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Written Statement to the IMFC

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The Global Economic Outlook

1. **The coronavirus pandemic is a public health crisis without precedent in living memory, and continues to result in widespread loss of life and severe human suffering.** A large part of the world economy is facing increasingly stringent containment measures as governments take all necessary steps to contain the spread of the virus and save lives. Activity in many sectors has been shut down completely, travel and mobility have been curtailed, confidence has been eroded and financial conditions have tightened abruptly. Many economies are now experiencing the largest single economic downturn since the Great Depression in the 1930s.

2. **The exact scale of the economic shock arising from the implementation of containment measures is extremely difficult to quantify, but it is clear that many economies are experiencing sharp and sudden contractions in output, spending and employment.** Illustrative estimates by the OECD, based on an analysis of sectoral output and consumption patterns across advanced and emerging-market countries, suggest that around one-quarter of the economy could be shut down in many countries as containment measures take effect, with consumers' expenditure potentially cut back by around one-third. This implies a decline in annual GDP growth of 2 percentage points for each month that strict containment measures continue. If the shutdown continues for three months, with no offsetting factors, annual GDP growth could be between 4-6 percentage points lower than it otherwise might have been. Changes of this speed and magnitude have few precedents and far outweigh anything experienced during the Global Financial Crisis in 2008-09. Tourism provides a clear illustration of the large potential costs of shutdowns in particular sectors. This sector contributes directly, on average, 4.4% of GDP and 6.9% of employment in OECD countries. Preliminary OECD estimates suggest that the COVID-19 impact could result in a decline of 45% in international tourism in 2020. This could rise to 70% if the recovery is delayed until September.

3. **Moreover, such estimates cover only the initial direct impact in the sectors involved and do not take into account any additional indirect impacts that may arise.** The eventual implications for annual GDP growth will depend on many factors, including the magnitude and duration of national shutdowns, the extent of reduced demand for goods and services in other parts of the economy, and the speed at which the significant fiscal and monetary policy support put in place by governments and monetary authorities takes effect. A slow recovery, with confinement measures eased only gradually, would inevitably raise the costs for annual growth in 2020 well beyond the initial impact of the shock. Existing vulnerabilities, such as high corporate debt and its declining quality, and trade tensions between major economies, could also deepen the downturn and slow any subsequent recovery.

4. **Early data are already making clear that the economic and social costs of the pandemic will be large:**

- Events in China provided a preliminary illustration of the economic impact of the stringent containment measures that successfully halted the spread of the epidemic. Industrial production in January and February was 13% lower than a year earlier and fixed investment declined by one-quarter. Even a few weeks after containment measures began to be eased cautiously, many parts of the economy are not yet back to normal.

- Business survey measures in the past month have also revealed large and sudden declines in output and incoming orders around the world. Such declines have been especially marked in service sectors and in the hardest-hit European economies, Italy and Spain, illustrating the scale of the economic shock induced by the necessary measures taken to control the epidemic.

- The direct impact on people's livelihoods has also been immediate and severe, particularly among the most vulnerable groups in society. The coronavirus pandemic thus risks exacerbating inequalities of income, wealth and opportunities, which were already pervasive and widening in many countries. Many of the most affected service sectors are employment-intensive, with workers, many of them women, often on low pay. Unemployment claims and applications for short-time work schemes have soared, reflecting job losses and reduced work hours. In the United States, the number of new unemployment claims in the last week of March and again in the first week of April were almost ten times the size of that in the previous worst week recorded, in 1982.

- Financial markets remain fragile. The rapid spread of the pandemic and the strict confinement measures adopted by governments have prompted massive declines in financial asset prices and a spike in volatility, with some markets ceasing to function properly. Rapid and sweeping responses by central banks, including the activation of international liquidity lines, have helped to restore some stability. Nonetheless, equity prices remain 20-30 per cent below mid-January levels and equity price volatility remains close to the levels seen in 2009. Long-term government bond yields have declined substantially in many advanced economies, reflecting monetary policy easing and a flight to safety, but spreads have risen on many emerging-market government bonds, amidst sizeable capital outflows and a substantial appreciation of the US dollar. Corporate bond spreads have also risen, particularly for the lowest rated corporate borrowers, with rising risks of downgrades in ratings on many existing bonds as the recession deepens due to the high level of indebtedness and the declines in credit quality seen in recent years.

- Many emerging-market economies and developing countries, particularly commodity producers, are experiencing considerable difficulties due to the dual health and economic crisis. The impact of the coronavirus pandemic is extremely challenging, with health systems often lacking the resources required to respond effectively. Plummeting commodity prices, weak external demand and capital outflows have compounded this challenge, leaving countries with rising difficulties in servicing dollar-denominated public and external debt.

