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Article

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Global economy: advanced economies facing a strong upturn

By Claus Michelsen, Guido Baldi, Geraldine Dany-Knedlik, Hella Engerer, and Sandra Pasch

ABSTRACT

Global recovery is progressing more slowly than was indicated in 2020 due to high coronavirus rates and related economic restrictions in Europe and Japan. Recently, a disparate picture has been forming: In the advanced economies, declining infection rates and continued progress in vaccination campaigns will presumably lead to a revival that will be especially noticeable in the retail and service sectors while the manufacturing industries will lag behind in the short-term due to high raw material prices. In some emerging economies, in contrast, recently skyrocketing coronavirus rates and a lack of vaccine doses are likely to hinder recovery before the situation improves. Overall, the growth rate should increase in the second half of 2021 so that the outlook for the global economy remains nearly unchanged: DIW Berlin estimates growth of 6.7 percent for 2021 and growth of 4.9 percent for 2022. The USA, euro area, and China are delivering positive momentum to this growth, as they have remained spared from a further wave of the virus.

Global economic growth had lost significant momentum at the beginning of 2021. High coronavirus rates hindered recovery in winter 2020/2021, especially in advanced economies. Following the powerful upturn in summer 2020, the global economy increased by 2.7 percent in the fourth quarter of 2020 compared to the previous quarter, but growth slowed significantly to only 0.7 percent in the first quarter of 2021 (Figure 1).

Coronavirus infections reached a new high in many European countries and in Japan in the first quarter of 2021. As a result, strict containment measures were passed in February and March 2021, which massively restricted the course of business in these countries. Nevertheless, economic losses are likely to be markedly lower than in spring 2020, primarily because industrial value added remained virtually unaffected by the state of the pandemic. Thus, at 0.6 percent, euro area production slipped into a recession at the beginning of 2021 after already shrinking in the fourth quarter of 2020. Economic output declined by 1.5 percent in the United Kingdom in the first quarter of 2021 due to further waves as well as its exit from the European Union at the beginning of 2021. Japan's economic output also declined by 1.3 percent in the first quarter. In contrast, the brisk progress of the vaccination campaign and the financial aid passed in winter 2020 enabled the recovery process in the USA to pick up speed by the first quarter of 2021: economic output increased by 1.6 percent in the first three months of 2021 compared to the previous quarter. And in most of the emerging markets, primarily China, recovery is initially continuing in the first quarter of 2021. However, at 0.6 percent, growth in China was somewhat worse than expected; sluggish normalization of private consumption in particular has been hindering economic recovery in China.

At the end of the first half of 2021, the declines in infection rates in advanced economies are contrasting with rapidly increasing rates in some emerging economies in Asia and South America. Therefore, economic developments in these two groups are likely to drift apart for the time being. Overall, the advanced economies should return to or continue on their recovery course over the summer as the current waves of the coronavirus subside. This is primarily the

case for the USA, followed by many European countries and, somewhat delayed, Japan.¹ Simultaneously, these countries are making marked progress in establishing wide-reaching immunity, which would enable a phased easing of the containment measures. Although the infection rate in Japan is small relative to the total population, strict containment measures weighed on the economy in the first and second quarters of 2021. The share of the vaccinated population is still low. Overall, in the advanced economies, the further easing of restrictions over the summer as well as solid industrial performance should revive precisely those sectors of the economy that have so far been subject to contact restrictions. This is likely to provide sales growth for the retail and personal services sectors in particular.

