OECD Economic Outlook, Interim Report

Strengthening the recovery: The need for speed

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BETTER POLICIES FOR BETTER LIVES

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STRENGTHENING THE RECOVERY: THE NEED FOR SPEED Summary

- Global economic prospects have improved markedly in recent months, helped by the gradual deployment of effective vaccines, announcements of additional fiscal support in some countries, and signs that economies are coping better with measures to supress the virus.
- Global GDP growth is projected to be 5½ per cent in 2021 and 4% in 2022, with global output rising above the pre-pandemic level by mid-2021. Despite the improved global outlook, output and incomes in many countries will remain below the level expected prior to the pandemic at the end of 2022.
- The significant fiscal stimulus in the United States, along with faster vaccination, could boost US GDP growth by over 3 percentage points this year, with welcome demand spillovers in key trading partners.
- There are increasing signs of divergence across countries and sectors. Strict containment measures will hold back growth in some countries and service sectors in the near term, while others will benefit from effective public health policies, faster vaccine deployment and strong policy support.
- Sizeable risks remain. Faster progress in vaccine deployment in all countries would enable restrictions to be lifted more quickly and enhance confidence and spending. Slow progress in vaccine rollout and the emergence of new virus mutations resistant to existing vaccines would result in a weaker recovery, larger job losses and more business failures.
- Cost pressures have begun to emerge in commodity markets due to the resurgence of demand and temporary supply disruptions, but underlying inflation remains mild, held back by spare capacity around the world.
- The top policy priority is to ensure that all resources necessary are used to produce and fully deploy vaccinations as quickly as possible throughout the world, to save lives, preserve incomes and limit the adverse impact of containment measures on well-being. The resources required to provide vaccines to lower-income countries are small compared with the gains from a stronger and faster global economic recovery.
- Fiscal policy support should be contingent on the state of the economy and the pace of vaccinations, with new policy measures implemented promptly and fully if required. A premature tightening of fiscal policy must be avoided.
- The current very accommodative monetary policy stance should be maintained, and allow temporary overshooting of headline inflation provided underlying price pressures remain well contained, with macroprudential policies deployed where necessary to ensure financial stability.
- Continued income support for households and companies is warranted until vaccination allows a significant easing of restraints on face-to-face activities, but should be refocused to support people and help companies with grants and equity rather than debt.
- Enhanced structural reforms are required in all countries to raise opportunities, improve economic dynamism, and foster a strong, sustainable and inclusive recovery.
- The sequencing and packaging of reforms is important to enhance their collective benefit and support near-term demand.
- International policy co-ordination is essential to increase the gains from national policy actions to tackle the pandemic, enhance resilience and ensure a strong and inclusive recovery.

OECD Interim Economic Outlook Forecasts March 2021

Real GDP growth

Year-on-year % change

	2020	2021		2022	
		Interim EO projections	Difference from December EO	Interim EO projections	Difference from December EO
World	-3.4	5.6	1.4	4.0	0.3
G20[1]	-3.2	6.2	1.5	4.1	0.4
Australia	-2.5	4.5	1.3	3.1	0.0
Canada	-5.4	4.7	1.2	4.0	2.0
Euro area	-6.8	3.9	0.3	3.8	0.5
Germany	-5.3	3.0	0.2	3.7	0.4
France	-8.2	5.9	-0.1	3.8	0.5
Italy	-8.9	4.1	-0.2	4.0	0.8
Spain[2]	-11.0	5.7	0.7	4.8	0.8
Japan	-4.8	2.7	0.4	1.8	0.3
Korea	-1.0	3.3	0.5	3.1	-0.3
Mexico	-8.5	4.5	0.9	3.0	-0.4
Turkey	1.8	5.9	3.0	3.0	-0.2
United Kingdom	-9.9	5.1	0.9	4.7	0.6
United States	-3.5	6.5	3.3	4.0	0.5
Argentina	-10.5	4.6	0.9	2.1	-2.5
Brazil	-4.4	3.7	1.1	2.7	0.5
China	2.3	7.8	-0.2	4.9	0.0
India[3]	-7.4	12.6	4.7	5.4	0.6
Indonesia	-2.1	4.9	0.9	5.4	0.3
Russia	-3.6	2.7	-0.1	2.6	0.4
Saudi Arabia	-4.0	2.6	-0.6	3.9	0.3
South Africa	-7.2	3.0	-0.1	2.0	-0.5

Note: Difference from December 2020 Economic Outlook in percentage points, based on rounded figures. World and G20 aggregates use moving nominal GDP weights at purchasing power parities.

1. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.

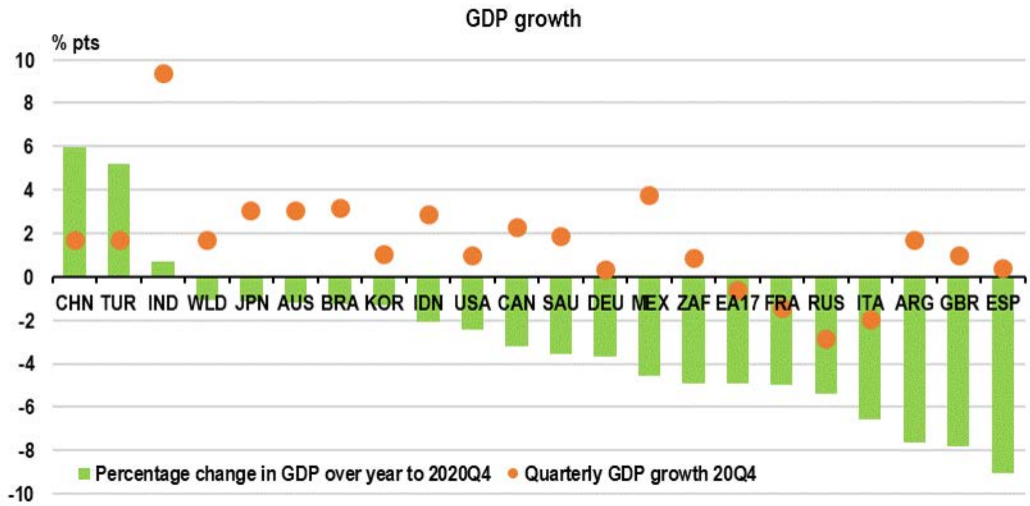
2. Spain is a permanent invitee to the G20.

3. Fiscal years, starting in April.

The rebound from the pandemic has been faster than expected

Prospects for an eventual path out of the crisis have improved, with encouraging news about progress in vaccine production and deployment and a faster-than-expected global rebound in the latter half of 2020, but there are signs of increasing divergence in activity developments across sectors and economies. Expectations for a stronger recovery are also being reflected in financial and commodity markets, with US long-term bond yields and oil prices returning to their levels prior to the pandemic.

Figure 1. Growth continued in the fourth quarter of 2020, but there are signs of rising divergence



Note: OECD projections for GDP in the fourth quarter of 2020 are used for Argentina and South Africa. World GDP is a PPP-weighted aggregate. World GDP is a PPP-weighted aggregate. Quarterly GDP growth in 2020Q4 is non-annualised.
Source: OECD Economic Outlook database.

