AXA Investment Managers

**1 February 2022**
**Research & Strategy Insights**

# Omicron update: Boon or Bust?

## An assessment of what Omicron means for the global economy

**David Page,**
Head of Macro Research
Macro Research – Core Investments

### Key points

- Since the Omicron variant emerged it has quickly become the dominant COVID-19 strain. Global cases have surged, but also retreated more quickly. Moreover, severe cases have increased proportionally far more slowly.
- Government restrictions have been mixed, if more muted, but individual behaviour has adjusted to Omicron – so we expect a weaker fourth quarter 2021 (Q4) and first quarter 2022 (Q1) in most economies. Activity is likely to rebound quickly and annual growth outlooks are broadly similar for developed economies.
- Emerging market (EM) economies will also be disrupted. The apparent lower severity of Omicron may be a boon for EMs if it makes people more resilient to future waves of the virus, something that could lift activity faster in the second half of 2022 and beyond. However, the risks from disruption are higher in EMs. Moreover, China faces a specific risk if its 'zero-COVID' policy is breached.
- Inflation is likely to remain elevated for several months longer because of Omicron but should still be in visible retreat from the spring – and may fall further if a benign outlook for EMs emerges. Yet risks to EMs and China pose upside risks to inflation rates globally.

### An immunity-skipping new variant

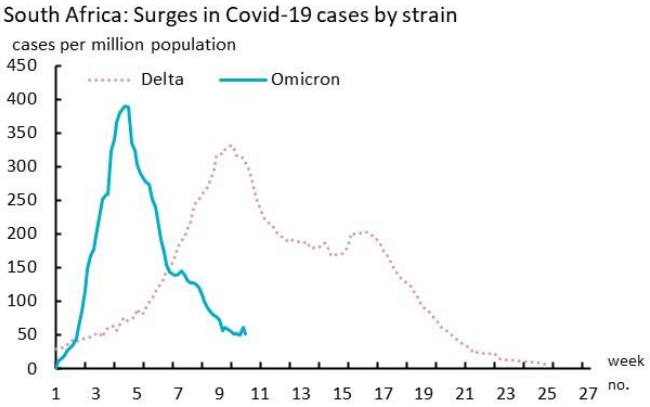
On 24 November 2021 South Africa identified a new variant of COVID-19, B.1.1.529, which was designated as Omicron. The variant had a large number of new mutations, including in the protein spike, and scientists were concerned that this would evade immunity built up by previous infection or by vaccination, which was reasonably widespread throughout developed economies and many emerging market economies, particularly in Latin America. Global case numbers of the virus in that week were 3.8mn. Since then, Omicron has dominated new COVID-19 cases, which have surged globally – the latest week recording 20.8mn. However, consistent with anecdotal reports in the first weeks of the outbreak in South Africa, Omicron has proved to cause less severe infections, and while hospitalisations and deaths have also increased, the rise has not been proportional to the explosion of cases.

In this paper we review the characteristics of the Omicron variant, including empirical findings from the UK, the first developed economy to suffer a significant outbreak. Armed with these findings, we draw tentative conclusions about what this might mean for disruption to key economies over the coming months and beyond. We highlight some of the key uncertainties around this view and assess the potential impact on inflation.

## The characteristics of Omicron

Some 10 weeks since the emergence of Omicron, evidence is now available about its impact. What was immediately obvious was that it was much more transmissible than previous variants and is now estimated to be four times more transmissible than the Delta strain – itself a faster spreader than previous variants. In South Africa, a country which had struggled with Delta less than six months before, new cases surged to exceed the previous peak, in about half the time (Exhibit 1).

