MR12

MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

NUMBER 451 | DECEMBER 2020

ECONOMIC & FINANCIAL ENVIRONMENT

DOSSIER: 2021 OUTLOOK

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
December 2020

The *Monthly Report* is a publication developed jointly by CaixaBank Research and BPI Research (UEEF)

CaixaBank Research
www.caixabankresearch.com
research@caixabank.com
Enric Fernández
Chief Economist
Oriol Aspachs
Director of Research
Sandra Jódar
Director of Banking Strategy
Adrià Morron Salmeron
Monthly Report coordinator
Javier Garcia-Arenas
Dossier coordinator

BPI Research (UEEF)
www.bancobpi.pt /
http://www.bancobpi.pt/grupo-bpi/estudos-e-mercados/mercados-financeiros
deef@bancobpi.pt
Paula Carvalho
Chief Economist

Date this issue was closed:
30 November 2020

INDEX

Outlook: year 1 after the pandemic

The title of this article reflects the central assumption of our economic forecasts for next year: it will be the year in which we will leave the pandemic behind. One of the keys to achieving this will be the successful deployment of the vaccines that have been discovered in record time, an extraordinary milestone in human history. Not so long ago, much of the scientific community doubted that it would be possible to obtain a vaccine in a matter of months rather than years. What has been achieved is proof of how far we can go when the world of research, private enterprise and the governments of different countries share a common goal and strive in a coordinated manner to achieve it. This is without doubt a valid lesson for other challenges we face, such as climate change.

The successful deployment of the vaccines will not be simple or immediate. Their production and distribution pose a formidable logistical challenge. Of course, it will also be crucial that the virus does not mutate in a way that reduces the vaccines' effectiveness, although it may be the case, as with the flu, that the vaccine will need to be updated periodically. Above all, it is essential that enough people are vaccinated in order to achieve so-called herd immunity, the threshold after which there are so many people immune to the virus that the famous R – the rate at which the virus spreads – is naturally below 1, at which point we can consider the epidemic under control. Some recent surveys suggest that it will be necessary to raise awareness that getting vaccinated is safe, effective and represents a show of solidarity. In short, it is necessary.

Until we achieve herd immunity, we will have no choice but to continue the widespread use of other tools to control the epidemic. These are tools we are already familiar with: masks, social distancing, hygiene standards, testing, contact tracing and isolations. Rapid antigen tests can also play an important role as part of this arsenal. At a much lower cost than a PCR test, with very high reliability and with the ability to deliver a result in 15 minutes, they will become a critical tool for increasing the detection of asymptomatic cases.

Controlling the epidemic will facilitate the economic rebound, but it will remain very important over the coming months to continue to support the sectors hardest hit by the virus. Indeed, as the impact of the pandemic becomes increasingly concentrated in a few sectors and we get close to bringing it under control, this support must be decisive. Furthermore, at the current juncture where many companies cannot afford to take on more debt, direct aid must assume a greater role.

The outlook for 2021 will also be marked by international relations. Within the EU, it will be absolutely crucial to unblock the European recovery plan, something which no one doubts will happen. The real possibility of leaving Hungary and Poland out of the plan should make it easier for them to agree to unlock it. As for Brexit, we are in stoppage time with no deal yet reached and we face the real possibility of it not being ready in time for January. The resulting disruption would no doubt facilitate an agreement early next year, but it would certainly be better if we could avoid the difficulties. Finally, the leadership change in the US is good news for multilateralism and international cooperation, including between the US and the EU. The tensions between the US and China, which reflect an underlying struggle for technological and economic world leadership, will continue, but the risks of a shock affecting the global economy as a whole will be lower.

Despite the seriousness of the crisis, Spain is in a different situation than it was in 2008. On that occasion, the economy amassed a 9% drop in GDP in five long years and it took three more years to return to pre-crisis levels. In this crisis, that same drop has taken place in three quarters and, although our expectation is that we might once again take three years to claw back the lost ground, everyone's goal should be to shorten this period. If we make good use of European funds to finance not only investments but also reforms that make us more competitive, we can do it.

Enric Fernández
Chief economist
30 November 2020

Chronology

NOVEMBER 2020

15 Australia, New Zealand and 13 Asian economies (including China) sign a large-scale trade agreement known as the Regional Comprehensive Economic Partnership.
20 The first COVID-19 vaccines seek official approval from the authorities after the trial phase comes to an end.

SEPTEMBER 2020

25 The European Council approves the granting of 87.4 billion euros in SURE loans to 16 Member States. Spain will receive 21.3 billion.
28 The official global COVID-19 death toll surpasses 1 million people.

JULY 2020

21 The European Council approves a 750-billion-euro recovery plan to combat the COVID-19 crisis (360 billion in loans and 390 billion in transfers), to be financed with debt issued by the EU.

OCTOBER 2020

16 The rating agency Moody's downgrades the United Kingdom's credit rating from Aa2 to Aa3.
25 The Spanish government declares a new state of emergency.
28 France announces a new lockdown and other European countries (such as Germany) also impose tighter mobility restrictions than in previous months.

AUGUST 2020

27 The Fed updates the strategic framework for monetary policy and announces that it will pursue an average inflation rate of 2%, temporarily tolerating higher inflation following periods with inflation below 2%.

JUNE 2020

4 The ECB expands the envelope for the pandemic emergency purchase programme (PEPP) by 600 billion euros (to 1.35 trillion), extends its duration until mid-2021 and announces a programme of reinvestments for the PEPP until the end of 2022.
21 The Government of Spain ends the state of alarm.

Agenda

DECEMBER 2020

2 Spain: registration with Social Security and registered unemployment (November).
Portugal: public debt (October).
Portugal: industrial production (October).
10 Governing Council of the European Central Bank meeting.
10-11 European Council meeting.
11 Spain: Fitch rating.
15-16 Federal Open Market Committee meeting.
17 Spain: quarterly labour cost survey (Q3).
Portugal: tourist activity (October).
22 Spain: loans, deposits and NPL ratio (October and Q3).
Portugal: home prices (Q3).
23 Spain: quarterly national accounts (Q3).
Spain: balance of payments and NIIP (Q3).
Spain: state budget execution (November).
Spain: household savings rate (Q3).
30 Spain: CPI flash estimate (December).
31 Portugal: NPL ratio (Q3).

JANUARY 2021

5 Spain: registration with Social Security and registered unemployment (December).
7 Portugal: employment and unemployment (November).
8 Portugal: international trade (November).
Portugal: turnover in industry (November).
15 Spain: financial accounts (Q3).
Portugal: tourism activity (November).
21 Governing Council of the European Central Bank meeting.
22 Spain: loans, deposits and NPL ratio (November).
26-27 Federal Open Market Committee meeting.
28 Spain: labour force survey (Q4).
Portugal: home prices (December).
Euro area: economic sentiment index (January).
US: GDP (Q4 and 2020).
29 Spain: GDP flash estimate (Q4).
Spain: CPI flash estimate (January).
Euro area: GDP (Q4).

China, and the rest of the world

We will remember 2020 as the year of COVID-19. That is obvious per clear. It will probably also become the year in which China consolidated itself as a strong candidate to lead the world economy. We did not imagine that a pandemic would break out in 2020. What is more, when it did, we did not think that China would manage it better than any other country, by far.

China continues to surprise us, it is keeping the pandemic under control and it is the country with the best economic figures. Mobility has practically recovered to pre-crisis levels. This is the case in the major cities, where the aftermath of the pandemic is only reflected in the increased use of private vehicles over public transport. Domestic air traffic has also bounced back and already has a similar volume of activity as prior to the pandemic. Social relations have recovered. Restaurants and cinemas have practically returned to normal. Household consumption and exports have already exceeded pre-pandemic levels and continue to show strong growth. Notably, online sales have enjoyed sustained growth, and exports of electronic goods are buoyant.

China is leading the global recovery. It offers a picture of what the rest of the world will look like in a few months' time. When we have the vaccine and are able to control the pandemic, China's experience tells us that the recovery could be rapid. That is what we hope, even though it might seem unlikely today. China's leadership is also reflected in the GDP data. Among the major economies, it is the only one that will end the year with positive growth, of 2.0% according to CaixaBank Research forecasts.

For the moment, at the global level, China is the exception. All other countries continue to struggle to curb the spread of the virus. Pending the widespread distribution of the vaccine over the coming weeks, the rate of infection has been stabilised in some countries, while in others it is rising again. The measures being taken to contain the pandemic are not as drastic as those imposed during the first wave. Moreover, they seem to be effective in curbing infections and are having a lower economic impact. This is reflected in the differing trends in mobility by category. For instance, the drop in commuting is generally smaller than the decline in journeys to shopping centres.

The US is one of the places where the second wave is gaining strength and the measures to reduce social interactions are being tightened. The economic indicators available to date still show some growth in economic activity and consumption, but they are likely to weaken over the coming weeks. GDP growth in the closing stages of the year will be limited, and for 2020 as a whole the decline will be of around 3.6%. In the coming weeks, another focus of attention will be the approval of the new fiscal stimulus package, which is likely to amount to around 6% of GDP. This is a considerable amount, albeit less than that initially proposed by Joe Biden. We should remember that US fiscal policy has been among the most expansive in the world in 2020. The country will end the year with a public deficit of around 20% of GDP (twice the level likely to be reached in all euro area countries). This figure is unprecedented in recent decades and has made it possible to sustain household incomes, among other things. In the US, these incomes have not fallen at an aggregate level, unlike in most developed countries. However, the fiscal stimulus measures have not served to conceal the lack of political leadership in managing the pandemic.

Europe, meanwhile, continues to wrestle with the health crisis, as well as fighting battles in the economic and political spheres. Although the response from monetary policy has been faster and more decisive than in the last financial crisis, the lack of political leadership has once again become apparent in the difficulties experienced in approving per implementing the long-awaited European recovery plan. It seems that the second wave is finally beginning to stabilise, but the economic cost will probably not be any lower. In the euro area as a whole, the drop in GDP could reach around 3.0% quarter-on-quarter in Q4 (the decline will probably be bigger in Italy and France, where the pandemic is having a more pronounced impact). For the year as a whole, the decline in GDP will end up at around 7.4% according to CaixaBank Research forecasts.

In Spain, the economic impact of the second wave is proving to be less pronounced than it is across the euro area as a whole, but uncertainty is very high. On the one hand, the mobility indicators show a clear decline versus Q3. The data for card spending registered on CaixaBank POS terminals and cash withdrawals also indicate a notable weakening in household consumption in October and November. Nevertheless, employment is performing relatively well in this context. There has not been a surge in the number of people affected by furlough (ERTE) schemes at the aggregate level. Indeed, the year-on-year rate of change in the number of people registered with Social Security has continued to recover over the past few months. Our forecast points to a fall in GDP in the last quarter of the year on the order of 2.5% in quarter-on-quarter terms, but if employment continues to perform better than expected in December, the figure could end up being closer to 0%.

Oriol Aspachs
Head of Research

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.55	2.50	1.75	0.25	0.25	0.25
3-month Libor	3.62	0.75	2.79	1.91	0.20	0.25	0.35
12-month Libor	3.86	1.26	3.08	1.97	0.35	0.50	0.70
2-year government bonds	3.70	0.80	2.68	1.63	0.20	0.30	0.50
10-year government bonds	4.70	2.58	2.83	1.86	0.95	1.20	1.40
Euro							
ECB depo	2.05	0.32	–0.40	–0.50	–0.50	–0.50	–0.50
ECB refi	3.05	0.90	0.00	0.00	0.00	0.00	0.00
Eonia	3.12	0.55	–0.36	–0.46	–0.45	–0.45	–0.45
1-month Euribor	3.18	0.67	–0.37	–0.45	–0.47	–0.45	–0.43
3-month Euribor	3.24	0.85	–0.31	–0.40	–0.48	–0.45	–0.40
6-month Euribor	3.29	1.00	–0.24	–0.34	–0.47	–0.43	–0.35
12-month Euribor	3.40	1.19	–0.13	–0.26	–0.45	–0.40	–0.30
Germany							
2-year government bonds	3.41	0.55	–0.60	–0.63	–0.70	–0.60	–0.45
10-year government bonds	4.30	1.82	0.25	–0.27	–0.50	–0.25	0.00
Spain							
3-year government bonds	3.62	2.06	–0.02	–0.36	–0.14	0.09	0.24
5-year government bonds	3.91	2.59	0.36	–0.09	–0.04	0.22	0.41
10-year government bonds	4.42	3.60	1.42	0.44	0.25	0.45	0.65
Risk premium	11	178	117	71	75	70	65
Portugal							
3-year government bonds	3.68	4.02	–0.18	–0.34	–0.08	0.17	0.34
5-year government bonds	3.96	4.67	0.47	–0.12	0.08	0.34	0.53
10-year government bonds	4.49	5.35	1.72	0.40	0.25	0.50	0.70
Risk premium	19	353	147	67	75	75	70
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.29	1.14	1.11	1.18	1.20	1.22
EUR/JPY (yen per euro)	129.50	126.40	127.89	121.40	124.51	128.40	130.54
USD/JPY (yen per dollar)	115.34	98.97	112.38	109.25	105.51	107.00	107.00
EUR/GBP (pounds per euro)	0.66	0.83	0.90	0.85	0.91	0.91	0.90
USD/GBP (pounds per dollar)	0.59	0.64	0.79	0.76	0.77	0.76	0.74
OIL PRICE							
Brent ($/barrel)	42.3	82.5	57.7	65.2	42.0	55.0	60.0
Brent (euros/barrel)	36.4	63.2	50.7	58.6	35.6	45.8	49.2

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
GDP GROWTH							
Global	**4.5**	**3.4**	**3.5**	**2.8**	**–4.1**	**5.5**	**3.9**
Developed countries	***2.7***	***1.3***	***2.2***	***1.7***	***–5.4***	***4.4***	***3.0***
United States	2.7	1.5	3.0	2.2	–3.6	4.1	3.2
Euro area	2.2	0.7	1.9	1.2	–7.4	4.3	2.7
Germany	1.6	1.3	1.6	0.6	–5.9	3.2	2.2
France	2.2	0.8	1.7	1.2	–9.3	5.7	3.1
Italy	1.5	–0.5	0.8	0.3	–9.0	5.0	2.5
Portugal	1.5	0.0	2.9	2.2	–8.3	4.9	3.1
Spain	3.7	0.3	2.4	2.0	–11.4	6.0	4.4
Japan	1.5	0.5	0.3	0.7	–5.3	3.5	1.4
United Kingdom	2.9	1.1	1.3	1.4	–11.0	6.9	4.1
Emerging and developing countries	***6.5***	***5.1***	***4.5***	***3.7***	***–3.2***	***6.3***	***4.6***
China	10.6	8.3	6.7	6.1	2.0	8.3	4.5
India	9.7	6.9	6.8	4.9	–10.3	9.5	7.3
Brazil	3.6	1.6	1.3	1.1	–5.0	3.0	2.5
Mexico	2.4	2.1	2.2	–0.3	–10.0	3.5	2.2
Russia	7.2	0.9	2.5	1.3	–4.2	3.0	2.2
Turkey	5.4	5.1	2.8	0.9	–3.0	4.0	3.4
Poland	4.0	3.4	5.4	4.2	–3.6	2.9	4.9
INFLATION							
Global	**4.1**	**3.7**	**3.6**	**3.5**	**3.0**	**3.1**	**3.3**
Developed countries	***2.1***	***1.5***	***2.0***	***1.4***	***0.7***	***1.3***	***1.6***
United States	2.8	1.7	2.4	1.8	1.2	2.0	2.2
Euro area	2.1	1.4	1.8	1.2	0.2	0.9	1.4
Germany	1.7	1.3	1.9	1.4	0.4	1.0	1.5
France	1.8	1.2	2.1	1.3	0.5	1.0	1.4
Italy	1.9	1.5	1.2	0.6	–0.2	0.7	1.2
Portugal	3.0	1.2	1.0	0.3	0.0	0.9	1.3
Spain	3.2	1.4	1.7	0.7	–0.4	1.0	1.7
Japan	–0.3	0.3	1.0	0.5	0.1	0.4	0.4
United Kingdom	1.9	2.4	2.5	1.8	0.8	1.3	1.4
Emerging countries	***6.7***	***5.7***	***4.9***	***5.1***	***4.8***	***4.5***	***4.4***
China	1.7	2.6	2.1	2.9	2.6	1.5	2.3
India	4.5	8.0	3.9	3.7	6.6	9.7	4.7
Brazil	7.3	6.1	3.7	3.7	2.8	3.2	3.7
Mexico	5.2	4.2	4.9	3.6	3.5	3.5	3.7
Russia	14.2	8.7	2.9	4.5	3.3	3.5	4.0
Turkey	27.2	8.4	16.2	15.5	11.8	10.4	8.0
Poland	3.5	2.0	1.2	2.1	3.5	2.1	2.4

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

Spanish economy

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
Macroeconomic aggregates							
Household consumption	3.6	–0.6	1.8	0.9	–13.7	6.6	4.0
Government consumption	5.0	0.9	2.6	2.3	3.5	3.3	2.2
Gross fixed capital formation	5.6	–2.8	6.1	2.7	–14.3	7.0	7.7
Capital goods	4.9	–0.5	5.4	4.4	–16.5	13.8	8.5
Construction	5.7	–5.2	9.3	1.6	–16.8	4.0	7.1
Domestic demand (vs. GDP Δ)	4.4	–0.7	2.9	1.4	–10.0	5.6	4.2
Exports of goods and services	4.7	3.1	2.3	2.3	–20.1	9.7	7.4
Imports of goods and services	7.0	–0.3	4.2	0.7	–17.8	9.1	7.4
Gross domestic product	**3.7**	**0.3**	**2.4**	**2.0**	**–11.4**	**6.0**	**4.4**
Other variables							
Employment	3.2	–1.0	2.6	2.3	–7.3	0.0	2.2
Unemployment rate (% of labour force)	10.5	20.5	15.3	14.1	16.0	17.9	16.5
Consumer price index	3.2	1.4	1.7	0.7	–0.4	1.0	1.7
Unit labour costs	3.0	0.1	1.2	2.4	6.3	–4.3	0.0
Current account balance (% GDP)	–5.9	–0.8	1.9	2.1	1.1	1.6	2.0
External funding capacity/needs (% GDP)	–5.2	–0.4	2.4	2.4	1.5	2.0	2.2
Fiscal balance (% GDP)[1]	0.4	–6.7	–2.5	–2.8	–12.4	–9.2	–6.6

Note: *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
Macroeconomic aggregates							
Household consumption	1.7	0.1	2.6	2.4	–6.7	4.0	3.6
Government consumption	2.3	–0.6	0.6	0.7	0.7	2.2	0.2
Gross fixed capital formation	–0.3	–2.0	6.2	5.4	–7.4	–0.6	4.1
Capital goods	1.2	1.2	8.9	2.8	–	–	–
Construction	–1.5	–4.4	4.7	7.2	–	–	–
Domestic demand (vs. GDP Δ)	1.3	–0.5	3.1	2.7	–5.6	3.4	3.8
Exports of goods and services	5.2	4.0	4.2	3.5	–16.4	20.3	8.2
Imports of goods and services	3.6	2.2	5.0	4.7	–11.0	15.5	8.4
Gross domestic product	**1.5**	**0.0**	**2.9**	**2.2**	**–8.3**	**4.9**	**3.1**
Other variables							
Employment	0.4	–0.6	2.3	1.0	–3.9	–0.8	1.7
Unemployment rate (% of labour force)	6.1	11.8	7.0	6.5	7.4	9.1	7.7
Consumer price index	3.0	1.2	1.0	0.3	0.0	0.9	1.3
Current account balance (% GDP)	–9.2	–3.6	0.4	–0.1	–1.8	–1.0	–0.6
External funding capacity/needs (% GDP)	–7.7	–2.2	1.4	0.9	–0.8	0.0	1.0
Fiscal balance (% GDP)	–4.6	–6.1	–0.3	0.1	–7.2	–5.7	–3.1

Forecasts

Optimism returns to the financial markets

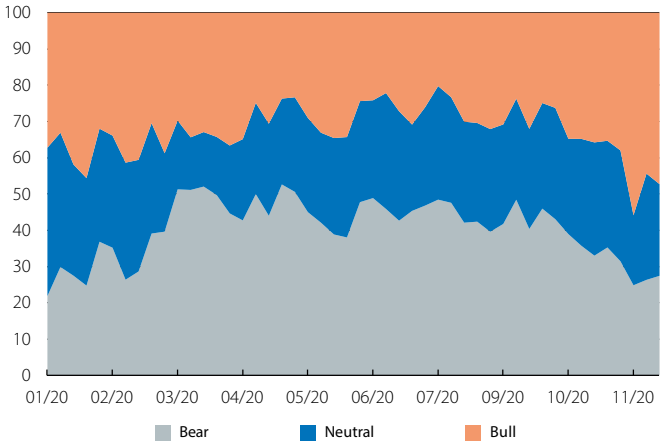
The US election and hopes about vaccines fuel risk appetite. The result of the US presidential election was welcomed by investors, anticipating a vigorous fiscal stimulus to support the economic recovery and a less belligerent tone in international relations. Furthermore, in November the preliminary results of three potential COVID-19 vaccines were published, the high efficacy of which led investors to anticipate an improved economic outlook for 2021. All of this resulted in greater risk appetite and a general rise in the values of financial assets more closely tied to the business cycle. In particular, stock market indices in the major advanced and emerging economies rallied, the Brent oil price rose to levels not seen since March, and most currencies appreciated against the dollar. These trends were also supported by the expectation that the central banks will continue to offer accommodative financial conditions. Nevertheless, the environment remains demanding and uncertainty is very high, most notably in relation to the evolution of the pandemic in this second wave (which is likely to cause declines in GDP in Q4), but also because of other factors such as the Brexit negotiations and the EU's recent tensions with Poland and Hungary, which have stalled the approval of the Next Generation EU plan.

