Global Macro Outlook
The darkness before the dawn

What a year! As this wild and turbulent year draws to a close, we look back in our Global Macro Outlook 2021, and focus on what to expect beyond lockdowns, the virus and the vaccine. We hope you will enjoy our analysis as we move into a year, which as far as we are concerned, could definitely do with somewhat less excitement than 2020
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Global Macro Outlook 2021: The darkness before the dawn

What a year! Who still remembers the start of 2020, when the global economy was discussing the eurozone’s Japanification, trade wars and how to revive or extend the very mature economic cycle? In January, Covid-19 was just a regional virus, and none of us thought it could end up becoming the driver of such turbulent year.

As the wild year slowly but surely draws to a close we look back on 2020, and see a global economy which had entered the pandemic on a much weaker footing than most previous economic crises and ended up in the most severe economic slump in almost a century.

Next to the economic fallout of the crisis, 2020 has also been a postmark for other remarkable developments. Just think of the end of austerity-dominated fiscal policies in the eurozone, unprecedented forms of European solidarity, Donald Trump becoming the fourth US president since the second world war who (presumably) didn’t win a second term, or the Asian-Pacific trade agreement, creating the world’s largest trading bloc without either the US or Europe. In any case, it has been a very remarkable year in all aspects.

Looking ahead, finally, we can spot some silver linings. Research breakthroughs on a vaccine against Covid-19 are now being announced by the week. First, it was the Pfizer/BioNTech vaccine, a week later Moderna released news about moving into the phase 2 of the FDA’s clinical trial. With any kind of vaccine being rolled out in the first half of 2021, hope is that most economies can return to a new normal. If the next US administration really takes a more cooperative approach to global trade too, risks to the economic outlook could finally, and for the first time in months, be tilted to the upside.

However, for many European countries and probably also the US, things will first get worse before they get better. The winter months will be characterised by more severe lockdowns, requiring a lot of stamina from people and also more fiscal and monetary support from governments and central banks.

Although, a low probability scenario, don’t rule out a combination of remaining risk factors such as: a delay in rolling out the vaccine due to unexpected side effects, a delay in the start of the European Recovery fund due to vetoes by Hungary and Poland, a more disruptive “no-trade deal” Brexit than anticipated, or unexpected political tensions in the US.

As much as we would like to, in the words of Monty Python, ‘look on the bright side, don’t grumble give a whistle’, the truth is that potential risk factors are still out there. Some would argue, they always are.

In our Global Macro Outlook 2021, we focus on what to expect beyond lockdowns, the virus and the vaccine. Our traditional forecasts and expectations can be found here. It is not always a look on the bright side but rather an forecasts and expectations analysis of what to expect from 2021. If you want, there is more on our special 2021 hub here, including broad country coverage.

We hope that you will enjoy our analysis as we move into 2021. A year, which as far as we are concerned, could definitely do with somewhat less excitement than 2020.
ING’s scenarios for Covid-19 and the global outlook

**Phase 1: Covid-19 spread before vaccine**

**Scenario A**
- **United States**: Modest restrictions in some hotspots as hospitalisations rise, but differ between states. Focus on limiting spread rather than closing businesses.
- **Europe**: Lockdowns succeed. Case growth falls, economies reopen quickly after short-lived lockdowns. Rapid testing capability and more controllable virus growth allows contact tracing to work more effectively until a vaccine arrives.
- **Asia**: Case numbers remain low or very low by international standards, and typically falling. Social distancing restrictions remain tight, but slowly easing, including international travel bubbles.

**Scenario B**
- **United States**: US follows Europe into tighter restrictions in a majority of states. Construction and manufacturing open, but hospitality heavily impacted.
- **Europe**: Tight restrictions remain until close to Christmas. Retail and some hospitality reopens or stay open but rules on household mixing remain stricter than before. Fears of more circuit breakers remain. Vaccine will be rolled out in H1 21.
- **Asia**: Repeated but isolated clusters dealt with by regional test, trace and isolation measures and brought swiftly under control, though no easing in overall distancing conditions.

**Scenario C**
- **Europe**: Lockdowns persist into 2021 or get stricter in the case of light lockdowns. Case growth takes much longer to slow than in April/May. Retail reopens/stays open but strict rules on household mixing largely prevents hospitality and tourism restarting until spring.
- **Asia**: Asia follows the rest of the world into a second or in some cases third wave and national measures re-imposed to squeeze out the virus. International travel bubbles closed.

**Phase 2: Vaccine development and roll-out**

**Vaccine Scenario I**
- **United States**: ING Base – Moving towards B from A
- **Europe**: ING Base
- **Asia**: Case numbers remain low or very low by international standards, and typically falling. Social distancing restrictions remain tight, but slowly easing, including international travel bubbles.

**Vaccine Scenario II**
- **United States**: US follows Europe into tighter restrictions in a majority of states. Construction and manufacturing open, but hospitality heavily impacted.
- **Europe**: Tight restrictions remain until close to Christmas. Retail and some hospitality reopens or stay open but rules on household mixing remain stricter than before. Fears of more circuit breakers remain. Vaccine will be rolled out in H1 21.
- **Asia**: Repeated but isolated clusters dealt with by regional test, trace and isolation measures and brought swiftly under control, though no easing in overall distancing conditions.

**Vaccine Scenario III**
- **Europe**: Lockdowns persist into 2021 or get stricter in the case of light lockdowns. Case growth takes much longer to slow than in April/May. Retail reopens/stays open but strict rules on household mixing largely prevents hospitality and tourism restarting until spring.
- **Asia**: Asia follows the rest of the world into a second or in some cases third wave and national measures re-imposed to squeeze out the virus. International travel bubbles closed.

**Vaccine timeline**
- **Several vaccines viable. Roll-out begins in 2021. First approvals in late-2020, but sufficient rollout not achieved much before summer 2021. Social distancing measures fully- unwound from 2H21.**
- **Handful of vaccines viable. Differential roll-out in 2021 across economies. Countries higher-up the orders list of successful vaccines see earlier roll-out and quicker emergence from social distancing rules.**
- **Vaccine development takes longer. Disappointing phase III trials mean no vaccine candidate emerges until later in 2021. Intermittent lockdowns and social distancing continue until 2022 or later.**

**ING forecasts under each different scenario combinations**

**Combination A**
- **Vaccine Scenario I**
- **Forecasts**
  - US: 4.6%  Eurozone: 6.1%

**Combination B**
- **Vaccine Scenario II**
- **Forecasts**
  - US: 3.6%  Eurozone: 3.5%

**Combination C**
- **Vaccine Scenario III**
- **Forecasts**
  - US: -1.1%  Eurozone: -0.5%

Source: ING
Back in the red

Recent newsflow on the efficacy of Covid-19 vaccines has undoubtedly come as welcome news, but we know that an inoculation programme remains several months away. With the number of cases rising rapidly and healthcare systems facing increasing challenges there is the very real prospect of individual states having to reintroduce containment measures.

As in Europe, we suspect that manufacturing, construction and most retail will remain open, but restrictions on other sectors will still come at a huge economic cost with millions of jobs potentially at risk. Adding to the problems, this comes at a time when millions of households are already experiencing cuts to their incomes as state unemployment benefits expire and Federal government support becomes more limited. The key question is how will politicians respond?

Given Donald Trump’s legal challenges to the election and claims of fraud, we sense that political animosity could delay or limit a government response, potentially deepening an economic crisis. The Federal Reserve may feel the need to respond, with more stimulus to try and shore up confidence. Either way, we fear the December-January period will be tough on both a human and an economic level with a probable negative GDP print for the first quarter.
US Covid-19 cases following Europe’s surge

But the turn is coming

However, as a vaccine programme starts to be rolled out – we assume it starts fairly early in the year following regulatory approval – this can give a huge lift to both consumer and business sentiment. The prospect of a return to normality, with people willing and able to get a flight, go to the cinema and meet with friends in a bar, could propel growth massively. As we have repeatedly noted, it is higher income households that have been holding back the recovery in consumer spending since they spend so much more of their income on experiences—something they haven’t been able to do due to Covid-19 restrictions.

Assuming a smooth transition to a Joe Biden presidency, the rebound could be further fuelled by a substantial fiscal stimulus. The 5 January runoff for the two Senate seats in Georgia will determine how ambitious he can be. The Democrats would need to defeat both incumbent Republican Senators to regain control and this looks challenging. Even if they don’t pull it off, we still assume a package of around $1 trillion is possible, equivalent to just under 5% of GDP.

This would be focused initially on low income households and hard-pressed state and local governments, but is also likely to leave a large chunk of money for investment projects. The $2 trillion proposed for Green Energy projects is on the table, but that runs the risk of being curtailed or delayed because of the challenges of getting it through the Senate. Tax hikes are also on the agenda, but we suspect they will be delayed until 2022/23 as next year is all about growth and recouping the 10 million jobs that are still to be regained.

With the Federal Reserve set to leave monetary policy ultra-loose for the next couple of years and Biden likely reverting to a more predictable, multilateral approach to international relations this can give businesses the confidence to put money to work through investment and hiring workers.
Jobs market remains much weaker than February

Could it be too good

One increasingly plausible scenario is that inflation expectations start to rise, and the yield curve steepens more sharply as market pricing for Federal Reserve interest rate increases are brought forward.

