

July 9, 2020

Economic Analysis Dept. Senior Economist  
Masayuki Suzuki

(written on June 30)

## Outline

In the followings, I would like to consider the medium- to long-term issues as well as the uncertain outlook of the world economy based on “OECD World Economic Outlook.” This OECD outlook emphasizes the globalization, digitalization and addressing the climate change for sustainable economic growth, which is slightly different from the Japan’s economic policy. It is important for our business to recognize such trend change of the world economy.

## OECD Scenario Assumes the “Second Wave”

In Figure1, as the OECD puts it, "global outlook is highly uncertain". The reason for this is that, while the spread of the new coronavirus (COVID -19) infection is subsiding in Europe and other regions, it is also spreading in emerging countries in South America and other regions, and there are continuing concerns about a second wave in the United States and China.

### Fig.1. Assumption of OECD World Economic Outlook

The global outlook is **highly uncertain**.

⇒ Two equally likely scenarios

- ✓ A. Double-hit scenario : The current easing of containment measures is assumed to be followed by a second, but less intensive, virus outbreak, taking place in October/November.
- ✓ B. Single-hit scenario : The current containment measures are assumed to successfully overcome the current outbreak.

(Source: OECD)

Here are two scenarios. Both are described as being "equally likely". The first is the “double-hit scenario”, which assumes that the infection will spread again this autumn and that restrictions on economic activities will be re-strengthened. The second scenario is the “single-hit scenario”, which assumes that the infection situation is fading and that large-scale restrictions on economic activities will not be implemented. Although they are "equally likely" scenarios, the fact that the Double-hit scenario is described earlier probably shows the true intention of the OECD that a second wave is possible.

The Figure2 summarizes the results of the OECD's Economic Outlook. On the right are the IMF and the World Bank forecasts both announced in June (IMF, *World Economic Outlook* and World Bank, *Global Economic Prospects*). The outlook of World Bank assumes that the COVID-19 infection will be fading out in the second half of 2020 and the economic activities will restart gradually. The outlook of IMF assumes that, in the economies where infections are declining, the economic activities will reopen gradually with downward pressure of social distancing and so on, but in economies struggling to control COVID-19 infection, the need to keep lockdowns will take an additional toll on economic and social activities. On the table, Note 1 and 2 respectively show the aggregation method used.

This Article (“Article”) is based on sources that Sumitomo Corporation Global Research Co. Ltd. (“SCGR”) deemed reliable. However, SCGR and Sumitomo Corporation Group (“SC Group”) do not warrant the Article’s correctness, accuracy, completeness, reliability, etc. The Article is written upon the views of the writer, and is not a collective opinion of SCGR or SC Group. SCGR and SC Group assume no responsibility for any direct or indirect damages arising from the use of the Article. The Article is a production of SCGR, and is protected by copyright law.

Looking at the OECD single-hit scenario in the right two rows, the global economy is expected to decline 6.0% in 2020, a significant drop from plus 2.7% in 2019. In this scenario, growth returns to plus 5.2% in 2021 because the infection is fading. However, the weak resilience in 2021 means that it will not be before 2022 when the GDP returns to the level of 2019. This trend is particularly evident in OECD countries. Non-OECD countries, including China, will see positive growth from minus 4.6% in 2020 to plus 5.6% in 2021. The rebound growth in 2021 is higher than that in 2019, when economic growth rate slowed down. But this growth cannot be described as “strong”, because, only with this growth, Non-OECD countries would not be able to return to the previous growth path. So, there are no driving forces in this world economic recovery.

**Fig.2. Economic Outlook Summary**

		OECD (Jun)					IMF (Jun)			World Bank (Jun)		
		2019	Double-hit		Single-hit		baseline			baseline		
			2020	2021	2020	2021	2019	2020	2021	2019	2020	2021
World	1	2.7	-7.6	2.8	-6.0	5.2	2.9	-4.9	5.4	2.9	-4.1	4.3
	2	-	-	-	-	-	-	-	-	2.4	-5.2	4.2
Advanced Economies	1	-	-	-	-	-	1.7	-8.0	4.8	-	-	-
	2	-	-	-	-	-	-	-	-	1.6	-7.0	3.9
OECD	1	1.7	-9.3	2.2	-7.5	4.8	-	-	-	-	-	-
Japan		0.7	-7.3	-0.5	-6.0	2.1	0.7	-5.8	2.4	0.7	-6.1	2.5
United States		2.3	-8.5	1.9	-7.3	4.1	2.3	-8.0	4.5	2.3	-6.1	4.0
Euro Area		1.3	-11.5	3.5	-9.1	6.5	1.2	-10.2	6.0	1.2	-9.1	4.5
Emerging Market and Developing Economies	1	-	-	-	-	-	3.7	-3.0	5.9	-	-	-
	2	-	-	-	-	-	-	-	-	3.5	-2.5	4.6
Non-OECD	1	3.5	-6.1	3.2	-4.6	5.6	-	-	-	-	-	-
China		6.1	-3.7	4.5	-2.6	6.8	6.1	1.0	8.2	6.1	1.0	6.9
India		4.2	-7.3	8.1	-3.7	7.9	4.2	-4.5	6.0	4.2	-3.2	3.1
Brazil		1.1	-9.1	2.4	-7.4	4.2	1.1	-9.1	3.6	1.1	-8.0	2.2
Russia		-	-	-	-	-	1.3	-6.6	4.1	1.3	-6.0	2.7

Note) 1. Aggregates based on GDP (PPP).

