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Global Macro Outlook 2021-22 (February 2021 Update)

G-20 economies will return to growth in 2021 but recovery will not be uniform

Summary

As COVID-19 and its variants continue to cast a shadow over the world's health systems and economies, the level of uncertainty and strength of the economic recovery will vary across countries. We expect real GDP in all G-20 countries to grow compared with last year, but some countries will take longer than others to return to full capacity. Fiscal and monetary policy response, as well as pandemic management, will play a key role.

» **Global recovery will remain unbalanced**. The pandemic's toll on global economic activity has been staggering, even as the economy has also shown a remarkable degree of resilience. But the effects on individual businesses, sectors and regions continue to be uneven, and the COVID-19 crisis will endure as a challenge to the world's economies well beyond our two-year forecast horizon.

» **Governments' approach to dealing with the virus will evolve further**. Vaccines will be key in suppressing the virus's spread and reducing fatalities. While new vaccines are likely to become available and production of existing vaccines will scale up, lack of cooperation among countries means that some nations without an assured supply of effective vaccines or production capacity will struggle to overcome the pandemic.

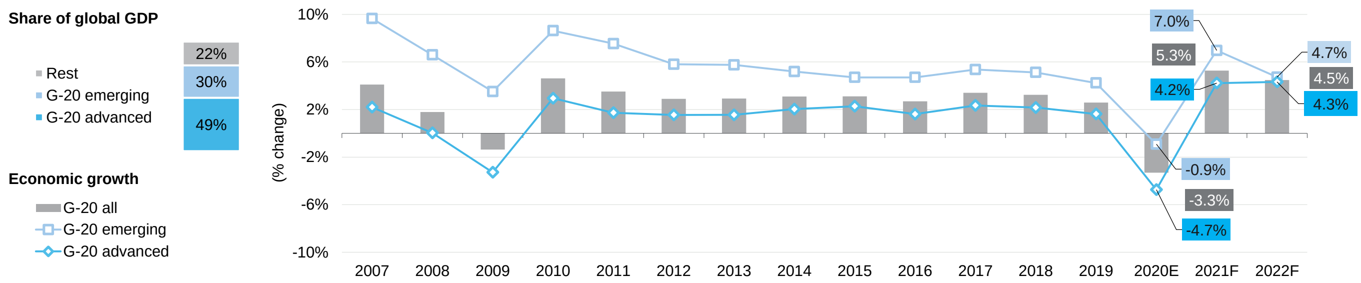
» **For most G-20 economies, real GDP will not return to 2019 levels before 2022.** The G-20 economies will collectively grow by 5.3% in 2021 and by 4.5% in 2022, after a 3.3% contraction in 2020. Economic activity in the second half of 2020 surprised to the upside. Nevertheless, the recovery will remain uneven and incomplete in 2021 as activity in contact-intensive sectors such as travel and tourism remains limited.

» **The US will lead the global services demand recovery in 2021-22, boosted by new stimulus.** Among other large economies, China had the strongest performance in 2020 with a V-shaped rebound. European economies will take longer to reach full capacity given the less strong fiscal impulse, slower vaccine rollout so far, and a continuation of structurally weaker growth. The virus situation is still uncertain in many emerging market countries.

» **Near-term risks remain firmly to the downside**. Persistent virus fears remain the main risk for a recovery in demand, with the risk of economic scarring higher in countries at risk of repeated outbreaks. The longer the crisis lasts, the higher the risk of business insolvencies will become, in particular for small and mid-size companies.

Exhibit 1

G-20 annual growth



Share of global GDP in 2019.
Source: Moody's Investors Service

Exhibit 2

Global macroeconomic outlook for G-20 countries, 2020-22

Economies	Real GDP Growth [1]			Inflation [2]				Unemployment		
G-20	20E	21F	22F	Target	20	21F	22F	20	21F	22F
Advanced	-4.7	4.2	4.3							
US	-3.5	4.7	5.0	2.0%	1.1	2.1	2.1	8.1	5.8	5.0
Euro area	-7.1	3.7	3.9	2.0%						
Japan	-4.8	3.2	2.2	2.0%	-1.1	0.0	0.5	2.8	3.0	2.8
Germany	-5.0	3.0	4.0	2.0%	-0.7	1.6	1.4	4.2	3.8	3.5
UK	-9.9	4.7	4.8	2.0%	0.8	1.9	2.0	4.4	6.4	6.0
France	-8.3	4.8	4.0	2.0%	0.0	1.0	1.3	8.2	10.5	9.5
Italy	-8.9	3.7	4.1	2.0%	-0.3	0.7	1.2	9.1	10.5	10.2
Canada	-5.5	4.0	5.0	2.0% (+/-1.0%)	0.7	1.6	1.7	9.6	7.9	6.5
Australia	-3.0	3.8	2.8	2.0%- 3.0%	0.9	1.5	1.5	6.5	6.3	5.5
South Korea	-1.0	3.1	2.8	2.0%	0.5	1.0	1.2	4.0	3.8	3.6
Emerging	-0.9	7.0	4.7							
China	2.3	7.5	5.5	3.0%	0.1	2.5	2.5	--	--	--
India	-7.2	13.9	5.0	4.0% (+/-2.0%)	4.5	4.0	4.0	--	--	--
Brazil	-4.7	3.3	2.6	3.75% (+/-1.5%) [3]	4.4	3.5	3.5	--	--	--
Russia	-3.1	2.3	2.1	4.0%	4.9	3.5	4.0	--	--	--
Mexico	-8.3	5.5	2.6	3.0% (+/-1.0%)	3.2	3.5	3.5	--	--	--
Indonesia	-2.0	4.5	5.0	3.0% (+/-1.0%)	1.7	3.0	3.0	--	--	--
Turkey	1.1	4.0	5.0	5.0% (+/-2.0%)	14.6	11.4	10.0	--	--	--
Saudi Arabia	-4.1	1.8	4.4	USD Peg [4]	5.3	2.0	2.0	--	--	--
Argentina	-10.0	5.0	2.0	monetary base [5]	35.8	50.0	40.0	--	--	--
South Africa	-7.0	4.5	1.1	3.0% - 6.0%	3.1	4.2	4.2	--	--	--
All	-3.3	5.3	4.5							

