

Eurozone Quarterly: Still in lockdown blues

The countries of the eurozone are still struggling with extended lockdowns, delayed vaccinations and (too) little fiscal stimulus



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Eurozone: The underachiever

The sluggish pace of the vaccination campaign continues to jeopardise the eurozone recovery, though stronger manufacturing and construction activity are limiting the damage. Inflation is moving up and is likely to top 2% in the summer, albeit temporarily. Meanwhile, the European Central Bank is trying to prevent too much steepening of the yield curve



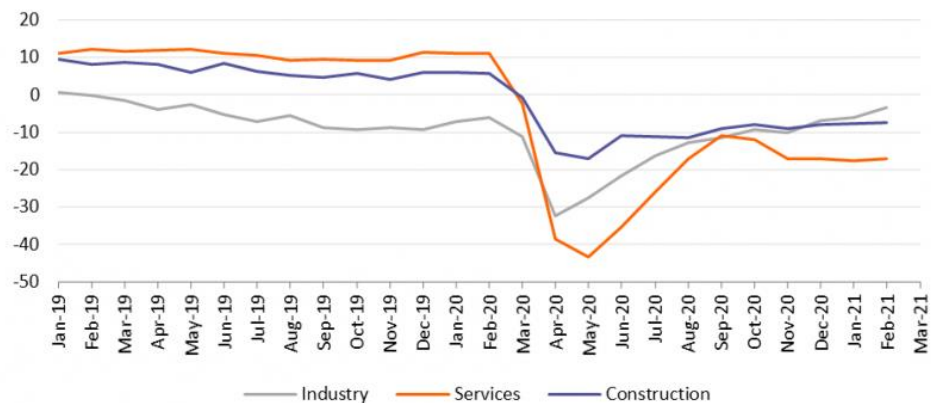
An elderly lady leaves after receiving a pfizer vaccine during a COVID-19 vaccination campaign in Pamplona, northern Spain

Sluggish vaccination campaign

At the risk of sounding like doomsdayers, we unfortunately have to repeat that the sluggish pace of vaccination continues to jeopardise the recovery in the eurozone. At the end of February, less than 5% of the population in the eurozone had received at least one dose of one of the vaccines. With Johnson & Johnson most probably able to step into the game from April onwards, supply constraints will ease, but the vaccination process also needs an urgent makeover in many countries if herd immunity is to be reached over the course of this year. This also explains why most eurozone countries have already announced that they will keep lockdown measures in place at least until the second half of March and probably even longer.

Industry and construction save the day

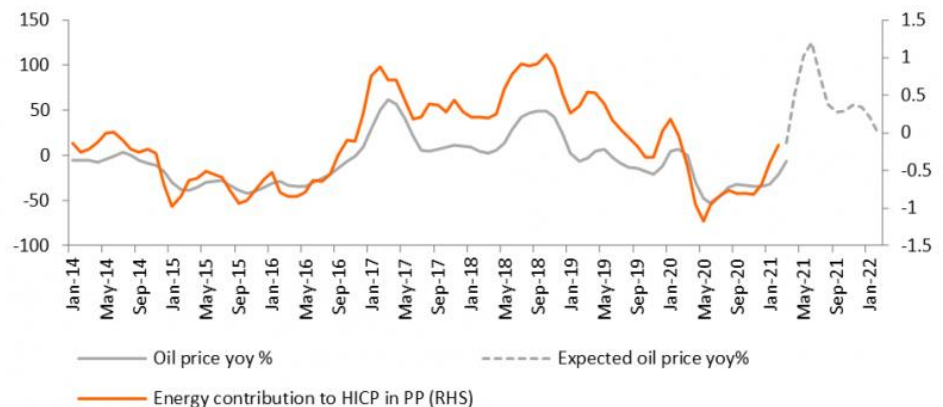
That said, eurozone companies are getting better at coping with the lockdown measures. While services are still heavily affected by the restrictions, both construction and industry are increasingly compensating for this. On the back of swelling order books, helped by the recovery in the rest of the world, confidence in industry rose in February to the highest level since May 2019. And while the first quarter is still likely to show a small contraction, a gradual reopening of the economy from the second quarter onwards should allow a recovery to take hold. Vaccinations probably won't be advanced enough to see a normal tourism season this year, but we still think the eurozone should manage to grow by 3.8% in 2021, followed by 3.5% in 2022 on the back of some decline in the savings ratio. Bear in mind that even then, the pre-crisis GDP level will only be reached by the end of 2022, about one year later than in the US.

Stronger industry & construction, weak services

Source: Refinitiv Datastream

Inflation to top 2%

Meanwhile, inflation remained at 0.9% in February, with core inflation at 1.1%. Because of base effects in energy prices, combined with likely price increases in the services that reopen and the full swing of the German VAT reversal unfolding from July onwards, we now expect inflation to top 2% over the summer months. Though most of these effects will disappear in 2022 and for the time being there's little reason to expect a wage-inflation spiral, underlying inflation might remain slightly above 1% beyond 2021. We expect an above consensus 1.8% inflation rate this year and 1.5% in 2022 (compared with an average inflation of 1.0% in 2016-2020). In other words, a little upward drift that the ECB is likely to welcome, but still at the low end of the ECB's inflation objective.

Oil prices will push inflation higher

Source: Refinitiv Datastream

Yield curve steepening

Through different speeches, the ECB has given some colour on what it is looking at in order to maintain favourable financing conditions - though some might call it too colourful to fully distil the ECB's reaction function. In our view, the GDP-weighted sovereign bond yield curve could be a key element in determining overall financing conditions. However, it would not be easy for the ECB to actually reshape this yield curve. For ECB Executive Board member Isabel Schnabel it is clear that "a rise in real long-term rates at the early stages of the recovery, even if reflecting improved growth prospects, may withdraw vital policy support too early and too abruptly given the still fragile state of the economy. Policy will then have to step up its level of support". In other words, the ECB will continue to lean against the US-induced upward push in bond yields, through its Pandemic Emergency Purchase Programme. That said, we continue to expect the recovery to lead to some curve steepening, with the German 10yr bond yield likely to leave negative territory by the first quarter of 2022.

Savings: The two-sided wildcard for growth

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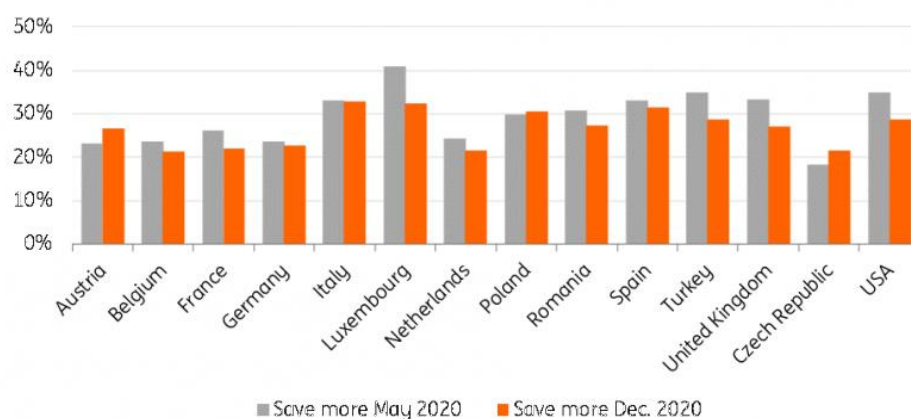
In the first lockdown, surging savings rates across the Western hemisphere were mainly the result of involuntary savings. As a result, the reopening of economies led to an almost full reversal of the excess savings into consumption. In 2021, the rotation from savings into consumption could be much more uneven on both sides of the Atlantic



The savings-consumption rotation during the first lockdown

The first lockdown saw an unprecedented surge in savings in the US and Europe. 'Involuntary savings' was the buzz phrase of the moment. With people suddenly sitting at home, retail stores, restaurants, bars and cultural events all closed, savings rates increased significantly. Planned vacations had to be cancelled, also adding to the increase in savings. The fact that these savings were mainly involuntary is also reflected in the relatively muted fall in consumers' willingness to spend. With the reopening of economies, savings dropped and consumption surged. In fact, the flow of savings equalled the flow of consumption almost entirely in the second and third quarters.

Did you save more or less?



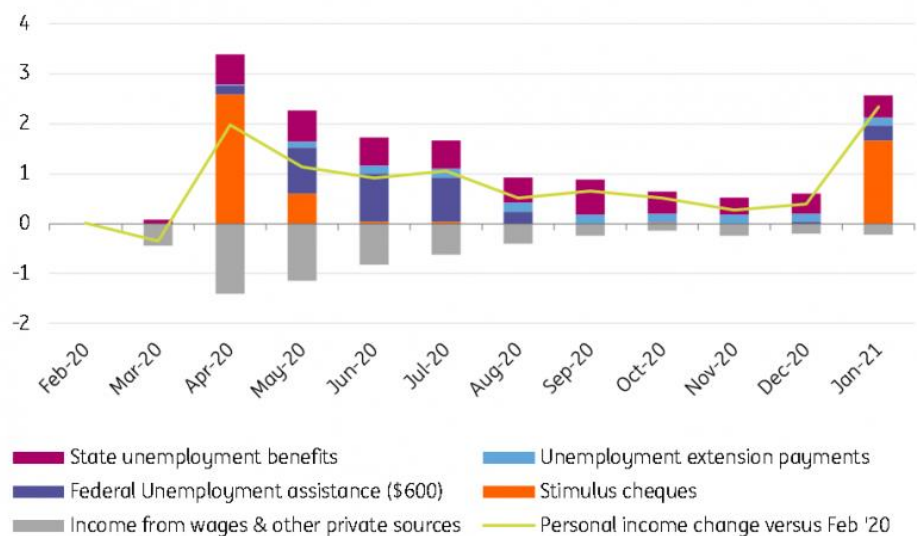
Source: ING International Survey

In the eurozone, short-time work schemes helped support household incomes. Unemployment rates remained relatively stable and the fear of potential job losses was high but short-lived. Savings rates across the eurozone surged on the back of involuntary and precautionary savings. According to European Commission surveys, the assessment of households' own financial situation worsened but only to historic averages and not below. Interestingly, the intention to save did not drop again in the third quarter, while excess savings were reduced and private consumption surged. The countries hit most by the crisis saw only half of these excess savings in 3Q actually spent in that quarter. In all countries, the savings rate remained higher than before the start of the crisis. This suggests that a larger part of the population increased savings as a precaution and not simply due to the lack of spending opportunities.

