Finanzgruppe
Deutscher Sparkassen- und Giroverband

The second wave of Covid-19 is gathering: Economic and monetary policymakers need to act circumspectly!

CORONA - NEWSLETTER

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From March to June 2020, the economists of the German Savings Bank Finance Group (Sparkassen-Finanzgruppe) regularly provided information in Newsletter format about the most important economic-policy developments during the first escalation phase of the coronavirus pandemic, marked by an extensive lockdown. The sharp surge in the tally of Covid-19 infections now that autumn has arrived, and the virtual conference bringing together Chancellor Merkel and the country's regional premiers on October 28, make it clear that we in Germany are once again entering a phase involving further restrictions on personal contacts. We do not expect this phase to have quite as massive an impact on the economic trend as the shutdown imposed in the spring. From our perspective, the following points need to be noted:

- A historical comparison with the Spanish flu epidemic 100 years ago permits the following inference for the coronavirus crisis: viral pandemics almost always unfold in waves and lead to sharper fluctuations in cyclical activity (see excursus).
- Following the strong GDP growth performance generated in the third quarter (8.2 percent quarter on quarter), we currently assume that German aggregate economic output growth in the fourth quarter of 2020 and the first quarter of 2021 will probably slow to around zero (cf. below the Dekabank study "Lockdown 2.0: Effects").
- We believe that both fiscal and economic policy in Germany, as in Europe as a whole, is well-positioned to contend with this renewed slowdown. Final negotiations on the European Reconstruction Fund will take place under the auspices of the German Council Presidency. Germany's national economic stimulus and crisis measures (Bridging Assistance III, and now, additionally, the Extraordinary Economic Aid programme) are crucial for the country's small and medium-sized enterprises. These schemes should be continued in a carefully-thought-through manner, taking into account pandemic-related structural changes.
- Monetary policymakers have so far reacted appropriately. It remains important, though, to keep the financing channel constituted by the banking industry open in order to support the recovery processes in the various economies. This will require further relief in the form of an increase in the ECB's tiering multiplier (relating to the exempt tier of excess liquidity holdings) for banks and savings banks.

Excursus

Spanish flu and coronavirus - what lessons can be learned from the past to help us with the second wave?

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An urgent question doing the rounds on the capital markets at present is: What economic effects is the second coronavirus wave going to have? For the purposes of economic policy, knowledge about the economic consequences of further restrictions, or even blanket lockdowns, would be important in order to find the right balance between containment of the pandemic, on the one hand, and free social life and free enterprise, on the other.

It is an obvious step to compare the current pandemic with the only similar situation in modern economic history, the Spanish flu epidemic of 1918/19. Unfortunately, drawing such a comparison is complicated by various factors. The most important of these is the almost complete absence of economic data from the earlier period. Data on income, employment, turnover or wages, let alone mobility data, are not available, especially not at a regional level. The technological circumstances of the two periods are also very different: in contrast to their colleagues in the early 20th century, policymakers are now, for the first time ever, in a position to decide on the length and extent of restrictions on economic activity, including lockdowns.

Insufficient data hampers comparison to the Spanish flu

In many sectors, digital communication has, for the first time, created the preconditions for keeping business operations going against a background of social distancing. Or to put the point differently: 100 years ago, attempts at social distancing had to be abandoned after a short time in order to keep the economy running at all.

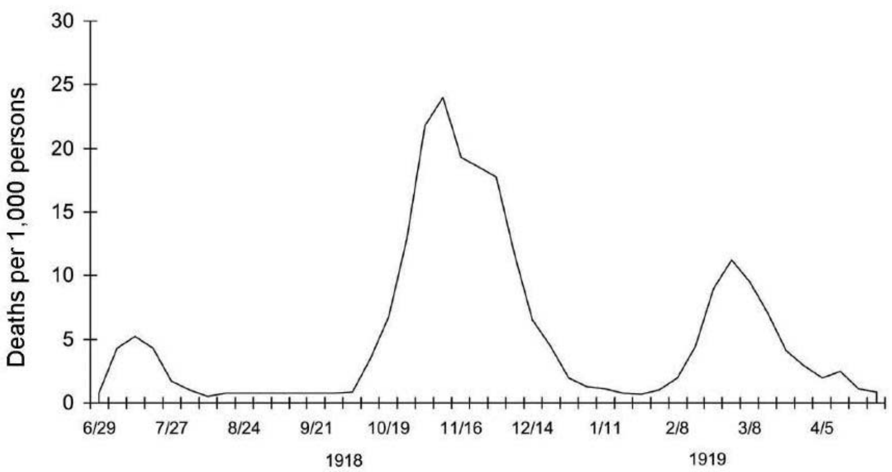
The macroeconomic toll taken by the Spanish flu can only be very rudimentarily gauged from the gross domestic product figures. In the USA, which was affected very adversely by the pandemic, aggregate economic output still rose significantly in 1918, and it was not until 1919 that there was a decline in GDP of about 4 percent that can be linked to the pandemic. The Dow Jones surged clearly throughout the entire pandemic-stricken year of 1918 through to about mid-1919.

The severe recession and the stock-market crash of 1920/21 can no longer be unambiguously attributed to the Spanish flu. In this context, it must also be taken into account that economic data in the early 20th century generally fluctuated more sharply due to the lack of automatic stabilisers in the form of social-insurance systems. Neither is it possible to chart the individual waves of the pandemic in terms of quarterly or monthly activity data.

A further point to note is that the overlap with military expenditure from the end of World War I probably makes it more difficult to isolate the knock-on effects of the pandemic.

