



**RESEARCH &  
INSIGHTS**

**COVID-19: THE WORLD AFTER THE PANDEMIC**

As of 28th April 2020



**-2,5%**

Global GDP growth  
in 2020



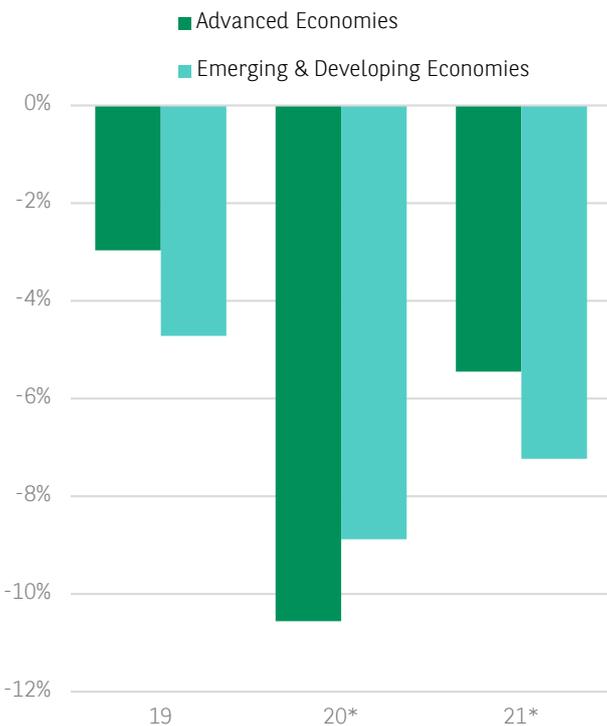
**85.3%**

World sovereign debt  
in 2020 (as % of GDP)

BNP Paribas - April 2020

International Monetary Fund, BNP Paribas Real Estate - April 2020

**Estimation of future deficit (as % of GDP) around the world**



Sources: International Monetary Fund, BNP Paribas Real Estate - April 2020

**Key Messages**

- Most European countries are past or at the peak of COVID-19 infection and their governments are now looking towards strategies to reactivate their economies. Whilst lockdown measures will be eased, social distancing may still apply, leaving businesses vulnerable. This is likely to mean that governments will maintain very ambitious measures to support their economies.
- Governments have large stimulus packages already in place to support the private sector through the paying of wages and supported employment schemes. More could be announced.
- Policy responses should be effective in supporting the economy. Nonetheless, global GDP may contract by 2.5% in 2020 before recovering sharply in 2021 to 5.6%.
- Expected disinflation in the short term. In the longer term, the range of potential inflation outcomes has widened as a result of COVID-19.
- Coherent international cooperation has been largely absent since the beginning of the crisis. European Union (EU) members have struggled to create a common approach.
- The EU will support members through the European Stability Mechanism (ESM) and will tolerate breaches of the Maastricht criteria on debt. Over the longer term this will test European solidarity and calls for reform may go unheeded.

