ACCA Think Ahead

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Global economic conditions survey report: Q1, 2020

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April 2020

Introduction

The Global Economic Conditions Survey (GECS) is the largest regular economic survey of accountants in the world.

The Global Economic Conditions Survey (GECS), carried out jointly by ACCA (the Association of Chartered Certified Accountants) and IMA (the Institute of Management Accountants), is the largest regular economic survey of accountants around the world, in terms of both the number of respondents and the range of economic variables it monitors.

The GECS has been conducted for over 10 years. Its main indices are good lead indicators of economic activity and provide a valuable insight into the views of finance professionals on key variables, such as investment, employment and costs.

Fieldwork for the Q1 2020 survey took place between 28 February and 12 March 2020 and attracted 983 responses from ACCA and IMA members, including over 100 CFOS.

ACCA and IMA would like to thank all members who took the time to respond to the survey. It is their first-hand insights into the fortunes of companies around the world that make GECS a trusted barometer for the global economy.

Executive summary

The Q1 Global Economic Conditions Survey (GECS) was conducted from 28 February to 12 March inclusive.

The Q1 Global Economic Conditions Survey (GECS) was conducted from 28 February to 12 March inclusive. This period included the spread of the COVID-19 to Europe and the US and saw some of the initial policy responses, mainly from central banks. But the major impact on economic activity from lockdowns and business closures had not yet begun to be felt. Even so, by this time such effects were being felt quite profoundly in the Asia-Pacific region, the source of the outbreak. This geographical split is reflected in some of the key indicators in the Q1 GECS.

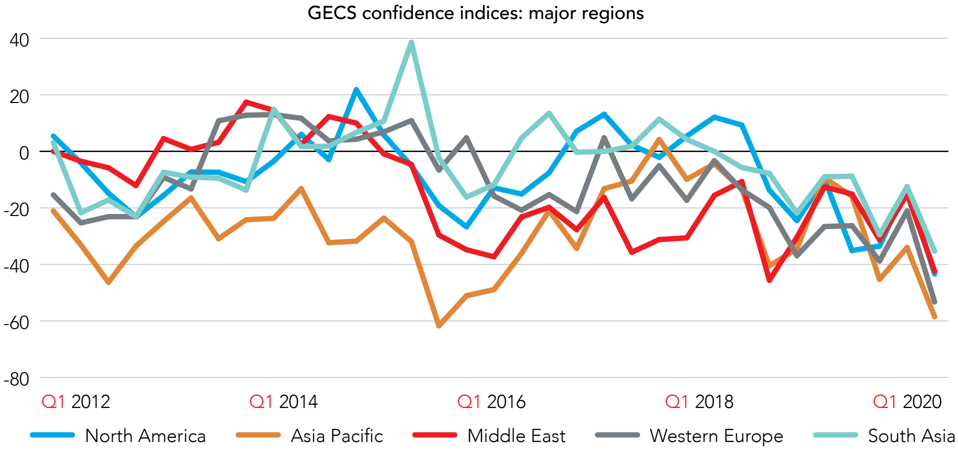
Global confidence fell to its lowest level on record with big falls in all regions. The global orders index, which tends to be less volatile than the confidence measure, also fell sharply but not to an all-time low. In Asia-Pacific confidence is the lowest among all regions and the orders balance fell by more than anywhere else in Q1.

In addition, the regional index of concern about suppliers going out of business jumped to a record high of 22 in Q1 compared with a long run average of 8 (Chart 2). Similarly, the index of concern about customers going out of business increased to 37 having been 27 at the end of 2019. By comparison, the global indices for Q1 are 16 for concern about suppliers and 22 for concern about customers.

Confidence fell everywhere and, in most cases, sharply and to the lowest levels since the survey began. The Q1 drop in Asia-Pacific confidence is less than the global average, but confidence here was already relatively weak as a consequence of US-China trade tensions. Hence it took less of a drop to reduce confidence in Asia- Pacific to the lowest among all regions. Western Europe and the Middle East have only a slightly higher confidence level. Indeed, there is relatively little

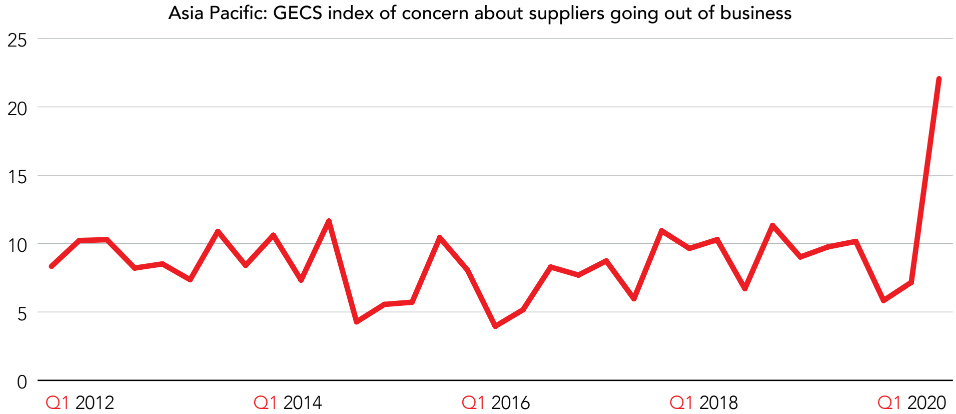
Global confidence fell to its lowest level on record with big falls in all regions. In Asia-Pacific confidence is the lowest among all regions and the orders balance fell by more than anywhere else in Q1.

Chart 1: Confidence falls everywhere



Source: ACCA/IMA (2012-20)

Chart 2: Asia-Pacific feels the economic pain first



Source: ACCA/IMA (2012-20)

divergence in confidence between regions, which is to be expected given the global nature of the COVID-19 economic shock.