After all, the pandemic has caused major structural changes to parts of the economy and there is the possibility that robust demand, coupled with supply constraints, leads to rising inflation numbers. For example many entertainment venues, bars and restaurants have gone out of businesses while airlines, car hire firms and hotel chains have cut back dramatically on capacity. A global recovery may put upward pressure on fuel prices, adding to the sense that inflation will move higher.

Of course, we continue to argue that the US is largely a service sector economy and weak wage growth in an environment of high unemployment will act as an offset. Nonetheless, we wouldn’t be surprised to hear the Fed gradually shift its language to indicate that it may not be as late as 2024 before they consider raising interest rates.
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.

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.
The digital economy is weaker in the Eurozone’s periphery, but EU funds could help

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. Sounds 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 lockdowns should trigger additional stimulus.

Add to that the likely losses on the governments’ guaranteed loans, it becomes clear that budget deficits will still be above 6% of GDP in 2021 after close to 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?

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’.

Source: Eurostat
China in 2021: Quantifying quality growth

In its fourteenth five year plan, China has outlined a vision for achieving high-quality growth. Here’s what it means in practice

To be an advanced economy means a lot for China

We’ve already written extensively about China’s 2021 goals here. The vision for 2035 provides a little more quantification. China wants an “advanced economy” in fifteen years’ time. There is no specific definition of this. But we can make some estimates.

Using the latest World Bank data, China’s GDP per capita is US$10.6 thousand. That compares to US$18 thousand for Greece. The UK, France and Japan are all about $39 thousand. While Germany is US$45 thousand, and the US is US$63 thousand. That shows where China stands relative to most advanced/developed economies.

From this standpoint, China’s objective in terms of GDP per capita would be to at least double within the next 15 years. And that is an aggressive target.

To realize this vision, China must pursue two main strategies

1) Become self-reliant in technology;

2) Export green products, such as vehicles, renewable energy technologies and so on, areas where it’s starting to have a technological advantage.

Achieving these objectives would help China sustain continuous income growth, as well as speeding up the engine of “domestic circulation”, creating more jobs from domestic consumption of goods and services.

While this may sound simple, it will be quite a challenge. China has relied on exports of technology for more than ten years. Although these were predominantly basic products using elementary technological inputs, they provided more than a third of China’s export value. This has been changed by the technology war. China has responded by promoting a new export area, “green” exports. As more countries set Environment and Social Governance (ESG) targets, they need renewable energy, waste management, and
water management systems, which China has been developing and can now export, and which will face far less resistance from other economies.

Our simple growth projection for the next 15 years is as follows: There will be faster growth in the first five years, but then slow gradually in the remaining years up to 2035. This projection assumes a roughly stable population. Promoting higher child-birth has been successful in some areas in China. But this policy also faces an ageing population and won’t make much difference to the labour force over this timescale. Our projected real GDP growth rate is 4.5% on average for 2021-2035.

**Growth in 2021 should be much stronger than this at around 7%**.

![GDP Growth Chart](chart.png)

Projection of GDP according to the 2035 envision to become an advanced economy by 2035.
Source: CEIC, ING

**Technology war is still the number one risk in 2021**

The biggest risk factor in 2021 is still the technology war, which we have incorporated into our forecast. This is not just confined to the US and China. Many more economies could become reluctant to use Chinese-made technology because of security concerns.

**Interest and exchange rate reform is both risk and opportunity**

We don’t expect any significant changes in monetary policy in 2021. The People’s Bank of China (PBoC) will take advantage of the stable interest rate environment, to promote market-based interest rate instruments on loan products to pave the way for further interest rate liberalisation.

The PBoC will do the same for exchange rate liberalisation. The recent fading out of the counter-cyclical factor in daily USDCNY fixing is a step in this direction. USDCNY and USDCNH will be more sensitive to intraday market information. And the CNY trend will also be more market-driven. We expect USDCNY to reach 6.30 by end of 2021.
UK in 2021: Another year of tough decisions

The end of the post-Brexit transition period poses a fresh challenge for the economic recovery, although we’re unlikely to see a Covid-style GDP collapse. Instead, the timing and way in which government support for jobs and businesses is unwound could have a bigger bearing on how far the UK economy recovers through 2021.

Three main themes for 2021

1. Brexit to add pressure to the jobs market, but it’s unlikely to trigger a Covid-style GDP collapse in early-2021. We expect GDP to rise by roughly 4.5% in 2021, but this is mainly a reflection of the sharper and more-prolonged lockdown in 1H20.

2. Unemployment set to rise further, potentially to high-single-digits if government support schemes are unwound before social distancing rules are meaningfully eased.

3. Bank of England to steer clear of negative rates, although it’s a close call.

2020 has been a comparatively bad year for the UK economy. Not only are Covid-19 mortality figures worse than many other developed economies, but the longer lockdown has also resulted in a slower recovery. And while subsequently reversed, the initial decision to end wage support earlier than many other European governments means unemployment is likely to have risen further over the course of the year.

Prospects for a vaccine and mass-testing means that, on paper, 2021 should be a better year for the UK economy. But given the risks surrounding Brexit, and the uncertainty of how government support will be unwound means the economy is unlikely to return to pre-virus levels next year.

Brexit to add unemployment pressure, but not like Covid-19

At the time of writing, we still don’t know whether the UK and EU will be able to sign-off a free-trade agreement before the end of 2020. But what we do know is that, compared to the current position of single market and customs union membership, all roads lead to a sharp change in trade-terms at the start of 2021.
With Covid-19 restrictions likely to remain relatively tight both in the UK and across the channel in January, the timing arguably couldn’t be worse. England will still be emerging from lockdown, which we expect to hit UK-wide GDP by 6-7% in November.

The hope is that assuming there is a deal, both sides will be able to agree on some sideline measures to help reduce the scale of the early disruption - mitigations to ease the congestion at ports from day one, alongside EU decisions on financial services equivalence and data-adequacy, among other things.

Even so, some initial disruption is to be expected, but importantly this is unlikely to trigger a Covid-19 style GDP hit early next year. In fact, barring another lockdown later in the winter, the first quarter will almost certainly record a positive growth figure, reflecting the technical bounce-back from the current shutdowns.

Instead, the impact may show through more clearly in the jobs market. The costs of new customs processes will put pressure on industries so far unscathed by the pandemic (eg agriculture). For other sectors, those already hit-hard by Covid-19 (eg carmakers), the new cost burden is likely to compound the damage already done by the pandemic.

**UK still set to underperform Europe and US**

![Graph showing real GDP level forecasts](chart)

Source: ING

Unwinding government support could bring new challenges

An equally, if not more important, question for 2021 is how the government will extricate itself from the unprecedented support it has offered the economy through 2020.

Take the furlough scheme, which helps to pay workers 80% of their normal salaries. The policy, which was originally set to be replaced by a less generous scheme from the start of November, has been extended to March given the return to lockdown. That will undoubtedly help limit the rise in unemployment, although admittedly the policy announcement will have come a little too late to save some jobs.

Further extensions to this policy are possible, but at some point in 2021, the government faces the tough decision over how and when to unwind this, and other similar crisis policies. At stake are potentially around 1.7 million jobs (roughly 6% of employees) - the number of people we estimate were still ‘fully furloughed’ in October before the latest restrictions came in. Many of these jobs will be in sectors that were never allowed to fully reopen after the first lockdown.

If social distancing rules are still a heavy feature when the furlough scheme is scaled back, then potentially we could still see the unemployment rate rise into the high single
digits at some point in 2021, as redundancies build in sectors that are still heavily constrained by Covid-19 rules.

3 **Negative rates still far from guaranteed**

Elsewhere, the Bank of England also faces a tough decision in 2021, when the debate on negative interest rates is likely to come to a head.

We think policymakers will more likely avoid rate cuts if they can next year, focusing instead on quantitative easing, but it’s a close call. You can read more about this debate in our 2021 outlook for central banks.
Asia in 2021: Ascendant

Fiscal and monetary policymakers have ripped up the rule book in Asia this year to battle the pandemic, but the strength of the recovery in 2021 will depend on how much Asian central banks push the boundaries in terms of unorthodox monetary policies, the nature of fiscal support rather than just the amount and the momentum for the semiconductor industry.

Three main themes for Asia in 2021

Three issues most likely to dominate the outlook for Asia in 2021, excluding China are:

1. The development of the semiconductor cycle
2. The effectiveness of Covid-19 support measures
3. Central banks drift towards unorthodox monetary policies

Semiconductor upcycle

Recent export and industrial production releases around the region have shown recovery from the depths of the pandemic. But the recovery has been uneven. Most industries are still struggling. The big exception to this is semiconductors and select electronic components.

This is of especial importance to the region’s semiconductor giants - South Korea and Taiwan. But there are few countries in Asia that are not tightly linked into the semiconductors cycle. Increasingly Vietnam, Thailand and Malaysia have been taking market share from China in this sector, attracting new inward foreign direct investment as well as some relocations from China. Indonesia and India are the two least affected economies and will likely miss out on any upturn.
Global Macro Outlook  
November 2020

Gains of electronics market share from China

While the momentum for the semiconductor industry is currently strong, this is a notoriously fickle sector, prone to overinvestment and excess capacity, price plunges as well as gains. With relations between the US and China over technology hanging in the balance, backing a continued technology upswing is not without risks.

