COVID-19: European consumers take fright

- **Massive hit to confidence:** The harsh lockdowns and social distancing policies to curb the spread of the coronavirus are delivering a huge blow to the European economy. Consumer confidence has collapsed – see chart. The economic recovery, which can begin in May with the gradual easing of some of the lockdown measures, will be much slower than the contraction. Beyond a lingering anxiety, high unemployment, impaired household balance sheets and slower real wage growth will retard the recovery in consumer spending.

- **A different type of shock:** The scale of the drop in confidence is comparable to that of the financial and euro crises. But the nature of the shock is very different this time around. 2008/09 and 2011/12 were largely financial sector shocks that sent waves through the real economy through the credit channel. But thanks to the aggressive ECB and BoE policies measures taken so far, and the generous credit initiatives by European governments, the risk of another credit crunch remains low. The current shock comes from the closures of most non-essential retail stores as well as many other services and much reduced activity in most parts of manufacturing. This has triggered an involuntary collapse in supply and demand as job losses and reduced hours slash aggregate purchasing power.

- **Limiting the damage:** To soften the damage to households from potential job losses, European governments have introduced un-/underemployment on-the-job schemes, made them more generous and/or broadened access to them. The schemes are mostly based on the German Kurzarbeitergeld. The schemes differ from country to country – they are comparatively generous in the Netherlands and France and less so in Italy and Spain. But they will probably all cushion the sharp but temporary rise in unemployment more than in the US where unemployment will surge by more.

- **Some signs of success:** It is still early days, but we see more and more evidence that the employment retention policies are making a difference. In Germany, more than 725k businesses had applied for Kurzarbeitergeld by 15 April, which could equate to up to 10m workers. In France, as of 23 April, the numbers are even higher – already 860k companies have opted for chômage partiel and passed on the benefits to 10m employees. In the UK, 140k businesses had tapped the government’s new “job retention scheme” for 1m workers, by 20 April – that number will go up much further. It is possible that up to a quarter, or even third, of workers in major European economies may benefit from such policies.

- **Lingering anxiety:** The coronavirus recession is unlikely to lower European potential growth. Still, it will take some time before consumer demand returns to something resembling normal. If and when the economically significant containment measures are gradually eased across the continent soon, a potential second major wave of infections could lead to renewed harsh lockdowns. Learning to live with the virus could involve semi-permanent disruptions to daily life well into next year. A sense of anxiety that lasts until the virus is defeated could continue to weigh on consumer demand for a while to come. Whereas we expect GDP to return to the Q4 2019 level some two years from now, the recovery to the pre-recession peak for consumption may take a little longer.

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