The orders balance is a better indicator of real economic activity than sentiment-driven confidence (Chart 4). The falls in orders may be less extreme than for confidence, but nevertheless are across all regions. The regional pattern reflects the geographical spread of COVID-19 at the time of the Q1 survey with the biggest fall in Asia-Pacific and the smallest in Africa.

The global economy is heading into recession as private economic activity collapses owing to an effective lockdown in many countries. If these conditions were to persist for three months or longer then falls in output approaching 10% would be entirely possible. (During the global financial crisis of 2008/09, the worst-affected economies suffered around a 6% fall in GDP.) Early data releases, such as US jobless claims and monthly activity surveys in the US, eurozone and UK point to plunging levels of economic output.

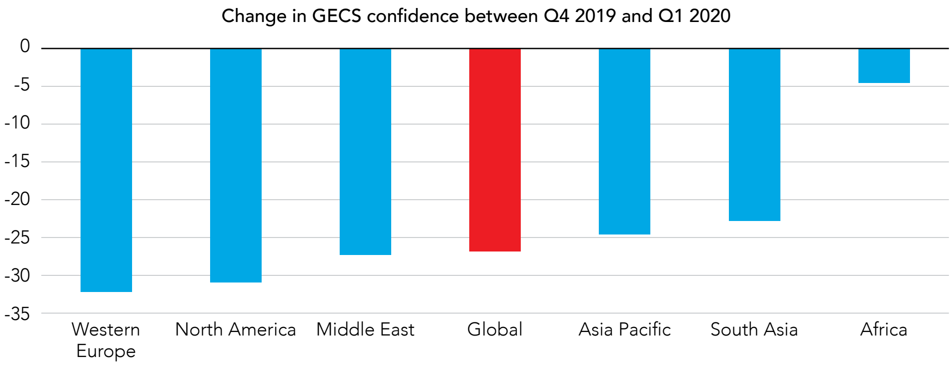
Emerging market (EM) economies face additional difficulties as a flight to quality among investors triggers capital outflows. In addition, for EMs with a significant amount of debt denominated in US dollars, the rise in the dollar adds to the burden. For oil exporters the collapse in the oil price will exacerbate the economic downturn as well as putting further pressure on government budgets.

The global policy response has been huge, if rather uncoordinated. On monetary policy, central banks have slashed interest rates where possible, launched or massively boosted quantitative easing (QE) and extended cheap funding to the banking system. But fiscal policy has to do the heavy lifting by supporting private incomes lost as a result of the crisis. Governments are seeking to do this in a number of ways. Measures introduced have included direct payments to households, paying the wages of workers, boosting benefit payments and delaying or foregoing tax receipts. The intention is to provide a 'bridge of income' so that when economic conditions improve, a recovery can be fairly quickly established. The total size of fiscal packages is very substantial, with those of the US, UK and Germany all worth around 10% of GDP (by end-March). It is a measure of the scale of this crisis that concerns are being expressed that more may yet be needed.

There will inevitably be long-term economic consequences, although at this stage much is conjecture. But what is certain is that the public finances in many countries will be in very large deficit this year, probably often exceeding 10% of GDP and greater than reached during the 2008-09 financial crisis. Once economies start to recover and temporary income support measures are removed, these deficits will shrink rapidly. But they will remain substantial and fiscal retrenchment will be necessary at some point. Given the nature of this crisis, it seems likely that this will be achieved to a greater extent through higher taxation than through reduced public spending.

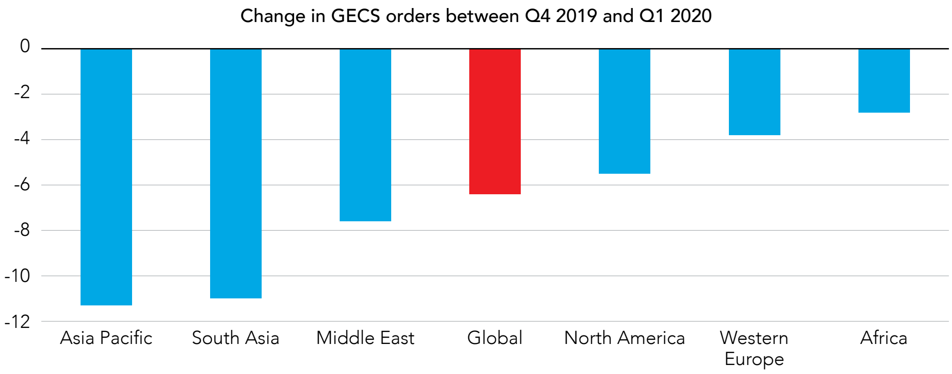
The falls in orders may be less extreme than for confidence, but nevertheless are across all regions. The regional pattern reflects the geographical spread of COVID-19 at the time of the Q1 survey with the biggest fall in Asia-Pacific and the smallest in Africa.

Chart 3: Confidence collapses almost everywhere



Source: ACCA/IMA (2012-20)

Chart 4: Orders fall in every region, especially Asia Pacific



Source: ACCA/IMA (2012-20)

1. Global and regional analysis

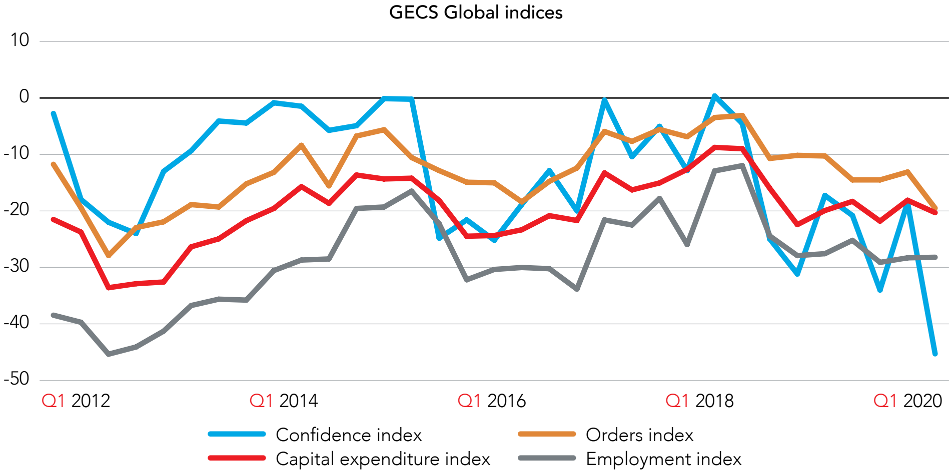
> At this point, the GECS only begins to paint the picture of the global economic collapse brought on by COVID-19.

