MACROECONOMIC CHALLENGES AND RISKS POSED BY THE GLOBAL CORONAVIRUS CRISIS

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Abstract: The article presents an analysis of the current global economic crisis caused by the coronavirus pandemic in 2020. The author's objecttives were to define and discuss the characteristics of the current crisis and its external causes as well as the macroeconomic, financial, institutional and social imbalances in the period after the global financial crisis of 2008 that led to its outbreak. Using this analysis, the author is identifying some longer-term macroeconomic challenges and risks that would deepen and prolong the current crisis as on a global scale as well as in the economies of Europe and Bulgaria. The main thesis to which the author adheres is that although the contemporary crises that occurred in 1929, during the 70s, and in 2008 had typical common characteristics and provided us with valuable lessons to be learnt, each of those crises had its own character and features. Based on this thesis, the article draws attention to the essential critical problems of the global economy in addition to those caused by the coronavirus shock.

Key words: economic crisis, macroeconomics, macroeconomic policies and challenges, sovereign debt, Euro Area, European Union, IMF, globalisation, Bulgaria.

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Introduction: times for insight, to learn the lessons from the crisis and for search of change

"In times of change, learners inherit the earth, while the learned find themselves beautifully equipped to deal with a world that no longer exists."

Eric Hoffer, 1973

The world and the global economy undergo a process of major transformations caused by the unprecedented lockdown of national economies, the international trade, supply and transportation channels, and cooperation chains. Hundreds of thousands and even millions of people around the world were literally sacrificed - physically and socially - for the common goal to stop the pandemic. Today, the main task of all governments, economic policy-makers, and international financial institutions around the world is to find a sound and long-lasting sustainable balance between the measures that have to be taken to contain the coronavirus pandemic and the like shocks and the creating of effective conditions that are needed for economic, financial and social recovery and development.

Despite the record levels of fiscal incentives launched over the last two months both on national level in a number of economies and on international and supranational level (such as the € 750 billion EU Recovery Plan), the global macroeconomic situation faces unprecedented levels of risk, uncertainty and challenge. Economies are trying to respond to excessive shocks in supply and demand of a scale no one has witnessed before. According to the IMF, the global economy is in a "synchronized slowdown". Markets are still trying to hold up despite the magnitude and ferocity of the macroeconomic storm, but with no success so far. In turn, the central banks around the world have mobilized unprecedented financial resources through financial instruments and incentives that were unheard of during the global financial crisis of 2008-2010. Nevertheless, all attempts to predict the course and outcome of the current global crisis have failed due to a number of reasons: macroeconomic data is measured and "mined" with a significant lag from the actual events, and the indicators we can use to understand their context in logical interaction change almost daily.

About 15 years ago, in the mid-90's, the famous economist and former Chair of the Federal Reserve, the central bank of the United States (FED) Ben Bernanke pointed out that "*to understand [the causes of] the Great Depression is the Holy Grail of macroeconomics,*" but "*we do not yet have our hands on the Grail by any means.*" He also wrote that "*not only did the Great Depression*

give birth to macroeconomics as a distinct field of study, but also – to an extent that is not always fully appreciated – the experience of the 1930s continues to influence macroeconomists' beliefs, policy recommendations, and research agendas." (Bernanke, 1995). Indeed, since 1936, when Keynes published his *General Theory of Employment, Interest, and Money* (Keynes, 1936), which "launched" the era of macroeconomics[1], a plethora of various explanations have been given to the Great Depression, which, according to Bernanke, *"remains a fascinating intellectual challenge"* because we still cannot plausibly explain how the economic situation deteriorated so much and remained such for so long (almost until the end of World War II) after the stock market crash in October 1929.

We emphasize all this not by chance, because with these thoughts in mind, we can define the **aim** of this article, which is to identify, understand and discuss the macroeconomic challenges and risks that characterize the phenomenon of the present economic and financial crisis (with a special focus on its manifestation in Bulgaria) as well as to investigate their dynamic interdependence. Although history never repeats itself exactly, we **believe** that this crisis has some common characteristics with the great financial crises in the past: the 1929–1934 crisis, the crises in the 1970s and the global financial crisis in the period 2008–2010.

The development and the extreme complexity of the current global crisis require further research in this field. The **research hypothesis** the author has tried to prove is that we cannot solve the current crisis using the tools employed in the past to deal with such crises and that we are now facing a new and unique combination of economic, financial, social, geopolitical and psychological factors, challenges, and risks, the mechanism of interaction of which is yet to be understood. But there is no doubt that it will require a significant change in our views on international cooperation and the processes of globalization, global trade, and in national economic specialization.

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[1] In his important research paper *The Importance of Beliefs in Shaping Macroeconomic Outcomes*, Rebuilding Macroeconomics, 20 April 2020, Roger A. Farmer (Warwick University) also states that "he history of macroeconomics began with the publication of The General Theory of Employment, Interest, and Money by John M. Keynes in 1936. Before that date, economics was separated into price theory, which dealt with the determination of relative prices, monetary theory (Patinkin, 1956), and Arthur Pigou's business cycle theory, which was captured in his book *Industrial Fluctuations* (Pigou, 1923).

I. What do we know about the characteristics of the current crisis?

Recessions, as an intrinsic component of the business cycle, are usually caused by a combination of stark economic and financial imbalances created during the expansion phase and delayed restrictive monetary measures within the cycle accompanied by errors in the implemented economic, monetary and fiscal policy. The current situation is quite different, as the main cause of this crisis is a completely exogenous shock, unrelated to the economic and financial spheres. Governments around the world have responded to the pandemic of the highly contagious Covid-19 with aggressive economic "lockdowns" or restrictive economic and social measures in order to stop any further spread of the virus. This immediately led to a sharp decline in the aggregate production and consumption in almost all economies; a decline that has been going on for more than three months now.

So, **the first conclusion we can draw** is that we are witnessing a recession[2], created by an external shock - in this case an acute virus - and backed by government decisions for the necessary temporary or partial suspension and/or closure of economic activities and national borders of entire economies or trade zones, and international trade restrictions aiming to prevent a major humanitarian crisis.

