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Economics Group

Special Commentary

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Renewed Restrictions Point to European Economic Stumble

Executive Summary

- With the resurgence in COVID cases across the northern hemisphere, many governments have re-imposed restrictions or closures as well as stay-at-home orders in an effort to curb the second wave of infections. Several countries, including the United States and in Europe, have announced school closures, restrictions on public gatherings as well as restrictions on some workplaces such as restaurants, bars and other public facilities. The United Kingdom has experienced the highest number of COVID deaths among the European countries, prompting the government to re-impose partial lockdown measures.
- One standout during the pandemic has been Sweden, as the Swedish government first elected not to pursue stringent lockdown measures similar to those adopted in many other Western nations during the initial spread of COVID. Now, as the rate of COVID infections has surged, the government opted for a somewhat stricter approach, including a partial lockdown on bars and restaurants, in addition to other social distancing advisories.
- Given the renewed imposition of restrictions, we believe the potential for an economic stumble has increased. We now look for a renewed decline in Eurozone Q4 GDP, which could restrain the euro over the near term. Meanwhile, the United Kingdom is also set for a decline in Q4 GDP growth, and we expect the British pound to remain a relative underperformer among the G10 currencies.

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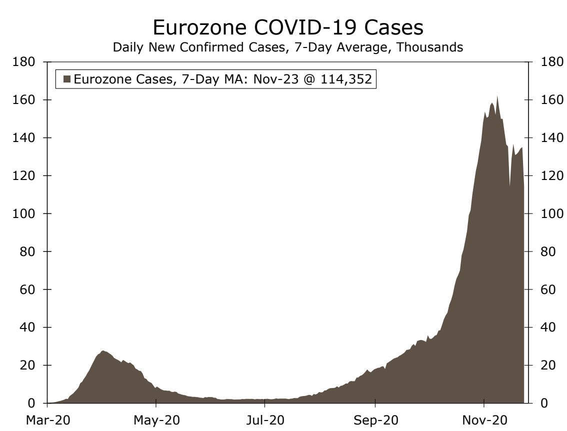
Surge in COVID Cases Threatens Economic Growth

As COVID cases over the past few months have climbed higher, many governments have re-imposed stricter public health measures in an effort to slow the spread of the virus. European countries were hit particularly hard, and although the seven-day average of cases has begun to fall in some European countries, confirmed new cases remain well above their spring-peak.

Figure 1



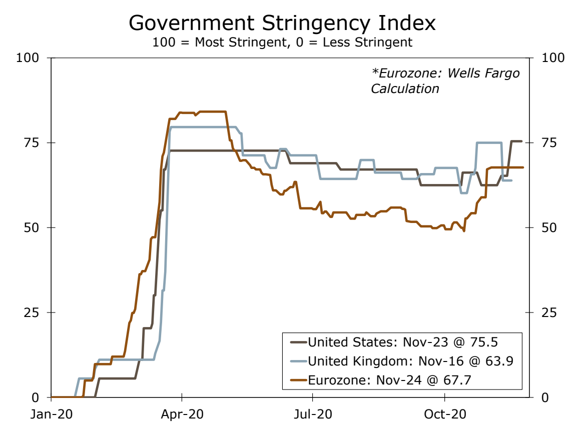
Source: Bloomberg LP and Wells Fargo Securities

Germany, Europe's largest economy, has experienced a significant rise in COVID cases.

In Europe, many countries have re-imposed restrictions on some gatherings and public events as well as orders to stay at home. Germany, Europe's largest economy, has experienced a significant rise in COVID cases with new cases topping 18,400 per day over the past week. As of November 2, the German government required restaurants, gyms, bars and cinemas to close for the entire month, cancelled public events, put restrictions on gatherings, encouraged citizens to stay at home and in some regions, put curfews in place, among other measures. This week, the government indicated that it may extend the lockdown until at least December 20, but it could be extended an additional 14 days beyond December 20 if the numbers remain above the government's target level. The plan would limit private gatherings to five people from a maximum of two households starting on December 1, although it may be relaxed ahead of Christmas holidays, while it also included banning the sale of fireworks for New Year's Eve and further restrictions on alcohol sales.

