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Article

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Global economy: recovery slowing down

By Claus Michelsen, Paul Berenberg-Gossler, Geraldine Dany-Knedlik, Hella Engerer, and Sandra Pasch

ABSTRACT

The global economy recovered more quickly than expected in the third quarter of 2020. Following the coronavirus-related slumps, economic output increased by seven percent. A decrease in infection rates and thus an easing of containment measures contributed to re-normalizing production processes and trade. Private households also began demanding more consumer goods again, especially personal services. However, the second wave in fall 2020 will slow down the recovery. In 2020, global production will shrink by 3.4 percent; the growth rates in 2021 and 2022, 6.3 and 4.4 percent respectively, are likely to be stronger than forecasts in fall 2020. Despite this, there are many risks: Even though the vaccine breakthroughs are promising, other uncontrolled increases in coronavirus cases could occur. Furthermore, the extent to which corporate insolvencies will increase and how a wave of insolvencies would impact economic recovery cannot be predicted.

The global economy grew significantly in the third quarter of 2020, partly recovering from the slumps in the first half of the year. In the third quarter, global production increased by seven percent compared to the previous quarter (see Figure 1), thus compensating for 68 percent of the losses from the first half of 2020. However, the coronavirus pandemic continues to leave its mark: economic output is lower than it was at the beginning of 2020 despite the catch-up effects and in many countries, further increases in the spread of the virus in the fourth quarter are slowing down the recovery.

In the third quarter of 2020, decreasing infection rates and an easing of containment measures drove recovery. Production processes and international trade normalized again. Private households began demanding more consumer goods and, after the restrictions were relaxed, were able to make use of personal services once more. In many countries, transport, tourism, stationary retail, and gastronomy recorded particularly strong growth in value added. Expansive monetary and fiscal policies in many countries likely supported the recovery process significantly: Many economies, for example in Europe and North America, launched fiscal aid programs, cushioned wage losses, and provided liquidity or loan guarantees on a significant scale to companies that suffered revenue losses due to the lockdowns.

At the beginning of the fourth quarter, the number of new coronavirus cases rose in many countries again rapidly. As of autumn 2020, significantly more people are contracting COVID-19 every day than in spring 2020, particularly in Europe, the United States and some South American countries. As a result, some governments have noticeably increased containment measures. For example, many European countries reimposed lockdowns, although they are often less restrictive compared to spring 2020.

Breakthroughs in vaccine development towards the end of 2020 have generated hope that the pandemic will soon come to an end. At the beginning of November 2020, some pharmaceutical companies applied for approval of COVID-19 vaccines and the first doses should be distributed in Europe and the United States by December 2020. However, effective herd

immunity will probably not be achieved in populous countries in the short term. Thus, it is unlikely that travel and contact restrictions will end in the first half of 2021.

The second wave dampened corporate and household sentiment markedly in fall 2020. The purchasing managers' indexes of manufacturing industries in many large economies have been stagnating since the end of summer 2020 and are slightly declining in some cases (see Figure 2). Consumer confidence is not increasing and remains under the pre-crisis level in many countries. However, the present surveys were conducted before the vaccine breakthroughs and thus cannot accurately depict the current state. The fact that recent breakthroughs have significantly brightened the economic outlook is reflected in the financial markets: At the beginning of November 2020, the stock markets recorded substantial price gains, reaching new record highs in some cases.

However, further economic recovery is expected to slow down towards the end of 2020. The increase in the infection rate in many countries, especially Europe, and the resulting stricter containment measures are likely to weigh on production and trade, especially personal services.

The present forecast assumes that the containment measures implemented in many countries will slow the spread in the short-term and prevent further uncontrolled, significant increases in the infection rate. New, expansive lockdowns are thus not assumed. In the first half of 2021, it is likely that containment measures will slowly be relaxed and replaced by gradual herd immunity. A moderate recovery can therefore be expected in the further course of the forecast. Global production will therefore probably reach its long-term growth path at the end of the forecast period.

