The ABCs of the post-COVID economic recovery

The economic activity of the U.S. has plummeted in the wake of the coronavirus pandemic and unemployment has soared—largely the result of social distancing policies designed to slow the spread of the virus. The depth and speed of the decline will rival that of the Great Depression. But will the aftermath be as painful? Or will the economy swiftly recover once the pandemic has passed? And when will that be?

Analysts are using shorthand when discussing the shape of the recovery: Z-shaped, V-shaped, U-shaped, W-shaped, L-shaped, and even the Nike Swoosh. We explain what these mean, and which one of these appears most likely. But first, let's talk about the downturn itself.

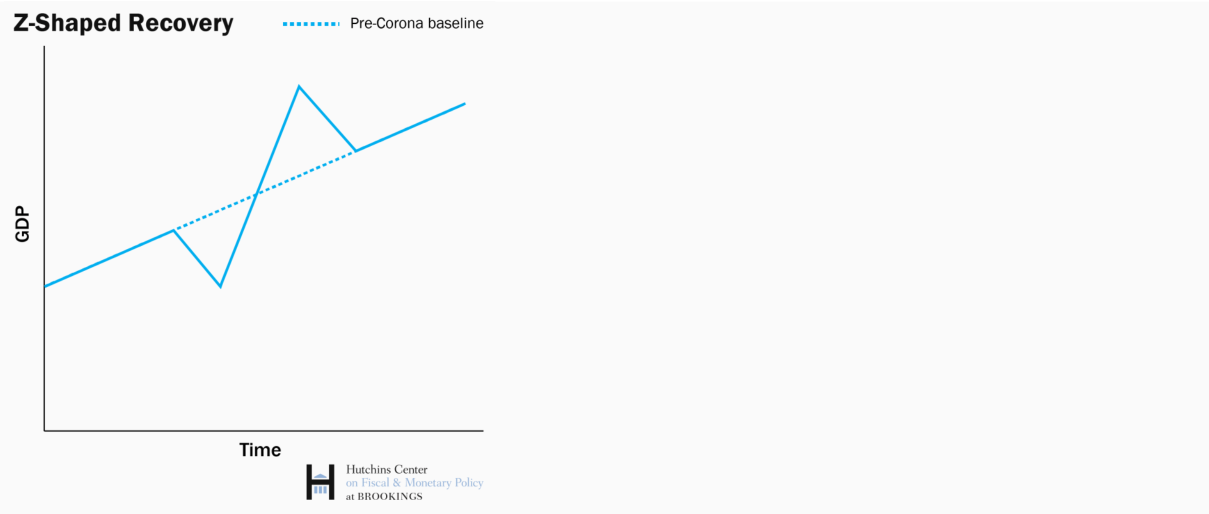
WHAT ARE THE IMMEDIATE EFFECTS OF THE VIRUS ON ECONOMIC ACTIVITY?

According to the most recent Bureau of Economic Analysis estimate, the level of real (inflation-adjusted) GDP in the first quarter was 1.2 percent below the fourth-quarter level, and analysts expect GDP to drop another 8.5 percent to 11 percent in the second quarter. At annualized rates—the way changes in GDP are reported—these translate into a decline of 4.8 percent in the first quarter and 30 percent to 40 percent in the second quarter. (Annualized rates show what would happen to the level of GDP if the quarterly rate of growth persisted over an entire year.) To put these numbers in context, the largest quarterly GDP decline observed during the Great Recession was 8.4 percent at an annual rate in the fourth quarter of 2008.

WHAT COULD THE RECOVERY LOOK LIKE?

