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Global Macro Watch

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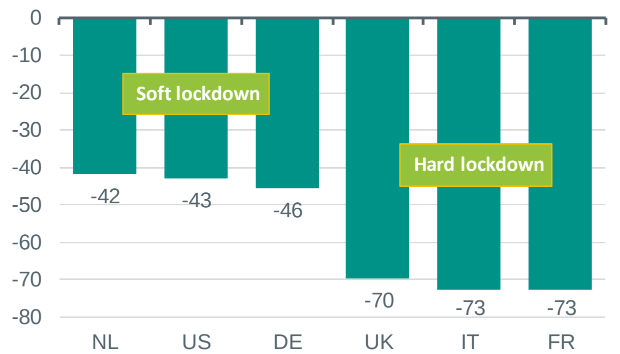
Covid-19 hit to GDP: Some will fare much worse than others

- **There are significant differences between countries in pandemic severity and lockdown intensity**
- **Alongside variation in digital preparedness and tourism exposure, this is leading to starkly different economic outcomes, with some countries experiencing more severe downturns than others**
- **We find that Italy, France and the UK are seeing the most significant macroeconomic impact, with the Netherlands, Germany and the US faring better**
- **In the US and UK, Q1 GDP fell by less than in other countries because lockdowns were implemented later, but a much bigger impact will be visible in Q2**
- **Those with more severe 2020 downturns are likely to experience more permanent economic damage**

We now have Q1 GDP data for all major advanced economies. While estimates remain tentative and subject to revision, they give an early read on the impact of covid-19 lockdowns on 2020 GDP. We see striking differences in Q1 output. Some of this is due to the differing timing of lockdowns, which means we are likely to see much bigger hits to GDP in Q2 in the UK and the US than in much of continental Europe, where lockdowns started earlier. However, this does not explain the full story, with significant differences between countries in our full year forecasts for 2020. This is due to the differing policy responses, with some countries pursuing far stricter lockdowns than others. We also see major differences in digital preparedness, and exposure to tourism, which is seeing a 'sudden stop' due to the outbreak. Overall, we find that the US, Germany and the Netherlands will see the smallest 2020 contractions, while the UK, Italy and France will see the biggest contractions. The countries with the biggest contractions will see bigger statistical rebounds next year due to base effects, but in these countries the permanent damage from higher bankruptcies and unemployment is likely to be greater.

Major differences in lockdown strictness…

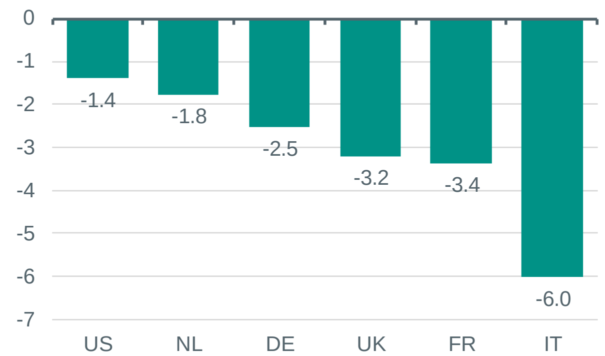
% change in visits to workplace and retail establishments in April



Source: Google, ABN AMRO Group Economics

…leading to even worse macro outcomes for some

Forecast change in GDP from Q4 2019 to Q4 2021, pp



Source: ABN AMRO Group Economics

Lockdown impact a function of strictness and length

Among advanced economies, the first country to implement a covid-19 lockdown was Italy. Starting on 21 February in the hardest hit Northern provinces, and expanding to the entire country by 9 March, Italy's lockdown has been both the longest so far, and one of the most strict. Following Italy, almost every advanced economy went into some kind of lockdown lasting at least one month. Indeed, one reason Italy is bearing the economic brunt of this crisis is that it was the first advanced economy to experience a major outbreak, while other countries had the advantage of being able to prepare more in advance. With that said, there has been significant variation in the strictness and the length of lockdowns even among the countries that moved later. Using Google's covid-19 mobility data as a proxy, we find that the UK and France have followed a similar lockdown model to that of Italy, while Germany, the Netherlands, and the US (on average) are experiencing less strict and shorter lockdowns. This reflects significant policy differences between countries. Broadly, we define these two lockdown models as follows:

