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Choosing the right path to unlock the economy

Uncertainty is keeping consumers from spending and businesses from investing. The road to recovery requires instilling confidence.

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In this episode of the *Inside the Strategy Room* podcast, we try to answer two urgent questions: How should governments approach the different possible paths to reopening their economies? And what is needed to spur businesses and consumers to start spending again? Two McKinsey senior partners who have been deeply involved in helping companies navigate the coronavirus pandemic discuss the current uncertainty and its impact on economic recovery. Penny Dash leads the healthcare systems and services practice in Western Europe while Sven Smit cochairs the McKinsey Global Institute and is a member of McKinsey's Shareholders Council. This is an edited transcript. For more conversations on the strategy issues that matter, subscribe to the series on Apple Podcasts or Google Play.

Sean Brown: Sven, what are the biggest sources of uncertainty and why is it so vital to address them right now?

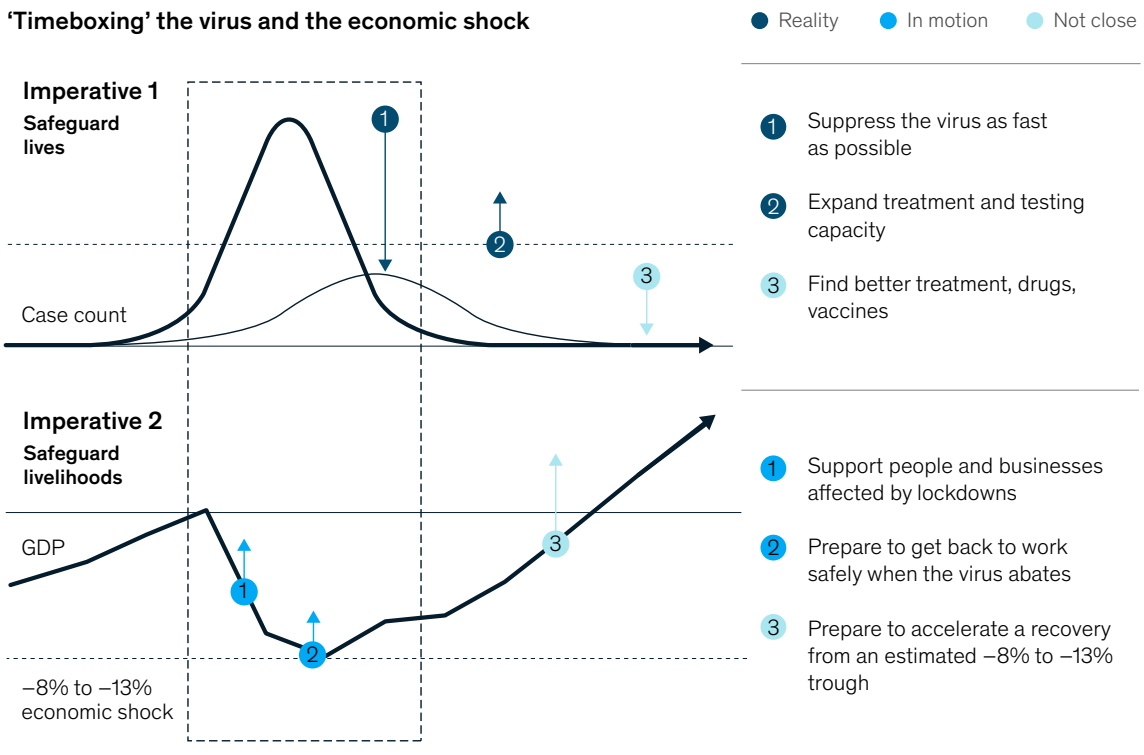
Sven Smit: The uncertainty stems from how policy makers' actions are affecting the presence of the COVID-19 virus and the resulting impact on economies. Flattening the infection curve as fast as possible and ensuring hospital capacity, treatment and testing were the imperatives to safeguard our lives. We also modeled an associated economic shock of 8 to 13 percent of GDP, which we are now seeing. This economic shock is progressing exponentially given that, for example, bankruptcies take some time to materialize. Many countries are now trying to get people back to work safely but the extent that we have the virus under control remains a big question.

