

# The economic impacts of COVID-19: Digest 2

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13 October 2020

Volunteers of the ICAT workstream F&I1 and the [Economics MIG](#) have joined forces to produce the following 'round-up' of activity capturing interesting news and events over the last month.

This is the second 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.

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## Section 1 – Macro-economic data, policy communications, and COVID updates

### October 2020 – Bank of England, "Financial Policy Summary and Record"

The Bank of England recently published an updated "Financial Policy Summary and Record" which provides a great perspective into the state of play of the economy and financial system in this stage of on-going recovery from COVID-19. In this report, the BoE examines risks for the financial system and assesses its resilience in many areas. The BoE notes that COVID has put strain on households and businesses and that both have sought support from the financial system. The BoE states that UK banks are strong enough to continue to support households and businesses through this crisis. Moreover, the UK banking system is resilient to a very wide range of potential economic outcomes.

The BoE identifies three main issues that disrupted markets in March 2020, which need to be examined and addressed: the mismatch between how quickly investors can sell their holdings of investment funds and how quickly the underlying assets can be sold; cash management by

financial market participants that could lead to quick sales under stress; and whether central banks should be able to lend cash to the wider financial system to maintain market functioning.

<https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/october-2020>

## 30 September 2020 – Speech by Christine Lagarde, ECB President, “The monetary policy strategy review: some preliminary considerations”

The President of the ECB discussed the ECB’s strategy review, touching on three main topics: the inflation objective, the relationship between inflation and the real economy, and monetary policy transmission and effectiveness. The President noted the lower than targeted inflation since 2008 and the related changes in the world economy and in monetary policy.

*Similar to recent decisions by the US Fed to target 2% inflation on average over a longer time period, the ECB also signalled that this may be considered in their strategy review. This may mean short periods of inflation above 2% in the EU and may change market expectations of inflation or have effects on real and nominal returns.*

<https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200930~169abb1202.en.html>

<https://www.ft.com/content/5d7d9e01-7880-4f6f-be84-cbea0b70cfb9>

## September 2020 – Nationwide House Price Index

Latest monthly UK house price index and Q3 Regional house price statistics, which show the continued recovery of house prices in September, being up 0.9% in month and 5.0% YTD with South West being the strongest growing region in the quarter. It also includes some commentary on their recent online survey which looks at people’s current attitudes to moving and the impact of COVID-19 has had on those attitudes.

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

## September 2020 – Halifax House Price Index

Latest monthly price index, shows prices up 1.6% in month and 7.3% YTD. Continues to expect significant downward pressure on prices at some point in the months ahead, as the effects of the economic recession are felt ever more keenly.

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

## September 2020 – Savills Spotlight – Revisions to mainstream residential forecasts

Revised forecasts giving 5-year house price growth to 2024 of 20.4% compared with 15.1% when last made in June. Also contains forecasts of house price growth to 2024 at a regional level and some forecasts for transactions for different types of buyer in 2020 and 2021.

[https://www.savills.co.uk/research\\_articles/229130/305695-0](https://www.savills.co.uk/research_articles/229130/305695-0)

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## Section 2 – Macro-economic prognoses, research, and surveys and trackers

### 9 October 2020 – NIESR's October 2020 GDP Tracker (UK)

The National Institute of Economic and Social Research expects recovery to stall due to heightened uncertainty caused by COVID-19. NIESR uses ONS (Office of National Statistics) estimates and their own macroeconomic forecasting model. NIESR predicts a recovery in Q4

2020 due to potential widening of lockdowns, winding down of government support schemes, and increased Brexit-related uncertainty. Their forecast for end 2020 is that GDP will be 8.5% below its end 2019 level.

