Global Economy: Slow Recovery Following Deep Recession

By Claus Michelsen, Guido Baldi, Geraldine Dany-Knedlik, Hella Engerer, Stefan Gebauer, Konstantin Kholodilin, Sandra Pasch, and Malte Rieth

ABSTRACT

The coronavirus pandemic caused a global market crash in the first half of 2020. Following a massive slump of around four percent in the first quarter, global GDP decreased in the second by five percent. Lower rates of new infections, together with far-reaching monetary and fiscal policy measures to dampen the economic impact of the pandemic, ensure that production and the trust of consumers and firms will slowly return. Notably, China's quick economic recovery is inspiring hope. As long as the rate of new infections does not continue to rise, global production in the third quarter is likely to increase markedly. DIW Berlin calculates that global production will shrink by 4.0 percent in 2020. During the forecast period, the global economy is likely to grow at quite strong rates of 5.8 percent in 2021 and 4.0 percent in 2022. However, risks still exist: if infection rates grow substantially again, a significant increase in insolvencies, combined with a rise in loan defaults, could destabilize the financial markets and ultimately threaten the solvency of some states.

In the first half of 2020, the coronavirus pandemic led to a global recession of historic proportions. Following a four percent decline in GDP in the first quarter, global production shrank by a further five percent (Figure). Almost all economies suffered considerable economic losses in the second quarter and international trade shrank by around twelve percent. In contrast, China was already experiencing strong growth by the second quarter. The sometimes rigorous measures to contain the spread of the coronavirus not only resulted in a standstill in trade and services, but also hampered production, which in turn disrupted local and global supply chains. In addition, uncertainty among households and companies decreased their propensity to consume and invest.

Decisive for the country-specific differences in production output are the intensity and duration of the coronavirus containment measures. For example, production losses were greatest in countries where prolonged, expansive lockdown measures occurred and where public life was significantly restricted, such as in the United Kingdom and India. However, even countries with fewer restrictions on daily life, like Sweden or South Korea, experienced declines in growth due to other factors, such as behavioral changes or weak export activity. However, economic losses due to illness-related work absences remain low, as the number of infected people in relation to the entire population continues to be very low.

Economies with a high value added from the services sector, such as Spain and Italy, have been disproportionately affected by the crisis. Due to global restrictions, tourism has significantly declined; border-crossing travel ended almost completely from April to June. Services requiring close human contact, for example gastronomy or hotel services, could not be provided in some places or could only be offered to a limited extent.

Over the summer of 2020, the global increase in infections slowed. However, the course of infection is heterogeneous across countries. Easing lockdown measures too early and enforcing hygiene and distancing measures too laxly led to an increase in new infections in some countries over the

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Table

Real GDP, consumer price inflation, and unemployment rate in the world economy

In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Change over previous year in percent											
	2019	2020	2021	2022	2019	2020	2021	2022	2019	2020	2021	2022
Euro area	1.2	−9.0	5.5	3.1	1.3	0.4	1.0	1.4	7.5	9.1	9.7	8.6
without Germany	1.4	−10.5	6.3	3.0	1.2	0.3	0.8	1.2	9.5	11.5	12.3	10.9
France	1.5	−10.3	7.8	2.8	1.1	0.4	0.7	1.2	8.5	9.9	10.9	10.0
Italy	0.3	−11.3	5.1	3.1	0.7	−0.1	0.6	0.9	9.9	11.0	12.0	10.5
Spain	2.0	−13.1	6.5	3.5	0.7	−0.1	1.1	1.6	14.1	18.4	18.7	16.5
Netherlands	1.6	−5.0	4.0	2.7	2.7	0.9	1.1	1.4	3.4	3.9	4.4	3.5
United Kingdom	1.5	−12.1	3.6	1.7	1.7	1.1	2.1	1.8	3.8	4.3	5.4	5.0
USA	2.2	−4.9	3.2	2.9	1.8	0.9	2.0	2.4	3.7	8.7	7.1	5.8
Japan	0.7	−6.0	2.2	1.5	0.6	0.0	0.2	0.7	2.4	2.8	2.6	2.4
South Korea	2.0	−0.3	4.4	3.0	0.4	0.5	1.3	1.5	3.7	4.1	4.1	3.7
East-Central Europe	3.9	−5.9	5.1	3.9	2.7	3.1	3.4	3.1	3.3	4.1	4.0	3.4
Turkey	1.0	−5.9	4.5	3.5	15.2	13.0	15.3	10.5	13.7	14.6	14.3	13.3
Russia	1.4	−5.9	4.8	3.1	4.5	3.7	4.3	3.4	4.6	6.0	4.5	4.8
China	6.2	1.4	8.3	5.3	2.4	3.7	3.1	3.0	4.1	4.1	4.1	4.1
India	4.7	−6.2	7.0	4.6	3.7	5.9	4.0	4.0				
Brazil	1.1	−6.3	4.0	3.7	3.8	2.3	2.7	3.5	11.9	13.6	12.5	11.5
Mexico	−0.3	−10.9	3.4	2.9	3.4	2.8	2.8	3.3	3.5	6.3	6.3	4.8
Developed economies	1.7	−6.4	3.7	2.7	1.4	0.7	1.5	1.9	4.5	7.5	6.9	5.9
Emerging markets	4.5	−2.4	7.0	4.7	3.6	4.5	4.0	3.8	5.2	5.8	5.5	5.3
World	3.4	−4.0	5.8	4.0	2.7	3.0	3.0	3.1	4.9	6.5	6.1	5.5

Sources: National statistical offices; DIW Autumn Projections 2020.

summer of 2020. In contrast, Japan, South Korea, and many European countries were able to reduce the number of new infections through strict lockdown measures, mass testing, or behavioral changes.

