

IMPACT OF COVID-19 ON THE GLOBAL ECONOMY: IS FEAR OF AN INFLATION PANDEMIC JUSTIFIED?

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ABSTRACT

International economies are fragile and vulnerable to the various volatilities that occur, due to classic economic imbalances caused by financial meltdowns, inflated balloons, or other internal and external macroeconomic shocks, due to unforeseen phenomena in the form of the economic term "*black swan*". The first focus of the paper was placed on examining the real impact of the virus on key macroeconomic indicators of the global economy and what is the attitude of international politics when it comes to creating a crisis structure. The implementation of the policy seen since the beginning of the 2020 crisis has led to the strengthening of an economic doctrine that is mitigating and out of mind, which has again shown that the world of central banks is easy on the "*monetary trigger*". The second focus of the work is singled out as a subtheme, where the current situation with China's Evergrande is to be addressed and how much impact the ultimate negative outcome can leave on the current recovery of the world economy. For the past twenty or thirty years, China's economic picture has led it to the world's second strongest economy, thanks precisely to the strong implementation of China's development policy. But rightly the world wonders what the real growth of the Chinese economy is. Labour's third focus has been placed on the issue of inflation as a potentially long-term problem. The implementation of the agreed policy over the last year and a half is a realistic reflection of the current situation with inflation. It is crucial to process whether its sudden jump can be a long-term problem for the entire economic structure of the European and global economies. Whether inflation can be corrected in the long run through the law of supply and demand, as has always been shown so far, needs to be seen.

Keywords: *Chinese Evergrande, impact of the virus, inflation, macroeconomic indicators*

INTRODUCTION

The year 2020 was a turning point for the global economy. The virus pandemic wiped out the economic golden years within one quarter. COVID-19 is a classic phenomenon of the "*black swan*", an event that is unpredictable and that

certainly no one expected, at least not on this scale. An event that comes and goes once every hundred years.

But the appearance of such an event also served to expose a much darker thesis – when a crisis of world proportions occurs, there are no friendships and everyone manages as they know how, what politically, what economically and what humanly. For the first time in 80 years, the United States experienced its deepest economic downturn, Europe found itself facing strong lobbies tailored by its own vaccine interest group promotions, and China and Japan were the only two countries to expressly return from a "temporary recession" since its initial economic sinking. Who can read between the lines, then also knows where to find a valid answer to the question of whether a new world order is trying to be tailored. From the initial failure to find and the inability to provide the right and correct form of answers what kind of crisis this is and what consequences it will leave, to this day, the world has forcibly learned what it is like for economic policy to fight the devastation. The focus of this research paper is on discovering the consequences left for the global economy, from macroeconomic structures to financial markets, but also what lies ahead in the future with strong quantitative easing and inflation. It has long become clear that maintaining inflation stability is no longer a short-term imperative, as all monetary and fiscal strength is focused on keeping the economy complete. But with such necessary decisions, it will be investigated whether there is justified fear of the current "*rampage*" of inflation, how many general current inflationary pressures are justified in these situations, at least in part of the crisis as a crisis, and can the world cope with inflation over the indicative and presumed targets leading up to the pandemic in the long run?

THE IMPACT OF THE CRISIS ON THE GLOBAL ECONOMY

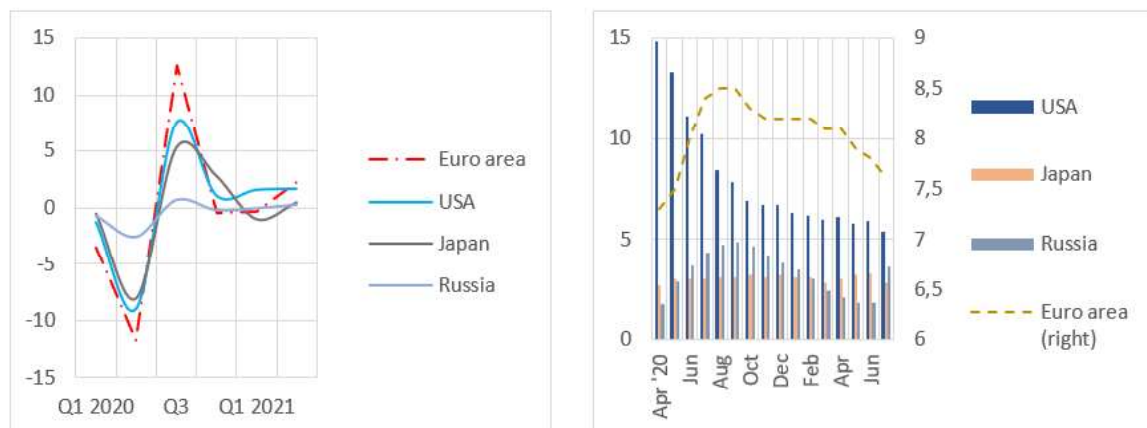
In the latest crisis felt by the world, a crisis of a health nature that occurs in this proportion certainly once a century, there has not only been an economic collapse, but other wounds such as political lack of empowerment and an apparent lack of leadership have surfaced there. COVID-19 is a macroeconomic shock that acted in the right aggregate supply. Due to exceptional circumstances, companies were no longer able to produce and ceased their normal course of operations. The price deflation that was present in the initial months of the crisis was as always, a reaction to the fall in oil prices and the fall in prices of those products that did not relate to food, but also the pressure to lower the quotas of a barrel of crude oil. In order to keep GDP sinking as low as possible, central banks around the world, primarily through the FED and ECB, began strong quantitative easing through lowering interest rates and placing loan arrangements precisely to stimulate investment and consumption growth, and consequently production itself. At the heart of the global financial crisis in 2012, the then head of the European Central Bank, and today's current Italian Prime Minister Mario Draghi, uttered three words that completely mirrored the fast-moving policies carried out by both the FED and the ECB with, still current, the coronavirus pandemic – "*Whatever it takes*". In 2012, in the booming crisis of European public debt, it was intended to

