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European Economic Forecast

Winter 2021 (Interim)

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EUROPEAN ECONOMY

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European Commission
Directorate-General for Economic and Financial Affairs

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Institutional Paper 144

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A CHALLENGING WINTER, BUT LIGHT AT THE END OF THE TUNNEL

The near-term outlook for the European economy looks weaker than expected last autumn, as the pandemic has tightened its grip on the continent. The resurgence in infections since the autumn, together with the appearance of new, more contagious variants of the coronavirus, have forced many Member States to reintroduce or tighten containment measures. The European economy is thus expected to have ended 2020 and started the new year on a weak footing. However, light has now appeared at the end of the tunnel that the European economy entered almost exactly one year ago. As vaccination campaigns gain momentum and the pressure on health systems to subside, containment measures are set to relax gradually. Activity is thus forecast to pick-up, still moderately in the second quarter, but more vigorously in the third, led by private consumption with additional support from global trade.

The breakthrough development of vaccines in the autumn and the start of mass vaccination campaigns has brightened the outlook beyond the near term. Furthermore, the agreement reached between the European Union and the United Kingdom on the terms of their future cooperation, reduced the cost of the UK's departure from the Single Market and Customs Union; while endorsement of the Recovery and Resilience Facility is set to support Member States on their way to a sustainable recovery. Finally, the European economy showed considerable resilience in the second half of the year, rebounding vigorously in the third quarter.

Overall, GDP is now forecast to grow by 3.7% in 2021 and 3.9% in 2022 in the EU, and by 3.8% in both years in the euro area. The EU economy would reach the pre-crisis level of output earlier than anticipated back in the Autumn Forecast, largely because of the stronger momentum in the second half of 2021 and in 2022. The speed of the recovery will, however, vary significantly across the EU. Some countries have suffered more during the pandemic than others, whereas some are more dependent on sectors such as tourism, which are likely to remain weak for some time. As a result, while some Member States are expected to see economic output return to their pre-pandemic levels by the end of 2021 or early 2022, others are forecast to take longer.

Inflation in the euro area and the EU is expected to be slightly higher in 2021 compared to last autumn, but to remain subdued despite a temporary boost from base effects. In the euro area, inflation is forecast to increase from 0.3% in 2020 to 1.4% 2021 before moderating slightly to 1.3% in 2022.

These projections are subject to significant uncertainty and elevated risks, predominately linked to the evolution of the pandemic and the success of vaccination campaigns. On the positive side, the vaccination process could lead to a faster easing of containment measures and therefore an earlier and stronger recovery. Moreover, the strength of the rebound could surprise on the upside driven by a burst of post-crisis optimism that would unleash stronger pent-up demand and innovative investment projects, thanks to historically high household savings, low financing costs, and supportive policies. On the negative side, the pandemic could prove more persistent or turn out more severe in the near term, pushing back the expected recovery. There is also a risk of deeper scars in the fabric of the European economy and society inflicted by the protracted crisis, through bankruptcies, long-term unemployment, and higher inequalities. The uncertainties around the forecast are illustrated by the scenario analysis presenting alternative paths for the European economy under different sets of assumptions. Last, but not least, an ambitious and swift implementation of the NextGenerationEU programme, including its Recovery and Resilience Facility, should provide a strong boost to the EU economy.

Table 1:

Overview - the winter 2021 interim forecast

	Real GDP growth						Inflation					
	Winter 2021 interim forecast			*Autumn 2020 forecast*			Winter 2021 interim forecast			*Autumn 2020 forecast*		
	2020	2021	2022	*2020*	*2021*	*2022*	2020	2021	2022	*2020*	*2021*	*2022*
Euro area	-6.8	3.8	3.8	-7.8	4.2	3.0	0.3	1.4	1.3	0.3	1.1	1.3
EU	-6.3	3.7	3.9	-7.4	4.1	3.0	0.7	1.5	1.5	0.7	1.3	1.5

1. EURO AREA AND EU OUTLOOK

1.1. INTRODUCTION

New developments since the autumn shape the outlook

Europe is still firmly in the grip of the pandemic. The resurgence in infections in the autumn forced many Member States to reintroduce or tighten containment measures that affect economic activity. More recently, new, more contagious variants of the coronavirus have been spreading around the globe, aggravating the epidemiological situation and leading to renewed lockdowns across the EU.

On the positive side, the breakthrough development of vaccines in the autumn and the start of vaccination campaigns in late 2020 or early 2021 in all Member States has brightened the outlook beyond the near term. Furthermore, the agreement reached between the European Commission and the United Kingdom on the terms of their future cooperation with the European Union reduces the cost of the UK leaving the Single Market and Customs Union, compared to what was assumed in the Autumn Forecast. The Council and the European Parliament reached consensus on the Multiannual Financial Framework and NextGenerationEU and, a few days later, a political agreement on the Recovery and Resilience Facility (RRF) was reached, which will help Member States pave the way to a sustainable recovery. This endorsement of forceful EU policy action has reinforced a strong upside risk for the EU's economic outlook. Finally, in the summer months, the European economy rebounded more strongly than previously expected, while activity appears to have been relatively resilient in the fourth quarter amid the second wave of the pandemic.

A delayed but stronger recovery

Overall, while the outlook for the near term looks weaker than expected last autumn, growth in the European economy is set to resume this spring and gather momentum in the summer, as progress in vaccinations allows for a gradual unfreezing of economic activity. External demand is also set to support the recovery on the back of an improved outlook for the global economy. These positive forces should allow the EU economy – on aggregate, though not for all Member States – to reach the pre-crisis level of output within the forecast horizon. Uncertainty and risks surrounding this baseline forecast remain elevated and crucially related to the evolution of the pandemic and the pace, efficiency and effectiveness of vaccination rollout.

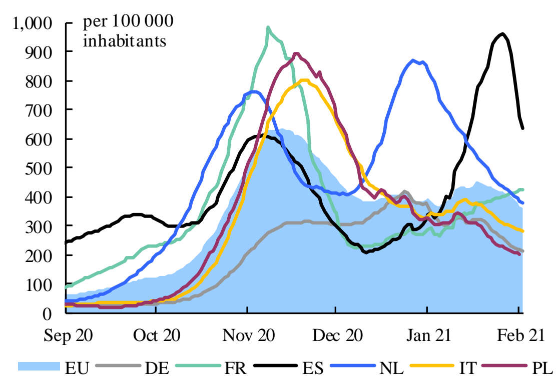
The Winter 2021 Interim Forecast provides an update of the Autumn 2020 Forecast, published on 5 November 2020, focusing on GDP and inflation developments in all EU Member States.

1.2. EVOLUTION OF THE PANDEMIC AND INTERVENTIONS TO STEM IT

The EU is still firmly in the grip of the pandemic

Following a sharp increase in infections to around 640 per 100,000 inhabitants in mid-November, the 14-day incidence of the virus in the EU decreased towards the end of last year and has fluctuated within an elevated range of 350-450 since late December (see Graph 1.1 and 1.2). Still, the situation remains very different and changeable across Member States. In early 2021, the infection's curve appeared to be getting worse in some Member States (e.g. France, Portugal and Ireland), but improving in others (e.g. Germany, The Netherlands, Italy and Poland). The emergence and subsequent spread of new, more infectious variants of the virus may have contributed to sustaining high infection numbers in recent weeks and is likely to put Member States under further pressure in the short term.

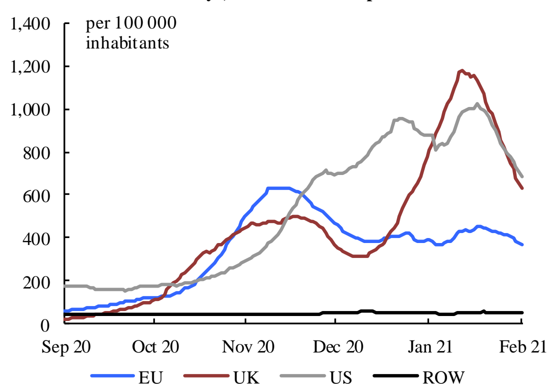
Graph 1.1: **Cumulative number of new COVID-19 cases in the last 14 days, EU**



Source: WHO.

The rise in infection rates in the autumn led to a surge in hospitalisations that has strained the capacity of intensive care units, forcing governments to reintroduce containment measures, restrict cross-border movements or reinstate lockdowns. These interventions, however, have generally been less stringent and more targeted than those imposed in March and April last year. Industry and construction have been largely allowed to operate, while schools and kindergartens have generally remained open, which together with an extensive use of remote working, has prevented the denting of the labour force. At the same time, restrictions on social gatherings and non-essential shopping came at a time of the year when these normally peak due to the festive season, amplifying the economic fallout.

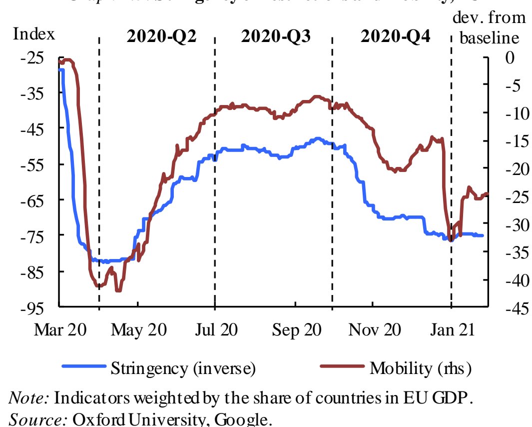
Graph 1.2: **Cumulative number of new COVID-19 cases in the last 14 days, international comparison**



Source: WHO.

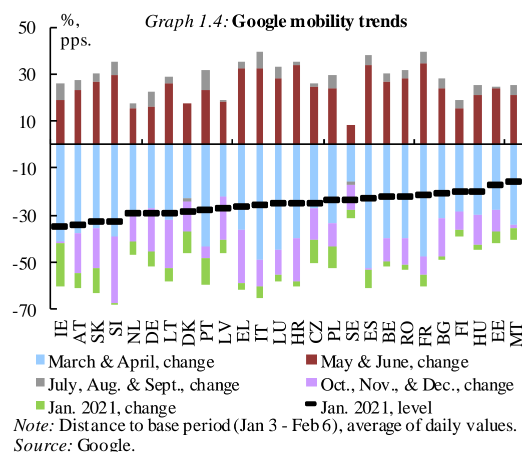
Accordingly, the Oxford Stringency Index showed an increase for the EU in the fourth quarter of 2020 and again in January (to 65.1 and 75.1, respectively), but remained below its April 2020 peak (82.0). Both imposed and self-imposed restrictions led to a sharp fall in mobility, as measured by the Google mobility index (see Graph 1.3). Compared to the period between 3 January and 6 February 2020 - before the outbreak of the pandemic in Europe - average mobility in the EU was about 17% lower in the fourth quarter of 2020, and declined further (to -26%) in January 2021. This compares to -25% and -9% on average in the second and third quarters of last year, respectively. The extent and timing of the decline in mobility varied considerably across Member States (see Graph 1.4). Some countries that had been spared a major surge in infections and hospitalisations in spring last year recorded their largest decline in mobility in the last quarter (e.g. Czechia, The Netherlands).

Graph 1.3: **Stringency of restrictions and mobility, EU**



Note: Indicators weighted by the share of countries in EU GDP.
Source: Oxford University, Google.

Graph 1.4: **Google mobility trends**



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

Vaccination underway in the EU

The official rollout of vaccinations in the EU began on 27 December 2020, marking the materialisation of a positive risk highlighted in the Autumn Forecast. So far the European Commission has secured 2.3 billion doses from six different vaccine producers for the use in Member States. Despite some organisational challenges and temporary supply shortages, vaccination campaigns are proceeding across all EU Member States, with the number of vaccinations administered reaching an average of 3 doses per 100 people in early February, with large cross-country differences.

Around the world, the situation and outlook for the pandemic varies by region

Outside the EU, the epidemiological situation varies widely both within and between regions. The increase in infection and mortality rates in both the US and the UK has far outstripped the EU in recent weeks (see Graph 1.2). At the same time,

vaccination campaigns appear to have progressed quickly in both countries, which improves the epidemiological outlook beyond the near term. Asia still shows relatively low aggregate numbers, with China and, to a lesser extent, Japan and South Korea appearing to have effectively contained the spread of the virus, despite some small outbreaks recently. On the other hand, there are signs of an uptick in infection rates in larger Latin American economies and parts of Africa.

1.3. GLOBAL ECONOMY: RECENT DEVELOPMENTS AND OUTLOOK

Swift bounce back after an unprecedented slump of the global economy

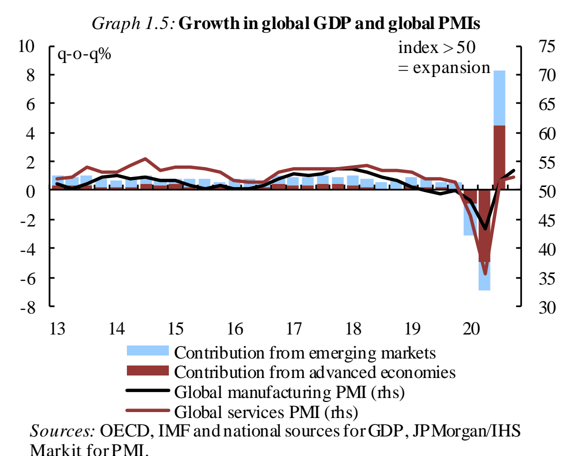
Following a severe contraction in the first half of last year, the global economy rebounded strongly in the third quarter, as virus containment measures were eased and aggressive and broad-based policy responses cushioned the impact of the crisis on incomes and kept credit channels open. The Global Composite PMI rose to around 53 points in the fourth quarter of 2020 (up from 52, on average, in the second), signalling expansion, with an improving situation in manufacturing in the US and most emerging market economies. Industrial production grew further in October and November, confirming the strong recovery in the goods sector, even if spending on consumer goods contracted in advanced economies in November as mobility faltered.

Weaker near-term growth due to renewed COVID-19 outbreaks, but overall improved outlook amid stronger policy support

Real GDP growth in the third quarter of 2020 surpassed expectations in a number of economies, which implies an upward revision to the 2020 forecast and a higher carryover for 2021. Conversely, global economic activity at the start of 2021 is likely to have been dented by renewed outbreaks of the pandemic, the widespread reintroduction of containment measures, and additional uncertainties around the emergence of new variants of the virus. At the same time, vaccination campaigns are progressing in advanced economies, which should help to sever the link between infections and economic activity progressively over the course of the forecast horizon. Moreover, the unprecedented fiscal and monetary stimulus measures that were put in place in several advanced economies in spring 2020 have been reinforced by new stimulus packages in Japan and the US.

Overall, real global GDP (excluding the EU) is projected to have contracted by 3.4% in 2020 and is set to rebound by 5.2% and 3.8% in 2021 and 2022, respectively. Compared to the autumn, the outlook has improved for the major advanced economies and Asian emerging market economies, but remains broadly unchanged for other regions. These projections are underpinned by an assumption that, globally, virus containment measures will remain in place throughout 2021, though they will be eased in the second half of the year in advanced economies and somewhat later in the emerging markets, reflecting the roll-out of vaccination campaigns.

Graph 1.5: **Growth in global GDP and global PMIs**



Sources: OECD, IMF and national sources for GDP, JPMorgan/IHS Markit for PMI.

Table 1.1:
International environment

(Annual percentage change)	2017	2018	2019	Winter 2021 interim forecast 2020	2021	2022	*Autumn 2020 forecast* *2020*	*2021*	*2022*
				Real GDP growth					
World (excl.EU)	3.9	3.7	3.0	**-3.4**	**5.2**	**3.8**	*-3.8*	*4.7*	*3.7*
				Trade volumes					
World (excl.EU) exports of goods and services	5.2	3.8	0.2	**-9.1**	**6.5**	**4.6**	*-10.5*	*6.0*	*4.4*
World (excl.EU) imports of goods and services	5.9	4.2	-0.5	**-9.4**	**7.5**	**4.9**	*-10.3*	*6.3*	*4.1*

The global (ex-EU) recovery in trade continues for goods but lags for services

Global (non-EU) trade in goods rebounded strongly in the third quarter of 2020 from a sharp and broad-based contraction in the first half of the year. Momentum is expected to have slowed since then due to the impact of renewed containment measures on global demand and hampered global supply chains. While the new export orders component of the Global Manufacturing PMI came in firmly above 50 points in the fourth quarter, it decreased close to the stagnation threshold in January. Going forward, growth in the global goods trade (excluding the EU) is projected to recover in line with global economic activity and should continue to benefit from the strong uptick in manufacturing activity. By contrast, the recovery of trade in services, after a steep contraction in the first half of 2020, has been subdued, and is forecast to remain so until the restrictions on tourism activities and travel are lifted. Global trade tensions and trade policy uncertainty are likely to continue to weigh on trade over the forecast horizon. Overall, world imports of goods and services (excluding the EU) are forecast to grow by 7.5% in 2021 followed by 4.9% in 2022.

Oil prices shoot up on expanded production cuts

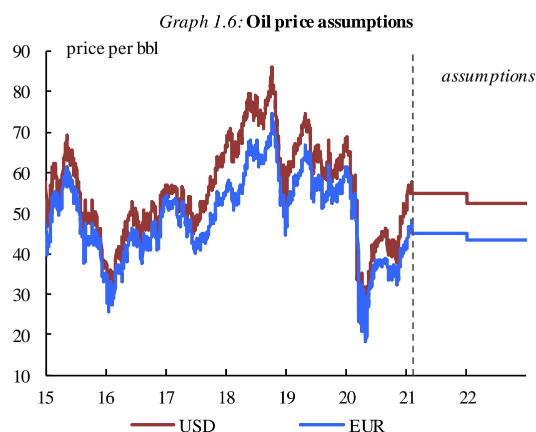
Oil prices have been rising since November 2020 reflecting sharp production cuts by OPEC+, compounded by a reduction of output by other producers, weakening USD, and, recently, the surprise announcement by Saudi Arabia to cut production by an additional 1 million barrels/day in February and March 2021. At the same time, inventories have fallen and demand for oil has recovered somewhat at the end of 2020, though remaining subdued compared to 2019 levels. Against this backdrop, market expectations of oil prices now average USD 54.2 per barrel in 2021 and USD 51.9 per barrel in 2022.

1.4. FINANCIAL MARKETS

Global financial markets have remained on a positive trend since the autumn

Global financial markets recovered further from their trough in March 2020, despite the ongoing pandemic and renewed containment measures implemented in many regions and particularly in Europe.

Graph 1.6: **Oil price assumptions**



Source: Intercontinental Exchange.

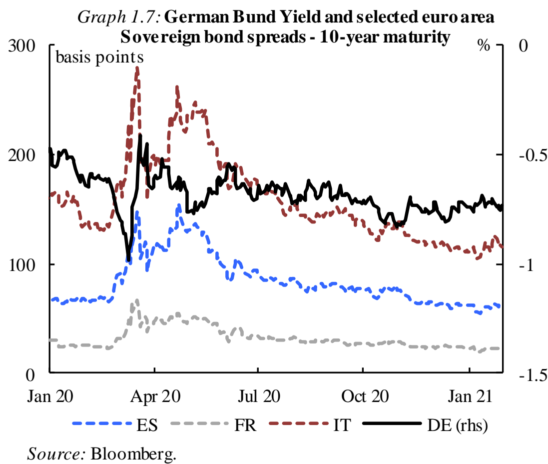
In the US, stock markets have risen well above their pre-pandemic levels, while long-term Treasury yields have increased, driven by the expectation of additional fiscal policy stimulus and an improved economic outlook. Markets have also started to price in a more inflationary environment, as the 10-year Treasury breakeven rates (the difference between the inflation-protected and nominal yields of the same maturity) rose above 2% for the first time since 2018.

The positive news about the breakthrough in vaccines and additional policy support in advanced economies has triggered a rapid rise in emerging market economies' stock markets. Spreads of emerging market sovereign debt have been compressed, particularly among investment grade issuers, driven by the global rotation towards emerging markets' more risky assets. Foreign capital inflows (mainly debt) into emerging market economies recovered rapidly towards the end of the year, in particular into China, while their currencies have strengthened vis-à-vis the USD.

European markets have mirrored global trends…

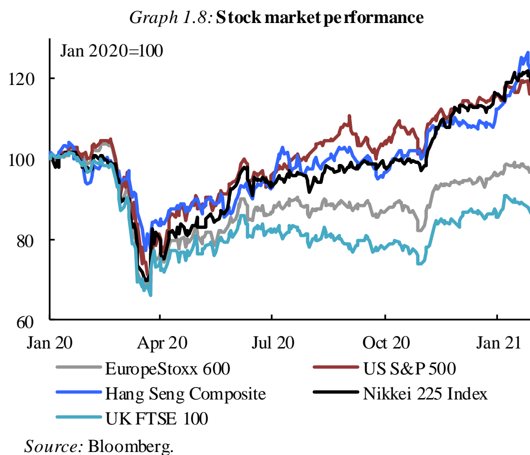
European stock markets have rallied since November. The announcement of effective vaccines, additional monetary easing and economic data confirming the ongoing industrial recovery in the euro area boosted the Euro Stoxx 50. On the bond markets, the increase in Europe's benchmark yields has been more limited than in the US (e.g. 10-year Bund yields added about 10 bps. over the past three months). Spreads of most euro area Member States vs German bunds have

tightened further in recent months, supported by the agreement reached in December on the Multiannual Financial Framework, NextGenerationEU and the Recovery and Resilience Facility (RRF). On the European corporate bond markets, spreads have narrowed further over the past few months, reaching roughly pre-pandemic levels for all credit ratings.



Graph 1.7: **German Bund Yield and selected euro area Sovereign bond spreads - 10-year maturity**

Source: Bloomberg.



Graph 1.8: **Stock market performance**

Source: Bloomberg.

