

[2020-22 Economic Outlook : World]

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## **World Economy Struggling to Break Out of the Worst, Bipolar Recession**

**— Risk of excessive debt problem in government and  
non-financial company sector —**

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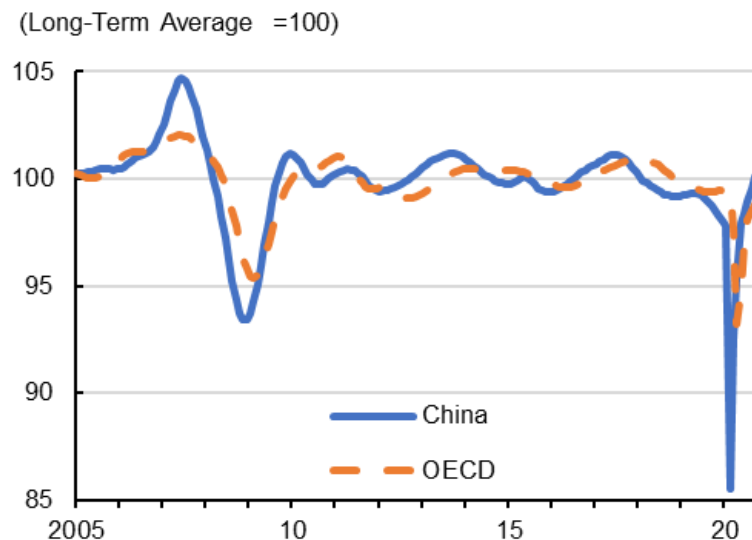
- ◆ The global economy saw a sharp decline in the first half of 2020 due to the spread of Covid-19 and the pick up that occurred in the middle of the year. In June, the IMF forecast growth in 2020 at minus 5.2%, but then raised it to minus 4.4% in October, indicating that excessive pessimism is receding. The pace of recovery in China, which was the first country to contain the spread of the disease, has been faster, while the pace of recovery has slowed in Europe and the United States, where the disease is spreading again.
- ◆ The current recession is characterized by (1) an enormous negative impact on employment, (2) widening income disparity, (3) high stock prices during the recession, and (4) record levels of fiscal and monetary expansion. Although the worst recession since the Great Depression has been brought to a halt by the mobilization of fiscal and monetary policies all over the world, polarization has developed in various fields.
- ◆ Looking at the world economy, for the time being, its recovery trend is expected to continue on the assumption that Covid-19 will settle down in the latter half of 2021 and that vaccines will gradually be put into practical use. However, the pace of economic recovery has so far been slow, especially in Europe and the United States, as people remain wary of the spread of the disease. Even if a vaccine is developed, it is expected to take time for it to be disseminated around the world. In 2021, the GDP growth rate is expected to increase by 5.2% from the previous year, and in 2022 it is expected to increase by 3.3%. However, the average growth rate between 2020 and 2022 was only about 2%, which is equivalent to that of past recessions.
- ◆ As for the outlook for the global economy in the near future, attention should be paid to (1) a relatively early recovery in the trade of goods, but a slow recovery in travel, (2) steady growth in the high-tech sector against the backdrop of increased investment in 5G, and (3) increased investment in green recovery-related industries, which will contribute to the growth of the global economy.
- ◆ The medium-term risk to the global economy is the possibility of a collapse of the debt bubble in the government and non-financial sectors, where the policy response to Covid-19 led to a sharp increase in debt. In order to reduce the debt of the two sectors without adversely affecting the economy after Covid-19, it is important to take measures such as (1) introduction of a special account to promote debt disposal, (2) preparation of a schedule for debt reduction, and (3) targeted support for the non-financial sector, which has experienced a sharp increase in debt. It is also necessary for G- 20 countries to cooperate in implementing countermeasures, as during the aftermath of the Lehman crisis.

# 1. Current state of the world economy

## (1) to pick up from July-September

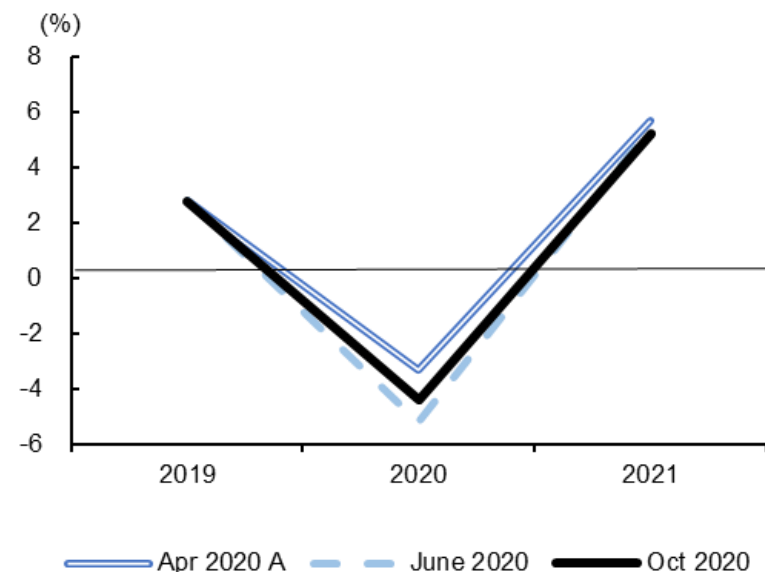
- The global economy plunged in the first half of 2020 due to the spread of Covid-19, but showed signs of recovery after the middle of the year. In October, the IMF raised its forecast for the world economy, reversing its excessive pessimism.
- By region, the pace of recovery was faster in China, but slower in the United States and Europe.

