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SG Economics & Sector Studies

Phase III marks the hard part for policy

- The resurgence of Covid19 has led to renewed restrictions on mobility, and the economic rebound is losing steam in several countries, giving place to what we term phase III of the Covid19 crisis. The first two phases were dominated by a collapse in activity under stringent lockdowns followed by a sharp bounce-back as lockdowns were eased. In contrast, this third phase is characterised by continuous virus circulation and more localised restrictive measures, which could well be with us for much longer.

- With the health crisis still ongoing, measures that were conceived as temporary have been extended to various degrees; and in some instances, not without difficulty. It is nonetheless encouraging to see political consensus emerging across many advanced economies to roll out public investment programs targeting infrastructure and focusing on digital and ecological transitions. Yet, this new phase of the policy response to the Covid19 crisis comes with far greater risks both on implementation and premature cut offs, not to mention that countries with fiscal fragilities are less well-equipped to finance large-scale investment programs requiring sizeable injection of public funds.

- For most advanced countries, we forecast a rebound in GDP after a sharp recession in 2020, but the level of GDP at the end of 2021 will still generally be below its level at the end of 2019. The expected pick up in 2021 is likely to be more pronounced in developing countries. Yet, we do not expect a true "decoupling" in terms of growth given weak prospects for commodity prices and a lack of a growth reservoir in the world economy.

- All the major central banks are set to maintain a highly accommodative policy stance for the foreseeable future.

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EXECUTIVE SUMMARY

World economy

Global GDP returned to positive territory in July and August, as lockdowns were gradually relaxed. However, the resurgence of Covid19 in many places has led to renewed restrictions on mobility, and the economic rebound is losing steam, giving place to phase III of the Covid19 crisis. The first two phases were dominated by a collapse in activity under stringent lockdowns followed by a sharp bounce-back as lockdowns were eased. In contrast, this third phase is characterised by continuous virus circulation and more localised restrictive measures, which could well be with us for much longer.

Policy getting much harder

The third phase brings new policy challenges and places far greater demands on policy as governments and corporates must learn to live with the coronavirus. With the health crisis still ongoing, measures that were conceived as temporary have been extended. France, Germany and Italy have all been successful in securing extensions for their respective worker support schemes, with Italy seeking support from the European Union's new SURE unemployment mechanism.

Yet, common to all countries is the concern that running crisis management support measures for an extended period will translate into higher public debt ratios and add significant strain to public finances. The United States shows an example of how difficult this situation can turn. Upon expiration in July of the supplementary USD 600 per week unemployment benefits, Congress failed to agree to an extension of the temporary relief package due to political gridlock. President Trump signed off on an executive order offering partial relief to unemployed workers (USD 400 per week) sourced from the American disaster relief fund. Households at risk yet face considerable uncertainty, as the fund could run out in a matter of weeks.

Public investment programs hold the key

Policy support for the third phase will have to deal with complex structural challenges. Already before the current crisis, debt levels in most economies were high, not least at the corporate level. Government guaranteed loans and central bank monetary easing has helped firms transit the shock. Yet, a mere extension of government guaranteed loans or various moratoriums will simply see corporates pile on more debt, which will ultimately threaten solvency and weaken potential growth.

Boosting public infrastructure investment, and not least those to aid digital and green transitions is an attractive orientation for the third phase policy.

It is encouraging to see political consensus emerging across many advanced economies to roll out public investment programmes focusing on digital and ecological transitions, such as Europe's "Next Generation EU" recovery plan.

Implementing such programmes in practice, however, brings numerous challenges ranging from the sheer logistics of approving projects, securing skilled workers, and ensuring that the projects selected come with the right enabling policies to secure positive multiplier effects across the economy. Governments must indeed address potential unintended risks associated with such transitions, be it for workers, individual sectors, or global supply chains.

Beyond the risks of implementation and premature cut off, countries with fiscal fragilities are less well equipped to finance these policy transitions and recovery more quickly, as large-scale investment programs require sizeable injection of public funds.

GLOBAL GROWTH: AN UNCERTAIN OUTLOOK

Given the high level of uncertainty regarding the pace of the pandemic, we maintain both a central and extended scenario reflecting different assumptions on the health crisis. Under the central scenario, we assume a gradual return to "normal" life by 1Q22, with disruptions until then due to localised mobility or activity restrictions (rather than economy-wide lockdowns). Under the extended scenario, we assume that health crisis runs an additional year, in this scenario daily life goes back to normal only in 1Q23.

In both scenarios, the world will experience in 2020 the worst economic contraction since the Second World war, clocking at -3.8% in the central and -4.9% in the extended. The world economy will pick up to 5% in 2021 in the central scenario, but remain lacklustre in the extended, at 3.1%.

The expected pick up in 2021 is likely to be more pronounced in developing countries than in advanced economies. Yet, we do not expect a true "decoupling" in terms of growth given weak prospects for commodity prices and a lack of a growth reservoir in the world economy. These factors will not pull up emerging markets, as was the case when China lifted the global economy post the Lehman shock.

The consequences of the Covid19 outbreak for the world economy will be long-lasting. We expect bleak GDP growth figures in 2022/2023 reflecting lower private investment and decreasing productivity gains. The question remains on what lifestyle changes and related spending and saving patterns will become permanent, and how companies will reconsider investment plans, especially in sectors directly hit by social distancing and/or involving higher risk of virus transmission.

Unexpected downsides should not be overlooked, not least from possible discontinuities from corporate bankruptcies. The post-pandemic world is also likely to see geopolitical rivalries, including tensions between US and China on trade and technology. Depressed growth could fuel social discontent and prove a breeding ground for populist policies. This in tandem with lower global policy cooperation will hurt trade and cross border investments, while also hindering efforts to achieve the necessary decarbonisation and combat global warming.

Advanced economies

In most advanced countries, the GDP level at the end of 2021 will still be below its level in 2019, and considerably lower than was expected prior to the pandemic.

Activity in the euro area in 2021 is expected to rebound by 5.8% following the -7.1% contraction in 2020 (central scenario). Out the major euro area members, Germany is expected to recover faster helped by significant fiscal stimulus and to return to pre-pandemic income levels by 1Q23 in the central scenario. Spain and Italy are likely to struggle as high levels of debt leave governments more cautious in offering fiscal support. France is somewhere in between these situations, with the economy boosted by the EUR 100bn Recovery Plan (4% of 2019 GDP).

In the United States, the pace of new jobs growth has been strong after the Covid19 outbreak. However, the Paycheck Protection Program expired end-July and there is a risk that the recovery fades with little new and much needed stimulus in sight, not least given the uncertainty surrounding the 3 November elections. In our central scenario we see GDP slump by -6% in 2020, followed by a modest pickup of 3.7% in 2021.

In Japan, activity has been declining for three consecutive quarters and the contraction recorded during 2Q20 marks the deepest since records began in 1955. The new PM Yoshihide Suga will face tough economic challenges in a recovery that will struggle under Japan's structural issues pre-Covid19 including high levels of public debt and the spectre of deflation. In our central scenario, we expect growth to clock at -5.3% in 2020, and to rebound in 2021 t0 2.2%.

Finally, the United Kingdom faces a challenging recovery which is complicated by the pressures associated with Brexit and the conclusion of the transition period end-2020. We assume a narrow trade agreement with the EU will come into force in 2021, however, a no-deal Brexit is a serious risk. We expect growth at -8.5% in 2020 and a rebound at 5% in 2021.

Emerging Markets

A recovery is now under way following the re-opening of businesses, but uncertainty remains high. Countries like India, Mexico and South Africa witnessed GDP contraction nearing 20% YoY in April-June and will post unprecedented low economic figures in 2020. China will still be the only G20 economy to achieve positive growth this year, although the expansion will be the slowest since 1976. Persistent signs of structural imbalances in China, weak bank balance sheets, and trade tensions with the United States are headwinds. In the post-pandemic era, Asia is expected to remain the fastest growing region in the world, followed by Africa. Latin

America and the Middle East will struggle amid weak commodity prices and the negative economic effects of the Covid19 pandemic.

Countries with good underlying fundamentals benefit now from cheap international liquidity and are rebuilding FX reserves. This situation contrasts that of March/April, when emerging markets had to face record-high capital outflows. Oil-exporting countries with low external buffers remain in a weak situation.

CENTRAL BANKS

By maintain highly accommodative policies, major central banks will continue to contribute to the environment of durably low interest rates. We expect a Fed funds rate target range at 0.00-0.25% until at least 2023. The Fed announced a new monetary policy strategy, which signals a Fed that will be far less proactive in tightening policy once recovery takes root. The ECB is also favouring ample liquidity. During the Monetary Policy Council of 10/9, President Lagarde emphasized the double function of the PEPP (which is now replacing the MTOs), namely stabilising markets and guaranteeing the re-convergence of inflation to the ECB target. Even with regards to the value of the USD, it is clear that the ECB is keen to let the markets know that it has many tools left available to support the economy if needed, notably the case of a euro appreciation translating into deflationary pressures.

The new round of monetary easing favoured a rebound in equities, high-yield bonds, and emerging market-assets after the market collapse in March/April. Yet, risk aversion has increased since the beginning of September with growing concerns about a second wave of Covid19 infections and with regards to doubts of the underlying strength of economic recovery, probably overstated on current asset valuations.