In the US, the story is slightly different. Rather than adopt the European style furlough schemes which were designed to preserve jobs, the US government took the decision to avoid interfering directly in the labour market. Instead, they chose to strengthen the financial safety net for those who lost their jobs by extending the duration of unemployment benefits, expanding the number of people who could receive them and then initiating a new \$600 weekly Federal unemployment benefit to boost incomes. In consequence, the University of Chicago calculated that 69% of unemployment benefit recipients actually earned more money being unemployed than when they were working. The median recipient received 134% of their previous after-tax compensation.

This has promoted a broad strengthening of the US household balance sheet with cash, checking and savings deposits increasing by \$2 trillion between 4Q 2019 and 3Q 2020 while outstanding credit card balances have fallen to a four-year low. Given the upscaled and expanded unemployment benefits and the \$1200 CARES Act stimulus payment, increases in US savings are likely to have been spread more broadly across the income spectrum versus Europe. ING's own international savings survey backs this up based on responses to who has increased savings rather than run them down.

Factors that have boosted US household incomes each month (annualised change in income versus February 2020 - USD tn)



Source: Macrobond, ING

The savings-consumption rotation during the second lockdown

Savings increased again during the second lockdown but in the eurozone, the willingness to spend has weakened, falling to the lowest level since June. This drop masks significant changes between what are basically two groups; the countries which entered a second lockdown in November like France or Belgium and the countries which entered a strict lockdown only at the end of 2020, like Germany. The former have seen a very subdued

willingness to spend since the initial spike after the reopening, while the latter saw the hit to consumer confidence only recently. Overall, the willingness to spend remains low, which argues against a sharp surge in consumption once economies reopen. In fact, it looks as if involuntary savings have been replaced by precautionary savings. At the same time, however, don't forget that a reopening will boost demand for services like hospitality, leisure and culture as well, something that is not fully captured by traditional surveys.

It is also worth noting that consumption has not collapsed as much as it did during the first lockdown as both retail stores and customers have been able to adapt to new circumstances, shifting towards online shopping, and fewer planned expenditures had to be cancelled. Therefore, with the more subdued downswing, an accentuated rebound looks less likely.

Unlike Europe, the US did not enter a full second lockdown with the most onerous restrictions experienced only by Californians. Now that California's stay at home order has been rescinded and New York and other cities are again open for eat-in dining there is more opportunity to spend.

Recent data has shown that the improved financial position of US households means that when presented with a windfall payment, such as the latest \$600 stimulus cheque, consumers have the confidence to spend it. This contributed to a 5% month-on-month jump in retail sales in January with daily credit and debit card transaction data from www.tracktherecovery.org indicating that the bulk of the additional spending came from lower income households.

This is an encouraging precedent for the outlook for consumer spending since President Biden is proposing to raise the extra Federal weekly unemployment benefit back to \$400 per week after it was tapered in 2H20 while also providing an extra \$1400 individual stimulus payment. He also has aspirations to raise the minimum wage to \$15/hour nationally, which if implemented would further boost the earning power of lower income households.

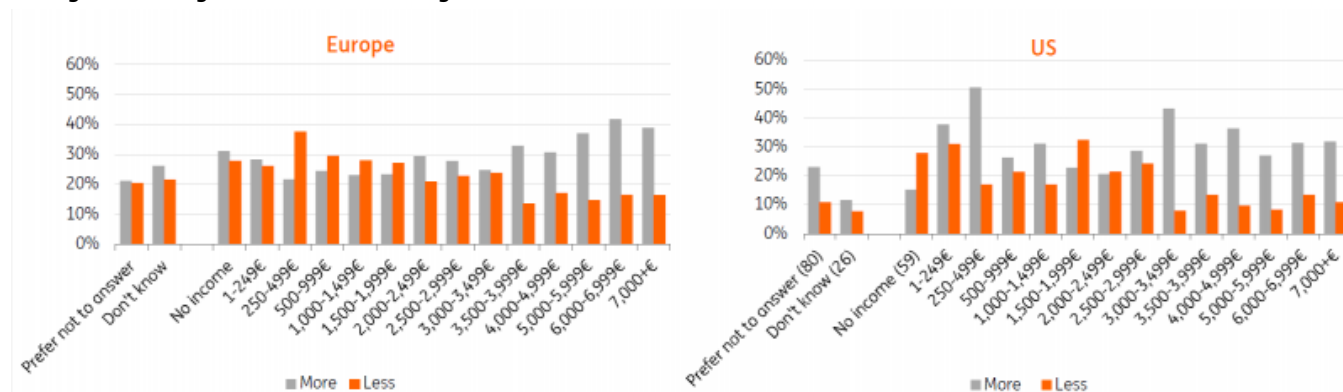
With the US Covid vaccination programme gaining momentum, there is a realistic chance of a broad economic reopening in mid to late 2Q 2020, including for consumer services, leisure and hospitality. This is potentially one to two quarters ahead of Europe. US job opportunities will therefore improve more swiftly, with surveys already suggesting that households expect jobs to become more plentiful, which could boost the chances that households use some of their accrued savings for spending over coming months. Significantly, the unemployed also have the guarantee of robust unemployment benefits to fall back on should they fail to find work.

Outlook: Pent-up demand or too elevated expectations?

Looking ahead, the key question for the economic outlook is whether the great rotation between savings and consumption in 2Q and 3Q will repeat itself or whether the latest increase in savings will be left unspent. The US and eurozone patterns differ significantly mainly due to two factors: the distribution of savings across different income categories and the sheer size of the income subsidies.

An important determinant of potential consumption is the distribution of excess savings across the different income groups. In theory, the propensity to spend is lower in high-income households than in low-income households. Against this background, the results of an ING survey give interesting insights. While in the eurozone between 30% and 40% of the higher-income households saw their savings increase during the pandemic, only around 20% of the lower-income households reported higher savings. In the US, these numbers are much more dispersed across the entire income range.

Changes in savings behaviour according to income



Source: ING International Survey

The size of the direct income subsidies has also been much larger in the US than in the eurozone. While in the eurozone even short-time work schemes mean at least a small drop in disposable income, the fact is that at least initially almost 70% of US unemployment benefit recipients earned more money due to the government support than when they were working. Additional payments of \$1200 and \$600 (with a third proposed payment of \$1400) helped further improve the financial position of millions of households.

Fiscal stimulus more targeted to the lower-income US households should lead to a stronger boost of private consumption than the more indirect stimulus in the eurozone. Also, the second lockdown seems to have anchored fears of potential job losses in the eurozone, shifting involuntary savings to precautionary savings. This is not something we have seen in the US.

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ECB: Looking through inflation (and platitudes)

A front-loading of asset purchases and a very nebulous reaction function. This is not only the European Central Bank's answer to higher bond yields but probably also the outcome of a controversial discussion at the ECB's Governing Council



How will the ECB react to the recent increase in inflation and bond yields? This was the main question ahead of today's ECB meeting. The announced decision to front-load asset purchases in the coming months and the press conference with ECB President Christine Lagarde suggest that the ECB is split on how to continue.

Fresh round of macro projections

In its broader general macro assessment, the ECB has not really changed its mind. Despite delays in the vaccination rollout and longer-than-expected lockdowns, the ECB's GDP growth forecasts remained almost unchanged from December, with the ECB now expecting GDP growth to come in at 4% in 2021, 4.1% in 2022 and 2.1% in 2023. The ECB remains optimistic that fiscal policy support and the reopening of economies will lead to a significant pick-up in the course of this year. Remarkably, the ECB changed its risk assessment from 'tilted to the downside but less pronounced' to 'more balanced'.

As regards inflation, the ECB seems to have updated its oil price assumption and actual inflation data for January and February but is not expecting an uncontrollable acceleration in inflation. At 1.5% for 2021, 1.2% in 2022 and 1.4% in 2023, the ECB sees just temporary and one-off factors driving inflation. According to Lagarde's comments during the press conference, the ECB will look through any temporary acceleration in prices. She also stressed the high level of slack in the eurozone economy which would prevent any wage pressures from emerging.

Explaining the ECB's reaction function

With the latest increase in bond yields, financial market participants had expected the ECB to better clarify its current reaction function. The decision to front-load its asset purchases over the next quarter took away some of the pressure, indicating that the ECB was willing to put a cap on yields. The comments during the press conference, however, were more confusing rather than providing any clarity.

What is clear is that the ECB will continue focusing on 'preserving favourable financing conditions'; no yield curve control as Lagarde stated during the press conference. According to the ECB, 'financing conditions are defined by a "holistic" and "multifaceted" set of indicators, spanning the entire transmission chain of monetary policy from risk-free interest rates and sovereign yields to corporate bond yields and bank credit conditions. The comments during the press conference, however, added confusion and no additional clarity. Holistic, multifaceted, upstream, downstream, anchor and compass. A series of platitudes my editor would not allow me to use; at least not this prolifically.

Three key takeaways

What to make of this festival of platitudes? Let's take a step back, forget the platitudes and just look at the facts. There are, in our view, three main takeaways from today's ECB meeting: i) the ECB will look through any temporary acceleration of inflation and expects inflation to slow down again next year; ii) the ECB will front-load asset purchases in the coming months to underline its willingness to look through higher inflation and limit further bond yield increases; iii) the change of the balance of risk for the economic outlook suggests that any increase in the total size of the asset purchases is still far out and unlikely. Instead, today's decision looks like a compromise of a split Governing Council.

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Germany: All good things eventually come to an end

Despite the messy and chaotic vaccination programme, Germany's economy is holding up relatively well, benefiting from better vaccination rollouts than in other parts of the world. Expect the German economy to grow by around 4% this year and in 2022



The Germany Chancellor, Angela Merkel

Germany and Germans are well-known for being organised, well structured and solid. These characteristics helped to get the country and the economy through the first phase of the pandemic relatively smoothly. The impressive U-turn on fiscal policy prepared the ground for what was supposed to be a stronger and swifter recovery than most other countries.

However, the second phase of the crisis has shown the other side of the Germany economy - the one that lacks flexibility and digitalisation - both of which are holding back the vaccination programme.

If you're wondering what happened to the good old German characteristics? Well, all good things eventually come to an end.

Strong manufacturing

At the end of 2020, industrial production, exports and the construction sector prevented the entire economy from falling into contraction. The often-criticised growth drivers - industry and exports, benefited significantly from strong demand from Asia and China.