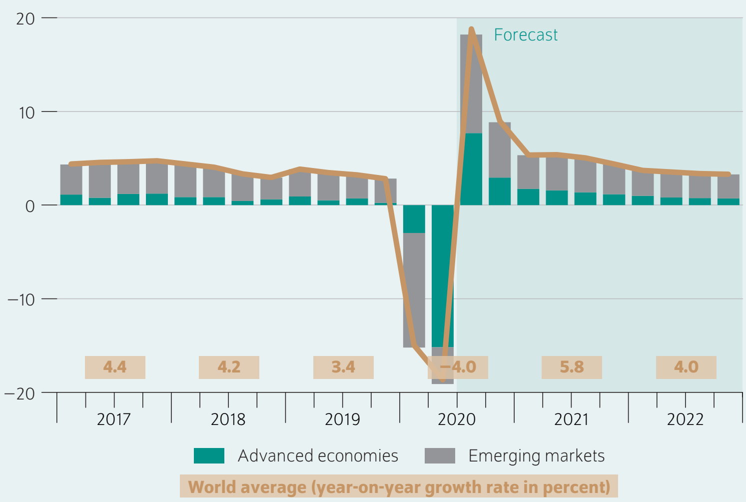
A reduced increase in new infections, more relaxed and targeted measures to combat the pandemic, and financial assistance have made households and firms more confident. In the largest economies, the purchasing managers' industrial production indices have risen again in recent months. In many places, they are once again above the expansion threshold. Consumer confidence has also returned, although it remains significantly below the pre-crisis level in most places. Nevertheless, the available indicators indicate a marked recovery in many economies. The confidence of market participants is also reflected in the financial markets, where the most important stock markets have already been able to compensate for the massive price losses in spring 2020.

If it is assumed that the pandemic can be further controlled, strong catch-up effects from the global economy can be expected in the second half of 2020. Afterwards, recovery is likely to slow, with global production gradually reaching its long-term growth path towards the end of the forecast period. In view of the extent of the current recession, financial and monetary policy is likely to remain expansionary in many regions and continue to support production. However,

Figure

World real GDP growth

Quarter-on-quarter, in percent



Sources: National statistical offices; DIW Autumn Projections 2020.

The trough seems to have been weathered: Global production is expected to grow again significantly in 2021 and 2022.

it can be assumed that financial aid will only partially cushion large entrepreneurial and household income losses and that they will probably only be offset gradually. Primarily, corporate investment activity is likely to remain low for a long time despite favorable financing conditions. In addition, the considerable decline in employment in many places suggests the coronavirus pandemic will leave a deep impact on the labor markets.

For example, unemployment is expected to continue to increase sharply in several countries. The resulting loss of income and increased uncertainty among households regarding future income trends are likely to weaken private consumption. The poor situation on the labor market is likely to weigh on wage trends in many economies. Together with continuing low energy prices, the recent weak consumer price inflation in many places will only gradually pick up again. However, low inflation for the time being should support private consumption. Despite the incipient recovery in the second half of 2020, global production will shrink by 4.0 percent this year (Table). Starting from a low level, the global economy is will grow at fairly strong rates of 5.8 percent in 2021 and 4.0 percent in 2022. Therefore, DIW Berlin is increasing its forecast for 2020 by 0.9 percentage points and is lowering its forecast for global economic growth next year by 0.3 percentage points.

This forecast excludes, as assumed, uncontrolled, significant increases in new infections and, correspondingly, a reintroduction of expansive lockdowns. It is assumed that in most economies, the virus is being successfully contained. By the end of 2020, it is likely that the general measures currently in place will be replaced by more targeted measures. It is assumed that these containment measures will be phased out gradually beginning in 2021.

However, as the further course of the pandemic remains uncertain, forecast uncertainty is still considerable and primarily involves downward risks. For example, new infections could increase again markedly worldwide, as has already happened in some countries. In that case, an increase in containment measures would be expected, which would again lead to significant slumps in economic output (See Scenario Box World). Moreover, a significant increase in corporate and personal insolvencies, combined with a rise in credit defaults, could destabilize the financial markets and ultimately threaten the solvency of some countries. With the latent trade conflicts between China and the USA and between Great Britain and the European Union, there are still risks unrelated to the pandemic that could lead to renewed trade policy escalations and corresponding distortions in the real economy.

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