An expansive monetary and financial policy should further support the recovery process. While parts of the fiscal measures from coronavirus aid packages will expire in 2021 in many major economies, in some, such as Europe, further aid packages are being prepared to support the recovery process.

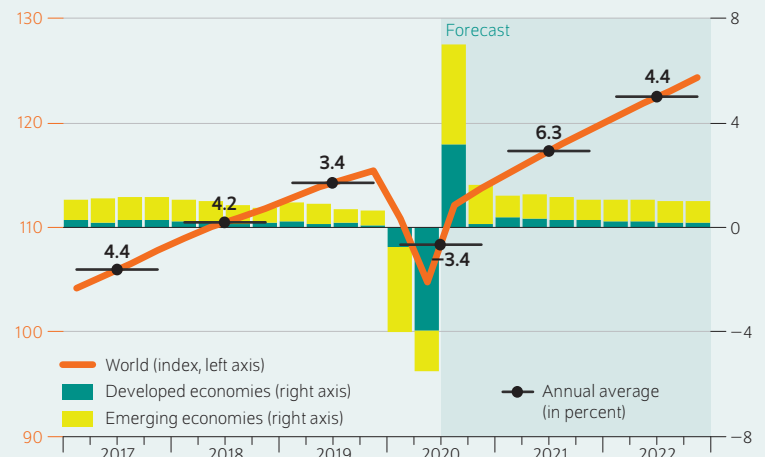
This extensive financial aid will probably only partially compensate for companies' revenue losses and the income losses of private households, resulting in a gradual recovery. The uncertainty in relation with the exit of the UK, despite the presumed ordered exit, will further slow down the recovery of European economies. This is likely to have a negative impact on companies' willingness to invest. On the other hand, the hope for an effective vaccine and future herd immunity should support the willingness to invest. Moreover, the victory of Democrat Joe Biden in the 2020 US presidential election is likely to resolve some trade uncertainties¹. In addition, the disruptions in international supply chains shall be resolved and world trade is likely to continue its rapid recovery. All in all, these developments will boost investment activity slightly.

¹ Cf. Paul Berenberg-Gossler et al., "Trumps protektionistische Handelspolitik hat ihre Ziele verfehlt," *DIW Wochenbericht* no. 50 (2020) (in German).

Figure 1

Growth of real GDP

Compared to previous quarter, in percent



Sources: National statistical offices; DIW Berlin Economic Outlook Winter 2020.

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By 2022, the global economy should have reached its long-term growth path.

The situation on the labor market is likely to only recover gradually. Many economies have recorded recent employment growth, but in most cases, this increase compensates for less than half of the employment losses of the first half of the year. Unemployment rates have also fallen again in many countries after what were in some cases historically unprecedented increases, but often remain well above pre-crisis levels. In some developed economies, the expiration of emergency aid for companies, such as short-time work benefits, is expected to lead to another increase in unemployment. Overall, private households' income losses and their continuing uncertainty about future income trends are likely to continue to weaken private consumption, which is reflected in many countries by high savings rates.