On the other hand, China’s push towards “new infra” and roll out of 5G could well provide a multi-year push for the sector, which would provide all of Asia with a considerable boost.

2 Effectiveness of fiscal support
The outlook for 2021 will be heavily tempered by how the pandemic evolves, possibility of a vaccine and potential return to more normal work and leisure practices.

But the difference between solid recoveries for some, and tepid and erratic recoveries for others, might be the scale and effectiveness of fiscal support measures put in place in 2020. All countries in Asia have provided considerable fiscal support measures, though there has been a considerable exaggeration of the scale of support in many instances, making a reliable comparison impossible.

What 2021 will show, is the effectiveness of these efforts in three important areas:
Protecting the business sector, and maintaining the productive capacity of the economy
Providing the same support/insurance, for the labour force
Longer-term reform measures undertaken in some economies

While there is probably some overlap between the amounts set aside for fiscal spending and the strength of the recovery in 2021, the nature of that spending may well prove as important as the amounts.

3 Unorthodox central bank policies in Asia
As well as ripping up the rule books on fiscal policy during the crisis, monetary policy has also come under assault from central banks running out of traditional support tools.

The assumption has always been that emerging market economies would not be “allowed” negative real interest rates, and if so then certainly not quantitative easing and definitely not direct deficit financing.

But while fiscal policy easing has been less constrained during the pandemic, emerging market economies have still had to pay heed to the mood of rating agencies, and that has meant preserving some vestige of fiscal respectability, some have been pushed towards more monetary easing.
Asian central banks’ conventional and unconventional policy easing during Covid-19 crisis

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* Cash Reserve Ratio/Statutory Liquidity Ratio  
** Asset-backed securities  
*** The Bank of Thailand has set up the Corporate Bond Stabilization Fund (BSF) to provide liquidity support and stabilize the corporate bond market as well as maintain overall financial stability.

Source: Newswires, ING

With negative real rates seemingly posing few problems, some governments have been emboldened to supplement their fiscal constraints with more imaginative monetary support – namely thinly-veiled direct deficit financing, or quasi-quantitative easing.

A number of economies have dabbled in this area, including South Korea, with their “Korean style” QE, and the Philippines, with some outright bond purchases in secondary markets. But perhaps most blatantly of all, Indonesia’s central bank, is engaged in small-scale (currently) direct primary market financing “burden-sharing”, and the independence of the Bank is also being watered down.
Asia Pacific – unorthodox policy by country

**Philippine central bank**

BSP unloaded a hefty monetary response with a flurry of conventional easing – 175bp of rate cuts and 200bp reduction in reserve requirements. As a result, PHP 1.5 trillion was released into the system.

**Indonesia central bank**

Bi has carried out its fair share of conventional easing, with rates slashed by 100bp and reserve requirements reduced for both dollar and specific IDR-denominated accounts in first quarter. But Indonesia is constrained by a vulnerable currency – the rupiah.

**Reserve Bank of India**

India’s central bank action has been a mix of both conventional and unconventional measures. The RBI cut policy interest rates by a total of 115bp and banks’ cash reserve ratio by 100bp from March to May.

**Bank of Korea**

The Bank of Korea kept in to help with a quick 50bp rate cut in March followed by another 25bp of easing in May. This is still where policy rates stand today, at 0.50% – still above zero, and indicating some slight additional room for further orthodox easing should it be required.

**Quantitative Easing**

**FULL** - The central bank has bought up government securities with no volume limits or target tenors. To date, we estimate, it has bought up roughly PHP 1.1 trillion worth of bonds & given the heft of their holdings relative to the outstanding total (20%).

**LITE** - The Bank’s charter allows short-term cash advances to the govt, capped at PHP 810bn. Given the cash crunch faced by authorities in October, the Bank agreed to purchase PHP 540bn worth of 3-month paper directly from the government. As time goes by, it looks like BSP may be willing to move on to full-on deficit financing.

**Deficit financing**

**FULL** - At the onset of the pandemic, Bi received provisional authority to expand its scope to purchases of long-term securities in the primary market via “perpetual” or presidential declaration to assist the govt, manage the impact of Covid. Currently, Bi’s monetary operations have totalled roughly IDR 658 trillion, worth roughly 4.2% of GDP.

**LITE** - The Bank’s charter allows the govt to fund a wide budget deficit. The main channel here is the RBI’s dividend payment and transfer of excess reserves to the government. The Bank also boosted its Ways and Means Advance limits for central and state governments. This isn’t a source of deficit financing per se – just a means to tide over short-term (usually up to 3 months) mismatch of government’s receipts and spending.

Despite pledging the use of unconventional policies was “time-bound” and will be phased out, authorities have secured legislation to extend and upsie the budget for cash advances, setting the precedent for more cash advances between monetary and fiscal authorities.

**Where do we go from here?**

Despite, pledging the use of unconventional policies was “time-bound” and will be phased out, authorities have secured legislation to extend and upsie the budget for cash advances, setting the precedent for more cash advances between monetary and fiscal authorities.

**Source:** ING
Philippines in 2021: The economy continues to lose steam

Philippine GDP growth contracted 10% in the first three quarters of the year and there's little hope of a big turnaround in 2021

Authorities forecast a quick recovery in 2021 but trends suggest otherwise
The Philippine economy is mired in a recession with year-to-date GDP at -10% as elevated Covid-19 infections force an ongoing 9-month-long partial lockdown in the capital and surrounding provinces.

Authorities have acknowledged that growth will contract sharply on a year-on-year basis in 2020 but continue to bet on a quick recovery in 2021 (6.5 to 7.5%) and 2022 (6.0%) touting the economy’s “solid fundamentals”.

ING maintains that growth will likely enter a lower trajectory as current trends point to a very different scenario heading into 2021 with the Philippine economy missing contributions from every sector of the economy. Worrisome trends for consumption, capital formation and government spending will not likely reverse quickly even as lockdown restrictions are relaxed.

Consumption lacking the remittance punch
Household consumption delivers the bulk of Philippine economic output and we expect this sector to struggle given elevated unemployment, virus concerns and fading remittance flows. Overseas Filipino (OFs) remittances augment domestic incomes with households receiving Php59,295 annually, roughly 19% of the average income in the Philippines. Land-based remittances will likely slide as global lockdowns are reinstated while a downturn in maritime traffic should impact remittances sent by seafarers.

Authorities estimate that up to 300,000 Filipinos will be repatriated due to the pandemic, depleting the stock of 2.2 million Filipino contract workers based abroad.

We forecast a 5-10% drop in remittances this year given renewed lockdowns and negative prospects for maritime traffic. This will translate to a drop of up to $3.1 bn in 2020 and 2021 with consumption missing the integral boost from these inflows.
Philippine remittances per source

Investment momentum stalls, potential output fades
Prior to the pandemic, capital formation was increasing thanks to a construction boom coupled with the administration’s hallmark infrastructure programme but the current trends point to stalling momentum for this sector.

Capital imports fell sharply in April and have recovered somewhat but remain below the 5-year average of $3.5 bn per month. We expect the recent downturn in capital goods to weigh on potential output as corporates are likely to put off large scale investments given the recession to protect cash and weather the downturn. Meanwhile, we also expect households to defer investment plans given the challenging job market, reflected in a steep fall in road vehicle sales, which are down 44.6% for the year.

Philippine imports of capital goods

Meanwhile, declining investment momentum is mirrored in trends for commercial bank lending, which has now been decelerating for five months through August. Loan disbursements to retail trade and manufacturing have turned negative with manufacturing activity now in contraction (October PMI: 48.5) while retail trade plunged as vacancies in mall space hit 14%, the highest level reported since the Asian financial crisis. Prospects for a pickup in lending to real estate are not particularly upbeat with office space vacancy rising to 8.3% as Chinese offshore gaming operators close shop.
BSP unconventional moves and low inflation

The response of the central bank, the BSP, to the pandemic has been aggressive, resorting to both conventional and unconventional measures, such as quantitative easing and de facto debt monetisation. The net effect of BSP’s unconventional moves was a surge in excess liquidity, now at Php1.4 trillion, roughly 7.2% of GDP and 8.9% of money supply, resulting in a flatter and lower yield curve. Inflation (2.5%) is not expected to accelerate in the next few months given depressed demand conditions and a stronger currency.

Inflation is expected to be benign through to 2022 and BSP is not expected to exit from unconventional policies soon, so we expect the yield curve to remain flat with rates suppressed unless government borrowing picks up substantially next year.

Fiscal response has been modest at best

Trends in government spending also point to a downward trajectory for growth. The fiscal response, however, has been modest with authorities recently passing additional Covid-19 funding worth Php140 bn, to bring the total Covid-19 response spending to roughly Php590 bn or 2.7% of GDP. After seeing an initial surge in spending, we’ve noted a sharp slowdown with September expenditures falling 15.5% as authorities clamped down on efforts to manage the budget deficit. Government officials have repeatedly turned down calls for additional fiscal packages in 2021 and it appears that the economy will not be able to count on government spending to help offset the slowing growth momentum.
Recession to continue into 2021 as trends point to weakness across key sectors

The Philippines is poised to remain in recession for a couple of more quarters with trends pointing to sustained weakness across key sectors. Government officials remain confident of a quick turnaround, but signs of soft consumption, decelerating investment and lacklustre government spending all suggest otherwise. Unless we see a reversal in these trends, we believe that the Philippine economy is on pace to enter a lower growth trajectory, failing to return to the pre-pandemic growth average of 6%.
Brazil in 2021: The focus is on fiscal policy

Brazil’s forceful policy reaction to the pandemic was crucial to mitigate its economic impact but it requires some correction in 2021. As it stands, the fiscal tightening dictated by current law would pave the way for a credit-fuelled virtuous cycle and higher growth. Another round of fiscal stimulus would, however, create a vicious cycle.