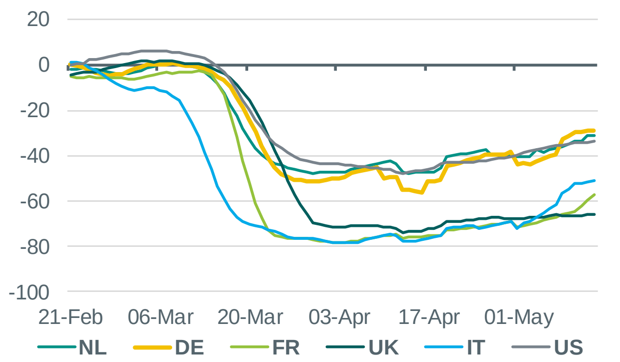
Hard '70%' lockdown: Broad restrictions on almost all forms of outdoor activity. All non-essential business (including manufacturing and construction work) banned. Movement falls of c.70%.

Soft '40%' lockdown: Highest risk activities involving close human contact are banned, but lower-risk manufacturing, construction, and even retail (in the Netherlands) allowed. Movement falls of c.40%.

The impact of a lockdown on GDP is rather mechanical, since by definition lockdowns restrict a significant proportion of economic activity (see our Watch notes on the eurozone, Netherlands and the US for more). While this varies per country, in the eurozone on average we estimate that each week of lockdown reduces 2020 GDP by 0.75pp.

Italy and France the first to go into lockdown

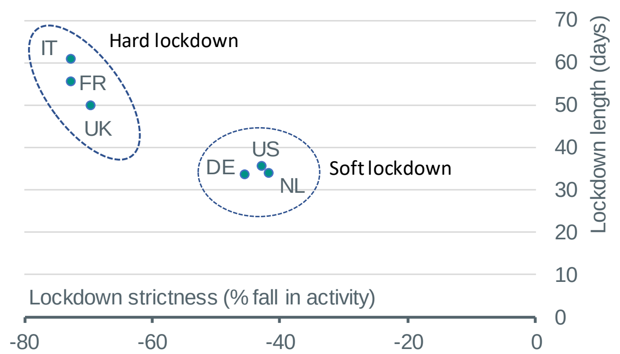
% change in travel to workplace and retail establishments



Source: Google, ABN AMRO Group Economics

These countries also have the strictest lockdowns

Lockdown strictness vs number of days



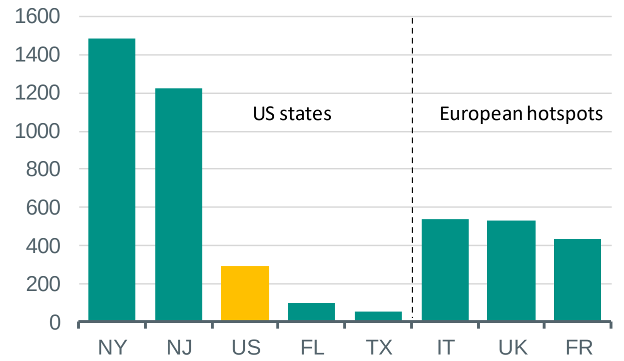
Note: Lockdown length is defined as the number of days with a fall in activity greater than 40%. Source: Google, ABN AMRO Group Economics

Some US states have fared much worse

Note that while on average the US is a 'soft lockdown' country, there is considerable variation between states, due both to intensity of outbreaks and differing politics. For instance, some northeastern states (New York, New Jersey, Connecticut and Massachusetts) have lockdowns similar in intensity and length to the 'hard lockdown' European countries. They also have even worse outbreaks of covid-19 than the hardest hit European countries; New York and New Jersey (combined population: 28.3mn) have almost three times the number of covid-19 deaths per million as Italy and the UK. However, the majority of states, including less densely populated states such as Florida and Texas have much less severe outbreaks, had less restrictive lockdowns, and are reopening their economies more quickly. This has meant overall falls in activity in the US are similar to a 'soft lockdown' European country.

