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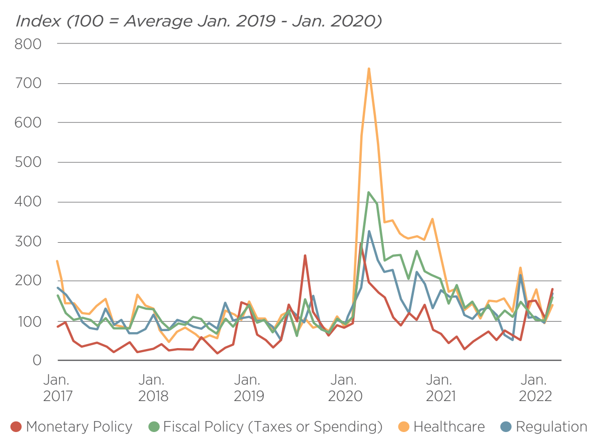
Pandemic-Era Uncertainty

Based on BFI Working Paper 2020-189, "Pandemic-Era Uncertainty," by David Altig, Federal Reserve Bank of Atlanta; Jose Maria Barrero, Instituto Tecnológico Autónomo de México; Nicholas Bloom, Stanford University; Steven J. Davis, Chicago Booth; Brent Meyer, Federal Reserve Bank of Atlanta; and Emil Mihaylov, Federal Reserve Bank of Atlanta

Main Street uncertainty aligned with Wall Street in reaction to the onset of the COVID-19 pandemic and over the ensuing two years; also, uncertainty remains quite elevated as of March 2022, though down significantly since the spring of 2020.

Economic uncertainty rose to record levels in the wake of the COVID-19 pandemic in the United States, fueled by concerns over the direct impact of the virus and the public policy response. Many uncertainty measures remain elevated relative to their pre-pandemic levels, even as the economy has recovered.

Figure 1 • Categorical Economic Policy Uncertainty



Note: This Figure shows that much of the initial EPU surge in reaction to the pandemic reflected concerns around healthcare and fiscal policy, reflecting early media reporting on pandemic-related matters. The CARES Act, a major fiscal policy response to the pandemic and its economic fallout, was enacted near the end of March 2020. As the pandemic wore on, the newspaper-based measure of fiscal policy uncertainty gradually receded. The healthcare policy uncertainty index fell sharply after spring 2020 and again after U.S. government approval of vaccines against the virus in Dec. 2020. Monetary policy uncertainty also fluctuated with Federal Reserve reactions to the pandemic and, eventually, emerging inflationary pressures. Data indexed to 100 from Jan. 2019 through Jan. 2020.

Source: PolicyUncertainty.com (EPU and TEU; data through March 2022)

The authors examine the evolution of several uncertainty measures that are both forward-looking and available in near real-time. Their analysis benefits from real-time measures that supplement traditional macro indicators, which become available with lags of weeks or months. Forward-looking uncertainty measures gleaned from business decision makers prove especially useful for assessing prospective responses to a pandemic shock or other fast-moving developments.

In brief, the authors find the following:

- Equity market traders and executives at nonfinancial firms have shared similar assessments about uncertainty at one-year look-ahead horizons. Put another way, the authors find that, contrary to the message in the popular press, they see little disconnect between "Main Street" and "Wall Street" views.

- The 1-month VIX (an index designed to show future market volatility), the Twitter-based Economic Uncertainty Index, and macro forecaster disagreement all rose sharply at the onset of the pandemic but retrenched almost completely by mid-2021. Thus, these measures exhibit a somewhat different time pattern than the one-year VIX and the authors' survey-based measure of business-level uncertainty.

- The newspaper-based Economic Policy Uncertainty Index shows that much of the initial pandemic-related surge in uncertainty reflected concerns around healthcare policy, which moderated post-vaccines, as well as fiscal policy and regulation. Rising inflation concerns and Russia's invasion of Ukraine became important sources of uncertainty by 2022.

- An analysis of the Survey of Business Uncertainty (SBU)[1] reveals that firm-level risk perceptions shifted sharply to the upside beginning in the summer and fall of 2020 and continuing through March 2022, revealing that decision makers in nonfinancial businesses share some of the optimism that seems manifest in equity markets over this time.

- Special SBU questions reveal that recently high uncertainty levels are exerting only a mild restraint on capital investment plans for 2022 and 2023. This finding differs from earlier in the pandemic, when first-moment revenue expectations were softer and downside risks still loomed large.

The authors note that these and other results illustrate the value of business surveys like the SBU that directly elicit own-firm forecast distributions and self-assessed effects of uncertainties on investment and other outcomes of interest.

[1] In partnership with Steven J. Davis of Chicago Booth and Nicholas Bloom of Stanford, the Federal Reserve Bank of Atlanta developed the Atlanta Fed/Chicago Booth/Stanford Survey of Business Uncertainty (SBU), a panel survey that measures one-year-ahead expectations and uncertainties that firms have about their own employment and sales. (atlantafed.org/research/surveys/business-uncertainty)

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