Growth forecast adjustment from November 2020.
X.X An upward adjustment ≥ 0.3 pp   X.X A downward adjustment ≥ 0.3 pp

1. See our previous Global Macro Outlook, [Nascent economic rebound takes hold globally but recovery will remain fragile (November 2020)](). 2. Dec-to-Dec, % change; Fiscal year ending March 31 for India; The ECB aims at inflation rates of below, but close to, 2% over the medium term (<2.0%); Federal Reserve aims for inflation of 2% over the longer run. 3. 2020 target at 4%. 4. Exchange rate arrangement is conventional peg to the US dollar. 5. Central Bank of Argentina relaxed monetary base target in 2019 from zero growth in monetary base as of September 2018.
Source: Moody's Investors Service

Global recovery from the COVID-19 crisis will remain unbalanced

More than a year after the discovery of COVID-19, the virus continues to spread around the world and claim lives, while precautionary behavior and official restrictions are still hampering interpersonal interactions. The resulting toll on global economic activity has been staggering, even as the economy has also shown a remarkable degree of resilience. Overall economic outcomes in 2020 exceeded our forecasts in most countries because of stronger-than-expected rebounds in the second half of the year. Aided by technology, many people and businesses quickly adapted so that they could carry on with daily activity with reduced in-person interactions. But the recovery remains unbalanced, with the pandemic affecting individual businesses, sectors and regions very differently.

Goods demand has almost fully recovered globally because goods can be produced and consumed with limited in-person interactions, while the recovery in services continues to lag. Within services, businesses that were able to effectively deliver their products at arms-length have stabilized, if not prospered. Large businesses with access to cheap funding have performed better than small and mid-sized firms. The transportation, hospitality, and leisure and arts sectors continue to languish, but the information technology, consumer goods, pharmaceuticals and financial sectors have thrived. Many individuals around the world have lost their jobs and continue to face employment uncertainty, but on the flip side, the forced decline in household consumption and the rise in asset prices have buttressed household financial balances at an aggregate level. Governments in advanced economies have been able to support households and businesses far more substantially than have emerging market and less-developed countries.

Growth recovery will be synchronous but at different speeds

All G-20 countries will post growth rates this year and next, but the pace of the recovery will vary significantly. The COVID-19 shock has exposed differences between countries in terms of political leadership, community health management, fiscal and monetary policy response, economic structures and inherent economic dynamism. Public health considerations drove the economic shock of the pandemic. In that sense, the steep declines in GDP in 2020 across advanced and emerging market countries were less a reflection of underlying weaknesses in the economy, and more a function of the combined effects of the spread of the virus and the stringency of lockdown measures.

For example, the virus had a broadly similar effect on the populations of the US and continental Europe, but stricter lockdowns in Europe resulted in larger contractions in European countries' second-quarter GDP. Naturally, the worst-affected European countries also rebounded more strongly on a sequential basis in the third quarter following the lifting of restrictions.

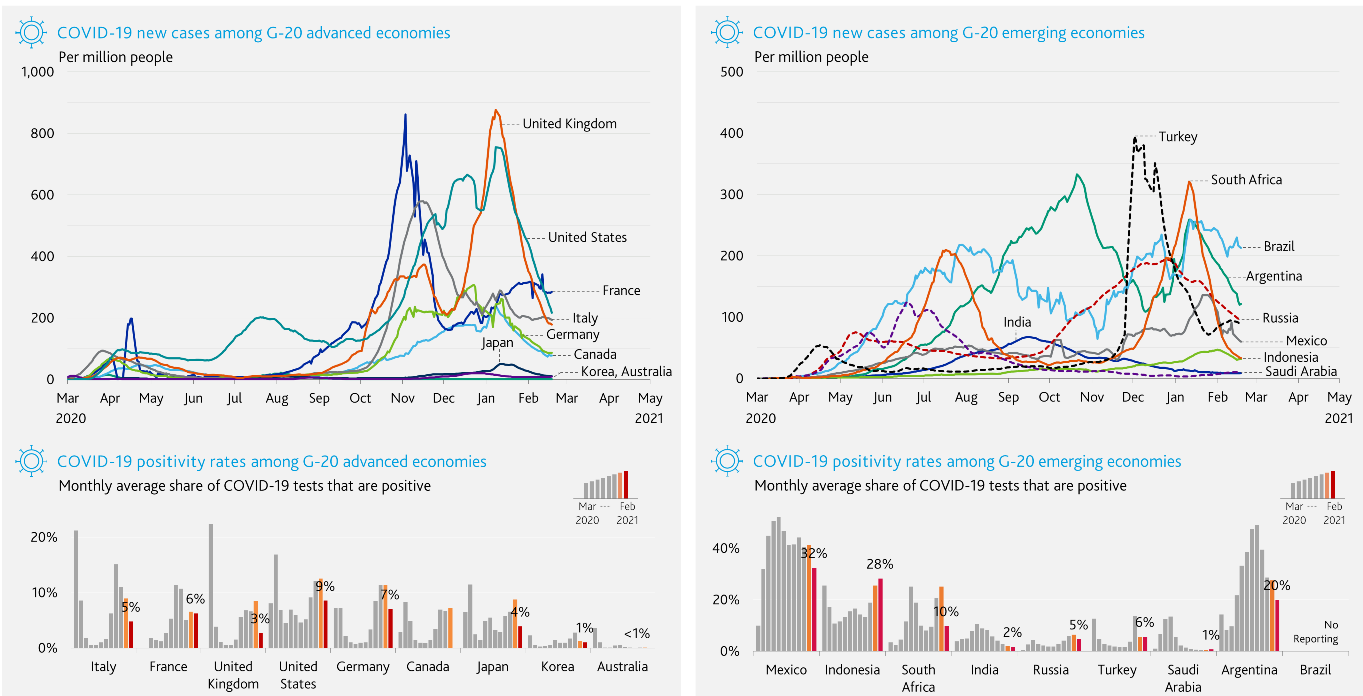
Economic outcomes will remain closely tied to the pandemic. The quicker countries can curb the spread of the virus, the faster their economic activity will recover. Otherwise the costs of keeping parts of the economy shut, in terms of lost income and revenue, will keep adding up. The longer the crisis lasts, the more difficult it will be for governments to compensate the private sector for its continuing losses. Without adequate government support, large-scale deterioration in asset quality will ensue. Such detrimental effects could eventually transmit the shock through financial channels to other parts of the economy.

