Beyond Brexit and the Covid-19 pandemic: the Europe outlook in 2020-23

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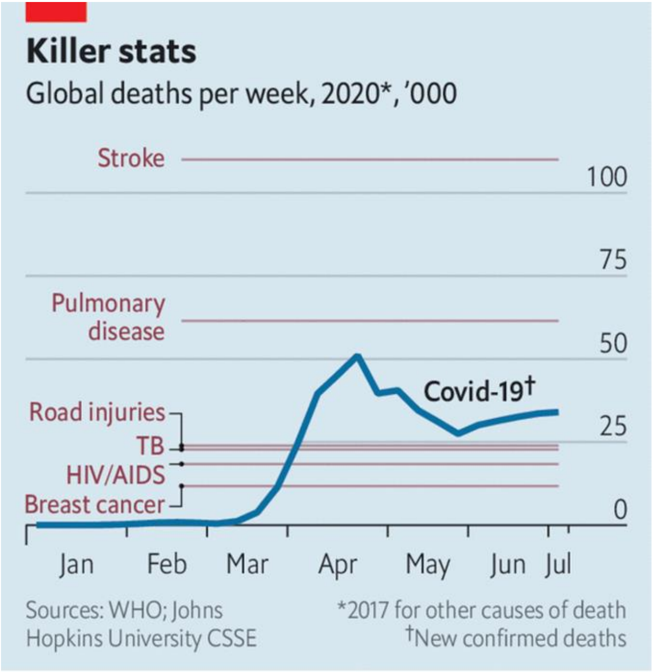
Some assumptions about the pandemic

The pandemic continues in 2021

- The spread of the virus is the main source of uncertainty in our forecasts.
- We assume that the virus will continue to spread until a vaccine is found.
- Our forecasts assume that public health measures will remain in place throughout 2021.
- We do not expect that a vaccine will be available until late 2021.

    - Downside risks: efficacy; production/distribution constraints; first rights/hoarding; low public trust, and may never be developed at all.
    - Upside risks: Effective vaccine; fast-track approval; pre-orders.



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What’s the impact on global growth?

Global output will contract sharply in 2020

The global picture is grim, with recessions across all G7 countries, and all but one G20 country (China)

Global growth Previously 2.3% Now **-5.0%** for full-year

Sharp drop in output in first half of 2020, modest recovery in second half of year.
Global GDP will recover to pre-coronavirus levels in 2022. 2020 and 2021 are lost years.
High risks that recovery could be derailed: local lockdowns, doubts around immunity.

US, Canada, France, Germany, Italy, UK, Japan **Full-year recessions**

One month of lockdown in France is estimated to slash annual growth by 3pp.

China Previously 5.9% Now **+1.8%**

Global trade Severe disruptions throughout 2020 Now **-11.6%**

Picture looks grim across the world

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The road to recovery will be long (and bumpy)

Source: The Economist Intelligence Unit.

