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Research Briefing | Global

Key themes 2021: New lease of life for the world economy

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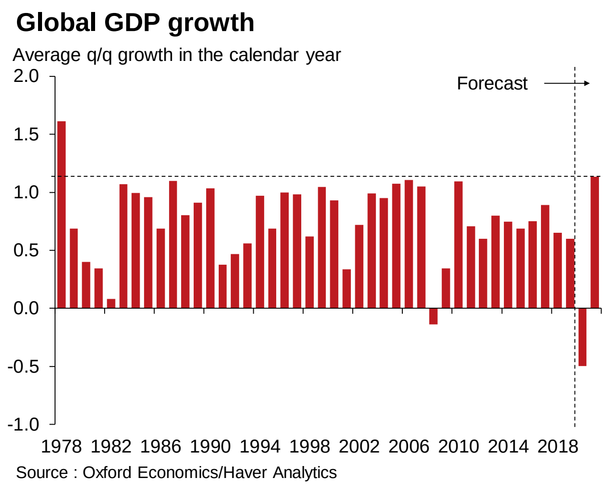
- **Buoyed by Covid-19 vaccines, we think the pace of global GDP growth in 2021 will be the fastest in over 40 years. But for many it won't feel much like a boom. Instead the global recovery is set to be uneven, dictated by three key themes.**
- **1. Vaccine winners and losers. We anticipate a sustained relaxation of restrictions in some advanced economies (AEs) around March/April, triggering a mid-year mini boom. Vaccine rollouts in emerging markets (EMs) will generally be slower, but some, particularly 'makers', will benefit from positive spillovers from the AE pickup. While vaccines will inevitably help travel and tourism, the transition may be slow. Long-haul travel will recover more slowly than domestic and short-haul.**
- **2. Industry will be a bright spot. Near-term prospects seem favourable as the sector continues to respond to pent-up demand and rebuilds inventories. But the second half of 2021 may prove tougher as these supports begin to fade, and consumers refocus their spending on services.**
- **Sticking with industry, despite considerable spare capacity, stronger capital spending could provide some upside surprises. The pandemic has accelerated structural shifts that are likely to trigger greater spending by the sectoral winners of 2020, such as distribution. Meanwhile, the trauma of lockdowns may encourage firms to adopt more labour-saving technologies to limit any future disruption from social distancing.**
- **3. The growth baton is passing from the public sector to the private. This will mark part of the transition to normal, but it won't be seamless. Past mistakes in rapidly moving to austerity won't be repeated, but policy will be uncoordinated globally and the risk of governments doing too little outweighs the risk of them doing too much. Consequently, we're still sceptical that underlying inflation will surge next year.**

Figure 1: Growth heads back to the seventies



We have upgraded our forecasts for 2021 following recent positive vaccine developments and expect the average quarterly GDP growth rate to be the strongest since 1978. But this will only be enough to return global GDP to pre-crisis levels. So, it's unlikely to feel like the best year in over four decades.

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Theme 1: Vaccine winners and losers

One of the biggest factors determining the strength of next year's economic recovery will be vaccination progress.

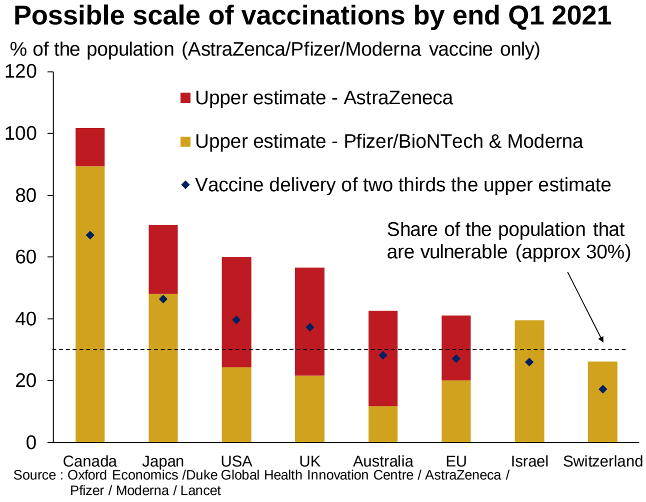
Many AEs may be able to vaccinate a high enough share of the vulnerable population to begin a meaningful and sustained relaxation of restrictions around March/April. This is conditional on the Pfizer/BioNTech, Moderna, and Oxford/AstraZeneca vaccines gaining speedy approval and production proceeding broadly as planned (**Figure 2**).

