2021 ECONOMIC AND INDUSTRY OUTLOOK

MAPFRE Economics

2021 Economic and industry outlook

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Contents

Presentation 9

Introduction 11

Executive summary 13

1. Economic outlook 17

1.1. Global economic outlook: on the road to the new normal 17
1.1.1 An environment of uncertainty 17
1.1.2 Scenarios and forecasts 19
1.1.3 A consumption-based recovery 29
1.1.4 A new international context 30
1.1.5 Risk assessment 32

1.2. Forecasts and risk assessment in selected economies 35
1.2.1 United States 35
1.2.2 Eurozone 38
1.2.3 Spain 41
1.2.4 Germany 43
1.2.5 Italy 46
1.2.6 United Kingdom 48
1.2.7 Japan 50
1.2.8 Turkey 52
1.2.9 Mexico 55
1.2.10 Brazil 57
1.2.11 Argentina 59
1.2.12 China 61
1.2.13 Indonesia 64
1.2.14 Philippines 66

2. Industry outlook ... 69

2.1. The economic environment and its impact on demand for insurance ... 69

2.1.1 Global markets ... 69
2.1.2 Eurozone ... 69
2.1.3 Germany ... 71
2.1.4 Italy ... 71
2.1.5 Spain ... 71
2.1.6 United Kingdom ... 72
2.1.7 United States ... 77
2.1.8 Brazil ... 78
2.1.9 Mexico ... 78
2.1.10 Argentina ... 79
2.1.11 Turkey ... 80
2.1.12 China ... 80
2.1.13 Japan ... 81
2.1.14 Philippines ... 82
2.1.15 Reinsurance ... 82

2.2. Regulatory trends ... 82

2.2.1 Global trends ... 82
2.2.2 European Union ... 83

Appendix: macroeconomic forecasts ... 85

Index of tables, charts and boxes ... 89

References ... 93

Presentation

As has been the case since 2017, Fundación MAPFRE publishes the economic and industry report produced by MAPFRE Economics at the beginning of each year, which provides an overview of the main macroeconomic and financial outlooks, both globally and for the major economies, as well as an assessment of their impact on insurance activity. The economic content and forecasts included in this study are updated quarterly in a publication that includes changes in the global economic environment and how they affect the insurance industry.

Following the analysis carried out throughout 2020 on the impact on the economy and insurance of the lockdown and social distancing measures imposed to contain the spread of COVID-19, and the measures implemented by governments and central banks to address the crisis, the *2021 Economic and Industry Outlook* continues to delve deeper into this analysis and presents revisions to economic growth forecasts for the coming years, together with a review of recent geopolitical events. Taking into account the uncertain environment, the study posits that the global economy is on track toward a new normal, and predicts growth of around 4.5% for 2021–2022, which could have a positive influence on the insurance industry.

In its fifth year of publication, the *Economic and industry outlook* has been consolidated as a reference document providing an up-to-date view on economic and insurance activity at the beginning of each fiscal year and throughout the year. In turn, this activity is part of Fundación MAPFRE's commitment to share insurance knowledge and culture and provides a study of all the factors that could influence its performance.

Fundación MAPFRE

Introduction

MAPFRE Economics presents the 2021 edition of its *Economic and industry outlook.* As is the case every year, this document seeks to provide an overview of economic performance outlooks for both the world as a whole and its major economies, and, from this general context, to analyze the environment in which the insurance industry will operate.

Following the profound impact of the crisis caused by the COVID-19 pandemic, which has brought about major changes to the world's production structure, the global economy is heading toward a new normal in which, despite the catalytic effect of vaccine development and application to reduce long-term risks, the potential remains for further contraction given the recent outbreaks of the virus. In this context, the report predicts that the world economy will resume growth in 2021, strongly supported by the performance of developed markets that will capitalize on double monetary and fiscal momentum, while emerging markets will also recover, albeit at a slower pace.

From an industry perspective, unlike other activities, the insurance sector has shown some resilience to the effects of the sharp and significant decline in economic activity. This has been supported by the compensation generated by the acyclic behavior of certain business lines compared to others that, on the contrary, have been strongly affected by the economic crisis. As such, the fall in activity has negatively affected the segments most linked to the economic cycle. Similarly, the accommodative monetary policies, as well as families and companies moving toward liquidity positions, have negatively affected the insurance business linked to savings, especially in developed markets. The economic revival expected for 2021 may underpin a recovery in the sector, especially in emerging countries. However, as is generally the case with economies, it will be uneven across the various markets and insurance business lines.

We trust that this report will continue to contribute to the understanding of general economic performance and therefore of the challenging environment that the insurance industry will face in 2021.

MAPFRE Economics

Executive summary

2021 Economic and Industry Outlook

Economic outlook

The global economy is facing times of extreme uncertainty. Regardless, the central vision of this report is as follows: Firstly, that normality will be achieved by the middle of the third quarter of 2021; secondly, that, overall, the world will recover the product levels reached at the end of 2019 by the middle of 2022, although with significant differences between regions and countries, which will be determined, among other factors, by the strength of healthcare systems in administering vaccines and therapeutic treatments, the effectiveness of economic policy measures taken during the pandemic to prevent impacts on production and employment, the specific sectoral composition of each economy, pre-pandemic structural economic vulnerabilities, and the governance and certainty in the implementation of economic policy in each country.

Despite this, there are still great unknowns on the horizon that reaffirm a dual vision of global performance: biological unknowns, related to the implications of virus mutations and how they relate to the new generalized lifting of severe restrictions at the global level; operational unknowns, which delay mass immunization, because of both its management by governments and its acceptance by the population; financial unknowns, derived from the pressures in the private and public sector due to vulnerabilities in household balance sheets and potential effects in terms of finance; economic unknowns, such as the effective scope of stimulus measures, the long-term effect of the disruption to production and value chains; and geopolitical unknowns, as 2021 marks the beginning of a different era with a new administration in the United States and its return to an approach committed to the global agenda and multilateralism, as well as a strengthened European Union aware of the challenges and opportunities of all kinds embodied in China playing a leading role.

Thus, the baseline scenario vision estimates that world growth will be slightly above 4.5% on average between 2021 and 2022, with emerging markets growing slightly less and developed markets growing slightly more. Developed markets are entrusted with spearheading the closing of the output gap over the coming years, contributing two-thirds toward this goal. This is relevant when thinking about the monetary policy that will emerge in 2023. On the other hand, the stressed scenario assumes that the return to normality will be delayed and that the epidemiological "endpoints" will not be reached until well into 2022, with recovery therefore delayed by one year. In this alternative scenario, average growth and contributions from each region are delayed until the 2022–2023 biennium. Thus, for 2021, near-zero global growth is expected followed by strong growth in 2022 (which has a base effect from the expansion of the crisis in 2020 and 2021), extending the momentum to 2023. Both scenarios feature recovery, but this is sooner or later depending on the pandemic.

The crisis caused by the COVID-19 pandemic has seen an unprecedented fiscal response, the significance of which transcends the value of its high contribution to growth. Its coordination with monetary policy has been fundamental because it has prevented a situation of fiscal dominance from emerging and because of the implicit shift that it entails toward monetization of the deficit and debt — something that could lay the foundation to unravel future inflation expectations.

The recovery envisaged in the central vision of this report has the role of consumption at its forefront. In particular, it is a recovery based on expectations that allow the monetary savings held onto during the crisis to be spent. For this to happen, there needs to be certainty about the pandemic's endpoints, monetary and fiscal support must remain abundant and long-term, real disposable income must grow against a backdrop of moderate inflation, and family and corporate balance sheets must be rebuilt. However, some triggers could lead to the early materialization of the risks seen in this report, which could still turn the central vision of foreseeable performance into an alternative risk vision that the report has not yet quantified. These triggers include the lockdown situation being stretched out, which would lead to problems in terms of solvency and economic depression, and the return of high and persistent inflation as a result of the loss of control of long-term inflation expectations.

In addition, the report emphasizes that economic recovery will take place within the framework of a new international context with profound changes in its main stakeholders. In the US, the Trump era and its bilateral and autonomous approach is coming to an end, and the new Joe Biden administration will reverse many of his predecessor's policies. The new US administration is expected to focus on increased fiscal progressiveness, an ambitious infrastructure and education investment program, a return to the Paris Agreement, the revival of a healthcare program similar to the Affordable Care Act, a return to multilateralism with the commitments abandoned by the Trump administration, and a narrative about China that differs in form, despite being similar in content.

As it did in the Lehman Brothers crisis, China will play a key role in global recovery. Its emergence from the COVID-19 crisis before any other country and its expected dynamism in the coming years will give it the ability to pull on the flow of global trade, demand for raw materials and checking account financing for other emerging markets. Its relationship with the US and Europe will be modulated, but it will not change its newly acquired status as a technological, geopolitical, and strategic trade rival.

In Europe, a major growth rebound is expected in 2021 despite recent new outbreaks of the virus, but it will not be enough for pre-crisis levels to be reached before mid-2022 and the output gap will not close before 2024. The next upturn in economic activity will have implications for the interest rate curve, inflation and exchange rates. In this region, four elements outline recovery: the scale of the initial shock, healthcare policies, and the level of restrictions implemented in each member of the European Union; the strength and coordination between monetary and fiscal policy that will remain extremely accommodative; the duality of the recovery that will initially favor industrial countries and later those oriented toward personal services such as tourism; and, importantly, the anticipated upturn in inflation starting in 2021, which is expected to be short-lived.

Finally, Latin America has been the region that has managed the crisis the worst, and its capacity for recovery is therefore lower. Poverty has skyrocketed, millions of small- and medium-sized enterprises have gone bankrupt, and millions of jobs have been lost. Per capita growth in Latin America had been stagnating since 2015, and, after the current crisis, per capita income is not expected to return to 2015 levels until 2025. In other words, the COVID-19 crisis will cause this region of the world to lose another decade.

Industry outlook

The forecast of a return to global economic growth in 2021 could lead to a relative recovery following the sharp fall in 2020, which would shift to the insurance industry, but uncertainty about new increases in the number of infections and the speed of administering vaccines remains high. Therefore, the expected global recovery may only be consolidated in 2022 and may not be even across countries. The wide range of forecasts is indicative of the high level of uncertainty affecting all sectors, including the insurance industry, where significant

setbacks are already evident, although in this case to a lesser extent than other sectors directly linked to travel, tourism or in-person services. High uncertainty affects the spending, hiring, and investment decisions of both households and businesses, which harms the performance of the insurance industry, although some business lines continue to show great resistance, particularly health insurance. The effectiveness of vaccination campaigns to achieve immunity that at least prevents the saturation of healthcare systems until herd immunity has been achieved will be a key element in a recovery that will be uneven due to the lack of healthcare infrastructure and logistical problems in distributing the vaccines in some countries, especially emerging economies.

The 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, and continues to provide stability to the financial markets, in which insurance companies are one of the major institutional investors, all while allowing governments, households and businesses to continue receiving financing at reduced costs. However, the fiscal measures taken are substantially increasing countries' deficits and debt levels, which is a significant limitation for those economies without sufficient fiscal, monetary, and additional borrowing capacity — a problem that greatly affects emerging countries. In some of these countries, the deterioration of public accounts is causing exchange-rate depreciation and inflationary pressures, fueled by accommodative monetary policy measures, which may delay recovery of the economy and of the insurance industry because of its close link to the economic cycle, as well as reducing the profitability of the insurance companies due to the increase in the cost of claims and the loss of financial return on their investments. Among emerging countries, for the time being, the Turkish insurance market is showing better performance, in parallel with its economy, which has suffered a less severe impact from the pandemic. In Mexico and Brazil, insurance markets are suffering from real-term declines in premiums.

The Spanish economy could embark on a partial recovery in 2021 after the sharp decline experienced in the previous year — one of the largest in the world, due to the effects of the restrictions imposed by the pandemic on consumption, trade, hospitality and tourism-related activity, with the resulting negative impact on employment, business and the solvency of households and enterprises being shifted to the insurance market. With the latest data available from November 2020, Non-Life premiums are decelerating year-on-year, but have not declined. This is because some business lines continue to show great resilience, in particular health insurance, which is always very resilient in economic crises, and especially so in the current health crisis. The Life business is the most affected by strong declines in premiums, although it showed some resistance in terms of managed savings, which only fell slightly. However, although only a small proportion of the savings managed by insurance companies, insurance types in which the policyholder assumes the risk of investment are experiencing significant growth in terms of savings and, above all, in terms of the number of policyholders. Moreover, the pattern of insurance business performance shows similarities to that of the 2007–2009 crisis. In the current crisis, however, the decisive intervention of the European Central Bank (ECB) has allowed Spain (and other eurozone countries) to receive financing at a reduced, or even negative, costs. Thus, together with the European Union's aid program, the action of economic policy has led to the prediction of a less profound fall and a faster recovery for the insurance industry than in that crisis.

In terms of supervision during 2020, the International Association of Insurance Supervisors carried out its first assessment exercise of the global insurance market from the perspective of its possible systemic risk, under the new framework approved the previous year and adapted for the pandemic. This result of this exercise showed that the greatest impact was on assets, negatively affecting the profitability and solvency of the insurance industry. However, insurers remained resilient both financially and operationally, although uncertainties remain about the future outlook. On the other hand, in its latest financial stability report published in

December, the European Insurance and Occupational Pensions Authority (EIOPA) highlighted that European insurers have been able to resist the dramatic situation and that the Solvency II regime has helped them better align their capital with risk, increase their resilience, and enhance risk management best practices. However, it indicated that uncertainty remains high, and may still impact their business models, and financial, liquidity and solvency positions. In this regard, it noted that the environment of low interest rates, which will continue for even longer, remains the main concern for both the insurance and pension industries, posing a challenge to the profitability of banks, insurance companies and pension funds. It also pointed to other risks emerging from the pandemic, such as downgrades in corporate credit ratings, increased bankruptcies, unemployment, the expected fall in the price of commercial real estate or the increase in financial defaults that can affect insurers and pension funds because of their high level of connection with the banking sector. Moreover, it also showed that, as a result of the crisis, public debt levels have increased dramatically. It pointed out that risk premiums and volatility have sharply reduced as a result of the ECB's asset acquisition programs. This has contributed significantly to mitigating the link between sovereign and banking risk in the eurozone's peripheral countries, which has a positive risk-containment effect on insurance companies and pension funds.

EIOPA notes in its report that, despite these turbulent times, it will continue to pay attention to other long-term objectives, such as sustainable finance and digitization, in order to not only enable insurers and pension funds to manage and mitigate climate and cyber risks, but also to reflect the preferences of policyholders and pension plan participants in their investments and seize business opportunities to actively support the transition to sustainable, digital economies.

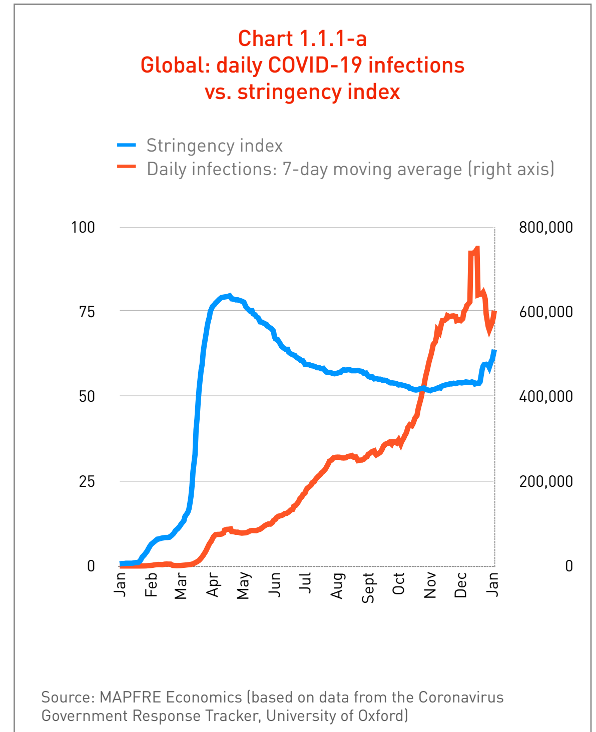
1. Economic outlook

1.1 Global economic outlook: on the road to the new normal

1.1.1 An environment of uncertainty

In the midst of the onset of a new widespread outbreak of COVID-19 infections (in both the developed and emerging worlds), and at beginning of the still incipient vaccination process and the emergence of new mutations of the virus (see Charts 1.1.1-a to 1.1.1-f), projections for global economic growth are still submerged in a broad spectrum of uncertainty, forcing general revisions of growth projections given in our last report[1]. In this sense, MAPFRE Economics has limited the scope of its forecasts to situations of normalization and new outbreaks in a context of growing fragility. In fact, recent developments in the form of new outbreaks around the world and new restrictions confirm the need to establish such a scope of forecasts.

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

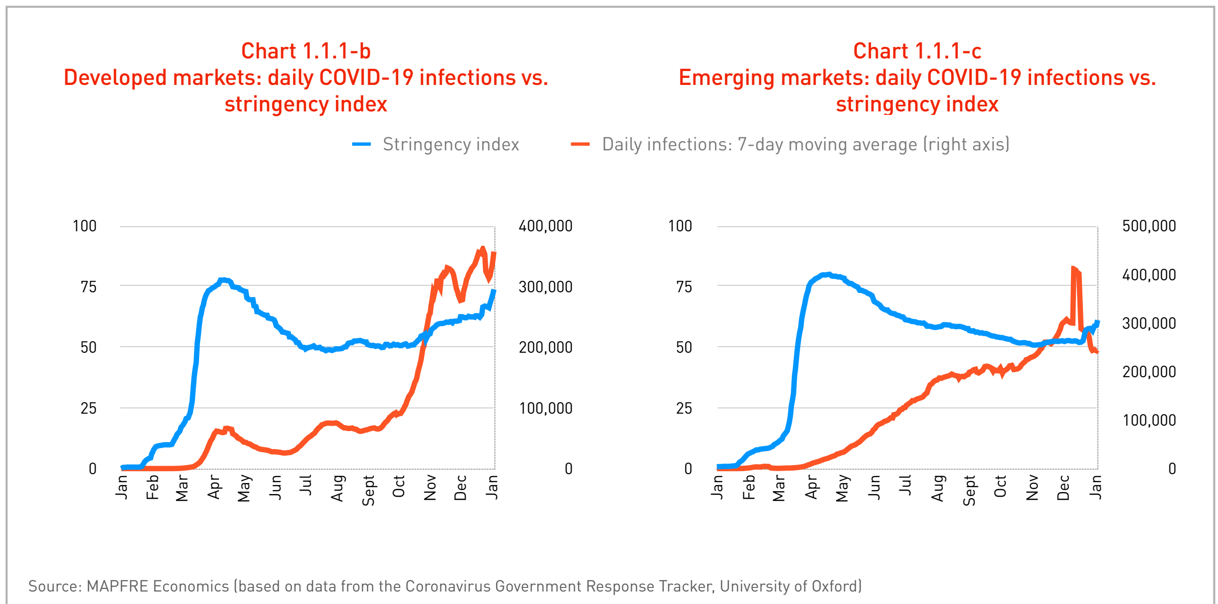


Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford)

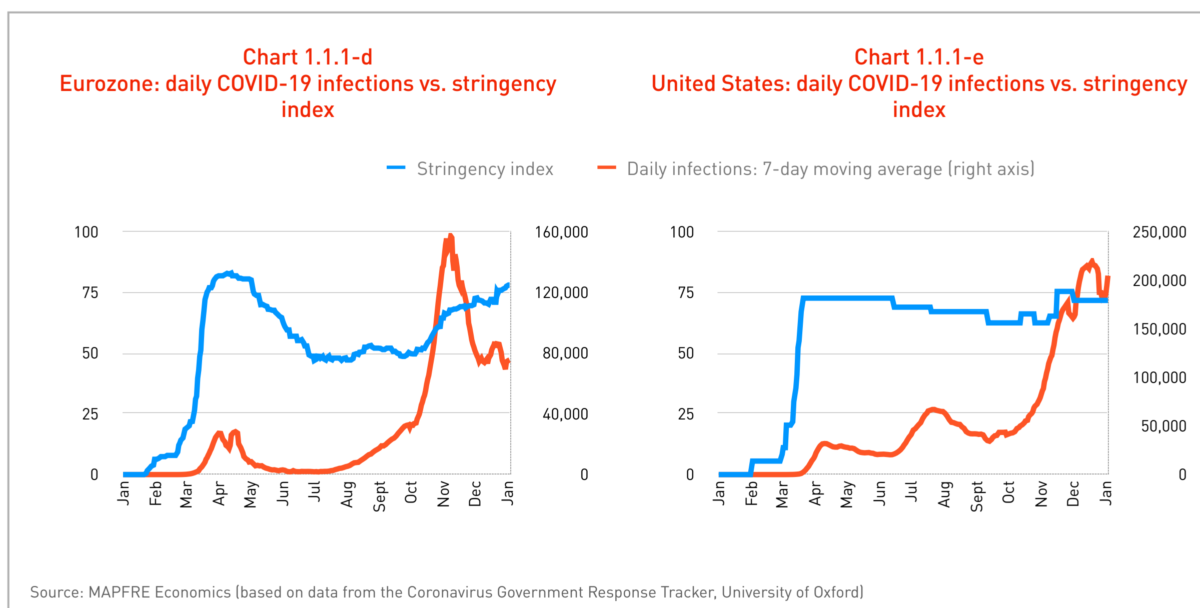
The central scenario considered in this report is that the deployment of mass vaccination begun at the end of 2020 will gain traction during the first quarter of 2021. The endpoint—or effective exit from the current exceptional situation—is

Chart 1.1.1-b
Developed markets: daily COVID-19 infections vs. stringency index

Chart 1.1.1-c
Emerging markets: daily COVID-19 infections vs. stringency index



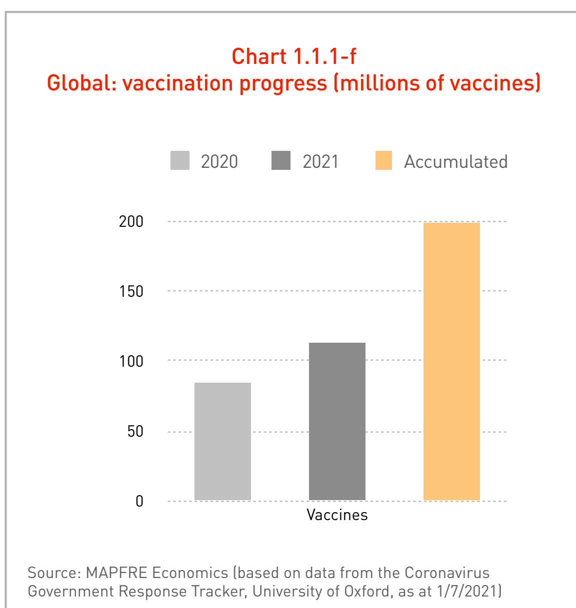
Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford)



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

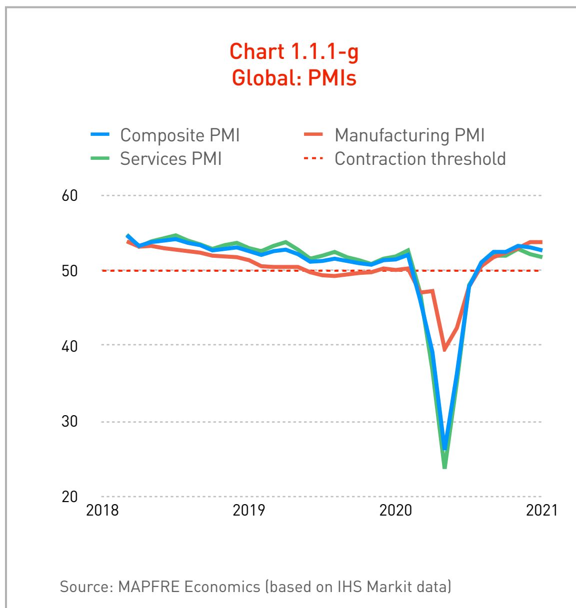
difficult to determine, as mass immunization, by either vaccination or herd immunity, still faces an indefinite number of unexpected scenarios, such as: (i) biological mutations of the virus and outbreaks; (ii) the commitment of society to inoculation; (iii) logistical difficulties in its distribution and application; and (iv) more importantly, the adequacy of its production[2].

Despite this, we share the belief indicated by the leading economic activity indicators that normality will be achieved by the middle of the third quarter of 2021 and that, as a whole, the world will recover the losses during the economic crisis in mid-2022, though with large differences between countries and regions. This imbalance will be determined, among other factors, by: (i) the strength of healthcare systems in administering vaccines and therapeutic treatments; (ii) the effectiveness of economic policy measures taken during the pandemic to prevent impacts on production and employment; (iii) the specific sectoral composition of each economy; (iv) pre-pandemic structural economic vulnerabilities; and (v) the governance and certainty in the implementation of economic policy in each country (see Charts 1.1.1-g to 1.1.1-i).



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, as at 1/7/2021)

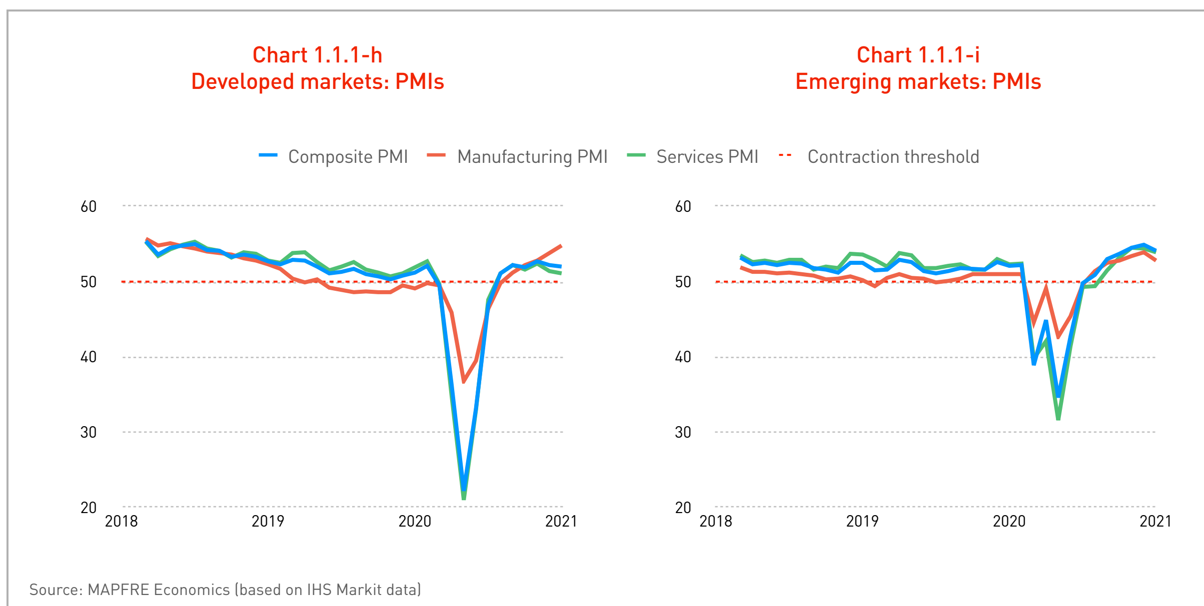
As such, there are still great unknowns on the horizon that reaffirm a dual vision of global performance. Five of these unknowns are the most significant. First, there are biological unknowns, related to the implications of virus mutations and how they relate to the new generalized lifting of severe restrictions at the global level[3]. Second, operational unknowns, which delay mass immunization, because of both its management by governments and its acceptance by the population. Third, financial unknowns, which are the result of pressures in the private and public sectors. Household balance sheets are deteriorating in terms of



real and financial assets, as well as in their income. Likewise, the balance of nonperforming loans is also increasing; at the corporate level, while excesses are fueled by abundant liquidity[4] (cryptocurrencies, gold, high yield, the price-to-earnings ratio of technology companies, low covenant debt, etc.), bankruptcies in the private sector are starting to increase, especially in energy and consumer services[5]. The dissonance between the real and financial sectors remains. Fourth, there are economic unknowns, such as the effective scope of stimulus measures, the long-term effect of the disruption to production and value chains, as well as the permanent effects on global potential growth and wealth distribution[6]. Fifth, geopolitical unknowns, as 2021 marks the beginning of a different era with: (i) the administration of President Biden and its return to a approach committed to the global agenda and multilateralism; (ii) a strengthened European Union, but one that is different from that of the past decade (new leadership in the European Commission and the European Central Bank, Angela Merkel's departure, the introduction of NextGenEU, Brexit, the renewal of the Atlantic entente); and (iii) a new awareness of the challenges and opportunities of all kinds embodied in China playing a leading role[7].

1.1.2 Scenarios and forecasts

In the central scenario considered in this report, the world emerges from the recession at the end of the first half of 2021, assuming that the new coronavirus outbreaks are controlled and there is no need for greater restrictions beyond the current ones. Immunity from the virus is achieved in the transition from 2021 to 2022, and the countries with the highest income support throughout 2020 and 2021 will recover to GDP levels at the end of 2019 the soonest. Thus, for example, the United States



Box 1.1.2-a
When will the pre-COVID-19 GDP level be recovered?
Analysis for selected economies in the base scenario

2019 GDP recovery

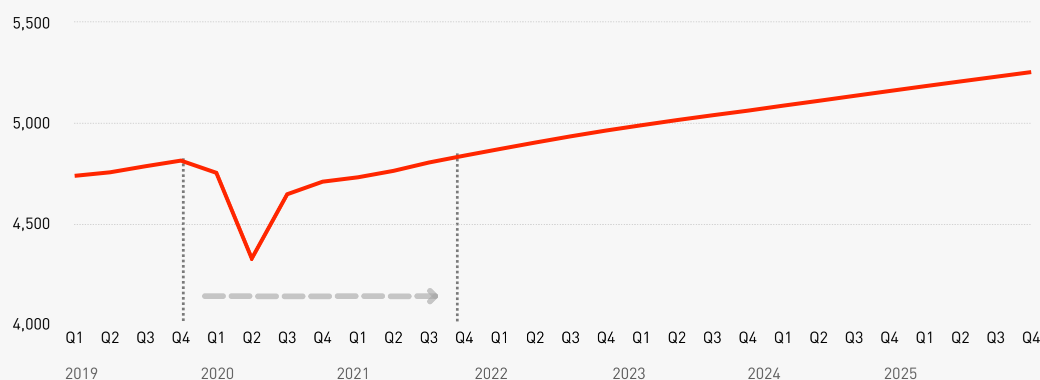
Global product recovery scenarios can vary greatly depending on the successive waves of the pandemic and the associated measures to contain its effects. Until now, uncertainty has stemmed directly from the endpoint to the pandemic being unknown. Herd immunity is one way out, and the start of mass vaccination programs throughout 2021 will accelerate this process, and has raised some optimism about a return to normality in the not too distant future.

However, it is not only biology that sets the tone for the possible recovery of activity, but also economic policy implemented both in the form of monetary packages (to ensure benign financing and broad liquidity conditions) and fiscal packages, aimed at replacing income lost as a result of restrictions imposed on economic activity (unemployment transfers, public investment, etc.). Last but not least, consumer behavior during and after the epidemiological crisis will also be a determining factor, both because of consumers' ability and propensity to consume once uncertainty has faded, and because of their intertemporal reaction to the fiscal measures enacted (Ricardian equivalence), which can prevent the required triggering of domestic demand, which is key to recovery.

Despite the obvious difficulty of hypothesizing in such an uncertain context, it is possible to try to provide some guidance on how recovery could look in four selected economies (the United States, the eurozone, Spain and Brazil) under the baseline scenario set out in this report. To this end, there has been talk that an initial level of recovery will have been achieved when the real GDP level in the fourth quarter of 2019 has been reached.

Since the onset of the economic crisis caused by the lockdown and social distancing measures implemented to tackle the pandemic, the decline in product was at its most severe during the second quarter of 2020. At that time, Spain was notably affected to a different degree to other economies due to the severity of the measures imposed. The US appears to be the economy to have suffered the least from this second quarter decline, because the health measures implemented were initially much milder. The eurozone and Brazil also had different degrees of contraction as a result of the restrictions imposed. It should be noted that the restrictions

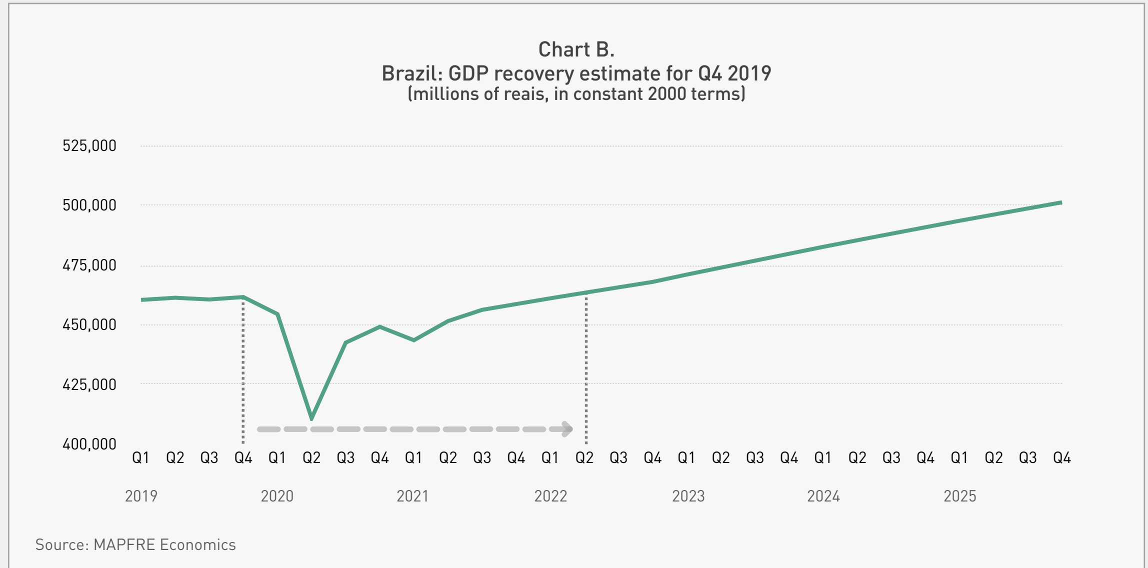
Chart A.
United States: GDP recovery estimate for Q4 2019
(billions of US dollars, in constant 2012 terms)



Source: MAPFRE Economics

Box 1.1.2-a (continued)
When will the pre-COVID-19 GDP level be recovered?
Analysis for selected economies in the base scenario

Chart B.
Brazil: GDP recovery estimate for Q4 2019
(millions of reais, in constant 2000 terms)

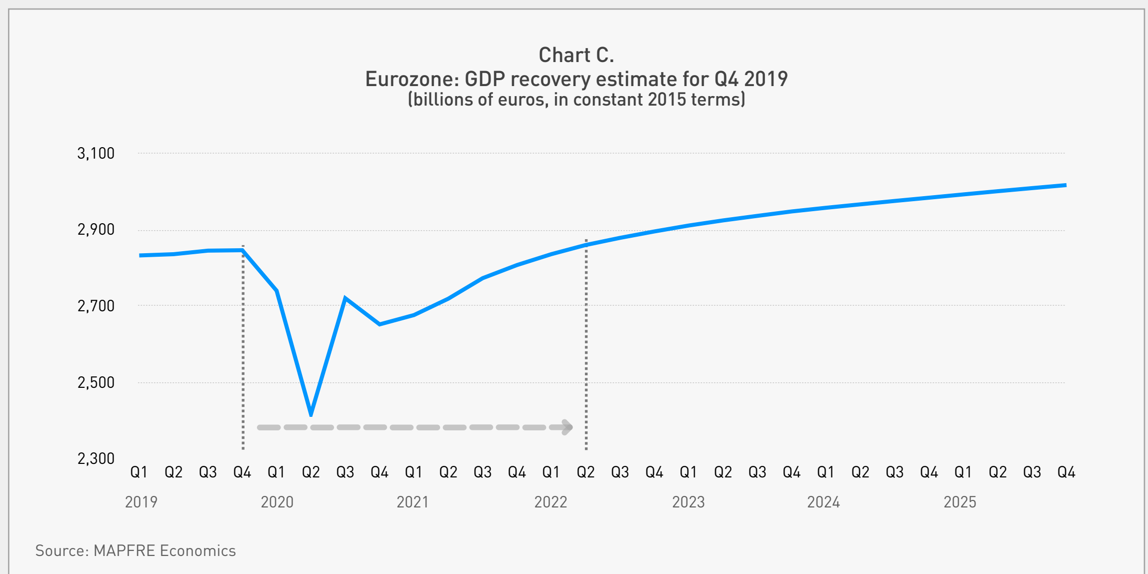


Source: MAPFRE Economics

not only had political and economic elements, but were proportional to the fatalities recorded, a parameter clearly linked to the size of the elderly population (particularly notable in Spain).