Some US states have been hit much harder than others

Covid-19 deaths per million



Source: Various, ABN AMRO Group Economics

Replication rate now below one in all major economies

Covid-19 replication rate

Source: Imperial College London, ABN AMRO Group Economics

‘R’ is now below one – how long it stays there will shape reopening of the economy

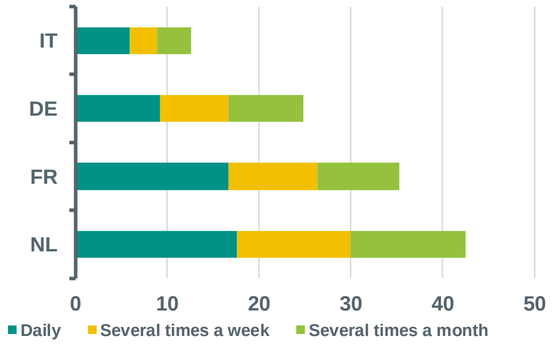
While there is uncertainty around estimates, all major advanced economies have managed to get the current virus replication rate (the so-called ‘r’) down to below one, meaning that each person infected with covid-19 infects less than one other person on average. Keeping this measure below one – and ensuring healthcare systems do not become overwhelmed again – appears to be the main policy goal now for most governments, rather than eradicating the virus entirely. This will therefore determine how much economies can continue to be reopened; if the ‘r’ rises above one in a sustained manner in a given country, the government will likely have to reimpose some restrictions. This will depend on the successful maintenance of social distancing rules, and implementation of mass testing and tracing regimes that have proved successful in Asia. While some data shows the ‘r’ moving up again in recent weeks, as economies have started gradually reopening, the increase has been rather small so far, and it seems in part at least to reflect increased testing (see for instance here).

IT infrastructure crucial for adaptability

The disruptions brought about by covid-19 also highlight the importance of IT infrastructure and digitalization, with working from home and online retail helping to ease the disruptions to activity. In this respect not only has private investment in hardware and IT infrastructure been important, but also public investment in online connectivity (high-speed broadband internet), mobile phone networks and digital skills. On almost every metric, we find that the Netherlands, Germany, the UK and the US have been best prepared for the shift of their economies online, with France and especially Italy markedly less well prepared.

Working from home the ‘new normal’

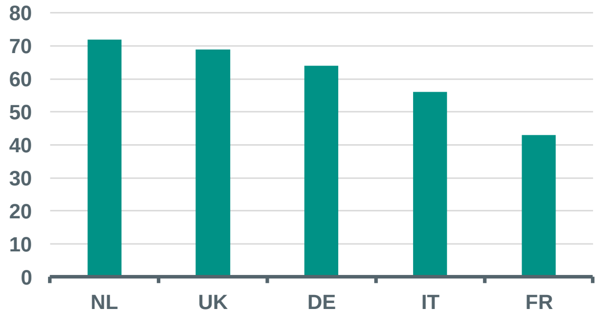
Survey, answer to: “How frequently did you work from home before the outbreak of covid-19?”



