2020 ECONOMIC AND INDUSTRY OUTLOOK: FOURTH QUARTER PERSPECTIVES

MAPFRE Economics

2020 Economic and industry outlook: fourth quarter perspectives

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Executive summary

2020 Economic and industry outlook: fourth quarter perspectives

Economic outlook

In a context of a sharp fall in the dynamics of global activity triggered by a shock unlike any other experienced during the most recent economic crises, we now find ourselves in a phase of stabilization and eventual recovery. However, this recovery will be slow and full of downside risks that will be exacerbated by the trend of the COVID-19 pandemic. In light of this, we have revised our forecasts for economic growth in 2020, considering the positive effects of the fiscal and monetary policy measures and the relatively minor severity of health policy. Despite this, we must not ignore the resilience of the virus and many economies' lack of preparedness, which could mean that the improved dynamic of global economic activity is temporary and that this sluggishness will persist until the end of the year and into the beginning of 2021. For this reason, we have revised this year's forecasts upward. However, this will mean a deterioration in next year's forecasts, which will be weaker and varied at a global level.

Global growth for 2020 is expected to be around -4.4% in 2020 and 5.2% in 2021. It is likely that practically all global economies (excluding China) will record a decline in their GDP. Meanwhile, emerging and developing countries will see their sovereign leverage reach levels rarely seen before (over 120% of GDP in 2021) due to the enormous deficit needed to alleviate the consequences of the pandemic. The fiscal capacity for a greater fiscal stimulus therefore seems to have depleted.

Monetary policy was the key to stabilizing markets and the real economy at the beginning of the crisis. However, efforts in this area are currently focusing on guaranteeing expectations and liquidity with the aim of containing the significant surge in global risk aversion. The latter, exacerbated by each economy's vulnerabilities, is causing stability problems related to the balance of payments, either due to large sovereign deficits or a strong correction of portfolio flows, which has immediate effects on the current account, exchange rate and reserves of many emerging economies. In short, the world is facing an unprecedented crisis, which is enormously challenging to overcome. What's more, any recovery, as well as being slow and fragile, will lead us toward a new normal, which poses its own challenges that societies must face.

Industry outlook

The global economy is experiencing an unprecedented sharp contraction as a result of the COVID-19 pandemic, although forecasts for the sharp economic downturn estimated for 2020 have improved slightly. However, forecast recovery will be slower than expected and subject to a great deal of uncertainty due to new outbreaks of the disease. It will vary by country and industry, meaning that the insurance industry will be negatively affected, but to a lesser extent than other sectors that are more vulnerable to the risks caused by the pandemic.

Unlike other economic crises, the measures being taken by monetary authorities and governments around the world are also unprecedented. The rapid intervention of central banks in the major economies stabilized the financial markets (where the insurance industry is one of the major institutional investors) with quantitative easing measures implemented through extensive asset-acquisition programs. These banks are also pursuing accommodative monetary policies with lower interest rates to support the real economy, along with packages of fiscal expansion measures from governments, which depend on each country's capabilities — whereby significant differences have been seen among each country due to the smaller initial room for maneuver in emerging countries and in some developed countries. All of these measures will be of great help to the insurance industry, which depends to a large extent on the economic cycle's performance and the correct functioning of the financial markets. However, the low interest rate environment, which will be extended for the long-term, will negatively impact their balance sheets, their profitability and the development of products in the Life Savings business.

In Spain, the performance of the insurance business in the first eight months of 2020 continues to show very similar patterns to those seen in previous economic crises, with a sharp fall in the automobile business and a setback in the multirisks of the trade. The most affected segment continues to be the Life Savings business, which had already been suffering before the pandemic-induced crisis. Health insurance, however, performs anti-cyclically and continues to grow, bolstered by the very nature of the current crisis. Homeowners and condominium insurance, however, are only slowing down, proving to be resistant, while other less important business lines such as travel assistance insurance are suffering from severe setbacks.

Finally, on the supervisory side, it should be noted that on September 4, the Joint Committee of European Supervisory Authorities for banking, securities and insurance (EBA, ESMA and EIOPA) published its report on risks and vulnerabilities in the European Union financial system in 2020. The report highlights that the coronavirus outbreak has brought about major social disruption and major challenges for the economy that will inevitably impact the finance sector, and outlines the problems faced by banks, mutual funds, insurance companies and pension funds. The intervention of central banks, as well as messages from the tax authorities regarding a wide range of measures to support the economy, both at a national level and a European Union level, have restored stability to the financial markets, which suffered one of the fastest declines in modern history in February and March. In part, this decline was driven by investors' dash for cash.

However, extending the low interest rate environment presents a challenge for banks' profitability, for life insurance companies and for pension funds. The report also notes that, since May, investors have begun to differentiate between issuers and asset classes, within a context of deterioration in economic fundamentals, in which concerns regarding credit risk begin to materialize. It also highlights that European banks had a strong capital position before the crisis. However, it warns that the dispersion of individual solvency positions remains high and some banks that had lower capital levels and greater exposures to risk at the start of the crisis may face significant challenges. As for insurance companies, the report also highlights banks' reasonable

solvency position before the shock caused by the pandemic, with an overall solvency ratio of 213% at the close of 2019. However, low risk-free interest rates, higher risk premiums ("double-hit scenario"), the credit impairment of assets and economic uncertainty could negatively impact their solvency and profitability in the medium- and long-term.

1. Economic outlook

1.1 The global economic outlook

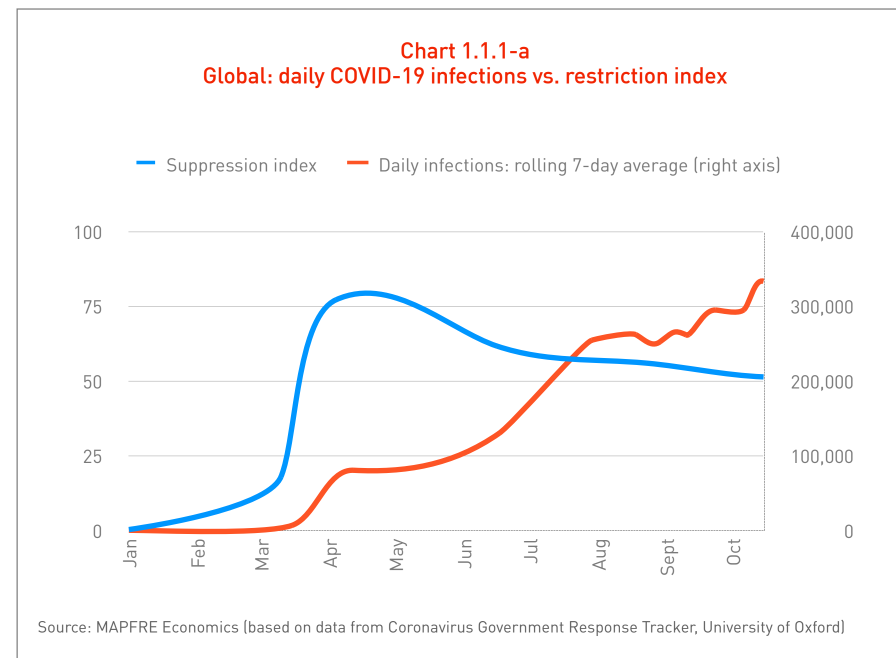
1.1.1 COVID-19 and the global crisis: update

Nine months after the COVID-19 pandemic was declared as such, it has proven to be exactly the disruptive tail event that we feared it would become[1]. The appearance of this "black swan" has generated an unprecedented shock in the global economy that has resulted in a sharp fall in activity levels. It has been characterized as totally unique due to its exogenous, global and uncertain nature.

Exogenous shock

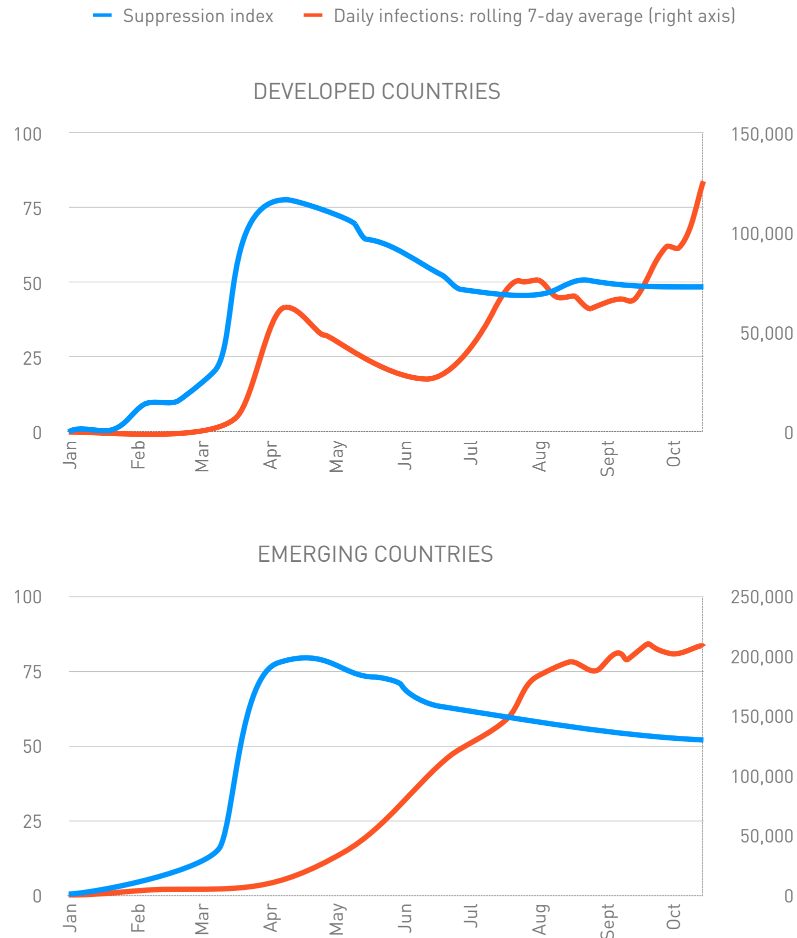
Firstly, this is a self-imposed and exogenous shock due to preeminently health-based decisions and measures (lockdown and social distancing) that have led to disrupted activity through restrictions on social interaction in both developed and emerging economies (see Charts 1.1.1-a, 1.1.1-b and 1.1.1-c). This shock will have different kinds of effects. In the first instance, it will have direct effects on supply and demand, which have led to the collapse of activity and expectations (due to uncertainty). Secondly, and depending on the extent to which social lockdown measures are finally adopted, these measures will lead to a deterioration in agents' income, growing pessimism among industries and consumers, with both groups facing increasing problems with liquidity. And, finally, the third type of effect of this shock relates to the long-term, in the normality that will be imposed by the incomplete recovery that lies ahead, which can translate into sovereign and financial solvency problems, distortions in the price of

Chart 1.1.1-a
Global: daily COVID-19 infections vs. restriction index



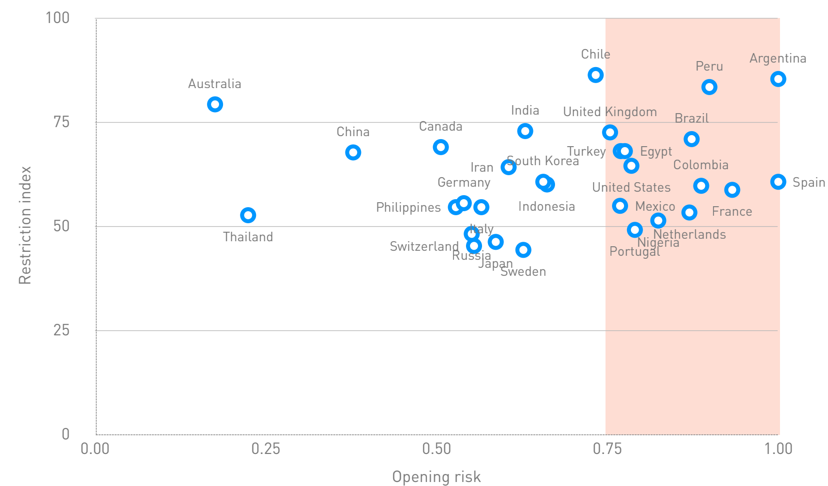
Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

Chart 1.1.1-b
Developed and emerging: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

Chart 1.1.1-c
Selected countries: restriction index vs. opening risk



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

assets, reduced capacity for long-term growth (lower physical capital, human capital and productivity) and high public debt, among other aspects.

Global shock

Secondly, this is a global shock that will reduce GDP in 90% of the world's economies (see Chart 1.1.1-d and Table A-1 in the appendix to this report). The effects will vary, conditioned by the productive structure of each country and by the economic and health vulnerabilities of each system. In terms of GDP, the shock will lead to a correction in the baseline scenario

of around -4.4% YoY in 2020, with significant differences between regions, will raise the level of unemployment (the International Monetary Fund estimates that 400 million jobs will be lost globally) and widen the poverty gap. In terms of disposable income, the expectation is for a widespread reduction of the increased levels of prosperity built up by the middle classes since the beginning of the millennium, especially in Latin America.

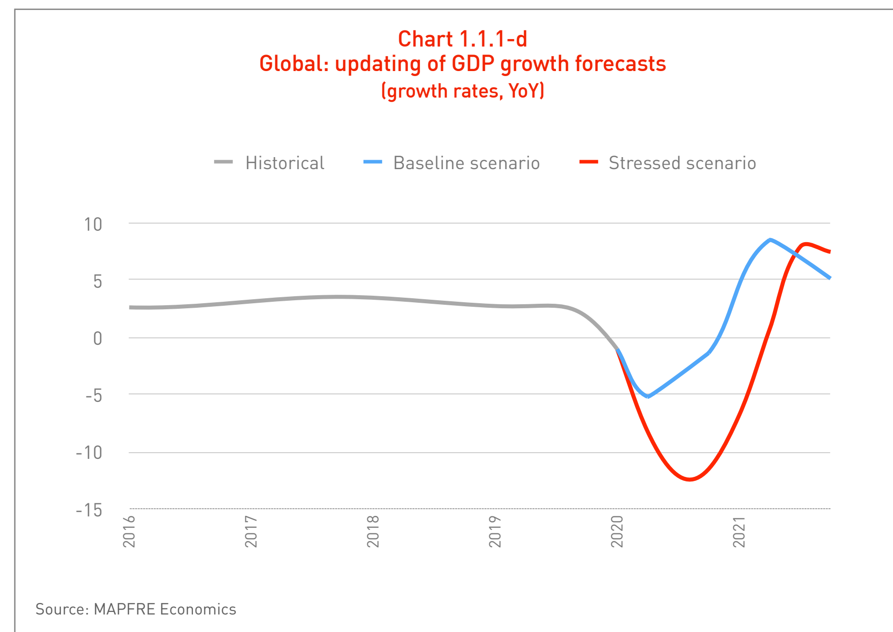
In terms of financial effects, the shock may involve current-account financing problems in many emerging markets, exerting pressure on their exchange rate and depleting their reserves (see Box 1.1.1-a). It may also distort the price of many safe-haven assets (gold, sovereign bonds, etc.), and may alter international investment preferences by virtue of a growing crowding out effect. Furthermore, the shock will enable the environment of financial volatility and fragility to persist, as well as distortion of the proper functioning of markets both due to the effects of the crisis per se and to the measures taken by governments and central banks to contain it.

The shock of uncertainty

And, thirdly, the very nature of this economic crisis means that uncertainty is high (which can be seen in the trust of producers and consumers) and also transcends the perception of global risk and its regional derivatives (VIX and EMBI). This phenomenon is noticeable in the management of global portfolios and in the mass migration of flows experienced since the beginning of the pandemic, in line with the rise in the emerging risk premium, altering net portfolio inflows in key countries for financing their current account (see Chart 1.1.1-e).

Risk aversion currently remains high, although it has eased, and financing flows stand at the level recorded in April, with their impairment being largely stopped thanks to the action of central banks in developed countries. Furthermore, in addition to this uncertainty, it is also possible that new risks will appear that we are currently unaware of, but which may be caused by the interaction of pre-existing risks and the crisis triggered by the COVID-19 pandemic.

Chart 1.1.1-d
Global: updating of GDP growth forecasts
(growth rates, YoY)



Source: MAPFRE Economics

Unprecedented economic policy measures

The unprecedented economic policy measures at the global level—although with different regional and local intensities—was a factor that helped to avoid a real economic collapse in the second and third quarters of the year. As shown in Charts 1.1.1-f and 1.1.1-g, as of May, the PMI (Purchasing Managers' Index) began to show a change in trend and managed to exceed the economic contraction threshold in July. This situation, on the whole, has allowed GDP growth forecasts for 2020 to be revised with less pessimism than at the start of the pandemic.

Box 1.1.1-a
Emerging vulnerability analysis: evolution of the Emerging Risk Index (ERI)

Analysis of the emerging vulnerability

In 2019, the global economy faced a widespread slowdown in a context of weak manufacturing, rising trade tensions and a widespread prospect of imminent cyclical change since mid-2018. However, the increasing monetary laxity implemented by the Federal Reserve and successive developed economies gave some support to emerging countries by transferring more favorable financial conditions, curbing the deterioration of certain emerging market currencies, boosting the flow of investments toward these countries, and, in general, creating the expectation of a predictable economic revival.

Under this new scenario, emerging countries (who were previously more exposed and penalized) were favored by renewed global monetary momentum. This is the case for most of the national measurements that inform our Emerging Risk Index (ERI) to date. This renewed laxity enabled the relocation of flows to emerging markets to be reactivated, temporarily stabilizing currencies and increasing margin to improve the external position. However, the COVID-19 pandemic has once again dashed all these efforts, in a context of strong currency deterioration, growing current imbalances, high dollar-denominated debt and extremely deteriorated activity as a result of restrictions in terms of lockdowns and social distancing, which were imposed to halt the spread of the pandemic.

Despite its global nature, the shock of COVID-19 will have different effects on emerging economies, exacerbating the weakness of those with worse external positions and depreciating their currencies throughout 2020 and part of 2021. Furthermore, countries with the greatest number of accumulated vulnerabilities are more sensitive to the cycle and to global risk aversion, which makes it more difficult for them to honor debts with the outside world, increasing the perception that this may result in a default or implicit write-off of debt issued in local currency (in light of progressive devaluations). The coverage required against this counterparty risk therefore increases the need for strong currencies (USD), which exerts even more pressure on local currencies and only serves to intensify the problem.

It is worth noting that, although the analysis collected in the ERI uses data from 2019, it is very much forward-looking, as it highlights weaknesses that affected the development of nominal stability in emerging countries throughout 2020 and 2021, and shows the differential effects of COVID-19.

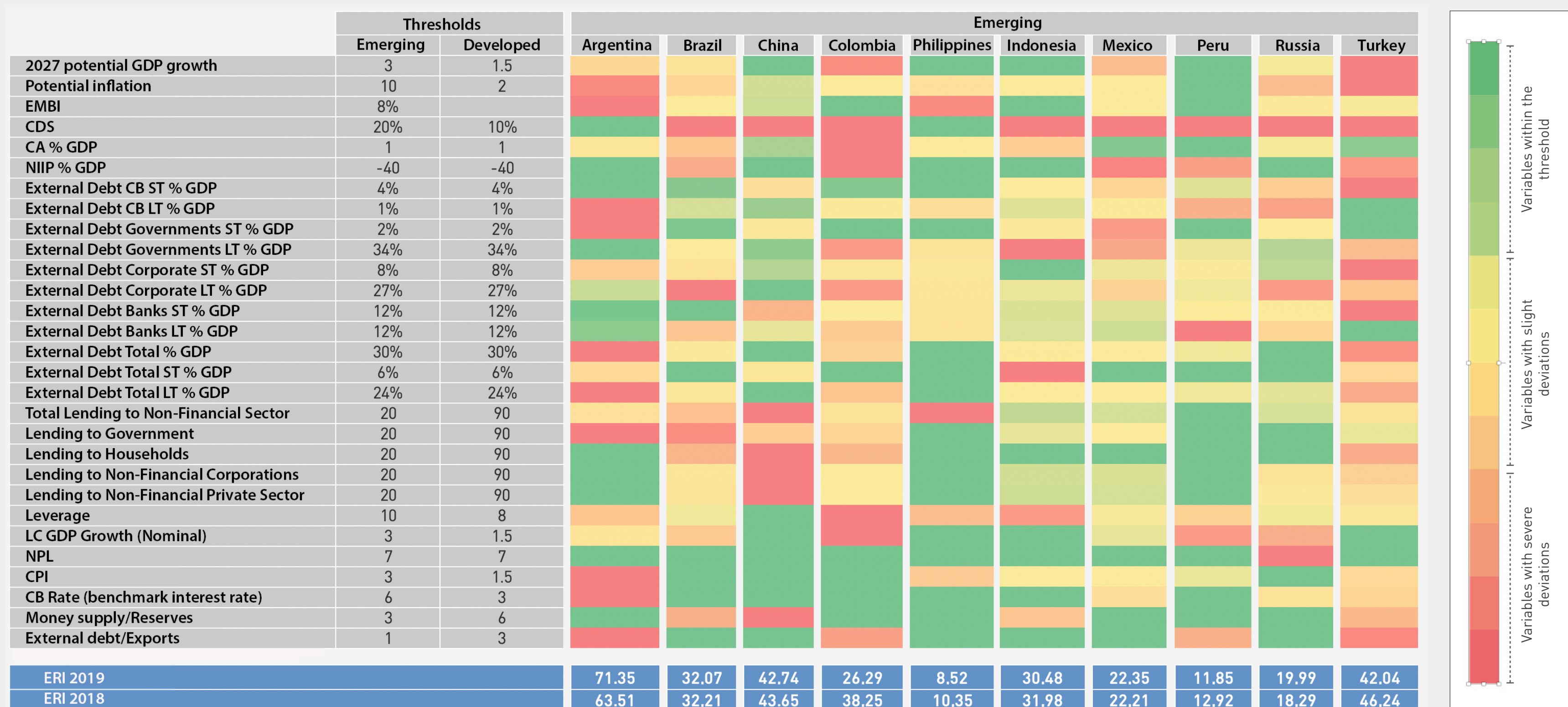
Main conclusions from the analysis

The study of the vulnerabilities of a number of markets through the construction of the ERI has allowed the following general conclusions to be drawn for the group of economies selected, which we have been constantly monitoring in previous reports (see Charts A to G in this Box):

- In Argentina, structural vulnerabilities continue to represent a deficit in the current account financed via foreign debt in dollars, high leverage in the finance sector and high inflation that exceeds recommended thresholds. Despite the central bank's efforts to defend the currency via interest rates and restrictions on the purchase of foreign currency, the Argentine peso has continued to depreciate. In Turkey, the current account went into surplus following a devaluation of its currency and, as

Box 1.1.1-a (continued)
Vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Chart A.
Selected markets: risk profiles and emerging risk index* (ERI) estimation



Source: MAPFRE Economics (estimates based on data from OEF, Haver, IMF, BIS, Bloomberg and World Bank)

* The variables used to construct this index are assessed in relation to certain sustainability thresholds. Deviations from these thresholds result in imbalances and are weighted to construct an index ranging from 0 to 100.

Click here to access the interactive version of this information

Box 1.1.1-a (continued)
Emerging vulnerability analysis: evolution of the Emerging Risk Index (ERI)

Chart B.
Argentina: ERI vs. EMBI

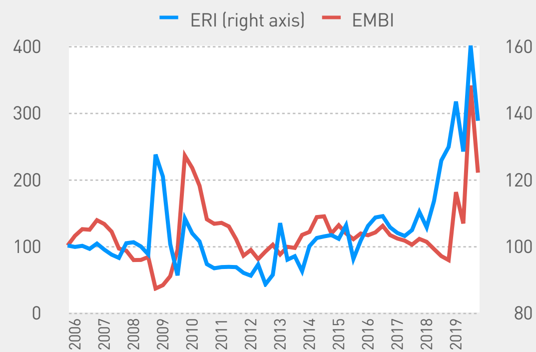


Chart C.
Peru: ERI vs. EMBI

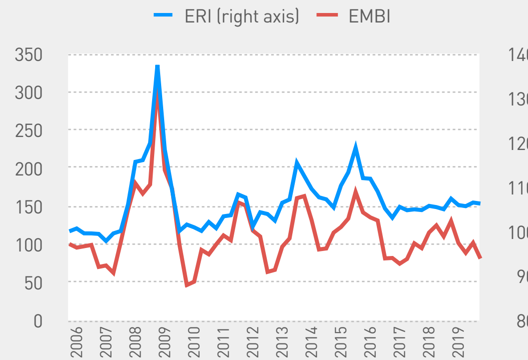


Chart D.
Indonesia: ERI vs. EMBI

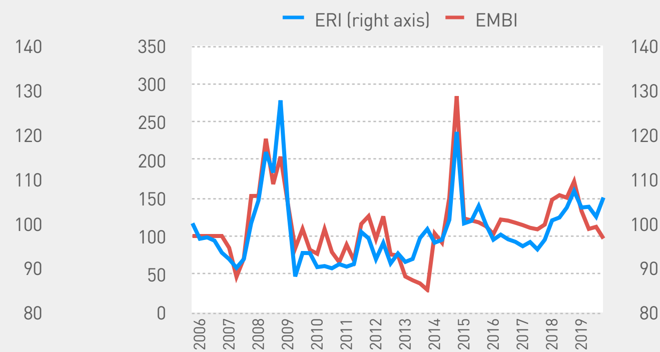


Chart E.
Turkey: ERI vs. EMBI

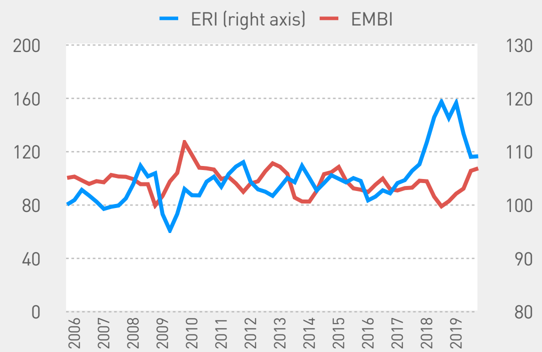


Chart F.
Russia: ERI vs. EMBI

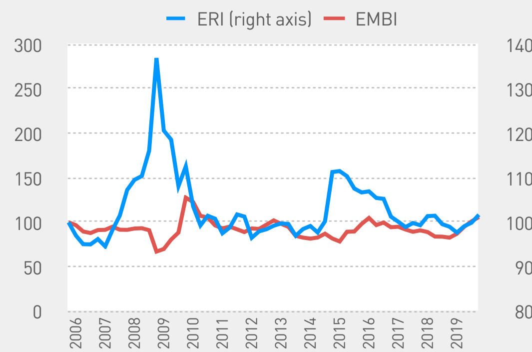
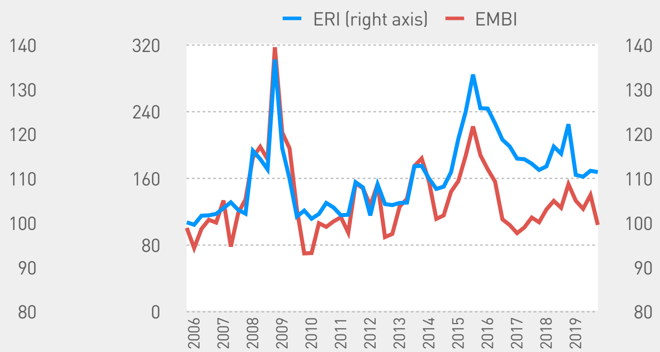


Chart G.
Colombia: ERI vs. EMBI



Source: MAPFRE Economics (own estimates and data from OEF, Haver)

Click here to access the interactive version of this information

Box 1.1.1-a (continued)
Vulnerability analysis: evolution of the Emerging Risk Index (ERI)

a result, recorded an improvement in the NIIP, allowing the value of the ERI to close part of its gap with respect to the EMBI (Emerging Market Bond Indicator). However, vulnerability remains latent given the leverage of the Turkish economy, the increase of which remains largely dependent on foreign currency inflows.

- The Peruvian and Russian economies maintained stable levels of vulnerability. There were slight downward variations in the Peruvian economy due to its balance in risk indicator, and slight upward variations in the Russian economy, although it generally still shows a stable position, as the vulnerabilities center around the finance sector where a deterioration in credit could have repercussions on a banking system whose NPLs (Non-Performing Loans) are already at high levels.

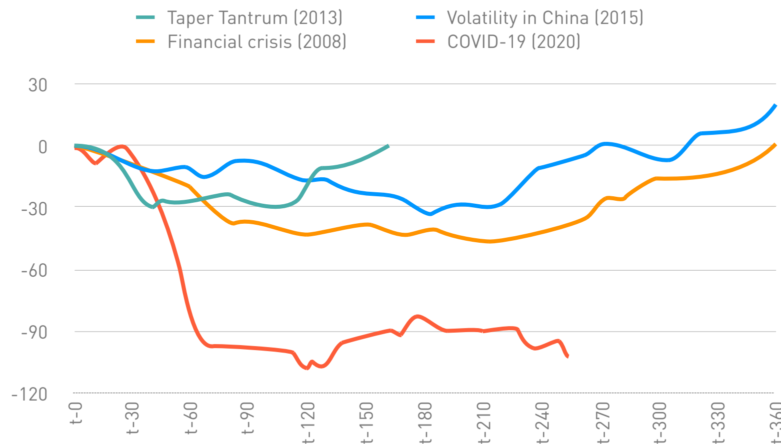
- Finally, the Indonesian and Colombian economies continue to be a potential source of instability in the future. Although the ERI values closed on a downward trend in 2019 (mainly in Colombia), giving some resilience to both economies, the outbreak of the COVID-19 pandemic could reveal certain vulnerabilities throughout 2020, though to a lesser extent than in other countries.

Source: MAPFRE Economics

On the one hand, monetary policy responded massively, with low interest rates and extensions of the ultra-accommodative bias by all central banks around the world, even activating larger and more varied asset-purchasing programs (including corporate fixed income). This was the case for the United States and, above all, the eurozone with the PEPP (Pandemic Emergency Purchase Program). Therefore, liquidity programs, such as dollar swaps and TLTROs in the eurozone, were maintained and even expanded, and the communication channel and expectation management regarding the future trend of interest rates (invariable until 2024) was reinforced. Inflation tolerance was even adjusted, with changes in the Federal Reserve's mandate and the relaxing of the objective and presentation of the European Central Bank (ECB)'s proposal to reform the monetary policy framework. Moreover, some emerging countries also joined quantitative easing, such as Colombia and Chile (see Box 1.1.1-b).

The mass monetary policy response has consolidated a process that began during the 2008 financial crisis. Central banks have gone from being last-resort lenders to becoming buyers and market makers filling a gap unoccupied by the private sector. Therefore, on this occasion, the measures implemented by central banks have played a key role in preventing financial collapse, curbing the liquidity problem and ensuring a minimum level in falling asset prices, all while cushioning sovereign tensions in the eurozone's most vulnerable countries (the periphery). The timely implementation of monetary policy measures has therefore prevented the economic crisis caused by the pandemic from becoming an

Chart 1.1.1-e
Emerging markets: portfolio investment flows
(billions of US Dollars)



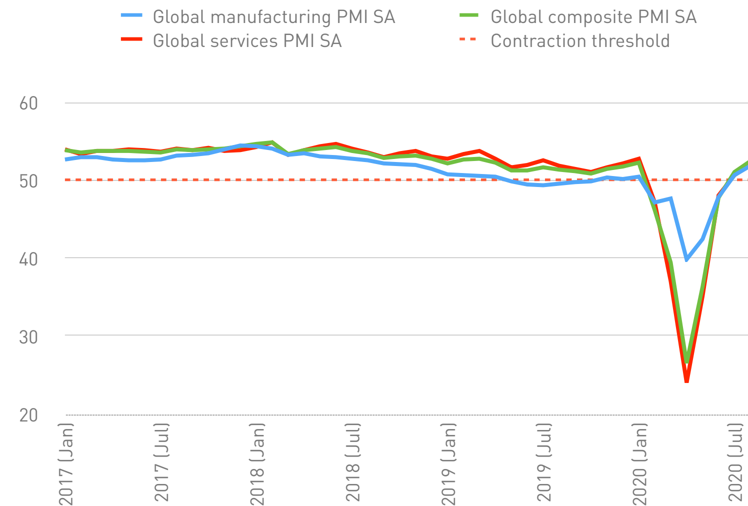
Source: MAPFRE Economics (based on IIF data)

event equivalent to the great Lehman Brothers financial crisis (2008) or the sovereign crisis in the eurozone in 2010.