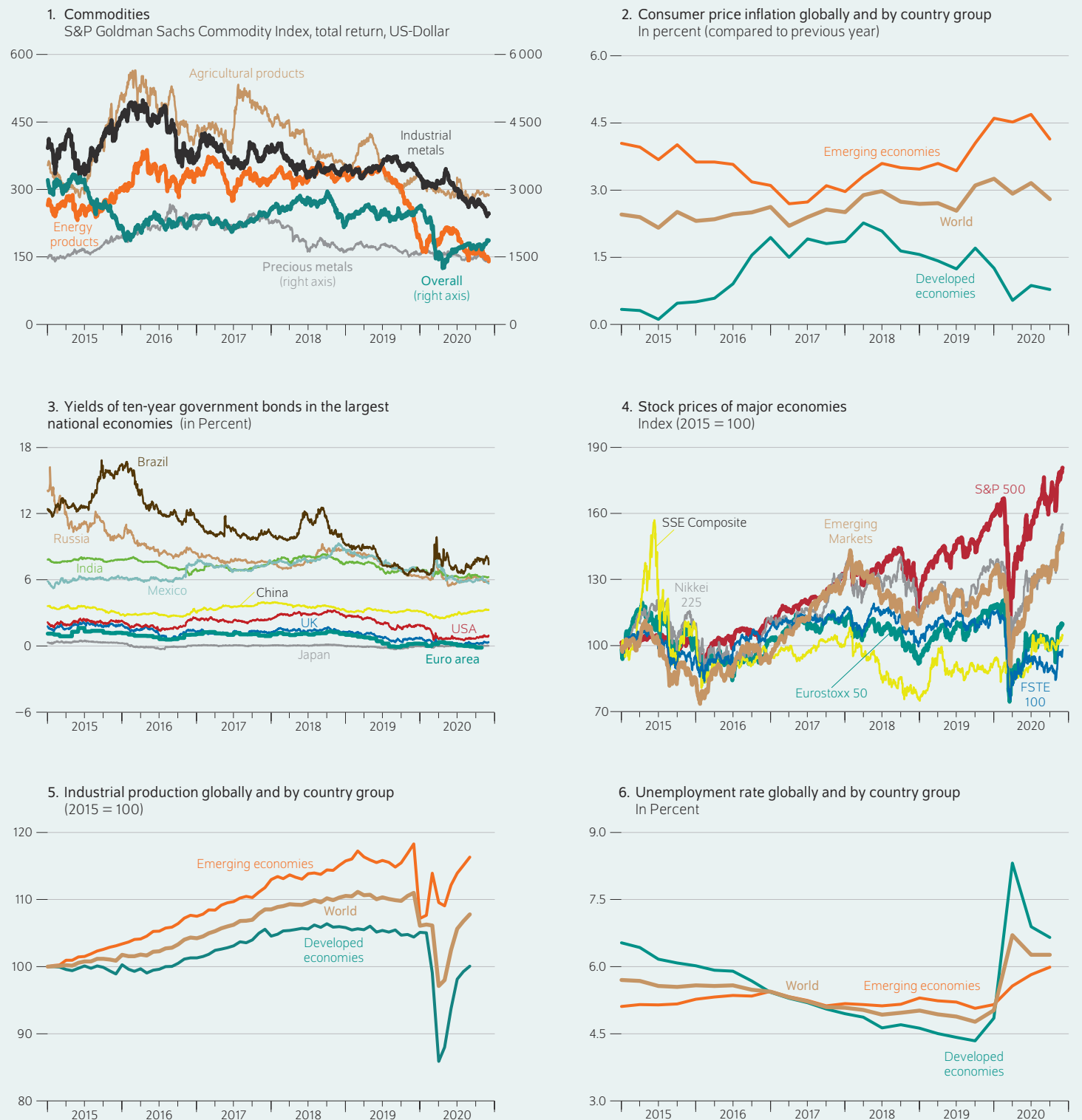
The poor situation on the labor markets will probably also affect wage development in many economies. If energy prices remain low, weak consumer price inflation is initially expected in many places, which should gradually increase over the course of the recovery process and rising wages.

Overall, the coronavirus pandemic will cause global production to shrink by 3.4 percent this year (Table). The recovery process is beginning at high growth rates of 6.3 percent in 2021 and 4.4 percent in 2022. Thus, DIW Berlin is increasing its forecast for 2020 by 0.4 percentage points, mainly due to the strong catch-up effects in the third quarter. DIW Berlin forecasts higher growth rates of around half a percentage point for 2021 and 2022, respectively.