Source: Eurofound

Remote digital access low for the French

Percentage of companies that provide employees with remote digital access to enterprise's email, documents and applications, in 2019



Source: Eurostat

Working from home the 'new normal' – but not every country was well prepared

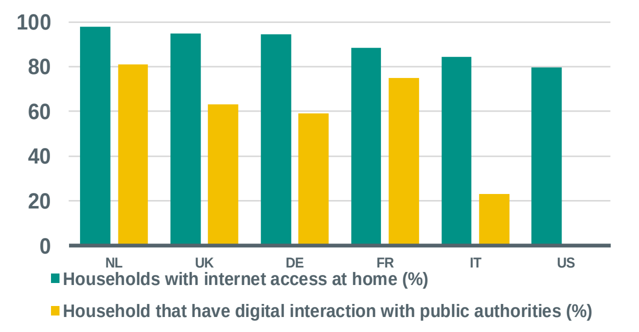
In some countries, working from home was already much more integrated in the daily lives than in other countries. For example, in the Netherlands around 60% of the working population had worked from home before, versus 32% in Italy. Eurostat data shows that over 70% of companies in the Netherlands provide remote access to business email, documents and applications, while the comparable number for France is only a little over 40%. Moreover, employees need (stable) internet access in order to work remotely. In general, internet connectivity among households is good among all countries covered here, although some differences remain. In the US, around 80% of the total population is connected to the internet, versus almost 100% in the Netherlands, the UK and Germany. There are also big differences in terms of digital connectivity to the government, as shown below in the left graph below. The data for Europe shows that between 60-80% of Dutch, UK, German, French and Spanish households have digital interaction with government, whereas this is just above 20% for Italy.

The shift to online retail has dampened the negative effects of the lockdown

80-90% of businesses in the Netherlands, Germany, the UK and the US have a website, with this figure closer to 70% for France and Italy. Online spending habits also differ considerably per country. The UK and the US are frontrunners in this respect, with online retail sales as a share of total retail sales at 17.5% and 16.6% respectively as of 2018. This is around 10% for France and the Netherlands, and significantly less (3.4%) for Italy. Using our own transaction data for the Netherlands, we find that there has been a rapid shift from offline to online spending. Indeed, this trend has accelerated in recent weeks – probably because retailers and consumers who were formerly less active online are now turning to digital platforms. The data shows, for instance, that in online orders placed with restaurants has doubled compared to 2019 (see: Consumer in the corona virus era). Online sales can partly offset the loss in offline sales, but the extent to which this can happen clearly differs massively between countries.

Digital connectivity of households high

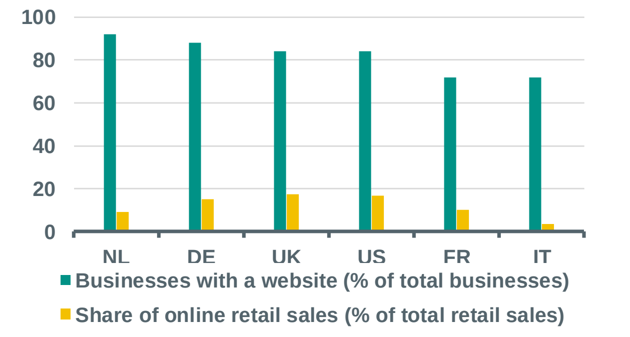
% share of total households, 2019; no data for the US



Source: OECD

Online sales particularly low in Italy

% share of total businesses, 2018



Source: Eurostat

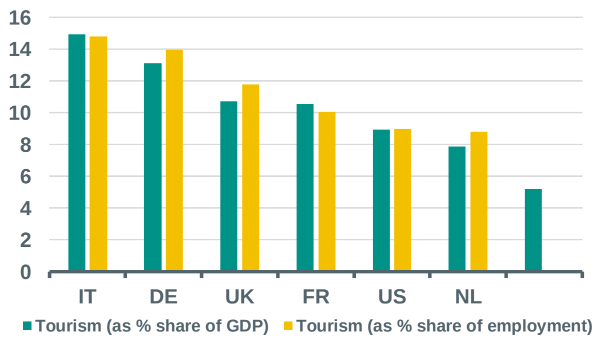
All in all, the Netherlands, together with Germany, the UK and the US are better positioned to quickly adapt to the rapid shift in digitalization. For France, and especially for Italy, the shift online has been more sluggish. Our expectation is that social distancing policies are likely to prevail for some time to come. Countries that have been better prepared, whether in terms of home working or e-commerce have not only been able to offset the activity losses of the current lockdowns, but will also be better prepared for the coming months – perhaps years.

