

MACROECONOMIC IMPACT OF THE COVID-19 PANDEMIC – GLOBAL EFFECTS AND UZBEKISTAN’S RESPONSE

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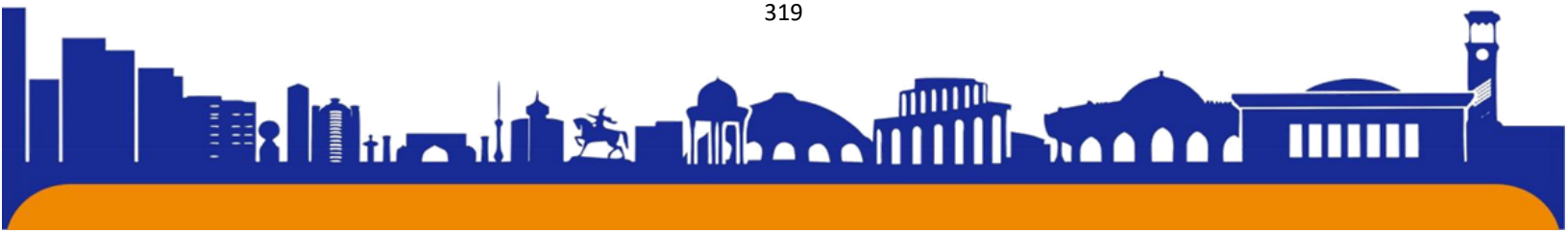
Abstract

This report analyzes the unprecedented economic impact of the coronavirus (COVID-19) pandemic, highlighting its effects on aggregate demand and supply, unemployment, price levels, and exchange rates globally. Originating from China's Hubei province, COVID-19 rapidly became a global health and economic crisis, resulting in a severe short-term recession, significant unemployment, falling inflation rates, and currency depreciation in developing economies. The tourism sector and related industries faced immediate substantial losses, with global GDP forecasts shifting sharply downward. Governments worldwide adopted substantial fiscal and monetary stimulus measures to mitigate the economic downturn. Using Uzbekistan as a case study, the paper further examines national responses, evaluates their effectiveness, and provides policy recommendations focused on direct financial support and targeted aid to small businesses and vulnerable populations.

Key Words: COVID-19 pandemic; global economic recession; aggregate demand and supply shocks; inflation dynamics; unemployment trends; exchange rate volatility; fiscal stimulus measures; monetary policy response; macroeconomic stability; Uzbekistan economic policy

Introduction

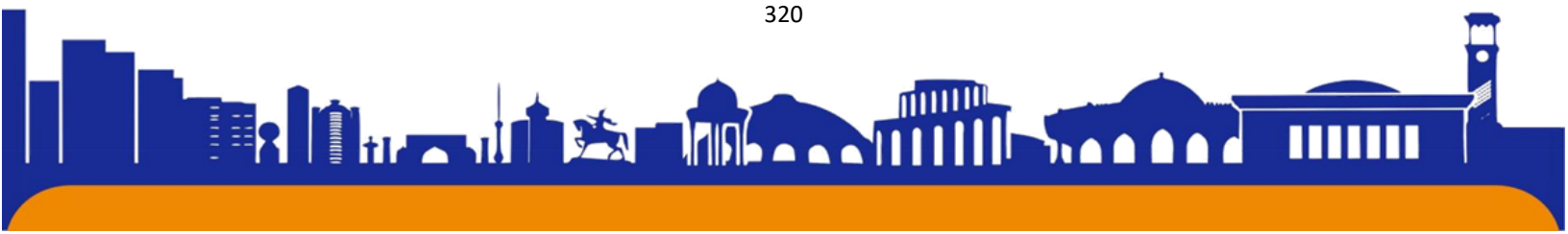
Coronavirus pandemic is a unique phenomenon that is currently testing the world's will and power to stand up against this new type of virus. The virus, which originated in Hubei province in China, has quickly spread across the world and is now threatening millions of human lives and the world economy. As of April 20, 2020, more