Exhibit 1: Omicron spread far quicker in South Africa

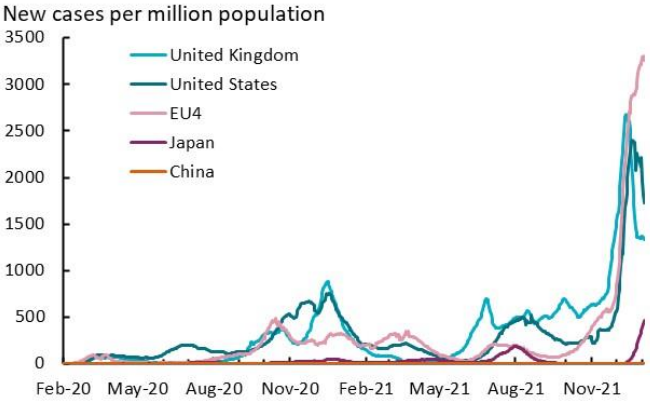



*Source: Our World in Data (OWID) and AXA IM Research, 28 January 2022*

South Africa was, however, quick to record that while case numbers shot up, hospitalisations were rising at a far slower rate and the severity of infection appeared lower. Treated with caution initially, a rigorous scientific assessment showed that in South Africa an Omicron infection was 73% less likely to be severe than Delta[1]. Different characteristics of the South African population, including the scale of vaccination, the demographic breakdown and the number of immuno-compromised people made a direct analogy with developed economies' populations problematic. Yet the fast pace of transmission meant that it was not long before Omicron had spread to developed economies (Exhibit 2).

The UK was the first developed economy to record a significant outbreak, with London the initial epicentre. The UK's population is similar to that of most developed economies. It was also highly vaccinated, with 61% double vaccinated and 20% having had 'booster' jabs by the start of December. Despite this, the number of UK virus cases surged, with daily cases reaching a high of 226k on 4 January, and the total for that week 1.25mn – around three times the previous peak in the same week of 2021[2]. The peak was again around five weeks after the original Omicron cases, spreading far faster than previous waves. This confirmed fast transmissibility and the apparent ineffectiveness of vaccines in containing the spread.

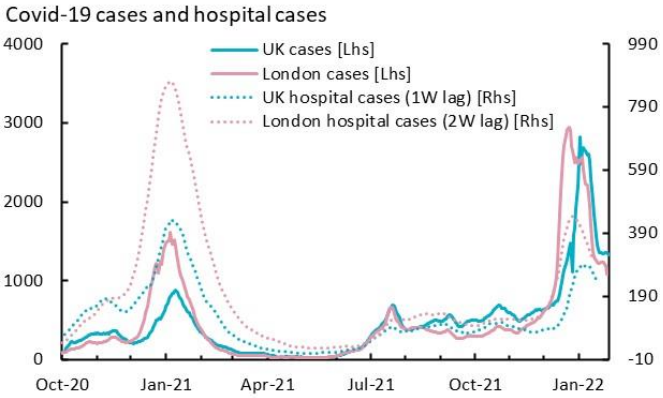
Exhibit 2: Omicron quickly spread around the world




*Source: OWID and AXA IM Research, 28 January 2022*

As in South Africa, while hospitalisations and deaths rose, they did not increase proportional to cases. Exhibit 3 shows the relationship between cases and hospitalisations for the UK as a whole and London specifically – the first area to see a significant spread. We can identify three distinct phases in this chart: Pre-vaccination (before March 2021), post-vaccination (March-November 2021) and Omicron (December 2021 onwards). The chart is normalised around the middle phase, illustrating that the ratio of hospitalisations to cases was relatively far higher before vaccination but have been far lower during the Omicron phase.