As the service industry continued to suffer from lockdowns and social distancing measures, the manufacturing sector was hardly hit by the second lockdown, and this divergence started last summer.

The nature of 'smart lockdowns' is clearly one important driver. While many parts of the German manufacturing sector voluntarily closed down during the first lockdown, also driven by severe supply chain disruptions, factories remained open during the second lockdown. Also, don't forget the German manufacturing sector seems to have benefited a lot from the strong and continuing recovery of the Chinese economy, however, there is a distinction between cyclical and structural rebound. In our view, the strong industrial performance since the summer is cyclical and not so much a structural rebound.

Looking ahead, it looks unlikely that the cyclical swings in industrial production, construction and exports will save the entire economy from falling into contraction again in the first quarter, even if the current picture is mixed. With production expectations in the manufacturing sector surging and order books still improving, the prospects of industrial production remain positive. On the other hand, with the sharp fall in January and the winter weather in February, the construction sector will hardly be a growth driver in the first quarter.

The not-so-perfect vaccination rollout

The outlook for services and consumption is obviously closely linked to social distancing and lockdown measures.

In this regard, the extension of the current lockdown measures until the end of March does not bode well. Even if some easing of the measures has been announced, the slow and chaotic vaccination rollout will leave its mark on the economy. In fact, while the supply of vaccinations will gain momentum in the coming weeks, bureaucracy and inflexibility are hampering the rollout, so much so that the expected 20 million vaccines by the end of March, some 8 million, could end up somewhere in the fridge, unused.

The problems with the vaccination rollout illustrate the German economy's problems and challenges after the pandemic, which in all honesty are similar to those of the previous crisis - namely, a lack of digitalisation, structural reforms and the need for more investment. However, these issues will only gain more momentum after the elections.

Until then, the course of the economy will mainly be determined by lockdown measures and their easing, as well as whether the government's announced support measures finally reach the corporate world. One of the current problems is the fact that only a fraction of the announced support has actually made its way to the real economy.

Private consumption with only mild rebound

“We expect the economy to grow by around 4% this year and in 2022”

While private consumption had a weak start to the new year, the low level of unemployment should argue in favour of a consumption pick-up over the course of the year. However, the

high number of people working part-time, the fear of potential job losses on the back of a bankruptcy wave and the drop in purchasing power as a result of higher inflation argue against too much optimism.

As a result of all of the above and assuming that the announced fiscal stimulus will eventually hit the real economy with full force, we expect the economy to grow by around 4% this year and in 2022. In this scenario, the German economy would return to its pre-crisis level at the turn of 2021/2022.

All good things come to an end

Since the summer of 2018, when the decline of the manufacturing sector started, the need for a digital transformation, structural changes and more investment have been on top of every political and economic agenda. The pandemic might have diverted attention but it hasn't reduced the urgency to act.

After the strong and highly respected management of the first phase of the pandemic, the second phase has become challenging. But it also serves as a reminder that the economic work won't be over once the pandemic ends. Banking on good old German strengths like industrial production and exports might be too short-sighted.

After all, it wouldn't be the first time good things came to an end.

The German economy in a nutshell (% YoY)

	2020	2021F	2022F	2023F
GDP	-5.0	4.0	3.8	1.5
Private consumption	-5.0	3.9	3.8	1.2
Investment	-4.0	3.1	3.1	2.0
Government consumption	3.8	3.1	2.9	1.8
Net trade contribution	-2.1	0.4	0.5	0.1
Headline CPI	0.4	2.5	1.3	1.6
Unemployment rate	3.8	4.4	4.4	4.0
Budget balance as % of GDP	-4.3	-3.5	-1.5	-0.5
Government debt as % of GDP	72.0	72.0	65.0	63.0

Source: Refinitiv Datastream, all forecasts ING estimates

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France: The French economy could outperform its European neighbours

The year 2020 ended with a further fall in French GDP and the first quarter of 2021 is not expected to see any significant improvement. Nevertheless, the outlook for the second half of 2021 is encouraging and France should see GDP grow more than its European neighbours



French President Emmanuel Macron

5% below the pre-crisis level

As with other European countries, the second wave of the coronavirus has had and continues to have a significant impact on the French economy. The new strict lockdown implemented in November with the closure of shops and drastic restrictions on mobility, as well as the severe restrictions imposed in December, led to a 1.3% drop in GDP in the fourth quarter of 2020, pushing the economy 5% below its pre-crisis level. In the end, for the whole of 2020, GDP fell by 8.2%, a historic drop for France and much sharper than that observed on average in the euro area. At the same time, thanks to the strong support measures put in place by the government, including the partial unemployment scheme, employment fell only slightly over the year (-1.1%) and household purchasing power was preserved.

Stagnation expected in the first quarter

For the beginning of 2021, the outlook remains lukewarm. Since the beginning of the year, and unlike Germany or the Netherlands, France has been able to avoid a new closure of shops and schools, but restrictions remain very important and continue to increase due to a health situation that is far from being completely under control. In particular, the 6pm curfew, the closure of major shopping centres, bars, restaurants, ski lifts, leisure and cultural venues are having a major impact on economic activity, and mainly on the services sector. Household consumption remains largely hampered. And the new restrictions, including weekend lockdowns, which have been in place since the end of February in certain cities, leave little hope that the situation will improve by the end of March.

“Industrial and construction sectors can drive the French economy forward”

Fortunately, the industrial and construction sectors are less sensitive to the restrictions than they were during the first lockdown and can act as a driver for the French economy.

Thus, industrial production recovered strongly in January, posting monthly growth of 3.3%, though still 1.7% below its pre-crisis level (February 2020). The construction sector is in a very good position, posting a 4.4% increase in January compared to its pre-crisis level. With business climate and PMI indicators in industry pointing in the right direction, industry should continue to drive the French economy throughout the first quarter. However, this will not fully offset the negative effects of the restrictions on the services sector.

For 1Q as a whole, economic activity in France is likely to stagnate at around 5% below its pre-crisis level. We, therefore, expect a GDP growth rate of 0% quarter-on-quarter in the first three months of the year.

Vaccination, a necessary condition for recovery in the second quarter

Since the beginning, the vaccination campaign in France has been moving at a very slow pace. On 8 March, only 6.1% of the total population had received at least one dose of the vaccine, which does not allow for any improvement in the health situation or to envisage any schedule for easing measures in the coming weeks. Nevertheless, the pace of vaccination has accelerated in recent days and the government expects that 10 million French people (15.1% of the population) will have received a first dose by mid-April, and 20 million by mid-May.

“Household savings will play an important role in the recovery”

This implies a relaxation of the health measures by the second half of April. The second quarter of 2021 should therefore see a gradual recovery in the sectors currently at a

standstill. While it is difficult to envisage a full return to normalcy by the summer, the recovery should strengthen strongly in 3Q, thanks in particular to a strong recovery in household consumption. Provided that household confidence does not deteriorate too much, the forced savings accumulated during the crisis due to restrictions (€110 billion over the year 2020) should play an important role in the revival of consumption, as was observed during the summer of 2020 and in December. Ultimately, for 2021 as a whole, we expect growth to be in the region of 5.3%.

The recovery will continue after 2021, still driven by consumption despite a likely deterioration in the labour market situation, and therefore confidence, following the reduction in support measures. Fiscal policies should continue to support the economy at both the European and national levels, driven by the context of the 2022 presidential elections in which Emmanuel Macron will seek re-election despite a disappointing reform record due to the pandemic. We expect GDP growth of 3.1% for the full year 2022.

The French economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-8.2	5.3	3.1	1.6
Private consumption	-7.3	5.1	5.2	1.0
Investment	-10.3	8.6	2.5	2.01
Government consumption	-3.1	3.8	0.9	1.2
Net trade contribution	-0.7	-0.1	-0.3	0.2
Headline CPI	0.5	1.5	1.4	1.3
Unemployment rate (%)*	8.2	10.3	9.6	8.3
Budget balance as a % of GDP	-10.5	-8.5	-6.5	-4.5
Government debt as a % of GDP	118	120	122	122

Source: Refinitiv Datastream, all forecasts ING estimates

* Eurostat definition

Italy: an eye on reforms

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Mario Draghi's government set a speedier vaccination rollout and the Recovery and Resilience Plan as obvious priorities. Success on both fronts will be crucial to sustainably higher growth in the medium term

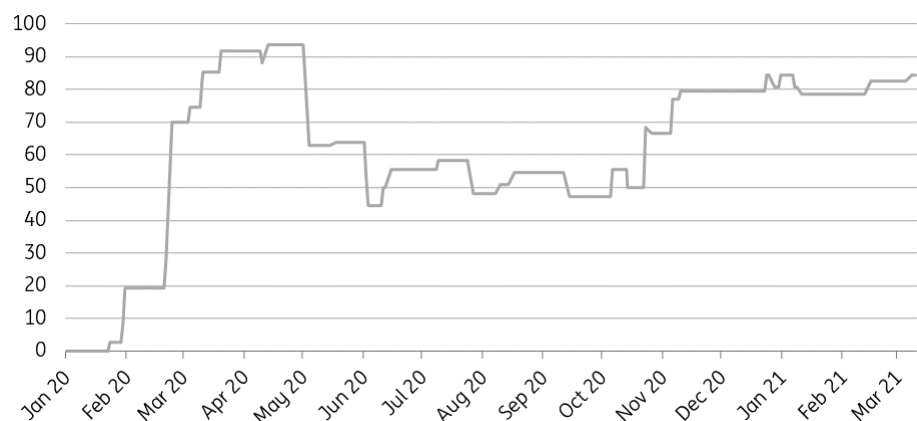


Italian Prime Minister Mario Draghi

Industry-services dichotomy still in place

After the impressive summer rebound, helped by staycations, Italian GDP contracted by 1.9% quarter-on-quarter in 4Q20, driven primarily by private consumption, but also by a surprising net exports drag. Asymmetry in the selective lockdown strategy has defined the pattern of growth, with the production side almost untouched and most restrictions concentrated on services and retail sectors. This has led to a dichotomy between industrial confidence and services confidence which extended into the first two months of 2021. Admittedly, confidence in the service sector turned around recently, but, unlike in industry, it remains far below pre-Covid 19 levels. Industrial resilience was confirmed by January production data, the single hard number available for 1Q21, which gained 1% month-on-month, leaving the index just 2.4% lower than in January 2020. The intermediate goods drive is an encouraging signal that Italy is still rooted in global value chains.