…also helped by further monetary easing by the ECB…

In response to the expected economic fallout caused by the resurgence of the pandemic in the fourth quarter of 2020, the ECB took a broad set of monetary policy easing measures at its December 2020 meeting. Most notably, the ECB extended the horizon for its net asset purchases under the pandemic emergency purchase programme (PEPP) to at least the end of March 2022 and increased its total envelope by €500bn to €1,850bn. It also extended the duration of reinvestments of maturing securities bought under the PEPP by twelve months, to the end of 2023. Moreover, the ECB announced additional liquidity-enhancing measures to support the flow of credit to households and firms. In this respect, it prolonged the very favourable conditions of its targeted longer-term refinancing operations (TLTRO III) as well as the duration of the collateral easing measures adopted in April 2020. It also announced three additional TLTRO III operations to be conducted between June and December 2021 and raised the total amount that banks are entitled to borrow in these operations. The ECB also plans to conduct four additional pandemic emergency longer-term refinancing operations (PELTROs) in 2021. These measures should help support liquidity conditions in the euro area financial system and preserve the smooth functioning of money markets by providing an effective liquidity backstop.

The ECB also extended until March 2022 the Eurosystem repo facility (EUREP) and all the bilateral and temporary swap and repo lines set up with EU central banks outside the euro area. These measures have been designed as a precautionary backstop to address possible euro liquidity needs in non-euro area Member States, but also to reduce possible spillovers of market dysfunctions from those economies to euro area bond markets. At the same time, most EU central banks have kept their monetary policies unchanged or taken additional easing measures to ensure that their monetary policies remain sufficiently accommodative to support the economic recovery from the pandemic crisis.

…with the euro stabilising on foreign exchange markets.

At the end of January 2021, the euro was broadly stable in nominal effective terms compared to the autumn. Since then, the euro appreciated against safe haven currencies such as the USD and the Japanese yen in the context of an improvement in global risk sentiment. However, this appreciation was broadly offset by the euro’s depreciation against the currencies of major emerging countries, including China, Russia and Turkey, and against the pound sterling following the EU-UK trade and cooperation agreement reached in December.

1.5. RECENT ECONOMIC DEVELOPMENTS IN THE EU

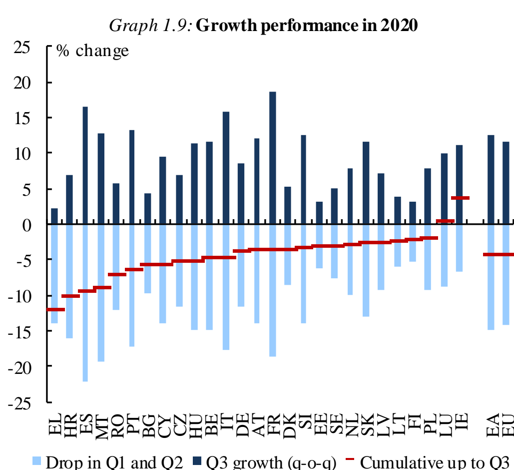
1.5.1. Economic growth

The European economy recovered some ground in the third quarter …

Economic activity bounced back strongly in the third quarter of 2020 as containment measures were lifted, but failed to recover fully. After an unprecedented contraction in the first half of the year, GDP increased by 11.5% (q-o-q) in the EU (12.4% in the euro area) in 2020-Q3, more than expected in the Commission's Autumn Forecast.

Just as the crisis brought about by the pandemic was broad-based but uneven, so was the bounce-back. Member States that saw activity fall more sharply in the first half of the year, enjoyed stronger increases in the third quarter. While this vigorous rebound helped to close two-thirds of the output loss incurred in the first half of the year, it left real GDP about 4¼% below its pre-crisis levels (2019-Q4) in both the EU and the euro area (see Graph 1.9). The gap compared to pre-crisis levels was highest in Greece (about -12%), Croatia (-10 ¼%), Malta and Spain (both close to 9%), reflecting the stronger reliance of these countries on tourism. It was smallest in Poland (-2%), Finland and Lithuania (both -2 ½%). Only Luxembourg and Ireland reported output levels close to, or higher than, their levels at the end of 2019.

Graph 1.9: **Growth performance in 2020**



…on the back of strong domestic demand.

The strong outturn in the third quarter was largely driven by private consumption (13.2% q-o-q) and gross fixed capital formation (11.9%). Growth also benefitted from a strong increase in public consumption (4.3%), as well as from a positive contribution from net exports, while inventories continued to subtract from growth. Private consumption was supported by a reduction in saving, as reflected in the household's saving rate in the EU, which fell to 16.1% of gross disposable income from 23.4% in the second quarter. However, it still remained well above the pre-crisis levels (11.9% and 15.6% in 2019-Q4 and 2020-Q1, respectively).

Among the GDP components, private consumption remained 4 ½% lower than before the crisis. While durable goods consumption fully recovered, this has not been sufficient to offset shortfalls in other items. Excluding Ireland, the gap in investment spending also stood at -4 ¼% in the EU. Despite a strong rebound in goods exports, services failed to keep pace amid restrictions to travel and tourism (see also Box 1.1).

The performance across sectors was also asymmetrical in the first three quarters of the year. Gross value added in contact-intensive services ([1]) remained severely depressed relative to pre-crisis levels (about -10%), despite strong growth in the third quarter. This contrasts with other services and construction (both -3 ¼%), as well as industry (-5%) where the gap was considerably smaller.

Fourth quarter outturn confirms the economy's resilience to renewed containment measures…

According to Eurostat's preliminary flash estimate, GDP in the EU contracted by 0.5% (q-o-q) in the fourth quarter of 2020 (0.7% in the euro area), lower than expected in the Commission's Autumn Forecast, but still relatively benign given the aggravation of the epidemiological situation. While most of the 11 reporting Member States avoided an outright contraction, GDP growth slowed down significantly in all of them compared to the third quarter. Among the largest euro area countries, output fell in Italy (-2.0% q-o-q) and France (-1.3%) but remained broadly stable in Germany (+0.1%) and expanded somewhat in Spain (+0.4%). The relatively mild outturn despite the resurging pandemic contrasts with the sharp contraction in the second quarter when the first wave hit the European economy. First, as

([1]) Wholesale and retail trade, transport, accommodation and food service activities, arts, entertainment and recreation.

Box 1.1: An update on the tourism sector: insights from big data

Tourism is a major contributor to the economies of several Member States. This box describes developments in 2020 to identify key patterns that emerged during the pandemic to help assess the sector's recovery prospects for 2021.

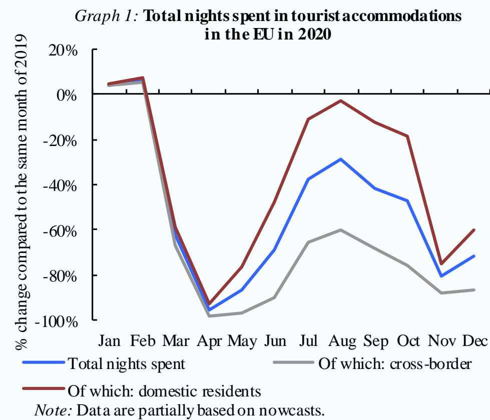
As Eurostat data on nights spent by visitors in 2020 are not yet fully available, this analysis relies on complementary nowcasts of total nights spent per country, for one to sometimes several months (see Table 1). These nowcasts are based on a real-time dataset of 45 million customer reviews for 2.3 million AirBnB holiday listings in the EU, following the methodology presented in the autumn 2020 forecast. (1) These nowcasts also make a distinction between nights spent by domestic tourists and non-residents by using the language of each review as a proxy.

A strong home bias helps to explain differences between countries…

The patterns of nights spent in tourist accommodations closely reflected the first and second major wave of COVID-19 cases in 2020, with some differences (see Graph 1). The decline in nights spent during the first wave was more pronounced and only slightly stronger for cross-border travel than for domestic tourism. During the summer season, tourism recovered some ground to its pre-pandemic levels but then suffered another setback. Over this period, cross-border travel was affected much more strongly than domestic tourism, hinting at a sizeable home bias.

For the EU as a whole, nights spent by domestic residents in 2020 declined by almost 30% compared to 2019. By contrast, those by non-resident tourists declined by about 70%. In 2020 as a whole, cross-border tourism was between 53% (Luxembourg) and 79% (Spain and Romania) lower than in 2019 (see Table 1). Where cross-border tourists mostly rely on car travel (e.g. Croatia, Netherlands), the decline turned out to be less strong than where air travel predominates.

Graph 1: **Total nights spent in tourist accommodations in the EU in 2020**



Note: Data are partially based on nowcasts.

…with city tourism most heavily affected…

City travel has been much more affected by the crisis than coastal and rural regions (see Graph 2 and Map 1). (2) *City tourism*, which normally accounts for about 60% of customer reviews across the EU, contributed the most to the decline in tourism activity in the EU in 2020. In addition to a possible change of preferences, cities have been hit more than other regions due to their reliance on spring and autumn tourism, business travel, short trips, and non-EU visitors. Overall, city tourism was down by about 30% on average compared to expected levels in 2020. (3) While several metropolitan areas have been more affected than others (e.g. -80% in Dublin, vs. -55% in Hamburg), the extent of the slump in city tourism contributed strongly to the overall decline in tourism in the respective Member State (see Graph 2).

In contrast, *coastal tourism* performed better, and on average contributed less to the tourism decline than suggested by its importance (coastal tourism accounted for 29% of EU reviews in 2019). Coastal regions in Denmark, Germany, France, the Netherlands, and Poland in particular saw activity in the third quarter close to, or even exceeding, expected levels. (4) Most Mediterranean Member States saw coastal tourism decline more strongly in view of their dependence on air travel, yet this

(1) See European Commission (DG ECFIN). (2020). 'Tourism in pandemic times: an analysis using real-time big data'. European Economic Forecast – Autumn 2020. Special Topic 3.3. Institutional Paper 136 for further methodological explanations.

(2) AirBnB customer reviews further allow for more granular insights by statistical region (NUTS 3).

(3) The expected level represents the number of overnight tourism trips that could have been expected for 2020 under normal circumstances. For more details please see the reference in footnote 1.

(4) The overall decline in reviews for coastal regions in these Member States is mostly due to an underperformance in off season week-ends during Q2 and Q4.

(Continued on the next page)

Box (continued)

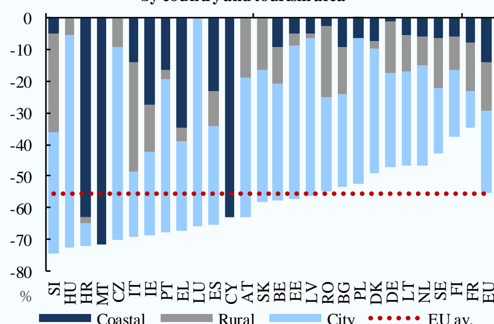
Table 1:
Tourism activity overview - nights spent in tourism accomodations

Country	Nights spent 2020, total		Nights spent, non-residents		Nowcast	Country	Nights spent 2020, total		Nights spent, non-residents		Nowcast
	Millions	% change y-o-y	Millions	% change y-o-y	Estimates from		Millions	% change y-o-y	Millions	% change y-o-y	Estimates from
Greece	39	-73%	27	-77%	Nov	**Luxembourg**	1	-49%	1	-53%	Dec
Malta	3	-71%	2	-74%	Nov	**Latvia**	3	-47%	2	-60%	Dec
Ireland	11	-70%	5	-73%	Jan	**Lithuania**	5	-45%	1	-72%	Nov
Spain	145	-69%	61	-79%	Dec	**Czechia**	31	-45%	8	-72%	Nov
Cyprus	6	-64%	6	-65%	Jun	**Poland**	52	-44%	7	-64%	Dec
Portugal	30	-61%	14	-74%	Dec	**Slovakia**	10	-44%	2	-62%	Nov
Hungary	14	-57%	4	-76%	Dec	**Slovenia**	9	-42%	3	-71%	Nov
Croatia	41	-55%	35	-58%	Dec	**Germany**	268	-39%	33	-63%	Nov
Bulgaria	12	-55%	5	-72%	Oct	**Austria**	79	-39%	51	-44%	Nov
Italy	200	-54%	65	-70%	Nov	**Finland**	14	-38%	2	-66%	Dec
Romania	15	-51%	1	-79%	Nov	**Sweden**	40	-37%	5	-71%	Nov
Belgium	21	-51%	7	-68%	Dec	**France**	282	-37%	43	-69%	Jan
EU-27	1443	-50%	418	-69%	-	**Denmark**	23	-32%	5	-63%	Dec
Estonia	4	-49%	1	-67%	Nov	**Netherlands**	86	-31%	22	-58%	Nov

Note: Number of nights spent reported via Eurostat, augmented by nowcasts based on AirBnB-reviews for the month indicated until Dec 2020.

decline was less pronounced than in their major cities (Italy, Spain, Portugal, Greece). Finally, *rural tourism* in some tourism-intensive regions saw activity comparable to that in coastal regions, most notably in France. Still, other rural areas saw a stronger deterioration, which may be related to declining sightseeing and business travel.

Graph 2: **Cumulative drop in reviews 2020, by country and tourism area**

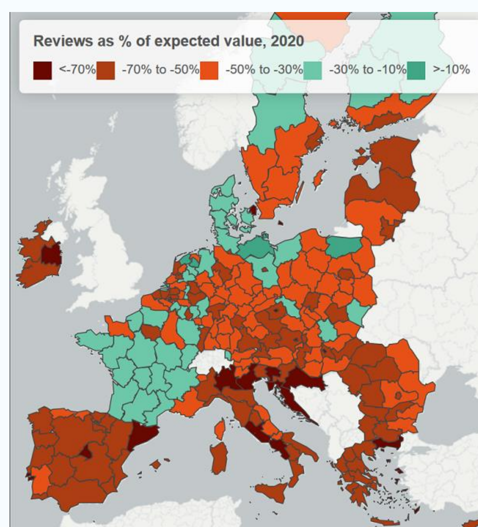


Note: Bars represent reviews 1 Jan to 31 Dec 2020, as % of total expected reviews over that period

...and also bound to lag behind in the recovery.

The pandemic will continue to shape the sector's outlook this year both directly via government restrictions on non-essential travel and indirectly, insofar as potential tourists want to limit health risks, until herd immunity is achieved. It is likely that business and city trips will continue to be heavily affected. Additionally, planning uncertainty might also have a big impact in 2021, especially for areas typically reached by air transport. Most importantly, it is expected that extra-EU travel will take more time to recover. As a consequence, city travel will take an additional hit. Moreover, since incoming tourists from outside the EU, on average, spend more by day, revenues will remain affected.

Map 1: **Regional tourism performance, Jan-Dec 2020**



On the upside, strong pent-up demand as well as high savings are likely to lead to a stronger summer season than in 2020. Given planning uncertainty and the possible wish to avoid crowds, this pent-up demand will likely result in more spontaneous trips in the home country or to destinations reachable by car. Thus, a relatively more forceful recovery in coastal and rural tourism can be expected. All in all, tourism flows on the whole are not expected to fully recover to their pre-crisis levels in 2021. (5)

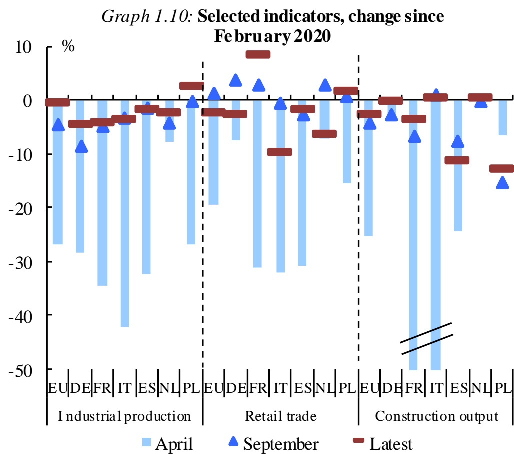
(5) For further information see IATA (2020). 'Deep losses continue into 2021'. Press release No. 95, 24 November 2020. and EUROCONTROL (2020). 'Five-year forecast 2020-2024'. November 2020.

suggested in Section 1.2, despite a markedly higher incidence of infections in the late autumn/winter wave, containment measures were more targeted and relatively less stringent, on average, than those enacted back in spring. Second, households and businesses appear to have gradually learned to live with the pandemic, weakening the link between stringency and mobility restrictions on the one hand, and economic outcomes on the other.

Solid industrial output contrasts with weak services

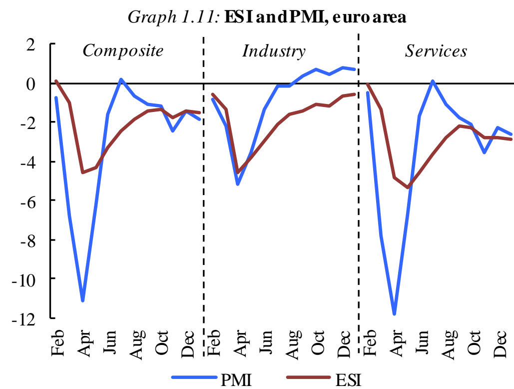
After growing strongly in the third quarter (by 16.4% q-o-q), *industrial production* in the EU continued to recover in the fourth quarter, rising in November 2020 for the seventh month in a row ([2]) and nearly returning to its February level. Likewise, *construction output*, continued to expand in November but remained about 2 ½% short of its pre-crisis level (see Graph 1.10). By contrast, following its full recovery in August, *retail sales* weakened again in November as restrictions were tightened across the EU (see Graph 1.10.). ([3]) ([4])

Graph 1.10: **Selected indicators, change since February 2020**



Survey data confirm that this divergence across sectors persisted throughout the fourth quarter (see Graph 1.11). According to Commission surveys, euro area *industrial confidence* increased to -8.8 points, on average, in the fourth quarter (back to its pre-crisis level) from -13.6 in the third, fuelled by sizeable improvements in the assessment of order books. Similarly, Markit's Eurozone *Manufacturing PMI* was up to 54.6 on average in 2020-Q4, from 52.4 in 2020-Q3. While the Commission's *services confidence* indicator also improved somewhat, on average, in the fourth quarter (compared to the third), it has so far recovered only some 50% of the losses incurred in the first two quarters of 2020. Markit's Services PMI fell back into contractionary territory during the last four months of the year and its average reading of 45.0 in Q4 still remains shy of its pre-crisis level in 2019-Q4.

Graph 1.11: **ESI and PMI, euro area**



Note: Standardised data based on 2000-'07 sample, last observation January 2021.
Source: IHS Markit, European Commission.

Policy support continues to cushion the hit to the labour market

In 2020, the widespread use of job retention schemes, supported by the EU instrument for temporary *Support to mitigate Unemployment Risks in an Emergency* (SURE), as well as other types of government interventions, cushioned the impact of the COVID-19 shock on jobs and incomes. The labour market has nevertheless seen the most dramatic changes in its history.

Never before has such a substantial decrease in employment (persons and hours worked) occurred so quickly, and never before has so much of that decline already been recovered in the subsequent quarter. Following an unprecedented decline in the first half of the year, in the third quarter 2020, the number of employed persons rebounded in the EU and in the euro area. However, the increase by 0.9% in the EU (as compared to the second quarter, 1.0% in the euro area), implied that the number of employed persons remained 2.1% (2.2% in the euro area) lower than in the fourth

([2]) It has to be noted however, that November's reading was largely due a significant increase in Ireland (+52.8%) without which production would have turned out broadly flat.

([3]) These developments were to a large extent driven by sales in France, Belgium and Austria, which saw strong monthly slumps at or above 10% in November.

([4]) The 10% rise in sales via mail order or internet compared to the third quarter was not enough to offset a 7 ½% fall in sales of textiles, clothing, footwear and leather goods, as well as in automotive fuel.

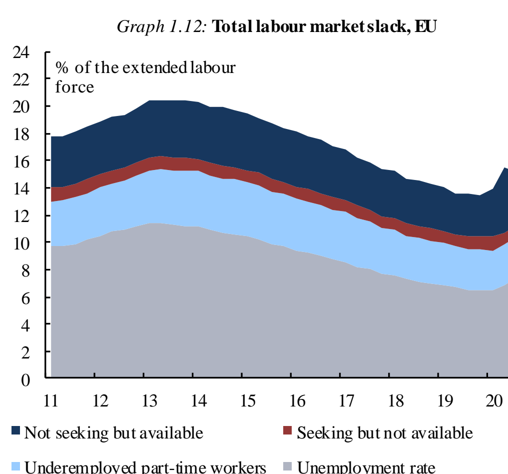
quarter of 2019. Likewise, solid growth during the same period in the number of hours worked (11.8% and 14.8% in the EU and euro area, respectively) still left their level significantly lower (by 3.7% and 4.6%) compared to the fourth quarter of 2019.

Increases in unemployment have remained contained. Following a peak in July at 7.8% (8.7% in the euro area), the unemployment rate continued to fall in the second half of 2020, as economic activity rebounded and the impact of the new containment measures remained limited. The unemployment rate stabilised in December at 7.5% in the EU (8.3% in the euro area). This is still about 1.2 pps. higher (1.4 pps. in the euro area) than in February 2020.

The evolution of labour market slack, (5) however, suggests that the impact of the pandemic has been more severe than indicated by the traditional measures of employment and unemployment. The indicator increased markedly in the second quarter of last year and dropped only slightly in the third quarter, remaining above its pre-pandemic level (see Graph 1.12). The increase in the second quarter was mainly due to large flows out of the labour force, especially in some Member States rather than increases in unemployment. These flows included people available to work but not seeking, due to the shutdown of many businesses or to parental responsibilities for taking care of children, or due to discouragement in light of the grim outlook. As activity resumed in the third quarter, the fall in the share of people available for work but not seeking offset the increase in the unemployment rate, suggesting that many people started searching for a job (again).

(5) According to Eurostat's definition, labour market slack is the sum of unemployed persons, underemployed part-time workers, persons seeking work but not immediately available and persons available to work but not seeking, expressed as a percentage of the extended labour force, which adds up the aforementioned sum and the employed persons. Unemployed persons are all persons without work, who are available to start work within two weeks, and who have actively sought employment at some time during the four previous weeks.

