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European Economic Forecast

Summer 2020 (Interim)

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A DEEPER RECESSION WITH WIDER DIVERGENCES

The European economy entered a sudden recession in the first half of this year with the deepest output contraction since World War II. To counter the spread of COVID-19, major containment measures were introduced around the world, voluntarily shutting down large parts of the economy. A string of indicators suggests that the euro area economy has operated at between 25% to 30% below its capacity during the period of the strictest confinement. Overall, the euro area economy is forecast to contract by about 8 ¾% in 2020 before recovering at an annual growth rate of 6% next year. These projections are somewhat lower than in the spring forecast and point to an incomplete recovery as output at the end of 2021 is expected to be about 2% lower than before the crisis and about 4 ½% below the GDP level forecast in winter. Inflation prospects are little changed since the spring forecast with 0.3% expected for this year and 1.1% in 2021.

Data for the first quarter confirmed initial estimates of a sizable economic impact despite confinement measures being introduced only around mid-March in most countries. GDP contracted by 3.6% in the euro area and by 3.2% in the EU. While economic disruptions have been broad based, first quarter data also confirmed the highly asymmetrical nature of the impact across countries and industries. For the second quarter, all screened indicators suggest an acceleration of the contraction in economic activity with persisting differences across countries and industries. The main reason for that is a much longer period of 'lockdown' compared with the first quarter while the easing of containment measures as of early May has been only gradual. The GDP decline is forecast to be particularly pronounced in the second quarter, at -13 ½% q-o-q. Looking forward to the second half of the year and 2021, the European economy is expected to bounce back, but with bigger and more persistent differences across Member States than expected in spring. Signs that economic activity has already passed the trough have been visible in May as the phasing out of restrictions was progressing. In June, indicators suggest that the economy has gained further momentum, providing a favourable starting point for a further pick-up in the third quarter.

Given the unusual uncertainty surrounding economic projections, this forecast continues to be based on a number of critical assumptions. Most importantly, it is assumed that containment measures in the EU will be gradually further lifted and no major second wave of infections will trigger new generalised restrictions. However, continued social distancing measures are factored in with repercussions on sectors requiring interpersonal contact. The fiscal and monetary policy measures credibly announced up to the cut-off date are expected to support the recovery and prevent large-scale bankruptcies and layoffs. Still, insolvencies and employment losses across Member States are likely to occur. At the global level, the still rising rate of infections, particularly in the US and emerging markets, has deteriorated the global outlook and is expected to act as a drag on the European economy.

Risks surrounding the growth projections continue to be severe and interconnected, leaving the balance of risks still tilted to the downside. The major risk is a new wave of infections which would falsify one of the key assumptions of this forecast. More permanent scars from the COVID-19 induced economic shock represents another major risk as, e.g. more widespread employment destructions and corporate insolvencies would lead to a slower recovery. The absence of a deal on the relationship between the EU and the UK as of 2021 remains an important risk. On the upside, the Commission's proposal Next Generation EU, which can not be reflected in the baseline until it is adopted by co-legislators, could give a sizable impulse to the EU economy, particularly in 2021.

Table 1:
Overview - the Summer 2020 interim forecast

	Real GDP growth						Inflation					
	Summer 2020 interim forecast			*Spring 2020 forecast*			Summer 2020 interim forecast			*Spring 2020 forecast*		
	2019	2020	2021	*2019*	*2020*	*2021*	2019	2020	2021	*2019*	*2020*	*2021*
Euro area	1.3	**-8.7**	**6.1**	*1.2*	***-7.7***	***6.3***	1.2	**0.3**	**1.1**	***1.2***	***0.2***	***1.1***
EU	1.5	**-8.3**	**5.8**	*1.5*	***-7.4***	***6.1***	1.4	**0.6**	**1.3**	***1.4***	***0.6***	***1.3***

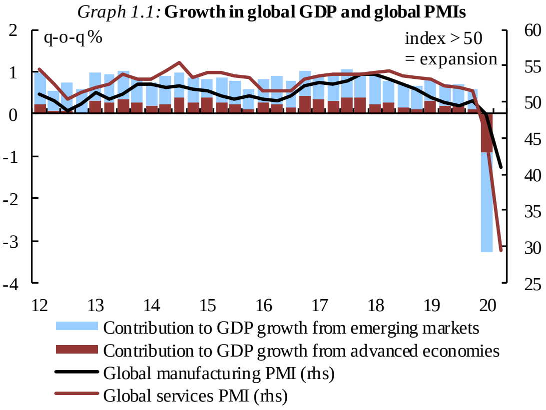
1. EURO AREA AND EU OUTLOOK

1.1. AN UNEVEN RECOVERY FOR THE GLOBAL ECONOMY

The COVID-19 pandemic and the confinement measures taken to limit its spread have caused a sharp slump in the global economy. The progressive spread of the virus earlier this year prompted authorities around the world to implement restrictions on mobility and public health measures in a bid to flatten the curve of infections and prevent healthcare systems from being overloaded. As a result, real global output (excl. EU) is estimated to have contracted by 3.3% q-o-q in the first quarter, the sharpest fall since WWII. China led the global decline, as all non-essential business activity in large parts of the country nearly froze in January and February. Most major economies also contracted in the first quarter, but to a lesser extent, as in the majority of countries confinement measures and social distancing were imposed only toward the end of the quarter. The slump in domestic demand in China together with increasing uncertainty about the economic outlook, extreme financial market volatility and the collapse in commodity prices, all further contributed to the abrupt downturn in the global economy.

The collapse in economic output is likely to be even deeper in the second quarter, reflecting the spread of the pandemic and the corresponding intensification of containment measures. Business activity is likely to have reached a trough in April when the global composite PMI fell to an all-time low of 26.2 (see Graph 1.1). Employment levels have also fallen at record rates. An estimated 160 million jobs were lost in March and April cumulatively across the non-EU G20 countries, with low-wage employment disproportionately affected across emerging markets (mainly in India) and advanced economies (mostly in the US). The downturn in the services sector was particularly fierce, especially in tourism, transport and recreation sectors. Manufacturing output was also severely affected, though less so than the services sector. New export orders plummeted, indicating a fast contraction in global trade. However, a moderate improvement in global activity followed in May as governments began relaxing containment measures to varying degrees and implemented unprecedented fiscal and monetary policy support measures. Activity in China has been recovering particularly swiftly since the relaxation of lockdown measures. Businesses have restarted operations, although capacity utilisation rates remain lower than usual, particularly among SMEs.

Graph 1.1: **Growth in global GDP and global PMIs**



Sources: OECD, IMF and national sources for GDP, JPMorgan/IHS Markit for PMI. 2020 Q2 PMI is the average over April and May.

Nevertheless, the global economic outlook remains subject to extraordinary uncertainty as the pandemic continues to progress, with the number of daily new infections globally still increasing and many containment measures still in force. The number of active cases globally has been growing at an average daily rate of around 1% over the past month. High rates of new infections are increasingly concentrated in a number of emerging market economies and the number of cases in the US has recently re-accelerated. There have also been a number of new localised outbreaks in some

Table 1.1:
International environment

(Annual percentage change)	2016	2017	2018	Summer 2020 interim forecast 2019	2020	2021	*Spring 2020 forecast* *2019*	*2020*	*2021*
					Real GDP				
World (excl. EU)	3.5	3.9	3.7	**3.0**	**-3.9**	**4.9**	*3.0*	*-2.9*	*5.0*
					Trade volumes				
World (excl. EU) exports of goods and services	1.9	5.6	3.4	**0.4**	**-11.8**	**6.2**	*0.4*	*-11.5*	*6.4*
World (excl. EU) imports of goods and services	1.3	6.0	4.1	**0.1**	**-11.5**	**6.1**	*0.1*	*-10.3*	*6.7*

Asian countries. Overall, efforts to contain the pandemic have succeeded to varying degrees in different parts of the world, increasing the uncertainty about the economic fallout.

Bleaker global outlook as the pandemic hits emerging markets…

The outlook for global growth outside the EU has weakened further since the spring. This is mainly due to sharply deteriorating prospects in a number of emerging markets where COVID-19 infections have risen more than expected and where lockdowns have been stricter and longer. Some countries have also seen a resurgence in new cases. Thus, real global GDP (excluding the EU) is forecast to contract by around 4% in 2020 before bouncing back by 5% in 2021. This implies that by the end of the forecast horizon global GDP should recover to a level above that of 2019 but substantially below that expected before the pandemic. These projections are underpinned by the assumption that the number of active COVID-19 cases globally will remain high but that there will not be any major second wave of infections. A number of public health measures are also assumed to remain in place over the forecast horizon but this does not include any renewal of strict confinement measures.

In the major advanced economies (excl. EU) the economic outlook remains broadly unchanged. In the US, bold monetary and fiscal policies taken in response to the COVID-19 crisis corroborated by recent better-than-expected economic data suggest that a tentative consumer-led recovery has begun. Nevertheless, the increasing rate of new infections in the country is expected to weigh on consumer and business confidence. In Japan, the economic recovery is also taking hold as expected after lockdown measures were ended in late May and an additional fiscal stimulus (3% of GDP) is set to support the rebound in the second half of this year. On the other hand, the prospects of the UK economy have slightly deteriorated, mainly due to pressures on corporate balance sheets and continued uncertainty about both COVID-19 and the future EU-UK trading relationship.

Across emerging markets, the recovery in China is progressing broadly as anticipated, but the outlook in many others has turned bleak. In Latin America and India in particular, the lockdowns imposed by the authorities have been stricter and longer than assumed and economic prospects have deteriorated substantially. In some major EU trading partners (e.g. Russia, Turkey) the recovery has been delayed as well, as authorities have extended their lockdowns in response to a significant rise in COVID-19 cases.

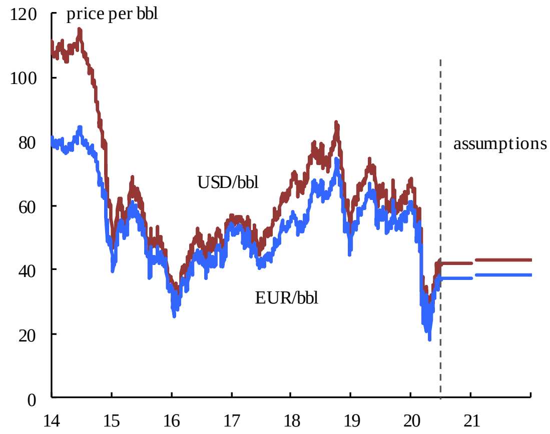
…while the slump in global trade is confirmed…

Global trade has contracted sharply since the beginning of the year, broadly in line with the projections in the spring forecast. The WTO estimates that the volume of merchandise trade in 2020-Q2, when the virus and associated lockdown measures affected a large share of the global population, may have fallen by as much as 18.5%, year-on-year. This is expected to be followed by some rebound in the third quarter. Trade in services has been equally affected and is set to take even longer to recover, especially in the tourism and hospitality sectors. Over the medium term, the pandemic experience may accelerate the recent trend towards re-shoring production. This could shorten supply chains and structurally reduce trade flows, but also efficiency-led long-term investment and the international division of labour. The persistent uncertainty surrounding US trade policies and the functioning of the WTO will also weigh on the rebound in trade. Overall, world imports of goods and services (excluding the EU) are projected to fall sharply by over 11½% in 2020 followed by an incomplete rebound of around 6% in 2021.

… but oil prices have partially recovered.

After some pronounced volatility in oil prices in April, Brent crude prices have partly recovered and stabilised at around USD 40/bbl. On the supply side, the recovery was supported by the sizeable OPEC+ production cut agreement that came into effect on 1 May and which is expected to last until the end of July. Meanwhile, the acute storage capacity exhaustion in April has turned out to be less severe than feared. Over the forecast horizon, upward price pressures are expected to be largely contained as several producers are ready to step up production in case of further price increases. Overall, an average Brent oil price of around USD 42/bbl in 2020 and USD 43/bbl in 2021 is assumed. In euro terms, this would imply an upward revision of around 7% and 4% in 2020 and 2021, respectively, compared to the spring forecast (see Graph 1.2).

Graph 1.2: **Brent oil price assumptions**



1.2. GLOBAL FINANCIAL MARKETS HAVE BEEN ON A POSITIVE TREND SINCE SPRING

After the sharp reassessment of growth prospects and the deterioration of risk sentiment in February and March, global financial markets have been recovering since April on the back of an unprecedented easing of global monetary policy and sizable fiscal support, as well as hopes for a strong economic recovery based on a quick re-opening of economic activities.

The US Fed slashed interest rates aggressively, sharply expanded its balance sheet through asset purchases, and set up several facilities to lend to struggling entities across the economy. As a result, global equity markets have rebounded strongly from their March lows with some indices, particularly in the US, now approaching or surpassing pre-crisis levels, decoupling from a much more gradual recovery in the real economy. At the same time, US bond markets have recovered, as well. In the US, the 10-year Treasury yield has moved sideways over the past few months, while spreads on corporate bonds have compressed as abundant market liquidity has led to a surge in corporate debt from already high levels.

The huge boost to liquidity provision in the advanced economies has spilled over to emerging markets despite the risk posed by still rising infection rates in a number of countries. Lower global interest rates have also provided space for additional rate cuts by emerging market central banks. As a result foreign investors have gradually returned to emerging markets in search of yield, lifting equity prices and compressing long-term yields and corporate spreads. As sentiment improved, the US dollar has weakened, particularly against emerging markets currencies.

Investor sentiment has improved significantly in the EU as well; first in response to monetary easing and bold fiscal policy actions, then following reports that the pandemic had peaked and that Member States were ending their confinement periods, and most recently in the light of some encouraging macroeconomic data.

The ECB has further eased its monetary policy since the spring forecast …

In light of signs that the euro area is facing an unprecedented economic contraction, the ECB has taken additional monetary policy easing measures in recent months to ensure the necessary degree of monetary accommodation and a smooth transmission of monetary policy across sectors and euro area Member States. At its meeting at the end of April, the ECB announced additional liquidity-enhancing measures to support the flow of credit to households and firms. It has further eased the conditions for the targeted longer-term refinancing operations (TLTRO III) and launched a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs). This new measure aims to support liquidity conditions in the euro area financial system and to help preserve the smooth functioning of money markets by providing an effective liquidity backstop. At its meeting at the beginning of June, the ECB decided to substantially increase the envelope for the pandemic emergency purchase programme (PEPP) by €600 bn to a total of €1,350 billion to further ease the monetary policy stance in response to the pandemic-related deterioration in its inflation outlook. At the same time, the ECB extended the horizon for net purchases under the PEPP to at least the end of June 2021 and decided to reinvest the maturing principal payments from securities purchased under the PEPP until at least the end of 2022.

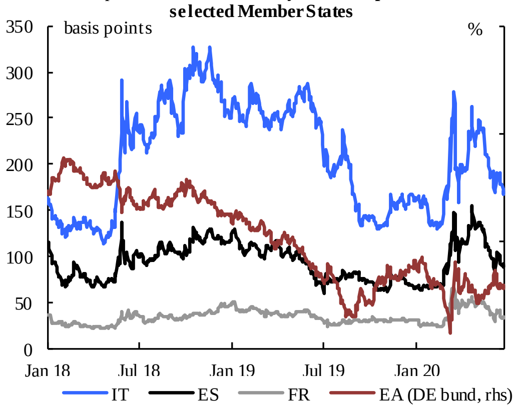
… and the euro has strengthened on the back of improved investor sentiment.

The euro has appreciated by over 2% in nominal effective terms compared to mid-May, reaching its highest level in almost two years at the end of June. This appreciation has been mostly driven by the euro's rise against other major currencies such as the US dollar, the Japanese yen and the Chinese yuan.

Euro area bond and equity markets reflect investors' renewed risk appetite…

Bond yields of the euro area's highest-rated sovereigns have remained broadly in negative territory since late April, trading within a tight range. The benchmark 10-year German bund yield has oscillated between -0.6% and -0.3% over this period. At the same time, sovereign bond spreads of most euro area Member States have narrowed since late April, returning to levels seen in 2019 (see Graph 1.3). This is indicative of investor confidence in this market segment, not least thanks to the ECB's launch of the PEPP in March and the additional measures taken since.

Graph 1.3: **Euro area bond yields and spreads of selected Member States**

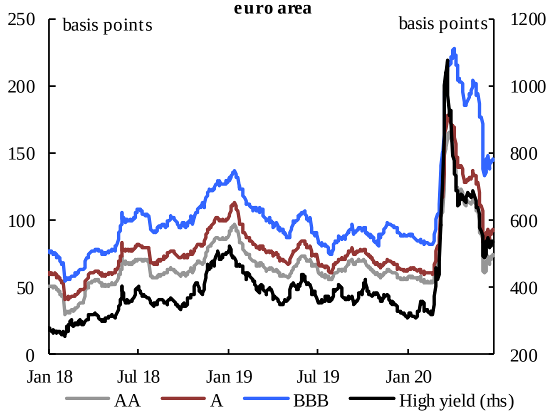


Source: Bloomberg.

A similar narrowing of spreads has taken place on European corporate credit markets since end-April, as the ECB's PEPP and extended APP have also helped this market segment. Spreads have narrowed considerably but remain above their pre-crisis levels. The widespread deterioration of corporate debt quality could imply downgrades of currently BBB-rated bonds to the non-investment grade segment. This concern is reflected in the spreads of BBB-rated corporate bonds, which have narrowed by less than for higher ratings (see Graph 1.4).

Stock markets have also recovered since end-April with broad-based gains across countries and sectors. EU banking stocks have significantly underperformed the broad market over this period, as the sector's low profitability has come under greater pressure from the flattening yield curve and the risk of a new wave of non-performing loans. EU banks, however, entered the crisis with more solid capital buffers than in the 2008 financial crisis, making them more resilient to shocks. Furthermore, they enjoy favourable funding conditions and have taken up significant volumes of central bank funding.

Graph 1.4: **Corporate bond spreads, 5-year maturity, euro area**



Source: Bloomberg.

… while private sector funding has picked up.

Bank lending flows to the private sector remain robust, increasing further to 4.9% annually in May, thanks to a significant pick-up in lending to the corporate sector. The annual growth rate of adjusted loans to non-financial corporations rose to 7.3% in May from 6.6% in April and 3.2% at the start of the year. For households, the annual growth rate of adjusted loans moderated to 3.0% in May from 3.4% in March and 3.7% in January. While the ECB's Bank Lending Survey for the first quarter indicates a slight tightening of credit standards for both enterprises and households, credit provision by banks to corporates has increased since April. To the extent this is driven by emergency liquidity needs and liquidity support measures, the drawing of credit lines and phasing in of government guarantees, the recent increase in bank lending is unlikely to signal corporate investment activity. In parallel, corporate bond issuance has surged for higher-rated borrowers while net equity issuance, though positive, remains very low.

Overall, global financing conditions are expected to remain volatile over the forecast horizon, swayed by economic news and policy measures compounded with fears of further pandemic-driven disruptions. While global equity valuations have recovered and debt markets assume low interest rates for longer, markets remain vulnerable to downward adjustments. In particular, EU equity and corporate bond markets could be undermined by a weaker than expected recovery of corporate earnings and a wave of corporate defaults.

1.3. WARMING UP THE ECONOMY AFTER 'HIBERNATION'

The euro area economy has taken an historic hit…

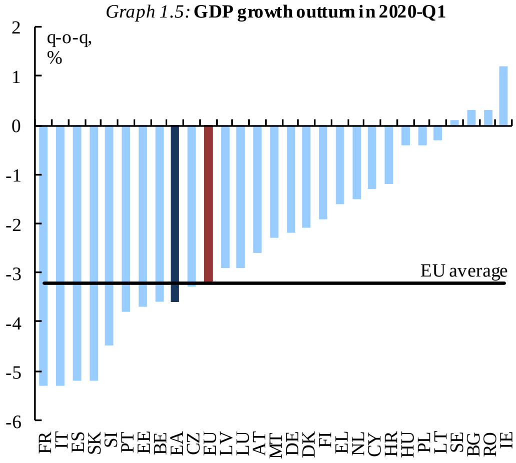
In an effort to flatten the growth curve of infections, stringent lockdown measures were implemented causing a wave of supply and demand shocks hitting the European economy. As the economy was put into what has been described as a state of 'hibernation', the lockdown is reflected in the sharp drop of 45% in mobility between March and mid-May compared to pre-pandemic levels. ([1])

The pandemic has resulted in worker absenteeism and factory shutdowns that have reverberated across supply chains. These have been aggravated by the closure of shops, restaurants and other services as a result of containment measures. At the same time, social distancing and reduced person-to-person contacts have weighed on consumer demand through reduced household spending, while uncertainty and concerns about jobs and incomes have led consumers to delay purchases. Uncertainty about sales and profits has also prompted firms to refrain from going ahead with planned investment or entering new ventures. Furthermore, a synchronised global retrenchment has dampened external demand.

