Global and European setting

Global economic developments

Global economic recovery lost steam in Q4

The exceptionally rapid global economic recovery, thanks to which a sizeable part of the slump caused by the pandemic was already recouped over the summer months, lost considerable steam in the fourth quarter. This was due mainly to new waves of infections across much of the world. The containment measures were re-tightened in Europe, in particular, which placed a marked strain on its economies. Economic output in the euro area fell by 0.6% in the fourth quarter of 2020 on the previous quarter. In the United States, Japan and the United Kingdom, growth of real gross domestic product (GDP) decelerated, albeit to varying degrees. The pace of recovery in some emerging market economies likewise slowed down perceptibly. However, in China, where no new pandemic wave has occurred thus far, growth remained brisk in the fourth quarter. China is the only large economy to have grown in the crisis year of 2020.

Global industrial activity and trade in goods still riding tailwind

In response to the experience of the spring, the containment measures taken in the past few months were more specifically directed at contact reduction. Manufacturing was therefore largely spared from production stoppages and disruptions to international supply chains and benefited from the (pandemic-induced) shift in demand from services to goods. According to the CPB Netherlands Bureau for Economic Policy Analysis, global industrial output picked up markedly in the fourth quarter and, like global goods trade before it already, is likely to have returned to its pre-crisis level towards year's end.

Pandemic-induced setback with regard to contact-intensive services

In the fourth quarter, activity in contact-intensive service sectors, especially in countries in which tighter restrictions had been imposed, suffered a distinct setback. The across-the-board closure of non-essential businesses in some European countries was reflected in areas such as mobility behaviour. In many places, however, losses were less drastic than in the spring. This is especially the case for retail sales. One possible reason for this is that households and enterprises have now become more successful in adapting to the pandemic and the restrictions and, for instance, are making greater use of contactless distribution channels. Another reason why the decline was smaller amongst service providers was that many of them had previously only partly recovered from their pandemic-induced losses.

IMF raises global growth forecast for the current year slightly

Owing to the persistently high incidence of infections and the further tightening of containment measures in some regions, the global economy is set to have experienced a sluggish start to the new year. However, the rapid development of vaccines means that vaccination

Real GDP in selected major economies

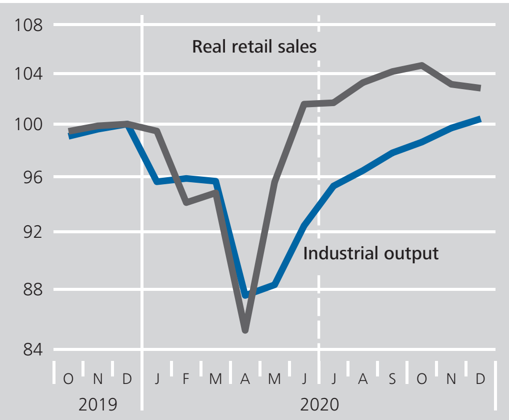
Q4 2019 = 100, seasonally adjusted, log scale

Sources: National Bureau of Statistics of China, Bureau of Economic Analysis, Eurostat, Office for National Statistics and Bundesbank calculations.

Deutsche Bundesbank

Global economic indicators*

December 2019 = 100, seasonally adjusted, log scale



Sources: CPB, national data and Bundesbank calculations. * Groups of countries vary due to data availability.
Deutsche Bundesbank

under the new president. These actions, along with similar measures in other countries, could have continued to jump-start global economic activity in the current year. Nonetheless, a sustainable global economic recovery can still only be achieved if the pandemic is combatted successfully. Efforts to accelerate the production and distribution of vaccines around the world are therefore particularly important – and not only for humanitarian reasons.

campaigns have now started in many industrial countries and some emerging market economies. This means there are hopes that it will be possible to ease restrictions markedly over the next few months. In addition, the latest increases made to fiscal stimulus packages in some industrial countries, particularly the United States and Japan, have led to a brightening of the economic outlook. Against this background, in the regular January update of the World Economic Outlook, the International Monetary Fund (IMF) staff raised its global economic growth projection slightly to 5.5% for the current year.[1] It left its projection for growth in the following year unchanged at 4.2%.

