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Trade in the Time of Corona: Broken Chains and Mended Barriers

by

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Trade in the Time of Corona: Broken Chains and Mended Barriers

Adrian R. Mendoza[1]

Abstract

In light of the unprecedented mutation of the COVID-19 pandemic into a global economic recession, the WTO projects world trade volume to plummet by a staggering 13 percent to 32 percent in 2020. This translates to large-scale losses in global output and employment, especially in trade-oriented emerging economies such as the Philippines. Recovering from this dystopic scenario greatly depends on the duration of the outbreak, the downside risks from protectionist tendencies, the severity of the global recession, and the ability of world leaders to come up with a coordinated policy response. This paper provides a quick assessment of the major risks that must be dealt with to overcome these "four horsemen of trade apocalypse".

Anchored on the WTO projections, this paper also assesses the short term prospects for Philippine trade. The results of the forecasting exercise suggest that Philippine merchandise exports could plummet in 2020 by 17.2 percent in the optimistic scenario and 39.5 percent in the pessimistic scenario. Compared to the pre-pandemic government target, the pessimistic case suggests that the country could lose up to US$31 billion export revenues this year due to the COVID-19 crisis. Merchandise imports are expected to experience a similar decline, albeit less severe. While the negative impact will likely be felt by all sectors, the biggest plunge is expected to be in electronics and other industries that are strongly connected to global production networks. On a positive note, Philippine exports and imports are expected to recover in 2021, albeit not fully, if the global public health crisis is resolved sooner than later.

Keywords: COVID-19 pandemic, global recession, trade collapse, Philippine exports and imports, 2020 projections
JEL: F01, F13, F17, F42, F50, F60

Introduction

As the world grapples with the COVID-19 pandemic, another global crisis is quickly unfolding. Just a few weeks ago, the IMF already declared that 2020 will be a recession year, with a contraction in output that is projected to surpass the 2009 global financial crisis.[2,3] This week, the IMF officially released the ugly numbers: in advanced economies, output is likely to dip by 6.1 percent while a 1 percent negative growth is expected for emerging markets and developing countries.[4] The warning signs have started to manifest. Commodity prices plunged in March, led by a 40 percent month-on-month drop in crude prices. Early reports also point to weak manufacturing activities in major economies such as the US, China, Germany, and Japan.[5] In the US, almost 10 million workers applied for unemployment claims in the second half of March. The prospects are not any better for emerging economies. In the Philippines for example, the purchasing manager's index (PMI) dropped way below the 50.0 benchmark, suggesting a sharp reduction

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[2] https://www.imf.org/en/News/Articles/2020/03/23/pr2098-imf-managing-director-statement-following-a-g20-ministerial-call-on-the-coronavirus-emergency

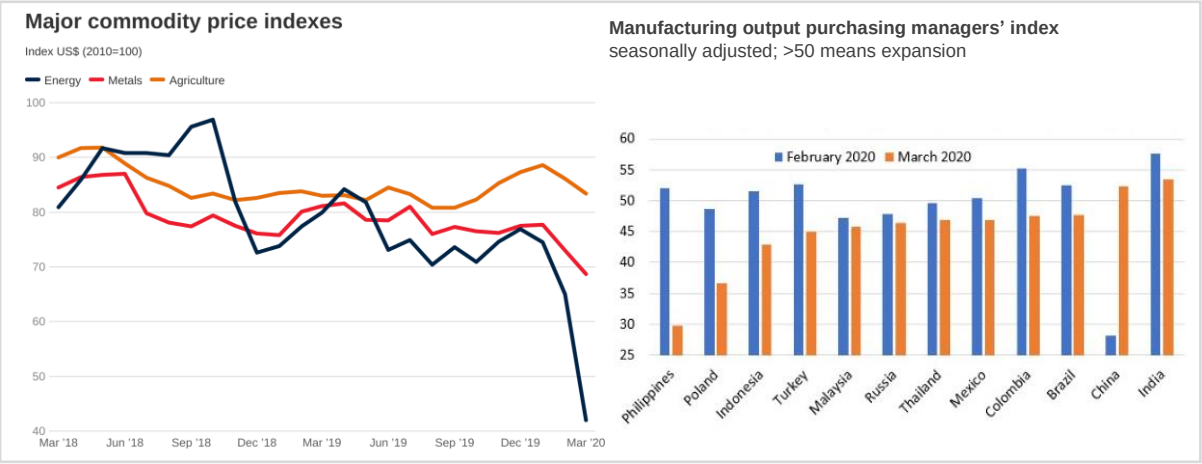
[3] Based on IMF and ILO data, world real GDP declined by 0.1 percent and unemployment reached 5.6 percent in 2009.

[4] https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/

[5] For the US: https://www.instituteforsupplymanagement.org/ISMReport/MfgROB.cfm?SSO=1; for China: https://www.rappler.com/business/254790-china-industrial-production-january-february-2020; for Germany: https://www.nytimes.com/reuters/2020/04/07/world/europe/07reuters-germany-economy-output.html; for Japan: https://www.nytimes.com/reuters/2020/03/30/world/asia/30reuters-japan-economy-output.html

in March's industrial output. The pattern is similar for other ASEAN members such as Indonesia, Malaysia, Thailand, Singapore, and Vietnam.[6]

Figure 1. Leading economic indicators in March 2020 point to an impending downturn



Sources: World Bank[7] and IMF[8]

We've seen similar synchronized global downturns before. The collapse of world trade in 2009 was mainly traced to demand shocks from Europe and the US that adversely affected global production through a complex web of trade transactions. Weak output and consumption in major global markets translated to a downward spiral of production in export-oriented emerging economies. In 2011, the flooding in Thailand and the tsunami in Japan caused severe disruptions in East Asia's automotive and electronics value chains. This paralyzed industrial production and resulted in several months of negative export growth in the region. The recent tensions between China and the US also slowed down trade and threatened the stability of global production networks through the effects of costly adjustments in world prices, exchange rates, investments, and productivity.[9] Bloomberg's pre-pandemic simulations show that global output could drop from the no-war scenario by at most 0.6 percent in 2021, the year of peak losses.[10] These examples show that the propagation of initially local shocks into a full-blown global crisis has become the new normal in the age of globalization. Seemingly minor risks can have ripple effects through various international transmission channels. As countries became interconnected through various financial, commercial, cultural, and geopolitical linkages, they also grew more sensitive to global business cycles and remote events that have systemic effects. Therefore, it is not only when the US (or China) sneezes that the world catches cold; the trouble may virtually come from anywhere in any form.

