A YEAR LIKE NO OTHER[*]

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2020 was a year like no other. The official death toll of the COVID-19 pandemic, likely substantially understated, was close to 2 million people worldwide, and continues to rise rapidly into 2021. World economic activity declined by 3.3 percent when measured with weights based on purchasing parity—the worst peacetime decline since the Great Depression. By comparison, during the global financial crisis of 2008-09 world GDP declined by 0.1 percent.[†] While the crisis affected the entire world economy, its incidence across the world was very uneven. At the country level, this reflected primarily three factors: the severity and duration of the domestic pandemic; the sectoral composition of economic activity, including the relative importance of contact-intensive sectors and the ease to work remotely; and the dependence on foreign demand, especially for travel and tourism. Within countries, the crisis impact was particularly severe for low-wage workers, especially women and the young, given the magnitude of their employment in contact-intensive sectors.[‡] A further hit to the employment for women came from the protracted school closures, which triggered a sharp decline in labor force participation among mothers.

1. THE OPENING ACT

The year 2020 opened with optimism that it would be better in terms of global economic growth than 2019, in which growth fell below 3 percent for the first time since the global financial crisis of 2008-2009. But financial markets had turned much more optimistic in the last quarter of 2019, and the IMF forecasts presented in Davos in January of 2020 envisaged a pickup in global growth to about 3.3 percent in 2020 (IMF, 2020a).

Just as those forecasts were finalized, the repercussions of COVID-19, a mysterious virus spreading in China's Hubei province, were becoming more apparent. Over the following weeks, China extended the national Lunar New Year holiday, implemented travel restrictions, and instituted a drastic lockdown of Hubei province (the epicenter of the outbreak), with much economic activity coming to a standstill in February.

Financial market optimism persisted into mid-February. But with evidence of the virus spreading outside China's borders, including a rapidly mounting caseload in Italy and other European countries in late February, a risk-off environment took hold, with world stock valuations declining by over a third between mid-February and March 23 (Figure 1), US long-term interest rates declining by 100 basis points, and the US dollar broad index appreciating by 8 percent in the space of a little over two weeks. Emerging economies were hit by unprecedented portfolio outflows and even the more liquid markets, such as the one for US Treasuries, suffered disruptions.

[†] World growth measured with weights based on GDP at market exchange rates (which give more weight to advanced economies) as -3.6 percent in 2020 and -2 percent in 2009.

[‡] See, for instance, Bluedorn et al (2021) and International Monetary Fund (2021, chapter 3)

2. THE GREAT LOCKDOWN

While China was able to stop the spread of the pandemic, and gradually re-open its economy in March, advanced economies facing rising infections implemented strict lockdown measures, which, together with voluntary social distancing, took a heavy toll on economic activity.

With the scale of economic disruption and the severity of the financial market turmoil becoming increasingly clear, governments took unprecedented measures to strengthen their health systems, support the most affected workers and sectors, ease financial conditions, and provide liquidity support. Those measures, which are well documented in the rest of this volume, were crucial in buttressing financial market stability and supporting confidence. Key examples are the measures adopted by the US Federal Reserve Board (credit facilities, international swap lines, asset purchase program…), the Pandemic Emergency Purchase Program and other actions taken by the European Central Bank, and the fiscal support provided by the U.S. government's $2.3 trillion CARES Act. These measures, together with similar actions undertaken elsewhere, played a crucial role in restoring financial market stability and supporting confidence.

With the drastic decline in activity during the month of March, and signs of an even more substantial hit to come in April, forecasts for global growth were slashed at an unprecedented speed and to an unprecedented extent: the IMF's April WEO forecast a decline in global GDP of 3.3 percent in 2020, a swing of 6 ½ percentage points in the space of 10 weeks. [§]

The first aggregate measure of the decline in overall economic activity associated with the pandemic came with the release of China's GDP for the first quarter of 2020: an unprecedented decline of 6.8 percent on a year-on year basis, and 9.8 percent on a quarterly basis. But GDP in the first quarter also declined in economies that were affected by the pandemic later than China, with US GDP declining by 1¼ percent and euro area GDP by 3 ¾ percent.

The global trough for economic activity came in the month of April, as more and more countries implemented lockdown measures and social distancing: activity in contact-intensive sectors came to a complete standstill in many economies, with domestic and especially international travel grounding to a halt, and global trade collapsed. By the end of April, close to 75 percent of all recorded cases were in advanced Europe, Canada, and the United States (Figure 2), and so were 87 percent of recorded deaths. In the US unemployment sky-rocketed, with 22 million jobs lost between February and April. In most European economies, hours worked dropped dramatically but the increase in unemployment was kept at bay by furlough and other measures to preserve jobs.

This decline in activity was not just unprecedented in its size and world scope: it was also unprecedented from the perspective of the composition of economic activity. Traditional recessions are characterized by a big decline in investment and consumption of durable goods—the manufacturing sector is the most affected, while demand for nondurable goods and especially services is more resilient (see for instance Figure 3, top panel for the experience during the 2008-09 global financial crisis). But during this crisis government policy through lockdown measures and people's social distancing choices to reduce the risk

[§] The growth forecast published in April 2020, -3 percent, was adjusted to reflect new PPP country weights implemented in June 2020.

of infection put the economy into something akin to a medically induced coma. The decline in economic activity was strictly linked to the extent of personal contact involved in its production and sales. As a result, services were much more severely affected than manufacturing (Figure 3, bottom panel), and consumption declined even more sharply than investment. Non-contact intensive sectors were affected as well through several channels: the decline in people's mobility, as well as the repercussions of measures such as school closures which reduced the labor supply of parents, especially women. The tragic toll of the crisis in terms of severe illness and lives lost was heavily concentrated among the elderly and people with pre-existing conditions.

The first few weeks of the crisis took a very heavy toll on commodity markets as well. With a fast deterioration in the outlook, much reduced mobility, and the breakdown of the OPEC+ agreement among oil suppliers, oil prices plummeted among a large accumulation of inventories. The price of Brent, which was close to $70 a barrel at the beginning of 2020, dropped to some $17 a barrel by late April (Figure 4). The decline in metal prices was more modest (some 18 percent between mid-January and early April) as the effects of the sharp decline in demand were partly offset by supply disruptions. The commodity shock compounded the difficulties of several oil exporters already facing rising COVID cases.