say that all monetary and fiscal "arsenals" would be used to preserve the euro and the eurozone, consequently by the ECB taking on the role of the last financial haven. All this was very much necessary for both the coronavirus and 2020, because a deep recession could not be stopped but everything could be done to alleviate it. The consequences affecting the European economy were reflected through several currents – a decrease in the growth of the Chinese economy in the first quarter, an increase in unemployment in Europe, a decrease in supply and demand, and a decrease in the liquidity of enterprises.

Central banks were adamant that the imperative to combat the overthrow of economies, through the consequences that the coronavirus has behind it, would be precisely the "blitzkrieg" of economic policies.

The impact of the crisis on macroeconomic indicators has been forceful, particularly reflected through some components of GDP, unemployment, and public debt. The deep negative movement of all macroeconomic indicators then surpassed the initial gap projections. Euro area GDP fell sharply by 12% in the second quarter, but what most strongly influenced such a sudden and profound decline not only in European, but also global, GDP is the very form of crisis. All the crises so far have been reflected in the framework of financial corrections and technological "boom", but the type of crisis brought about by COVID-19 has been artificially created. Thus, there have not been any temporary corrections in financial markets, either by deflating the real estate sector, or by correcting the technology sector. There was a forced shutdown of the economy here because it required a healthy temper. Therefore, all those components of GDP that should not have grown – they grew, and all those components of GDP that should not have fallen – fell. Personal consumption stagnated and fell sharply, government spending due to the financing needs of national economies grew rapidly, investments stagnated, and exports were deeply lower than imports. Thus, not only was the entire structure of GDP in the red, but the negative gap of the foreign trade balance deepened.

Fig. 1. Real GDP (% , left) and unemployment rate (% , right)



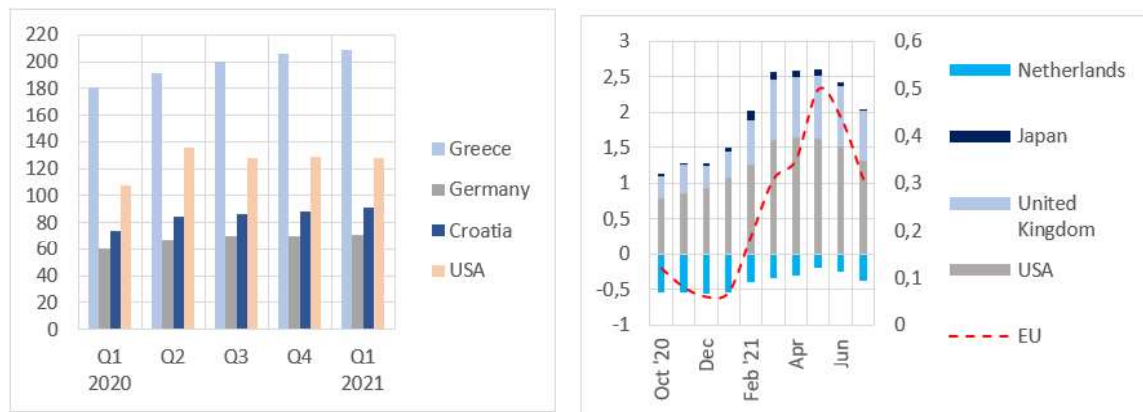
Source: authoring

The 2020 tourist season for the fringe countries of Europe, for which a strong share of GDP is the tourism sector, is historically the worst year. The global tourism sector was wiped out by more than \$1.3 trillion, up as much as 11 times from the 2008 global financial crisis [1]. The 2021 tourist season, which already surpassed all planned projections according to preliminary data, at least contained the problem of unemployment and budget for a while. Spain and Greece recorded an overall unemployment rate of less than 15% for the first time in two years, and Croatia surpassed its gold in 2019. But underneath this, the question arises: why are the financial results of one Greece and Spain so much weaker compared to one Croatia? Croatia has fully managed to take advantage of its situation with keeping the exponential number of growths of patients at the level.