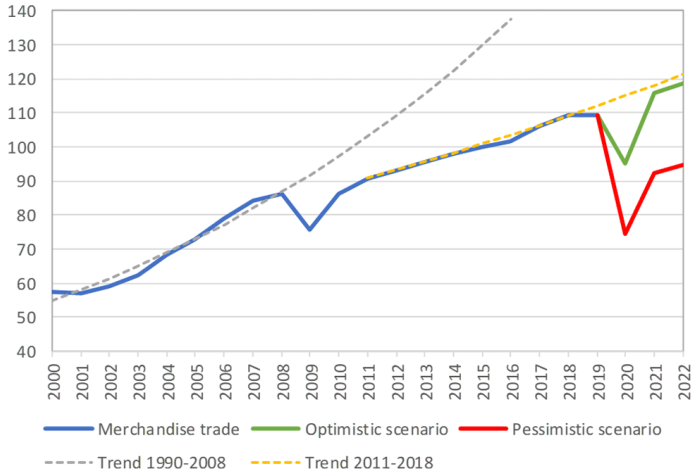
This time, it started with a virus. A certain individual contracted the infection late last year in a wildlife market in Wuhan, China. The new strain of coronavirus soon made its way to the rest of the world through Chinese tourists and businessmen going to foreign destinations and non-Chinese travelers returning home from Wuhan. (Yes, globalization accelerated this contagion.) Three months later, a global pandemic is in full effect with more than 2 million people infected in six continents. It didn't take long before the health crisis mutated into a looming economic downturn. As half of the world has been put on lockdown, many industries temporarily closed, millions of workers lost productive employment, and vulnerable households suffered from cutbacks in income and consumption. With limited manufacturing activities and restricted international mobility everywhere, domestic supply shocks are gradually leaking into the global economy through disruptions in trade flows and supply chain operations. We're no longer talking here of production delays but of partial or complete shutdown of global industries—an economic "sudden stop".[11] This is particularly true for products that are mainly manufactured in the epicenters of the outbreak. The

[6] For Singapore: https://sipmm.edu.sg/about-sipmm-academy/singapore-pmi/; for Vietnam: https://www.vir.com.vn/vietnams-march-2020-pmi-drops-to-record-low-due-to-covid-19-75252.html
[7] https://blogs.worldbank.org/opendata/commodity-prices-tumbled-further-march-pink-sheet
[8] https://blogs.imf.org/2020/04/06/an-early-view-of-the-economic-impact-of-the-pandemic-in-5-charts/
[9] https://www.piie.com/sites/default/files/documents/pb19-17.pdf
[10] https://www.bloomberg.com/graphics/2019-us-china-trade-war-economic-fallout/
[11] https://www.ft.com/content/a47396be-4449-11ea-a43a-c4b328d9061c

automotive sector for example has a long list of companies that indefinitely closed plants in Asia, Europe, and America.[12] To make things worse, some countries have resorted to protectionist measures in the guise of securing domestic supplies, especially of food and medical products. For instance, Kazakhstan has restricted its exports of wheat flour while Vietnam stopped issuing new rice export certificates.[13] In light of this mounting global uncertainty, the WTO projects world trade volume to plummet by a staggering 13 percent to 32 percent in 2020.[14] Note that in 2009, the free fall stopped at 10.7 percent.

Figure 2. Historical and projected trend of world merchandise trade volume, 2000-2022

Index, 2015=100



Source: WTO

Based on WTO estimates, the pessimistic trade scenario could slash real GDP by up to 8.8 percent in 2020. This translates to large-scale losses in output and employment, especially in trade- and consumption-driven emerging economies (such as the Philippines). Recovering from this dystopic scenario greatly depends on the duration of the pandemic, the downside risks from protectionist tendencies, the severity of the global recession, and the ability of world leaders to come up with a coordinated policy response. In a truly apocalyptic sense, it's like overcoming the four horsemen in order to prevent a catastrophic collapse of world trade.

The Rider of the Pale Horse: COVID-19 Plague

Until the global public health crisis due to COVID-19 is completely resolved, it is almost futile to talk about resuming to the prevailing economic order prior to the outbreak. Returning to business as usual without a systematic testing and treatment or an effective vaccine will only heighten the risk of a second wave of large-scale infection. As we've seen from Wuhan's experience, a single undetected case is a ticking time bomb that can infect thousands in a matter of weeks. Recent empirical evidence suggests that flattening the COVID-19 curve would require stricter lockdowns and social distancing.[15] However, the prolonged industrial inactivity that these drastic measures entail may inflict lasting damages on firms' productivity, especially in developing countries with less efficient health care systems. Production lines will remain disrupted as long as workers are unable to report for duty. On the other hand, partial operations may be sub-optimal when factories cannot reach their minimum efficient scale. Even with increased worker mobility or with automation, returning to full capacity is difficult when supply chains are broken. Firms whose suppliers remain on lockdown have no choice but to suspend production until new input sources have been secured. Worse still, the potential spate of bankruptcies and firm deaths may exacerbate the deteriorating supply base. Cross-border distribution of raw materials and intermediate goods may also take a hit from scaled-down operations of the logistics sector.