than 2 million people are infected in more than 170 countries and the virus caused the death of 165,759 people (Worldmeters, 2020). The USA and the Eurozone are the biggest epicenters of coronavirus infection. The virus is new and, currently, there is no effective vaccine to cure it (Spinney, 2020). As a result, social distancing is considered to be the only viable option to ameliorate the situation. In many countries, travel is restricted, educational institutions are closed, entertainment events are canceled and all gatherings are banned. As a result, economic activity stopped and this may lead to catastrophic economic losses (Masters, 2020). In January 2020, the world economy was forecasted to grow by 3.3% in 2020. After only three months, the forecasts downgraded to -3% recession or about USD 1.8 trillion loss in economic activity. Three economic superpowers, namely China, the USA and Eurozone area are expected to shrink by -3%, -5.5% and -9%, respectively (Capital Economics, 2020). Global unemployment is expected to increase by 5.3 million people in the best case or 24.7 million under the pessimistic scenario (ILO, 2020). Low demand and disagreements between oil-rich countries caused oil and commodity prices to fall by 37% on average. Moreover, because of high uncertainty and the absence of effective vaccine, global equity markets lost more than USD 6 trillion in one week (WEF, 2020) and most developing countries' currencies experienced significant depreciation (UNCTAD, 2020).

Tourism and related industries were one of the first to experience the negative consequences of the coronavirus crisis. Demand for travelling plummeted because of travel bans and quarantines and associated losses are estimated between USD 63 billion to USD 113 billion in 2020 or 11-19% decline in passenger revenue (Zhang and Whitley, 2020). Other businesses are also operating at loss and quarantine measures are draining savings fast. To prevent the economy from experiencing deep recession, governments are adopting unprecedented financial stimulus policies (Masters, 2020).

The aim of the report is to examine the coronavirus pandemic and its impact on global economy. The report will start with analyzing shifts in demand and supply, followed by the investigation of the virus's impact on key macroeconomic parameters. The next part focuses on policy responses by governments to ameliorate the consequences of the crisis. Finally, the report will conclude with the analysis of the

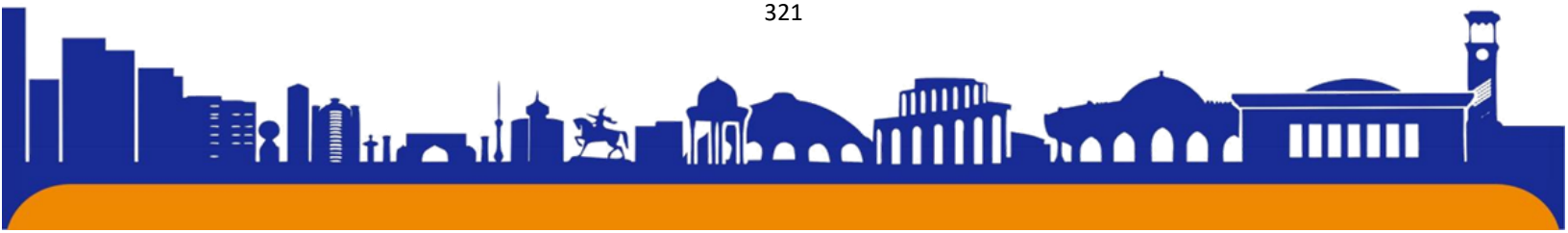




current situation in Uzbekistan, actions taken by the Uzbek authorities to prevent the spread of the virus and policy recommendations to stimulate the economy.

Aggregate Demand and Supply. The coronavirus crisis differs from the previous crises in that it initially caused a supply shock (Tadei, 2020). To contain the spread of coronavirus, governments from across the world were forced to impose strict quarantine measures. China, the initial epicenter of the virus, completely isolated several regions around Hubei province for nearly 3 months. The country banned all public events and prohibited large gatherings of people. As a result of lockdown and restrictions in labor movement, services, retail sales, production, construction and nearly all other economic activity decline in double digits (Hjelmgaard, 2020). Travel, touristic companies and related industries were forced to stop their operations due to quarantine measures. Manufacturing activity in the country also declined by 15 percentage points (Prescott, 2020). Although not as strict as in China, similar measures were imposed in Europe: in most member states, all educational and recreational places are closed, public events are cancelled and travel is restricted. The world's biggest economy, the USA, despite the slower reaction, also closed schools, restaurants and banned all public events (Masters, 2020). As the economic activity slowed in the world's 3 superpowers that account for more than 55% percent of the world GDP, global supply curve shifted inward. This in turn, led to widespread panic among public and loss of confidence across the world. Consequently, the supply shock led to demand shock. In the US, consumer confidence declined by nearly 10 percentage points. Hotel occupancy rate, which reflects demand for hotel services, fell from 70% to about 20% in the US. Retail store sales, after short period of panic buying exhibited -2% decline in growth (Capital Economics, 2020).

