

Slow, but not so steady

Until the Covid-19 virus is finally defeated, the recovery looks set to continue at an uneven pace.

- _ In our view, pandemic containment will remain an economic drag for the foreseeable future.
- _ Over the course of the summer, we have already seen signs of the initial, V-shaped recovery giving way to a much flatter curve of improving global economic activity.
- _ The good news is that most developed countries appear better prepared for potential renewed virus surges in the fall than they were in spring



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To get an idea as to what has been going on in the global economy, you could do worse than glancing at the changing shopping habits of U.S. households. Since January 2020, department stores saw their sales decline by more than 5%. In the chart below, you can find them under GAFO. GAFO represents sales at stores that sell merchandise normally sold in department stores. This includes general merchandise stores, as well as certain specialized retailers.¹ So far, so unsurprising during an economic slump!

More revealingly, though, the decline was much worse in other areas. Namely at food services and drinking establishments, which mainly includes full-service restaurants, limited-service eating places, as well as bars and food-delivery services.² And this was, mind you, after such establishments in much of the country were able to reopen. Gasoline stations also took an unusually large hit. Meanwhile, sales at non-store retailers, such as online and mail-order businesses and shopping for hobbies, such as garden and home improvements, were up, probably boosted disproportionately by one-time stimulus payments.

This fits well with our analytic framework, which we developed at the beginning of the Covid-19 pandemic. As outlined

in previous issues of this publication, we looked at the supply side of the economy on a sector-by-sector basis. Overall, our assumptions for both the loss in output for various sectors during the lockdown as well as for the duration of the lockdown were pretty close to the actual outcome for economic activity, both in the U.S. and in other countries. As a result, we feel reasonably confident in sticking with this framework.

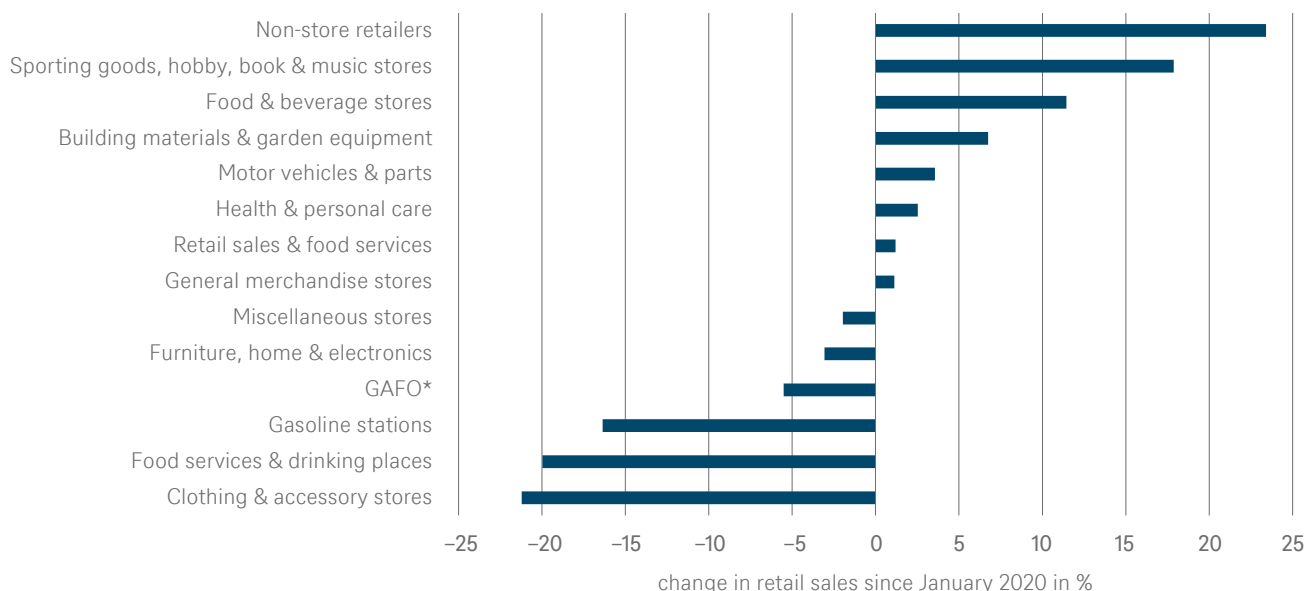
However, we are making some adjustments. Notably, we expect the recovery to proceed in two stages. The first stage began in May and June in the Western world, and is now largely behind us. It was marked by a V-shaped bounce back, triggered by re-opening of plants, restaurants, bars and the like and supported by pent-up demand as an additional driver. This has led to some quite spectacular growth rates in German car production, for example. Over the course of the summer, however, we have already seen signs of the recovery losing some momentum. We expect it to continue, but on a much more gradual path, as businesses and their customers learn to adjust to a new normal. We expect Covid-19 to remain a drag on the economy for quite a while yet. There have been some positive signs in the development of various vaccines already, but these are unlikely to prove a game changer in the coming months.

