

The Eurozone in 2021

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Eurozone in 2021: Digital, fiscal and monetary changes

A double-dip in the eurozone has become almost inevitable. But despite all the government support to soften the blow to the economy, the structural face of the crisis will emerge next year. We think there is more in the offing for the eurozone in 2021, and here is what you should watch out for



Carsten Brzeski on 2021

[Watch video](#)

Key Themes in 2021

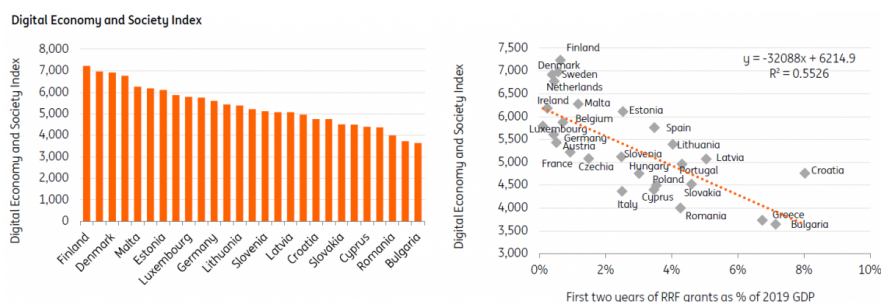
1. Digitalisation is key to a sustained recovery and investments in the digital economy could be the 2021 game-changer for more convergence in the eurozone.
2. With the need for more growth-oriented public investments, a discussion around more fundamental reform of the fiscal rules for the bloc.
3. Expect the ECB to follow in the footsteps of the Fed and apply the principle of symmetry to its inflation target.

□ Digitalisation is key to a sustained recovery

During the peak of the first wave, we looked at the [vulnerability of eurozone countries](#) to a prolonged Covid-19 slump, which showed that the old eurozone periphery has a larger chance of a weak recovery than core or northern economies. Looking beyond the pace of the immediate recovery, sustainable growth seems to be more dependent on digitalisation due to the crisis. This means that countries that have an edge in terms of digitalisation are even more likely to have a stronger structural growth path.

[Why Eurozone's periphery is in peril](#)

The digital economy is weaker in the eurozone's periphery, but EU funds could help



Source: Eurostat, European Commission and ING calculations

Among the countries that do best according to the Eurostat's Digital Economy and Society Index are Finland, Netherlands and Ireland. Greece, Italy and Portugal are among the weakest. Sound familiar? This means that digital infrastructure, connectivity, integration of digital technology, etc. could be as decisive for eurozone divergence and convergence as fiscal and monetary policies.

There is one upside for 2021 though, which is that the Recovery and Resilience Fund has an investment in digitalisation as a requirement for disbursement of the grants. Investments in the digital economy could be the 2021 game-changer for more convergence in the eurozone.

□ Fiscal rules to change once again?

One remarkable game-changer of the crisis has been the U-turn of fiscal policy.

Between 2008 and 2012, the preferred policy prescription to tackle the crisis was structural reforms and austerity, but from the start of this crisis, eurozone governments have opened their pockets big time and the second lockdown should trigger additional stimulus.

Add to that the likely losses on governments' guaranteed loans, it becomes clear that budget deficits will still be above 6% of GDP in 2021 after close to a 10% deficit this year. At the same time, the debt level in the eurozone will rise above 106% of GDP, more than 20 percentage points higher than in 2019.

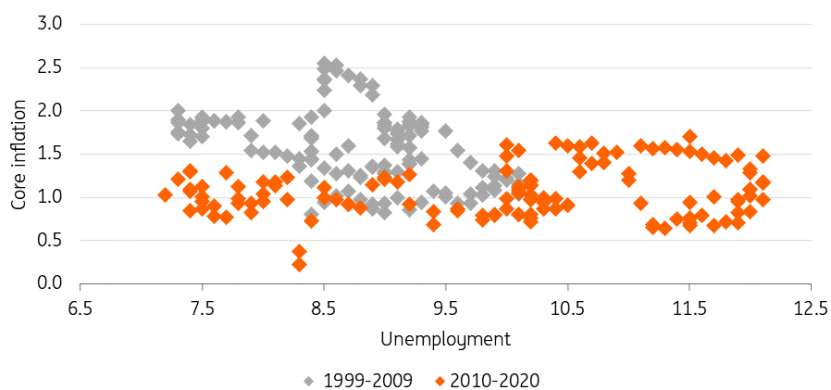
And there is more. Thanks to the so-called 'escape clause', the fiscal rules of the Stability and Growth pact have been put aside at least until 2021. In our view, this temporary waiver could once again open the door for a more fundamental discussion about the fiscal rules in the eurozone. This discussion is even older than the monetary union itself and there have been many attempts and actual changes to the rules. However, with the need for more growth-oriented public investments and the seeds for a eurozone budget now planted in the form of the European Recovery fund, 2021 could bring a more fundamental reform of the fiscal rules.

□ 2021 – The year the Phillips curve finally died in the eurozone

While currently, it is still all hands on deck for the ECB to support the eurozone economy and bring inflation expectations and projections finally back to target, the second half of the year could see an unexpected twist. At the end of the ongoing strategy review, we expect the ECB to follow in the footsteps of the Fed and apply the principle of symmetry to its inflation target, without going all the way and deciding on an average inflation target.

We expect the ECB to announce a new definition of its 'below but close to 2%' to 'around 2%', however, the question will be whether this 2% target will be credible as structural forces continue to weigh on inflation. As such the link between unemployment and the inflation rate - the so-called Phillips curve, has flattened.

Is the Phillips curve dead?



Source: Eurostat

The Covid-19 induced acceleration of digitisation, which is putting pressure on employment in some sectors, will only reinforce this trend. If the ECB sticks to the 2% target and makes it even more symmetric, this would suggest an ultra-accommodative monetary policy for even longer than the current 'very long'.

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Germany in 2021: The U-turn

From austerity champion to big spender, the German government's complete U-turn on fiscal policy is the most remarkable feature of the crisis and should help steer the necessary structural transition in 2021



Source: Shutterstock

Getting through better than most

At the start of the pandemic, the verdict seemed clear and straight-forward: the German economy would be one of the first and one of the strongest to come out of the crisis. A good health sector (which for a couple of years was deemed by many experts to be far too expensive), the German government's well-considered crisis management, and the unprecedented huge fiscal stimulus made a strong case for this argument. More than half a year later, this verdict has become more nuanced.

Germany is still managing to get through the crisis better than many other countries. However, it has not jumped ahead of the rest. In fact, while the slump in the second quarter was less severe than in most other eurozone countries, the rebound in the third quarter was also less pronounced. A reason behind this development is the fact that up to now, large parts of the fiscal stimulus package haven't actually been used. Many of the funds made available, be it in the form of grants or guarantees and loans, have simply not been taken up, at least not yet.

Short-term outlook

Looking ahead, the outlook for the German economy will be affected by cyclical and structural

considerations. As for the cyclical part, the second lockdown will push services and consumption into contraction in the fourth quarter of 2020. Involuntary savings by consumers are likely to become precautionary savings. Also, the second lockdown is hurting sectors which had not recovered fully from the first lockdown, such as leisure, travel, culture, restaurants and hotels. These are sectors which employ around 10% of total German employment.

