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COVID-19: THIRD-WAVE RISKS IN EUROPE

Berenberg Macro View

The writing is on the wall: exactly one year after Covid-19 started to strike Europe badly, much of the continent may be heading for a third wave. The semi-lockdowns that have been in place more or less since November have sufficed to contain the second wave of the original virus. But they have not prevented a rapid increase in recorded infections with the more contagious variants. Last week, the "Kent" variant already accounted for 22% of registered new infections in Germany and 36% in France. As many countries on the continent are now reporting a rising case load again, the seven-day incidence of recorded infections has started to creep up again in the Eurozone after bottoming out on 18 February – see charts 1 and 2. As a result, lockdowns will likely have to be extended in many countries and probably be tightened in some others.

How badly would this hit the Eurozone economy? As a rule of thumb, the current lockdowns probably keep economic activity in the Eurozone some 6% below normal. An extension by one month beyond mid-March, which so far is our base case for the start of some noticeable easing, would reduce average annual GDP growth by roughly 0.5ppt, that is to c3.6% instead of our 4.1% call for 2021 and raise 2022 growth by a similar magnitude. But whether or not the economic rebound will indeed be delayed significantly remains an open question. As economists, we cannot really assess or even predict the medical situation. But we can make a few observations to put it into context.

1) Economies seem to be getting better at dealing with the lockdowns. Even in the hard-hit services sector, the lockdown damage is far smaller than it was during the first wave last spring. Despite the fall to 44.7 in February 2021, the services PMI for the Eurozone remains far above its trough of 11.7 of April 2020. The sector still seems to be faring less badly than we had expected at the start of the second wave last November.

2) The UK, Ireland, Spain and Portugal have shown that well-calibrated restrictions can contain the rise of infections even with the Kent variant of the virus.

3) Spring is coming. With luck, warmer and sunnier weather and the start of the outdoor season will slow the spread of the new virus variants significantly, as is does for other seasonal respiratory viruses.

4) Strains on the medical system matter at least as much as the infection numbers. Although continental Europe is lagging far behind the UK and the US (see chart 2), vaccinations are progressing and look set to pick up speed in coming weeks and months. The focus is largely on the old and vulnerable as well as on key healthcare workers. In a few weeks, this can help to contain pressures on medical systems in two ways: (i) As the most vulnerable are protected, the share of infections leading to serious medical complications and deaths can - hopefully - decline. In the UK, the number of deaths associated with Covid-19 has already fallen by more

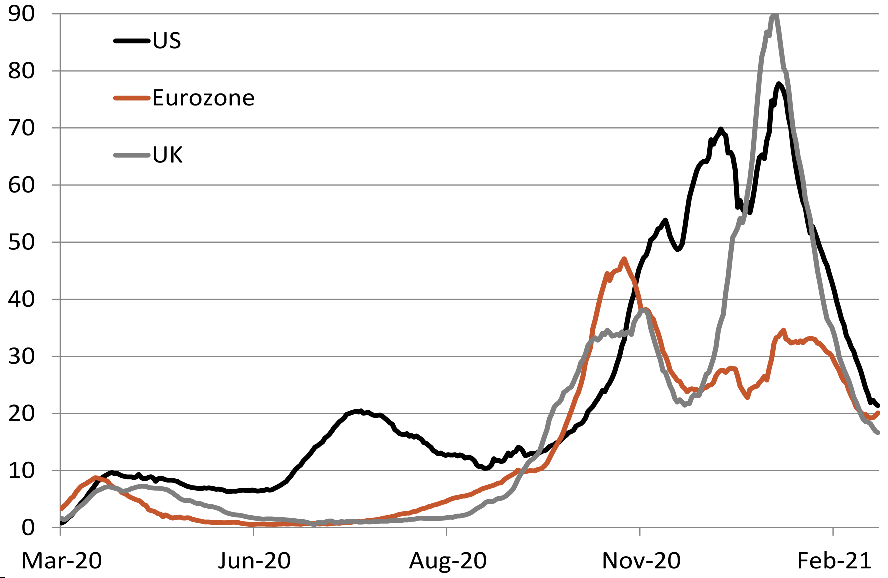
than half since the peak some three weeks ago to a level that is, however, still 50% above that of the Eurozone in per-capita terms. (ii) A smaller share of key medical personnel may fall ill with Covid-19 or go into quarantine, relieving a key bottleneck in many medical systems.

As long as a positive seasonal effect indeed kicks in during March and especially April, lockdowns may thus have to be extended and/or tightened only modestly beyond our current assumptions in the Eurozone. If so, we can maintain our current forecasts apart from some of the usual fine-tuning in response to revisions of or surprises in backward-looking data. Following a projected 2.0% qoq drop in Eurozone GDP in Q1 2021 after a surprisingly modest 0.6% qoq contraction in Q4 2020, we look for a a 3.1% qoq rebound in Q2. Of course, the near-term risks are now tilted to the downside. Whereas the precise time profile of the rebound may change, we maintain our view that the Eurozone economy will likely get back to its pre-pandemic GDP by Q2 2022, in line with the UK but well behind the fiscally supercharged US (Q2 2021). After the UK suffered a worse recession than the Eurozone in 2020 (-9.9% vs -6.8% for real GDP), the UK looks set to make up some lost ground this year, helped by rapid vaccination progress. We project a 6.1% rebound in UK real GDP this year with a strong 5.5% qoq bounce in Q2.