In EMs, vaccine rollouts will be patchier and generally slower. Many Eastern European EU members will benefit from EU vaccine procurement. Elsewhere, some EMs, such as India, Brazil, and Indonesia, have pre-ordered vaccines, or held trials in exchange for future vaccine supplies, potentially leaving them with enough vaccine to inoculate the most vulnerable (**Figure 3**). But China and Russia produce a large share of EM vaccine pre-orders, which require further testing before being approved. This points to a slower rollout than in AEs. Other logistical problems associated with mass vaccination may also be greater in EMs.

The biggest winners will be the economies that have suffered the most severe restrictions in containing Covid-19. A vaccine will thus allow a larger unwinding of restrictions and perhaps bigger reductions in voluntary social distancing. In the AEs, the UK and Spain have both recorded large falls in GDP and had persistently weak mobility, suggesting they may gain more than most (**Figure 4**). As with the AEs, the EMs that have seen particularly sharp drops in activity (**Figure 5**) and major disruption this year look set for the biggest gains. Parts of Eastern Europe look well placed in this respect.

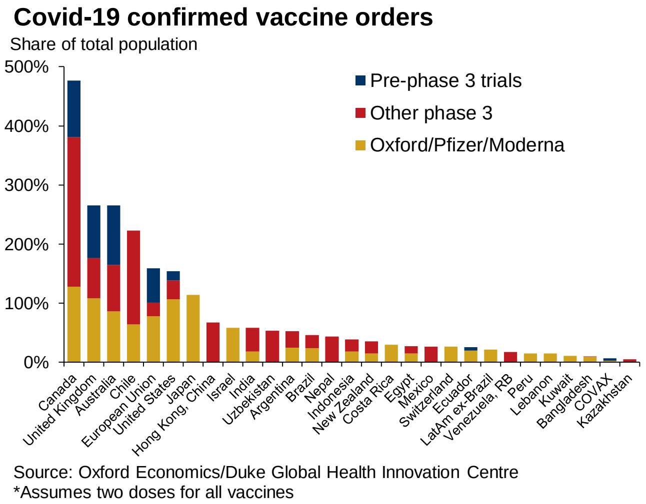
At the other extreme lie countries, such as China, South Korea Taiwan and Vietnam, that have contained the virus without imposing blunt national restrictions. While the vaccine will provide a boost to some forms of 'social spending', the pickup is likely to be more muted than elsewhere. The other relatively poor performers will be those with limited or no access to initial vaccine supplies, or that lack the infrastructure to deliver a vaccine speedily to the most at-risk groups. These countries are likely to be poorer and smaller EMs that account for only a small share of global GDP. Programs such as COVAX should help some of them gain access to vaccine supplies.

Figure 2: Many AEs may have sufficient vaccine stocks for fast, widespread programs



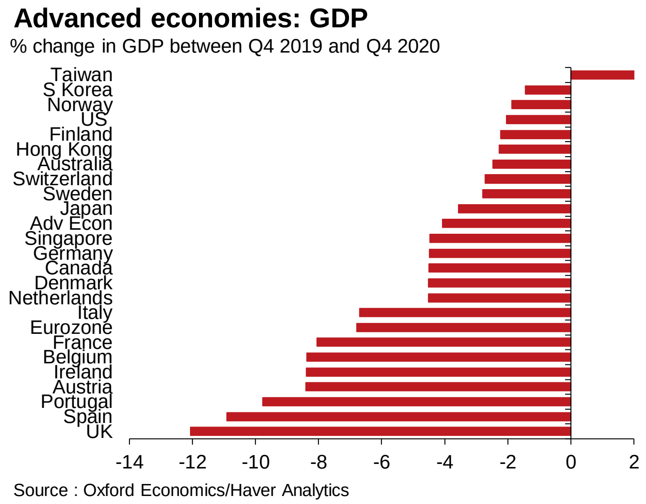
Source : Oxford Economics /Duke Global Health Innovation Centre / AstraZeneca / Pfizer / Moderna / Lancet