Exhibit 3: Relationship of UK cases and hospitalisations



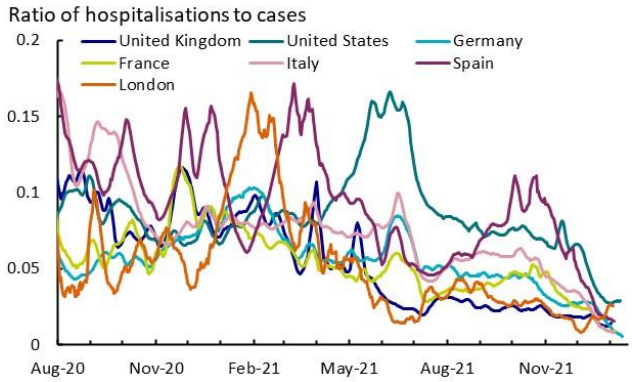

*Source: UK Health Security Agency, OWID and AXA IM Research, 28 January 2022*

Omicron has subsequently spread further. This later spread and further time lags between cases and hospitalisations make conclusions more tentative on a broader international basis. Nevertheless, Exhibit 4 shows how ratios of hospitalisations to cases have fallen in most major economies. If anything, these suggest that the decline in the UK's ratio of about one half, if anything, understates the effect seen elsewhere. Some countries including France, Italy, and Spain are seeing declines of between 70% and 80%.

[1] Jassat, W. and Karim S.A., "Clinical Severity of COVID-19 Patients Admitted to hospital in Gauteng, South Africa during the Omicron Dominant Fourth Wave", The Lancet, 29 December 2021.

[2] Data from Johns Hopkins University.

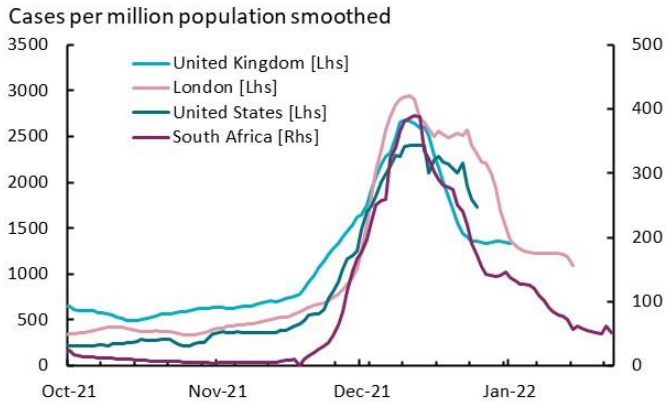
Exhibit 4: Hospitalisation to cases ratios




*Source: UK Health Security Agency, OWID and AXA IM Research, 28 January 2022*

As well as reduced severity, the faster transmissibility also appears to have led to a faster burn out. South Africa saw only a modest tightening of restrictions in the face of the Omicron wave, but cases fell quickly after surging to a peak and restrictions have subsequently been all but removed. A similar pattern has been seen in London, with the broader UK tentatively following. International economies seem to be behaving similarly (Exhibit 5). It is noteworthy that the spread of Omicron has been very similar in different countries despite the use of different restrictions.

Exhibit 5: Omicron burn out




*Source: UK Health Security Agency, OWID and AXA IM Research, 28 January 2022*

The optimistic assessment of Omicron is that it is a more transmissible, but less severe, variant of coronavirus. This could mark a turning point in the pandemic to a more manageable endemic phase. The fast spread and fast burn out is likely to see broad swathes of the population become immune by infection, with relatively fewer suffering severe episodes. Scientific studies suggest that while Delta immunity did not protect against Omicron, Omicron immunity does protect against Delta. This may provide more widespread population resilience to future waves of COVID-19.

However, a number of uncertainties surround this outlook. First, while South Africa is a country with relatively low vaccination rates (24% double-dosed and no boosters), its population is younger than that of most developed economies, which may have contributed to the reduced severity. Subsequent infections have been in more highly vaccinated countries and it is possible that while vaccines have not stopped the spread of Omicron, they have suppressed its severity. There remains a risk that as Omicron spreads through less vaccinated populations in other countries – a process now underway – the severity of infection will rise.