As Roubini (2020) points out, unlike the global recessions of 1929 and 2008, **this new, coronavirus-induced global crisis comprises both a supply shock and a demand shock.** The supply shock is caused by the disruption of established chains of international supply and cooperation, slower processes of world trade, and closed borders, which significantly slow down the global supply processes, if they do not stop them altogether. This supply shock, in addition to widespread fear, panic and uncertainty, led to a demand shock as well. This combination caused the fastest contraction and decline of production in the modern economic history, which affected not only the most developed economies and the Euro zone, but also the economy of China and other Asian economies and all emerging economies. Undoubtedly, all economies will report officially various levels of recession. Moreover, never before have the depth

[2] In their report of June 8, 2020, The Business Cycle Dating Committee (BCDC) of the US National Bureau of Economic Research (NBER) has determined that a peak in monthly economic activity occurred in the U.S. economy in February 2020. According to the Committee, the peak marks the end of the expansion that began in June 2009 and the beginning of a recession in accord with their definition of this term. Another significant fact related to this recession is the unprecedented magnitude of the decline. USA's GDP for the first quarter of 2020 was about 6% below its level of 2019Q4 and the decline is expected to exceed 30 or even 40% during the second quarter of 2020. In June 2020 alone, according to NY FED and GDPNow, the decline was 48.5%. Refer to the text for further information.

and speed of the contraction in world production been so great and extremely rapid – much greater and faster than those of the Great Depression of 1929. And that makes today's crisis unique compared to all the others. The crisis of 2008-2010 was a crisis of aggregate demand as its main cause. It demanded solutions that would create fiscal stimulus. That's why the Obama administration (at that time) dealt with the crisis[3] far more successfully and faster than Europe, which instead of implementing a plan of strong fiscal incentives to stimulate demand, chose the exact opposite path of a sharp contraction in public spending and salaries as a policy of austerity and naturally came out of the crisis much later and sustained much greater damage.

In April, in their World Economic Outlook blog the IMF projected global growth in 2020 to fall to -3 percent. This is a downgrade of 6.3 percentage points from January 2020, a major revision over only three months. According to IMF, this makes the "Great Lockdown" - as they refer to it - the worst recession since the Great Depression, and far worse than the Global Financial Crisis of 2008. (Gopinath, 2020)

Figure. 1 shows a comparison between the real growth of the GDP of both selected advanced economies and emerging market and developing economies during the crisis of 2008-2010 and the actual crisis of 2020 as year-on-year percent change:

[3] It is worth noting that on 17 February 2009, less than a month after his inauguration, President Obama signed a stimulus huge both in terms of financial resource (about 800 bln. USD) and number of pages (1073 pages), which included a whole package of acts known as the Recovery Act. The document was signed literally during the maelstrom of the global financial crisis. Obama's administration followed the "manual" of Keynes, the "godfather" of fiscal stimulus and his advice „to prime the pump" during downturns, i.e. stimulate growth by pouring gobs of public money into the economy. Michael Grunwald (2012) explains in detail haw this decision was made and turned out a success.

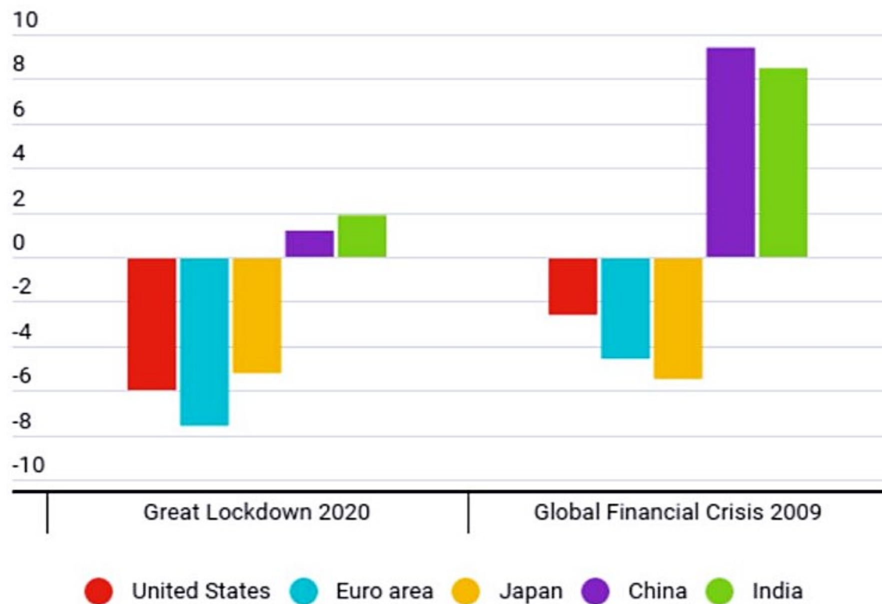
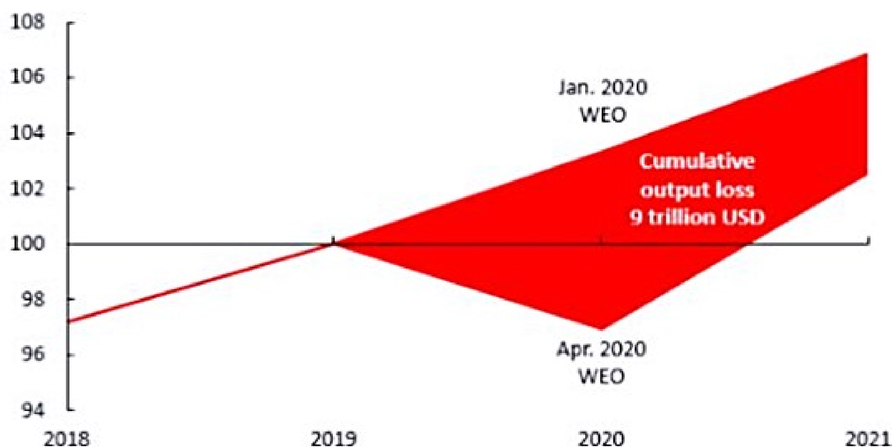


Figure 1. ***GLOBAL CRISIS: Comparison between the real growth of the GDP of both advanced economies and emerging market and developing economies during the crisis of 2008-2010 and the actual crisis of 2020 – the changes are in real GDP growth (year-on-year percent change)***

The economists of the large investment banks Morgan Stanley and Goldman Sachs (Kennedy, 2020) predict that advanced economies will contract with more than 30% in the second quarter of 2020 following the contraction of 6% in the first three months. Federal Reserve Bank of St. Louis President James Bullard predicted the U.S. unemployment rate may hit 30% in the second quarter because of shutdowns to combat the coronavirus, with an unprecedented 50% drop in gross domestic product. (Matthews, 2020).

In May 2020, central banks around the world (including the Euro Area and the EU) stimulated and promised to support their economies by 2021 with unprecedented record liquidity in various forms of quantitative easing (for their banking systems) with a view to halting or delaying the forthcoming debt crisis of historical proportions. Governments also responded with fiscal measures and increased budget deficits. Nevertheless, the IMF predicts (see Figure 2) that the cumulative output loss over 2020 and 2021 from the pandemic crisis could be minimum around 9-10 trillion USD.