So far, the path to recovery is marked by three factors: (i) restrictions (determined by the number of cases); (ii) economic specialization (the pandemic particularly affected the services and direct trade sector); and (iii) aid provided (direct transfers have a greater effect than public guarantees). Based on these characteristics, the base scenario considered in this report predicts that the US economy will return to the 2019 GDP level by the end of 2021, thanks to significant public transfers that have so far amounted to more than 15% of GDP, the diversification of the economy and, in general, a more lax imposition of measures under President Trump's administration. Brazil is expected to be the

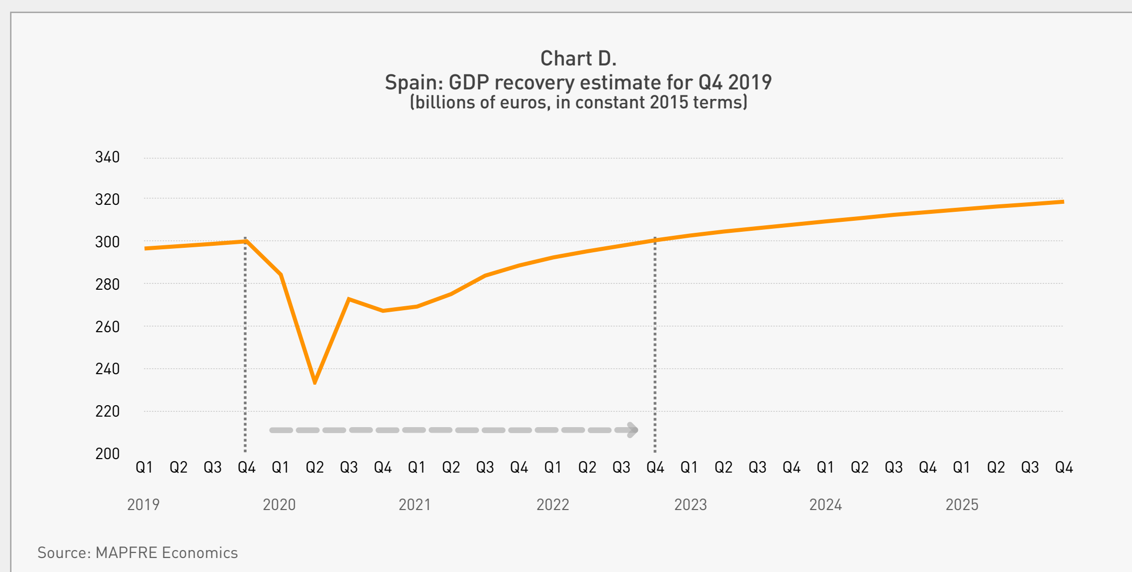
Chart C.
Eurozone: GDP recovery estimate for Q4 2019
(billions of euros, in constant 2015 terms)



Source: MAPFRE Economics

Box 1.1.2-a (continued)
When will the pre-COVID-19 GDP level be recovered?
Analysis for selected economies in the base scenario

Chart D.
Spain: GDP recovery estimate for Q4 2019
(billions of euros, in constant 2015 terms)



Source: MAPFRE Economics

second economy to reach the aforementioned threshold of recovery given the relative laxity of measures at the peak of infections and because the measures taken, as in the United States, had a strong focus on income transfer at the start of the crisis (disposable income actually grew in the US despite falling GDP). In the eurozone, monetary policy reacted instantly, but with no centralized fiscal authority, the response (and delays) on this matter depended on each country's ability to react (quickly in Germany's case, and more slowly for Spain) and the nature of the aid, which has so far been very focused on the system of public guarantees and not so much on income transfer.

Thus, given the initial loss of GDP in the first half of 2020, and the sectoral effects of the pandemic and each economy's health capacity, it is expected that the first to recover the output level of the last quarter of 2019 will be the United States and Brazil (both in 2021), followed by the eurozone economy. Within the eurozone, Spain's economy will be the last to recover. However, it should be emphasized that it is precisely the high dependence of the Spanish economy on the services sector, hindering recovery in 2021, that will make it one of the fastest growing economies in 2022. Nevertheless, it will not recover the product level of the end of 2019 until at least the second half of 2022, with a strong likelihood that it will not happen until 2023.

Source: MAPFRE Economics

comes first, followed by Brazil; the rest, including the European Union, Latin America, and Spain, lag far behind, conditioned by their production structure and the nature of the stimulus received. Depending on the outbreaks of the pandemic and the restrictions imposed by governments to control them, the emergence from the pandemic will be achieved sooner or later at the global level (see Box 1.1.2-a).

Thus, the baseline scenario vision estimates that world growth will be slightly above 4.5% on average between 2021 and 2022, with emerging markets growing slightly less and developed markets growing slightly more. Developed markets are entrusted with spearheading the closing of the output gap over the coming years, contributing two-thirds toward this goal. This is relevant when thinking about the monetary policy that will emerge in 2023 (see

Tables A-1 to A-5 in the Appendix to this report).

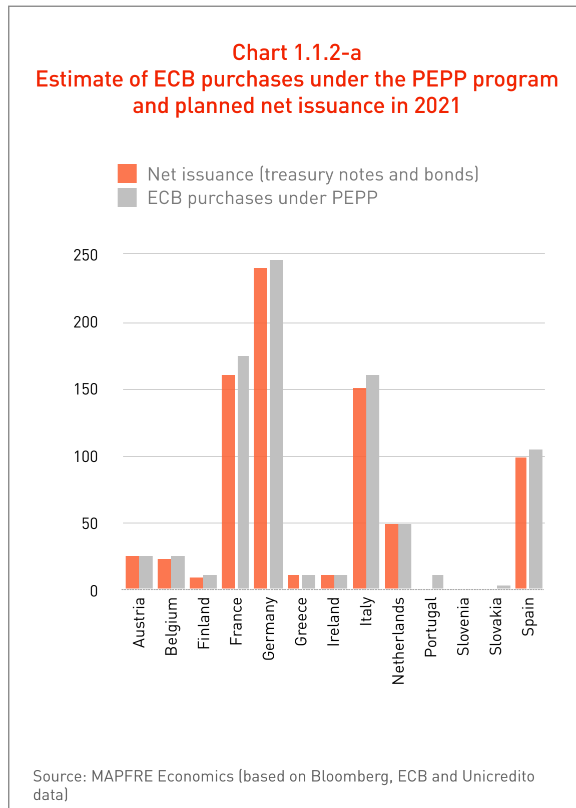
On the other hand, the *stressed scenario* of our central vision assumes that the return to normality will be delayed and that the epidemiological endpoints will not be reached until well into 2022, with recovery therefore delayed by one year. In this alternative scenario, average growth and contributions from each region are delayed until the 2022–2023 biennium. Thus, for 2021, near-zero global growth is expected followed by strong growth in 2022 (which has a base effect from the expansion of the crisis in 2020 and 2021), extending the momentum to 2023. Both scenarios feature recovery, but this is sooner or later depending on the pandemic.

This central vision of the global economy also envisages that oil will maintain its current path of reversion to its equilibrium price (60–65 US dollars per barrel) starting in 2024, as a result of global demand. It also estimates that global risk aversion (VIX) will remain on its path to normalization (despite short-term temporary outbreaks), converging the average values from the last five years until 2022 (20 basis points). Risk aversion also reduces in the stressed version of this central vision, albeit more slowly.

In both central vision scenarios, monetary policy in developed economies remains extremely accommodative and countercyclical as part of efforts to generate unprecedented favorable liquidity conditions and to accommodate fiscal policy. G7 central banks maintain expectations around their baseline vision of the economy and bolster exceptional programs against the effects of the COVID-19 pandemic (see Charts 1.1.2-a and 1.1.2-b), and Box 1.1.2-b).

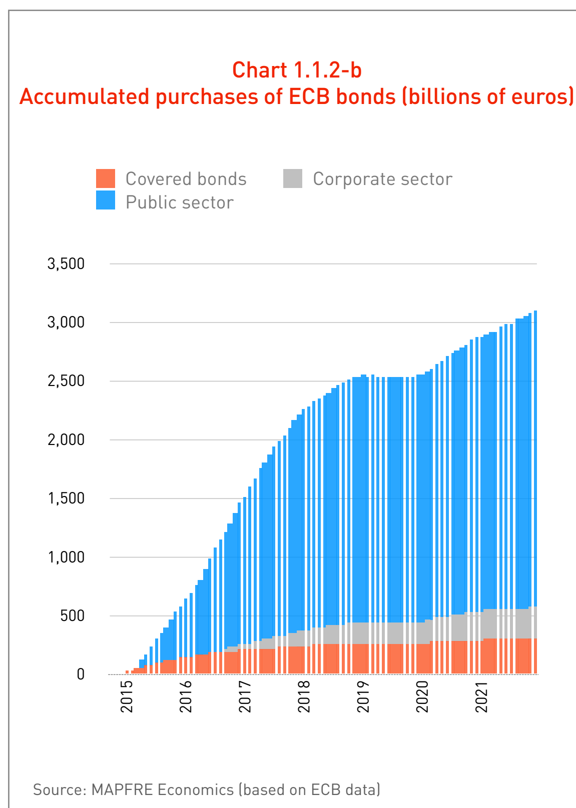
With the massive fiscal effort implicitly monetized and coupled with the clear reflationary pivot (change of the inflation target) of the Federal Reserve (Fed), US inflation expectations have grown again as the dollar generally weakens against all global

Chart 1.1.2-a
Estimate of ECB purchases under the PEPP program and planned net issuance in 2021



Source: MAPFRE Economics (based on Bloomberg, ECB and Unicredito data)

Chart 1.1.2-b
Accumulated purchases of ECB bonds (billions of euros)



Source: MAPFRE Economics (based on ECB data)

Box 1.1.2-b
Monetary policy update

The Federal Reserve

At its December meeting, the US Federal Reserve kept its monetary policy unchanged, keeping interest rates in the range of 0.00–0.25%, and maintained the monthly pace and composition of asset purchases. As such, and in line with expectations, the Federal Reserve has maintained its commitment to keep interest rates low until at least 2023, with a progressively increasing balance sheet forecast, in line with the objectives proposed in the recent strategic review of monetary policy toward full employment and inflation.

In terms of macroeconomics, the projections presented show a stronger performance for the US economy, but inflation is expected to remain the same. Core inflation is expected to remain below 2.0% until the end of 2022, although this forecast may change if the inflation target is adjusted.

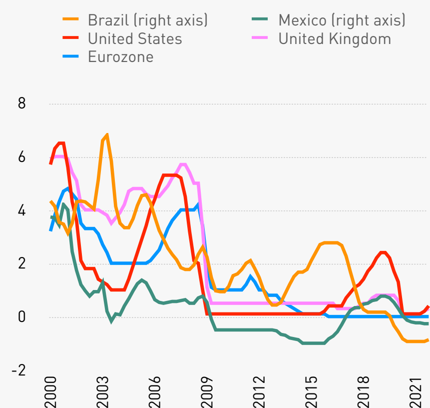
Moving forward, despite the dynamism of the US economy, many challenges will arise in the face of recovery, including a new increase in cases of COVID-19 and a foreseeable new round of mobility restrictions under President Biden's administration in a context of partial recovery of the labor market. The Federal Reserve has made it explicit that it welcomes further direct fiscal stimulus, which it has committed to accompany with sufficient monetary accommodation and without an explicit limit. The appointment of Janet Yellen as the next Secretary of the Treasury appears to reaffirm this attitude.

In this regard, monetary policy in the United States is expected to remain free from significant disputes among members of the FOMC and be balanced between the current accommodative situation and the possibility of further action if the pandemic requires it. In any case, it is hoped that any additional measures introduced will be directed toward quantitative easing, with the possibility of adjustments in both monthly purchases and the balance sheet profile (moving it toward a composition of longer maturities) with which to extend the control range of the interest rate curve.

European Central Bank

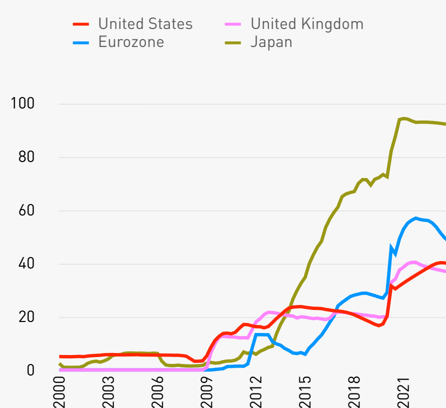
Despite the positive catalyst generated by the conclusion of the vaccine development process in early November, the surge in infections has caused the manufacturing sector, and especially the services sector, to lose traction. This has

Chart A.
Official interest rates
(%)



Source: MAPFRE Economics (based on data from central banks)

Chart B.
Balance sheet of central banks
(% of GDP)



Source: MAPFRE Economics (based on data from central banks)

Box 1.1.2-b (continued)
Monetary policy update

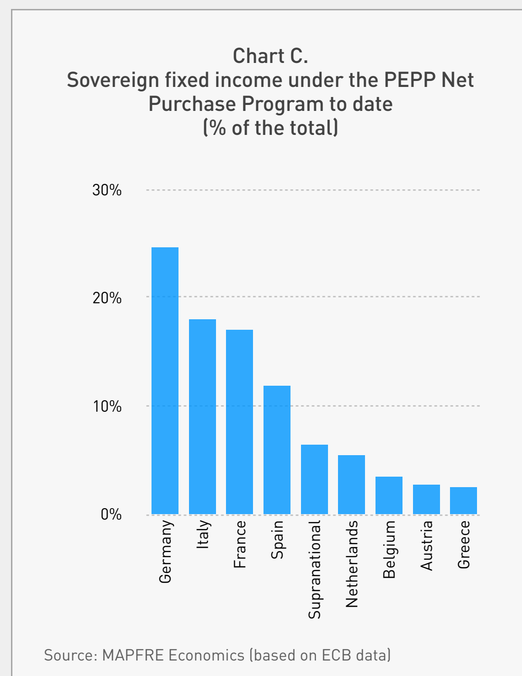
forced the ECB to increase monetary laxity and maintain favorable financial conditions and thus contribute to the flow of credit to all sectors of the economy, allowing a more dynamic cyclical exit. Thus, the risk that a liquidity problem could transform into a solvency problem remains latent. In this sense, the increase in arrears is a sign to be taken into account.

The news about the development of vaccines has partly diluted uncertainty for the long-term, but in the short-term, uncertainty regarding the biological development of the virus prevails. Both factors have forced the ECB to adjust its forecasts, which now predicts a not-so-severe recession in 2020, but also envisages a much more strained exit in the coming years.

In this context, at its December meeting, the ECB kept the official interest rates unchanged (0% for refinancing and -0.5% for deposits), reiterating that they would remain at or below those levels for as long as needed. As for the current asset purchase program, PEPP, purchases increased by 500 billion euros to 1.85 trillion euros, and the program was extended (until March 2022). It was also confirmed that the reinvestment of principal payments from assets that are currently maturing would be extended until at least 2023. The composition of the PEPP clearly favors Italy and Spain, which, despite occupying the second and fourth positions in volume purchased, rank first and second in terms of GDP.

In addition, the standard asset purchase program was maintained, with net purchases of 20 billion euros per month as long as they see it necessary, to be normalized only following interest rate increases (not expected before 2023). Similarly, the ECB's Governing Council will continue the reinvestment of principal payments for an extended period of time, as long as necessary, maintaining broad monetary accommodation and favorable liquidity conditions.

In addition, TLTRO III has been extended until June 2022 and the total amount that counterparties will be able to borrow under the program has been increased from 50% of their eligible loans to 55%, in other to provide favorable conditions for maintaining credit. However, this liquidity will be conditional on



banks achieving certain loan targets. To grant access to this credit, the Governing Council also extended the duration of collateral measures to be met by credit institutions. Finally, the repo facility (EUREP) and all temporary repo lines with non-Eurosystem central banks will be extended until 2022 (to provide liquidity in euros).

Both balance sheet and liquidity measures place the eurozone's monetary bias in an extremely lax area, which, in addition to facilitating liquidity and balance sheet stability, accommodates the huge growth in public debt resulting from the debt needed by countries to tackle the pandemic through fiscal policy. For this reason, despite the fact that European public debt exceeds 120% of GDP, the costs of its financing measured by the real effective rate are expected to remain virtually zero. Sovereign spreads from the most vulnerable countries in the eurozone show monetary and fiscal bias in the midst of the pandemic.

Box 1.1.2-b (continued)
Monetary policy update

Chart D.
Eurozone: Monetary and fiscal policies vs. output gap*

Source: MAPFRE Economics

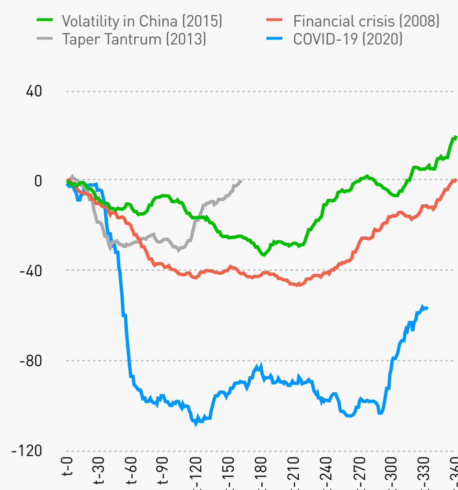
* Variables expressed as differences

Outlook

Uncertainty remains high moving forward, both in terms of the dynamics of the pandemic and the timetable for the deployment of vaccines, and in the risks arising from the expansion of the situation, which could lead to solvency problems. In such a context, it will also be necessary to monitor the evolution of the exchange rate as it pertains to the possible implications for the medium-term inflation outlook.

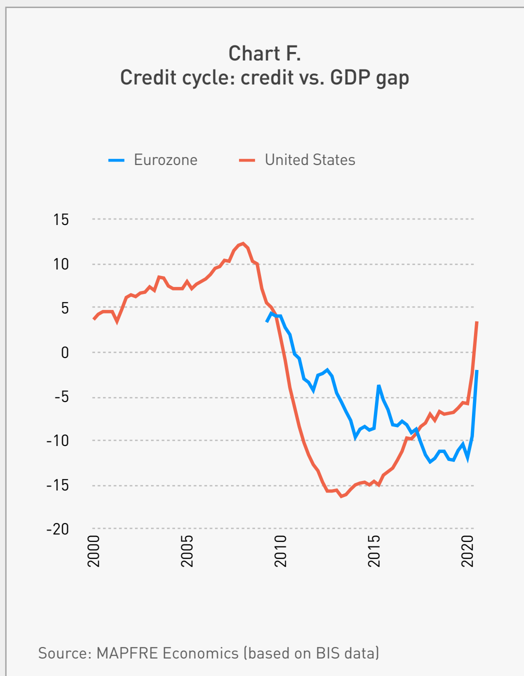
Some challenges to monetary policy remain visible on the horizon. First, the strength of the euro will make the inflation target even more difficult to achieve, both because of its effect on global activity as euro trade rises, and because of its limits on cost pass through. In this sense, we put the USD/EUR exchange rate on the path toward its equilibrium price (1.25) at the beginning of 2022. Inflation will also be under downward pressure during 2022, not so much in 2021, due to effects resulting from bottlenecks in 2020.

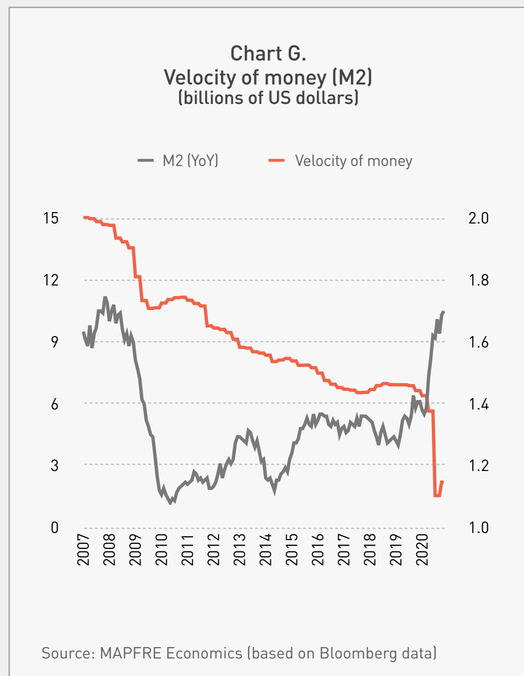
Chart E.
Accumulated portfolio investment flows to emerging markets
(billions of US dollars)



Source: MAPFRE Economics (based on IIF data)

Box 1.1.2-b (continued)
Monetary policy update





Second, renewed monetary laxity has returned net flows into the financial accounts of emerging countries in search of higher yields, making their current deficit viable and allowing for moderate financial costs that help mitigate debt service. However, a misinterpretation of the intentions of monetary policy could reverse this quickly, draining emerging markets of liquidity and creating pressure on safe-haven fixed income (with the consequent pressure on the interest-rate curve).

Thirdly, there will be a difficult balance to attempt to increase credit to economic agents, while the current balance of funding deteriorates due to the increase in arrears as a result of the significant and prolonged reduction economic activity.

Finally, there are limits on the tools available, penalties on deposits and loan incentives, in an attempt to move stagnant liquidity in the form of reserves. The velocity of money continues to slow down. Despite the scale of the monetary measures, much of the liquidity remains stagnant in the financial circuit in the form of reserves and without the increase in the monetary supply being adjusted to nominal growth in the economy.

Source: MAPFRE Economics (based on ECB and Federal Reserve data)

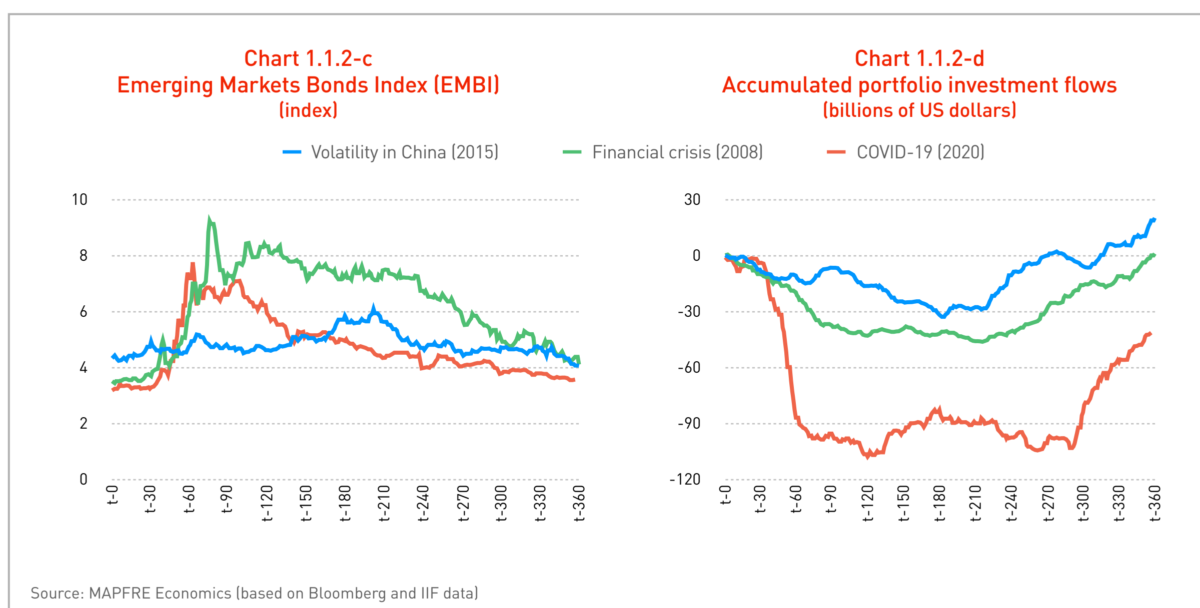
currencies. In the case of the euro, the path toward a balance of 1.25 is being consolidated, with expectations that it will oscillate in the range of 1.21 to 1.22 in both 2021 and 2022. A more stressed situation would entail greater fiscal and monetary efforts in the eurozone and United States, but it would not change euro-dollar parity.

The global reduction in risk aversion (VIX), coupled with the Fed's accommodative stance, will allow emerging market currencies to stabilize their exchange rate against the dollar over the next two years, even in an increasingly inflationary environment that will not be matched by comparable monetary responses.

A gradual risk appetite, the Fed's monetary position and some checking account restructuring based on lower consumption and loss of reserves before and during the COVID-19 crisis will promote the return of net portfolio and credit flows to Latin America and Asia (see Charts 1.1.2-c and 1.1.2-d). Direct investment, however, will have more trouble returning in a context of global production reshoring. The recovery of the raw materials cycle (in particular food and new metals), coupled with remittances, will allow the accumulation of liquidity and reserves over the next few years in favor of the stability of emerging market currencies. A stressed view of this situation would make for a volatile year in currency exchange in 2021, but it would stabilize in 2022.

Global fiscal policy, especially in the developed world, has learned from the mistakes of the past, when there was support for austerity and it took too long to respond decisively to the 2008–2009 crisis. In addition to the more or less explicit temporary suppression of fiscal stability rules (debt ceiling in the United States and the Stability and Growth Pact in the eurozone), there have been stimulus packages of a different fiscal or quasi-fiscal nature[8]. These packages have tended toward direct income transfers in the United States, while the emphasis has been on the provision of guarantees and the temporary replacement of employment income in the European Union. In 2021 and 2022, fiscal stimulus will remain strongly expansionary, but less so than in the past.

The significance of this fiscal expansion goes beyond the value of its contribution to growth (which, on average, will be 200 basis points of global growth). Its coordination with monetary policy has been fundamental for two reasons.



Source: MAPFRE Economics (based on Bloomberg and IIF data)

First, because it has made it easier to avoid fiscal dominance (to prevent the financial costs of sovereign debt from skyrocketing) by allowing it to be sustainable and, preventively, by circumventing a possible crowding out effect from private investment in the future. Second, because of the implicit shift toward the monetization of deficits and debt, which lays the foundation to unravel future inflation expectations, which, coupled with renewed growth potential (if conditions are met), could be the key to future fiscal sustainability.

With the acceleration of inflation and growth in 2021 and 2022, a gradual improvement in the term premium could be expected with moderate rises in the slope of the interest rate term structure. The risk-free rate curve in mature economies is at its lowest point, but improvements are expected over the next two years[9].

1.1.3 A consumption-based recovery

The recovery envisaged in the central vision of this report has the role of consumption at its forefront. In particular, it is a recovery based on expectations that allow the spending of non-intermediate monetary savings held onto as a precaution and/or in anticipation of future fiscal costs. Certain conditions are required for this to occur:

1) Expectations must be become reality — in other words, certainty about the endpoints of the pandemic is needed.

2) Monetary and fiscal support must remain abundant for a long time (income, liquidity, moderated financial costs and transformational investment policies).

3) It must be possible to grow real disposable income, and growth must be accompanied by even moderate inflation in the short-term.

4) Family and corporate balance sheets must be rebuilt. Global liquidity must allow for the rebalancing (portfolio rebalancing theory) of assets to guarantee the wealth effect needed for consumption.

However, this central vision faces enormous challenges stemming from the scars of an unprecedented crisis taking place in a context of global imbalances and vulnerabilities, as has been summarized in previous reports[10]. Although in some cases, the COVID-19 pandemic may be seen as an accelerator of correction, in most cases it will put additional pressure on the risk scenario as described in the risk assessment section later in this report. Although the emergence of coronavirus vaccines reduces the likelihood of some of these risks materializing early, avoiding the costs of the tax bill, the accumulated financial imbalances, the problems of industry stagnation, aging, climate change and social impairment resulting from structural unemployment and the widening poverty gap will be a bold aim to say the least.

There are some factors that could trigger the early materialization of the risks seen in the risk assessment section and turn the central vision into one of risk (which is not quantified as part of this report). The most relevant aspects would be the following:

1) A further delay in implementing restrictions to tackle the pandemic, which could cause the current liquidity problem to evolve into a solvency problem (for example in the mortgage and corporate consumer sectors).

2) The return of high and persistent inflation beyond 2021[11], which could unanchor long-term inflation expectations, but for reasons other than demand. Some causes starting to take shape by consensus are: (i) the energy transition and reshoring, which will lead to

higher production costs; (ii) the smaller deflationary role of emerging markets; (iii) changes in wage-setting; (iv) supply problems in sectors damaged by the crisis; (v) the effects of tacit monetization of global fiscal efforts and global value chains[12]; and (vi) the end of the demographic transition that saw the baby boomer generation mature (and later disappear).

3) An eventual fiscal dominance, if the central banks' asset-purchase mechanism loses its effect on sovereign spreads in countries with poorer fiscal positions. In this case, there could be increasingly high (and, in many cases, unsustainable) financing costs, leading to a correction of aggregate demand.

4) Incorrect transmission or interpretation of monetary policy and the expectations of the relevant monetary authorities, resulting in a sudden economic stop (credit, prices, equity, exchange rate, financial flows, etc.).

The central vision in this report is that this does not necessarily have to happen, but that if it were to happen, the scenario would not be a recession but a depression of activity with inflation. The latter would be an alternative scenario to which this report assigns neither likelihoods nor costs, but which should not be discarded.

1.1.4 A new international context

As initially mentioned, global society faces the third decade of the century in a context of international relations in which the relationship between its three leaders has changed.

China

First, China is no longer an emerging country requesting access to the World Trade Organization (WTO), as it was in the first decade of the 21st century. It is a formidable geopolitical, technological and trade rival, and its status and relationship with the United States and the European Union is transforming accordingly. The dangers of too much integration with the Chinese economy in global value chains have become apparent during the COVID-19 crisis. On one hand, President Biden's administration will most likely not change the current US position on trade with China. On the other hand, as soon as the new presidency of the European Commission began, the trade, industrial and strategic threat posed by China's ambiguity with regard to multilateral trade rules was recognized. Recently, the Comprehensive Agreement on Investment has sought to shore up equality on the playing field by seeking China's commitment to adhering to level playing field rules for state-owned enterprises. In the pursuit of reciprocity, the European Union also appears to have been given access to investment in strategic sectors in China. This is an ideal agreement on paper, but one that runs counter to the return to multilateralism promoted by the new US administration and whose problems lie in the details and implementation.

As it did in the Lehman Brothers crisis, China will play a key role in global recovery. Then, it was because China had a development plan aimed at meeting its five-year plans; today, it has the explicit strategy of economically overtaking the US in this decade, while it has also emerged from the COVID-19 crisis before any other country (with growth at 1.5% in 2020 and around 6.5% on average throughout 2021 and 2022). In this sense, the carry-over effect from China, which has been recovering for six months now, will be felt on the global trade flow, on demand for raw materials (which has returned to pre-COVID-19 levels), and on the growing issuing of credit flows to Latin America (for technological infrastructure), and, as soon as we have immunity, on tourism flows to the

countries of the Association of Southeast Asian Nations (ASEAN).

Latin America

The region most affected by COVID-19 has been Latin America, due to the lukewarm economic response (limited fiscal space), poor health preparedness and capacity, and the existing imbalances and vulnerabilities (low savings, external vulnerability, dependence on the commodity cycle and the tourism sector). The region has suffered permanent impairment in growth expectations, from the 3% we proposed a year ago to -8.1% expected for 2020. Poverty has soared from 23% to 30% among the population, nearly 3 million small and medium-sized enterprises (SMEs) have gone bankrupt and nearly 9 million jobs have been lost. Per capita growth in Latin America had been stagnating since 2015, and, after the current crisis, per capita income is not expected to return to 2015 levels until 2025. In other words, the COVID-19 crisis will cause this region to lose another decade.

United States

In the US, the Trump era and its bilateral and autonomous approach is coming to an end, and the Biden administration has announced that it will reverse many of his predecessor's policies. This is happening in the context of an expected recovery in industrial production for high consumption (especially automobiles), supported by growth in per capita income through fiscal stimulus and a job market that recovers smoothly, as well as through the use of savings. With this new US federal administration, a new boost in investment is expected as soon as activity picks back up. Also of note is a moderate but steady recovery of inflation that is expected (thanks to the Fed reforming its target and the monetization of fiscal stimulus) to approach and exceed 2% during 2022 and 2023.

As such, President Biden's new administration is expected to focus on: (i) increased fiscal progressiveness; (ii) an ambitious infrastructure and education investment program; (iii) the United States rejoining the Paris Agreement; (iv) the revival of a healthcare program similar to the Affordable Care Act; (v) a return to multilateralism with the commitments abandoned by Trump (WTO, NATO, Iran, West Bank, etc.); and (vi) a narrative about China that differs in form, despite being similar in content.

Recently, a 900 billion dollar stimulus package was approved, which, paradoxically, more than tripled at the request of the Republican faction (after Trump called for aid checks to be 2,000 dollars, more than three times what Biden had proposed). This was immediately supported by the Democrats to facilitate the final approval of the stimulus. Although it may sound like good news, the movement seems to represent more of a blockage than a stimulus. Biden's proposal was highly progressive in terms of tax revenues (almost the entire stimulus was taxed to the top fifth of income earners and the corporate tax burden increased). That is probably what will be negotiated after the generous Republican move. For the time being, fiscal sustainability is of little concern, especially when the Fed's monetary policy guarantees historically low financial costs for debt due over the next two to five years.

Europe

Despite recent new outbreaks in Europe, a major rebound in economic growth is expected in 2021, but it will not be enough for pre-crisis levels to be reached before mid-2022, with the output gap therefore not closing before 2024. The next upturn in economic activity in the region will have implications for the interest rate curve, inflation and exchange rates.

In this sense, four elements seem to outline the recovery. Firstly, the the scale of the initial shock, healthcare policies and the level of restrictions implemented in each European Union member state and the proximity to the COVID-19 endpoints[13]. Europe is one of the regions most heavily affected by lockdowns[14]. Economic activity will contract 7.3% in 2020, despite monetary and fiscal efforts. In view of this, it is difficult to coordinate recovery in a federation. However, the vaccine will be a long-term positive catalyst that reduces the risk of depression, but not the risks to short-term activity.

Secondly, economic policy. On the one hand, monetary policy is fully committed to

facilitating stability and liquidity, as well as activating support to mitigate unemployment risks in an emergency (SURE) and reconstruction (NextGenEU). In this regard, the ECB has decided to maintain the basic accommodative monetary policy (purchase of assets unaltered, keeping rates at zero, negative deposits), and to expand the emergency asset program (unconstrained purchase of assets, the Pandemic Emergency Purchase Programme [PEPP] and the third Targeted Longer-Term Refinancing Operations [TLTRO III] program, and list of collateral rules). It is also managing expectations in order to leave no doubt that it will do everything it can, paying particular attention to containing the sovereign spreads of peripheral countries and prevent a new sovereign/financial crisis like in 2010, given the current fragility of the banking system. In addition, fiscal policy has been strengthened by a temporary annulment of the rules of financial stability, and unprecedented fiscal and quasi-fiscal stimulus, with a view to ensuring liquidity via guarantees and credits, as well as replacing employment income.

Thirdly, recovery is expected to be delayed. Part of this recovery will be due to industrial production that will respond to the contained demand during 2020, particularly in the automotive sector, and due to the need to replenish high-consumption stocks. Another part will occur in 2022 thanks to the recovery of consumption and tourism with herd immunity as a guarantee.

Finally, an increase in inflation is expected during 2021 and 2022, but still far from the ECB's target. It should be noted that this impact will be equally delayed and differentiated within the region, with Central Europe recovering first and the periphery later.

In the end, Europe will emerge from this crisis badly damaged economically, but much stronger institutionally. There have been two triggers: (i) the renewal of the ECB and all European bodies (Council, Commission, Parliament) which has resulted in a new cast of strong leaders, giving less room to Euroskepticism and practices that undermine the rule of law (for example, the treatment given to Poland and Hungary), as well as synchronization and coordination between the ECB and the European Commission, which accommodate monetary and fiscal policies in a reciprocal manner; and (ii) the effective departure of the United Kingdom from the European Union[15] along with its blocking and veto power in common projects. More recently, the European Union's 750 billion euro reconstruction and resilience plan[16] has been approved. Beyond the profound transformation to the production system that it proposes, it is intended to promote the European project, with the financing of the reconstruction package being designed partly on the basis of debt mutualization and the creation of a new financial instrument eligible for the market and the ECB.