Figure 3: Some EMs have also ordered large quantities of the vaccines



Source: Oxford Economics/Duke Global Health Innovation Centre
*Assumes two doses for all vaccines

Figure 4: European economies have recorded the biggest GDP falls over 2020



Source : Oxford Economics/Haver Analytics

The middle group comprises economies that have less upside potential from a vaccine in terms of lifting restrictions because they have already limited the GDP hit from Covid by keeping their economies mostly open at the expense of allowing higher Covid-19 cases. Larger EMs that fall into this category include Brazil and Turkey, while among AEs, some US states and Sweden also fall into this group.

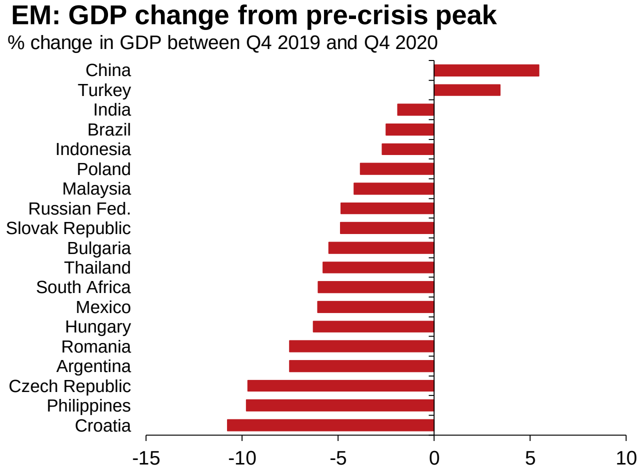
Still, even those economies that gain a relatively small or delayed domestic lift from vaccine deployment will benefit from widespread vaccinations elsewhere. **Industries such as travel and tourism and oil will benefit from more widespread travel again. And EMs in particular stand to benefit from an extension of recent market trends, such as a weaker US dollar, rising commodity prices, and larger capital inflows into EMs**.

Even if domestic Covid-19 cases remain high, makers and miners should still benefit from global strength, as long as businesses can remain open. By contrast, those economies that are more reliant on international tourism will probably need low Covid-19 cases and minimal restrictions to encourage tourists back. More generally, we expect tourists to initially have a greater preference for domestic travel or shorter-haul destinations where Covid-19 cases are low, and for overall travel and tourism spend to recovery only slowly (**Figure 6**). Accordingly, in 2021, the environment for EM travel and tourism sectors will likely remain challenging.

As **Figure 7** shows, the biggest GDP growth rebounds over the course of 2021 are expected to be in Europe, with UK and Spain in particular sitting toward the top. Owing to China's remarkable rebound already, it sits low in the growth league (behind serial poor performer Italy).

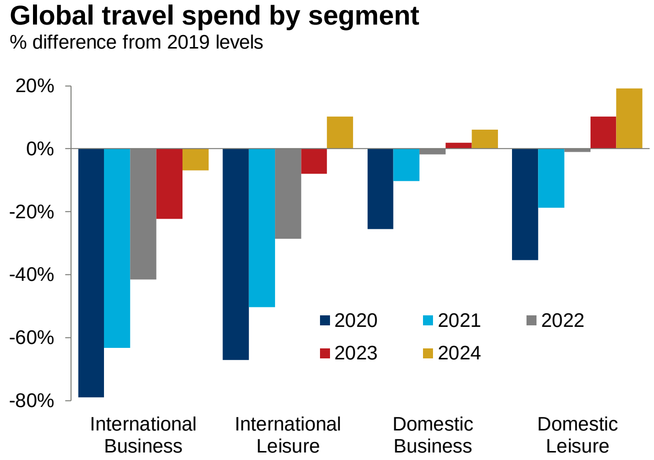
Despite edging more positive on the economic outlook following recent vaccine news and anticipating solid growth through 2021, we don't expect global GDP to reach its pre-crisis peak until Q3 next year. Although the trough has been deeper, we envisage the global economy following a similar growth pattern to the post-GFC recovery (**Figure 8**). But China flatters this figure – by Q3 2021, GDP there is expected to be 8% above its pre-crisis peak. Our baseline forecasts assume that GDP in the AEs and non-China EMs won't fully regain the lost ground from H1 2020 until around the end of 2021 and GDP will remain persistently below the path we anticipated prior to the pandemic.

