

HIGHLIGHTS from Chapter 3: Lasting Scars from the Pandemic

Key Points

- *Unprecedented restrictions needed to address the COVID-19 pandemic have triggered deep recessions in many advanced economies and emerging market and developing economies (EMDEs). EMDEs with weak health systems; that rely heavily on trade, tourism, or remittances from abroad; and that depend on commodity exports will be particularly hard-hit.*
- *Deep recessions currently underway are likely to leave lasting scars through multiple channels, including lower investment and innovation, erosion of the human capital, and retreat from global trade and supply chains.*
- *These effects may well lower potential growth and labor productivity in the longer term. The long-term damage will be particularly severe in economies that suffer financial crises, and, in energy exporters, due to plunging oil prices. For example, in the average EMDE, over a five-year horizon, a recession combined with a financial crisis could lower potential output by almost 8 percent.*

Severe short-term impact. While outbreaks in most advanced economies appear to be abating, the pandemic is rapidly spreading across EMDEs, including in low-income countries (LICs), where health care systems have very limited capacity. The pandemic and the widespread restrictions put in place to stem it have already caused a deep global recession (**Figure 1**). Along with the public health crisis, EMDEs are facing tighter financing conditions, lower commodity prices, sharp declines in remittances, and collapsing international trade.

Impacts magnified by pre-existing vulnerabilities. Many EMDEs entered this global recession less prepared, and with larger macroeconomic vulnerabilities, than they did the last global recession in 2009. The EMDEs most vulnerable to the impact of the pandemic include those that have weak health systems, that rely heavily on global trade or tourism, that are susceptible to financial disruptions, and that depend on oil and other commodity exports.

Lasting scars. COVID-19 and the resulting global recession will leave lasting scars. Investment and innovation will be weakened. Human capital will be eroded through unemployment and lost education. Trade linkages and supply chains may be permanently unwound. Behavioral patterns, including more cautious services consumption, may persist.

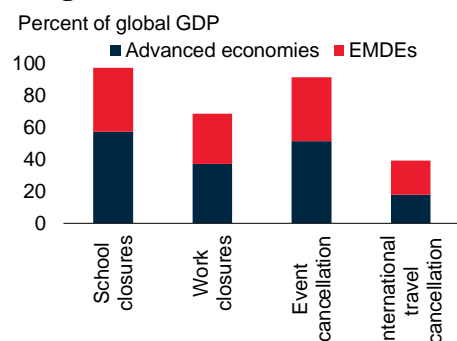
Aggravation of long-term challenges. These prospects come on the heels of already challenging conditions in EMDEs. During the past decade, EMDE growth projections were downgraded repeatedly amid steadily declining potential growth. The pandemic is expected to exacerbate the trend slowdown in potential output growth and productivity growth. In the average EMDE, over a five-year horizon, a recession combined with a financial crisis could lower potential output by almost 8 percent, while in the average EMDE energy exporter, a recession combined with an oil price plunge could lower potential output by 11 percent. Past epidemics lowered investment by about 11 percent and labor productivity by 6 percent after five years in affected countries, and in some instances significantly more.

Global Economic Prospects

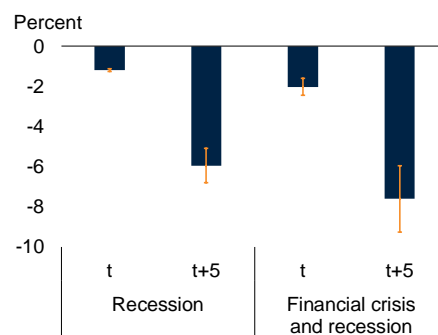
Figure 1. Long-term implications of the COVID-19 pandemic for the global economy

Nearly all of the world economy has been subject to restrictions on activity, which have contributed to a collapse in global trade and commodity prices and a tightening of financing conditions. Past recessions have led to lasting output losses, especially if accompanied by financial crises or, for energy exporters, by oil price plunges. Past epidemics have led to lasting investment and productivity losses. These adverse effects on long-term growth prospects may be magnified by pre-existing macroeconomic vulnerabilities, human capital erosion during the pandemic, and changes in consumption habits that extend after the pandemic.