Impact of tourism collapse is especially big for southern Europe

Global tourism flows have collapsed since the outbreak of the coronavirus, either because authorities have put certain countries in a state of lockdown, or have issued negative travel advice, or because tourists have cancelled or postponed trips voluntarily. Even with lockdown measures now being lifted, tourism is unlikely to jump back to levels seen before the coronavirus outbreak. Some governments are imposing quarantine requirements on inbound arrivals (UK), while others are not (Italy). Moreover, tourists from outside of Europe may be hesitant to visit given that the virus has yet to be fully contained. Looking at tourism as share of GDP in the left graph below, southern Europe is especially vulnerable to the sharp drop in tourism. The Netherlands seems least hit, although a similar share of workers are in tourism as in the US.

Tourism especially important for South

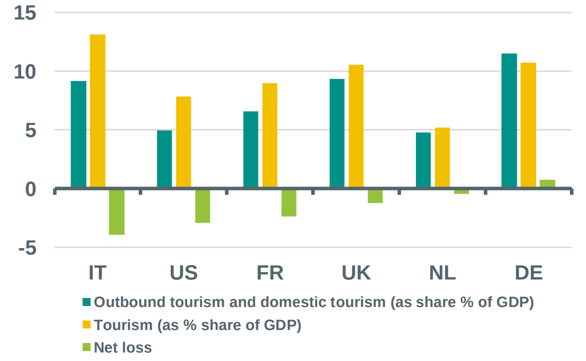
% share of of GDP / employment (in 2018)



Source: Worldbank

South biggest loser if borders don't open

% share of GDP (in 2018)



Source: Worldbank and ABN Amro Group Economics

With tourism having essentially ground to a halt during the lockdown period[1], we find that the biggest negative impact will be on Italy (around 2.5pp off 2020 GDP), with notably smaller impacts elsewhere (as low as 1pp in the Netherlands). Now lockdowns are being lifted and the bans on free movement of people within countries is relaxed, some countries could benefit from higher domestic tourism. If we look at the countries that would benefit the most if their residents decided to spend their holidays in their home country instead of abroad, Germany and the Netherlands are likely to be the biggest beneficiaries. The dark green bar in the right graph above shows the sum of the total expenditure by domestic tourists and tourist from that particular country abroad. The yellow bar shows the total tourism revenues (foreign and domestic) as percentage share of GDP. The light green bar shows the countries loss/profit as percentage share of GDP if their citizens decide to spend their holidays domestically. Such a scenario would especially be devastating for southern Europe. The negative impact for Italy for example would be around 4% of GDP.

Unprecedented fiscal support measures across all countries

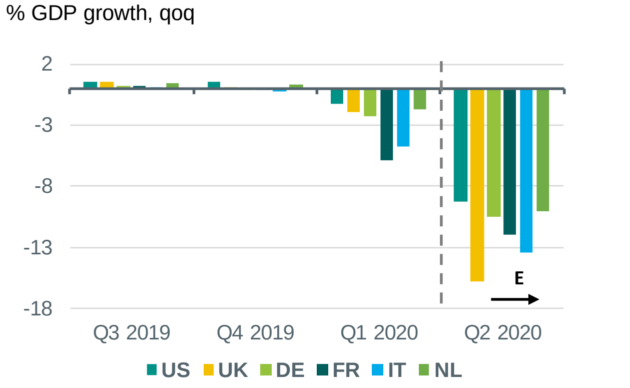
Governments have announced a flurry of fiscal support measures since the outbreak of the covid-19 virus. In the eurozone the largest part of the announced stimulus has come in the shape of liquidity support, e.g. bank loan guarantees as well as lending schemes, which amounts to around 20% of GDP on average in 2020. These liquidity support measures are designed to limit the instant hit to the economy from lockdowns and to give businesses and consumers a 'liquidity bridge' to the post-lockdown economy. Germany and Italy have announced the biggest liquidity support measures (see graph below), although in the UK there is no longer an overall cap on guarantees. Besides this, governments have also announced discretionary policy measures (e.g. investment in health care, direct income support for small companies and households, and tax deferrals), with the smallest in France (3.0% of GDP) and the largest and most ambitious in the US (11.3%). These discretionary policy measures tend to support growth with a lag of a couple of quarters. Finally, there will be a fiscal impulse from the working of the so-called automatic stabilisers (equal to around 5.7% GDP on average), including for instance an increase on social security spending and tax income declines during an economic downturn. These automatic stabilisers are expected to be largest in France, Italy and the Netherlands. Overall, there is significant fiscal support in all countries, with the key differentiator likely to be how quickly and efficiently governments are able to disburse that support. On this, the jury remains out, but we suspect European countries – which have more experience with wage subsidy schemes that keep workers on payroll – might fare better than the US, where workers on furlough have had to apply for unemployment benefits (thus raising the risk that they become permanently displaced from the labour market).

