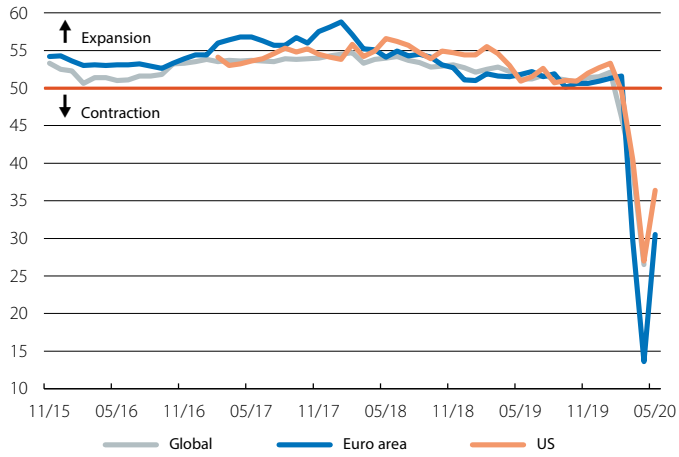
Incipient recovery, with the permission of COVID-19

Very gradual recovery as the lockdowns begin to be lifted. In recent months, it has become apparent that the COVID-19 outbreak will have a very significant impact on economic activity. Moreover, all the indicators suggest that the macroeconomic figures for the second quarter as a whole will be far worse than in Q1, and somewhat worse than initially predicted. For instance, in April the Composite Purchasing Managers' Index (PMI) for the global economy plunged to 26.5 points, its lowest value since the series began to be published. In May, the slowdown in infections brought about a gradual lifting of the lockdowns in major advanced economies, which naturally led to an incipient improvement in the economic indicators, although they remain low and reveal weak economic activity. Insofar as the epidemic remains under control and evolves positively, the lifting of the lockdown and social distancing measures will bring about a recovery in the economic indicators over the coming months. Nevertheless, the normalisation of the economy will be subject to the COVID-19 epidemic being contained and to medical progress curbing its spread. These are two conditions without which global economic activity is unlikely to fully return to normal.

Europe gives new impetus to its economic policies. Faced with the unprecedented impact of the pandemic on the economy, economic policy is generally responding rapidly and with ambitious measures. That said, there are significant differences between regions and countries, with advanced countries, given their greater capacity to take on debt, deploying a more decisive battery of measures than emerging countries. There is also significant disparity among advanced countries, which is largely explained by differences in their capacity to implement a fiscal stimulus (greater margin in the US and in the economies of the core of the euro area than in Europe's periphery). However, in May, European institutions took an important step forward in implementing a common European response to the economic impact of the COVID-19 epidemic. In particular, a few days after France and Germany expressed their support for a possible 500 billion euro package to be distributed among EU countries in the form of non-reimbursable transfers (thereby not increasing states' public debt ratios), the European Commission proposed a Recovery Plan that would include a fund of some 750 billion euros (5.4% of EU GDP), most of which (approximately 500 billion euros) would be disbursed in the form of transfers, with the rest taking the form of loans. In addition, the funds would be obtained through the issuance of truly European debt by the European Commission, which would be supported by an increase in the capital ceiling of the EU budget (from 1.2% of GDP to 2.0%), which would also include the creation of new taxes at the European level. The funds would be evenly distributed over a four-year period (between

Composite PMI

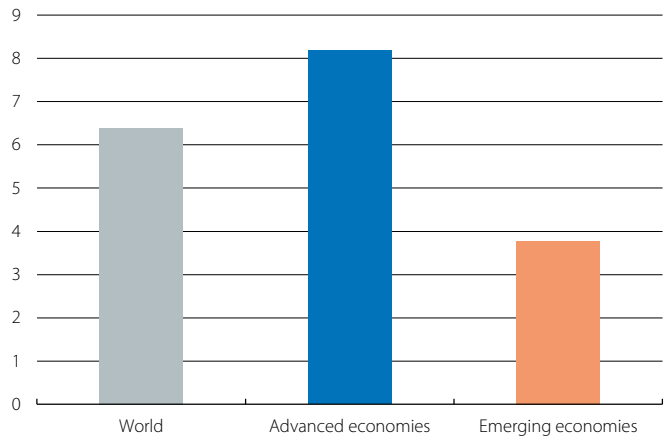
Level



Note: *The data for May for the euro area and the US correspond to the Flash PMI.*
Source: *CaixaBank Research, based on data from IHS Markit.*