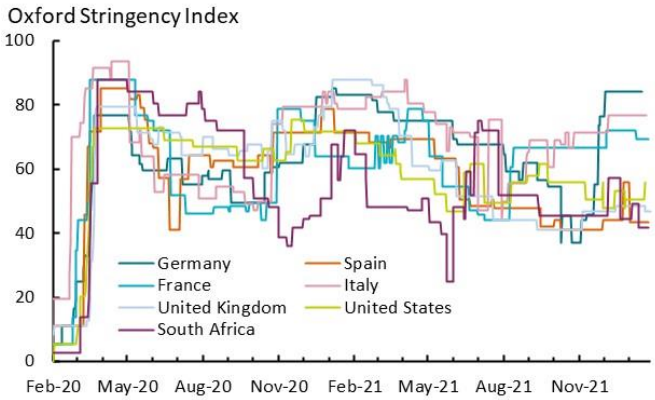
Second, there are still risks of local health services being overrun. The number of hospitalisations is still likely to be high with the sheer number of Omicron cases generating high admissions, even if the hospitalisation-case ratios fall. Additionally, countries that have struggled with Omicron so far have seen high infection rates result in significant staff absences, including medical staff. Hence healthcare has struggled with a combination of rising demand and falling capacity to meet that demand, which could lead to problems for some countries, particularly emerging markets.

Finally, there is still the risk of the emergence of another new variant: Omicron need not mean Omega. It is true that as viruses mature, they tend to mutate less. However, if Omicron becomes endemic, it will be active in a much larger population, and this will raise the potential number of mutations and hence the chances that one of those will be able to outcompete Omicron. There remains an ongoing need for vigilance against future malign mutations.

## The short-term economic impact - disruption

In the initial waves of the pandemic, the scale of economic damage largely reflected the imposition of government restrictions to reduce activity, minimise the spread of the virus and protect struggling health services. As time has passed, the imposition of such restrictions has eased and in reaction to Omicron, the response was particularly mixed.

Exhibit 6: Estimated increases in restrictions

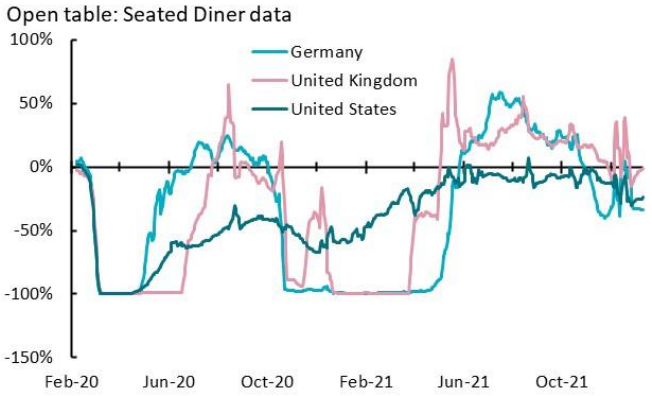



*Source: Blavatnik School of Government, University of Oxford and AXA IM Research, 28 January 2022*

Exhibit 6 illustrates the scale of restrictions imposed in a small selection of economies. As discussed, South Africa imposed only minimal restrictions, including reduced large

gatherings and a curfew for indoor dining, and these have largely been removed. By comparison, Germany increased its restrictions sharply, belatedly reacting to the threat of Delta, before increasing further to protect against Omicron. France, by comparison, raised its restrictions only modestly, but was already elevated in its defence against Delta. The US and UK saw similarly limited official reactions.