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[12] https://www.cnet.com/roadshow/news/covid-19-automakers-plant-shutdowns-coronavirus/

[13] https://www.theguardian.com/global-development/2020/mar/26/coronavirus-measures-could-cause-global-food-shortage-un-warns

[14] https://www.wto.org/english/news_e/pres20_e/pr855_e.htm

[15] https://www.nber.org/papers/w26906?utm_campaign=ntwh&utm_medium=email&utm_source=ntwg3

In an unprecedented turn of events, the rider of the pale horse transformed efficient supply chains into a series of hurdles for globally-oriented manufacturers. However, the possibility of this "black swan" event is not unthought-of. A 2012 WEF survey actually shows that supply chain managers rank pandemics as the third most serious environmental event (next to natural calamities and extreme weather) that could cause system-wide disruptions to production networks.[16] Although the chances seemed remote, we know now that these disasters could happen outside fictional cinematic landscapes. Compared to natural disasters that only cripple certain areas of production in specific locations, global contagions have the potential to halt all types of economic activities in virtually all countries. This means that the devastating effect of COVID-19 on world trade will be more severe than the tsunami-and flooding-induced shock to East Asian supply chains in 2011, especially because the former simultaneously hit major industrial hubs in Asia, Europe, and America. The numbers agree. In February 2020, the global PMI dived from 59.5 to 37.5, suggesting a steep decline in industrial production and exports.[17] The UNCTAD also anticipates a 40 percent cut in global FDIs as downward revisions in sales forced multinationals to postpone previously pipelined projects.[18] Early reports also indicate a slump in international cargo traffic due to the combined effects of weak manufacturing output (particularly in China), reduced consumption, low demand for freight services, lockdowns, and stricter precautionary measures imposed on the transport sector.[19]

In the age of geographically fragmented production, malfunctioning supply chains mean broken linkages and interrupted trade flows. While containing the coronavirus should be the most critical component of any short-term strategy to restart global factories, lessons from past supply chain disruptions provide useful insights on how to survive the impending crisis. The following recommendations are based on the 2012 WEF survey mentioned above. First, governments and lead firms should jointly conduct rapid and frequent assessments of current and potential risks to production bases and distribution networks. Identifying the sources of these risks is a key step towards implementing coordinated business and policy actions. For example, if certain customs procedures are causing unnecessary delays, firms and regulators may quickly decide on a temporary fix. Second, information sharing is very important given that one's failure can paralyze other firms. Access to reliable real-time data will allow suppliers to recognize potential threats immediately. Standardized risk measurements should be developed so that red flags can be easily detected. Based on these indicators, suppliers can plan ahead, revise projections, and prepare calibrated responses to various contingencies. Lastly, transparent and effective risk communication is needed to preserve synchrony among all stakeholders. In the current structure of production networks where glitches have inherent systemic effects, the one thing that governments and lead firms should avoid is releasing information that causes disjoint, confusion, and panic within supply chains and beyond.

The Rider of the Red Horse: Trade Wars and Trade Barriers

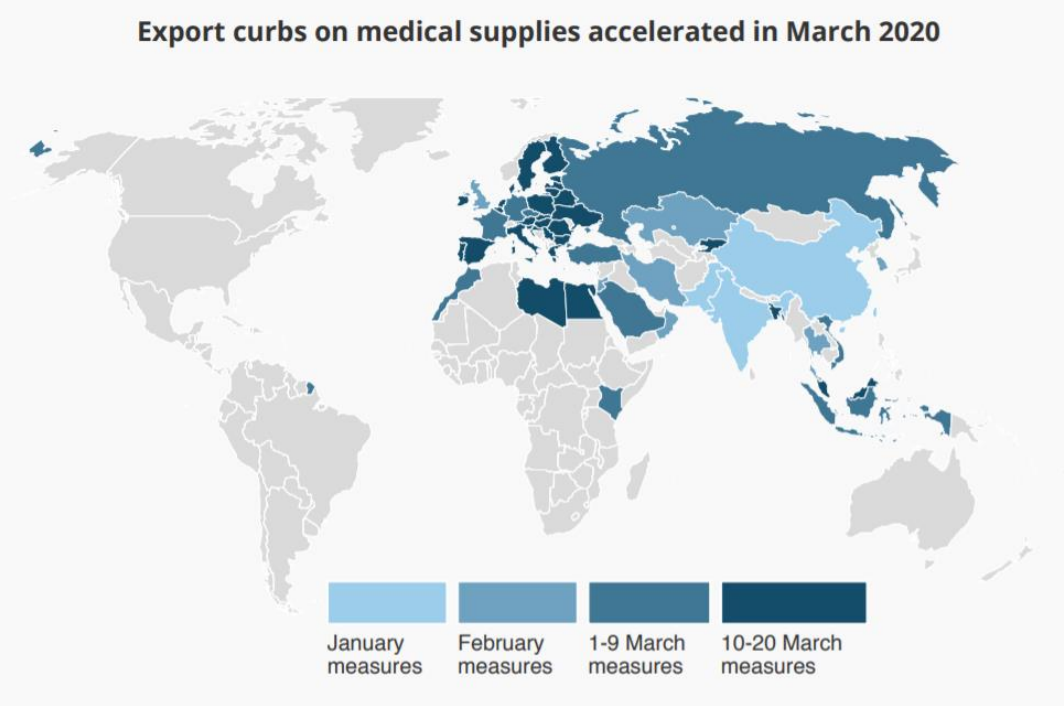
Rising protectionist policies amid the COVID-19 outbreak are hurting world trade in obvious and subtle ways. Consider for example the export restrictions and import duties on essential pharmaceutical and medical supplies such as face masks, protective garments, disinfectants, soaps, and ventilators. A recent study by Global Trade Alert[20] finds that 54 governments have introduced 46 export curbs on medical products as of March 21, 2020; 33 of which were only announced after February. On the other hand, 78 countries have increased soap tariffs to at least 15 percent, 23 imposed restrictions on imported disinfectants, and 15 implemented non-tariff import curbs on protective gear. These reports show how quickly protectionist tendencies have escalated with the exponential spread of coronavirus across national boundaries.

