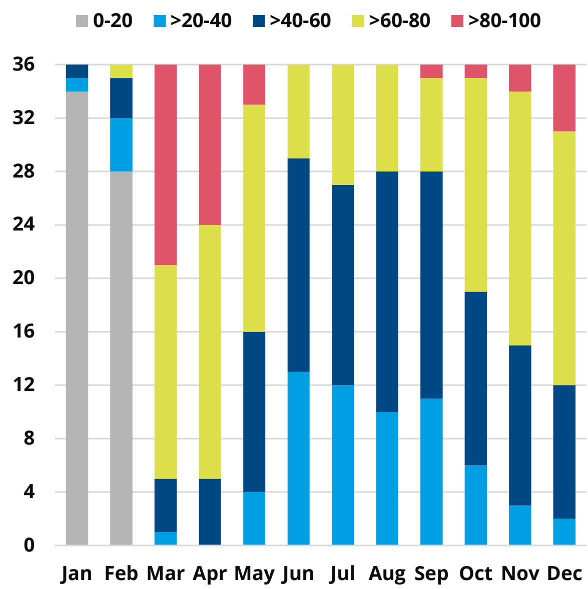
# Creditreform Economic Briefs: Between Lockdowns and Vaccines

One conclusion from the extraordinary year 2020 will have to be that the Covid-19 pandemic has inflicted tremendous economic and social damage on economies worldwide, requiring an unprecedented fiscal and monetary policy response that was delivered considerably faster than during the global financial crisis. The former will lift general government deficits and debt levels to new historical heights, whereas the latter will support affordability thereof for the time being, as financial market conditions remain benign.

Figure 1: Advanced economies implementing more stringent Covid-19 policies again

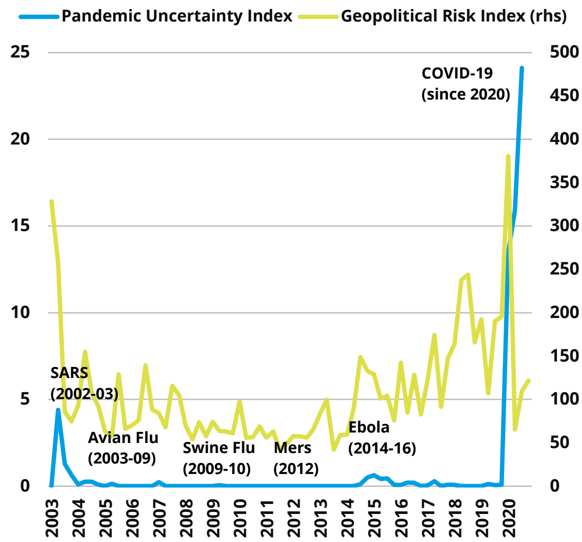
Government Response Stringency Index (100 = strictest response) based on indicators including e.g. workplace closures and travel bans, number of advanced economies (IMF country classification) at the end of a respective month (in 2020)




Sources: Creditreform Rating, Blavatnik School of Government

Global real GDP will have seen a record slump in 2020, far exceeding the fall in 2009 resulting from the global financial crisis. Nevertheless, there seems to be light at the end of the tunnel, as rapid progress was made in developing vaccines against Covid-19, with the first wave of immunization having started in a large number of countries at the turn of the year. However, progress was not fast enough to prevent new lockdowns in numerous countries, as infection numbers had reached dangerous levels over the course of Q4-20, threatening to overwhelm health systems. Public life forced to a virtual standstill again (see Figure 1) will lead to a weak start into 2021 and, in tandem with extended aid measures, add to the fiscal burden, before wider immunization should enable a broad-based economic recovery in the course of the year. That said, uncertainty over the evolution of this health crisis remains exceptionally high (see Figure 2), and any delays in rolling out the vaccines – or limited effectiveness thereof in practice – will mean that the recovery remains prone to setbacks.

Figure 2: Covid-19 triggered massive increase in uncertainty, while pandemic-related geopolitical risks seem to abate



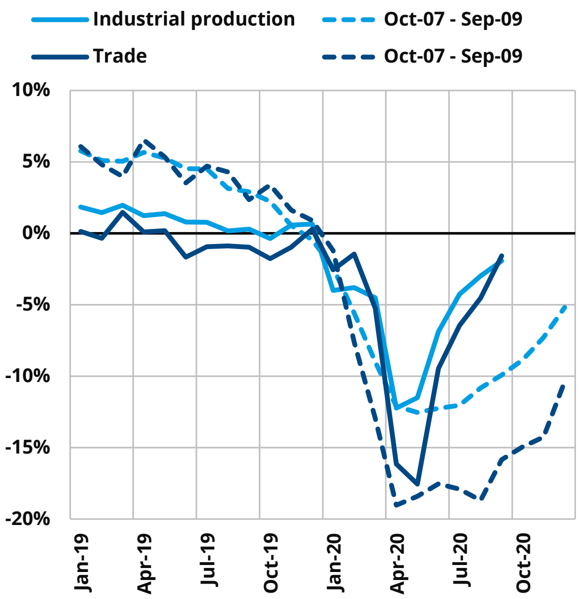

Sources: Creditreform Rating, Caldara and Iacoviello, Ahir, Bloom, and Furceri

*V-shaped recovery in global economic growth still base case scenario*

In October 2020, the International Monetary Fund (IMF) slightly increased its forecast for global real GDP growth to -4.4% for 2020, up from -4.9% in June, while lowering the outlook for 2021 somewhat to 5.2%, from 5.4% in June. For 2022, the IMF expects global output to expand by 4.2%. The global trade volume is set to see a steep decline of -10.4% in 2020, before recovering by 8.3% in the current year, not least thanks to a comparatively fast rebound in global export activity (see Figure 3). The recovery of China's economy where the spread of the virus apparently could be reined in relatively quickly also played an important role in this regard. External demand boosted by demand for medical equipment as well as equipment for teleworking helped to limit China's economic slowdown to about 1.9% in 2020, whereas output growth is expected to bounce back to 8.2% this year.

