Creditreform Rating

Creditreform Economic Briefs: Bumpy Recovery Amid Abnormal Uncertainty

More than a year into this global pandemic, limited albeit increasing availability of vaccines, smart vaccination strategies and ongoing substantial fiscal and monetary policy support are feeding economic recoveries. However, these remain fragile in light of virus mutations and struggles to suppress their spread, not least as many people and businesses are running out of patience amid repeated lockdowns. In the meantime, government debt has soared to new peaks. While debt affordability remains high for now, not least thanks to ongoing accommodative monetary policy, reducing debt levels will be a challenging task over the coming years, bearing in mind that in many countries the transformation towards greener and more digitized economic growth will have to be funded, along with the necessity to minimize any scarring effects from this crisis. Potentially difficult to achieve political consensus could make these tasks even more demanding.

Figure 1: V-shaped recovery masks regional divergence and is subject to unusually high uncertainty

Annual percentage change

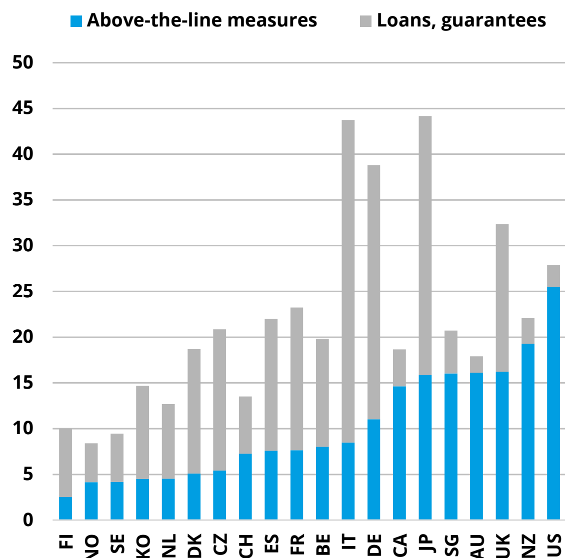
Sources: Creditreform Rating, IMF

In its WEO update from April, the IMF estimates that global GDP has contracted by 3.3% in 2020 (see Figure 1), representing a considerably steeper fall than witnessed during the global financial crisis. Nevertheless, this decline was milder than expected in October 2020 (-4.4%), as economic output especially in Q3-20 recovered somewhat more vividly on the back of easing of restrictions in many economies.

Despite resurging lockdowns from Q4-20, as infection numbers were approaching dangerous levels once more, the IMF has lifted its global GDP forecast from 5.2% to 6.0% for 2021, reflecting vaccination progress, extended and/or additional fiscal support and adapting behavior of businesses and consumers. Governments have provided about 9.2% of GDP in the form of spending measures or foregone revenue to combat the crisis since January 2020, flanked by about 6.1% of GDP in liquidity support including guarantees (see Figure 2). Moreover, cumulative Covid-19 vaccinations stood at about 973mn worldwide as of 22 April, or about 12.49 vaccination doses administered per 100 people.

Figure 2: Massive fiscal response to the pandemic, with the size of government support varying significantly across economies

In % GDP, above-the-line measures represent additional government outlays (to support the health system and mitigate the economic fallout) as well as foregone revenue



Sources: Creditreform Rating, IMF

For 2022, the IMF now expects a GDP growth moderation to 4.4% (October 2020: 4.2%). Due to the swifter and more sizeable fiscal and monetary policy response to the outbreak of the pandemic compared with the global financial crisis, scarring effects should overall be smaller, although the IMF reckons that this mainly applies to advanced economies, whereas Emerging Market and Developing Economies generally seem to be affected more severely by this health crisis. Real GDP of advanced economies is expected to rise by 5.1% this year, after a record contraction of 4.7% in 2020, and by 3.6% in 2022. While Emerging Market and Developing Economies are forecast to experience a stronger rebound of 6.7% this year, following a decline by 2.2% in 2020, this will be mainly driven by sharply rising growth in China (2021: 8.4%) and India (2021: 12.5%). In 2022, Emerging Market and Developing Economies' output expansion could moderate to 5.0%, with the Chinese economy expected to grow by 5.6%.

Chinese and US economy as drivers for global growth

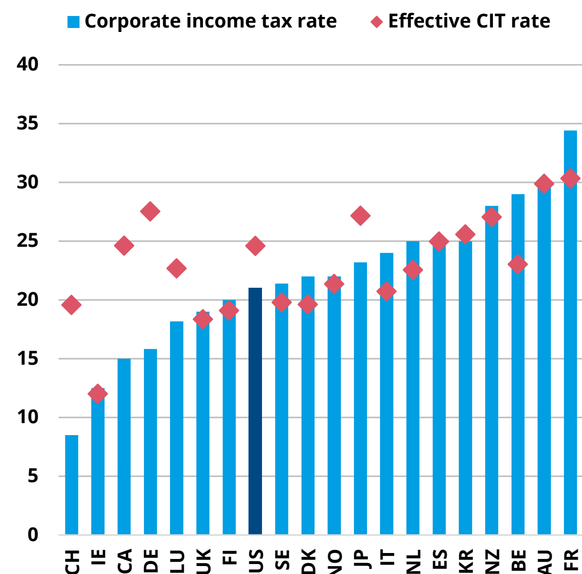
China's swift recovery from the pandemic played a vital role in reigniting global growth in the second half of last year, and will presumably continue to do so in 2021 and beyond. In 2020, it was the only major country to post positive GDP growth (2.3%), thanks to apparently very effective containment measures and material fiscal support.

Along with China, the US looks set to be a driver for global GDP growth as well. After a comparatively mild contraction in 2020 (-3.5%), the US has made good progress regarding vaccination (64.6 vaccinations per 100 people as of 21 April). Apart from that, in 2021, the USD 1.9tn Covid-19 Stimulus Package (The American Rescue Plan Act of 2021) signed off in March will boost the recovery, while the US Federal Reserve remains committed to maintaining an accommodative monetary policy stance. At its latest monetary policy meeting in March, the Federal Reserve raised its GDP growth projection for 2021 substantially from 4.2% to 6.5%. For 2022, it expects an economic expansion of 3.3%.

