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RESEARCH ARTICLE

AN EMPIRICAL EVIDENCE OF ECONOMIC RECOVERY DURING THE PANDEMIC PERIOD INTO WORLD ECONOMY

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Abstract

We are in the midst of an asymmetrical recovery. In some countries, COVID-19 infection rates have fallen significantly, while in others, the virus remains difficult to control. But whether governments are actively managing outbreaks or returning to normality, economic recovery is central to their forward-looking agenda; without a broad-based economic expansion, it is difficult to address other challenges, such as education and healthcare.The International Monetary Fund(IMF) recently raised its projection for economic growth in 2021 to 6%, up from 5.5%, and projects 4.4% growth in 2022. The upgraded outlook is based on how well the pandemic continues to be controlled, the efficacy of fiscal policy in mitigating economic damage and global financial conditions. Although businesses are the engines of the economy, governments create the environment and structure that enable enterprise to flourish . How governments create and shape the environment for economic recovery—and the opportunities and challenges they face in doing so—will depend on two decisions they make about their approach.

Introduction:-

The Framework of Economic Issues

The global economic recovery is continuing, even as the pandemic resurges. The fault lines opened up by COVID-19 are looking more persistent—near-term divergences are expected to leave lasting imprints on medium-term performance. Vaccine access and early policy support are the principal drivers of the gaps.[1]

Rapid spread of Delta and the threat of new variants have increased uncertainty about how quickly the pandemic can be overcome. Policy choices have become more difficult, confronting multidimensional challenges—subdued employment growth, rising inflation, food insecurity, the setback to human capital accumulation, and climate change—with limited room to maneuver.

A year and a half since the onset of the COVID-19 pandemic, the global economy is poised to stage its most robust post-recession recovery in 80 years in 2021.But therebound is expected to be uneven across countries, as major economies look set to register strong growth even as many developing economies lag.[2]

[1]IMF, World Economic Report(2021)

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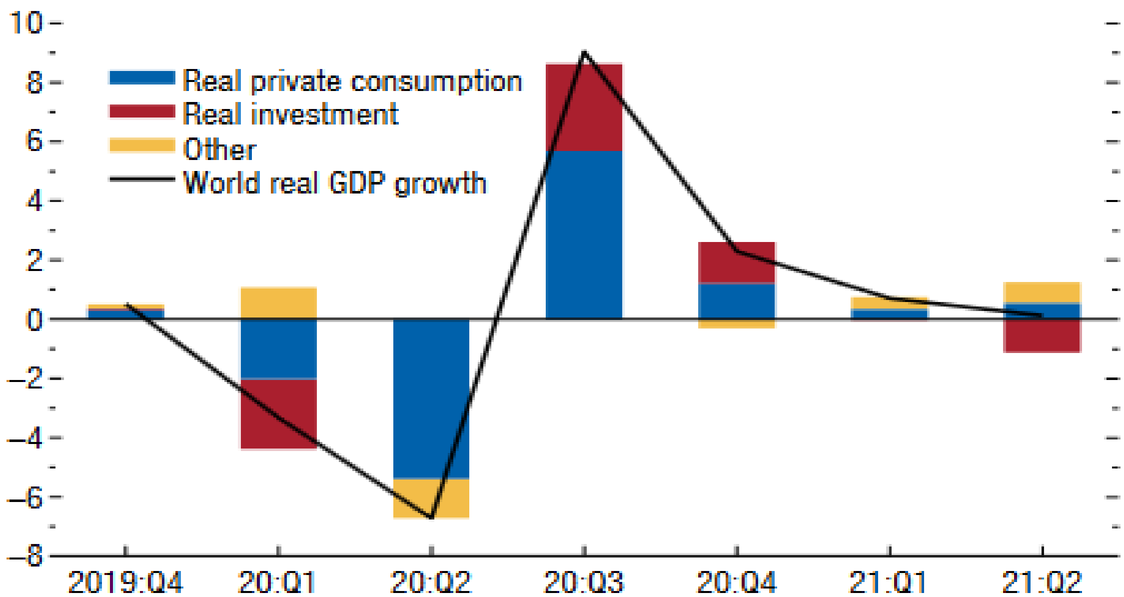
GDP growth in the first half of 2021 was broadly in line with expectations. Outturns for first quarter global GDP were stronger than anticipated, reflecting continued adaptation of economic activity to the pandemic and associated restrictions as well as ongoing policy support in many countries. Momentum, however, weakened in the second quarter, weighed down by increasing infections in many emerging market and developing economies and by supply disruptions. Expenditure decompositions are consistent with input shortages contributing to weak investment in the second quarter (Figure 1.1):

Figure 1.1:- Drivers of Global Growth.

