

The Economic Impacts of COVID-19: Digest 1

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30 September 2020

Volunteers of the ICAT workstream F&I1 and the [Economics MIG](#) have joined forces to produce the following 'round-up' of activity which has taken place over the summer.

This will be the first of regular updates which will be showcased in the ICAT Newsletter which goes out monthly with links on the Economics MIG webpage, so do look out for these.

Purpose of these updates

COVID and the developing economic crisis create a great deal of uncertainty within the core assumptions that we use as actuaries in our daily work. This compounds via the interconnected nature of our core risks, uncertainties and assumptions and with the complex nature of the real economy, financial economy and interconnected financial markets and global trade.

Where, in the past, we could provide a reliable guess as to a "central scenario" or for the baseline assumptions for a stochastic model, the present crisis requires us to analyse and synthesise many changing parts all at the same time. The outcome of this mental exercise cannot be a single central scenario, but must incorporate a multiple of potential what-ifs and various outcomes. Perhaps this means many more ORSA-type scenarios, perhaps this means many more investment scenarios, perhaps this means a dynamic back-of-the-envelope mental approach to stress testing to filter and identify the more important assumptions and scenarios. The objective of this update is to provide the first step for you the reader as you undertake to gather information in a rapidly changing and uncertain world. In the sections below, summaries of publications are provided in plain text with the *actuarial implications* in italics to ease reading.

Section 1 – Macro-Economic Data, Policy Communications, and COVID Updates

27 August 2020 – The US Fed's FOMC changes its "Statement on Longer-Run Goals and Monetary Policy Strategy"

The FOMC recently made some important changes to its stated approach to meeting its longer-run policy goals of maximum employment, price stability, and moderate long-term interest rates. Regarding employment, the FOMC has switched from the historic focus on "deviations" from maximum employment to focussing on "shortfalls" going forward. For inflation targeting, the FOMC signalled that monetary policy may shift to targeting inflation moderately above 2% for some time to achieve an average inflation of 2% over time, given recent years of inflation below the 2% target. The FOMC also said that downward risks to employment and inflation have increased and reiterated its commitment to using its full set of tools to achieve maximum

employment and price stability, especially as the Fed Funds rate is closer to its effective lower bound.

The longer-term focus and flexibility may mean short periods of inflation above 2%. This may change market expectations of inflation or have effects on real and nominal returns.

<https://www.federalreserve.gov/newsevents/pressreleases/monetary20200827a.htm>

<https://www.federalreserve.gov/monetarypolicy/guide-to-changes-in-statement-on-longer-run-goals-monetary-policy-strategy.htm>

12 August 2020 – UK GDP estimated down 20.4% for Q2 (April to June)

The UK Office for National Statistics released its initial estimates for quarterly GDP with Q2 estimates at -20.4%, following -2.2% for Q1. There were record falls in services, production and construction, with those sectors being most exposed to government restrictions. Private consumption accounted for 70% of the expenditure measure of GDP. With two consecutive quarters of negative GDP, the UK enters a recession for the first time since 2008/9, as a result of the COVID-19 pandemic and extraordinary government measures.

<https://www.ons.gov.uk/economy/grossdomesticproductgdp>

8 September 2020 – EuroStat "Euro area GDP down 11.8% for Q2, employment down 2.9%"

For Q2 2020, seasonally adjusted GDP is down 12.1% in the euro area and down 11.4% in the EU, in part due to continued COVID containment measures. This followed Q1 falls of 3.7% and 3.3%, respectively. Employment also fell by 2.9% and 2.7%. Q2 GDP estimates are available for all EU countries as well as UK, US, Iceland, Switzerland and Norway. For Q2, Spain was hit hardest in the EU with a fall of 18.5% and the UK falling 20.4% (see graph page 2 and table page 7). Employment for the EU is measured by the number of employed persons (-2.7% for Q2) and the number of hours worked (-10.7% for Q2).