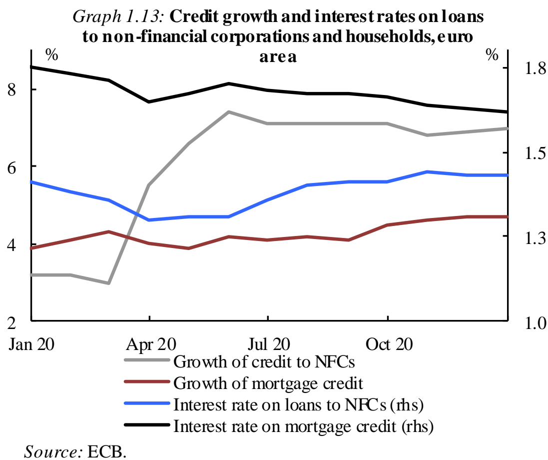
Graph 1.12: **Total labour market slack, EU**



Private sector funding has been sustained despite tighter credit standards

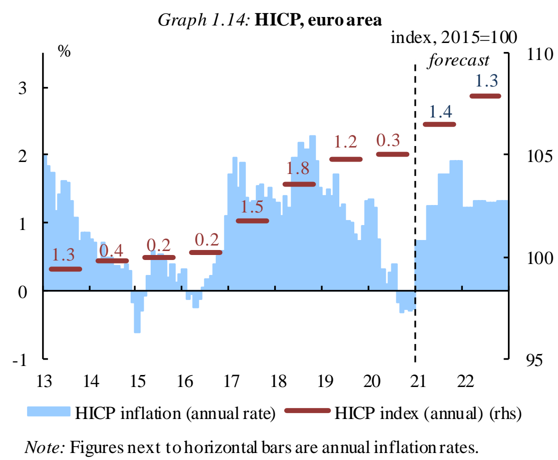
The annual growth rate of loans to the private sector stood at 4.7% in December 2020, broadly stable since August, but higher than before the crisis. Lending to non-financial corporations continues to be strong, after having picked up decisively in March/April 2020. The annual growth rate of lending to non-financial corporations stood at 7% in December, compared to 3.1% for households (see Graph 1.13). Non-financial corporations have also increasingly tapped the markets for their funding needs. The annual growth rate of outstanding debt securities issued by euro area enterprises stood at a robust 11.6% at the end of November. Listed shares issued by euro area enterprises gained some traction, increasing by 1.1% year-on-year at the end of November.

While government guarantees on loans to enterprises have supported bank lending during the pandemic, the ECB Bank Lending Survey pointed to further tightening of credit standards in the euro area across all loan categories in the fourth quarter of 2020. Banks' terms and conditions tightened mainly on the back of more stringent collateral requirements and wider loan margins. The tightening of credit standards for corporations is also consistent with the observed decline in the actual take-up of guaranteed loans. Businesses' demand for loans or drawing of credit lines continued to decline, while households' demand for housing loans increased.



Graph 1.13: **Credit growth and interest rates on loans to non-financial corporations and households, euro area**

Source: ECB.



Graph 1.14: **HICP, euro area**

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

1.5.2. Price developments

Weakness in inflation extends across many categories

The impact of the pandemic has extended to inflation developments in both the euro area and the EU. Headline inflation in the euro area, as measured by the Harmonised Index of Consumer Prices (HICP), averaged -0.3% in the fourth quarter of 2020 and remained in negative territory since August. Inflation rates have differed substantially across the non-euro area Member States, from just above 3.5% in Poland, to negative in Croatia.

Headline inflation was driven lower predominantly by the sharp fall in energy inflation, but also by services inflation depressed by demand shortfalls. In the euro area, energy inflation averaged -8% in the fourth quarter, as the impact of the pandemic shock on oil prices felt in March exerted negative base effects. Services inflation declined to just over 0.5% in the fourth quarter, a full percentage point below its average over 2019. The drop in demand and in oil prices led in turn to negative non-energy industrial goods inflation, thus dominating remaining supply side constraints reflected, for example, by higher shipping costs. As a result, euro area core inflation (all items excluding energy and unprocessed food) fell rapidly to 0.4% in 2020-Q4, from 1.3% in the same quarter of 2019. The initial supply shock that drove food prices higher in spring last year has abated in both processed and unprocessed food. Tax cuts in a number of countries, especially in Germany, and the euro's appreciation, also weighed on euro area inflation.

1.6. NEW FACTORS SHAPING THE OUTLOOK AND ASSUMPTIONS UNDERPINNING THE FORECAST

The pandemic and the measures taken to contain it are set to remain key determinants of activity, with two new developments coming to the fore: (i) the aggravation of the epidemiological situation, due in part to the emergence of new, more infectious variants, and the ensuing tightening of containment measures at the turn of the year; (ii) the start of mass vaccinations campaigns that could allow for withdrawal of containment measures earlier than expected in the Autumn Forecast. Other important new elements affecting the European economy over the forecast horizon include the improved outlook for external demand, and the Trade and Cooperation Agreement (TCA) reached between the European Commission and the United Kingdom on 24 December and provisionally in application since 1 January 2021.

A challenging race between injections and infections

The Autumn Forecast factored in an interruption in the economic rebound towards the end of 2020, against the background of a resurgence in COVID-19 infections (the 'second wave'). Since then, the pandemic has tightened its grip on the EU economy, forcing many Member States to reintroduce or tighten containment measures (see Section 1.2), and raising the potential for additional measures in the near term[6].

(6) Following recommendations of the European Centre for Disease Prevention and Control in 'Integrated COVID-19 response in the vaccination era'. 1 February 2021. Stockholm: ECDC; 2021

The start of vaccinations in all Member States has brightened the outlook. The question is now how quickly the vaccine can be rolled out, and at what point restrictions can be loosened. In its recent Communication, [7] the European Commission called on Member States to accelerate vaccinations, with the targets of vaccinating at least 80% of people over the age of 80 and 80% of health and social care professionals in every Member State by end March, and a minimum of 70% of the adult population by summer 2021. These targets take into account the number of doses that are expected to be delivered in the coming months, as foreseen in the contracts with manufacturers, (see Section 1.2), and assume no delays in their administration. Provided vaccination is accompanied by continued efforts to contain the virus, through physical distancing and limited social contacts, the achievement of these targets would considerably ease pressure on hospitals (including intensive care units) and reduce the number of deaths starting from the second quarter of 2021.

Evidence is still lacking as to the efficacy of the vaccine in cutting transmissions. A high number of infections, sustaining pressure on the health system, may persist until vaccinations reach a critical mass of people. Furthermore, the new variants increase uncertainty around the epidemiological outlook by raising important questions about the effectiveness of the vaccines (for which preliminary evidence is reassuring), and the implications of higher infectiousness on prospects for herd immunity.

The forecast crucially hinges upon assumptions on the stringency of virus containment measures…

Given current epidemiological trends, the possibility of a renewed tightening of containment measures cannot be ruled out in the near term in some Member States. However, the subsequent inoculation of the most vulnerable groups in society is expected to allow for a very gradual relaxation of containment measures from their highs in the first-quarter, leading to a progressive 'unfreezing' of the sectors where activity is currently most restricted or subdued. While there may be differences in the approach of Member States to lifting restrictions, with some putting more weight on overall infection targets [8], reduced pressure on health-care systems should, on average, lead to a gradual lifting of containment measures starting in the course of the second quarter.

Overall, this forecast assumes that after a significant tightening in the fourth quarter of 2020, containment measures remain strict in the first quarter of 2021 before easing marginally towards the end of the second quarter, and then more markedly in the second half of the year, when the most vulnerable and an increasing share of the adult population should have been vaccinated. It is assumed that containment measures will be marginal towards the end of 2021, with only targeted sectoral measures still present in 2022. These technical assumptions are subject to risks related to, inter alia, the emergence of new variants, progress in vaccinations, and global epidemiological developments. Meanwhile, economic agents continue adapting to and learning to live in the COVID-19 environment, leading to a progressively decreasing impact of a given level of restrictions on economic activity.

… and a new outlook for external support.

The EU-UK free trade agreement implies a somewhat less negative impact on activity in the EU and the UK compared to the WTO terms assumed in the Autumn Forecast. Model estimates suggest that the cumulative impact of the UK leaving the EU amounts to around -½% of GDP over 2021-2022 for the EU (compared to around -¾% under the WTO scenario). Details of the analysis are summarised in Box 1.2.

A somewhat stronger rebound of the global economy than expected in the autumn is likely to support the European economy in 2021 and 2022. The improved outlook for the major advanced economies, with new policy measures in the United States and Japan, as well as better prospects for Asian emerging market economies, are set to provide a welcome boost to external demand for EU exporters starting from the second half of this year.

(7) See 'A united front to beat COVID-19' Communication from the Commission to the European Parliament, the European Council and the Council, 19 January 2021

(8) The rate of daily new infections is set to take longer to subside, likely persisting at elevated levels until herd immunity is achieved.

Box 1.2: The Trade and Cooperation Agreement between the EU and the UK and model simulation of the short-term economic impact of the included Free Trade Agreement

On 24 December 2020, the European Commission and the United Kingdom reached agreement on a Trade and Cooperation Agreement (TCA). Following the Council decision of 30 December 2020, the TCA is provisionally in application since 1 January 2021 ([1]). The TCA consists of a Free Trade Agreement (FTA), a close partnership on citizens' security, and an overarching governance framework. This box, after a brief description of the FTA, presents the results of a simulation that estimates its short-term economic impact, used as input for the forecast.

The EU-UK FTA covers a broad range of areas, including goods, services, investment, competition, subsidies, tax transparency, air and road transport, energy and sustainability, fisheries, data protection, and social security coordination. In goods trade, the FTA provides for zero tariffs and zero quotas on all goods complying with the appropriate rules of origin. Both parties have also committed to ensuring a robust level playing field by maintaining high levels of protection in areas such as environmental protection, the fight against climate change and carbon pricing, social and labour rights, tax transparency and subsidy control. The TCA provides for commitments on effective, domestic enforcement with an effective role for UK courts, a binding dispute settlement mechanism and the possibility for both parties to take remedial measures, as well as rebalancing measures in case of significant divergences on level playing field standards. The agreement also provides for e.g. continued and sustainable air, road, rail and maritime connectivity and for a new framework for energy trading and interconnectivity. It includes a chapter on fisheries, with a joint management of fish stocks in EU and UK waters ([2]).

Even though the TCA goes beyond traditional agreements in scope and depth, an FTA cannot match the level of economic integration that is enjoyed by being a Member State of the EU. As a consequence of the UK's decision to leave the Single Market and Customs Union, the EU and the UK form two distinct and separate regulatory and legal spaces ([3]). Free movement of persons, goods, services and capital between the UK and the EU has ended. This has inevitably created significant new non-tariff barriers (NTBs) to trade in goods, services and to cross-border mobility and exchanges.

To consistently reflect the FTA in the forecast, its impact on the UK economy and that of its trading partners in the EU is assessed through the simulation model that was used in the 2020 Autumn Forecast to estimate the impact of the 'WTO assumption', against the benchmark of trade relations under EU ([4]). The simulation focuses on the short-term impact on trade flows, and does not look at dynamic trade adjustments over the medium and long-term. It does also not include effects of potential changes in migration flows, the exchange rate or productivity. The simulation uses data that do not take into account the impact of the COVID-19 pandemic.

The model

The model is static and builds on the global-input output tables published by the OECD ([5]). The impact of the FTA on production and value added is estimated through a trade shock, based on the assumptions on tariffs, non-tariff barriers and trade elasticities set out below.

In line with the FTA, tariffs in the scenario analysis were set at zero ([6]). The increase in NTBs resulting from the UK leaving the EU is estimated at sector level, based on the Commission's internal assessment. The tariff equivalent of the NTBs amount to 10.9% and 8.5 % on average (trade-

([1]) The agreement was signed by the EU and the UK on 30 December, and ratified by the UK Parliament on the same day.

([2]) For details on the EU-UK Trade and Cooperation Agreement, please see: https://ec.europa.eu/info/relations-united-kingdom/eu-uk-trade-and-cooperation-agreement_en.

([3]) Union rules relating to goods and the Union Customs Code will continue to apply to and in Northern Ireland.

([4]) For further information on the WTO assumption or the model used, please see box 1.4.2 "Technical assumption on the future trading relations between the EU and the UK and model simulation of their economic impact", European Commission 2020 Autumn forecast.

([5]) www.oecd.org/sti/ind/inter-country-input-outputtables.htm, released in December 2018, latest data from 2015.

([6]) Potential costs of complying with new rules of origin are modelled as small tariff increases.

(Continued on the next page)

Box (continued)

weighted at sectoral level) for EU and UK imports, respectively.

In the model, part of the increase of NTBs is applied with immediate effect, with the remainder gradually phasing in over time ([7]). Additional temporary disruptions are assumed to occur in the first quarter of 2021, reflecting the observed initial difficulties for economic actors in adjusting to the new EU-UK trading relations. The trade elasticities used in the model are based on the sectoral trade substitution elasticity estimates used in the Global Trade Analysis Project (GTAP) model of trade and taken from Hertel and van der Mensbrugghe (2016) ([8]), adjusted to make them appropriate for a short-term analysis. The UK's current FTAs with 3rd countries are taken into account, but no new agreements are assumed to be signed over the forecast horizon.

([7]) While many NTBs such as customs checks or the need for certificates to prove compliance with EU standards already apply since 1 January 2021, others will only come into play at a later stage (e.g. the impact of a potential divergence between EU and UK standards).

([8]) Hertel, T. and D. van der Mensbrugghe (2016). "Chapter 14: Behavioral Parameters (Center for Global Trade Analysis)". Purdue University, West Lafayette, In Global Trade Analysis Project (GTAP).

Results

For the EU on average, the exit of the UK from the European Union on FTA terms is estimated to generate an output loss of around ½ % of GDP by the end of 2022, and some 2 ¼ % point for the UK. Compared to the 'WTO assumption' that was modelled in the Autumn forecast, the EU-UK FTA reduces this negative impact for the EU on average by about 1/3 and for the UK by about 1/4. Whereas the FTA sets tariffs and quotas on goods at zero, there is a significant increase in NTBs for both goods and services. Member States with a higher share of goods trade with the UK therefore benefit relatively speaking more from the FTA than those with a higher share of trade in services.

In sum, while the FTA improves the situation as compared to an outcome with no trade agreement between the EU and the UK, it cannot come close to matching the benefits of the trading relations provided by EU membership.

As the pandemic crisis gets protracted, some important questions become more relevant

- *The duration and timing of the eventual withdrawal of supportive policy measures in the Member States.* This forecast assumes that supportive policies will continue in general as long as official containment measures pose serious limitations to business activity. This differs significantly across Member States and depends on the types of policies in place, the fiscal space available, and other country-specific factors. A premature withdrawal of such support measures remains an important downside risk.

- *The extent of lasting damage inflicted by the pandemic.* A delayed recovery increases the potential for permanent scars to the fabric of Europe's economies and societies, predominately through bankruptcies and higher unemployment. This is particularly relevant for sectors that rely on face-to-face contacts where restrictions continue to weigh heavily on revenues, increasing insolvency risks. Emergency policy measures and monetary policy support have continued to cushion the shock and so far largely kept European firms afloat, by preventing or delaying bankruptcies of affected viable firms. However, there is also a risk of keeping an increasing number of non-viable firms alive, which may have negative implications for long-term productivity ([9]) ([10]). The labour market is therefore more and more likely to suffer from hysteresis effects, with negative implications for inequality. Importantly, this forecast assumes that a large wave of post-crisis insolvencies can be avoided, even if such an outcome constitutes a significant downside risk to the baseline.

- *The outlook for the household saving rate.* Given its currently elevated level, (see Section 1.5.1) the household saving rate is expected to gradually come down in line with the

([9]) Claeys, G., M. Hoffmann and G. Wolff (2021) 'Corporate insolvencies during COVID-19: keeping calm before the storm', Bruegel Blog, 7 January

([10]) Banerjee, R. and B. Hofmann (2020). 'Corporate zombie: anatomy and life cycle'. BIS Working Papers 882, September.

relaxation of containment measures over the course of 2021. Forced savings are set to come down faster, as soon as spending opportunities open up again, in particular in currently inactive service sectors (e.g. tourism). On the other hand, precautionary savings may remain at a higher level for somewhat longer due to the protracted pandemic crisis and related uncertainty, before coming down eventually as the pandemic is finally brought under control and household sentiment improves. At the same time, persistently higher precautionary savings as a legacy of the COVID-crisis remains a clear negative risk for the economic outlook.

The Recovery and Resilience Facility still not fully incorporated in the forecast

– The incorporation of the Recovery and Resilience Facility (RRF) into the forecast remains in line with the usual no-policy change assumption and is unchanged from the Autumn Forecast. Following the political agreement reached on the RRF in December 2020, preparation of national Resilience and Recovery Plans (RRPs) has intensified in virtually all Member States. In most cases though the status of the draft RRPs is not sufficiently advanced to allow for their incorporation in the Winter Forecast. In line with the customary no-policy-change assumption, the forecast only incorporates those measures that have either been adopted or credibly announced *and* specified in sufficient detail, notably in national budgets. The economic projections for only a few Member States take account of some measures expected to be financed under RRF. In particular, the projections for France incorporate measures from the French Recovery Plan, amounting to 1.6% of GDP in 2021, part of which is expected by the government to be financed by the RRF. This implies that RRF could fuel stronger growth than projected in this forecast, supporting a faster and more sustainable recovery in the EU Member States, once RRPs are implemented.

1.7. THE OUTLOOK FOR THE EU/EA

1.7.1. Economic growth outlook

The year 2021 is set for a subdued start …

Survey indicators point to depressed economic activity at the start of the year. In the EU, the Commission's *Economic Sentiment Indicator* (ESI) edged down to 91.2 in January 2021, moving further away from its pre-crisis level (103.6 in February 2020). Similarly, Markit's Flash *Purchasing Managers Composite Output Index* for the euro area slipped further into contractionary territory, to 47.5, down by 1.6 points compared to December. It has now remained below the no-change threshold of 50 for the third month in a row.

January also saw the Commission's *consumer confidence* in the EU weakening to its lowest level since May last year, dampened by growing concerns about the general economic situation, a deterioration in households' views on their past and future financial conditions, as well as in their intentions to make major purchases. This has coincided with an increasing number of respondents reporting scope for saving. Forward-looking indicators for the labour market also hint at a deteriorated economic situation. In January, the Commission's *Employment Expectations Indicator* decreased in the EU and the euro area and stood markedly below their long-term averages and much lower than in February 2020.

The dichotomy between the performance of industry and services appears to have continued in early 2021, as highlighted by January readings of the Commission's surveys and Markit's PMIs. Furthermore, the Commission's latest quarterly survey ([11]) estimated that capacity utilisation in the services sector declined to 85.7% in 2021-Q1 (from 86.5% in 2020-Q4), while recovering in industry to 77.7% (from 76.5%). This increase occurred amid rising shortages of materials and/or equipment reported by managers as hindrances to higher output.

…with the resurging pandemic delaying the rebound further into 2021.

Following the output contraction in the last quarter of 2020, the European economy is expected to open 2021 on a weak footing under the weight of

([11]) Conducted in January 2021.

the pandemic. Moreover, while the EU-UK agreement has alleviated some of the drag on growth (compared to the Autumn Forecast), the UK's departure from the Single Market and the Customs Union is still expected to weigh on growth (see Box 1.2), particularly in the first quarter of 2021. Overall, real GDP is set to shrink by 0.8% and 0.9% q-o-q in the EU and euro area, respectively in the first quarter of 2021, thus leading the European economy into a technical recession. Real GDP is projected to fall in most Member States, with the steepest contractions in Portugal (-2.1%), Ireland (-1.6%) and Austria (-1.4%).

Looking beyond the first quarter, as vaccination campaigns gain momentum and containment measures are gradually relaxed, activity in the EU and the euro area is expected to start picking up, though only moderately in the second quarter. In line with the assumption of a significant lifting of restrictions in the second half of 2021, growth is expected to accelerate to 3.0% in the third quarter and remain solid in the fourth quarter (1.0% q-o-q) in both the EU and the euro area, benefitting also from stronger external demand. The seasonal drop in infections as well as a significant relaxation of containment measures should also allow countries with large tourism sectors to benefit from recovering intra-EU (domestic and foreign) tourism traffic over the summer. Thereafter, growth is expected to moderate.

Consumption to drive growth as confidence returns

As new consumption opportunities open up, the recovery is set to be driven by private consumption, even after an initial outburst of pent-up demand. A large stock of accumulated savings ([12]), sheltered household incomes, brightening sentiment, and favourable financing conditions are set to create conditions for a sustained strengthening of private consumption. Government consumption is projected to continue playing a supportive role.

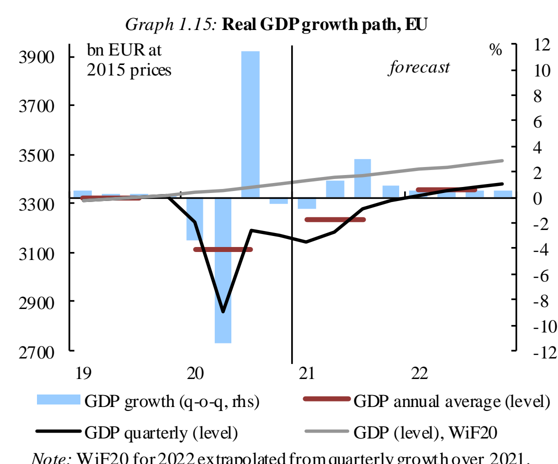
Significant idle capacity in capital-intensive sectors, lower profitability, as well as higher debt compared to the pre-crisis period, are set to act as dampening factors for private investment spending. However, as vaccination campaigns progress and uncertainty dissipates, a highly accommodative monetary policy and targeted government support schemes are all expected to lead firms to increase investment. Gross fixed capital formation is expected to continue firming up gradually throughout the forecast horizon as idle capacity falls and public investment rises.