At this point, the GECS only begins to paint the picture of the global economic collapse brought on by COVID-19. The Q1 survey was conducted from 28 February to 12 March. In normal circumstances, economic conditions change little in the space of just a few weeks. But these are not normal circumstances. So, although global confidence and orders both fell significantly in the Q1 survey (Chart 5), they do not convey the true scale of the global economic contraction that is now in progress. Orders in Q1 are still above their all-time low and the capital expenditure and employment indices are relatively little changed. This pattern is unlikely to be repeated in the Q2 survey.

Inflation concerns fell to a record low in the latest survey. The global economy is suffering both a supply shock and a demand shock. But the overwhelming force is one of a savage reduction in demand that will exert downward pressure on prices in the short term. (How can one measure the prices in a basket of goods and services when a large proportion of the usual basket is unavailable?) For now disinflation will persist, helped further by the drop in oil prices.

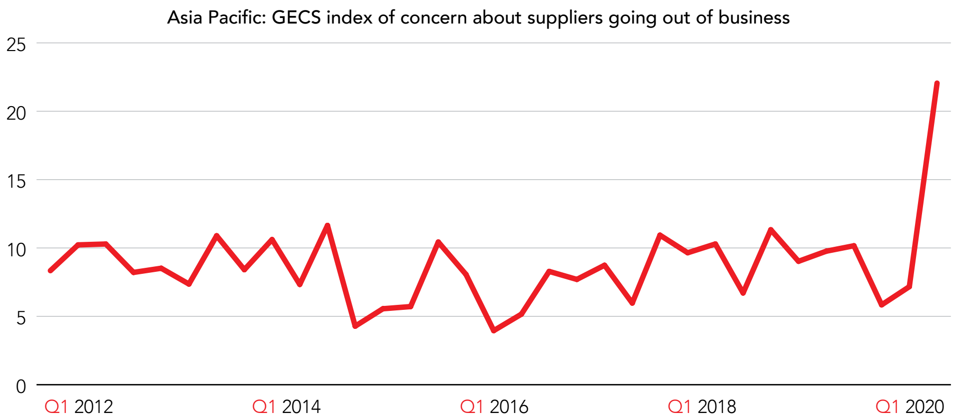
There is relatively little variation in the economic prospects of the major regions: Charts 6 to 12 summarize the regional picture. Asia-Pacific was the first to suffer the economic consequences of COVID-19 and this is reflected in the Q1 GECS. As well as recording the lowest level of confidence across all regions, respondents in Asia-Pacific also reported a dramatic rise in concern about suppliers going out of business (Chart 6). There is also a similar jump in concern that customers will fail. Other regions, such as North America and Western Europe reported very modest increases in these concerns.

Chart 5: Global confidence plummets, orders register modest fall



Source: ACCA/IMA (2012-20)

Chart 6: Asia-Pacific region concerns about suppliers

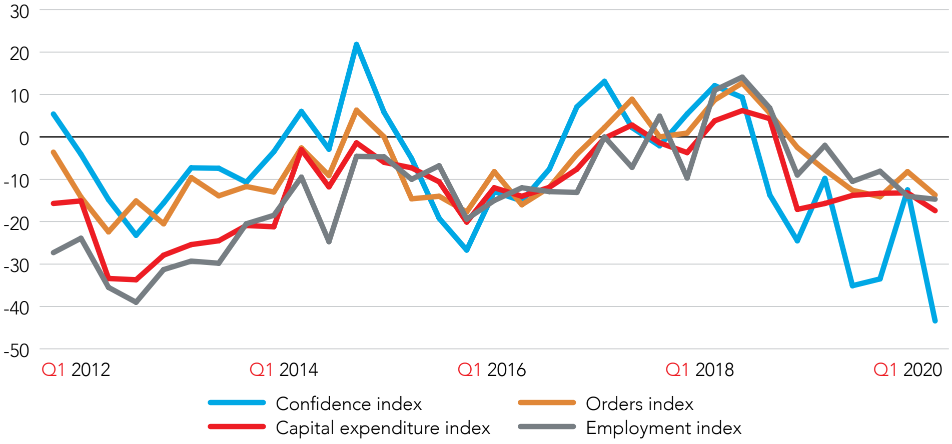


Source: ACCA/IMA (2012-20)

GECS regional picture

North America
COVID-19 was beginning to spread to North America at the time of the GECS survey. But many of the restrictive measures that cause economic contraction were not in place. The longest economic expansion in US history, lasting over 10 years, is coming to an abrupt end.