ECONOMIC FORECASTS

Real GDP growth (annual, %)

	2019	2020f		2021f		2022f		2023f	
	Actual	Central	Extended	Central	Extended	Central	Extended	Central	Extended
Developed Markets	**1.7**	**-6.3**	**-7.3**	**4.1**	**1.7**	**1.9**	**3.5**	**1.9**	**1.9**
United States	2.3	-6.0	-7.1	3.7	1.0	2.8	4.7	2.4	2.2
Japan	0.7	-5.3	-6.7	2.2	-0.5	0.5	2.0	0.5	1.2
United Kingdom	1.5	-8.5	-10.0	5.0	2.0	2.0	4.7	1.8	2.0
Euro area	1.3	-7.1	-8.1	5.8	3.4	1.2	2.8	1.4	1.5
Germany	0.6	-5.5	-6.5	4.0	2.5	1.1	1.9	1.3	1.3
France	1.5	-8.5	-10.0	6.5	4.0	1.0	3.2	1.5	1.5
Italy	0.3	-9.9	-10.9	6.8	3.2	1.3	3.9	1.0	1.6
Spain	2.0	-11.2	-12.5	8.2	3.9	1.9	4.6	1.9	2.8
Emerging Markets	**3.6**	**-2.5**	**-3.6**	**5.5**	**3.9**	**3.3**	**3.7**	**3.5**	**3.4**
Asia	5.1	-0.8	-2.3	6.6	4.8	4.4	4.9	4.4	4.4
China	6.1	2.5	1.1	6.6	4.4	4.8	5.0	4.6	4.7
India	4.2	-7.2	-10.6	8.4	7.6	5.3	6.6	4.5	5.1
CEE	2.1	-4.6	-5.5	3.8	2.7	2.0	1.8	2.4	1.8
Czech Republic	2.5	-6.0	-7.5	5.8	4.0	1.5	0.5	2.0	1.4
Romania	3.6	-6.5	-8.0	5.7	5.0	1.6	1.8	2.0	2.0
Russian Federation	1.4	-3.5	-5.0	2.0	1.5	1.5	0.5	1.5	0.5
Latin America	0.1	-6.8	-7.5	3.6	2.1	1.4	1.9	1.5	1.4
Brazil	1.1	-5.8	-7.2	3.5	2.1	2.3	3.5	2.0	2.0
Middle East & C.Asia	-0.2	-5.0	-5.4	3.7	2.2	1.2	1.4	1.5	1.4
Africa	3.2	-2.8	-3.2	4.6	3.1	2.3	2.6	2.9	2.6
World (PPP weighted)	**2.9**	**-3.8**	**-4.9**	**5.0**	**3.1**	**2.8**	**3.7**	**2.9**	**2.8**

Market variables

end of period	Central 2020f	Central 2021f	Central 2022f	Central 2023f	Extended 2020f	Extended 2021f	Extended 2022f	Extended 2023f
United States								
Fed Funds target (high)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10y government bonds	0.80	0.90	1.00	1.50	0.50	0.50	0.50	0.50
Euro area								
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit facility rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
10y government bonds								
Germany	-0.40	-0.40	-0.30	0.00	-0.60	-0.60	-0.60	-0.50
France	-0.10	-0.10	0.20	0.40	-0.30	-0.20	0.10	0.10
Italy	1.10	1.10	1.70	2.00	0.90	1.15	1.90	1.75
Spain	0.40	0.40	0.80	1.00	0.20	0.35	0.80	0.75
United Kingdom								
Bank rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10y government rate	0.50	0.60	0.70	1.00	0.30	0.40	0.60	0.60
Japan								
BoJ rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
10y government bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

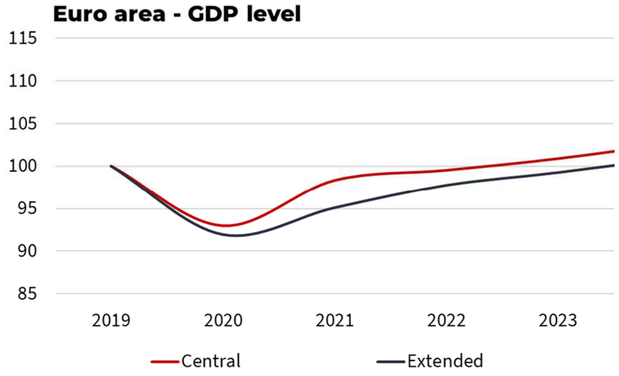
end of period	2020f	2021f	2022f	2023f	2020f	2021f	2022f	2023f
EUR / USD	1.15	1.15	1.15	1.20	1.15	1.10	1.10	1.10
EUR / GBP	0.90	0.95	0.95	0.95	0.90	1.00	1.00	1.00
GBP / USD	1.28	1.21	1.21	1.26	1.28	1.10	1.10	1.10
USD / JPY	110	110	110	105	105	105	105	105
USD / CNY	6.95	7.05	7.10	7.05	7.20	7.20	7.20	7.25
Brent ($/B)	43	45	55	55	39	38	50	50

EURO AREA

- **The recovery in activity will be very gradual in 2021-2022 and it will take several years for GDP to return to its pre-crisis trend**
- **Monetary policy will remain very accommodative and interest rates are set to stay low over the forecast horizon**
- **There are several downside risks; notably financial instability or a surge in Euroscepticism**

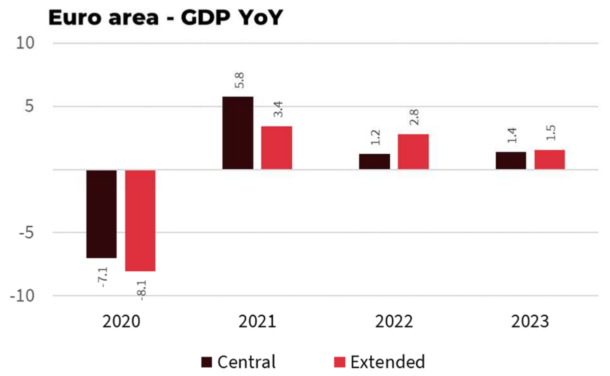
Growth is set to rebound strongly in 2021, mainly on the back of favourable base effects. But sequential growth will remain moderate in 2021-2022. The emergency measures taken by governments in response to the health crisis will have delayed the negative impact of the forced shutdown of the economy on employment and investment. Admittedly, the planned European-wide stimulus will support growth and help ruling out a scenario of an excessively (although present) divergence in the growth paths of the different economies. However, precautionary savings by households and businesses will mitigate the impact of the different stimulus packages. Against this backdrop, GDP will not return to its pre-crisis level before early 2023. In the scenario where the second epidemic wave led to the reintroduction of measures negatively impacting business activity, convergence would be postponed by one year.

GDP will back to its pre-crisis level in early 2023



Source: SG Economic and Sector Studies

Growth to remain moderate until 2023



Source: SG Economic and Sector Studies

World trade will suffer from a very gradual recovery in global activity in 2021-2022. In particular, the absence of a major recovery in China (unlike what was observed after the 2008-2009 crisis) rules out the scenario of a marked rebound in external demand. Exports would therefore show moderate growth over the forecast horizon.

In the wake of the shock recorded in 2020, the rebound in domestic demand will be modest. With the support of various national public guarantee mechanisms, companies will have greatly increased their debt to compensate for the losses linked to the forced shutdown of the economy. In this context, the deterioration in debt ratios, already high in some countries before the crisis, will weigh on the recovery of investment.

On the household side, the rise in unemployment and the moderation of wages will weigh on consumption. The “forced” savings accumulated during the confinement period will certainly not be entirely spent, as precautionary behaviour prevails in an uncertain economic environment. The loss of income and the tightening of the conditions for granting mortgage loans will also weigh on residential investment.

Public demand will be stronger. However, despite the low financing costs of governments, the public debt ratios already high before the crisis in some countries limit the room for budgetary manoeuvre. The subsidies that will benefit Member States as part of the European Recovery Plan in 2021-2023 will finance part of the support measures, which will help to rule out the scenario of a strong divergence in growth trajectories (which will nevertheless be observable).

In the short run, the ECB’s strategy will continue to be dictated by managing the direct repercussions of the crisis (ample supply of liquidity to banks and massive asset purchases). Its balance sheet is set to swell to 55% of GDP in 2020-2021, an increase of 15pp of GDP compared to the start of 2020. In the longer term, any normalisation of monetary policy appears difficult and the risk is tilted towards additional easing measures. Inflation will be low in 2021-2022. Moderate labour costs and weak demand will deter companies from raising prices, while at the same time oil price growth will remain moderate over the forecast horizon. Thus, even if a further drop in the deposit rate seems to have been ruled out for the time being, TLTROs and asset purchases (thanks to an extension and an increase in the size the PEPP) will remain at the heart of the ECB’s strategy (despite the recent decision of the German Constitutional Court).

The main upside risk to our scenario is a faster than anticipated absorption of the health crisis. In parallel, the list of downside risks is long., A deterioration in the quality of bank balance sheets, linked in particular to the rise in corporate debt ratios, will be watched. Similarly, lowering the sovereign rating of the most fragile states would rekindle tensions in sovereign debt markets. Finally, a new surge in Euroscepticism and political risk cannot be excluded, particularly in Italy.

Euro area	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	1.3	-7.1	-8.1	5.8	3.4	1.2	2.8	1.4	1.5
Inflation, %	1.2	0.5	0.4	1.2	0.8	1.3	1.6	1.3	1.4
Unemployment, %	7.6	8.0	8.0	10.2	11.0	10.8	11.4	10.6	11.1
Fiscal balance, % GDP	-0.9	-9.3	-9.8	-6.1	-8.1	-6.0	-7.2	-5.5	-6.6
Public debt, % GDP	89	107	109	109	115	112	117	115	120

Central = Central scenario
Ext. = Extended scenario

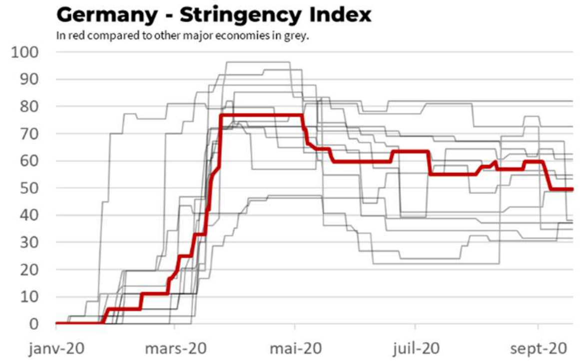
GERMANY

- **Growth will remain moderate despite significant fiscal stimulus**
- **With aggregate demand depressed, core inflation will settle over the forecast horizon**
- **Despite the deterioration of public and private debt ratios, the risks to financial stability are limited**

The recovery will be gradual in the wake of the 2020 recession. Growth will rebound strongly in 2021 mainly due to favourable base effects at the start of the year. But in 2022, the delayed effects of the crisis on jobs, investment and external demand will weigh on activity. Massive government intervention will support growth, but households and corporates precautionary savings will dampen the impact of the stimulus. Thus, GDP will grow only slightly above its potential and will not return to its pre-crisis level before the beginning of 2023 (2024 in a scenario of an extended health crisis).

