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ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

Editorial

Sudden stop to be followed by a gradual, uneven recovery

The COVID-19 pandemic has caused a sudden stop in an increasing number of countries. This in turn had led to international spillovers via a decline in foreign trade and an increase in investor risk aversion triggering a global rush for dollar liquidity and a surge in capital outflows from developing economies. A forceful reaction has followed in major economies in terms of monetary and fiscal policy in an effort to attenuate the impact of the pandemic. The near-term dynamics of demand and activity will entirely depend on the length and severity of the lockdown. Once the lockdown has ended, the recovery is likely to be gradual and uneven and policy will have to shift from pandemic relief to growth-boosting measures, thereby putting additional pressure on public finances.

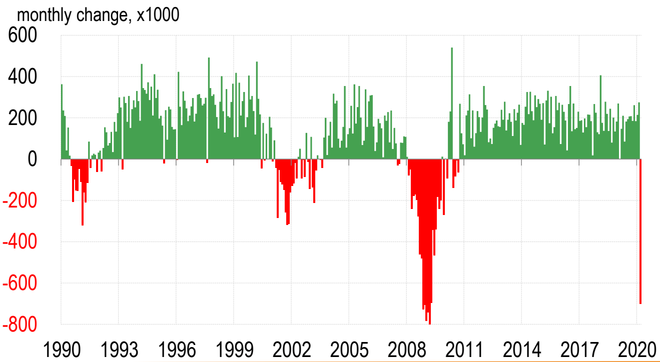
Sudden stop triggers swift and forceful policy reaction

The coronavirus pandemic has confronted major parts of the world economy with a sudden stop which is becoming more visible by the day. In the eurozone, several business surveys have seen record drops in March on a monthly basis. In the US, initial unemployment claims have skyrocketed to a degree never seen before and employment has fallen dramatically. The prospect of a big hit to GDP has triggered a swift and forceful policy reaction from central banks. The Federal Reserve has taken the federal funds rate down to zero, embarked on a programme of buying commercial paper as well as high-quality corporate bonds. It has also sent a message saying it would do 'whatever it takes' to stabilize the treasury market as well as the market for agencies' mortgage-backed securities. The ECB has introduced a EUR 750 bn Pandemic Emergency Purchase Programme and given itself the much-needed flexibility of deciding which bonds it would buy. The US administration and Congress have agreed on a fiscal stimulus plan corresponding to 10% of GDP. Several European countries have also taken measures to support households and companies. These measures should attenuate the impact of the crisis and limit the risk that a temporary health crisis ends up inflicting lasting damage to the economy, thereby weighing on the potential to recover swiftly.

Gradual and uneven recovery

The end of lockdowns will lead to a 'mechanical' rebound in activity and demand. Pent-up demand and inventory rebuilding are likely to give an additional short-term boost to growth. The key question is what happens to the growth outlook afterwards. The experience in China, in recent weeks, is a reminder that we cannot take a V-shaped recovery for granted, quite the contrary. It will probably be gradual because i/ not all countries move at the same pace towards normality (which will hinder exports, as we have already seen in China today) and ii/ the economic impact of the pandemic differs as well. This impact has a bearing on how fast demand and activity will get back to the pre-pandemic growth path. Several factors suggest that the process will likely be gradual and bumpy. By then, balance sheets of many companies will have deteriorated, causing a preference for deleveraging over increasing capital expenditures. It may even have an impact on hiring plans. These considerations are particularly important for small and mid-sized companies, where many tend to have less-diversified business models, which make them more sensitive to the economic shock. Certain households will adopt a precautionary savings attitude, seeking to re-establish some

United Sates: Non Farm Payrolls



Source: US Bureau of Labor Statistics

financial cushion. Lingering health risk concerns may also act as a drag on certain expenditures – e.g. international travel - without necessarily leading to an equivalent increase in other areas. More than anything, household spending will depend on how unemployment develops. In the US, where costs of laying off people are low, Federal Reserve officials expect the unemployment rate to increase significantly. Finally, international trade will probably remain sluggish for months to come, whereby exports from countries where the lockdown has ended up suffering from the drop in import demand from countries which have gone in lockdown at a later stage. Against this background, it is quite likely that fiscal policy, after having provided -- together with monetary policy -- a strong dose of pandemic relief, will need to also provide demand stimulus to ensure that the recovery gathers sufficient pace.

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United States

State of emergency

The American people and the US economy will no longer be spared the coronavirus pandemic, no more than any other country. Arriving belatedly on US soil and long belittled by President Trump, the virus is now spreading rampantly, to the point that WHO is now preparing to declare the United States the pandemic's new epicentre. With its federal structure, the US has taken a scattered approach, leaving each state to decide whether or not to introduce lockdown measures. Although the White House has closed the country's borders (to the European Union and Canada, among others), it was reluctant to restrict domestic movements of goods and people. Foreseeing recession, the markets have plunged and the central bank has launched a veritable monetary "Marshall Plan".

On 12 March 2020, the tone in Washington was serene even as Italy, already swamped by the epidemic, was strengthening its lockdown measures and former Prime Minister Matteo Renzi was urging Europe to do the same. President Trump was convinced that a vaccine would be rapidly discovered and the virus would disappear quickly, with little propagation[1]. To the contrary, the situation has deteriorated rapidly, to the point that the World Health Organisation (WHO) is preparing to declare the US as the pandemic's new epicentre. As we went to press, the world's number one superpower had reported 280,000 confirmed cases and 7,000 deaths. Covid-19 contamination is progressing exponentially, comparable to the curves already seen in European affected countries.

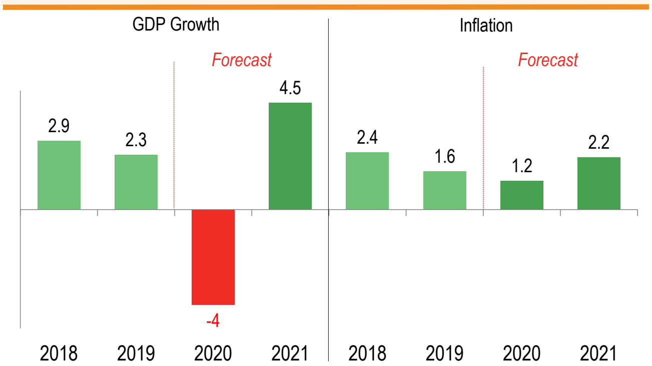
With its federal structure, the US has taken a scattered approach to the pandemic. Since 15 March, the hardest hit states (New York and California) have imposed lockdown measures or social distancing on their residents, limiting the movements of non-essential workers and closing most recreational spaces (bars, restaurants, theatres, sports facilities, etc.) and retail stores. Other states, such as New Jersey, Illinois, Florida and Texas, have followed suit with more or less severity. Despite the President's hopes of seeing "all the churches packing their pews again by Easter", measures have been taken at the local level to protect residents, and only a very small list of places have put no restrictions into place of any kind. The US economy is freezing up. Industrial orders as depicted by the Investment Supply Manager (ISM) index – that is closely correlated with investment and economic activity – fell to 42.2 in March, the lowest level since 2009, and will continue to fall, raising the spectre of a record-breaking contraction of GDP in Q2 2020.

High-risk populations and massive fiscal support

Although the US has a leading-edge healthcare system, it is not well equipped to handle a mass epidemic. The highly-selective system is costly – the US devotes 17 points of GDP to healthcare, the highest among the OECD countries – but its hospital capacity is limited to only 2.8 beds per 1000 inhabitants, two times less than in France and three times less than in Germany. Without universal healthcare coverage, the system provides only limited access to those with no

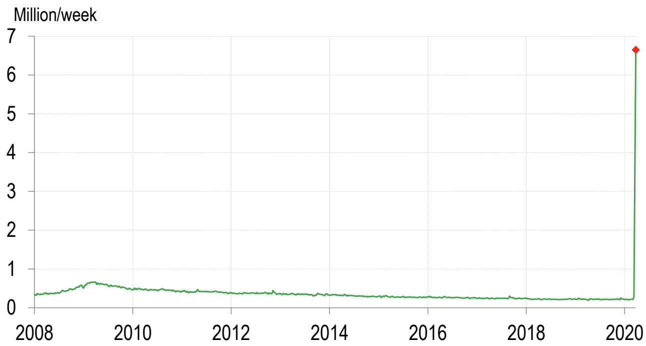
[1] *"It's going to go away […] because of what I did and what the administration did with China, we have 32 deaths at this point. When you look at the kind of numbers that you're seeing coming out of other countries, it's pretty amazing when you think of it". D. J. Trump, 24 February 2020.*

1- Growth and inflation
(Y/Y, %)



Source: BNPP, Interim Forecasts (Before Global Markets updated scenario)

2- Initial claims



Source: US Department of Commerce

3- Coronavirus Aid, Relief, and Economic Security Act (USD mds)

Cash grant to households	**634**
- Tax credit ("checks")	290
- Unemployed (benefits extension)	260
- Various (food stamp, education aid…)	84
Guaranteed Loans	**881**
- Large companies and States	504
- Small and medium size companies	377
Emergency transfers	**400**
- States and local authorities	175
- Hospitals	180
- Disaster Relief Fund	45
Corporate tax cuts and deferred payments	**280**
TOTAL	**2,200**

Source: Committee for a Responsible Federal Budget, BNP Paribas private insurance – i.e. nearly 106 million Americans (1 in 3)[2]. More often than not, health care protection is provided through jobs, and the surge in unemployment (see chart 2) will only increase the population's vulnerability in the face of the pandemic.

Finally aware of the stakes at hand, the Trump administration pushed Congress to pass the Coronavirus Aid, Relief, and Economic Security Act (CARES), an unprecedentedly large fiscal stimulus package (USD 2,200 bn, the equivalent to 10% of GDP or 50% of the annual Federal budget). The bill doubled in size under pressure from the Democrats, who have a majority in the House, to cover the needs of low-income individuals and those who have lost their jobs. In addition to guaranteed loans for companies, which could amount to as much as USD 900 bn, the Federal government will transfer roughly USD 630 bn to American households (see table 3) through tax credits or extended benefits. Using a means-tested system[3], each American household will receive a check from the Treasury for a maximum amount of USD 3,000 each. The Federal government will also top up unemployment benefits, which vary from state to state but which average roughly USD 300 a week, by USD 600 a week during the 4-month period ending 31 July 2020.

Monetary bazooka

The government is preparing to buffer an economic shock which it can no longer deny, and which has been largely foreseen by the markets and the Fed. Starting on 3 March, the Fed began cutting its key rates, slashing them to virtually zero on 15 March[4]. It reactivated the exceptional liquidity facilities that were set up during the 2008 financial crisis. Quantitative easing, the Fed's securities purchasing programme, which had been raised to a maximum of USD 700 bn a year, is now being conducted with virtually no limits (see box 4). These actions, coupled with swap arrangements and concerted actions with other central banks, have helped restore some calm, at least temporarily, in the foreign exchange and bond markets, where the squeeze on USD liquidity has led many currencies to depreciate, and interest rate spreads have widened sharply.

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4- Monetary Marshall Plan

In the US, reassessment of the risk associated with the prospects of an economic contraction have resulted in a widespread flight to liquidity and requests to convert assets (equities, bonds and shares in mutual funds) into cash, putting enormous pressure on key players for the smooth functioning of the markets, including primary dealers and money market funds. To avoid systemic sclerosis, the Fed re-opened the facilities created during the 2008 financial crisis and positioned itself as the "buyer of last resort" for nearly unlimited amounts.

- A series of special financing facilities*. Alongside the exceptional injection of liquidity via repo operations (up to USD 5800 bn from mid-March to mid-April), on 17-18 March the Fed reactivated its Primary Dealer Credit Facility (PDCF) and Money Market Mutual Fund Liquidity Facility (MMLF). Through these facilities, the Fed lends funds in exchange for collateral that has become harder to dispose of and seeks to facilitate debt market refinancing, a vital organ of the economy. But it does not stop there. Through Special Purpose Vehicles (SPV), the Fed will purchase high quality corporate bonds (i.e. with an investment grade rating), not only in the primary market via the Primary Market Corporate Credit Facility (PMCCF) but also in the secondary market via the Secondary Market Corporate Credit Facility, (SMCCF). Using an SPV, it has also reactivated the Term Asset-Backed Securities Loan Facility (TALF) to support the securitisation of new loans to households and small businesses (and prevent it from shutting down).*

- Switch to unlimited QE. *This is the most spectacular measure announced so far, and the first to begin to restore calm in the markets. On 23 March, the Fed announced that its securities holdings via the System Open Market Account (SOMA) will be increased by as much as needed to ensure the smooth functioning of the markets. In other words, quantitative easing (QE) would only be limited by the amount of eligible Treasuries outstanding (which are also about to increase sharply) and Mortgage-Backed Securities (MBS), which were expanded to include commercial mortgage-backed securities.*

- Swap arrangements. *The squeeze on USD liquidity required central bank action not only because of the situation in the United States. Like in 2008, debt issued in the US, especially corporate bonds, have been recycled globally, especially in the form of exchange-traded funds (ETF), increasing the US dollar refinancing needs of non-American financial intermediaries. In Japan, the eurozone and the UK, the first signs of dollar rarefication appeared with the depreciation of their currencies (demand for USD conversion) and an increase in the cost of swaps. In response, the Fed and five central banks – the ECB (eurozone), BoE (UK)), BoJ (Japan), BNS (Switzerland) and BoC (Canada) – reached an agreement on 15 March allowing currencies to be swapped at a reduced rate (OIS + 25 bp), with USD lending in each jurisdiction of up to 85 days (in addition to the usual 7-day operations). On 19 March, the Fed extended these swap arrangements to include other key central banks around the globe (Australia, New Zealand, Brazil, South Korea, Mexico, Singapore, Sweden, Norway and Denmark, among others).*

Source: BNP Paribas

[2] Of the 106 million Americans without access to private insurance, 78.4 million depend on Medicare (for persons over age 65) and Medicaid (for low-income individuals or families), which provide only partial coverage. 27 million Americans do not have any insurance coverage at all. See Census Bureau, Health Insurance Coverage in the United States: 2018, November 2019.

[3] Revenue of up to USD 99,000 a year for singles, USD 198,000 a year for a couple without children and USD 218,000 a year for a couple with children.