Fiscal measures

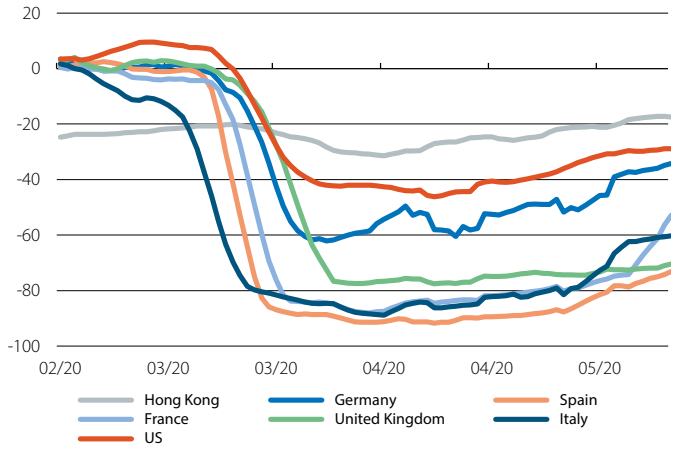
(% of GDP)



Note: *Estimates by Goldman Sachs for direct spending, liquidity and tax deferral measures, etc.*
Source: *Goldman Sachs.*

Population mobility in retail establishments

*Change relative to the base level * (%)*



Notes: *7-day average data. (*) The base level corresponds to the average mobility recorded on the same day of the week between 3 January and 6 February.*
Source: *CaixaBank Research, based on the Google Mobility Report.*

2021 and 2024) and the allocation between countries would take into account the severity of the impact of the coronavirus. Although there are still no official figures on the potential distribution by country, we estimate that Spain could benefit from an annual sum of between 1.5% and 2.0% of its GDP (see further details in the Brief Note of 29 May 2020 entitled «Propuesta de Plan de Recuperación»). This proposal, however, will have to be approved at the European Council (in June or July) and then ratified by the European Parliament and by all Member States.

The US and China revive geopolitical tensions. While on the trade front a new tariff hike seems unlikely – given that, in early May, the two countries were quick to declare that the established agreements were being complied with – the rhetoric between the two economies has once again toughened (in recent months, the US president has repeatedly blamed China for the spread of COVID-19) and new fronts of tension have opened. In particular, the US has pointed out that it could exclude Chinese companies from American stock exchanges. In addition, following the adoption of the Hong Kong Security Law by the Chinese government, the US secretary of state, Mike Pompeo, announced that Hong Kong could no longer be regarded as an autonomous territory of China (which would result in the loss of certain trade and financial benefits enjoyed by the region).

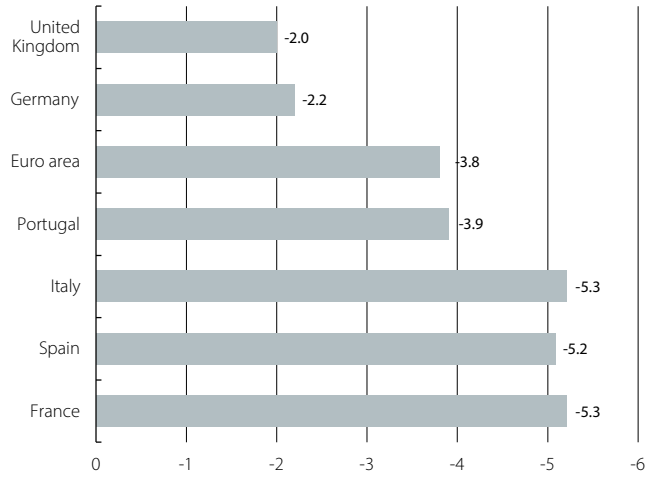
ADVANCED ECONOMIES

Unprecedented declines in economic activity are expected in the major advanced economies in Q2. Following GDP figures for Q1 2020 that have already begun to capture the impact of the pandemic (the US economy contracted by 1.2% quarter-on-quarter, Japan by 0.9%, the UK by 2.0%, Germany by 2.2%, and France, Spain and Italy by around 5.0%), the intensification of restrictions on mobility during April and their extension throughout much of May in most European countries and in the US will lead to unprecedented contractions (in many cases, on a scale unseen since World War II) in the economic activity of these countries in Q2 (see the Focus «The COVID-19 dilemma: mobility and economy» in this same *Monthly Report* for an analysis of the impact of the lockdown measures on GDP in Q2). For instance, in the US the New York Fed's high-frequency economic activity index points towards declines in GDP of more than 10% (in year-on-year terms).