Supply disruptions are weighing on private investment.

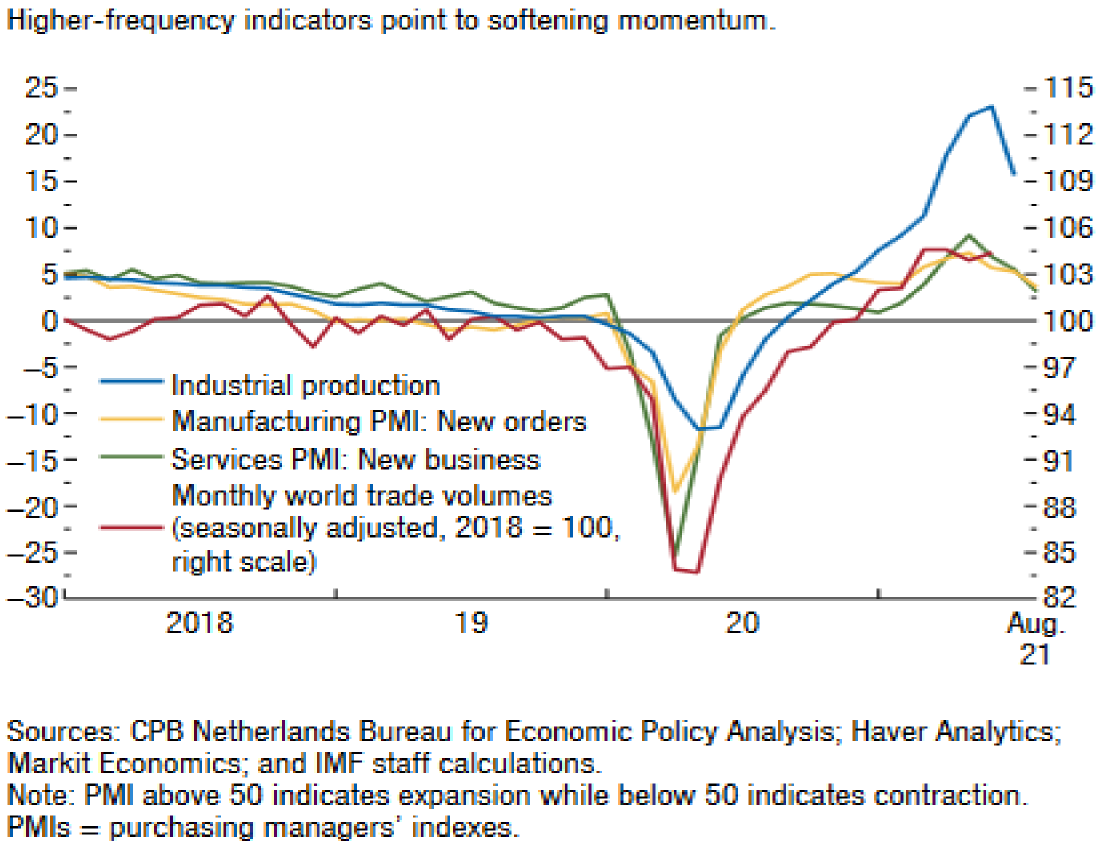


Sources: Haver Analytics; and IMF staff calculations.
Note: The estimate of world real GDP at the quarterly frequency is based on a sample of economies covering 79.4 percent of global economic activity in 2020. "Other" includes the sum of contributions from public consumption and a residual component, which mixes contributions from the sample's net exports to economies not covered and a statistical discrepancy.