We have cut our estimate of the 2020 contraction for the G-20 countries. We now expect a collective contraction of 3.3%, compared with our previous estimate of 3.8%, because of a better-than-expected recovery across a wide range of advanced and emerging market economies in the second half of the year. We expect the G-20 countries to grow by 5.3% in 2021 and 4.5% in 2022, up from our prior forecasts of 4.9% and 3.8%, respectively.

Among advanced economies, we have made significant upward revisions to growth expectations for the US (Aaa stable) for both 2021 and 2022 on account of the expectation of a sizable new fiscal stimulus as well as continued progress with mass vaccinations. We have cut our 2021 growth projections since our last update in November 2020 for the UK (Aa3 stable), the euro area and Canada (Aaa stable) on account of pandemic-related weakness in the first quarter. We expect economic activity in these economies to accelerate in the second half of the year as vaccinations help bring the pandemic under control and allow for reduced restrictions (see Exhibit 3). Accordingly, we have revised upward our 2022 growth projections for the UK, the euro area and Canada. We also raised our 2022 growth forecasts for Japan (A1 stable) on account of broad fiscal support to its economy and the improved growth prospects globally.

Economic activity will return to the pre-pandemic trend in the US next year. In contrast, our baseline forecasts for the UK, euro area and emerging market countries assume slower recoveries, resulting in the expectation that real GDP will remain below the pre-pandemic trend over our two-year forecast horizon. However, there is a great deal of uncertainty around our forecasts. Actual outcomes for individual countries may differ considerably from our current expectations depending on their success in managing the pandemic.

Exhibit 3
Tracking the pandemic situation across G-20 economies



Sources: Moody's Investors Service, Haver Analytics and Our World in Data

We have also raised our 2021 real GDP growth forecast for China from 7.0% to 7.5% as the country's economy ended the year slightly better than we had previously expected.

Other significant upward forecast revisions are to India (Baa3 negative), Mexico (Baa1 negative) and Turkey (B2 negative). India's economy has rebounded quickly from one of the world's longest and most stringent lockdowns, which also came with the steepest fall in GDP in the second quarter of 2020. Aggregate economic activity is estimated to have mostly recovered to the pre-pandemic level by the end of 2020, resulting in a significant carry-over and, hence, an upward revision to our growth projection for 2021. We also raised our growth expectations for Mexico and Turkey following strong rebounds in the second half of 2020. (For more on our forecasts for Turkey, see Government of Turkey – B2 Negative: Update following assignment of ESG credit impact scores, February 5, 2021.) For Mexico, improved US growth expectations further support its economic outlook this year and next.

We expect the fiscal and monetary policy mix to be broadly supportive across major G-20 advanced economies this year and next. In all major economies, demand remains below what would be required to sustain inflationary pressures. We believe central banks across advanced economies will maintain a low interest rate environment over the next two years to support post-pandemic growth and employment recoveries.

After the US recovery strengthens sufficiently, we expect the Fed to calibrate policy incrementally and communicate any changes well in advance, so as to prevent sudden financial repricing. Long-term nominal interest rates will naturally move up with stronger recovery expectations. We believe that the Fed will hold short-term rates down and lean against a sudden and sharp steepening of the yield curve so as to manage financial stability risks. Similarly, the European Central Bank will use its Pandemic Emergency Purchase Program to keep euro-area bond rates anchored. Other central banks, such as the Bank of Japan and the Reserve Bank of Australia, are also following some form of yield-curve control.

Benign financial conditions in the US and Europe will help central banks in emerging market countries hold interest rates low. In fact, central banks in emerging market countries where real interest rates have room to decline could cut rates further if the recovery is delayed.

Near-term risks to forecasts are to the downside, but successful virus containment could provide an upside

The experience of the last year shows that all countries are at risk from new coronavirus outbreaks after social interactions resume. Despite their superior healthcare facilities and financial capacities, advanced economies such as the US, Canada, the UK and the euro area have struggled as much as some emerging market countries to keep infections from rising repeatedly. Emergence of new variants of the virus in the UK, Brazil (Ba2 stable) and South Africa (Ba2 negative) underscores the risk of mutations, particularly in countries that are unable to tame the spread of the virus.