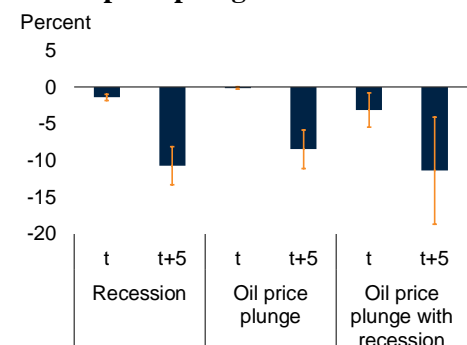
A. Share of global GDP affected by mitigation measures



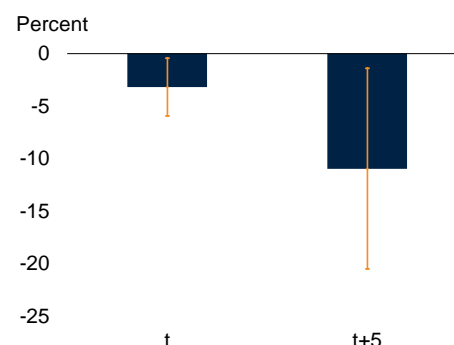
B. Cumulative EMDE potential output response after recessions and financial crises



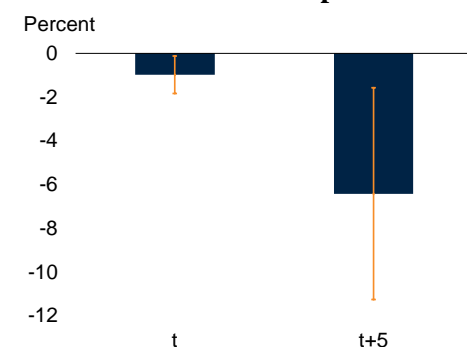
C. Cumulative EMDE potential output response in energy exporters after recessions and oil price plunges



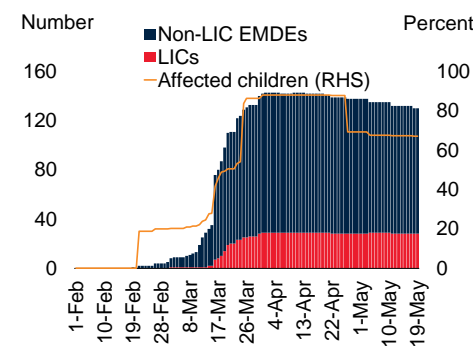
D. Cumulative investment response in affected countries after epidemics



E. Cumulative labor productivity response in affected countries after epidemics



F. School closures



Source: Ha, Kose, and Ohnsorge (2019); IMF *International Financial Statistics*, *World Economic Outlook*; Kose et al. (2017); Oxford University's database Variation in Government Responses to COVID-19; Raigor et al. (2020); UN World Population Prospects; World Bank World Development Indicators; World Bank.

Global Economic Prospects

A. Figure shows share of GDP accounted for by economies with restrictions. Restrictions are counted if required (i.e., not only recommended) and, for school and work closures, if applied across all levels and sectors, respectively. Travel restrictions are counted if they entail a ban on arrivals from all regions or a total border closure. Data is for April 1, 2020.

B. C. Charts show impulse responses for 75 EMDEs from local projections model. Dependent variable is cumulative slowdown in potential output after a recession, financial crisis, or oil price plunge event. Bars show coefficient estimates; vertical lines show 90 percent confidence bands.

D.E. Bars show the estimated impacts of SARS (2002-03), MERS (2012), Ebola (2014-15), and Zika (2015-16) on investment (D) and labor productivity (E) levels. Vertical lines show range of the estimates with 90 percentile confidence. Swine flu (2009), which coincided with the 2008-09 global financial crisis, is excluded to limit possible confounding effects. The sample includes 116 economies: 30 advanced economies and 86 EMDEs.

F. Number of countries that have either recommended or required school closings as part of measures to contain the domestic spread of COVID-19. Last observation is May 19, 2020.