OECD leading indicators



Source: The Japan Research Institute, Ltd. based on OECD data "Composite leading indicator (CLI)" (Y/M)

IMF Outlook

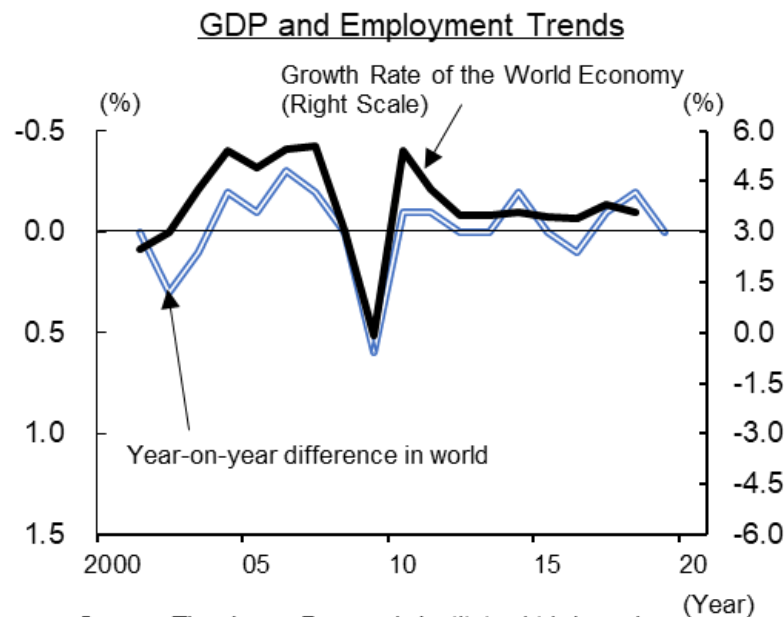


Source : The Japan Research Institute, Ltd. based on IMF "World Economic Outlook" data

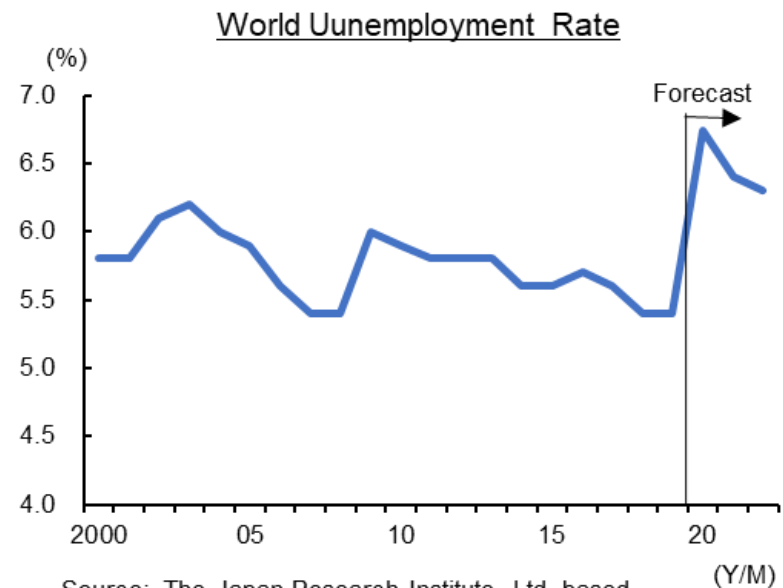
# 1. Current state of the world economy

## (2) Characteristics of the current recession A. Significant negative impact on employment

- One characteristic of this recession is a significant global loss of employment in the short term.
- Looking at past trends, the world unemployment rate is linked to the real growth rate of the world economy. Based on our company's projections, the world unemployment rate in 2020 will be 6.8%, the worst of the 21<sup>st</sup> century so far. Employment will likely remain lackluster on the whole.



Source: The Japan Research Institute, Ltd. based on IMF and ILO data.



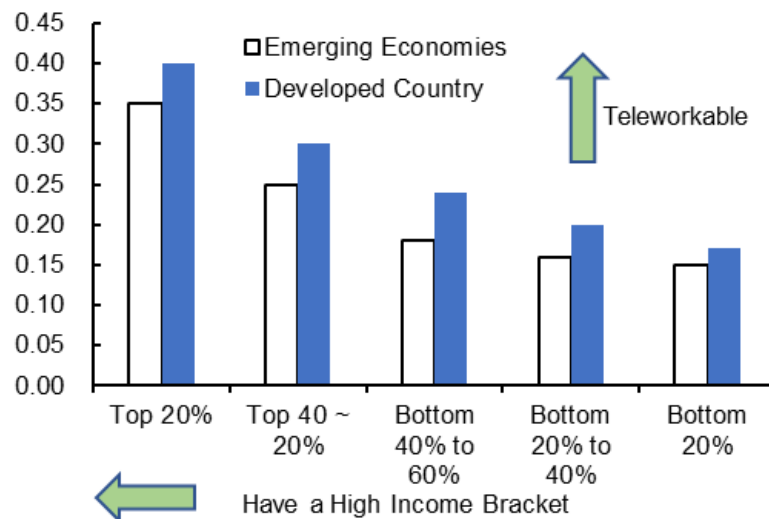
Source: The Japan Research Institute, Ltd. based on ILO data

