

Intelligence MEMOS



From: Glen Hodgson
To: Canadians Concerned about COVID-19
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Re: **WHAT WILL A PANDEMIC MEAN FOR ECONOMIC PERFORMANCE?**

The COVID-19 pandemic is having an immediate impact on population health locally and globally, and on the performance of the economy. What can we expect as it unfolds?

Pandemic Patterns

Pandemics dating back to the Middle Ages usually appear in two or more waves, although their timing and number may not be consistent regionally. Although pandemics remain widespread, mortality rates have dropped significantly. Significant improvements in public health practices, enhanced analysis and information sharing, and modern medical science and practices, have and can all be used to constrain a pandemic by flattening the now-famous curve and reducing the amplitude of successive waves.

The 1918-19 Spanish flu is believed to have infected half the world's population. It had three distinct waves: the spring of 1918, the fall of 1918, and the winter of 1918-1919. The first and third waves were fairly mild, but the second resulted in tens of millions of deaths. Total mortality is estimated at up to 50 million people.

In comparison, the 2009 swine flu, which killed up to 575,000 people, had three waves in Mexico, while pandemic peaks in the rest of North America were more consistent with a two-wave profile.

COVID-19 is still in its first wave, starting in China and spreading to Asia, Europe and North America. At the time of writing, nearly 250,000 cases had been confirmed, leading to more than 10,000 deaths, and the numbers are still quickly ramping up.

Economic impacts

Pandemics impose an economic cost globally and in affected regions. The Spanish flu saw significant social and economic disruption as sick employees and students led to shutdowns of schools and businesses, with many bankruptcies. The available literature refers to a drop of nearly 5 percent in global GDP (without providing any source or methodology). Claims against life insurance policies soared by as much as 745 percent.

More recent pandemics have had lower mortality rates and more refined estimated economic impacts. The 1957-59 Asian flu saw some societal disruption in schools and the workplace, mostly concentrated among children, teachers, and healthcare workers. The pandemic reduced industrial production by about 1.2 percent in Canada at the peak and reduced US GDP by about 1 percent. Economic recovery was almost immediate.

Academic research has examined the potential economic cost of a modern pandemic. A recent study suggests GDP losses from a modern pandemic in Europe of approximately 0.5 to 2 percent. The estimated costs of school closures and prophylactic absences (or social distancing) more than triples these effects. Increasing school closures to the duration of the pandemic almost doubles the economic cost.

Possible Patterns of Recession and Recovery

At this stage, a few factors can be considered related to recession and recovery. One is the possibility of a sharp "V" contraction, where the economy quickly contracts during the pandemic, hits bottom in terms of lost output, and then quickly rebounds over one or two quarters.

A second and more likely pattern is a sharp drop in output, and a longer bumpy U-shaped recession, with the possibility of a secondary contraction wave and then eventual recovery. The sharp drop in output is already taking place, and a longer recession period would reflect an extended period of social distancing and the prospect of additional pandemic waves that could mean reintroducing social distancing, which is the major productivity killer.

An additional factor is the likelihood of robust recovery once the pandemic subsides, due to expected pent-up consumer demand, housing purchases and business investment delayed during the pandemic period. A strong recovery would be consistent with past pandemic periods. However, a robust recovery would only partially replace the GDP lost during the recession period.

A realistic outlook

Economic analysts have begun releasing revised forecasts that take the current and anticipated impact of the pandemic into consideration. Based on the research shared here and my review of available forecasts, I anticipate the following pattern taking shape for Canada and the US:

2020 Q1: flat GDP or a small contraction.

Q2: a contraction of 3-5 percent (annualized) in Canada, and 5 percent or higher in the US, where the effects of the pandemic appear to be more severe.

Q3: further contraction of 0.5 to 2 percent for Canada, and 2 to 3 percent in the US.

Q4: a return to growth of 4 to 5 percent.

This profile would mean a mild contraction in annual 2020 GDP of around 0.5 percent. Growth in 2021 is projected to be at or above potential, within a range of 1.8 to 2.5 percent. American growth in the recovery period should be slightly higher than that projected for Canada.

Economic forecasts for Canada and the US are being quickly revised. It would be realistic to expect up to three quarters of output contraction, with Q2 experiencing the deepest contraction. Economic growth could rebound before the end of the year, and GDP growth in 2021 should be at or above potential.

Governments should remain ready to make further policy adjustments as required, and continue to reinforce public confidence that the pandemic can be contained and that economic recovery will happen.

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