1.1.5 Risk assessment

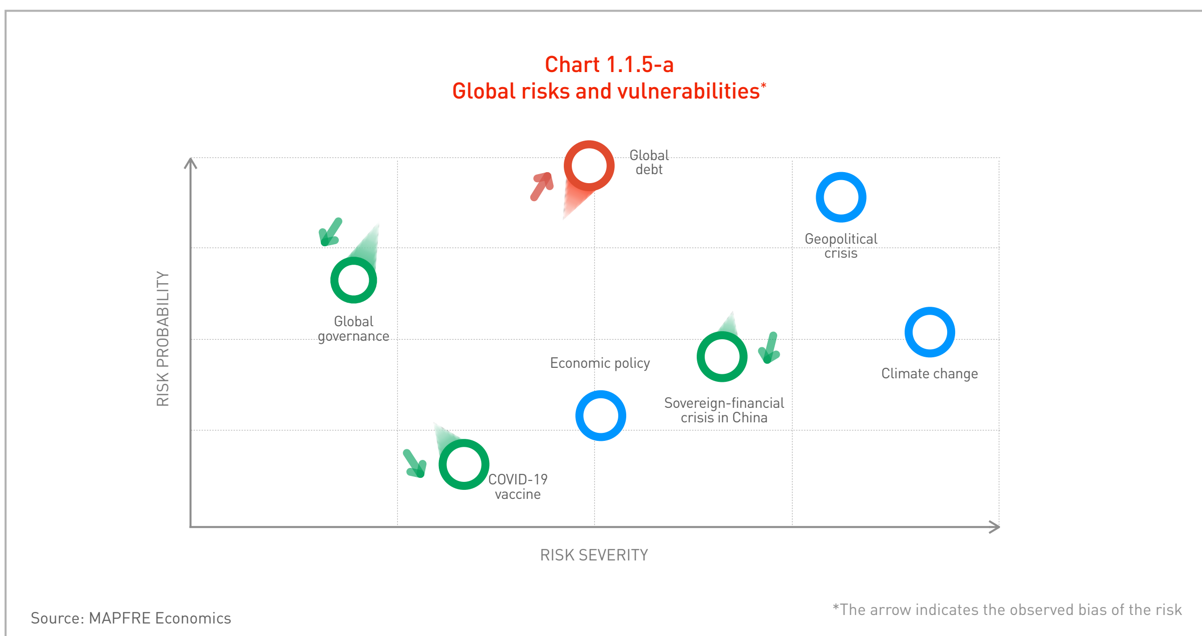
Chart 1.1.5-a illustrates the updates to the risk map for the global economy. This analysis is detailed below.

Global governance

First, in the scenario in the United States, the unknowns surrounding the presidential election were cleared up with the victory of the Democratic Party led by Joe Biden. Despite a disorderly recount process, the result passes control over to the Democrats in both the House of Representatives and the Senate, which will facilitate the implementation of the new administration's economic policy. Likewise, under this configuration, certain foreign policy risks that had been accumulating under President Trump's administration will be reduced with an approach that is expected to be more transparent, multilateral and calm. However, as anticipated earlier, the scenario is not spared geopolitical conflicts, such as trade tensions with China, with whom the same line is expected to continue but in a less volatile way. At the national level, regardless of the new configuration of the US legislature, disputes are expected on key issues such as climate change, immigration, the healthcare system and fiscal policies.

In addition, following an accelerated final negotiation process, the second source of uncertainty, Brexit, saw the end of a long process that began in 2016 with a minimal trade agreement between the United Kingdom and the European Union. However, the

Chart 1.1.5-a
Global risks and vulnerabilities*



Source: MAPFRE Economics

*The arrow indicates the observed bias of the risk

transition process could be extended further with still-pending negotiations on a path that looks set to be dragged out and with no consensus, exacerbated by the uncertainty surrounding the pandemic and the need to align coordinated actions.

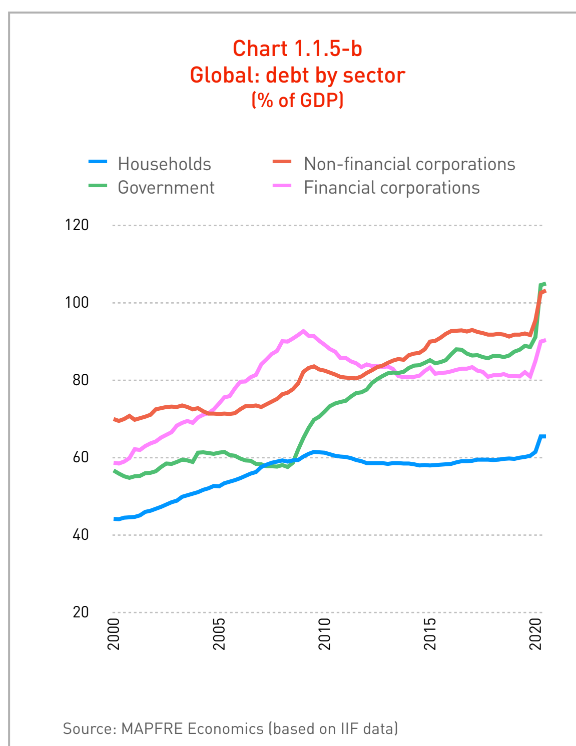
Finally, in terms of governance in emerging regions, confrontation and instability persist (though they are covered up by the health emergency), with increasingly frequent protests and a climate of growing political unrest in both Latin American countries and Asia-Pacific regions, where institutions continue to show signs of fragility.

Global debt

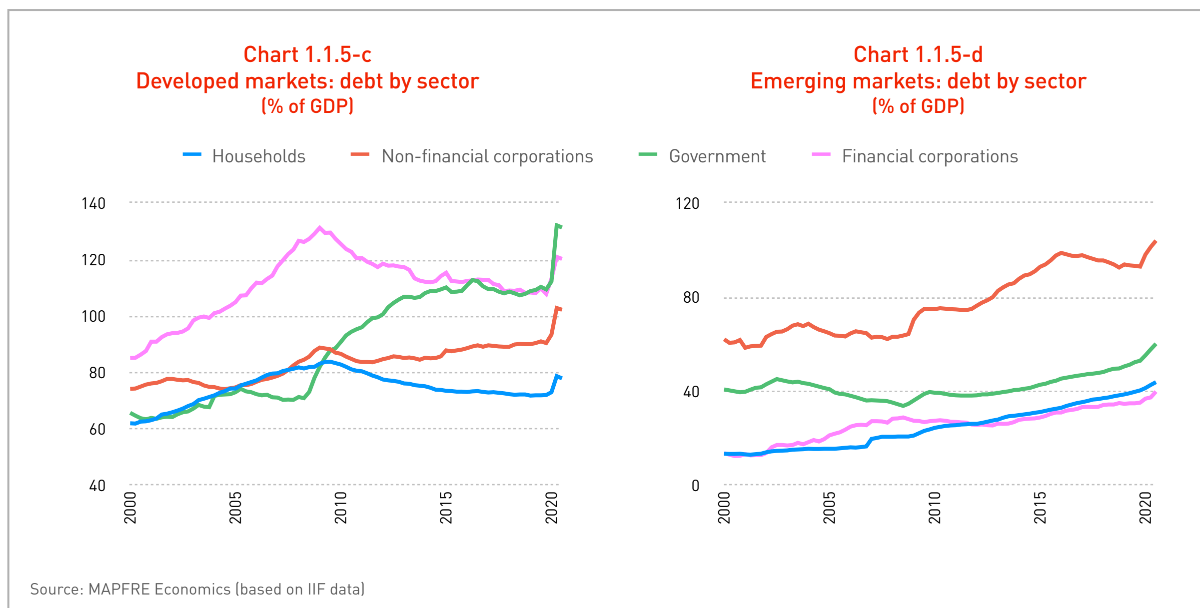
The economic recession caused by the lockdown and social distancing measures implemented to address the COVID-19 pandemic boosted the global debt/GDP ratio to a new historic peak of 356% in the third quarter of 2020, compared to 322% in the fourth quarter of 2019 (see Chart 1.1.5-b)[17]. With regard to emerging markets, the largest leverage was recorded in the non-financial private sector (corporate and, to a lesser extent, households), while the largest contribution in developed markets was in the finance sector and in governments. Overall, inertia to greater leverage—due to the disruption caused by the pandemic—and widespread monetary flexibility prevail in an environment of uncertainty, which is not expected to be stable enough to support the burden until 2021 (see Chart 1.1.5-c).

The greatest risk for emerging economies remains the continued rise in dollar debt levels, owing to a weaker dollar and generally very favorable financial conditions that keep the effective interest rate below nominal growth, as well as external debt positions as means of leverage for financing against the most recent shocks. From an investor point of view, a low appetite for local currency debt covered by foreign exchange exposures, together with the

Chart 1.1.5-b
Global: debt by sector
(% of GDP)



Source: MAPFRE Economics (based on IIF data)



Source: MAPFRE Economics (based on IIF data)

absorption of liabilities for external demand, represents an increase in vulnerabilities, mainly fragile in those economies with the greatest accumulated imbalances.

For developed economies, the higher debt concentration under exceptionally flexible monetary policies continues to be balanced toward the public sector. As falling incomes undermine the perception of debt servicing and sustainability, the need to rebalance policies toward fiscal sustainability could occur early and abruptly (see Chart 1.1.5-d).

Finally, in the United States, as well as in several EU countries, prospects for the corporate debt segment of Collateralized Debt Obligations (CLOs), whose interconnection with the economic system became evident in 2008, remain negative, supported by rising default rates, refinancing accelerated by the health emergency and their systemic risk potential, despite the benefit to risk markets of the news of effective vaccines that have helped narrow the open gap in credit spreads.

Sovereign-financial crisis in China

With China's growth gradually recovering the levels prior to the shock caused by the health crisis, a progressive recovery of domestic consumption, strong exports as a competitive advantage and an expansive economic policy, the country in a more positive scenario than the global outlook on average. In this regard, and despite the uncertainty around how events will develop, the positive momentum has been reflected in the positive balance of inflows, which strengthens the local currency, while also addressing the reforms needed to further open the financial system to the outside. But the country's debt overhang remains latent as a vulnerability in which credit discipline showed signs of stress following the recent corporate debt defaults in the state-owned sector. Despite the Chinese economy's early recovery, the chain of greater liquidity problems leading to solvency problems not contained by regulators could serve as negative catalysts with global repercussions for the financial system.

US economic policy

Monetary easing continues to be the main pillar on which the global response to the shock rests, with a more moderate profile in recent months, though with the same purpose of reinforcing the measures taken to date and continuing to exercise its role as an automatic stabilizer. At the same time, the fiscal response is doubling down on efforts with an expansionary policy that could continue to grow in the coming months and extend beyond 2021. In this scenario, the monetary pillar faces a delicate communication process that could lead to the materialization of both downside risks that support new measures and upside risks that would necessitate the current laxity to be eradicated from expectations. In the fiscal framework, budgetary discipline continues to

be defined by a temporary relaxation, the prolongation of which could, in time, result in structural imbalances that compromise stability in the medium- and long-term, and lead to sustainability adjustments.

Geopolitical crisis

The intensity of adverse geopolitical events remains high as global uncertainty consolidates, opening a gap between developed and emerging countries, which is exacerbated by further institutional deterioration. In the United States, the election result lowers the pressure felt in this area during the Trump administration. However, it could continue to advance the protectionist approach it has inherited and move forward in its disengagement with China. In Latin America, social unrest has continued with a number of protests, maintaining a climate of instability, albeit temporarily masked by the effects of the health crisis. In the Middle East, regional instability is evident and accelerating. The frequency and reverberation of conflicts is increasing and spreading to a growing number of countries experiencing conflict dynamics in which spheres of interest gravitate around strategic competition. The future of Europe's relationship with the United Kingdom will continue to shape the near future under the challenge of implementing the agreements reached. Furthermore, in the more distant future, the change in German leadership is approaching against the backdrop of a fragile populist landscape across Europe, which could put the stability of the union at risk.

Climate change

Amid the widespread recession caused by the COVID-19 pandemic and lockdown and social distancing measures implemented to tackle it, the trend toward sustainability and greater environmental awareness is accelerating. The European Union's proposal, with recovery-fund investments focused on the energy transition and technological development, complements the aspirations proposed at the recent World Economic Forum (WEF) Sustainable Development Impact Summit with ambitions focused on streamlining the 'new normal' and building the pillars of recovery and productivity gains in what they call the Fourth Industrial Revolution.

COVID-19 vaccine

The prompt and positive news on the progress of the different COVID-19 vaccines is an important positive catalyst, providing the foundations for the pandemic to be eradicated. However, as the global economy faces the consequences of a new wave of infections, with downside risk due to the mutation in its structure, the prospect of new, more severe restrictions to contain it and the challenging phase of vaccine implementation in the race to herd immunity could create outlook imbalances in the first half of 2021. At a time when forecasts are heavily leveraged upward, unforeseen difficulties in the mass rollout of the vaccine could negatively impact the more imminent economic outlook amid the conditional uncertainty that defined 2020.

1.2 Forecasts and risk assessment in selected economies

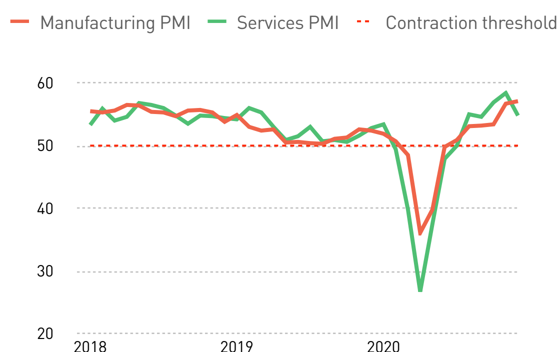
1.2.1 United States

New administration and fighting the pandemic

The US economy recovered in the summer, growing by 7.4% QoQ (non-annualized) and leaving the year-on-year rate at -2.9% in the third quarter, thanks to huge fiscal and monetary stimulus. Consumption has also recovered (+8.9% QoQ), although it has not returned to normal (-2.9% YoY). The surge in COVID-19 cases in December has been worrying and many cities have reimposed lockdown restrictions. As a result, GDP is expected to have fallen again in the fourth quarter, when recovery had previously been expected to continue. It is expected that 2020 will have closed with a drop of around -3.5% YoY.

Although the country started administering vaccines on December 14, it is estimated that it will take several months for a significant portion of the population to be immunized. The first half of 2021 is therefore expected to be somewhat turbulent, with new waves and drops in activity.

Chart 1.2.1-a
United States: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.1-b
United States: ISM

Source: MAPFRE Economics (based on Markit data)

In the last few days of December, a new stimulus package of 900 billion dollars was approved to support businesses, families and especially the unemployed and other beneficiaries[18]. By doing so, the government is committing to sustain economic activity, which is important in preventing permanent business closures. The baseline scenario considered in this report points to a YoY GDP recovery of 3.9% in 2021—higher than previously estimated (3.3%)—and 2.8% in 2022 (see Charts 1.2.1-c and 1.2.1-d, and Table 1.2.1). Thus, the US economy is expected to reach the GDP level seen at the end of 2019 in the fourth quarter of 2021 (see Box 1.1.2-a).

At the activity level, industrial production in November was -5.5% YoY, down from the previous year. Vehicle sales are about 12% below normal levels, at 15.6 million (annualized). Retail sales were strong in October (5.7% YoY), thanks to checks distributed to families. The December Purchasing Managers' Indices (PMIs) were all above the 50 points that would indicate the threshold of expansion, due to improved optimism about the situation thanks to the vaccines. However, the reality of the current wave of infections means that more pessimistic levels can be expected in early 2021.

United States

- The growth forecast for the US economy in 2021 has risen to 3.9%.
- A new stimulus package for 900 billion dollars is under review.
- Mass vaccination has begun, but the first quarter of the year is still expected to be turbulent.
- With the expectation that 2021 will see the end of the pandemic, the balance sheet of the businesses that survive remains to be seen.
- A return to multilateralism is expected with President Biden's administration.

In addition, inflation stood at 1.2% in November, while core inflation also stood at 1.6% YoY. While in the short-term, developments in employment, wages and demand did not point to a surge in inflation, markets are already discounting a gradual rise in the next 5 years, as reflected in the 5-year swap rate (now at 2.3%).

At its December 16 meeting, the Fed decided to maintain the target range for federal fund interest rates at 0.00–0.25%. It is expected that it will be appropriate to keep them at this level until job market conditions have reached levels compatible with full employment, and inflation has reached 2% and is on track to moderately exceed that figure for some time. In addition, the Fed will continue to increase its holdings of Treasury securities by at least 80 billion dollars per month and agency mortgage-backed securities by at least 40 billion dollars per month until substantially more progress has been made toward the full employment and price stability targets. These asset purchases help to promote the proper functioning of the market and financial conditions that are

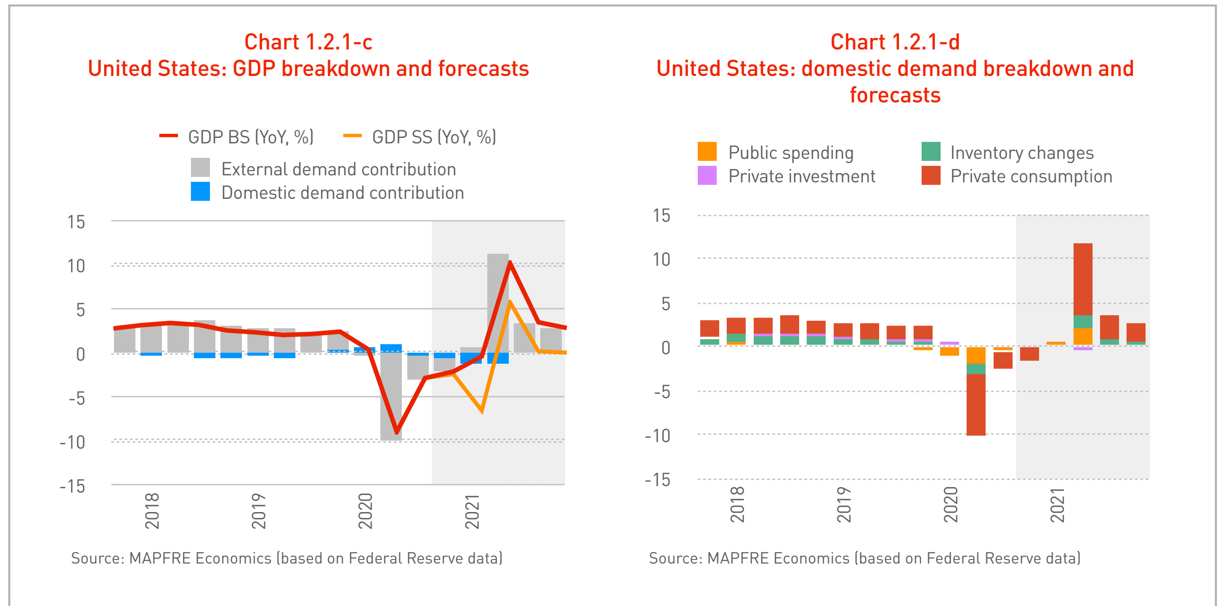


Table 1.2.1
United States: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)	2021(f)	2022(f)
GDP (% YoY, average)	1.7	2.3	3.0	2.2	-3.5	3.9	2.8	-0.2	3.8
Domestic demand contribution	1.9	2.6	3.3	2.4	-3.6	4.5	2.8	0.1	3.8
External demand contribution	-0.2	-0.2	-0.3	-0.2	0.1	-0.5	0.1	-0.3	-0.1
Private consumption contribution	1.9	1.8	1.9	1.7	-2.6	3.2	2.3	-0.2	2.8
Total investment contribution	0.4	0.7	1.0	0.5	-0.3	0.7	0.5	0.2	0.7
Public spending contribution	0.3	0.1	0.2	0.2	0.1	-0.1	-0.1	-0.1	-0.1
Private consumption (% YoY, average)	2.8	2.6	2.7	2.4	-3.8	4.6	3.4	-0.3	4.1
Public consumption (% YoY, average)	1.8	0.6	1.5	1.8	0.6	-0.7	-0.4	-0.7	-0.4
Total investment (% YoY, average)	1.8	3.5	4.8	2.3	-1.3	3.0	2.4	0.8	3.1
Exports (YoY in %)	0.3	3.9	3.0	-0.1	-13.4	4.7	7.6	-3.5	9.1
Imports (YoY in %)	1.6	4.7	4.1	1.1	-10.4	6.4	5.1	-0.3	6.8
Unemployment rate (%, last quarter)	4.8	4.1	3.8	3.5	6.7	6.2	5.3	6.8	5.9
Inflation (% YoY, last quarter)	2.1	2.1	1.9	2.3	1.1	1.8	1.8	1.1	2.0
Fiscal balance (% of GDP)	-5.4	-4.2	-6.2	-6.6	-15.4	-8.1	-6.9	-9.5	-7.9
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)	-4.1	-4.3	-4.4	-4.1	-4.2	-4.3	-4.1	-4.2	-4.1
Current account balance (% of GDP)	-2.1	-1.9	-2.2	-2.2	-3.1	-3.0	-2.6	-2.9	-2.7
Official interest rate (end of period)	0.75	1.50	2.50	1.75	0.25	0.25	0.25	0.20	0.20
3-month interest rate (end of period)	1.00	1.69	2.81	1.91	0.20	0.20	0.20	0.20	0.20
10-year interest rate (end of period)	2.45	2.40	2.69	1.92	0.93	1.28	1.56	0.74	1.03
Exchange rate vs. US dollar (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)	1.05	1.20	1.15	1.12	1.21	1.21	1.22	1.21	1.22
Private lending (% YoY, average)	3.3	6.9	4.7	5.8	9.8	9.0	-4.9	9.2	-5.0
Household lending (% YoY, average)	2.1	3.4	3.5	3.1	3.7	5.6	5.7	5.1	5.8
P.S. non-financial lending (% YoY, average)	5.4	6.7	8.9	6.5	7.7	0.6	4.0	0.6	4.0
P.S. financial lending (% YoY, average)	4.3	2.9	2.2	2.2	1.9	1.2	1.6	1.1	1.3
Savings rate (as % pers. disp. income, avg.)	6.9	7.2	7.8	7.5	16.1	10.7	9.1	13.9	11.9

Source: MAPFRE Economics (based on Federal Reserve data)
Forecast end date: January 4, 2021.

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accommodating, thereby supporting the flow of credit to households and businesses. In assessing the appropriate stance of monetary policy, the Federal Open Market Committee (FOMC) will continue to assess economic data and its consequences on the outlook.

With the start of the new Biden administration in January, some reversal of US protectionist policies is expected, including less confrontation with China, which was not complying with the signed trade agreement. It is also expected that there will be less animosity toward the European Union, in terms of both trade and NATO. The United States is also expected to rejoin the Paris Agreement on climate change and possibly reposition itself with respect to the issue of funding the World Health Organization (WHO). At the geopolitical level, the Biden administration's position on a military presence in conflicts in the Middle East are yet to be announced.

The risks to the US economy in the short-term are focused on further waves of the pandemic forcing recurrent shutdowns. The mass deployment of vaccinations will mean we begin to see benefits more toward the second half of 2021. It remains to be seen how many businesses will survive the pandemic and lockdowns. At the fiscal level, we don't expect the new administration to have much capacity to reverse the tax cuts made during the Trump era, but that it will instead reach agreements with the Republicans to continue to provide new stimulus packages as long as the economy continues to need them. At the geopolitical level, greater openness to multilateralism is expected, and new uncertainty will likely arise over the return to a more proactive military posture overseas.

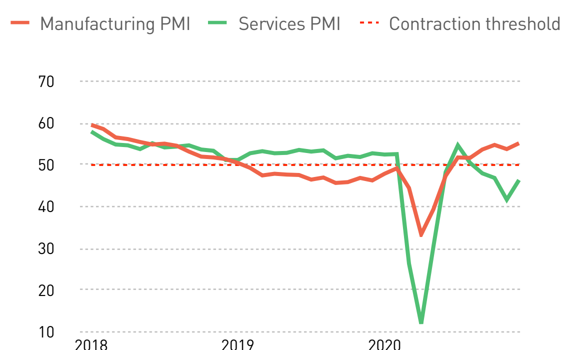
1.2.2 Eurozone

Hopes placed on vaccination plans and monetary and fiscal stimulus

The third quarter, over summer, was one of recovery, with growth of 12.5% QoQ (-4.3% YoY), but the second wave of COVID-19 infections that occurred mainly in November and December forced further business interruption in many European countries. Activity will therefore have contracted again in the fourth quarter of the year (-2.5% QoQ), although less sharply than in April and May, and it is expected that 2020 will close with a decline in output of around -7.3% YoY.

2021 presents many uncertainties. In terms of health, vaccines will be deployed to the

Chart 1.2.2-a
Eurozone: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.2-b
Eurozone: ZEW growth expectations index

Source: MAPFRE Economics (based on Markit data)

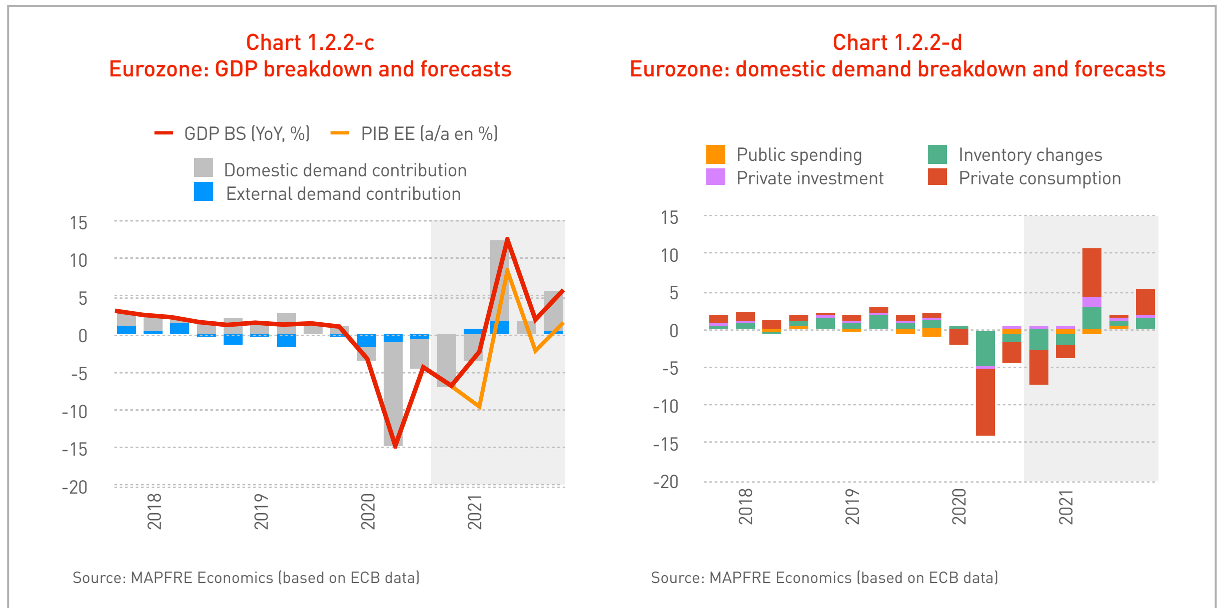


Table 1.2.2
Eurozone: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)	2021(f)	2022(f)
GDP (% YoY, average)	1.8	2.7	1.9	1.3	-7.3	4.5	4.5	-0.5	5.4
Domestic demand contribution	2.3	2.3	1.8	1.8	-6.6	3.6	4.3	-1.1	5.2
External demand contribution	-0.4	0.4	0.1	-0.5	-0.7	0.9	0.2	0.6	0.2
Private consumption contribution	1.0	1.0	0.8	0.7	-4.4	2.1	2.7	-0.6	3.0
Total investment contribution	0.8	0.8	0.7	1.2	-2.1	0.9	1.1	-0.4	1.3
Public spending contribution	0.4	0.2	0.2	0.4	0.1	0.6	0.3	0.6	0.3
Private consumption (% YoY, average)	1.9	1.9	1.5	1.4	-8.3	4.0	5.1	-1.1	5.7
Public consumption (% YoY, average)	1.9	1.1	1.2	1.8	0.3	2.8	1.5	2.8	1.5
Total investment (% YoY, average)	3.9	4.2	3.3	5.7	-9.5	4.6	5.2	-1.8	6.2
Exports (YoY in %)	2.9	5.9	3.6	2.5	-11.1	8.1	6.4	0.2	8.0
Imports (YoY in %)	4.3	5.4	3.6	3.9	-10.4	6.6	6.6	-1.3	8.2
Unemployment rate (%, last quarter)	9.7	8.7	7.9	7.4	8.8	9.1	8.3	10.8	9.8
Inflation (% YoY, last quarter)	0.7	1.4	1.9	1.0	-0.1	1.4	1.3	0.4	1.3
Fiscal balance (% of GDP)	-1.4	-0.9	-0.5	-0.6	-7.7	-6.1	-3.7	-8.2	-5.5
Primary fiscal balance (% of GDP)	0.6	1.0	1.4	1.0	-5.9	-4.3	-2.0	-6.3	-3.8
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)	3.0	3.1	2.9	2.3	1.9	2.5	2.5	2.8	2.6
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.32	-0.33	-0.31	-0.38	-0.54	-0.77	-0.78	-0.70	-0.67
10-year interest rate (end of period)	0.93	1.13	1.17	0.32	-0.19	-0.02	0.35	-0.02	0.36
Exchange rate vs. US dollar (end of period)	1.05	1.20	1.15	1.12	1.21	1.21	1.22	1.21	1.22
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)	1.5	2.3	2.7	3.3	2.8	3.5	3.8	2.0	2.4
P.S. non-financial lending (% YoY, average)	2.9	1.4	3.5	1.9	3.9	0.2	2.4	-2.4	2.3
P.S. financial lending (% YoY, average)	3.8	2.5	-1.1	1.6	-0.8	0.8	3.3	0.6	3.3
Savings rate (as % pers. disp. income, avg.)	12.3	12.2	12.3	12.8	18.9	16.9	14.4	19.5	16.7

Source: MAPFRE Economics (based on ECB data)
Forecast end date: January 4, 2021.

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Eurozone

- Vaccinations may bring about a relative normalization of economic activity by the end of 2021.
- In the first quarters of the year, new outbreaks and further closures of activity may still occur.
- European Union funds are more likely to be deployed in the second half of 2021.
- GDP growth in 2021 is expected to be 4.5%.

population, although a sufficiently high percentage of the population will not be vaccinated until the second half of the year. In addition, the first half of the year will be very turbulent, with upturns in the number of infections and new closures and restrictions on economic activity. However, as time progresses, the medical experience acquired will also lead to an increase in effective treatments. The combination of prevention (vaccines) and increasingly effective treatments will lead to reduced mortality rates and allow for a gradual return to normal.

Economically, it is expected that the first two quarters of 2021 will still be affected by closures, with private consumption and exports therefore impacted. The fiscal stimulus provided by the European Union through the Next Generation EU (NGEU) program will likely start to be deployed toward the second half of 2021, as the deadline for the submission of spending plans runs until the end of April. Its impact will depend on what types of plans are presented, as they may have a cyclical one-time effect (spending) or provide longer-term structural benefits to the economy (investment). What seems to be a requirement is that investments be "green" or promote progress in digitization. In this context, 4.5% growth is expected in 2021 and 2022, assuming that activity will be resumed, albeit with restrictions, starting in the first quarter of the year. In the second half of 2021, European funds will begin to be released and a greater proportion of the population will also begin to be immunized (see Charts 1.2.2-c and 1.2.2-d, and Table 1.2.2). Thus, the eurozone economy is expected to reach the GDP level seen at the end of 2019 in the second quarter of 2022 (see Box 1.1.2-a).

In terms of activity, industrial production has not recovered completely, but it is the sector that has returned closest to normal. By contrast, services, especially those that require a physical presence, are still suffering strong constraints. This is reflected in the PMIs, with manufacturing indicating expectations for improvements (55.5 points) in December and services continuing to contract (47.3 points).

Furthermore, the eurozone's aggregate inflation remained negative at -0.3% in November, with core inflation also very weak at 0.2%. The ECB did not disappoint at its meeting on December 10, taking a series of additional measures to ensure that liquidity and financing conditions remain broadly accommodating throughout the eurozone. Interest rates have remained at current levels (0% for main refinancing operations and -0.50% for deposit facilities). The new development was the expansion of the PEPP by 500 billion euros to 1.85 trillion, and the extension of the purchase horizon to March 2022. They also added that in any case they would continue to make purchases until they consider the coronavirus crisis to be over. The ECB council has also decided to extend TLTRO III until June 2022 in order to ensure broad liquidity conditions and maintain a high level of bank credit. The Council also referred to the very low level of inflation, estimating that core inflation (excluding food and energy) will stand at 1.2% by 2023. They also made a brief reference to the strength of the euro, indicating that surpassing the 1.20 USD/EUR level is still not concerning.

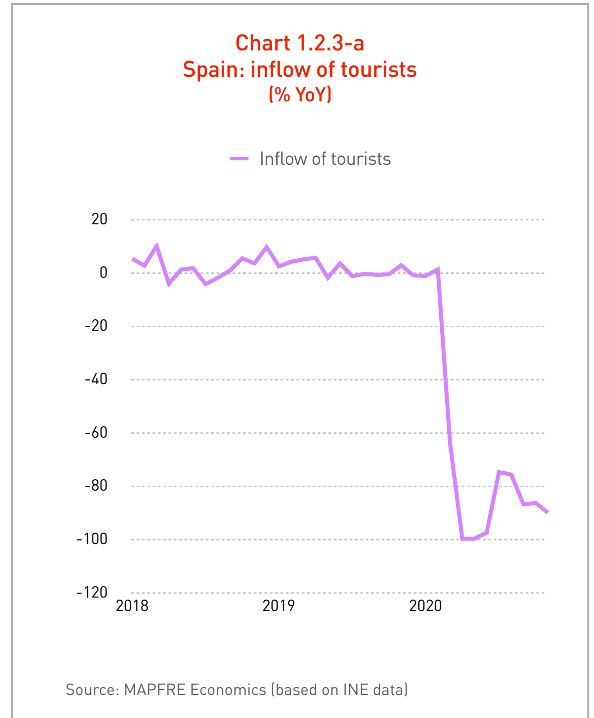
The risks for the eurozone economy center around recurrent pandemic outbreaks that

bring about new restrictions, or activity returning to normal at a slow pace due to the vaccination program taking longer than expected. Export recovery is also vital, and that also depends on the activity levels of its trade partners. In addition, the eurozone will be affected by Brexit, which will cause certain problems with trade and production chains. The deployment capacity of aid funds is another uncertainty, while the depth of the damage caused by the crisis to the business sector, employment and the financial sector remains to be seen.

1.2.3 Spain

Immunization, investment, damage minimization and recovering confidence

Spain's GDP recovered 16.7% QoQ in the third quarter, still falling -8.7% YoY below the previous year. In general, all elements have shown a relative recovery since the gradual resumption of activity. However, the occurrence of a second wave of coronavirus infections and the imposition of new regional restrictions will lead to a further economic contraction in the fourth quarter of the year. This should bring the 2020 annual GDP to an estimated contraction of –11.3% YoY.



Source: MAPFRE Economics (based on INE data)

Outlook surveys indicate a decline in the last quarter of 2020, with PMIs worsening again, with composite at 41.7 points, manufacturing at 49.8 and services up to 39.5. Likewise, the consumer confidence index fell again to -29 points, retail sales are still 2.4% below the previous year (October), and industrial production is at -1.2%. Car registrations in November remained 19% below those in 2019.