Figure 5: After China, Brazilian and Turkish GDP have been remarkably resilient



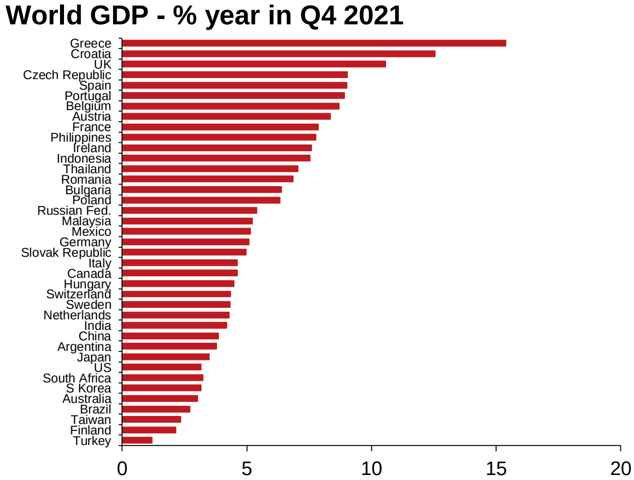
Source : Oxford Economics/Haver Analytics

Figure 6: Tourism revival will take time even with a vaccine



Source: Tourism Economics

Figure 7: Europe to lead the charge in 2021



Source : Oxford Economics/Haver Analytics

Theme 2: Industry will be a bright spot

Against the backdrop of a global economy recovering but struggling with scarring and seeing structural changes accelerating, a key question is which sectors will be the relative winners. The industrial sector has been widely regarded as showing more resilience than the wider economy, but strikingly in most AEs industrial production is expected to be even further ahead of pre-crisis levels than overall GDP by the end of 2020 (**Figure 9**).

There are several reasons why industry may fare well in early 2021. **First, we think continued robust production will be needed to meet the surge in demand for some products and the release of pent-up demand after lockdown, which has led to shortages of some goods.**

Second, although global supply chains have proved to be more robust than many feared, container shipping has been hugely disrupted by events in 2020, resulting in a surge in shipping prices and widespread logistical issues.

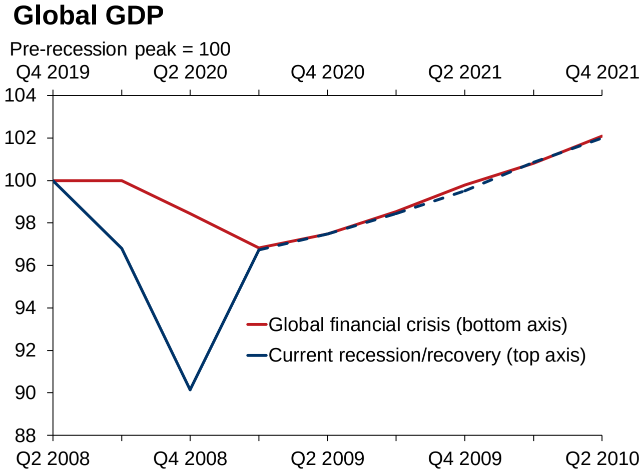
Both factors have resulted in production recovering by less than orders, triggering a reduction in inventories (**Figure 10**). Waning disruption and a rebuilding of inventories point to production expanding more quickly than orders in H1.

Third, although reducing restrictions on activity will see households re-orientate spending back toward services (**Figure 11**), in the short term goods spending is likely to continue to perform well, benefitting industry. **And the reopening of parts of the service sector will benefit some industrial sector too.** For example, bringing cruise ships and aircraft back into service will lead to increased demand for replacement parts and material for refits.

More generally, the reopening of the economy will support the recovery and employment, so even if industries share of the economy shrinks a bit this may be offset by the pie becoming larger.