However, we should remember that these widespread monetary policy measures could also have undesirable effects, having increased the distortions that were already present in the financial markets before the pandemic: (i) artificially limiting the price of sovereign and credit risk in some countries and markets; (ii) reducing long-term interest rates and jeopardizing business models based on liability management; and (iii) creating visible distortions between the financial world and the real world, where significant corporate PER growth has been faced in sectors with continued declines in revenue and EBIDTA.

Furthermore, the action of fiscal and quasi-fiscal policies has also been significant (see Table 1.1.1 and Chart 1.1.1-h). This economic policy measure has been formalized through tax deferment, guarantee and direct aid programs in the form of bank transfers. In this regard, the most notable include the aid implemented (and which will possibly be extended) in the United States for 2 trillion dollars (15% of GDP), and the activation of European rescue and aid programs (in the form of credits and guarantees), such as SURE (Support to mitigate Unemployment Risks in an Emergency) and Next Generation EU, which aim to allocate

Chart 1.1.1-f
Global: PMI performance



Source: MAPFRE Economics (based on data from JP Morgan)

Box 1.1.1-b
Monetary policy update

European Central Bank

At its meeting in September, the European Central Bank (ECB) maintained its monetary policy stance. First, it kept both official interest rates unchanged (0.0% for loans and -0.5% for deposits), although with the appreciation that they would remain at equal or lower levels over time. It also maintained the current status of the asset-purchase program, and did not introduce any new developments with respect to the Pandemic Emergency Purchase Program (PEPP). The only significant notification, which was announced after the meeting, was the decision to extend the applicable requirements of Regulation (EU) 2020/852 of June 22, thereby extending eligibility to bonds with coupon structures linked to certain ESG (Environmental, Social and Governance) targets that meet the requirements set out in the EU Taxonomy Regulation, or any of the UN Sustainable Development Goals on climate change or environmental degradation to be applied from January 1, 2021. The universe of eligible instruments has expanded under this agreement, in line with the objectives proposed by the reconstruction fund to guide recovery toward sustainable priorities that involve transitioning toward climate neutrality.

At the macroeconomic level, the ECB's outlook for GDP growth improved in 2020 to -8.0%, up from -8.7% proposed in June. However, the figures for 2021 and 2022 decreased to 5.0 and 3.2% respectively, down from 5.2% and 3.3% in the previous meeting. Inflation projections, for their part, remained virtually unchanged, the most notable aspect being a slight rebound in inflation expected for 2022, which is projected to rise from 0.9% to 1.1%.

Following the meeting in June, the eurozone's path to economic recovery began with a strong stimulus that led to optimism in the first half of the summer period. Since August, however, this dynamic has been marred by growing concern surrounding the evolution of COVID-19 and its effects on mobility and consumption. Thus, as the latest purchasing managers' indices (PMIs) show, expectations for an intense recovery have lost the initial traction they gained in both the manufacturing and service industries, with the latter showing more obvious signs of fatigue. In turn, the recent strength of the euro exerts downward pressure on inflation prospects, negatively impacting exports and, therefore, economic recovery, at a key moment. Despite this, the ECB did not seem excessively concerned in this regard and maintained its stance to not intervene in the foreign exchange market, despite having the power to do so.

Strategic review

The first considerations regarding the strategic review process underway since last January reveal the central points for the debate on the future of monetary policy, directing the framework toward the following aspects: (i) the redefinition of inflation; (ii) the relationship between inflation and the real economy; and (iii) the transmission and effectiveness of monetary policy. With permanently low inflation prospects on the time line, global structural forces, and a potentially understated output gap, initial conclusions point toward addressing the temporary inconsistency of inflation expectations by implementing a symmetrical adjustment of the target, where lower-term upward and downward deviations are neutralized and gravitate around the average of 2%, and also point toward normalizing

Box 1.1.1-b (continued)
Monetary policy update

the use of unconventional tools such as asset purchasing and forward guidance policy as stability mechanisms for the longer-term.

Looking ahead

Conflicting signs of recovery keep recovery prospects in line with previous projections, complicating prospects for the presence of change catalysts in the economic sphere. The response to the impact of the COVID-19 pandemic continues in an uncertain environment, which can only be mitigated under the coordination of effective, preventive responses to control the spread of the virus, thereby safeguarding economic policy options and relegating them to a more reactive approach, which may dampen the growing possibility of new outbreaks impacting the economy. In this regard, the possibility of further stimuli has been postponed pending the evolution of data, giving the ECB time to progress with its strategic review; the ECB's tool of action, if necessary, is expected to remain being the route of widening the balance sheet.

In fiscal terms, the historic stimulus plan, which is subject to fewer conditions, has provided promising backing for the widely demanded ECB support. However, the need to continue moving toward a fiscal union, the consolidation of which strengthens the joint response mechanisms, persists. Despite this, a potential sharper-than-initially-expected economic decline (which will demonstrate the need for larger stimuli to be implemented without advancing at that point) could be a deterrent to undertake limited structural reforms under the recent outline of specific recommendations.

The Federal Reserve

Jackson Hole Symposium

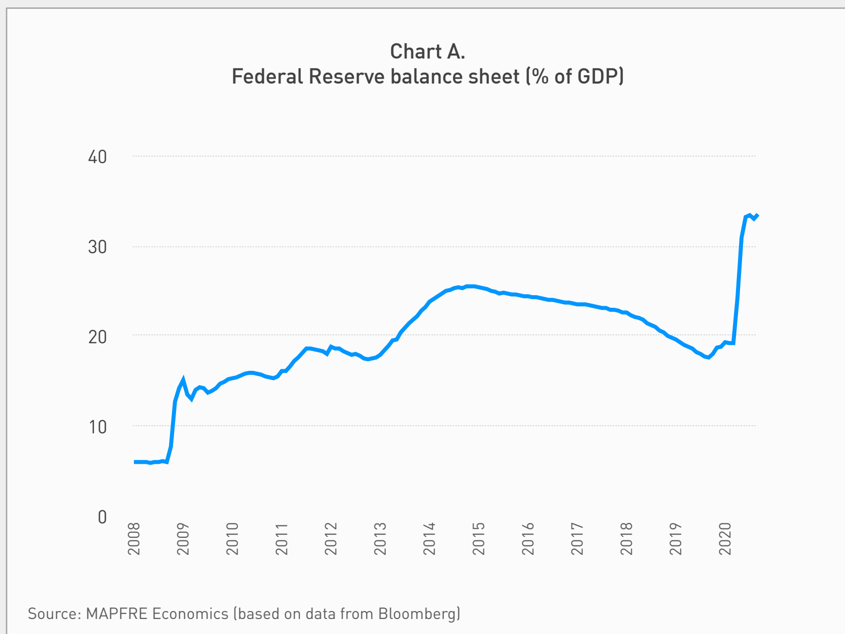
At the end of August, the chairman of the Federal Reserve presented the conclusions of the Monetary Policy Review ("long run-goals"). Firstly, he announced a change in the 2% inflation target, which is becoming a flexible average inflation target (FAIT) over the long-term. Secondly, he altered the wording regarding the objective of full employment; under this new approach, decisions on interest rates would be removed from the previous objective of covering deviations in the workforce and would focus on the deficiencies that enable maximum employment levels to be achieved. Finally, the evolution of these new targets will be reviewed every five years.

The change in this new policy framework suggests that greater flexibility in inflation and employment targets routes the Federal Reserve toward a more pro-cyclical or pro-inflationary stance. In this sense, it would involve reviving the Phillips curve theory, allowing unemployment to fall below its natural rate to generate inflationary pressures that are robust enough to consistently average around 2%, a position that could generate some credibility for expectations.

September meeting

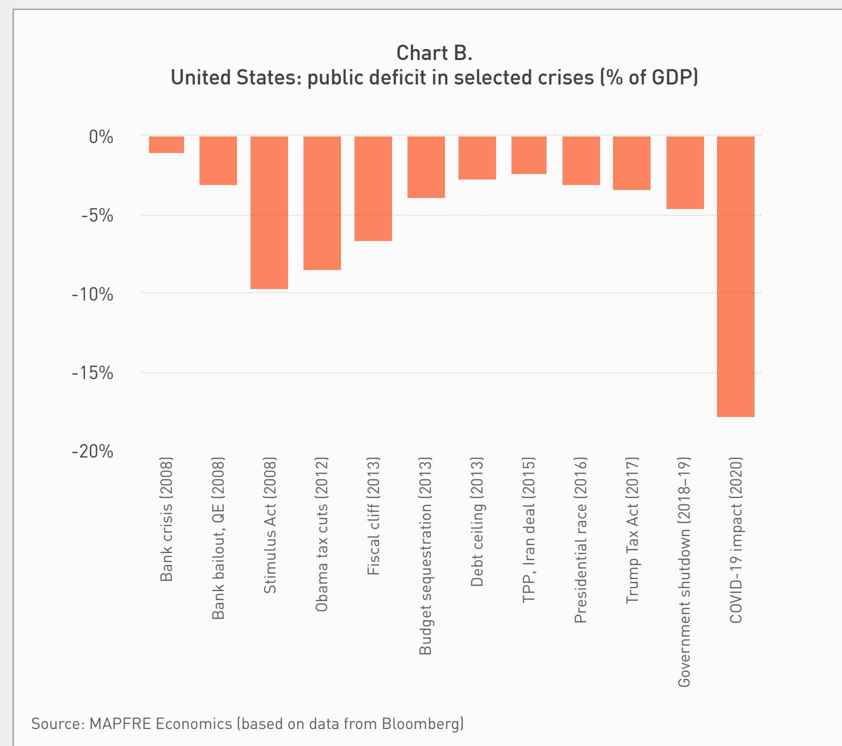
During its September meeting, the Federal Reserve maintained its monetary policy stance, keeping interest rates in the range of 0.0–0.25% and maintaining the monthly pace of its purchase program. In his statements, Jerome Powell reiterated his commitment to keeping interest rates low at least until 2023 (previously 2022), despite the accompaniment

Box 1.1.1-b (continued)
Monetary policy update



of a macroeconomic outlook that is slightly on the upside. In this regard, the summary of projections reflects a more optimistic outlook on economic performance, whereby the average GDP projection for 2020 is -3.7% (compared to -6.5% previously), core inflation would stand at 1.5% (compared to the previous 1.0%) and the unemployment rate is expected to be 7.6% (compared to the previous 9.3%).

In the fiscal sphere, he expressed the possibility of further stimuli in the future as necessary support, although specifics were not provided given the context of recent disagreements in Congress on this matter and given the



Box 1.1.1-b (continued)
Monetary policy update

proximity of the forthcoming elections. In short, he provided little additional information to the monetary policy reviews announced during the Jackson Hole symposium, numbing expectations of the current monetary flexibility deepening.

Looking ahead

Although the Federal Reserve has taken a major step forward by allowing inflation to overshoot and float above 2% until it consolidates at the average rate, and by emphasizing the maximum employment target, the framework could be considered to be incomplete insofar as unconventional monetary policy tools, which remain active since the previous crisis, are yet to be specifically mentioned in the review process.

Under this prism, the real effect of monetary policy is expected to continue to be dominated by asset purchases, leaving interest rates at the current lower limit, and aims to remain coordinated with the government's fiscal stimuli. However, the path for funding excessive deficits could signal the end of current monetary policy and the detriment of the Modern Monetary Theory (MMT), the pillars of which would be based on discretionary spending decisions by governments regardless of deficit or debt levels and subject only to the performance of inflation.

Internationalizing expansionary monetary policy

Quantitative easing monetary policies, introduced by the major developed economies in the wake of the 2008 crisis, have expanded their scope and scale in light of the need for a rapid response to the shock induced by the social distancing and lockdown measures implemented to curb the pandemic. Given the global nature of the crisis caused by COVID-19, a process of internationalizing these unconventional tools has therefore been triggered in the major emerging economies around the world.

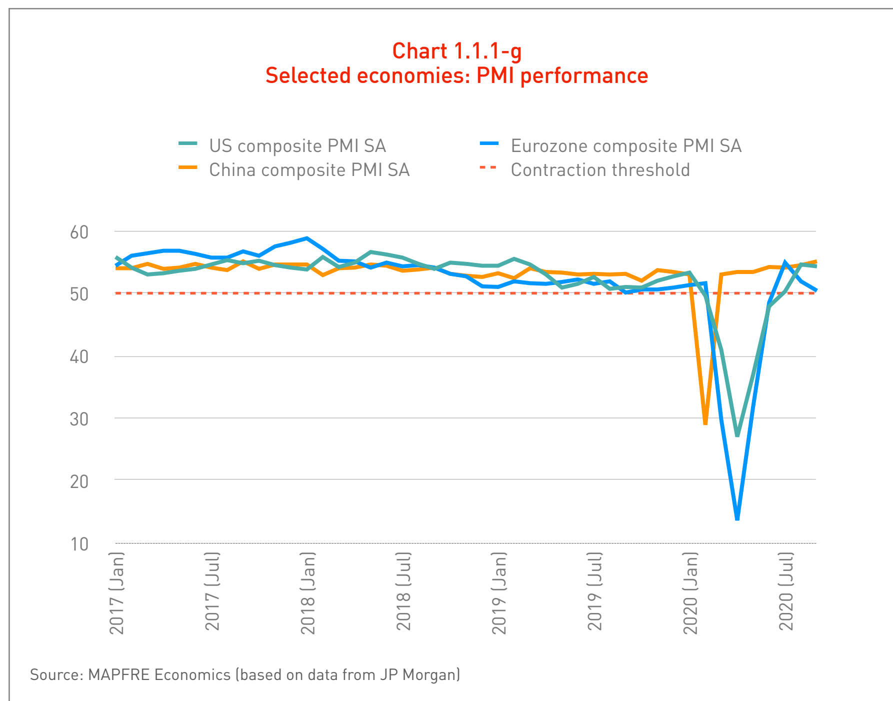
Although under diverse schemes that are still modest in size, the widespread call for monetary policy as a mechanism to meet funding needs may result in a number of risks beyond the economic-financial sphere, especially in emerging economies (see Box 1.1.1-a), involving institutional risks where the credibility and effective independence of the central bank are assumed to be essential factors.

Source: MAPFRE Economics (with information from the ECB and the Federal Reserve)

750 billion euros to the region's recovery. Both programs, together with the multiannual financial framework, amount to almost 2.4 trillion euros, roughly 17% of the European Union's GDP (see Box 1.1 1-c).

Although the exceptional fiscal response has been unique to the few countries that had fiscal leeway to implement it, the stimuli implemented will impact fiscal sustainability, given that the deficit is now expected to go into double-digits in 2020 and 2021, while many countries' public debt will

Chart 1.1.1-g
Selected economies: PMI performance



Source: MAPFRE Economics (based on data from JP Morgan)

exceed 120% of GDP. The world will therefore survive on high levels of debt for a long time, something that was unthinkable just a few years ago.

A crisis in two phases

As a conclusive summary, the timeline of progression for the crisis caused by the COVID-19 pandemic can be conceptualized in a two-phase process. Firstly, a containment phase (during the second and third quarters of 2020), which has been initially marked by social distancing and lockdown measures. During this phase, shocks affected global value chains, there was limited demand—especially for services—and high uncertainty, leading to increases in the savings rate and a fall in consumption. However, as restrictions eased and monetary and fiscal economic policy began to show effect, the situation improved to the point where, in general, the initial forecasts for economic growth for 2020 were revised with greater levels of optimism.

Secondly, there would then be a transition phase (which would extend from the last quarter of 2020 and last throughout 2021), during which the world would enter a second wave of infections, with an increase in the number of coronavirus cases and a consequent return of restrictions, with mixed effects on global activity depending on the corresponding specializations and renewed levels of pessimism among consumers and producers. This would take place in an environment with reduced monetary and fiscal leeway for the application of public policies and thus a lower capacity for positive surprises in the future.

It is from this potential situation that we have reformulated our baseline and stressed scenarios, as defined in the previous report. However, we now have a greater chance of entering into a stressed scenario and witnessing its effect on the capacity for recovery in 2021, which would be significantly lower. It should be noted that this is not a pessimistic and unlikely scenario; this would, in any case, be a scenario in which the recessionary environment turns into a depression following systemic bankruptcy and the erosion of trust, activity, income and long-term growth.

Our forecast for what could happen beyond 2021 lies within this long-term perspective. Without being too pessimistic, we believe that the future will be dominated by three aspects of the new normal mentioned throughout this text: (i) substantially higher levels of debt; (ii) lower long-term economic growth; and (iii) lower market share in favor of the public sector and central banks.

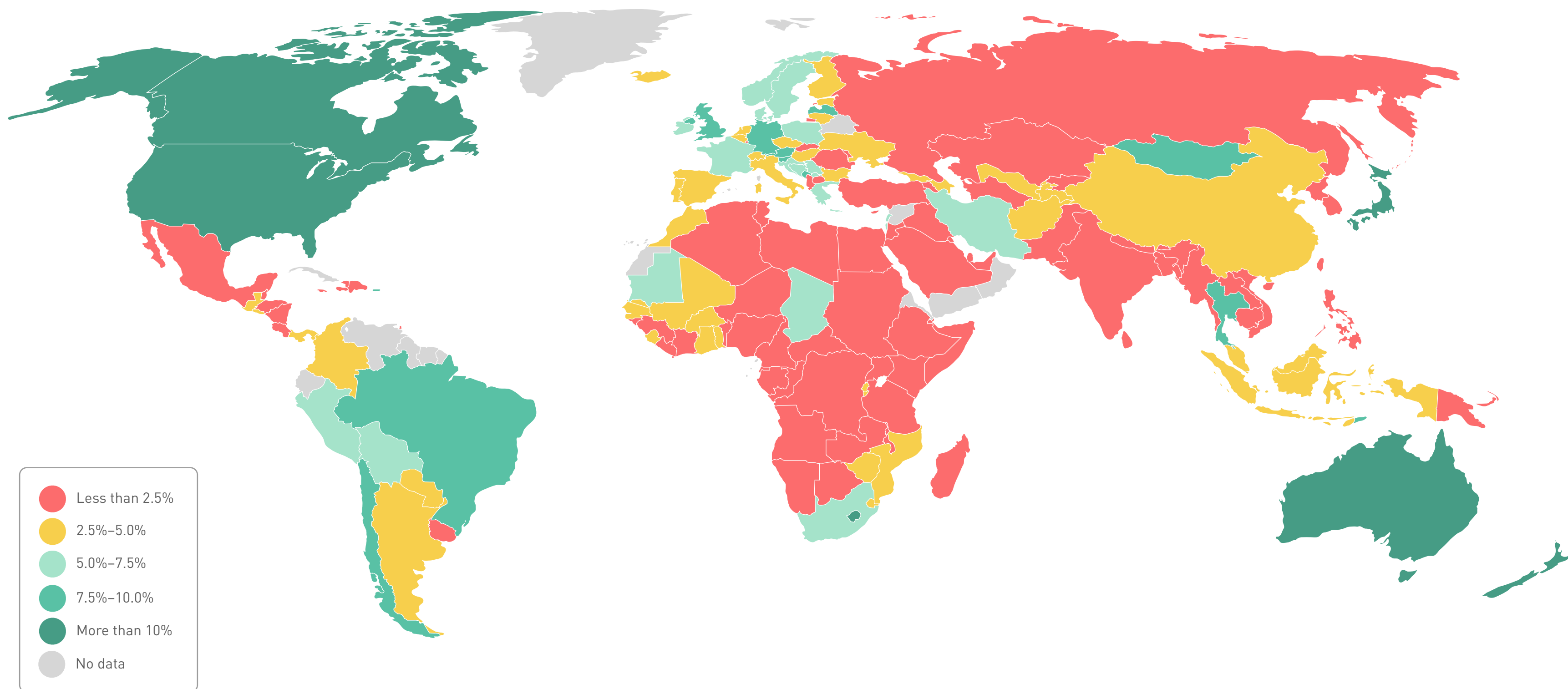
Table 1.1.1
Summary of fiscal measures in response to the COVID-19 pandemic
(% GDP 2019)

		Discretionary spending				Liquidity support			
		Additional expenses or foregone earnings			Accelerated expenses/ deferred revenue		Capital injections, loans, asset purchases and debt assumption	Contingent liabilities	
	Total	Subtotal	Health sector	Non-health sector		Subtotal		Guarantees	Quasi-fiscal operations
United States	14.2	11.8	1.5	10.3	0.1	2.5	0.3	2.2	
United States*	4.8	4.8							
European Union	10.7	3.8	0.0	3.8		6.9	6.3	0.6	
European Union**	5.2	2.6				2.6			
France	21.0	5.2	0.6	4.6	2.5	15.7	0.9	14.8	
Germany	39.2	8.3	0.7	7.7		30.8	6.0	24.8	
Italy	37.9	4.9	0.4	4.5	0.4	33.0	0.2	32.8	
Spain	17.7	3.5	0.5	3.0		14.2	0.1	13.2	0.9
Japan	35.0	11.3	1.0	10.3	4.9	23.7		3.0	20.7
United Kingdom	25.7	9.2	1.5	7.6	0.2	16.6	0.0	16.5	
Turkey	13.8	0.8	0.3	0.5	1.5	13.0	0.4	10.2	2.4
Argentina	6.0	3.9	0.2	3.7	0.0	2.1		2.1	
Brazil	14.6	8.3	0.9	7.4	2.9	6.3	1.0		5.3
Mexico	1.1	0.6	0.2	0.5	0.2	0.5	0.2		0.3
China	5.9	4.6	0.1	4.5	1.6	1.3		0.4	0.9
Indonesia	3.8	2.7	0.5	2.2		1.2	0.2	0.9	
Philippines	3.4	2.3	0.4	2.0		1.1	0.4	0.7	0.0

Source: MAPFRE Economics (based on data from the International Monetary Fund and Bruegel)

* If the 1 trillion US dollars proposed by the Trump administration is approved after the election.
** Corresponds to Next Generation EU (not yet paid in).

Chart 1.1.1-h
Summary of fiscal measures in response to the COVID-19 pandemic*
(% of GDP)



Source: MAPFRE Economics (based on data from the International Monetary Fund and Bruegel)
* Discretionary spending

Box 1.1.1-c
European Recovery and Resilience Plan

The plan

On July 21, following the longest meeting in the history of the Eurogroup, the Recovery and Resilience Facility (RRF) was approved. It was promoted by the European Commission and complements the draft European Multiannual Financial Framework (MFF 2021/2027), which, with this agreement, also saw its foundations laid. It should be noted that, although the proposal has yet to be endorsed in the European Parliament and by the respective national parliaments, it is almost certain that the agreement will go ahead.

The so-called Next Generation EU is a program that represents an additional fiscal effort aimed at counteracting the long-term effects generated by the COVID-19 pandemic and complements the emergency, short-term plan SURE (Support to mitigate Unemployment Risks in an Emergency), approved three months ago. Furthermore, the measure has a transformational objective for the European economy, which is consistent with the objectives of sustainability, digital transition and reduction of inequality.

In short, this is the biggest initiative in the European Union's architecture since the single market was created 30 years ago, not only due to the scale of the financial effort made, but also due to the economic and political consequences it will have on the future of the Union. Due to its characteristics, this important fiscal force can be valued both from a political perspective and from the point of view of its economic effects and consequences.

Political commentary

From the first of these perspectives, the RFF represents a political milestone within the framework of the European Union, insofar as it revalidates the regional project based on solidarity and cements the Franco-German leadership (the initial architects of the project), at a time when doubts surrounding the European project were emerging and the risk of fragmentation was once again looming. The agreed plan will not only help stabilize and redirect the region's economy but will also be key to dispelling the mounting Euroskepticism, which would undoubtedly gain ground if the welfare gap within the region widens (which could increase if the effects of the pandemic are not mitigated).

Furthermore, although this movement is far from being a "Hamilton moment," and will not imminently result in the creation of a common fiscal policy, it is a first step toward achieving certain intermediate objectives:

a) Establishing centralized budgetary objectives consistent with the needs of each region

b) Setting an acceptable degree of tax harmonization

c) Starting the transfer of certain powers necessary to create a European Treasury in the future.

Box 1.1.1-c (continued)
European Recovery and Resilience Plan

It is worth noting that, although this is a purpose that remains on the long-term horizon, there is no doubt that it is a fundamental sign to legitimize the European Union project.

Economic commentary

Regarding its characteristics, effects and economic consequences, the RRF will be endowed with 750 billion euros which, added to the 540 billion euros from the SURE, represents an additional fiscal stimulus for the European Union of more than 10% of GDP; a stimulus that more than doubles the financial capacity established for the European Union during the next seven years.

Together, the RRF (750 billion euros), the SURE (540 billion euros) and the Long-Term Budget (1.07 trillion euros) account for 17% of the European Union's GDP, which is greater than the financial capacity mobilized by the United States to tackle the pandemic (15% of GDP). Moreover, if we add the effort made by the European Central Bank (ECB) to this figure, the monetary and fiscal ammunition available to combat the effects of COVID-19 exceeds 25% of the region's GDP.

Composition

The RRF will be composed of 390 billion euros in non-refundable transfers and 360 billion euros in receivables. Of this total:

- 90% will be dedicated to the resilience fund (i.e. resources allocated toward productive transformation and job creation)
- The remaining 10% will go to other investment items such as digital adoption, agricultural transition and the sectoral consequences of COVID-19.

Frontloading

An important aspect of the program is that it is intended to overweight the short-term in aid (frontloaded). Consequently:

- 70% of this aid will arrive in 2021–2022
- The remaining 30% will arrive in 2023.

In addition, a pre-subsidy of 10% of the money will be made, to become available in 2021. As such, all the fiscal effort is made over the next three years and therefore accounts for more than 1% of the European Union's GDP per year in additional fiscal effort.

Consistency with the principles of the EC proposal

Despite the complex negotiation process that was involved in its approval, the agreed version of the RFF is largely consistent with the principles contained in the original European Commission proposal in early June, although it substantially reduces the objective of encouraging private investment through cooperative arrangements (PPP), the headings of which are disappearing. In fact, the RFF differs by 110 billion euros less in the form of transfers and guarantees, which have been brought under the heading of receivables.

Box 1.1.1-c (continued)
European Recovery and Resilience Plan

Conditionality

The RRF proposal establishes that it will be limited in time (so as not to generate perverse incentives), limited in size (so as to avoid displacing private initiative) and measured in scope (according to the damage caused by COVID-19 and the need for repair). However, the de facto nature of the proposal is to transform the production system (in favor of the sustainability, digitalization and equity agenda), a criterion to which the recipients of the funds must agree.

The funds shall therefore be disbursed following approval and review of each country's transformation and investment plans, and financing may be vetoed by a qualified majority in the Council if these plans and their development do not pass judgment by a European Commission technical committee. Although there is no unilateral right of veto, the program will therefore be subject to the risk of political deadlock, which could generate a certain degree of uncertainty in its implementation.

Keys to delivery

The keys to the funds to be allocated between 2021 and 2023 are as follows:

- The initial 70% of the funds (to be distributed between 2021 and 2022) will be distributed mainly taking into account the situation of the labor market (based on unemployment recorded in 2015–2019), which benefits countries like Spain and Italy.
- The remaining 30% (to be distributed in 2023) will be distributed using the lost product (the fall in accumulated GDP) in 2020–2021 as reference, which will benefit the countries of Central Europe.

RFF power is not nominal

One point to be noted is that the maximum level at which Member States can borrow is 6.8% of the GDP, not forgetting that many of these receivables will compete with similar loans given under SURE at lower interest rates long before this time. For this reason, it is foreseeable that part of the firepower of the RRF is not exactly nominal and that part of these 360 billion euros will not actually be used at all.

Financing of the RFF

The spending program will be financed through borrowing on the capital market (an unprecedented mechanism), i.e. through issuing top-quality sovereign fixed income bonds worth 750 billion euros at 2018 prices. All net borrowing must be done before 2026 (which implicitly introduces a grace period) and amortization will be fully predictable and stable until 2058.

This means that a new long-term instrument will be created with a predictable and guaranteed profitability, of the highest quality and totally liquid; an instrument that, due to its characteristics, may be ideal for completing the balance sheets of the financial system in the current

Box 1.1.1-c (continued)
European Recovery and Resilience Plan

situation (the insurance industry could be a large buyer of this type of asset).

Furthermore, this asset may also be likely to be acquired in the European Central Bank's balance-sheet operations (and those of other central banks), giving more power to quantitative easing exercises and taking pressure off traditional top-quality assets (such as the Bund). In addition, the increased availability of euro-denominated assets will necessarily expand liquidity requirements in this currency, which could have significant effects on the performance of the exchange rate.

Tax implications

From a fiscal perspective, the RFF is redistributive in nature, in that the countries most affected by the COVID-19 pandemic will be those that benefit most from the program; countries which, for the most part (except Italy), are net recipients of funds from the European budget. The program is also designed to prevent it from becoming an obvious additional tax burden. This could have undesirable Ricardian-type effects (depression of consumption today with the expectation of a higher tax burden in the future); however, the mechanism reserves the right to extend the ceiling of own resources for each Member State's contribution to the European Union's budget to 2%.

This would be a measure of last resort and would be used primarily with the creation of new tax figures. The only way not to increase the tax burden in the European Union would be to tax non-European sources of income, the digital levy, carbon border adjustments and a possible financial levy would meet this requirement. In this context, it would seem desirable to take advantage of the possible additional tax structure to create the necessary incentive system to adopt digital and green transformation in the European Union. Thus, to the extent that taxes are instruments for internalizing negative externalities, the RFF could have a transformational effect in terms of tax incentives, if the right incentives were to be created.

In conclusion

The RFF is a giant step forward in the project of European construction on a political and economic level. This is undoubtedly an instrument that can help to actively transform the European Union's productive model and economic structure by making it fairer, more competitive, more balanced and more sustainable, if implemented correctly.

On the resources side, its financing will involve a first step in the creation of joint financial instruments that offer a new world of possibilities for financial development. And, on the fiscal side, the program represents a still distant but firm step toward future coordination in this matter; in other words, a decisive move toward European solidarity.

