

## Global and European setting

### Global economic developments

*Huge declines in economic output in large parts of the world ...*

Within the space of just a few weeks in the first half of 2020, the coronavirus pandemic brought economic output to its knees in almost all parts of the world, throttling activity to a far greater extent even than the global financial and economic crisis of 2008-09. Downturns were particularly severe in countries whose governments had felt impelled to take very far-reaching measures to contain the spread of the infection or kept restrictions in place for a protracted period. This was true of the United Kingdom, in particular, where real gross domestic product (GDP) fell by one-fifth in the second quarter compared with the already depressed level recorded in the previous quarter. Contractions were somewhat less pronounced in the euro area, in the United States and prob-

ably also in Japan. Most emerging market economies suffered substantial declines as well. One bright spot was the Chinese economy, which in the second quarter had already recouped the heavy losses from the beginning of the year.

When it became clear how severely many economies would be affected by the pandemic, the International Monetary Fund (IMF) lowered its forecasts again in June. It now expects global GDP (calculated at purchasing power parity exchange rates) to decline by almost 5% in the current year before then returning to its pre-crisis level next year. However, this rebound would be due mainly to the rapid recovery of the Chinese economy, with losses outside China remaining considerable.<sup>1</sup>

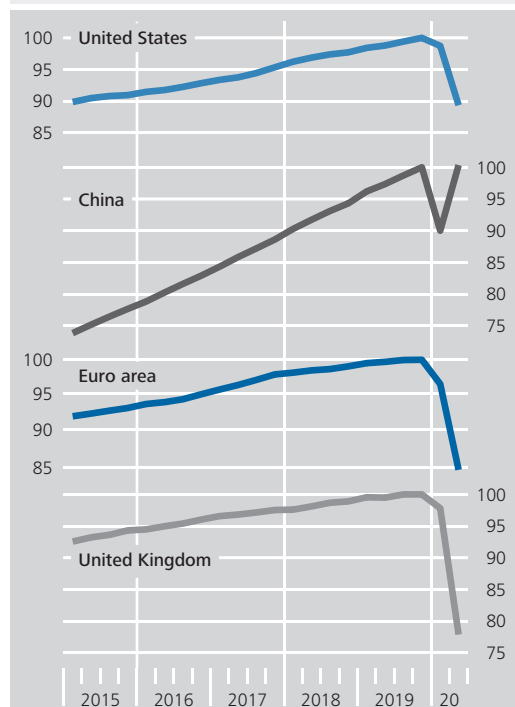
*... led IMF to revise global economic outlook further downwards*

However, the surprisingly good economic data coming out of some countries in the past few weeks and various political decisions suggest that the IMF's outlook, at least for the short term, is a little overly pessimistic.<sup>2</sup> Starting at the end of April, the relaxation of containment measures ushered in a certain degree of normalisation in many countries. The impact of these steps can be seen, amongst other things, in mobility behaviour. In both industrial and emerging market economies, many people returned to their workplaces and spent more time at retail establishments, restaurants and recreational facilities.<sup>3</sup> Consumption of goods in a number of countries had even returned to pre-crisis levels by the end of the second quarter. Catch-up and switching effects are likely to

*But lowest point of crisis probably already passed*

#### Real GDP in selected major economies

Q4 2019 = 100, seasonally adjusted, log scale



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

Deutsche Bundesbank

<sup>1</sup> See International Monetary Fund (2020a).

<sup>2</sup> Even the IMF staff seem to have revised their June assessment somewhat at this point. At least for the United States, they now expect GDP to decline by 6½% this year, compared with -8% previously. See International Monetary Fund (2020b).

<sup>3</sup> Google location data taken from mobile devices suggest that, in the first week of August, the time spent at retail establishments, restaurants and recreational facilities worldwide was still around 18% lower than at the start of the year, following a decline of around 55% in mid-April.

have played a role in this, as are government support measures, which, particularly in industrial countries, offset a significant portion of direct income losses. New recovery packages, such as the one recently adopted in the European Union, are likely to provide a further boost to the economic recovery.

*Industry and world trade slow to recover*

So far, industry and world trade have been slower to recover. Data from the CPB Netherlands Bureau for Economic Policy Analysis show that global industrial production increased only marginally in May after being hit by severe slumps since the start of the year. This was due primarily to deep production cuts by major oil exporters. Other regions experienced an extensive revival of industry.<sup>4</sup> At the end of the quarter, a further recovery was on the horizon, supported not least by production being ramped up in the automotive sector. Against this backdrop, goods exports also picked up again in many countries. However, global industrial production and world trade are likely to have continued to fall far short of pre-crisis levels.

*Services sectors continued to lag far behind*

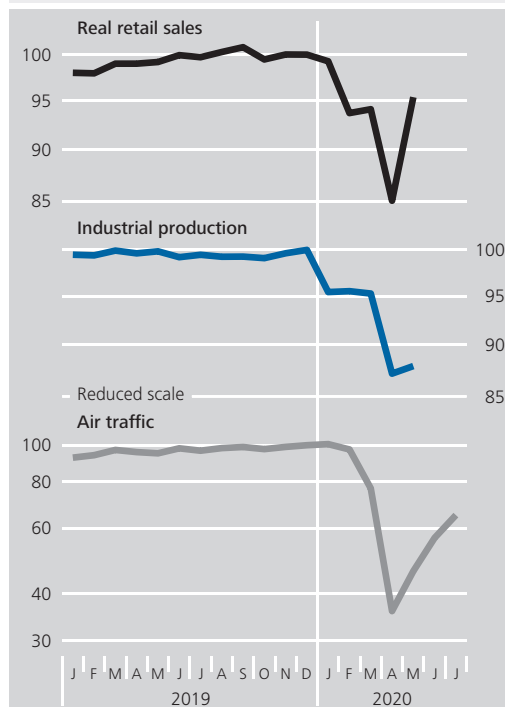
Continued restrictions placed the greatest strain on the services sectors such as food services and the events industry, in which it is difficult to enforce social distancing requirements, as well as on international tourism and economic sectors dependent on it. Air traffic has been recording marked growth again for several months now. However, the July figures were still just over one-third lower than pre-crisis levels. Given how long these restrictions have been in place and the uncertain outlook for the future, longer-term damage might be an issue, especially for these sectors, e.g. in the form of a prolonged period of subdued investment or rising numbers of corporate insolvencies, which will then have a greater or lesser impact on other sectors of the economy.