At least if you watch the peak tourist season. Unfortunately, this is not the situation for Greece and Spain. Thus, although countries such as Greece and Spain have a significant part of GDP declining on tourism and tourist air transport, there is talk of about 20%, the biggest problem of gain through financially high-quality results is precisely the decline in the number of newly infected. We are of the opinion that the combined results, both financially and the results of the employment-unemployment ratio, will be worse for Greece and Spain at the end of the year, and consequently will be worse for both the export component itself and the entire structure of GDP. There is one strong gap in filling the state budget, and ultimately through employment itself, because the situation with the pandemic is not calming down in the countries and the question is how long it will be withdrawn. The tourism sector is one of the more challenging sectors of the whole of Europe, it is not just a question of Greece and Spain, given that the sector covers about 12%, and this is almost 40 million people in the EU.

The decline in US GDP in the second quarter of 2020 reached 32%, only to return by 33% in the next quarter [2]. The global economy is back in the shape of a "U." Such a deep decline in the U.S. economy was largely reflected by a sharp decline in personal consumption, an increase in unemployment at a level of more than 20 million Americans, a sharp drop in imports and exports, and a stagnation in private investment. But this situation has happened with the entire global economy, both from Europe itself to Japan and Russia. In all this, we have singled out the Chinese economy for a reason, because it is doubtful how official and accurate China's official data really is. China is a very rare country that has not only kept its economy level in the COVID-19 crisis but has been delivering positive results from the outset. Of course, the economic momentum that China's official government portrays is certainly not so great. The question arises of the reliability of official data? The problem with the Chinese economy over the past five years is that China's provinces are extremely indebted, to such an extent that they themselves do not provide reliable data waiting for the balloon to burst and the burden to shift to the central government. There are additional things like social and social inequality that were very much felt in the crisis, so we rightly wonder what China's real economic growth is.

Fig. 2. Public debt (% GDP, left) and 10-years government bond yields (% right)