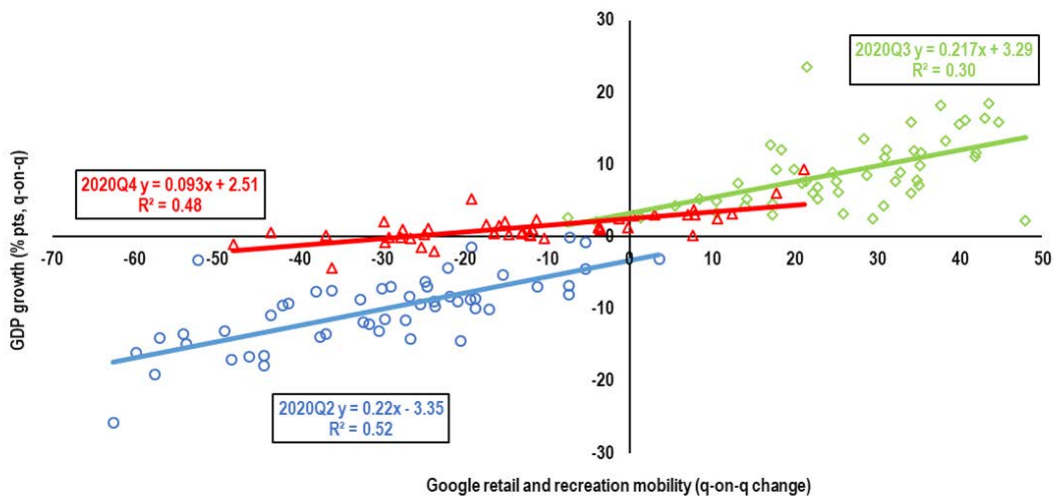
The recovery in activity continued in the fourth quarter of 2020, despite new virus outbreaks in many economies and tighter containment measures. Global output remained around 1% lower than prior to the pandemic, with marked variation in the pace of recovery across economies (Figure 1).[1] The rebound has been relatively fast in several large emerging-market economies. Activity moved above pre-pandemic levels in China, India and Turkey, helped by strong fiscal and quasi-fiscal measures and a recovery in manufacturing and construction. Output shortfalls remained relatively mild in many Asia-Pacific economies, including Australia, Japan and Korea, reflecting strong and effective containment measures, government support and the broader regional revival in manufacturing. Strong stimulus measures and improved financial conditions have boosted activity in the United States, although momentum slowed at the end of 2020. In the major European advanced economies the pace of the recovery has been more modest, reflecting extended disruptions from renewed virus outbreaks and associated reductions in working hours in many service sectors. The different sector specialisation of economies is also affecting growth, with the economies most dependent on international travel and tourism generally experiencing a larger GDP decline in 2020.

Containment measures and the associated declines in mobility now appear to be having a smaller adverse impact on activity than in the early stages of the pandemic (Figure 2). In part, this may reflect a more careful targeting of public health measures and income support. Recent restrictions have focused largely on service sectors with high levels of direct contact between consumers and producers, with manufacturing and construction activities generally affected only mildly. Businesses and consumers have also adapted to changes in working arrangements and sanitary restrictions. Whilst this helps to ensure that the economic cost of current containment measures is lower than in spring 2020, it also suggests that the economic rebound from their eventual removal might be smaller than generally expected.

[1] Differences in the national measurement of non-market service activity during shutdowns and re-openings complicate the comparison of GDP developments across economies since the pandemic began.

Figure 2. The impact of mobility restrictions on activity has moderated

GDP growth and mobility 2020Q2 to 2020Q4

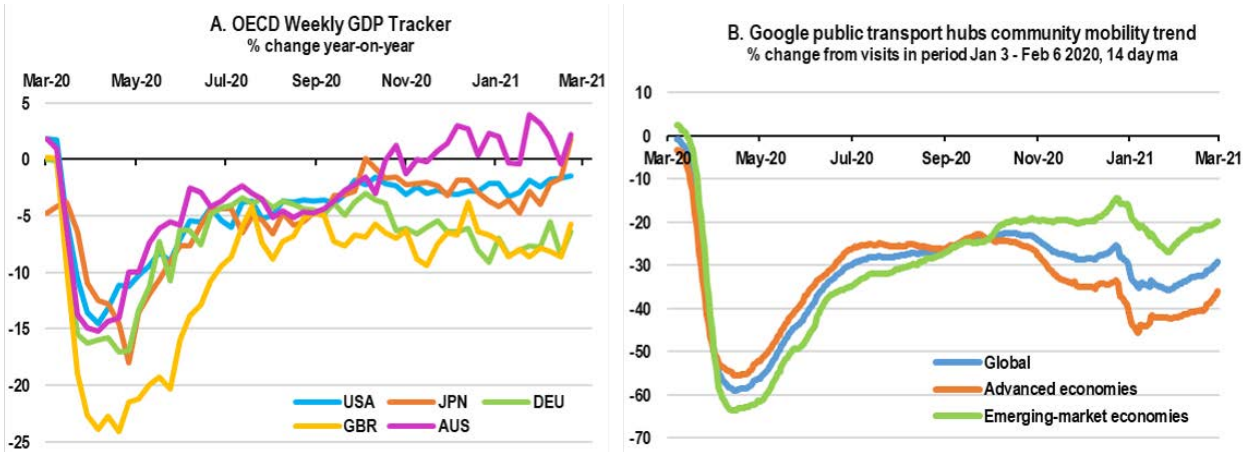


Note: Based on a sample of 51 advanced and emerging-market economies in the second (blue) and third (green) quarter of 2020, and 43 countries in the fourth (red) quarter. The coefficients imply that on average a quarterly decline (rise) of 10 points in mobility was associated with a 2.2 percentage point decline (increase) in quarterly GDP growth in 2002Q2 (and 2020Q3), and a 0.9 percentage point decline in 2020Q4.
Source: OECD Economic Outlook database; Google LLC, Google COVID-19 Community Mobility Reports, https://www.google.com/covid19/mobility; and OECD calculations.

High-frequency activity indicators point to increasing divergence in the early part of 2021 (Figure 3). The OECD weekly tracker of GDP growth, based on Google Trends search-based indicators, points to stable or improving outcomes in countries such as Australia, the United States and Japan, relative to those in countries such as Germany and the United Kingdom, where strict containment measures persist. A similar pattern is apparent in recent business surveys, with weaker output PMI indicators in the major European economies than elsewhere, particularly in services. Location-based Google mobility indicators of retail activity and travel also show rising divergence, with continued improvement in the emerging-market economies relative to the advanced economies.

Global industrial production has continued to strengthen in recent months and global merchandise trade has now returned to pre-pandemic levels (Figure 4), helped by the strong demand for IT equipment and medical supplies. Business investment has also picked up sharply, despite continued near-term uncertainty and high corporate debt. However, momentum eased towards the end of 2020 in the economies with monthly measures of economy-wide output or GDP, reflecting the impact of subdued service sector activities.

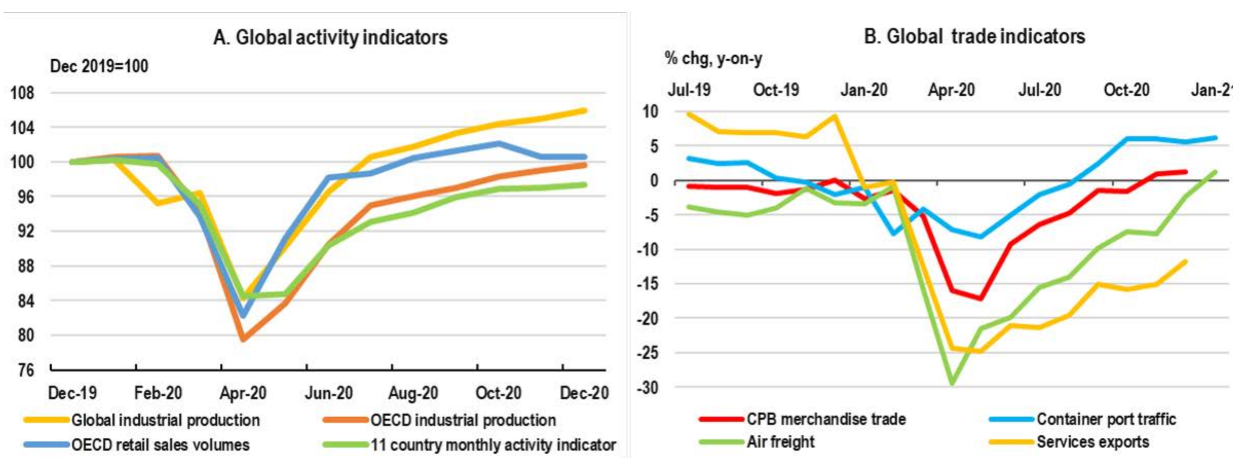
Figure 3. High-frequency indicators point to rising divergence



Note: The OECD Weekly Tracker of GDP growth is a real-time high-frequency indicator of economic activity using machine learning and Google Trends data. The Tracker provides estimates of the year-on-year growth rate of weekly GDP. Data in Panel B are location-based indicators of mobility and aggregated using PPP weights.

