INDIA

How COVID-19 has unleashed uncertainties unseen before and yet all’s not lost

Successful strategic management of uncertainties has shaped domestic and global policies, setting many economies on faster recovery and sustained growth paths

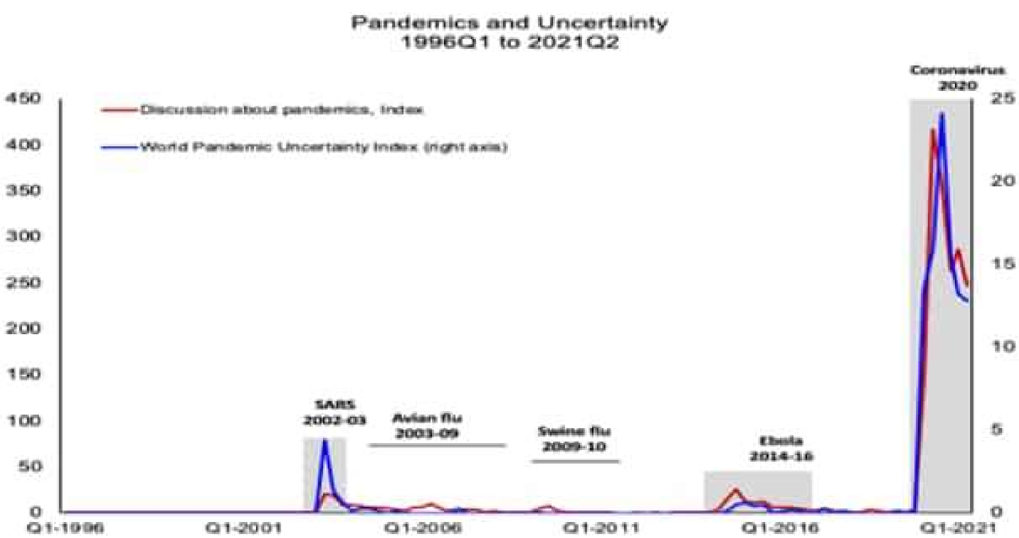
Namrata Nair | November 09, 2021 11:51:10 IST

Over 30 lakh migrant workers have returned to Uttar Pradesh during lockdown. AP

Proponents of informed policymaking rest their assumptions on specific economic certainties. These certainties could be historically determined or based on projections. In either case, it rests on information that can be analysed and predicted with a certain level of accuracy.

Economic certainties translate into an effective assessment of country-specific challenges and measurement of its progress. While most policy formulation is based on some form of expected outcomes, it does account for a level of uncertainty. However, unforeseen events that produce high levels of uncertainties distort existing policy frameworks and leave economies worse off. The extraordinary scale of the COVID-19 pandemic and consequent shocks induced rendered all existing policies defenceless. The evidence in Figure 1 suggests that novel coronavirus has created the highest uncertainties compared to other pandemics.

Figure 1: Quarterly World Pandemic Uncertainty Index



Source: Economic Intelligence Unit. The World Pandemic Uncertainty Index (WPUI) is computed by the number of times "uncertainty" is mentioned near a word related to pandemics or epidemics in the Economist Intelligence Unit (EIU) country reports. A higher number means higher uncertainty and vice versa.

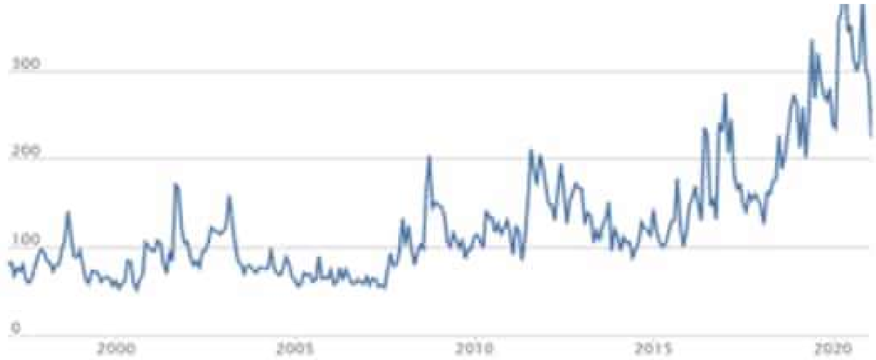
The uncertainties amplified the impact of the negative shock, reduced impacts of stimulus policy and slowed the rate of economic recovery.

Measuring uncertainties

The negative impact of uncertainties on economic outcomes is widely recorded in the empirical literature. The IMF estimates that one standard deviation increase in uncertainty is associated with a 0.3-1.4 percentage point decrease in output growth. Documented evidence suggests high policy uncertainties during the two economic slowdowns — the Great Depression (1929) and the Financial Crisis (2008).

However, the challenges following the coronavirus pandemic are more complex and more global in scope. It has more profound impacts than any other crisis that policymakers have experienced or anticipated due to no reference case for the same. The Economic Policy Uncertainty (EPU) Index, an index constructed based on newspaper articles containing terms uncertainty and uncertain policy, captures the state of economic uncertainty in economies. *Figure 2* traces the EPU Index over three decades confirming the unprecedented and unanticipated uncertainties associated with the pandemic.

