

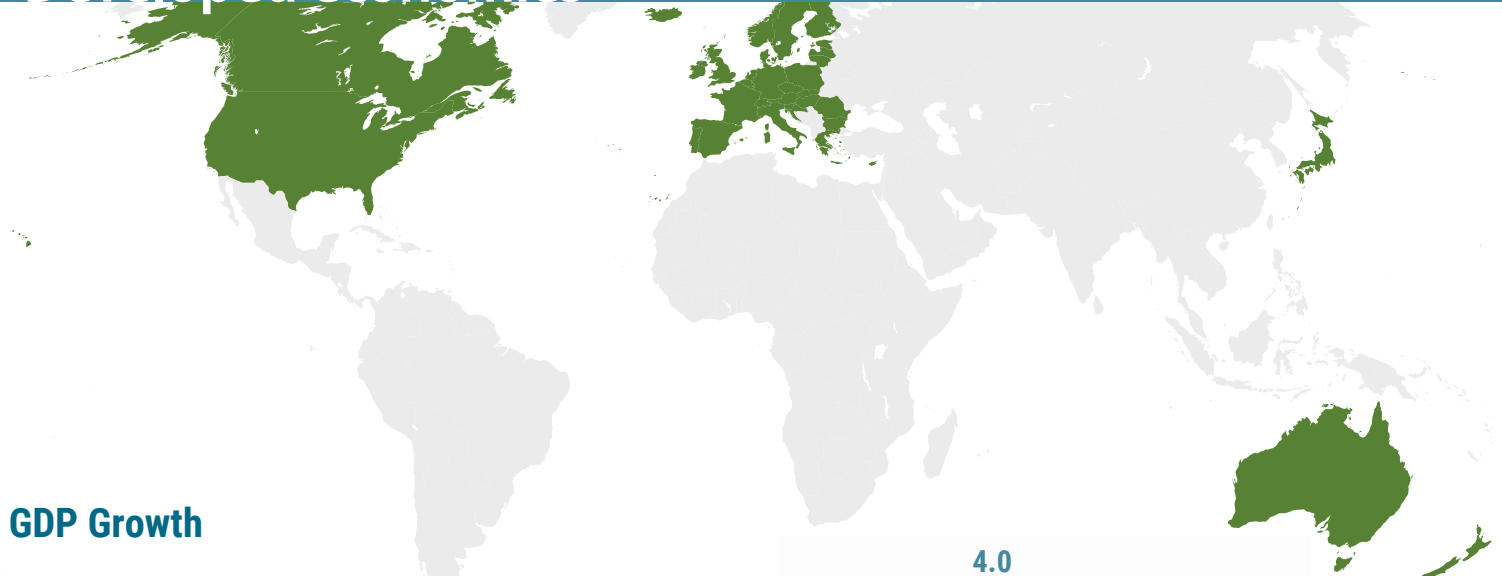
World Economic Situation and Prospects

2021

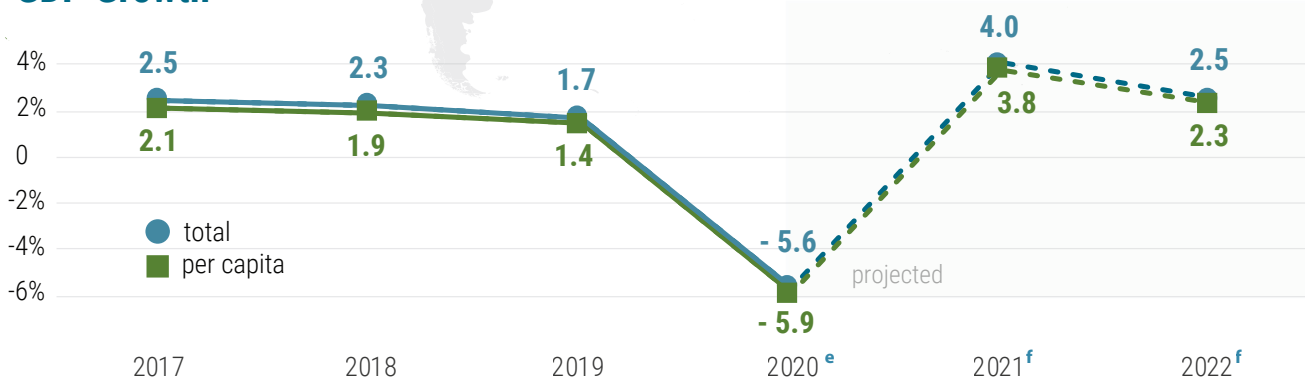


United Nations

Developed economies

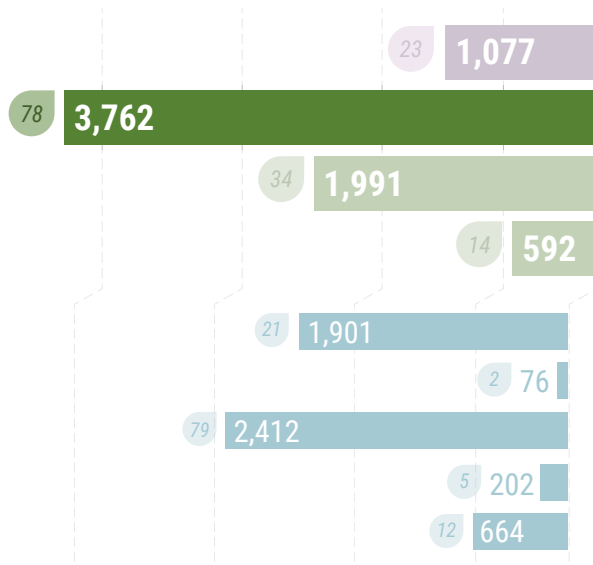


GDP Growth

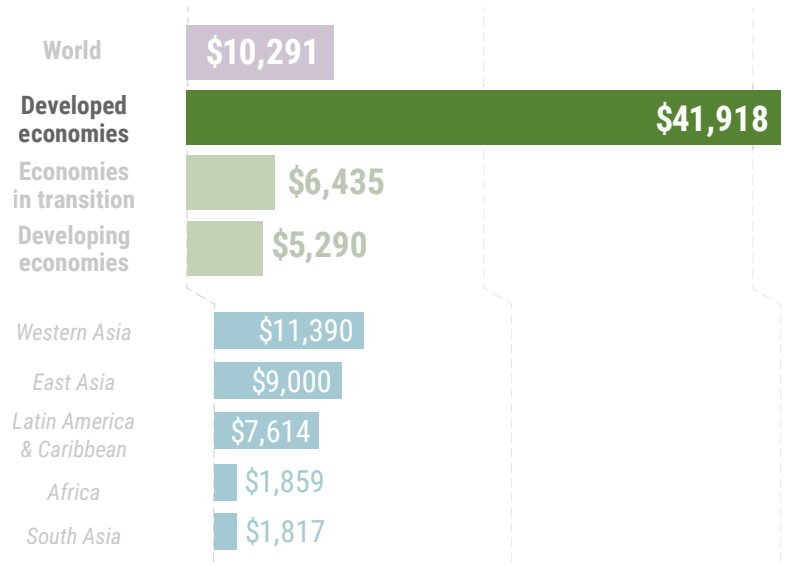


COVID-19 Cases per 100,000 people by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita 2020



Note: The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2021*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

Aggregate data for Africa, excluding Libya.

e: 2020 estimates, **f:** 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

Regional developments and outlook

Developed economies

- In their midyear rebound, developed economies failed to attain the pre-crisis level of economic output
- Domestic demand recovery has been fragile and could easily be reversed if fiscal support measures weaken
- Economies with larger exposure to tourism were hit hard

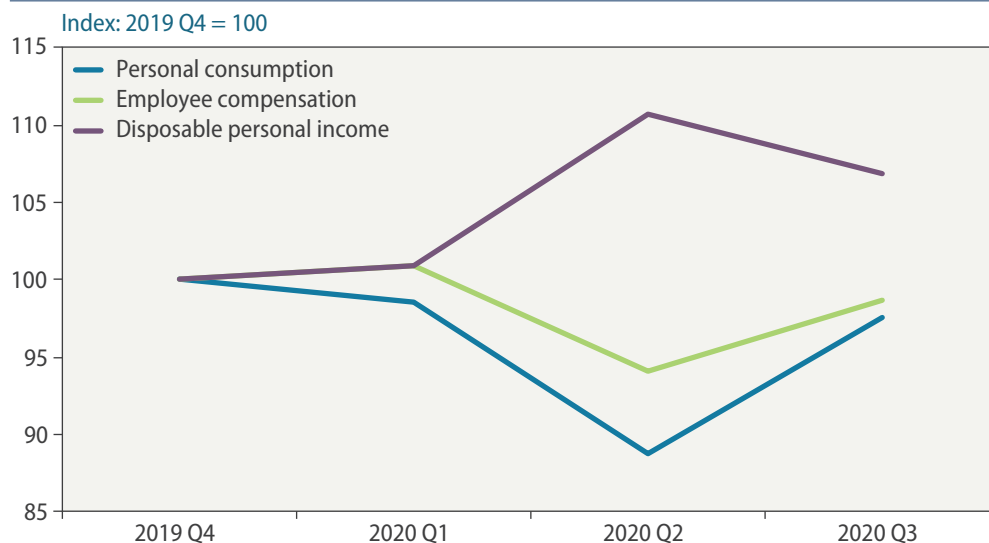
Northern America: the strong midyear economic rebound nevertheless fell short of the pre-crisis level of output

In the United States of America, real gross domestic product (GDP) is estimated to have contracted by 3.9 per cent in 2020. The economy came to a standstill in mid-March owing to lockdown measures taken to combat the coronavirus disease (COVID-19) pandemic; and the unemployment rate jumped to 14.7 per cent in April from 3.5 per cent in February. The Government promptly responded with an unprecedented stimulus package (the Coronavirus Aid, Relief, and Economic Security (CARES) Act), whose size cumulatively totalled 12 per cent of GDP by the end of October. This measure, which expanded income transfers to households and provided emergency loans to businesses, sustained growth in aggregate disposable personal income in the second quarter (figure III.1). Nevertheless, domestic demand imploded.

United States of America: while GDP plunged, aggregate personal income grew owing to stimulus measures

Figure III.1

Disposable personal income, employee compensation and personal consumption in the United States



Source: The Bureau of Economic Analysis of the United States Department of Commerce, "Gross Domestic Product, Third Quarter 2020 (Advance Estimate)", October 29, 2020, available at https://www.bea.gov/sites/default/files/2020-10/gdp3q20_adv.pdf.

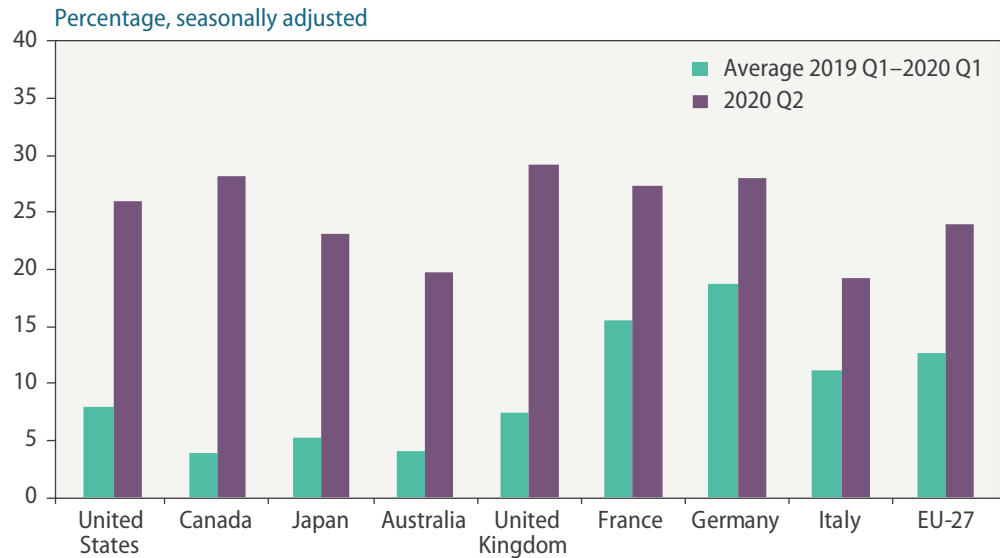
Note: Calculation based on seasonally adjusted annual rates.

Household savings rates spiked in the United States and other developed economies

In the United States, while the impact of the stimulus packages has been waning, the household savings rate has remained high, at 13.6 per cent in October, significantly higher than the pre-crisis yearly average of 8.0 per cent. There are several explanations for the pattern of such increases in savings rates which emerged across the developed economies (figure III.2).

Figure III.2

Household savings rate, selected developed economies



Sources: Australian Bureau of Statistics (2020); Statistics Canada (2020); Japan, Cabinet Office (2020); United Kingdom, Office for National Statistics (2020b); United States Department of Commerce, Bureau of Economic Analysis (2020); Eurostat (2020) (France, Germany, Italy and EU-27).

The main driver of the spikes has been a massive decline in household consumption and large increases in temporary government transfers. However, as lockdown measures prevented households from spending on non-essential items, the decline in spending does not necessarily represent a fundamental shift in savings behaviour. According to the permanent income hypothesis (PIH), households do not change their patterns of consumption expenditure in response to a temporal change in income if they perceive no change in their permanent income. The PIH can therefore partially explain household behaviour in countries where the household disposable income increased in the second quarter of 2020 despite the plunge in wages and wage supplements, for example, Australia, Canada, Japan and the United States (Australian Bureau of Statistics, 2020; Statistics Canada, 2020; Japan, Cabinet Office, 2020; United States Department of Commerce, Bureau of Economic Analysis, 2020;). However, in several large European economies, such as France, Germany, Italy and the United Kingdom of Great Britain and Northern Ireland, the scale of income transfers could not offset the decline in wages and wage supplements (European Central Bank, 2020; United Kingdom, Office for National Statistics, 2020a). Another factor that can account for the spikes in the household savings rate is household perception of future uncertainties. In developed economies, as both nominal interest rates and consumer price inflation rates were at historical lows, households, absent inflation expectation, felt no pressure to discount their future income and spend now, which led to historically high levels of precautionary savings.

During the second quarter of 2020, growth of household debt in the United States was curbed as the outstanding amount decreased from \$14.30 trillion in the first quarter to \$14.27 trillion, which represented the first quarterly decline since 2014. Households refrained from taking up new loans to purchase durable goods. In the same period, the amount of non-financial corporate debt exhibited an increase as total liabilities grew from \$16.9 trillion to \$17.6 trillion, reflecting the utilization of the special credit facilities made available by the stimulus package. Despite the accelerating financial hardship, the delinquency rate of commercial bank loans remained low, at 1.54 per cent. At its last peak, which occurred in the first quarter of 2010, the delinquency rate had stood at 7.4 per cent. Although the magnitude of the negative shock on economic activities was unprecedented, the United States banking sector—which had accumulated a sufficient level of liquidity and capital owing to the prudential regulations adopted after the global financial crisis of 2008—was able to absorb that shock. This regulatory buffer prevented the amplification of the economic shock throughout the financial sector, thereby limiting the second-round economic impact of the COVID-19 pandemic crisis.

In the United States, the financial sector absorbed the initial shock, limiting the second-round shock inflicted by the crisis

During the third quarter of 2020, the United States economy rebounded as lockdown measures were relaxed. The consumption of goods and residential investments exceeded the pre-crisis level, while the personal savings rate decreased to 14.1 per cent in August from 33.6 per cent in April. As economic activities partially recovered, the unemployment rate decreased to 7.9 per cent in September. However, the midyear rebound fell short of the pre-crisis levels of both consumption of services and corporate investments, which remained weak. Moreover, hopes for the realization of a straightforward recovery scenario were dashed by accelerating COVID-19 outbreaks in many parts of the United States as some business restrictions were reimposed.

The United States economy is forecast to grow by 3.4 per cent in 2021. As monetary easing continues, consumption of durable goods and residential investments continue to grow. However, other demand components, particularly corporate investments and exports, are forecast to remain weak as long as the uncertainties associated with the COVID-19 pandemic persist. While loans to the household sector, particularly through mortgages, are projected to grow, the banking sector is expected to be more cautious in issuing new corporate loans. In a context of weak employment prospects and wage growth, the fragile recovery could easily be reversed if fiscal support measures, including income transfers and loan guarantees, remain inadequate.

The fragile recovery could falter if the fiscal stimulus wanes

In Canada, the economy is estimated to have contracted by 5.6 per cent in 2020 and is forecast to grow by 3.8 per cent in 2021. To alleviate the economic impact of the COVID-19 outbreak, an unprecedented fiscal stimulus package (amounting to 16 per cent of GDP), which included income support, loan guarantees and liquidity assistance, was implemented. The fiscal measures supported the growth of aggregate personal income in the second quarter, while production activities plunged. The economy broadly rebounded in the third quarter, led by strong residential investments and housing sales, as a result in part of monetary easing. The unemployment rate, which had jumped to 13.7 per cent in May, fell gradually to 8.9 per cent in October; it remained, however, far above the pre-crisis level, in January, of 5.5 per cent. The energy sector remained weak, reflecting subdued global energy demand, which is likely to constrain the country's growth prospects in the near term.

Canada: the energy sector remains weak amid the midyear recovery

Europe: fallout from the pandemic is compressing economic activities

Europe has been experiencing an economic crisis of historic proportions, with the region expected to have seen an economic contraction of 7.8 per cent in 2020 (for EU-27) as a consequence of the pandemic. At the end of the first quarter, with rising case numbers and fatalities, a large number of countries implemented widespread and rigorous lockdown measures in order to contain the spread of the pandemic. This led to a virtual standstill in large parts of the economy, which set off a cascade of negative effects. Businesses—especially small businesses with fewer financial reserves—were thrown into a liquidity crisis, as revenues fell off the cliff while costs remained unchanged. After a respite during the summer and signs of economic revival, the pandemic outbreak started again to worsen at the end of October, with many countries, including France, Germany, Italy and the United Kingdom, reintroducing various lockdown measures.

Great uncertainty is associated with the growth forecast for 2021

While it is forecast that the region will experience a return to positive growth of 5.2 per cent in 2021 and 2.6 per cent in 2022, this needs to be put in context. First, base effects would account for the greatest part of the rebound; and second, the baseline forecast is predicated on the assumption that the lockdown measures renewed in the fourth quarter will improve the public health situation. Consequently, an exceptional degree of uncertainty is tied to this forecast. The major risks include a longer-lasting wave of pandemic infections, leading to a continued contraction of economic activities. By contrast, in case of the approval and introduction of a vaccine, sectors such as tourism could see a faster recovery, with actual growth exceeding the recovery's forecasted trajectory. Besides the aforementioned risks, the region is also facing challenges that predated the pandemic, including those related to the future relationship between the European Union (EU) and the United Kingdom as well as disruptive structural changes in the automotive industry in a number of countries, where the shift to alternative technologies would entail the revamping of entire supply sectors.

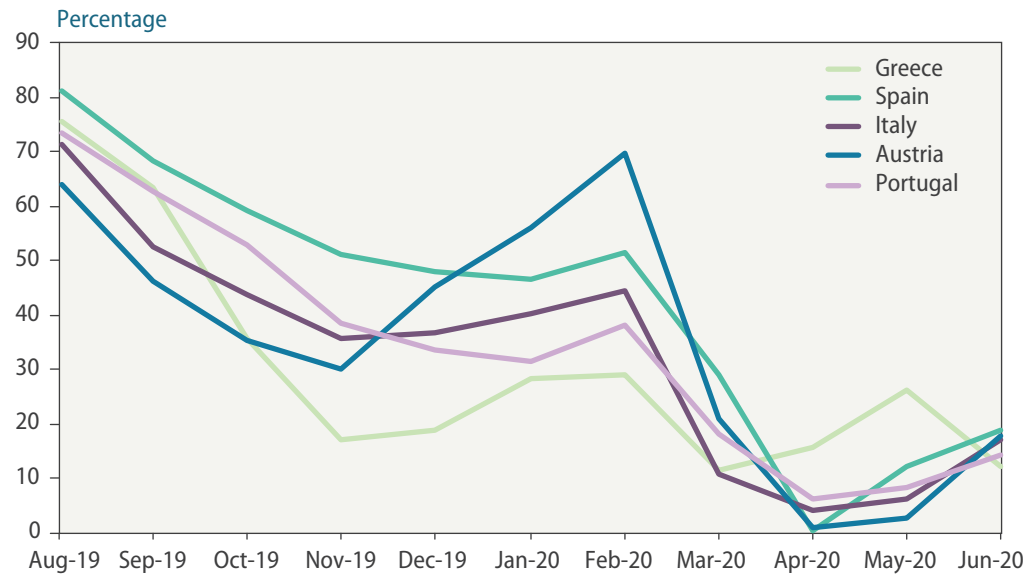
Countries with larger exposure to tourism have been hit hard

There has been some variation in the fallout from the pandemic across the region. Belgium, France, Italy and Spain have been hit especially hard, in terms of case numbers and fatalities or the magnitude of their economic contraction. In Germany, on the other hand, the fallout and resulting economic contraction, while still significant, have been more limited. The length of the instituted lockdowns and the role and share of the service sector in the economy largely account for the differences in economic contraction across countries. The economies of Southern Europe generally rely to a greater extent on services, in particular tourism. In consequence, large swaths of economic activities were shut down when, in a matter of days, the travel industry, including hotels, restaurants and airlines, suffered a complete collapse (figure III.3). By contrast, over the summer, countries such as Germany, with larger manufacturing sectors and greater exposure to global trade, experienced a quicker rebound. The pandemic has also contributed to the widening of already existing differences across the euro region, inasmuch as several countries with higher pre-existing debt and unemployment levels have been hit especially hard.