The indicators suggest that the bulk of the weakness was concentrated in April, while in May incipient signs of recovery appeared thanks to the gradual lifting of the lockdown. The information available in real time is scarce and the more conventional indicators available as of the close of this report (such as industrial production, retail sales and the unemployment rate) still relate to March. Nonetheless, high-frequency indicators such as electricity consumption, card payments and indices related to the mobility of people (based

Europe: Q1 2020 GDP

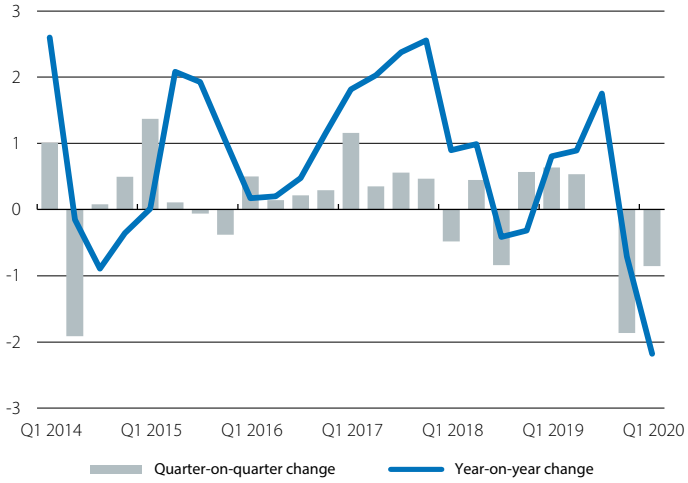
Quarter-on-quarter change (%)



Source: *CaixaBank Research, based on data from Eurostat and national statistics offices.*

Japan: GDP

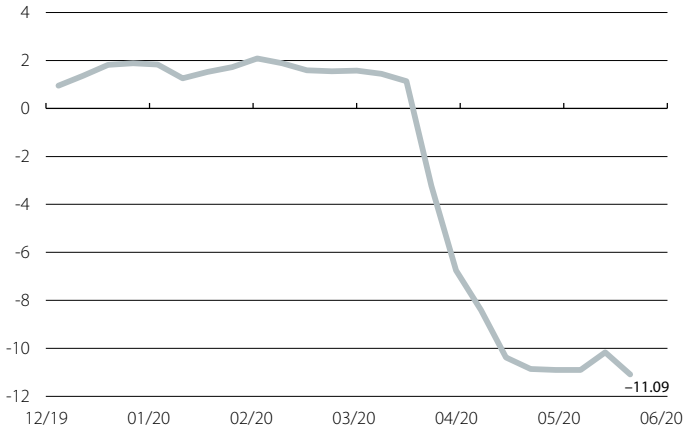
Change (%)



Source: *CaixaBank Research, based on data from the Cabinet Office of Japan.*

*US: weekly economic activity index **

(%)



Note: ** Index built using 10 daily and weekly indicators. It is scaled to coincide with year-on-year GDP growth. It is not an official forecast index of the New York Fed.*
Source: *CaixaBank Research, based on data from the New York Fed.*

on mobile phone geolocation data) suggest, on the one hand, that production remained markedly weak in April and, on the other, that a gradual restoration of economic activity in the major advanced economies began in May. The recovery is, however, very gradual.

COVID-19 weakens inflation, especially due to the fall in energy prices (caused, in turn, by the collapse in global demand) and those of the services hardest hit by the lockdown measures (notably leisure and tourism). Thus, in April, US inflation stood at 0.3%, 1.2 pps below the figure for March, while inflation in the euro area stood at 0.1% in May, –0,2 pps compared to April and –0.6 pps compared to March.