2. Aggregate based on GDP (2010 price, market exchange rate)

(Source: OECD, IMF and World Bank)

On the other hand, in the double-hit scenario with two rows in the middle, the economic growth rate is expected to decline even more in 2020 than in the single-hit scenario due to the impact of the second wave of infection. World economic growth is expected to drop 7.6% in 2020 and recover only 2.8% in 2021. The re-strengthened restrictions on economic activities in the third quarter of 2020 will remain in the first half of 2021.

In summary, the IMF and the World Bank have assumed that the spread of the disease will fade in the second half of 2020 and economic activities will resume step by step, which is equivalent to the OECD's single-hit scenario. Although there are some differences in the data available up to the time of the announcement, there are at least two common points.

First point is that the negative growth rate of approximately 4 ~ 6% in 2020 will exceed that of the Lehman shock. The impact of Great Recession was so huge, that the monetary policies of advanced economies stepped into the unconventional areas such as quantitative easing. And the advanced economies such as Japan and Europe remain unable to get rid of such unconventional areas even after 10 years since the Lehman shock. As a result of shortage of rooms for monetary policy, fiscal expenditures increased significantly this time. If this situations are prolonged, there will be little room for both monetary and fiscal policy, and the available policy tools may be limited in the next recession phase.

This Article (“Article”) is based on sources that Sumitomo Corporation Global Research Co. Ltd. (“SCGR”) deemed reliable. However, SCGR and Sumitomo Corporation Group (“SC Group”) do not warrant the Article’s correctness, accuracy, completeness, reliability, etc. The Article is written upon the views of the writer, and is not a collective opinion of SCGR or SC Group. SCGR and SC Group assume no responsibility for any direct or indirect damages arising from the use of the Article. The Article is a production of SCGR, and is protected by copyright law.

Second point is that it will be difficult to recover the 2020 negative growth within 2021. This suggests that the world economy may take long time to fully recover the previous market scale such as in private consumption and in business investment. As shown in the followings, this means the quality of purchasing power may be impaired, and the slow recovery may give undesirable impacts on the world economy.

### Lost Purchasing Power

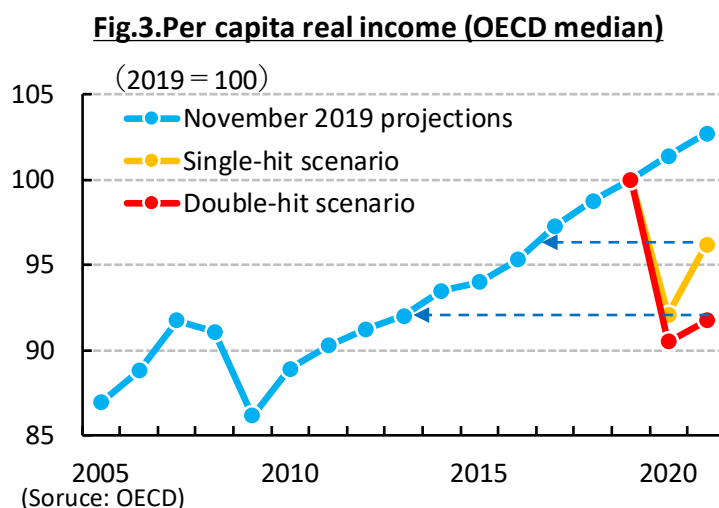
The Figure 3 shows changes in "real income" which is income adjusted by inflation. It is the OECD median per capita income.

The light blue line is the projection based on the outlook as of November 2019. You can see that we will not reach that level in 2021 either under the single-hit or the double-hit scenario. Also, we cannot even recover the actual level of 2019.

Under the single-hit scenario, the 2021 level is the same to the 2016 level, which can be described as "the lost five years". In the double-hit scenario, the level in 2021 would only recover to the level of 2013, and there is a risk of "the lost eight years".

A decline in real per capita income means a decline in the "quality" of demand in terms of purchasing power. Thus, COVID-19 suggests that per capita purchasing power will be lost for five to eight years and that recovery will take considerable time.