Figure 3: Global economic activity recovering significantly faster than in the wake of the Global Financial Crisis

Annual growth in global industrial production and merchandise world trade, monthly data; dotted lines representing respective development in the period October 2007 to June 2009




Sources: Creditreform Rating, Centraal Planbureau (CPB)

As to the US economy, where compared to many European countries restrictions seem to have been less severe, latest estimates of the Federal Reserve Open Market Committee foresee real GDP to shrink by 2.4% in 2020, before bouncing back by 4.2% in 2021. Compared to the September projection, this constitutes an upward revision.

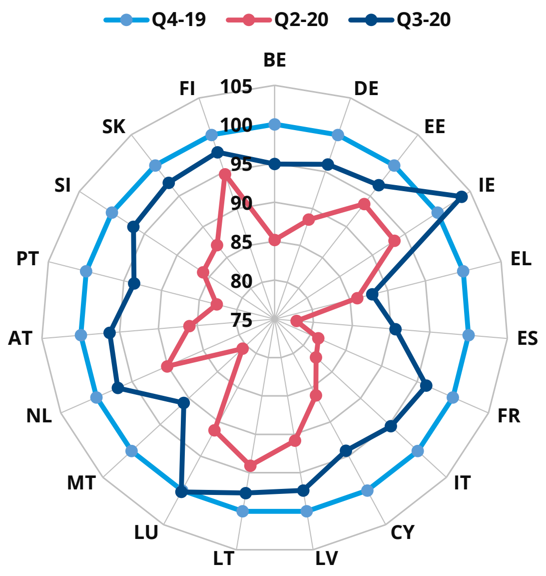
Overall, advanced economies should experience a more drastic downturn than emerging market and developing economies in 2020, with real GDP forecast to shrink by 5.8% this year, against -3.3% in emerging market and developing economies. For 2021, the IMF expects advanced economies to post GDP growth of 3.9%, which should be clearly outpaced by the 6.0% assumed for the emerging and developing economies. However, excluding China, the outlook for many emerging and developing markets remains less positive, as the pandemic poses grave challenges to health care systems and as popular tourism destinations are heavily afflicted by this crisis. In such a context, the trade agreement (RCEP) struck among Asian-Pacific countries in mid-November last year, creating the largest trade bloc in the world and comprising Australia, Brunei, Cambodia, China, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, South Korea, Thailand, and Vietnam, certainly comes as constructive news. Although still at a more preliminary stage, the Comprehensive Agreement on Investment (CAI) between China and the EU, announced on 30 December, also remains one to watch.

### *Euro area: In sickness and in health*

Despite extraordinarily strong economic growth in Q3-20, euro area GDP will likely register an unprecedented setback in 2020. Following a dramatic fall in GDP in the first half of 2020 (Q2-20 vs. Q4-19: -15.0%), the third quarter saw a significant rebound in economic growth (12.5% q-o-q) as restrictions in most countries were gradually lifted, enabling first and foremost the release of pent-up private consumption. Having said that, amplitudes of declines and rebounds were uneven across euro area members (see Figure 4), depending above all on the economic structure and cyclical situation at the onset of the crisis, the strictness and duration of the shutdowns, the scale and speed of targeted aid measures deployed and, more generally, on structural features such as available infrastructure to work remotely.

Figure 4: Covid-19 prompting an uneven contraction – and recovery – during the crisis

Real GDP, index (Q4-2019 = 100)



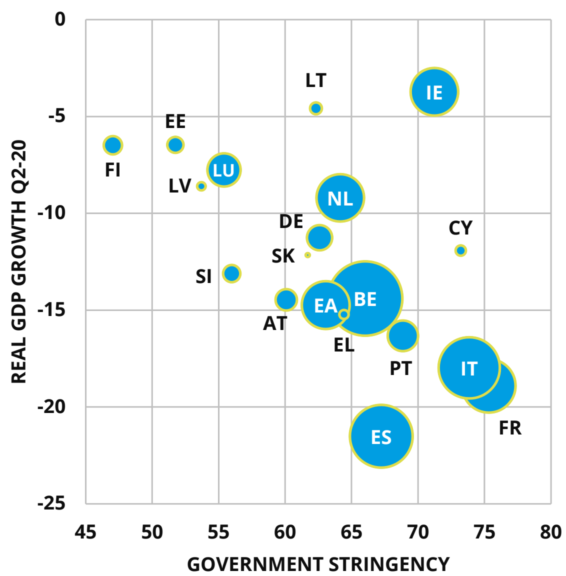

Sources: Creditreform Rating, Eurostat

With the renewed infection wave requiring a new round of confinement measures in Q4-20, prospects for the turn of the year have clouded, suggesting a weak start into 2021 as the lockdown in many countries will last well into January, and very likely beyond. At the same time, patterns will continue to diverge – not least depending on strictness and duration of the restrictions (see Figure 5). At present, confinement measures still appear less severe in many economies than during the first lockdown phase in March/April of last year.