Supply shock, followed by demand shock, resulted in recession. However, the recession is expected to last only in the short term. Currently, more than 60 vaccines are being tested and health experts project that mass vaccination will be possible in 12 to 18 months (Spinney, 2020). Therefore, the crisis is likely to have short term impact on economic growth. According to IMF (2020), the world GDP will decline by 3% in 2020, but exhibit strong growth of 5.8% in 2021. This can be due to mass vaccination and delayed spending in 2020.

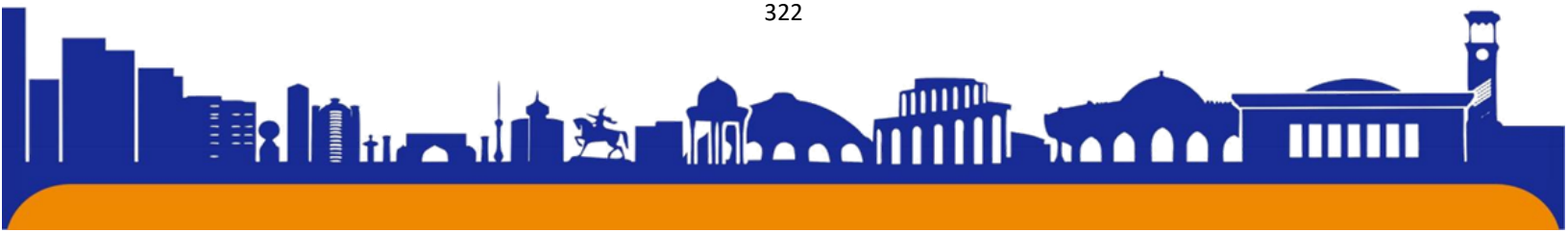




Price Levels. From economic theory, price levels are generally positively related to GDP growth (Mankiw, 2020). As quarantine measures slow down economic activity, there is less demand for goods and services, money circulation in the economy is weak. Although, there is strong demand for particular goods (basic necessities and medical masks) which causes their price to increase, overall demand for most goods in the economy is low. As a result, there is downward pressure on the rate of inflation. Due to expected strong recession, the inflation across the world, should be much lower than the previous years. The projections by IMF, support the theory. Overall inflation in the world is expected to decrease from 3.8% in 2019 to 2.5% in 2020. In the USA, inflation is expected to decrease from 1.9% (2019) to 0.8% in 2020. Similarly, price levels are expected to grow marginally (1% in 2020) in China in comparison with 4% inflation in 2019. On the other hand, Euro area is projected to experience -0.1% deflation, in start contrast to its 2019 inflation rate of 1.3%. Uzbekistan will most probably have lower rates of inflation in 2020 (11.2%) than in 2019 figure of 15%. Despite this, deceleration of price level increases is expected to be temporary. Due to combination of huge injections by governments and recovered demand, the price levels are expected to increase by 3.4%, reverting back to its pre-crisis levels (IMF, 2020).

Unemployment. High unemployment is the most obvious consequence of the covid crisis. With strict quarantine measures, millions of people became unemployed at least temporarily. For instance, in Italy, around 50% of labor is working efficiently and 22 million people requested unemployment benefits in the USA (Tadei, 2020). Moreover, given deep recession in 2020, high unemployment is likely to be problem even after quarantine measures are lifted. In 2020, unemployment is projected to reach 8.3% (from 4.8%) in advanced economies (IMF, 2020). The situation is even worse in developing countries, most of which already had high levels of unemployment. In most developing countries, unemployment is projected to reach double digits figures, due to which the poverty levels in many parts of the world may rise (World Bank, 2020).

