

# Global Monthly

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## Is the Eurozone missing the boat?

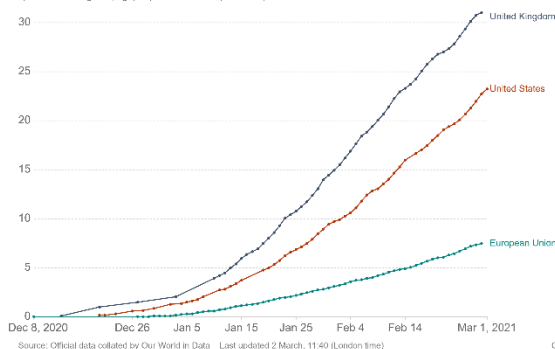
The point at which the economic recovery kicks off depends largely on the pace of vaccination (provided, of course, existing vaccines protect against new mutant strains). Our new baseline scenario<sup>1</sup> assumes that our economies can reopen towards the summer, marking the first step towards a sustainable recovery. Great uncertainty still surrounds the virus and vaccinations. President Biden, for instance, last week announced a massive vaccine production drive to achieve herd immunity in the US as early as May. If realized, this would cause an upside risk to our current scenario. In view of the rapidly evolving situation, we have developed two alternative scenarios: one with an earlier reopening and one with a later reopening. Depending on how events pan out, the second round effects such as business bankruptcies and unemployment will be lower or higher. With the end of the crisis in sight, a divergence is beginning to emerge in the recovery paths of the largest economies. Though the pandemic hit all parts of the world in virtually the same manner, not every region is equally well-placed for recovery.

### Policy choices at the heart of divergence

Policy choices lie at the root of these differences – choices about health crisis management, fiscal stimulus for consumers and businesses and, finally, central bank interventions. Obviously, multiple other factors also influence the economic impact of the virus and a country's ability to recover: dependence on tourism, quality of digital infrastructure, fear of infection and vaccination take-up (acceptance and speed).

#### Cumulative vaccinations per 100 people

Cumulative COVID-19 vaccination doses administered per 100 people  
This is counted as a single dose, and may not equal the total number of people vaccinated, depending on the specific dose regime (e.g. people receive multiple doses).



Source: Our World in Data

#### Cumulative deaths per 100,000 people

Cumulative deaths attributed to Covid-19 in United States and European Union  
Cumulative deaths (per 100K)



Source: Financial Times

<sup>1</sup> The speed of vaccinations and the spread of the virus are causing some upside risk to our scenario. See [here](#) for recent developments.

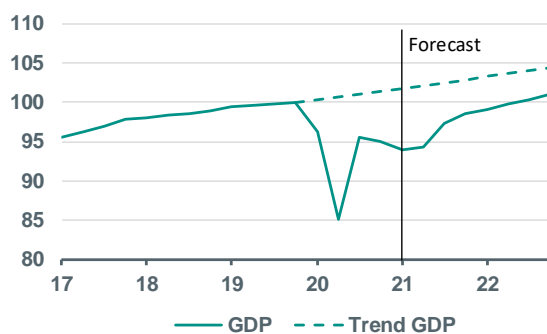
All these differences jointly have brought about a strong divergence between the various national escape routes from the crisis. The eurozone, for one, is clearly falling behind. The lockdown currently in force across Europe is causing substantial economic damage: almost twice as much (-6.8%) as in the US (-3.5%) in 2020. On the other hand, the death toll in the US is far higher (per 100,000 inhabitants).

The Chinese government's intervention to quell the virus was relatively brief but draconian. The Chinese economy has largely got over the contraction sustained in early 2020 and was already outpacing its pre-pandemic growth trajectory at the end of last year. As for the eurozone we expect 3.3% and 4.2% growth, respectively, in 2021 and 2022.

Compare that with the US economy, which is looking at 5.8% and 4.1% in 2021 and 2022, respectively. A substantial difference! The US is thus on course to close the output gap by the end of 2021, while eurozone prosperity will still be languishing at 3.3% below potential at the end of 2022. Apart from the fundamental differences in attitude towards the virus and the underlying economic structure, this divergence is attributable to marked differences in fiscal stimulus policy. Both the scale (about 8% of GDP in the eurozone versus about 15% of GDP in the US) and the nature of fiscal support matter in this context. The US focused on boosting demand (think of the stimulus checks) while most Eurozone countries targeted financial support at businesses to help them keep staff on the payroll.

