

Economics
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Covid after Omicron: What it means for the economy

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Economics has been dubbed the “dismal science”, but that term might be better applied to epidemiology. When your job is to track infectious diseases and warn about what comes next, it’s hard to sound too cheery. As for economists, if there’s a bias, it’s actually to be upbeat, as until a recession is actually underway, consensus forecasts are always for another year of respectable growth.

That bias isn’t to blame for the fact that virtually all economic forecasts are predicated on the assumption that the Omicron wave will pass quickly. The scientific consensus, backed by data showing turning points in the first locales hit by Omicron (Chart 1), is also overwhelmingly on that side, expecting a month or so of elevated cases, and perhaps a couple of months of hospital chaos. By mid-February, US biostatistician Trevor Bedford sees this wave petering out in the US, because including many undocumented cases, it might have already infected roughly 40% of the population in only eight weeks.

But economists’ tendency to lean optimistically might be behind the fact that virtually all their forecasts assume that

this will be the last disruptive variant we deal with. There are indeed scientists who support that view. But others with equivalent credentials have a more sobering scenario in mind. For investors and business leaders, understanding these various viewpoints, and what they would imply for the economy, should be an important element in risk management.

Less heard about the herd

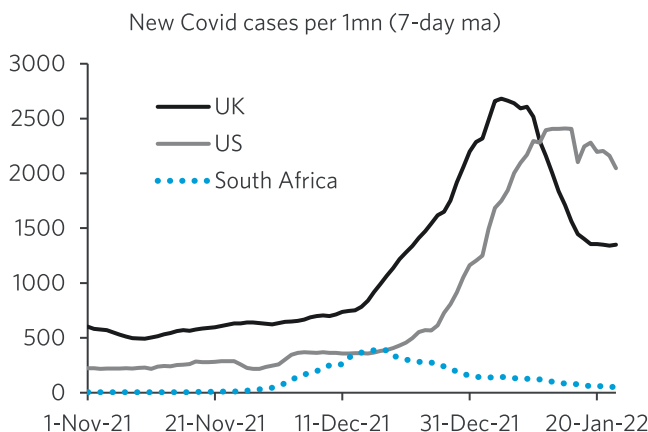
The experts these days no longer talk much about achieving “herd immunity” or the eradication of the SARS-CoV2 virus. Using vaccines to wipe it out through mass immunity went by the wayside as epidemiologist like Harvard’s Marc Lipsitch reworked the math to take into account a higher degree of transmissibility than earlier thought. The math changed again as it became clear that vaccines’ efficacy in preventing breakthrough infections and transmission was falling with time and new variants. Without belaboring the details, full herd immunity seemed unattainable even at much higher global vaccination rates.

So the consensus is now that the SARS-CoV-2 virus will remain with us. Even so, one gets 6,000 Google hits on the phrase “all pandemics end,” and they indeed do. But if you want the worst historical case (and you don’t), the plague, or Black Death, eventually ended, but not before hitting London in 40 waves of mass casualties over a period of 300 years. Fortunately, we have centuries of medical advances helping us out this time, but there’s still no certainty on what a post-pandemic phase for Covid-19 will look like, and some of that is in our own hands.

The optimists: From tsunami waves to “common cold” ripples

The optimistic case, and the one behind the most bullish economic forecasts, has the pandemic ending right after Omicron. Technically, that just means that we won’t be seeing the whole world subject to synchronous major waves of

Chart 1: UK, South Africa saw quick Omicron peaks



Source: Our World in Data, CIBC

contagion, but doesn't rule out regional outbreaks at various times over the coming years. An "endemic" disease could have a steady annual average pace, but within each year, there will be local epidemic outbreaks. The key to the optimistic take is the assumption that these future Covid waves will be mere ripples by comparison to what we've seen so far.