Source: OECD; Google LLC, Google COVID-19 Community Mobility Reports, https://www.google.com/covid19/mobility; and OECD calculations.

Figure 4. Industrial activity and trade are rebounding but service sectors have lost momentum

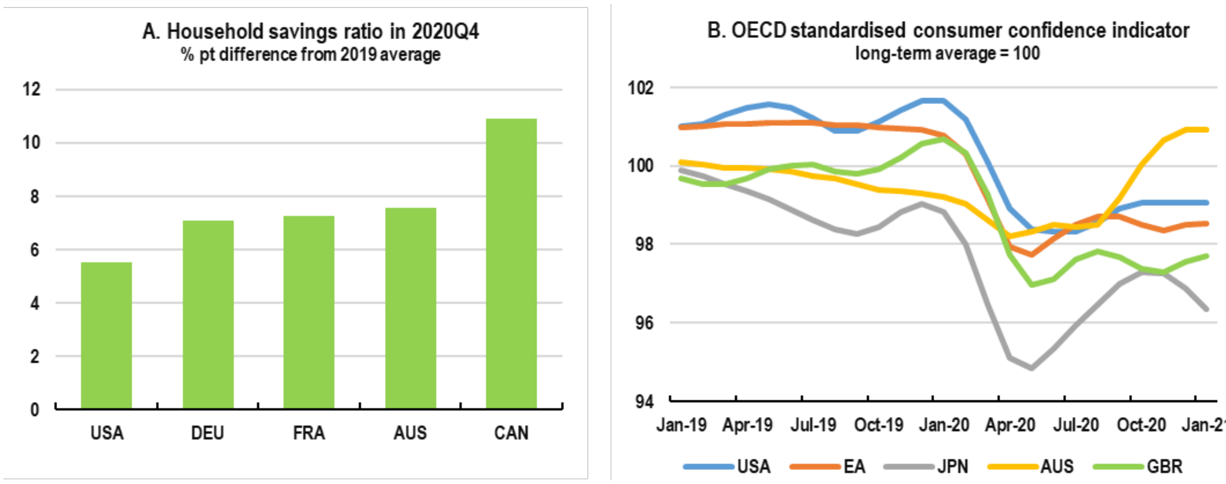


Note: Data in Panel A are PPP-weighted aggregates. The retail sales measure uses monthly household consumption for the United States and the monthly synthetic consumption indicator for Japan. The 11-country activity indicator uses GDP or economy-wide output data for Argentina, Brazil, Canada, Chile, Colombia, Finland, Japan, Korea, Mexico, Norway and the United Kingdom. Data in Panel B are all in volume terms apart from services exports, which are an aggregate of monthly nominal USD exports in 38 countries.

Source: OECD Economic Outlook database; CPB; IATA; RWI/ISL Container Throughput Index; WTO; and OECD calculations.

Consumer spending drove the initial rebound in activity as economies reopened last summer but remained broadly flat through the fourth quarter, reflecting the resurgence of health concerns and the impact of renewed containment measures on retail and leisure spending. Cross-border services trade also remained weak. Household saving rates were still well above pre-pandemic levels in the fourth quarter of 2020, providing scope for future spending, but consumer confidence has yet to recover in most countries (Figure 5). Faster progress in vaccine deployment will be needed to help restore confidence, improve labour market conditions and reduce precautionary saving.

Figure 5. Household savings provide scope for pent-up demand but confidence remains weak



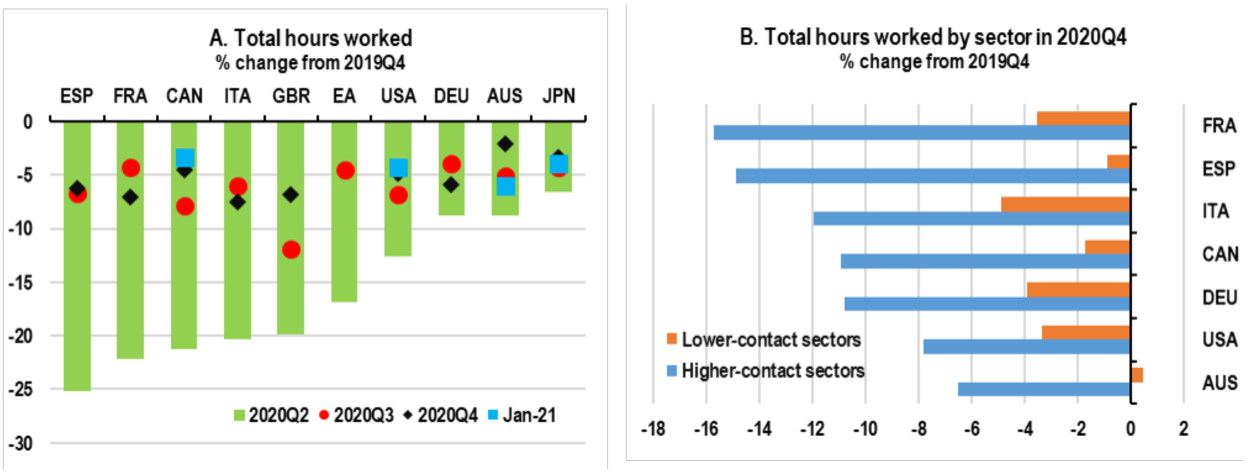
Source: OECD Economic Outlook database; Insee; OECD Main Economic Indicators database; and OECD calculations.

Labour market conditions are recovering slowly, with job retention measures such as short-time work schemes and wage subsidies continuing to help preserve employment in Europe and Japan. However, across the OECD economies, almost 10 million more people are unemployed than prior to the crisis, inactivity rates have risen and employment rates have declined. In developing countries, substantial job losses have increased poverty and deprivation of millions of workers. Total hours worked remain around 5% lower than prior to the pandemic on average in the large advanced economies (Figure 6, Panel A), with marked differences across sectors. Shortfalls are concentrated largely in job-rich service activities with high levels of social interactions (Figure 6, Panel B), such as leisure, hospitality, transportation, and retail and wholesale trade. Taken together, these sectors account for between 20-30 per cent of employment in most economies, highlighting the still-precarious nature of many jobs unless vaccines are deployed rapidly and containment measures are eased substantially. Women, youth and low-income workers are particularly exposed to such risks given the relative importance of these sectors for their employment.

Significant fiscal and monetary support continues to underpin activity. Additional discretionary fiscal measures announced in several countries during the past three months will add to the overall support this year, including in the United States, Japan, Germany, Canada, and India. Many countries have also extended existing income support schemes, or planned for their reintroduction as in Brazil. However, fiscal policy may tighten in some emerging-market economies this year, including China. In Europe, spending from the Next Generation recovery fund is due to begin later this year, but the total discretionary fiscal stimulus in 2021 appears likely to be relatively mild, at around 1% of GDP in the euro area, despite considerable spare capacity.

The extent of fiscal support in the United States this year is set to be considerably larger than in most other economies. The Consolidated Appropriations Act enacted in December contained new temporary measures worth USD 900 billion (4% of GDP), largely concentrated on emergency assistance for households and the unemployed. US household real disposable income jumped by 11% in January, and real consumer spending by 2%, with most of the additional funds initially being saved. The forthcoming American Rescue Plan provides a considerably larger stimulus, potentially raising aggregate demand by between 3-4% on average in the following four quarters, with welcome spillovers for activity in major trading partners (Box 1).