While unemployment increased, short-time work measures helped cushion the impact

Under short-time work measures, many employees in the region accepted some reduction in income to avoid unemployment, at least in the first instance. Nevertheless, unemployment increased in the region to 7.5 per cent in September 2020, compared with 6.6 per cent in 2019, with Greece and Spain registering the highest unemployment rates:

Figure III.3

Hotel occupancy rate in selected European countries

Sources: Eurostat.

Note: Estimates for Greece cover January, February, March, May and June 2020.

16.8 per cent (July) and 16.5 per cent, respectively. Moreover, youth unemployment, which remains a serious challenge across the European Union, increased by more than 2 percentage points year-on-year to 17.1 per cent in September.

The need to address the pandemic and its fallout triggered the enactment of significant fiscal policy measures, although there were differences among individual countries in terms of the extent and level of their efforts and the limitations they confronted. At the outbreak of the pandemic, the immediate aim was to ramp up spending on health-care capacities and to increase testing and tracing capabilities, within a context where policymakers had only a limited time-window for preventing both the freezing-up of entire economies and further stress in financial markets. This generated a range of fiscal policy measures across countries, which included, among others, wage support schemes, liquidity assistance and tax deferrals. The size and impact of those measures depended, however, on the individual country's fiscal position at the onset of the crisis. Italy, for example, was already facing relatively high levels of public debt and consequently experienced constraints in rolling out a sufficiently large fiscal response to the pandemic. Germany, in contrast, was able, given relatively low public debt, to use its available policy space to initiate a significant fiscal stimulus. The pandemic also led the European Union to take unprecedented fiscal policy-related steps. For example, it activated the escape clause of the Stability and Growth Pact (SGP), which normally limits national fiscal deficits to 3 per cent of GDP and public debt to 60 per cent of GDP. The Pact still remains in force under the escape clause but countries now have the increased flexibility with respect to budgetary rules that they need to support their health-care systems, firms and employees. In addition, the EU has loosened State-aid rules, thereby giving national Governments more leeway in providing support to firms. In recognition of the severity of the policy challenges, the EU also agreed for the first time on joint-debt issuance. This will serve as the means of financing a recovery plan in the amount of

Fiscal policy measures included unprecedented steps taken at the EU level

The European Central Bank initiated significant monetary stimulus measures

750 billion euros. Under the plan, which will prioritize ecologically sustainable development, digitalization, support for companies and strengthening of health-care systems, loans and grants will be made available to the neediest and hardest-hit economies in the region.

The pandemic also led to a wide range of monetary policy actions. In March 2020, the European Central Bank (ECB) initiated a pandemic emergency purchase programme (PEPP) and in June subsequently increased its total volume to 1,850 billion euros, equivalent to more than 10 per cent of euro zone GDP. Other central banks in the region have taken similar steps towards providing support within the context of the pandemic. The ECB programme features significant flexibility with regard to the types of assets purchased and the time frames for purchases. The exercise of that flexibility will lead to further increases in the size of the Bank's balance sheet, which has already ballooned over the past years owing to the implementation of similar programmes. In addition, the Bank has kept its policy interest rate at -0.5 per cent. The immediate aim of these measures is to reduce the negative impact of the health crisis on the real economy and to prevent the emergence of a financial crisis. In accordance with its mandate, the ECB continues to target an inflation rate of below—but close to—2 per cent. However, even with the significant increase in stimulus measures, the inflation rate has become negative and in September stood at -0.3 per cent for the euro area. Lower energy prices have been a major contributing factor, but even when energy and unprocessed food are excluded, inflation stood at only 0.4 per cent, well below the policy target. This sets the stage for an increasingly serious policy predicament. While the undershooting of the policy target and the looming spectre of deflation could very well merit a further increase in or extension of stimulus measures, such steps could lead to renewed criticism that, by financing public budgets, the European Central Bank is overstepping its mandate.

Developed Asia: linkage with developing East Asia holds the key to post-crisis recovery

Developed Asia—comprising Japan, Australia and New Zealand—experienced an unprecedented plunge in the level of its economic activities in the second quarter of 2020. While these countries could afford to implement unprecedented fiscal stimulus packages, it is the revival of their external demand—particularly from developing East Asia and notably from China—that will make recovery solid and sustainable. Indeed, Japan shares global supply chains for manufacturing with developing East Asia; East Asia is Australia's largest destination for commodity exports; and the recent growth in New Zealand's tourism sector has benefited from the visits of tourists from East Asia. For a post-crisis recovery to succeed, it is therefore crucial that developed Asia ensure the restoration of the value chains it has been sharing with developing East Asia.

Japan: exports are expected to lead the recovery

In Japan, real GDP is estimated to have contracted by 5.4 per cent in 2020 and is forecast to grow by 3.0 per cent in 2021. Despite the roll-out of an unprecedented stimulus package, including income transfers and employment subsidies, real GDP plunged in the second quarter, marking the third consecutive quarterly decline. Owing to stagnating domestic demand, household debt increased only slightly in the second quarter, to 345 trillion yen from 343 trillion yen in the previous quarter. In the same period, the debt of the non-financial sector showed a steep increase, from 1,754 trillion to 1,852 trillion yen, reflecting the utilization of emergency loan facilities. The third-quarter rebound was weak as

households remained cautious when spending; and residential and corporate investments stayed subdued despite easing financing conditions. Although Japan was able to avoid a one-time surge in unemployment in the second quarter, the unemployment rate gradually rose to 3.0 per cent in September from 2.4 per cent in January. The fragile employment situation reflects weak prospects for corporate profits and wage growth; and domestic demand growth is projected to be mild. It is exports that are projected to lead the recovery as demand from the East Asian economies recovers.

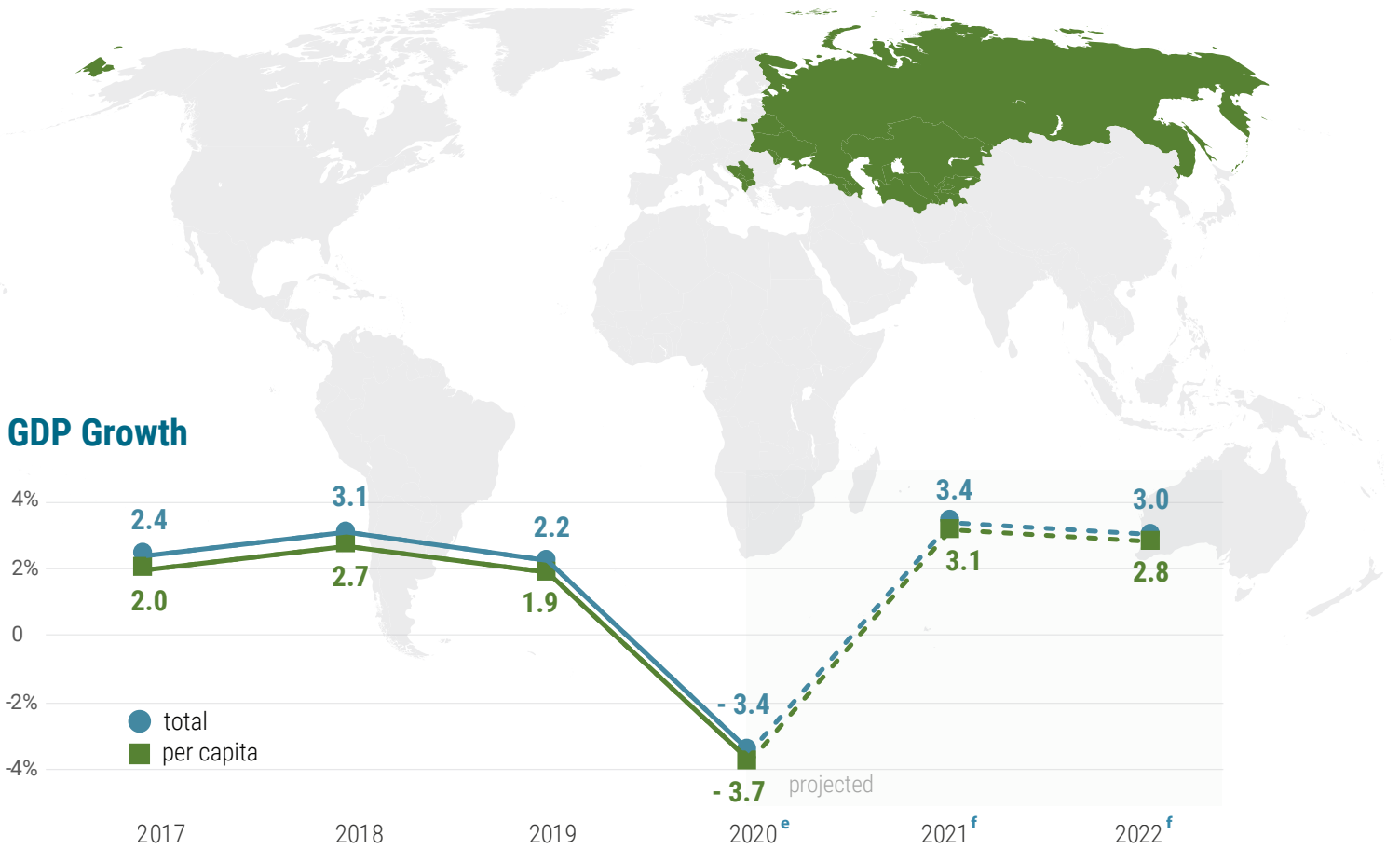
In Australia, real GDP, which is estimated to have contracted by 4.5 per cent in 2020 and will grow by 3.3 per cent in 2021, dipped substantially in the second quarter, reflecting the economic effects of the lockdown measures. The midyear recovery was relatively slow, due partly to another lockdown in the State of Victoria in August instituted in response to a second wave of pandemic outbreaks. While the unemployment rate has remained high, after jumping from 5.3 per cent in January to 7.5 per cent in July and decreasing only slightly to 7.0 per cent in October, the pace of recovery nevertheless picked up towards the end of the year. External demand for Australia's commodity exports is expected to lead growth in 2021.

In New Zealand, real GDP is estimated to have contracted by 6.1 per cent in 2020, with an expansion by 5.2 per cent expected in 2021. While lockdown measures instituted to contain community infection were successful in bringing down the number of COVID-19 outbreaks, the economy nonetheless came to a standstill in the second quarter with a plunge in domestic demand. The midyear recovery, on the other hand, was robust, with housing sales growing rapidly on the back of monetary easing. The recovery of exports has been weak, however, as strict border controls impacted the tourism sector, the main pillar of New Zealand's services exports. Also fragile is the employment situation: the unemployment rate jumped to 5.3 per cent in the third quarter from 4.0 per cent in the previous quarter.

Australia: the pace of recovery picked up towards the end of 2020

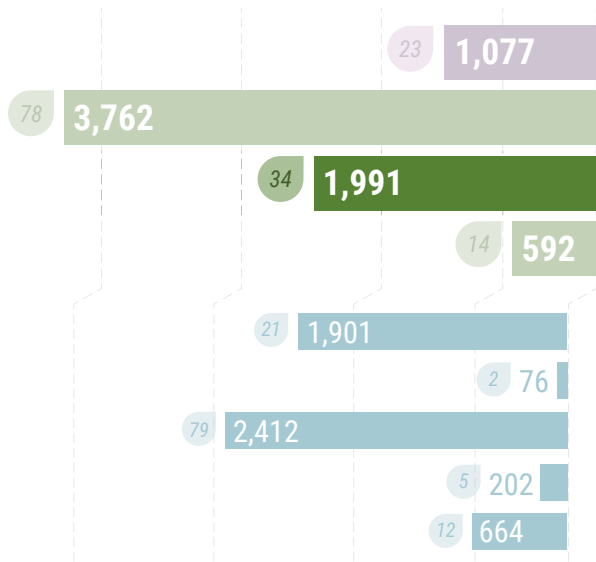
New Zealand: the high-performing tourism sector was hit by the impact of border closures

Economies in transition

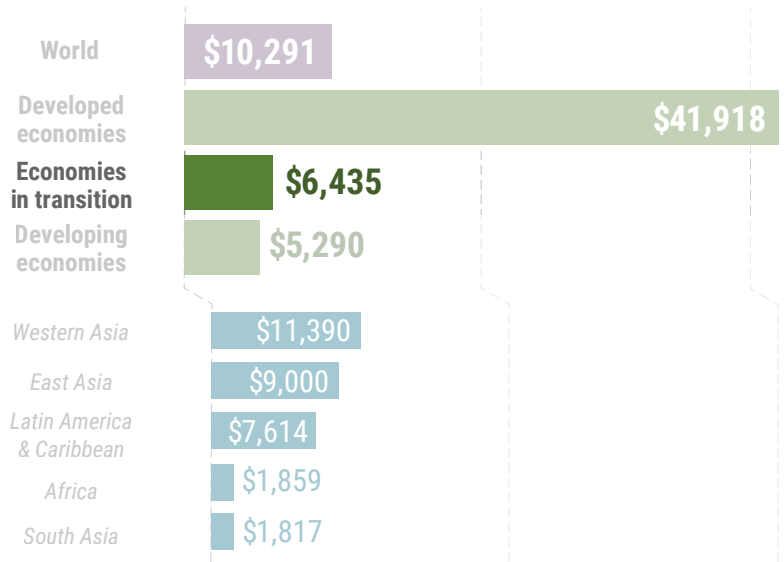


COVID-19 Cases per 100,000 people by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita 2020



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Aggregate data for Africa, excluding Libya.

e: 2020 estimates, **f:** 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

Economies in transition

- Both in the Commonwealth of Independent States and in South-Eastern Europe economic activities are unlikely to experience a quick recovery
- Lower commodity prices amplified the shock in the Commonwealth of Independent States
- Tourism-dependent countries in South-Eastern Europe were hit the hardest

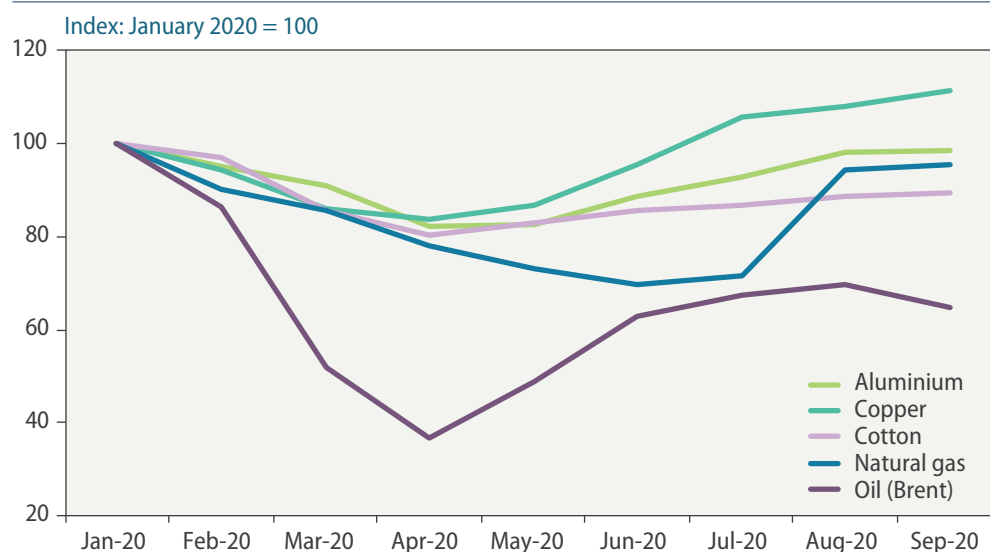
Commonwealth of Independent States and Georgia: the pandemic has unleashed multiple shocks

The outbreak of the COVID-19 pandemic has unleashed multiple shocks in the Commonwealth of Independent States (CIS) and Georgia, having heavily depressed economic activity since the early part of the second quarter of 2020. The imposition of lockdowns and quarantine measures in the region, first introduced around April and then, after some loosening, reintroduced later in the year, caused far-reaching disruptions. Lower commodity prices, including for important non-oil commodities exported by the CIS countries (except for gold, whose higher price benefited gold exporters in Central Asia), exacerbated the contractionary effects of the pandemic (figure III.4). These shocks have been widespread across the region, resulting in declines in output in almost all countries. The magnitude of those declines has depended on a country's economic structure and its capacity to adopt offsetting measures.

The region's services sector has been particularly affected by the pandemic, with international tourism, a critical economic sector for some countries in the Caucasus and Central Asia, having been dealt a telling blow. Trade and transport disruptions in the region and reductions in levels of economic activity in the Russian Federation have led to a decrease in remittances and disrupted temporary migration flows, with a significant impact on small-

Figure III.4

Global prices of selected commodities exported by the CIS countries



Source: UNCTAD and FRED (Federal Reserve Economic Data) database.

er economies in Central Asia. Although non-service sectors performed relatively better, oil production cuts under the OPEC+ agreement depressed industrial output in Azerbaijan, Kazakhstan and the Russian Federation. In addition, bad harvests contributed to poor economic performance in Azerbaijan and Ukraine. After expanding by 2.2 per cent in 2019, the aggregate GDP of CIS and Georgia is estimated to have shrunk by 3.4 per cent in 2020. Only a modest recovery is expected, with growth of 3.4 per cent for 2021 and 3 per cent for 2022.

Consumption has declined sharply and living standards have been deteriorating

Consumption in the region sharply contracted in 2020 as a result of the restrictions associated with the instituting of quarantines, higher unemployment and lower remittances, which led to a worsening of living standards, despite the provision of government support. While investment also contracted, it seems to have trailed behind the decline in consumption. In a number of countries, geopolitical tensions and internal conflicts in the second half of the year, including domestic political tensions in Belarus in the aftermath of presidential elections and the resumption of hostilities between Armenia and Azerbaijan as related to the conflict in Nagorno-Karabakh, contributed further to disruptions in economic activities and increased uncertainties.

The region's energy-importing countries saw deeper contractions in 2020

The economic contraction in 2020 was deeper in energy-importing countries, as the beneficial effect of lower oil prices on their economies was offset by multiple negative factors. The 2021 recovery in the region should, however, be supported by somewhat improved terms of trade and some breakthroughs in containment of the pandemic. The return to growth will nevertheless be insufficient to compensate for the output losses in 2020 and investment—against a background of persistent economic headwinds—is expected to remain weak. Moreover, within a context marked by multiple risks and increased geopolitical tensions, growth projections are understandably subject to significant degrees of uncertainty. Exchange rate flexibility in most of the CIS countries has helped to offset the shocks, including that of lower energy prices in those energy-exporting countries—Kazakhstan, for example—where the devaluations have been particularly large. It has also helped to reduce the drain on reserves. However, the speed of exchange rate weakening constrained the implementation of policy options and prompted interventions designed to reduce volatility.

Some countries responded to the crisis by implementing large stimulus packages

Countries have reacted to the multiple shocks by implementing large stimulus packages, including an increase in health spending and social benefits. In addition, support—including through direct income transfers, utility subsidies and tax exemptions—has been directed towards individuals and sectors directly affected by containment measures, with small and medium-sized enterprises being a common target in this regard. The size of these programmes, which varies, has been determined largely by the availability of fiscal space. Energy-exporting countries have been able to tap into their sovereign wealth funds to finance increased spending; and in Kazakhstan, for example, the financing of the anti-crisis programme was equivalent to about 9 per cent of GDP.

Inflation remained for the most part contained, while labour-market conditions deteriorated

While inflation-related developments in 2020 in the CIS area have been generally benign, supply disruptions and currency depreciation have created upward pressures in some countries of Central Asia. In Kyrgyzstan, temporary price controls for food items were introduced to dampen inflation pressures; price controls for certain items and services, accompanied by food rationing, were continued in Turkmenistan; and to provide support to households, Kazakhstan capped utility prices. In Uzbekistan, inflation remains relatively elevated, reflecting the impact of past depreciation, but has declined as a result of weak demand and the postponement of utility price increases. By contrast, the impact of the

rouble's weakness on prices has been limited in the Russian Federation. Despite support programmes, unemployment rates have increased throughout the region; and restrictions placed on mobility have contributed to the deterioration of labour markets in countries that rely on temporary migration, aggravating the situation in Central Asia.

Fiscal deficits, which were modest in most CIS countries in 2019, have widened in 2020, owing to lower revenue and higher spending. In the Russian Federation, the central government budget balance will change from a surplus in 2019 to an estimated deficit of over 4 per cent in 2020, as a result of low energy revenues, declining economic activity and tax relief measures. The Government has borrowed in domestic financial markets and issued local-currency debt. Moreover, the stimulus packages enacted for 2020 and 2021 are together equivalent to about 7 per cent of GDP. To accommodate fiscal spending in 2020–2021 in an environment of low oil prices, some components of the fiscal rule have been temporarily relaxed and the application of certain articles of the Budget Code has been extended to 2021 in order to allow the Government to allocate funds for the financing of anti-crisis measures without amending the budget. Despite the country's massive international reserves and the relatively low public debt-to-GDP ratio (estimated at 13.7 per cent in June 2020), overall fiscal spending under the proposed 2021–2023 budget is likely to shrink in real terms, as the Government continues to prioritize fiscal stability. In Kazakhstan, previous fiscal consolidation plans have been postponed, while in Kyrgyzstan, border closures and the reduction of trade have directly impacted revenues, given the importance for that country of custom duties. Public debt ratios have increased sharply as a result of higher financing needs, output contraction and exchange rate depreciation. However, in energy-exporting countries, which can tap into their sovereign wealth funds (as noted above), these increases will be more limited.

