Interview with Dr. Gian Maria Milesi-Ferretti, Deputy Director of the Research Department of the IMF

The IMF's Assessment of the Struggling Global Economy Under the Covid-19 Pandemic & Prescriptions for Recovery

By *Japan SPOTLIGHT*

The International Monetary Fund (IMF) published its World Economic Outlook on Oct. 13, 2020 titled "A Long and Difficult Ascent". Though three months have passed since its publication, we believe the observations and analysis of the global economy during the pandemic crisis in this outlook are still useful in considering the prospects for the economy in 2021.

After a brief introduction of the essence of the report largely based on an IMF blog of Oct. 13, 2020 written by Dr. Gita Gopinath, chief economist at the IMF, and several other points mentioned by her and her colleague Dr. Gian Maria Milesi-Ferretti, deputy director in the research department of the IMF, in a press conference at the time of its publication, *Japan SPOTLIGHT* introduces an interview with Dr. Milesi-Ferretti on some aspects of the future global economy.

(Interviewed on Oct. 13, 2020)

Brief Introduction of the Main Points of the Outlook

In this outlook, the IMF predicts a deep recession for the global econopmy in 2020, with GDP growth at -4.4% but growth of 5.2% in 2021. Its forecast for advanced economies for 2020 is -5.8% and that for 2021 is 3.9%, while the forecasts for emerging market and developing countries (excluding China) are -5.7% in 2020 and 5.0% in 2021. The forecast for the Chinese economy is 1.9% in 2020 and 8.2% in 2021. The IMF sees a growing divergence in recovery between China and other nations and also between developing economies excluding China and advanced economies *(Table)*. By the end of 2021, the loss in output relative to the pre-pandemic projected level for emerging and developing economies excluding China is -8.1%, much larger than the loss for advanced economies of -4.7% *(Chart)*. It would take a long time for economies that have suffered from such a great loss to recover. Employment will remain below pre-pandemic levels and investment will be held back by uncertainty and balance sheet problems, with lost schooling impairing human capital.

Dr. Gian Maria Milesi-Ferretti

After 2021, the IMF predicts global growth to be around 3.5%, a gradual slowdown but still steady growth over the mid-term, but the cumulative loss in output relative to the pre-pandemic projected path is predicted to grow from $11 trillion over 2020-2021 to $28 trillion over 2020-2025. This means large output losses and a severe setback to the improvement in living standards in the long term. In this regard, the recovery process will be long and tough.

Divergence is seen not only among nations and regions but also among people in each economy. As low-income workers, youth and women are harder hit by the pandemic crisis, the poor are getting poorer, with close to 90 million people in the world expected to fall into extreme deprivation in 2020. But tremendous uncertainty remains around the outlook with both downside and upside risks. The virus is resurging with localized lockdowns being re-instituted. If this worsens and prospects for treatments and vaccines deteriorate, the toll on economic activity would be severe and likely amplified by severe financial market turmoil. Growing restrictions on trade and investment and rising geopolitical uncertainty could harm the recovery. On the upside, faster and more widespread availability of tests, treatments, vaccines and additional policy stimulus can significantly improve outcomes.

Thus, overall, the recovery process for the global economy in 2021 can be characterized as "a long, uneven and uncertain ascent". Therefore, it is essential that fiscal and monetary policy support is not prematurely withdrawn. Considerable fiscal support and loose monetary policy overall has prevented the global economy from falling into catastrophe so far. There is still much to be done to ensure a sustained recovery, including greater international collaboration to achieve enough production and widespread

TABLE

Latest World Economic Outlook growth projections (Oct. 2020)