We all hope for a recovery that scales fast. We have flattened the peak of infections and got it within the treatment capacity, but on testing, it is still a mixed picture and cure is a long way out (Exhibit 1). In terms of supporting people and businesses, the money is out there but people are not spending it yet. We are in the process of getting back to work but even in a country like Germany that has reopened, only about 5 percent of people have come back to offices. As for scaling the recovery, there is deep uncertainty.

Exhibit 1

What we have learned.

'Timeboxing' the virus and the economic shock



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>
> —Penny Dash

Sean Brown: So we have made progress but a lot of uncertainty still remains.

Penny Dash: Yes. This is quite a mixed picture. Some aspects of how healthcare systems have responded surprised even those systems themselves. The expansion of treatment capacity has been impressive; we can think back to when Wuhan managed to build a hospital in two weeks, and no one in Europe or the US believed it would be possible there—but it was. Testing was slow to get off the ground, but it is now in place in most developed countries and we see it as absolutely crucial not just to managing the virus but to managing society’s confidence, which is essential to returning people to work and spending money. There is great progress on the treatment front but developing vaccines is a challenge now as the decline in the virus has made it more difficult to test them. And we have to wait and see whether any immunity is conferred from having acquired this disease and if so, how long that immunity may last.

Sean Brown: Sven, you mentioned an economic impact on the GDP of 8 to 13 percent. How exactly does that play out on the ground?

Sven Smit: The way we think about this is the duration of the lockdown and the duration of the suppression, which vary by region. The economic impact of a lockdown is deep because discretionary spending drops by roughly 50 percent in locked-down countries, not only because people are afraid for their jobs but because you are not out where you can spend when you work from home. There is also the fear of the virus. Sweden did not have an intense lockdown, but people still stayed home and didn’t travel.

We need to overcome this response. People are not coming back to the offices because they think they may not be safe yet. Even though governments are allocating 10 percent, 20 percent, 30 percent of their GDP to helping companies and individuals overcome this crisis, will people spend that money? Savings rates are way up. Even in China, young people are saving for the first time. That suggests this policy response intending to mitigate the blow to the economy may be only partially effective.

Sean Brown: How do you actually measure uncertainty?

Sven Smit: You can measure uncertainty in many ways, but one important gauge is economic policy uncertainty, and that is at its peak level since 1985. We believe it is possible to think of the current drop in the GDP as being 50 percent due to the economic fundamentals and 50 percent due to uncertainty. That’s significant. To lower uncertainty, we need to get out of these lockdowns.

Sean Brown: What are the different scenarios that countries are looking at in choosing the paths to reopening their economies?