5. **Given the unprecedented events that are unfolding, it is too early to be confident in setting out new projections for economic growth.** It seems likely that global growth will be negative in the first half of 2020, but there is little certainty about the subsequent outlook. The next *OECD Economic Outlook*, due out in June, will set out scenarios for how global economic developments may evolve. A gradual recovery could get underway in the latter half of 2020, but equally the coronavirus pandemic might last for an extended period if confinement strategies prove ineffective or health systems do not have sufficient capacity. Difficult decisions are required about the best way to ease confinement measures, with possible differences between sectors, workers, regions and age groups. The coronavirus pandemic could also return towards the end of the year after the easing of confinement measures, particularly as it will take time to develop effective treatments and vaccine.

6. **Governments and monetary authorities have reacted quickly to the crisis and provided large and wide-ranging support to bolster health sectors and cushion the impact of the economic downturn for workers and companies.** More measures are required to deal fully with the current health crisis, mitigate the economic downturn, restore confidence and protect the most vulnerable in societies. Policymakers also need to prepare for the possibility of a deeper or renewed outbreak of the coronavirus pandemic. Deeper international co-operation and coordination are essential to tackle the crisis effectively, address the underlying vulnerabilities that result, and rebuild economies in a sustainable and inclusive manner.

7. **Government efforts to support the economic recovery are essential, but careful choices are required to ensure that they are consistent with the actions needed to limit the long-term threat from climate change and support vulnerable people and communities**. Existing environmental standards should not be rolled back during the recovery and sector-specific financial support measures should be conditional on environmental improvements where possible. Governments also need to avoid the mistakes made in the aftermath of the Global Financial Crisis. Support should be focused on all aspects of people's lives, especially the vulnerable in society. Integrating these distributional aspects into policy responses is essential to prevent inequalities from widening further and to ensure a durable recovery for all.

Risks

8. **The sharp slowdown in economic activity raises risks that bankruptcies of non-financial companies could rise substantially, especially if the downturn proves protracted.** This will have negative effects on creditors, including banks. Financial stress has already intensified in the high-yield corporate bond market in the United States and the euro area, with the cost of market financing increasing abruptly to levels last seen in 2009. A surge in corporate defaults could occur over the next 12 months, especially in sectors hard hit by confinement measures and amongst highly indebted corporates. Further sell-offs of corporate bonds are likely if some of the bonds issued in recent years just above the non-investment grade are downgraded, as some institutional investors would be bound by regulation to sell these bonds. Banks are much better prepared to weather a recession than in 2008 but will still be adversely affected. Bank equity prices have declined sharply in many advanced economies since mid-January bank, credit default swap spreads have increased, and bank price-to-book values have declined significantly. Weaker bank earnings and rising non-performing loans, in the low-growth and low-interest environment, will constrain banks' willingness to lend in spite of monetary policy support.

9. **Emerging-market economies and developing countries remain highly vulnerable to the global recession and the coronavirus pandemic.** To a varying degree, they are heavily dependent on demand from advanced economies and China, and exposed to exchange rate risks. Many have high public and external debt, limited room for policy accommodation, and will find it difficult to deal with the pandemic given less developed health care sectors and social safety nets. Commodity producers with limited financial buffers are likely to be particularly affected. Risk perceptions with respect to emerging-market economies and developing countries have deteriorated rapidly, with yield spreads rising to 2009 levels, especially in Latin America, record portfolio capital outflows and downgrades of sovereign bonds.

10. **Global trade is being hit hard by the economic downturn.** Disruptions to supply chains as key producers shut down, and the rapid collapse of international travel and tourism, will spread the costs of the crisis throughout an increasingly interconnected world. In this extremely challenging context, there are risks that additional restrictions could arise on trade and investment, harming essential supply chains still further. Many countries cannot produce all the essential goods they need to be able to deal with these disruptions and restrictions effectively. Export restrictions on agro-food products are counterproductive for food security. Over 40 countries have also introduced restrictions on exports of medical supplies, although many others have either lowered tariffs or committed to keep supply chains open. These measures add to the trade tensions that were already a key factor behind the weakness of the global economy before the coronavirus outbreak and will result in allocative inefficiencies that reduce growth prospects further.

Policy Requirements

11. **Global co-operation and coordination is essential to tackle the severe challenges all countries are facing.** Acting together creates positive spillovers that will be more effective for each country than if they acted alone. Joint measures are required to enhance the production of medical infrastructure, equipment and supplies, and to ensure that affordable vaccines and treatments are widely and swiftly available wherever needed. Co-operation to lower trade tensions and offer debt relief is also vital to mitigate the damage to activity, ensure financial stability, support low-income economies and help restore confidence. And all countries must ensure that support for households and companies is provided on a timely basis through cash transfers, tax deferrals and loan guarantees, as is being done in many countries, with appropriate safeguards to ensure that this gradually fades once a recovery starts.