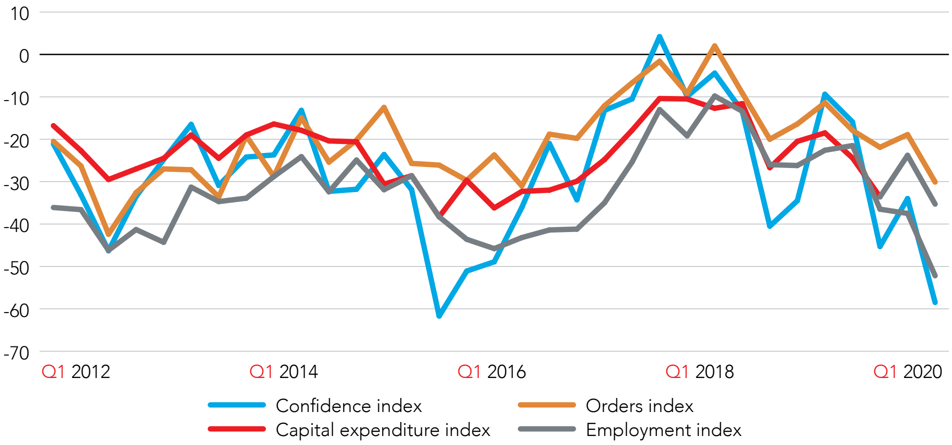
Chart 7: North America



Source: ACCA/IMA (2012-20)

Asia-Pacific
The Asia-Pacific region had already suffered weaker confidence last year as US-China trade tensions took their toll. The region was also the first into the COVID-19 crisis. Not surprising confidence in the region is at a record low. The orders index fell the most of any region in Q1.

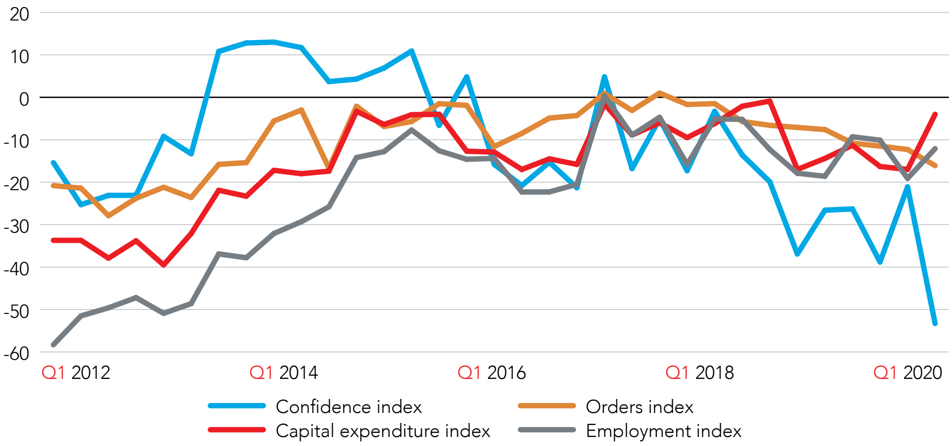
Chart 8: Asia Pacific



Source: ACCA/IMA (2012-20)

Western Europe
Confidence fell sharply in Q1 in Western Europe but other indicators held up, reflecting that few restrictions were in place at the time of the survey. The region, including the UK, will suffer a sharp economic contraction in coming months.

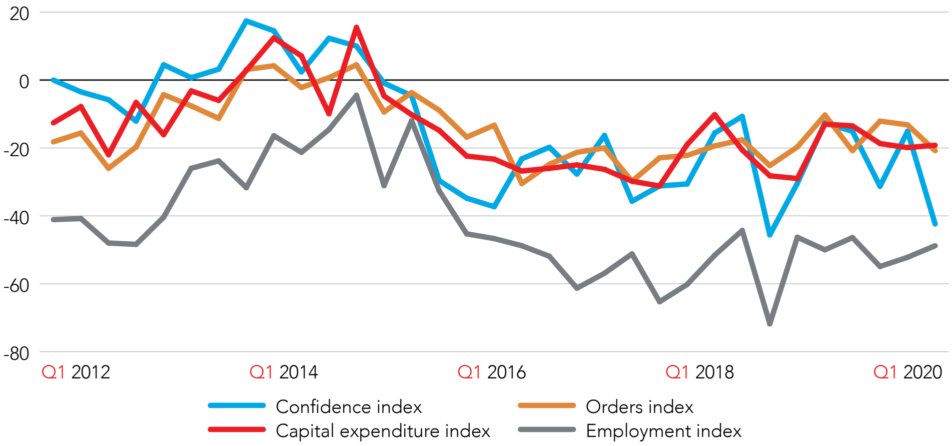
Chart 9: Western Europe



Source: ACCA/IMA (2012-20)

Middle East
Confidence in the Middle East registered a fairly modest fall in Q1, but most of the survey was conducted before the big drop in oil prices in March. The combined effect of COVID-19 and lower oil prices will cause significant economic pain to oil exporting economies.

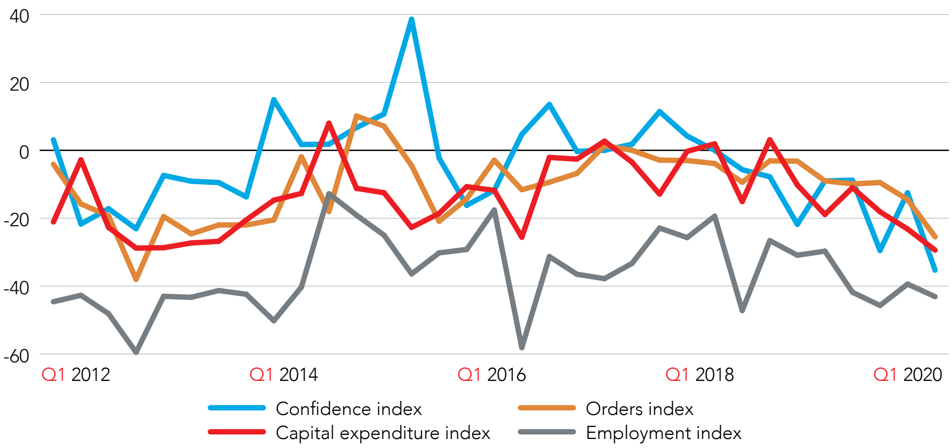
Chart 10: Middle East



Source: ACCA/IMA (2012-20)

South Asia
South Asia, dominated by India and Pakistan did not show a collapse in confidence in early March. Both economies were suffering from weak growth before the pandemic and will quickly fall into economic contraction.