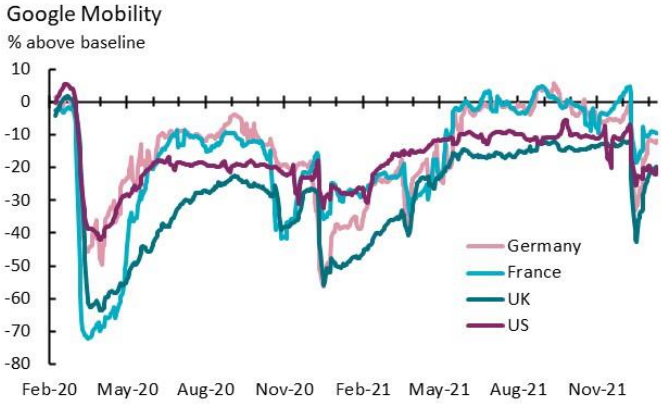
Exhibit 7: Consumer services spending to bear brunt




*Source: Open Table and AXA IM Research, 28 January 2022*

Yet despite the lack of more significant public intervention, evidence suggests that individual behaviours changed. The US recorded a 1.9% fall in the value of retail sales in December, and the UK a 3.7% fall in the volume. This is despite the fact that previous virus waves had boosted spending on consumer durables and that a fall in restaurant dining has typically supported supermarket food sales. Moreover, Exhibit 7 shows that, as in previous waves, individuals cancelled restaurant bookings voluntarily in the face of the Omicron outbreak, a precaution likely mirrored across the broader consumer services spectrum and could have a marked impact over Christmas.

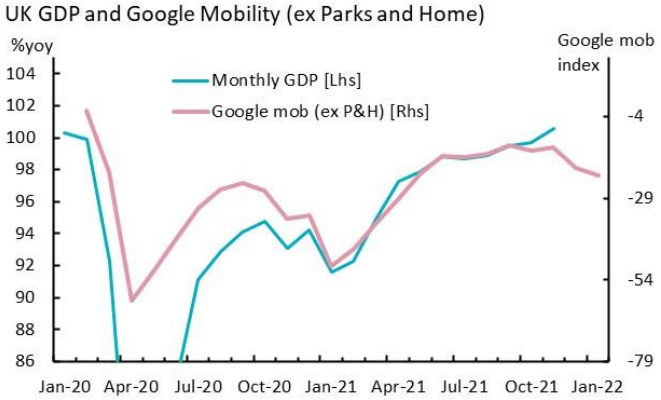
Exhibit 8: Google mobility indicators fall sharply




*Source: Google and AXA IM Research, 28 January 2022*

Although first estimates of Q4 GDP have only started to emerge and Q1's GDP figures are months away, we can start to gauge the impact of the Omicron disruption from declines in the movement of people shown by Google Mobility reports. Exhibit 8 shows sharp drops in mobility (excluding parks and households) in four large economies. Interestingly, the declines in Germany and the UK were broadly similar despite different scales of official intervention. Exhibit 9 illustrates how mobility has proven a good guide to levels of GDP in the UK since the start of last year. Similar relationships exist for other large economies. Mobility suggests a downturn in activity for December and January. This is also consistent with sharp declines in preliminary estimates of January's services Purchasing Managers Index (PMI) in the US and France (in the UK this drop happened in December).

Exhibit 9: Google mobility a good guide to UK GDP




*Source: National Statistics, Google and AXA IM Research, 28 January 2022*

In all, we are lowering our outlook for GDP modestly in Q4 for countries impacted by Omicron, and more substantially for Q1. This includes lowering US Q1 GDP growth to 0.4% quarter-on-quarter (qoq) from 0.7%, UK to 0.4% from 0.9%, Japan to 0.7% from 1.1% and Canada to 0.4% from 0.7% (leaving Eurozone growth unchanged at 0.6%).

However, with Omicron appearing to fade more quickly and restrictions being lifted in several early-exposed economies, including South Africa, the UK and Canada, we also see the prospect of a sharp rebound in subsequent months – likely starting in February in the UK. This would still leave Q1 lower but should lift Q2 and result in a more stable second half (H2) 2022. On balance, we have not materially revised our outlook for growth as a whole across the year, with consumers likely running down higher levels of savings later in the year following the Omicron disruption.

The longer-term growth outlook is likely to be affected by a number of additional factors. First, whether Omicron helps secure greater global resilience to future shocks. Second, any emergence of future new variants. Third, the impact of Omicron on supply conditions across the course of this year. For that we consider the implications of Omicron for emerging markets and China specifically.