*Start of recovery, but risks exceptionally high*

The global economic recovery has therefore already begun, and business surveys indicate that this upward movement will continue. Given the depth of the slump, however, a return to normal activity levels is still a long way off. There is

### Global economic indicators\*

December 2019=100, seasonally adjusted, log scale



Sources: CPB, Flightradar24, national data and Bundesbank calculations. \* Groups of countries vary due to differences in data availability.  
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also a high risk of setbacks in view of, for instance, the still almost unbridled growth in infection rates in many emerging market economies and the resurgence of the pandemic in some industrial countries, especially in the United States.

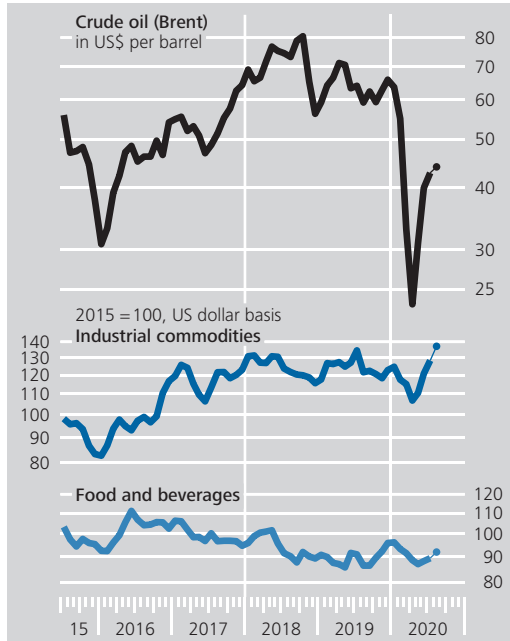
As the global economy strengthened, commodity prices also recovered a good deal from May onwards. In addition to the prices of industrial commodities, crude oil prices rose, in particular. One of the main reasons for this was the lifting of mobility restrictions. This led to a marked upturn in energy demand. This was especially the case in China, where, following a considerable decline in the first quarter, crude

*Commodity prices recovered markedly from lows recorded at end-April*

<sup>4</sup> Excluding Eastern Europe and Africa including the Middle East, the country groups to which the majority of oil producers complying with the agreed production cuts belong, global industrial production increased by 3% in May compared with the previous month. However, even going by this definition of other regions, production was still down by almost 12% compared with the level recorded at the end of 2019.

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

Monthly averages, log scale



Sources: Bloomberg Finance L.P. and HWWI. • Latest figures: average of 1 to 7 August 2020, or 1 to 13 August 2020 for crude oil.

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oil consumption in the second quarter was already back above the previous year's level. Oil prices were also propped up by supply-side adjustments. OPEC countries and their partners took the decision to significantly cut production between May and July and for the most part subsequently stuck to the agreement. Other major oil-producing countries, such as the United States and Canada, also made further significant reductions to their output. The price of a barrel of Brent crude oil, which had dropped below US\$20 at one point around the end of April, had rebounded to around US\$44 as this report went to press. However, that still leaves prices almost 35% below the level recorded at the start of the year. Futures suggest only minor price increases in the months to come.

Following the decline in commodity prices, energy initially became considerably cheaper at the consumer level, thereby dampening global inflation. In industrial countries, the year-on-

*Consumer price inflation in industrial countries perceptibly subdued*

year increase in consumer prices decreased from 1.2% in March to 0.1% in May. In the aftermath of rising oil prices, the rate went back up to 0.6% in June. At the same time, however, the core inflation rate excluding energy and food dipped again slightly to 1%.

### Selected emerging market economies

In China, where the pandemic first emerged, economic output had already bottomed out at the end of the first quarter. Since then, it has recovered surprisingly strongly. The official estimate indicates that, having fallen by 6.8% in the first quarter, real GDP was already up by 3.2% in the second quarter compared with the same period in 2019. The fact that infection rates appear to have been effectively brought under control prior to this was most likely key to the rapid recovery. Following disruptions in February as a result of the containment measures, industrial production was ramped up particularly strongly in recent months. This was boosted by strong foreign demand for personal protective equipment (see the box on pp. 15 f.). In addition, once domestic car sales had returned to normal, motor vehicle production rose sharply.

*Already very strong economic recovery observed in China, ...*

Despite the all in all fairly rapid improvement, the Chinese economy is still far from returning to normal. Activity in a number of sectors, especially services, remained subdued in the second quarter. Although the situation on the labour market improved somewhat, the unemployment rate remained at a markedly elevated level until the end of the period under review. Against this backdrop, it is not surprising that consumer price inflation decreased across the board in recent months. On average for the months from April to June, the core inflation rate excluding energy and food decreased to 1.0%, its lowest level since the start of 2010. The headline inflation rate fell even more sharply, to 2.7%.

*... but impact of the crisis remains clearly visible*

## China's foreign trade withstanding the global economic crisis

The pandemic has also left a deep imprint on world trade in recent months. According to calculations by the CPB Netherlands Bureau for Economic Policy Analysis, global trade in goods was down in April-May 2020 by just over one-sixth on the year. Almost all major economies saw their foreign trade take a severe hit. The important exception was China, where second-quarter goods exports revenues in US dollar terms were at a similar level to the same period of the previous year. In July, exports were even up by 7% in terms of value over the same period 12 months earlier. One reason for this comparatively good performance is likely to have been orders from the beginning of the year, which, owing to the lockdown measures imposed at the time and the associated production cutbacks, could not be processed until later.<sup>1</sup> However, such catch-up effects alone cannot explain China's robust export performance in recent months.

Instead, China's export sector benefited significantly from strong additional demand for certain products which were particularly sought after in connection with the pandemic. These included computers and other IT equipment, exports of which generated nearly one-quarter more revenue on the year in the second quarter. In this context, the global transitioning of numerous employees to working from home is likely to have created an additional need for the necessary technology. Exports of personal pro-

ductive equipment rose even more strongly than those of IT products. In particular, deliveries of face masks, which had previously played a wholly negligible role in Chinese exports, surged. Between April and June, exports in the category of goods which includes masks alongside other special textile products amounted to US\$31 billion, compared with just US\$1.7 billion a year earlier.<sup>2</sup> These products thus accounted for a sizeable 5% of total Chinese export revenues during that period.

