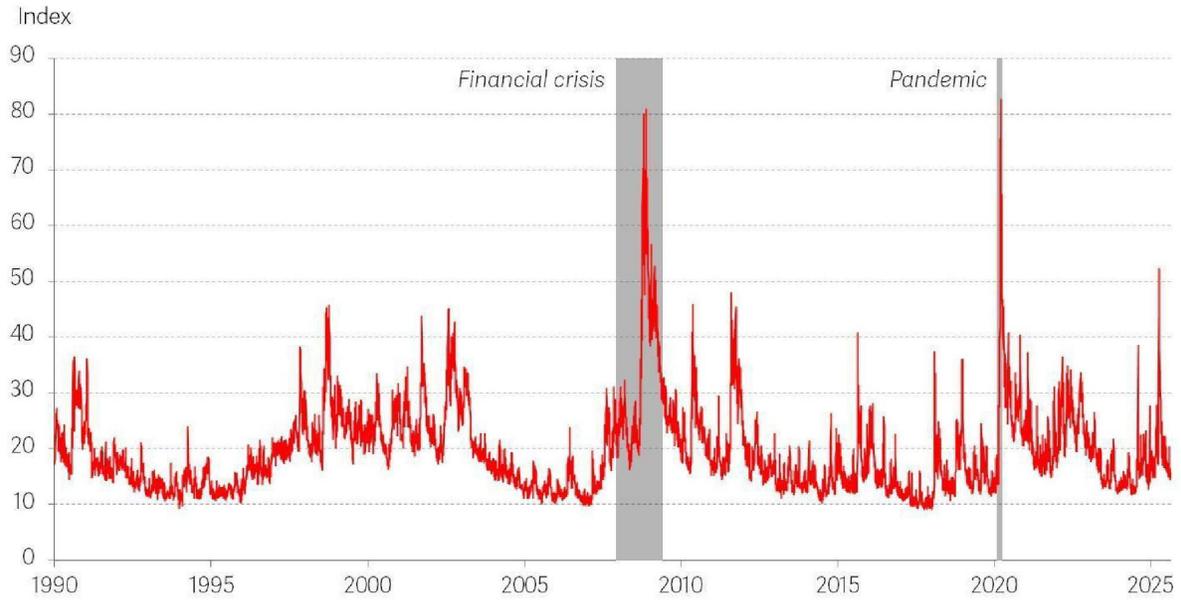


26. This phenomenon is referred to as 'equilibrium social distancing' in research that seeks to incorporate economic behaviour into models of the transmission of health crises – so-called 'epi-macro' models (for a discussion, see: Toxvaerd, 2021 or Eichenbaum, Rebelo and Trabandt, 2021). That is, absent the virus being clearly under control, people will socially distance themselves with or without government instructions (although they probably wouldn't do enough to keep cases to a low level), leading to similar amounts of economic damage.
27. These behavioural effects can become entrenched, however, and extend well beyond the lockdown period. In the UK, demand for in-person services remained depressed long after health concerns receded, whereas sectors such as e-commerce, home delivery, and digital services experienced accelerated growth. The shift to remote work and online consumption is expected to have long-lasting implications for labour markets and productivity (for more on this, see: Barrero, Bloom and Davis, 2021).
28. This creates a risk of a pandemic having a more long-lasting impact – if people become accustomed to behaving as though health restrictions are in place. So an important risk for macroeconomic policymakers is to push against any 'hangover' from the pandemic that comes in the form of prolonged reluctance to return to economic behaviours dependent on social interaction as this will tend to exacerbate the risk that the pandemic has a long-lasting, or even permanent, impact on the size of the economy and wider economic prosperity.

#### **Risks in the pandemic**

29. A final point that is relevant to understanding the pandemic macroeconomic policy response is that there was reason to think that the economic shock could feed back into a severe financial crisis. As shown in Figure 4, measures of financial-market volatility reached very extreme levels – even higher than during the financial crisis – indicating large falls in asset prices. But after the first few months of the pandemic, there was a significant easing in financial conditions. It is striking that, during this period, the huge economic hit and the big swings in asset prices did not lead to the collapse of financial institutions or financial infrastructure. As discussed below, this was by no means assured before the crisis with the Bank of England repeatedly warning about risks in the financial system and low levels of liquidity since the financial crisis (see, for example, Bank of England, 2020).

**Figure 4: VIX volatility index**



Notes: the VIX index measures market expectations of near-term volatility conveyed by US equity options prices. Shaded areas show US recessions.

Source: RF analysis of Chicago Board Options Exchange, CBOE Volatility Index: VIX, retrieved from FRED, Federal Reserve Bank of St. Louis.