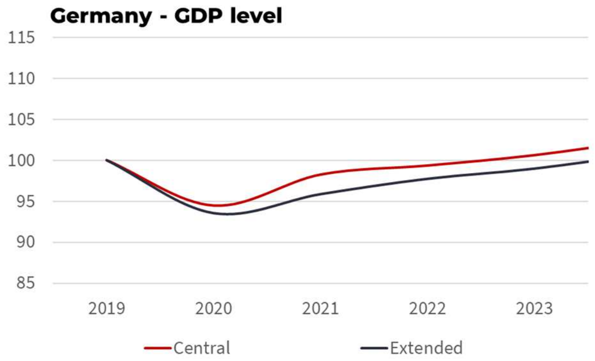
Contrary to the situation observed in 2010, German companies will find it difficult to count on the dynamism of emerging markets to compensate for weak demand in Europe. The magnitude of the recovery will be more modest in China, while several emerging economies are facing a perfect storm. In total, exports will post modest growth in 2021-2022, in line with the trajectory of world trade.

Lockdown was less stringent in Germany…



Source: University of Oxford

… but the recovery is set to be slow



Source: SG Economics & Sector Studies

The subsidies granted and the equity provided by the public authorities will have ruled out the scenario of too great a deterioration in the balance sheet of companies. However, debt ratios will have increased significantly with the interruption of activity in 2020. This factor, combined with the weakness of expected demand and persistent uncertainty, will weigh on the recovery of investment in 2020-2021. On the household side, the rise in unemployment and the decline in per capita income will weigh on consumption in 2021-2022. Growth in housing investment will also be modest for the same reasons, suffering in addition from a likely tightening of credit conditions by banks.

Emergency "Above the line" fiscal measures	EUR/bn
Enhancement of health care provisions	58.5
Economic Stabilisation Fund	100.0
Grants to small and individual businesses	50.0
Total	208.5
% GDP	6.1%
Measures of the recovery plan	
Temporary VAT rate cut (2S-2020)	20.0
Temporary energy tax cut	11.0
Exceptional social benefit (400 EUR per child)	4.0
Stronger incentives to buy electric vehicles	2.2
Tax deferrals for companies	25.0
Exceptional credits to local administrations	13.0
Other spending measures	54.8
Total	130.0
% GDP	3.8%

The increase in public demand recorded in 2020 as part of the emergency measures and the fiscal stimulus will continue to have positive effects on activity. Emergency fiscal measures adopted so far and the recent fiscal stimulus package account for c. 10% of GDP. Public debt will increase by c. 30 points of GDP over the forecast horizon, approaching 90% of GDP in 2023. With slowing aggregate demand and moderating unit labour costs, core inflation will slow over our forecast horizon. With oil prices remaining low over the forecast horizon, inflation will be low.

Despite the deterioration in public and private debt ratios, the risks to financial stability seem limited. The main upside risk to our scenario would be a faster than expected health risk reduction. The positive impact on confidence would certainly reverse precautionary savings and boost growth. But at the same time, the downside risks remain numerous. One of them would be the failure of negotiations between the UK and EU27 regarding their future relationship. Similarly, a resumption of trade tensions with, for example, the increase by the United States of customs tariffs on their imports of vehicles would weigh heavily on the German automobile industry, already in difficulty since 2018.

Germany	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	0.6	-5.5	-6.5	4.0	2.5	1.1	1.9	1.3	1.3
Inflation, %	1.4	0.5	1.0	0.8	1.5	1.3	1.5	1.4	1.4
Unemployment, %	5.0	6.1	6.4	7.3	8.1	7.6	8.4	7.4	8.2
Fiscal balance, % GDP	1.4	-7.6	-8.0	-5.9	-7.2	-5.1	-5.9	-4.5	-5.4
Public debt, % GDP	60	76	77	79	82	83	86	86	90

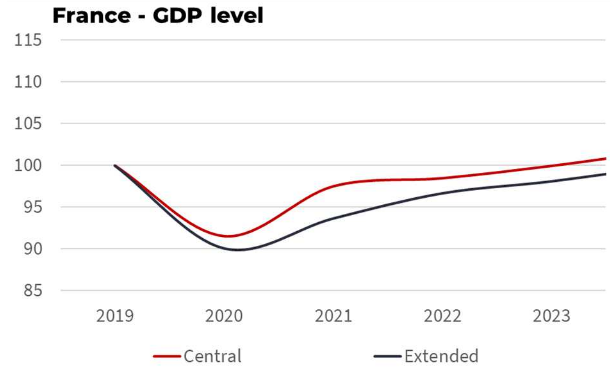
Central = Central scenario
Ext. = Extended scenario

FRANCE

- **GDP levels will remain moderate in 2021-2022 and unemployment is projected to exceed 10% over the forecast horizon**
- **Moderate labour costs and lower oil prices will maintain a very low inflation environment**
- **Public debt would increase by 30 points of GDP over the forecast horizon, approaching 130% of GDP in 2023**

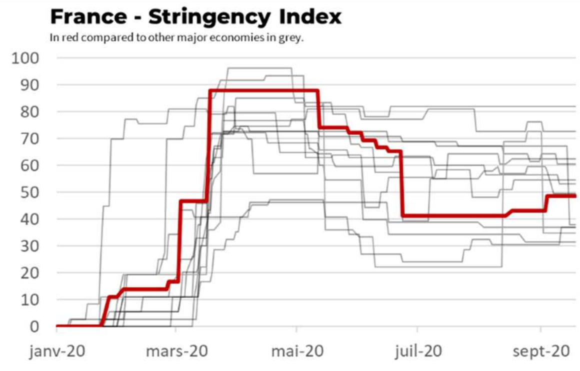
After recording a recession in 2020 of a magnitude not seen since WWII, the French economy is expected to post very moderate sequential growth in 2021-2022. Indeed, the emergency measures taken by the government in 2020 have only postponed some of the real effects of the crisis on employment and investment. The stimulus package will support the economy in 2021, but it will not allow for a full recovery of the revenue loss recorded in 2020. In the current state of affairs, GDP would return to its pre-crisis level at the beginning of 2023 only and the unemployment rate would stand above 10% on the forecast horizon. In the second wave of the pandemic were to require new measures hampering normalisation in the activity, GDP would not return to pre-crisis levels over our forecast horizon.

Recovery is set to be slow



Source. SG Economic and Sector Research

Stringent lockdown has hurt the economy



Source: University of Oxford

External demand will remain sluggish. The sectors driving French exports (aeronautics, tourism, automotive) are particularly affected by the uncertainty surrounding the evolution of the pandemic. In addition, France's main trading partners will also be affected by the spread over time of the effects of the crisis. Finally, the absence of a major stimulus in China (contrary to what was observed after the 2008-2009 crisis) will weigh on international trade. The dynamics of foreign trade should therefore remain moderate in 2021-2022.

Companies will emerge financially fragile from the forced shutdown of the economy. Government emergency measures (partial unemployment and State Guaranteed Loans in particular) have supported corporate liquidity, but their debt ratios are nevertheless very degraded. Consequently, the need to free up financing capacities to stabilise debt ratios will strongly constrain capital spending in the medium term. Against this backdrop, cuts in taxes on production planned in the stimulus package are likely to have only a limited impact on growth.

A EUR 100 bn fiscal stimulus plan	**EUR/bn**
▪ **ECOLOGY**	**30**
Including:	
▪ **Transportation**	**11**
▪ *Inc. SNCF*	*4,7*
▪ *Inc. support for the purchase of clean vehicles*	*1,9*
▪ *Inc. public transportation and bike*	*1,2*
▪ **Renovation of buildings**	**6,7**
▪ *Inc. Public buildings*	*4*
▪ *Inc. housing renovation (energy efficiency improvement)*	*2*
▪ *Inc heavy renovation of subsidised social housing buildings*	*0,5*
▪ **Energy and green technology**	**9**
▪ *Inc. Key markets in green technologies*	*3,4*
▪ *Inc. Aeronautics and automotive sectors*	*2,6*
▪ *Inc. hydrogen*	*2*
▪ *Inc. Nuclear sector*	*0,4*
▪ **Agroecological transition**	**1,2**
▪ **COMPETITIVENESS AND INNOVATION**	**34**
Including:	
▪ **Cuts in production taxes**	**20**
▪ **Investment plan**	**11**
▪ **Recapitalisation instrument for companies**	**3**
▪ **Support to industrial investment**	**1**
▪ *Inc. Regions' attractiveness*	0,4
▪ *Inc. Relocation projects*	0,6
▪ **SOCIAL AND TERRITORIAL COHESION**	**36**
Including:	
▪ **Employment and training**	**15,3**
▪ *Inc. Plan for the employment of people below 26*	6,7
▪ *Inc. Temporary unemployment*	7,6
▪ *Inc. Investment in training*	1
▪ **Investment in the health sector**	**6**
▪ **Support to the investment of local governments**	**5**
▪ **Research (universities)**	**3**
▪ **Social benefits**	**0,8**
Total	**100**
% GDP	4,1

On the household side, job destruction and income moderation will weigh on spending. Housing investment will thus remain sluggish in 2021-2022 despite very low interest rates. The absorption of accumulated forced savings (in the first half of 2020 alone, the saving rate increased by 12.3 points compared to 4Q19) during the lockdown will pull private consumption in the second half of this year. But with rising unemployment and persistent uncertainty surrounding the evolution of the pandemic, households will certainly build up precautionary savings, ruling out the scenario of a sustained rebound in consumption.

Falling oil prices, moderating wage costs and weak anticipated demand will help maintain a very low inflation environment in 2021-2022. Supply chain disruptions would only aggregate a limited (bullish) impact on inflation.