Global real GDP level, index



Sources: IMF, World Economic Outlook, April 2020, IMF Staff calculations

Figure 2. ***Total Output Losses for the Global Economy: The cumulative output loss over 2020 and 2021 from the pandemic crisis could be minimum around 9-10 trillion USD.***

As the unfolding of the crisis is still at an early stage, we shall assume that it has several working characteristics and build on these assumptions in order to form the main pillars of further reflections on the coming macroeconomic challenges and risks in the short- and medium as well as in the long-term run:

- Every major national economy or group of economies in the world will experience an extremely sharp downturn, perhaps the largest since the middle of the last century. There is no economy that is immune to the impact and effects of this crisis. Potential economic, financial and social damage will at best be within a limited period of time.
- COVID-19 will affect all vital systems of the global economy. As Roubini (2020) points out: *"In other words, every component of aggregate demand – consumption, capital spending, exports – is in unprecedented free fall. What took around three years during the [2008] global financial crisis and the Great Depression to play out (i.e. stock markets to collapse, debt and credit markets to seize up, economic stagnation, unemployment rates to skyrocket), in*

the current crisis have materialized in three weeks. ... So, we know that this is a Great Recession that is worse than the global financial crisis of 2008. As such, the risk of a new Great Depression, worse than the original – a Greater Depression – is rising by the day and this time it is unlikely to last only two or three quarters. It may well persist during most of the following year.“

- The main economic drives are slow and limited, and this will slow down the overall creation of wealth among all social strata.
- At this stage, economic downturn is not due to decreasing demand. The effect of demand shock will come later, perhaps as late as at the end of the second or third quarter of 2020, when economists will be able to estimate the expected duration of the crisis.
- What is and will remain important for both the national economies and the international markets, will not only be the depth of the economic downturn in the second and third quarters of 2020, but also the duration of the expected crisis and its effects for the weaknesses of each economy. If, depending on the exogenous shock, the crisis lasts only a few months, by the end of 2020 at the latest, things could return to the previous state relatively quickly, but if it lasts longer, the "recovery" will be quite problematic.
- The longer it takes for each national economy to recover and return (if at all possible) to its "normal state", the more difficult it will be to avoid the risk of massive bankruptcies of companies and households, and the more severe their consequences will be.
- The nature of this crisis is such that it will be "guided" and affected mainly by the services sector and will be affected to a lesser extent by investment decisions and industrial development.
- The aggressive interventions of most central banks around the world have so far managed to reduce the risk of a credit crisis like the one we had in the period 2008-2009, but such a risk still exists.
- Notwithstanding the importance of the promised and undertaken massive fiscal stimulus programs, they can only help the economies recover rather than prevent their current downturn.
- At this stage, considering the demand shock described above, we do not believe that the average global volume of fiscal stimulus for the national economies and regions will raise the level of inflation in the short run. In fact, it will create conditions to reduce inflation to some extent and help some market players with poor or inefficient performance, who will survive by increasing their debt rather than their sales revenue. Grants and credit facilities will undoubtedly provide a backstop, but at the same time they "undermine" the efforts to increase labour productivity by keeping afloat the less efficient companies.

- Since this crisis affects mainly the services sector, it can definitely be said that especially in developed economies, the stronger and larger a business is (above average), the easier it will be to deal with the crisis, and vice versa. This will increase further the economic and social inequality of social strata. According to World Bank Director David Malpass, more than 60 million people worldwide could be pushed into “extreme poverty” by the effects of coronavirus (Malpass, 2020).
- Due to its specific nature and characteristics, this crisis will slow down and change the processes of globalization. Global flows and channels of trade, cooperation, labour, and capital will be less accessible for a prolonged period of time as, unfortunately, economic nationalism and protectionist policies become more popular. Political pressures and deglobalisation trends, influenced by the nature of the current crisis, will deal severe blows to the economic and social development worldwide and it is unlikely to return to its previous average rates and trends.
- The nature of this new global crisis has already dealt severe blows to almost all international and supranational institutions and organizations that advocate the processes of globalization. We observe the dramatic failure of the World Health Organization, a highly hesitant and controversial EU policy, the dispassionate behaviour of the World Trade Organization; of NATO; of the United Nations, of G20, and the IMF, whose failure to offer an effective solution to the profound debt crisis in Argentina did not Improve the credibility of this organization. All this cannot but act as a catalyst (negative or positive) to the destructive effect of this crisis for the hitherto established "world order".
- The crisis caused by the coronavirus pandemic will also cause global shocks. According to the UN’s World Food Program, the number of people in the world who will experience acute malnutrition will double in just one year due to the shock caused by the crisis, and will reach 265 million[4].
- There is no doubt that Covid-19 and the resulting economic crisis will require profound structural changes in the global economy over the next few years, including a different balance between economic nationalism and globalization, radical reforms of trade and monetary unions with a focus on more developed digital economy, long periods of extremely low interest rates and policies of significantly larger budget deficits. All of this brings us back to Keynes's *General Theory* that in order for budget deficits, government fiscal stimulus programs, and central bank "quantitative easing" policies to be

[4] This is a substantial increase of more than 130 million people from 2019. Most of them are in countries with military conflicts, drastic climate changes and grave economic shocks and social problems. A separate detailed analysis deserves the Global Report on Food Crises, 2020 and the official news release of the World Food Program of 21 April 2020.

effective, the return (or "payback" as Keynes puts it in his publication) on investments made and financial support provided through debt instruments must "give birth" to a higher rate of return than the debt used to fund them. This is particularly true for programs established at the expense of higher budget deficits.

II. Major macroeconomic challenges and risks beyond the immediate recession

When we analyse the macroeconomic challenges and risks arising from the coronavirus pandemic, we must not ignore that today, just over ten years after the previous crisis, the global and, in particular the European economies still face a number of extremely risky factors, the importance and content of which indicated even in 2019 that a new, bigger crisis may be looming on the horizon. After the 2008-2012 crisis, the global financial system continued to grow and accumulated a debt of more than USD 200 trillion, which is an enormous burden for a highly toxic economic and geopolitical environment (Ivanov, D., 2019).

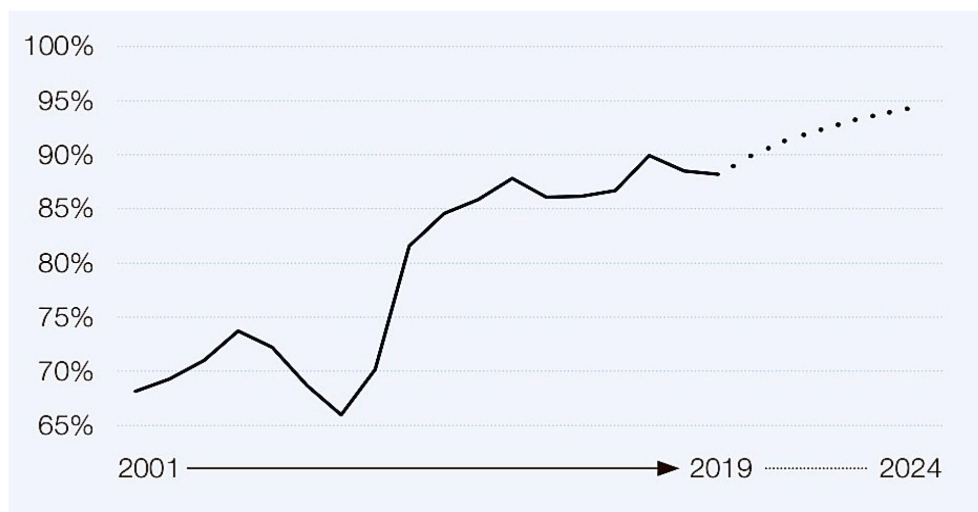
The risks were observed by many analysts: the slowdown of China's economy - the world's largest consumer; sharply declining return on investment; a growing crescendo of dangerous populist and protectionist policies and decisions; covert trade wars between the United States and China; political chaos in the United States; strong political and economic discord in the EU and the Euro Area; the Brexit which was troublesome not only for Britain, but for the whole EU, Italy's economy in a technical recession, uncertain Italian banks, a huge political rift in France, even the economic leader of Europe - Germany from 2019 was on the verge of possible recession; continuing volatility of the emerging economies.