[4] On 15 March 2020 (effective 16 March), the Federal Open Market Committee (FOMC) decided to cut the key fed funds target rate by 100 basis points, to a range of between 0% and 0.25%. The interest on reserves and excess reserves (IOR and IOER) was cut by 150 bp to 0.1%.

China

Is the worst over?

China's population and its economy were the first to be struck by the coronavirus epidemic. Activity contracted abruptly during the month of February before rebounding thereafter at a very gradual pace. Although the situation on the supply side is expected to return to normal in Q2, the demand shock will persist. Domestic investment and consumption will suffer from the effects of lost household and corporate revenues while world demand is falling. The authorities still have substantial resources to intervene to help restart the economy. Central government finances are not threatened. However, after the shock to GDP growth, the expected upsurge in domestic debt ratios will once again aggravate vulnerabilities in the financial sector.

China, the first country to be hit by the coronavirus outbreak, reported a very sharp drop in activity after the population was put in lockdown, from the Chinese New Year celebrations at the end of January through the end of March or early April (rules and dates vary from region to region). The brutal shock was transmitted through numerous channels, ranging from a supply-side shock to a shock on domestic demand and exports, a revenue shock and a confidence shock. Activity has begun to rebound in the past few days, and the authorities have launched stimulus measures that should help bolster the recovery. Major downside risks persist however. Lost corporate revenues, a deteriorated labour market and uncertainty over the pandemic's future course will hamper domestic demand. At the same time, the export sector is bound to be hit by the repercussions of the sanitary and economic crisis that is currently spreading worldwide. We expect to see an unprecedented contraction in real GDP in Q1 2020 (-8% year-on-year), followed by a slow normalisation of economic growth starting in Q2.

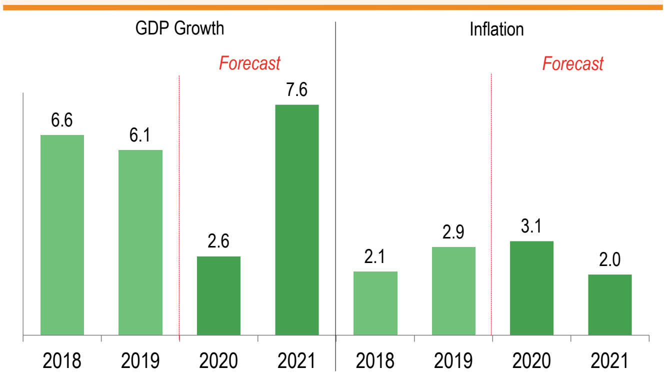
An unprecedented shock

After the authorities imposed drastic measures to contain the epidemic, consumption of goods and services collapsed (graph 2). Retail sales volumes declined by 23% year-on-year (y/y) in the first two months of 2020, with automobile sales entering a free fall (-78% y/y in February). Online retail sales were more resilient, but nonetheless contracted by 3% y/y in January-February due to the decline in sales of services and non-essential goods. Transport networks were paralysed (with passenger traffic down 84% y/y in February). Construction and the real estate sector were also hard hit (property sales were down 40% in the first two months of the year)[1].

The supply-side shock was just as severe since factories were forced to remain shuttered after Chinese New Year and the work force was put in lockdown. Industrial output plunged 13.5% y/y in real terms in the first two months of 2020 (vs. +5.8% in 2019). The shutdown of production lines and transport blockages contributed to the decline in merchandise exports (-17% y/y in January-February). Lastly, falling revenues and uncertainty over future growth prospects led corporates to drastically scale back investment in all major economic sectors. Total fixed-asset investment declined by 25% y/y in the first two months of the year.

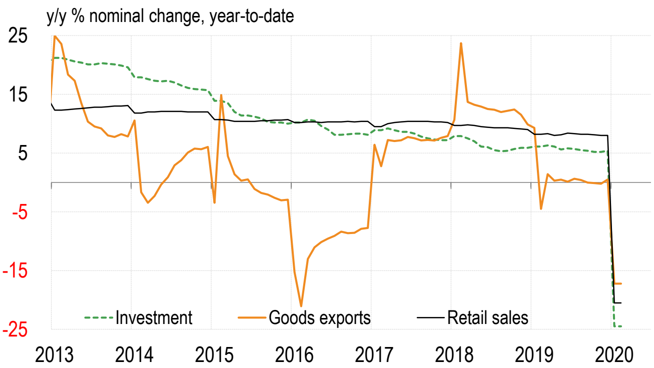
[1] Services account for 54% of GDP, including retail trade (10%), transport (4%) and real estate (7%). The industrial sector accounts for 39% of GDP, including construction (7%).

1- Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- Collapse



Source: NBS

For the moment, the epidemic's spread in China is contained and the economy is recovering. Restrictions have been lifted on domestic passenger traffic and merchandise transport (albeit only partially in Hubei) and export activity has started up again. At the end of March, the official work resumption rate was 98% for large industrial enterprises (and 85% in the province of Hubei) and more than 70% for small and medium-sized enterprises (SMEs). Yet production capacity utilisation rates are still far below pre-crisis levels (it was 77% in the industry in Q4 2019). Production facilities are expected to return to normal by the end of April for industry and by the end of Q2 for services (with the exception of tourism).

Yet just as the supply-side shock is winding down, a new demand shock is taking shape. The collapse in world demand will rapidly undermine China's exports. Therefore, their contraction could worsen in Q2 2020, severely threatening the recovery in the manufacturing sector (which also continues to be affected by US tariffs). This should drive export corporates to reduce inventories and scale back investment. In addition, both households and corporates have been hit by a revenue shock, which will continue to squeeze domestic demand in the short term. Finally, there has been a severe erosion in confidence due to the pandemic and uncertainty over its future course.

The financial situation of many corporates has weakened and their capacity to invest and repay loans has deteriorated (profits of industrial enterprises declined by 38% y/y in the first two months of 2020, and eight SMEs out of ten reported cash-flow problems in early March). Total domestic debt of the corporate sector is excessively high, at 150% of GDP at year-end 2019 (more than two thirds of which are bank loans). The debt burden reduces corporates' resilience to shocks, and the increasing risk of default on bank loans and in the local bond markets could weaken the financial sector. In contrast, corporates' external debt in foreign currency is small (estimated at 7% of GDP) and is not a source of instability for China's external accounts, even if payment difficulties and refinancing risk increase.

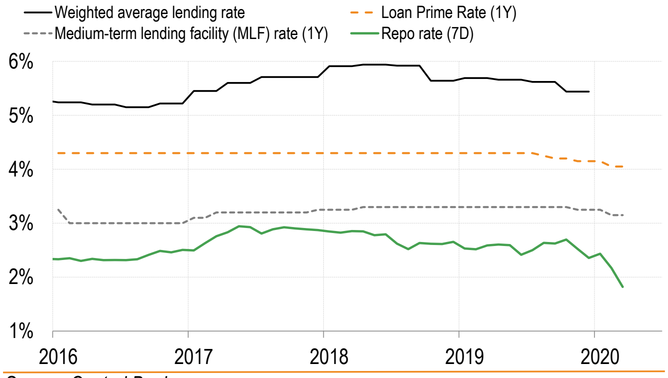
Chinese consumers are expected to remain both constrained by their income loss and very cautious. Job market conditions deteriorated rapidly during the confinement period: the unemployment rate surged to 6.2% in February from 3.6% in December 2019. The shock will also be amplified by household indebtedness. Their debt-to-GDP ratio was 55% of GDP at the end of 2019, which is not excessively high yet. However, it has increased significantly over the past ten years. More importantly, the debt burden is much higher for low-income households, which are also more vulnerable to income shocks. Consequently, there is likely to be an even sharper downward adjustment in private consumption in the short term.

Actions on all fronts

Since February, the government and the central bank have launched a series of measures that aim: 1) to support corporates that have been hard hit by the coronavirus outbreak, help prevent defaults and bankruptcies, limit the risk of financial-sector instability and facilitate the economic recovery, and 2) to offset the decline in revenues and to stimulate investment and consumption. As the external environment deteriorates, Beijing is expected to bolster its stimulus measures in the weeks ahead.

Monetary conditions have been eased gradually since the beginning of the epidemic. The central bank has injected liquidity in the financial sector in order to meet demand (RMB 3 trn in the first two weeks of February). It initially opted for a moderate reduction in policy rates (the rate on medium-term lending facilities was lowered from 3.25% to 3.15% in February and then left unchanged in March), but recently stepped up the easing in interest rates. Special credit programmes have been introduced, such as an expansion of relending facilities (RMB 700 bn) and a special loan program by policy banks to help small firms (RMB 350 bn).

3- Lower interest rates



Source: Central Bank

In mid-March, reserve requirement ratios were lowered by between 50 bp and 200 bp (depending on the bank) in order to free up RMB 550 bn for targeted loans. Banks have also been sent directives instructing them to cover the financing needs of corporates hit by the epidemic, refinance loans and reschedule loan repayments of clients facing difficulties. Prudential standards have been (moderately) eased for commercial banks, as well as the rules for issuing corporate equity and bonds.

On the fiscal front, the central government has opted for a relatively measured response until now. It has increased spending (notably on healthcare: +RMB 110 bn), exonerated companies from some social welfare contributions (RMB 500 bn) and taxes, reduced electricity rates for corporates by 5%, and announced fiscal incentives to stimulate domestic demand. Local governments also participate actively in stimulus efforts, notably by increasing investment in infrastructure projects (a traditional policy tool in China) and through direct aid for enterprises and households (such as reduced rent for land leases and the distribution of coupons). Beijing has substantially increased the local government bond issuance programme to finance infrastructure projects (RMB 850 bn in addition to the initial quota of RMB 1 trn for 2020).

Public finances can absorb the shock

The authorities' actions will play a key role in restoring economic growth. The central government has comfortable fiscal manoeuvring room and the central bank has ample liquidity cushions to ensure the stabilisation of the financial system. In contrast, the debt excess of the economy is constraining monetary policy as well as the investment capacity of local governments (their total debt already represents about 50% of GDP). Consequently, while it is highly likely that the central bank will continue to ease monetary conditions in the short term and that local governments will further increase investment, the central government will have to give priority to fiscal stimulus measures. Fiscal deficits will rise to historically high levels, but the central government's financing needs will be easily covered and its debt will remain moderate: it represented 16% of GDP at year-end 2019; it is almost entirely in local currency, and more than 90% of which is held by local investors.

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Japan

Recession on the cards despite new fiscal stimulus package

The shock of the Covid-19 pandemic comes hard on the heels of a difficult second half of 2019 for the Japanese economy. Like many others, the country is exposed to the economic fallout from this crisis. Its significant economic dependence on China, for imports, exports and tourist flows, further weakens the Japanese economy. The latest economic indicators suggest that the shock will be important. Japan will thus go into recession this year. Lacking adequate room for manoeuvre on the monetary front, fiscal policy will need to provide support. To this end, the Abe government would be preparing a major stimulus package.

The shock of the Covid-19 pandemic comes at a time when economic conditions in Japan were already fragile.

Considerable exposure to the pandemic shock

The Japanese economy is exposed to the Covid-19 pandemic shock *via* a number of channels[1]: 1) a fall in tourist numbers, with February bringing the sharpest drop in the number of people visiting Japan since the Fukushima disaster; 2) shortages in supply, particularly of metals, as a result of the collapse in Chinese exports; 3) weakening exports to China – these experienced their 15th consecutive monthly fall in February; 4) a lack of consumer confidence, which had already taken a knock from the increase in VAT in October 2019; and 5) slowdown in the global economy.

As in many countries, the latest economic indicators for Japan now incorporate the pandemic shock to a large extent. In particular, the Purchasing Managers Index (PMI) for March was 35.8, its lowest level since the Fukushima disaster in March/April 2011. The services sector PMI is at a record low of 32.7. The indicator of machine tool orders has also performed very poorly since the beginning of the year.

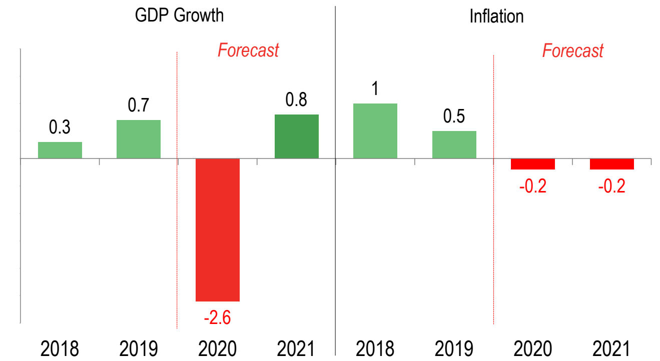
All in all, Japan is therefore likely to go into recession in the early part of this year. Any recovery is unlikely to be particularly robust, given the continued fragilities in the global and national economies. The absence of any clear-cut recovery in tourism and the postponement of the Olympic Games will also hit the Japanese economy.

Support from economic policy, particularly on the fiscal front

The Bank of Japan (BoJ) is fast running out of options in terms of monetary policy. At its last monetary policy meeting it held its policy rate at -0.1%. The authorities are paying very close attention to the effect of negative interest rates on the financial system. The BoJ decided, however, to double the volume of purchases of ETFs (exchange traded funds) and J-REITs (Japan real estate investment funds), to more than USD110 billion.

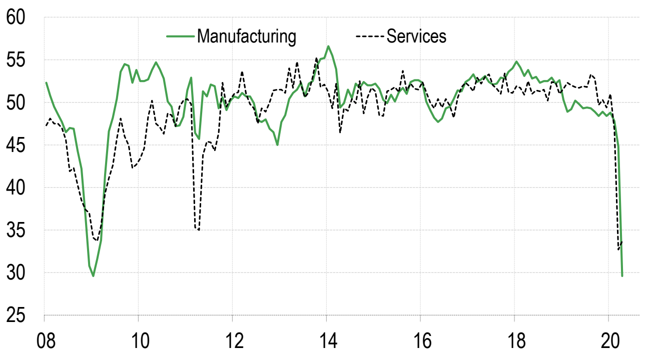
On the fiscal front, there have been a series of programmes since the beginning of the year. These were initially fairly limited in terms of volume, but the March programme was more substantial and included direct fiscal support (to companies affected and households dealing with the effects of school closures) and assistance in the financing of companies, particularly SMEs. An even bigger programme is now being worked up by the Abe government and is likely to be announced in April. Most notably this is likely to include the distribution of direct aid to consumers, as was previously done in response to the economic crisis of 2009.

1- Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- PMI index in Japan



Source : Markit

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[1] *Covid-19 update 23/03/2020 – Japan,* DG Trésor, 23 March 2020

Eurozone

A new, massive shock

The Covid-19 pandemic has triggered a recession in the Eurozone that looks likely to be deep but short-lived. After a difficult year and a half on the economic front, the Eurozone was showing some resilience and was even beginning to show signs of stabilisation. The current shock – in demand, supply and uncertainty simultaneously – has completely changed the outlook. The health measures taken- which have been necessary to protect the population from the virus- have created the conditions for a recession. Monetary and fiscal policymakers have reacted swiftly and, so far, proportionately. However, the profile of the economic recovery remains unclear and will be crucial in assessing the damage ultimately caused by the pandemic.

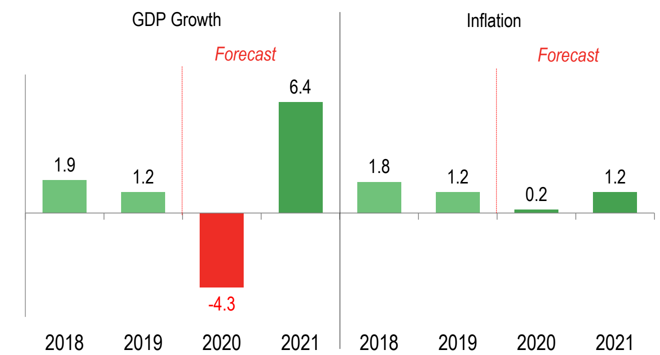
Just three months ago we, along with many other observers, were expecting the beginning of an economic stabilisation. Both the global and Eurozone economies had managed to come through many challenges and imbalances, such as the significant rise in tensions in international trade, the marked slowdown in China and the difficulties of the manufacturing sector and stretched valuations in certain markets. However none of these factors had proved sufficient to send the global economy into recession. Clearly, the picture today is different. The Covid-19 pandemic has created a massive shock, which will push the Eurozone economy into recession this year.

A three-pronged shock: supply, demand, uncertainty

Until recently, the available economic indicators that we usually monitor only partially reflected the shock. At that stage, the Covid-19 was seen as a uniquely Chinese - and thus fairly distant-phenomenon. The expectations of economic agents in the Eurozone did not deteriorate immediately, and the same was true in the US economy, where the standard deviations of forecasts is still high, reflecting the considerable uncertainty surrounding possible economic scenarios[1]. The publication of the Purchasing Managers Index (PMI) figures for March has changed the picture. The composite PMI fell from 51.6 in February to 31.4 in March. This collapse was largely due to the abrupt fall in the service sector PMI, which hit a record low of 28.4. The previous low point, dating back to February 2009, saw the service sector PMI drop to 39.2, highlighting the scale of the current shock. These figures confirm the real-time data[2].

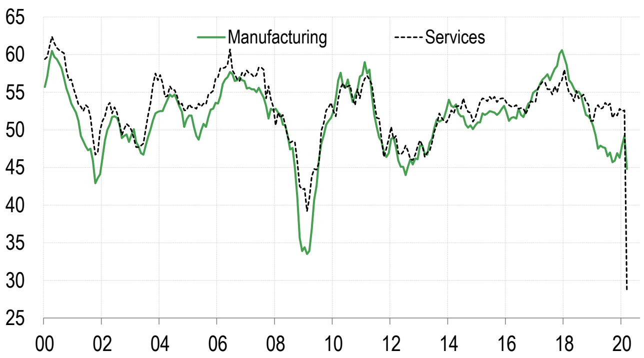
The Covid-19 is a triple shock for the economy. First there is a supply shock, seen in the forced closure of factories and a shortage of workers, who no longer go to their workplaces. Other production facilities are hit by the shortage of intermediate goods flowing from upstream, and scale back business volumes in response. Then there is a demand shock, coming from consumers. The confinement measures taken in various European countries and the closure of many shops automatically hit consumer spending. Finally, there are still many uncertainties, notably regarding the duration of confinement measures, the strength of pent-up demand and the

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- PMI index in Eurozone



Source: Markit

effectiveness of economic stimulus policies (see below). These uncertainties will hold back company investment and lead to a build-up in precautionary savings.

According to the OECD's initial evaluation[3], the impact on Eurozone countries is likely to be temporary but strong. The initial shock of the health measures will lead to an overall loss of economic activity, in real terms, of between 25% and 30% in the largest European economies (relative to a normal situation). Given the nature of the composition of the different economies the impact will be greater in the transport sector in Germany than in France for example.

[1] A. Dietrich et al., *News and uncertainty about the economic fallout of COVID-19: Survey evidence and implications for monetary policy*, VOX CEPR, 24 March 2020

[2] *Real-time data show virus hit to global economic activity*, Financial Times, 22 March 2020

[3] *Evaluating the initial impact of Covid containment measures on activity*, OECD, March 2020

Considerable uncertainty remains, however, and several factors could accentuate or attenuate the initial effect. This will depend on the duration of confinement measures and the possible tightening of the lockdown in the short term, and the extent to which the lost ground can be regained in the medium term. For example, lost spending in "restaurants and hotels" and "leisure services", which together account for 12% of total consumer spending in the Eurozone, cannot be regained. It would therefore be a dead loss. Conversely, spending on "clothes and shoes" is at least partially redeemable, either through the substitution of online purchases or increased spending once shops re-open. This sector accounts for nearly 5% of total consumer spending. In addition, the 'forced' savings built up by consumers during confinement could provide a strong base for a vigorous recovery (particularly as oil prices have fallen significantly, thus helping boost purchasing power). However, the return to normal patterns of consumer spending will depend on consumer confidence in the Eurozone. If the deterioration in confidence seen in March (The European Commission consumer confidence index fell to -11.6, the lowest figure since the end of 2014) continues, then precautionary behaviours could limit the recovery.

The key challenge for public policy: ensuring the best conditions for a robust recovery

The health measures taken in the Eurozone have an inevitable and immediate effect on growth. Economic policy will then have a role to play to ensure the conditions for a vigorous recovery. Short-term measures to avoid a shortage of liquidity will need to be backed up with measures to limit the threat to the solvency of many companies. The measures taken so far look logical given the experience of previous crises. The introduction of short-time working facilities and cash flow support for companies (through government guarantees on loans or deferred-payment deadlines for tax and social security costs) would therefore look like sensible moves[4], and indeed have been adopted in several countries. These actions should mitigate the impact of the crisis on employment and productive capacities. That said, the scale of the Covid-19 shock and the extent of health measures taken vary from one country to another, as do the fiscal responses. Thus the discretionary fiscal stimulus (excluding loan guarantees and payment deferrals) is currently much greater in Germany than in France, Italy or Spain[5]. At the European level, some decisions have been taken, although this remains relatively limited and no consensus has emerged on a common fiscal tool (such as *Coronabonds*). Most notably, the Commission has triggered the *"general escape clause"* due to the shock being both exceptional in nature and out of the control of governments[6]. This clause allows member states derogation from public finance targets, through a suspension of the rules. In other terms, countries are now allowed to deviate from the nominal deficit target of 3% or from imposed structural adjustments.

Fiscal support has once again been facilitated by the monetary policy adopted by the European Central Bank (ECB). The ECB has announced massive and flexible measures to respond to the economic effects of the Covid-19 pandemic. At the monetary policy meeting on 12 March, Christine Lagarde had already introduced several support measures, and in particular the creation of an additional budget of EUR 120 bn between now and the end of 2020 (in addition to the existing asset purchase programme). A further emergency programme was announced on 18 March. Worth a total of EUR 750 bn, the temporary Pandemic Emergency Purchases Programme (PEPP) is likely to last until the end of 2020 and will limit the risk of a tightening of financial conditions and of fragmentation within the Eurozone. In a new development, the existing asset purchase limits in the initial asset purchase programme will not apply to the emergency programme, giving it much greater flexibility[7]. In addition, the PEPP will target short-dated assets, thus increasing the response to liquidity issues. Assuming net monthly purchases of EUR20 billion, a total of EUR 1000 bn in assets will be purchased by the ECB in 2020, or nearly 10% of Eurozone GDP.

In the medium term, the effects of the Covid-19 pandemic will have a lasting downward effect on the real natural interest rate in the Eurozone[8], which is already close to zero, if not negative. Investment will be reduced. Conversely, discretionary savings will be increased, either due to a more cautious approach or simply because people will seek to rebuild the capital lost during the epidemic phase.

In summary, this crisis poses many questions. It has forced monetary policy to go further in the use of non-conventional tools. What might the next step be? The possibility of a direct distribution of cash to economic agents is already being discussed, but raises significant questions, particularly from a democratic point of view. For governments, the support made necessary by the crisis, and the expected collapse in economic activity, will increase government deficits and debt. Will this be followed by fiscal consolidation? Will the crisis accelerate the Japanisation of the Eurozone? We will return to all these questions once the health and the economic emergencies have been dealt with.

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[4] G. Gopinath, *Limiting the economic fallout of the Coronavirus with large targeted policies*, IMF Blog 9 March 2020
[5] J. Anderson et al., *The fiscal response to the economic fallout from the coronavirus,* Bruegel, 27 March 2020
[6] *Coronavirus: Commission proposes to activate fiscal framework's general escape clause,* European Commission, 20 March 2020
[7] *Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on the temporary PEPP (ECB/2020/17)*
[8] O. Jordà et al, *Longer-run economic consequences of pandemics*, Federal Reserve Bank of San Francisco, March 2020

Germany

Historic stimulus for fighting corona crisis

The German economy has come to a standstill because of the almost complete lockdown. To fight the economic consequences, the government launched a massive stimulus plan to increase spending in the health sector, protect jobs and support businesses. Nevertheless, production losses may reach dimensions that are well beyond growth falls in previous recessions. In the worst scenario of a three-month lockdown, GDP growth could lose around 20 percentage points and 6 million people may have to join the short-time work scheme.

Coronavirus derails economy

In March, the German economy came virtually to a halt because of an almost complete lockdown. The measures are meant in the first place to stem the rapid expansion of the coronavirus and avoid overloading the health system. However, they will have a massive economic impact.

Some sectors have completely shut down such as education, non-essential retail outlets, hotels, restaurants and the tourism industry. In some services sector, activity could be maintained, albeit at a much slower pace, thanks to teleworking. In the manufacturing sector, production had often to be halted because the breaking down of supply chains. Production in the car industry was halted not only because of supply disruptions or staff shortages, but also because of collapsing demand.

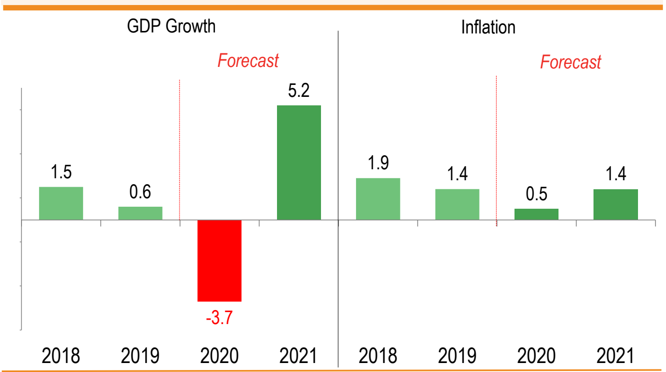
The March surveys indicate a sharp deterioration of the business climate. The Ifo climate index, a reliable business sentiment indicator, collapsed by 10 points the steepest fall ever recorded since German reunification. Other indicators available within a particular short time delay also show a sharp decline in demand. At Frankfurt Airport, in the week of 16-22 March, passenger numbers slumped by almost 75% from a year earlier, whereas cargo volume dropped by about one fifth. The German economy is in shock.

Quick and strong action to protect the economy

In March, the German government launched an aid package of historic proportions. The main aim is to protect jobs and income. The package has three pillars. The first pillar is dedicated to protect the health care sector. EUR 3.5 billion are made available for emergency measures, such as buying protective suits and masks, working on a vaccine. Additionally, EUR 55 bn are made available to fight the pandemic.

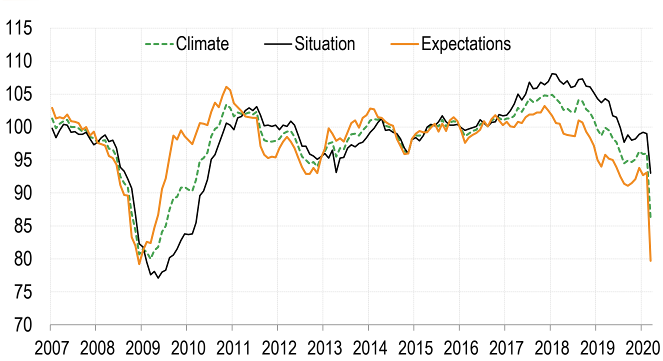
The second pillar consists of measures to protect jobs by facilitating access to short-time working scheme (Kurzarbeit), under which the Federal Employment Agency (FEA) pays 60-67% of the forgone wages of workers whose hours are being cut. The scheme was very successful in protecting jobs during the great recession in 2008-09. During that period, the FEA disbursed about EUR 10 billion, mainly to workers in the manufacturing sector. This time the scheme will be much widely used in other sectors, such as retail, hotels and restaurants. In addition, eligibility requirements to the scheme have been loosened. The costs of the measure are hard to predict as they depend on the depth and duration of the crisis (see below).

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- Deterioration in the business climate in March
2015=100



Source: IFO

The third and by far the largest pillar of the package is an extensive assistance programme to support businesses, partly through the expansion of existent schemes – liquidity assistance programmes and loan guarantees mainly through the German state development bank KfW – or a new programme to support small businesses, freelancers and the self-employed. Tax authorities will grant tax payments deferrals. Moreover, funds are available at the federal and the state (Land) level to buy equity stakes in struggling companies.

The budgetary costs are considerable. The Federation will take out new loans totaling roughly EUR 156 bn (4.5% of GDP). This does not include possible calls on the loan guarantees or participations in equity.