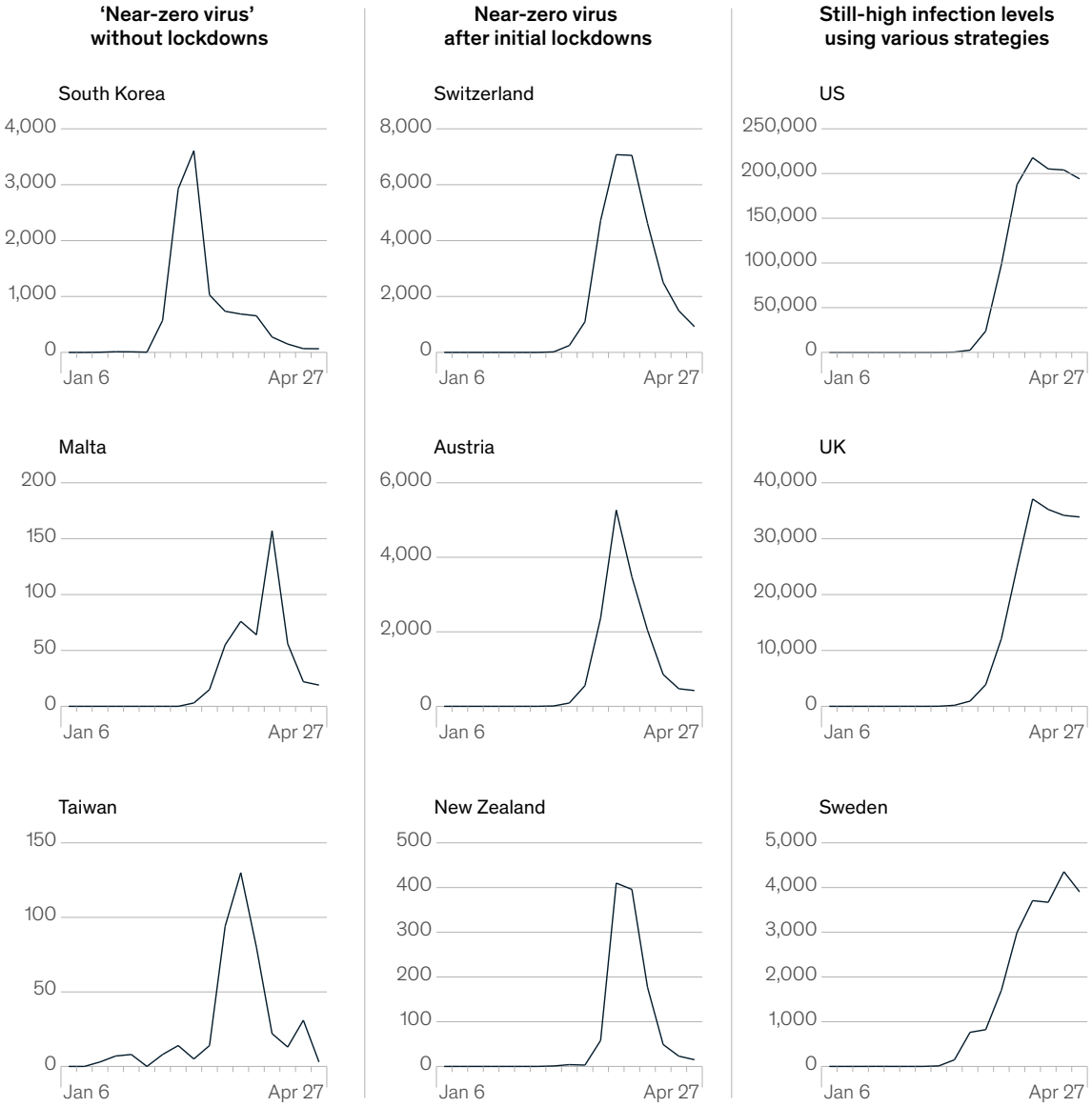
Sven Smit: Think about the uncertainty level on the vertical axis, in terms of the viral spread and public-health response, and the other axis represents the knock-on effects countered by the economic policy response (Exhibit 2). Where you have rapid and effective control of the virus, be it post-lockdown or from the get-go, as in Taiwan, you can get back to life. In places that have responded effectively largely through lockdowns, you see the economies opening up but there is fear the virus may come back if potential resurgence zones are not countered properly.

In an executive poll we conducted in April and May, these two scenarios received more than half of the vote as being most likely. What surprised us was just how diverse the poll results were. Executives are still all over the map in their expectations and this level of uncertainty is crushing for the economy.

Exhibit 2

Is 'near-zero virus' a possibility?

Number of new COVID-19 cases per week in selected geographies



Source: COVID-19 data set, Our World in Data

If you are low in the virus, you will want to avoid the risk of infections going up again so you may enter a balancing act, where you start to gradually lift lockdowns even though the virus is still around. In that scenario, uncertainty still high but you start to open up the economy with the intent of later transitioning to complete control of the virus, or at least near complete control. In this near-zero-virus world, flights are possible again, restaurants can open with more vigilance, and people can get back to life. The question is, how many places can get there?

Sean Brown: So what are the outcomes of different countries' chosen paths?

Penny Dash: The research here is going to be fascinating. Some countries that were on the case quickly were helped by their natural geography, New Zealand being a good example. Others, such as Switzerland , managed the pandemic effectively by adopting well-proven techniques including lots of testing, tracing people, and fostering a strong sense of community. Countries that were slower to implement lockdown measures saw significant case increases and much higher mortality rates, but there were probably other factors such as the age and health of the populations.