Recent high-frequency data are mixed. They suggest that the recovery continues, but with some softening in the third quarter, even while broadening across sectors. Services production is expanding, albeit prone to setbacks (Figure 1.2).

[2] IMF, World Economic Report(2021)

Figure 1.2.:- Global Activity Indicators.



Empirical Results

According to IMF[3], the outlook for the low-income developing country group has darkened considerably due to worsening pandemic dynamics. The downgrade also reflects more difficult near-term prospects for the advanced economy group, in part due to supply disruptions. Partially offsetting these changes, projections for some commodity exporters have been upgraded on the back of rising commodity prices. Pandemic-related disruptions to contact-intensive sectors have caused the labor market recovery to significantly lag the output recovery in most countries.The dangerous divergence in economic prospects across countries remains a major concern. [4]

Since the beginning of 2021, headline consumer price index (CPI) inflation has increased in advanced and emerging market economies, driven by firming demand, input shortages, and rapidly rising commodity prices. Despite large uncertainty about the measurement of output gaps around the pandemic, a significant relationship remains between economic slack and inflation. Long-term inflation expectations have stayed relatively anchored so far, with little evidence that recent exceptional policy measures have de-anchored those expectations[5]. Looking ahead, headline inflation is projected to peak in the final months of 2021, with inflation expected back to pre-pandemic levels by mid-2022 for both advanced economies and emerging markets country groups, and with risks tilted to the upside. Long-term inflation expectations are projected to remain anchored in the baseline forecast[6]. Given the recovery's uncharted nature, considerable uncertainty remains, particularly relating to the assessment of economic slack. Prolonged supply disruptions, commodity and housing price shocks, longer-term expenditure commitments, and a de-anchoring of inflation expectations could lead to significantly higher inflation than predicted in the baseline.

[3]IMF, World Economic Report(2021)

[4]Agarwal, Ruchir, and Gita Gopinath. (2021)

[5]Barnichon, Regis, and Geert Mesters. (2021)

[6]Reinsdorf, Marshall. (2020).

Clear communication, combined with appropriate monetary and fiscal policies tailored to country-specific contexts, however, could prevent “inflation scares” from unhinging inflation expectations.[7]

The global recovery is strong but imbalanced

Output in most OECD countries has now surpassed its late-2019 level and is converging on its pre-pandemic path but lower-income economies, particularly those where vaccination rates are low, are at risk of being left behind.

The unevenness of the recovery is widespread

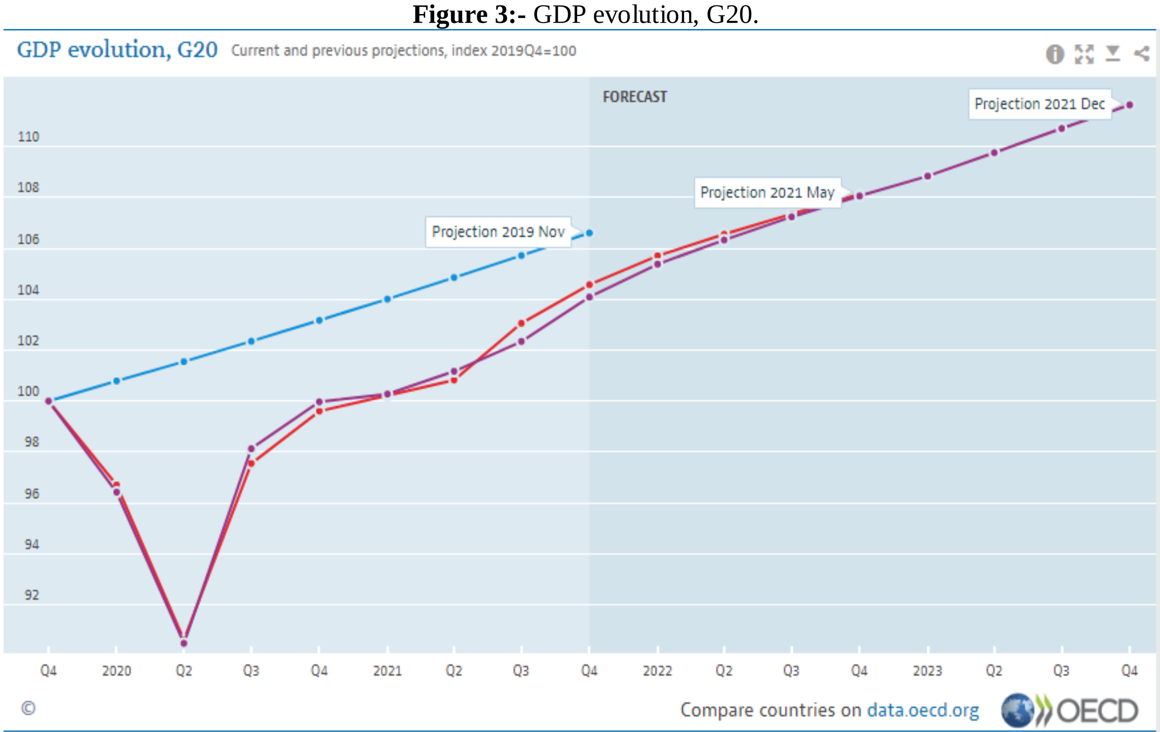
The recovery is also uneven within advanced economies. Employment is still relatively weak in the United States, but is already higher than its pre-pandemic level in the Euro Area. At the same time, United States GDP has recovered faster than Europe’s. Different protection models mean different challenges looking ahead.