In line with the stronger-than-previously-expected recovery in demand from major trading partners (see Section 1.3), export growth is set to gain traction, despite the adverse (lagged) effects of the recent appreciation of the euro's exchange rate. Prospects, however, are set to remain muted in the export of services, due to the likely delayed normalisation in hospitality and transportation services for tourists originating from extra-EU markets.

Stronger growth from mid-2021 helps advance the recovery to pre-crisis levels…

After contracting by an estimated 6.3% and 6.8% in 2020 (in the EU and the euro area, respectively), growth is forecast to rebound to 3.7% and 3.8% in 2021 (in the EU and the euro area, respectively). As the recovery takes hold and boosted by a high carry over, the 2022 annual EU GDP growth rate is forecast at 3.9% (3.8% in the euro area). Marking a notable improvement compared to the Autumn Forecast, GDP is now expected to reach pre-crisis levels by mid-2022 on average in both the EU and the euro area (see Graph 1.15).

Graph 1.15: **Real GDP growth path, EU**



Note: WiF20 for 2022 extrapolated from quarterly growth over 2021.

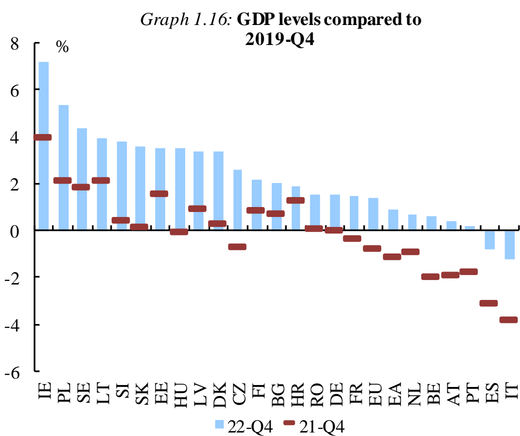
However, this faster-than-expected return to the pre-crisis output levels will still leave a sizeable gap to the volume of GDP that would have been reached under the growth path that was projected before the outbreak of the pandemic (illustrated by the distance between the black and grey lines in Graph 1.15).

([12]) Excess household savings are estimated at about 3% of euro area GDP in the first three quarters of 2020.

...which, however, is set to be uneven across countries.

Significant country divergences are set to persist over the forecast horizon. This is best reflected in the wide dispersion of real GDP recovery paths towards 2019-Q4 levels (see Graph 1.16). In addition to the different severity of the pandemic's shock and the ensuing stringency and duration of containment measures, the expected speed of the recovery reflects differences in the structure of each economy, particularly the relative importance of tourism and leisure activities as well as the magnitude of policy responses.

Graph 1.16: **GDP levels compared to 2019-Q4**



Note: No GDP quarterly forecasts are reported for CY, EL, MT and LU.

While some Member States are expected to see the distance to their pre-crisis output levels close by the end of 2021, others are forecast to take longer. This is particularly the case for Spain and Italy, which are not expected to reach those levels by the end of the forecast horizon.

1.7.2. Inflation outlook

Inflation outlook to remain subdued despite temporary boost from base effects

The delayed recovery into the second quarter of this year is set to continue dampening aggregate demand pressures on prices. In addition, the euro appreciation against the dollar, by approximately 4% since early November, is expected to weigh on prices of imported goods, including oil.

The increase in oil prices close to their levels in January 2020 puts upward pressure on inflation (see Section 1.3). With oil prices assumed to stay just above USD 50 per barrel, significant positive base effects should kick in from March until at least 2021-Q3. Moreover, the recent large increase in global shipping costs is expected to have a temporary cost-push impact on imported goods inflation, until backlogs in orders are cleared and the supply of shipping capacity adjusts.

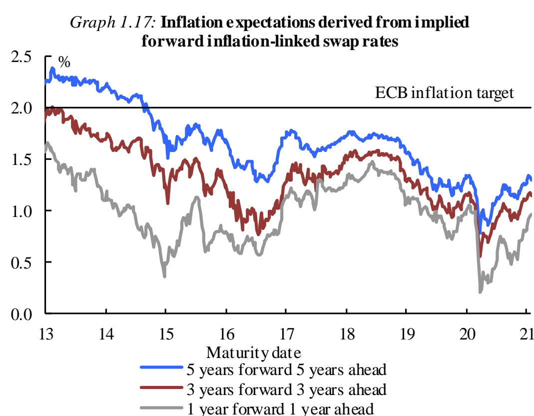
Taking into account these factors, the inflation outlook for the euro area and the EU has improved slightly in 2021 and remains unchanged in 2022 compared to the autumn. In the euro area, inflation is forecast to increase from 0.3% in 2020 to 1.4% in 2021 (see Graph 1.14). In 2021, weak underlying price pressures are expected to be temporarily neutralised by strong positive base effects in energy inflation in line with the current oil price assumptions. Moreover, in the second half of this year, strong pent-up consumer demand following the relaxation of lockdown measures is likely to meet some supply side constraints as production capacity adjusts. Most of the upward revision for 2021 since the autumn comes from Germany, which saw a strong increase in inflation in January due to the reversal of VAT tax cuts and the introduction of new energy taxes. In 2022, as supply adjusts and base effects taper out, euro area inflation is expected to moderate again towards 1.3%.

Market-based inflation expectations have recovered in line with oil prices

Despite inflation remaining negative in the last two months of 2020, market-based measures of inflation expectations along the maturity spectrum have increased since November last year and at the end of January 2021 stood close to January 2020 levels, i.e. before the COVID-19 crisis struck. Much of this increase can be attributed to the recovery in oil prices, especially in November. At the cut-off date for this forecast, inflation-linked swap rates at the one-year forward one-year-ahead horizon stood at 1% (see Graph 1.17).

On a longer horizon, the three-year forward three-years-ahead rate implies an average inflation of 1.1% while the widely-watched five-year forward five-years-ahead indicator stood at just 1.3%, which is below the ECB's definition of medium-term price stability.

Graph 1.17: **Inflation expectations derived from implied forward inflation-linked swap rates**



Source: Bloomberg.

1.8. RISKS TO THE OUTLOOK

Uncertainty and risks surrounding this baseline forecast remain elevated. They are crucially related to the evolution of the pandemic and the efficiency and effectiveness of vaccination rollout. The scenario analysis presented in Box 1.3 illustrates some of those risks.

Risks have become more balanced compared to the Autumn Forecast

As compared to the autumn, risks have become more balanced as some downside risks have diminished and some upside risks have materalised. This relates first and foremost to the multiple approval of COVID-19 vaccines, but also the Trade and Cooperation Agreement between the EU and the UK reducing the cost of the UK leaving the Single Marekt and Customs Union, as well as the diminishing risk of a further intensification of trade disputes.

Positive risks are mainly related to the possibility that the vaccination process leads to a faster easing of containment measures and therefore an earlier and stronger recovery.

Also, the strength of the rebound could surprise on the upside, as economic growth could benefit from a burst of post-crisis optimism, which could unleash stronger pent-up demand and investment projects, thanks to historically high household savings, low financing costs, and supportive policies.

Similarly to the EU, the outlook for the global economy is subject to high uncertainty around the path of the pandemic and the vaccination process, but the materialisation of positive risks for the global outlook would have positive growth spillovers for the EU. Finally, following the results of the US Presidential election, the risks related to the persistence of global trade tensions and the weakening of global economic governance have subsided.

Last but not least, an ambitious and swift implementation of the NextGenerationEU programme, notably its Recovery and Resilience Facility, should provide a strong boost to the EU economy.

On the *downside*, there is the risk that a flaring up of contagions as a result of new and reportedly more contagious variants of the coronavirus, or a slow rollout of vaccinations, could delay the lifting of virus containment measures and have negative effect on confidence, keeping precautionary savings at persistently high levels and withholding investment decisions.

A protracted crisis could also leave deeper scars on the fabric of the European economy and society than assumed in the forecast, through widespread bankruptcies and higher unemployment as the policy support measures are lifted. Insolvencies would in turn lead to a surge in non-performing loans, causing stress in the banking sector and financial markets. More generally, the widening disconnect between the current upbeat market valuations and a real economy dominated by corporate weaknesses and high uncertainty is a source of concern. Unemployment, which would also result from more widespread insolvencies, could become entrenched due to hysteresis effects and skills mismatches in the process of sectoral reallocation. This would then lead to a surge in inequality, given the particularly adverse impact of the crisis on workers on temporary or precarious jobs, the lower-wage earners, and more vulnerable cohorts (youth, women). Carefully designed exit strategies from current support schemes would therefore seem vital, as premature withdrawal could pose important risks in this respect across the EU.

In addition, the large cross-country divergences observed since the outset of the crisis could become entrenched, leading to fragmentation that would disrupt the functioning of the internal market, cause efficiency losses and ultimately become self-reinforcing.

The risks to the inflation outlook are broadly balanced

In the short term, *upside* risks stem from protracted supply and shipping capacity constraints. In addition, an increase in firm bankruptcies in some sectors may strengthen the pricing power of incumbent firms. The annual statistical update in the weights of the categories in the consumption basket, published in February, may artificially affect inflation in 2021. As the pandemic lowered the consumption of many non-essential services such as in the hospitality sector and package holidays in 2020, the adjustment of weights may be skewed in favour of components that have higher inflation, especially food. Finally, a stronger than projected recovery in 2022 could also increase price pressures.On the *downside*, the weaker near term outlook could further depress underlying demand pressures and wage growth.

Box 1.3: The road out of the crisis: an update of alternative scenarios

Exceptional risks continue to surround the forecast...

A year has passed since the outbreak of the COVID-19 pandemic in Europe. While the rollout of vaccination campaigns makes the road ahead clearer and brighter, the evolution of the pandemic remains a decisive determinant of the economic outlook.

According to the key assumption underpinning this forecast, the stringency of measures taken to contain the virus is expected remain high throughout the first quarter of 2021, ease marginally in the second quarter, and fall markedly, yet not completely, thereafter. As a result, real GDP in the euro area is forecast to shrink somewhat in the first quarter before posting a moderate uptick in the second, with the rebound strengthening markedly from the third quarter onwards.

The possibility of surprises, which could have either positive or negative implications for the growth outlook, however, cannot be excluded. A faster-than assumed pick-up in the production and distribution of vaccines could boost confidence among households and firms and facilitate a faster reduction in voluntary social distancing as well as in the tightness of restrictions to mobility and economic activity. By contrast, a flaring up of contagion as a result of new and reportedly more contagious mutations of the coronavirus, or a slow rollout of vaccinations, could delay the lifting of virus containment measures and have the opposite effect on confidence.

The scenarios presented in this box shed light on some of the uncertainties surrounding the outlook. The analysis makes use of the Commission's Global Multi-Country (GM) Model, an estimated macroeconomic model in the New-Keynesian tradition ([1]), which has been augmented to capture key features of the pandemic-induced crisis. In particular, the model incorporates forced savings (or 'lockdown shocks') which have been driven by social distancing and the closure of non-essential services, and which were found in the autumn 2020 forecast to represent about two-thirds of the increase in household savings in 2020. ([2])

... and thus warrant alternative scenarios ...

Two alternative scenarios have been designed around the baseline forecast to illustrate the possible path for the economy under a set of stylised assumptions. ([3]) The *upside scenario* incorporates an earlier and more meaningful relaxation of containment measures occurring in the second quarter of this year. ([4]) This improves consumer confidence and encourages households to reduce both forced and desired savings, unleashing pent-up demand. These positive developments would extend into the summer season, when intra-EU tourism would experience a faster recovery than expected under the central projection.

The *downside scenario* illustrates the impact of restrictions to daily life staying in place throughout 2021. In this scenario, the recovery would be delayed though not derailed. Compared to the forecast baseline, depressed confidence prompts households to accumulate a greater share of their income as savings. Moreover, the slower relaxation of restrictions in this scenario results in a more protracted period of sluggish economic activity that leads to more persistent damages to the economic fabric, exemplified in the simulations by a tightening of financial conditions. Damage to balance sheets and the higher rate of bankruptcies associated with this scenario take their toll on both

([1]) The Global Multi-Country (GM) DSGE model has been developed by DG ECFIN and the Joint Research Centre of the European Commission. For a detailed description, see Albonico, A., L. Calès, R. Cardani, O. Croitorov, F. Di Dio, F. Ferroni, M. Giovannini, S. Hohberger, B. Pataracchia, F. Pericoli, P. Pfeiffer, R. Raciborski, M. Ratto, W. Roeger and L. Vogel (2019). 'The Global Multi-Country Model (GM): an Estimated DSGE Model for the Euro Area Countries'. ECFIN *Discussion Paper No*. 102.

([2]) See Special Issue 3.1 'The road out of the crisis remains bumpy and uncertainty' in European Commission (DG ECFIN) (2020). 'European Economic Forecast: Autumn 2020'. *Institutional Paper* 136, pp. 61-65.

([3]) Both scenarios focus on developments in the euro area. They also do not include additional discretionary fiscal or monetary policy action beyond the baseline.

([4]) Specifically, the upside scenario assumes that the stringency of containment measures in 2020-Q2 is around 1/3 lower than the forecast baseline and remains below after that date. As a consequence, together with the assumed confidence gains, the model predicts that the savings rate is around 2 pps. below baseline in the second half of 2021.

(Continued on the next page)

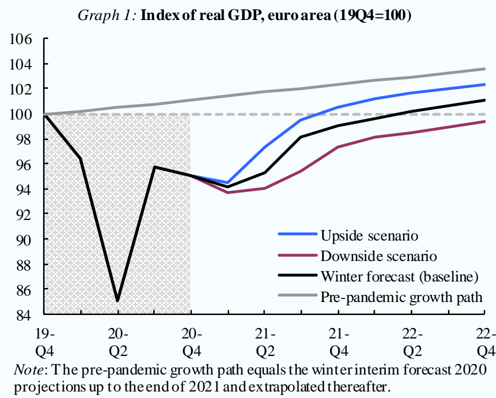
Box (continued)

employment and output, as does a prolonged shortfall in business investment. (5)

... to illustrate the impact of upside risks ...

Based on this set of assumptions, the *upside scenario* projects a fast and forceful rebound from the crisis (see Graph 1). In this scenario, the quarterly growth rate of the euro area would likely exceed 3% in 2021-Q2, mostly on the back of a boost from consumer spending. This is significantly faster growth than expected in the baseline scenario. The performance in 2021-Q3 would be equally vigorous on the back of a strong summer tourism season. Confidence effects continue to support economic activity thereafter, with household savings returning close to pre-pandemic levels. Overall, the annual rate of growth in the euro area would reach around 5 ¼% in 2021 and around 4% in 2022 (see Graph 2) and output would surpass its end-2019 levels by the end of 2021.

Graph 1: **Index of real GDP, euro area (19Q4=100)**



Note: The pre-pandemic growth path equals the winter interim forecast 2020 projections up to the end of 2021 and extrapolated thereafter.

... as well as still significant downside risks.

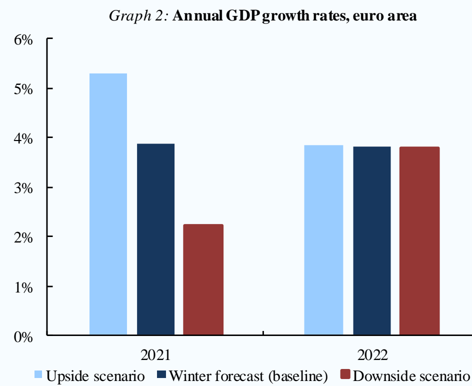
By contrast, the slower pace assumed for the lifting of restrictions in the *downside scenario* leads to persistently high savings and lower confidence that dampens private consumption. With demand subdued for a longer time, the financial position of firms would become more vulnerable, which combined with tighter credit conditions, would delay the start of the recovery until later in 2021.

(5) The model simulation illustrates these adverse developments with a stylised (and persistent) risk premium shock of around ½ of the size identified during the financial crisis in 2008-2009.

Furthermore, impaired capital accumulation in this scenario would erode the productive capacity of the economy and weaken potential output to some extent. Euro area GDP growth under these assumptions would be around 2 ¼% in 2021 (6), but would pick-up at a rate close to that of the central projection in 2022. Output in this scenario fails to recover to pre-pandemic levels before the end of the forecast horizon.

Finally, it is worth highlighting that even if positive growth surprises were to materialise in line with those described in the *upside scenario*, output would not reach the level that was projected before the pandemic. (7)

Graph 2: **Annual GDP growth rates, euro area**



(6) Additional adverse shocks to confidence and increases in forced savings ('lockdown shocks') imply that the households' savings rate remains around 2 pps. higher than in the central projection.

(7) The pre-pandemic growth path coincides with the path for GDP as projected in the winter 2020 interim forecast, the last Commission forecast before the pandemic outbreak. Euro area GDP was forecast to grow by 1.2% in 2020 and 2021. See European Commission (2020): 'European Economic Forecast: Winter 2020'. Institutional Paper 121.

2. PROSPECTS BY MEMBER STATES

EURO AREA

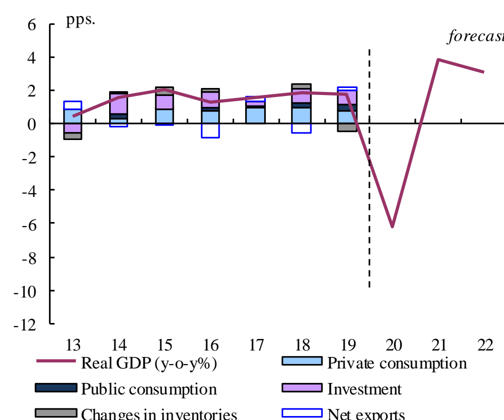
2.1. BELGIUM

The economy of Belgium was severely hit by the COVID-19 outbreak in 2020, as domestic demand suffered from restrictive measures and a large drop in confidence. Consequently, GDP fell dramatically. After a steep decline in the first two quarters and a stronger-than-expected rebound in the third quarter, renewed restrictions linked to a second wave of infections brought the recovery to a halt in the fourth quarter. GDP growth is estimated to have reached 0.2% in the fourth quarter. All in all GDP is expected to contract by 6.2% in 2020.

The current level of restrictions is set to remain in place in early 2021, weighing especially on the consumption of services, before a gradual easing, linked to the rollout of vaccinations. Support measures, still ongoing at the beginning of 2021, should limit job losses and bankruptcies in the most affected sectors such as leisure, restaurants, hotels and transport, at least in the short term. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

Growth is forecast to be roughly flat in the first quarter, with GDP then rebounding in the second and third quarters of 2021. Private consumption is projected to be the main driver as households spend some of their forced savings. In a context of continued uncertainty, investment is expected to recover only gradually over the forecast horizon. After a deep contraction in the first half of 2020, exports and imports are projected to recover quickly as global trade recovers and reflecting Belgium's position as a trade hub. Mirroring consumption developments, the quarterly growth rate of GDP is then set to gradually return to its long-term trend once pent-up demand is exhausted. All in all, annual GDP growth is forecast to reach 3.9% in 2021 and 3.1% in 2022. GDP is set to return to its pre-crisis level in the second half of 2022.

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



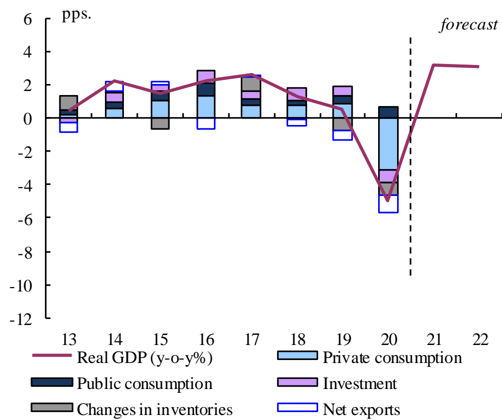
The fall in economic activity and energy prices depressed annual HICP inflation from 1.2% in 2019 to 0.4% in 2020. In line with the oil price assumptions and the expected rebound of economic activity, annual HICP inflation is forecast to rise to 1.8% in 2021 and 2022.

2.2. GERMANY

After 10 years of expansion, Germany's economy contracted in 2020 by 5% due to the COVID-19 pandemic and the measures taken to contain it. Manufacturing activity declined by 10.4%, mainly due to supply chain disruptions. Sanitary restrictions and health concerns led to a strong decline in non-food stationary retail, hospitality and other contact-intensive services, and foreign travel. Overall, gross fixed capital formation also declined by 3.5% as the fall in private investment outweighed the continued strong growth in public investment. For the first time since 2009, exports and imports of goods and services decreased in 2020, by 9.9% and 8.6%, respectively.

The extended regulations on short-time work helped prevent dismissals on a larger scale and employment decreased by just 1.1% in 2020. Wage growth came to a standstill (-0.4%) after 2.9% the year before. Nevertheless, the net saving rate of households rose from 10.9% to an unprecedented 16.3% as consumption declined strongly (6%) despite a slight increase in disposable income due to the employment and income support measures put in place.

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



Economic activity experienced large swings over the course of 2020. The fallout from the pandemic was already apparent in the first quarter when GDP declined by 2.0%. The brunt of the impact fell in the second quarter when GDP dropped by 9.7%, its sharpest quarterly decline on record. In the third quarter, by contrast, GDP rebounded by 8.5%, as a relaxation of confinement measures and the revival of foreign trade led to a partial resumption of activity in both industry and services. In the fourth quarter, the number of new infections soared and restrictions were re-imposed on a number of sectors. GDP, however, avoided another contraction as industry posted robust growth and some consumer spending was redirected from services to goods.

With sanitary restrictions in place, consumption is expected to remain depressed in early 2021, particularly for services. In addition, exports are expected to suffer from weak demand in key European trading partners and some temporary supply disruptions. As a result, economic activity is expected to dip again in the first quarter of this year. With more vaccinations taking place and infection rates subsiding, some relaxation of restrictions is assumed in subsequent quarters. A number of other factors should also favour a resumption of the economic rebound. Strong industrial order books suggest that exports are likely to grow again and sentiment in industry is high. Government support for businesses is expected to avert a large wave of insolvencies and employment growth should resume. Accumulated savings should spur a recovery in consumer spending, which should benefit the repair of contact-intensive service sectors. In anticipation of all that, investment is expected to start recovering.