Source: MAPFRE Economics

1.1.2 Risk assessment

Chart 1.1.2 illustrates the update to our risk map, which, in addition to the risks analyzed in the previous edition of this report, includes the risk relating to the development and global distribution of a vaccine against COVID-19. This analysis is detailed below

Global governance

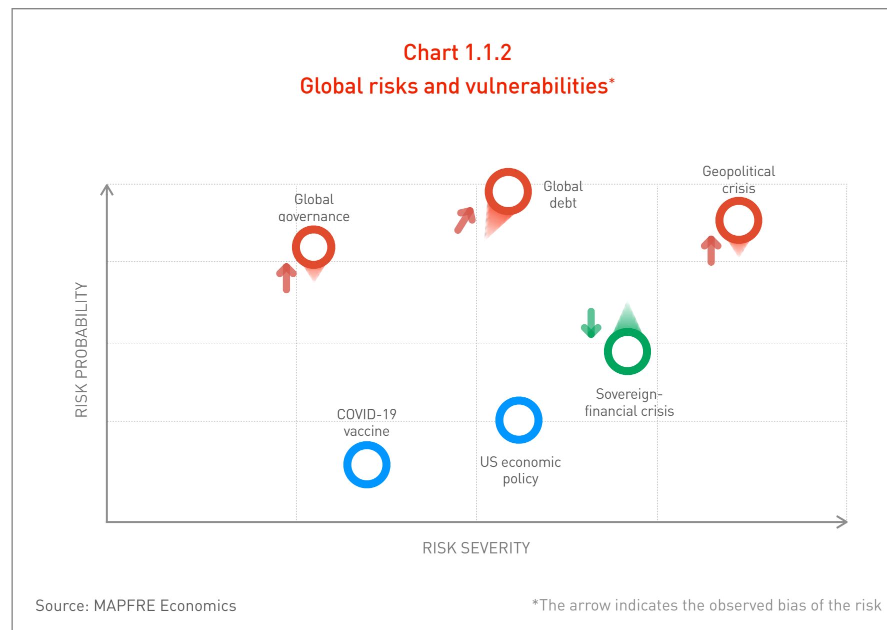
Measures to tackle the spread of the COVID-19 pandemic could enter into a second stage, as the number of infections continues to rise and the pandemic moves toward a second wave. With widespread fiscal and monetary involvement in providing support, policy restrictions to tackle the infection curve and labor measures to protect employment are the main factor of uncertainty. The consequences of this could lead to the need for greater accommodation in economic policy, as well as triggering a greater climate of social anger that could increase the risks affecting governance. In this sense, the greatest vulnerabilities are emerging in countries with the most widespread outbreaks of the virus, in emerging regions where health systems have unresolved deficiencies, and in countries where the relevance of the shadow economy and the structure, informal nature and inflexibility of the labor market expose the workforce to deeper and more permanent shocks than can be absorbed by the employment protection mechanisms that have been proposed.

Global debt

The recession created by the implementation of the lockdown and social distancing measures necessary to control the spread of the COVID-19 pandemic has brought with it a number of undesirable effects. One of these undesirable effects is the increase in the global debt-to-GDP ratio to a new historic peak of 331% in the first quarter of 2020, compared to 320% in the fourth quarter of 2019. With regard to emerging markets, the largest leverage was recorded in the non-financial private sector (primarily corporate and only to a lesser extent in households), while the largest contribution in developed markets was in the finance sector and in governments. Overall, the boom recorded in debt dynamics throughout 2020 allowed agents to be given greater financial flexibility in terms of extending maturities and reducing interest expenditures in a broadly accommodative monetary-policy environment. But the current challenging outlook implies a likely deterioration in credit ratings and an increase in defaults, which could lead to solvency-related tensions.

The greatest risk to emerging economies remains the relentless rise in dollar debt levels, given the low appetite among investors for local currency debt, which increases the risk of future uncovered exposures, mainly in those with the greatest accumulated vulnerabilities. As for

Chart 1.1.2
Global risks and vulnerabilities*



Source: MAPFRE Economics

*The arrow indicates the observed bias of the risk

developed economies, the greatest response in recent decades by central banks continues to cushion the shock, with a clear predisposition to continue to provide more monetary support if necessary. In turn, these have been accompanied by far-reaching fiscal support. However, the duration of this support pillar is contingent, in the medium- and long-term, on the limits on the foreseeable need to rebalance policies toward fiscal sustainability.

Finally, in the United States, as well as in several European Union countries, prospects for the corporate debt segment of the CLO's (Collateralized Debt Obligations) continue to tilt toward the negative. With the abrupt change in financial conditions in March, credit spreads widened the gap between the speculative grade and investment grade. However, following measures by the central banks, the reaction to liquidity growth was varied, showing how there was a certain delay in recovery among the various segments and pointing out that the risk of refinancing, in light of new volatility events, could have a more pronounced differentiating effect than previously experienced.

Sovereign-financial crisis in China

As stated in the previous report, the Chinese economy continues to recover, accompanied by a set of expansionary economic policies that enable the accumulation of positive indicators in both manufacturing and services to be reactivated. Nevertheless, by contrast, domestic demand data has not shown the same level of reactivation, with much more limited recovery rates at a time, like now, of a complete transition toward an economic model with greater internal rebalancing, whereby prolonged vulnerability in domestic sources of growth could hinder the momentum of production.

US economic policy

Monetary easing in the United States, as in the aftermath of the 2008 financial crisis, has once again substantially increased its role as an automatic stabilizer in light of the crisis caused by COVID-19, consolidating the tools used more than a decade ago in developed countries as a stimulus when facing periods of recession, and extending mechanisms such as asset-purchasing programs to other developing economies around the world. At the same time, the most recently observed fiscal dynamics add to the stimulus stream rebalancing the prominence of predominantly monetary policies of recent years, the involvement of which in economic policy could continue to grow in the coming months through tax cuts accompanied by increased spending proposals under a temporary relaxation of budgetary discipline.

Geopolitical crisis

The evolution of the pandemic has not changed the rising trend in geopolitical tensions. With the US-China episode, the gap between the two powers is widening in light of accusations regarding responsibility for the pandemic, the new national security law imposed on Hong Kong and the frequent disagreements regarding the technology sector. At the same time, large bilateral trade surpluses continue to accumulate in favor of China, as well as a greater share of world exports, despite phase 1 of the agreement between both countries, which still is yet to make any constructive progress. In the Persian Gulf, pressure continues to escalate following the death of General Qasem Soleimani and the regional instability caused by the recent Arab-Israeli agreement. In Europe, the renewed prospect of a hard Brexit is once again raising its head, crystallizing a problem that seems far from resolution, just at a time of economic vulnerability when the European Union is trying to move in the opposite direction, i.e. toward policies intended to consolidate the bloc and develop joint response mechanisms in the region.

COVID-19 vaccine

As the global economy recovers from the consequences of the first wave of infections caused by the COVID-19 pandemic, the pressure caused by a resurgence of cases that may force new closures and social distancing measures is increasing, dashing expectations that a safe and effective vaccine or treatment will be available in the critical months of the second wave. Despite political optimism and the tremendous effort made in terms of its development, estimates from the companies themselves regarding the latest clinical trials show a more conservative timetable, the approval of which could be extended to the first half of 2021.

1.2 Forecasts and risk assessment in selected economies

1.2.1 United States

The stimuli support an eventual recovery, but not a return to normality.

The United States economy contracted by -9.1% YoY in the second quarter of 2020 (half as much as the majority of countries in the Americas and Europe), mainly thanks to the significant fiscal and monetary stimuli implemen-ted in a deficit monetization strategy that is becoming less and less hesitant. This strategy has also led to a sharp widening of the deficit (with direct transfers, subsidies and exemptions having increased public spending by 2.1%). It has also increased national debt (131% of GDP) and impacted the Federal Reserve's balance sheet (34% of GDP), which has almost reached the point of resorting to direct asset purchases. It is worth noting that, to date, the fiscal effort made amounts to approximately 15% of GDP.

In the summer months, the end of the restrictions supported a significant increase in the consumption of durable goods (particularly cars), signaling a relative improvement in consumption expectations and resumed activity. This is also the case in a context whereby the rate of unemployment has fallen to almost half (7.9%) of the level recorded in April (14.7%). Surveys regarding general PMIs, manufacturing and services have therefore re-entered positive territory since the summer.

The effect of the stimuli, a relative relaxation of the restrictions imposed to control the pandemic (see Chart 1.2.1-c) and an improvement in confidence, have therefore led to a revision of economic growth forecasts, with a lower-than-expected deterioration in 2020 (-4.0% vs. -8.0% initially) and 3.3% in 2021 (see Table 1.2.1 and Charts 1.2.1-a and 1.2.1-b). Nevertheless, it is worth noting that forecasts are subject to a high level of uncertainty based not only on the evolution of the pandemic, but also on November's election result.

- **The forecast for growth in the United States in 2020 has been revised up to -4.0%.**
- **Fiscal and monetary stimuli support trade and manufacturing, although uncertainty regarding the duration of the effect still persists.**
- **A possible additional fiscal stimulus has been postponed until after the election.**

Core inflation in August (1.7% YoY) accounted for the increase in demand resulting from the stimuli. However, this year's inescapable sluggishness requires waiting for an overall CPI to grow below 1% in 2020, reinforcing deflationary dynamics that openly concern the monetary authority, as Jerome Powell put it during his speech at the Jackson Hole symposium when he shared the Federal Reserve's intention to ease the inflation target (see Box 1.1.1-b). At its meeting in September, the Federal Reserve made no changes to its monetary policy, leaving interest rates in the range of 0.0–0.25% and maintaining the monthly rhythm of its asset-purchasing program. In his statements, Powell insisted on his commitment to keep interest rates low until the labor market reaches levels considered "full employment" and inflation is well on track to exceed 2% for some time. The central bank is expected to maintain the asset-purchasing pace of

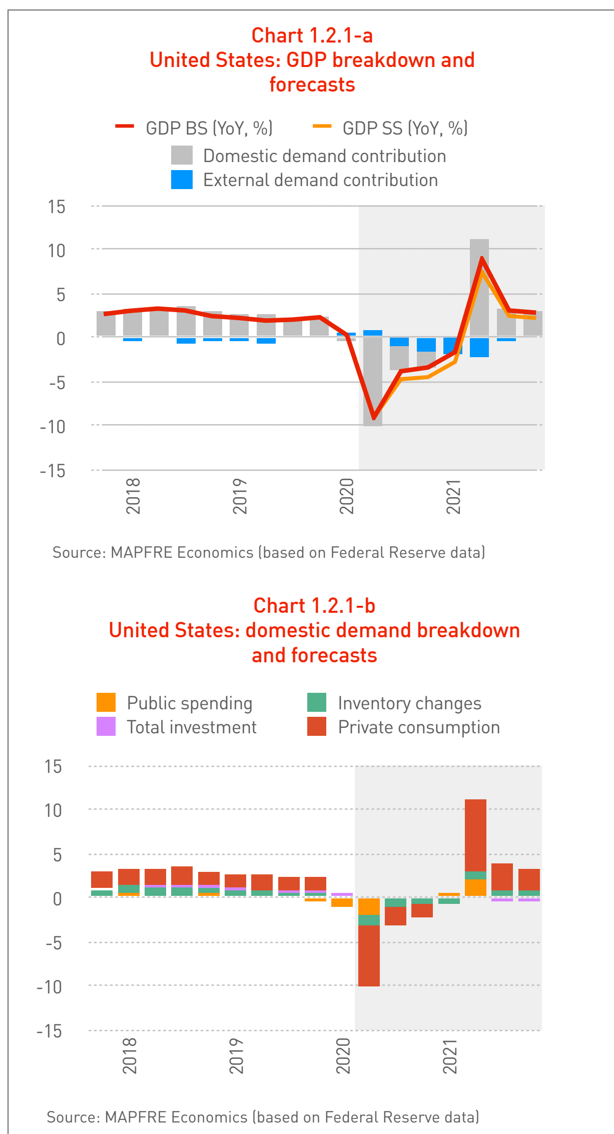


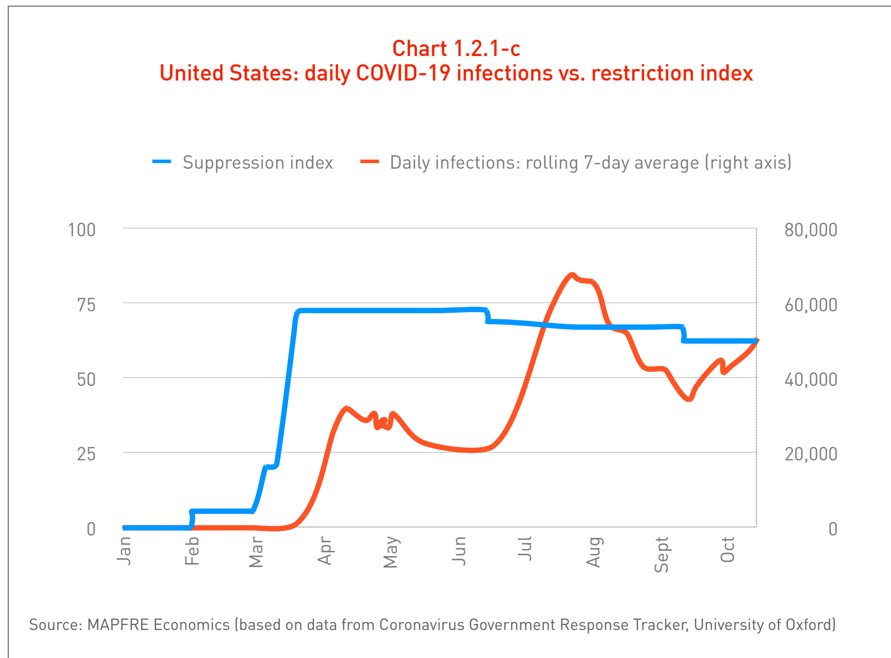
Table 1.2.1
United States: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	3.1	1.7	2.3	3.0	2.2	-4.0	3.3	-4.5	2.4
Domestic demand contribution	3.9	1.9	2.6	3.3	2.4	-3.7	4.5	-3.8	3.9
External demand contribution	-0.8	-0.2	-0.2	-0.3	-0.2	-0.2	-1.1	-0.7	-1.5
Private consumption contribution	2.6	1.9	1.8	1.9	1.7	-2.7	3.5	-2.7	3.4
Total investment contribution	0.7	0.4	0.7	1.0	0.5	-0.6	0.4	-0.6	0.1
Public spending contribution	0.2	0.3	0.1	0.2	0.2	0.2	-0.1	0.2	-0.1
Private consumption (% YoY, average)	3.8	2.8	2.6	2.7	2.4	-3.9	5.0	-3.9	4.8
Public consumption (% YoY, average)	1.6	1.8	0.6	1.5	1.8	1.8	-1.0	1.8	-1.0
Total investment (% YoY, average)	3.7	1.8	3.5	4.8	2.3	-2.7	1.9	-2.7	0.2
Exports (YoY in %)	0.4	0.3	3.9	3.0	-0.1	-14.0	4.6	-14.1	4.3
Imports (YoY in %)	5.2	1.6	4.7	4.1	1.1	-11.7	6.9	-11.7	6.3
Unemployment rate (%, last quarter)	5.0	4.8	4.1	3.8	3.5	7.6	6.3	7.7	6.6
Inflation (% YoY, last quarter)	0.7	2.1	2.1	1.9	2.3	1.1	1.6	1.2	1.6
Fiscal balance (% of GDP)	-4.7	-5.4	-4.2	-6.2	-6.6	-15.7	-8.1	-15.7	-8.3
Primary fiscal balance (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance (% of GDP)	-4.4	-4.1	-4.3	-4.4	-4.1	-4.0	-4.2	-4.0	-4.1
Current account balance (% of GDP)	-2.2	-2.1	-1.9	-2.2	-2.2	-2.9	-2.8	-2.9	-2.8
Official interest rate (end of period)	0.50	0.75	1.50	2.50	1.75	0.20	0.20	0.20	0.20
3-month interest rate (end of period)	0.61	1.00	1.69	2.81	1.91	0.20	0.20	0.20	0.20
10-year interest rate (end of period)	2.27	2.45	2.40	2.69	1.92	0.79	1.33	0.79	1.33
Exchange rate vs. USD (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Exchange rate vs. euro (end of period)	1.09	1.05	1.20	1.15	1.12	1.18	1.18	1.18	1.18
Private lending (% YoY, average)	2.4	3.3	6.9	4.7	5.8	9.3	3.9	9.3	4.1
Household lending (% YoY, average)	1.1	2.1	3.4	3.5	3.1	3.6	4.9	3.6	4.9
P.S. non-financial lending (% YoY, average)	6.0	5.4	6.7	8.9	6.5	7.7	0.6	7.7	0.6
P.S. financial lending (% YoY, average)	2.1	4.3	2.9	2.2	2.2	2.0	1.4	2.0	1.5
Savings rate (as % pers. disp. income, avg.)	7.5	6.9	7.2	7.8	7.5	16.1	9.7	16.0	9.6

Source: MAPFRE Economics (based on Federal Reserve data)
Forecast end date: October 16, 2020.

Click here to access the interactive version of this information

Chart 1.2.1-c
United States: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

80 billion dollars per month in Treasury securities, and 40 billion dollars per month in mortgage securities by the end of 2020.

Congress approved the CARES Act, mobilizing an additional fiscal stimulus of 2 trillion dollars (15% of GDP) to reduce financial tensions for households and businesses. Negotiations are now underway regarding an extension of 1.2 trillion dollars, but its approval has been postponed until after the election (and may also be conditioned by it).

The uncertainty caused by the COVID-19 pandemic will continue to weigh on consumer and business confidence. The extension of this uncertainty over a long period of time will test the solvency of many businesses and the strength of the labor market. In this sense, both households and businesses will see a surge in defaults. If this persists over a long period of time, this could lead to structural damage to the corporate fabric, especially in activities related to the travel, accommodation, transport, hospitality and leisure sectors. As a result, many countries are under financial stress, and falling tax revenue and increased spending associated with the crisis may also cause difficulties in public spending and employment.

1.2.2 Eurozone

A slight improvement in the outlook for 2020, but downside risks for activity in 2021.

The eurozone suffered a contraction of -14.7% YoY (-11.8% QoQ) in economic activity in the second quarter of the year, which varied between countries (Spain -21.5%, Italy -17.7%, Germany -11.3%, France -18.9%), but which generally led to an unprecedented self-inflicted contraction in domestic demand as well as a closure of the foreign sector. During the third quarter, "hard" indicators and trust have made a clear recovery compared to the previous quarter. Manufac-turing fell by -7.0% in July (compared to -30% in April), while industrial PMIs entered positive territory (53 points). The services sector, however, is still lagging behind (with a PMI of 48 points in September) as a result of the lockdown.

This relative improvement in the eurozone's economic performance has been due to the easing of lockdown measures and the rapid implementation of monetary and fiscal stimuli at both national and community levels (see Chart 1.2.2-c). We have therefore revised our estimate for economic growth in 2020 to -7.6% (from -10.0%), but with broad downside risks as a result of uneven recovery among sectors and countries, precisely due to the particularities of each of the eurozone's markets (see Table 1.2.2 and Charts 1.2.2-a and 1.2.2-b).

Furthermore, pressures on demand, deteriorating expectations and very high levels of uncertainty (both biological and economic) pressure prices downward (-0.3% in September). This has forced the European Central Bank (ECB) to not only shore up its management of expectations regarding the measures it can take (dispelling any doubt about the limits of its action), but also to anticipate a revision of its policy framework, which opens the door to being more tolerant of inflation, as was the case for the Federal Reserve. All of the monetary authorities are concerned about the perverse dynamic that may be established between high debt levels and low or even negative nominal growth. In this regard the ECB made no changes to its monetary policy during its meeting in September. Interest rates remained unchanged at 0.0% for loans and -0.5% for deposits. Most notable, however, are the forward-facing policy guidelines for which its president, Christine Lagarde, indicated that these rates would remain at levels equal to or below current levels. This has led markets to extend the horizon regarding expected increases. The central bank also made no changes to the asset-purchasing program implemented to tackle the crisis caused by the pandemic, which amounts to 1.35 trillion euros. It has not ruled out the fact that the central bank may want to expand the program again during the fourth quarter of the year, due to the weakness of the latest inflation data (see Box 1.1.1-b).

- **Eurozone GDP will contract less than expected in 2020 (-7.6%); the implementation of national stimulus plans will mitigate the contraction.**
- **New outbreaks of infections, fatigue over measures, delayed vaccination and parliamentary deadlock regarding approval of the recovery and resilience program pose downside risks to recovery in 2021.**
- **The ECB has focused on maintaining financial conditions, as well as expectations regarding the duration and size of asset purchases.**
- **There are signs of a possible increase in inflation tolerance.**

At its meeting on July 21, the European Commission approved the implementation of the Next Generation EU mechanism. This comprises different items, including the Recovery and Resilience Facility (RRF), totaling 750 million euros, aimed at promoting recovery from the crisis and the productive transformation of the Union. The most recent information in this regard is that disagreements between the European Council and Parliament will delay the implementation of the tax support mechanism, which will result in a more reserved effect in 2021. The sum of the fiscal effort made through Next Generation EU, the SURE (Support to mitigate Unemployment Risks in an Emergency) rescue program implemented at the beginning of the second quarter and the European Union's budget allocation, is equivalent to 2.4 trillion euros or 15% of the region's GDP (see Box 1.1.1-c).

The risks to the eurozone's economy are generally to the downside in view of the surge in infection across the eurozone (see Chart 1.2.2-c), the new lockdown restrictions and their effects on uncertainty, and activity in a context of already tight monetary space and severe national fiscal imbalances. The latter will soon put pressure on financing costs, especially in the European periphery. Furthermore, a deep and protracted crisis may transform current liquidity problems into solvency problems. The European Banking Authority (EBA) has already expressed concern on the surge in household arrears, especially in southern Europe. In a context of low revenue, an increase in arrears would lead to a deterioration in banks' regulatory solvency levels. Sovereign financial adjustments have been prolonged and painful throughout Europe (2010–2013).

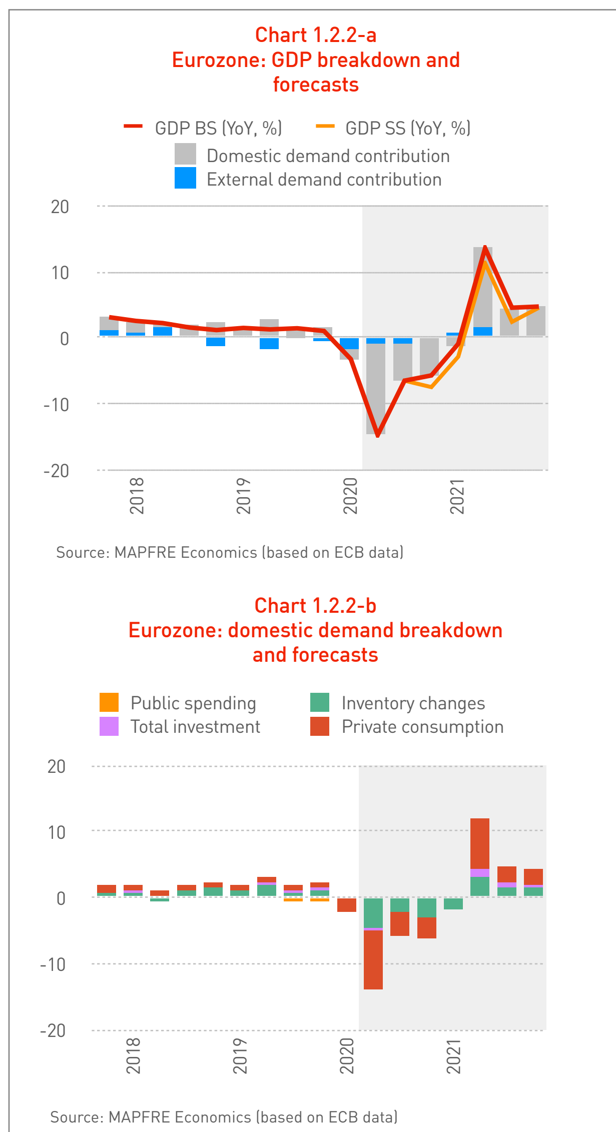


Chart 1.2.2-a
Eurozone: GDP breakdown and forecasts

Source: MAPFRE Economics (based on ECB data)

Chart 1.2.2-b
Eurozone: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on ECB data)

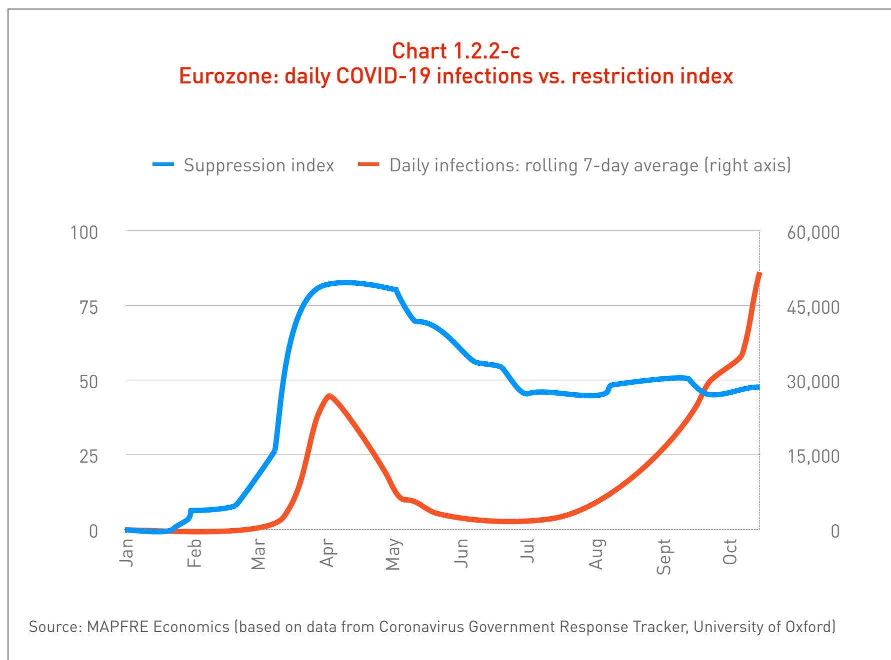
Table 1.2.2
Eurozone: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	1.9	1.8	2.7	1.9	1.3	-7.6	5.5	-8.0	3.8
Domestic demand contribution	2.1	2.3	2.3	1.6	1.8	-6.7	4.8	-7.3	3.5
External demand contribution	-0.1	-0.4	0.4	0.2	-0.5	-0.9	0.6	-0.7	0.3
Private consumption contribution	1.0	1.1	1.0	0.8	0.7	-4.5	3.2	-4.9	1.9
Total investment contribution	0.9	0.8	0.8	0.6	1.2	-2.3	1.2	-2.3	1.1
Public spending contribution	0.3	0.4	0.2	0.2	0.4	-0.1	0.7	-0.1	0.7
Private consumption (% YoY, average)	1.8	1.9	1.9	1.4	1.3	-8.3	6.0	-9.2	3.5
Public consumption (% YoY, average)	1.3	1.9	1.1	1.1	1.8	-0.2	3.0	-0.2	3.0
Total investment (% YoY, average)	4.4	3.9	4.1	3.2	5.7	-10.6	5.8	-10.5	5.6
Exports (YoY in %)	6.4	2.9	5.8	3.7	2.5	-11.1	9.8	-11.2	8.2
Imports (YoY in %)	7.5	4.2	5.3	3.5	4.0	-10.1	9.1	-10.2	7.7
Unemployment rate (%, last quarter)	10.5	9.7	8.7	7.9	7.4	9.4	9.0	9.6	9.5
Inflation (% YoY, last quarter)	0.3	0.7	1.4	1.9	1.0	0.1	1.4	0.1	0.8
Fiscal balance (% of GDP)	-2.0	-1.4	-1.0	-0.5	-0.6	-8.3	-5.2	-8.4	-5.7
Primary fiscal balance (% of GDP)	0.3	0.7	1.0	1.4	1.0	-6.6	-3.6	-6.7	-4.0
Trade balance (% of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current account balance (% of GDP)	2.8	3.0	3.1	2.9	2.3	1.8	2.2	1.8	2.2
Official interest rate (end of period)	0.05	0.00	0.00	0.00	0.00	-0.01	-0.01	0.00	0.00
3-month interest rate (end of period)	-0.13	-0.32	-0.33	-0.31	-0.38	-0.60	-0.63	-1.00	-0.92
10-year interest rate (end of period)	1.26	0.93	1.13	1.17	0.32	-0.15	0.13	-0.19	0.33
Exchange rate vs. USD (end of period)	1.09	1.05	1.20	1.15	1.12	1.18	1.18	1.17	1.18
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	0.9	1.5	2.3	2.8	3.3	2.6	3.6	2.6	3.4
P.S. non-financial lending (% YoY, average)	8.8	2.9	2.1	3.7	2.3	1.3	-4.2	1.2	-5.1
P.S. financial lending (% YoY, average)	17.1	3.3	2.7	-0.9	1.5	-0.2	1.9	-0.2	2.0
Savings rate (as % pers. disp. income, avg.)	12.3	12.3	12.2	12.3	12.8	18.6	15.3	18.8	16.3

Source: MAPFRE Economics (based on ECB data)
Forecast end date: October 16, 2020.

Click here to access the interactive version of this information

Chart 1.2.2-c
Eurozone: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

1.2.3 Spain

Uncertainty surrounding the economy is on the rise due to the surge in infections.

Spain's GDP fell by -21.5% YoY in the second quarter of the year, a decline of a different nature in the eurozone area given the weight of domestic demand in Spain, its orientation toward foreign trade in a context of limited exports (especially services) and, in general, the service-oriented productive model that characterizes the country. Regardless, the fiscal measures adopted during April and May alleviated the adjustment, while there was some easing in the deterioration of products and services (tourism), which was albeit short-lived.

- **Spanish GDP is expected to shrink by around -11.8%, with significant downside risks (health, economic and sovereign).**
- **The political deadlock jeopardized access to the European Union's recovery funds, making economic recovery in 2021 an uncertain prospect.**
- **The high dependence on the services sector in the Spanish production model is a permanent risk factor resulting from the COVID-19 pandemic.**

The surge in cases of COVID-19 infections since August (see Chart 1.2.3-c) forced new lockdown measures to be implemented, once again dashing economic expectations, especially in the services sector (with a PMI of 42.4 points in September). Deterioration in the sector is leading to accelerated stoppage of retail activity. Unemployment, mitigated by temporary layoff programs, stands at 15.3%. Our estimate for GDP in 2020, in the base scenario, is therefore -11.8%. The outlook for recovery in 2021 is maintained (at 6.7%), but is moderate and elusive given the context of biological and economic uncertainty, in a context of political stalemate and severe erosion of institutional stability, which has blocked the adoption of a financial program that could give access to the European Union's recovery fund (see Table 1.2.3 and Charts 1.2.3-a and 1.2.3-b).