The risk of increasing structural damage in the form of higher unemployment and bankruptcies has clearly risen. Interestingly, there is currently a new divergence between weakening services and a still strong manufacturing sector. The positive momentum in the manufacturing sector is, in our view, driven by the delayed rebound after the first lifting of lockdown measures in the spring and a better-than-expected recovery in China. However, the ongoing structural changes in the manufacturing industry suggest that it could still take a while before industry returns to pre-crisis levels.

Covid-19: The accelerator of structural change

The Covid-19 crisis has accelerated several structural trends in the German economy that had already been brewing under the surface in recent years. The most important ones are the U-turn on fiscal policy, digitalisation and the transition of manufacturing.

The most remarkable development of 2020 is, without doubt, the transformation of the German government from austerity champion to big spender. The government was swift, and certainly not thrifty, in its reaction to the economic impact from the lockdowns. At least at face value, Germany has had the largest fiscal stimulus package of all European countries, with more than 30% of GDP put on the table to support the economy. While the largest part of these measures are guarantees, the government also led the way for other European governments with a stimulus package that aims to use the current crisis to steer structural changes. The latest €130 billion stimulus package not only included a temporary VAT reduction but up to €60 billion was dedicated to investment in sustainability, innovation, digitalisation and tackling climate change. Interestingly, this change of heart had already been in the making in 2019, with the first tentative investment packages, but it gained enormous momentum due to the crisis.

Covid-19 will not be a wasted crisis

Driven by the crisis, home-schooling, online learning and working from home have once again highlighted the urgent need for more and better digitalisation in Germany. While this is not new, the awareness and the pressure to act, together with the agreed fiscal stimulus, support our view that at least regarding investment in digitalisation, Covid-19 will not be a wasted crisis for Germany.

On a more negative note, the crisis seems to have aggravated the need for structural change in the manufacturing sector. The sector had been on a downward trend already since mid-2018. Trade tensions, increased competition from Asia and a general shift of the global economy towards services will continue to put pressure on industry. Several announcements of restructuring and job shedding are another illustration of this structural change.

The final structural change will be political. Elections in autumn next year will mark the end of

Chancellor Angela Merkel's term in office. Probably. Even though Merkel remains by far the most popular German politician - a popularity which actually increased during the crisis - she has ruled out another term on several occasions. The leadership race in her own party is still going on and will only be decided in early 2021. While it is too early to predict the outcome of the elections, it is clear that any new chancellor will not be able to fill Merkel's shoes immediately.

The German economy in a nutshell

	2019	2020F	2021F	2022F
GDP (%)	0.6	-5.6	3.4	3.2
Private consumption (%)	1.5	-5.3	3.8	3.8
Investment (%)	2.7	-4.2	3.0	3.1
Government consumption (%)	2.1	3.8	3.1	2.9
Net trade contribution (%)	-0.4	-2.1	0.4	0.5
Headline CPI (%)	1.4	0.1	1.4	1.8
Unemployment rate (%)	3.2	3.8	4.4	4.0
Budget balance as % of GDP	1.8	-8.0	-4.0	-2.0
Government debt as % of GDP	58.0	76.0	77.0	73.0

Source: Thomson Reuters, all forecasts ING estimates

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The Netherlands in 2021: More positive about recovery despite second-dip

The Dutch economy is forecast to grow by 2.6% in 2021 in our base case scenario, reaching 99% of its pre-covid size by the end of next year. A second GDP dip by the end of 2020 due to a flare-up of Covid-19 and reinstated social distancing measures will weigh on the recovery early into 2021, but fiscal support remains and prospects for virus containment improve



Second wave holds back recovery, but it's less severe

While the Dutch GDP was -9.9% lower in the second quarter of 2020 than in 4Q19, it jumped back to -3.0% in the third quarter. This better-than-expected recovery was halted by the second Covid-19-outbreak that started in September. Gradually, the Dutch government reinstated social distancing measures, but less strict than the lockdowns seen in the spring but bars, restaurants, theatres, cinemas and museums are closed again, while schools, gyms, hair salons are now open.

Since businesses are better prepared and policies are less strict, we project the fall in GDP in 4Q20 (-2.0% QoQ) to be much less severe than in 2Q20. For the full year, we forecast GDP to be 4.3% lower than in 2019. While this is an unprecedented hit to the economy, it is not as bad as we had foreseen initially, despite a second partial lockdown. The most important reason is that the third quarter has shown a surprisingly strong rebound, probably on the back of a generous government

support package. Breaking with austerity has helped to soften the impact of covid-19 on the Dutch economy.

Government continues to support the economy

In mid-October, the Dutch government announced additional stimulus and the extension of some existing support measures, notably some guarantees. This amounts to €0.5 billion (0.1% GDP), which is minor from a macro-economic perspective. This comes on top of the third package, which kicked off on 1 October and roughly mirrors the extension of the main support instruments, such as wage subsidies, benefits for self-employed and compensation for fixed costs, until mid-2021.

The government recently stressed that these support instruments automatically fluctuate with firms' turnover and that it stands ready to spend these higher amounts when such turnovers go down in 4Q20. We estimate total spending on support measures in 4Q20 to amount to about 1% of annual GDP.

Weak start for 2021 as social distancing measures are lessened only gradually

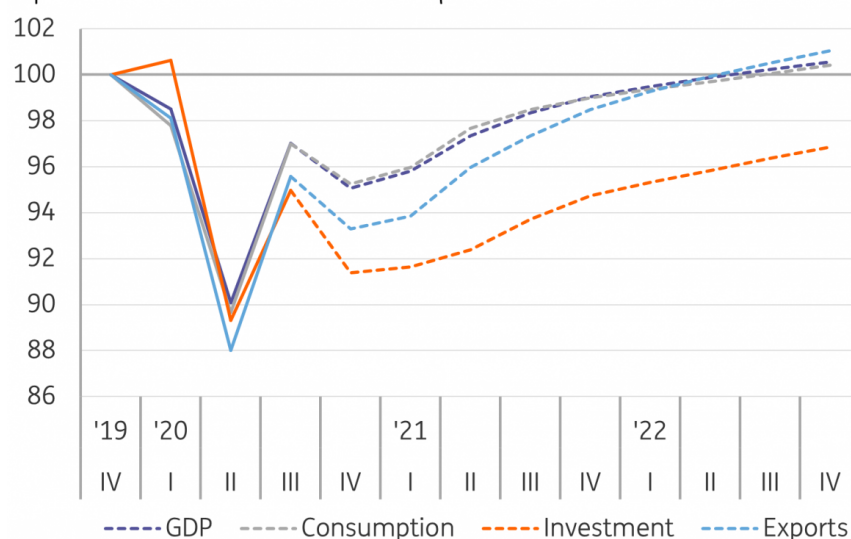
It's assumed that European governments will be more careful with a gradual unwinding of anti-coronavirus measures during the second wave so we expect subdued growth in the first quarter of 2021, which should accelerate in the second quarter. We should see more testing in the Netherlands, while the start of the vaccination programme will be made available in the first half of the year.