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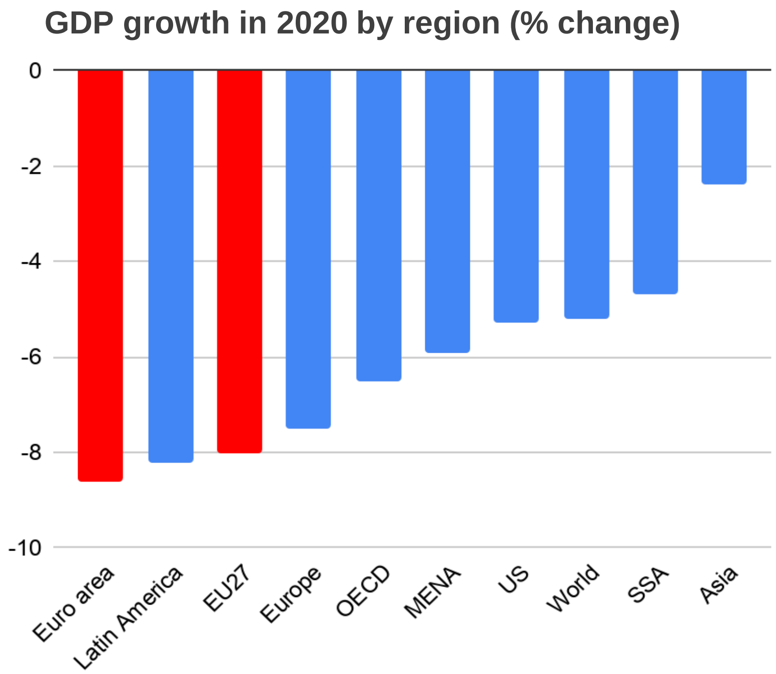
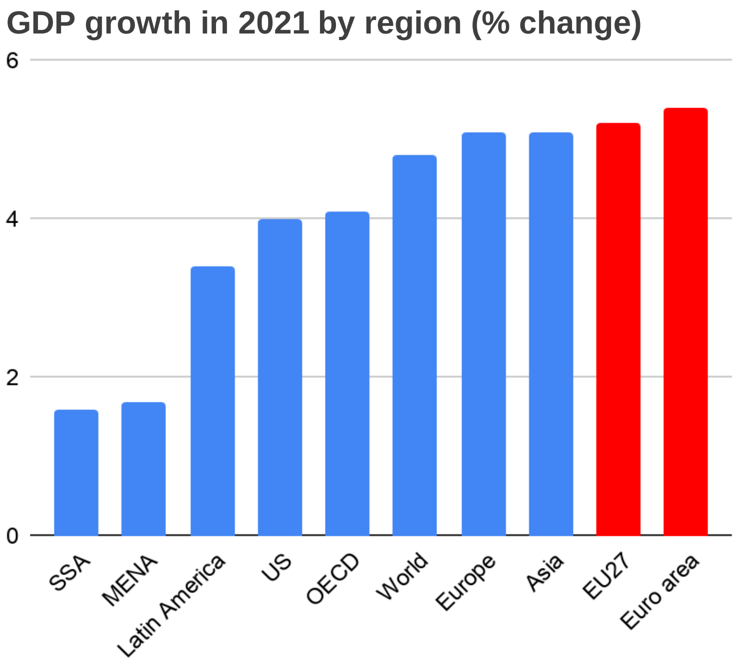
A closer look at Europe

Europe is one of the most affected regions

In absolute terms, Europe faces one of the worst downturns in 2020. We expect a sharp but incomplete rebound in 2021. Real GDP will return to pre-crisis levels only towards the end of 2022.