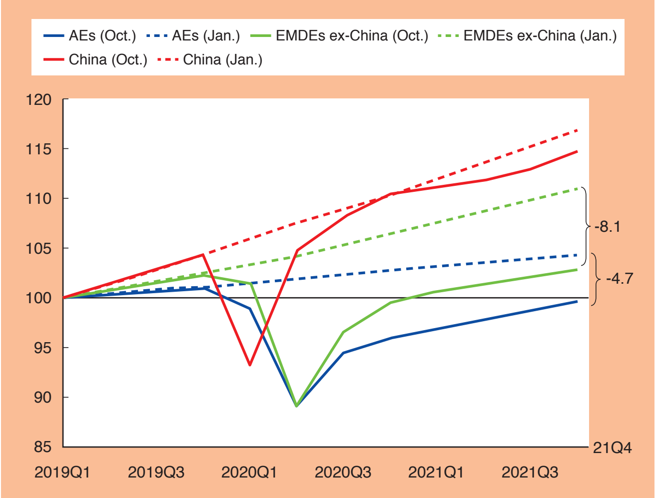
(real GDP, annual percent change)	2019	PROJECTIONS 2020	2021
World Output	**2.8**	**-4.4**	**5.2**
Advanced Economies	**1.7**	**-5.8**	**3.9**
US	2.2	-4.3	3.1
Euro area	1.3	-8.3	5.2
Germany	0.6	-6.0	4.2
France	1.5	-9.8	6.0
Italy	0.3	-10.6	5.2
Spain	2.0	-12.8	7.2
Japan	0.7	-5.3	2.3
UK	1.5	-9.8	5.9
Canada	1.7	-7.1	5.2
Other Advanced Economies	1.7	-3.8	3.6
Emerging Markets and Developing Economies	**3.7**	**-3.3**	**6.0**
Emerging and Developing Asia	5.5	-1.7	8.0
China	6.1	1.9	8.2
India	4.2	-10.3	8.8
ASEAN-5	4.9	-3.4	6.2
Emerging and Developing Europe	2.1	-4.6	3.9
Russia	1.3	-4.1	2.8
Latin America and the Caribbean	0.0	-8.1	3.6
Brazil	1.1	-5.8	2.8
Mexico	-0.3	-9.0	3.5
Middle East and Central Asia	1.4	-4.1	3.0
Saudi Arabia	0.3	-5.4	3.1
Sub-Saharan Africa	3.2	-3.0	3.1
Nigeria	2.2	-4.3	1.7
South Africa	0.2	-8.0	3.0
Low-Income Developing Countries	5.3	-1.2	4.9

Source: IMF, World Economic Outlook, Oct. 2020

For India, data and forecasts are presented on a fiscal year basis, with FY 2020/21 starting in April 2020. India's growth is -8.6% in 2020 and 6.8% in 2021 based on the calendar year.

CHART

Partial recovery, growing divergence



Note: AEs = Advanced Economies; EMDEs = Emerging Markets and Developing Economies
Sources: IMF, World Economic Outlook, and IMF staff calculations

distribution of vaccines to all parts of the world, continuing to provide income support, wage subsidies and unemployment insurance, and policies supporting reallocation of workers from shrinking sectors to growing sectors.

Emerging market and developing economies will need to prioritize critical spending on health and on the poor, and ensure maximum efficiency as well as continued support such as international grants and concessional financing. Policies should be also designed with an eye toward placing economies on paths of stronger, equitable and sustainable growth. For example, the global easing of monetary policy, while essential for the recovery, should be complemented by measures to prevent the build-up of financial risks over the medium term. Investments in health, digital infrastructure, green infrastructure and education can help achieve productive, inclusive and sustainable growth. Expanding the safety net where gaps exist can ensure the most vulnerable are protected while supporting near-term activity.

In the light of the worst crisis since the Great Depression, it will take significant innovation on the policy front, at both the national and international levels, to recover from this calamity.

Questions on Some Major Economies & Assumptions on the Pandemic

The press conference mentioned above produced some interesting observations on the major economies, and also on assumptions about how long the pandemic would continue. A Q&A with these points highlighted follows.

1) The US economy and other hard-hit economies

Q: The new forecast is for a decline of 4.3% in US GDP in 2020, a shift of 3.7 percentage points from the IMF forecast in June 2020 of an 8.0% decline. Why has there been such a big turnaround in the forecast for the United States?

Gopinath: For the US we do have a significant upgrade for the forecast this year. And it comes from a couple of factors. One is that in the second quarter, the recovery came about sooner than we expected, and continuing into Q3 the indicators have been strong. Part of the challenge in forecasting in this crisis is that we have to rely on high-frequency indicators like mobility to be able to project where economies are headed. That relationship between mobility and economic activity has changed quite a bit since April and March when there was a severe lockdown as opposed to what we are seeing right now.