3. GRADUAL REOPENING

The drop in mobility, as a result of lockdowns and social distancing, was generally effective in containing infections in the most affected countries, reducing the pressure on health systems and allowing for a gradual re-opening during May and June. But while the pandemic slowed in most advanced economies, especially in Europe, cases rose sharply in several emerging and developing economies: India, Latin American countries, as well as Russia, Turkey, and South Africa. The strengthening of activity was mostly visible in retail sales, as discretionary consumer spending rebounded after the dramatic decline during the months of March and April. Industrial production also ticked up, but even by June it remained some 7.5 percent below the levels recorded in late 2019 (Figure 5, top panel).

The mood in financial markets also brightened considerably, with world stock prices continuing to make up some of the ground lost during late February and March, spreads declining, and portfolio flows to emerging market economies gradually turning positive again. The improved outlook was also reflected in commodity markets: oil prices recovered from their April lows, while remaining well below their levels early in the year, while metal prices also edged higher, benefiting from the brisk recovery in China. Stronger market sentiment implied reduced pressure on emerging market currencies that had depreciated sharply in March and made it easier for central banks of these countries to adopt conventional and unconventional easing measures to cushion the impact of the crisis on activity, as documented in the later chapters of this book.

Notwithstanding the progress made during May and June, as well as sizable government support to the private sector, especially in advanced economies, economic activity during the second quarter recorded an unprecedented decline, which was even more evident if China was excluded. The hit to activity differed across regions, reflecting in particular differences in the severity of the pandemic, the extent of lockdown restrictions and social distancing, and the composition of economic activity, with countries most reliant on contact-intensive sectors, such as tourism, hit more heavily. Collapsing external demand also took a heavy toll on more open economies.

Across advanced economies, GDP in the second quarter declined by 17 percent in Spain, 19 percent in the UK, 14 percent in Italy, 13.6 percent in France, and 9 percent in the US on a quarter-on-quarter, non-annualized basis. Advanced Asian economies, that managed to contain the pandemic more effectively, fared somewhat better, with Japan contracting by 8.4 percent and in the group of other Asian advanced economies (Hong Kong, Korea, Singapore, and Taiwan) by 3.7 percent.

For the group of emerging and developing economies, there was a very sharp dichotomy between developments in China and elsewhere. With the pandemic brought under control, the Chinese economy gradually re-opened and activity experienced a very strong rebound, with GDP growth reaching 13.5 percent. Public investment spurred economic activity and exports also fared very well, sustained by the demand for medical equipment, including masks and ventilators, increased demand for equipment to ease remote work, as well as by the limitations to production elsewhere imposed by the lockdown restrictions.

But elsewhere in the emerging and developing world outcomes were much more dire, and GDP declined very sharply—by some 14 percent for a sample of larger economies that publish quarterly data. A notable case was India, which adopted very severe lockdown measures to counter rapidly rising infections: GDP declined by a quarter. Across other emerging regions, Latin America—hit particularly severely by the pandemic, and experienced a GDP decline of 14 percent, and emerging Europe by 9.8 percent.

4. THE BIG REBOUND

The third quarter saw a continuation of the general pickup in economic activity across the globe as reopening proceeded. Recorded COVID cases continued to rise, but in some cases, for instance in advanced Europe, this reflected a massive increase in testing, which also captured asymptomatic or light cases of COVID.[**] The average age of infected individuals also dropped sharply, as the older, more vulnerable segments of the population adopted precautionary measures to prevent infection. The recovery in aggregate demand was supported by the sizable government measures implemented in the first half of the year, which boosted disposable income despite the toll taken by business closures on private earnings. By the month of July, global PMIs were back in expansionary territory for both manufacturing and services [††]. Given the nature of the crisis, the recovery in manufacturing was more rapid than the one for services, and by September global industrial production was above its level at the start of the year, powered in particular by China and other East Asian economies such as Korea and Taiwan.

[**] While the number of new recorded cases in advanced Europe in the 3rd quarter rose to 1.8 million (from 1.1 million in the 2nd quarter), the number of recorded deaths declined more than ten-fold, from 140 thousand in the 2nd quarter to around 12 thousand in the 3rd.

[††] With the crisis causing severe disruptions in the collection of traditional statistics, the use of alternative data sources (mobility data, credit card payments, hotel and restaurant reservations etc.) helped provide a better real-time picture of underlying economic activity.

These developments were also reflected in the dynamics of trade in goods, where manufacturing and mining output play a crucial role (Figure 5, top panel). By the month of September, the volume of world trade in goods was only 1.5 percent below its level a year earlier, in comparison with a 17 percent shortfall in May. The speed of the recovery in the goods sector stands in sharp contrast with the experience during the global financial crisis (Figure 5, bottom panel). But activity and international trade in services remained instead much weaker: trade was down by a quarter in value terms in the third quarter of 2020 compared to 2019.

Overall, the more encouraging macroeconomic prospects were also reflected in a further improvement in risk sentiment, with the MSCI index of global stock prices back at its end-2019 levels, supported in particular by rising share prices in the United States. The size of the economic rebound in the third quarter was roughly proportional to the size of the decline in the first half of the year, but the lingering impact of the pandemic and associated restrictions and social distancing measures implied that the strong recovery was not sufficient to fully reverse the previous sharp output declines.

- Among advanced economies, the United States grew by 7.5 percent, the euro area by 12.4 percent, and the UK by over 16 percent. This notwithstanding, at the end of the third quarter GDP for advanced economies was still below its pre-pandemic level (Q4 2019) by 3.7 percent.
- For emerging economies excluding China, GDP rebounded by over 10 percent q/q, as India and economies in Latin America and emerging Europe recovered some of the lost ground. This notwithstanding, GDP remained well below its pre-pandemic level at the end of the quarter.
- Meanwhile, the recovery in China continued, with GDP rising by a further 1.9 percent.

However, more negative news came towards the end of the quarter: after the summer lull infection cases started to rise again, prompting concerns that the re-imposition of restrictions on mobility and economic activity could lead to a “double dip” recession.

5. THE SECOND WAVE AND VACCINES

The last quarter of the year saw a combination of two crucial factors pushing in opposite directions: a dramatic resurgence of infections, which led to a re-imposition of restrictions and a decline in mobility; and the development of effective vaccines, which contributed to further boost financial market confidence.