Moreover, acting supportively, the industry and construction sectors are less affected by downtime at this stage. For the euro area as a whole, we now expect the economic output to contract by 7.6% in 2020, with strong declines in private consumption and trade data, as well as a devastating outturn in gross fixed capital formation, as uncertainty was weighing heavily on the near-term prospects especially in the first half of last year. Government consumption, on the other hand, should have contributed positively. Among the four major euro area economies, we expect the German economy to have posted the smallest decline in 2020 (see below), whereas Spain and Italy are set to have experienced markedly steeper fall, heading for a double-digit percentage contraction against 2019, exacerbated also by a larger exposure to the especially hard-hit tourism sector.

Figure 5: Renewed wave of infections should weigh heavily on economic developments at the turn of the year

Real GDP growth annual percentage change, Government Response Stringency Index: average Mar-Jun, size of bubbles: Number of Covid-19 deaths per 1 million population (30-06-20)




Sources: Creditreform Rating, Eurostat, Blavatnik School of Government, ECDC

### *New round of lockdowns entailing less severe economic damage than in spring 2020*

While the magnitude of negative effects from the present confinement phase remains uncertain as this depends on how long public life will be muted, our base case remains a recovery over the course of 2021, backed by the sizeable support packages provided on the national level as well as on the European level. We also assume that lockdowns will be less of an issue from Q2. The recovery should be driven by a pick-up in domestic demand, although precaution may prevail until there is growing conviction that the pharmaceutical means to combat this crisis are effective and sufficient in quantity to cater for wide immunization. Against the backdrop of generous schemes to maintain jobs and incomes, private consumption should remain cushioned, presumably representing the main growth engine in the euro area. Trade activities are set to strengthen, too, once shops and restaurants are allowed to open again. Gross fixed capital formation should recover as well, albeit somewhat more hesitant than the other growth components.

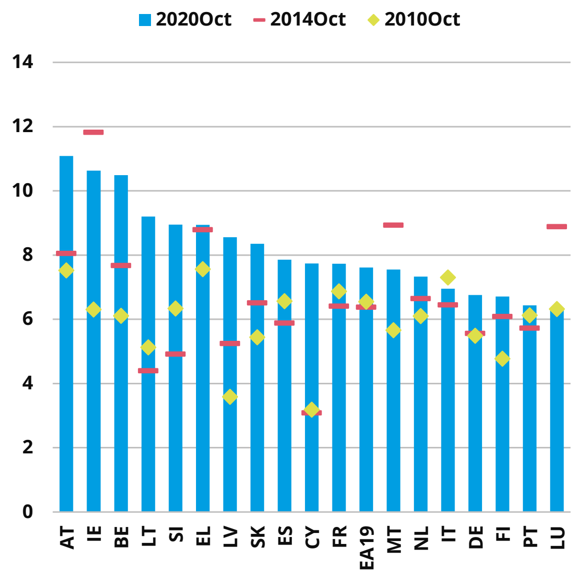
Swift and successful vaccination of the population and growing confidence in herd immunity clearly constitutes a key requirement for a stronger economic rebound in countries highly exposed to tourism, in particular smaller economies such as Greece or Cyprus, but also major economies such as Spain or Italy. Generally, the outlook for the service sector remains less upbeat at the current juncture, as also reflected in December's service PMI which may not fully include the negative effect from extended and/or intensified lockdowns. The indicator posted at 46.4 – still in contractionary territory. Contrary to that, the industrial sector still proves supportive, as reflected in the manufacturing PMI, which in December climbed to 55.2 points, its highest level since May 2018.

The ECB delivered the expected addition to and extension of its accommodative monetary policy in December. The PEPP envelope was increased by EUR 500bn to a total of EUR 1,850bn, while the horizon for net purchases under the PEPP was extended to at least the end of March 2022. Along with extended and enhanced refinancing operations (TLTRO, PELTRO), this should prolong the benign financial market environment for the time being, thus not only decisively contributing to affordability of high government debt levels (see Figure 6), but also ensuring favorable financing conditions for companies' investment once confidence has returned.

Over a more medium term, the large-scale funds provided via NextGenerationEU (NGEU) amounting to EUR 750bn, along with allocations to be made under the new Multiannual Financial Framework (MFF) 2021-27 that comprises EUR 1.074trn (in 2018 prices), should lend significant clout to plans currently being drawn up by the EU countries to drive forward the digitization and greening of their economies.

Figure 6: Concerns regarding public debt sustainability mitigated by diminishing rollover risks

Average weighted maturity of government debt securities, measured in years




Sources: Creditreform Rating, ECB

According to the political agreement reached between the European Council and the European Parliament on the Recovery and Resilience Facility (RRF), which represents the largest chunk of NGEU, on 18 December, the EU member states would have to dedicate a minimum of 37% of expenditure on investments and reforms contained in each national recovery and resilience plan to climate objectives. A minimum of 20% should be directed towards the digital transition. To monitor progress also in terms of implementation, a scoreboard is to be established and made available to the public. With a view to the envisaged timeline, first disbursements could be made towards the end of the first quarter 2021.

