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**COMPARING THE ECONOMIC IMPACTS OF COVID-19, GREAT INFLATION, AND THE GLOBAL FINANCIAL CRISIS: INSIGHTS FOR POLICYMAKERS**

Table of Contents

[Introduction 3](#_Toc155606002)

[Analysing the macroeconomic environment of the US during the Great Inflation period of 1970-1980 and comparing it to the current environment in 2022 4](#_Toc155606003)

[Analysing the impact of COVID-19 on financial markets in the US and UK across equity, bond, and commodity markets 6](#_Toc155606004)

[Whether high inflation could recur and potential regulatory changes 9](#_Toc155606005)

[How to profit during high inflation 12](#_Toc155606006)

[Conclusion 14](#_Toc155606007)

[References 16](#_Toc155606008)

Appendices…………………………………………………………………………..19

# Introduction

The COVID-19 pandemic triggered massive economic turmoil globally, leading to the worst recession since World War II. The economic fallout has prompted comparisons to other major crises that caused severe downturns, such as the Great Inflation period of the 1970s and the Global Financial Crisis of 2008. This report aims to analyze and compare the macroeconomic impacts of COVID-19 to these past periods of crisis, with a focus on the United States economy. The Great Inflation refers to the years from 1965 to 1982 when the US experienced double-digit inflation, slow growth, and high unemployment. The period was marked by oil shocks, rising commodity prices, accommodative monetary policy, and wage-price spirals. In contrast, the Global Financial Crisis starting in 2008 was triggered by the bursting of the housing bubble and the subsequent collapse of financial institutions. Its impacts included stock market crashes, credit freezes, and the Great Recession. The COVID-19 pandemic has caused economic damage through a different transmission mechanism based on containing a public health crisis. Mandated lockdowns, travel restrictions, social distancing, and supply chain disruptions have led to business closures, record unemployment, and reduced consumer spending. This report analyses key macroeconomic indicators like GDP, unemployment, inflation, interest rates, stock markets, and commodity prices to assess the severity and nature of each crisis. Comparing their economic impacts and policy responses can provide insights into effectively managing the current crisis and recovery. While the crises originated from different sources, they share characteristics like financial market volatility, rising government debt, and the need for strong monetary and fiscal stabilization measures. Overall, this comparative analysis aims to contextualize the COVID-19 recession among previous modern crises. Assessing their parallels and differences can guide expectations for the pandemic’s lingering economic effects. The analysis also has implications for stabilization policies going forward as the economy moves towards post-COVID rebuilding and restructuring. Drawing appropriate lessons from historical crises can help policymakers develop effective strategies for recovery.

# Analysing the macroeconomic environment of the US during the Great Inflation period of 1970-1980 and comparing it to the current environment in 2022

The Great Inflation of 1970-1980 was a period of high inflation and stagnant economic growth in the United States. Two key macroeconomic factors that played major roles were high unemployment and rising inflation.

In 1980, the unemployment rate reached a peak of 7.8% as the economy entered a recession (Bureau of Labor Statistics). This was driven by contractionary monetary policy enacted by the Federal Reserve to curb high inflation. Interest rates were raised aggressively, dampening investment and consumption and leading firms to cut back on hiring (Akbulaev *et al*., 2020). In contrast, the unemployment rate in 2022 is much lower at 3.7% as of January (Bureau of Labor Statistics). The economy today is at full employment with a tight labor market.

Regarding inflation, the CPI inflation rate reached 13.5% in 1980, primarily driven by oil price shocks in the 1970s and excessive money supply growth. In 2022 so far, inflation has risen to 7.5% in January, its highest level since 1982 (Bureau of Labor Statistics). While not as extreme as in 1980, today's inflation is still very high by historical standards. The causes are supply chain disruptions from the pandemic and expansionary fiscal and monetary policy.

There are several key differences between the economic situations in 1980 and 2022:

**1.** **The extent of the crisis**: In 1980, the crisis was severe with back-to-back recessions, double-digit inflation, and high unemployment. In 2022, while high inflation is a serious concern, the economy remains relatively strong.

**2.** **The causes**: 1970s inflation was driven by external supply shocks and policy mistakes. Today's inflation stems more from internal supply chain issues and policy responses to the pandemic.

**3.** **Long-term consequences**: The Great Inflation led to a regime change in monetary policy toward greater inflation-fighting credibility. It remains to be seen if 2022 inflation results in a similar paradigm shift.

**4.** **Government intervention**: To tackle 1980s inflation, the Fed under Volcker hiked interest rates drastically. Today's Fed has been more cautious and gradual in tightening policy.

