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Research Briefing | Global

The global economy enters a short, sharp, recession

Economist

Innes McFee

Managing Director

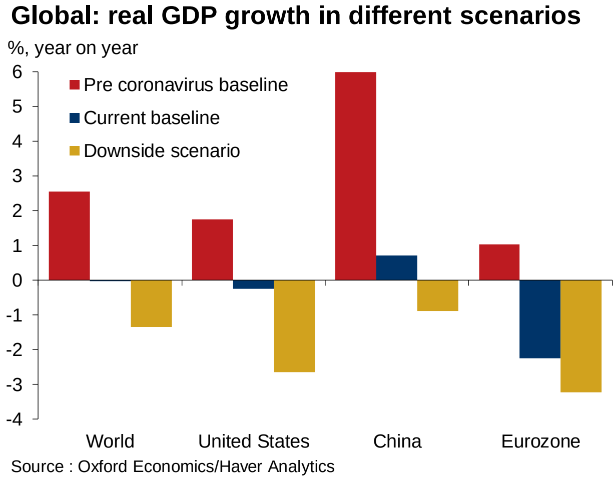
+44(0)20 3910 8028

- **In recent weeks we have revised down our baseline forecasts as more countries announced draconian policy measures to limit the spread of coronavirus. Our latest forecasts now show the global economy and many major economies entering a deep recession in the first half of 2020. Over the full year, we expect a rate of global growth of 0%, the second-weakest rate in almost 50 years.**
- **The near-term outlook is extremely challenging. But we believe that, consistent with historical experience, the bounce back in activity will be very strong once social distancing measures are relaxed, and monetary and fiscal stimulus combine with a resumption in discretionary spending. Businesses that can weather the crisis should be prepared for a strong end to 2020 and start to 2021, with global growth rising as high as 5% in annual terms.**
- **Still, as the rapid downgrades to our baseline demonstrate, we see huge uncertainty in this rapidly evolving environment. Therefore, we have updated our downside scenario to incorporate a worsening of the outbreak, the imposition of social restrictions, and financial stress. This scenario sees the global economy enter outright contraction in 2020, with GDP falling by 1.3%.**

The spread of the coronavirus to more economies, the imposition of social distancing across most of the western world, plus ongoing financial market turmoil despite heavy central bank intervention, lead us to make further significant across the board cuts to our 2020 GDP forecasts (**Figure 1**).

We now see global growth contracting in Q1 at a faster pace than during the global financial crisis. Global growth is likely to average just 0% in 2020, down from 2.5% in January, making this our largest two-month forecast revision ever, including the GFC. Within the global picture, revisions for the eurozone, China, and the US are most stark.

Figure 1: We now expect a global recession in both our baseline and alternative downside scenarios



Relative to our pre-coronavirus forecast, we have made huge downgrades to the outlook for economies around the world. We cannot rule out further downgrades to the baseline due to more measures to curb the spread of coronavirus. Therefore, we have also made available our view of a high probability downside scenario.

Contact: Innes McFee | imcfee@oxfordeconomics.com

In China, the latest official data for February was even worse than our already dire expectations, prompting us to cut our Q1 growth forecast from 2.3% to -5%, on an annual basis. For the eurozone, considering widespread lockdowns, factory closures, and travel restrictions, we have reduced our growth forecast by more than 5ppts for Q2 2020 with Italy and Germany particularly badly affected. Lockdowns in major US cities led us to lower our Q2 GDP forecast by more than 3ppts since early March.

Baseline: Recession, then a sharp rebound

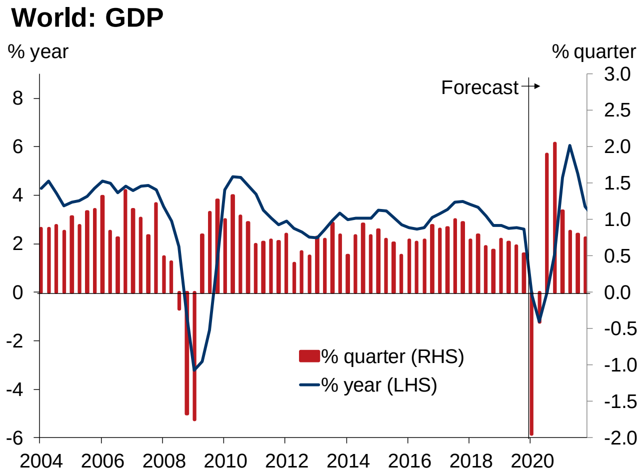
These truly staggering GDP contractions mean the global economy is set to shrink by 2% on a quarterly basis in Q1 and 0.4% in Q2 (**Figure 2**) – well past the GDP per capita contraction definition of a global recession. The speed and scale of the falls in GDP across so many countries (**Figure 3**) will make the first half of 2020 look very much like the global financial crisis.