### Eurozone output gap

Index, 19Q4=100



Source: Refinitiv, estimates ABN AMRO Group Economics

### US output gap

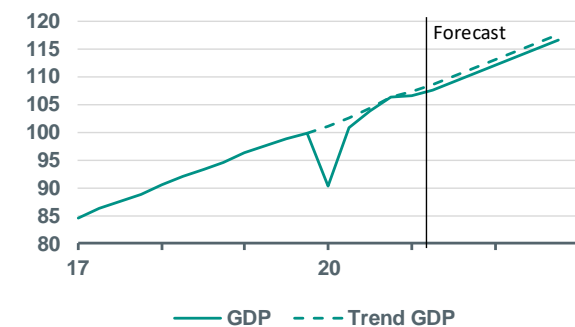
Index, 19Q4=100



Source: Refinitiv, estimates ABN AMRO Group Economics

### China output gap

Index, 19Q4=100



Source: Refinitiv, estimates ABN AMRO Group Economics

## Baseline scenario

### Eurozone & Netherlands:

*Vaccine versus variants: later but faster..*

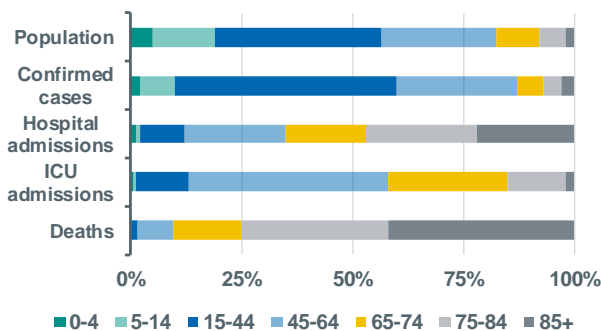
Our baseline scenario assumes that lockdown restrictions will remain in force in the eurozone until June, some 2 months longer than we initially estimated. Though certain sectors such as schools (which have little economic impact) may open earlier, we assume that non-essential shops, hospitality businesses and other economic activities will not fully reopen until the summer. This assumption is based on several arguments.

First of all, we expect the restrictions imposed upon the outbreak of the crisis to persist until sufficient people have been vaccinated. This is to prevent hospitals becoming overburdened. Due to the advent of more infectious variants of the virus, case rates are rising among middle-aged people, which could put added strain on hospitals. The 46 to 64 age group now accounts for the largest number of Covid patients in intensive care (see figure). We assume that restrictions can be safely lifted as soon as half of the over-50s have been vaccinated, as this will take the pressure off the intensive care units. This may take place faster than we previously assumed, provided it is safe to do so. An effective vaccine considerably curbs the risk of the virus flaring up again like last summer.

The pace of vaccination is therefore crucial. The current vaccination rate\* is almost equal throughout the eurozone, despite some countries having started before others.

### Why is it important for over-50s to be vaccinated?

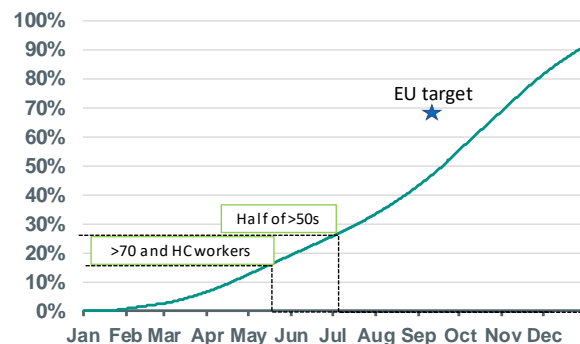
Subdivision in %



Source: NHS England

### Expected vaccination rate\*

Percentage of population vaccinated



Source: Group Economics ABN AMRO

In the first quarter the vaccine roll-out ran up against supply constraints, but these will almost wholly disappear in the second quarter. The pace will pick up as soon as the elderly population has been vaccinated. Young people, after all, are better able to reach the vaccination sites under their own steam. By the end of the third quarter, the levels of vaccination and naturally acquired immunity will be sufficient to achieve herd immunity. In principle, all economic activities barring international travel to countries without herd immunity will then be possible.