The risks to the Spanish economy are varied, the most significant being: the resurgence of the pandemic (which entails the risk of new economic slowdowns), the government's challenge of gathering the necessary majorities required to approve budgets and expenses for public accounts relating to measures to alleviate the effects of the crisis. The decline in activity will put pressure on fiscal revenue and will mean that the fiscal

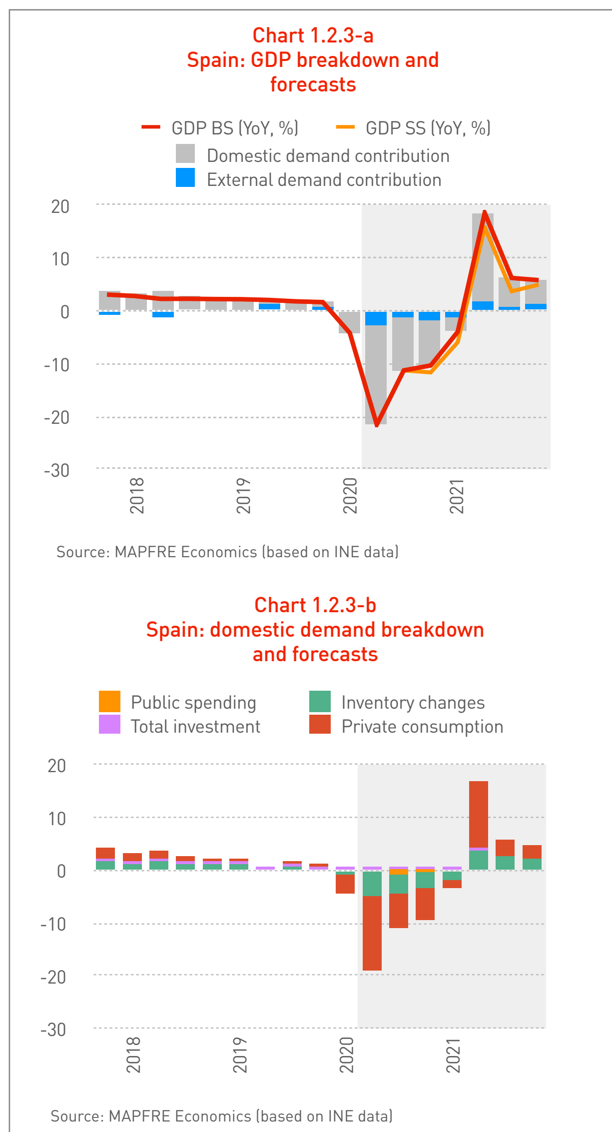


Chart 1.2.3-a
Spain: GDP breakdown and forecasts

Source: MAPFRE Economics (based on INE data)

Chart 1.2.3-b
Spain: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on INE data)

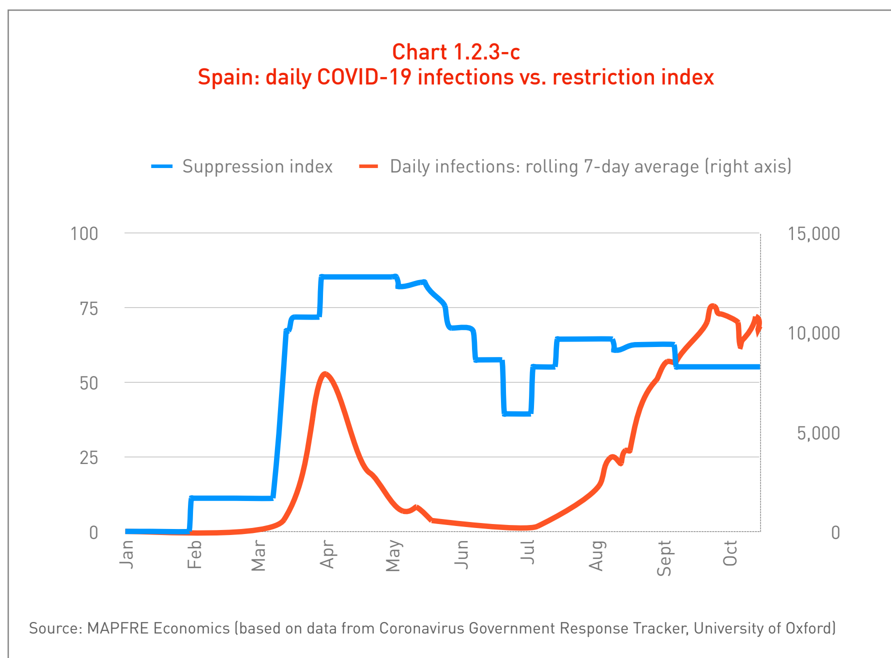
Table 1.2.3
Spain: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	3.8	3.0	3.0	2.4	2.0	-11.8	6.7	-12.1	4.7
Domestic demand contribution	3.9	2.0	3.1	3.0	1.4	-10.3	6.1	-11.0	3.6
External demand contribution	-0.1	1.0	-0.2	-0.5	0.6	-1.5	0.6	-1.2	1.0
Private consumption contribution	1.7	1.6	1.8	1.0	0.5	-7.5	4.0	-8.1	2.9
Total investment contribution	0.9	0.4	1.2	1.1	0.5	-3.2	1.5	-3.2	0.8
Public spending contribution	0.4	0.2	0.2	0.5	0.4	0.7	0.4	0.7	0.4
Private consumption (% YoY, average)	2.9	2.7	3.0	1.8	0.9	-13.1	7.3	-14.2	5.2
Public consumption (% YoY, average)	2.0	1.0	1.0	2.6	2.3	3.8	2.0	3.8	2.0
Total investment (% YoY, average)	4.9	2.4	6.8	6.1	2.7	-16.5	8.7	-16.8	4.9
Exports (YoY in %)	4.3	5.4	5.5	2.3	2.3	-22.1	11.4	-22.2	10.2
Imports (YoY in %)	5.1	2.7	6.8	4.2	0.7	-19.9	9.6	-20.1	5.8
Unemployment rate (%, last quarter)	20.9	18.6	16.6	14.5	13.8	17.8	17.4	18.5	18.6
Inflation (% YoY, last quarter)	0.0	1.6	1.1	1.2	0.8	-0.2	1.0	-0.3	-0.1
Fiscal balance (% of GDP)	-5.2	-4.3	-3.0	-2.5	-2.9	-12.4	-7.6	-12.6	-8.6
Primary fiscal balance (% of GDP)	-2.2	-1.5	-0.5	-0.1	-0.5	-10.0	-5.4	-10.2	-6.3
Trade balance (% of GDP)	-1.9	-1.3	-1.9	-2.5	-2.1	-1.0	-1.5	-0.9	-0.7
Current account balance (% of GDP)	2.0	3.2	2.8	1.9	2.1	0.9	1.4	0.9	2.2
Official interest rate (end of period)	0.05	0.00	0.00	0.00	0.00	-0.01	-0.01	0.00	0.00
3-month interest rate (end of period)	-0.13	-0.32	-0.33	-0.31	-0.38	-0.60	-0.63	-1.00	-0.92
10-year interest rate (end of period)	1.77	1.35	1.51	1.41	0.46	0.19	0.52	0.25	0.89
Exchange rate vs. USD (end of period)	1.09	1.05	1.20	1.15	1.12	1.18	1.18	1.17	1.18
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-3.7	-2.5	-1.4	-0.3	-0.2	0.5	3.3	0.5	2.6
P.S. non-financial lending (% YoY, average)	-3.0	-2.7	-1.2	-1.3	-0.2	3.5	0.5	3.0	-4.5
P.S. financial lending (% YoY, average)	-7.7	-17.1	-9.7	-3.5	-5.4	-1.1	2.7	-1.1	3.2
Savings rate (as % pers. disp. income, avg.)	7.7	7.5	6.1	5.9	6.6	15.4	12.6	15.8	14.1

Source: MAPFRE Economics (based on INE data)
Forecast end date: October 16, 2020.

Click here to access the interactive version of this information

Chart 1.2.3-c
Spain: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

deficit could exceed 14% of GDP, and that gross public debt could reach 120% of GDP. As such, rating agencies, by changing the outlook, are already warning that the sovereign credit profile could be downgraded during the next revision. Finally, in an area that is more general and common to virtually all of the world's economies, if the crisis caused by the pandemic spreads, we could see an upturn in corporate insolvencies, financial defaults and more job losses, which are being contained for the time being thanks to state aid for temporary redundancies (ERTEs), which have been extended in Spain until January 31.

1.2.4 Germany

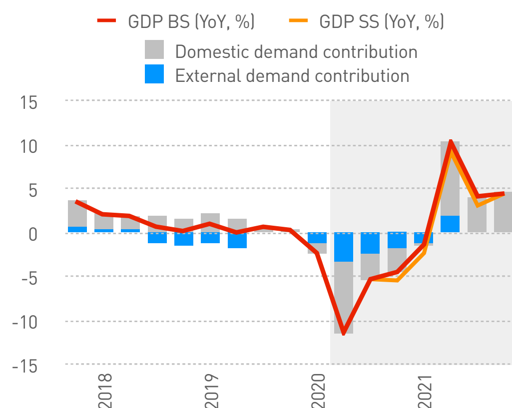
A moderate upward revision in growth, but far from pre-COVID-19 levels.

- Growth of the German economy for 2020 has been revised upward (-5.8%).
- However, risks of renewed deterioration in the fourth quarter of the year persist.
- Germany has triggered additional new stimuli to boost consumption.

Germany's GDP shrank by a record-breaking -11.3% YoY (-9.7% QoQ) in the second quarter. However, stabilized figures during the third quarter and the opening of global trade revived activity and encouraged expectations to improve. However, the surge in new cases of COVID-19 infections (see Chart 1.2.4-c) will once again exert pressure on consumption, triggering a new wave of saving as a precautionary measure. In light of this, the German government has decided to support activity with a one-off VAT cut until the end of the year. We therefore estimate that Germany's GDP will contract the least in the eurozone, -5.8% in 2020, to grow by 4.5% in 2021 on the basis that activity and global value chains will return to normal (see Table 1.2.4 and Charts 1.2.4-a and 1.2.4-b).

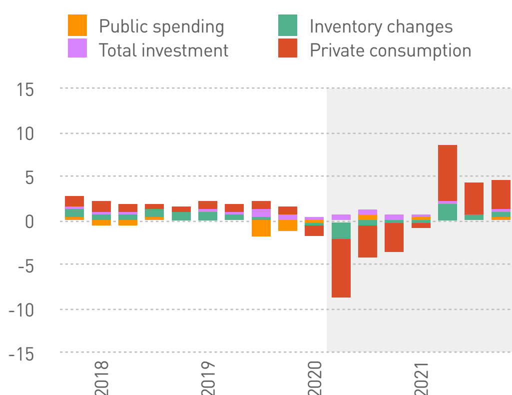
The risks to the German economy mainly center around weak domestic demand and export products, containing investment until using capacity is not depleted again, the effect of the crisis on employment and the solvency of individuals, companies and, as a consequence, the banking system. Despite low interest rates and financing facilities, when there is a surge in arrears, banks tend to be more cautious in lending in times of a surge in arrears, thus behaving in a pro-cyclical manner, which contrasts to what the economy would require at this present time.

Chart 1.2.4-a
Germany: GDP breakdown and forecasts



Source: MAPFRE Economics (based on DESTATIS data)

Chart 1.2.4-b
Germany: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on DESTATIS data)

Table 1.2.4
Germany: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	1.2	2.1	2.9	1.3	0.6	-5.8	4.5	-6.0	3.7
Domestic demand contribution	1.1	2.8	2.7	1.7	1.2	-3.8	4.2	-4.2	3.9
External demand contribution	0.2	-0.7	0.2	-0.4	-0.6	-2.0	0.2	-1.8	-0.2
Private consumption contribution	1.0	1.2	1.0	0.8	0.8	-3.7	3.1	-4.2	2.2
Total investment contribution	0.2	0.7	0.6	0.7	0.5	-0.7	0.6	-0.7	1.4
Public spending contribution	0.6	0.8	0.3	0.2	0.5	0.6	0.2	0.6	0.2
Private consumption (% YoY, average)	1.8	2.2	1.8	1.5	1.6	-7.0	5.9	-7.9	4.3
Public consumption (% YoY, average)	2.9	4.1	1.6	1.2	2.7	2.8	1.1	2.8	1.1
Total investment (% YoY, average)	1.2	3.6	3.2	3.6	2.6	-3.4	3.0	-3.1	6.3
Exports (YoY in %)	4.9	2.3	5.4	2.5	1.0	-11.2	10.3	-11.3	8.6
Imports (YoY in %)	5.4	4.4	5.8	3.8	2.6	-8.5	11.0	-8.7	9.9
Unemployment rate (%, last quarter)	6.3	6.0	5.5	5.0	5.0	6.3	5.7	6.5	6.1
Inflation (% YoY, last quarter)	0.7	1.4	1.4	1.6	1.5	0.0	2.0	0.0	1.6
Fiscal balance (% of GDP)	1.0	1.2	1.4	1.8	1.5	-5.9	-2.6	-6.0	-3.1
Primary fiscal balance (% of GDP)	2.3	2.4	2.2	2.8	2.2	-5.1	-1.9	-5.2	-2.4
Trade balance (% of GDP)	8.1	8.0	7.8	6.8	6.5	5.2	5.4	5.2	5.1
Current account balance (% of GDP)	8.7	8.4	7.8	7.5	7.2	6.5	5.9	6.5	5.7
Official interest rate (end of period)	0.05	0.00	0.00	0.00	0.00	0.00	-0.00	0.00	0.00
3-month interest rate (end of period)	-0.13	-0.32	-0.33	-0.31	-0.38	-0.60	-0.63	-1.00	-0.92
10-year interest rate (end of period)	0.63	0.21	0.43	0.25	-0.19	-0.58	-0.45	-0.65	-0.37
Exchange rate vs. USD (end of period)	1.09	1.05	1.20	1.15	1.12	1.18	1.18	1.17	1.18
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	1.9	2.8	3.2	3.6	4.4	4.7	5.7	4.7	5.4
P.S. non-financial lending (% YoY, average)	2.9	4.1	5.2	7.5	5.4	5.2	-1.2	5.2	-0.9
P.S. financial lending (% YoY, average)	5.1	2.2	0.7	3.9	6.3	0.9	4.3	0.9	4.6
Savings rate (as % pers. disp. income, avg.)	10.1	10.4	10.5	10.9	10.8	16.3	11.8	16.9	13.6

Source: MAPFRE Economics (based on DESTATIS data)
Forecast end date: October 16, 2020.

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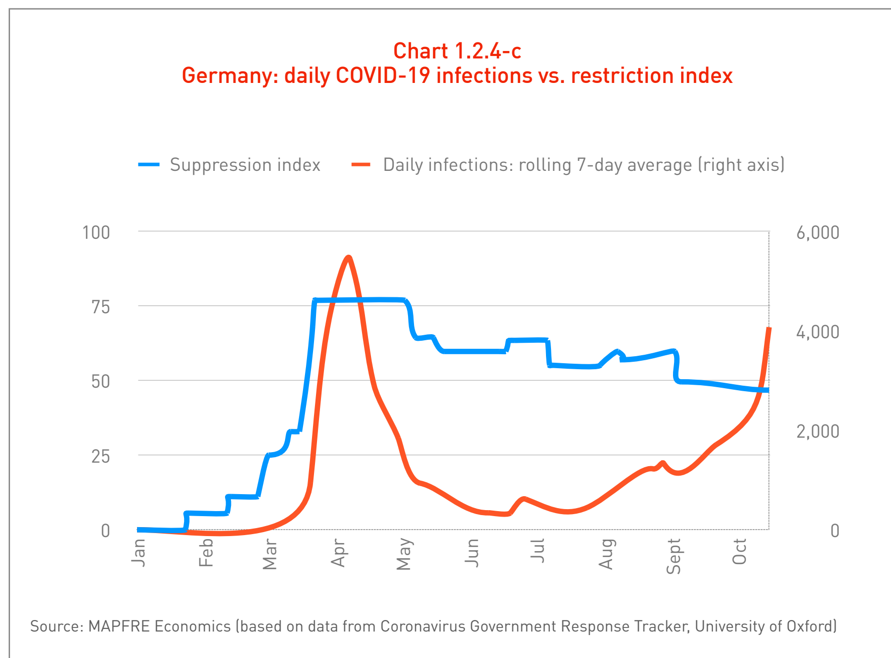
Chart 1.2.4-c
Germany: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

1.2.5 Italy

Very modest activity, which is key to lower levels of infection.

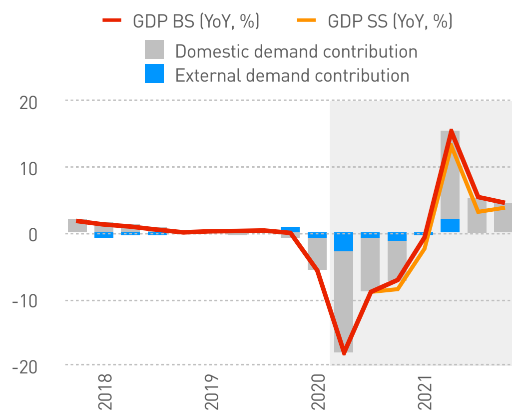
GDP fell by -12.8% QoQ in the second quarter (-17.7% YoY), in light of sluggish domestic demand and disrupted foreign demand. In the context of lacking additional fiscal leeway for further fiscal stimuli in addition to the 125 billion euros that have already been implemented, aid from the European Union (209 billion euros) will be key to economic recovery in 2021. Despite improved manufacturing PMI, overall expectations remain strained due to the problems faced by the services sector and tourism in particular. The PMI of the services sector therefore remains below 50 points, coinciding with the European pattern of asymmetric recovery both sectorally and geographically.

- **Weak demand and tourism have led to a downward revision of Italy's GDP growth forecast in 2020 to -9.8%.**
- **Italy will be the largest beneficiary of the European Recovery Fund, with 209 billion euros.**
- **Fiscal momentum and falling revenues again raise fears of debt sustainability.**

We have therefore adjusted our GDP growth forecast for 2020 slightly downward to -9.8% (from -9.3%), based on data from the second quarter, a weaker recovery in exports and a surge in pandemic infections that could lead to new restrictions on economic activity (see Table 1.2.5 and Charts 1.2.5-a, 1.2.5-b and 1.2.5-c). Recovery of 6.3% is forecast for 2021. However, it is worth noting that Italy still faces the challenge of undertaking structural reforms that will enable it to raise its potential growth and thus ensure medium- and long-term fiscal sustainability.

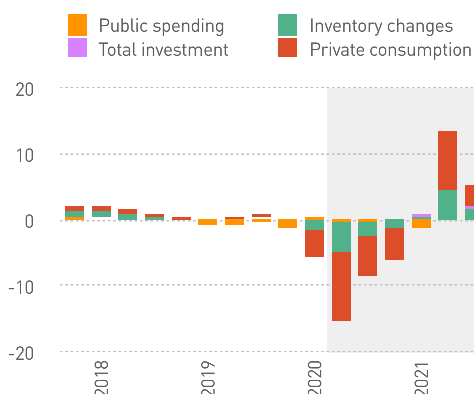
In addition to the risks of the Italian economy, the usual high deficits, high debt and possible political instability, there is also a chance that external demand will take a long time to recover and that the crisis will greatly affect unemployment. There is hope regarding the positive impact of European funds. However, the European Union's monitoring of the use of these funds and the strict conditions on access to said funds, which will be project-based, will pose a challenge in terms of using of all of the funds.

Chart 1.2.5-a
Italy: GDP breakdown and forecasts



Source: MAPFRE Economics (based on ISTAT data)

Chart 1.2.5-b
Italy: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on ISTAT data)

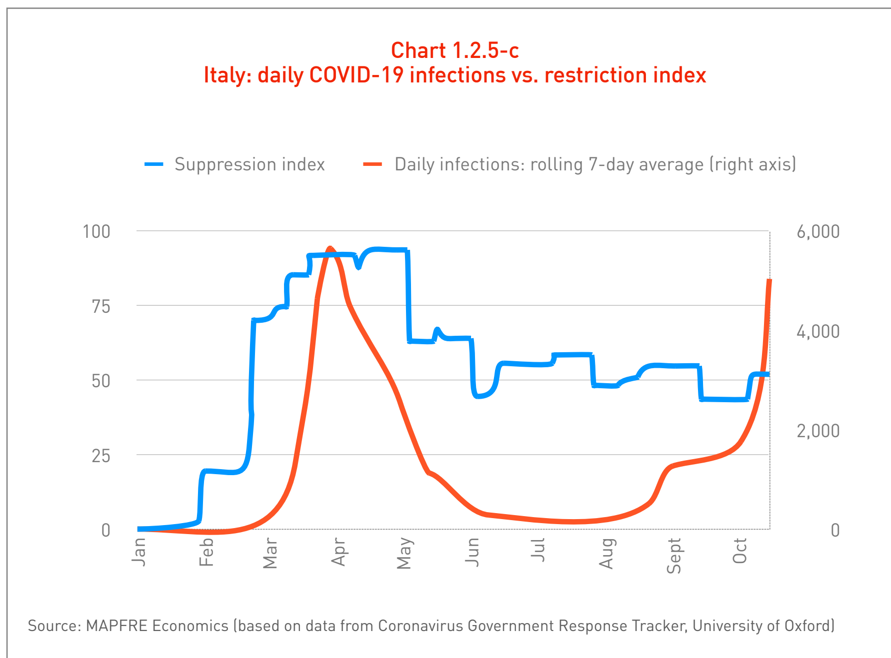
Table 1.2.5
Italy: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	0.7	1.4	1.7	0.8	0.3	-9.8	6.3	-10.2	4.6
Domestic demand contribution	1.1	1.9	1.7	1.2	-0.2	-8.6	5.8	-9.2	3.9
External demand contribution	-0.4	-0.5	0.0	-0.3	0.5	-1.3	0.5	-1.0	0.7
Private consumption contribution	1.1	0.7	0.9	0.6	0.3	-6.3	3.7	-6.9	2.4
Total investment contribution	0.3	0.7	0.6	0.5	0.3	-2.1	1.9	-2.2	1.4
Public spending contribution	-0.1	0.1	-0.0	0.0	-0.0	-0.1	0.3	-0.1	0.3
Private consumption (% YoY, average)	1.9	1.2	1.5	1.0	0.5	-10.4	6.1	-11.3	4.0
Public consumption (% YoY, average)	-0.6	0.7	-0.1	0.2	-0.2	-0.6	1.4	-0.6	1.4
Total investment (% YoY, average)	1.6	4.2	3.4	2.9	1.6	-11.6	11.0	-11.9	8.0
Exports (YoY in %)	4.1	1.9	6.0	1.6	1.3	-17.0	20.8	-17.1	18.9
Imports (YoY in %)	6.3	4.1	6.5	2.9	-0.4	-14.2	19.3	-14.4	15.8
Unemployment rate (%, last quarter)	11.5	11.8	11.0	10.5	9.5	10.1	10.4	10.3	11.0
Inflation (% YoY, last quarter)	0.1	0.5	0.9	1.1	0.5	-0.2	0.6	-0.3	-0.2
Fiscal balance (% of GDP)	-2.6	-2.4	-2.4	-2.2	-1.6	-12.4	-7.0	-12.6	-7.9
Primary fiscal balance (% of GDP)	1.5	1.5	1.4	1.4	1.8	-8.8	-3.6	-8.9	-4.4
Trade balance (% of GDP)	3.3	3.5	3.1	2.6	3.2	3.6	3.5	3.6	4.1
Current account balance (% of GDP)	1.5	2.6	2.6	2.5	3.1	2.8	2.8	2.8	3.4
Official interest rate (end of period)	0.05	0.00	0.00	0.00	0.00	-0.01	-0.01	0.00	0.00
3-month interest rate (end of period)	-0.13	-0.32	-0.33	-0.31	-0.38	-0.60	-0.63	-1.00	-0.92
10-year interest rate (end of period)	1.61	1.82	2.00	2.77	1.43	0.77	1.35	0.84	1.72
Exchange rate vs. USD (end of period)	1.09	1.05	1.20	1.15	1.12	1.18	1.18	1.17	1.18
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-0.3	0.5	1.2	1.8	2.1	0.5	1.2	0.4	0.9
P.S. non-financial lending (% YoY, average)	-1.9	-2.1	-2.9	-0.4	-0.6	3.3	2.4	2.8	-1.6
P.S. financial lending (% YoY, average)	-3.0	-3.9	-13.2	25.1	-5.0	19.8	-0.7	19.3	-2.6
Savings rate (as % pers. disp. income, avg.)	10.2	10.2	9.8	9.6	9.6	14.6	12.3	15.1	14.7

Source: MAPFRE Economics (based on ISTAT data)
Forecast end date: October 16, 2020.

Click here to access the interactive version of this information

Chart 1.2.5-c
Italy: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

1.2.6 United Kingdom

Further uncertainty regarding the end of the Brexit transition period.

The UK economy shrank by -21.5% YoY in the second quarter of the year (-19.8% QoQ), but activity indicators have recovered moderately since June thanks to attempts to ease lockdown and restrictions on foreign tourism. As a result, retail sales and trust have improved moderately.

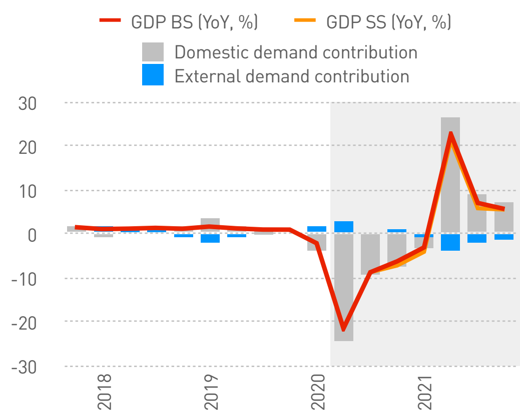
However, this improvement seems to be short-lived, in view of data on growing infection rates (see Chart 1.2.6-c): the strong deterioration in consumer confidence (GfK) up to September anticipates this. We have therefore adjusted our estimate for GDP growth to -9.6% in 2020 and 8.1% in 2021 (see Table 1.2.6 and Charts 1.2.6-a and 1.2.6-b).

It is worth noting that, by 2021, uncertainty regarding the performance of the United Kingdom's economy is higher than in the other countries of the region, owing to uncertainty surrounding a possible trade agreement with the European Union. The possibility therefore remains that, from January 1, 2021, the United Kingdom will have to be subject to World Trade Organization (WTO) protocol to establish trade links with the European Union, which removes any privilege of access to the region.

- In addition to the uncertainty of the crisis caused by the pandemic, the end of the Brexit transition period is drawing closer with no signs of a trade agreement with the European Union.
- The GDP growth forecast for 2020 has been revised to -9.6% and downside risks are on the up.
- The significant upsurge in COVID-19 infections casts doubt on economic recovery, even in 2021.

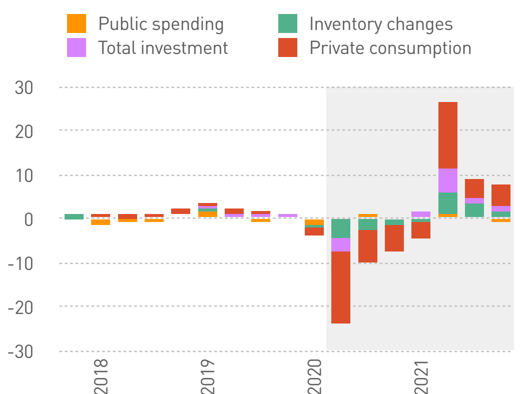
Furthermore, inflation continues to ease, to 0.2% in August, with core inflation also falling to 0.9%, revealing weak demand. Recovery in inflation can only be expected when there is a clear recovery in demand. However, this crisis, which will impact wages, means that it is currently difficult to envisage said recovery. We must therefore prepare ourselves for lax monetary policies that will last for some time. In this regard, at its meeting in September, the Bank of England's Monetary Policy Committee decided to keep interest rates unchanged at 0.10%. We predict that stimulus policies will now focus more on the fiscal aspect and that the Bank of England will therefore stick to its current course. We therefore believe that no changes will be made unless the economy deteriorates more so than expected, whether due to the pandemic or due to the lack of a trade agreement with the European Union.

Chart 1.2.6-a
United Kingdom: GDP breakdown and forecasts



Source: MAPFRE Economics (based on data from the Office for National Statistics)

Chart 1.2.6-b
United Kingdom: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on data from the Office for National Statistics)

Table 1.2.6
United Kingdom: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	2.4	1.7	1.7	1.3	1.3	-9.6	8.1	-9.8	7.2
Domestic demand contribution	2.9	3.1	1.5	0.3	1.6	-11.1	10.0	-11.3	9.1
External demand contribution	-0.6	-1.4	0.2	0.9	-0.4	1.5	-1.8	1.5	-1.9
Private consumption contribution	1.8	2.3	0.6	0.8	0.5	-7.7	5.3	-7.9	4.8
Total investment contribution	0.9	0.8	0.5	0.1	0.3	-2.3	2.1	-2.3	1.7
Public spending contribution	0.3	0.2	0.1	0.1	0.8	-0.9	2.3	-0.9	2.3
Private consumption (% YoY, average)	3.0	3.7	1.0	1.3	0.8	-12.4	9.0	-12.7	8.3
Public consumption (% YoY, average)	1.8	1.0	0.7	0.6	4.1	-4.8	11.3	-4.8	11.3
Total investment (% YoY, average)	5.3	4.5	2.8	0.4	1.5	-12.6	12.0	-13.1	10.0
Exports (YoY in %)	2.8	2.7	5.5	3.0	2.8	-10.8	4.4	-10.9	3.1
Imports (YoY in %)	5.5	4.0	2.7	2.7	3.4	-16.8	13.4	-16.9	12.1
Unemployment rate (%, last quarter)	5.1	4.7	4.4	4.0	3.8	6.5	5.5	6.5	5.9
Inflation (% YoY, last quarter)	0.5	1.8	2.7	2.0	1.3	0.4	2.0	0.4	1.8
Fiscal balance (% of GDP)	-4.6	-3.3	-2.4	-2.2	-2.4	-15.4	-7.4	-15.4	-7.7
Primary fiscal balance (% of GDP)	-1.9	-0.5	0.5	0.5	0.1	-13.2	-5.3	-13.2	-5.5
Trade balance (% of GDP)	-6.0	-6.6	-6.5	-6.4	-5.9	-4.3	-4.6	-4.3	-4.5
Current account balance (% of GDP)	-5.0	-5.5	-3.8	-3.7	-4.3	-2.7	-3.7	-2.7	-3.7
Official interest rate (end of period)	0.50	0.25	0.50	0.75	0.75	0.10	-0.06	0.07	0.00
3-month interest rate (end of period)	0.59	0.37	0.52	0.91	0.79	0.06	0.05	0.03	-0.04
10-year interest rate (end of period)	2.02	1.28	1.25	1.33	0.91	0.27	0.37	0.20	0.36
Exchange rate vs. USD (end of period)	1.48	1.23	1.35	1.28	1.32	1.32	1.33	1.32	1.33
Exchange rate vs. euro (end of period)	1.36	1.17	1.13	1.11	1.18	1.12	1.12	1.13	1.13
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	3.0	3.7	4.0	3.1	2.1	3.1	3.2	3.1	3.0
P.S. non-financial lending (% YoY, average)	-1.9	4.5	9.4	7.1	-4.3	4.5	3.0	4.4	2.9
P.S. financial lending (% YoY, average)	-9.9	7.7	8.4	5.3	1.9	14.6	4.1	14.6	4.1
Savings rate (as % pers. disp. income, avg.)	10.1	7.6	5.7	6.1	6.5	15.4	9.4	15.7	9.8

Source: MAPFRE Economics (based on data from the Office for National Statistics)
Forecast end date: October 16, 2020.