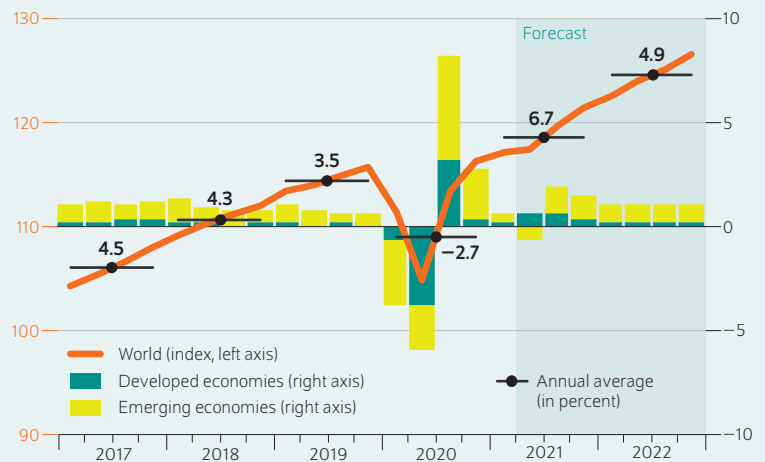
In some emerging economies, especially India and Brazil, case numbers worsened drastically and are likely to significantly weigh on growth into the third quarter of 2021. Public life was partially or almost completely paralyzed in most of the emerging economies affected. Additionally, many of these countries have been unable to begin comprehensive vaccination campaigns due to vaccine shortages. The domestic economies of the affected countries in Asia and South America should be accordingly hindered over the summer. Moreover, travel warnings and quarantine requirements have been implemented for travelers returning from these areas, resulting in a major lack of income from international tourism. So far, China has been spared from the increases in infection rates in Asia. The Chinese government's strict containment strategy as well as the acceleration of its vaccination campaign in May 2021 significantly lower the probability of another increase in case numbers and, thus, a wide-reaching lockdown. Chinese economic output, together with the production from advanced economies, are likely to have carried global growth in the second quarter of 2021 and compensated for the growth losses in some emerging markets.

The different developments in coronavirus rates are also reflected in consumer confidence. For example, consumer sentiment in the USA, the euro area, and the UK brightened noticeably in April and May 2021. In contrast, consumers in India and Brazil currently view the future more pessimistically (Figure 2). Moreover, the severity of the restrictions on public life can also be seen in retail sales. Industrial output as well as purchasing manager sentiment, however, remained almost untouched by pandemic-related developments since the beginning of 2021. For example, the purchasing manager indices for the manufacturing sectors in the advanced and emerging economies have recently been above the expansion wave of 50 index points (See chart-book world). Moreover, international retail is continuing its upward trend and should continue to be supported by stable industrial growth.

Figure 1

Growth of real GDP

Compared to previous quarter, in percent



Sources: National statistical offices; DIW Berlin Economic Outlook Summer 2021.

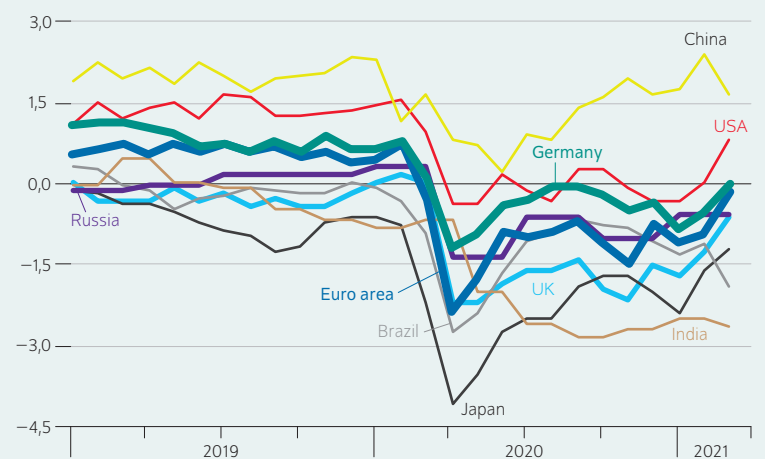
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Advanced economies are carrying the continuing recovery.

Figure 2

Consumer confidence

Indices (standardized)



Sources: Confidence Board; GfK UK; Japanese Cabinet Office; European Commission; IBRE Brazilian Institute of Economy; China Economic Monitoring and Analysis Center; Russian Federal State Statistics Services; Reserve Bank of India; authors' own calculations.

