Covid transparency would soothe markets – Harvey

“Why aren’t our policy-makers sharing their models?” asks Duke University economist

Markets may be wracked with nerves but Campbell Harvey, the Duke University economist, sees at least one step that could help calm them.

Investors may dislike bad news, but they hate no news even more. So governments should be much more open about their Covid-19 models and assumptions, he tells Risk.net: “Investors need to have some sort of expectation and right now there is no forecast – just a lot of uncertainty.”

Harvey wants officials to provide an estimated time-to-peak for the Covid-19 outbreak with a confidence interval around it. “People would see there was an end,” he says. “That would calm markets.”

Epidemiological models apply assumptions about the pass-on rate of disease together with data on factors such as demographics, population density or geographical movement to predict the spread of the disease over time.

https://www.risk.net/investing/quant-investing/7508651/covid-transparency-would-soothe-markets-harvey
Opinion among investment analysts and economists about the likely duration of outbreaks in different countries varies widely, though. The modelling by some governments of the likely path of the Covid-19 epidemic, and a lack of transparency surrounding it, has also come under fire.

The UK government abandoned its initial less-aggressive response to the epidemic within days, thanks to modelling by academics at Imperial College that revealed the government’s plans would lead to eight times more intensive care admissions than the UK health system could accommodate.

The dates investors need a handle on are the inflection point at which the rate of new case numbers starts to decrease and the high point of the “hump” when the rate of increase in new cases goes to zero, Harvey says.

Without such information, there is a chance other new data will be misunderstood. In the US the number of new cases is expected to climb “dramatically” in coming days and weeks, Harvey says, and increasing levels of testing could lead many incorrectly to extrapolate a rate of exponential growth that is “far too high”.

The path of growth in new cases can be modelled easily using data from China and other countries where outbreaks are more advanced, but the US Centers for Disease Control and Prevention (CDC), which leads the work on tracking Covid-19, is yet to release its models.

Data from China captures the outbreak from start to apparent containment, with no new homegrown cases reported in the country in recent days. Models could be calibrated to that data and applied to other countries including the US, Harvey says, taking into account factors such as differences in age distribution.

Other academics have made efforts to determine with relatively simple models the upper and lower bounds of likely paths for the epidemic in countries outside China, using such data.

“The real question is: why aren’t our policy-makers sharing their models? We should not have to rely on leaks reported by the New York Times,” Harvey says, referring to a recent story reporting
scenarios apparently developed by the CDC. “To help resolve some of this uncertainty, we need a forecast and a confidence range.”

New models

Earlier this month MIT professor Andrew Lo told Risk.net that markets would remain **highly volatile** until investors saw convincing and co-ordinated public health measures from policy-makers.

Lo also said investors and risk professionals would need to gain a rapid understanding of epidemiological models, so as to assess the likely damage from the global pandemic on the economy and markets.

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In some quarters those efforts are underway.

Some macro hedge funds are understood to be working on epidemiological models to assess the economic impact and spread of the virus. On the sell-side, UBS research analysts hosted a call for clients earlier this week with an epidemiology professor from Columbia University.

Elsewhere, though, there is little evidence that finance quants are seeking to understand the likely progression of the pandemic and gauge the efficacy of steps to slow it.

Meanwhile, the S&P 500 is down more than 26% since February 21 when the first lockdowns in Italy went into effect. The Eurostoxx 50 is down more than a third over the same period.

Central banks worldwide have slashed interest rates and launched hundreds of billions of dollars of asset purchases to bolster markets.
Liquidity has been strained in **US Treasuries**. Banks have called for clearing houses to **hike initial margin requirements** on benchmark futures and options contracts. The spectre of exchange closures amid erratic price moves has rattled investors who fear such steps could trigger **derivatives unwinds**.

Harvey predicts a “bad recession” in the US as measures to lock down and prevent the spread of the virus freeze economic activity.

“I had called a recession for 2020 on June 30, 2019, based on my yield curve model but predicted it would be mild,” he says. “The pandemic makes it a bad recession.”

The initial Q1 GDP results will show positive growth because the preliminary number will be based on pre-Covid data, but the revised number will show no growth or negative growth, he predicts.

“My guess is that the Q2 number in the US will run -8% annualised if we are lucky. The recession peak will be dated Feb 2020 and be the easiest recession to date in the history of the National Bureau of Economic Research dating committee.”

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