Milesi-Ferretti: One factor is that we had a stronger performance in the second quarter than what we were anticipating. There is more of a recovery in the third quarter. We were thinking that the increase in the number of infections could imply some decline in mobility and activity, but that has not really materialized during the third quarter and that has been one of the factors.

Q: When do you expect some of the hardest-hit countries including the US, European nations, and Latin America to rebound to pre-pandemic levels of output?

Gopinath: If you exclude China from our 2020 numbers, cumulative growth between 2020 and 2021 is going to be negative for the global economy. For many countries, we are seeing a return to 2019 levels – not in per capita terms – by 2022 but there are some regions of the world where it is projected to take even longer, and Latin America, for instance, we have returning to pre-pandemic levels in 2023. There is variation – China is already exceeding 2019 levels in 2020 and continuing to grow cumulatively by 10% between 2020 and 2021, but for many other countries around the world the return is gradual – by 2022 or 2023.

2) Indian economy

Q: India has been badly hit by the pandemic. What is your view of the government's response so far? Has enough be done? What other measures are needed to support the economy and help it get back on track?

Gopinath: We do have a significant downgrade for India's growth for FY 2021: it is minus 10.3%. The hit to the economy has been large and broad-based, and you saw that in the April/May/June period. In terms of what can be done going forward, on the fiscal side we believe there is more that can be done to provide support to households who have been affected by this, and to provide support to firms that have been affected, and to tilt the composition of support towards more of the direct spending and tax relief measures, and to rely slightly less on the liquidity support measures and guarantees, which are clearly important to support the provision of credit in the economy. But if you look at the approach that was taken, there was more of an emphasis on that kind of measure, and we think there is room to recalibrate and to provide more direct relief and spending support which could have a first-order impact on preventing even worse outcomes.

On the monetary policy side, the Reserve Bank of India (RBI) had come in very aggressively early on. It has paused recently with its interest rate cuts, looking through this spike in inflation that it has had recently. But we believe there is more that the RBI can do too, if there is room to cut…if needed…and we think that should be done once this inflation spike is more under control. And together with these efforts both on the fiscal side and the monetary side, we think that would put India on a path to recovery.

There have also been efforts recently on the structural side to improve medium-term growth prospects. We have had progress on labor reform bills and we think this will advance the structural reform agenda in an important way, remove supply-side constraints in the agricultural sector and in the labor market also allow for a better matching of workers with firms, provide firms with a bit more flexibility in terms of hiring options, and also provide more social security and safety net options for workers as well. So with those structural elements in place as well to reinforce cyclical support, the Indian economy will be well-placed to recover from this horrible crisis that it is experiencing right now.

3) Impact of the failure of a EU-UK trade deal on the European Union and United Kingdom

Q: What would be the impact of the failure of the EU and the UK to agree on a trade deal?

Gopinath: We are obviously in the final 100 meters of these negotiations, and we are hoping that there will be an agreement. We had said that the lack of a deal would further reduce GDP by 3.5% to 4.5% over a two-year period after a no-deal Brexit, which would be a significant hit to growth for the UK and also for some of the smaller economies in the EU. A baseline assumption is that there will be some kind of agreement.

4) Japanese economy

Q: Japan has one of the lowest rates of Covid cases, but economic growth is said to be minus 5%. This is worse than the US and other countries, and recovery next year could be slower than in other countries. Could you explain the reason for this?

Gopinath: In the case of Japan, I would say that compared to other advanced economies Japan is not among the worst hit just in terms of GDP numbers. It has been able to control the pandemic quite well and has provided extraordinary amounts in terms of fiscal and monetary support. So we are seeing slow signs of recovery. Of course, Japan does depend on external demand, and as long as that remains subdued it is going to weigh on the economy. Over the medium term, it does make a big difference what the pre-trends are for a country in terms of where it is headed with regard to an aging population and low productivity growth. That explains the numbers that we have.