The recovery of the stock markets accelerates in November. This greater risk appetite was clearly evident in the performance of the major stock market indices, which in some cases ended the month with the biggest monthly gains ever recorded (the Eurostoxx 50 and Ibex, for instance). Of particular note were the gains registered in sectors more closely linked to the business cycle, which had been harder hit since the outbreak of the pandemic. For instance, sectors such as energy (closely linked to oil prices) and finance enjoyed significant rallies and moderated the declines amassed in the year to date. In contrast, the gains were smaller in the basic consumption and health sectors, which had managed to weather the pandemic somewhat better. By region, the gains were greater in the euro area (Ibex 35 +25.2%, PSI 20 +16.7%, and Eurostoxx 50 +18.1%) than in the US or emerging economies (S&P 500 +10.8% and MSCI Emerging Markets index +9.2%). Nevertheless, most indices in the Old Continent remain below the levels of the beginning of the year, unlike in the US and China.

Brent oil breaks free of the 43-dollar resistance level. After remaining in the 37-43 dollar range since the end of summer, in November the price of a barrel of Brent oil reached 48 dollars, a level not seen since March. This increase was supported by the widespread improvement in investor sentiment and the actions of OPEC and its allies. In particular, the crude oil price was hoisted up by the expectation that OPEC and its allies will re-adjust production levels to offset

US: market sentiment

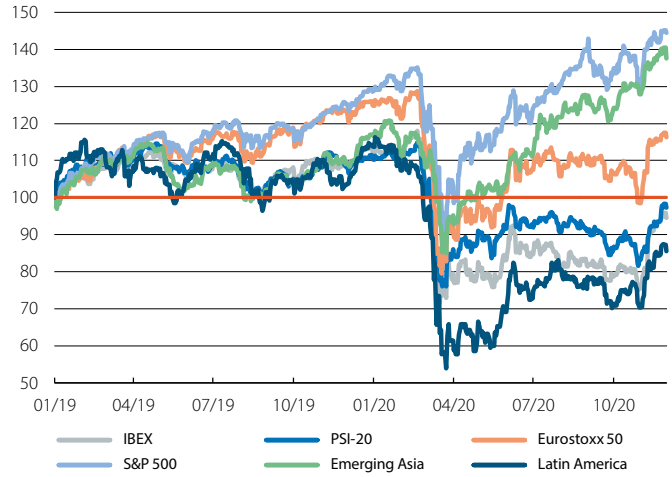
(%)



Note: *The percentage of investors responding to the American Association of Individual Investors survey about their sentiment: optimistic (bull), pessimistic (bear), or neutral.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Main international stock markets

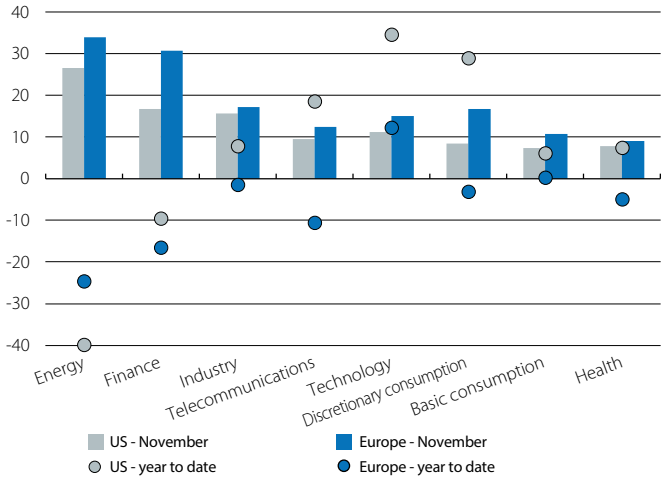
Index (100 = January 2019)



Source: *CaixaBank Research, based on data from Bloomberg.*

Sectors of the S&P 500 and Eurostoxx 600

Change (%)



Source: *CaixaBank Research, based on data from Bloomberg.*

the weak demand over the coming months (OPEC and its allies meet in early December to take a decision).

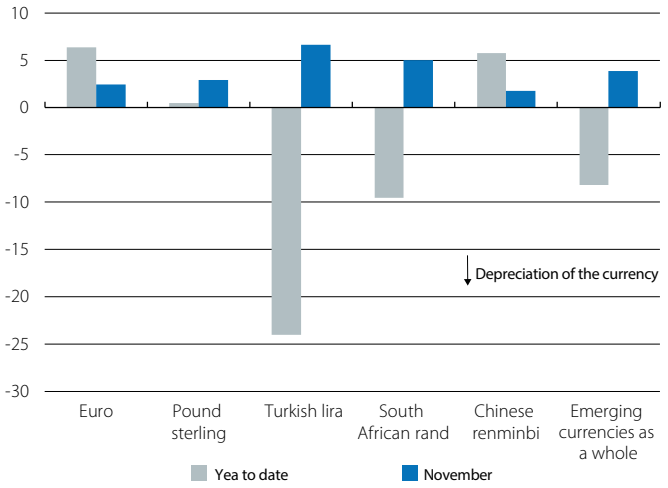
Emerging currencies gain strength, although there are some pockets of instability. In November, the set of emerging currencies as a whole appreciated against the US dollar by almost 4%. One of the currencies that appreciated the most was the South African rand (+5.0%), despite a decline in the country's debt rating and uncertainty surrounding various African countries' ability to repay sovereign debts. In Turkey, meanwhile, the change of leadership in both the central bank and the finance ministry was well received by investors and managed to stabilise the depreciation of the lira. In addition, thanks to a 450-bp interest rate hike implemented by the central bank, its currency appreciated by around 7% in the month as a whole. In advanced economies, meanwhile, currencies considered safe-haven assets (namely the Japanese yen, the Swiss franc and the US dollar) weakened as a result of the increased risk appetite. The euro thus managed to exceed 1.19 dollars, while the pound sterling strengthened slightly in a month with little sign of progress in the Brexit negotiations.

The ECB and the Fed set the stage for new stimulus packages. After the ECB's last meeting, Christine Lagarde made it clear that the monetary institution would offer new monetary stimuli at its meeting on 10 December. Based on the speeches given by members of the Governing Council and the minutes of the last meeting, the ECB's main tools will most likely include asset purchases and liquidity injections, articulated through the PEPP and the TLTROs, respectively. In particular, the ECB is likely to increase the scale of these programmes (by increasing the maximum volume of assets it can acquire and offering new rounds of TLTROs), as well as their duration (prolonging net purchases of assets under the PEPP and the attractive conditions of the TLTROs until at least the end of 2021). While the ECB has not ruled out other tools, such as an interest rate cut or an acceleration in the pace of purchases through the APP, these options appear less likely, as well as less effective. The Federal Reserve, meanwhile, is studying the possibility of offering an even more accommodative monetary policy, as was made apparent in the minutes of the October meeting. Some of the strategies being considered by the Fed include the possibility of increasing the monthly rate of net purchases of treasuries and MBSs (currently 120 billion dollars), increasing the average maturity of the assets that are purchased (buying more long-term treasuries seems the most likely option), extending the horizon of net purchases and/or providing greater clarity on the future path of asset purchases. Thus, both central banks are determined to extend a highly accommodative financial environment with interest rates at very low levels.

Oil: price of a barrel of Brent
(Dollars per barrel)

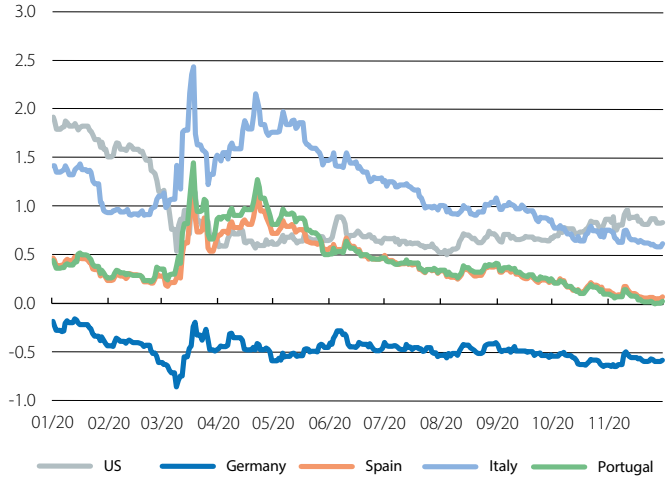
Source: *CaixaBank Research, based on data from Bloomberg.*

Currencies against the dollar
(%)



Source: *CaixaBank Research, based on data from Bloomberg.*

10-year sovereign debt yields
(%)



Source: *CaixaBank Research, based on data from Bloomberg.*

Interest rates (%)

	30-Nov.	31-Oct.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	0.00	0.00	0	0.0	0.0
3-month Euribor	–0.53	–0.52	0	–14.3	–12.5
1-year Euribor	–0.49	–0.49	0	–23.8	–21.4
1-year government bonds (Germany)	–0.67	–0.70	3	–3.6	–5.2
2-year government bonds (Germany)	–0.74	–0.79	5	–14.2	–11.6
10-year government bonds (Germany)	–0.57	–0.63	6	–38.6	–21.1
10-year government bonds (Spain)	0.08	0.14	–5	–38.7	–33.5
10-year government bonds (Portugal)	0.03	0.11	–7	–40.8	–36.7
US					
Fed funds	0.25	0.25	0	–150.0	–150.0
3-month Libor	0.23	0.22	1	–168.3	–168.0
12-month Libor	0.33	0.33	0	–166.6	–162.2
1-year government bonds	0.11	0.12	–1	–146.0	–147.9
2-year government bonds	0.15	0.15	0	–142.1	–146.3
10-year government bonds	0.84	0.87	–3	–107.9	–93.7

Spreads corporate bonds (bps)

	30-Nov.	31-Oct.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	49	65	–16	4.9	1.1
Itraxx Financials Senior	61	85	–24	9.0	4.1
Itraxx Subordinated Financials	113	164	–50	–0.1	–4.8

Exchange rates

	30-Nov.	31-Oct.	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.193	1.165	2.4	6.4	8.3
EUR/JPY (yen per euro)	124.420	121.930	2.0	2.2	3.2
EUR/GBP (pounds per euro)	0.895	0.900	–0.5	5.8	5.1
USD/JPY (yen per dollar)	104.310	104.660	–0.3	–4.0	–4.7

Commodities

	30-Nov.	31-Oct.	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	428.4	409.6	4.6	6.7	10.9
Brent ($/barrel)	47.6	37.5	27.0	–27.9	–23.8
Gold ($/ounce)	1,777.0	1,878.8	–5.4	17.1	21.4

Equity

	30-Nov.	31-Oct.	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	3,621.6	3,270.0	10.8	12.1	15.3
Eurostoxx 50 (euro area)	3,492.5	2,958.2	18.1	–6.7	–5.7
Ibex 35 (Spain)	8,076.9	6,452.2	25.2	–15.4	–13.6
PSI 20 (Portugal)	4,604.7	3,945.1	16.7	–11.7	–10.2
Nikkei 225 (Japan)	26,433.6	22,977.1	15.0	11.7	13.5
MSCI Emerging	1,205.1	1,103.5	9.2	8.1	15.9

The vaccine illuminates a difficult end to the year

The new COVID-19 outbreaks weigh down the global recovery in the closing months of the year. Following a strong rebound in economic activity in Q3 in the major economies, the latest available data confirm a loss of buoyancy in the last quarter, particularly in Europe. Several governments had to increase and prolong their restrictions in November in the face of a resurgence of COVID-19 cases, and while they are already preparing for a de-escalation, December will still be affected. Nevertheless, there are differences compared to the first wave. While in several European countries the number of daily cases has exceeded the peak of the first wave, the mortality rate is more moderate. Consequently, more targeted and localised measures are being taken during this second wave: for instance, in Italy and the United Kingdom restrictions are determined by region according to the incidence of the virus. The fall in economic activity is therefore much less pronounced than in March and April: for example, the composite PMI for the euro area fell to 45.3 points in November. While below the threshold separating contractionary and expansionary territory, this is comfortably above the historically low levels of the first wave. On the other hand, the US economy is resisting despite a surge in COVID-19 cases, while in China the pandemic is under control and the economy is already consolidating its recovery.

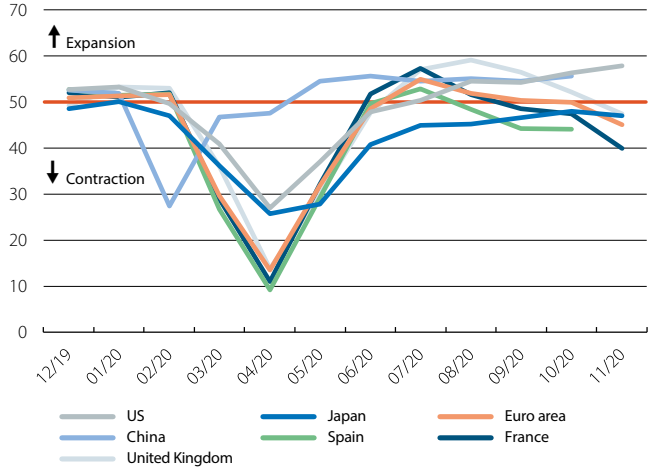
The vaccine will drive economic recovery in 2021. In November, several COVID-19 vaccines completed their trials with a high degree of effectiveness and the procedures for the authorities to validate them have already begun. Although the approval dates and distribution capacity remain to be resolved, according to the available information, the US and the UK could start distributing the first vaccines in December, while in Europe the approval process could take a few weeks longer.

ADVANCED ECONOMIES

So far, the US economy has resisted the impact of the COVID-19 pandemic somewhat better. An increase in the infection rate and a later wave than in Europe, as was the case in spring, cannot be ruled out. However, so far the data for the US are much more robust than in most advanced economies. The industrial production index, for instance, increased by 1.1% month-on-month in October, placing production 5.3% below last year's levels (–6.7% in September), while confidence indicators have remained high in both industry and services. However, some indicators do show a certain slowdown, especially those related to consumption. We saw this a few days ago with less dynamic retail sales and, more recently, with a reduction in the Conference Board's consumer

Composite PMI by country

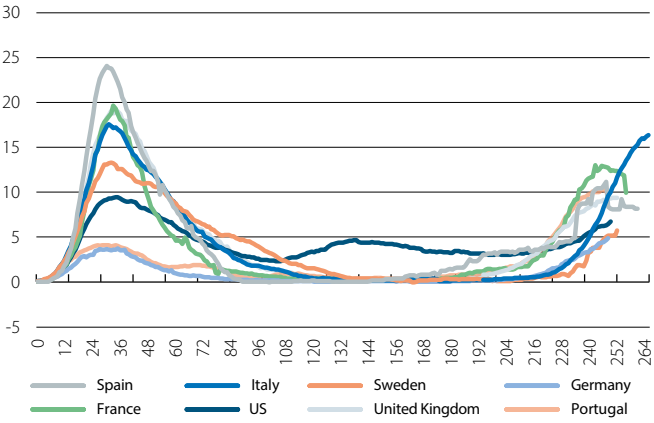
Level



Note: *The index for November is a flash estimate.*
Source: *CaixaBank Research, based on data from Markit.*

Mortality from COVID-19

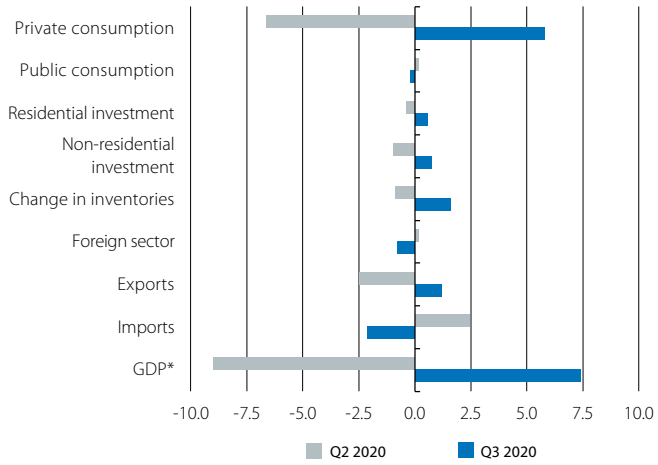
Deaths per 100,000 inhabitants (14-day cumulative figure)
(from the day on which >1 death per million inhabitants was recorded)



Note: *Data available up until 26 November 2020.*
Source: *CaixaBank Research, based on Johns Hopkins CSSE, UN World Population Prospects.*

US: components of GDP in Q2 2020 and Q3 2020

Contribution to non-annualised quarter-on-quarter growth (pps)



Note: ** Non-annualised quarter-on-quarter change (%).*
Source: *CaixaBank Research, based on data from the Bureau of Economic Analysis.*

confidence index. Thus, the forecast models developed by the Atlanta and New York Federal Reserves suggest that US GDP could continue to grow in Q4, albeit at more moderate rates (+2.7% and +0.7% quarter-on-quarter, respectively).

In this context, negotiations continue on a new fiscal stimulus in the US. Following Joe Biden's victory in the presidential election, the US Congress has resumed negotiations to launch a new fiscal package. Although the Senate remains divided between Democrats and Republicans, new proposals began to be drawn up in November. An agreement is likely to be reached on a fiscal support package amounting to some 1.2 trillion dollars (~6% of GDP), which would be added to the 3 trillion already approved.