In other words, the preferences of both households and firms, as well as the quality of demand, may have changed compared to those in the pre-COVID-19 days. The former refers to the change in the type of taste and preference, such as preferring to take food home rather than eating out from the viewpoint of keeping the social distance. The latter refers to the downgrading of the consumers' living standard levels as if they retrace anti-clockwise their past growth experience, in which, for example, their self-owned transportation vehicles had developed from bicycles to motorcycles and then to automobiles in line with their households' income increase along with the general economic growth. It is necessary for businesses to launch suitable goods and services to the market in line with these changes.



## Current Situation of the World Economy

As summarized in Figure 4, when this OECD Economic Outlook was released, economic activities in the United States and Europe were beginning to resume, and we had time to look back at the past situation and think about the future.

Looking back on the situation so far based on the OECD Outlook, we can see that, while the spread of infection is common throughout the world, the pain was not uniform. For example, talking about industry types, the industries that have been hard hit include tourism, restaurant & accommodation, entertainment, and the aviation, which have many opportunities to interact with people, or those related with transportation.

Looking at the labor market, although layoffs and temporary leaves of absence spread worldwide, the target population was heavily concentrated on young people and unskilled workers as OECD showed. It has also become clearly evident whether one is in an environment that enables remote working or working from home and whether one works in such type of business. If the fallout is prolonged, we may be concerned because the human capital (human skills etc.) may not be accumulated at a desired pace, which would give downward pressure to the long-term economic growth in the future.

In addition, as the issue is the fight against infectious diseases, there was a tendency for people to undergo harder pains in emerging economies, where social security networks such as medical systems and employment measures were not fully developed.

In other words, there was a tendency for the weak parts of the economy to be hit harder. In the first phase of the infection, the governments and central banks focused on helping the finance for households and firms, as well as supporting the medical system. However, in the second phase, it will be necessary to widen the policy targets and support those weak parts of the economy.

Fig.4. with/after COVID-19 world

- ✓ Impact to specific sectors are large.
  - industries···tourism, restaurant & accommodation, recreation, aviation and so on.
  - labor···youth, unskilled, difficulty to remote work and so on.
  - emerging economies···weak social security system including medical system
- ✓ Medium and long-term impacts are large.
  - firms' financial support ⇒ government deficit/debt outstanding increase
  - investment, supply chain ⇒ globalization, digitalization, treatment of climate change
- ✓ Summary part of "Living with COVID-19: Two scenarios for the world economy" (video message)
  - ⇒ "Adapting to a changing world···"
  - invest in people,
  - invest in health,
  - invest in the environment.

(Source: OECD)

## Medium- to Long-Term Issues

From a medium- to long-term perspective, we utilized our experience from the Lehman Shock and other events to quickly implement financing and other measures through large-scale fiscal and monetary policies. On the other hand, the government debt has been increasing, and addressing fiscal problem has been postponed. Companies are being asked to reconsider their management.

This Article ("Article") is based on sources that Sumitomo Corporation Global Research Co. Ltd. ("SCGR") deemed reliable. However, SCGR and Sumitomo Corporation Group ("SC Group") do not warrant the Article's correctness, accuracy, completeness, reliability, etc. The Article is written upon the views of the writer, and is not a collective opinion of SCGR or SC Group. SCGR and SC Group assume no responsibility for any direct or indirect damages arising from the use of the Article. The Article is a production of SCGR, and is protected by copyright law.

strategies, such as reviewing their supply chains. Against this backdrop, the OECD has been advocating the importance of addressing globalization, digitalization, and climate change for sustainable growth.

At the end of the survey, a video titled "Living with COVID -19" was published on the OECD website. From the perspective of how to adapt to a changing world, three points are mentioned: "investment in people", "investment in health" and "investment in the environment". The emphasis placed on "environment" rather than "digitalization" clearly shows the perspective of the OECD, which mainly consists of developed countries centered in Europe.

Japan's government has promoted the framework for the global free trade, such as Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and Japan-EU Economic Partnership Agreement (EPA), even in the world's protectionism mood. And it has become evident that Japan has not invested enough in the system and human capital for the digitalization. In addition, we recognize the need to address the private information issue, in our progress for the digitalization. Therefore Japanese government shows its positive stance to promote further digitalization.

On the other hand, it is true that sense of crisis is rising, as the word "environmental crisis" was featured in the "Annual Report on Environment" by the Ministry of the Environment of Japan this year. But so far, climate change measures have not been conspicuous among the government policies. Of course, it is true that EU has a more medium- to long-term perspective, as shown in the formulation of a medium- to long-term EU budget, while Japan has so far focused its economic measures mainly on supporting the emergency situation. All viewpoints discussed above are considered to be important for us to grasp the trends of the times from a medium- to long-term perspective.

## Reference

IMF, (2020), *World Economic Outlook Update*, (June 2020).

OECD, (2020), *OECD Economic Outlook*, (June 2020).

World Bank, (2020), *Global Economic Prospects*, (June 2020).