The labour market is imbalanced. Many people are struggling to find jobs yet businesses in a number of sectors have difficulty recruiting workers. The skills demanded in the wake of the crisis are not necessarily the same as before.

A shortage of workers in some sectors also reflects a decline in labour force participation rates in most OECD countries. Participation is expected to normalise as the effects of the pandemic wane increasing labour supply helping to keep wage growth moderate.

Imbalances also remain across industries, with sectors dependent on interpersonal contact such as travel, tourism and leisure continuing to suffer, while demand for consumer goods has been strong, especially in the United States.

Figure 3:- GDP evolution, G20.



Strong goods demand faces supply bottlenecks

The rebound is losing some momentum as the surge in demand for goods has met bottlenecks in production chains. Inflationpressureshaveemerged in alleconomies, as:

1. disruptions in energy, food and commodity markets have pushed up prices
2. high energy prices and fuel shortages are limiting manufacturing of key materials and intermediate goods
3. bottlenecks in production chains are spreading to more generalised shortages of goods.

[7]Bems,et. Al (2021).

The renewed inflationary pressures risks lasting longer than was expected a few months ago. Rising food and energy prices are hitting low-income households in particular.

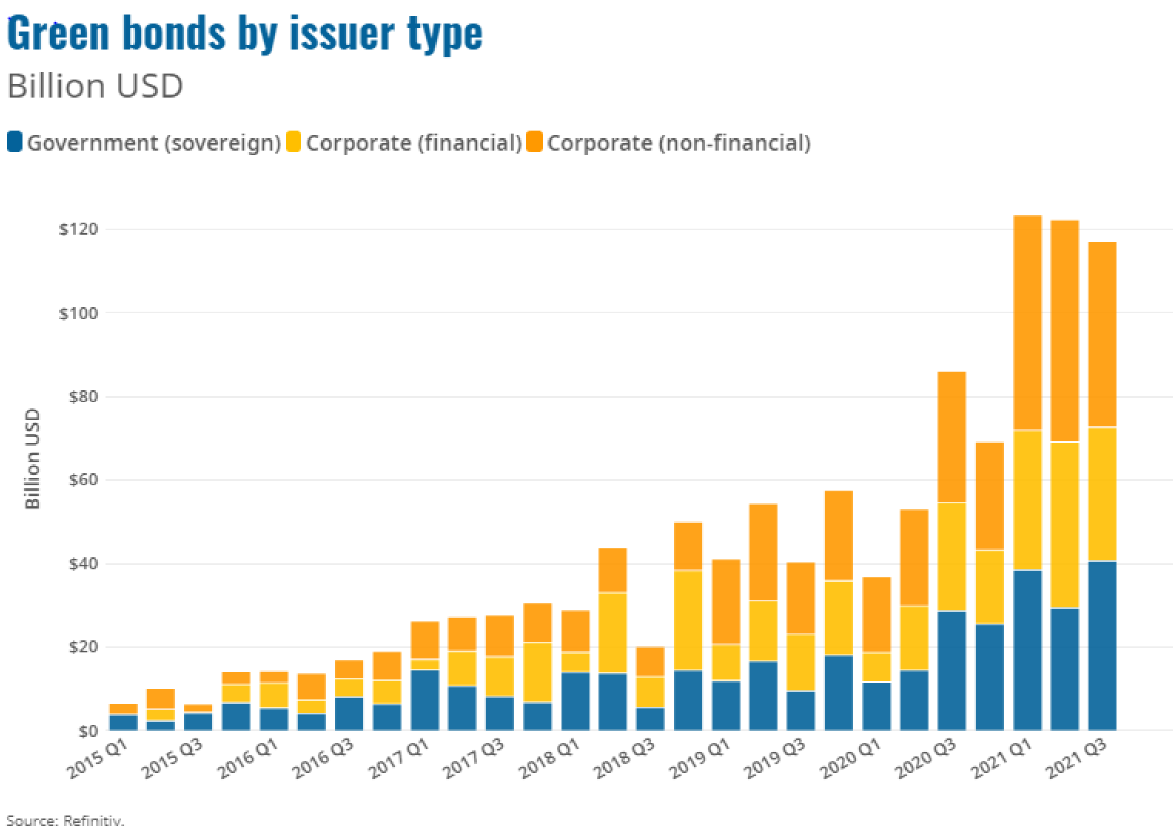
Green bonds grow – but challenges remain

Global green bond issuance volumes topped USD 362bn in the nine months to September 2021, according to Refinitiv data – more than double the volume in the same period 2020 (their share of global bond issuance surging from 2.1% to 4.6%).

A shift in investor sentiment has driven the market's rapid growth. Unlike conventional bonds, investor proceeds must be earmarked for "green" projects, as part of the wider effort to reallocate capital to lower-carbon, less-polluting economic output. ("Sustainable bonds", a broader category that includes green bonds, "social bonds" and others, now accounts for nearly 10% of all global bond issuance volume.)