In January 2019, the World Bank published their Global Economic Prospects report with the subheading ***Darkening Skies***, which is indicative of the bleak outlook depicted in the report (World Bank, 2019). The report of the World Bank revised downwardly the estimate growth rate of the advanced economies for the period 2019–2020 from 2.2 % to maximum 1.6%.

And only a year later, a coronavirus pandemic broke out. In addition to its characteristics, discussed in the previous chapter, the crisis, which affected the economies all over the world and revealed all flaws and deficiencies of the world economy and above all the huge aggregate unsecured debts of many developed economies.

Figure 3 shows that, according to the projections towards 2024, the expected total government debt of the G20 countries would reach a minimum

of 95 per cent of their total GDP. Note that the data was collected before the large fiscal stimulation interventions since the beginning of the coronavirus pandemic, which are expected to increase.[5]



Sources: Expected calculations by the IMF staff, World Economic Forum and data used from IMF Datamapper, https://www.imf.org/external/datamapper/GGXWDG_NDGP@WEO/OEMDC/ADVEC/WEOWORLD , calculated on 15 December 2019

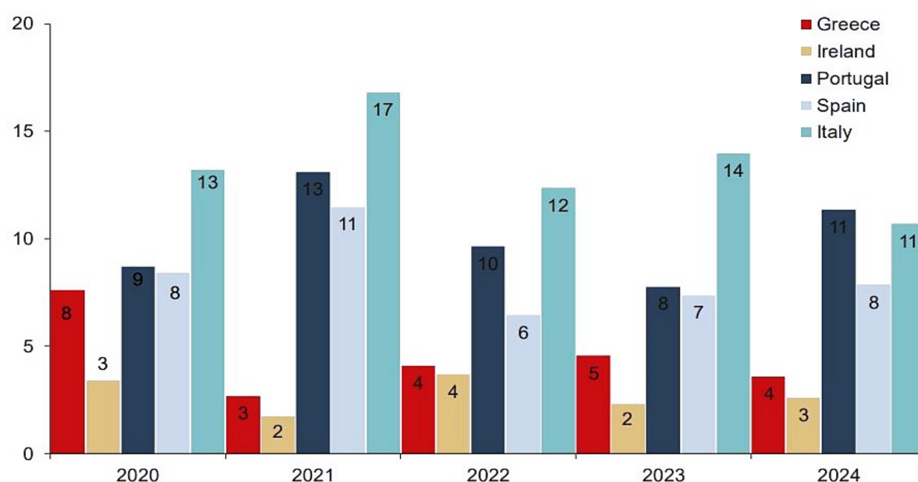
Figure. 3 ***Expected total government debt (towards 2024) as a share of gross domestic product in G20 countries in 2018 and projections for 2024. According to the projections, it would reach a minimum of 95 per cent of their total GDP (this calculation was made before the large fiscal stimulation interventions during April and May 2020)***

In this sense, the first and foremost macroeconomic challenge is the exceptional indebtedness of many national economies. In fact, the level of total debt in the world today, compared to the economic result (in terms of GDP), is more than twice as high as it was at the beginning of the crisis of 2008. Today, central banks continue to inject liquidity into national or regional banking systems. This growing and obviously difficult to service debt (despite of its cheaper price) creates an additional hurdle in the fight against the crisis. This situation cannot but hinder the required rapid recovery from the crisis. The debt of the Euro Area today exceeds 84.2% of its member states' GDP[6]. And this debt was accumulated before the coronavirus crisis. France has a gross external debt of 129.5% of its GDP. The Italian economy is in a deep debt crisis

[5] The US sovereign debt alone is expected to exceed 115.8 % of the country's GDP in 2024.

[6] Authors' calculation using data from ECB, Eurostat and ECB for 2019.

with 156% debt to GDP (for 2020). Spain and Portugal have external debt in excess of 135% and 144%, respectively, and Greece continues to be heavily burdened with debt in excess of 181% of its GDP, despite the debt restructuring in 2012 (Kraemer, 2020). The big problem for the Euro Area economies is that many of them, and in particular those from the southern periphery of the Euro Area, have debt repayment schedules that completely coincide with the next few years until 2024, during which period these economies will have to deal with both the recession and massive internal structural problems (see Fig. 4).

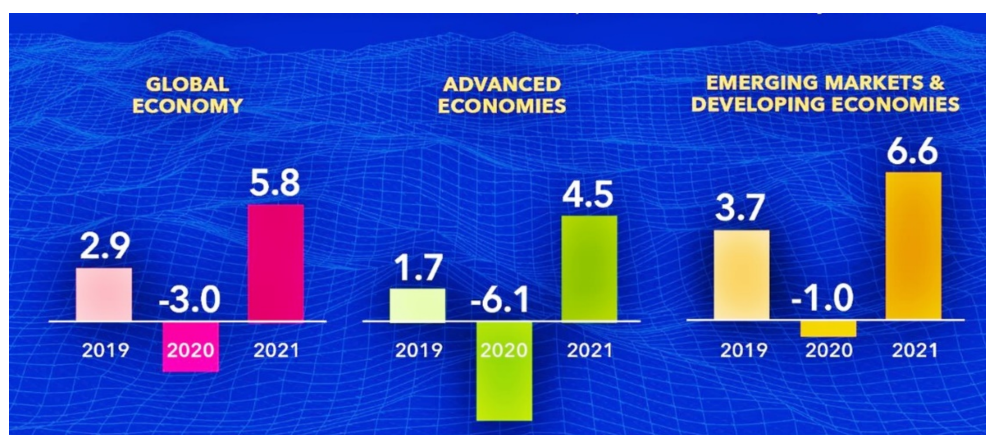


Notes: All repayment amounts include both principal and accrued interest. All GDP values are projections from the latest data from the International Monetary Fund. All values are nominal.
Sources: Data used from Bloomberg, International Monetary Fund, Haver Analytics, and the Globalization Institute of the Federal Reserve Bank of Dallas, May 2020

Figure 4. ***Sovereign debt repayment schedule for select Euro Area economies from the periphery of the Euro Area, including the repayment ratio towards their GDP (in percentage of GDP)***

Regarding indebtedness as a significant macroeconomic challenge for both the global economy and, above all, for Europe, it must be said that the level of corporate and private sector indebtedness in the EU member states is far from being overlooked. This year's crisis and the deglobalization processes will soon make the levels of this debt difficult to service and potentially leading to massive corporate bankruptcies, which can trigger a spiral of bank failures. All this, as well as the continuing increase of debt levels, will contribute to a slow and painful W-shaped or L-shaped recovery of national economies, rather than the expected rapid V-shaped recovery.