¹ For details, see: <https://www.census.gov/retail/definitions.html>

² See: <https://www.bls.gov/iag/tgs/iag722.htm#about>

HOW U.S. SHOPPING PREFERENCES HAVE CHANGED DURING THE COVID CRISIS

Since January 2020, retail sales have been impacted very unevenly. Non-store retailers, such as online businesses, saw swift rises, contrasting with sharp declines in other areas.



* General merchandise, apparel and accessories, furniture and other sales (GAFO) represent sales at stores that sell merchandise normally sold in department stores. GAFO figures as of June 2020 (one-month lag).
Sources: Census Bureau and Haver Analytics as of 08/13/20

Given the unprecedented resources devoted to Covid-19 vaccines by both the public and the private sectors, positive surprises certainly appear possible. Aside from the question whether and when an effective vaccine can be found, however, significant obstacles are likely to remain well into 2021, in ramping up production and convincing enough people to actually get vaccinated.

Indeed, premature government announcements could well prove counterproductive further down the line, by fostering suspicions among already skeptical members of the public. To make matters worse, the medical understanding of why Covid-19 lingers for months in some patients, remains quite limited.³ One reason for this might be delayed immune responses. Against this backdrop, it would not be surprising to see a version of what crowd psychologists call the penguin effect. Penguins tend to wait for their peers to jump into the water first, before deciding it is safe. Similarly, the initial

uptake of new vaccines might prove quite slow. But, the penguin effect also suggests a sudden surge in vaccinations after a while. (Once penguins decide there is no shark around and the water is safe, the laggards all tend to suddenly jump in at roughly the same time.)

More immediately, the good news is that most developed countries appear better prepared for potential renewed virus surges in the fall than they were in the spring. Most have gotten the virus under control. Testing quality and testing capacities have improved, and could, together with better contact tracing, serve as a functional equivalent of a vaccine in terms of the economic impact.⁴

The bottom line is that we do not expect a repeat of the general, nation-wide lockdowns which we saw in March, at least not for any of the world's biggest economies. However, we do expect the counter-measures to remain in place, and

³ For an excellent overview of recent research on the topic, see <https://www.economist.com/science-and-technology/2020/08/22/when-covid-19-becomes-a-chronic-illness>

⁴ Of particular note are efforts to supply cheap, mass produced, rapid tests to detect infectious individuals readily available for every day use at home. See: <https://harvardmagazine.com/2020/08/covid-19-test-for-public-health>

any loosening to be partially reversed if and when required. This means that pandemic containment may well remain an economic drag for the foreseeable future. At best, the initial, V-shaped recovery could turn into a much flatter curve of improving economic activity.

All in all, we expect global economic output to take until 2022 before we see pre-crisis levels again. Only China is likely to be a lot quicker. The Eurozone should see a strengthening in 2021 due to grants from reconstruction funds, which we expect to support growth in hard-hit countries, notably Spain and Italy, from the second quarter of 2021 onwards.

But the U.S. estimate comes with some big caveats. The fast reopening meant that the country never really gained control over the pandemic. Due to political gridlock in Washington, some of the fiscal support has run out, damaging economic sentiment. We hope to see progress in Congress during the coming weeks, especially in critical areas such as the extension of unemployment relief and help for state and local government. Nor will the November elections necessarily end the stalemate.

GLOSSARY

The **Democratic Party (Democrats)** is one of the two political parties in the United States. It is generally to the left of its main rival, the Republican Party.

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

The **United States House of Representatives** is a legislative chamber consisting of 435 Representatives, as well as non-voting delegates from Washington, D.C. and U.S. territories. Representatives are elected for two-year terms and each state's representation is based on population as measured in the previous Census.

A lot could still happen in the run up to the elections, including the derailment of the Democratic candidate Joe Biden, who has led the polls throughout the year. But in analyzing the economic impact of various scenarios, one needs to look beyond the race for the White House in our opinion. We expect Democrats to hold on to their majority in the House of Representatives. Much will depend on whether they can win back the Senate, too. Even such unified party control is no guarantee that Congress could act quickly to preempt further economic setbacks. Given current procedural rules in the Senate, more than a simple majority is required on most matters. In our view, there is no doubt the Federal Reserve Board (Fed) will continue to actively support the recovery, by targeting financial conditions. Inflation is no immediate threat at the moment, but that, as the Fed has been outlining, limits the potency of both its traditional and its more recent policy tools. If the recovery were to falter, Congress too would need to act. Alas, fiscal-policy paralysis remains a distinct possibility, no matter who wins the Presidency.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

The **U.S. Federal Reserve**, often referred to as "the Fed", is the central bank of the United States.

The **United States Congress** is the legislature of the federal government. It is comprised of the Senate and the House of Representatives, consisting of 435 Representatives and 100 Senators.

The **United States Senate** is a legislative chamber consisting of 100 Senators, with each state being represented by two Senators. Senators are elected for six year, overlapping terms in their respective state.

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