Outlook surrounded by major uncertainty

Nonetheless, the economic outlook remains surrounded by major uncertainty regarding how the pandemic will unfold. One possibility is that tighter restrictions over a longer period of time might become necessary in order to contain the new, apparently more contagious variants of the virus. However, other factors having nothing to do with the pandemic have recently caused the risk assessment to brighten markedly. A trade and cooperation agreement was concluded between the European Union (EU) and the United Kingdom (see box on p. 16 f.), thereby avoiding a disorderly Brexit. Moreover, an additional sizeable fiscal stimulus package in the United States is on the cards

Commodity prices up considerably across the board

Expectations of increased demand have probably contributed to the very recent hike in the prices of key commodities. In the reporting period, crude oil prices went up by over 40%. As this report went to press, a barrel of Brent crude oil cost US$63 after trading at US$43 in November 2020. Given that infection numbers are currently still high in much of the world, the OPEC members and their partners also agreed to only gradually increase production up until at least March 2021. Saudi Arabia additionally declared its intent to cut its own production considerably for two months as of February. This means that, according to forecasts by the International Energy Agency, global oil demand in the first quarter will have continued to marginally exceed global production.[2] Non-energy commodity prices, too, have risen across the board since November, according to the HWWI index, with prices for industrial commodities, in particular, once again surging – due, amongst other things, to persistently strong demand from China. As this report went to press, they were just under 50% higher than the pre-crisis levels of December 2019.

Consumer price inflation in industrial countries remains subdued

Surging prices for many commodities are likely to gradually feed through to consumer prices in the coming months. As 2020 was coming to a close, annual consumer price inflation was once again shaped by the weak price tendencies of the preceding second quarter. The average headline rate across the industrial countries rose to merely 0.7% by December. Core infla-

1 See International Monetary Fund (2021).
2 See International Energy Agency (2021).

tion (from which energy and food prices are stripped out) remained stable at 1.1%.

China

Economic output surpasses pre-crisis trend

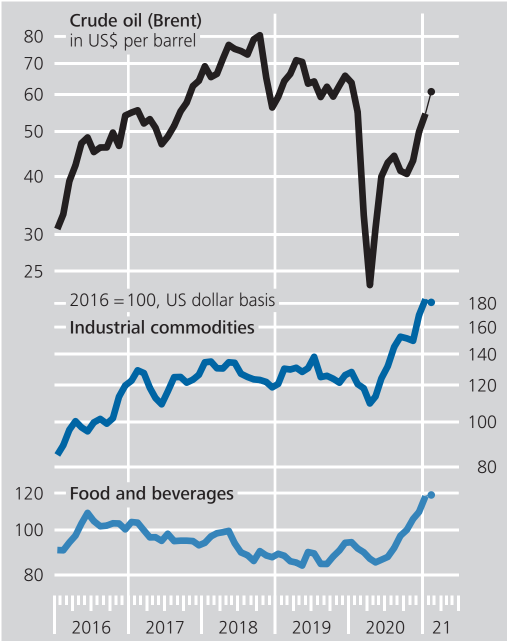
Unlike many other countries, China was spared a second wave of infections in the fourth quarter, which gave the economy the necessary headroom to continue its strong expansion. Real GDP in the fourth quarter of 2020 was up by 6.5% on the year, according to the official estimate. Aggregate output was thus even somewhat higher than the level expected prior to the pandemic for this period. In the quarter just ended, the strong economic growth was again largely propelled by the industrial sector. Buoyant export business was the main driver here, with revenue from goods exports up by nearly 17% from the previous year on a US dollar basis. In the process, Chinese exporters benefited from the substantial growth of goods consumption in many industrial countries.

Widespread return to normal in services, too

Services grew at a considerably more moderate pace. In the meantime, however, all of its major sectors, including accommodation and food services, have likewise markedly exceeded their pre-crisis levels. Consistent with this picture, the unemployment rate continued to fall in the past few months, reaching its level of the previous year in December 2020. Despite the widespread return of economic activity to normal, upward pressure on consumer prices remained quite weak. On average for the months from October to December, the inflation rate excluding energy and food held steady at 0.5%. The headline rate even shrank to 0.1%. This was due primarily to a distinct decline in meat prices, which had previously increased sharply as a result of African swine fever.

World market prices for crude oil, industrial commodities and food and beverages

Monthly averages, log scale



Sources: Bloomberg Finance L.P., HWWI and Bundesbank calculations. • Latest figures: average of 1 to 12 February 2021, or 1 to 18 February 2021 for crude oil.
Deutsche Bundesbank

Other selected emerging market economies

Recovery of India's economy making progress

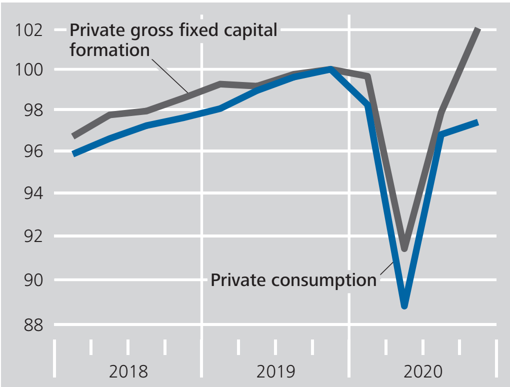
In the past few months, India's economy has continued to recover from a slump in the second quarter that was particularly severe by international standards. Although no official estimate of real GDP for the fourth quarter is available yet, the indicators are pointing to a potential return to its previous year's level. The recent improvement was aided by a considerable reduction in infection figures. The number of reported new infections is now down by nearly 90% from its peak in September. India has launched a vaccination campaign with the goal of inoculating 300 million people – with particularly at-risk segments of the population being given priority treatment – by the early summer. A fall in food prices caused consumer price inflation to weaken considerably to 4.6% in December. The central bank has left its policy rate unchanged at 4% since May.

