Economic structure and resilience against shocks in the euro area

As is well known, the COVID-19 pandemic was an unprecedented health, social and economic shock, with a highly uneven impact across countries, despite the decisive economic policies implemented to soften the blow. These disparities can be largely explained by the severity of the restrictions that were imposed, the sectoral structure of the different economies, their starting point, and even the quality of their institutions.[1]

From the difficulties experienced by the service sectors which rely on social interaction...

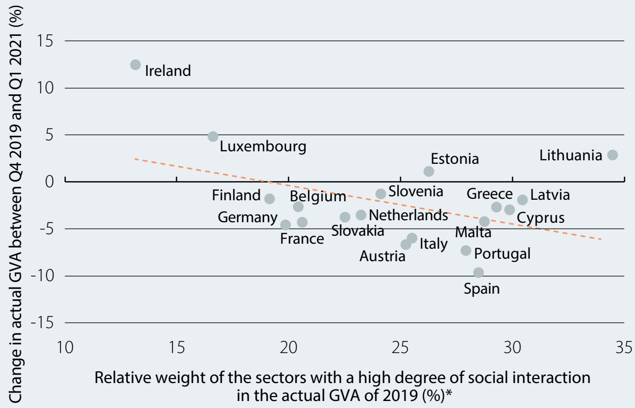
With regard to the sectoral composition, the nature of the measures imposed to curb the spread of the virus dealt a particularly heavy blow to activities with a high component of social interaction (tourism, hospitality, entertainment, etc.).[2] In fact, at the height of the crisis (from Q4 2019 to Q1 2021), the most pronounced drops in economic activity occurred where these sectors account for a larger portion of GVA. Focusing on the big four EU economies, only in Germany these branches had a relative weight clearly below the euro area average in 2019 (19.8% versus 22.4%), while in France it stood around the average (20.6%), and in Italy and Spain it was clearly above the average (25.5% and 28.5%, respectively).

It is true that these sectors experienced a significant recovery beginning in Q2 2020, once the restrictions began to be lifted, but the punishment endured as a result of the «great lockdown» has left somewhat more persistent scars. Over a year after the crisis began, activity in the retail, hospitality, catering and entertainment sectors in the euro area is still more than 11% below its pre-crisis level. In contrast, industry (excluding construction), financial services, communications and the public sector have already exceeded their pre-crisis levels since Q2 2021.

This uneven behaviour among the various sectors of the economy has also affected employment, an impact which would have been even greater if it were not for the important economic policies implemented (such as temporary employment reduction mechanisms), as reflected in the behaviour of employment and the volume of hours worked. According to data from Eurostat, between Q4 2019 and Q2 2021 in the more «social» sectors, the number of jobs fell by 5.2%, while the decrease in the

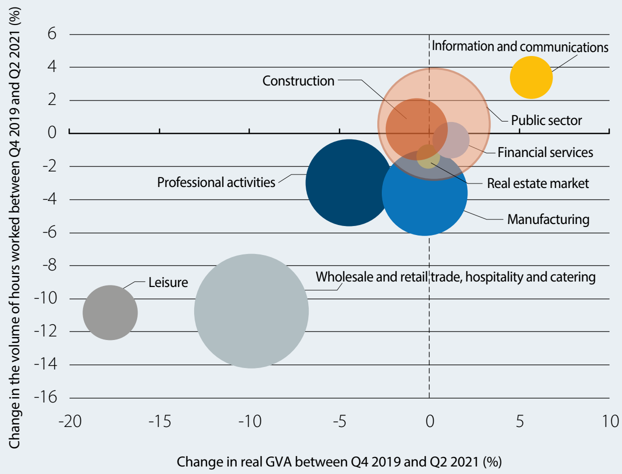
1. See the Bruegel report (2020). «Why has Covid-19 hit different European Union economies so differently». Policy Contribution. Issue nº 18, September.
2. See ECB (2021). «The heterogeneous economic impact of the pandemic across euro area countries». ECB Economic Bulletin. Issue 5/2021.

Euro area: sectoral composition and economic impact



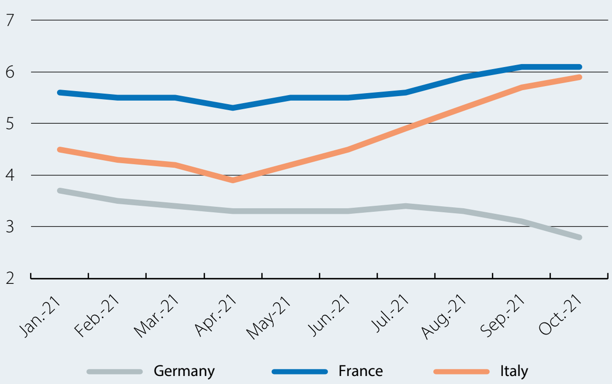
Note: ** Wholesale and retail trade, transportation, catering, hospitality, leisure and culture.*
Source: *CaixaBank Research, based on data from Eurostat.*

Euro area: hours worked and economic activity by sector



Note: *The size of the bubble represents the volume of hours worked in each sector in Q2 2021.*
Source: *CaixaBank Research, based on data from Eurostat.*

Euro area: GDP growth forecast for 2021 *
Annual change (%)



Note: ** Growth forecast published in each month.*
Source: *CaixaBank Research, based on data from the Consensus Forecast.*

volume of hours worked more closely resembles the decline suffered in their economic activity (10.8%).