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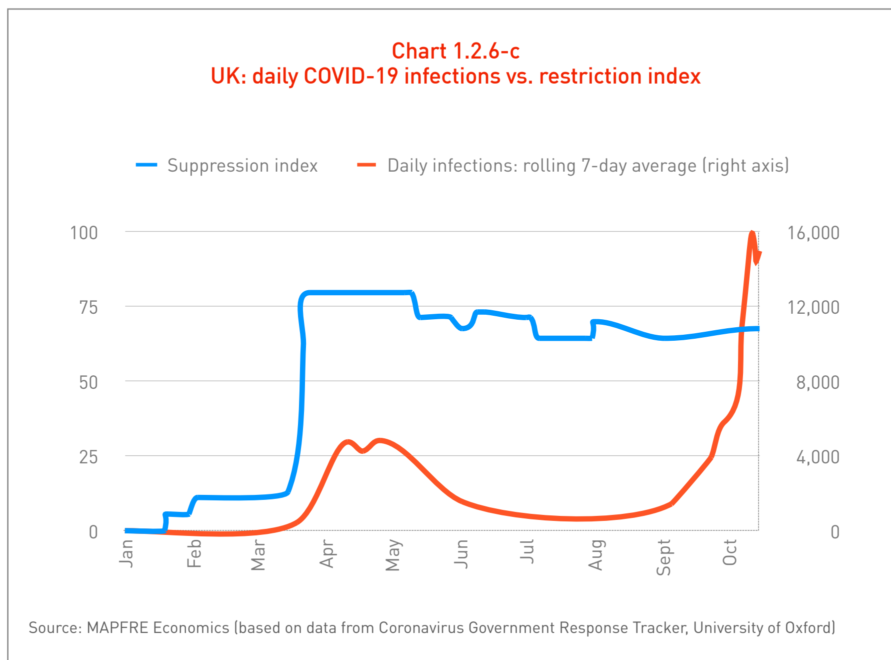


Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

The risks to the British economy mainly center around the pandemic crisis worsening (which has once again forced social distancing and lockdown restrictions) and around the risk of failing to reach a trade agreement with the European Union. This would completely change the outlook for foreign trade and investment, in which case the country's forecasts in terms of economic performance would have to be completely revised.

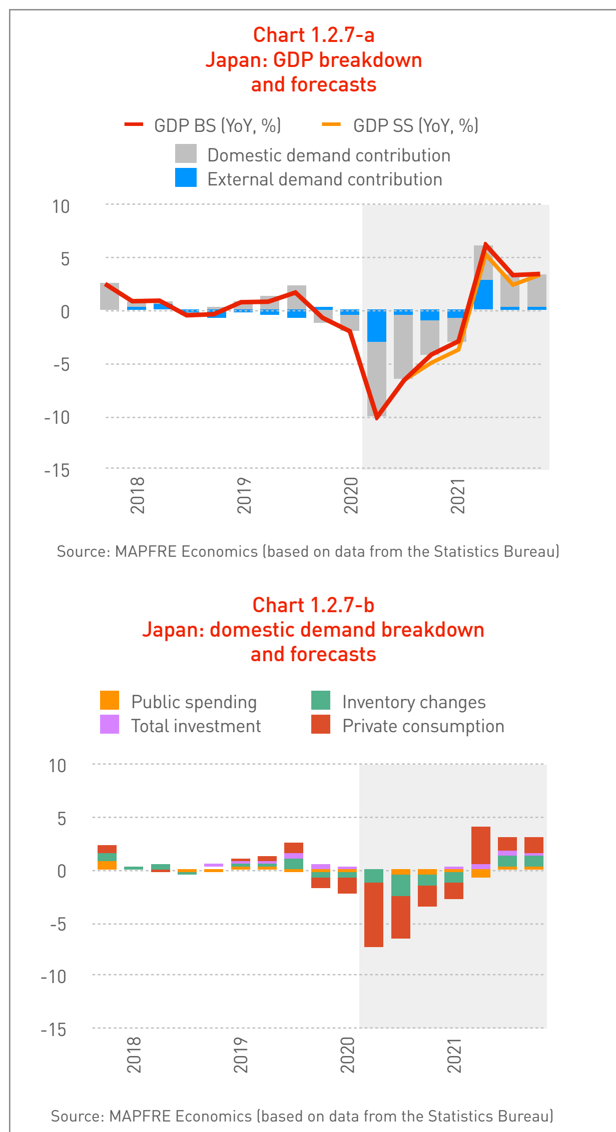
1.2.7 Japan

Weak recovery following three quarters of contraction.

Japan's GDP has contracted in the second quarter by -9.9% YoY (-7.9% QoQ), which is its third consecutive quarterly contraction, given that the last quarter of 2019 had already suffered a contraction due to the October 2019 tax hike. Quarterly growth must therefore recover, but very slightly, and positive year-on-year growth will not be seen until the second quarter of 2021. Economic momentum has only been supported thanks to fiscal and monetary expansion, as consumption and investment will continue to be curtailed by economic agents' precautions in the face of an uncertain future. The level of family savings is high (up to 9% of GDP in 2020), due to both reduced trade activity and due to beliefs (a culture of saving). Furthermore, Japan has managed to control pandemic infections rather effectively, which has limited lockdown and social distancing measures and, as a consequence, the knock-on impacts on economic performance (see Chart 1.2.7-c). Based on the above, we have adjusted our economic growth forecast for 2020 to -5.7%, and 2.6% in 2021, from the previous -6.0% and -2.8% respectively (see Table 1.2.7 and Charts 1.2.7-a and 1.2.7-b).

In this context of sluggish activity, inflation stood at 0.2% in September, with core inflation at -0.2%, and it is expected to remain very close to zero in the coming quarters, at least as long as demand does not strengthen. The Bank of Japan kept interest rates at -0.10% during its meeting in September and Haruhiko Kuroda, the governor of the Bank of Japan, has no intention of changing monetary policy for the time being. He has, however, indicated his willingness to align with government policies, showing a continuity with the previous governor. The central bank will continue the asset-purchasing program. With inflation so low, the trend will be to continue supporting the economy with expansionary monetary and fiscal policies.

Chart 1.2.7-a
Japan: GDP breakdown and forecasts



Source: MAPFRE Economics (based on data from the Statistics Bureau)

Chart 1.2.7-b
Japan: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on data from the Statistics Bureau)

Table 1.2.7
Japan: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	1.3	0.5	2.2	0.3	0.7	-5.7	2.6	-5.9	1.9
Domestic demand contribution	0.9	-0.1	1.6	0.3	0.9	-4.6	1.8	-4.8	1.4
External demand contribution	0.4	0.6	0.6	0.0	-0.2	-1.1	0.8	-1.0	0.5
Private consumption contribution	-0.1	-0.2	0.8	-0.0	0.1	-3.4	1.2	-3.5	1.1
Total investment contribution	0.4	-0.1	0.7	0.1	0.3	-1.2	0.3	-1.3	0.0
Public spending contribution	0.3	0.3	0.0	0.2	0.4	0.2	0.4	0.2	0.4
Private consumption (% YoY, average)	-0.2	-0.3	1.3	-0.0	0.2	-6.0	2.2	-6.2	2.0
Public consumption (% YoY, average)	1.5	1.4	0.1	0.9	1.9	1.1	1.7	1.1	1.7
Total investment (% YoY, average)	1.7	-0.3	3.0	0.6	1.3	-5.0	1.4	-5.5	0.2
Exports (YoY in %)	3.0	1.7	6.8	3.5	-1.6	-14.5	7.4	-14.6	4.7
Imports (YoY in %)	0.7	-1.6	3.4	3.7	-0.6	-8.3	1.9	-8.5	0.9
Unemployment rate (%, last quarter)	3.3	3.0	2.7	2.4	2.3	3.3	2.7	3.4	2.9
Inflation (% YoY, last quarter)	0.2	0.3	0.6	0.9	0.5	-1.0	0.0	-1.0	-0.4
Fiscal balance (% of GDP)	-3.6	-3.5	-3.0	-2.4	-2.6	-12.7	-9.0	-12.7	-9.2
Primary fiscal balance (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance (% of GDP)	-0.2	1.0	0.9	0.2	0.1	0.1	0.2	0.1	0.1
Current account balance (% of GDP)	3.1	3.9	4.2	3.6	3.6	2.9	3.5	3.0	3.5
Official interest rate (end of period)	0.04	-0.06	-0.06	-0.06	-0.07	-0.05	-0.12	-0.48	-0.50
3-month interest rate (end of period)	0.08	-0.05	-0.02	-0.07	-0.05	-0.04	-0.11	-0.48	-0.50
10-year interest rate (end of period)	0.27	0.04	0.05	0.01	-0.02	-0.02	-0.05	-0.16	-0.15
Exchange rate vs. USD (end of period)	120.50	116.80	112.90	110.83	109.12	105.89	106.07	106.81	106.58
Exchange rate vs. euro (end of period)	131.19	123.12	135.40	126.90	122.59	124.82	125.38	124.91	125.52
Private lending (% YoY, average)	2.0	2.2	4.2	2.9	2.4	5.8	3.0	5.7	2.1
Household lending (% YoY, average)	1.4	1.5	2.5	3.0	2.4	2.1	-0.7	2.1	-0.6
P.S. non-financial lending (% YoY, average)	0.4	1.8	2.2	1.9	3.4	7.8	1.6	7.8	1.6
P.S. financial lending (% YoY, average)	7.8	-0.2	8.0	6.3	3.0	15.6	-3.2	15.6	-3.0
Savings rate (as % pers. disp. income, avg.)	1.2	2.9	2.5	4.3	4.9	9.3	7.0	9.5	7.2

Source: MAPFRE Economics (based on data from the Statistics Bureau)
Forecast end date: October 16, 2020.

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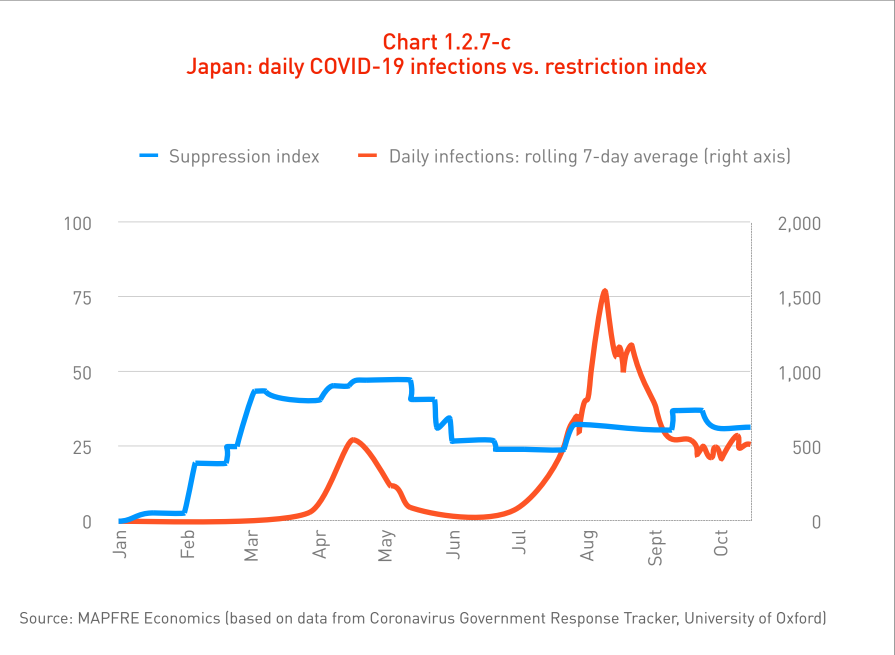
- Japan's new prime minister, Yoshihide Suga, must continue with the same economic policies as his predecessor.
- A -5.7% decline in GDP in 2020 and a weak rebound of 2.6% in 2021 is predicted.
- The Bank of Japan will continue to support the economy by purchasing assets.
- The government also plans to expand its investment and debt-issuing financing program.

Prime Minister Yoshihide Suga took office on September 16 after winning the Liberal Democratic Party's (LDP) elections to replace former Prime Minister Shinzō Abe, who resigned due to health reasons. The new prime minister's policy is expected to be one of continuity. It is worth noting that Suga's term will be short (until September 2021), as he is replacing Abe. Further elections must be held when the time comes.

The risks to Japan's economy are those of continued sluggishness due to weak demand and, consequently, low investment needs. Monetary policy has been expansionary for several years and already has very limited capacity to increase. Momentum can therefore only come from fiscal expansion, which, in turn, risks increasing the future burden on citizens at a time when an aging population and rising social security costs are already a concern.

Chart 1.2.7-c
Japan: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

1.2.8. Turkey

External vulnerability, the Achilles' heel.

- **Improved data on activity and consumption was recorded between the second and third quarters of the year, leading to a less pessimistic outlook for 2020.**
- **GDP growth has been revised to -2.7% for 2020; recovery in 2021 (4.6%) will be conditional on external vulnerability.**
- **Risks to the sustainability of the external position and the tension regarding the balance of payments will negatively affect the Turkish lira.**

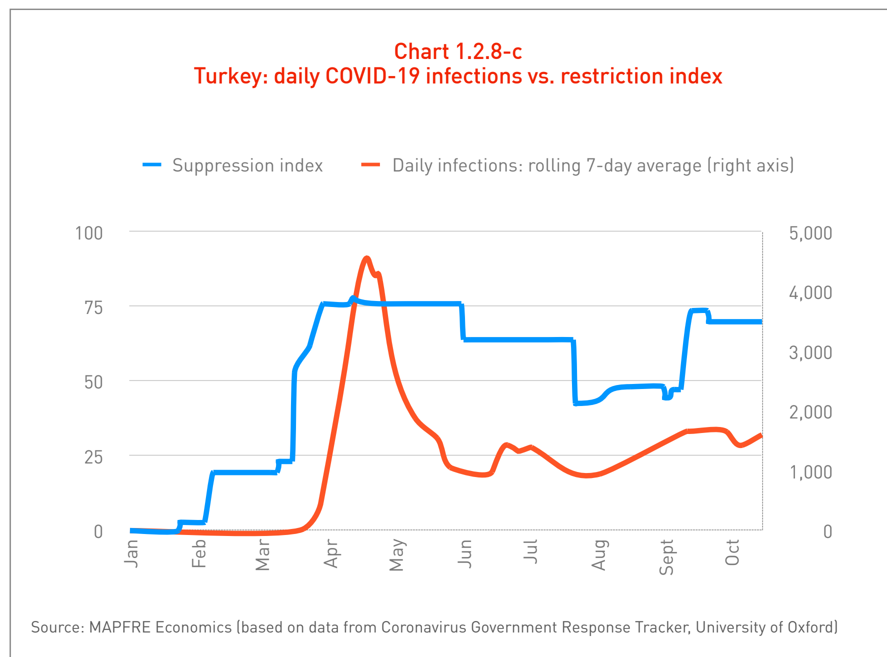
Following the contraction of the Turkish economy during the second quarter of the year (-10% YoY) as a result of the sharp depreciation of the lira and the effects of the pandemic, high frequency signals (mobility and credit card consumption) have been recorded, which indicate recovery during the third quarter.

However, we believe that this recovery is temporary and sustained by the relaxation of health restriction measures, which could be eased in line with new COVID-19 cases (see Chart 1.2.8-c). This, in addition to growing uncertainty regarding economic policy, suggests that following the pause in the third quarter, the economy will contract again during the fourth quarter of the year and into the next quarter. GDP growth is therefore expected to fall by -2.7% in 2020 and recover 4.6% in 2021 (see Table 1.2.8 and Charts 1.2.8-a and 1.2.8-b).

Furthermore, despite sluggish demand, strong external dependence in an environment of exchange-rate depreciation brought inflation to around 11.7% in September and core inflation to 11.3%. This indicates that inflation expectations are still a long way off from forming part of the Central Bank's objective. In light of strong exchange-rate depreciation and inflation far from the target area, Turkey's Central Bank tightened its monetary bias in September by raising its one-week repo rate by +200 basis points, to 10.25%, which, in terms of weighted cost of financing, represents an effective rate of more than 11%. This involves a shift in monetary stance that takes it to restrictive ground in the middle of the pandemic, which coincides with our view that 2020 will be complex in terms of activity.

In addition to the structural imbalances that have traditionally weighed on the Turkish lira (explained in Box 1.1.1-a and in the analysis of emerging exchange-rate vulnerability presented in our previous quarterly report[2]), there is also the recent drought in credit and portfolio flows in response to

Chart 1.2.8-c
Turkey: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

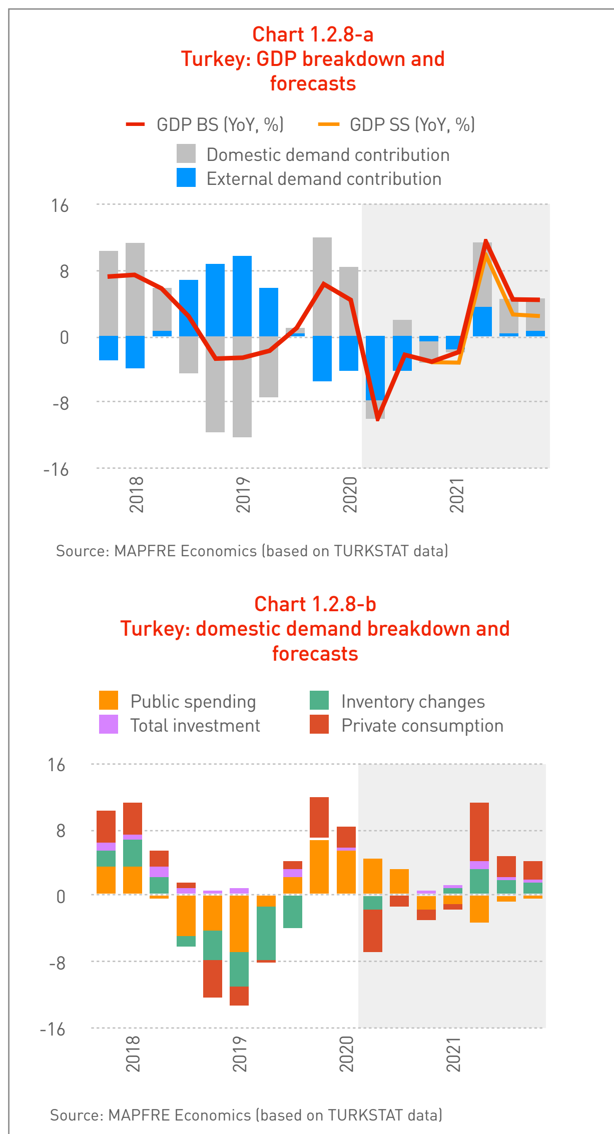


Table 1.2.8
Turkey: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	6.0	3.4	7.4	3.3	0.8	-2.7	4.6	-2.7	3.0
Domestic demand contribution	5.4	4.6	7.0	0.1	-1.9	1.5	3.9	1.5	3.3
External demand contribution	0.6	-1.1	0.4	3.2	2.6	-4.1	0.7	-4.2	-0.3
Private consumption contribution	3.3	2.3	3.5	0.6	0.8	-1.2	2.9	-1.2	2.6
Total investment contribution	2.6	0.7	2.4	0.2	-3.6	-0.5	1.9	-0.5	1.6
Public spending contribution	0.5	1.3	0.7	0.9	0.6	0.2	0.5	0.2	0.4
Private consumption (% YoY, average)	5.4	3.8	5.9	0.9	1.5	-2.0	4.9	-2.0	4.4
Public consumption (% YoY, average)	3.5	9.8	5.2	6.6	4.6	1.6	3.2	1.6	2.9
Total investment (% YoY, average)	9.1	2.4	8.2	0.5	-12.1	-2.0	7.5	-2.0	6.5
Exports (YoY in %)	3.2	-1.6	12.5	8.7	5.1	-17.6	13.7	-17.7	12.3
Imports (YoY in %)	0.7	3.0	10.5	-4.9	-4.2	-0.7	9.1	-0.8	8.0
Unemployment rate (%, last quarter)	10.5	12.1	10.3	12.3	13.3	14.6	12.1	14.6	12.7
Inflation (% YoY, last quarter)	8.8	8.5	11.9	20.3	11.8	11.1	8.8	11.1	8.4
Fiscal balance (% of GDP)	-1.1	-1.3	-1.6	-1.9	-2.9	-4.7	-2.8	-4.7	-2.9
Primary fiscal balance (% of GDP)	1.2	0.7	0.2	0.0	-0.6	-1.6	1.0	-1.6	0.9
Trade balance (% of GDP)	-5.7	-4.6	-6.8	-5.2	-2.2	-4.1	-4.3	-4.1	-4.3
Current account balance (% of GDP)	-3.2	-3.1	-4.7	-2.6	1.2	-4.2	-3.7	-4.2	-3.8
Official interest rate (end of period)	8.81	8.31	12.75	24.06	11.43	12.59	11.17	12.57	10.47
3-month interest rate (end of period)	11.47	9.90	14.61	24.07	10.76	12.76	11.27	12.84	11.56
10-year interest rate (end of period)	10.74	11.40	11.72	16.53	11.95	12.35	11.28	11.96	10.85
Exchange rate vs. USD (end of period)	2.92	3.52	3.79	5.29	5.95	7.89	8.13	7.89	8.19
Exchange rate vs. euro (end of period)	3.18	3.71	4.55	6.06	6.68	9.30	9.61	9.23	9.65
Private lending (% YoY, average)	22.9	13.1	20.9	20.2	8.5	23.9	6.6	23.9	6.5
Household lending (% YoY, average)	12.5	7.1	17.5	9.8	3.3	41.2	16.3	41.2	15.7
P.S. non-financial lending (% YoY, average)	29.9	14.7	24.3	20.9	5.4	25.9	5.5	25.9	3.8
P.S. financial lending (% YoY, average)	26.4	9.0	27.2	25.1	18.3	27.7	17.5	27.7	15.6
Savings rate (as % pers. disp. income, avg.)	28.3	32.8	30.9	30.1	28.6	21.4	24.8	21.4	24.5

Source: MAPFRE Economics (based on TURKSTAT data)
Forecast end date: October 16, 2020.

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the phase of strong global risk aversion, which has pushed the Turkish lira beyond the levels its fundamentals would currently indicate (around 7.80 TRY/USD). It is predicted to continue on this path for some time due to both idiosyncratic and global reasons. Moreover, the strong dollarization of dollar deposits and the dependence on flows in hard currencies exert even greater pressure on the currency.

1.2.9 Mexico

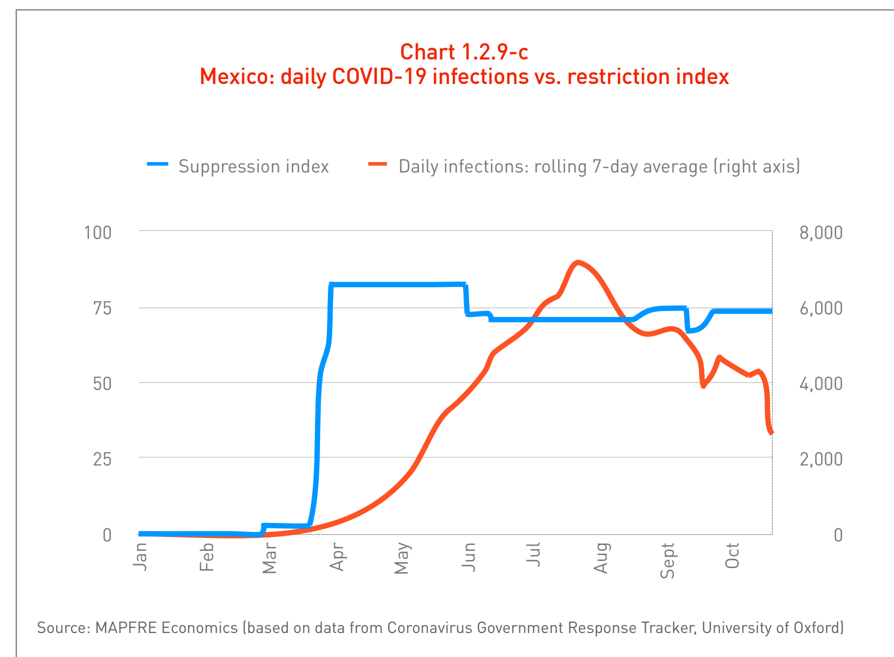
A sharp drop in growth in 2020 and no fiscal leeway to offset it.

The Mexican economy contracted by -18.7% YoY in the second quarter of the year, with sharp falls in all the headings of the national accounts as a result of the global shock and the direct and indirect effects of the pandemic that is yet to be controlled (see Chart 1.2.9-c). Although the latest indicators show relative stabilization in the third quarter, the coming recovery will be slow and fragile, and the Mexican economy will not return to 2019 levels until 2023, at best. We have therefore revised economic growth for 2020 downward to -9.6%, and have revised recovery in 2021 to 3.6% (see Table 1.2.9 and Charts 1.2.9-a and 1.2.9-b).

- **Based on activity data from the second quarter and advanced data from the third quarter, Mexico's GDP growth forecast for 2020 has been revised to -9.6%; weaker recovery is expected in 2021.**
- **The low price of crude oil and the fiscal effort made could force fiscal adjustments, while the margin for monetary stimuli is depleting.**
- **The depreciation of the peso throughout the crisis caused by the pandemic can be seen through inflation.**

Relatively controlled inflation and the stabilization of the peso at around 21.5 MXN/USD, together with the accommodative bias of the Federal Reserve, allowed the Bank of Mexico, at its meeting in September, to cut another 25 basis points in the intervention rate, accumulating 300 basis points of decline so far this year to the current rate of 4.25%, in a clear bias toward monetary laxity. These declines in support of economic activity have been made possible by relatively controlled inflation, which stood at 4.01% in September (just above the upper limit of the central bank's target range). However, additional room for further declines appears to be somewhat lacking, as exchange-rate stability is a factor that must be taken into account. Indeed, the interest rate cut in September has already led to a small adjustment in the currency's value.

Chart 1.2.9-c
Mexico: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

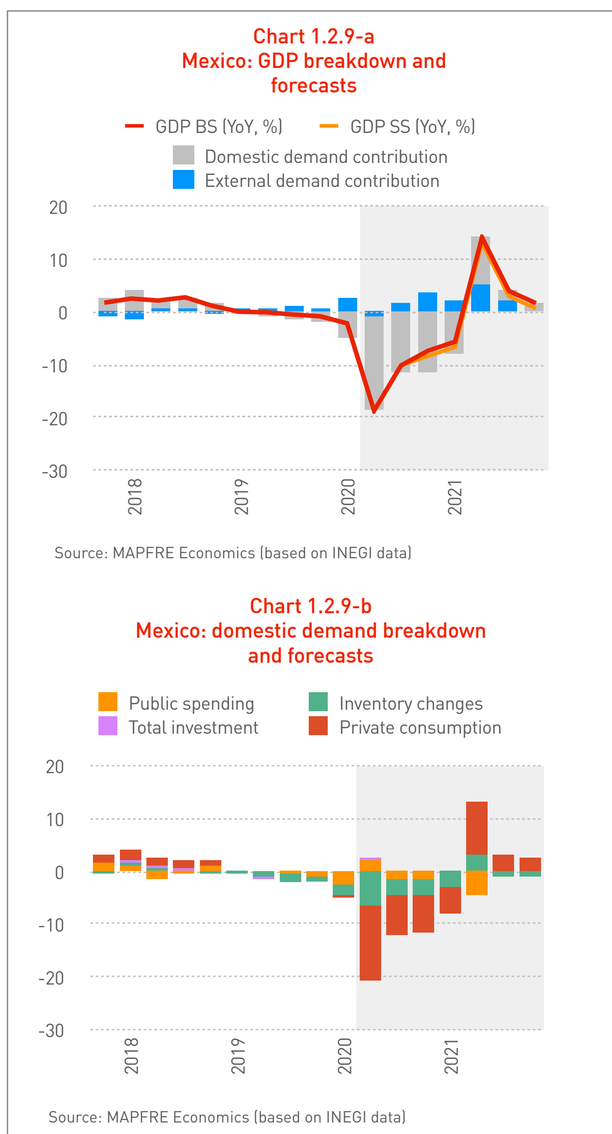


Chart 1.2.9-a
Mexico: GDP breakdown and forecasts

Source: MAPFRE Economics (based on INEGI data)

Chart 1.2.9-b
Mexico: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on INEGI data)

Table 1.2.9
Mexico: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS)		Stressed (SS)	
						2020(e)	2021(f)	2020(e)	2021(f)
GDP (% YoY, average)	3.3	2.4	2.3	2.2	-0.3	-9.6	3.6	-9.8	2.6
Domestic demand contribution	2.5	2.0	3.2	2.2	-1.2	-11.4	1.1	-11.7	1.2
External demand contribution	0.8	0.4	-0.9	-0.0	0.9	1.8	2.5	1.9	1.4
Private consumption contribution	1.8	2.3	2.3	1.6	0.3	-7.3	2.6	-7.4	2.8
Total investment contribution	1.0	0.2	-0.2	0.2	-1.0	-3.7	-0.5	-3.8	-0.4
Public spending contribution	0.2	0.3	0.1	0.3	-0.2	0.3	0.1	0.3	0.1
Private consumption (% YoY, average)	2.7	3.5	3.4	2.4	0.4	-10.7	4.0	-11.0	4.3
Public consumption (% YoY, average)	1.9	2.6	0.7	2.8	-1.4	2.4	0.6	2.4	0.6
Total investment (% YoY, average)	4.9	0.9	-1.1	1.0	-5.1	-19.0	-2.0	-19.8	-1.6
Exports (YoY in %)	8.6	3.6	4.3	5.9	1.5	-10.7	10.5	-10.9	5.1
Imports (YoY in %)	6.0	2.4	6.9	5.9	-0.9	-16.4	4.0	-16.8	1.5
Unemployment rate (%, last quarter)	4.2	3.5	3.3	3.3	3.4	5.2	5.0	5.3	5.4
Inflation (% YoY, last quarter)	2.1	3.4	6.8	4.8	2.8	3.7	2.7	3.7	2.4
Fiscal balance (% of GDP)	-3.4	-2.5	-1.1	-2.0	-1.7	-3.1	-3.8	-3.2	-3.9
Primary fiscal balance (% of GDP)	-1.2	-0.1	1.4	0.6	1.1	-0.0	-0.9	-0.0	-1.0
Trade balance (% of GDP)	-1.2	-1.2	-0.9	-1.1	0.4	2.1	4.4	2.2	3.4
Current account balance (% of GDP)	-2.7	-2.3	-1.8	-2.1	-0.3	1.1	3.1	1.1	2.1
Official interest rate (end of period)	3.25	5.75	7.25	8.25	7.25	4.00	4.00	4.05	2.25
3-month interest rate (end of period)	3.58	6.19	7.66	8.63	7.45	4.33	4.25	4.42	3.00
10-year interest rate (end of period)	6.28	7.42	7.66	8.70	6.84	5.79	5.70	5.52	5.37
Exchange rate vs. USD (end of period)	17.20	20.74	19.67	19.65	18.93	22.86	22.55	22.91	22.97
Exchange rate vs. euro (end of period)	18.73	21.86	23.59	22.50	21.26	26.95	26.65	26.79	27.06
Private lending (% YoY, average)	13.6	16.3	12.1	10.4	8.9	-1.2	8.1	-1.4	6.9
Household lending (% YoY, average)	8.4	12.8	10.0	8.4	6.2	3.8	8.3	3.8	7.8
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	-11.4	3.5	1.7	-0.8	6.2	11.4	14.3	11.1	13.1
Savings rate (as % pers. disp. income, avg.)	14.7	12.8	10.7	12.4	16.6	25.4	21.4	25.5	20.7

Source: MAPFRE Economics (based on INEGI data)
Forecast end date: October 16, 2020.

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The government has presented the 2021 budgets with a tone of fiscal austerity, projecting a primary deficit of zero in a context of low fiscal and oil revenues (by price and quantity), meaning that there is no fiscal leeway to mitigate new incentives relating to the pandemic. Like the other Latin American countries, debt issuance is currently the only source for financing economic containment measures against COVID-19, although the Mexican government has repeatedly reiterated its resistance to raising debt levels.

The risks to Mexico's economy lie, on the one hand, in the external context of contraction and lower oil prices and, on the other, in domestic consumption, which has weakened significantly due to the pandemic and the low level of public aid implemented.

1.2.10 Brazil

Economic improvement in light of eased lockdown measures.