The impact on the wider economy is likely to be profound. We expect world trade for the year to contract for only the second time since the mid-1980s. As a consequence of the collapse in activity and likely insolvencies, employment is set to fall by more than 1ppt in H1 2020, relative to the end of 2019. Global CPI inflation is set to undershoot even our pessimistic expectations and fall to 2.8% in 2020 from 3.2% in 2019.

Meanwhile, weaker demand and higher supply have led us to slash our oil price forecast for 2020, with prices falling to just $31pb in Q2 (**Figure 4**). While this will clearly benefit oil importers and provide a boost to consumer spending later in the year, it will also impact growth prospects for oil producers, including in the US. With prices remaining below current estimates of breakeven for most shale producers, we could start to see widespread defaults in the US energy sector. The resulting further disruption in credit markets is a key risk to our forecasts.

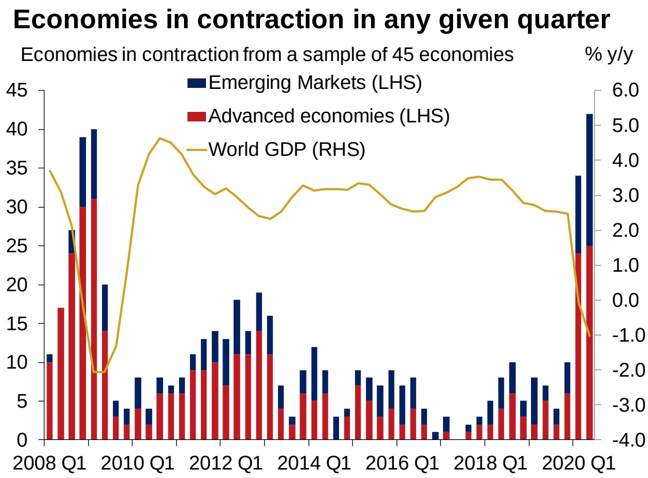
For financial markets, we do not expect respite any time soon. Equities are now in bear market territory (having fallen by more than 20%), and typically this depth of sell-off would have a lot further to go before reaching its conclusion (**Figure 5**). Considering the high starting point for valuations and the collapse in earnings, we expect US equities to reach their bottom in Q2, having fallen by around 30% from Q4 levels. Safe haven bond yields are likely to trough around the same time and stay low as the risk aversion of markets and weak inflation completely outweigh any influence from

Figure 2: The largest quarterly contraction in the global economy in living memory



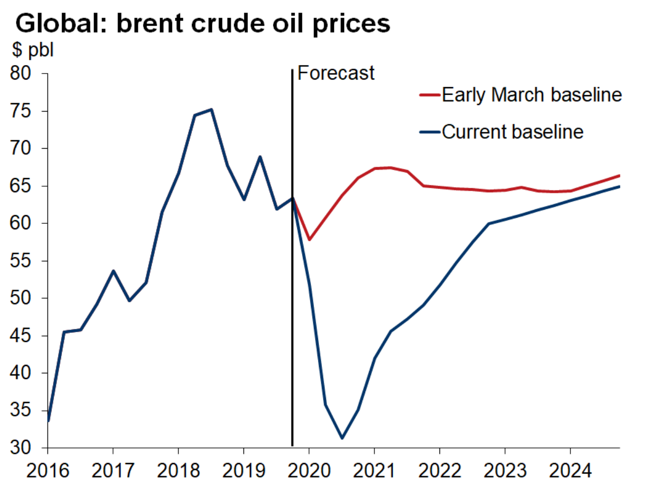
Source : Oxford Economics/Haver Analytics

Figure 3: We forecast contractions in 42 out of 45 countries in Q2 2020



Source : Oxford Economics/Haver Analytics

Figure 4: Oil prices are set to remain low this year and next



Source : Oxford Economics/Haver Analytics higher levels of issuance due to fiscal measures to combat the virus.

