell goods for immediate payment, the recession will deepen. Given the extent to be feared, this can by no means be offset by the government's bridging loans. All the contradictions of the capitalist economy that have arisen in the past are now coming to a head at a particularly dramatic pace, to the point of breaking up supply chains. There is the threat of major bankruptcies and a chain reaction such as the world has not seen in 90 years.

How long will the state be able to act at all? Together with its central bank, it can still use enormous financial resources (rescue programmes of various kinds). However, there are already limits to the economic impact, for example when the Fed cut interest rates to zero in panic mode and, just like the ECB, promised to buy bonds on a large scale. Unlike in the past, these measures had little calming effect; share prices remained volatile. The power of the central banks is increasingly being questioned by the business community, which is concentrated in the financial sector. Fiscal policy is also reaching its limits in some countries, such as Italy. State bankruptcies as a result of the already high and now rapidly growing level of public-sector lending can no longer be ruled out. And the next euro crisis is more than probable and, with the expected dramatic worsening, could even lead to the end of the euro.

## Political consequences

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Eric Toussaint, one of the directors of the CADTM , advocates a comprehensive socialization of the entire financial sector and comes to the conclusion:

*"This measure must be part of a larger programme of urgent, radical and far reaching measures that include suspending and eventually the abolition of public and private illegitimate debt, closing down the stock exchanges, creating an authentic National Health System, expropriating, without indemnities, the pharmaceutical companies and private laboratories, energy sector corporations (in order to plan and manage the ecological crisis) and placing them under citizens' control aimed at improving the populations' living conditions.*

*The response to the coronavirus epidemic should become an opportunity to encourage an authentic deep rooted revolution in life styles, property structures, mode of production, in the values that inspire social relationships among human beings as well as between human beings and nature. This can only happen if the victims of the system mobilise themselves, self-organise and dislodge the 1% and their lackeys from positions of power to create truly democratic power structures. An ecological, socialist, feminist and self-management revolution is necessary."*

**Translated from German by the Exploring Economics Team**