Caseloads in many countries increased very sharply in October and triggered a return of restrictions to economic activity. Market conditions reflected the increased uncertainty on the recovery, with some decline in stock prices and oil prices in October. But economic activity proved more resilient than expected, with a much-improved ability of economies to function under these hazardous conditions. With signs of this resilience and the positive news on vaccines in November, there was a return of market optimism, and world stock prices in US dollars finished the year 14 percent higher than when the year started, and 68 percent higher than at their trough on March 23. In commodity markets oil prices rebounded and base metal prices rose above pre-pandemic levels, sustained by the robust recovery in China’s industrial production and strong demand from the electric vehicle market. Portfolio flows to emerging and developing economies (some $200 billion during the quarter) were the highest ever recorded in nominal terms. While over half of those flows went to China, flows to other emerging economies were robust as well

Government restrictions and declines in mobility again affected most severely contact-intensive services, while industrial production continued its recovery, with robust demand for goods, especially durables, benefiting from substitution effects as consumers were unable to spend on contact-intensive services.[‡‡] Aggregate demand was again supported by the strength of private disposable income, particularly in advanced economies where government transfers remained substantial.

A double-dip recession materialized in the euro area, where the second wave of infections was particularly severe, with sharp contractions in activity in France and Italy. But growth remained generally positive elsewhere, despite the rising infections: around 1 percent in the US and the UK, close to 3 percent in Japan, and stronger in some of the countries with deeper recessions in the second quarter: over 9 percent in India and around 4 percent in Latin America.

6. A LOOK BACK AT 2020

The countries that fared best, comparing their performance in 2020 with the pre-pandemic growth forecasts (as presented in IMF, 2020a) were China and a few advanced economies in East Asia, including Korea and Taiwan. They were able to quickly bring infections under control and were subsequently able to leverage their manufacturing prowess, benefiting from the strength of global demand for goods, both in terms of medical equipment and telecommunications equipment.

Among the remainder of emerging economies, emerging Asia (excluding China) and Latin America were very severely hit, as the restrictive measures to control the spread of the pandemic, together with social distancing, took a very heavy toll on activity. In January 2020 the World Economic Outlook was forecasting growth of 5.5 percent in emerging Asia excluding China: the preliminary figures for the outturn point to a contraction exceeding 5 percent. The growth forecast for Latin America was more modest (1.6 percent)—GDP is estimated to have declined by 7 percent. But contractions were severe across the board, including in the Middle East, emerging Europe, and sub-Saharan Africa, where even countries with less severe domestic effects of the pandemic were severely affected by the decline in external demand. Small countries heavily dependent on tourism were among the most affected (Figure 6).

Among advanced economies, the decline in GDP was particularly large in Europe, which was very severely affected by both waves of the pandemic. GDP declined by 6.6 percent in the euro area, where countries relying more heavily on tourism such as Spain and Italy were very severely hit, and by close to 10 percent in the United Kingdom. The GDP decline in the United States was more moderate at -3.5 percent, as the plunge in activity in the first half of the year was somewhat less severe and the economy continued to grow in the fourth quarter.

The crisis affected employment-intensive sectors, and hence its impact on employment was even more severe than the one on GDP. By the end of 2020, US employment was 9.5 million jobs below its pre-pandemic level. In Europe, the decline in employment was reduced by the substantial recourse to furlough, but hours worked In Italy, Spain, and the United Kingdom dropped by over 10 percent during the first 3 quarters of 2020 relative to the corresponding period in 2019.

[‡‡] For example, US consumption of durable goods was up by 12 percent in the quarter compared to the corresponding period in 2019.

The impact of the crisis on inflation was a priori ambiguous, given the combination of large shocks from both the demand and the supply side. In practice, however, inflation in 2020 remained below pre-pandemic levels throughout the period, both in advanced economies and in most emerging markets, with measures of inflation expectations generally inching down.[§§]

Given the severity of the macroeconomic shock, one could have expected very severe financial market repercussions and a wave of defaults. Instead, after the initial panic in March, financial markets stabilized and subsequently recovered almost across the board. The unprecedented extent of timely support from central banks and fiscal authorities across the globe was crucial in avoiding large-scale bankruptcies and their amplification effects on the extent of the downturn. Indeed, bankruptcies declined relative to the previous year, while they typically rise substantially during recessions (IMF 2021, Figure 1.21). But the macroeconomic legacy of the crisis and the large increase in public debt will pose thorny challenges to public finances across the globe for the years ahead. And the unwinding of the monetary policy, credit, and liquidity support described in the chapters of this book will challenge monetary and financial regulation authorities.

7. PROSPECTS FOR 2021 AND BEYOND

The world economy is projected to recover at a brisk pace in 2021. Projections from the IMF's April 2021 WEO envisage growth of 6 percent in 2021 (Figure 7) and 4.4 percent in 2022. The progress on the vaccine front, especially in advanced economies, as well as continued fiscal support are projected to facilitate reopening and strengthen activity and employment.

But the world economy is far from being out of the woods. Vaccine access for lower-income countries remain limited, and this is taking a heavy toll both in terms of health and in terms of the pace of recovery. And within countries the crisis has taken a heavy toll on the most vulnerable across the world. In advanced economies and some emerging markets an appropriately large fiscal response has helped to cushion the impact of the crisis on disposable income, but action has been more limited in the fiscally-constrained economies of most of the emerging and developing world, which are experiencing rising poverty and a worsening of income distribution.

So, when can countries expect to regain their pre-pandemic level of economic activity? A few, including China, have registered positive growth in 2020, but 165 have experienced outright output declines and an even larger number have experienced declines in GDP per capita. And will the crisis entail sizable permanent losses in activity relative to the pre-pandemic trend? As already mentioned, the crisis has affected all countries, but to different degrees, depending in particular on the severity of the pandemic, the structure of the economy (especially dependence on contact-intensive sectors) and the extent and efficacy of policy support. Those same factors, together with the pace of vaccination, are going to be crucial in the recovery phase as well. And, as noted in the April 2021 WEO (IMF, 2021b) "factors such as the proportion of "teleworkable" jobs, share of employment in small and medium enterprises, depth of

[§§] A caveat is that changes in the composition of consumption baskets and the de facto changes in the nature of some services imply that consumer price inflation may have underestimated the increase in the cost of living during 2020.

capital markets, size of the informal sector, and quality of and access to digital infrastructure also played roles—in both the downturn and the speed of the recovery."