What we still do not know is the differential impact of various lockdown measures. Hopefully, research over the next few months will make it clearer what aspects of lockdowns work in suppressing the virus and that may enable countries to move into near-zero-virus situations. As Sven said, achieving that greater knowledge about what works will have an important impact on people's confidence and therefore on the economy.

Various factors will determine how easy it is for countries to get to near-zero-virus. One is the degree to which the population is willing to adhere to lockdown measures. Certainly, not everyone will consent to have an app trace their movements, identify who they are in close contact with, and so on, and we see that making a significant difference. Additionally, the health status and age profile of the population, as well as preexisting conditions, matter. Another factor is the availability of testing and the ability to get it to the right people at the right time. Yet another element is how porous a country's borders are.

Sean Brown: Penny, you are close to developments in the medical community. What lessons are we learning about this virus? For example, how effective is the herd-immunity approach?

Penny Dash: There was a sense of optimism, particularly in Sweden, about herd immunity: that by allowing contact—encouraging it even, particularly among younger people—and not having the severity of lockdowns that other places implemented, immunity could be built among lower-risk populations and thereby confer some indirect protection to higher-risk populations. We may well

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end up seeing some benefits from that, but certainly the degree of immunity acquired has been lower than people had hoped. In cities that have had high rates of infections, such as Stockholm, London, and Paris, only around 20 percent of the population seem to have antibodies in their blood, and we still do not know whether that confers immunity.

In terms of vaccine development, it's impressive to see the level of global collaboration, but the challenge is that there are not enough people out there at risk of contracting the virus to test whether a vaccine is offering protection, so the research is likely to take longer than expected. Then, of course, we have the challenges of manufacturing, distribution, and administration of the vaccine. It would be naïve, I think, to assume a vaccine will be available by fall and will suddenly protect everybody.

Sean Brown: Are you seeing new testing protocols that would help get people back to work and so help get economies moving?

Penny Dash: Yes, there is much discussion about that. Should you be tested before you get on an airplane or before you go into an office? The challenge is that antigen testing covers only a moment in time, and given that so many people are asymptomatic, someone may still get the virus between the times you test them. It's not a foolproof mechanism, and it is very invasive to be testing everybody every day. Different countries are slowly finding their way through with a mixture of testing people with symptoms and doing random testing to see the prevalence of the virus in asymptomatic populations, as well as ramping up antibody testing.

Sven Smit: I do not see the innovations around treatments and vaccines as a silver bullet. But many things are improving. Because Japan, Korea, and Taiwan had been prepared by SARS, they did not have lockdowns but tested, traced, quarantined the sick, took care with high-risk groups, asked people to wear masks, and so on. But, as Penny said, we cannot be sure which of these measures worked because there are probably ten or 15 elements around virus protection. Taiwan thinks there are 122 measures, ten of which are big. Then there is the question, can western countries apply the same discipline? It's not money constraining the ability to get to near-zero-virus situations, it's the mindsets.

Sean Brown: How important are coordination and communication between nations to finding the way out of this crisis?

Sven Smit: I have never seen ideas travel faster than they do now. The whole world has become epidemiologists, the whole world knows about vaccines. We know the names of complicated things I can't even pronounce, like remdesivir. We are learning at an incredible speed, with institutions and governments all collaborating.

Penny Dash: Just to put a bit of context around this, remember HIV? I was a junior doctor working with patients with HIV in the mid-to-late 1980s. We did not know what we were dealing with at that time. It felt similar to today, but we did not have any personal protection equipment [PPE]. We did not have testing. We were flying completely blind for several years before we started to understand the risk factors and how the virus was transmitted and then began to explore treatments. If we compare that to now, we are making progress at a dramatically faster rate. In five, six months we know an enormous amount. It the '80s, that took five, six years. So we should take heart from our ability today to learn from each other much faster.

Sean Brown: How has our understanding of the different risk groups and outcome factors developed?

Penny Dash: We have increasingly good information. Risks of bad outcomes are dramatically higher if you are old, if you are male, and if you are overweight. There is also good data from the UK looking at occupation groups.

