RECOVERY WATCH

4 November 2020

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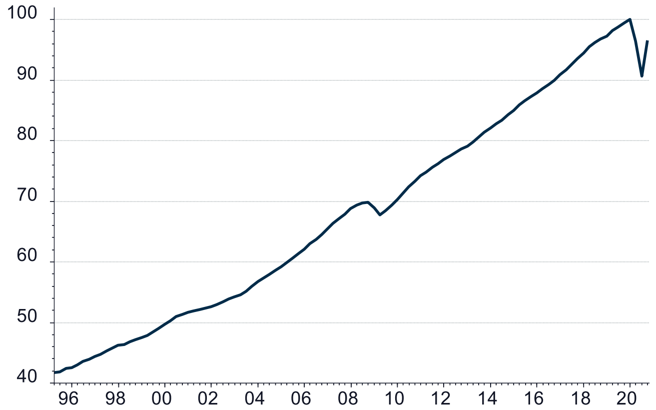
Headlines

- Renewed national lockdowns have been imposed across a number of major European economies
- With global growth stronger than we had assumed in our central case in Q3, and given the experience of other nations that have enacted second lockdowns, the impact on our forecast for the level of economic activity in Q4 may be small
- Whether it is Joe Biden or Donald Trump that wins the US presidential vote, a divided Congress makes further US fiscal stimulus unlikely

Over the past week Belgium, France and Germany have responded to the dramatic increase in identified cases of COVID-19 across Europe by imposing nationwide restrictions on economic activity. And from midnight tonight, England will join Northern Ireland and Wales in implementing its own second national lockdown. The restrictions are, in general, less severe than those imposed in the spring, with schools remaining open. The intention at least is that the constraints will be time-limited, with most countries planning to shut down sectors of their economy for four to six weeks.

G24 GDP

Index, 2019 Q4 = 100



Source: Refinitiv Datastream / Fathom Consulting

With third quarter GDP data now available for close to one half of the global economy, the recovery through to September looks to have been even more rapid than we had assumed in our central, largely V-shaped scenario when we published our *Global Economic and Markets Outlook* for 2020 Q3: we estimate that activity was some 3%-4% below 2019 Q4 levels. It now seems inevitable that European economic growth will be weaker in Q4 than we had assumed. But how much weaker? In this week's Recovery Watch, we examine some of the available evidence and conclude 'probably not much'.

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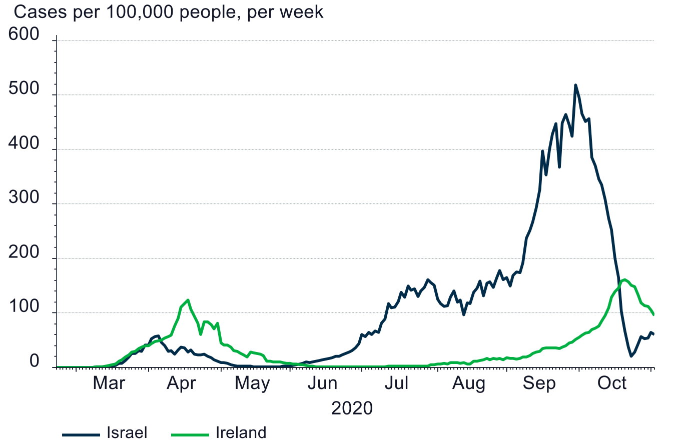
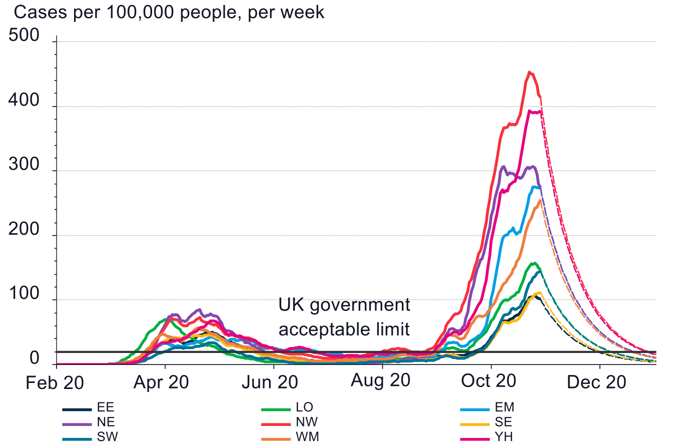
COVID-19 new cases