The next biggest macroeconomic recovery challenge and risk will be the status and development of the EU economy and in particular the Euro Area. This is the next. At this stage, the IMF's forecasts and estimates predict that the current crisis will be over by the end of 2020 and that from the beginning of 2021 at the latest almost all national economies will begin to recover. However, all reputable international financial organizations make their forecasts based on a minimum of two scenarios: a scenario with only one pandemic wave and a scenario with a second, recurring pandemic wave. Figure 5 presents the latest IMF forecast, but the author does not believe that the current global crisis will end so quickly. According to the latest Economic Report of the Organization for Economic Co-operation and Development of June 10, 2020 (OECD, 2020), with a single coronavirus pandemic wave the global economic growth rate will fall by 7.6% in 2020 and the unemployment rate will rise to 10%**.**



Sources: IMF, World Economic Forum, April 2020

Figure 5. ***Comparisons and IMF growth projections (GDP growth rate) for the period 2019 - 2021.***

Europe will face most problems, despite ECB's ambitious sovereign bond purchases programme to support the EU's economies. **The historical political mistakes in the architecture and organization of the European Economic and Monetary Union (EMU) and the delay in resolving them remain some of the greatest difficulties and challenges**. The single currency was intended as a means to unite Europe's economies, but instead of convergence all indicators show that today there is even greater social and economic divergence within what should have been an "optimal currency area", which creates a risk of slowing down the process of recovery of the European economy.

This time, the looming second crisis (after the crisis of 2010-2012) in the euro area is likely to be deeper and more complex and pose a greater overall threat for the union than the previous crisis. There are at least four main indicators for such a development:

1. The fundamental contradictions in the construction of the Euro Area could not be eliminated completely, despite the last eight years of continuous debate on how this could happen. And while the focus of these controversies previously was a relatively weak Euro Area member state such as Greece, today the focus is on Italy, the EU's third strongest economy, which was already in a deep crisis before the coronavirus pandemic. Figure 6 shows the difference between the levels of industrial production in Italy and Germany.

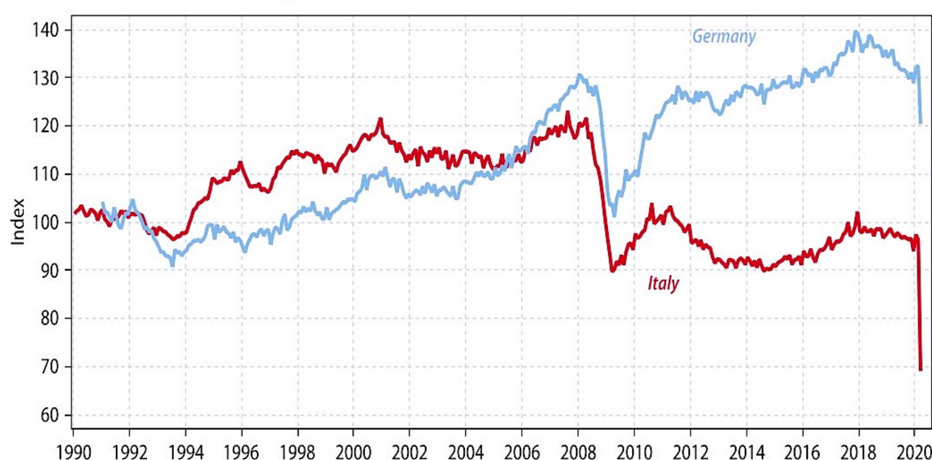


Figure 6. ***Industrial production of Italy and Germany (1990 = 100)***

The main fundamental contradiction of the Euro Area - that its *ad-hoc* supranational monetary policy is not institutionally and legally guaranteed by an effective balancing and risk-sharing mechanism to coordinate imbalances between countries and regions in the area – still exists. Thus, the Euro Area does not yet act as a "transfer currency union", and Germany itself continues to be an advocate not for a transfer union but for a union of "monetary and economic stability" (Kaletsky, 2020).

2. The economic development of the Euro Area countries, including that of its strongest economy – Germany, is still slow. This slowness and weakness of the economies has been and continues to be particularly characteristic of the countries from the southern periphery of the Euro Area. Greece's GDP for 2019 only reached the level of 2002, while Spain, Portugal, Italy and even France have not been able to reach their pre-crisis levels since 2008. Average

wages have stagnated, social inequality has risen, especially in Spain and Italy together with their public debt.

3. The issue of the role and rights of the ECB, which, unlike other central banks, is still not fully operational as a central bank with unlimited capacity to buy member states' government bonds in the event of a crisis, has not been fully resolved. This issue was provisionally resolved after the outbreak of the coronavirus pandemic (with the establishment of the EU Recovery Fund of € 750 billion[7] - see Figure 7), but it has not yet been voted on and has already created a huge conflict between the northern and southern member states of the Euro Area and the Governing Council of the European Central Bank.