## A long period of uncertainty

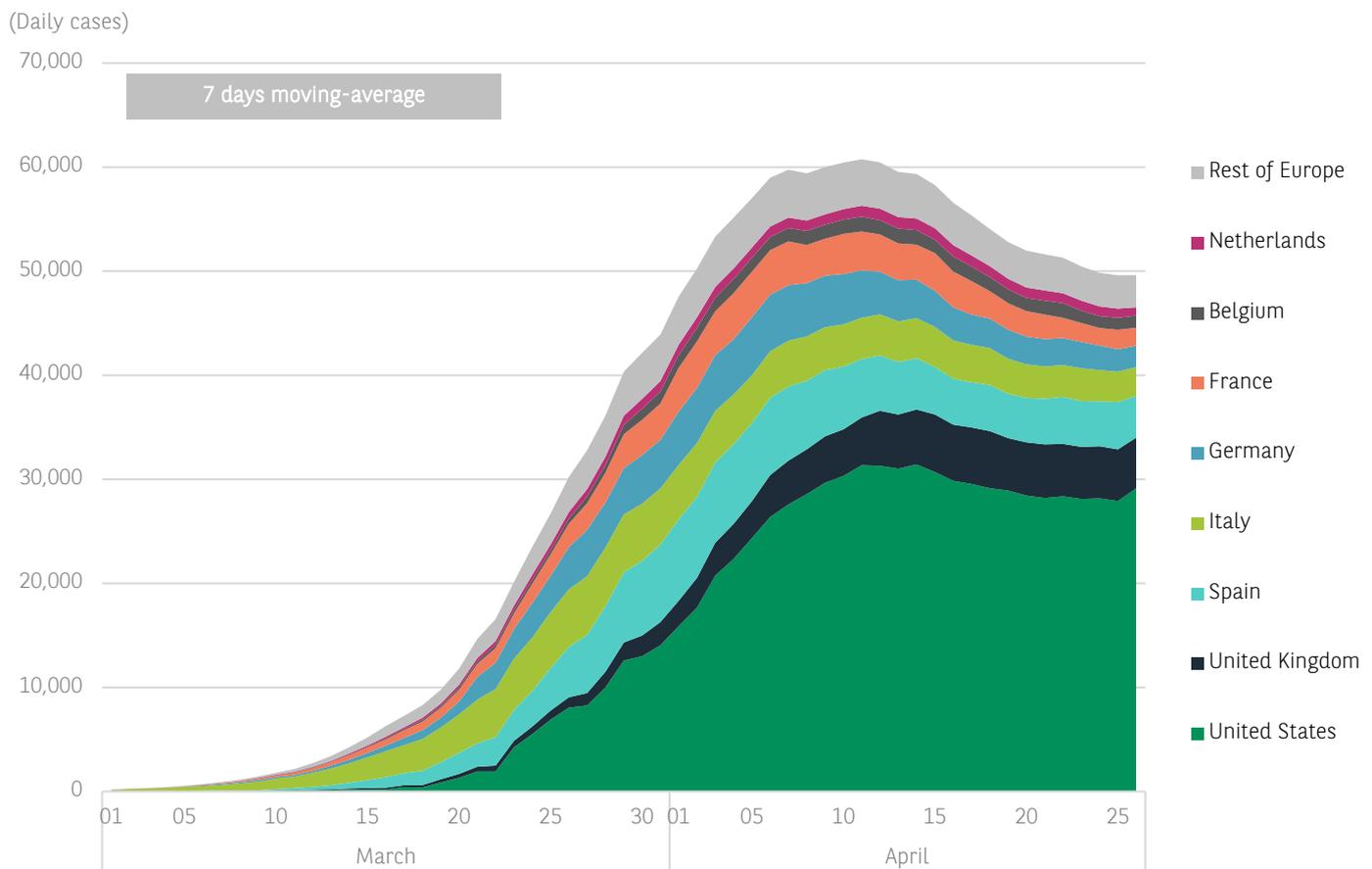
Stricken by the initial shock last month, the world is now facing a long period of uncertainty. Most activity and demand stopped overnight, pushing companies towards unknown horizons.

When a shock occurs, we tend to look for similar historic events. However, with the exception of the First and Second World Wars, the modern global economy has never really stalled for a long period of time. The ability to calibrate an economic model to estimate the potential damage is therefore highly limited. The only option is economic theory and thought experiment: understand what is currently happening and evaluate the different responses and their theoretical impact on the global economy.

## From easing infection rates to easing lockdowns

Since the beginning of March, many economists around the world have become amateur epidemiologists. Understanding how the virus is spreading, its rate of infection and mortality rate are important to fully estimate the economic implications. Fortunately, the infection curve seems predictable and is looking quite encouraging for many countries, particularly in Europe.