The contraction in activity, the increase in public demand and the emergency measures taken by the government to address the health crisis will see greatly degraded public finances in 2020. The unwinding of certain exceptional measures (partial unemployment, for example) and subsidies from the EU Recovery Plan will help improve the public balance in 2021. But with the very moderate recovery in activity and the implementation of the stimulus package, public debt ratios will remain high over the forecast horizon. However, the risk surrounding debt financing will be limited as long as the ECB ensures financing conditions remain very favourable for governments.

The main upside risk to our scenario would be the final evacuation of the health risk (with the fast-track development of a vaccine against Covid19, for example). At the same time, the list of downside risks remains long. Especially, the risks that structured 2019 (trade tensions with the US, negotiations in the wake of Brexit, social movements, etc.) are still present. Finally, the deterioration of debt ratios, especially of companies and public administrations, increases the vulnerability of the economy to rising interest rates. However, such a scenario remains very unlikely today.

France	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	1.5	-8.5	-10.0	6.5	4.0	1.0	3.2	1.5	1.5
Inflation, %	1.3	0.8	0.7	0.8	0.6	1.3	1.3	1.3	1.3
Unemployment, %	8.2	8.1	8.5	10.2	11.5	11.2	11.9	11.0	11.8
Fiscal balance, % GDP	-2.3	-9.4	-10.1	-6.3	-8.4	-6.1	-7.0	-5.4	-6.3
Public debt, % GDP	98	115	118	121	127.9	125	130	128	134

Central = Central scenario
Ext. = Extended scenario

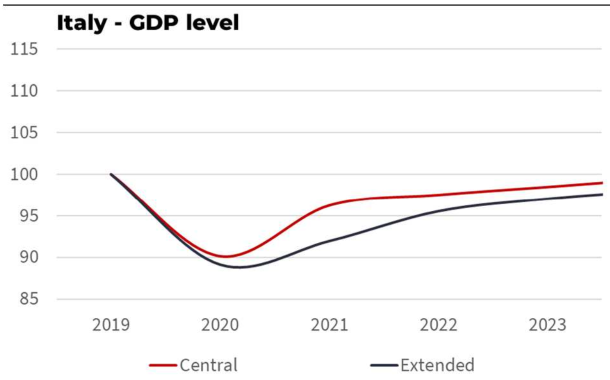
ITALY

- **The crisis has amplified the structural problems that prevailed pre-crisis risking further divergence from core-Europe**
- **Bold government support will cushion the impact of the crisis but also lead to a dramatic increase in government borrowing needs**
- **The sovereign spread has been contained by massive European policy support, but political risk remains**

Italy was struck particularly forcefully by the coronavirus pandemic. Nationwide lockdown measures, including production shutdowns, resulted in a 13% drop in GDP in 2Q20 and 17% over one year. Economic activity has started to resume in May and will gradually normalise, allowing output growth to bounce back, helped by sizeable policy support (both Italian and European). Real GDP fall is set to be in the 10% to 11% range in 2020 and would most probably not fully recover before 2024.

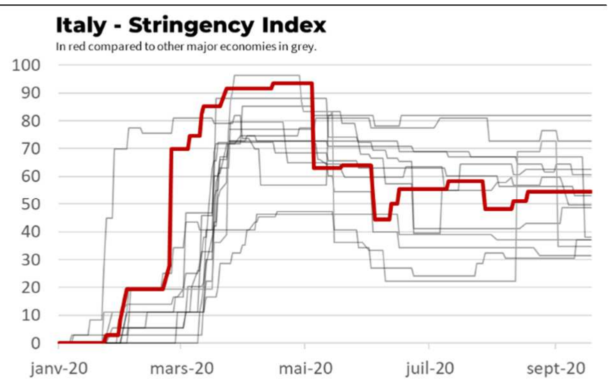
The consumer catch-up effect expected in 2H20, a large stimulus package and the weakness in oil prices will only partially offset the drop in activity caused by the pandemic. Growth is set to rebound slightly in 2021-2022 but unemployment is set to head north. The surprising drop in the unemployment rate in 2Q20 is linked to an unprecedented fall in the activity rate, as people do not declare being actively looking for a job during the lockdown. We assume this pattern to be temporary and the unemployment rate to rise to 12% next year. Close to 550 000 jobs have been lost during the lockdown period (March to June), mostly temporary contracts. With the current ban on permanent workers layoffs, the employment response is likely to be protracted and job destructions are set to continue in 2021. We estimate at 800 000 jobs the total loss of the crisis.

A slow recovery with structural headwinds



Source: SG Economic and Sector Research

Italy faced one of the toughest lockdowns



Source: University of Oxford

Companies will be hard hit by the fall of consumption and industries shutdowns. Profit margins are expected to shrink and productive investment to contract. Despite liquidity assistance for SMEs, it will become difficult for some firms to avoid bankruptcies, and non-performing loans are set to increase.

“Above the line” fiscal measures	EUR/bn
August decree	**25.0**
Relaunch Decree (15 May), of which:	**50.0**
Wage supplementation schemes (employment support)	15.0
Measures to support small businesses (cancellation of corporate tax - IRAP, grants for most affected SMEs…)	12.0
Guarantee income and decent living conditions for Italian households and self-employed	6.5
Extra spending for the Civil Protection and the healthcare sector	4.5
Subsidies for tourism and leisure (tax reductions, vouchers...)	4.0
"Cura Italia" decree (17 March), of which:	**25.0**
Keeping people employed and supporting the unemployed	2.4
Additional healthcare related spending	10.4
Reduced taxes and contributions for small firms	3.2
Total	**100.0**
%GDP	6.2%

The Italian government approved three rescue packages to cushion the impact of the crisis for households and firms: the “Cura Italia” Decree on 8 March, the “Rilancio” Decree on 14 May and a last Decree in August. In total, the three packages are expected to have an impact of 6.2% of GDP on general government net borrowing in 2020 and 1.5% in 2021.

This government support will provide a liquidity cushion for households and small enterprises most impacted by the crisis but will not be enough to boost the economic recovery. More support for investment projects and structural reforms would help to foster potential growth. On this front, the European Recovery and Resilience facility is very welcome. Italy will be entitled to EUR 65bn of grants (3.7% of GDP) an potentially EUR 120bn of loans over the next three years.

On top of this investment support starting next year, the country is eligible in 2020 to EUR 36bn of ECCL (ESM credit lines) with light conditionality, EUR 9bn of EIB credit guaranties and EUR 27bn from the SURE mechanism for unemployment benefits.

The latest package includes EUR 15bn in support to businesses and especially SMEs: EUR 6bn grants in favour of the most-affected SMEs (annual turnover <EUR 5mn for a maximum of EUR 40k); EUR 4bn cancellation of the corporate tax (IRAP); EUR 1.5bn compensation for rents paid during the lockdown; EUR 0.6bn compensation for utility bills paid during the lockdown. There is also unspecified support by *Cassa Depositi e Prestiti* (Italy’s development bank) to the capital of larger companies (annual turnover >50bn).

Support to households and the labour market reaches EUR 25bn. It includes: EUR 15bn for the wage supplementation schemes (*Cassa integrazione in deroga*); EUR 5bn subsidies up to EUR 600 a month for self-employed workers (the good news is that funds will now arrive automatically to those who already got them with the first decree); EUR 1.5bn for so-called 'Emergency Income', i.e. a monthly subsidy for those not covered by other schemes up to EUR 400/800 per person; EUR 1.4bn extra spending for education, university and research (with new hiring); EUR 0.6bn for babysitting vouchers and parental leaves.

The rest of the package includes transfers to local authorities to face the emergency (EUR 12bn); extra spending for the Civil Protection and the healthcare sector (EUR 4.5bn); subsidies for the transport sector and subsidies for tourism and leisure.

Deficit and debt are set to increase significantly in 2020. Half of the increase in public deficit will stem from the large stimulus package (4.5% of GDP in 2020) and the other half from the fall in government revenues. As of 2022, the Italian government has announced a reduction strategy based on achieving primary budget surpluses and reviving public and private investment. The market reaction has so far remained muted, thanks to massive monetary policy support via the ECB's PEPP.

The political situation remains unstable, with the running coalition (PD and Five Stars) totalling less than 40% of voting intentions in opinions polls. Support for the Lega has declined to 25% while Fratelli d'Italia (former fascists) is on the rise, reaching 15%, just behind Five Stars. Together with Forza Italia, these two parties could win an outright majority in the next elections, due in May 2023 at the latest.

Italy	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	0.3	-9.9	-10.9	6.8	3.2	1.3	3.9	1.0	1.6
Inflation, %	0.6	-0.1	-0.2	0.1	-0.1	0.9	0.9	0.9	0.7
Unemployment, %	9.9	9.6	9.7	12.0	13.0	11.5	12.1	10.8	11.4
Fiscal balance, % GDP	-1.6	-12.5	-13.0	-6.7	-10.1	-7.3	-9.5	-7.1	-8.9
Public debt, % GDP	135	162	166	158	169	162	168	165	171

Central = Central scenario
Ext. = Extended scenario

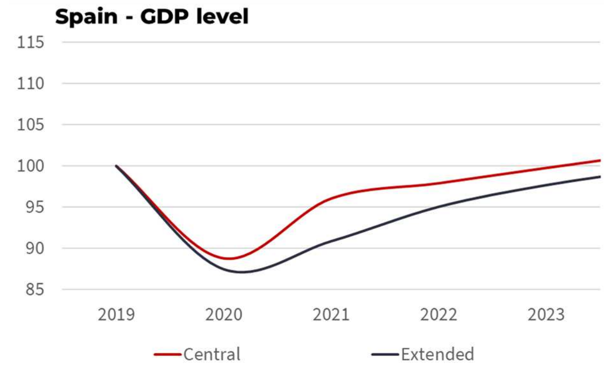
SPAIN

- **The long-lasting lockdown is expected to take an unprecedented toll on economic activity, with a severe impact on the services sector**
- **Measures to limit job losses and support the corporate sector will cushion some of the impact but will be insufficient to support growth. The EU recovery fund will therefore be essential**
- **The fragmentation of the political landscape with no majority in parliament will continue to prevent from bold government support**

The Covid19 pandemic has triggered an unprecedented slump in 2020. GDP contracted by 18% QoQ in 2Q20 after 5% in 1Q20. The 'mechanical' rebound in the second half of 2020 will not be strong enough to bring GDP back to pre-crisis level soon. Activity is set to return to its 4Q19 level at the end of 2023 in the central scenario and one year later in the extended scenario.