Source: Refinitiv Datastream / Fathom Consulting

Israel was the first country to enter a second period of national lockdown, which was in place for one month from 18 September. Ireland followed a month later, beginning a six-week period of national lockdown on 21 October. As our chart shows, renewed lockdowns in these two countries have proved extremely effective in bringing down the number of identified cases of COVID-19. We estimate that in Israel the reproductive rate of the virus, 'R', fell to around 0.5. In Ireland, where the schools remained open, in contrast to Israel but in common with most other countries, including England, 'R' looks to be closer to 0.7. 'R' is, to a significant degree, dependent on human behaviours, as well as biological factors such as the level of immunity in a population - in a recent blog post, we argued that confidence in the measures being taken by one's government might be an important determinant of 'R'.

COVID-19 new cases by English region, forecast

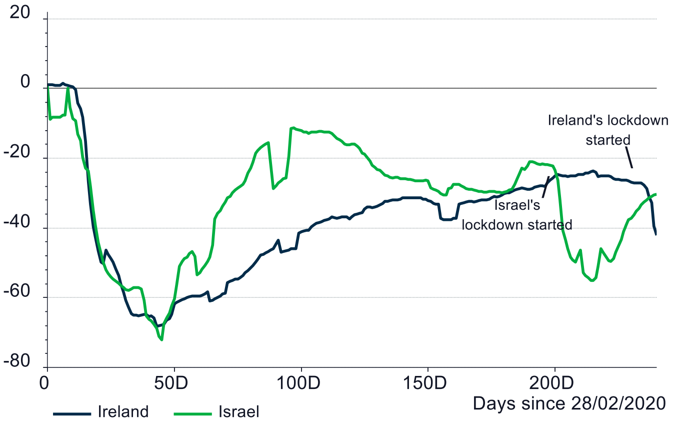


Source: Refinitiv Datastream / Fathom Consulting

If the renewed lockdowns we are seeing across Europe are as successful in bringing down 'R' as those we have seen elsewhere, then it is possible that four to six weeks of restrictions may prove sufficient. In the chart above, we derive projections for the seven-day rate of infections for each of England's nine regions, on the assumption that 'R' falls to 0.7 from tomorrow in each case. On that basis, much of southern England would drop below 20 cases per 100,000 people, per week, by the beginning of December, with London a week behind, and parts of northern England up to three weeks behind. This is a rate of infection with which the UK government seems comfortable. If we are right, the national lockdown will probably come to an end on 2 December, as planned, though with some regions continuing to face more restrictions than others.

Time spent in the workplace

Relative to normal levels, seven-day moving average, per cent

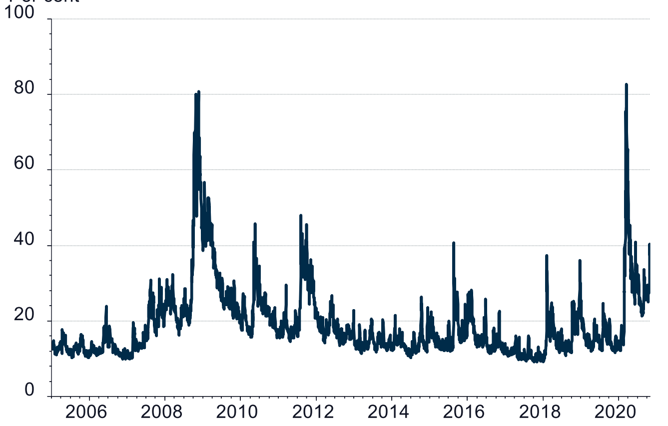


Source: Refinitiv Datastream / Google / Fathom Consulting

How will these renewed national lockdowns affect economic activity? There are grounds to believe that a week of lockdown will have a much smaller impact the second time around than it did in the spring. First, in almost all cases, the restrictions are less severe, with schools remaining open. Second, and perhaps more importantly, we have learnt more about the virus, and we are more prepared, which ought to mitigate the economic impact still further. On the demand side, we know more about the modes of transmission than we did in the spring, so people are likely to be less fearful about leaving the house to visit those businesses that do remain open. And there is less uncertainty, with fiscal support measures tending to be in place before the lockdowns were enacted, and with a vaccine seemingly just around the corner. On the supply side, businesses have adapted. Those that are allowed to open have already made themselves COVID-secure. Many of those that are not, particularly in the hospitality sector, will already have established an online presence, offering delivery or takeaway options. Google mobility data for Israel and Ireland show that the proportion of time spent in the workplace - a crude proxy for the impact on supply - fell by one quarter to one half the amount recorded during the first lockdown. In that regard, we consider a reduction in activity per week of lockdown that is one half the size of that seen in the spring to be a cautious rule of thumb.