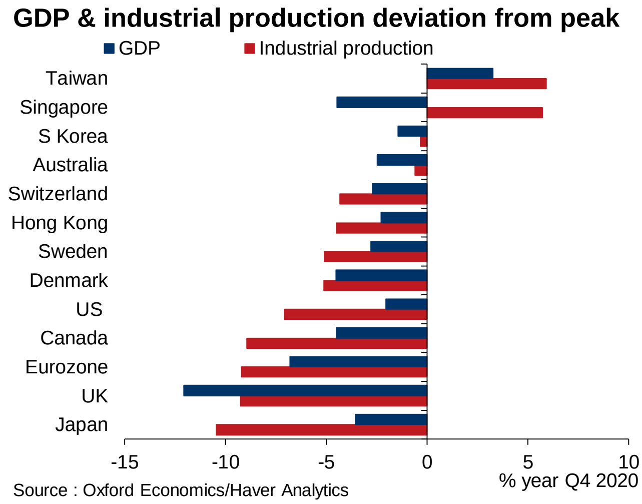
For industry to continue to thrive beyond H1 other sub-sectors, such as capital goods, will also need to broaden. At surface level, we see grounds for cautious pessimism on this front. Large amounts of spare capacity suggest little need for investment to expand productive capacity. What's more, reversing the recent surge in corporate debt and rebuilding free cash flow may be a priority for many firms (**Figure 12**). Meanwhile the chances of global capital producers riding on the coattails of a sustained period of strong investment-

Figure 8: Underlying growth to broadly match the post-GFC rebound in 2021



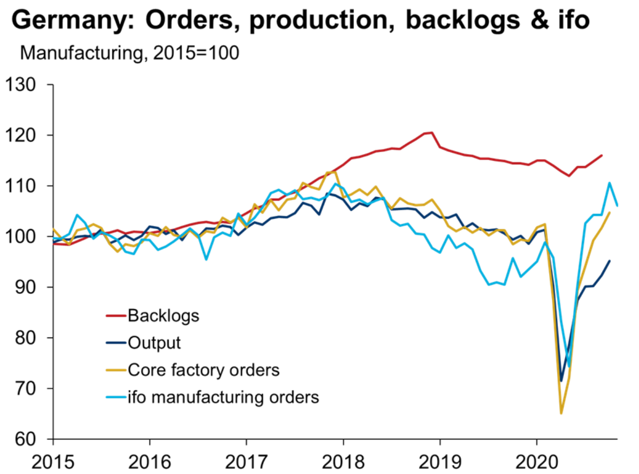
Source : Oxford Economics/Haver Analytics

Figure 9: Industrial output has contracted by more than GDP in many AEs



Source : Oxford Economics/Haver Analytics

Figure 10: Production has lagged behind orders



Source : Oxford Economics/Haver Analytics

driven growth in China, as seen in the post-global financial crisis period, look slim, given our view that Chinese growth will be steady but unspectacular next year (**Figure 7**).

Elsewhere, we expect to see healthy capex growth this year, albeit not strong enough to bring the level back to its pre-crisis peak (**Figure 13**). **Still, we think capital spending has scope to deliver an upside surprise and extend the period of industrial strength beyond H1.**

First, although Chinese investment growth is set to slow, we expect the composition to shift toward corporate investment, benefitting capital producers abroad.

Second, investment normally rises long before spare capacity is used up (**Figure 14**). Indeed, after the GFC, the initial period of the recovery saw the strongest period of investment, despite a large amount of slack and challenging financial conditions (**Figure 15**).

Furthermore, while some behavioural changes in response to Covid-19 may be short-lived, others, such as the shift to greater online shopping and remote working, may not. The latter shifts may bring forward some investment.

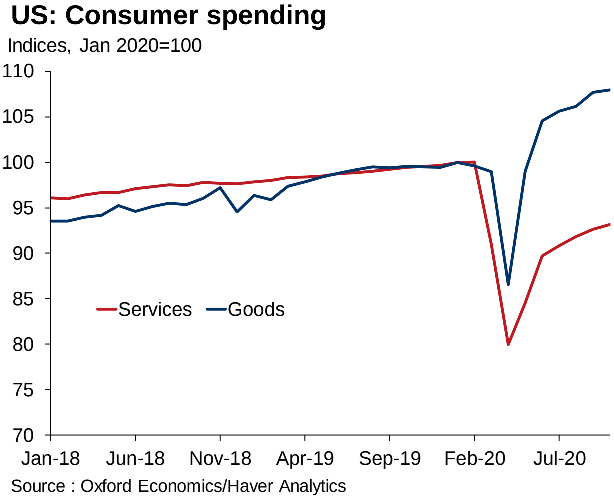
The pandemic could also lead firms to adjust production processes. True, we have been sceptical that Covid-19 will lead firms to re-shore or dramatically adjust supply networks. But the past ten years has also seen growth being very labour driven and growth in capital stock has been sluggish – while GDP has typically surprised to the downside, employment has been persistently stronger than anticipated. At the margin, preferences could shift toward less labour-focused production processes, boosting investment.

