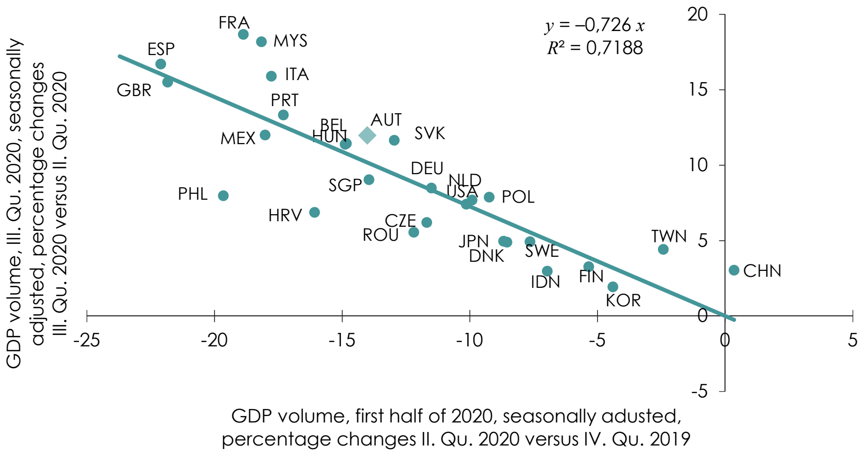
Second COVID-19 Lockdown Dampens Economic Performance

Business Cycle Report of December 2020

Stefan Schiman

- **As the measures to contain the COVID-19 pandemic were eased in the third quarter, the economy recovered worldwide and in Austria.**
- **However, the negative correlation between lockdown intensity and economic growth weakened in the third quarter. Instead, the extent of the economic slump proved to be a good indicator of the strength of the rebound thereafter.**
- **The rebound in Austria in the third quarter was even more pronounced than expected. Commerce in particular recovered quickly.**
- **Both internationally and in Austria, manufacturing is less affected by the second lockdown than by the first in spring 2020.**
- **However, business sentiment deteriorated in November. Only in the construction industry are the majority of companies still optimistic.**
- **The second lockdown has resulted in a rise in unemployment and a renewed increase in the use of COVID-19 short-time work.**

Link between economic slump and recovery



The more severe the economic slump in the first half of 2020, the stronger the rebound in the third quarter of 2020 tended to be. The growth rate in the third quarter of 2020 averaged 72.6 percent of the decline in the first half of the year. The coefficient of determination of this correlation is high (Source: Eurostat, Oxford Economics, Statistics Austria, WIFO).

"The rebound in Austria in the summer of 2020 was above average in an international comparison when compared with the preceding slump in economic output. In Europe, the recovery was above average in France, Italy and Slovakia, among others, and below average in the Czech Republic, Croatia and Romania."

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As measures to contain the COVID-19 pandemic were relaxed in the third quarter, the global economy recovered. However, the negative correlation between lockdown intensity and economic growth weakened. Rather, the extent of the previous economic slump proved to be a good indicator of the strength of the rebound. In Austria, the rebound was even more pronounced than expected, with commerce in particular recovering rapidly. Both internationally and in Austria, manufacturing industry was less affected by the second lockdown than by the first. However, business sentiment deteriorated in November, and unemployment increased.

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The negative correlation between lockdown intensity and economic growth weakened in the third quarter. The extent of the economic slump is one of the factors determining the strength of the subsequent rebound.