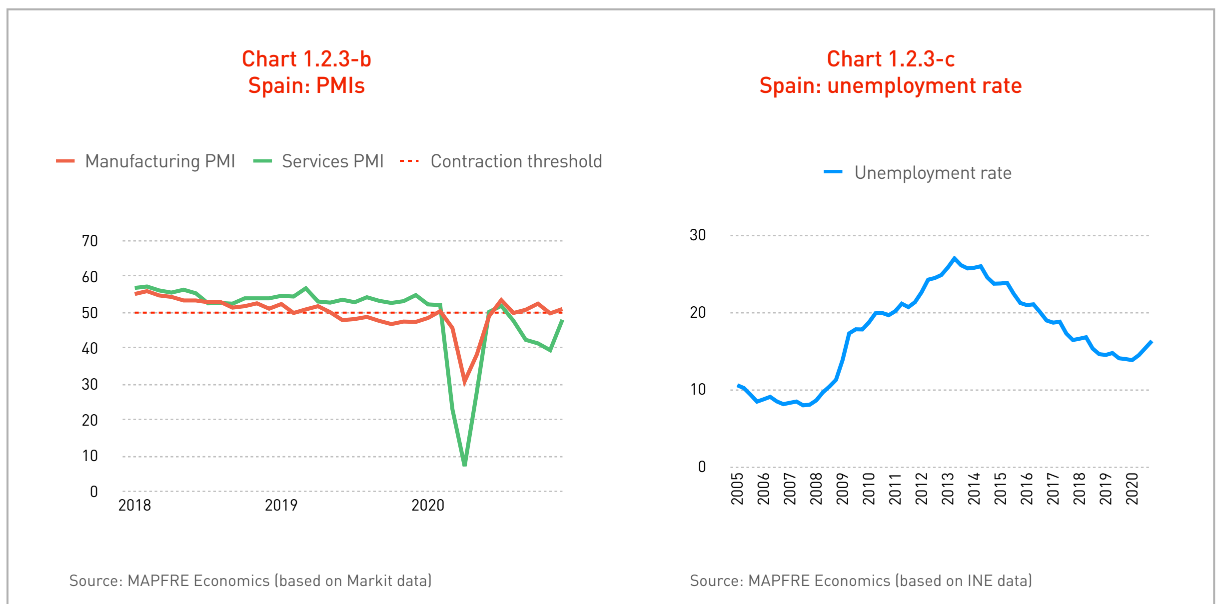
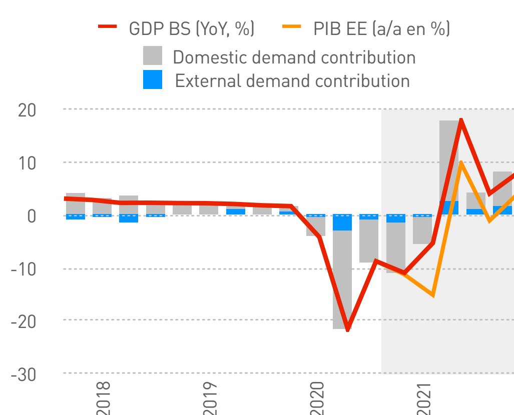
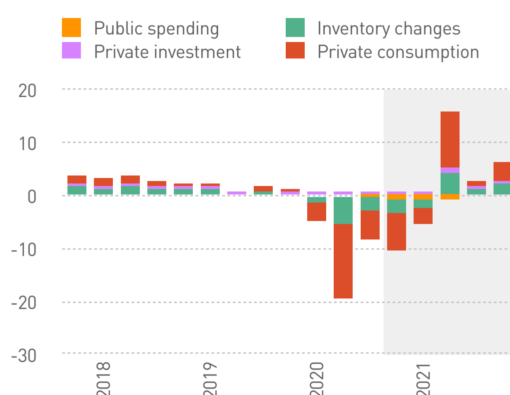


Chart 1.2.3-d
Spain: GDP breakdown and forecasts



Source: MAPFRE Economics (based on INE data)

Chart 1.2.3-e
Spain: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on INE data)

Table 1.2.3
Spain: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)	2021(f)	2022(f)
GDP (% YoY, average)	3.0	3.0	2.4	2.0	-11.3	6.1	6.3	-0.6	9.1
Domestic demand contribution	2.0	3.1	3.0	1.4	-9.9	4.9	5.3	-2.2	8.0
External demand contribution	1.0	-0.2	-0.5	0.6	-1.4	1.3	0.9	1.6	1.1
Private consumption contribution	1.6	1.8	1.0	0.5	-7.7	3.2	3.4	-0.7	4.4
Total investment contribution	0.4	1.2	1.1	0.5	-2.7	1.4	1.6	-0.1	2.1
Public spending contribution	0.2	0.2	0.5	0.4	0.7	0.7	0.3	0.7	0.3
Private consumption (% YoY, average)	2.7	3.0	1.8	0.9	-13.4	5.8	6.1	-1.2	7.9
Public consumption (% YoY, average)	1.0	1.0	2.6	2.3	3.7	3.0	1.4	3.0	1.4
Total investment (% YoY, average)	2.4	6.8	6.1	2.7	-13.9	7.8	8.6	-0.2	11.1
Exports (YoY in %)	5.4	5.5	2.3	2.3	-20.1	11.8	10.2	0.2	14.5
Imports (YoY in %)	2.7	6.8	4.2	0.7	-18.0	7.8	8.1	-5.8	12.3
Unemployment rate (%, last quarter)	18.6	16.6	14.5	13.8	16.6	17.9	16.4	19.9	18.2
Inflation (% YoY, last quarter)	1.6	1.1	1.2	0.8	-0.6	1.1	0.8	-0.5	0.4
Fiscal balance (% of GDP)	-4.3	-3.0	-2.5	-2.9	-12.1	-8.6	-6.0	-11.4	-7.6
Primary fiscal balance (% of GDP)	-1.5	-0.5	-0.1	-0.6	-9.8	-6.5	-4.1	-9.1	-5.5
Trade balance (% of GDP)	-1.3	-1.9	-2.5	-2.1	-0.7	-0.5	-1.5	0.0	-0.8
Current account balance (% of GDP)	3.2	2.8	1.9	2.1	0.7	1.7	1.7	2.4	2.3
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.32	-0.33	-0.31	-0.38	-0.54	-0.77	-0.78	-0.70	-0.67
10-year interest rate (end of period)	1.35	1.51	1.41	0.46	0.09	0.39	0.79	0.50	0.92
Exchange rate vs. US dollar (end of period)	1.05	1.20	1.15	1.12	1.21	1.21	1.22	1.21	1.22
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)	-2.5	-1.4	-0.3	-0.2	0.1	2.4	3.0	0.4	1.6
P.S. non-financial lending (% YoY, average)	-2.7	-1.1	-1.4	-0.6	3.0	0.1	1.7	-10.2	1.7
P.S. financial lending (% YoY, average)	-16.4	-7.9	-0.5	-4.9	1.2	4.4	3.0	4.5	3.0
Savings rate (as % pers. disp. income, avg.)	7.5	6.1	6.0	6.6	15.1	13.7	11.9	16.3	14.9

Source: MAPFRE Economics (based on INE data)
Forecast end date: January 4, 2021.

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Spain

- Economic activity will be affected until widespread immunity is achieved.
- European Union funds may contribute up to 2 points of GDP each year during 2021–2023.
- Maintaining aid for the unemployed and the hospitality sector will be necessary to minimize the pandemic's damage to the economy.
- Confidence will return with the normalization of activity and employment gains.

The scenario for 2021 is fraught with uncertainty, especially with the recurrence of waves of infection until widespread immunity of the population is achieved, which may take a few quarters. Uncertainty persists over the tourism, hospitality and leisure sectors, in particular those that involve a physical presence. It is estimated that the use of European Union's NGEU funds will have an impact of up to 2 percentage points (pp) of GDP each year from 2021 to 2023. In this context, the base scenario considered in this report provides for a recovery of the Spanish economy of 6.1% in 2021 and 6.3% in 2022 (see Charts 1.2.3-d and 1.2.3-e, and Table 1.2.3). Thus, not the Spanish economy will not return to the GDP level of the last quarter of 2019 until the fourth quarter of 2022, two quarters later than the average for eurozone economies (see Box 1.1.2-a).

Inflation, on the other hand, remains negative, at -0.8% in November, while core inflation continues to weaken at 0.2% , which is a symptom of weak demand. Energy, transport and communications are applying downward pressure, while, as in other countries, food is incurring price increases. In 2021, inflation will return due to the base effect on energy and other elements as activity and employment recover. Unemployment support is expected to remain until activity recovers and employment levels are stabilized. Government support for the hotel industry seems inevitable if a reduction in the country's tourism supply capacity is to be avoided.

The risks to the Spanish economy stem primarily from potential new outbreaks of COVID-19, which would periodically force new restrictions in 2021. Until a large part of the population is immunized, further outbreaks are expected. For 2021, a surge in business insolvencies, financial defaults and a spike in unemployment are expected. However, they are contained for the time being thanks to temporary layoffs (*Expedientes de Regulación Temporal de Empleo* — ERTEs), which could be extended, at least in the sectors that are suffering the greatest restrictions. Some insolvencies, particularly in the hotel and tourist transport sectors, could leave somewhat more lasting damage, resulting in a reduction of the tourist supply, which is a key sector in Spain's economy

1.2.4 Germany

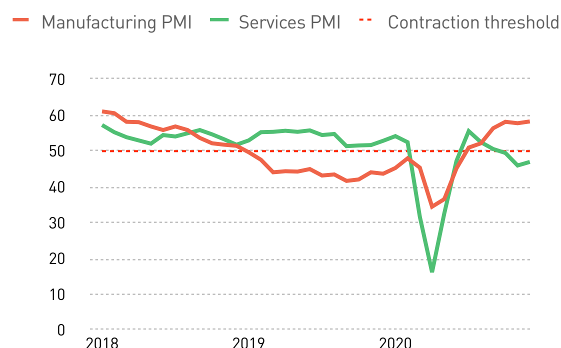
The pandemic will define the times in this 'super election year.'

Germany's GDP had an upturn of 8.5% QoQ in the third quarter, but the year-on-year rate is still -4.0%. The resumption of activity caused consumption to bounce back by 10.8% QoQ (-3.7% YoY) and exports by 18.1% QoQ (-9.4% YoY). Investment remained at -10.2% below the previous year, while government spending on

Germany

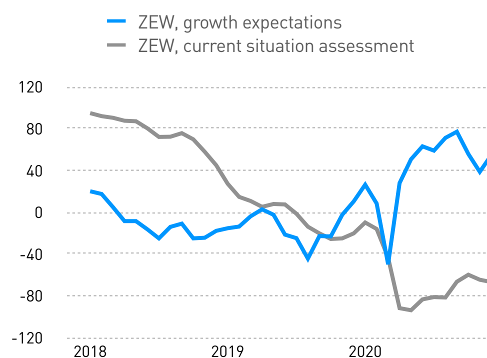
- The spike in COVID-19 infections at the end of 2020 and the respective lockdowns could extend into the first quarters of 2021.
- In the industrial sector, there are some signs of recovery and exports will have to carry the economy in 2021.
- Private consumption will continue to the extent the pandemic allows, and will therefore remain affected until a large part of the population has been immunized.

Chart 1.2.4-a
Germany: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.4-b
Germany: ZEW growth expectations index and current situation



Source: MAPFRE Economics (based on Markit data)

measures to support the economy rose by 4.2% YoY.

Hope of vaccines has raised the expectations of economic agents, but the current health situation is still worrying. During December, Germany had the second-worst statistics in Europe in terms of new COVID-19 infections, second only to Russia. The country had imposed lockdown measures that were somewhat more flexible, but that will still have affected economic performance in the fourth quarter and possibly the start of 2021. The ZEW Indicator of Economic Sentiment has climbed back up to 55 points, exceeding expectations (46). However, the ZEW Current Conditions index has barely moved and remains pessimistic (-66.5). The IFO Business Climate Index has again dropped slightly in December to 91.5 points — this index was over 100 two years ago, and normalization will take time. The composite and manufacturing PMIs were optimistic in December (51.7 and 57.8 points, respectively) while services remained pessimistic (46.0).

In this context, German GDP fell slightly less in 2020 than previously anticipated thanks to improved performance in the third quarter. As a result, a drop ofaround -5.5% (compared with -5.8% earlier) is expected. For 2021, however, many uncertainties remain, mainly in the first quarter of the year. Because of the increase in infections at the end of 2020 and the time it will take to deploy a mass vaccination program, service activity will still be reduced. Thus, for 2021, growth of 3.6% (compared with 4.5% earlier) is expected, because of both the base effect and the pandemic crisis extending into 2021, while in 2022, growth is expected to be 4.1% (see Charts 1.2.4-c and 1.2.4-d, and Table 1.2.4).

Inflation was negative in November at -0.3%, driven by fuel, transport, communications and clothing. Inflation, excluding energy, stands at +0.7%, and food inflation is +1.4%. Inflation is expected to rise by the middle of the year due to the base effects, at least in energy and transport.

Germany will hold a super election cycle in 2021, with federal and state elections in several regions. It will be an eventful year on the political front, and debate will arise over who will bear the costs of fiscal stimulus, among other matters. The risks are concentrated in the persistence of weak domestic demand, at least until a large part of the population can return to normal life, and in whether export activity recovers to a greater or lesser extent, depending on external demand. The effect of the crisis on employment has been mainly felt in job offers. However, the rise in the unemployment rate has not been as serious as it could have been if the government had not provided support.

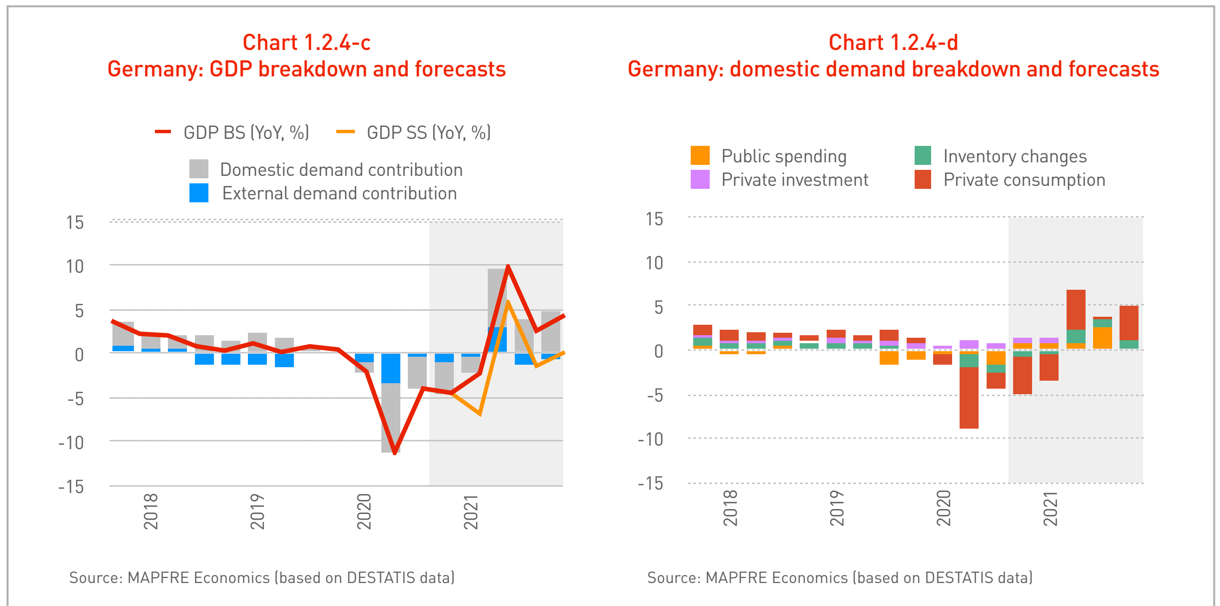


Table 1.2.4
Germany: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	2.1	2.9	1.3	0.6	-5.5	3.6	4.1	-0.6	4.3
Domestic demand contribution	2.8	2.7	1.7	1.2	-4.0	3.3	4.4	-0.5	4.5
External demand contribution	-0.7	0.2	-0.4	-0.6	-1.5	0.2	-0.3	-0.1	-0.2
Private consumption contribution	1.2	1.0	0.8	0.8	-3.5	1.4	3.8	-0.9	3.3
Total investment contribution	0.7	0.6	0.7	0.5	-0.8	0.8	0.6	0.1	0.8
Public spending contribution	0.8	0.3	0.2	0.5	0.8	0.2	0.1	0.2	0.1
Private consumption (% YoY, average)	2.2	1.8	1.5	1.6	-6.6	2.8	7.3	-1.6	6.3
Public consumption (% YoY, average)	4.1	1.6	1.2	2.7	3.9	0.7	0.6	0.7	0.6
Total investment (% YoY, average)	3.6	3.2	3.6	2.6	-3.8	3.8	2.6	0.2	3.5
Exports (YoY in %)	2.3	5.4	2.5	1.0	-11.5	8.9	6.6	0.7	8.0
Imports (YoY in %)	4.4	5.8	3.8	2.6	-9.5	9.0	8.0	0.8	9.3
Unemployment rate (%, last quarter)	6.0	5.5	5.0	5.0	6.4	5.9	5.5	7.4	6.8
Inflation (% YoY, last quarter)	1.4	1.4	1.6	1.5	-0.1	2.0	1.6	1.1	1.7
Fiscal balance (% of GDP)	1.2	1.4	1.8	1.5	-5.0	-3.6	-1.0	-5.4	-3.0
Primary fiscal balance (% of GDP)	2.4	2.4	2.7	2.3	-4.2	-2.9	-0.4	-4.7	-2.3
Trade balance (% of GDP)	8.0	7.8	6.8	6.5	5.5	5.4	5.3	5.1	5.2
Current account balance (% of GDP)	8.4	7.8	7.5	7.2	6.7	6.2	5.6	6.4	5.8
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.32	-0.33	-0.31	-0.38	-0.54	-0.77	-0.78	-0.70	-0.67
10-year interest rate (end of period)	0.21	0.43	0.25	-0.19	-0.55	-0.58	-0.30	-0.71	-0.40
Exchange rate vs. US dollar (end of period)	1.05	1.20	1.15	1.12	1.21	1.21	1.22	1.21	1.22
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)	2.8	3.2	3.6	4.4	4.3	6.8	6.7	5.4	5.0
P.S. non-financial lending (% YoY, average)	3.8	5.2	7.5	5.4	4.4	0.2	4.6	-0.1	4.3
P.S. financial lending (% YoY, average)	2.2	0.7	3.9	6.3	5.5	1.6	7.2	1.7	7.1
Savings rate (as % pers. disp. income, avg.)	10.4	10.5	10.9	10.8	17.0	14.6	10.4	16.9	13.1

Source: MAPFRE Economics (based on DESTATIS data)
Forecast end date: January 4, 2021.

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1.2.5 Italy

2021 will mark the end of emergency aid and a surge in defaults

Third-quarter GDP in Italy recovered +15.9% QoQ with activity resuming, but it did not return to pre-crisis levels and remains below normal (-5.0% YoY). All components of GDP showed a relative recovery in quarterly terms, but remain below the previous year (consumption -7.4% YoY; exports -9.1%; imports -11.9%). In the fourth quarter, activity fell again due to the second wave of the COVID-19 pandemic, which led to new restrictions being imposed. However, this fall will not be as abrupt as in the second quarter because the restrictions have not lasted as long and have focused more on sectors where social distancing is more complicated, as other activity is attempted to be carried out as normal.

In November, economic sentiment fell again, dropping from 90.2 points to 81.5, as did vehicle registration, at 8% below the previous year. The November PMIs also fell again, with the composite at 42.7 points, services at 39.4 and manufacturing at 51.5.

In this context, the growth forecast for Italian GDP for 2020 has been adjusted to -8.8% YoY, based on a fourth quarter that was weaker than expected. For 2021, a recovery of 4.6% is expected — lower than previously predicted (6.3%), since until all business can return to normal, activity will remain low. Looking ahead, growth is estimated at around 3.9% for 2022 (see Charts 1.2.5-c and 1.2.5-d, and Table 1.2.5).

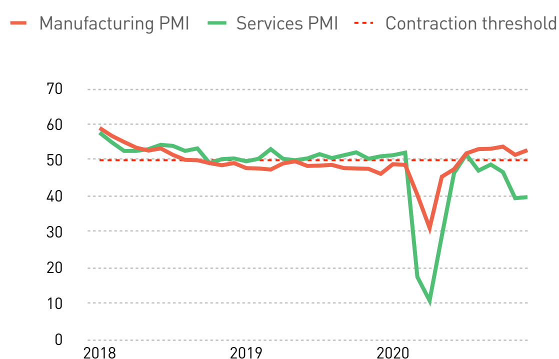
Italy

- In 2021, the Italian economy will not yet return to the level of GDP pre-crisis.
- GDP growth is expected to be around 4.6% in 2021.
- The level of debt is now less concerning. The uncertainty revolves around the end of emergency aid and the possible rise in defaults.
- Being able to apply all European aid will be key to recovery.

In addition, inflation is negative (-0.2% in November), due to the demand shock that is taking place, mainly due to the prices of flights (-31.1%) and telecommunications (-20.7%). In food, there is upward pressure on prices (1.8% in November).

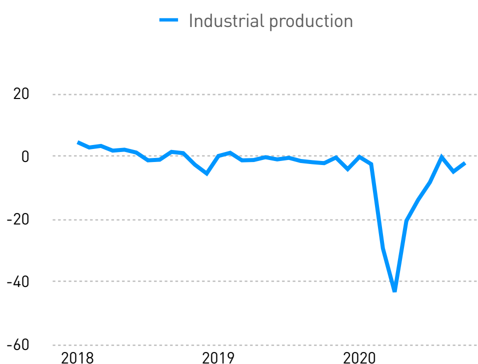
Like in other countries, risks in the Italian economy are now centered on a possible surge in financial defaults in 2021. Furthermore, its routine political instability and the country's capacity to take full advantage of the funds allocated to it within the framework of the European Recovery Fund must be taken into

Chart 1.2.5-a
Italy: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.5-b
Italy: industrial production
(% YoY)



Source: MAPFRE Economics (based on ISTAT data)

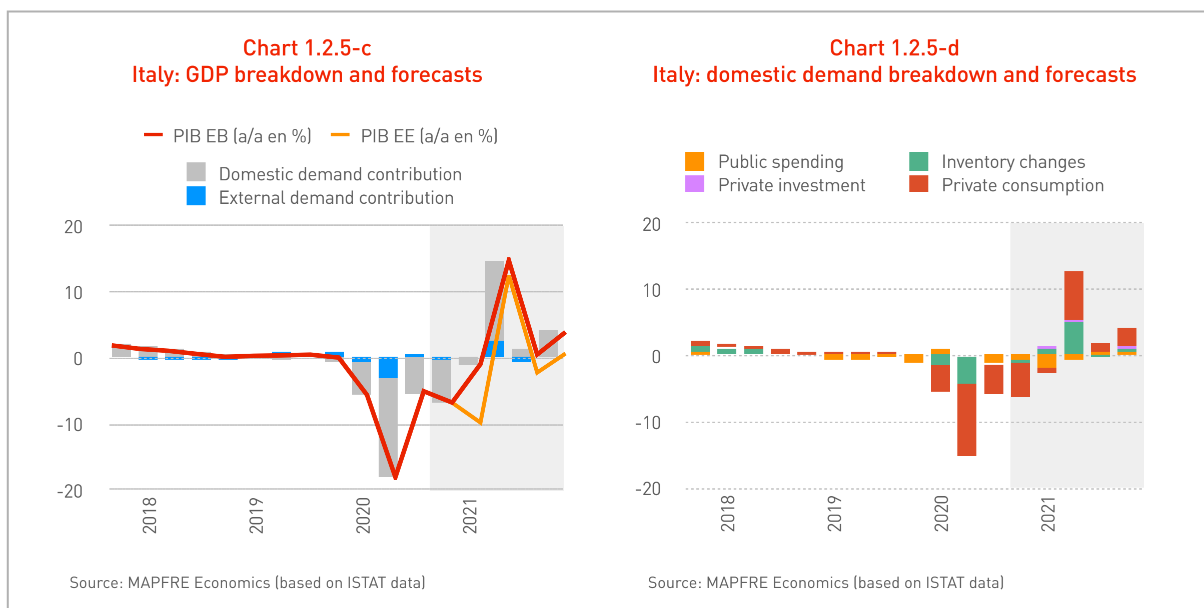


Table 1.2.5
Italy: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	1.4	1.7	0.8	0.3	-8.8	4.6	3.9	0.3	4.9
Domestic demand contribution	1.9	1.7	1.2	-0.2	-7.9	4.1	3.7	-0.0	5.3
External demand contribution	-0.5	0.0	-0.3	0.5	-0.9	0.5	0.2	0.4	-0.4
Private consumption contribution	0.7	0.9	0.6	0.3	-6.1	2.6	2.3	0.1	3.4
Total investment contribution	0.7	0.6	0.5	0.3	-1.5	1.6	0.5	0.0	1.0
Public spending contribution	0.1	-0.0	0.0	-0.0	-0.1	0.3	0.2	0.3	0.2
Private consumption (% YoY, average)	1.2	1.5	1.0	0.5	-10.1	4.2	3.9	0.1	5.8
Public consumption (% YoY, average)	0.7	-0.1	0.2	-0.2	-0.6	1.3	0.9	1.3	0.9
Total investment (% YoY, average)	4.2	3.4	2.9	1.6	-8.1	9.0	2.9	0.6	5.4
Exports (YoY in %)	1.9	6.0	1.6	1.3	-15.2	14.9	6.1	2.5	9.2
Imports (YoY in %)	4.1	6.5	2.9	-0.4	-13.5	13.3	5.9	0.8	11.4
Unemployment rate (%, last quarter)	11.8	11.0	10.5	9.5	10.4	10.4	9.9	11.6	11.2
Inflation (% YoY, last quarter)	0.5	0.9	1.1	0.5	-0.4	0.6	0.8	-0.3	0.8
Fiscal balance (% of GDP)	-2.4	-2.4	-2.2	-1.6	-10.9	-7.4	-5.0	-9.3	-6.5
Primary fiscal balance (% of GDP)	1.5	1.4	1.4	1.8	-7.4	-4.0	-1.7	-5.8	-3.0
Trade balance (% of GDP)	3.5	3.1	2.6	3.2	3.8	3.7	3.9	3.0	2.7
Current account balance (% of GDP)	2.6	2.6	2.5	3.1	3.4	3.4	3.3	3.6	2.7
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.32	-0.33	-0.31	-0.38	-0.54	-0.77	-0.78	-0.70	-0.67
10-year interest rate (end of period)	1.82	2.00	2.77	1.43	0.64	1.15	1.69	1.28	1.82
Exchange rate vs. US dollar (end of period)	1.05	1.20	1.15	1.12	1.21	1.21	1.22	1.21	1.22
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)	0.5	1.2	1.8	2.1	1.0	2.1	2.7	1.0	1.4
P.S. non-financial lending (% YoY, average)	-2.1	-3.0	-0.4	-1.1	2.9	2.1	1.3	-8.4	3.4
P.S. financial lending (% YoY, average)	-3.9	-13.2	25.1	-5.7	20.9	-1.2	0.4	-5.0	0.3
Savings rate (as % pers. disp. income, avg.)	10.2	9.8	9.6	9.6	14.4	13.3	11.1	16.0	12.5

Source: MAPFRE Economics (based on ISTAT data)
Forecast end date: January 4, 2021.

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consideration. The debt level seems to be of less concern now due to low interest expenditure, ECB support and the government's willingness to comply with the European Commission's guidelines, and because the demands for fiscal balance due to the pandemic have been somewhat relaxed. However, it is important to emphasize that Italy still needs to make structural reforms, and difficult political balances may continue to delay them.

1.2.6 United Kingdom

End of the transition period and new relationship with the European Union

The UK economy contracted -9.6% YoY in the third quarter of the year (+15.5% QoQ). However, the recovery seen during the summer was not repeated in the autumn and winter, because of new lockdowns put in place from November onwards and an increase in COVID-19 cases, which, in December, forced the reintroduction of restrictions on economic activity according to the impact of the pandemic in the different regions. GDP is expected to fall again in the fourth quarter of the year from the previous quarter (-2.6% QoQ and -12% YoY).

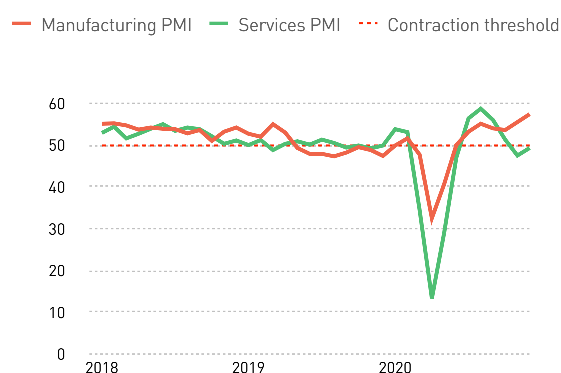
In terms of activity data, retail sales recovered slightly until October, but the indicator worsened again with the lockdown in November, as shown by vehicle registrations falling by 27% in November. Industrial production has largely recovered, but remains -5% below 2019. Some of this strength is estimated to be due to the fact that the industrial sector has been taking inventories in advance of the end of the Brexit transition period on December 31. Similarly, consumer confidence (GfK) has dropped again in October and November to -31 points. The 2020 GDP growth estimate has therefore been adjusted to -11.4% (from -9.6% before).

United Kingdom

- **The surge in infections in December has led to new restrictions and further impacts on economic activity.**
- **Although the population has started to receive vaccinations, it is expected to be well into 2021 before a large proportion of the population is immunized.**
- **The GDP growth forecast for 2020 has been lowered to -11.4% and stands at 5.7% for 2021.**
- **The United Kingdom and the European Union finally reached a post-Brexit trade deal.**

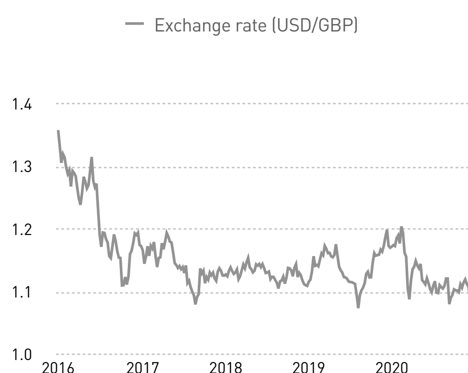
The United Kingdom was the first European country to start the vaccination process for its population on December 7. However, this vaccination effort will still take several quarters, depending on providers' capacity to produce and deliver vaccines. As a result, with the current level of cases, the decline in activity will extend into the first quarters of 2021. GDP is therefore expected to grow by 5.7% in 2021 (from 8.1% in

Chart 1.2.6-a
United Kingdom: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.6-b
United Kingdom: exchange rate



Source: MAPFRE Economics (based on Markit data)

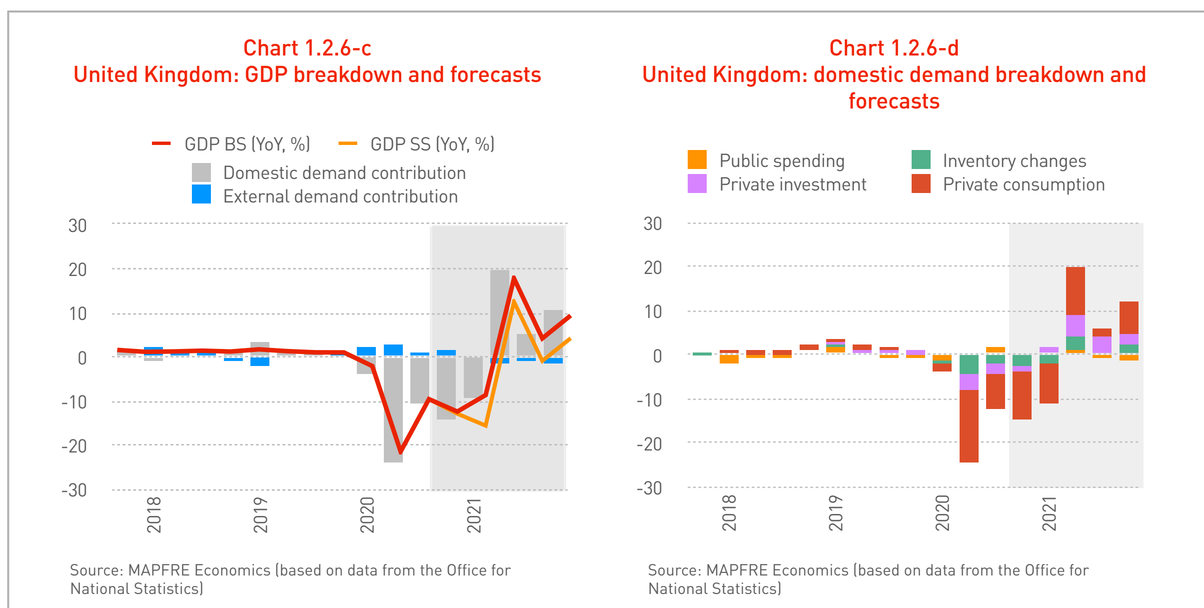


Chart 1.2.6-c
United Kingdom: GDP breakdown and forecasts

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

Chart 1.2.6-d
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

						Baseline (BS)		Stressed (SS)	
	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)	2021(f)	2022(f)
GDP (% YoY, average)	1.7	1.7	1.3	1.3	-11.4	5.7	6.1	0.1	6.7
Domestic demand contribution	3.1	1.5	0.3	1.6	-13.2	6.5	6.5	-0.6	6.8
External demand contribution	-1.4	0.2	0.9	-0.4	1.8	-0.8	-0.4	0.7	-0.1
Private consumption contribution	2.3	0.6	0.8	0.5	-9.2	2.6	4.7	-2.6	5.0
Total investment contribution	0.8	0.5	0.1	0.3	-2.3	0.9	1.4	-0.8	1.1
Public spending contribution	0.2	0.1	0.1	0.8	-1.7	3.1	0.5	3.1	0.6
Private consumption (% YoY, average)	3.7	1.0	1.3	0.8	-14.9	4.6	8.1	-4.0	9.0
Public consumption (% YoY, average)	1.0	0.7	0.6	4.1	-9.1	15.7	2.4	15.7	2.4
Total investment (% YoY, average)	4.5	2.8	0.4	1.5	-13.1	5.1	8.0	-4.5	6.8
Exports (YoY in %)	2.7	5.5	3.0	2.8	-12.6	1.9	3.8	-4.9	4.8
Imports (YoY in %)	4.0	2.7	2.7	3.3	-20.4	7.9	5.8	-4.8	6.1
Unemployment rate (%, last quarter)	4.7	4.4	4.0	3.8	6.3	6.7	5.3	10.1	8.4
Inflation (% YoY, last quarter)	1.8	2.7	2.0	1.3	0.6	1.8	1.6	0.9	1.6
Fiscal balance (% of GDP)	-3.3	-2.4	-2.2	-2.4	-14.6	-11.2	-6.5	-14.2	-8.9
Primary fiscal balance (% of GDP)	-0.5	0.5	0.5	0.1	-12.7	-9.8	-5.0	-12.9	-7.4
Trade balance (% of GDP)	-6.6	-6.5	-6.4	-5.9	-4.4	-4.9	-4.9	-3.9	-3.8
Current account balance (% of GDP)	-5.5	-3.8	-3.7	-4.3	-2.2	-2.5	-2.7	-0.8	-0.7
Official interest rate (end of period)	0.25	0.50	0.75	0.75	0.10	0.00	0.00	-0.25	-0.25
3-month interest rate (end of period)	0.37	0.52	0.91	0.79	0.04	-0.05	-0.05	-0.06	-0.06
10-year interest rate (end of period)	1.28	1.25	1.33	0.91	0.34	0.24	0.59	-0.18	0.18
Exchange rate vs. US dollar (end of period)	1.23	1.35	1.28	1.32	1.36	1.37	1.39	1.36	1.38
Exchange rate vs. euro (end of period)	1.17	1.13	1.11	1.18	1.13	1.13	1.14	1.13	1.14
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	4.0	3.1	2.1	2.9	2.9	2.9	1.9	0.1
P.S. non-financial lending (% YoY, average)	4.5	9.4	7.1	-4.3	4.5	3.1	1.0	2.7	0.4
P.S. financial lending (% YoY, average)	7.7	8.4	5.3	1.9	14.6	4.1	5.1	4.0	4.8
Savings rate (as % pers. disp. income, avg.)	7.6	5.7	6.1	6.5	17.8	14.2	9.7	18.3	12.6

Source: MAPFRE Economics (based on data from the Office for National Statistics)
Forecast end date: January 4, 2021.

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our previous forecast), while in 2022, this growth will accelerate to 6.1% (see Charts 1.2.6-c and 1.2.6-d, and Table 1.2.6).

In addition, inflation remains low, mainly due to energy (fuels, gas and electricity), at 0.3% in November, with core inflation at 1.1%. In 2021, inflation is expected to pick up, because of both base effects and the increase in energy, and because of the effect of the euro gaining strength. There may also be supply reduction effects as a result of the crisis. At its meeting on December 16, 2020, the Bank of England's Monetary Policy Committee considered that the current monetary policy stance remains appropriate and therefore decided to keep the official interest rate at 0.10%. It also decided to keep the stock of corporate bond purchases at 20 billion pounds, to continue the 100 billion pound government bond purchase program and to start the previously announced 150 billion pound program, keeping the stock target of these government bond purchases at 875 billion pounds and thus the total target stock of asset purchases at 895 billion pounds.