Since achieving broad immunity takes time, 2021 will be a year in which the economic recovery will still be held back. Investment, in particular, is forecast to suffer from the uncertain outlook that hinges so much on the development of the virus, being only back at 95% of pre-Covid levels by the end of 2021. Merchandise exports are forecast to have fully recovered by then, while consumption is expected to still lag by 1%. GDP could be 2.6% higher in 2021 than in 2020, reaching 99% of the pre-covid size by the end of the year. The uncertainty remains high, and growth may also be slower.

But for once, risks seem tilted to the upside: vaccination, mass testing and better treatment options may all come together and allow for a surprisingly rapid full opening of the economy.

Slower investment hampers the recovery

Expenditures* as index where fourth quarter of 2019 = 100



Source: Macrobond, forecasts ING Research from 4Q20. *seasonally adjusted and in constant prices

Big yet only partial rebound for hospitality and transportation

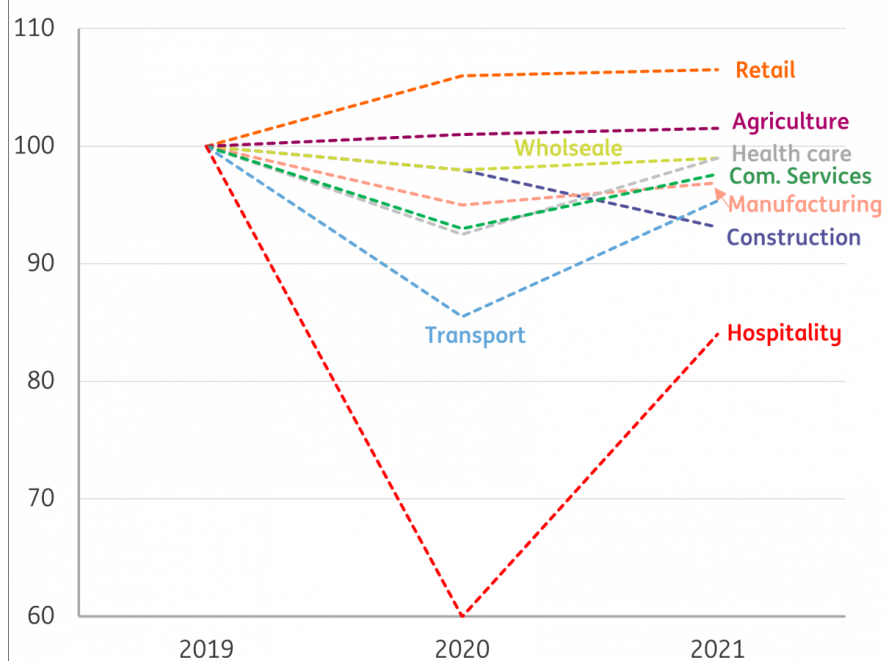
Hospitality, transport (notably aviation and public transport) and services (mostly the travel industry and staffing) faced the biggest decline in 2020. These sectors will also show the highest growth in 2021, although they will not fully recover. For the hospitality sector, we expect growth of 40% in 2021, after a 40% decline in 2020. Higher unemployment will dampen consumer spending in hotels, restaurants and bars, while the return of foreign tourists will be uncertain and dependent on virus developments.

In contrast to other industries, retail expanded in 2020, when mainly DIY-stores and online shops benefitted from the coronavirus crisis. Here we expect only limited growth for 2021. Online shopping increased the demand for parcel delivery. Other business service providers, such as civil-law notaries, accountants and consultants, were only mildly affected. While demand for some services is lower, working from home will continue in 2021.

The demand for temporary workers is expected to pick up again in the course of next year. Companies will often hire temporary workers first when they start growing again. Industrial production should show a modest recovery of 2% in 2021 since exports will go up and supply chains (from Asia) remain intact in contrast to early 2020. The construction industry is the only sector for which we project a decrease in production in 2021. It is often hit late in the economic cycle due to long project lead times.

High growth in many sectors in 2021 but 2019 levels not reached

Value added* as index where 2019 = 100



Source: ING Sector Research, *At constant basic prices

The Dutch economy in a nutshell

	2019	2020F	2021F	2022F
GDP	1.7	-4.3	2.6	2.5
Private consumption	1.5	-6.7	2.6	2.6
Investment	4.6	-5.0	-1.0	3.2
Government consumption	1.6	-0.4	3.8	1.4
Net trade contribution (%-point)	-0.1	-0.2	0.8	0.4
Headline CPI	2.6	1.3	1.4	1.1
Unemployment rate (%)	3.4	4.1	5.6	4.9
Budget balance (% of GDP)*	1.7	-8.4	-5.5	-4.1
Government debt (% of GDP)*	48.7	59.9	62.6	64.8

Source: Macrobond, all forecasts ING estimates. *Fiscal projection deviate from official forecasts by the Netherlands Bureau of Economic Policy Analysis (CPB) i.a. due to differing views on the output gap.

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France in 2021: Growing crises make recovery uncertain

France will end the year with contracting GDP growth. 2021 looks uncertain, with any economic recovery taking place amidst a complicated political environment



A few ups but a lot of downs

After the terrible shock of the lockdown, which led to a historic GDP contraction in France (-13.8% QoQ in 2Q20 and -5.9% in 1Q20), the recovery appeared to be particularly dynamic.

In the third quarter, France posted the highest growth rate in the eurozone (18.2% QoQ or 95.4% in annualised QoQ). Unfortunately, the fourth quarter will be synonymous with a new contraction in activity due to another lockdown implemented in France in November. Although less strict than that in spring, the new one means all bars, restaurants, non-essential shops, sports, tourist and cultural places are now closed, and non-essential travel is prohibited too. As a result, a drop in activity of around 15% over the month is to be expected, which implies that GDP should fall by 5% QoQ in the fourth quarter and 9.5% over the whole year; the contraction of GDP would amount to 9.5%.

The risks are still skewed to the downside. Indeed, President Emmanuel Macron has warned people that the lockdown could be extended if the number of cases does not fall to 5,000 per day (compared to 45,000 per day at the beginning of November). There is, therefore, a high probability

that this target will not be achieved in early December and the lockdown will be extended. As December is an extremely important month for shops, the economic impact could be even higher than in the previous month. An extended lockdown for the whole month of December would probably mean a decline in GDP of more than 10% in the fourth quarter and an annual contraction of more than 1 percentage point additionally.

Political risks

Nonetheless, it is not clear that President Macron and his government will dare to opt for an extension of the lockdown for the whole of December. Indeed, public support for the measures has fallen sharply compared to the spring. Clearly, they are difficult to accept and "corona fatigue" is being felt. There is also anger about the closure of small shops which are deemed to be non-essential while all schools remain open and workers continue to go to their workplaces.

France is facing three crises at the same time

Politically, the situation is very complicated for French officials. Social unrest could be on the horizon, reminding Macron of the painful "yellow vests" period. France is facing three crises at the same time: a health crisis, an economic crisis, caused by Covid-19, and a security crisis given the various attacks that have taken place on French territory in recent weeks.