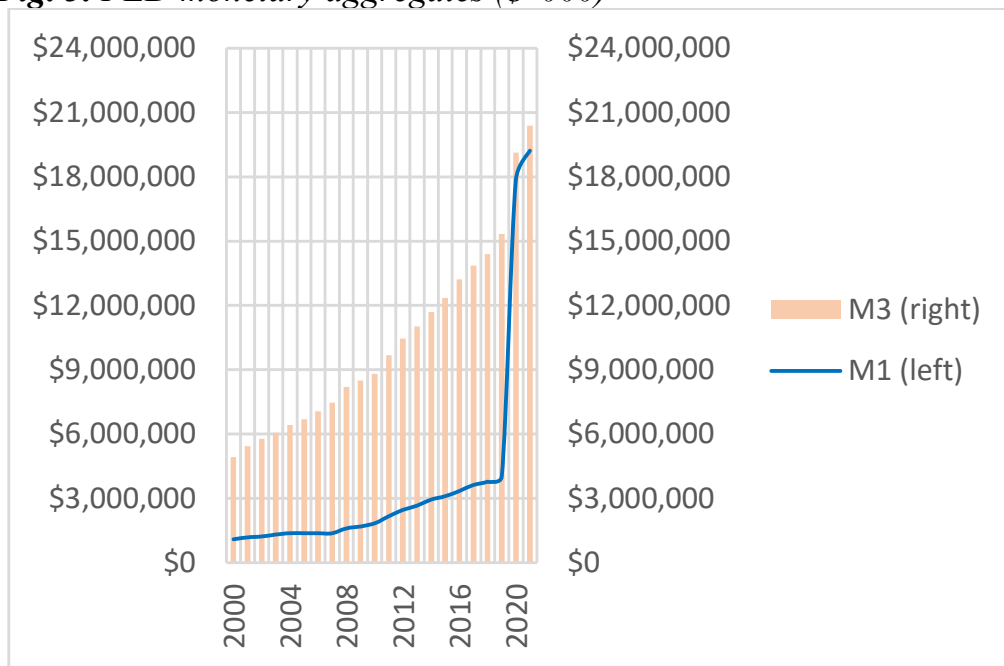
Source: authoring

The impact of the crisis was also adversely reflected in the burden of public debt repayment, yields on 10-year government bonds, as well as the final increase in monetary aggregates and money in circulation. The increase in public debt in these situations is expected and justified, especially if one considers the fact that part of the revenue structure has been lost and part of the expenditure has increased and will increase due to the financing needs of the global economy. The second quarter of 2020 was the most disastrous for the public finances of European countries. The next question that can be asked is: will the problem of public debt, after the pandemic, become a longer-term problem? This depends on how much the economic depth gap will still widen with the pandemic, but consequently in which direction the policy of the upper and lower limits of interest rates will move after the end of the pandemic itself. It is already obvious that there is not much to expect about this, because the period of cheap money is over and in the long run the period of low interest rates comes as the "*new normal*".

And what the famous Michael Burry was announcing – that's what happened. Inflationary pressures after strong monetary policy implementation are there, for some South American countries and hyperinflationary. With the impact of coronavirus on the economy, the economy has once again strengthened the mix branch of neoliberalism and post-Keynesianism – *modern monetary theory*. MMT operates through a policy that a country that has its own currency, such as the United States, Japan, Canada, Russia, and the United Kingdom, can never go bankrupt because it can always borrow in the currency it creates from nothing [3]. The FED itself has created 40% of all current dollars in circulation, and the ECB more than €2 trillion to repair the effects of the coronavirus. An important insight into the state of over-liquidity in the system shows the movement of key monetary aggregates, M1 and M3, through the US Fed. Ever since the last financial crisis, the FED, and the ECB itself, have tended to ease steadily quantitatively, which consequently leads to the global financial structure being too liquid. Such maintenance of long-term policy is not desirable, since any significant volatility

also causes a significant fluctuation in inflationary pressures, as is the current situation.

Fig. 3. FED monetary aggregates (\$ '000)



Source: authoring

On only two occasions, in two different terms of two different presidents, the U.S. Senate approved a plan to recover the economy to a total of \$5 trillion. Central and federal governments have not thought about another problem that could arise here - and it emerged during the deepest crisis, when 20 million Americans lost their jobs. Namely, the monetary stimulus that was intended from this printing of money, mostly ended up in the accounts of small and large investors, investment banks, where it was this majority of the money that ended up on U.S. exchanges – in order from stocks to ETFs and cryptocurrencies. It is a \$240 billion total amount of money paid to U.S. citizens in the form of a cash stimulus. This is a problem because the short- and medium-term consequence of this is that today the financial market is in a bubble.

The correction of the financial market has been present since 2020, among all other factors and pumping "helicopter" money into the system is one of the reasons why Tesla shares had their own correction of 35%, right down to the cream of the American *future* economy – Roku, Nvidia, Facebook, Apple, Microsoft (...). Thus, this should have been predicted as a problem because even the current reflection of the financial market in the third quarter of 2021 does not give a real picture of the situation. The global economy began to create its newly created added value only at the end of the first and beginning of the second quarter of 2021, until then it was a pure reflection of the synthetic recovery. In more concrete figures, according to some preliminary calculations of the author, this would look the following:

- two tranches of cash stimulus - \$1,200 and \$1,400
- 90 million - the figure of the American population that received the payment
- 13.5 - 42 million - number of people who have redirected their stimulants to the financial market
- \$110 - 170 billion - preliminary figure of total inflows to the U.S. stock market from this portion of cash assistance alone

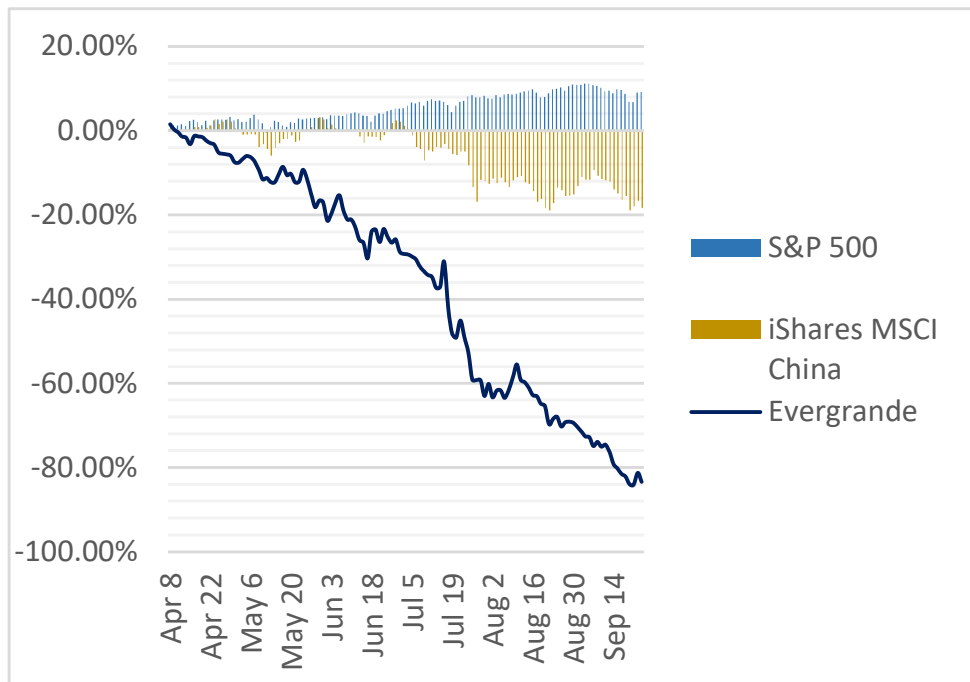
CHINA'S EVERGRANDE: IS THE WORLD IN FOR ANOTHER FINANCIAL CRISIS?