These restrictions do not only undermine global efforts to end the pandemic, they also push the world economy into a deeper crisis. As Global Trade Alert puts it, these trade distortions "sicken thy neighbor" by depriving many countries of the critical medical products needed to cure COVID-19 patients and prevent new infections. The double whammy of lower global supply and higher prices disproportionately hurt poorer nations that have inefficient health systems to begin with. This compromises their ability to

[16] https://www.weforum.org/agenda/2020/03/covid-19-coronavirus-lessons-past-supply-chain-disruptions/
[17] https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2297
[18] https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2313
[19] https://ww2.frost.com/frost-perspectives/global-logistics-industry-grappling-with-supply-shocks-across-markets-amid-covid-19/
[20] https://www.globaltradealert.org/reports/50

contain the epidemic which in turn creates health risks that transcend trade borders. Left unchecked, this could generate a second round of contagion that leads to extended lockdowns, indefinite closure of businesses, and protracted disruptions of domestic and international supply chains. Unlike the first time, governments, firms, and workers will enter the second round with much more financial and psychological stress. It's not unwarranted to expect permanent shutdowns and widespread unemployment under this scenario. The message is clear: sans a vaccine or effective therapeutics, no country is completely safe until all are safe. Therefore, trade restrictions on medical supplies are counterproductive since the tides of globalization will somehow lead the repercussions back home.

Figure 3. Medical supplies are the first casualties of heightened trade restrictions due to COVID-19



Source: Global Trade Alert

In addition to pharmaceutical and medical products, many countries have also put up different types of barriers in the name of protecting domestic health and food security. As of April 9, 2020, the WTO has already received 41 notifications related to COVID-19.[21] Half of these were filed in April alone. The most common types are sanitary and phytosanitary standards, technical barriers to trade, and quantitative restrictions. While some pertain to trade facilitation measures that simplify documentary processes (e.g., Australia, EU, South Africa, Brazil, Chile, Costa Rica) and others moved to temporarily relax import restrictions on essential products (e.g., Canada, Colombia, Brazil, and Ukraine), a handful of notifications explicitly hamper food and medical exports or restrict "high-risk" imports. The descriptions of these policies are summarized in Table 1. However, lessons from past crises suggest that export restrictions are bad policies. They distort the global supply, create artificial shortages in importing countries, and unnecessarily increase price for everyone. They may also inadvertently discourage local firms from mass producing when there are no foreign markets to absorb their domestic surplus.[22] In the case of food products, export barriers (especially in major producers) may result in price volatility and a spike in hunger. So far, Thailand's move may have the most significant impact given that it is the second largest rice exporter.

Imposing protectionist policies amid a global emergency is not a good gesture of being one with the international community. It creates tensions between governments that may eventually trigger retaliations and full-blown trade wars. For example, current restrictions on imports from China may not be taken positively in Beijing. A situation where China matches these restrictions may have a devastating effect on

[21] https://www.wto.org/english/tratop_e/covid19_e/covid19_e.htm
[22] https://www.globaltradealert.org/reports/50

its trading partners given its stature in the world economy. Worse, export and/or import controls in one country may urge many others to follow suit, causing additional stress to already fragile trade linkages.

Table 1. Some WTO members' notifications on COVID-19 as of April 9, 2020

Date	Member	Subject	Type
08/04/2020	EU	Export authorization of certain products	QR
08/04/2020	Kenya	Prohibition of the importation of second-hand/used garments and used footwear (Mitumba)	TBT
02/04/2020	Colombia	Restriction on the export of certain goods to prevent critical shortages of essential commodities and protect the health of the population.	QR
02/04/2020	Thailand	Extension of the temporary export prohibitions to prevent the critical shortage of food stuffs up to 30 April 2020.	ER/QR
02/04/2020	North Macedonia	Temporary prohibition on exports of wheat, meslin, and wheat flour to protect human health and prevent critical shortage of essential products.	ER/QR
31/03/2020	Russian Federation	Extension until further notice of the temporary restriction on imports of exotic and decorative animals, including insects, arthropods, amphibians, reptiles and other, live fish and hydrobionts from China	SPS
31/03/2020	Kyrgyz Republic	Temporary export prohibitions on select food products to supply the Kyrgyz Republic population with strategic food stuff and other products.	ER/QR
31/03/2020	Ukraine	Temporary implementation of export licensing requirements on anti-epidemic goods.	QR
30/03/2020	Brazil	Establishes previous authorization for the export of chloroquine, hydroxychloroquine, and azithromycin and its salts.	TBT
27/03/2020	Albania	Temporary prohibition of exports of drugs and medical devices to protect human health and prevent critical shortage of essential products.	QR
23/03/2020	Mauritius	Temporary restriction on imports of live animals, including fish from People's Republic of China, Italy, Iran, South Korea, Switzerland, Reunion Island and European Union Countries	SPS
20/03/2020	Indonesia	Requiring any importation and/or movement of mammals and pets from Hong Kong, China be accompanied with laboratory test result for COVID-19.	SPS
16/03/2020	Brazil	Extraordinary conditions for execution of conformity assessment activities in countries affected by COVID-19.	TBT
28/02/2020	Kazakhstan	Temporary restriction on import and transit of live fish and fish products from China.	SPS

Source: WTO
Note: ER – Export Restriction, QR – Quantitative Restriction, SPS- Sanitary and Phytosanitary, TBT – Technical Barriers to Trade