*\*Update March 12<sup>th</sup>: the pace of vaccinations is currently accelerating in Europe as well. Today, around 9,3 percent of the population is inoculated. A number we had anticipated a few weeks later (see [here](#) for details) in our current baseline scenario (from March 8<sup>th</sup>). As things stand, this poses some upside risk to our base case, but not with sufficient economic implications to change our base case.*

### *Restrictions into the second quarter less damaging*

Even if the current restrictions remain in place until June, consumer spending and capital expenditures will suffer less than in the first lockdown. The current lockdown measures will last longer, but are less strict. In addition, unlike during the first lockdown, the manufacturing industry was not affected this time around. The frictions currently seen in certain distribution chains are temporary and conceal a strong underlying recovery of world trade (see box). Another significant factor is that the level of prosperity was already lower when the second lockdown started. Eurozone consumption will shrink some 6% in this second lockdown and investments by some 7.5%. For comparison: during the first lockdown consumer spending declined 16% and capital expenditures 22%. The Dutch economy is subject to the same dynamics, but will be less hard hit than other eurozone economies. Consumer spending in the Netherlands will retreat about 5.5% in this second lockdown. With demand fall-out continuing to affect the entire eurozone until June and industrial output staying stable, exports will make a positive contribution to the European economy. The second half of 2021 will see a reversal of this pattern, as domestic demand starts to pick up strongly.

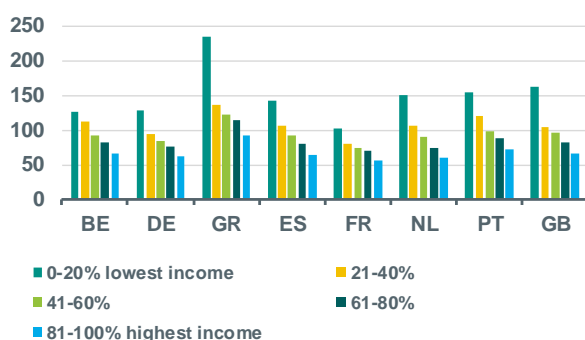
### *Catch-up growth: yes, but not exuberant*

A steep recovery path is on the cards from the third quarter. This is partly due to the base effects of the lower level of prosperity, but the accumulated savings of consumers is another factor. Relieved consumers will be keen to return to the services denied them for almost one and a half years, triggering a partial catch-up. In Q2 2021 consumer spending is expected to grow 6.5% in the eurozone and some 5% in the Netherlands. Investments will then rebound by about 8%. In addition, the European recovery fund will boost growth, notably in the southern eurozone economies, while monetary policy will also continue to foster a benign lending climate for some time to come.

The spectacular reopening statistics notwithstanding, actual prosperity will remain well behind potential for some time yet. One important drag on growth is the labour market, which is in worse shape than official unemployment statistics suggest. Some 3.6 million jobs were lost during the crisis, while the unemployment figure rose by 'only' 1.7 million. About 1.1 million people are not included in the unemployment data, despite not working any hours whatsoever. And a further 1 million or so people have withdrawn from the labour market since the outbreak of Covid. A portion of these 'hidden unemployed' are likely to register as job seekers when the economy regains upward momentum. We anticipate a further rise in unemployment towards 10% at the end of 2021 in the eurozone and 5.5% in the Netherlands after the restrictions and fiscal support measures start to be wound down.

#### % disposable income consumed

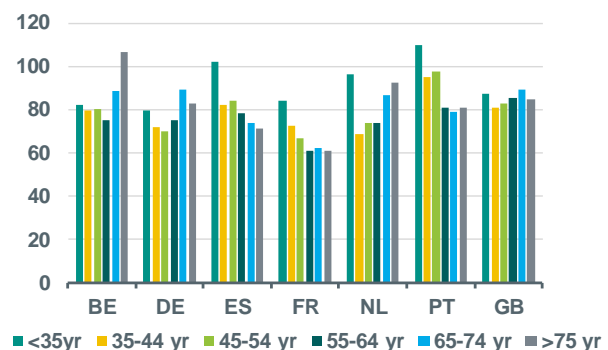
broken down by level of income, 2015



Source: Eurostat

#### % disposable income consumed

broken down by age, 2015



Source: Eurostat

The higher unemployment grows, the stronger the brake on consumer spending. Unemployment traditionally hits workers in the lower half of the income distribution and the under-35s are also over-represented in the group that runs a greater risk of

losing their job. It is the lower middle incomes and young people who consume the largest share of their income, so that their unemployment has the biggest impact on consumer spending.

The European recovery fund can potentially offset these growth-inhibiting factors, but on this score too we foresee less additional growth than indicated by the European Commission. We think that the recovery fund can boost growth by some 0.3% and 0.4% in, respectively, 2021 and 2022. Many projects that will be realised with recovery funding were already planned and countries that can expect to raise cheaper funding in the capital market will prefer this option.

#### *Managed withdrawal of support to prevent 'Fiscal Cliff'*

A tricky period lies ahead when governments start to wean European businesses off fiscal support. Our baseline scenario assumes that governments will gradually wind down their support to businesses, notably the worst-hit SME sectors, in order to keep rising bankruptcy and unemployment levels under control.