Despite the considerable domestic economic recovery and healthy export activity, Chinese imports did not, at first glance, hold up quite as well in the second quarter. In terms of value (denominated in US dollars), they were down by just under one-tenth from the previous year's level. However, the slump in commodity prices must also be taken into account. If only manufacturing goods are considered, the shortfall amounted to just 5%. Imports of machinery, electronics and transport equipment even nearly maintained their previous year's level.

<sup>1</sup> At the beginning of February, the authorities in large parts of the country extended the plant shutdowns beyond the Chinese Lunar New Year holiday. The subsequent resumption of production was very arduous. Against this backdrop, exports of goods fell by two-fifths in February.

<sup>2</sup> Goods assigned the HS code 6307 (Other made-up articles, including dress patterns).

### Chinese foreign trade\*

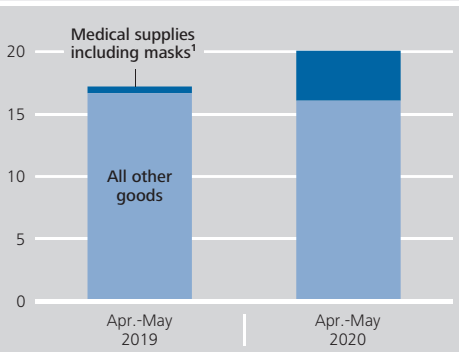
2019 = 100, quarterly, seasonally adjusted, log scale



Sources: China's General Administration of Customs, CPB and Bundesbank calculations. \* Unadjusted figures denominated in US dollars. <sup>1</sup> Price adjusted.  
 Deutsche Bundesbank

### German imports of goods from China

€ billion, two-month totals



Sources: Eurostat's COMEXT database, Federal Statistical Office and Bundesbank calculations. <sup>1</sup> Defined in accordance with the dataset "EU trade since 2015 of COVID-19 medical supplies".

Deutsche Bundesbank

The essentially robust Chinese demand for imports has also proved to be a valuable support for German exporters in recent months. Compared with the previous year, revenue from goods exports to China in euro terms was down by only 4% in the

second quarter. The losses were thus much smaller than in business with other trading partners. On the import side, the discrepancy between imports from China and those from other countries was even greater. While total German imports fell sharply, German imports from China rose by 18% on the year in terms of value. The enormous demand for masks and other medical protective equipment was a major factor. Owing to diverging export and import trends, the German trade deficit with China expanded to just under €10 billion in the second quarter in seasonally adjusted terms – the highest figure ever measured. However, the deficit is likely to decline again going forward as imports from China are expected to return to normal.

*Indian economy plunged into deep crisis as a result of pandemic*

The Indian economy suffered a particularly deep slump in recent months. Between the end of March and the start of May, the government imposed a strict lockdown, which had a severe impact on economic life. Industrial production in April fell by almost 60% on the year. Despite the measures taken, it was not possible to contain the spread of the virus. Nevertheless, the government began to ease restrictions in May and June in view of the economic emergency. The economy has recovered somewhat since then. However, the increasing incidence rate throughout the reporting period is likely to hinder a rapid and widespread return to normal activity levels. India's central bank cut its policy rate to 4.0% in May, but has since refrained from further monetary policy easing. This was also due to the rather sharp rise in prices. In the second quarter, the year-on-year rate of the consumer price index (CPI) stood at 6.5%.

The Brazilian economy also remains firmly in the grips of the pandemic. The marked decline

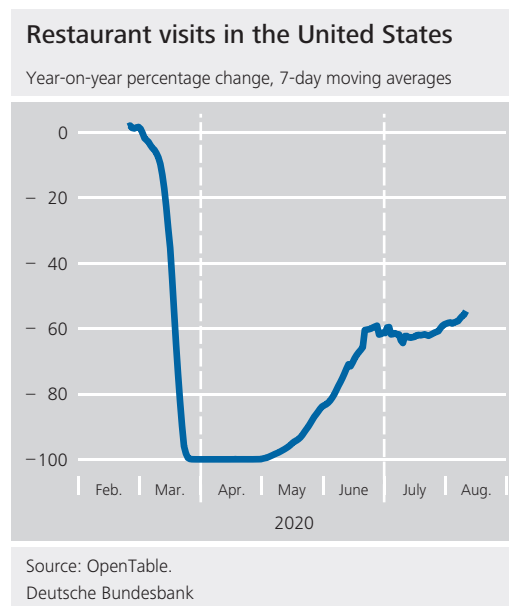
in economic activity already seen at the end of the first quarter intensified considerably again in April. Private consumption, in particular, plummeted. A number of indicators suggest that the economic slump bottomed out at mid-quarter. Economic recovery was rather muted, though, probably in part due to the virus hitherto spreading unchecked. Overall, real GDP might have been around 10% lower in the second quarter than one year earlier. Consumer price inflation sank to 2.1% on the year in the second quarter, Brazil's lowest inflation rate in more than 20 years. Following significant cuts in May and June, the country's central bank lowered its policy rate further to 2%.

According to initial estimates published by Russia's Federal State Statistics Service, economic output in Russia fell by 8.5% on the year in the past quarter. This was due chiefly to the fact that the government had ordered many businesses to shut down from the end of March to mid-May to contain the spread of the infection.

*Massive economic slumps also seen in Brazil ...*

*... and Russia*

In addition, lower oil prices and the production cuts agreed with OPEC producers dampened economic activity. Short-term indicators suggest that the economy moved onto a recovery path following the easing of containment measures. However, activity levels still remained well short of pre-crisis levels, with retail sales in June still just under 8% below the previous year's level after price adjustment. Consumer price inflation remained relatively low in the second quarter, at 3.1%. Against this backdrop, starting in March, the Russian central bank cut its policy rate in three steps by a total of 175 basis points to 4.25% at the end of the reporting period.



## United States

*Dramatic slump in GDP in Q2*

The US economy plunged into a severe pandemic-induced crisis in the first half of the year. According to the first official estimate, real GDP contracted by almost 10% after seasonal adjustment in the second quarter compared with the preceding quarter, in which it had already fallen by 1¼%. This was chiefly attributable to the strict containment measures, such as restrictions on movement and business closures, as well as voluntary behavioural adjustments. All of this weighed particularly heavily on the usually fairly steady private services consumption.<sup>5</sup> However, investment in private housing construction and trade and industry was also down considerably. Exports even fell by almost one-quarter after price adjustment. Alongside the export-oriented industrial sector, the tourism sector suffered heavily from the slump in foreign business. International travel restrictions also left a deep imprint on the import side. The only reason why the decline in imports was not as sharp overall was because supplies from China rose substantially as its economy reopened.