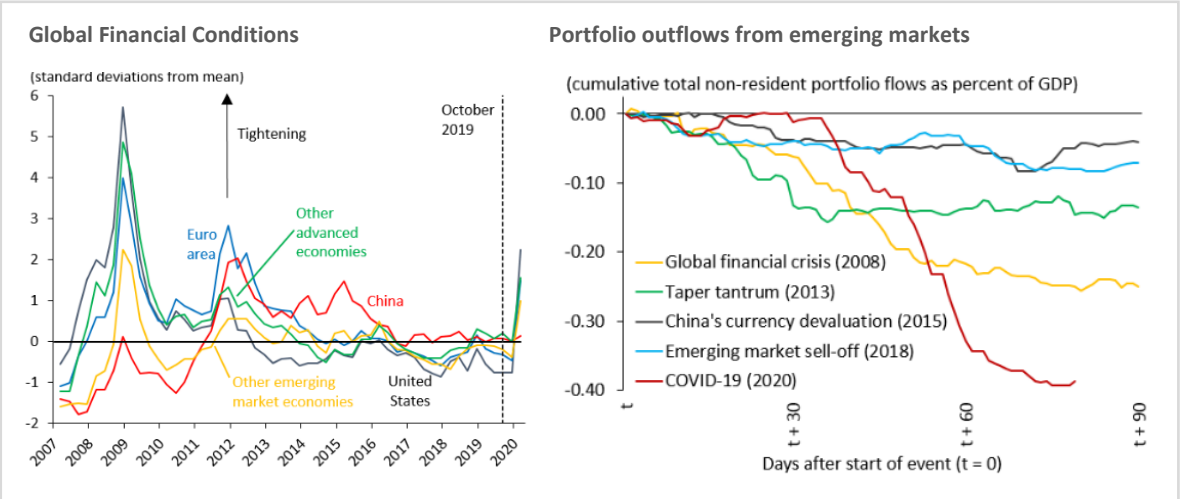
The ongoing free fall of global production should not be aggravated by accommodating the rider of the red horse. Instead, governments should work together to preserve the efficient flow of goods (and services) across borders. In anticipation of the looming crisis, countries should focus on stimulating trade by 1) resisting the temptation of erecting counterproductive barriers; 2) relaxing, even at least temporarily, existing export and import restrictions, especially on pharmaceutical and medical goods, food products, and raw materials and inputs; 3) accelerating reforms on trade facilitation measures; and 4) coordinating with the international community to avoid contradicting policy actions. The current situation where mobility is limited and social distancing is strictly enforced offers a golden opportunity for regulators to institutionalize the use of modern technology (e.g. application of big data analytics, paperless customs transactions, and automated inspection, clearance, and valuation systems) in logistics and customs administration. Mitigating the damages of the looming trade collapse calls for the commitment of all nations. However, smaller economies admittedly take cue from global giants. What would be interesting to see is for China and the

US to demonstrate responsible leadership by putting an end to their trade wars. This should somehow reverse the global trade slowdown that started in 2017.

The Rider of the Black Horse: Global Recession & Company

Depending on the duration and severity of the twin health and economic crises, the global recession may enter a dangerous phase when supply disruptions and industrial shutdown start to strain other economic sectors. A likely scenario is that prolonged lockdowns and production breaks will drive many establishments out of business. Airlines, transport and shipping companies, hospitality and tourism-related establishments, food and agri-related businesses, and manufacturers of "non-essential" goods were the early victims of lockdowns. Small and medium enterprises will be disproportionately hit while bigger corporations may be able to tolerate temporary losses. Regardless of sector and size, bankruptcies or financial distress may force vulnerable firms and employees to default on their loans, essentially transmitting the risks to the financial system. Hereafter, we may see chain reactions parallel to the events during the global financial crisis. The heightened stress can be easily handled in countries with healthy financial institutions and credible monetary authority. However, countries entering the recession with a weak financial and macroeconomic position will find themselves on a slippery downhill. Governments with limited monetary and fiscal policy scape will have a hard time preventing widespread business failures and layoffs from causing systemic financial instability. The possible tightening of financial conditions could further restrict credit flows and increase borrowing costs, especially for crisis-hit borrowers who need credit the most. Without public support or any alternative sources of funding, this deadlock could trigger more bankruptcies and joblessness. Ultimately, this translates to devastating income losses and sharp cutbacks in household and business spending. Now we have a demand shock aggravating the lockdown-induced supply shocks. Misery loves company, indeed! The catastrophic impact of deteriorating consumption on global trade could be similar to, but worse than, what happened during the great collapse in 2009. In this case, stimulating trade will require unprecedented efforts to rebuild not only the production base but also business and consumer confidence.

Figure 4. Global financial conditions have tightened while portfolio outflows from emerging markets intensified



Source: IMF

The corporate sector is not the only source of stress to financial markets. In the first quarter of 2020, emerging economies already endured significant capital outflows as investors expectedly took flight to safety.[23] Policy rate cuts may have also contributed to these movements. As shown in Figure 4, the portfolio reversals from emerging markets during the COVID-19 pandemic are larger and faster compared to similar episodes in recent history. Past crises (read: Thailand circa 1997) have shown that the immense volatility created by these outflows can impair asset and exchange rate markets which again compromises the financial health of banks and corporations. Massive loss of asset value means lower capitalization, deferred

[23] https://blogs.imf.org/2020/04/14/covid-19-crisis-poses-threat-to-financial-stability/

investments, and delayed recovery for many establishments. The good news is that financial institutions and central banks are more prepared today, thanks to the hard lessons from 10 years ago. However, it remains to be seen whether financial systems can stay resilient even when the crisis lasts longer than expected. Another silver lining is that (free-floating) exchange rates will adjusts to ease these outflows. However, the potential benefit of depreciating currencies to exports will be limited as long as many areas of industrial production remain on hold.