This is a difficult time for Macron given that he is coming to the end of his presidential term and will, in 2021, begin his campaign for re-election the following year. The current situation doesn't give him much chance of making progress on the major reforms he promised, including on pensions and public governance. The only advantage for him at the moment is that no other candidate for the Presidency seems capable of showing that they could have managed the health crisis any better.

Currently, polls predict a tie between Emmanuel Macron and Marine Le Pen, from the far right, for the next presidential election. Given the very complicated security context, Macron will have to please right-wing voters, otherwise, they risk being lured by Le Pen, while at the same time being seen not to abandon left-wing voters. It's a decidedly delicate balance not least because there are so few certainties about the economic recovery next year.

An uncertain 2021 with consumers in focus

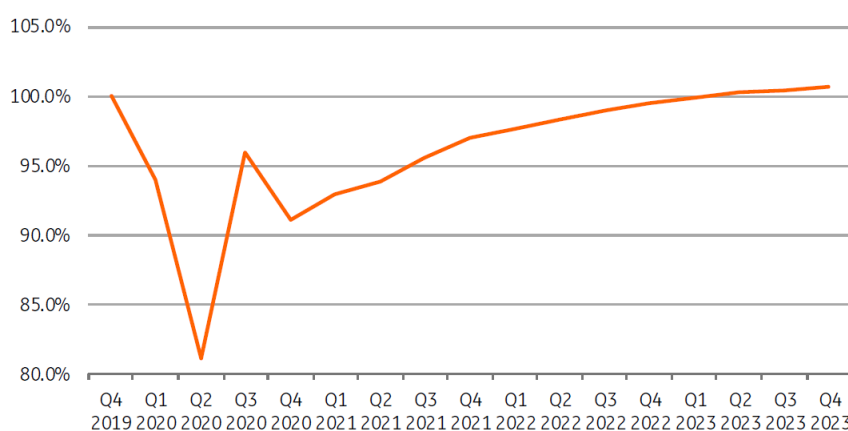
After a fall in GDP of at least 9.5% in 2020, the year 2021 should be synonymous with economic recovery. A rebound can indeed be expected in the first quarter of 2021 after the current lockdown, but it is highly unlikely to be as dynamic as that observed in 3Q20, after the initial one. Firstly, winter and indoor activities seem to be more conducive to the spread of the virus than summer, which raises fears of a more gradual easing of lockdown measures than the first time. Secondly, because the message is now clear: as long as there is no vaccine or treatment, the coronavirus will remain and fears of a third outbreak of the pandemic and the restrictive measures that follow will still be present. Unfortunately, neither households nor businesses will be able to exclude a third lockdown from their future prospects. As a result, there's likely to be more caution when the second lockdown ends and that could well hamper the recovery.

Of course, the French government has put in place a whole series of measures to try to mitigate the worst of the economic problems that the country is facing and it is hoping that the economy can bounce back pretty quickly. Although there's a system of temporary unemployment, subsidies to closed companies, loans and state guarantees, these emergency measures alone will not restore confidence.

Consumers are likely to adopt more cautious behaviour

In particular, household consumption will need to be monitored. This had contributed strongly to the rebound of the economy after the first lockdown and was only 2.3% below its pre-crisis level at the end of September. One reason for this is that the labour market, and thus household purchasing power, was not too badly affected thanks to the temporary unemployment mechanism that avoided redundancies. Nevertheless, as the crisis deepens and the overall economic situation deteriorates, consumers are likely to adopt more cautious behaviour. Declining consumer confidence and rising fears about jobs are worrying. Business investment is also likely to remain sluggish for a long period. And French exports are likely to remain impacted in 2021 by the crisis, because they are concentrated in sectors dramatically hit by the health crisis, including aeronautics and international tourism, which will take time to recover.

French GDP expectations (4Q19 =100%)



Source: INSEE data up to 3Q20 and ING forecasts afterwards

It looks as though only a vaccine against Covid-19 will bring a real recovery in the French economy. Consequently, we can hope for a more dynamic recovery in the second part of 2021 than in the first half if those vaccine trials are successful. The bright spot is that the French government's recovery plan should give a boost to activity, with an estimated impact of around 1 to 1.5ppt on GDP growth in next year. We're forecasting GDP growth of around 4.7% in 2021. The rest of the economic recovery will probably take place in 2022, where that plan will continue to play an important role, with a return to the level of activity that prevailed before the crisis forecast for 2023.

The French economy in a nutshell

	2019	2020F	2021F	2022F
GDP growth (%)	1.50	-9.50	4.70	4.00
Headline CPI (%)	1.10	0.30	0.80	1.40
Unemployment rate* (%)	8.50	7.60	10.40	9.20
Budget balance as % of GDP	-3	-11	-7	-5
Government debt as % of GDP	99	120	118	118

Source: ING forecasts

*Eurostat definition

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Spain in 2021: Many economic hurdles to recovery

Looking at the challenges for Spain in 2021, one could become dismayed. The health crisis was severe, and together with the specific characteristics of the Spanish economy, this has had a disproportionate effect on activity. We expect those same factors will lead to a slow recovery in 2021 and beyond



Spain's economic downturn in 2020 is likely to be the worst of all eurozone countries. Economic activity is currently still 9% lower compared to the pre-crisis level, while for the eurozone as a whole, the damage lies around 4%. The strict lockdown during the first wave, the second which came early, the reliance on tourism, a high share of small businesses in the service industry and, limited fiscal space all contribute to this.

Spain's economic downturn in 2020 is likely to be the worst of all eurozone countries

And many of the reasons why Spain was hit so hard will likely lead to a slow recovery in 2021 and

beyond. It is unlikely that the tourism sector fully recovers in 2021. And the high share of small businesses in the service industry will lead to a sharp increase in bankruptcies and redundancies. Indeed, recent research from the ECB shows that one in seven (14%) Spanish workers are in non-financial companies at risk of bankruptcy, which is the largest share in the eurozone. Compared to pre-crisis levels, the unemployment rate already increased by 2.5 percentage points to 16.3% in the third quarter, and we expect it to rise to 17.5% in the course of 2021.

Given the high structural deficit and elevated government debt before the Covid-19 crisis, it was also more difficult for Spain to embark on large fiscal stimulus plans. Indeed, some politicians were afraid that the European Commission would toughen its position on the budget rules and that eventually, bond investors would punish Spain with higher borrowing costs. [Research from Breugel](#), a think tank, shows indeed that current fiscal measures in Spain are limited compared to other hard-hit countries, such as France and Italy. We think the same issues will hold for 2021.

For further fiscal support, Spain is looking to Europe. First, it will be important that the European fiscal rules continue to be suspended. This is already the case for 2020 and 2021, but it will also be important for 2022 and probably longer. The European fiscal board, an advisory board to the commission, advised that fiscal rules should apply again when output is back to pre-pandemic levels. According to our current scenario, this will not happen before 2023. Second, Spain expects to receive €140bn in grants and loans from the Next Generation EU fund. This could give oxygen to public finances and the economy.