Overall, real GDP is forecast to rebound by 3.2% in 2021, returning to its pre-crisis level at the turn of the year. In 2022, it should continue growing by 3.1% on the back of the momentum gained in the second half of this year and as the repair of the economy advances. Those projects related to the Recovery and Resilience Facility that were included in the 2021 budget have been taken into account in this forecast.

HICP inflation fell from 1.4% in 2019 to 0.4% in 2020 amid weak demand, cheaper energy and reflecting a reduction of VAT rates in the second half of the year. The flash estimate for January 2021 HICP inflation came in relatively strong at 1.6% y-o-y. This could be due to a combination of economic and statistical factors. The reinstatement of almost all of the regular VAT rates seems to have been passed through to a larger extent than the reduction in July 2020. Energy prices inflation will be spurred by an upward adjustment of CO2 taxation. In addition, shifts in the consumer basket could also be driving the inflation rate up. Combined with the expected recovery in consumer demand, these factors should push inflation to 2.3% in 2021. With the base effects dissipating and energy prices again exerting a disinflationary effect, inflation is expected to ease to 1.3% in 2022.

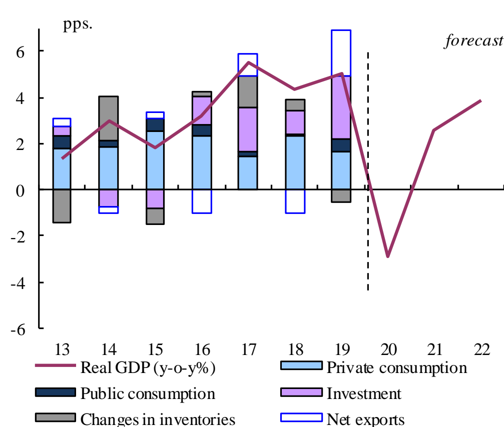
2.3. ESTONIA

Real GDP is expected to show a contraction of about 3% in 2020, which is less than average in the EU. This is due to a relatively limited contraction in private consumption and the resilience of exports. Employment weakened mostly in the sectors directly affected, such as hotels and restaurants. Restrictions in response to the second wave of the COVID-19 pandemic were introduced in December 2020, primarily affecting indoor dining and educational, cultural and sporting facilities. With these measures limiting economic activity much less than those taken in the spring of 2020, the negative impact on GDP is projected to be smaller.

As COVID-19 restrictions are assumed to be lifted gradually, GDP is forecast to grow by 2.6% in 2021, with growth expected to strengthen towards the second half of the year. Growth momentum is forecast to drive annual GDP up by 3.8% in 2022. In both years, growth is expected to be driven mainly by private consumption and a gradual

resumption of private investment. In spite of the economic crisis, aggregate household savings accumulated over 2020, which should boost consumption once the COVID-19 restrictions are lifted. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk. The recent changes to the second pillar of the pension system, which allow savers to withdraw their accumulated pension assets before pension age, also present a positive risk to private consumption and growth over the second half of 2021 and 2022.

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

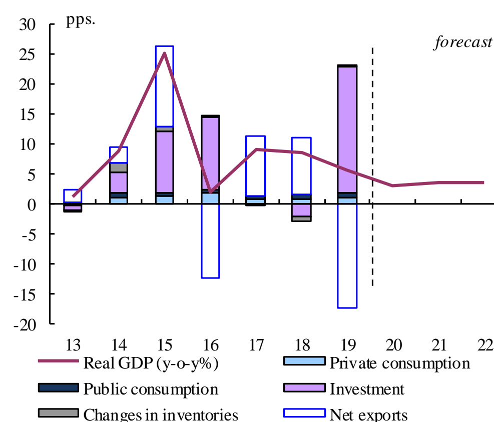


Inflation turned negative in 2020, with the annual rate falling to -0.6% due to factors such as the temporary cuts to diesel excise taxes (which will be reinstated in 2022) and lower restaurant and accommodation prices. Inflation is forecast to increase to just over 1% in 2021, dampened by the persisting slack in the labour market and the economy following the 2020 crisis. As private consumption picks up and the excise taxes on diesel return to their previous rates, inflation is forecast to rise above 2% in 2022.

2.4. IRELAND

Real GDP is estimated to have grown by 3.0% in 2020, the only positive growth rate in the EU, boosted by exports from multinational companies specialising in medical equipment, pharmaceuticals and computer services. In the third quarter, growth was very strong as, in addition, private consumption and domestic investment rebounded after the lifting of pandemic-related restrictions. Movement restrictions for the public were reintroduced again in the fourth quarter, dampening domestic activity, but the lifting of restrictions in the run-up to Christmas helped retail trade. Confidence indicators and very strong production data for November suggest that the impact of the pandemic on GDP growth should be relatively benign in 2020-Q4.

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



Ireland started 2021 under a strict lockdown that includes a ban on non-essential construction that is set to last until 5 March. This, and the UK's departure from the Single Market and Customs Union on 1 January 2021, which has led to inevitable trade frictions, are expected to dampen growth in the first quarter. Thanks to the EU-UK Free Trade Agreement, the loss of trade and GDP growth for Ireland is expected to be smaller compared to what was projected in the Commission's Autumn Forecast, which assumed EU-UK trade based on WTO terms.

The government extended income subsidy schemes until end-March to continue cushioning the economic impact of the pandemic. Limited possibilities to spend, combined with income support imply that household savings will continue to accumulate at a historically brisk pace, which should boost consumption once restrictions are lifted. The expected global recovery should also support strong growth in Ireland from the second half of 2021. Overall GDP growth is projected at 3.4% in 2021. In 2022, growth is projected to reach 3.5% on the back of strong private consumption, exports, and a recovery in investment.

HICP inflation was negative in 2020 when it was dragged down by low energy and non-energy industrial goods' prices. Services' inflation subsided to nearly zero in 2020-Q4. After dropping to -0.5% in 2020, HICP inflation is forecast to rise to 0.7% in 2021, when it is expected to be

moderated by economic weakness early in the year but fuelled by higher non-tariff-related trade costs with the UK. Inflation is projected to increase to 1.6% in 2022 as the economic recovery stabilises.

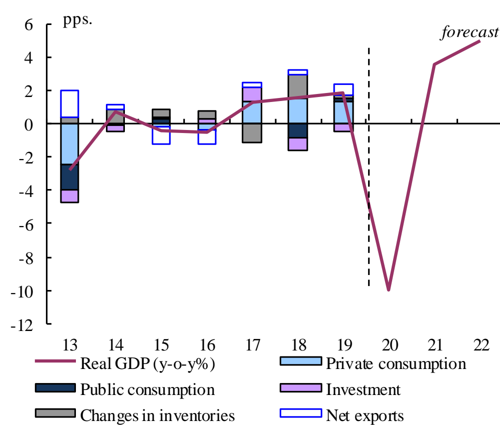
Risks specific to Ireland's economic outlook are linked to changes in the international taxation environment and the activities of multinationals registered in Ireland, which could shift GDP growth in either direction. Future spending related to the Recovery and Resilience Facility the Brexit Adjustment Reserve are not included in this forecast and constitute an upside risk.

2.5. GREECE

Greece's GDP increased by 2.3 % (q-o-q) during the third quarter of 2020, reflecting the reopening of the economy and the temporary easing of the containment measures at that time.

The recovery in the third quarter was mainly driven by domestic demand. Economic activity in the services sector decreased sharply due to the negative impact of the COVID-19 pandemic on tourism, while construction showed some resilience. Following the re-introduction of containment measures during the fourth quarter of the year, output growth is forecast to turn negative in quarterly terms. Overall, real GDP is expected to have declined by 10% in 2020.

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



Containment measures are expected to weigh on Greece's recovery, with real GDP expected to grow by 3.5% in 2021, before rising to 5% in 2022. The recovery will continue to be supported mainly by private consumption, on the back of the gradual reopening of retail trade, improving consumer confidence and the supportive setting of fiscal policy in the economy. Net exports are expected to contribute positively to growth in 2021 and 2022, with the rollout of vaccination campaigns expected to support only a gradual return of tourists to Greece. Investment is forecast to recover as well but at a slower pace. The support measures adopted by the authorities have bolstered credit growth to businesses.

Unemployment stood at 16.7 % in October 2020, similar to a year before, indicating that the labour market impact of the economic crisis remains relatively contained. Employment however decreased, primarily due to lower hirings in the tourist sector.

After dropping by 1.3% in 2020, HICP inflation is forecast to remain mildly negative in 2021 before turning positive in 2022. The negative growth in prices is mainly driven by an expected drop in service sector prices.

The forecast remains subject to large uncertainty. The developments regarding the global health crisis and the vaccination rollout will be crucial for the recovery of the tourism sector and the speed of recovery in the private sector after the expiry of government support measures. In addition to that, geopolitical tensions in the region and the migration crisis add uncertainty to the forecast. On the upside, the forecast does not incorporate the impact of the Recovery and Resilience Plan, which could provide a significant boost to domestic demand once implemented.

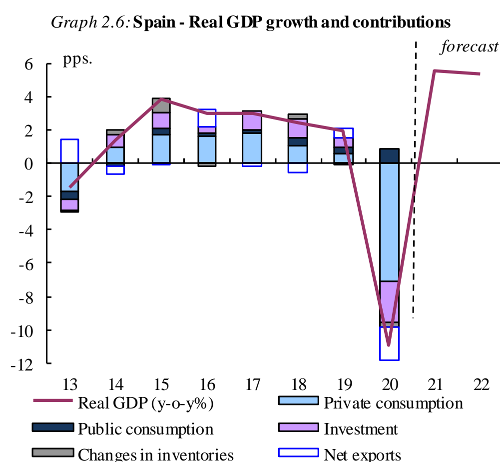
2.6. SPAIN

GDP growth in Spain rebounded strongly in the third quarter of 2020, after the unprecedented contraction in the first half of the year. The rebound was mainly driven by domestic demand, with a strong increase in both private consumption and investment. Net exports also posted a positive contribution to GDP growth. Containment measures, which began to be re-introduced in August in an effort to stem the increase in infection rates in several regions, have continued and tightened further though in a less severe way than in other large European countries. Mobility and social interaction activities declined, thus weakening economic activity in the final months of the year. Nonetheless, GDP growth in the fourth quarter remained in positive territory, at 0.4%, even though domestic demand components

strongly reduced their pace of growth. As a result, GDP decreased by 11% in 2020 as a whole.

The near-term outlook for 2021 is clouded by the rise in infection rates in the first weeks of the year and the more restrictive measures put in place by most Spanish regions. As a result, private consumption and investment are expected to fall in the first quarter before recovering slightly in the second. As the vaccination process advances and restrictions are progressively lifted, economic activity should pick-up strongly, driven by the materialisation of pent-up demand over the second half of 2021. As a result, the household saving rate is expected to decline. Investment is also set to rebound, driven by improved expectations about the economy and lower uncertainty. A soft recovery in international tourism should result in exports growing faster than imports and a positive contribution to growth from net exports in 2021. Overall, GDP is forecast to grow by 5.6% in 2021. In 2022, the tourism recovery is expected to gain momentum, with most impediments to activity fully lifted, while domestic demand growth will likely moderate once pent-up demand is reabsorbed. This would result in a still robust growth rate of 5.3%.

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



Policy measures to protect jobs and provide liquidity for firms taken in the first stage of the pandemic were extended several times and are expected to remain in place until mid-2021. They will continue to help mitigate job losses and cushion the damage of the crisis to productive capacity. A downside risk is that of a surge in corporate insolvencies, mainly concentrated in those sectors most affected by activity restrictions, materialising as policy support measures are wound down. This could lead to an increase in unemployment and result in reduced productive capacity. On the upside, the forecast does not incorporate the impact of the frontloaded Recovery and Resilience Plan, which is expected to provide a significant boost to domestic demand as it is implemented, and to potential growth over time. After declining in the second half of 2020, HICP inflation is forecast to increase to 0.8% in 2021, driven by the gradual strengthening of the price of consumer services and the unwinding of the base effect due to the drop in oil price in 2020-Q2. In 2022, headline inflation is expected to rise further to 1.1%.

2.7. FRANCE

Economic activity during the first half of last year was marked by a severe contraction. All domestic demand components took a hit, with private consumption falling by 17% and investment by 24%. Net exports also weighed significantly on growth, with the drop in exports exceeding the fall in imports. After a stronger-than-expected rebound during the summer months, economic activity suffered from a renewed tightening of restrictions which began in November. According to Eurostat's flash estimate, activity in the fourth quarter fell by 1.3%. Overall, GDP growth in 2020 showed a contraction of 8.3%.

The level of restrictions is set to remain high over the first half of 2021, particularly in the first quarter, which will weigh especially on services consumption. Growth is expected to be negative (-1.3%) in the first quarter and turn positive in the second quarter, when restrictions are assumed to relax somewhat and a few positive effects of the national recovery plan on investment kick in.

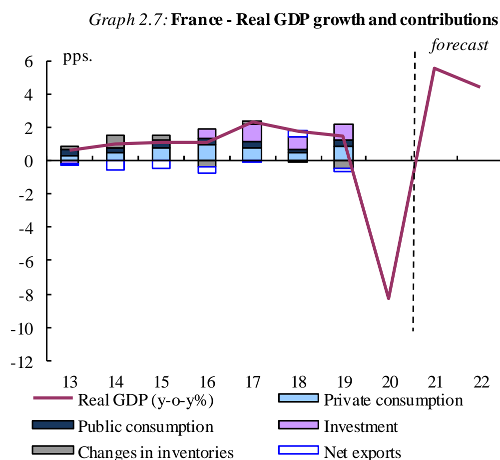
Key support measures (in particular short-time working scheme, the solidarity fund and the exoneration of social security contributions) are set to remain operational during the first half of 2021. These should help mitigate the effects of the decline in activity on employment. In the third quarter, activity is set to rebound strongly as the most stringent restrictions are lifted and as the effect of the national recovery plan are felt. The plan, incorporated into this forecast only for 2021, amounts to 1.6% of GDP this year, of which 0.7pps is expected by the government to be financed through the Recovery and Resilience Facility. It notably includes €10 billion (0.4% of GDP) of permanent cut in taxes on production. Private consumption is set to be the main driver of

the rebound, but with net exports also contributing significantly again to growth.

Under the usual no-policy change assumption, the pace of growth in 2022 is set to slow down as pent-up demand peters out and since no additional expenditure under the national recovery plan is as yet included in the forecast for next year. Activity is set to reach pre-crisis levels during the first half of 2022. Overall, in terms of annual growth, real GDP is projected to expand by 5.5% in 2021 and by 4.4% in 2022.

Annual HICP inflation decreased to 0.5% in 2020 due to lower oil prices and the sizeable negative demand shock. In line with the rebound in both oil prices and economic activity, annual HICP inflation is expected to rise to 1.1% in 2021 and 1.5% in 2022.

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

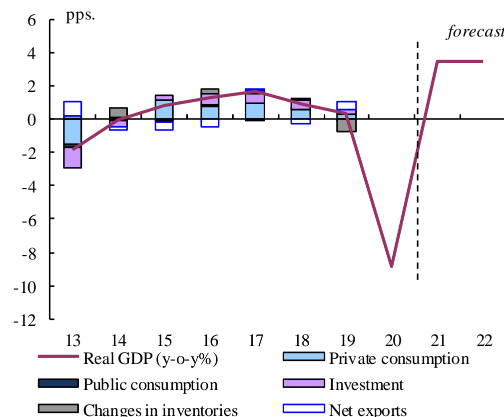


2.8. ITALY

After the strong rebound in real GDP over the summer when the Italian economy recovered almost three fourths of the output loss incurred in the first half of 2020, the COVID-19 pandemic has again tightened its grip. Rising infection and hospitalisation rates required the government to re-impose restrictions on mobility and economic activity, implying an output contraction in autumn that is likely to continue into the first quarter of 2021. However, compared to spring 2020, the latest containment measures directly affect a much smaller fraction of economic activity. In particular, the industrial sector, which accounts for a large share of the Italian economy, and the construction sector, continue to operate without restrictions, which prevented an even larger output drop in Q4 2020. By contrast, contact-intensive services including tourism continue to reel under the pandemic's economic impact and are again set to take the brunt of the imposed selective lockdown measures.

Based on quarterly GDP outturn data, real output fell by 8.8% in 2020. Owing to the negative carry over from the fourth quarter of 2020 and the weak start to this year, real GDP is projected to expand by 3.4% in 2021. Real output is set to grow at a similar pace in 2022 on the back of the momentum gained in the second half of this year and the continued recovery of the services sector.

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



The projected recovery rests on continued policy support to cushion the fallout from the pandemic on earnings and jobs and to preserve the viability of cash-strapped firms, particularly SMEs. Nonetheless, real GDP is not expected to fully return to its 2019 level by the end of 2022. The growth impact from policy measures related to Next Generation EU is not yet included in this forecast and thus constitutes a sizeable upside risk to the growth outlook.

The assumed relaxation of restrictions by summer 2021 should particularly benefit consumer spending as it is set to unleash pent-up demand in the second half of the year. However, as high (forced and partly precautionary) household savings are likely to decline only gradually, private consumption growth is forecast to moderate over the remaining forecast period. Housing investment will continue to benefit from the *Superbonus 110%,* a tax incentive for improving the energy efficiency of residential buildings and protecting against seismic risks. Business investment, after having registered a steep decline in 2020, is set to gain traction this year on the back of recovering cash flows and brightening demand prospects.

Investment tax credits (*Transizione 4.0*) are likely to lend further support to capital spending. The rebound of Italy's main trading partners in the second half of 2020 is likely to gain strength this year, implying a sizeable growth contribution from net trade, with exports projected to grow broadly in line with global trade. However, the recovery of the tourism sector, particularly hit by the pandemic, will be lagging behind, as visitors, especially from overseas, are expected to only gradually return as uncertainty diminishes.

HICP inflation averaged -0.1% in 2020 due to the sharp drop in oil prices. In 2021, inflation is forecast to remain below 1%, as positive base effects related to the projected increase in energy prices are partly offset by existing slack in the economy, which limits the scope for wage growth. In 2022, headline inflation is set to edge up to roughly 1% as the recovery continues.

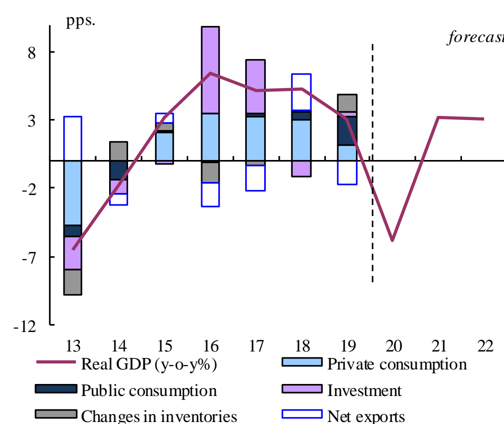
2.9. CYPRUS

Real GDP rebounded strongly in the third quarter of 2020 (+9.4% compared to the second quarter). This rebound was driven by domestic demand, which was mainly underpinned by fiscal stimulus, while exports of goods and services decreased. The recovery lost some steam towards the end of the year as lockdown measures were reintroduced to combat a resurgence in COVID-19 infections. Economic sentiment and consumer confidence worsened in the last two months of the year and again in January 2021. Real GDP is estimated to have contracted by 5.8% in 2020.

In 2021, a partial recovery is forecast, with real GDP growth expected to reach 3.2%. Containment measures have become stricter since the start of the year but they affect a smaller share of economic activity than in spring 2020. As restrictions are expected to continue until vaccinations pick up and cases drop, the recovery is expected to take place mainly in the second half of 2021. Domestic demand is again expected to be the main contributor to growth. Policy measures adopted to mitigate the impact of the crisis have been extended into 2021, and some of them, such as the loan repayment moratorium, are planned to remain in place at least until June 2021. These measures should continue to support employment, household incomes and help businesses to maintain their capacity. Furthermore, construction activity has so far escaped disruption from the lockdown measures.

Tourism, a key sector for Cyprus, has borne the brunt of the COVID-19 pandemic. Receipts from tourism have significantly declined by around 85% in 2020. This trend is expected to be only partially reversed in 2021. On the supply side, interruptions to airline capacity and, on the demand side, varying progress with vaccinations in Cyprus's main tourist markets and lower confidence in air travel are expected to weigh on the sector's recovery. In 2022, real GDP is forecast to grow by 3.1% and return to its 2019 level. This will be mainly on the back of domestic demand, as well as a small positive contribution from net exports. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

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



Headline inflation fell to -1.1% in 2020, dragged down by lower prices for energy and processed foods. In addition, the VAT rate reduction in the hospitality industry led to a fall in the prices of services. Inflation is forecast to turn positive again in 2021 and 2022, at 0.7% and 1.1%, respectively, underpinned by higher energy and services prices.

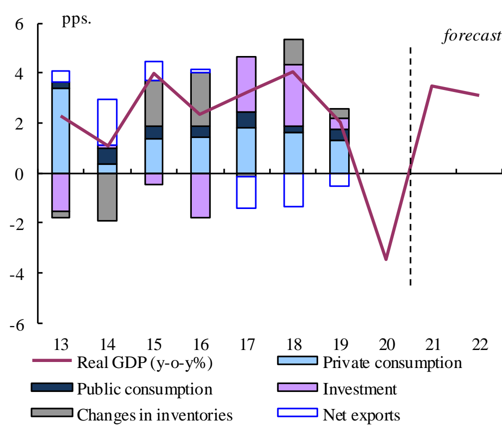
2.10. LATVIA

Latvia's GDP is expected to have declined by 3.5% in 2020. Private consumption and exports suffered the most as pandemic containment measures dampened consumer demand and restricted the supply of services, in particular. The first two quarters saw a significant fall in output, before recovering strongly in the third quarter. The recovery stalled in the last quarter of the year due to a renewed tightening of restrictions following a

resurgence in COVID-19 cases. These restrictions are expected to impact economic growth throughout the first quarter of 2021.