The first glimpse into the negative impact on economic output was provided by data from business and consumer surveys in March. The early hit was then fully revealed in the GDP outturn for the first quarter, which confirmed that the European economy had slipped into contraction after almost seven years of uninterrupted growth. Compared to the last quarter of 2019, GDP contracted by 3.6% in the euro area, and fell by 3.2% in the EU. This is consistent with activity levels in the euro area having dropped by about 25% in the last two weeks of March, when the strictest forms of lockdown were imposed across Member States. ([2])

Economic disruptions have been broad based across countries. GDP expanded or remained almost unchanged in only four Member States and fell in all others (see Graph 1.5). ([3]) There were, however, significant differences in the magnitude of the output loss. Among the largest euro area countries, above-average GDP contractions were reported in France, Italy and Spain (at around -5%) while Germany (-2.2%) and the Netherlands (-1.5%) saw smaller hits. Differences across countries can be largely attributed to the different timing and stringency of lockdowns and containment measures, as well as to different economic structures, particularly exposure to tourism and services reliant on person-to-person contact.

Graph 1.5: **GDP growth outturn in 2020-Q1**



…with no sector spared…

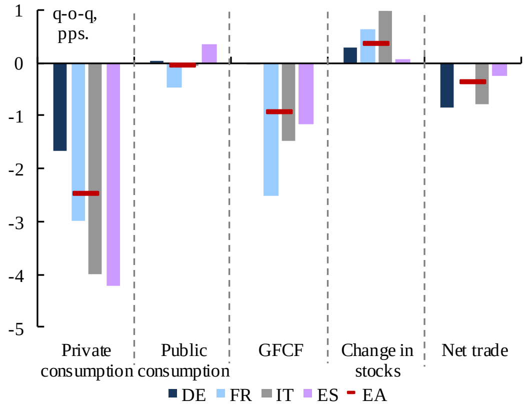
In the euro area, private consumption took the greatest hit in the first quarter, decreasing by 4.7% (q-o-q). While the consumption of both durable and non-durable goods fell, the former saw the sharpest drop. Investment spending also contracted, declining by 4.3%, with construction falling the most compared to other investment categories. The picture is, however, somewhat varied across the largest euro area countries, with construction picking-up strongly in Germany and the Netherlands thanks to a good start of the year, while falling significantly in France, Spain and Italy. Government consumption declined much more mildly (-0.4%). With exports falling more significantly than imports, net trade subtracted about 0.4 pps. from growth, while inventories started to pile up (see Graph 1.6).

([1]) Google mobility index accounting for the average length of stay in retail and recreation activities, groceries, pharmacies, transit stations, residency and at work.

([2]) Estimation assuming that the level of economic activity in 11 of 13 weeks was similar to that of end-2019. For a similar approach see Banco de España (2020). 'The initial economic impact of the health crisis and the lockdown measures on the euro area countries'. *Economic Bulletin 2*, Box 3, June.

([3]) Among these, Germany, France and Italy have by now recorded two consecutive quarters of contraction, thereby entering into a technical recession.

Graph 1.6: **Contributions to GDP growth, EA and selected Member States, 2020-Q1**



The impact has also been highly asymmetrical among industries. The sharpest declines were observed in trade, transport, accommodation and food services as well as arts, entertainment and other service activities (both at -6.8% q-o-q). Agriculture, forestry and fishing, together with financial and insurance activities saw the mildest declines (at -0.8%).

...and strong indications that the second quarter will turn out worse...

While restrictions were being phased out towards the end of the second quarter, the lockdown occupied a much greater portion of the second quarter than in the first, aggravating the economic fallout. Mobility, pollution and electricity indicators reveal a large reduction of activity over the period between April and mid-May. The extent of the damage is already visible in more standard hard and soft data.

Retail spending in April fell by 11.7% in the euro area, a testament to the strict restrictions during the month after a similar decline in March. The euro area average, however, hides significant differences among countries. Sales in April were about 30% below their February readings in France, Italy and Spain, compared to about 10% below in Germany.

Commission surveys hint at a significant piling-up of involuntary or 'forced' savings, rather than precautionary savings. This is suggested by the large divergence between consumers' assessment of their *savings at present* and those for the following year. ([4]) In the same vein, the ECB's monetary statistics also show a substantial flow into deposits placed by households. These are now growing at their fastest rate since April 2009. ([5])

New passenger car registrations fell by 45% in April. Although they rebounded strongly in May, they are still about 50% below their level three months earlier. ([6])

Industrial production collapsed by 17.1% in April, resulting in a cumulative contraction of about 27% since February. Output fell in almost all industrial activities. Looking at its breakdown by sector, only two sectors out of 30 managed to pull through with increased output in April. The most affected industries were the manufacture of motor vehicles, trailers and semi-trailers (about -70%), as well as that of leather and related products (around -60%) followed by clothing (around -40%). Most activities saw output contractions of between 15% and 25%.

Euro area *production in construction* fell by 14.6% in April but was highly uneven across countries. While France and Spain both saw production fall by more than one quarter of total output, the reduction in Germany and the Netherlands was only in the single digits.

Overall, these indicators suggests that the euro area economy was operating at between 25-30% below its capacity at the depth of the crisis. Survey results point to a trough in April and a gradual recovery starting in May and gathering pace in June.

The Markit *Purchasing Managers Composite Output Index* (PMI) reached an all-time low in April before showing signs of bottoming-out in May and rising again in June when the flash estimate approached the no-change threshold of 50 (from 13.6, to 31.9 and 47.5 respectively). While it is still consistent with continued output contraction last month, it adds to evidence that the recession has likely moved beyond its trough.

([4]) The jump in the French household savings rate (up 4½pps. to 19.6% in 2020-Q1, the highest since 1978) suggests that consumers have funds available to support a rebound in spending in coming months.

([5]) From an annual growth rate of 5.7% in January to 7.0% in May.

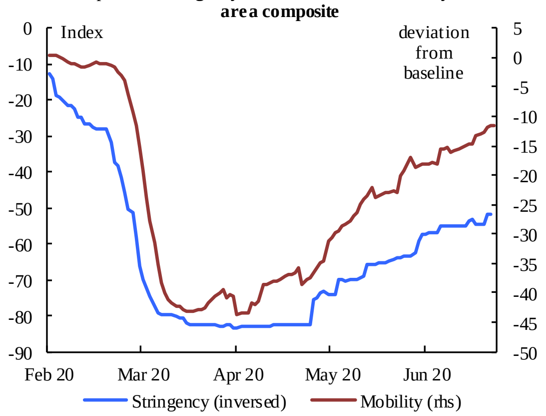
([6]) This highlights the postponable nature of durable goods consumption, which usually experiences wider swings compared to households' income. Still, contrary to the consumption of leisure and other 'social' services, which are permanently lost, a fall in the flow of durable goods compared to the desired stock can be expected to build pent-up demand, which will prove supportive in the recovery phase. See ECB (2010). 'Household consumption of durable goods during the last recession'. ECB *Monthly Bulletin*, July.

Similarly, the Commission's *Economic Sentiment Indicator* (ESI) for the euro area hit an all-time low of 64.8 in April but moved up slightly in May and further up in June to 75.7. It is however still well below the 103.4 level seen in February. As expected, the services sector appears to bear the brunt of the hit. The Commission's *services confidence* indicator declined significantly more than industry confidence in April and continued declining in May, while rebounding in June thanks to a second month of rallying demand expectations. By contrast, *industrial confidence* showed stronger signs of improvement on the back of brighter production expectations, which were almost back to their February level in June and which provide a glimmer of hope for the months to come.

…but a gradual turnaround is taking place.

There have been nascent signs of revival since the stringency of containment measures began to ease in May (see Graph 1.7). While on average, euro area *mobility* ([7]) in the second quarter is estimated at about 30% below its base period level, by the end of June it stood at about -10%, bottoming-out from about -45% towards the end of March.

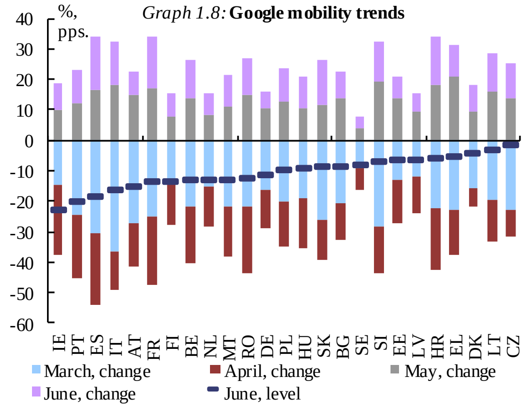
Graph 1.7: **Stringency of restrictions and mobility, euro area composite**



Source: Oxford University, Google.

The enforcement and easing of lockdowns show non-negligible differences across countries (see Graph 1.8). The *stringency index* ([8]) for instance ranged between 60 in Germany, about 70 in Italy, 75 in Spain and around 80 in France on average between April and mid-June. Mobility levels have been moving in lock-step. While recovering, these were still below their usual levels in June and quite different among Member States: -20% in Ireland, Portugal and Spain, -15% in Italy, Austria and France, compared to about -10% in Germany and close to pre-crisis levels in Czechia.

Graph 1.8: **Google mobility trends**



Note: Distance to base period (Jan 3 - Feb 6), average of daily values.
Source: Google.

Other real time indicators, such as German *truck toll activity* ([9]) and *pollution levels* ([10]) in the euro area also hint at a gradual pickup in activity starting in the second half of May. The former fell to a trough of close to -15% during the month of April, compared to the same period in the previous year, started to catch up in May and settled at about -5% in June. Pollution levels also saw their lowest reading in April, falling to about 30% below their minimum over the past four years, but rose significantly in June to only about 10% below. Also *electricity consumption* has increased from April's lows although at a slower pace (see Graph 1.9). ([11])

At the same time, the expectations of an economic turnaround continuing in the second half of the year in the euro area are increasing. According to the *ZEW Financial Market Survey*, financial market experts' expectations for euro area economic growth rose for the second time in a

([7]) GDP weighted index of 17 euro area countries. Percentage deviation from the base period (for each day of the week, the median between 3 January and 6 February).

([8]) As reported by Oxford Government Response Tracker, which collects publicly available information on 17 indicators of government responses.

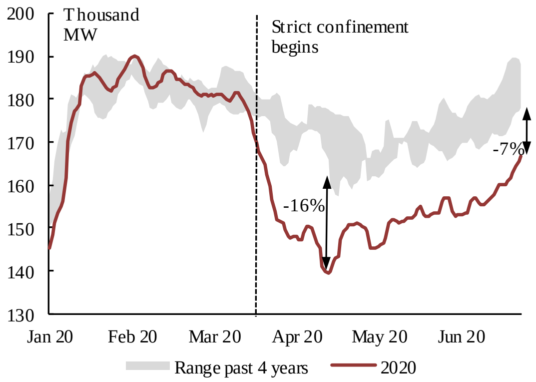
([9]) Truck toll data capture the evolution of transport services and thus give insights into the evolution of the country's industrial activity. See Destatis (2020). 'Truck toll mileage index is updated every day for the time being'. *Press release* 129, 9 April.

([10]) Measured as average weekly nitrogen dioxide (NO2) concentrations, as published by the European Environment Agency. Calculations consider the average reading across all station types and cities of a given country. Composite based on the GDP-weighted values for DE, FR, IT and ES.

([11]) Similarly, the French statistical office estimates that the economy is was operating at about 12% below normal in June, up from 22% in May and 29% in April. See Insee (2020). 'Point de conjoncture'. *Insee conjoncture*, 17 June.

row, climbing to its highest since 2015 in June. In late June, Citigroup's daily *Economic Surprise Index* jumped from an historical low in the first half of May, although it has only recovered about half the ground it has lost since January.

Graph 1.9: **Electricity consumption, euro area**



Note: Temperature adjusted 7-day rolling average.
Source: ENTSO-E, NOAA.

All in all, given that containment measures lasted well into the second quarter and that the easing of containment measures has been gradual rather than sudden, the GDP loss in the second quarter is likely to be a multiple of that recorded in the first. However, the positive signals on the latest indicators provide some hope of a swift recovery in the second half of 2020.

Pent-up demand and government support measures kick-start the recovery…

As highlighted in the spring forecast, economic projections remain subject to more fundamental uncertainty ([12]) than usual. As a result, the present forecast is again based on a larger than usual number of assumptions (e.g. concerning the evolution of the pandemic, the path of containment measures, speed of the rebound).

Importantly, this forecast is based on the assumption that the pandemic has peaked in Europe and that there will not be a major second wave, while at the global level infections continue to spread but not accelerate anymore. It is assumed that the gradual lifting of containment measures will continue to allow the economy to recover at a relatively strong pace. Nonetheless, the dampening impact of mandatory or voluntary social distancing, in particular on services, is taken into account. It is also assumed that fiscal and monetary policy measures announced up to the cut-off date of this forecast are successful in preserving the economic fabric (e.g. products, processes and human capital), thus avoiding large scale bankruptcies and layoffs. Still, insolvencies and destruction of employment is expected across Member States in 2020. ([13]) To cast some light on the effects of changes in these assumptions on the outlook, Box 1.1 presents an update of the model-based scenarios discussed in section I.3 ('*How the pandemic shaped the forecast*') of the spring forecast 2020.

Private consumption in the euro area has fallen sharply in the first half of this year as consumers lacked the opportunity or confidence to spend. At the same time, household income has been partially sheltered by targeted government measures and automatic stabilisers resulting in increased precautionary and forced saving. ([14])

These excess savings, coupled with a rebound in consumer confidence, offer room for consumption to crawl back to some extent over the upcoming quarters. However, in the currently highly uncertain environment, consumer behaviour may take time to normalise, maintaining saving rates at a higher than usual level.

Government consumption is projected to offer the first line of defence against the economic fallout this year and should benefit from exceptional and front-loaded spending. Governments have also enacted or announced a wide range of discretionary policy measures. These come on top of automatic stabilisers and are expected to provide for a countercyclical impulse to growth. ([15])

([12]) Different dimensions of uncertainty reflect the lack of data (e.g. about important parameters of the pandemic such as the true number of infected people), lack of information about the probability of key events (e.g. mutations of the virus, availability of a vaccine) as well as uncertainty about the adequacy of standard economic and econometric tools in the current situation.

([13]) See European Commission (DG ECFIN) (2020). 'European Economic Forecast: Spring 2020'. *Institutional Paper 125*, 8 May.

([14]) On the financial resilience of households, see Zabai, A. (2020). 'How are household finances holding up against the Covid-19 shock?'. *BIS Bulletin* 22. June. Policymakers have enacted a range of measures to alleviate the impact of the shock, including reducing debt burdens (i.e. debt moratoriums and lowering interest rates), unemployment benefits and expanded social protection programmes, salary subsidies (i.e. short-time work schemes) and moratoriums on tax payments.

([15]) Importantly, this forecast takes into account all fiscal packages credibly announced, including the ones announced since the spring forecast. So far, Member States have committed to provide liquidity support for sectors and

After a steep fall in the first half of the year, *investment* is projected to pick up in the second half of 2020, in line with the gradual resumption in activity. However, the recovery in investment is expected to be sluggish given the strong increase in idle capacity ([16]) and the elevated uncertainty around the outlook for domestic and external demand. ([17]) This is compounded by liquidity constraints as well as lower profits which may prove existential for many firms. Left with larger debt burdens, distressed firms may sell assets, reduce investment, or go into insolvency.

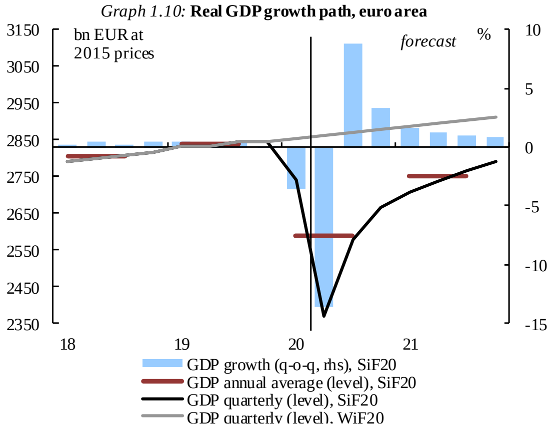
In 2021, investment is expected to grow more quickly than other demand components as expectations brighten, the strain on company profit margins diminishes and capacity utilisation recovers. The recovery should receive significant backing from monetary policy, stepped-up public investment and targeted government support schemes.

Most of the impact of the pandemic on euro area *exports* and *imports* is estimated to have occurred primarily in the first half of this year when demand and supply crashed simultaneously. Starting from the second half of the year, export growth is projected to gain some traction, in line with the expected recovery in major trading partners. But the prospects for a strong catch-up are muted by the severe global aftershocks of the crisis. As the lifting of containment measures follows different patterns in different parts of the world, a swift rebound may be delayed. Also, trade tensions and heightened uncertainty add to the challenges facing a revival in trade. As regards services, the lost output, particularly in travel and tourism, is expected not to be recouped. ([18])

Taking all things together, the euro area will experience a technical recession in the first half of this year with an expected cumulative hit of around 17% of GDP. The GDP loss is forecast to be particularly pronounced in the second quarter (-13 ½% q-o-q), a deeper contraction than expected in spring (-12 ¼% q-o-q). A rebound is forecast for the second half of the year, also boosted by supportive discretionary fiscal and regulatory measures.

For 2020 as a whole, the euro area economy is forecast to contract by about 8 ¾%, a deeper contraction than envisaged in the spring. As the shock wears off, a lower starting level in 2020 and a high carry over into 2021 should boost the annual growth rate to about 6%. This results in an incomplete recovery, as it implies that GDP at the end of 2021 will be about 2% smaller than it was before the crisis in 2019 and about 4 ½% below the level forecast in winter (see Graph 1.10).

Graph 1.10: **Real GDP growth path, euro area**



Projections for 2021 are based on a purely technical assumption of status quo in terms of trading relations between the EU and the UK. This is for forecasting purposes only and reflects no anticipation or prediction of the outcome of the negotiations between the EU and the UK on their future relationship.

…which will be gradual and uneven across countries.

While many countries have been pushed into recession by a common shock, the impact on output is heterogeneous. Similarly, countries are likely to emerge from it in an asymmetric way, with a wide dispersion of recovery paths (see Graph 1.11). This reflects the different timing at which containment and social distancing measures were introduced and lifted; the structure of the

companies facing disruptions, consisting of public guarantee schemes and deferred tax payments. These are currently estimated to amount to around 23 ½% of EU GDP. Also, measures with a direct budgetary impact are estimated at about 4½% of GDP. The “Next Generation EU” package proposed by the Commission by contrast is not yet reflected in this forecast as it has not yet been adopted by co-legislators.

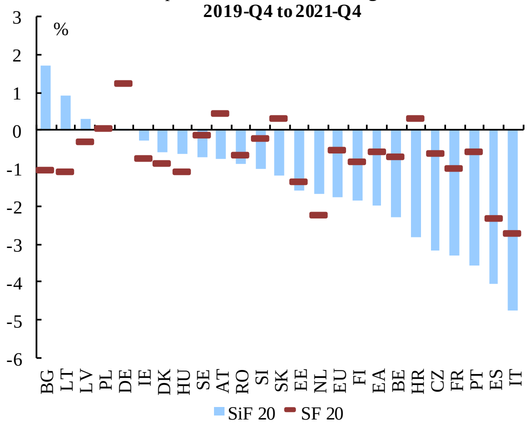
([16]) According to Commission’s surveys conducted in April, capacity utilisation in the manufacturing sector is estimated to have dived to 69.7% in the second quarter to close to its historical low of 69.4% in 2009-Q3.

