Coronavirus: Living with Uncertainty

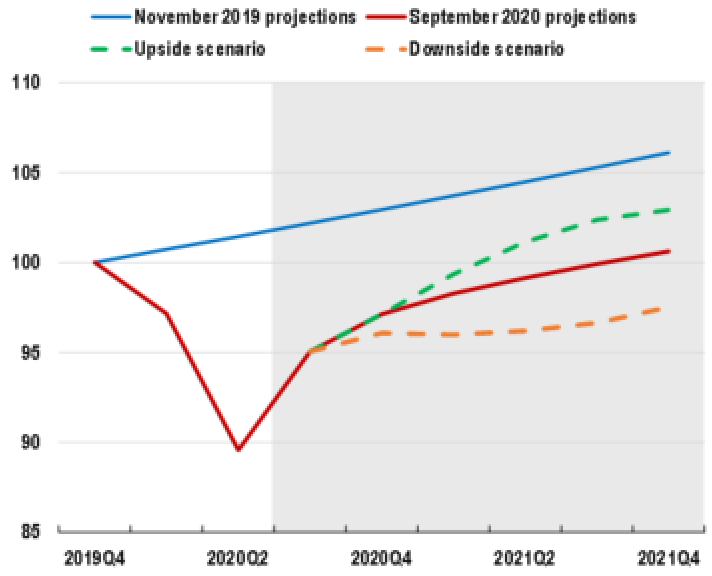
by Laurence Boone, OECD Chief Economist

The global economy is facing unprecedented uncertainty as the evolution of the Covid-19 pandemic weighs heavily on the economic outlook. Nine months after the initial outbreak in Wuhan, it is still difficult to predict the path of the virus. Each country has been hit in a different way, and response strategies have varied. There is much we still do not know. Research for a vaccine is ongoing across the globe, but more needs to be done to prepare for mass-scale testing, manufacturing and distribution that will be required. It seems clear today that we will have to live with the virus for some time, with our principal defence being tigher hygiene standards and physical distancing measures.

Amid this unprecedented uncertainty, what we know is that the world will be much poorer than it would have been without the virus. If our central projection of a gradual recovery, after the rebound, materialises, global income will be USD 7 trillion lower by the end of 2021 than what we projected less than a year ago in November 2019. This is roughly equivalent to losing a year’s production from France and Germany combined.

The initial economic shock in the first part of 2020 was deep and profound. In the wake of national confinements, the global economy plunged 7.8% in the second quarter of this year, an unprecedented drop in peace time. The decline would have been harder had governments not put in place a wide safety net for firms and individuals. As economies began to reopen, activities that could operate with physical distancing rebounded strongly. But it would be imprudent to infer from this that the recovery is V-shaped and global income can rapidly return to pre-crisis levels. In some industries a rapid recovery will occur; those linked to digital activity for example, but others will not be able to fully recover for some time. Scheduled flights are still down around 50% on a year ago in September. Entertainment and tourism have been deeply affected. Overall, 13-20% of OECD employment is threatened.

Figure: Global GDP Projections
Constant pries, index 2019Q4 = 100



Source: OECD Economic Outlook database; OECD calculations.

Because developments are so varied across countries and uncertainty is so high, we have produced two scenarios around our central projection. On the upside, if businesses and households were to become more confident because a vaccine or treatment is in sight or only mild containment measures were required to contain virus outbreaks, world growth would be stronger (figure). The loss of global output would be around USD4 trillion by the end of 2021. On the downside, if confidence remains weak because outbreaks were to intensify or stricter containment measures were required, household spending and business investment would weaken and the recovery would slow, and the loss in output would be USD11 trillion.

Even if this crisis is strikingly different from others we have experienced and uncertainty is extremely high, we have seen that policy matters. In the confinement phase of the Covid-19 crisis, policymakers worldwide used a rich policy toolbox. These measures included short-term working schemes, furloughed employment, credit or grants to firms and tax holidays. This is pushing debt up by around 15 percentage points of GDP across the OECD, but was necessary, and will remain so for 2021. Central banks provided liquidity support, and low rates kept debt interest payments at lower levels.

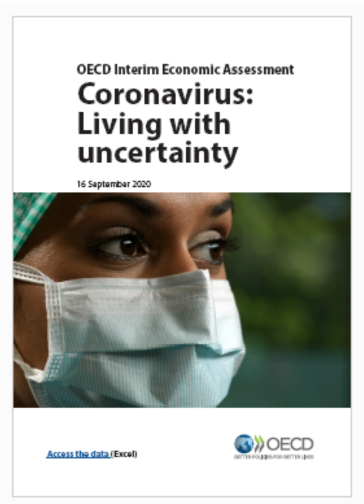
Policy will continue to play an important role in the next phase of the crisis. We learnt from the aftermath of the Global Financial Crisis that tightening fiscal policy prematurely could impart a serious blow to an already weakened economy. Fiscal support will have to continue. We also learnt that policy can only temporarily prevent a rise in bankruptcies and unemployment. Support to firms must evolve to let non-viable firms go and encourage viable ones to grow. Equity instruments could be deployed for large firms, with state support, provided competition is preserved and a clear strategy for exit designed. However, it will require more creativity for SMEs, for example in the form of tax credits, with repayments occuring when firms sustainably return to profit.

Individuals in vulnerable sectors also need policy support.

For sectors where the shock is seen as temporary, short-term working schemes may continue, with more flexibility to allow people to take on new activity. For other sectors, existing schemes to support individuals and firms need to be tailored to avoid maintaining support to unviable jobs and firms that blocks reallocation necessary for a strong and persistent recovery. Training and job placement should be supported by digital infrastructure and be tailor-made to individuals as a norm. Policymakers need to make an extra-effort to be sure support reaches those who need it most. Furthermore, the first phase of the crisis has shown that barriers to trade can be hugely disruptive for an efficient supply of goods and services. International cooperation must resume to ensure health goods and services can be delivered to all, but also that trade barriers do not rise further putting some firms and activities, and the associated jobs, at risk.

Looking further ahead, there is no way today to predict how people will behave after 18 months of a pandemic, how they will work and undertake leisure activities. We can sketch out how some trends will accelerate though. First, there will be a wider use of teleworking, although the limits of out-of-office work must be taken into consideration. Second, we will see more services move online and increased online retail sales. Third, there will be greater demand, and need, for crisis management preparation, including health, cybersecurity, energy security and protection against natural disasters. Fourth, as the crisis impacts more precarious workers, the essential workers who cannot telework, those living in crowded accomodation, those in poor health, public demand for greater access to essential goods and services including public health and education provision should prevail. Amid a background of public disapproval with the evolution of inequality, policies will need to improve on transparency, increasing competition and reducing collusion, and finding the means for a more efficient delivery of public services.

Policymakers have to aim higher than trying to restore our pre-pandemic living standards: they need to deal with pre-crisis trends that threaten our future and seize the opportunity for change. It is an opportunity to implement green recovery and a significant shift in the sustainability of our economies. Governments are spending a lot of money in the policy response to the pandemic, but not enough of this is focused on sustainable solutions. Some countries are taking measures, but the effort needs to be bolder. Still, over 50% of policy support for energy in recovery packages is going to 'brown' fossil fuels. As recovery plans will be at the heart of governments budget preparation for 2021, the opportunity to reboot the economy on a stronger, fairer and more sustainable footing should not be wasted.



Further reading:

OECD Interim Economic Outlook, 16 September, 2020