*Fiscal policy providing bolstering effect*

By contrast, public sector demand rose slightly in the second quarter. This was mainly due to high government expenditure on services related to the implementation of government

support measures.<sup>6</sup> The bulk of the assistance measures adopted by the government, such as unemployment benefits and one-off payments, were aimed at cushioning households' losses in earnings. This led to a sharp rise in households' disposable income in the second quarter of just over 9% and – owing to depressed consumption expenditure – to an increase in the saving ratio from 9.5% in the first quarter to almost 26%.

The remarkably sharp quarter-on-quarter decline in economic output should not detract from the fact that the US economy already left the trough of the crisis behind in May. Since then, almost all economic indicators, chiefly private consumption of goods, have been clearly pointing upwards again. The situation in the labour market also improved to some extent. In July, the unemployment rate fell to 10.2%, 4.5 percentage points below its all-time high from April. However, the gap to its pre-crisis level is still considerable. Against this

*Recovery probably faltering recently*

<sup>5</sup> In the second quarter alone, expenditure in this area fell by more than 13% on the quarter after price adjustment, after a decline of 2½% had already been recorded in the first quarter. In the previous 73 years, the sharpest decline had amounted to just -¾%.

<sup>6</sup> Government expenditure on banking services related to the processing and administration of loan applications under the Paycheck Protection Program increased by around US\$15 billion in the second quarter.



backdrop, it is worrying that the economic recovery appears to have been faltering in recent weeks. This is probably mainly due to the renewed sharp rise in new infections since mid-June. As a result, fear of contagion seems to be prompting many US residents to adopt more cautious consumption behaviour.<sup>7</sup> In addition, the majority of US states have now suspended the planned easing of containment measures or even imposed new restrictions. These are aimed, in particular, at the restaurant industry and other service sectors with high contact risks. Especially those sectors that were particularly hard hit by the pandemic are therefore initially unlikely to benefit from the prospective new fiscal demand impulses.<sup>8</sup> The US central bank maintained its highly accommodative stance during the period under review, also owing to subdued consumer price inflation.

## Japan

*Sharper decline in economic output*

In Japan, the pandemic has so far taken a considerably milder course than in other industrial countries. Nevertheless, according to the available indicators, economic output decreased further in the second quarter. This exacerbated the economic downturn, which had already begun in Japan at the end of 2019 with the increase in VAT. Alongside the slump in domestic demand, weak foreign business weighed on the economy. The recession also took a toll on the labour market. The unemployment rate rose markedly and the number of persons on furlough climbed dramatically in the meantime. To support the economy, the Japanese government adopted a comprehensive economic stimulus package, which includes direct assistance and loans for enterprises as well as a one-off payment to every resident. Against this backdrop, too, the economy recovered to some degree at the turn of the quarter. However, the number of new infections has risen considerably in recent weeks, significantly exceeding the record highs from April. This is likely to hold back the economic recovery in the near future. The core inflation rate – as

measured by the year-on-year rate of the CPI excluding energy and food – was only marginally positive in June at 0.1%. Against this backdrop, the Japanese central bank maintained its highly accommodative policy stance.

## United Kingdom

In no other advanced economy did economic output fall as sharply in the second quarter as it did in the United Kingdom.<sup>9</sup> According to the first official estimate, real GDP decreased by a seasonally adjusted 20½% compared with the previous period. This was certainly also due to the fact that sweeping measures, which the government had not implemented until at a late stage compared with other countries, were in force for a longer period of time. Against the backdrop of restrictions on movement and business closures, economic activity in the hotel and restaurant sector virtually came to a standstill. Other services, such as culture and entertainment, education and health, were also severely affected. In addition, there were severe slumps in the construction and manufacturing sectors. The labour market situation deteriorated dramatically. Although the unemployment rate remained unchanged in the second quarter at 3.9%, this figure does not take into account the almost 10 million employees on furlough who received continued wage payments from the government. At the same time, the upward pressure on prices eased significantly. In June, the year-on-year rate of the CPI stood at just 0.6%, mainly due to lower energy prices. The UK economy is likely to have picked up speed again in the third quarter, with a far-reaching easing of contain-

*Economy suffering particularly severe slump by international standards*

<sup>7</sup> The significance of voluntary behavioural adjustments was already evident in the early stages of the pandemic: in March of this year, high-frequency indicators for mobility and spending behaviour fell in many places even before containment measures were introduced. In addition, the recovery began even before the easing of restrictions. See Chen et al. (2020).

<sup>8</sup> The US Congress was negotiating a new fiscal package of at least 5% of GDP as this report went to press.

<sup>9</sup> Looking at the first half of the year as a whole, the cumulative decline in GDP in Spain was almost as sharp.

ment measures since the beginning of July as well as the fairly low number of new infections recorded recently. However, uncertainty with regard to the further course of the pandemic is expected to weigh on economic growth. Moreover, the uncertain outlook for future economic relations with the European Union is unsettling. The Bank of England recently saw downside risks to economic development, but did not ease its monetary policy stance any further.

## Poland

*Previously buoyant upswing abruptly ended by coronavirus crisis*

Poland had managed to contain the pandemic by taking rigorous measures at an early stage. However, these measures weighed markedly on economic activity, which contracted by 8.9% in the second quarter compared with the previous quarter. This brought an abrupt end to the previously buoyant upswing, as was the case in the other central and eastern European EU Member States (see the box on pp. 22 ff.). During the second quarter, however, restrictions were eased and aggregate economic activity recovered markedly, with retail sales and industrial output climbing robustly in May and June, for instance. However, at the end of the period under review, they remained significantly down on their pre-crisis levels. Despite the sharp contraction in the economy as a whole, unemployment increased only slightly. This increase was tempered by government measures to support enterprises in paying wages. Consumer price inflation slowed only a little on the year to 3.3% in June. The core inflation rate excluding energy and food even increased to 4.1%. Against the backdrop of the economic crisis, the Polish central bank nevertheless cut its policy rate by a further 40 basis points to 0.1%.