5) Brazilian economy

Q: Could you give more details as to why the IMF reduced the drop in Brazil's GDP in 2020 and reduced

the projection for the country's growth in 2021, compared with your June outlook?

Gopinath: We do have an upgrade for Brazil since our June numbers, and this reflects the fact that recoveries after re-openings came about a little bit faster. Again, these are pretty tough recessions but the recovery was a little bit faster over there partly because of the extension of some fiscal support measures. There has been a big expansion this year in terms of fiscal support but then there is going to be a negative impact coming because of the pulling back of that support likely to be implemented.

Milesi-Ferretti: Let me just add that we really have to look at what we are projecting for the level of economic activity in 2021 and not just the growth rate. We are seeing a less deep recession this year than we were anticipating and that is also because of very substantial fiscal and monetary support that was absolutely essential to preserve livelihoods, together with the health policy response. But when you lift the level of activity in 2020, the growth rate in 2021 is going to be relative to a higher base and hence will look lower. But overall activity in 2021 is a lot stronger than we were anticipating in June. Still, we would like to see a stronger recovery and it is very important to make sure that support is well-targeted but not withdrawn too early.

6) Middle East and North Africa (MENA) economies

Q: How can the MENA region countries work to improve their macroeconomic signs amid the ongoing crisis, especially with the expected second wave of the virus?

Gopinath: The MENA regions are being hit by the pandemic quite severely, and you can see that in our projections in terms of contractions of 4% in 2020. There are, of course, very different regions in MENA countries. There are oil exporters that are being hit by oil production cuts. Then you have countries that are oil importers but tend to rely on tourism and remittances and they are getting hit on that front too, and you also have fragile states in that area. So what we have learned from international experience is that dealing with further waves of the virus will require more smart and targeted lockdowns, localized as much as possible, and also people relying very heavily on wearing masks and social distancing and hygiene. Measures of that kind made the second wave of the virus that we saw in many parts of the world in the summer have a much smaller negative impact than what we saw in the spring.

Milesi-Ferretti: Let me just add that it has been a tragic crisis across the globe but the pandemic has hit countries in the MENA region very severely, the second most severely after Latin America. It is a big challenge because of the impact of the pandemic and the impact of declining oil prices for exporters, and some countries like Egypt that rely heavily on tourism are also hit by that. So really, containing the pandemic and maintaining the policy support that is needed to protect the most vulnerable is essential.

7) Assumptions on the pandemic in the forecast

Q: What is the baseline for when the virus will be brought under control as of now?

Gopinath: We are assuming, based on our consultations with public health officials, that it will take until the end of 2022 to bring local transmissions down to low levels pretty much everywhere in the world. So this is going to take some time, even though there is the prospect of vaccines and treatments. The lags that there will be in terms of production and delivery are other factors, and also the effectiveness of these measures is another reason why we believe it will take a couple of years before we come down to low levels of local transmission.

JEF Interview with Dr. Gian Maria Milesi-Ferretti for Further Thoughts

1) Consumption growth

JS: I would like to ask your opinion about pent-up demand. Consumption growth would be a key to economic growth forecasts for 2020 and 2021. Lockdown policies should create pent-up demand, but how do you think this will contribute to growth?

Milesi-Ferretti: I think pent-up demand is clearly important for things like consumer durables or potentially investment goods if the news on recovery is positive. Those are things that you can postpone during a downturn and then buy later. We have seen this since the trough in April; we have seen consumption and retail sales recover in a number of countries. The problem is that a lot of the hit to consumption comes from a decline in consumption of services provided in contact-intensive sectors. For sure we would all love to go to restaurants if everything turned out to be fine, but it is not as if we will have five times more meals at restaurants if things turn out better than we would have had otherwise, so some of the loss in activity is permanent. We cannot travel 11 months a year because we have not travelled for a while. Clearly, there will be a pickup, there is a bit of pent-up demand in some sectors, but it is not the same as going to buy a car, for example.

2) Labor market

JS: In Japan now, the unemployment rate is increasing due to the pandemic, as it is in the US and other countries. What is your view regarding the prospect for employment rates overall?