Figure 2: Monthly Global Economic Policy Uncertainty Index



Source: Baker S Bloom N and Davis S Economic Policy Uncertainty Index

High future uncertainties reduced growth prospects and the world GDP contracted approximately 3.5 percent in 2020. It becomes imperative to look at the differential impact of uncertainties on the four components of GDP — consumers, firms, government and the global economy.

The option theory can be used to understand the differential impact of the pandemic induced uncertainties on the four components. The option theory suggests that there is value in waiting to have uncertainties resolved. High uncertainties concerning employment prospects and incomes, reduced consumer demand and deferred spending.

For firms, uncertainties meant lower investments and risk-taking at present. Firms delayed projects and hiring plans as uncertainties raised the cost of borrowing and declined expected returns. Governments experienced a large decline in revenues and increased spending to combat the health and fiscal crisis. The high interdependence of nations meant that uncertainties also reduced global economic activity. Conflicting policy messages of countries and mitigation strategies raised global trade tensions. Most economic policies address underlying economic conditions. However, in the wake of the pandemic, new challenges mandated new design and policy implementation strategies.

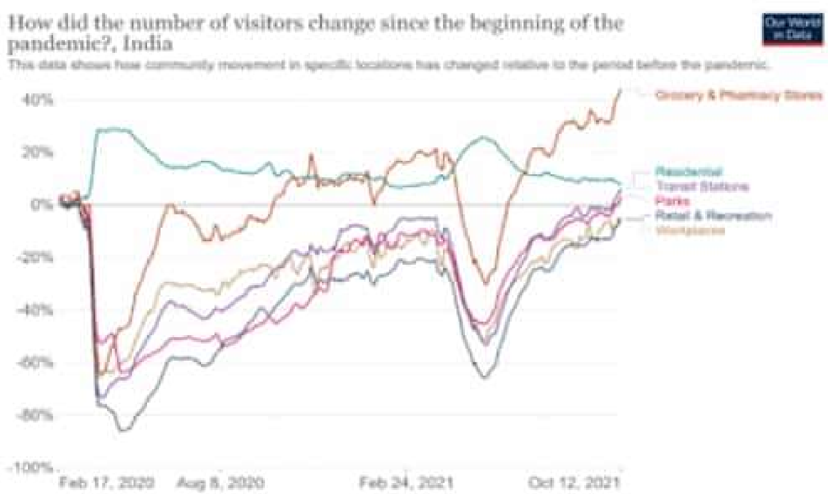
Tracking outcomes

How damaging is economic uncertainty? While empirical studies have estimated the impact of uncertainties on economic growth during the great depression of the 1930s and 2008 recession, the unexpected consequences of the pandemic require novel metrics. High uncertainties during the pandemic warranted lockdowns which reduced human movement. School closures, work from home, cancellation of gatherings and absence of public transport had large negative consequences on growth. Thus, uncertainties affected economic activity through the indirect channel of lockdowns.

Insights from the data that Google presents in its COVID-19 Community Mobility Report help understand how the movement of people has been affected due to the pandemic. It is a useful ballpark to understand how uncertainties have altered the behaviour of people during the peak and fall of spread of coronavirus .

It tracks the pattern of visits to several public places over the course of the pandemic. Mobility trends for India in *Figure 3* reveal maximum restrictions to combat uncertainties in the peak of the first and second wave of COVID-19 with a gradual but differentiated resumption in movement post the second wave.

Figure 3: Google COVID-19 Mobility Trends for India



Source: Our World in Data

High-frequency data-driven indicators such as the Nomura India Business Resumption Index (Nibri) have tracked the impact of Covid-induced uncertainties on the economic performance of India. Nibri value crossed the pre-pandemic threshold of 100 in August 2021, signposting the V-shaped recovery and waning effects of the second wave. It crashed to an all-time low during the peak of the first wave to 44 but stabilised to 99.3 prior to the second wave. It recorded a fall, less steep than the first wave over March 2021, and noted a quick recovery.

COVID-19 uncertainties have created space for new indicators and metrics which have proved useful to gauge consumer trends, investor sentiments and policy decisions.

Nibri score, based on labour force participation, power demand and mobility indicators, has been instrumental in understanding the performance of the Indian economy. Thus, identifying areas of uncertainties, quantifying them, and allowing the policy to flow from it are of utmost importance. In this period of unprecedented change, uncertainties can no longer be viewed as having solely damaging effects. It has raised questions of growth sustainability and technology used to predict and mitigate challenges on an ongoing basis.

Successful strategic management of uncertainties has shaped domestic and global policies, setting many economies on faster recovery and sustained growth paths. Most economies have experienced positive growth revisions than predicted. Countries have also witnessed policy objective shifts to improve the ability of societies to face future challenges.

The pandemic has toppled misunderstandings of uncertainty and created a potential for the development of a multitude of digital tools to accurately quantify and predict trends. Alleviating economic challenges collectively has provided the greatest chance of global coordination and cooperation enabling a robust recovery.

The writer is a Research Associate at the Insolvency and Bankruptcy Board of India (IBBI). Views expressed are personal.

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