Increased infection rate hampers Brazil's recovery

The Brazilian economy continued to recover in the final quarter, albeit at a reduced pace. An increase in the infection rate weighed markedly on economic activity. Real GDP is therefore unlikely to have returned to its pre-crisis level yet.

Consumption and investment in the United States

Q4 2019 = 100, seasonally and price adjusted, log scale



Sources: Bureau of Economic Analysis and Bundesbank calculations.
Deutsche Bundesbank

Owing to the strong fourth-quarter increase in production, output in industrial sector, however, has already significantly surpassed its pre-crisis level. On the other hand, accommodation and food services, in particular, are still lagging far behind. The situation in the labour market also remained difficult. Since peaking in the third quarter, the unemployment rate has diminished only slightly. Consumer price inflation strengthened to 4.3% on the year. The Brazilian central bank left its policy rate unchanged at 2%.

Russian economy contracted comparatively moderately in pandemic year

The economic recovery appears to have continued in Russia, too. Like elsewhere, there appears to have been a hidden bifurcation: whereas parts of the services sector suffered a setback following the resurgence of new infections, industrial production picked up sharply. Manufacturing output in the fourth quarter even exceeded pre-pandemic levels. For 2020 as a whole, the only period for which an official estimate is available, real GDP contracted by 3.1%. This contraction was rather mild by international standards, even though the Russian economy not only had to cope with the strains caused by the pandemic but also took a hit due to a sharp slump in oil exports. On the whole, oil revenues last year fell by 40% on a US dollar basis owing to falling prices and production cutbacks. Since the onset of the pandemic, the rouble has trended markedly downwards. The inflation rate as measured by the consumer price index (CPI) therefore picked up in the fourth quarter to 4.4%, thus slightly exceeding the central bank's target of 4%.

United States

Recovery lost considerable momentum in Q4

In the United States, the overall economic recovery continued with diminished momentum in the final quarter of 2020. According to the preliminary estimate, real GDP increased by 1.0% on the quarter after seasonal adjustment. This followed a third quarter in which economic output had achieved growth of 7.5%, thus recouping most of the pandemic-related losses from the first half of the year. The main reason for the considerable deceleration in growth was that private consumption hardly grew in the fourth quarter. Amidst mounting pandemic-related burdens, consumers even cut back their spending distinctly in the last two months of the year. By contrast, business investment in machinery and equipment and private residential construction strongly accelerated once again in the reporting quarter, even far exceeding pre-crisis levels. Enterprises also increased their inventories. In addition, exports – particularly to China – rose markedly. However, imports grew even more dynamically, causing aggregate growth to be somewhat weaker than demand growth.

Prospect of improvement following sluggish start to year

The situation in the US labour market remained difficult at the beginning of the year. In January, employment in the area of contact-intensive services such as, in particular, leisure and hospitality remained far short of its pre-crisis level. Initial easing of containment measures in economically significant states could potentially jump-start an economic recovery in the coming months. A contribution may well be made by the extensive stimulus package adopted in late

2020, too.[3] The new administration has additionally pledged even more extensive fiscal stimulus programmes. Given muted inflationary pressures, monetary policy is likewise set to remain highly accommodative for the foreseeable future. CPI-based annual inflation clocked in at 1.4% in January.

Japan

Recovery continued at diminished pace in Q4

Japan's economic upturn decelerated during the fourth quarter. According to the initial official estimate, real GDP was up, after seasonal adjustment, by 3% from the third quarter, in which it had grown by just over 5%. Private consumption was the main factor behind the moderation of growth. In an environment of resurging infection counts, households were holding back on consumer spending. By contrast, exporters benefited from the buoyant global demand for goods, with goods exports once again increasing strongly. Business investment showed a significant revival in the fourth quarter, in the light of which imports rose sharply. The labour market proved robust. The fourth-quarter unemployment rate held steady at 3%, as in the previous quarter. Annual consumer price inflation, in negative territory since October, clocked in at -0.6% in January. The Japanese central bank maintained its accommodative stance.