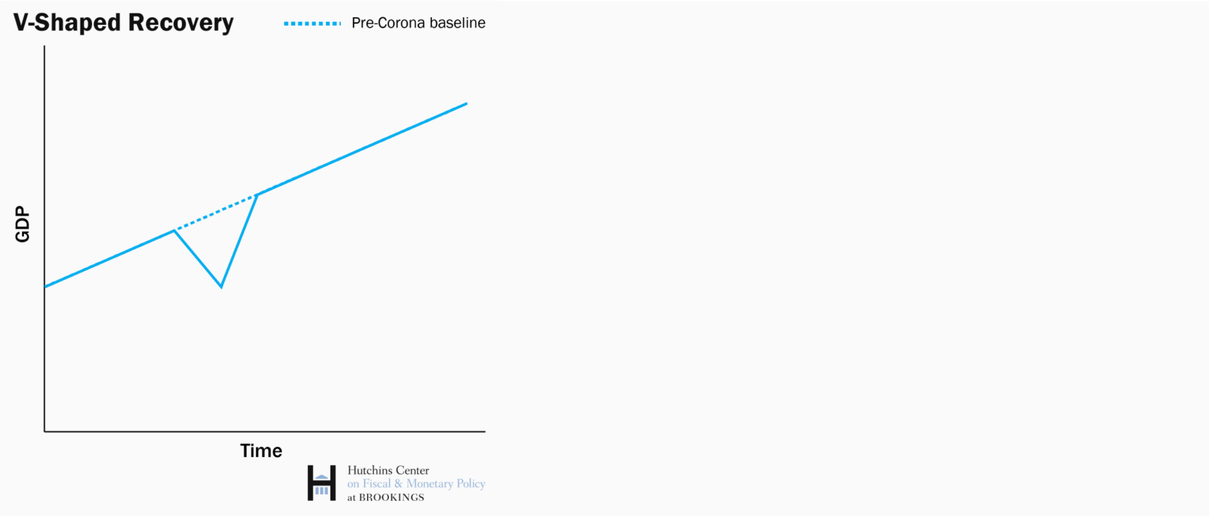
Most optimistic: The Z

The economy suffers a downturn during the pandemic, but then bounces back up above the level it would have been in a pre-pandemic baseline, as pent-up demand creates a temporary boom. In this scenario, a good part of the GDP foregone during lockdowns—the shopping we didn't do, the restaurant meals we didn't enjoy, trips we didn't take—was simply delayed, and is made up once the risk from the pandemic passes.



Still very optimistic: The V

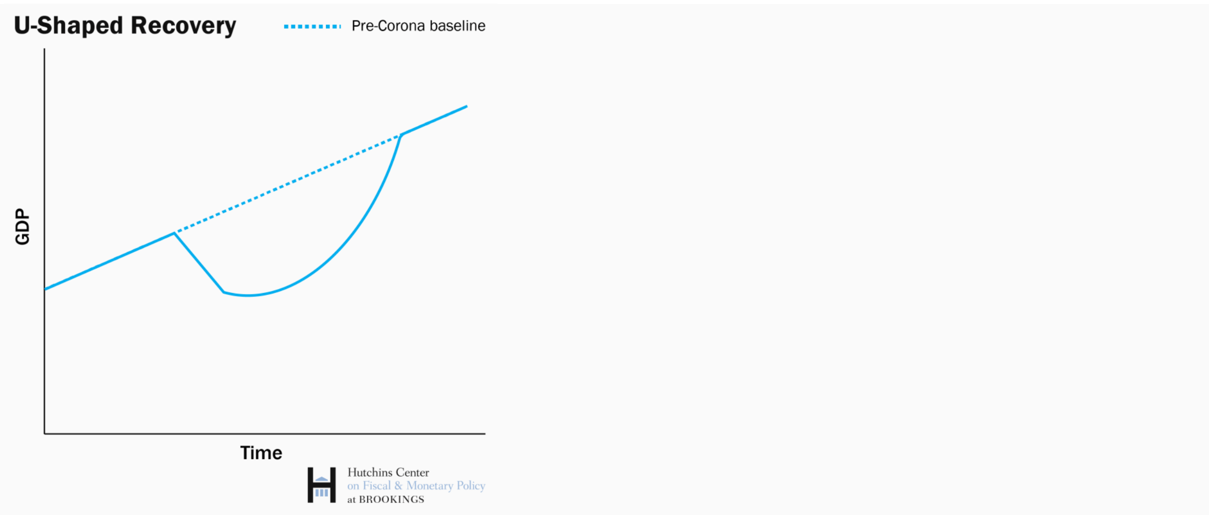
The economy permanently loses the production that would have occurred absent the pandemic, but very quickly returns to its pre-pandemic baseline once social distancing is lifted. Trips not taken, restaurant meals not purchased, and concerts not attended are forgone, rather than delayed, but once life returns to normal, everything is just as it would have been before.