After several months of negotiations, the United Kingdom and the European Union reached a trade agreement on December 24, thereby averting the danger of a 'hard' Brexit and laying the groundwork for the normalization of trade and security relations in 2021 and beyond. Ratification of the treaty by both the British Parliament and the European Parliament is still pending. However, this agreement already sets the parameters for the United Kingdom's relationship with the European Union, which was in a transition period following the formalization of Brexit on January 31.

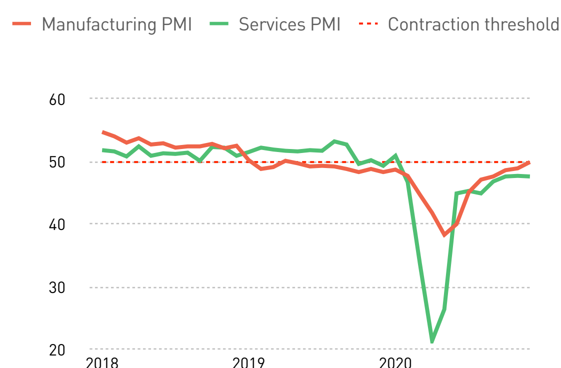
The risks to the British economy are concentrated in the health crisis worsening, since the impact caused by the risk of failing to secure a trade agreement with the EU has reduced, which would have changed the outlook entirely for foreign trade and investment.

1.2.7 Japan

The Government passes the third economic stimulus package

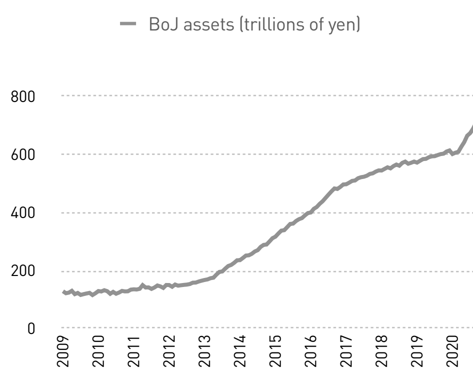
In the third quarter of the year, the Japanese economy contracted -5.7% YoY, but recovered 5.3% QoQ from the previous quarter. Private consumption fell -7.8%, investment -10.8%, exports -15.7% and imports -13.3%. The government, which has released several aid packages, has increased its spending by 3.3% and its investment by 3.8%.

Chart 1.2.7-a
Japan: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.7-b
Japan: central bank assets



Source: MAPFRE Economics (based on data from the Bank of Japan)

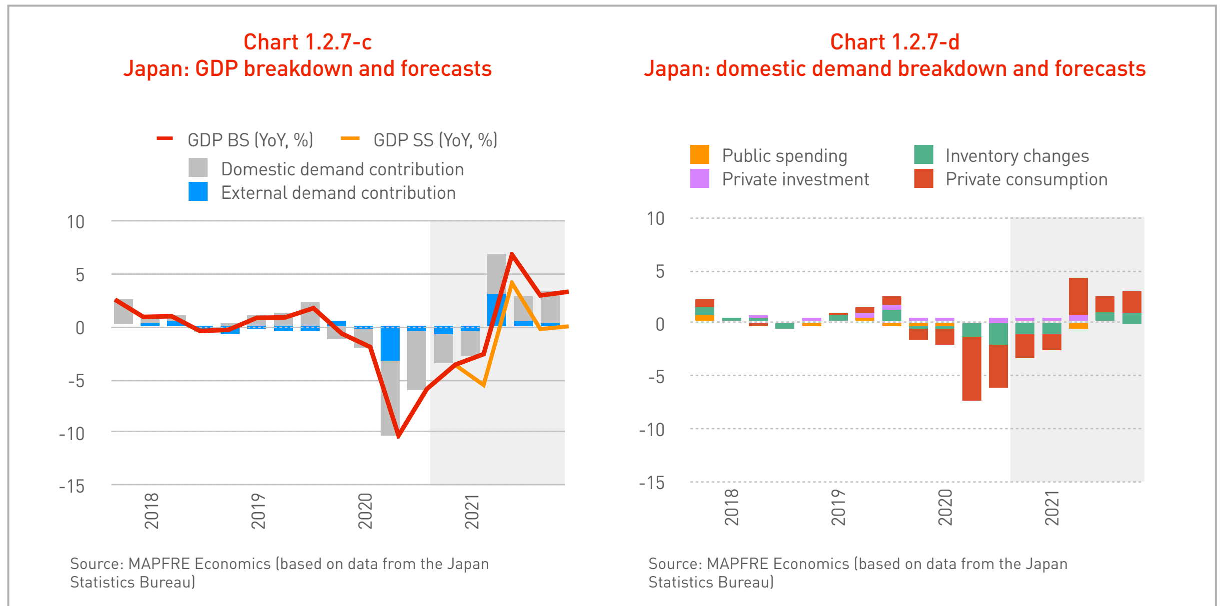


Table 1.2.7
Japan: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	0.5	2.2	0.3	0.7	-5.4	2.6	2.4	-0.4	2.1
Domestic demand contribution	-0.1	1.6	0.3	0.9	-4.3	1.7	2.1	-0.5	1.7
External demand contribution	0.6	0.6	0.0	-0.2	-1.1	0.9	0.3	0.1	0.4
Private consumption contribution	-0.2	0.8	-0.0	0.1	-3.5	1.4	1.2	0.1	1.1
Total investment contribution	-0.1	0.7	0.1	0.3	-1.1	0.2	0.8	-0.3	0.3
Public spending contribution	0.3	0.0	0.2	0.4	0.4	0.3	0.1	0.3	0.1
Private consumption (% YoY, average)	-0.3	1.3	-0.0	0.2	-6.2	2.5	2.1	0.1	1.9
Public consumption (% YoY, average)	1.4	0.1	0.9	1.9	1.8	1.5	0.3	1.5	0.3
Total investment (% YoY, average)	-0.3	3.0	0.6	1.3	-4.8	0.8	3.5	-1.4	1.4
Exports (YoY in %)	1.7	6.8	3.5	-1.6	-13.4	9.8	5.8	1.4	7.5
Imports (YoY in %)	-1.6	3.4	3.7	-0.6	-7.1	3.3	3.8	0.5	4.6
Unemployment rate (%, last quarter)	3.0	2.7	2.4	2.3	3.2	2.7	2.4	3.6	3.2
Inflation (% YoY, last quarter)	0.3	0.6	0.9	0.5	-0.6	-0.3	0.3	-1.7	-0.4
Fiscal balance (% of GDP)	-3.5	-3.0	-2.4	-2.6	-12.7	-9.5	-5.9	-10.6	-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)	1.0	0.9	0.2	0.1	0.4	0.8	0.4	0.8	0.5
Current account balance (% of GDP)	3.9	4.2	3.6	3.7	3.0	3.9	4.0	3.8	3.8
Official interest rate (end of period)	-0.06	-0.06	-0.06	-0.07	-0.10	-0.28	-0.30	-0.25	-0.25
3-month interest rate (end of period)	-0.05	-0.02	-0.07	-0.05	-0.12	-0.27	-0.32	-0.26	-0.26
10-year interest rate (end of period)	0.04	0.05	0.01	-0.02	0.02	-0.12	-0.14	-0.09	-0.09
Exchange rate vs. US dollar (end of period)	116.80	112.90	110.83	109.12	104.46	104.32	104.30	102.18	102.82
Exchange rate vs. euro (end of period)	123.12	135.40	126.90	122.59	126.40	125.90	127.02	123.15	124.99
Private lending (% YoY, average)	2.2	4.2	2.6	2.0	7.1	3.8	-1.3	0.4	-3.1
Household lending (% YoY, average)	1.5	2.5	3.0	2.4	2.1	-0.6	0.1	-1.6	-1.1
P.S. non-financial lending (% YoY, average)	1.8	2.2	1.9	3.4	7.8	1.7	-0.6	1.6	-0.7
P.S. financial lending (% YoY, average)	-0.2	8.0	6.3	3.0	15.6	-3.2	-2.8	-3.1	-2.6
Savings rate (as % pers. disp. income, avg.)	2.9	2.5	4.3	4.4	11.6	7.0	5.4	8.0	5.3

Source: MAPFRE Economics (based on data from the Japan Statistics Bureau)
Forecast end date: January 4, 2021.

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Industrial production has recovered from lows of 26% in May, but remains -3.2% (October) below 2019. The PMIs are all below 50 points, with the composite at 49 points. The Tankan business conditions index recovered across all of its components, but slowly and only slightly, and there is still no sight of a strong recovery. In terms of leading indicators, the Coincident Index (October) also showed some level of recovery (87.5).

In this sense, the exceptional situation of contraction of activity as a result of the lockdown and social distancing measures implemented to tackle the pandemic led the government to release a third aid package for the economy on December 8 for a total of 73.6 trillion yen, including projected investment from the private sector and quasi-state banks. The net figure for government spending is 32 trillion yen, made up of 20 trillion from the 2020 supplementary budget and 12 trillion from the 2021 budget.

Based on the new vaccination prospects in 2021, activity is expected to normalize toward the second half of 2021, but in no case will the previous GDP trajectory be recovered. Thus, a contraction of -5.4% is estimated in 2020 followed by a growth of 2.6% in 2021 and 2.4% in 2022 (see Charts 1.2.7-c and 1.2.7-d, and Table 1.2.7).

In this context of less activity, inflation stood at -0.7% in November, with core inflation at -0.3%, and it is expected to remain negative in the coming quarters, at least as long as demand does not strengthen. At its meeting on December 17–18, the Bank of Japan kept its monetary policy intact, with interest rates at -0.10%, but it extended its financial support program for businesses by an additional six months until September 2021. This maintenance of monetary support is aligned with the efforts of the government, which also announced the stimulus package on December 8. Perhaps most importantly, the Bank of Japan announced plans to revise monetary easing, with a view to achieving its inflation target of 2%, given that economic activity and prices are expected to remain under downward pressure for a long period of time.

Japan

- **With the prospect of prolonged economic weakness, the government enacted a third stimulus package for 73.6 trillion yen, including 32 trillion from government spending and investment.**
- **There will be no return to normal in 2021, but sights are set on 2022.**
- **It is exports, public spending, and investment that must carry the economy.**

In the coming quarters, the recovery will come mainly from public spending, investment, and exports, as household consumption is likely to remain low for some time. The risks to the Japanese economy will therefore come from a lack of strength in exports, as well as from the fact that private demand will take a long time to recover. Monetary policy has been expansionary for several years and already has very limited capacity to increase. Momentum can therefore only come from the fiscal expansion that is being activated through spending and investment, but this time faces the risk of increasing the future burden on citizens at a time when an aging population and rising social security costs are already a concern.

1.2.8 Turkey

The level of activity offers positive surprises, but with inflation and weakness in the exchange rate

The third quarter of the year saw a surprising upturn in the Turkish economy of 6.7% YoY (unadjusted, or 5.5% seasonally adjusted), corresponding to +15.6% QoQ (seasonally adjusted). Consumption grew by 6.3% YoY and

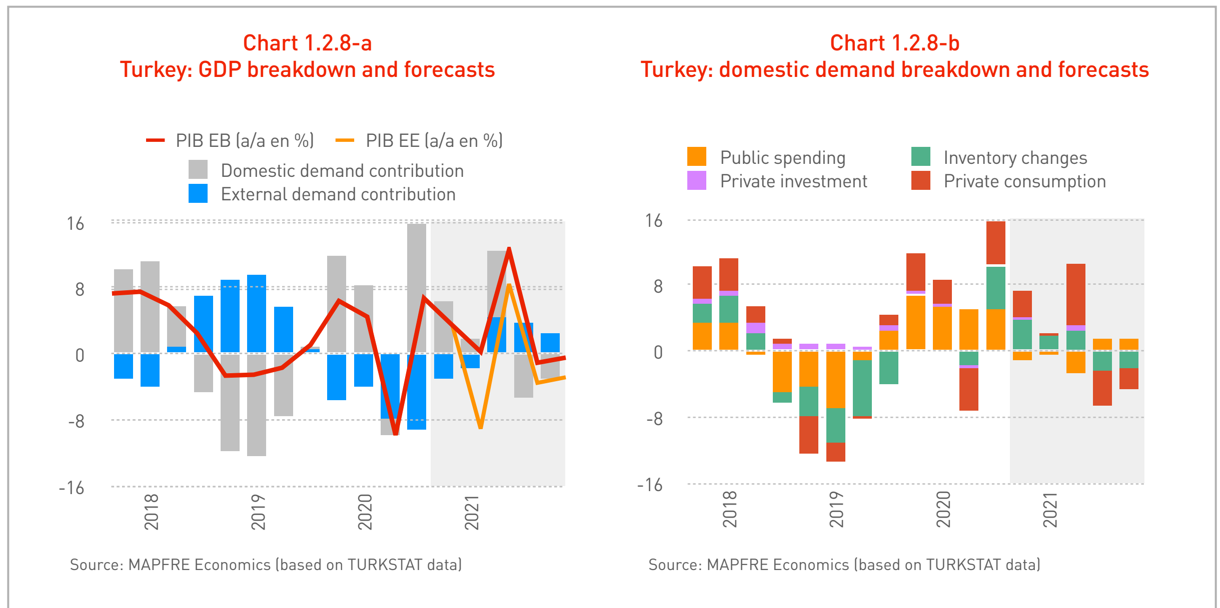

Table 1.2.8
Turkey: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)	2021(f)	2022(f)
GDP (% YoY, average)	3.4	7.4	3.3	0.8	1.2	2.8	3.4	-1.8	5.5
Domestic demand contribution	4.6	7.0	0.1	-1.9	7.1	0.4	2.9	-3.1	4.5
External demand contribution	-1.1	0.4	3.2	2.6	-5.9	2.4	0.5	1.3	0.9
Private consumption contribution	2.3	3.5	0.6	0.8	1.5	0.3	1.5	-1.8	2.7
Total investment contribution	0.7	2.4	0.2	-3.6	1.8	-0.0	0.8	-1.3	1.0
Public spending contribution	1.3	0.7	0.9	0.6	0.2	0.2	0.3	0.0	0.3
Private consumption (% YoY, average)	3.8	5.9	0.9	1.5	2.6	0.4	2.5	-3.0	4.5
Public consumption (% YoY, average)	9.8	5.2	6.6	4.6	1.4	1.4	1.8	0.1	2.0
Total investment (% YoY, average)	2.4	8.2	0.5	-12.1	7.6	0.1	3.1	-4.8	4.1
Exports (YoY in %)	-1.6	12.5	8.7	5.1	-18.6	14.3	6.8	2.5	12.7
Imports (YoY in %)	3.0	10.5	-4.9	-4.2	6.3	1.2	5.1	-5.3	8.2
Unemployment rate (%, last quarter)	12.1	10.3	12.3	13.3	13.1	12.7	11.9	13.4	12.7
Inflation (% YoY, last quarter)	8.5	11.9	20.3	11.8	13.3	10.8	10.4	10.5	10.0
Fiscal balance (% of GDP)	-1.3	-1.6	-1.9	-2.9	-4.3	-3.9	-3.5	-4.7	-4.1
Primary fiscal balance (% of GDP)	0.7	0.2	0.0	-0.6	-1.3	-0.0	0.3	-0.5	-0.1
Trade balance (% of GDP)	-4.6	-6.8	-5.2	-2.2	-5.0	-3.7	-3.6	-4.1	-3.4
Current account balance (% of GDP)	-3.1	-4.7	-2.6	1.1	-5.2	-3.3	-3.1	-4.2	-3.3
Official interest rate (end of period)	8.31	12.75	24.06	11.43	16.00	13.75	11.00	13.70	10.16
3-month interest rate (end of period)	9.90	14.61	24.07	10.76	16.38	14.41	11.21	14.92	10.70
10-year interest rate (end of period)	11.40	11.72	16.53	11.95	12.37	11.19	10.85	10.57	10.34
Exchange rate vs. US dollar (end of period)	3.52	3.79	5.29	5.95	7.74	8.04	8.29	8.33	8.47
Exchange rate vs. euro (end of period)	3.71	4.55	6.06	6.68	9.36	9.70	10.10	10.04	10.30
Private lending (% YoY, average)	13.1	20.9	20.2	8.4	31.8	13.9	6.6	13.7	6.0
Household lending (% YoY, average)	7.1	17.5	9.8	3.3	41.2	16.2	10.0	14.0	9.9
P.S. non-financial lending (% YoY, average)	14.7	24.3	20.9	5.4	35.4	6.7	1.8	-1.8	3.4
P.S. financial lending (% YoY, average)	9.0	27.2	25.1	18.3	19.5	4.7	13.2	0.6	15.6
Savings rate (as % pers. disp. income, avg.)	32.8	30.9	30.1	28.6	19.4	23.2	23.4	22.9	23.2

Source: MAPFRE Economics (based on TURKSTAT data)
Forecast end date: January 4, 2021.

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investment had a strong recovery of 22.5% YoY (+20.5% QoQ). Exports remain -22.4% below the previous year after a record fall in the second quarter (-35%). This third-quarter upturn was due to the demand that accumulated in the previous quarter, due to the closures and subsequent opening during the summer, in particular in terms of tourist activity.

This strength in consumption and investment, and in what can be seen in other indicators such as industrial activity, electricity consumption, retail sales and car sales, suggests that growth will remain strong, albeit with a moderated dynamic. As a result, we have revised our growth forecast for 2020 to 1.2%, with a growth of 2.8% in 2021, and 3.4% in 2022 (see Table 1.2.8 and Charts 1.2.8-a and 1.2.8-b).

In addition, November inflation surged to 14%, while core inflation stood at 13.3%. Food inflation was particularly high (21%), partly due to currency depreciation. The Central Bank of Turkey increased its one-week repo rate by +475 basis points (bp) to 15.00% in November, but recent inflation and currency behavior could force the rate level to be revised.

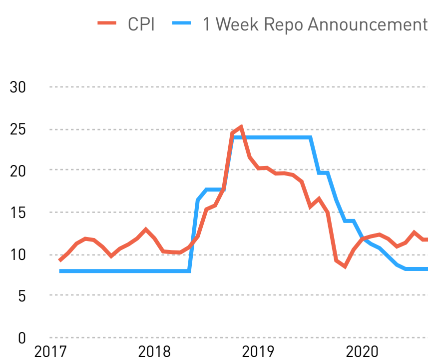
Turkey

- **GDP was a positive surprise in the third quarter of the year with growth of 6.7%.**
- **The estimate for the fourth quarter has also been revised upward based on activity indicators.**
- **Inflation showed a strong upward trend (14%), especially in food (21%).**
- **The Central Bank may act again in light of inflation and currency weakness.**

The checking account balance went further into negative territory due to the sharp fall in exports during the second quarter. Although they did recover, it was weaker than imports. This is another factor, in addition to inflation and strong corporate debt in dollars, that will keep the exchange rate under pressure.

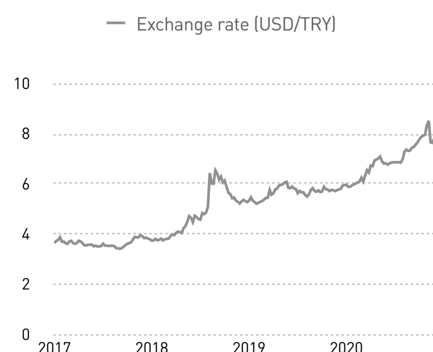
The risks to the Turkish economy stem mainly from a sharp shift in foreign investment flows, given that banks and companies alike are highly dependent on external financing in dollars. The difficulty lies in massive debt renewals every year, which put pressure on the central bank's dollar reserves. The return to free-market policies after a more interventionist period will continue to put the currency under pressure.

Chart 1.2.8-c
Turkey: inflation and interest rates



Source: MAPFRE Economics (based on CBRT data)

Chart 1.2.8-d
Turkey: exchange rate



Source: MAPFRE Economics (based on CBRT data)

1.2.9 Mexico

Mexico

- Mexico already had lingering problems before the pandemic broke out, with falling investment and a lack of stimulus to reactivate it.
- The government has enacted a small aid package, amounting to only 1.5% of GDP, which will determine the speed and depth of recovery in 2021.
- The trend of inflation could limit further interest-rate declines.
- In addition, the slow recovery of oil prices will not help the process to revive the Mexican economy.

Weak recovery in 2021

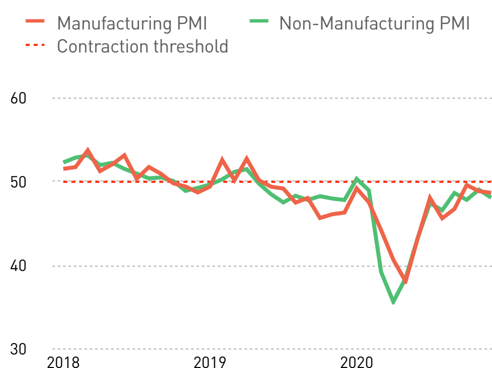
The Mexican economy recovered in the third quarter of the year (+12.1% QoQ) after the strong fall of -17% in the previous quarter, leaving year-on-year growth at -8.6%. Industrial production recovered, although it remains below pre-crisis levels; retail sales (-8.0% in September) and vehicle sales are -30% below levels three years ago. Consumption dropped -12.7% YoY, investment -18% YoY and exports -2.7% YoY. The government's response to the economic crisis has been among the most timid in all of Latin America, with aid packages amounting to just 1.0–1.5% of GDP, steepening the decline and weakening the recovery.

Looking at 2021, we assumed that exports would recover and investment would only partly recover, as investments had already fallen by -5.0% in 2019 due to idiosyncratic factors. Similarly, consumption will not fully recover during 2021. Although vaccination programs have already begun, it will be during 2021 that these efforts will be carried out on a massive scale, and it will not be until the second half of the year that a substantial part of the population will be immunized. The return to normal in services will be very gradual. Thus, a contraction in GDP of -9.0% is estimated in 2020, with revival in 2021 with growth of 3.4%, followed by 2.0% in 2022 (see Charts 1.2.9-c and 1.2.9-d, and Table 1.2.9).

Inflation, on the other hand, showed an upward trend after the summer, reaching 4.09% in October, with a high figure of +6.9% in essential agricultural products and almost 10% in other agricultural products, although according to data from the close of the fiscal year, inflation fell to 3.15% in November. The Bank of Mexico left the benchmark interest rate unchanged at 4.25% at its last meeting on December 17. Although Mexico is one of the countries in the region with the highest interest rates, both nominal and real, a possible upturn in inflation could make the central bank choose to keep them at the current level.

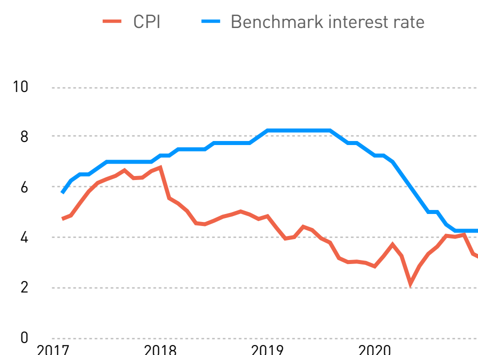
The risks to Mexico's economy are downside and are mainly concentrated on a delay in overcoming the pandemic (and the resulting

Chart 1.2.9-a
Mexico: PMIs



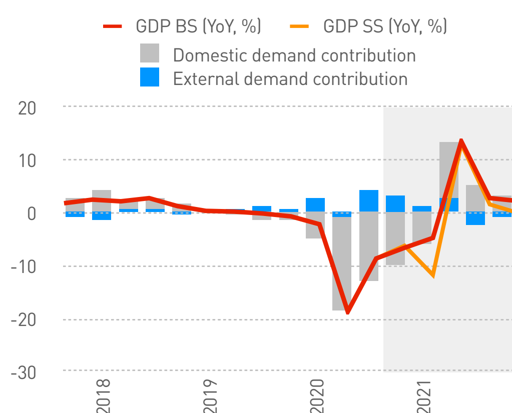
Source: MAPFRE Economics (based on Markit data)

Chart 1.2.9-b
Mexico: inflation and interest rates
(%)



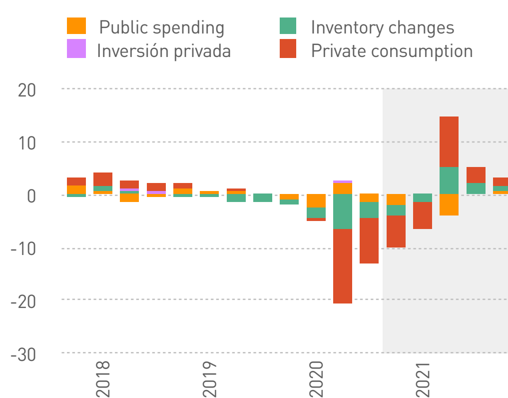
Source: MAPFRE Economics (based on data from the Bank of Mexico and INEGI)

Chart 1.2.9-c
Mexico: GDP breakdown and forecasts



Source: MAPFRE Economics (based on INEGI data)

Chart 1.2.9-d
Mexico: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on INEGI data)

Table 1.2.9
Mexico: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	2.4	2.3	2.2	-0.0	-9.0	3.4	2.0	0.7	3.6
Domestic demand contribution	2.0	3.2	2.2	-0.9	-11.3	3.3	2.8	-2.1	5.4
External demand contribution	0.4	-0.9	-0.0	0.9	2.3	0.2	-0.8	2.8	-1.8
Private consumption contribution	2.3	2.3	1.6	0.3	-7.4	2.4	1.4	-0.5	3.4
Total investment contribution	0.2	-0.2	0.2	-1.0	-3.5	1.6	0.5	-0.5	1.0
Public spending contribution	0.3	0.1	0.3	-0.2	0.3	0.1	0.2	0.0	0.2
Private consumption (% YoY, average)	3.5	3.4	2.4	0.4	-10.9	3.7	2.2	-0.7	5.3
Public consumption (% YoY, average)	2.6	0.7	2.8	-1.4	2.6	0.4	1.4	0.3	1.4
Total investment (% YoY, average)	0.9	-1.1	1.0	-5.1	-18.3	10.4	2.9	-1.6	6.1
Exports (YoY in %)	3.6	4.3	5.9	1.5	-8.8	8.1	2.4	3.4	5.3
Imports (YoY in %)	2.4	6.9	5.9	-0.9	-16.4	8.8	4.7	-5.3	12.2
Unemployment rate (%, last quarter)	3.5	3.3	3.3	3.4	5.0	5.2	5.2	5.5	5.6
Inflation (% YoY, last quarter)	3.4	6.8	4.8	2.8	3.6	2.6	2.1	2.6	2.3
Fiscal balance (% of GDP)	-2.5	-1.1	-2.0	-1.7	-3.1	-3.9	-3.5	-4.4	-3.5
Primary fiscal balance (% of GDP)	-0.1	1.4	0.6	1.1	0.0	-1.0	-0.5	-1.5	-0.5
Trade balance (% of GDP)	-1.2	-0.9	-1.1	0.4	2.8	2.4	1.5	3.6	1.8
Current account balance (% of GDP)	-2.3	-1.8	-2.1	-0.3	2.1	1.6	0.8	4.0	1.9
Official interest rate (end of period)	5.75	7.25	8.25	7.25	4.25	3.00	1.50	1.39	1.12
3-month interest rate (end of period)	6.19	7.66	8.63	7.45	4.31	3.31	1.62	1.64	1.37
10-year interest rate (end of period)	7.42	7.66	8.70	6.84	5.76	5.74	5.19	5.46	5.58
Exchange rate vs. US dollar (end of period)	20.74	19.67	19.65	18.93	21.00	22.17	22.99	22.36	22.45
Exchange rate vs. euro (end of period)	21.86	23.59	22.50	21.26	25.41	26.75	28.00	26.94	27.30
Private lending (% YoY, average)	16.3	12.1	10.4	8.9	4.1	7.9	6.9	6.6	7.8
Household lending (% YoY, average)	12.8	10.0	8.4	6.2	3.7	7.8	8.2	7.8	8.2
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)	3.5	1.7	-0.8	6.2	6.1	10.9	10.5	8.7	11.6
Savings rate (as % pers. disp. income, avg.)	12.8	10.7	12.4	16.6	25.2	21.9	21.1	23.4	20.6

Source: MAPFRE Economics (based on INEGI data)
Forecast end date: January 4, 2021.

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impact on consumption), as well as the limited size of the public aid package implemented, which could have profound effects on the business fabric and employment and slow and hinder recovery. The recovery of its external surroundings, especially the US economy, and of oil prices, will also be key. The risk that investment will take a long time to recover must also be taken into account, given that it has already been shrinking since 2019.

1.2.10 Brazil

Activity has returned, but the outlook is uncertain because of the end of emergency aid

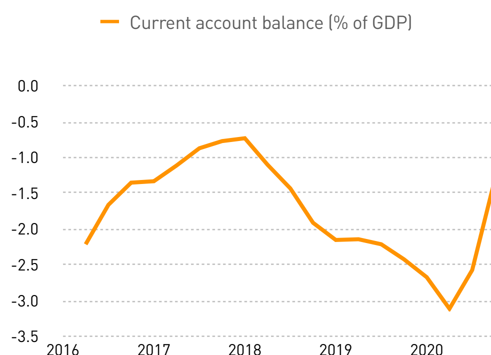
The Brazilian economy has had a third-quarter recovery in which activity grew by 7.7% QoQ (-3.9% YoY), with industrial production, and the manufacture and sale of cars returning to pre-crisis levels, also helped by the reduction of inventories. Retail sales were strong in the third quarter, partly because of state aid given to families (the 'Coronavoucher'), which was originally intended to last until June but has been extended by the government. Consumption and investment have rebounded (7.6% QoQ and 11% QoQ, respectively), exports continued to decline (-2.1% QoQ) and imports continued to deteriorate (-9.6% YoY). Recovery is expected to continue in the last quarter of 2020, but the pace is slowing according to some leading indicators.

Brazil

- **Activity is recovering, although it shows some signs of slowing down.**
- **The big question now is the impact of the end of government aid.**
- **The central bank maintained interest rates and monetary stimulus, but showed some concern about the return of inflation.**
- **Inflation has risen to 4.3% due to a weak currency and the effect of family aid.**

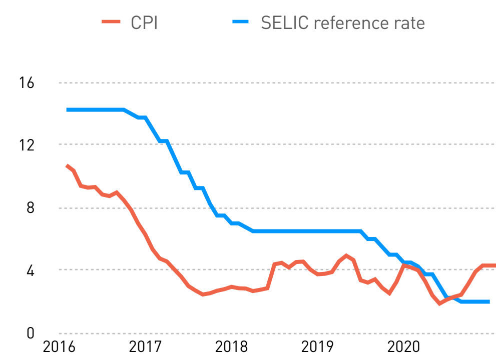
For 2021, one of the important issues will be the continuation of emergency aid, which is scheduled to end in December 2020 with the expiration of the 'state of calamity,' which has suspended fiscal rules. In this regard, President Bolsonaro's team will have to find a solution to avoid an abrupt interruption that would have a major impact on the economy. This aid costs 322 billion reais (4.5% of GDP) and continuing it is fiscally unsustainable. That is why it will be difficult to find a solution that prevents an economic downturn without damaging the country's fiscal credibility. To ensure a 'soft landing,' one solution being evaluated is *Renta Ciudadana* (Citizen Income), an improved formula compared to the current one, *Bolsa Familia* (Family Subsidy), but whose size is between 30 and 40 billion reais.

Chart 1.2.10-a
Brazil: current account balance



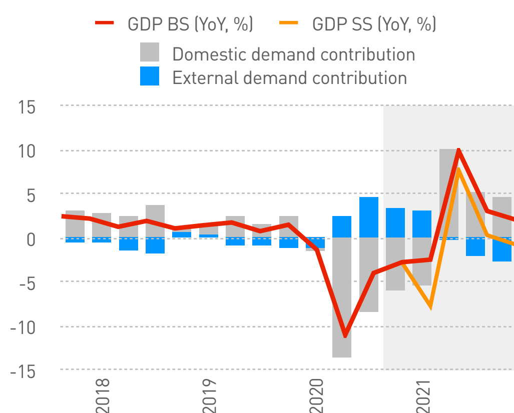
Source: MAPFRE Economics (based on data from the Central Bank of Brazil)

Chart 1.2.10-b
Brazil: inflation and interest rates
(%)



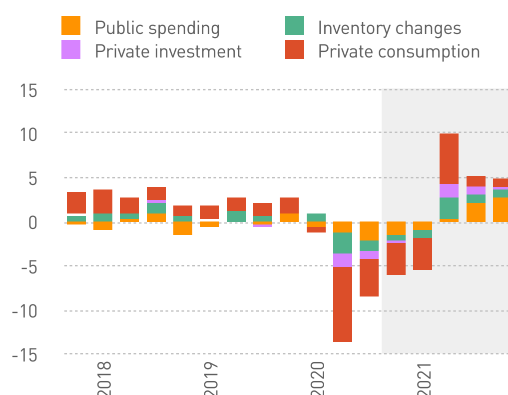
Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics)

Chart 1.2.10-c
Brazil: GDP breakdown and forecasts



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

Chart 1.2.10-d
Brazil: domestic demand breakdown and forecasts



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

Table 1.2.10
Brazil: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)	2021(f)	2022(f)
GDP (% YoY, average)	-3.5	1.6	1.7	1.4	-4.7	3.2	2.7	-0.1	3.1
Domestic demand contribution	-5.4	2.0	2.4	2.0	-7.1	3.6	4.5	-0.2	5.6
External demand contribution	1.9	-0.4	-0.7	-0.6	2.4	-0.5	-1.8	0.1	-2.5
Private consumption contribution	-2.6	1.3	1.6	1.5	-4.2	1.1	2.1	-1.6	3.2
Total investment contribution	-2.3	-0.4	0.8	0.6	-0.9	0.8	1.0	-0.4	1.0
Public spending contribution	0.0	-0.1	0.1	-0.1	-0.7	0.7	0.1	0.7	0.1
Private consumption (% YoY, average)	-3.8	2.0	2.4	2.2	-6.0	1.6	3.1	-2.3	4.7
Public consumption (% YoY, average)	0.2	-0.7	0.8	-0.4	-4.0	3.8	0.6	3.8	0.6
Total investment (% YoY, average)	-12.0	-2.5	5.2	3.5	-5.0	4.6	5.9	-1.9	5.8
Exports (YoY in %)	1.0	5.3	3.3	-2.3	-1.2	4.2	4.5	-0.9	5.1
Imports (YoY in %)	-9.7	7.3	7.1	1.1	-14.0	8.2	15.4	-0.1	21.0
Unemployment rate (%, last quarter)	12.0	11.8	11.6	11.0	13.8	12.3	12.1	13.9	13.7
Inflation (% YoY, last quarter)	6.3	2.9	3.7	4.3	3.5	3.4	3.3	2.9	2.8
Fiscal balance (% of GDP)	-9.0	-7.8	-7.0	-5.8	-17.1	-9.8	-8.2	-11.5	-9.6
Primary fiscal balance (% of GDP)	-2.5	-1.7	-1.5	-0.8	-12.5	-4.6	-2.7	-6.1	-3.8
Trade balance (% of GDP)	2.5	3.1	2.8	2.2	3.7	3.5	2.9	3.0	2.2
Current account balance (% of GDP)	-1.3	-0.7	-2.2	-2.7	-0.2	-1.0	-2.3	-1.1	-2.7
Official interest rate (end of period)	13.75	7.00	6.50	4.50	2.00	1.75	2.00	1.13	0.96
3-month interest rate (end of period)	13.65	6.90	6.40	4.40	1.89	1.39	1.93	1.03	0.86
10-year interest rate (end of period)	11.36	10.24	9.28	6.86	7.31	7.91	7.83	7.62	7.69
Exchange rate vs. US dollar (end of period)	3.26	3.31	3.87	4.03	5.14	5.36	5.52	5.52	5.61
Exchange rate vs. euro (end of period)	3.43	3.97	4.44	4.53	6.22	6.47	6.72	6.65	6.82
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)	4.4	4.7	7.0	10.8	9.9	13.9	12.2	12.4	11.9
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.)	17.2	17.4	16.4	16.2	18.4	14.1	16.7	15.9	17.4

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics)
Forecast end date: January 4, 2021.

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The program to immunize the population, which will allow activity to return to normal, will take time to deploy throughout 2021, so economic recovery will be gradual. The GDP growth forecast for 2021 is 3.2%, following an estimated decline of -4.7% in 2020, and 2.7% for 2022 (see Charts 1.2.10-c and 1.2.10-d, and Table 1.2.10). Thus, the Brazilian economy is expected to reach the GDP level seen at the end of 2019 in the second quarter of 2022 (see Box 1.1.2-a).