Sean Brown: As you said, we are all learning at incredible speed. What are some lessons that businesses can apply?

Sven Smit: We ramped up homeschooling within days, and it's hard to imagine an education system doing anything in three days on a national scale. A pharma company found that when they minimized the number of people in the factory to lower coronavirus risk, they got much higher productivity. One unique characteristic of this moment is that it is not just trend rich but event rich. Government representatives have told me, "We are doing the work of decades in days." When you plan ahead for your strategic response in the recovery, you need to account for a whole new level of speed and potentially a completely different level of productivity.

Sean Brown: How has COVID-19 changed the trajectory of trends forecasting for the coming decades?

Sven Smit: Many things have accelerated almost structurally—everything digital, home delivery, telemedicine, and outcome-based health, the need for a new social contract between companies and their employees and communities. Many components of the future of work expected to be a decade away happened in a week. Telemedicine penetration was in the low teens before the pandemic and moved to more than 70 percent in four days.

But will this acceleration stay? One filter I use is whether the change feels better on all sides. With education from home, the kids want to go to school and parents do not want them home all the time, so that may not stay. Globalization clearly has some twists to it and I don't think it will completely reverse—the globalization of ideas is massive now.

The jury is still out on a few things. The green agenda is not off the table, but the speed and directionality may shift. The balance between emerging markets and developed markets will be affected. Trade disputes and new politics might flare up. People will look for resilience not just in banks but all companies and institutions, and they will look more broadly than just supply chains. And the speed and scale of innovation that drives the acceleration is fundamentally new.

Penny Dash: I cannot overemphasize the piece about supply chains. That has been a massive wake-up call for many companies that suddenly have to think at very senior levels, where do we get our day-to-day things? You could argue that 20 years ago, the role of human resources director suddenly rose in prominence. I think the change in prominence in 2020 is the role of the supply chain director and logistics people.

Sean Brown: Have most companies moved from dealing with crisis response to looking at how these shifts you describe will affect their strategies?

Sven Smit: While companies have crisis teams dealing with business continuity, it is healthy to also set up separate plan-ahead teams. These are not your normal strategy teams but planning groups that develop ideas for moving faster in this crisis. If you are a fashion retailer, for example, you could choose to wait until the government lets you reopen and then possibly find that a store no longer has great economics, or you start working on reshaping the retail landscape. The future in many ways is now.

Sean Brown: As you both mentioned earlier, consumer confidence is critical to economic recovery. How do we get people excited about spending again?

Sven Smit: There is a study that looked at the past 287 recessions, both small and large, and found the point at which consumers return to spending and businesses to investing is when they see the path out of the valley and can take the first step. It is not enough to see the path—they have to be able to make that step. Consumers need to have their first dinner out and say, "Hey, this works!" It's as mundane as that. If the first step works, you start to get your confidence back. Another piece of research asked consumers when they expected life to return to normal. The range of answers was between weeks and three years. That is just too long. We have to crush this uncertainty.

Sean Brown: Many people worry about a virus resurgence, a second wave. How do you get back to normal life when this uncertainty persists?

Penny Dash: There may well be a second wave. It would be almost surprising if there wasn't. But most countries are in a much better position now to respond. They have good surveillance, they have testing up and running, stocks of PPE. They know how to expand their healthcare systems to cope. Crucially, we are learning about which lockdown measures are needed. I am confident we will have much greater clarity about how to manage a second wave.

Sean Brown: Last question. Do you see a consensus emerging on how the world should deal with future pandemics?

Penny Dash: My tentative answer is, first, the past is not a prediction of the future, but if we do look at the past, such pandemics are unusual events. Second, this crisis has allowed us to identify the weak points in societies and healthcare systems. I am sure every country will try to address those weak spots. At the same time, whatever comes along next will be slightly different than the coronavirus, so the key is to learn the necessary response measures. For me, that requires good data and agility so we can respond quickly to whatever may hit us.

Sven Smit: I will make a small prediction. I believe that when we look back at this crisis three to four years from now—and I believe we will be looking back by then—we will say, this was a once-in-60-years virus, a once-in-80-years economy, and we did a good job managing it.

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