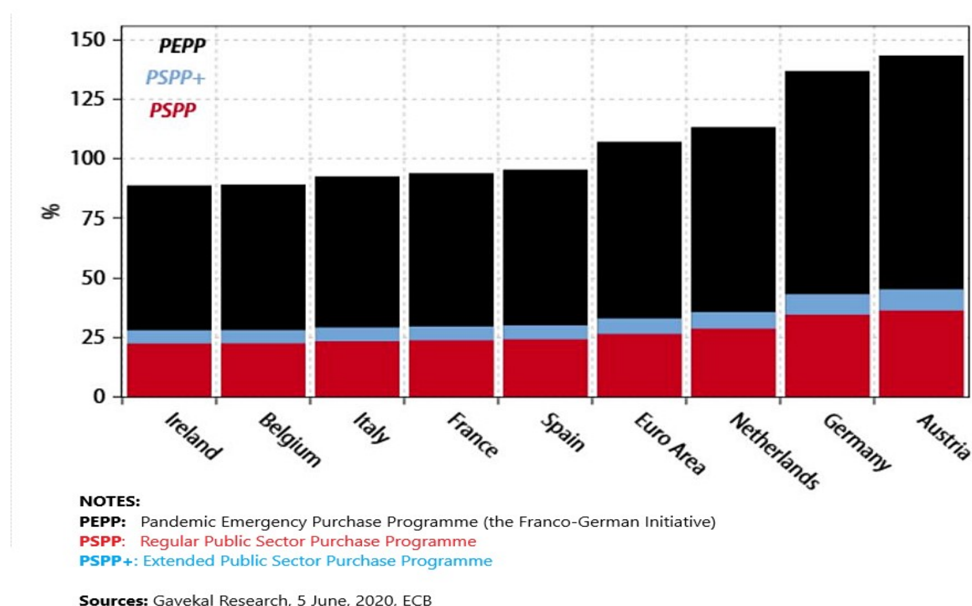
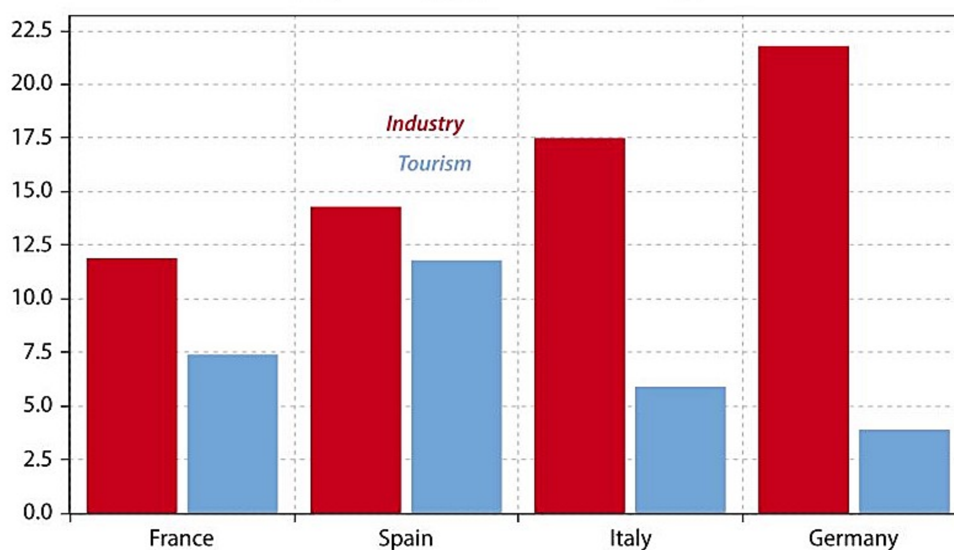


Figure 7. ***The announced potential ECB sovereign bond purchases programme 2020-2021 (share of projected budget deficits of some member states)***

[7] The so-called Pandemic Emergency Purchase Programme (PEPP), a programme for sovereign bond purchases with initial budget of € 750 billion, later increased to € 1.35 trillion due to a Franco-German political initiative and extended for another six months until June 2021. The European Central Bank also confirmed its intention to re-invest all contractual maturity receipts from PEPP at least until the end of 2022. The final draft of the PEPP has not yet been passed as there are a number of questions regarding the distribution criteria, its size, and the mechanism of its implementation. At this stage, overall budget of this initiative for recovery of the EU economies has grown to 1.95 trillion euro, including 1.35 trillion for PEPP and 480 billion for PSPP (the Regular Public Sector Purchase Programme of EUR 20 billion monthly - the decision and the "legacy" of Mario Draghi) and an additional 120 billion euro of the extended PSPP. The aim of this massive recovery fund is to cover at least 75% of the expected budget deficits of the EU member states, which will increase during the crisis.

4. The idea of a European Banking Union remained unfinished, mainly due to Germany's resistance to this idea. One of the main reasons for this is the still large amount of non-performing loans in the balance sheets of many European banks worth a total of 786 billion Euro (of which about 350 billion in Italian banks).[8] The European Fiscal Union does not work actively and in accordance with its functions. Now, after the growing budget deficits of a number of European economies and the growth of their debts, it is obvious that the rules of the Fiscal Union are not observed at all.

All these contradictions in the Euro Area, as well as the heterogeneity of the structure of their economies, will create additional asymmetric opportunities to overcome the current crisis due to its specifics. Figure 8 shows how the asymmetric sectoral structure of some economies would benefit the German economy at the expense of the others.



Sources: Gavekal Data/Macrobond, May 2020

Figure 8. *A forecast for asymmetric exit from the crisis of the leading Euro Area economies*

The potential asymmetric exit from the crisis will increase further the economic and social divergence across the EU, although the goal is exactly the opposite. This is exactly what happened after the crisis of 2008, and it is very likely that the same process will be repeated now. The dynamics of

[8] According to data from ECB.

real GDP growth of selected EU economies since 2008 in Figure 9 clearly shows the divergent recovery rates of these economies after the 2008 crisis.

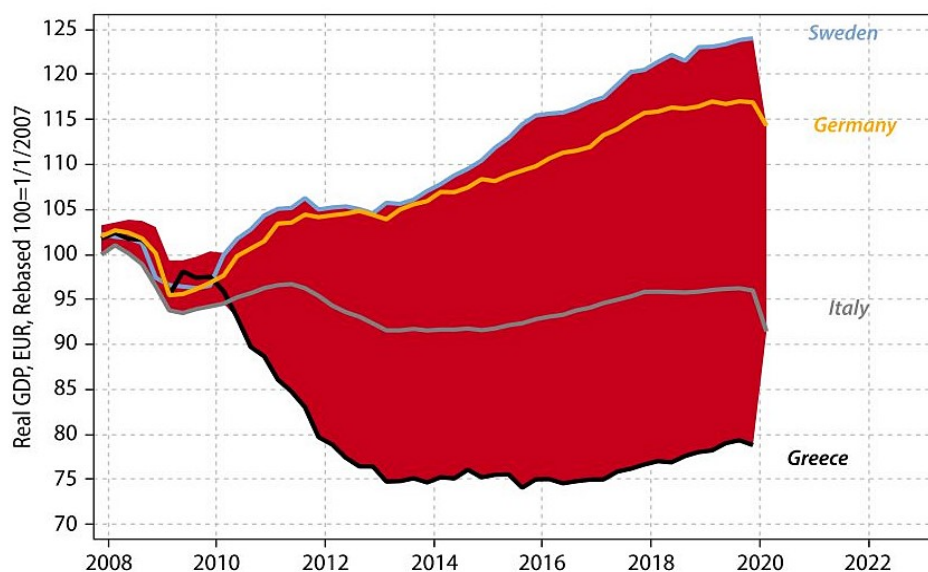
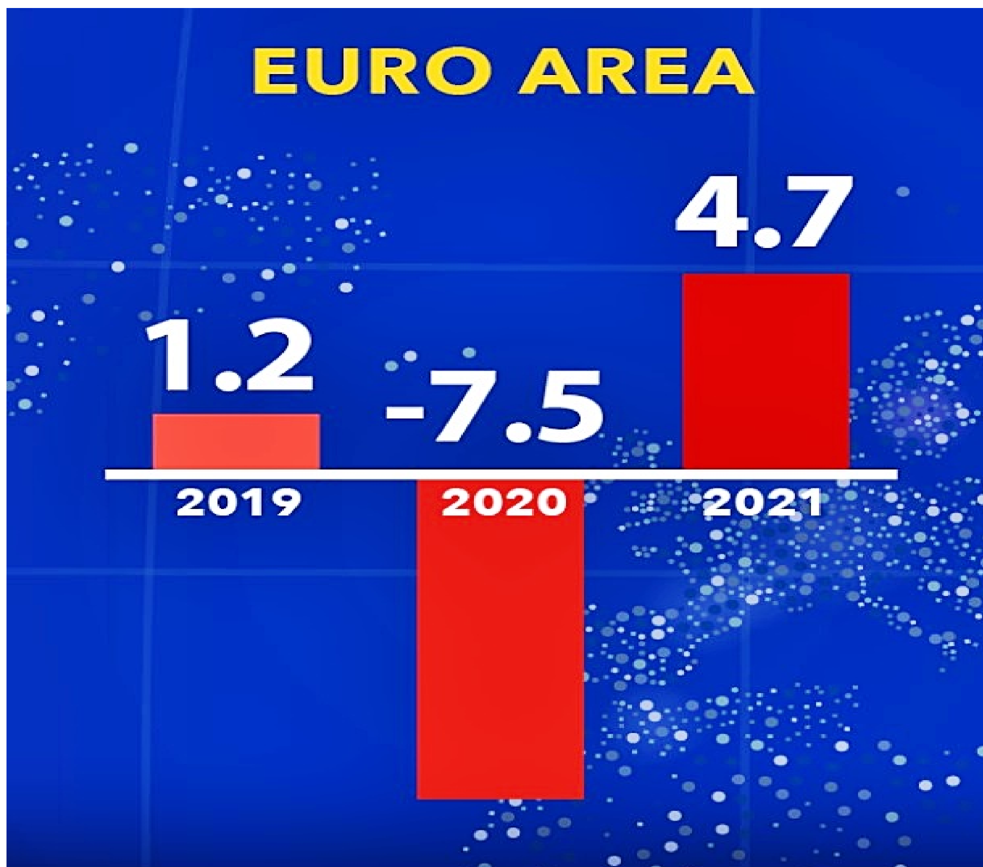