## Macroeconomic trends in the euro area

The euro area economy also had to cope with severe downturns as a result of the pandemic.

According to Eurostat's flash estimate, seasonally adjusted real GDP fell by 12.1% in the second quarter compared with the preceding quarter, in which it had already dropped by 3.6%.<sup>10</sup> The slump was largely due to the measures taken from March onwards to contain the coronavirus. In April, the level of activity was estimated to have been around one-quarter below the pre-pandemic level. Economic activity recovered as the infection rate slowed and restrictions were eased. However, the recovery remained incomplete throughout the reporting period. An estimated 87% of the normal level was reached in May and around 93% was attained in June.<sup>11</sup>

*Steep quarterly decline in real GDP; partial recovery over the course of the quarter*

Not all economic sectors benefited equally from the easing of restrictions. Activity picked up substantially again, particularly in areas in which earlier strict restrictions were eased. These included, for example, parts of the retail trade, the sale of motor vehicles, the hotel and restaurant sector and also parts of industry. In some sectors, especially tourism, restrictions were not eased in many places until the end of June, while in other areas – especially with regard to large events such as trade fairs – business activity is still largely prohibited. Movements of people between EU Member States and non-EU countries continue to be subject to considerable restrictions, which is affecting tourism in particular, but also industry. This is making it very difficult, in many cases, to provide services that have to be performed by employees on site. All in all, however, supply-side constraints are likely to have become less significant. Economic activity is now being increasingly encumbered by weak domestic and foreign demand. One contributing factor in this is that households continue to be cautious.

*Eased administrative restrictions; increasing demand-side burdens*

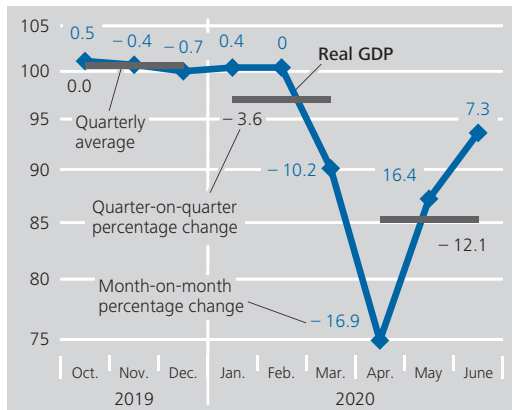
<sup>10</sup> According to current calculations, the impairment of activity was therefore not quite as strong as the Eurosystem staff had assumed in the baseline scenario of the June projection. At that time, a decline of 13% had been expected. See European Central Bank (2020a).

<sup>11</sup> In order to gain an overview of the monthly pattern of macroeconomic activity, the quarterly GDP series was broken down into monthly data using key economic indicators. For details on the methodology, see Deutsche Bundesbank (2020).



### Estimated monthly path for aggregate output in the euro area

Dec. 2019 = 100, price and seasonally adjusted, log scale



Source: Bundesbank calculations based on data from Eurostat. Deutsche Bundesbank

Investment activity, too, suffered a setback in the second quarter. In this vein, construction activity in some countries was severely restricted during the lockdown. However, it recovered rapidly after the containment measures were eased thanks to the positive orders situation. In other Member States, construction output was barely affected. Conversely, investment in machinery and equipment appears to have lost considerable momentum. In May, too, the industrial sector's domestic sales of capital goods were still down on their pre-pandemic level by one-quarter.

*Massive drop in investment*

Other key reasons are likely to be the deterioration in the medium-term growth outlook and the considerable increase in uncertainty, which are weighing on enterprises' propensity to invest.<sup>12</sup>

*Sharp drop in private consumption; clear recovery over the course of the quarter*

Out of the expenditure components, private consumption was immediately hit hardest by the containment measures. Various consumption options were temporarily eliminated or severely hampered. As a result, the saving ratio already jumped to almost 17% in seasonally adjusted terms in the first quarter, compared with around 13% in the preceding quarters. It is likely to have remained at an elevated level in the second quarter, too. This contrasted with very substantial revenue losses in retail trade and among service providers. In April, for example, seasonally adjusted retail sales were down on their pre-pandemic level by around one-fifth and the number of new motor vehicle registrations was down by roughly three-quarters. Following the easing of restrictions, retail sales rose steeply until June, probably partly owing to catch-up effects. By contrast, the passenger car market recovered only partially. Income losses and heightened concerns about unemployment are likely to have left a mark here.

Foreign trade was very slow to recover following the severe slump in March and April. This is especially true of trade with non-euro area Member States, whereas intra-trade regained its footing somewhat faster. This is consistent with the fact that the pandemic recently appeared to be largely under control in the EU, while the number of new cases was increasing in many parts of the world. Towards the end of the quarter, trade with non-euro area Member States only reached 85% of the pre-pandemic level. The sluggishness in sales was broadly spread across regions, with losses in trade with the United Kingdom being particularly high. Exports to China were a notable exception, even seeing a quarter-on-quarter rise in the second quarter. That said, exports to China had fallen considerably in the first quarter as the pandemic had broken out earlier there.

*Major strain on foreign trade*

Although industrial output picked up again after restrictions were lifted – in some Member States, all non-essential production had been halted temporarily – and adjustments were made to comply with increased hygiene requirements, recovery was still sluggish. Capacity utilisation in the manufacturing sector rose by only 4 percentage points to 72% between April and July, thus remaining well below its long-term average of just over 80%. Con-

*Slow recovery in manufacturing*

<sup>12</sup> For more information on the impact of uncertainty on investment activity, see Deutsche Bundesbank (2016) and (2018).

sumer goods output remained quite robust, but the situation of many manufacturers of intermediate and capital goods remained poor, not least because of their greater dependence on global economic developments. The automotive industry, whose output in June reached three-quarters of the pre-crisis level, remained particularly affected.