Monetary policy in CIS has been loosened throughout the year. In Kazakhstan, the depreciation of the tenge prompted the authorities, in March, to increase the key policy rate, but this hike was later fully unwound. In the Russian Federation, the key rate was cut by 200 basis points to a record low of 4.25 per cent. Amid concerns over exchange rate instability and the signs of a strengthening of economic activities, the authorities paused the loosening process in the second half of the year. In Ukraine, interest rates were cut from 15.5 to 6.0 per cent in the first half of the year, within a context of declining inflation. In the Republic of Moldova, in addition to interest rate cuts, there has been a relaxation of reserve requirements in order to increase liquidity and credit flows. Many countries have also introduced measures aimed at providing support to the banking sector, which has been asked to grant payments holidays and assist in debt restructuring.

Current account balances will deteriorate in most countries in the region, owing to lower hydrocarbons exports, reduced remittances and reduced tourism revenue; and capital outflows have increased the need for balance-of-payments support in some countries. Although debt distress risks in the region are relatively low, some countries appear to be particularly vulnerable. Kyrgyzstan and Tajikistan have benefited from the G20 Debt Service Suspension Initiative, which has saved them the equivalent of 0.6–0.8 per cent of GDP in their 2020 debt servicing costs. Official financing is playing a critical role in covering the external funding requirements in most energy-importing countries. In June 2020, the Executive Board of the International Monetary Fund (IMF) approved a new standby programme for Ukraine (enabling an immediate disbursement of \$2.1 billion), which was designed to address financing needs and advance reforms, and which could unlock access to further

Fiscal deficits are larger and public debt is higher

Monetary conditions in the region have been relaxed

Kyrgyzstan and Tajikistan are benefiting from the Debt Service Suspension Initiative

The economic outlook is marred by uncertainties and reduced policy space

resources. While Belarus, Kazakhstan and Ukraine successfully issued international sovereign bonds, access of the CIS countries to external financing has generally become more difficult (box III.1) amid perceptions of the volatility of risk. Moreover, geopolitical tensions which arose in the second half of the year are further constraining financing options.

The economic outlook for the region is uncertain, with downside risks predominating. The reintroduction of containment measures, should the outbreak of the pandemic lead to a further deterioration, would both inflict new damage in the realm of economic activities and undermine confidence. While the banking sector has remained stable over the course of the current period of turbulence, the deterioration of asset quality and high levels of dollarization in many countries will constrain lending and increase risks. In addition, geopolitical tensions have mounted and, in some cases, have spiralled into real conflict. Clearly, the COVID-19 crisis has exposed existing vulnerabilities in the region and reduced existing policy space.

Box III.1

External financing constraints and the impact of the COVID-19 crisis on the Commonwealth of Independent States and Georgia

The COVID-19 crisis has inflicted multiple shocks upon the economies of the Commonwealth of Independent States (CIS) and Georgia. It has negatively impacted foreign exchange earnings derived from commodity exports, tourism and remittances. Public financing needs related to funding the crisis response have increased, while revenues have slumped; consequently, access to external financing has become ever more critical for many of the countries in the region. However, external financing needs vary across the region, reflecting heterogeneity in economic structures and external trade composition. And for some countries, external financing needs were already large prior to the crisis.

Figure III.1.1

Share of public debt in foreign currency and public debt as percentage of GDP



Sources: National Ministries of Finance; IMF projections, World Economic Outlook database, October 2020.

Note: Foreign debt is used as a proxy for foreign currency debt if other data is unavailable.

(continued)

The energy-exporting countries entered the crisis with large amounts of foreign assets in their sovereign wealth funds and have been able to draw on these resources to partially finance growing budgetary imbalances and smooth exchange rate fluctuations. In Azerbaijan, Kazakhstan and the Russian Federation, those funds are substantially larger than their financing needs. Their public debt ratios are low, although they have increased during the crisis; and total external debt is also low, except for Kazakhstan where local subsidiaries' increased borrowing from their parent companies abroad has elevated private sector external debt in recent years. On the other hand, the introduction of sanctions for the Russian Federation starting in 2014 has significantly reduced the ability of public and private sector entities to borrow from international capital markets.

While the financing situation is less favourable in the region's energy-importing economies, there are nevertheless important differences among them in terms of their market access and liquidity positions. A common denominator in this crisis has been the reliance on official financing. All of these countries, except Belarus and Turkmenistan, have relied on official financing and received International Monetary Fund (IMF) emergency financing. The IMF also approved a new standby arrangement for Ukraine.

These new borrowings will further increase the already large share of external public debt owed to official creditors—both bilateral and multilateral. In Ukraine, commercial borrowing is more significant, which makes it stand out among energy importers; but even in this case, official creditors had accounted for 46 per cent of public and publicly guaranteed external debt by the end of September 2020. In recent years, several countries in the region have taken advantage of a favourable environment for the placement of government bonds in international capital markets, which included debut issues by Tajikistan (2017) and Uzbekistan (2019). In this regard, Georgia and Ukraine are likely to face additional financing constraints, as their international bonds are maturing in the immediate future. However, commercial borrowing has not fundamentally altered reliance on funding from bilateral and multilateral creditors, particularly on the part of the Central Asian countries. The growth of public debt in Kyrgyzstan, for example, is explained by increased bilateral official borrowing, despite the cancellation of debts to the Russian Federation in the aftermath of the 2014 crisis.

Overall, public and external debt has increased throughout the region in recent years. The growth of total external debt since the 2014 downturn has been driven by increased public liabilities, while the decline in borrowing costs has contributed to increased fiscal space in a few countries. In Ukraine, for example, interest payments fell to about 3 per cent of GDP in 2019, down from 4.2 per cent in 2015. This positive trend, however, is now being reversed.

Foreign currency reserves can help cushion growing external financing needs; and many energy-importing countries—including Armenia, the Republic of Moldova and Ukraine—have increased reserve holdings in recent years, amid an improving balance of payments. In contrast, in Belarus, international reserves remain precariously low. On the other hand, high gold prices have dampened the impact of the crisis on external finances in Uzbekistan and other countries with large gold holdings as part of total reserves.

The high share of foreign currency debt remains a major generator of vulnerability in the region, as countries are unable to tap financing in their own currency (figure III.1.1). While flexible exchange rates have contributed to a partial offset of the impact of declining sources of foreign income, improving competitiveness of exports and discouraging imports, currency depreciation has increased the relative debt burden, thus reducing further fiscal space. As high dollarization rates in energy-importing economies have amplified the destabilizing effect of exchange rate declines, reducing external risks would therefore require further efforts directed towards development of domestic capital markets and reduction of dollarization of those economies. Over the immediate horizon, the continued support of official creditors will be required to stave off reductions in public spending so that countries of the region can fully recover from the crisis, build back better and advance the 2030 Agenda for Sustainable Development.

Box III.1 (*continued*)

Author: José Palacín (ECE)

South-Eastern Europe: standstill in tourism-related activities is dragging down economic performance

The subregion of South-Eastern Europe has displayed high rates of COVID-19 infection and has been affected by the repeated introduction of coercive social distancing measures, which has led to business closures and reduced consumer demand. Unemployment has increased from already high levels, reversing some of the improvements seen in previous years. The worsening economic situation in the European Union, the main destination for its exports and a source of investments and remittances, has depressed external demand and reduced income; and supply chain disruptions have dampened manufacturing production. However, as the external and health situations improve, growth is expected to return to the region.

The pandemic's impact in the subregion has varied

The impact of the pandemic on the countries of the subregion has varied. Serbia, with a relatively diversified economy, is likely to have seen only a modest contraction in GDP in 2020, at about 2 per cent, in part because of the implementation of a large fiscal programme (equivalent to 13 per cent of GDP), which contained the fall in output and prevented a sharp deterioration in the labour market. By contrast, the ability to implement expansionary policies designed to offset the contractionary effects of the crisis has been limited in countries with high public debt, including Albania and Montenegro, where tourism is an important contributor to overall output. Consequently, their economies are expected to have contracted by 6-11 per cent in 2020. The tourism industry's recovery will fall short of previous levels, which will exert a persistent dampening effect on economic activity in those two countries. In addition, the impact of government initiatives to support the economy through wages subsidies and credit guarantees, in particular in Albania and North Macedonia, has been limited because of the difficulties inherent in efforts to reach the informal sector.

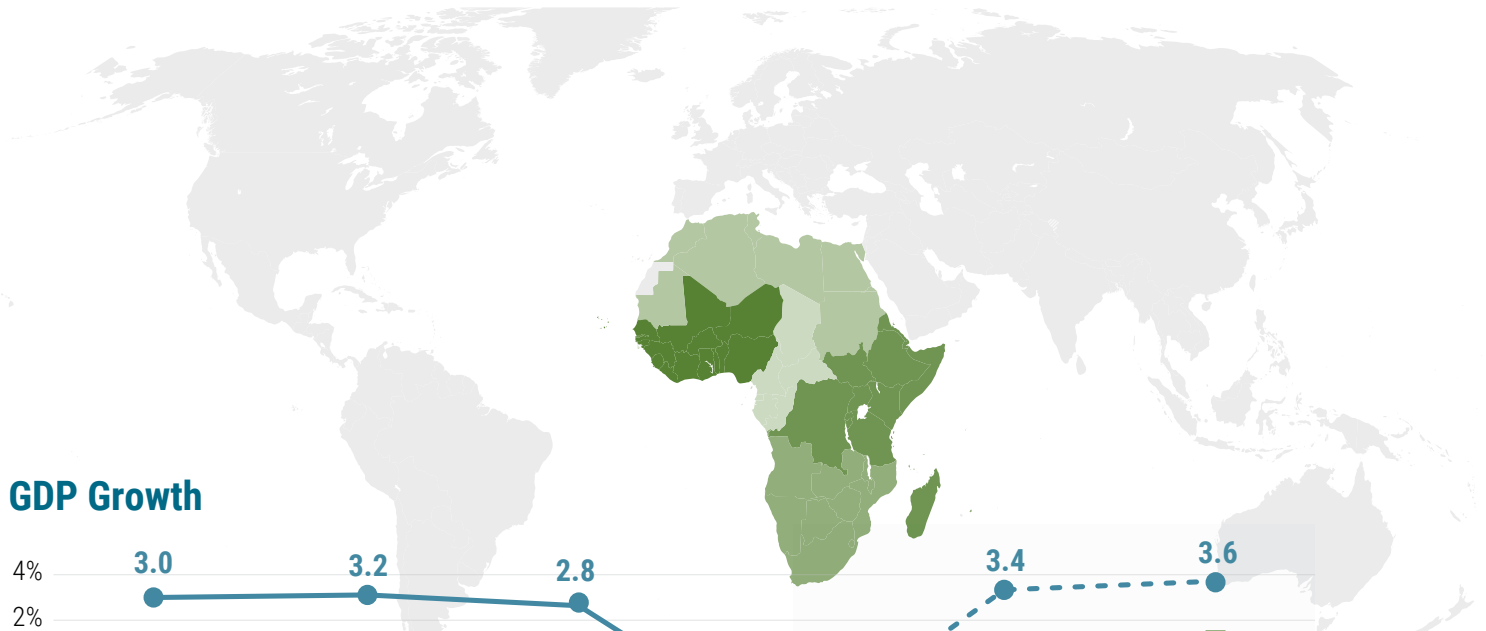
To counteract the pandemic, the countries in the region increased health expenditures; but with lower fiscal revenues, this has resulted in widening fiscal deficits. After years of surpluses, Bosnia and Herzegovina recorded a fiscal deficit. In those countries with an independent monetary policy, namely, Albania and Serbia, the monetary authorities have cut policy interest rates to support economic activity. The policy interest rate was also cut in North Macedonia, where monetary policy is somewhat constrained by the pegging of the exchange rate to the euro.

Inflation has not been observed in the region

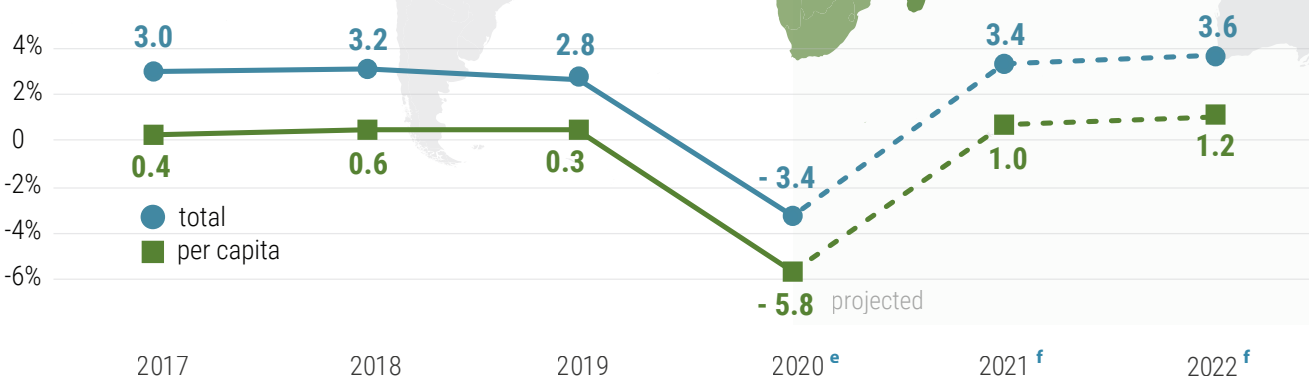
Inflationary pressures in the region have been absent, owing to weak demand and lower energy prices. Moreover, the noticeable deterioration of labour-market conditions in 2020 has represented a setback in the context of previous improvements.

The pandemic has exacerbated structural weaknesses

The subregion is confronting many adverse structural factors—including a challenging business environment, low productivity and the shrinking of its labour force due to population ageing and persistent outward migration—which will limit its recovery. EU accession, although not an immediate prospect, remains a critical anchor for policies and a source of financing. The aggregate GDP of South-Eastern Europe, after expanding by 3.5 per cent in 2019, is expected to have declined by 3.8 per cent in 2020, with a return to growth of 4 per cent expected in 2021 and 3.1 per cent in 2022.

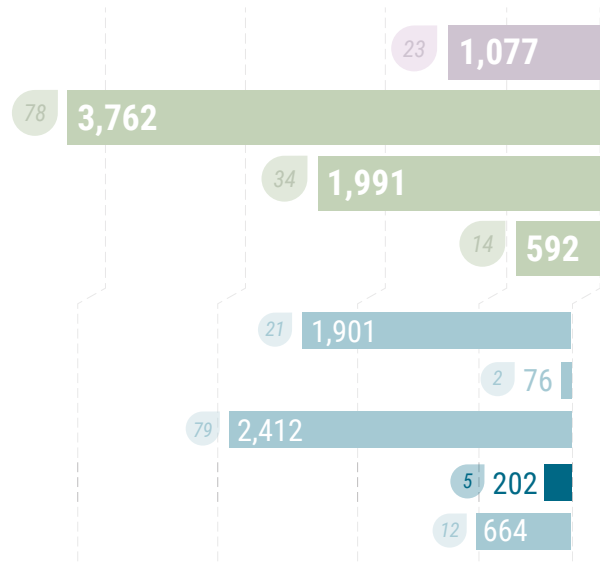


GDP Growth

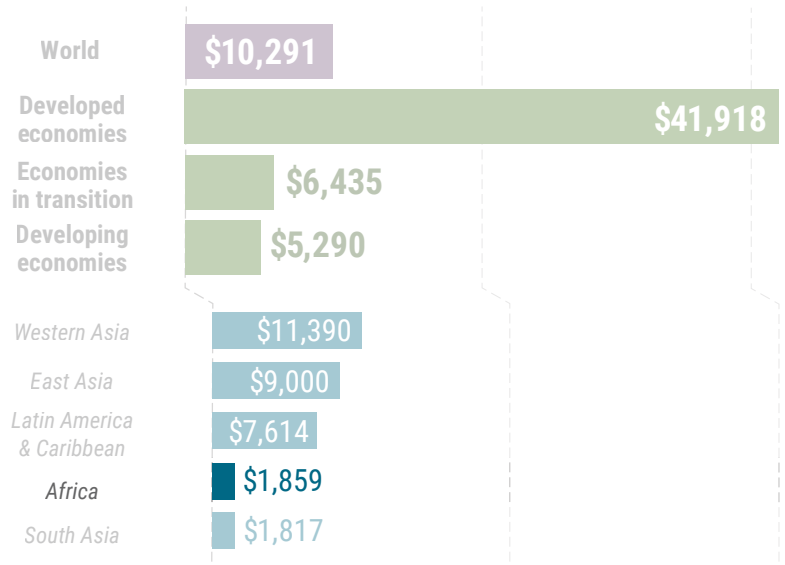


COVID-19 Cases per 100,000 people by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita 2020



Note: The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2021*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

Aggregate data for Africa, excluding Libya.

^e: 2020 estimates, ^f: 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

Developing economies

Africa: a huge economic downturn is undermining development prospects

- The magnitude and unequal nature of the current crisis have resulted in an enormous setback to recent development gains, with impacts on unemployment, poverty and inequality
- After the largest economic contraction on record in 2020, there is only a feeble and uneven recovery projected for 2021, reflecting the region's limited policy space
- Forging the path towards a stronger and sustained recovery will require forceful policy actions and further multilateral support

An unprecedented economic downturn has occurred in 2020...

Africa is experiencing an unprecedented economic downturn with major adverse impacts on the long-term development of the continent. The lower external demand and lower commodity prices, the collapse of tourism and lower remittances—exacerbated through the institution of much-needed domestic lockdowns and other measures required to control the spread of the COVID-19 pandemic—have caused a severe and widespread deterioration of the economic situation. Also, more difficult financing conditions and rising public debt are exposing many countries to debt distress. Given its magnitude and unequal effects across population groups, the current crisis is causing a rise in unemployment, poverty and inequality which threatens to wipe out the development gains of recent decades. While African countries have acted quickly to limit the spread of COVID-19, most of them are nevertheless confronting enormous challenges as they strive to keep the pandemic under control and mobilize the financial resources needed to support health systems, protect vulnerable population groups and support the recovery.

...with prospects for only a moderate recovery in 2021

After a contraction of 3.4 per cent in 2020—the first in 27 years and the largest on record—Africa is projected to achieve a modest recovery, with regional GDP expanding by 3.4 per cent in 2021 (figure III.5) and 3.6 per cent in 2022. The achievement of the projected recovery is predicated on a recovery of domestic demand as generated through the relaxation of lockdown constraints and the pickup of exports and commodity prices. Still, many African countries will have to carefully manage policy priorities on the road to recovery, amid limited liquidity and elevated debt burdens. Should countries experience a spike in infections, saving lives and protecting livelihoods must remain the priority, with increased health spending and financial support to vulnerable groups. In countries where the pandemic has receded, emphasis should be placed on stimulating economic activities.

The recovery faces significant downside risks

The recovery faces downside risks, with the outlook being subject to high uncertainties over the progression of the pandemic at the local and global levels and the development of a vaccine, including its accessibility. New surges of the virus could force countries to reinstate lockdowns and other restrictive measures. So far, Africa continues to be the least

Figure III.5
Real GDP growth in Africa, by subregion



Source: UN DESA, based on projections and scenarios produced with the World Economic Forecasting Model (WEFM).

Note: Data for 2020 are estimations and data for 2021 are forecasts (e = estimate, f = forecast). Excludes Libya.

affected continent, with most cases occurring in Morocco and South Africa. At the time of writing, Africa accounts for only 3 per cent of confirmed cases (~2.5 million) and 3 per cent of reported COVID-19-related deaths (~59,000), while the continent accounts for 17 per cent of the world population. The incidence rate is highest in Cabo Verde, Libya, Morocco, South Africa and Tunisia, where tens of thousands of cumulative cases exist per million people. Given the renewed surges in several developed economies, African countries should take necessary measures to keep COVID-19 under control.

The challenges related to external financing and high debt levels pose a major risk. The elevated public debt is limiting the capacity to boost spending at this critical juncture. At the same time, meagre growth prospects mean less capacity to sustain debt levels, as foreign reserves, remittances and capital flows falter and depreciations constrain the capacity to service foreign currency-denominated debt. In this regard, gross debt-to-GDP ratios are projected to have increased in 2020 by, on average, about 8 percentage points and by over 20 percentage points in the Congo, Seychelles, the Sudan, and Zambia. Indeed, six African countries are in debt distress (Mozambique, Republic of the Congo, São Tomé and Príncipe, Somalia, Sudan and Zimbabwe), while 14 other countries are at high risk (IMF, 2020d).