Overall, GDP growth is forecast to rebound in 2021, reaching 3.5%. In the first half of the year, the recovery will be relatively limited as the restrictive measures are expected to be lifted only gradually. However, the extension of income support programmes should help the economy maintain activity at around the same level as at the end of 2020. A much more significant easing of restrictions will be possible, once the level of vaccination coverage reaches a substantial part of population towards the end of summer. This is expected to provide a strong short-term boost to growth as restricted parts of the economy reopen. Overall, GDP growth in 2022 is expected to reach 3.1% with the largest contribution to growth coming from private consumption and exports. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

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



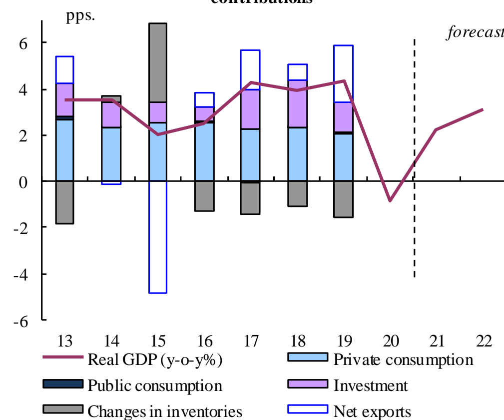
HICP inflation was very low in 2020, averaging 0.1% as a result of a significant decline in energy prices on the one hand and an elevated inflation of unprocessed food prices on the other side. In 2021, inflation is forecast to pick up to 1.5%, primarily due to a recovery in energy prices. It is set to increase further to 1.9% in 2022 as the return of economic growth is projected to revive wage pressures and hence push for accelerating services price growth.

2.11. LITHUANIA

According to the preliminary data, real GDP contracted by 0.9% in 2020, which is one of the smallest declines in the EU. Data available so far show that the slump in domestic demand was partially offset by a positive contribution to growth from net exports. Lithuanian exports remained relatively resilient as manufacturing output was only slightly affected by the restrictive measures imposed to control the pandemic, and external demand remained strong. Output in agriculture also supported economic results. Still, the economic recovery in the last quarter of the year was impacted by a surge in infection rates and a subsequent reintroduction of strict lockdown measures. Consumer, retail and service sector sentiment indicators have worsened as a result.

As measures to contain the pandemic are assumed to be only gradually lifted, economic growth is forecast to remain subdued in the first half of the year. From the third quarter onwards, however, pent-up demand combined with continued wage growth are projected to boost private consumption. At the same time, public investment is set to contribute to the recovery in 2021, while private investment is expected to follow with a lag. Overall, real GDP in Lithuania is forecast to grow by 2.2% in 2021 and then by 3.1% in 2022. This forecast does not include any measures expected to be funded under the Recovery and Resilience Facility, posing an upside risk to the growth projections.

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



In 2020, annual HICP inflation stood at 1.1%, as a substantial drop in energy prices partially offset higher service prices, as well as increases in the prices of food and industrial goods. In 2021, energy prices are forecast to pick up, which together with wage growth and the gradual recovery of domestic demand, should lead to higher inflation. Overall, HICP inflation is forecast at 1.7% in 2021 and 1.8% in 2022.

2.12. LUXEMBOURG

The COVID-19 pandemic resulted in a recession that is projected to have lowered GDP in 2020 by 3.1%. ([13]) Although better than average compared to the rest of the EU, this is the sharpest decline since the financial crisis in 2009 for the Luxembourg economy. Lockdown measures, especially in the first half of 2020 but also in the fourth quarter, have had a very significant impact on private consumption, private investment, and on Luxembourg's international trade in goods and non-financial services. Net exports are expected to have weighed on GDP growth. The impact on economic growth has been mitigated by two economic support programmes launched by the government in 2020. GDP was also supported by the relatively strong performance of the country's international trade in financial services, which actually grew during the first three quarters of 2020. The financial sector has demonstrated resilience during the crisis, including the banking and fund management sectors.

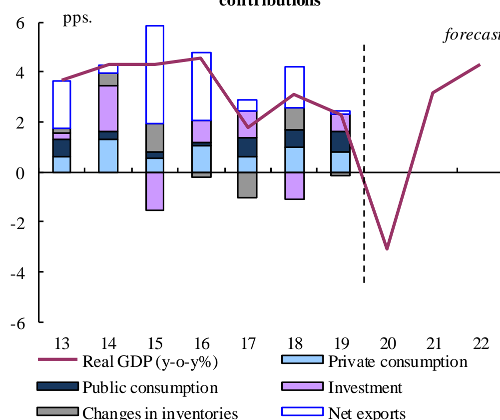
GDP is expected to recover in 2021 when it is forecast to grow at a rate of 3.2%. As containment measures are assumed to continue into the first half of 2021, the rebound is set to take place mainly in the second half of the year. The recovery is expected to be driven by a rebound in private consumption and investment from their low 2020 levels. Private consumption is projected to be supported in 2021 by the labour market, which held up relatively well during the crisis, and by household savings accumulated in 2020. The extension of government support measures into the first half of 2021 should also support domestic demand during this period. Following the removal of the majority of the restrictions, a strong recovery is expected with GDP growth of 4.3% in 2022, mainly driven by domestic demand but also supported by net exports.

The main risks to the forecast for Luxembourg are related to potential vulnerability in the valuation of equity markets, which could spill over into the financial and the external sector, and to the impact the EU-UK trade agreement could potentially have on trade in financial services. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

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

In 2020, annual HICP inflation declined to 0.0%, mainly reflecting the large drop in oil prices and the introduction of free public transport in March 2020. In 2021, the expected increase to 1.7% is supported by higher oil prices and the introduction of a carbon tax. Service inflation is projected to increase over the forecast period but remain below the 2019 rate due to lower expected wage growth in 2021. In 2022, inflation is expected to normalise to 1.9%, fuelled by wage indexations expected in the first half of the year.

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



2.13. MALTA

The Maltese economy registered a severe contraction in 2020. Limitations on air traffic, tourism and social activities were mainly to blame for an expected fall in real GDP of around 9%, which came after robust growth of 5.3% in 2019.

Investment fell, mainly due to a surprise drop in construction, while private consumption was dampened by contractions in sectors such as retail and hospitality. The toll on the economy, however, has been partially mitigated by government stimulus measures. The second wave of restrictions globally has placed additional strain on the highly open economy in the last quarter of 2020 and continues to weigh in the first quarter of 2021.

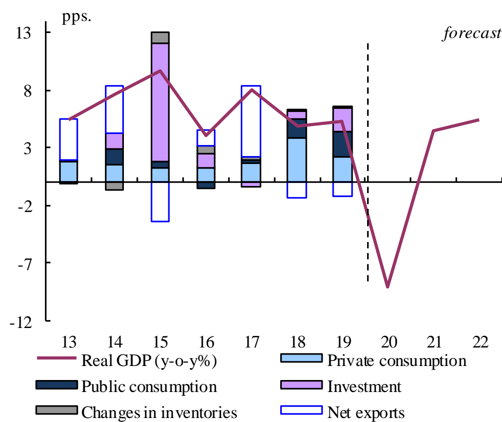
The expected rollout of vaccinations in 2021 and a gradual easing of restrictions in the EU should set the tourism sector back on the path to recovery and re-invigorate domestic demand. In 2021, real GDP growth is expected to reach 4.5%. Growth is set to

be mainly driven by net exports and domestic consumption, as inbound tourism and global trade recover gradually. The EU-UK Free Trade Agreement reduced a part of the negative impact assumed by the WTO-rules based assumption in the Autumn Forecast. The potential growth impact from policy measures related to the Next Generation EU programme is not yet included in this forecast and, thus, constitutes an upside risk to the growth outlook.

In 2022, Malta's economy is forecast to expand by 5.4% as net exports return as the main contributor to GDP growth while domestic demand makes a slower but steady contribution. By the end of 2022, the tourism sector is expected to recover close to pre-pandemic levels and international trade should be significantly restored.

HICP inflation averaged 0.8% in 2020, lower than the 1.5% in 2019, driven mainly by subdued energy prices and lower inflation in services, against the background of the contraction in demand. In 2021, inflation is expected to rise to 1.3% on the back of recovering domestic demand and a higher demand for tourism services. In line with a stronger economic recovery in 2022, inflation should pick up further to around 1.6%.

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



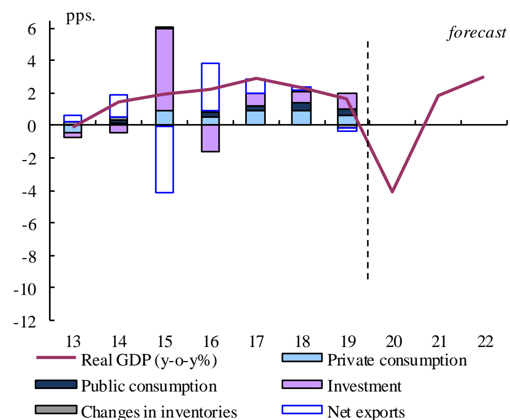
2.14. THE NETHERLANDS

The Dutch economy is expected to have contracted by 4.1% in 2020 as the COVID-19 pandemic and the related restrictions significantly affected the economy. Following a nationwide lockdown in the spring, a strong rebound started in the third quarter of 2020 but was interrupted by a second wave of COVID-19 infections in the autumn. The associated reintroduction of containment measures and their progressive tightening since October have constrained economic activity particularly in contact-dependent services in hospitality, retail trade, entertainment and transport. As a result, the Dutch economy is forecast to enter another technical recession, contracting by 1.3% q-o-q and 1.0% q-o-q in the fourth quarter of 2020 and the first quarter of 2021, respectively. On the positive side, government support measures are set to continue operating until the summer of 2021, protecting employment and disposable incomes.

Containment measures are expected to gradually ease towards the middle of 2021 as vaccinations progress, leading to a partial consumption-led rebound of economic growth on the back of pent-up demand and firmer consumer confidence. Business investment is expected to recover more slowly, dampened by turnover losses and increased debt levels in sectors long-affected by the pandemic. In 2022, labour market adjustments and subdued wage growth are expected to slow the pace of the recovery in domestic demand. Given the strong recovery in the global goods trade, net exports are set to contribute positively to GDP growth over the forecast horizon.

Overall, real GDP is expected to grow by 1.8% in 2021 and 3.0% in 2022, the latter also driven by base effects. At the end of the forecast horizon, the level of economic activity is projected to increase to just above 2019 levels. This forecast does not include any measures funded under the Recovery and Resilience Facility, constituting an upside risk to the growth projections.

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



Consumer price inflation declined to 1.1% in 2020 and is forecast to increase slightly to 1.4% and 1.5% in 2021 and 2022, respectively. Subdued domestic demand and lower wage growth are set to

place downward pressure on prices, partly counterbalancing higher oil prices and firming inflationary pressures in the manufacturing sector in 2021 and 2022.

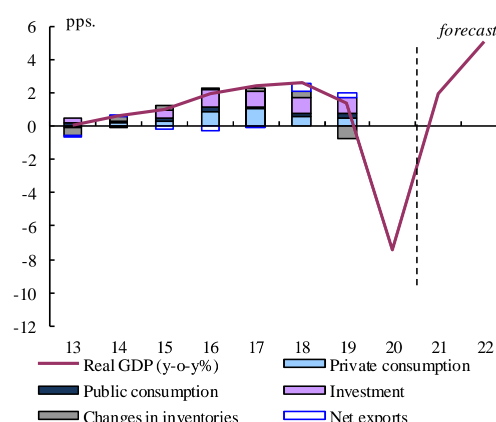
2.15. AUSTRIA

Austria's economy has been strongly affected by the COVID-19 pandemic and related containment measures, with GDP expected to show a 7.4% contraction in 2020. The first half of 2020 recorded the deepest recession since the Second World War. In the third quarter of 2020, the lifting of travel restrictions and gradual easing of containment measures, together with government measures supporting the economy, gave rise to a strong and broad-based rebound, reaching 12% quarter-on-quarter growth. A resurgence in infections sparked a second lockdown in November, which was temporarily eased between the 7th and 25th of December. This led to a 4.3% decline in GDP in the fourth quarter that was mainly due to a fall in private consumption and tourism services. Nevertheless, the economic effect of the second lockdown was less severe than in the spring, as the industrial sector and foreign trade were less affected.

The lockdown in the first quarter of 2021, although set to be eased somewhat as of 8 February, is expected to lead to a further contraction of GDP of 1.4%. Private consumption is expected to remain subdued, while containment measures and the extension of travel warnings in many EU countries are expected to shut down most of the Austrian winter tourism season. The gradual easing of restrictions and continued government support over the following quarters is expected to lead to a solid rebound in GDP growth. This is set to be mostly driven by pent-up demand, while a recovery in the tourism sector over the summer, similar to that witnessed in July and August last year, should provide an additional boost in the third quarter. For the fourth quarter of 2021 and the whole of 2022, GDP is expected to recover gradually, in line with the lifting of restrictions and as activity in the tourism sector is expected to return close to pre-crisis levels. Overall, GDP is expected to grow by 2.0% in 2021 and 5.1% in 2022. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

Despite the economic contraction and a strong fall in energy prices, headline inflation decreased only marginally to 1.4% in 2020. While initially dropping in the first half of 2020, inflation increased again in the second half of the year, driven by rising prices for industrial goods, food and services. The relatively strong inflation in services was mostly due to increases in hotel and restaurant prices, which can be partly explained by measurement issues. ([14]) In 2021, the assumed increase in oil prices, compared to 2020, is expected to push inflation to 1.7%. Inflation is expected to remain at 1.7% in 2022.

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



2.16. PORTUGAL

Portugal's economy contracted sharply in 2020 as the spread of the COVID-19 pandemic took a heavy toll on all aspects of social and business activities, with a particularly strong impact on the country's large hospitality sector. Portugal's GDP is estimated to have fallen by 7.6% in 2020. Quarterly rates closely followed the evolution of the pandemic and the consequent introduction of restrictions. After a cumulative drop of around 17% in the first half of 2020, GDP rebounded by 13.3% in 2020-Q3. However, the resurgence of infections brought new restrictions towards the end of the year and GDP growth weakened to 0.4% in the last quarter. With the introduction of a more stringent lockdown in mid-January 2021, GDP is projected to fall again in the first quarter of 2021, before starting to recover as of the second quarter of the year, with a major rebound in the summer months. This entails expectations for a notable rebound in tourism in the summer, particularly in

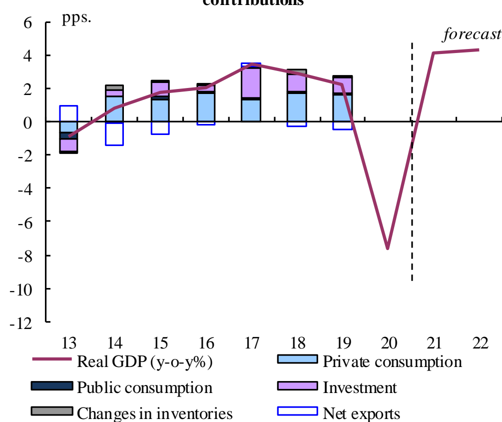
([14]) http://www.statistik.at/web_de/statistiken/wirtschaft/preise/verbraucherpreisindex_vpi_hvpi/125192.html

intra-EU travel, and a more gradual recovery thereafter. However, the tourism sector is projected to remain somewhat below its pre-crisis level until the end of the forecast period.

In full-year terms, GDP is projected to grow by 4.1% in 2021 and 4.3% in 2022. A full return to pre-pandemic levels is expected towards the end of 2022 but risks remain significant due to the country's large dependence on foreign tourism, which continues to face uncertainties related to the evolution of the pandemic. On the other hand, measures specified in Portugal's draft Recovery and Resilience Plan, beyond those planned in the budget for 2021 (¼% of GDP), are not factored in the forecast and constitute an upside risk.

Service exports and equipment investment recorded the largest drops in 2020 but private consumption also fell significantly amid a steep rise in savings. On the other hand, investment in construction continued to grow, helped by the cycle of EU-funded projects. After the initial shock, manufacturing also performed relatively well, recovering to near pre-crisis levels. Pent-up consumer demand and the expected surge in business sentiment are projected to drive the economic recovery. Private consumption is also expected to benefit from a relatively resilient labour market, where the drop in employment compared favourably with that of output and government social transfers provide further support to incomes.

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



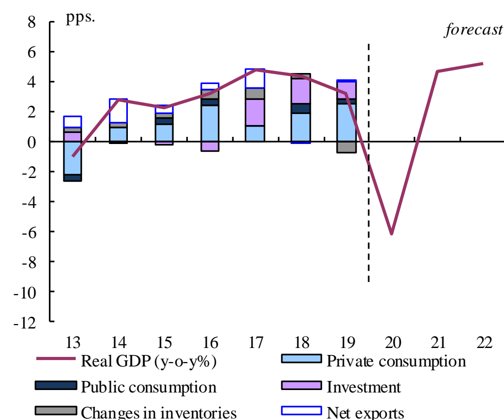
Consumer prices (HICP) dropped marginally by 0.1% in 2020 and are set to increase by 0.9% in 2021 and 1.2% in 2022. The projected increase in energy prices is expected to be the main driver of inflation in the first half of 2021, followed by a gradual pickup in service prices as of the third quarter of this year.

2.17. SLOVENIA

Slovenia's GDP is estimated to have contracted by 6.2% in 2020. Over the first three quarters, private consumption was 8.4% and investment 6.5% lower than in the same period in 2019. Imports fell more than exports, leading to a positive contribution from net exports. The recovery in the third quarter of last year, however, was followed by a strong resurgence in COVID-19 infections and the introduction of new restrictions in the fourth quarter that dampened economic sentiment and reduced private consumption significantly. The impact of the crisis was softened by extensive government measures to support employment and limit insolvencies. Still, employment decreased and the unemployment rate increased slightly.

The pandemic and its associated restrictions continue to exert a strong influence over the economy in early 2021, particularly in the services sector. Industrial production and construction are expected to be less affected. The economic situation is expected to gradually improve as more people are vaccinated and restrictions are relaxed, leading to stronger growth in the second half of the year. Overall, GDP is forecast to grow by 4.7% in 2021 supported by both strong domestic demand and positive net exports. Thereafter, the economy is expected to grow by 5.2% in 2022, driven by the same factors as in 2021. GDP is expected to exceed its end-2019 level by the end of 2022.

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



Once support measures end, the recent increase in the minimum wage could place additional strain on struggling companies in the services sector. This

constitutes a downside risk to the forecast. The forecast factors in some of the measures expected to be funded under the Recovery and Resilience Facility representing about 0.6% of GDP. Higher use of the facility is an upside risk.

The sharp decline in energy prices in March 2020 led to deflationary pressures that were still being felt at the end of 2020 despite the partial recovery in energy prices. Overall, prices decreased by 0.3% in 2020. Inflation is expected to remain very low in the beginning of 2021 and to increase somewhat in the second half of the year. Overall, prices are expected to increase by 0.8% in 2021. In 2022, taking into account the projected recovery and assumed increase in energy prices, inflation is expected to reach 1.7%.

2.18. SLOVAKIA

After a strong rebound in the third quarter, a second wave of the COVID-19 pandemic is expected to have suppressed economic activity in Slovakia towards the end of 2020, resulting in a 5.9% contraction of GDP compared to 2019. While prolonged pandemic-related restrictions are assumed to keep weighing on real output in early 2021, the gradual rollout of vaccination should enable a sharp rebound in the second half of the year, bringing annual GDP growth to 4%. The Slovak economy is forecast to reach its pre-pandemic output level by the end of 2021 and to grow by about 5.4% in 2022.

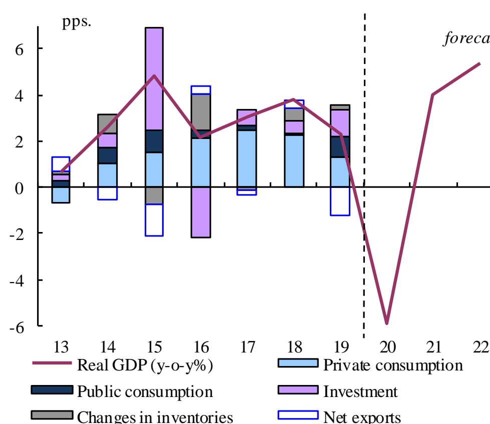
The deteriorating near term outlook mainly affects domestic spending. Despite continued fiscal measures cushioning the fall in private incomes and employment, closed businesses and travel restrictions are depressing private consumption, particularly in the service sector. In addition, prolonged uncertainty keeps precautionary savings of households high and also discourages investment spending. However, with the assumed lifting of most containment measures, a sharp rebound in domestic demand is expected from the second half of 2021.

In contrast to services, industry is proving to be more resilient, being largely shielded from domestic pandemic-related restrictions. This bodes well for Slovakia's industry-heavy export sector, which should also benefit from improved foreign demand. Due to a large share of imported intermediate inputs, strong exports should also sustain faster import growth despite initially weaker domestic spending. On balance, net exports are forecast to contribute positively to GDP growth over the forecast horizon.

Inflation is expected to slow sharply at the beginning of 2021 due to a drop in administered energy prices. The deteriorating near-term outlook will act as an additional disinflationary force via weaker domestic demand, resulting in an annual inflation rate of 0.5% in 2021. The more dynamic rebound in the second half of 2021 is forecast to set off rising price pressures, mainly in the domestic service sector, leading to gradually increasing inflation rates, before stabilising around 1.6% in 2022.

Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

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



2.19. FINLAND

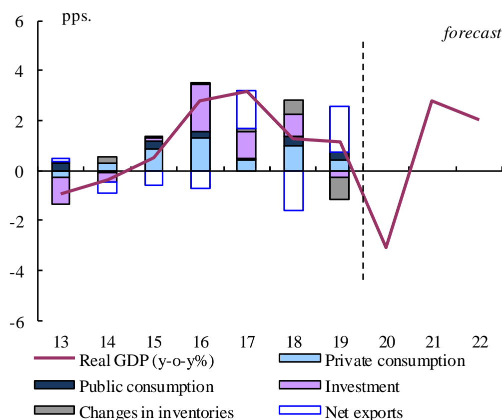
Finland's real GDP is estimated to have fallen by 3.1% in 2020. Although the economy was impacted by the COVID-19 pandemic, Finland has weathered the crisis relatively well so far and is one of the least affected countries in the EU, both economically and in terms of public health. All demand components, except government consumption, are expected to fall in 2020. The main hit to GDP came from the decline in private consumption as consumers increased their precautionary savings and had fewer opportunities to spend. The economy bounced back in the third quarter and is expected to keep the same level in the fourth quarter.