We base our global forecasts on one key assumption: by autumn 2021, vaccinations will have progressed enough – and will be effective enough – to prevent a major new wave in the Northern hemisphere that would force countries into renewed serious lockdowns. So far, the vaccination results in countries which have taken the lead in vaccinations seem to be encouraging, including especially an Israeli study showing that the BioNTech vaccine is highly effective in reducing the transmission of the virus and not just in preventing the Covid-19 disease.

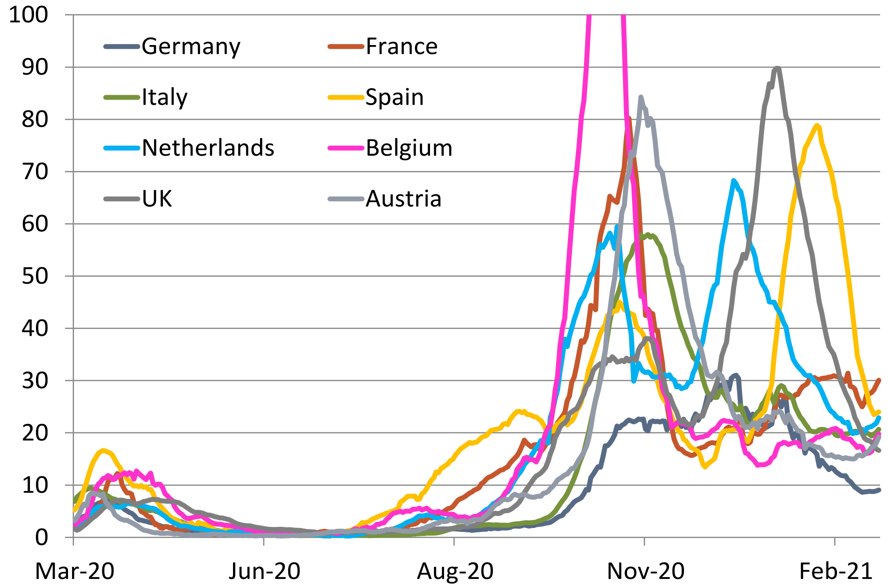
Click here for Florian Hense's in-depth analysis of the situation as of 17 February. See forecasts at a glance for our full set of forecasts.

Chart 1: Confirmed new SARS-CoV-2 infections, per day, per 100,000 people



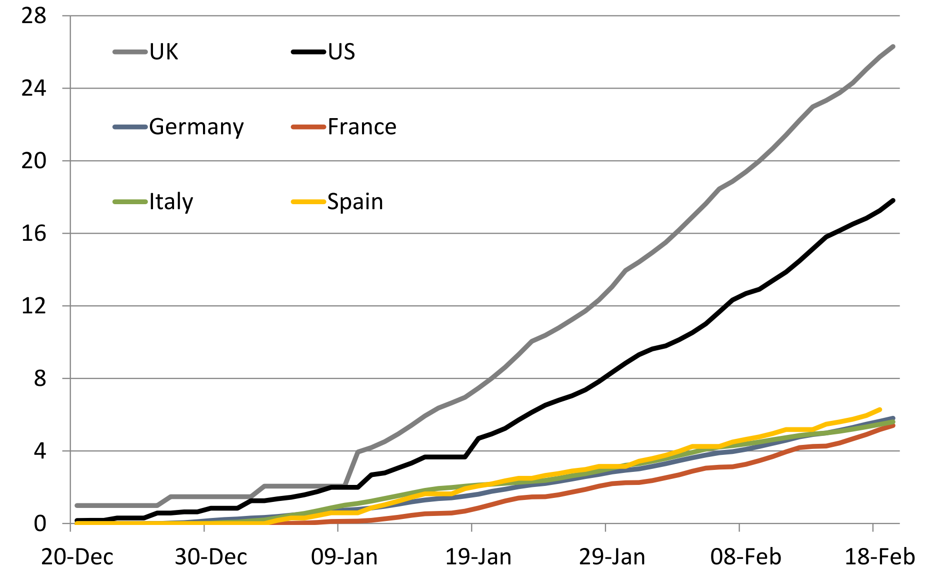
Seven-day averages. Source: Johns Hopkins University.

Chart 2: Confirmed new SARS-CoV-2 infections, per day, per 100,000 people



Seven-day averages. Source: Johns Hopkins University.

Chart 3: Total number of COVID-19 vaccinations administered, per 100 people



Source: Our World in Data