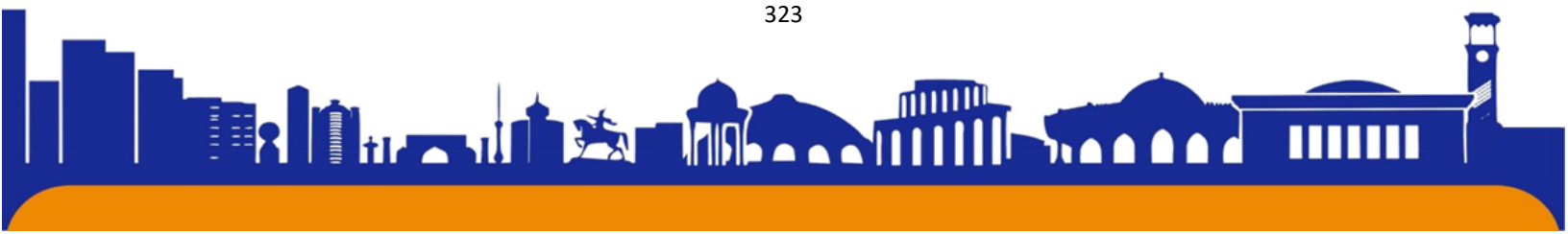
Exchange Rates. The coronavirus crisis had more profound impact on the economies of developing countries than advanced countries. While currencies of advanced economies generally remained stable, the currencies of many developing countries experienced sharp depreciation during the first quarter of 2020. The degree



of depreciation was stronger than in 2008 financial crisis: in some developing countries, such as Mexico and Brazil, local currency lost more than 20% of its value (UNCTAD, 2020). There are several factors contributing to this situation. Firstly, due to high uncertainty capital outflows from developing countries reached all time high figures. On average net portfolio outflows reached -70% in February (UNCTAD, 2020), which is greater than any other crisis period. As a result, demand for more stable currency, such as USD, in developing countries increased sharply, while supply generally shrank due to lower exports. Consequently, local currencies lost their value against the USD. Another reason is the contraction of exports. Due to coronavirus, global demand decreased and many countries were not able to find markets for their goods and services to export. For instance, Uzbekistan, which relies heavily on remittances from Russia (around 20% of exports (Tashkent Times, 2020), experienced reduction in supply of USD after Russia imposed quarantine measures and many Uzbek migrants were forced to return to their homes (IWPR, 2020). As a result, net exports reduced, which caused depreciation of som.

As it was discussed in previous sections, the coronavirus pandemic has already brought serious risks to global economy. Many experts are projecting deep recession, high level of unemployment and stagnating price levels or even deflation. In other words, strong economic downturn is projected to result. If governments and central banks leave the situation to market forces and does not interfere, there is high probability that the recession will be deep and its effect on economy will be long-lasting. Therefore, I think that the governments should take Keynesian approach and act immediately to alleviate the impact of the coronavirus impact on economy. The action should be taken by both governments and central banks.

Governments should on their side implement wide range of expansionary fiscal policies to stabilize the economy. Considering the seriousness of the situation, which many compare to the Great Depression in 1930, fiscal stimulus should be very strong. Specifically, governments should cut rates or delay tax and credit payments until the epidemic situation ends or at least becomes less severe. Another approach is to support businesses. Low rate loans, state guarantee to obtain funding, direct financial support to businesses and compensation of labor costs are all directed to prevent mass