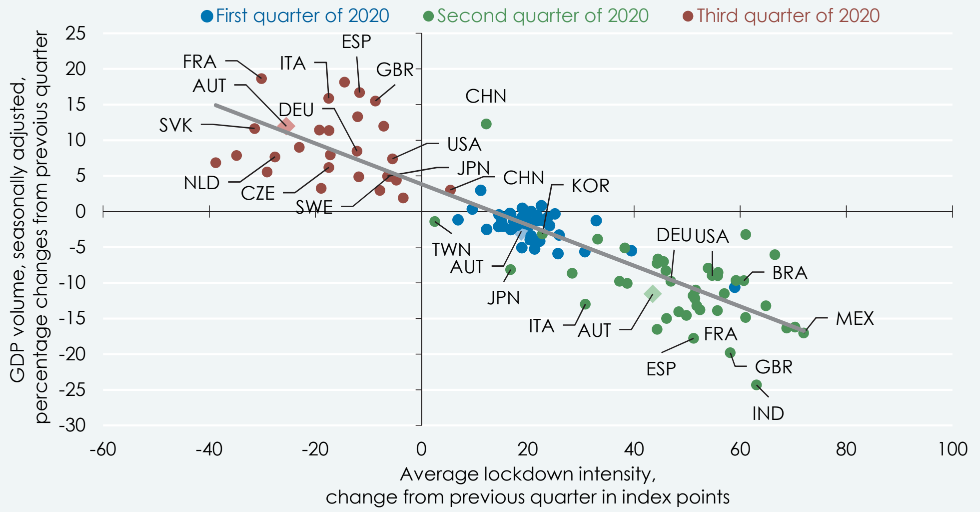
The measures taken so far to contain the COVID-19 pandemic have been diverse and have had a direct or indirect impact on economic development. Factory and business closures and the cancellation of events mean direct losses in value creation. Indirectly, school closures can also have a negative impact if parents are hampered in their work from home. Curfews, traffic and assembly restrictions also disrupt customary social behaviour and the economic cycle. Travel restrictions also hinder tourism.

In the first half of 2020, a correlation therefore emerged between the extension of the intensity of the lockdown in a country and the severity of the economic slump: the more severe the lockdown, the more pronounced the slump in economic output tended to be (Figure 1).

The correlation also seems to apply in reverse: the more the lockdown was relaxed, the higher the rebound. However, this correlation weakened in the third quarter. While the coefficient of determination for the observations in the second quarter of 2020 (increase in lockdown intensity and GDP decline) was around 38 percent, it fell to around 7 percent for the observations in the third quarter (reduction in lockdown intensity and GDP recovery). For the totality of observations from the first to the third quarter, there is in turn a relatively high coefficient of determination of 80 percent.

However, caution is required in the causal interpretation. It is true that the causality between the change in the intensity of a lockdown and the extent of the economic effects can be well justified. However, as the reduction in the coefficient of determination in the third quarter shows, the extent of the easing alone cannot explain the strength of the rebound. Rather, a better predictor seems to be the preceding economic slump itself: the deeper the slump in the first half of 2020, the stronger the rebound in the third quarter of 2020 (see chart in the preamble). The coefficient of determination of this correlation is 72 percent. The constant in the regression of the GDP change rate in the third quarter on the change rate in the first half of the year is – plausibly – not significantly different from zero. The regression coefficient of 0.73 implies that the rate of change in the third quarter of 2020 was on average 73 percent of the rate of change in the first half of 2020.

Figure 1: **Change in lockdown intensity and gross domestic product**



Source: Eurostat; Oxford Economics; Statistics Austria; WIFO; University of Oxford, Blavatnik School of Government. First to third quarter: R^2 = 0.7972, second quarter: R^2 = 0.3756, third quarter: R^2 = 0.0689. Lockdown intensity, measured by the Blavatnik School of Government indicator, is a composite index combining various indicators on restrictions on public life and the intensity of public information campaigns (https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker).

1. International industry less affected by new lockdown than in spring

The industry in the euro area was also affected by the second wave of COVID-19 infections. However, the restrictions placed by individual countries to contain it are less profound and do not cause major disruptions in the supply chain. In addition, news of the rapid availability of a vaccine against SARS-CoV-2 may limit the gloom in corporate sentiment. Electricity consumption decreased only moderately in the euro area recently, with countries with stricter restrictions such as France, Austria and Belgium recording larger declines. In Germany, on the other hand, truck mileage actually increased in the first half of November.

The current restrictions are more targeted and focus on private contacts and contact-intensive services. Non systemically relevant industrial companies are not closed and there are no wide-ranging border closures. These were important drivers of the massive decline in industrial production in the second quarter of 2020.

Private demand for passenger cars flattened only slightly in recent weeks. In addition, companies may be restocking during the lull in order to be prepared for the expected recovery. Moreover, the pandemic in Asia seems to be better under control. In particular, demand from China should be a support for the industry especially in Germany and the regional supply chains.

The international supply chains will not be interrupted by the new lockdown measures. The industry can continue to produce without disruption.