In Europe, the second wave will lead to a contraction in economic activity in Q4. Although the retail sales data were positive in October in most countries (up 2.6% month-on-month in Germany and 2.8% in France), the impact of the restrictions on citizens' mobility is already apparent, with a considerable drop in mobility registered in November, especially in France and Italy. Nevertheless, as we have said, the containment measures taken during this second wave are more targeted and localised, and are therefore not having as strong an impact as they did in March and April. The impact of this second wave of restrictions will also be different across sectors, since in many cases the restrictions focus on reducing socialising and closing non-essential shops, while industrial plants are generally allowed to operate. Indeed, this is reflected in the indicators: while the euro area services PMI is in recessionary territory and fell to 41.7 points in November, the manufacturing PMI (53.8 in November) continues to suggest growth in industrial production. However, the restrictions will continue to determine the state of play towards the end of the year and over the coming months, leading us to project a contraction in the euro area's GDP in Q4 (of 3% quarter-on-quarter, a much smaller decline than that of Q2, when GDP fell 11.8%). That said, the impact will be greater in France and Italy, where the restrictions have been stricter.

Poland and Hungary cast doubt over the agreement on the European budget and NGEU. The two countries' governments refused to ratify the new EU budget and NGEU, the European recovery plan, in protest against the mechanism for the protection of the rule of law, which was agreed in mid-November and could result in the suspension of payments from the European budget to Member States that violate principles on the quality of the rule of law. This could jeopardise NGEU, the recovery plan through which the EU will disburse some 750 billion euros in loans and grants to its Member States to help support their economies. This is a delicate situation, as we expect the NGEU plan to have a considerable impact on the growth of European countries over the coming years. The negotiations between Member States

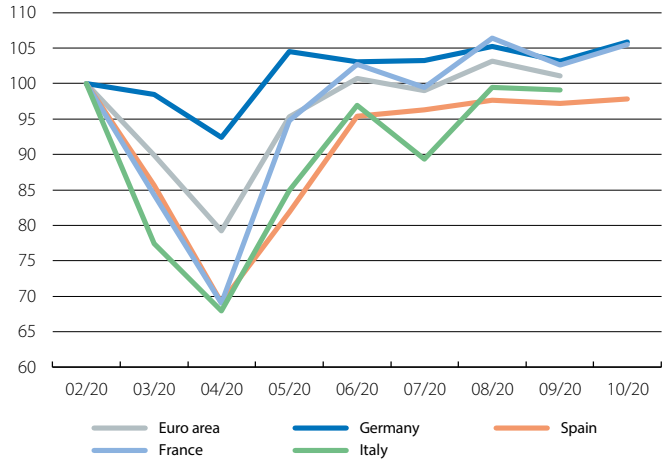
US: consumer confidence index

Level (100 = 1985)

Source: *CaixaBank Research, based on data from the Conference Board.*

Euro area: retail sales

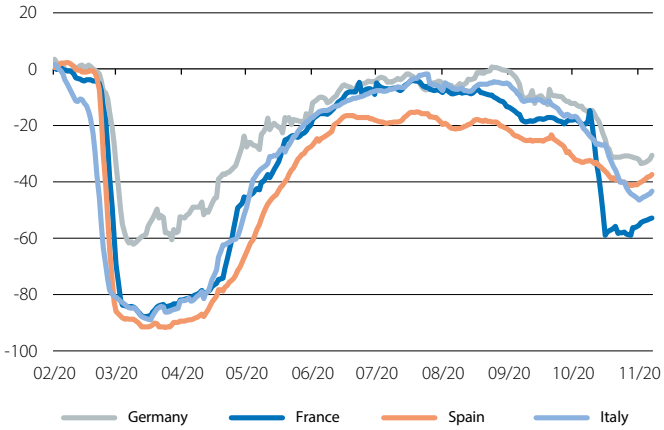
Index (100 = February 2020)



Note: *Seasonally adjusted series.*
Source: *CaixaBank Research, based on data from Eurostat.*

Mobility in retail and recreation

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



Notes: *7-day average figures. (*) The baseline level corresponds to the average mobility recorded on the same day of the week between 3 January and 6 February 2020.*
Source: *CaixaBank Research, based on data from Google Mobility Report.*

continue, but they are complex and will have to be carried out quickly to avoid delays in the implementation of the common budget and NGEU.

The Brexit negotiations are entering the final stretch, as there is little time left to reach an agreement on the UK-EU trade relationship before the transition period ends on 1 January 2021. There was very little news about the negotiations in recent weeks, and at the close of this report the main disagreements over the level playing field (referring to state aid rules and the environmental, social and labour standards that could affect the country's competitiveness) and over fishing rights remained unresolved. Although the deadline is drawing very close and accidents cannot be ruled out, an agreement can be expected to be reached to prevent trade between the EU and the United Kingdom from becoming regulated according to World Trade Organization rules from January (which would lead to tariff rises and regulatory barriers).

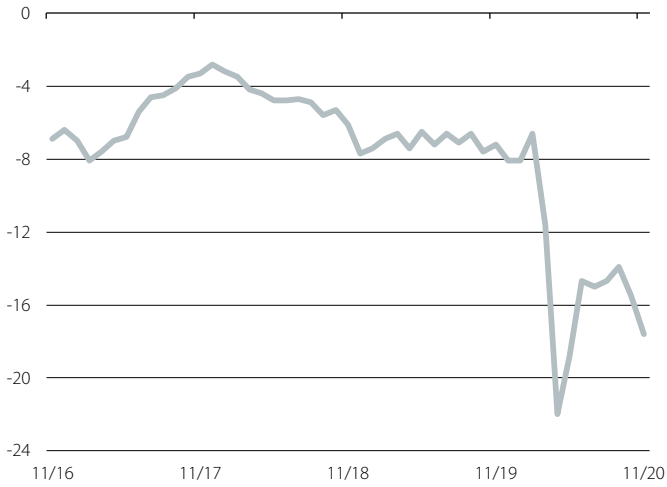
The Japanese economy also experienced a strong recovery in Q3 and faces a Q4 with outbreaks that are currently still under control. GDP rose by 5.0% quarter-on-quarter, a considerable rise but still insufficient to offset the three consecutive quarters of contractions that the Japanese economy had suffered. As for Q4, the latest data suggest that the recovery continues in the Asian economy, and the second wave of coronavirus is not affecting the country as severely as it is in Europe. However, the considerable increase in infections in recent weeks invites prudence.

EMERGING ECONOMIES

The recovery of emerging economies has proven stronger than expected in Q3. Although in different stages of the cycle (China, for instance, has already regained its pre-crisis levels), the major emerging economies registered significant GDP growth in Q3. In Turkey, GDP grew by 6.7% year-on-year, while India and Russia also bounced back, albeit still with negative year-on-year growth (–7.5% and –3.6%, respectively). Without doubt, China's economy (which grew by 4.9% year-on-year in Q3) is recovering the most vigorously among the world's large economies. In Q4, the high exposure to the European economy in Turkey and Russia could weigh down their economic activity, while in China and India, which have closer ties to the US and global economy, the recovery could be more dynamic. This is supported by the November composite PMI indicator, which rose in China to 55.7 points, while it fell in Turkey, although it is still above the 50-point threshold.

Euro area: consumer confidence

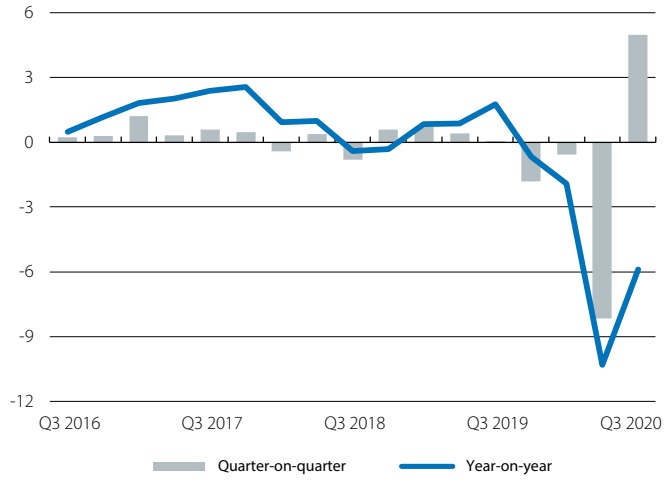
Level



Source: *CaixaBank Research, based on data from the European Commission.*

Japan: Real GDP

Change (%)



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

Composite PMI by country

Level

Note: *Turkey: manufacturing PMI.*
Source: *CaixaBank Research, based on data from Markit.*

US: what will the new administration bring?

- **US policies will focus on domestic needs: a new fiscal package and increased infrastructure spending are shaping up to be the main areas of actions.**
- **In foreign policy, we can expect to see a reconnection with multilateral cooperation agencies and a rapprochement with Europe, while the standoff with China will continue.**

The Democratic candidate, Joe Biden, beat Republican Donald Trump in the recent US presidential election. As for Congress, it seems that it will remain divided, with the House of Representatives in Democratic hands and the Senate in Republican hands.[1] In this political environment and with the COVID-19 crisis ever present, what can we expect from US domestic and foreign policy in 2021?

Domestic policy: fiscal package, green infrastructure, tax rise?

With an economy still severely affected by the economic crisis resulting from the pandemic, domestic policy will be the focus of attention in 2021. One of the highlights will be the new fiscal package to help combat the impact of the COVID-19 pandemic. Based on how the negotiations are currently progressing, this new package is expected to be approved in the coming weeks and to amount to some 1.2 trillion dollars (~6% of GDP). This is a substantial package, which we estimate could contribute between 3.0% and 4.0% to GDP growth in 2021.[2] It includes measures such as a renewed extension of unemployment benefit, new aid for businesses (such as new loans under the umbrella of the Paycheck Protection Program) and direct aid for states.

Secondly, for years both Democrats and Republicans have been talking about the need to invest in infrastructure, but they have not managed to make significant progress in this area. Although a divided Congress might still make progress difficult, the current context of the pandemic offers a good opportunity to drive forward at least parts of the president-elect's infrastructure plan. This is especially the case for the elements related to the climate agenda and green investment, since they would serve to revitalise regions where the crisis has had a significant impact on the productive fabric of the economy.

One example can be found in the states that are closely linked to oil and gas. In recent months, the oil and gas industry has lost over 100,000 jobs (representing 15% of the total number of employees it had at the beginning

Policies under Biden

Joe Biden
President-elect of the United States

Senate:
Probably Republican majority (but not definitive)

House of Representatives:
Democratic majority

Domestic policy
- New fiscal stimulus (approximately 1.2 trillion dollars).
- Infrastructure plan and investment in green technology.
- Tax rise (corporation, capital gains...)?

Foreign policy
- Reconnection with multilateral agencies (WHO, Paris Climate Agreement...).
- Rapprochement with European allies.
- Continuity of the decoupling process with China (though less belligerent).

Source: *CaixaBank Research.*

1. The final outcome for the Senate has not yet been determined. Georgia still has to appoint two senators (they will be decided in a second ballot on 5 January) and this will determine the future of the Senate.

2. We took a fiscal multiplier of 0.58, estimated by the Congressional Budget Office in reference to the effect of the CARES Act (the fiscal package approved at the end of March 2020 to combat the COVID-19 crisis).

of the year) and its unemployment rate exceeds the country's average (around 14% in October, compared to 6.9% nationally). Moreover, the recovery of employment in the sector is being hampered by the prospect of moderate oil prices (in the face of global demand hit by the pandemic). These regions could therefore accelerate their revival if they were to benefit from a plan for the development of alternative infrastructures.[3]

Finally, in his electoral programme, Biden proposed a tax rise to partially reverse the significant cuts introduced by the Trump administration in late 2017.[4] However, in the short term it seems unlikely that the future president will gain sufficient support in Congress.

Foreign policy: some things will change, but not the position with China

With Biden in the White House, the US will seek to reconnect with various multilateral agencies following the disagreements and withdrawals that occurred during the Trump administration. Indeed, Biden has promised to request for the US to be reinstated in the Paris Climate Agreement on his first day in office, and it will surely not be long before we see the US once again forming part of the World Health Organization, from which it withdrew a few months ago. Yet one of the great unknowns that Biden's presidency will have to resolve is the extent to which the Trump era has marked a turning point in the US' capacity to lead proposals in the field of multilateral cooperation.

Biden's victory has also led to talk of a rapprochement with Europe. After all, the alliances forged between the two regions and other Asian countries led to the «international liberal order», which protected common interests and values for decades. On this occasion, the more-than-likely transatlantic rapprochement will have a lot to do with the US' need to seek allies in its efforts to curb the rise of China, especially in the technological sphere.[5] Nevertheless, although trade and investment relations between the US and the EU remain the closest in the world,[6] Europe could find that it is highly constrained, given that the Old Continent faces the next industrial revolution without major technological champions and a high degree of dependence on Chinese technology.

The US-China decoupling process will be an area of continuity under the Biden administration. One only has to look at the «Buy American» slogan proclaimed during the Democratic presidential campaign for evidence of this. However, the way in which the rivalry with China is approached will probably be different under Biden's mandate. For instance, the new administration is more likely to seek strategic alliances to force change in China. Biden may also try to open new diplomatic avenues with the Asian giant in the fight against threats that are clearly global in nature, such as climate change.

Ultimately, in 2021 US policies will focus on domestic needs, at a time when the COVID-19 crisis is having a serious impact on the economy (that is, a fiscal package and infrastructure spending). As for foreign policy, a reconnection with multilateral cooperation agencies and a rapprochement with Europe can be expected, while the dispute with China will continue (but undoubtedly with a more diplomatic approach).

Clàudia Canals

3. In addition, states with close links to the oil and mining sector tend to have Republican senators.
4. With the Tax Cuts and Jobs Act of 2017.
5. See the Focus «The US-China technology conflict: an initial insight» in the MR11/2020.
6. The EU remains the US' main trading partner (even without the United Kingdom), and it is also the region with which it maintains the closest relations in terms of foreign direct investment.

Mobility and economic activity in the second wave: how much will GDP fall by in Q4?

- **The second wave of coronavirus has led to a further tightening of mobility restrictions and all the indicators suggest that economic activity will contract in Q4.**
- **The statistical relationship between mobility and economic activity suggests that the contractions in activity will be more moderate and far from the double-digit declines suffered in Q2.**
- **Factors such as the resilience of industry, economies' capacity to adapt, and support from economic policies will help to soften the blow of the second wave.**

Economic activity managed to rebound firmly and across the board in Q3, but the second wave of SARS-CoV-2 infections has led to a further tightening of mobility restrictions in many countries (especially in Europe), and most indicators suggest that economic activity will contract once again in the current fourth quarter. But how much of a contraction are we talking about?

The pandemic has plunged us into an environment of high uncertainty in which it is particularly difficult to gauge the magnitude of the rebounds and relapses in economic activity. The changes in the economy are faster and more abrupt, but there are few indicators that give us real-time information. One such indicator is that of spending carried out on CaixaBank cards, which points towards a further contraction in Spanish consumption in the current quarter.[1]

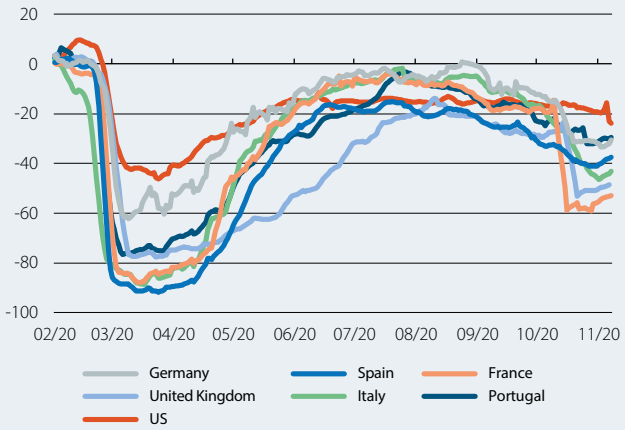
Another indicator is precisely that of the mobility of people, captured in near real-time thanks to geolocation data from mobile phones.[2] The second wave of COVID-19 has led to a further reduction in the mobility of people around retail and recreational areas (first chart), as well as an increase in mobility in residential areas (second chart).

These two mobility measures have shown a very strong correlation with GDP performance in the first three quarters of 2020 (see third chart). Specifically, the strong statistical relationship between mobility and economic activity allows us to obtain a first approximation of the relapse of economic activity that is occurring in Q4.[3]

A first important observation is that, in general, the tightening of mobility in this second wave is clearly milder and more gradual than last spring (reflecting a more limited series of restrictions). Indeed, the statistical relationship between mobility and economic activity indicates far more moderate contractions in activity during Q4 than those registered in Q2 (see fourth chart).[4,5]

Mobility of the population in retail

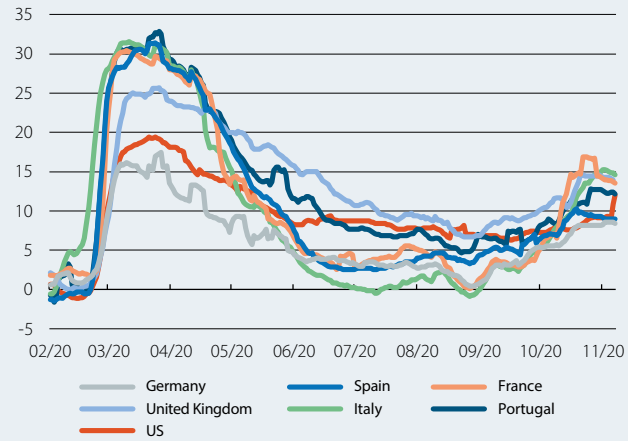
*Change relative to the baseline level (%) **



Note: ** 7-day moving average figures. The baseline 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 data from Google Mobility Report.*

Mobility of the population in residential areas

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



Note: ** 7-day moving average figures. The baseline 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 data from Google Mobility Report.*

1. See https://www.caixabankresearch.com/en/etiquetas/monitor-consumo.
2. Specifically, Google produces mobility reports that are available at https://www.google.com/covid19/mobility/.
3. In the Focus «Rebound in mobility and economic activity» in the MR09/2020, we have used the relationship between mobility in retail areas and economic activity to gauge GDP movements. We now add mobility in residential areas, which has also shown a strong association with GDP growth and has managed to closely predict economic performance in countries such as France (see the Economic Outlook Note by INSEE of 17 November 2020).
4. We estimate regressions of the quarter-on-quarter change in GDP in Q1, Q2 and Q3 2020 of the major advanced economies (21 countries) with the change in the level of quarter-on-quarter mobility in retail and residential areas, respectively, based on data from Google (Google Mobility Report).
5. The GDP projection for Q4 2020 is based on the mobility observed in October and November, and the assumption that mobility improves in December in Europe (recovering towards October levels, but without reaching them) but deteriorates slightly in the US.

In the case of the US, for example, where mobility in retail areas has registered a far more moderate reduction than in other countries (and mobility in residential areas has also increased by less), the exercise indicates very slight declines in GDP, while other indicators suggest that the US economy could even continue to grow in Q4. In the case of European economies, where the changes in mobility have been greater than those on the other side of the Atlantic, GDP declines seem much more likely, albeit far from the double-digit contractions of Q2 and with significant differences between countries.

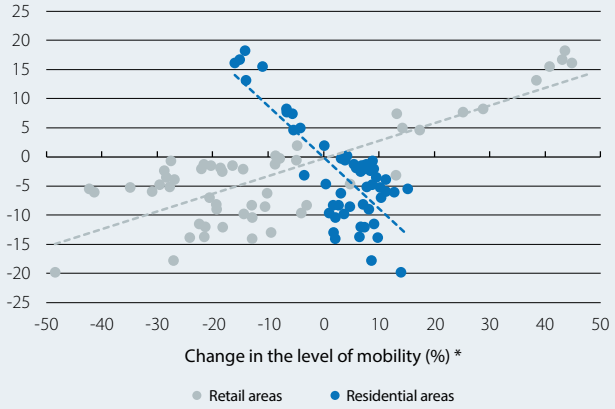
In France and Italy, the mobility data indicate declines in economic activity of around 5%-8% quarter-on-quarter. However, the impact on GDP could be somewhat milder than the data suggest. Various economic sentiment indicators (such as the PMI indices) point towards a more moderate contraction in European economies' economic activity in Q4. The new restrictions have been less widespread, and while the services sector is suffering a significant blow, industry has remained more active (and various indicators suggest that manufacturing activity will continue to grow in this last quarter of 2020). Moreover, we must not overlook economies' capacity to adapt, with many managing to make good use of teleworking, or the support that economic policies continue to offer to sustain household and business incomes.