*Despite silver lining on vaccination front, risks to our growth forecast still skewed to the downside*

At this point in time, we expect the euro area's real GDP to bounce back by about 3.5% in 2021. Downside risks would relate to delays in rolling out the vaccines, or limited effectiveness thereof, also in view of new virus mutations, as this would maintain susceptibility to new infection waves and associated restrictions. In such a scenario, a rising number of insolvencies and job losses is very likely, with negative reverberations to private consumption, trade and investment, highlighting the risk of deeper scarring of the economy.

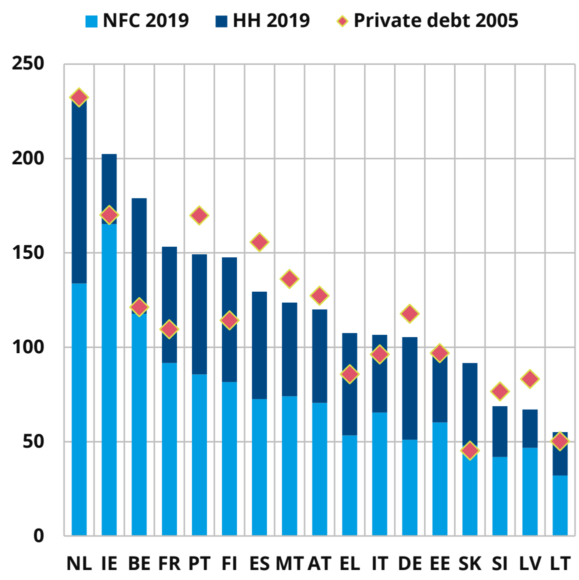
Moreover, fiscal burdens would continue to grow, potentially diminishing the space to tackle structural challenges in a timely fashion. Partly related to that, dynamics of private debt will have to be monitored with a view to possible challenges to macro-financial stability, for debt moratoria, waivers as regards regulation on insolvency procedures and suspended macro-prudential tools are widely envisaged to be phased out in the course of 2021 (see Figure 7). So far, negative reverberations on the banking sector have remained limited, not least as banks are in a markedly stronger position in terms of risk buffers, i.e. lower NPL ratios, than at the onset of the global financial crisis.

Set against such risks are a number of positive factors that give reason for more optimism. As has been noted in the past, Europe seems to be progressing towards a higher degree of political and economic cooperation and integration only in times of crisis. In this vein, it took a pandemic for a swift and hearted response on the fiscal and the monetary policy level. Thus, the pandemic has resulted not only in an exceptional empowerment of the European Commission to borrow on capital markets to fund the crisis repair via grants and loans (NGEU), but also in a possibly decisive push to advance the digital transformation of the European economy.

Apart from a growing current of medical means potentially suitable to sustainably suppress the spreading of the coronavirus, the outlook for a more cooperative international trade environment seems to have brightened following the US election, which could add some fuel to trade activities. The same should hold true regarding the UK-EU post-Brexit deal now in place (see below). Despite leaving large gaps as regards trade in services, the deal points to willingness on both sides to find a compromise after all. Although still at an early stage, the advancements made with respect to the EU-China investment agreement, which aims to ensure better access to the Chinese consumer market for EU investors, and for providing a level playing field vis-à-vis China, would add favorably to prospects further out.

Figure 7: Private debt developments should be monitored against the backdrop of financial stability

Consolidated private debt of non-financial corporations and households, measured in % of GDP, total private sector debt for 2005




Sources: Creditreform Rating, Eurostat

In addition, we think the ECB will maintain a very accommodative stance for the foreseeable future, thus contributing to favorable financial market conditions that would also support fiscal sustainability, not least as it makes debt more affordable than in the past. To this end, concerns over record highs in public debt levels that in some cases aggravate sovereign credit weaknesses are mitigated to an extent. Given all these points, there also appears to be room for upside surprises in 2021, besides significant downside risks from possible delays of vaccination activity. For 2022, we currently envisage relatively broad-based GDP growth of about 4.0%, which would ultimately lift GDP over the level seen before the corona crisis struck.

### *There is no free lunch*

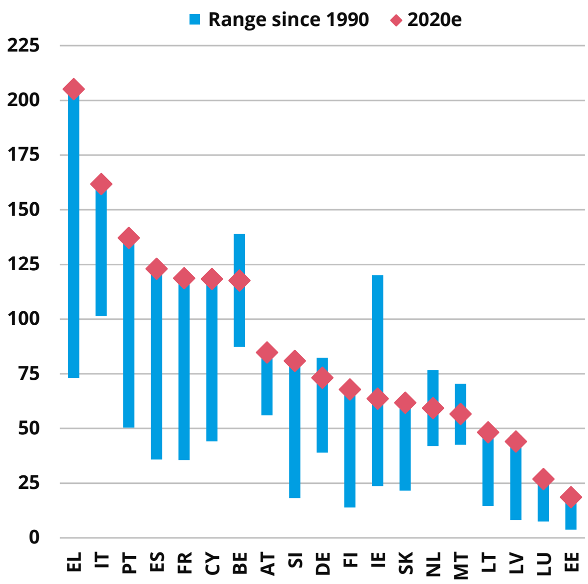
While the corona crisis seems to have become an important catalyst for investment in digitalization, artificial intelligence, innovative technologies and human capital, there are also some unpleasant risks at the horizon that may have to be dealt with once the acute phase of the pandemic has been overcome. A possible legacy may include a delayed wave of insolvencies and job losses when exceptions on debt servicing, insolvencies, and macroprudential regulation are expiring, as it seems conceivable that a larger number of non-viable companies has been kept alive through the rescue policies.