[1] We make the general assumption that the lockdown period was two months for all countries. We also assume that during this period there was no domestic tourism (as in most countries unnecessary travel within the country was prohibited).

Growth outlook: Southern Europe and the UK will see the biggest hits to GDP

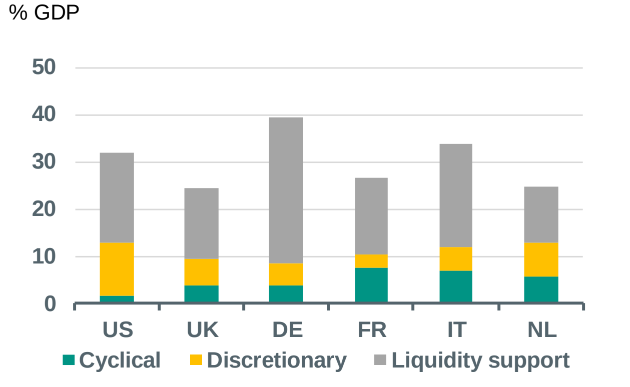
While every country will take a big hit from the covid-19 outbreak, taking everything together – strictness of lockdowns, digital preparedness, and tourism reliance – we find that southern Europe and the UK are likely to see the biggest falls in GDP when all is said and done.

Every country to see the biggest hit in Q2



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Discretionary fiscal support the highest in the US



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

In France and Italy, which went into lockdown the first (on 17 March and 9 March, respectively) and also implemented the most stringent lockdown measures (keeping all people in non-essential occupations confined to their homes unless they had to go out to buy food or seek medical advice), GDP fell by 5.8% and by 4.7% qoq, respectively, versus the eurozone total of -3.8%. The fact that GDP contracted more sharply in France than in Italy seems surprising given that France's economy is less dependent on tourism than Italy's, and that working from home appears to be more prevalent in France than in Italy (see '**Working from home the 'new normal' – but not every country was well prepared**'). We think these differences will make themselves more apparent in the coming quarters though.

