

WHAT IF THE ROAD TO COVID-19 IMMUNITY IS LONGER THAN EXPECTED?

The prospect of the deployment of a Covid-19 vaccine has raised expectations that the stop-start cycle seen this year will make way for a lasting economic recovery in 2021. There is concern however that bringing the pandemic under control could take more time than is currently assumed in economic projections. Under such a scenario, worries about possible new restrictions would remain elevated, although one can assume that, because of vaccination, these measures would be less strict than before and more local. Nevertheless, in the more exposed sectors, investment and employment could be clear victims.

The prospect of the deployment of a Covid-19 vaccine has raised expectations that the stop-start cycle seen this year will make way for a lasting economic recovery in 2021. A key factor in this respect is the decline in uncertainty: vaccination reduces the risk of new infection waves and the ensuing hit to the economy.

Covid-19 should cease to be a key factor in decisions taken by households and businesses when herd immunity - whereby enough people have immune protection so that sustained transmission is no longer possible¹ - is reached. The time to get there depends, amongst other things, on the speed and scope of the vaccination, the number of people accepting to be vaccinated, logistical factors, the longer-term effectiveness, etc. It raises concern that progress could be slower than is currently assumed in economic forecasts. Under such a scenario, worries about possible new restrictions triggered by another increase in infections would remain elevated. The extent to which economic agents would incorporate this uncertainty in their spending decisions depends on three factors.

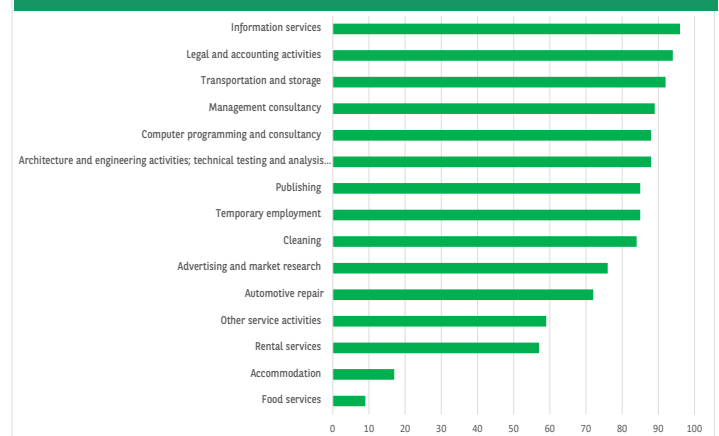
Firstly, the time horizon of the decision. Whereas day-to-day purchases by households should hardly be impacted, big ticket items such as cars could suffer from an increase in precautionary savings. Recurring bouts of Covid-19-related uncertainty should have a more severe impact on household investments (residential construction) and corporate investments. They represent a long-horizon commitment of financial resources and hence require sufficient confidence over the longer term. Secondly, the irreversibility of the decision. For households and businesses, stopping an investment project before it has been finalised comes at great cost. This means that, de facto, the decision to invest, once taken, is very difficult to revert. This weighs on the willingness to invest when uncertainty is high. The final factor is the value of waiting. Postponing an investment project until uncertainty has dropped to a sufficiently low level creates value. It avoids being hit by bad outcomes because the drop in uncertainty reduces the likelihood of such outcomes.

In analysing Covid-19-related uncertainty, the value of waiting increases with the potential production shortfall caused by restrictive measures. The value of waiting and hence the tendency to postpone will also be higher when investments are irreversible and when the commitment horizon is long.

Should reaching a state of herd immunity take more time, the introduction of temporary restrictions may be necessary, depending on how new infections evolve. One can assume that, because of vaccination, these measures would be less strict than before and more local. This would imply that the economic impact, at the aggregate and sector level, would be more limited than in the second wave (see chart). Nevertheless, in the more exposed sectors, investment -an irreversible long-horizon commitment of financial resources- and employment could be clear victims.

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FRANCE: EXPECTED LEVEL OF ACTIVITY IN MARKET SERVICES IN NOVEMBER 2020 (IN % OF NORMAL)



SOURCE: BASED ON BANQUE DE FRANCE, UPDATE ON BUSINESS CONDITIONS IN FRANCE, OCT. 2020

1. Source: McKinsey, *Covid-19: Briefing materials*, 30 October 2020.



Should vaccination take more time than expected in reducing health risk, the economic impact would be felt in investment and employment in those sectors which are most exposed to restrictions.