However, we do expect the economy to bounce back toward the end of 2020 in our baseline scenario. As historical experience from short recessions and previous outbreaks shows, most activity tends to be delayed rather than destroyed entirely. The resumption of activity combined with growing levels of policy stimulus should create the conditions for growth to return to our pre-coronavirus baseline relatively quickly – potentially during 2021.

Downside scenario: Deeper, longer recession

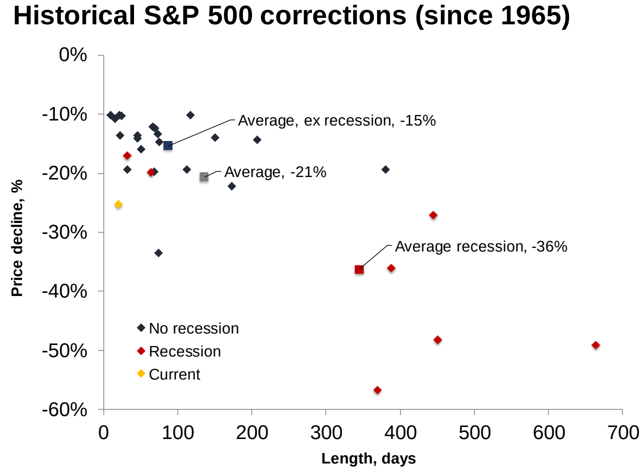
As in 2008, forecasting the economy at the moment is like trying to predict where the next lightning bolt will strike. The imposition (and lifting) of public health measures have dramatic impacts on the economy and financial markets, but are virtually impossible to anticipate from week to week. Needless to say, the lack of any exact historical precedent for the current crisis makes predicting what happens next all the more difficult. Because of this extremely volatile environment, we do not have the usual high degree of confidence in our baseline forecast.

As such, despite the downward revisions in recent months, we see ongoing, sizeable downside risks. First is the duration of the current outbreak and the possibility of further waves, alongside associated policy measures to limit the spread. Second is the ability of policy makers to stem panic among market participants and firms, helping to limit the spike in unemployment. Third is the degree to which the crisis has lasting effects on the behaviour of firms and individuals.

Building on our previous pandemic scenario, we model a worse, yet plausible downside for the global economy. In this alternative scenario more countries suffer even worse effects that are longer lasting, while the financial market spillovers are greater than in our current baseline (see calibration details below). **Rather than being a low probability, extreme case, to us this scenario represents a plausible alternative baseline that, if the situation continues to deteriorate at the current pace, could become our central view in the coming months.**

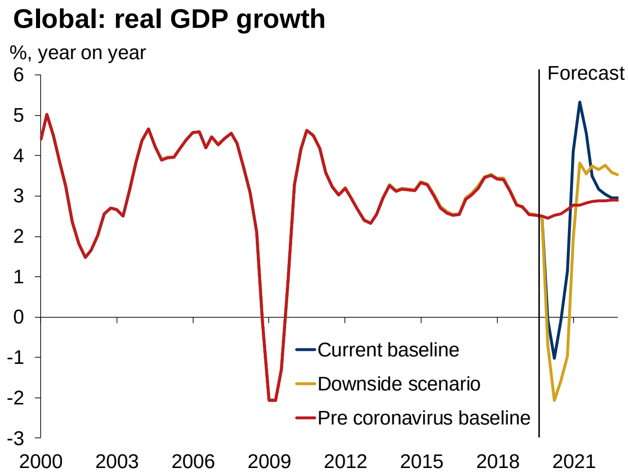
In this scenario, the global economy suffers an outright contraction of 1.3% in 2020 (**Figure 6**) with severe recessions in all major economies during 2020. In general, the impacts and channels are similar to those in the current

Figure 5: Equity prices tend to fall much further when the economy is in recession



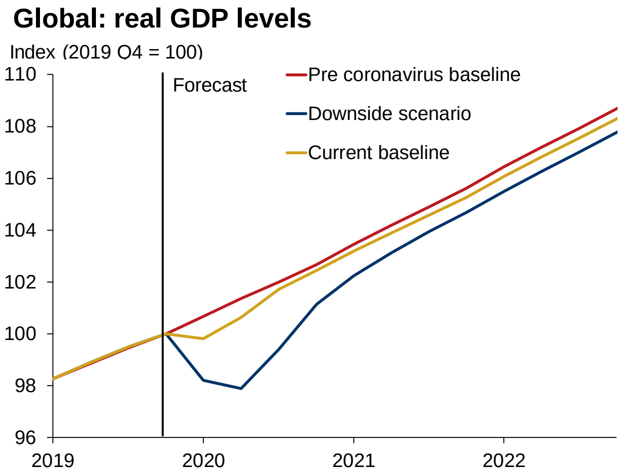
Source : Oxford Economics/Refinitiv Datastream