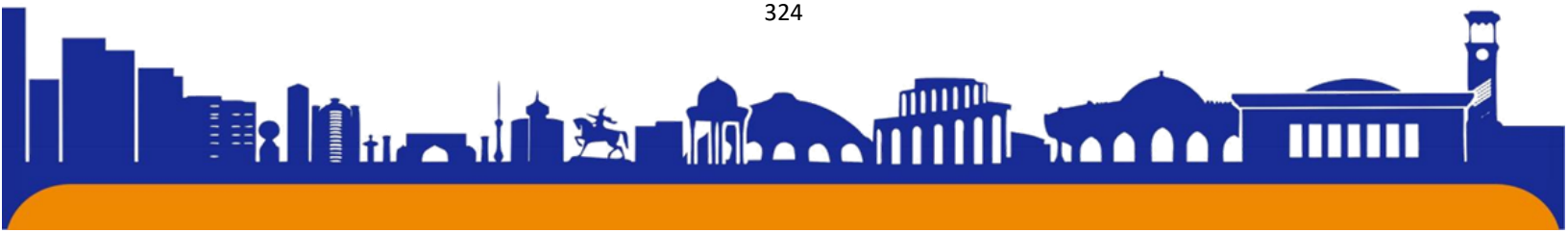
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shutdown of business and spike of unemployment. In my opinion, these measures should mostly be directed at labor intensive industries rather than capital intensive industries such as IT sector. This allows to save more jobs and prevent the rise of unemployment. Additionally, as in the USA, the governments may decide to make direct payments to citizens who lost their jobs due to quarantine measures (Masters, 2020).

On the monetary side, central banks should cut interest rates to stimulate lending. In addition to this, reducing reserve requirements as in China or UK (Masters, 2020) will allow banks to extend their loan portfolio and inject more money into struggling businesses. Additionally, the central banks can support banks and other financial institutions that are facing liquidity problems. In such crisis times, ensuring the stable operation of financial institutions is essential as they are responsible for lending activity and money circulation in the economy.

In fact, many countries are already widely implementing above-mentioned fiscal and monetary policies (Masters, 2020). Although some may argue that such strong expansionary policies will lead to excessive government debt that future generations should bear, it is essential to implement these measures to stabilize the economy. Even with such strong stimulus, IMF projects -3% recession in 2020 and warns that the situation may worsen if the virus is not contained. (IMF, 2020). Moreover, low demand may cause many businesses and individuals default on their loans, which may destabilize banks. If this happens, the situation may worsen as stable financial markets play major role in lending process. Finally, unemployment may skyrocket and it may have long-term impact on poverty rates in the country (WorldBank, 2020).

Coronavirus hit hardly most parts of the world and Uzbekistan is not exception. The first cases of coronavirus have been detected on March 14, 2020 and since then this number rose to more than 1600 cases (Worldmeters, 2020). As any other country infected by the virus, the Uzbek government faced dilemma of whether to save economy or people and authorities opted for the second one. In one day after the first cases have been reported, it was decided to close all educational institutions, restaurants, non-food markets and cancel all public, entertainment events (Hashimova, 2020). Over the next

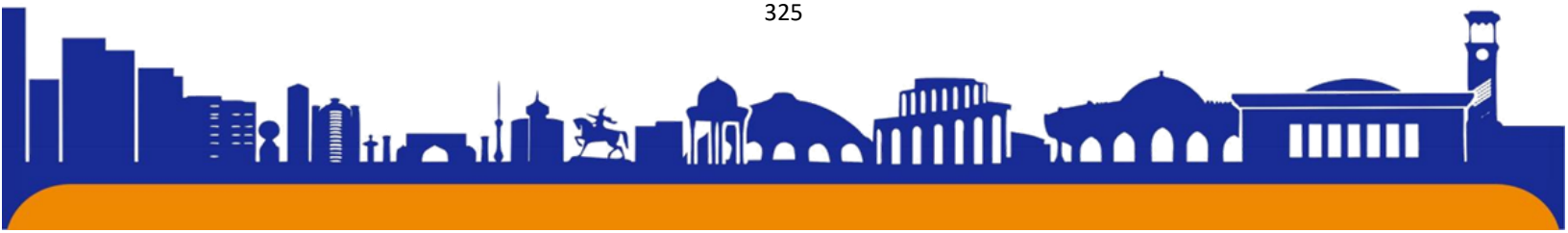




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days, the country closed its borders, severely restricted mobility and made wearing masks mandatory. As a result, Uzbekistan was able to better handle the crisis than most countries. As of 21 April, 2020, 1657 people infected the virus, 269 recovered and only 5 people died (Worldmeters, 2020). Although these results are impressive considering 33 million population, it will most likely come at high cost to economy.