Along with the perception that the US is re-engaging with a number of international partners, the Biden administration also throws its weight behind introducing a global minimum corporate tax to establish a more level playing field in the taxation of multinational enterprises. This could deliver a decisive boost for the OECD to agree on a new regime, possibly as early as this summer, which may require multinationals to pay tax in the country where they generate profits and/or introduce a universal minimum corporate tax rate, with possible significant reverberations on international mobility of enterprises (see Figure 3).

Figure 3: Corporate tax rates may explain activities of multinational enterprises and shape government revenues

In %, statutory corporate income tax rate is the standard rate (central government level) that is not targeted at any particular industries or income type, effective average tax rate is average tax contribution a firm makes on an investment project earning above-zero economic profits



Sources: Creditreform Rating, OECD

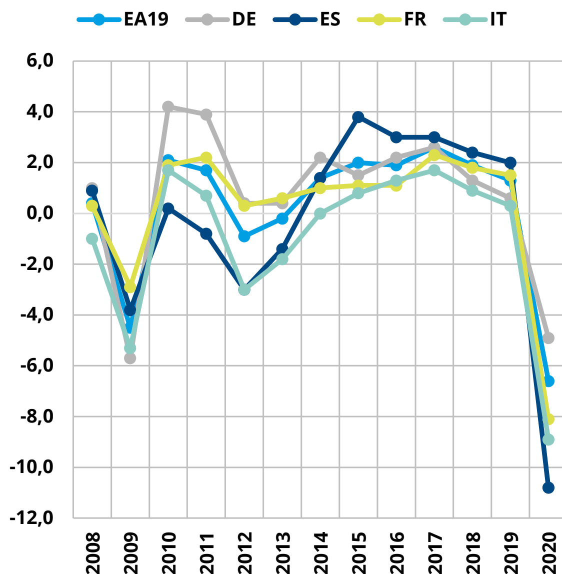
Euro area: Slow vaccination progress holds back stronger recovery

Slumping by 6.6% in 2020, the euro area's economic output registered a record fall under the impression of the Covid-19 pandemic last year, with pronounced divergence among the member countries, depending on their economic structure and position in the

business cycle when the virus broke out, the size and composition of their fiscal response and containment strategies including stringency thereof (see Figure 4). Among the four major euro area economies, Germany's GDP experienced the mildest fall, shrinking by 4.9%, whereas Spain registered a record contraction by 10.8%. French and Italian output fell by 8.1% and 8.9%, respectively.

Figure 4: Severe economic damage due to Covid-19, though medium-term output losses likely smaller than in the wake of the global financial crisis

Real GDP growth in %



Sources: Creditreform Rating, Eurostat

The quarterly real GDP profile has largely mirrored the epidemiological developments and related measures to contain the pandemic since its outbreak. Last year's second quarter thus saw a record-high decline among a comparatively strict first lockdown that had partly affected the first quarter as well, coming in at -11.6% q-o-q, followed by a rebound of 12.5% q-o-q in Q3. In the last quarter of 2020 the euro area economy contracted again (-0.7%) in the face of a second infection wave and associated restrictions to public life.

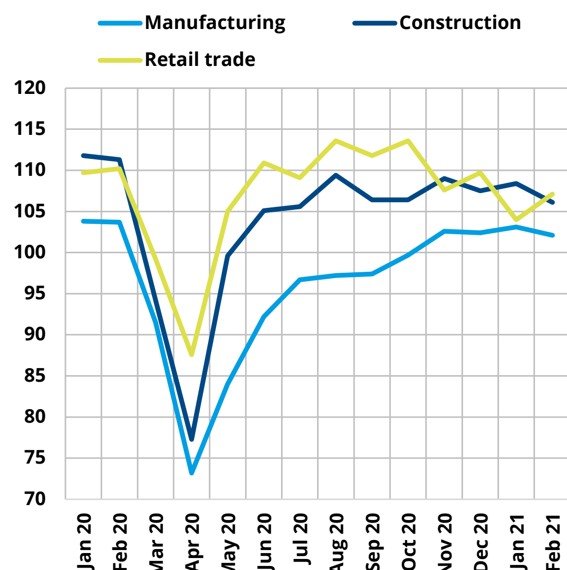
Ultimately, the overall annual contraction of euro area real GDP by 6.6% was somewhat less grave than expected in our last outlook earlier this year (-7.6%).

Private consumption bore the brunt of the decline, contributing -4.3p.p. to the overall fall in GDP, as it was heavily affected by the spring 2020 lockdown, while gross fixed capital formation took 1.8p.p. off GDP growth. With net exports posing a drag as well (-0.5p.p.), general government consumption was the only component to deliver a positive impact on GDP growth last year (0.3p.p.).

While the beginning vaccination campaign towards the end of last year seemed to mark the desired turning point in this pandemic, limited availability of globally coveted vaccines and safety concerns regarding some of these render the economic recovery fragile and prone to setbacks, as currently witnessed. Re-introduced or prolonged lockdowns amid a third wave of Covid-19 cases in a number of euro area countries has likely caused real GDP to contract again in Q1-21. That said, the decline will be less severe than seen in spring 2020, not least as the industrial sector as well as construction seem considerably less affected this time around and thus act as a stabilizing factor (see Figure 5). In addition, consumers and businesses have adapted their behavior.