Germany supports the efforts on the European level. It welcomes the plan to establish a EUR 25 bn Coronavirus Response Investment Initiative. It also has opened its hospitals for corona victims from other EU countries. However, the government remains opposed to the pooling of European debt, which would have helped lending to the southern European countries that are most hit by the coronavirus.

Outlook depends on length and depth of the crisis

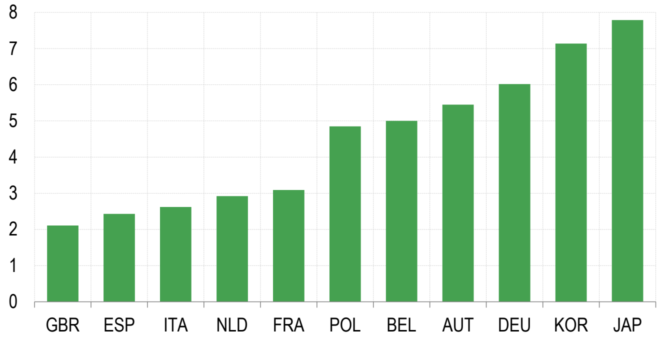
The effect of the corona crisis is much more severe than anything that the Federal Republic has experienced in its history. The output losses will depend on the duration of the lockdown period, the fall in activity during that time, and the subsequent recovery period. To gain some insight in the possible magnitude, the Ifo institute has developed three scenarios – low, high, and a medium scenario based on business expectations in the March Ifo survey – combined with different lockdown durations and recovery periods.[1] These calculations assume that the lockdown period will last between one month in the mildest scenario to three months in the most severe one. In all scenarios, activity could return in 2021 to the same as level as before the crisis.

In the mildest scenario - 40% GDP loss in the lockdown month and one month post-lockdown recovery period – the annual GDP growth rate could decline by around 5%. In the most severe scenario, the GDP loss in the lockdown month amounts to 48.7% and the loss in the annual growth rate could be 6.1%. If the lockdown period lasts for 2 months and the recovery period 3 months, the decline in the annual GDP growth rate amount to 12% and 14% in the low and high scenario, respectively. In the worst case scenario, a three-month lockdown followed by a four-month recovery period, the losses could amount to around 20% of GDP.

In all scenarios, the total number of short-time workers rises to levels that exceed the 1.5 million part-time workers during the 2008-09 financial crisis significantly. In the case of a one-month lockdown, 2.1 million to 3.9 million can be expected according to the Ifo calculations. If the lockdown continues for two or three months, the number should increase to 3.4 to 5.5 million and 4.2 million to 6.6 million, respectively.

The state budget is likely to be heavily impacted. From a stabilisation point of view, this is a desirable effect. A study on the impact of the tax and transfer systems in the European Union and the US in the 2008-09 economic crisis found that the automatic stabilisers absorb 48% of an income shock in Germany, compared with 38% in the EU and 32% in the US.[2] The Ifo scenarios show that, depending on the length of the lockdown period and the severity of the activity fall, the burden on the state budget could be between EUR 50 bn or 1.4% of GDP (low scenario, 1 month lockdown) to EUR 200 bn or 5.7% of GDP (high scenario, 3 month lockdown).

3- High hospital bed capacity in Gemany
Acute care hospital beds per 1000 people



Source: OECD

These budgetary costs do not include losses on state-guaranteed loans and the contribution to the European emergency package. It is likely that the German government accounts remain in deficit for a considerable period.

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[1] Ifo (2020*), Shutdown für Deutschland: Eine Szenarienrechnung*, ifo Schnelldienst, 2020, 73, Nr. 04.
[2] Dolls, M., Fuest, C., & Peichl, A. (2012). *Automatic stabilizers and economic crisis: US vs. Europe*. Journal of Public Economics, 96(3-4), 279-294.

France

Massive recessionary shock

Clearly, 2020 will not be another year of slow but resilient growth as we were forecasting just last quarter. We must now expect a massive recessionary shock triggered by the Covid-19 pandemic. To date, the INSEE estimates the instantaneous loss of economic activity linked directly to confinement measures at 35%, which is equivalent to slashing off 3 points of annual GDP per month of confinement. In March, the business climate was in free fall, which gives us a first glimpse of its scope. A full arsenal of measures have been deployed to mitigate the shock as best possible. According to our estimates, French GDP could contract by 3.1% in 2020, more than the 2.8% decline reported in 2009, before rebounding by 5.4% in 2021. These forecasts are highly uncertain, with risks on the downside.

A relatively positive pre-crisis situation

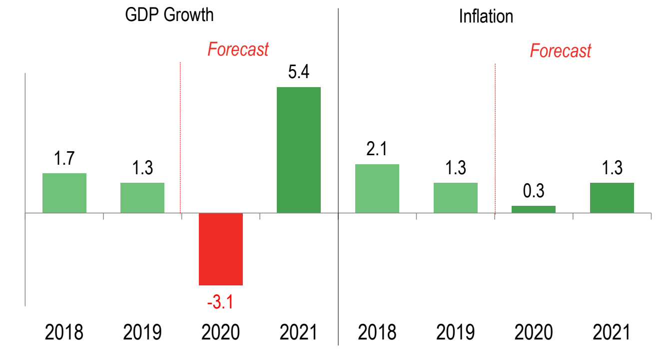
Q4 2019 figures surprised on the downside as GDP unexpectedly contracted by 0.1% q/q (vs expectations of +0.3%). Yet this fall followed five consecutive quarters in which France showed remarkable resilience to the global slowdown. The poor Q4 performance was also marred by strikes and protests against pension reform, as well as other sector troubles (automobile sector, aeronautical sub-contractors) and mild weather conditions (which meant less energy consumption). Lastly, business confidence surveys for January and February continued to show signs of resilience and the horizon seemed to be clearing on the international front. A strong technical rebound seemed to be taking shape in the first quarter, and it looked like full-year 2020 GDP growth would hold close to the 2019 rate of 1.3%.

Covid-19 crisis: a "black swan" shock

Yet we hardly had time to formulate this scenario before it was shaken by the outbreak of the Covid-19 epidemic in China in January. It became totally obsolete as the virus spread globally in February and March, with the introduction of confinement measures and business restrictions to try to halt the contagion. The Covid-19 outbreak is a perfect example of an extreme "black swan" shock: an unpredictable, low probability-huge cost event. Indeed, the Covid-19 pandemic is an unprecedented, multi-dimensional shock that is hitting both supply and demand, an abrupt, widespread, global shock affecting all sectors of economic activity in both the real and financial spheres, with innumerable multiplier effects.

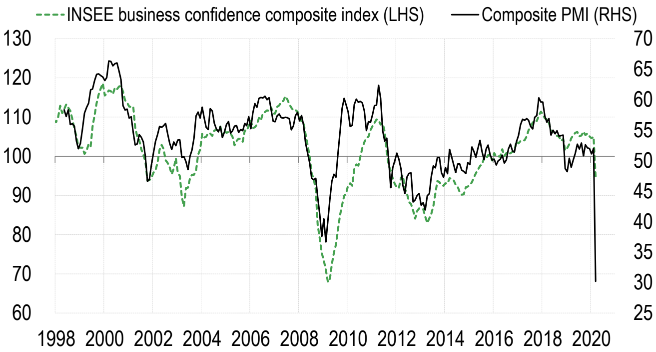
Today its cost is difficult if not impossible to quantify given the unprecedented nature of the shock, and because we still do not know its end date. Nonetheless, the release of the business confidence survey results for March provides us with a first glimpse of its scope. The PMI and INSEE indexes have both plunged. The INSEE composite business climate index dropped by 10 points in one month – an unprecedented decline – to 95, beating by a full point the record fall reported in October 2008. Although the index has fallen back below the long-term average of 100, it is still far above the all-time low of 68 reported in March 2009, unlike the Markit composite PMI, which dropped to 30.2. Just this once, it was the manufacturing sector that proved to be the most resilient: the INSEE manufacturing index declined only 3 points while the services and retail indexes were down 14 and 13 points, respectively. The stability in the construction sector was not significant. Considering the circumstances, indeed, the INSEE warned that for all these surveys, the March statistics might not be as precise as usual. Most of the responses were collected before 16

1- Growth and inflation
(Y/Y, %)



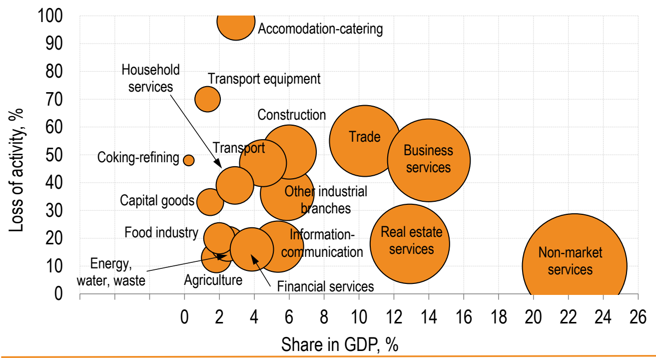
Source: BNP Paribas Global Markets

2- Business confidence



Source: INSEE, Markit, BNP Paribas

3- Sector impact of the Covid-19 containment measures
The size of the circles corresponds to the share in the GDP



Source: INSEE, OFCE (policy brief n°65, March 2020), BNP Paribas

March, the date when confinement was first announced. In each sector, it was the balance of opinions concerning future prospects that fell the most. The labour market climate was also swept up in the turmoil and dropped 9 points.

As to household confidence, a "data collection" effect limited the decline in the INSEE synthetic indicator to 1 point. According to the INSEE, the publication essentially reflects household opinions on the economic situation in early March. Yet even so, worries were already beginning to surface, as illustrated by the large dip in the balance of opinions concerning the opportunity to purchase big ticket items and future trends in unemployment and the standard of living in France. In April, we should expect to see a sharp drop in household confidence, as well as in the business climate, although we can hope the decline will be less vertiginous.

Along with these business confidence surveys, the INSEE also published its preliminary estimate of the loss of economic activity linked directly to measures to halt the Covid-19 pandemic. The instantaneous loss is estimated at 35%, which is equivalent to slashing off 3 points of full-year GDP per month of confinement. Similar estimates were released by the OFCE, the French economic observatory, and the OECD: the monthly loss of activity was estimated at about 30% and 25%, respectively, and the negative shock on GDP at 2.6 points and roughly 2 points[1]. These headline figures for the loss of activity mask major disparities between sectors in terms of the size of the decline (see chart 3) and the slight "buffer" effect in some sectors, which have managed to maintain or increase activity (food stores, e-commerce, pharmacies, telecommunications and healthcare). From a more general perspective, the sector structure of the French economy is both favourable and unfavourable in the current crisis. The weight of the non-market services sector contributes to mitigate the impact of the crisis while the large share of the market services sector, which usually serves as the buffer, is a strong negative this time.

To manage the shock, an arsenal of measures has been deployed to preserve as best as possible production capacities, employment, household revenues and corporate cash flows, to avoid bankruptcies in chain. In this way, once the healthcare crisis is over, the country would be prepared to return to work and restart the economy as rapidly as possible. These measures can be grouped into three categories:

- *Direct support*: simplification and strengthening of short-time working schemes (EUR 8.5 bn for two months); additional healthcare expenditures (EUR 2 bn); a solidarity fund for very small businesses, the self-employed, professionals and micro-enterprises that have been hard hit by the crisis (EUR 1 bn per month); and looser conditions for the payment of the Macron tax-free bonus (the government is also exploring the possibility of doubling the amount to EUR 2000);
- *Deferrals* (for companies and the self-employed): taxes and social welfare contributions due in March (EUR 32 bn); rent, water, electricity and gas bills (for small businesses experiencing hardships); and bank payments for a 6-month period;
- *State guarantees*: on liquidity loans granted between 16 March and 31 December (EUR 300 bn); public reinsurance for credit insurance outstanding (EUR 10 bn); and an increase in various public insurance facilities for export companies.

The government's stimulus package initially totals EUR 45 bn, which is considered to be a minimum. In addition to these fiscal and financial support measures, there are also European measures, the ECB's monetary support measures, and the easing of prudential regulations in the banking sector to keep monetary and financial conditions from tightening and to ensure the smooth financing of the economy. These measures look appropriate to address the dire consequences of the crisis; their effectiveness will now be put to the test. The dive in oil prices provides a mitigating effect that is hardly a drop in the bucket in the near term, but which could prove to be a major support factor during the post-crisis period.

The post-crisis period: what kind of a recovery?

Predicting the type of recovery that will follow the Covid-19 crisis is just as difficult as trying to estimate the scope of the recessionary shock. One would hope for a V-shaped recovery, in which activity restarts rapidly and business quickly returns to pre-crisis levels, i.e. by the end of 2020. This scenario is still within the realm of the possible. Though extremely abrupt and widespread, the economic shock triggered by the Covid-19 pandemic should be only temporary, and its roots are not as deep as in the 2008 financial crisis. Moreover, economic policy responses have been rapid and massive, and will continue to be implemented as needed. The economy could bounce back rapidly once the health risk has receded. But when might that happen? That is the big question. Until then, the longer the crisis lasts, the more it will erode the capacity for a rapid, comprehensive rebound. Looking at the situation on a sector basis, we cannot say "the harder the fall, the more rapid the recovery". Take tourism, air transport and aeronautics, to name but three examples at the heart of the French economy: it will probably take a long time before these sectors return to pre-crisis levels. Among the consumer spending and investment projects that were postponed, many will never be restarted or replaced. And even if demand is on track, would supply be able to handle it? And vice versa? Lastly, regaining confidence is also a key factor. For all these reasons a V-shaped recovery does not seem to the most likely scenario. A more realistic scenario would be a U-shaped recovery, with a longer recuperation period. An L-shaped scenario cannot be excluded either, depending on what scars, hysteresis effects and changes in behaviour the crisis leaves in its wake.

In conclusion, we estimate that French GDP could contract by 3.1% in 2020 (average annual growth rate, seasonally and working days adjusted), a bigger contraction than the 2.8% reported in 2009. Thereafter, the economy would rebound by 5.4% in 2021. It goes without saying that these forecasts are highly uncertain, with risks on the downside.

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[1] https://www.insee.fr/fr/statistiques/fichier/version-html/4471804/Point_de_conjoncture_INSEE_26mars2020_7h30.pdf ; https://www.ofce.sciences-po.fr/pdf/pbrief/2020/OFCEpbrief65.pdf ; https://read.oecd-ilibrary.org/view/?ref=126_126496-evgsi2gmqj&title=Evaluating_the_initial_impact_of_COVID-19_containment_measures_on_economic_activity.