2020 is a year we all want to forget, but unfortunately, it will cast a long shadow. Given the depth of the recession in 2020 and some structural characteristics, the Spanish economy will need a lot of time to fully recover.

The Spanish economy in a nutshell

	2019	2020F	2021F	2022F
GDP growth (%)	2.0	-11.5	3.2	3.0
Headline CPI (%)	0.8	-0.4	0.3	1.3
Unemployment rate (%)	14.1	15.6	17.0	16.5
Budget balance as % of GDP	-2.8	-12.0	-8.3	-5.7
Government debt as % of GDP	95.5	119.0	122.5	123.4

Source: Refinitiv Datastream, all forecasts ING estimates

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Portugal in 2021: Structural factors point to a weak recovery

Portugal's economy faces a number of hurdles in 2021 to a swift recovery, notably the revival of the tourism sector. But the situation is not as grim as that in neighbouring Spain



Particular vulnerabilities

Even though the health crisis was less severe in Portugal than in other European countries, notably Italy and Spain, the economic impact of the first wave and corresponding lockdown measures was harsh. In the first half of 2020, economic activity dropped by 18% compared to pre-crisis levels, while neighbouring Spain, where the health crisis was one of the worst in Europe, lost about 22% of activity over the same period. Obviously, the economy recovered in the third quarter, but the resurgence of the pandemic in October and new containment measures make a double-dip recession more likely.

The Portuguese economy has a number of characteristics that make it more vulnerable

The Portuguese economy has a number of characteristics that make it more vulnerable to both the

initial shock of the pandemic and its aftermath. For starters, the country has a large tourism sector, which is impacted strongly by the crisis. In addition, Portugal ranks in the top five eurozone countries with the highest share of small companies (defined as companies with 0 to 9 employees). Smaller companies generally have limited financial, managerial and technological resources. It is, for example, more difficult for small firms to respond to the crisis with technological solutions such as telework. And the fiscal space of Portugal is also relatively low, as the government debt-to-GDP ratio stood at 117% last year.

These characteristics lead us to conclude that the Portuguese economy will need more time to recover from the 2020 recession compared to the eurozone average.

Interestingly, Spain also suffers from the same structural issues discussed above as Portugal. But we think that the situation in Portugal is less grim. First, the health crisis was not as severe compared to Spain. Second, even though Portugal has a similar share of vulnerable workers as its neighbour, the unemployment rate is much lower. Spain entered the crisis with an unemployment rate of 13.8%, while Portugal's was just 6.7%. Finally, even though the debt level is high and will increase sharply, the structural budget balance in 2019 calculated by the European Commission was lower than in Spain, which implies more fiscal space. On top of that, Portugal will receive grants worth more than 4% of GDP over the next two years from the European Next Generation EU fund.

The Portuguese economy in a nutshell

	2019	2020F	2021F	2022F
GDP growth (%)	2.2	-8.2	3.5	3.1
Headline CPI (%)	0.3	-0.3	0.2	1.2
Unemployment rate (%)	6.6	7.3	7.9	7.5
Budget balance as % of GDP	0.1	-7.1	-4.5	-3.5
Government debt as % of GDP	117.2	132.3	130.7	128.6

Source: Refinitiv Datastream, all forecasts ING estimates

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Italy in 2021: In search of a safe path

The forthcoming soft patch for Italy will likely call for extra funding. To avoid debt sustainability concerns resurfacing down the road, effective use of the EU's recovery fund and an increase in the pace of reforms will be necessary



Growth still hostage to the mechanics of lockdowns and re-openings

Italy's 2020 growth profile is being dramatically affected by the sequence of lockdowns and reopenings, which will extend at least until the end of the year. After contracting a cumulative 17.6% over the first half of 2020, the Italian economy rebounded by 16.1% in the third quarter, clearly beating expectations. In principle, this could have been a good starting point for 2021, but the dynamics of the Covid-19 pandemic are again changing the external environment. Since early October the number of new infections has again been growing at an accelerated pace, putting increasing pressure on medical services and prompting a response from the Italian government.

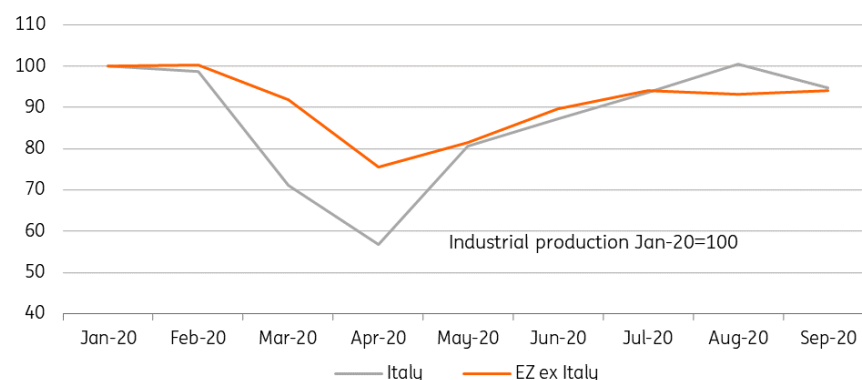
Locally differentiated measures, but W seems inevitable

The new measures, which will apply until 3 December, are differentiated regionally based on a set of parameters monitoring both the epidemic and the resilience of hospitals. They range from mild restrictions to soft lockdowns in the most critical cases. As industrial and construction activity is not

affected, the current measures are clearly less severe than those imposed nationally during the first wave in the spring, but more severity cannot be ruled out should the curve fail to flatten.

As risks are tilted towards the lengthening of restrictions into December, a GDP fall in 4Q20 looks almost inevitable. On the assumption that most regions will eventually shift into soft lockdown mode, we tentatively anticipate a 3% quarter-on-quarter fall for Italian GDP over the last quarter of 2020, with downside risks.

Deeper early fall in production fully compensated over 3Q



Source: Refinitiv Datastream, ING

Unfavourable statistical carry-over calls for 2021 budget draft revision

The upshot of this is that 2021 looks set to start with a poor statistical carry-over, which will likely translate into a softer average yearly growth number than previously anticipated, notwithstanding the recent good news on the vaccine front. To be sure, early availability of the vaccine would likely spur a solid rebound thereafter, but this is, to some extent, already incorporated into our forecast profile. The Italian government based its draft budget for 2021 on the assumption that growth would reach 6% in 2021. In the current circumstances, with another soft patch in the making, this seems out of reach, and a substantial revision to the draft plan looks inevitable.

