‘This crisis is different’: the dramatic rebound in the global economy

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Chris Giles, *The Financial Times*, April 9, 2021

As advanced economies grow optimistic that reopening will bring recovery, in emerging markets, the economic outlook is stormier

From an economic point of view, it is almost as if the last year was just a bad dream.

The IMF predicts that most advanced countries will emerge largely unscathed from the pandemic. Is this too optimistic?

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As recently as October, the IMF was warning that coronavirus will cause “lasting damage” to living standards across the world with any recovery likely to be “long, uneven and uncertain”.

Yet the forecast it released this week is very different. By 2024, the IMF now believes, the US economy is likely to be stronger than it had predicted before the pandemic. For most advanced economies, it says, there will be only limited scars from the crisis.

Such a positive transformation in the global economic outlook within the space of just six months is extremely rare.

The City of London in lockdown after a year of the pandemic. Although the effects of Covid-19 are still being felt, the IMF predicts that advanced economies are on course to lose less than 1 per cent of output by 2024 compared with its pre-pandemic forecasts © Charlie Bibby/FT

It has underpinned an upbeat mood at the virtual spring meetings of the IMF and World Bank even though everyone knows the pandemic is not yet over. The consensus view is that with the right policies in place, the world can beat Covid-19. A new spirit of international co-operation might even resolve longstanding conflicts over issues as thorny as the taxation of multinationals in a globalised world — a cause the Biden administration is now taking up.

“It’s remarkable how quickly the consensus has shifted in only six months,” said Neil Shearing, chief economist of Capital Economics, a consultancy. It is now becoming clear that the pessimism last autumn about the longer term outlook for advanced economies was an “intellectual failure”, he said, because most economists “reached back to the financial crisis and applied the lessons from that period, but this crisis is different”.

Not everything in the global economy is rosy, of course. Amid the new optimism, there is also concern that some poorer countries and some people within wealthier countries will not share in the improved outlook. In what is becoming something of a tradition, Kristalina Georgieva, the IMF managing director, borrowed this week from Russian literature to characterise the outlook. “Leo Tolstoy in *Anna Karenina* captures very well where the world economy is today,” she said, quoting the novelist: “All the variety of life is made up of light and shadow.”

The global financial crisis hit advanced economies much harder than emerging economies

Source: IMF
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Fiscal and monetary heft

Advanced economies, and especially the US, represent the light in the world. Since last October, economic assessments of rich countries have been revised sharply higher with the remarkable turnround based on three forces, none of which were easy to see in the autumn.

The first is that countries adapted much better than expected to lockdowns, restrictions and social distancing in the second wave of the virus than the first. Instead of repeating the double-digit plunges in output of the second quarter of 2020, households and companies have adapted well, learning to work more effectively from home, shop online and enjoy leisure pursuits digitally. In a new paper on the economic effects of lockdowns in Europe, the authors Olivier Blanchard and Jean Pisani Ferry, said: “The evidence, however, is clear that these countries were able to contain [virus] contagion at a lower output cost during the second confinement.”

The coronavirus crisis is likely to be felt for longer in the emerging world outside China

Real GDP, 2019-2024 (2019=100) — Autumn 2019 forecast — Spring 2021 forecast

Source: IMF
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With most countries having upward revisions to data for economic data in the second half of 2020 and at the start of 2021, the starting point for the forecasts of advanced economies has been much better than feared.

A second boost to economic performance has been the willingness and ability of North America, Europe and Japan to use the power of government to support incomes through the crisis even when they could not go to work. Central banks helped with huge increases in purchases of government debt, facilitating the expansive use of fiscal policy during the crisis.

“Without them, without those fiscal and monetary measures, the global contraction last year would have been three times worse. This could have been another Great Depression,” Georgieva said.

A closed restaurant in Nice during lockdown. The willingness of the EU to support businesses during the crisis even when they couldn’t open has been a boost to the bloc’s economic performance © Valery Hache/AFP via Getty Images

The third force behind the upgraded forecasts was nothing to do with economics, but the ability of science to deliver effective vaccines that point the way back towards more normal life in the years ahead. In Europe, doubts over the safety of the AstraZeneca jab and the chaotic rollout of vaccinations could hold its economies back in 2021, but this is unlikely to cause much lasting damage, according to the IMF’s forecasts.

Together these improvements in the outlook have led the fund to predict that, as a whole, advanced economies are on course to lose less than 1 per cent of output by 2024 compared with its pre-pandemic forecasts — an outcome that seemed barely plausible last October. The US is top of the pack and now has forecasts showing it on a stronger path than before the pandemic, but other advanced economies are not far behind in the medium term.

A vaccination centre in Naples, Italy. The ability of science to deliver effective vaccines that point the way back towards more normal life has boosted confidence © Ciro De Luca/Reuters

Emerging concerns

The real benefit of an absence of lasting scars from this crisis, in stark contrast to the global financial crisis of 2008-09, is that the advanced world can also look forward to largely self-correcting public finances.