United Kingdom

Strong pandemic-induced deceleration of recovery in Q4

Following a resurgence of infections in the United Kingdom beginning in October, containment measures were tightened in more and more parts of the country and only temporarily eased somewhat in December. The recovery, which had still been strong in the third quarter, consequently decelerated considerably in the fourth quarter of 2020. Real GDP increased after seasonal adjustment by only 1% on the third quarter. It contracted by 7.8% on the year. Various contact-intensive services were affected once again by the restrictions. Activity slowed back down considerably in the accommodation and food services sector, in particular, such that its output in December was only around half of its pre-pandemic level. Other sectors, by contrast, continued to recover in the fourth quarter. Construction activity and manufacturing output were up perceptibly from the third quarter. The labour market took a slight turn for the worse. The average unemployment rate for the three months ending in November rose to 5% as against 4.5% on average for the June to August period.

Strains caused by pandemic and withdrawal from the EU at the beginning of the year

In the light of the spread of a more highly contagious variant of the coronavirus, containment measures in the UK were tightened considerably towards the end of the year and, despite falling infection counts, have not been eased again. Business sentiment accordingly deteriorated at the end of the period under review. The Purchasing Managers' Index for the economy as a whole slipped well below the expansion threshold in January. Although the trade deal with the EU averted the imposition of tariffs and quantitative restrictions, it brought with it other constraints for many sectors of the economy which have been making themselves felt since the beginning of the year (see box on p. 16 f.). The inflation rate as measured by the consumer price index (CPI) picked up slightly in January to 0.7%. The Bank of England maintained its accommodative stance.

Poland

Poland less hamstrung by pandemic wave in Q4 than expected

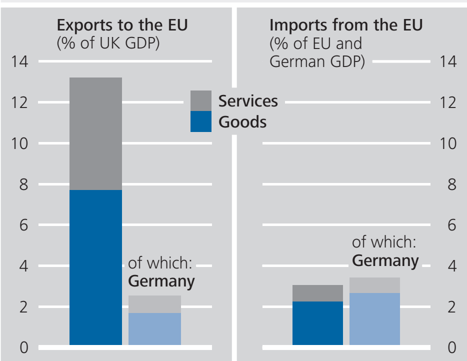
Poland, too, faced a drastic increase in infection counts in the fourth quarter. Measures in retail trade and other contact-intensive services, as well as in education, were therefore

3 To wit, easier access to extra unemployment benefits has been extended until mid-March. In addition, new one-off stimulus payments of US$600 to each eligible citizen and a revamped assistance programme for small and medium-sized enterprises were adopted. The overall fiscal cost of the package is estimated to run to nearly 4½% of GDP. The non-partisan Congressional Budget Office assumes that the measures taken could boost GDP by 1½% on average for 2021 and 2022. See Congressional Budget Office (2021).

How will economic relations between the United Kingdom and the European Union be governed going forward?

Following intensive negotiations, the European Union and the United Kingdom concluded a trade and cooperation agreement shortly before 2020 drew to an end.[1] This sets out fairly comprehensive rules for trade in goods and generally excludes tariffs and quantitative restrictions. It goes further than any other EU trade agreement to date. A mechanism has also been agreed that is designed to prevent competition-distorting state aid and the undermining of certain social and environmental standards. In the event of a suspected breach of level playing field rules, both partners may unilaterally impose sanctions, which can then be reviewed by an arbitration tribunal. However, the agreement represents a clear step backwards compared with membership of the EU single market, even for trade in goods. For example, product standards are no longer subject to automatic mutual recognition, and there are import controls and other forms of red tape. Furthermore, the zero tariff provisions do not apply to goods with a high share of value added from third countries.[2]

The United Kingdom's trade links with the European Union*



Sources: Office for National Statistics, Eurostat, Haver Analytics and Bundesbank calculations. * Averages for 2016 to 2019.
Deutsche Bundesbank

The agreement contains only rudimentary provisions on trade in services and lacks extensive rules on financial services, for example. Many market participants are hoping for quick follow-up negotiations and better arrangements in future.[3] However, as these would also touch on the competences of the individual EU Member States, supplementary arrangements will be difficult to agree. There are retrograde steps in many other areas, too. For instance, both the free movement of people and the mutual recognition of professional qualifications have come to an end, making labour mobility considerably more difficult.

