



A Ray of Light

Economic forecasting this year has been like trying to shoot a fast moving target. As soon as your forecasts are locked in, the elusive target moves. Even forecasts published just over a month ago by the IMF and OECD have been overtaken by events. A second wave to the coronavirus really has really taken hold in many developed economies in recent weeks, resulting in the re-imposition of restrictions on activity, with many European countries going back into lockdown.

The economic recovery seen in the third quarter has been stopped in its tracks, with many countries now looking at a double-dip recession in the fourth quarter. The virus is also proving persistent, which means the consequent economic restrictions are likely to extend well into next year. As a result, growth forecasts for 2020 and 2021 are being revised down. The Bank of England recently lowered its 2020 UK GDP forecast from -9.5% to -11%, with the projected size of the rebound in growth in 2021 cut from 9% to 7.25%.

The past week, though, has seen news from Pfizer that it has developed what appears to be a highly effective vaccine, which points to upside risks to growth forecasts over the next couple of years. Although, there is still considerably uncertainty about the vaccine and it is likely to be mid-2021 or later before it becomes widely available.

There are questions about whether the vaccine will be effective among the most vulnerable groups of the population in particular the elderly, how long will immunity last, and if other companies will be able to produce a successful vaccine also, boosting the available supplies.

Despite these uncertainties, the news of a vaccine is seen as very positive for the world economy as reflected in the bounce in global stock markets following its announcement. It should allow restrictions to be lifted more quickly over the course of 2021, helping a strong sustained recovery to take root during next year.

However, it still needs to be borne in mind that this has been a deep and severe recession, which is likely to leave scarring effects and accelerate structural changes that may inhibit the recovery in activity. Scarring effects include rising numbers of business failures and bad debts, permanent job losses and lower labour force participation rates, inefficient uses of resources as well as long-term damage to confidence.

Structural changes that will impact negatively on parts of the economy include a shift to remote working, lower levels of international trade and travel, as well as a fall-off in in-store shopping. There have been casualties already and more are likely, with some sectors taking years to recover from the collapse in demand they have experienced in 2020.

Thus, central banks will keep monetary policy very accommodative over the next number of years. Indeed, more easing measures are still very much on the cards from the ECB next month. However, a successful vaccine reduces the chances of further rate cuts by central banks next year.



Meantime, governments will also need to maintain supports for businesses and households through what is going to be a very challenging winter. Overall, it is still likely to be 2022 before we see a full recovery from the 2020 recession. However, the news of a vaccine means there is now increased confidence about such a recovery. Markets can smell it, even if it still some time off.

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