Even before the pandemic, long-term economic growth rates were expected to slow in many advanced economies and in China, in large part because of demographic shifts. The pandemic could further weaken long-term growth prospects in countries where it takes longer to restore economic activity. The longer the pandemic lasts, the greater the risk of permanent economic damage will be. The inability of countries to fully open is taking a toll on economic output and on the finances of both public- and private-sector entities. As we have stated previously, the pandemic has set back many years of economic and social progress.

Persistent uncertainty will weigh on business investment. There is also a risk of erosion of human capital because of higher long-term unemployment. Additionally, there are concerns that the mix of low interest rates, compressed credit spreads and ample fiscal support aimed at preventing large-scale business failures will keep low-productivity companies alive and stymie the natural process of creative destruction. The resulting misallocation of capital toward low-productivity companies could further impede growth prospects.

From a longer-term perspective, the coronavirus shock came as the world grapples with multiple challenges, such as climate risks, a reassessment of the merits of globalization, and increased social disaffection. The experience of the pandemic could also have some positive effects in terms of more digitization, which can boost efficiency and productivity, and improved public health infrastructure in some countries.

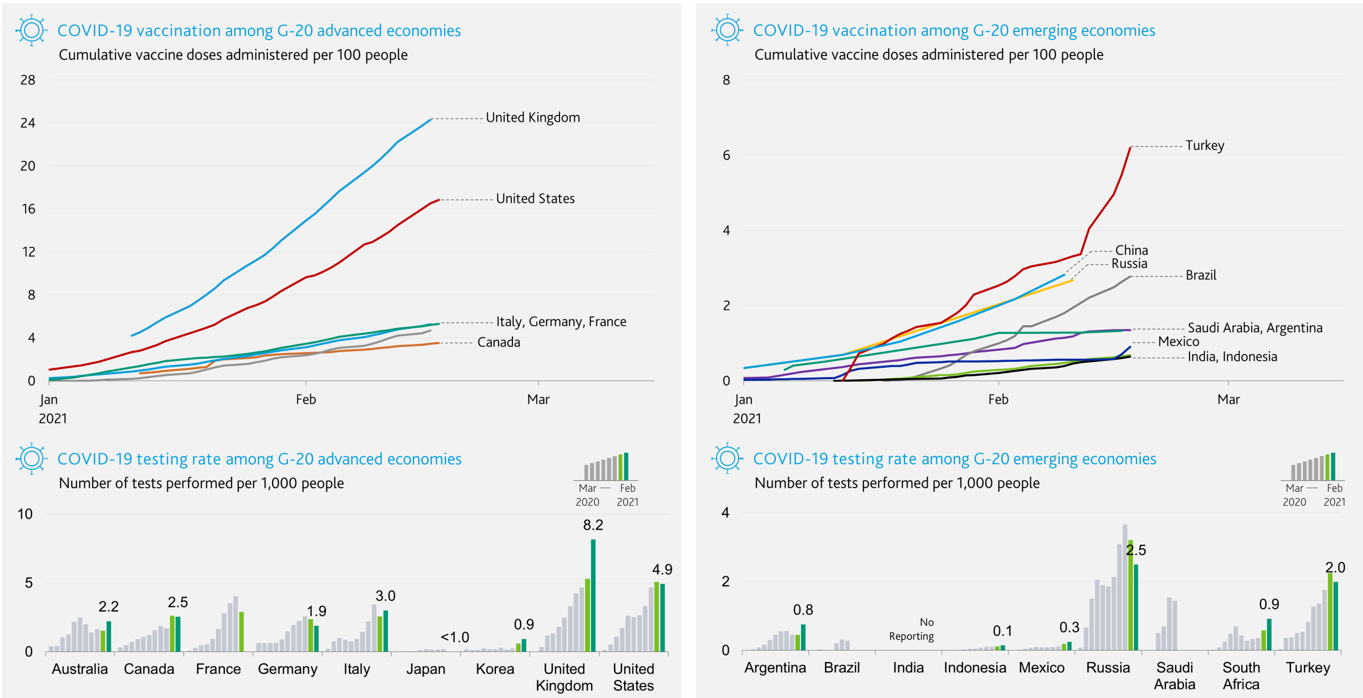
The pandemic has accelerated many existing disruptive trends; it is also likely to usher in new secular shifts that will reshape the global economy, politics and international institutional frameworks. These shifts will be most visible in five ways: (1) the reorganization of supply chains; (2) an increase in populism and inward-looking policies in the event of a jobless recovery or a recovery that increases inequality; (3) geopolitical realignment; (4) a policy push for a "greener" economy; and (5) a technological transformation that increases productivity, as well as makes a large number of job functions obsolete.

Vaccinations will significantly aid pandemic management

Advances in biotechnology have allowed for rapid development of effective and safe vaccines, with new vaccines, including from Johnson & Johnson (Aaa negative) and Novavax Incorporated, expected to be brought into use in the first half of this year. Meanwhile, antiviral drugs and other COVID-19 treatments also might continue to improve, aiding in pandemic management.

In addition, production of approved vaccines from BioNtech-Pfizer, Moderna and Oxford University-AstraZeneca is being scaled up, which will help alleviate current shortages in advanced economies over the coming months (see Exhibit 4). In emerging market economies, Russia (Baa3 stable), China and India are largely fulfilling vaccine needs. The Oxford University-AstraZeneca vaccine is being rolled out widely in emerging market countries. Low-income countries will depend on the multilateral COVAX facility for vaccine doses. Nevertheless, lack of cooperation between advanced and emerging countries means that less-developed countries that do not have enough assured supplies of effective vaccines or the capacity to produce them will struggle to overcome the pandemic. And even in countries that successfully curb the spread of the virus, vigilance will continue to be paramount.