Overall, the United Kingdom is therefore expected to suffer considerable economic losses in spite of the trade and cooperation agreement.[4] Although transitional arrangements still apply in some areas and many firms increased their stockholdings in the

1 The agreement is currently in force only on a provisional basis. For it to remain in force permanently, it needs to be ratified by the European Parliament. The agreement does not have to be ratified by the Member States' national parliaments, however, as the European Commission has deemed it to be an "EU-only" agreement that covers only areas of exclusive EU competence.
2 According to simulations, total UK trade in goods could shrink by around one-tenth over the medium term as a result of the aforementioned new barriers. See International Relations Committee Brexit Task Force (2020).
3 Financial services, in particular, are very important for the United Kingdom, having accounted for around 9% of UK exports to the EU in recent years. The corresponding figure for the services sector as a whole is more than 40%.
4 Analyses conducted by the International Relations Committee Brexit Task Force (2020) show that UK GDP could shrink by significantly more than 1% over the medium term as a result of the reduction in EU-UK trade caused by new non-tariff barriers alone. This is compounded by potential net migration outflows, subdued foreign direct investment (FDI), and productivity losses. However, owing to the lack of precedents, estimating the effects is subject to considerable uncertainty.

final quarter of 2020 in anticipation of possible disruptions at the beginning of this year, it is likely that initial problems were already noticeable in the current quarter.[5] New bureaucratic requirements have created difficulties for many enterprises. In the financial services sector, some business activities have been relocated to other countries. For the UK economy, which is already facing severe restrictions due to the coronavirus pandemic, the additional burdens come at a very bad time. It remains to be seen whether the regained possibilities of forging a more independent economic policy will give the United Kingdom an edge in its trading activities.

The new relationship with the United Kingdom will also entail economic losses for the European Union, especially for those Member States with particularly close trade links with the United Kingdom. However, the losses in relation to economic output are likely to be significantly smaller for most Member States than for the United Kingdom.

5 Freight volumes in the UK's external trade in goods were exceptionally low in January. Possible explanations for this include transactions being brought forward and COVID-related falls in demand. However, it is also possible that enterprises in the United Kingdom lost export orders or preferred not to trade on account of the new rules, or that this is at least the reason why delays occurred. See also Bank of England (2021).

tightened considerably again. Nonetheless, the economic recovery was less hamstrung by the recent wave of the pandemic than expected. Real GDP contracted by merely 0.7% in the final quarter of the year after seasonal adjustment. This was due primarily to the sharp quarterly rise in industrial production by nearly 5%. Despite the renewed restrictions, price-adjusted retail sales picked up once again somewhat compared with the third quarter after seasonal adjustment. According to an initial estimate, GDP contracted by 2.8% for full-year 2020, which was relatively mild by international standards. However, it should be borne in mind that the Polish economy had grown by as much as 4.5% in 2019. Owing to extensive support measures, including those promoted by the EU, the crisis has had virtually nil impact on the labour market thus far. The average unemployment rate for the fourth quarter, at 3.3%, was a mere 0.4 percentage point up on the year. Annual consumer price inflation decelerated to 2.4% by December. By contrast, the core rate, excluding energy and food, fell only slightly to 3.7%. The Polish central bank kept its policy rate at a historically low level of 0.1%.

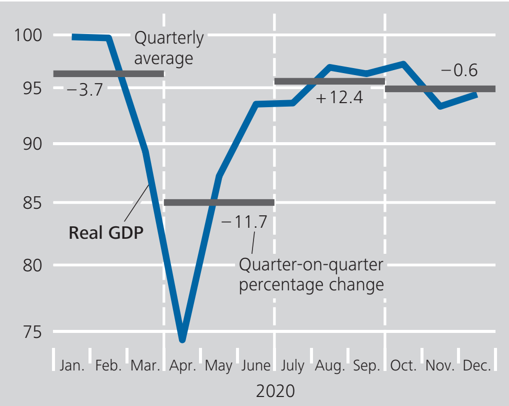
Macroeconomic trends in the euro area

Economic activity contracted again in Q4

Macroeconomic activity in the euro area contracted again somewhat in the final quarter of 2020 against the backdrop of a resurgence of new infections and tighter containment measures. According to Eurostat's flash estimate, seasonally adjusted real GDP fell by 0.6% in the fourth quarter compared with the third quarter. The year-on-year shortfall increased to 5%. According to preliminary calculations, aggregate output decreased by 6.8% on an annual average for 2020. The downturn was thus much stronger than during the 2009 global financial and economic crisis, when real GDP declined by 4.5%.

Estimated monthly path for aggregate output in the euro area

Q4 2019 = 100, price and seasonally adjusted, log scale



Source: Bundesbank calculations based on Eurostat data.
Deutsche Bundesbank

Considerably tighter restrictions again from November

The pandemic had already picked up momentum again in some Member States in the third quarter. In November, the infection rate then increased so significantly that several Member States felt compelled to tighten containment measures again considerably. Restrictions were eased in some cases in December, but other Member States have now tightened their measures. The time profile of the restrictions was therefore less homogeneous in the fourth quarter than in the second quarter. However, a feature they shared was that they were primarily geared to contact-intensive services and parts of the retail sector. Most governments also tried to keep child daycare centres and schools open.