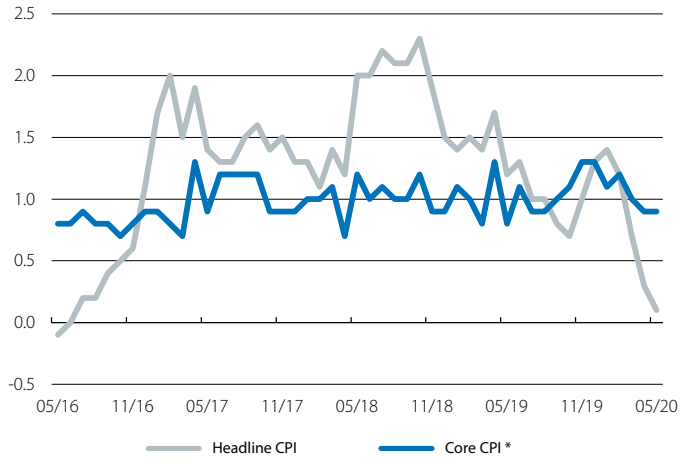
EMERGING ECONOMIES

Gradual and patchy recovery in China. The economic activity indicators for April and May show a disparate recovery by sector in the Chinese economy. Whilst the manufacturing and construction sectors have already recovered their normal levels of production, activity in the services sector is still affected by the maintenance of various social distancing measures and by weaknesses in household consumption, which is making it recover at a slower pace (see the analysis in the Focus «Gradual recovery in China: cautious optimism with some restrictions» in this same *Monthly Report*). In this context, the Chinese cabinet decided, for the first time, not to set a GDP growth target for 2020. However, the government did announce an increase in the public deficit target for this year, up to at least 3.6% of GDP (higher than the 2.8% in 2019). Although this increase may seem modest, it should be borne in mind that the government is also implementing a significant increase in the spending and investment of public enterprises and local entities that do not fall within the scope of the government's budget (this spending could amount to around 3% of GDP). With this package of measures, the fiscal stimulus will help to facilitate the recovery of the Chinese economy in the second half of 2020.

In other major emerging countries, the impact of the pandemic in Q1 was uneven. In India, Turkey and Russia, the impact of the COVID-19 outbreak was yet to leave a significant mark on the economic figures in the first quarter of the year, while in Brazil the impact was much more apparent. Specifically, India's economy grew by 3.1% year-on-year in Q1, versus 4.1% year-on-year in Q4 2019. In Turkey, year-on-year growth stood at 4.5%, lower than the 6.0% registered at the end of 2019 but still buoyant. In Russia, meanwhile, GDP rose by 1.6% year-on-year in Q1 (2.1% in the previous quarter). In contrast, Brazil's GDP fell by 0.3% year-on-year, dented by the lockdown measures decreed in the various states from 13 March (in Q4 2019, the economy had grown by 1.7%). We expect, however, the declines in economic activity for Q2 to be much more significant in all these economies.

Euro area: harmonised ICP

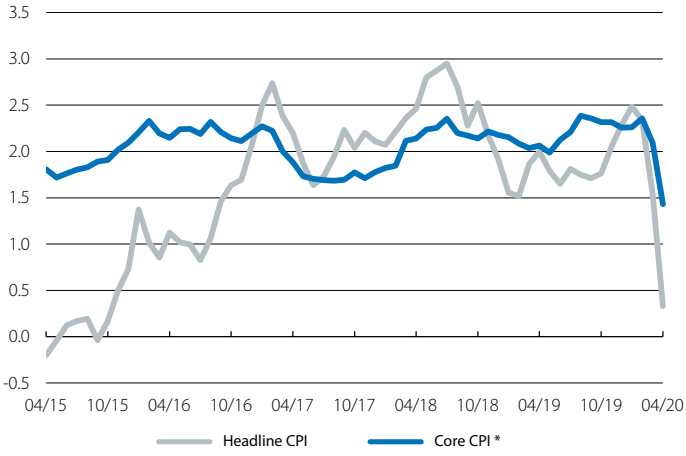
Year-on-year change (%)



Note: ** Excluding energy, food, alcohol and tobacco.*
Source: *CaixaBank Research, based on data from Eurostat.*

