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The Great Economic Shutdown: a quarter of the cake gone

Key takeaways

- Shutdown measures in major advanced economies lower overall economic activity by around one quarter, the biggest hit coming in the services sector.
- Every week of shutdown costs about 0.5% of annual GDP.
- Emerging markets are more vulnerable, with a 22-29% loss in output.
- Despite a large services sector, the US is less vulnerable due to a large share of the public sector.
- Sectors to suffer the most are hospitality, wholesale and retail trade, air travel, and other consumer facing services.
- The extent of overall output losses will depend on length and severity of shutdowns, sectoral compositions of economies, and policy measures.

In a nutshell

We estimate the shutdown measures in place today on account of the Covid-19 outbreak are leading to a 20-25% reduction in economic activity in most advanced markets. The different sector compositions of countries will be a main factor in determining the size of the impact. Emerging markets are likely impacted more given their larger (in relative terms) consumer-facing sectors. Meanwhile, large public services and manufacturing sectors will contribute to stronger resilience in some other economies.

This current crisis is different from a typical economic downturn as the services sector, which is usually more stable, has been hit harder than manufacturing. This is because the containment measures to combat the Covid-19 pandemic have disproportionately restricted services, with largest output losses seen in hospitality, wholesale and retail trade, air travel, and other consumer facing areas. A few sectors such as online sales and telecommunications will benefit from the lockdown measures and contribute to the resilience of economies. And the public services sector is likely to benefit most from higher government spending on health and administration.

The length and severity of shutdown measures vary across countries and are important determinants of the output loss. The stringency index developed by Oxford University (see Figure 1) tracks the evolution of the measures' severity. The index tracks 7 indicators of public response including, eg, school and workplace closures. Italy and Spain are among the countries with the most stringent measures in place, whereas in Sweden the measures have been least drastic. Based on Italy's sectoral composition and the severity of the measures imposed, we estimate a hit to output of about one third due to a ban of all "non-essential" economic activities until very recently. Meanwhile as of today, the hit to Sweden's economy is likely to be less than half that of Italy. However, the more stringent measures in Italy (and elsewhere) may also result in shorter lockdowns, which may lessen longer-running economic damage.

Output losses will also depend on the sectoral composition of different economies. Looking at the world's 20 largest economies, we observe that emerging markets are particularly vulnerable in the current crisis. They tend to have relatively larger retail and wholesale sectors than advanced economies, and much smaller public service sectors. Among advanced economies, Spain stands out as an exception given its large hospitality sector (6.9% of gross value added), compared to 1-3% in others. Meanwhile, Germany has a large manufacturing footprint – a sector that is less affected by the shutdown in most countries with the exception of Italy, where all non-essential manufacturing has been shut.

To isolate the effect of different sectoral compositions from the stringency of the measures, we look at a stylized scenario, assuming that the measures

About Economic Insights
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taken are the same across G20 countries.[1] For example, we assume that hospitality and air transport operate at only 10% of normal capacity, retail and wholesale activity declines by 60%, construction runs at just above half its capacity, and manufacturing takes a 20% hit. On the positive side, activity in telecommunications and public services increases by 20%. The results show that in the stylized shutdown, on average economic activity in emerging markets declines by 22-29%, with Turkey hardest hit (-29%). For the advanced economies, the decline ranges from19% to 25%, with the US suffering least among the 20 largest economies (-19%). A 25% GDP shortfall is equivalent to a weekly output loss of around 0.5% of annual GDP.

While our estimation illustrates sectoral vulnerabilities to shutdown measures, the eventual economic impact will also depend on other factors including fiscal and monetary policy reactions. For instance, compared to emerging markets, most advanced economies have relatively generous unemployment schemes, which will protect a part of employees' incomes and therefore consumption. Also, many central banks reacted quickly by cutting policy rates and actioning liquidity and lending schemes, which will enable suffering companies to continue operating. Other central banks had less capacity to do so. We will look at the role of public policy response in an upcoming Economic Insights publication.

Figure 1 Stringency Index (0-100), consisting of 13 indicators of government response

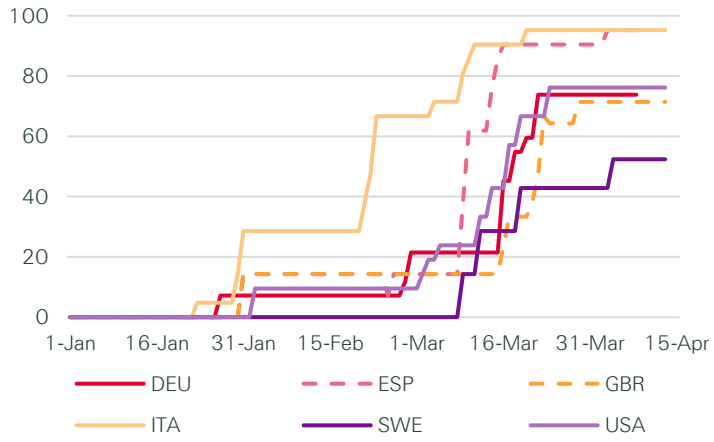
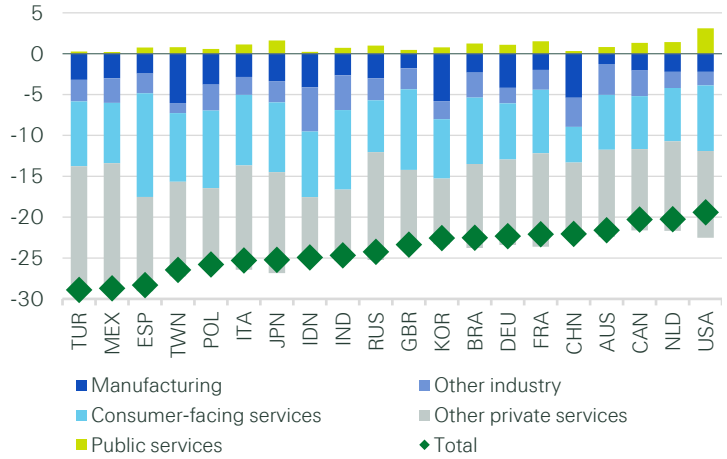


Figure 2 Direct impact on real GDP (%) of Covid-19 related shutdowns in 20 major economies, assuming the measures are the same across all countries



Sources: Oxford COVID-19 Government Response Tracker; Capital Economics, Swiss Re Institute

1 We consider these assumptions as broadly reasonable on average. However, the resulting impacts for individual countries will be imprecise as the variability in the measure stringency is ignored.