In these challenging times, it is expected that governments will respond to the crises with extraordinary promptness and prudence. Large sums of money are needed to attend to COVID-19 patients, administer mass testing, support medical frontliners, and implement public health interventions. On top of that, supporting businesses and households facing liquidity and solvency problems will also require a huge budget. This is a delicate balancing act that governments must execute in order to prevent the crises from further straining other sectors such as supply chains and financial systems. However, a stimulus plan in which the economy must be put to sleep is too costly, especially for governments with already limited fiscal headroom prior to the pandemic. To make things worse, the sudden stop of many economic activities may cause tax collection to fall. (Others actually propose tax relief for badly-hit sectors.) The erosion of the revenue base will be most severe in economies that rely heavily on tourism, manufacturing, foreign trade, and remittance-driven consumption. Although the tradeoff between health and wealth presents a seeming dilemma, experts and policymakers agree that containing COVID-19 should be the priority and that governments and central banks must "do whatever it takes" to put an end to the pandemic.[24] For fiscally-challenged countries, "whatever it takes" may involve emergency borrowings and having to accept a temporary rise in government deficit.

The Rider of the White Horse: Global Coordination Failure

At this point, it is worthwhile reiterating the first law of ecology: everything is connected to everything else. In the context of the current crisis, every thoughtful or reckless action by individuals, businesses, and governments can have repercussions on the global fight against coronavirus. However, it's not just any action but collective action. The COVID-19 pandemic is a global threat that requires global solutions. Unfortunately, lack of international cooperation and transparency is the elephant in the room. It may be even harder to resolve than the contagion itself. A recent example is China's move to restrict the publication of research on the origins of COVID-19.[25] This is uncalled-for especially vis-à-vis UNESCO's efforts to advance COVID-19 research through stronger international scientific collaborations, knowledge pooling, and greater access to data and research findings.[26] Another unexpected move is the decision of the US to suspend its contribution to the WHO's budget pending an assessment of the organization's poor handling of the crisis. This is an ill-timed pronouncement regardless of merits. Recent reports also suggest that the US voted against allowing access to the IMF's special drawing rights.[27] As you read this sentence, the international flow of medical supplies and other essential products is being disrupted by trade bottlenecks, large-scale hogging, and unfair commercial practices. Whatever the motivation may be, whether political or nationalist, actions like these are not helping in the speedy development of vaccines and other therapeutics. They also obstruct the road to global health and economic recovery.

Divide and conquer is the trick of the rider of the white horse. Hence, multilateral cooperation is needed more than ever. The pandemic is a global public bad that will persist unless all nations jointly strategize on how to end it. Instead of export restrictions, trade wars, and competition for supplies, governments should realize that coordination is key to make the current structure of globalization work in emergency situations. Critics argue that it is the inherent weakness of interconnectedness. This has to be dealt with in future reconfiguration of global value chains. Until then, teamwork is the best survival strategy available at our disposal. That a country puts itself and others in danger by not harmonizing its policies should be good enough incentive to cooperate. Still, while everybody loses from coordination failure, world leaders need

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[24] For the list of monetary and fiscal policy responses to COVID-19, see https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

[25] https://edition.cnn.com/videos/world/2020/04/13/coronavirus-covid-19-china-research-restrictions-watson-intl-hnk-vpx.cnn

[26] https://en.unesco.org/news/unesco-mobilizes-122-countries-promote-open-science-and-reinforced-cooperation-face-covid-19

[27] https://www.cepr.net/imf-offers-partial-debt-relief-but-us-continues-to-block-sdr-allocation/

to demonstrate that smaller nations will have a fair share of the gains from global trade and economic recovery. Developed countries should start by immediately rebuilding a coalition that is united by mutual trust and diplomacy. G20 members succeeded in 2009 because their governments saw the value of banding together in the face of a shared threat. Surviving a global crisis is a group sport, not an individual event. That playbook should still be relevant today. In the meantime, as the world is being distracted by scientific secrecy, protectionist policies, 21st century buccaneering[28], political brawls, and conspiracy theories, poor countries in Asia, Latin America, and Africa are facing the health and economic crises with overstretched medical workers and facilities, insufficient facemasks, testing kits and ventilators, and limited monetary and fiscal policy space.

Developing countries need to be assured that advanced economies and multilateral organizations are ready to support their local efforts to contain the epidemic and prevent the recession from causing large scale bankruptcies, financial distress, and unemployment. The credit facilities offered by the IMF and World Bank should be augmented by developed countries, international aid organizations, and other multilateral institutions when the need arises. Again, coordination is key. The geographic distribution of relief efforts should be well-targeted to make sure that the most vulnerable regions receive the highest priority. This will let the worst-hit recuperate faster so that every nation reaches full recovery at the same time. Only then can we talk meaningfully about rebooting the world economy and repairing broken supply chains.

Prospects for the Philippines

The short-term outlook on Philippine trade is expectedly grim, owing to the country's high sensitivity to disruptions in global production networks. Trade transactions will also take a hit from the extended shutdowns in major industrial regions in Luzon. Recession in the country's major markets will further add to the drag in trade activities. Anchored on the WTO's latest trade projections, a simple forecasting exercise was performed to track the possible directions of Philippine exports and imports in the next two years. The optimistic scenario assumes a sharp contraction of world trade followed by a fast recovery in the second half of 2020. The pessimistic case projects a larger decline and a slower and weaker rebound of world trade. The results summarized in Table 2 suggest that Philippine merchandise exports could plummet by 17.2 percent and 39.5 percent in 2020 based on the WTO's optimistic and pessimistic scenarios, respectively. Compared to the DBCC's original projection of a 4 percent export growth in 2020[29], the worst case assumption suggests that the country could lose up to US$31 billion export revenues this year due to the COVID-19 crisis.[30] Merchandise imports are expected to experience a similar decline, albeit less sharp. The country's total import payments in 2020 could plunge by 14.1 percent in the optimistic case and 30.1 percent in the pessimistic case. Based on these estimates, total merchandise trade could fall by 15.4 percent to 33.8 percent in 2020. However, the trade deficit is likely to decrease, driven by the recession-induced plunge of imports. Based on the left panel of Figure 5, the slump of Philippine exports and imports in 2020 could be much worse that what we saw in 2009.