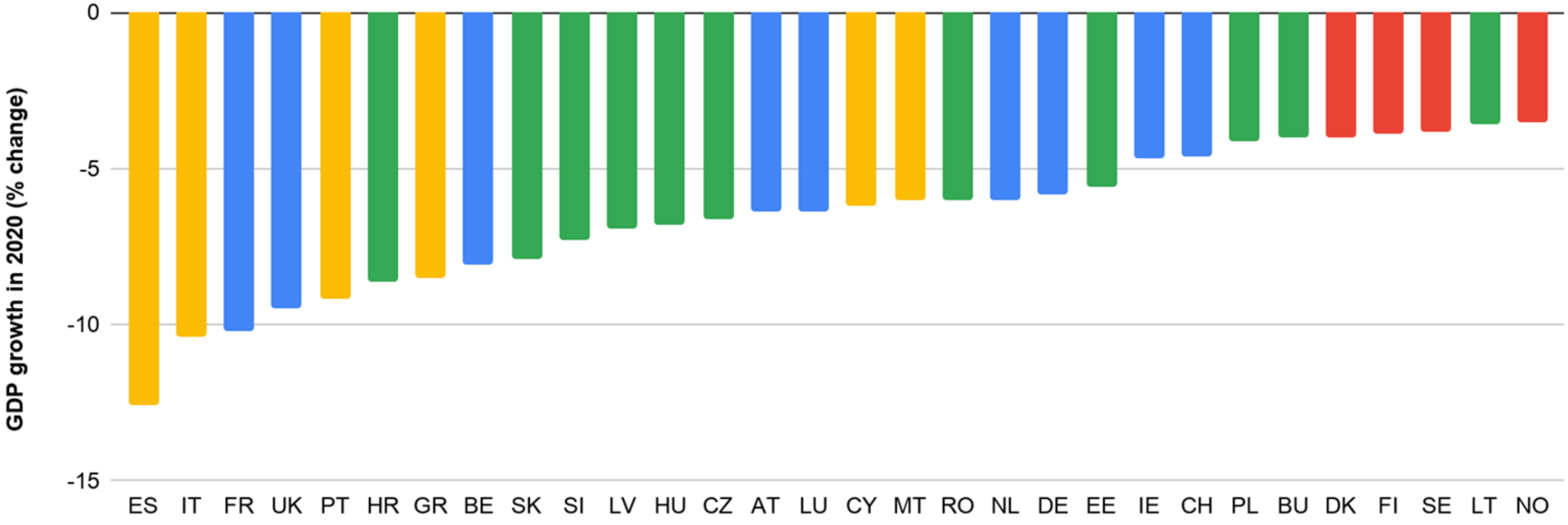




The impact of Covid-19 is highly asymmetric

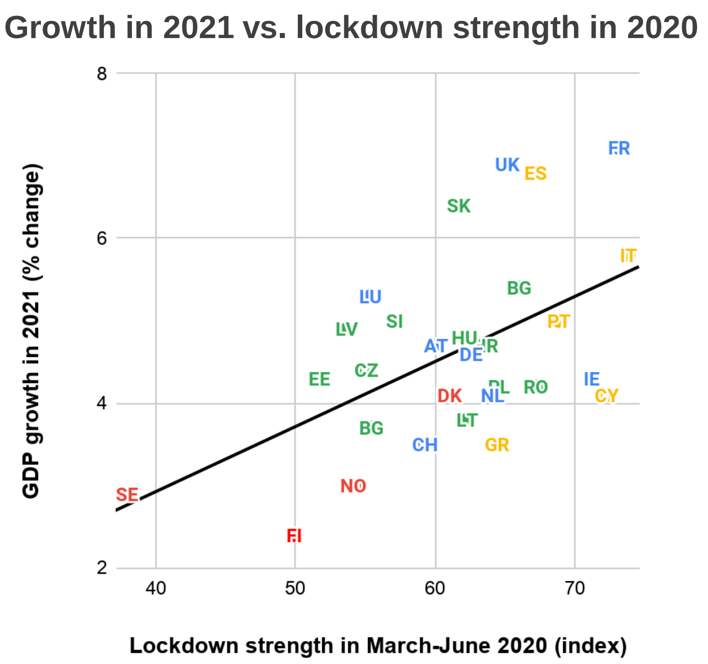
The range of growth forecasts for 2020 is exceptionally wide. **Southern** Europe is the most affected; the **Nordics** the least. **Western** and **Eastern** Europe stand in the middle.

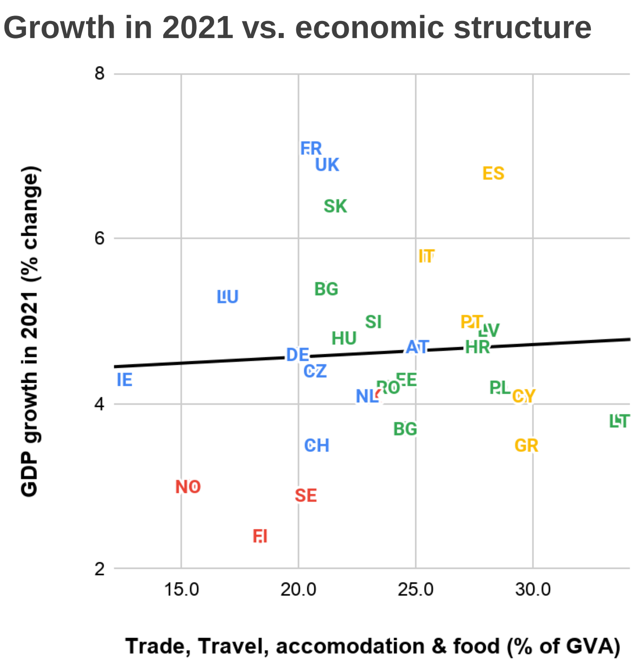
GDP growth in 2020 across countries (% change)



We expect a partial rebound in 2021

We forecast that EU27 GDP will remain 3% below pre-crisis levels. European countries will benefit from a post-lockdown rebound, but activity in some sectors (e.g. tourism) will remain suppressed.