The exit from the unprecedented aid measures will be a huge challenge that should not be underestimated by European governments. Permanent economic support may result in overstretched public finances, and an increasing zombification of the corporate sector which would weigh on the economy's growth potential. On the other hand, exiting too early from supporting corporate liquidity may cause a wave of insolvencies and negative repercussions on the labor market and banking sector. In 2021, decision-makers will thus find themselves walking a tightrope.

As far as record-high public debt (see Figure 8) and affordability thereof is concerned, the latter seems to hinge very much on ongoing accommodative monetary policy, thus increasing political pressure on the ECB to act accordingly. With ongoing split opinions on how to lower public debt – or whether at all – among euro area members, political controversy over these issues may resurface further afield, possibly intensifying political fragmentation or even cause actual political power shifts towards parties advertising a degree of re-nationalization within some member states. In view of continued low interest rates, pressure on financial market participants to find alternative ways of investing will thus remain high, potentially fostering bubble-like developments in asset classes other than fixed income.

Figure 8: Government debt reaching historically high levels in the euro area

General government debt-to-GDP-ratio, candle sticks representing the range over 1990-2020, IMF forecast for 2020




Sources: Creditreform Rating, Eurostat, IMF

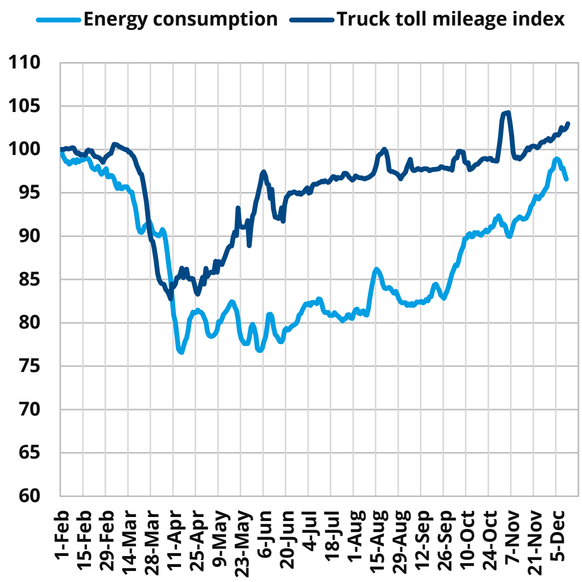
### *German GDP growth likely to slow down at the turn of the year*

Following the largest quarterly contraction in total output since World War II in Q2-20 (-9.8% q-o-q), Germany's real GDP rebounded by 8.5% in the third quarter of 2020, chiefly driven by private consumption (delivering 5.8 p.p.) and net exports (+3.9 p.p.). Higher frequency data depicting energy consumption or reflecting road traffic clearly depicts resuming activity as public life started to normalize from May 2020 (see Figure 9). Contrary to that, and highlighting the more mechanical nature of rebounding consumption and trade as public life resumed amid gradually lifted restrictions from May, investment activity continued to shrink (-1.2 p.p.), reflecting the persistently high level of economic uncertainty.

Germany's economic recovery was also mirrored by rising industrial production, which was less affected by partly ongoing cautious consumer behavior than consumer-facing services. However, despite posting continued monthly increases since May, Germany's industrial production (including construction) in Oct-20 still fell about 3% short of its pre-crisis level at the end of 2019. A more positive picture emerges regarding manufacturing orders, which kept rising since May and by October were back at pre-corona level. The rise in retail sales following the end of the first lockdown phase includes the release of pent-up demand, with the Oct-20 reading surpassing Dec-19 by 7.5%.

Figure 9: Real-time indicators signaling normalization of economic activity in Germany

Moving 7-day average, 1 February 2020 = 100




Sources: Creditreform Rating, Bundesnetzagentur, Statistisches Bundesamt

Generally supporting the recovery in Germany were costly aid measures to sustain jobs and thus household income, ensure sufficient liquidity to companies and prop up the health sector. Thanks to suspended obligation to file for insolvency, by now extended until the end of January 2021, subject to certain conditions, a wave of delinquencies could so far be avoided. According to the national statistical office, the number of insolvencies from Jan-Sep-20 was 13.1% below the number observed in the same period of the preceding year.

Against this backdrop, the situation on the German labor market has deteriorated only gradually over the last few months, with the unemployment rate increasing to 4.5% in Oct-20 from 3.3% in Dec-19 (LFS, Eurostat), after reaching an all-time low mid-2019. With that, the rate remains one of the lowest in the euro area (Oct-20: 8.5%). According to provisional estimates based on the Labor Force Survey, the number of unemployed people in Germany rose by 474,000 (+34.5%) in 2020 against the preceding year, to an annual average of 1.85mn. Heavy use of the short-time work scheme to retain staff has prevented worse during the first lockdown in spring, with the number of short-term workers reaching a historical high close to 6 million people in April 2020. Thanks to resuming economic activity in Q3-20, the number dwindled to about 2.2 million in Sep-20. Overall employment shrunk by 1.1% in 2020 versus 2019. In absolute numbers, services registered the strongest job loss (-281,000), corresponding to -0.8%. While employment in the industrial sector (excluding construction) declined by 2.3%, the construction sector delivered positive impulses (+0.7%).

