Nobel Perspectives: on a post COVID-19 world

Sir Christopher Pissarides

As part of the UBS Nobel Perspectives program we are pleased to bring you a webinar series that allows you to ask your questions directly to Nobel Laureates in Economic Sciences.

UBS Nobel Perspectives addresses the questions shaping our world, cutting through the noise and nonsense, and holds the largest content library of Nobel Laureate interviews.

Sir Christopher Pissarides, Nobel Laureate and labor market economist was awarded the prize in 2010 for his work on the economics of unemployment, including job flows and the effects of being out of work. Prior to that, in 2005, he became the first European economist to win the IZA Prize in Labor Economics. He joined Evan Brown, Head of Multi-Asset Strategy in a webinar to discuss in detail the implications of the pandemic and what it means for investors.

Key webinar takeaways

- Given the nature of this recession, a V- or W- shaped recovery is more likely than a U-shaped one
- Government subsidy programmes would support the economy by retraining workers displaced by technology or low growth industries
- Further fiscal stimulus is required by governments to minimize job losses and support economies
- Some industries will take longer than others to recover post COVID-19 such as personal services, the hospitality sector and the broader services sector
- COVID-19 has accelerated the deglobalization trend as supply chains are brought back to domestic markets
- Opportunities still exist in the medical sector, land ownership and online education sectors

Evan Brown, Head of Multi-Asset Strategy, UBS Asset Management

With much of Pissarides' research focusing on the dynamics of unemployment amid changes in the economic environment, this webinar was a prime opportunity to tap into the mind of one of the world’s greatest thinkers amid such uncertain times.

Sir Christopher Pissarides transformed how the field of economics looks at unemployment, bringing it beyond pure supply and demand to incorporate how employers and employees search for, and find each other.

We are now sadly living in a world of historically high unemployment due to COVID-19 and related lockdowns. Millions across the globe have lost their jobs and unemployment rates in some countries are at the highest since the Great Depression.

> "This time around we are seeing the typically less cyclical, service sectors leading the downturn."
>
> Evan Brown

Q&A

The world in the grasp of COVID-19

What are your thoughts on the road ahead in getting people back to work and healing the global economy?

It is a difficult road ahead over a long-term horizon but this is not like previous recessions, which destroyed some of the capital stock or like the Great Financial Crisis in 2008/2009. For example when a vaccine is found, there is no reason why we shouldn't be able to recover from this much quicker than previous crises.

What kind of recovery shape will we see, in your opinion?

If we start seeing the opening up of economies it could be a W-shaped recovery, where we come out of the lockdown and the economy starts growing and then the virus comes back, and we see a double dip. I don’t see a U-shaped recovery, staying at the bottom of the curve for a long time and then going up if you look at the current infection rate levels. Lockdowns in Europe especially were successful. Governments will want to relax lockdown restrictions soon to support the economy but in my opinion this is too soon. I therefore believe it will be a V or W shape recovery curve, depending on the trajectory of the virus. It is unlikely that after opening-up the economy will crawl along the bottom for long.

The COVID-19 crisis is a service-sector driven recession, less cyclical sectors are driving the downturn – does this mean it’s easier to restore pre-crisis level economic activity?

Yes, it will be easier as it is not a capital stock issue like in previous crises. In a cyclical-driven recession for example when demand falls in industries such as manufacturing and machines are no longer in use, when demand returns years later, those machines are no longer serviceable and require investment. We are looking at much shorter durations in this crisis, travel and tourism sectors will bounce back more quickly than manufacturing or housing sectors could have in the past as there is no capital stock or business investment needed to resume business. If a vaccine is introduced and demand returns, activity can resume immediately for airlines and hotels.

Response from policymakers

The pandemic has catalyzed policymakers into action, particularly from western governments. In your opinion, have governments done enough and what does the optimal policy response look like to you?

Focusing on developed economies, it was necessary to provide ample support. For example the furlough system in the UK worked very well in keeping the labor market operational and prevented many layoffs. It is very important that governments continue that support, indeed the UK will extend its furlough scheme to October to support workers and protect millions of jobs.

In Europe, the policymakers reacted very well flooding the economy with liquidity through its monetary policy actions which prevented many bankruptcies.

In contrast, the US from what I can tell, has not provided enough support. Supporting companies directly and not via employment resulted in a higher unemployment rate that could have been prevented.

Do you therefore think that the UK and Europe will recover from the crisis faster than the US?
In previous crises the US has exited a recession more quickly than Europe because it is more flexible and has lower administrative burdens. Post COVID-19, Europe will recover faster relative to its past performance so it could even exit at either before or at the same time as the US this time around.