### Figure 1: Daily infections in Europe and in the United States



The prevalent approach to stopping the spread of the virus has been through lockdown (partial or total), thus restricting all movements and interactions. The impact on economies and public finances is immense. As Europe moves beyond its peak of daily infections and deaths, exit strategies are now becoming the focus of government attention. Several countries are making plans to wind down containment and ease lockdown measures; Austria, Denmark and Norway have been the first to loosen their measures, while Germany, France, Spain and Italy are likely to follow soon.

However, despite the end of lockdown measures, the virus will still be part of our life. The second wave of infections in Japan and Singapore reminds us that the only way to eradicate COVID-19 will be through an effective vaccine. Thus, whilst lockdown measures will be eased, social distancing may still apply, leaving businesses vulnerable. This is likely to mean that governments will maintain very ambitious measures to support their economies.

## Keynesian policies make a return

The ambitious and necessary measures of governments are aimed at directly supporting jobs and salaries in the real economy. This aspect makes the COVID-19 crisis different from the GFC of 2008. Even though severe adjustments in the financial markets were witnessed in Q1 2020, this crisis has not originated from the financial sector.

The lockdown measures and the loss of consumer confidence have seen consumer demand shrink enormously. This has forced governments to take unprecedented steps to protect economic agents, both businesses and households, by preserving jobs and income. Large stimulus packages are already in place and more could be announced.

The main central banks were the first to announce economic measures to improve the sentiment of investors and give considerable leeway to governments. They announced emergency securities' purchase programmes (sometimes open-ended, as with the Federal Reserve) and major rate cuts.

The policy measures announced by governments have been equally significant and timely, providing further support to businesses and households. The measures are similar across regions and involve a mix of liquidity and solvency measures. They can be boiled down into two types: (1) direct intervention in the economy to support households and private consumption, and (2) the guarantee of credit lines for businesses. The existence of 'automatic stabilisers' that counterbalance fluctuations in GDP, such as the benefit system (including progressive taxation and unemployment benefits), is also driving the response of governments.

In Europe, government intervention and income protection is already the norm. However, reinforcement and simplification of existing policies may be needed to support households and businesses more efficiently. This includes:

- short-time working schemes
- suspension of mortgage payments
- increase in existing social allowances
- investments into the private sector

European countries seem to have mainly concentrated on credit provisions and public guarantees for companies. The objective with these types of measures is to provide companies with credit which, currently, banks and capital markets are not facilitating. This means that companies will be able to meet their liabilities, thereby lowering the risk of major bankruptcies and any possible knock-on effects for subcontractors and suppliers.

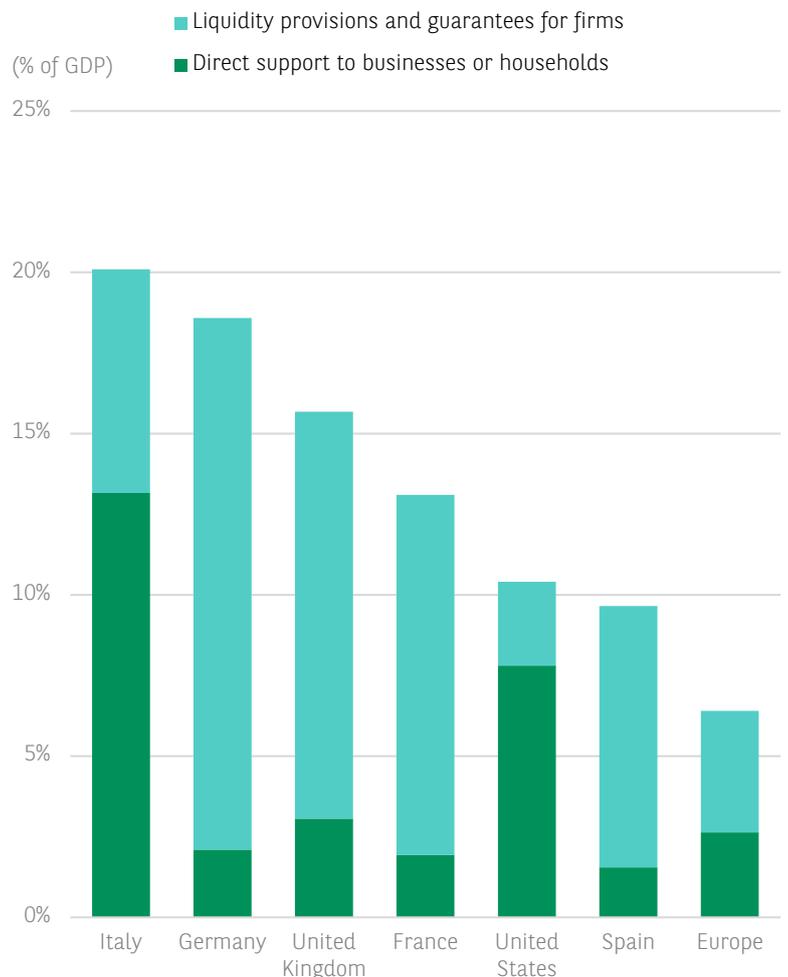
Recently, the Eurogroup decided on a package involving different European institutions. Four policies have been agreed:

1. €500 billion of lending is to be distributed among countries according to their GDP through the European Stability Mechanism (ESM)
2. The European Investment Bank will step in to support small and medium-sized businesses with a guarantee scheme
3. A loan facility has been arranged to support national schemes that protect employment and income
4. The Eurogroup will create a recovery fund to finance new projects to relaunch economies at the end of the crisis

In contrast to Europe, social protection in the United States is quite low and 75% of its bill will be in the form of direct support for households and businesses from federal authorities using the Federal Pandemic Unemployment Compensation (FPUC) scheme. The FPUC is a \$2 trillion programme created under the CARES (Coronavirus Aid, Relief, and Economic Security) Act, signed into law by President Trump on 27 March 2020.

These unprecedented measures taken by governments and central banks seem necessary to support businesses and households in dealing with the economic disruption from the virus. However, the consequences of these fiscal and monetary policies do have implications.

**Figure 2: Announced measures in the main economies (as % of GDP)**

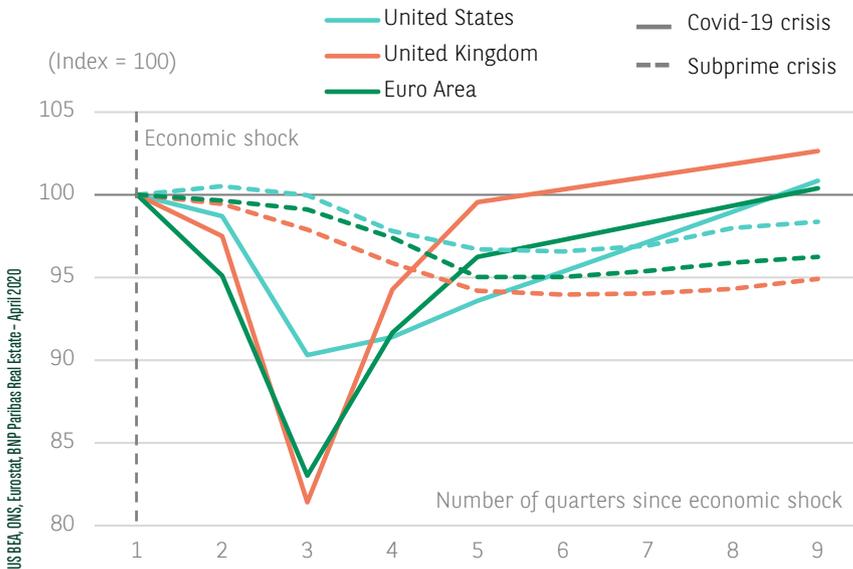


Sources: BNP Paribas Real Estate - Research - April 2020

## Economic implications: a wide range of post-lockdown possibilities

In our base case scenario, we project that global GDP will contract by 2.5% in 2020, recovering sharply in 2021 to 5.6%. Social distancing measures are anticipated to be in place for eight weeks on average (with some variation in duration and extent across countries) before being gradually relaxed. We expect the policy