

The beginning of the pandemic's end?

We are increasingly confident in our constructive base case for the world economy in 2021 and beyond, but plenty of question marks remain.

- _ Learning to cope with the virus was always likely to be an uneven process, but there are signs of progress.
- _ So far, there are few signs of permanent economic scarring one might expect from such a sharp contraction.
- _ The economic rebound of recent months hints at a bright future ahead, once lockdown measures are fully lifted.

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We are increasingly confident in our constructive base case for the world economy in 2021 and beyond. In part, that reflects recent economic data. Around the world, the economic recovery after the collapse in spring has been quite impressive. This shows a few things, notably that at least so far, there are few signs of permanent economic scarring one might expect from such a sharp contraction. It is becoming increasingly clear that there are now several ways of how daily life might return to something close to the pre-pandemic normal. These paths are no longer just potentially feasible but also increasingly visible. That is more than could have been said with much confidence three months ago.

Based on the experience of coronaviruses causing the common cold, getting quickly towards first-generation vaccines that might work was not a given.¹ Given the vast resources deployed we hoped for as much, and had already included some relief over the course of 2021 into our forecasts. Set against this are the renewed, if somewhat more targeted, lockdown measures during the winter months in most of the Northern Hemisphere. Learning to cope with the virus was always likely to be an uneven process, but there are signs of progress. Alternative, quicker testing solutions have become

available. Trends for therapeutics appear encouraging. As with vaccines, there is, of course, still the potential for plenty of setbacks, not least in terms of how quickly policymakers will prove able to use them well.

Policymaking is one of the reasons why many question marks remain. With the U.S. elections finally behind us, the likely outcome of a Biden administration with a Republican Senate has not significantly changed our forecasts. While there is a risk of fiscal-policy paralysis, the downside risk to economic forecasts is partly offset by the evidence so far that the U.S. economy has proved flexible enough to bounce back even as infection rates continued to rise. The picture is murkier in Europe. Still, the two-stage recovery we forecast this spring has, if anything, underestimated the initial strength of economic momentum somewhat. From now onward, we have penciled in a softening of momentum. We expect many of the measures to contain the virus to remain for months, not weeks. That said, we do not expect a broad third or fourth wave of nationwide lockdowns. We believe this strengthens the prospects of a year 2021 with above-potential growth, and even growth in 2022 could be decent. In our view, inflation should not be an issue of 2020 nor 2021.

¹ <https://www.nature.com/articles/d41586-020-02400-7>

With gloomy headlines on the rise again now, all this might sound a bit too good to be true, by the time you read this. We would certainly not wish to downplay the role of sentiment effects, merely suggest that in another three months, the headlines and the sentiment might already be very different. In his book "Narrative Economics," the economist Robert Shiller describes how perceptions and the stories we tell each other can drive economic events.² Some of his most striking and timely examples concern "the 1918 flu pandemic, often called the Spanish flu, [which] cost more lives than World War I" (p.108). Prior to Covid-19, the period from 1920 to 1921 was "the sharpest depression (meaning the fastest decline and recovery) in U.S. history since the advent of modern statistics," Shiller writes (p. 242). In marked contrast to perceptions of the Great Depression a decade later, this "Forgotten Depression" was swiftly followed by a sharp recovery, starting in 1921. It was seen as "a transitional phase back to normalcy after a war and an influenza epidemic," Shiller concludes (p. 252).

What to make of any such historic analogy? Clearly, not too much at the outset of a once-in-100-years crisis. As far as the U.S. is concerned, that "Forgotten Depression" of 1920 constituted a sample size of one – not enough, as any first-year undergraduate of statistics will know, to draw meaningful inferences from. The picture becomes quite bleak, once the experience of other industrialized countries during the 1920s is considered alongside the economic boom in the U.S. (where it soon came known as "The Roaring 20s," as chronicled by F. Scott Fitzgerald in "The Great Gatsby").

Clearly, a lot has changed since then but not, perhaps, the capacity of economic commentators to be led astray by the most recent data or the moment's most compelling narrative. The economic rebound of recent months hints at a bright

future ahead, once lockdown measures are fully lifted – "a transitional phase back to normalcy," to use Shiller's wording. Still, we would warn readers not to place too much reliance on any particular bit of news, whether it appears positive or negative. It is far too early to say whether any of the first generation of vaccines will offer sterilizing immunity – that is prevent those vaccinated not just from getting sick but also from spreading the virus.³ Worse still, as Nassim Taleb pointed out 15 years ago, investors are not the only ones to be frequently "Fooled by Randomness."⁴ When it comes to complicated scientific matters such as late-stage clinical trials, journalists and especially their headline writers may sometimes make pretty elementary mistakes. A perennial favorite is to confuse the absence of evidence with the evidence of absence.

Early results of the first large-scale vaccine trials were widely touted with eye-catching headlines. However, these were interim and partial results, released via press release. The data had been collected a mere seven days after the second dose was administered. It revealed 94 symptomatic cases, of which 86 appear to have been in the group that had been given the placebo instead of the vaccine.⁵ The next release suggested that effectiveness might be even higher than initially thought, as did data from a competing vaccine also under development.⁶ Rather than focusing on the specific percentages and small changes in how high effectiveness seem in any particular cohort, this should serve as a reminder of the role randomness necessarily plays in such trials. Pharmaceutical companies structure their trials so as to extract as much information as possible from early data. Still, we believe it will take quite a bit of time, and a lot more data, to see whether any one particular vaccine will prove both safe and "highly effective." Let alone mark a decisive turning point in the fight against Covid-19.⁷

² Shiller, R. (2019) "Narrative Economics: How Stories Go Viral and Drive Major Economic," Princeton University Press

³ <https://www.statnews.com/2020/08/25/four-scenarios-on-how-we-might-develop-immunity-to-covid-19/>

⁴ Nassim Nicholas Taleb (2004), "Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets," 2nd edition, Thomson Texere.

⁵ <https://www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-announce-vaccine-candidate-against>

⁶ <https://www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-conclude-phase-3-study-covid-19-vaccine> and <https://investors.modernatx.com/news-releases/news-release-details/modernas-covid-19-vaccine-candidate-meets-its-primary-efficacy>

⁷ See, for example, the overview of recent vaccine developments in:

<https://www.economist.com/briefing/2020/11/14/an-effective-covid-19-vaccine-is-a-turning-point-in-the-pandemic>

GLOSSARY

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

The **Great Depression** was the deepest and longest-lasting economic downturn in the history of the Western industrialized world.

The **Republican Party (Republicans)**, also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

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