# 1. Current state of the world economy

## (2) Characteristics of the current recession B. The widening gap

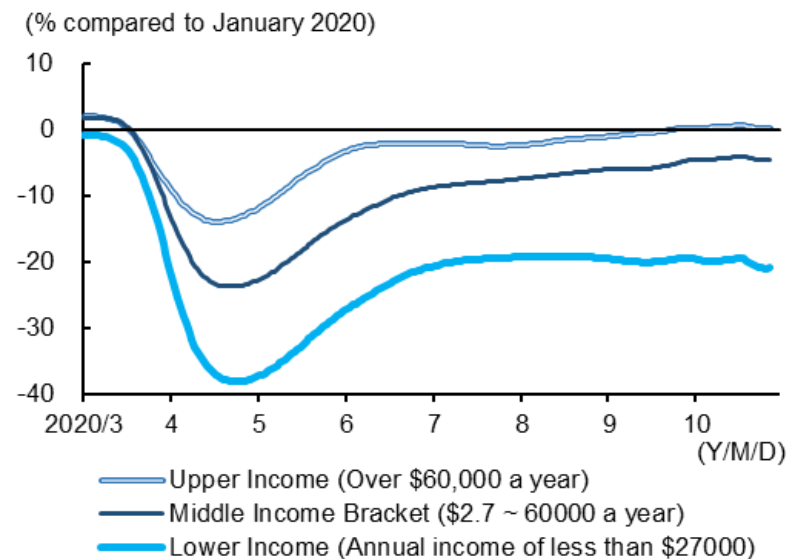
- Covid-19 has contributed to the development of bipolarization. In the IT industry, where social distancing has created special demand, and for jobs with a high telework rate, income is solid despite the economic downturn.
- Looking at employment levels by income bracket, the upper income bracket tends to recover faster than the lower income bracket, accelerating employment polarization.

Relationship between Income and Telework Rate



Source: The Japan Research Institute, Ltd. based on IMF data  
Note: 1 if everything is via telework, 0 if none.

Employment Levels by Income Class in the United States



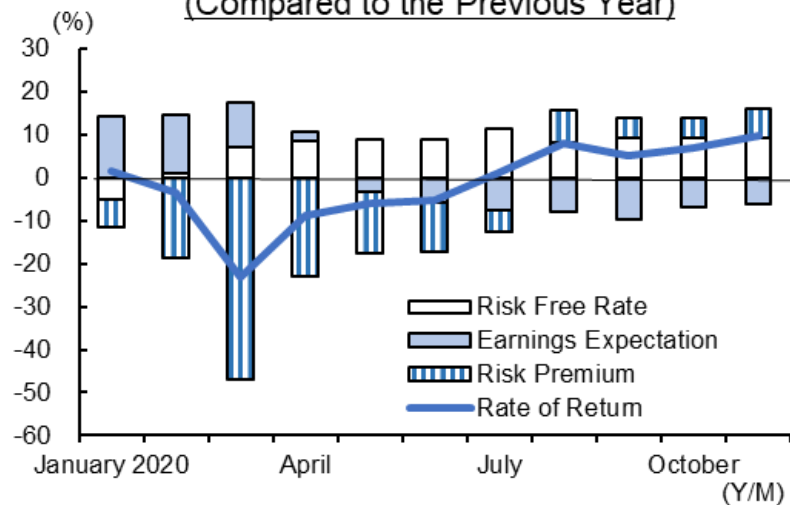
Source: The Japan Research Institute, Ltd. based on The Opportunity Insights data

# 1. Current state of the world economy

## (2) Characteristics of the current recession C. High stock prices

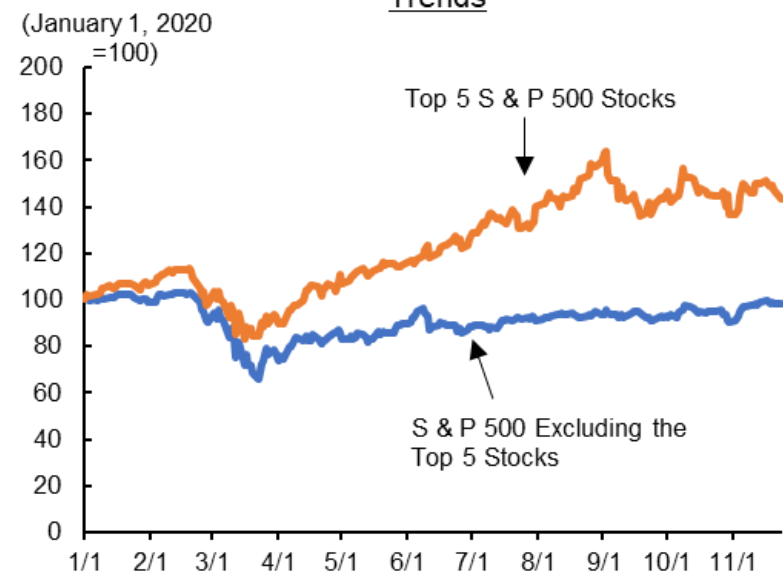
- Stock prices are robust while the real economy is in the worst recession since the Great depression. However, price support factors are the risk-free rate reduction and high risk appetite of investors. Expected return contributes negatively.
- The number of good performance stocks is very small.

