THE COVID-19 RECESSION: THIS TIME IS REALLY DIFFERENT

Across time and countries, financial crises and, more broadly, recessions and recoveries, have had much in common. Recessions predominantly impact the demand side whereas the influence on the supply side is more limited. This time is different. The pandemic-induced recession will have a longer lasting influence on the allocation of household expenditures, if not on the level of spending. More than a normal recession, it will also have major repercussions on the supply side, through changes in global value chains, working from home or the disruption of the economics of businesses which are confronted with a forced capacity reduction on social distancing grounds.

Back in 2009, when the world was trying to escape from the Great Recession, Carmen Reinhart and Kenneth Rogoff published a book which turned into a bestseller: *"This time is different – Eight centuries of financial folly"*. Its title was misleading because, as the authors explain in the preface, *"Our basic message is simple: we have been here before."*

Indeed, across time and countries, financial crises and, more broadly, recessions and recoveries, have much in common. Chart 1 provides a simplified representation of the 2008-2009 recession. Years of rising leverage had created a bubble in several property markets, which eventually burst. This caused a shock to demand but also to market-based financing as well as bank wholesale funding. A major financial crisis and a severe recession followed. Chart 2 represents the current recession. Its origin is exogenous and non-economic but the consequences for the economy are profound. The lockdown causes shocks to demand and supply and impacts severely balance sheets of households, companies, central banks and the public sector. This has led to a recession which is different from anything seen before in recent history.

In a normal recession, behavioural relationships –i.e. how demand reacts to interest rates, income, fiscal policy– tend to be rather stable. This impression that history repeats itself helps in producing forecasts. The impact on the supply side is rather limited and essentially works via the influence of subdued corporate investment on the capital stock, productivity and potential GDP growth. Post the pandemic, we can no longer assume that economic life will go back to how it was before.

This structural change complicates the task of forecasting. On the demand side, health risk has become a key factor and it is likely to remain so until a vaccine has been found and mass vaccination is possible. It influences how people shop and travel. Time will tell whether it will cause a substitution effect –less exotic travel, fewer visits to restaurants versus more expensive bikes to avoid public transports– or will lead to an increase in the savings rate, which would act as a drag on growth. Even more important and far reaching are the changes to the supply side. Long and complex global value chains may very well be revisited so as to make them shorter, simpler and more resilient. However, such nearshoring could also make them more expensive, which would force companies to invest in process innovation or to cut costs in other areas such as premises, if due to competition, they are not in a position to hike prices.

In this respect, the experience of successfully working from home has been an eye opener for many: it is cheaper for the employer, who needs less office space, the employee saves money by having to commute less often and there is an efficiency gain because the time otherwise spent in public transports or traffic jams can be used more productively. In addition, the environmental footprint also declines. Needless to say that in the medium run this will weigh on the demand for office space.

Another consequence of the pandemic is the deterioration in the economics of businesses such as restaurants which are temporarily confronted with a forced capacity reduction on social distancing grounds. Given that they are very labour intensive, the repercussions go well beyond the companies directly involved. This overview is clearly not exhaustive, but it does show that the pandemic-induced recession will have longer lasting consequences, in particular via changes in the supply side. This time is really different.

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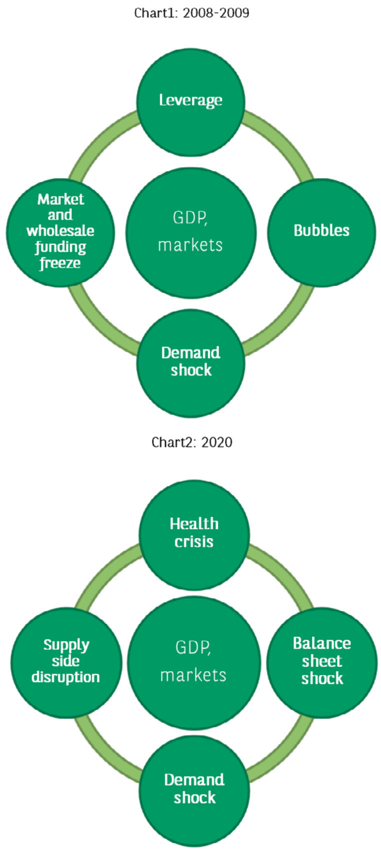
2008-2009 RECESSION VERSUS 2020 RECESSION



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