Consumers, for their part, will redirect part of their spending towards services, causing the disruptions that marred the distribution chains in early 2021 to disappear again. Commerce will then reignite the recovery that had already started at the end of the first wave (see box).

#### **World trade contending with temporary glitches**

After contracting 5.3% in 2020, world trade is expected to rebound to 7.5% growth in 2021. The worst production glitches will then be behind us, barring a few remaining obstacles. One notable problem is the current shortage of containers – not because of a lack of units, but because they are in the wrong place. Returning containers empty to China was previously too expensive. As a result, there are too few containers in China, leading to delays and high shipping costs. See also [here](#) for more detail.

Another supply issue affecting industry is the shortage of chips and semiconductors. When industrial output faltered last year, companies put their orders on hold. Now that chip stocks are running low, it turns out that production capacity is limited. Companies looking to place new chip orders must line up at the end of the queue. The resulting production delays and rising costs are temporary.

In the second half of this year, services will also gain renewed momentum in the wake of the accelerating goods trade. A higher vaccination rate, after all, will create scope for easing contact restrictions. Service sectors such as tourism will benefit from this, injecting fresh impetus into world trade.

Brexit will continue to hinder international trade, with more intensive border checks causing congestion and delays. Some companies are considering avoiding the UK altogether to bypass the cumbersome procedures. The effect will be to slow, but not stifle, the recovery of international trade.

The Dutch services sector is riding the wave of reviving trade, whilst receiving an additional shot in the arm from the current terms of trade. These once again improved last year: the international prices of goods and services exported from the Netherlands are rising faster than the prices of goods and services imported into the Netherlands. After a brief decline in 2020, international trade will once again make a modest positive contribution to GDP growth in 2021. (Philip Bokeloh)

#### **China**

By the end of 2020 the Chinese economy was already growing faster than on the eve of the pandemic. The chief cause is that the extremely strict lockdown to curb the first outbreak was followed by a series of highly successful – albeit privacy-invasive – measures such as testing and micro-quarantine. In 2021 and 2022 the Chinese economy is expected to grow by, respectively, 8.5% and 5.5%. That said, some signs of weakening were visible in the Chinese economic data for January. The reason is disappointing exports to countries where demand is still stagnant as well as the change in the policy cycle. Moreover, even China is evidently not immune to minor upsurges of the virus, leading to local lockdowns that impede the recovery in the leisure sector. The vaccination roll-out in China is considerably slower than in the West. The forecast is that 3.5% of the population will have received the jab in March. But this is far less crucial for China's recovery, as the economy was already growing strongly even before the first vaccine was announced.

## US

In the US, as in Europe, policy choices have largely determined the economic impact of the virus and subsequent recovery. President Biden's success in securing a Democratic majority in the Senate cleared the way for an unprecedented support package of USD 1.9 billion. This stimulus is so expansive that it can add 2.5% growth to the US economy in 2021 and 2022. But that is not all. The extremely limited restrictions despite renewed outbreaks of the virus was another key factor. This, together with an ambitious package of climate and infrastructure investments, leads to a growth forecast of 5.8% for 2021 and 4.1% for 2022.

US prosperity will already reach its pre-Covid level in the second quarter of this year. And the gap between actual and potential prosperity will be entirely closed at the start of 2022.

Despite the enormous number of hospitalisations and over 500,000 Covid deaths, lockdowns and even restrictions remain few and far between. Apart from the policy considerations underlying this stance, the virus infections are now also spread more evenly across the country, so that hospital capacity is under less strain than during the first wave. The vaccination process is progressing a lot more smoothly in the US than in the eurozone. This raises the likelihood that sufficient people will be vaccinated before the more infectious British variant becomes dominant.

We are closely monitoring the discussion about possible economic overheating in the US. However, the US Federal Reserve seems to be ready to continue accommodating President Biden's fiscal plans for the time being by keeping the policy rate at around zero per cent for at least 2 to 3 years. Any subsequent tightening will take place later and on a smaller scale than earlier rate hikes. We foresee a moderate uptick in interest rates towards the end of 2023.

### Concerns about rising yield curve US

The recent increase in the yield curve (which indicates the interest rates for different maturities) has sparked widespread debate about inflation expectations and rising interest rates. We think that, alongside increased inflation expectations, investors are also unsure about the exact effect of the Federal Reserve's new policy framework. As long as it is inflation expectations, and not an actual increase in real interest rates, that cause the yield curve to rise, the Fed has no cause for concern.