Figure 5: Industrial and construction production less impacted during the second and third wave, buttressing economic activity in the euro area

2015 = 100

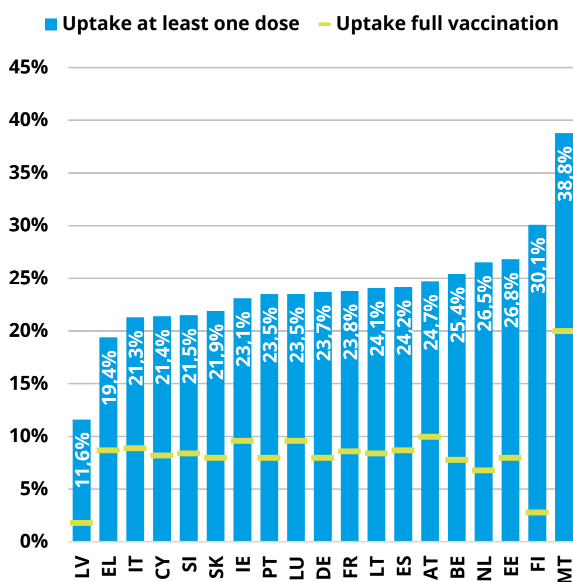


Sources: Creditreform Rating, Eurostat

In view of ongoing restrictions to public life, the initially anticipated recovery from Q2-21 is likely pushed back to the second half of this year. With vaccinations expected to progress faster over the next few months, a key requirement for a more stable recovery could finally fall in place, but remains subject to uncertainty not least as further emerging virus mutations may pose downside risks. As of 22 April, the cumulative uptake of the first vaccine dose among adults in the EU was at 23.7% (ECDC), with France (23.8%), Germany (23.7%) and Italy (21.3%) slightly below Spain (24.2%, see Figure 6).

Figure 6: Sluggish progress in terms of vaccination almost five months into the year

Cumulative uptake of at least one vaccine dose and full vaccination among adults (18+) as of 22-Apr-21



Sources: Creditreform Rating, ECDC

Economic developments thus remain contingent on the epidemiological situation, especially for economies with a high dependency on tourism such as Spain, Portugal, Austria, and Greece. In the meantime, governments continue to provide a substantial fiscal cushion. Especially the widely used furlough schemes to maintain employment have been extended until at least the middle of the year, as they are largely proving successful in limiting unemployment increases, thus providing support to household income and private consumption. Similarly, liquidity measures including provision of state-guaranteed loans to companies and/or direct support to companies in particularly hard-hit sectors contribute to keeping enterprises afloat, as do deferrals of taxes and payments and suspension of the obligation to file for insolvencies in some cases. Once these deferral policies expire in full, the number of bankruptcies may go up, and, in tandem with that, the unemployment rate.

Apart from fiscal policy, monetary policy looks set to remain very supportive, providing fertile ground for strengthening investment activities amid favorable financing conditions, once confidence in the ability to keep the epidemiological situation under control has returned. Crucially, the expected continuation of a benign financial market environment would also support affordability of public debt. The ECB's total Pandemic Emergency Purchase Program (PEPP) envelope currently comprises EUR 1,850bn, with the horizon for net purchases under PEPP to last until at least the end of March 2022. Moreover, net purchases under the Asset Purchase Program (APP) continue at a monthly pace of EUR 20bn. Besides, nonstandard refinancing operations (TLTRO, PELTRO) remain in place, as do collateral easing measures.

Brightening global trade outlook to support growth rebound

Our main scenario remains a recovery that should gain traction in the course of the second half of the year, as higher inoculation coverage will be reached. While consumer-facing services will remained hampered for the time being, limiting household expenditure dynamics to some degree, the global recovery especially in the industrial sector should prove supportive, not least fueled by the rapid Chinese economic recovery.

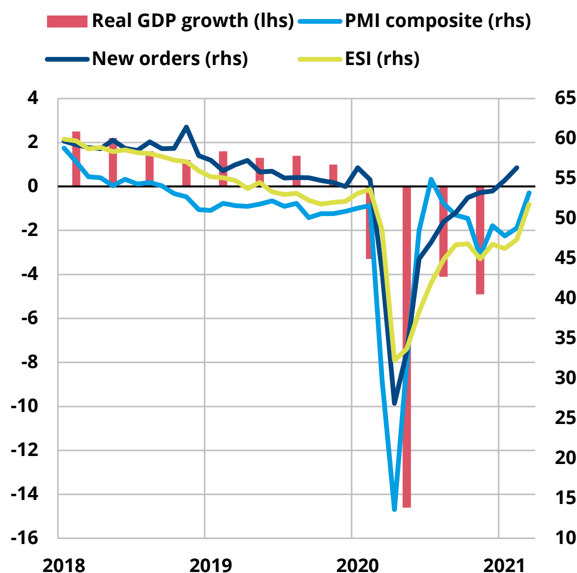
The composite Purchasing Manager Index (PMI) for the euro area rose to its highest level since last July in March (53.2), with the indicator for the manufacturing sector setting a new record at 62.5 and signaling considerable acceleration of business activities (see Figure 7). At the same time, the indicator for the service sector remained slightly in contractionary

territory (49.6), illustrating the current dichotomy of the economic recovery. Once restrictions are eased or even removed as wider immunization is achieved, pent-up demand should drive private consumption more substantially.

Figure 7: Euro area growth prospects brightening markedly, built on sizeable fiscal support and hopes on broader vaccine coverage throughout the year

LHS: y-o-y change in real GDP in %

RHS: Diffusion indices. Economic Sentiment Indicator (ESI) and New Industry Orders have been standardized and re-scaled to display the same standard deviation and mean values as the Purchasing Managers' Index (PMI)



Sources: Creditreform Rating, ECB, Eurostat, Refinitiv

A more conciliatory tone between the US and the EU since the new US administration took office backs expectations of a more cooperative international trade environment. With regard to the Trade and Cooperation Agreement between the EU and the UK, in force since 1 January, a major downside risk for trade was averted, although we note that ratification by the European Parliament is still pending. Moreover, a memorandum of understanding over financial services reached between the two jurisdictions in March gives rise to hopes for limited disruptions to financial services trade beyond any grace periods.

Expect NGEU to set impulses for making growth more sustainable

We continue to think that the EU level support program Next Generation EU (NGEU), first and foremost the Recovery and Resilience Facility (RRF), could provide decisive stimulus in some euro area countries, if implemented effectively, possibly starting from the second half of this year. Funds via this source will demonstrably have to go into fostering environmentally and socially sustainable growth as well as into digitization. First disbursements could be made later this year, once the national Recovery and Resilience plans, supposed to be submitted to the European Commission by 30 April, are assessed by the Commission and approved the Council.

