

THE FINANCIAL ANATOMY OF CURRENT PANDEMIC CRISIS

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Abstract:

The current crisis is the first in human history global pandemic cataclysm. The latter has caused colossal losses globally due to massive disease of population, efforts to counter the pandemic and consequences of isolation in the hope of avoiding contamination of healthy people. The analysis of pandemic crisis is complicated by the fact that it takes place in conditions of cyclical economic crises started in previous years. Financial aspects of pandemic crisis are different, such as stock market crashes, rising levels of indebtedness, fiscal problems, affecting investment, insurance and other segments of global financial market activity. The current crisis situation is highly likely to degenerate into a deep financial crisis. In order to alleviate the crisis, central authorities in different countries have taken respective complexes of measures, the effectiveness of which will be demonstrated over time.

Keywords: *pandemic crisis, economic crisis, financial crisis*

JEL classification: *F65, G01*

Introduction

In the opinion of many economists, "COVID-19 is more than a health crisis, with unprecedented socio-economic implications, and pandemic is disrupting every country it affects, with the power to generate devastating social, economic and political effects, which will leave deep scars." (*Pandemia...*, n.d.)

The world community is currently facing an unprecedented pandemic cataclysm. Human history has repeatedly experienced pandemic crises, but they have had a regional character, while the current one is the first with a truly global character.

After the rapid spread of infectious diseases called COVID-19, the global health care system received a catastrophic blow, with the number of sick people increasing. Of course, this process will also have important economic and financial consequences in the form of losses caused by the inability of a large number of patients to work, as well as increased costs for the maintenance of the medical system. On the other hand, isolation measures, unlike most countries, have led to significant bottlenecks in the operation of international trade and logistics systems, as well as the cessation of many economic activities.

Mario Arturo Ruiz Estrada is of the opinion that the entire world community is affected by the crisis in the form of uncontrolled economic decline due to the COVID-19 pandemic, because of the negative impact on economic processes, which directly affects the process of global GDP. (Estrada, 2020)

World Bank experts say that COVID-19 pandemic crisis "would represent the deepest recession since the Second World War, with the largest fraction of economies experiencing declines in per capita output since 1870". (*COVID-19 to Plunge...*, n.d.)

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Economic analyzes of pandemic crisis largely overshadow its financial aspects, which are largely seen as signs of economic crisis. However, following significant financial risks, it is fully possible to trigger a deep financial crisis.

All this requires a wide range of measures to prevent it.

Description of the problem

The evolutionary model of global pandemic crisis is presented in Figure 1 as anatomy of current economic and financial crisis.

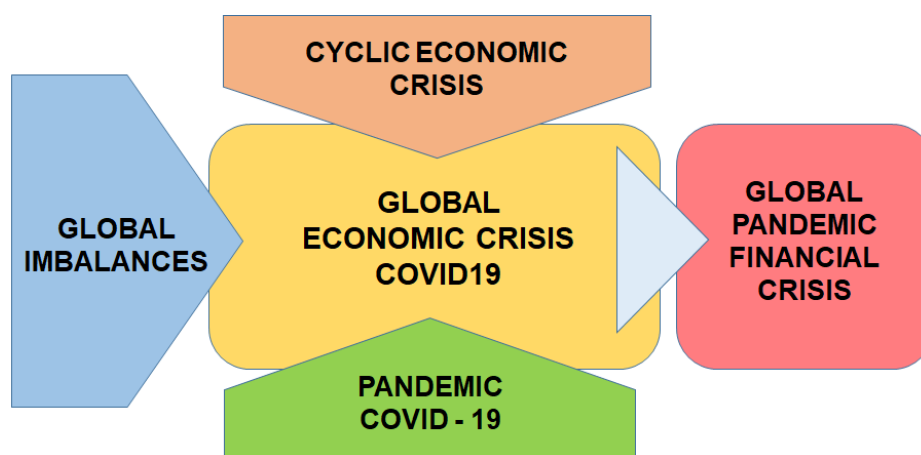


Figure 1. The anatomy of current economic and financial crisis

Source: developed by the authors

At present, there are controversies in the academic environment regarding the status of COVID-19 crisis:

- *The COVID-19 recession* expresses by a decrease in production, a reduction in investment, a temporary stagnation of business, being a phase of decline in economic activity and a temporary decline in global economic activity under the influence of the SARS virus pandemic CoV-2, its consequences, as well as measures to prevent its spread based, in large part, on isolation. (*COVID-19 recession*, n.d.)
- *The economic crisis COVID-19* can manifest itself as a period of economic decline, which is the result of influence of a complex of factors and which has its roots in cyclical economic crisis triggered in December 2018. (*Муровей...*, n.d.)
- The COVID-19 depression can manifest itself as a long-term economic collapse, as a result of the global pandemic, as a catalyst for economic and financial cataclysms, whose potential has been accumulated a few years ago. It can be characterized by following manifestations: significant increase in unemployment rate, credit crunch, major decline in industrial production and investment, price deflation, hyperinflation, numerous bank failures, significantly reduced trade, a highly volatile and unpredictable exchange rate (mainly with trend of devaluation), reduced demand for goods and services, increase of production costs, decrease of production volume, decrease of profit rate, reduction of living standard of population. (*The Next...*, n.d.)

As confirmation, experts from several international institutions have made different forecasts for the dynamics of Gross Domestic Product (GDP) worldwide, with GDP reduction forecasts ranging from 3% to 6% (*Congressional...*, n.d.), including: International Monetary Fund (- 4.9%); World Bank (-5.2%); Bloomberg (-3.7%).

According to experts from the Asian Development Bank, the global losses from the coronavirus pandemic will amount to between USD 5.8 trillion and USD 8.8 trillion. (*Coronavirus...*, n.d.)

By 2020, the World Trade Organization has forecast a reduction in world trade in the range from 13% to 32%. (*Trade...*, n.d.)

Given the specifics of crisis, analysts cannot guarantee a resumption of trade even in 2021, noting the dependence on duration of pandemic and effectiveness of measures taken.

The recession has led to a drop in the price of oil triggered by the 2020 war for Russia and Saudi Arabia, the collapse of tourism, the hospitality industry, the energy industry and a significant drop in consumer activity compared to the previous decade.

The COVID-19 pandemic recession has caused unusually large and rapid rises in unemployment in many countries.

One of the fundamental problems of COVID-19 crisis is that along with the negative impact of the pandemic is still the cyclical economic crisis triggered in December 2018.

As in the case of other economic cataclysms, the COVID-19 crisis has brought important disruptions to the functioning of international financial mechanisms.

Methodology and data sources

In order to conduct the research on current pandemic crisis, information from international financial institutions, official information sources, public institutions' reports, as well as opinions, results of analysis carried out by experts were studied. The study was completed by formulating the conclusions related to this financial phenomenon.

Results obtained

The COVID-19 pandemic crisis generated a complex of financial problems:

➤ *Instability of global financial market liquidity.* This is determined by the accentuation of the behavior of hot money, whose mobility was amplified during the pandemic. Partly this problem is complicated by the mobilization of free money on the market in the form of loans by central authorities in many countries to finance anti-crisis programs.

In addition, between February and March 2020, the global stock market crashed. In particular, the S & P500 Index decreased by 33.9% (*S7P500...*, n.d.), the EuroStoxx50 Index - by 38.23% (*EURO...*, n.d.) and the TOPIX Index - by 27.2% (*Tokyo...*, n.d.).

On the other hand, there has been an increase in demand for shelter assets. In particular, in 2020 world gold prices set the historical record of 2070 USD / ounce in August 2020 (*Gold...*, n.d.).

➤ *Disruptions in the international foreign exchange market.* The COVID19 pandemic, as well as the derived economic crisis, is spreading unevenly in the global economic space, which has caused important changes in the formation of foreign exchange rates of different countries.

Thus, in the period 10.05.2020-03.01.2021, the exchange rate of US Dollar against Euro decreased by 13.5%. (*Yahoo...*, n.d.). This process compromises the role of the US dollar as a reserve currency.

It was largely due to political and social instability in the US and the increased issuance of the US dollar. To reduce the impact of pandemic crisis, the additional issuance of US dollar is made through the purchase of Federal Reserve System of government bonds and commercial papers with mortgage backing. The volume of these transactions in 2020 amounted to approximately USD 4.3 trillion. (Trofimov, 2020)

Thus, are aggravated problems with general expression as Triffin Dilemma, which put it this way: "In order to provide central banks in other countries with the amount of dollars needed to form national foreign exchange reserves, it is necessary for the United States to have a constant balance of payments deficit. But a balance of payments deficit undermines confidence in USD and reduces its value as a reserve asset, so a balance of payments surplus is needed to increase confidence".

The trend of continuous growth in the volume of international trade and services provided internationally requires a continuous increase in available liquidity, including in US dollars.

