Questions That Matter

Longer COVID | What Harm Will New Lockdowns Do To The Economy?

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An extension of lockdowns in the U.S. and Europe would result in a temporary sharp reduction in GDP of 4%-5%, but spillovers to China and the rest of the world would be minimal.

How this will shape 2021

New lockdowns slow economic activity. The recent resurgence of COVID-19 cases led to a new round of lockdowns across much of Europe and the U.S. Mobility indices first flattened then turned down over the past month as social-distancing restrictions were reimposed and households and firms dialed back their spending.

Recovery stalled. As a result of the new lockdowns, the strong rebound in economic momentum witnessed in the third quarter—where annualized growth exceeded 30% in many economies—has stalled.

Lower starting point for the economy. In our baseline, the current lockdowns cause growth in the fourth quarter to turn negative again, with the weak momentum carrying over into the start of 2021 and somewhat delaying the recovery, despite vaccines being widely available by midyear.

What we think and why

Lockdown lite. Societies are learning to live with the virus, allowing authorities to better calibrate the restrictions they impose on mobility. Besides decreased tightness, our baseline also assumes the lockdowns will last around one month.

Less impact than before. With shorter and less stringent lockdowns this time, our baseline has a much more moderate contraction in activity than earlier this year, with no additional permanent damage to the growth potential of the economy.

What could go wrong

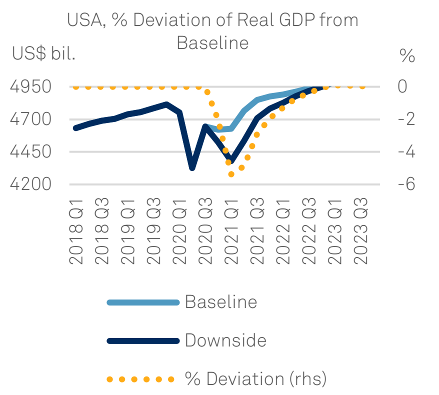
Lockdowns could be longer. Governments could struggle to contain the latest outbreak, especially after the holidays, resulting in two to three months of restricted movement and sharper declines in activity than in our baseline. The epicenter of the shock will be the services sector in Europe and the U.S. This downside scenario keeps our baseline assumptions for vaccine availability, delays of which would further amplify the impacts described here.

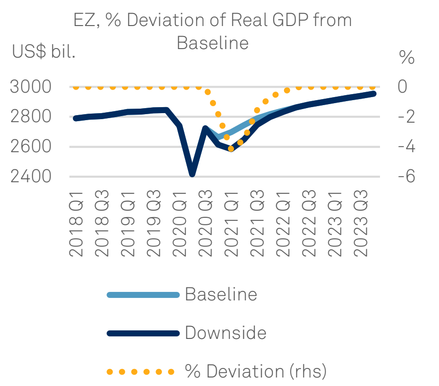
Differing impact based on policy response. At the peak of the shock, GDP could drop by 5% in the U.S. and 4% in Europe (see charts). A key source of this difference is that we believe that no extra fiscal support—especially for the labor market—will come for the U.S. in this scenario. This is contrary to the significant support already in place for Europe, with likely additional packages from national governments if things get worse.

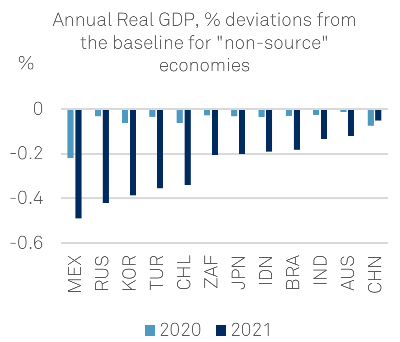
Differing impact based on geography. Given the service-centered nature of this shock, the cross-border transmission will be weak. Moreover, we would expect China to calibrate infrastructure support such that it effectively neutralizes the impact of this shock. With Chinese growth remaining steady, the rest of the world sees only modest declines in GDP on the order of less than 0.5%.

No permanent damage beyond our baseline, but significant sectoral impact. We assume little lasting disruption to the supply side of economies relative to our baseline. The main impact to activity will be a rephasing of growth within 2021. However, severe stress is likely in some sectors close to the epicenter of the shock, stretching balance sheets and resulting in a loss of access to financing.

A Long COVID Scenario Could Harm U.S. GDP More Than Europe







This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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