Uncertainty over medium-term fallout from the crisis

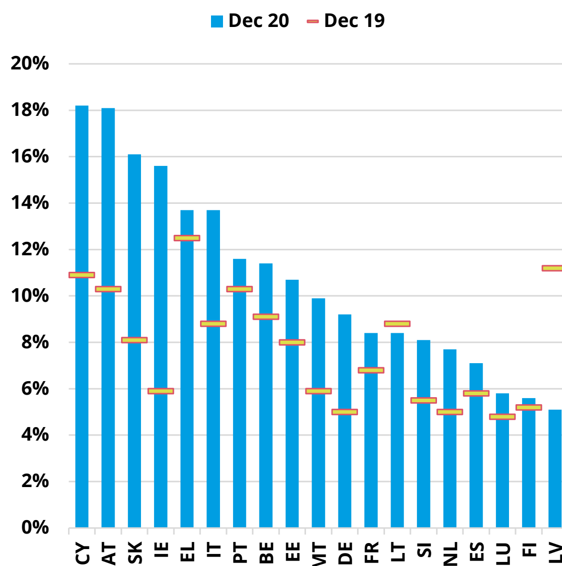
Overall, we currently expect real GDP in the euro area to rebound by about 4.1% this year, driven both by domestic demand and by net exports, although the latter will be harder to achieve by popular tourist destinations. For 2022, we would pencil in growth of about 4.3% at this juncture. Uncertainty remains unusually high, and downside risks continue to relate to any further delay in vaccine availability, or limited effectiveness thereof, also in view of new virus mutations. In such a scenario, an increase in bankruptcies could be higher than envisaged in our base scenario, and would go hand in hand with a higher increase in unemployment, thus likely hampering domestic demand in particular. Ultimately, a lagging recovery would increase the risk of deeper scarring effects and possibly eat into funds otherwise earmarked to foster the greening and digitizing of the economy. Furthermore, this would make it harder to pursue fiscal consolidation in the medium term and present difficult choices to politicians in charge.

Also, we see some risk that the banking sector, which is under pressure in terms of profitability anyway might be more negatively affected than currently seems the case in view of declining NPL ratios and relatively high capital ratios as of Q4-20 (EU NPL at 2.6%, CET1at 15.9%). In this context, EBA has pointed to an 110bp rise in the share of loans that show a significant increase in credit risk, so-called stage 2

loans, from Q3-20 to Q4-20, now standing at 9.1% (see Figure 8). The share of stage 2 loans under moratoria was nearly three times this ratio (26.4%), suggesting that loans still subject to moratoria carry substantially higher credit risk.

Figure 8: Stage 2 loans hint at deteriorating credit quality, prompting euro area banks to increase their loan loss provisioning

In the context of IFRS 9, stage 2 loans are loans whose credit quality has deteriorated significantly since initial recognition but offer no objective evidence of a credit loss event, in % of total loans and advances at amortized cost



Sources: Creditreform Rating, EBA

As for issues other than coronavirus, a possible international minimum corporate tax rate (see above), such a decision would presumably strongly influence enterprises' choice of location, potentially making smaller European countries such as Ireland and Luxembourg a less attractive destination for foreign direct investment for instance, with negative consequences for the respective local labor markets, infrastructure and possibly innovation potential.

German economy benefiting from recovery in important export destinations

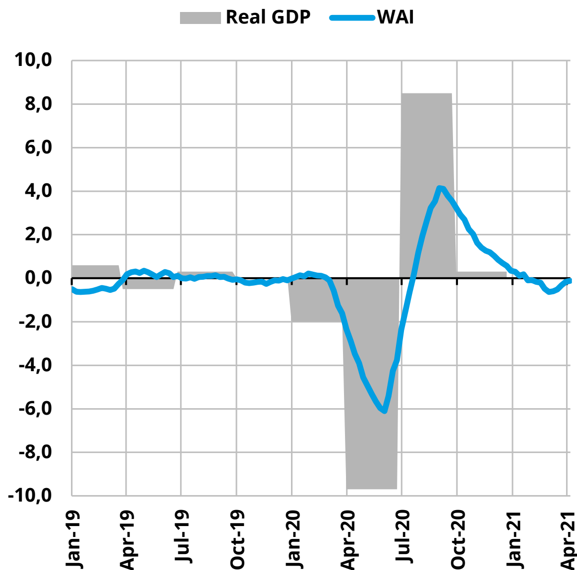
Following ten consecutive years of economic expansion, the Covid-19 crisis caused real GDP to fall by 4.9% in 2020 (2019: +0.6%), a more moderate decline than seen during the Global Financial Crisis (2009: -5.7%) and, as mentioned above, smaller than that of the euro area . Thanks to the relatively large gross value added share of its industrial sector (excluding construction, Q4-20: 23.7%, EA: 19.7%), the German economy was able to show more resilience in the second half of last year, when its export-oriented manufacturing sector was less affected than during the first infection wave. Moreover, the fallout from the economic and health crisis was cushioned by substantial fiscal measures, including guarantees.

In light of the relatively fast Chinese economic rebound, Germany's exports to China in Q4-20 exceeded their level in the same quarter of the prior year by 8.5%, helping to secure moderate economic growth in the final quarter of 2020 (Q4-20: 0.3% q-o-q, EA: -0.7%). Ultimately, net exports posed a drag on growth last year (-0.9p.p.), as did domestic demand. Private consumption fell by 6.1% in 2020, while gross fixed capital investment posted a decline of 3.1%, mostly due to collapsing investment in equipment and machinery (-12.1%), whereas construction investment proved growth-supportive (1.9%). While government consumption contributed positively, growing 3.3%, inventories shaved 0.8 p.p. off GDP growth.

The first quarter of 2021 will likely have seen economic activity shrink again on account of a renewed lockdown starting in November, with an increasing level of stringency over the following months. The weekly activity index (WAI, Bundesbank) underscores this expectation, pointing to a GDP growth rate of -1% for the 13 weeks up to 28 March against the preceding period of 13 weeks (see Figure 9). Against this backdrop, private consumption should have declined, also as a consequence of mostly reinstated VAT rates from January after being lowered for the second half of 2020. A likely setback in construction activity, partly due to severe winter weather in January and February, will have additionally weighed on Q1-21.