2. Renewed economic slump as a result of the second lockdown in Austria

From 3 to 16 November 2020, health policy measures were in force in Austria similar to those in the first half of May 2020: all retail was open, personal services were allowed, gastronomy and hotels were closed, and events were (largely) prohibited. As of 17 November, the measures were tightened similar to the first lockdown in March and April 2020; in particular, non-systemically relevant commerce had to close and full-day curfews applied.

The Weekly WIFO Economic Index (WWWI), which measures real economic activity in Austria in real time on the basis of high-frequency indicators and is reported as an annual GDP rate of change, already reflects the effects of the second lockdown: between the beginning of September (calendar week 36 –2.7 percent) to the end of October (calendar week 44 –2.6 percent), it did not change significantly. With the partial lockdown coming into effect on 3 November 2020, the WWWI dropped to as low as –9.2 percent in calendar week 46. The full

As a result of the renewed measures to contain the COVID-19 infection, indicators for trade and services fell again. Production is proving robust.

lockdown since 17 November 2020 resulted in a further decline in economic activity (calendar week 48 –14.1 percent). Specifically, indicators for credit card sales, the labour market and mobility all declined. In manufacturing, however, the underlying momentum is upward, in contrast to the lockdown in the spring.

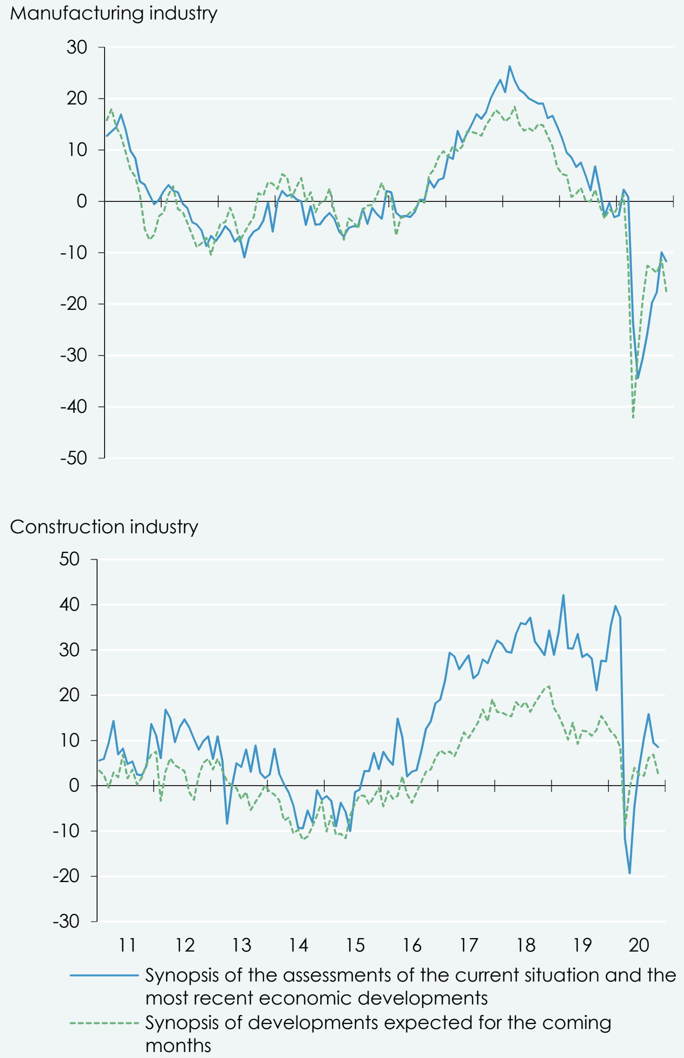
Figure 1: **International Business Climate**

Seasonally adjusted, 2015 = 100, 3-month moving average

Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD. – [1] Excluding construction. – [2] Manufacturing.