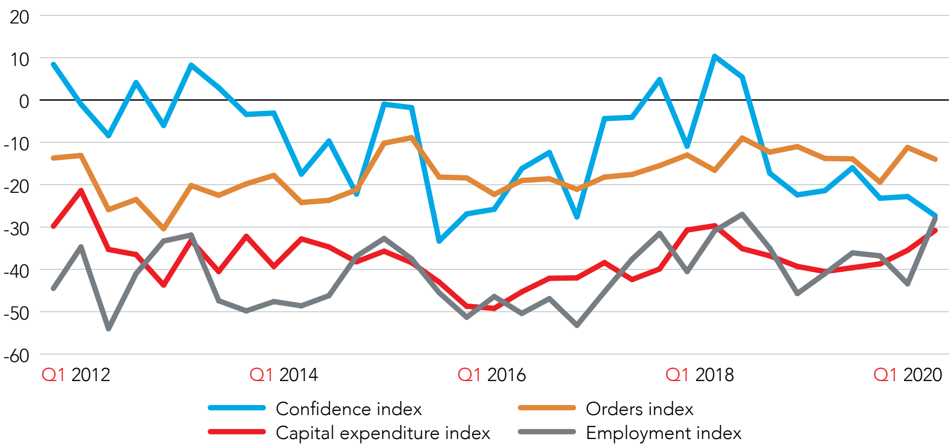
Chart 11: South Asia



Source: ACCA/IMA (2012-20)

Africa
The African region experienced by far the smallest drop in confidence of any region. Again, at the time of the survey, there had been relatively few reported COVID-19 cases in the region.

Chart 12: Africa



Source: ACCA/IMA (2012-20)

The global economy is heading into a recession, initially at least a severe one.

THE ECONOMIC CONSEQUENCES OF THE COVID-19 PANDEMIC

The global economy is heading into a recession, initially at least a severe one. The measures introduced by governments in an attempt to slow the spread of the virus are having a dramatic effect on huge swathes of economic activity. There is the direct loss of output and employment caused by the closure of shops, bars, restaurants, the reduction in travel and, in some areas, complete lockdown. Factory closures and supply chain disruption add a further downward turn to economic activity. Even in businesses that continue to operate with employees working from home, productivity and output will inevitably suffer. Such extreme economic pain is being felt simultaneously across virtually the entire global economy.

Two of the most significant economic regions, Europe and the US, are among the most badly affected. One early measure of the scale of the impact is the jump in US jobless claims to 6.6mn in the last week of March, ten times the previous peak in 2009 (Chart 13).

Financial conditions have tightened, a potential route to exacerbating the economic downturn. Volatility in financial markets has rocketed in recent weeks, beyond even what was seen at the height of the financial crisis. Chart 14 shows the VIX index, a measure of volatility derived from the US equity market and published by the Chicago Board Options Exchange. Global equity prices are down by around 30% since the start of the year and corporate bond yields have risen sharply, both factors raising the cost of capital for companies.

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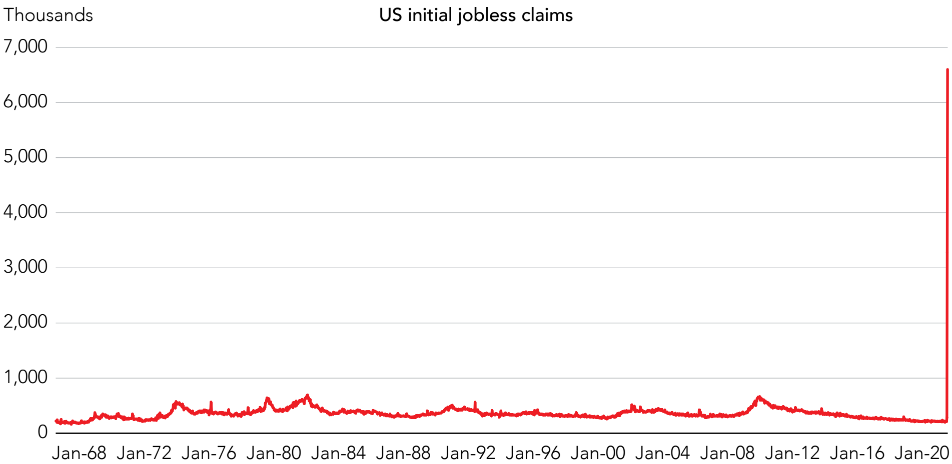
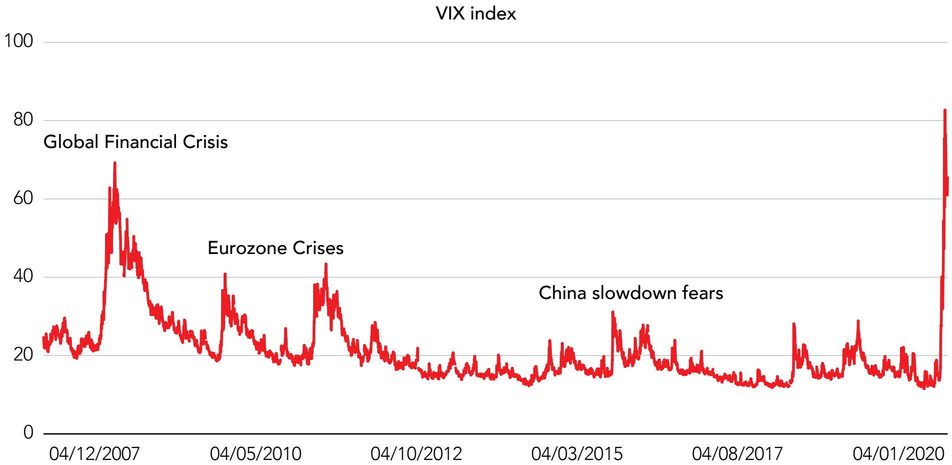
Chart 13: US jobless claims have soared