November inflation stood at 4.3%, with an upward trend due especially to foods and beverages and industrial goods, because of the persistent depreciation of the real, the increase in the prices of raw materials and the aid program which has increased citizens' income. At its December meeting, the Monetary Policy Committee kept SELIC interest rates at 2%, indicating that conditions still require monetary stimulus, but there is already some caution about inflationary pressures. The monetary base grew by 35.6% YoY in November.

The short-term risks to Brazil's economy lie in the inevitable reduction of aid for families, due to its fiscal unsustainability and its implications for the country's fiscal credibility. The pressure on the currency is related to the above and to the increase in the money supply, which is common among many countries at the moment. The fiscal deficit is expected to have risen to record levels of 18% of GDP in 2020, and will remain high (-9%) in 2021. Government gross debt could reach 98% of GDP in 2020 and 103% in 2021. So the focus will now be on the gradual withdrawal of aid, the evolution of the pandemic and the continuation of reforms that allow the public accounts to be balanced in the long-term.

1.2.11 Argentina

Inflation and currency pressure point to renewed economic difficulties

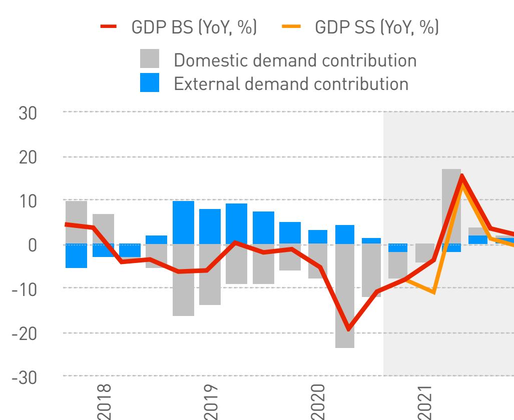
In the third quarter of the year, GDP recovered from the previous quarter (+12.8% QoQ), but declined against the previous year by -10.2% YoY. Private consumption did not recover (-14.2% YoY) nor did investment (-10.7% YoY). Both exports and imports fell substantially (-17% and -22% YoY, respectively), while government spending had no room for stimulus (-6.5%). The construction sector shrank by 27%, and the hotel and restaurant sector contracted by 61.5%.

Argentina

- **The currency continues its relentless depreciation, with the monetary supply doubling in one year.**
- **The authorities would like to reduce this monetization of the deficit through funding with other multilateral agencies in addition to the IMF.**
- **Inflation is on the rise and the depreciation of the currency threatens further interest rate increases.**

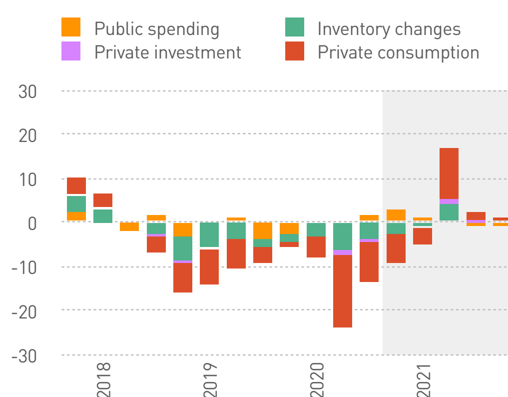
The Ministry of Economy is trying to gain control over the growing macroeconomic instability, with high currency and inflation risks that will cause problems for consumption, investment and economic activity. To this end, it is acting to promote specific export and construction sectors, reduce currency controls, reduce dependence on monetary financing of the deficit, commit to funding more with other multilateral organizations besides the International Monetary Fund (IMF) and send a proposal to Congress to adjust pension calculations. However, adjusting the deficit may be a difficult task in a year with legislative elections (October 24, 2021, preceded by primaries on August 8). In this context, GDP is expected to fall by -10.7% in 2020, with a weak recovery of 4.4% in 2021 and 2.3% in 2022 (see Charts 1.2.11-a and 1.2.11-b, and Table 1.2.11).

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

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	-2.0	2.8	-2.4	-2.1	-10.7	4.4	2.3	0.9	2.5
Domestic demand contribution	-1.6	6.4	-3.9	-9.4	-12.4	3.8	1.8	-0.4	3.5
External demand contribution	-0.4	-3.6	1.5	7.3	1.6	0.6	0.5	1.3	-0.9
Private consumption contribution	-0.5	3.0	-1.6	-4.8	-9.0	2.5	1.0	-0.6	2.5
Total investment contribution	-1.1	2.5	-1.2	-3.2	-4.0	0.6	0.4	-0.5	0.6
Public spending contribution	-0.1	0.4	-0.2	-0.1	-0.5	0.5	0.3	0.5	0.3
Private consumption (% YoY, average)	-0.7	4.2	-2.4	-6.3	-12.7	3.9	1.5	-0.5	3.5
Public consumption (% YoY, average)	-0.5	2.7	-1.6	-1.0	-3.6	3.4	1.7	3.4	1.7
Total investment (% YoY, average)	-5.7	13.2	-4.8	-15.5	-23.3	5.1	2.8	-2.3	4.7
Exports (YoY in %)	6.0	2.6	0.8	9.1	-10.9	4.8	1.9	-2.2	3.1
Imports (YoY in %)	6.1	15.5	-3.6	-18.5	-17.5	3.1	-0.3	-7.6	8.2
Unemployment rate (%, last quarter)	7.6	7.2	9.1	8.9	11.3	9.8	8.4	11.6	9.9
Inflation (% YoY, last quarter)	37.5	23.3	47.4	52.2	38.7	39.4	29.6	40.9	29.4
Fiscal balance (% of GDP)	-5.8	-5.9	-5.0	-3.8	-9.1	-6.4	-4.3	-7.3	-4.9
Primary fiscal balance (% of GDP)	-4.2	-3.8	-2.3	-0.4	-7.0	-4.9	-2.7	-5.7	-3.2
Trade balance (% of GDP)	0.8	-0.8	-0.1	4.1	5.1	5.5	5.3	5.9	4.9
Current account balance (% of GDP)	-2.7	-4.8	-5.0	-0.9	2.0	2.7	2.2	3.0	1.8
Official interest rate (end of period)	24.75	28.75	59.25	55.00	38.00	38.00	23.00	36.36	23.57
3-month interest rate (end of period)	26.23	27.44	56.76	45.13	30.51	30.62	21.81	30.41	22.49
10-year interest rate (end of period)	7.00	5.91	10.86	19.36	15.39	9.37	6.80	9.24	6.51
Exchange rate vs. US dollar (end of period)	15.89	18.65	37.70	59.89	83.52	113.96	142.49	119.71	146.40
Exchange rate vs. euro (end of period)	16.75	22.37	43.17	67.28	101.06	137.54	173.54	144.27	177.97
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: January 4, 2021.

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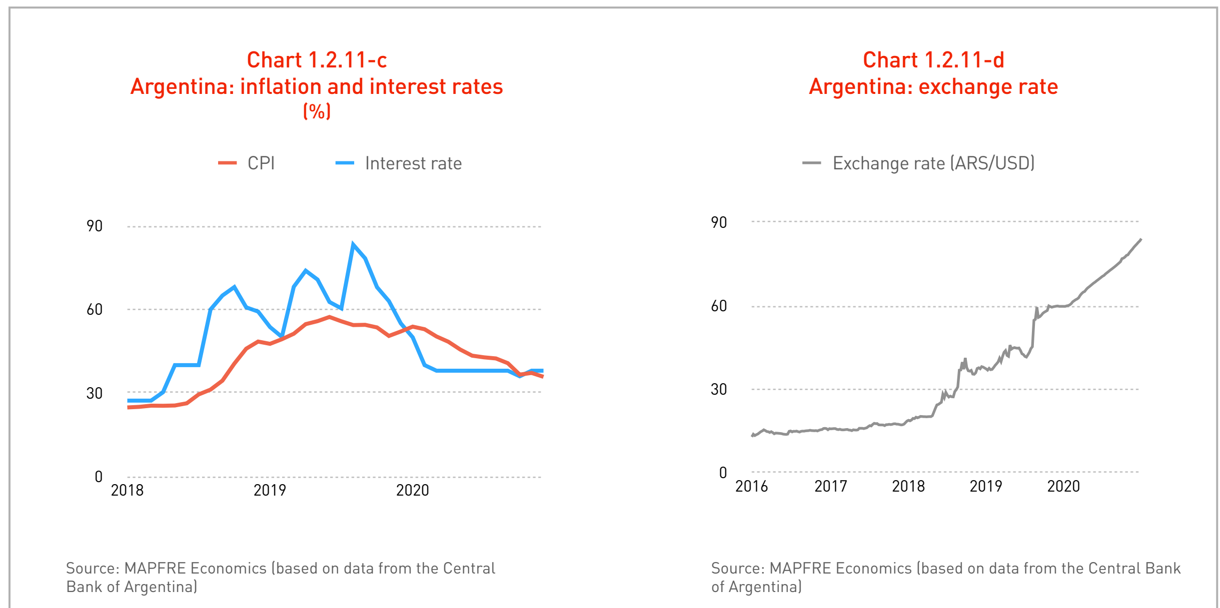


Source: MAPFRE Economics (based on data from the Central Bank of Argentina)

Source: MAPFRE Economics (based on data from the Central Bank of Argentina)

October inflation stood at 37.2% (3.6% MoM) with an upward trend, as predicted by the October producer price increase of 4.7% MoM. The pressure on the currency continues, and is made evident in the difference between official and parallel market rates. In light of this, the central bank has prevented a stronger depreciation through the use of reserves. However, reserves available for trading on the exchange market are being depleted and, therefore, an acceleration in currency depreciation and, consequently, further interest-rate increases are to be expected. The central bank has raised the 7-day LELIQ benchmark interest rate to 38% after a short period (just over a month) at 36–37%. With the M3 monetary base growing to 84% (November), 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 expensiveand inflation will remain high. The monetary stimulus via state deficit financing is highly expansionary.

As such, the currency continued its relentless depreciation as the money supply expanded, approaching 84 ARS/USD at the end of December. Inflation is therefore expected 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

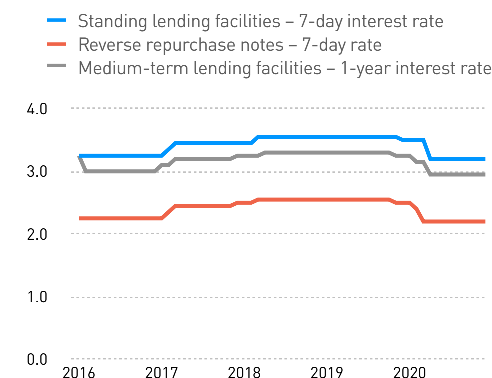
Strong economy with great help from exports and investment

Chinese GDP grew by 4.9% YoY in the third quarter — slightly worse than expected, lowering the year's forecast by four tenths to 1.5%. Consumption remained below 2019 levels (-0.5% YoY), but is

China

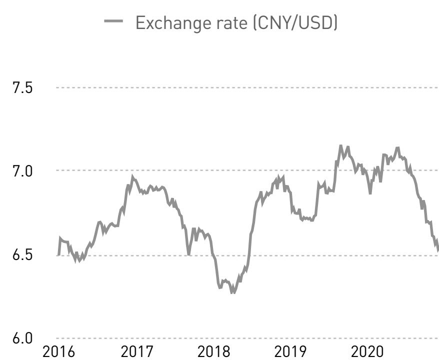
- The Chinese economy will grow by 1.7% in 2020.
- GDP growth in 2021 is expected to be around 8.5%, subject to the absence of second waves of infection both in China and abroad.
- Export growth was strong, standing at 6.4% in the third quarter, due to the global reopening of the economy.
- Fiscal policy was expansionary in 2020 and will remain that way in 2021, albeit on a smaller scale.
- A strong push for infrastructure investment.

Chart 1.2.12-a
China: interest rates



Source: MAPFRE Economics (based on PBOC data)

Chart 1.2.12-b
China: exchange rate



Source: MAPFRE Economics (based on PBOC data)

showing signs of recovery. Exports increased by 6.4%, benefiting from the recovery in external markets, while investment grew by 8% and government spending by 12%.

Indicators are already showing normal activity levels, with retail sales growing by 4.6% in October and car sales returning to normal levels. In October, PMIs had improved and were in expansion (above 50 points), with services at 56.8 and manufacturing at 53.6. Similarly, consumer confidence increased sharply in September from the lows seen in June. As a result, China will reach pre-pandemic GDP levels in 2021 before the rest of the world, with an estimated growth of 8.0% in 2021 and 5.0% in 2022 (see Charts 1.2.12-c and 1.2.12-d, and Table 1.2.12).

Inflation fell sharply in recent months, dropping to 0.5% in October (and is estimated at 0.4% for the last quarter of the year). Core inflation also stood at 0.5% and producer prices (-2.1%) have been deflating since the middle of 2019. This sharp decline in the overall consumer price index (CPI) is due to some foods (pork, -2.8%, and eggs, -16.3%) and energy (-8.9%), which has led to expectations that inflation will fall at least in the first quarter of 2021.

With regard to monetary policy, which is managed through multiple instruments in China, interest rates are expected to remain stable until the second half of 2022. Moreover, with the economy on the path toward recovery, it is not likely that the central bank will need to release additional stimulus. The country's fiscal policy is expansionary, with the budget deficit expected to reach -8.5% of GDP in 2020 (quarterly average), compared to -5.4% in 2019. Strong investment in infrastructure (a 2.6 trillion 5-year plan) and tax cuts are other measures used to support the economy.

In addition, the renminbi has been appreciating against the dollar since June, within a context of strong exports (+11.4% YoY in October) and a strong current account balance (+1.5% of GDP). Thus, the currency has increased in value from 7.15 against the dollar as seen at the end of May, to 6.60 today.

One of the risks for China's economy is a return to rising trade tensions with the US — even if the new US president intends to ease them, China is currently failing to meet the import quotas provided for in the Phase One trade deal. The other risk is that of the evolution of the pandemic, both within the country and beyond it, as China is "the world's factory" and

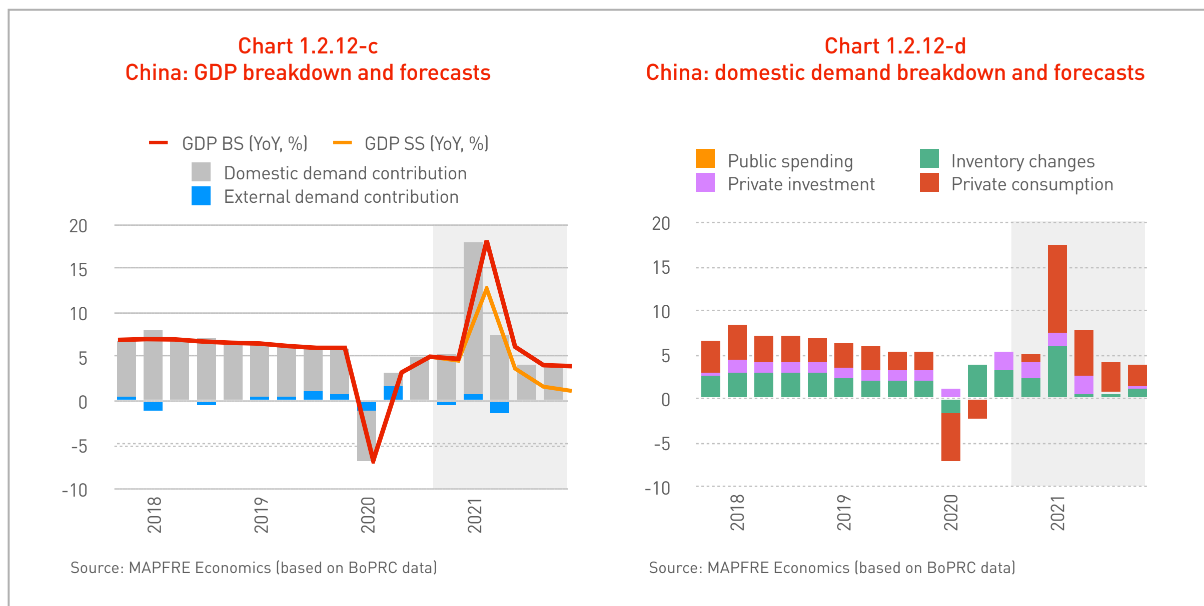


Table 1.2.12
China: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	6.8	7.0	6.8	6.1	1.5	8.0	5.0	4.7	5.3
Domestic demand contribution	7.7	6.6	7.3	5.4	1.4	8.1	4.7	4.6	4.9
External demand contribution	-0.9	0.3	-0.5	0.7	0.1	-0.1	0.3	0.1	0.4
Private consumption contribution	3.3	3.6	3.2	2.4	-1.7	5.2	2.8	2.1	3.1
Total investment contribution	3.1	2.5	3.0	2.1	2.0	2.1	1.4	1.7	1.4
Public spending contribution	1.3	0.4	1.2	1.2	1.1	1.0	0.7	1.0	0.7
Private consumption (% YoY, average)	8.7	9.4	8.2	5.9	-4.0	13.5	7.2	5.5	8.1
Public consumption (% YoY, average)	8.0	2.3	7.8	7.5	7.0	6.0	4.0	6.0	4.0
Total investment (% YoY, average)	7.3	5.9	7.1	5.0	4.8	4.8	3.4	4.0	3.2
Exports (YoY in %)	1.8	7.0	4.5	2.4	0.3	6.7	4.7	0.2	5.0
Imports (YoY in %)	3.2	8.3	6.9	-0.8	-0.8	7.8	5.3	-0.6	5.4
Unemployment rate (%, last quarter)	3.8	3.8	3.7	3.8	5.0	3.6	3.5	5.2	4.9
Inflation (% YoY, last quarter)	2.2	1.8	2.2	4.3	0.4	3.0	2.3	2.0	2.4
Fiscal balance (% of GDP)	-4.3	-4.8	-4.7	-5.5	-8.3	-6.6	-5.6	-7.8	-6.7
Primary fiscal balance (% of GDP)	-1.6	-1.8	-1.5	-2.1	-4.7	-3.3	-2.4	-4.5	-3.6
Trade balance (% of GDP)	4.4	3.9	2.8	3.0	3.5	2.8	3.0	3.2	3.4
Current account balance (% of GDP)	1.8	1.6	0.2	1.0	2.0	1.5	1.4	2.1	1.9
Official interest rate (end of period)	3.00	3.25	3.30	3.25	3.00	2.75	2.75	1.02	0.78
3-month interest rate (end of period)	4.25	5.53	3.70	3.20	2.95	2.67	2.82	1.09	0.92
10-year interest rate (end of period)	3.05	3.91	3.26	3.15	3.36	3.22	3.33	2.43	2.56
Exchange rate vs. US dollar (end of period)	6.94	6.51	6.88	6.99	6.60	6.53	6.51	6.58	6.53
Exchange rate vs. euro (end of period)	7.32	7.80	7.87	7.85	7.99	7.89	7.92	7.93	7.94
Private lending (% YoY, average)	13.8	13.1	12.9	13.1	13.1	12.6	8.6	13.4	7.8
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.)	39.3	38.7	37.9	38.2	42.2	39.6	38.7	43.0	41.6

Source: MAPFRE Economics (based on BoPRC data)
Forecast end date: January 4, 2021.

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lower external demand would eventually affect it.

1.2.13 Indonesia

The pandemic, still in the first wave, could threaten the economic recovery expected in 2021

Indonesia's third-quarter GDP shrank -3.5% YoY, with consumption falling -4.0%, investment -6.5%, and exports -10.8%. Imports have massively contracted by -21.9%, revealing the extent of the crisis and its effect on consumption capacity and the slowdown in investment.

The COVID-19 pandemic has played out differently in Indonesia than in other countries. The government initially avoided resorting to lockdown measures, and the evolution of the pandemic shows a gradual upward trajectory, like a first wave. This has mitigated the damage in the short-term, but may lead to more negative performance in the long-term. In September, with cases increasing, the government had to impose more restrictions, primarily on the capital, Jakarta. Activity in the fourth quarter of 2020 and the first quarter of 2021 will have been adversely affected as a result.

Indonesia

- **Indonesia's economy suffered fewer closures than in other countries, but this might catch up with it later.**
- **The government is working to boost the economy with an infrastructure plan equivalent to 2.5% of GDP.**
- **The currency's recovery facilitated a further interest rate cut in November.**

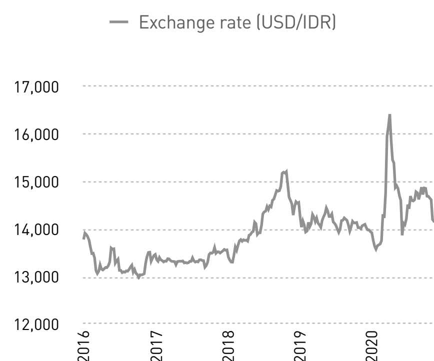
GDP is forecasted to grow by 5.1% in 2021 and 6.4% in 2022, following an estimated contraction of -2.1% in 2020 (see Charts 1.2.13-c and 1.2.13-d, and Table 1.2.13). This will depend on the evolution of the pandemic and the degree to which consumption resumes. The government is trying to provide infrastructure investment equivalent to 2.5% of GDP and reduce barriers to foreign investment in order to activate both components. The manufacturing PMIs improved in the fourth quarter of 2020, but were still contracting (47.2 points).

Furthermore, inflation was 1.6% in November, rising two tenths. At its December 17 meeting,

Chart 1.2.13-a
Indonesia: inflation and interest rates
(%)

Source: MAPFRE Economics (based on Markit data)

Chart 1.2.13-b
Indonesia: exchange rate



Source: MAPFRE Economics (based on Bloomberg data)

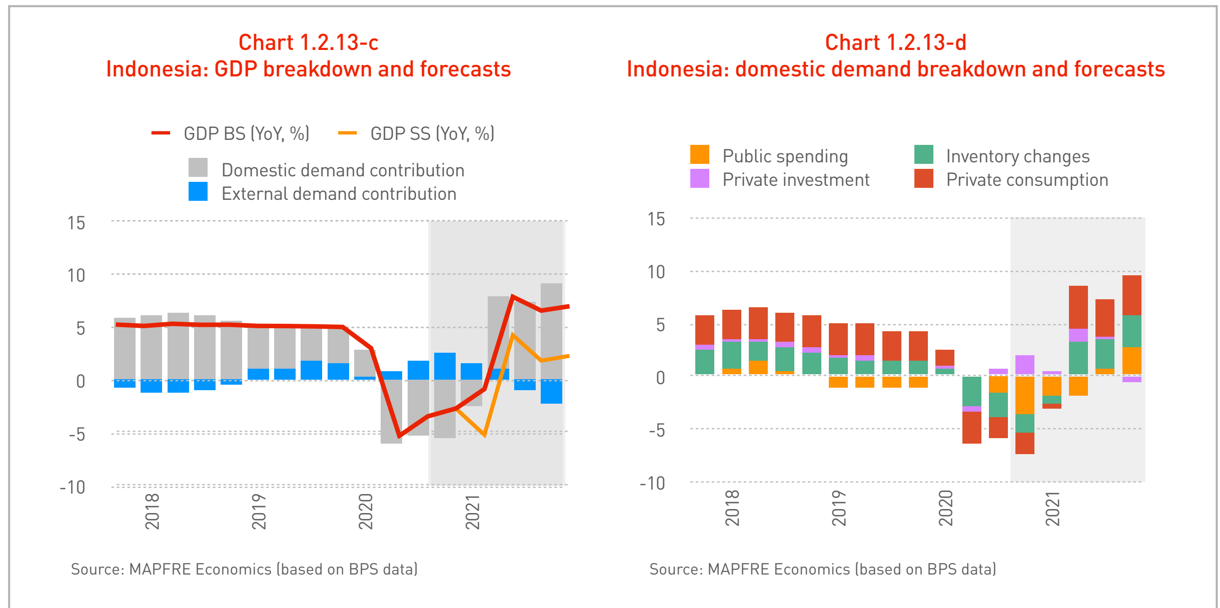


Table 1.2.13
Indonesia: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	5.0	5.1	5.2	5.0	-2.1	5.1	6.4	0.7	5.8
Domestic demand contribution	4.9	4.8	6.1	3.6	-3.5	5.2	7.6	-0.2	5.9
External demand contribution	0.1	0.3	-0.9	1.4	1.4	-0.1	-1.2	0.9	-0.2
Private consumption contribution	2.8	2.8	2.8	2.9	-1.4	2.7	3.5	-0.4	3.2
Total investment contribution	1.5	2.0	2.2	1.5	-1.5	2.1	2.7	-0.1	2.3
Public spending contribution	-0.0	0.2	0.4	0.3	0.6	0.4	0.4	0.4	0.4
Private consumption (% YoY, average)	5.0	5.0	5.1	5.2	-2.6	4.9	6.3	-0.8	5.9
Public consumption (% YoY, average)	0.7	2.0	4.7	3.7	6.3	6.7	4.7	6.7	4.7
Total investment (% YoY, average)	4.5	6.1	6.7	4.5	-4.6	6.6	8.2	-0.4	7.2
Exports (YoY in %)	-1.6	9.0	6.6	-0.9	-7.3	6.6	5.2	0.0	6.1
Imports (YoY in %)	-2.4	8.1	12.1	-7.7	-15.5	9.0	13.9	-5.5	16.3
Unemployment rate (%, last quarter)	5.5	5.3	5.1	5.1	7.2	6.0	4.4	9.9	7.6
Inflation (% YoY, last quarter)	3.3	3.5	3.3	2.7	1.5	2.1	2.6	1.5	2.2
Fiscal balance (% of GDP)	-2.5	-2.6	-1.7	-2.2	-7.0	-6.0	-4.5	-6.8	-5.3
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)	1.6	1.9	-0.0	0.3	2.7	2.8	1.3	0.0	0.0
Current account balance (% of GDP)	-1.8	-1.6	-2.9	-2.7	-0.6	-1.0	-2.0	0.6	-0.5
Official interest rate (end of period)	4.75	4.25	6.00	5.00	3.50	3.25	3.00	1.12	1.00
3-month interest rate (end of period)	7.46	5.48	7.70	5.51	3.79	3.51	3.32	1.43	1.31
10-year interest rate (end of period)	7.85	6.30	7.90	7.05	6.13	6.04	6.11	5.70	5.97
Exchange rate vs. US dollar (end of period)	13,525	13,484	14,380	13,883	14,193	14,047	13,819	14,316	13,971
Exchange rate vs. euro (end of period)	14,257	16,171	16,465	15,596	17,174	16,953	16,829	17,253	16,984
Private lending (% YoY, average)	7.8	8.2	10.8	8.8	2.5	12.6	13.8	-2.4	4.0
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)	10.1	15.1	5.6	-3.0	-0.2	10.6	8.1	6.3	6.5
Savings rate (as % pers. disp. income, avg.)	22.9	23.6	24.0	22.8	21.3	22.0	22.8	22.0	22.8

Source: MAPFRE Economics (based on BPS data)
Forecast end date: January 4, 2021.

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the Central Bank of Indonesia left interest rates at 3.75%. Looking ahead, Governor Perry Warjiyo reiterated that the bank will maintain an accommodative monetary policy stance until 2021 in order to help the economy recover. The Bank of Indonesia noted that global activity has continued to improve thanks to increased mobility and continued fiscal stimulus, and both effects are expected to continue to support recovery in 2021. On the domestic front, the central bank sees encouraging signs of a recovery in high-frequency data points.

The main risk to the Indonesian economy is the infection curve, which is still in the first wave, forcing restrictions and threatening the recovery forecasted for 2021. Although the medical solution to the pandemic is on the horizon, it will still take a long time to take effect. It is therefore expected that the crisis will continue to have a significant effect on tourism and that the international context will affect exports, although its main export, palm oil, is performing well.

1.2.14 Philippines

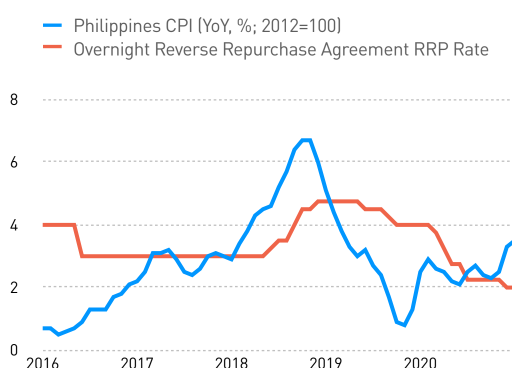
Weaker than expected recovery and a continuing negative outlook

Philippines

- The confidence of economic agents remains affected and mobility continues to recover.
- There was a spike in infections in the third quarter, preventing the reopening of several activities and hindering recovery.
- There is little room for additional fiscal and monetary stimulus.
- Migrant remittances rose back up to normal levels.

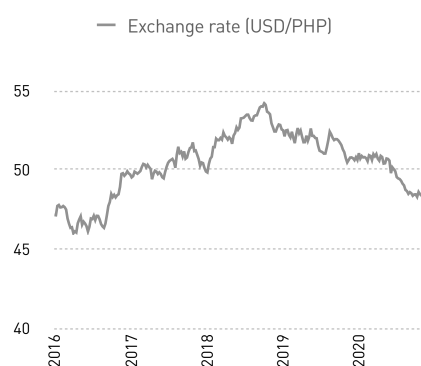
In the third quarter of the year, the Philippines' GDP fell by -11.5% YoY (+8.0% QoQ), worse than expected. Private consumption remained severely affected (-9.3%), as a surge in COVID-19 cases in August and September led the government to impose new restrictions. Investment fell by -37.1% YoY, with key sectors such as construction (-43.5%) and durable machinery (-34.4%) particularly notable. Positive contributions have come from government spending (+5.8%) and net exports; imports contracted more than exports, at -21.7% and -14.7%, respectively.

Chart 1.2.14-a
Philippines: inflation and interest rates
(%)



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.14-b
Philippines: exchange rate



Source: MAPFRE Economics (based on Bloomberg data)

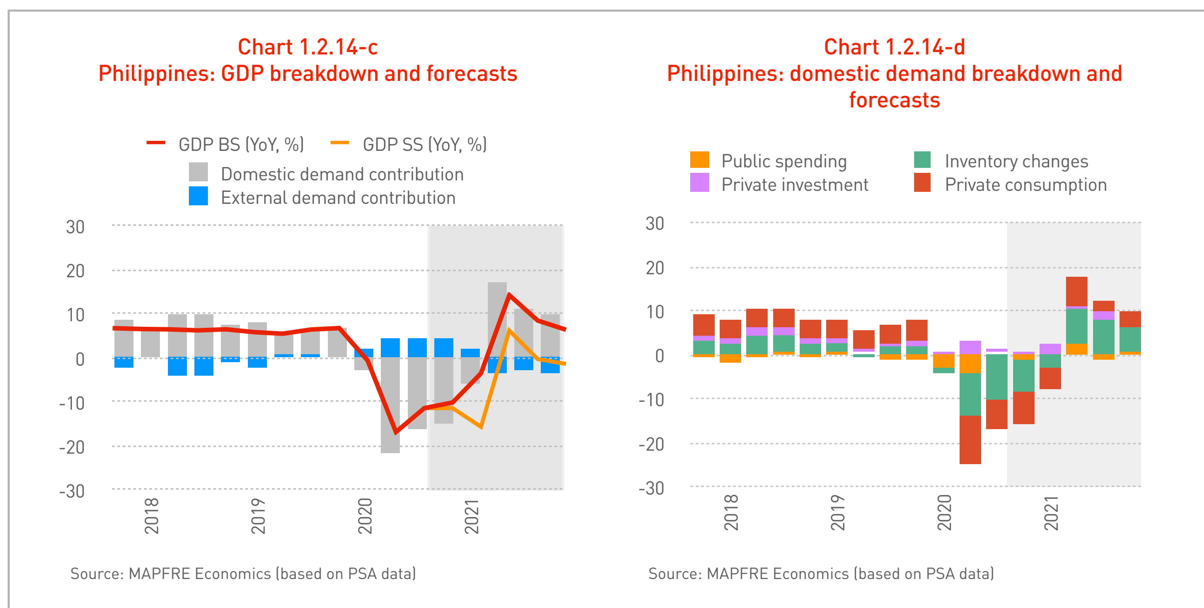


Table 1.2.14
Philippines: main macroeconomic aggregates

	2016	2017	2018	2019	2020(e)	Baseline (BS) 2021(f)	Baseline (BS) 2022(f)	Stressed (SS) 2021(f)	Stressed (SS) 2022(f)
GDP (% YoY, average)	7.2	6.9	6.3	6.0	-9.8	6.3	7.0	-2.9	8.9
Domestic demand contribution	10.9	7.8	8.6	6.1	-13.7	8.1	7.9	-2.3	11.1
External demand contribution	-3.8	-0.9	-2.3	-0.1	3.9	-1.8	-0.9	-0.6	-2.1
Private consumption contribution	5.3	4.4	4.2	4.3	-6.1	1.8	4.0	-2.2	5.6
Total investment contribution	4.6	2.6	3.3	1.1	-7.1	4.8	2.8	-1.5	4.2
Public spending contribution	1.0	0.7	1.5	1.1	1.4	1.1	0.2	1.1	0.2
Private consumption (% YoY, average)	7.2	5.9	5.8	5.9	-8.5	2.5	5.6	-2.9	7.6
Public consumption (% YoY, average)	9.1	6.7	13.5	9.8	10.8	7.6	1.3	7.6	1.3
Total investment (% YoY, average)	21.1	10.6	12.9	4.1	-26.3	23.8	11.5	-5.5	22.0
Exports (YoY in %)	9.2	17.4	11.9	2.4	-16.7	10.9	14.2	4.6	14.3
Imports (YoY in %)	18.9	15.1	14.6	2.0	-22.0	14.2	13.1	5.9	16.7
Unemployment rate (%, last quarter)	4.7	5.0	5.1	4.6	8.8	8.3	7.3	11.2	9.5
Inflation (% YoY, last quarter)	2.0	3.0	5.9	1.5	2.5	2.6	3.3	1.9	2.8
Fiscal balance (% of GDP)	-2.3	-2.1	-3.1	-3.4	-7.7	-7.6	-7.1	-9.3	-8.5
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)	-11.2	-12.2	-14.7	-13.1	-9.2	-9.6	-10.0	n/a	n/a
Current account balance (% of GDP)	-0.4	-0.7	-2.6	-0.9	2.7	1.3	0.9	2.3	1.2
Official interest rate (end of period)	3.00	3.00	4.75	4.00	2.00	1.75	1.50	0.63	0.84
3-month interest rate (end of period)	2.50	3.22	5.03	3.97	1.82	1.80	1.67	0.60	0.87
10-year interest rate (end of period)	4.63	5.70	7.05	4.44	3.01	3.27	3.74	2.57	3.23
Exchange rate vs. US dollar (end of period)	49.81	49.92	52.72	50.74	48.26	48.31	48.09	49.14	48.48
Exchange rate vs. euro (end of period)	52.51	59.87	60.37	57.01	58.40	58.31	58.57	59.22	58.94
Private lending (% YoY, average)	15.3	17.6	16.8	9.5	3.8	9.6	17.8	10.2	17.3
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)	8.5	9.4	10.3	6.9	-8.2	13.7	9.2	4.0	10.6
Savings rate (as % pers. disp. income, avg.)	9.3	9.7	9.3	8.4	6.0	8.3	10.8	9.9	10.1

Source: MAPFRE Economics (based on PSA data)
Forecast end date: January 4, 2021.

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Mobility levels are still 30% below normal, compared to -10% in other Asian countries. Travel to the workplace is 37% below normal, and activity in restaurants, stores and leisure outlets is down -41%. Restrictions are affecting spending levels, and a strong recovery looks unlikely as long as the level of infection remains high. The restrictions will also continue to affect investment, specifically the infrastructure works planned by the government and other construction projects. The October manufacturing PMI worsened again and began to contract (48.5 points). Despite lower interest rates and broad liquidity conditions, bank credit has stagnated, both because of demand that has been retracted by poor outlooks, and because banks defaults increasing. In these circumstances, GDP is expected to contract by -9.8% in 2020 (more than the 7.8% projected three months ago). A recovery of 6.3% and 7.0% is also expected for 2021 and 2022, respectively (see Charts 1.2.14-c and 1.2.14-d, and Table 1.2.14).

Inflation stood at 3.3% in November, showing some upward pressure in recent months. In November, BSP, the Philippines' central bank, lowered official interest rates (Overnight Repo) by 25 bp to 2.0%, after a series of declines from 4.0% at the end of 2019. Real interest rates are now negative, so no further decline is expected for the time being. Financial conditions are already lax and the M3 money supply is growing above 12%. Lowering interest rates further would not have a major impact on financial conditions at the moment, and could negatively affect the exchange rate.