The situation with the Chinese economy and Chinese official data leads to another, ongoing, problem that is largely caused by the implementation of the company's internal policy in the wake of the crisis – the Chinese Evergrande. Synonymous is also named as the Croatian "*Agrokor*" or the American "*Lehman Brothers*" because the current extremely difficult financial situation with Evergrande is followed by the whole world. Evergrande is a Chinese real estate giant, the second largest in China and its financial problem could spill over into the rest of the global economy and financial market to some extent. Evergrande's problems began for two key reasons; the first reason is that Evergrande's growth was made possible, until last year, by China's uncontrolled development policy in the form of a real estate "*boom*". The second reason is that the central government in Beijing last year tightened the regulatory part of the operations and debts of such companies, therefore, even then, the first problems began to arise in paying suppliers and covering other operating costs, and today it has only become clear what the real indicators of illiquidity and insolvency of the company are.

The most important thing now is to see what proportion systemic risks could spill over into the rest of the global economy, should there be a shortening of the negative outcome. The current picture of the situation is as follows [4];

- \$305 billion is the total sum of debt
- \$7.4 billion - corporate bonds due in 2022
- 200,000 - number of employees
- 1.5 million unfinished buildings
- 85% - total share price drop

Fig. 4. S&P 500, iShares MSCI China ETF, Evergrande daily share price changes (%)



Source: authoring

By comparison, Croatia's general debt is about \$50 billion, so one European country is six times less indebted than Evergrande. There is no doubt in how much importance this company has for China's development economy, and what importance it has had over the past twenty years. A key question arises here; in the face of known all the risks to the Chinese economy, but also to the Chinese financial system, will Beijing step in to save it? I'm sure he will, for three key reasons. Namely, for China, Evergrande is what it was for the USA in 2008 – "*too big to fail*". The first key reason lies in the fact that the Chinese bought real estate from said company before they were built, deposits were paid and if the company goes bust it means not only a financial loss for citizens, but ultimately the loss of purchased real estate. Another reason is that the company owes too many financial and non-financial institutions, so the financial shock would be too great and would certainly not only affect the Chinese financial system, but spill over into the global one in part. The third reason is that the company cooperates with a very large number of companies from the construction sector, and the collapse of a company like Evergrande means a large financial loss of all the companies with which it cooperates, and consequently for most of them bankruptcy.

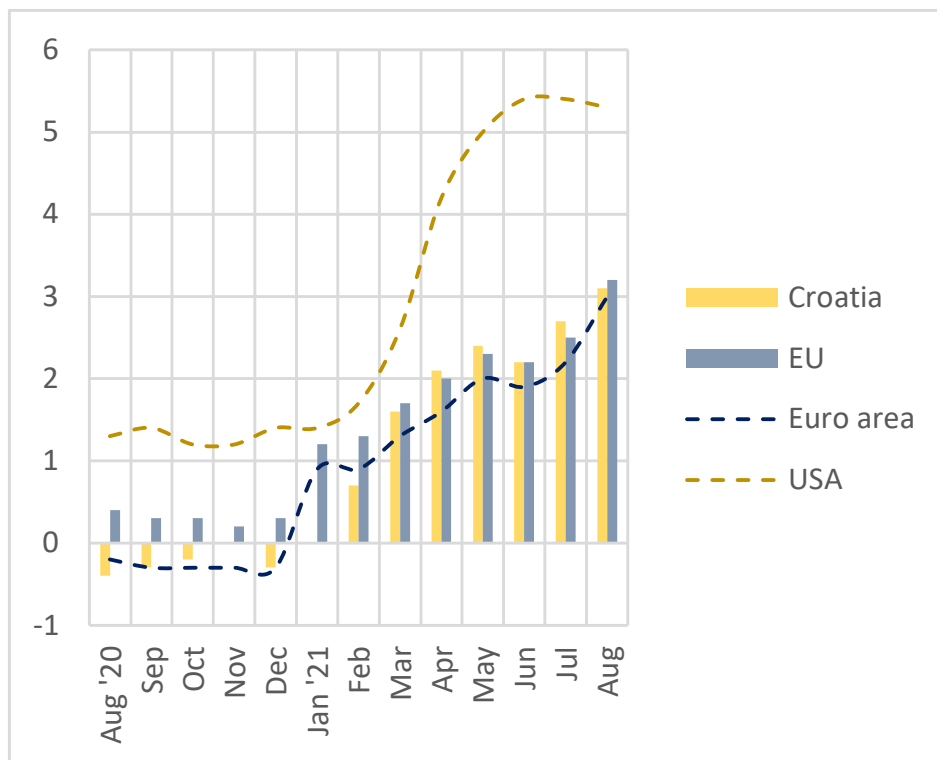
The financial turmoil brought about by the situation with the Chinese company certainly represents a demanding task before the regulatory authorities, but also in general before the central government, over the past few years.