Finally, for the Spanish economy, the mobility data suggest more moderate setbacks, and there are a number of other considerations, in addition to those mentioned above, which support this. Firstly, the mobility restrictions imposed since October have been much more selective than those implemented in the spring, so their impact on economic activity might not be as abrupt as the relationships identified in the data for Q2 and Q3 might suggest. By way of example, and as the last chart illustrates, in October and November, whilst average mobility around shopping centres had fallen compared to Q3, mobility around workplaces had increased (in contrast, in Q2 it had fallen). This has not been the case in countries such as France and Italy. Thus, while the measures implemented to date in Spain have sought to reduce social contact in certain environments to limit the spread of the virus, their impact on firms' and workers' ability to carry out their work may be more limited. Furthermore, the labour market is proving more resilient than expected in the face of the tighter mobility restrictions. In particular, after falling 8.1% year-on-year in Q3, the decline in the number of workers registered with Social Security who are not affected by a furlough (ERTE) scheme stabilised at –5.8% in October and November.

Laura Becerra, Clàudia Canals, Oriol Carreras and Adrià Morron Salmeron

Economic activity and mobility

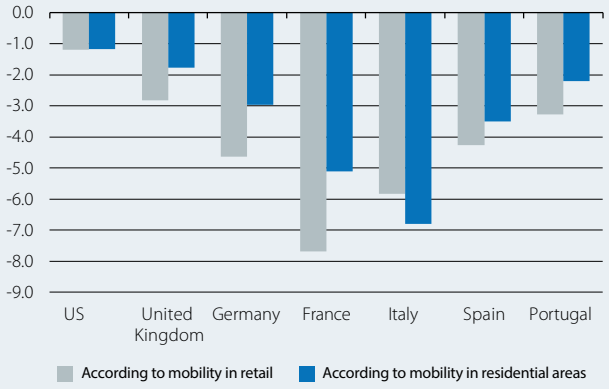
Quarter-on-quarter change in GDP in Q1, Q2 and Q3 (%)



Note: ** The change in the level of mobility is built using Google's mobility reports, which measure how the number of shop visits has changed compared to the average of the same day of the week between 3 January and 6 February (a situation they define as «normal»). We compute the final value for each quarter based on the average of daily data.*
Source: *CaixaBank Research, based on data from Google Mobility Report and Refinitiv.*

Impact of mobility on economic activity in Q4

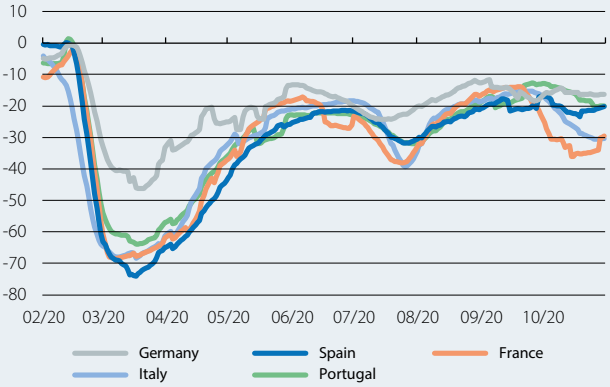
Contribution to quarter-on-quarter growth in Q4 (pps)



Note: *Estimates obtained from the result of the regression detailed in note 4 of the article.*
Source: *CaixaBank Research, based on data from Google Mobility Report and Refinitiv.*

Mobility of the population in workplaces

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



Note: *14-day moving average figures. * The baseline 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 data from Google Mobility Report.*

COVID-19 and inflation: a statistically significant impact

- **The weakness of European inflation has intensified in recent months, reaching negative rates and all-time lows.**
- **This weakness is largely due to the impact of the COVID-19 crisis. Demand-side factors are largely to blame, but the effect of tax cuts in some countries is also playing an important role.**
- **Inflation will gain traction with the economic revival, although the scars from the COVID-19 crisis will likely result in a very gradual recovery.**

In recent years, European inflation has been stubbornly below the ECB's desired rate, and since 2018 it has been slipping even further away. This weakness has intensified with the COVID-19 crisis, and core inflation, which reflects underlying price trends, has lost almost 1 pp since January (in October it registered a record low of +0.2%). Will this weakness be temporary or permanent?

The sensitivity of prices to the COVID-19 pandemic

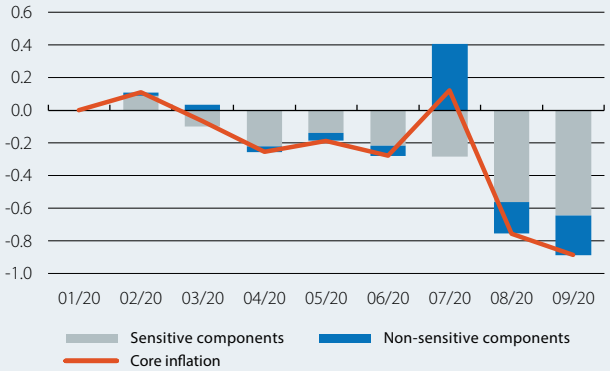
The COVID-19 pandemic can explain a large part of the recent inflation problems. To illustrate this, we will focus on core inflation and, following a methodology similar to that developed by the Federal Reserve Bank of San Francisco,[1] we will identify both those components of the set of consumer goods that are «sensitive to COVID-19» and those that have experienced abnormally large price changes since the spring.[2] On this basis, 68% of these goods and services in Spain and 51% in the euro area have proven to be sensitive to COVID-19. Some components have shown sensitivity to the pandemic due to them suffering significant price increases, such as in the case of electronic equipment or sporting goods. However, as the first two charts illustrate, most prices sensitive to the pandemic have pushed inflation down and indeed explain the bulk of its weakness in 2020.

Among the effects of the COVID-19 pandemic, demand-side factors predominate

One of the particularities of the pandemic is that it is affecting prices in very different ways: it has led to a fall in both demand and supply (as well as generating price measurement problems). However, economic intuition helps us to distinguish between one factor and the other: when the shock is on the demand side, prices and quantities tend to move in the same direction, whilst if the shock is related to supply, they move in opposite directions. Thus, the fall in aggregate inflation registered in recent months (in parallel with a fall in economic activity) suggests that the demand-side disinflationary forces have outweighed the reduction in supply. The analysis of the components suggests a similar conclusion. We illustrate this for the case of Spain, where we separate the components between those that have suffered a shock in demand, those that have suffered a shock in supply, and the rest (for which the shock is of an

Euro area: contribution to core inflation by component

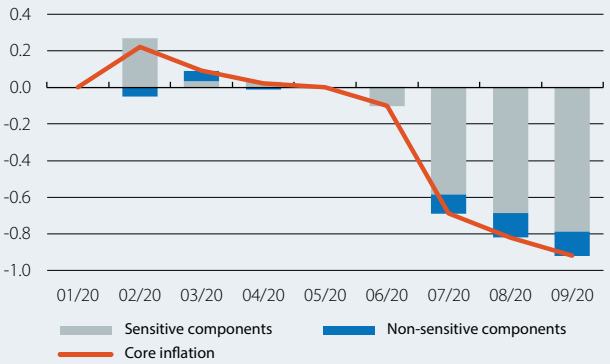
(pps)



Notes: *Contribution of each component category to the deviation of core inflation compared to its January 2020 level. We consider components to be sensitive to the pandemic if the change registered between March and September has been statistically different to that observed previously.*
Source: *CaixaBank Research, based on data from Eurostat.*

Spain: contribution to core inflation by component

(pps)



Notes: *Contribution of each component category to the deviation of core inflation compared to its January 2020 level. We consider components to be sensitive to the pandemic if the change registered between March and September has been statistically different to that observed previously.*
Source: *CaixaBank Research, based on data from Eurostat.*

1. See A.H. Shapiro (2020). «Monitoring the inflationary effects of COVID-19». FRBSF Economic Letters.
2. Specifically, a component *i* is sensitive to the COVID-19 pandemic if the parameter β_1 of the equation $\pi_{t,i} = \beta_{0,i} + \beta_{1,i} * COVID_t + u_{t,i}$ significantly differs from 0. $\pi_{t,i}$ is the year-on-year change in the price of the component *i*, $COVID_t$ is a dummy variable which takes a value of 1 starting from March 2020 and 0 in all other cases, and $u_{t,i}$ is the error term.

ambiguous nature).[3] As the third chart shows, some supply-side forces have driven up prices, but overall they have been moderate and have been offset by the disinflationary pressure of the demand-side shock.

Euro area: VAT also plays a role

Another factor must be added for the euro area as a whole: the VAT reduction. To address the economic crisis caused by the COVID-19 pandemic, some countries such as Germany, Belgium and Austria included a reduction in VAT in their fiscal stimulus packages. In Germany, for instance, the federal government reduced this tax from 19% to 16% for most products, and from 7% to 5% for many others, between July and December 2020. Since a VAT reduction has a direct impact on the purchase price, it could explain some of the fall in inflation. In fact, Eurostat publishes an inflation series in which it maintains taxes constant and which suggests that core inflation in 2020 would have been 0.7 pps higher without the VAT effect.

If the VAT reduction has such a significant impact, it could have tainted our estimates: could it be the case that the pandemic-sensitive components we have identified are only so because of the impact of VAT? This may be partly true, but not in most cases: 65% of the components that we initially identified as being sensitive to the COVID-19 pandemic remain so if we correct for the impact of taxes (the remaining 35% cease to be sensitive).[4]

Therefore, when the VAT reduction is reversed in the coming months, inflation will bounce back. Nevertheless, the sensitivity of many of its components suggests that, beyond the statistical effect of taxes, inflation will continue to show weakness as long as the pandemic continues to restrict economic activity. It is therefore the economic recovery that will help inflation to return to pre-pandemic levels. That said, faced with the prospect that the revival of economic activity could take a long time to be completed, it appears likely that the ECB will still have work to do over the coming quarters to steer inflation towards its target (below, but close to, 2%).

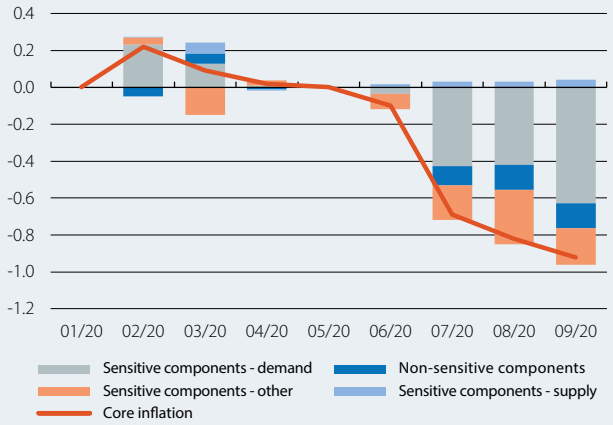
Luis André Pinheiro de Matos and Ricard Murillo Gili

3. Since we do not have sufficiently detailed data on quantities, we base our illustration on the exercise conducted by Shapiro (2020) for the US, where the necessary level of detail is known. Specifically, if the price of a component moves in the same direction in Spain and the US, we apply the movement of the quantities observed in the US to the case of Spain. Thus, we identify shocks in demand (prices and quantities move in the same direction), in supply (movements in opposite directions) and others (non-significant movements in quantities and/or prices). For instance, in a case where there is no significant change in quantities, there may be a combination of shocks acting in opposite directions. On the other hand, if there are no significant changes in prices but there are in quantities, this would indicate simultaneous shocks in the same direction.

4. Although they remain «sensitive to COVID-19», these components exhibit more moderate price fluctuations after correcting for the effect of the VAT reduction.

Spain: contribution to core inflation by component

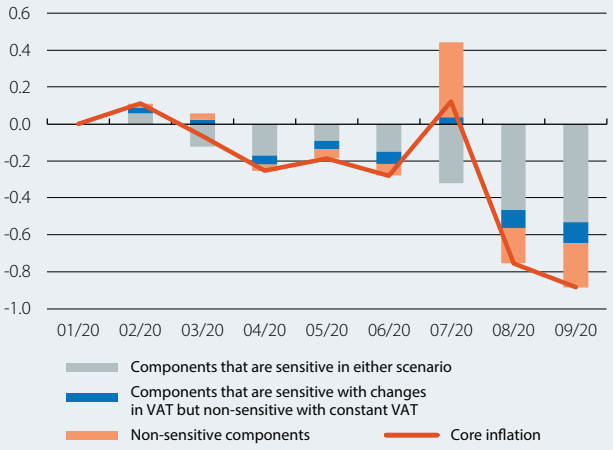
(pps)



Notes: *Contribution of each component category to the deviation of core inflation compared to its January 2020 level. We consider components to be sensitive to the pandemic if the change registered between March and September has been statistically different to that observed previously. We determine each component's type of sensitivity based on changes in quantities, using data from Shapiro (2020).*
Source: *CaixaBank Research, based on data from Eurostat.*

Euro area: contribution to core inflation by component

(pps)



Notes: *Contribution of each component category to January's core inflation gap. We consider components to be sensitive to the pandemic if the change registered between March and September has been statistically different to that observed previously. We calculate this for the standard core inflation series and also for the series in which VAT is kept constant.*
Source: *CaixaBank Research, based on data from Eurostat.*

Year-on-year (%) change, unless otherwise specified

UNITED STATES

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
Activity									
Real GDP	3.0	2.2	2.3	0.3	–9.0	–2.9	–	–	–
Retail sales (excluding cars and petrol)	4.7	3.9	4.0	3.1	–4.9	5.2	5.2	6.6	6.5
Consumer confidence *(value)*	130.1	128.3	127.0	127.3	90.0	93.1	86.3	101.3	101.4
Industrial production	3.9	0.9	–0.7	–1.9	–14.2	–6.7	–6.7	–6.7	–5.3
Manufacturing activity index (ISM) *(value)*	58.9	51.2	48.1	50.0	45.7	55.2	56.0	55.4	59.3
Housing starts *(thousands)*	1,248	1,295	1,433	1,484	1,079	1,440	1,373	1,459	1,530
Case-Shiller home price index *(value)*	211	217	219	222	224	228	228	231	...
Unemployment rate *(% lab. force)*	3.9	3.7	3.5	3.8	13.0	8.8	8.4	7.9	6.9
Employment-population ratio *(% pop. > 16 years)*	60.4	60.8	61.0	60.8	52.9	56.1	56.5	56.6	57.4
Trade balance[1] *(% GDP)*	–2.2	–2.7	–2.7	–2.6	–2.7	–2.9	–2.9	–2.9	...
Prices									
Headline inflation	2.4	1.8	2.0	2.1	0.4	1.2	1.3	1.4	1.2
Core inflation	2.1	2.2	2.3	2.2	1.3	1.7	1.7	1.7	1.6

JAPAN

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
Activity									
Real GDP	0.3	0.7	–0.7	–1.9	–10.3	–5.9	–	–	–
Consumer confidence *(value)*	43.6	38.9	38.1	36.0	24.7	30.5	29.3	32.7	33.6
Industrial production	1.0	–2.7	–6.7	–4.3	–20.5	–12.6	–12.3	–10.6	–3.4
Business activity index (Tankan) *(value)*	20.8	6.0	0.0	–8.0	–34.0	–27.0	–	–	–
Unemployment rate *(% lab. force)*	2.4	2.4	2.3	2.4	2.8	3.0	3.0	3.0	...
Trade balance[1] *(% GDP)*	–0.2	–0.3	–0.3	–0.2	–0.5	–0.3	–0.4	–0.3	–0.2
Prices									
Headline inflation	1.0	0.5	0.5	0.5	0.1	0.2	0.2	0.1	–0.4
Core inflation	0.3	0.6	0.7	0.7	0.3	0.1	–0.1	–0.1	–0.2

CHINA

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
Activity									
Real GDP	6.7	6.1	6.0	–6.8	3.2	4.9	–	–	–
Retail sales	9.0	9.0	7.7	–18.2	–4.0	0.9	0.5	3.3	4.3
Industrial production	6.2	5.8	5.9	–7.3	4.4	5.8	5.6	6.9	6.9
PMI manufacturing *(value)*	50.9	49.7	49.9	45.9	50.8	51.2	51.0	51.5	51.4
Foreign sector									
Trade balance[1,2]	352	421	421	361	412	453	455	453	469
Exports	9.9	0.5	1.9	–13.4	0.1	8.8	9.5	9.9	11.4
Imports	15.8	–2.7	3.4	–3.0	–9.7	3.2	–2.1	13.2	4.7
Prices									
Headline inflation	2.1	2.9	4.3	5.0	2.7	2.3	2.4	1.7	0.5
Official interest rate[3]	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Renminbi per dollar	6.6	6.9	7.0	7.0	7.1	6.9	6.9	6.8	6.7

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *CaixaBank Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Thomson Reuters Datastream.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
Retail sales *(year-on-year change)*	1.6	2.4	2.1	–1.2	–6.9	2.2	4.4	2.2	...
Industrial production *(year-on-year change)*	0.7	–1.3	–2.1	–5.8	–20.2	–6.8	–6.7	–6.8	...
Consumer confidence	–4.9	–7.1	–7.6	–8.8	–18.5	–14.5	–14.7	–13.9	–15.5
Economic sentiment	111.5	103.1	100.6	100.0	69.4	86.9	87.5	90.9	91.1
Manufacturing PMI	55.0	47.4	46.4	47.2	40.1	52.4	51.7	53.7	53.8
Services PMI	54.5	52.7	52.3	43.8	30.3	51.1	50.5	48.0	41.7
Labour market									
Employment (people) *(year-on-year change)*	1.6	1.2	1.0	0.4	–2.9	...	...	–	–
Unemployment rate *(% labour force)*	8.2	7.6	7.4	7.3	7.6	8.2	8.3	8.3	...
Germany *(% labour force)*	3.4	3.1	3.2	3.6	4.2	4.5	4.5	4.5	...
France *(% labour force)*	9.0	8.5	8.2	7.8	7.1	7.5	7.5	7.9	...
Italy *(% labour force)*	10.6	9.9	9.5	9.1	8.5	9.7	9.7	9.6	...
Real GDP *(year-on-year change)*	...	...	1.0	–3.3	–14.8	–4.4	–	–	–
Germany *(year-on-year change)*	1.3	0.6	0.4	–2.1	–11.2	–4.0	–	–	–
France *(year-on-year change)*	1.8	1.5	0.8	–5.7	–18.9	–3.9	–	–	–
Italy *(year-on-year change)*	0.8	0.3	0.1	–5.6	–18.0	–5.0	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
General	1.8	1.2	1.0	1.1	0.2	0.0	–0.2	–0.3	–0.3
Core	1.0	1.0	1.2	1.1	0.9	0.6	0.4	0.2	0.2

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
Current balance	3.0	2.4	2.4	2.1	2.3	...	2.1	...	...
Germany	7.4	7.1	7.1	7.1	6.8	...	7.0	...	...
France	–0.6	–0.7	–0.7	–0.8	–1.3	...	–1.8	...	...
Italy	2.5	3.0	3.0	3.2	2.9	...	3.4	...	...
Nominal effective exchange rate[1] *(value)*	95.1	92.4	91.4	91.2	93.4	95.6	96.0	95.9	95.7

Credit and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	08/20	09/20	10/20
Private sector financing									
Credit to non-financial firms[2]	3.9	3.8	3.5	3.9	7.0	7.1	7.1	7.1	6.8
Credit to households[2,3]	3.0	3.4	3.5	3.6	3.0	3.0	3.0	3.1	3.1
Interest rate on loans to non-financial firms[4] *(%)*	1.2	1.2	1.2	1.1	1.2	1.3	1.3	1.2	1.3
Interest rate on loans to households for house purchases[5] *(%)*	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Deposits									
On demand deposits	7.9	8.0	8.7	9.3	12.9	14.1	13.7	14.4	14.3
Other short-term deposits	–1.5	0.3	0.3	–0.2	0.4	1.0	0.3	1.4	1.4
Marketable instruments	–4.2	–1.9	–3.3	3.9	7.1	10.2	7.8	11.9	14.0
Interest rate on deposits up to 1 year from households *(%)*	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

Source: *CaixaBank Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

Spain: a difficult end to the year and a recalibration of forecasts

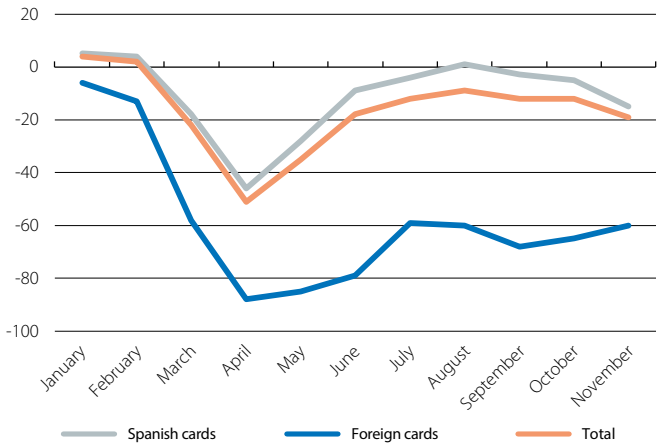
The recovery of economic activity in Q4 is tarnished by the new outbreaks. Following the notable recovery in mobility and economic activity in Q3, the persistent rise in the number of confirmed COVID-19 cases in Spain forced new mobility restrictions to be imposed in October. The impact of these measures has already become apparent in the economic activity indicators and forces us to once again update the forecast scenario, given that a decline in activity in Q4 is likely. In particular, the November data for total card spending registered on CaixaBank POS terminals and cash withdrawals indicate a 19% year-on-year decline, the worst monthly figure since June. The mobility data also reflect a deterioration in the situation: with data from 1 to 27 November, mobility around shopping centres was almost 40% below the pre-crisis level, 9 points below that of October and 18 below September. Furthermore, in November the PMI for the services sector was in clearly contractionary territory (39.5 points), continuing the negative trend of the previous months (the services PMI stood at 51.9 points in July). In contrast, the counterpart indicator for the manufacturing sector stood at 49.8 points, very close to the threshold which indicates no change (50 points) and suggesting that the restrictions on activity are not affecting all sectors alike.