Meanwhile, in early November, the Italian government issued a decree valid until December 3, which imposed a nationwide curfew, extended protections in place requiring the use of masks and closures of facilities like gyms, museums, pools, cinemas and theaters, among other measures. Given that Italy has now reported more than 32,200 cases per day over the past week, and COVID fatalities have surpassed 50,000, further restrictions are likely to be put in place. In addition, Prime Minister Conte hinted that holiday celebrations would be limited due to COVID and to prepare for a more "sober Christmas." The government's next emergency decree is due by December 3, which should provide the latest details of the country's restrictions. In contrast, the French government plans to ease lockdown measures in three steps as infection rates recede. The first easing of restrictions will occur around December 1 which includes non-essential shops to re-open, while the second should take place prior to the end of year holidays and the third sometime in January. However, the government did opt to maintain some restrictions, including travel limitations and restrictions on restaurants and bars. The infection rate in Spain has also begun to slow, allowing some regions to relax existing restrictions.

Figure 2



Source: Bloomberg LP and Wells Fargo Securities

The United Kingdom will return to an approach based on three tiers.

Elsewhere, the United Kingdom has experienced the highest number of COVID fatalities across Europe. New cases have exceeded 19,500 per day over the past week, even higher than in March and April when COVID first spiked in the U.K. The U.K. government has responded with a range of measures to curb the second wave of infections. This week, the U.K. released its COVID winter plan, in which Prime Minister Boris Johnson indicated that the national restrictions will be lifted on December 2, and instead the United Kingdom will return to an approach based on three tiers. Regardless of the tier, non-essential shops and gyms will re-open, group worship, weddings and outdoor sports will resume. The government's new plan also modified the 10PM closing rule for hospitality to 11PM, in addition to relaxing restrictions on private gatherings to allow people to see more of their friends and family over the Christmas holiday. However, regional tier rules will be tougher than those prior to the partial lockdown to keep the virus under control. In the highest level of restrictions, Tier 3, all hospitality will close except for delivery, takeaway and drive-through, hotels and other accommodation providers must close and indoor entertainment venues must also close. In Tier 2, only pubs and bars selling substantial meals will be allowed to remain open, while in Tier 1, the government will reinforce the importance of working from home when possible. As for which areas fall into which tier, the government is expected to announce that during the course of this week.

A notable outlier during the pandemic has been Sweden. The Swedish government first elected not to pursue some of the stringent lockdown measures adopted in many other Western nations, despite local COVID cases climbing in Sweden. While the Swedish government did impose some restrictions on activity, more stringent lockdowns were generally avoided. Now, as the second wave of COVID takes hold, the government opted for a somewhat stricter approach, including a range of different measures to limit the spread of infection within the country. As a general rule, the government opted to prohibit public gatherings and events with more than eight participants (with the exception for religious gatherings held in connection with a death as long as no more than 20 people participate), ban the sale of alcoholic beverages after 10PM, as well as other social distancing advisories.

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Data Pointing to Slower Q4 in Some Countries

With the resurgence of COVID cases across the northern hemisphere, in addition to the re-imposition of lockdown restrictions, we believe the risk of an economic stumble has increased. Recent data have already hinted at the rebound losing its steam. In the Eurozone, November survey data continued to soften, with the manufacturing PMI edging lower to 53.6, while the services PMI fell further into contraction territory at 41.3, a clear indication COVID cases and containment measures are weighing on economic activity. In addition, consumer confidence fell for a second consecutive month in November.

Leading indicators have also softened in the United Kingdom. Although the decline was less-than-expected, the November services PMI fell to 45.8 from 51.4 amid temporary business closures given the renewed COVID spread. With the stricter containment measures in addition to subdued economic data, we look for a renewed economic contraction in the Eurozone and U.K. economies in Q4, forecasting declines of 3% quarter-over-quarter and 1.5% quarter-over-quarter respectively. Of course, there has also been a renewed surge in COVID cases across the United States, and some partial restrictions that have been re-imposed in parts of the country. We will be monitoring developments closing in the coming weeks and months to see if some of the economic dynamics that are playing out internationally potentially transpire in the United States as well.

In this context, with the some European economies in particular set to post negative growth in the fourth quarter, we believe this could also restrain the euro and pound in the coming months. We currently look for the euro to remain range bound around current levels through Q1-2021, and expect the currency to gain modestly versus the greenback over the medium and longer-term reaching $1.2200 in Q1-2022. For the pound, the U.K. currency is already above our year-end target of $1.3200. While we forecast modest appreciation to $1.3600 in Q1-2022, recent U.K. developments could weigh on the pound over the short and medium term. Indeed, there is a risk that COVID cases accelerate even more than currently expected, and any additional government lockdown measures could harm industries further. Should this scenario materialize, we would see risks to our GDP growth forecasts and currency forecasts as tilted toward the downside.

The euro and pound could be restrained in the coming months.

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