The IMF projections suggest that U.S. GDP will exceed its pre-pandemic level in the 2nd quarter of 2021 and exceed its pre-pandemic trend in the 4th quarter of this year, supported by rapid vaccine rollout and sizable fiscal stimulus. European advanced economies, however, experienced a deeper recession in 2020 and have generally slower vaccine rollout (with the exception of the U.K.): GDP is projected to exceed its pre-pandemic level only in 2022.

Among emerging and developing economies, the picture is even more heterogeneous. While GDP in some countries exceeded its pre-pandemic level in the last quarter of 2020 (for instance India and Turkey), others are expected to regain that level of activity only in 2021 or even 2022, given the difficulties in obtaining and distributing vaccines as well as generally weaker policy support. As a result, in many emerging market economies and low-income countries the consequences of the crisis on activity are projected to be longer lasting, with permanent output losses relative to pre-pandemic projections substantially exceeding those in advanced economies (Figure 7).

Uncertainty remains high. This relates primarily to the evolution of the pandemic—in particular the speed with which vaccinations will proceed, the effectiveness of vaccines vis-à-vis COVID-19 variants, the path of infections more generally, and how economic activity adjusts to health-related challenges. Adverse developments on the pandemic front could trigger a reassessment in fundamentals and tighter global financial conditions. Such tightening could also occur as a result of the asynchronous nature of the recovery. In particular, with the U.S. likely to exceed its pre-COVID GDP trend later this year, markets could price in a more rapid pace of monetary policy normalization. In turn, this could pose challenges to policymakers in emerging economies, where sovereigns will have substantial financing needs and the recovery is likely to be more delayed.

On the other side, expedited vaccine production and rollout would facilitate a more rapid return of affected sectors to pre-pandemic levels of activity and limit the extent of scarring. And the size and persistence of the health-related challenges to the economy matter crucially for economic policy strategies as well, as they affect the cost of supporting affected people and firms and the extent of structural reallocation of resources that may need to take place.

In closing, a few words on inflation prospects. With a strong economic recovery in the next few quarters and the increase in commodity prices, inflation is expected to rise temporarily, and long-term interest rates have risen in recent months, particularly in the U.S. Well-anchored inflation expectations, still-substantial labor market slack, and relatively flat Phillips curves would suggest that a more persistent increase is unlikely. This notwithstanding, a heated policy debate has developed in the U.S. on the likelihood of a more persistent rise in inflation, given the sizable fiscal stimulus and the very accommodative stance of monetary policy.[***] These issues are going to be taken up in part IV of this book and in the conclusions.

[***] See, for instance, Summers (2021) and Blanchard (2021).

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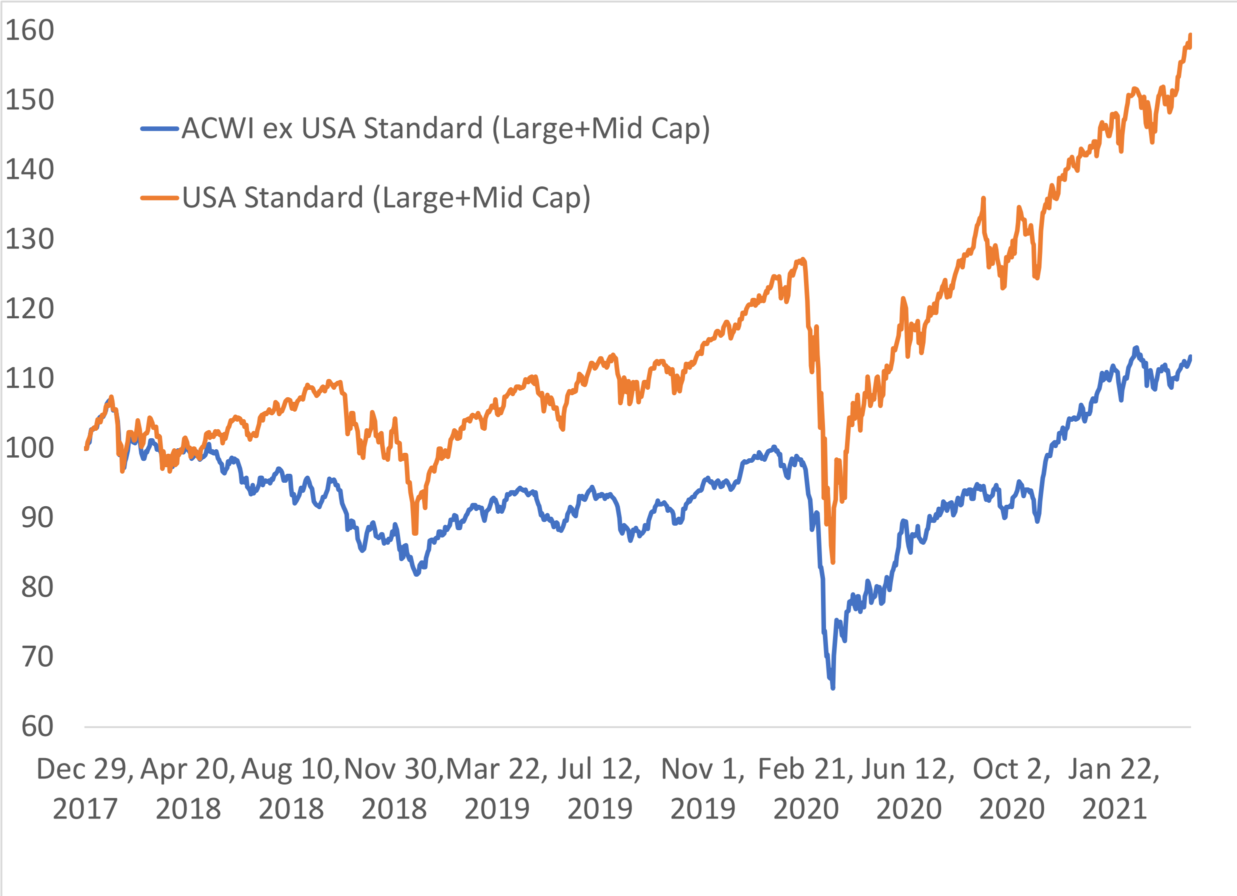
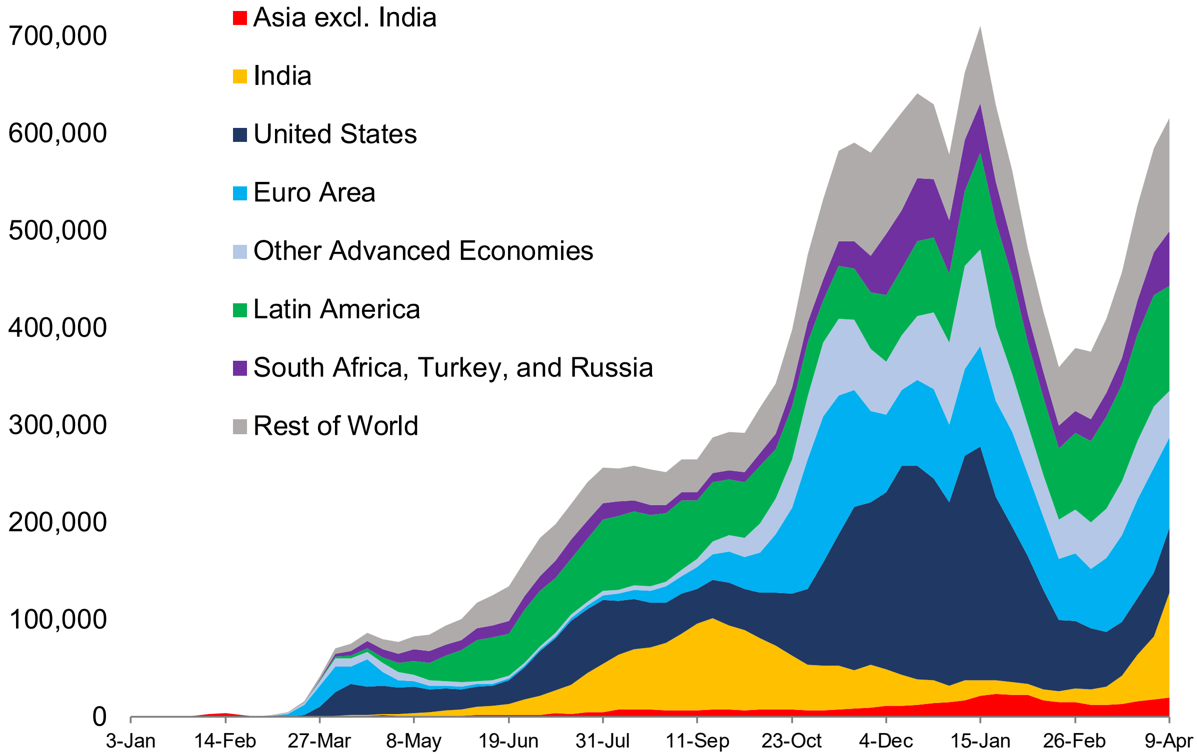
Figure 1. Stock price indices in US dollars: United States and Rest of the World