*Large differences in economic recovery within services*

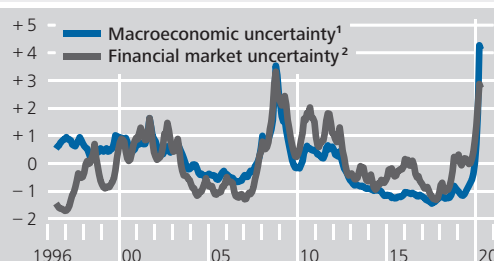
A distinction should be made between services in those areas which remain subject to significant administrative constraints or are avoided by consumers for precautionary reasons or due to inconvenience, and those in sectors which have not been subject to any notable restrictions or for which these restrictions have since been largely lifted. Among the latter, large parts of the bricks-and-mortar retail sector recovered and mail order business remained extremely buoyant. A number of customer-related services were also able to resume their activities after taking into account hygiene requirements. The information and communications sector was only marginally affected by the crisis. By contrast, activity in the hotel and restaurant sector remained considerably depressed. The recovery in business-related services, which include trade fairs and employment services, has also been weak so far.

*Particularly sharp decline in Spain's GDP*

No euro area country was spared the economic consequences of the pandemic. There were, however, significant differences depending on the prevalence of the infection and the nature and duration of the measures taken. Spain saw the sharpest drop in economic activity, where GDP in the second quarter was down by 18½% on the quarter. The main reason for this was that significant restrictive measures were in force for three months until the end of June. As a result, international tourism, which accounts for a major share of the Spanish economy, came to a standstill in the second quarter. The number of international visitors in that quarter was only around 1% of the corresponding figure for the previous year. Manufacturing and construction also suffered considerably. The crisis had a severe impact on the labour market

### Measures of uncertainty for the euro area\*

Monthly data



Source: Bundesbank calculations based on data from Eurostat, Haver Analytics, Global Insight and the Fama/French Data Library. \* A rise (fall) in the standardised indicators implies an increase (decrease) in uncertainty. Data for the period up to April 2020 are presented. **1** Based on the volatility of forecast errors of a comprehensive economically relevant dataset. **2** Based on the volatility of forecast errors of a great number of financial market variables.

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despite extensive measures to safeguard jobs, such as extending short-time working benefits. Between March and June, employment fell by just under 7% in seasonally adjusted terms.

According to an initial estimate, economic output in France contracted by almost 14% in the second quarter. One reason for this was that activities outside the services sector, such as in the construction sector, were also severely restricted at times. The economy made some progress in recovering as restrictions were gradually lifted. According to the Banque de France, economic activity was 9% below normal levels in June, after having lagged by 27% in April.<sup>13</sup> The situation on the labour market also saw a slight improvement. The number of short-time workers fell considerably in June, and the unemployment rate also declined somewhat.

*Gradual recovery in France following sharp downturn*

At 12½%, the drop in overall economic activity in Italy was actually smaller than in Spain and France despite the pandemic having prompted particularly strict measures very early on. Some of these measures were soon eased again, however, which is why the immediate drop

*Sharp decline in Italy's GDP giving way to fairly strong recovery*

<sup>13</sup> For more information, see Banque de France (2020a). In July, the lag behind the normal level narrowed to 7%. August is showing signs of stabilisation or a slight improvement (see Banque de France (2020b)).

## How the coronavirus pandemic has impacted on the convergence process of the central and eastern European EU Member States

The central and eastern European EU Member States<sup>1</sup> had continued to experience quite strong economic growth up until the outbreak of the COVID-19 economic crisis. Real gross domestic product (GDP) in this group of countries rose by 3.6% in 2019, following growth of 4.5% the previous year. Gross fixed capital formation, in particular, increased by a substantial 8.4%, aided in part by the inflow of EU funding. Unemployment rates fell to new lows, such as 2.0% in the Czech Republic or 3.3% in Poland, and wages, measured in terms of gross wages and salaries per employee, were up by 7.9%, almost as much as in the previous year.<sup>2</sup> This meant that wage growth again significantly outpaced productivity growth, which averaged 3.5%.<sup>3</sup>

Consumer prices, too, picked up significantly, especially in the non-euro area central and eastern European EU Member States. Five countries exceeded this year's reference value of 1.8% in the regular convergence assessment.<sup>4</sup> Only Croatia fulfilled the criterion.<sup>5</sup> Moreover, in Poland, Romania and Hungary, inflation rates exceeded the respective monetary policy target corridors.<sup>6</sup>

Their strong GDP growth enabled the central and eastern European EU Member States to make further progress in convergence last year. They once again perceptibly reduced the gap between their incomes and the EU average. Measured in terms of nominal per capita GDP, in 2019 this group of countries attained 47.6% of the EU average, following 46.1% in 2018. In real terms, i.e. as measured by per capita GDP in purchasing power standards, this was 74.8%,

compared with 73.1% in the previous year. The Czech Republic remained the country showing the greatest convergence, at 92.6% of the EU average per capita GDP, followed by Slovenia at 87% and Estonia at 83.2%. The figure for both Poland and Hungary was just over 72% of the EU average. Romania made the greatest progress, advancing by 3.4 percentage points to 68.9%. In addition, according to the World Economic Forum (WEF) competitiveness indicator, locational conditions in most of the countries in this group improved as well.<sup>7</sup> This meant that the conditions were in place for further progress towards convergence.

However, the outbreak of the coronavirus pandemic brought the positive economic

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<sup>1</sup> This group of countries comprises five EU Member States that belong to the euro area (Slovenia, Slovakia, Estonia, Latvia and Lithuania) and six other EU Member States (Poland, Czech Republic, Hungary, Romania, Bulgaria and Croatia).

<sup>2</sup> Aggregate of countries excluding Romania, where wage growth was overstated by one-off developments. The rate of average wage growth for this group of countries is calculated by weighting gross wages and salaries per employee (in local currency) with the relevant employment shares. See Deutsche Bundesbank (2019).

<sup>3</sup> Average productivity growth for this group of countries is calculated by weighting the growth rates of real GDP per employed person in the countries in question with the relevant employment shares. Whether Romania is included or excluded is largely inconsequential.

<sup>4</sup> The 12-month average inflation rates were 2.6% in Bulgaria, 2.8% in Poland, 2.9% in the Czech Republic, and 3.7% in both Hungary and Romania.