## Emerging market impact

The impact on EMs could be different from that expected in developed economies. In contrast to developed economies:

- EMs are generally not as highly vaccinated as developed economies (Latin America is an exception, but vaccinations are largely not the more effective mRNA-based ones)
- They typically have less healthcare capacity
- Governments and populations have lower per capita incomes and do not have the same savings buffers as developed economies
- Inflation expectations are less well anchored, which has required central banks to tighten monetary policy quickly when inflation has increased.

All of these factors leave EMs vulnerable to more severe economic disruption if Omicron cases continue to rise. Risks include a much bigger health impact on the population, or governments having to tighten restrictions to protect healthcare systems. Economically, the lack of fiscal space and saving could result in a larger demand shock as incomes are less protected, while further upward pressure on inflation may result in further tightening in domestic monetary policy, something that would slow growth more in the future. In short, mechanisms that provide confidence that disruption to developed economies should be short-lived are not as strong in emerging markets, which could result in a weaker economic path even as the Omicron wave passes, despite individual populations' greater resilience to future shocks.

This poses a downside risk to our EM outlook this year. However, it also adds a downside growth risk to developed economy growth, which could continue to be restrained by supply chain issues, and upside risks to inflation.

## China – a special case

China has responded well to the initial onslaughts of COVID-19. A 'zero-COVID' policy with strict lockdowns to contain outbreaks has left it with relatively few cases and a fraction of the virus-related deaths of most large economies. China's population is also highly vaccinated, with 85% double vaccinated. However, China's vaccines are not the mRNA vaccines that have proved the most effective at preventing the spread of Omicron. Moreover, China's very success at limiting the spread of COVID-19 to date means that its population would have little natural immunity to Omicron.

A highly transmissible virus spreading through China's 1.4bn population would likely be incredibly damaging. A Peking University study[3] estimated that dropping the zero-COVID strategy would result in 630k daily cases. This was for the Delta variant, and the Omicron impact would likely be higher – a significant strain on the healthcare system. And even if China saw similar death-to-case ratios as low as in other large countries, this would still suggest thousands of deaths per day. In fact, China's ratio would likely be higher if Omicron reaches China's so-far-protected vulnerable citizens. This would also likely result in severe economic disruption.

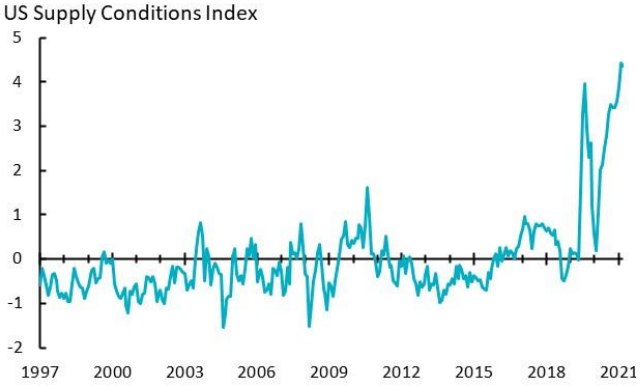
As such we expect the Chinese government to persist with a zero-COVID policy. Unless China's vaccine technology evolves to provide greater protection, or a future variant proves to have a lower fatality rate, we think the Chinese authorities will continue to try to restrict the spread of the virus. This is evident now as China once again discourages free mixing over its New Year holidays, despite the economic cost.

Yet China may not be able to continue to control the spread of Omicron. A draconian lockdown, by Western standards, has just been lifted in the city of Xi'an where a persistent Delta outbreak has just been eradicated. China is currently dealing with a number of Omicron outbreaks, although for now these remain under control. China is soon to host the Winter Olympics, which will see thousands of overseas athletes, support staff, officials and journalists arriving in the country. There is a significant risk that Omicron breaks out in China and moves too quickly for the authorities to control.