The labour market weathers the crisis better than expected. In contrast, the labour market is showing remarkable resilience. Together with the success of the furlough (ERTE) schemes in sustaining employment and supporting the recovery in the number of workers, this leads us to anticipate a smaller rise in unemployment than previously projected (we expect the unemployment rate to be 16.0% in 2020 and 17.9% in 2021). A sign of the good performance of the labour market during this crisis is the November Social Security affiliation data which, despite the tightening of restrictions on activity, showed a slight increase in registered workers (+32,000 people, bringing the total to 19.02 million). In year-on-year terms, this figure represents a fall in affiliation of 1.8%, 5 decimal points less than the previous month. In addition, the number of employees affected by furlough (ERTE) schemes remained stable at 747,000 people, an increase of 18,000 compared to October. Thus, the number of registered workers who are not affected by an ERTE fell by 5.8% year-on-year, the same figure as in October but significantly less than the –8.1% registered in Q3.

Adjusting the scenario in the run-up to a recovery in 2021. The new macroeconomic projections for the Spanish economy reflect the context of heightened restrictions and weak indicators. Our forecasts are compatible with a scenario in which the restrictions on activity are maintained across large parts of the country until the end of the year and continue, to some extent, during the first quarter of next year. However, the economic impact of the new measures is expected to be lower than during the first half of the year. Assuming that the restrictions imposed to curb the pandemic will not be intensified, the new macroeconomic scenario puts the decline in GDP in Q4 at around 2.5% quarter-on-quarter. There is a great deal of uncertainty surrounding this estimate, given that the range of indicators provide conflicting messages. For instance, whereas the mobility, confidence, and consumption data mentioned earlier point towards a setback in economic activity, the resilience shown by the labour market, if maintained over

*Spain: evolution of expenditure on CaixaBank POS terminals **

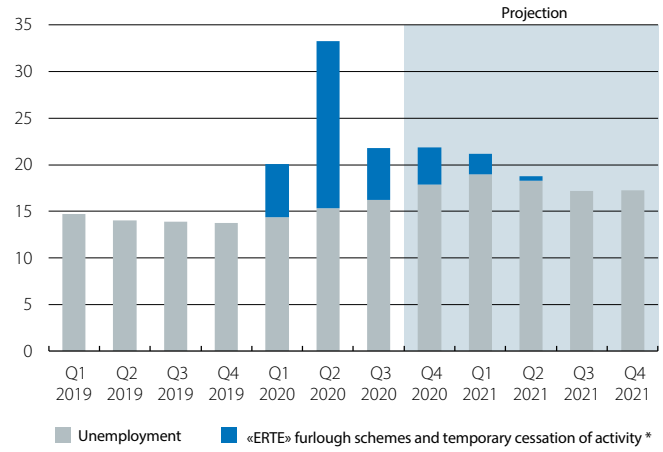
Year-on-year change (%)



Notes: ** Includes payments registered on POS terminals and cash withdrawals at CaixaBank ATMs.*
Source: *CaixaBank Research, based on internal data.*

Spain: unemployment rate and furlough schemes

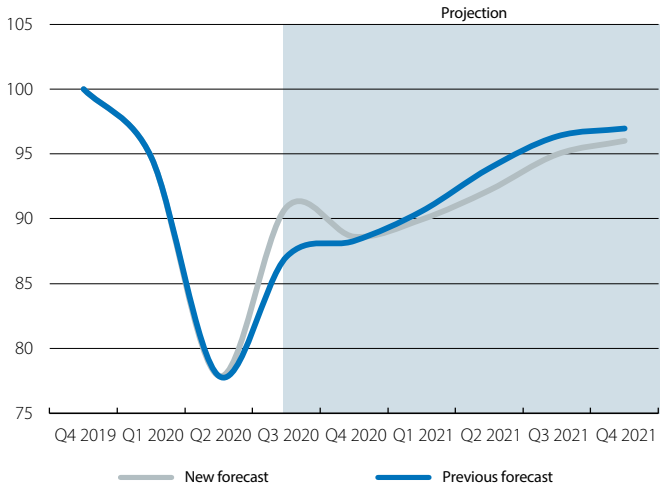
(% of the labour force)



Note: ** Registered workers who are affected by an «ERTE» furlough scheme (total or partial) and self-employed workers who are registered as having temporarily ceased their activity. The latter figure is an internal estimate.*
Source: *CaixaBank Research, based on data from the Ministry of Work, Migration and Social Security, and from the National Statistics Institute (Labour Force Survey).*

Spain: GDP

Level (100 = Q4 2019)



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

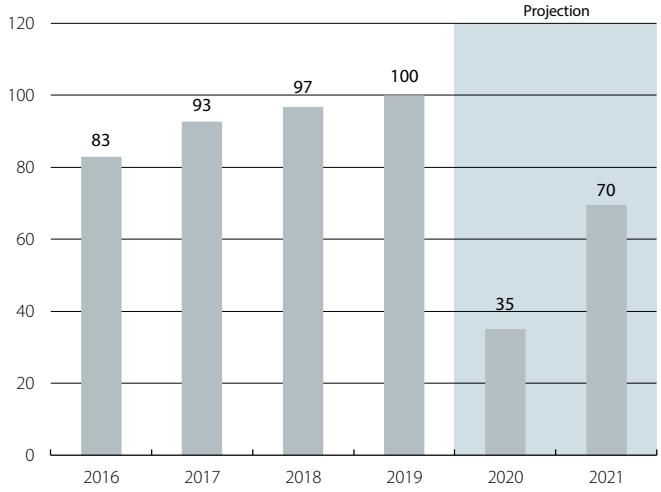
the Christmas period, could limit the decline in GDP. Despite the decline in activity which we project for the closing stages of the year, the strong rebound that occurred in Q3 leads us to revise our 2020 GDP forecast up from –12.5% to –11.4%. Looking ahead to 2021, we anticipate that the stabilisation of the pandemic in Q1 will allow for a gradual improvement and that the recovery will gain strength beginning in Q2 through more extensive use of rapid tests and the administration of the vaccine among the main risk groups. All of this will help to boost confidence, which we expect will have a knock-on effect on all areas of the economy and, in particular, on international mobility. Thus, we expect that tourism GDP will experience a significant recovery in 2021 and that the sector will go from operating at around 70% below its pre-crisis level in 2020 to 30% below in 2021. Finally, the economy will also be supported by fiscal policy, with the launch of the Next Generation EU (NGEU) recovery plan, which could contribute slightly more than 1 pp to GDP growth in 2021 (under a baseline assumption that projects amounting to slightly over 1.0% of GDP can be implemented this year). With the impetus of all these factors, we expect to see a significant rise in economic activity in Q2 and Q3 2021, and we place the economy's growth at 6% for the year as a whole. However, it will take time for the economy to achieve a complete revival, and this will weigh on inflation, which is expected to recover very gradually (–0.4% in 2020 and 1.0% in 2021).

COVID-19 will continue to weigh on the public accounts in 2021. The lower projected fall in GDP for 2020 leads us to slightly improve our deficit forecast for this year, now placing it at 12.4% of GDP, with public debt at 120.4%. Nevertheless, these are still historically high levels, reflecting the unprecedented state action taken to support households, workers and businesses during this pandemic, which will leave its mark over the coming years. Indeed, while the economic recovery will favour a certain correction of the deficit next year, the business cycle and the need to maintain exceptional measures to address the COVID-19 crisis will continue to put pressure on the public accounts in 2021 (we project a deficit of 9.2% and debt of slightly below 120%).

The real estate sector performs very differently to in the previous recession. The real estate sector entered the COVID-19 crisis with much stronger fundamentals than in the previous recession. The level of indebtedness of both households and firms was much lower and there was no situation of over-supply in the sector. Also, on this occasion the origin of the crisis is not within the real estate sector itself. As a result, the crisis should have a less pronounced impact on the sector than it did during the previous recession, and this is corroborated by the latest data. According to valuation data published by the Ministry of Transport, Mobility and Urban Agenda, the price of housing rose by 0.6% quarter-on-quarter in Q3, thus moderating the year-on-year decline (–1.1% *versus* –1.7% in Q2). Furthermore, the number of sale transactions enjoyed a strong recovery in September (–1.1% year-on-year), leaving behind the sharp declines experienced during the lockdown (–36% year-on-year between March and July). Given the strength of the sector's indicators, we have reduced the projected fall in home prices in 2020 from –3.6% to –1.5%. However, the sector will not be immune to the economic context, both in terms of losses of income resulting from the rise in unemployment and in terms of deteriorating confidence, so we expect the decline to continue in 2021, amounting to around 2%.

Spain: tourism GDP

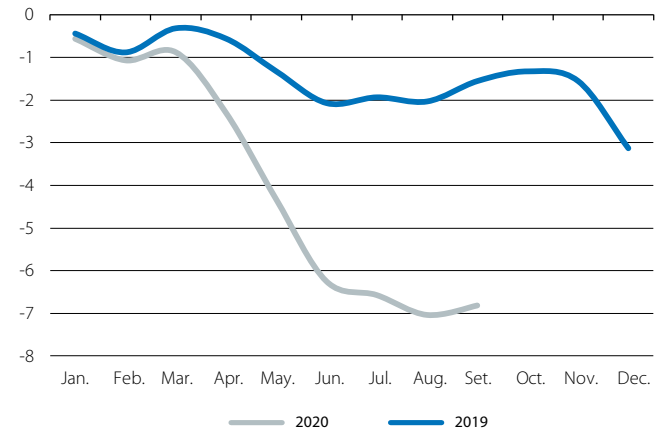
Level (100 = Q4 2019)



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

Spain: general government lending capacity/funding needs

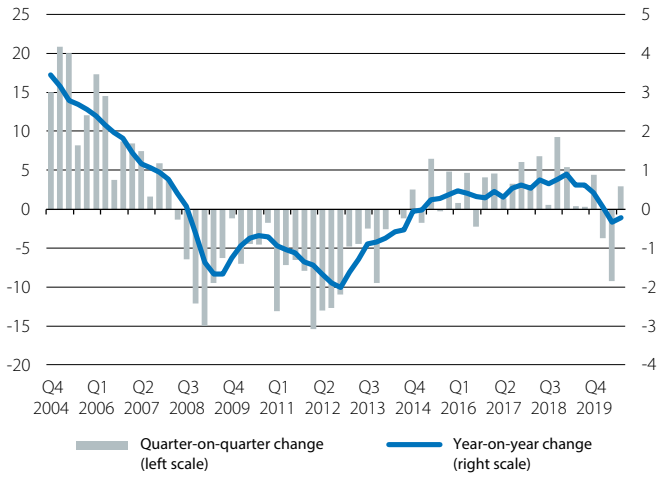
(% of GDP)



Note: *Excludes financial aid and local corporations.*
Source: *CaixaBank Research, based on data from the Comptroller General of the State (IGAE).*

Spain: home prices

Change (%) *Change (%)*



Source: *CaixaBank Research, based on data from the Ministry of Transport, Mobility and Urban Agenda.*

The awakening of e-commerce in the retail sector

- **The pandemic has had a profound impact on face-to-face retail sales. E-commerce has thus emerged as an alternative to soften the blow.**
- **The sector's strong ability to adapt to online sales channels has led to a significant and prolonged growth in e-commerce.**

The measures imposed to curb the spread of the pandemic have had a major impact on many sectors of the economy. One of the hardest hit is retail,[1] as many shops had to lower their shutters during the first wave of the pandemic and, more recently, have witnessed how the new restrictions introduced to combat the second wave have once again slowed their recovery. In this context, the online sales channel is helping many retail establishments to cushion the blow of the crisis.

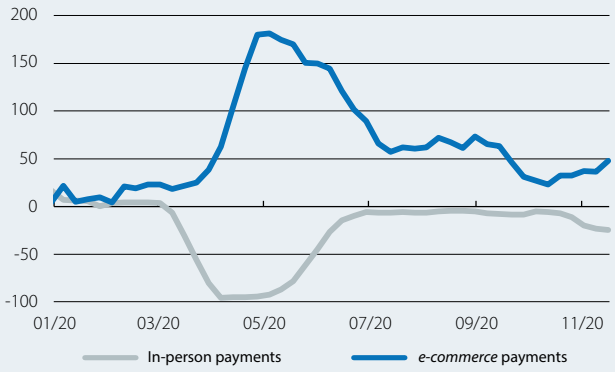
E-commerce spending has experienced a significant boom since the start of the pandemic, reaching three-digit growth rates during the months of April, May and June. Although this growth rate moderated as the mobility restrictions were relaxed, it has remained very high and has picked up again with the recent tightening of measures to contain the COVID-19 pandemic. This trend contrasts with that of face-to-face sales, which fell sharply during the first lockdown and again in October, albeit to a lesser extent (see first chart).

To better assess the scale of the rise in online sales, we analysed the trend in online sales relative to those carried out in person and paid for by card using Point of Sale (POS) terminals.[2] As shown in the second chart, during the month of May – the first month in which many shops reopened as the lockdown was gradually lifted, although some mobility restrictions remained in place – the relative weight of e-commerce experienced a significant spike in shop categories across the board. This highlights the sector's enormous adaptive capacity, as it was able to multiply its e-commerce turnover by a factor of almost three, barely two months after the outbreak of the pandemic. In addition, the investment that many shops have made to boost their online sales seems to be bearing fruit. Indeed, in October, a month with far fewer mobility restrictions in place, the relative weight of e-commerce still remained significantly above that recorded a year earlier.

1. Retail is defined as encompassing all shops selling textiles, footwear, jewellery, furniture, books and stationery, household appliances and sporting goods, as well as department stores. Food shops are not included because the consumption of essential goods has shown a very different behaviour from the rest since the outbreak of the pandemic (see the Focus «Analysing private consumption during the COVID-19 crisis» in the MR07/2020).
2. This metric does not reflect the actual share of the online sales channel, as it does not take into account sales paid for in cash. To the extent that there has been an increase in card payments in place of cash payments in recent months, this approach may be underestimating the increase in the relative weight of the online channel observed in 2020.

Spain: e-commerce spending by sales channel

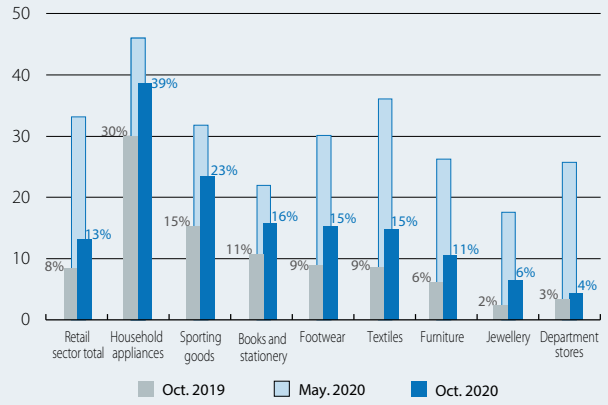
Year-on-year change (%)



Note: *A simple four-week moving average has been applied to all series.*
Source: *CaixaBank Research, based on internal data.*

Spain: relative weight of e-commerce spending

(% of the total spending registered on POS terminals)



Source: *CaixaBank Research, based on internal data.*

CaixaBank's internal data also indicate that the increase in online sales is not limited to just a few shops – quite the opposite. Although large retail businesses continue to take a large share of online sales, the current context has prompted small and medium-sized retail businesses to open and promote this sales channel over the past few months.

All this suggests an acceleration in the growth of e-commerce following the outbreak of the pandemic, a channel that is proving key to softening the blow of the COVID-19 crisis on face-to-face sales, although it is still too early to emphatically state that we are witnessing a permanent shift in consumption habits.

Javier Ibáñez de Aldecoa and Eduard Llorens i Jimeno

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2019	09/20	10/20	11/20
Industry									
Industrial production index	0.3	0.7	0.3	–6.4	–24.3	–5.0	–3.4	...	...
Indicator of confidence in industry *(value)*	–0.1	–3.9	–5.2	–5.4	–27.8	–11.9	–11.1	–10.8	–11.7
Manufacturing PMI *(value)*	53.3	49.1	47.2	48.2	39.4	51.4	50.8	52.5	49.8
Construction									
Building permits *(cumulative over 12 months)*	25.7	17.2	8.0	0.1	–12.5	–19.0	–19.0	...	...
House sales *(cumulative over 12 months)*	14.2	3.6	–2.0	–3.7	–12.3	–18.2	–17.5	...	...
House prices	6.7	5.1	3.6	3.2	2.1	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	4.0	1.4	1.2	–1.0	–22.8	–50.7	–59.8	–67.7	...
Services PMI *(value)*	54.8	53.9	53.6	42.5	28.4	47.3	42.4	41.4	39.5
Consumption									
Retail sales	0.7	2.3	2.3	–3.9	–18.4	–3.4	–3.3	–2.7	...
Car registrations	7.8	–3.6	5.1	–27.6	–68.6	–7.5	–13.5	–21.0	–18.7
Consumer confidence index *(value)*	–4.2	–6.3	–10.5	–10.3	–27.9	–26.9	–26.3	–26.7	–29.0
Labour market									
Employment [1]	2.7	2.3	2.1	1.1	–6.0	–3.5	–	–	–
Unemployment rate (% labour force)	15.3	14.1	13.8	14.4	15.3	16.3	–	–	–
Registered as employed with Social Security [2]	3.1	2.6	2.2	1.2	–4.4	–3.0	–2.3	–2.3	–1.8
GDP	**2.4**	**2.0**	**1.7**	**–4.2**	**–21.5**	**–8.7**	**–**	**–**	**–**

Prices

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2019	09/20	10/20	11/20
General	1.7	0.7	0.4	0.6	–0.7	–0.5	–0.4	–0.8	–0.8
Core	0.9	0.9	1.0	1.1	1.1	0.5	0.4	0.3	...