Figure 6. Labour market conditions are still weak in some sectors



Note: Economy-wide data for hours worked in all economies apart from the United States, where the data refer to total hours worked by private non-farm employees. For Japan, estimates are based on total employment and average monthly hours worked by employed persons. High-contact sectors are ones with high social interactions between consumers and producers. These include retail and wholesale trade, accommodation and food services, transportation and storage, arts and entertainment, and other personal services.

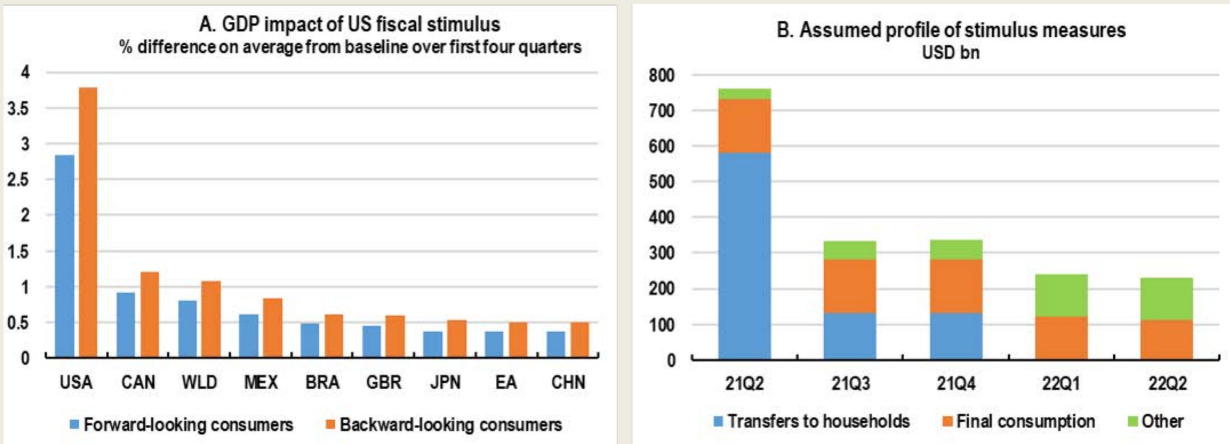
Source: Bureau of Economic Analysis; Statistics Canada; Australian Bureau of Statistics; Statistics Bureau, Japan; Eurostat; Office for National Statistics; and OECD calculations.

Box 1. The potential impact of the American Rescue Plan

The planned fiscal stimulus in the United States, set out in the American Rescue Plan, will provide a significant near-term boost to activity if enacted in full. In total, the new measures are planned to be worth up to USD 1.9 trillion (around 8½ per cent of baseline GDP). The pace at which these measures would take effect remains uncertain, although there would be a clear immediate boost from stimulus payments to households, which represent around one-fifth of the overall package of measures. Other measures, such as stronger final consumption spending at the Federal and State level and tax credits, are only partly pandemic-related and may be spread over the next year or so. Continued US monetary policy accommodation, as implied by the current policy stance, would help to raise the near-term multiplier effects of the package. However, containment measures could moderate the speed at which higher income feeds through to spending, and uncertainty is likely to enhance precautionary saving by households.

Illustrative simulations on the NiGEM macroeconomic model suggest that the proposed measures could raise US output by around 3-4 per cent on average in the first full year of the package (from 2021Q2 to 2022Q1), broadly equivalent to the spare capacity currently estimated to exist in the US economy. This helps to stimulate demand in other economies, with output rising by between ½-1 percentage point in Canada and Mexico, and between ¼-½ percentage point in the euro area and China (Figure 7, Panel A). In the near-term, US employment is also boosted, rising by between 2¼-3 million at the end of 2021, but inflation also rises, by around ¾ percentage points per annum on average in the first two years of the shock. Strong US import growth widens the US current account deficit by around ¾ per cent of GDP on average in the first four quarters of the shock.

Figure 7. The GDP impact of the stimulus will be sizeable



Note: The profile of the stimulus shown in Panel B is illustrative.
Source: OECD calculations using the NiGEM macroeconomic model.

These simulations assume that two-fifths of the overall stimulus takes effect in the second quarter of 2021, largely via higher government transfer payments, with the remainder spread over the following year (Figure 7, Panel B). Policy interest rates remain unchanged in the United States and other advanced economies until mid-2022, but are endogenous in the emerging-market economies. The simulations do not incorporate a rise in the Federal minimum wage.

The largest near-term impact of the US fiscal package arises if consumers are more sensitive to current income developments, and thus immediately benefit from the stimulus payments. In contrast, consumers more focused on the lifetime income path of incomes and the potential budgetary offset from higher tax payments in the future, may spend less of the stimulus. In either case, there are substantial near-term gains to output, but the lasting impact of the new package on output, and on inflation, after 2022 is likely to be modest. This reflects the temporary nature of the additional spending. The overall budgetary cost is lower than the size of the stimulus, with higher nominal activity offsetting around one-quarter of the initial discretionary stimulus measures, but the government debt-to-GDP ratio is raised by 6 percentage points by 2023.

An improving global outlook with persisting divergence

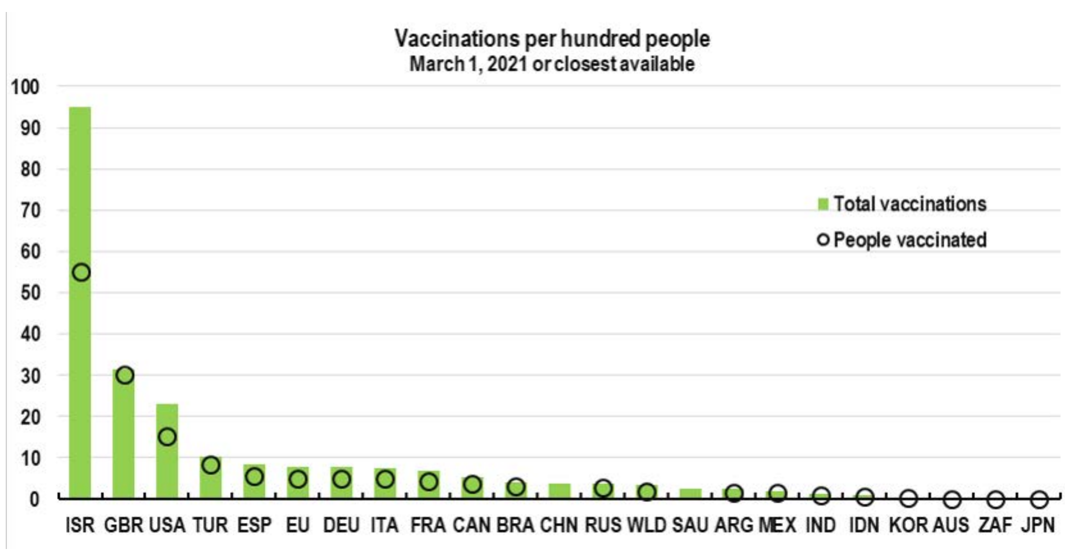
The successful development and gradual deployment of effective vaccines has improved prospects for a durable recovery significantly, provided steps are taken to ensure that such vaccines are deployed fully throughout the world. It will take some time before production can be raised sufficiently and vaccines distributed, and risks remain from potential mutations of the virus that are resistant to current vaccines. Vaccination campaigns are proceeding at different rates around the world (Figure 8), and the scale of policy support and sectoral specialisation differ considerably across economies. The evolution of the virus is uncertain, and targeted restrictions on mobility and activity may still be implemented in event of new outbreaks. Such restrictions would check the pace at which the most affected service sectors and tourism-dependent economies can rebound.