Industry and construction not directly affected

Industry and construction were not directly affected by the renewed tightening of measures and benefited from the rapid recovery in global trade and robust construction demand. Alongside switching effects by consumers, this was the main reason why aggregate losses were considerably lower than in the second quarter.

Marked decline in economic activity in November

From a monthly perspective, aggregate output is even likely to have risen somewhat further in October. In November, it then fell markedly. It probably recovered a little in December, but remained roughly just under 6% lower than its pre-crisis level.[4]

Further decline in consumption of services, relatively robust consumption of goods

Private consumption, in particular, suffered in the fourth quarter as a result of the tightening of containment measures. There were particularly heavy losses in services used by households, above all in accommodation and food services, in culture, entertainment and recreation and in personal services. Household expenditure on the purchase of goods declined only in some segments. Overall, retail sales, after price adjustment, only fell by just under 1% on the quarter. However, they were still up by around 2% on the year. Household demand for furnishings and electronic equipment continued to increase. In addition, the number of new motor vehicle registrations rose markedly in the fourth quarter. This is probably due to pull-forward effects associated with the expiry of various fiscal incentives. In the light of the increased restrictions on consumption opportunities, households' saving ratio is likely to have risen again recently.

Investment probably up slightly

Investment in the fourth quarter is likely to have risen slightly compared with the third quarter. Expenditure on machinery and equipment, which had contracted sharply in the first half of 2020 and subsequently recovered only partially, probably increased slightly, at best. Although capital goods manufacturers' sales in the euro area continued to rise in October and November, imports of capital goods fell somewhat. New registrations of commercial vehicles also declined markedly in comparison with the preceding quarter. By contrast, investment in intellectual property probably expanded again significantly. In particular, the trend towards digitalisation, which has been accelerated by the conditions of the pandemic, is likely to have had a stimulating effect here. Investment in this area had already returned to pre-

4 In order to gain an overview of the monthly dynamics of macroeconomic activity, an econometric method and key economic indicators were used to convert quarterly GDP into a monthly frequency. For details on the methodology, see Deutsche Bundesbank (2020).

pandemic levels in the third quarter.[5] Construction investment probably stagnated. In any case, construction output remained virtually unchanged in comparison with the previous quarter.

Significant recovery in foreign trade with non-euro area countries

Foreign trade was the main driver of growth in the final quarter. Exports to non-euro area countries picked up substantially in this period. Exports to the United Kingdom rose particularly sharply, probably first and foremost owing to uncertainty about the outcome of negotiations between the EU and the United Kingdom. Exports to China also went up significantly. Exports to the United States likewise increased markedly, but, unlike exports to the United Kingdom and China, they remained well below their pre-crisis level. Euro area exports of services to non-euro area countries also continued to recover, but still suffered from the persistent weakness in tourism. The exchange of goods amongst euro area countries, which had made significant progress towards recovery in the third quarter, continued to normalise. Euro area imports from non-euro area countries increased less sharply than exports in the light of subdued domestic activity once again.

Significant improvement in manufacturing

Industrial output continued to recover in the fourth quarter, supported by brisk demand for goods at home and abroad. Capacity utilisation in the manufacturing industry rose significantly between October and January, but remained below its long-term average. Above all, the manufacture of computers and electronic and optical devices picked up.[6] There were also significant increases in the production of other capital goods and intermediate goods. In December, the production of automobiles edged much closer toward its pre-crisis level. By contrast, the manufacture of other transport equipment, and above all aircraft production, despite some recovery, remained distinctly below pre-crisis levels. Consumer goods output increased only marginally from an already high level.

In several services sectors, the situation deteriorated again considerably in the fourth quarter

Sentiment indicators for the euro area*

Balance of positive and negative responses as a percentage of all responses, seasonally adjusted, monthly data

Source: European Commission. * Deviations from the respective average since 2000.
Deutsche Bundesbank

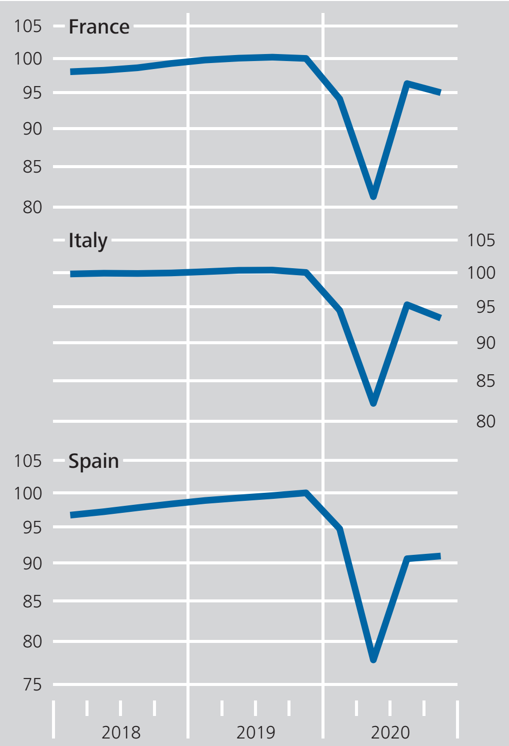
Some services again severely affected by pandemic