Decomposition of S & P Performance Factors  
(Compared to the Previous Year)



Source: Based on the International Monetary Fund "Global Financial Stability Report October 2020," Bloomberg. L.P.  
Created by the Japan Research Institute  
Note: Factor analysis of S & P rate of return by regression analysis using FF rate and earnings forecast of each company.

Top 5 S & P 500 Stocks and Other Stock Trends



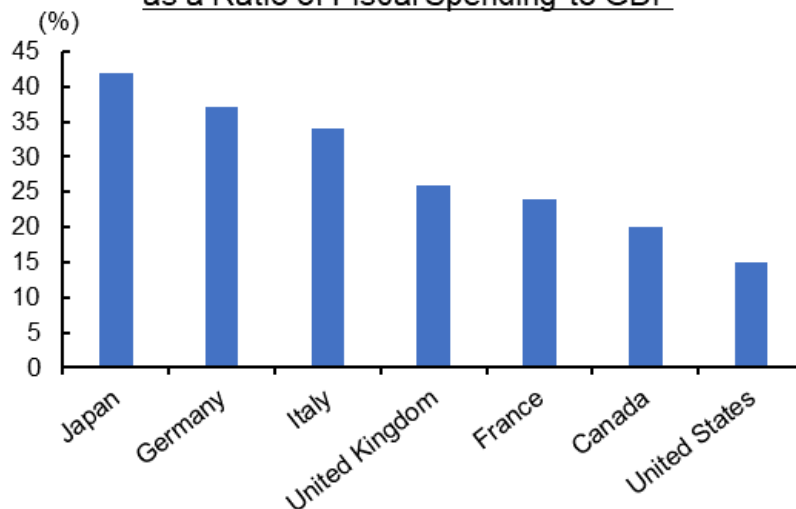
Source: The Japan Research Institute, Ltd. based on Bloomberg L.P. data (M/D)

# 1. Current state of the world economy

## (2) Characteristics of the current recession D. Biggest fiscal and monetary expansion ever

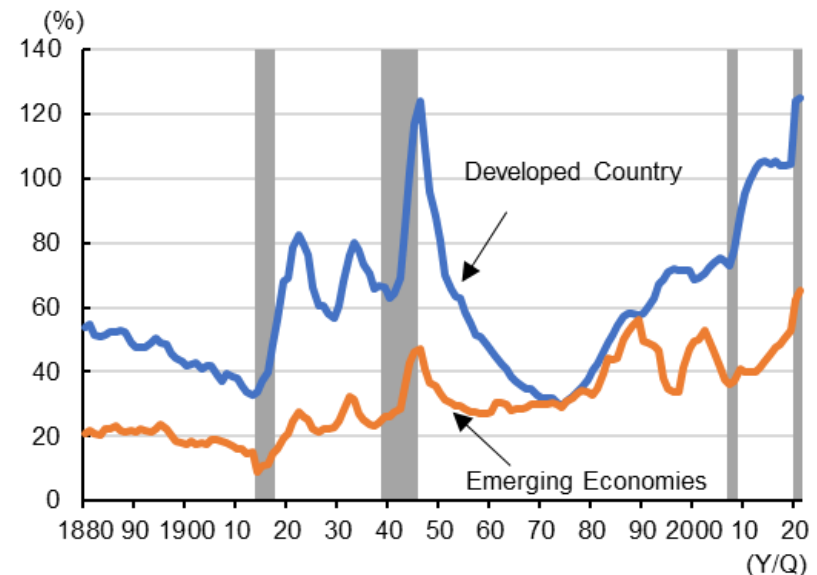
- In each country, large-scale economic stimulus measures were implemented to cope with Covid-19. As a result, the ratio of outstanding government bonds to GDP is the worst since 1880. Interest rates are also historically low.
- After the end of Covid-19, fiscal and monetary policies will normalize, but there is a risk that this will cause great confusion.

