CAPITAL ECONOMICS

GLOBAL ECONOMICS UPDATE

How quickly will the world economy rebound?

- **The world is heading for the sharpest and deepest global slowdown since WW2. Assuming that the virus is brought under control within a few months, the subsequent rise in world GDP should also be sharp. However, it could still take years for demand to recover completely.**

- Given the lockdowns in place across much of the world, we have downgraded our forecasts further in recent days, with the result that **we now expect global real GDP to fall by over 3% this year.** That compares with our pre-virus forecast that it would *grow* by about 3%. This means that 2020 is set to be the worst year for the global economy since the end of the Second World War, when world GDP in 1945 plunged by 5.5%. (See Chart 1.) Most of the output lost in the first half of this year will probably be lost for ever.

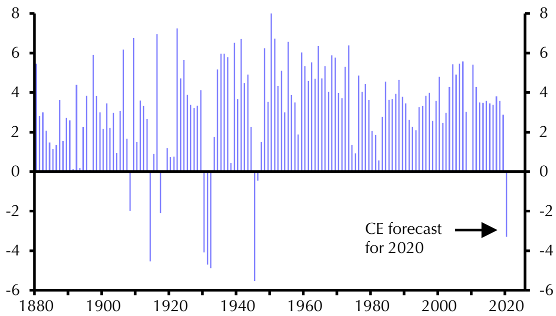
- Given the nature of the crisis, there is nonetheless scope, in theory, for a rapid return to previous levels of activity. **Once the virus has passed and restrictions are eased, the economy's capacity to produce goods and services should rebound strongly**; firms will re-open and people who were temporarily laid off or took unpaid leave will go back to work. Of course, this will not be possible if lots of previously solvent firms hit the wall during the shutdown. Indeed, some business failures are unavoidable. **But as long as the substantial government support in the forms of loans and grants proves effective, we do not envisage a big permanent reduction in supply.** And people are unlikely to lose their skills during only a short period of unemployment.

- That said, restrictions may be eased in a gradual and piecemeal manner. **Moreover, even if the world's supply capacity goes back to "normal" quite quickly, there is more uncertainty about how quickly *demand* will bounce back.** In an optimistic scenario, demand will also return rapidly, as people catch up on their missed hairdresser appointments, meals out with friends etc. They might even make up for some of the activity lost during the shutdowns – for example, buying the things they wanted to buy when the shops were shut. **In this scenario, growth could be very strong as soon as the third quarter.**

- **In reality, we expect a more gradual pick-up than this.** Policymakers have staved off the risk that, even after the virus passes, demand keeps falling in a downward spiral of job losses and income and spending cuts. **However, consumer and business confidence might well remain subdued for some time, not least if fears of a second wave of the virus linger.** Firms will be considering how to repay the emergency loans. In some countries, there might be the prospect of a new wave of austerity to repay the rise in public debt. And demand for travel abroad might stay weak for years. Note that the early signs from China are that demand has been slow to return despite firms being told to resume normal operations in February.

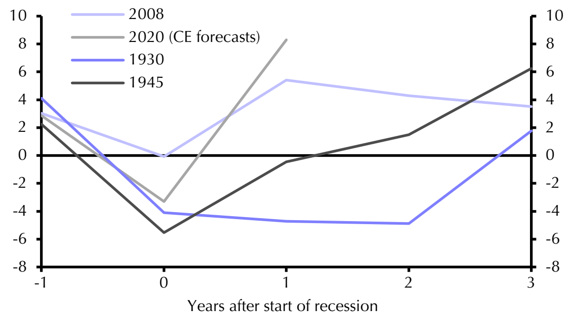
- We have explained elsewhere that most economies should ultimately return to the path of output they were on before the crisis. We are not so pessimistic as to expect the U-shaped recession that some are predicting, with economies bumping along the bottom for a long time. In fact, this recovery should be strong by past standards. (See Chart 2.) **However, with demand weakness lingering, it may well take a few years to get back to where we were and even longer for some economies.** Moreover, the world that follows may be fundamentally different in many respects, such as the role of the state and the future of globalisation.

Chart 1: World Real GDP (% y/y)



Sources: Maddison, Refinitiv

Chart 2: World Real GDP (% y/y)



Sources: Maddison, Refinitiv, Capital Economics

Vicky Redwood, Senior Economic Adviser, victoria.redwood@capitaleconomics.com