On a positive note, the catastrophic drop in world trade is likely to be short-lived if the global health crisis is resolved quickly. Based on this assumption, Philippine exports and imports are expected to recover in 2021, albeit not fully. In particular, merchandise exports could rebound by 31.1 percent and 37.4 percent in optimistic and pessimistic scenarios, respectively. It should be noted that the stronger growth in the pessimistic case is traced to the base effect of very low projected export values in 2020. Regardless, the weak recovery in the pessimistic scenario indicates that exports in 2021 could be up to US$19 billion lower compared to the DBCC's old trajectory.[31] Merchandise imports could also post a double-digit resurgence in 2021— 21.3 percent in the optimistic case and 16 percent in the pessimistic case. Consequently, total

[28] https://www.washingtonpost.com/business/2020/04/03/white-house-scrambles-scoop-up-medical-supplies-angering-canada-germany/

[29] https://www.dbm.gov.ph/wp-content/uploads/DBCC/2019/177th-DBCC-approved-Macroeconomic-Assumptions.pdf

[30] While the DBCC projection is based on the BOP definition, this estimate is based on the PSA definition of exports which was assumed to also grow by 4 percent in 2020.

[31] While the DBCC projection is based on the BOP definition, this estimate is based on the PSA definition of exports which was assumed to also grow by 6 percent in 2021.

trade in 2021 could expand by 23.7 percent and 25.1 percent in the gloomy and rosy scenarios, respectively. The trade deficit could increase or decrease depending on the relative performances of exports and imports.

It should be noted that these projections imbibe the inherent limitations of their benchmark WTO figures. Therefore, the estimates should be seen as explorations of likely scenarios rather than a strict interval of forecasted growth values. Given the extreme uncertainty that the global economy is currently facing, the WTO cautions that the actual numbers may be better than the optimistic case or worse than the pessimistic case. This all depends on how countries deal with the four horsemen of trade apocalypse.

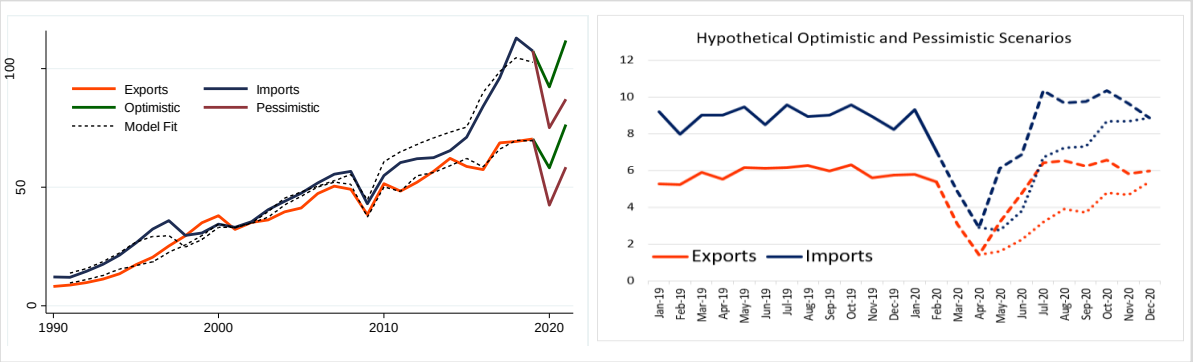
Table 2. Possible scenarios for Philippine merchandise trade based on WTO projections

Indicator	2019 Baseline	Optimistic		Pessimistic		Model Fit	
		2020	2021	2020	2021	Adj. R^2	MAPE
Merchandise exports (%)	1.5	-17.2	31.1	-39.5	37.4	0.99	6.2
Merchandise imports (%)	-4.9	-14.1	21.3	-30.1	16.0	0.99	6.7
Total trade (%)	-2.5	-15.4	25.1	-33.8	23.7	-	-
Trade deficit (US$ bn)	37.0	34.0	35.5	32.6	28.6	-	-

Source: Author's calculations based on PSA and WTO data
Note: The estimates are obtained using cointegrating regressions; n = 29.

Nevertheless, these projections mirror the gloomy outlook on the country's major trading partners according to recent assessments by the IMF, World Bank, and ADB. The IMF projects the global economy to shrink by 3 percent in 2020, driven by the slump in advanced countries. In particular, the US and Japan's real GDP will dip by 5.9 percent and 5.1 percent, respectively. Among emerging markets, China's growth is expected to decelerate from 6.1 percent in 2019 to 1.2 percent in 2020 while ASEAN-5 (which includes the Philippines) is likely to contract by 0.6 percent. This is broadly consistent with World Bank's lower case forecast of a 0.5 percent negative growth for East Asia and the Pacific.[32] ADB's prospects for 2020 are relatively optimistic, which only see a significantly slower but still positive growth in developing Asia.[33]

Figure 5. Projected trend of Philippine merchandise trade (US$ bn)



Source: Author's calculations based on PSA and WTO data
Note: The projections in the left panel are obtained using cointegrating regressions.
Note: The broken and dotted lines in the right panel assume the optimistic and pessimistic scenarios, respectively.

Leading indicators for industrial activities in the country point to the looming decline of trade. Import and export values in February 2020 are respectively, 24.1 percent and 6.7 percent lower compared to a month earlier.[34] In March 2020, the Philippines' PMI dived from 52.3 to 39.7, reflecting the adverse impact of the disruptions in industrial activities during the first weeks of the Luzon-wide community quarantine.[35] This free fall of the country's manufacturing and trade activities is expected to continue at least until April 2020. In fact, the Philippine Economic Zone Authority reported that 703 companies have suspended their operations as of March 20, 2020.[36] This includes 309 Cavite-based manufacturers that employ 86,549

[32] https://www.worldbank.org/en/region/eap/publication/east-asia-pacific-economic-update
[33] https://www.adb.org/publications/asian-development-outlook-2020-innovation-asia
[34] https://psa.gov.ph/content/highlights-philippine-export-and-import-statistics-february-2020-preliminary
[35] https://www.portcalls.com/ph-manufacturing-activity-sees-historic-low-in-march/
[36] https://newsinfo.inquirer.net/1245942/lockdown-shutters-700-luzon-factories

workers. In addition to forced lockdowns, social distancing, and strict checkpoints, the suspension of public transport also made reporting for duty nearly impossible for most workers.