responses to be effective in supporting economies. As a result, household and business sentiment should rebound once the shock fades. The uncertainty surrounding these forecasts is exceptionally high and includes longer-than-expected lockdowns or a second wave of infections potentially dampening the recovery. In both cases, the current policy responses would be less effective, leading to a rise of unemployment rates and more bankruptcies. However, GDP growth is not the only variable affected by uncertainties.

**Figure 3: GDP growth recovery - 2020 vs 2008**



By increasing their balance sheets and buying government bonds, central banks are financing public spending. This is called 'debt monetisation'. The main state interventions will be funded by the issuance of debt that central banks are committed to buy. However, if all the measures put in place either by central banks or governments end up creating inflation, the final impact of lockdown on private consumption becomes difficult to estimate.

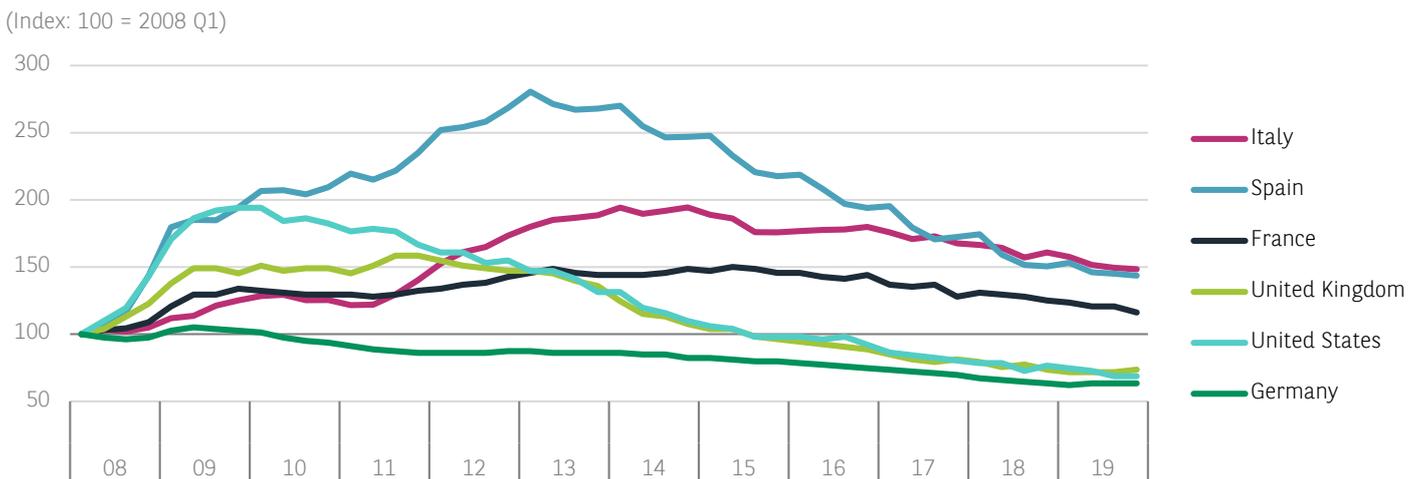
The mid-term outlook for inflation is more uncertain than it has been for years. In the short term, contraction in activity typically leads to disinflationary trends. In the medium to long term, the implications are far reaching, as economies could move from disinflation to a strong increase in prices. Further complications to the inflation outlook would come from a second wave of COVID-19 or an increase in the unemployment rate that a government struggles to reduce. This may impact household confidence, thus preventing big-ticket expenses and increasing saving ratios while leading to decreased demand, which could keep prices low for a long period.