On the face of it, this might seem surprising. Deficits in many countries were higher in 2020 than at any time since the second world war and average net public debt among advanced G20 countries is set to rise from 82.1 per cent of national income in 2019 to 103.2 per cent in 2021.

But the fiscal forecasts then show debt levels stabilising, rising only to 105.7 per cent by 2026 as economies recover their lost ground. Unlike in the 2010s, austerity or tax rises are not expected to be needed to repair public finances in this crisis. Instead, any tax increases, the IMF said, should be on the rich and companies that prospered to show "solidarity" with those that had not been so fortunate.

An man in Manila, unemployed as a result of coronavirus, receives cash aid. The coronavirus crisis has hit emerging economies hard © Ezra Acayan/Getty Images

The optimism in the economic outlook is reflected in advanced economy equity markets, pushing many to new highs this week. It also is increasingly corroborated by strong economic data. Global purchasing managers' indices hit a six-year high in March, highlighting a "strong" global economy displaying "resilience" in both manufacturing and the service sectors, according to James Pomeroy, global economist at HSBC.

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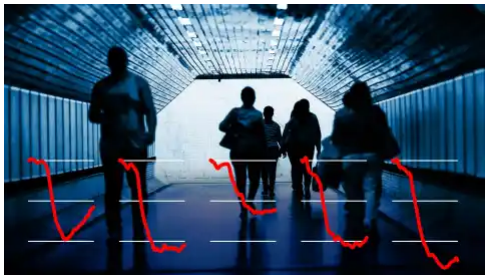

For all the good news, however, it is important to remember that these data for advanced economies are far from the whole global story. Emerging economies became a larger share of total global output during the 2008-09 financial crisis and now account for 58 per cent of the global economy, according to the IMF. In emerging economies, especially

excluding China, the coronavirus crisis has hit hard. This has delayed the catch-up of their living standards with those of the advanced world and put them on a path of significantly slower growth than expected before the pandemic.

These are the large “shadows” in the global outlook Georgieva worried about, where societies were not rich enough to shield their populations from the income losses resulting from Covid-19, often did not have sufficient credibility in financial markets to borrow heavily, had worse health systems and could not push themselves to the front of the queue for coronavirus vaccines.

The burial of a Covid-19 victim in Peru. The coronavirus crisis could leave the economies of Latin American countries 6 per cent smaller in 2024 than was expected before the pandemic © Rodrigo Abd/AP

While emerging economies sailed mostly unharmed through troubled waters of the global financial crisis, the coronavirus crisis could leave their economies on average 4 per cent smaller in 2024 than expected before the pandemic, the IMF forecasts. Losses in Latin America will be over 6 per cent and almost 8 per cent in emerging Asia outside China.

Economic setbacks in emerging markets always raise fears of debt crises and capital flight, especially if advanced economies snap back so quickly that central banks are forced to raise interest rates earlier than expected to deal with emerging inflationary pressures. Robin Brooks, chief economist of the Institute of International Finance, representing the world’s largest banks, worries that as the data from advanced economies continue to surpass expectations, market interest rates in the US and other countries will rise, triggering an exodus of funds and increasing pressure on emerging economies.