The markets, however, currently (24.02.) take a different view. Markets appear to be pricing in an aggressive rate hike in the first half of 2023. We deduce that from the 3-year interest rate outlook (a key yardstick for long-term interest rates) and from the real 10-year rate. Both recently climbed 30 basis points.

We believe that this reaction is overdone because a) the inflation outlook is currently at the level of 2018, while the macroeconomic picture looks much worse, b) there will still be substantial surplus capacity in the economy at the end of this year and c) there is temporary inflation due to e.g. rising oil prices.

Taking all this into account, we think that the inflation outlook is too high. If the Fed's new projections on 17 March eliminate this overblown concern, the priced-in interest hikes will be factored out and the yield curve will flatten again. (Jolien van de Ende and Bill Diviney, see [here](#) for more detail)

**\*Update ECB PEPP purchases as of 12.03. see [here](#)**

That completes our baseline scenario. As noted, we have also developed two alternative scenarios for the q-on-q GDP development of the major economies and the Netherlands. These scenarios are less elaborate as we consider the baseline scenario to be by far the likeliest outcome.

## Negative scenario

Our negative scenario assumes headwinds on multiple fronts:

- **Virus & vaccine setbacks:** Diverse circumstances may cause the restrictions to be lifted later (some 2 months) than assumed in our baseline scenario. New mutant strains that are resistant to the current vaccines, for instance, could become dominant. However, virologists are already preparing for such contingencies, so we expect such an event to lead to a delay rather than a fresh disaster. New mutant strains could also be deadlier, causing restrictions to be kept in place for longer despite an effective vaccine being rolled out as planned. Delays in the delivery of vaccines could, of course, also be an inhibiting factor.
- **Bankruptcy meltdown:** unlike our baseline scenario which assumes a slow and managed rise in bankruptcies as the fiscal support is scaled back, this scenario foresees a sharp surge in bankruptcies. Accordingly, unemployment will also climb much higher.
- **Crumbling perseverance:** social unrest arising from the measures could undermine people's faith in institutions, triggering a chain of adverse effects. The main consequence in this scenario is a widespread rejection of the vaccines, which would delay the reopening of the economy. The second-round effects such as unemployment and bankruptcy will also increase as a result of this.

Fortunately, there is also a positive scenario:

- **Virus and vaccine tailwinds:** this scenario sees restrictions being lifted as early as the end of March. The British variant is kept in check, hospital capacity is not overstretched and effective mass testing clears the way for an earlier economic reopening. In this scenario, the vaccination roll-out also receives a boost, though this will no longer make much difference by the time this publication appears.
- **Consumers go on a spending spree:** this scenario requires consumers to raid their Covid windfall savings and swing the economy into top gear. Economic growth soars on the back of this consumer boom.
- **Government also decides to prolong the fiscal support for businesses** so that bankruptcies and unemployment are kept to a minimum.

The consequences of these alternative scenarios are shown in the table below alongside our customary overview of the most important projections.

Indicator	Base scenario	
	2021	2022
NL - GDP	2.1	4.1
NL - Private consumption	-0.3	4.9
NL - Fixed investments	6.3	5.1
NL - Unemployment	4.7	5.5
NL - House market index	5.0	1.0
NL - Commercial real estate index	-4.0	1.5
Oil (Brent)	55	56
Eurozone - GDP	3.3	4.2
US - GDP	5.8	4.1
China - GDP	8.5	5.5
<b>Interest rates</b>		
3m interbank interest rate	-0.55	-0.55
10yr state	-0.40	-0.40

Source: Forecasts ABN AMRO Group Economics

	base scenario (% qoq)								negative scenario (% qoq)							
	2021				2022				2021				2022			
	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
<b>GDP</b>																
Netherlands	-4.3	5.6	3.1	4.2	7.5	6.7	1.6	0.8	-5.8	3.3	-3.0	2.3	6.9	6.7	5.6	0.3
Eurozone	-2.5	10.9	1.9	3.8	5.6	5.9	3.1	2.4	-4.5	7.6	-4.4	-1.6	2.2	3.5	4.2	2.5
US	-0.4	12.3	5.6	6.2	6.2	4.2	3.6	2.6	-2.1	8.5	2.3	1.7	3.6	3.4	2.7	2.9
China	18.0	7.0	5.0	4.0	5.3	5.5	5.5	5.5	16.5	5.5	3.8	2.3	4.8	5.0	5.1	5.2

Source: Refinitiv, forecasts ABN AMRO Group Economics

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