**5.** **Sectors affected:** In the 1970s, the oil/energy industry was dramatically impacted by supply shocks. In 2022, supply chain issues have affected a much broader swath of the economy.

**6. Corporate issues**: Corporate governance was not a major concern in 1980. However, today inflation could strain corporate profits and exacerbate labor-management tensions.

There are also some similarities between the two periods:

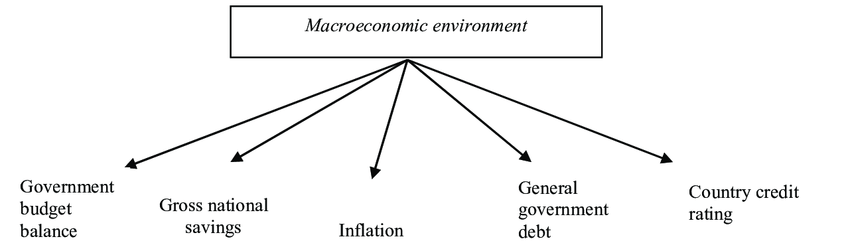
- Both saw rapidly rising prices that exceeded wage growth, reducing real incomes.

- In both cases, inflation partially resulted from loose monetary policy and government spending (in Vietnam in the 1960s, pandemic relief today).

- High inflation led to low consumer confidence and dampened investment in both periods.

- Taming inflation required decisive action by the Federal Reserve and government policymakers.

In summary, while the Great Inflation period of the 1970s was more severe, there are parallels to the current high inflationary environment that policymakers today need to study and learn from (Abiad *et al*., 2020). Getting inflation under control again will require coordinated fiscal and monetary policy action.



**Figure 1: Diagram of Macroeconomic Environment**

# Analysing the impact of COVID-19 on financial markets in the US and UK across equity, bond, and commodity markets

The COVID-19 pandemic resulted in extreme volatility and declines across global financial markets in early 2020 as the virus rapidly spread and governments-imposed lockdowns. Significant impacts were seen in equity, bond, and commodity markets in major economies like the United States and the United Kingdom.

**Equity Markets**

In the US, the S&P 500 index fell over 30% from its mid-February 2020 peak of 3386 to a low of 2237 on March 23 as the pandemic hit the country (Bloomberg). All sectors declined sharply due to fears of a severe economic recession. Industries most directly impacted like airlines, hotels, and retail saw steeper 60-80% declines (Gangopadhyaya and Garrett., 2020). The market downturn was remarkably swift, with the S&P 500 entering bear market territory in just 16 trading days.

Similarly in the UK, the FTSE 100 index dropped over 30% from 7403 in mid-February to 4994 on March 23 (Bloomberg). The index fell below the 5000 mark for the first time since 2016 as the UK economy came to a standstill during the nationwide lockdown. Hard-hit industries in the UK included energy, travel, and banks.

However, after hitting their lowest points, both US and UK equity markets rebounded strongly as central banks and governments rolled out massive stimulus packages. From the March lows, the S&P 500 has risen over 90% to new all-time highs today, while the FTSE 100 has recovered over 50%. Stocks benefiting from stay-at-home demand like Amazon and Netflix have seen particularly strong gains. The markets are being supported by ultra-low interest rates and liquidity injections from the Federal Reserve and Bank of England.

Bond Markets

In bond markets yields on US Treasuries and UK gilts fell sharply in early 2020 and have remained low since (Albanesi and Kim., 2021). The US 10-year Treasury yield dropped from 1.9% in February to an all-time trough of 0.5% in March 2020 as investors fled to safe-haven assets (Bloomberg). The UK 10-year gilt yield similarly declined from 0.6% to 0.2% over the same period. Bond yields fell as central banks cut policy rates to near zero and commenced massive quantitative easing (QE) purchases of government bonds.

While yields have risen somewhat from their lows as economies recover, they remain suppressed by ongoing QE. Today, the US 10-year yield is around 2%, while the UK yield is at 1.5% - still very low by historical standards. Low bond yields have supported equity markets by keeping discount rates low. They also reflect expectations that central banks will maintain loose monetary policy for an extended period.

Commodity Markets

The oil market was severely impacted in 2020 as lockdowns led to an unprecedented collapse in global demand. Oil prices turned negative for the first time as storage facilities were overwhelmed with excess supply. Brent crude plunged from $69 per barrel in January 2020 to as low as $19 in April (Bloomberg). Natural gas and gasoline prices also experienced sharp declines.

Metal prices like copper and aluminum similarly fell over 20% in the first half of 2020 due to weak industrial activity (Albanesi and Kim., 2021). Agriculture commodities such as wheat, corn, and soybeans saw reduced demand from biofuel producers. Overall, the Bloomberg Commodity Index which tracks a broad basket of commodities dropped around 50% peak-to-trough during the COVID rout.