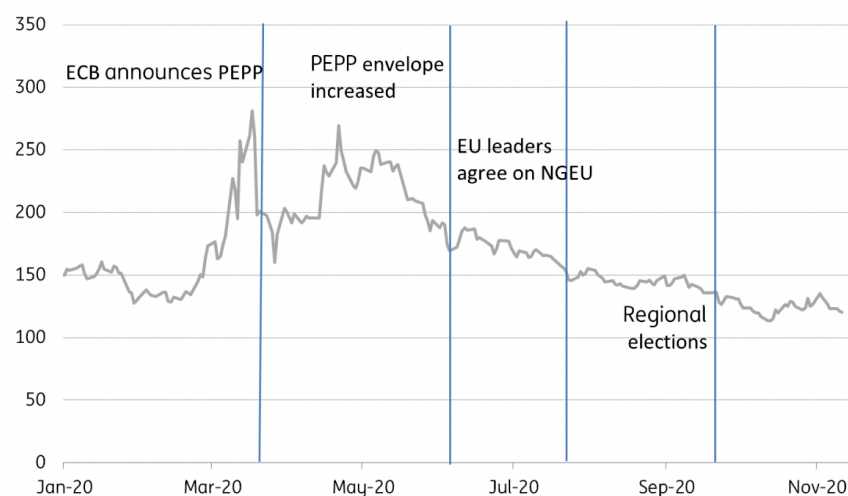
Higher deficit will call for new funding decisions, with an eye on sustainability

Lower growth, lower tax revenues and possible extraordinary outlays in the absence of a spending review will likely translate into a higher budget deficit than previously planned for 2021. In an environment of rising funding needs, it will be increasingly difficult for the Italian government to ignore the existence of potentially available cheap funds (some €36bn for Italy) from the European Stability Mechanism Covid facility. While fear of a 'stigma effect' remains within the 5SM party, the other parties in the government alliance have already stated their willingness to tap the fund.

The alternative would be tapping the market. Provided the ECB remains fully in the reinforced QE game for the whole of 2021, as seems likely, this should be doable without raising immediate debt sustainability concerns, as has been the case in 2020. The issue could eventually resurface towards the end of next year should the debt to GDP ratio inch up again, as we believe. From this perspective, it will be extremely important for Italy to prove it is able to effectively use the

opportunity offered by the EU Recovery fund to spur potential growth. This will call for a careful selection of projects and, in parallel, an unambiguous willingness to step up the pace of reforms.

ECB safety net crucial in containing BTP-Bund spread at bay



Source: Refinitiv Datastream, ING

The Italian economy in a nutshell (%YoY)

	2019	2020F	2021F	2022F
GDP	0.3	-8.7	3.6	2.8
Private consumption	0.4	-8.7	3.9	2.1
Investment	1.4	-11.5	6.5	4.8
Government consumption	-0.4	-0.7	1.8	1.3
Net trade contribution	0.5	-1.7	-0.1	0.3
Headline CPI	0.6	-0.2	0.5	1.2
Unemployment rate (%)	9.6	9.3	11	10.8
Budget balance as a % of GDP	-1.7	-10.7	-8.2	-4.6
Government debt as a % of GDP	134.8	158.0	159.8	158.6

Source: Refinitiv Datastream, all forecasts ING estimates

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Belgium in 2021: Testing the limits

Without doubt, 2020 tested the limits of the Belgian economy and its health system. 2021 can only be better, but the capacity for recovery will depend on the state of public finances and the capacity of households to spend the money they've saved during the lockdown



Second wave

The new Belgian government led by Alexander De Croo is facing a second wave of the pandemic, which is particularly virulent in Belgium. The number of people hospitalised has surpassed that of the first wave, even though the rate of absenteeism due to illness is high among healthcare staff. The limits of the Belgian health care system are clearly being tested.

This second wave has a whiff of collective failure, as it demonstrates the inability to control the pandemic by partial measures. The government therefore had to impose an almost complete lockdown, although still leaving some room for economic activity. This will probably result in negative growth in the fourth quarter. For 2020 as a whole, we are forecasting a contraction in GDP of around 7.5%.

Collateral damage

It is highly likely that 2021 will still be marked by partial restrictions, as the Minister of Health has already warned that the strategy post lockdown will be stricter than after the first wave, as a third wave would be untenable for the economy and its healthcare system. As a consequence, the

financial limits of many companies will be tested until a vaccine arrives: they will have to cope with consumer caution and strict health rules, sometimes hampering their operations. We, therefore, expect a sharp increase in bankruptcies as soon as the deferral of loan repayments and the bankruptcy moratorium are lifted.

In order to limit the damage caused by the crisis, the federal and regional governments are stepping up support measures: suspension of social security contributions, postponement of payments and an increase in benefits for the self-employed. Refinancing of health care is also planned. This should cushion the shock, but it will further deteriorate public finances. The public deficit, which is expected to reach 9.4% in 2020, should be lower next year, but it will remain huge, around 5.2%. The public debt ratio could peak at 115.5%, which is not far from the safe debt limit for the Belgian economy (120%) according to a recent study by the National Bank.

Slow recovery

Once a vaccine is available and widely distributed, hopefully from the second quarter onwards, the Belgian economy should grow faster, thanks in particular to household consumption. According to the National Bank, a savings reserve of €20 billion has been built up by households through forced savings by the various confinement measures decided in 2020. This will partly be the key to the post-Covid recovery.

Household savings will partly play a role in the post-Covid recovery

However, we remain cautious with regards to this reserve. Admittedly, the figures do show an increase in household savings, but will it really be used for consumption in 2021? It could also be used to reduce household debt or to build up a reserve for pensions. On the other hand, let's not forget that a significant number of households will have to use the reserves built up to soften the shock of job losses. In fact, we expect the loss of almost 100,000 jobs by the end of 2021, which will raise the unemployment rate to almost 8.0% of the active population.

The other key to the post-Covid recovery will be the ability of the authorities to define a coherent recovery plan. Clearly, the current crisis has shown the limits of the Belgian federal system, through the many shortcomings in the management of the crisis (there are no fewer than nine ministers responsible for health across the different Belgian entities). Better coordination of the different levels of power will be necessary for a successful recovery.

So 2021 could therefore be a pivotal year in the transformation of the Belgian economy, both for companies, which will have to get through the crisis, often by reinventing themselves, and for the authorities, which will have to manage public finances that have been severely stretched by the crisis and a recovery that has yet to unfold.

The Belgium economy in a nutshell

	2019	2020F	2021F	2022F
GDP (%)	1.4	-7.5	2.9	3.3
Headline CPI (%)	1.4	0.8	1.6	1.7
Unemployment rate (%)	5.4	6.2	8.0	7.5
Budget balance as % of GDP	-1.9	-9.4	-5.2	-3.8
Government debt as % of GDP	98.7	114.7	115.2	113.6

Source: National Bank of Belgium, Forecast: ING

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Greece in 2021: Between vulnerabilities and opportunities

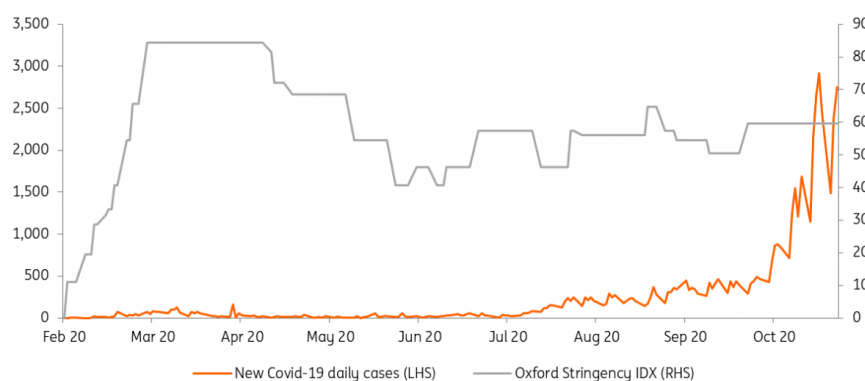
The tourism-related service sector is a lingering point of vulnerability for the Greek economy. The transition towards a proper recovery path might be helped by the inflow of grants from the European Union