As early as last year, the Central Government of Beijing introduced increased monitoring on the overall debt structure of large investors in China, so it is

realistic to expect that it will itself engage in some form of rescue of the company. The next question that comes in; if for a year there has been strong monitoring on demanding investment projects and the overall debt structure of such investors, how could this have happened? The government in Beijing will surely go towards selling discount as soon as possible the assets Evergrande owns, and that the bankruptcy plan protects small investors, while everyone else, in the first tidal wave, will suffer losses. In particular, the emphasis here is on Evergrande corporate bondholders, whose maturity comes due in part as early as the end of September, as well as the \$7.4 billion next year. In the face of this situation, we say that some of the risk would spill over into the global economy, but one insignificant part. Even though the European economy itself is strongly linked to Chinese imports, the systemic risk is not great to significantly disrupt the European financial system. China's real estate sector is not significantly linked to foreign land, so long-term systemic risk is a burden China would bear on its own.

INFLATION - TEMPORARY MOMENTUM OR LONG-TERM PROBLEM?

The current level of inflation is "*raging*" in Europe and the rest of the world. The United States has recorded a rate of 5% in the last three months, the same situation is with European countries – Hungary, Lithuania, Estonia. If one takes the current factual situation, which is that the proliferation of inflation in the current gabarites is temporary in nature, then it can be said that the long-term forecasts that it should be kept to the predicted 2%, somewhat below/above that, and this could become a situation that comes under the "*new normal*". But what about short- and medium-term developments? Namely, the reflection of the current state of stronger inflationary pressures is also a reflection of the situation a year and a half ago. This is a consequence of the implementation of global politics, but this global policy was also necessary to contain the scale of the economic crisis. Fuel to the fire about "*high*" inflation is also added by people with their perception of significant price hikes.

Fig. 5. Inflation in previous months (%)

Source: authoring

This problem also persists when inflation increases slightly year-on-year by 0.2% or 0.3%, or for example when the Member States of the European Union start adopting the euro – it is always people's perception that prices will skyrocket. Clearly, the current rampage of inflation is not denied by anyone and is really reflected in people's purchasing power, and on the other hand, there is currently no real wage increase. As the global economy resets, the more and more we feel the imbalance of global supply and demand; oil, shipping, energy and raw material prices, real estate, and agricultural land prices. These are some of the reasons why this crisis is more like that of the 1970s than the one in 2008. The question arises; if they are central banks and whose primary task is to rein in prices, then where is one FED, what decisions can it make to contain further uncontrolled price spikes? In this situation, possibly through an increase in the reserve requirements rate towards banks, because this situation is extremely logical – money is abundant, the increase in citizens' savings is measured in millions in a short period of time, and therefore by increasing the reserve required rate, one part of the money can be withdrawn from circulation in order to partially regulate inflation. In addition, it remains relatively only to leave the reset of the global economy to return to its natural balance through supply and demand. With debt levels so high, at 125% of GDP [5], it is questionable whether the FED intends to maintain key interest rates at its current level, or whether it will go into raising them given the increase in inflation that is increasingly a problem for the recovery of the U.S. economy. The situation is a double-edged sword, because even if it went to bring down inflation through the monetary tools available to it,

it could bounce back, primarily in the form of credibility. The same situation is with the ECB's monetary approach.