On the other hand, with the low level of supply that we anticipate in the near future and the support of private demand by governments, prices may rise naturally. Moreover, with ongoing discussions about supply chain organisation, we may see some relocation of production sites to higher-cost locations which will impact profit margins and could cause inflationary pressures. Finally, governments may tolerate periods of high inflation as it will reduce the real value of their debt. What this means is that the range of very different inflation outcomes in the medium to long term is wide.

The outcome will be mainly determined by household confidence in the global economy and in their governments. The rise in unemployment in the short term may prevent any strong and quick recovery if household expectations are low, particularly as the recovery of some sectors such as leisure, restaurants or transport will be highly dependent on confidence.

The unemployment falls from the dot-com and subprime crises came years later, and employment took much longer to return to its pre-crisis level. As governments are introducing unprecedented measures to provide protection to their economies, this recession is likely to be short-lived. Once restriction measures are lifted, it will be crucial to boost consumer demand to reverse the increases in unemployment and to prevent confidence being undermined. Exit strategies will be extremely crucial for governments to reassure households and to prevent any possibility of a second wave of infections crippling economies.

**Figure 4: Unemployment rate recovery since 2008.**



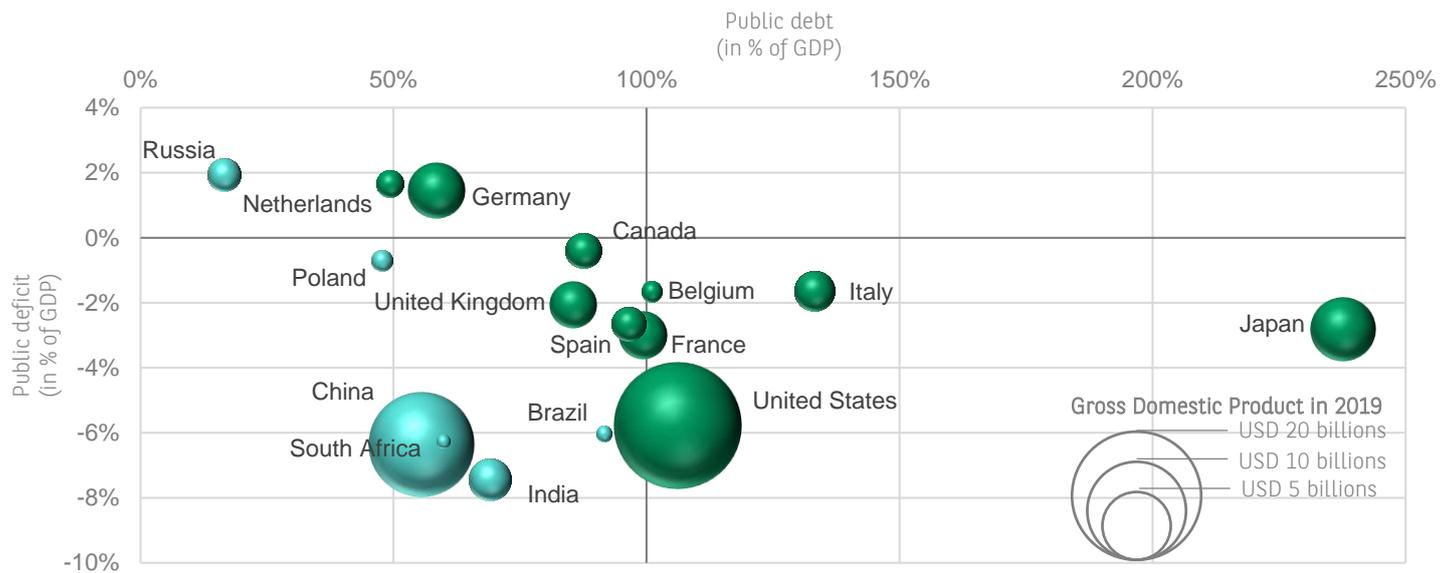
Sources: BLS, ONS, INE, GFEA, Istat, INSEE, BNP Paribas Real Estate - April 2020