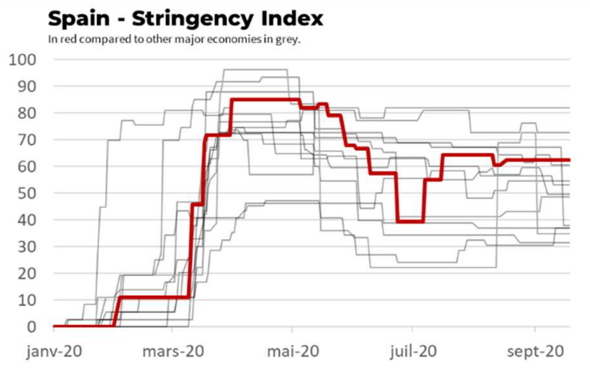
Among the demand components, household consumption will be the most dynamic: it will return in 4Q20 to 95% of its 4Q19 level. The three months of lockdown led to a sharp increase in household savings which will gradually be absorbed. Partial unemployment schemes (called "ERTE") used in large numbers supported household income during the downturn. Thus, over the whole of 2020, consumption would experience a 12% drop while household income would only contract by 4%. In 2021, a strong catch up in consumption is set to bring the savings rate back to pre-crisis level.

GDP will take time to recover pre-crisis levels



Source: SG Economic and Sector Research

Some lockdown measures are still in place



Source: University of Oxford

The widespread use of ERTE schemes has not prevented a rapid fall in employment, which has particularly hit temporary workers. Over the 1,1 million job losses that occurred in March-April 2020, one third were reabsorbed during the summer. A second wave of job destruction is expected at the end of 2020 and early 2021, due to company bankruptcies or the adjustment of business plans to new market conditions. The unemployment rate would peak at 19.5% at the end of 2021 in the central scenario and at 21% in the extended scenario. It is set to remain high amid high uncertainty, weak corporate balance-sheet positions, and the disproportionate impact of the crisis on labour intensive sectors, such as retail and hospitality, where more than half of the job losses occurred in 1H20.

Spending by foreign tourists in Spain accounts for 6% of GDP, and we estimate that the current crisis would cost close to 4% of GDP this year. The sharp contraction in exports will also lead to a deterioration in the current account, which will go into negative territory and will take time to rise again.

On the business investment side, the picture is bleak. After a record contraction in 2Q20 (-25% QoQ for construction, -27% for capital goods), the catching up will only be partial. Measures aimed at supporting the corporate sector may reduce the number of bankruptcies, but weak demand, high uncertainty, liquidity shortages, and impaired profitability are set to limit the recovery in investment. It will take between one and three years for companies to regain their financing capacity.

“Above the line” fiscal measures	**EUR/bn**
Labour market measures: increase protections of vulnerable workers and self-employed, exemptions of social security contributions, temporary employment schemes (ERTEs) …	26.2
Strengthening the financing of health and research sectors: increase allocation to health ministry, transfer of money to regions, implementation of a 0% VAT rate for medical supplies	5.3
Introduction of a universal basic income: guaranteed income for low income households, between 461 euros per month for a single person and 1.105 euros for a family	3.5
Ensure corporate viability: possibility to adapt corporate and income tax payments	1.1
Total	**36.1**
%GDP	3.2%

In this context, the European aid plan called “Next Generation EU” will be essential to support economic growth. Spain has been allocated a ceiling of EUR 71 billion in European grants (6% of Spanish GDP and 20% of total grants), which will be paid over the period 2021-2024.

The total of the support measures adopted by the Spanish government is close to 3% of GDP, which is in the low range of national aid plans. However, the severe downturn is expected to have a deeply negative impact on government finances. The contraction of tax bases is expected to lead to a significant drop in revenues, while the increase in unemployment and the extensive use of short-time work schemes (‘ERTEs’) should result in large increases in social transfers. In addition, health care expenditure is increasing significantly. These factors, together with the already-enacted increases in pensions and public sector pay, should push the deficit up in 2020. The deficit should then narrow in 2021 on a no-policy-change basis, as economic activity resumes and most of the measures put in place to respond to the Covid19 crisis have a temporary effect.

The political landscape remains very fragmented in Spain with no majority in parliament and difficult decision making. This will continue to prevent the government from taking quick and effective action and limit the size of public support to the economy. Spreads will still be contained by massive monetary policy support.

Spain	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	2.0	-11.2	-12.5	8.2	3.9	1.9	4.6	1.9	2.8
Inflation, %	0.8	-0.3	-0.4	0.9	0.9	1.5	1.8	1.3	1.3
Unemployment, %	14.1	15.7	15.8	18.9	19.9	18.7	20.0	18.0	19.3
Fiscal balance, % GDP	-2.8	-11.7	-12.5	-7.3	-10.7	-7.7	-9.9	-7.3	-9.0
Public debt, % GDP	96	119	121	116	127	120	129	123	133

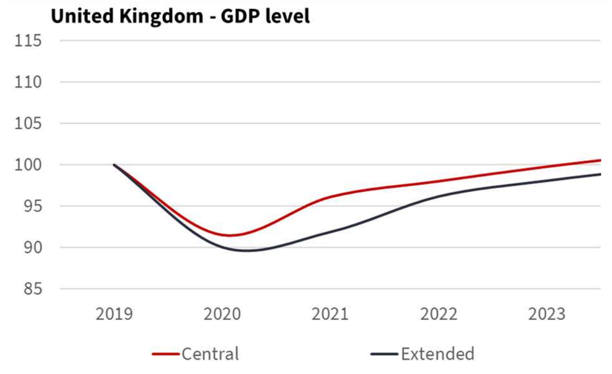
Central = Central scenario
Ext. = Extended scenario

UNITED KINGDOM

- **With one of the highest death tolls in Europe and of the longest lockdown, the UK is severely hit by the Covid19 outbreak**
- **Bold fiscal and monetary policy actions will only partially cushion the blow and both public and private debt will sharply increase**
- **The EU and the UK still have divergent positions regarding the post-Brexit arrangement, adding significant uncertainty**

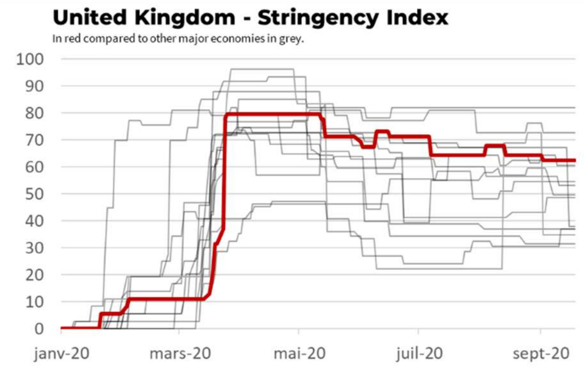
In response to the Covid19 outbreak, the UK government announced a strict lockdown across the country on 23 March. It had an immediate and strong impact on business activities. Compared with the end of 2019, the UK fell by a cumulative 22.1% in the first six months of 2020 (the second sharpest fall in Europe after Spain). The economy has started to recover as the lockdown measures eased. Looking at the monthly profile, GDP grew by 8.7% in June 2020, following growth of 2.4% in May and a record fall of 20% in April 2020.

Long lasting effects on UK GDP



Source: SG Economic and Sector Research

A high average stringency index in H1 - 20



Source: University of Oxford

To mitigate the effect of the outbreak on the economy, the UK authorities have set up a package of support for households, business and public services of an unprecedented scale in the UK.

On the fiscal side (see table below), the response encompasses additional funding for the NHS, public services, charities and culture (GBP 51bn), the strengthening of the social safety net, notably by increasing payments under the Universal Credit scheme as well as expanding other benefits (GBP 8bn) and measures to directly support businesses, like property tax holidays, grants for small firms and firms in the most-affected sectors, and compensation for sick pay leave (GBP 30bn). Through the Self-Employment Income Support Scheme (SEISS) and the Coronavirus Job Retention Scheme (CJRS), the government pays 80% of the earnings - to a maximum of GBP 2,500 per employee per month - of self-employed workers and furloughed employees (GBP 69bn).

In July, the Chancellor announced a further package of measures aiming at preserving jobs. The plan is estimated to cost up to £30 billion this year. The main measure is the Job Retention Bonus that is a one-off payment of GBP 1,000 to UK employers for every furloughed employee who remains continuously employed through to the end of Jan. 2021 (up to GBP 9bn).

The government has also launched schemes aiming at easing firms' access to credit. Three separate loans schemes are currently available: the Coronavirus Business Interruption Loan Scheme to support SMEs and the Coronavirus Large Business Interruption Loans Scheme to support bigger firms, which carry an 80 % guarantee for loans up to GBP 5 m for the former and up to GBP 200 m for the latter. To further ease access to credit for smaller firms facing difficulties, the government has then put in place the Bounce Bank loan scheme for SMEs with 100 % guarantee for loan amounts up to GBP 50,000.

"Above the line" fiscal measures	**GBP bn**
Public services spending: - Health services, local authorities, measures to support vulnerable individuals, supporting rail services and funding for the devolved administrations	51
Employment support: - Coronavirus job retention scheme - Self-employed income support scheme - Job retention bonus	99
Welfare package: - Universal credit - minimum income floor - Increase weekly universal credit by £20 - Employment and support allowance: removing 7 day wait - Local Housing Allowance measures	8
Business support: - Small business grant schemes - Business rates package	30
Total	188
% GDP	9%

The Office for Budget Responsibility, the UK public finance watchdog, recently estimated that the direct impact of these new policy measures on cash borrowing on the fiscal year 2020-21 will be GBP 192 bn, or more than 9% of GDP. Because of the concomitant drop in government receipts, borrowing of around GBP 322 bn over on the fiscal year 2020-21, or 15% of GDP, are expected in a central scenario. A level which has not been reached since the Second World War.