The authors see this reflection of inflation through three currents. The first current is due to the strong quantitative easing carried out by central banks, which consequently draws with it another realistic conclusion; the age of cheap money is rapidly coming to an end. True, the central bank's strong expansionary policies have been implemented since the last financial crisis, the one in 2008. Already mentioned earlier, 40% of all current dollars in circulation were created in the second and third quarters of 2020, the European Central Bank "*created*" over €3 trillion in just one year, therefore, the expansionary policy in 2008 did not trigger as much stronger inflationary motion as it implemented such a policy today. This can also be presented through a simple equation of quantitative monetary theory ($MV=PQ$). What has been talked about before – in the long term, when there is a situation where the amount of money in circulation (M, it is M1) grows faster than the output of real GDP (Q), then such a situation can also cause increased inflationary movements. Thus, the amount of money put into the system, through the implementation of quantitative policy, grew significantly faster than the global economy was recovering. The global economy began to recover from the beginning of the second quarter of 2021, while everything previously was a synthetic recovery caused by just created money that had no cover in the newly created productive value of the global economy. This is clear and expected through moves by central banks in crises.

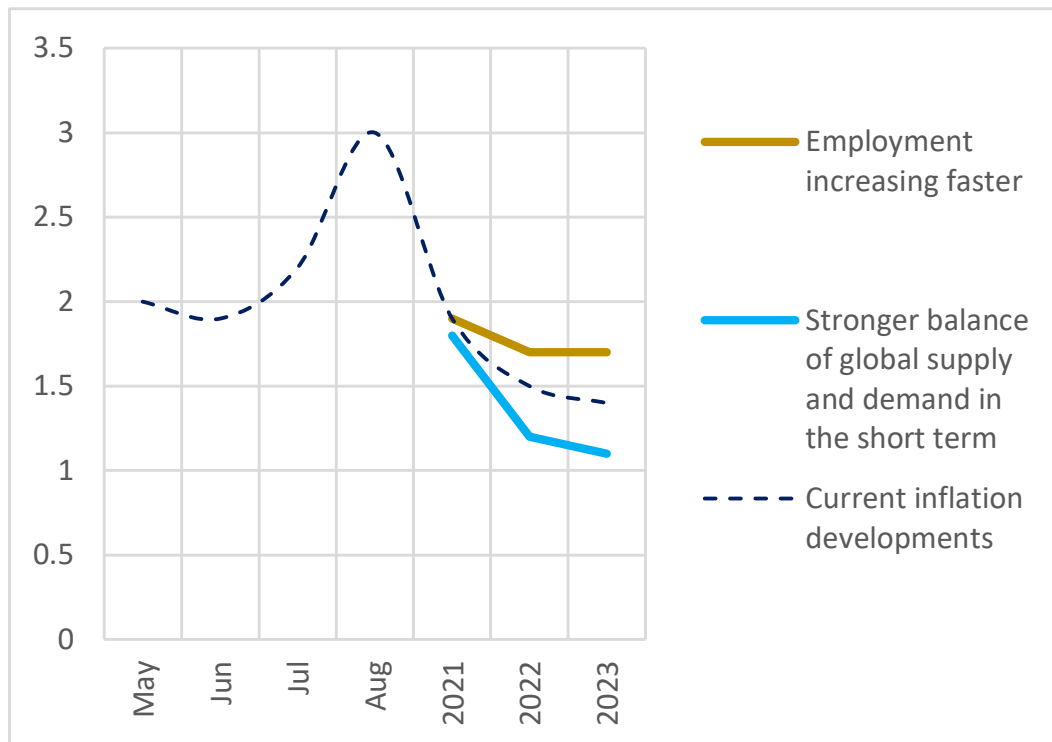
The second current is due to the current strong global demand for loans. Namely, one of the reasons for the real evolution of inflation is the very need for increased, or reduced, financing of all three sectors. When inflation occurs, when prices rise, then the need for credit financing also increases, which increases interest rates from which lenders benefit.

The third current of increased inflation is reflected in the recovery of the global economy. The most pronounced sectors with inflationary movements are the food and beverage, services and transport, energy, and raw materials sectors. Namely, the reset of the economy also means an increase in global demand. It will certainly be some time before energy and raw materials are balanced, as there is currently stronger demand for them than supply, especially if taken as a key fact that the biggest contribution to the rise in the annual inflation rate has also yielded a significant increase in oil prices in the market.

Someone could single out the import problem as the fourth current. This is especially pronounced in those countries whose economic strength is not so diffusive and large, so they plague the problem with stronger imports than exports. Developing economies, and the authors know this especially on the example of the home country of Croatia, do not have a large capacity of domestic production to cover demand, and then import most goods and services. On the example of Croatia, and economies like its own, the strongest component of exports is

tourism, about 20% of national GDP. The problem arises in the summer when the tourist season is and when due to strong demand, by a large influx of tourists, there is also a strong influx of imports of goods and services, but there is still stronger external demand than domestic supply. This is another factor that in these months has a profound effect on inflationary pressures and they are visible every summer, and in parallel there is no real increase in wages in order to mitigate this inflation on the purchasing power of domestic citizens. So, it's external inflation, imported, and it doesn't have a valid thesis on the current jump in inflation.