The range of economic output is wide-ranging, strongly dependent on how governments handle the sanitary crisis and protect jobs and incomes. However, as the duration of lockdown measures is still uncertain, the final extent of fiscal measures remains difficult to gauge and could be greater than anticipated to support the recovery. On the one hand, the ongoing debt monetisation suggests that the sustainability of measures is not an issue for now. Moreover, as demand for government debt will be high, bond yields should trend lower and governments will then be able to roll over their debt at a lower cost (meaning they can sell new securities to pay for the redemption of maturing ones). However, in the longer term, while some countries may be able to increase their interventions, others might struggle to find lenders and to continue to protect household incomes. As a result, government bonds for weaker economies may increase, leading to a higher cost of debt.

### Political Implications: weakness in international cooperation

Government interventions are being supported by the International Monetary Fund (IMF) and the global level of debt is expected to rise. The current volume of sovereign debt in the world is estimated at 69.4% of GDP according to the IMF. The increase in borrowings by governments will be huge in 2020 and the IMF is already expecting the global level to reach 85.3% by the end of the year. This may raise some questions on the financing and on the risk/return faced by private investors.

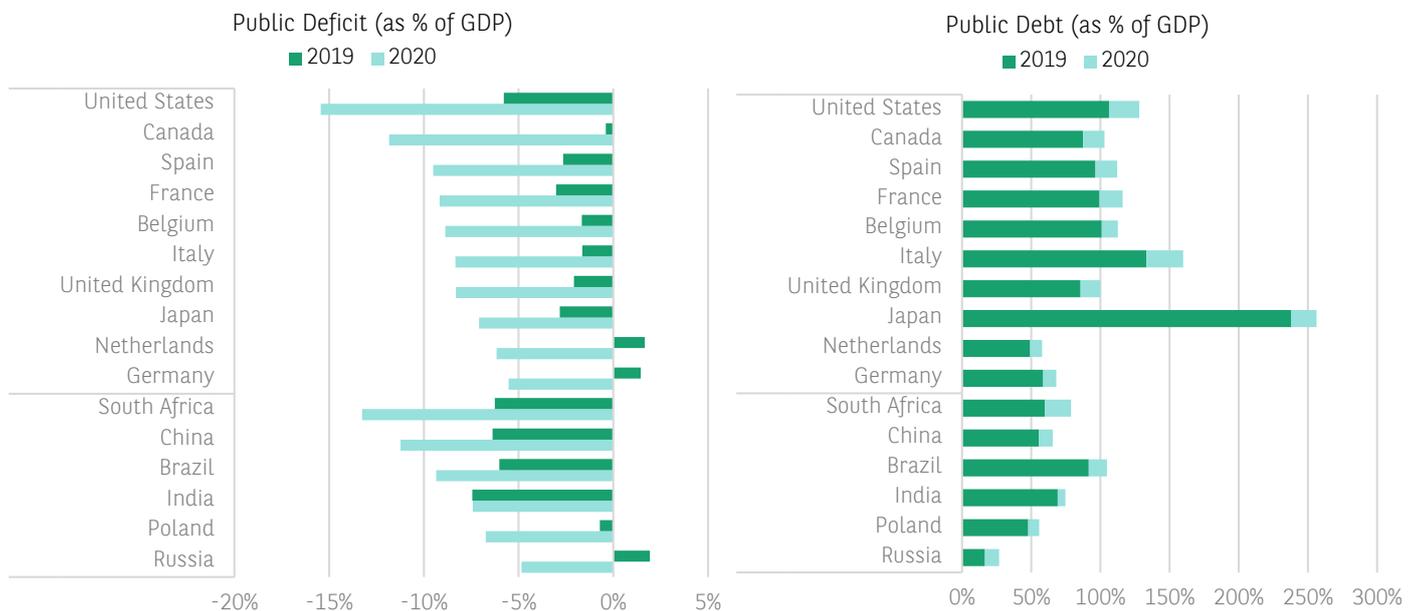
Figure 5: Debt and deficit for the biggest economies in the world in 2019 (as % of GDP)