Global economic prospects have improved, with global GDP growth now projected to strengthen to 5½ per cent in 2021 and 4% in 2022. The currently projected rebound in global GDP is faster than in the December 2020 OECD Economic Outlook, reflecting the impetus provided by stronger economic activity in the latter half of 2020, increasing evidence of the efficacy of COVID-19 vaccines, and the demand stimulus from additional policy support put in place in many countries this year, particularly the United States (Figure 9).

Fiscal and monetary policy support should continue to underpin demand. Reduced uncertainty, improved confidence and, eventually, a better labour market outlook will allow households to reduce saving gradually (Figure 5), though the increasing concentration of saving amongst higher-income households with a lower marginal propensity to consume may slow the spending rebound in some countries. The upturn in global industrial production and merchandise trade should also help business investment to strengthen and boost the outlook for those economies integrated into regional supply chains. Higher commodity prices, and the delayed recovery in global travel, will however be a headwind for some emerging-market economies.

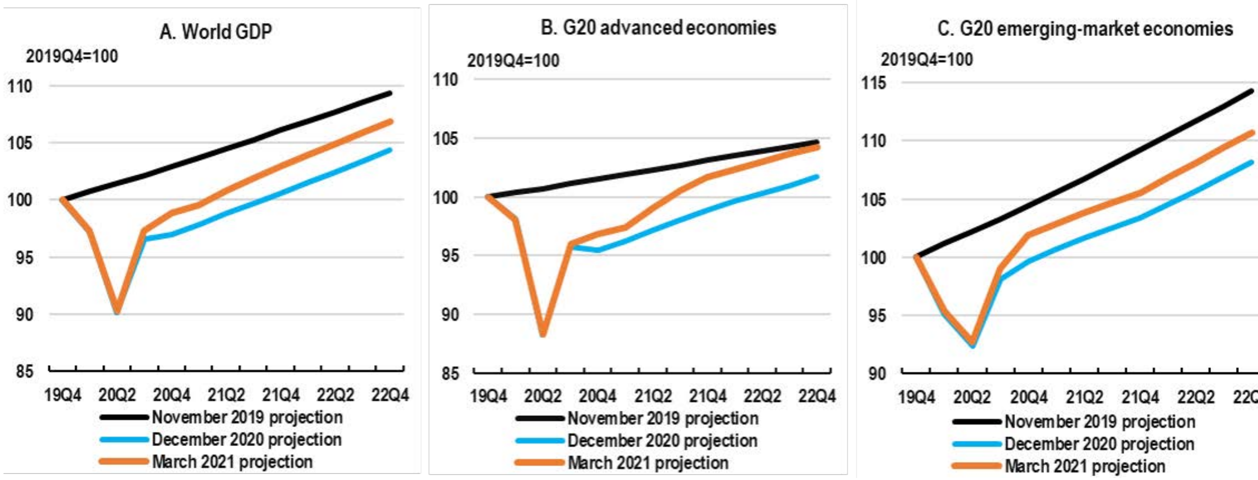
Global GDP should be above the pre-pandemic level by the middle of 2021, although this is not the case in all countries. Considerable heterogeneity in near-term developments is likely to persist, both between advanced and emerging-market economies and between wider regions. The risk of lasting costs from the pandemic also remains high, with global output projected to remain weaker than expected prior to the pandemic at the end of 2022 (Figure 10). This is particularly the case in many emerging-market economies, with the shortfall in the median G20 emerging-market economy projected to be more than twice that in the median G20 advanced economy. Turkey is a notable exception, largely reflecting the rapid rebound in the latter half of 2020.

Figure 8. The pace of COVID-19 vaccinations differs substantially across countries



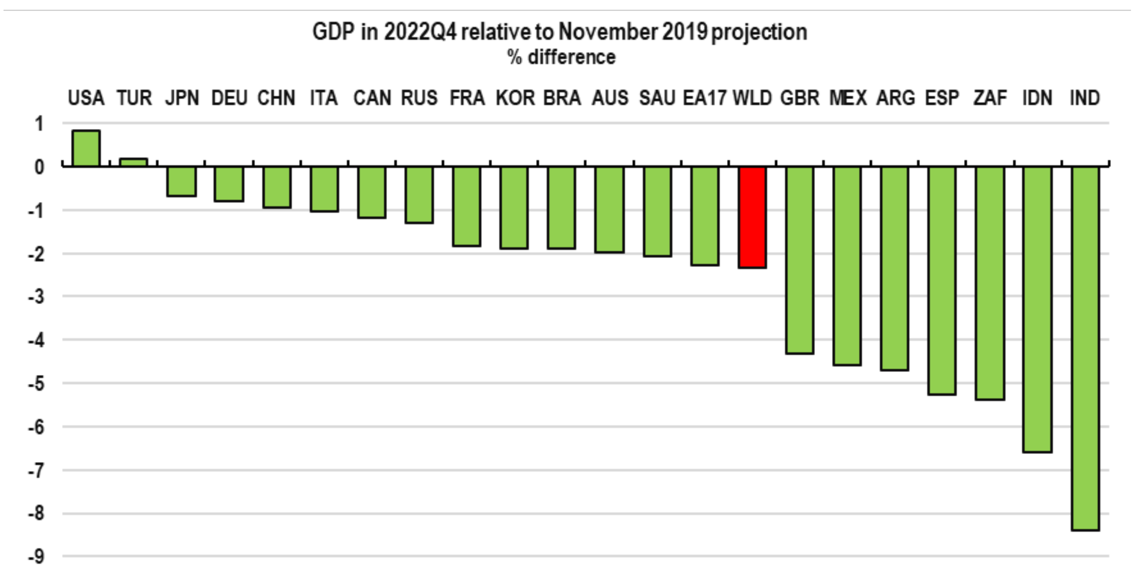
Note: Data for China and South Africa are for February 28. Data for Korea and South Africa are for March 2. People vaccinated refers to the number of people who have received at least one dose of vaccine.
Source: Our World in Data vaccination database, accessed March 3, 2021.

Figure 9. Global growth prospects have improved



Note: The November 2019 OECD Economic Outlook projections are extended into 2022 using the November 2019 estimates of the potential output growth rate for each economy in 2021.
Source: OECD Economic Outlook database.

Figure 10. The risk of lasting costs from the pandemic remains high in many countries



Note: The November 2019 OECD Economic Outlook projections are extended into 2022 using the November 2019 estimates of the potential output growth rate for each economy in 2021.
Source: OECD Economic Outlook database; and OECD calculations.