12. **Health systems are facing their most serious crisis in a century.** Containing and mitigating the spread and infection rate of the coronavirus is essential to reduce the pressure on health systems to manageable levels, provide effective patient care and reduce the incidence of infections. Key policy priorities include: ensuring access of the vulnerable to diagnostics and treatment; providing all resources necessary to strengthen the capacity of health systems; leveraging digital solutions and data to improve surveillance and care; and enhancing research into new diagnostics, treatments and vaccines. International co-operation and coordination via the G20 and other global fora is essential to track the spread of the pandemic, share information on effective containment and treatment interventions, ensure the smooth functioning of cross-border medical supply chains, and enhance joint research efforts.

13. **Many central banks have aggressively cut policy interest rates, committed to buy large amounts of sovereign and private assets, and implemented numerous measures to support liquidity in the financial sector and boost bank lending to businesses and households, including via special programmes and easing of prudential regulation.** The US Federal Reserve has also expanded currency swap lines with key central banks. All these measures should help ease stress in financial markets in the short-run and subsequently support the economic recovery. They also offer flexibility to deal with any return of financial market panic in many countries, which could occur if the duration and effects of confinement restrictions are greater than expected or if significant outbreaks of the epidemic occur in new countries. Risks remain, however, that some emerging-market economies and developing countries could still face liquidity shortages. The key objective for all central banks will be to prevent a systemic financial meltdown triggered by confinement-induced financial stress, especially in vulnerable sectors.

14. **Governments have announced and started implementing various support programmes.** Measures with direct impact on budget balances include extra spending on the healthcare sector, income support measures to individuals (mainly via wage subsidies to laid-off workers and the self-employed, temporary expanded unemployment benefits, exceptional support for child or other care needs, and expanded sick leave), and reductions in tax and social security contributions. In addition, many governments have deferred taxes and social security contributions for individuals and firms, and provided extensive state loan guarantees for private borrowers. Moratoria on interest payments and rents have also been announced in some countries. In the G20 economies, the value of all these measures is estimated to be over USD 5 trillion (5% of G20 GDP in 2019). Large direct stimulus measures have been announced in Japan and the United States, potentially amounting to around 6% and 7% of GDP in 2020, respectively. In many other countries, the largest part of the fiscal measures taken is accounted for by sizeable loan guarantees (amounting to around 15% of GDP in the United Kingdom and Spain, and over 25% of GDP in Germany). Additional expansions of fiscal programmes are already planned in several large economies.

15. **The main benefit of monetary and fiscal stimulus, together with automatic fiscal stabilisers, during the duration of confinement will be to support household incomes and liquidity in the economy, and to prevent the liquidity stress morphing into a widespread solvency crisis.** During this period, standard monetary and fiscal multipliers will likely be small, given containment restrictions for many economic activities and heightened economic uncertainty. Lifting of the containment restrictions will make the stimulus and automatic stabilisers more effective.

16. **If the crisis persists due to a recurrence of the pandemic and confinement measures, the onus for supporting and reviving the economy will be increasingly on fiscal policy, as room for lowering interest rates has been largely exhausted.** Central banks should maintain a low cost of borrowing, ensure the proper functioning of financial markets and minimise the risks of financial turmoil. This may require increased purchases of government bonds and private assets, or the more widespread adoption of yield curve control. The past and announced purchases of government bonds by central banks effectively monetise part of government debt if central banks maintain these bonds on their balance sheets and keep the remuneration of excess reserves low.

17. **In the euro area, fiscal challenges in some countries hard-hit by the pandemic may require finding new solutions to prevent the escalation of debt crises that could undermine the integrity of the euro area.** Possible solutions could involve expanded financing from the European Stability Mechanism (ESM), removing the ECB capital key rule for sovereign bond purchases so it can act a lender of last resort, and issuance of European debt instruments. All options are difficult politically but co-operation is essential to find a solution that enhances the European project in the longer term. In addition, a more prolonged suspension of some fiscal rules may be necessary to prevent the mistakes made in the aftermath of the 2008 crisis, with excessively rapid fiscal consolidation.

18. **Policymakers also need to take coordinated action to keep trade and investment flowing freely and ensure the functioning of essential supply chains.** The rapid spread of the coronavirus has raised the prospects of a reversal in globalisation as companies seek to mitigate risks of disruption in supply chains. Such re-shoring could have important adverse implications for global efficiency and inequality, as well as international trade and prices, eroding gains in living standards arising from the exploitation of comparative advantages. Confidence-building measures, such as strengthening the rules-based international trading system, as well as other forms of international co-operation, are essential to address these challenges.