

Deloitte Banking Alert

September 2020

ECB: Most of the economies will not return to their previous performance peaks until late 2022

A new working paper issued by the **ECB presents the COVID-19 recovery and recession forecasting**. The document reports that **most of the countries have already entered into deep economic crisis and will not return to their previous performance peaks until late 2022**. Much will depend not only on the evolution of the pandemic and effective therapeutic and vaccine deployment, but also on the monetary, fiscal, trade, and regulatory policies that are pursued. ECB, policymakers and commentators are thus examining previous episodes in search of an effective response. **The goal of this paper is to consider simple methods that can improve the nowcasts and forecasts specifically during the Covid-19 crisis and recovery period**

Another Great Recession?

A rationale to build forecast adjustments for the Covid-19 crisis on the Great Recession lies in similarities between the two downturns. **Although the Great Recession and the Covid19 crisis are due to different shocks, yet, they also share similarities**. First, the uncertainty has increased in both episodes implying negative and long-lasting effects on real activity. Second, **in terms of size of the implied demand and supply shocks the Great Recession is the most similar event to the Covid-19 crisis in the past decades**. Thus, the ECB believes that the performance of nowcasting models during the Great Recession could be informative for the Covid-19 crisis, which is indeed what we find empirically, at least for 2020Q1.

A similar finding also emerges when we replicate the analysis for the other G7 countries, with a similar timing. **Moreover, the drop in GDP growth in 2020Q1 is expected to be particularly**

severe in France, Italy and the UK, limited in Japan, and intermediate in Germany. The cross-country heterogeneity is evident also in the forecasts, with the first group of countries experiencing a very slow recovery and Japan a stronger recovery.

Predicting the Covid-19 effects on investment

All models predict an important decrease of the US investment growth in the first quarter of 2020. The predictions are between -18%, -12% and -11%. These values turn out to be too pessimistic, while the average forecast corresponds almost exactly to the actual observed decrease of -8.2%. **Most of the models, and averaging, predict a quite persistent effect of the pandemic shock since the pre-Covid investment level will be only achieved during 2022.**

The results of the forecasts **predict a very slow recovery for France, Italy and UK, and a faster recovery for Germany (comparable to the US) but with a new slowdown predicted for 2022, and Japan a stronger recovery.** These results seem in line with the extent of the spread of the disease and the differential policy responses in the countries under analysis

Conclusions

The adjusted growth nowcasts for 2020Q1 get closer to the actual value, and the adjusted forecasts based on alternative indicators become much more similar, all **unfortunately indicating a much slower recovery than without adjustment and very persistent negative effects on trend growth.** Similar findings in terms of bias of the unadjusted Covid-19 growth nowcasts and forecasts, and ranking and effects of the various adjustments methods, also emerge for the other G7 countries, with some interesting cross-country differences such as the **expected faster recovery in Germany and slower in France, Italy and the UK.**

The results are also similar for US private investment, a main driver of business cycle fluctuations. IP turns out to be the most reliable indicator, given timing, and intercept adjustment produces a precise nowcast for 2020Q1 and lowers the forecasts for the subsequent two-year period, in line with those for GDP growth.

For further questions regarding the aspects mentioned in this alert, please don't hesitate to contact us.



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