Source: MSCI

Figure 2. New confirmed cases

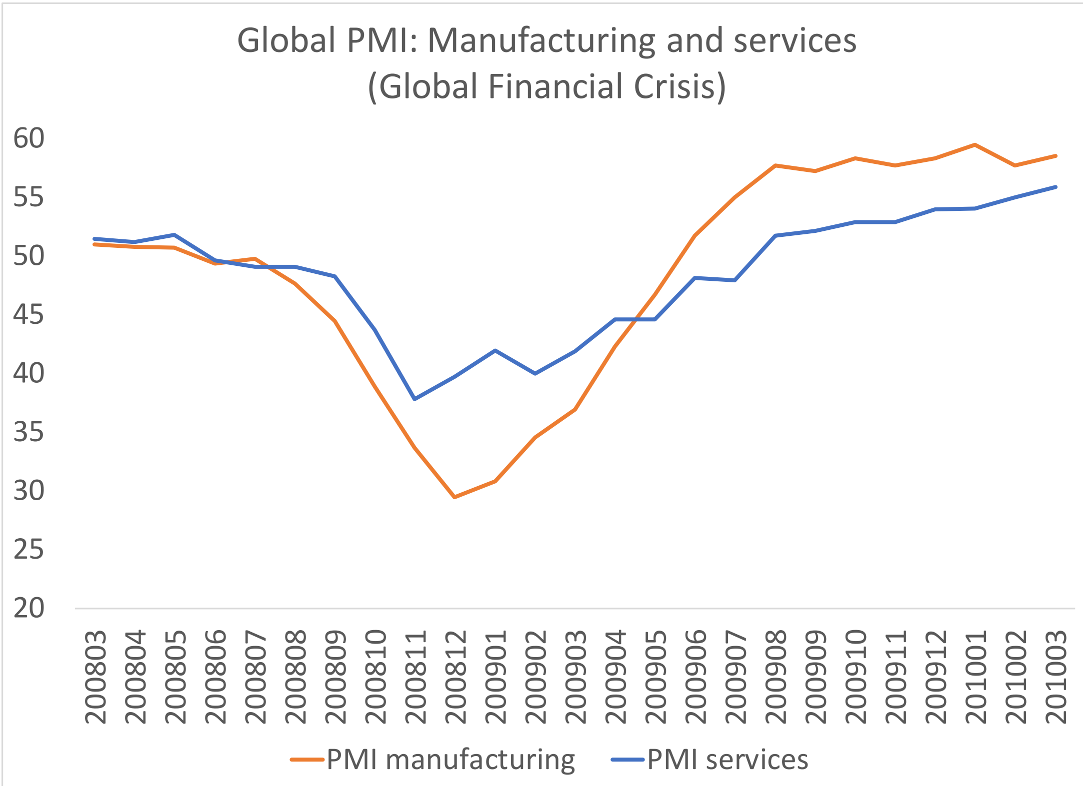
(daily average over previous week; updated April 9)