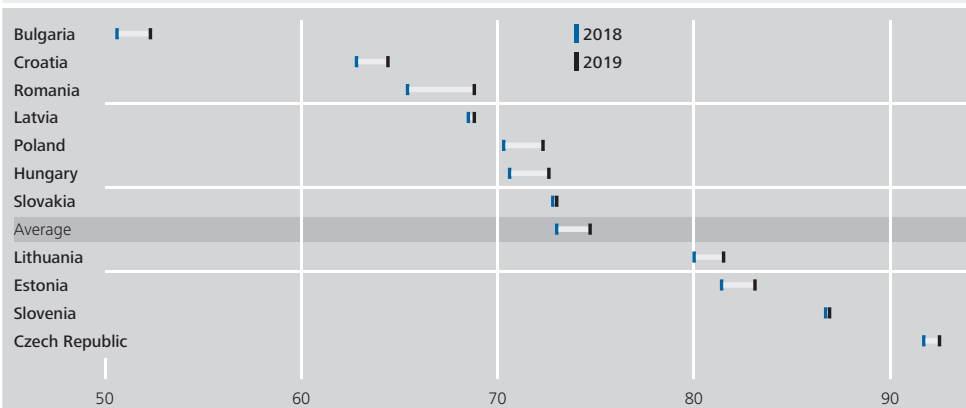
<sup>5</sup> See European Central Bank (2020b).

<sup>6</sup> Based on national consumer price indices, the rates of change of which can vary slightly from HICP inflation rates.

<sup>7</sup> The WEF's Global Competitiveness Index 4.0 assesses locational conditions on the basis of institutions, policies and other factors that can impact on productivity. Cross-country averages were calculated based on population shares. For more information, see World Economic Forum (2019).

### Per capita GDP in central and eastern European EU Member States

As a percentage of mean per capita GDP in the EU,<sup>1</sup> purchasing power adjusted



Sources: Eurostat and Bundesbank calculations. <sup>1</sup> EU-28 including the United Kingdom.  
 Deutsche Bundesbank

development to an abrupt halt. The central and eastern European EU Member States saw a need to impose quite stringent prevention measures early on. According to the Oxford University index,<sup>8</sup> the measures taken in those countries were often even more stringent than in Germany, for example. Economic activity, especially private consumption, suffered considerably as a result. To make matters worse, the economic situation in all EU partner countries suddenly soured. In addition, the European automotive industry, in the value added process of which these countries had been becoming increasingly incorporated, was particularly hard hit by the crisis. As a result, as early as in the first quarter of 2020, GDP in this group of countries as a whole contracted by 1.3%. Quarterly rates of change of GDP ranged from -5.2% in Slovakia to +0.3% in Romania as well as Bulgaria.

In the second quarter, GDP growth in all the countries under review is likely to have shrunk significantly. Although measures to contain the pandemic were eased during the second quarter, and economic activity subsequently picked up again, economic indicators have so far shown only a partial recovery following the sharp declines in

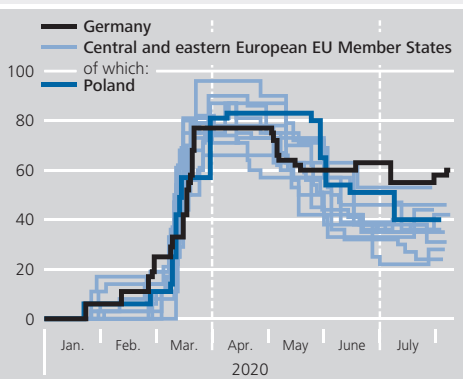
March and April. They are still well short of their pre-pandemic levels in many places, particularly for exports and industrial production. This was particularly because the automotive industry is of major importance in some countries, particularly in Slovakia and the Czech Republic. In addition, tourism, which had been particularly affected by the pandemic, is a key economic activity in a number of countries, including Croatia, Hungary and Bulgaria. It must be said, however, that, compared with the contraction in GDP in the EU as a whole, the average combined GDP of the central and eastern European EU Member States contracted somewhat less sharply.

The crisis also led to a deterioration in the labour market situation in the central and eastern European EU Member States. The unemployment rate went up in the second quarter to 4.4%. Consumer price inflation fell markedly in the second quarter, to 2.7% in the region's non-euro area Member States and to as little as 0.5% in the region's euro area Member States. Here, the decline in crude oil prices was passed through in

<sup>8</sup> Oxford COVID-19 Government Response Tracker.

### Stringency of government containment measures

Index values, daily data



Source: Oxford COVID-19 Government Response Tracker.  
 Deutsche Bundesbank

full without being dampened by a currency depreciation.

The monetary and fiscal policy response to the coronavirus crisis in these countries was essentially similar to that in the rest of the EU. Central banks cut policy rates and took a combination of measures intended to strengthen the liquidity of the banking sector and facilitate banks' lending to enterprises. Governments, for their part, attempted to contain the impact of the crisis on the economy through economic stimulus packages and guarantees for enterprises, along with other measures to stabilise income and employment. However, fiscal leeway was, in some cases, quite limited. According to OECD estimates, national fiscal measures in Bulgaria and Romania, for example, were limited to just over 1% of GDP.<sup>9</sup> In the other central and eastern European countries, they were significantly larger.

In order to overcome the COVID-19 crisis, central and eastern European countries have also, since the early stages of the crisis, been receiving direct EU assistance, such as the newly created EU short-time work programme SURE. In July, the Euro-

pean Council decided to provide additional financial assistance to cushion the effects of the pandemic, of which €672.5 billion will be provided under the Recovery and Resilience Facility (RRF)<sup>10</sup> (see the box on pp. 78ff.). As the distribution of funds is also based on per capita GDP, the shares of the central and eastern European EU Member States are comparatively large. Just over one-quarter of the RRF assistance is earmarked for them. As a percentage of GDP, this assistance would account for around 10% of gross national income for Slovenia, the Czech Republic and Estonia, 11% for Hungary, 12% for Lithuania and Poland, around 13% for Latvia, Slovakia and Romania, just under 17% for Bulgaria and just under 18% for Croatia. The EU assistance motivated by the economic crisis is likely to more than offset the expected decline in regular EU funding for the central and eastern European EU Member States entailed by the 2021-27 multiannual financial framework (MFF) and contribute to stabilising the economic situation.

On the whole, it appears possible that some of the central and eastern European EU Member States have been better able to get through the crisis than some of the older EU Member States. Assistance from the EU budget could be a major factor here. In the medium term, central and eastern European countries could also benefit from the fact that enterprises have been responding to the experience of the crisis by reorganising international supply chains and further diversifying their supply chains.

<sup>9</sup> See OECD (2020).