owing to the pandemic, with the hotel and restaurant sector, trade fairs and travel agencies bearing the brunt once more. Art and cultural activities also returned to a very low level of activity. By contrast, the situation for certain business-related services, such as advertising or the activities of employment placement agencies improved. They probably benefited from the ongoing recovery in industry. Much the same was true for some transport services and information and communication technology (ICT).

5 In the euro area excluding Ireland. For several years now, the statistical recording of intellectual property investment in the euro area has been strongly influenced by the business activities of multinational enterprises domiciled in Ireland (see Deutsche Bundesbank (2018)). In the final quarter of 2019, this investment shot up by more than 30% owing to a one-off effect in Ireland. Investment volumes were significantly lower in the subsequent three quarters. In the third quarter of 2020, the investment volume for the euro area as a whole was therefore one-quarter down on the pre-pandemic level. Excluding Ireland, by contrast, it reached its pre-crisis level once again.
6 This increased massively in November, especially in Ireland, probably in connection with the business activities of multinational enterprises domiciled in Ireland.

Real GDP in France, Italy and Spain

Q4 2019 = 100, seasonally adjusted, log scale



Sources: Eurostat and Bundesbank calculations.
Deutsche Bundesbank

Diverging developments in Member States in some instances

Whilst economic output had risen sharply in all Member States in the third quarter, it declined markedly in some Member States in the final quarter, whereas in others it stagnated or even rose. This was mainly due to differences in how the pandemic developed and in the economic structure of the individual countries. These also had a bearing on the differing degrees of variation from the pre-pandemic level, which remained high, especially in countries heavily reliant on tourism.

Decline in economic output in France

In France, economic output contracted by 1.3% in the final quarter compared with the third quarter, in which it had increased again to just over 96% of its pre-crisis level. This meant that the slump was comparatively mild despite the considerable tightening of containment measures once more. One reason for this was that investment activity was barely affected by the additional restrictions and picked up again. This is particularly true of construction investment, which, however, is likely to have benefited again from some catch-up effects. Exports of vehicles and pharmaceutical products, in particular, also increased significantly. By contrast, there were major shortfalls as a result of the operating bans for restaurant services and for various service providers, as well as in the retail sector on account of the temporary closure of non-essential shops. As the measures were eased, the economy appears to have revived at the end of the quarter. According to estimates by the national statistical office, the backlog in GDP compared with pre-crisis levels narrowed from 8% in November to 4% in December. For 2020 as a whole, GDP declined by 8.3%.

Clear GDP decline in Italy

In Italy, too, economic output fell again significantly in the fourth quarter after recovering a large part of its pandemic-related losses in the third quarter. Real GDP fell by 2% on the quarter. This meant that it was around 7% down on its pre-pandemic level. Here, too, resurgent infection rates and the tightening of containment measures had an impact on consumer-related services sectors in particular. But other sectors of the economy did not maintain the third-quarter level either. Industrial output, especially of consumer goods, dropped somewhat in the fourth quarter. Construction output, which had already risen significantly above its pre-pandemic level in the third quarter, was probably down sharply. Consumption of goods is also likely to have declined. In any case, on average over the fourth quarter, retail sales were down markedly on the level of the previous period. Thus, while the domestic economy tended to be weak again, exports of goods increased somewhat. In 2020 as a whole, real GDP fell by 8.9%.

Level of activity in Spain remains very depressed despite slight GDP growth

In Spain, economic output even rose slightly by 0.4% in the final quarter. However, it remained around 9% down on its pre-pandemic level. The further steep rise in public consumption of 4.5% was a key factor in the – albeit small – aggregate gain. In addition, activity in the manufacturing industry and in some business-related services sectors continued to recover.

There was also a small increase in the retail sector. By contrast, aggregate activity was weighed down by the steady decline in construction activity. In 2020 as a whole, real GDP fell by 11%.

Economic developments also different in smaller Member States

In the smaller Member States, too, developments in macroeconomic activity presented a mixed picture in the fourth quarter. In Austria, the decline in real GDP, at -4.3%, was very large compared with the third quarter. In the Netherlands, economic output was virtually stagnant (-0.1%). In Belgium and Portugal, by contrast, aggregate output rose slightly by 0.2% and 0.4%, respectively. In Latvia and Lithuania, real GDP even increased by around 1% in both countries.