African countries need further support from the international community in averting a debt crisis, protracted low growth and a high-debt trap. A debt crisis would not just cause a brutal further deterioration of current conditions, making for a dire outlook, but also force painful fiscal adjustments, thereby worsening development prospects. In the absence of international assistance, some countries might find themselves facing extreme difficulties in their attempts to revive economic activity, which would make debt servicing more arduous. Against such a backdrop, social unrest and political tensions may easily escalate, which could in turn increase insecurity, violence, internal displacement, migration and food insecurity. Extreme weather events, such as floods and droughts, could also disrupt economic activities; and the La Niña phenomenon, in particular, is projected to create drier- than-nor-

African countries must avert a painful debt crisis

mal conditions in East Africa and lead to increased rainfall in Southern Africa up until the first quarter of 2021.

**Nigeria and South Africa
face major economic
challenges**

Among the largest economies, Nigeria was dealt a severe blow by the twin shocks of low oil prices and COVID-19-related restrictions. In 2020, GDP is estimated to have contracted by 3.5 per cent, amid lockdowns, lower oil production and weak oil prices. Although output is projected to expand by 1.5 per cent in 2021, tighter foreign exchange liquidity, mounting inflationary pressures and subdued global and domestic demand are clouding the medium-term outlook. After a strict lockdown which led South Africa's economy to contract by what is estimated to have been 7.7 per cent in 2020, GDP is projected to expand by 3.3 per cent in 2021. However, it remains uncertain whether, amid power shortages, elevated public debt and policy challenges, a strong and sustained recovery will materialize in the medium-term. Raising potential output in South Africa is a step critical to tackling the strong impacts of the crisis on the labour market. In Egypt, higher fiscal expenditures supported by foreign currency financing secured through multilateral institutions and an easing monetary stance helped prevent a contraction on a yearly basis in 2020. Egypt's GDP is estimated to have grown by 0.2 per cent in 2020; and in 2021, GDP growth is projected to climb to 5.4 per cent, underpinned by a strong recovery of domestic demand and facilitated by the absence of severe balance-of-payments constraints.¹

**The crisis is severely
impacting commodity-
and tourism-dependent
economies**

The commodity-dependent economies are experiencing the full force of the crisis, and its impact has been exacerbated by the fall in the prices of commodities, especially oil. Algeria's GDP is projected to undergo an expansion of 5.2 per cent in 2021, underpinned by the recovery in crude oil production after a contraction of 7.7 per cent in 2020. Still, Algeria's fiscal position has weakened, and austerity measures planned by the government may hamper the recovery. A key challenge is the implementation of a reform agenda that can promote private investments. Angola's economic difficulties are continuing after a prolonged downturn, with GDP growth projected at only 1.2 per cent in 2021. There are also significant downside risks associated with the inability of recent macroeconomic policies and structural reforms to ensure external and fiscal sustainability.

In Central Africa, West Africa and Southern Africa, many oil and mineral exporters—the Central African Republic, the Congo, Equatorial Guinea, Namibia and Zimbabwe—face a bleak outlook. After its first contraction in almost three decades, in 2020, Cameroon's economy is projected to recover in 2021 underpinned by strengthened external and domestic demand. Risks are tilted towards the downside, however, owing to domestic political tensions and lingering conflict in English-speaking regions. Following a contraction of 0.5 per cent in 2020, the economy of Ethiopia, among agricultural exporters, is projected to expand by 2.3 per cent in 2021, which is well below the potential level of growth. While agricultural exports are showing resilience, the tourism sector's performance will likely remain restrained throughout 2021.

The crisis is severely impacting tourism-dependent economies, including Morocco and small island developing States such as Cabo Verde, Mauritius, São Tomé and Príncipe and Seychelles. As tourism accounts on average for more than 25 per cent of employment and 15 per cent of GDP in these countries, the effect on unemployment rates, poverty and inequality is clearly visible. Amid restrictions on international travel, potential tourists' fear

¹ In terms of fiscal years, GDP growth is estimated at 3.5 per cent for FY 2020, and for FY 2021, the forecast is 2.1 per cent.

of contagion and renewed waves of infection worldwide, the outlook for these economies is bleak. In Morocco, GDP growth is projected at 5.6 per cent in 2021, after an estimated contraction of 7.1 per cent in 2020. In the short term, amid the shutdown of tourism and rising unemployment, economic activity will remain relatively subdued.

The crisis has dealt a major blow to labour markets; and in 2020, unemployment rates increased across the continent, especially in urban areas. The nature of its impact, however, has been heterogeneous, being dependent on the severity of the downturn and the stringency of containment measures. As the COVID-19 pandemic discouraged some workers from job seeking, the size of the labour force has also declined in large economies, such as Nigeria and South Africa, which can have longer-term consequences for potential growth and fiscal revenues. In South Africa, the number of employed persons declined significantly throughout 2020, with the unemployment rate climbing to a record-high of 30.8 per cent in the third quarter. In Nigeria, the unemployment rate had risen to 27.1 per cent by mid-2020. Notably, the number of Nigerians who are unemployed stands at about 21 million, which exceeds the figure for the population of any one of more than 30 countries on the continent.

The size and unequal impacts of the crisis are plunging millions into poverty and aggravating inequalities, which represents a major setback to gains reaped in the previous decades. The current job losses, disproportionately affecting women, youth and migrants in the informal sectors, are compounded by the lack of social protection systems. This being the case, countries that have recently made substantial progress on poverty reduction, such as Liberia, Mauritania, Rwanda and Sierra Leone, will likely witness years of development gains reversed or even erased.

The increase in a range of deprivations will also raise multidimensional poverty to levels observed a decade ago, on average, affecting education, health and other services such as sanitation, drinking water and electricity (United Nations Development Programme and Oxford Poverty and Human Development Initiative, 2020). For example, the crisis could affect measures such as years of schooling and school attendance in countries that were already relatively deprived (for example, Burkina Faso, Chad and the Niger). Maternal and child mortality, in addition to being directly affected by the COVID-19 pandemic, could be indirectly affected through the disruption of health systems, whose impacts may include lower rates of vaccination and regular immunization, and food deprivation.

African Governments have embarked on fiscal expansion to combat the impact of the crisis. However, given limited fiscal capacity, the responses are significantly more constrained than in the rest of the world. Indeed, the fiscal response in sub-Saharan Africa has amounted to only 3 per cent of GDP on average so far, compared with a figure for developed countries of about 7 per cent of GDP (IMF, 2020e). Most countries have opted for more immediate support in the form of additional spending and/or through the forgoing of fiscal revenue, entailing mostly non-health sector measures, although some (e.g., Chad, Namibia and South Africa) decided in favour of equity, loans and guarantee schemes, which have less immediate impact on fiscal balances but increase contingent liabilities.

Although Governments have implemented a wide array of measures, the delivery of assistance has been hampered by a chronic lack of safety nets which would allow a swifter allocation of resources to those most in need. On the other hand, certain digital methods—most notably mobile money transfers—have been effective in boosting social protection efforts, for example, in Burundi, Kenya, Lesotho, Malawi and the United Republic of Tanzania.

A major blow has been dealt to employment across the continent...

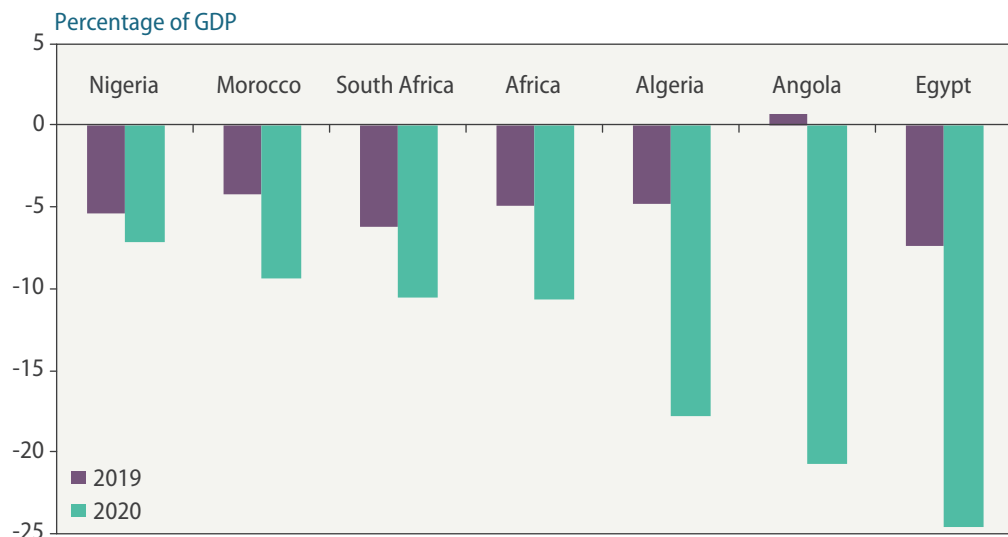
...and the outlook for ending poverty, reducing inequality and other Sustainable Development Goals is worsening

Fiscal spending aimed at containing the impact of the crisis is on the rise...

...with fiscal deficits reaching double digits in a number of countries

Africa's average fiscal deficit is estimated to have climbed to 10.7 per cent in 2020, from 4.9 per cent in 2019 (figure III.6). In the medium term, many countries will need both to implement reforms for creating fiscal space and to guarantee their sustainability by improving debt transparency and management, promoting efficiency of public spending and expanding the tax base.

Figure III.6

General government overall balance, selected African economies

Multilateral institutions have provided financial assistance, but more is needed

Multilateral institutions have been quick to provide financial assistance and debt relief. The IMF has extended \$25 billion in assistance to African countries (representing 25 per cent of global financial assistance) and has provided debt service relief in the amount of almost \$400 million (which represents 83 per cent of total debt service relief granted globally). For its part, the World Bank has pledged to deploy \$50 billion for African countries over a 15-month period to cover operations ranging from expansion of virus testing and provision of medical equipment to the scaling up of social safety nets and support to farmers. In April 2020, the G20 finance ministers endorsed the Debt Service Suspension Initiative (DSSI), under which the world's poorest countries can postpone debt repayments due between 1 May 2020 and end of June 2021 (with the date possibly extended) and spread them over six years. Some countries—including Angola, the Congo, Djibouti, Mauritania and Mozambique—stand to save 1–2 per cent of GDP through participation in this initiative; and to date, 29 African countries have been benefiting from its implementation.

A debt moratorium will not suffice for the most indebted African countries

However, the expansion of private lenders has complicated debt relief efforts. In 2019, about 40 per cent of public and publicly guaranteed long-term external debt in sub-Saharan Africa was owed to private creditors, which have not yet begun to provide debt relief on equal terms. Rating agencies have made it clear that requests put forward by countries to private creditors for treatment on G20-comparable terms could lead to downgrades of those countries' credit rating. Strong action from Governments, citing force majeure, for example, could enforce comprehensive standstills (Rashid and Stiglitz, 2020). Yet, a debt moratorium will not suffice for the most indebted countries, and debt relief will be needed to avert

defaults. In anticipation of such a need, the G20 reached an agreement, in principle, on a Common Framework for Debt Treatments, which it endorsed on 13 November, to facilitate debt restructuring on a case-by-case basis. This could represent a breakthrough under the international debt agenda. Ultimately, the current crisis not only calls for the creation of new liquidity initiatives (box III.2) but also presents an opportunity to establish a predictable, rules-based and comprehensive sovereign debt restructuring mechanism.

Most African economies have sharply eased their monetary policies. In 2020, policy rates were cut in 25 countries as well as in the 14 member countries of the Central African Economic and Monetary Community (CEMAC) and the West African Economic and Monetary Union (WAEMU); other measures have included liquidity injections, moratoriums on debt repayments and restructuring of existing obligations. Cabo Verde, Guinea and Morocco also

Aggressive monetary easing has been implemented amid contained inflationary pressures

Box III.2

Development financing through SDRs and the LSF—Options for policymakers

The COVID-19 pandemic has created financing challenges for numerous Governments in Africa saddled with high pre-COVID-19 debt levels and fiscal deficits, increasing borrowing costs, depreciating currencies and falling tax revenues (ECA, 2020). Africa's average debt-to-GDP ratio increased significantly, from 39.5 per cent of GDP in 2011 to an estimated 61.3 per cent of GDP in 2019.

Generally, borrowing costs are relatively high in Africa compared with developed and some emerging economies, as markets generally impose higher risk premiums on African economies. Estimates show that they pay about 2.9 percentage points more than their macroeconomic fundamentals would support (Olabisi and Stein, 2014), creating significant challenges for countries seeking to raise additional funding at reasonable cost. Furthermore, most African bonds are issued in dollars or in euros, which presents a high exchange rate risk for borrowing Governments if their currencies depreciate as a consequence of the COVID-19 pandemic.

These existing financing challenges have severely curtailed Africa's fiscal space for responding effectively to the pandemic, since even those economies that have access to international financial markets are finding it difficult to access liquidity on favourable terms. At the same time, the funds that have been freed by the G20 Debt Service Suspension Initiative for the poorest countries, and through International Monetary Fund (IMF) emergency funding for low- and middle-income countries, fall short of the vast amounts required to mitigate the effects of the crisis. More innovative financing measures are therefore needed to address both liquidity and solvency issues. Liquidity issues could be addressed through enhanced access to emergency funding facilities and new liquidity lines for the private sector in Africa, while solvency issues would require a more comprehensive temporary debt standstill as well as debt restructuring and reduction measures.

Special drawing rights

Access to special drawing rights (SDRs) can provide much-needed financing for many African countries. In April 2020, the IMF called on the G20 to support a new general allocation of SDRs which would benefit all countries. An alternative proposal is for developed economies to donate or lend unused portions of their existing SDR holdings to low- and middle-income countries that are in need of support. The combination of a new general allocation of SDRs with a mechanism for their subsequent reallocation to the countries most in need would further enhance the impact on liquidity.^a

Under the IMF Articles of Agreement (articles XV and XVIII), any new general allocation of SDRs is distributed among member States in proportion to their quotas.^b A new issuance of SDRs worth US\$ 500 billion would therefore result in an allocation of US\$ 11.9 billion for 51 African countries (excluding

^a For further details on these two approaches in a global context, see, for example, United Nations (2020b).

^b For further details regarding special drawing rights, see IMF (2020f).

(continued)

Box III.2 (*continued*)

Somalia, the Sudan and Zimbabwe) that account for a combined 2.381 per cent of IMF quotas—at no discernible cost. This is almost equivalent to the US\$ 12.9 billion in debt relief offered through the Debt Service Suspension Initiative in 2020.

Alternatively, if all G20 countries were to lend or donate all of their existing unused SDRs (SDR 128.7 billion, equivalent to US\$ 179.2 billion), this could go a long way towards helping African countries meet their immediate financing needs (estimated at \$100 billion) (United Nations, ECA, 2020). Given the current interest rate of 0.5 per cent on SDR holdings, a voluntary redistribution of SDRs would entail a small cost for the giving country in the form of forfeited revenue. A case-by-case agreement on who is to bear this cost—the developed countries redistributing their SDRs or the developing countries receiving them—would be needed to facilitate the reallocation. For example, developed countries could levy charges, on a case-by-case basis, on lower-middle-income countries to help absorb the costs for low-income countries.

Joint proposal by ECA and PIMCO for a liquidity and sustainability facility

The liquidity problems facing economies across Africa have been exacerbated by high borrowing costs and a significant decline in capital flows. Some relief has been provided in the form of official sector debt moratoriums and standstill agreements. However, private sector debt, which has been mounting in Africa in recent years, has not benefited from such moratoriums and unlike other markets of developed countries, most COVID-impacted developing countries do not have access to central bank liquidity programmes with the ability to facilitate market functioning and help reduce financing costs. The establishment of a liquidity and sustainability facility, as proposed by ECA and PIMCO, would lead to an immediate reduction in borrowing costs for Governments in Africa and enhance their access to international capital markets and could also generate new investment interest from non-traditional investors. All risk would be borne by the private sector institutions accessing the facility, which could benefit official sector creditors and development finance institutions through its improvement of overall debt sustainability.^c

Apart from pursuing its objective of raising the capital needed to address COVID-related needs and associated economic disruptions, the facility could also address the continent's debt problem. It is estimated that the facility could enable regional total savings in the amount of \$39 billion-\$56 billion over a five-year period, thereby significantly improving debt sustainability for vulnerable countries. The facility is designed for financing by central banks with hard currency reserves and would benefit for the most part vulnerable emerging market countries issuing bonds on the continent and even beyond, who face challenges related to market access and liquidity.^d

^c For further details, see the joint proposal of the Economic Commission for Africa and PIMCO regarding a liquidity and sustainability facility to improve market access for emerging market and other vulnerable sovereigns (United Nations, ECA, and PIMCO, 2020); and Songwe (2020).

^d Joint proposal, p. 1, fourth bullet point.

Authors: Hopestone Kayiska Chavula and Christine Achieng Awiti (ECA)

reduced capital adequacy ratios and liquidity coverage ratios. While monetary policies will likely remain accommodative in the short-term, barring inflationary pressures, those policies should nonetheless balance supporting aggregate demand with preserving exchange rate stability, especially in case of a double-dip global recession and renewed financial turmoil.

In 2021 and 2022, aggregate inflation in Africa is projected to ease to 9.0 per cent and 6.4 per cent, respectively, as inflationary pressures decline at the same pace as the containment of the outbreak. Inflation is projected to remain elevated in only a handful of countries (e.g., South Sudan, the Sudan and Zimbabwe), amid macroeconomic imbalances coupled with deteriorating economic and financial conditions and the monetization of fiscal deficits. If renewed supply disruptions and financial turbulence were to emerge, the inflation outlook could worsen. In this regard, aggregate inflation trended upward in 2020 as a result of exchange rate depreciation in domestic currencies and food price inflation associated to supply disruptions in Nigeria, South Sudan, the Sudan and Zimbabwe.

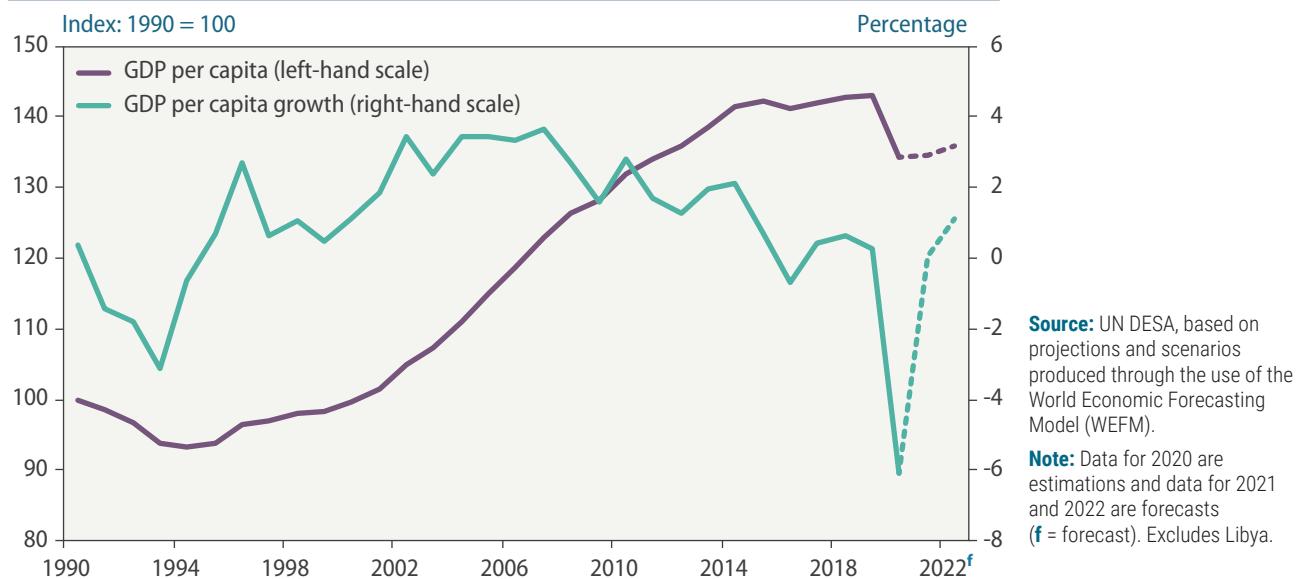
Africa needs a sustained revival of growth. In 2020, GDP per capita is estimated to have regressed to the level observed a decade ago (figure III.7), owing to the current crisis

There is an urgent need for a robust and sustained growth uplift

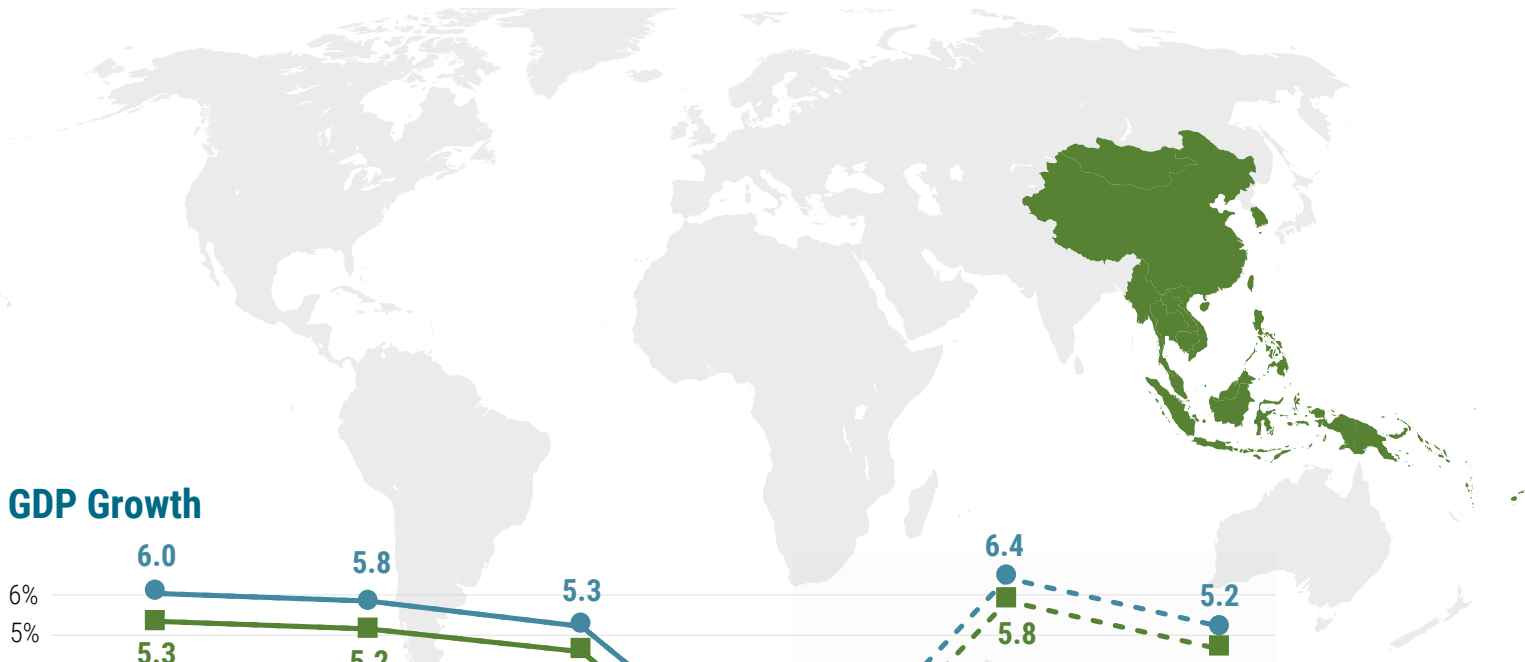
and the slowdown that has taken hold since the end of the commodity boom. While a focus on the short term is essential, African countries still need to lay the groundwork for a strong and inclusive development path in the medium term, which would entail the creation of decent and inclusive jobs at a large scale. As countries will be emerging from the crisis with higher levels of debt, a careful balance of policy priorities will be required to build resilience and boost productivity. This would include accelerating both implementation of the reform agenda to unlock growth opportunities and institutional changes to improve transparency and build trust in the rule of law, as well as forceful policy actions in the areas of technology adoption, climate resilience and domestic revenue mobilization. African countries should prioritize, in particular, the use and diffusion of digital technologies, supported by the expansion of affordable and universal digital infrastructure. In addition, an effective framework for the implementation of the African Continental Free Trade Area could become a major tool for promoting intra-African trade, food security and productivity.