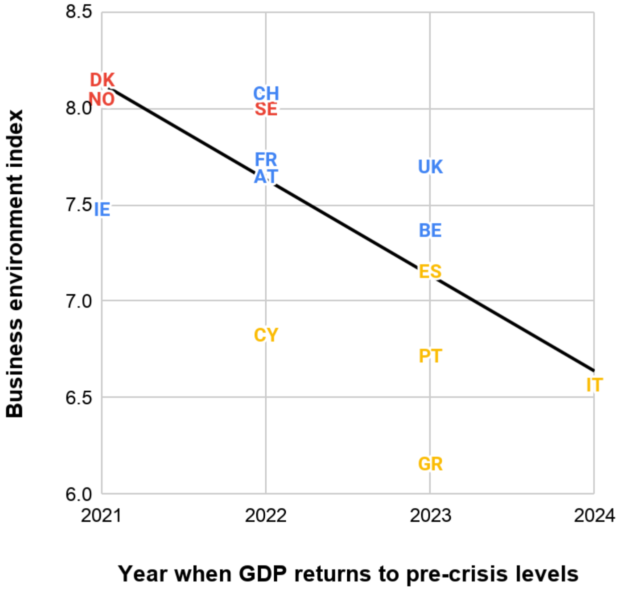
From 2022 onwards: a slow and uneven recovery

The EU27 will return to pre-crisis levels of GDP in 2022H2. We expect the recovery to be slow and uneven across sub-regions. Economic resilience plays a role in how fast countries recover.

Factors weighing on the economic recovery

- Limited policy space
- Deterioration in corporate balance sheets
- Bankruptcies
- Exit of discouraged workers
- Resources reallocation and adjustment costs

Economic resilience vs. year of economic recovery

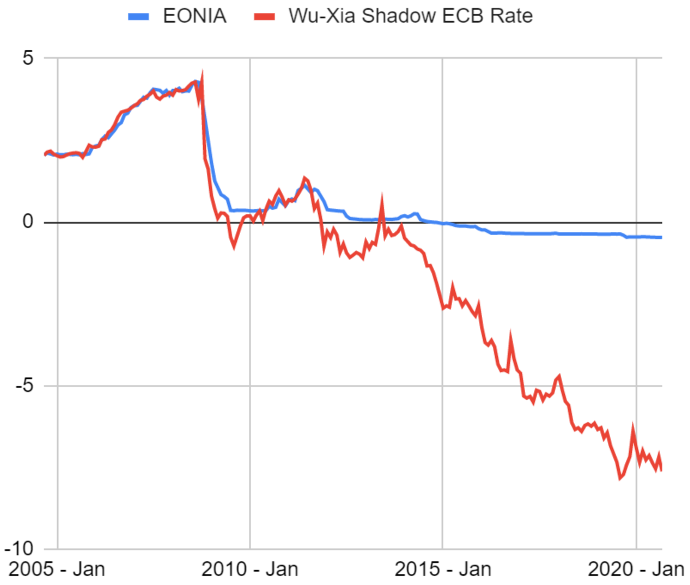


What does this mean for policymakers?

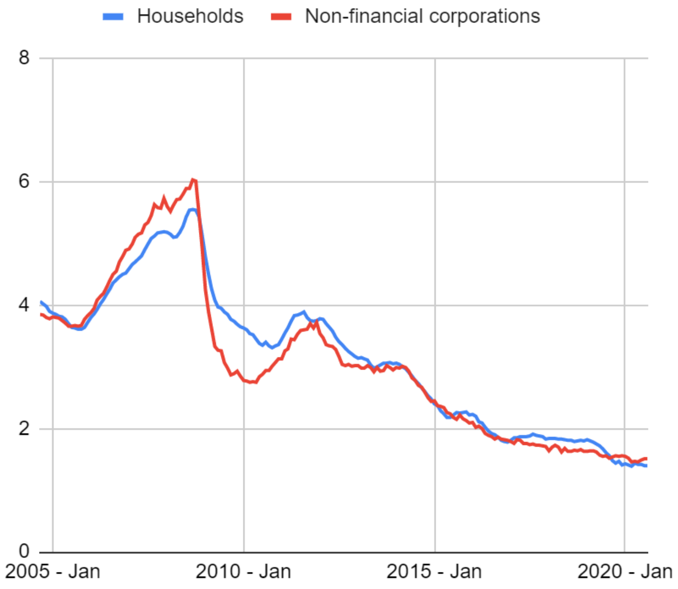
Monetary policy is out of ammunition

When Covid-19 struck, monetary policy was already very accommodative and borrowing costs for the private sector were already at record-low levels. The impact of further stimulus is likely limited.