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2019	09/20	10/20	11/20
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	2.9	1.8	1.8	1.0	–7.2	–8.9	–8.9	...	...
Imports *(year-on-year change, cumulative over 12 months)*	5.6	1.0	1.0	–1.0	–9.3	–13.3	–13.3	...	...
Current balance	**23.2**	**26.6**	**26.6**	**27.1**	**17.6**	**12.1**	**12.1**	**...**	**...**
Goods and services	32.8	37.5	37.5	38.0	27.7	21.9	21.9	...	...
Primary and secondary income	–9.5	–10.9	–10.9	–10.9	–10.1	–9.8	–9.8	...	...
Net lending (+) / borrowing (–) capacity	**29.0**	**30.8**	**30.8**	**31.3**	**21.5**	**16.2**	**16.2**	**...**	**...**

Credit and deposits in non-financial sectors [3]

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2019	09/20	10/20	11/20
Deposits									
Household and company deposits	3.2	5.4	5.4	4.4	8.0	9.0	8.8	9.2	...
Sight and savings	10.9	10.7	10.3	8.9	13.0	13.8	13.8	14.2	...
Term and notice	–19.9	–13.4	–13.9	–16.4	–16.1	–16.5	–16.9	–16.2	...
General government deposits	15.4	8.8	–2.1	–6.2	–6.6	5.2	4.7	4.4	...
TOTAL	**3.9**	**5.6**	**4.8**	**3.8**	**7.1**	**8.7**	**8.5**	**8.9**	**...**
Outstanding balance of credit									
Private sector	–2.4	–1.5	–1.5	–1.0	1.5	2.0	2.2	2.4	...
Non-financial firms	–5.5	–3.4	–3.0	–1.7	6.1	7.1	7.7	7.8	...
Households - housing	–1.1	–1.3	–1.5	–1.7	–2.1	–1.8	–1.7	–1.6	...
Households - other purposes	2.8	3.2	2.2	2.5	0.7	0.3	0.2	0.9	...
General government	–10.6	–6.0	–1.2	1.7	0.1	1.1	0.7	2.8	...
TOTAL	**–2.9**	**–1.7**	**–1.5**	**–0.9**	**1.5**	**1.9**	**2.1**	**2.5**	**...**
NPL ratio (%) [4]	**5.8**	**4.8**	**4.8**	**4.8**	**4.7**	**4.6**	**4.6**	**...**	**...**

Notes: *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*

Source: *CaixaBank Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.*

Portugal: strong resilience and the vaccine, key for 2021

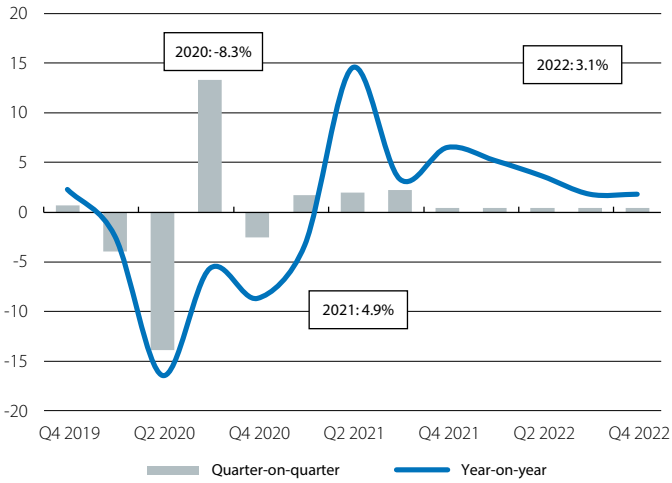
Temporary interruption of the recovery in Q4. Economic activity has shown a strong capacity to recover (GDP growth of +13.3% quarter-on-quarter in Q3, with a widespread revival of both domestic and foreign demand), but the second wave of infections is causing a temporary interruption of the recovery in Q4. Since October, there has been a reduction in the mobility indicators, although they remain well above the levels of April/May. Card payments also stabilised in October in year-on-year terms, while retail sales fell by 0.7% year-on-year and the growth of cement sales slowed significantly to 1.3% year-on-year. The data available for November are more scarce, but up until the 23rd, daily car sales had fallen by 36% month-on-month, while sentiment indicators for the month as whole also fell in all sectors. Overall, the data suggest a drop in GDP in the closing weeks of the year, but with a clearly more gradual and less significant decline than in the spring (we expect GDP to contract by 2.6% in Q4). Nevertheless, since the rebound in economic activity in Q3 was stronger than expected, we have improved our GDP forecast for 2020 as a whole to –8.3%. In addition, the economy is expected to settle into a more sustained growth path in 2021, supported by mass vaccination and testing, a certain revival of tourism activity and support from domestic and European economic policy. Thus, we project GDP growth of around 5% in 2021. However, the economic and health environment remains highly uncertain and, beyond the initial rebound, the economy will take time to recover to pre-pandemic levels. It will therefore be very important to ensure that the economic policy measures are fine-tuned and properly implemented, especially those included in the European Recovery and Resilience Plan, and that they are appropriate in order to boost underlying economic growth.

The labour market shows resilience. Employment remains below pre-pandemic levels, but in October the number of people in employment rose in month-on-month terms for the fifth consecutive month. Job offers have followed a similar trend, although the impact of the pandemic on the labour market continues to be felt, with the unemployment rate reaching 7.5% in October (+1.1 pps compared to February). Moreover, unemployment is likely to rise over the coming quarters as the restrictions on redundancies imposed in the wake of the COVID-19 emergency are relaxed and the economic scars of the pandemic begin to emerge.

Tourism activity remains significantly weakened. In September, the number of guests in tourist accommodation establishments was 52.7% lower than in the same month of 2019, while the total revenues of these establishments fell by 59.2%. In addition, 24% of tourist accommodation establishments were closed or failed to register any overnight stays (22.8% in August). This weakness is accentuated in the

Portugal: GDP

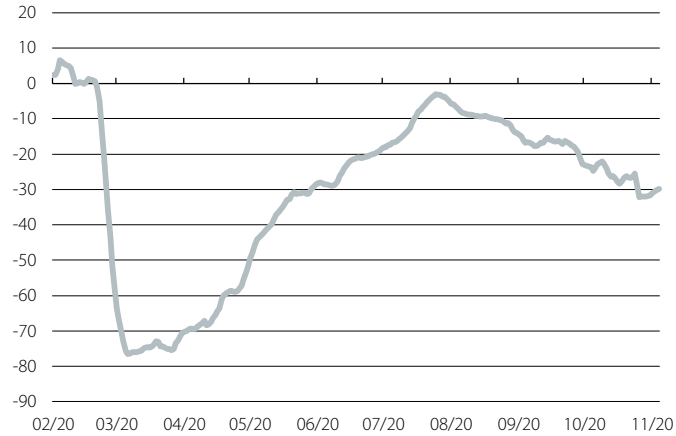
Change (%)



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

Portugal: mobility in retail and recreational areas

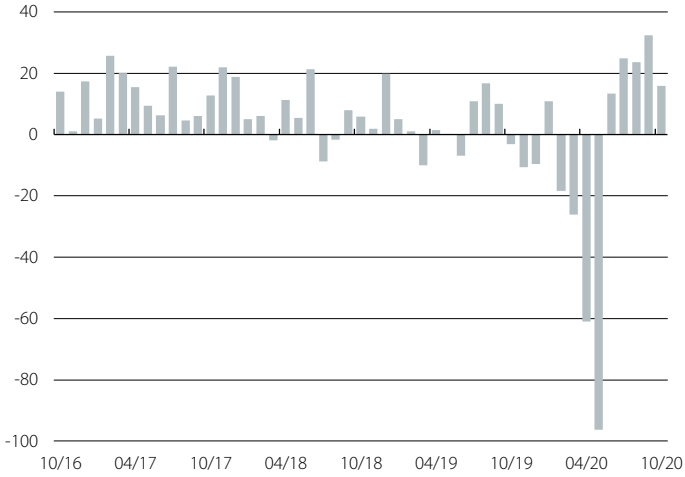
*Change relative to the baseline level (%) **



Note: ** 7-day moving average figures. The baseline 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 data from Google Mobility Report.*

Portugal: employment

Monthly change (thousands of people)



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

case of foreign tourism: the number of non-resident guests decreased by 73.8%, with sharp declines in overnight stays among American, Canadian, Chinese and Irish visitors. Furthermore, the preliminary data for October indicate a deterioration of the situation: a year-on-year decrease of 59.3% in the number of guests (–63% in the number of overnight stays).

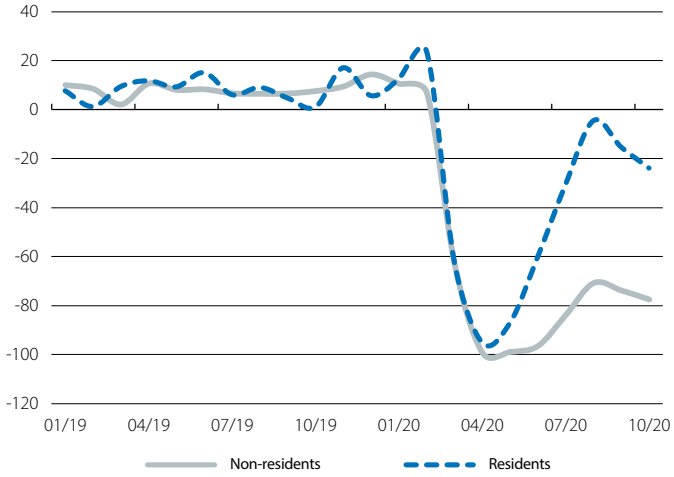
The pandemic deteriorates the public accounts. The public policy action taken to support households and businesses during the pandemic is taking a heavy toll on the public accounts. With data up to October, the expenditure-related measures had totalled 2,356 million euros, while the measures to postpone, suspend and provide exemptions for tax payments account for the reduction of around 1,508 million euros in revenue collection. In this context, the general government deficit for the first 10 months of the year as a whole stood at 4.3% of GDP, with a 6.4% decline in revenues and a 5.1% increase in expenditure. The pressure on the public accounts will continue through to the end of the year and we expect the deficit to reach around 7% of GDP for 2020 as a whole. In 2021, it should gradually reduce to slightly below 6% thanks to the economic revival, although uncertainty is high and the pandemic will continue to affect the public accounts.

The current account deficit continued to rise in September. The current deficit stood at 2,434 million euros (12-month cumulative balance). In GDP terms, the balance stood at –1.2% of GDP, representing a 0.1-pp higher deficit than in August and 0.9 pps higher than a year earlier. Among other factors, this deterioration reflects the pandemic's impact on international tourism. Specifically, the tourism surplus stood at +3.2% of GDP, compared to 6.1% a year earlier.

Disparate trends in credit growth. Whilst new lending for housing increased by 3.1% year-on-year in September, bringing it to around 9% above pre-pandemic levels, new lending to firms fell by 15.3% year-on-year (7% below the figure for February) and new consumer lending fell by 16.4% (around 18% below the pre-pandemic level). This reflects the lower confidence among households and the worsening outlook for unemployment over the next 12 months. However, thanks to debt moratoriums, the stock of credit has continued to grow in all segments. In fact, in September credit moratoriums reached a total of 751,725 contracts, particularly benefiting housing credit and other mortgage loans (which accounted for over 42% of the total). In addition, the period for accessing moratoriums was recently extended until March 2021.

Portugal: overnight stays in tourist accommodation

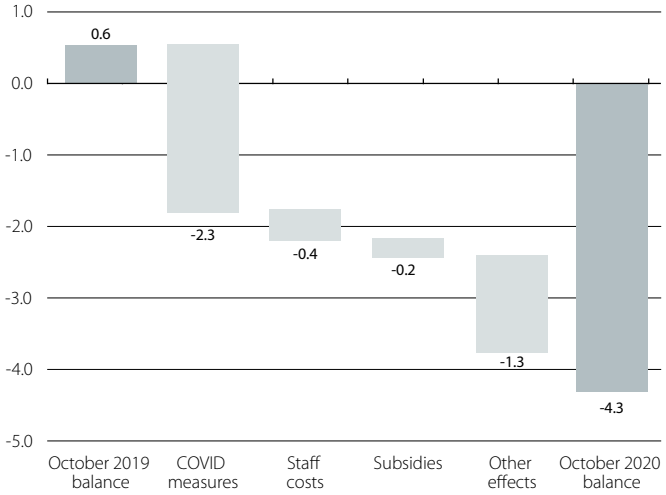
Year-on-year change (%)



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

Portugal: government balance

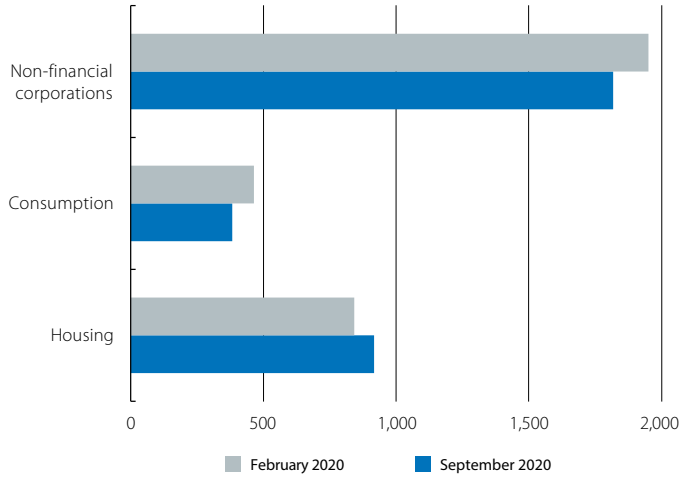
(% of GDP)



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

Portugal: new lending

(EUR millions)



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

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	09/20	10/20	11/20
Coincident economic activity index	3.0	1.0	–0.7	–3.4	–7.1	–7.8	–7.4	–6.7	...
Industry									
Industrial production index	0.1	–2.2	0.4	–1.4	–23.5	–0.4	2.9	...	...
Confidence indicator in industry *(value)*	0.8	–3.2	–4.3	–4.6	–24.8	–19.1	–14.3	–14.3	–15.0
Construction									
Building permits *(cumulative over 12 months)*	20.3	5.9	5.9	1.9	–1.3	–1.7	–1.7	...	...
House sales	16.8	1.7	6.1	–0.7	–21.6	...	...	...	...
House prices *(euro / m² - valuation)*	8.6	10.4	11.1	11.2	8.9	6.9	5.8	5.8	...
Services									
Foreign tourists *(cumulative over 12 months)*	4.8	7.8	7.8	3.2	–29.7	–57.6	–57.6	...	...
Confidence indicator in services *(value)*	14.1	12.9	10.6	5.8	–36.9	–37.2	–27.7	–20.0	–17.0
Consumption									
Retail sales	4.2	4.4	3.7	3.0	–12.9	–2.3	0.6	–1.1	...
Coincident indicator for private consumption	2.4	1.9	0.6	–3.6	–7.6	–7.2	–6.3	–4.9	...
Consumer confidence index *(value)*	–4.6	–8.0	–7.1	–8.6	–27.7	–26.9	–26.3	–25.5	–26.9
Labour market									
Employment	2.3	1.0	0.5	–0.3	–3.8	–3.0	–2.5	–2.1	...
Unemployment rate (*% labour force*)	7.0	6.5	6.7	6.7	5.6	7.8	7.9	7.5	...
GDP	**2.8**	**2.2**	**2.3**	**–2.4**	**–16.4**	**–5.7**	**–5.7**	**...**	**...**

Prices

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	09/20	10/20	11/20
General	1.0	0.3	0.3	0.4	–0.3	0.0	–0.1	–0.1	–0.2
Core	0.7	0.5	0.4	0.2	–0.1	–0.1	–0.2	–0.1	–0.2

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	09/20	10/20	11/20
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	5.2	3.6	3.6	1.5	–6.8	–7.8	–7.8	...	...
Imports *(year-on-year change, cumulative over 12 months)*	8.3	6.0	6.0	2.8	–7.6	–12.3	–12.3	...	...
Current balance	**0.8**	**–0.2**	**–0.2**	**–0.6**	**–0.9**	**–2.4**	**–2.4**	**...**	**...**
Goods and services	1.5	0.8	0.8	0.4	–1.1	–3.0	–3.0	...	...
Primary and secondary income	–0.7	–1.0	–1.0	–1.0	0.2	0.6	0.6	...	...
Net lending (+) / borrowing (–) capacity	**2.8**	**1.9**	**1.9**	**1.5**	**1.5**	**–0.1**	**–0.1**	**...**	**...**

Credit and deposits in non-financial sectors

Year-on-year change (%), unless otherwise specified

	2018	2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	09/20	10/20	11/20
Deposits [1]									
Household and company deposits	4.7	5.2	5.2	6.4	9.0	9.2	9.2	...	...
Sight and savings	16.2	14.8	14.8	17.6	20.1	18.4	18.4	...	...
Term and notice	–3.3	–2.9	–2.9	–3.2	–1.0	0.4	0.4	...	...
General government deposits	–32.3	5.6	5.6	–10.4	–15.7	–13.8	–13.8	...	...
TOTAL	**2.7**	**5.2**	**5.2**	**5.7**	**7.9**	**8.2**	**8.2**	**...**	**...**
Outstanding balance of credit [1]									
Private sector	–2.1	–0.1	–0.1	0.5	0.5	2.2	2.2	...	...
Non-financial firms	–4.5	–3.7	–3.7	–2.6	1.0	4.4	4.4	...	...
Households - housing	–1.7	–1.3	–1.3	–0.8	–0.3	0.6	0.6	...	...
Households - other purposes	4.2	16.5	16.5	15.7	2.2	2.0	2.0	...	...
General government	–12.9	–4.7	–4.7	–4.9	–9.7	–5.6	–5.6	...	...
TOTAL	**–2.6**	**–0.3**	**–0.3**	**0.2**	**0.1**	**1.8**	**1.8**	**...**	**...**
NPL ratio *(%)* [2]	**9.4**	**6.2**	**6.2**	**6.0**	**5.5**	**...**	**...**	**...**	**...**

Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Datastream.*

2021, a year of change

«It's tough to make predictions, especially about the future». So said a worldly wise man, Yogi Berra (others believe it was Niels Bohr, but frankly, it sounds to us more like Berra). He was, and still is, absolutely right, especially at times like the present when the degree of uncertainty is unprecedented. But right now, when making forecasts is particularly complex and risky, is when it makes complete sense. In this article we will try to justify why 2021 is going to be a very different to 2020 and in what ways this difference is going to materialise.

To start with, the return to growth

When we talk about growth in 2021, one of the key points of the year, we can assume with conviction that such a recovery will take place. This is the result of two factors that we consider to be practically guaranteed: (i) in several periods of 2020 the economies of all countries have halted to an extreme degree, and we trust that in 2021 this will not be repeated, and (ii) stimulus measures have been introduced in most states, including highly ambitious ones in many places (Europe, the US and Brazil, in particular).

But just how much growth will there be? Here we enter more uncertain territory. We establish the figure essentially on the basis of two premises. The first is that the pandemic will be less disruptive than it has been in 2020 (more on this later), but that the economic consequences will vary considerably by country. The second is that the bigger the stimulus, the greater the recovery (this claim is not as simple as it may seem, since the composition and timing of the stimulus packages vary from country to country).