Source: US Department of Labor: Employment and Training Administration

Chart 14: Financial market volatility spikes



Source: Chicago Board Options Exchange

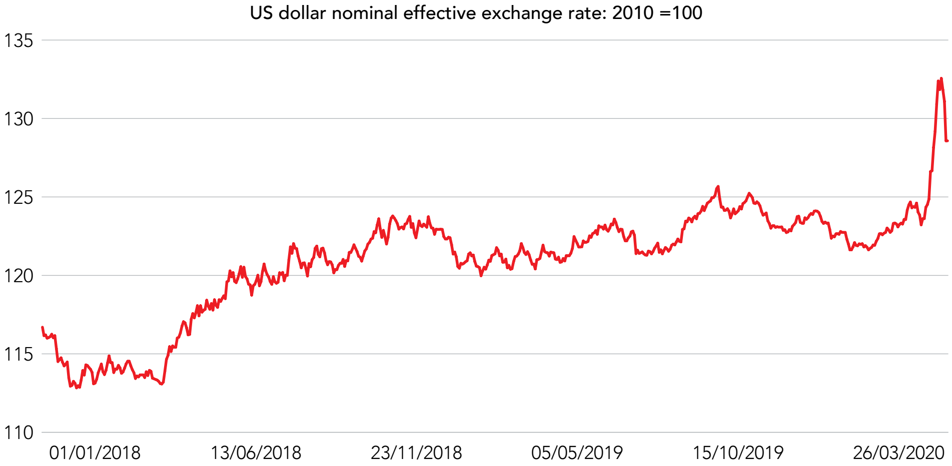
Many EM economies are vulnerable to the effects of the change in financial conditions and risk appetite. Capital outflows may further undermine EM as a 'flight to quality' results in investors moving out of risky assets and into 'safe havens', such as US dollar assets, government bonds and gold. Over the course of March, the US dollar increased by around 4% on a trade-weighted basis, raising the burden of dollar denominated debt for EM economies even as US interest rates were slashed to zero. In January the World Bank (2020) highlighted EM debt as a risk, noting that such debt as a proportion of GDP is higher now than before the financial crisis.

Commodity prices have fallen sharply, especially for oil. Oil prices fell by around 60% over the first three months of this year with Brent crude selling at less than $30 per barrel (p/bl) at the end of March. Oil exporters will suffer a further significant hit to their economies as oil revenues decline. Every oil exporter bases its government budget on an assumption for the oil price that is a very long way above the current level, often in the $70p/bl to $80p/bl range.

The unprecedented nature of this economic shock means that only guesstimates can be made of its magnitude. The short-term hit to global GDP will almost certainly be greater than during the 2008-09 recession, which at its low point recorded global GDP falling at an annual rate of around 2.5%. Unlike that downturn, however, the 2020 COVID-19 recession is truly global in nature with no region of any economic significance spared. In addition, growth has started its decline from a low base having lost momentum through last year mainly owing to US-China trade

Over the course of March, the US dollar increased by around 4% on a trade-weighted basis, raising the burden of dollar denominated debt for EM economies even as US interest rates were slashed to zero.

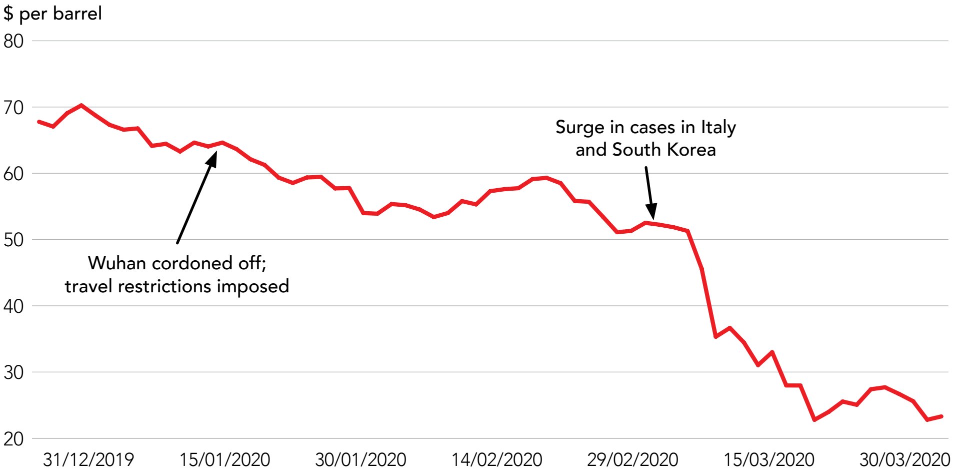
Chart 15: Risk aversion sends the US dollar sharply higher



Source: Bank for International Settlements

Oil prices fell by around 60% over the first three months of this year with Brent crude selling at less than $30 per barrel (p/bl) at the end of March.

Chart 16: Oil prices fall dramatically



Source: US Energy Information Administration tensions. Our best guess is that world GDP will fall at an annual rate of 4% to 5% in the second quarter of this year. Many economies will record much sharper annual percentage falls than this, possibly running well into double digits.

Once the health crisis is substantially over, and depending on the success of the policy measures discussed below, there *should be* a fairly rapid return to reasonable rates of economic growth. Some of the lost economic activity is likely to be recouped, for example delayed purchases of consumer durables such as TVs and white goods will eventually take place. But much will be permanently lost, including in the service sector – cancelled visits to hotels, bars, restaurants, cinemas, etc are never regained.