([17]) An increased push to repatriate supply chains (‘reshoring’) and undo their fragmentation could increase domestic investment in the near-term but dampen productivity prospects and long-term growth, a key metric for the return on investment.

([18]) See Schuler, T. (2020). ‘Impact of the COVID-19 lockdown on trade in travel services’. ECB *Economic Bulletin* 4, June, pp. 46-50.

economy, particularly the importance of tourism and leisure activities; as well as the magnitude and effectiveness of the policy response. Likewise, the shortfall of investment induced by the crisis is set to differ substantially across countries.

Graph 1.11: **Cumulative GDP growth, 2019-Q4 to 2021-Q4**



Over the forecast horizon the recovery is expected to be incomplete in a large majority of euro area countries, as the level of GDP at the end of the last quarter of 2021 is forecast to be inferior to what it was in the last quarter of 2019. Among the largest euro area economies, this difference is forecast at about -4 ¾% in Italy, -4% in Spain and -3 ¼% in France. In Germany, output is forecast to return to its pre-crisis level. However, these considerations only capture one part of the output loss, because in a situation without the pandemic, all Member States had been expected to see positive GDP growth rates throughout the entire period.

1.4. PANDEMIC CAUSES NEW EMPLOYMENT CHALLENGES

In the first half of 2020, the euro area *labour market* underwent a massive deterioration induced by the COVID-19 pandemic and the measures taken to contain it. This has translated essentially into a sharp decline in the number of hours worked. However, the restrictions in the euro area economy since March have yet to fully feed through to employment statistics thanks to the measures taken to contain the COVID-19 impact on labour markets but also due to reporting lags. Although economic activity shrank significantly in the first quarter, employment in the euro area fell by only 0.2% (0.1% in the EU). This is in stark contrast to the normally close link between developments in employment and GDP growth.

The recent increases in *unemployment* have also been small compared to the decline in economic activity. In April 2020, the second month after COVID-19 containment measures were implemented by most Member States, the unemployment rate increased only slightly in the euro area (to 7.3% from the multi-year low of 7.1% in March) and in the EU (from 6.4% to 6.6%). The institutional set-up and some statistical and legal issues explain why the containment measures have not led to larger increases in the unemployment rate and why substantial differences have emerged across countries:

First, extended *short-time work schemes* have played an important role in keeping employees attached to their jobs even in periods without any or with substantially reduced economic activity. This contrasts significantly with several non-EU countries such as the US where temporary lay-offs push employees to register as unemployed. In the EU, the number of persons notified for short-time work have reached unprecedented levels (e.g. in Germany). However, these numbers only indicate how many companies consider the schemes as a precaution and not the actual number of persons receiving short-time allowance, which will remain unknown for some time. In addition, working time accounts and a reduction of overtime hours helped to smoothen the impact of the shock. However, these schemes are not identical in all Member States, which contributes to marked differences. In the future, the EU's new instrument for temporary Support to mitigate Unemployment Risk in an Emergency (SURE) should limit such differences by assisting Member States to cover the costs directly related to the creation or extension of national short-time work schemes.

Second, to be counted as unemployed, a person has to be available to the labour market, which was not possible everywhere during strict lockdowns. Many persons only loosely attached to the labour market were also discouraged from actively seeking a job and therefore did not count as unemployed. This *statistical issue* helps in part to explain why the pandemic initially had a dampening effect on unemployment rates in some cases, such as in France and Italy. In Italy, for example, the unemployment rate fell in April to 6.3% from 8.0% in March, before moving higher in May.

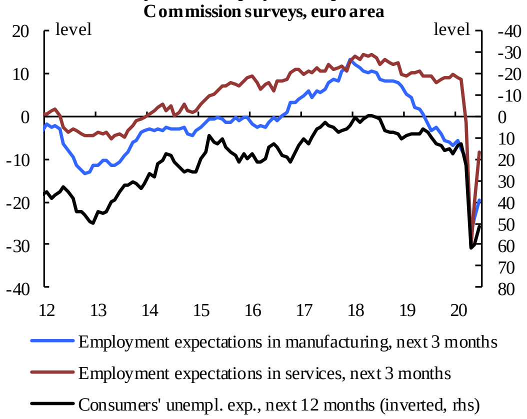
Third, in some countries, legal issues impact on the development of labour market statistics, including unemployment rates. In several Member States, changes in the legal framework of the economy have made lay-offs more difficult or almost impossible. This includes measures that exclude insolvencies for some time or that explicitly forbid companies to lay off staff because of the crisis or during a state of emergency ('dismissal bans'), as for example in Italy and Spain.

The burden of the labour market deterioration is carried unevenly across labour market categories. Persons employed in relatively unstable low-paid part time jobs felt the development first. The youth unemployment rate has increased more than the overall rate. Self-employed persons have also suffered massively from the shutdowns, whereas those able to work remotely and/or employed in the public sector or critical sectors were less affected.

Forward looking indicators of the labour market signal the impact of the deteriorated economic situation and outlook. In April, the Commission's Employment Expectations Indicator (EEI) had fallen to all-time troughs in both the euro area and the EU, but started to rebound in May. This pattern, including new all-time lows, was shared by employment expectations in services and retail trade (see Graph 1.12), whereas expectations in manufacturing and construction followed the same directions but did not fall as much as during the Global Financial Crisis. Similarly, consumers' unemployment fears fell slightly in May and June after a sharp deterioration in April, but remained below historical peaks. Over the coming months, the labour market outlook has the potential to brighten given that many persons in services and retail are expected to return to their jobs as restrictions are progressively eased.

However, a number of factors are expected to slow the labour market's return to its pre-pandemic situation. Many short-time work subsidy schemes are limited in time and despite recent extensions, the schemes will not indefinitely preserve the employment relationship and support incomes. In the case of a prolonged period of weak economic activity and with an increasing number of firms expected to downsize their activities or go out of business, schemes cannot fully prevent an eventual increase in unemployment. In the second half of the year, a number of companies are likely to see liquidity problems turn into solvency problems that make liquidation or bankruptcy unavoidable. Continued social distancing measures that limit a wide range of services could play a role in this. Without a significant recovery in demand, which depends on the easing of containment measures and therefore on the evolution of the pandemic, it will be difficult to sustain an improvement in labour market indicators over the medium term. Layoffs in the wake of bankruptcies are likely to leave many jobseekers struggling to retain their skills and attachment to the labour market, which does not bode well for the labour market outlook.

Graph 1.12: **Employment expectations, Commission surveys, euro area**



The expected rise in unemployment rates across the EU may prove particularly hard to overcome in those Member States where unemployment was already relatively high before the start of the pandemic, where the economic rebound is expected to be sluggish, or labour markets and social safety nets lack efficiency and effectiveness.

1.5. A QUICK DROP IN INFLATION

Headline inflation fell strongly ...

Headline inflation in the euro area, as measured by the Harmonised Index of Consumer Prices (HICP), averaged 1.1% in the first quarter of 2020, but fell quickly to 0.2% in the second quarter as the impact of COVID-19 led to sharp declines in the price of energy and a number of non-essential goods and services. Inflation stood just above zero in May, driven down by a 12% drop in the energy inflation component, and increased marginally to 0.3% in June as the strongly negative impact of the year-on-year fall in oil prices started tapering out. Nonetheless, food price inflation in the second quarter increased notably, particularly for unprocessed food which increased to 7.6% in April and 6.5% in May compared to last year. This category of goods has been affected by supply chain disruptions, shortages of seasonal workers in the agriculture sector and also by demand substitution. In June, food prices started to moderate again although they are likely to remain elevated for the rest of the year.

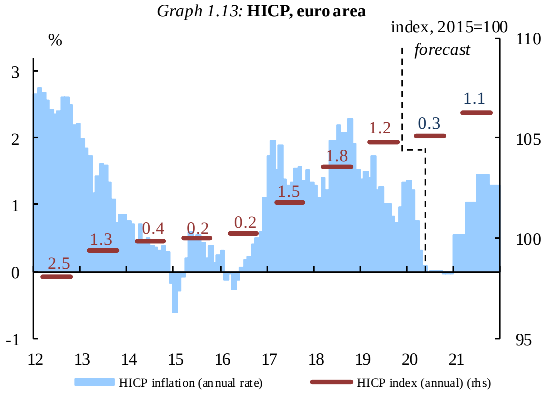
Euro area core inflation (all items excluding energy and unprocessed food) fell slightly to 1.1% in the second quarter after averaging 1.3% in the previous two quarters. Since the prices of many non-essential services have suffered from a lack of data collection since March, it will take several months to see the direct impact of COVID-19 on services inflation. The prices of services related to package holidays and accommodation and those of housing are likely to face further declines.

… and expected to remain depressed in 2020.

The inflation outlook has not changed substantially since spring but there are four important new factors that, overall, are expected to balance each other out. First, oil prices have recovered since May and currently stand above the oil price assumptions of the spring forecast. The decline in energy inflation is henceforth expected to be less negative in 2020. Second, food price inflation came in stronger than expected in the second quarter and will thus have a higher carryover effect for the rest of the year. These two effects will exert an upward push in inflation in 2020.

On the other hand, a number of Member States have announced temporary measures, such as selective reductions in VAT rates or facilitated rent reductions, which should lower the prices of certain categories of goods and services in 2020 with reversed and positive base effects in the second half of 2021. Finally, a weaker economic outlook will continue to exert a downward drag on general price pressures throughout the forecast horizon. Overall, euro area headline inflation is forecast to average 0.3% in 2020 and to increase to 1.1% in 2021 (see Graph 1.13).

Graph 1.13: **HICP, euro area**

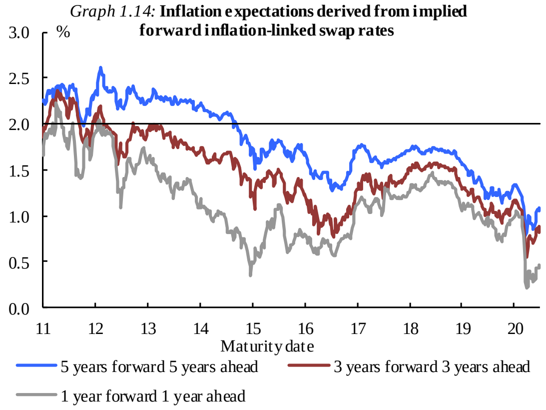


Note: Figures next to horizontal bars are annual inflation rates.

Inflation expectations remain low.

Market-based measures of inflation expectations along the maturity spectrum have recovered somewhat from the low levels recorded in mid-May. This followed a more convincing uptick in energy prices which are closely correlated with inflation expectations. At the cut-off date for this forecast on 30 June, inflation-linked swap rates at the one-year forward one-year-ahead horizon stood at 0.5% (see Graph 1.14). Swap rates at the three-year forward three-years-ahead horizon imply an average inflation of 0.9%. On a longer horizon, the widely watched five-year forward five-years-ahead indicator suggests inflation at just 1.1%, below the ECB's definition of medium-term price stability.

Graph 1.14: **Inflation expectations derived from implied forward inflation-linked swap rates**



Source: Bloomberg.

The latest ECB Survey of Professional Forecasters for the second quarter of 2020 shows HICP inflation expectations standing at 0.4%, 1.2% and 1.4% in 2020, 2021 and 2022, respectively. The figures were revised lower from the previous survey round (from 1.2%, 1.4% and 1.5%, respectively). Longer-term inflation expectations (for 2024) remained at 1.7%.

1.6. PROMINENT RISKS ON THE DOWNSIDE

The *uncertainty surrounding this summer interim forecast* is very high, as the scale and duration of the pandemic remain essentially unknown. There is also uncertainty regarding the duration and scope of the social distancing measures that may be needed after the relaxation of stricter containment measures in recent weeks.

Risks surrounding the growth projections are severe and most of them are on the downside. Major risks concern the total economic impact of COVID-19 on the EU economy, which will depend upon the scale and duration of the pandemic. The summer interim forecast is based on the assumption that the pandemic has exerted its biggest impact in the second quarter of 2020. We assume that containment measures will be gradually eased over the coming months and that there will be no new deterioration that requires strict containment measures to be reintroduced. Such a risk exists though, as the already implemented or announced *relaxations of containment measures could prove premature* and spark another outbreak ('second wave') before any treatment or vaccine is available.

The pandemic has inflicted high costs on firms, lowered their cash flows (revenues) and worsened their profit outlook. In the absence of a rapid recovery in demand, corporations may proceed with more widespread lay-offs when the temporary short-time work schemes come to an end. There is a significant risk that the negative impact for labour markets becomes more pronounced than envisaged in the baseline scenario. For most indebted corporates, there is a risk that initial liquidity strains could turn into solvency problems that lead to *default or bankruptcy*. A rise in corporate defaults could prevent companies from restructuring and end up in liquidations with further knock-on effects on employment. This could amplify and lengthen the pandemic shock while raising non-performing loans which would also negatively affect banks, particularly those with high exposures to pandemic-sensitive sectors or the hardest hit countries.

In such a context, financial market turmoil cannot be excluded, particularly given the recent decoupling of developments in financial markets and in the real economy. This would have further negative implications on companies' access to credit and their funding costs. Frictions in credit markets could lower economic efficiency due to higher costs of capital and/or by capital being misallocated away from its most productive uses. For some sovereigns, the budgetary burden of implemented and planned measures could become more difficult to cope with than currently expected.

The recovery in Europe could still suffer from *insufficiently coordinated national policy responses* and a too limited common response at the EU level. In an environment where demand from the external environment seems out of reach as a substitute for strong domestic demand, this could hamper the rebound, leave deeper scars in the labour market and prolong the period of weak economic activity.

The global economic outlook is subject to exceptionally high uncertainty and risks given the spread of new infections in many countries. It is still impossible to predict the future path of the pandemic and the structural changes it may have on social behaviour, international trade and global value chains. In advanced economies outside the EU, similar risks as in the EU apply, notably insufficient policy response to prevent more permanent layoffs and corporate bankruptcies and a sharp reassessment of financial risks, market volatility and negative feedback effects, further weakening the recovery. This could also result in negative spillovers to emerging and low-income countries via both the financial and trade channels. Renewed capital outflows and currency depreciations in many of these countries risk undermining the stability of their domestic corporate and banking sectors, in the most vulnerable cases putting stress also on sovereign borrowing.

The downside risk of a *stronger-than-expected impact of the pandemic on the EU's external environment* identified in the spring forecast has somewhat materialised, but a further deterioration cannot be excluded. This could also leave deeper scars than currently assumed in the EU's external trade of goods and services. Finally, after the UK's exit from the EU at the end of January, the UK entered a transition period, which lasts until the end of 2020. It is possible that the transition period ends without any agreement on the future trading relationship. Even if a trade agreement between the EU and the UK is concluded, the future EU-UK trading relationship will be less beneficial than assumed in the purely technical assumption of an unchanged trading relationship, and will therefore lead to more negative outcomes for both sides, in particular for the UK for which trade with the EU is more important than trade with the UK for the EU. On a broader scale, the return of *protectionist policies* in the global economy could negatively affect trade and economic growth. The same could be said about a too strong re-nationalisation of cross-border production links ("de-globalisation").

On the upside, a faster than expected availability of a vaccine against COVID-19 would allow social distancing measures to be removed earlier than currently assumed and improve economic conditions. On the policy side, the Commission's proposal Next Generation EU, if agreed upon, would give a positive impulse to the EU economy, particularly in 2021.

As regards *risks surrounding the inflation outlook*, in the near term, the downside risks to the growth outlook remain the most relevant downside risks. A deeper recession and a slower rebound would negatively influence inflation expectations and limit price pressures. On the upside, a faster-than-expected rebound or a more favourable-than-assumed development in the external environment could push commodity prices up and lift external price pressures but also strengthen the price-setting power of euro area firms.

Box 1.1: **The impact and recovery from COVID-19: a model-based scenario analysis**

The road out of the crisis remains highly uncertain…

In addition to its impact on human health, COVID-19 has spurred a worldwide contraction of economic activity of speed and size unprecedented in peacetime. Entire sectors of the economy, such as air transport or entertainment, all but stopped operating. Consumers, both out of fear and lack of opportunity, cut spending; companies reduced production levels due to administrative restrictions, supply-chain disruption and reduced demand.

Real-time or 'fast' data has broken some ground in offering insights into the magnitude of the shock. While more standard indicators have since become available, high uncertainty still surrounds the future course of the pandemic and its impact on the economy. Model-based analysis can offer some orientation in such uncharted territory.

This Box sheds some light on the likely impact of three different trajectories of the pandemic on the EU economy. It builds on and updates the model simulations presented in the European Commission's Spring 2020 Forecast. ([1]) Compared to the previous analysis, the new baseline scenario extends the length of the 'lockdown' (strict containment and social distancing measures) from six to eight weeks, consistent with available information. ([2]) As a result, the disruptions observed over the first half of the year are proportionally larger than assumed before. Moreover, targeted containment measures and demand shortfalls are assumed to extend further into 2021. The simulation also includes an additional deterioration outside the EU due to the differentiated geographical spread of the pandemic and its impact on international trade. Finally, the scenario pencils in additional discretionary policy measures that have been announced by national authorities since the cut-off date of the spring forecast. By design, the projection of the 'baseline' scenario is in line with the GDP growth in this summer interim forecast.

…highlighting the value of alternative scenarios…

Building on this baseline, the 'slower recovery' scenario assesses potentially more persistent effects of the current crisis. It assumes that precautionary savings behaviour of households will have an even longer-lasting effect on the recovery from the second half of the year onwards. The 'second wave' scenario considers a potential resurgence of the pandemic in the last quarter of 2020 requiring additional confinement measures later in the year and in early 2021, with an average length similar to the one experienced in the first half of 2020. The renewed lockdown in this scenario, however, is assumed to cause smaller economic disruptions compared to the initial wave, provided that acquired experience and testing infrastructure allow for smaller and more targeted restrictions. ([3])

…which build on several shocks to simulate the impact of the pandemic…

The scenario analysis uses DG ECFIN's structural macro model QUEST. ([4]) This multi-region model has been adjusted to account for the novel type of economic disruptions caused by the pandemic and the associated containment strategies. ([5]) The scenarios distinguish a series of transmission channels. *Demand* and *supply* shocks distort households' consumption-savings decisions and dampen production, depressing consumer spending and the supply of goods and services. The assumed profile and size of the shocks follow a sector-by-sector assessment, which aims to capture the asymmetric effects across economic activities. These are further amplified in the 'second-wave' scenario, due to renewed tightening of restrictions and precautionary behaviour. Additional *risk premia shocks* reflect heightened uncertainty in the

([1]) See Special Issue 'How the pandemic shaped the forecast' on European Commission (DG ECFIN) (2020). 'European Economic Forecast: Spring 2020'. *Institutional Paper* 125, pp. 65-72.

([2]) Based on the number of weeks the GDP-weighted Oxford COVID-19 Government Response Tracker remained above 70 – a threshold which indicates widespread lockdowns.

([3]) The scenario assumes that demand and supply disruptions are around 50% lower than in March and April 2020. Reinstatement or introduction of measures could be considered at a local or regional level, or for specific population groups. See ECDC (2020). 'Coronavirus disease 2019 (COVID-19) in the EU/EEA and the UK'. 11 June.

([4]) See Burgert et al. (2020), 'A Global Economy Version of QUEST: Simulation Properties', *European Economy Discussion Paper* 126.

([5]) See Pfeiffer, P., Roeger, W. and in 't Veld, J., (2020), 'The COVID19 pandemic in the EU: Macroeconomic transmission and economic policy response', *Covid Economics*: *Vetted and Real-Time Papers*, Issue 30, 2020, 120-145.

