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Covid-19 crisis to widen the economic resilience gap

Key takeaways

- The Covid-19 crisis is likely to widen the economic resilience gap.
- The most vulnerable economies from a sectoral perspective, including Spain, Mexico and Turkey, receive least fiscal stimulus.
- Increasing polarisation risks exacerbating the divisions across the European Union.
- Countries entering the crisis with weak economic resilience to start with look more vulnerable to the Covid-19 shock.
- China is the exception. Starting from a low/middle position, it looks well positioned to come out stronger from this crisis.

In a nutshell

We expect the Covid-19 crisis to widen the economic resilience gap. The countries highly exposed to the hardest hit sectors are among those receiving least fiscal stimulus. Some European economies were among the least resilient already before the crisis, and look very vulnerable to the pandemic shock, risking further divisions across the EU. China – ranking in the middle to lower economic resilience levels before the onset of the pandemic shock – looks best positioned to emerge stronger from the crisis.

Among the large economies, China is the least vulnerable to the Covid-19 pandemic, in our view, followed by those countries which are structurally most resilient and which are also actioning fiscal and monetary policy stimulus. The countries most exposed to the sectors hit hardest by Covid-19, such as hospitality and retail trade (see EI 8/2020: *The Great Economic Shutdown: a quarter of the cake gone*), will need large and well-designed policy stimulus to cushion the negative GDP impact. However, Figure 1 reveals that some of the economies hit hardest, including Spain, Mexico and Turkey, will enjoy little fiscal stimulus. By contrast, some of the sectorially most resilient economies, including the US, Canada, Australia and Germany, will enjoy larger offsetting fiscal measures. Many European countries have announced large fiscal packages in the form of loans and guarantees (not included in Figure 1). Such measures may help economies weather the pandemic storm but they will also add to private debt burdens, which in turn will weigh on future economic resilience. In some vulnerable economies from a sectorial perspective (eg Turkey and Mexico), central banks have cut interest rates. During this crisis, however, we believe that fiscal, not monetary policy, will do the heavy lifting.

Some of the countries looking strongest from a sectoral perspective also exhibit some labour market characteristics that should make them more resilient to the Covid-19 shock. While strong labour protection may hamper economic dynamism during normal times, it is likely to help companies get up and running again more quickly once the lockdown measures are lifted. In addition, it provides income stability for households. For example, France and Germany are likely to benefit from strong labour protection. In addition, a large share of their jobs (45% in France and 37% in Germany) can be done remotely. While Italy and Spain have also strong labour protection, only about 15% of their jobs are suitable for teleworking. The US look vulnerable in this respect. While a decent proportion (33%) of jobs can be done remotely, labour protection is lowest among the largest 20 economies.

Aggregating the above and a few additional dimensions of economic structure and policy, China looks best positioned to weather the Covid-19 shock. Figure 2 provides a ranking of the 19 largest economies. China fares well on most dimensions, including strong labour protection, a relatively low share of services, as well as prompt monetary policy reaction, but so far just

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limited fiscal stimulus. Most countries positioned at the top when it comes to structural resilience also rank highly when it comes to policy stimulus. Meanwhile, some of the structurally weak economies, including Spain and Italy, look vulnerable when it comes to policy stimulus as well.

This polarisation bodes ill for the "economic resilience gaps" identified in *sigma* 5/2019. Figure 2 compares those economic resilience indices (which are based on a different and much broader set of indicators) to the Covid-19 vulnerability factors as discussed above. Economies at the bottom of the resilience rankings before the crisis look (fourth column in Figure 2) more vulnerable to the Covid-19 shock than those at the top. This risks exacerbating the divisions across the EU in particular. The pandemic shock is also likely to widen the resilience gap across countries. China is a notable exeption. Placed in the middle-to-lower ranks of economic resilience before the crisis, it may well emerge stronger from the Covid-19 shock.

Figure 1 Sectoral vulnerability (% of GDP, applying the same sectoral shock across all countries) vs fiscal stimulus (% of GDP) in major economies

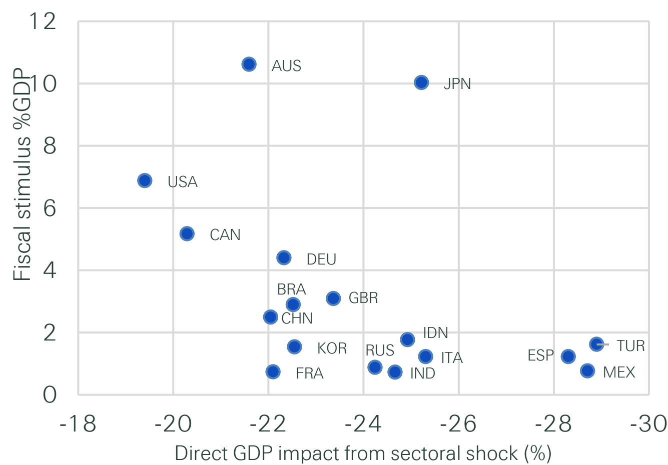

Figure 2 Vulnerabilty ranking to the Covid-19 shock of major economies, based on structural and policy indicators, compared with broader "Economic Resilience Index"

	Vulnerability to Covid-19 shock			Broad Economic Resilience Index
	Overall	Structural	Policy	(pre-Covid)
China	1	1	4	20
Australia	2	4	3	12
Germany	3	2	11	11
Netherlands	4	2	13	7
United States	5	9	1	3
United Kingdom	6	9	4	6
Indonesia	7	4	12	
South Korea	8	11	7	14
Russia	9	6	16	27
Mexico	10	8	9	24
Brazil	11	12	8	29
France	11	7	19	17
Canada	13	13	13	2
Turkey	14	16	2	26
Japan	15	13	15	9
Poland	16	18	4	
Italy	17	15	17	30
India	18	19	9	25
Spain	19	17	18	22

Note: Higher/lower numbers refer to higher/lower vulnerability. The structural index is based on the direct GDP impact resulting from a stylized sectoral shock as published in Swiss Re Economic Insights: *The Great Economic Shutdown: a quarter of the cake gone*, the share of consumer-facing services, the share of jobs that can be done remotely, the OECD labour protection index and the peak of the "stringency index" by Oxford University. The policy index is based on central bank interest rate drops since end February 2020, fiscal stimulus packages (including expenditures and revenues as well as guarantees and loans) and 2019 debt/GDP ratios. The "Economic Resisience Index" is based on a different and broader range of indicators.

Sources: Capital Economics; Oxford University; OECD; Refinitiv; Bloomberg; IMF; J. I Dingel, B. Neiman, [How many jobs can be done at home?](), Brecker Friedman Institute; [*sigma*]() 5/2019 - Indexing resilience: A primer for insurance markets and economies, Swiss Re Institute.

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