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Research Briefing | Global

New virus variants, new economic risks

Economist

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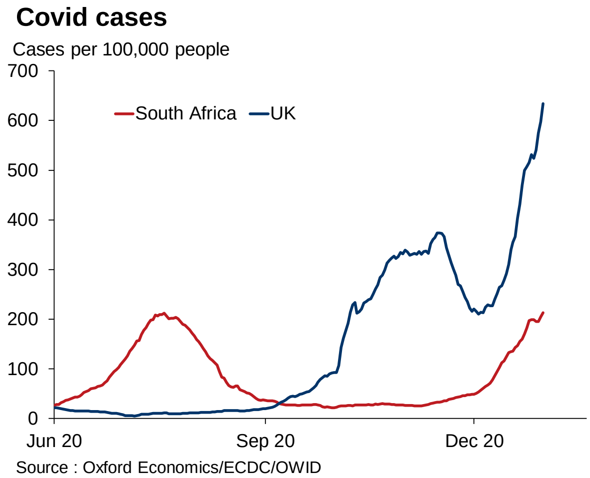
- **News on vaccine progress has offered some light at the end of the Covid tunnel, but the discovery that more transmissible variants have spread outside the UK and South Africa means the downside risks to our global baseline forecasts are rising once again.**
- **Clear signs are already emerging that the UK and South African economies will be hit hard by tighter restrictions needed to contain the surge in Covid-19 cases and hospitalisations. We now expect that UK GDP will not rebound after a small fall in Q4, but will instead contract 4% in Q1 as lockdown 3.0 takes hold.**
- **Other economies will most likely need to implement similar lockdowns. Europe is perhaps the most at-risk region, while APAC economies seem generally better prepared to keep the new variants at bay.**
- **For now, we see a second global lockdown that prompts a global double dip as still a risk rather than the most likely outcome. But the 15% probability that we previously attached to such an outcome now looks too low. The risks to our baseline particularly in the short term once again look skewed to the downside.**

The end of year optimism about the outlook for 2021 has waned following the discovery of more transmissible strains of Covid-19 in the UK and South Africa. While both of the new variants do not appear to be more harmful than other forms of the virus, evidence suggests they are spreading much faster.

In response to surging Covid cases (**Figure 1**), UK policymakers have implemented a third lockdown. Similarly, South Africa has also been forced to impose tighter activity restrictions to slow down transmissions. The key question is whether these two economies are early warning signs for what is likely to happen elsewhere?

Figure 1: UK and South African Covid cases have surged, coinciding with the discovery of virus mutations that appear to be more transmissible



In the UK, Covid cases fell back in late November and early December as a national lockdown was imposed. But since then, cases have surged despite stringent restrictions being maintained.

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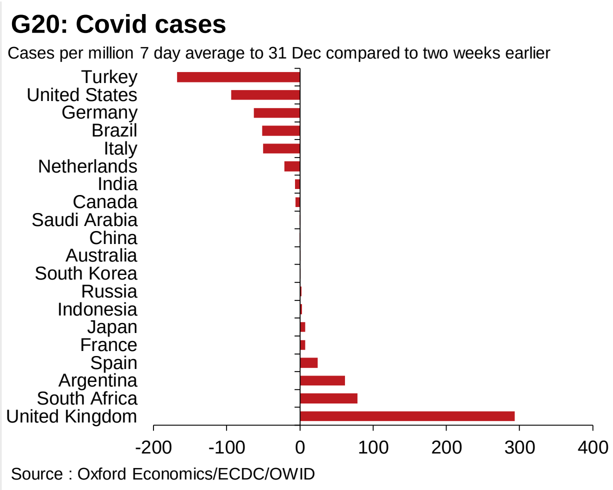
Higher transmissibility will likely mean tighter restrictions are needed to contain the virus

Were the UK and South African variants to spread internationally, this would certainly be cause for concern. The new UK variant, B117, is estimated to be around 50%-70% more transmissible. During the UK's second lockdown in November, cases of Covid-19 caused by older variants of the virus declined, whereas cases caused by the new variant surged. In fact, over the period, the R number for B117 is estimated to have been about 1.45. Accordingly, even tougher restrictions have now been imposed in the UK to try to dampen transmission.

Meanwhile, the South African variant is also believed to be much more transmissible than older variants. But a greater medical concern is that the existing vaccines may be less effective against the South African variant compared to the strains for which they were initially designed.

The UK now has the highest number of cases per million people in the G20, while South Africa sits in seventh place. But as **Figure 2** shows, over the past two weeks the rise in cases in both economies has been substantially higher than elsewhere.

Figure 2: The acceleration in the number of Covid cases in the UK and South Africa is a major concern



The rapid increase in the UK and South Africa in the number of new cases over recent weeks is far greater than in most of the rest of the G20.

How far have the new variants spread?

So far, almost 40 countries have reported cases of the UK mutation while seven countries have found cases of the South African variant. **Positive tests are not automatically a cause for panic, though.** For instance, Australia has detected the UK variant in new arrivals, but strict quarantine conditions are believed to have prevented its spread to the domestic population.

The bigger concern is if cases begin to emerge among individuals that have not been abroad recently. **Reports suggest that outside the UK there have been possible incidences of community spread in Ireland, parts of mainland Europe, the US, and Canada.**

So far, most detected cases have been associated with people recently traveling from the UK or their close relatives. However, a major caveat is that globally there is limited capacity to test for the mutations. **This situation is reminiscent of last March, when official Covid case figures showed a distinctly skewed version of reality.**

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We may have only seen the tip of the iceberg so far

The UK variant is believed to have been in the UK since September. **Worryingly, this suggests ample opportunity for it to have spread abroad prior to increased restrictions being placed on those arriving from the UK.** Given its high transmissibility, it would be no surprise if clusters of undiscovered cases were discovered around the world.