Sources: International Monetary Fund, BNP Paribas Real Estate - April 2020

The US budget deficit is likely to triple in 2020, from 5.8% to 15.5%. In Europe, deficits will also increase. Germany, for example, will have a negative deficit this year at around -5.5%, a first since 2011. Southern European countries will also widen their deficits, with a fivefold increase for Italy and almost a fourfold increase for Spain.

Figure 6: Estimated government deficit and public debt in 2020



Sources: International Monetary Fund, Consensus Forecast, BNP Paribas Real Estate - April 2020

For advanced and emerging economies, these extraordinary measures may have consequences on the political landscape. The massive issuance of debt to protect economies could have negative consequences along with the nature of responses by governments. Here, the absence of multinational cooperation during the crisis might end up constraining globalisation.

Major damage may be caused to already-fragile public finances. The stronger economies should be able to roll over their debt without too much damage, providing that government bond yields stay low and central banks continue their quantitative easing programmes. However, the worsening public finances of the weaker economies, in addition to diminished global demand and lower commodity prices, could result in some limits to future spending. In the long term, governments will need to curb public spending or increase taxes to recover and ensure debt sustainability.

The role of government intervention after the pandemic will be interesting. Debt monetisation with contained inflation may lead to higher levels of debt. Indeed, countries may be tempted to accumulate more debt as Japan did, with its debt spiralling to 200% of GDP. We could see further government interventions to protect employment or to support consumer demand. Some companies might need more support from their governments to survive, putting them in competition with public services for resources, and probably leading to politically contestable situations.

In the Eurozone, the measures that countries are taking (in terms of deployed spending to protect their economies) are not paying much heed to the Maastricht criteria for Eurozone stability. Although this has been tacitly approved by the Eurogroup, the flouting of the 3% deficit rule risks normalisation. In 2010 we saw a number of countries that were unable to refinance their debt without the help of third parties (like the ECB and the EU), and this created a shock for all countries in the Eurozone. As public debt and deficits grow, we could face another situation where the more fragile economies suffer greater damage than more stable countries.

The Maastricht criteria will not be met for a long time by some countries and the pressure of European institutions on highly indebted members to ensure that their debt is sustainable will create tensions. During the 2010-2012 sovereign debt crisis, we saw the rise of anti-globalisation and anti-European parties as countries struggled with refinancing and faced popular resentment to reform programmes. These concerns may rise again, depending on the global response after the crisis. Calls for reform may go unheeded in many European countries.

Any coherent international cooperation has been largely absent since the beginning of the crisis, which will be a major issue once lockdown measures are lifted. Some emerging countries will need the support of other countries to avoid bankruptcies, major rises in unemployment or even famines. Travel and export restrictions are creating shortages of supply, and prices of essentials products are already starting to soar globally.

Advanced economies are not immune to political risk either. The lack of cooperation for the production or the purchasing of COVID-19 protective equipment or treatments may imply some mistrust in international relations. Governments and companies may also want, in the longer term, to close borders or relocate some production sites, leading to inflationary pressures and greater domestic fiscal spending.

## End of lockdown does not mean end of the crisis

A lot of uncertainties remain. Exit strategies are now being put in place by governments and we should soon have a better idea of the shape of the recovery. Monetary and fiscal measures taken by governments across the globe are protecting the global economy, but their real effect will be only seen in the months to follow. Indeed, the economic (inflation or deflation), social (steep recovery of employment, household confidence) or political (international cooperation, debt management) impacts are still difficult to estimate. Stronger interventions might even be needed for a steeper and faster recovery. One of the only things that we know for sure is that the end of lockdown measures does not mean the end of the crisis.

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European Economist

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