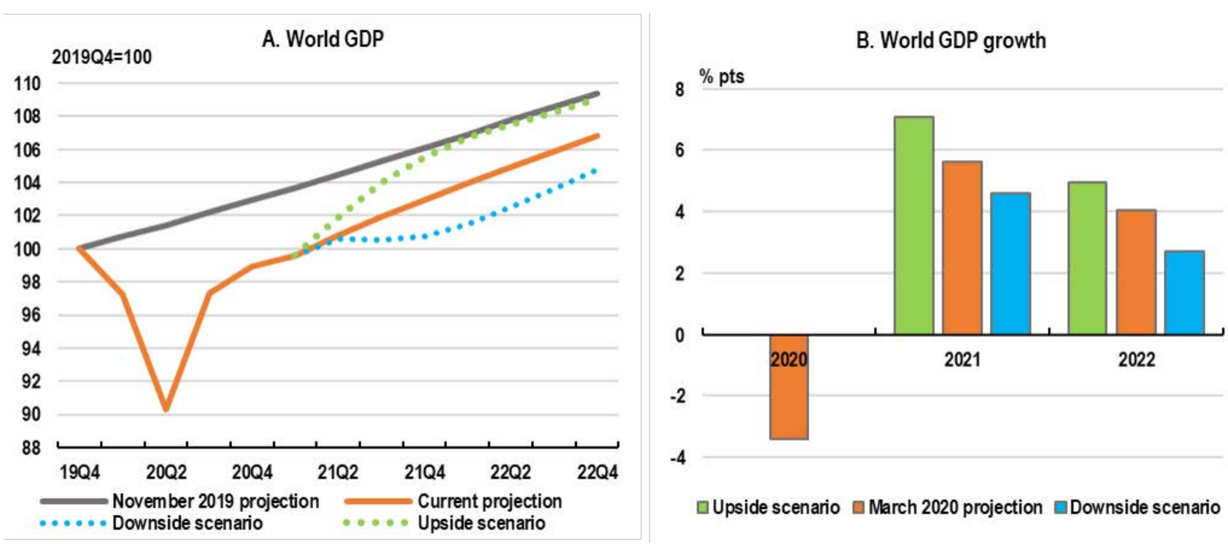
The economic impact of the pandemic and its aftermath remains well contained in many Asia-Pacific economies, reflecting effective public health measures, and the significant regional boost provided by the upturn in industrial activity and the rebound in China. Additional fiscal support will also help the recovery in Japan and India. In the United States, strong fiscal support should strengthen demand substantially and enable a stronger recovery from the pandemic, with beneficial spillovers for other economies, particularly Canada and Mexico. A more gradual upturn appears likely in the major European economies, reflecting continued containment measures in the early part of 2021 and more limited fiscal support, although the acceleration of vaccine deployment should help momentum to build, particularly in the United Kingdom. Emerging-market economies in Latin America and Africa are also facing a renewed resurgence of the virus, and the slow pace of vaccine deployment and limited scope for additional policy support is likely to moderate the recovery.

The baseline projections are conditional on the evolution of the pandemic, judgements about the pace at which vaccines can be deployed, and the economic impact of a gradual re-opening of economies through the course of 2021-22. The distribution of risks has become better balanced in recent months, but a wide range of outcomes remains possible.

On the upside, faster progress in deploying effective vaccines around the world and a wide take-up amongst the eligible population would enhance the pace at which containment measures can be relaxed and provide a stronger boost to the confidence of consumers and companies.

- In a scenario with a faster release of pent-up saving than projected, with an ex-ante decline of 1½ percentage points in household saving rates from 2021Q2, global output could be brought close to the path expected prior to the pandemic (Figure 11). Global GDP growth would be raised by around 1½ and 1 percentage point in 2021 and 2022 respectively, taking it to 7% and 5%.

Figure 11. The recovery remains subject to sizeable risks



Note: See text for description of the scenarios. The November 2019 OECD Economic Outlook projections are extended into 2022 using the November 2019 estimates of the potential output growth rate for each economy in 2021.
Source: OECD Economic Outlook database; and OECD calculations using the NiGEM macroeconomic model.

These outcomes are conditional on the assumptions that policy interest rates remain at their baseline levels and that there is no additional removal of discretionary fiscal support beyond that assumed in the baseline. The automatic fiscal stabilisers are allowed to operate fully in all countries, so that the fiscal balance improves as activity picks up. Stronger growth also helps to ease government debt burdens, with the government debt-to-GDP ratio declining by around 5 percentage points in the median advanced economy in 2022.

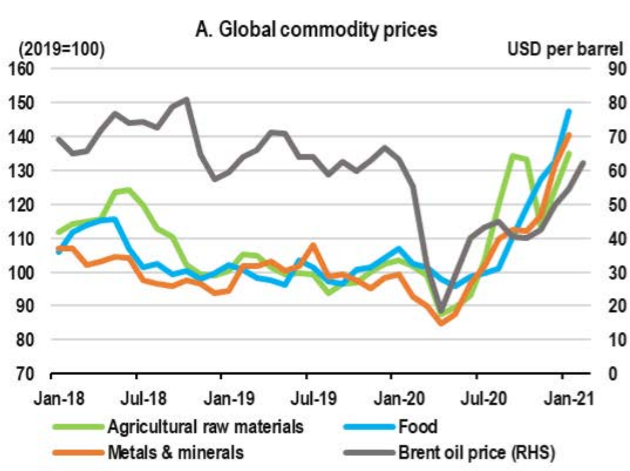
On the downside, the key risk is that the speed of vaccine production and deployment will not be fast enough to stop the transmission of the virus, especially if there is a wider emergence of new mutations that require new or modified vaccines. In such circumstances, confidence would remain weak for longer and spending would slow, with possible renewed restrictions on mobility during the latter half of 2021.

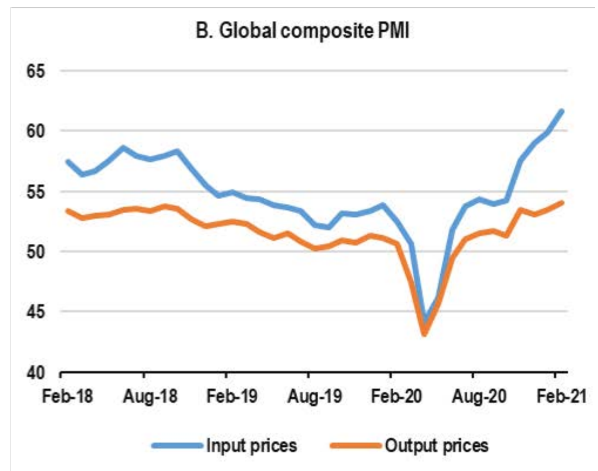
- There are potential differences across economies in the timing of downside shocks. For many emerging-market and developing economies, the risk of a slower-than-expected vaccine rollout is an immediate concern that could dampen spending. Additional risks through the projection period come from the potential emergence of new mutations of the virus resistant to current vaccines. The advanced economies, as well as vaccine suppliers such as China, India and Russia, also face potential risks from the spread of new mutations and the re-imposition of containment measures from the latter half of 2021, but face less near-term uncertainty about vaccine production and deployment, which is likely to be completed during 2021. All countries could face substantial repricing in financial markets, reflecting greater risk aversion, and weaker global commodity prices.
- In a scenario of this kind, global GDP growth could be lowered by close to 1 percentage point in 2021 and 1¼ percentage point in 2022 respectively, taking it to 4½ per cent and 2¾ per cent respectively (Figure 11). Output would remain below the pre-crisis path for an extended period, raising the chances of long-lasting costs from the pandemic. The shocks imposed include an increase in household saving rates of 1 percentage point and an ex-ante reduction of ½ per cent in the business capital stock.
- Macroeconomic policies help to cushion part of these shocks. Policy interest rates are allowed to decline, though there is assumed to be a binding zero lower bound, with policy rates remaining unchanged where they are already negative and no additional unconventional policy measures. The automatic fiscal stabilisers are also allowed to operate fully in all countries. In the median advanced economy, the government debt-to-GDP ratio is increased by over 5 percentage points in 2022.

Some signs of inflation have begun to emerge

The improved prospects for a sustained global recovery have been reflected in rising expectations of future inflation, particularly in financial markets. Headline inflation has recently risen in many advanced economies, and remains high in some emerging-market economies, in part due to jumps in commodity prices and past currency depreciation. A faster-than-expected recovery in demand, especially from China, coupled with shortfalls in supply, has pushed up food and metals prices considerably, and oil prices have rebounded to their average level in 2019 (Figure 12, Panel A). Temporary supply shortages in specific sectors, including semi-conductors and shipping, are also contributing to the higher input cost pressures apparent in business surveys (Figure 12, Panel B). Underlying price pressures generally remain mild in the advanced economies, reflecting sizeable spare capacity and still weak labour markets (Figures 6 and 14), although one-off factors, such as re-opening in sectors previously subject to containment measures and indirect tax changes, are contributing to inflation at present. In the major emerging-market economies, inflation could be higher than expected if domestic currencies depreciate further due to rising relative returns in the United States. Higher commodity prices will also raise inflation in net commodity importers, such as India and Turkey, relative to commodity exporters.