Milesi-Ferretti: This is one of the reasons why this is such an awful crisis. It affects the contact-intensive services sectors that by their own nature have high employment. They typical employ relatively lower-skilled people, a lot of young people, a lot of women, and unfortunately the hit to employment is very severe. We may not see it so much in the official unemployment figures because of all the schemes to protect employment and subsidize part-time work and the like, but ultimately we do have a very sharp decline in working hours because these sectors are operating at only a fraction of their capacity. It is a big challenge for countries because there is a lot of uncertainty going forward as to the extent and timing of these jobs coming back. We don't know whether we have to think about a massive reallocation of resources for sectors, or whether we have to wait it out until science comes to the rescue and allows us to go back to an almost normal pace of contact-intensive activity. For now, unfortunately that prospect is not there, and we need to think actively about labor force reallocation.

JS: In thinking about labor force reallocation, technology might be key. Thanks to digital technology, economies may not necessarily be falling into more serious situations. However, digital technology is labor-saving and so in the long run a digital economy, which would expand after the pandemic, might have a negative impact upon employment.

Milesi-Ferretti: You raise a point that many people were grappling with before the crisis. There was a big discussion on automation and its likely impact on employment. We are thinking a lot about remote work – it is not *a priori* obvious to me why that would have a negative impact on employment. If anything, where it is feasible, it may allow people who are distant from places of work to join the labor force. What we are worried about is the future of contact-intensive sectors because I think that due to the way societies and economic activities have evolved, the demand for contact-intensive services has gone up extensively and it goes up with the aging of populations as well. So it is important to fundamentally get the pandemic under control, get transmissions under control, and then we can hope that scientific research will yield those improved therapies and vaccines that will allow those sectors to come back. If that does not happen, it is going to be a long and painful road because of the number of people employed by these sectors and the difficulty of doing labor reallocation on that scale.

JS: At the same time, we are facing aging societies. We need to raise our labor productivity as much as possible, and I suppose the pandemic should reinforce that need. In that regard, perhaps digital technology would be a key to restoring the economy.

Milesi-Ferretti: There are clearly some underlying trends in the way production is organized that will be enhanced by this crisis, and some of them will be good for productivity. We still need to have a holistic view of what is happening across the economy, and there are many other sectors that have started re-operating but under reduced productivity and reduced production costs. Think of medical care and all the additional precautions and filters and things that a normal dentist visit or therapist visit entails, or in a store. In the short run, there is clearly a severe hit to productivity. There will be productivity gains from the ease of remote communication and digital technology for sure, but we have to recognize that this crisis is also bringing a number of additional costs, and we really need to concentrate our efforts on coming out of the medical emergency.

3) Concerns about inflation

JS: The outlook emphasized the need for a loose monetary policy and stimulative fiscal policy, and the need to continue such macro policy in order to restore the economy. But there are concerns that this would lead to inflation afterwards.

Milesi-Ferretti: I think that at the moment it is important to fight the war, and you really need to keep the connective tissue of the economy alive. It is essential for economic activity to allow firms to restart when restrictions are lifted, otherwise there will be no firms to re-open or it will be very costly and slow to restart activity. It is important, of course, to retain the institutional strength of central banks, so that you don't lose that credibility that anchors inflation expectations. But so far, if anything, the problems that we have in advanced economies are with inflation expectations being too low compared to what we would like, so I don't think that at the moment we should be primarily worried about potential price pressures. Again, "never say never" is something that needs to be on our radar screen, but in the current context supporting activity and the possibility of having deficient demand are much bigger challenges than having excess demand.

4) Concerns about trade protectionism

JS: Turning to world trade, in the press briefing there was a question about the outcome of a late EU-UK FTA, and the environment surrounding world trade is very severe, due in part to rising protectionism. World trade has been significantly declining according WTO reports recently. How do you see the impact of this decline upon the world economy?