Real GDP growth is forecast to rebound by 2.8% in 2021. Even the worst hit parts of the economy are expected to start recovering once the most vulnerable groups of the population are vaccinated. Growth is expected to be broad-based, with private consumption and investment posting the strongest contributions. In 2022, GDP is forecast to grow by 2.0%, weakening gradually after the boost from the recovery phase. Growth is set to be driven by domestic demand, which is expected to enjoy the support of rising consumer confidence and disposable incomes. The level of output recorded at end-2019 is forecast to be surpassed by mid-2022.

HICP inflation was very subdued in 2020 at 0.4%, as a result of the collapse in demand and energy prices. Inflation is expected to rise slightly above 1% in both 2021 and 2022. Energy prices are forecast to give a temporary boost to inflation in 2021. However, inflation is expected to remain at historical lows due to the absence of significant domestic price pressures because of the relatively high level of unemployment.

The Finnish economy showed resilience during the crisis, which could turn out to be a positive accelerator in the recovery phase. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

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



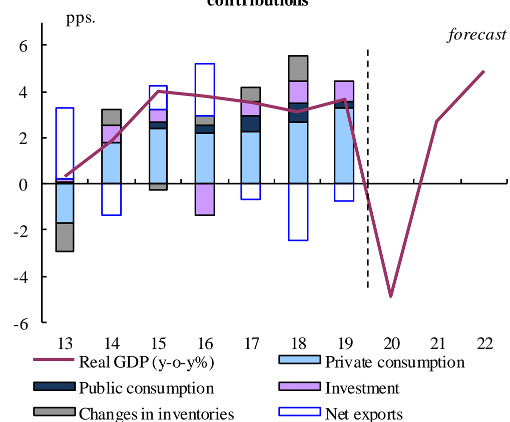
NON-EURO AREA

2.20. BULGARIA

Economic activity in Bulgaria declined markedly in 2020 due to the COVID-19 pandemic. Private consumption dynamics followed the introduction and subsequent relaxation of containment measures. In late November 2020, a second wave of the pandemic led to the re-introduction of containment measures which are still in place and which continue to weigh on household consumption and business sentiment in trade and the services sector. Private investment remained depressed throughout the first nine months of 2020, while public sector investment increased markedly in 2020-Q3. Although exports within the EU have been recovering since mid-2020, sales to non-EU countries have continued to falter. The COVID-19 pandemic has led to a significant loss in revenues from foreign tourists, which typically account for around three quarters of revenues from tourist accommodation. Overall, real GDP is expected to have fallen by 4.9% in 2020.

Looking forward, domestic demand is forecast to remain subdued in the first half of 2021, given the assumed extension of containment measures. The eventual re-opening of the economy should provide a boost to consumption and investment in the second half of 2021. Goods exports are expected to gradually recover from the second quarter onwards, while foreign tourists are expected to start returning in the third quarter. The recovery in foreign tourism, however, is subject to a downside risk linked to the relative rates of vaccination and contagion in Bulgaria compared to alternative tourist destinations. Against this backdrop, real GDP growth is forecast to reach 2.7% in 2021, before accelerating to 4.9% in 2022 on the back of strong domestic demand and more buoyant exports. As the forecast does not take into account the implementation of the Recovery and Resilience Plan, an upside risk to public investment emerges.

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



Annual average inflation fell to 1.2% in 2020 due to falling energy prices and abating price dynamics in services and unprocessed foods. Inflation is set to increase to 1.7% in 2021 and 1.8% in 2022, driven by price increases in processed foods and services.

2.21. CZECHIA

Economic growth in Czechia reversed sharply in 2020 as the pandemic brought significant disruptions, particularly to the country's large export-oriented manufacturing industry. According to the latest figures available, real GDP declined by 5.6% in 2020. The recovery is expected to take hold in spring 2021 and GDP is forecast to reach its pre-crisis level by the end of this year.

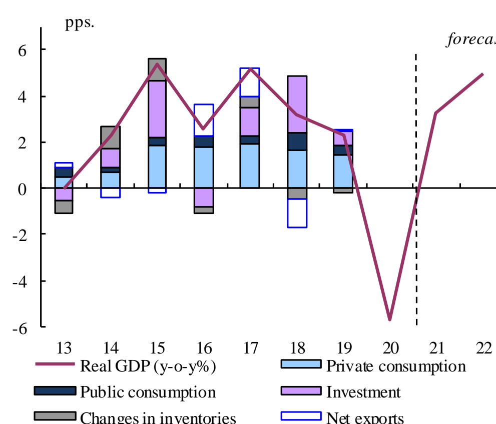
Czechia has been severely hit by the second wave of the pandemic. Restrictions introduced in October 2020 likely impacted domestic demand and investment, but due to strong foreign demand, economic activity is estimated to have increased in 2020-Q4 by 0.3% compared to the previous quarter, according to the latest figures available. Except for a short relaxation over the Christmas period, strict measures have been kept in place. Czechia is thus expected to see at least six weeks of lockdown in the first quarter of 2021, when GDP is expected to contract. The economy should gradually recover from the second quarter onwards, leading to an annual growth rate of around 3.2% in 2021, recovering the GDP losses sustained last year. Measures expected to be funded under the Recovery and Resilience Facility amounting to 0.2% of GDP are factored into this forecast.

Private consumption is likely to be the main driver of the economic recovery, reflecting a stable situation on the labour market, pent-up demand, and a decline in the high households saving rate. Cuts in personal income tax rates that came into effect at the start of 2021 will also be supportive of private consumption. Due to persisting disruptions in supply chains, including bottlenecks in the labour market, investment is expected to recover at a slower rate.

The trade balance is likely to be slightly positive in both 2021 and 2022, reflecting also the ongoing rebound in Czechia's key trading partners. However, the negative impact of the pandemic on client-facing services such as hospitality, tourism and transport may last longer. GDP is forecast to increase by 5% in 2022.

HICP inflation is forecast to slow to 2.5% in 2021 and to 2.2% in 2022. Price pressures are expected to ease due to anti-inflationary demand effects from the second wave of the pandemic amid subdued domestic economic activity. At the same time, muted wage growth is forecast to dampen increases in domestic labour costs. The slowdown in inflation rates is projected to be driven by falling core inflation and by slowing growth in food prices. Administered price inflation is also expected to decrease due to slower growth in electricity prices and a decline in gas prices. Overall, over the forecast horizon, inflation is projected to slow towards the central bank's monetary policy target of 2%.

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



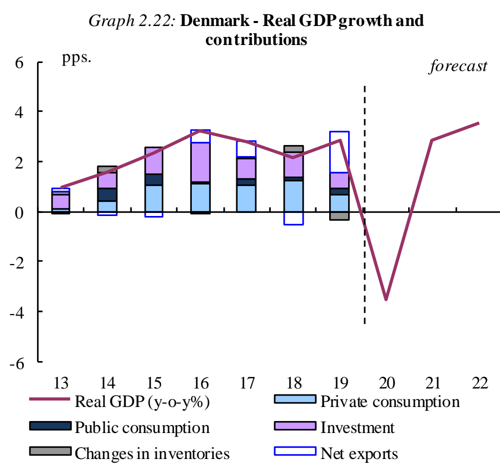
2.22. DENMARK

A sharp contraction in real GDP of 7.1% q-o-q in the second quarter of 2020 was followed by robust growth of 5.2% q-o-q in 2020-Q3 as lockdown measures in response to the COVID-19 pandemic were gradually lifted. In particular, household consumption and investment bolstered the recovery. Economic conditions deteriorated again when confinement measures were gradually tightened from 9 December onwards. Overall, the Danish economy proved its resilience with an estimated real GDP contraction of only 3.5% in 2020. This is mainly due to Denmark's relatively successful handling of the pandemic at the early stage, which allowed it to avoid a lockdown in many sectors, as well as a favourable industrial specialisation (pharmaceuticals, food industry) which have proved relatively resilient to the downturn.

Ongoing lockdown measures at the beginning of the year in Denmark and across the EU are projected to weigh on economic activity. However, progress with vaccinations across the EU could pave the way for restrictions to be lifted over the course of the year. The Danish government is prolonging several COVID-19 emergency measures in order to support the sectors most hurt by the pandemic. Private consumption is set to be further bolstered by another round of cash transfers to households in spring 2021. This transfer is related to the release of households' 2021 frozen holiday savings and is equivalent to two weeks of household income or 1% of GDP. Investment has surprised on the upside throughout the coronavirus crisis and should be further supported by the government's 'recovery package', which is equivalent to approximately 1.6% of GDP over the forecast horizon.

Nevertheless, weak economic activity at the beginning of this year will be a drag on annual growth figures for this year as a whole and real GDP is forecast to expand by 2.9% in 2021. Economic recovery is projected to continue next year on the back of the momentum gained in the second half of this year and growing external demand. Also helped by a stronger carry over effect, real GDP is forecast to expand by 3.6% in 2022. Future spending related to the Recovery and Resilience Facility are not included in this forecast and constitute an upside risk.

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



Consumer price inflation (HICP) remained moderate in 2020 at 0.3%. The collapse in oil prices in March wiped out inflationary pressures for the year even though oil prices have recovered somewhat since. This effect was only partially compensated by higher tobacco taxes and rising food prices. The recovery in economic activity and the higher energy prices assumed are set to lead to an increase in consumer prices from the second half of this year. Accordingly, HICP inflation is forecast to rise to 1.2% in 2021 and to 1.3% in 2022.

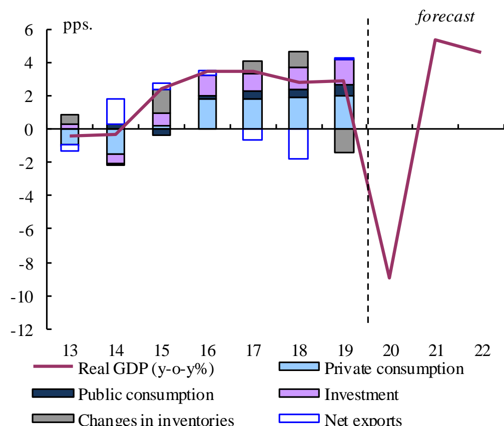
2.23. CROATIA

Croatia's economy is estimated to have contracted by 8.9% in 2020. This sharp decline is mainly attributable to the impact of the COVID-19 pandemic on service exports, particularly tourism, which suffered greatly due to the fall in demand for air travel and the imposition of travel restrictions in many countries. Private consumption also fell, reflecting the accumulation of involuntary and precautionary savings. Following a better-than-expected third quarter, GDP is estimated to have contracted again towards the end of the year as pandemic suppression measures were reintroduced in December.

Real GDP is forecast to bounce back by 5.3% in 2021, as domestic demand should rebound once pandemic containment measures are phased out and more people are vaccinated. Pent-up demand, coupled with a gradual recovery in the labour market, is expected to boost private consumption. Investment should rebound on the back of the already strong dynamics in the construction sector, supported by rebuilding efforts following the strong earthquakes in the Banija region and Zagreb. A gradual pick up in longer-term investment projects, is also expected. The recovery in external demand, however, is expected to be uneven. Goods exports are expected to increase strongly on the back of the improved global outlook but services exports are projected to remain subdued in both 2021 and 2022 compared to their 2019 levels. This is mainly because the recovery in the travel and hospitality sectors are likely to take several years. This forecast does not include any measures expected to be funded under the Recovery and Resilience Facility, posing an upside risk to the growth projections.

HICP inflation rate dropped to 0% in 2020 on the back of a strong decline in energy prices, while core inflation remained broadly stable at around 1%. As the effect of last year's fall in oil prices dissipates, inflation is expected to pick up slightly in 2021 but should remain subdued throughout the forecast horizon (1.2% in 2021 and 1.5% in 2022).

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



2.24. HUNGARY

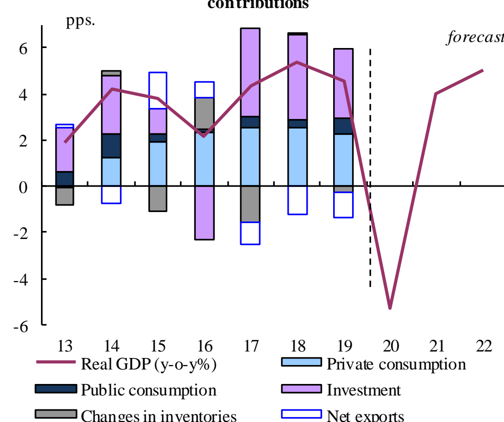
Hungary's economy bounced back by 11.4% q-o-q in the third quarter of 2020 after the first lockdown to contain the pandemic ended. Industry, construction and retail sales remained strong in October and November. However, the rebound was interrupted by a second wave of the pandemic, which led to another round of restrictions from mid-November that mainly affected the hospitality, leisure and entertainment sectors. As a consequence, GDP is expected to have decreased slightly in the fourth quarter of 2020. Overall, Hungary's GDP is expected to show a 5.3% contraction in 2020, mostly driven by plummeting investment and service exports. Consumption is also likely to show a decrease given the fall in household income and confidence and the limited opportunities to consume certain services during the lockdown.

The current containment measures will start to be eased only once case numbers drop substantially or vaccines become widely available, thus they will remain a drag on GDP growth in the near-term. In addition, the manufacturing sector faces supply chain disruptions, which could hinder production in the short-term. The assumed easing of public health measures should set the stage for a quick rebound in economic activity from mid-2021. GDP is forecast to grow by 4% in 2021 and by 5% in 2022, supported by all final demand components. There are upside risks to this forecast as the baseline projection does not include any measures funded by the Recovery and Resilience Facility.

The unemployment rate stood at 4.3% in December 2020, almost unchanged compared to previous months. However, an increasing share of employees reported zero working hours and household unemployment expectations also rose. The government has provided some support to preserve employment in the sectors most affected by the second lockdown, which is mitigating its negative economic impact. Job creation is expected to resume after the economy returns to growth, but lingering labour market slack is likely to temper wage growth.

Inflation eased in the last months of 2020 as food and fuel prices decreased. HICP inflation was at 3.4% in 2020 and it is projected to remain at 3.5% in 2021 due to the pass-through of earlier currency depreciation and rising excise duties on tobacco. After these temporary factors fade, inflation is expected to ease to 2.9% on the back of the subdued growth of unit labour costs.

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



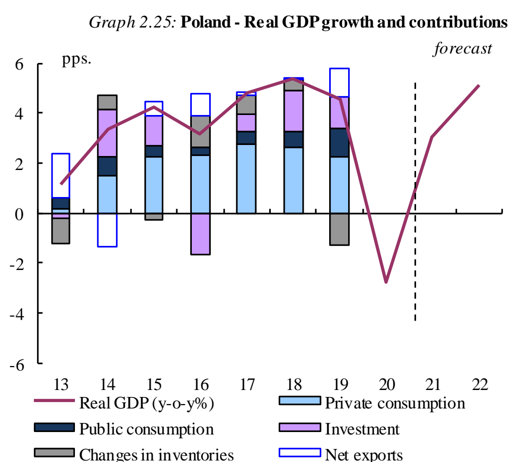
2.25. POLAND

Poland's economy rebounded strongly in the third quarter after a steep fall in economic activity in the first half of 2020. Real GDP grew by 7.9% quarter-on-quarter, mainly driven by a sharp rebound in household consumption and a rise in exports, which boosted the trade balance. The economy continued on a strong footing into the last quarter of 2020, but a surge in new infections and the reintroduction of restrictions to control the pandemic supressed economic activity towards the end of the year, particularly in the services sector. As a result, despite some favourable readings of industrial production and retail sales during the last months of 2020, the fourth quarter is expected to show a mild contraction, leaving the annual growth rate of real GDP at -2.8%, according to the latest data by the national statistical office.

The prolongation of restrictions into early 2021 are expected to weigh on economic activity at the start of the year. However, as vaccinations are gradually rolled out and the stringency of containment measures is eased, real GDP is expected to rebound in the second half of the year. Private consumption is set to lead the recovery driven by an expected reduction in accumulated savings, increased confidence and a favourable situation on the labour market. The outlook for investment is also expected to brighten towards the end of the second quarter on the back of improved business sentiment and low borrowing costs, which are also likely to support the construction sector. Foreign trade is set to rebound strongly too, but imports should grow faster than exports after a sharp fall in 2020. Consequently, net trade is expected to detract from growth in 2021 and, to a lesser extent, 2022. Overall, real GDP growth is expected to reach 3.1% in 2021 and 5.1% in 2022. This forecast does not include any measures expected to be funded under the Recovery and Resilience Facility, posing a significant upside risk to the growth projections.

Contrary to most EU countries, HICP inflation in Poland rose noticeably in 2020 to 3.7%, mainly driven by rising service and food prices. A hike in administrative prices, which reflected changes in waste disposal charges and electricity prices, also played a role. Slower wage growth and higher un-employment are expected to dampen price pres-sures in 2021, bringing inflation down to 2.3%. In line with the steady recovery of economic activity, HICP inflation is expected to increase again to 2.9% in 2022.

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



2.26. ROMANIA

After a 12.2% contraction in the second quarter of last year, Romania's economy rebounded by 5.8% in 2020-Q3, mainly due to a recovery in private consumption. The strong performance of the construction sector sustained gross fixed capital formation growth throughout the year. Meanwhile, net exports continued to contribute negatively to growth in 2020 despite exports recovering somewhat faster than imports in the third quarter. Industrial production made up for some of its earlier losses in the second and third quarter of 2020, but this positive performance appeared to stall in the beginning of the last quarter. Economic activity is expected to have weakened somewhat in 2020-Q4 as pandemic containment restrictions were reintroduced in response to a new wave of infections. Fiscal support measures, some of which have been extended until mid-2021, mitigated the impact of the crisis on the economy in 2020. The unemployment rate remained around 5%, as government policy measures cushioned the blow to the labour market.

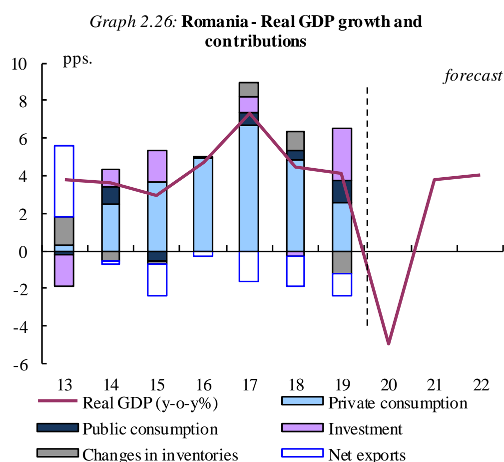
Real GDP is forecast to grow by 3.8% in 2021 and by 4% in 2022. Private consumption is expected to recover strongly from the second half of 2021 as the rollout of vaccinations should allow for a gradual lifting of restrictions. Consumption is expected to remain robust in 2022. Investment is set to remain strong over the forecast horizon, supported by the construction sector. Exports are expected to recover against the backdrop of improved economic conditions in Romania's main trading partners. However, the contribution of net exports to growth is expected to remain negative over the forecast horizon. Future spending related to the Recovery and Resilience Facility is not included in this forecast.

Risks to the growth forecast are tilted to the upside. Particular upside risks for Romania are a fast implementation of the Recovery and Resilience Plan and an improvement of public finances.

In 2020, a sharp drop in energy prices and subdued aggregate demand pushed headline inflation down to 2.3% from 3.9% in 2019. In 2021, some inflationary pressures are expected to come from higher oil prices and the liberalisation of the retail electricity market on 1 January, which is set to increase energy prices in the first part of the year. The annual average rate of inflation is forecast to

slightly increase to 2.6% in 2021 and to decline somewhat to 2.4 % in 2022.

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



2.27. SWEDEN

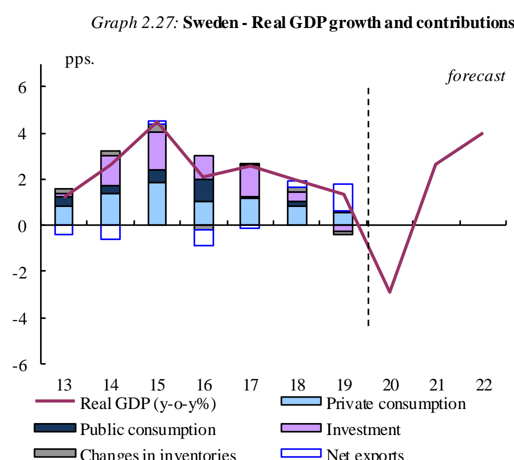
Sweden's economy rebounded strongly in the third quarter of 2020 after a steep contraction in the second quarter. Real GDP grew by 4.9% quarter-on-quarter, chiefly on the back of strong private consumption and exports. Fiscal policy supported resilience, notably through measures to bridge temporary unemployment, cushioning the impact of the crisis on the labour market. The economy entered the fourth quarter of 2020 on a strong footing, but weakened towards the end of the year as restrictions were tightened to counter the spread of the virus and the economies of trading partners were affected by further COVID-19-related disruptions. The dispersion in sector performance continued to widen in the second half of 2020. Industrial production, merchandise exports and the purchase of durable consumer goods drove the recovery while contact-related services in particular suffered from a substantial fall in turnover. This pattern is expected to continue into 2021.

Real GDP is forecast to fall slightly in the first quarter of this year, with a subsequent recovery expected to gather pace only in the second half of the year, when the pandemic is expected to recede. Private consumption is expected to grow on the back of a resilient labour market and the boost in available spending power stemming from low inflation and deferred household expenditure in 2020. The outlook for investment is set to brighten in the wake of the projected recovery, supported by a buoyant housing market and low borrowing costs. Inventories should be reduced as the economy gathers pace, whereas exports are set to benefit from the expected recovery in Sweden's main trading partners.