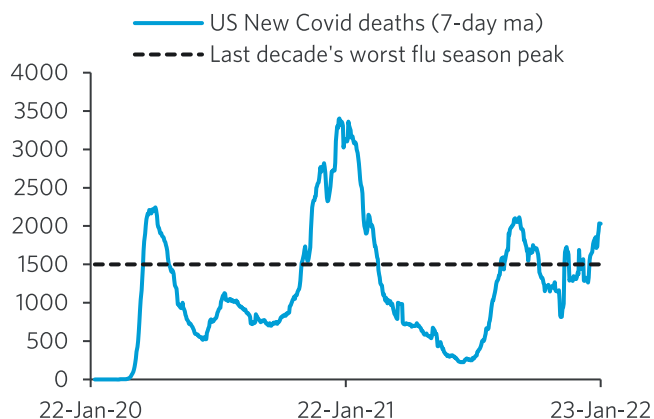
That rests on the idea that we are running out of people who will be facing future waves with no protection from either vaccines or prior infections. As Harvard's William Hanage put it, "every exposure, whether to a virus or a vaccine, reduces the likelihood of severe illness on subsequent ones." Studies varied, but the statistical evidence assigned a substantial share of Omicron's reduced mortality and morbidity to the fact that it hit countries that were heavily vaccinated, or as in South Africa, had already seen the vast majority of the population infected with an earlier, related variant.

In the very best case, the mass infections with Omicron, coupled with higher vaccination rates, will reduce future waves to something closer to the common cold, which is after all caused by a coronavirus. We're far from seeing that now, and in a more realistic base case, future waves will be similar to the seasonal flu, which does cause deaths and hospitalizations, but at levels society chooses to tolerate and go about its business as if it didn't exist.

In a commentary in the January 19, 2022 online issue of The Lancet, Christopher Murray notes that the past decade's worst US flu season caused some 52,000 deaths with a peak of over 1,500 per day, using that to claim that Omicron might not be any worse. He may have been premature in that comparison; the last 7-day average has daily American deaths topping 2,000 and on a rising trend (Chart 2).

Still, as we're seeing in TV broadcasts showing crowded basketball arenas, Americans might choose to just live with such waves and not do much to stand in their way. That

Chart 2: Omicron deaths already top worst US flu season



Source: Our World in Data, CIBC

prospect improved in the wake of recent evidence in an Israeli study by Paul Kuodi et al that suggested that vaccination substantially reduced the odds that mild Covid cases could still turn into troublesome "long Covid" infections, making mild cases something that we might choose to tolerate. At home treatments that dramatically lower hospitalization rates are already here, if in limited doses, and could be used to protect the unvaccinated or immunocompromised.

If Omicron ends up being the last of its kind, we will permanently remove the barriers to supply that are related to Covid-tied production or shipping shutdowns, but also permanently lift the demand headwinds for high-touch services. Growth could accelerate, but so too would potential output, leaving more room for the economy to expand without upward pressure on inflation. Because we're starting from near full employment, we would still face a Canadian and US monetary tightening cycle, akin to CIBC's forecast that short rates will top 2% in 2024, but the improvement in productivity might allow for two more years of 4% growth, a firmer pace than in our projection.

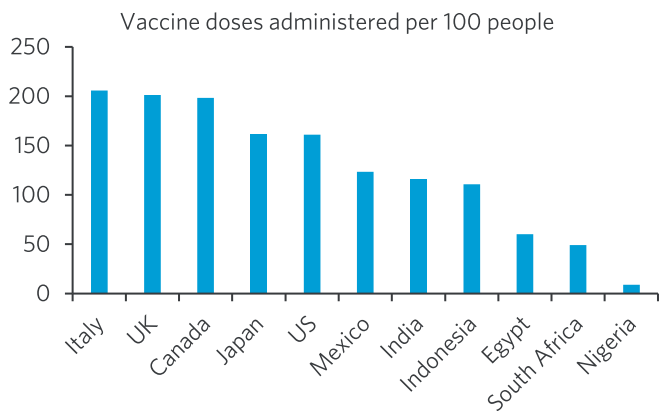
Not quite so rosy: From global tsunami to local surfing waves

Many epidemiologists aren't quite that sanguine, so our own forecast leaves room for at least a few headwinds to growth, including a bit of a slowing next winter given some seasonality with this virus that seems to be in evidence. In addition, viral waves in other parts of the world will keep supply chain issues from fully evaporating post-Omicron, and the need for some social distancing and limits on indoor crowds would continue to hamper productivity.