Oxford stringency index suggests another GDP contraction in 1Q21



Source: Refinitiv Datastream

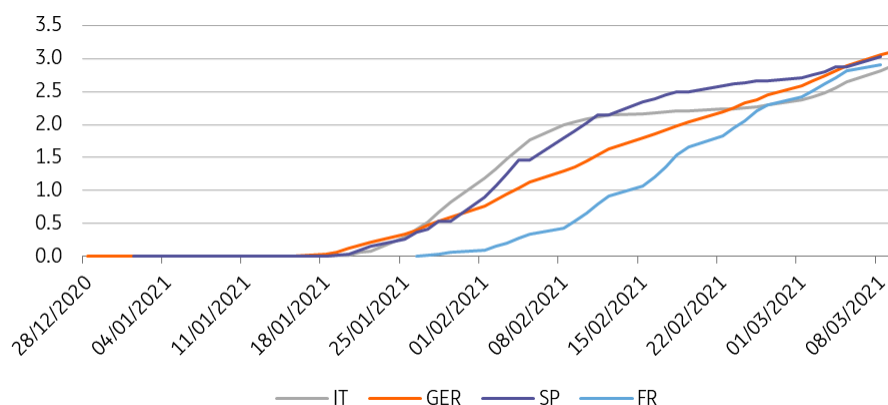
Labour support schemes refinancing to help disposable income and consumption

The poor consumption reading would likely have been worse without the strong safety net deployed to protect workers. The combination of the CIG short-time work scheme and the redundancy ban limited damages, helping contain the employment contraction over 2020 to -1.7% since the inception of the pandemic. This mainly affected short-term contracts, most frequent among young and female workers, and independent workers. Labour protection and the compensatory monetary handouts will very soon be extended for (at least part of) 2021 as part of an already budgeted €32bn package, and will support disposable income. The big question is to what extent future reopenings will free up pent-up demand currently frozen in higher savings rates. We remain prudent here, as lower income brackets, those with lower saving rates, have not and will not be fully compensated under the schemes and remain more liable to layoffs once the safety nets are lifted. Expect a pick-up in consumption, but not a spending splurge on reopening.

Speed of recovery hangs on pace of vaccination

The speed of the 2021 economic recovery will remain heavily dependent on the pace of vaccinations. With the UK highly infectious variant now dominating in Italy, progresses on the vaccination front will be even more essential, particularly in view of the summer tourism season. For the time being, the arrival of new PM Draghi has not produced substantial changes to the process, notwithstanding changes to the two top officials in charge of it. A speedier vaccination is now officially a top priority, but even improved organisation of the vaccination infrastructure can do little if vaccine supply shortages continue. As we write, slightly less than 3% of population has received both jabs, and herd immunity is a distant prospect. At the current juncture, notwithstanding the industrial resilience, another contraction in 1Q21 GDP seems highly likely and the risk is that restrictions remain tougher than we hoped for over the first part of 2Q21.

Fully vaccinated (%) still too few to accelerate re-openings



Source: Refinitiv Datastream

Recovery plan more a medium-term growth story

The other key short-term priority for the Draghi government will be the finalisation of the Italian Recovery and Resilience Plan, to be submitted to the EU Commission before the end of April. In a recent parliamentary hearing, the new finance minister Daniele Franco said it will build on the last draft which will be strengthened in its strategic objectives and, crucially, in the reforms of justice and public administration, badly needed to ensure a proper implementation. That said, we expect the relevant boost to growth to kick in gradually, as the first €25bn tranche (out of a total of €191bn combining grants and loans) frontloaded over 2H21 will be likely be used to a good extent to finance existing projects, not incremental ones. A sound implementation of the

Italian RRP and the resulting structural increase in potential output would bear big potential medium-long term benefits both domestically and beyond national borders. Internally, it would make public debt more sustainable and the country more resilient to shocks; in the EU it would represent useful political capital with the idea of non-temporary burden sharing becoming less of a distant concept.

The Italian economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-8.9	3.3	3.4	2.1
Private consumption	-10.7	3.2	4.5	1.7
Investment	-9.2	7.9	3.3	3.6
Government consumption	1.6	2.9	1.2	0.6
Net trade contribution	-0.8	-0.6	-0.6	0.3
Headline CPI	-0.1	1.2	1.1	1.3
Unemployment rate (%)	9.1	9.6	10.1	9.9
Budget balance as a % of GDP	-9.5	-8.6	-6.5	-3.9
Government debt as a % of GDP	156	158	157.9	156

Source: Refinitiv Datastream, all forecasts ING estimates

The Netherlands: Preparing for lift-off

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The Dutch economy is forecast to grow by 2.4% in 2021, after a record decline in 2020. The year starts with a quarter of negative growth, but as social distancing measures are gradually phased out, the rebound should gain traction and be stronger than during the financial crisis



Dutch Prime Minister Mark Rutte gets his hair cut, Leidschendam, Netherlands

Record year for GDP despite surprisingly small end of year decline

Despite the fact that Dutch GDP hardly changed in 4Q20, shrinking only 0.1% quarter-on-quarter, 2020 will go down in history as the year with the largest post-WWII decline (-3.8%). While the Netherlands went into an arguably stricter lockdown in mid-December than in March 2020, with retail stores forced to close, the economic consequences so far have been much less profound. This can be explained by a number of factors:

- 1) Businesses adjusted their models (such as more restaurants switching to home deliveries) and got their distribution channels for online shopping in order. This has, for instance, boosted investment in transport equipment.
- 2) Consumers are more used to buying online, substituting service consumption for the purchase of goods.
- 3) There is less uncertainty. Vaccines have provided light at the end of the tunnel and fiscal support instruments are already in place, automatically fluctuating with a firm's turnover. This means higher investment than during the first lockdown.
- 4) Manufacturing is holding up well, facing fewer input supply restrictions from e.g. China and stronger foreign demand. The Netherlands is benefiting from the recovery of world trade. While service exports are still weak, goods exports are higher than the pre-Covid peak.

First quarter will take GDP down further temporarily

Despite the relatively benign experience in 4Q20, we nevertheless expect the first-quarter figure to be worse. In particular, household consumption is expected to come in with more negative growth, as is indicated by a fall in the value of ING's debit card, IDEAL and cash withdrawal transactions (the total amount spent by consumers, based

on their debit card, ATM withdrawals and online payments was 12% and 8% below normal in January and February, respectively) and in retail sales (-4% month-on-month in January).

“Don't be surprised if lockdowns are extended”

The lockdown will continue at least until the end of March and one should not be surprised if it is extended. In recent weeks, the extensions have often been accompanied by a piecemeal loosening of the social distancing measures. While the 9pm curfew and a maximum of one guest per day still hold, schools have reopened partially, most contact occupations (hairdressers, masseurs, driving instructors, etc.) have been allowed to operate again, shopping can be done via click-and-collect or by appointment, and sport is allowed for young people.

As of 31 March, bars and restaurants can serve guests on terraces and retail stores may get some more options to welcome back customers. Such a relaxation should translate into the beginning of a recovery in the second quarter, even though it will probably take more time for a full reopening of the economy. The government expects adults to have received their first Covid-19 vaccine injection only by 1 July, which suggests that much of the GDP rebound should happen in the second half of the year.

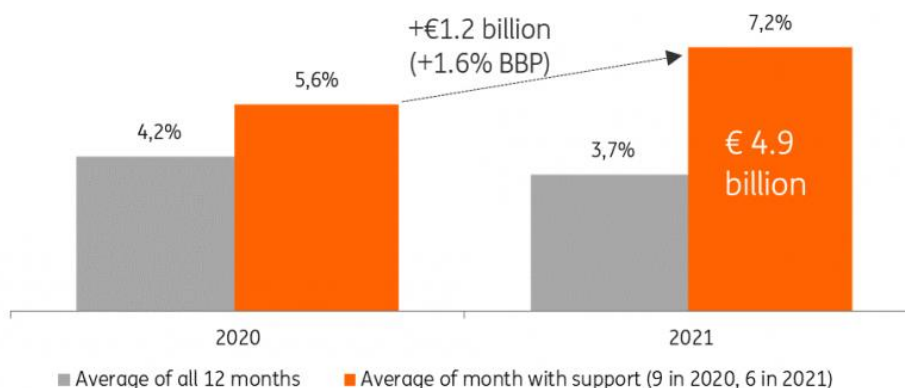
Stimulus even higher in the first half of 2021

The government maintains sizeable support for the economy in 2021. Even though projected public Covid expenditures are lower for the full year 2021 than in 2020, the average per month with support is higher. The intended phasing out of support (mainly wage subsidies and fix cost compensation) has been scratched for the first two quarters; support continues to fluctuate automatically with the turnover of firms. Furthermore, the government announced in mid-February a National Education Programme aimed at making up for the lost years of schooling during school closures, which implies a cumulative €8.5 billion (1% GDP) additional spending for the next 2.5 years.

Economic support expenditure

While public support for the economy is lower in 2021 than in 2020, the average per month with support is more generous

Net expenditure on economic support measures per month as ratio to GDP



Source: Rijksoverheid.nl, calculations ING Research

Fiscal policy of next government probably expansionary

There will be general elections for the House of Representatives on 17 March. The outcome will determine the direction of fiscal policies of the Dutch government. Our earlier analysis of the policy proposals and their effects shows that most political parties, both parties currently in the government and also parties in the opposition, are opting for further increases in public spending for the next term up to 2025.

The direction of taxation depends more on the political composition of the next coalition – a centre-left government would increase the tax burden while a centre-right government is likely to go for lower taxation – but generally, the direction of almost all parties is a loosening of the fiscal stance. So for the medium term, economic developments are expected to be supported. Although this would imply a shift of the fiscal burden to future generations, and hence a possible need for an upward revision to our public debt ratio projections, it is likely that public debt in the Netherlands will remain low by international standards.

Unemployment and insolvencies expected to rise

Despite ample support for the economy and the possibility of even more spending after elections, we currently still expect some negative repercussions of the earlier hit to the economy to play out. Most support measures will end in mid-2021, and this is when it will become more apparent which businesses are structurally viable. This should coincide with an increase of insolvencies and layoffs, but not to a level seen during the aftermath of the Global Financial, as the cause of the losses is more temporary in nature this time around. Still, policies are accommodative: a total of about €13 billion in tax deferrals need to be paid back by businesses, but they are allowed to spread the payment over no less than 36 months.