Binding fiscal constraints imply binary 2021 outcomes

Brazil’s economic policy response to the pandemic was unusually aggressive by emerging market standards. The monetary easing was perhaps the most forceful in EM when you consider that the current level of the policy rate of 2% relative to the ten-year historical average of 10%. The persistent FX sell-off has been the primary side-effect of that easing, which is, arguably a minor concern in the current low-inflation environment.

Much more consequential has been the fiscal stimulus enacted, especially the household income transfers to help offset wage income lost to Covid-19 movement restrictions.

The combined effect of the larger spending and the recession-related drop in tax collection should result in a major fiscal deterioration in 2020, as you can see in the chart below. And 2021 is likely to be a crucial year for Brazil to reveal its commitment, or not, to a sustainable fiscal trajectory.

Fiscal deficit surged to record-highs, provoking a sharp rise in public debt

Source: Shutterstock

Source: Macrobond, ING
With the household income transfers set to end in December and government spending already set to reach the legal limit stipulated in the “fiscal spending ceiling” in 2021, temptation to change the law to accommodate greater spending has increased, resulting in frequent efforts to weaken the fiscal framework.

Those efforts have, so far, encountered severe resistance and we expect them to continue to fail. But uncertainty regarding that outcome would keep risk premiums elevated and limit prospects for the economic recovery.

**Continued monetary stimulus depends on fiscal consolidation**

As it stands, the current fiscal framework, centred on the “fiscal spending ceiling” mandate, which has frozen government spending in inflation-adjusted terms, would ensure a gradual improvement in Brazil’s fiscal trajectory.

Our base-case scenario is that this fiscal framework will remain unaltered in the foreseeable future, as advocated by the Finance Ministry. This scenario should not be taken for granted, but we believe there’s enough opposition within Congress, fiscal regulators, and the press, along with disciplinary market forces, to prevent the creation of a constitutional majority in Congress to change the law.

A corollary of our fiscal assumption is that fiscal policy will turn contractionary in coming years, paving the way for a prolonged period of expansionary monetary policy. And this monetary stimulus, amid favourable prospects for a credit-fuelled economic recovery, is the main reason to be optimistic about Brazil’s growth prospects.

**Bank lending continues to rise, amid record-low delinquency**

![Graph showing bank lending and delinquency trends](image)

**Credit market trends**

Recent credit market trends suggest that, despite the pandemic, bank lending has surged and the outlook remains favourable, especially in the housing and construction sectors, which should benefit from record-low rates and new financing options.

There are two other growth-enhancing drivers. The first is the expected progress in pro-growth legislation such as the approval of the new regulatory framework for natural gas and private sector investment in water/sanitation services. The second is a more competitive FX environment, which should help local producers so long as the inflation outlook remains anchored, as we expect.
Inflation expectations should remain anchored, but we see upside risk to GDP growth

Source: Macrobond, ING
CEE in 2021: Bracing for the post winter rebound

Once winter has passed, the CEE region should brace itself for a meaningful economic rebound from 2Q21 onwards, but the prospects of a reflation narrative are limited as deflation has never been an issue. We expect some central banks to ease but this is unlikely to derail the rebound in local FX which should experience a benign and less volatile year in 2021.

Three main themes for CEE in 2021

1. After the cold winter months, the region should brace itself for a meaningful economic rebound from 2Q21 onwards
2. The wider reflation narrative is, in isolation, less relevant for CEE as low inflation has never been an issue
3. Local central banks may ease more, but this won’t derail a rebound in local FX. We prefer the Czech koruna and Turkish lira

Second dip now, but a strong recovery from 2Q21 onwards

The double-dip recession the region will experience is now certain as the second wave of the pandemic and related restrictions in Europe weigh both on domestic demand as well as exports. All CEE countries will experience negative quarter-on-quarter growth and shallow activity in the first quarter of 2021.

The rebound is expected to come in the second quarter next year once we pass the tough winter months (in line with the expected recovery path of the Eurozone economy). With the prospects of a successful vaccine in place, this (a) reduces downside risks to the growth outlook for 2H21 (i.e, a low probability of the winter lockdown in late 2021); (b) the brighter outlook for global trade should benefit open CEE economies.

Moreover, the new EU funds should provide further cushion to the regional growth outlook, though the front-loaded investments within the seven-year EU budget are more likely to materialise in 2022 rather than next year.
External, internal reflation theme narrative

In isolation, the prospects of the reflation narrative are limited in Eastern Europe, with the local inflation dynamics being vastly different from developed Europe.

As Figure 1 shows, inflation should on average be lower in the region in 2021, not higher. The deflation threat isn’t really present in the region this year given the cushion the tight labour market provided to domestic prices. All CEE countries started the year with above-target inflation and now we see a normalisation towards the target, which is also likely to continue next year (mainly in Q1) as the Covid-19 related one-offs and the labour market shortage ease.

From this perspective, any reflation theme for the region next year will be more about the pick-up in local economic growth (which should reduce the easing bias of some of the local central banks, despite above-target CPIs and higher long end core rates (reflecting the re-rating of the economic outlook and inflation expectations in the developed world) rather than domestic price pressures – as these will decelerate, not accelerate compared to 2020.

Preference for higher real rates

Source: ING, Bloomberg
Modest easing ahead, but EMEA FX should do well nonetheless

Despite the brighter outlook for 2021 and limited deflation risks, the near-term bias remains towards more easing among regional central banks, albeit for different reasons.

In Hungary, the central bank is likely to reverse its 15 basis points FX stabilising hike in September. In Poland, the Bank may cut reference rate by 10bp (and/or explore other measures) should the currency continue appreciating, while in Russia the benign inflation outlook points to more rate cuts.

For the easing prone Poland and Hungarian central bank, in particular, the bar is high for a move towards less accommodative policy in 2021, pointing to steeper local curves. However, the Czech central bank should be the outlier in the region, with a non-negligible probability of the Bank delivering a hike at the end of 2021, suggesting higher front-end CZK rates vs PLN.

In contrast to this year, EMEA FX should experience a more benign and less volatile year in 2021. The more supportive global backdrop (due to more predictable US international relations policy and the Covid-19 vaccine), the sharp pick up in CEE growth from 2Q21 onwards and gradually rising EUR/USD should be beneficial for CEE.

We heavily favour CZK to PLN and HUF, given the inherent dovish bias of Poland and Hungarian central banks versus the Czech national bank. The benign global environment and lower volatility should favour carry. Within the high yielding EMEA space, TRY outlook for upcoming months looks the most attractive as the central bank is likely to deliver meaningful tightening, in turn cementing its superior carry and real rate position within the emerging market space.

This should also further compress some of the still profound risk premia and help the lira.
Central Banks in 2021

Global central banks have had a busy 2020, but their job is far from over. What tools do policymakers have left to deploy and what should we expect from monetary policy in 2021?

The outlook for central banks in 2021

**European Central Bank**
Ending the year with a bang. After Christine Lagarde’s comments in October, the question is no longer if but what the ECB will announce at its December meeting. We expect an increase in QE by some EUR500B, an inclusion of so-called Fallen Angels in corporate bond purchases and even more favourable liquidity for the banks. In 2021, all focus should be on the strategy review and the ‘greening’ of the ECB, that is, at least as long as the economy enters the expected recovery.

**Federal Reserve**
The Federal Reserve’s dot plot suggests little chance of an interest rate rise before end 2023. We are cautious on the near-term macro outlook as surging Covid case numbers prompt fears of renewed containment measures. However, a vaccine roll-out looks possible in a few months and there is the prospect of a significant reflationary fiscal stimulus under President Biden. This could generate a rethink on economic prospects with rate hike expectations likely creeping forward.

**Bank of Japan**
With no prospects of a change in Governor at the BoJ, we see little prospect of any new thinking in terms of policy. Asset purchases will fluctuate to keep JGB yields at about 0%, and the policy rate will remain -0.1%.

**Bank of England**
Negative rates aren’t our base case, but definitely shouldn’t be ruled out if the outlook deteriorates further. That said, it’s clear the BoE thinks QE is a more useful tool, and we suspect any foray into negative rates would be both time- and depth-limited.

**Bank of Canada**
The BoC has signalled rates are on hold until the 2% inflation target is “sustainably achieved”, which on their current forecasts won’t happen until 2023. As with the Fed we see the potential for market expectations to edge upwards on an earlier move.

**Reserve Bank of Australia**
With the cash rate target and 5Y yield target both reduced to 0.1%, along with the adoption of numerical quantitative easing, the RBA has almost nowhere further to do with policy as it still rules out negative interest rates.

**China (PBoC)**
Stable Covid-19 means the need for monetary easing has reduced. We expect no change in policy interest rates or the RRR from now to the end of 2021. Instead, the central bank has put more focus on interest rate and exchange rate liberalization.

