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Economy

Will the economy be rapidly vaccinated against the virus?

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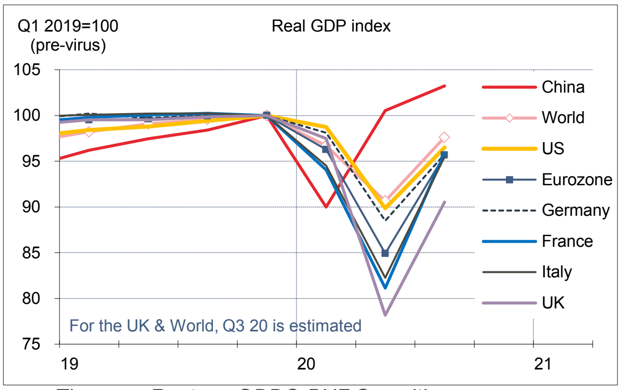
Encouraging news about the discovery of an effective vaccine against coronavirus saw equity markets sky rocket yesterday. This reaction reflects a scenario in which the global economy could be expected to rapidly return to 100% of its pre-virus activity conditions - whereas, in the current situation, most countries have recovered just 90-95% of their capacity, with little hope of making up the rest before several quarters. We examine here (in a somewhat fictional mode, as this vaccine has yet to be produced on a large scale) what changes this scenario would trigger in the economy and economic policy.

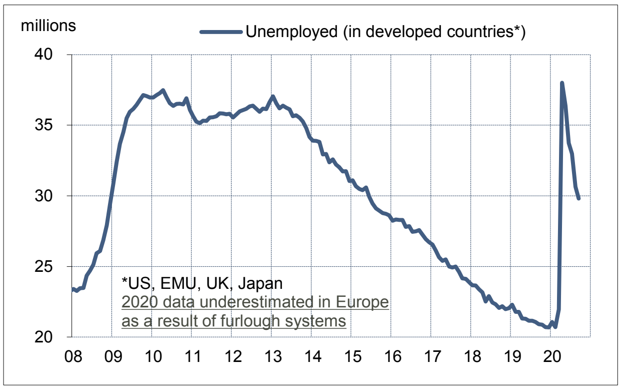
Give me one more, one more shot (Jagger/Richards)

It has often been said in these pages[1], but there is no harm in repeating it again, the crisis caused by the coronavirus differs in general and in detail from an ordinary economic crisis. Its origin, its sudden onset in the absence of prior macroeconomic imbalances, its magnitude, its geographic reach, the reactions of central banks and fiscal authorities that it provoked, nothing in this crisis fits into the canon of recessions. Can we also imagine that the way out of this crisis will also be atypical, i.e. quick and miraculous rather than long and painful? This would be the case, for example, if an effective vaccine were produced and distributed on a large scale fairly rapidly. This question comes after yesterday's announcement of clinical trials perhaps pointing in this direction. **For the sake of our imagined scenario, let us therefore place ourselves in the working hypothesis that the entire global economy will rapidly be vaccinated against the coronavirus. What will be the consequences?**

Real GDP indices: pre- and post-coronavirus



Number of unemployed



Sources: Thomson Reuters, ODDO BHF Securities

Let us take as our starting point the situation after three quarters marked by the pandemic. Globally, the level of activity in Q3 2020 was 3-4% below its pre-pandemic level (Q4 2019), after having fallen by almost 10% at its peak.[2]. This figure is "inflated" by the contribution of China, which to date is the only major country to have really overcome the shock of the coronavirus[3]. For the other major economies, the loss of activity is between 5 and 10% compared to the pre-virus level, after instantaneous losses of up to one-third at the depths of the March-April lockdown. **In any case, the global economy has trended far below its normal capacity** (chart lhs). The number of unemployed is considerably higher than a year ago (chart rhs) - a number moreover underestimated due to measurement errors triggered by short-time working regimes. **The longer the period of under-employment of the factors of production, the**

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[1] *See Economy Flash of 23 March 2020, "Unidentified economic object"*
[2] *See Economy Flash of 24 August 2020, "Global economy – And suddenly 10% of GDP has vanished"*
[3] *See Economy Flash of 16 September 2020, "China is siphoning off the stimulus provided by the rest of the world"*

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greater the risk that part of the activity potential will be permanently destroyed. Employees kept out of the labour market will lose their skills as companies postpone capital spending on both expansion and renewal. **It is not immaterial to ask whether the shock will be erased in one year, two years, three years, or never.**