Preparing for lift-off

Given all the uncertainties that surround the Covid virus, risks to the projections remain large. But the rebound will happen, sooner or later, and since we have recently observed progress on the consumption side – the laggard among expenditures – we maintain our view that the Dutch economy could be back to the pre-coronavirus peak around the turn of 2022.

The Dutch economy in a nutshell (% YoY)

	2020	2021F	2022F	2023F
GDP	-3.8	2.4	3.3	1.6
Private consumption	-6.6	-0.3	5.0	1.6
Investment	-3.2	3.7	2.4	1.9
Government consumption	0.2	3.5	3.0	2.0
Net trade contribution (%-point)	-0.2	0.8	0.0	0.0
Headline CPI	1.3	1.9	1.5	1.5
Unemployment rate (%)	3.8	4.2	4.0	4.0
Budget balance (% of GDP)*	-5.8	-5.2	-1.4	-0.7
Government debt (% of GDP)*	56.2	59.4	57.9	57.1

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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Spain: Consumers and tourists to the rescue?

The worsening of the health situation at the beginning of 2021 will probably lead to a contraction of activity in the first quarter. But afterwards, we expect the economy to recover. The strength of it will depend on consumers and international tourists



Pedro Sánchez, Spain's Prime Minister

A bad start to the year

At the end of 2020, there were a number of reasons to be optimistic. But as 2021 started, the number of new infections began to rise sharply, from about 10,000 daily cases at the end of December to about 30,000 by mid-January. Things can change very quickly in a pandemic.

The government was forced to introduce new restrictions and some regions decided to close bars and restaurants and/or close non-essential shops. The measures, however, were implemented in a smarter way compared to the first wave. In Andalusia, for example, non-essential shops were required to close in locations with a Covid infection rate of over 1,000 per 100,000 people in the last 14 days.

“Things can change very quickly”

Luckily, the number of infections has come down since the peak in mid-January. The latest figures show about 5,500 daily new cases and some regions have recently announced a light relaxation of the containment measures. But the situation remains precarious. Rates remain high in a number of regions and there are already cases of the more infectious strain of coronavirus first detected in South Africa.

The outlook for the first quarter of 2021 is therefore still uncertain. For now, we think that the Spanish economy will contract by 0.8% quarter-on-quarter. Admittedly, the economy managed to grow marginally, by 0.4%, in the fourth quarter of 2020, but we think that the duration of the lockdown measures will take its toll.

Vaccinate, vaccinate, vaccinate...

According to the Spanish health ministry, over 85% of care home residents in Spain have received two doses of a Covid-19 vaccine, while another 11% have received one dose. So even though the vaccination programmes are running slower compared to the US or UK,

the strain on the Spanish health system should decline. Barring a fourth wave, this will allow the government to eliminate some of the confinement measures so the recovery can begin in the second quarter.

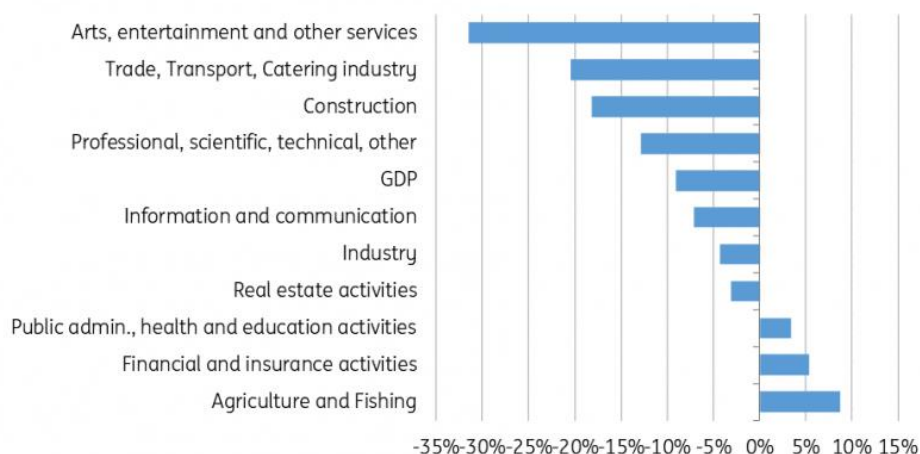
Pedro Sánchez, Spain's prime minister, recently said that he is confident of reaching the target of vaccinating 70% of the Spanish population by the end of the summer. This implies that restrictive measures will be a thing of the past in the fourth quarter.

What does this mean for the recovery?

The economy has a lot of ground to recover after the contraction of 11% in 2020. Looking at the various sectors, the 'Arts and entertainment' (4% of added value today), 'Trade, Transport, Catering industry' (20% of added value) and the construction sector (6% of added value) have been the hardest hit (see Figure). These three sectors are about 30% of added value.

This leads us to think that the consumer and international tourism will be crucial for the Spanish recovery, as the recovery of the 'Arts and entertainment' and 'Trade, Transport, Catering industry' largely depend on them.

Level of added value in 4Q 2020 compared 4Q 2019



Source: Refinitiv

As the lockdown measures are loosened we expect consumption to grow (by 7.7%, compared to -12.4% in 2020), but it will not go straight back to pre-Covid levels for two reasons. First, consumer optimism remains subdued, even though the vaccination programmes have started and there is light at the end of the tunnel. Second, even though the savings rate went up quite a bit in 2020, and so there is a buffer to consume, we think that an important part of the extra saving is precautionary. This will take time to unwind.

Concerning tourism activity, there is also a lot of uncertainty. A vaccination target of 70% of the total population by the end of the summer is too little too late for the tourism sector. But a vaccination passport could save the summer and Spain is pushing for such a passport at the European level. It remains uncertain whether such a passport will be introduced as it might seem unfair to those who want to get vaccinated, but aren't yet due to supply issues. In the meantime, Many Britons have already booked a holiday in Spain from May onwards when the international leisure travel ban will possibly be lifted. However, this remains uncertain and so these bookings might yet be cancelled.

We think the most likely scenario is that the economy will start to recover from the second quarter onwards. For 2021 and 2022, we expect growth to be around 5%, which would imply that the pre-crisis level of GDP is not reached before 2023.

The Spanish economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-11	5.4	5.6	2.0
Private consumption	-12.4	7.7	5.5	2.1
Investment	-13.5	1.2	8.2	2.4
Government consumption	4.5	4.9	1.5	1.5
Net trade contribution	-1.7	-0.3	0.6	0.1
Headline CPI	-0.3	1.3	1.5	1.7
Unemployment rate (%)	16	17	16	15
Budget balance as a % of GDP	-10.3	-6.5	-4.5	-3.0
Government debt as a % of GDP	117	116	113	112

Source: Refinitiv Datastream, all forecasts ING estimates

Greece: Hoping for vaccine availability

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The higher dependence on tourism makes faster vaccination crucial for Greece in view of the summer season. In the meantime, effective labour protection schemes should continue supporting income and backing consumption.

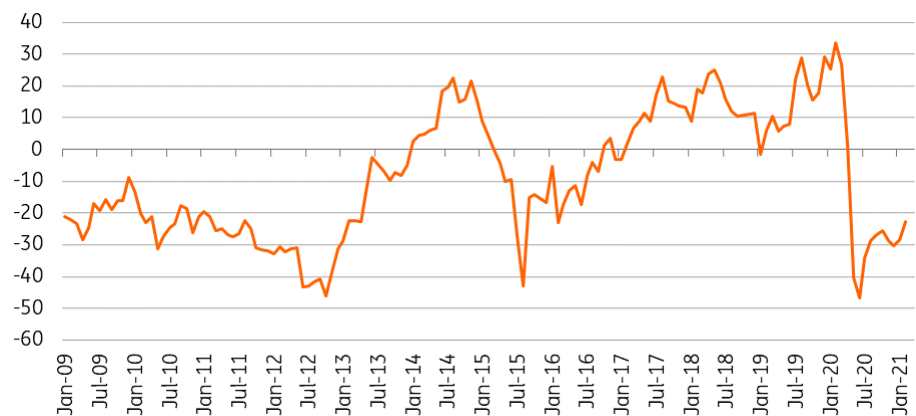


Greek Prime Minister Kyriakos Mitsotakis

GDP growth beat expectations in 2020

The impact of the Covid-19 pandemic on the Greek economy is turning out to be smaller than anticipated, with an average GDP contraction of 8.2% in 2020. Notwithstanding a higher dependence on tourism activities and a smaller role of resilient manufacturing in value added generation, Greece would have outperformed countries such as Italy and Spain. To be sure, Greece was hit by the pandemic with a slight delay, but the reported preliminary profile remains somewhat puzzling. In fact, the provisional 4Q20 GDP estimate, recently released by ELSTAT, shows an upward revision to the 3Q20 rebound (now 3.1% quarter-on-quarter) and, more importantly, a 2.7% QoQ expansion in 4Q20. The latter comes as a surprise, as such a strong rebound would have happened at a time when Greece entered lockdowns to suppress the virus. Looking into available details, it appears that this has to do with a 32% QoQ increase in exports of goods and services in the quarter, while private consumption contracted. We suspect that data revisions might materialise at a later stage.

Service confidence still battered by lockdowns

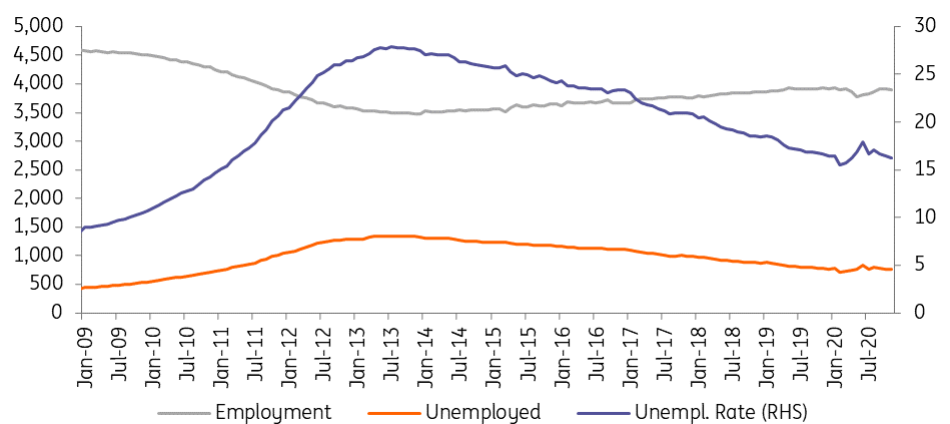


Source: Refinitiv Datastream

Labour support schemes to continue helping income

To be sure, the combined effect of labour support schemes and temporary ban on redundancies, managed to limit the impact on employment. Comparing November with January seasonally adjusted data, we note that the contraction in employment was contained at -0.9%. Also, over the same period there was no meaningful increase in the pool of inactives and the unemployment rate barely moved (at 16.2% in November). Lifting supporting measures will be a delicate exercise, which will likely start only when the pandemic emergency phase is over. With the new more infective variants becoming dominant, this does not look imminent, unfortunately. In the short-run, income-enhancing support measures should continue benefiting from a relatively benign inflation backdrop. The ongoing commodity-driven push will likely be tempered by remaining downward pressure on the tourism-related component, whose weight in the index is higher in Greece than in the eurozone aggregate.