- **A less strict lockdown and resumed activity have improved Brazil's GDP growth forecast in 2020 to -5.3%.**
- **Despite this resumption, activity will take a long time to return to the levels seen prior to COVID-19.**
- **The crisis jeopardized the structural reform program and, therefore, long-term sovereign stability.**

The Brazilian economy contracted by -11.4% YoY in the second quarter of the year, with a lower drop than in other countries, thanks to greater laxity in the lockdown and social distancing measures implemented to tackle the COVID-19 pandemic (see Chart 1.2.10-c). However, pre-pandemic activity levels are still a long way off. The GDP growth forecast for 2020 has therefore been revised upward to -5.3%, from -7.5% in our previous report (see Table 1.2.10 and Charts 1.2.10-a and 1.2.10-b).

It is worth noting that Brazil also experienced tensions in their balance of payments, recording significant net portfolio outflows when transitioning from the first quarter of the year to the second. However, these outflows tended to stabilize in the third quarter, not only with the easing of global risk aversion but also with the repatriation of domestic flows, which allowed for a greater buffer in Brazil's financial account. The current account, for its part, was more stable thanks to the strong adjustment on imports and a fairly low level of suffering on the export side given its lower dependence on raw materials compared to other economies in the region (the current account is now at the stable deficit threshold that we defined in our analysis in this regard[3]). This makes it possible to predict that it will support the Brazilian real's stability during future global shocks. The current account balance, which is approaching equilibrium, stood at -1.6% in August, with exports maintaining a stable trend in the second quarter (+0.5%) and imports declining (-15%).

Furthermore, inflation stood at 2.4% in August and is rebounding especially due to food and beverages. The central bank forecasts inflation of 2.1% in 2020 and 3.0% in 2021. The Monetary Policy Committee has continued its intention to maintain monetary stimuli, which would only be altered if there was a significant deviation from the inflation target. The Central Bank therefore maintained the Selic rate at 2.00% in September, indicating that there are inflation risks in both directions.

The risks to currency and inflation also depend, to some extent, on fiscal deficit outlooks and on markets' perception of the commitment to pursue the necessary structural reforms for the Brazilian economy. The increase

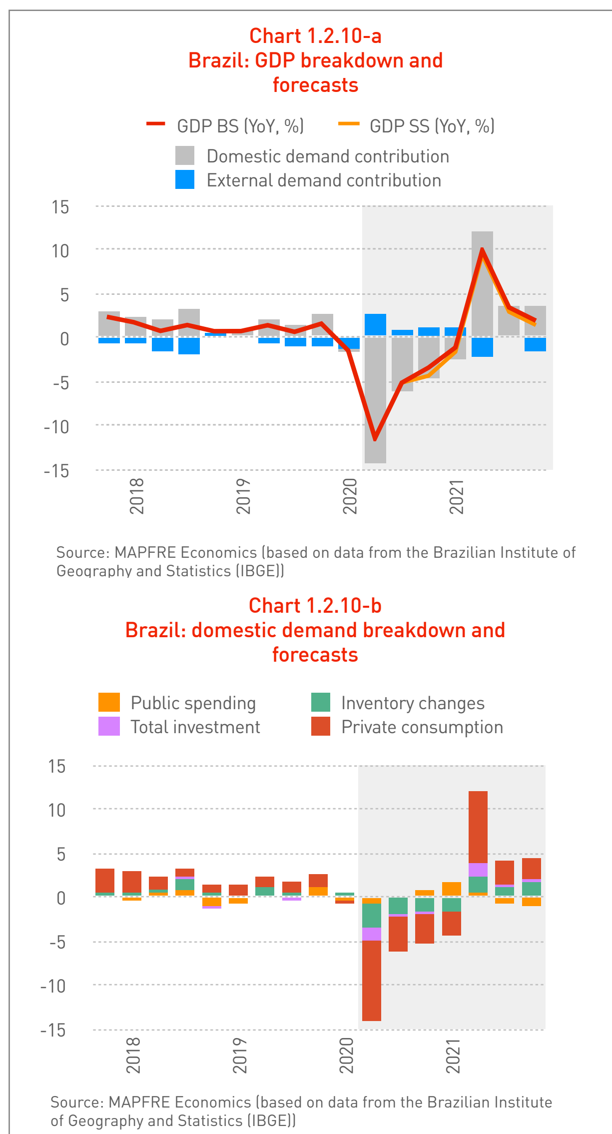

Chart 1.2.10-a
Brazil: GDP breakdown and forecasts

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics (IBGE))

Chart 1.2.10-b
Brazil: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics (IBGE))

Table 1.2.10
Brazil: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2015	2016	2017	2018	2019	2020(e)	2021(f)	2020(e)	2021(f)
GDP (% YoY, average)	-3.5	-3.5	1.6	1.2	1.1	-5.3	3.6	-5.6	3.1
Domestic demand contribution	-7.1	-5.3	2.0	2.0	1.7	-6.3	4.2	-6.5	3.7
External demand contribution	3.6	1.9	-0.4	-0.8	-0.6	0.9	-0.6	1.0	-0.7
Private consumption contribution	-2.2	-2.6	1.3	1.4	1.3	-4.3	2.6	-4.4	2.4
Total investment contribution	-2.9	-2.3	-0.4	0.6	0.4	-1.4	0.8	-1.5	0.5
Public spending contribution	-0.2	0.0	-0.1	0.1	-0.1	-0.5	0.6	-0.5	0.6
Private consumption (% YoY, average)	-3.2	-3.8	2.0	2.1	1.8	-6.2	3.8	-6.4	3.6
Public consumption (% YoY, average)	-1.4	0.2	-0.7	0.4	-0.4	-2.9	3.1	-2.9	3.1
Total investment (% YoY, average)	-14.0	-12.1	-2.2	3.7	2.3	-8.4	5.2	-9.1	3.7
Exports (YoY in %)	6.9	0.8	5.4	3.4	-2.4	0.5	3.1	0.4	1.3
Imports (YoY in %)	-14.0	-9.8	7.3	7.7	1.2	-6.0	7.5	-6.2	6.4
Unemployment rate (%, last quarter)	8.9	12.0	11.8	11.6	11.0	13.7	11.2	13.8	11.4
Inflation (% YoY, last quarter)	10.7	6.3	2.9	3.7	4.3	2.0	2.9	2.0	2.7
Fiscal balance (% of GDP)	-10.2	-9.0	-7.8	-7.1	-5.9	-18.0	-8.1	-18.1	-8.3
Primary fiscal balance (% of GDP)	-1.9	-2.5	-1.7	-1.6	-0.9	-13.7	-4.1	-13.8	-4.3
Trade balance (% of GDP)	1.0	2.5	3.1	2.8	2.2	4.1	3.4	4.1	3.4
Current account balance (% of GDP)	-3.0	-1.3	-0.7	-2.2	-2.8	0.3	-1.3	0.3	-1.4
Official interest rate (end of period)	14.25	13.75	7.00	6.50	4.50	1.75	2.50	1.75	0.25
3-month interest rate (end of period)	14.15	13.65	6.90	6.40	4.40	1.83	2.75	1.91	0.63
10-year interest rate (end of period)	16.10	11.36	10.24	9.28	6.86	7.67	7.79	7.39	7.48
Exchange rate vs. USD (end of period)	3.90	3.26	3.31	3.87	4.03	5.53	5.10	5.55	5.59
Exchange rate vs. euro (end of period)	4.25	3.43	3.97	4.44	4.53	6.52	6.46	6.50	6.58
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	10.2	4.4	4.7	7.0	10.8	8.2	13.5	8.2	13.3
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (as % pers. disp. income, avg.)	18.5	17.2	17.4	16.1	15.8	17.3	17.2	17.4	17.3

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics (IBGE))
Forecast end date: October 16, 2020.

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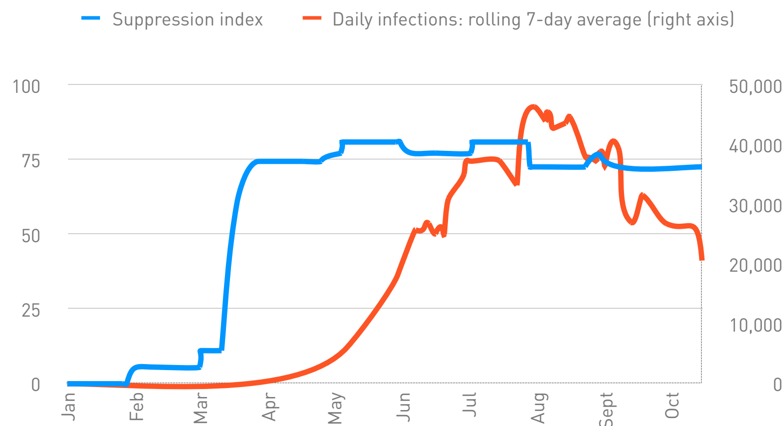
Chart 1.2.10-c
Brazil: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

in spending (the government has implemented a budget of 5.6% of GDP to combat the economic effects of the pandemic), along with the fall in fiscal revenues, could bring the deficit to record-breaking levels of 18% of GDP, and total government debt could reach 91% of GDP. In terms of the risks to the Brazilian economy—in addition the evolution pf the pandemic—the focus is therefore on the uncertainties that the gradual reduction of exceptional government aid will generate, as well as on the fact that the pandemic has not derailed the path of structural reforms that remain essential to the balance of sovereign accounts in the long-term.

1.2.11 Argentina

A difficult exit from the crisis.

- **The Argentinian economic crisis, in addition to the crisis caused by the pandemic, remains financial and economic.**
- **Monetization of the fiscal deficit has exerted pressure on the currency, which will continue to depreciate.**
- **The forecast for GDP contraction has been lowered to -10.4% in 2020.**

Despite its failure to control the number of COVID-19 infections, Argentina has seen the strictest lockdown measures (see Chart 1.2.11-c). This has caused GDP to fall by -19.1% YoY in the second quarter (-16.2% QoQ), with a sharp contraction in domestic demand due to the tightest restrictions on mobility in the world, which have impacted construction, imports and consumption without public sector support (public spending -10%). We have therefore revised our estimate for GDP growth for 2020 downward to -10.4%, given the contraction in the second quarter and the difficult prospects for recovery in the third quarter, with a partial recovery of 6.3% 2021 (see Table 1.2.11 and Charts 1.2.11-a and 1.2.11-b). However, recovery will be only partial and will begin to drift away, given the difficulties in stimulating demand as a result of the crisis, which is both a health crisis and a financial crisis.

In the face of the collapse in demand and thanks to the current exchange rate flexibility, the trade balance and the current account have entered positive ground, where we think it will remain for the next few months. The primary fiscal balance, for its part, deteriorated despite efforts to shore up fiscal consolidation, given the burden of its automatic stabilizers. We believe, however, that this will moderate as tax revenues stabilize. The country has restructured debt issued under foreign legislation for an amount of 66 billion dollars, having managed to decrease interest rates to

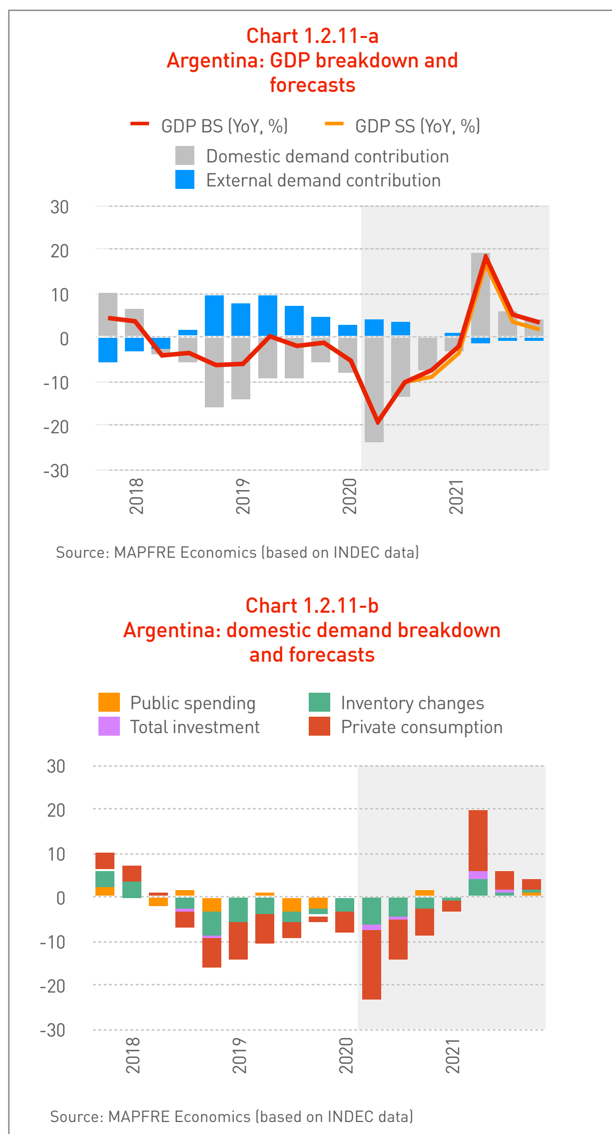


Chart 1.2.11-a
Argentina: GDP breakdown and forecasts

Source: MAPFRE Economics (based on INDEC data)

Chart 1.2.11-b
Argentina: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on INDEC data)

Table 1.2.11
Argentina: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	2.7	-2.0	2.8	-2.4	-2.1	-10.4	6.3	-10.8	4.7
Domestic demand contribution	4.4	-1.6	6.4	-3.9	-9.4	-13.1	6.6	-13.5	4.8
External demand contribution	-1.7	-0.4	-3.6	1.5	7.3	2.7	-0.3	2.7	-0.1
Private consumption contribution	2.5	-0.5	3.0	-1.6	-4.8	-8.9	4.5	-9.1	3.6
Total investment contribution	0.7	-1.1	2.5	-1.2	-3.2	-4.2	1.1	-4.4	0.3
Public spending contribution	0.9	-0.1	0.4	-0.2	-0.1	-0.4	0.7	-0.4	0.7
Private consumption (% YoY, average)	3.7	-0.7	4.2	-2.4	-6.3	-12.6	6.7	-12.9	5.4
Public consumption (% YoY, average)	6.9	-0.5	2.7	-1.6	-1.0	-3.1	4.5	-3.1	4.5
Total investment (% YoY, average)	3.4	-5.7	13.2	-4.8	-15.5	-24.8	8.5	-25.9	2.6
Exports (YoY in %)	-2.8	6.0	2.6	0.8	9.1	-8.9	6.2	-9.0	4.5
Imports (YoY in %)	4.9	6.1	15.5	-3.6	-18.5	-19.8	8.3	-20.2	5.9
Unemployment rate (%, last quarter)	7.0	7.6	7.2	9.1	8.9	11.0	9.1	11.3	9.7
Inflation (% YoY, last quarter)	26.0	37.5	23.3	47.4	52.2	38.7	40.0	38.6	39.4
Fiscal balance (% of GDP)	-5.9	-5.8	-5.9	-5.0	-3.8	-8.9	-5.9	-9.0	-6.2
Primary fiscal balance (% of GDP)	-3.9	-4.2	-3.8	-2.3	-0.4	-6.9	-4.4	-6.9	-4.7
Trade balance (% of GDP)	-0.1	0.8	-0.8	-0.1	4.1	5.6	4.4	5.6	4.4
Current account balance (% of GDP)	-2.7	-2.7	-4.8	-5.0	-0.9	2.5	1.7	2.5	1.7
Official interest rate (end of period)	33.00	24.75	28.75	59.25	55.00	38.00	37.97	37.97	37.64
3-month interest rate (end of period)	23.50	26.23	27.44	56.76	45.13	25.07	27.01	25.22	27.26
10-year interest rate (end of period)	6.65	7.00	5.91	10.86	19.36	14.23	7.91	14.12	7.70
Exchange rate vs. USD (end of period)	13.04	15.89	18.65	37.70	59.89	81.94	113.35	82.28	114.94
Exchange rate vs. euro (end of period)	14.20	16.75	22.37	43.17	67.28	96.60	133.99	96.22	135.36
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (as % pers. disp. income, avg.)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: MAPFRE Economics (based on INDEC data)
Forecast end date: October 16, 2020.

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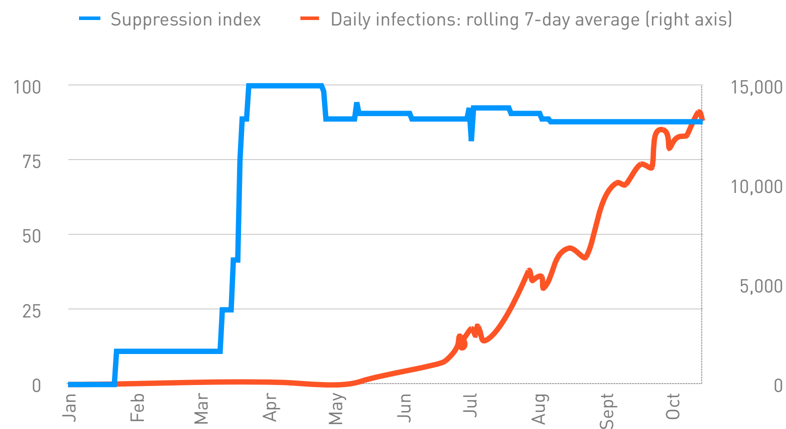
Chart 1.2.11-c
Argentina: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

3% from 7% and having deferred principal repayment of 38 billion dollars, which was due in 10 years. Despite efforts to dominate the twin deficit problem (the fiscal deficit and the current account deficit) in the context of the global crisis, the Argentinian economy's structural problems will persist. The Central Bank is monetizing its fiscal deficit without reserves, contributing to the expansion of the monetary supply (M3 stood at 88% in September); the persistence of inflation therefore continues to support the currency's devaluation.

The Central Bank's benchmark interest rate (the seven-day LELIQ) has remained stable at 38% since March. We do not expect any changes to official rates given that there is no margin to do so. With an M2 monetary base that has almost doubled compared to the previous year (90% growth), restrictions on access to the official dollar market due to the low level of reserves and the use of parallel dollar markets, imports may become more expensive and inflation will remain high. In this regard, inflation in August stood at 35.3%. The monetary stimulus via state deficit financing is already highly expansionary.

The currency continues its inevitable depreciation, as the money supply expands and was approaching 76 ARS/USD at the end of September. We therefore expect inflation to be around 40% by the end of the year. With bonds currently in default, the capacity to expand credit is diminished, and a continuation of Treasury financing by the Central Bank appears to be the main alternative. Argentina needs a fiscal consolidation plan, a curb on monetary expansion, and an agreement with the IMF. All of these requirements will be rather difficult and will take time, so macroeconomic stability remains high risk.

1.2.12 China

Economic revival in China now a reality.

- **GDP growth of 1.9% is forecast in 2020, with activity returning to pre-pandemic levels by the end of the year (one year after its inception).**
- **In a world with disrupted value chains and significant domestic demand to satisfy, 2021 could entail growth in Chinese GDP of around 7.9%.**

GDP grew by 3.2% YoY in the second quarter, which was better than expected thanks to China's ability to control the pandemic (see Chart 1.2.12-c), to growing external demand that lacked another source of supply (hindered value chains), and to demand for real goods and domestic services (China focused on attracting domestic tourists while the world was in quarantine). All high-frequency indicators point to a vigorous and sustained recovery (sales of cars, cement, houses, hotel

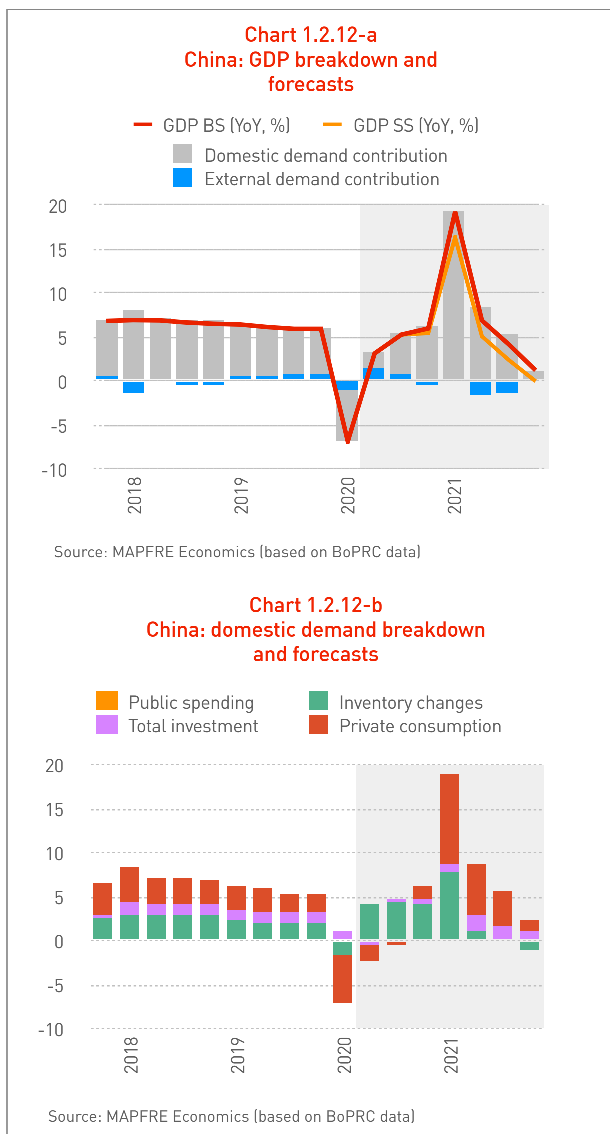


Table 1.2.12
China: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	7.0	6.9	7.0	6.8	6.1	1.9	7.9	1.8	6.0
Domestic demand contribution	6.5	7.7	6.6	7.3	5.4	1.6	8.5	1.5	6.4
External demand contribution	0.5	-0.9	0.3	-0.5	0.7	0.3	-0.6	0.3	-0.5
Private consumption contribution	3.2	3.3	3.6	3.2	2.4	-1.6	5.3	-1.6	4.6
Total investment contribution	2.3	3.1	2.5	3.0	2.1	2.8	2.0	2.7	0.7
Public spending contribution	1.7	1.3	0.4	1.2	1.2	0.4	1.3	0.4	1.3
Private consumption (% YoY, average)	8.6	8.7	9.4	8.2	5.9	-3.8	14.1	-3.9	12.1
Public consumption (% YoY, average)	11.1	8.0	2.3	7.8	7.5	2.5	8.5	2.5	8.5
Total investment (% YoY, average)	5.3	7.3	5.9	7.1	5.0	6.8	4.6	6.6	1.5
Exports (YoY in %)	0.4	1.8	7.0	4.5	2.4	-1.0	5.1	-1.1	2.8
Imports (YoY in %)	0.2	3.3	8.3	6.9	-0.8	-2.2	7.7	-2.4	4.1
Unemployment rate (%, last quarter)	3.3	3.8	3.8	3.7	3.8	4.9	3.7	5.0	4.2
Inflation (% YoY, last quarter)	1.5	2.2	1.8	2.2	4.3	1.9	2.4	1.9	2.2
Fiscal balance (% of GDP)	-3.6	-4.3	-4.8	-4.7	-5.5	-9.3	-7.0	-9.3	-7.6
Primary fiscal balance (% of GDP)	-1.5	-1.6	-1.8	-1.5	-2.1	-5.8	-3.7	-5.8	-4.3
Trade balance (% of GDP)	5.3	4.4	3.9	2.8	3.0	3.7	2.5	3.7	2.7
Current account balance (% of GDP)	2.8	1.8	1.6	0.2	1.0	2.4	1.1	2.4	1.3
Official interest rate (end of period)	3.00	3.00	3.25	3.30	3.25	2.95	2.74	2.89	1.81
3-month interest rate (end of period)	3.05	4.25	5.53	3.70	3.20	2.77	2.56	2.72	1.63
10-year interest rate (end of period)	2.82	3.05	3.91	3.26	3.15	3.13	3.39	2.78	2.89
Exchange rate vs. USD (end of period)	6.49	6.94	6.51	6.88	6.99	6.77	6.77	6.78	6.87
Exchange rate vs. euro (end of period)	7.07	7.32	7.80	7.87	7.85	7.99	8.00	7.93	8.09
Private lending (% YoY, average)	14.7	13.8	13.1	12.9	13.1	13.2	12.4	13.3	12.7
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (as % pers. disp. income, avg.)	40.6	39.3	38.7	37.9	38.2	41.0	38.6	41.0	39.4

Source: MAPFRE Economics (based on BoPRC data)
Forecast end date: October 16, 2020.

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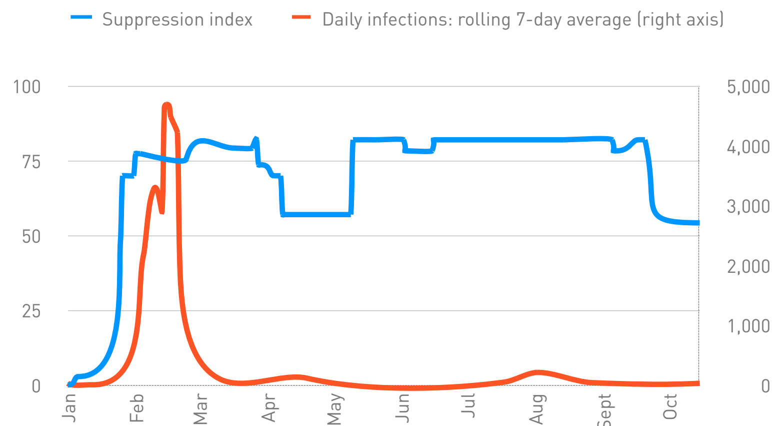
Chart 1.2.12-c
China: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

occupancy and mobility). We have therefore revised our GDP estimate for 2020 in our central scenario upward to 1.9%. China will therefore reach pre-pandemic levels in 2021, before the rest of the world, with estimated growth of 7.9% (see Table 1.2.12 and Charts 1.2.12-a and 1.2.12-b).

Inflation stood at 2.4% in August (2.7% in the second quarter) and is expected to reach 2.0% by the end of the year. The current account stood at 1.3% of GDP in the second quarter thanks to strong growth in net exports, particularly the substitution of foreign tourism by domestic tourism. This, coupled with a curb on the drainage of net portfolio and credit flows, has sustained the renminbi. The currency has increased in value from 7.15 to the dollar as seen 3 months ago, to 6.70 today.

It is worth noting that China is failing to comply with the import quotas provided for in the phase-one trade agreement and is therefore jeopardizing reaching a complete and stable agreement with the United States. Trade tensions are therefore expected to increase, unless the November election results in an administration that is willing to tackle the problem of America's trade imbalance through other instruments.

1.2.13 Indonesia

The pandemic is still accelerating and at risk of extending into 2021.

- Indonesia's GDP is forecast to fall by -1.7% in 2020, owing to continued weak economic activity in the second half of the year.
- The central bank plans to continue supporting recovery through macro-quantitative measures.
- The currency seems to have found a balance of around 14,700 IDR/USD.

Indonesia's GDP shrank by -5.3% YoY in the second quarter (-4.2% compared to the previous quarter), with exports falling by -11.7% and imports falling by -17.0% YoY. Other items have also revealed a bleak outlook, with private demand falling by -5.5%, government spending by -6.9% and investment by -8.6%. The COVID-19 crisis in Indonesia has evolved differently to the Europe; spread has been slower and the country is still riding its first wave. However, the rate of infection is now beginning to increase significantly, with more than 4,000 new cases a day (see Chart 1.12.13-c). This distinctive feature suggests that reactivation is still not up for discussion and activity will remain rather limited in 2020, which places the recovery horizon into 2021, though this depends on the evolution of the pandemic. Our forecast for GDP growth in 2020 predicts a contraction of -1.7%, due to continued restricted activity, i.e. the economy will remain

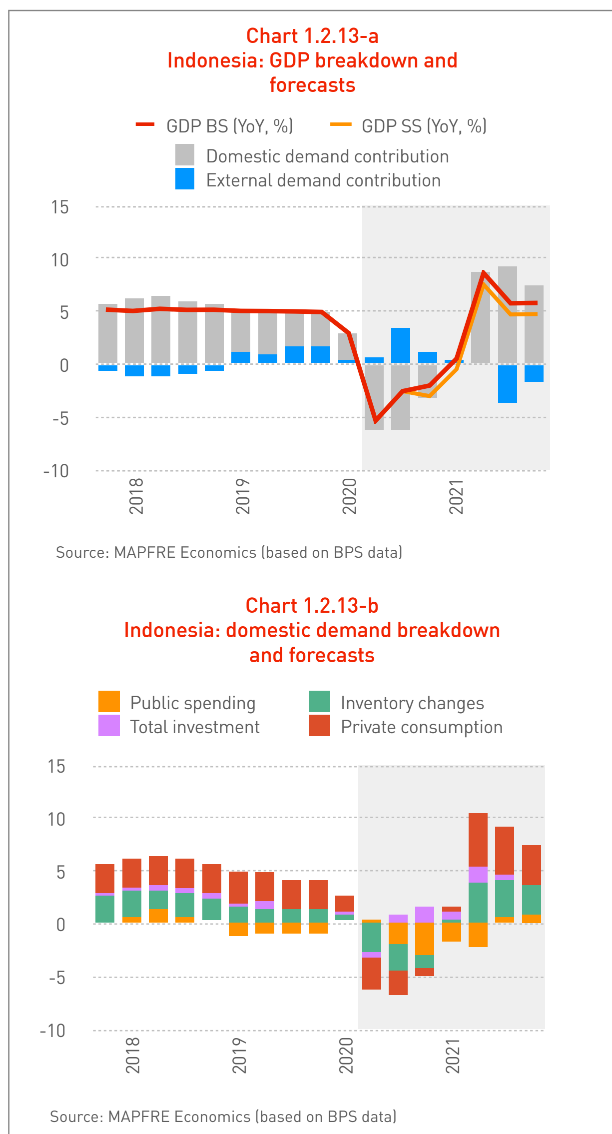


Chart 1.2.13-a
Indonesia: GDP breakdown and forecasts

Source: MAPFRE Economics (based on BPS data)

Chart 1.2.13-b
Indonesia: domestic demand breakdown and forecasts

Source: MAPFRE Economics (based on BPS data)

Table 1.2.13
Indonesia: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	4.9	5.0	5.1	5.2	5.0	-1.7	5.2	-2.0	4.2
Domestic demand contribution	3.9	4.9	4.8	6.1	3.6	-3.2	6.3	-3.5	5.3
External demand contribution	0.9	0.1	0.3	-0.9	1.4	1.5	-1.1	1.5	-1.1
Private consumption contribution	2.7	2.8	2.8	2.8	2.9	-1.2	3.6	-1.3	3.1
Total investment contribution	1.6	1.5	2.0	2.2	1.5	-1.4	2.6	-1.6	2.0
Public spending contribution	0.5	-0.0	0.2	0.4	0.3	0.5	0.7	0.5	0.7
Private consumption (% YoY, average)	4.8	5.0	5.0	5.1	5.2	-2.1	6.6	-2.4	5.7
Public consumption (% YoY, average)	4.9	0.7	2.0	4.7	3.7	5.8	9.4	5.8	9.4
Total investment (% YoY, average)	5.0	4.5	6.1	6.7	4.5	-4.4	8.3	-4.9	6.4
Exports (YoY in %)	-2.1	-1.6	9.0	6.6	-0.9	-6.5	5.0	-6.6	3.1
Imports (YoY in %)	-6.2	-2.4	8.1	12.1	-7.7	-12.7	10.1	-13.1	7.7
Unemployment rate (%, last quarter)	5.8	5.5	5.3	5.2	5.1	7.7	5.7	7.9	6.5
Inflation (% YoY, last quarter)	4.8	3.3	3.5	3.3	2.7	1.4	2.3	1.4	2.3
Fiscal balance (% of GDP)	-2.6	-2.5	-2.6	-1.7	-2.2	-6.7	-5.8	-6.7	-6.0
Primary fiscal balance (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance (% of GDP)	1.6	1.6	1.9	-0.0	0.3	1.6	1.2	1.7	1.3
Current account balance (% of GDP)	-2.0	-1.8	-1.6	-2.9	-2.7	-1.58	-2.38	-1.53	-2.30
Official interest rate (end of period)	6.25	4.75	4.25	6.00	5.00	4.28	4.30	4.15	3.66
3-month interest rate (end of period)	8.86	7.46	5.48	7.70	5.51	4.27	4.73	4.34	4.91
10-year interest rate (end of period)	8.81	7.85	6.30	7.90	7.05	6.81	6.90	6.48	6.46
Exchange rate vs. USD (end of period)	13,836	13,525	13,484	14,380	13,883	14,852	13,947	14,892	14,094
Exchange rate vs. euro (end of period)	15,063	14,257	16,171	16,465	15,596	17,507	16,487	17,415	16,598
Private lending (% YoY, average)	10.6	7.8	8.2	10.8	8.8	2.9	12.1	2.8	11.7
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	32.0	10.1	15.1	5.6	-3.0	2.3	7.2	2.0	6.2
Savings rate (as % pers. disp. income, avg.)	17.0	17.0	17.0	17.1	17.0	17.3	16.8	17.4	16.7

Source: MAPFRE Economics (based on BPS data)
Forecast end date: October 16, 2020.