Figure 9: WAI suggests further contraction of German economy in Q1

Weekly (economic) activity index, quarterly real GDP growth in %



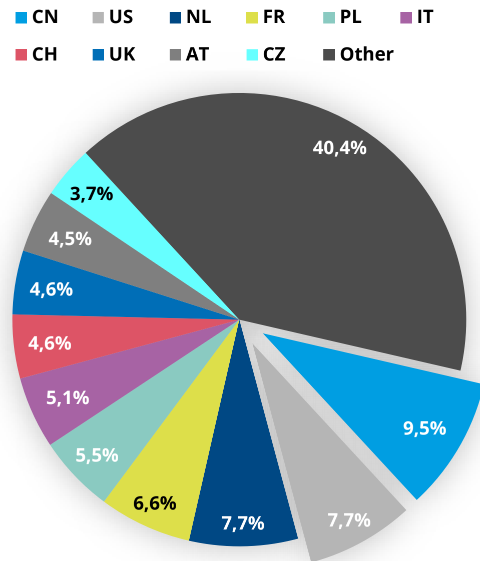
Sources: Creditreform Rating, Bundesbank

However, the overall decline in real GDP should be mild compared to Q2-20, when the first lockdown suffocated economic activity on a broader base, as the manufacturing industry continued to benefit from the ongoing recovery in China as well as from comparatively strong economic activity in the US, hence in Germany's two most important export destinations (see Figure 10).

Germany thus looks set to experience an economic recovery aided by external trade this year, as the near-term outlook for exports is brightening, also bearing in mind removal of significant downside risks related to the post-Brexit agreements between the EU and the UK. According to the ifo institute, export expectations among the German manufacturing industry have climbed for a fourth consecutive month in March (balance of 24.9, Mar-20: -16.7), reaching the highest level since January 2011.

Figure 10: German export growth should benefit from dynamic recovery in the US and China

Share in Germany's external trade in %, 2020



Sources: Creditreform Rating, Destatis

Domestic demand should contribute to growth as well this year. Against the backdrop of better prospects for export activity, and improving sentiment in particular in manufacturing, the outlook for gross fixed capital formation is becoming more positive. The overall ifo business climate indicator rose to 96.6 in March, a level last seen in June 2019, mainly carried by further strong improvement of the sentiment in the manufacturing sector. Sentiment in services, and especially in trade, remains rather muted despite some silver linings such as IT services or retail trade being allowed to open over recent weeks. Business climate in the construction sector, although still at a subdued level, reached a 12-month-high in March, pointing to possible growth impulses. Continued favorable financial market conditions, also as monetary policy remains accommodative, should provide an environment conducive to the recovery.

We expect investment to be chiefly driven by rebounding demand for machinery and equipment this year, while residential construction should also add positively amid low mortgage rates and demand for dwellings apparently still exceeding supply. In the medium-to-longer term, however, residential supply

should become more balanced with respect to demand, as impulses e.g. via demographics are likely to fade. Germany stands ready to receive only comparatively small amounts from the RRF (EUR 23.6bn in grants in 2018 prices) which may, if used effectively, add a little to both public and private investment.

Household income waiting for release

Due to the epidemiological situation and rather sluggish progress in terms of vaccination, household spending growth looks set to be subdued in the early part of 2021, also in reaction to the reinstating of most of the VAT rates following the lower level in the second half of 2020. Generally, the short-time work scheme that was extended until end of the year 2021 should favor a recovery of private consumption, partly aided by the increase of the minimum wage, which is to be raised in four steps to EUR 10.45 per hour by July 2022.

Beyond the first half of the year, pent-up demand should be released if vaccinations can be stepped up significantly upon increased supply of vaccines. Given households' high saving rate, which at 15.7% in Q4-20 remained close to the peak reached in Q1-20 (16.2%, Bundesbank data), there is substantial room for maneuver despite somewhat higher inflation rates compared to 2020 due to the VAT changes, higher oil prices, and as CO2 pricing has been introduced from January 2021.

Limited fallout on the labor market so far, but watch out for insolvencies

The labor market was still performing well when the crisis hit, following a long-running streak of job creation and record-low unemployment. Thanks to the short-time work scheme, the fallout from the pandemic has been limited so far. Having said that, the number of employees subject to short-time work increased for a third consecutive month to roughly 2.851mn in January (preliminary data, Federal Employment Agency). Despite this rise, the number remains well below its peak registered in April 2020 (roughly 5.995mn). Indicated short-time arrangements concerned 197,000 employees in March 2021, down from a revised 535,000 in February, after having gone up towards the end of last year. The monthly unemployment rate (Eurostat, LFS) has slowed its increase observed since the start of 2020 (3.4%), broadly stabilizing around 4.5% (Feb-21) since the summer months, still one of the lowest readings in EU.

We expect wage increases to remain moderate, as the main focus lies on preserving jobs at this stage, judging by the recent conclusion of wage negotiations in the metal and electronics industries in Germany's most populous state (North-Rhine Westphalia), which may serve as a blueprint for further industries.

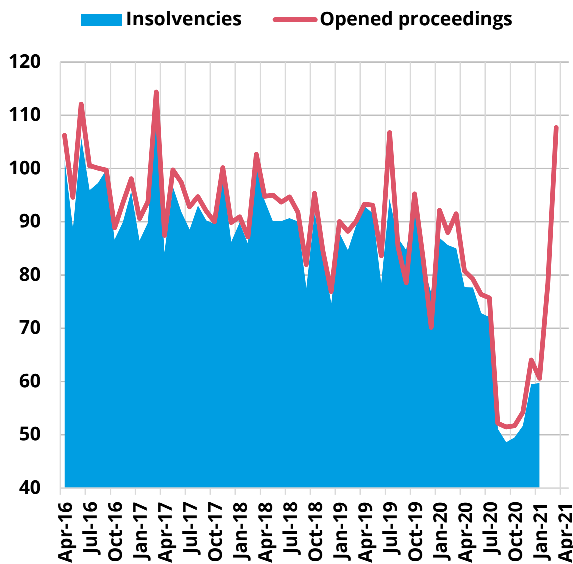
We do see some risks for the economic recovery relating to the labor market in the form of sharply rising insolvencies once the exceptional policy of suspended obligation to file for insolvency fully expires. While parts of the exceptional policy have been phased out already, companies still awaiting the so-called November support can defer filing for insolvency until the end of April. In 2020, insolvencies fell by 15.5% compared with 2019, with this result substantially affected by the aforementioned policy.