S&P 500 VIX

Per cent



Source: Refinitiv Datastream / Fathom Consulting

Increased nervousness on the part of investors is evident in the VIX measure of equity market volatility, which has risen sharply since mid-October. Nevertheless, this so-called 'fear gauge' remains substantially below levels seen in March. Our own proprietary metrics tell a similar story. Fathom's Risk Off Gauge, the FROG, has jumped back into uncertain territory, from a position back in early October where investors were decisively 'risk on'. Finally, the FLiq, our measure of market liquidity based on the discount earned on closed-end funds, showed a further fall in liquidity last month. Assets exposed to a shortage of liquidity are likely to suffer in the near-term until uncertainties about the outcome of the US election are resolved.

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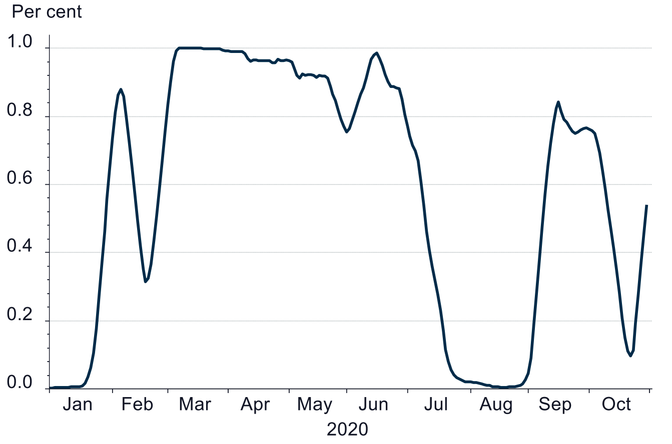
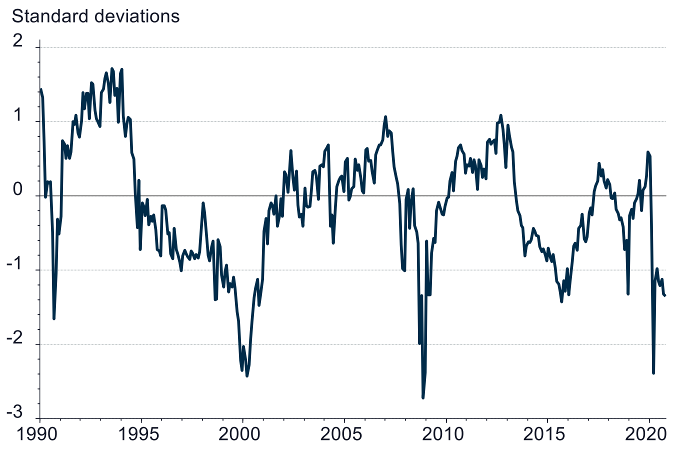
Fathom risk-off gauge (FROG), daily



Source: Refinitiv Datastream / Fathom Consulting

Fathom Liquidity Indicator



Source: Refinitiv Datastream / Fathom Consulting

Interesting reading

- 80% of recent UK COVID-19 infections are from a strain of the virus that emerged in Spain over the summer, according to research cited by the FT, suggesting that international travel may have been responsible for seeding the UK's second wave, just as it was the first: https://www.ft.com/content/2782655a-0441-4d38-bb03-5c4e67ead110
- The UK governments 'Eat Out to Help Out' scheme may have helped to drive up the number of new cases, research carried out at the University of Warwick concludes: https://warwick.ac.uk/fac/soc/economics/research/centres/cage/manage/publications/wp.517.2020.pdf
- A dashboard of projected COVID-19 new cases by English region (desktop only): https://public.tableau.com/profile/laurence.turner#!/vizhome/ProjectingUKCOVID-19cases/Casesper100000
- In a recent NBER working paper, Pol Antràs, Stephen Redding, and Esteban Rossi-Hansberg consider the relationship between globalisation and the frequency and severity of pandemics, concluding, as is often the case in economics, that it is ambiguous: https://www.nber.org/system/files/working_papers/w27840/w27840.pdf

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