China, as the "first-mover" in the COVID-19 crisis may offer some clues to the duration and severity of the likely economic damage elsewhere. In Q1 the Chinese economy will have contracted sharply quarter on quarter, given the monthly data from indicators such as retail sales, industrial production and investment. More recently, there has been an easing of restrictions as the health crisis there has abated and there are tentative signs of improved economic activity, such as reopening of factories and increased travel. This would suggest the possibility of a relatively short, sharp economic shock, followed by recovery. But such an outcome is not guaranteed in China and is highly uncertain for the rest of the global economy.

The ultimate goal of policy is to prevent an inevitable sharp economic contraction from becoming a prolonged recession or even a depression with very high and persistent rates of unemployment.

POLICY RESPONSE

The global policy response to the COVID-19 pandemic has been unprecedented. The ultimate goal of policy is to prevent an inevitable sharp economic contraction from becoming a prolonged recession or even a depression with very high and persistent rates of unemployment.

On the monetary side, most central banks have now pushed interest rates to the floor and are scaling up other monetary easing measures, including massive quantitative easing (QE) – the purchase of financial assets from the private sector. The pace of this is greater than during the financial crisis of 2008-09. For example, the European Central Bank (ECB) has announced a "Pandemic Emergency Programme" in which it will buy €750bn of assets this year, on top of an existing QE programme. The US Federal Reserve has set no limit to the size of its asset purchases and has extended the range of assets it will buy to include high-yield corporate debt and other risky assets – an approach not adopted during the financial crisis. QE is intended to boost liquidity in the financial sector and prevent a liquidity squeeze. Central banks are also relaxing certain capital adequacy requirements and providing cheap and ample funds to the banking system – these are designed to keep credit flowing, especially to those affected by the crisis, and to prevent a more widespread credit crunch. The good news is that banks are generally more resilient than they were before the 2008 financial crisis because regulators have required greater liquidity and capital reserves.

The speed and scale of the economic collapse has meant that large scale fiscal action is required. Indeed, as Christine Lagarde, president of the ECB emphasized recently the policy response should be 'fiscal – first and foremost'. By this is meant a massive increase in government spending and intervention to replace as much as possible of the lost private sector incomes. The more of this that can be done now, the less policy stimulus will be required when conditions for normal economic activity are restored. The total fiscal support provided by many governments is substantial – the US, UK and Germany have all enacted (as of late March) packages worth around 10% of GDP. It remains to be seen whether more is required.

One of the most important fiscal measures being taken is direct transfer of state funds to individuals. In some cases, this involves sending payments directly to all qualifying residents. Hong Kong has already done this earlier this year and it is included as part of the $2trn US stimulus package. A more targeted approach is for the state to pay most or all of the wages of workers in affected companies. This is the policy adopted by the UK and Danish governments. By paying the wages of those in jobs that are in temporary furlough, companies are helped to survive, employees are not laid off and they avoid financial hardship. Moreover, as conditions improve, everything is in place for a return to normal economic activity.

The economic damage in coming months will be huge. But if appropriate policy action is taken, then conditions for recovery will be in place when the COVID-19 health crisis is substantially over.

Other measures include delaying or even waiving some taxes, increasing benefit payments, and making grants and guaranteeing loans to affected companies. Many fiscal packages include specific help for small and medium sized enterprises (SMEs), which are especially vulnerable since they have much lower financial buffers than larger companies. For example, the US stimulus includes $367bn of support for SMEs, much of it initially in the form of loans that can be made into non-repayable grants under certain conditions.

The economic damage in coming months will be huge. But if appropriate policy action is taken, then conditions for recovery will be in place when the COVID-19 health crisis is substantially over. Once confidence is restored, then this recovery should gather momentum, even if it is initially rather patchy. For now, the focus of economic policy is on preventing the COVID-19 pandemic from causing significant and permanent damage to the global economy.

LONG-TERM EFFECTS

The sheer scale of the current economic shock is bound to have long-term implications. The following are merely some initial thoughts.

Higher public spending, higher taxation

In many countries, the scale of government intervention will resemble war-type conditions: huge state involvement funded mainly by increased borrowing. The fiscal cost will be very large indeed, public sector deficits and debt will soar; deficits in many cases will rise well into double digits as a percentage of GDP. This dynamic will be made more dramatic since GDP is currently contracting at a fast pace throughout the global economy. Chart 17 plots the UK public sector balance since 1929, showing the impact of the Second World War on the budget deficit (during wars economies tend to grow as production is shifted from 'butter to guns'). The US pattern is very similar. It is not inconceivable that a similar pattern emerges now, given the combined effect of a massive rise in public spending and a collapse in private sector activity. As the temporary state support is withdrawn, budget deficits will shrink but remain substantial and public sector debt will rise significantly. As with public sector debts run up during war time, debt consolidation can be spread over the coming years and decades. The ultimate outcome may be a permanent increase in the share of public spending in the economy and the role of the state – similar to the experience in many advanced economies after the Second World War. The rebuilding of public sector finances after the global financial crisis involved a long period of austerity with cuts in public spending. Approximately two-thirds of the adjustment occurred by austerity measures with one-third from higher taxation. In the aftermath of the current crisis, it is very likely that it will be a rise in the burden of taxation that contributes most to the rebuilding of the public finances.