Exhibit 4
Tracking vaccination progress across G-20 economies



Source: Moody's Investors Service, Haver Analytics and Our World in Data

Vaccines should prove quite effective, according to Phase III clinical trial results, but how long immunity will last is still unclear. Furthermore, whether patients who have recovered from COVID-19 attain lifelong immunity is not known. The efficacy of the vaccines against the three known mutations – the Brazilian, the South African and the UK variants – remains in question. And there remains the possibility that a more infectious and/or deadly variant may still emerge. Given these uncertainties, it is very likely that a continuation of mass vaccinations will be required to sustain any recovery.

The economy could improve faster if vaccines bring forward a normalization of activity

Under our baseline economic forecast, the world will continue to battle COVID-19 and its variants over the course of 2021 and 2022, and the virus will be tamed only gradually with vaccinations and treatments. This assumption underpins the gradual recovery of economic activity we forecast in most countries. At the very least, the need for large-scale lockdowns will decline significantly if vaccines can help lessen the severity of the illness. Thus, vaccines will be important in the tool kit of public health authorities to suppress the virus's spread and reduce fatalities. The recovery could be pulled forward in countries that can curb the pandemic with a mix of measures, including vaccinations and continued virus testing.

US economy will lead the global services demand recovery

The US economy advanced at a 4.0% annualized rate in the fourth quarter of 2020, but the headline figure masks the fact that the economy has lost momentum since November, when COVID-19 cases began to rise. We expect this current moderation in economic growth to be temporary. Economic momentum will likely pick up pace over the course of 2021 and 2022, supported by: (1) enhanced pandemic control, (2) significant additional fiscal support to the economy, and (3) a more predictable policy environment.

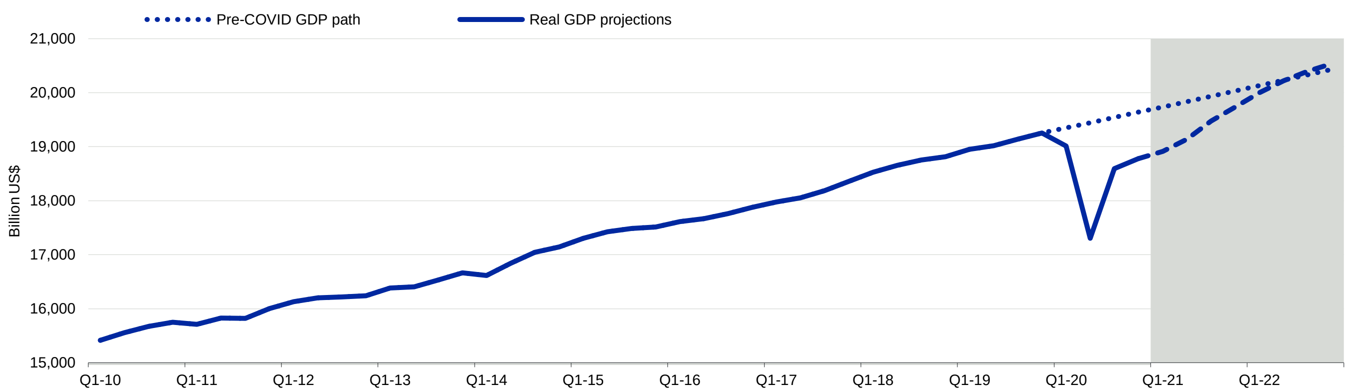
With infection rates now starting to fall, economic momentum should naturally pick up again in the second quarter and into the summer as individual states progressively ease up social distancing restrictions. We believe that a stronger pandemic management response from the Biden administration, including mass vaccinations, increased testing for mutations and overall enhanced community health, will increase public confidence and allow for a relaxation of restrictions over this year and next. The Biden administration's efforts to increase the pace of vaccinations, if effective in reducing the severity of the health crisis, will accelerate the recovery in services.

The injection of new federal stimulus will come on top of the $900 billion of support, primarily for households and businesses, enacted at the end of last year. The new stimulus, which we forecast will total $1.5 trillion to $1.7 trillion, or 7%-8% of US GDP, will also come at a time when the pace of growth in the US is already accelerating. While details of the new stimulus package are still being negotiated, we expect the aid to be directed toward individuals, businesses, educational institutions, states and local governments, and for enhanced pandemic management.

We forecast US real GDP to expand by 4.7% in 2021 followed by 5.0% growth in 2022. At these growth rates, the real GDP level will converge with the pre-pandemic GDP path in 2022 (see Exhibit 5). The forecast annual growth rates for 2021-22 are not enough, however, to make up for the output lost on a cumulative basis since the first quarter of 2020.

Exhibit 5

US real GDP level will converge with the pre-pandemic path in 2022



Source: Moody's Investors Service

Our forecasts assume that economic activity will substantially pick up in the second half of the year, aided by the reopening of schools and offices in parts of the country where the virus has been brought under control. We factor in the combined effect of pent-up demand, a gradual restoration in household demand for services, a buoyant housing sector and strong business activity spread over several quarters in our annual growth estimates for this year and next.

The Federal Open Market Committee's US economic outlook will likely turn more optimistic this year as stimulus-fueled economic momentum builds. However, we expect the Fed to continue to stress its goals of achieving long-term average inflation of 2%, maximum employment and financial stability. We expect it to err on the side of providing too much support instead of too little in pursuit of these goals. (For details, see Macroeconomics – US: US inflation may rise temporarily, with sustained price pressures a long way off, January 21, 2021.)