**Reserve Bank of New Zealand**
The RBNZ opted to keep some policy leeway in reserve and not follow the RBA’s recent rate cutting. Instead, it has opted to pursue a more direct path to stimulus through a funding for lending program. Conventional rate cuts and negative rates remain an option though.

**Norges Bank**
With rates already at zero, further stimulus is unlikely - neither negative rates nor QE are viable. Instead, expect continued signals of a 2022 rate hike, which would re-cement Norges Bank’s position as a hawkish outlier.

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**Source:** ING
Federal Reserve
Financial markets have performed strongly since it became clear that Joe Biden will be the next President of the United States while positive news flow on a Covid-19 vaccine has provided further fuel for the rally in risk assets. However, we are becoming more concerned about the near-term story with unemployment benefit income being tapered for millions of households at a time when Covid-19 cases are rising rapidly. Vaccines could take several more months to roll out, so we have to acknowledge the possibility for the return of pandemic containment measures in the US, similar to what Europe is currently experiencing, in an effort to limit the strains on the healthcare sector.

Legal challenges surrounding the election could intensify already high levels of political animosity, which may hamper the ability or limit the desire for politicians to agree to a swift package of measures that could support the economy during this period. This could make the Federal Reserve feel compelled to step up via asset purchases and/or liquidity injections to calm nerves and ensure smooth market functioning if we are correct and the economy enters a more troubled period.

Nonetheless, there is scope for a significant fiscal package in excess of $1trn next year (equivalent to around 5% of GDP). This stimulus, when combined with a long-anticipated Covid-19 vaccine, can really lift the economy and drive growth. We consequently remain very upbeat on the prospects for 2021 and 2022, which could help pull interest rate hike expectations forward from the 2024 dateline currently implied by the Fed dot-pot.

Depending on how robust the recovery is, we could see Fed asset purchases slow or even stop during 2021.

European Central Bank
After Christine Lagarde’s comments at the October meeting, the only question is not if but only what the ECB will announce at its December meeting.

Even recent news on a vaccine will not prevent a downward revision of the ECB’s growth and inflation outlook. As a consequence, we expect the ECB to announce an increase in its quantitative easing programme by around 500bn euro, the inclusion of the so-called ‘fallen angels’ into corporate bonds purchases and even more favourable liquidity for banks.

In our view, the ECB will want to keep maximum flexibility and will therefore change its definition of price stability from ‘below, but close to, 2%’ to ‘around 2%’.

Bank of England
The Bank of England has extended its quantitative easing programme to allow it to continue asset purchases throughout 2021, but the combination of the new UK-EU trading relationship and the risks surrounding Covid-19 suggest more stimulus may be needed. But will this involve negative rates? We think the jury is still out.
Policymakers are currently collecting evidence from banks on the impact sub-zero rates may have on profitability, although we doubt this will ultimately be enough to block the policy. The central bank has already hinted it may follow the ECB’s lead with a tiered system of implementing negative rates.

Instead, the decision will hinge on MPC consensus on whether the policy would be of much use - and so far that’s not been the case. Our own feeling is that lower rates are unlikely to add a great deal of impetus to the recovery. We, therefore, think the BoE will steer away from negative rates, barring a significant deterioration in the outlook.

**Bank of Japan**

It has been many years since we have pretended that the Bank of Japan had anything relevant or interesting still to come in terms of monetary policy, and that remains the case.

Policy rates are at -0.1% and are unlikely to be cut again, and certainly aren’t going up for years to come. Likewise, we don’t see any merit in the central bank pushing bond yields substantially below zero - the current target. Indeed, their most recent policy push seems more concerned with shoring up the banking sector, something that has arguably been talked about, though not necessarily undertaken on a large scale, since the 1990s when the controversial “Convoy system” was implemented.

Returning to this theme won’t necessarily bring an end to Japan’s slow growth, low inflation or sluggish lending. But if turning deposits into profitable assets remains next to impossible in Japan, cutting fixed costs and overheads through mergers and acquisitions still seems a worthwhile endeavour, even if only to deliver a bit more support and stability to the banking sector.

**People’s Bank of China**

The People’s Bank of China has stopped cutting the loan prime rate since May 2020 and hasn’t slashed the reserve requirement ratio since February.

Economic recovery from fewer Covid-19 cases has been the main reason behind the neutral stance. We expect no change in the monetary policy until the end of 2021, instead the core focus of the central bank will be interest rate and exchange rate liberalisation.

We have seen more advocacy from the central bank governor urging banks to apply the policy rate and link it to pricing financial products. The central bank has also started to phase out the use of counter-cyclical factors in the USD/CNY daily fixing formula, which means the exchange rate is likely to be increasingly driven by the market.

**Bank of Canada**

The Bank of Canada, like the Federal Reserve, has effectively signalled a shift to average inflation targeting.
Their forward guidance now states that policy won’t be normalised until the 2% inflation target is “sustainably achieved”, which under their current forecasts is not expected to happen until 2023.

The central bank has also recalibrated its asset purchases so they are focused at the long end of the curve in the hope that a flatter, lower yield curve will deliver the conditions that give the most benefit to household and corporates. We don’t envisage any major changes to this policy mix in 2021 although as with the Fed, market interest rate hike expectations could start inching earlier.

**Reserve Bank of New Zealand**

At its last meeting (10 Nov) the RBNZ left open the possibility of a single further conventional rate cut. In leaving cash rates at 0.25% at its latest meeting, the RBNZ noted “better than expected” economic activity. But at the same time, they kept their options open in terms of further easing of policy rates, including, controversially, negative rates.

In the meantime, the RBNZ, which already owns about 37% of the outstanding stock of government debt after only six months, is supplementing its QE programme with a NZD100bn funding-for-lending scheme. Against the backdrop of a red-hot housing market, even if the labour market remains soft, further rate cuts by any channel may prove awkward. And in all likelihood, the RBNZ is out of substantive further easing measures. In our view, all of this discussion about alternative policies is simply part of an elaborate attempt to manipulate market expectations. But even if we are right and there is no further easing, we don’t anticipate any tightening in 2021.

**Reserve Bank of Australia**

At its most recent rate meeting, the Reserve Bank of Australia cut the official cash rate and 3-year yield target to just 0.1% from 0.25% and implemented a (numerical) quantitative easing policy (yield curve control is already a form of QE). This new scheme was for bonds at a 5-10Y tenor.

With the Australian economy picking up after its lockdowns came to an end, it is not entirely clear why the central bank decided the economy needed this extra and arguably very marginal additional easing. The latest policy announcements had a very limited and temporary effect on both the AUD and Australian bond yields.

Unlike the RBNZ, the Australian central bank Governor Lowe remains unequivocal in his opposition to negative rates. So even more than the RBNZ, the RBA looks to have hit rock bottom for cash rates, and in all probability, for all other substantive incremental easing measures, though that may not stop them from implementing some additional “cosmetic” measures during 2021.

**Riksbank**

While Sweden continues to take a more liberal approach to Covid-19 restrictions relative to its European neighbours, the virus nevertheless poses risks for the domestic economy.

The first wave of the pandemic showed us that individuals are likely to ‘act with their feet’ by taking a more cautious approach to going out-and-about. That said, there are potentially some brighter spots too. Manufacturing looks set to be less affected by lockdowns globally than in 1H20 - good news for Sweden’s production-heavy economy.

More stimulus can’t be ruled out, but we’d continue to expect this to take the form of quantitative easing over a return to negative rates. The Riksbank currently plans to complete its balance sheet expansion by the middle of 2021, something that could be feasibly extended. But having hiked the repo rate out of the negative territory at the end
of 2019 and opting against returning below zero during the peak of the pandemic, we suspect the bar is high for a rate cut in 2021.

**Norges Bank**

2021 has the potential to be a pretty unexciting year for Norwegian monetary policy. That's not because the economy doesn't face challenges - the country has imposed new restrictions on socialisation that will undoubtedly halt the recovery and risk a further rise in unemployment.

Instead, a lack of action from the Norges Bank in 2021 reflects an absence of realistic options to add further stimulus. Negative rates are not seen as a viable option, while logistical constraints mean quantitative easing is unlikely.

The more interesting question, therefore, is whether the Bank will be one of the first to hike interest rates after the pandemic. Clearly, this is unlikely next year, but policymakers are officially projecting the first increase could come in the second half of 2022. While that may seem ambitious given the signals being offered by other central banks, it's worth remembering that Norges Bank was a key hawkish outlier through 2019 where it hiked rates three times against a more dovish global backdrop.
### Key political events in 2021

In the next twelve months, from Peru to India, the Netherlands to Australia, many key political events in 2021 have the potential to shape the economic outlook.