The unveiling of the next normal

What would you like to see more of from policymakers to restore unemployment back to previous levels?

Firstly, It would be better for everyone if there was greater transparency on the plan to exit the lockdown. We need a plan even if it's a conditional plan and the avoidance of vague guidance. Secondly I would like to see more collaboration and coordination between governments in the European Union. We should learn from other countries. Lastly, we would need a road map to be aware of how governments intend to manage the debt burden brought about by the economic downturn of the crisis. In my view, they shouldn't rush to introduce austerity measures and would wait for the economic recovery to properly take effect.

We are going to see an explosion in debt-to-GDP levels. How concerned are you about the expansion of debt and the impact on future growth and inflation?
As long as interest rates remain low I am not overly concerned. I believe the best response is through expansionary monetary policy and not through restrictive fiscal policy and raising taxes. Interest rates should remain at zero and along with liquidity entering the markets inflation targets should be relaxed. If inflation reaches 3%, let it remain at that level until the economy recovers.

If you are going to use fiscal policy then use it to improve infrastructure, public investment, rescue large companies such as major airlines, transport systems and not to cover the debt levels.

"As long as interest rates remain low, I am not overly concerned about high debt-to-GDP levels. I believe the best response is through expansionary monetary policy and not through restrictive fiscal policy and raising taxes"

Sir Christopher Pissarides

We currently have a deflationary shock, however there is so much monetary and fiscal stimulus in the financial system, is the stage now set for a rapid rise in inflation?
I never worry about inflation and I expect it to be fairly benign. If it goes up to 4% for a short period of time to deal with high debt levels and increasing demand until the central bank starts to withdraw liquidity from the economy, then that is not a reason to panic. The economy needs some inflation to revive quickly.

The path of long term trends

If you painted a picture of a post COVID-19 world, what would it look like?
A long-term trend we have been observing pre-crisis is technological change through automation and artificial intelligence in manufacturing and some professional services sectors. Those working in these sectors will earn higher incomes and have more free time to spend on consumption in sectors which include creative services industries, personal services and hospitality sectors.

After COVID-19, those service sectors were the worst affected by the crisis and even if we find a vaccine, they will take the longest to recover. In contrast, healthcare sectors have seen a boost and recognition for the efforts in the fight against the virus. I expect more financial support entering this sector than before the crisis.

Some industries are having to introduce social distancing measures and manage behavioral changes including the hospitality sector where we can expect more job losses. The optimal solution is retraining workers in the growth sectors where there are more job opportunities, this could be in the form of governments subsidizing businesses to train individuals. Land could become of higher value with social distancing measures imposed upon businesses requiring more space.

Audience Q&A

What will the impact of COVID-19 be on globalization?

I don't see globalization disappearing completely. The virus is, however, a shock to the globalization trend because technology developments have enabled the return of domestic supply chain processes in the absence of overseas supply chains. One of the benefits of supply chains being overseas is the low labor cost of manufacturing, but this can now be automated within domestic markets in response to the global lockdown of countries. Globalization will remain if organizations such as the World Trade Organization and United Nations can continue working together since deglobalization posed an issue even before the COVID-19 crisis.

How does Italy's debt crisis compare to what happened in Greece?

I am disappointed in the performance of the country, it boasts a highly educated population especially in the north and yet it has a poorly structured political system. It also has a poor legal system which hinders its economic growth. As far as the debt is concerned, the country has a larger economy than Greece, so Italy is therefore viewed as too big to fail. The European institutions will do everything to prevent this, unlike their response to Greece's debt crisis in the past. The Italian government does need to collaborate more with other southern European countries in order to add gravitas for southern Europe with the European institutions.

How will we support unemployed workers during the transition phase and beyond?

It is important to provide income support to these groups of society. Universal basic income is often criticized but I am in favor of universality in the sense of not strictly means-testing because the administration of that is expensive. Certain vulnerable groups require more subsidy support in the form of essential services, for example the provision of social and childcare. In terms of design I am in favor of Milton Friedman's old proposal of a negative income tax.

What are your thoughts on the future of education?

The online education industry with the absence of face-to face interaction will grow, for example learning a new language or corporate internal training systems. There are many start-ups in Europe and especially in China gaining traction in this industry. I see opportunity in these niche, specialist education areas but structurally, there is an additional need for pastoral care for school-aged children to enable parents to stay in the workforce and this can only be given through physical school attendance.

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