The ECB's monetary policy stance



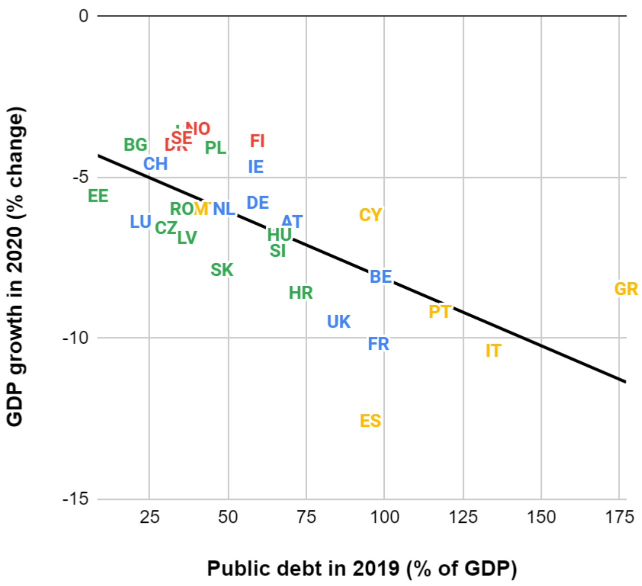
Cost of borrowing in the euro area (%)



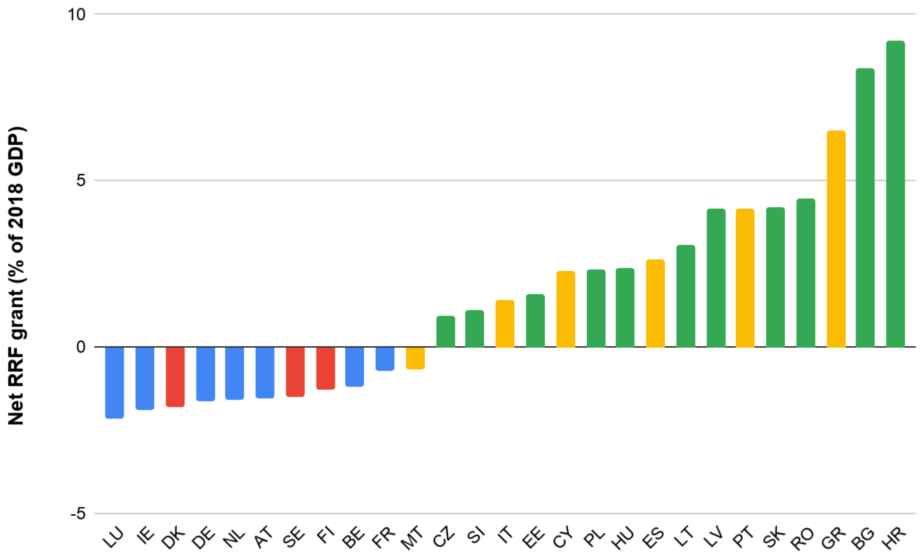
In many countries fiscal space is limited

The countries that have suffered the biggest downturn in 2020 are those with the least available fiscal space. The adoption of NGEU partly addresses this problem.