Accordingly, we expect the Fed to continue to communicate that it will remain patient when it comes to removing policy support to the economy. Therefore, we do not expect an increase in the fed funds rate this year or next. With regard to quantitative easing, the Fed will likely continue to purchase Treasurys and mortgage-backed securities at a monthly pace of $80 billion and $40 billion, respectively, at least until the end of this year. The Fed will likely calibrate and time the decision to taper asset purchases carefully, taking into consideration the upcoming pace of Treasury issuance, so as to not crowd out other issuers.

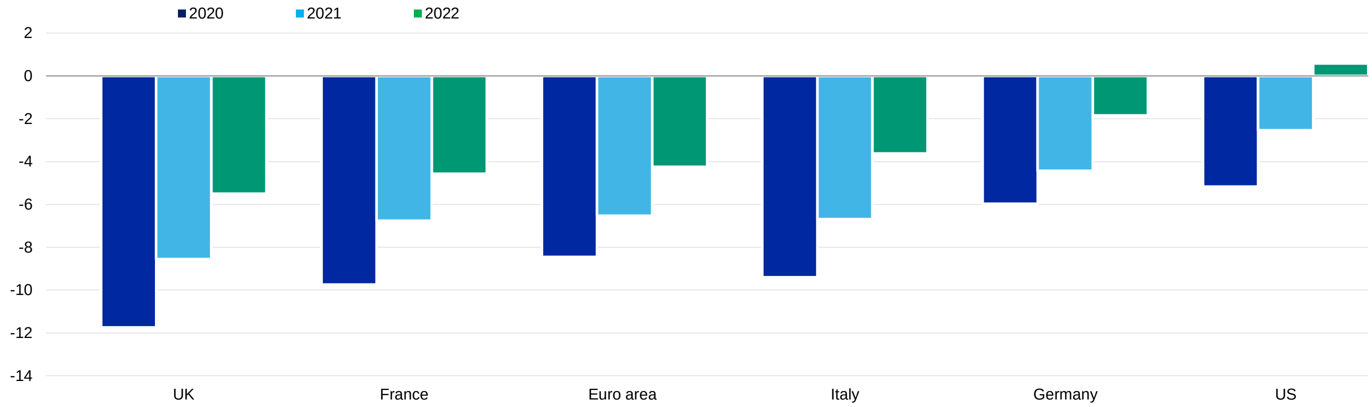
Economic recovery will be slow and uneven in euro area countries

We project real GDP growth in the euro area will rebound to 3.7% in 2021 and 3.9% in 2022, following our expectation of a 7.1% contraction in 2020. Continued expansionary fiscal and monetary policy, and good access to credit for households and businesses, will continue to support economic recovery in 2021. As in other regions, consumer spending in the euro area will likely increase in the second half of this year as households release the savings they accumulated during lockdowns. However, growth rates will vary across the region and much will depend on pandemic developments, including vaccine availability and distribution (see Exhibit 6).

Exhibit 6

In euro area, output shortfall remains large compared with pre-pandemic trend

Output shortfall as a share of 2019 real GDP, %



Source: Moody's Investors Service

Germany (Aaa stable) recorded a milder decline in economic activity in 2020 compared with other countries in the region, mainly reflecting structural economic features but also its crisis management and large fiscal stimulus packages. Thus, we expect a faster return to pre-crisis output levels, with real GDP likely to rebound by 3.0% in 2021 and by 4.0% in 2022, after a 5.0% contraction in 2020. Consumption and investment will remain weak throughout the first quarter of 2021 and improve only moderately in the second quarter, with many restrictions still in place. We expect a stronger rebound in the second half of 2021 following widespread vaccinations among vulnerable groups, which will allow a significant easing of restrictions. However, the current lockdown likely is having only a limited effect on the industrial sector. Government support measures will keep the supply side of the economy mostly intact.

We expect a gradual recovery of France's (Aa2 stable) economy, with growth of 4.8% expected in 2021 and 4.0% growth in 2022, after a contraction of 8.3% in 2020. Virus restrictions in place since the end of October will weigh on economic recovery in 2021. We expect a gradual recovery starting in the second quarter of 2021, which will only moderately accelerate in the second half of the year amid the gradual rollout of vaccinations.

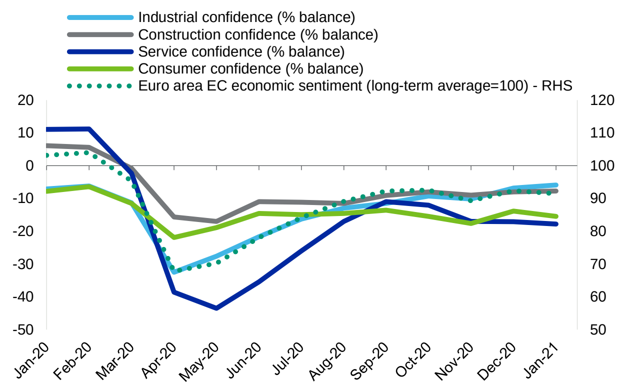
For Italy (Baa3 stable), we have revised down our 2021 growth forecast to 3.7% from 5.6%, based on renewed curbs on mobility and businesses in response to rising infections. We forecast real GDP growth of 4.1% in 2022. Italy stands to receive around €209 billion (close to 12% in projected 2021 GDP) in EU recovery funds by 2026. These funds could bolster the country's growth prospects if directed and used effectively for public infrastructure and other growth-enhancing spending. The inauguration of a cross-party government under Prime Minister Mario Draghi increases the likelihood of that happening.