There are challenges, including methodological frameworks on third party verifications and quantifiable impact assessments. Investor sentiment will continue to drive market growth – but whether green bonds are greening the economy remains to be seen.

Figure 4:- Green bonds by issuer type.



Government support measures for fossil fuels across 81 economies tumbled to USD 351 billion in 2020, 45% off its peak two years earlier, according to OECD and IEA data, as energy prices fell following the COVID-19-induced economic shock[8].

As economies have reopened, energy prices have soared, with fossil fuel subsidies and other types of support measures expected to follow suit in 2021 (although complete data are not yet available).

Support for fossil fuels encourages their continued production and consumption, crowds out investment in sustainable energy infrastructure and other public services, and disproportionately benefits households that use more

[8] A Balancing Act, OECD Economic Outlook, December 2021

fuel and energy, which tendto be wealthier. This is a challenge for governments' net-zero pledges. Seeking ways to target support for low-income households may be the key[9].(OECD,2021)

1. National economies are beginning to return to pre-pandemic levels - but at wildly different paces.
2. US, South Korean, Japanese and German economies should return to normal by the end of 2021 - South Africa and Argentina could be waiting until 2025.
3. Whilst there are difficulties, an efficient worldwide COVAX programme can ensure countries experience a more even recovery, writes a finance expert.

National economies are beginning to return to their pre-pandemic levels. But like the uneven impact of the pandemic itself, the pace of economic recovery is massively divergent across countries.

In 2020, the global economy contracted by 4.3%, with some countries doing considerably worse than others. For example, the UK economy suffered its worst recession in 300 years, shrinking by nearly 10%. The resulting impact on jobs was also unprecedented, and ten times worse than during the 2009 global financial crisis, with 114 million jobs lost globally in 2020.

