The global economy is climbing out from the depths to which it had plummeted during the Great Lockdown in April. But with the COVID-19 pandemic continuing to spread, many countries have slowed reopening and some are reinstating partial lockdowns to protect susceptible populations. While recovery in China has been faster than expected, the global economy’s long ascent back to pre-pandemic levels of activity remains prone to setbacks.

Global Growth Outlook and Risks

Near-term outlook. Global growth is projected at −4.4 percent in 2020, a less severe contraction than forecast in the June 2020 World Economic Outlook (WEO) Update. The revision reflects better-than-anticipated second quarter GDP outturns, mostly in advanced economies, where activity began to improve sooner than expected after lockdowns were scaled back in May and June, as well as indicators of a stronger recovery in the third quarter. Global growth is projected at 5.2 percent in 2021, a little lower than in the June 2020 WEO Update, reflecting the more moderate downturn projected for 2020 and consistent with expectations of persistent social distancing. Following the contraction in 2020 and recovery in 2021, the level of global GDP in 2021 is expected to be a modest 0.6 percent above that of 2019. The growth projections imply wide negative output gaps and elevated unemployment rates this year and in 2021 across both advanced and emerging market economies.

Medium-term outlook. After the rebound in 2021, global growth is expected to gradually slow to about 3.5 percent into the medium term. This implies only limited progress toward catching up to the path of economic activity for 2020–25 projected before the pandemic for both advanced and emerging market and developing economies. It is also a severe setback to the projected improvement in average living standards across all country groups. The pandemic will reverse the progress made since the 1990s in reducing global poverty and will increase inequality. People who rely on daily wage labor and are outside the formal safety net faced sudden income losses when mobility restrictions were imposed. Among them, migrant workers who live far from home had even less recourse to traditional support networks. Close to 90 million people could fall below the $1.90 a day income threshold of extreme deprivation this year. In addition, school closures during the pandemic pose a significant new challenge that could set back human capital accumulation severely.

The subdued outlook for medium-term growth comes with a significant projected increase in the stock of sovereign debt. Downward revisions to potential output also imply a smaller tax base over the medium term than previously envisaged, compounding difficulties in servicing debt obligations.

The baseline projection assumes that social distancing will continue into 2021 but will subsequently fade over time as vaccine coverage expands and therapies improve. Local transmission is assumed to be brought to low levels everywhere by the end of 2022. The medium-term projections also assume that economies will experience scarring from the depth of the recession and the need for structural change, entailing persistent effects on potential output. These effects include adjustment costs and productivity impacts for surviving firms as they upgrade workplace safety, the amplification of the shock via firm bankruptcies, costly resource reallocation across sectors, and discouraged workers’ exit from the workforce. The scarring is expected to compound forces that dragged productivity growth lower across many economies in the years leading up to the pandemic—relatively slow investment growth weighing on physical capital accumulation, more modest improvements in human capital, and slower efficiency gains in combining technology with factors of production.

Risks. The uncertainty surrounding the baseline projection is unusually large. The forecast rests on public health and economic factors that are inherently difficult to predict. A first layer relates to the path of the pandemic, the needed public health response, and the associated domestic activity disruptions, most notably for contact-intensive sectors. Another source of uncertainty is the extent of global spillovers from soft demand, weaker tourism, and lower remittances.
A third set of factors comprises financial market sentiment and its implications for global capital flows. Moreover, there is uncertainty surrounding the damage to supply potential—which will depend on the persistence of the pandemic shock, the size and effectiveness of the policy response, and the extent of sectoral resource mismatches.

Progress with vaccines and treatments, as well as changes in the workplace and by consumers to reduce transmission, may allow activity to return more rapidly to pre-pandemic levels than currently projected, without triggering repeated waves of infection. And an extension of fiscal countermeasures into 2021 could also lift growth above the forecast, which factors in only the measures implemented and announced so far.

However, the risk of worse growth outcomes than projected remains sizable. If the virus resurges, progress on treatments and vaccines is slower than anticipated, or countries’ access to them remains unequal, economic activity could be lower than expected, with renewed social distancing and tighter lockdowns. Considering the severity of the recession and the possible withdrawal of emergency support in some countries, rising bankruptcies could compound job and income losses. Deteriorating financial sentiment could trigger a sudden stop in new lending (or failure to roll over existing debt) to vulnerable economies. And cross-border spillovers from weaker external demand could amplify the impact of country-specific shocks.

**Policy Priorities: Near-Term Imperatives, Medium-Term Challenges**

Besides combating the deep near-term recession, policymakers have to address complex challenges to place economies on a path of higher productivity growth while ensuring that gains are shared evenly and debt remains sustainable. Many countries already face difficult trade-offs between implementing measures to support near-term growth and avoiding a further buildup of debt that will be hard to service down the road, considering the crisis’s hit to potential output. Policies to support the economy in the near term should therefore be designed with an eye to guiding economies to paths of stronger, equitable, and resilient growth.

Tax and spending measures should privilege initiatives that can help lift potential output, ensure participatory growth that benefits all, and protect the vulnerable. The additional debt incurred to finance such endeavors is more likely to pay for itself down the road by increasing the size of the economy and future tax base than if the borrowing were done to finance ill-targeted subsidies or wasteful current spending. Investments in health, education, and high-return infrastructure projects that also help move the economy to lower carbon dependence can further those objectives. Research spending can facilitate innovation and technology adoption—the principal drivers of long-term productivity growth. Moreover, safeguarding critical social spending can ensure that the most vulnerable are protected while also supporting near-term activity, given that the outlays will go to groups with a higher propensity to spend their disposable income than more affluent individuals. In all instances, adhering to the highest standards of debt transparency will be essential to avoid future rollover difficulties and higher sovereign risk premiums that raise borrowing costs across the economy.

