

From SARS to swine – the economic and market effects of pandemics

We are not epidemiologists, so anyone interested in a forecast of precisely how and indeed whether the current outbreak of swine flu centred on Mexico will spread should look elsewhere. As economists and strategists, however, we can provide a guide to the likely economic and market effects of a pandemic, were one to develop.

The response of financial markets to swine flu has so far been both moderate and predictable. Airline and cruise ship stocks have declined, while pharmaceuticals companies have rallied – notably Roche, which distributes the Tamiflu anti-viral medication. Any further significant spread of the infection would probably exaggerate these sectoral trends, with government bonds and safe-haven currencies benefiting at the expense of risk assets.

The response of Asian economies to the outbreaks of SARS and avian flu during 2003-07 helps to outline some of the longer-term economic effects of a relatively mild pandemic.

Consumer confidence declined sharply in a number of economies, leading to a significant reduction in consumer spending, as the uncertainty and fear generated caused people to stay at home.

Exports of services, in particular tourism-related exports, were hardest hit. Goods exports were much less affected.

Investment was affected by reduced overall demand and heightened uncertainties. Foreign investment inflows were delayed.

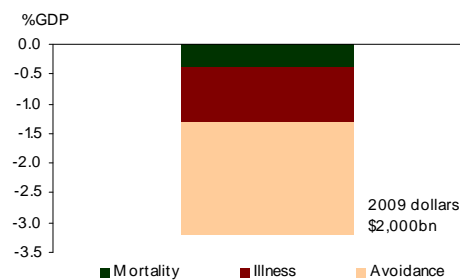
Indeed, the impact on trade and investment flows may be greater today than at the time of the SARS and avian flu outbreaks, given that both flows are already declining rapidly in response to falling demand and restricted credit conditions.

Economists have the Great Depression as the pre-eminent example of a truly disastrous real world outcome; epidemiologists have the flu pandemic of 1918-19. This was an H₁N₁ viral strain, as is the

current outbreak, and was spread by soldiers returning from the First World War. Around 500 million people were infected, and 50 million died.

In September 2008, the World Bank carried out a study to gauge the economic impact of such an extreme pandemic. They estimate that GDP would be hit by 3%, with Latin America and Africa suffering more and high-income countries less so. The main impact on GDP would be ‘avoidance’, such as the closing of public transportation facilities.

World Bank model of 1918-19 scale pandemic



Aside from the incalculable human suffering and loss that such a pandemic would cause, the estimated economic cost would not exactly be ‘the end of the world’. The risk, however, is that any large negative supply-side shock occurring during 2009 would augment and feed off an already large negative demand shock, as unemployment increases and credit conditions remain tight.

Indeed, the 1918-19 flu pandemic provides an example of a similar confluence of a flu-driven supply-side shock and already shrinking demand, caused by the end of the First World War. In the UK, the result was the 1920-21 recession, with a peak-to-trough decline in UK GDP of over 20% – the deepest ever recession in UK economic history. This is a very unlikely medical or economic outturn. Yet, in a market already dominated by tail-risk concerns, investors have just been handed another large-impact, low-probability event to consider.

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