A second related concern is that it took at least a couple of months from the new strain's initial appearance in the UK for it to account for a significant proportion of cases. Against this backdrop, limited evidence of its presence elsewhere may not give a true indication of the risk that cases will surge in February or beyond.

Who is most at risk?

Economies that already have recorded domestic transmission of the new variants are clearly the most at risk to renewed restrictions, either to limit the spread of the new virus or, in time, to prevent healthcare services from becoming overwhelmed. As already noted, though, an absence of positive tests may merely reflect testing limitations. In this respect very rapid growth in case numbers could be a cause for concern in other economies.

Existing restrictions on air travel should slow the spread

Vulnerability to the new Covid variant is likely to be heavily influenced by geographical proximity to the UK and South Africa. Airports are the most likely entrance points for travellers from far-flung destinations and air travel is already tightly regulated in most economies. Around 50 economies are thought to be almost completely closed to non-citizens via air travel, and many others, such as China, have limited travel to a small group of low-risk economies. For other economies that still allow foreigners to enter, strict and rigid quarantines limit the likelihood of carriers of the new Covid variants passing them on to others after entry. Negative Covid tests prior to flying are also becoming increasingly common conditions of travel elsewhere.

Many Asian economies typically have tougher rules to reduce the risk of importing Covid cases via air passenger arrivals. The region thus appears to have less downside risks to growth at least in the form of significantly tighter domestic activity restrictions caused by the new variants. In contrast, it remains easier to cross land borders particularly where freedom of movement between countries is the norm, such as Europe. Given a general lack of cross-border restrictions within the EU and the incidences of the UK strain discovered on the European mainland, the risk of country-to-country spread of new variants is likely to be higher there, even if cross-border travel remains much lower than normal.

How big an economic hit would a new wave of lockdowns inflict?

The experience of the UK is that quite severe restrictions may be needed to contain the spread of the UK variant. The ineffectiveness of the November "lockdown-lite" in preventing the new strain from spreading has prompted a more severe lockdown to be imposed, with stay-at-home orders and the closure of schools.

Still, in comparison to the March lockdown, the UK's current restrictions are less restrictive. As a result, and perhaps in combination of a degree of lockdown fatigue, early indications point to greater activity outside the home than in March.

Given this, plus the lower starting point for GDP, the fact that firms are better placed to cope with renewed restrictions than during the first wave, and a better global economic backdrop to support exports, we expect the hit to GDP in the UK from the new lockdown

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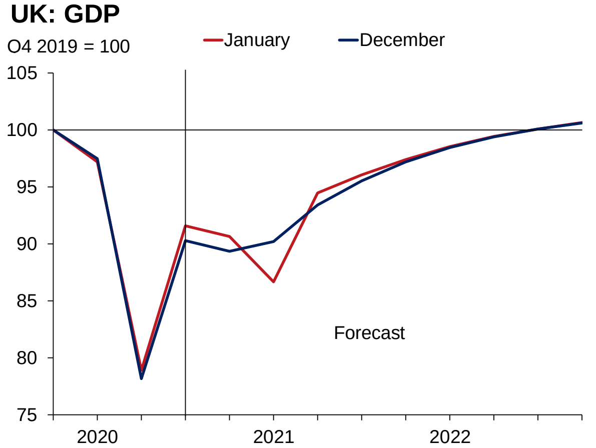
to be about 4% in Q1. This is far smaller than the 19% plunge recorded in Q2 2020 (**Figure 3**). The 4% contraction is conditional on existing restrictions lasting until mid-February, followed by a modest loosening in conditions between then and the end of March. For now, this provides a plausible benchmark for the broad magnitude of the hit that other economies re-entering fairly stringent lockdowns might face. In South Africa, we have pencilled in a 3% GDP fall in Q1 as a result of the increase in restrictions.

Figure 3: Our revised UK forecasts point to significant further economic weakness in Q1



Sources: Oxford Economics, Haver Analytics

The UK's third lockdown is expected to have a bigger negative impact on GDP than the second lockdown in November. But the GDP fall is likely to be much less than the decline in the first lockdown which began in March 2020.

More generally, the experience of late last year is that while further lockdowns for individual economies or regions are clearly bad news for those affected, the rest of the world can generally shrug off setbacks. Despite European composite PMIs falling back into recession territory in Q4, the global composite PMI remained at a robust level and our own forecasts point to solid growth outside Europe last quarter.

But should large swathes of the global economy be forced into lockdown, the hit to individual economies would likely be much more severe than the 4% fall we envisage for the UK in Q1. As our global second wave scenario illustrates, we think that another global lockdown could lead GDP to grow by just 1% or so this year compared to our baseline forecast of around 5%. At an individual economy level, domestic weakness would be exacerbated by larger falls in foreign demand and renewed weakness in financial markets.

In addition, it's doubtful whether the expansionary policy response to a renewed global lockdown would be as large as in 2020. What's more, another extended period of crisis could be the last straw for many struggling businesses. All this would result in more medium to long-term economic scarring than assumed in our baseline forecast.

Downside risks have increased, but there are plenty of known unknowns

In all, the news on the spread of new more transmissible variants of Covid-19 is clearly bad and adds to near-term uncertainty. While the extent of the spread of the new variants remains the key "known unknown", we think the development increases the risk of a second global lockdown. But for now, the probability of such an outcome remains too low to be considered the baseline outcome.

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