However, we note that there seems to have been a turnaround in the number of opened insolvency proceedings, which have been exceeding their level of the preceding year in March 2021 for the first time within a year (+18% vs. March 2020), suggesting that the number of bankruptcies may be about to go up (see Figure 11).

Unemployment could thus rise more markedly in the course of the year and beyond, potentially dampening domestic demand dynamics. Non-financial corporation (NFC) debt had already been on the rise before the pandemic hit and has reached its highest level since the reunification. Nevertheless, at 63.5% of GDP (Q3-20, Q3-19: 59.5%), NFC debt still compares as relatively moderate, moving somewhere in the middle-range among EU countries.

Figure 11: Opened insolvency proceedings skyrocket in March, signaling substantial increase in insolvencies down the road

2015 = 100



Sources: Creditreform Rating, Destatis

Looking at financial stability, losses entailed by presumably rising corporate insolvencies seem manageable for the German banking system from the current point of view. The combination of relatively vivid mortgage lending, dynamic house price developments and deteriorating affordability may still chiefly reflect demand-supply fundamentals and the low interest rate environment, but should be monitored.

Recovery prone to setbacks as long as vaccination campaign cannot be accelerated decisively

Overall, we expect real GDP to rise by about 3.1% this year. Given the unfavorable infection dynamics on account of a seemingly more contagious virus mutation, as well as a number of setbacks in the vaccination campaign, the recovery which we anticipated to start from Q2-21 now looks likely to be pushed back into the second half of the year, as further tightening of containment measures cannot be ruled out. A new emergency break introduced by law this April automatically imposes a curfew during night hours and foresees restrictions to private gatherings and non-essential shop openings if certain incidence rates are exceeded. What is more, due to small amounts of available vaccines, partly limited application due to safety concerns, Germany's vaccination campaign seems sluggish (see above) and prone to disruptions, rendering economic recovery fragile.

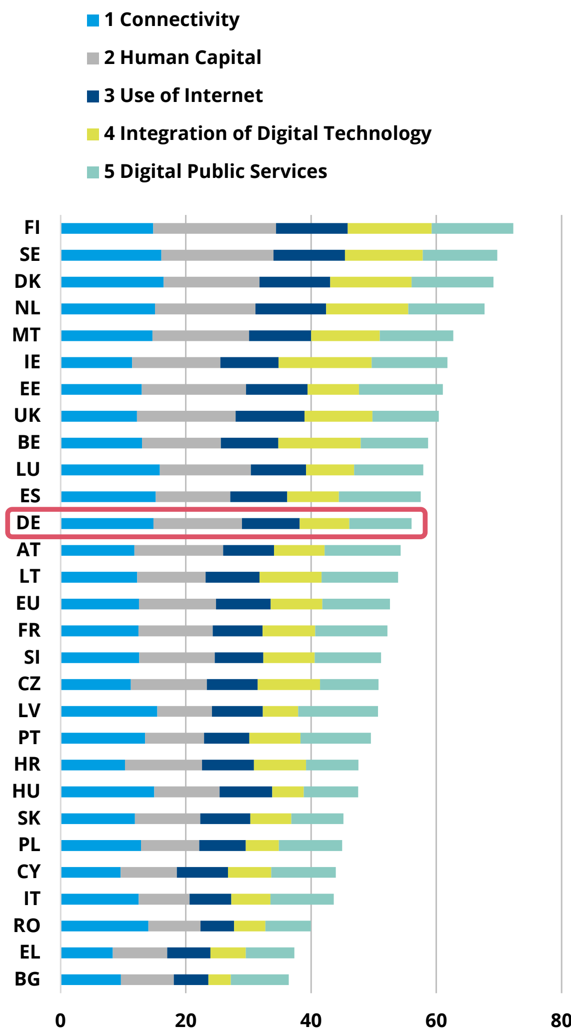
Looking beyond this year, domestic demand should gain traction due to the easing of social distancing, as well as an elimination of other deterring effects on private consumption, and we expect total output to expand by 3.8% in 2022. This should also be supported by a firmer recovery in other European countries, based on positive effects via RRF impetus. For the coming year, we would assume that herd immunity is by and large reached and no more severe restrictions will need to be imposed, enabling a more stable quarterly GDP profile than witnessed last year, although the possibility of vaccine development/supply lagging behind virus mutations would pose downside risks to that.

As regards the more medium-term outlook, some risks relate to the pivotal automotive industry's ongoing slow shift towards electric mobility. Furthermore, we consider that the economy may experience deeper scarring in case of repeated or more protracted lockdowns. Challenges remain with regard to the ongoing digital transformation in general and having to catch up in terms of digitalization in the educational sector and in public administration in particular (see Figure 12).

Intensified use of pivotal infrastructure such as high-speed broadband and cloud computing while striking a good balance with data protection count among these as well. Unfavorable demographic prospects increase pressure to enhance the growth potential through decisive progress on these fronts. Germany's Recovery and Resilience Plan (GRRP) picks up on these issues, suggesting that the corona crisis is acting as a catalyst in this respect.

Figure 12: Germany with significant shortcomings in terms of integration of digital technology and digital public services

DESI 2020, Digital Economy and Society Index summarizes relevant indicators on digital performance and tracks evolution of EU Member States in digital competitiveness



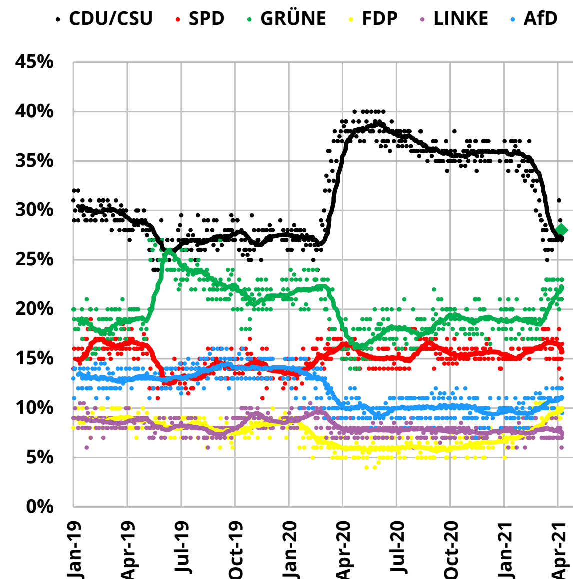
Sources: Creditreform Rating, European Commission

Federal election: Heading for the first black-green coalition?