Firstly, external factors are already exerting strong pressure on Uzbek currency. Specifically, remittances from Uzbek migrants in Russia stopped (IWPR, 2020) and investors are trying to return their investments from the country (UNCTAD, 2020). Additionally, local population is actively purchasing US dollars due to fears of Uzbek som depreciation. Consequently, som depreciated by more than 6.25% in April 2020 (CBU, 2020). Secondly, since strict quarantine measures nearly stopped the economy, IMF (2020), projects real GDP growth to decline from 5.6% in 2019 to 1.8% in 2020. However, the economy is expected to recover and exhibit 7% growth in 2021. Unemployment rate is expected to increase significantly because of migrants returning to their homes and bankrupt business due to crisis. In 2019, the unemployment rate was around 9.4% (Uzreport, 2020). Although there is no forecast for 2020, considering the situation, it should be much higher than the 2019 figures. Finally, inflation is expected to reduce to 11.2% (IMF, 2020). Although the country was struggling with high inflation and the falling inflation would be considered as good news in any other case, in the current situation, it represents slowdown of economic activity, as a result of which people's real incomes will deteriorate. To alleviate the impact of covid on economy, Uzbekistan adopted wide range of fiscal stimulus programs worth of 10 trillion UZS (Gazeta, 2020). Namely, the state announced tax delays and reductions, support with loan obtaining and reduced prepayment rates for utilities. In my opinion, Uzbek government used all its tools to support the economy. Recommendation would be to make direct cash payments to citizens in need. This form of support is more effective and affects consumption directly. Also, lend more short-term credits to SMEs and start-ups at very low interest rates. This would help them to recover and sustain their businesses.



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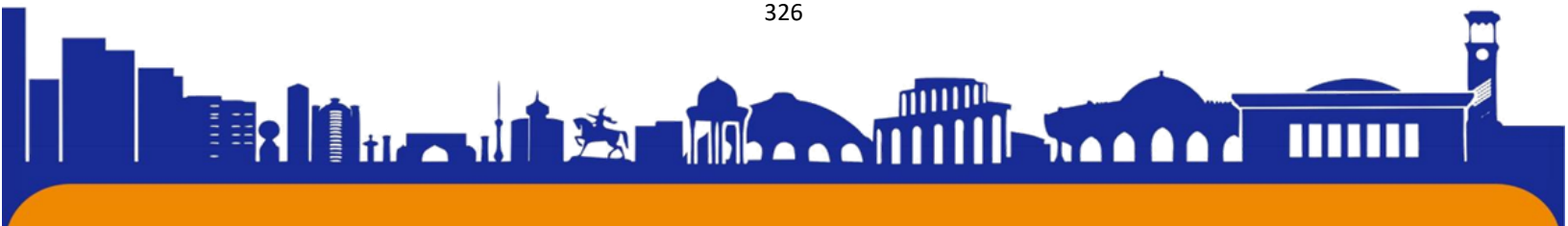
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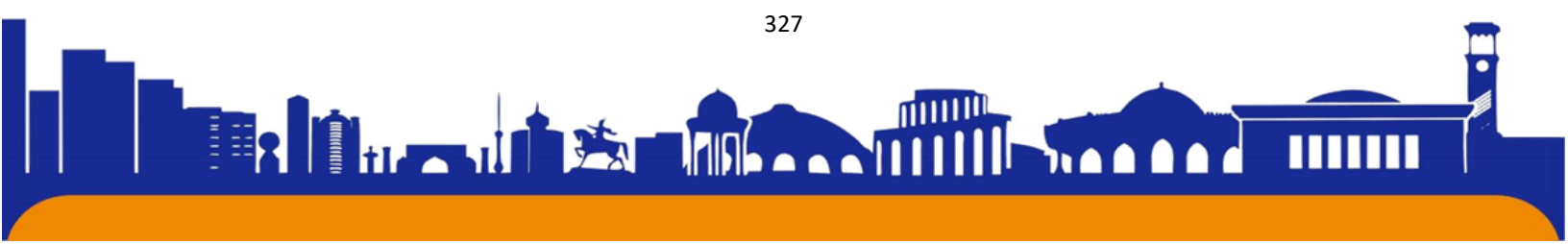
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