Thus, the volume of world trade increased from \$5.2 trillion in 2000 to \$19.5 trillion in 2018. (*Trends...*, n.d.)

➤ *Increasing global debt.* In the conditions of the pandemic crisis, the formation of the global debt bubble continued (Figures 2 and 3).

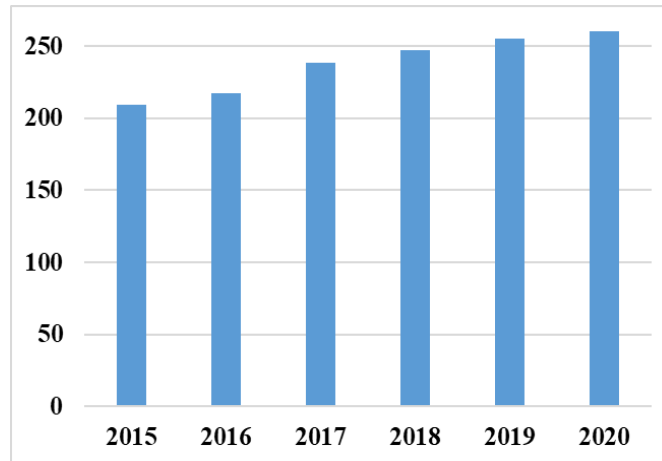


Figure 2. Global debt dynamics (trillions USD)

Source: (*Luchian, Tepordei, 2020*), (*Amaro, 2020*)

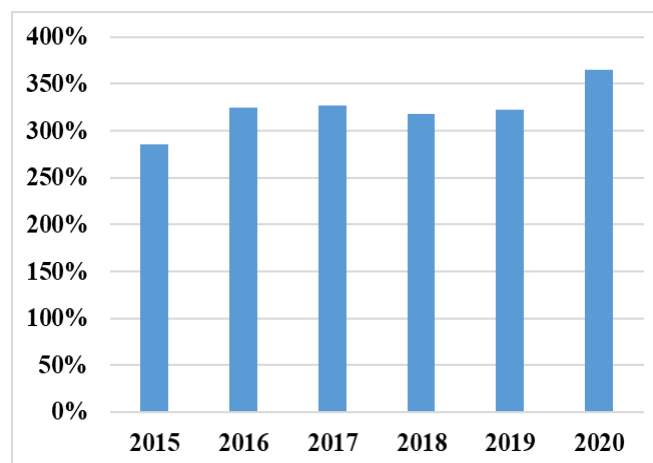


Figure 3. Dynamics of the ratio of global debt to global GDP (%)

Source: (*Luchian, Tepordei, 2020*), (*Amaro, 2020*)

The recessionary conditions caused by the pandemic determined the global debt to GDP to reach a new record of USD 272 trillion in the first three quarters of 2020 (increasing by USD 15 trillion). It is also expected to reach the level of USD 277 trillion by the end of the year. Thus, in the last 20 years the global debt has increased 3.2 times.

Thus, the forecasts of the global debt increase until 2030 to the level of 360 trillion USD are gradually coming true. (*Aris, 2020*)

In the structure of global debt in the third quarter of 2020, the debt of industrially developed countries had a share of 72.1%, amounting to USD 196 trillion. And the debt of developing countries had a share of 27.9%, reaching the level of USD 76 trillion. (*Lu, 2020*)

It is also significant the fact that during the years 2015-2020 the global debt in the global GDP by 79 pp, reaching the level of 365%.

The global public debt also had a tendency to increase as a share in GDP during the years 2015-2020 by 24 pp, reaching the level of 98%. (*Global public...*, n.d.)

Fiscal measures taken in countries around the world in the amount of USD 11.7 trillion contributed to this, which accounted for about 12% of global GDP. Government deficits accounted for 9% of global GDP in 2020. (Bacani, 2020)

In this context it should be mentioned that the COVID-19 crisis caused a new form of global imbalances of anti-crisis economic and financial measures. At the moment, the discrepancy between the industrially developed and the developing countries becomes evident in view of the economic-financial intervention of the central authorities for mitigating the consequences of the global pandemic crisis.

But undertaking these activities required the mobilization of additional funds in the form of loans, which, in turn, led to a worsening of global debt problem.

➤ *Significant reduction in the volume of direct investments.* The pandemic crisis has negatively influenced trends in foreign direct investment (Figure 4).