Italy

At war with the virus

The outbreak of Covid-19 hit Italy while the economy was already contracting. The exceptional growth of infected people has brought the Italian Government to take harsh measures, that include stopping all economic activities, excluding those considered as necessary, and imposing a quarantine for the entire population. The combination of an induced supply and demand shocks is going to cause a recession, which is expected to be deep and to last at least until June. In 2020 as a whole, despite the strong support coming from fiscal and monetary policy, the Italian economy should decline by some percentage points.

An already contracting economy

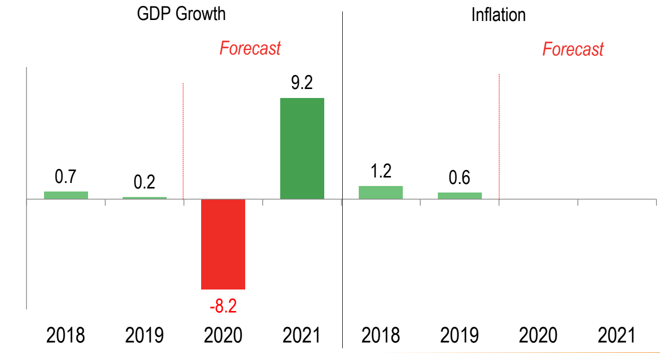
The outbreak of Covid-19 hit Italy while the economy was already contracting. In Q4 2019, real GDP declined by 0.3% q/q, with the annual growth rate falling to 0.1%. Domestic demand was disappointing. Private consumption slightly fell, as Italian households suffered from a still moderate evolution of income. Labour market conditions were mixed. The number of hours worked declined, remaining well below the 2008 level. Investment has further stagnated, as firms continued to be extremely cautious. The contribution of net exports was positive, as imports strongly fell, while destocking subtracted 0.7 percentage points from the overall growth. The carry-over for 2020, assuming no quarterly GDP increase, is -0.2%.

The crisis from a regional and sector perspective

In Italy, since the first Covid-19 case appeared, the number of infected people has significantly and rapidly increased. In response to this health crisis, the Italian Government has taken several measures, culminating in the quarantining of the entire Italian population. People are forbidden to leave their homes except for emergencies or essential work-related purposes. In the first stage of the quarantine, bars, restaurants, schools, museums and all retailers, other than pharmacies and food and beverages shops, were closed. A second set of measures implemented the shutdown of all productive activities, excluding those considered as necessary, such as food and pharmaceuticals industries and activity in some segments of metal products, machinery and equipment sectors. These measures have had a strong economic impact. Services, which have sustained the Italian economy over the last few years, enabling to recovering terms of value added what had been lost during the last recession and partly offsetting the decline in manufacturing, are now suffering from a substantial standstill of activity. This is particularly true of tourism, owing to the banning of all non-essential trips and public gatherings and the fact that similar measures were adopted in other countries. Since the end of the global financial crisis, the tourism sector had been growing, with expenditure by foreign travellers rising by almost a half and reaching EUR 42 bn, 7% of total exports of goods and services. The total number of nights spent in Italy had reached 430 million, the historical highest value.

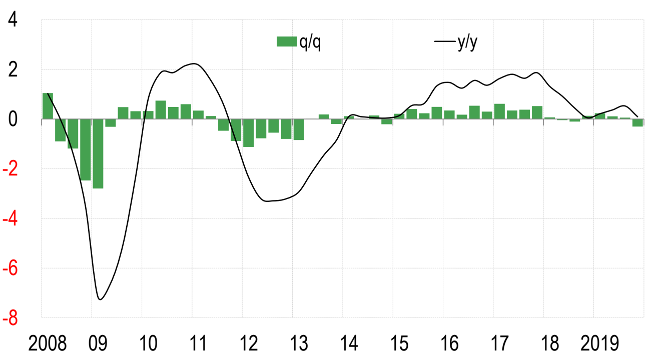
The crisis has also negatively impacted hotels and restaurants, a sector that had previously showed strong dynamics, becoming extremely important for the economy.

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- Real GDP
% change



Source: BNL, calculations on Istat data

In the last ten years, Italian households have deeply changed their consumption habits, spending much in restaurants and less in food and beverages shops. Private spending in hotels and restaurants rose well above EUR 110 bn, about 10% of total yearly consumption. With respect to the 2008 values, employment in this sector has risen by almost one third, against only a moderate evolution in the economy as a whole, reaching 1.7 million of the working population with EUR 65 bn of value added.

The effect of the restrictive measures on the retail and wholesale trade seems to be mixed, with some sectors, such as the food industry, benefiting from an increasing demand, while others, such as the clothing sector suffering from a total stop of activity. In Italy, the retail and wholesale trade sector as a whole employs more than

3.7 million people, about 15% of total employment, and contributes to almost 12% of value added.

The manufacturing sector in Italy was experiencing a decline before the outbreak of the virus. In the last two years, value added has decreased by almost 2%, declining by more than 10 percentage points below 2008 level. Manufacturing accounts for about 17% of total economy. The decision to stop non-essential activities has impacted the metal products sector, which has the highest share on manufacturing as a whole, with more than EUR 40 billion of value added, and the machinery and transport sectors. The pharmaceuticals sector, which is playing an important role in this period, with less than EUR 10 bn of value added, covers only 0.6% of the total economy, also showing a significant dependence on imports. A strengthening of demand seems also to be involving the food and beverages sector, which in 2019 recorded EUR 30 bn of value added with a workforce of almost 500 thousand people.

From a geographical perspective, the regions most affected by the Covid-19 outbreak are the wealthiest and most industrialized in Northern Italy. In 2019, Lombardia, Veneto and Emilia Romagna together accounted for more than half of total exports, with a turnover of almost EUR 260 bn made abroad. These three regions are strongly embedded into European supply chain, providing vital components to German factories.

A difficult fiscal manoeuvre to counter the crisis

The Italian Government has approved the “CuraItalia” decree, trying to counter the worsening of overall conditions. Total measures amount to EUR 25 bn, about 1.5% of GDP, with 3.5 billion to strengthen the health system, also financing the hiring of about 20 thousand people.

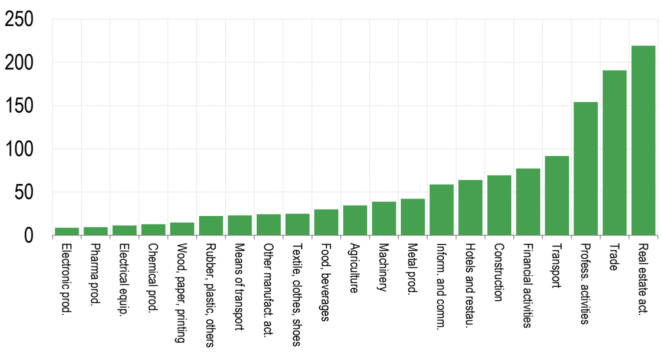
The SME guarantee fund will benefit from about EUR 1.2 billion in new financing, to provide public guarantee to bank loans to SME. The Fund will cover loans up to EUR 5 million, while easier procedures will be applied to guarantees below EUR 3,000. To sustain Italian exports, the Ministry of Economy will provide SACE (the Italian exports credit agency) with a guarantee aimed at supporting the sectors most hit by the crisis.

For SMEs, payments for mortgages and loans are suspended. Revocable (overdraft) credit facilities cannot be revoked until September 30th, non-instalment loans with contractual expiration are extended until September 30th, and payment of any instalment is suspended until that date.

To support the labour market (employment and workers) the legislative decree provides the extension of unemployment benefits to all enterprises, included one-person enterprises, for a total public finances cost of up to EUR 5 billion.

A personal income support has been introduced, with a one-time payment of 600 euros provided in March to workers, freelance professionals, workers with a non-fixed term contract and seasonal workers, who are employed in tourism or agriculture sectors (with at

3- Value added by sector
€ million, 2019



Source: BNL, calculations Istat data

least a 50 working days record in 2019). In total, eligible workers are almost 5 million and the measure will amount to a cost of EUR 2.8 bn.

To support enterprises and households that have been particularly affected by the crisis, the deferral of the deadline of taxes and social contributions is made possible.

Given the persisting uncertainty about the duration of the health crisis, the economic impact of the Covid-19 epidemic will be significant, although difficult to assess at this stage. The combination of induced supply and demand shocks is going to cause a recession that is expected to be deep and to last at least until June. In 2020 as a whole, despite the strong support coming from fiscal and monetary policy, the Italian economy is expected to decline by some percentage points. Should the mitigation measures be effective, economic activity could come back to a sort of normality through the second half of the year. The strength of the recovery would also depend on the strength of the external demand.

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Spain

Badly hit by the Covid-19

Spain is Europe's second hardest-hit country by the coronavirus pandemic, and is likely to suffer a sharp economic contraction this year. The economic impact remains hard to quantify. GDP is nonetheless likely to fall by more than 3% in 2020, before a recovery in 2021. The structure of the Spanish economy – turned heavily towards services and with a high proportion of SMEs – suggests that the economic shock could be greater than in other industrialised countries. Endemic unemployment could intensify, leaving a lasting mark on growth over the medium term. However, the improvement in public finances before the virus outbreak and a more stable political situation gives the government some leeway to face the crisis.

Spain has been heavily hit by the Covid-19 epidemic. At the end of March, the country had the second highest number of reported cases in Europe, after Italy. Prime Minister Pedro Sanchez has announced a substantial fiscal package. EUR 200 bn (16.6% of current GDP[1]) will be provided primarily via bank guarantees and deferred social security contributions for companies. [2] A postponement in loan repayments has also been introduced for the most vulnerable households. The Spanish economy should contract by at least 3.3% in 2020 before a recovery in 2021. GDP growth was strong in 2019 (+2.0%), although both the economy and the labour market began to lose steam in the summer of last year.

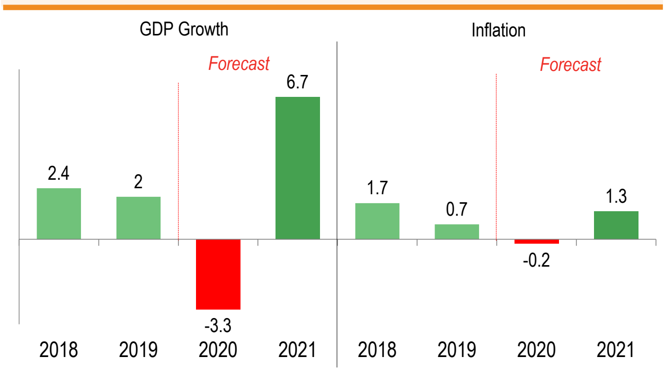
Spain: particularly vulnerable to the Covid-19 shock...

The structure of the Spanish economy renders the country particularly fragile against the coronavirus shock. First, the Spanish economy is composed largely of SMEs, whose cash positions are by nature less robust than major companies. Nearly one-third (32.1%) of gross value added in the non-financial sector is generated by companies with fewer than 20 employees. This is well above the EU27 average of 27.2%.[3]

Furthermore, the Spanish economy has a strong focus on the service sector. This sector consists in large part of businesses that are considered as 'non-essential' (tourism, leisure) and which are currently closed down. On this metric, Spain ranks highly within the EU: its service sector accounts for 74.2% of total value added, compared with an EU average of 73.0%.[4]

Lastly, Spain continues to face mass unemployment. Although the jobless rate has fallen significantly since its peak of 26.1% in Q2 2013, it was still 13.6% in February. Even if economic activity restarts in the second half of 2020, job offers will, in all likelihood, take much longer to recover as companies needs to first ensure their financial viability before recruiting. Long-term unemployment – which has a much greater impact on individuals than short-term unemployment – could thus increase sharply.

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

... but debt levels are lower than in 2009-2011

Nevertheless, it is worth noting that the coronavirus crisis has emerged at a time when the government's fiscal position had improved significantly. Indeed, the government deficit has shrunk considerably since Spain came out of recession in 2013: the Spanish primary balance recorded then a deficit of 3.6% of GDP.[5]

The public accounts for 2019 – published on 31 March – showed a primary deficit of 0.36% of GDP, a slight increase on the 0.10% of GDP in 2018. Spain's structural primary balance is estimated at a deficit of 0.8% of GDP in 2019.[6] Thus before the announcement of its emergency plan, the government had some fiscal leeway to 'cushion' the slump in economic activity.

The Spanish economy was also in a less 'perilous' financial position than during the 2008 financial crisis or during the European sovereign debt crisis in 2011. Although the ratio of total debt to GDP remains high, it has fallen by nearly 30 points of GDP since the peak in Q3 2014, reaching 267.3% in Q3 2019. Private sector debt (non-financial companies and households combined) was at its lowest since Q3 2004 (Figure 2). Part of the fall in private debt has, however, been transferred to the public sector. Government debt stood at 97.9% of GDP in Q3 2019.[7]

[1] Based on 2018 GDP.
[2] EUR117 billion will be provided by the government and EUR83 billion by the private sector, primarily the banks. The plan, announced on 24 March, stipulates that the government will guarantee 80% of bank loans taken out by SMEs and the self-employed. This guarantee is reduced to 70% for companies with more than 50 employees.
[3] Eurostat figures for 2017
[4] Eurostat figures for 2017

[5] The primary balance excludes debt interest payments. INE data.
[6] The structural primary balance excludes the impact of the economic cycle, one-off spending and debt interest payments from the calculation of the budget balance. See https://ec.europa.eu/economyfinance/ameco/user/serie/SelectSerie.cfm
[7] Bank for International Settlements data.

Towards a return of public investment?

With government spending set to rise sharply in 2020, the role of government investment as a support for economic growth could come back at the top of the political agenda. Government investment in Spain has stalled in recent years, even after the recession ended in 2013. The share of public investment in GDP has thus fallen from a peak of 5.2% in 2009, to 2.0% in 2019 (Figure 3). This decline is the result of the fiscal consolidation pursued by the former government of Mariano Rajoy, which followed a period of over-investment, particularly in the real estate sector.