Figure 2: **Results from the WIFO-Konjunkturtest (business cycle survey)**

Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and –100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

2.1 Business sentiment worsens

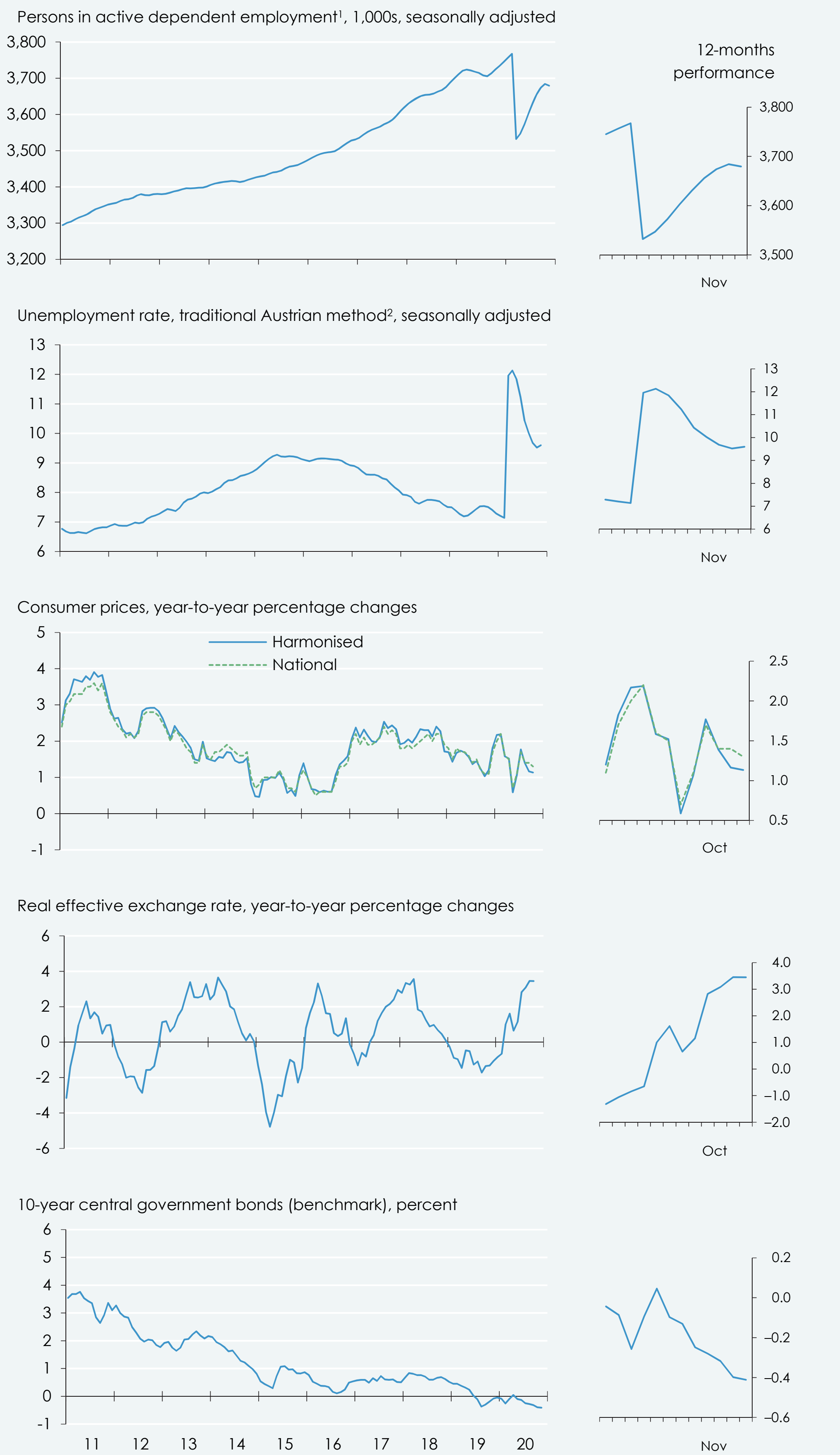
The second wave of the COVID-19 pandemic and the lockdown in Austria are also influencing companies' economic assessments. The WIFO Business Climate Index fell by 5.2 points in November (seasonally adjusted) and, at –14.7 points, was again more clearly in negative territory. Companies were more sceptical about the current situation, and expectations for the coming months in particular dimmed considerably.