Labour support schemes very effective so far



Source: Refinitiv Datastream

Speed of vaccination a key determinant of 2021 GDP growth

As elsewhere, in Greece the pace of the economic rebound of 2021 will heavily hinge on the speed of vaccination, which will set the boundaries for reopenings during the next tourist summer season. As we write, Greece has fully vaccinated (two jabs) 3.6% of the population and partially vaccinated (one jab) another 7.2%, which can be considered a good performance by European standards. Still, herd immunity lies far away as the country cannot escape the vaccine supply shortages that are hitting all European countries. Even assuming a marked acceleration of vaccination over 2Q21, we suspect that Greece will be forced to gradually lift social distancing measures over the next few

months, and that some will remain in place over the summer to protect the vital tourism season.

First tranche of RRF a positive for 2H21

The second half of 2021 has another potentially relevant growth enhancer: the inflow of funds from the EU Recovery and Resilience Facility (RRF). Greece is expected to take advantage of both the grant component (some €17.8bn, with possible downwards adjustments due to a stronger than expected 2020 GDP outcome) and the loan component (c. €12.6bn). The Greek government has stated that it wants to maximise the use of grants, using loans to finance high added-value private investment. Should the 13% pre-funding option be requested both for grants and loans, some €3.7bn would be available over 2H21.

The Greek economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-8.2	3.0	4.2	1.5
Private consumption	-4.7	2.5	2.2	1.0
Investment	0.3	5.0	4.8	4.0
Government consumption	2.6	3.4	2.5	1.0
Headline CPI	-1.3	-0.2	0.9	1.0

Source: Refinitiv Datastream, all forecasts ING estimates

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Belgium: The abnormal cycle

From an economic point of view, the Covid crisis is unlike any other. It has been very deep in terms of activity, but the labour market has shown great resilience. Despite some delayed effects on bankruptcies and employment, the conditions seem to be right for the economy to begin its recovery.



Belgian Prime Minister Alexander De Croo during a Facebook Live video session, regarding the COVID-19 measures

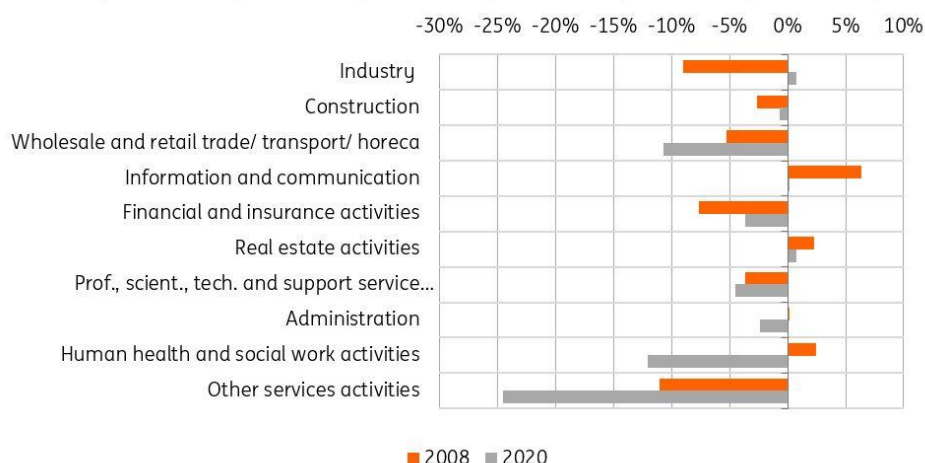
Uneven negative shock

With a slight decline in activity in the fourth quarter (-0.1%), it can be said that the Belgian economy has limited the economic damage despite the strong second wave of the pandemic. In the end, the Belgian GDP contracted by 6.2% in 2020.

On the demand side, household consumption paid the heaviest price for the crisis. At the end of last year, it was almost 10% below its pre-crisis level. The other components of demand are lagging less far behind. It is particularly noteworthy that after a strong rebound of 20% in the third quarter, productive investment continued its recovery in the fourth quarter (+4.6%), so that by the end of 2020, it only lags 3.6% behind its pre-crisis level. This makes the Covid crisis an atypical one: in a normal cycle, household consumption tends to resist rather well whereas business investment is one of the main drivers of any recession.

This specificity of the current crisis can obviously be found on the supply side. Four quarters after the peak of the cycle, the loss of activity due to the Covid crisis is still greater than the loss suffered during the financial crisis (which at the time was considered the worst crisis in the post-war period). But the sectoral decomposition of that loss is contrasted. In fact, the contraction of activity in 2020 is particularly marked in trade, transport, hotels and restaurants (-10.7% in the last quarter of 2020 compared to the pre-crisis level) and in the "other services" sector, which include culture, leisure and events (-24.6% over the same period). The other sectors of the economy seem to have resisted better, with industry even finishing the year with 0.7% more activity than before the crisis.

Value added gain(+) or loss (-) four quarters after the beginning of the financial crisis (2008) and the Covid crisis (2020) (in % of the peak of the cycle)



Source: National Bank of Belgium, ING

Labor market resilience

The evolution of employment is equally remarkable. After having lost 50,000 jobs during the first and second quarters of last year, the labour market has regained jobs: more than 7,000 in the third and more than 20,000 in the fourth, mainly in the scientific, technical and administrative support professions (+11,600 jobs in Q4) and the healthcare sector (+6,500 jobs). In the latter case, it is most likely linked to the preparation for the vaccination campaign. Notwithstanding the employment support measures (including temporary unemployment), this labour market resilience is surprising and bodes well for the recovery. Since the beginning of the crisis, total employment has contracted by 22,000. But compared to the economic shock, this is a very small correction: following the historical relationship between economic activity and employment, the Belgian economy should already have lost nearly 75,000 jobs!

Delayed effects would be limited?

However, we should not be naive. The effects of the crisis has up to now been masked by support measures, but it is also highly likely that they will be felt with a delay, paradoxically when the economy starts to recover and when the support measures come to an end. Beyond the sanitary situation, the strength of the economic recovery in 2021 will therefore depend heavily on the capacity of the economy to maintain the resilience observed so far. There are indications that this may be the case. On the one hand, we have seen that some key sectors of the economy (industry, construction, etc.) have already returned to their pre-crisis levels. This proves that there is not a general lack of demand in the economy. Bankruptcies and job losses in these key sectors should be limited.

On the other hand, the relatively small decline in household income during the crisis (thanks to support measures and small job losses) and the accumulation of savings should accelerate the recovery of household consumption when the economy reopens. Therefore, even if the sectors directly related to household consumption are currently the most affected, the recovery in these sectors will be stronger than usual, thus limiting the lagged effects of the past crisis. To be sure, there will probably be more bankruptcies and job losses in these sectors, but this will not be commensurate with the past crisis. By way of comparison, if the cumulative loss of activity since the beginning of the crisis is three times the loss incurred during the financial crisis, we expect an impact in terms of bankruptcies to that of the financial crisis, not more.

Public finances challenge

If the labour market and household income have shown resilience during the crisis, it is obviously due to the fact that the governments has supported the largest share of the cost of the crisis. As a consequence, the public deficit reached 10% of GDP in 2020, and the debt ratio increased by 17 points. In 2021, the economic recovery should automatically bring more revenue to the government, while expenditure should logically decrease. That said, the public deficit should remain significant this year, around 5.5% of GDP, or even more depending on the support measures that will be maintained and the stimulus measures that will be decided upon. As long as the ECB acts to maintain a reasonable financing cost and as long as the safeguard clause is in force, the situation of public finances is not a real problem. The whole question is therefore how and when European budgetary rules will evolve again, and until when the ECB is ready to keep financing costs artificially low. It is clear that putting public finances back on a stable track is in the long run one of the greatest challenges for the Belgian economy.

The Belgian economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-6.2	3.6	2.7	1.8
Private consumption	-8.2	4.4	4.5	1.6
Investment	-7.7	7.3	1.7	1.9
Government consumption	-0.6	1.7	3.0	2.0
Net trade contribution	-0.5	0.2	-0.5	0.2
Headline CPI	0.7	1.8	1.7	1.9
Unemployment rate (%)	5.6	7.0	7.2	6.8
Budget balance as a % of GDP	-10.1	-5.6	-4.1	-3.2
Government debt as a % of GDP	114.8	115.0	114.8	114.5

Source: Refinitiv Datastream, National Bank of Belgium, all forecasts ING estimates

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Austria: Walking a tightrope

Keeping Covid-19 cases under control whilst bringing the economy back on track will be a tough balancing act during the next few months. A loss of balance could easily trigger a long cycle of lockdowns and re-openings



Israeli Prime Minister Benjamin Netanyahu (L), along with Danish Prime Minister Mette Frederiksen (R) and Austrian Chancellor Sebastian Kurz (C) as they seek closer cooperation on Covid-19 and vaccines

The Austrian economy contracted by 2.7% quarter-on-quarter in 4Q20. As a result, the alpine country's economy contracted by 6.6% in the full year of 2020. The feared double-dip could not be avoided as the tourism sector has almost come to a standstill since last November.

“Looking ahead, keeping control over Covid-19 cases while simultaneously bringing the economy back on track will be similar to walking a tightrope.”

Since the easing of lockdown measures and the partial opening of the economy in February, Covid-19 cases are rising again. But according to chancellor Sebastian Kurz, lockdown measures have been eased because the wider population no longer supports them - and

Austria isn't alone, even though this increases the risk of new rounds of lockdowns in the long run.