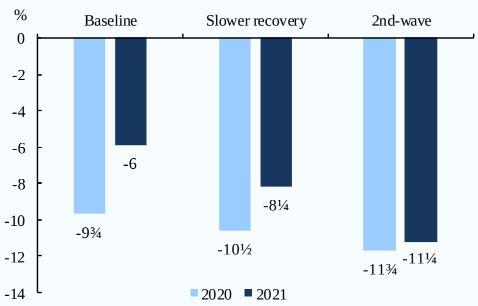
(Continued on the next page)

Box (continued)

current context. The model illustrates the dynamic adjustment of the economy to these transitory shocks. (6) In particular, firm *liquidity constraints* amplify the impact of cash flow shortages on investment, production, and employment. By contrast, *policy measures* through direct fiscal stimulus and liquidity support prevent a sharper output loss. (7)

The 'baseline' scenario illustrates the massive detrimental economic impact on the EU economy from the crisis. The combined effect of the above channels amounts to an output loss of 9¾% relative to the growth path expected prior to the pandemic (see Graph 1). (8) This corresponds to a GDP contraction of around 8¼% in 2020.

Graph 1: **GDP deviations from pre-pandemic path**



Note: Deviation from the GDP growth path expected in the winter 2020 interim forecast.

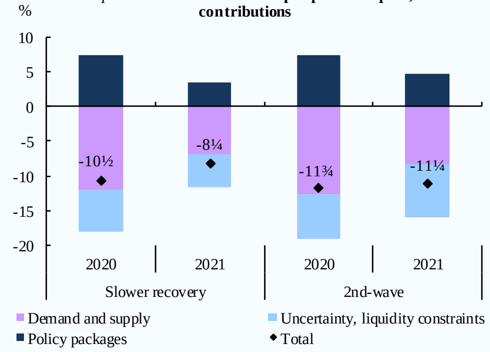
...in a situation where risks remain tilted to the downside.

Were consumption patterns to revert only very gradually to normality, output losses could grow substantially bigger. In the 'slower recovery' scenario, GDP falls around ¾ pps. and 2¼ pps. further below the baseline projection in 2020 and 2021, respectively. The slower recovery also implies increased adverse effects coming from firm liquidity constraints, which can only partially be stabilised by guarantees and liquidity support to firms.

A 'second-wave', even if under less stringent containment, could renew liquidity shortages via further contractions in private consumption, restrictions on production and new spikes in uncertainty. The more fragile financial position of firms following the initial pandemic shock diminishes their resilience when faced with a renewed outbreak, risking a further tightening of liquidity constraints. Further to this, scarring effects would likely take hold, impairing capital accumulation and hence the economy's productive potential. The simulated output loss amounts to 11¾% and 11¼% in 2020 and 2021, respectively.

In all scenarios, most of the contraction is associated with demand and supply disruptions (see Graph 2). In addition, firm liquidity constraints and uncertainty substantially prolong the slump, leading to a more 'U-shaped' recovery. As a result, output in 2021 remains still markedly below its expected pre-pandemic path. The simulations also show that timely discretionary fiscal policy and liquidity support help cushion more than one-third of the economic fallout.

Graph 2: **GDP deviations from pre-pandemic path, contributions**



Note: Deviation from the GDP growth path expected in the winter 2020 interim forecast.

Finally, besides the significant downside risks considered here, further policy action remains an upside factor. A coordinated policy response at the EU level as recently proposed by the Commission's 'Next Generation EU: A recovery plan for Europe' could substantially support the recovery. (9)

(6) All shocks are applied to all regions in the model.
(7) The discretionary fiscal stimulus includes national and EU-level (non-health related) government expenditure (4.9% of EU GDP) and tax cuts (0.8% of EU GDP). Liquidity support (50% of GDP, excluding ECB measures in 2020 and 2021) is assumed to offset about half of the amplification coming from firms liquidity constraints. All scenarios feature automatic stabilisers.
(8) Before the pandemic, EU GDP was forecast to grow by 1.4% in 2020 and 2021, which is taken as the 'pre-pandemic path'. See 'European Economic Forecast: Winter 2020'. *Institutional Paper* 121.
(9) See European Commission (2020), 'Identifying Europe's recovery needs', *Staff Working Document* (2020) 98.

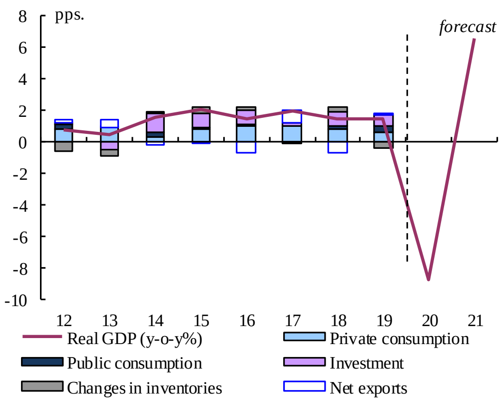
2. PROSPECTS BY MEMBER STATES

EURO AREA

2.1. BELGIUM

Economic growth in Belgium is set to be hit hard by the COVID-19 outbreak in 2020 but should rebound strongly in 2021. Despite support from fiscal measures, consumption and investment fell as a result of the lockdown restrictions. Supply chain disruptions and a historic drop in confidence are projected to impact strongly on domestic demand in 2020. Weak international trade is expected to detract from growth in both 2020 and 2021.

Graph 2.1: **Belgium - Real GDP growth and contributions**



Real GDP growth is forecast to fall to -8¾% in 2020 and to rebound to 6½% in 2021. Domestic demand dropped by 4.4% in the first quarter of 2020 and is set to plunge even lower in the second quarter of 2020. Economic activity is forecast to start rebounding in the third quarter, as survey indicators point to an acceleration of the recovery in business turnover in June following the lifting of most restrictive measures. The recovery is set to be driven notably by a resumption of household consumption growth, as signalled by the improvement of consumer confidence indicators in May and June. A more significant fall in investment due to supply chain disruptions and falling aggregate demand is expected. Public investment is forecast to decrease in 2020 and rebound progressively from 2020-Q3. Household investment growth is projected to recover gradually due to strong fundamentals. In contrast, business investment growth is expected to rebound more slowly as business supply chains are expected to take longer to readjust and uncertainty regarding the evolution of demand lingers.

The contribution of net exports to real GDP growth is expected to remain negative in both years amid a fall in the growth of world trade in 2020. Reflecting Belgium's position as a trade hub, imports are largely expected to evolve in line with exports, resulting in a contraction in 2020 and a rebound in 2021.

Unemployment is projected to rise, notably due to a higher likelihood of bankruptcies in the most affected sectors such as arts, leisure, hotels and restaurants. This is set to weigh on the recovery of household consumption from the second half of 2020.

The fall in economic activity is expected to weigh on annual HICP inflation, which is forecast to decrease from 1.2% in 2019 to 0.3% in 2020, mainly due to lower fossil fuel and wholesale electricity prices. Inflation is forecast to edge up to 1.4% in 2021, with a positive contribution from energy prices.

2.2. GERMANY

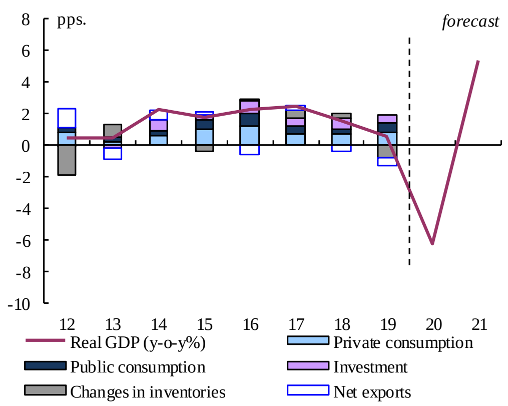
Germany's real GDP contracted by 2.2% in the first quarter of 2020. This was the second consecutive decline after -0.1% in the last quarter of 2019, indicating a technical recession. In January and February, the ailing manufacturing sector seemed to be bottoming out, hinting at a possible revival of growth. Over the course of March, the COVID-19 pandemic reached Germany and the imposition of confinement measures paralysed numerous activities, particularly in the services sector. In addition, manufacturing increasingly felt the disruption of value chains and a demand slump in key markets.

Mandatory and voluntary shutdowns in the second half of March led to a sharp decline in private consumption and exports in the first quarter (-3 % for both). Investment fell slightly overall, masking the differing fortunes of construction activity, which remained robust, and equipment spending which fell significantly.

Although a relatively benign epidemiological situation allowed Germany to be among the first

EU countries to start relaxing confinement measures, with significant easing beginning in mid-May, economic activity in the second quarter is still expected to show an unprecedented decline. In April, industrial production was down by 22% compared to March and by 30% compared to February. Similarly, monthly exports were 24% less than in March and 32% less than in February. Retail turnover shrank 7% in April (after declining by only 3% in March), with food, medicines and toiletries staying resilient, while store sales of non-food items were sinking further after the collapse in March. The unemployment rate is still close to historical lows (3.5% in March and in April) but this conceals an unprecedented surge in short-time work, which according to the IFO institute involved an estimated 6.7 million employees or 15% of the workforce in June.

Graph 2.2: **Germany - Real GDP growth and contributions**



Since spring, the German government took further sizeable measures to stabilise the economy in the wake of the outbreak of the pandemic. The initial response in March included vast liquidity support for companies in the form of public guarantees for loans, tax deferrals, grants for small businesses and extended and simplified access to short-time work schemes. In total, the deficit-relevant measures amounted to 4.7% of GDP in 2020, while guarantees amounted to some 40% of GDP. On top, in early June the government announced a fiscal stimulus package of about EUR 130 bn (3.8% of GDP) for the years 2020 and 2021 to support the economic recovery. It includes measures to boost consumption (notably lower VAT rates in the second half of this year) and investment, alleviate the balance sheet impact of company losses and maintain the investment capacity of local governments. The package also provides incentives for future-oriented investments aimed at helping the green and digital transition.

Despite weaker-than-expected growth in the first quarter and a deterioration in the external outlook, real GDP is forecast to decline in 2020 largely in line with the spring forecast by 6¼%. The massive fiscal stimulus is expected to boost demand, provide needed liquidity support and avert a surge in unemployment. It is therefore expected to pave the way for a relatively swift recovery, starting in the second half of this year. GDP is expected to grow by 5¼% in 2021.

Risks are tilted to the downside and relate to a possibly more protracted international fallout and depressed export demand. Given the strong export orientation of Germany, this would take a larger toll on industrial activity and may slow down the recovery. Domestically, consumer demand could take longer to recover if sanitary concerns linger, income uncertainty persists and the effects of the consumption stimuli prove weaker.

The currently weak inflationary pressures will be further attenuated by the low energy prices. The VAT cut from July till December 2020, is expected to be at least partly passed on to consumers and slow inflation even further later this year. Next year would see a strong base effect, as the VAT rates are restored in January, but inflation is set to remain moderate overall. Accordingly, HICP inflation is expected to ease to 0.4% this year and return to about 1.5% in 2021.

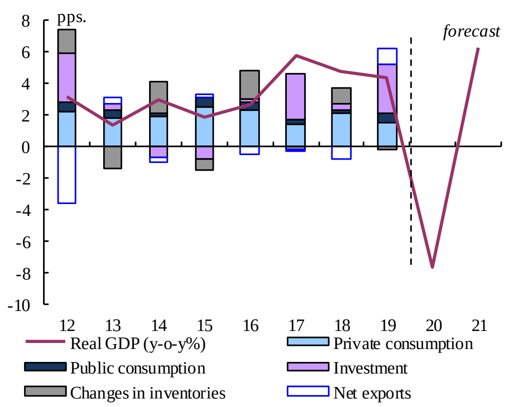
2.3. ESTONIA

GDP fell more than expected in the first quarter of the year, by 3.7% q-o-q and 0.8% y-o-y. The contraction was largely due to factors unrelated to the COVID-19 lockdown measures such as lower production in the energy sector and negative effects on GDP from stocking of motor fuels in the last quarter of 2019. The growth of household consumption flattened to little over zero and corporate equipment investment dropped in the first quarter. At the same time, construction activity was affected less quickly and still expanded. Imports declined by more than exports, increasing the current account surplus.

Estonia's labour market has reacted relatively rapidly to the crisis. In end-June the registered unemployment rate hit almost 8%, compared to 4.7% a year ago. Many companies have responded by either shedding jobs or cutting wages or both but the fall in employment is currently still cushioned by a wage subsidy scheme, in which the state Unemployment Insurance Fund pays part of the wage, subject to certain conditions. After rising sharply early on, the rise in unemployment slowed in May and June.

The economic crisis is expected to bottom out in the second quarter. Some rebound has already been suggested by short-term indicators in May, including a pick-up in retail trade. Pessimism in the manufacturing sector, however, remains entrenched due to high uncertainty surrounding foreign markets and the high reliance of the Estonian economy on exports. The tourism sector will likely have to rely this summer season mostly on tourists from some neighbouring countries, who typically account for fewer than half of foreign tourists in Estonia. Given the weaker first quarter and the extended uncertainty for the exporting sectors, GDP is now forecast to contract by over 7½ % in 2020. In 2021, GDP is expected to rebound by over 6%, reflecting the base effects and the already taken stimulus measures boosting investment and overall confidence.

Graph 2.3: **Estonia - Real GDP growth and contributions**



Inflation turned strongly negative in April and May, primarily reflecting lower energy prices and cuts in excises on some energy products in May. The economic crisis appears to have supressed prices in most product and service categories and the supply side restrictions during the confinement did not lead to higher prices overall. Inflation is forecast to reach just 0.3% in 2020, but to rebound to about 2% in 2021, in line with the assumed recovery in energy prices and the economy.

2.4. IRELAND

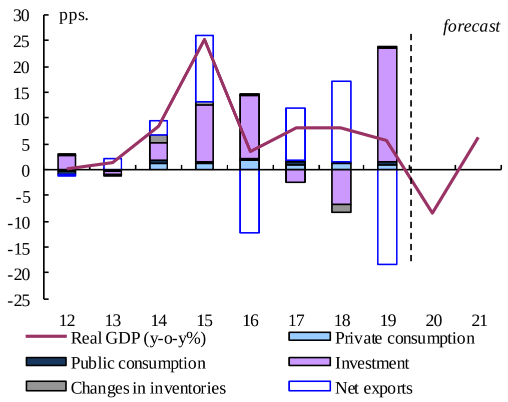
Real GDP in Ireland grew by 1.2% (q-o-q) in the first quarter of 2020, despite a decline in private consumption. Growth was supported by strong exports of goods, particularly pharmaceuticals, as well construction investment. Manufacturing and the information and communication sectors performed particularly well, while distribution, transport, accommodation and food services already contracted.

Economic activity is expected to have plunged in the second quarter of the year due to the COVID-19 pandemic and its associated lockdown. Private consumption is set to be particularly hit, since Ireland’s quarantine measures were long and wide-ranging. High frequency indicators as well as business and consumer sentiment suggest that activity collapsed in April and has been recovering only gradually since then with levels in June still lower than they were before the pandemic. On the production side, some economic activities resumed earlier than initially envisaged, limiting somewhat the domestic economic fallout. Official unemployment remained low at about 5.3% in the second quarter of 2020, while COVID-adjusted unemployment (i.e. including persons who are receiving unemployment payments for losing their job because of the pandemic) surged to 28.2% in April, before declining to 26.6% in May and 22.5% in June. Fiscal stimulus released in the second quarter to support households and businesses is expected to have dampened the decline in real GDP. Fiscal policy is set to remain supportive in the second half of the year. However, the spread of the global pandemic, which caused a marked decline in exports in April, has also weakened the prospects of exports for the second half of the year.

All in all, real GDP is projected to contract by 8½ % in 2020, while the economy is expected to grow by 6¼ % in 2021, on the back of the pent-up domestic demand release and the global post-crisis recovery.

HICP inflation has been gradually decreasing since the beginning of the year, turning negative in April and May. Falling oil prices had a particularly negative impact. Services inflation remains positive but has fallen and is likely to continue moderating over the coming months as social distancing measures continue. Processed food prices on average have risen by less than 0.5% since the start of the year. HICP inflation is forecast to remain very low in 2020 at -0.2%, and to increase to 0.8% in 2021, amid a gradual restoration of economic activity.

Graph 2.4: **Ireland - Real GDP growth and contributions**



Ireland's economic outlook remains affected by specific uncertainty concerning the future relationship between the EU and the UK, potential changes in the international taxation environment and the activities of multinationals registered in Ireland.

2.5. GREECE

Greece's GDP declined by 1.6% q-o-q in the first quarter of 2020 compared to the previous quarter, reflecting the beginning of the containment measures at the end of March.

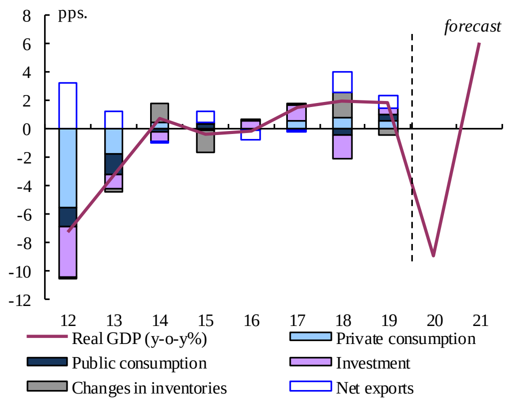
The decline in GDP was driven by a drop in investment and lower exports, while government expenditure and private consumption contributed positively. Economic activity was first to decrease in services, and to a lesser extent industry and the agricultural sector, while construction cushioned the downturn, likely due to a cut in the sector's VAT rate in January.

The full economic effect of the containment measures is expected to have materialised in the second quarter with a strong decline in domestic demand and exports. As social distancing measures are gradually relaxed, economic activity is expected to start recovering, leading to a partial recovery of domestic demand. The swift implementation of fiscal measures amounting to about 9½% of GDP to counteract the economic impact of the pandemic should cushion domestic demand to some extent. It is also expected to help prevent hysteresis effects in the labour market as well as widespread bankruptcies. Real GDP is expected to decline by 9% in 2020 and to increase by 6% in 2021.

The recovery of exports depends heavily on the outlook in Greece's main trading partners. In particular, tourism and transport are expected to be hit hard by the crisis. The concentration of tourism in the summer months makes Greece particularly vulnerable to travel restrictions and COVID-19 induced changes in travel behaviour.

Following the introduction of the containment measures, movements in and out of the labour market effectively stalled in March and April, also due to measures protecting employment and disposable incomes. The economic downturn, is still expected to lead to a relatively short-lived increase in unemployment.

Graph 2.5: **Greece - Real GDP growth and contributions**



Consumer prices increased by 0.6% (y-o-y) in the first quarter, but decreased by 0.8 % and 0.6 % (y-o-y) in April and May. The price level is expected to decrease further during the rest of the year and only start increasing in 2021 along with the economic recovery.

The forecast remains subject to an exceptional level of uncertainty, in particular due to the large exposure to risk surrounding travel and the impact on the Greek tourism sector. Upside risks are related to a more benign outlook for domestic demand, in case of a faster improvement in sentiment.

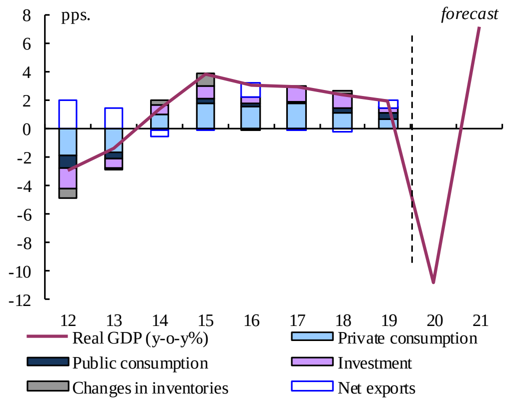
2.6. SPAIN

The severe outbreak of the COVID-19 pandemic in Spain and the confinement measures taken in response since mid-March have resulted in an unprecedented contraction of activity in the first half of the year, with the service sector being the most affected. Sentiment and economic indicators bottomed out in April and improved in May, when restrictions started to be lifted in a gradual and differentiated way across sectors and regions. The country entered a 'new normality' in late June, during which social distancing measures will remain in place until further notice. These measures, together with changes in consumer behaviour, are expected to have a long-lasting impact on activities in which personal interaction is intrinsic to the provision of the service, such as food and accommodation, retail trade, personal services, and arts and entertainment. In the case of international tourism, the impact will be aggravated by reduced flight connectivity, despite the gradual opening of borders. Activity in the manufacturing sector is expected to resume more quickly than in the services sector. Still, disruptions in global value chains and weak demand may impede a normalisation of industrial activity before the end of the year.