Meanwhile, although emergency fiscal support measures look set to be scaled back, other forms of fiscal policy support may be increased. Given the calls preceding the pandemic for greater government investment, the second half of 2021 could see governments turn their focus to upgrading infrastructure and greening the economy, boosting both construction and industry.

Theme 3: Passing on the baton

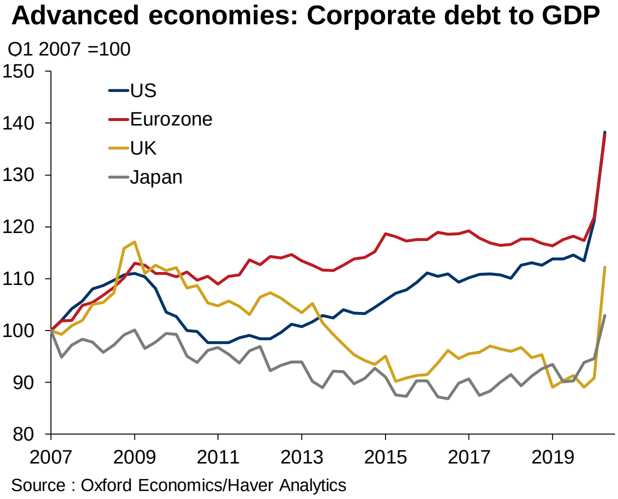
Policymakers deserve some credit for acting quickly during the pandemic and providing large levels of policy support. But we think the next phase – passing the growth baton back to the private sector– will be much more challenging and is unlikely to be seamless.

Figure 11: The rotation to goods spending has helped industry, but it may soon start to reverse



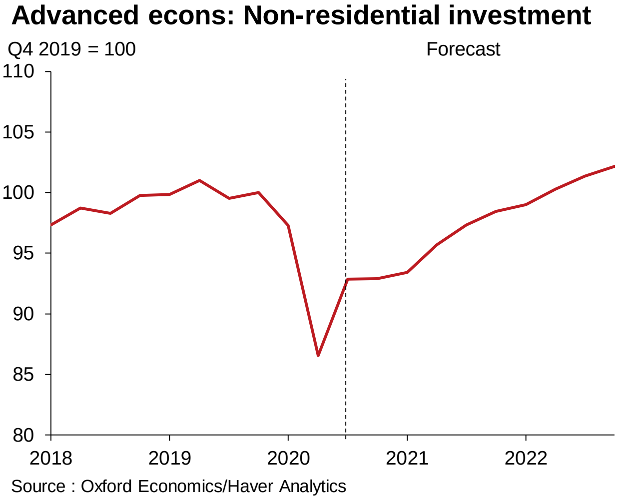
Source : Oxford Economics/Haver Analytics

Figure 12: Reducing corporate debt may be the priority for many firms



Source : Oxford Economics/Haver Analytics

Figure 13: Non-residential investment to grow solidly, but remain well below its prior peak



Source : Oxford Economics/Haver Analytics

We agree with the IMF and others that policymakers should err on the side of providing too much stimulus rather than too little. Economies are particularly vulnerable to recession in the early stages of a recovery. But rock-bottom bond yields mean debt-servicing costs remain low, providing plenty of policy space, and we doubt that action so far will lead to a sustained inflation surge (**Figure 16**).

Still, the optimal course of action may differ from the actual policy path. How concerned should we be about too much policy tightening in 2021? We see little chance of a major tightening by central banks. In the advanced economies in particular a sustained and strong rise in core inflation looks unlikely. Given that the past decade has seen too little inflation, a faster-than-expected rise in inflation wouldn't be an immediate cause for alarm. Meanwhile, a weaker US dollar is likely to reduce any pressure on EMs to raise interest rates. While monetary policymakers may not loosen policy significantly further, the prospect of a notable tightening is unlikely.