*Since NIESR's GDP forecast last month, an increased perception of the downside risks of widening lockdowns and less in government support packages have meant gloomier forecasts for the rest of 2020. This 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/october-2020-gdp-tracker>

## 5 October 2020 – Bank of England, “How persistent will the impact of Covid-19 on unemployment be?”

The Bank of England's Bank Overground, which share internal analyses supporting policy decisions, published a piece on the persistence of COVID on unemployment. The BoE authors expect a material rise in unemployment for the second half of 2020. They also note that unemployment reverses slowly after crisis, taking seven years after the past two recessions (early 90s, 2008-9, see chart in link). The authors point to two explanatory factors: delayed hiring due to uncertainty in future demand for companies' products/services and that it may take longer to fill available vacancies. While government policies have supported economic activity and employment, COVID has led to greater uncertainty about the economy and the chances for finding work. This is reflected in the graph, which shows a great deal of variation in the potential forecasts for unemployment.

<https://www.bankofengland.co.uk/bank-overground/2020/how-persistent-will-the--impact-of-covid-19-on-unemployment-be>

## 10 September 2020 – European Central Bank, staff macroeconomic projections

The ECB staff projections for the Euro area macroeconomy are published each quarter. The forecasts cover GDP, exports and imports, employment, inflation, exchange rates and interest rates, the government budget and government debt. Key assumptions are that the recent resurgence of COVID cases will be handled better this time implying lower economic costs and that job losses and bankruptcies will be managed by monetary, fiscal and labour market policies which will contain adverse feedback loops between the real economy and the financial system. To allow for the heightened uncertainty caused by COVID, the ECB macroeconomic projections contain three scenarios—the baseline, a milder scenario and a more severe one. Box 3 and Chart A in the report describe the differences in assumptions and effects. The main difference is the stringency of future lockdown measures. Projections of real GDP and unemployment are sensitive to the extent of lockdown measures in the future.

*The ECB projections provide a useful starting point to consider the macroeconomic effects of the potential for a future wave of COVID cases through their presentation of the three scenarios.*

[https://www.ecb.europa.eu/pub/projections/html/ecb.projections202009\\_ecbstaff-0940bca288.en.html](https://www.ecb.europa.eu/pub/projections/html/ecb.projections202009_ecbstaff-0940bca288.en.html)

## Surveys, trackers and dashboards

### 1 October 2020 – European Systemic Risk Board's Quarterly “Risk Dashboard”

Each quarter the ESRB publishes their risk dashboard, a set of quantitative and qualitative indicators of systemic risk in the EU financial system. This is the third dashboard during the COVID crisis (April, June, October). The ESRB risk dashboard is a regularly updated set of fixed indicators which spans eight chapters, including interlinkages and composite measures, macro risks, credit risk, funding and liquidity, market risks, profitability and solvency (of EU banks and insurers), structural risk, and risks related to central counterparties.

It is valuable to compare the indicators (mainly graphical) from this update to a year ago, pre COVID. Figure 2.1 provides an overview of real GDP and forecasts by country and figure 2.4 provides figures and forecasts for unemployment.

<https://www.esrb.europa.eu/pub/rd/html/index.en.html>

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

ESRB COVID Policy

Tracker <https://www.esrb.europa.eu/home/search/coronavirus/html/index.en.html>

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>

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## Section 3 – Interpretations and forecasts from academia, asset managers and beyond

21 September 2020 – Resolution Foundation’s

“Macroeconomic Policy Outlook Q3 2020” focussing on the Labour Market and Forecasted Unemployment

The Resolution Foundation, a think-tank focused on improving the living standards of those on low-to-middle incomes, publishes their Macroeconomic Policy Outlook for Q3 2020. It focuses on macroeconomic drivers of labour market and what the data tells about future outlook on unemployment, for which the Bank of England and OBR (Office for Budget Responsibility) have very different forecasts for the fourth quarter of this year, 7.5% and 11.9% respectively. The article also has interesting graphs on productivity forecast, improvements in mobility and forecast for rise in unemployment through 2023.

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

28 September 2020 – FT article “Coronavirus threatens Europe’s pension industry”

The adverse effects of COVID-19 to the economy have a significant impact on the pension systems across Europe. This impact comes from a rise in unemployment which leads to a reduction in the funds raised from the Governments through taxes as well as a reduction in the

overall contributions from the members and sponsors of the occupational pension schemes. Additionally, the presence of increased volatility in the markets affects the value of the assets held from the occupational pension schemes which now offer lower returns than previously expected.

