No country 'immune' to COVID-19 economic shock, but Asian nations will bounce back faster

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Global GDP will drop three percent below pre-pandemic estimates by the end of 2021, with many Western nations seeing "deeper and longer-lasting" effects compared to China and other Asian economies, a study

suggests.

Moreover, nations that adopted less stringent lockdowns—Sweden, for example—will not be shielded from the economic losses of COVID-19 either, owing to spillovers from other countries.

Published by the *National Bureau of Economic Research*, the macroeconomic study captures the economic volatility caused by the last forty years of "rare events". It uses this historical data to forecast the longer term effects of the pandemic on individual economies.

The research suggests that economic growth will be stymied in at least 80% of the world's advanced nations and many emerging market economies due to "excess global uncertainty".

Two Cambridge economists conducted the study with an international team of researchers. They argue that the pandemic will lead to a "significant fall in world output"—the consequences of which could last much of the dawning decade.

"The COVID-19 pandemic is a global shock like no other, involving simultaneous disruptions to both supply and demand in an interconnected world economy," said co-author Dr. Kamiar Mohaddes, a Cambridge Judge Business School economist.

"Infections reduce labour supply and productivity, while lockdowns, business closures, and social distancing also cause supply disruptions. On the demand side, redundancy and the loss of income from death, quarantines, and unemployment plus worsened economic prospects reduce household consumption and firms' investment."

The study from Mohaddes, a Fellow of King's College at Cambridge, and colleagues, including M. Hashem Pesaran, Fellow of Trinity College,

uses the IMF's GDP growth forecast revisions between January and April 2020 to identify the COVID-19 economic shock.

The research team created a model of 33 countries covering 90% of the global economy, using data from 1979 onwards—in particular the rare economic shocks—to predict the range of GDP loss likely to be suffered by each nation and region as a result of the pandemic. The study accounts for the "nonlinear" effects of global economic volatility.

"The techniques developed in this study are intended to capture the effects of rare events such as COVID-19, and account for interconnections and spillovers between countries and markets," said Mohaddes, who worked with colleagues from the International Monetary Fund, Johns Hopkins University and the Federal Reserve Bank of Dallas.

The study suggests that the US and the UK are likely to experience deeper and longer-lasting effects, while China has more than a 50% chance of its economy improving far quicker than its major western counterparts. The odds for the Euro area are "skewed negatively", but it's likely to experience a speedier and sturdier recovery than the US by the end of 2021.

"Pulled by China, most of the emerging economies in Asia have a higher chance of performing better than the global average," said Mohaddes. He argues that China and others in the region may fare better globally thanks to their manufacturing bases.

Economies with strong service industries have proved resilient in the past as manufacturing was more exposed to market fluctuations, but COVID-19 and the digital age have turned this on its head: services suffer as people stay at home en masse while goods are still traded through online platforms.

"Non-Asian emerging markets stand out for their vulnerability, and will suffer from a significant output collapse in 2020, with a less than 30% chance of not experiencing an output loss by the end of 2021. Turkey, South Africa, and Saudi Arabia will almost certainly see at least eight quarters of severely depressed economic activity," Mohaddes said.

The study pays close attention to Mohaddes' home nation of Sweden, where the government took a markedly different approach, with little in the way of the mandatory social distancing and lockdowns adopted by most countries.

"The Swedish economy will also see a large fall in GDP, very similar to other European economies," he said. "Our estimates for Sweden illustrate that no country is immune to the economic fallout of the pandemic, because of interconnections and the global nature of the shock."

The study predicts lower interest rates in core advanced economies—about 100 basis points or 1 percentage point below pre-COVID rates. "The crisis raises precautionary savings and dampens investment demand," said Mohaddes.

However, he warns that the same cannot be said with certainty about emerging market economies in regions such as Latin America, where borrowing rates can increase rapidly, with implications for "debt servicing".

The study's calculations involve "both the temporal and cross-sectional dimensions" of data that take into account real and financial drivers of economic activity, and common factors such as oil prices and global volatility. Country-specific models include output growth, the real exchange rate, as well as real equity prices and long-term interest rates when available.

Added Mohaddes: "Given its unprecedented nature, any analysis of COVID-19 has to go beyond identifying the economic shock and account for its non-linear effects and cross-country spillovers, as well as the uncertainty surrounding forecasts. This is what we address with our econometric model."

More information: Alexander Chudik et al, A Counterfactual Economic Analysis of Covid-19 Using a Threshold Augmented Multi-Country Model, (2020). DOI: 10.3386/w27855

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