Covid-19 puts Europe into lockdown and rewrites economic forecasts

Economic forecasts issued only a few weeks ago in Europe, which projected continuing slow increase this year in GDP and business activity in sectors critical to the timber industry, such as construction and furniture, will need to be completely revised in the face of the Covid-19 outbreak.

Issues like Brexit, enforcement of EUTR, the slowing pace of manufacturing in Germany, and the US-China trade dispute, that only a few weeks ago seemed likely to lead the narrative of changing demand for tropical wood products in Europe during 2020, have taken a back seat in response to the transformative effects of the pandemic.

In the last two weeks, large parts of Europe have been put into lockdown to control spread of the virus. Schools and universities, and most shops, bars, restaurants and other public venues have been forced to close. People are being ordered to remain at home. Public transport is being reduced to a skeleton service for essential workers.

Manufacturing and construction activity is continuing in Europe but at much reduced levels and pressure is mounting to stop altogether to prevent any further spread of the virus.

Governments in Europe, as elsewhere, face a tough choice to strike the right balance for the health and welfare of the population. If they bring industry and construction to a halt along with the entertainment and travel sectors already shut down, the resulting recession could inflict lasting damage on their economies; if they do not, commuters and workers could fall ill and continue to spread the virus, prolonging the health crisis and the economic downturn.

The response to the pandemic has varied to some extent across Europe, dependent partly on differences in political culture and regulatory and enforcement regimes, partly on the timing and extent of the spread of the virus, and partly on the capacity of health services to respond.

Lockdown in Italy since 9 March

The lockdown began in Italy with an emergency decree on 9 March covering the Lombardy region, Italy's financial and industrial powerhouse and home to much of the country's design and fashion sectors, together with 14 other northern provinces including Venice, Parma and Treviso. The lockdown was extended to the whole of Italy on 21 March.

All population movement in Italy has been banned except for health and other urgent reasons. Schools, universities and all non-essential businesses have been required to close — with supermarkets, banks, pharmacies and post offices the only businesses allowed to remain open.

The economic shutdown in Italy is not absolute, Giuseppe Conte, the Italian Prime Minister having stated that “we will slow down the country’s productive engine, but we will not stop it”. However, his government has ruled that any business or factory that was not “strictly necessary, crucial or indispensable” must shut until April 3 when the decision will be reviewed.

Italian trade unions have argued that these measures are not strict enough to protect workers. But Confindustria, the business confederation, wrote to Mr Conte to ask him to ensure essential supply chains and support services that allow companies to keep working were maintained.

General confinement order in Spain

Similar measures have been progressively extended into other European countries. The Spanish government issued a general confinement order for more than 46 million people on 14 March.

Initially the regulations in Spain were less stringent than in Italy, with Nadia Calviño, Spain's deputy prime minister for the economy, emphasising the need to "safeguard [labour] activity and employment so that there is an adequate base to return to growth when we leave this health crisis behind".

This emphasis has allowed construction work to continue in some areas in Spain, but as the number of Covid-19-related deaths and cases have mounted, there has been rising pressure from trade unions and some regional administrations for an Italian-style comprehensive stay-at-home order for all workers except those providing key services.

France aims to avoid complete stoppage of economy

The lockdown in France started on 17 March when the government banned all public gatherings and told the country's 67 million residents to stay inside except for grocery shopping and other essential tasks.

Unlike Italian prime minister Giuseppe Conte, the French government has repeatedly called on companies to stay open and on workers to show up for their jobs even if they are not in essential services such as food supply.

The French government has also reached an agreement with trade unions in the construction sector, an important driver of the economy that accounts for 1.5m jobs and nearly 6 per cent of GDP, to continue operations "to avoid a complete stoppage of building sites, which would not only undermine the businesses involved but also the whole economic supply chain". This is subject to measures being put in place to protect workers.

Belgium and Netherlands keep ports open

Belgium has been in lockdown since March 18 and implemented tough enforcement measures. The country's 11.4 million residents have been ordered to stay at home and to avoid outside contact as much as possible. People are only allowed to leave home to visit the doctor, buy food or assist others in need. Police are patrolling the streets and have the power to enforce fines on those not abiding by the restrictions.

However, the Belgian prime minister asked for important sectors of industry to keep their activities going. The port of Antwerp, a major hub for imports of wood and other commodities into the whole of the EU, subsequently confirmed that the entire port is fully functional and will remain so in the future.

Unlike most other European countries, the Netherlands has so far stopped short of ordering people to remain at home. Instead, in a series of measures issued on 12 March, the Dutch government has asked that people stay at home as much as possible, banned gatherings except those "necessary to ensure the continued daily operations of institutions, businesses and other organisations", and is encouraging other social distancing measures.

Since the Netherlands plays a vital role in European supply chains, the Dutch government has specifically identified air and sea freight chains, road transport, as well as food and medical supply chains as vital processes in view of Covid-19. Government support is being provided to ensure employees vital to the operation of these chains can go to work without interruption.

