

Eurozone: Second wave balancing act

With coronavirus measures being tightened again, the eurozone recovery is likely to lose steam. At the same time, inflation remains stubbornly low, increasing the pressure on the European central bank to act again



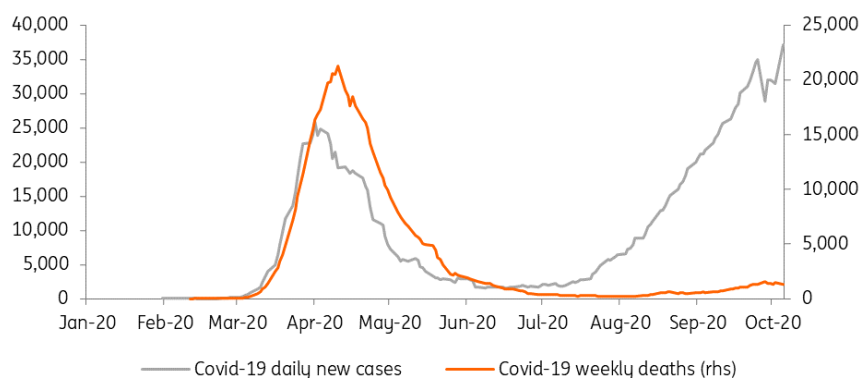
Source: Shutterstock

The return of Covid-19

The dreaded second Covid-19 wave seems to be materialising in Europe, though a repeat of the scenes of overcrowded hospitals, like we saw in March/April, can probably still be avoided. That is basically the reason why several European governments (Spain, France, the Netherlands, Belgium,...) have announced a tightening of Covid-19 measures as well as return to targeted lockdowns.

This might raise the spectre of a double-dip recession. The PMI indicator already fell in September on the back of a weakening services sector. While the European Commission's economic sentiment indicator still saw progress in the services sector last month, expectations deteriorated.

Covid-19 in the 6 biggest eurozone countries



Source: Refinitiv Datastream

Second round effects and structural disruption

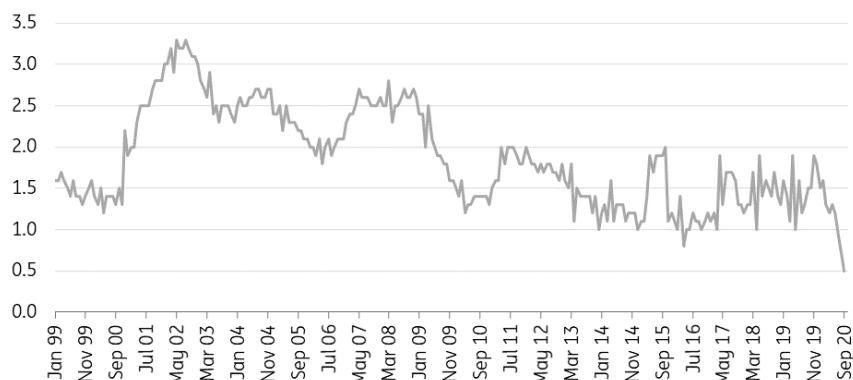
To be sure, the third quarter will likely show stellar growth: we pencil in a 9% non-annualised quarter-on-quarter GDP growth rate. Very strong retail sales in August seem to confirm that the opening of the economy boosted consumption over the summer months. But a number of factors are likely to lead to much weaker growth over the next two quarters. Apart from the tightening of Covid-19 measures, there is the risk that second-round effects will manifest themselves in a more pronounced way: companies that refrained from lay offs until now, might be forced to reduce manpower in the wake of renewed confinement measures, especially as temporary unemployment schemes will gradually peter out in most countries.

On top of that, we mustn't forget that the crisis seems to have accelerated a number of structural trends (like digitisation) that might have a disruptive effect on the European economy. For example, the shift to home working and electric cars is leading to an important restructuring in the German car industry (even though Germany is coping better than most other countries on the back of massive fiscal stimulus). Finally, the European recovery fund seems to be in for some delay, while the Brexit negotiations will, at best, deliver a limited trade agreement, which both blur the outlook for 1Q growth. While we maintain our -8% forecast for 2020, we have reduced our 2021 forecast to +4%, with the risks still skewed to the downside.

Deflationary pressures strengthen

HICP inflation surprised to the downside again, with headline falling to -0.3% and core inflation printing a mere 0.2% in September, the lowest level since the start of the monetary union. While changes in the sales period over the summer months have distorted inflation figures, the unrelated fall of services inflation to 0.5% clearly demonstrates the deflationary impact of the Covid-19 crisis. Hence, we have revised our inflation forecast down to 0.3% for this year and 1.1% for 2021.

Service inflation falls to very low levels



Source: Refinitiv Datastream

The ball is in the ECB's camp

With the ECB in the midst of its strategy review, it is not yet clear how the bank will redefine its inflation target. In some preliminary considerations, ECB President Christine Lagarde opened the door to a more symmetric inflation target, not discarding the possibility of a Fed-like average inflation aim. In any case, the Governing Council cannot ignore the current trends and will have to add stimulus. We still consider a rate cut as a low probability outcome (though not impossible), but stick to our forecast of an additional €400 billion in asset purchases to be announced before the end of the year. It is likely that these purchases would be made under the Public Sector Purchase Programme to give the impression of more permanency, as the Pandemic Emergency Purchase Programme was set up as a temporary tool to fight the crisis.

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 <http://www.ing.com>.