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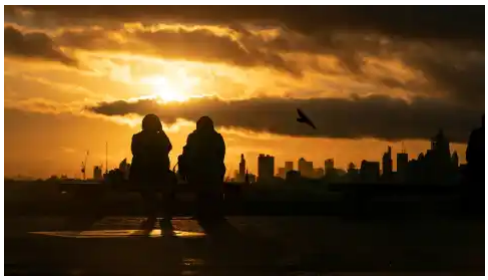
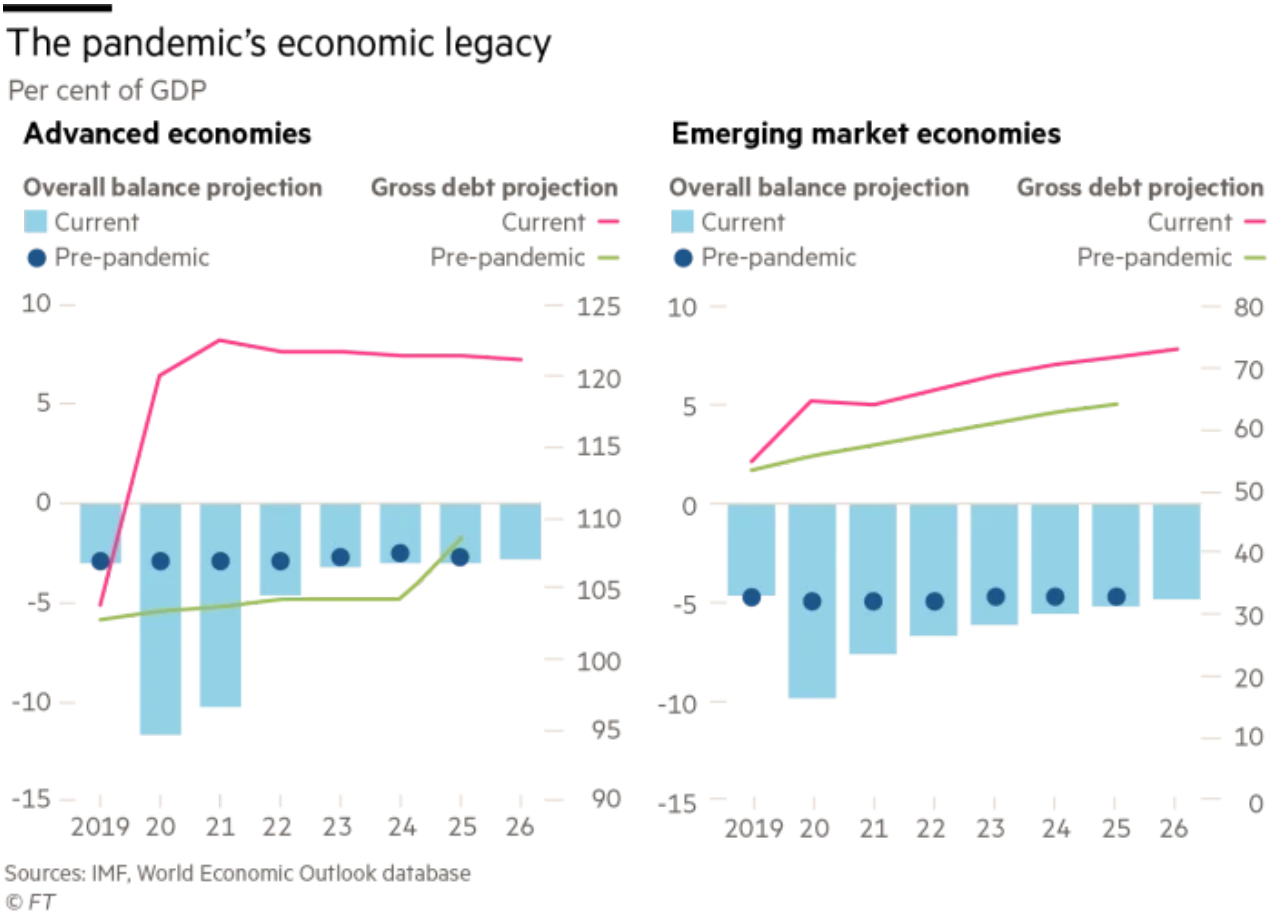


Even though their fundamentals are stronger than in 2013, the last time this process happened, he said it was likely that the improved outlooks in advanced economies put pressure on financial flows to developing ones, especially Turkey, Brazil and Colombia. “Emerging markets are not yet out of the woods,” Brooks says.

The global economic narrative is therefore one of celebration that the coronavirus crisis appears much less serious than feared alongside a recognition that the winners from the crisis need to have regard for those that have suffered more, both within their societies and around the world.

But there is also still a nagging fear that perhaps the world is now too optimistic in general — just as it was too pessimistic six months ago.



Sources: IMF, World Economic Outlook database
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With new variants of the virus potentially limiting the effectiveness of vaccines and requiring repeatedly updated jabs, inefficient rollout of inoculations in some advanced economies and only modest access to vaccines in most emerging economies, the outlook might soon become more troubled again in what a new paper from the Peterson Institute for International Economics calls the “pandemic age”.

“In such an age, global economic and health policy co-operation is not a luxury or an idealistic dream. It is a necessity,” says Adam Posen, president of the Peterson Institute.

A Covid ward in Bihar, India. With new variants of the virus potentially limiting the effectiveness of vaccines, and only modest access to vaccines in most emerging economies, the outlook might soon become more troubled again © Danish Siddiqui/Reuters

One of the most important elements of that co-operation will be determining when countries should begin to roll back their economic support packages as they lift restrictions. These decisions spill over from one country to another so, not only do governments need to worry about the domestic timing, the international dimension is almost as important.

Go too fast in this process and there will be excessive pain alongside higher unemployment and unnecessary bankruptcies. Yet too slow removal of support risks creating an unsustainable boom in the short term followed by a bust alongside highly unstable financial conditions for emerging economies. The consensus view in 2021 is that the world made a mess of this handover from support to self-reliance in 2010 after the global financial crisis, imposing austerity too early before economies were ready.

Erik Nielsen, chief economist of UniCredit, says the main risk is still the virus and possible variants. “We’re not over it yet and that has to be a major, major risk.” He is also worried the European Central Bank will begin to tighten monetary policy too early and that trade tensions, especially with China, might flare up again.

Timing the exit from coronavirus crisis support is just as difficult. So, while the broad direction of travel has been positive for six months, the global economy remains a highly uncertain and risky place as it emerges from the pandemic.