US: CPI

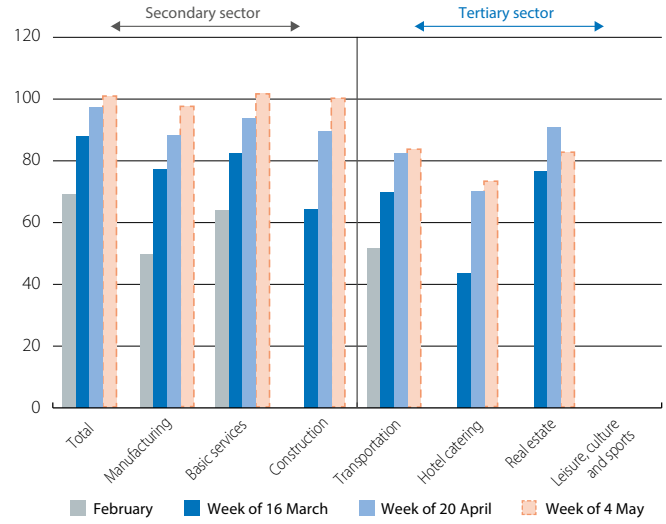
Year-on-year change (%)



Note: ** Excluding energy and food.*
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

China: recovery of economic activity

Percentage of the level of 2019 (%)



Source: *Goldman Sachs Global Investment Research.*

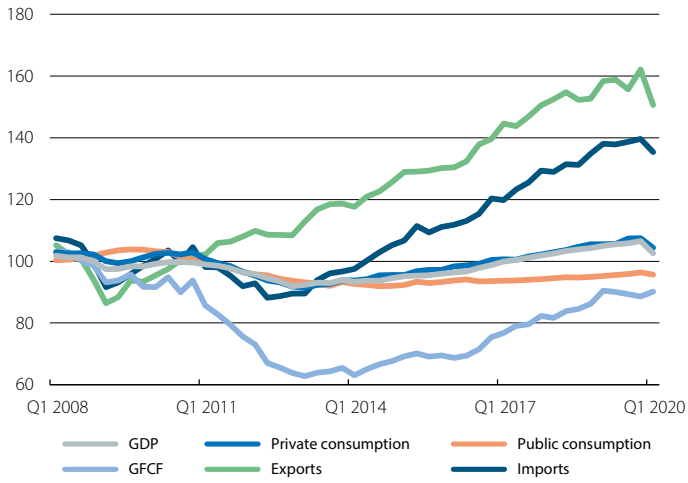
COVID-19 deals a heavy blow to economic activity, but there are signs of a gradual revival

COVID-19 takes a heavy toll in the first quarter of the year. GDP fell by 2.3% year-on-year in Q1 (–3.8% quarter-on-quarter) as a result of the social distancing measures, representing a greater quarter-on-quarter contraction than those registered during the financial crisis. Economic activity was particularly hard hit in the last 20 days of March, when the state of alarm began in Portugal and the lockdown measures were at their peak. From the aggregate data for Q1 it can be inferred that the fall in economic activity in those weeks amounted to around 25%. In the breakdown by component for the quarter as a whole, a significant impact is evident in both domestic and foreign demand. In particular, household consumption fell by 1.0% year-on-year (–3.0% quarter-on-quarter) and investment (gross capital formation) fell by 2.5% (gross fixed capital formation fell by 0.3% year-on-year), while public consumption rose by 0.5%. Overall, domestic demand subtracted 1.1 pps from year-on-year GDP growth and –2.0 pps from quarter-on-quarter growth. Foreign demand, meanwhile, also fell sharply, with exports of goods and services shrinking more than imports (7.1% quarter-on-quarter and 4.9% year-on-year, compared to 3.1% quarter-on-quarter and 2.0% year-on-year, respectively).

Greater declines are expected in Q2 2020, but an incipient recovery occurred in May. The latest indicators show a sharp decline in economic activity in April caused by the extension of the lockdown throughout the month, which also means that more weeks will have been affected by the restrictions on mobility in the second quarter than in Q1. Specifically, the Bank of Portugal's coincident indicators for aggregate economic activity and for consumption (which have a close correlation with GDP and consumption) fell to –1.7% and –2.7% in April, respectively, accentuating the –0.9% and –1.5% declines already registered in March. Indicators such as electricity and fuel consumption are also indicative of the extent of the paralysis in activity in April. Electricity consumption on working days fell by 13.8%, diesel consumption fell by 46.9% and that of petrol, by 58.4%. Data on credit and debit card payments also reflect a drop in consumption, as they fell by around 38% in April. As for May, the available indicators are still limited, but they suggest a slight improvement in economic activity (e.g. car sales and mobility indicators). In the same vein, the credit and debit card purchasing index recovered to 75 points (59 at the end of April and 44 at the end of March). However, electricity consumption continues to show a weak recovery, as the average daily consumption in the first 20 days after the lockdown was eased was 1.8% lower than in the previous 20 days, despite the percentage of companies in operation