Fig. 6. Possible further developments scenarios (%)



Source: authoring according to projections via ECB

In the long run, while increased inflation will represent something the post-virus world will have to adapt to, it should be balanced at the projected +/- 2% year-on-year. When there is a strong development of global supply, prices can also be expected to fall again, i.e., balancing them on the envisaged frameworks. What could be singled out as a potential long-term problem after the virus is the stagflation of the economy. Now, it is not realistic to talk about stagflation but hypothetically we point out that forecasts around inflation and real GDP growth are to blame, and that high inflation is sustained in the long run and real GDP achieves measly growth rates.

Stagflation is a dangerous game from which central banks with their monetary policy do not know how to emerge victoriously and it is a more dangerous phenomenon than inflation. Here, countries could slip lightly into an economic depression. Indeed, the problem of stagflation would be reflected entirely through a high inflation rate that is not collapsing, a high unemployment rate and an unproductive national economy. The fringe countries of Europe, a

tourist country, will have a distinct problem at the end of the year with the unemployment rate, it is doubtful that inflation will normalize by the end of the year and what the real GDP growth will be, given that in such countries tourism accounts for a plume of GDP, on average about 18-23%.

REVIEW OF THE CONTRIBUTION TO RESEARCH

The aim of this research paper was to set a valid thesis that could be taken as discussions in the future. First, the current picture of the state of China's Evergrande shows once again that China is incapable of leading a new global order, for several reasons. The first reason is that one of the plumes of national GDP is the real estate sector, about 20-25%, which means that a negative outcome with Evergrande could seriously harm foreign capital in China as well as its development economy and confidence in the regulatory system. Another reason is that China's official data is opaque, and the question arises as to how much real growth the economy has been over the past 20 years. When one wants to take the baton of the new world order, such geostrategic politics is not pursued. The third reason is that, apart from Europe as its strong export partner, it is surrounded by the policies of "*party capitalism*". So, it may be a new era, but it remains an old way of thinking. The real estate sector, as a plume, is a synthetic driver of Chinese development, because if you go deeper into the story then it is understood that there is empty housing (estimates are at 90 million) more than one Germany or the UK has a population. The last reason is that the gap between rich and poor is constantly widening. The medical care system is far smaller than it is in Europe, for example, but it is also far more unequal. Someone from china's provincial backgrounds can hardly afford medical care, for example, in Shanghai, Beijing or Guangzhou.

Another conclusion regarding the Evergrande situation showed that the systemic risk it carries should not seriously harm the rest of the global economy. Namely, the Chinese development economy is quite limited within the framework of China itself, and with this, even capital does not necessarily go beyond it. Here, the only systemic risk could be posed to European banks under which the company has obligations in the form of loans received, but it should also be limited given that the latest regulatory "*rebalancing*" of the central government in Beijing limits the capital of foreign banks to projects of national importance to China.

The third objective was to establish whether there was justifiable fear behind the current inflation pressure? In the short term, yes, but not in the long run. From the three currents already mentioned, which result in stronger inflation, it shows that it has been expected in the overall situation for the previous year and a half. Pursuing stronger quantitative policies than those in 2008, the FED and ECB's decision to lower interest rates, strong demand for credit activities, the current strong and natural recovery of the global economy, from oil, energy, and commodity prices to higher global demand from the supply.

So, in the long run through well-implemented policies, inflation will stabilise, although it will be somewhat higher than the world is used to, its pressures will be limited and corrected. If the wrong policies are implemented, the world will no longer need to discuss the inflation problem, but potentially the problem of stagflation.

CONCLUSION

While one views the crisis as a bogeyman, it is a natural correcting of the economy for economists. For the virus that came at the end of 2019, there was no idea what proportions it would leave on the global economy and its components, although these proportions are already widely known. The sudden recovery of the global economy was primarily due to strong quantitative easing and although there was talk of a synthetic recovery at the time, now it is both natural and the world is no longer a problem with the impact of the crisis on economies, but what comes now after it, that is, what are the long-term consequences of this. This is not only a problem for national economies or expected inflation, but there is also a problem in geopolitical relations that have changed in the last two years, especially in the form of the Russian-Saudi price war, or in the scheduling of the European Union in the form of poorly tailored contracts for the purchase of vaccines, as well as its distribution. Wrong decisions made at the wrong time are very damaging to both relationships and the economy.

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