As the vaccination programme progress at a slow pace in the EU, the Austrian government has allied with Denmark and Israel to develop and possibly produce a vaccine and secure supplies in the long run. At the time of writing, nine out of 100 people were at least partially vaccinated in Austria, so while the partnership with Denmark and Israel will be a stabiliser in the long run, more headwinds can be expected in the short-term.

According to Eurostat, the seasonally adjusted unemployment rate stood at 5.7%, which is 1.3 percentage points above the pre-pandemic level. While the increase in unemployment is relatively mild, it is much more significant in sectors most affected by lockdown measures. According to country data, unemployment in the tourism sector has doubled since last year. Additionally, this mainly hits female employment, as more women than men are employed in these sectors. However, the full impact of the crisis

on the labour market will only be visible when fiscal support measures, like short-time-work schemes, expire.

“Despite the headwinds in the short run, we expect the Austrian economy to grow by 2.4% in 2021”

Given that the economic recovery will take longer than expected and unemployment looks set to increase substantially in 2021, especially without further fiscal support, more labour market supporting measures will probably be

introduced in the second half of 2021. To further support Austrian businesses, large fiscal support packages were granted to both companies affected by lockdowns and companies which were neither directly nor indirectly affected by containment measures but generated revenue losses of at least 40 percent between November 2020 and June 2021.

But all of these support measures mean that Austria's government debt rate is estimated to increase to 87% of GDP in 2021 and 88% in 2022. Having said that, we think it is unlikely for austerity measures to come back to the fore before 2022, and the government has recently noted that higher growth should help to reduce the debt burden rather than more taxation.

Austria's short-term growth outlook is dependent on how the country manages the balancing act between reopening the economy and containing the pandemic.

In any case, a strong construction sector, exports and hopefully the return of tourists on the back of vaccines by the summer should bring the economy back on track in 2021. Despite the headwinds in the short run, we expect the Austrian economy to grow by 2.4% in 2021.

The Austrian economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-6.6	2.4	3.5	2.5
Private Consumption	-9.8	4.5	3.5	1.2
Investment	-4.9	3.1	2.8	2.3
Government Consumption	0.8	1.5	0.9	0.8
Net trade contribution	-1.3	0.5	0.7	0.6
Headline CPI	1.4	1.8	1.7	1.7
Unemployment rate (%)	5.3	5.5	4.9	4.5
Budget balance in % of GDP	-8.0	-5.5	-3.0	-1.5
Government debt in % of GDP	84.2	88.0	87.0	84.0

Source: Refinitiv Datastream, all forecasts ING estimates

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Portugal: A postponed recovery

An extension of the lockdown does not bode well for economic activity in the short run, but we still think that economic activity will pick up from the second quarter onwards. A lot, however, will depend on how consumers respond and whether international tourism ramps up



Portugal's Prime Minister Antonio Costa at the beginning of the vaccination against COVID-19 in health centers in Lisbon, Portugal

A terrible start

It was a terrible start to the year for Portugal. The number of new infections moved from about 3,000 at the beginning of January to more than 16,000 by the end of January. A new lockdown was inevitable and came into force on 15 January. Non-essential services were closed, remote work was made compulsory where possible and schools were shut. During February, the number of new infections came down and the latest figures show less than 600 daily new cases.

The current lockdown will last at least until mid-March and so this implies that the lockdown applied at least for two thirds of the first quarter. The Portuguese economy managed to avoid another contraction in the fourth quarter of 2020 (it grew by 0.2% quarter-on-quarter), while the number of infections rose. It is unlikely, however, that this will be repeated in the first quarter of 2021 given the harsher confinement measures. We think that the economy will contract by 1.5% quarter-on-quarter.

The impact of the second lockdown, in our view, will not be as strong as the first, as consumers and businesses have adapted to this new situation. Indeed, consumer and business confidence remains low, but was not impacted as strongly as during the first lockdown. Consumer confidence even rose in January and February. Obviously, retail sales dropped significantly in January due to the lockdown measures that were applied mid-month, but to a lesser extent than in March 2020, a month which also saw two weeks of lockdown. In January, retail trade turnover (seasonally and calendar adjusted) dropped by 4.8%, while it dropped by a whopping 12% in March 2020.

A recovery starting in the second quarter

From the second quarter onwards, we expect growth to pick up as the confinement measures will gradually be loosened. The strength of the recovery will largely depend on consumers and international tourists. For now, we think that consumption will recover in

2021 (+3.6% in 2021 compared to -6% in 2020), but it will not go straight to pre-Covid levels. Consumer confidence hasn't really edged higher since the vaccine news. And on top of that, we think that not all of the extra savings built up during 2020 will be spent in 2021 as consumers remain cautious.

“Recovery will not go straight to pre-Covid levels”

As for tourism, a lot will depend on the vaccination programme and the existence of a vaccine passport in Europe. Health minister Marta Temido recently said that Portugal aims

to reach herd immunity by some point in the summer, as the vaccination programme accelerates in the second quarter. This implies that the tourism sector will not have a normal summer season. A European vaccination passport could help and is supported by Portuguese authorities, but it is uncertain whether it will be introduced. Indeed, it might seem unfair to those who want to get vaccinated but aren't yet able due to supply issues. During the second half of the year, we expect public investment to grow on the back of the Next Generation EU fund.

We think the most likely scenario is that the economy will start to recover from the second quarter onwards. For 2021 and 2022, we expect growth to be around 4% and 4.5%, respectively, which would imply that the pre-crisis level of GDP is reached at the end of 2022.

The Portuguese economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-7.6	4.0	4.5	1.7
Private consumption	-6.0	4.7	5.8	1.7
Investment	-4.9	4.5	6.4	4.5
Government consumption	0.5	5.8	1.8	1.3
Net trade contribution	-2.3	-1.5	-0.8	-0.1
Headline CPI	-0.1	1.2	1.5	1.7
Unemployment rate (%)	7.0	8.5	8.0	7.0
Budget balance as a % of GDP	-7.2	-4.5	-3.5	-3.0
Government debt as a % of GDP	134	132	128	127

Source: Refinitiv Datastream, all forecasts ING estimates

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Ireland: Looks can be deceiving

Positive growth in 2020 masks underlying weakness in the economy, although Ireland does seem well-positioned to recover from the crisis compared to other eurozone economies



Irish Taoiseach Micheal Martin

That GDP is hardly a measure of how the Irish economy is performing is a well-known fact at this point, which is once more confirmed by the 3.4% growth rate for 2020. Yes, that is positive and comfortably higher than the Chinese 2.3% for example. This is thanks mainly to strong outflows of multinationals' profits and growth in the very globalised ICT and industry sectors. The modified domestic demand statistic that the Irish Central Statistics Office prefers as a measure for underlying domestic activity decreased by -5.4% in 2020. This is much more in line with economic contractions in other eurozone economies and better reflects the economic reality in Ireland at the moment.

A rough start to 2020

After a hard lockdown in 4Q, Ireland briefly reopened before being hit with a significant increase in cases at the start of January. This severe spread of the virus was met with another strict lockdown, lasting for most of 1Q. Some of the restrictions put in place in January have now been lifted, but most remain in place. This includes measures like the closure of non-essential construction and non-essential retail. These measures will now remain in place until 5 April, meaning that even the start of 2Q will be affected by the measures.

Another factor adding to this rough start to the year for the Irish economy is the end of the Brexit transition period. Stockpiling caused a surge in exports from Ireland to the UK in November, but the start of the year is expected to have been poor. With several checks yet to be phased in, disruptions could continue to plague Irish exports to their largest trade partner for a while to come. That makes it difficult to gauge the longer-term impact.

Upside for the rest of the year

In terms of vaccinations, Ireland has made an encouraging start and outpaces the EU average. At the time of writing, Our World in Data reports a 10% uptake of the first dose, compared to 8.7% for the EU average. Of course, Ireland is similarly bound by supply constraints like other EU countries, meaning that the pace of vaccinations will be limited by supply over the coming months. Once the economy reopens, there is a chance of a quick bounce back though as government subsidies continue to curb unemployment and boost household incomes. Savings have been running high, which bodes well for a rapid consumption recovery.

So while the start to the year is set to be severe once more, the base case scenario for Ireland is one of a relatively decent recovery for the latter part of the year. As vaccinations pick up and initial Brexit teething troubles fade, modified domestic demand should improve and start a more sustainable recovery.

The Irish economy in a nutshell (% YoY)

	2020	2021F	2022F	2023F
GDP	3.4	3.2	3.7	2.8
Private consumption	-9	11.4	7.4	3.1
Investment	-32.3	14.3	14.1	5.1
Government consumption	6.6	-0.1	-0.8	0
Net trade contribution	22	-4.5	-3.6	-0.5
Headline CPI	-0.5	1.5	1.5	1.7

Source: Macrobond, ING Research

Finland: A mild pandemic limits the damage

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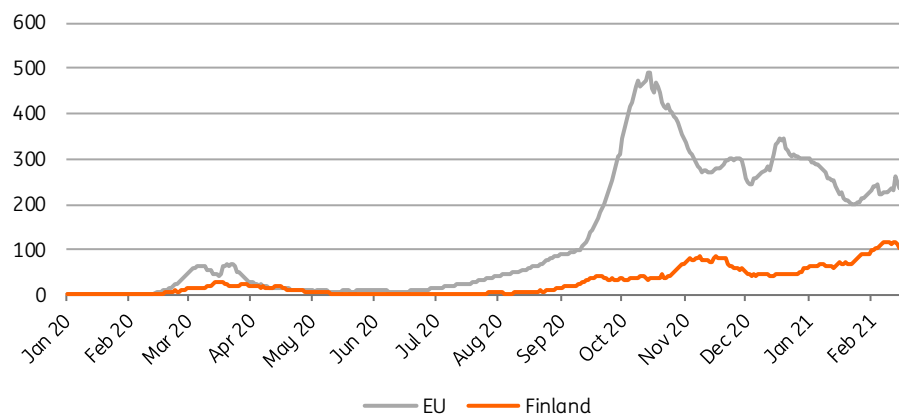
In comparison to the rest of the eurozone, Finland has experienced a very mild pandemic despite the recent rise in the number of Covid-19 cases. Thanks to government support, bankruptcies are at an all-time low and unemployment rose by just 1.5% and 4Q20 GDP was just -1.7% lower than in 4Q19



Finland's Prime Minister Sanna Marin

The number of cases as a percent of the total population in Finland has remained far below average rates seen in the eurozone, despite the new highs seen recently. But to put that into perspective, the latest data puts Finnish daily new cases at 115 per million, which is still considerably below-average levels in the EU.