More than a year on from the start of the pandemic, global prospects appear to be improving, according to recent reports by the OECD and the World Economic Forum. The data shows that some countries – such as the US, South Korea, Japan and Germany – are on course to recover to pre-pandemic levels of GDP per capita by the end of 2021.[10]

But others, such as Spain and Iceland, both of whom suffered a huge blow from the collapse in tourism revenues, are expected to operate below pre-pandemic levels until at least mid-2023. Worse still, countries such as South Africa and Argentina are forecast to remain below their 2019 levels until the end of 2024, or well into 2025[11].

Uneven Recovery Model

Two main factors underpin the speed of a country's economic recovery from the pandemic: the strength of its COVID-19 policy response, and the success of its vaccination programme.

Unsurprisingly, the UK and the US, with the highest projected growth rates among advanced economies – 7.2% and 6.9%, respectively – also top the league tables for size of pandemic response policy packages and share of the population successfully vaccinated.

Leaders across the globe deployed a range of economic policy responses in the fight against the pandemic. Public spending measures included transfers to (low-income) households, grants and tax holidays to businesses, and additional funding for healthcare systems. Some supplemented conventional interest rate cuts with unconventional measures such as liquidity injections and asset purchases. Many governments also used financial measures including foreign exchange interventions.

Importantly, policy action varied significantly across countries in type, size and scope. The pandemic hit emerging markets harder than advanced economies, unlike in the aftermath of the 2008 global financial crisis. Many poorer countries have found it harder to contain and mitigate the virus because of their limited healthcare capacity, and with less ability to expand public spending, suffered greater losses from the pandemic.

The divergence in recovery can also be linked to the varying success of national vaccination programs – as the OECD put it, "more jabs, more jobs". For example, while Israel has vaccinated about 60% of its population, in many other countries, fewer than one in ten have received any vaccinations. Israel's economy is expected return to pre-pandemic levels by early 2022.[12]

[9] A Balancing Act, OECD Economic Outlook, December 2021
[10] A Balancing Act, OECD Economic Outlook, December 2021

[11]OECD, Global Outlook, December 2021
[12]OECD, Global Outlook, December 2021

What is worse, many poor countries may see almost no vaccinations until at least the end of 2021. This – and the significant ongoing variation in both infection and death rates – suggests that the pattern of recovery from the public health crisis will also be uneven.

Future Implications Goals

According to IMF,aggregate output for the advanced economy group is expected to regain its pre-pandemic trend path in 2022 and exceed it by 0.9% in 2024. By contrast, aggregate output for the emerging market and developing economy group (excluding China) is expected to remain 5.5%below the pre-pandemic forecast in 2024, resulting in a larger setback to improvements in their living standards.These economic divergences are a consequence of large disparities in vaccine access and in policy support. While almost 60% of the population in advanced economies are fully vaccinated and some are now receiving booster shots, about 96% of the population in low-income countries remain unvaccinated. Emerging and developing economies, faced with tighter financing conditions and a greater risk of de-anchoring inflation expectations, are withdrawing policy support more quickly despite larger shortfalls in output.[13]

Policy support has helped create the conditions for a handoff to private demand in the recovery. Where deployed, extensive fiscal measures have provided insurance to households and firms, enabling many to replenish or build up their savings, and creating the conditions for private demand to propel the recovery, particularly in 2022 when the advanced economy group is projected to shift its fiscal stance toward tightening. Indeed, household savings accumulated in excess of the pre-pandemic trend shows a positive relationship vis-à-vis the extent of fiscal support.[14]

Moreover, there are signs that historically low-saving countries have tended to accumulate greater savings in the wake of the COVID-19 crisis, putting their finances on firmer footing going forward. The forecast assumes a smooth handoff from extraordinary policy support to private activity-led growth, with some of the additional savings buildup retained in places where previous saving rates were low. Demand is assumed to pick up as vaccination coverage rises— given that vaccines seem to protect against severe illness. The speed with which this happens—and excess savings are drawn down—will influence the pace of the recovery and inflationary pressures (if supply is unable to adjust quickly enough).