Perceptions of how the corona crisis has been managed will presumably play a large role in the upcoming federal election on 26 September. While two state elections (Baden-Württemberg, Rhineland Palatinate) yielded continuation of the previous coalitions, possibly suggesting voters' preference for stability, the same cannot be said about the federal level. Yet another Grand Coalition of CDU/CSU and SPD, even if the two parties combined obtained a majority of the ballots, looks highly unlikely. Having gained support in the initial stages of the pandemic, the Christian Union has fast been losing popularity lately, having drawn criticism over its crisis management, including of the vaccination campaign and perceived lack of a coherent strategy as far as reducing social contacts is concerned. Moreover, contrary to the coalition partner SPD as well as the Green party, selecting their candidate for chancellorship has not been a smooth procedure for CDU/CSU. While the Union is still slightly ahead in many polls, according to some surveys the Greens have become the front-runner (see Figure 13).

Figure 13: Polls seeing a shift to a possible black-green coalition – or green-black?

Polling data for September's general election in Germany



Sources: Creditreform Rating, Infratest, Kantar, Forsa, F'gruppe Wahlen, Allensbach, INSA

A coalition of CDU/CSU and the Green party might thus still be the most likely option, although a variety of conceivable models has emerged. The Green party's support has climbed to about 22% of the vote, according to the polls, which would be more than double the share won in the 2017 federal election (8.9%). While we would ultimately expect a new German government to remain consensus-seeking and,

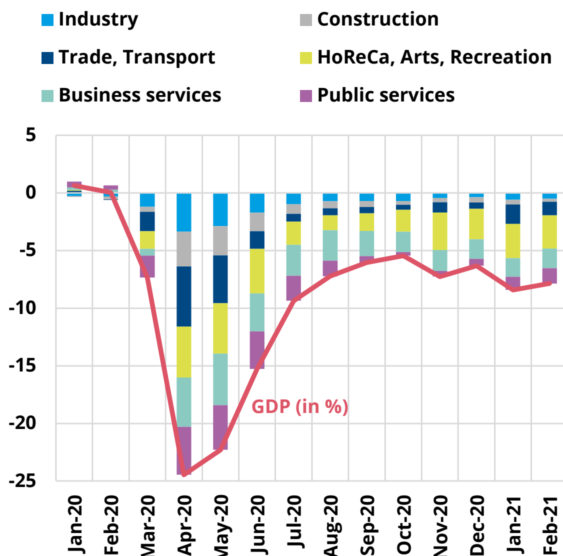
by and large, exert a high level of political predictability, we think that the debt brake might come under scrutiny in a more left-leaning coalition.

United Kingdom: Coming to terms with coronavirus and the post-Brexit world

Following moderate real GDP growth burdened by Brexit uncertainty over the last few years (average 2015-19: 1.7%), the Covid-19 pandemic drove total output down by a record 9.8% in 2020. This corresponds to the strongest decline in the G7, largely driven by relatively strict and longer lockdown phases and the higher significance of consumer-facing services for the UK economy (see Figure 14).

Figure 14: Total output fell on the back of restrictive confinement measures, weighing on consumer-facing services in particular

Contribution to monthly GDP change since January 2020



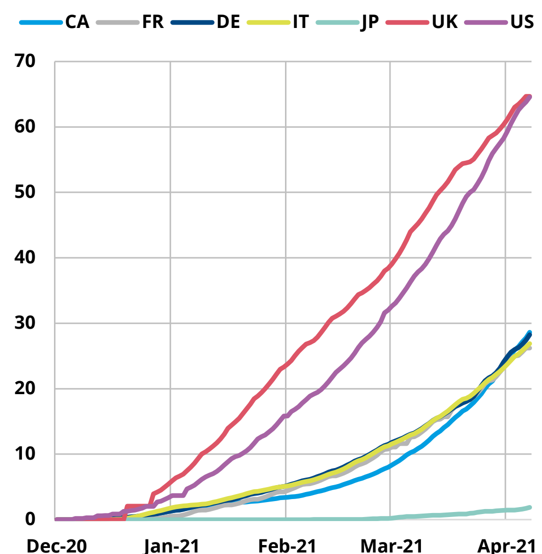
Sources: Creditreform Rating, ONS

Domestic demand contributed negatively to overall GDP growth, with strong falls in household consumption (-10.6%) and gross fixed capital formation (-8.8%), while exports and imports contracted by 15.8% and 17.8% respectively.

Amid a third comparatively strict lockdown and initial frictions in merchandising trade as the post-Brexit regime kicked in, we expect GDP to have shrunk in the current year's first quarter, but expect a recovery to take hold from Q2-21, given fast progressing inoculations and ongoing substantial government support. The UK is far ahead of EU countries in the vaccination process, enabling envisaged easing of restrictions. The number of first vaccination doses administered has climbed to 64.7 per 100 people in the total population as of 21 April, one of the highest readings worldwide, and well ahead of other G7 economies (see Figure 15).

Figure 15: The UK and US are vaccination frontrunners in a global context

Share of people who received at least one dose per 100 population



Sources: Creditreform Rating, Ourworldindata

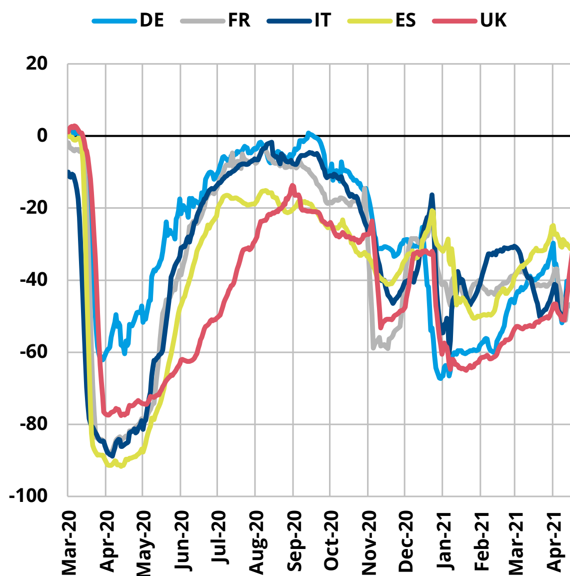
Containment measures might come to end by Q3-21 altogether, if the government follows through on its roadmap on exiting the lockdown, which foresees return to normality by 21 June, conditional on the evolution of vaccination success and infection numbers. Obviously, this remains subject to high uncertainty against the backdrop of the spread of new strains of the virus.