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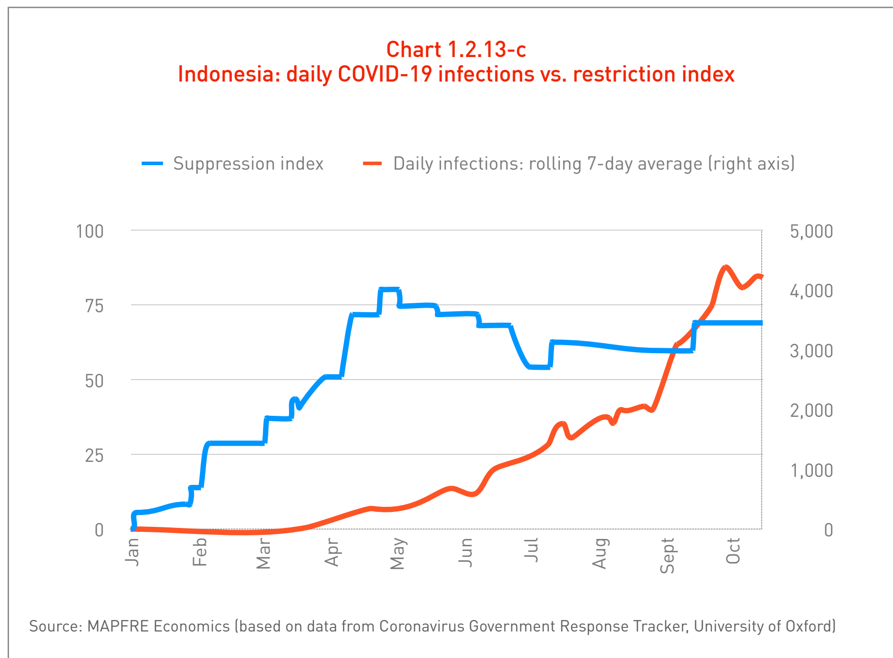
Chart 1.2.13-c
Indonesia: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

below 2019 levels throughout 2020. Growth may return in 2021 (5.2% in our forecast), but this will depend on the evolution of the pandemic and the restoration of conditions that allow demand to recover (see Table 1.2.13 and Charts 1.2.13-a and 1.2.13-b).

Inflation rose to 1.4% in September, up from 1.3% in August, reflecting weak demand, which will give the central bank room to keep interest rates down. The Central Bank of Indonesia kept rates stable at 4.0% at its meeting in September, after having lowered them four times this year (accumulating -100 basis points). The Central Bank said that it kept rates stable to help with the currency's stability and that the role of quantitative support measures is now more important than interest rate levels. Looking ahead, the central bank plans to continue taking accommodative macro-quantitative measures to aid economic recovery, a shift from its previous focus on minimizing risks in the finance sector.

A public deficit of 6.7% of GDP, which is significantly higher than the usual range of 2–3%, is forecast as a result of spending on economic support measures and falling revenue due to lower economic activity. Bearing in mind that the pandemic is still in its first wave and the peak of infections is close, we forecast a high risk of the disease extending into 2021. Beyond the public health risk, there is the risk that consumer confidence and tourism activity will still take a long time to recover.

1.2.14 Philippines

Difficult return to normal in environment with fewer remittances.

The Philippines' GDP contracted by -15.2% QoQ (-16.5% YoY) in the second quarter of the year due to the severity of government-imposed closures to control the pandemic, for which the number of infections appears to have begun to decline (see Chart 1.2.14-c). Activity in the third quarter should only be slightly higher than the level observed in the second quarter, as re-opening has been very gradual. Real activity data has therefore led us to revise our forecast for 2020 down again to -7.8%, from -6.8% in our previous report, considering recovery with growth of around 7.6% in 2021 (see Table 1.2.14 and Charts 1.2.14-a and 1.2.14-b). President Rodrigo Duterte's government launched a second aid package worth 140 billion Philippine pesos (0.8% of GDP), which, in addition to the first package, amounts to 4.1% of GDP. This, combined with financing guarantees, amounts to around 7.8% of GDP.

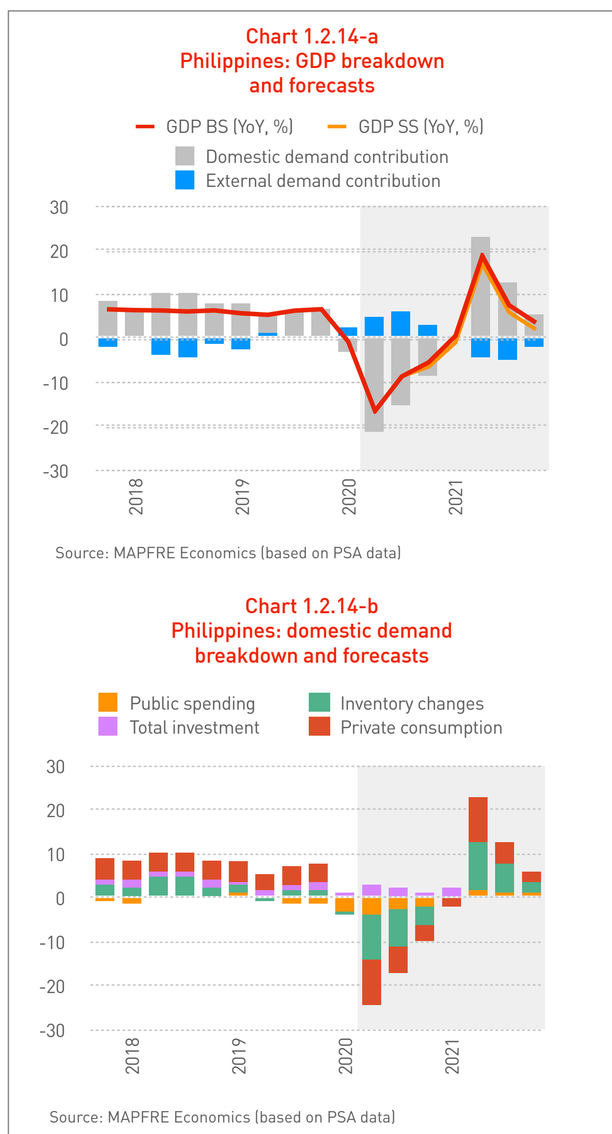


Table 1.2.14
Philippines: main macroeconomic aggregates

	2015	2016	2017	2018	2019	Baseline (BS) 2020(e)	Baseline (BS) 2021(f)	Stressed (SS) 2020(e)	Stressed (SS) 2021(f)
GDP (% YoY, average)	6.3	7.2	6.9	6.3	6.0	-7.8	7.6	-8.1	6.0
Domestic demand contribution	8.3	10.9	7.8	8.6	6.1	-11.9	10.4	-12.2	8.6
External demand contribution	-2.0	-3.8	-0.9	-2.3	-0.1	4.1	-2.8	4.2	-2.6
Private consumption contribution	4.7	5.3	4.4	4.2	4.3	-5.1	3.9	-5.2	2.9
Total investment contribution	2.8	4.6	2.6	3.3	1.1	-5.9	5.0	-6.1	4.2
Public spending contribution	0.9	1.0	0.7	1.5	1.1	1.9	0.5	1.9	0.5
Private consumption (% YoY, average)	6.4	7.2	5.9	5.8	5.9	-7.1	5.5	-7.4	4.1
Public consumption (% YoY, average)	8.7	9.1	6.7	13.5	9.8	14.9	4.1	14.9	4.1
Total investment (% YoY, average)	13.5	21.1	10.6	12.9	4.1	-21.9	24.5	-22.4	20.9
Exports (YoY in %)	10.0	9.2	17.4	11.9	2.4	-21.8	18.0	-21.9	15.8
Imports (YoY in %)	15.0	18.9	15.1	14.6	2.0	-25.0	21.3	-25.3	19.2
Unemployment rate (%, last quarter)	5.6	4.7	5.0	5.1	4.5	9.8	7.8	9.8	7.9
Inflation (% YoY, last quarter)	0.3	2.0	3.0	5.9	1.5	2.1	2.7	2.1	2.3
Fiscal balance (% of GDP)	-0.9	-2.3	-2.1	-3.1	-3.4	-7.2	-6.9	-7.3	-7.3
Primary fiscal balance (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance (% of GDP)	-7.6	-11.2	-12.2	-14.7	-13.1	-9.6	-13.0	-9.6	-12.8
Current account balance (% of GDP)	2.4	-0.4	-0.7	-2.6	-0.9	2.1	-2.2	2.1	-2.0
Official interest rate (end of period)	4.00	3.00	3.00	4.75	4.00	2.34	1.21	2.30	0.91
3-month interest rate (end of period)	3.03	2.50	3.22	5.03	3.97	2.04	1.55	2.16	2.06
10-year interest rate (end of period)	4.10	4.63	5.70	7.05	4.44	2.90	2.76	2.71	2.48
Exchange rate vs. USD (end of period)	47.17	49.81	49.92	52.72	50.74	48.08	48.51	48.12	48.67
Exchange rate vs. euro (end of period)	51.35	52.51	59.87	60.37	57.01	56.68	57.34	56.27	57.31
Private lending (% YoY, average)	12.8	15.3	17.6	16.8	9.5	6.6	12.3	6.5	11.5
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	3.9	8.5	9.4	10.3	6.9	-6.5	10.7	-6.8	9.2
Savings rate (as % pers. disp. income, avg.)	9.3	9.3	9.7	9.3	8.4	9.9	14.2	10.0	14.5

Source: MAPFRE Economics (based on PSA data)
Forecast end date: October 16, 2020.

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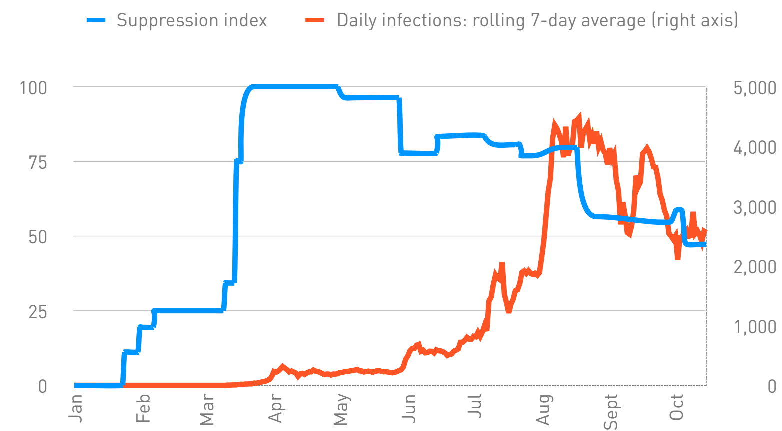
- The Philippine GDP growth estimate for 2020 has been revised to a contraction of close to -7.8%.
- The economy is still struggling to revive in the third quarter, so the supposed basis is a recovery in 2021 pf around 7.6%.
- The central bank kept rates at 2.25% in August, and everything seems to indicate that it will now implement a pause.

Prospects for rapid recovery are increasingly difficult to foresee in any country due to the difficulties the tourism industry is facing in terms of recovery and reduced activity in general due to social distancing. However, in the Philippines, which saw a growth rate of 6% per year before the pandemic, the 2019 GDP level could potentially be exceeded in 2021, a feat that few countries in the world will manage. This effect, however, is somewhat accountable for, as imports contracted more than exports, while private consumption will struggle to recover 2019 levels. Beyond 2021, the normalization of the movement of people in trade, hospitality and the recovery of the external context can sustain the recovery of growth levels seen before the pandemic.

The fiscal deficit will be close to 7.2% of GDP, due to the fall in tax revenues, while fiscal spending is increasing as a result of the aid packages. Inflation eased again in September to 2.3%, allowing the central bank to continue adjusting monetary policy in support of the economy. The Central Bank of the Philippines (BSP) kept official interest rates stable at 2.25% in August (Overnight Repo), after a series of declines from 4.0% at the end of 2019. Nevertheless, it has now implemented a pause and real interest rates are negative, meaning that no further decline is expected for the time being, unless inflation once again provides room to this end.

Chart 1.2.14-c
Philippines: daily COVID-19 infections vs. restriction index



Source: MAPFRE Economics (based on data from Coronavirus Government Response Tracker, University of Oxford)

The risks to the Philippine economy are generally related to a difficult return to normality, the contraction in retail trade, the fall in tourism and migrant remittances.

2. Industry outlook

2.1 The economic environment and its impact on insurance demand: update

2.1.1 Global markets

In the context of the COVID-19 pandemic, the global economy continues to be immersed in an unprecedented contraction, though forecasts regarding the strong economic downturn estimated for 2020 has improved slightly. However, recovery will be slower than expected, as it will be subject to high uncertainty as a result of outbreaks in infections (see Charts 1.1.1-a and 1.1.1-b), and will vary by country and sector. The insurance industry will be adversely affected in this environment, although to a lesser extent than other sectors that are more vulnerable to the risks caused by the pandemic crisis. In this context, the expected decline in economic growth for 2020 as a whole could range from -4.4% to -4.6%, compared to growth in 2019 of 2.8% (3.6% in 2018).

Rapid intervention at a global level by central banks with low interest rates and quantitative easing measures through bond-acquisition programs (both sovereign and corporate) has been crucial for the insurance industry, as they have stabilized the financial markets for which the insurance industry is one of the major institutional investors, all while allowing governments and businesses to continue financing at reduced costs. However, in conjunction with fiscal action, additional fiscal policy measures will be required to support the respective economies. The fiscal measures that have already been adopted are substantially increasing government deficits and debt levels, which represents a significant limit for economies that lack sufficient fiscal leeway and additional borrowing capacity, which a problem that greatly affects emerging countries.

2.1.2 Eurozone

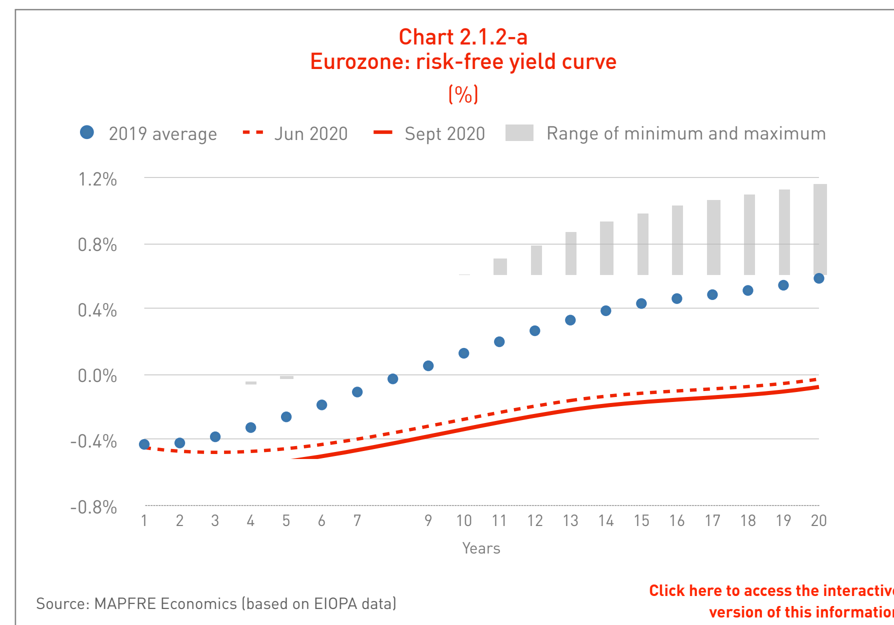
The decline in GDP estimated for the eurozone in 2020 stands at between -7.6% and -8.0%, which represents a contraction that is somewhat lower than expected in the previous report, but still represents a deep decline from the 2019 growth of 1.3% (1.9% in 2018). The effects on the economy of social distancing measures taken as a result of the pandemic and its new outbreaks (see Chart 1.2.2-c) are beginning to have a significant impact on employment and on the viability of small- and medium-sized enterprises. The effects of this are moving into the insurance business, which is closely linked to economic performance.

For the time being, the European Central Bank (ECB) has decided not to extend its generous stimulus measures further. It has, however, informed the market that it will extend the measures if necessary and will continue to firmly support the eurozone's financial markets by resorting to the widespread use of unconventional monetary policy measures to provide liquidity to sovereign and corporate bond markets, in which insurance companies are large investors (see Box 1.1.1-b). These measures are relaxing risk premiums and ensuring that bond markets function properly, but the sharp increase in fiscal deficits and increased uncertainty surrounding issuers' solvency are leading major credit rating agencies to consider potential downgrades. The asset-purchase programs have now reached a combined total of 1.35 trillion euros and are flexible in terms of the maximum limits that can be purchased from different countries, in order to increase purchases according to countries' needs. In addition to this, the fiscal measures taken within the European Union, with a package of measures amounting to 750 billion euros (390 billion in grants and the rest in loans), in addition to the measures already being taken by Member States themselves in the form of temporary benefits for workers who are unable to perform their roles as a result of the pandemic, among others (see Box 1.1.1-c). It is worth noting that, unlike the measures taken by the ECB, which have an almost immediate effect, the effects of the European reconstruction fund's fiscal measures require that the projects to which the funds of this recovery program are to be allocated be presented and approved.

Moreover, despite the quantitative easing measures taken by the ECB, inflation remains weak for the eurozone as a whole. The September risk-free interest rate curve produced by the European Insurance and Pension Authority (EIOPA) has deepened the curve's negative trend, affecting all the curve's terms and even exceeding twenty years, which basically hinders the development of the Life Savings and traditional annuity insurance business lines (see Chart 2.1.2-a)[4].

The Euro Stoxx 50 index has partially recovered from the significant drop it suffered as a result of the crisis and is showing lower volatility. If the situation remains as it is, this lower volatility could favor the development of Life insurance products for which the policyholder assumes the risk of the investment. However, while high uncertainty is a stimulus for saving, it also raises the preference to maintain liquidity positions, discouraging the acquisition of other types of financial assets, especially those with higher risk.

Chart 2.1.2-a
Eurozone: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

2.1.3 Germany

Expectations regarding the decline in German GDP have improved slightly and are expected to remain in the range of between -5.8% and -6.0%, compared to growth of 0.6% in 2019 (1.3% in 2018). As a result of new outbreaks in recent weeks that are particularly affecting consumption (see Chart 1.2.4-c), the German government continues to expand its package of expansionary fiscal measures in order to offset the economic effects caused by the pandemic. This situation can lead to a reversal of the Non-Life insurance premiums, as a result of the deterioration of the economic situation.

The aid to workers and small- and medium-sized enterprises included in the approved comprehensive package of measures (one of the largest in the world and equating to 39.2% of German GDP) could, however, help to mitigate this decline (see Table 1.1.1). As a reference, during the 2007–2009 crisis, German GDP slowed sharply in 2008 and fell by -5.6% in 2009, with a negative (but moderate) effect on the Non-Life premium volumes, whose worst moment came in 2008 with a fall of -2.5%. The worst part of that crisis impacted the Life Savings and traditional annuity insurance business due to the low interest rate environment in which Germany and the entire eurozone economy found themselves and which will continue as a result of the monetary expansion measures taken due to the pandemic and which will continue to have an adverse effect on this business. The German DAX, however, has recovered from the sharp fall it experienced in April, which may stimulate the development of Life insurance investment products for which the policyholder assumes the risk of investment. This is due to the fact that Germany's sovereign bond stands at negative levels in all its maturities, including the 30-year bond, and due to the fact that this low interest rate environment is expected to continue for a long time.

2.1.4 Italy

The forecast for the Italian economy is for GDP to fall within a range of between -9.8% and -10.2% in 2020. In Italy, the situation before the crisis was one of low growth (0.3% in 2019 and 0.8% in 2018), with a high level of public debt as the main vulnerability. This will be exacerbated by the fiscal measures taken to support its economy as a result of measures taken to tackle the COVID-19 pandemic. The quantitative easing measures adopted by the ECB (which are country-flexible) have allowed it to continue financing in the markets without an excessive surge in the risk premium, which is facilitating the implementation of fiscal measures as risk premium is controlled at low levels. This will be added to the funds received in the form of grants and loans from the recently approved European recovery fund, of which it will be one of the main beneficiary countries, along with Spain. However, this may be delayed as these funds are granted subject to the presentation and approval of the projects for which they will be used.

For the time being, the strong economic recession in Italy, which could be exacerbated by the new surge in infections (see Chart 1.2.5-c), will jeopardize the development of its insurance market. As a reference, the two successive economic crises experienced in the 2007–2012 period led to significant declines in Non-Life insurance premiums for six consecutive years. The Life business also suffered during the worse moments of the crisis, with very volatile performance since then and a notable influence not only on GDP performance, but also on the interest rate environment, fluctuations in the risk premium and the term premium of Italian sovereign debt, which also contributed to significant growth in certain years. On this occasion, however, the ECB's strong intervention in the bond markets has kept the term premium low, meaning that the interest rate environment is less favorable than at that time and the fall in GDP sharper,

which could also lead to significant setbacks in the Life business. High uncertainty and potential bailouts will also negatively affect the development of Life insurance investments, which were starting to grow significantly in this market.

2.1.5 Spain

The strict lockdown and social distancing measures adopted in Spain were successful in controlling the health crisis caused by the first wave of the pandemic. However, new outbreaks are increasing, forcing the adoption of new partial measures in order to control these outbreaks (see Chart 1.2.3-c). This situation anticipates an effect on the economy, which could see its GDP decline by between -11.8% and -12.1% for 2020 as a whole, compared to growth of 2.0% in 2019 (2.4% in 2018), thereby increasing uncertainty surrounding future recovery, which is estimated to arrive partially in 2021. The effects on consumption, trade, hospitality and tourism-related businesses are unprecedented and the lasting effects on employment and on the solvency of families and businesses remain to be seen.

This situation is impacting the insurance market, which is very sensitive to the deterioration of these economic indicators. As a reference, the 2007–2009 crisis, in which GDP fell by -3.8% (in 2009), caused a decline in insurance industry premiums of -7.8% and -10.0% in real terms in Non-life and Life businesses respectively (as early as 2010). Based on the latest data available for August 2020[5], Non-Life premiums have slowed down in interannual terms, growing by 0.4%, with a decline of -2.2% in the automobile line. The lines of health (4.8%) and multirisk, both for homeowners (2.4%) and neighborhood communities (2.9%), are showing great resistance, especially health, which is always very resilient in economic crises. Life business premiums are falling by -27.8% as a result of the decline in Life Savings insurance premiums (-34%), as Life Protection premiums have only slowed down (0.7%). However, despite the sharp decline in premiums, savings managed by insurance companies have remained stable and only suffered a slight fall of -0.75% in the first half of the year. In this way, the performance pattern for the insurance business shows many similarities with the pattern observed during the 2007–2009 crisis, although it is predicted that the current crisis could have a faster recovery, meaning that decline could be smaller, although there remains much uncertainty in this regard.

As with Italy, the quantitative easing measures adopted by the ECB are ensuring the smooth functioning of the bond market in which insurance companies are large investors, allowing Spain to continue to finance itself in the markets at a reduced cost, which is facilitating the implementation of fiscal measures to support the economy as risk premium is controlled at low levels. To this end, funds will be added in the form of grants and loans from the recently approved European recovery fund, of which Spain (along with Italy) will be one of the main beneficiary countries. This is still subject to the presentation and approval of the projects for which they will be used.

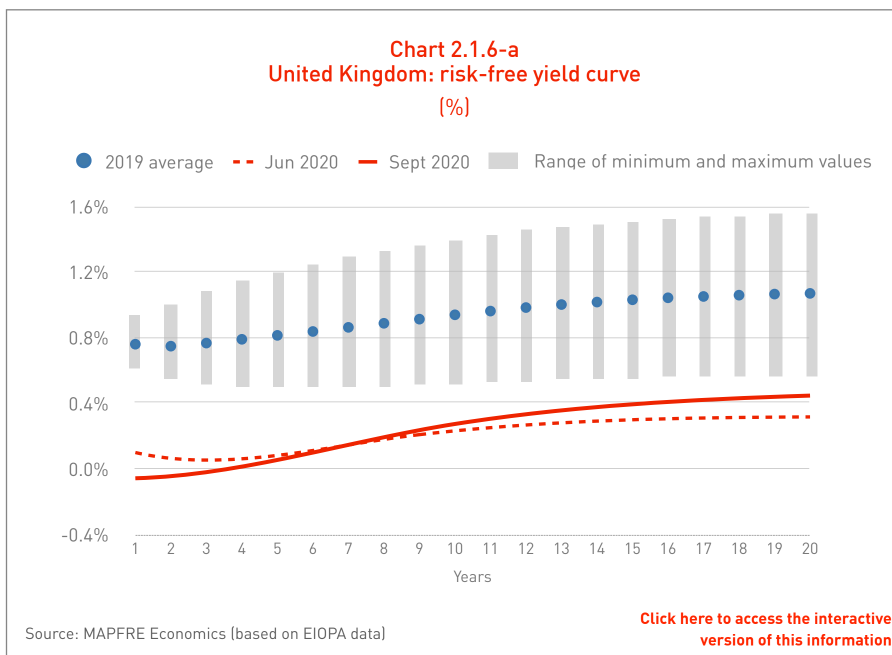
2.1.6 United Kingdom

The forecast for the UK economy anticipates a decline in GDP by a range of between -9.6% and -9.8% in 2020, compared to growth of 1.3% in 2019 and 2018. In addition to the effects of the pandemic on its economy, uncertainty has also been generated by the new surge in infections (see Chart 1.2.6-c) and its possible exit from the European Union without a trade agreement. The unemployment rate has increased and consumer confidence has fallen, which will undoubtedly have a negative impact on the development of the Non-Life and Life Protection insurance business, which is slowing down and may suffer severe setbacks given the magnitude of the estimated decline in GDP. As a reference, the 2007–2009 crisis, in which UK GDP fell by -4.2% (in 2009), albeit with some delay, led to a decline of -3.5% in Non-Life business premiums in 2011.

In terms of Life Savings and traditional annuity insurance, the Bank of England is keeping interest rates close to zero in light of the magnitude of the pandemic crisis. It is also maintaining a comprehensive asset-acquisition quantitative easing program to ensure the smooth functioning of bond markets and access by bond issuers to low-cost financing with controlled risk premiums. The EIOPA risk-free interest rate curves (see Chart 2.1.6-a) show the new decline of the curve's sections for up to eight years compared to the previous quarter. The section of the curve with maturities exceeding eight years remained above that of the previous quarter, gaining a certain positive trend.

The sharp decline in GDP expected this year and the low interest rate environment will undoubtedly jeopardize the development of the Life Savings and traditional annuity business, due to the loss of business and the bailouts that may occur. However, the positive trend that the curve has taken and the expectation that interest rates could fall even lower for a long time could be an incentive for marketing medium- and long-term products that take advantage of the term premium to offer rates that are higher than short-term rates. We must also add to this the negative effect that the decline could have on the business and on possible bailouts, and the high volatility of the FTSE 100 (which is still far from recovery) on the perception of Life insurance for which the policyholder assumes the risk of the investment, which are widely distributed in the British market, while the lower stock prices may attract investors who have liquidity and are willing to take risks.

Chart 2.1.6-a
United Kingdom: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

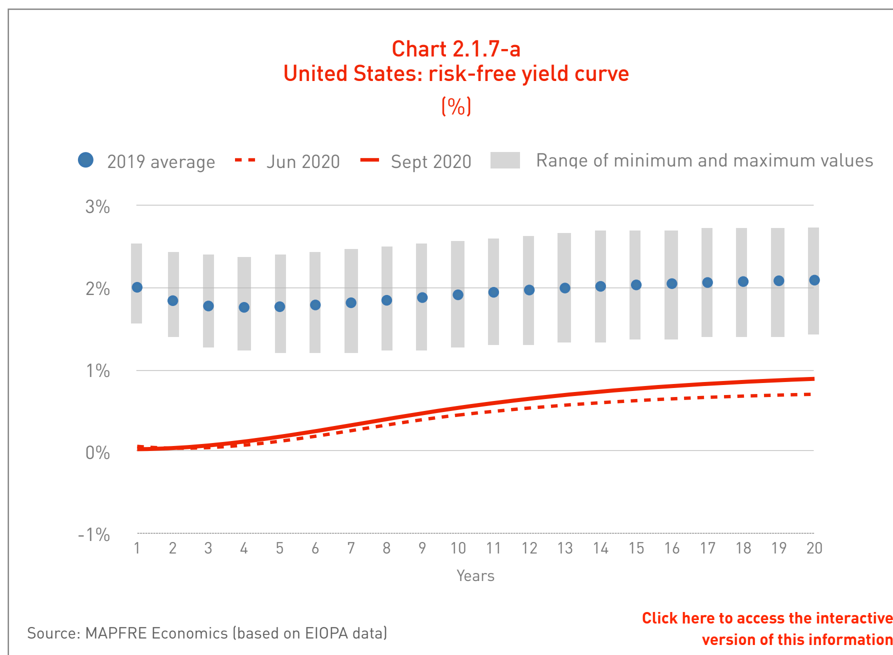
Click here to access the interactive version of this information

2.1.7 United States

The fall in GDP estimated for the United States in 2020 stands in the range of between -4.0% and -4.5%, which represents a smaller decline than forecast in the previous report (though this is still an unprecedented contraction), compared to growth of 2.2% in 2019 (3.0% in 2018), and is still subject to the evolution of infections caused by the pandemic (see Chart 1.2.1-c). The unemployment rate has improved significantly (following the sharp increase in April), and some indicators such as consumption of durable goods, including car purchases, have performed better than expected, which could mitigate the impact that the economic contraction has on premiums in the Non-Life and Life Protection insurance business. The generous package of both monetary and fiscal measures (through unemployment benefits and aid for businesses) have bolstered this improvement (see Table 1.1.1). In any case, significant declines in premiums for these lines of business are to be expected, as was the case during the 2007–2009 crisis when the -2.5% decline in GDP (in 2009) led to a decline of -1.7% and -13.0% in premiums for Non-Life and Life businesses respectively.