Despite the unprecedented size of the public support, it is worth noticing that the announced packages interact with the pre-existing benefit system. In this respect, the UK tends to stand out by offering a relatively low level of income support to employees who become unemployed, notably when compared to other European countries whose insurance-based systems already provided a much greater level of insurance. The announced fiscal responses are thus unlikely to prove sufficient to avoid economic scarring. A recent survey found that 11% of furloughed workers are confident that they will be laid off when the scheme closes and a further 14% thought that was fairly likely. Assuming that the proportion of those furloughed workers that move into unemployment is 10%, the unemployment rate is expected to peak at 9.7% in 2020.

The UK economy is also supported by extremely accommodative monetary policies aiming at preserving firms' and households' access to financing and insuring market liquidity. The Bank of England (BoE) reduced their main rate by 65 bps to 0.1% in March. The BoE expanded the central bank's holding of UK government bonds and non-financial corporate bonds by GBP 300bn (that is a 67% increase as compared to amount held in March). The BoE also introduced a new Term Funding Scheme for the commercial banks to reinforce the transmission of the rate cut, with additional incentives for lending to the real economy, and especially SMEs. The Treasury and the Bank of England launched the Covid Corporate Financing Facility which, together with the above-mentioned Coronavirus Business Interruption schemes, makes GBP 330bn of loans and guarantees available to businesses. The Treasury and the BoE also agreed to extend temporarily the use of the government's overdraft account at the BoE to provide a short-term source of additional liquidity to the government if needed.

These policies have efficiently supported corporates' access to liquidity. The latest figures indicate that UK private sector businesses raised a total of GBP 69bn from banks and financial markets from March to June in debt instruments, causing the amount of outstanding debt to grow by 9.2% over the past 12 months at the end of June.

The UK has formally left the EU but the terms of its new trading arrangements with the bloc have yet to be fixed, and time is running short to agree a deal before transition arrangements expire in December. The EU insists that a final agreement has to be reached by the end of October to give enough time to the European Parliament and the Council to have their say.

So far, negotiations have reached a deadlock over fishing rights and EU demands for common standards on state aid, workers' rights and the environment, the so-called level playing field. The UK is also reluctant to include the horizontal dispute settlement mechanisms asked by the EU. A no-deal Brexit thus remains a very serious possibility.

Our working assumption on the agreement on the future relationship between the UK and EU27 is that an agreement on goods will be found to allow future trade without quotas and tariffs on condition of UK regulatory alignment to the EU27. On financial services, the EU has been undertaking equivalence assessments of the UK's regime, but has already stated that it will not assess the UK in some areas, including the direct provision of cross-border investment banking services, in the short or medium term. This is likely to lower British export of financial services by requiring the UK to seek an equivalence regime in each EU jurisdiction. The European Commission is considering the adoption of a temporary equivalence decision for the regulatory framework for UK CCPs. This will nonetheless leave the City at risk of revocation. Concerning other services, we expect these to become subject to various restrictions. For example, while UK hauliers should be able to transport goods freely between the UK and EU27, we do not expect them to be allowed to operate freely within the EU27.

Medium-to-long term, we consider Brexit to be a substantial headwind to the UK economy, taking 0.8pp off trend potential compared to the pre-Brexit referendum trend, thus lowering this to 1.0% under our working assumption.

Overall risks are firmly biased to the downside, with the UK being both hit by the pandemic and by uncertainties over the post-Brexit relationship with the EU.

United Kingdom	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	1.5	-8.5	-10.0	5.0	2.0	2.0	4.7	1.8	2.0
Inflation, %	1.8	0.9	0.9	1.4	1.4	2.1	2.1	2.0	2.0
Unemployment, %	3.8	7.7	8.1	8.9	11.9	6.5	8.1	5.6	7.1
Fiscal balance, % GDP	-2.2	-13.7	-15.2	-9.0	-11.6	-6.2	-7.7	-5.1	-6.5
Public debt, % GDP	85	107	110	109	117	110	117	111	118

Central = Central scenario
Ext. = Extended scenario

UNITED STATES

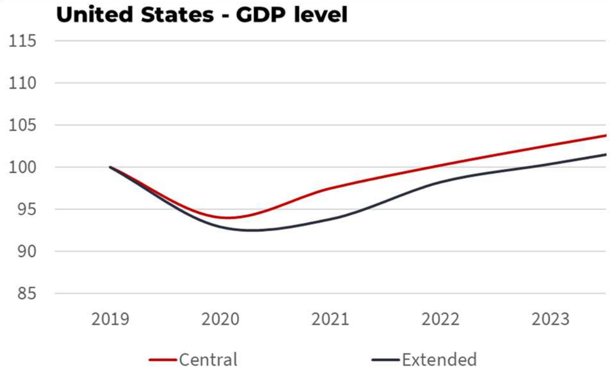
- **The economic recovery is set to be sluggish amidst a continuous health crisis and fading fiscal stimulus**
- **The Fed decided to change its objective to an average inflation target. This change will translate into lower policy rates in the coming years**
- **The main risks are a spike in the number of casualties linked to the Covid19 and increasing social and political tensions around the November 3rd General election.**

Economic activity and labour market conditions remain severely impacted by the Covid19 crisis. Real GDP contracted by 32% QoQ AR in 2Q20 with private consumption and non-residential posting major declines. The labour market also deteriorated markedly. The unemployment rate has declined from 14% in April to 8.4% in August, a level that is however still higher than the highest level reached during the Lehman crisis. Moreover, the recovery of the activity and the job market is likely to be progressive as the persistent health crisis has coupled with rising social tensions and rising political uncertainties regarding the November general elections.

High frequency indicators like the number of passengers through airports has stalled at 40% of its pre-crisis level amidst a resurgence of the number of Covid19 cases and the implementation or extension of NPI measures by some states. New job creations have also stalled as reflected, pointing to an unemployment rate that is likely to remain high in the coming months. Finally, some consumption indicators have recovered to their pre-crisis levels sustained by the large but temporary fiscal transfers to households. As most of these transfers expired or have significantly diminished, it's likely that private consumption recovery will stagnate. All in all, GDP is set to contract 6% in 2020 and expand by 3.7% in 2021. In case of an extension of the health crisis in the coming months, the economy is set to contract by 7% in 2020 and to grow by only 1% in 2021.

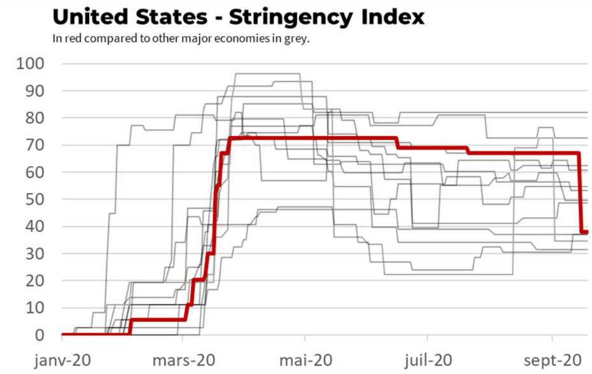
The Federal reserve announced significant changes to its long-term goals and its monetary policy framework. Under the new framework, the Fed "*will seek to achieve inflation* ***that averages 2 percent over time***" and will also assess "***the shortfalls of employment from its maximum level*** *rather than by deviations from its maximum level"* to determine the stance of monetary policy. In practical terms, this means that the Fed will tolerate that core PCE inflations trends above 2% for some time after periods where inflation undershoot while low unemployment itself will no longer justify a tighter policy in the absence of clear inflationary pressures as it did on the past. This change of the framework comes after a long period where core PCE inflation continuously trended under 2% (the 5-year moving average stands at 1.5%) while the unemployment rate reached historical lows before the Covid19 crisis. Regarding the different asset purchases programs, the Fed balance sheet has peaked at USD 7tn as Treasury and MBS purchases have slowed as financial market volatility has significantly drop. Additionally, the other asset purchases like the Corporate Credit Facility (USD 750bn allowed) or the Main Street Lending Facility (USD 500bn allowed) remain largely unused. All in all, the Fed is set to maintain its monetary policy rate range at 0%-0.25% in the years to come while the balance sheet is also set to remain large.

The economy is expected to return to its 2019 only by 2023



Source: SG Economic and Sector Research

NPI measures have partly reversed amidst an increase of the number of infections



Source: University of Oxford

On the fiscal side, the US Congress and the executive failed to reach an agreement to extend several measures of the CARES act. Namely, the extra USD 600 weekly unemployment benefits paid by the Federal government expired end of July, the time to apply to the PPP loans (forgivable loans to small and medium firms in exchange of keeping the payroll constant) expire in July and the moratorium of housing evictions in case of unpaid rents end in September. These measures have so far proved successful as despite the large unemployment rate, household disposable income increased in 2Q20 while the PPP loans allowed to smooth the drop of corporate profits. As a result, the end of these measures should translate into a softer recovery of domestic demand. Given the electoral calendar, it's unlikely that another significant stimulus bill is voted in Congress.

"Above the line" fiscal measures	Size USD bn
Cash headcounts to US residents USD 1,200 (USD 2,400 for couples) + USD 500 per child for every person earning less than USD 75 000 per year (USD 150 000 per household)	293
Paycheck protection program (Loans up to USD 10 millions per firm that can be forgiven if the firm retains its payroll in the 2 months following the loan origination)	670
Extended unemployment insurance (unemployment benefits are extended for 13 weeks and will be assume by the Fed. govt, it will give USD 600 per week until July 31)	268
Transfers to States and local govt.	150
Increase in health expenditures	121
Temporary tax cuts	161
Other expenditures	347
Total	2010
% GDP	11.2%

The main risks for the outlook remain the extension of the health crisis and rising social and political tension. The rising number of cases has forced some states to reimpose again some NPI measures, delaying hence the recovery. The November 3 election will also take place in a deteriorated social and political environment, and risks seeing much needed stimulus delayed.