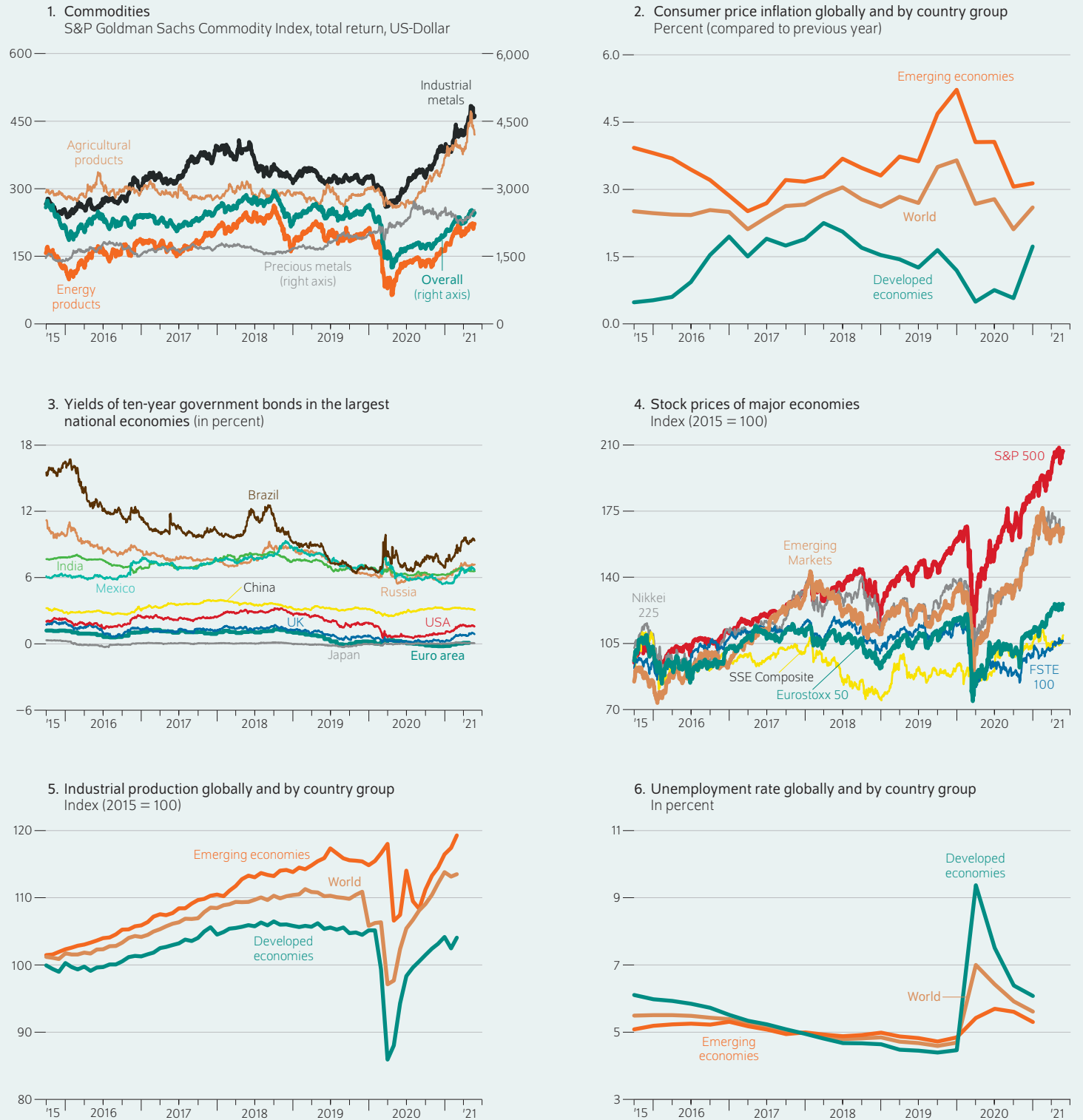
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Consumer confidence in advanced economies has brightened considerably recently.

¹ The seven-day-incidences in most European countries as well as in the USA have been declining since mid-April 2021. As of publication, they are at fewer than 50 new infections per 100,000 inhabitants in one week.