<https://ec.europa.eu/eurostat/documents/2995521/10545471/2-08092020-AP-EN.pdf/43764613-3547-2e40-7a24-d20c30a20f64>

August 2020 – Nationwide House Price Index

Latest monthly price index, shows sharp recovery in August, up 2.0% for the month and 3.7% YTD, expects stamp duty changes to provide some near-term support to housing market in particular for London & South East. Still sees housing market activity dampening as labour market conditions worsen over coming quarters.

<https://www.nationwide.co.uk/about/house-price-index/headlines>

August 2020 – Halifax House Price Index

Latest monthly price index, shows prices up 1.6% for the month and 5.2% YTD. Expects downwards pressure on prices in the medium term, as government support measures (stamp duty / help to buy) end and labour market pressures increase.

<https://www.halifax.co.uk/media-centre/house-price-index.html>

Section 2 – Macro-Economic Prognoses, Research, and Surveys and Trackers

7 July 2020 - European Commission "EU GDP growth expected to contract by 8.3% in 2020"

Following COVID-19 and a slower recovery than expected, GDP growth prospects for the EU in 2020 have been revised downwards from -7.4% to -8.3%. The European Commission said that the EU will experience a deep recession in 2020 due to the slow release of lockdown measures.

https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1269

https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/summer-2020-economic-forecast-deeper-recession-wider-divergences_en

19 August 2020 – HMT Gathers Forecasts for the UK Economy

Each month, HM Treasury compiles independent economic forecasts. Medium term economic forecasts see recession in 2020, recovery in 2021 and return to normal through 2024. Inflation (CPI) is forecast at 0.7% for 2020, 1.5% for 2021 and 2.1% thereafter. Public sector net borrowing (PSNB) is forecast much higher than pre-COVID times, at £330bn for 2020-2021 compared £50bn from the December 2019 forecasts. Forecasts for PSNB through 2024 are three times higher than the Dec 2019 forecast.

Government debt is expected to increase markedly due to COVID-19. The combination of increased market volumes of government and corporate bonds and extraordinary policy measures may have implications for future yields, market rates, and investment portfolios. With the real losses caused by COVID-19, the fiscal support for the economy, and the monetary support for financial markets, the economy may have been temporarily rebalanced by increasing the debt portion and shrinking the equity portion.

<https://www.gov.uk/government/statistics/forecasts-for-the-uk-economy-august-2020>

September 2020 – US Congressional Budget Office, "The 2020 Long-Term Budget Outlook"

The US Congressional Budget Office regularly issues long-term budget projections, the *extended baseline projections*, that provide estimates of what federal debt, deficits, spending, and revenues are expected to be over the next 30 years, assuming current laws generally remained unchanged.

As a consequence of the economic disruption caused by the 2020 coronavirus pandemic and the federal government's response, US federal debt is projected to be higher in 2020 projections than in the 2019 projections. Debt as a percentage of GDP is projected to increase in most years as the government incurs budget deficits that are large relative to the growth of the economy. US federal budget deficits are expected to be substantially larger over the next 30 years than they were over the past 50 years. In CBO's projections, deficits rise after 2030 as mandatory spending—in particular, outlays for the major health care programs—and interest payments on federal debt grow faster than revenues. That growth in deficits causes projected debt to rise as a percentage of GDP over the 2030–2050 period.

Long term negative effects within the baseline projections may mean rising debt, with broad impacts on macroeconomic variables, interest rates, asset valuations, and potentially US creditworthiness. This may impact financial and non-financial institutions in the medium and long-term via expectations of future returns on invested capital and long-term expectations for credit, counterparty and market risks.

<https://www.cbo.gov/publication/56598>

Surveys & Trackers

11 September 2020 - NIESR's Monthly GDP Tracker Q2 & Forecast for Q3 (UK)

The National Institute of Economic and Social Research forecasts that UK GDP will recover by 15% in Q3 2020 (Q-on-Q). NIESR uses ONS (Office of National Statistics) estimates and their own macroeconomic forecasting model. NIESR points to resuming economic activity, but notes that the increase in GDP for Q3 recovers only about half of the losses from COVID in the first half of 2020. GDP losses in Q2 were due mainly to services and are expected to recover in Q3. NIESR identifies the withdrawal of government support packages as a downside risk to GDP.