Based on these early figures, the right panel of Figure 5 shows a hypothetical short-term trajectory of Philippine exports and imports. The optimistic Philippine scenario suggests a precipitous drop of trade in April 2020 before normalizing in the second half of 2020. This case assumes that exports and imports will return to the original DBCC trajectory as early as July 2020. According to the WTO, a strong rebound is highly likely if households and firms view the outbreak as a "temporary, one-time shock". In this case, business and consumer confidence will rebound quickly, leading to the fast recovery of investments and spending. On the other hand, the pessimistic Philippine scenario is consistent with a protracted and weak recovery of exports until the end of the year while imports may slightly pick up in October 2020 in time for the seasonal spike of consumption in the last quarter.

Which Philippine industries are going to endure the staggering contraction of world trade? The simple answer is "all industries". However, some sectors will expectedly suffer more than others. Industries that are highly integrated to global production networks such as electronics, automotives, and garments will definitely feel the brunt of lockdowns and supply chain disruptions. In addition, raw materials, intermediate inputs, food, and other agri-related exports will likely decline due to lower demand from crisis-hit countries. Lessons from recent crisis episodes provide useful hints on the possible sectoral pattern of the ongoing export decline. Recall that the dotcom crisis happened in 2001, the global financial crisis peaked in 2009, and the tsunami- and flooding-fueled disruption of East Asian supply chains occurred in 2011. Table 3 shows that the Philippines experienced significant export losses in all scenarios.

Table 3. Growth of Philippine exports in different crisis years

Commodity Group	2001	2009	2011
Total Exports	-15.6	-21.7	-6.2
Coconut Products	-7.9	-40.6	18.3
Sugar Products	-43.4	39.7	649.3
Fruits and Vegetables	3.4	-4.7	51.1
Fish Products	-12.5	-13.0	8.8
Forest Products	-49.4	-1.9	79.5
Mineral Products	-17.4	-41.1	47.2
Petroleum Products	-44.5	-76.4	74.5
Manufactures	-16.6	-19.4	-12.0
Electronic Products	-19.2	-22.2	-23.4
Semiconductors	-26.5	-26.0	-25.4
Electronic Data Processing	2.8	-5.4	-22.7
Consumer Electronics	-1.3	-37.2	-19.1
Automotive Electronics	6.6	-34.2	110.5
Garments	-6.3	-21.7	11.4
Textile Yarns/Fabrics	-9.4	-24.5	8.5
Footwear	-4.5	-28.8	49.9
Wood Manufactures	-44.0	-10.7	63.6
Furniture & Fixtures	-21.9	-37.4	8.5
Chemicals	-3.0	-14.1	22.8
Non-Metallic Mineral Manufactures	-8.3	-25.9	9.1
Machinery & Transport Equipment	2.2	-8.0	9.3
Processed food and Beverages	22.7	-11.4	11.1
Iron & Steel	-42.7	-54.6	29.2

Source of data: Philippine Statistics Authority

What we'll probably see in 2020 is a blown-up version of 2011 combined with more severe cases of 2001 or 2009. Based on the behavior of Philippine exports in 2011, electronics will definitely take a hit from the sudden stop of factories in East and Southeast Asia, especially in China. Similar to 2001 and 2009, the sector is likely to face additional downward pressure from demand cuts in global market such as EU, Japan, and the US. While the adverse impact of economy-wide supply disruptions outside electronics remains to be seen, the catastrophic effects of global demand shocks are very evident in 2001 and 2009. In both years, almost all major categories of Philippine exports experienced negative double-digit growth. In 2009, the biggest losers came from a wide variety of primary and manufacturing sectors such as coconut products,

mineral products, petroleum, consumer electronics, automotive electronics, furniture and fixtures, and iron and steel. If we were to factor in the effect of supply chain distortions into the 2001 and 2009 scenarios, the likely outcome for 2020 seems in favor of the pessimistic case discussed above.

Overall, 2020 is poised to be a bad year for the country's current account. The deep recession in advanced economies could have a significant dent on remittances, conditional on the counter-cyclicality of these inflows. Tourism revenues will be hit hard by extended travel bans and lower demand from cautious, impoverished vacationers. Logistics is also likely to suffer from supply chain disruptions. Nevertheless, there are relatively resilient sectors such as IT and IT-enabled business services. BPOs remain one of the last sectors standing during the lockdown, alongside essential businesses in the food, pharmaceutical, trucking, and utilities industries. Amid the 2009 recession, the country's net exports of computer and information services still soared by 55.1 percent. Likewise, net exports of miscellaneous business, professional, and technical services delivered an impressive 28 percent growth. If that is any indication of the sector's buoyancy during downturns, we can still expect BPOs to perform relatively well in 2020. In fact, others suggest that the sector may benefit from the cost-cutting measures of crisis-impaired companies in developed countries.[37] Notwithstanding, prolonged lockdowns that imperil the health and mobility of BPO workers pose significant downside risks. The community quarantine provides a golden opportunity for firms and regulators to explore the potential of e-commerce and work-from-home arrangements. However, this requires heightened government efforts to enhance the reliability of the country's IT infrastructure. ■

[37] https://news.abs-cbn.com/business/04/13/20/bpo-industry-in-philippines-seen-benefitting-as-firms-abroad-cut-costs-due-to-pandemic