Figure III.7

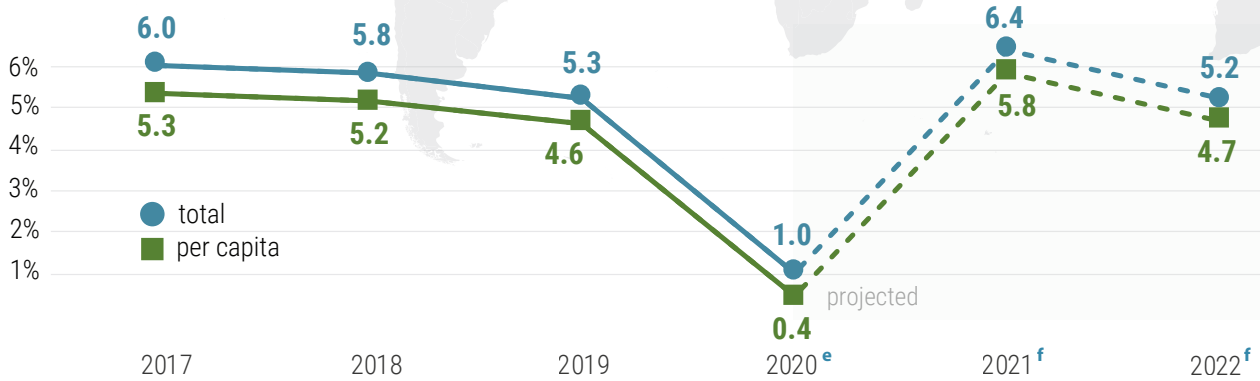
Real GDP per capita in Africa



East Asia

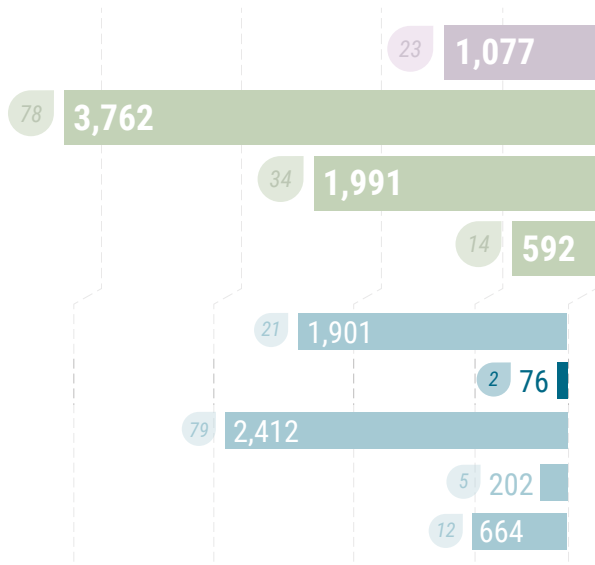


GDP Growth

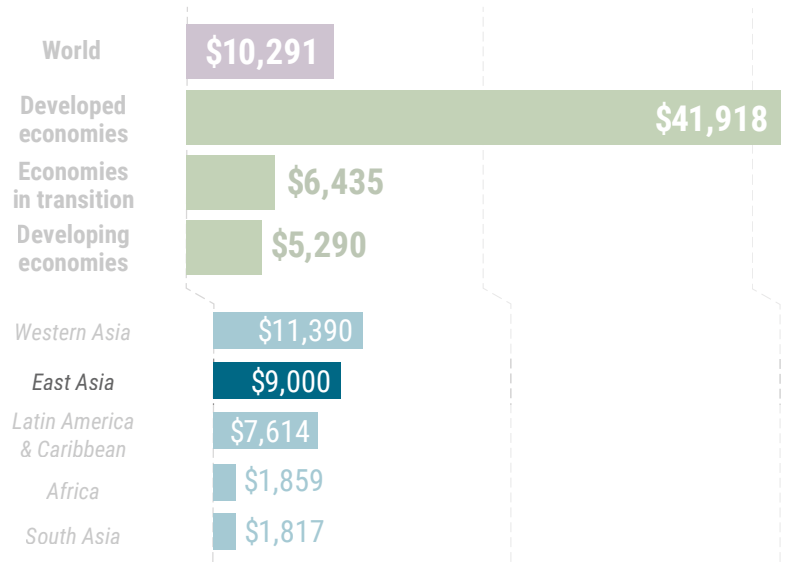


COVID-19 Cases per 100,000 people by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita 2020



Note: The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2021*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

Aggregate data for Africa, excluding Libya.

e: 2020 estimates, **f:** 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

East Asia: growth is projected to rebound but downside risks are high

- The pandemic has set back the region's progress towards sustainable development
- Recovery in domestic demand needs to be supported by monetary and fiscal stimulus measures
- Key downside risks to the growth outlook stem from the potential for renewed lockdowns, rising trade tensions and persistent financial market volatility

East Asia's GDP growth decelerated sharply to 1.0 per cent in 2020, marking the region's weakest expansion since the Asian financial crisis (figure III.8). Measures designed to contain domestic outbreaks, including widespread restrictions on mobility and enforced business closures, significantly curtailed household spending and investment activities; and the region's investment prospects have been further dampened by heightened uncertainties and risk aversion. In many economies, however, the introduction of large policy stimulus packages provided some support to domestic demand during the year. On the external front, export volumes contracted owing to supply chain disruptions and weakened global economic activities. While, looking ahead, East Asia is projected to recover from a low base, with growth rebounding to 6.4 per cent in 2021, before moderating to 5.2 per cent in 2022, these growth projections are deeply contingent on the successful containment of the virus, both domestically and abroad. Indeed, with multiple waves of the pandemic threatening to trigger a renewal of lockdowns, downside risks to East Asia's growth outlook are high. Importantly, the pandemic has inflicted long-lasting socioeconomic damage on many parts of the region, with a disproportionate impact on the vulnerable segments of society.

Figure III.8
Real GDP growth in East Asia



Source: UN DESA.

Note: Data for 2020 are estimations and data for 2021 and 2022 are forecasts (f = forecast).

Prospects for a recovery depend on the type and effectiveness of pandemic containment measures

The growth prospects for East Asia, compared with the prospects for other developing regions, suggest relatively greater resilience. With a large number of countries in the region successfully containing the virus, East Asia is likely to be the only developing region to observe positive growth in 2020. Nevertheless, the aggregate figures mask a wide divergence in the projected recovery paths of its different economies, with China being the main driver of the region's growth. For all countries, however, one of the major determinants of the strength of the short-term economic recovery will be the type and effectiveness of pandemic containment measures. Although it was the initial epicentre of the COVID-19 outbreak, China quickly contained the outbreak's spread, enabling a quick rebound in growth. In the South-East Asia subregion, most countries also imposed widespread social distancing restrictions, which resulted in sharp contractions in economic activity, particularly private consumption. However, while Singapore, Thailand, and Viet Nam flattened the curve relatively quickly and with shorter lockdowns, Indonesia, Myanmar and the Philippines are still struggling with high daily levels of new infections. In the latter group, a more prolonged period of limited mobility and weak sentiments will depress consumer spending and private investment, thus constraining the pace of recovery.

In contrast, the Republic of Korea and Taiwan Province of China did not impose large-scale social distancing regulations but, instead, utilized a strategy of extensive testing, contact tracing and targeted quarantines to control domestic outbreaks. As public confidence and domestic demand were less adversely impacted, these economies averted a severe economic downturn and had returned to a path of positive quarter-on-quarter growth by the third quarter. Indeed, the Asian Development Bank (2020) recently found that as compared with school and workplace closures, gathering bans, mass testing and contact tracing were associated with smaller output losses.

Growth prospects of the trade-dependent economies hinge on the strength of the global economic recovery

The pandemic's shock to global demand as well as its disruptions to production networks had a visible impact on East Asia's trade performance in 2020. Between January and October, nominal merchandise exports in the region contracted by 0.8 per cent compared with the same period in the previous year. However, the decline in East Asia's export performance was less severe than that of other developed and developing regions. For several East Asian economies, a surge in global demand for pandemic-related goods partially offset significantly weaker demand in other export sectors, such as commodities and automobiles. Economies that are deeply integrated into the region's electrical and electronic (E&E) production networks, including China, the Republic of Korea, and Taiwan Province of China, benefited from an increase in shipments of semiconductors, laptops and other work-from-home products. China also experienced a strong increase in exports of medical goods and protective equipment. As the effects of the pandemic subside, however, demand for these goods will eventually normalize.

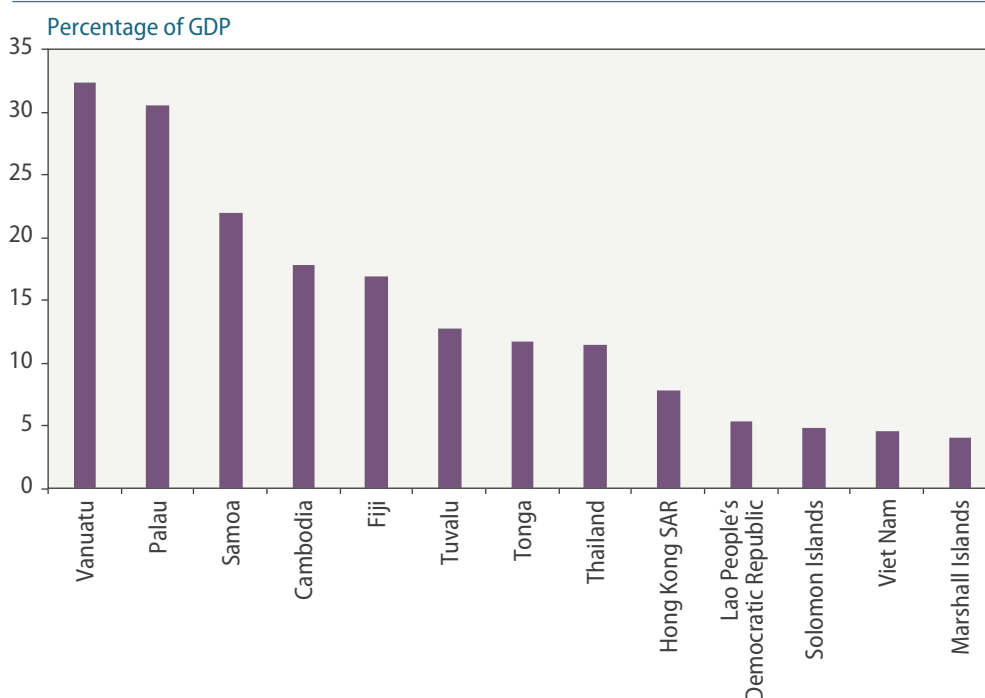
Recent leading trade indicators, such as new export orders and business sentiments, point towards continued trade weakness ahead; and given strong external headwinds, the region's trade outlook is highly fragile. Several of East Asia's major trading partners, including many countries in Europe, could face a more prolonged period of lockdowns, which would weigh on their import demand. In 2020, trade tensions between China and the United States re-escalated, extending deeper into the areas of technology and telecommunication. While trade-related tensions between these two major economies could abate given the election of a new United States Administration, they are unlikely to dissipate completely considering the long-standing and complex nature of the issues under dispute.

The growth outlook for the East Asian economies will also be strongly influenced by their degree of reliance on other external sources of income, in particular tourism, remittances and commodities. Given the slow reopening of borders and cautious consumer behaviour, a swift rebound in international travel appears highly unlikely. This bleak outlook has severe implications for the growth prospects of the tourism-dependent economies in the region, given the importance of the tourism industry as a source of foreign exchange earnings, employment and income. Before the pandemic, international tourism receipts accounted for 18 per cent of GDP in Cambodia and 11 per cent of GDP in Thailand. The level of economic reliance on tourism is even higher in the Pacific island States. Indeed, in Fiji, Palau, Samoa and Vanuatu, international tourism receipts account for 17–32 per cent of GDP (figure III.9). Within these countries, the prolonged slump in tourist arrivals threatens the viability of many small and medium-sized enterprises, while at the same time affecting the livelihoods of low-skilled workers who depend on income derived from tourism-related industries.

The pandemic shock has severely impacted economies that rely heavily on other external sources of income, in particular tourism, remittances and commodities

Figure III.9

International tourism receipts in selected East Asian economies, 2019



Source: UN World Tourism Organization.

The deterioration of global economic conditions will also hurt countries with a high reliance on remittance inflows. In the Philippines and Viet Nam, for example, remittances account for about 9 per cent and 6 per cent of GDP, respectively. However, from January to August 2020, the Philippines saw a contraction in remittance inflows by 2.6 per cent, a stark contrast to solid annual average growth in remittances of 4.1 per cent over the past five years. As migrant workers in host countries face employment losses and wage cuts, households in recipient countries could see a large decline in this major source of their income, which would constrain private consumption.

Growth will rebound in China, supported by stimulus measures

At the same time, the commodity-exporters, such as Brunei Darussalam, Indonesia, Mongolia and Timor-Leste, will confront strong headwinds arising from the renewed decline in global commodity prices. Not only will persistently low commodity prices hurt export revenues but they could also drive large capital outflows, exerting downward pressure on exchange rates. In addition, the collapse in commodity-related income will further weaken the fiscal positions of these economies, constraining the ability of their Governments to utilize additional fiscal stimulus measures to counter the pandemic and support domestic demand.

In China, early lockdown measures were successful in quickly containing the domestic spread of COVID-19, which enabled an economic recovery to unfold from the second quarter of 2020 onward. Following a deep GDP contraction of 6.8 per cent in the first quarter, growth picked up on the back of a rebound in industrial production and exports, as pandemic control measures were gradually removed. Growth was also supported by an increase in infrastructure investment as well as a modest revival in private consumption. Against this backdrop, the Chinese economy is likely to have expanded by 2.4 per cent in 2020, making it the only major economy in the world to have experienced positive growth in 2020.

Looking ahead, China's GDP growth is projected to increase to 7.2 per cent in 2021, before moderating to 5.8 per cent in 2022; but given the highly challenging environment, monetary and fiscal stimulus will remain in place over the outlook period. The economic recovery, however, is expected to be uneven across sectors. Public spending on infrastructure investment is likely to strengthen, supported by a rise in the issuance of local government special-purpose bonds. In contrast, private consumption is likely to recover at only a moderate pace, as weak sentiments constrain the willingness of consumers to purchase discretionary items. Also, amid elevated uncertainty over future income and employment prospects, household savings have risen to an estimated level of more than 35 per cent of disposable income. In addition, despite the initial strong revival in manufacturing production, growth in private investment will be dampened by the fragile outlook on domestic and external demand.

The region is subject to bouts of high volatility in international financial markets

Amid persistent uncertainty surrounding the duration and impact of the pandemic, financial markets in East Asia will remain subject to abrupt shifts in investor sentiment over the outlook period. In the first quarter of 2020, widespread COVID-19 outbreaks and sudden lockdowns across the world caused strong financial market turbulence and an increase in demand for safe-haven assets. Against this backdrop, the region experienced substantial portfolio outflows during the first quarter, reflected in large equity market declines and domestic currency depreciations. In Indonesia, the Philippines and Thailand, stock markets weakened by about 30 per cent compared with the previous quarter.

Financial market conditions in East Asia improved in the second quarter, as investor sentiments were supported by massive liquidity injections and unprecedented monetary stimulus measures taken by central banks, particularly in the developed economies. Moreover, financial markets began to stabilize as mobility restrictions and lockdown measures around the world were gradually eased. Nevertheless, the emergence of new waves of infections across the world in the latter part of the year continued to trigger periodic bouts of market volatility in the region.

Inflation will remain muted amid subdued domestic demand and low commodity prices

Inflationary pressures are expected to remain subdued in most East Asian economies, reflecting weak aggregate demand and low global commodity prices. In 2020, headline inflation remained below central bank targets in several countries and areas, including the

Republic of Korea, Taiwan Province of China and Thailand. Malaysia, Singapore and Thailand experienced deflation during the year amid a sharp contraction in economic activities. In contrast, inflation edged up in China and Viet Nam as an increase in domestic food prices more than offset conditions of weaker demand.

In most countries of the region, core inflation will remain low over the outlook period, amid a projected slow recovery in economic activity and soft labour-market conditions. Given renewed lockdowns in many parts of the world, disruptions to production and trade could result in supply shortages, thereby exerting upward pressure on product prices in the region. In addition, depreciation in domestic currencies due to heightened financial market volatility could drive up the cost of imported goods.

The severe economic shock from the pandemic prompted swift monetary policy easing by central banks across the region (figure III.10). Some of the more aggressive interest rate cuts were seen in the Philippines, Mongolia, Myanmar and Viet Nam, where policy rates were reduced by between 175 and 300 basis points during the year. In the Republic of Korea and Thailand, interest rates were brought down to a record low of 0.5 per cent.

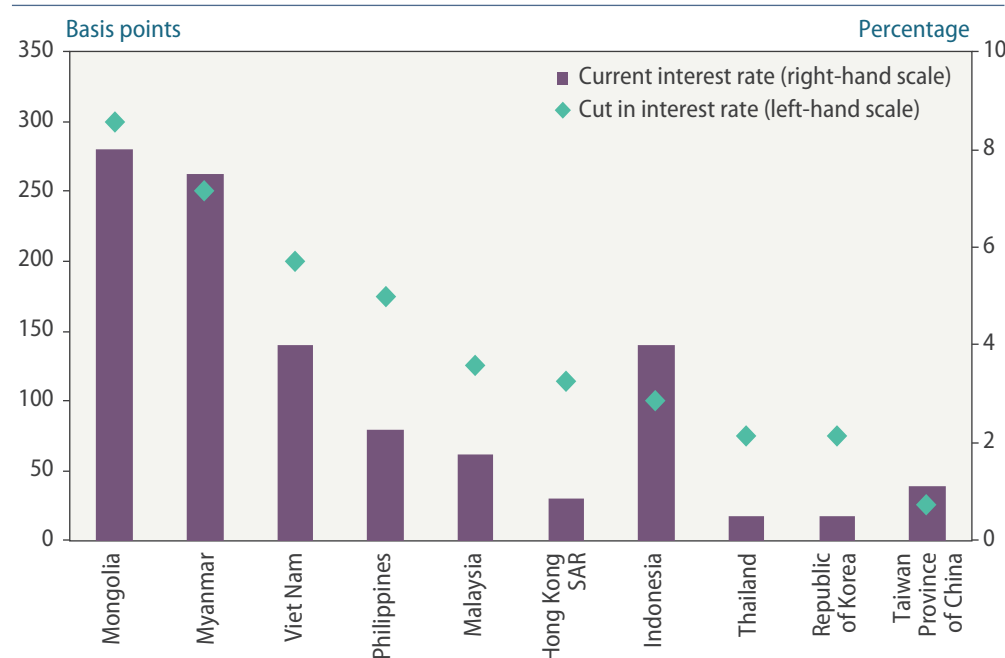
Alongside interest rate cuts, central banks in the region deployed a range of other policy tools aimed at stabilizing financial markets and supporting credit flows. These measures included lowering reserve requirement ratios, loosening countercyclical capital buffers and setting up special credit facilities. Several central banks also announced loan extensions and debt moratoriums to ease cash flow to households and businesses. For the first time, given the severity of the shock, central banks in Indonesia, the Philippines and the Republic of Korea introduced quantitative easing measures through the outright purchase of government bonds.