![Chinese President Xi Jinping (C-L), German Chancellor Angela Merkel (C) and Russian President Vladimir Putin (C-R) pose for the official photo during a cultural event at the G20 summit in Osaka.](Source: Shutterstock)

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#### The key events we’ll be watching in 2021

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| Portugal: Presidential election, takes over EU presidency | **13 Jan** | Early Malaysia: Potential snap election  
US Inauguration |                |
| **10 Jan** | **20 Jan** | **21 April** | **18 July** | **07 August** |
| New UK-EU relationship begins | US Senate confirmation hearings on Joe Biden’s cabinet choices | Peru: General elections | Mexico: Midterm legislative elections | Malaysia: House of representatives and half senate election (earliest date) |
| **14 March** | **06 May** | **04 July** | **02 Nov** | **21 Sept** |
Thailand: 2022 Budget  
India: Various state elections |
| **17 March** | **19 Sept** | **21 Nov** |
| Netherlands national elections | Russia: Parliamentary elections | Chile: General elections  
Brazil: Presidential elections  
US: Florida House of Representatives special election  
US: Virginia special election  
US: Georgia runoff elections for Senate seats  
UK: UK elections  
UK: Scotland general election  
US: Florida Supreme Court special election  
US: Georgia Senate runoff election |

Source: ING
United States: The early-2021 race for the Senate

The US political calendar in 2021 will kick off with the run-off elections for Georgia's two Senate seats.

No candidate got the required 50% of the popular vote in the presidential elections so it will be a straight race between the Democrat and Republican candidates in the absence of any other contenders. This will be critical for how aggressive Joe Biden can go with his legislative agenda. Should the Democrats win both seats this will leave a 50-50 tie in the Senate with vice-president Kamala Harris will be given the deciding vote on any piece of legislation that is split down party lines. This would facilitate a more ambitious policy change on tax, regulation and spending as there would be less need for watering down a piece of legislation to get Republicans onside. Nonetheless, filibuster rules, which require 60 votes to close a debate and move to a vote, will remain difficult to overcome.

On balance, it will be tough for the Democrats to win both, but tens of millions of dollars will be spent to try and convince the electorate in Georgia given the critical role these two votes play. We suspect that negotiations over a new fiscal stimulus will remain tricky and it will end up coming in closer to $1 trillion rather than $3 trillion in size. Nonetheless, with the very real prospect of a vaccine that can lift sentiment and lead to a broader re-opening of the economy, this should still provide a strong platform for growth in 2021/22.

Europe: Rumbling core

It is often said that political and sometimes even existential tensions for the eurozone come from the periphery. In this regard, 2021 could be a good year for the monetary union as no elections are scheduled in southern European countries, though one can never entirely rule out Italian elections. On a more serious note, however, next year political calendar will put the theory to test that it is not the periphery but rather the core countries in which anti-European parties could eventually bring the eurozone closer to the brink.

It is hard to see that differing views on Europe will decide the elections in either Germany or the Netherlands. Instead, the management of the pandemic will probably be high on the agenda alongside other important topics. Nevertheless, watch out for right-wing populist parties in both countries. The more votes they garner, the more problematic forming new governments will be.

In any case, both the Dutch and German elections could become historic events. Another term in office for Dutch prime minister Mark Rutte could make him the longest-serving government leader in Europe, at least if the other historic event materialises, i.e Angela Merkel definitely not running in the Fall elections. The end of Merkel's term in office could create a (short-lived) vacuum in European politics as currently none of her potential successors looks set to – at least not immediately – fill her shoes.

UK: Brexit noise to give way to Scottish uncertainty

Those hoping that Brexit will disappear off the news agenda forever from 2021 may be a little disappointed. Even if a deal is agreed, it will inevitably be a basic one. A free-trade agreement will avoid tariffs but may not prove to be a particularly sustainable trading platform in the long-term. That's even more true if both sides begin trading on World Trade Organisation terms from January - a deal will still inevitably be needed further down the line.
That said, the rollercoaster ride of Brexit is likely to give way to more focus on the push for Scottish independence. The prospects of a relatively arms-length deal with the EU (Scotland did not vote for Brexit overall), combined with the unfavourable public perception of the handling of Covid-19 by the UK government, has seen support for independence climb through 2020.

Of course, the government in London needs to give its approval for another referendum akin to the one in 2014, something the current Conservative administration is very reluctant to do. But the pressure will inevitably grow through 2021, particularly in light of Scottish parliamentary elections in May that are predicted to heavily favour the Scottish national party. Another referendum is probably a few years off, but there is nevertheless a creeping sense that a second vote may be more of a question of ‘when’ rather than ‘if’.

**Asia: Japanese, Indian and (possibly) Malaysian elections the focus**

On paper, 2021 promises to be a relatively quiet period for Asia, with possible snap elections resulting from the perennially weak government in Malaysia the likely highlight on the calendar.

Japanese elections for the House of Representatives are unlikely to be very eventful, rubber-stamping prime minister Yoshihide Suga’s hold on power. Otherwise, a string of local and regional elections fill the political calendar. Some of these, for example, state elections in India, may provide an indication of potential future upsets in general elections.

More likely, it will be unscheduled events that attract the most attention, with growing unrest in Thailand the front runner to generate some political backlash as protesters push for government change and reform of the monarchy.

**Latam: Peru, Chile and Mexico to stage key elections**

Latin America’s political calendar will be dominated by general elections in Peru and Chile, along with mid-term elections in Mexico.

Peru and Chile have already been facing tremendous political tumult for the last few years and, even though elections typically generate uncertainties, there’s some hope that, in these two cases, elections could pave the way for less political friction.

In Peru, the April election of a president with a working legislative majority appears essential to end years of political dysfunction that has resulted in a very unstable presidential mandate, including three presidents in less than the five-year typical mandate. In Chile, social unrest provides fertile ground for political instability that could also calm down following the election of a constitutional convention to rewrite the country’s constitution, taking place in April, and general elections in November.

Overall, while uncertainties are likely to remain elevated, the political calendar could also serve to reset political expectations and create a more harmonious political environment in the Andes. In Mexico, the focus will be on mid-term elections in July, with Congressional races helping determine President Lopez Obrador’s ability to hold on to the large majority he currently enjoys. AMLO remains popular, but the deep recession and Mexico’s questionable handling of the pandemic may reduce MORENA’s ability to keep its current share of seats in the Lower House.
Trade tension to soften... only marginally

Despite the election of a new president, US-China trade relations are unlikely to experience much of an improvement after a tumultuous few years of tit-for-tat tariff hikes.

While Joe Biden isn’t a fan of tariffs given American businesses and consumers pay the price, it is a narrative that has struck a chord with voters. Acting forcefully against perceived Chinese indiscretions surrounding trade, security and intellectual property has bipartisan support. This view is unlikely to change soon, but one crumb of comfort is that we don’t expect to see a broadening out of tariffs under this administration.

“One crumb of comfort is that we don’t expect to see a broadening out of tariffs under this administration”

Trade war to heighten

From a US perspective, there is next to no tolerance about China overtaking the US in technology given the economic, security and military implications, which is a key concern in Europe too. Given Joe Biden’s more internationalist credentials relative to Donald Trump there appears greater scope for Americans and Europeans to work together to maintain a technological advantage over China.

China will face an extremely tough situation to sell technology products in these big markets. And it is likely to find it increasingly difficult to source raw materials to produce integrated circuits. That means, achieving self-sufficiency in tech advancement is not only about self-reliance on the know-how of the technology but also the raw materials, some of which, China needs to import.
Global Macro Outlook  
November 2020

Semiconductor industry

The beginning of another cold war?
Even though China would like to persuade some European economies to adopt their technology, the chances of success look slim if the fear is about the increase of China’s influence. China may find a more united international front in any new technology war than it has met so far.

Moreover, if Canada and Australia join a US-Europe alliance, it will only add to concerns of a potential increase in geopolitical tensions. This could prompt fears that we could be on the verge of what feels like another cold war.

Optimists say that supply chains and partnerships mean the world is too interlinked for that to happen. But Europe and the US may well feel that they need to take a stand. We suspect that China is trying to create a pro-China circle that would include most Belt and Road economies, including Russia, some economies in the Middle East and Africa, plus a few in Latin America.

Potential impact of a cold war
Technology is at the core of the battlefield. Surrounding it is the trade of raw materials and parts to produce technological products. Competition for talent in this sector is also a factor. Another cold war would definitely slow down China’s technological advancement, but it is unlikely to stop it altogether.
If China can achieve a level of self-reliance in technology, then it could circumvent some of the discomforts of a new cold war.
International trade in 2021: Plenty of challenges, but recovery in sight

World trade will not be far from news headlines in 2021, and despite the new leadership both in the US and soon at the World Trade Organisation, this is no guarantee of international co-operation. But at least it offers some hope for thawing of trade tensions.

With a vaccine, trade will rebound but second round effects will drag into 2021

Progress towards a vaccine is a key step towards restoring consumer and investment confidence over the course of 2021, helping trade volumes recover to their pre-pandemic levels from the 16% collapse in 2Q20. But some Covid-related disruptions to transport capacity will take time to unwind and cause a persistent drag even as demand recovers.

Even though trade will respond quickly as demand recovers, it may take until 2022 to reach pre-pandemic volumes again.

As Covid-19 restrictions ease, trade bounces back

We forecast a 7% fall in goods trade volumes in 2020 followed by growth of around 5% in 2021, to reach pre-pandemic levels in early 2022.

As Covid-19 restrictions lessen, trade bounces back

Source: UNCTAD, ING
As the recovery progresses, government support packages which have been essential for consumers and businesses alike pose a downside risk to trade volumes, as subsidies create an uneven playing field for exporting firms. If government support is unwound, the dampening effect on trade volumes should be limited.