Regional anecdotal information reports similar developments to those which can be observed today: revenue and income losses exceeding 50 percent in the services sector, a decline in industrial production of more than 50 percent at the peak of local lockdowns. In almost no country was there a centralised anti-pandemic policy; the authorities' reactions took place exclusively at a local level.

The Spanish flu was the most devastating epidemiological event in modern times, causing an estimated 20-50 million fatalities worldwide (including 675,000 in the USA), and although parallels to the coronavirus pandemic are unmistakable, the death toll at the beginning of the second wave (Johns Hopkins University data, cut-off date: 29.10.2020) is 1.17 million worldwide (including 228,000 in the USA). In view of the developments that are becoming apparent on a daily basis, the important thing is to remain vigilant and to ponder loosening measures very carefully so that they are not applied prematurely - this holds true especially in the case of mobility and contacts - so that history does not repeat itself on the scale of 1918/19.



Source: diagramm adapted from Taubenberger JK, Morens DM. 1918 influenza: the mother of all pandemics. 2006

The chart above shows weekly fatalities (per thousand) during the Spanish flu in Great Britain, and makes clear the severity of the second wave, which began in the autumn/winter of 1918/19, by comparison to the first wave.

Regarding today's situation, the most obvious conclusion to be drawn from this anecdotal evidence is that, from an economic perspective, the health crisis should be contained regionally for as long as possible, but that a coordinated anti-pandemic policy is nevertheless essential.

Below please find the latest Macro Research publication by DekaBank, "Lockdown 2.0: Effects."

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Lockdown 2.0: Effects

1. If the measures are, in the end, implemented as discussed in the run-up to the consultations, they will entail a significant setback for the economic recovery. All the same, a further slump in aggregate economic output of the magnitude sustained in the second quarter (-9.7 percent) is not to be expected, as the new lockdown rules are more flexible and targeted than back in the spring. In addition, the economy has adapted to production under the shadow of Covid-19 with the help of better job-security strategies, and global demand is improving thanks to stable Chinese and US markets. Schools and day-care centres are also scheduled to remain open, cushioning the economic impact.

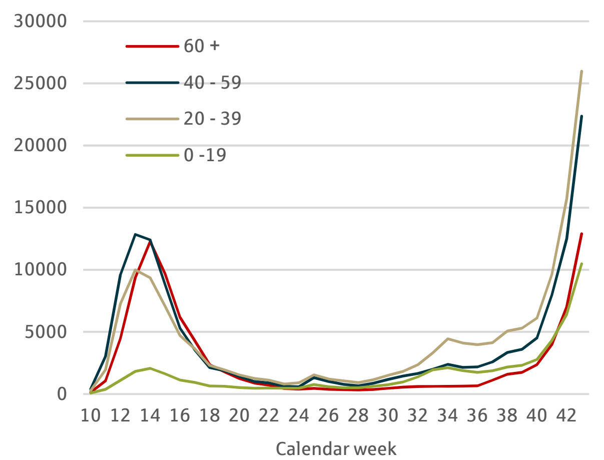
2. Nevertheless, the almost complete lockdown in the catering, tourism and events segments spells extensive production losses in the services sector. These segments account for about 15 percent of overall private consumption in Germany. Continued strong global demand for exports is being counteracted by a slowdown in neighbouring European countries, which have also been hard hit and absorb 40 percent of German exports.

3. Overall, the gross domestic product in Germany, which in the absence of new measures would have continued on its recovery trajectory in the fourth quarter, racking up a growth rate of around 1½ percent, is now likely to shrink again by up to two percentage points compared to the previous quarter. The further course of events will depend very much on the trend in the tally of infections. In view of the possibility of the new, stricter rules being relaxed again, the growth rate for the first quarter of 2021 could beat the current projection of ½ percent, amounting to 2 percent on a quarter-on-quarter basis. On the other hand, if the measures are not eased at the beginning of the new year, aggregate economic output will do little more than stagnate in the first quarter.

4. With regard to medium-term prospects, it is important that fiscal coronavirus relief measures should be extended and expanded. Only in this way can it be ensured that the new set of lockdown measures does not spawn any second-round effects, such as major job losses, lastingly damaged consumer confidence or negative spillover effects on the financial sector. For the hardest hit sectors, particularly the services sector, this second lockdown phase is going to aggravate insolvency risks even though transitional aid is being extended.

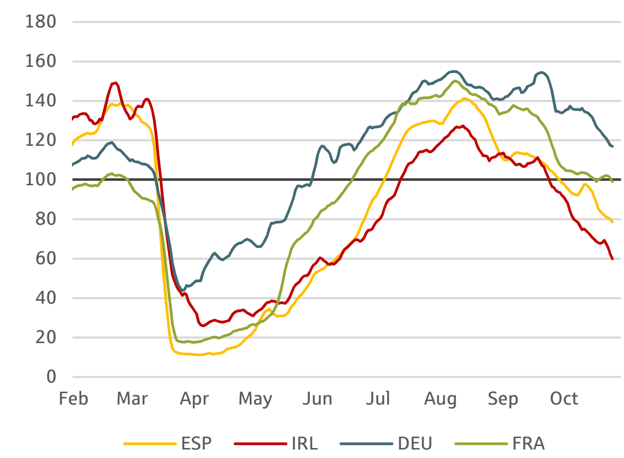
5. On equity markets, investors have grown cautious in view of the recent economic setbacks. Unlike at the time of the lightning stock-market crash in the spring, however, monetary-policy and fiscal-policy countermeasures are now well-established and continue to constitute a credible stabilising factor. Apart from the moderate declines sustained by equity markets, no tensions have yet been observed in other market segments following the outbreak of the second wave.

Germany: Number of infected by age groups



Sources: RKI, DekaBank

Mobility indicators (index, weekly moving average)



Sources: Apple, DekaBank

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