Amid a highly fragile growth outlook, monetary policy in East Asia is likely to remain expansionary, with further easing measures expected in parts of the region. However, given the existence of very low interest rates in many countries, central banks do not have much

Monetary policy will remain expansionary, given the fragile economic outlook and elevated downside risks

Figure III.10

Interest rate cuts in selected East Asian economies, 2020



Source: National authorities.

space for embarking on further rate cuts, which may lead to more experimentation with unconventional monetary policy measures in the region. Hofman and Kamber (2020) caution, however, that pursuing unconventional monetary policies may entail risks for central banks that lack certain key preconditions for the conduct of such policies, for instance, credibility (p. 3). In addition, while a more prolonged period of low borrowing costs and high liquidity will provide some support to growth in the short term, it is likely to exacerbate financial vulnerabilities, particularly high indebtedness. It is worthy of note in this regard that household debt-to-GDP ratios in Hong Kong Special Administrative Region, Malaysia and the Republic of Korea have risen to above 80 per cent of GDP, exceeding those of several developed countries including Japan and the United States.

Fiscal stimulus measures have been critical in providing support to households and businesses

Policymakers across East Asia have rolled out large fiscal stimulus packages aimed at reducing the adverse health, economic and social consequences of the pandemic. The size of these packages have ranged from less than 2 per cent of GDP in countries such as Myanmar and the Lao People's Democratic Republic to about 20 per cent of GDP in Singapore. There were also differences among countries with respect to policy priority areas based on national circumstances. To ease cash flow for businesses, particularly small and medium-sized enterprises, the measures that were introduced included tax reliefs, soft loans that came with favourable interest rates and lending guarantees, as well as utilities and rental subsidies. Many countries, including Malaysia, Singapore and Thailand, also implemented wage subsidies to help firms retain employment. To support household incomes and consumer spending, countries in the region announced a range of measures including income tax cuts, cash transfers and the expansion of unemployment benefits. Looking ahead, fiscal policies in the region are likely to remain expansionary so as to aid economic recovery from the pandemic. In Indonesia, the Philippines and Thailand, public spending on infrastructure is likely to be an important driver of growth over the outlook period.

Downside risks to the region's growth outlook have intensified

While the prospects for an effective COVID-19 vaccine indicate that it is on the horizon, the East Asia region still faces multiple downside risks to its growth outlook. The occurrence of new waves of the pandemic before the successful development and distribution of the vaccine could lead to renewed lockdowns, which would in turn cause deeper and more prolonged economic slumps. On the financial front, stronger market turmoil could trigger a sharp tightening in credit conditions and large asset price declines, which would not only amplify the weaknesses in the real economy, but also exacerbate existing financial vulnerabilities, including high corporate and household debt.

The pandemic has intensified challenges to sustainable development in the region

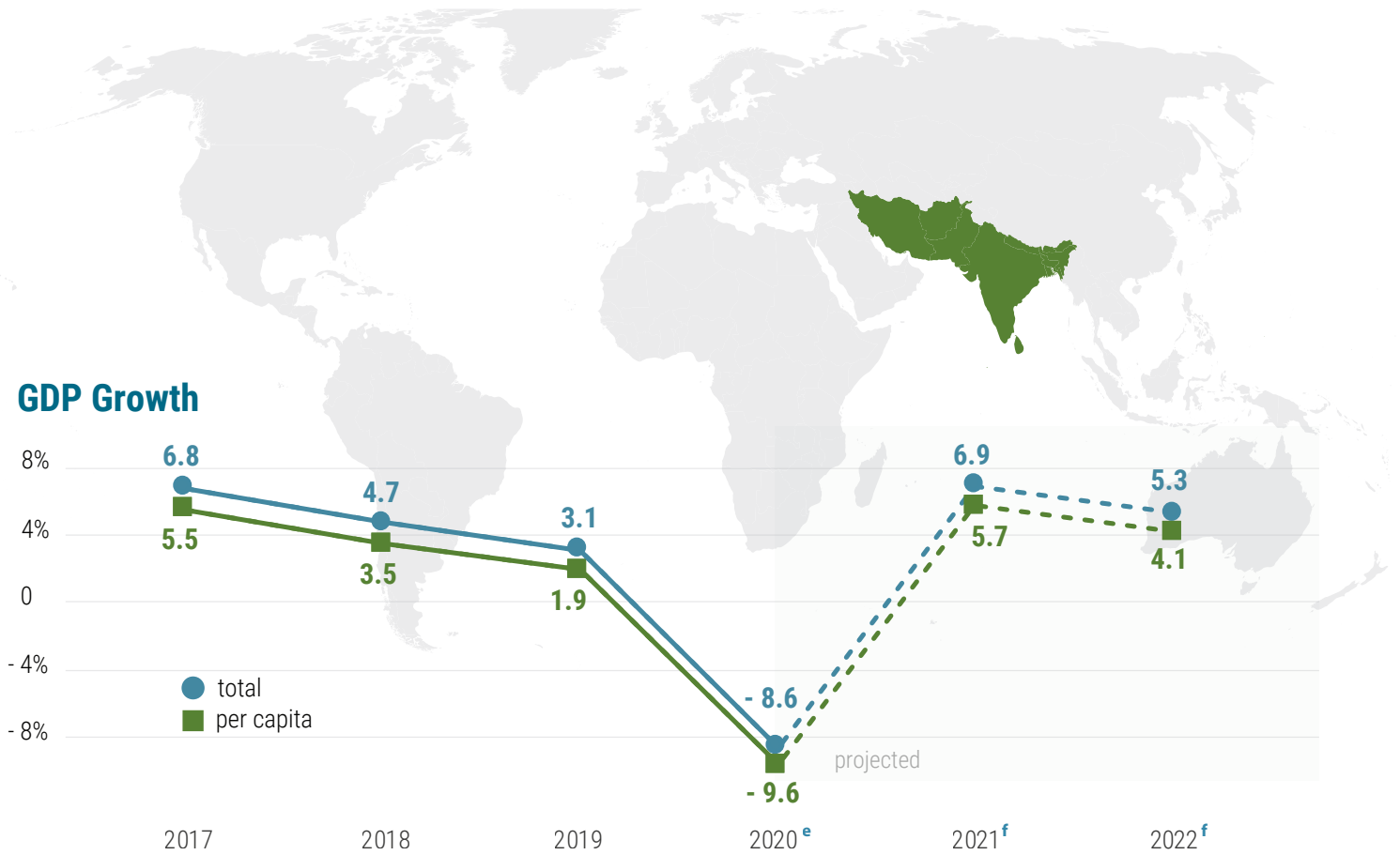
The pandemic is threatening to reverse much of the progress made by the East Asian region in advancing its development agenda. Across the region, unemployment rates have risen to multi-year highs amid prolonged disruptions to economic activity. Importantly, job losses due to the pandemic have been disproportionately higher in the informal sector, where workers often earn low incomes and are vulnerable based on their employment conditions. Hence, countries characterized by a higher degree of informality are most at risk of experiencing significant setbacks to poverty eradication and a widening of inequality. In Cambodia, Indonesia and Myanmar, informality affects close to 90 per cent (or even more) of all workers (ILO, 2018). Given the high level of informality and a large digital divide, the share of workers that can work from home in South-East Asian and Pacific economies is much lower than the world average (ILO, 2020b).

The pandemic provides an opportunity for East Asian economies to reprioritize policies in order to enhance the region's resilience to future shocks. It is imperative for the region to improve social protection and public health emergency preparedness if it is to support the vulnerable segments of society. ESCAP (2019) estimates that to achieve the Sustainable Development Goals, the developing countries of Asia and the Pacific would need an additional annual investment of \$1.5 trillion (or 5 per cent of GDP), including \$669 billion for the provision of a social protection floor, targeted cash transfers for the poor, nutritious food, quality education and universal health-care systems.

As the effects of climate change on the region intensify, Governments will need to explicitly incorporate environmental sustainability into all policies going forward. This would entail, inter alia, accelerating green public investment, including in clean energy and climate-resilient infrastructure. Such investments have the potential to create jobs that are more secure, which would help to partially offset some of the job losses due to the pandemic.

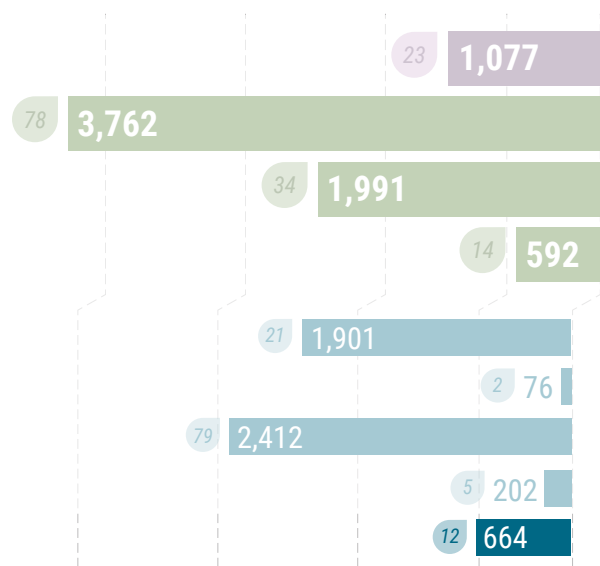
Policymakers need to pursue recovery strategies that are greener and more inclusive and that promote a more resilient development path

South Asia

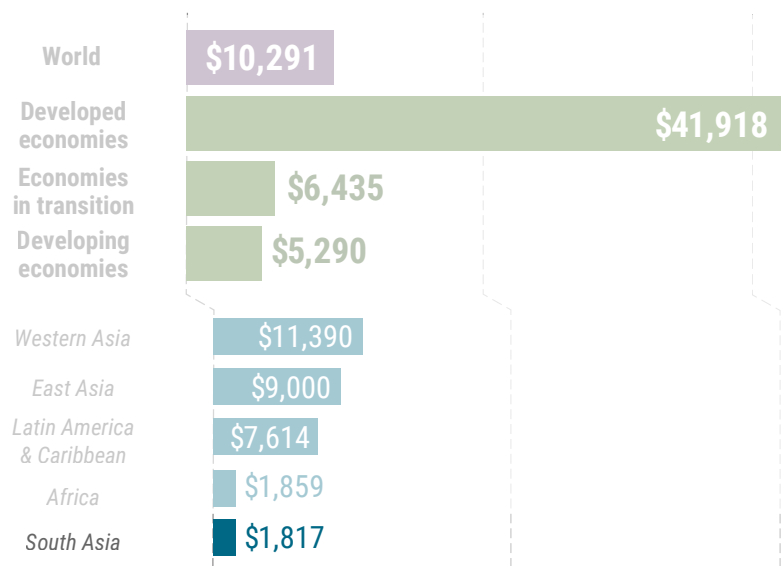


COVID-19 Cases per 100,000 people by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita 2020



Note: The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2021*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

Aggregate data for Africa, excluding Libya.

^e: 2020 estimates, ^f: 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

South Asia: this former champion will have to find its way back to growth

- The pandemic and resulting economic crisis have ravaged South Asia, the former growth champion, and turned it into the worst performing economic region
- Poverty has shot up and progress on many other Sustainable Development Goals has been reversed
- The long path to recovery will require structural reforms aimed at addressing South Asia's critical vulnerabilities

Weak progress on achieving the Sustainable Development Goals—not least on ensuring the quality and accessibility of the public health infrastructure—has made South Asia a pandemic hotbed (United Nations, ESCAP, 2020). Before COVID-19 struck, the region was more or less on track towards achieving its targets on education (SDG 4) and energy (SDG 7) but was lagging behind with respect to access to drinking water and basic sanitation (SDG 6), ending hunger (SDG 2), reducing income inequality (SDG 10) and achieving gender equality (SDG 5), while in fact regressing in the area of peace, governance and institutions (SDG 16) (ibid.). Moreover, the region's public health infrastructure was in dire straits, with low levels of public health expenditure and few physicians, nurses, midwives and hospital beds per capita, as compared with both the global average and measures for other developing regions. This necessitated a rapid enforcement of lockdowns and other containment measures which were more stringent than those in other developing regions, even though caseloads and fatality were relatively moderate during the early months of the pandemic. The fact that, across South Asia, informal employment is the norm and social safety coverage minimal has aggravated the region's particular vulnerability to the unprecedented public health shock and limited the effectiveness of government response.

The pandemic and the global economic crisis have consequently left deep marks on South Asia, turning this former growth champion into the worst performing region in 2020. Regional economic growth fell dramatically from 3.1 per cent in 2019 to -8.6 per cent in 2020, a far cry from the 5.1 per cent growth predicted in 2019. Without exception, all economies in the region have been badly hit by the crisis, whose impacts have been amplified and accelerated by existing vulnerabilities. Poorly organized labour markets and the absence of a reliable social safety net prevented Governments from implementing the effective restrictions needed to contain the spread of the pandemic, while fiscal constraints and limited economic diversification restricted Governments' manoeuvring space. In this regard, countries of the region compare unfavourably with other developing countries in Asia. Higher price inflation due to COVID-19-induced supply constraints limited the space required for monetary policy to make up for the shortfall. India's economic growth has fallen from 4.7 per cent in 2019 to -9.6 per cent in 2020,² as lockdowns and other containment efforts slashed domestic consumption without halting the spread of the disease, despite drastic fiscal and monetary stimulus. The Islamic Republic of Iran has suffered triply—from global sanctions, the sharp drop in oil prices and a fall in domestic consumption—which has deepened its

COVID-19 has hit an already vulnerable region...

...and has left deep marks on every part of South Asia

² All growth figures for South Asia provided are on a calendar-year basis. For fiscal-year growth figures, please refer to the Statistical Annex.

already severe recession as evidenced by a growth contraction from -7.0 in 2019 to -13.3 per cent in 2020. Economic growth in Pakistan, which was already in the grip of an ongoing twin fiscal and balance-of-payments crisis, has fallen from 0.3 per cent in 2019 to -2.7 per cent in 2020. Maldives, meanwhile, took a brutal hit from the near standstill in international tourism, erasing more than a fifth of its output in 2020 compared with the previous year. Even Bangladesh, the fastest growing economy in the region, has seen economic growth fall, from 8.4 per cent in 2019 to 0.5 per cent in 2020, although this was cushioned somewhat by a recovery in trade and remittances in the second half of the year.

Perhaps even more worryingly, the crisis has devastated livelihoods across the region, reversing many years of progress on achieving the Sustainable Development Goals. As the population continued to grow in 2020, GDP per capita fell by nearly 10 per cent. Poverty is rising sharply and existing inequalities are widening. Nearly two out of five of 2020's new global poor are in South Asia. At the same time, it is the most vulnerable that have been hit hardest by the crisis. Women, for example, are significantly more likely to work in high-risk sectors and have been reported to suffer from increased domestic abuse during lockdowns; and children, especially those in poor households and in rural areas, suffer disproportionately from school closures, which could severely limit their lifetime earnings and increase their chances of ending up in poverty. Other vulnerable populations that have experienced a disproportional impact on their livelihood include slum dwellers, migrant workers and the elderly.

Recovery will be slow
and uneven...

Economic growth in South Asia in 2021 will be insufficient, at 6.9 per cent, to make up for the losses of 2020, as pandemic hotspots re-emerge and, increasingly, the ability of Governments to deal with the multitude of challenges becomes exhausted. While trade, remittances and investment are expected to pick up in 2021, as much of the global economy moves towards recovery from the widespread lockdown, investment and domestic consumption in many South Asian countries will nevertheless remain subdued owing to the continuing threat of the pandemic and the scarring effects of the crisis. Regional economic growth for 2022 is forecast at 5.3 per cent, which would allow South Asia to finally exceed its 2019 economic output, albeit only marginally. On the other hand, South Asian countries that are relatively more exposed to global economic conditions, such as Bangladesh and Maldives with their high share of foreign trade and Nepal with its dependence on tourism and remittances, will enjoy a stronger rebound, of about 10 per cent growth in 2021. Other countries in the region will experience economic growth ranging from 3.1 per cent (Sri Lanka) to 7.3 per cent (India).

...and will remain subject
to many risks

The recovery is subject, however, to significant risks. The forecasts assume effective containment of the virus in South Asia and the rest of the world including no further lockdowns in 2021, resurgence of global trade, and the effective continuation of fiscal stimulus and containment efforts in South Asia and other regions. Failure of any or all of these baseline assumptions to materialize could plunge the region deeper into crisis. Opportunities exist as well but they are less likely and would be less impactful than the downside risks. The development of new growth sectors, aided by targeted fiscal stimulus and the disruptive effects of the crisis, could propel South Asia's development trajectory and allow the region to make up lost ground much more quickly. A forceful global commitment to counter the negative consequences of the pandemic, particularly in developing countries, could also

allow the region to build back better and stronger and regain its position as the global development champion.

But to grow back stronger, South Asian countries will need first to redouble their efforts to diversify their economies, while at the same time taking stock of global trends initiated by the crisis, such as reshoring of global value chains (GVCs) (box III.3) and a decreased appetite for contact-intensive services. Economic diversification is in fact low or minimal in many South Asian economies, with the near single-trade economies of Bangladesh (garments), the Islamic Republic of Iran (oil) and Maldives (tourism) especially exposed to external demand shocks (United Nations, 2020c). South Asian Governments should promote, in particular, the development of more complex, high-skills and high value added sectors that could reach a broader base of trade partners within and outside of South Asia or even the domestic market. Achieving resilience to external shocks should be among the most important considerations within the decision framework for policymakers in South Asia who are currently rethinking their industrial policies.

Policymakers in South Asia will need at the same time to strengthen their efforts to formalize labour markets and strengthen their social protection systems to dampen the impact of the crisis on the most vulnerable and improve macroeconomic resilience. Informal workers, accounting for over 80 per cent of workers in Bangladesh, India and Pakistan (International Labour Organization, 2020b), have indeed been far more exposed to loss of employment than formal workers during the crisis and South Asia's widespread informality has almost certainly magnified the impact of the pandemic (World Bank, 2020c). The COVID-19 fiscal response in South Asia has consisted of a vast ad hoc expansion of social assistance and direct cash transfers for the most needy but this kind of special support is neither sufficient nor sustainable. Policymakers in South Asia, taking stock of recent lessons, will therefore have to design their social protection systems with a view to rendering them more inclusive, especially for those in the informal sector, and more flexible and resilient.

However, they will need significantly more fiscal space to achieve all of these goals. While increased domestic revenue mobilization can make up for some of the shortfall, both bilateral and multilateral creditors will still need to adopt a concessionary stance to avert protracted debt crises in an already deeply wounded region. Indeed, several South Asian countries have run fiscal deficits of about 10 per cent of GDP in 2020 and government debt is forecast to grow significantly for most countries. Yet, fiscal austerity is not desirable until South Asian countries are back at or close to their economic growth potential, which might still take several years.

Box III.3

Global value chains in the aftermath of COVID-19: implications for Asia and the Pacific

While developing countries in the Asia-Pacific region continue to rely on global value chains (GVCs)^a for sustained economic growth, structural transformation and poverty reduction, the feasibility of the GVC-led development model has come under scrutiny in recent years.

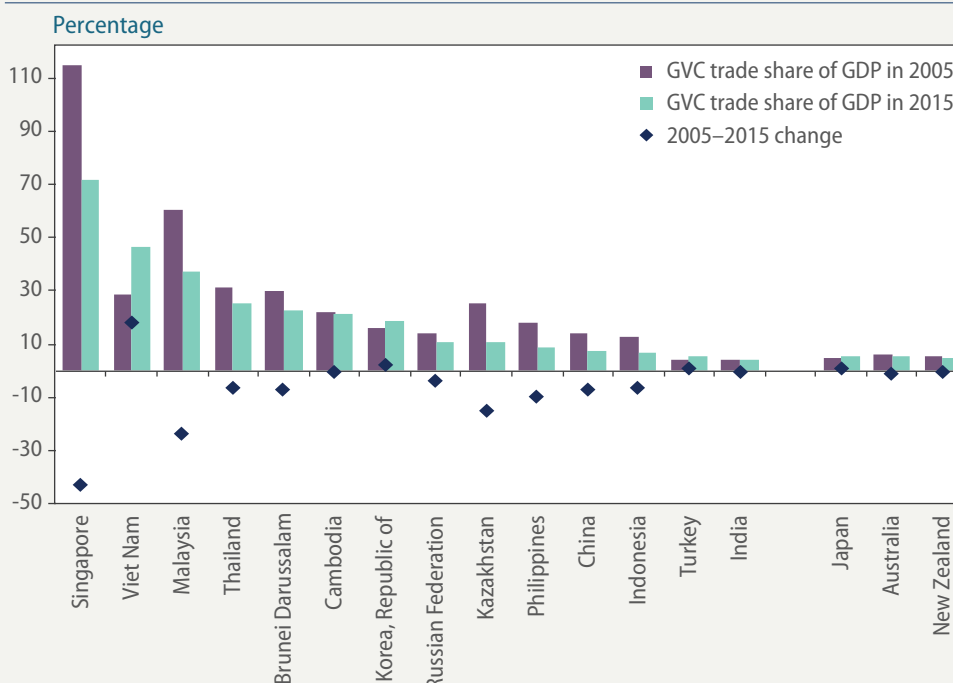
Persistent trade tensions, rising protectionism and a potential economic and technological “de-coupling” have cast a shadow over the future of GVCs. On the other hand, continuing deceleration in global trade implies that the “good old days” of fast growth fuelled by hyper-globalization may have truly peaked, even without factoring in the uncertainties brought about by automation and digitalization. Additionally, rising inequality and environmental damages call for new reflections on how to balance the economic, social and environmental objectives of GVC-led economic growth.