Given the global nature of the shock and common challenges across countries, strong multilateral efforts are needed to fight the health and economic crisis. A key priority is funding advance purchase commitments at the global level for vaccines currently under trial to incentivize rapid scaling up of production and worldwide distribution of affordable doses (for example, by bolstering multilateral initiatives for vaccine development and manufacture, including the Coalition for Epidemic Preparedness Innovations and Gavi, the Vaccine Alliance). This is particularly important given the uncertainty and risk of failure in the search for effective and safe vaccines. A related priority is to help countries with limited health care capacity.

Beyond assistance with medical equipment and know-how, several emerging market and developing economies—in particular low-income countries—require support from the international community through debt relief, grants, and concessional financing. Where debt restructuring is needed, creditors and low-income-country and emerging market borrowers should quickly agree on mutually acceptable terms. The global financial safety net can further help countries deal with external funding shortfalls. Since the onset of the crisis, the IMF has expeditiously provided funding from its various lending facilities to about 80 countries at unprecedented speed.

For many countries, sustaining economic activity and helping individuals and firms most in need—while ensuring that debt remains sustainable—is a daunting task, given high public debt, the spending needs triggered by the crisis, and the hit to public revenues. Governments should do all that they can to combat the health crisis and mitigate the deep downturn while
being ready to adjust policy strategy as the pandemic and its impact on activity evolve. Where fiscal rules may constrain action, their temporary suspension would be warranted, combined with a commitment to a gradual consolidation path after the crisis abates to restore compliance with the rules over the medium term. Room for immediate spending needs could be created by prioritizing crisis countermeasures and reducing wasteful and poorly targeted subsidies. Extending maturities on public debt and locking in low interest rates to the extent possible would help reduce debt service and free up resources to be redirected toward crisis mitigation efforts. Although adopting new revenue measures during the crisis will be difficult, governments may need to consider raising progressive taxes on more affluent individuals and those relatively less affected by the crisis (including increasing tax rates on higher income brackets, high-end property, capital gains, and wealth) as well as changes to corporate taxation that ensure firms pay taxes commensurate with profitability. Countries should also cooperate on the design of international corporate taxation to respond to the challenges of the digital economy.

With the pandemic continuing to spread, all countries—including those where infections appear to have peaked—need to ensure that their health care systems can cope with elevated demand. This means securing adequate resources and prioritizing health care spending as needed, including on testing; contact tracing; personal protective equipment; life-saving equipment, such as ventilators; and facilities, such as emergency rooms, intensive care units, and isolation wards.

Countries where infections continue to rise need to contain the pandemic with mitigation measures that slow transmission. As Chapter 2 shows, lockdowns are effective in bringing down infections. Mitigation measures—a much-needed investment in public health—set the stage for an eventual economic recovery from the downturn brought on by mobility constraints. Economic policy in such cases should limit the damage by cushioning income losses for affected people and firms while also supporting resource reallocation away from contact-intensive sectors that are likely to be constrained for an extended period of time. Retraining and reskilling should be pursued to the extent feasible so that workers can look for jobs in other sectors. Because the transition may take a while, displaced workers will need extended income support as they retrain and search for jobs. Complementing such measures, broad-based accommodative monetary and fiscal responses—where fiscal space exists—can help prevent deeper and longer-lasting downturns, even if their ability to stimulate spending is initially hampered by mobility restrictions.

As countries reopen, policies must support the recovery by gradually removing targeted support, facilitating the reallocation of workers and resources to sectors less affected by social distancing, and providing stimulus where needed to the extent possible. Some fiscal resources freed from targeted support should be redeployed to public investment—including in renewable energy, improving the efficiency of power transmission, and retrofitting buildings to reduce their carbon footprint. Moreover, as lifelines are unwound, social spending should be expanded to protect the most vulnerable where gaps exist in the safety net. In those cases, authorities could enhance paid family and sick leave, expand eligibility for unemployment insurance, and strengthen health care benefit coverage as needed. Where inflation expectations are anchored, accommodative monetary policy can help during the transition by containing borrowing costs.

Beyond the pandemic, multilateral cooperation is needed to defuse trade and technology tensions between countries and address gaps—for instance in services trade—in the rules-based multilateral trading system. Countries must also act collectively to implement their climate change mitigation commitments. As discussed in Chapter 3, joint action—particularly by the largest emitters—that combines steadily rising carbon prices with a green investment push is needed to reduce emissions consistent with limiting increases in global temperature to the targets of the 2015 Paris Agreement. A broadly adopted, growth-friendly mitigation package could raise global activity through investment in green infrastructure over the near term, with modest output costs over the medium term as economies transition away from fossil fuels toward cleaner technologies. Relative to unchanged policies, such a package would significantly boost incomes in the second half of the century by avoiding damages and catastrophic risks from climate change. Moreover, health outcomes would begin to improve immediately in many countries thanks to reduced local air pollution. The global community should also take urgent steps to strengthen its defenses against calamitous health crises, for example by augmenting stockpiles of protective equipment and essential medical supplies, financing research, and ensuring adequate ongoing assistance to countries with limited health care capacity, including through support of international organizations.