The government is planning a 10% increase in budget spending in 2021, which must be approved by the end of the year. In the absence of additional fiscal stimulus, it is difficult to be more optimistic about the prospects for recovery. Control over the pandemic, reopening the economy and restoring consumer confidence are all prerequisites for better prospects.

The risks to the Filipino economy stem from continued restrictions due to the difficult control of the pandemic; low mobility and, as a result, no recovery of consumption in sight; the fall in tourism; and migrant remittances.

2. Industry outlook

2.1 The economic environment and its impact on insurance demand

2.1.1 Global markets

Global economic growth in 2021 is estimated to range from 5.2% (base scenario) to 0.9% (stressed scenario), after an estimated decline in 2020 of around -4.4%, which represents a virtually unprecedented contraction as a result of the COVID-19 pandemic. The wide range of forecasts for growth in 2021 is indicative of the high level of uncertainty affecting all sectors, including the insurance industry, although to a lesser extent than other sectors directly linked to travel, tourism and in-person services. The good news on vaccines, however, is being offset by new outbreaks of the disease, which put pressure on health systems and require new measures to be adopted with partial closures and restrictions on movement.

The return to growth in the third quarter of 2020, following the partial resumption of economic activity, was tarnished in the last quarter as a result of new closures. These closures have been much more limited than those endured at the outset of the pandemic, but they increase uncertainty and affect spending, hiring, and investment decisions for households and businesses alike, which harms the performance of the insurance industry. The effectiveness of vaccination campaigns in achieving a level of immunity that at least prevents the collapse of healthcare systems, until herd immunity is reached, will be a key element in a recovery that will be uneven due to the lack of healthcare infrastructure and logistical problems of distributing the vaccines in some countries, especially in emerging economies.

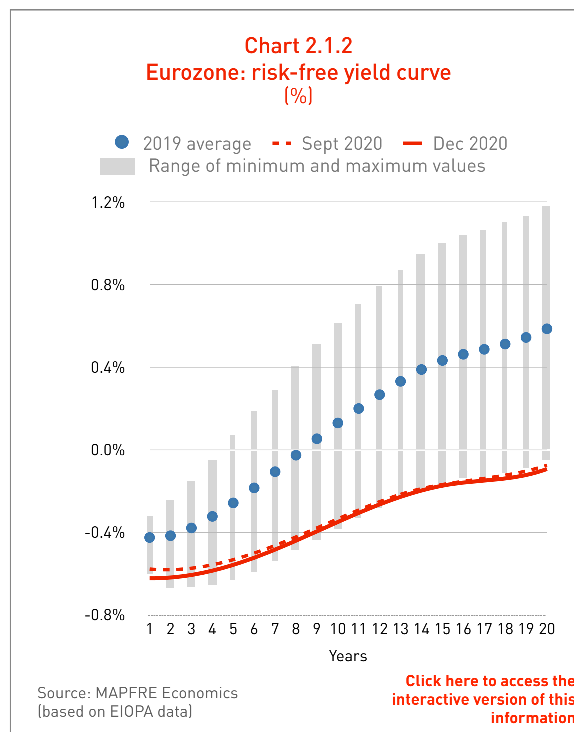
Global intervention by central banks, including lowering interest rates and quantitative easing measures through bond-acquisition programs (both sovereign and corporate), has been crucial for the insurance industry, and continues to provide stability to the financial markets, in which insurance companies are one of the major institutional investors, all while allowing governments, homes and businesses to continue financing at a reduced cost. However, as noted in previous reports[19], the fiscal measures taken are substantially increasing the deficits and debt level of countries. This is a major restriction for those economies without sufficient fiscal space and additional borrowing capacity, a problem that greatly affects emerging countries. In some of these countries, the deterioration of public accounts is causing exchange-rate depreciation and inflationary pressures fueled by accommodative monetary policy measures. This may delay recovery of both the economy and the insurance industry, because of its strong link to the economic cycle, and reduce the profitability of the insurance companies as a result of the increase in the cost of claims and the loss of financial return on their investments.

2.1.2 Eurozone

Economic growth for the eurozone in 2021 is estimated to range from 4.5% (base scenario) to -0.5% (stressed scenario), after an

estimated decline in 2020 of around -7.3% — a virtually unprecedented contraction, as a result of the pandemic. The monetary stimulus adopted by the ECB have prevented economic and financial collapse by allowing member states to finance their debt and the large fiscal deficits incurred to help families and businesses at a very low, or even negative, cost. Vaccination plans launched in the final days of 2020 still require several months to reach a high percentage of the population. In addition, tax aid plans through the European Union reconstruction fund will take a long time to implement, given they require that the projects to which the funds of this recovery program will be allocated be presented and approved. In the meantime, there remains a risk of further outbreaks of infection and partial closures, with consequent negative effects on the employment and viability of small- and medium-sized enterprises, which will continue to adversely affect the insurance industry, especially in the first half of 2021, until the economy recovers.

At its final meeting in December, the ECB kept interest rates at current levels (0% for main refinancing operations and -0.50% for deposit facilities). However, it continues to expand unconventional measures to secure financing through sovereign and corporate bond markets, ensuring their liquidity with low risk premiums. As such, it expanded the asset purchase facility to 1.85 trillion euros, with a time horizon that will last until they deem the coronavirus crisis to be over. In addition, it also decided to extend TLTRO III until June 2022 in order to ensure broad liquidity conditions and maintain a high level of bank credit. It therefore continues to strongly support the eurozone's financial markets, in which insurance companies are large institutional investors. However, uncertainty about the solvency of some issuers is increasing, leading major rating agencies to impose downgrades.



Moreover, despite the quantitative easing measures taken by the ECB, inflation remains weak, even negative, for the eurozone as a whole. The December risk-free interest rate curve produced by EIOPA remains in negative territory throughout with a level similar to the previous quarter, which continued to affect all the curve's longer terms—even 20-year terms—practically halting the development of the Life Savings and traditional annuity insurance business lines. Chart 2.1.2 shows the minimum, average and maximum interest rate levels reached in 2019, along with the level of the latest curves published by EIOPA for September and December 2020.

The EURO STOXX 50 index, however, continues to show signs of recovery, which favors the development of Life insurance products in which the policyholder assumes the risk of the investment. In addition, improving economic expectations can help this business, which has so far been adversely affected by the preference of economic agents to remain in liquidity positions.

2.1.3 Germany

Economic growth for the German economy in 2021 is estimated to range from 3.6% (base scenario) to -0.6% (stressed scenario), after an estimated decline of around -5.5% in 2020, which represents a moderate improvement on expectations. The expansionary fiscal measures adopted are partly compensating for the economic effects of the fresh outbreaks that have occurred in recent weeks, and continue to particularly impact consumption due to partial closures and uncertainty. The aid for workers and small- and medium-sized enterprises included in the comprehensive tax package and the expectations of a return to economic growth may help to moderate the negative effects of the crisis on the insurance business, especially in the business of Non-Life and Life Protection.

However, the situation remains complex for the Life Savings and traditional annuity insurance business due to the low interest rate environment in which Germany and the entire eurozone economy find themselves and which will remain as a result of the monetary expansion measures taken due to the pandemic. The German DAX, however, has recovered from the sharp fall it experienced in April, and closed the year with a slight revaluation, 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 in 2021 is for GDP growth in the range of 4.6% (base scenario) to 0.3% (stressed scenario), compared to an estimated drop in 2020 of -8.8% as a result of the pandemic. In Italy, the pre-crisis situation was already one of low growth and with a high level of public debt, which is rising as a result of the fiscal measures implemented to support the economy. The extension of 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. On top of this, additional funds will be received in the form of grants and loans from the European recovery fund. The expected return to economic growth this year will help the development of business in the country's insurance markets, especially in the Non-Life business, which is experiencing severe setbacks as a result of the sharp economic contraction seen in 2020. Uncertainty, however, is high because of the rise in the default rate expected as a result of the economic downturn and the time it may take to gain access to EU reconstruction funds. In addition, as noted above, the ECB's strong intervention in bond markets has kept the risk premium and the term premium of Italian sovereign debt low. Thus, the interest rate environment is less favorable for the Life business, which may partly offset the positive impact of the economic recovery forecast in this business.

2.1.5 Spain

Economic growth for Spain in 2021 is estimated to range from 6.1% (base scenario) to -0.6% (stressed scenario), after an estimated decline in 2020 of around -11.3%. The effects of the restrictions resulting from the fight against the pandemic on consumption, trade, hospitality and tourism-related businesses continue to particularly intensely affect the Spanish economy and disposable household income. The negative impacts on employment,

businesses and the solvency of households and businesses are translating to the insurance market and the recovery forecast for 2021 will depend largely on the pace of vaccination until herd immunity is achieved and the measures taken as a result of the outbreaks can be eased.

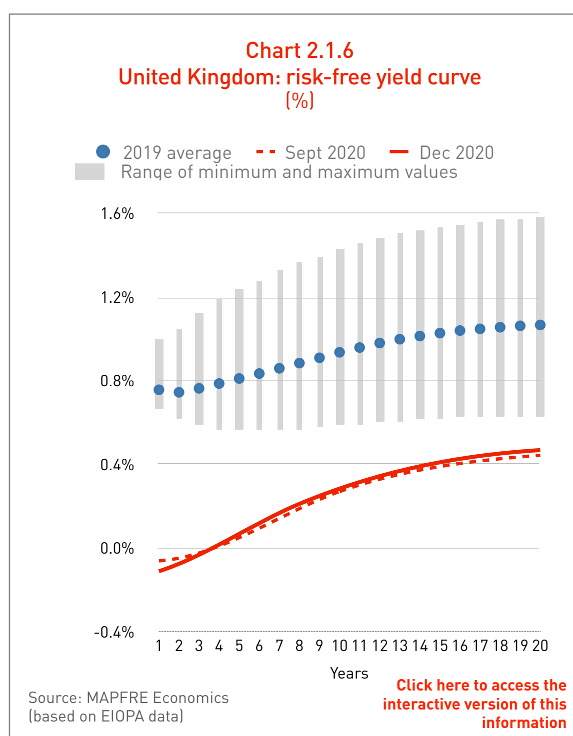
The wide range of estimates reflects the high level of uncertainty. Based on the latest data available for November 2020[20], Non-Life premiums have slowed down in interannual terms, growing by 0.6%, with a decline of -1.9% in the automobile line. The lines of Health (4.8%) and Multirisk, both for homeowners (2.7%) and condominiums (2.9%), are showing great resistance, especially Health, which is always very resilient in economic crises, and particularly so in the current health crisis. Life business premiums are falling by -23.7% as a result of the decline in Life Savings insurance premiums (-28.7%), and the slight slowdown in Life Protection premiums (-0.25%). However, despite the sharp decline in premiums, savings managed by insurance companies have remained stable and only suffered a slight fall of -0.9%, based on data from September. However, insurance policies in which the policyholder assumes the risk of investment are worth mentioning. Although they still only represent 7.3% of the savings managed by insurance companies, the savings themselves grew by 5.5% in the period while the number of policyholders grew by 67.5%. Moreover, the pattern of behavior of the insurance business shows many similarities with that of the 2007–2009 crisis. However, in the current crisis, the decisive intervention of the ECB—which has allowed Spain to finance itself at reduced, even negative, costs—and the European Union's aid program—which is estimated to contribute up to 2 pp of growth to Spanish GDP each year over the next three years—mean we can expect a less profound decline and a faster recovery for the insurance industry than in that crisis (see Box 2.1.5).

2.1.6 United Kingdom

The forecast for the UK economy for 2021 is for GDP to grow in the range of 5.7% (base scenario) to 0.1% (stressed scenario), compared to the -11.4% decline seen in 2020 due to the pandemic and uncertainties resulting from Brexit. The unemployment rate and outbreaks of the pandemic continue to rise, which is affecting consumer confidence, and it will still take a few months for a high percentage of the population to be vaccinated. The trade agreement reached in late December between the United Kingdom and the European Union has reduced uncertainty, but it remains to be seen how the new situation will affect the country's economy. However, expectations for the performance of the Non-Life and Life Protection insurance business in 2021 have improved, in line with the start of economic recovery.

In terms of Life Savings and traditional annuity insurance and in light of the magnitude of the pandemic crisis, the Bank of England is keeping interest rates close to zero and maintaining a comprehensive sovereign and

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



Source: MAPFRE Economics (based on EIOPA data)

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Box 2.1.5
Spanish insurance industry performance: forecasts for premium growth

General considerations

The pandemic situation during 2020 has made it extremely complex to forecast the performance of the insurance industry as measured by the growth of direct premiums in the Life and Non-Life segments. This is because the performance-based approach to preparing forecasts of macroeconomic fundamentals has four clear limitations terms of modeling demand development in non-linear situations such as the current one:

(1) It is not granular enough, as the (often-changing) elasticity of each of the lines that form the Life and Non-Life segments is not considered. In fact, there are lines that are clearly sensitive to the economic cycle (see chart on Automobiles), while the behavior of others appears to be less pro-cyclical (see chart on Health).

(2) There is a delayed relationship between determinants and premium performance (due to the use of low-frequency data such as national accounting data or because the historical inertia of the relationship between the two in normal situations indicates this), something that does not necessarily occur during a situation such as the current one.

(3) It is subject to an element of additional uncertainty that is instantaneous, exogenous and simultaneous, determining both the explanatory variables (macroeconomic fundamentals) and the explained variables (premiums) — the degree of social restrictions imposed to address the health crisis.

(4) It discards the anticipatory nature of economic agents in light of new incoming information, so it does not reflect expectations.

For this reason, an alternative approach has been developed for situations like this one, in which forecasts for premium growth have been prepared in both an 'optimistic scenario' and a 'pessimistic scenario' depending on how the pandemic plays out. These forecasts are based on variables related to activity (industrial production, tourism, etc.), financial variables (credit, savings, etc.) and expectations (of consumers and producers), when all of these are clearly determined by the degree of social restrictions imposed in accordance with the evolution of the pandemic.

The case of the Spanish insurance market

In this sense, models have been estimated for the Spanish insurance market taking into account all elements of the Non-Life (Automobiles, Multirisk, Health and Other Non-Life lines) and Life (Savings and Protection) segments, in an attempt to gain the perspective of the reaction of each of these and their contribution to the aggregate of each segment of the insurance business as the restrictions determine the explanatory variables.

As such, two clearly differentiated scenarios, starting from December, have been taken into account: one in which the uncertainty and restricted movement diminish throughout 2021 (optimistic scenario), and another in which this does not happen due to the reasons discussed in this report (pessimistic scenario). Thus, although the first scenario is expected to happen, the second cannot be discarded. These are, therefore, two complementary realities.

The effect of each scenario on the evolution of the cyclical and non-cyclical elements of the premiums of both segments of the insurance business is presented in Charts A to D. In this sense, it should be noted that the cycle-sensitive lines in the Non-Life segment (cyclical lines) are Automobiles, Commercial Multirisk (Commercial Multirisk and Industrial Multirisk) and Other Non-Life lines (Accidents, Assistance, Fires, Personal Injury, Third-Party Liability, Pecuniary Losses, Burials, Legal Defense, Credit and Surety), since their growth is reduced as income and activity worsen, given the nature of the risks that are insured in these lines of business. The least cycle-sensitive lines (acyclic lines), on the other hand, are Health and Individual Multirisk (Homeowners Multirisk and Condominium Multirisk). In addition, in the Life business, Life Protection is cycle-sensitive because of its link to the mortgage market. Although Life Savings is not very cycle-sensitive in normal times, in extraordinary situations such as the pandemic, it

Box 2.1.5 (continued)
Spanish insurance industry performance: forecasts for premium growth

reacts in a non-linear way because it requires the forced recovery of financial savings.

Optimistic scenario

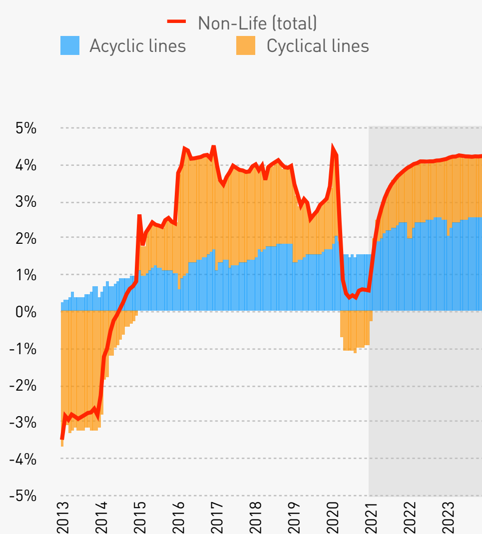
As can be seen from the charts, after the most difficult phase of the pandemic ended without the growth of the Non-Life sector collapsing, and with the growth of some lines (cyclical lines) being offset by others (acyclic lines), from January 2021, the scenario of diminished uncertainty and the gradual return to normality until there are no restrictions would result in the rapid return of premium growth to a rate close to what can be considered its long-term (between 3.5% and 4%). This should be achieved from the second quarter of 2021 and is consistent with what models based on macroeconomic fundamentals produce.

For its part, in the case of the Life business, reduced uncertainty means people use financial savings (Life premiums) less and the contraction of this business gradually slows down. Structurally, however, this segment of the insurance business continues to fall since the Life business faces more structural problems that limit its recovery, the main one being the secular fall in the temporary premium. This business would return to neutrality only after 2023, when monetary policy in the eurozone and the United States is expected to approach normalization.

Pessimistic scenario

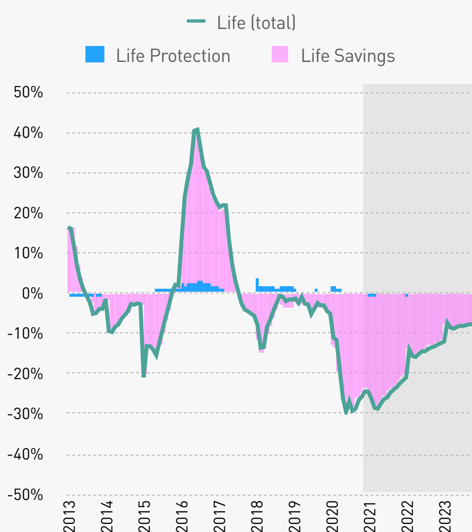
However, if, on the contrary, the announcement and deployment of vaccines faces a new wave of uncontrolled infections, or if it is found that the effect of vaccination is insufficient to control the pandemic, we would find that this scenario of restrictions and uncertainty would continue, further sinking the cyclical demand for Non-Life insurance in 2021 and leaving the acyclic demand inert. This would lead to a contraction of the Non-Life segment and then a relatively dynamic recovery (two years after the outbreak of the crisis, as a result of herd immunity), until growth rates consistent with the long-term, as per the models based on fundamentals, are

Chart A.
Optimistic scenario: contribution to growth from Non-Life lines
(%)



Source: MAPFRE Economics

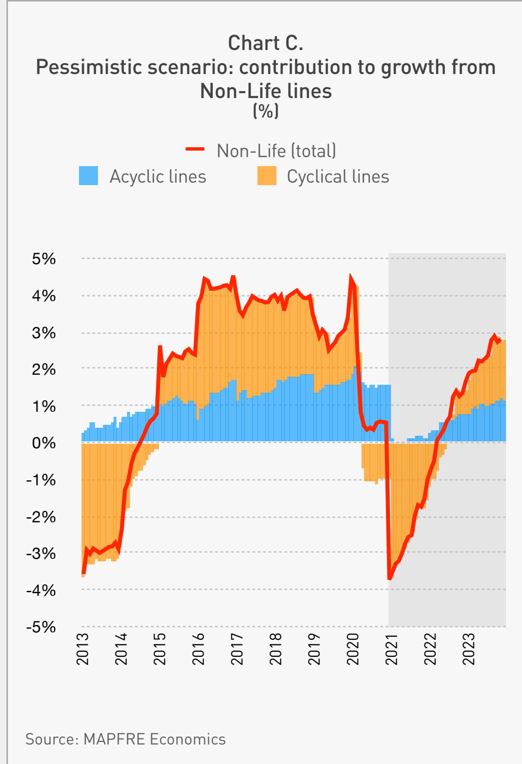
Chart B.
Optimistic scenario: contribution to growth from Life Protection and Life Savings
(%)



Source: MAPFRE Economics

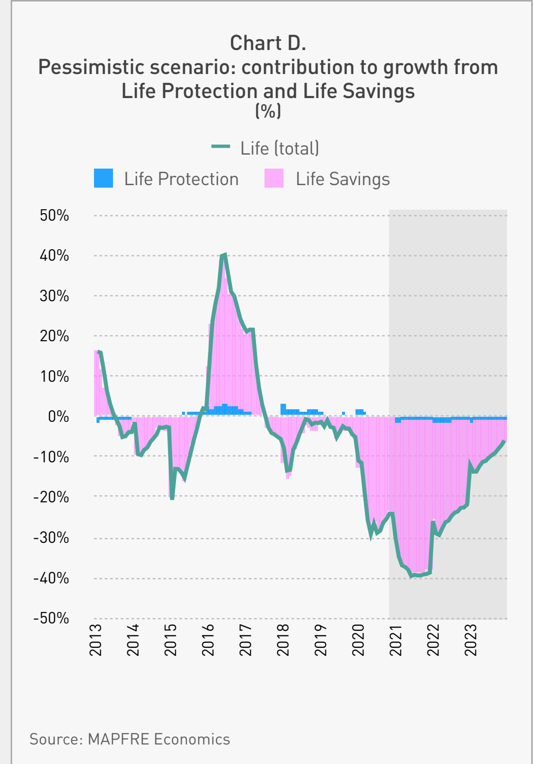
Box 2.1.5 (continued)
Spanish insurance industry performance: forecasts for premium growth

Chart C. Pessimistic scenario: contribution to growth from Non-Life lines (%)



Source: MAPFRE Economics

Chart D. Pessimistic scenario: contribution to growth from Life Protection and Life Savings (%)



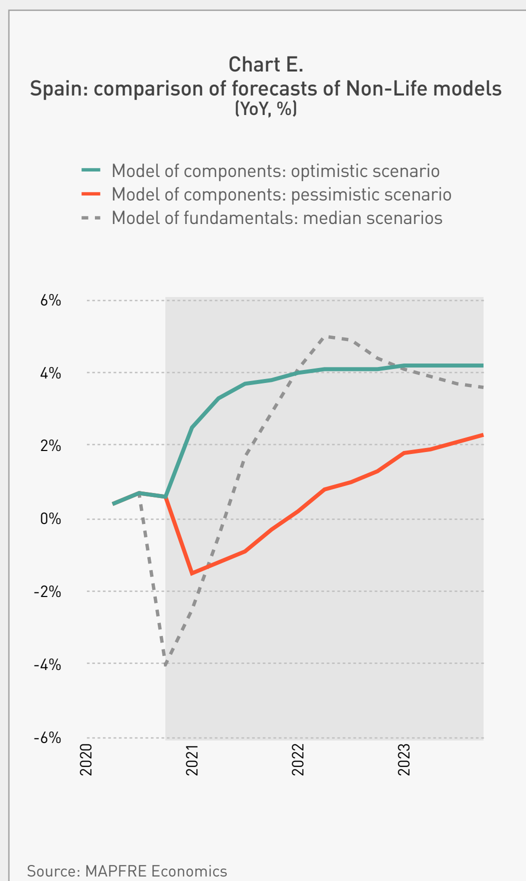
Source: MAPFRE Economics

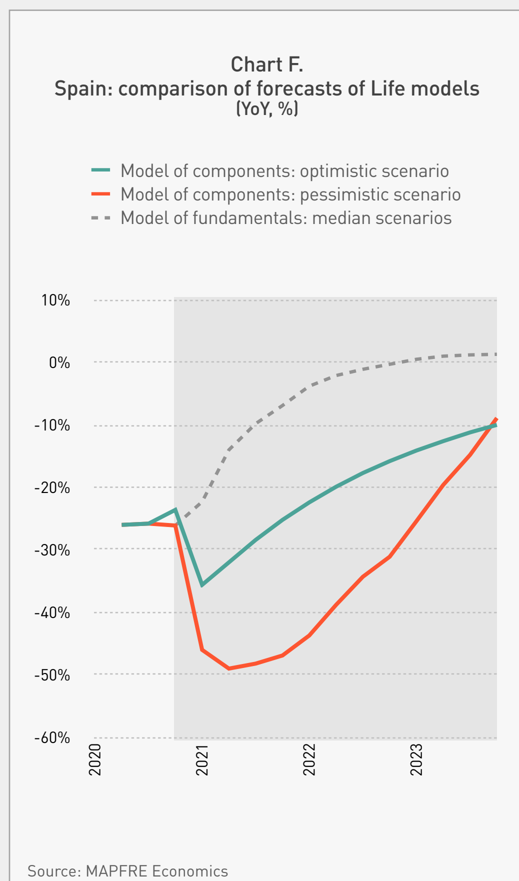
Table A. Non-Life and Life: forecasts for premium growth, model of components vs. models of fundamentals (year-on-year rate, %)

Period	Non-Life			Life		
	Model of fundamentals[1]	Model of components		Model of fundamentals[1]	Model of components	
		Optimistic scenario	Pessimistic scenario		Optimistic scenario	Pessimistic scenario
Q2	0.4%	0.4%	0.4%	-26.0%	-26.0%	-26.0%
Q3	0.7%	0.7%	0.7%	-25.8%	-25.8%	-25.8%
2020 Q4*	**-4.0%**	**0.6%**	**0.6%**	**-26.1%**	**-23.6%**	**-26.1%**
Q1	-2.5%	2.5%	-1.5%	-22.3%	-35.6%	-46.0%
Q2	-0.5%	3.3%	-1.2%	-14.0%	-32.0%	-49.0%
Q3	1.7%	3.7%	-0.9%	-9.8%	-28.4%	-48.2%
2021 Q4	**2.9%**	**3.8%**	**-0.3%**	**-6.9%**	**-25.2%**	**-46.9%**
Q1	4.1%	4.0%	0.2%	-3.8%	-22.4%	-43.7%
Q2	5.0%	4.1%	0.8%	-2.1%	-19.9%	-38.8%
Q3	4.9%	4.1%	1.0%	-1.1%	-17.7%	-34.3%
2022 Q4	**4.4%**	**4.1%**	**1.3%**	**-0.3%**	**-15.8%**	**-31.1%**
Q1	4.1%	4.2%	1.8%	0.5%	-14.1%	-25.4%
Q2	3.9%	4.2%	1.9%	1.0%	-12.6%	-19.6%
Q3	3.7%	4.2%	2.1%	1.2%	-11.2%	-14.8%
2023 Q4	**3.6%**	**4.2%**	**2.3%**	**1.3%**	**-10.0%**	**-8.9%**

Source: MAPFRE Economics
(*) Data at November 2020
1/ Median scenarios according to the model of macroeconomic fundamentals

Box 2.1.5 (continued)
Spanish insurance industry performance: forecasts for premium growth





achieved.

As for the Life business under this scenario, uncertainty and further quantitative easing would deepen insurance bailouts, further depressing growth in this segment of the insurance business.

Finally, the differences between the two scenarios, between the two segments of the insurance business (Non-Life and Life) and between the estimates of both the model of components and the model based on macroeconomic fundamentals, are set out in Charts E and F, and Table A. According to this information, it is confirmed that the model based on macroeconomic fundamentals overestimated the effect of overall economic performance on insurance demand at the end of 2020 for the reasons explained above. In the medium-term, the dynamics in both the Non-Life and Life segments are clearly different. However, a very significant observation is that all the models coincide on the same path in the long-term, first in the Non-Life segment and later in the Life segment.

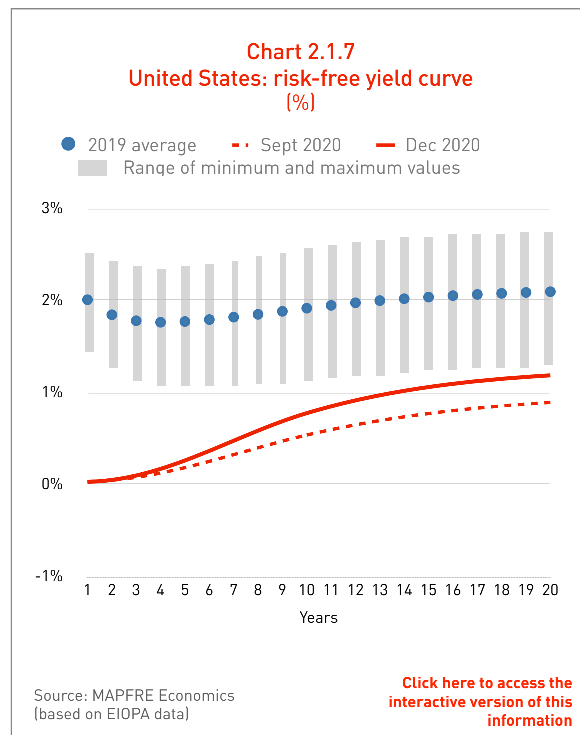
Source: MAPFRE Economics

corporate bond-acquisition quantitative easing program to ensure the smooth functioning of bond markets and access for bond issuers to low-cost financing with controlled risk premiums. However, the EIOPA risk-free interest rate curves (see Chart 2.1.6) show stabilization in all sections of the curve over the previous quarter and still show an upward trend, which, along with the expectation that interest rates could remain low for a long time, could be an incentive for the marketing of medium- and long-term products that take advantage of the term premium to offer higher rates than short-term rates. In addition to this, there is the positive effect that the return to economic growth could have on business. The fall and high volatility of the FTSE 100 (one of the few securities markets that remains far from recovery) could be unfavorable for the image of Life insurance in which the policyholder assumes the risk of the investment, widely distributed in the British market, while the low levels of stock prices may attract investors who have liquidity and are willing to take risks.

2.1.7 United States

In the United States, economic growth is estimated to range from 3.9% (base scenario) to -0.2% (stressed scenario) in 2021, which represents a slight improvement on previous expectations, following a decline in GDP of around -3.5% in 2020. The extensive direct aid packages given to businesses and the unemployed have allowed some indicators, such as consumption, to recover, although they are still far from returning to normal. The vaccination campaign began in December, at a time when there was an increase in infections, which kept uncertainty high and slowed activity because of the new restrictions imposed as a result of these outbreaks. The expected economic recovery (supported by generous packages of both monetary and fiscal measures) will help to recover premiums in the Non-Life and Life Protection insurance business, especially those business lines that are most affected by the pandemic, including Automobiles insurance.

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



Source: MAPFRE Economics (based on EIOPA data)

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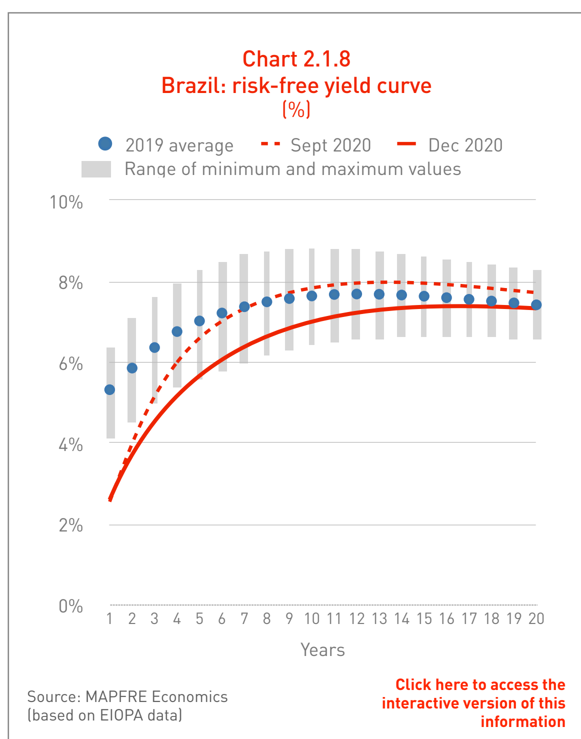
At its last meeting in December, the Federal Reserve kept monetary policy unchanged by leaving interest rates in the range of 0.00–0.25% and maintaining the monthly pace of its sovereign and corporate bond-purchasing program, which relaxes risk premiums. The latest EIOPA rate curves (see Chart 2.1.7) show the stabilization of risk-free interest rates, with a slight rise in all sections, 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), combined with the positive effect of the economic recovery predicted. In addition, securities markets continue to perform well, 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.

2.1.8 Brazil

The forecast for the Brazilian economy in 2021 is for GDP growth in the range of 3.2% (base scenario) to -0.1% (stressed scenario), compared to an estimated drop of -4.7% in 2020 as a result of the pandemic. Government aid to families has helped to prevent a major decline and promoted a return to economic growth. However, its effect on public accounts—already significantly unbalanced before the pandemic—and on inflation have raised uncertainty about the effects of discontinuing fiscal and monetary stimulus. For the time being, improving the economic situation may help to soften the negative impact that the sharp fall in GDP is having on the insurance industry, which is suffering a significant decline in real terms.

Chart 2.1.8
Brazil: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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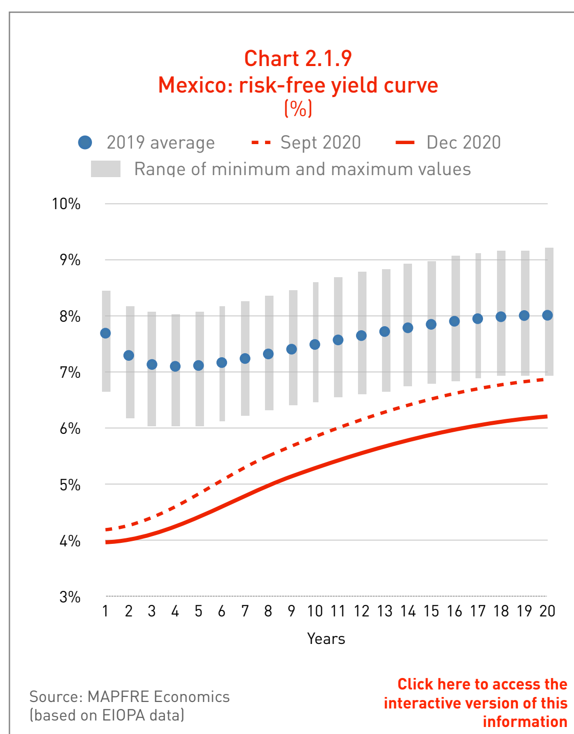
Furthermore, the Bank of Brazil has decided to maintain its accommodative monetary policy to stimulate the economy, despite the trend of rising inflation. The EIOPA risk-free interest rate curve (see Chart 2.1.8) shows a fall in all sections of the curve, which continues to have a steep positive slope. The favorable interest rate environment therefore persists, as guaranteed medium- and long-term rates that are higher than short-term rates (term premium) can be offered, which can go some way to offset the negative effect that GDP contraction has on the Life Savings and annuity insurance business, which has suffered a decline in premiums, based on data from the end of September.

2.1.9 Mexico

The forecast for the Mexican economy in 2021 is for GDP growth in the range of 3.4% (base scenario) to 0.7% (stressed scenario), compared to an estimated real drop in 2020 of -9.0%. This is a partial and weak recovery from pre-pandemic activity levels, which is expected to be gradual and still subject to considerable uncertainty in terms of how the pandemic and vaccination campaigns play out, with the difficulties resulting from the under-development of its healthcare system, as is generally the case in emerging economies. This recovery could benefit from factors such as the price of oil (which continues to recover slowly) and expectations of a return to growth in the US economy, its main trading partner. The sharp

Chart 2.1.9
Mexico: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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fall in GDP in 2020, one of the largest in Latin America, is influencing the adoption of more limited fiscal and monetary measures than in other economies in the region. This economic environment is hindering the development of the insurance industry, particularly the Non-Life business, which had a nominal decline in 2020 of close to -2%, in the absence of data for the last quarter. However, the return to economic growth forecast to take place in 2021 will help the recovery of the insurance business with growth higher than GDP growth, as was the case in previous economic crises. The low level of insurance penetration in the Mexican economy means that an improvement in economic conditions translates into larger growth in the insurance business, as is often the case in other emerging markets.

Moreover, the monetary policy adopted by the Bank of Mexico continues to be accommodative, although with little room for maneuver, due to inflation and the negative effect it may have on exchange rates. The EIOPA curves (see Chart 2.1.9) continue to show a certain stability in risk-free interest rates, with a curve that is trending upward in practically all its sections, though it has flattened slightly. This interest rate environment remains favorable for the performance of the Life Savings and annuities insurance business, by providing a positive term premium, and being able to offer guaranteed medium- and long-term rates that are higher than short-term rates. This is offsetting the negative effect of the strong economic contraction in 2020 with a Life business that has slowed, but has yet to regress, in the absence of information for the last quarter of the year. The economic recovery planned for 2021 will also help this business.