Euro area survey data show resilience amid near-term weakness

The reintroduction of domestic restrictions by some European countries in response to rising infection rates at the start of the year is leaving some scars (see Renewed lockdowns will not trigger widespread credit deterioration, January 18, 2021). The impact of the new lockdown measures at the start of the year is evident in the slight decline in the latest PMI data. The European Commission's January Economic Sentiment survey took a similar turn, showing declining retail confidence linked to a more pessimistic assessment of the current situation.

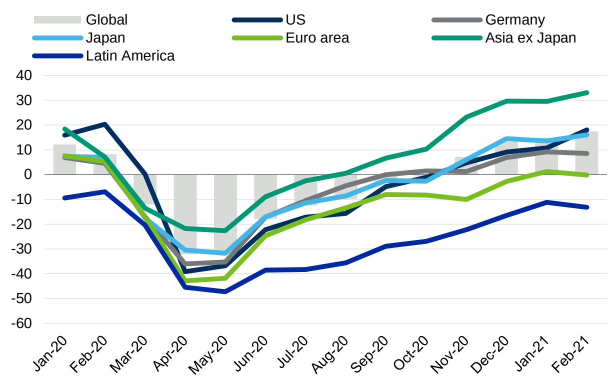
Forward-looking indicators show some resilience. The manufacturing–services divide remains large, and Germany continues to perform better than the other euro area economies (see Exhibit 7). The expectation component in retail suggests that businesses expect a pickup in activity in the coming months. Business confidence continues to improve with a willingness to look through the period of weaker consumer demand, a similar theme as in the PMI survey. The PMI confidence component improved in January on hopes that vaccine rollout will help ease restrictions and boost economic activity (see Exhibit 8).

Exhibit 7
The manufacturing–services divide in Europe remains large
Economic sentiment indicator by sector (% balance)



Sources: Haver Analytics and Moody's Investors Service

Exhibit 8
Sentiment has improved in the euro area, but still lags that in the US
Sentix economic index (% balance)



Sources: Haver Analytics and Moody's Investors Service

Tight pandemic control measures in China will likely delay shift in growth drivers toward domestic consumption

As was widely expected, China's economy outperformed all other major economies in 2020 with a V-shaped rebound resulting in a 2.3% expansion of real GDP. We expect the economy to grow by 7.5% in 2021, up from our prior forecast of 7.0%, followed by 5.5% growth in 2022. We raised our 2021 forecast to account for the economy having ended 2020 slightly stronger than our expectations.

New localized virus outbreaks and tightened travel restrictions are dragging on China's economic growth, as shown in weak service activity around the Lunar New Year. Service sector PMIs dropped in January, and new orders took a similar turn. We expect the solid growth momentum to continue into 2021, notwithstanding the recent tightening of COVID-19 restrictions. However, economic growth this year will be tempered by the efforts to reduce the credit impulse in the economy out of concerns surrounding leverage risks in the nonfinancial sector.

Overall, the economic rebound last year was supported by investment spending related to property and infrastructure, and by robust export growth. Strong supply-side stimulus helped ramp up manufacturing activity to meet the post-pandemic rise in demand for electronics and personal protective equipment.

China has done better than other major economies in tamping down the virus early and keeping its economy open, but periodic localized outbreaks have continued and therefore the country has kept some restrictions in place. China's economic growth recovery has been weighted toward infrastructure, property and exports. The pace of recovery in consumer demand remains lackluster, and will remain so until virus-related fears and uncertainty completely subside.

Our baseline forecasts assume that investment will remain China's main growth engine, but that household consumption growth will gradually accelerate, supported by employment gains. A sustained pickup in consumption growth is essential for a more balanced and self-sustaining recovery. China's current account surplus in the second and third quarters of 2020 rose sharply, averaging almost three times that in 2019, as exports picked up sharply while domestic household demand remained muted. The level of exports will likely remain high as the pace of recovery in the rest of the world picks up. Whether the current account balance gradually shrinks to pre-pandemic levels will depend on the level of pickup in domestic demand.

Fiscal policy will remain supportive in order to maintain employment. However, we expect the People's Bank of China to tighten liquidity and credit conditions gradually. The central bank is also adopting targeted measures such as curbs on lending to the property sector to guard against financial-sector risks. Calibrating monetary tightening to reduce financial risks, while also ensuring employment growth, will not be easy. If growth takes priority, long-term financial risks from rising leverage will increase. On the other hand, overly tight credit conditions could slow economic growth faster than expected.

Outlook varies widely across emerging markets

The economic performance of emerging market countries in 2020 was a function of the intensity of the health crisis, the severity of pandemic-related restrictions on in-person interactions, and policy support from fiscal and monetary authorities. The ability to curb the pandemic will remain the single most important factor that determines economic outcomes across emerging markets in 2021.

Differentiation in economic outlooks among emerging market countries has been a long-standing theme. It has become even more relevant now, as management of the pandemic has differed starkly across countries. A number of countries are embarking on mass vaccination programs using a variety of vaccines. But attaining herd immunity will be a slow process because of vaccine supply and logistical issues in most countries. Even in China, Russia and India, which have the capacity to produce and administer vaccines on a mass scale, it will take many months. Nevertheless, vaccines will be an important weapon in the fight against COVID-19 and will aid efforts to bring some semblance of normalcy to societies and economies.