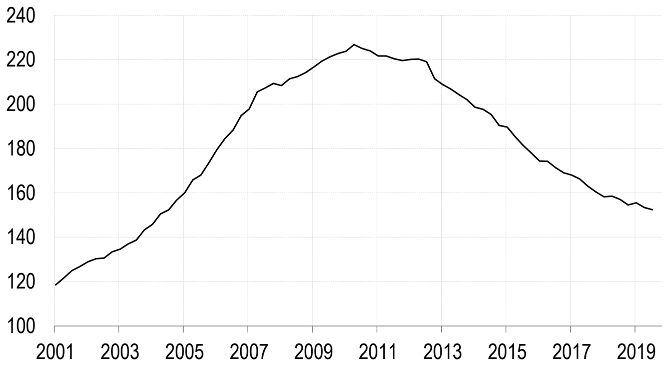
Once the health crisis finishes, there will be legitimate questions to be asked about the pursuit of low public-sector investment. This is true in healthcare, where GFCF was 0.8% of GDP in 2017.[8] More broadly, targeted public sector investment that supports innovation and boost productivity remains a significant driver of economic growth.

Political tensions have eased, for now

The coronavirus crisis has eased the political divisions that have shaken Spain for several years. The government received quasi unanimously the congressional support to extend the state of emergency until 12 April. It is nevertheless worth noting that the coalition government secured some notable successes prior to the crisis: the initial budget for 2020 was approved by the Congress at the end of February (although the budget has of course been substantially revised since then). This budget included, amongst other things, a 5.5% increase in the monthly minimum wage – to EUR950 – which follows a substantial 22% hike in 2019. The government objective is to raise the minimum wage to 60% of average wages by the end of the current parliamentary term in 2023.

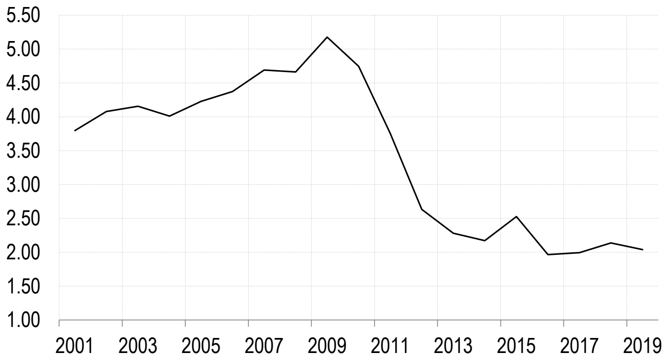
However, once the crisis finishes, Prime Minister Pedro Sanchez will remain under pressure. The socialist party (PSOE) has 120 seats in Congress. To maintain a congressional majority he will need to negotiate with the Catalan Separatist Party (ERC, 13 seats) and keep the unity with its coalition partner, Podemos, which has 35 seats. Podemos urgently wants to revisit some labour law reforms introduced by the Rajoy government. In particular, Podemos wants to restore branch-level agreements and move away from intra-company agreements that have been preferred in recent years. Meanwhile, the ERC is asking a referendum on Catalonia independence and amnesties for a number of separatist leaders.

2- Private debt
Private non-financial sector debt (% of GDP)



Source: BIS

3- Public investment
GFCF (% of GDP)



Source: Spanish Ministry of Finance

Some political opponents (the Partido Popular), and indeed even the Bank of Spain[9], fear that the labour law reforms could ultimately have a negative impact on business competitiveness and hold back the country's economic growth.

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[8] This figure is above the OECD average of 0.5%, but below those of other European nations such as Germany (1.1%), Belgium (0.9%) and the Netherlands (0.9%). OECD data.

[9] Spain's central bank urges government to stick with labour reform, *Financial Times*, 4 February 2020.

The Netherlands

Emergency package to protect jobs and businesses

As the country went into a selected lockdown, business confidence plummeted. To limit the economic fallout, the government announced a comprehensive package to protect jobs and businesses, its favourable budgetary position giving it sufficient firing power. Nevertheless, each month of lockdown may reduce output growth by around 2 percentage points. In the case of a rapid recovery, the GDP shrinkage could be limited to around 3.5% in 2020.

Confidence plummeted in March

As a result of the coronavirus, the economic climate has seriously deteriorated. Producer confidence plummeted in March, as enterprises anticipated a sharp decline in activity. In particular, consumer oriented branches such as retail, hospitality and travel reported sharp deteriorations in the business climate. In the manufacturing sector, businesses still reported well filled order books and low inventories of final products. However, these positive signals are likely to disappear as the country is in lockdown.

An emergency plan

The government has taken a raft of measures to support employees, self-employed and businesses. In order to protect salaries, companies that expect a decline of at least 20% of their turnover, can apply for a wage subsidy amounting to a maximum of 90% of the salary for three months for both permanent staff and flex workers under condition that no workers will be dismissed. Self-employed can receive a benefit of maximum EUR 1500 per month.

To avoid liquidity problems, enterprises that have difficulties in getting bank loans or bank guarantees can get a loan guarantee from the state. Starters may obtain a deferment of their reimbursements for 6 months. Moreover, companies may apply for tax deferment.

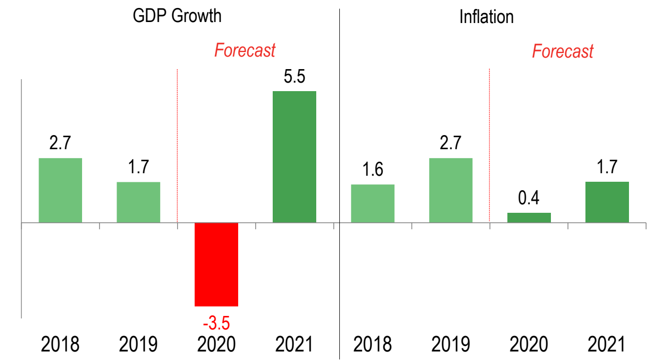
The budgetary costs of the emergency plan are substantial, possibly between EUR 10-20 billion per quarter. The government estimates that the costs of the short-time work scheme on its own could already at EUR 10 billion, if 25% of employers applied for it for 45% of the wage bill for three months. This is affordable even if the crisis would last for several quarters. In 2019, the budget surplus amounted to EUR 14 billion (1.7% of GDP) and the public sector debt was only 48.6% of GDP.

As a result of the crisis, public debt will rapidly increase in the coming months as tax receipts fall and social security benefits are set to increase. Moreover, the government might have to increase its participation in some struggling companies. Fortunately, the government finances are in good shape. The major problem might be an efficient implementation of the loan guarantees and other support measures in the coming quarters.

Output losses could be substantial

As a result of the lockout, activity is expected to contract in a wide range of sectors. The lockout measures in particular affect the services sectors such as hospitality, tourism, and personal services.

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

Other sectors such as manufacturing might be affected because of supply chain disruption and slumping demand. The Netherlands Bureau of Economic Policy Analysis (CPB) estimates that in the case of a three-month lockdown, economic activity could shrink by 10-15% in Q2. In this scenario, the GDP growth would contract by 1.2% in 2020, compared with 1.4% growth estimated in early March. The government deficit would amount to 1.3% of GDP, whereas the CPB had earlier expected a surplus of 1.1% of GDP.

The CPB might have substantially underestimated the economic consequences of the lockdown. The OECD estimates that for each month of lockdown, annual GDP growth could decline by around 2 percentage points. Assuming a selected lockdown of around 2 months followed by a quick recovery, GDP could shrink by close to 3.5% in 2020. It would make the current recession the severest since the Second World War.

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Belgium

Firm government measures support economy but add to long term fiscal worries

Due to the Covid-19 virus our growth outlook declines by 5 percentage points to -3.5% for the whole of 2020, despite government measures to attenuate the impact of the epidemic. We see strong hits across almost all sectors, most notably construction and real estate related activities. Prime Minister Wilmés was empowered by a "corona coalition", which provides a welcome if only temporary breather from government formation talks. The government so far managed this crisis in decisive fashion but eventually the bill will have to be footed.

Most sectors of the economy will suffer

Already before it became clear to what extent the Covid-19 virus would impact the global economy, Belgian GDP growth was expected to slacken. For a small open economy, a slowdown in international activity would inevitably have negative effects on its growth. The strong job creation under the Michel-I government's rule was a persistent boost to private consumption. Also, investment growth picked up again in the last quarter of 2019. For 2020, the heavy-lifting was expected to be done mostly by government spending, with a strong focus on large infrastructure projects, like Oosterweel, a highway infrastructure project around the city of Antwerp.

As much as we emphasised the government role in supporting economic growth for the country in earlier publications, its actual impact in supporting domestic activity over the next coming months will be crucial. Measures include an increase in payment to those in temporary unemployment and delayed tax-payments by corporations. Negotiations about a EUR 50 bn-program carried by the government, the largest banks and the National Bank of Belgium are expected to reach their conclusion over the next coming days.

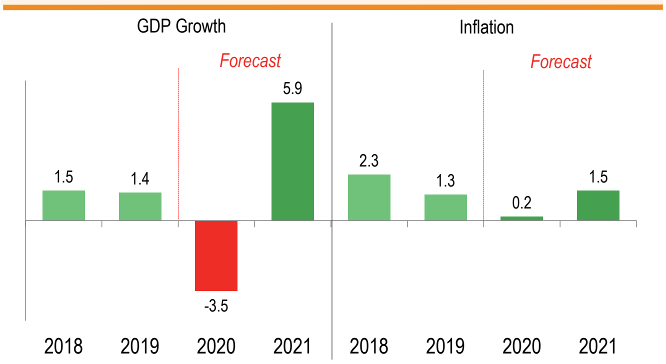
Still, the 3.5% decline in GDP we are currently forecasting is the largest such dip since the 2nd World War. This takes into account the current measures taken by the government to support household income and keep businesses from going broke.

To reflect the expected impact of the Covid-19 virus and its subsequent disruptions, we put aside the traditional "expenditure"-approach to calculate total GDP. Instead, we focussed on a "production"-approach, a framework that allows to more clearly specify changes to the added value on a sector level.

The subsequent analysis showed that most sectors of the economy will indeed suffer over the coming weeks and months, bar notable exceptions such as healthcare. For Belgium, the largest slowdown in activity is expected in the construction sector and for real estate related activities. For the former, the physical nature of the job renders it almost impossible for most businesses to comply with the strict social distancing rules, whereas the latter's sector federation actually supported a recent government decision to forbid house-visits by prospective buyers.

The forced closing of certain aspects of social life obviously adversely impacts the demand in all sectors, but also on the supply side there are issues. According to the Secretary of Labour Nathalie Muylle, at least one million workers (20% of the total workforce) are, at currently, temporarily unemployed. Under this scheme, these workers are eligible to receive social support to the tune of 70% of their normal earnings, within some constraints.

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

In addition, there has been a strong focus on telework. Data from 2017 show that about 17% of all employees regularly works from home, with public workers actually well ahead of their peers in the private sector. However, as schools and daycare centres increasingly only take in children from parents with jobs considered essential, the amount of telework will presumably be closer to 50% today. Many of these workers (and their employers) might not yet be as experienced in the technological side of such setup. Combined with potential round-the-clock childcare, a slump in productivity seems inevitable.

Public finance

At the time of the first Covid-19 outbreak in Europe, the political situation in Belgium was still best described by a deadlock, following the May 2019 elections. In the meantime, Prime Minister Wilmés, who inherited a minority-backed government from Charles Michel when he became European Council President, received support from all but two parties in the federal parliament to execute a "corona"-mandate. This in theory authorizes the PM and her secretaries to fight the current crisis without consulting parliament on a regular basis.

Public finance was already deteriorating in 2019, as the deficit shot up again from a post-crisis low of 0.7% in both 2017 and 2018 . A recent publication from the National Bank of Belgium investigates how large GDP-shocks could adversely impact the deficit in various European countries. This analysis identified the strong automatic stabilisers in Belgium as a prime reason for the country's high budget sensitivity, coming in a close second to France. Based on the analysis by the NBB, the budget deficit for 2020 could increase again by an additional 4 % points to an estimated 7%. But even with this kind of deficit, Belgium will be far from the worst pupil in the class. We're living in different times.

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Portugal

Caught up by the crisis

After what proved to be a rather mild slowdown, Portugal's GDP growth ended up in the upper range of expectations at 2.2% in 2019. The Covid-19 pandemic will surely erase the country's enviable performances as whole segments of the economy come to a standstill and the country sinks into a major recession in the weeks ahead. Similarly to its European counterparts, the Costa government is steadily implementing a series of measures to preserve the economic system during the crisis and safeguard the country's capacity to recover.

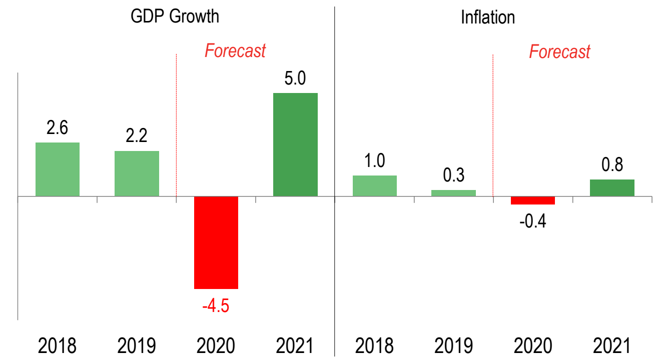
Portugal was already in the midst of a gradual but firm economic slowdown when it was caught up by the Covid-19 epidemic. Although the Q4 2019 rebound in GDP came as a surprise (+0.7% q/q after +0.3% in Q3), the mediocre quality of its components confirmed that the economy was running out of steam, (the first signs of which had appeared last fall), and that the business climate was deteriorating. Supported by a strong rebound in exports (which is sure to be short lived), the fourth quarter was marked by the stagnation of private consumption, a downturn in investment and massive destocking, which only amplified the slowing of domestic demand, a trend that gradually set in over the course of last year.

The coronavirus epidemic hit Portugal somewhat belatedly. At the end of March, the situation was not nearly as disastrous as in the neighbouring countries (Spain, France and Italy). The crisis is nonetheless poised to intensify in the weeks ahead, although the lag has given the Lisbon government some precious time to make a few early decisions. After closing schools and certain public spaces, the government declared a countrywide state of emergency effective 20 March, imposing confinement measures that are virtually identical to those in France. Portugal closed its borders with Spain, one of the epicentres of the epidemic, except for merchandise transport and cross-border workers. All air, sea and river travels were suspended.