Figure 12. Cost pressures have begun to rise





Source: Refinitiv; and Markit.

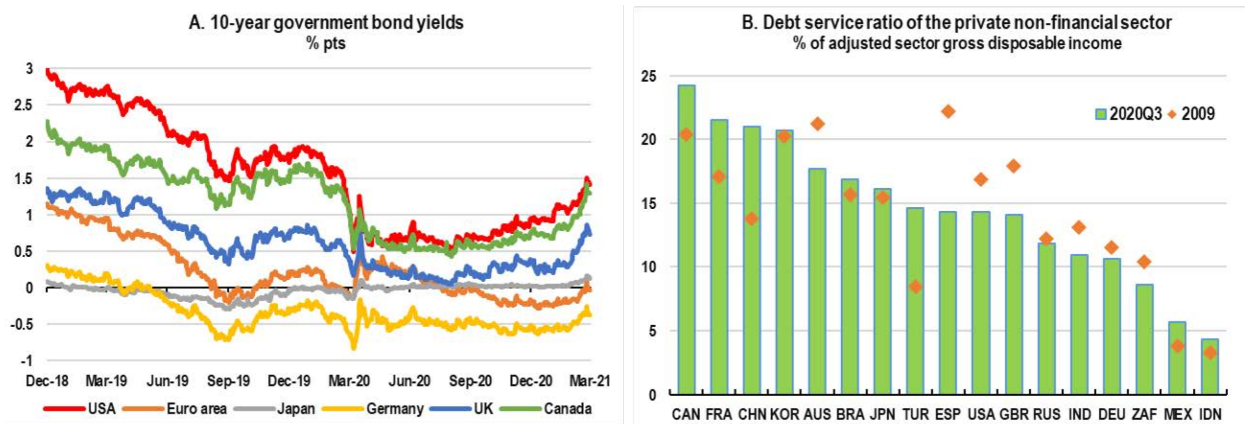
Significant financial market vulnerabilities persist

Rapid and sweeping responses by central banks, along with government business support programmes, continue to support financial market conditions. Nonetheless, substantial risks remain in particular market segments, including concerns over elevated equity valuations and strong house price growth in some economies. Underlying credit quality has also declined, with investors moving into riskier market segments in a search for yield, increasing their exposure to lower-rated companies and emerging-market economies. The return of long-term interest rates on US government bonds to around 1½ per cent at the end of February, their level immediately prior to the pandemic, has triggered a round of repricing across financial markets. Bond yields are now rising in other countries and market segments, although they generally still remain very low (Figure 13, Panel A).

A particular risk for emerging-market economies is that rising US bond yields could trigger a reversal of capital flows and higher currency volatility, as experienced during the "taper tantrum" in 2013. Stronger-than-expected inflation effects from the US fiscal stimulus, or increasing divergence between the recovery in the United States and other advanced economies, would heighten such risks. The dependence of most emerging-market economies on external financing is currently lower than in 2013, with higher private sector saving offsetting high sovereign borrowing, which should reduce the impact of capital flow reversal. However, rising commodity prices will place pressure on the external balances of net commodity importers, and many economies will continue to be adversely affected by the continued weakness of international travel and tourism.

A broader concern in all economies is the high level of debt, especially corporate debt, with private sector debt service burdens at or above their level during the global financial crisis despite historically low nominal interest rates (Figure 13, Panel B). Although some firms have used borrowing to build up sizeable cash buffers since the onset of the pandemic, high leverage could moderate new investment. More generally, a slow recovery, as in the downside scenario above, or ending government support schemes too soon could trigger additional debt delinquencies or defaults, with adverse pressures on lenders from non-performing loans and a heightened risk of rising bankruptcies. Congestion in bankruptcy courts could then lead to the liquidation of businesses that would otherwise be viable after restructuring. Young firms, small and medium-sized enterprises (SMEs), and businesses in the sectors hardest hit by containment measures, particularly leisure and hospitality, are most exposed to the risk of failure.

Figure 13. Bond yields have begun to increase and private debt service burdens are high in some countries



Note: The debt service ratio is defined as the ratio of interest payments plus amortisations to income. Gross disposable income is augmented by interest payments (and dividends for non-financial corporations) to reflect the income available to service debt.
Source: Refinitiv; BIS debt service ratios statistics; and OECD calculations.

Public sector support through loans, credit guarantees and tax deferrals, along with temporary changes to insolvency regimes, has so far prevented a sharp rise in bankruptcies during the pandemic. Governments face increasingly challenging choices in finding the balance between supporting ultimately viable firms who can switch back to private capital markets as the recovery progresses, and phasing out support for other businesses. Debt financing has helped to ease immediate liquidity constraints, but equity-type financing would be beneficial for many businesses, including SMEs. Possible approaches could include converting some pandemic-related public loans into grants, with repayment conditional on performance and regular assessments of viability, or providing incentives for private sector equity financing and co-participation in public support schemes.

Continued policy support is needed to improve the prospects for a sustainable and inclusive recovery

Policies play a pivotal role in supporting the economy while the health crisis persists and in easing the adjustment to a post-COVID-19 environment. Effective and well-resourced health policies to ensure vaccines are deployed throughout the world, as well as supportive and flexible macroeconomic and structural measures, are essential to strengthen confidence, overcome the impact of the virus, and reduce the long-run costs of the pandemic on living standards.

The pace of vaccine production and deployment needs to be accelerated

The key priority, both on epidemiological and economic grounds, is to ensure vaccines are produced and deployed as quickly as possible for the adult population. Everything necessary should be done to enhance the capacity for a faster pace of vaccinations and ensure that supplies are used fully as they become available. Failure to do so would raise the long-lasting economic and social costs from the pandemic.

National policy efforts need to be accompanied by greater global co-operation and funding to ensure adequate and timely availability of affordable vaccines throughout the world. At present, the supplies of vaccines for the poorest countries, and the funds committed to the COVAX initiative, remain well below what is required if vaccinations are to be provided to all in need. Failure to ensure the global suppression of the virus raises the risk that new, more threatening mutations appear, with some restrictions on mobility having to remain in place. The announcement by some high-income countries, including Canada and the United Kingdom, that surplus vaccines will be distributed to lower-income economies is welcome, and provides an example for others.

Governments also need to provide sufficient resources to allow test, track, trace and isolate programmes to operate effectively and limit further sharp rises in infection numbers, as has been achieved in several Asia-Pacific countries. Such steps would allow timely and targeted localised measures to be used to deal with any new outbreaks before vaccination campaigns are complete, limiting the overall economic and social costs.

Monetary policy should remain accommodative

Accommodative monetary policies need to be maintained in the major advanced economies, as currently planned, to help preserve favourable financing conditions and low long-term interest rates. The current numerous monetary and financial policy programmes offer ample flexibility to deal with fluctuations in the pace of the recovery and heightened financial market volatility. Buffers still exist within the current programmes for emergency lending and bank lending support and the pace of asset purchases can be varied if required. Macroprudential tools can also be deployed to help ensure stability in financial and housing markets if asset valuations appear stretched.

Transitory factors that push up headline inflation do not warrant changes in the policy stance. Underlying price pressures generally remain mild, held in check by ample spare capacity around the world. In the United States, the likely boost to demand from the new fiscal stimulus measures helps to ease the burden placed on monetary policy to support the economy. Strong demand growth may push up US inflation to some extent, but the new flexible average inflation-targeting framework should allow this to be accommodated without immediate increases in policy interest rates. In emerging-market economies, scope exists to further ease interest rates in several economies where fiscal support is limited, provided the effects of higher commodity prices on inflation can be contained and exchange rates remain stable. Enhanced currency swap lines between the major central banks could help to ensure orderly market conditions.