The COVID-19 outbreak has provided a new impetus for GVC adjustments, with an emphasis on GVC resilience and sovereign control over essential supplies for national security. These new considerations are likely to shift the focus from cost efficiency through lean inventories and just-in-time production towards resilience-building through shortened supply chains, greater redundancy in GVC configuration, larger buffer stocks of supplies, greater diversification to reduce overdependence, and digitalization for more efficient resilience management. Meanwhile, growing national security concerns are likely to trigger a further shift towards protectionism and onshoring, leaving less space for participation of developing countries in GVCs.

It is crucial for developing countries to anticipate these upcoming changes and recalibrate their related strategies and policies. In the Asia-Pacific region, three emerging trends can be anticipated. First, there will be a continuation of the shift in GVC diversification from China to established GVC hubs in neighbouring developing countries. Before COVID-19, such GVC reallocation was largely driven by rising production costs in China. Now, the need for both supplier diversification and less dependence

^a GVCs break up production processes across countries, allowing them to engage in further specialization and participate in global production through the trade of components and other intermediate goods, instead of having to produce entire products by themselves.

Figure III.3.1

Global value chain (GVC) trade as share of GDP, 2005–2015

Source: ESCAP calculation, based on World Trade Organization, “Trade in value-added and global value chains” statistical profiles; and World Bank, World Development Indicators.

(continued)

on a single country for essential intermediaries provides another motivation, potentially accelerating the process. However, the process will be gradual; and it is also more likely to benefit the more advanced members of the Association of Southeast Asian Nations in the ASEAN subregion, such as Indonesia, Malaysia, the Philippines, Thailand and Viet Nam, compared with the least developed country members of ASEAN^b and developing countries in other parts of Asia, given the manufacturing-related advantages of the members of the first group (which are necessary for implementation of local sourcing and shortened supply chains) as well as their infrastructure and institutions.

Second, rising protectionism and ongoing trade tensions, coupled with continued deceleration in global trade and economic growth, imply intensified competition for GVC investment and less space for future GVC expansion. Under such a scenario, labour's share in GVC profits could be further squeezed. The least developed countries of the Asia-Pacific region that are hoping to leverage GVCs as an engine for development, such as Bangladesh and Cambodia, may feel both increasingly compelled to divert scarce public revenues or assets^c to GVC investments and increasingly challenged to meet the rising social-environmental standards demanded by end consumers in the advanced economies.

Last but not least, the weaker potential of GVCs to boost growth and growing public awareness of long-term social-environmental challenges would put a greater onus on policymakers to balance the demands associated with the economic, social and environmental pillars of development. Although important for economic growth and transformation, GVCs are unlikely to generate double-digit gross domestic product (GDP) growth in the near future. Within a context of lower expectations for improvements in income, the traditional GDP-centric development thinking in the Asia-Pacific region will be challenged, with social-environmental concerns becoming more urgent.

While there is no silver bullet, two strategies could help Asia-Pacific developing countries better address these challenges. First, Asia-Pacific countries should continue promoting regional integration and regional value chains. As the Asia-Pacific region is the biggest economic block and market worldwide and possesses mature and advanced regional value chains, a more integrated regional economy would help offset many of the GVC deceleration shocks from outside. Second, Asia-Pacific countries should accelerate domestic economic reforms and transformation. Between 2005 and 2015, GVC trade as a share of GDP stagnated or decreased in most countries of the region (figure III.3.1), indicating that countries may find it increasingly difficult to rely on GVCs as a main vehicle for growth thrusts. Instead, more emphasis should be placed on maximizing the catalysing effect of GVC participation for sustained productivity improvement in the domestic economy.

Box III.3 (*continued*)

^b Cambodia, Lao People's Democratic Republic and Myanmar.

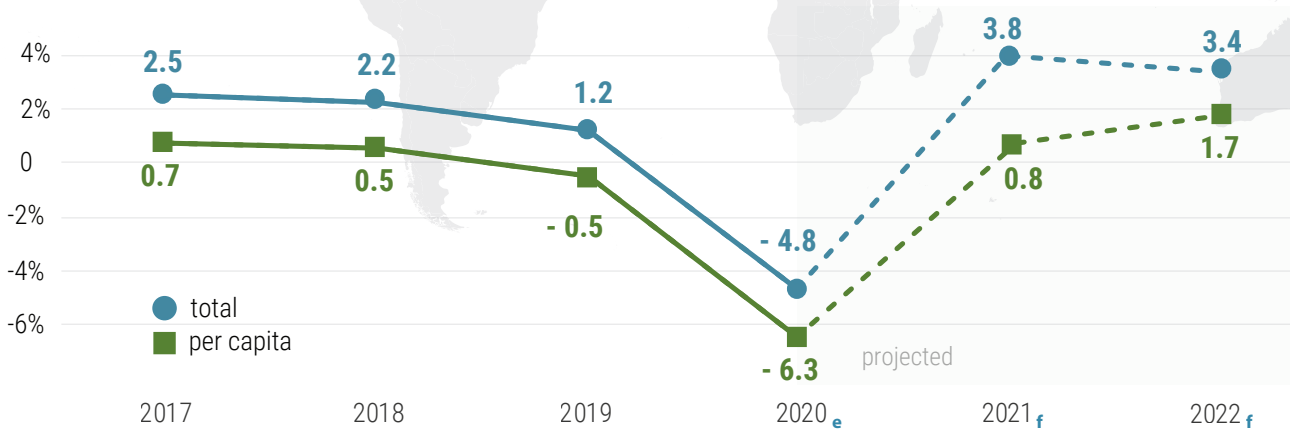
^c Such as land or resources.

Author: Zheng Jian (ESCAP), with a contribution by Witada Anukoonwattaka (ESCAP)

Western Asia

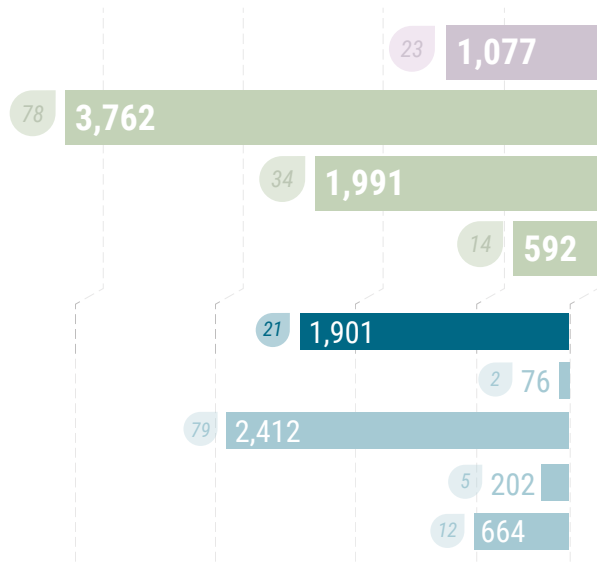


GDP Growth

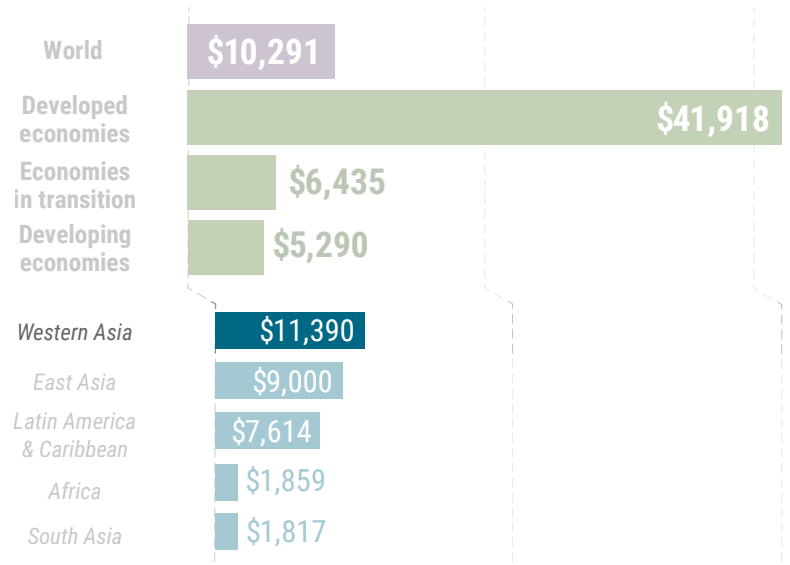


COVID-19 Cases per 100,000 people by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita 2020



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Aggregate data for Africa, excluding Libya.

e: 2020 estimates, **f:** 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

Western Asia: deteriorating fiscal positions cloud post-crisis recovery prospects

- The region faces plunging domestic and external demand.
- The midyear recovery in 2020 was weak given the region's excessive dependence on energy and tourism.
- Fiscal space has shrunk, except for a few high-income countries in the region, which clouds post-crisis recovery prospects.

Western Asia, on average, is estimated to have contracted by 4.8 per cent in 2020 and a slow recovery with growth of 3.8 per cent is expected in 2021. The COVID-19 pandemic and mitigation measures for the ensuing public health emergencies stalled economic activities in the region. Early in the second half of the year, those emergency measures were gradually relaxed; this, however, rendered several countries in the region susceptible to a second wave of outbreaks. Consequently, Western Asia's midyear rebound was weak. The pandemic's impact was felt most acutely in the region's high-performing tourism sector, and that impact led to a significant weakening of accommodation, transport, and wholesale and retail trade services. Only a few sectors—telecommunications and financial services—have managed to maintain positive growth.³

The energy sector, the main driver of the region's growth and government revenues, suffered significant contractions. In compliance with the Organization of the Petroleum Exporting Countries (OPEC)-led crude oil production quota, the region's major oil exporters cut crude oil production substantially. For example, crude oil production was cut by 6 per cent in Saudi Arabia and by 14 per cent in Iraq. Despite the production cuts, however, oil prices remained 35 per cent lower than the 2019 average, as global energy demand failed to recover completely from the shock of the initial shutdowns. Government revenues of the Member States of the Gulf Cooperation Council (GCC)⁴ are estimated to have declined by 54 per cent on average and that of Iraq is estimated to have declined by 69 per cent (United Nations, ESCWA, 2020a).

Nevertheless, the GCC countries utilized their available fiscal space to implement stimulus packages of an estimated size of \$194 billion to combat the current crisis (United Nations, ESCWA, 2020a). Other countries in the region, however—particularly Iraq, Jordan, Lebanon, the Syrian Arab Republic and Yemen—were not able to take countercyclical economic measures to deal with their overstretched health expenditures. The fiscal space of Iraq, despite its being the world's fifth-largest crude oil producer, contracted sharply as oil revenues were estimated to have declined by 69 per cent. In view of this general deterioration of fiscal positions (figure III.11), Governments attempted to diversify revenue sources. Saudi Arabia, for example, hiked the value added tax (VAT) rate in July from 5 to 15 per cent. However, most countries—including Saudi Arabia—became more dependent on debt to finance growing fiscal outlays.

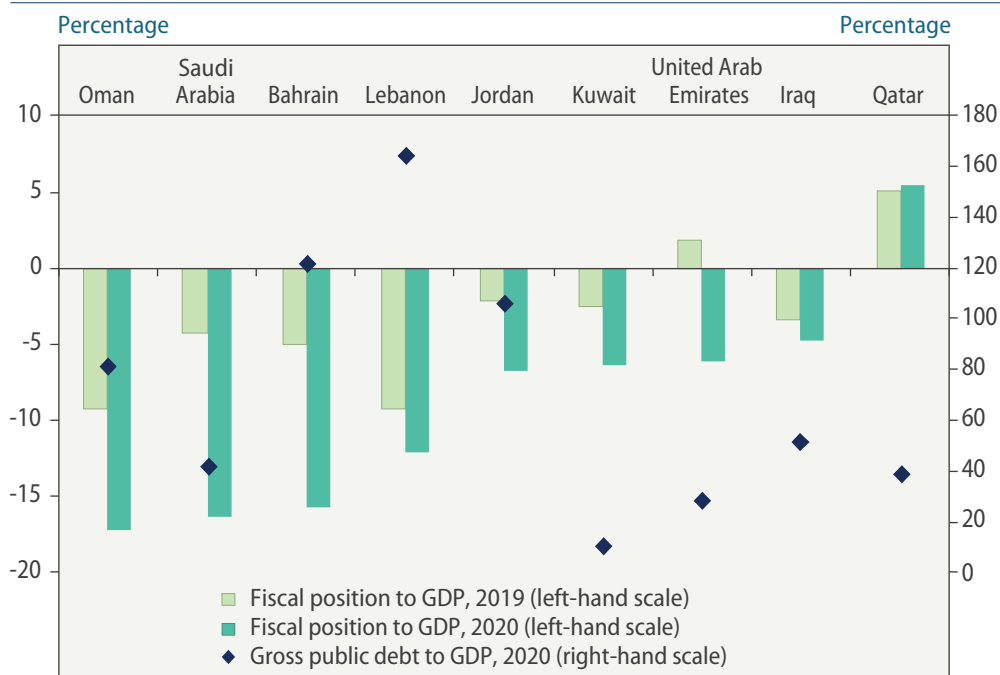
Heavy suffering has been inflicted on the energy sector

Fiscal positions have deteriorated rapidly

³ See annex table A.3 for GDP estimates and forecasts for individual countries.

⁴ Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Figure III.11

Fiscal position and public debt as a percentage of GDP in selected ESCWA countries

Source: United Nations, ESCWA, Survey of Economic and Social Developments in the Arab Region, 2019–2020 (forthcoming).

Conflicts and political instability are exacerbating the dire economic situation

Iraq, Lebanon, the Syrian Arab Republic, Yemen and the State of Palestine continue to endure conflicts, political instability and tense geopolitical situations. Despite the international community's appeal for a global ceasefire during the pandemic, continuing hostilities have made the region more prone to humanitarian crises. In Lebanon, the situation swiftly became dire owing to the rapid deterioration of living standards and rising poverty (box III.4).

The midyear rebound in Israel has been substantially weak

In Israel, the renewed lockdown in September instituted to contain the spread of the pandemic's second wave dented the midyear rebound, despite the Government's large-scale fiscal stimulus. In Turkey, despite an early reopening of the borders for tourists, third-quarter tourism revenue plunged by 71 per cent, compared with the same period in 2019. In addition, continuing high inflation due to a rapid depreciation of the Turkish lira has eroded real household income.

There has been a jump in the unemployment rate

Except for a few oil exporting high-income economies, the employment situation in Western Asia, was already dire before the onset of the pandemic, owing partly to ongoing armed conflicts and displacements. Along with the plunge in economic activities, job losses mounted in the second quarter of 2020. For Saudi nationals, the unemployment rate jumped to 15.4 per cent, from 11.8 per cent in the first quarter; and in Jordan, it surged to 23 per cent from 19.3 per cent in the first quarter.

Recovery prospects are highly uncertain

Economic recovery in the region will depend on global energy demand, international tourism and the extent of the recovery of domestic demand on the back of fiscal support measures. Both global energy demand and international tourism are projected to recover slowly, and to reach pre-crisis levels only after 2022. Domestic demand is projected to recover to a certain extent with the stabilization of the pandemic situation; still, without additional fiscal support, it is projected to remain below the pre-crisis level. As there are no

Box III.4

Overlapping crises in Lebanon: rising poverty, urgent needs for reform and significant regional fallout

Before the tragic explosion at the port of Beirut on 4 August 2020, Lebanon was already undergoing one of the most severe economic crises in the modern period of its history. The crisis began in autumn 2019, when the banks imposed limits on the withdrawal of dollars from Lebanese accounts in order to prevent a bank run and assure an adequate supply of dollars. Unfortunately, owing to the inability of the government to pursue economic reforms and reduce twin deficits and a massive government debt burden of more than 150 per cent of GDP, the Central Bank of Lebanon could not provide the supply of dollars needed to maintain the pegged exchange rate. This led to a further exacerbation of the economic crisis, fuelling protests where protesters called for the abolishment of the sectarian power-sharing system and the overthrow of the political elite. The COVID-19 pandemic and lockdowns initiated to contain the disease further aggravated the crisis; and the explosion at the port of Beirut only added fuel to the public discontent in Lebanese society which was already at high levels.

The Rapid Damage and Needs Assessment conducted by the World Bank in cooperation with the European Union and the United Nations in August estimates that, besides exacting a heavy human toll, the explosion has inflicted significant economic damage in the short run stemming from (a) the destruction of physical capital stock, resulting in up to 0.4 and 0.6 percentage point declines in the growth rate of real GDP in 2020 and 2021, respectively; and (b) an increase of trade costs stemming directly from the destruction of port facilities, resulting in an additional loss of 0.4 and 1.3 percentage points of GDP growth in 2020 and 2021, respectively (World Bank, European Union and United Nations, 2020).

These impacts are further deepening the double-digit contraction in real GDP growth resulting from the pre-existing economic and financial crisis and the repercussions of COVID-19. Moreover, the explosion will have important social repercussions. Before the explosion, general and extreme poverty rates as measured at the thresholds of \$14 per day (2011 PPP) and \$8.5 per day (2011 PPP) were at 45 per cent and 23 per cent, respectively. The headcount poverty rate is expected to have jumped from 28 per cent in 2019 to 55 per cent in May 2020, with a corresponding increase in the extreme poverty rate from 8 to 23 per cent. This would bring the total number of poor in the Lebanese population to 1.1 million and 2.7 million for the lower and upper poverty lines (as referred to above), respectively. The figure of \$2.7 million poor represents an increase of 1.3 million from the figure under the reference growth scenario for 2020 (pre-COVID-19 and pre-explosion). The corresponding rise in the number of extreme poor would be 750,000 (ESCWA, 2020b).

The crisis does, however, present a unique opportunity to implement a number of required policy and social reforms, which would include:

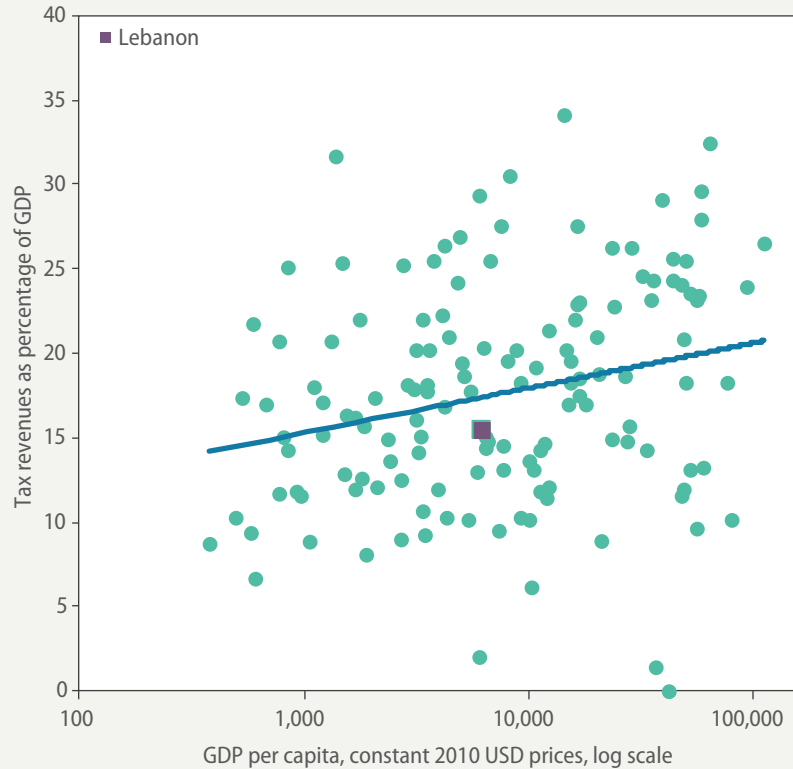
1. Establishment of a national solidarity fund to tackle the country's humanitarian crisis and close the poverty gap. For this purpose, Lebanon should mobilize its own substantial resources, based on a fair system of shared responsibility. Currently, Lebanon has lower tax revenues as a share of GDP than other countries at a similar level of income (figure III.4.1). To reduce poverty, progressive income taxation should be introduced and taxes increased and this should be accompanied by political will and strong institutional capacity so as to ensure societal solidarity.
2. Bolstering of food and health security and social protection, which urgently requires the support of the international community.
3. Enactment of necessary economic governance reforms, limits on rent-seeking activities and enhancement of transparency and accountability. Greater transparency with respect to income and wealth would allow the ministries of finance and social affairs as well as related institutions to improve poverty-targeting practices.