Developed Countries' Corona Policy as a Ratio of Fiscal Spending to GDP



Source: The Japan Research Institute, Ltd. based on data published by governments in each

Ratio of Government Bond Issuance to GDP



Source: The Japan Research Institute, Ltd. based on IMF "Fiscal Monitor October 2020" data

# 2. Outlook for the world economy

## (1) Summary

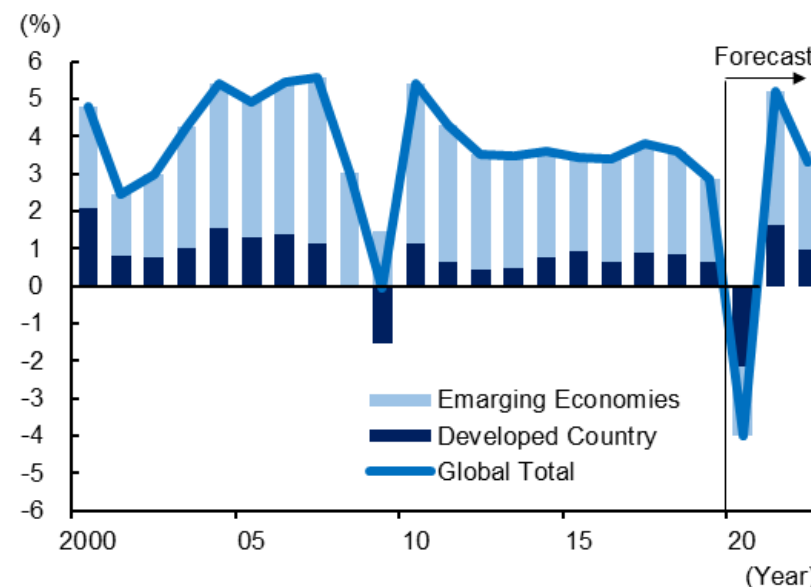
- The global economy continues to recover, particularly China. However, the pace of world economic recovery is slow.
- In 2021, it is expected to increase by 5.2%, and 3.3% in 2022. However, between 2020 and 2022, the average growth rate is expected to be around only 2%, which is equivalent to a "recession" according to conventional standards.

Global Real GDP Growth Outlook

(Calendar year,%)

	2019 (Achievements)	2020 (Forecast)	2021 (Forecast)	2022 (Forecast)
Global total	2.8	▲4.0	5.2	3.4
Developed Countries	1.6	▲5.6	4.3	2.8
Americas	2.2	▲3.6	3.9	3.2
Eurozone	1.3	▲7.1	4.9	2.3
United Kingdom	1.3	▲11.1	7.0	3.2
Japan	0.7	▲5.1	2.3	1.9
Emerging Economies	3.5	▲3.0	5.8	4.3
BRICs	4.8	▲1.5	7.3	4.6
China	6.1	1.8	8.2	5.1
India	4.2	▲10.6	11.0	5.5
Russia	1.3	▲4.1	2.8	2.3
Brazil	1.1	▲5.8	2.8	2.3
NIEs	1.7	▲1.3	3.5	2.1
South Korea	2.0	▲1.0	3.0	2.1
Taiwan	2.7	2.0	3.9	2.1
Hong Kong	▲1.2	▲6.0	2.7	2.2
ASEAN 5	4.8	▲3.3	5.7	5.0
Indonesia	5.0	▲1.4	5.4	5.2
Thailand	2.4	▲6.3	3.4	2.9
Malaysia	4.3	▲5.2	6.4	4.5
Philippines	6.0	▲9.4	8.1	6.1
Vietnam	7.0	2.7	7.2	6.6

Breakdown of Contributions to Global GDP Growth



Source : The Japan Research Institute, Ltd. based

Source: The Japan Research Institute, Ltd. based on statistics data from each country by the IMF.

Note 1: 193 countries around the world. Developed countries exclude NIEs from the IMF classification. Specifically, the United States, Japan, and the Euro area (19 countries) and 35 other countries, including Britain, Australia and Canada. Countries other than developed countries are defined as emerging countries.

Note 2: regions are based on purchasing power parity.

Note 3: Annual basis for India only (From April of the current year to March of next year).