*These events set obstacles for every pension system and may push individuals and sponsors to consider the option of early retirement, which may mean that pensioners will have insufficient funds in the long term. Low, falling and stable lower rates and expected yields put pressure on guaranteed returns, and on the future earning power of funds (re)invested today, and on liability valuations depending on supervisory regime.*

<https://www.ft.com/content/386ff141-b1f8-40e2-9621-f6be41546094>

## 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>

## 29 September 2020 – VoxEU “Forecasting the COVID-19 recession and recovery: Lessons from the financial crisis”

VoxEU is a policy portal set up by CEPR (Centre for Economic Policy Research) where research-based policy analysis and commentary are published. This latest column analyses various models for nowcasting and short-term forecasting of economic conditions and potential recovery paths from the COVID-19 crisis by evaluating and adapting the models used in the 2007-2009 financial crisis.

The article explains that although the 2007-2009 financial crisis and Covid-19 crisis have been triggered by different shocks, by understanding the similarities and differences in economic conditions, sentiments and reaction of monetary authorities in these two crises, one can build the forecast adjustments for the current pandemic crisis based on 2007-2009 financial crisis. The resulting recession forecast with and without such adjustments are shown in graphical format for comparison and interpretation.

*The GDP gap seen after the 2007-2009 financial crisis appears again in the authors’ COVID-induced forecasts. With increased debt levels following 2007-2009 and exacerbated by COVID, the GDP gap may make it more difficult for households, companies and countries to service debt. Low and lower rates may make debt service affordable, but increased debt levels increase the exposure of the overall economy to a rise in rates or to further economic shocks. For life insurance and pensions savings, lower for longer causes trouble via reinvestment while the alternative, a return to higher rates, might now bring unwelcome and widespread defaults.*

<https://voxeu.org/article/forecasting-covid-19-recession-and-recovery>

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## Section 4 – News, events, and opinion pieces

### 1 October 2020 – IMF blog “Reform of the International Debt Architecture is Urgently Needed”

The COVID-19 pandemic has pushed debt levels to new heights. Compared to end-2019, average 2021 debt ratios are projected to rise by 20 percent of GDP in advanced economies, 10 percent of GDP in emerging market economies, and about 7 percent in low-income countries. These increases come on top of debt levels that were already historically high. While many advanced economies still have the capacity to borrow, emerging markets and low-income countries may face much tighter limits on their ability to carry additional debt. The IMF accompanying report also identifies gaps in the current architecture for restructurings and provides options to strengthen the resolution toolkit for the future.

*Calls to reform the international debt architecture are not new. In March 1989, the then U.S. Treasury Secretary Nicholas Brady proposed a new approach to resolving developing country debt and restoring the creditworthiness of restructuring countries, the plan was dubbed the "Brady Plan", and resulted partially in the "Brady Bonds", which were restructured bank loans. The plan provided debt relief to troubled countries and, opened access to further international financing. Debt restructuring has a direct effect on the credit and sovereign risk of insurance and banks portfolios who have exposure to those assets, impacting their risk profiles and regulatory & economic capital requirements.*

<https://blogs.imf.org/2020/10/01/reform-of-the-international-debt-architecture-is-urgently-needed/>  
<https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/09/30/The-International-Architecture-for-Resolving-Sovereign-Debt-Involving-Private-Sector-49796>

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## Section 5 – Indications of a changing economy and other things of interest

### 2 October 2020 – ECB publishes “Report on a digital euro”

The ECB published a report on a “digital euro”, examining the issuance of a central bank digital currency. The report discusses reasons to issue a digital euro, its potential effects, requirements and legal considerations, and design and technical aspects. The ECB identifies the potential for risks and benefits, including monetary policy, financial stability, and effects on commercial banks’ deposit base and on risk-free rates.

*This is an interesting report and an interesting space to watch in the evolving financial system. Precisely what it means for actuaries and our stakeholders is unclear, and we defer to another IFoA working party, [A Cashless Society](#).*

<https://www.ecb.europa.eu/euro/html/digitaleuro.en.html>

*Special thanks to Lawrence Hababbeh, the ICAT F&I1 volunteers and the [Economics MIG](#).*

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## Previous editions

[30 September 2020](#)