However, much of the support provided has no formal end-date and could therefore have unintended effects on trade’s recovery.

Policy responses to the vulnerabilities revealed by Covid-19 may result in countries stockpiling certain goods and even trying to incentivise re-shoring. But supply chain disruptions from lockdown in China proved to be a smaller problem than collapsing demand in export markets, especially thanks to China’s swift re-opening. For many firms, increasing supply chain resilience is easier said than done. The costs of diversifying supply and holding larger inventories will limit any grand migration of supply chains in 2021.

**Trade war act II will be milder**

US trade policy under President-elect Joe Biden looks likely to continue to put pressure on US-China trade relations while de-escalating other disputes.

The tariffs on US-China trade flows are likely to remain in place, though talks may resume. As part of a Biden campaign pledge to “work with our closest allies” on trade, US tariffs on steel and aluminium may be reduced, and the threat of US tariffs on EU cars forgotten.

Alongside continued strained trade relations with the US, and now also Australia, China faces the threat of continued restrictions on its investment abroad. In response, it may redouble its efforts to lower trade costs and build export markets closer to home through its Belt and Road connectivity projects and develop its high-tech manufacturing capacity as part of its ‘Made in China 2025’ strategy, reducing imports in the process.

**Challenges right from the start, with high stakes**

Thanks to Brexit, we are almost guaranteed to start the new year talking about trade disruption. Even if a trade deal is signed, cancelling the prospective tariff increases on goods between the two countries, new customs checks on the origin of goods and safety standards will delay cargo travelling from the UK to the EU from 1 January 2021.

By early 2021, the new director-general of the WTO should have been appointed, just in time for the world trade system to play its part in the distribution of Covid-19 vaccines. Countries have signed up to the principle of fair allocation but making this work will be key to a global recovery in 2021, and prospects for multilateral co-operation thereafter. The stakes couldn’t be higher.

The incoming WTO director-general has other daunting issues to address too. Various disputes caused by the trade war are working their way through the WTO’s courts, including the US steel and aluminium tariffs, which require the WTO’s appellate body to get back on its feet. There is also a dispute with China about the use of state subsidies, where the US has been joined by the EU and Japan in voicing concerns. Progress on these difficult issues is required to avoid future trade wars.

**Cautious optimism on global trade seems warranted**

Trade will not be far away from the headlines in 2021, and being ‘under new management’ is no guarantee of international co-operation on a vaccine.
for-tat trade war, and the effects of subsidies introduced during the pandemic risk dampening the recovery.

But in spite of the challenges and risks, cautious optimism for 2021 is warranted as economies are set to recover and trade policy may be done through talks, rather than tariffs.
President-elect Biden: Ushering in a warmer period of US-EU relations
The US President-elect Joe Biden’s domestic ambitions for a redistributive fiscal mix of higher taxes on corporates and the wealthy while offering more support for people on the lower end of the income spectrum will depend critically on whether the Democrats regain control of the Senate on 5 January. Assuming the Republicans hold, there will be an inevitable watering down of aspirations, but we still think a substantial fiscal stimulus, of the order of $1 trillion is likely.

When coupled with the introduction of a vaccine, which can allow a full re-opening of the economy, we suspect the US will grow very rapidly with full-year growth forecast at 3.6% despite a negative first quarter. This will help to fuel global optimism while also sucking in imports and supporting activity elsewhere.

The contrast between Joe Biden and Donald Trump with regard to international relations couldn’t be starker. While we may not see much improvement in US-China tensions – see the section in our global outlook on the tech war – there is clearly an opportunity for the US and European relations to be rebuilt. Biden is likely to revert to a more rules-based multilateral approach, which should at the minimum give greater predictability of policy than experienced under Donald Trump.

We would expect a return to the World Health Organisation together with a re-engagement with the World Trade Organization and NATO. His advocacy of Green energy also suggests a strengthening of the partnership on dealing with climate change. With international relations on a more stable footing, we may also start to see an unwinding of tariffs with Europe and Canada that can give businesses greater clarity and the confidence to implement investment plans that may have been put on hold.
Brexit – a new, less uncertain chapter for the UK on the world stage?
When it comes to Brexit and the UK’s role on the global stage, 2021 could go one of two ways.

If a deal is agreed with the EU, then this should put UK-European relations on a more stable footing. While a basic free-trade agreement will inevitably need to be built upon, a deal would presumably usher in a more constructive relationship on other issues, at a time when the US is looking to rebuild its ties with the EU.

By putting an end to the recent chapter of Brexit noise and also some of the uncertainty facing Northern Ireland, the Johnson administration also stands a better chance of resetting relations with the new Biden team. The President-elect’s stance on issues such as climate change and geopolitics (e.g. the Iran deal) is arguably more aligned with PM Johnson’s than that of President Trump.

However, things could look pretty different if the UK and EU fail to agree to a deal by the end of the year. While some of the above may still be true, the UK is likely to find itself more isolated geopolitically with both Europe and the US.

Ultimately Britain will need a trade deal with its closest partner, and therefore at some point, both sides will need to return to the negotiating table - where presumably many of the same issues, chiefly on state aid, will resurface. This, combined with the Scottish independence story coming to the fore in 2021 under a no-trade deal scenario, means the cloud of uncertainty that has hovered over the UK economic outlook relative to Europe and the US since 2016, may well linger for another few years to come.
The ongoing pandemic has led countries around the world to take exceptional economic and financial measures. In the eurozone, national measures were followed by pan-European action. As a result, debt ratios have surged. During the previous financial and sovereign debt crisis, debt ratios in the Eurozone rose from 65.9% of GDP in 2007 to around 93% of GDP five years later. By the end of 2019, the ratio had only come down to 87% of GDP, indicating how difficult it is to return government debt to any pre-crisis level.

Right now, we expect government debt in the eurozone to increase by some 15% of GDP to more than 100% GDP in 2020. Italy, Spain and Greece should see the strongest increases, with debt-to-GDP ratios surging by more than 25%.

As we expect many eurozone governments to provide more stimulus and possibly even write off some of the guaranteed loans to tackle the second wave of the pandemic, debt ratios are likely to rise further. As a consequence, discussions on how to eventually reduce the debt levels could return quickly.

Based on our calculations, even with a return to the fiscal balances and nominal growth of 2018 and 2019, it would take until 2029 for the eurozone to return to pre-crisis debt levels. Luxembourg and Ireland could already be back to their 2019 debt levels by the end of 2021 while Germany could reach its pre-crisis debt level by 2023. However, it would take countries with high pre-crisis debt levels, such as Greece, Spain or France until 2030, 2031 and 2032 respectively. Italy - the country with the second-highest pre-crisis debt level would take until 2060 to be able to reach a debt-to-GDP ratio of 134.4%.
If governments continue their current accommodative fiscal policies – again all else being equal – nominal growth would have to propel to 14.1% of GDP from 2021 to 2025 to return debt levels to their 2019 level. For example, if Germany were to continue with current fiscal policies, the country would need a nominal yearly GDP growth of nearly 18% to get back to pre-crisis levels by 2025.

### 2020 government debt per GDP ratios

Source: European Commission, ING estimates

An argument often heard is that very low-interest rates enable governments to have higher debt. If we follow this line of thought, it is also argued that the ECB will actually have a hard time increasing interest rates again as this would put an unbearable burden on public finances. To test this argument, we investigate how an increase in bond yields by 200 basis points would affect public finances.

A 200bp increase would mean that the average debt ratio in the eurozone would not return to its pre-crisis level until 2040, at the earliest.

Assuming nominal GDP growth and a primary balance at the average 2018 / 2019 level, countries with high pre-crisis debt levels such as Italy, Greece, Spain and France, could have significant difficulties in lowering their debt burden at all. By 2030, Italy and Greece’s debt levels would have increased further and reached 188.5% and 222.8% of GDP, respectively. Spain and France would stand at 115.7% and 120.2% of GDP.

In contrast, if bond yields fell by 100bps, we would see eurozone debt levels returning to their pre-crisis stage by 2025.

Even though there is no alternative to extensive fiscal stimulus to tackle the economic fallout from the crisis, accelerating government debt could return quicker to the European agenda than many might think. Low-interest rates are almost an inevitable prerequisite to keeping government debt in check.
A yield of at least 1% on the US 10yr should be a structural thing for 2021

The recent vaccine moment vindicates a move of the US 10yr to 1%, where it has a so-called 1-handle. It's a key level, as it brings us back to the notion of describing yield in percentage rates rather than in basis points. It is also foreign territory to the 10yr German rate at -50bp. Deviating from that is something to be strived towards. While negative rates have served the purpose of providing ultra-low financing conditions, they are also not a desired outcome.

We see 2021 as a year in which the spread between the German and the US 10yr widens back towards 175bp. And this is important for eurozone yields, as higher US yields can help to pull eurozone ones up too; which is a good thing as higher yields usually mean better things in terms of underlying macro circumstances. We don’t see this as being a consequence of more supply. That might come. But for now the dominant pull on market yields is a reflationary 2021.

We’ll see this in the shape of the curve too; it should steepen. Watch the US curve here more than the eurozone one, as the latter has a strange front end that can go as deeply negative as it likes it seems, bringing long end rates with it. The US curve is more anchored at zero. When it stretches steeper, it means something. Our target is for it to be in the 100-125bp range as a theme for 2021, with the 10yr trading between 1% to 1.25%. The German 10yr likely stays in -50bp territory, but at least is shown the way by the US, especially if the US manages a break above 1.25%.