Remember that Omicron managed to generate a significant disruption even among people who were "fully vaccinated" given its ability to overcome that protection. As Trevor Bedford tweeted, "my big question now is to what extent Omicron-like emergence events characterize endemic circulation of SARS-CoV-2. Given it occurred once, having it occur again would not be surprising at all, but I don't know whether to expect this every year or every ten". Other experts stress the fact that immunity from either vaccines or natural infection fades over time, implying that a period of calm this spring or summer might not last.

Some stress the vulnerability to future variants that owes to the low level of global vaccinations, which leaves parts of the world as laboratories for future infections and mutations. There are three billion people in the world who have yet to receive a single dose according to University of Oxford data, let alone the three mRNA dose series that seems necessary to make a dent in Omicron infections. Many countries have shockingly low vaccination rates this far into the pandemic (Chart 3), particularly if a three-dose series is needed for true protection.

Chart 3: Many countries very far from 3 does for all



Source: Our World in Data, CIBC

Some have used vaccines that are proving to be ineffective against Omicron.

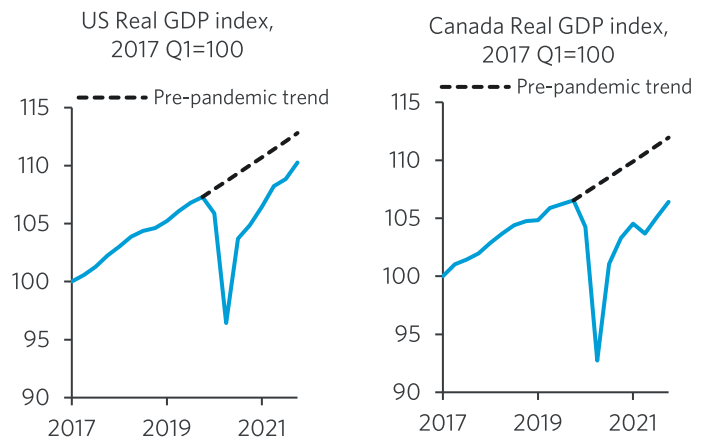
A joint report from experts with the groups Prep4all and Partners in Health (including Saskatchewan virologist Angie Rasumssen) concluded that “The scientific evidence is clear: only by universally deploying the vaccines currently most effective against infection — which for now appear to be mRNA vaccines — will we be able to blunt the virus’s evolution and begin to bring the pandemic under control globally.” The study noted that “every infection offers the opportunity for both transmission and viral mutation” and suggested that we need an additional 22 billion vaccines to complete a global, 3 dose mRNA series.

Current production plans would leave the world some 15 billion vaccines short of that need this year. Further, many epidemiologists stress the need to complete work on a broader spectrum vaccine that would protect against a wider range of variants, or nasal sprays that work better to prevent the initial infection rather than just help fend off the disease once infected. Given where we stand today in terms of the vaccines currently available and their supply, that suggests that at least for 2022 or perhaps 2023, we remain vulnerable to a new, immune escaping “pi” or “rho”, or simply fading immunity against all variants ahead.

That will leave us reliant on what respiratory physician and epidemiologist Guy Marks et al called a “vaccine plus” strategy in a January 2022 essay in Health Policy Review. In addition to vaccine progress, and a more equitable distribution of them, the third leg of the strategy entails periodic returns to effective (N95) mask wearing, testing tracing and quarantining. Japan has kept cases and death rates well below those in North America without ordering outright lockdowns, but there are still periods in which outbreaks see the public take steps to reduce indoor activities.

Looking ahead, in this scenario, which matches our base case, we likely face a couple more years of smaller, less-globally synchronous Covid outbreaks that are still disruptive to

Chart 4: US and Canadian GDP gaps remain after nearing full employment



Source: BEA, Statistics Canada, CIBC

production, and which generate temporary pull backs in high-touch services.