Lockdown and tourism dependence weighed on 2Q20

Greece suffered the Covid-19 shock with somewhat of a delay. Having been little hit by the infection in the first quarter, it fully felt the shock over the second when the economy contracted by an unprecedented 14% quarter-on-quarter. This reflected the effect of containment measures on an economy particularly vulnerable due to the very high share of tourism activities. Social distancing and restrictions on mobility weighed heavily on both domestic demand and exports of tourism services. We suspect the same factors will limit the scope for a rebound in 3Q20 GDP comparable with what has been seen in other peripheral countries. It's worth noting that the preliminary estimate has not yet been published.

Less restrictive during the second wave

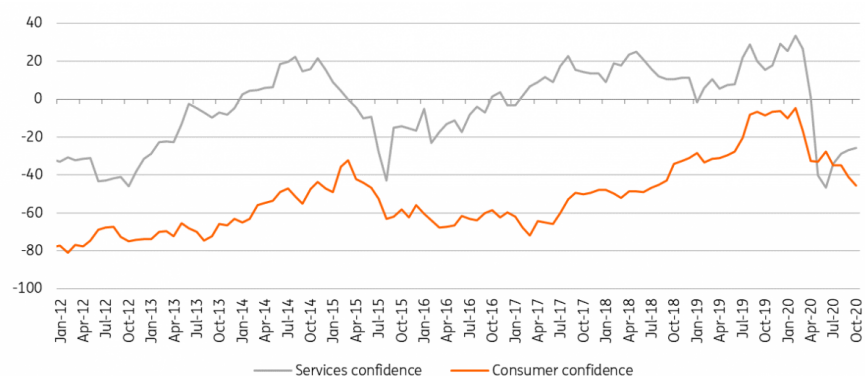


Source: Refinitiv Datastream, ING

New soft lockdown at the heart of a likely 'W'

Prime Minister Kyriakos Mitsotakis, confronted with the risk that rising Covid-19 cases is putting excessive pressure on the Greek healthcare system, recently announced a three-week nationwide lockdown. As elsewhere, this is a softer version of what was seen in April and May but should be enough to depress growth through the domestic demand channel. Recently published August employment data suggests that support measures, while backing job retention, could not stop a fall in employment which went together with an increase in inactivity. With the unemployment rate at 16.8%, domestic demand looks set to act as a drag on growth in the fourth quarter of this year. We are currently pencilling in an 8% QoQ rebound in 3Q, and a 2% QoQ fall in 4Q20, with downside risks for the latter.

Services businesses and households scarcely comforted by reopenings



Source: Refinitiv Datastream, ING

Slow fiscal push reversal not a big source of concern in 2021

Uncertainty about the development of the pandemic is unlikely to be dispelled until the beginning of 2021. Should a vaccine be rolled out, 2021 will hopefully be the year when Greece will find a way to unwind extraordinary measures while preparing for a genuine recovery. Before Covid-19, the country was just emerging from a multi-year economic and financial crisis with ample labour

market slack, and so we suspect that the process will have to be dealt with carefully.

Fresh resources might still be needed over the first half of 2021, and this will limit the scope for a meaningful improvement in public account ratios. Also, public finance developments will be subject to uncertainty related to the potential activation of state guarantees issued as part of the emergency Covid-19 measures. To be sure, given the low share of Greek debt held by private investors, this should not upset the market too much.

Recovery fund inflows an opportunity for 2H2021 and beyond

On a positive note, 2021 will also be the year when grants from the EU Recovery and Resilience Facility will start flowing into the Greek state coffers to fund eligible projects. Given the good share of funds Greece is entitled to, these might act as a growth accelerator over the second half of next year. Against this backdrop, it will be extremely interesting to see whether the projects financed and the related reforms will make Greece more attractive in the eyes of foreign investors. If this is the case, chances are that growth-wise, 2022 will turn out better than 2021.

The Greek economy in a nutshell (%YoY)

	2019	2020F	2021F	2022F
GDP	1.9	-8.5	2.2	3.4
Private consumption	0.7	-5.4	2.4	2.5
Investment	4.5	-6.7	8.7	13.8
Government consumption	2.2	2.1	2.7	1.5
Headline CPI	0.5	-1.2	0.0	0.9

Source: Refinitiv Datastream, all forecasts ING estimates

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Ireland in 2021: The lock of the Irish

Ireland is facing the challenge of bouncing back from its huge economic decline at the end of 2020 while experiencing all the uncertainty and possible trade problems that Brexit may bring



Brexit and Covid-19 collide

Like the rest of the eurozone, the Irish economy has been dominated by coronavirus developments this year. Compared to other countries though, GDP appeared to contract much less in the second quarter – just -6.1% QoQ. This suggests that the impact of the first lockdown was fairly mild but the well-known distortions to GDP due to multinational profit flows actually mask a much worse domestic performance. Modified domestic demand, which strips out the multinational accounting effects, actually contracted by -16.4%, indicating that the economic contraction from the first lockdown has been among the worst in the eurozone.

Against that backdrop, the strict second wave response is currently dealing another heavy blow to the Irish economy. While third quarter GDP figures are not yet known, modified domestic demand figures are likely to place Ireland's economic performance during the Covid-19 crisis at the lower end of the eurozone spectrum so far. The second lockdown came quicker than in other countries as cases rose above the threshold for significant new measures to be taken. Ireland has closed non-essential businesses and has curbed non-essential travel. As such, Google mobility data suggests that Ireland is experiencing a worse fourth quarter in terms of economic activity than other eurozone economies.

Life after Covid and Brexit

The fiscal response to the pandemic is key to a swift recovery in 2021. As income support has been extended by the new government, this should mitigate some of the second-round effects of the virus and help the economy recover. This has resulted in a very expansionary budget proposal for next year, causing debt-to-GDP to increase significantly. After Ireland had managed to bring down debt levels to below 60% in the years after the euro crisis, it is now set to increase to 66% in 2021, according to the 2021 budget proposal. That, however, is still pretty modest when compared with other countries.

The outcome of Brexit negotiations is key to the Irish economy's recovery

A very dominant factor for the Irish recovery in 2021 will obviously be Brexit. Even if a deal is reached between the EU and UK, any initial disruption would still dampen the recovery path of the economy moving out of the second lockdown. The worst-case scenario would involve tariffs introduced between the UK and the EU, which would have a significant negative impact on the Irish economy as it involves its closest trading partner and the tariffs that the UK would introduce would disproportionately hit products that Ireland exports to the UK. This means that the outcome of ongoing negotiations is key for the Irish economy, but the result will be a negative impact on the economic recovery regardless.