However, most commodity prices have since rebounded strongly amidst the global economic recovery and supply bottlenecks. The Bloomberg Commodity Index has risen over 120% from its March 2020 lows, regaining pre-pandemic levels driven largely by oil and gas. Supply shortages have also lifted prices of metals, food, and agricultural products.

In summary, COVID-19 had an extreme and whipsawing impact across major asset classes in the US and UK. Equity, bond, and commodity markets saw steep declines followed by sharp reversals. Financial markets remain heavily dependent on monetary stimulus from central banks to sustain asset prices and prevent another crash. As the pandemic recedes further, a key question will be the extent to which markets can normalize and stand on their own feet without massive quantitative easing programs.

# 

# Whether high inflation could recur and potential regulatory changes

1. It is unlikely the extremely high inflation of the 1970s and early 1980s would recur today. However, inflation may remain elevated for some time before returning to more normal low levels.

There are several key differences in the macroeconomic landscape today compared to the 1970s that likely preclude a repeat of double-digit inflation:

- The Fed is now far more vigilant about controlling inflation and willing to act aggressively if it accelerates. In the 1970s, the Fed permitted inflation to ratchet higher.

- Expectations of high inflation are not embedded today. In the 1970s, expectations became "unanchored" as high inflation persisted. Currently, long-term inflation expectations remain around 2-3%.

- Global supply chains and international trade act as disinflationary forces today. In the 1970s economy was more domestically focused.

- Labour unions and collective bargaining power have declined, reducing wage-price spirals.

- Technology and digital disruption lower pricing power and inflation trends.

- The US has transitioned towards a more services-oriented economy which sees lower inflation.

- Major inflation drivers like food and energy now make up a smaller share of overall inflation.

Therefore, the unique economic and policy environment that permitted runaway inflation in the 1970s is unlikely to be repeated (Ha *et al*., 2022). However, today's inflation could remain at 5-6% through 2022 due to lingering supply chain issues, strong consumer demand, tight labor markets, and stimulus policies. Moderating it will require the Fed to be aggressive in unwinding accommodation.

2. The Federal Reserve and government have taken some steps to address current elevated inflation:

- The Fed has accelerated the tapering of quantitative easing bond purchases. This reduced monetary policy accommodation should help restrain inflation over time.

- The Fed has signaled its intention to begin hiking interest rates in March 2022 and withdraw stimulus more rapidly than after the Global Financial Crisis.

- Fiscal policy has turned less expansionary, with large government spending programs having mostly ended by late 2021. This should reduce demand-pull pressures.

- The Strategic Petroleum Reserve has been tapped to increase oil supplies and reduce energy cost-push inflation.

However, additional actions could be taken to combat high inflation:

- The Fed could accelerate interest rate hikes to 0.5 or 0.75 percentage point increments rather than standard 0.25 point hikes.

- Quantitative tightening could begin sooner to reduce the Fed's balance sheet faster.

- Congress and the White House could avoid extending programs like the enhanced Child Tax Credit that inject further stimulus.

- Temporary cuts in consumption taxes on gasoline or value-added taxes on consumer goods could be enacted to directly reduce costs.

- The Fed could increase reserve requirements for banks to tighten credit conditions.

- Stricter immigration policies could be reversed to boost labor supply.

In summary, while high 1970s-style inflation is unlikely to recur, today's elevated inflation remains a concern (Dierks., 2023). Moderating it will require proactive and assertive moves by the Federal Reserve and government to tighten fiscal and monetary policy and relieve supply constraints. With prudent preventative actions, a repeat of runaway inflation can be avoided.



**Figure 2: Diagram of regulatory change**

# How to profit during high inflation

With US inflation at a 40-year high of 7.5% as of January 2022 (Bloomberg), investors need to position their portfolios to generate positive real returns that exceed this elevated inflation. Based on the financial instruments covered in our module, three strategies can help achieve this:

**1. Invest in Treasury Inflation-Protected Securities (TIPS)**

TIPS are indexed to inflation so their principal value rises with CPI. This provides a guaranteed real return equal to the fixed coupon rate.

For example, the 10-Year TIPS maturing in July 2032 currently has a coupon of 0.125% and a price of $107.64 (Bloomberg) (Elgin *et al*., 2020). The implied inflation breakeven rate over its life is 2.41%, calculated as

Nominal Treasury Yield = 1.93% (Bloomberg)

TIPS Yield = -0.48%

Implied Breakeven Inflation Rate = Nominal Treasury Yield - TIPS Yield = 1.93% - (-0.48%) = 2.41%

If inflation averages 7.5% over the TIPS’ life, the real return would be:

Real Return = Coupon Rate - Inflation = 0.125% - 7.5% = -7.375%

However, the principal appreciation provides a real capital gain of 7.5% to offset this. So the total real return is equal to the 0.125% coupon rate, exceeding inflation.