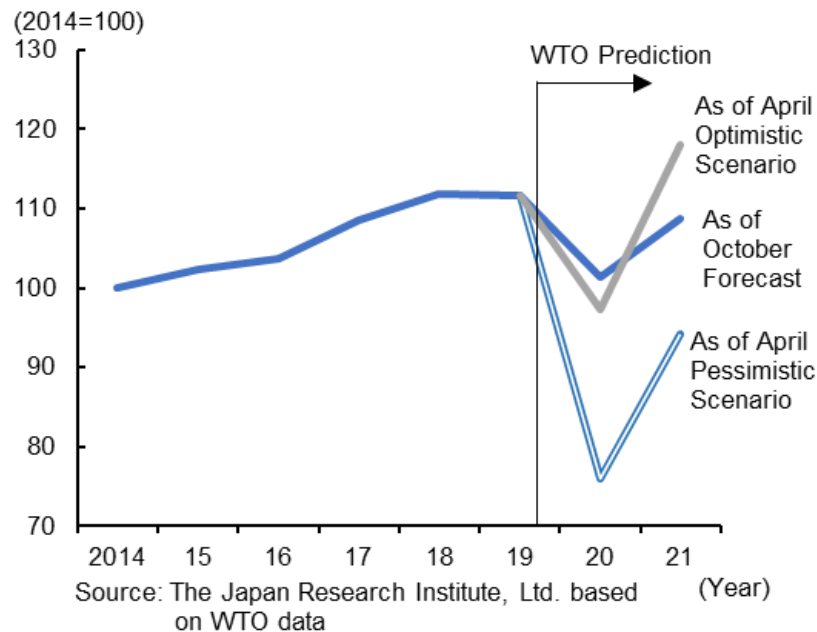


# 2. Outlook for the world economy

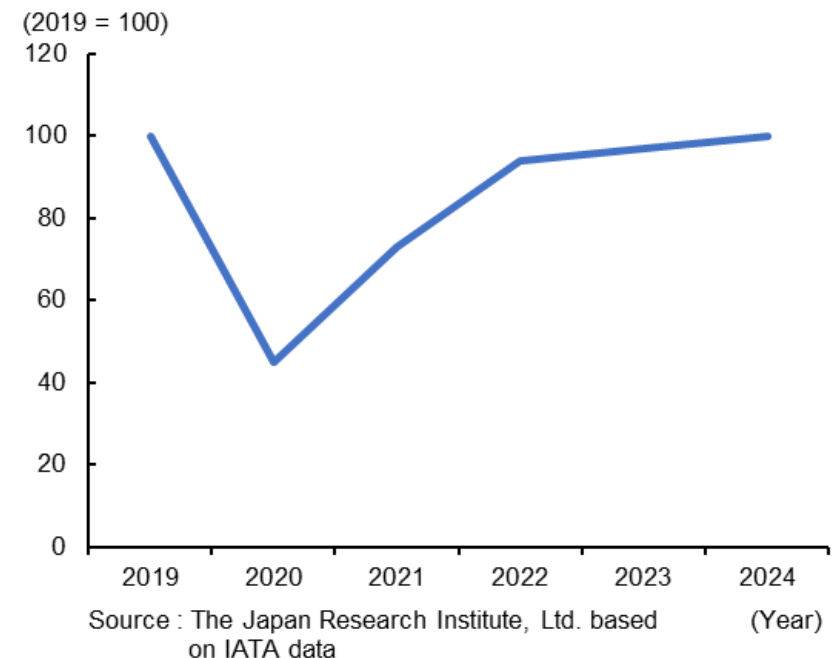
## (2) Points of Attention A. Trade

- World trade has already bottomed out. The global economy is expected to recover to pre-Corona levels in 2021 as the global economy recovers moderately.
- On the other hand, as entry restrictions continue in various countries, the recovery of activities such as the demand for air travel has been slow. Recovery to levels “before Covid-19” will likely come after 2022.

WTO World Trade Outlook



Forecast of Passenger Numbers by IATA



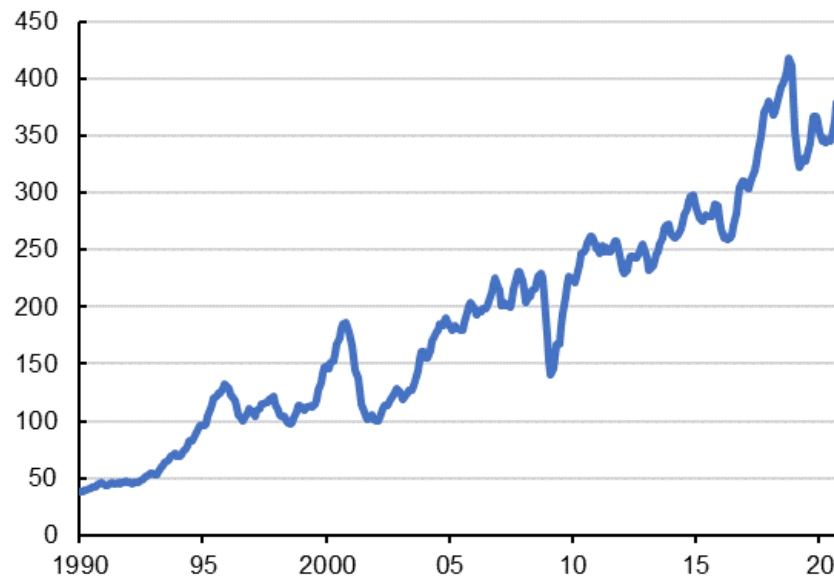
# 2. Outlook for the world economy

## (2) Points of Attention B. Digital Economy

- Digitalization is progressing under Covid-19. Sales of Semiconductors are recovering.
- Looking ahead, IT is expected to increase due to high demand for 5G (next generation communication standards) and telework devices.

