

What Europe's Reopening Means for Economic Growth

Liz: Hi, Jari.

Jari Stehn: Hi, Liz.

Liz: You're the chief European economist for Goldman Sachs Research, and you recently published a report on the economic implications of Europe's reopening. What's your outlook for the economic rebound in Europe?

Jari Stehn: Yes, so we expect Europe to rebound strongly this year. The near term of course remains challenging because you still have elevated infections. We still have restrictions in place. But we're quite optimistic that the vaccine rollout, which is underway, will unlock quite significant pent-up demand as we move into the summer.

So I think the case is clearest in the UK. We've seen falling infections here. The vaccine rollout is progressing well. There's a lot of pent-up demand, so GDP is about 10% below the pre-pandemic levels. And of course the reopening has already begun, and the government has signaled that they want all of these restrictions to be gone by the end of June. And so we think we're set for a very strong rebound in the UK in the second quarter and expect the annual growth number for 2021 to be 7.1%, which is quite sharply above where the consensus is.

Liz: And what about the euro area more broadly?

Jari Stehn: On the euro area, we think things are lagging behind somewhat. So you have infections in some parts of the euro area that are rising again. Some countries have put new restrictions in place. The vaccine rollout is going slower than anticipated. And so we think the reopening in the euro area will happen a month or two after the UK.

But we also think that as we go into the summer that the reopening will unlock services spending to a very significant degree. And we also look for a pretty sharp bounce back both in the second quarter and in the third quarter in the euro area. And is our number for 2021 as a whole for the euro area is 5.1%, which is also above where the consensus is.

Liz: And across the euro area broadly, what are the different regional variations that you expect to see in terms of

economic growth?

Jari Stehn: Yes, the main thing here is really the difference between the north and the south. So we expect Germany to return to the pre-pandemic level quite a bit earlier than the southern European economies. Now, one reason here is that German activity is less reliant on COVID-sensitive activities. So it's more reliant on industrial activity, and that is more geared towards the global cycle which has remind quite strong.

Then Germany has provided quite a bit more fiscal support. Has been able to provide that stimulus to support the economy. And lastly, the reopening in Germany has already started. Whereas in some of the southern European countries such as Italy, we've actually seen a slight tightening in those restrictions more recently. So as a result of that, we think Germany will return to the pre-COVID level of activity already in the third quarter of this year. Whereas Italy and Spain are lagging behind by roughly six months in our forecast.

Liz: And looking across Europe broadly, what sectors do you think are poised to bounce back the fastest?

Jari Stehn: Sure. So manufacturing is already in pretty good shape. If you look at industrial production, for example, in the euro area, that's already close to the levels it was at before COVID. I think that's partly because the restrictions that are in place don't really affect manufacturing as much as they affect services. And also because global the industrial cycle has been pretty strong. And I think the indicators here suggest that the positive momentum in manufacturing has more to run in the near term.

But services activity remains very depressed. That's particularly true of course for the COVID-sensitive parts such as arts, entertainment, travel, which are deeply depressed relative to normal levels. And we think that's of course because the restrictions target those types of activity quite specifically that are still in place. And so in the data, we don't yet see the significant improvement in services activity, and we think it will take time until the restrictions are lifted for those COVID-sensitive parts of services to come back. But at that point, we think they should come back pretty strongly.

And I think what's encouraging is that the forward-looking indicators in the services industry are already moving up. And

I think that's consistent with the idea that we will see a rebound here as we move into the summer.

Liz: So Jari, overall, a pretty optimistic economic outlook for Europe, but what are the risks to your views?

Jari Stehn: I would say, in the near term, the risks are tilted to the downside, particularly in the euro area. And that's really related to the new virus strains that are more infectious than the original strain. It's related to the risk that the vaccine rollout turns out slower than expected. And then ultimately of course related to the risk that the reopening timeline that we discussed earlier, that this is pushed back.

Now, it is important, though, that, if the reopening were to be delayed, that it would lower near-term growth, but we think it would effectively shift that growth into later in the year as long as herd immunity is reached at some point later this year. So I think the key downside risk is really that you are going to see weaker near-term activity, but then stronger activity down the road.

But we also have some upside risks, and here I would flag in particular the consumer where you've seen a very strong accumulation of excess savings. So the kind of forced savings that consumers have done on top of the normal saving behavior. That's worth about 15% of GDP in the euro area, and it's almost 30% in the UK. So there's a lot of saving that's sitting there with households. And in our base case, that saving unwinds fairly gradually, but I think there is a risk that this unwind happens much more quickly. And this could really provide a much bigger boost to consumption than we have in the forecast. And I would flag that as a key upside risk for Europe.

Liz: Thanks, Jari.

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