The forecast is predicated on financial conditions remaining supportive. Financial market sentiment has largely stayed attuned to the policy outlook as the recovery has proceeded.[15]

However, the high uncertainty around the conjuncture has also led to heightened sensitivity to any news, in particular about inflation prospects in advanced economies. The first quarter of 2021 and a brief period in June saw a bout of financial market volatility, with investors repositioning portfolio holdings as they reassessed the outlook for US inflation and monetary policy. Concerns about the spread of the Delta variant and associated implications for the recovery have also sparked episodes of volatility. Even so, the overall picture is still one of broadly supportive financial conditions. Equity markets are buoyant, credit spreads remain tight, and net flows to emerging market economies have hitherto been broadly stable (particularly into hard currency bond funds). The global growth forecast is predicated on this support continuing.[16]

Advanced economies: Growth prospects for 2021 are revised down compared to the earlier forecasts, largely reflecting downgrades to the United States (due to large inventory drawdowns in the second quarter, in part reflecting supply disruptions, and softening consumption in the third quarter); Germany (in part because of shortages of key inputs weighing on manufacturing output); and Japan (reflecting the effect of the fourth State of Emergency from July to September as infections hit a record level in the current wave). The U.S. outlook incorporates the infrastructure bill recently passed by the Senate and anticipated legislation to strengthen the social safety net, equivalent to about $4 trillion in spending over the next 10 years. The baseline also includes expected Next Generation European Union (EU) grants and loans for EU economies.[17] Across advanced economies, an anticipated

[13]Carrière-Swallow, *et.al*.(2021)

[14]Summers, Laurence (2021)

[15] Powell, Jerome (2021). "Virtual Hearing—Oversight of the Treasury Department's and Federal Reserve's Pandemic Response." March 23.

[16] McLeay, Tenreyro. (2020).

[17]Willems (2020)

stronger rebound in the first half of next year, as vaccination proceeds, yields an upward revision to the growth forecast for 2022. As regards emerging market and developing economies, the forecast for the group is marked up slightly compared to the earlier estimations, reflecting upgrades across most regions. China's prospects for 2021 are marked down slightly due to stronger-than-anticipated scaling back of public investment. Outside of China and India, emerging and developing Asia is downgraded slightly as the pandemic has picked up. Growth forecasts in other regions have been revised up slightly for 2021. The revisions in part reflect improved assessments for some commodity exporters outweighing drags from pandemic developments (Latin America and the Caribbean, Middle East and Central Asia, sub-Saharan Africa). Elsewhere, stronger-than-anticipated domestic demand in key regional economies further lifts the 2021 forecast (emerging and developing Europe). [18]

The growth forecast for the low-income developing country group is marked down 0.6% point relative to July, with the continuing slow rollout of vaccines as the main factor weighing on the recovery. IMF staff analysis indicates that low-income developing countries will require close to $200 billion in spending to combat the pandemic and $250 billion to regain the convergence paths they were on prior to the pandemic. Labor market prospects for low-skilled workers and youth continue to be relatively bleak compared to other demographic groups, pointing to increasing inequality and higher vulnerability to incomes falling below extreme poverty thresholds within countries in this group. About 65–75 million additional people are estimated to be in extreme poverty in 2021 compared to pre-pandemic projections.

Two decisions shape governments' approach to recovery:all governments need to reduce debt and stimulate growth, but few governments aside from those with the largest economies have the option to simultaneously tackle their balance sheets and their economic recovery. Most will take actions that enable economic recovery by minimising expenditure or creating a positive return on investment, in ways that consider their global worldview, country context, legislative structure, political will and national ideology. Countries can make two decisions to help them understand the approach best aligned with their needs.

Suggestions-Proposals

Decision 1: What will best drive a country's immediate economic recovery—an approach that's more locally orientated or globally orientated?

Countries that are at risk for acute and systemic insolvency, that have high levels of domestic inequality and/or disgruntled citizens, or whose supply chains for vital industries are at risk will probably prioritise local economic recovery. Countries that rely on global supply chains and financial flows, and believe global problems require global solutions, will probably lead with a globally orientated recovery.

Decision 2:What's the best option for stimulating national economic growth—active involvement and oversight of issues or enablement of the private sector and local institutions?