According to UNCTAD forecasts, the overall volume of FDI is set to decline by 42%, to \$ 858 billion. Such a low level was last seen in 1990s and is more than 30% below the global FDI level, which followed the global financial crisis of 2008-2009. In this context, UNCTAD expects FDI flows to decline modestly in the range of 5-10% in 2021. In 2022 an upward trend may form. (*Global foreign...*, n.d.)

The general picture of global distribution of FDI is as follows.

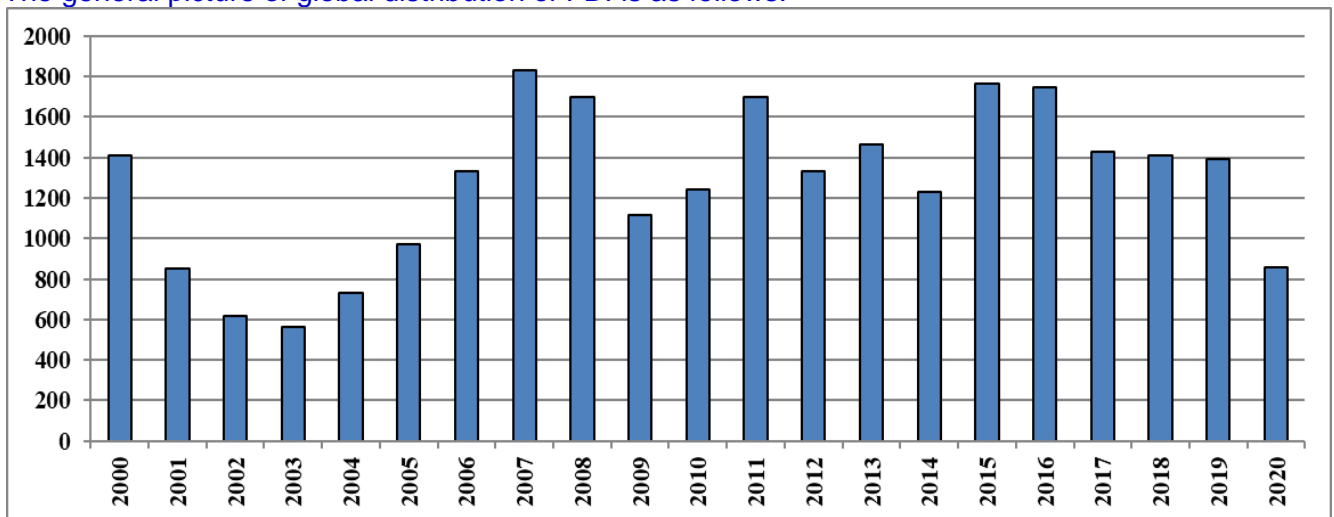


Figure 4. Dynamics of global FDI flows (billion USD)

Source: (Bîrcă, Luchian, Tîrlea, 2020), (*Global foreign...*, n.d.)

During the years 1995-2020, the share of FDI attracted by countries with developed economies was 55.6%. In 2020, the projected volume of FDI in these countries is USD 229 billion, decreasing compared to 2019 by USD 501 billion or 69%.

The share of FDI attracted by developing economies was 40.2%. In 2020, they amounted to USD616 billion, decreasing compared to 2019 by USD 86 billion or 12%.

Countries with economies in transition had a share of 4.2%, attracting USD13 billion in FDI by 2020, down 45 billion or 77% from the previous year. Thus, the COVID-19 pandemic crisis affected in terms of attracting FDI most countries with developed and transition economies. Inevitably, these problems will affect the functioning of the global banking system and global insurance systems.

The current crisis is very likely to degenerate into a deep financial crisis.

In order to alleviate the crisis, central authorities in different countries have taken complex measures, largely aimed at strengthening the financial system and maintaining the financial situation of economic operators, as well as the social protection of population.

Conclusions

The COVID-19 pandemic crisis, which has a unique character, is currently in full swing. Based on a cyclical global economic crisis, which is exacerbated by various negative factors, this crisis is mainly manifested by the significant losses caused by the pandemic, as well as the isolation

measures taken in over 200 countries. The non-uniform interregional and interbranch exposure of the effects of the crisis is remarkable. The pandemic crisis also has multiple financial aspects, which indicate important risk factors. Among the most important we consider the financial problems related to the international monetary system and the collapse of the international investment market. But the most dangerous is the modal debt bubble, which in certain circumstances can generate an additional financial crisis.

Future Directions to Be Approached

The study of addressed topic in the paper is to be continued by results monitoring global pandemic crisis evolution.

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