Germany progressively tightening Covid-19 restrictions

The German federal government has not so far implemented a nationwide lockdown in response to Covid-19, although state governments across the country have progressively tightened restrictions on movement, prohibiting large gatherings, calling on people to stay at home, and asking that they observe other social distancing measures in an effort to stop spread of the virus.

On 22 March, the German state of Saxony joined Bavaria and the Saarland in prohibiting residents from leaving their dwellings except for good reasons.

However, the German government has stressed the need to keep key sectors of the national economy functioning. The three largest contractor associations in Germany – ZDB, HDB and BVMB - have jointly welcomed a German government decree for construction to continue despite the crisis and, on 25 March, stated that they "are currently making great efforts to maintain construction site operations".

UK lockdown from 23 March

The British government ratcheted up Covid-19 controls from mid-March, culminating in an order for a lockdown on 23 March, limiting people to trips outside the home solely for grocery shopping, medical needs and traveling to work if working from home is not an option. All non-essential businesses were ordered to close.

However, the UK government also said that builders on sites should continue to work but that they must practice social distancing. Some construction companies, arguing that this is impractical, have shut down all sites, while others are continuing. The UK government has also stated that work carried out to repair and maintain houses should continue, and that "hardware shops" can stay open, allowing some large DIY chains to remain operational.

An initial insight into the impact of Covid-19 on the timber sector in the UK can be derived from a Timber Trade Federation member survey published on 20 March. Around two thirds of the respondents reported a drop in demand for timber as the sector prepares for six to twelve months of disruption. The impact on businesses was reported as 'medium' by half of the respondents, while a quarter reported the impact as minimal and the remainder as high.

UK timber businesses are reporting they are taking precautionary measures, including cancelling physical meetings and switching customers visits with phone calls and other digital technologies. More than 80% of businesses have limited travel for staff, and a third are reporting some impact to their operation from employees who have needed to self-isolate as a precautionary measure.

Currently UK timber businesses are reporting that they expect these containment measures to run for three months and projecting that demand be restored between Q3 2020 and Q1 2021.

First indications of scale of European downturn

The first clear indications of the wider economic effects of Covid-19 across Europe came with publication of the IHS Markit 'flash' composite purchasing managers' index on 24 March. The index has dropped to its lowest reading since the series began in the 1990s in both the eurozone and the UK.

The eurozone index fell from 51.6 in February to 31.4 in March, while in the UK the index dropped from 53 to 37.1. A reading below 50 indicates the majority of businesses reported a deterioration compared with the previous month.

The 'flash' PMI data were based on responses collected in mid-March, before the most severe elements of national lockdowns had been implemented, which means the data for April are likely to be even worse.

Chris Williamson, chief business economist at IHS Markit, said the survey data for mid-March is consistent with an annualised 8% decline in eurozone and UK GDP, and that the expanding lockdowns means "it is unlikely that the index has hit rock bottom yet".

The most severe downturns in activity recorded by the PMI were in consumer-facing sectors, notably hotels, restaurants and other leisure-based activities, while there were record falls in the transport and travel sectors. The index for the eurozone's services sector dropped from 52.6 in February to 28.4 in March, also the lowest ever recorded. The PMI for UK services plunged to 35.7, another unprecedented low.

Although contracting at a marginally slower pace, the eurozone manufacturing activity index fell over nine points, from 48.7 to 39.5, the largest monthly contraction since April 2009. Britain's manufacturing activity PMI fell by less, to 48.0 from 51.7.

IHS Markit said that even these figures under-estimate the decline in manufacturing because they reflect an upward distortion due to the positive impact on the index of lengthening delays from suppliers, usually a sign of a sharp rise in demand, but in this case caused by Covid-19.

European governments act to mitigate economic effects of Covid-19

European countries have engaged in unprecedented and swift fiscal measures to tackle the economic crisis caused by Covid-19 and the preventive measures to "flatten the curve". To date, European governments have committed at least $1.5 trillion in spending and loan guarantees in a desperate bid to protect business, workers and families from the worst of the pandemic-induced pain.

National measures have taken a similar form across Europe and have included a combination of direct fiscal stimulus, short-time work schemes, and guarantees and liquidity support for companies with financing problems. According to Eurogroup President Mario Centeno, eurozone member states have, on average, adopted fiscal stimulus measures of some 2% of GDP and guarantee schemes of some 13% of GDP.

The rise in national spending has been facilitated by an unprecedented decision of EU member states on 23 March to suspend the Stability and Growth Pact obligations. EU finance ministers approved the Pact's 'general escape clause' to pause the structural adjustments that countries must implement to meet their fiscal targets. The clause can be activated only in response to a "severe economic downturn" in the eurozone or the EU as a whole.

