Economics

New Strain to Test Europe's Economic Resilience to Lockdowns

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November 26, 2021, 7:59 PM GMT+7

Updated on November 26, 2021, 9:57 PM GMT+7

- High-frequency data suggest bruising has become less painful
- ECB policy makers were showing quiet confidence on resilience

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The new coronavirus variant is set to test the European economy's recent ability to withstand fresh restrictions on activity.

With the new strain from South Africa looming as a threat to public health, adding to the existing headache of rising infections that have already forced Austria and Slovakia to impose lockdowns, a pandemic that countries around the region had previously learned to live with is casting a shadow over the region's prospects.

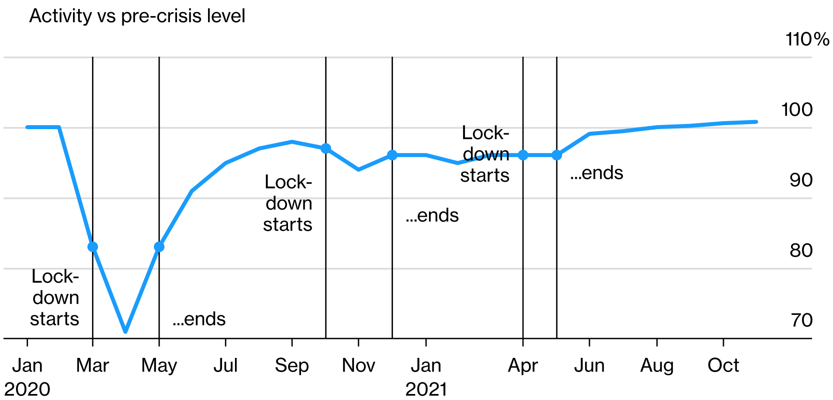
European central bankers were expressing quiet confidence about the economy's ability to weather fresh restrictions before revelations of the variant emerged amid global travel curbs. Meanwhile high frequency data suggest the bruising to growth from such measures has become less painful with each successive lockdown, providing some grounds for hope.

European Central Bank Vice President Luis de Guindos retained some of that sentiment on Friday.

"All the uneasiness generated by the new strain and the increase in outbreaks -- I think its effects over the economy will more limited than last year. I'm optimistic," Guindos said in Spain. "However, it could affect the ongoing problems with supply bottlenecks and energy costs with more intensity."

French Resilience

Economic impact of each lockdown was less severe than previous one



Source: Bank of France

French data support his point: Economic activity in the euro zone's second-biggest economy dropped as much as 29 percentage points during its initial March-May lockdown last year. Yet a subsequent lockdown in October 2020 only dented activity by 4 percentage points, while one starting in April had an almost negligible impact.

If that pattern were to play out across the region -- as data from Bloomberg Economics suggests -- that raises the prospect that the wider economy could just be able to weather a second winter of severe shutdowns without the need to resort to new emergency fiscal aid, or derailing ECB plans to shift away from crisis stimulus.

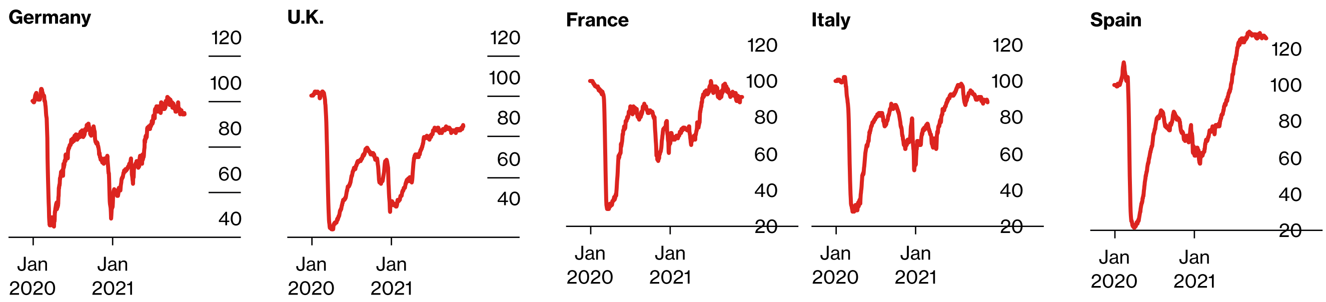
"The experience of the past 20 months shows that each new wave of coronavirus has caused less economic damage than the previous one," Bank of France Governor Francois Villeroy de Galhau told German newspaper Boersen-Zeitung earlier this week. "One thing must not be forgotten either: Vaccination is more advanced in Europe than on any other continent. This is a great sanitary achievement but also an economic advantage."

Just like her French colleague, ECB Executive Board member Isabel Schnabel was sanguine about the possibility of further restrictions, in an interview with Bloomberg this week. Her hawkish colleague, Dutch Governor Klaas Knot, meanwhile expressed confidence that any restrictions wouldn't postpone the ECB's plan to end emergency bond buying in March.

New containment measures are "likely to have a moderating effect on activity in the short run, in particular in the contact-intensive services sector," Schnabel said. "But I do not think that this will derail the overall recovery."

Recovery Watch

Alternative data show Spanish activity above pre-crisis readings, with German & French activity near that level and Italy & U.K. still lagging



Source: Bloomberg Economics, Google, Moovitapp.com, German Statistical Office, BloombergNEF, Indeed.com, Shoppertrak.com, Opportunity Insights
Note: Jan. 8, 2020 = 100

Bloomberg Economics' high-frequency dashboard does paint a similar picture of strength in Europe's other major economies. One reason is that the prevailing policy is now that schools should remain open, allowing parents to focus less on childcare even if their country is in lockdown.

Factories have also learned how to operate during the pandemic. Vaccines and widely available testing facilities have helped that and other sectors of the economy to stay open, though that may be not enough for some consumer-facing businesses such as restaurants.

Paul Donovan, an economist at UBS AG, observes that the biggest economic damage comes from fear of the virus, and that Austrian data suggest that sentiment is less prevalent now that people have got used to living with it.

The new unknown here is the variant, clouding what economists can reasonably predict. The so-called B.1.1.529 strain carries a high number of mutations in its spike protein, which plays a key role in the virus' entry into cells in the body and is also what is targeted by vaccines.

If the variant takes hold and if inoculations are less effective against it, that could change the calculation for economic growth.

Even if it doesn't the current juncture already brings challenges as infections spike. Full lockdowns may still cost 0.5% of quarterly gross domestic product per week, according to calculations by Citi economists, who note that such measures tend to be disinflationary and could incur more government borrowing and monetary support if they persist.

Economists such as Aline Schuiling at ABN Amro still point to how this time is different from the first lockdowns last year that caused global growth to instantly shrivel -- even though the legacy of that slump remains.

"Economies are indeed more resilient," she said. "So the impact will be less dramatic than during previous waves. But you are still in an economy that hasn't yet fully recovered from the waves that we've seen so far."

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– With assistance by Catherine Bosley, Jeremy Diamond, Andrea Dudik, Simon Kennedy, and Bjorn Van Roye

(Updates with ECB vice president starting in fifth paragraph)
