

Eurozone: Second leg of the recession coming up

The second wave in Covid-19 infections has led to new lockdowns in the eurozone, most probably leading to a fall back into recession in the fourth quarter. With inflation close to 0%, the European Central Bank has announced more policy action in December



An empty Champs Elysees avenue in Paris, France

Source: Shutterstock

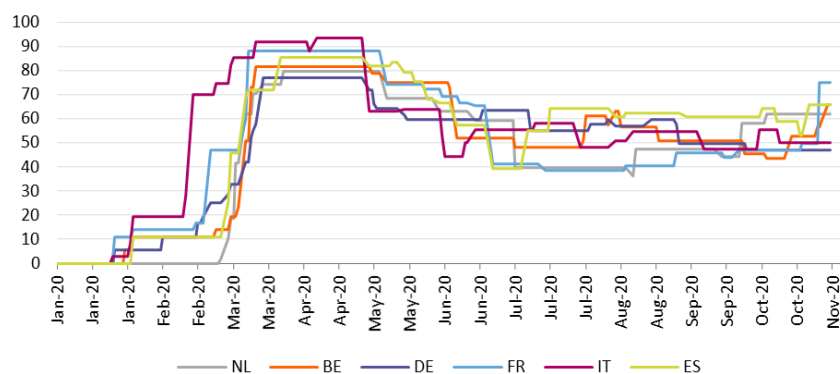
Third quarter mirage

With the seemingly unstoppable increase in Covid-19 infections and the consequential pressure on health systems, most eurozone countries have been forced to put in place more stringent confinement measures again. While schools and companies remain mostly open, at least for the time being, bars and restaurants and non-essential stores have been closed in several of the bigger member states. Add to that a higher level of sickness-induced absenteeism and the negative impact on confidence, and negative growth in the fourth quarter seems hard to avoid.

The spectacular 12.7% non-annualised GDP growth in the third quarter was no more than a mirage, caused by the reopening of the economy after the lockdown constrained second quarter growth. Interestingly, amongst the bigger countries, the snap back has been proportional to the GDP contraction in the second quarter, meaning that most are now close to each other in terms of

year-on-year contraction. Spain remains the odd one out, with a much deeper recession.

Covid-19 government response stringency index

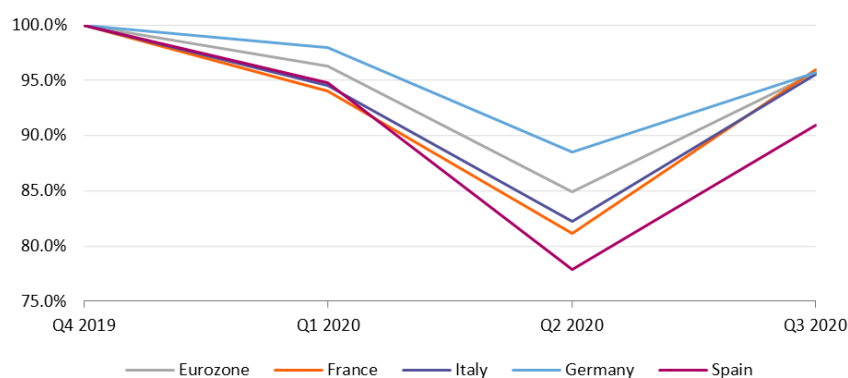


Source: Refinitiv Datastream

2021 growth and inflation forecast downgraded

Manufacturing started the fourth quarter on a strong footing, with PMI figures for October pointing to solid growth. However, the retail sector and services are going to be hurt again by the confinement measures, not to mention the negative effects on confidence. The fall in consumer confidence in October doesn't bode well in that regard. We now expect a 2% GDP contraction in 4Q with risks skewed to the downside. Because of the very strong 3Q growth, we had to revise our 2020 GDP growth estimate upwards to -7.1%, but at the same time we lowered our 2021 forecast to +3.5%. Indeed, this time, authorities will probably be more prudent in the loosening of confinement measures, signalling a rather weak start to the year as a result. Only from the second quarter onwards should things speed up, as this is when a vaccine will probably start to be rolled out. Meanwhile, inflation remains uncomfortably low, with core inflation still at a mere 0.2%. With German elections in 2021 and taking into account the fall back into recession, we think the German government might refrain from hiking VAT rates in January, which will probably keep average eurozone inflation below 1% next year.

GDP evolution since the beginning of the year



Source: Refinitiv Datastream

Fireworks in December?

While the ECB held policy steady at its October meeting, there was a clear signal from President Christine Lagarde that fireworks are in the offing at the December meeting, with a “recalibration of its instruments”. We expect an additional €500 billion in quantitative easing, possibly announced as a monthly instalment and continuing as long as needed. To keep financing costs low, the preferential Targeted Longer-Term Refinancing Operations (TLTRO) rates (allowing the banks to fund themselves cheaply if they don’t shrink their credit portfolio) are probably going to be lengthened until the summer of 2022. An increase in the tiering for excess liquidity, exempting a bigger chunk of bank liquidity from the negative deposit rate, is also likely. Just like the Federal Reserve, the ECB might also decide to incorporate bonds of “fallen angels” (companies that lost their investment grade rating this year) into its corporate bond purchase programme. While a deposit rate cut cannot be excluded, it is probably not the most preferred policy measure at the current juncture.

Author

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.