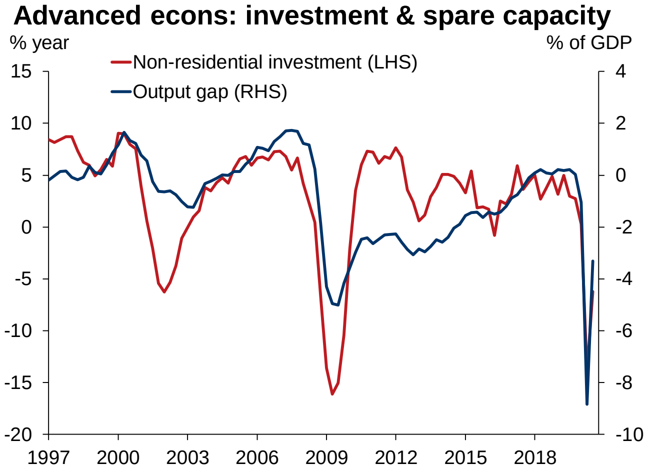
The fiscal outlook is more uncertain, but given the declining effectiveness of monetary policy, will be more important . Our baseline forecasts assume that fiscal policy is tightened across the vast majority of economies, largely as a result of the phasing out of emergency support measures (**Figure 17**). This shouldn't be a cause for alarm or pessimism – it is part of the process of returning to normal. With household savings high and debt in many economies generally lower than a decade ago, it seems likely that some of this slack will be picked up by households as the corner is turned in the fight against Covid-19.

However, with GDP still well below the pre-crisis peak, substantial support will still be needed to fully recover lost ground and minimise scarring risks. Although our forecasts assume a reasonably smooth transition, we see several key fiscal risks to watch out for.

First, huge budget deficits could make governments too eager to tighten (Figure 18). This might reflect concerns about being punished by financial markets, ideological aversions to large deficits and big government, or over-optimism surrounding the strength of the economy.

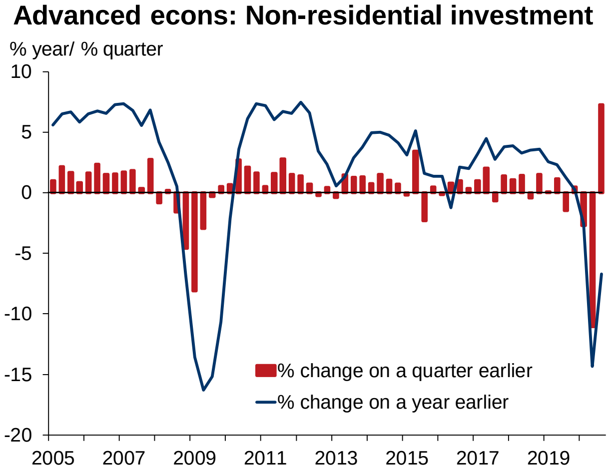
A second and related point, is that a lack of co-ordination among policymakers at a global level may diminish the effectiveness of any support. If governments of smaller open economies expect aggressive policy easing

Figure 14: Investment growth and spare capacity aren't closely correlated in practice



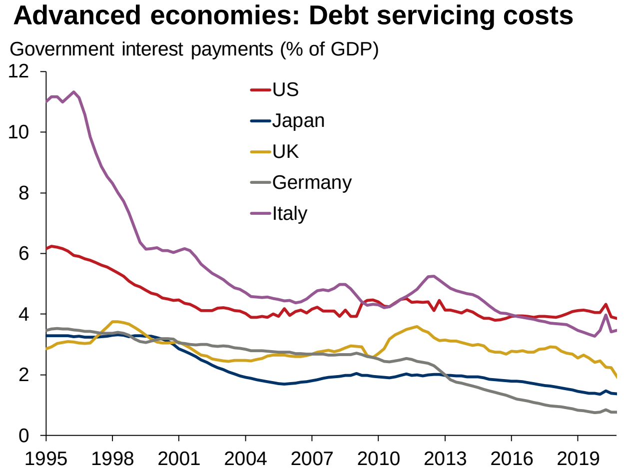
Source : Oxford Economics/Haver Analytics