Such recovery in GDP may depend on the upside with the resumption of economic activity, the relaxing of lockdown measures, and the adaptability of the workforce and on the downside with potential future lockdowns as well as supply and demand shocks from Q1 and Q2 including redundancies in the worst affected sectors (travel, hospitality, recreation).

Government support packages could have impacts on corporate profitability, bankruptcies, employment and redundancies, market valuations of corporate bonds and equities, and on pension scheme funding and covenant risk.

<https://www.niesr.ac.uk/publications/september-2020-gdp-tracker>

[https://www.niesr.ac.uk/sites/default/files/files/Monthly_GDP_%20Tracker_September2020FullDocument\(1\).pdf](https://www.niesr.ac.uk/sites/default/files/files/Monthly_GDP_%20Tracker_September2020FullDocument(1).pdf)

Other Useful Trackers

IMF Policy Tracker <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>

OECD Policy Tracker <https://www.oecd.org/coronavirus/country-policy-tracker/>

European Commission Policy Tracker “Policy measures taken against the spread and impact of the coronavirus”

Harvard Business School <https://www.hbs.edu/covid-19-business-impact/Insights/Economic-and-Financial-Impacts/Global-Policy-Tracker>

Bloomberg Recovery Tracker <https://www.bloomberg.com/graphics/recovery-tracker/>

FT Global Economic Recovery Tracker <https://www.ft.com/content/272354f2-f970-4ae4-a8ae-848c4baf8f4a>

Section 3 – Interpretations and Forecasts from Academia, Asset Managers and Beyond

Resolution Foundation – Housing Outlook Q3 2020

Article on why outlook for first time buyers may not be as positive in spite of the OBR predicting declines in house prices over next few years. Also, there is a good graph that compares the impact of previous recessions with those now predicted by the OBR for the current one.

<https://www.resolutionfoundation.org/publications/housing-outlook-q3-2020/>

11 September 2020 – The Economic Observatory's "How will coronavirus affect occupational pensions?" (UK)

Market volatility and monetary policy responses in reaction COVID-19 have raised important questions again for funding levels of occupational pension schemes and further pressure this could put on the Pension Protection Fund. The analysis looks at the effects of market losses, discount rates and inflation on pension valuations. Higher deficits can weaken sponsor covenant, which could lead to regulatory intervention, de-risking, or eventual benefit write-downs. In a time of heightened macro-economic uncertainty and emergency fiscal and monetary support measures, medium and long-term impacts and outcomes following COVID-19 remain unclear. Short-term asset performance and long-term yields may be similarly difficult to assess given the many areas of uncertainty and the many moving parts.

<https://www.coronavirusandtheeconomy.com/how-will-coronavirus-affect-occupational-pensions>

14 September 2020 – Oxford Economics revises global GDP forecasts downward

Oxford Economics has revised their forecast for global GDP growth downward through Q2 2021 due to their expectation of the need for increased social distancing measures in the future. They revised their forecast for global GDP in 2021 from 5.8% to 5.4%. The balance of risk on global GDP due to COVID-19 still weighs towards the downside.

<http://blog.oxfordeconomics.com/coronavirus/2021-gdp-forecast-down-again>

Section 4 – News, Events, and Opinion Pieces

August 2020 – EIOPA “European insurers remain exposed to high risks since the outbreak of COVID-19”

In their regularly updated risk dashboard, EIOPA sees credit risk exposures of the European Union insurance sector remaining at a high level, as the risk of credit events persist going forward. Further, in May, 2020, 60% of the outstanding BBB rated non-financial corporate debt covering EU-27 and UK instruments were downgraded to negative outlook by the credit rating agencies. EIOPA foresees further deterioration in Q3 for SCR ratios, for both life and non-life, driven by the low yield environment and the possible depreciation of assets in the future.