Despite the prospect of vaccine rollouts in winter 2020 and early 2021 in many countries, uncertainties regarding the short-term course of the pandemic remain. Accordingly,

Figure 2

Global economic indicators



Note: Last observations on December 3, 2020 (parts 1,3, and 4) and October 22, 2020 (parts 2,5, and 6)

Sources: National statistical offices; IMF; Macrobond; Eurostat; CPB World Trade Monitor, S&P Dow Jones Indices, STOXX, Nikkei Inc.; Shanghai Stock Exchange, FTSE; own calculations.

Table

Real GDP, consumer prices, and unemployment rate in the global 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	1.3	−7.5	4.8	2.9	1.3	0.0	0.8	1.3	7.5	8.2	9.8	9.5
without Germany	1.6	−8.4	4.5	2.9	1.2	−0.2	0.4	1.2	9.5	9.9	12.4	12.1
France	1.5	−9.7	5.2	2.8	1.1	0.6	0.7	1.1	8.5	7.9	10.5	10.6
Italy	0.3	−9.2	4.4	2.9	0.6	−0.1	0.5	1.3	9.9	9.4	11.1	11.0
Spain	2.0	−11.3	5.9	3.6	0.7	−0.2	0.8	1.1	14.1	15.8	18.8	17.7
Netherlands	1.6	−5.2	2.1	2.0	2.7	1.1	1.3	1.4	3.4	4.4	6.5	6.1
United Kingdom	1.3	−10.0	4.7	2.7	1.7	1.0	0.9	1.6	3.8	4.4	6.7	6.3
USA	2.2	−3.5	3.9	3.0	1.9	1.3	2.3	2.0	3.6	7.6	6.4	5.3
Japan	0.7	−5.2	2.6	1.2	0.6	0.0	0.2	0.6	2.4	2.9	2.7	2.5
South Korea	2.0	−1.0	3.0	2.8	0.4	0.6	1.3	1.4	3.7	3.9	4.1	3.7
East-Central Europe	4.1	−4.7	5.4	4.0	2.7	3.2	3.0	2.6	3.3	3.8	4.2	3.7
Turkey	1.0	0.4	2.5	3.1	15.2	11.6	10.7	10.0	13.7	14.5	14.3	13.3
Russia	1.3	−3.7	2.6	1.9	4.5	3.3	3.9	3.4	4.6	6.0	5.9	4.8
China	6.2	1.8	9.0	5.8	2.4	3.6	2.9	3.0	4.1	4.1	4.1	4.1
India	4.7	−9.8	9.2	7.9	3.7	6.2	4.4	4.0				
Brazil	1.1	−5.0	5.9	2.0	3.8	3.1	4.7	3.5	11.9	13.4	12.5	11.5
Mexico	−0.3	−8.6	4.5	2.2	3.4	3.4	3.4	3.3	3.5	4.6	5.1	4.0
Developed economies	1.7	−5.1	3.9	2.7	1.5	0.8	1.6	1.6	4.5	6.7	6.7	6.0
Emerging markets	4.5	−2.4	7.8	5.4	3.6	4.5	3.9	3.7	5.2	5.6	5.6	5.2
World	3.4	−3.4	6.3	4.4	2.8	3.0	3.0	2.9	4.9	6.1	6.0	5.5

Sources: National statistical offices; DIW Berlin Economic Outlook Winter 2020.

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the forecast uncertainty continues to be predominantly afflicted with considerable downside risks. For example, global infection rates could continue to increase markedly despite containment measures, which would slow down the recovery process. Stricter containment measures that last into 2021 would be necessary and would lead to renewed slumps in economic output. A further risk is that there will be a sharp increase in corporate and private insolvencies in

2021, which could lead to considerable loan defaults that would destabilize the financial markets, endangering the solvency of several countries. The recovery process in Europe is also likely to be slowed down considerably if an agreement between the EU and the United Kingdom fails despite the last agreement in the negotiations. Effective, faster containment of the pandemic through rapid herd immunity would strengthen the global upswing.

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