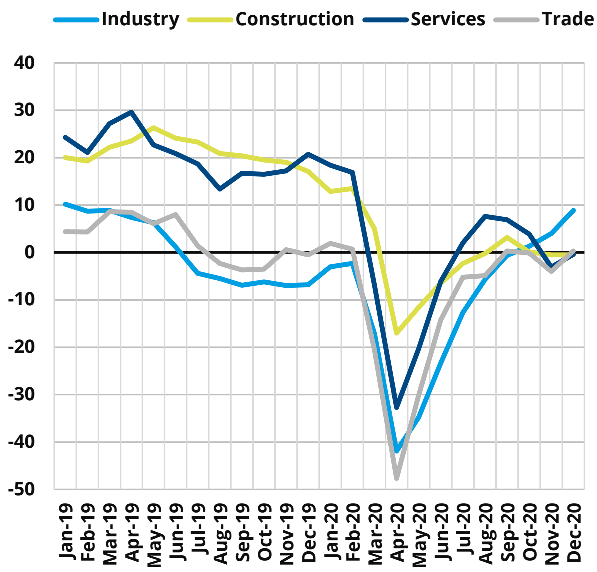
*Industrial sector likely to be more supportive than during the first infection wave*

Amid dramatically rising Covid-19 infection numbers, Germany entered a so-called lockdown light from 2 November 2020, during which non-essential shops remained open, whereas restaurants, cafes, sports facilities and cultural centers had to close. However, upon realizing that the restrictions failed to substantially lower the number of positive corona cases, among other things expressed by a persistently increasing cumulative 14-days number of Covid-19 cases per 100 000 inhabitants, the lockdown was strengthened from 16 December 2020, with all non-essential shops having to close and with stricter rules applied for any gatherings. Initially envisaged to last at least until 10 January 2021, the current confinement measures have been extended to 31 January, along with the introduction of stricter rules on movement, aiming to bring down Covid-19 cases to a satisfyingly low number that would allow tracing of chains of infections.

For the time being, we would expect the new confinement measures to exert a less detrimental effect on real GDP than in Q2-20, due to a less detrimental impact on manufacturing and construction, adapted behavior of the working-age population, and as viable hygiene concepts are widely in place. Nevertheless, as mentioned above, economic damage would increase with the length of the shutdown period. For some, such as the retail sector or the recreational sector, the vaccination campaign that started on 27 December cannot come soon enough, as the consequences of a second phase of imposed inactivity could be severe. Estimates by the German Trade Association (HDE) suggest that among 560,000 workplaces in retail trade in cities centers, between 150,000 and 250,000 might disappear.

Figure 10: Softer impact of second Covid-19 wave due to targeted restrictions

Sectoral ifo business climate , balances, seasonally adjusted




Sources: Creditreform Rating, ifo Institut

Given the current circumstances, real GDP will likely contract in Q4-20 from a q-o-q perspective, or stagnate at best. Sentiment indicators for October and November underscore this expectation, with the German ifo business climate index falling in October and November, but improving in December, to 92.1 points, hence still below the level reached in September following a brightening outlook. In particular, sentiment in the retail and service sectors suffered in October and November, whereas expectations regarding the manufacturing sector improved, surpassing pre-corona levels (see Figure 10). Tying in with that, the manufacturing PMI reached a 34-month high at 58.6 in Dec-20, thus strengthening the impression that the industrial sector should act as a supportive pillar in the current phase.

Consumer confidence, after a strong increase from June to August 2020, shifted into backward gear from September, deteriorating more strongly in December, and remaining far below its pre-crisis level, which hints at some downside risks to private consumption. However, we generally expect the latter to remain cushioned by the short-time work scheme which supports disposable income, as well as by the prospect of a more powerful economic recovery if and when vaccination activity has been stepped up decisively.

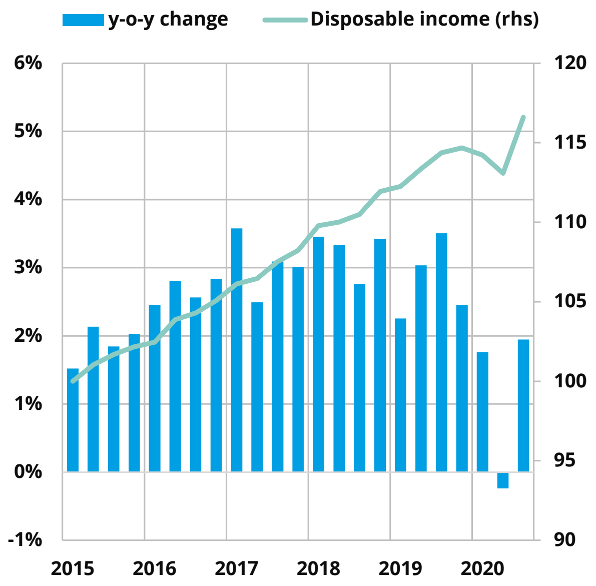
Overall, we now expect real GDP to shrink by about 5.8% in 2020, with strong declines in domestic demand as well as a negative contribution from net trade. Contrary to pronounced decreases in investment in equipment and machinery, construction investment should have delivered a positive contribution, also thanks to residential construction.

### *Robust labor market and disposable income paving the way for rebound in private household spending*

Looking ahead, we assume a rebound of real GDP growth to about 3.4% next year, backed by private consumption, which in turn should be supported by disposable income as the measures to combat the corona crisis have been extended well into this year (see Figure 11). Moreover, the minimum wage will be increased by 12% until 1 July 2022. Resuming or intensified trade activities should enable a positive contribution from net trade. As opposed to 2020, we would also expect gross fixed capital formation to contribute positively to growth, as investment in machinery and equipment should resume amid progressing immunization against Covid-19, which would be a sine qua non to a firmer economic recovery also among important German trading partners. Residential construction looks set to bolster investment, as housing demand remains strong, also reflected in an overhang of housing permits which from Jan-Aug-20 have increased by 1.4% y-o-y against the comparable period in 2019, and as financing conditions remain very benign. Tax incentives come on top of that.