Portugal: components of GDP

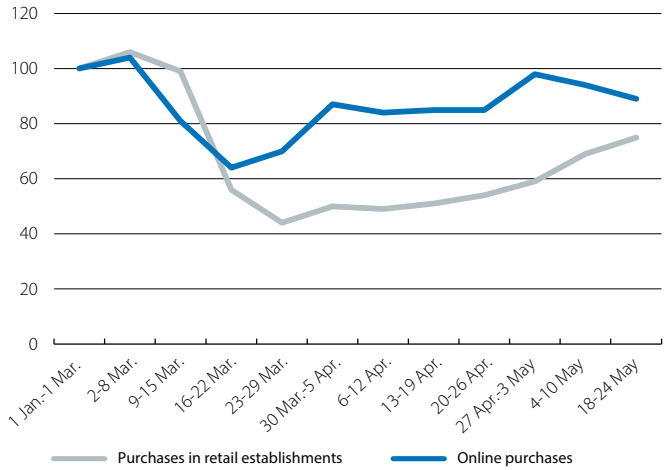
Index (100 = Q1 2007)



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

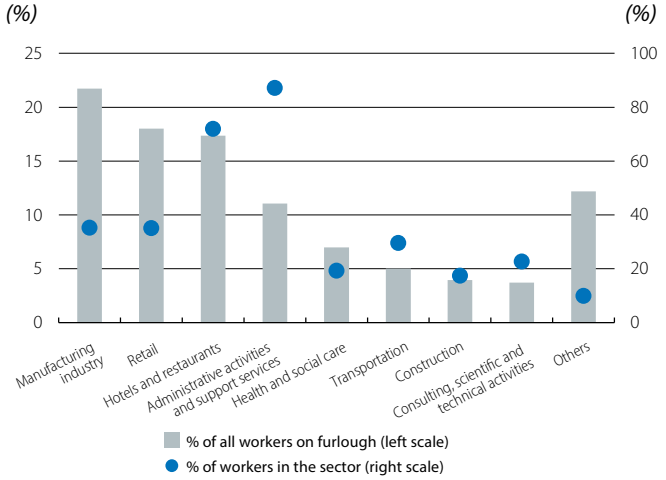
Portugal: credit and debit card payments

Index (100 = 1 January to 1 March)



Source: *CaixaBank Research, based on data from the government of Portugal and internal estimates.*

Portugal: workers on furlough



Nota: *Cumulative data up to 21 May.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal and GEP.*

increasing to 90% from the 84% registered in the second half of April.

The contraction of the economy will be felt in the labour market. The first signs of the impact of COVID-19 on the labour market were already apparent at the end of Q1: there was a reduction in employment of 0.3% year-on-year (the first since Q3 2013), as well as a significant increase in the inactive population (some unemployed people were reclassified as inactive due to their inability to actively seek work because of the restrictions imposed to curb the pandemic). Yet the latest data confirm that the impact will be greater in Q2. For instance, the number of people receiving unemployment benefits increased by more than 17% year-on-year in April, reaching 197,949 people. At the same time, the number of the number of registered unemployed in job centres rose by 30.1% year-on-year in May (based on the latest data up to 26 May), while collective redundancies have affected more than 2,500 people since the state of emergency was declared (just under 1% of the unemployed population). Finally, as of 27 May, 1,332,114 people were on furlough, a situation mainly affecting workers in the manufacturing, retail, accommodation and catering industries (which account for more than 57% of all furloughed workers).