Smaller Q1 falls in Germany, the Netherlands, US and UK

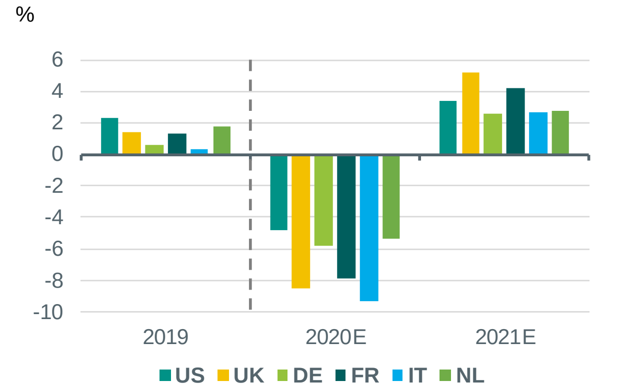
Germany and the Netherlands went into lockdown around the same time as France, but implemented less stringent measures, and still allowed people to leave their houses. Moreover, similar to France, working from home is relatively common in Germany and the Netherlands, and the economic importance of tourism is relatively modest in these countries as well. As a result of all these factors, GDP in Germany and the Netherlands fell considerably less sharply than the eurozone total, by 2.2% and 1.7%, respectively. Finally, in the US (-1.2% qoq) and the UK (-2.0% qoq) the contractions in Q1 GDP were also relatively mild, which largely reflects that fact that these countries went into lockdown towards the end of Q1 – about one week after France and about two weeks after Italy. In the US, it is also because the lockdown has been less far-reaching overall.

Every country to see a big Q2 contraction – but especially the UK

Looking forward to Q2, all six countries continued their lockdown measures during the full month of April and subsequently eased them very gradually and step-by-step during the course of May. As the UK implemented the same stringent lockdown measures as France and Italy albeit about one to two weeks later (as from 23 March onwards), we expect the UK economy to be hit particularly hard in Q2 and we see GDP contracting by almost 16% (see figure above). Next, we expect GDP in Italy and France to contract by around 13.5% and 12%, respectively, with Italy weaker than France due to Italy's relatively large dependence on tourism, and because working from home is a far less established custom. We think these factors will weigh heavier than the fact that Italy eased its strict lockdown measures around one week earlier than France (4 May versus 11 May). As the lockdowns in the US were not as stringent as in France and Italy, and more comparable to Germany and the

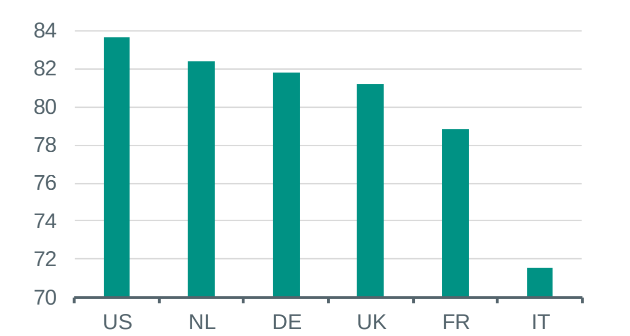
Netherlands, we expect the US's GDP to contract by around 9.2% qoq in Q2, which is roughly comparable to the rates of contraction that we expect for Germany and the Netherlands (of around 10.5% and 10% qoq, respectively).

Annual growth forecasts



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

US and Netherlands top the competitiveness ranks



Source: WEF, Global Competitiveness Report 2019

2021 Outlook: Look past the statistical rebound effects

Countries that have experienced the sharpest contractions in GDP due to the covid-19 crisis and lockdowns in 2020, will start 2021 from a lower base and will show a stronger statistical rebound in 2021. However, in these countries the second round effect of lockdowns due for instance to higher unemployment, tighter financial conditions, corporate defaults and supply chain disruptions will be stronger than in countries that have experienced shorter and less severe downturns in 2020. Next, the size and effective implementation of the fiscal and monetary support measures will also play a major role in determining 2021 growth prospects.

Finally, more fundamental differences that determine a country's competitiveness, its longer-term growth potential and ability to recover from negative shocks are also relevant. These include the regulatory environment, the efficiency of the goods and the labour market, technological progress, the quality of the infrastructure and the functioning of institutions. On global competitiveness rankings that measure these economic characteristics, the US and the Netherlands tend to score the highest of the six countries that are discussed in this note, Germany, France and the UK in the middle, and Italy the lowest. Moreover, countries that had a stronger starting point, such as a tight labour market and low government debt, are likely to bounce back more quickly. Taking all factors together, we expect Italy to see the biggest overall hit, with GDP likely to be 6pp lower in Q4 2021 compared to Q4 2019, while the US, the Netherlands and Germany will see the smallest GDP hits.