Figure 11: Prerequisites for a solid recovery in private consumption appear to be in place

Households' disposable income per inhabitant, index (Q1-2015 = 100)




Sources: Creditreform Rating, Statistisches Bundesamt

With the prospect of substantial funds to many EU countries via NGEU, in particular the RRF, for which disbursement should start from 2021, Germany could be set to benefit from positive spillover effects. Germany itself will receive about EUR 15.2bn over 2021-22 in grants, subject to the EU's approval of a required plan setting out in detail how the country will be using the funds to advance its digital as well as its green agenda. In total, Germany will be allocated about 0.7% of 2019 GDP in grants and about 0.5% of 2019 GDP in loans from the RRF over the next few years. Not least in view of this likely tailwind to public and private investment, we would tentatively pencil in GDP growth to the tune of about 3.9% for 2022.

Uncertainty to our current forecasts relates among other things to the length of the present lockdown. An extension to this as well as delays in availability of vaccines would pose downside risks to our described base case. However, there are also circumstances that could foster a positive surprise this year, as a stronger rebound of trade activity in light of more cooperative behavior as regards international trade practices following the US election would be beneficial for Germany as a key trading partner. Likewise, the follow-up agreement on UK-EU trade struck at the last minute in December improves prospects for a recovery of external demand.

### *Limited fiscal and financial stability risks in Germany*

We note that fiscal sustainability risks appear remote at the current juncture. To combat the corona crisis and aid a recovery, the German parliament approved two supplementary budgets of EUR 156bn in March and another EUR 130bn in June in 2020, which will drive up public debt, although at an expected level of some 70% in 2020, Germany's debt-to-GDP level would still appear moderate from a European perspective.

In terms of financial stability, losses entailed by inevitably rising corporate insolvencies should be manageable for the German banking system – if corporate insolvencies develop roughly as in the wake of previous recessions, as projected by e.g. Deutsche Bundesbank. However, this is subject to high uncertainty, and as mentioned above, usual regulatory requirements regarding insolvency procedures are still partly suspended. With a view to private sector debt, Germany does not exhibit any excessive levels by European comparison, with non-financial corporations displaying a debt-to-GDP ratio of 62.9% in Q2-20 (euro area: 113.7%), and household debt standing at 56.4% of GDP (euro area: 60.5%). Developments pertaining to the residential property sector may have to be monitored, as, in an unfavorable scenario, risks to financial stability could stem from defaulting real estate loans in combination with collapsing property prices. At least in Q2-20, house prices have continued to rise rather dynamically in a year-on-year comparison, climbing by 6.6% (euro area: 5.0%).

With a view to the political landscape, Germany faces a pivotal year as Chancellor Merkel's final term draws to a close. CDU will presumably hold a party convention in mid-January to determine a new leader who will run as candidate for chancellor. According to current polls, CDU/CSU are on course to win the election, with a share of the vote moving around 36%, having benefited from their crisis management in this pandemic. A coalition with the Green party, which has dramatically gained support compared to the 2017 election, possibly more than doubling their share of the vote to about 19%, seems more likely than yet another Grand Coalition with SPD, which could suffer further losses, reaching only roughly 16% according to current polls. A black-green coalition could be expected to put more emphasis on sustainability topics and foster digitization more determinedly, while the pace of the transition towards higher use of renewable energy and its financing could harbor potential for conflict.

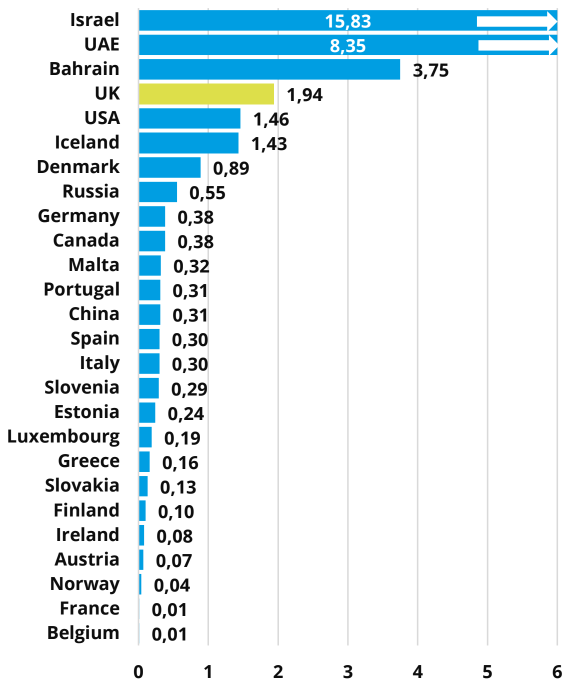
### *United Kingdom heading towards the worst recession since the Industrial Revolution*

Not only did the UK economy have to battle with ongoing Brexit-related uncertainty in 2020, the Covid-19 crisis took a heavy toll as well, meaning that 2020 could mark the worst recession for the UK in the last three centuries. As of 3 January 2020, the UK was the European country having to mourn the highest number of Covid-19 fatalities (71,109) only behind Italy (71,925). Against a strict lockdown, real GDP contracted by 18.8% q-o-q during Q2-20 (vs. -11.3% in EU-27), marking the sharpest drop compared to the remaining EU-27 members. With restrictions being gradually lifted in the third quarter, real GDP bounced back strongly, by 16.0%, driven above all by household consumption (+18.3% q-o-q) which had also received a boost by the 'eat out to help out' scheme to support the gastronomy, but also to some extent by a positive contribution from net external trade.