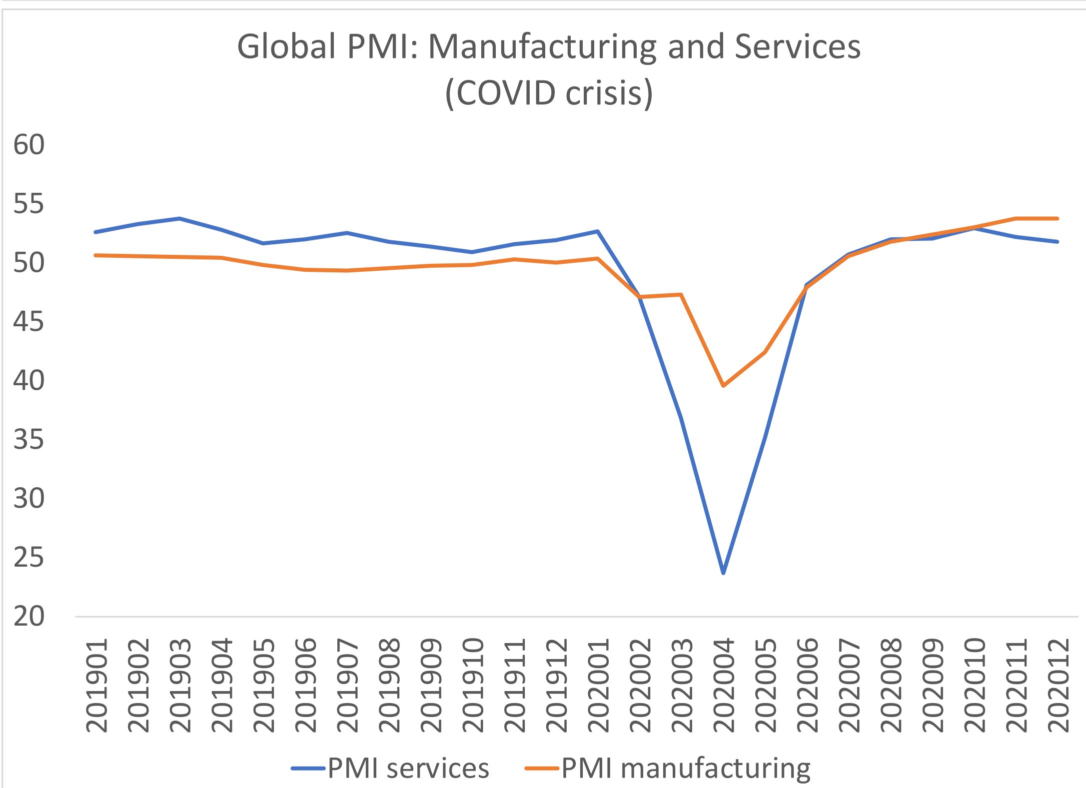


Source: Johns Hopkins University.

Source: International Monetary Fund.

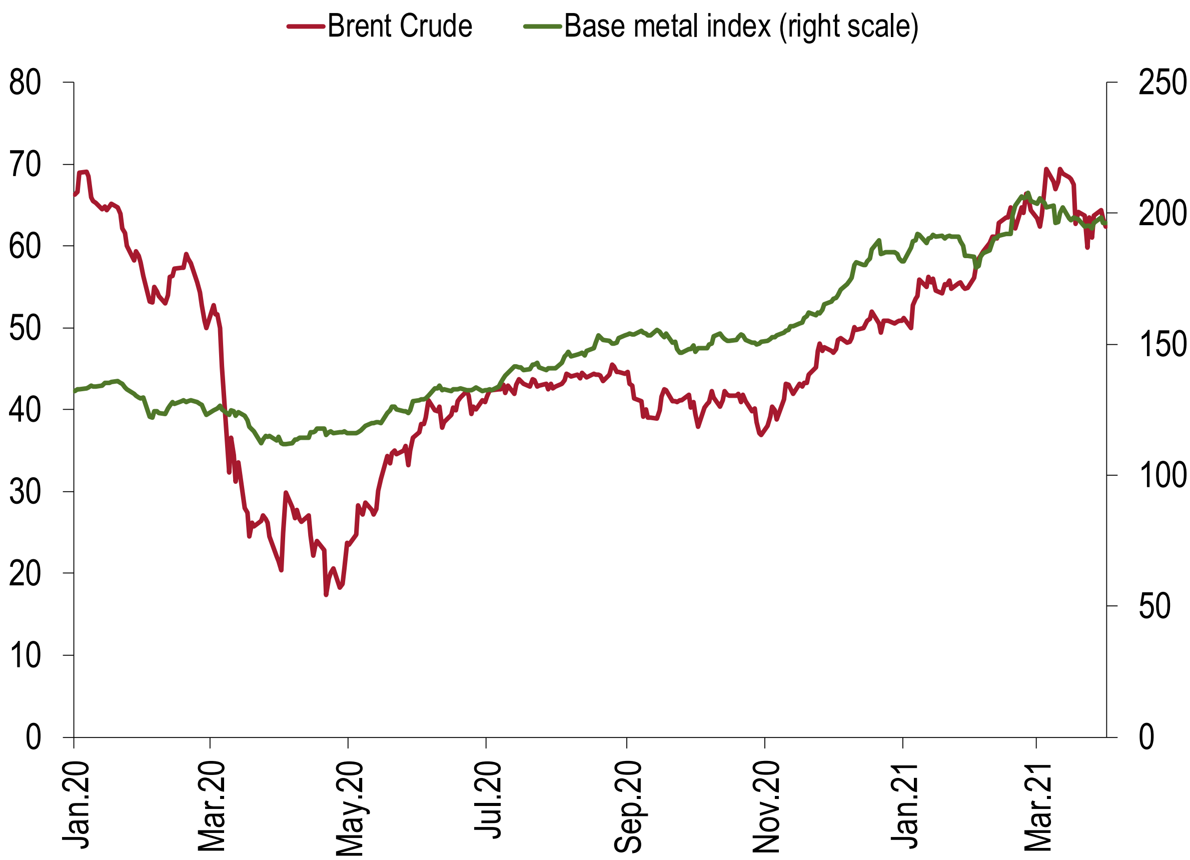
Figure 3. Global PMI: COVID crisis and global financial crisis