Like the other European economies, Portugal will now have to prepare for a major recession in the months ahead. The downturn will apparently be concentrated in the second quarter, followed by a rebound, although for the moment, it is hard to foresee its timing or size. At this stage, rather than serving as veritable forecasts, our estimates mainly provide an idea of the order of magnitude. In Q2, we can expect the economy to contract by at least 10% q/q, which would bring the decline in full-year 2020 GDP to between 4% and 5%. We should expect coronavirus confinement measures to be accompanied by a major decline in the volume of services, especially personal care, retailing, and hotel and food services. The impact will not be as severe in other sectors of activity, like corporate services, construction and industry, although it will still be strong. Portugal has two other weaknesses: the heavy weighting of tourism and international goods transport. The epidemic could have a major, lasting impact on international tourism and travel, the weight of which has more than doubled over the past 10 years and now accounts for over 8% of GDP.

In addition to expenditures linked directly to the health crisis, the government has set up a series of measures to mitigate as best as possible the impact of shutting down businesses on employment and corporate solvency, in order to be prepared for the recovery. Portugal's economic fabric can be characterised by the high density of small and mid-sized companies, which means it must be particularly careful to minimize the destruction of productive capacity.

1- GDP Growth and inflation
(Y/Y, %)



Source: National Statistics, BNP Paribas

For the moment the government's economic support plan is built around four vectors: 1) vast measures to subsidise partial unemployment, which enable workers to preserve up to two thirds of their wages in the hardest hit sectors; 2) deferred tax payments and social security contributions; 3) a moratorium on capital and interest payments for certain bank loans to households (residential) and companies; and 4) corporate credit lines provided by banks with state guarantees. Initially estimated at EUR 9.2 bn (including EUR 3 bn in state guarantees), the cost of these and any additional measures will certainly rise in the weeks ahead.

Although Portugal still has a very high public debt ratio of just under 120% of GDP, the country is entering the crisis with solid public finances. In 2019, it ended up reporting a fiscal surplus of 0.2% of GDP, which it was not targeting until 2020. The fiscal manoeuvring room that Portugal has built up so diligently in recent years is about to pay off.

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United Kingdom

Put to the test

Now a global phenomenon, the Covid-19 pandemic reached the United Kingdom relatively late and did not give rise to immediate protective measures. Having initially opted for a 'herd immunity' strategy, Boris Johnson's government finally decided, on 24 March, to introduce a national lockdown. As in Italy, France and indeed generally across continental Europe, people's movements and interactions are now limited in the UK. The disease, meanwhile, has spread rapidly, on a trajectory similar to that seen in the worst affected countries. Faced with the health and economic threats created by the pandemic, the government and the monetary policy authorities have introduced an exceptional package of support.

The population of the United Kingdom and its economy are faring no better than elsewhere in the face of the coronavirus pandemic. Its relatively late arrival in Britain – on 29 February 2020 there were 23 confirmed cases, compared to a hundred or so in France and more than a thousand in Italy – did not trigger immediate protective measures. Boris Johnson's government initially adopted a 'herd immunity' strategy, before pivoting to a national lockdown from 24 March. At the time of writing (2 April 2020) most public places (schools, restaurants, pubs, sports clubs, etc.) and non-essential shops had been ordered to close, and restrictions had been placed on the population's movements. The disease, meanwhile, has rapidly taken hold with around 6,000 new cases per day and the loss of 4,300 lives due to Covid-19.

The economy is now showing the initial effects of the crisis. The March PMI fell to 37.1, a level never before seen, not even during the financial crisis of 2008. Back then, UK GDP showed a sharper drop than in France or in Europe as a whole[1], which could be explained both by the limited scale of the automatic stabilisers (public transfers) and the significance of wealth effects, in a country that remains a leading financial services centre.

A substantial fiscal commitment, mainly in the form of loan guarantees

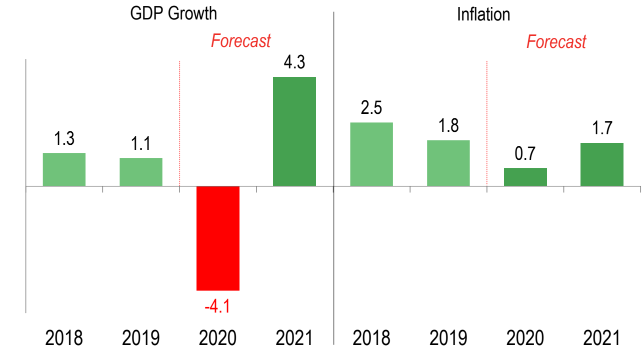
Viewed as of high quality and considered a 'national treasure', the UK's National Health Service (NHS) has nevertheless gone into the pandemic crisis in a weakened state. Although free care has been maintained to date, government spending on the service, and in particular capital spending, has been tightly constrained over the last decade. As a share of GDP spending fell regularly up until 2017, when Theresa May changed course[2]. Today the country is far from being well placed in terms of healthcare staff and capacity (2.57 hospital beds per 1,000 inhabitants, a level at the bottom end of the OECD range, Figure 2).

Fiscal measures to tackle the effects of the pandemic presented on 11 March by Rishi Sunak, Chancellor of the Exchequer, included an additional GBP5 billion for the NHS (4% of its annual budget) which might look puny given the scale of the crisis. In reality, the bulk of the government's commitments relate to guaranteed cash flow loans

[1]Between the first quarter of 2008 and the second quarter of 2009, UK GDP fell by 6%, compared to 3.9% in France and an average of 5.6% in the European Union. Source: Eurostat.

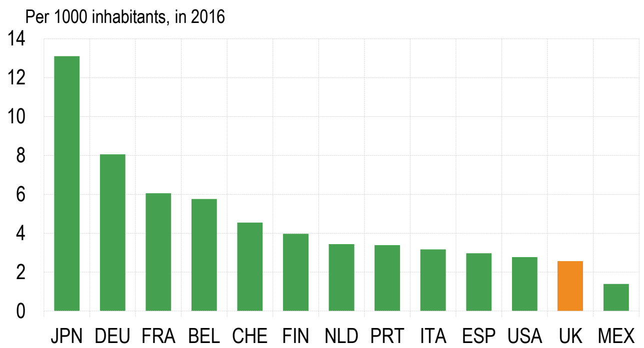
[2] See Office for Budget Responsibility, *Fiscal sustainability and public spending on health*, September 2016.

1- GDP Growth and inflation
(Y/Y, %)



Source: BNPP, Interim Forecasts (Before Global Markets updated scenario)

2- Hospital beds



Source: OECD

3- Fiscal support measures (GBP billion)

Loan guarantees	**330**
- To major companies (CCFF*)	n.s.
- To SMEs (BILS**)	n.s.
Direct transfers, contribution reductions and deferrals	**39**
- To companies	27
- To social organisations (including NHS)	12
TOTAL	**370**

* *Covid Corporate Financing Facility* ***Business Interruption Loan Scheme*

Source: Government, IMF, Press

to companies suffering from a loss of business (Table 3). On 17 March, Mr Sunak announced that their total value could reach GBP330 billion, or 15% of GDP. Although the precise split has not been spelt out (it will depend on the scale and spread of the crisis), the bulk of the allocation will go to large companies through the Covid Corporate Financing Facility (CCFF), a programme of buying commercial paper that will be open for 12 months and run by the Bank of England (BoE). Eligible securities (for a minimum amount of GBP1 million and for maturities ranging from 1 week to 12 months) must be issued by companies "making a significant contribution to the economy" with an investment grade credit rating on 1 March 2020[3].

Small and medium-sized companies, with annual revenue of up to GBP41 million, will be covered by the Business Interruption Loan Scheme (BILS), a system of loans made by banks for an amount of up to GBP5 million. The UK Treasury will guarantee 80% of the loan value and cover the first six months of interest payments.

To complete the picture, the government is planning direct cash grants to companies and offering deferral of contribution payments for a total of at least GBP 20 billion (GBP 27 bn on the IMF's reckoning).

Substantial monetary support

As is the case around the world, the fiscal effort has been backed by an unprecedented monetary stimulus. Since 11 March, the BoE's policy rates have been close to zero, the financial system has received exceptional injections of liquidity, in both sterling and dollars, and the pace of quantitative easing has increased (see box). At the latest regular meeting of its Monetary Policy Committee (MPC), on 25 March 2020, the BoE did not take any new measures but indicated its readiness to increase asset purchases if necessary and emphasised its vigilance over the application of the measures introduced, to guarantee their correct transmission into the real economy.

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4- The BoE has deployed substantial resources

Mark Carney's term as the Governor of the Bank of England ended on 16 March, having been extended to help deal with possible Brexit-related complications. At the time of his departure, the BoE had pursued a more or less unchanged monetary policy for several months with an asset purchasing programme, launched in 2009, capped at GBP445 billion, and a policy rate that was raised to 0.75% in August 2018 and held at that level despite the repeated votes, since November 2019, by two MPC members to cut it to 0.5%.

Faced with the Covid-19 crisis, the BoE reacted relatively quickly and strongly at the extraordinary MPC meetings on 11 and 19 March. The policy rate was cut first to 0.25%, then to 0.10%. The asset purchasing programme was increased by GBP200 billion, including GBP10 billion in private securities. The long-term refinancing programme was relaunched as the Term Funding Scheme Small and Medium Enterprises (TFSME), which as its name suggests has a particular focus on SMEs. Planned to last 12 months, the TFSME is designed to make available 4-year funding equivalent to 10% of participants' real economy lending at preferential rates. The counter-cyclical buffer applicable to UK lending was cut from 1% to 0% for 12 months with immediate effect, freeing up the equivalent of up to GBP190 billion of potential financing according to BoE estimates.

An agreement was also reached with the Fed to improve liquidity supply through US dollar liquidity swaps. In practice, the effective rate on this type of financing fell by 25 basis points on 16 March. On 18 March, the BoE announced that it had already allocated GBP12 billion of this type of funding. On 24 March, it also triggered the Contingent Term Repo Facility (CTRF), temporarily enhances its capacity to provide sterling liquidity.

Lastly, the BoE plans to adjust the timetable and application of certain prudential measures. The stress tests due to be carried out in 2020 have been cancelled – the 2019 round of tests having been judged satisfactory by the BoE – and the Biennial Exploratory Scenario looking at liquidity and climate change delayed. The BoE has also expressed its support for a flexible application of the rules for classifying loans under IFRS 9 such that, should the authorities impose or encourage repayment holidays, this does not automatically feed through into the recognition of cases under Stage 2 – which would require an increase in bank provisions. The BoE has also decided to delay by one year the implementation of proposals relating to the definition of default, probability of default and loss given default and the move to 'hybrid IRB' models as part of the finalisation of Basel III measures. Since this decision, the Basel Committee has made a similar recommendation.

Laure Baquero

[3] It is worth noting that the BoE will have some flexibility on these criteria, particularly if they prove to be too selective. See: Financial Times, *Loan guarantees: what funding will be available to UK businesses?* March 20, 2020.

Sweden

Resilient but not off the hook

After the economic slowdown was confirmed in 2019, the global shock of the coronavirus pandemic will probably drive Sweden into recession in 2020. The evaporation of global demand, notably from the European Union and China, will trigger a drop-off in exports, and production channels will temporarily freeze up. Investment and consumption will both be hit. The central bank has adopted unprecedented support measures while the government is devoting its financial manoeuvring room to funding a fiscal stimulus policy that supports jobs and businesses.

In 2019, GDP growth slipped to 1.3%, the lowest level since 2013. The economic fallout of the Covid-19 pandemic, coupled with the slowdown already underway, will probably drive Sweden into recession in 2020, even though official forecasts are still in positive territory (+0.8% according to Magdalena Andersson, Minister for Finance).

Demand falters

With exports accounting for 45.6% of GDP, the Swedish economy will be hard hit be the slowdown in global trade engendered by the Covid-19 crisis. Swedish exports will decline in the first half of 2020 as demand is bogged down for its main trading partners, notably China and the European Union[1].

The Covid-19 crisis will affect corporate production chains in Sweden and aboard, resulting in a decline in private investment. For example, 90% of Swedish business leaders operating in China foresee a sharp drop in sales in 2020.

For the moment, the virus has not hit Sweden very hard (only 180 Covid-19 victims at the time we went to press, which as a share of its population is 12 times less than in Italy). It has not had to impose strict confinement measures either. Consequently, it is counting on household spending to be relatively resilient. Even so, private consumption will be squeezed by several negative factors (rising unemployment[2], higher precautionary savings), and is likely to level off at best in 2020, after rising 1.2% in 2019. Lastly, after declining by 8% in 2019, residential investment is expected to stabilise at a low level[3] thanks to the absorption of surplus house stocks for sale on the market.

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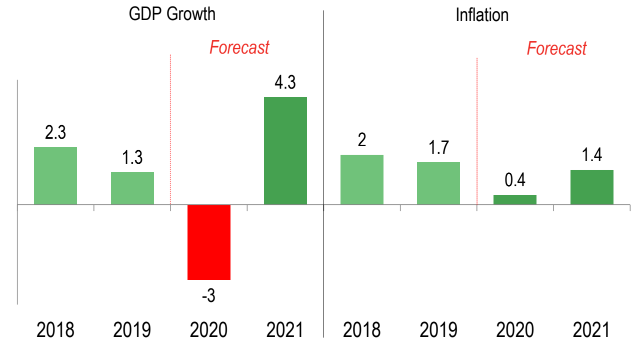
1- GDP Growth and inflation
(Y/Y, %)



Source : National Statistics, BNP Paribas

2- Economic stimulus measures

*- **Monetary policy:** to defend the value of the Swedish krona and to support the economy, Riksbank announced an exceptional quantitative easing programme with SEK 300 bn in securities purchases in 2020 (covered municipal bonds and government bonds).*

On 23 March, the central bank also authorised USD lending to ensure the ongoing supply of dollars, a vital currency for Swedish companies. Yet it did not reverse its decision to maintain the repo rate at 0% for all of the year 2020.