The figures we obtain broadly suggest global growth of 5.5% in 2021 (compared to the –4.1% we estimate for 2020), with China in advanced stages of the recovery (+2.0% in 2020 and +8.3% in 2021), the US emerging from recession at a reasonable rate (–3.6% in 2020 and +4.1% in 2021) and the euro area, unfortunately, recovering only part of the lost ground (+4.3% in 2021 *versus* –7.4% in 2020). In this context, we anticipate growth of 6.0% for Spain (–11.4% in 2020) and 4.9% for Portugal (–8.3% in 2020).

What about the risks? There is no shortage of them, and they have a clearly downside bias. New waves of the virus are possible; economic policy mistakes (such as prematurely relaxing efforts to alleviate the shock in the short term) cannot be ruled out; the strange complacency that seems to surround the financial markets could lead to a phase of greater sensitivity to macrofinancial risks; or, finally, the political situation, which is sensitive in many areas, could generate negative surprises.

However, besides growth, 2021 will also be different in several key ways which lay the path for much of our future world.

Bringing the COVID-19 pandemic under control

We believe that the fight against the pandemic is likely to turn a decisive corner in 2021. In line with the opinion of many epidemiologists, we do not expect this shift to come in the form of a single «magic bullet» that eliminates the virus. While we are confident that several vaccines will be deployed during the course of 2021, we align with those who expect their effectiveness to be high, but not total. We also share the view that there could be potential production and distribution difficulties in achieving the high rate of vaccination that guarantees the long-awaited herd immunity. That said, we have no doubt that it will be possible to vaccinate risk groups and essential workers, such as those in healthcare. In fact, we are confident that it will be possible to achieve this during the first half of the year. In short, the vaccine will be a key ingredient of the cocktail of measures that will allow us to turn the tide of the pandemic, but it will not be the only one.

What are the other ingredients? We foresee them including the ability to conduct rapid tests at a low cost and on a mass scale, advances in therapies to treat the illness, and more efficient coordination of the various elements that make up national health systems.

The new mobility

More activity means more mobility. Will we see pre-pandemic levels be restored? Not likely. Firstly, activity in 2021 will still be lower than it was at the end of 2019. Moreover, the final level of mobility is likely to be lower on quite a permanent basis. The main reason for this is the consolidation of teleworking which, according to our own estimates, could eliminate around 7% of commutes to large cities.

Moreover, there will be a qualitative change in mobility. There is a lot of concern about the loss of public transport's share in the mobility mix. This is a justified concern, since according to a Boston Consulting Group survey conducted in the EU, China and the

US, when a vaccine is available or the virus is contained, only half of those interviewed who stopped using public transport say they will go back to using it again. A more promising trend will be the continued growth of electric cars (both fully electric and hybrid variants), a segment which surpassed that of diesel in Europe for the first time in September.

An important year for the sustainable economy

This accelerated «greening» of the fleet of overly-polluting vehicles opens the door to the next sphere of change, that of the sustainable economy. 2021 is going to be a year of accelerating trends, but whether or not it will be enough to achieve the long-awaited goal of decarbonisation (by 2050 in the world and by 2060 in China) is open to debate.

In 2020, according to estimates by the International Energy Agency, although global energy demand will have fallen by 5%, electricity produced from renewable energies will have increased by 9%, and this rate will accelerate in 2021. In fact, renewables are on track to become the main source of electricity by 2025 (ending five decades of dominance of coal).

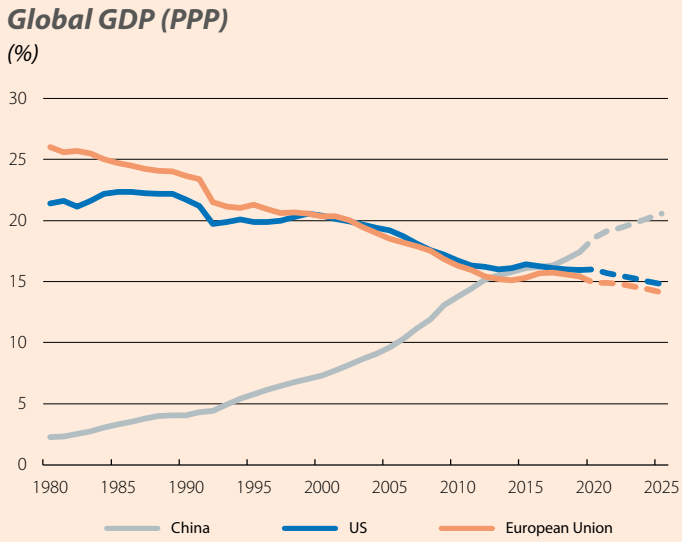
5G, the key technology infrastructure

Decarbonisation will go hand in hand with the digitalisation of society, a trend that should facilitate the partial replacement of flows of people and goods with those of data. The key to this shift towards intangible flows largely depends on an incipient technology, 5G, which offers unprecedented possibilities for connection speeds and device connectivity, all with minimal latency.

This is a critical development, but progress in Europe is slower than desirable. Although multiple projects are being announced, the fact is that in 2020 only 11 EU states had 5G roadmaps and only 20.5% of the 5G radio spectrum had been allocated. 2021 should be different. In Spain, for example, the auction will be held for the 700 MHz spectrum, which is key to the development of 5G and will enable greater infiltration of the network across the country (the challenge is to cover territory, not just population).

Who is in charge? Complexities of a multipolar world

5G is inevitably associated with the US-China technology conflict and, more broadly, with the struggle for global dominance. China is waiting for no one. A few weeks ago, it was announced that a free-trade area will be created in Asia, led by China, which will encompass approximately one-third of the world's GDP. In this context, the US must decide whether the current hard-line approach is truly benefiting it. It does not look like it. The US is now insinuating the idea of a rapprochement with its traditional partners (that is, the EU) and of rejoining the World Health Organization and the Paris Climate Agreement (we will see whether the domestic political situation will allow them to go much further).



Source: *CaixaBank Research, based on data from the IMF.*

This does not mean that the competitive impulses will not continue, since the tensions between the US and China are unlikely to subside, but they could at least be framed within cooperation schemes that help agreements that reduce the current uncertainty to be reached. The alternative to this new global cooperation would be the acceleration of what we might call the «new global mercantilism», that is, going further down the path towards a more unilateral world based on relations of relative power (and less on global rules and institutions). For the time being, and to put it as prudently as possible, the signs indicate a certain inclination towards the first scenario.

In short, if we are not too mistaken, next year will be radically different from the fateful 2020, with its wake of human losses, economic destruction and social upheaval. In years of change, more than ever, the past can be a deceptive guide to the future, and we must be attentive to the possibilities that present themselves, which should be plentiful.

Àlex Ruiz

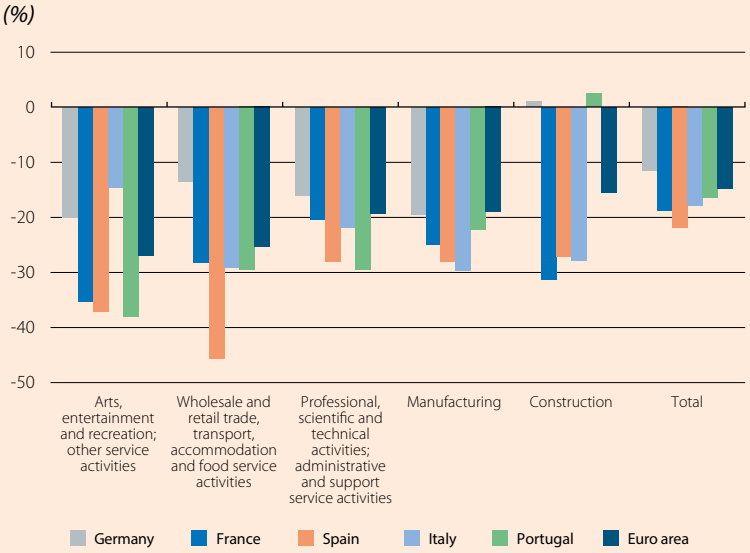
Post-COVID-19 Europe: a story of convergence or divergence?

2020: an unprecedented economic crisis

The economic shock triggered by the COVID-19 pandemic in 2020 has been unprecedented, of a global magnitude, and uneven between countries and sectors. This has also been the case for the euro area: while GDP has fallen in all the region's economies, the impact has varied according to the prevalence of the virus in each country, the measures implemented to contain it, the structure of the economy and the economic policies developed by governments to soften the blow.

The hardest hit sectors have been leisure and catering, as well as retail, transport, accommodation and food services. As a result, the fall in GDP is more pronounced in countries that are more dependent on these sectors, such as Spain, France and Italy. Industrial activity, on the other hand, is being less affected by the crisis, although it has also declined considerably.

Change in the real gross value added for a selection of sectors in Q2 2020 compared to Q4 2019



Note: *Ordered by the magnitude of the fall in the euro area. Excludes Agriculture, forestry and fishing. Information and communications; Financial and insurance activities; Real estate activities; and Public administration, defence, education, human health and social work activities.*
Source: *CaixaBank Research, based on data from Eurostat.*

To counter the economic shock and avoid a surge in unemployment and business failures, as well as to preserve the productive fabric of the economy, European governments have deployed an unprecedented package of fiscal measures: according to the budget plans that each country sent to the European Commission in October, they amount to 4.2% of the euro area's GDP and are mainly aimed at strengthening the health sector, offsetting the fall in workers' and businesses' incomes and, to a lesser extent, boosting the economic recovery through measures such as indirect tax cuts and new investments. In addition, Member States also undertook a series of initiatives to support households' and businesses' liquidity, such as suspending tax payments and social security contributions or granting guarantees for business loans. In this sphere there are also differences between countries: those with a lower level of public debt provided more direct aid, while countries with a weaker fiscal position opted for a higher proportion of measures aimed at supporting liquidity. In addition to these discretionary measures, the automatic stabilisers of European economies also played their part in cushioning the shock, and the euro area deficit for 2020 is expected to stand at around 9% of GDP.

The recovery in economic activity in Q3, following the first wave of the virus and the relaxation of social distancing measures in most European countries, was spectacular and demonstrated European economies' resilience and the success of the fiscal and monetary measures deployed. However, the second wave of the pandemic in Q4, which is being fought with more targeted and localised measures, is causing a new contraction in economic activity. Once again, the scale of this contraction will differ between countries, as the mobility data suggest (this is an indicator that is proving very accurate in assessing the economic impact of the COVID-19 pandemic).[1] For the year as a whole, we expect Spain, France and Italy to end 2020 around 11%, 8.4%, and 7.9% below their respective pre-crisis levels (in contrast, Germany's GDP will be only 6.1% below).

2021: a year of recovery, but still marked by uncertainty

In 2021, one of the key words will be recovery, but the word uncertainty, unfortunately, will continue to accompany us. Although the latest news is that a COVID-19 vaccine will soon be available, there are still questions over the production and distribution capacity, as well as over who can – or even who will want to – get vaccinated, and when. Therefore, it may be necessary in some countries to prolong the restrictions of recent weeks or to reactivate them in the early stages of next year after a de-escalation phase, depending on how the pandemic evolves. However, uncertainty should not be confused with pessimism. In our baseline

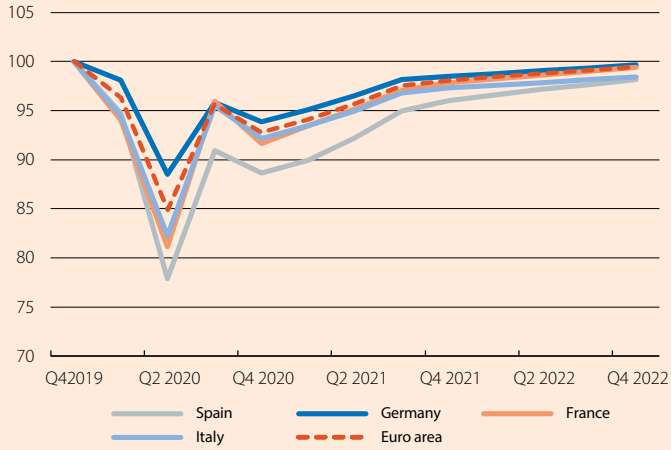
1. See the Focus «Mobility and economic activity in the second wave: how much will GDP fall by in Q4?» in this same *Monthly Report*.

scenario, we see European economies kick-starting their recovery in 2021 largely thanks to a more positive outlook, favoured by the foreseeable widespread use of rapid tests and the aforementioned availability of vaccines. Thus, despite the uncertainties that will dominate, sooner or later the medical advances ought to have a positive effect in 2021 that will translate to the economy. Nevertheless, we will probably have to wait until 2023 before pre-crisis levels of economic activity can be reached.

Similarly, we are unlikely to return to the pre-pandemic «normal» any time soon: the restrictions, although reduced, will not be completely lifted until herd immunity is achieved and the pandemic is under control, and new social behaviours will not disappear overnight. For this reason, it is also unlikely that the economic sectors heavily affected by this crisis, such as tourism and air transportation, will return to pre-crisis levels of activity quickly. Consequently, economies that depend more heavily on these sectors, such as Spain, will likely take longer to recover to pre-COVID-19 activity levels. There is also a risk that countries with less fiscal margin will be more reluctant to continue supporting the economy to the same extent if the pandemic persists for longer than expected.

Real GDP

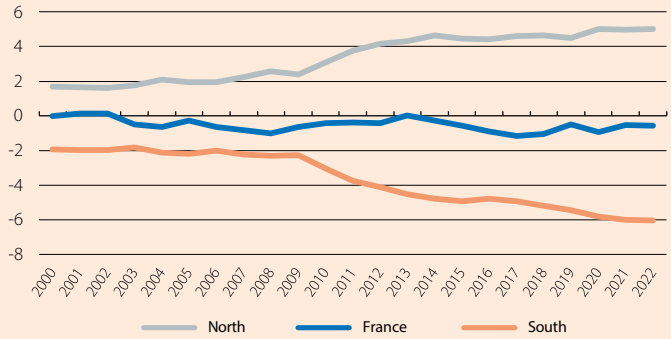
Index (100 = Q4 2019)



Source: *CaixaBank Research, based on data from Eurostat and CaixaBank Research forecasts.*

Deviation from the euro area's average GDP per capita (PPP), weighted by population

EUR thousands



Note: *North: Austria, Belgium, Germany, Finland and the Netherlands. South: Greece, Italy, Spain and Portugal. The European Commission's forecasts do not take into account the impact of NGEU.*
Source: *CaixaBank Research, based on European Commission data and forecasts.*

As a result, this crisis, like the previous one endured by the euro area, could further increase the gap in economic prosperity between European countries (see third chart).

Next Generation EU: a catalyst for convergence?

One of the major differences between the current crisis and the previous one is the economic policy response at the European level. In addition to setting up a series of funds through which the EU will be able to lend to its Member States at reduced interest rates (ESM, SURE, etc.), the European Council approved the creation of a European recovery plan, known as Next Generation EU (NGEU), with a budget of 750 billion euros. The main component of NGEU is the Recovery and Resilience Instrument. This instrument will provide 312.5 billion euros in grants and 360 billion in loans between 2021 and 2026 to EU Member States to help finance investment projects and reforms that boost the recovery and their economies' resilience. Crucially, the amounts available for each country will depend on how severely-affected they will be by the crisis. This is a historic agreement, as it will be the first time the EU has issued its own debt to transfer such large sums to its Member States.

NGEU was created to support Member States' efforts to respond to the COVID-19 crisis and to boost the EU's green and digital transitions. In addition to supporting economies' recovery, the goal is for NGEU to trigger a substantial and widespread increase in public investment, which has been weak in the euro area over the past 10 years, especially in countries with higher public debt (which has contributed to the economic divergence between countries after the 2008 financial crisis). Through NGEU, countries with less fiscal space will be among those that will receive a greater sum of European funds to invest in investment projects and national reforms. It is estimated that Spain, for instance, could receive some 72 billion euros in transfers, a considerable amount that could have a substantial impact on the country's economy.

The implementation of this historic decision lies in the hands of the European Commission and the European Council, which will have to approve each country's national recovery plans in 2021. Above all, however, it is in the hands of national governments, which must use the funds in the best way possible and not let this enormous opportunity go to waste. In developing their

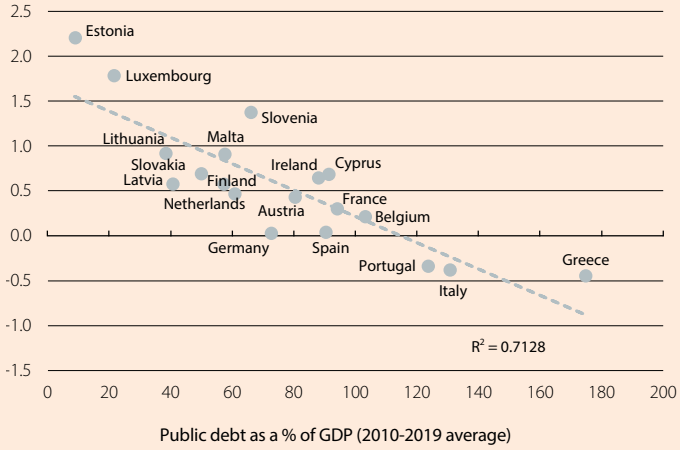
national recovery plans, they will have to think about which investment projects are most appropriate to drive the recovery and transformation of their economies, which reforms to accompany them with, and what processes will be necessary to ensure the best execution of those projects.

This will involve a Herculean effort, even more so in the midst of the euro area's biggest ever crisis, and this effort will have to be sustained for several years. However, if well executed, it will end up being a catalyst for convergence that could become a permanent tool, helping to complete the architecture of Europe's monetary and economic union.

Álvaro Leandro

Public debt and net public investment, 2010-2019

Net public investment as a % of GDP (2010-2019 average)

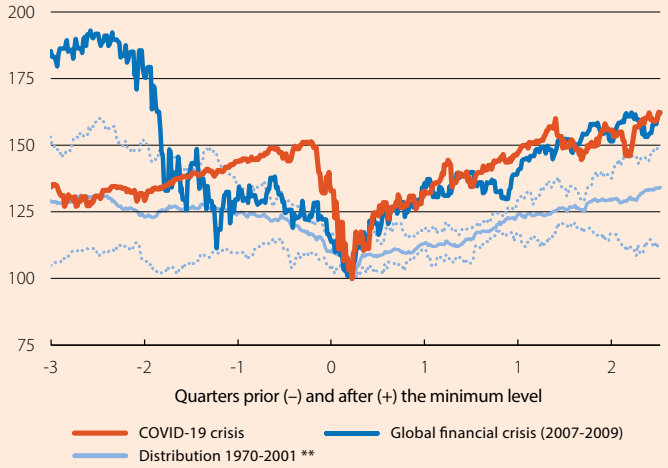


Source: *CaixaBank Research, based on data from Eurostat.*

The market-macroeconomic connection in times of pandemic

28 October 1929, Black Monday (the Wall Street Crash). 19 October 1987, Black Monday. 16 March 2020… another Monday, also Black. 2020 has placed another Monday on the podium of the worst trading sessions of the last 100 years.[1] Indeed, as the first chart shows, the COVID-19 pandemic provoked one of the most sudden and severe crashes ever experienced in the financial markets: during the 2008-2009 recession it took a year and a half to accumulate losses of 60%; in 2020, the US stock market lost over 30% of its value in a single month. And yet, following this collapse, financial markets have managed to make a significant and rapid recovery before the year is out, to the point that the US stock market was once again registering all-time highs at the end of November.