Analysing the behaviour of the hospitality, catering and leisure sectors in the four major economies, the same pattern of behaviour is observed, albeit with different degrees of intensity. In Germany, the combined activity of these sectors in Q2 2021 was 8.0% below its pre-COVID level, compared to the marked correction experienced in Spain (22% below) and France (15% below). In Italy, meanwhile, these sectors achieved a significant recovery in Q2 2021, ending up just 9.7% below their pre-crisis level (compared to 18% in Q1 2021). This differentiation is largely explained by the differing importance of international tourism in each country.

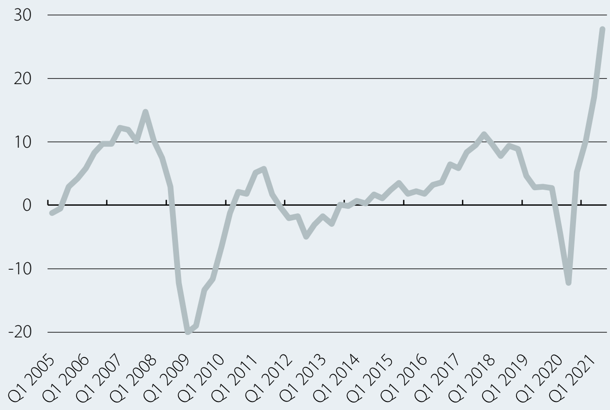
The evolution of the volume of hours worked in these more social sectors, meanwhile, also reflects the different economic pattern of each country. Thus, in France between Q4 2019 and Q2 2021, the volume of hours worked in the most social sectors fell by more than 14%, accounting for around 75% of total volume of lost hours in the economy as a whole; in Italy and Spain, hours worked fell by 12% and 9.0%, respectively, explaining in both cases around 90% of the total drop in hours. In Germany, meanwhile, despite the hours worked in these sectors falling by around 10%, they account for just 60% of the total loss of hours.

...to the troubles in industry over the mismatches in global supply

With these data, it could be assumed that economies in which these «social» sectors play a smaller relative role were better positioned to overcome the ravages of the crisis, and in this regard Germany was well in the lead... until the summer. While the significant role of its industry initially limited the impact of the crisis, now the lack of supplies caused by the disruptions in global supply chains are having a particularly harsh impact.

In Q2 and Q3 2021, Germany's growth was already lower than expected, while France and Italy performed better than anticipated. It is no coincidence that in the latter cases the relative weight of industry in their economies (14% and 20%, respectively) is lower than in the case of Germany (26%). Moreover, the importance of German's automotive sector (representing over 20% of the country's industry) also plays against it: almost 90% of German car manufacturers acknowledged experiencing supply problems in October. To date, and according to estimates by the Ifo, the losses caused by these bottlenecks in German industry as a whole amount to around 40 billion euros, more than 1% of annual GDP. And not only that: according to the Ifo, these supply problems could last another eight months for the whole industry, and almost 10 months in the chemical and automotive industries. If this prediction becomes a reality, industry would suffer losses of around 2.0% of annual GDP in 2022, a significant downside risk for Germany's growth forecasts.

Germany: industrial orders with respect to production capacity
(%)



Source: *CaixaBank Research, based on data from the Bundesbank.*

It is true that the supply problems are affecting all euro area countries, and this explains the sharp slowdown that is expected across the board in Q4. Nevertheless, Germany's economic structure makes it much more vulnerable to these bottlenecks, which explains the deterioration in its growth outlook.

The good news is that this situation is temporary, and once the supply mismatch is resolved German industry will be able to return to full capacity. This is especially apparent given that demand is currently in excellent health: industrial orders in Germany exceed current production capacity by more than 30%, the highest mismatch ever recorded.

On balance, all the indicators suggest that growth in the euro area will experience a notable slowdown in Q4 due to the bottlenecks, although for the time being we are confident that the quarter-on-quarter growth rates will still be above their long-term average. In any case, uncertainty is still very high and the risks are largely skewed to the downside. Indeed, the rapid spread of the virus in Europe has forced countries to take drastic measures: Austria has placed the entire country under lockdown for at least 20 days, and Germany could introduce a law prohibiting non-vaccinated people from carrying out certain activities. If these measures become widespread, euro area growth over the coming months would be markedly affected, which could have ramifications for the ECB's current roadmap.

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