The Life Savings business will be adversely affected by the low interest rate environment, which exacerbates the negative effects resulting from the strong economic contraction. Following the fall in interest rates in the previous quarter, during its last meeting, the Federal Reserve maintained its monetary policy, keeping interest rates in the range of 0.00–0.25%, and maintained the monthly pace of its sovereign and corporate bond-purchasing program, which relaxes risk premiums (See Box 1.1.1-b). The latest EIOPA rate curves (see Chart 2.1.7-a) show the stabilization of risk-free rates, with a slight rebound in the curve section for maturities exceeding four years, gaining a positive trend. This could mitigate the negative effect of the depressed interest rate level, by offering a medium- and long-term interest rate that is higher than short-term rates (term premium), bolstered by the expectation of further declines and the extension of this low interest rate environment. Outlooks for the equity markets are improving (although they are still susceptible to high levels of volatility), which may favor the business of Life insurance for which the policyholder assumes the risk of the investment, which is very common in this market.

Chart 2.1.7-a
United States: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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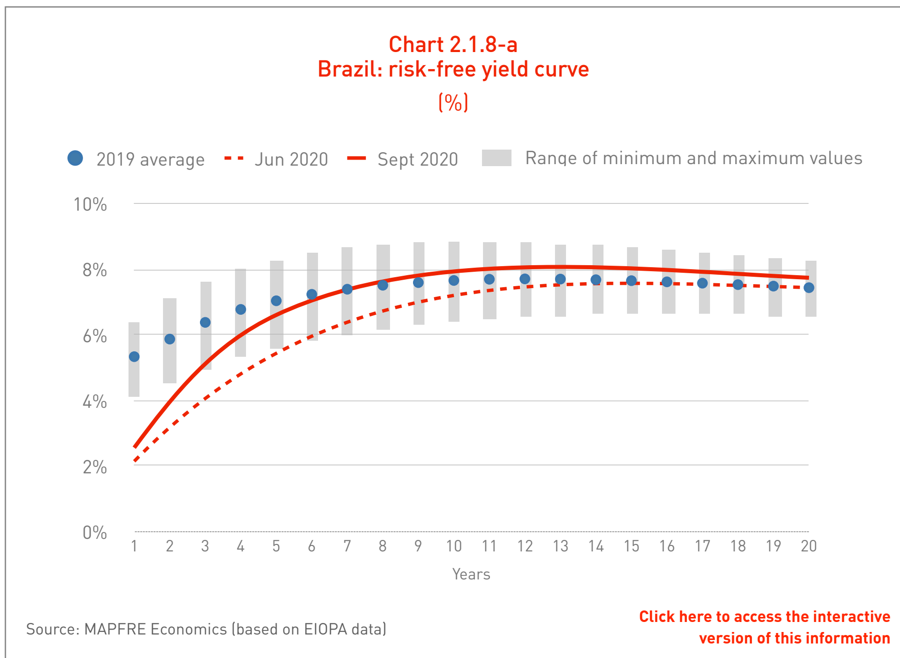
2.1.8 Brazil

In Brazil, economic expectations for 2020 anticipate a decline in GDP as a consequence of the pandemic, ranging between -5.3% and -5.6%, compared to the estimated real growth of 1.1% in 2019 (1.2% in 2018). Despite this sharp decline, this is an improvement in the estimates provided for in our previous report, with a trend that, as of August, appears to be decreasing in the number of infections caused by the pandemic (see Chart 1.2.10-c). This environment could mitigate the negative impact that the sharp fall in GDP may have on its insurance industry, particularly for the Non-Life business. To provide a reference, Brazilian GDP fell by -6.8% overall during the 2015–2016 crisis, with Non-Life insurance premiums falling by -6.6% overall in those two years, both in real terms.

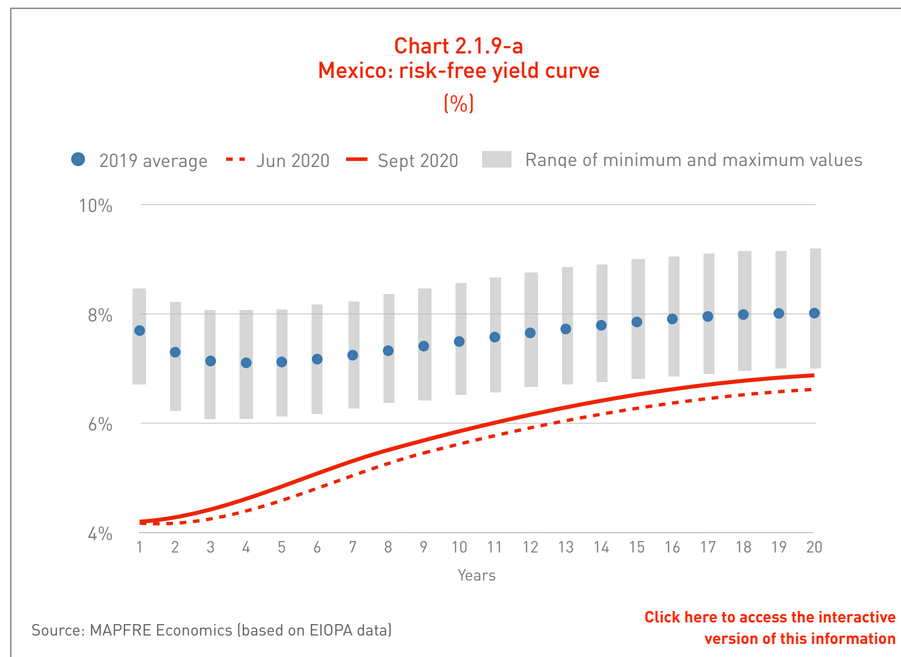
However, the Bank of Brazil has decided to maintain its accommodative monetary policy in order to stimulate the economy, in light of inflation that remains controlled, albeit with a slight rebound in recent months. The EIOPA risk-free interest rate curves (see Chart 2.1.8-a) show a sharp upward trend in the short section of the curve, which has even increased from that of the previous quarter. The favorable interest rate environment therefore persists, as guaranteed medium- and long-term rates that are higher than short-term rates (term premium) are able to be offered, which can mitigate the negative effect that GDP contraction has on the Life Savings insurance and annuity insurance business.



2.1.9 Mexico

Expectations for the Mexican economy anticipate a sharp contraction in GDP in 2020, although with a slight correction upward compared to our previous report due to the tentative recovery in oil prices (which remain at depressed levels) and the smaller decline forecast for the US economy, its main trading partner. In this context, economic expectations for 2020 anticipate an economic contraction as a result of the pandemic that could range between -9.6% and -9.8%, following growth of -0.3% in 2019 (2.2% in 2018).

The sharp decline in GDP forecast for this year will be detrimental to the development of the insurance industry, particularly for the Non-Life business. As a reference point for what happened in previous economic crises, in the most-recent crisis of 2007–2009, the Mexican economy suffered a contraction in GDP of -5.0% (in 2009), which translated into a fall of -3.8% in Non-Life insurance premiums in 2010; when that crisis passed, the insurance industry experienced strong growth, well above GDP growth. This recovery was helped by the low level of insurance penetration in the Mexican economy, which led to an improvement in economic conditions that translated into larger growth in the insurance business, as is often the case in other emerging markets. However, uncertainty surrounding the timing of recovery persists in the current crisis, as the health crisis is far from being resolved, with the number of infections



showing a certain resilience in recent months (see Chart 1.2.9-c). The best-case scenario estimates that the economy will not recover to 2019 levels until 2023.

The Bank of Mexico continues to adopt an accommodative monetary policy, though with less room for maneuver because, while inflation remains controlled (just above the upper limit of the central bank's target range), the negative effect that greater laxity in momentary policy may have on exchange rates will be a significant factor. The EIOPA curves (see Chart 2.1.9-a) show a certain stability in risk-free interest rates, with an interest rate curve that is trending upward in practically all its sections. This may mitigate the negative effect of GDP contraction on the annuity insurance and Life Savings business by offering a positive term premium, enabling guaranteed medium- and long-term rates that are higher than short-term rates to be offered.

2.1.10 Argentina

The strict lockdown implemented in Argentina as a result of the pandemic, where the evolution in the number of infections is yet to be controlled (see Chart 1.2.11-c), coupled with the structural imbalances related to its external debt, anticipate a fall in GDP by a range of between -10.4% and -10.8% in real terms in 2020, compared to -2.1% in 2019 (-2.4% in 2018). The sharp contraction in domestic demand means that prospects for developing the insurance business remain depressed, as it had already been suffering the consequences of Argentina's economic crisis, with setbacks in the Non-Life business of -7.2% and -12.6% in 2018 and 2019 respectively.

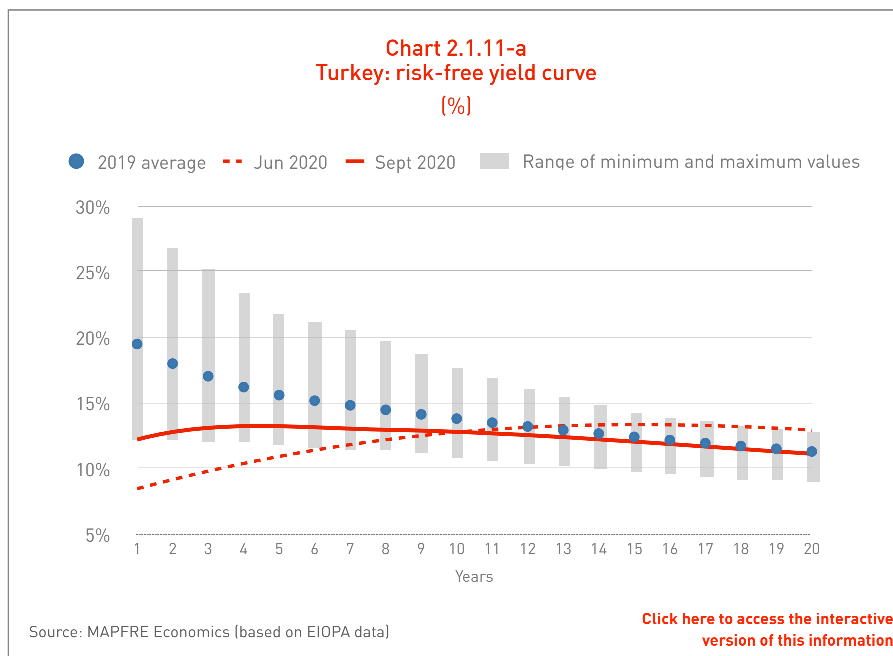
Inflation remains high (35.3% year-on-year in August) and the currency continues to depreciate, which will have a negative impact on the cost of claims for insurance companies that are unable to take full advantage of the monetary policy's high interest rates to shore up the financial profitability of these lines of business. This is due to the regulatory limits imposed on insurance companies for investments in short-term public debt instruments.

The central bank's benchmark interest rate remains stable at 38% with the aim of controlling inflation and currency depreciation. This interest rate environment could be an opportunity to market annual temporary Life Savings insurance products that are renewable with short maturity terms, offering a renegotiation of the guaranteed rate for each maturity term. However, the regulatory limits on investments complicates developing this kind of product. This economic and regulatory environment negatively impacts the Life business with a fall in premiums that reached -11.1% and -17.8% in 2018 and 2019 respectively. This fall could worsen this year, given the expected decline in GDP.

2.1.11 Turkey

After some relaxation of the social distancing measures implemented to combat the COVID-19 pandemic as a result of relative control in the number of infections (see Chart 1.2.8-c), certain signs of recovery have been observed, leading to improved forecasts for the Turkish economy whereby GDP is expected to fall by around -2.7% in real terms in 2020, in contrast to growth of 0.8% in 2019 (3.3% in 2018). In any case, this is a significant decline, which will negatively impact the development of the insurance industry, particularly for the Non-Life and Life Protection business. As a reference, if we look at what happened during the 2007–2009 crisis, the Turkish Non-Life insurance industry experienced a sharp slowdown during the first few years of the crisis and a slight decline of

Chart 2.1.11-a
Turkey: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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-2.1% in 2009 (when GDP fell by -4.7%), once again experiencing significant growth in the four years following recovery.

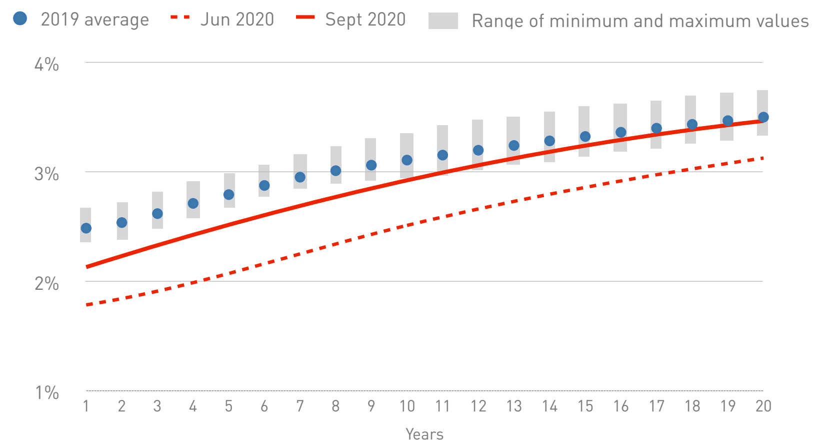
Furthermore, the depreciation of the exchange rate and the high inflation affecting the Turkish economy continue to negatively impact its profitability, due to the increased cost of claims. The high interest rate level may help to partially offset these adverse effects by shoring up the financial profitability of these lines of business. The central bank has decided to raise interest rates in order to control inflation and avoid further depreciation of its exchange rate. The EIOPA curves (see Chart 2.1.11-a) show a surge in the risk-free interest rate with a curve that has flattened (with the exception of its short section) and is even beginning to show a slight negative trend in its medium and long sections. This interest rate scenario may favor the marketing of Life Savings insurance products with renewable short-term guaranteed rates that enable the guaranteed rates to be revised at each renewal. The situation of economic recession, however, which may encourage saving to the detriment of consumption, is expected to have a negative impact on the employment and saving capacity of individuals and families, and may lead to a marked increase in bailouts by those suffering from reduced income, due to their inability to perform their duties as a result of the pandemic.

2.1.12 China

In China, the pandemic seems to be under control (see Chart 1.2.12-c) and its growth expectations for 2020 are improving. It is the only major economy in the world that will grow this year, although it will suffer a sharp slowdown with real GDP growth of around 1.9%, compared to 6.1% in 2019 (6.8% in 2018). The Chinese government's ongoing fiscal and monetary stimulus program could accelerate the return to higher economic growth rates, mitigating the negative impact of the sharp economic slowdown on the insurance industry. In any case, the Non-Life business has shown great resilience in previous global crises with double-digit premium growth over the past twenty years. It was the Life insurance business that proved most sensitive to the economic cycle, with a decline of -14.8% in real terms and zero growth in 2011 and 2012, respectively.

The EIOPA curves (see Chart 2.1.12-a) show some recovery in the risk-free interest rates, as was the case in the previous quarter, following the sharp fall at the peak of the pandemic, with an upward trend in the sections of the curve with maturities exceeding ten years and surpassing the lows reached in 2019. This may mitigate the negative effect that GDP

Chart 2.1.12-a
China: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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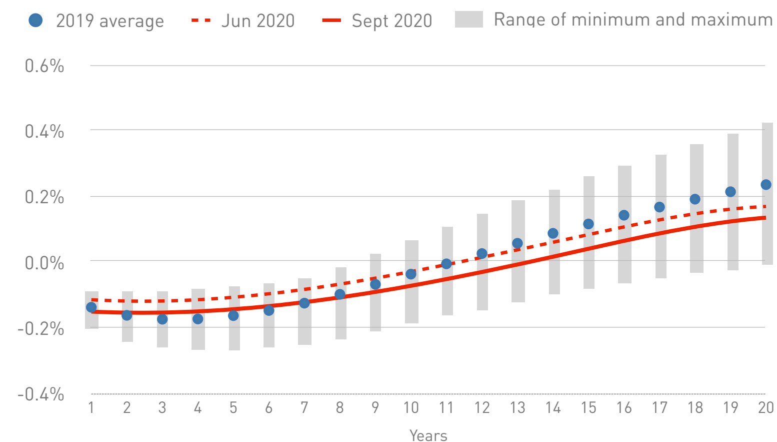
2.1.13 Japan

Thanks to controlling the effects of the pandemic (see Chart 1.2.7-c) and easing the restrictions implemented, growth forecasts for the Japanese economy in 2020 have improved slightly, but still anticipate a sharp recession with a fall in GDP that could range between -5.7% and -5.9% in 2020, compared with growth of 0.7% in 2019 (0.3% in 2018). The monetary and fiscal expansion measures adopted by the Japanese authorities are softening the impact of the pandemic on its economy. In any case, the sharp drop in GDP forecast for this year will undoubtedly be detrimental to the development of the insurance industry, both in terms of the Non-Life and Life Protection business, the growth of which is closely linked to economic performance. If we analyze what happened in the Japanese insurance market during its worst economic crises, we can see that the contraction has on the annuity insurance and Life Savings insurance business, by being able to offer higher medium- and long-term guaranteed rates than short-term rates.

Chart 2.1.13-a
Japan: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

Click here to access the interactive version of this information

housing bubble bursting in the early 1990s marked a turning point both in economic growth and in the development of the country's insurance industry, which has not yet recovered to date.

Furthermore, the EIOPA curves (see Chart 2.1.13-a), show that the risk-free interest rates have suffered a slight decrease compared to the levels recorded in the previous quarter, and they still have negative values for maturities up to 13 years and a low term premium from these maturities, which makes it very difficult to market Life Savings and annuity insurance products. This sustained context of low interest rates continues to be detrimental to the development of the specified lines of business.

2.1.14 Philippines

The economic expectations for the Philippine economy in 2020 have significantly worsened, forecasting a decline in GDP in the range of between -7.8% and -8.1%, compared to real growth of 6.0% in 2019 (6.3% in 2018). The crisis caused by the pandemic, for which the number of infections seems to have begun to decline in recent weeks (see Chart 1.2.14-c), is driving strong growth in the unemployment rate with significant setbacks in investment and private consumption, which had been the main driver of economic growth. This situation may have a significant impact on the insurance industry, particularly for the Non-Life business, the growth of which is closely linked to the economic cycle. The government has decided to increase the package of fiscal measures to support the economy, which could help to mitigate the impact on the insurance business. As a reference, the notable Asian crisis in 1997 led to a fall in Non-Life insurance premiums of -14.5%, when GDP fell from growth of 5.2% to a decline of -0.6% in one year. The Life business suffered a strong slowdown at that time, but maintained positive growth of 1.5%.

With regard to Life insurance, the Central Bank of the Philippines has not taken further steps to reduce the monetary policy benchmark rate since June, when it stood at 2.25% (with two declines in the year from 4.0%), while the yield on the ten-year sovereign bond, which stood at 4.44% at the end of June, is slightly below 3%, meaning that the interest rate curve continues to flatten. This environment of low interest rates, coupled with the flattening of the risk-free rate curve, complicates the outlook for the Life Savings and annuity insurance lines, which are exposed to the risk of a loss of business due to the drop in premiums and the bailouts that may occur as a result of the sharp rise in unemployment and economic deterioration.

2.2 Regulatory trends

Risks and vulnerabilities in the European Union financial system.

On September 4, the Joint Committee of the European system of financial supervision for banking, securities and insurance (EBA, ESMA and EIOPA) released its report on risks and vulnerabilities in the European Union's financial system in 2020[6]. The report highlights that the coronavirus outbreak has resulted in major social disruption and challenges for the economy that will inevitably impact the finance sector, and sets out the problems faced by banks, mutual funds, insurance companies and pension funds, as well as the possible effects on financial stability, which may enhance the connection between these sectors.

Intervention by central banks through providing liquidity and announcing large-scale acquisitions of both sovereign and corporate bonds, as well as messages from fiscal authorities of a wide range of economic support measures, both at national and EU levels, has restored stability to the

in February and March (close to 40% in a twenty-day period for the main indices), and even forced some mutual funds to temporarily suspend reimbursements. This decline was partly driven by investors' dash for cash. However, following the stabilization of financial markets, the longer-term extension of the low interest rate environment poses a challenge to the profitability of banks, Life insurance companies and pension funds. This situation may also encourage higher-risk investment strategies as these types of companies begin searching for increased profitability.

Furthermore, since May, investors have begun to differentiate between issuers and asset classes, in an environment of deteriorating economic fundamentals where concerns surrounding credit risk are beginning to materialize. Credit rating downgrades have increased sharply since the beginning of March, though the pace has slowed since April. Within the universe of investment-grade issuers, those rated BBB (which account for 40% of corporate bonds with a credit rating) are especially vulnerable to a downgrade below investment grade (high yield), which could lead to forced sales by investors.

The report highlights the fact that European banks entered the crisis related to the COVID-19 pandemic with a strong capital position, which has helped them to increase credit in the economy in the short-term, particularly for sectors that are most in need of liquidity, and should help them withstand the impact of future losses from the credit risk assumed from the crisis. However, the report also warns that the dispersion of individual solvency positions remains high and some banks that had lower capital levels and greater exposures to risk at the start of the crisis may face significant challenges.

As for insurance companies, the report also highlights banks' reasonable solvency position before the shock caused by the pandemic, with an overall solvency ratio of 213% at the close of 2019. Furthermore, improved asset valuation as a result of the fall in interest rates and the rebound in variable income in the first half of the year has given them some leeway to combat the economic downturn. However, low risk-free interest rates, higher risk premiums (the "double-hit scenario"), the credit impairment of assets and economic uncertainty could have a negative impact on their balance sheets and profitability in the medium- and long-term.

Tables: macroeconomic forecast scenarios

Table A-1
Baseline and stressed scenarios: gross domestic product
(annual growth, %)

	Baseline scenario (BS)						Stressed scenario (SS)					
	2016	2017	2018	2019	2020(e)	2021(f)	2016	2017	2018	2019	2020(e)	2021(f)
United States	1.7	2.3	3.0	2.2	-4.0	3.3	1.7	2.3	3.0	2.2	-4.5	2.4
Eurozone	1.8	2.7	1.9	1.3	-7.6	5.5	1.8	2.7	1.9	1.3	-8.0	3.8
Germany	2.1	2.9	1.3	0.6	-5.8	4.5	2.1	2.9	1.3	0.6	-6.0	3.7
France	1.1	2.3	1.8	1.5	-9.8	6.0	1.1	2.3	1.8	1.5	-10.1	5.6
Italy	1.4	1.7	0.8	0.3	-9.8	6.3	1.4	1.7	0.8	0.3	-10.2	4.6
Spain	3.0	3.0	2.4	2.0	-11.8	6.7	3.0	3.0	2.4	2.0	-12.1	4.7
United Kingdom	1.7	1.7	1.3	1.3	-9.6	8.1	1.7	1.7	1.3	1.3	-9.8	7.2
Japan	0.5	2.2	0.3	0.7	-5.7	2.6	0.5	2.2	0.3	0.7	-5.9	1.9
Emerging markets	4.6	4.8	4.5	3.7	-3.3	6.0	4.6	4.8	4.5	3.7	-3.5	5.2
Latin America[1]	-0.6	1.2	1.0	0.0	-8.1	3.6	-0.6	1.2	1.0	0.0	-8.3	3.0
Mexico	2.4	2.3	2.2	-0.3	-9.6	3.6	2.4	2.3	2.2	-0.3	-9.8	2.6
Brazil	-3.5	1.6	1.2	1.1	-5.3	3.6	-3.5	1.6	1.2	1.1	-5.6	3.1
Argentina	-2.0	2.8	-2.4	-2.1	-10.4	6.3	-2.0	2.8	-2.4	-2.1	-10.8	4.7
Emerging Europe[2]	4.8	3.3	6.0	2.1	-4.6	3.9	4.8	3.3	6.0	2.1	-4.8	3.2
Turkey	3.4	7.4	3.3	0.8	-2.7	4.6	3.4	7.4	3.3	0.8	-2.7	3.0
Asia Pacific[3]	6.3	6.3	6.1	5.7	-2.5	6.9	6.3	6.3	6.1	5.7	-2.8	6.1
China	6.9	7.0	6.8	6.1	1.9	7.9	6.9	7.0	6.8	6.1	1.8	6.0
Indonesia	5.0	5.1	5.2	5.0	-1.7	5.2	5.0	5.1	5.2	5.0	-2.0	4.2
Philippines	7.2	6.9	6.3	6.0	-7.8	7.6	7.2	6.9	6.3	6.0	-8.1	6.0
World	3.4	3.8	3.6	2.8	-4.4	5.2	3.4	3.8	3.6	2.8	-4.6	4.0

Source: MAPFRE Economics

[1]Argentina, Brazil, Chile, Colombia, Mexico and Peru; [2]Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
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Table A-2
Baseline and stressed scenarios: inflation

(end of period, %)

	Baseline scenario (BS)						Stressed scenario (SS)					
	2016	2017	2018	2019	2020(e)	2021(f)	2016	2017	2018	2019	2020(e)	2021(f)
United States	2.1	2.1	1.9	2.3	1.1	1.6	2.1	2.1	1.9	2.3	1.2	1.6
Eurozone	0.7	1.4	1.9	1.0	0.1	1.4	0.7	1.4	1.9	1.0	0.1	0.8
Germany	1.4	1.4	1.6	1.5	0.0	2.0	1.4	1.4	1.6	1.5	0.0	1.6
France	0.5	1.1	1.9	1.1	0.5	0.6	0.5	1.1	1.9	1.1	0.4	0.5
Italy	0.5	0.9	1.1	0.5	-0.2	0.6	0.5	0.9	1.1	0.5	-0.3	-0.2
Spain	1.6	1.1	1.2	0.8	-0.2	1.0	1.6	1.1	1.2	0.8	-0.3	-0.1
United Kingdom	1.8	2.7	2.0	1.3	0.4	2.0	1.8	2.7	2.0	1.3	0.4	1.8
Japan	0.3	0.6	0.9	0.5	-1.0	0.0	0.3	0.6	0.9	0.5	-1.0	-0.4
Emerging markets	4.3	4.3	4.8	4.7	5.0	5.3	4.3	4.3	4.8	4.7	4.8	4.9
Latin America[1]	5.6	6.0	6.2	7.2	6.2	6.7	5.6	6.0	6.2	7.2	5.6	5.8
Mexico	3.4	6.8	4.8	2.8	3.7	2.7	3.4	6.8	4.8	2.8	3.7	2.4
Brazil	6.3	2.9	3.7	4.3	2.0	2.9	6.3	2.9	3.7	4.3	2.0	2.7
Argentina	37.5	23.3	47.4	52.2	38.7	40.0	37.5	23.3	47.4	52.2	38.6	39.4
Emerging Europe[2]	5.5	5.4	6.2	4.0	5.2	5.4	5.5	5.4	6.2	4.0	3.5	4.0
Turkey	8.5	11.9	20.3	11.8	11.1	8.8	8.5	11.9	20.3	11.8	11.1	8.4
Asia Pacific[3]	2.6	2.6	3.0	3.0	1.8	2.5	2.6	2.6	3.0	3.0	1.8	2.2
China	2.2	1.8	2.2	4.3	1.9	2.4	2.2	1.8	2.2	4.3	1.9	2.2
Indonesia	3.3	3.5	3.3	2.7	1.4	2.3	3.3	3.5	3.3	2.7	1.4	2.3
Philippines	2.0	3.0	5.9	1.5	2.1	2.7	2.0	3.0	5.9	1.5	2.1	2.3
World	2.8	3.0	3.3	3.1	2.8	2.9	2.8	3.0	3.3	3.1	2.7	2.8

Source: MAPFRE Economics

[1]Argentina, Brazil, Chile, Colombia, Mexico and Peru; [2]Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
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Table A-3
Baseline and stressed scenarios: 10-year government bond yield

(end of period, %)

	Baseline scenario (BS)						Stressed scenario (SS)					
	2016	2017	2018	2019	2020(e)	2021(f)	2016	2017	2018	2019	2020(e)	2021(f)
United States	2.45	2.40	2.69	1.92	0.79	1.33	2.45	2.40	2.69	1.92	0.79	1.33
Eurozone	0.93	1.13	1.17	0.32	-0.14	0.13	0.93	1.13	1.17	0.32	-0.19	0.33

Source: MAPFRE Economics
Forecast end date: October 16, 2020.

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Table A-4
Baseline and stressed scenarios: exchange rates

(end of period, %)

	Baseline scenario (BS)						Stressed scenario (SS)					
	2016	2017	2018	2019	2020(e)	2021(f)	2016	2017	2018	2019	2020(e)	2021(f)
USD-EUR	0.95	0.83	0.87	0.89	0.85	0.85	0.95	0.83	0.87	0.89	0.86	0.85
EUR-USD	1.05	1.20	1.15	1.12	1.18	1.18	1.05	1.20	1.15	1.12	1.18	1.18
GBP-USD	1.23	1.35	1.28	1.32	1.32	1.33	1.23	1.35	1.28	1.32	1.32	1.33
USD-JPY	116.80	112.90	110.83	109.12	105.89	106.07	116.80	112.90	110.83	109.12	106.81	106.58
USD-CNY	6.94	6.51	6.88	6.99	6.77	6.77	6.94	6.51	6.88	6.99	6.78	6.87

Source: MAPFRE Economics
Forecast end date: October 16, 2020.

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Table A-5
Baseline and stressed scenarios: official benchmark interest rate

(end of period, %)

	Baseline scenario (BS)						Stressed scenario (SS)					
	2016	2017	2018	2019	2020(e)	2021(f)	2016	2017	2018	2019	2020(e)	2021(f)
United States	0.75	1.50	2.50	1.75	0.20	0.20	0.75	1.50	2.50	1.75	0.20	0.20
Eurozone	0.00	0.00	0.00	0.00	-0.01	-0.01	0.00	0.00	0.00	0.00	0.00	0.00
China	3.00	3.25	3.30	3.25	2.95	2.74	3.00	3.25	3.30	3.25	2.89	1.81

Source: MAPFRE Economics
Forecast end date: October 16, 2020.

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References

1/ An update of the suppression measures, confirmed cases and changes in the consensus expectations for the growth of the global economy by country can be seen on MAPFRE Economics' online analysis. "Institutional response to the COVID-19 crisis and effects on expected growth," at: https://app.klipfolio.com/published/ca635768cc1b32264d33836fc491e79c/institucional-response-to-the-covid19-crisis-and-effects-on-expected-growth

2/ MAPFRE Economics (2020), 2020 Economic and industry outlook: third quarter perspectives. Madrid, Fundación MAPFRE, pg. 13–15.

3/ See the MAPFRE Economics Analysis "Emerging market currencies, differentiated depreciation and balance of payments (2020 update)" at: https://app.klipfolio.com/published/46829ade6a0eaed59de2db17b55e2791/monedas-emergentes-depreciacin-diferenciada-y-balanza-de-pagos--actualizacin-2020

4/ Chart 2.1.2-a shows the minimum, average and maximum levels reached in 2019, along with the level of the latest curves published by EIOPA for June and September 2020. Other months and currencies can be viewed in the interactive chart that forms part of the MAPFRE Economics Analysis "EIOPA curves" at: https://app.klipfolio.com/published/29577612d0ba9ff3681af85b8ee8a998/curvas-eiopa

5/ ICEA data, taken from a sample covering 95.19% of the Spanish insurance sector.

6/ See: https://esas-joint-committee.europa.eu/Publications/2020-67-report-on-risks-and-vulnerabilities.pdf

Other MAPFRE Economics reports

MAPFRE Economics (2020), The Latin American insurance market in 2019, Madrid, Fundación MAPFRE.

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