The economic impact of the confinement in the first half of 2020 looks likely to turn out worse than expected in the spring forecast. This will not be fully offset by the rebound expected in the second half of 2020 as most restrictions to activity are lifted. As a consequence, annual GDP growth in 2020 is now forecast at almost -11%, about 1½ pps. lower than projected in spring. Activity should continue recovering during the first half of 2021 and then moderate gradually in the second half. This, together with a strong positive carryover from the last quarters of 2020, would bring annual GDP growth to about 7% in 2021 (broadly unchanged since spring), leaving the volume of output in 2021 about 4½ % below its 2019 level.

Short-time work schemes ('ERTEs') have helped to limit large-scale job losses so far. Still, the disproportionate impact of the crisis on labour intensive sectors will result in a significant rise in the unemployment rate, and further increases are likely once ERTEs are phased out. Although private consumption is not expected to recover its pre-crisis level over the forecast horizon, it should bounce back more quickly than other demand components, as the forced increase in savings imposed by the lockdown is partly reversed. Investment is expected to rebound more slowly due to weak demand, high uncertainty, liquidity shortages, and impaired profitability. Net exports are expected to detract from growth this year due to weak receipts from international tourism, and become positive again next year as the sector starts to recover.

Graph 2.6: **Spain - Real GDP growth and contributions**



Owing to the marked drop in oil prices, headline inflation is expected to decline from 0.7% in 2019 to -0.1% this year, before picking up to 0.9% in 2021, as base effects fade away.

2.7. FRANCE

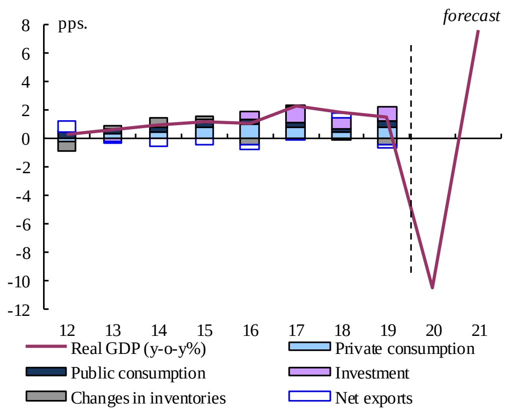
GDP growth in 2019 has been revised up to 1.5% but the forecast for 2020 has been revised down to about -10 ½% from close to -8 ¼% in the spring. (19) Lockdown measures adopted in mid-March to contain the COVID-19 outbreak led GDP to decline by 5.3% (q-o-q) in the first quarter of 2020. All expenditure components took a hit, with private consumption falling by 5.5% and investment by 10.5% quarter-on-quarter. Public consumption also shrank, although more mildly. In turn, net exports weighed slightly on growth, with the drop in exports exceeding the fall in imports.

The contraction in GDP is forecast to be sharper in the second quarter of 2020, due to the longer-lasting period of mandatory confinement. After collapsing to historical lows in April, business sentiment, consumer confidence and PMIs showed a partial uptick in May and rose further sharply in June, with PMIs entering back into expansionary territory. Following the easing of restrictions, the French economy is expected to rebound gradually from the third quarter onwards. But the negative impact on some sectors is set to be more protracted, especially those reliant on person-to-person contact, such as food services and accommodation, recreational activities, transport, and tourism more generally.

(19) Annual GDP growth figures are not calendar-adjusted. Calendar-adjusted growth remained at 1.5% in 2019 and is forecast reach -10.8% in 2020 and expand by 7.6% in 2021.

After sinking in the first half of the year, private consumption is projected to gather momentum from the second half onwards. The decrease in private consumption is set to bring about a sizeable increase in household savings in 2020 that underpins the projected rebound starting in the third quarter. Job losses, value chain disruptions, high uncertainty and liquidity constraints are expected to continue weighing on investment, although fiscal measures adopted by the government to mitigate firms' liquidity difficulties are projected to offer some help to support the rebound. Net exports are expected to weigh slightly on GDP growth in 2020, in line with weaker global demand.

Graph 2.7: **France - Real GDP growth and contributions**



The projected economic recovery is set to remain on track in 2021, with GDP expanding by some 7 ½%. Despite this strong rebound, France's GDP at the end of 2021 will be lower than it was in 2019. Private consumption and investment are projected to take the lead, whereas the negative contribution of net exports to growth is expected be largely the same as in 2020. In turn, the severe knock to growth is expected to push unemployment up in 2020, cushioned to some degree by the extension of France's short-term activity scheme.

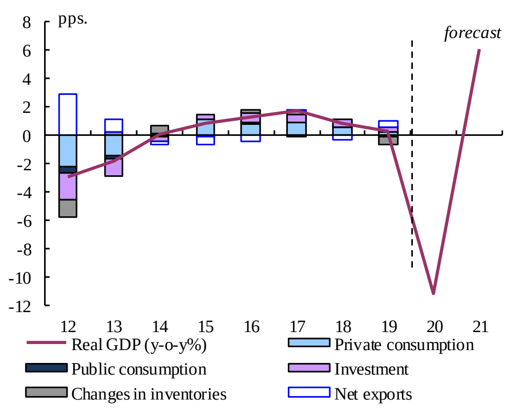
Annual HICP inflation is set to decrease to 0.3% in 2020, due to lower oil prices and the sizeable negative demand shock. In line with the rebound in economic activity, annual HICP inflation is expected to rise to 0.7% in 2021 on average.

2.8. ITALY

The COVID-19 outbreak and the associated containment measures have pushed Italy's economy into a deep contraction. According to the national statistical office, Istat, real GDP fell by 5.3% in the first quarter of 2020, led by sizeable declines in investment and exports. The stringent lock-down measures imposed by the Italian government in March, including production shutdowns, mean that the damage to economic activity is expected to be even greater in the second quarter.

High-frequency indicators suggest that the economy began to recover from the output trough inflicted by the COVID-19 pandemic as soon as the associated containment measures started to ease in May. In the absence of a second wave of infections, economic activity is set to start bouncing back in the third quarter of this year, helped by substantial policy support. While industrial production is likely to pick up pace more quickly, tourism and many other consumer-related services are set to recover more gradually, thus dampening the rebound in demand.

Graph 2.8: **Italy - Real GDP growth and contributions**



Output losses in the first two quarters are likely to be larger than assumed in spring, with real GDP forecast to fall by 11¼ % this year. In 2021, the expansion will shift from a technical rebound to a more genuine recovery. In addition, the quarterly profile over 2020 implies a substantial carry-over effect, contributing sizeably to annual average output growth of 6% in 2021. However, real GDP is not expected to return to its 2019 level by the end of 2021.

With the lifting of confinement measures, consumer spending is set to bounce back in the second half of 2020. Household deposits have risen sizeably and income support through social transfers and short-time work schemes is expected to partly offset the negative impact of the pandemic on employment and disposable incomes. By contrast, business investment is likely to remain depressed this year, given high demand uncertainty and the need of firms to shore up liquidity, even though loan guarantees, tax payment deferrals and tax credits provide valuable support. Capital spending is set to gain traction in 2021, supported by public investment. The economies of Italy's trading partners are set to contract sharply in 2020, implying a substantial drop in exports, with tourism among the hardest-hit sectors. However, the export sector may lead the recovery once the global economy picks up pace. In 2021, exports are projected to grow in line with global trade.

The growth outlook remains subject to downside risks. A protracted labour market slump once emergency measures have expired and subdued consumer sentiment could hold back the expected recovery.

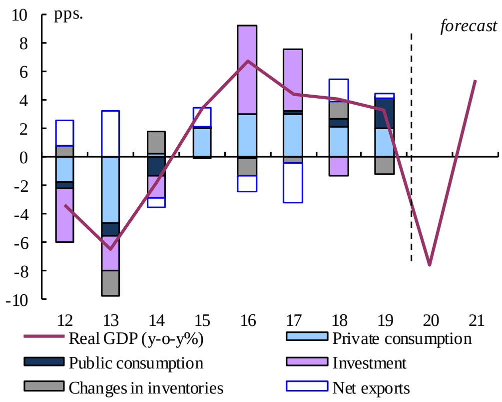
HICP inflation averaged 0.6% in 2019 but is set to drop to around zero in 2020, as the upward pressure from rising food prices is more than offset by falling energy prices. In 2021, consumer prices are projected to pick up to 0.8%, largely due to base effects linked to oil prices, while wage growth is likely to remain subdued over the forecast period.

2.9. CYPRUS

Cyprus was on a solid growth path before the global outbreak of COVID-19. The pandemic and the confinement measures that followed have dramatically changed the picture. In the first quarter of 2020, economic growth slowed down considerably, 0.8% (year-on-year), reflecting a significant fall in external demand for goods and tourism. Economic sentiment and expectations in services are at a historic low, despite a slight improvement in June.

Real GDP is forecast to contract by 7¾% in 2020 and to partially recover in 2021 by 5¼%. Private consumption and investment, notably in equipment, are expected to decline substantially. The stimulus measures adopted are expected to support employment and household incomes and help businesses to continue investing and maintaining their capacity, thus somewhat mitigating the severe impact on domestic demand. This is also reflected in a robust increase in public consumption. The contribution of net exports to GDP growth is set to be significantly negative in 2020 and to turn positive in 2021, albeit not recovering fully to its pre-pandemic levels. Downside risks to the outlook are significant.

Graph 2.9: **Cyprus - Real GDP growth and contributions**



Tourism, the main pillar of Cyprus' economy, has been severely affected. The COVID-19 pandemic is expected to significantly dampen international demand for tourism. Tourist arrivals and revenues decreased by 46.5% and 52.4%, respectively in the first quarter of 2020 (year-on-year). The travel restrictions in place throughout the second quarter, had a severe impact on the sector. Even if the expected gradual recovery begins in July, revenues from tourism could hover around 25% of last year's level. Further prolongation of the travel restrictions from the UK and Russia – Cyprus' main tourist markets – could have a strong negative effect. Furthermore, the sharp increase in unemployment in services linked to tourism and the increased risk of bankruptcies does not bode well for the recovery in 2021.

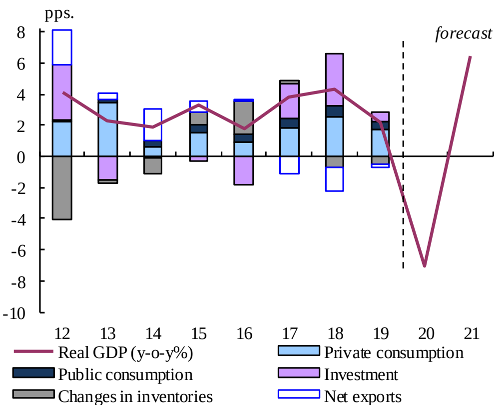
Headline inflation is forecast to fall from 0.5% in 2019 to -0.5% in 2020, driven by lower prices for energy, processed food and services. Headline inflation is expected to turn positive again in 2021, at 0.8%, reflecting the recovery of energy prices and services. Core inflation is expected to fall by 0.2% in 2020 and to edge up moderately in 2021.

2.10. LATVIA

In the first quarter of 2020, the economy declined by 2.9% compared to the previous quarter, somewhat less than expected in the spring. Consumption took by far the largest hit as containment measures enacted in the middle of March shut many services down and uncertainty over future incomes made consumers hold back on purchases of durable goods. Exports of services declined substantially due to border closures and falling demand. Government consumption picked-up because of increased spending on healthcare.

The drag on consumer activity is estimated to have peaked in April as containment measures have gradually been eased since the start of May. A notable improvement in expectations among key industries together with a resumption of mobility patterns, both in May, further support this view. However, demand from European trading partners appears to be taking longer to recover and as a result, exports may still show a decline in May before resuming growth. Also, the pace of recovery is set to differ significantly across the economy – private investment and exports may still struggle in the third quarter while consumption is forecast to pick up at a brisk pace relatively soon. Public consumption and investment are set to get a boost from the government stimulus package. Overall, GDP is forecast to decline by some 13% in the first half of 2020 compared to the last quarter of 2019. It is expected to recover rather quickly receiving a particular boost at the end of the year when work begins on the Rail Baltica project, which will integrate the rail systems of the Baltic countries with the rest of the EU. Overall, GDP is projected to contract in 2020 by 7%. In 2021, GDP growth is forecast to exceed 6%.

Graph 2.10: **Latvia - Real GDP growth and contributions**



Inflation is forecast to slow to a near standstill due to declining energy prices and deflationary pressure stemming from a sizeable demand shortfall. Conversely, it should pick up again in 2021, as demand recovers, led primarily by food and services prices.

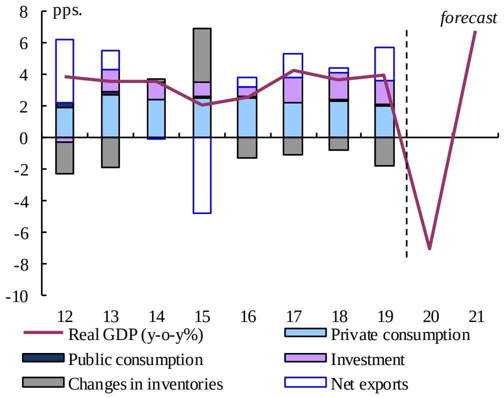
2.11. LITHUANIA

In the first quarter of 2020, real GDP in Lithuania held up relatively well, shrinking by a mere 0.3% (q-o-q), comparing favourably with the euro area as a whole. A strong economic performance in January and February offset much of the negative economic effects of the COVID-19 pandemic and its containment measures, which kicked in at the end of March. In relative terms, investment and exports contracted the most, while private consumption remained relatively resilient.

The second quarter of 2020 is set to be shaped by a more pronounced economic contraction, as confinement measures in Lithuania and abroad disrupted usual consumption patterns and negatively affected investment and the international flow of goods and services. In April, goods exports dropped by nearly one quarter, while industrial production contracted by 8% compared to March.

Even as the lockdown eases, businesses and households are expected to face a high degree of uncertainty for some time. For some companies this means getting shorter-duration contracts compared to the situation before the pandemic and a lower propensity to invest. At the same time, an increase in unemployment and savings and lower labour incomes are expected to have a negative impact on private consumption. Overall, real GDP in Lithuania is forecast to decrease by about 7% in 2020 and then bounce back partially by around 6 ¾% in 2021.

Graph 2.11: **Lithuania - Real GDP growth and contributions**



In 2020, annual HICP inflation is forecast to stand at 0.8%. From February to May, the annual inflation rate was on a downward path as increases in service prices and prices of some food products were partially offset by a considerable drop in energy prices. In 2021, due to the slight increase in oil prices projected and recovering aggregate demand, HICP inflation is forecast to reach 1.5%.

2.12. LUXEMBOURG

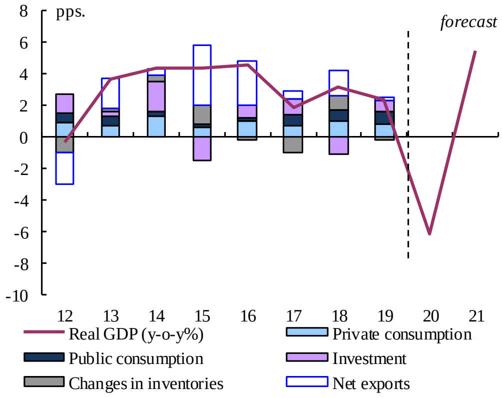
Real GDP grew by 2.3% in 2019, below the rate observed in recent years, but still above the euro area average. Real GDP is projected to fall by 6¼% in 2020, as a result of the COVID-19 outbreak. In the first quarter of 2020 real GDP declined by 2.9% versus the last quarter. Domestic demand is forecast to decline due to lower private consumption and investment, while government consumption is set to cushion only part of the fall in 2020. Net exports are also expected to contribute negatively to GDP growth. ([20])

Private consumption is expected to decline markedly in 2020 due to the pandemic and its associated containment measures and due to the weakening of the labour market via both a higher unemployment level and lower employment creation. The lockdown is likely to have reduced both the cross-border consumption in fuels and tobacco and the consumption by the large number of cross-border workers in Luxembourg. However, government measures, notably for short-time employment and special family leave, are projected to soften the shock to consumption. Investment is projected to fall in the private sector due to the uncertain economic outlook. As a consequence of the crisis-related measures, government consumption is expected to rise strongly in 2020. Net exports are expected to weigh on growth due to the decline in international trade. The volatility on financial markets following the outbreak of the health crisis and the decline in economic activity is projected to weigh on the value added of the financial sector, which represents a large share of Luxembourg's GDP.

For 2021, a rebound in GDP growth to 5½% is expected, but with risks that are mainly on the downside, depending on the evolution of the health situation and the developments in the financial and external sectors.

HICP inflation declined to 1.6% in 2019, is forecast to drop to 0.1% in 2020 and rebound to 1.5% in 2021. In 2020 a sharp decline is expected, as lower energy prices, the fall in demand due to the crisis, and the introduction of free public transport in March are expected to outweigh the rise in food prices. Wages are expected to be under pressure in 2020 and 2021 and therefore lead to moderate inflation in service prices.

Graph 2.12: **Luxembourg - Real GDP growth and contributions**



2.13. MALTA

After several years of high growth fuelled mainly by domestic demand, Malta's economy was beginning to slow down even before the COVID-19 pandemic. The disease and the containment measures it has necessitated, however, are expected to cause the economy to swing from growth of 7.3% in 2018 and 4.7% in 2019 to a contraction of 6.0% in 2020.

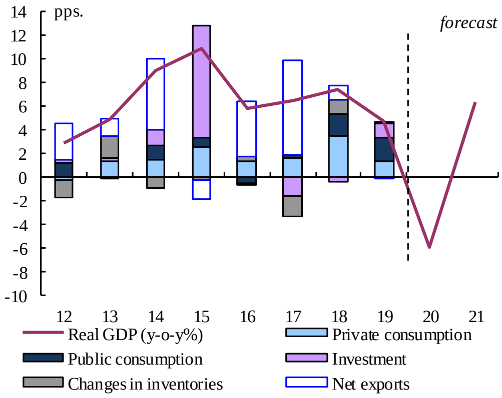
Malta will be significantly affected by the pandemic this year mainly because of its impact on the tourism sector but also because of the country's partial lockdown and the disruption to international supply-chains. As a result, investment and net exports are expected to be severely hit by the crisis, as well as private consumption. Numerous financial aid packages from the government, however, should help to cushion the economic impact. Recent economic indicators, in particular in the construction and manufacturing sectors suggest a modest recovery. In addition, upward revisions in GDP figures from the second half of 2019 may add an artificially negative statistical effect in 2020 rates.

The easing in general restrictions is expected to re-launch domestic demand, pushing GDP annual growth to 6¼% in 2021. The main driver of the recovery is set to come from investment, supported by the recovery packages announced by the

([20]) Luxembourg's national accounts can be subject to significant revisions, among others due to methodological difficulties stemming from the role of multinational firms and financial services in the external sector.

authorities. Net exports are also set to contribute significantly to the rebound as global trade gradually normalises.