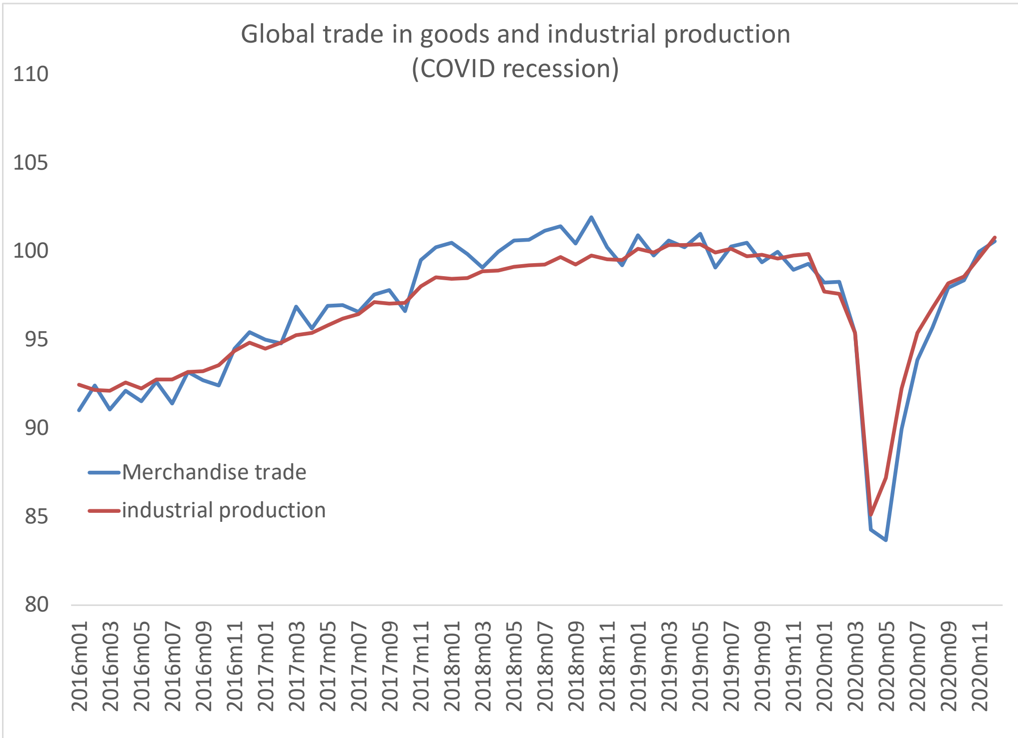
Source: IHS Markit.

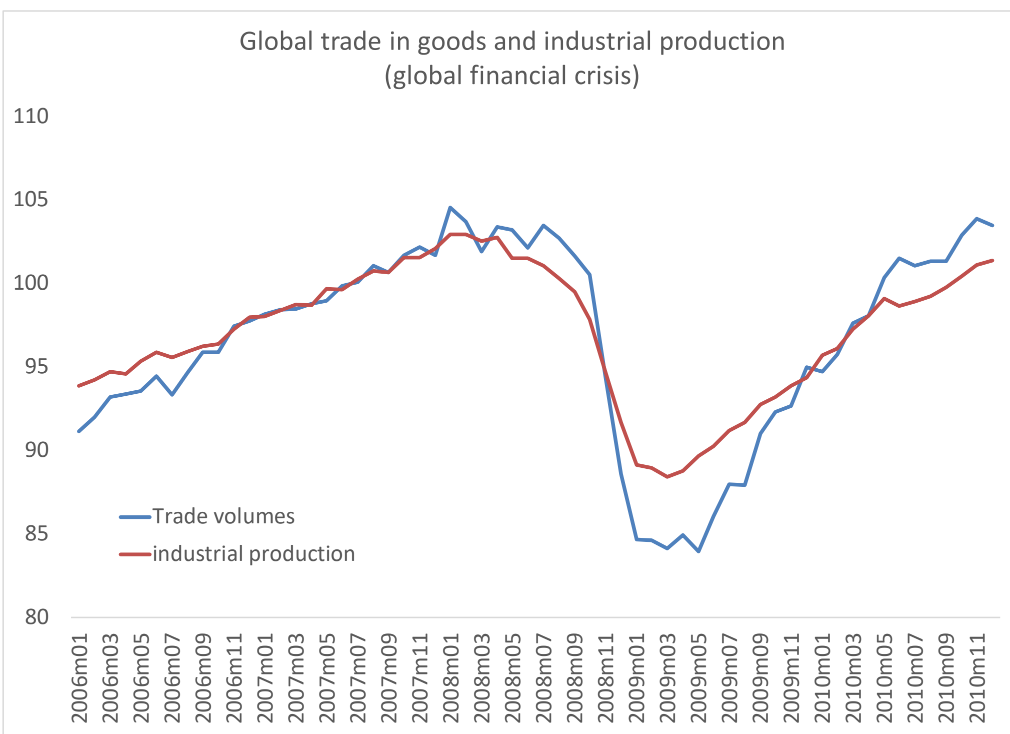
Figure 4. Commodity price indices



Source: International Monetary Fund.