Global Semiconductor Sales

(0.1 billions of dollars)



Source: The Japan Research Institute, Ltd. based on SIA data

IT Market Size (% YoY)

	2019 (Achievements)	2020 (Forecast)	2021 (Forecast)
Data Center	1.0	▲3.1	5.2
enterprise software	11.7	▲3.6	7.2
device	▲0.3	▲13.4	4.0
IT Services	4.8	▲4.6	4.1
communication service	▲0.6	▲2.9	2.8
IT as a whole	2.4	▲5.4	4.0

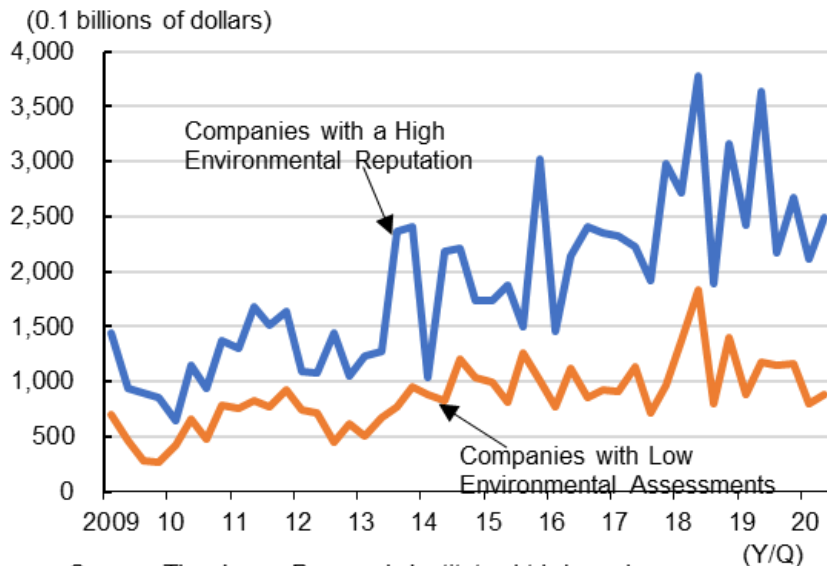
Source: The Japan Research Institute, Ltd. based on data on Gartner

## 2. Outlook for the world economy

### (2) Points of Attention C. Green Recovery

- The amount of green bonds issued, which dropped in the first half of this year due to the spread of Covid-19, has recovered rapidly. Syndicated loans to companies with high environmental scores consistently exceed those with low scores.
- Looking ahead, the expansion of environment-related investment is expected to contribute positively to the growth of the world economy, given the growing concern for the environment worldwide.

Amount of Syndicated Loans



Movement of Each Country toward Green Recovery

	General Important
Eurozone	About 40% of the 750 billion Euro reconstruction fund, "Next Generation EU," that the government has decided to establish will be used for environmental protection.
China	In addition to declaring carbon neutrality through 2060, "China Manufacturing 2050" states the "Full promotion of green manufacturing"
Japan	Prime Minister declares a carbon-neutral, decarbonized society by 2050
United States	In addition to a return to the Paris agreement, Biden vowed to eliminate net greenhouse gas emissions throughout the economy by 2050.

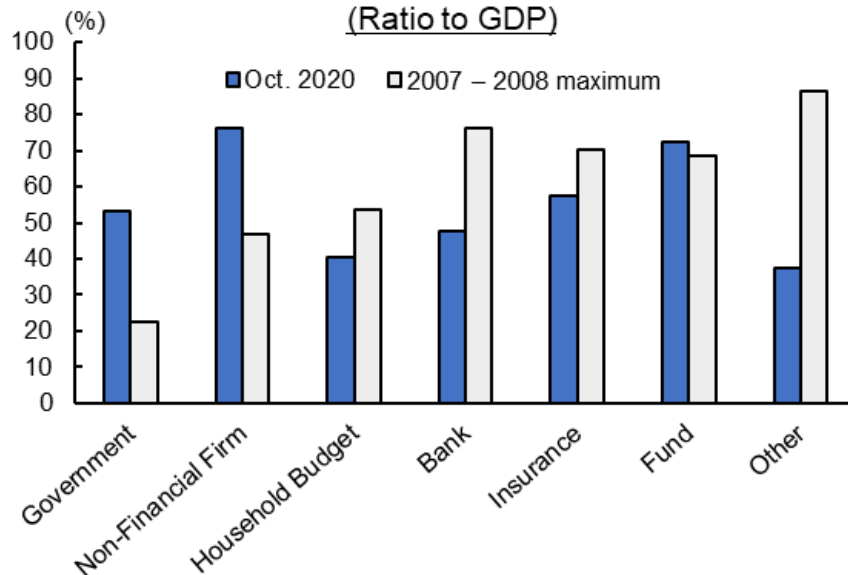
Source: The Japan Research Institute, Ltd.

### 3. Medium-term risk

#### Financial crisis in the government sector and non-financial companies

- According to the IMF's financial risk vulnerability analysis, balance sheets from the government sector and non-financial enterprise sector have expanded beyond the level of the Lehman shock, and financial vulnerability exists in both developed and emerging countries.
- Government debt is at an all-time high, and debt in the nonfinancial sector, which had been rising before Covid-19, is growing further. The government and nonfinancial companies are likely to be the epicenters of future financial crisis risks.

