

FOREWORD

More than one million lives have been lost to COVID-19 since the start of the year and the toll continues to rise. Many more have suffered serious illness. Close to 90 million people are expected to fall into extreme deprivation this year.

These are difficult times, yet there are some reasons to be hopeful. Testing has been ramped up, treatments are improving, and vaccine trials have proceeded at an unprecedented pace, with some now in the final stage of testing. International solidarity has strengthened along some dimensions, from rolling back trade restrictions on medical equipment to enhancing financial assistance for vulnerable countries. And recent data suggest that many economies have started to recover at a faster pace than anticipated after reopening from the Great Lockdown.

We are projecting a somewhat less severe though still deep recession in 2020, relative to our June forecast. The revision is driven by second quarter GDP outturns in large advanced economies, which were not as negative as we had projected; China's return to growth, which was stronger than expected; and signs of a more rapid recovery in the third quarter. Outturns would have been much weaker if it weren't for sizable, swift, and unprecedented fiscal, monetary, and regulatory responses that maintained disposable income for households, protected cash flow for firms, and supported credit provision. Collectively these actions have so far prevented a recurrence of the financial catastrophe of 2008-09.

While the global economy is coming back, the ascent will likely be long, uneven, and uncertain. Indeed, compared to our forecast in June, prospects have worsened significantly in some emerging market and developing economies where infections are rising rapidly. Consequently, emerging market and developing economies, excluding China, are projected to incur a greater loss of output over 2020-21 relative to the pre-pandemic projected path when compared to advanced economies. These uneven recoveries significantly worsen the prospects for global convergence in income levels.

Moreover, recovery is not assured while the pandemic continues to spread. With renewed upticks in COVID-19 infections in places that had reduced local transmission to low levels, re-openings have paused, and targeted shutdowns are being reinstated. Economies everywhere face difficult paths back to pre-pandemic activity levels.

Preventing further setbacks will require that policy support is not prematurely withdrawn. The path ahead will require skillful domestic policies that manage trade-offs between lifting near-term activity and addressing medium-term challenges. The October 2020 *Global Financial Stability Report* highlights such trade-offs for monetary policy. Sustaining the recovery will also require strong international cooperation on health and financial support for countries facing liquidity shortfalls. Finding the right policy mix is daunting, but the experience of the past few months provides grounds for cautious optimism that the priorities laid out in this report can be achieved.

A key aspect of combating the health crisis is to ensure that all innovations, be they in testing, treatments, or vaccines, are produced at scale for the benefit of all countries. Advance purchase commitments for vaccines under trial can help spur this process for manufacturers who may otherwise hesitate to bear the upfront cost. This effort should include a strong multilateral component to help distribute doses to all countries at affordable prices. More generally, the global community will need to continue helping countries with limited health care capacity through sharing equipment, know-how, and through financial support from international health agencies.

At the national level, governments have already responded with a variety of fiscal countermeasures that include efforts to cushion income losses, incentivize hiring, expand social assistance, guarantee credit, and inject equity into firms. These measures have prevented widespread firm bankruptcies and have helped employment rebound partially. Employment and labor force participation, however, remain well below pre-pandemic levels, and many more millions of jobs are at risk the longer this crisis continues. To preserve

jobs, it is important for governments, where possible, to continue to support viable but still vulnerable firms with moratoria on debt service and equity-like support. Over time, once the recovery has taken a strong hold, policies should shift gradually to facilitating reallocation of workers from sectors likely to shrink on a long-term basis (travel) to growing sectors (e-commerce). Along the transition, workers will need to be supported, including through income transfers, retraining, and reskilling programs.

Advanced economies have generally been able to deliver larger direct spending and liquidity support relative to GDP than others constrained by elevated debt and higher borrowing costs. Those constrained countries will need to create room for immediate spending needs by prioritizing crisis countermeasures and reducing poorly targeted subsidies. Some will require additional help from creditors and donors through debt restructuring, grants, and concessional financing, building on important initiatives under way. The IMF has been central to these initiatives through its joint call with the World Bank on debt service suspension for low-income countries, its call for reform of the international debt architecture, and its extension of funding at unprecedented speed to several member countries.

Further complicating the task that countries face is the need to address challenges coming out of the pandemic. In this report we are releasing medium-term growth projections for the first time since the crisis started. While uncertainty remains substantial, growth is expected to moderate significantly, following the projected rebound in global activity in 2021. Both advanced and emerging market economies are likely to register significant losses of output relative to their pre-pandemic forecasts. Small states as well as tourism-dependent and commodities-based economies are in a particularly difficult spot.

Most economies will experience lasting damage to supply potential, reflecting scars from the deep recession this year and the need for structural change. The persistent output losses imply a major setback to living standards relative to what was expected before the pandemic. Not only will the incidence of extreme poverty rise for the first time in over two decades, but inequality is set to increase because the crisis has disproportionately affected women, the informally employed, and those with relatively lower educational attainment, as discussed in Chapter 2 of this report. The loss of human capital accumulation after widespread school closures poses an additional challenge.

Moreover, sovereign debt levels are set to increase significantly even as downgrades to potential output imply a smaller tax base that makes it harder to service the debt. On the plus side, the prospects of low interest rates over a longer period, alongside the projected rebound in growth in 2021, can help alleviate debt service burdens in many countries. To ensure that debt remains on a sustainable path over the medium-term governments may need to increase the progressivity of their taxes and ensure that corporations pay their fair share of taxes while eliminating wasteful spending.

Near-term support policies should be designed with a view toward placing economies on paths of stronger, equitable, and sustainable growth. As discussed in Chapter 3 of this report, policymakers can simultaneously aim to mitigate climate change and bolster the recovery from the COVID-19 crisis. This can be achieved through a comprehensive package that includes a sizable green public infrastructure push, a gradual rise in carbon prices, and compensation for lower income households to make the transition fair. More generally, expanding the safety net where gaps exist can ensure the most vulnerable are protected while supporting near-term activity, as already seen, for example, in many advanced economies where disposable income remained relatively stable even as GDP registered record collapses. And investments in health and education (including to remedy losses incurred during the pandemic) can help achieve participatory and inclusive growth. The October 2020 *Fiscal Monitor* makes a strong case for public investment in these times of heightened uncertainty.

We have already had significant policy innovations in the past few months: the establishment of the European Union pandemic recovery package fund, the launch of asset purchases by emerging market central banks, and the novel use of digital technologies to deliver social assistance in places like sub-Saharan Africa. Such actions have prevented even more extreme collapses and are a powerful reminder that effective, well-designed policies protect people and collective economic well-being. Building on these actions, policies for the next stage of the crisis must seek lasting improvements in the global economy that create secure, prosperous futures for all.

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