Figure 9. ***dynamics of real GDP growth of selected EU economies (2008–2020)***

Considering the above analysis of the risks associated with the current crisis in Europe and the subsequent recovery, we believe that the IMF growth projections for the Euro Area for the period 2019-2021 are slightly optimistic (see Fig. 10). Most analysts believe that the slowdown this year will be about 10%, and for next year their forecasts are more moderate, given a number of factors and risks that have been discussed so far.



Sources: IMF, World Economic Outlook, April, 2020

Figure 10. ***IMF Growth Projections for the Euro Area for the period of 2019-2021.***

Several other macroeconomic challenges and risks that are not related to the coronavirus shock are expected on the horizon of this and subsequent years. These include **the apparent intensification of the trade war between the United States and China, and possibly between the United States and the European Union**; the growing geopolitical controversy and turbulence between the United States, on the one hand, and China, Russia, Iran, and North Korea, on the other; the dangerous fluctuation of the prices of oil and other raw materials. **A major macroeconomic and political challenge that will be persistently on the agenda of many governments around the world will be the continuing widening of the economic and social disparities and the growing inequalities in many countries**.

III. Macroeconomic challenges and risks for Bulgaria

The main macroeconomic and political challenges and risks for Bulgaria this and the following 2021 and 2022 years seem to be the lack of a clear program for overcoming the systemic crisis which has plagued Bulgaria's economy for many years, the change of the economic model and the mitigation of the economic and political confrontation and polarization in the country. Without economic and social stability, our country will not be able to effectively control, allocate, and manage the significant financial resources that will come from both the European budget and the ECB. Bulgaria faces powerful economic, demographic, social and technological forces and trends that are changing dynamically our economic and financial potential.

There are still a number of macroeconomic imbalances and unfinished institutional elements of Bulgaria's market economy, which continue to create economic and financial uncertainty and inequality; hamper the modernization of the economy and reduce its competitiveness. These imbalances are about to increase in the second half of 2020, increasing the risk of stagnation and a slow exit from the crisis. Today, the theoretical postulates of low trade and investment barriers, lack of red tape, strict fiscal discipline, attractive investment climate, financial and banking infrastructure that motivates entrepreneurship and innovation, which are considered the fundamental principles and drives of economic growth, are opposed to a number of contradictory nationalist and protectionist policies.

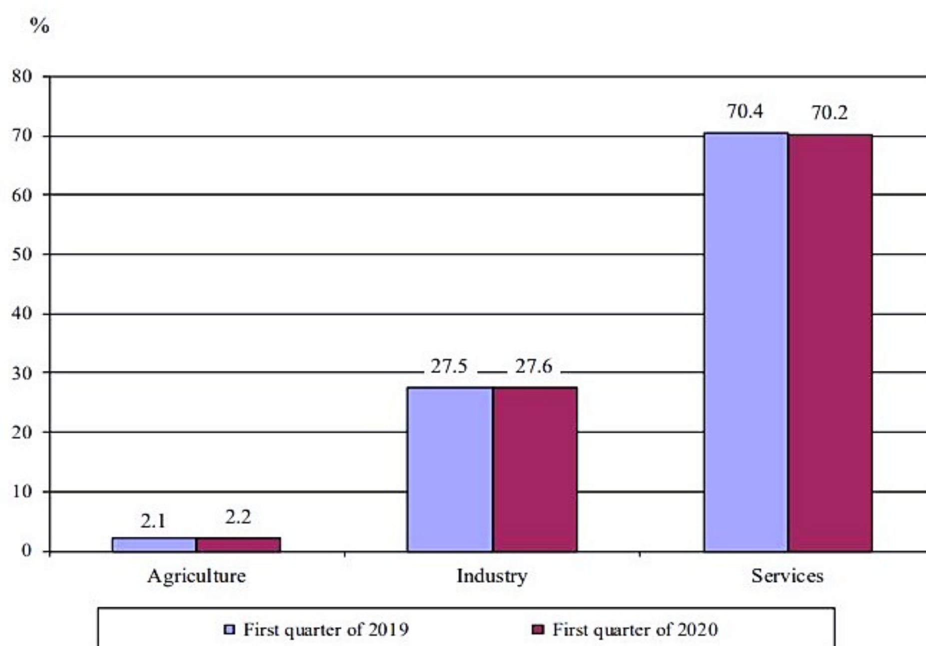
Regarding inequality, Eurostat's **GINI Coefficient** `for Bulgaria indicates that inequality has increased rapidly over the last nine years. Bulgaria is officially the country with the largest inequality in the whole EU with a GINI Coefficient of 40.2% and is outranked considerable (with almost 5 percentage points) by the next country in the ranking Lithuania[9].

Even more dramatic is the severe inequality in terms of wealth accumulated over the years. **It systematically creates another inequality – the inequality of opportunity**. Measuring the interdependence between income inequality and intergenerational prosperity with the so-called **Great Gatsby Curve** (the name of the curve refers to the main character in Scott Fitzgerald's novel), introduced by the economist Alan Krueger (2012), shows that in Bulgaria there is already a persistent relationship between the advantages and disadvantages of income and the well-being passed on from parents to

[9] Moreover, for the last five years Bulgaria has consistently ranked last (in some years shared the last place with Lithuania) in terms of Eurostat's six main indicators measuring the social standards for poverty and social exclusion in Europe., Eurostat, *Dataset Details: People at risk of poverty or social exclusion*, 2020.

children, and new generations find it increasingly difficult to climb the social ladder when, figuratively speaking, the “steps of the ladder” are too far apart; i.e. without a previously accumulated "supporting" wealth, the ascent becomes impossible.