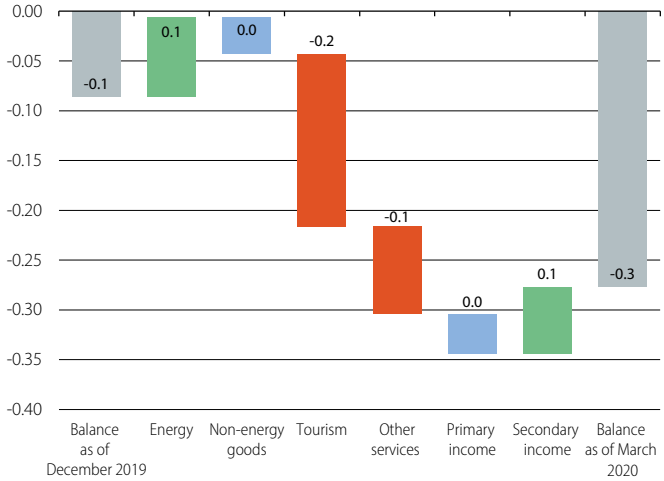
The current account balance deteriorated in Q1. The current account balance worsened by 595 million euros over the past 12 months and reached –0.3% of GDP in March, which represents a 2-decimal-point decline compared to December 2019. This deterioration is largely due to the reduction in the tourism balance and the decline in the sector's revenues in March. With this deterioration, the economy's external lending capacity declined to +0.7% of GDP.

Almost total shutdown of tourism activity in April. Only 68,000 guests were registered in tourist accommodation establishments in the month of April, a year-on-year decline of 97.1% (–62.3% in March). In the context of the state of emergency, 80.6% of tourist accommodation establishments would have closed or registered no movement of guests. In addition, 74.4% of establishments reported the cancellation of bookings for June, with this figure standing at 63.6% for July and 57.5% for August.

The fiscal budget balance deteriorated due to the impact of the pandemic. In April, the fiscal balance stood at –2.5% of GDP (year-to-date), worse than the –1.9% registered in the same period of 2019. The impact of the COVID-19 outbreak on the public accounts was particularly visible in the deferral of revenues (320 million euros) and in the significant increase in some expenditure items, such as current transfers and the acquisition of goods and services. Overall, it is estimated that COVID-19-related expenditure already implemented up to April amounted to 345 million euros (0.2% of GDP). Over the coming months, the impact of the expenditure related to economic support measures will become more visible as the aid measures are implemented and, potentially, expanded.

Portugal: current account balance

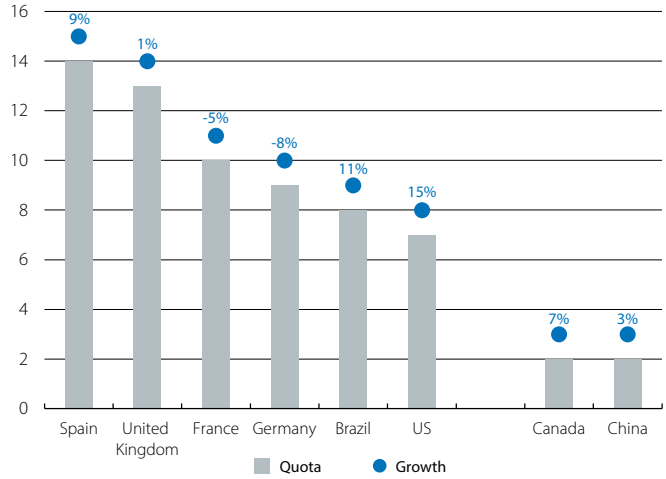
Contribution (pps of GDP)



Source: *CaixaBank Research, based on data from the Bank of Portugal.*

Portugal: non-resident tourism

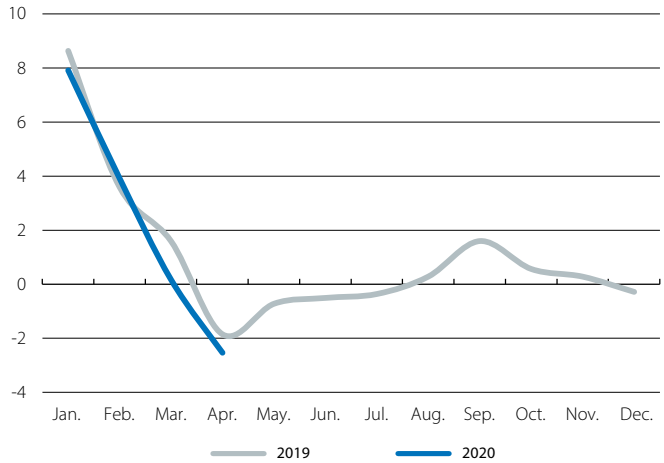
Quota and growth in the last 12 months to March 2020 (%)



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: general government balance

(% of GDP)



Note: *Public accounting data.*
Source: *CaixaBank Research, based on data from the DGO.*