S&P 500 stock index in economic recessions
*Index (100 = minimum level for the period) **



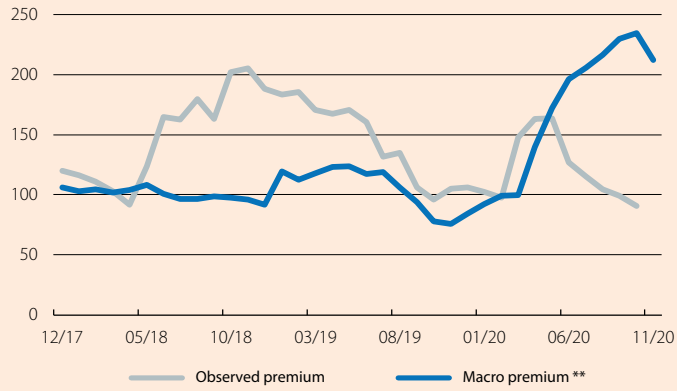
Notes: ** In the last two recessions, the minimum levels correspond to 23/03/2020 and 09/03/2009. 09/03/2009. ** Average (solid line) and minimum and maximum (dotted lines) of stock market performance at each given moment in the various recessions of the period.*
Source: *CaixaBank Research, based on data from Bloomberg and dating of the business cycle by NBER.*

Is there a disconnect between the economy and the markets?

The good performance of the markets in recent months has raised fears that prices are 'disconnecting' from the real economy. This risk of market complacency cannot be downplayed in a context of unprecedented declines in economic activity. However, at least part of the contrast between market performance and economic activity is a reflection of the very economic measures that have been launched to protect the economy, just as there has also been a 'disconnect' between the slumps in GDP and the rate of corporate bankruptcies or job destruction.

For example, in normal times, the sharp contraction that GDP is suffering would result in a significant rise in corporate bankruptcies. Indeed, some estimates suggest that if we extrapolate historical relationships, the cumulative decline in economic activity expected for 2020-2021 would be associated with a 10%-30% rise in bankruptcies in the euro area.[2] However, the reality of 2020 is that even fewer insolvencies have been registered than in recent years. In addition, the likelihood of corporate bankruptcy implicit in the financial asset valuations remains contained.

Sovereign risk premium for peripheral 10-year debt *
(bps)



Notes: ** Weighted average of Spain, Ireland, Italy and Portugal. ** Risk premium predicted by the macroeconomic fundamentals (global financial conditions, conventional and unconventional monetary policy of the ECB, public debt, and growth and inflation expectations) and estimated according to the historical relationships up until the beginning of 2020.*
Source: *CaixaBank Research, based on data from Refinitiv, Eurostat, Consensus Economics and Focus Economics.*

In the same vein, part of the recovery in the stock markets also reflects the measures which economic and monetary policy have employed to protect the economy. The battery of economic measures as a whole, and the accommodative monetary policy in particular, have anchored an environment of low interest rates (for instance, in the US, sovereign rates have fallen by between 100 and 150 bps in 2020) and have favoured a recovery in investor sentiment. According to IMF estimates, these two factors have more than offset the impact of the contraction of corporate earnings on the stock markets.[3]

Economic policies are also playing a vital role in fixed income markets, and in particular in the euro area's sovereign risk premiums. Our estimates[4] suggest that the deterioration in the macroeconomic fundamentals should have led to a significant rise in the euro area's sovereign yields. Indeed, the second chart shows how peripheral risk premiums initially rose in line with the macroeconomic fundamentals. However, the stress was widely reverted following the ECB's barrage of

1. On 16 March 2020, the S&P 500 index fell 12.0%, close to the –12.9% drop registered in 1929, but still far from –20.5% of 1987.
2. See R.N. Banerjee, G. Cornelli and E. Zakrajšek (2020). «The outlook for business bankruptcies». Bulletin nº 30. Bank for International Settlements.
3. IMF Global Financial Stability Report of October 2020, chapter 1.
4. Based on historical relations, we estimate the sovereign yield that would be consistent with the macroeconomic fundamentals (global financial conditions, the state of the ECB's monetary policy, public debt ratios, and GDP and inflation expectations). See the Focus «The macroeconomic fragility of interest rates» in the MR10/2020 for further details.

announcements throughout the spring and the EU's fiscal packages.

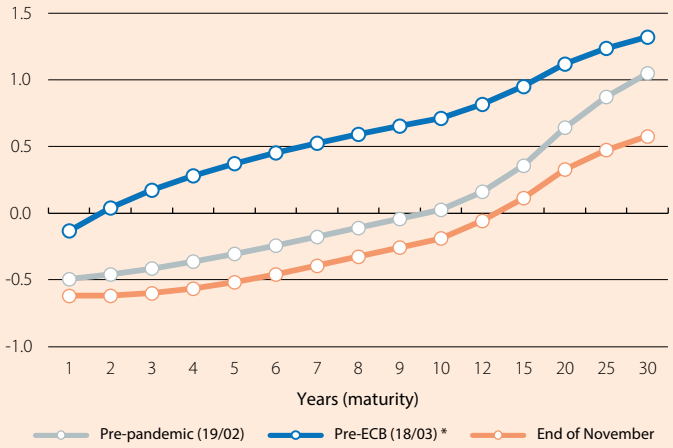
All of this shows that the support from policies, coupled with the expectation of economic recovery in 2021 (which, due to its anticipatory nature, is already reflected in the financial asset prices), has been key to explaining the performance of the markets in 2020. Therefore, the evolution of the pandemic, the resilience of the economy and the protection which policies have provided to the economy will continue to set the tone in the financial markets in 2021.

Monetary policy, a bastion of liquidity and low rates to combat the pandemic

In the face of the COVID-19 crisis, monetary policy has anchored an accommodative financial environment and has done so successfully, as the third chart clearly shows. This defensive strategy had a triple effect: (i) avoiding liquidity problems, (ii) helping firms and households to get easier access to credit, and (iii) anchoring a low-interest-rate environment which, in addition to supporting the economic recovery, provides coverage to allow fiscal policy to act aggressively and without raising doubts about the sustainability of the public accounts.

Sovereign yield curve for the euro area

(%)

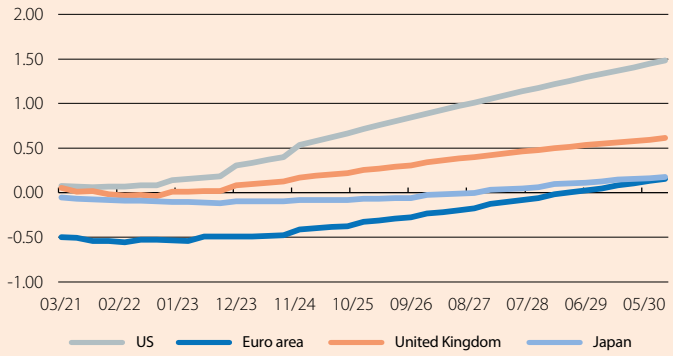


Note: ** Just before the launch of the PEPP, the purchasing programme aimed at combating the economic effects of the health emergency.*
Source: *CaixaBank Research, based on data from the European Central Bank.*

The current environment is highly demanding and all the indicators suggest that the bulk of the measures launched by the central banks must remain in force in the new year. 2021 will be a year of change and will remain a difficult year. Beyond the initial rebound, economies will take a long time to return to normal. Furthermore, in addition to the impact of the restrictions to contain the pandemic itself, there is a risk that some of its scars will begin to surface in the form of destruction of the economy's productive fabric.

Expectations of central bank official rates implicit in market interest rates *

(%)



Note: ** Forwards at the end of November 2020. References for the calculation: OIS curves (EONIA in the euro area).*
Source: *CaixaBank Research, based on data from Bloomberg.*

Indeed, monetary policy has already made its intentions perfectly clear, and as the fourth chart shows, investors' expectations point towards a long period of low interest rates. Furthermore as we have shown in a recent Focus,[5] in 2021 the ECB's monetary policy will continue to make a key contribution to market liquidity, thereby indirectly continuing to provide coverage for the necessary action from fiscal policy.

Even at this challenging time, 2021 will also be important for the underlying transformations of the central banks. By mid-year, the ECB is expected to complete its monetary policy strategy review (the first since 2003). There are unlikely to be any big, sweeping developments (its definition of price stability could shift from the current «close to, but below, 2%» to a simple and symmetrical «2%»). However, the review will also focus on other major issues, such as the effectiveness of the various monetary tools or the importance of employment, social inclusion, climate change and financial stability in the ECB's decision-making.

Similarly, in the US the change of administration could lead to a more constructive relationship with the Fed (remember that President Trump was highly and publicly critical of the central bank, and that the Treasury has unilaterally opted not to renew various aid programmes that had been launched in collaboration with the Fed). This institutional relationship will be important for the composition of the Fed's Governing Council: in early 2022, Jerome Powell's term as chair is due to be renewed for four more years, while Vice Chairman Clarida's term also expires in early 2022, and the Council still has two vacancies yet to be filled (Trump nominated Judy Shelton and Chris Waller, but they have not yet been confirmed by the Senate).

Adrià Morron Salmeron

5. See the Focus «Sharp rise in public debt: will the euro area resist?» at www.caixabankresearch.com.

2021: notable but incomplete recovery of the Spanish economy

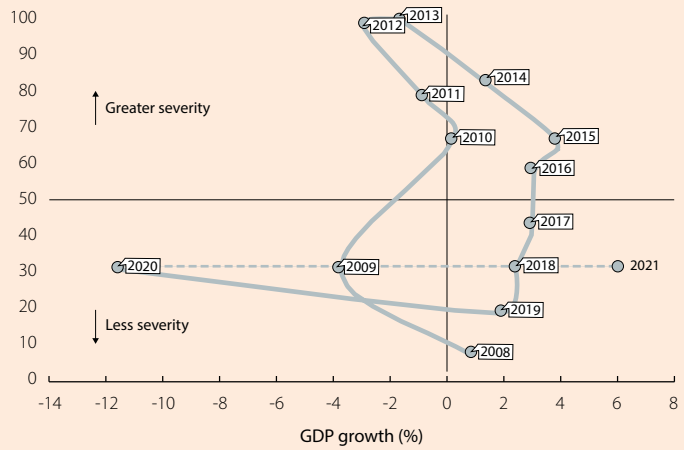
2020 is a year we are unlikely to forget. There are critical moments in history that can mark an entire generation: a war, a crisis, or a pandemic. These events, which we can call extreme, can accelerate social and economic transformations. Their legacies are uncertain, but certainly profound. In this article, we will review the economic impact of the pandemic and explore what will be the main driving forces of next year.

2020, the year of the pandemic

The 2008 financial crisis is still fresh in the collective memory. However, the 2020 crisis is of a very different nature. For starters, the crisis has originated from a health emergency, so the economy has been the victim of the measures needed to tackle the pandemic. Secondly, the COVID-19 crisis has been of an unprecedented magnitude. Whereas at the height of the 1993 and 2008 crises GDP fell to 2.5% and 9% below the pre-crisis level, respectively, during the COVID-19 crisis GDP has reached 22% below the pre-crisis level. Thirdly, the dynamics have also been very different. To the extent that COVID-19 has been the trigger of the 2020 crisis, the economy has evolved according to the fluctuations of the pandemic. Thus, the speed of the recovery has been much quicker than in previous crises. In 2020, in a single quarter (Q3) the economy recovered almost 60% of its lost output, compared to the nine quarters it took during the financial crisis.

Economic conditions index and GDP growth

Synthetic index of the severity of economic conditions



Source: *CaixaBank Research, based on data from the National Statistics Institute and Bloomberg.*

Another feature of the current crisis has been the key role played by monetary and fiscal policy in alleviating the effects of the pandemic. To illustrate this, in the first chart we show the relationship between a synthetic index of the severity of the economic conditions (built using the unemployment rate and the sovereign risk premium) and annual GDP growth.

The large drop in GDP has been accompanied by a much smaller deterioration in the severity index than one might have expected given the experience of the financial crisis. This has largely been due to the decisive action of the ECB and all the actions taken by fiscal and economic policy to secure the incomes of those affected by the restrictions on activity, whether through Spain's «ERTE» furlough schemes, extraordinary temporary cessations of activity in the case of self-employed workers, debt moratoriums or tax deferrals.

This does not mean that we have already seen all the implications of this crisis: many are yet to emerge, and we will refer to them later. However, to use a health metaphor, economic policy has acted as an anaesthesia to stabilise the vital signs of a patient entering the critical phase.

What will 2021 bring us?

2021 will continue to be dominated by the pandemic, although it is expected to be the year in which the economy will consolidate its recovery. The measures that had to be taken at the end of 2020 to combat the second wave of infections are likely to have some continuity in the first few months of 2021. However, we are confident that the availability of a vaccine, together with more intensive use of rapid tests, will allow the pandemic to be kept under control without having to resort to measures as restrictive as those imposed to date. In this regard, we expect the growth of economic activity to pick up from Q2, when the highest-risk groups should already have been immunised, while international mobility should enjoy a stronger recovery, with the resulting positive impact on tourism.

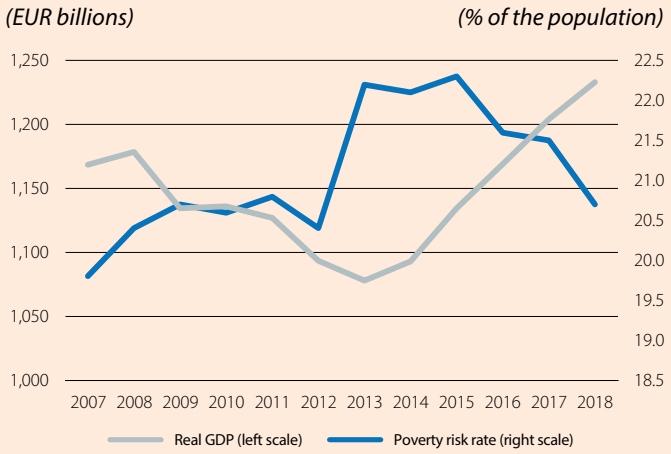
Overall, we expect economic growth in 2021 to be around 6.0%. While the pace of recovery is high, this would still leave the economy 6.2% below the pre-crisis GDP level. In fact, we do not expect the economy to return to pre-crisis levels until 2023.

The economic scars of the COVID-19 pandemic

The economy will recover over the next few years at the macroeconomic level, but it will leave some major scars. It will therefore be essential to pursue appropriate economic policies so that these scars can be closed in the shortest possible time and to avoid persistent effects in certain economic sectors and for those who work in them.

The labour market will gradually recover in 2021, although labour policies will have to accompany this recovery in order to prevent the sectors hardest hit by the pandemic – tourism, leisure, hospitality... – from emerging with deep scars. Thus, furlough (ERTE) schemes will remain an important tool in the first half of 2021, albeit in a more selective and temporary manner than in 2020.

GDP and poverty risk



Note: *The risk rate is calculated by taking 60% of the median annual income per unit of consumption as the poverty threshold.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Change in gross income per capita by percentile for 2008-2014

Source: *O. Bover* et al. *(2018). «La desigualdad de la renta, el consumo y la riqueza en España», Occasional Papers, n° 1,806. Bank of Spain.*

Another scar that ought to be closed quicker than in the Great Recession is the rise in inequality. Sometimes the consequences of crises take time to emerge at the social level: the percentage of the population at risk of poverty in Spain rose significantly between 2013 and 2015, just as the worst of the previous crisis had already passed and the economy was embarking on an incipient recovery. In fact, based on our forecasts for growth and unemployment, we see that the sum of the poverty risk rate and the social exclusion rate[1] could increase in 2021 to 27% of the population (25.3% before the pandemic), an increase of 750,000 people. This highlights the importance of continuing to develop inclusive policies that allow the recovery to reach everyone: in 2020, the Gini index increased by 2 points between February and September taking into account public sector transfers, but it would have increased by 4 points in their absence, according to CaixaBank Research's Inequality Tracker.

2021 will also be an important year for the Spanish economy's productive fabric. It is essential that Spanish firms do not emerge excessively weakened from this pandemic. This will require a combination of financial relief for viable companies that are hardest hit in order to ensure that their solvency does not deteriorate – for instance, via recapitalisations and direct aid – together with structural policies that adapt the productive fabric of the economy to a more digital and green post-pandemic world.

Finally, it will be essential to combine a fiscal policy that offers support for the short-term recovery with a medium-term vision focused on rebalancing the public accounts and recovering some fiscal margin to ensure that the next crisis catches us with room to pursue counter-cyclical policies.

The hope of the NGEU European funds

The European Recovery Fund, Next Generation EU (NGEU), will represent a unique opportunity to modernise the Spanish economy and boost its potential growth. In 2021, Spain will submit the full details of its Recovery Plan to the European Commission and, after its expected approval, will begin receiving funds mid-year. These funds will total some 72 billion euros in non-reimbursable transfers between 2021 and 2026, equivalent to 5.8% of GDP in 2019.[2] This is a very significant amount and it is key that the funds are used to design an intelligent investment plan focused on infrastructure and the green and digital transitions, accompanied by reforms that address the structural challenges of the economy (the incidence of temporary contracts in the labour market, education and vocational training, innovation, etc.).

The government expects to execute 26.6 billion euros of NGEU funds in 2021 by anticipating the budgeted funds in order to accelerate the planned investments. This is a considerable sum which, prior to its execution, would require the selection and design of a large number of projects in record time. Being conservative, our growth forecast for Spain next year incorporates the execution of 50% of this sum of 26.6 billion euros, which would contribute 1 point to next year's growth.[3]

The European funds are big news, but it is worth looking at what macroeconomic impact fiscal policy as a whole (including these European funds) will have in 2021.[4] When we perform this analysis,[5] we come to a total fiscal boost in 2021 of around 2.5% of GDP with a macroeconomic impact of 1.5 pps, comprising 1.0 pp resulting from NGEU and the rest from current expenditure.[6] In short, the European funds are the catalyst that will enable economic policies to stimulate economic growth in 2021 (and beyond).

Oriol Carreras Baquer and Javier Garcia-Arenas

1. This is the AROPE index (*At Risk Of Poverty and social Exclusion*), which counts the population at risk of poverty, with severe material deficiencies or with low levels of employment.
2. This amount could reach 140 billion euros if we include the loans that can be requested.
3. We use a fiscal multiplier of 0.9.
4. We calculate the expected increase in current and capital spending between 2020 and 2021 above what the expected inflation rate for 2021 would suggest.
5. We exclude the extraordinary measures introduced in 2020 to combat the pandemic that will be partially withdrawn in 2021.
6. For current expenditure, we apply a fiscal multiplier of 0.4.

Through our studies, we help to stimulate debate and the exchange of views among all sectors of society, as well as to promote the dissemination of the major themes of the socio-economic environment of our time. Both the *Monthly Report* and the rest of CaixaBank Research's publications are available at: www.caixabankresearch.com

We recommend:

Inequality dossier

How has the COVID-19 crisis affected Spaniards' wage incomes? We analyse the evolution of inequality and the role of the welfare state in real time, using internal CaixaBank data and *big data*.

Everything you ever wanted to know about the European Recovery Plan but were afraid to ask

What exactly is the NGEU and how will it work? We answer the frequently asked questions about the European Recovery Plan, the timetable for its approval and implementation, the conditions attached to it and the distribution of the funds.

Next Generation EU: a golden opportunity for the Spanish economy

NGEU represents an extraordinary opportunity to give the Spanish economy a new modernising boost. Will the country get the most out of it? We analyse the overview of the action plan presented by Spain.

The growth of e-commerce during the pandemic: myth or reality?

We investigate whether the COVID-19 pandemic has changed e-consumption habits in Spain using anonymised data from card payments carried out by CaixaBank's 13.5 million customers, analysed using *big data*.

Sharp rise in public debt: will the euro area resist?

The COVID-19 crisis is causing a sharp increase in public debt and public funding needs. What tools exist to soften this blow?

Consumption tracker

How is consumption behaving in the COVID-19 crisis? Follow the state of household consumption in real time using internal CaixaBank data at: https://www.caixabankresearch.com/en/etiquetas/monitor-consumo

Follow us on: www.caixabankresearch.com @CABK_Research Newsletter CaixaBank

Design and production: www.cegeglobal.com
Legal Deposit: B. 21063-1988 ISSN: 1134-1920

CaixaBank Research