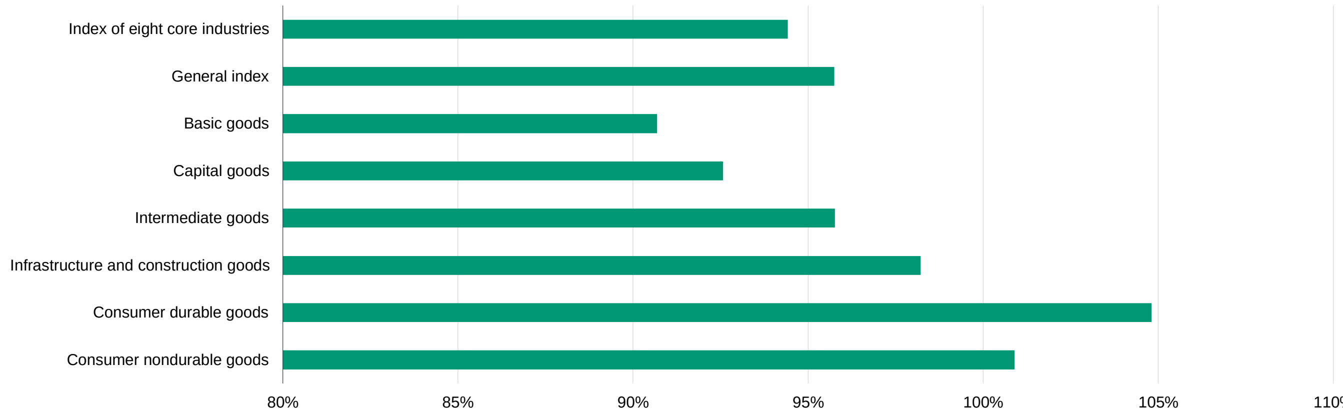
India's economy will continue to recover in 2021 provided pandemic remains contained

India has not yet published real GDP data for the fourth quarter of 2020, but a number of high-frequency indicators, including PMIs, industrial production (see Exhibit 9), passenger car sales, and mobility indicators suggest that the economy ended the year better than we had expected. A steady economic recovery appears to be underway and should continue into 2021, as vaccine rollout allows for a steady removal of restrictions.

We forecast real GDP growth of 13.9% in 2021 and 5.0% in 2022, following a 7.2% contraction in 2020. While these growth rates look high, the economy will in fact only be 5.6% larger in the fourth quarter of 2021 relative to the fourth quarter of 2020 under these forecasts. We expect the economy to accelerate on a sequential basis only in 2022. Progressively strengthening consumer demand and an improving external environment should continue to aid the recovery over the next two years. We expect the Reserve Bank of India to maintain an accommodative policy stance. Budget measures for fiscal 2021, if implemented, could support the post-pandemic recovery and serve to significantly reduce downside risks. These measures include funds for healthcare improvement, infrastructure spending, financial sector reform and privatization.

Virus control will be the ultimate determinant of economic outcomes. India has steadily reduced its COVID-19 cases and is so far managing to keep them from rising again despite the progressive relaxation of mobility restrictions. We expect the government to continue to focus on keeping infections low, aided by the ongoing vaccination drive. India aims to vaccinate 300 million people by around mid-year 2021, starting with healthcare and frontline workers followed by the 50+ population. This is an achievable goal given the country's large domestic vaccine manufacturing capacity and experience with annual mass immunizations. A renewed increase in virus cases would undermine the recovery and potentially inflict lasting damage.

Exhibit 9
India's industrial production continues to recover
Index of industrial production compared with February 2020 levels



Sources: Haver Analytics and Moody's Investors Service

Vaccine procurement and rollout remains key for Indonesia's recovery

Indonesia's (Baa2 stable) economy took a smaller hit in the second quarter of 2020 than did the economies of most other major emerging market countries, in part because of less-stringent mobility restrictions. As a result, its contraction was only 2.0% in 2020. Nevertheless, Indonesia's real GDP was 2.2% smaller than in the fourth quarter of 2019. High-frequency data point to a renewed slowdown since November 2020, when COVID-19 cases started to surge; retail sales decreased in January 2021 by around 14.0% year-on-year, despite improvement on a sequential basis from December.

Indonesia is carrying out mass vaccinations with the Sinovac Biotech vaccine. Unlike other countries' vaccination campaigns, Indonesia's plan will prioritize the working-age population over the elderly, after medical workers and government workers. We expect economic momentum to improve as vaccinations help reduce COVID-19 cases. A gradual improvement in household consumption, which accounts for nearly 60% of GDP, will support the recovery this year. We forecast real GDP to grow by 4.5% in 2021 and by 5.0% in 2022. Fiscal and monetary policy is likely to be broadly supportive to aid the recovery.

Inflation remains soft – well below the 2.0%–4.0% target range – because of demand weakness. The Bank of Indonesia will likely cut the policy rate at least once this year and hold rates steady thereafter.

COVID-19 shock exacerbates existing structural challenges in South Africa

We expect South Africa's economy to grow by 4.5% in 2021 and by 1.1% in 2022, following an estimated 7.0% contraction last year. This would make South Africa's recovery one of the weakest among emerging market countries. The economy has struggled to build momentum for many years, and as a result suffers from chronically high unemployment. The COVID-19 shock has made the economic situation all the more challenging.

The latest high-frequency data show that mining and manufacturing output in South Africa has rebounded strongly from the April 2020 slump. However, continued power cuts by Eskom (Caa1 negative), the state-owned utility, will limit further improvement. After bringing down the pace of COVID-19 infections with stringent lockdowns, the country is now dealing with a second wave of the virus and a more infectious variant. Measures to contain the virus will also weigh on the overall pace of the recovery in the near term. However, even if South Africa can successfully bring the pandemic under control with mass vaccinations, underlying structural issues will continue to hinder the economic recovery next year.

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