A reversal of globalisation

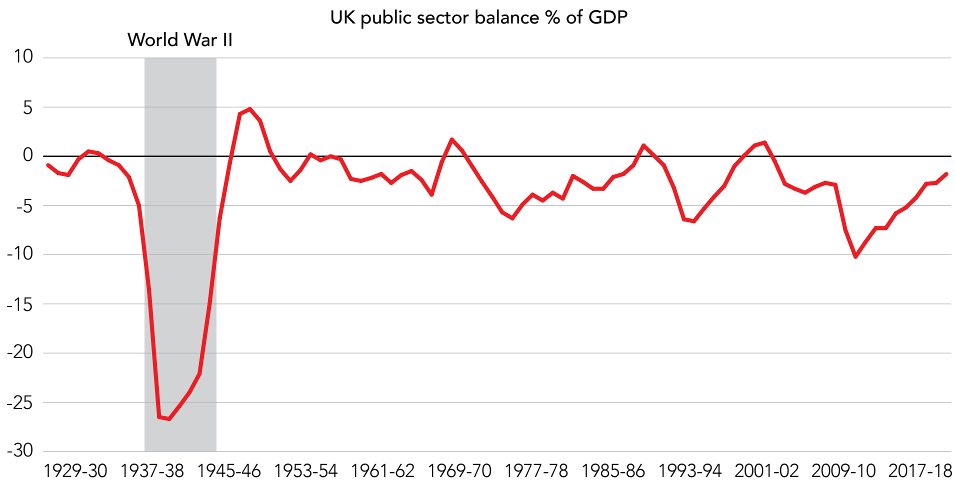
The COVID-19 crisis may give further impetus to retrenchment from globalisation. This trend had already been established to some degree with increased protectionist measures in many areas, not just between the US and China. The crisis has led to further trade restrictions, including outright bans on the export of certain foods and medical equipment, in some cases. These will prove temporary but are indicative of an attitude less positively inclined towards free trade. The long-term effect of the crisis is likely to be to further shorten supply chains, their vulnerability having been exposed. Global trade will fall sharply this year, possibly by as much as 20%. But a question mark hangs over whether trade will recover lost ground when eventually the global economy returns to growth.

The eurozone – make or break?

The fallout from this crisis is likely to have significant consequences for the eurozone. As discussed above fiscal policy is doing the heavy lifting in the policy response. Within the eurozone this means that individual member states are launching their own fiscal packages in an attempt to mitigate the effect on their economies. There is simply no eurozone-wide finance ministry with tax and spending powers able to provide fiscal support. The aftermath of this economic shock will leave many eurozone countries with large public sector deficits and debt, at well-above the limits set for membership of the single currency. The risks of another sovereign debt crisis will inevitably increase. Even before the current economic shock, Italy was viewed by many as the most likely candidate for such a crisis, with very high public sector debt (130% of GDP) and an anaemic economy. This could be the catalyst for the fiscal union that is ultimately necessary if the monetary union is to survive and be successful.

> The fiscal cost will be very large indeed, public sector deficits and debt will soar; deficits in many cases will rise well into double digits as a percentage of GDP.

Chart 17: A return to wartime public sector finances?



Source: UK Office for Budget Responsibility

Appendix I:
Economies covered by Q1 survey responses

North America	Middle East	Asia Pacific	Central & Eastern Europe	South Asia	Western Europe	Africa	Caribbean	Central & South America
Canada	Bahrain	Australia	Bulgaria	Afghanistan	Cyprus	Cameroon	Barbados	Belize
Mexico	Egypt	Mainland China	Czech Republic	Bangladesh	Finland	Ethiopia	Bermuda	Brazil
USA	Iraq	Hong Kong SAR	Hungary	India	Germany	Ghana	Grenada	Columbia
	Israel	Indonesia	Moldova	Kazakhstan	Greece	Ivory Coast	Guyana	Costa Rica
	Jordan	Japan	Poland	Maldives	Ireland, Republic of	Kenya	Jamaica	
	Kuwait	Korea, Republic of	Romania	Nepal	Italy	Liberia	Puerto Rico	
	Lebanon	Malaysia	Russia	Pakistan	Luxembourg	Malawi	St Vincent	
	Oman	New Zealand	Slovakia		Malta	Mauritius	Trinidad & Tobago	
	Palestine	Philippines	Ukraine		Netherlands	Namibia		
	Qatar	Singapore			Spain	Nigeria		
	Saudi Arabia	Vietnam			Switzerland	Sierra Leone		
	United Arab Emirates				Turkey	South Africa		
					UK	Sudan		
						Tanzania		
						Uganda		
						Zambia		
						Zimbabwe		

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Global economic conditions continue to dominate business and political life. News and debates on economic issues are almost constantly the focus of media attention. While most national economies are now growing once again, it is far from clear how sustainable this growth is or how long it will be before a sense of normalcy returns to the global economy.

ACCA and IMA have been prominent voices on what the accounting profession can do to help turn the global economy around. Both bodies have published extensively on a range of topics, from the regulation of financial markets or the prevention of fraud and money laundering, to fair value or the role of international accounting standards, to talent management and the development of an ethical business culture.

ACCA and IMA aim to demonstrate how an effective global accountancy profession contributes to sustainable global economic development; to champion the role of accountants as agents of value in business; and to support their members in challenging times. Both professional bodies believe that accountants add considerable value to business, and never more so than in the current environment.

Accountants are particularly instrumental in supporting the small business sector. Small and medium-sized enterprises (SMEs) account for more than half of the world's private sector output and about two-thirds of all employment.

Both ACCA and IMA focus much of their research and advocacy efforts on articulating the benefits to SMEs of solid financial management and reliable financial information.

WHERE NEXT?

As countries around the world continue to consider strategies to promote stability and stimulate growth, the interconnectedness of national economies, and how they are managed and regulated, is now under close scrutiny. The development of the global accountancy profession has benefited from, and in turn contributed greatly to, the development of the interconnected global economy. The fortunes of the two are tied. ACCA and IMA will, therefore, continue to consider the challenges ahead for the global economy, and focus on equipping professional accountants for the uncertain future.

CONTACTS

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