Graph 2.13: **Malta - Real GDP growth and contributions**



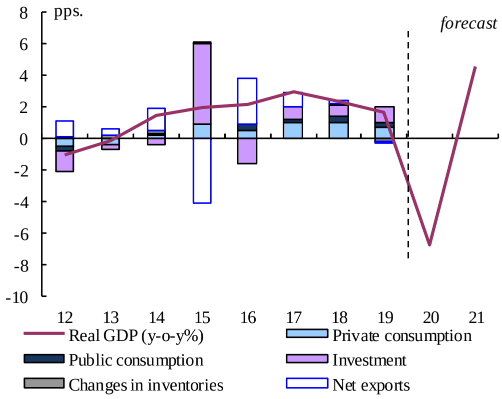
HICP inflation is set to decrease from 1.5% in 2019 to 0.8% in 2020, driven mainly by falling services inflation, impacted by demand contraction and wage reductions. Headline inflation is expected to rise to 1.2% in 2021 in line with a recovery in domestic demand and a revival in tourist demand for non-essential services.

2.14. THE NETHERLANDS

The Dutch economy contracted by 1.5% q-o-q in the first quarter of 2020, reflecting the impact of the COVID-19 pandemic which has made itself felt since mid-March. The economic implications of the virus and its associated containment measures, however, are set to be concentrated in the second quarter, with a projected quarterly decline in GDP of around 11½%. In view of tentative signs of improving indicators and the easing of containment measures since mid-May, the second quarter should constitute the trough in economic activity. Subsequently, a partial (technical) recovery of production and consumption is expected, albeit from a low base. For this year, real GDP is forecast to decline by 6¾% and to see a partial recovery of 4½% in 2021. This will leave output levels substantially below 2019 levels.

The government has adopted successive packages of emergency measures with the aim of protecting employment and mitigating losses in disposable income. Nonetheless, private consumption is expected to contract sharply this year and experience only a partial recovery next year because of adverse employment expectations and subdued wage developments. Given the collapse in world trade, exports are forecast to decline strongly in 2020 and only see a muted recovery next year. However, the contribution of the external balance to GDP growth is expected to be limited by a broadly similar development of imports. A more protracted drop in demand for exports poses a downside risk for the ensuing recovery period. Investment in equipment is projected to decline sharply this year and remain subdued next year due to low capacity utilisation and lingering uncertainty. Construction investment is forecast to experience a delayed response to the unfolding economic crisis, despite persistent housing shortages.

Graph 2.14: **The Netherlands - Real GDP growth and contributions**



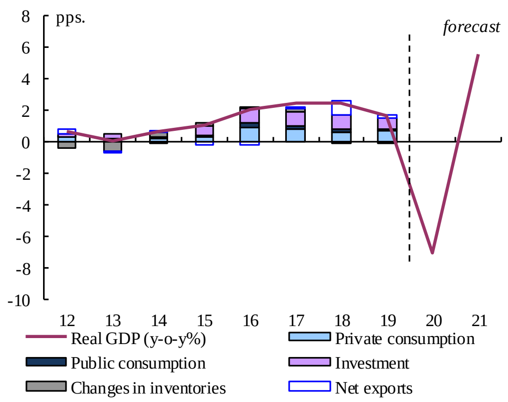
Consumer price inflation is projected to moderate to 0.8% y-o-y this year, after having increased by 2.7% last year. This in part reflects base effects from the 2019 increase in indirect taxes, as well as dissipating domestic price pressures. Moreover, the sharp drop in oil prices in combination with a lowering of energy-related indirect taxes explains about 1 pp. of this decrease. As base effects fade away, inflation is expected to pick up to 1.2% in 2021.

2.15. AUSTRIA

The COVID-19 pandemic and related containment measures have strongly affected Austria's economy, leading to a quarter-on-quarter contraction in GDP of 2.6% in 2020-Q1. As a result of the general shutdown, registered unemployment rose significantly in March and April and, despite decreasing since then, remains at high levels. The parallel substantial uptake in short-time work, with at its peak in May, more than 1.3 million applications, is another indication of the extent of the impact of the crisis on the Austrian labour market ([21]).

In the second quarter, the economic contraction is expected to be more severe as social distancing and containment measures continue to put a strain on the economy. However, a turning point seems to have been reached in April when the lockdown started to be gradually withdrawn. Together with the subsequent easing of travel restrictions, this led to improving economic and sentiment indicators, which is also reflected in the weekly GDP indicator published by the Austrian central bank (OeNB) ([22]). Private consumption in 2020-Q1 was visibly affected by the containment measures and accounted for roughly two-thirds of the decrease in GDP. The services sector, an important share of private consumption, but also the consumption of durable goods have been particularly affected and are expected to remain subdued in 2020-Q2. Investment is also expected to decline further, in particular due to a fall in equipment investment. Disruptions in supply chains, the fall in domestic demand in Austria's main trading partners and the slow expected recovery in the tourism sector, also put a drag on GDP growth in 2020-Q2, as exports are expected to fall more strongly than imports.

Graph 2.15: **Austria - Real GDP growth and contributions**



In the second half of the year, GDP growth is expected to rebound, assuming a gradual normalisation of economic activity. Overall, the economy is projected to contract by 7% in 2020 followed by a solid recovery with 5½ % growth in 2021, which would nevertheless leave the level of real GDP below pre-crisis levels.

([21]) https://www.bmafj.gv.at/Services/News/Aktuelle-Arbeitsmarktzahlen.html
([22]) https://www.oenb.at/Presse/20200619.html

Oil prices are set to fall significantly in 2020, dampening inflation. Additionally, the crisis is expected to put a drag on services and industrial good prices in light of subdued demand. Overall, inflation is expected to fall to 0.8% in 2020 and increase to 1.2% in 2021.

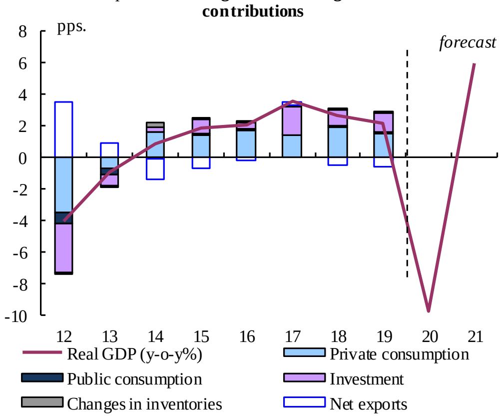
The government has taken sizeable measures to help stabilise the economy and preserve production potential. In June, the government announced a new fiscal stimulus package in the order of €19 billion (4.7% of 2019 nominal GDP). While not all details of the measures (e.g. the budgetary impact over the years) are yet known, the current projections assume a positive impact on private consumption and investment in 2020 and 2021.

2.16. PORTUGAL

Economic activity in Portugal reversed sharply in March as the COVID-19 pandemic brought significant disruptions, particularly to the country's large hospitality industry. Consequently, GDP fell by 3.8% quarter-on-quarter and 2.3% year-on-year in 2020-Q1 despite very positive data in the first two months of the year. Economic performance is expected to deteriorate at a much steeper pace of about 14% (quarter-on-quarter) in 2020-Q2 reflecting dramatic contractions in most of economic indicators. Tourism has been the most dramatically affected, with visits collapsing by almost 100% in April relative to a year earlier. The Commission's Economic Sentiment Indicator also dropped abruptly from 105.7 points in February to 63.0 points in May before a partial recovery to 74.1 points in June. On the positive side, unemployment remained broadly stable in the range of 6.2-6.3% in March and April as temporary dismissals did not have an immediate statistical impact and government short-term work schemes also helped offset the shock.

With the confinement starting to ease in May, economic activity is slowly picking up but for many businesses, such as airlines and hotels, it is expected to remain well below its pre-pandemic level over a longer period. GDP is thus projected to drop by around 9 ¾% in 2020 before rebounding by about 6% in 2021. The risks are still tilted to the downside due to the large impact of foreign tourism, where the uncertainties over the medium term remain significant.

Graph 2.16: **Portugal - Real GDP growth and contributions**



The effects of the pandemic on consumer prices are already visible. During the first half of 2020, the Harmonised Index of Consumer Prices (HICP) dropped below zero, reflecting a significant fall in energy prices, which more than offset a rise in food prices. Despite the fact that the crisis has created a combination of supply and demand shocks with opposite effects on prices, downward pressures due to weak aggregate demand are projected to prevail. Consequently, headline inflation is forecast to remain subdued in 2020 and rise gradually in 2021 in line with the expected economic recovery.

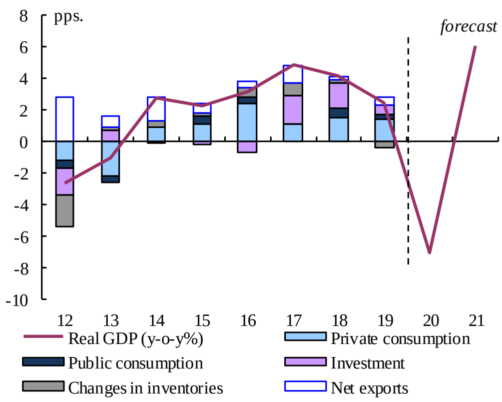
2.17. SLOVENIA

The COVID-19 pandemic put an end to several years of healthy growth in Slovenia. As in other countries, the economy has been strongly affected by containment measures and the collapse in international trade. At the same time, large-scale support measures have been put in place to limit the damage on companies and employment. These include short-term work schemes to support people who were temporarily laid off and payment of social contributions for those who continued to work. Also, a debt moratorium was put in place to give payment relief to private and corporate customers adversely affected by the pandemic, supported by public guarantees for existing and new loans. To dampen the decrease in international tourism, the government also made available vouchers for residents to buy Slovenian tourism services.

In the first quarter, the economy contracted by 4.5% q-o-q. As the second quarter was more affected by confinement measures, the decline in GDP is expected to be even steeper. The rise in unemployment has been rather modest so far, due to the support measures.

Slovenia has advanced significantly with its re-opening process, having removed most of the restrictions and established lists of countries from where it is safe to travel without quarantine. Registered unemployment had already stabilised in June and confidence has been improving since May. Household incomes have been maintained and thus the recovery in consumption is expected to be quite rapid in the second half of the year. A recovery in investment, however, is expected to be held back as uncertainty remains very high. Real GDP is forecast to fall by 7% in 2020 and to rebound by around 6% in 2021.

Graph 2.17: **Slovenia - Real GDP growth and contributions**



Inflation slowed in the beginning of the year, with HICP being 0.8% lower in June than it was in June 2019. Upward price pressure is expected to be low also during the second half of the year as energy and services prices moderate. Overall, consumer price inflation is forecast at 0.2% y-o-y in 2020 and 1.1% y-o-y in 2021.

2.18. SLOVAKIA

The COVID-19 crisis is projected to severely suppress domestic and foreign demand for Slovak goods and services. Despite government measures put in place to cushion this impact, real GDP in Slovakia is forecast to contract sharply by 9% in 2020 amid a deep recession in the first half of the year, but to recover as containment measures are lifted and to grow by about 7½% in 2021.

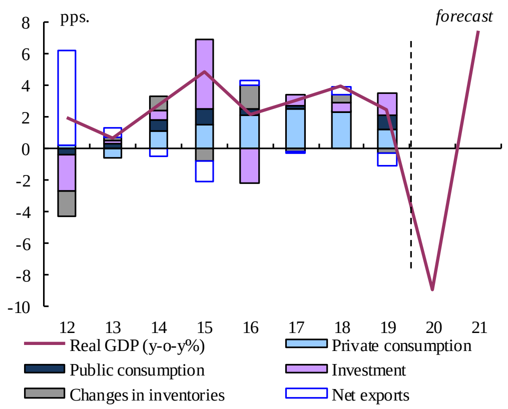
Private consumption is expected to drop sharply in 2020 as consumers withhold spending due to closed stores, travel restrictions and higher precautionary savings. It is expected to recover swiftly in the second half of 2020 and in 2021, but not to fully return to its previous trajectory, as employment and wage growth are also impacted. The uncertainty, liquidity constraints and restrictions to business activity are projected to weigh even more on investment in 2020.

Supply chain disruptions and weaker demand in key trading partners are projected to take their toll on exports in 2020, particularly so for Slovakia's large, export-focused automotive sector, which saw exceptionally steep drops in production during the lockdown. Nevertheless, goods exports, the bulk of Slovakia's trade activity, are expected to recover relatively well in the second half of 2020 and in 2021. As the drop in imports is expected to be less pronounced, net exports are likely to act as a drag on growth. While the recovery in trade remains subject to significant uncertainties and depends on prospects in Slovakia's key trading partners and on demand in the automotive sector, Slovakia's exports are well-positioned to regain market share.

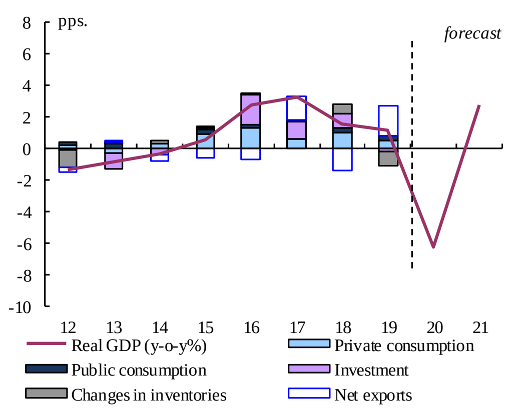
since late spring. The effect of the crisis is expected to be most pronounced in the second quarter, after which a sizeable turnaround should occur. The outlook, however, remains extremely uncertain. The low level of economic sentiment and rising unemployment caused by the crisis are likely to weigh on growth in the medium term.

Real GDP this year is expected to fall by 6¼%. Although an unprecedented fiscal stimulus is expected to soften the impact of the crisis, growth in most GDP components is expected to be negative. As the effects of the pandemics start to fade in the third quarter, the recovery should gather pace, but this will also depend on the recovery in Finland's main trading partners. In 2021, GDP growth is forecast to reach 2¾%, mainly due to the recovery in domestic demand and strong carry-over effects. This means that the level of GDP will remain lower than it was in 2019. This forecast scenario assumes that there will be no significant second wave of the pandemic.

Graph 2.18: **Slovakia - Real GDP growth and contributions**



Graph 2.19: **Finland - Real GDP growth and contributions**



HICP inflation is forecast to decline substantially over the forecast horizon, moderating from 2.8% in 2019 to 1.9% in 2020 and to 0.8% in 2021. Energy prices are a prime contributor as fuel prices collapsed in early 2020. This is expected to reduce regulated energy prices in 2021. Services price inflation is also expected to slow overall inflation as the recession weighs on demand and on wage growth. Food prices are projected to continue growing more swiftly than overall inflation.

2.19. FINLAND

Economic activity in Finland continues to be severely affected by the COVID-19 crisis although some signs of stabilisation have been apparent

HICP inflation has been subdued and even turned negative in April and May as a result of the collapse in demand and energy prices. With the recovery taking hold, stronger consumer demand and an expected increase in energy prices should drive inflation higher. However, inflation is forecast to remain below the euro area average over the forecast horizon.

Risks to the outlook are high, both on the upside and on the downside. Growth could turn out better than expected if some trading partners recover more quickly than expected, fuelled by huge fiscal stimuli and investment support. On the other hand, a second wave of infections or postponed investment projects could delay the expected recovery.

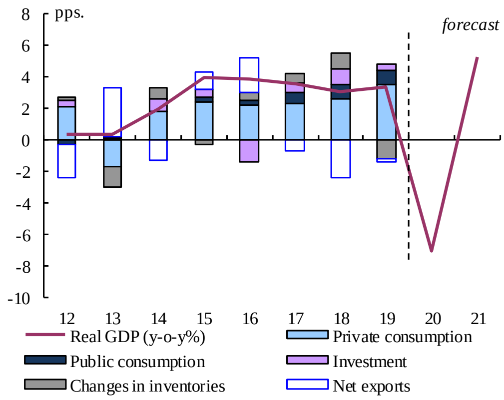
NON-EURO AREA

2.20. BULGARIA

Despite a good economic performance at the start of the year, the COVID-19 pandemic and the measures needed to contain it since mid-March have had an adverse impact on economic activity. Annual real GDP growth fell from 3.4% in 2019 to 1.2% (y-o-y) in 2020-Q1. Domestic demand declined on the back of lower private consumption and shrinking investment. The deterioration in business sentiment and short-term indicators, which began in April, point to a sharp drop in economic activity in the second quarter. Private consumption has slumped as a result of containment measures, while reduced revenues, lower capacity utilisation and high uncertainty are set to hold back investment. Since March 2020, the significantly worsened external environment has weighed on goods exports, while travel restrictions have resulted in a sharp drop in services trade.

With the easing of lockdown measures, private consumption is expected to rebound in the second half of the year and continue to expand at a moderate pace in 2021 as consumer confidence is gradually restored. Investment is expected to return to positive quarterly growth only next year, mainly because uncertainty remains high. Exports are forecast to pick up gradually throughout the second half of the year and into 2021. Overall, real GDP is expected to decline by around 7% in 2020 and then pick up by 5¹/3% in 2021. Risks to the forecast are broadly balanced, in line with the risks to the economy of the EU.

Graph 2.20: **Bulgaria - Real GDP growth and contributions**



Inflation is forecast to settle at around 1% in 2020 and 2021. Headline inflation has been on a downward path since the beginning of the year, owing to the drop in energy prices. The expected contraction of seasonal demand for tourist services and the temporary reduction of VAT rates for the sector are set to dampen services price inflation in the second half of the year. In 2021, inflation is expected to remain low, with positive contributions from food and services prices.

2.21. CZECHIA

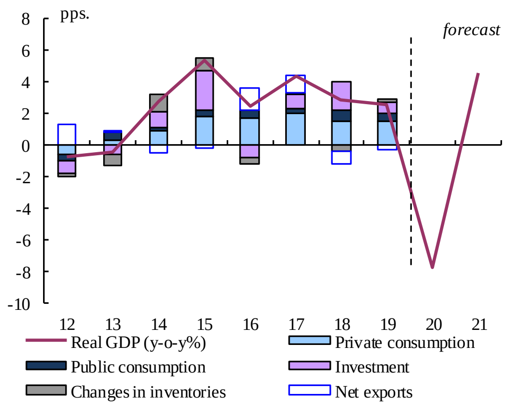
Economic activity in Czechia reversed sharply as the COVID-19 pandemic brought significant disruptions, particularly to the country’s large export-oriented manufacturing industry. Despite partial recovery in 2021, GDP is forecast to stay below its pre-crisis level.

Czechia implemented lockdown measures rather early in March and lifted most of them by the beginning of June. As a result, GDP in the first quarter of 2020 shrank by 3.3% compared to the previous quarter. Due to disrupted supply chains, investment was particularly hit, posting a quarterly drop of almost 10%. In the second quarter, when the country saw almost 7 weeks of lockdown, GDP is expected to show a contraction of 10¾%. The economy should gradually recover from the third quarter onwards, but the impact on client-facing services such as hospitality, tourism and transport may last longer. Consequently, GDP is estimated to increase by almost 4½% quarter-on-quarter in the third quarter and by 3½% in the fourth quarter leading to an annual decline by 7¾% in 2020.

In 2021, GDP is expected to grow by 4½%, only partially recovering the losses sustained in 2020. Private consumption is likely to remain the main driver of GDP movements, despite slower growth in wages and pension incomes. The fiscal measures adopted by the government in the first half of 2020 may help the economy avoid large scale layoffs. Investment is expected to rise in 2021, contributing to the upturn in economic growth.

The trade balance is likely to be negatively impacted by ongoing supply-chain disruptions and weaker demand in Czechia’s key trading partners. This applies in particular to the automotive sector. As the drop in imports is expected to be less pronounced, net exports are likely to act as a drag on economic activity. The recovery in trade remains subject to significant uncertainties and depends on prospects in Czechia's key trading partners.