The decision was taken on condition that actions by EU countries are "timely, temporary and specific" and that additional spending is dedicated only to fighting the pandemic and relaunching the economy, especially in support of SMEs and the most affected sectors and their workers.

On 19 March, the European Central Bank announced a huge increase in quantitative easing within the eurozone in an effort to keep the financial system liquid when investors are running scared. The 'Pandemic Emergency Purchase Programme (PEPP)' mandates the ECB to buy up to an additional €750 billion government and corporate bonds.

The PEPP brings the ECB's planned purchases for this year to 1.1 trillion euros, its biggest annual amount ever, with the newly agreed buys alone worth 6% of the euro zone's GDP.

Meanwhile negotiations between EU finance ministers are on-going on an EU-wide fiscal stimulus package that would come on top of the national initiatives to address the economic fallout of the virus. Essentially, ministers are trying to decide on the role, if any, of the European Stability Mechanism (ESM) in tackling in the economic fallout from the pandemic.

The ESM has €410 billion available financed by members of the eurozone set aside to address the European sovereign-debt crisis and help euro area countries in severe financial distress. It provides emergency loans to countries committed to reform programmes.

One option would be for the ESM to issue common debt in the eurozone in the form of bonds to mitigate the economic impact of Covid-19. These temporary eurobonds, or 'coronabonds', would particularly help countries with higher borrowing costs that are also most affected by the pandemic, such as Italy and Spain.

However, this option still seems unlikely given staunch resistance from some member states, including Germany, the Netherlands and Austria. More likely is that the ESM will be used to provide precautionary credit lines for member states requesting temporary help. In the last week of March, discussions were on-going on the countries that might qualify for such help and the conditionality attached.

Companies advised to prepare for the long haul

The combined effect of the pandemic and the wide-ranging policy response on the future direction of the European economy, and the fallout for the timber and associated industries, is impossible to assess at this time.

However, some insight into the possible range of outcomes can be derived from McKinsey, the global management consultancy company, who are publishing free and regularly updated briefings on the implications of the Covid-19 pandemic for business (https://www.mckinsey.com/business-functions/risk/our-insights/covid-19-implications-for-business).

The McKinsey briefings set out scenarios for how the Covid-19 pandemic might develop and the consequences for the wider global economy. The scenarios are constantly being updated and revised as more data comes available. In their briefing published 25 March, McKinsey was able to consolidate and simplify their analysis into just two likely scenarios, one which is relatively "optimistic", the other less so.

The more optimistic 'Delayed Recovery' scenario projects that new case counts in the Americas and Europe rise until mid-April, Asian countries peak earlier, and epidemics in Africa and Oceania are limited. The scenario assumes successful roll out and implementation of social distancing and testing practices and that the virus proves to be seasonal, further limiting its spread.

Even in this scenario, McKinsey expect large-scale quarantines, travel restrictions, and social-distancing measures to drive a sharp fall in consumer and business spending until the end of the second quarter of 2020, producing a worldwide recession that would continue at least until the end of the third quarter.

In this scenario, it would take until the fourth quarter of 2020 for European and US economies to see a genuine recovery and total global GDP this year would fall, but only slightly. Nevertheless,

unemployment levels would rise sharply, business investment would contract, and corporate bankruptcies would soar, putting significant pressure on the banking and financial system.

The other scenario, equally plausible and more pessimistic, is for "Prolonged Contraction" in which the global economic impact is severe, approaching the global financial crisis of 2008–09. If this scenario plays out, global GDP is projected to contract significantly in most major economies in 2020 and recovery would not begin until the second quarter of 2021.

In the 'Prolonged Contraction' scenario, it is assumed the epidemic does not peak in the Americas and Europe until May, as delayed testing and weak adoption of social distancing stymie the public-health response. Also, the virus does not prove to be seasonal, leading to a long tail of cases through the rest of the year.

In this scenario, Africa, Oceania, and some Asian countries also experience widespread epidemics, though countries with younger populations experience fewer deaths in percentage terms. Even countries that have been successful in controlling the epidemic (such as China) are forced to keep some public-health measures in place to prevent resurgence.

In the case of 'Prolonged Contraction', demand would suffer as consumers cut spending and the number of corporate layoffs and bankruptcies in the most affected sectors rises throughout the rest of this year, feeding a self-reinforcing downward spiral. Fiscal and monetary-policy responses would prove insufficient to break this spiral.

McKinsey suggest that a full-scale banking crisis would be averted even in the case of 'Prolonged Contraction', because of banks' strong capitalization and the macroprudential supervision now in place, but the financial system would suffer significant distress.

McKinsey conclude with some hard-nosed guidance to companies on the best way to respond to the pandemic emphasising, for example, that "facing up to the possibility of a deeper, more protracted downturn is essential, since the options available now, before a recession sets in, may be more palatable than those available later".

Companies involved in all sectors are strongly advised to ensure they have a business continuity plan in place and to monitor developments closely.