A particularly complicated problem for the recovery of Bulgaria’s economy (not only from the current crisis!) is its changed structure. Instead of a high-tech and industrially developed economy with developed agriculture, the Bulgarian economy has become a service economy (see Fig. 11) and this is what will make its recovery from the crisis very difficult, because the services sector was affected most.

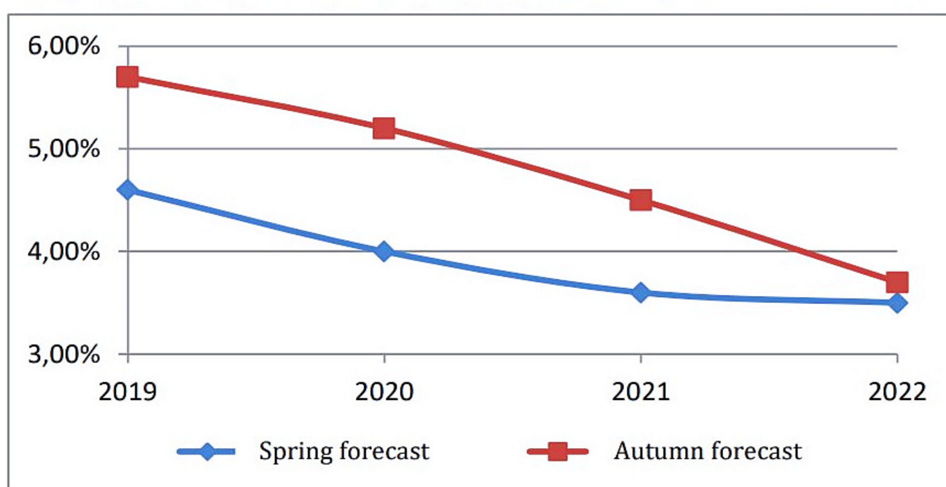


Sources: Data from the National Statistical Institute of Bulgaria, 4 June 2020

Figure 11. ***Share of the gross added value by main aggregated economic sectors of Bulgaria in the first quarter of 2019 and 2020 (in percent)***

In Bulgaria, low-income households and companies are affected most. Regardless of the temporary measures to maintain lending, liquidity of businesses and households, Bulgaria’s fiscal and monetary markets are more limited than those in the developed economies. In order to keep the capitals in the country, the monetary tightening will be much stricter than in other advanced economies. The author disagrees with the common opinion that the

measures are adequate and believes that corporate indebtedness, intercompany debt, exhausted tax incentives (in the current tax system), political uncertainty and the ongoing process of impoverishment will play a role in slowing down the recovery of our economy. This will lead to a decline in consumption, which actually existed before the coronavirus crisis (see Fig. 12), capital spending, investments, housing and real estate, car sales, exports, incomes, imports and all elements of economic and business activity. Growth will be too slow.



Source: Opinion on the Draft Law on the General Government Budget of the Republic of Bulgaria for 2020 and Updated Medium-term budget forecast for 2020-2022, Fiscal Council of Bulgaria, 28 October 2019, page 9

Figure 12. ***Consumption expectations in the spring and autumn projections of the Ministry of Finance of Bulgaria for the period of 2019 – 2022 (before the crisis of 2020)***

For those who have lost their income, the uncertainty of the future will remain even when they start receiving their regular income again – it will no longer be the same income or the same job under the previous conditions. At the same time, household debt keeps rising due to rents, mortgages, consumer loans, education and healthcare expenses. If the crisis lasts for a long time, all or the great majority of the consumers will have to cut further their consumer spending in order to have sufficient funds to cover their current liabilities. Many people today simply do not have an emergency cash stash. Therefore, the situation we can expect will be a situation of lower incomes, need for extraordinary savings, and much lower consumption, which will affect the overall consumption and demand in the economy. Those employed in the

private sector will save more and invest even less than before. All this means a slow recovery.

As many companies go bankrupt, the number of the so-called bad or non-performing bank loans will increase, which will inevitably reduce their volume. The quantitative easing stimulus for the banking system will not be sufficient and there will be a delay in the distribution of new loans and credits. It is not certain whether this widely proclaimed quantitative easing will be able to maintain or boost consumption and investments that are needed to speed up the recovery of Bulgaria's economy. And let us not forget that all this will happen against the background of a severe demographic crisis in Bulgaria and its social security and pension systems already in the risk zone.

Therefore, without a comprehensive economic and social program to deal with the crisis, without a new model of economic governance, Bulgaria will find it difficult to change its status of a weak, poor and uncompetitive economy from the periphery of the EU.

Conclusion

The intention of the author of this article was, based on the lessons of previous global crises, to define the longer-term macroeconomic challenges and risks to the world economy in general and Bulgaria in particular, assuming that such a result can be achieved with by means of such a short analysis of a complex and still unexplored topic. We do not think that 2020 will be similar to 1929 or even 2019, but given the scale of the shock for the world economy, its weaknesses since 2010, the huge indebtedness of the largest economies and the combination of macroeconomic and geopolitical challenges, we are convinced that the crisis will not be overcome so quickly. The easing of quarantine measures and lockdowns reveals absolutely nothing about the dynamics of consumption and investment consequences from the rising unemployment, bankruptcies, and the stark structural problems of national economies. We know that those who survive the crisis will be more indebted; that households will sustain a shock regarding their savings and will have to cut down their post-crisis consumption. At present, macroeconomic science cannot give an exact answer as to when the crisis will end, much less in what scenario. It all depends on hundreds of combinations of many factors, including health, social, political, government behaviour, elections, decisions of international organizations, behaviour of large groups of people, etc.

Nonetheless, we can still learn some lessons from both the crises in the past and the current crisis:

✓ Economies may collapse at any time – both the shock and the moment of truth may occur at any moment.

✓ Financial markets are complex systems.

✓ Aggregate demand and supply are key factors for overcoming the crisis.

✓ Aggressive fiscal policies are needed.

✓ Preservation of the financial system is a key priority.

✓ Each business cycle is unique.

✓ Reduction of inequality is critical together with the solutions for overcoming the slowdown.

✓ Military conflicts are typical inflation events because they boost demand while pandemics reduce both demand and supply.

Those who agree with the arguments used in this article are aware that the global economy and financial markets, the corporate sector, and the household sector are likely to go from the phase of shock to the phase of gradual recovery within the next six months or year. In any case, this transition will not be the same for everyone or synchronized as the shock was and will be accompanied by considerable crisis disappointments and failures. Governments, investors, companies, and households should prepare for a relatively different economic and investment landscape, regulations, and post-crisis life.

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