A mild pandemic for Finland



Note: the chart shows new Covid-19 cases per million
Source: ING Research

Despite the relatively mild pandemic compared to other eurozone economies, measures have been firmed up to battle the second wave yet again.

On 1 March, the government declared a state of emergency, and all bars and restaurants were closed from 9 March until 28 March. Upper secondary schools have been instructed to homeschool in areas where the virus is spreading fast. These

measures are milder than the restrictions in neighbouring countries like Sweden and other larger eurozone economies but will surely weigh on the GDP outlook for the first quarter of the year.

So far though, the impact on the economy has been small compared to other countries. Fourth-quarter GDP for 2020 was just -1.7% lower than in 4Q19. For context, in the US, this was -2.4%, Sweden -2.1%, Germany -3.6% and the UK -7.8%. This sets Finland up well for recovery with relatively limited long-term damage.

“We expect Finland to recover to pre-pandemic levels of economic activity towards the end of 2021, which is much faster than the eurozone average”

With all-time low levels of bankruptcies, thanks to government support and unemployment that rose by just 1.5%, most of the uncertainty is around the withdrawal of government support. Government support has been quite significant, much larger than what has been

seen in Sweden and Denmark, but stimulus effects will fade rather quickly in 2021.

Cyclically adjusted net lending will decrease from -5.3 to -3.5% this year, which leaves the risk of increased economic damage when support is taken away too quickly.

In short, in comparison to many other countries, Finland seems much better geared up to limit the impact of the pandemic.

The Finnish economy in a nutshell (% YoY)

	2020	2021F	2022F	2023F
GDP	-2.9	3.8	3.5	1.5
Private consumption	-4.9	4.5	4.0	1.4
Investment	-2.8	4.4	4.1	2.2
Government consumption	0.3	0.1	-0.3	0.1
Net trade contribution	0.1	0.2	-0.4	-0.2
Headline CPI	0.5	1.7	1.4	1.5

Source: Macrobond, all forecasts ING estimates

Housing markets in the eurozone

While all eurozone economies saw major contractions in economic activity in 2020, the impact on residential real estate prices was diverse. Some countries saw growth slowing down while others saw it accelerate. Here is an overview of some key developments

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Germany: Prices set to increase further

House prices in Germany don't seem to be showing any signs of levelling off. The year-on-year change in the statistical office's house price index in 3Q20 reached 7.8% - its highest level since 2016 (8.4% in 4Q). The increase was driven mainly by existing house prices, fitting in nicely with monthly price data from home sales, which has only sporadically dipped below 10% YoY since mid-2019.

Existing houses driving the increase is an indication that hotspot cities with limited space for more construction are still the main force behind elevated prices. Speculation that the pandemic could slow down or even reverse house price growth has failed to materialise so far.

With record levels of savings, amassed mainly by affluent consumers, and low-interest rates, prices look set to increase further.

France: Property prices to rise by 1.5% to 2%

In 2020, the French residential property market remained buoyant despite the lockdowns and the 12-week ban on property visits.

Prices increased by 4 to 5% over the year, however, the momentum could slow down in 2021 as the delayed effects of the crisis are felt, particularly on the labour market and household purchasing power. The tightening of macroprudential rules could also limit price increases.

At the same time, the supply of new housing is likely to be under pressure as a result of the construction sector closing down during the first lockdown and the fall in productivity in 2020. This is likely to put pressure on new house prices, especially as new environmental regulations come into force this year and increase construction costs.

We expect property prices to rise this year, but less than they did in 2020, by around 1.5% to 2%. We also expect less dynamism in large cities than in medium-sized cities, as has been the case since the end of 2020.

Italy: Marginal contraction in 2021

The pandemic and the 8.9% GDP contraction has had a limited impact on the Italian housing market in 2020.

During the first wave, the introduction of labour market support schemes helped support disposable income while banks, helped by state guarantees on part of their new assets, did not tighten credit standards. Despite transactions shrinking rapidly, house prices proved resilient for most of the year and increased on average by 1.5% over 2020.

“Overall we expect a marginal contraction in average prices over 2021”

The protraction of labour market support schemes and redundancy ban should continue to provide support in 2021, but their potential end over the second half of the year might increase prudence. The scope of a rebound in transactions and prices over the course of the year heavily depends on the vaccination programme.

Overall, we expect a marginal contraction in average prices over 2021.

Spain: Price growth to moderate in 2021

House price growth cooled significantly in 2020. According to the house price index of Eurostat, house prices grew by 2% in 2020, compared to 5% in 2019 and 7% in 2018.

Given the difficult economic situation ahead, we expect price growth to moderate in 2021 but we don't expect a sharp contraction. Compared to the financial and eurozone crisis (when prices dropped by 35% between 2007 and 2014), the impact of this recession on Spanish residential real estate looks minor. But having said that, market foundations are much stronger than they were back then.

At the beginning of 2020, the financial situation of households and companies in the sector was healthier than in 2008. There was also no construction boom in the years before Covid-19, as was the case before the financial crisis. On top of that, mortgage rates are expected to remain low. One issue that could lead to more downward pressure is Brexit.

From 2021 onwards, Britons are only allowed to stay in the EU without a visa for 90 days within a 180-day period, leading to lower demand for Spanish houses by Britons. Still, it could also lead to more homes owned by Britons coming to the market, especially in Costa del Sol and Costa Blanca.

The Netherlands: Housing market to cool in 2021

Despite the strong year for the Dutch housing market in 2020, uncertainty remains exceptionally high due to the pandemic.

Further interest rate decreases, increased activity by investors and confidence in the housing market explain why prices in 2020 on average increased by 7.8% (2019: +6.9%). The number of existing homes sold increased to 236,000 (2019: 219,000). Although the tightening of the housing market increased, the housing shortage (the difference between the size of the housing stock and the number of potential households) declined by approximately 30,000 homes in 2020, out of a total shortage of 330,000 homes.

This is mainly due to the lower inflow of foreign labour migrants. As a result, household growth stalled around 44,000 (-40% compared to 2019), while growth of the housing

stock amounted to 75,000. A further decline of this shortage may lower housing demand in 2021. This is one of the main reasons why we assume a cooling down of the housing market in 2021, with an average price increase of 5.0% and home sales down 10% compared to 2020. The surrounding uncertainty, however, is higher than normal. The pace of economic recovery, level of confidence and path of interest rates will largely determine the impact of the crisis on the housing market in 2021.

Belgium: Downward pressure on yields

At the beginning of 2020, some dark clouds were emerging over the Belgian real estate market: The economic outlook at the time was not great, the National Bank of Belgium estimated that Belgian houses were overvalued, an important tax break was scrapped in Flanders and new restrictions were introduced for mortgages. And then the Covid-19 pandemic caused damage all over the world. But while the Belgian economy contracted sharply, residential real estate prices proved to be resilient.

In fact, price growth accelerated to about 5%, from 4% in 2019. The income support provided by the government, low mortgage rates, active investors and a higher willingness to pay can explain this. For 2021 and 2022, we expect house price growth to cool down to 3% and 2%, respectively. We expect the unemployment rate to increase as government support measures are phased out. We also think that investors will be less active as it becomes more difficult to achieve an attractive yield. Indeed, higher house prices coupled with weaker income growth that make asking higher rents more difficult puts downward pressure on yields.

Portugal: House price to cool down in coming quarters

Since 2016 house price growth was very dynamic. Indeed, house prices grew by 39% between 2016 and 2019 (based on the house price index of Eurostat) on the back of a good economic performance and foreign interest in Portuguese real estate. House price growth cooled down from 10% YoY in the first quarter of 2020 to about 7% in the third quarter. The Covid-19 crisis obviously makes it more difficult for foreigners to buy Portuguese real estate.

We expect that house prices will cool further in the coming quarters due to the difficult economic times ahead, but we do not expect a major price correction. First, low supply coupled with higher demand will continue to be a feature of the market. Second, the suspension of loan repayments is extended from March 2021 to September 2021 and so this will limit the downward pressures. Third, when compared to other European countries, Portuguese real estate remains competitive.

Austria: Real estate price to rise in rural areas

In Austria, the residential real estate market continued to grow as demand for detached houses, as well as houses with a garden or terrace, increased. In 2020, house prices increased by about 11.6% YoY.

Looking ahead, we expect real estate prices to rise especially in rural areas, as the demand for detached houses and dwellings including a garden already increased during the last year.

However, affordability is expected to decrease, as strong increases in income are not expected for the time being and financing conditions may worsen, due to stricter lending criteria. [According to the OeNB's Financial Stability Report](#), terms and conditions for loans to households for house purchases continued to tighten during the fourth quarter of 2020.

Greece: Expect house price inflation to fall

The Greek housing market entered 2020 while still benefiting from previous reductions in ANFIA property and of tax incentives for non-EU house purchasers. Also, Greece was hit

by Covid with a delay with respect to the rest of the eurozone, leaving 1Q20 little affected by the economic shock. The safety net deployed for workers by the government in the form of short term work and a temporary redundancy ban also helped support household disposable income. All this should have allowed house prices to grow at a very respectable 4% YoY clip over 2020.

However, the housing inflation profile declined, which might continue over 1H21, as pandemic uncertainty continues with the new variants. As elsewhere, the success of vaccination will be critical to determining the economic exit speed, but might not work its magic before 4Q21. We expect that Greece will manage to avoid seeing house prices contract again in 2021, but anticipate that average yearly house price inflation will fall nonetheless to the 1.2% area.

Ireland: Supply shortage driving prices higher

The Irish housing market continued to perform well in 2020 despite the pandemic. Price growth, which had been on a declining trend since 2018, saw a pickup in 4Q 2020 to a modest 0.6% YoY. Household incomes, propped up by government support, increased over the first three quarters of the year, which provided significant support to the housing market. For next year, price growth seems set to continue as supply shortages remain a large theme in the Irish housing market.

Finland: Housing market outlook remains positive

The Finnish housing market has seen price growth accelerate for one-family houses. The pace picked up to a strong 5.4% in the final quarter of 2020, which is the fastest growth seen since 2011. That comes on the back of positive household disposable income growth, increased savings and low-interest rates. The outlook is helped by expectations of a quick economic recovery to pre-pandemic levels. Downside risks like unemployment trending somewhat higher due to withdrawal of government support, and higher interest rates do dampen the outlook somewhat though.

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