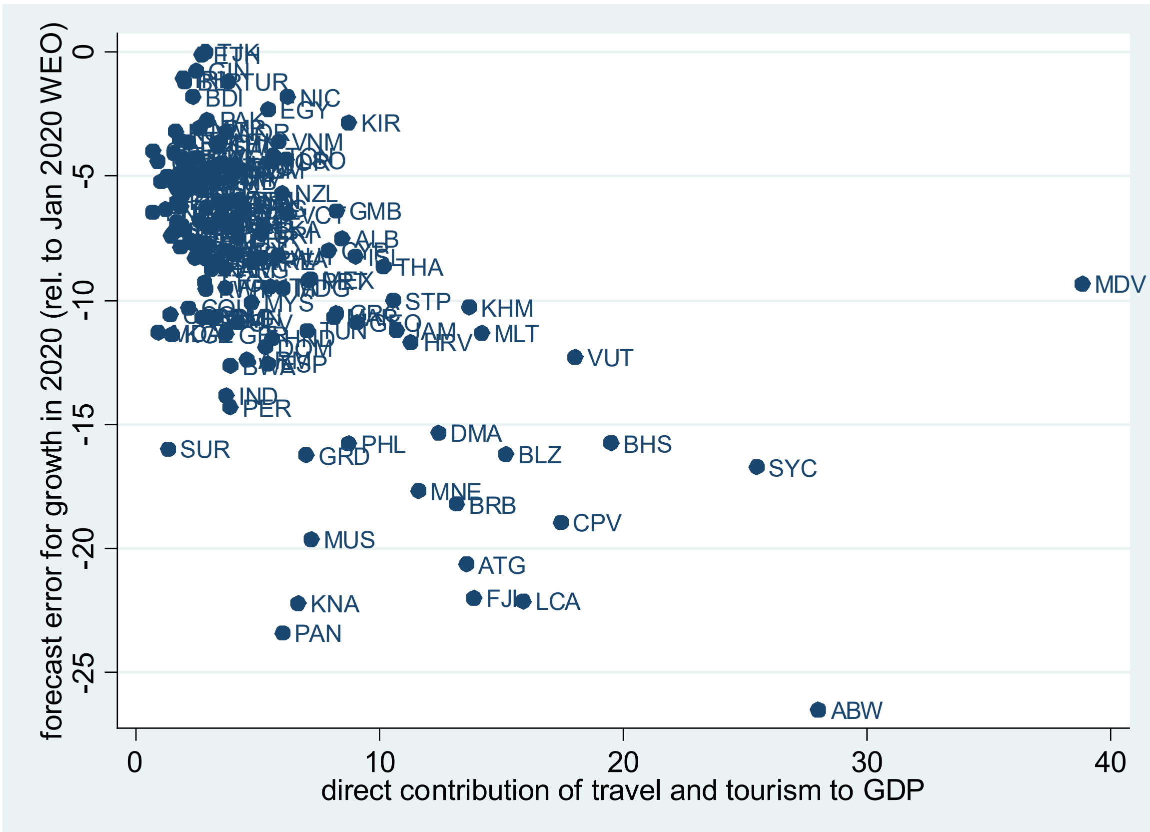
Figure 5. Global Trade in Goods and Industrial Production: COVID crisis and global financial crisis





Source: CPB, the Netherlands.

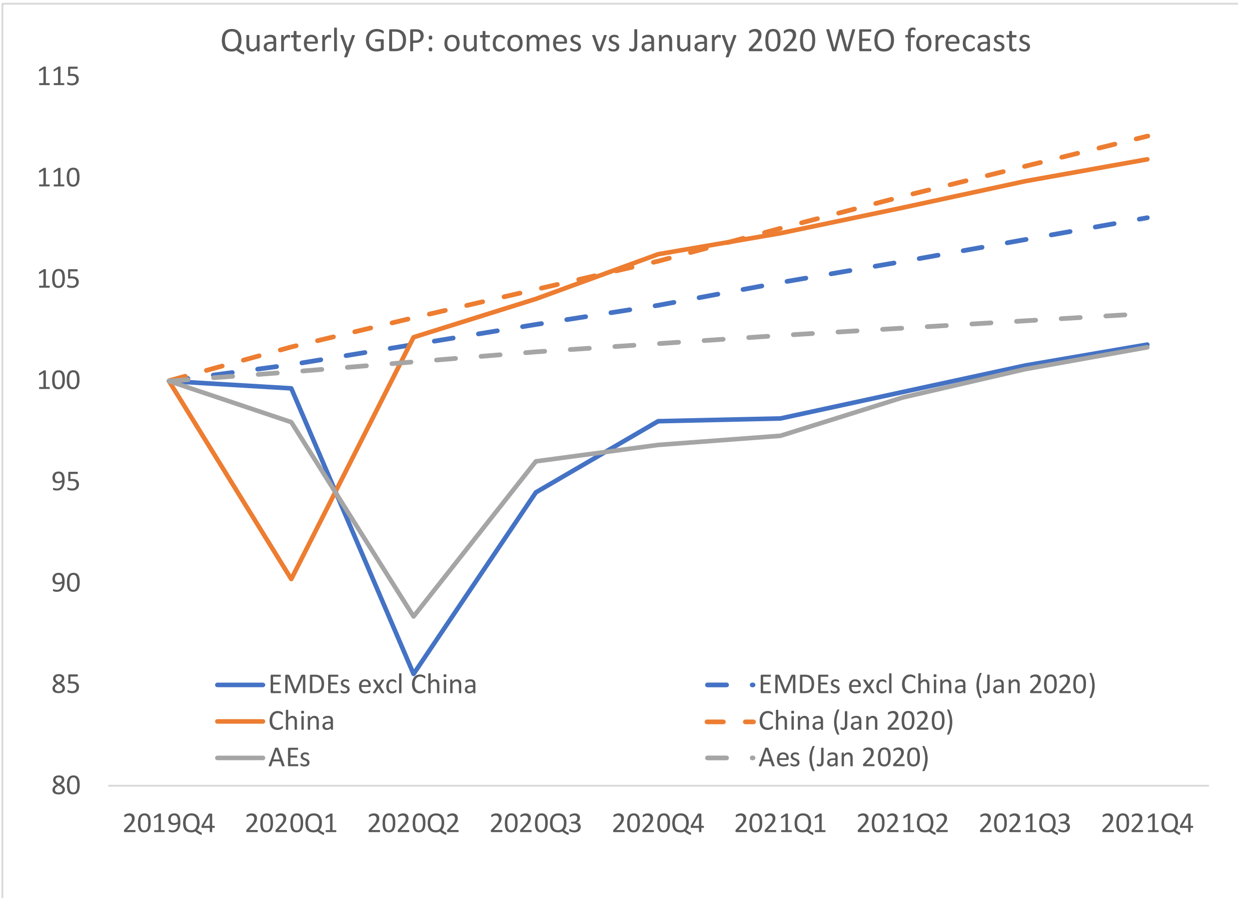
Figure 6. GDP growth in 2020 (deviation from pre-COVID forecast) and the share of tourism



Note: the horizontal axis measures the share of GDP accounted for by travel and tourism activities. The vertical axis measures the deviation of growth outcomes in 2020 from pre-COVID forecasts (IMF, 2020a).

Source: The World Bank (share of tourism activities); International Monetary Fund (deviation of growth outcomes in 2020 from pre-COVID forecasts).

Figure 7. Quarterly GDP, advanced economies and emerging market and developing economies: preliminary 2020 outcomes and 2021 IMF forecasts (compared to January 2020 forecasts)



Source: International Monetary Fund (2020a, 2021) and author's calculations.