The Irish economy is therefore set for a tumultuous year. Brexit certainty will not necessarily be helpful as it's difficult to see how any outcome would not harm economic recovery in 2021. Still, the impact from Brexit won't be as severe as that seen following Covid-19, and as the lockdown is lifted, the economy will start another mechanical economic recovery.

The Irish economy in a nutshell

	2019	2020F	2021F	2022F
GDP (%)	5.6	-2.3	2.5	2.8
Private consumption (%)	3.2	-8.3	10.3	6.9
Investment (%)	74.9	-42.5	14.9	14.4
Government consumption (%)	5.8	13.5	-0.4	-1.1
Net trade contribution (%)	-17.5	17.1	-4.1	-4.0
Headline CPI (%)	0.9	-0.5	0.4	1.6

Source: Eurostat and ING Research forecasts

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Finland in 2021: Strong Covid-19 report card provides no guarantees

The Finnish economy has been exemplary in its performance this year. A contraction could not be avoided – obviously – but the economy is experiencing a much milder coronavirus crisis than most of the eurozone



A relatively mild economic decline in 2020

The Finnish economy has undergone one of the mildest of all eurozone contractions in the first half of 2020. The restrictive measures imposed were relatively lenient, which was in line with a relatively small number of infections per 100 thousand people in the first wave. The declines of -1.4 and -4.4% in the first two quarters of the year do represent a historically large decline however and therefore adequate fiscal stimulus has been necessary to allow the economy to bounce back in the third quarter. Additional fiscal spending has been below average for the eurozone at 2.6% of GDP, but also taking 1.8% accelerated spending into account, it's a decent package given the relative decline in output and will bring debt-to-GDP ratios well above the 60% threshold again at 71.8% in 2021.

Also in the second wave, Finland managed to outperform the eurozone. After a rise in new cases in September, new regional restrictive measures have been introduced, which mainly impact hospitality and events, while nationally working from home is strongly advised. These are among the lighter restrictions seen in the eurozone, which shows up in Google mobility data indicating

that Finland has seen just a modest drop from the peak in activity in early October. All that means that the domestic economy has limited downside risk in the fourth quarter, but exports are likely to be battered as the rest of the eurozone sees activity impaired much more significantly at this point.

Uncertainty around the recovery remains enormous

While Finland is clearly ahead of other countries in terms of its economic performance over the course of the Covid-19 crisis, this provides no guarantee to the outlook for 2021. As the country is closer to its pre-coronavirus level of economic activity than most countries, concerns about second-round effects on the economy are lower. Still, unemployment has been trending higher and once supportive measures from banks and governments end, bankruptcies are also expected to trend somewhat higher again. That would curb the potential of the domestic recovery, although a quick rollout of an effective vaccine is a clear positive for the outlook.

The latter is obviously the big game changer for 2021 as it would also lift global demand significantly, helping the crucial Finnish export sector to recover. If rollouts take longer than expected, the export sector could suffer disproportionately and cause the Finnish economy to take longer to get back to pre-Covid levels.

The Finnish economy in a nutshell

	2019	2020F	2021F	2022F
GDP (%)	1.1	-4.1	2.3	2.3
Private consumption (%)	0.8	-4.2	3.2	3.6
Investment (%)	-1.0	-5.0	3.8	4.3
Government consumption (%)	1.1	4.8	0.1	-0.7
Net trade contribution (%)	1.7	-1.6	-0.2	0.0
Headline CPI (%)	1.1	0.4	1.3	1.5

Source: Eurostat and ING Research forecasts

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Austria in 2021: This time it's different

Strong growth in the third quarter was only a snapshot. The new lockdown measures in Austria will push the economy into recessionary territory, and there's likely to be more bad news ahead



Source: Shutterstock

Lockdowns, unemployment and debt

The Austrian economy grew by 11.1% quarter-on-quarter in 3Q20, which is still 5.3% below last year's level.

After the easing of lockdown measures in April and May, catch-up effects led to a sharp increase in private consumption of 11.8% during the third quarter. The opening of borders in June enabled both the tourism and the export sector to gain some momentum, resulting in a market services growth rate of 14.5%, under which these sectors are grouped.

The last two months of the year will bring some economic challenges. Like everywhere in Europe, cases began to rise sharply again in October, forcing the government to introduce new lockdown measures at the beginning of November which were further tightened in mid-November. Austrians are not permitted to leave their homes, except if they are commuting for work. As curfews are only allowed for 10 days, these measures will initially remain in place until 26 November and will then be extended if necessary.

New lockdown measures in the entire eurozone have put yet another tourist season at risk

All schools and kindergartens have been closed too, but in case of emergencies, care services will be available. Retail stores, restaurants, hotels and cultural sites were forced to close and this will hold until 6 December. While restaurants are allowed to offer delivery and pick-up services from 6am until 7pm, other sectors may be unable to bridge the widening gap.

Therefore, the government has decided to support the labour market and businesses by granting affected businesses compensation up to 80% of the revenue in the same month of last year. The payment of this compensation is bound to the condition that no employee is made redundant. Additionally, the short-time work scheme has been adjusted and extended until the end of March 2021. And to make it possible for families to celebrate Christmas together, mass testing will be introduced when the lockdown is eased.

Since January, the seasonally adjusted unemployment rate (Eurostat) increased by 1.2 percentage points to 5.5%. Given that the new lockdown measures in the entire eurozone have put yet another tourist season at risk, unemployment looks set to increase more substantially in 2021. Although this second wave should not come with a strong supply shock as we experienced during the first wave, there is definitely the risk of a demand shock due to precautionary savings as uncertainty about the duration of the lockdown, or the introduction of a third one increases.

With all the supportive measures taken so far, Austria's government debt rate is estimated to increase by some 14 percentage points to 84.2% of GDP in 2020 and to 85.2% in 2021. The government has not yet announced any proposals for reducing the debt ratio. Plans to increase taxes would become relevant in 2022 at the earliest, according to the president of the fiscal council, however, it might take up to 10 years until the debt ratio returns to pre-crisis levels.

No protective shield

The diversity of the Austrian economy, which usually guarantees stable, albeit moderate, growth, may not work as a protective shield this time, as the crisis affects all sectors and one of Austria's growth engines - the tourism sector, which could well remain affected into next year. Government support should reduce the negative impact, but we expect the Austrian economy to shrink by 1.5% in the fourth quarter and an overall contraction of 7.5% for the whole of 2020.

We expect the economy to rebound by some 2.9% in 2021.

The Austrian economy in a nutshell

	2019	2020F	2021F	2022F
GDP	1.5	-7.5	2.9	3.5
Private Consumption	1.3	-7.5	3.6	4.0
Investment	2.8	-6.2	3.1	2.4
Government Consumption	0.7	1.7	1.5	0.9
Net trade contribution	0.1	-1.5	0.3	0.5
Headline CPI	1.5	1.5	1.7	1.7
Unemployment rate (%)	4.4	5.7	6.0	5.2
Budget balance in % of GDP	0.7	-9.6	-6.4	-3.7
Government debt in % of GDP	70.4	84.2	85.2	85.1

Source: Thomson Reuters, all forecasts ING estimates

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