Overall, real GDP growth is set to reach 2.7% in 2021 and pick up to 4% on average in 2022 as impediments dissipate and the global economy recovers. Sweden intends to use the Recovery and Resilience Facility to finance part of its 2021 budget, which is already included in this forecast.

HICP inflation is expected to rise notably in the first months of 2021 due to a rebound in energy prices and the effects from earlier (partly crisis-related) price changes. Economic slack, lagged effects from the krona's appreciation and relatively moderate multi-annual wage agreements among social partners (which extend into 2023) are set to dampen price pressures over the remainder of the forecast horizon. The effects of COVID-19-induced changes in the consumption basket for 2020 (which are used as weights for the HICP index in 2021) as well as crisis-related changes in seasonal patterns and price imputation for certain items should influence measured inflation in 2021. Overall, HICP inflation is expected to average 1.3% in 2021 and decrease slightly in 2022.

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



STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2002-2022) 2.2.2021

	5-year averages						Winter 2021 forecast			*Autumn 2020 forecast*		
	2002-06	2007-11	2012-16	2017	2018	2019	2020	2021	2022	*2020*	*2021*	*2022*
Belgium	2.2	1.3	1.2	1.6	1.8	1.7	**-6.2**	**3.9**	**3.1**	*-8.4*	*4.1*	*3.5*
Germany	1.0	1.2	1.4	2.6	1.3	0.6	**-5.0**	**3.2**	**3.1**	*-5.6*	*3.5*	*2.6*
Estonia	8.1	-0.7	2.5	5.5	4.4	5.0	**-2.9**	**2.6**	**3.8**	*-4.6*	*3.4*	*3.5*
Ireland	5.3	-0.4	7.1	9.1	8.5	5.6	**3.0**	**3.4**	**3.5**	*-2.3*	*2.9*	*2.6*
Greece	4.2	-3.5	-2.0	1.3	1.6	1.9	**-10.0**	**3.5**	**5.0**	*-9.0*	*5.0*	*3.5*
Spain	3.3	0.0	0.7	3.0	2.4	2.0	**-11.0**	**5.6**	**5.3**	*-12.4*	*5.4*	*4.8*
France	1.8	0.8	0.8	2.3	1.8	1.5	**-8.3**	**5.5**	**4.4**	*-9.4*	*5.8*	*3.1*
Italy	0.9	-0.5	-0.6	1.7	0.9	0.3	**-8.8**	**3.4**	**3.5**	*-9.9*	*4.1*	*2.8*
Cyprus	4.2	1.8	-0.5	5.2	5.2	3.1	**-5.8**	**3.2**	**3.1**	*-6.2*	*3.7*	*3.0*
Latvia	9.3	-1.5	2.8	3.3	4.0	2.1	**-3.5**	**3.5**	**3.1**	*-5.6*	*4.9*	*3.5*
Lithuania	7.8	0.9	3.1	4.3	3.9	4.3	**-0.9**	**2.2**	**3.1**	*-2.2*	*3.0*	*2.6*
Luxembourg	3.5	1.9	3.3	1.8	3.1	2.3	**-3.1**	**3.2**	**4.3**	*-4.5*	*3.9*	*2.7*
Malta	2.5	2.7	6.2	8.0	4.8	5.3	**-9.0**	**4.5**	**5.4**	*-7.3*	*3.0*	*6.2*
Netherlands	1.6	1.0	0.9	2.9	2.4	1.7	**-4.1**	**1.8**	**3.0**	*-5.3*	*2.2*	*1.9*
Austria	2.2	1.2	0.9	2.4	2.6	1.4	**-7.4**	**2.0**	**5.1**	*-7.1*	*4.1*	*2.5*
Portugal	0.8	-0.1	-0.1	3.5	2.8	2.2	**-7.6**	**4.1**	**4.3**	*-9.3*	*5.4*	*3.5*
Slovenia	4.1	0.9	0.9	4.8	4.4	3.2	**-6.2**	**4.7**	**5.2**	*-7.1*	*5.1*	*3.8*
Slovakia	6.1	3.8	2.4	3.0	3.8	2.3	**-5.9**	**4.0**	**5.4**	*-7.5*	*4.7*	*4.3*
Finland	2.9	0.6	0.1	3.2	1.3	1.1	**-3.1**	**2.8**	**2.0**	*-4.3*	*2.9*	*2.2*
Euro area	1.7	0.5	0.8	2.6	1.9	1.3	**-6.8**	**3.8**	**3.8**	*-7.8*	*4.2*	*3.0*
Bulgaria	6.3	2.4	2.1	3.5	3.1	3.7	**-4.9**	**2.7**	**4.9**	*-5.1*	*2.6*	*3.7*
Czechia	4.6	1.5	1.8	5.2	3.2	2.3	**-5.7**	**3.2**	**5.0**	*-6.9*	*3.1*	*4.5*
Denmark	1.9	-0.3	1.7	2.8	2.2	2.8	**-3.5**	**2.9**	**3.6**	*-3.9*	*3.5*	*2.4*
Croatia	5.0	-0.5	0.5	3.4	2.8	2.9	**-8.9**	**5.3**	**4.6**	*-9.6*	*5.7*	*3.7*
Hungary	4.4	-0.5	2.1	4.3	5.4	4.6	**-5.3**	**4.0**	**5.0**	*-6.4*	*4.0*	*4.5*
Poland	4.0	4.5	2.6	4.8	5.4	4.5	**-2.8**	**3.1**	**5.1**	*-3.6*	*3.3*	*3.5*
Romania	6.2	1.6	3.4	7.3	4.5	4.1	**-5.0**	**3.8**	**4.0**	*-5.2*	*3.3*	*3.8*
Sweden	3.3	1.5	1.9	2.6	2.0	1.3	**-2.9**	**2.7**	**4.0**	*-3.4*	*3.3*	*2.4*
EU	2.0	0.7	1.0	2.8	2.1	1.6	**-6.3**	**3.7**	**3.9**	*-7.4*	*4.1*	*3.0*

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter) 2.2.2021

	2020/1	2020/2	2020/3	2020/4	2021/1	2021/2	2021/3	2021/4	2022/1	2022/2	2022/3	2022/4
Belgium	-3.4	-11.8	11.6	0.2	0.0	0.7	1.4	0.8	0.7	0.7	0.7	0.6
Germany	-2.0	-9.7	8.5	0.1	-1.2	1.9	2.6	0.7	0.4	0.4	0.4	0.4
Estonia	-0.8	-5.5	3.3	-0.4	-0.2	0.8	4.1	0.6	0.4	0.5	0.5	0.5
Ireland	-3.5	-3.2	11.1	-0.8	-1.6	0.1	2.1	0.6	0.8	0.7	0.7	0.7
Greece	0.1	-14.1	2.3	:	:	:	:	:	:	:	:	:
Spain	-5.3	-17.9	16.4	0.4	-0.4	0.9	3.8	2.1	0.8	0.5	0.5	0.6
France	-5.9	-13.7	18.5	-1.3	-1.3	1.0	4.4	0.9	0.7	0.5	0.4	0.3
Italy	-5.5	-13.0	16.0	-2.0	-0.4	0.5	2.0	1.0	0.7	0.7	0.6	0.6
Cyprus	-0.9	-13.1	9.4	:	:	:	:	:	:	:	:	:
Latvia	-2.3	-7.1	7.1	1.1	-0.4	0.3	2.1	0.6	0.6	0.6	0.6	0.6
Lithuania	0.0	-5.9	3.8	1.2	-0.5	0.4	3.1	0.5	0.5	0.5	0.4	0.4
Luxembourg	-1.5	-7.4	9.8	:	:	:	:	:	:	:	:	:
Malta	-2.7	-17.1	12.7	:	:	:	:	:	:	:	:	:
Netherlands	-1.5	-8.5	7.8	-1.3	-1.0	1.4	2.4	0.7	0.4	0.4	0.4	0.4
Austria	-2.8	-11.6	12.0	-4.3	-1.4	2.2	4.3	1.2	0.6	0.6	0.6	0.6
Portugal	-4.0	-13.9	13.3	0.4	-2.1	1.8	4.1	0.8	0.6	0.5	0.5	0.5
Slovenia	-4.7	-9.8	12.4	-2.3	-0.2	1.4	4.2	0.9	0.8	0.8	0.8	0.8
Slovakia	-5.1	-8.3	11.6	-2.6	-1.0	2.3	3.3	1.2	0.9	0.9	0.8	0.7
Finland	-1.5	-3.9	3.2	0.0	0.8	0.8	1.3	0.4	0.4	0.4	0.3	0.2
Euro area	-3.7	-11.7	12.4	-0.7	-0.9	1.2	3.0	1.0	0.6	0.5	0.5	0.5
Bulgaria	0.4	-10.1	4.3	-2.2	0.8	1.5	5.5	1.4	0.3	0.3	0.3	0.3
Czechia	-3.3	-8.5	6.9	0.3	-1.3	1.9	2.9	1.1	1.0	0.9	0.7	0.6
Denmark	-1.5	-7.1	5.2	1.0	-0.4	1.2	1.6	0.8	0.7	0.7	0.7	0.7
Croatia	-1.3	-15.0	6.9	-0.8	0.3	5.3	7.5	0.4	0.1	0.2	0.1	0.1
Hungary	-0.4	-14.6	11.4	-0.2	-0.4	2.2	2.6	1.3	0.9	0.9	0.9	0.9
Poland	-0.3	-9.0	7.9	-2.2	-0.4	2.2	3.8	1.0	0.8	0.8	0.8	0.8
Romania	0.0	-12.2	5.8	0.6	0.4	1.8	3.6	1.2	0.4	0.4	0.3	0.4
Sweden	0.3	-8.0	4.9	0.5	-0.1	0.7	2.6	1.3	0.6	0.6	0.6	0.6
EU	-3.3	-11.4	11.5	-0.5	-0.8	1.3	3.0	1.0	0.6	0.5	0.5	0.5

Table 3: Harmonised index of consumer prices, (percentage change on preceding year, 2002-2022) 2.2.2021

	5-year averages							Winter 2021 forecast		*Autumn 2020 forecast*	
	2002-06	2007-11	2012-16	2017	2018	2019	2020	2021	2022	*2021*	*2022*
Belgium	2.0	2.4	1.4	2.2	2.3	1.2	0.4	**1.8**	**1.8**	*1.4*	*1.6*
Germany	1.6	1.8	1.1	1.7	1.9	1.4	0.4	**2.3**	**1.3**	*1.4*	*1.3*
Estonia	3.3	5.1	1.8	3.7	3.4	2.3	-0.6	**1.2**	**2.1**	*1.4*	*2.1*
Ireland	3.2	0.8	0.5	0.3	0.7	0.9	-0.5	**0.7**	**1.6**	*0.3*	*1.6*
Greece	3.4	3.3	-0.5	1.1	0.8	0.5	-1.3	**-0.1**	**0.6**	*0.9*	*1.3*
Spain	3.3	2.4	0.6	2.0	1.7	0.8	-0.3	**0.8**	**1.1**	*0.9*	*1.0*
France	2.0	1.8	0.8	1.2	2.1	1.3	0.5	**1.1**	**1.5**	*0.9*	*1.5*
Italy	2.4	2.2	1.0	1.3	1.2	0.6	-0.1	**0.8**	**0.9**	*0.7*	*1.0*
Cyprus	2.6	2.6	0.1	0.7	0.8	0.5	-1.1	**0.7**	**1.1**	*0.9*	*1.3*
Latvia	4.9	6.3	0.7	2.9	2.6	2.7	0.1	**1.5**	**1.9**	*1.3*	*1.8*
Lithuania	1.4	5.3	0.9	3.7	2.5	2.2	1.1	**1.7**	**1.8**	*1.5*	*1.7*
Luxembourg	2.9	2.7	1.1	2.1	2.0	1.6	0.0	**1.7**	**1.9**	*1.5*	*1.8*
Malta	2.5	2.4	1.4	1.3	1.7	1.5	0.8	**1.3**	**1.6**	*1.3*	*1.6*
Netherlands	2.1	1.6	1.2	1.3	1.6	2.7	1.1	**1.4**	**1.5**	*1.3*	*1.4*
Austria	1.7	2.2	1.6	2.2	2.1	1.5	1.4	**1.7**	**1.7**	*1.7*	*1.7*
Portugal	2.9	1.8	0.8	1.6	1.2	0.3	-0.1	**0.9**	**1.2**	*0.9*	*1.2*
Slovenia	4.4	2.9	0.8	1.6	1.9	1.7	-0.3	**0.8**	**1.7**	*0.9*	*1.8*
Slovakia	5.3	2.3	0.9	1.4	2.5	2.8	2.0	**0.5**	**1.6**	*0.7*	*1.4*
Finland	1.1	2.4	1.4	0.8	1.2	1.1	0.4	**1.2**	**1.2**	*1.1*	*1.4*
Euro area	2.2	2.0	0.9	1.5	1.8	1.2	0.3	**1.4**	**1.3**	*1.1*	*1.3*
Bulgaria	5.6	5.7	-0.2	1.2	2.6	2.5	1.2	**1.7**	**1.8**	*1.4*	*1.8*
Czechia	1.5	2.6	1.2	2.4	2.0	2.6	3.3	**2.5**	**2.2**	*2.3*	*2.0*
Denmark	1.8	2.2	0.7	1.1	0.7	0.7	0.3	**1.2**	**1.3**	*1.1*	*1.3*
Croatia	2.7	2.8	1.0	1.3	1.6	0.8	0.0	**1.2**	**1.5**	*1.2*	*1.5*
Hungary	4.8	5.3	1.6	2.4	2.9	3.4	3.4	**3.5**	**2.9**	*3.3*	*3.0*
Poland	1.9	3.5	0.7	1.6	1.2	2.1	3.7	**2.3**	**2.9**	*2.0*	*3.1*
Romania	13.1	6.1	1.3	1.1	4.1	3.9	2.3	**2.6**	**2.4**	*2.5*	*2.4*
Sweden	1.5	2.0	0.7	1.9	2.0	1.7	0.7	**1.3**	**1.1**	*0.8*	*1.3*
EU	2.4	2.3	0.9	1.6	1.8	1.4	0.7	**1.5**	**1.5**	*1.3*	*1.5*

Table 4: Harmonised index of consumer prices, (percentage change on preceding year) 2.2.2021

	2020/1	2020/2	2020/3	2020/4	2021/1	2021/2	2021/3	2021/4	2022/1	2022/2	2022/3	2022/4
Belgium	1.0	0.0	0.4	0.3	0.5	1.8	2.3	2.5	2.2	2.0	1.4	1.4
Germany	1.6	0.7	-0.2	-0.6	1.6	1.7	2.7	3.2	1.1	1.3	1.4	1.5
Estonia	1.5	-1.4	-1.3	-1.3	-0.2	1.2	1.8	1.9	1.9	2.0	2.2	2.2
Ireland	0.8	-0.6	-0.9	-1.1	0.0	0.6	0.8	1.1	1.4	1.6	1.7	1.9
Greece	0.6	-1.2	-2.2	-2.2	-2.1	-0.6	1.0	1.3	1.3	1.1	0.4	-0.3
Spain	0.7	-0.6	-0.6	-0.8	0.1	1.0	1.1	1.1	1.1	1.1	1.1	1.1
France	1.3	0.3	0.4	0.1	0.6	1.2	1.3	1.5	1.3	1.5	1.6	1.5
Italy	0.2	-0.2	-0.2	-0.4	0.0	0.7	1.2	1.1	0.9	0.8	0.8	0.9
Cyprus	0.6	-1.6	-2.3	-1.1	-0.3	1.3	0.8	0.8	0.9	0.9	1.2	1.2
Latvia	1.9	-0.7	-0.3	-0.6	0.4	1.7	1.9	1.8	1.8	1.8	1.9	1.9
Lithuania	2.5	0.6	0.9	0.3	0.8	2.0	2.2	2.0	1.8	1.8	1.8	1.9
Luxembourg	1.6	-0.9	-0.1	-0.5	0.0	2.5	2.0	2.3	2.1	1.9	1.8	1.8
Malta	1.2	1.0	0.6	0.3	1.1	1.2	1.4	1.4	1.3	1.6	1.6	1.6
Netherlands	1.3	1.2	1.0	0.9	1.2	1.3	1.4	1.6	1.6	1.6	1.5	1.5
Austria	2.0	1.1	1.4	1.1	1.5	2.0	1.8	1.7	1.6	1.6	1.7	1.7
Portugal	0.5	-0.2	-0.4	-0.4	0.2	1.0	1.1	1.2	1.2	1.2	1.2	1.2
Slovenia	1.6	-1.2	-0.6	-0.9	-0.1	0.3	1.2	1.7	1.6	1.6	1.7	2.0
Slovakia	2.9	2.0	1.5	1.6	0.2	0.3	0.6	1.0	1.5	1.7	1.7	1.6
Finland	1.1	-0.1	0.4	0.2	1.2	1.5	1.1	1.1	1.2	1.2	1.2	1.2
Euro area	1.1	0.2	0.0	-0.3	0.7	1.3	1.7	1.9	1.2	1.3	1.3	1.3
Bulgaria	3.0	1.1	0.6	0.3	0.3	1.8	2.2	2.5	2.3	2.0	1.4	1.5
Czechia	3.7	3.3	3.5	2.7	2.3	2.4	2.2	3.1	2.2	2.2	2.1	2.1
Denmark	0.6	0.0	0.4	0.4	0.6	1.5	1.3	1.2	1.2	1.2	1.3	1.4
Croatia	1.2	-0.4	-0.5	-0.2	0.6	1.5	1.4	1.4	0.8	2.0	1.5	1.5
Hungary	4.4	2.5	3.8	2.9	3.2	4.3	3.1	3.5	2.8	2.8	2.9	3.0
Poland	3.9	3.4	3.7	3.6	2.4	2.2	1.9	2.5	3.1	3.2	3.0	2.4
Romania	3.1	2.1	2.4	1.8	2.9	2.6	2.5	2.4	2.4	2.3	2.4	2.4
Sweden	1.2	0.3	0.8	0.4	1.5	1.5	1.1	1.3	1.2	1.1	1.1	1.2
EU	1.5	0.6	0.5	0.2	0.9	1.4	1.7	1.9	1.4	1.4	1.4	1.4

Box .1: Some technical elements behind the forecast

The Winter 2021 Interim Forecast provides an update of the Autumn 2020 Forecast of 5 November 2020, focusing on GDP and inflation developments in all EU Member States.

The cut-off date for taking new information into account in this forecast was 2 February 2021.

ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounting (ESA 2010). Due to differences in revision schedules of annual and quarterly national accounts, annual and quarterly figures may not be fully consistent for some Member States. 2021 and 2022 are forecast years. 2020 GDP data are also forecast, except for AT, BE, CZ, DE, FR, IT, ES, LV, LT, PL and PT where preliminary or flash estimates exist.

Working-day adjustment

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are.

The working-day effect in the EU and the euro area is estimated to be limited in 2020, 2021 and 2022, implying that adjusted and unadjusted annual growth rates differ only marginally (by up to ±0.1 pps.).

External assumptions

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 15 and 28 January) were used for exchange and interest rates, and for oil prices.

The technical assumption regarding exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to an implied average USD/EUR rate of 1.21 in 2021 and 2022. The average JPY/EUR is 125.9 in 2021 and 125.87 in 2022.

Interest rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. As a result, short-term interest rates are assumed to be -0.6% in 2021 and -0.5% in 2022 in the euro area. Long-term euro area interest rates are assumed to average -0.5% in 2021 and -0.4% in 2022.

Commodity price assumptions are also based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 54.7 USD/bbl in 2021 and 52.4 USD/bbl in 2022. This would correspond to an oil price of 45.1 EUR/bbl in 2021 and 43.2 in 2022.

Trade policies

The forecast pencils in only the measures that have been implemented until the cut-off date. Compared

Table 1:
Technical assumptions

		Winter 2021 interim forecast		*Autumn 2020 forecast*	
	2020	2021	2022	2021	2022
3-month EURIBOR (percentage per annum)	-0.4	**-0.6**	**-0.5**	*-0.5*	*-0.6*
10-year government bond yields (percentage per annum) (a)	-0.5	**-0.5**	**-0.4**	*-0.5*	*-0.5*
USD/EUR exchange rate	1.14	**1.21**	**1.21**	*1.18*	*1.18*
JPY/EUR exchange rate	121.81	**125.90**	**125.87**	*124.23*	*124.23*
GBP/EUR exchange rate	0.89	**0.89**	**0.89**	*0.91*	*0.91*
EUR nominal effective exchange rate (annual percentage change) (b)	3.9	**2.3**	**0.0**	*2.7*	*0.0*
Oil price (USD per barrel)	43.4	**54.7**	**52.4**	*44.6*	*46.4*
Oil price (EUR per barrel)	38.0	**45.1**	**43.2**	*37.9*	*39.4*

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

(Continued on the next page)

Box (continued)

to the Autumn Forecast, there have been the following changes to the baseline scenario:

- On 10/11/2020, the EU took countermeasures against illegal U.S. subsidies to aircraft maker Boeing after formal authorisation by the World Trade Organisation. These include additional tariffs of 15% on aircraft as well as additional tariffs of 25% on a range of agricultural and industrial products imported from the U.S.

- On 18/12/2020, the US places a major Chinese semiconductor producer (Semiconductor Manufacturing International Corporation) on the entity list thus restricting US exports such as designs and software to the company.

- On 1/01/2021, the Trade and Cooperation Agreement between the EU and the UK has become applicable. For details on the agreement and how it is treated in the forecast, see Box 1.2.

- On 12/01/2021, the US administration raised the levies it imposes on certain goods from the EU in relation to the long-lasting aircraft dispute over subsidies to aircraft maker Airbus after formal authorisation by the World Trade Organisation.

Geographical zones

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

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