The index of current assessments for the overall economy fell in November (seasonally adjusted) by 3.4 points to –12.5 points. In the service industries the index decreased by 5.0 points to –17.4 points. In the construction industry, on the other hand, there was only a slight decline of 0.9 points. Moreover, the index remained in positive territory at +8.6 points. In manufacturing the situation index lost 1.7 points and was still clearly negative at –11.7 points.

Business expectations deteriorated in all sectors. The index fell by 7 points in November to only –16.9 points. Only in the construction industry was the expectations index above the zero line separating negative from positive expectations, at +2.7 points, despite a decline of 4.2 points. In the service industries the expectations index lost 8.1 points and at –20.4 points was again similarly far into negative territory as in the spring. In manufacturing, too, expectations lost considerable momentum (–6.1 to –17.5 points).

The recovery in business sentiment recently broke off again. In construction, the majority of companies are still optimistic.

Figure 3: **Key economic indicators**



Source: Public Employment Service Austria, Federation of Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – [1] Excluding persons in valid employment contract receiving child care benefit or being in military service. – [2] As a percentage of total labour force excluding self-employed, according to Public Employment Service.

2.2 Rebound in third quarter even stronger than expected

According to the latest calculation by Statistics Austria, the rebound in the third quarter was stronger than forecast by WIFO at the beginning of October and also somewhat higher than reported in the national accounts flash estimate from the end of October. Seasonally adjusted, real GDP rose by 12.0 percent compared to the previous quarter. Economic output was thus only 4.0 percent below the previous year's level.

The economic recovery in the summer benefitted almost all business sectors. The sectors of trade, transport and accommodation and catering, which were particularly affected by the first lockdown, recorded a strong growth of 32.9 percent in the third quarter compared to the previous quarter (–4.5 percent compared to the previous year). Similarly, the combined value added of the culture and entertainment and personal services sectors grew by 39.2 percent in real terms over the previous quarter (–7.7 percent over the previous year). The manufacturing of goods exceeded the level of the previous quarter by 15.7 percent in real terms, but was still 4.0 percent below the level of the previous year. The construction industry reached the previous year's level again with an increase of 10.1 percent compared to the previous quarter. The housing, health, education and social services and public administration sectors, which were less affected by the health policy measures to contain the COVID-19 pandemic, continued to develop stably in real terms.

On the expenditure side, almost all GDP components recovered in the third quarter. Consumption of durable goods – especially of furnishings and furniture – even exceeded the previous year's level by 7.7 percent in the third quarter. Investments in transport equipment also increased above average (+6.4 percent). Exports of services, especially travel, continued to develop weakly.

2.3 Further strong price increase in catering services, stagnation in the accommodation sector

Consumer prices rose by 1.3 percent in October. In this context, prices in the catering sector continued to rise strongly (catering services +3.8 percent). After a slowdown in May below +3 percent, the acceleration of price increases in this sector confirms the recovery of value added. In contrast, prices in the hotel industry (accommodation services), which had always recorded strong inflation rates before the COVID-19 crisis, stagnated.

Commerce developed unexpectedly well in the summer. In particular, demand for furniture and furnishing rose strongly.

Housing costs again proved to be a price driver in October (housing rents paid +5.6 percent, housing maintenance and repair +3.0 percent), as did food prices (+2.6 percent). Together, "housing, water, energy", "restaurants and hotels" and "food and non-alcoholic beverages" contributed about 87 percent to the overall inflation rate in October.

2.4 Another large take-up of COVID-19 short-time work

According to a preliminary estimate by the Federal Ministry of Labour, Family and Youth (BMAFJ), the number of persons in active dependent employment at the end of November 2020 was 1.4 percent below the previous year's level. The negative employment effects of the second lockdown are thus so far much smaller than those of the first one in spring 2020 (March –4.9 percent). On the other hand, the number of employees registered for short-time work rose from 133,000 to 276,000 in November.

In line with the lower negative cyclical effects, unemployment rose less in the second lockdown than in the first.

After a significant increase between mid-March and mid-April 2020, unemployment gradually decreased after the end of the first lockdown and with the onset of the recovery until the end of September. From mid-October onwards, unemployment increased again, and the rise accelerated somewhat in the first half of November. The decline in job vacancies reported to the Public Employment Service Austria (AMS) at the end of November, at –18.2 percent compared to the previous year, was also somewhat stronger again after the gradual recovery in recent months.