Figure 15: Investment strength greatest in the early stages of the post-GFC recovery



Source : Oxford Economics/Haver Analytics

Figure 16: Low bond yields mean conventional government debt metrics are no longer valid



Source : Oxford Economics/Haver Analytics

elsewhere to create a strong pickup in global demand, then a robust domestic recovery might be achievable even if emergency support is allowed to expire with few offsetting fiscal measures. Co-ordinated action is often talked about but only typically occurs when the global economy is on the edge of a precipice. This does not bode particularly well for co-ordinated fiscal action next year. In the past, the US or China have effectively playing the role of spender of last resort. But the likelihood of a divided congress in the US and stability concerns in China mean that governments in both economies cannot be relied upon to take on that role next year.

Third, providing an appropriate level of fiscal policy support is inherently difficult due to long and variable lags. The switch back to using fiscal policy as the primary demand management tool is likely to increase the risks of policy mistakes and a bumpier economic cycle.

Finally, if providing the right amount of fiscal policy is hard, doing it while also transitioning away from "life-support" fiscal transfers to other forms of support that take time for their full impact to materialise will be harder still.

The above factors probably suggest that the risks are skewed toward too little rather than too much fiscal support. This is consistent with the view of our own economist survey which shows the majority of governments are judged to be more likely to tighten too much than too little (**Figure 19**). While we are sceptical that governments will go down the road of full-blown austerity and push their economies back into recession, an overly conservative fiscal response may prompt bumpy and uneven growth, increasing the potential scale of scarring in some economies.

Booming growth, but it may not feel that way

The three themes we've identified will be keys to the speed and scale of the recovery globally next year. While we expect the recovery will be strong by historical standards, for many it won't feel that way and there may be bumps and volatility ahead. Even if the economy grows in line with our estimates, Covid will leave lasting scars that will take years to heal fully.

Figure 17: Withdrawal of emergency support to result in less supportive fiscal policy in 2021

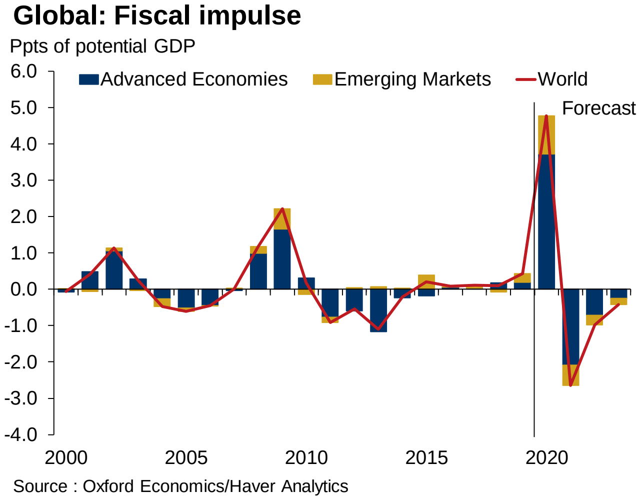


Figure 18: Despite H2 rebound, large deficits may provide pause for thought

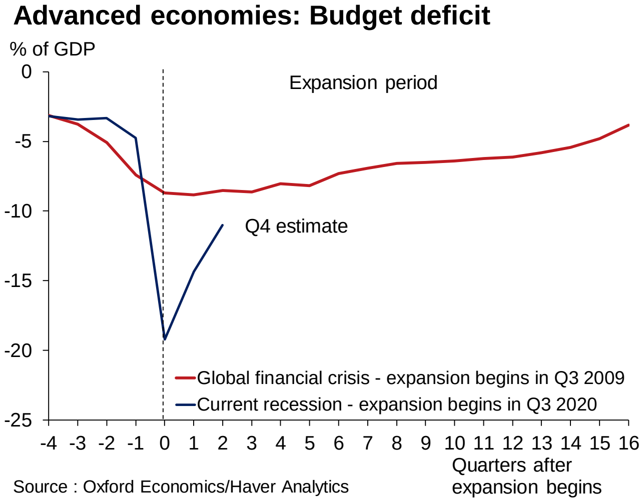


Figure 19: Governments especially likely to tighten too much