Figure 3

Global economic indicators



Note: Last observations on May 26, 2021 (part 1); first quarter of 2021 (part 2); April 30, 2021 (part 3); May 26, 2021 (part 4); March 1, 2020 (part 5); second quarter of 2021 (part 6).

Sources: S&P Dow Jones Indices (part 1); German Stock Exchange, CBOE (part 2); ECB, PboC, Federal Reserve, BoE, BOJ, Central Bank of Brazil (part 3); Bureau of Labor Statistics (part 4); IHS Markit (part 5); Macrobond (part 6). National statistical offices; IMF; Macrobond; Eurostat; CPB World Trade Monitor, STOXX, Nikkei Inc.; Shanghai Stock Exchange, FTSE; authors' 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	-6.7	4.1	4.7	1.3	0.1	2.3	1.5	7.5	8.0	8.4	7.9
without Germany	1.6	-7.5	4.5	4.9	1.2	-0.1	2.1	1.2	9.5	9.7	10.3	9.7
France	1.5	-8.2	5.7	4.4	1.3	0.5	1.4	1.1	8.5	8.1	9.2	8.7
Italy	0.3	-8.9	4.2	4.7	0.7	-0.3	1.4	1.2	10.0	9.3	10.0	9.8
Spain	2.0	-10.8	5.6	6.6	0.7	-0.3	1.5	1.3	14.1	15.8	15.8	14.4
Netherlands	1.6	-3.7	2.6	3.4	2.8	1.2	1.8	1.5	3.4	3.9	4.4	4.3
United Kingdom	1.4	-9.8	5.4	5.5	1.7	1.0	1.8	2.4	3.8	4.5	5.7	5.2
USA	2.2	-3.5	6.9	3.7	1.9	1.2	3.5	2.0	3.7	8.1	5.4	4.3
Japan	0.0	-4.7	2.2	3.0	0.5	0.0	0.2	1.0	2.4	2.8	2.5	2.0
South Korea	2.0	-0.9	3.8	2.6	0.4	0.5	1.7	1.4	3.7	3.9	4.0	3.7
East-Central Europe	4.2	-3.6	5.0	4.5	2.7	3.1	4.0	3.3	3.3	3.7	4.0	3.7
Turkey	1.0	1.6	5.3	2.7	15.2	12.3	15.2	12.9	13.7	13.2	13.3	13.1
Russia	1.8	-2.6	2.6	2.7	4.5	3.4	5.3	4.1	4.6	5.8	5.5	4.9
China	6.0	2.0	8.3	5.5	2.9	2.5	1.8	2.3	3.6	4.0	3.7	3.6
India	4.6	-6.9	8.9	7.9	3.7	6.6	4.3	3.9				
Brazil	1.4	-4.4	4.2	2.3	3.8	3.3	5.4	4.0	11.9	13.5	14.9	13.8
Mexico	0.0	-8.5	5.2	3.3	3.4	3.4	4.1	3.5	3.5	4.4	3.9	3.4
Developed economies	1.6	-4.8	5.4	3.9	1.5	0.8	2.6	1.8	4.5	6.9	5.7	4.9
Emerging economies	4.6	-1.4	7.4	5.4	3.8	4.1	3.8	3.7	4.8	5.4	5.3	5.0
World	3.5	-2.7	6.7	4.9	2.9	2.8	3.4	3.0	4.7	6.0	5.5	5.0

Sources: National statistical offices; DIW Berlin Economic Outlook Summer 2021.

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From the second half of 2021, the global economic upturn will pick up again strongly. For the purposes of this forecast, it is assumed that the pandemic will be able to continue to be contained in most advanced economies until the summer and that the increasing immunity there will prevent further intense waves of the virus. The existing restrictions on social life will be successively lifted and replaced with less far-reaching measures. From the fourth quarter of 2021, the restrictions should barely hinder economic activity. General hygiene and social distancing rules, mask requirements, and capacity constraints will continue to apply to selected economic sectors, such as the event or tourism industries. The pandemic is expected to be combated more slowly in less advanced economies; especially in countries in which the vaccination campaigns are not progressing as quickly, the only initial response can be a severe lockdown.