The impacts on inflation from these further, but still milder Covid waves are ambiguous. Periods in which either public health restraints or consumer caution reduce activity in these services will put downward pressure on demand, and therefore on services prices, while perhaps amplifying some goods prices if demand shifts to those items. In terms of goods and services supply, governments might be less willing to impose mandatory worker quarantines or distancing measures than they have in earlier waves, reducing the supply shock boost to prices relative to past waves, but we might still face supply issues during such periods due to absenteeism tied to symptomatic cases.

That said, we still see the economy operating near full employment during lulls in Covid case counts, as was the case just ahead of Omicron. That will therefore see central banks on a gradual tightening path, with the end point for rates in 2023 or 2024 not materially different than in the optimistic scenario.

But this is still a less rosy outlook for equities, particularly those counting on a once-and-for-all return to full demand for services, and for the level of output. While we neared full employment, real GDP just ahead of Omicron was still running well below its pre-pandemic trend line in the US, and actually below the pre-pandemic level in Canada (Chart 4). Both countries suffered a loss in potential GDP — the output realized at full employment — due to repeated pandemic production disruptions and costs. In Canada, the growth hit was larger during upturns in Covid, as more limited hospital capacity necessitated earlier and tougher public health restraints on economic activity, despite the country’s higher vaccination rate.

The pessimists: Nightmare on hospital row

There’s still one further scenario, in which Covid-19 prevents us from returning to life as we knew it on a more sustained basis. For one, humanity could be its own worst enemy if it fails in some of the tasks noted above. Covid-fatigue and divisive

politics might prevent us from taking necessary public health step and keep vaccination rates at sub-par levels, thereby making future waves more problematic.

Writing in Australian weekly *The Saturday Paper*, epidemiologist Raina Macintyre sounded the alarm of what that would look like. For one, she disputes the confidence around whether we can really tolerate large numbers of supposedly mild cases, noting that polio was mild for 90 percent of children who caught it. Longer term concerns for those surviving Covid include elevated risks for diabetes in children, and evidence of damage to the heart and brains of adults. Citing other viruses known to have long term consequences, she concludes that “it’s too early to know if Covid-19 will result in early onset dementia or heart failure in a decade’s time.” Should such risks start to be identified, it would represent a challenge to the idea that we will ignore seasonal Covid outbreaks the way we do with the flu, should our current immunity fade again.

Mass vaccinations, even globally and with new variant-proof versions could also fail to prevent new mutations. Kristian Andersen, a Scripps Research Institute immunologist, is among those who theorize that Omicron didn’t originate in a human carrier, but in animals that caught an earlier version of Covid from humans, then carried the disease in animal populations as it mutated before reinfecting a human. Covid has already been found in mink, deer, dogs and other species, and a recent paper presented evidence that suggested mice might be the source for Omicron. Without herd immunity for our herds of farm animals or pets, we might see the “return of Covid” horror show in our future.

Economically, that scenario would be outside any forecast we’ve seen. Large enough waves of a more deadly variant than Omicron would likely push us well back from full employment, while still hampering supply. It would present central banks with an unenviable choice between letting inflation, particularly in the goods sector, run hot due to supply issues, or tightening policy and thereby sending unemployment well about where we now sit. For equity markets, the most adverse scenarios might be a plus for firms that benefited while we were stuck at home, but a major disappointment for equities tied to travel, restaurants, entertainment, offices and other high touch activities.

Again, that’s not our forecast. But investors need to keep it in mind as a risk in considering optimal portfolios and hedging strategies, while firms vulnerable to future Covid waves should be putting some weight on defensive measures and balance sheet strength.

Hopefully we won’t have to use them, as we’re counting on governments to take Covid seriously enough to remain vigilant for signs of new variants ahead. We’re also looking forward to improvements on both vaccines and treatments that will be key to countering what nature might dish out against us. The public’s willingness to live with some inconveniences in order to tamp down outbreaks is being tested, but we expect that the majority will still do their part if that’s what’s called for. While we’ve laid out some scarier possibilities for public health and the economy, our less frightful base case ultimately rests on the vote of confidence that’s been earned from some remarkable achievements that medical science has made in the two years that Covid has been with us, including records broken for vaccine development. Indeed, being mindful of the remaining risks from this virus that we’ve raised in this paper will be critical for businesses and governments to work together to stay the course.

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