Such an outbreak would likely deal a large shock to the global economy. Disruption would likely be high even if Beijing eased restrictions in a losing fight. GDP contracted by 10.5% (qoq) in Q1 2020 at the onset of COVID-19. While we would not expect a repeat of this, activity could still fall sharply in an economy that has not "learned to live with" the virus. This significant disruption to economic activity would be exacerbated globally, first impacting satellite economies that are part of the Chinese production value chain, and second through further disrupting global supply chains and sending a further supply shock through the global economy.

## The inflationary impact of Omicron

Exhibit 10: Supply chain disruption immense




*Source: Bloomberg and AXA IM Research, 28 January 2022*

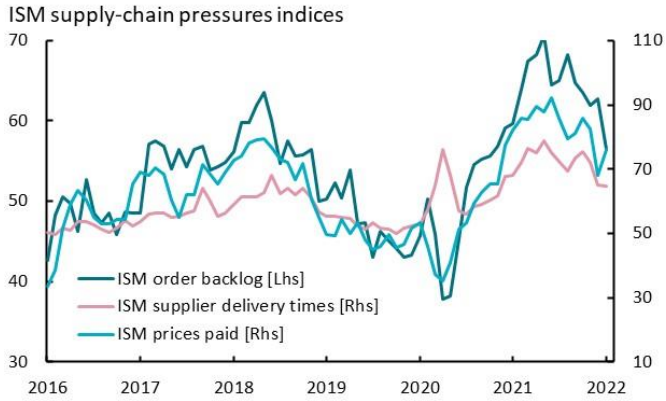
The pandemic has led to a much greater impact on inflation than we forecast. While the drop in demand had an immediate impact on prices, the fiscal boost supporting this decline was greater than we had anticipated, while consumer

[3] Reuters News 28 November 2021

behavioural shifts, from spending on unavailable services to goods, exacerbated goods price inflation. However, it has been the deterioration to the supply side of the economy that was most unexpected. COVID-19 caused a supply shock of an order of magnitude not seen since the 1970s (Exhibit 10), increasing the scarcity of key goods. Meanwhile, the pandemic had a more insidious effect on some labour markets, including the US and UK, which threatens more persistent inflation even as the supply shock abates. Both are factors that Omicron could exacerbate.

Exhibit 11 illustrates that supply chain pressures appeared to be easing at the end of 2021. The initial impact of Omicron is likely to be to reverse some of this improvement, both by creating staff shortages across the US – adding to distribution bottlenecks – and reducing production more broadly. In our base case, this should be a relatively brief period of disruption, likely keeping inflation elevated over the coming months. We still expect to see inflation visibly softening from the spring. However, risks across EM could see inflationary pressure persist for longer.

Exhibit 11: Omicron risk to supply chain improvement

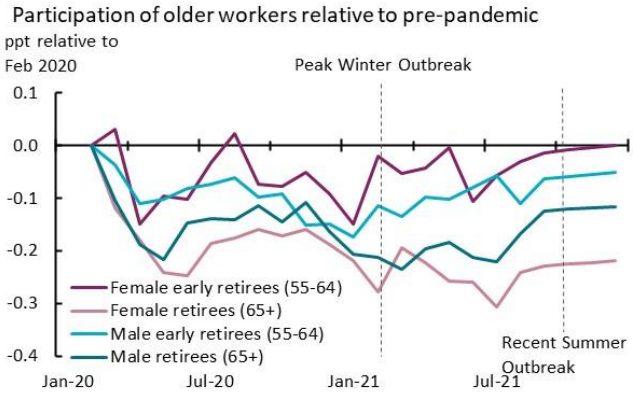



*Source: ISM and AXA IM Research, 28 January 2022*

At the same time, another wave of COVID-19 is likely to further impact labour markets. In the US, and other economies, labour market supply has been restrained by workers affected by care-giving responsibilities, exacerbated by school closures, healthcare concerns and, in some instances, government restrictions including vaccine mandates. The Omicron surge is likely to temporarily reverse the improvement that a fading virus would support (Exhibit 12). Again, while we expect Omicron to pass quickly and reduce the chances of further disruptive waves, the improvement in labour supply could be stronger than we have anticipated even by the second half of this year. However, the short-term effect is likely to be to exacerbate labour supply shortages, adding to tightness in labour markets and inflationary pressure in key regions.