Rates: Far from risk free

This is it! The final year for Libor, at least for the US, the UK and some others. Euribor continues, but the rest need to get ready for ‘risk-free’ rates. The transition will be helped by flat central bank rates, but expect volatility in longer dates. The bias will be steeper and higher for market rates, assuming the Covid-19 threat diminishes.
A picture of reflation, a mini reflation so far, but better than the deflation discounted in mid-2019

Source: Macrobond

Why is Libor so low and where is it heading to in 2021

Libor will live out its final days in market centres through 2021, but it is strutting through 2020 with quite a bit of attitude. One of the issues with Libor is the implied bank risk that it contains, which proved exceptionally volatile during crises (most notably through the great financial one). But as we head towards the end of the year, Libor is on the floor. USD Libor at 20bp is some 5bp below the Fed funds ceiling. There’s not much-implied bank credit risk there.

The likelihood in 2021 is that this changes. We think that USD Libor should be some 10bp higher than it is currently, and we’d assert similar for Ibor in most other centres. For example, remarkably, 3mth Euribor is currently flat to the ultra-safe ECB’s deposit rate. While this can be rationalised on account of advantageous bank funding conditions, it still looks anomalous.

So while central banks may not do an awful lot in 2021 in terms of policy changes, we would expect to see Ibor rates drift higher from current levels. An ancillary rationale here centres on the likelihood that risk attributed to banks and the system ratchet higher again, especially as default risk gets re-elevated. The end of Covid-19 is clearly positive, but it also means the Band-Aids come off, in many cases, leaving ghastly unhealed wounds that will result in numerous uncomfortable shutdown stories, even as economies begin to structurally rebound.

Why risk free rates are the future, and what to expect in 2021

Actually, there is no such thing as a risk-free rate. All rates have risk. The transition here is from Libor, which contains a bank credit risk, to overnight rates that minimise both credit and counterparty risk. The transition must happen in 2021, as there (likely) will be no, for example, USD Libor in 2022. Initial resistance to change has morphed to inertia, as players await first movers. And there has not been huge movement so far, to say the least. One Federal Reserve spokesperson likened the process to herding cats; very apt.
Still today the vast majority of derivatives trades are set with reference to Libor, and not to the new replacement ‘risk-free’ rates. Many are awaiting a build-up in volumes before switching. We expect to see a material build in such volumes through 2Q 2021, and we view it as being a simultaneous process, as volume in all product builds at the same time. This is vital. Such a build in volumes would allow for derivatives referencing risk-free rates to begin to dominate Libor. While not a flick of a switch, we do feel that transition to the use of the new rates can be swift, happening over a matter of weeks.

That, in turn, would facilitate the mapping out of term rates in the USD risk-free rate in particular e.g. a 3mth rates rate in advance (and not in arrears). A decent rump of players in the loans market globally is calling for this as a must-have. We expect term rates to be in place by early 3Q 2021, and this is a critical call for a smooth transition. The other issue is how to deal with the legacy Libor product and especially loans. Here, bi-lateral conversations will have to be had, effectively on suitable spreads that translate from Libor to risk-free rates. There are traded market spreads that can help as a reference, but they move. Not easy. Also not easy as Libor is so low now that the market spread is below average, which makes the discussion that bit more complicated.

And we have not even touched on different methodologies to be used in derivative versus loans. It’s really very messy; get ready for it as best you can.
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.

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 sharply rise again in October, forcing the government to introduce new lockdown measures at the beginning of November which were further tightened in mid-November. The Austrians may not 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.

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 6 am until 7 pm, other sectors suffer from a lack of possibilities 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 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 ten 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 well into next year. The 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 (%YoY)**

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<td>84.2</td>
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</table>

Source: Thomson Reuters, all forecasts ING estimates
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.

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**

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<thead>
<tr>
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<td>Unemployment rate (%)</td>
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<td>Government debt as % of GDP</td>
<td>98.7</td>
<td>114.7</td>
<td>115.2</td>
<td>113.6</td>
</tr>
</tbody>
</table>

Source: National Bank of Belgium, Forecast: ING

“Household savings will partly play a role in the post-Covid recovery”
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. This is among the lighter restrictions seen in the eurozone, which shows in Google mobility data which indicates 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 to the outlook for 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 guarantees for 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 roll-out of an effective vaccine is a clear upside to 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-corona levels.

The Finnish economy in a nutshell

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

Source: Eurostat and ING Research forecasts
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 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 ppt 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 an unprecedented 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 period of the “yellow jackets”. France is facing an unprecedented three crises at the same time: a health crisis, and economic crisis, caused by Covid-19, and a security crisis given the various attacks that have taken place on French territory in recent weeks.

What a difficult time for Emmanuel 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. And the current situation doesn’t give him much chance to make 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 dual 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 task 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 the country’s facing and it’s hoping 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.

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.

**Expected evolution of the French GDP level (4Q19 =100%)**

![Graph showing expected evolution of the French GDP level from 2019 to 2023.](image)

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 1.5 ppt 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

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
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<th>2021F</th>
<th>2022F</th>
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</thead>
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<tr>
<td><strong>GDP growth (%)</strong></td>
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<td>0.30</td>
<td>0.80</td>
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<tr>
<td><em><em>Unemployment rate</em> (%)</em>*</td>
<td>8.50</td>
<td>7.60</td>
<td>10.40</td>
<td>9.20</td>
</tr>
<tr>
<td><strong>Budget balance as % of GDP</strong></td>
<td>-3</td>
<td>-11</td>
<td>-7</td>
<td>-5</td>
</tr>
<tr>
<td><strong>Government debt as % of GDP</strong></td>
<td>99</td>
<td>120</td>
<td>118</td>
<td>118</td>
</tr>
</tbody>
</table>

*Eurostat definition

Source: ING forecasts
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

Carsten Brzeski
Chief Economist, Eurozone, Germany, Austria, and Global Head of Macro
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carsten.brzeski@ing.de

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.

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**

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

Source: Thomson Reuters, all forecasts ING estimates
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 2H2011 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.
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 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. This has caused Google mobility data to suggest that Ireland is experiencing a worse fourth quarter in terms of economic activity than other eurozone economies.

Life after Covid and Brexit

From the coronavirus perspective, the fiscal response 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.

“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 trade 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, as large an impact as Covid-19 has had cannot be expected from Brexit and as the lockdown gets lifted, the economy will start another mechanical economic recovery.

**The Irish economy in a nutshell**

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

*Source: Eurostat and ING Research forecasts*
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 re-openings, which will extend at least until the end of the year. After contracting a cumulated 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 is 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 all industrial and construction activities are 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 lengthening of restrictions into December, a new 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% QoQ fall for the Italian GDP over the last quarter of 2020, with downside risks.
Deeper early fall in production fully compensated over 3Q

Industrial production Jan-20=100

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 in softer average yearly growth number than previously anticipated, notwithstanding the recent good news coming from 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 in 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 ESM 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 it 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, as we believe, inch up again. Given this perspective, it will be extremely important for Italy to prove it’s able to use effectively 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

The Italian economy in a nutshell (%YoY)

<table>
<thead>
<tr>
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<th>2020F</th>
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<th>2022F</th>
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<td>0.3</td>
<td>-8.7</td>
<td>3.6</td>
<td>2.8</td>
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<tr>
<td>Private consumption</td>
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<td>3.9</td>
<td>2.1</td>
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<td>Investment</td>
<td>1.4</td>
<td>-11.5</td>
<td>6.5</td>
<td>4.8</td>
</tr>
<tr>
<td>Government consumption</td>
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<td>-0.7</td>
<td>1.8</td>
<td>1.3</td>
</tr>
<tr>
<td>Net trade contribution</td>
<td>0.5</td>
<td>-1.7</td>
<td>-0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Headline CPI</td>
<td>0.6</td>
<td>-0.2</td>
<td>0.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>9.6</td>
<td>9.3</td>
<td>11</td>
<td>10.8</td>
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<tr>
<td>Budget balance as a % of GDP</td>
<td>-1.7</td>
<td>-10.7</td>
<td>-8.2</td>
<td>-4.6</td>
</tr>
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Source: Refinitiv Datamstream, all forecasts ING estimates
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 for 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**

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Source: Refinitiv Datastream, all forecasts ING estimates
Spain in 2021: Many economic hurdles to recovery

Looking at the challenges for Spain in 2021, one could become depressed. The health crisis was severe, and together with a number of characteristics of the Spanish economy, this had a disproportionate effect on activity. We expect those same particularities 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.

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

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Source: Refinitiv Datastream, all forecasts ING estimates
## GDP Forecasts

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1. Norway: Forecasts are mainland GDP
2. World GDP figure calculated from countries covered in INGF
3. Source: ING estimates
### CPI Forecasts, pa

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¹ Quarterly forecasts are average over the quarter; yearly forecasts are average over the year

Updated 17 November 2020

Source: ING estimates
### Global Macro Outlook November 2020

**Policy Rate Forecasts (end period)**

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¹Upper level of 25bp range, *PBOC 7-day reverse repo rate

Updated 17 November 2020

Source: ING estimates
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