Figure 6: Our downside scenario sees a prolonged outright contraction in global GDP



Source : Oxford Economics/Haver Analytics

Figure 7: The downside scenario illustrates a larger temporary, and more permanent, shock

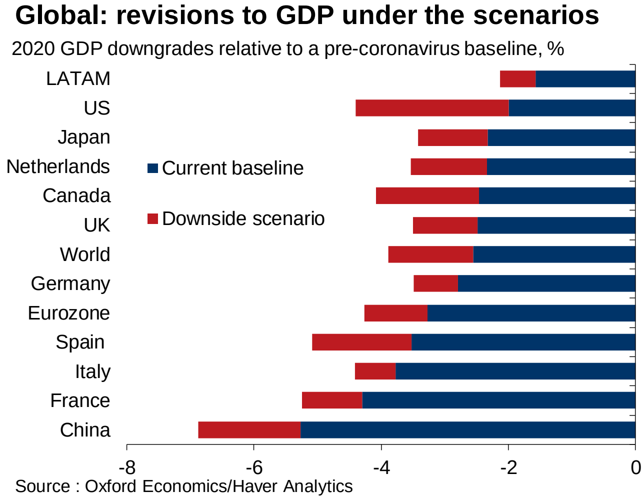


Source : Oxford Economics/Haver Analytics baseline, but amplified and for longer. In that sense our downside scenario envisages a protracted downturn with more permanent damage to activity, reducing the size of the rebound in the near term (**Figure 7**).

The magnitude of the revisions to 2020 growth in the downside scenario illustrate the risks to our current baseline for the major economies (**Figure 8**). Clearly, in countries that are currently very badly affected (China and Italy), further downside risk is limited. But in countries where the impact on the forecast is relatively (in the current environment) small, the risks to the downside are far bigger.

Time will tell how authorities will balance the interests of the economy against the threat to life. Either way, the near-term economic consequences will be dire. Still, this crisis will not go on forever.

Figure 8: GDP revisions vs the pre-coronavirus baseline are huge under both scenarios



Source : Oxford Economics/Haver Analytics

Calibrating the alternative downside scenario

We have calibrated the downside scenario to be consistent with the changes to the March baseline forecast and our previous pandemic scenario (albeit with greater financial market shocks). In a sense, the downside scenario simply reflects a more severe (although still plausible) flexing of those assumptions given the high levels of uncertainty in the outlook. We broadly categorise countries into three buckets in terms of the severity of coronavirus outbreak and containment measures. Under the baseline, countries are mainly in the middle bucket with a few (China and parts of the eurozone) in the most severe category. Under the downside scenario, more advanced economies (including the US and UK) are pushed into the severe category, and no economies are left in the mildly affected bucket. The model shocks or transmission channels, which vary by country according to the harshness of announced measures, can be categorised as follows:

- **An ex ante shock to discretionary consumption.** Based on previous work on the impacts of pandemics (see Keogh-Brown et al), we calibrate an initial shock to consumption based on assumptions about the delay to spending by consumption category. The assumptions we flex between the baseline and alternative scenario are the duration of the epidemic and the proportion of consumers changing their behaviour. This shock is applied ex ante (meaning that second-round effects – particularly from equity markets) are then allowed to feed back into consumption. We will publish a Research Briefing soon with more detail on how we have conducted this calibration and its assumptions.
- **Travel and tourism impacts.** As with our previous global pandemic scenario, we assume severe levels of impact and reflect these in shocks to services imports and exports at a country level.
- **Financial market contagion.** To reflect the deterioration in sentiment (rather than purely fundamentals that the model already captures), we apply negative shocks to equity markets globally, reflecting the size of sell-offs during severe recessions, and to bond risk premia (negative to safe havens like the US). We apply positive shocks to less creditworthy sovereigns, which are scaled according to our latest sovereign risk scores that assess underlying levels of vulnerability.

Global Economic Model clients will be able to access the scenario via the “predefined scenarios” section on the Global Model Workstation after having done a full model installation. We will also make the eqn file available upon request. For non-model users we can make data available on request.