In total, we have raised our inflation outlook for 2022 in most regions. In the Eurozone we now see inflation averaging 2.7% this year (from 2.1% last year), in the UK 4.5% (from 3.8%) and in Japan 0.9% (from 0.7%). Admittedly, some of this reflects the unexpected developments along the Ukrainian border, which have kept European energy prices higher – hence the larger adjustment in European inflation forecasts. However, the likelihood of a more persistent pandemic effect is a part of that story. In the US, however, we have lowered our inflation outlook to 4.0% from 4.1% as we now expect a faster monetary policy tightening from the Federal Reserve.

Exhibit 12: Labour supply improvement could reverse




*Source: Bureau of Labor Statistics and AXA IM Research, 28 January 2022*

## Omicron brings some hope, but risks remain

To date, Omicron has delivered an eye-watering surge in new cases across the globe, but that surge appears to be fading more quickly and is resulting in proportionately fewer severe cases, hospitalisations and deaths. In developed economies, this underpins our expectations that Omicron disruption will be focused around the turn of the year and should see a stronger bounce back thereafter, leaving overall growth broadly unchanged.

We also hope for a relatively benign impact on emerging markets, where disruption should be equally swift, but should fade quickly there as well. This could leave EM and the global economies more resilient moving into H2 2022. However, we also recognise that the disruption to EMs could play out differently to developed economies, and we consider the risks surrounding the Chinese economy as a special case. The risks to our outlook are of a more disruptive impact from Omicron. Moreover, the broader risks of a further malign mutation of COVID-19 persist.

Finally, we expect Omicron to have a marginal upward impact on inflation for 2022, reversing tentative improvement in supply chain disruptions and labour market shortages temporarily, but we still envisage inflation reversing sharply from elevated levels after the spring. However, the risks of a more disruptive impact on EMs and China provide a further upside risk for the inflation outlook this year.

## Our Research is available on line: http://www.axa-im.com/en/insights


DISCLAIMER

This document is for informational purposes only and does not constitute investment research or financial analysis relating to transactions in financial instruments as per MIF Directive (2014/65/EU), nor does it constitute on the part of AXA Investment Managers or its affiliated companies an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities.

It has been established on the basis of data, projections, forecasts, anticipations and hypothesis which are subjective. Its analysis and conclusions are the expression of an opinion, based on available data at a specific date.

All information in this document is established on data made public by official providers of economic and market statistics. AXA Investment Managers disclaims any and all liability relating to a decision based on or for reliance on this document. All exhibits included in this document, unless stated otherwise, are as of the publication date of this document.

Furthermore, due to the subjective nature of these opinions and analysis, these data, projections, forecasts, anticipations, hypothesis, etc. are not necessary used or followed by AXA IM's portfolio management teams or its affiliates, who may act based on their own opinions. Any reproduction of this information, in whole or in part is, unless otherwise authorised by AXA IM, prohibited.

Issued in the UK by AXA Investment Managers UK Limited, which is authorised and regulated by the Financial Conduct Authority in the UK. Registered in England and Wales No: 01431068. Registered Office: 22 Bishopsgate London EC2N 4BQ

In other jurisdictions, this document is issued by AXA Investment Managers SA's affiliates in those countries.

AXA Investment Managers SA
Tour Majunga – La Défense 9 – 6 place de la Pyramide 92800 Puteaux – France
Registered with the Nanterre Trade and Companies Register under number 393 051 826