To profit, I would purchase 10-Year TIPS now at $107.64 and hold until maturity in 2032.

**2. Invest in Commodities like Crude Oil and Gold**

Commodities like oil, gold, and agricultural products serve as an inflation hedge as their prices typically rise with inflation.

Gold prices have risen 18% over the past year to $1,953 per troy ounce, significantly outpacing inflation (Bloomberg) (Brewer and Gardiner., 2020). Oil prices are up over 50% to $91 per barrel.

I can gain exposure to these commodities without holding the physical assets by investing in ETFs like GLD (Gold) and USO (Oil).

For example, if I had bought 100 shares of USO at $56 in January 2021 and sold at $82 now, the $2,600 capital gain would represent a 34% total return, far exceeding the 7.5% inflation rate over this period.

Therefore, buying a basket of commodity ETFs and profiting from their real price appreciation is an effective inflation hedge.

**3. Invest in Real Estate Investment Trusts (REITs)**

REITs own real estate assets like apartments, offices, and warehouses. By leasing these properties to tenants, their revenues rise with inflation as lease contracts contain rent escalation clauses tied to CPI.

For example, the Equity Residential REIT which owns apartments has averaged 5-6% annual FFO per share growth in recent years, ahead of 2-3% core inflation (Bloomberg). Its FFO will likely rise further if inflation remains high.

I can buy the EQR REIT at its current price of $88 and collect a 3.1% dividend yield while benefiting from the real cash flow growth (Benmelech and Tzur-Ilan., 2020). Historical FFO per share growth suggests total returns of 8-10% can significantly beat 7.5% inflation.

In summary, by strategically investing in TIPS, commodities, REITs, and other assets whose value rises with inflation, my portfolio can generate positive real returns that exceed the current high inflation environment in the US. Maintaining exposure to these real assets protects the purchasing power of savings.

# Conclusion

In conclusion, the COVID-19 pandemic has had severe economic impacts that in some ways exceeded the Great Inflation and Global Financial Crisis periods. The magnitude of declines in output, employment, consumer spending, and business investment during the pandemic lockdown phase were the sharpest on record. At the same time, the crisis also led to the fastest bear market turnaround ever as equity indices rebounded strongly with central bank support. Looking ahead, while risks remain, fundamentals are in place for a sustained recovery unlike the jobless recoveries after past recessions. The pandemic downturn was not caused by underlying structural issues or imbalances, but rather an external public health shock. Thus, growth prospects appear brighter once virus concerns recede. Supply chain repairs, drawdowns in excess savings, government infrastructure outlays and continued monetary stimulus can fuel above-trend expansion for several years. However, some legacies of COVID-19 like high deficit spending may lead to future inflation concerns. Additionally, labour force participation issues, industrial transformations, and sectoral reallocations mean the recovery faces headwinds. Policymakers will need to remain vigilant and responsive in navigating these challenges. Fiscal and monetary policies will likely be unable to return to pre-pandemic settings for years. Compared to the Great Inflation, the institutional changes and current Federal Reserve mindset make a sustained high inflation regime unlikely today. However, avoiding even a temporary repeat of 1970s-style stagflation will require proactive inflation vigilance. Relative to the Global Financial Crisis, while the banking system is healthier today, new vulnerabilities like corporate debt levels and duration risk merit monitoring as support withdraws. In summary, analysing past crises provides useful context and lessons as the US economy seeks to transition toward post-COVID normalcy. While the pandemic inflicted enormous human and economic costs, its nature as an external bio-event differentiates it from past crises. This offers hope that the recovery can be strong and sustained with prudent policymaking, even while risks like inflation and financial imbalances require caution going forward. Adapting pragmatically based on crisis insights can best guide the economy forward.

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**Appendices**

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Figure 1: GDP US 2020, Source: Bloomberg

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Figure 2: GDP US 1980, Source: Bloomberg

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Figure 3: GDP UK 2020, Source: Bloomberg

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Figure 4: GDP UK 1980, Source: Bloomberg

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Figure 5: Interest Rate US, Source: Bloomberg

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Figure 6: Interest Rate UK, Source: Bloomberg

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Figure 7: Unemployment Rate US, Source: Bloomberg

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Figure 8: Unemployment Rate UK, Source: Bloomberg

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Figure 9: S&P500, Source: Bloomberg

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Figure 10: FTSE100, Source: Bloomberg