Graph 2.21: **Czechia - Real GDP growth and contributions**



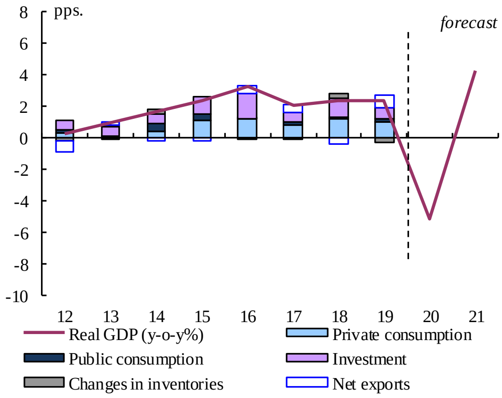
HICP inflation is projected to reach 2.8% in 2020, as the upward pressure from rising food prices is expected not to be fully offset by falling energy prices. Prices of services kept rising in the first half of 2020, but are expected to weaken over the remainder of the year also due to the easing of wage growth. Inflation is projected to drop temporarily below 2% at the start of 2021, despite an easing of the monetary conditions in both the exchange rate and interest rate components. Consistently with the projected pick-up in economic activity, it is expected to rise during the rest of the year and reach an annual rate of 2.2% in 2021.

2.22. DENMARK

Although Denmark was one of the first European countries to impose extensive lockdown measures in response to the COVID-19 pandemic, economic activity in the first quarter of 2020 proved more resilient than previously expected. The fall in private consumption was fairly moderate and construction investment held up relatively well. Exports also surprised positively, mirroring the high share of pharmaceuticals and agricultural products in Denmark's export mix. As a result, real GDP declined by 2% quarter-on-quarter in the first quarter of 2020, less than the 3.2% average decline experienced in the EU over the same period.

Real GDP growth is estimated to have bottomed out in the second quarter of 2020, while a rebound is expected from the third quarter onwards. Due to the decline in the number of COVID-19 infections, the government started to ease the lockdown earlier than planned. The government has also expanded its 'emergency measures' to mitigate the negative economic effects of the pandemic. A new 'recovery package' to support the economic upturn has been adopted, a key element of which is the release of households' holiday savings equivalent to three weeks of household income. This measure is expected to provide an impetus to private consumption from the end of this year. The investment outlook has deteriorated since the spring forecast, with gross fixed capital formation projected to fall sharply in 2020, constrained by weak domestic and foreign demand and considerable uncertainty about the economic outlook. Investment is expected to recover moderately in 2021, helped by public investment and government support. Partly due to the swift, effective and recently stepped-up policy responses, real GDP is set to contract by 5¼% in 2020, less than projected in the spring forecast. The acceleration of economic activity from the third quarter of this year onwards is set to give rise to real GDP growth of around 4¼% in 2021.

Graph 2.22: **Denmark - Real GDP growth and contributions**



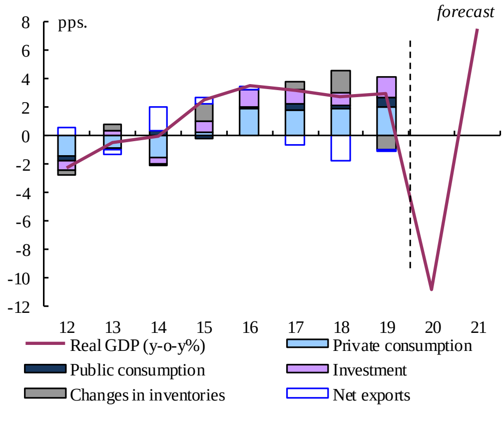
Denmark's consumer price inflation (HICP) is forecast to slow to 0.3% y-o-y in 2020, in part driven by a sharp fall in energy prices in the first half of 2020. The recovery of economic activity, a marked increase in tobacco excises and the price effects of a tax reform linked to rented summer houses, are expected to lead to an acceleration of consumer prices, and HICP is accordingly projected to increase by 1.2% in 2021.

2.23. CROATIA

When the COVID-19 pandemic reached Croatia, the economy was in a more resilient position than it had been at the onset of the 2008 global financial crisis. Nevertheless, GDP growth turned negative in the first quarter (-1.2% q-o-q), as both domestic and external demand contracted, and is expected to have been even more negative in the second quarter. Available high frequency and sentiment indicators suggest that a trough in economic activity may have been reached in April and may be followed by a sharp recovery in May and June.

Overall, real GDP is expected to contract sharply in 2020 (close to 11%) and to partially recover in 2021, leaving output below its pre-crisis level. Domestic demand is expected to be the main driver of both the drop in GDP in the first half of 2020 and its recovery thereafter. Private consumption should recover quickly with the reopening of the economy, as large scale layoffs appear to have been avoided, thanks to the government's wage support measure. Ongoing and new projects financed by EU funds and several liquidity support measures for companies should facilitate recovery in investment. Croatia's sizeable tourism sector, accounting for the majority of services exports, is expected to remain depressed throughout 2020 and to only gradually recover in 2021, owing to remaining disruptions in international travel. Overall, exports are expected to take longer to recover, also given the worsened global outlook and uncertainties surrounding global trade.

Graph 2.23: **Croatia - Real GDP growth and contributions**



The HICP inflation rate picked up slightly in the first quarter of the year due to the dissipating effect of a VAT decrease on unprocessed food enacted in 2019. It has since turned negative, mainly on account of a significant decline in energy prices, which are expected to remain the main driver of inflation in 2020 and 2021. Food prices are also expected to positively contribute to inflation, but core inflation is expected to remain stable in both 2020 and 2021.

2.24. HUNGARY

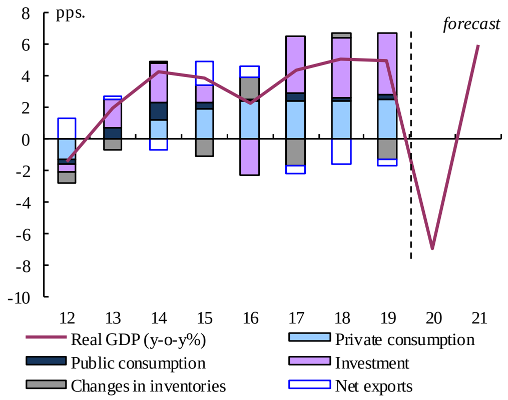
Hungary's economy was on track for a gradual slowdown before COVID-19. Lockdown measures to contain the pandemic began in mid-March, and thus had a smaller impact on economic data in the first quarter, when GDP contracted by 0.4% q-o-q. Confirmed case numbers remained limited and the physical distancing measures have been gradually lifted since the beginning of May. High-frequency indicators suggest that economic activity reached its trough in April. However, the pace of recovery is expected to be uneven across sectors over the remainder of the year. Retail sales rebounded in May as pent-up demand returned, but the deteriorating labour market situation should limit household purchasing power. Tourism and related sectors came to a standstill in the spring, and only a partial recovery is expected. Industrial production dropped 38% between February and April, and muted international demand suggests that the recovery in capacity utilisation rates will be gradual. Construction was less affected by the initial lockdown measures, but second-round effects from the recession may result in further output declines.

Hungary's GDP is projected to drop by 7% in 2020, after growing by 4.9% in 2019. Household consumption is forecast to decrease with the hit to labour income and higher precautionary saving. Investment, which was already on course for a slowdown before the pandemic, is projected to plummet from a record high level in 2019. Due to the recession, several ongoing projects are likely to be cancelled or put on hold. Exports are expected to drop sharply in 2020 because Hungarian exporters specialise in highly cyclical products (e.g. automotive), and in tourism and travel services which will remain constrained by physical distancing measures. The cyclical recovery could lift GDP by 6% in 2021, supported by all final demand components.

Employment fell by nearly 3% between February and April according to the Labour Force Survey, with many more on furlough but officially still in employment. Establishment data point to a larger, 5.8% drop in the number of employees in the same period. Around 4% of workers participate in the temporary wage subsidy scheme, working reduced hours. The first signs of improvement have emerged with rising monthly employment in May and a decreasing number of registered jobseekers in mid-June. Unemployment is set to decrease gradually as the economy recovers, and persistent slack in the labour market could keep real wage growth muted in 2020 and 2021.

Inflation has slowed since the COVID-19 outbreak on the back of falling fuel prices and the impact of the recession on service prices. However, food inflation has remained high due to commodity price increases and supply disruptions. Indirect tax hikes on fuel and tobacco will have raised consumer prices in July. Inflation is projected at 3.5% in 2020, similar to the 3.4% in 2019. It is set to decrease to 2.8% in 2021 as the food price shock recedes.

Graph 2.24: **Hungary - Real GDP growth and contributions**



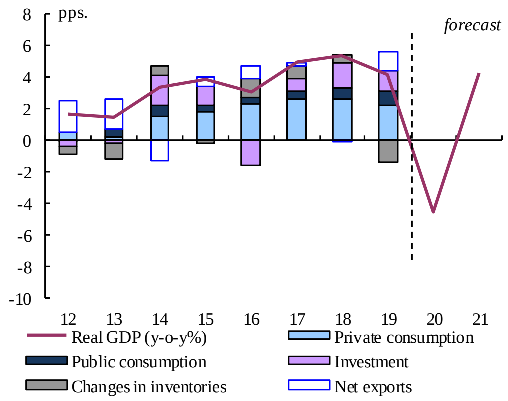
2.25. POLAND

Poland's economy proved relatively resilient in the first quarter of 2020, mainly due to its low exposure to hard-hit sectors and diversified economic structure. GDP fell by -0.4% quarter-on-quarter driven by a significant fall in private consumption, while investment decreased only moderately as the construction sector kept expanding and industrial production recorded just a mild contraction.

GDP is expected to plunge in the second quarter and to gradually recover from then onwards, leaving annual GDP growth at around -4½% in 2020 and 4¼% in 2021. Despite the government measures put in place, private consumption is likely to suffer in 2020 as consumers accumulate precautionary savings and withhold spending due to social distancing and high uncertainty. Coupled with supply chain disruptions and a fall in orders in March and April, low business confidence will likely have an impact on investment, which is projected to plunge in the second quarter and to recover only partially over the forecast horizon. Furthermore, a fall in demand in Poland's main trading partners will likely take its toll on exports in 2020, especially in the transport and tourism sectors. As the drop in imports is expected to be less pronounced, the trade balance is set to be a drag on growth in 2020.

HICP inflation accelerated significantly at the end of 2019 and the beginning of 2020, driven by a sustained increase in service and food prices. However, slower wage growth and weak demand caused by the COVID-19 pandemic is set to put an end to a nearly two-year-long trend of uninterrupted increases in service price inflation, which is expected to drop in the second half of 2020 and early 2021. Moreover, a significant fall in oil prices in the first four months of the year is likely to bring energy prices down in 2020. As a result, HICP inflation is expected to average 2.7% y-o-y in 2020 and to reach 2.8% in 2021 as economic activity recovers.

Graph 2.25: **Poland - Real GDP growth and contributions**

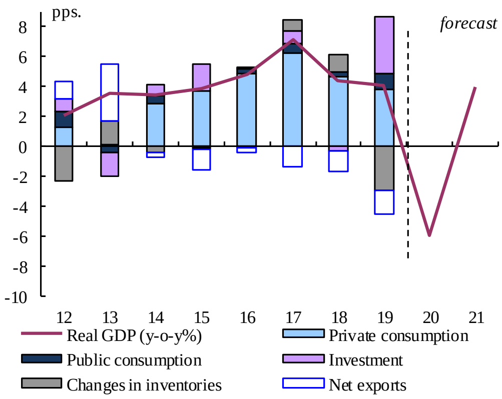


2.26. ROMANIA

The Romanian economy showed signs of resilience in the first quarter of the year. Real GDP increased by 2.4% year-on-year (0.3% quarter-on-quarter), supported mainly by private consumption and the build-up of inventories. Gross fixed capital formation continued to grow, albeit at a significantly slower pace than in 2019 as a whole. Net exports weighed down on growth as exports fell due to the drop in external demand.

Due to the lockdown triggered by the COVID-19 pandemic, real GDP growth is forecast to show a sharp drop in the second quarter of the year. Private consumption is expected to decline as a result of restrictions on movement as well as lower incomes. Uncertainty is set to weigh significantly on investment decisions this year, while construction activity could offer some relief. The reduced economic activity in Romania's main trading partners is expected to take a significant toll on exports. All in all, after falling sharply in the first half of 2020, economic activity is forecast to gain traction in the second half, as restrictions are gradually lifted, and to pick up further in 2021. Real GDP is set to contract by 6% in 2020 and then rebound by 4% in 2021.

Graph 2.26: **Romania - Real GDP growth and contributions**



Risks to the growth outlook are tilted to the downside. A second wave of infections in Romania or one of its main trading partners could delay the economic recovery. In addition, an important factor is how the authorities address the concerns on the fiscal trajectory pre-dating the COVID-19 crisis, which if unaddressed may eventually feed into depressed investor confidence, higher financing costs and a lower growth path.

The sharp drop in energy prices, as well as subdued aggregate demand, are set to reduce inflationary pressures in 2020, compensating an expected increase in food prices, following supply chain disruptions and as a result of a drought. HICP inflation fell from 4% in December 2019 to around 1.8% in May 2020 and is forecast to average 2.5% over the year as a whole. It is expected to pick up to an average of 2.8% in 2021, supported by a recovery in demand.

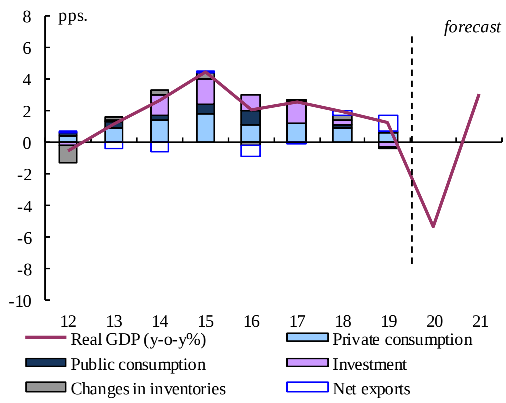
2.27. SWEDEN

The Swedish economy showed a relatively robust performance in the first quarter of 2020, in spite of the COVID-19 pandemic triggering a sharp deterioration in economic activity from mid-March onwards. Real GDP grew 0.1% q-o-q in the first quarter, mainly due to positive net exports. Even though only some restrictions were put in place to counter the spread of the disease, both the demand and supply side of the economy took a hit. While the rather less restrictive measures helped cushion the immediate impact on the economy, particularly on domestically oriented branches, exporting industries experienced strong declines in output as cross-borders value chains were disrupted. Durable consumer goods, travel services and capital goods-producing sectors were particularly affected.

Real GDP is expected to show a sharp fall in the second quarter of 2020, with a recovery following in the second half of the year. The uncertain outlook for demand and lower capacity utilisation should lead to a sharp decline in capital formation this year. Equipment investment is also expected to suffer, as it is the investment category that reacts most strongly to the business cycle. Private consumption decreases follow on from substantial job losses and uncertainty, as well as the impact of restrictions. The sharp fall in economic activity forecast in Sweden's main trading partners is expected to translate into a large decline in exports.

Economic growth is set to turn positive in 2021 as impediments slowly dissipate and the economies of major trading partners recover. A return to work should foster a bounce back in consumption growth in 2021. In 2020, economic growth is expected to fall to -5.3% before recovering to 3.1% in 2021. A second pandemic wave in Sweden or its major trading partners is the main downside risk to the GDP forecast for Sweden.

Graph 2.27: **Sweden - Real GDP growth and contributions**



The shrinking economy, sharply lower energy prices, the stabilisation of the krona and the postponement of wage negotiations are set to dampen price pressures this year. These dampening factors are expected to outweigh increases in food prices, which remain relatively strong in view of unchanged demand and bottlenecks in production and supply. Overall, HICP inflation fell to around 0% in April and May 2020 and is forecast average 0.6% for the year as a whole. Base effects from energy prices and reinvigorated domestic demand are expected to support a rise in inflation to over 1% in 2021. However, underlying inflation is set to moderate further on the back of economic slack and muted wage growth.

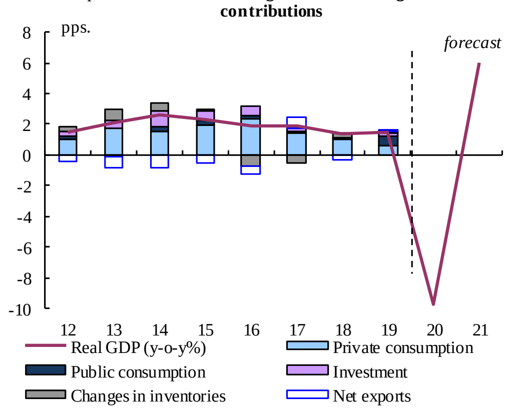
P.M. UNITED KINGDOM (23)

After growing by 1.5% of GDP in 2019, UK GDP fell by 2.2% in the first quarter of 2020. The quarterly fall was mainly driven by a 6.9% fall in monthly GDP in March 2020, caused by the COVID-19 pandemic and the measures the government took to contain the spread of the disease. The lockdown, which was implemented in late March, has been gradually lifted since mid-May, but several restrictions remain in place.

Following the UK's withdrawal from the EU as of 1 February 2020 and the entry into force of the Withdrawal Agreement, the UK entered a transition period until the end of 2020 during which Union law, with a few exceptions, continues to apply to and in the UK. Projections for 2021 are based on a purely technical assumption of status quo in terms of trading relations between the EU and the UK. This is for forecasting purposes only and has no bearing on the negotiations between the EU and the UK on their future relations.

GDP is forecast to fall substantially in the second quarter of 2020. The lockdown has led to a sharp slowdown in business activity in many sectors, particularly the hospitality sector, construction, and arts and entertainment. Private consumption and business investment are also projected to fall significantly. In the second half of 2020, private consumption and business investment are forecast to rebound, supported by the further easing of the lockdown, an expansionary fiscal stance and supportive monetary policy. Business investment, however, is expected to catch up more gradually, due to pressure on balance sheets as a consequence of the COVID-19 pandemic and the continued uncertainty about future of EU-UK trading relations. Net exports are expected to negatively contribute to growth, while government consumption is expected to make a positive contribution. Reflecting these factors, GDP is forecast to fall by 9¾ % in 2020 and, based on the technical assumption, to grow by 6% in 2021. As the technical assumption implies a status quo for 2021 in terms of trading relations, the risks to the forecast are predominantly to the downside.

Graph 2.28: **The United Kingdom - Real GDP growth and contributions**



Consumer price inflation averaged 1.8% in 2019. Due to lower energy prices and the disinflationary effect of the COVID-19 pandemic, inflation is forecast to fall to 0.9% in 2020, before picking up somewhat to 1.3% in 2021.