Growth in 2020 vs. starting level of debt



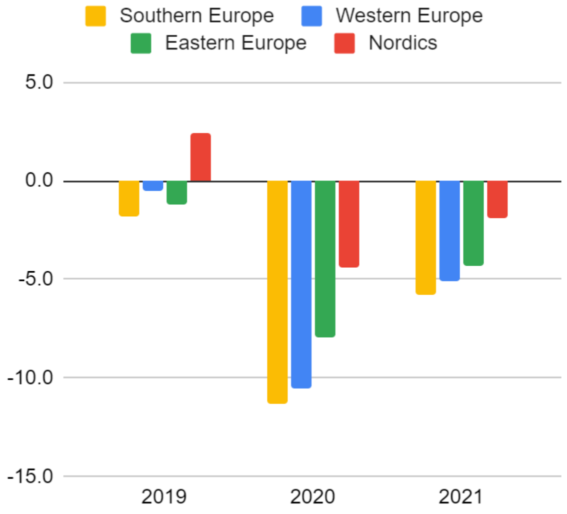
Distribution of grants under the Recovery and Resilience facility



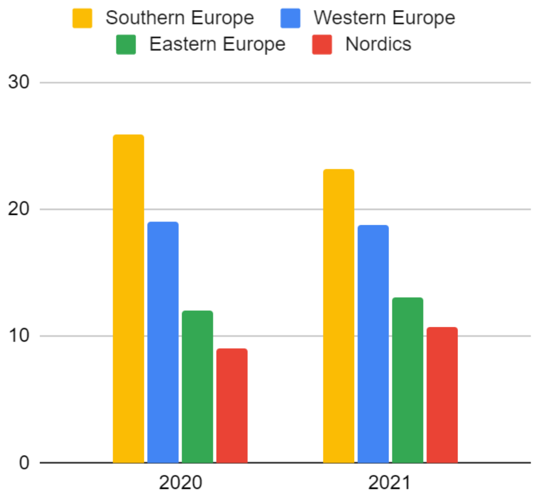
Debt levels will increase substantially

Fiscal stimulus will continue in 2021. Together with a slow recovery and a permanent reduction in the level of GDP, this will lead to a sharp increase in public debt.

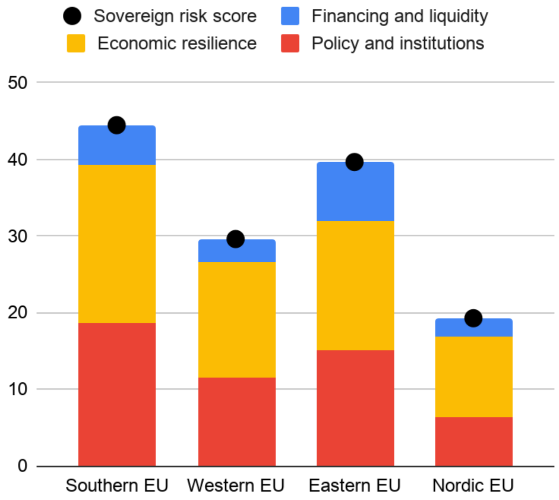
Budget deficits
(% of GDP)



Increase in public debt
(% point increase wrt 2019)



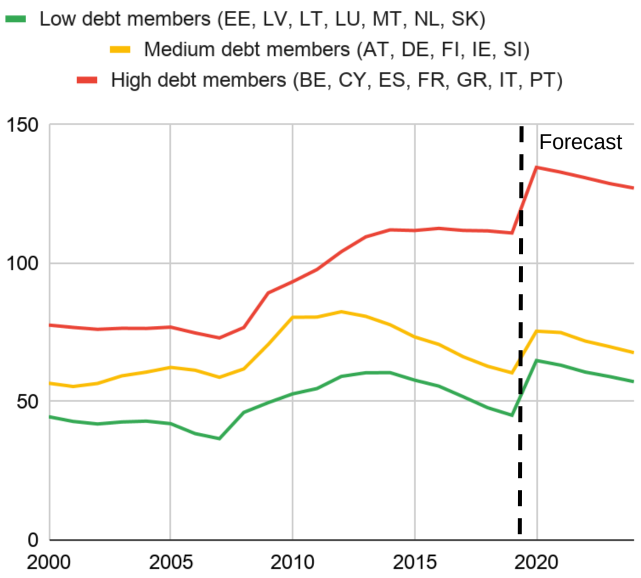
Sources of sovereign risks in the EU
(Index)



