The Impact of COVID-19

Business cycle review uses a ZACCI proprietary tool that measures real gross domestic product fluctuations in the economic environment to predict short and medium term economic and business trends. It simply expresses fluctuations on the state of economic activity in one figure (index) of real gross domestic product polynomial residuals.
BUSINESS CYCLE REVIEW

The Impact of COVID-19

The business cycle is the periodic but irregular up-and-down movement in economic activity, measured by fluctuations in real gross domestic product (GDP) and other macroeconomic variables. A business cycle is typically characterized by four phases - recession, recovery, growth, and decline that repeat themselves over time.

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For More Information Contact

Lusaka Showgrounds, Financial Services Lane No. A10

P.O. Box 30844, Lusaka, Zambia

Tel: +260 211 252483/+260 211 253007

Telefax: +260 211 253020

Cell: 0971 581467

secretariat@zacci.co.zm

www.zambiachamber.org
**INTRODUCTION**

“Cycles are not, like tonsils, separable things that might be treated by themselves, but are, like the beat of a heart, of the essence of the organism that displays them”

Joseph Schumpeter, Economist, 1939

20th Century Economist Joseph Schumpeter would assert that of the three basic building blocks of economics - theory, statistics, and history – the last is by far the most important. It is important is building our understanding of the economy that we from time to time review key developments in economic parameters.

**BUSINESS CYCLE**

The business cycle is the periodic but irregular up-and-down movement in economic activity, measured by fluctuations in real gross domestic product (GDP) and other macroeconomic variables. A business cycle is typically characterized by four phases—recession, recovery, growth, and decline—that repeat themselves over time.

- **Downturn**
  - Risk aversion prevails during recessions with emphasis on long maturity, high quality fixed income.
  - Duration: -8%, Credit: -11%

- **Recovery**
  - Credit tends to be the first of the risk assets types to bounce following recession.
  - Duration: 14%, Credit: 6%

- **Expansion**
  - Equities generally fare best through the expansion phase.
  - Duration: 9%, Credit: 19%

- **Slowdown**
  - The “flight to safety” occurs as a recessionary environment approaches.
  - Duration: 13%, Credit: 4%

*We remain in the expansion stage enjoying a late cycle growth spurt.*
Where we are in the business cycle has significant implications for market returns. During a downturn, the Bank of Zambia is usually lowering rates, aiding Treasury returns (yields and prices move in the opposite direction), while credit and equities generally decline. The opposite then often holds true during the recovery and expansion phases. Finally, during a slowdown, a “flight to safety” occurs as a recession approaches, with Treasuries again being the performance leader.

Understanding Business Cycles

VOLATILITY OF INVESTMENT SPENDING

Variations in investment spending is one of the important factors in business cycles. Investment spending is considered the most volatile component of the aggregate or total demand (it varies much more from year to year than the largest component of the aggregate demand, the consumption spending).

MOMENTUM

Many economists cite a certain “follow-the-leader” mentality in consumer spending. In situations where consumer confidence is high and people adopt more free-spending habits, other customers are deemed to be more likely to increase their spending as well. Conversely, downturns in spending tend to be imitated as well.

TECHNOLOGICAL INNOVATIONS

Technological innovations can have an acute impact on business cycles. Indeed, technological breakthroughs in communication, transportation, manufacturing, and other operational areas can have a ripple effect throughout an industry or an economy. Technological innovations may relate to production and use of a new product or production of an existing product using a new process.

VARIATIONS IN INVENTORIES

Variations in inventories—expansion and contraction in the level of inventories of goods kept by businesses—also contribute to business cycles. Inventories are the stocks of goods firms keep on hand to meet demand for their products.

FLUCTUATIONS IN GOVERNMENT SPENDING

Variations in government spending are yet another source of business fluctuations. This may appear to be an unlikely source, as the government is widely considered to be a stabilizing force in the economy rather than a source of economic fluctuations or instability.
Many economists have hypothesized that business cycles are the result of the politically motivated use of macroeconomic policies (monetary and fiscal policies) that are designed to serve the interest of politicians running for re-election. The theory of political business cycles is predicated on the belief that elected officials (the president, members of Congress, governors, etc.) have a tendency to engineer expansionary macroeconomic policies in order to aid their re-election efforts.

Variations in the nation's monetary policies, independent of changes induced by political pressures, are an important influence in business cycles as well. Use of fiscal policy—increased government spending and/or tax cuts—is the most common way of boosting aggregate demand, causing an economic expansion. The Central Bank, in the case of the United States, the Bank of Zambia, has two legislated goals—price stability and full employment. Its role in monetary policy is a key to managing business cycles and has an important impact on consumer and investor confidence as well.

The difference between exports and imports is the net foreign demand for goods and services, also called net exports. Because net exports are a component of the aggregate demand in the economy, variations in exports and imports can lead to business fluctuations as well. There are many reasons for variations in exports and imports over time. Growth in the gross domestic product of an economy is the most important determinant of its demand for imported goods—as people's incomes grow, their appetite for additional goods and services, including goods produced abroad, increases.
Gross domestic residuals remained positive in the first two quarters of 2018. The Economy began performing under capacity in 2015 after currency depreciation and energy shocks led to productivity cuts.

A similar underperformance is expected with the GDP residuals expected to underperform due to effects of the COVID-19 pandemic. According to IMF\(^1\) the social and macroeconomic impact of the COVID-19 shock, on top of a severe drought last year, will be heavy. Growth is forecast at around -5 percent in 2020, substantially lower than envisaged at the beginning of the year, and the number of people living in extreme poverty is expected to increase. Fiscal pressures in 2020 have increased due to significantly lower revenue collections and higher spending needs. Zambia has requested support under the G20 Debt Service Standstill Initiative, which would provide temporary fiscal space this year.

The COVID-19 shock has significantly impacted economic prospects growth this year will be negative, poverty has likely increased, and fiscal pressures have increased further with lower revenues, higher expenditure needs, and an already high debt service burden.

Policy will need to focus on both near- and medium-term targets to address these challenges and the underlying macroeconomic vulnerabilities, including the main elements of the revised 2020 Budget with a focus on spending for the COVID-19 health, social and economic response. There is need to rationally determine Government policies and priorities in the formulation of the revised 2020 Budget, as well as the medium-term fiscal stance needed to restore debt sustainability, revive growth and lower poverty.