<sup>10</sup> See European Council (2020).

was deeper yet the subsequent recovery was quite strong, as seen in industrial output, construction output, retail sales and motor vehicle sales. The total number of hours worked had already fallen considerably in the first quarter. Employment also went down, although this decline was tempered by government measures to safeguard jobs. According to the monthly data provided by the Italian National Institute of Statistics (Istat), the decline in employment has recently weakened significantly.

*Strong GDP losses in other Member States, too*

Belgium and Portugal similarly saw very severe GDP losses. In Austria, GDP contracted on a scale similar to that in Germany. In other euro area countries, the drop in activity was more moderate, ranging from 8.5% in the Netherlands to 3.2% in Finland.

*Labour market situation deteriorated further*

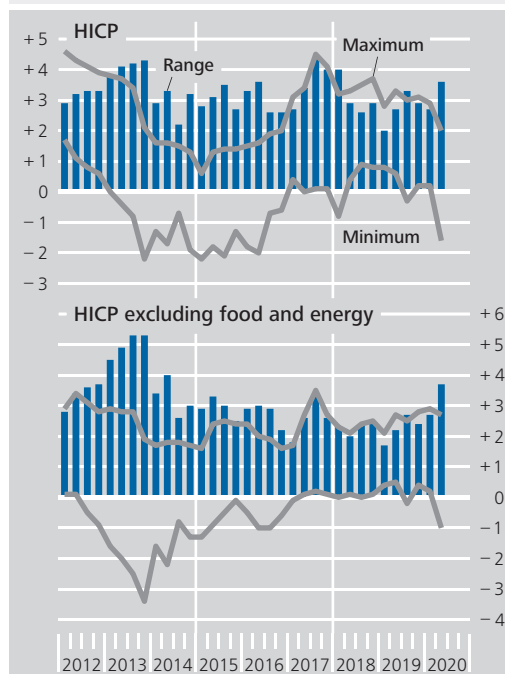
As a result of the deterioration in labour markets in many countries, the number of persons in employment in the euro area fell in the second quarter by a seasonally adjusted 2.8% on the quarter. The standardised unemployment rate rose by 0.6 percentage point to 7.8% between March and June. The reason that this severe crisis has not left a deeper mark on the unemployment figures is probably because some of the restrictions were considered to be of a temporary nature. Existing or newly established government programmes provided support in maintaining employment. In addition to a wide variety of short-time working arrangements, these also comprised liquidity assistance for enterprises including social contribution deferrals. However, it is likely to have become much more difficult to find a job for those who lost their jobs or for those looking for a job for the first time. According to European Commission surveys, labour shortages in manufacturing and services had fallen by July to their lowest levels since 2014 and 2010, respectively.

*Euro area consumer prices down in Q2 due to energy*

In the second quarter, consumer prices fell markedly on the quarter after seasonal adjustment. This was chiefly attributable to the decrease in energy prices. By contrast, food prices, particularly those for unprocessed food,

### Range of national inflation rates in the euro area\*

Year-on-year percentage rates, range in percentage points, quarterly data



Sources: Eurostat and Bundesbank calculations. \* Highest and lowest inflation rates of all Member States.  
 Deutsche Bundesbank

rose sharply. Services prices were also up markedly, while prices for industrial goods excluding energy remained virtually unchanged. The general rate of price increase as measured by the year-on-year increase in the Harmonised Index of Consumer Prices (HICP) fell very significantly from 1.1% to 0.2% in the second quarter. By contrast, the inflation rate excluding energy and food declined by only 0.2 percentage point to 0.9%. If volatile components such as travel services as well as clothing and footwear are also factored out, the rate remains at 1.1%. The measurement uncertainty caused by the pandemic declined significantly over the course of the second quarter.<sup>14</sup>

The range of national inflation rates widened by 1 percentage point in the second quarter

<sup>14</sup> The share of goods and services for which prices had to be estimated ("imputed") narrowed from 32% in April to 11% in June (see Eurostat (2020)). Initially there had been major limitations on measuring prices, especially for travel and cultural services.



*Range of national year-on-year rates widening*

and spanned from -1.6% in Cyprus to 2.0% in Slovakia. The energy component was not the only factor behind this larger spread: the core inflation rate excluding energy and food also diverged somewhat more broadly, from -1.0% in Cyprus, where prices for travel services fell markedly, to 2.7% in Lithuania.

*Prices up slightly in July chiefly due to industrial goods excluding energy*

According to Eurostat's flash estimate, seasonally adjusted consumer prices in July rose slightly on the month. Likewise, the year-on-year figure of the HICP increased somewhat, from 0.3% in June to 0.4% in July.<sup>15</sup> The core inflation rate excluding food and energy even expanded considerably from 0.8% to 1.2%. This was due, in particular, to the later and weaker summer sales effects in individual Member States compared with the previous year. This development masked the slowdown in the rise in prices for services and the price-dampening effect of the reduction in VAT rates in Germany.

*Although strong GDP growth is expected in Q3, recovery will be slower over the course of the quarter*

Given that the euro area economy had already recovered significantly in the course of the second quarter, real GDP is expected to surge in the third quarter. Nonetheless, this will not offset the losses from the first half of the year. Rather, the recovery is even likely to progress much more slowly over the remainder of the third quarter than in the May to July period. With the areas in which restrictions have been

lifted or largely eased having mostly returned to normal, the remaining restrictions and voluntary precautionary measures are weighing on the economy. Moreover, given the dynamic nature of the pandemic in many places, there are still no signs of a comprehensive improvement in the global setting. The surveys also paint a mixed picture. Although the Purchasing Managers' Index for the economy as a whole has risen strongly again in recent months and recently exceeded the expansion threshold,<sup>16</sup> the European Commission's surveys indicate that sentiment amongst enterprises and households remained subdued despite some improvement. Confidence in manufacturing and services also remained well below its long-term average in July. Furthermore, it remains to be seen how effective the measures taken in many places to stabilise the economy and the labour market will be. Their full effect will only be seen once Member States have succeeded in keeping the pandemic under control in the euro area and other parts of the world are able to contain it.

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<sup>15</sup> The share of imputed HICP data in July stood at 3%.

<sup>16</sup> At the current end, the interpretation of this metric is made more difficult by the fact that many respondents appear to assess production growth over a longer period of time than intended by the question, which is aimed at a month-on-month comparison. For example, the index did not exceed the "expansion threshold" of 50 points until July, despite the economic recovery in the preceding months.

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