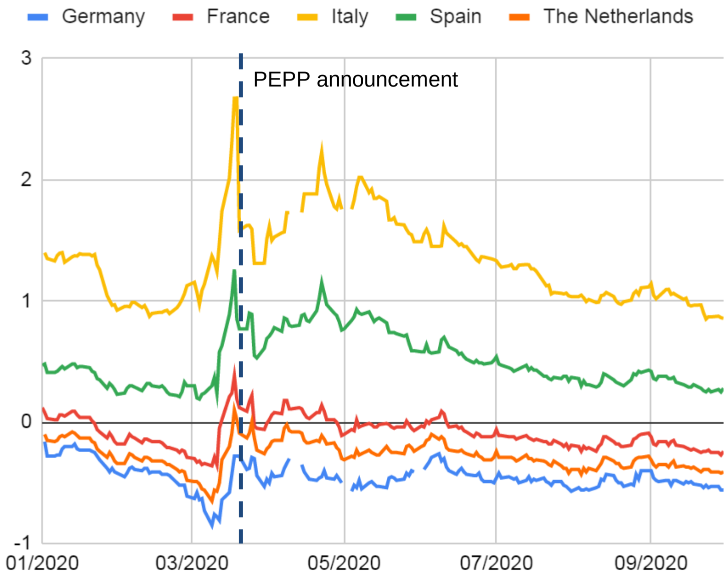
The euro area faces increasing fiscal divergence

Public debt in high-debt Member States will reach record levels, but sovereign bond yields will remain low thanks to ECB's asset purchases. The ECB remains a prominent bond buyer in 2021.

Public debt across euro area members (% of GDP)



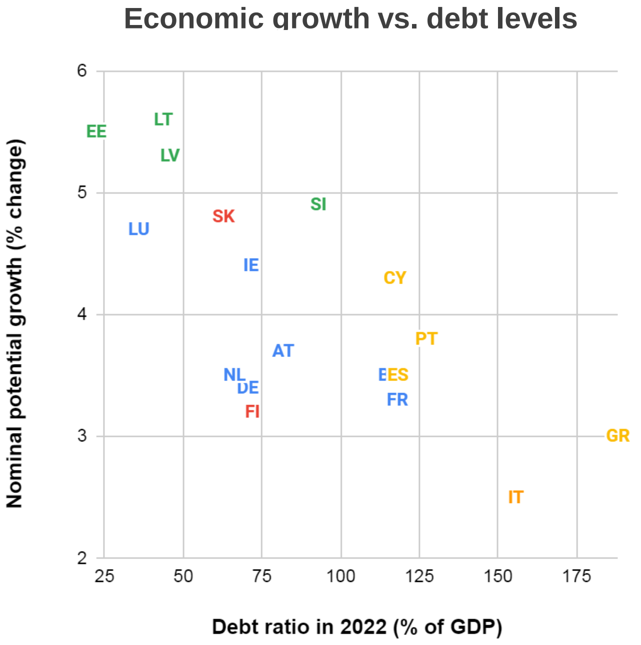
10-year sovereign bond yields (%)



Reducing fiscal imbalances will prove difficult

Once the Covid-19 pandemic is over, high-debt Member States will need to pursue a significant fiscal tightening. Adherence to the 60% debt reference value is doubtful.

- High debt is often associated with weak economic growth
- The Stability and Growth Pact requires debt levels to shrink to 60% at a ‘satisfactory pace’
- In some countries, this entails a fiscal commitment that is not credible
- Growth-enhancing reforms can mitigate the size of the necessary fiscal adjustment



A few thoughts on the US and UK

Covid-19 has hit US economy hard

- Coronavirus continues to spread in the US.
  - Second highest number of cases worldwide (after India).
  - Slow, piecemeal response from the US administration.
- Impact will have been mainly felt during Q2.
  - Sharp drop in consumption and investment.
  - Abrupt rise in unemployment claims.
  - **Full-year recession of 4.6%.**
  - **US economy back to pre-coronavirus GDP levels in Q3 2022.**
- High downside risks.
  - Assumes containment measures (almost fully) lifted in H2.
  - Assumes ~ stimulus package implemented quickly.
- Serious risks for Trump's re-election.
  - Economy sinking: will Trump manage to shift blame to China?
  - Scrutiny of administration's response.

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Will there be a UK-EU trade deal?

Thank you!

Questions and comments welcome

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