How governments' tough COVID restrictions can help limit economic damage

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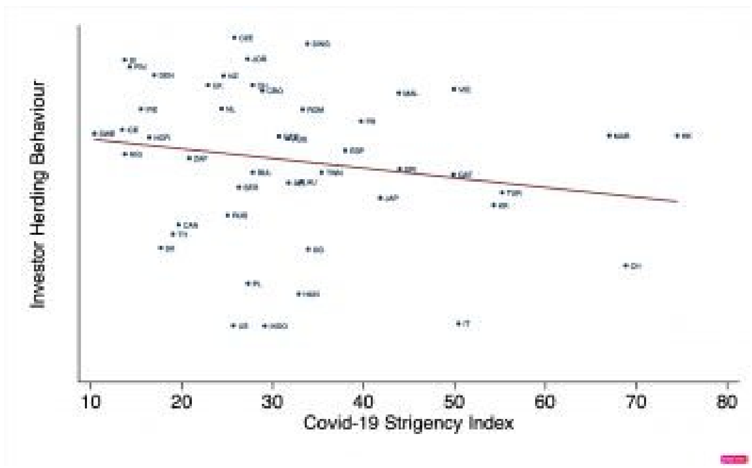

Graph showing trend for greater investor herding in countries with less stringer COVID restrictions. Credit: University of Sussex

The UK Government's hesitancy to bring in tougher COVID restrictions exacerbated investor herding, market volatility and greater harm to its economy compared to countries with swifter and more decisive pandemic responses, new research indicates.

Countries with more stringent government responses to the coronavirus crisis benefitted from lower levels of investor herding, newly published research from the University of Sussex Business School, Southampton Business School and University of Brescia (Italy) reveals.

Stringent government restrictions mitigated investor herding behavior by reducing multidimensional uncertainty, the authors found.

The research also indicates that strict restrictions on individual freedoms and economic operations do not have a wholly negative impact upon a country's economy.

Study co-author Dr. Panagiotis Tzouvanas said it was likely that the delayed response from the UK government to impose strict measures increased herding and volatility while its reluctance may have also alarmed investors and encouraged them to move to other markets.

Dr. Tzouvanas, Lecturer in Finance at the University of Sussex Business School, said: "While other European countries have almost recovered from the COVID shock, the UK's stock market is still lagging behind. Of course, the role Brexit has played cannot be discounted as a factor but it is likely its' impact must have been priced even before the pandemic.

"Our study brings something new to the ongoing public debate over the trade-off between public health and the economy by showing that the imposition of stringent government and regulatory restraints to control the transmission of COVID-19 can also have a positive impact on countries' economies by alleviating the presence of investor herding behavior.

"It is also interesting to note that our analysis shows that if a government with a more relaxed approach then tries to impose tougher restrictions later on, this can cause herding behavior. It seems that governments should go "all-in" to reassure investors, lenient measures do not solve the problem."

Renatas Kizys, Associate Professor in Finance in the Southampton

Business School at the University of Southampton, said: "Stock market investors succumbed to the growing uncertainty surrounding the economy and the financial system created by the emergence of the coronavirus pandemic and instigated massive sales of risky assets."

"In such times, investor herding can be extremely dangerous as it causes volatility to increase and potentially cause some stocks might collapse.

"Our study shows that governments that take strict measures in response to COVID-19 increased the confidence of investors to take their own decisions."

Michael Donadelli, Associate Professor of Economics at the University of Brescia, said: "More broadly, our study also indicates that when uncertainty is ruling the market due to unprecedented events like the COVID-19, certain government interventions may have a direct impact on investors' behavior avoiding companies' failure."

The study, published in the *International Review of Financial Analysis*, analyzed daily stock market data from 72 countries in the first quarter of 2020 to see whether the nature of a government's response to the COVID-19 pandemic, as measured by the Oxford COVID-19 Government Response Tracker, could mitigate investor herding behavior in international stock markets.

The authors found government orders to close schools, cancel events and impose restrictions on movements caused herding to decrease as investors interpreted the steps to be positive news for both public health and long-term growth prospects.

The study revealed travel controls were the only restriction that appeared to induce herding behavior.

Researchers found across the world, national responses in the first quarter of 2020 mitigated investor herding behavior except for in the Americas where governments' responses were less uniform and restrictions introduced more slowly compared to European counterparts, China or South Korea.

More information: Renatas Kizys et al. From COVID-19 herd immunity to investor herding in international stock markets: The role of government and regulatory restrictions, *International Review of Financial Analysis* (2021). DOI: 10.1016/j.irfa.2021.101663

Provided by University of Sussex

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