Powerful economic growth in the USA, robust production gains in China, and production recovery in the euro area are expected to buoy the global economy over the further course of the forecast period. Additionally, good and sustained development of industry is expected overall. Nevertheless, the recent high industrial raw material prices and temporary supply bottlenecks of primary products should weigh on industrial value added in the short term. Irrespective of this, corporate investment is likely to develop solidly in many places.

The loosening of many coronavirus-related restrictions should significantly boost private household consumption,

as some of the recently weak private consumption is likely to catch up. It is expected that sufficient immunity and less fear of new waves will give private consumption additional momentum and decrease the savings rate.

The labor market is likely to recover more sluggishly than production in many places. With rapidly progressing immunity and fiscal stimuli, the unemployment rate should continue to decline in advanced economies as long as emergency aid for businesses, such as short-time work allowance, is not ended too early. In many less developed and emerging economies, which often have less fiscal leeway, the situation in the employment sector will likely only gradually improve. Therefore, gradual recovery on the labor markets is also likely to weigh on wage developments in many economies; because of this, only a moderate increase of the consumer price inflation is expected in many places (Figure 3).

Additionally, fiscal stimuli are likely to support the recovery over the coming years. The fiscal aid packages passed in the USA in the amount of over two and a half trillion USD are expected to provide the biggest boost. In addition, substantial fiscal aid from the European Recovery and Resilience Facility is expected to flow to some large euro area economies in 2021 already and by 2022 in any case. Thus, the first approvals of spending programs by the European Commission and corresponding advance payments of funds can be expected from the end of July 2021. If the programs submitted so far are all approved in 2021, the upfront payments of 13 percent

of the countries' plans are expected to total 34 billion euros for the year. In contrast to the short-term stimulus packages designed to stabilize corporate and household revenues during the lockdown phases, the financial assistance recently launched in many places contains a substantial proportion of investment-enhancing funds that will support the recovery process over the next years.

In addition to expansionary fiscal policy, the further favorable financing conditions will support corporate investments. Although there has recently been a strong upturn in consumer price inflation in many places, a significant part of this increase can be attributed to energy and food prices, which are usually subject to greater fluctuations. The crude oil price recently increased to around 70 USD per barrel and thus was slightly below the pre-crisis level. Thus, the central banks of the major economies have so far seen no need for action. Monetary policy should remain expansionary initially. Nevertheless, long-term interest rates are increasing slightly due to the improved economic outlooks in most advanced economies. Overall, however, the interest rate should remain low. Initial restrictive monetary policy steps over the course of the global economy recovery are expected from the second half of 2022.

Overall, global economic growth at the beginning of 2021 was somewhat stronger than last projected, primarily due

to the powerful recovery in the USA and the milder than expected growth losses in Europe. However, beginning in summer 2021, the production losses in some emerging markets are likely to weigh more heavily on the global economy than previously forecast. Thus, global production will likely only be able to reach its long-term growth path by the second half of 2022. Overall, DIW Berlin confirms its global economic forecast from spring 2021 and is expecting growth rates of 6.7 percent for 2021 and 4.9 percent for 2022 (Table).

Downward risks have lessened recently due to the progress in vaccination campaigns. However, the overall forecast remains tainted with predominantly negative risks, especially due to the continuing uncertainties about the course of the pandemic and the effectiveness of available vaccines against new virus mutations. If ineffective, stricter restrictions would be required again, especially in countries with low vaccine protection. In turn, this would likely further delay an economic upswing. Another risk is that corporate and personal insolvencies will rise sharply, in particular as a result of the continuing (partial) lockdowns. This could lead to significant loan defaults and destabilize the financial markets, which could also jeopardize the solvency of a number of countries. Global recovery, on the other hand, would be strengthened by faster vaccine distribution and more effective treatments for COVID-19.

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