Despite improvements in second half of year, labour market situation still depressed

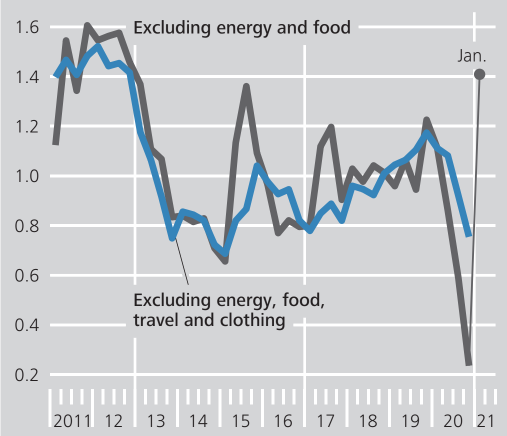
Despite the economic setback, the number of persons employed in the euro area increased slightly in seasonally adjusted terms by 0.3% in the fourth quarter, but was still around 2% down on the final quarter of 2019. The number of unemployed persons declined until November; only in December did it rise again slightly. On a quarterly average, the standardised unemployment rate stood at 8.4%, following on from 8.6% in the third quarter. At the same time, enterprises reported that their employment plans had improved. The same applies to service providers. This suggests that they consider the most recent setback to be temporary and are looking to the future with greater confidence. It should also be borne in mind that employment continues to be massively supported by various economic policy measures. Although short-time work is decreasing in most countries, it continues to play a major role.

Consumer prices in euro area unchanged in Q4

Consumer prices remained unchanged in seasonally adjusted terms in the fourth quarter compared with the previous quarter. Prices for energy, food and services increased moderately, while prices for non-energy industrial goods fell considerably. The annual inflation rate as measured by the Harmonised Index of Consumer Prices (HICP) dropped further from 0.0% to -0.3% in the final quarter. The rate excluding energy and food decreased markedly from 0.6% to 0.2%.

Core HICP rates in the euro area

Annual growth rates (%), quarterly data



Source: Eurostat.
Deutsche Bundesbank

Core rate significantly lower in Q4

Lower prices for clothing and footwear played a major role in the decline in the core rate in the fourth quarter. Excluding the weaker end-of-season sales effect in the summer, the core rate would probably have been lower at that time. In addition, the temporary reduction in VAT rates in Germany continued to dampen the core rate. Prices for recreational and personal services as well as transport services probably also rose only slightly again owing to the lower demand caused by the pandemic. But the increase in the prices of the other components of the HICP basket of goods was also somewhat weaker. Accordingly, the rate excluding energy, food, travel and clothing also fell to 0.8% in the fourth quarter, following on from 0.9% in the third quarter.

Inflation rate rose sharply in January

According to Eurostat's flash estimate, the annual inflation rate (HICP) rose sharply overall in January to 0.9%, and the rate excluding energy and food rose to 1.4% – its highest level since 2015. The sharp rise is likely to be partly attributable to a statistical effect as a result of the annual adjustment of the HICP weights, which was particularly pronounced this time owing to pandemic-induced changes in the consumption structure in 2020. Alongside this, shifts in end-of-season sales and sharp increases in electricity prices probably played a role in some countries. In addition, one-off effects in Germany placed upward pressure on prices (see the box on pp. 63 ff.).

Overall economic recovery likely to remain on hold in Q1

The macroeconomic situation in the euro area is likely to remain strained for the time being. Although vaccination campaigns have been rolled out in the euro area countries, the initial low availability of vaccine quantities means that only slow progress has been made so far. The vaccination campaign is unlikely to gain more momentum until the second quarter. In addition, there was a resurgence of infections in several Member States owing to the spread of different variants of the virus. The containment measures were therefore not only extended in many places, but also tightened in some cases. This is reflected in the Purchasing Managers' Index for the economy as a whole, which fell further below the expansion threshold in January. This was primarily due to the much gloomier assessment in the services sector, whilst in the manufacturing industry, the signs continue to point to expansion. A similar split development across sectors is reflected in the European Commission's survey results, which show that sentiment in industry even improved and almost reached its long-term average in January. According to the surveys, the stock of orders in the construction sector increased again from an already high level. By contrast, sentiment among service providers indicated that the gap compared with the long-term average widened further. Household confidence also deteriorated, with less favourable assessments of the economic outlook, in particular. This could mean that, if restrictions were eased, the additional savings resulting from the pandemic would not be dissolved quickly. Overall, the macroeconomic recovery is expected to remain on hold in the first quarter.

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