United States	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	2.3	-6.0	-7.1	3.7	1.0	2.8	4.7	2.4	2.2
Inflation, %	1.8	1.0	0.8	2.7	1.2	2.3	2.6	2.5	2.1
Unemployment, %	3.5	10.0	11.6	9.0	10.5	8.0	9.0	7.0	8.0
Fiscal balance, % GDP	-6.7	-17.4	-18.2	-13.0	-15.0	-8.2	-11.0	-6.7	-8.0
Public debt, % GDP	80	110	120	120	135	125	140	130	143

Central = Central scenario
Ext. = Extended scenario

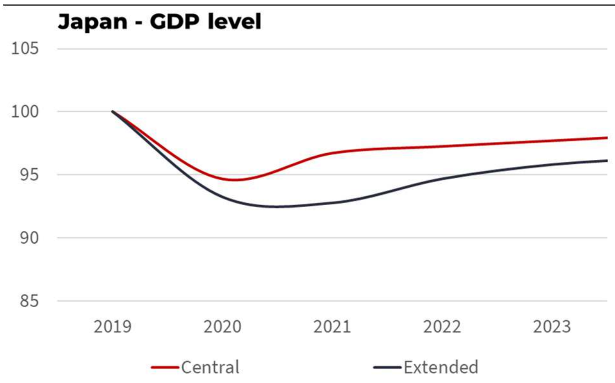
JAPAN

- **Growth is recovering, but in a moderate way**
- **The risk of a deflationary spiral should not be ignored**
- **The considerable fiscal stimulus generates a rapid increase in public debt**

The economy is beginning to recover after recording the sharpest contraction since 1955 (-7.8% in QoQ in 2Q20), mainly due to the fall in household consumption. With health uncertainties weighing on the psychology of economic actors, the rebound in 2021 is likely to be moderate and the economy would take several years to regain its pre-Covid19 level.

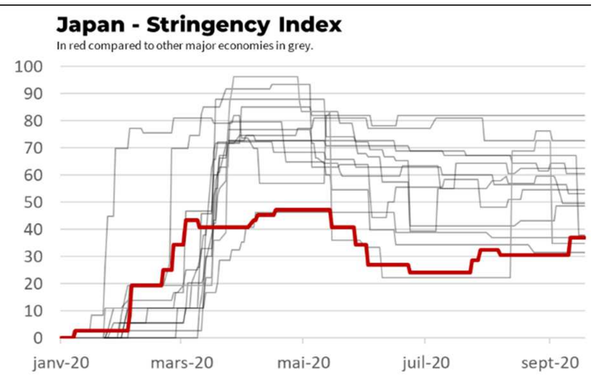
Faced with the health crisis, Japan first experienced between 4 and 7 weeks of emergency depending on the prefectures during 2Q. If it is not a strict containment, household confidence has been severely damaged. Despite a low infection rate and mortality rate, the resurgence of contamination cases in summer (in higher number than in April) does not allow consumers in the archipelago to regain the confidence. Retail sales have indeed rebounded since June, but are still below their level of a year ago (-2.9% YoY in July).

Inexorable GDP loss



Source: SG Economic and Sector Research

Low stringency despite a rise in cases



Source: University of Oxford

The low level of confidence could be the beginning of a vicious cycle that weighs on the dynamics of the business for a long time. Indeed, the aging Japanese society has already experienced a deflationary past. If the perception of households does not improve because of the health crisis, this implies a very slow return to normal in their level of consumption, which impacts investment, and the target of reflation becomes even more difficult to achieve.

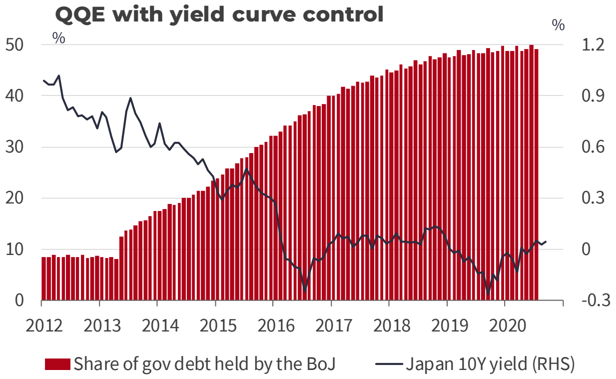
Inflation has indeed shown signs of weakening since April: inflation excluding fresh foods is close to 0%, while the BoJ's target is 2%. The risk of a deflationary spiral therefore tends to increase.

Faced with such a risk, the fiscal stimulus is considerable despite an already high ratio of public debt to GDP (close to 240%). The total of the three stimulus plans reaches 40% of the GDP. And even if we only consider direct government spending known as "mamizu", it amounts to 65.2 trillion yen, i.e. 11.7% of GDP. This puts Japan among the countries that have supported their economies the most. These fiscal efforts, combined Japanese style lockdown that was not as tight as other developed countries, help explain an expected slower contraction in Japan than the later ones in 2020.

"Above the line" fiscal measures	**JPY/tn**
Cash payment for SMEs, self-employed individuals and furloughed employee	7.1
Cash payment for households (JPY 100,000 for all residents)	12.8
Rental subsidies for corporates	2.0
Spending on medical system	4.8
Spending on public facilities	4.7
Miscellaneous spending on structural improvement	10.7
Lending facility for corporates	11.6
Go-to campaign which will subsidize people's travel expenses and tickets for entertainment events	1.6
Reserves for future prevention of virus outbreak	10.0
Total	65.2
%GDP	11.7%

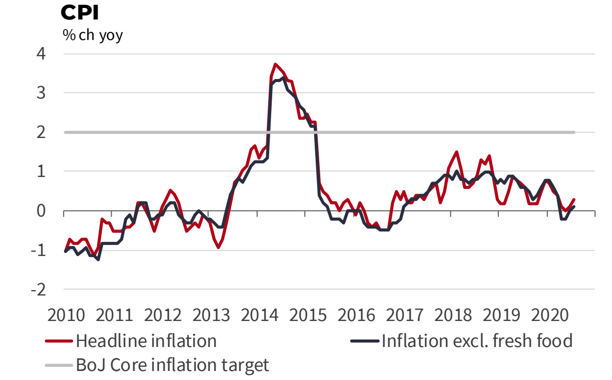
On the monetary side, the BoJ has kept the same targeting of short (-0.1%) and long (0%) rates by actively modifying the ceiling of its asset purchase program. It thus achieved significantly higher purchase amounts from May to August than before, with a monthly average of 10.9 trillion yen in JGBs (treasury bills), 950 billion yen in ETFs (index trackers), 530 billion commercial papers and 320 billion corporate bonds. The only asset class that the BoJ has not bought more aggressively is REITs (listed real estate investment companies). Purchases are therefore aimed at maintaining government funding at almost zero cost and supporting that of businesses (the yield on new issues of commercial paper at 3-month maturity is reduced from 0.23% in April to 0.02% in August). As a result, the BoJ's balance sheet goes from 109% of GDP in April to 120% of GDP in August. At this rate, it likely exceeds 125% of GDP by the end of the year.

10Y yield kept around 0% by the BoJ



Source : BoJ, Ministry of Finance, SG Economic and Sector Studies

Relapse into low inflation



Source : BoJ, SG Economic and Sector Studies

As a result of the economic contraction and unprecedented budgetary efforts, the fiscal deficit is widening and the public debt ratio increasing. The latter is heading straight for 250% of GDP in 2020. The question of debt sustainability therefore arises, especially since the reflation policy is struggling to succeed. Even if the cost of financing the public debt is kept extremely low with the vast majority (90%) of debt held by domestic investors including the BoJ, the repeated delay in the fiscal consolidation schedule could affect investors' perception of risk.

Japan	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	0.7	-5.3	-6.7	2.2	-0.5	0.5	2.0	0.5	1.2
Inflation, %	0.5	0.2	-0.2	0.4	-0.3	0.5	0.5	0.5	0.5
Unemployment, %	2.3	2.7	2.8	2.6	3.2	2.4	3.1	2.4	3.2
Fiscal balance, % GDP	-2.8	-13.5	-16.0	-6.5	-10.0	-3.3	-3.1	-3.0	-2.8
Public debt, % GDP	237	250	254	256	265	258	267	260	268

Central = Central scenario
Ext. = Extended scenario

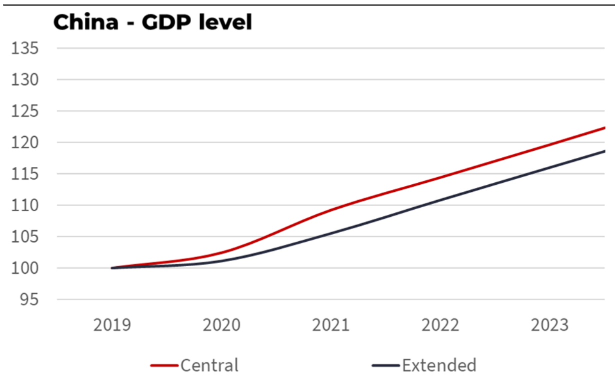
CHINA

- **The recovery continues but along with persistent signs of structural imbalances**
- **The policy target is shifting to the sustainability of growth from immediate recovery, the stimulus may have peaked**
- **In relative respite, credit events will resume once liquidity conditions tighten**

The economy is expected to continually grow as the epidemic has been contained and the stimulus effective. On the other hand, in order to prevent the structural imbalance from worsening, economic policy is turning towards the sustainability of growth instead of intensively pursuing the recovery. As a result, GDP growth will be lower than expected in 2021.