2.1.10 Argentina

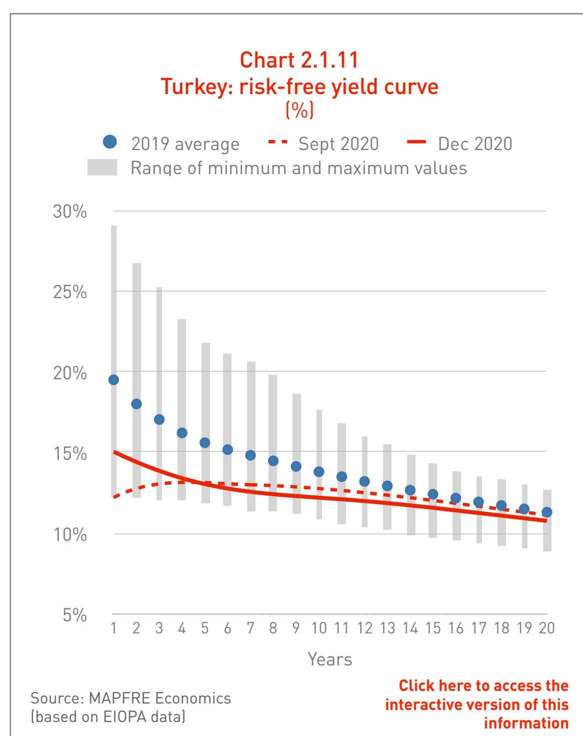
The forecast for the Argentinian economy in 2021 is for GDP growth in the range of 4.4% (base scenario) to 0.9% (stressed scenario), compared to an estimated drop in 2020 of -10.7% — a sharp financial contraction as a result of the pandemic. This situation is linked to the structural imbalances related to Argentina's external debt and the weakness of its currency, which continues to depreciate. The performance outlook for the insurance business continues to be marked by this situation, which was already suffering from the country's economic recession before the pandemic. However, in the first few months of 2020, the Non-Life business seemed to show signs of recovery that have since been cut short by the health crisis. The economic recovery expected in 2021 may help to recoup that growth, mainly in the second half of the year, if the evolution of the pandemic allows. Inflation has not stopped and remains high (38.7% YoY in December) and the currency continues to depreciate. This will have a negative impact on profitability for insurance companies, which 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, 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 maturities and renegotiation of the guaranteed rate at each maturity, but regulatory limits on investments make it difficult to develop such products. This is coupled with the sharp decline that the Argentinian economy is suffering, which could improve toward the second half of the year. This economic and regulatory environment continues to negatively affect the Life business, which, based on the data from the first quarter of 2020, continued to show declines in real terms, in line with what happened in the previous two years.

2.1.11 Turkey

The Turkish economy experienced a marked improvement following the relaxation of measures taken in light of the pandemic. Economic forecasts for 2021 anticipate GDP growth in the range of 2.8% (base scenario) to -1.8% (stressed scenario), compared to estimated growth of 1.2% in 2020, making Turkey one of the few countries in the world whose economy has not shrunk as a result of the health crisis. This growth seems to indicate a shift in trend in light of the sharp slowdown that the Turkish economy has been suffering due to its structural imbalances, in particular

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



Source: MAPFRE Economics (based on EIOPA data)

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its foreign private debt in dollars coupled with its currency's strong tendency to depreciate. This change in trend in economic performance is favorable and can already be seen in the insurance industry, which is experiencing positive real growth in 2020, based on the data available at the end of the third quarter. However, inflation remains high and is on the rise again. Together with the behavior of the exchange rate (which is depreciating), this could change the outlook and have a negative impact on the profitability of the insurance industry, particularly the Non-Life business, because of the rise in claims that this situation entails. The central bank is taking action by raising interest rates again, which may help to partially offset these adverse effects by propping up the financial performance of these lines of business.

The EIOPA curves (see Chart 2.1.11) presents the rise in short-term risk-free interest rates with a rate curve that again shows a negative slope over all terms. This interest rate scenario remains favorable for 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 emerging trend change in economic growth also favors this type of business, which experienced significant real growth in its premium volume in 2020, according to the data available at the end of the third quarter.

2.1.12 China

The forecast for the Chinese economy in 2021 is for GDP growth in the range of 8.0% (base scenario) to 4.7% (stressed scenario), compared to an estimated growth in 2020 of 1.5% — a sharp economic slowdown as a result of the pandemic. At the moment, the pandemic appears to be controlled and growth expectations are improving, with China being the only major economy in the world to grow in 2020. The Chinese government's extensive fiscal and monetary stimulus program is accelerating the return to higher economic growth rates. This will carry over to the insurance industry, whose business, especially the Non-Life business, has shown great resilience in previous global crises with double-digit premium growth over the past 20 years, aided by the low level of insurance penetration into the economy. Low inflation and the current appreciation of the currency are also favorable to the profitability of this business. The Life insurance business, which in

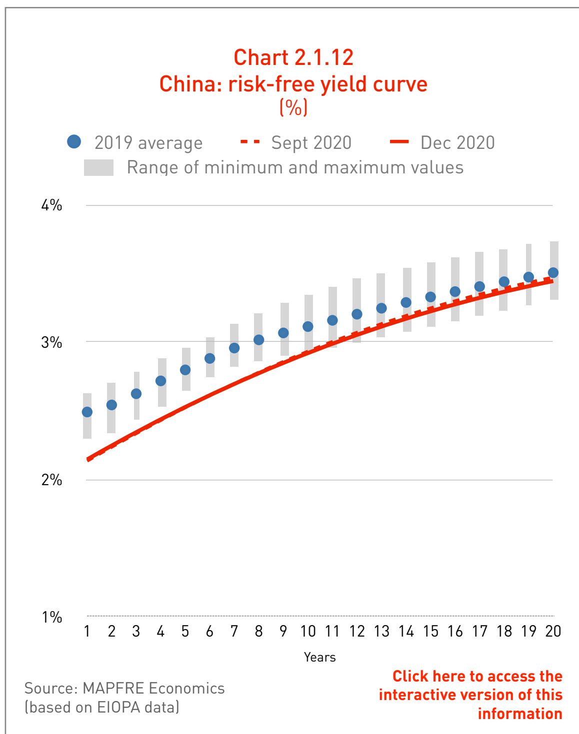

Chart 2.1.12
China: risk-free yield curve
(%)

Source: MAPFRE Economics (based on EIOPA data)

previous crises proved more sensitive to the economic cycle, will also benefit from this recovery.

The EIOPA curves (see Chart 2.1.12) show a stabilization of interest rates from September levels, following the sharp drop at the peak of the pandemic, with a positive slope over all terms. This interest rate environment is favorable for the Life Savings and annuity insurance businesses, by being able to offer guaranteed medium- and long-term rates that are higher than short-term rates. This is in addition to the positive effect that the recovery of the expected high rates of economic growth has on this type of business.

2.1.13 Japan

Economic expectations for the Japanese economy in 2021 are for GDP growth in the range of 2.6% (base scenario) to -0.4% (stressed scenario), depending on how the pandemic plays out. This growth contrasts with the estimated sharp economic contraction in 2020 of -5.4%. In light of this outlook, authorities are continuing to expand the broad packages of fiscal expansion measures, which, together with the monetary expansion measures already taken, could accelerate a recovery that will remain slow regardless. The sharp fall in GDP estimated for 2020, which will extend into the first few months of 2021, threatens the performance of the insurance industry, which may begin to recover throughout the year, in line with the recovery of the economy and consumption in particular, which is the indicator suffering the most in this crisis.

Furthermore, the EIOPA curves (see Chart 2.1.13) show that the risk-free interest rates have barely changed compared to the levels recorded in the previous quarter, with continued 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 low-interest-rate environment, which is expected to continue for a long time, continues to be detrimental to the development of the aforementioned lines of business. The fall in interest rates on US Treasury bonds may have benefited Japanese

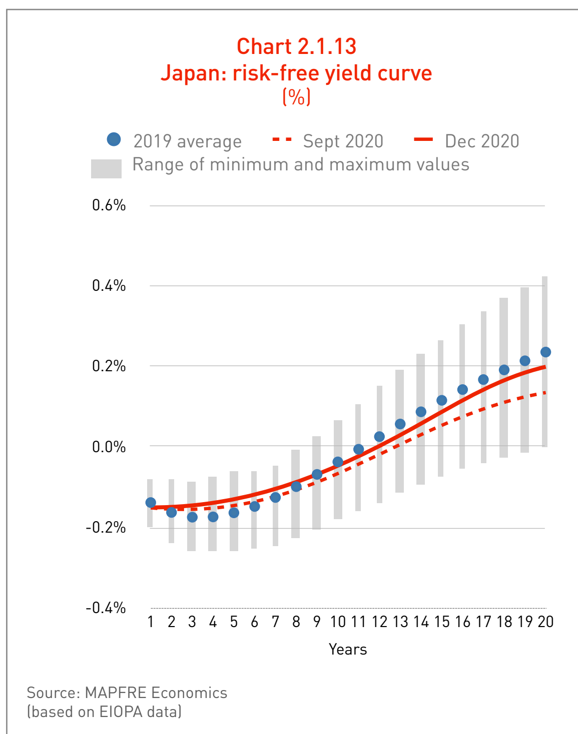

Chart 2.1.13
Japan: risk-free yield curve
(%)

Source: MAPFRE Economics (based on EIOPA data)

life insurance companies (who have been using them as alternative investments to increase the profitability of their portfolios) in the short-term, but it is an additional limitation to development in this line of business.

2.1.14 Philippines

The forecast for the Filipino economy in 2021 is for GDP growth in the range of 6.3% (base scenario) to -2.9% (stressed scenario), depending on the country's capacity to effect vaccination programs and the evolution of the pandemic. This growth contrasts with 2020's estimated sharp economic contraction of -9.8%, which is expected to continue during the first few months of 2021 with a sharp increase in unemployment and significant setbacks in investment and private consumption. This situation will negatively impact the insurance industry, particularly the Non-Life business, whose behavior is closely linked to the economic cycle. Moreover, the economy is not expected to grow again in 2021, and there remainsgreat uncertainty on this matter. As a reference, the Asian crisis that took place toward the end of the 1990s 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.

With regard to Life insurance, in November, the Central Bank of the Philippines took further steps to reduce the monetary policy benchmark interest rate to 2% (with three declines in the year down from 4%), and the yield on the ten-year sovereign bond, which stood at 4.44% at the end of June, has dropped to around 3%. The interest-rate curve has slowed the flattening it was experiencing and is expected to rise again in 2021, which may aid the performance of the Life Savings and annuity insurance business lines, especially when the expected economic recovery arrives, by being able to guarantee medium- and long-term rates higher than short-term rates.

2.1.15 Reinsurance

The situation caused by the pandemic has highlighted the importance of insuring against catastrophic risks, whatever their origin, provided that there is coverage available on the market. It has also put pressure on reinsurance prices in a market where, because of the low frequency of such events, the notion of real risk gets lost and demand and prices drop. Therefore, an increase in reinsurance prices is to be expected in upcoming renewals. In this regard, EIOPA has warned in its latest financial stability report that this price increase may make access to coverage and an increase in the insurance gap more difficult, with the consequent risk associated with this protection gap.

2.2 Regulatory trends

2.2.1 Global trends

IAIS common frameworks for supervision of groups

In 2020, the International Association of Insurance Supervisors (IAIS) conducted its first global insurance market evaluation exercise from the perspective of its potential systemic risk, under the new regulatory and supervisory framework called the Holistic Framework, approved at the end of the previous year. This exercise (The Global Monitoring Exercise — GME) is part of the monitoring measures aimed at contributing to the preservation of global financial stability. In 2020, it was adapted to assess the impact of the pandemic on the industry. The result of this exercise showed that the greatest impact was on assets, negatively affecting the profitability and solvency of the insurance industry, although insurers remained resilient both financially and operationally. However, uncertainties still remain about the outlook for the future (details on the outcome of

this exercise can be found in the *2020 GIMAR, Covid-19 Edition*[21] document).

Furthermore, in 2020, IAIS continued its activities related to the future implementation of the Common Framework (ComFrame) for the cross-border solvency supervision of Internationally Active Insurance Groups (IAIGs)[22]. This supervisory framework was approved in December of the previous year and the planned implementation period features two phases: a five-year monitoring phase from 2020 to 2025, followed by an implementation phase starting in 2026. The ComFrame includes a number of Insurance Core Principles (ICPs) applicable to the supervision of IAIGs and an International Capital Standard (ICS) for these insurance groups. In the monitoring phase, the minimum solvency capital calculation for IAIGs will be used for discussion by supervisory colleges on a confidential basis and will not lead to supervisory action based on the results of the standard being applied. The information provided by the supervisors during the process will help to drive additional improvements prior to the implementation of the standard as a Prescribed Capital Requirement (PCR).

Finally, in addition to activities related to the Holistic Framework and the ICS, the main objective of the IAIS for 2021 is to carry out activities focused on strengthening the resilience of insurers with exchanges of information between supervisors and guidance for the monitoring of emerging risks that have a tendency to accelerate such as technological innovation and cyber risks, as well as climate risk. With regard to the Holistic Framework, for systemic risk assessment, liquidity risk assessment activities are being strengthened and progress is being made in the development of criteria for assessing the systemic importance of insurance companies.

2.2.2 European Union

Solvency II: revision of the guidelines framework

On December 17, 2020, EIOPA published the technical paper submitted to the European Commission containing its opinion on the aspects to be addressed by the reform of the Solvency II guidelines framework[23]. This is a very important document as it will support the European Commission in drawing up its legislative proposal for reform, which should be completed by the third quarter of 2021. Once the Commission has prepared its proposal, it will be debated and approved by the co-legislators (European Council and Parliament), meaning that publication of the reform in the Official Journal of the European Union may not take place until 2022.

The general idea expressed by EIOPA is that the Solvency II guidelines framework is functioning properly and that the risk management capacity of insurance companies and their groups has been significantly strengthened as a result of its implementation. It therefore suggests an evolution of this guidelines framework, rather than a revolution. However, it makes significant changes to some key aspects such as calculating capital risk weights by interest rate risk, interest rate curves, volatility adjustment, and risk margin, with regard to the calculation of technical provisions, among other things. It also contains a novel proposal regarding equity investments, noting that the ability to maintain securities of this type is greater if they support illiquid long-term insurance obligations, which would justify a more favorable prudential treatment.

Risks and vulnerabilities in the European Union financial system

In December, EIOPA published its latest financial stability report[24]. The report highlights

that we continue to be immersed in an economic crisis that is not yet over, with uncertainties remaining as to its duration and depth and the resilience of households and companies, which are beginning to suffer declines in their disposable income, aggravated by new lockdowns in most European countries, as a result of the second wave of the pandemic. It also warns of the possible abrupt effects of removing the fiscal stimulus they are receiving. However, news about the vaccine and the possible reduction in geopolitical tensions may somewhat mitigate the risks and increase the hope that 2021 will be a year in which economies begin to recover.

The report indicates that European insurance companies have been able to resist the dramatic situation and that the Solvency II regime has helped them to better align their capital with risk, increase their resilience, and enhance risk management best practices. However, it indicated that uncertainty remains high, and may still impact their business models, and financial, liquidity and solvency positions. In this regard, it notes that the environment of low interest rates, which will continue for even longer, remains the primary concern for both the insurance and pension industries, and poses a challenge for insurance companies, pension funds, and the profitability of banks. It also points to other risks emerging from the pandemic, such as downgrades in corporate credit ratings, increased bankruptcies, unemployment, the expected fall in the price of commercial property and the increase in bank delinquency, which can affect insurers and pension funds because of their high interconnection with the banking sector.

In addition, it shows that as a result of the crisis, public debt levels have increased dramatically. It pointed out that risk premiums and volatility have sharply reduced as a result of the ECB's asset acquisition programs. This has contributed significantly to mitigating the link between sovereign and banking risk in the eurozone's peripheral countries, which has a positive risk-containment effect on insurance companies and pension funds.

Despite these turbulent times, EIOPA notes in its report that it will continue to pay attention to other long-term objectives, such as sustainable finance and digitization, in order to enable insurers and pension funds to manage and mitigate not only climate and cyber risks, but also reflect the preferences of policyholders and pension plan participants in their investments and seize business opportunities to actively support the transition to sustainable, digital economies.

Appendix: macroeconomic forecasts

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

	Baseline scenario (BS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	2.3	3.0	2.2	-3.5	3.9	2.8
Eurozone	2.7	1.9	1.3	-7.3	4.5	4.5
Germany	2.9	1.3	0.6	-5.5	3.6	4.1
France	2.3	1.8	1.5	-9.8	6.0	7.0
Italy	1.7	0.8	0.3	-8.8	4.6	3.9
Spain	3.0	2.4	2.0	-11.3	6.1	6.3
United Kingdom	1.7	1.3	1.3	-11.4	5.7	6.1
Japan	2.2	0.3	0.7	-5.4	2.6	2.4
Emerging markets	4.8	4.5	3.7	-3.3	6.0	4.9
Latin America[1]	1.2	1.0	0.0	-8.1	3.6	3.6
Mexico	2.3	2.2	-0.0	-9.0	3.4	2.0
Brazil	1.6	1.7	1.4	-4.7	3.2	2.7
Argentina	2.8	-2.4	-2.1	-10.7	4.4	2.3
Emerging Europe[2]	3.3	6.0	2.1	-4.6	3.9	4.9
Turkey	7.4	3.3	0.8	1.2	2.8	3.4
Asia Pacific[3]	6.3	6.1	5.7	-3.5	6.5	6.2
China	7.0	6.8	6.1	1.5	8.0	5.0
Indonesia	5.1	5.2	5.0	-2.1	5.1	6.4
Philippines	6.9	6.3	6.0	-9.8	6.3	7.0
World	3.8	3.6	2.8	-4.4	5.2	4.2

	Stressed scenario (SS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	2.3	3.0	2.2	-3.5	-0.2	3.8
Eurozone	2.7	1.9	1.3	-7.3	-0.5	5.4
Germany	2.9	1.3	0.6	-5.5	-0.6	4.3
France	2.3	1.8	1.5	-9.8	0.1	4.6
Italy	1.7	0.8	0.3	-8.8	0.3	4.9
Spain	3.0	2.4	2.0	-11.3	-0.6	9.1
United Kingdom	1.7	1.3	1.3	-11.4	0.1	6.7
Japan	2.2	0.3	0.7	-5.4	-0.4	2.1
Emerging markets	4.8	4.5	3.7	-3.3	1.7	5.0
Latin America[1]	1.2	1.0	0.0	-8.1	2.4	3.1
Mexico	2.3	2.2	-0.0	-9.0	0.7	3.6
Brazil	1.6	1.7	1.4	-4.7	-0.1	3.1
Argentina	2.8	-2.4	-2.1	-10.7	0.9	2.5
Emerging Europe[2]	3.3	6.0	2.1	-4.6	0.3	6.5
Turkey	7.4	3.3	0.8	1.2	-1.8	5.5
Asia Pacific[3]	6.3	6.1	5.7	-3.5	6.1	6.7
China	7.0	6.8	6.1	1.5	4.7	5.3
Indonesia	5.1	5.2	5.0	-2.1	0.7	5.8
Philippines	6.9	6.3	6.0	-9.8	-2.9	8.9
World	3.8	3.6	2.8	-4.4	0.9	4.7

Source: MAPFRE Economics (using data from national statistical centers and IMF)

[1]Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; [2]Russia, Turkey, Commonwealth of Independent States and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
Forecast end date: January 4, 2021.

Table A-2
Baseline and stressed scenarios: inflation
(end of period, percent)

	Baseline scenario (BS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	2.1	1.9	2.3	1.1	1.8	1.8
Eurozone	1.4	1.9	1.0	-0.1	1.4	1.3
Germany	1.4	1.6	1.5	-0.1	2.0	1.6
France	1.1	1.9	1.1	0.5	0.6	1.6
Italy	0.9	1.1	0.5	-0.4	0.6	0.8
Spain	1.1	1.2	0.8	-0.6	1.1	0.8
United Kingdom	2.7	2.0	1.3	0.6	1.8	1.6
Japan	0.6	0.9	0.5	-0.6	-0.3	0.3
Emerging markets	4.3	4.8	4.7	5.0	4.7	4.7
Latin America[1]	6.0	6.2	7.2	6.2	6.7	6.7
Mexico	6.8	4.8	2.8	3.6	2.6	2.1
Brazil	2.9	3.7	4.3	3.5	3.4	3.3
Argentina	23.3	47.4	52.2	38.7	39.4	29.6
Emerging Europe[2]	5.4	6.2	4.0	5.2	5.2	6.2
Turkey	11.9	20.3	11.8	13.3	10.8	10.4
Asia Pacific[3]	2.6	3.0	3.0	1.5	2.6	2.8
China	1.8	2.2	4.3	0.4	3.0	2.3
Indonesia	3.5	3.3	2.7	1.5	2.1	2.6
Philippines	3.0	5.9	1.5	2.5	2.6	3.3
World	3.0	3.3	3.1	2.8	2.8	3.8

	Stressed scenario (SS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	2.1	1.9	2.3	1.1	1.1	2.0
Eurozone	1.4	1.9	1.0	-0.1	0.4	1.3
Germany	1.4	1.6	1.5	-0.1	1.1	1.7
France	1.1	1.9	1.1	0.5	0.2	1.2
Italy	0.9	1.1	0.5	-0.4	-0.3	0.8
Spain	1.1	1.2	0.8	-0.6	-0.5	0.4
United Kingdom	2.7	2.0	1.3	0.6	0.9	1.6
Japan	0.6	0.9	0.5	-0.6	-1.7	-0.4
Emerging markets	4.3	4.8	4.7	5.0	4.3	4.1
Latin America[1]	6.0	6.2	7.2	6.2	10.5	9.0
Mexico	6.8	4.8	2.8	3.6	2.6	2.3
Brazil	2.9	3.7	4.3	3.5	2.9	2.8
Argentina	23.3	47.4	52.2	38.7	40.9	29.4
Emerging Europe[2]	5.4	6.2	4.0	5.2	2.8	2.8
Turkey	11.9	20.3	11.8	13.3	10.5	10.0
Asia Pacific[3]	2.6	3.0	3.0	1.5	1.8	2.5
China	1.8	2.2	4.3	0.4	2.0	2.4
Indonesia	3.5	3.3	2.7	1.5	1.5	2.2
Philippines	3.0	5.9	1.5	2.5	1.9	2.8
World	3.0	3.3	3.1	2.8	2.2	2.6

Source: MAPFRE Economics (using data from national statistical centers and IMF)

[1]Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; [2]Russia, Turkey, Commonwealth of Independent States and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
Forecast end date: January 4, 2021.

Table A-3
Baseline and stressed scenarios: 10-year government bond yield
(end of period, percent)

	Baseline scenario (BS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	2.40	2.69	1.92	0.93	1.28	1.56
Eurozone	1.13	1.17	0.32	-0.19	-0.02	0.35

	Stressed scenario (SS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	2.40	2.69	1.92	0.93	0.74	1.03
Eurozone	1.13	1.17	0.32	-0.19	-0.02	0.36

Source: MAPFRE Economics (using data from national statistical centers and IMF)
Forecast end date: January 4, 2021.

Table A-4
Baseline and stressed scenarios: exchange rates
(end of period, percent)

	Baseline scenario (BS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
USD-EUR	0.83	0.87	0.89	0.83	0.83	0.82
EUR-USD	1.20	1.15	1.12	1.21	1.21	1.22
GBP-USD	1.35	1.28	1.32	1.36	1.37	1.39
USD-JPY	112.90	110.83	109.12	104.46	104.32	104.30
USD-CNY	6.51	6.88	6.99	6.60	6.53	6.51

	Stressed scenario (SS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
USD-EUR	0.83	0.87	0.89	0.83	0.83	0.82
EUR-USD	1.20	1.15	1.12	1.21	1.21	1.22
GBP-USD	1.35	1.28	1.32	1.36	1.36	1.38
USD-JPY	112.90	110.83	109.12	104.46	102.18	102.82
USD-CNY	6.51	6.88	6.99	6.60	6.58	6.53

Source: MAPFRE Economics (using data from national statistical centers and IMF)
Forecast end date: January 4, 2021.

Table A-5
Baseline and stressed scenarios: official benchmark interest rate
(end of period, percent)

	Baseline scenario (BS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	1.50	2.50	1.75	0.25	0.25	0.25
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00
China	3.25	3.30	3.25	3.00	2.75	2.75

	Stressed scenario (SS)					
	2017	2018	2019	2020(e)	2021(f)	2022(f)
United States	1.50	2.50	1.75	0.25	0.00	0.00
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00
China	3.25	3.30	3.25	3.00	1.00	0.75

Source: MAPFRE Economics (using data from national statistical centers and IMF)
Forecast end date: January 4, 2021.

Index of tables, charts and boxes

Tables

Table 1.2.1 United States: main macroeconomic aggregates. 37
Table 1.2.2 Eurozone: main macroeconomic aggregates 39
Table 1.2.3 Spain: main macroeconomic aggregates 42
Table 1.2.4 Germany: main macroeconomic aggregates 45
Table 1.2.5 Italy: main macroeconomic aggregates 47
Table 1.2.6 United Kingdom: main macroeconomic aggregates 49
Table 1.2.7 Japan: main macroeconomic aggregates 51
Table 1.2.8 Turkey: main macroeconomic aggregates 53
Table 1.2.9 Mexico: main macroeconomic aggregates 56
Table 1.2.10 Brazil: main macroeconomic aggregates 58
Table 1.2.11 Argentina: main macroeconomic aggregates 60
Table 1.2.12 China: main macroeconomic aggregates 63
Table 1.2.13 Indonesia: main macroeconomic aggregates 65
Table 1.2.14 Philippines: main macroeconomic aggregates 67
Table A-1 Baseline and stressed scenarios: gross domestic product (GDP) 85
Table A-2 Baseline and stressed scenarios: inflation 86
Table A-3 Baseline and stressed scenarios: 10-year government bond yield 87
Table A-4 Baseline and stressed scenarios: exchange rates 87
Table A-5 Baseline and stressed scenarios: official benchmark interest rate 87

Charts

Chart 1.1.1-a Global: daily COVID-19 infections vs. stringency index 17
Chart 1.1.1-b Developed markets: daily COVID-19 infections vs. stringency index 17
Chart 1.1.1-c Emerging markets: daily COVID-19 infections vs. stringency index 17
Chart 1.1.1-d Eurozone: daily COVID-19 infections vs. stringency index 18
Chart 1.1.1-e United States: daily COVID-19 infections vs. stringency index 18
Chart 1.1.1-f Global: vaccination progress 18
Chart 1.1.1-g Global: PMIs 19
Chart 1.1.1-h Developed markets: PMIs 19
Chart 1.1.1-i Emerging markets: PMIs 19
Chart 1.1.2-a Estimate of ECB purchases under the PEPP program and planned net issuance in 2021 23
Chart 1.1.2-b Accumulated purchases of ECB bonds 23
Chart 1.1.2-c Emerging Markets Bonds Index (EMBI) 28
Chart 1.1.2-d Accumulated portfolio investment flows 28
Chart 1.1.5-a Global risks and vulnerabilities 33
Chart 1.1.5-b Global: debt by sector 33
Chart 1.1.5-c Developed markets: debt by sector 34
Chart 1.1.5-d Emerging markets: debt by sector. 34
Chart 1.2.1-a United States: PMIs 36
Chart 1.2.1-b United States: ISM 36
Chart 1.2.1-c United States: GDP breakdown and forecasts 37
Chart 1.2.1-d United States: domestic demand breakdown and forecasts 37
Chart 1.2.2-a Eurozone: PMIs 38

Chart 1.2.2-b Eurozone: ZEW growth expectations index . . . 38
Chart 1.2.2-c Eurozone: GDP breakdown and forecasts . . . 39
Chart 1.2.2-d Eurozone: domestic demand breakdown and forecasts . . . 39
Chart 1.2.3-a Spain: inflow of tourists . . . 41
Chart 1.2.3-b Spain: PMIs . . . 41
Chart 1.2.3-c Spain: unemployment rate . . . 41
Chart 1.2.3-d Spain: GDP breakdown and forecasts . . . 42
Chart 1.2.3-e Spain: domestic demand breakdown and forecasts . . . 42
Chart 1.2.4-a Germany: PMIs . . . 44
Chart 1.2.4-b Germany: ZEW growth expectations index and current situation . . . 44
Chart 1.2.4-c Germany: GDP breakdown and forecasts . . . 45
Chart 1.2.4-d Germany: domestic demand breakdown and forecasts . . . 45
Chart 1.2.5-a Italy: PMIs . . . 46
Chart 1.2.5-b Italy: industrial production . . . 46
Chart 1.2.5-c Italy: GDP breakdown and forecasts . . . 47
Chart 1.2.5-d Italy: domestic demand breakdown and forecasts . . . 47
Chart 1.2.6-a United Kingdom: PMIs . . . 48
Chart 1.2.6-b United Kingdom: exchange rate . . . 48
Chart 1.2.6-c United Kingdom: GDP breakdown and forecasts . . . 49
Chart 1.2.6-d United Kingdom: Domestic demand breakdown and forecasts . . . 49
Chart 1.2.7-a Japan: PMIs . . . 50
Chart 1.2.7-b Japan: central bank assets . . . 50
Chart 1.2.7-c Japan: GDP breakdown and forecasts . . . 51
Chart 1.2.7-d Japan: domestic demand breakdown and forecasts . . . 51
Chart 1.2.8-a Turkey: GDP breakdown and forecasts. . . . 53
Chart 1.2.8-b Turkey: domestic demand breakdown and forecasts . . . 53
Chart 1.2.8-c Turkey: inflation and interest rates. . . . 54
Chart 1.2.8-d Turkey: exchange rate . . . 54
Chart 1.2.9-a Mexico: PMIs . . . 55
Chart 1.2.9-b Mexico: inflation and interest rates. . . . 55
Chart 1.2.9-c Mexico: GDP breakdown and forecasts . . . 56
Chart 1.2.9-d Mexico: domestic demand breakdown and forecasts . . . 56
Chart 1.2.10-a Brazil: current account balance . . . 57
Chart 1.2.10-b Brazil: inflation and interest rates . . . 57
Chart 1.2.10-c Brazil: GDP breakdown and forecasts . . . 58
Chart 1.2.10-d Brazil: domestic demand breakdown and forecasts . . . 58
Chart 1.2.11-a Argentina: GDP breakdown and forecasts . . . 60
Chart 1.2.11-b Argentina: domestic demand breakdown and forecasts . . . 60
Chart 1.2.11-c Argentina: inflation and interest rates . . . 61
Chart 1.2.11-d Argentina: exchange rate . . . 61
Chart 1.2.12-a China: interest rates . . . 62
Chart 1.2.12-b China: exchange rate . . . 62
Chart 1.2.12-c China: GDP breakdown and forecasts . . . 63
Chart 1.2.12-d China: domestic demand breakdown and forecasts . . . 63
Chart 1.2.13-a Indonesia: inflation and interest rates . . . 64
Chart 1.2.13-b Indonesia: exchange rate . . . 64
Chart 1.2.13-c Indonesia: GDP breakdown and forecasts . . . 65
Chart 1.2.13-d Indonesia: domestic demand breakdown and forecasts . . . 65
Chart 1.2.14-a Philippines: inflation and interest rates . . . 66
Chart 1.2.14-b Philippines: exchange rate . . . 66
Chart 1.2.14-c Philippines: GDP breakdown and forecasts . . . 67
Chart 1.2.14-d Philippines: domestic demand breakdown and forecasts . . . 67
Chart 2.1.2 Eurozone: risk-free yield curve . . . 70
Chart 2.1.6 United Kingdom: risk-free yield curve . . . 72
Chart 2.1.7 United States: risk-free yield curve . . . 77

Chart 2.1.8 Brazil: risk-free yield curve 78
Chart 2.1.9 Mexico: risk-free yield curve 78
Chart 2.1.11 Turkey: risk-free yield curve 80
Chart 2.1.12 China: risk-free yield curve 81
Chart 2.1.13 Japan: risk-free yield curve 81

Boxes

Box 1.1.2-a When will the pre-COVID-19 GDP level be recovered? Analysis for selected economies in the base scenario 20
Box 1.1.2-b Monetary policy update 24
Box 2.1.5 Spanish insurance industry performance: forecasts for premium growth 73

References

1/ See: MAPFRE Economics (2020), *2020 Economic and industry outlook: fourth quarter perspectives*, Madrid, Fundación MAPFRE.

2/ The World Health Organization (WHO) estimates that a total of around 8 billion vaccines can be produced in 2021. This means that, at best, half of the global population will be immunized by the end of the year. Biology will determine whether this is sufficient to achieve herd immunity.

3/ See the interactive section "Institutional response to the COVID-19 crisis and effects on expected growth" prepared by MAPFRE Economics, at: https://app.klipfolio.com/published/ca635768cc1b32264d33836fc491e79c/institucional-response-to-the-covid19-crisis-and-effects-on-expected-growth

4/ The portfolio balance theory states that, when there is excess liquidity, the risk premium decreases so that the value of the assets is equal to that of cash, increasing the price of lower-quality assets until there is a correction that adjusts their value to the fundamentals.

5/ Although the number of bankruptcies in the latter is similar to pre-Lehman Brothers times, for now we are ruling out a similar systemic crisis, since household balance sheets are healthier.

6/ One issue that will be key in the coming years is understanding which effects of the current crisis will be temporary and which will be permanent, something that will be determined by the existing imbalances and the effective scope of public policies.

7/ The latest developments in the United States (the seizure of the Capitol by supporters of Donald Trump) demonstrate the level of tension and uncertainty in the world today.

8/ See: MAPFRE Economics (2020), *2020 Economic and industry outlook: fourth quarter perspectives*, Madrid, Fundación MAPFRE.

9/ See the risk-free interest rate curves prepared by the European Insurance and Occupational Pensions Authority (EIOPA), "EIOPA curves" at: https://app.klipfolio.com/published/29577612d0ba9ff3681af85b8ee8a998/curvas-eiopa

10/ See: MAPFRE Economics (2020), *2020 Economic and industry outlook: fourth quarter perspectives*, Madrid, Fundación MAPFRE.

11/ To be expected, in terms of emerging from the crisis.

12/ Monetizing the current debt may have an effect on inflation through the traditional monetary mechanism, but also by breaking the perverse dynamic between announcing monetary policy and secular stagnation, which is detailed in our report: MAPFRE Economics (2018), *2018 Economic and industry outlook*, Madrid, Fundación MAPFRE.

13/ If distribution is effective in the first quarter of 2021 and herd immunity is accelerated, the effective emergence from the pandemic could at best be achieved by the end of the second quarter of the year. Otherwise, if the process is slower, immunity would likely be achieved during the fourth quarter of 2021. This defines the ranges of our *base* and *stressed* scenarios of the central vision featured in this report.

14/ See the interactive section "Institutional response to the COVID-19 crisis and effects on expected growth", prepared by MAPFRE Economics, at: https://app.klipfolio.com/published/ca635768cc1b32264d33836fc491e79c/institucional-response-to-the-covid19-crisis-and-effects-on-expected-growth

15/ On December 24, a ceiling agreement was reached whereby the United Kingdom permanently left the European Union. This agreement will, in all likelihood, have a format like the EU's Comprehensive Economic and Trade Agreement with Canada, whereby almost all tariff barriers are removed or reduced and agreement to a form of uniform ground rules is promoted. It is estimated that leaving the European Union will cost the United Kingdom about 1–4 pp of GDP, w hile for Europe the effect will be 0.3–0.5 pp.

16/ See: MAPFRE Economics (2020), *2020 Economic and industry outlook: fourth quarter perspectives*, Madrid, Fundación MAPFRE, pg. 28–31.

17/ See the interactive section Global debt prepared by MAPFRE Economics, at: https://app.klipfolio.com/published/589a425b508e83425df84d48b34ce7ac/global-debt

18/ This stimulus package is currently under review following the Republican proposal to more than triple the value of planned transfers.

19/ See: MAPFRE Economics (2020), *2020 Economic and industry outlook: fourth quarter perspectives*, Madrid, Fundación MAPFRE.

20/ ICEA data, taken from a sample covering 95.12% of the Spanish insurance industry.

21/ See: https://www.iaisweb.org/file/94221/iais-global-insurance-market-report-2020

22/ See: https://www.iaisweb.org/page/supervisory-material/comment-letters/file/94256/iais-comments-on-iasb-business-combinations-goodwill-and-impairment/29.12.2020

23/ See: https://www.eiopa.europa.eu/content/opinion-2020-review-of-solvency-ii_en

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