AFTER A MOST DIFFICULT YEAR, CAUTIOUSLY HOPEFUL FOR 2021

Until the very end, 2020 has been a difficult year, to say the least. However, there are reasons to be cautiously hopeful about the economy in 2021. Vaccination should reduce the uncertainty about the economic outlook. Ongoing fiscal and monetary support is also important. However, more than ever, caution is necessary in making forecasts. Reaching herd immunity may take longer than expected and some of the economic consequences of the pandemic may only manifest themselves over time.

2020 has been a difficult year, to say the least. The Covid-19 recession was completely unexpected, abrupt and deep. It has triggered a huge effort from monetary and in particular fiscal policy to cushion the impact on the financial situation of households and companies. 2020 was difficult until the very end with another wave of infections in the US and several European countries, causing new restrictions. High frequency indicators such as the Google Mobility[1] data – which are closely correlated with household spending - show that the rebound after the drop in November has come to a halt. This means that the new year will start on a softer note than previously expected.

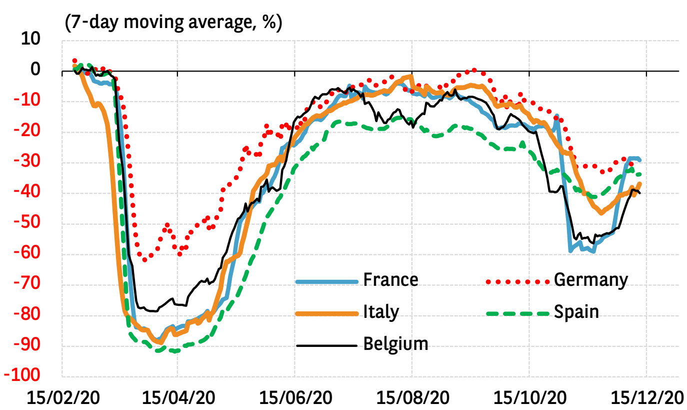
CAUTIOUSLY HOPEFUL

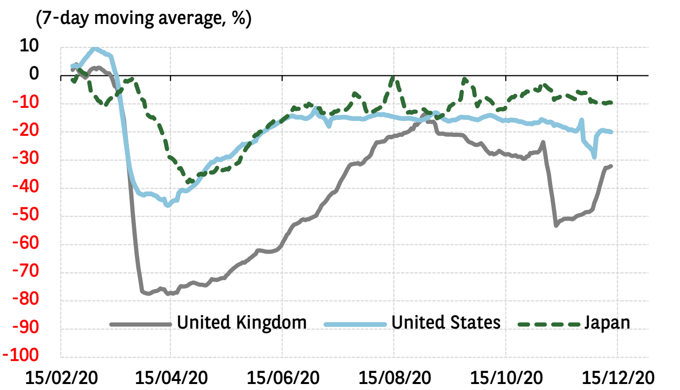
Nevertheless, there are reasons to be cautiously hopeful about the economy in 2021. Vaccination has already started in some countries and will gradually be extended to others. This should lower the risk of disruptions due to waves of new infections and hence reduce the uncertainty about the economic outlook. Consequently, the support coming from fiscal and monetary policy should make itself felt more clearly. However, more than ever, caution is necessary in making forecasts. Reaching herd immunity may take longer than expected, which would imply that infections-related uncertainty might linger on. In addition, we should be mindful that the links between final demand and its drivers -e.g. interest rates, income, company earnings- are not rigid. Psychology plays a key role. For households, unemployment expectations are an essential indicator to monitor. After declining during the economic rebound in the third quarter, the assessment by European households of the labour market outlook has deteriorated again as of late. In the near term, this may act as a drag on spending and boost precautionary savings. In addition, savings have been increased as consumer choices were restricted by the lockdown measures. Subsequently, as the outlook improves, this should go in reverse and households may very well tap into the savings accumulated during lockdown. For companies, what matters more than anything is visibility stretching far enough into the future. It will drive their decisions in terms of investments and recruitment. The latest European Commission survey on investment intentions shows only a small increase is planned for next year. The aggregate picture masks a high degree of heterogeneity. Business sentiment in the manufacturing sector has been holding up well in the euro area whereas services are suffering from the restrictions introduced in recent weeks. Companies that have seen a big increase in their debt load due to a drop in turnover during lockdown may prioritise deleveraging over investing. On the other hand, profitable businesses with a good balance sheet and an improving demand outlook may step up their investments, which would have favourable spillover effects on other sectors.

UNEASE ABOUT THE 'KNOWN UNKNOWNS'

Assessing the pace of growth in 2021 and beyond is challenging because some of the consequences of the pandemic may only manifest themselves over time. This would mean that the economy could still face headwinds even when the health situation would be considered under control. A key unkown is the impact of ending income and liquidity support measures to households and businesses. There is concern that this could cause an increase in unemployment, as companies which are financially fragile try to lower their cost base or close their activities altogether. This implies that the pick-up in activity will need to be sufficiently strong, in particular in sectors such as leisure and hospitality which have been under huge stress due to social distan-

RETAIL AND RECREATION MOBILITY





SOURCE: GOOGLE (LAST UPDATE 13/12/2020), BNP PARIBAS

1 Google Mobility Reports show how visits and length of stay at different places change compared to a baseline. The baseline is the median value, for the corresponding day of the week, during the 5-week period Jan 3–Feb 6, 2020. A figure of negative 30% indicates that traffic was down 30% compared to a baseline. The reports show trends over several weeks with the most recent data representing approximately 2-3 days ago—this is how long it takes to produce the reports. In order to smooth the series, we use a seven-day moving average of the raw data in the Google Mobility Reports. Source: Google.

cing and administrative closures. Another important unknown is the reaction of financial markets should central banks gradually shift their guidance in reaction to a sustained increase in GDP. Finally, there is the important question to which extent changes in behaviour observed this year could become permanent. This unknown is particularly relevant at the sector level. One can think of how working from home will influence the need for office space, how online shopping will impact the demand for retail shopping space, how video streaming will weigh on visits to cinemas, theatres or stadiums and how video conferencing can have repercussions on business travel.

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