*- **Fiscal policy:** on 16 March, the Swedish government announced a series of measures amounting to SEK 300 bn (6% of GDP) that would cover the cost of all sick leave taken in April and May, and that would allow companies to defer tax and VAT payments (retroactively, for all of the year 2020). The Debt Office is also authorised to provide State guarantees on bank loans to companies hit financially by the Covid-19 pandemic (up to 70% of loans outstanding). Guaranteed loans will amount to a maximum of SEK 75 million and are geared notably to supporting the airline companies.*

Source: Swedish government, central bank

[1] Swedish exports to the European Union and China account for 58.3% and 5% of total exports.
[2] The upturn in the jobless rate was already alarming in the first months of 2020, reaching 8.2% in February after 6% in December 2019.
[3] It is expected to drop to a record low in 2020, falling below the SEK 200 bn threshold for the first time since 2015 (SEK 198 bn).

Norway

The other shock

With the coronavirus epidemic and its impact on oil prices, which are plummeting, the Norwegian economy is heading for a contraction in 2020. Exports, which account for 41% of GDP, are likely to be hit first. Norway's central bank cut its key rate to nearly zero and has considerably increased NOK and USD lending, injecting liquidity into the economy while supporting the currency. The government has introduced fiscal measures to buffer the shock for companies and households.

After slowing in 2019, Norwegian GDP growth should swing into negative territory in 2020 due to the spread of the coronavirus epidemic and its impact on the economy and on world demand for oil.

Moribund exports and the first confinement measures

Exports of goods and services in the energy sector account for nearly 20% of Norway's GDP. Consequently, the drop-off in world oil demand should have a major impact on the economy, which the government has admitted will enter recession in 2020.

In addition to the decline in exports, which will be accentuated by the restrictions on cross-border movements of goods and persons, public and private investment both will be hit hard by low crude oil prices. The price per barrel of Brent crude oil fell to USD 20 at the end of March, which erodes the profitability of investment projects. After the major infrastructure expenditures of 2019, spending plans for 2020 have been frozen (notably for roadway and motorway infrastructure).

Although Norway has been relatively sheltered from the coronavirus epidemic (16 deaths reported at 31 March), the number of new cases has increased rapidly. As a result, the government introduced travel restrictions and social distancing recommendations. Schools and universities were closed on 12 March, and then non-residents were banned from entering the country on 16 March. Discretionary travel that is not work related is highly discouraged. To offset the ensuing loss of revenues, notably in the tourism, retail and transport sectors, the government has rolled out major fiscal efforts via guaranteed loans and deferred payments (see box).

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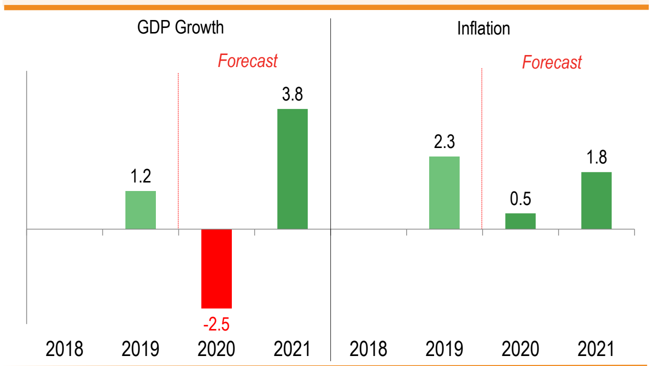
1- GDP Growth and inflation
(Y/Y, %)



Source: National statistics, BNP Paribas

2- Economic stimulus measures

*- **Monetary policy:** to mitigate the effects of the coronavirus epidemic, Norges Bank made a series of key rate cuts, bringing it to 0.25% (vs 1.5% on 12 March). It also extended the maturity and increased the amount of NOK and USD refinancing operations (for example, USD 690 m in 12-month loans at 19 March, thanks to swap arrangements with the Federal Reserve). It also lowered the limits on the amount of callable collateral.*

*- **Fiscal policy:** the government set up support measures to offset the future economic effects of the coronavirus crisis. Companies will be provided NOK 100 bn in financing through state guarantees on loans and bond issues.*

In 2019, the sovereign pension fund, also known as the "oil fund", amounted to NOK 10,000 bn (330% of GDP excluding oil-related activities and maritime transport), the highest valuation ever reported. This gives the government a comfortable financial mattress to fall back on if bigger stimulus measures are needed. Prime Minister Erna Solberg said she was prepared to take unprecedented measures to preserve the level of employment of Norwegians and to support businesses.

Source: Norwegian government, central bank

Denmark

Not spared

The Coronavirus epidemic is also sweeping Denmark, which has now introduced relatively strict lockdown measures. With its very open economy (exports account for more than 50% of GDP), GDP growth will contract in 2020. To mitigate the shock, the government has launched major fiscal support measures, comprised notably of paying compensation for all or part of wages for a 3-month period. The central bank is ensuring DKK and EUR liquidity, after signing a swap arrangement with the ECB.

Like many countries around the globe, Denmark must face up to the Coronavirus pandemic, a major economic and health crisis that will result in a contraction of GDP in 2020. Although the country does not seem to have been hit very hard to date[1], the government decided to introduce relatively strict confinement measures as of 13 March. Schools, universities, restaurants and most other public and cultural spaces have been closed, while non-essential public and private sector employees are urged to work from home.

Economic threat and massive fiscal measures

The crisis is expected to have a heavy impact on the economy, with a sharp contraction of GDP in Q2 2020. To handle the crisis, the government has adopted strict measures, taking advantage of its substantial manoeuvring room (recurrent fiscal surplus since 2015 and a mild debt ratio of 33% of GDP).

The biggest measure calls for the State to cover the payment of company operating expenses to limit job loss due to the shutdown of businesses. These measures are crucial in a country where household debt is very high (281% of net disposable income, the highest in the OECD) and supports the housing market. Under the Tripartite Agreement on Temporary Wage Compensation, which was passed on 14 March and strengthened on 31 March, the state will pay compensation for 75% of the wages of companies and self-employed workers experiencing hardships during a 3-month period (9 March to 9 June), within the limit of DKK 30,000 (EUR 4000) per person per month.

Like (nearly) every other country, the package also provided direct transfers under certain conditions (subsidies to help pay rent and other fixed charges), deferred tax and VAT payments, and guaranteed loans to companies for a total of DKK 60 bn (see box).

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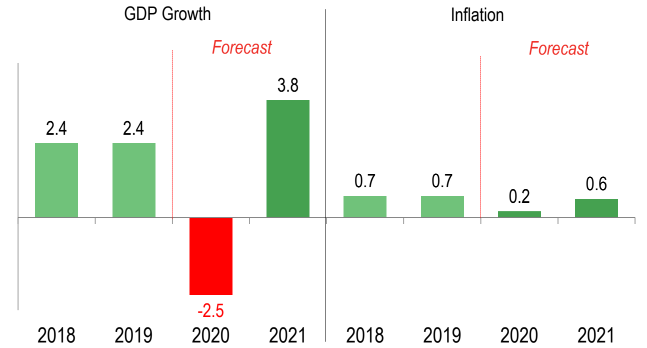
(Y/Y, %)



Source : National Statistics, BNP Paribas

2- Economic stimulus measures

- Monetary policy: *to counter pressures on the Danish krona (DKK) and defend its euro peg, the central bank initially raised its key rate to -0.60% from -0.75%. Pressure was then alleviated following the reactivation of a swap line with the ECB (20 March), the maximum amount of which is EUR 24 bn.*

- Fiscal policy: *on 14 March, all parties in the National Assembly agreed to a DKK 55 bn economic stimulus package. The stimulus measures include paying financial compensation to self-employed workers and companies (Tripartite Agreement on Temporary Wage Compensation) in order to reduce their operating costs. The government also said it would offer guarantees on corporate loans for up to DKK 60 bn (more than 5% of GDP). These unprecedented measures are much larger than those taken following the 2008-09 crisis. The Danish government is seeking to avoid the threat of recession in 2020 by stimulating production and employment in the second half.*

Source: Government, central bank

[1] The official contamination rate (500 cases for a million inhabitants) is relatively high in Denmark, but great caution is needed when making comparisons: at 31 March, the country had 90 Coronavirus victims, or 13 times fewer than Italy as a share of the population.

Finland

Entering recession

Economic activity will plummet under the impact of the Covid-19 pandemic, but not only via the export channel. The recession could become more virulent if household consumption and production channels were also to freeze up. In addition to the ECB's monetary policy support, the government will also try to use fiscal policy to buffer the shock and limit the decline in employment.

Through 2019, the Finnish economy was still looking good, even though growth was slowing. A major boat shipment bolstered exports, while GDP growth, at 1.5%, exceeded the European average. In 2020, the global economy has come to a standstill due to the Covid-19 pandemic, which will drive Finland into recession, the size of which is yet to be seen.

As activity declines, a fiscal stimulus is launched

A major supplier of capital goods and refined oil (one of its top export items), Finland has been particularly hard hit by the shutdown of global supply chains. The decline in exports, notably to its eurozone trading partners (47% of total exports), and the downturn in corporate investment spending will be the main drivers of the recession. Last year's decline in the number of building permits (down 17.7% y/y in Q4 2019) was already a warning signal for residential investment, which is also expected to decline.

Finnish households will be holding back on purchases. Implementation of the Competitiveness Pact, which curbed wage growth, had already begun to erode consumer confidence, and the index fell sharply in March when it became clear that the country would not be spared the Covid-19 epidemic. Declining household consumption could accentuate the drop-off in GDP in 2020.

In evaluating the economic impact of the Coronavirus pandemic, the Finnish central bank has drawn up two scenarios. If the economy is hit solely by plummeting exports, then stimulus measures should suffice to limit the recession to an average annual decline of 1.5% in 2020 GDP. Yet if household consumption also slumps, then the decline in GDP would be closer to 4%.

Fiscal policy is still neutral for the moment, but the government will take a more expansionist stance to counter the crisis. In addition to ECB measures to support liquidity and finance the economy, the coalition government (with the Social Democrats in the majority) adopted a private sector rescue package totalling EUR 15 bn (6.4% of GDP). It calls for direct transfers to small businesses and social security organisations as well as measures to reduce and/or defer corporate charges, such as the EUR 910 m reduction in employer pension contributions in 2020.

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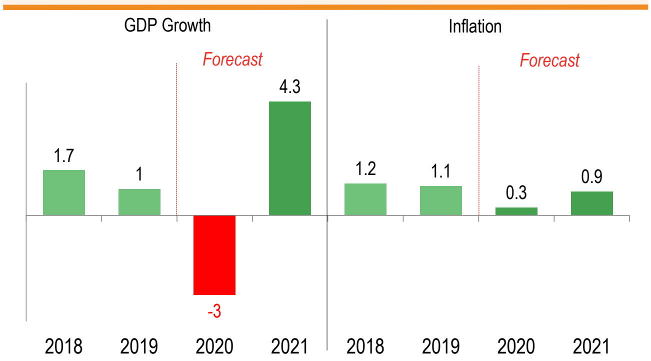
(Y/Y, %)



Source: National Statistics, BNP Paribas

Economic forecasts

%	GDP Growth *** 2019	2020 e	2021 e	Inflation *** 2019	2020 e	2021 e
United-States	2.3	-4.0	4.5	1.6	1.2	2.2
Japan	0.7	-2.6	0.8	0.5	-0.2	-0.2
United-Kingdom	1.1	-4.1	3.4	1.8	0.7	1.7
Euro Area	1.2	-4.3	6.4	1.2	0.2	1.2
Germany	0.6	-3.7	5.2	1.4	0.5	1.4
France	1.3	-3.1	5.4	1.3	0.3	1.3
Italy	0.2	-8.2	9.2	0.6	-	-
China	6.1	2.6	7.6	2.9	3.1	2.0
India*	4.9	3.3	5.3	4.7	3.5	4.0
Brazil	1.1	-1.0	3.0	3.7	3.6	3.5
Russia	1.3	0.5	2.5	4.3	3.3	3.5

Source : BNP Paribas (e: Estimates & forecasts)
* Fiscal year from April 1st of year n to March 31st of year n+1
*** Interim Forecasts, before Global Markets updated scenario

Financial forecasts

Interest rates, %		2019		2020						
End of period		Q3	Q4	Spot (02/04/2020)	Q2e	Q3e	Q4e	2018	2019	2020e
US	Fed Funds (upper limit)	2.00	1.75	0.25	0.25	0.25	0.25	2.50	1.75	0.25
	T-Notes 10y	1.67	1.92	0.61	0.80	1.00	1.25	2.69	1.92	1.25
Ezone	Deposit rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
	Bund 10y	-0.57	-0.19	-0.44	-0.50	-0.30	-0.20	0.25	-0.19	-0.20
	OAT 10y	-0.28	0.08	0.01	-0.15	0.00	0.05	0.71	0.08	0.05
	BTP 10y	0.83	1.32	1.48	1.30	1.20	1.10	2.77	1.32	1.10
	BONO 10y	0.15	0.47	0.71	0.50	0.50	0.50	1.42	0.47	0.50
UK	Base rate	0.75	0.75	0.10	0.10	0.10	0.10	0.75	0.75	0.10
	Gilts 10y	0.40	0.83	0.29	0.55	0.85	0.90	1.27	0.83	0.90
Japan	BoJ Rate	-0.06	-0.05	-0.02	-0.10	-0.10	-0.10	-0.07	-0.05	-0.10
	JGB 10y	-0.22	-0.02	-0.01	0.00	0.00	0.05	0.00	-0.02	0.05

Source: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES), last update 20/03/2020

Exchange Rates		2019		2020						
End of period		Q3	Q4	Spot (02/04/2020)	Q2e	Q3e	Q4e	2018	2019	2020e
USD	EUR / USD	1.09	1.12	1.09	1.12	1.13	1.14	1.14	1.12	1.14
	USD / JPY	108	109	108	108	106	105	110	109	105
	GBP / USD	1.23	1.32	1.24	1.35	1.36	1.39	1.27	1.32	1.39
	USD / CHF	1.00	0.97	0.97	1.00	0.99	1.00	0.99	0.97	1.00
EUR	EUR / GBP	0.89	0.83	0.88	0.83	0.83	0.82	0.90	0.83	0.82
	EUR / CHF	1.09	1.09	1.06	1.12	1.12	1.14	1.13	1.09	1.14
	EUR / JPY	118	122	117	121	120	120	125	122	120

Source: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES), last update 11/03/2020

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