This choice may be based on a government's political party affiliation or structure and operating model. Other determinants include how deeply a government thinks it can trust in businesses and citizens to drive decisions, how agile it thinks public and private institutions are, and what core skill sets the government possesses.

Opportunities and challenges for each archetypal approach

Centralised and local governments view a high-touch, centralised government and local empowerment as the primary drivers of economic recovery. Key questions for these governments revolve around how to best:invest locally, identify and support industries that will drive economic recovery, promote domestic spending through cash-transfer programmes, protect local businesses from foreign competitors, safeguard industries that are vital to national security, promote exports, create a society that's inclusive, more equitable and skilled for the future.

These governments have an opportunity to build their national security and resilience by revitalising local industries and, by extension, local communities. It will be important to identify 'national champions'—industries at the foundation of the nation's economy. Money previously spent on foreign-aid contributions can be redirected to these industries.

[18] World Economic Outlook, 2021

Large, centralised governments will have to be mindful, though, not to overwhelm small or nascent industries or communities with too much funding or regulation. These governments can take advantage of public–private–civil partnerships to understand how best to help these developing industries and communities thrive and grow. In areas of targeted investment, governments will want to monitor key indicators, such as industry growth and employment, to understand the impact of their investment. And upskilling will be vital to ensuring that local industries are staffed with people who have the know-how to help drive growth.

For instance, Japan's Government has expanded the stimulus programmes that it initiated for small enterprises at the beginning of the pandemic to include direct government financing for medium and large entities. The programme now involves government-backed lenders in Japan providing subordinated loans and preferred shares to all pandemic-impacted companies. Interest rates are about 1%, compared with the usual rate of 5% or more, and the loans don't have to be coordinated with private lenders, as is usually required.

Decentralised and local governments maintain light central oversight, preferring that states and municipalities manage their affairs independently. Businesses have a wide berth to operate in a way that maximises profits, under the premise that those businesses that do well also create more jobs and put more money into local economies. If there's a significant regulatory framework, it probably pertains to national safety and security, specifically protecting national supply chains and the economy from foreign interference. These governments rely on private, civil and local organisations as governance partners. A central question concerns how to enable industries and communities to support themselves. Doing so will generally involve removing obstacles to corporate and individual economic growth, for instance by reducing taxes, introducing protectionary tariffs, promoting tax incentives and risk guarantees to stimulate investment, and creating incentives for corporations and local governments to upskill their workforce.

These governments have an opportunity to not only help local communities maximise their growth and fulfill their specific needs, but to also free up central government resources for redistribution to local institutions. This approach to governing can create thriving hyperlocal ecosystems, with cottage industries that can serve as the basis of the national economy.

Such an economy, however, depends on a central government's strong partnerships with, and trust among, the local governments, private sector and civil society organisations that serve as a bridge to the local economies that drive national GDP growth. These decentralised and local governments will also have to manage potential social and economic disparities among individual parts of the country. The central government can help manage these disparities by coordinating the sharing of knowledge and best practices among local partners and customising the stimulus and incentives they offer to different local governments.

Concluding Remarks:-

This multispeed recovery from the pandemic and the ensuing economic crisis will have repercussions, not just for the countries with slower recoveries but also for the global economy. On the health front, no country will be fully safe from the virus until all are safe. Local vaccination successes will not be sufficient to protect individual countries from potential further outbreaks, especially in cases of new variants.

Overall, the balance of risks for growth is tilted to the downside. The major source of concern is that more aggressive SARS-CoV-2 variants could emerge before widespread vaccination is reached. Inflation risks are skewed to the upside and could materialize if pandemic-induced supply-demand mismatches continue longer than expected (including if the damage to supply potential turns out worse than anticipated), leading to more sustained price pressures and rising inflation expectations that prompt a faster than-anticipated monetary normalization in advanced economies.

Multilateral efforts to speed up global vaccine access, provide liquidity and debt relief to constrained economies, and mitigate and adapt to climate change remain essential.

Finally, it is important to deal with the challenges of the postpandemic economy: reversing the pandemic-induced setback to human capital accumulation, facilitating new growth opportunities related to green technology and digitalization, reducing inequality, and ensuring sustainable public finances.

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