Fiscal policy should continue to support demand and be well-targeted

Strong and timely fiscal support since the onset of the pandemic has played a vital role in supporting incomes and preserving jobs and businesses. A premature and abrupt withdrawal of support, as in the aftermath of the global financial crisis, should be avoided whilst economies are still fragile and growth remains hampered by containment measures and a slow pace of vaccinations. Debt levels have risen substantially but debt-servicing costs remain low, helped by the space provided by very accommodative monetary policy. In the advanced economies, ensuring debt sustainability should be a priority only once the recovery is firmly in place.

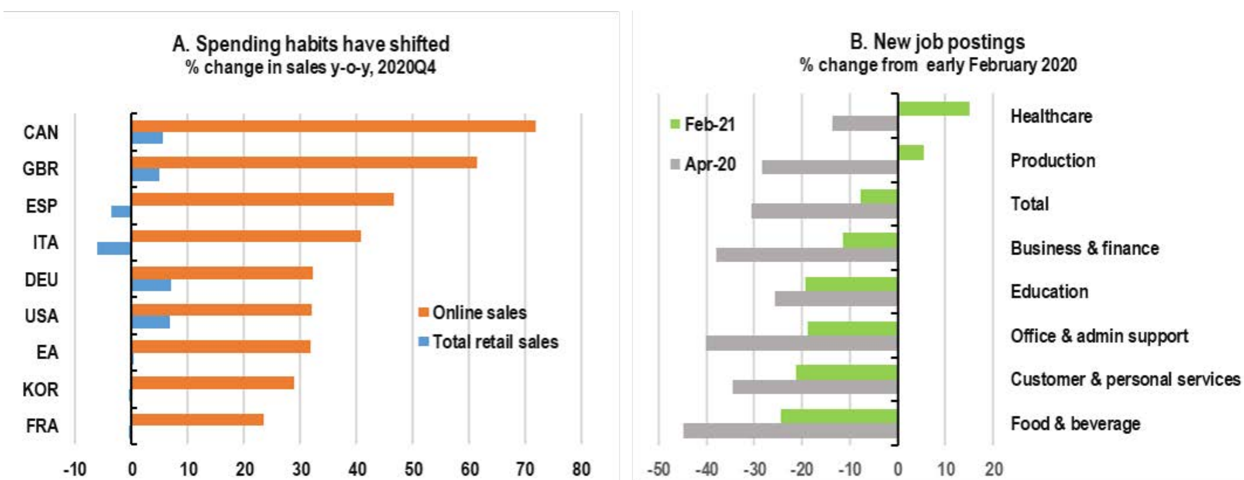
New fiscal measures, recently decided or currently planned, need to be implemented quickly and effectively to give a boost to growth and enhance job opportunities. Where new medium-term spending plans have been established, as in the EU economies, intensified efforts must be made to bring actual disbursement forward and fully utilise the resources available. At the same time, the initial broad support to the whole economy will need to evolve towards more targeted support to the hardest-hit sectors as the recovery progresses, facilitating labour and capital reallocation from sectors facing structural demand weakness. Decisions about the expiry of special programmes should be contingent on the state of the economy and the sanitary situation, and if necessary be offset by other more targeted measures.

The extent of fiscal support is likely to vary significantly across economies over the next two years (as discussed above), with substantial extra spending in the United States, and to a lesser extent Japan and Canada, but limited discretionary measures in others, particularly in Europe. Nonetheless, budget deficits will remain large, as appropriate, and the automatic fiscal stabilisers should be allowed to operate fully. In the emerging-market economies, fiscal support should be maintained while market conditions remain favourable and where debt sustainability is not at risk.

Structural reforms are needed to improve resilience, facilitate reallocation and strengthen growth prospects

Enhanced structural reform efforts are required in all countries to raise opportunities for displaced workers, improve economic dynamism, and foster resource reallocation towards sectors and activities that strengthen growth, improve resilience and contribute to environmental sustainability. The crisis is likely to require some labour and capital reallocation, although the extent remains uncertain. Some sectors most affected by physical distancing requirements and associated changes in consumer preferences may be permanently smaller after the crisis. A lasting shift towards remote working, reductions in business travel and the increasing digital delivery of services, including e-commerce, could also change the mix of jobs available and the location of many workplaces (Figure 14). Such potential shifts would accentuate long-standing pre-pandemic challenges from an extended period of weak growth, widening inequalities in outcomes and access to opportunities, and the need to adjust to digitalisation and climate change.

Figure 14. The pandemic has led to marked changes in product and labour markets



Note: Retail sales in current prices. Internet and mail order house sales in the euro area, internet sales in the United Kingdom, online e-commerce sales in the United States and Canada, and online shopping in Korea. Data for Canada do not include online purchases from foreign-based retailers. Data for Korea are from the Online Shopping Survey and exclude non-goods purchases. The annual growth of online sales in France is based on the change over the year to October and November 2020. Data in Panel B are seasonally-adjusted online job postings by type of occupation and aggregated over 20 countries. April 2020 and February 2021 respectively refer to the weeks 24-30 April 2020 and 21-27 February 2021.

Source: US Department of Commerce Statistics Canada; Eurostat; Office of National Statistics; KOSIS; Indeed; and OECD calculations.

The policies put in place to foster the recovery from COVID-19 are an opportunity to address these old and new challenges if economic stimulus measures and recovery plans combine an emphasis on restoring growth and creating jobs with the achievement of environmental goals and improved resilience. As past OECD research has shown, the eventual scars from a large recession are likely to be smaller in countries in which product and labour markets can accommodate the necessary reallocations of capital and labour in the aftermath of the shock.

The sequencing of reforms will be particularly important to help the economic recovery gain traction. Measures with a fiscal dimension, such as planned public infrastructure investments in digital networks, transportation and energy, can help support demand, improve productivity and be an important source of new jobs for displaced workers. Strong income support for poorer households helps to make the recovery more inclusive and support demand, given their high marginal propensity to spend. Strengthening economic dynamism by tackling barriers to market entry, and enhancing activation and skill acquisition, will also improve labour market opportunities for all and help to foster productivity-enhancing reallocation.

To facilitate the reallocation of labour resources, government measures put in place at the height of the pandemic to support jobs and incomes need to become more targeted, increasingly focus on people rather than jobs, and be accompanied by structural measures to enhance training and aid job search and placement. Setting clear state-contingent criteria for this support, such as linking the resources used to changes in labour market conditions, could help to increase the effectiveness of reforms.

The shift towards the use of online platforms and teleworking during the pandemic has underlined the opportunities provided by digital technologies. Effective and well-targeted policies are required to accelerate the digital transformation of public and private sector activities and ensure that poorer households, small firms, remote regions and lower-income countries are not left behind. Improving broadband connectivity, helping firms develop online business models, enhancing digital skills, and ensuring secure online payments and data privacy, are all areas in which further reforms would accelerate the adoption of digital technologies.

Government efforts to support the economic recovery also need to incorporate the necessary actions required to foster the shift from fossil fuels to renewables and limit the long-term threat from climate change. Sector-specific financial support measures should remain conditional on environmental improvements where possible, such as stronger environmental commitments and performance in pollution-intensive sectors that are particularly affected by the crisis. Early signalling of future alignment of long-term price signals with environmental and climate policy objectives, including through carbon pricing, would lower environmental policy uncertainty and improve the prospects for the funding of investments in clean technologies, although compensating measures would be essential to mitigate the adverse impact on poorer households and small businesses. Well-designed large infrastructure investment projects, including expanded and modernised electricity grids and spending on renewables, and projects with shorter payback periods such as more energy-efficient buildings and appliances can also be a source of demand and new employment opportunities at an early stage of the recovery.

OECD Economic Outlook, Interim Report

Strengthening the recovery: The need for speed

The COVID-19 pandemic continues to cast a long shadow over the world's economies but economic prospects have improved with the forthcoming global vaccines rollout, although divergences are increasing across and within countries.

This Interim Report provides updates for G20 country projections made in the December 2020 issue of the OECD Economic Outlook (Number 108).

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