Milesi-Ferretti: I would separate the two aspects of this. One is what has happened to global trade with this crisis. Because this crisis has been concentrated in contact-intensive services, this has had a very severe impact on trade in services, particularly tourism and transportation. However, the decline in trade in goods has been severe, but less so than one could have imagined given the size of the global GDP contraction. We have a falling global trade which is roughly the same order of magnitude as the one in 2009. Yet the decline in GDP in 2009 was minus 0.3%, and this time it is minus 4.4%. The reason why this is happening is that a normal recession involves a collapse in manufacturing activity, in investment, in purchases of consumer durables, while in this crisis the main collapse has to been to services that are less traded than other goods. But there is a second part to your question – what about trade further down the road? What about the medium term? What about trade tensions and trade barriers? All those are very important threats to economic activity across countries, and clearly it is important for the international community to come together and address grievances and differences in order to minimize the impacts of those factors on trade, because trade has been an engine of growth and rising living standards for the last 30 years.

5) Macro policy international cooperation

JS: The need for international cooperation is emphasized in your report. I am thinking about possible macro policy coordination. All countries are now involved in an active fiscal policy and also suffer from fiscal debt that will impede growth in the future. What do you think of the idea of a new tax on financial assets adopted by all countries globally in order to share the burden of debt?

Milesi-Ferretti: Once the emergency is over, countries will have a higher stock of public debt, and that higher stock has been incurred over the past year for very good reasons. You need to keep economic activity alive; you need to keep livelihoods going for people who lost their earnings to the extent possible. But there will be a challenge for governments to deal with this higher stock. Progressive taxation is clearly important on that score, particularly because you are facing a crisis that is taking a disproportionate hit on lower-skilled workers and is increasing inequality. So there has to be an element of progressivity in tax measures on the personal side. Coming to something a bit closer to what you were exactly asking me – there is clearly an issue of having a system of international corporate taxation where everybody pays their fair share. It is clearly a very complex issue as well as a controversial one. But, you know, we need to have an international corporate taxation system that deals with the innovations in production and geographical allocation of production entailed by digital technology in an effective way, so that countries get their share of revenues and firms pay their fair share of revenues regardless of the type of economic activity they created.

6) Questions on long-term prospects

JS: Looking at more long-term questions, one is about the nature of capitalism. In global supply chains, efficiency is a key concept for setting up supply chains. With the pandemic, efficiency is no longer a key concept; rather risk resilience or the redundancy of global supply chains might be the answer. Could this change the nature of capitalism or market-oriented economies?

Milesi-Ferretti: I think that your point about resilience is very important. But I don't think that the implication of that is necessarily that you need a short supply chain, or something that is more domestically sourced. It is just a different set of risks, but you face risks anyway. It could be a domestic disruption as opposed to a cross-border one. I think that firms are actively engaged in trying to find ways to ensure the resilience of their supply chains. How this will pan out, we don't know. A lot will depend on what happens to geopolitical tensions and whether we see a world with more fragmented technological standards, or more or less polarized, and what is going to happen to trade barriers and geopolitical relations more generally. Our hope is that the spirit of international cooperation prevails, and this goes well beyond economics and extends to things that are more important than the efficiency of supply chains.

JS: Does the IMF have any plans to issue mid-term or long-term outlooks for the global economy?

Milesi-Ferretti: For the first time, we are putting out a forecast over a five-year horizon. We have alternative scenarios and uncertainty is very high. My hope is that by April 2021 we will have better news on vaccines, and will have a better idea about the persistence of the shock and the ability of the economy to cope with this increase in cases in the past few weeks. Hopefully that will be done effectively and in a much less costly fashion than was the case during the big lockdowns in March, April and May. But uncertainty is very high and the best we can do is scenarios. We have to be honest about the margins of uncertainty, which are very, very large, including on the third quarter just ended. Even with all the high-frequency indicators, with respect to normal circumstances, uncertainty is three times larger at least. We need to think through in a consistent fashion what alternative scenarios could look like, and think about policy options. We have to be ready to change our numbers and views and policies as the reality on the ground shifts. We have learned a lot, but we still face many difficulties posed by the pandemic to economic activities and there is a lot that we don't know. Aggressive response is super important for economic activity and social reasons also, but also we need to be very flexible and be ready to adapt as the reality on the ground changes. JS

Written with the cooperation of Joel Challender who is a translator, interpreter, researcher and writer specializing in Japanese disaster preparedness.