As in other European countries, new lockdown phases from November have deteriorated quarterly growth prospects for the winter half-year 2020/21, with private consumption likely to bear the brunt. On 4 January, stricter restrictions including stay-at-home orders for England and Scotland were announced, expected to last until mid-February. Having said that, the outlook for a meaningful recovery over the course of the year remains positive, not least as the UK is among the European countries that have advanced the most in terms of administering Covid-19 vaccinations, starting as early as 8 December. By 27 December, roughly 945,000 people had received their first injection (see Figure 12). Moreover, the country has become the first to use a second vaccine in the combat against the pandemic. The UK government plans that at least 10 million people should be vaccinated by April 2021.

Figure 12: Vaccinations have been administered comparatively swiftly in the UK

Total number of vaccination doses administered per 100 people in the total population, counted as a single dose, and may not equal the total number of people vaccinated; as of 5 January 2021 or latest available




Sources: Creditreform Rating, Our World in Data

*Post-Brexit trade deal: Johnson presenting a 1,246-page Christmas present*

In a last minute decision, on 24 December the UK and the EU finally agreed on a trade deal that entered into force from 1 January 2021, although still subject to approval by the European Parliament, following the end of the transition period. The new deal cements the absence of tariffs and quotas regarding goods trade, whereas terms on trade in services, especially in financial services, remain vague and subject to equivalence rules which are temporary by nature. While generally constructive, a lot of detail on concrete terms thus still remains to be fleshed out, leaving a considerable amount of uncertainty after all, which is likely to hamper gross fixed capital formation for the time being. With likely negative quarterly growth in Q4-20 and a rebound in Q1-20 becoming less likely as lockdowns are extended, we now expect GDP growth to fall by 11.5% in 2020, before recovering to roughly 4.8% this year.

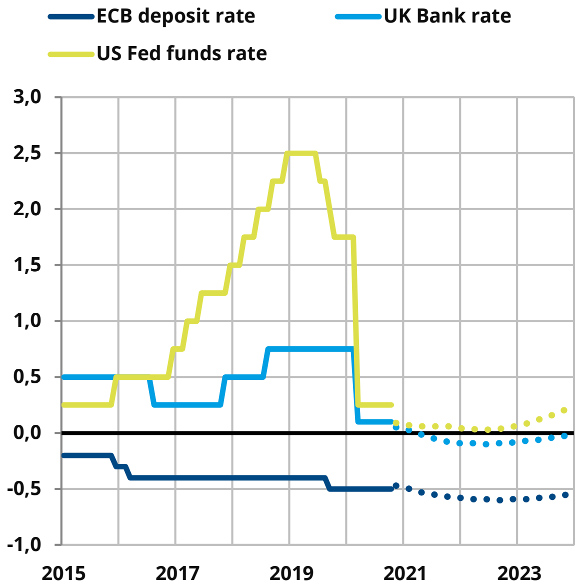
As everywhere, the quarterly profile remains very uncertain. While, crucially, the agreement provides for continued and sustainable air, road, rail and maritime connectivity, although not matching what the Single Market offered, the outlook to attract skilled labor may have deteriorated to some degree, given that EU citizens will need a work permit for the UK and a visa to stay for longer than three months. From a more institutional point of view, political cohesion may once more be put to the test, as Scotland's SNP, the current frontrunner in the polls ahead of Scotland's parliamentary elections in May this year, is exploring options to hold another Scottish referendum on independence from the UK.

Along with fiscal policy, monetary policy remains supportive to a recovery. At its December meeting, the Bank of England's Monetary Policy Committee unanimously decided to maintain the policy rate at 0.1%, the level in place since March 2020 (see Figure 13). The Committee also voted unanimously to continue with the program of GBP 100bn of government bond purchases and to start the previously announced program of GBP 150bn of government bond purchases, maintaining the target for the stock of these government bond purchases at GBP 875bn.

With the decision to also maintain the stock of sterling non-financial investment-grade corporate bond purchases at GPB 20bn, the target for the overall stock of asset purchases remains at GBP 895bn.

Figure 13: Key interest rates are set to remain lower for longer

Nominal policy rates, forward overnight index swap rates in the 15 business days to 28 October 2020, Fed funds rate depicted by upper bound of the target range




Sources: Creditreform Rating, Bank of England calculations

Figure 14: Real GDP forecasts are exceptionally uncertain

In %, IMF forecasts for World

| | 2010-19 | 2019 | 2020e | 2021e | 2022e |
|---|---|---|---|---|---|
| **World** | 3.7 | 2.8 | -4.4 | 5.2 | 4.2 |
| **Euro area** | 1.4 | 1.3 | -7.6 | 3.5 | 4.0 |
| **Germany** | 1.9 | 0.6 | -5.8 | 3.4 | 3.9 |
| **UK** | 1.8 | 1.4 | -11.5 | 4.8 | 4.4 |

Sources: Creditreform Rating, IMF

## CONTACT

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