(23) The United Kingdom withdrew from the European Union as of 1 February 2020. The Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and European Atomic Energy Community (OJ L 29, 31.1.2020, p. 7) entered into force on the same date. It provides for a transition period which will end on 31 December 2020. During the transition period, Union law, with a few exceptions, is applicable to and in the United Kingdom. For the purposes of Union law applicable to it during the transition period, the United Kingdom is treated as an EU Member State, but will not participate in EU decision-making and decision-shaping.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2001-2021) 30.6.2020

	5-year averages							Summer 2020 forecast		*Spring 2020 forecast*	
	2001-05	2006-10	2011-15	2016	2017	2018	2019	2020	2021	*2020*	*2021*
Belgium	1.9	1.5	1.3	1.5	1.9	1.5	1.4	**-8.8**	**6.5**	*-7.2*	*6.7*
Germany	0.5	1.2	1.7	2.2	2.5	1.5	0.6	**-6.3**	**5.3**	*-6.5*	*5.9*
Estonia	7.3	-0.3	3.3	2.6	5.7	4.8	4.3	**-7.7**	**6.2**	*-6.9*	*5.9*
Ireland	5.3	0.4	6.7	3.7	8.1	8.2	5.5	**-8.5**	**6.3**	*-7.9*	*6.1*
Greece	3.9	-0.3	-4.0	-0.2	1.5	1.9	1.9	**-9.0**	**6.0**	*-9.7*	*7.9*
Spain	3.3	1.0	0.0	3.0	2.9	2.4	2.0	**-10.9**	**7.1**	*-9.4*	*7.0*
France	1.7	0.8	1.0	1.1	2.3	1.8	1.5	**-10.6**	**7.6**	*-8.2*	*7.4*
Italy	0.9	-0.3	-0.7	1.3	1.7	0.8	0.3	**-11.2**	**6.1**	*-9.5*	*6.5*
Cyprus	4.0	2.7	-1.7	6.7	4.4	4.1	3.2	**-7.7**	**5.3**	*-7.4*	*6.1*
Latvia	8.2	-0.5	3.6	1.8	3.8	4.3	2.2	**-7.0**	**6.4**	*-7.0*	*6.4*
Lithuania	7.6	1.1	3.8	2.6	4.2	3.6	3.9	**-7.1**	**6.7**	*-7.9*	*7.4*
Luxembourg	2.9	2.4	2.9	4.6	1.8	3.1	2.3	**-6.2**	**5.4**	*-5.4*	*5.7*
Malta	2.1	2.0	5.7	5.8	6.5	7.3	4.7	**-6.0**	**6.3**	*-5.8*	*6.0*
Netherlands	1.3	1.4	0.7	2.2	2.9	2.4	1.7	**-6.8**	**4.6**	*-6.8*	*5.0*
Austria	1.8	1.3	1.1	2.1	2.5	2.4	1.6	**-7.1**	**5.6**	*-5.5*	*5.0*
Portugal	0.9	0.6	-0.8	2.0	3.5	2.6	2.2	**-9.8**	**6.0**	*-6.8*	*5.8*
Slovenia	3.6	1.9	0.4	3.1	4.8	4.1	2.4	**-7.0**	**6.1**	*-7.0*	*6.7*
Slovakia	5.0	4.9	2.6	2.1	3.0	3.9	2.4	**-9.0**	**7.4**	*-6.7*	*6.6*
Finland	2.6	0.9	0.1	2.8	3.3	1.5	1.1	**-6.3**	**2.8**	*-6.3*	*3.7*
Euro area	1.5	0.8	0.8	1.9	2.5	1.9	1.3	**-8.7**	**6.1**	*-7.7*	*6.3*
Bulgaria	5.7	3.2	1.8	3.8	3.5	3.1	3.4	**-7.1**	**5.3**	*-7.2*	*6.0*
Czechia	3.9	2.4	1.7	2.5	4.4	2.8	2.6	**-7.8**	**4.5**	*-6.2*	*5.0*
Denmark	1.3	0.2	1.3	3.2	2.0	2.4	2.4	**-5.2**	**4.3**	*-5.9*	*5.1*
Croatia	4.5	0.5	-0.2	3.5	3.1	2.7	2.9	**-10.8**	**7.5**	*-9.1*	*7.5*
Hungary	4.4	-0.2	2.1	2.2	4.3	5.1	4.9	**-7.0**	**6.0**	*-7.0*	*6.0*
Poland	3.1	4.8	3.0	3.1	4.9	5.3	4.1	**-4.6**	**4.3**	*-4.3*	*4.1*
Romania	5.6	2.8	3.0	4.8	7.1	4.4	4.1	**-6.0**	**4.0**	*-6.0*	*4.2*
Sweden	2.6	1.8	2.2	2.1	2.6	2.0	1.2	**-5.3**	**3.1**	*-6.1*	*4.3*
EU	1.7	1.0	1.0	2.1	2.7	2.1	1.5	**-8.3**	**5.8**	*-7.4*	*6.1*
P.M.: United Kingdom	*2.8*	*0.5*	*2.0*	*1.9*	*1.9*	*1.3*	*1.5*	*-9.7*	*6.0*	*-8.3*	*6.0*

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter) 30.6.2020

	2019/1	2019/2	2019/3	2019/4	2020/1	2020/2	2020/3	2020/4	2021/1	2021/2	2021/3	2021/4
Belgium	0.1	0.3	0.4	0.5	-3.6	-15.5	11.5	3.1	1.5	1.2	0.9	0.7
Germany	0.5	-0.2	0.3	-0.1	-2.2	-9.7	4.5	3.2	1.4	1.4	1.2	1.1
Estonia	1.0	0.9	1.2	0.9	-3.7	-11.1	4.9	2.6	2.6	1.9	1.1	1.0
Ireland	2.9	-0.6	2.1	1.7	1.2	-15.3	-1.5	3.0	3.9	3.7	3.5	2.9
Greece	0.2	1.0	0.4	-0.7	-1.6	:	:	:	:	:	:	:
Spain	0.6	0.4	0.4	0.4	-5.2	-16.9	12.9	3.4	1.8	1.2	0.8	0.6
France	0.5	0.3	0.2	-0.1	-5.3	-16.8	14.7	2.9	2.2	0.9	0.5	0.4
Italy	0.2	0.1	0.0	-0.2	-5.3	-15.8	10.8	5.2	0.6	0.6	0.6	0.6
Cyprus	1.0	1.1	0.0	1.0	-1.3	:	:	:	:	:	:	:
Latvia	-0.5	0.7	0.6	0.1	-2.9	-10.3	5.1	2.8	2.2	1.6	1.9	0.8
Lithuania	1.1	0.9	0.8	1.1	-0.3	-12.6	2.9	2.6	2.6	2.5	2.4	1.9
Luxembourg	0.1	2.1	0.4	0.4	-2.9	:	:	:	:	:	:	:
Malta	1.4	0.4	1.6	1.1	-2.3	:	:	:	:	:	:	:
Netherlands	0.5	0.4	0.3	0.5	-1.5	-11.6	5.0	2.5	1.6	1.3	1.1	0.8
Austria	0.7	-0.1	0.0	0.0	-2.6	-12.5	9.2	2.9	1.1	0.9	0.8	0.7
Portugal	0.7	0.5	0.3	0.7	-3.8	-14.1	6.8	2.9	2.2	1.6	1.3	0.8
Slovenia	0.5	0.0	0.8	0.4	-4.5	-10.4	8.0	3.8	1.0	0.8	0.7	0.7
Slovakia	0.6	0.4	0.4	0.6	-5.2	-12.3	8.0	4.1	1.8	1.4	1.2	1.1
Finland	0.1	0.8	0.3	-0.3	-1.9	-7.6	1.7	1.3	1.3	1.3	1.2	1.2
Euro area	0.5	0.1	0.3	0.1	-3.6	-13.6	8.8	3.4	1.6	1.2	1.0	0.8
Bulgaria	1.0	0.7	0.7	0.8	0.3	-11.7	0.3	0.2	3.3	3.3	3.4	3.5
Czechia	0.6	0.5	0.4	0.5	-3.3	-10.7	4.4	3.5	1.2	1.3	0.7	0.7
Denmark	0.4	0.9	0.4	0.4	-2.1	-8.6	3.9	3.0	1.0	0.9	0.9	0.9
Croatia	1.1	0.6	0.6	0.4	-1.2	-15.9	2.0	4.7	3.4	3.2	2.5	0.2
Hungary	1.9	0.8	0.9	0.7	-0.4	-14.3	5.2	2.7	2.5	2.2	1.7	1.2
Poland	1.4	0.7	1.2	0.2	-0.4	-9.2	3.5	2.1	1.6	1.3	1.1	0.9
Romania	1.5	0.6	0.5	1.2	0.3	-11.9	2.0	2.3	1.8	1.8	1.8	1.8
Sweden	0.2	0.1	0.2	0.0	0.1	-9.1	1.9	1.7	1.4	1.3	1.3	1.3
EU	0.6	0.2	0.3	0.1	-3.2	-13.1	8.0	3.2	1.6	1.2	1.0	0.9
P.M.: United Kingdom	*0.7*	*-0.1*	*0.5*	*0.0*	*-2.2*	*-18.2*	*11.9*	*3.4*	*1.3*	*1.2*	*1.0*	*1.1*

Table 3: Harmonised index of consumer prices (percentage change on preceding year, 2001-2021) 30.6.2020

	5-year averages							Summer 2020 forecast		*Spring 2020 forecast*	
	2001-05	2006-10	2011-15	2016	2017	2018	2019	2020	2021	*2020*	*2021*
Belgium	2.0	2.2	1.7	1.8	2.2	2.3	1.2	**0.3**	**1.4**	*0.2*	*1.3*
Germany	1.6	1.6	1.5	0.4	1.7	1.9	1.4	**0.4**	**1.5**	*0.3*	*1.4*
Estonia	3.6	4.9	2.6	0.8	3.7	3.4	2.3	**0.3**	**1.9**	*0.7*	*1.7*
Ireland	3.4	1.1	0.8	-0.2	0.3	0.7	0.9	**-0.2**	**0.8**	*-0.3*	*0.9*
Greece	3.5	3.3	0.2	0.0	1.1	0.8	0.5	**-0.5**	**0.5**	*-0.6*	*0.5*
Spain	3.2	2.5	1.2	-0.3	2.0	1.7	0.8	**-0.1**	**0.9**	*0.0*	*1.0*
France	2.0	1.7	1.2	0.3	1.2	2.1	1.3	**0.3**	**0.7**	*0.4*	*0.9*
Italy	2.4	2.0	1.6	-0.1	1.3	1.2	0.6	**0.0**	**0.8**	*-0.3*	*0.7*
Cyprus	2.5	2.3	1.0	-1.2	0.7	0.8	0.5	**-0.5**	**0.8**	*-0.2*	*1.0*
Latvia	4.1	6.8	1.5	0.1	2.9	2.6	2.7	**0.4**	**2.0**	*0.2*	*1.9*
Lithuania	0.9	5.2	1.6	0.7	3.7	2.5	2.2	**0.8**	**1.5**	*0.8*	*1.5*
Luxembourg	2.8	2.5	1.8	0.0	2.1	2.0	1.6	**0.1**	**1.5**	*0.7*	*1.6*
Malta	2.5	2.4	1.7	0.9	1.3	1.7	1.5	**0.8**	**1.2**	*0.7*	*1.1*
Netherlands	2.8	1.5	1.7	0.1	1.3	1.6	2.7	**0.8**	**1.2**	*0.8*	*1.3*
Austria	1.9	1.8	2.1	1.0	2.2	2.1	1.5	**0.8**	**1.2**	*1.1*	*1.5*
Portugal	3.2	1.7	1.4	0.6	1.6	1.2	0.3	**0.0**	**1.2**	*-0.2*	*1.2*
Slovenia	5.6	3.0	1.3	-0.2	1.6	1.9	1.7	**0.2**	**1.1**	*0.5*	*1.2*
Slovakia	5.9	2.3	1.8	-0.5	1.4	2.5	2.8	**1.9**	**0.8**	*1.9*	*1.1*
Finland	1.4	2.0	2.0	0.4	0.8	1.2	1.1	**0.3**	**1.1**	*0.5*	*1.4*
Euro area	2.2	1.9	1.4	0.2	1.5	1.8	1.2	**0.3**	**1.1**	*0.2*	*1.1*
Bulgaria	5.5	6.5	0.7	-1.3	1.2	2.6	2.5	**1.0**	**1.1**	*1.1*	*1.1*
Czechia	2.0	2.6	1.6	0.6	2.4	2.0	2.6	**2.8**	**2.2**	*2.3*	*1.9*
Denmark	1.9	2.1	1.2	0.0	1.1	0.7	0.7	**0.3**	**1.2**	*0.3*	*1.3*
Croatia	2.9	3.0	1.6	-0.6	1.3	1.6	0.8	**0.4**	**1.4**	*0.4*	*0.9*
Hungary	5.9	5.3	2.3	0.4	2.4	2.9	3.4	**3.5**	**2.8**	*3.0*	*2.7*
Poland	2.8	2.9	1.6	-0.2	1.6	1.2	2.1	**2.7**	**2.8**	*2.5*	*2.8*
Romania	18.6	6.2	2.7	-1.1	1.1	4.1	3.9	**2.5**	**2.8**	*2.5*	*3.1*
Sweden	1.8	2.1	0.7	1.1	1.9	2.0	1.7	**0.6**	**1.1**	*0.4*	*1.1*
EU	2.7	2.2	1.5	0.2	1.6	1.8	1.4	**0.6**	**1.3**	*0.6*	*1.3*
P.M.: United Kingdom	*1.5*	*2.7*	*2.3*	*0.7*	*2.7*	*2.5*	*1.8*	***0.9***	***1.3***	*1.2*	*2.1*

Table 4: Harmonised index of consumer prices (percentage change on preceding year) 30.6.2020

	2019/1	2019/2	2019/3	2019/4	2020/1	2020/2	2020/3	2020/4	2021/1	2021/2	2021/3	2021/4
Belgium	2.0	1.7	0.9	0.5	1.0	0.0	0.2	0.3	0.4	1.5	1.7	1.8
Germany	1.6	1.7	1.0	1.2	1.6	0.7	-0.3	-0.3	0.8	1.1	2.1	2.1
Estonia	2.3	3.0	2.1	1.7	1.5	-1.4	0.2	0.7	1.2	2.3	2.1	2.1
Ireland	0.9	1.3	0.6	0.8	0.8	-0.6	-0.9	-0.1	0.2	0.5	1.4	1.2
Greece	0.8	0.6	0.2	0.4	0.6	-1.1	-0.9	-1.0	-0.8	0.4	1.1	1.3
Spain	1.1	1.1	0.4	0.5	0.7	-0.6	-0.3	-0.3	0.1	1.5	1.1	1.0
France	1.4	1.3	1.2	1.3	1.3	0.3	0.6	0.3	0.7	0.5	1.1	0.5
Italy	1.0	0.9	0.3	0.3	0.2	-0.2	-0.1	0.0	0.2	0.9	1.1	1.1
Cyprus	1.3	0.6	0.1	0.2	0.6	-1.7	-0.5	-0.5	0.2	1.3	0.8	0.9
Latvia	2.8	3.3	2.8	2.1	1.9	-0.7	-0.1	0.4	0.8	2.5	2.4	2.3
Lithuania	2.1	2.5	2.3	2.0	2.5	0.6	-0.3	0.5	0.9	1.8	1.7	1.7
Luxembourg	2.1	2.0	1.4	1.2	1.6	-0.9	-0.2	0.1	0.2	2.5	1.7	1.5
Malta	1.2	1.7	1.8	1.3	1.2	1.0	0.5	0.6	0.9	1.0	1.3	1.4
Netherlands	2.5	2.7	2.8	2.7	1.3	1.2	0.6	0.7	1.2	1.3	1.2	1.1
Austria	1.6	1.7	1.3	1.4	2.0	0.7	0.3	0.3	0.7	1.5	1.3	1.2
Portugal	0.8	0.6	-0.3	0.2	0.5	-0.2	-0.1	-0.2	0.4	1.7	1.4	1.2
Slovenia	1.3	1.7	2.1	1.6	1.6	-1.2	0.4	0.1	0.4	0.8	1.4	1.9
Slovakia	2.4	2.6	3.0	3.1	2.9	2.0	1.5	1.4	0.5	0.8	0.9	1.2
Finland	1.2	1.3	1.1	0.9	1.1	-0.1	0.0	0.5	0.9	1.3	1.2	1.1
Euro area	1.4	1.4	1.0	1.0	1.1	0.2	0.0	0.0	0.6	1.0	1.4	1.3
Bulgaria	2.5	2.8	2.2	2.3	3.0	1.0	0.0	0.2	-0.1	1.0	1.6	1.7
Czechia	2.3	2.4	2.6	3.0	3.7	3.0	2.3	2.2	1.8	2.2	2.4	2.5
Denmark	1.2	0.7	0.4	0.7	0.6	0.1	0.3	0.4	0.7	1.4	1.2	1.3
Croatia	0.8	0.8	0.7	0.9	1.2	-0.3	0.3	0.6	0.9	2.0	1.6	1.3
Hungary	3.2	3.8	3.1	3.5	4.4	2.6	3.8	3.5	2.9	3.6	2.3	2.2
Poland	1.2	2.2	2.5	2.6	3.9	3.1	2.5	1.3	1.0	2.1	3.6	4.5
Romania	3.8	4.3	3.9	3.7	3.1	2.3	2.3	2.3	2.5	3.0	2.8	2.9
Sweden	1.9	1.9	1.4	1.7	1.2	0.1	0.5	0.5	0.6	1.3	1.2	1.3
EU	1.5	1.6	1.2	1.3	1.5	0.4	0.2	0.2	0.7	1.2	1.6	1.5
P.M.: United Kingdom	*1.8*	*2.0*	*1.9*	*1.4*	*1.7*	*0.6*	*0.6*	*0.7*	*0.8*	*1.1*	*1.5*	*1.7*

Box .1: Some technical elements behind the forecast

The summer 2020 interim forecast provides an update of the outlook of the spring 2020 forecast of 6 May 2020 and focuses on GDP and inflation developments in all EU Member States.

Given that the future relations between the EU and the UK are not yet clear, projections for 2021 are based on a purely technical assumption of status quo in terms of their trading relations. This is for forecasting purposes only and reflects no anticipation or prediction with regard to the outcome of the negotiations between the EU and the UK on their future relationship.

The United Kingdom withdrew from the European Union as of 1 February 2020. The Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and European Atomic Energy Community (OJ L 29, 31.1.2020, p. 7) entered into force on the same date. It provides for a transition period which will end on 31 December 2020. During the transition period, Union law, with a few exceptions, is applicable to and in the United Kingdom. For the purposes of Union law applicable to it during the transition period, the United Kingdom is treated as an EU Member State, but will not participate in EU decision-making and decision-shaping.

The cut-off date for taking new information into account in this forecast was 30 June 2020.

ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounting (ESA 2010). Due to differences in revision schedules of annual and quarterly national accounts, annual and quarterly figures may not be fully consistent for some Member States. 2020 and 2021 are forecast years.

External assumptions

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 15 and 26 June) were used for exchange and interest rates, and for oil prices.

The technical assumption regarding exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to an implied average USD/EUR rate of 1.11 in 2020 and 1.12 in 2021. The average JPY/EUR is 119.83 in 2020 and 120.40 in 2021.

Interest rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. As a result, short-term interest rates are assumed to be -0.4% in 2020 and -0.5% in 2021 in the euro area. Long-term euro area interest rates are assumed to average -0.4% in 2020 and 2021.

Commodity price assumptions are also based on market conditions. According to futures markets,

Table 1:
Technical assumptions

		Summer 2020 interim forecast		***Spring 2020 forecast***	
	2019	**2020**	**2021**	**2020**	**2021**
3-month EURIBOR (percentage per annum)	-0.4	**-0.4**	**-0.5**	*-0.3*	*-0.4*
10-year government bond yields (percentage per annum) (a)	-0.3	**-0.4**	**-0.4**	*-0.4*	*-0.3*
USD/EUR exchange rate	1.12	**1.11**	**1.12**	*1.09*	*1.09*
JPY/EUR exchange rate	122.05	**119.83**	**120.41**	*118.35*	*117.78*
GBP/EUR exchange rate	0.88	**0.89**	**0.90**	*0.87*	*0.87*
EUR nominal effective exchange rate (annual percentage change) (b)	-1.2	**2.4**	**1.0**	*1.5*	*0.5*
Oil price (USD per barrel)	64.1	**41.8**	**43.1**	*38.4*	*40.2*
Oil price (EUR per barrel)	57.2	**37.6**	**38.3**	*35.1*	*36.9*

(a) 10-year government bond yields for the euro area equal the German government bond yields.
(b) 42 industrial countries EU TR CH NR UK US CA JP AU MX NZ KO CN HK RU BR.

(Continued on the next page)

Box (continued)

prices for Brent oil are projected to be on average 41.8 USD/bbl in 2020 and 43.1 USD/bbl in 2021. This would correspond to an oil price of 37.6 EUR/bbl in 2020 and 38.3 in 2021.

Trade policies

This forecast is published against a background of elevated trade tensions. The forecast pencils in only the measures that have been implemented until the cut-off date. Compared to the spring forecast, there have been no changes to the baseline scenario.

Working-day adjustment

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are. The working-day effect in the EU and the euro area is estimated to be limited in 2020 and 2021, implying that working-day adjusted and unadjusted annual growth rates differ only marginally (by up to ±0.1pps.).

Geographical zones

Euro area: EA19 (BE, DE, EE, IE, EL, ES, FR, IT, CY, LV, LT, LU, MT, NL, AT, PT, SI, SK and FI).

European Union: EU (EA19, BG, CZ, DK, HR, HU, PL, RO, and SE).

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