Global Assets by Sector  
(Ratio to GDP)



Source: The Japan Research Institute, Ltd. based on IMF "Global Financial Stability Report, October 2020" data

Financial Vulnerabilities by Sector and Region

	Government		Non-financial firm		Household Budget		Bank		Insurance		Fund		Other	
	Apr. 2020	Oct. 2020	Apr. 2020	Oct. 2020	Apr. 2020	Oct. 2020	Apr. 2020	Oct. 2020	Apr. 2020	Oct. 2020	Apr. 2020	Oct. 2020	Apr. 2020	Oct. 2020
United States	4	5	3	4	2	2	1	1	4	4	4	4	4	4
Eurozone	5	5	4	5	1	2	4	5	2	2	3	4	2	2
Other Developed Countries	3	5	3	4	5	5	2	2	4	4	3	3	3	4
China	3	4	5	5	5	5	5	5	3	3	5	4	3	3
Other Emerging Economies	5	5	4	5	4	5	5	5	3	3	2	3	4	3

Source: The Japan Research Institute, Ltd. based on data of IMF  
Note: 5 is the most vulnerable and 1 is the healthiest.

# 3. Medium-term Risk

## Non-financial Firms Whose Finances are Deteriorating

- Looking at the debt of nonfinancial firms, the proportion of firms that cannot cover their financial costs with operating profits has risen sharply.
- Looking at each sector, food and accommodations are in a difficult situation, while infrastructure is relatively sound.

### Financial Conditions of SMEs (World Base)

Liabilities of Companies with an Interest Coverage Ratio of 1 or Less  
% of Total Liabilities

	2019	2020	2021
Europe	12.68	24.68	45.72
Other Developed Countries	19.31	26.45	41.99
Emerging Economies	9.72	17.75	29.18

Net Worth Minus Corporate Debt  
% of Total Liabilities

	2019	2020	2021
Europe	7.80	11.62	23.82
Other Developed Countries	9.49	11.17	20.31
Emerging Economies	6.37	9.65	17.70

Source: The Japan Research Institute, Ltd. based on IMF data

Note 1: Figures for 2021 are IMF projections.

Note 2: Interest coverage ratio (times) = (Operating income + interest and dividend income) / financial expenses (interest and discount expenses). If less than 1, the company cannot cover its financial costs with operating profits.

Note 3: Targeting SMEs based on IMF standards.

Liabilities of companies with an interest coverage ratio of 1 or less

### Percentage of total liabilities

(Industry, Global, Small and Medium-Sized Enterprises)

	2019	2020	2021
Eating, Drinking and Lodging	20.94	56.01	88.48
Education	21.31	52.61	86.06
Arts & Entertainment	20.71	63.14	86.00
Other Services	29.00	42.61	65.12
Technical Professional Services	14.14	33.26	64.85
IT Relationship	20.66	34.29	62.57
Real Estate	13.54	32.88	53.66
Wholesale Retailing	13.57	29.80	51.68
Administrative Work	13.45	25.17	39.35
Construction	12.98	21.05	37.17
Nursing Care and Medical Care	11.54	18.22	37.02
Manufacturing	15.73	20.89	33.57
Transportation and Storage	10.06	19.21	29.79
Mining Industry	7.95	18.53	23.24
Electric Machinery and Gas	12.59	13.57	21.99
Water Supply	11.97	13.99	19.39
Agriculture	11.17	11.45	17.68

Source: The Japan Research Institute, Ltd. based on IMF data

Note 1: Figures for 2021 are IMF projections.

Note 2: Targeting SMEs based on IMF standards.

# 3. Medium-term Risk

## Avoiding the Financial Crisis Caused by the Debt Bubble

- As debt risk increases in the government and non-financial sector, it is important to take a systematic approach to avoid a financial crisis.
- In the government sector, in addition to dealing with the problem through a special account, it is essential to promptly clarify the timetable and the targets for the soundness of the government sector so that the government can correct its debts at a pace that does not adversely effect the economy, while communicating with the market to provide a sense of security.
- With regard to the non-financial sector, not all industries are experiencing deterioration, so it is important for the government to provide assistance not to the entire business sector but to those sectors that are facing difficulties. The scope of industries in which government assistance is provided should be limited and government should set deadlines for the assistance period.
- The G- 20 summit was held after the Lehman Brothers collapse, and the global response contributed to early recovery from the crisis. This is a good example of risk management for global crises. In response to Covid-19, the G- 20 and other multilateral frameworks should be actively utilized.

### Measures to be Taken Globally to Avoid a Financial Crisis

#### Debt Reduction in the Government Sector

1. Introduction of a special account for Covid-19 to distinguish between ordinary government expenditure and Covid-19 (Example: Great East Japan Earthquake Special Account)
2. Develop a timetable for debt reduction and sound targets, and engage in dialogue with the market

#### Nonfinancial Debt Reduction

1. Government support is limited to industries that are seriously affected, not all industries.
2. Government support is contingent on clear deadlines and structural reform of supported companies to avoid the emergence of zombie companies.
3. Development of a system that does not spread to the banking crisis (Strengthening of the Deposit Insurance Law)

#### International Cooperation

1. Respond in an integrated manner by utilizing the Group of 20 and other resources
2. Japan will lead the discussion

Source : Created by JRI

**This is a English version of “世界経済見通し】戦後最悪・二極化不況からの脱却に苦闘する世界経済～その後に控える政府・非金融企業の過剰債務問題～” in JRI Report (The original version is available at <https://www.jri.co.jp/MediaLibrary/file/report/researchreport/pdf/12250.pdf>)**

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