Recent unconventional leading indicators such as Google mobility (see Figure 16) as well as sentiment indicators would back expectations of our baseline scenario for 2021, which foresees real GDP to

bounce back mainly on account of rebounding private consumption, with household incomes supported by the extended furlough scheme. Consumer confidence (GfK) in March climbed to its highest level since the outbreak of the corona crisis, and the manufacturing and services PMI in March posted strong increases, with sentiment among service providers back in expansionary territory amid prospects of lockdown to be lifted. Households' high saving rate (16.5% in Q3-20) suggests there is plenty of room to spend, although in the face of the UK's relatively high ratio of household debt to disposable income (128.7% in Q3-20), consumption dynamics may be restrained once an initial bounce-back has taken place as non-essential shops are re-opening.

Figure 16: Broader vaccine coverage allowing for easing of restrictions – boding well for a swifter economic recovery

Google mobility indicator for Retail & Recreational, 7-day moving average of percent deviation from baseline



Sources: Creditreform Rating, Google

Gross fixed capital formation should pick up as well, assuming that uncertainty will subside, aided by government measures such as the extended business rates holiday and the reduced VAT rate for heavy-hit sectors. The so called 'super deduction' announced with the March Budget could provide an additional boost, and increasingly so in 2022, aiming to incentivize businesses to bring forward investment in plants and machinery. Furthermore, investment will remain supported by favorable funding costs entailed by the Bank of England's (BOE) very accommodative monetary policy (see below). Apart from that, as part of plans to spend GBP 600bn in gross public investment over the next five years, the government announced GBP 100bn of capital investment in FY 21/22.

Monetary policy continues to lend strong support to a recovery, and we expect the BoE's monetary policy to further contribute to benign refinancing conditions, making debt increasingly affordable. The Monetary Policy Committee (MPC) signaled continued accommodative monetary policy at its meeting in March, voting unanimously to maintain the Bank Rate at 0.1%, to maintain the stock of sterling non-financial investment-grade corporate bond purchases at GBP 20bn and to continue its UK government bond purchase program, with the target for the stock of government bonds remaining at GBP 875bn.

Moreover, while not intending to signal lowering the Bank Rate into negative territory, the MPC has suggested that the Prudential Regulation Authority (PRA) should engage with PRA-regulated firms over starting preparations that would enable implementation of a negative Bank Rate at any point from August 2021.

With economic activity resuming in the UK and elsewhere as vaccination progresses, trade dynamics should generally pick up going forward. In the near term, there remains some uncertainty especially over services trade with the EU and initial obstacles in implementing the new customs regime, possibly weighing on trade activities. Amid a likely stronger increase of imports, we would expect net trade to exert a negative impact on growth in 2021/22.

For 2021 as a whole, we expect real GDP growth to rebound to about 5.0%, followed by a further increase to 6.0% in 2022, with downside risks primarily relating to the coronavirus and the adjustment to the post-Brexit environment.

What could spoil the post-Brexit party

Against the backdrop of non-tariff barriers concerning trade with the EU, as well as the uncertainty over details in services trade, we see risks that the UK's competitiveness may come under pressure. At this point in time, we would be rather skeptical as to whether the strains emanating from Brexit on UK trade will be compensated for by more favorable terms under FTAs with non-EU countries. In addition, it will likely take several years to work out further details regarding the FTA with the EU. Past experience shows that comprehensive agreements with the EU took between five and ten years.

That said, we observe that there has been good progress regarding further trade agreements with non-EU countries. More recent trade deals with non-EU countries include a trade agreement with Turkey, signed in December 2020, which is to form the basis for a more comprising trade relationship between the two countries in the future. The UK-Japan Comprehensive Economic Partnership Agreement (CEPA) was signed on 23 October 2020. Moreover, the UK has formally applied to join the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). We understand that formal negotiations are to start this year.

Growth further out will also likely be constrained by the government's indicated steps towards reining in public finances. In this regard, household expenditure could be dampened by the announced freeze to the income tax personal allowance and to the higher rate threshold between April 2022 and April 2026. In addition to that, business investment should be hampered by the envisaged higher corporate tax rate from 2023.

As to institutional issues, Scotland's parliamentary election to be held on 6 May will likely see SNP, which wants to explore options to hold another referendum on independence from the UK, as the winning party, judging by latest polls. However, polls on holding another referendum on independence deliver a rather split picture at present, with only a thin lead by the approving side. Further to a more institutional point of view, handling of the new EU border between Northern Ireland and the Republic of Ireland might cause further tensions, both in the affected area near the new border as well as with regard to the quality of the new relationship between the UK and the EU.

Figure 17: Our real GDP forecasts point to a diverging speed in economic recovery among advanced economies

In %, IMF forecasts for World

	2010-19	2019	2020	2021e	2022e
World	3,7	2,8	-3,3	6,0	4,4
Euro area	1,4	1,3	-6,6	4,1	4,3
Germany	*1,9*	*0,6*	*-4,9*	*3,1*	*3,8*
France	*1,4*	*1,5*	*-8,1*	*5,1*	*4,1*
Italy	*0,3*	*0,3*	*-8,9*	*4,0*	*4,2*
Spain	*1,1*	*2,0*	*-10,8*	*6,0*	*4,8*
UK	1,8	1,4	-9,8	5,0	6,0
US	2,3	2,2	-3,5	4,2	3,3
China	7,3	5,8	2,3	8,4	5,6

Sources: Creditreform Rating, IMF

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