

Dislocation will be 2021's buzzword

Andrea Garnero, Fabrizio Pagani, *Bloomberg*, January 13, 2021*

Dislocation will be the buzzword for 2021: of supply chains, credit and, above all, the labour market across the European, and global, economies. What we don't know is how long-lasting and far-reaching the changes resulting from the ongoing Covid-19 pandemic's economic aftermath will be. Many companies and workers are still in a state of limbo between the pre-virus world and the new (brave?) one. While the rollout of effective vaccines pushes us to look forward, the full extent of the shock is unknown.

On the business side, services – especially lodging, restaurants, travel, retail and all facets of the hospitality economy – have been badly hit by the crisis as governments and customers minimised face-to-face interactions. However, manufacturing is also affected by the ongoing turmoil. European factories, especially small- and medium-sized enterprises, in the business-to-business sector, are experiencing dislocations in their value chains: supplies are coming in late or at prices materially higher than in the past.

There are still some disruptions in production, but logistics have become less reliable and more complex. With flights suspended and borders restricted, and numerous transportation businesses struggling, competition in logistical services has declined, putting upward pressure on prices in traditionally low-margin sectors, such as freight. Air cargo capacity increased during the last quarter of 2020, but is still down 57% from 2019 levels, according to Accenture. How long this will last and whether it will permanently affect supply chains is uncertain. These changes may be mostly temporary, at least for larger firms. In a recent survey by the European Central Bank, for instance, firms across Europe did not see major supply-chain disruptions. But at this stage, that's still just a hunch.

Credit is equally affected by the pandemic. In most European countries, normal business lending mechanisms have been disrupted: existing loans are often suspended by credit repayment holidays and new ones are benefitting from state-backed guarantee programmes. In France, businesses have access to the “prêt garanti par l'Etat” until the end of June. Similar guarantee schemes have been enacted across several European countries and they enjoy protection from antitrust, thanks to the temporary relaxation of state aid rules adopted by the European Commission. It is

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difficult to assess the true cost of private credit until these measures are fully phased out. In the current framework, we do not know which, and how many, businesses will fail or how long it will take to adjust the financing of surviving firms towards a “new normal” way of conducting business.

Consequently, it is difficult to assess the longer-term impact on bank balance sheets and capital requirements. Recent communications by the European Commission and the European Banking Authority address the issue of how to tackle non-performing loans in the aftermath of the pandemic. But even central bankers and regulators acknowledge that these are still uncharted waters.

Last, but certainly not least, come workers and their families: the full impact of the Covid- 19 crisis on the labour market still flies well below public attention. Large and generous job retention schemes have cushioned the impact on the labour market. Even if well below the peak reached in April, at the end of 2020, 3 million workers in France, 1.2 million in Italy and up to 5 million in the United Kingdom were still on some sort of subsidy, even if they counted as employed in official labour market statistics. At the peak of the global financial crisis in 2009, there were 600,000 workers on job retention in France and 275,000 in Italy (the UK introduced its scheme only in April 2020).

The biggest single question for economists, not to mention political leaders, is what will happen when these public support measures are phased out. There is a clear risk of a sudden surge in bankruptcies, particularly smaller businesses and retail shops, and unemployment stemming not from firms’ inefficiencies or the healthy process of “creative destruction”, but simply because of the dislocation that Covid-19 brought, and which policymakers are still fully unable to assess.

Facing such huge uncertainty, it would be better to err on the side of caution. Support to families and companies affected by the economic effects of Covid-19 should continue while countries prepare their recovery packages and fully grasp the medium- and long- term effects of the pandemic. The short-term costs of this additional effort must be balanced against the potential damage of a protracted slump. Rolling back support now because “it costs too much” would be an unforgivable mistake, reminiscent of the ones that policymakers made in 2010-11 when too-rapid fiscal tightening on both sides of the Atlantic threatened to kill the recovery and left long-term scars. Leaders need to show they have learned the lesson of the last 10 years.

Only by ensuring the viability of their economies in the short term can nations, particularly in the European Union, set the preconditions needed for the introduction of investments and reforms essential to make their markets strong and sustainable in the long run.