While the political and economic crisis is deeply rooted in Lebanon, it will nevertheless exert significant pressure on the entire Arab world. The most important impact will be on the Syrian Arab

(continued)

Box III.4 (continued)

Figure III.4.1

GDP per capita vs. tax revenues as a percentage of GDP (latest available year)

Source: World Bank, World Development Indicators database.

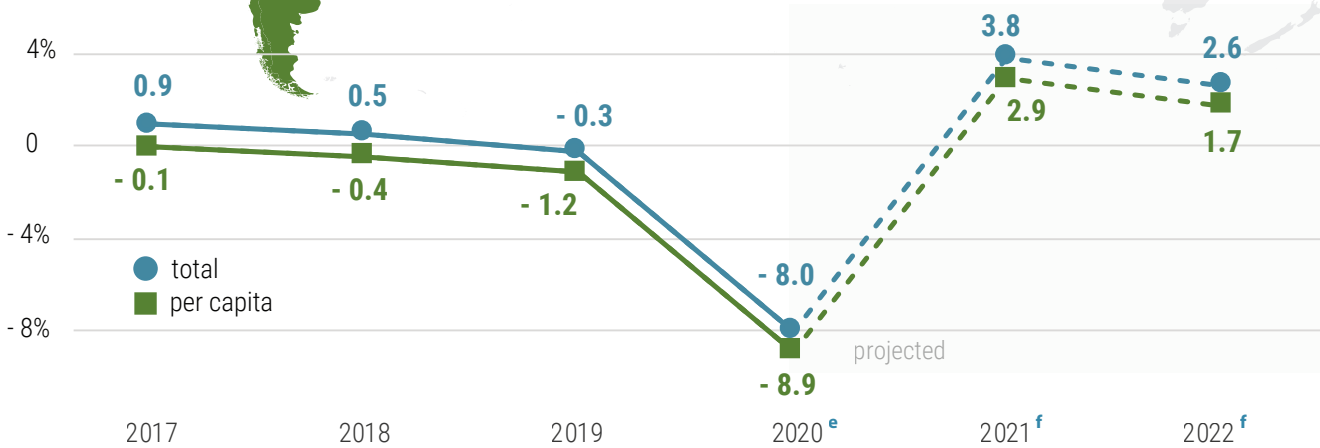
Republic, as the economies of both countries are deeply intertwined. Indeed, many Syrians have been affected by the informal capital controls, as they parked their savings in Lebanese banks. The crisis has also had a profound impact on the approximately 1.5 million Syrian refugees residing in Lebanon who, as a result of losing their jobs, have been unable to provide remittances to their families. Despite various obstacles, some evidence regarding return migration to the Syrian Arab Republic has emerged (Center for Operational Analysis and Research (COAR), 2019). At the same time, the current crisis will also accelerate the process through which the location of the Arab world's financial hub has been shifting to Dubai. This would extinguish Lebanon's aspirations towards building a modern economy based on financial and information technology services.

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prospects for improvement in public revenue over 2021 and 2022, the region's high-income countries are likely to depend to a greater extent on debt financing. However, without international financial support, the current situation would likely compel the region's middle- and low-income countries to curtail or roll back fiscal support measures that could impede their economic recovery.

Latin America & Caribbean

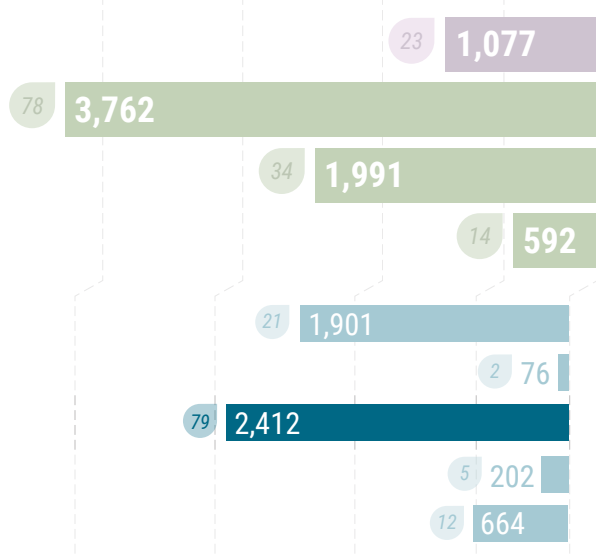
GDP Growth



COVID-19 Cases per 100,000 people

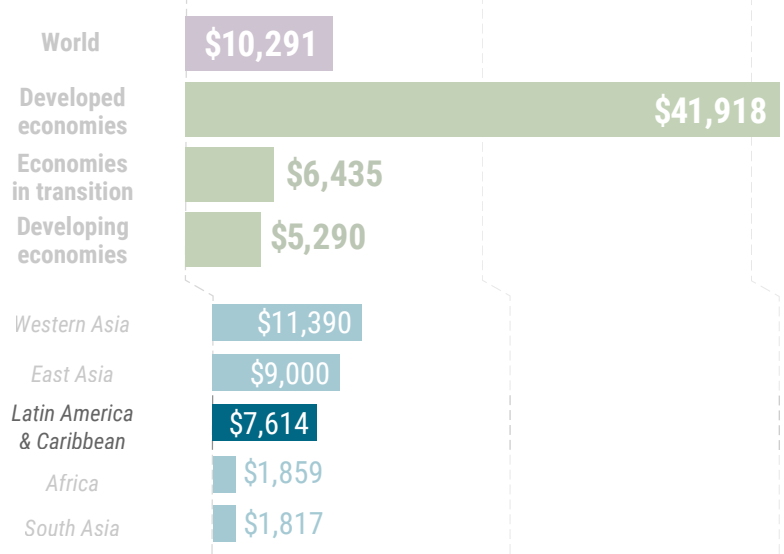
by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita

2020



Note: The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2021*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

Aggregate data for Africa, excluding Libya.

e: 2020 estimates, **f:** 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

Latin America and the Caribbean: the recovery from a historic recession will be uneven and fragile

- The pandemic has wreaked havoc on the region's economy, exacerbating deep-rooted inequalities and pushing millions into poverty
- Continued monetary and fiscal support are critical for the recovery even as policy space is constrained
- The crisis offers an opportunity to redefine the social contract and embrace a new development model

The region has suffered a devastating health and economic crisis

The COVID-19 pandemic has ravaged Latin America and the Caribbean, exacting a heavy human toll and inflicting massive economic damages. Although most countries implemented early and strict containment measures, the region has become an epicentre of the pandemic and now has one of the world's highest per capita mortality rates. The health crisis has been accompanied by an economic downturn of historic proportions, which follows several years of disappointing growth. Real GDP is estimated to have declined by 8 per cent in 2020 as prolonged national lockdowns, weaker merchandise exports and a collapse in tourism undermined economic activities. Amid a drastic contraction in employment, an estimated 45 million people in the region have been pushed into poverty, wiping out all progress made over the past 15 years (United Nations, ECLAC, 2020c). Moreover, the crisis has been responsible for further setbacks to achievement of the Sustainable Development Goals by exacerbating deep-rooted structural inequalities, for example, between formal and informal workers and women and men. Despite severe fiscal constraints, many of the region's Governments have adopted substantial stimulus packages in response to the pandemic. This support, along with monetary easing, a gradual lifting of restrictions and a pickup in global economic activity, has prompted a modest recovery starting in the second half of 2020. Regional growth is forecast at 3.8 per cent in 2021, before moderating to 2.6 per cent in 2022, while aggregate output is expected to reach its pre-crisis level only by the end of 2023. The recovery will likely remain fragile and uneven, with outlook risks tilted towards the downside. Indeed, a resurgence of infection rates could lead to a renewed tightening of containment measures. At the same time, several countries in the region face significant political risks and the possibility of a debt crisis.

Lockdowns have caused massive employment and income losses, aggravating disparities

The pandemic disrupted economic activities in Latin America and the Caribbean at a time when many countries were already engaged in a struggle against severe economic difficulties. Stagnant growth, weak investment and limited macroeconomic policy space made the region highly vulnerable to a global shock. National lockdowns and movement restrictions have led to massive employment and income losses, aggravating long-standing disparities. According to estimates of ECLAC and ILO (2020), 47 million workers in Latin America and the Caribbean lost their jobs in the first half of 2020. Working hours dropped by about 21 per cent during the first nine months, while labour income fell by 19 per cent (ILO, 2020b). Job losses have been particularly severe in the informal sector, where most occupations are contact-intensive; and women, young people and workers with low education, who make up the bulk of employment in sectors such as retail and hospitality, were disproportionately affected. Countries where informal work is widespread and where Governments implemented stringent and lengthy lockdowns have experienced the largest employment shocks. In

Peru, for example, the employment rate declined by a staggering 38 per cent in the second quarter, as the country experienced one of the region's largest output contractions.

The job and income losses have caused sharp declines in household spending, with private consumption expenditure estimated to have contracted by about 9 per cent at the regional level in 2020. As movement restrictions are gradually easing, labour markets have started to improve and this trend is expected to continue in 2021. While employment gains, especially in some of the hardest-hit countries, are expected to lift household spending and buttress the recovery, some of the damage to labour markets (through, for example, departure of women from the workforce) will not be quickly reversed and will leave lasting scars.

Investment activities across the region have taken a severe—and most likely prolonged—hit from the pandemic. Amid falling consumer demand, temporary business closures and heightened uncertainties, firms have rolled back planned investment. Gross fixed capital formation declined by an estimated 13 per cent in 2020, dwarfing the drop experienced in 2009. According to estimates of the United Nations Conference on Trade and Development (UNCTAD) (2020b), foreign direct investment (FDI) flows to the region may have fallen by up to 50 per cent, with the travel and leisure and oil sectors recording the largest losses. While investment bounced back quickly following the global financial crisis, a fast recovery seems unlikely this time around. Uncertainties over the regional and global outlook, coupled with lingering effects of the crisis such as elevated unemployment and increased fiscal pressures, are expected to weigh on capital spending over the coming year. According to the baseline projections, gross fixed capital formation in the region will increase by about 7 per cent in 2021 and by only 3 per cent in 2022.

The domestic shock from the undermining of economic activities has been compounded by a rapidly deteriorating external environment as the global economy fell into recession. Many of the region's economies are highly dependent on external inflows, most notably from commodity exports, personal remittances and tourism (figure III.12). Merchandise exports and commodity prices plummeted in the first half of 2020 but have since been recovering, which can be attributed mostly to a strong rebound in industrial activity and import demand from China. During the first eight months of 2020, the level of exports of Latin America and the Caribbean was about 6 per cent lower than one year ago. Unlike oil prices, which remain well below the pre-pandemic level, prices of metals and agricultural commodities have recouped their losses. Further moderate gains are expected for 2021, which should support the recovery in major commodity exporters. Brazil, Chile and Peru appear to be best positioned to gain from a continued rebound in China. Remittance flows to the region have also pulled back from the lows during the second quarter and are likely to be at a level for the year similar to that in 2019, which has helped to mitigate the shock experienced by remittance-dependent Central American countries. Tourism flows, by contrast, have remained at a standstill, leading to sharp contractions in economic activities in Caribbean countries; but given a gradual improvement in international tourism flows in the coming years, most Caribbean countries should expect a recovery from a low base.

Across the region, Governments have responded forcefully to limit the socioeconomic fallout from the crisis, preserve financial stability and boost recovery. Central banks have eased monetary policy and provided liquidity to the financial system; and in many countries, policy rates have been cut to record low levels. These measures have supported credit flows to the private sector, reduced market stress and contributed to a general improvement in financial conditions. After a spike in risk aversion triggered massive capital outflows from the region in early 2020, the situation improved in the subsequent quarters. However, given

Investment will recover from a deep slump but only slowly

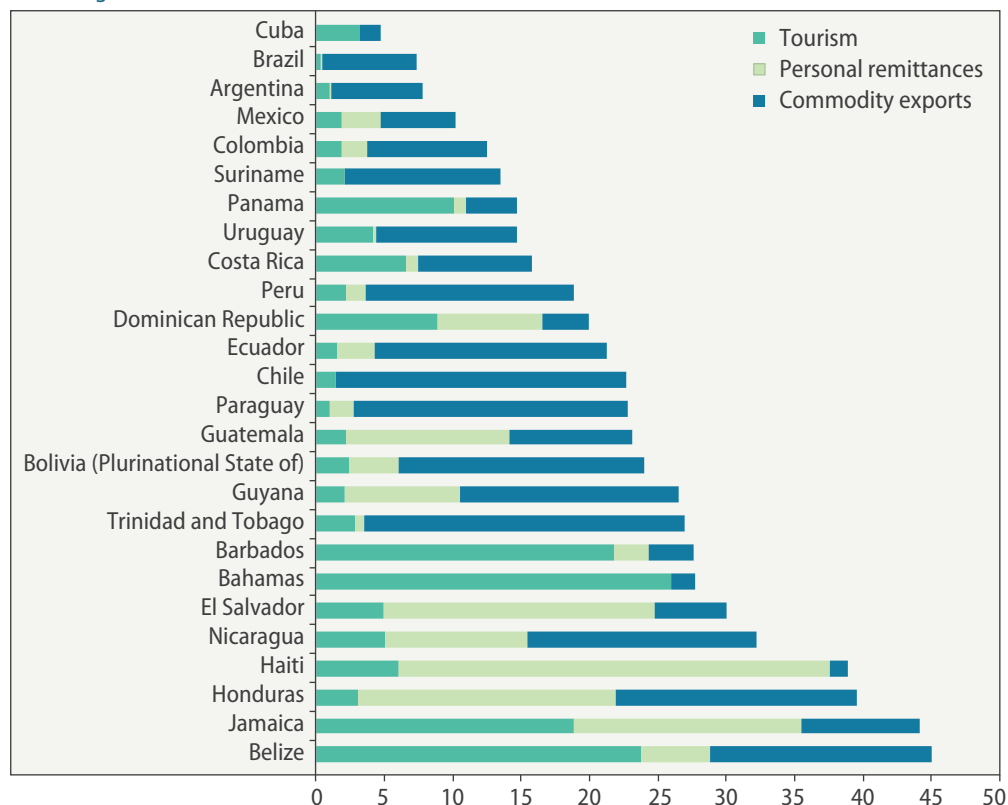
Recoveries in exports, commodity prices and remittances are providing some measure of uplift

Monetary policy is expected to remain extraordinarily accommodative

Figure III.12

Contribution of commodity exports, personal remittances and tourism to GDP, 2016–2018 average

Percentage



Sources: UN DESA, based on World Bank, World Development Indicators; UNWTO; and UNCTAD.

Note: Personal remittance data is not available for the Bahamas and Cuba.

considerable global uncertainties and the subdued outlook for Latin America and the Caribbean, capital flows will likely have a rocky period ahead. In view of subdued inflationary pressures—mainly due to the persistence of economic slack—monetary policy is set to remain extraordinarily accommodative in the coming years.

Fiscal support remains critical for recovery

Large-scale fiscal policy stimulus has been critical in strengthening health-care systems and providing lifelines to firms and households. Although many countries entered the pandemic with sizeable fiscal deficits and high public debt levels, Governments deployed considerable resources to combat the economic shock. Brazil, Chile and Peru introduced the largest packages in the region in terms of direct support through additional expenditure and forgone revenue. The total fiscal stimulus packages in these three countries, including loans, equity injections and government guarantees, are estimated to have amounted to 10–15 per cent of GDP. In this regard, Brazil's fiscal response stands out, as it provided sizeable support for households and workers, which helped boost the country's recovery during the second half of 2020. By contrast, Mexico's fiscal response has been relatively timid, as the Government focused on public finance sustainability even as economic activity collapsed; and in many Caribbean economies, government responses were constrained by a lack of fiscal space. Going forward, Governments must balance the need for further fiscal

Box III.5**Challenges for fiscal policy in Latin America and the Caribbean during the post-pandemic period**

The unfolding COVID-19 crisis has triggered an economic and social collapse of historic proportions in Latin America and the Caribbean and it is projected that a return to pre-crisis levels of economic activity will take from two to three years. The region, like so many others, is witnessing the destruction of its productive capacities and increases in unemployment, poverty and inequality and will bear the scars of the collapse well into the future. In this context, the role of the public sector and active fiscal policy will be crucial as Governments support recovery efforts and seek to build back better. The post-pandemic period will provide an opportunity for the countries of the region to embark on a different development path, one that is in line with the objectives of the 2030 Agenda for Sustainable Development, and to move in the direction of establishing welfare States and introducing universal social protection schemes.

Despite the strain on public accounts induced by the crisis—with average central government gross public debt projected to increase by 9.3 percentage points of gross domestic product (GDP) and to reach 55.3 per cent of GDP in 2020—fiscal austerity is not an option and would inflict unnecessary social and economic harm. Active fiscal policies should link the short term (covering the emergency period) with the medium and long terms by gearing public spending, tax policies and regulations towards achieving the goals of stimulating economic activities and building back better. These goals will require policies that boost aggregate demand, while placing an emphasis on supporting household consumption, encouraging investment, reducing inequalities, protecting the environment and laying the foundations for sustainable development. To the extent that these policies revived the economy and improved the prospects for post-pandemic growth, they would also increase the likelihood that countries could meet their fiscal commitments despite the prevailing constraints.

Creating the space necessary to maintain active fiscal policies hinges critically on the mobilization of both domestic and external resources. With tax evasion and avoidance as well as illicit financial flows endemic in the region, there is substantial room at the national level to enhance the State's revenue-raising capacity. The Economic Commission for Latin America and the Caribbean (ECLAC) (2020b) estimates that countries in Latin America lost a combined US\$ 325 billion in 2018, equivalent to 6.1 per cent of GDP, owing to income tax and value added tax non-compliance. Tax expenditures—i.e., revenue losses resulting from the granting of various forms of tax advantages—are widely used and entail significant forgone revenues, averaging 3.7 per cent of GDP between 2015 and 2019 (*ibid.*). The region's tax intake is low and skewed towards regressive indirect taxes. Moreover, the fact that direct taxation on income—particularly personal income—and on property is especially weak deprives countries of revenues and leaves tax systems with little leverage for reducing income and wealth inequalities. There are also opportunities to bolster taxation of other tax bases, such as those related to the digital economy, and to levy corrective taxes related to the environment and public health. At the same time, given the importance of fiscal policy as a development tool, it is critical that the efficiency, effectiveness and equity of public interventions be enhanced. Further, the resources mobilized need to be channelled towards investments that reduce inequality and foster growth.

Efforts at the national level must be supplemented by greater access to external finance on favourable terms, whether it be on international markets or through international financial institutions. To this end, the international community should take steps to create additional liquidity for low- and middle-income countries, for example, through issuance of special drawing rights (SDRs), along with implementation of mechanisms that allow for the transfer of SDRs between countries. Other measures could include additional funding for multilateral lending institutions and promotion of closer cooperation between central banks. International cooperation should play a fundamental role in coordinating debt service suspensions and the creation of an international mechanism for the restructuring of sovereign debt.

(continued)

Box III.5 (*continued*)

Source: Economic Survey of Latin America and the Caribbean: Main Conditioning Factors of Fiscal and Monetary Policies in the Post-COVID-19 Era.

The fund to alleviate COVID-19 economics (FACE) is a concrete example of this type of innovative mechanism conceived to unleash the potential for greater international cooperation in providing assistance during the period of recovery from the COVID-19 pandemic. As described in a proposal put forward by the President of Costa Rica in September 2020 within the framework of the seventy-fifth session of the General Assembly, the objective of the FACE initiative would be to mitigate the social and economic impact of the pandemic and contribute to a sustainable recovery. Under the initiative, the distribution of global liquidity to developing countries would be improved through the provision of concessional financing to those countries with a repayment period of 50 years and interest rates close to zero. Importantly, the allocation criteria of the fund—which would hold US\$ 516 billion in resources, to be channelled through multilateral banks—would not incorporate conditionalities.

Threat of another lost decade has prompted calls for a new development model

support to buttress a fragile recovery against increased pressure for fiscal consolidation. Box III.5 discusses the region's fiscal challenges in the post-pandemic period.

Although Latin America and the Caribbean is projected to see a moderate recovery in 2021 and 2022, the danger of another lost decade—in terms of both economic growth and development progress—is looming large. Judging by the experience of previous crises, there are likely to be significant long-term damages to potential output. Prolonged school closures, challenges associated with remote learning activities and persistently high unemployment are expected to have a negative effect on human capital accumulation (Di Groppello, 2020). This could exacerbate skills shortages, which have been a severe constraint in many countries. In addition, corporate and public investment will likely be hampered by heightened uncertainties, sluggish household demand and needs for fiscal consolidation, which could, in turn, further stifle innovation and productivity growth. In this context, an increasingly fragmented and uncertain global trade environment could generate external headwinds to exports and growth. Against this challenging backdrop, ECLAC has called for a new development model which centres on a radical transformation of production and consumption patterns, with investment redirected towards productivity, environmental stewardship, employment and social inclusion (United Nations, ECLAC, 2020b; OECD, 2020a).