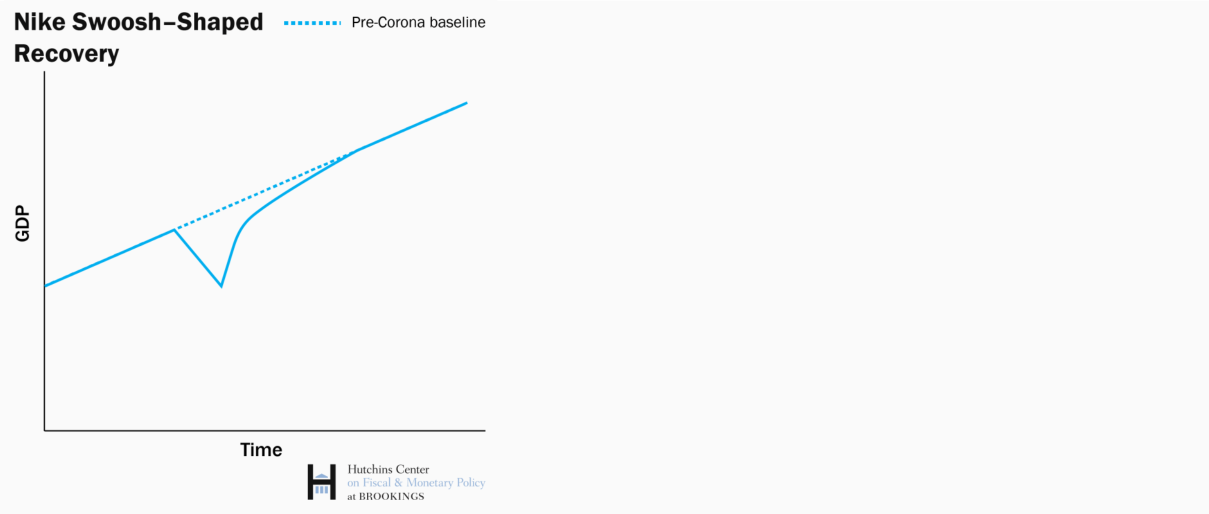
Somewhat pessimistic, and probably more likely: The U or the Nike Swoosh

The effects of the pandemic on economic activity last well beyond the end of the social distancing, and GDP recovers slowly. Even after the health risks recede, the economy still doesn't quickly go back to where it would have been, though it does get there eventually.

This basic story has many possible shapes. In the U-shape, the level of GDP stays low for a while (perhaps because social distancing norms last a long time), but then recovers back to baseline slowly.

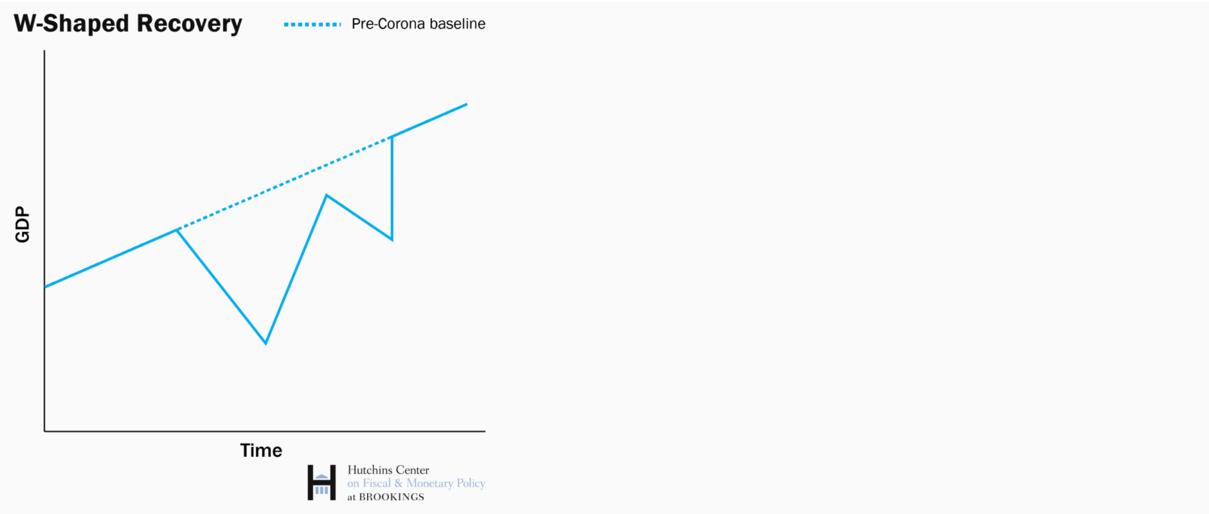


In the Swoosh, borrowed from Nike's logo, the economy starts to bounce back sharply, as restrictions are lifted and economic activity increases, but consumers, businesses, and state and local governments are still hesitant to spend, and it takes a long while for the economy to get back to pre-pandemic trajectory.



Also possible: The W

If the response to the pandemic is a first round of openings that is followed by a surge in COVID-19 cases and another round of closures in the fall, the recovery could be W-shaped.



But then the question will be, what does the recovery from the second (or third, if we do that multiple times) downturn look like?

Most pessimistic: The L

The pandemic has a permanent effect on GDP. Lost investment during the crisis, a rethinking of global value chains, a permanent change to fiscal policy, and a slowdown in productivity growth all have the potential to cause the trajectory of GDP to be lower than it otherwise would. This is basically what the recovery from the Great Recession looked like. (Despite the fiscal stimulus of the American Recovery and Reinvestment Act of 2009 and all the efforts of the Federal Reserve, it took six years for per capita GDP to return to 2007 levels, and real GDP is still well below pre-recession projections.)