As a consequence of COVID-19 induced market stress and the potential for a second wave of the pandemic, the prospects of future rating downgrades, for both investment grade and high yield, as a result of projected slower global economic growth and uncertainty in future earnings could impact companies' ability to service debt. Large-scale downgrades and defaults could add further pressure to insurance sector capital ratios and profitability. Widespread credit deterioration could also induce large-scale portfolio rebalancing away from affected bonds.

<https://www.eiopa.europa.eu/tools-and-data/risk-dashboard>

September 2020 – OECD's Interim Economic Outlook “Building Confidence Amid an Uncertain Recovery”

The OECD sees “some respite and hope for the world economy in the second half of the year, as the downturn is not as severe as previously feared but downside risks and uncertainty remain

elevated.” Their latest economic report shows the world economy will contract by 4.5% in 2020, an upward revision from June's estimate of -6%.

There are three key takeaways. First, policymakers reacted swiftly and massively to buffer the 2020 recession. Next, the outlook remains extraordinarily uncertain and dependent on the virus, policies, people's behaviour and confidence. Third, policymakers can play an important role in shaping the recovery in terms of: to keep supporting the economy and not withdrawing fiscal support too early; to help people find new jobs, targeting those who most need support; and to seize the opportunity for change, focussing on long overdue investment in digitalisation and the environment.

https://read.oecd-ilibrary.org/view/?ref=136_136495-20g6l69n4a

<http://www.oecd.org/economic-outlook/september-2020/>

29 September 2020 – OECD's NAEC publishes a tour de force in *The Financial System*

Following the economic challenges seen with the onset of the COVID pandemic, the OECD's New Approaches to Economic Challenges (NAEC) initiative published a collection of 34 insightful essays written by renowned authors on three main aspects of the financial system: theory and models of the financial system, the role of the financial system, and financial policy. Authors offer deep and diverse views. Authors include the Rana Foroohar, William White, Andy Haldane, Ann Pettifor, Olivier Blanchard, Steve Keen, Adair Turner, and many more.

More than a review of economic developments since March 2020, this short book takes a step back to consider the weaknesses in economics, the economy and financial system exposed by the pandemic.

<http://www.oecd.org/publications/the-financial-system-d45f979e-en.htm>

Section 5 – Indications of a Changing Economy and Other Things of Interest

1 September 2020 - Financial Times "Future of work: how managers are harnessing employees' hidden skills"

An interesting opinion piece from the FT on emerging trends in the workplace and employment in reaction to the COVID-19 induced lockdowns. Much work—both office work and retooling industrial machinery—has needed to be done remotely, without travel but still collaboratively. Some new trends in working from home may stay around after COVID. Some think work will be done remotely as the new rule. Management approaches will need to adapt. Companies are focussing on future-proofing and rethinking the allocation of tasks with limited physical access and physical interaction.

There are downsides to remote working, as companies may be able to hire cheaper, more remote labour and the blurring of the distinction between the home office and home. Bringing new hires into the corporate culture and team may be difficult. Some companies are flattening hierarchies and looking to employees for a more flexible application of skills beyond reporting lines.

<https://www.ft.com/content/01fd6ad5-b062-4699-b098-ab81bdc8f7b2>

16 September 2020 – McKinsey "COVID-19 and the Great Reset"

Following the disruption and uncertainty of COVID-19, McKinsey identifies ten actions and trends that companies can use to emerge stronger. They include to treat returning as a muscle to be exercised, to make bold portfolio moves and rebuild for speed, to rethink entire portfolios, including where work gets done and reimagining the workforce from the top down. Companies should also consider resetting their plans for technology, rethinking their global footprint, taking the lead on climate and sustainability, thinking about the roles of government and regulation, and making purpose a part of everything.

<https://www.mckinsey.com/business-functions/risk/our-insights/covid-19-implications-for-business>

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