If an effective COVID vaccine was administered to everyone tomorrow, what would happen? Uncertainty (risk premium) would be massively and sustainably reduced. In short, this what yesterday's surge in the equity markets told us. **At the macroeconomic level, the hypothesis that we are formulating amounts to envisaging an immediate boost to spending (note that 5-10% at least has to be made up) but with a sharper rebound from those sectors most affected by the pandemic and, therefore, lagging furthest behind in the recovery.** By way of illustration, let's take the example of France, since the latest report by the central bank published yesterday provides a detailed real-time estimate of the gaps between sectors (table lhs). The impact of the current lockdown is estimated to be about three times weaker than the impact of the first, in March-April, but it is very negative nonetheless. The level of total activity would lose 8 points (from -4% to -12%) in one month, but for many service sectors, the shock would be much stronger (-31 points to -40% for trade, transport and catering activities). In relative terms, therefore, it is these sectors most exposed to the risk of virus/lockdown that would stand to gain the most if we could live again without worrying about the coronavirus.

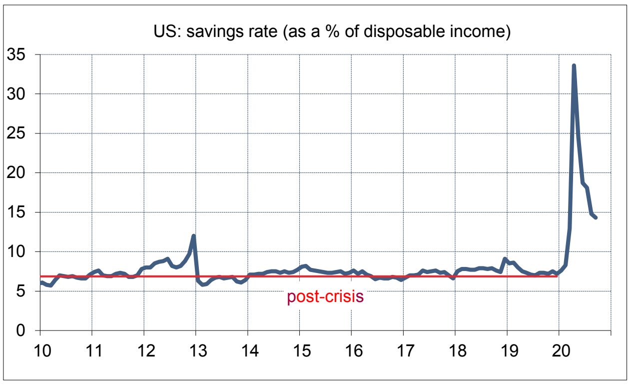
As long as we reason in the abstract, the adjustment would be complete and immediate. Everyone would resume flying again, booking their sun holidays, preparing for the most festive Christmas ever. **There is no shortage of forced savings accumulated over the last few months to finance this catch-up of spending, either in Europe or even in the US** (chart rhs). In reality, as the exit from the first lockdown last spring showed, those parts of the economy that have ground to a halt cannot be re-started instantaneously. There can therefore be gaps between supply and demand, and thus temporary price surges.

France: sector impact of the virus/lockdown risk

France: estimate of loss of activity

Deviation from pre-pandemic (%)	Share of GDP (%)	Periods under review			
		April	Sept.	Oct.	Nov.
Agriculture + Agri-food	4	-31	-4	-4	-5
Energy, water, waste	3	-21	-4	-4	-5
Manufacturing	9	-44	-6	-5	-7
Construction	6	-65	-7	-6	-8
Trade, transports, accommodation	18	-46	-8	-9	-40
Finance & Real estate	17	-5	0	0	-1
Other market services	22	-30	-5	-6	-12
Non-market services	22	-30	0	0	-5
GDP (total)	**100**	**-31**	**-4**	**-4**	**-12**

US: household savings rate



Sources: BdF, Thomson Reuters, Oddo BHF Securities

The other question raised by a scenario of a widespread and rapid vaccination concerns economic policy. Since last spring, the common denominator in the actions of central banks and tax authorities has been to ensure that an additional public deficit (government dissaving) can be financed comfortably to compensate for the increase in the private sector savings. **If households and businesses start spending again, the need for government support is automatically reduced** (again, allowing for the time it takes to adjust)**. This should not be seen as a fiscal tightening as it is the cyclical part of public deficits that will adjust.** Moreover, bear in mind that the coronavirus crisis has changed not only the actions of the policymakers but also the way of thinking about their mandate. The monetary doctrine is no longer the same at the Fed or the ECB and, at least in Europe, neither is the fiscal doctrine. **Can the current policy-mix be inverted at the risk of paving the way for a rapid normalisation, i.e. a hike in policy rates, the end of the QE and fiscal restrictions? This is a risk, but it seems to us to be minimal.** On the monetary side, the new central banks' strategies now state that it is less risky to have exposure to an overheating of the economy than to normalise too early. This point will not be called into question. **It is hard to imagine central banks letting borrowing rates skyrocket and making the additional debt associated with the virus unsustainable.**

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