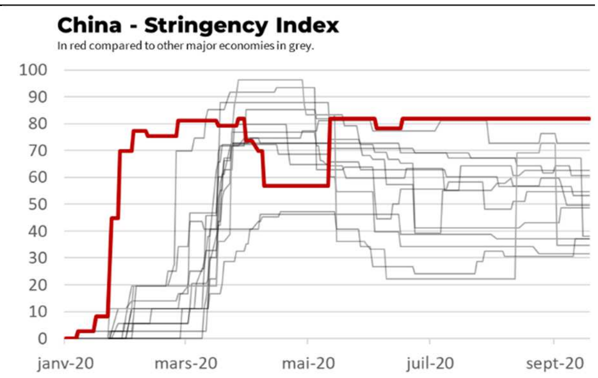
The recovery from its sharp low in 1Q20 has been rapid. But it shows signs of structural imbalance akin to the old growth model, a model that is not sustainable.

Deeper loss in GDP in extended crisis would require more stimulus



Source: SG Economic and Sector Research

Return to normal in practice despite high stringency index



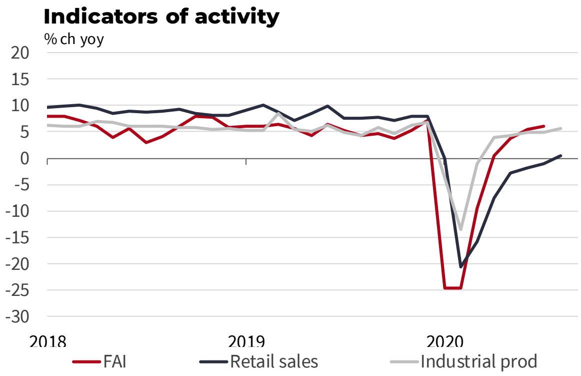
Source: University of Oxford

On the one hand, this recovery is led by production, investment and exports as household consumption struggles to return to its pre-crisis level. Growth in industrial production turned into positive territory in April and is progressing steadily at a YoY rate of around 5%. Urban investment continues the rebound that started in April as well, with an increase of 6% YoY over the last three months. Finally, exports performed with 9.5% growth in August, while international trade contracted. However, the return to normal of retail sales was delayed, it was only in August that they barely recovered to the level of the previous year, up 0.5%.

On the other hand, the rebound in investment is led by real estate and infrastructure which are growing at a YoY rate of over 10% and 6% respectively over the last three months. However, investment in manufacturing sector remained in a contraction zone over the same period (at -1%). With construction activity boosted by the stimulus, the manufacturing sector received less capital, increasing the sector imbalance to the detriment of future productivity gains.

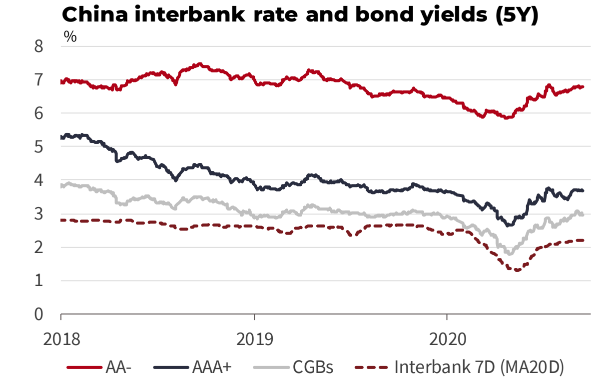
These signs of imbalance are reminiscent of the old growth model which since 2015 has been in transition to a new more sustainable one. Now that the recovery pace is satisfactory and the epidemic under control, not worsening structural imbalances and continuing the transition then becomes the object of economic policy adjustment. Since July and August, tackling medium-term structural challenges and better controlling the risk linked to structural imbalance have taken on greater importance in the communication of economic policy makers, while the immediate need for economic recovery takes second place.

Recovery of activity at two speeds



Source: NBS, SG Economic and Sector Studies

Rise in interbank rate in May



Source: PBoC, NBS, SG Economic and Sector Studies

In terms of policy actions, a certain neutralization seems to have already started, especially on the monetary side. It translates into a rise in the interbank rate in May, as well as that of yields on the bond market. Indeed, the PBoC rather withdrew liquidity over the period. In addition, in order to better control the risk associated with the imbalance generated by the stimulus, real estate developers are no longer allowed to issue bonds and the credit policy continues to target small and medium-sized enterprises. On the fiscal side, support will still be relatively stable in 2020 but without additional efforts. The rate of issuance of special local government bonds will be fairly comparable to that since early 2020. As of August, 40% of the issuance quota remains for an annual total of 3.750 billion yuan. Infrastructure projects ranging from transport to urban innovation are expected to benefit from the bond issuances of which the use is supervised the central government. The other, less dominant stimulus measures have already been put in place. The central government special bonds of 1,000 billion yuan are all issued in July. The exemption from charges and taxes will end in December. The peak of the stimulus would therefore have been reached.

Since the stimulus policy takes into consideration the sustainability of growth (i.e. not worsening the structural imbalance), growth will not be as high as expected (the market consensus is forecasting 8% in 2021).

Fiscal measures	**Size** CNY/bn
Special local government bonds	3750
Special central government bonds	1000
Increases in general government spending and social security outlays*	750
Reduction in social security charges and tax*	2500
Total	8000
%GDP	8%

* estimated by SG Economic and Sector Studies, net from automatic stabilisers

Nevertheless, the stimulus has generated and will still generate new debts, in private and public sectors. Hence the probable reappearance of credit risk in the years to come despite the current lull due to still favourable liquidity conditions. On the other hand, compared to previous stimulus cycles, this comes after the deleveraging campaign and the repression of shadow banking from 2017. Credit risk should thus remain in the visible and regulated segments of the financial system, which will allow a better appreciation.

China	**2019**	**2020f**		**2021f**		**2022f**		**2023f**	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	6.1	2.5	1.1	6.6	4.4	4.8	5.0	4.6	4.7
Inflation, %	2.9	2.8	2.5	2.0	1.4	2.2	2.3	2.3	2.3
CA balance, % GDP	1.0	2.3	2.1	1.8	1.5	1.6	1.3	1.4	1.1
Fiscal balance, % GDP	-3.1	-3.6	-3.8	-2.8	-3.0	-2.8	-2.8	-2.8	-2.8
Public debt, % GDP	38.5	45	46	45	47	45	47	45	47

Central = Central scenario
Ext. = Extended scenario

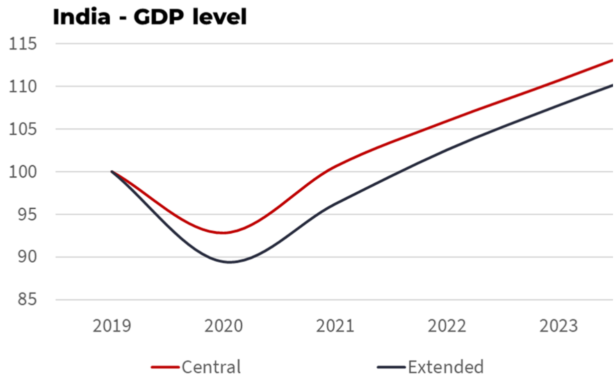
INDIA

- **Heavily hit by the Covid19, growth is to resume very gradually**
- **The fiscal stimulus being limited, a fine margin of maneuver is possible on the monetary side**
- **The vulnerability of the financial system is increasing with the sharp decline in growth**

GDP growth is very heavily hit by the Covid19, it will only resume gradually over the next quarters. The risk of entering a much weaker growth regime than the past decade tends to increase.

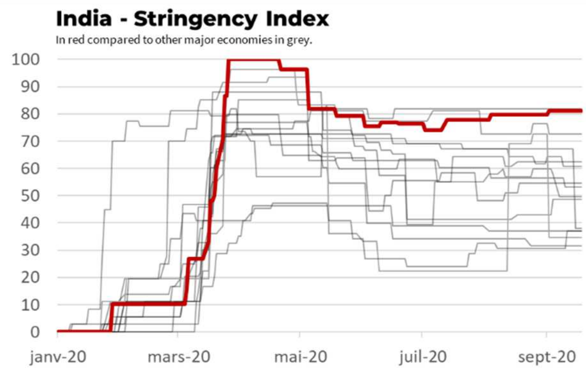
The country recorded a violent contraction of GDP in April-June 2020, of -24% YoY, due to the repetitive extensions of lockdown. Mobility data seems to show a return to normal. But in some activities, attendance is still well below the pre-crisis period, such as retail distribution and leisure, which were -40% at the end of August. The health context is in fact not favorable to a genuine normalization of economic and social life, as the number of new Covid19 cases still shows no sign of improvement (more than 80,000 per day at the beginning of September). Health uncertainties are therefore the first factor constraining economic recovery.

Entering a weaker growth regime



Source: SG Economic and Sector Research

No stark improvement in cases control yet



Source: University of Oxford

The second factor is the reduced stimulus capacity, both on the fiscal and monetary side. On the fiscal side, the stimulus plan is marked by budget constraints, with the ratio of public debt to GDP approaching 70%. First, some stimulus measures are just existing measures re-included in the plan; second, a large majority of measures concern credit facilities, guarantees or extensions of payment terms, they do not involve additional fiscal expenditure; finally, the "real" measures implying a reduction in government revenues or an increase in expenditure should represent only 1.2% of the GDP while the plan as announced goes up to 11% of the GDP. Fiscal support is therefore not sufficient in the face of the scale of economic collapse, nor to help the economic recovery.

"Above the line" fiscal measures	INR/bn
March Stimulus mainly based on Pradhan Mantri Garib Kalyan Package (support to low-income households, e.g. in-kind or cash payment)	910
EPF (Employment Provident Fund) liquidity relief (paid by the government for 6 months) and statutory contribution rate reduction	93
A reduction of 25% of existing rates of Tax Deducted at Source (TDS) & Tax Collection at Sources (TCS)	500
Food distribution for migrants (benefiting 80 mn migrants)	35
Proposal under Compensatory Afforestation Fund Management and Planning Authority (CAMPA) funds to provide employment to tribal people	60
Investment in agriculture	150
Investment in 8 critical sectors (coal, mineral production, defence, airspace, social infrastructure, power distribution, space and atomic energy)	481
Total	2229
%GDP	1.2%

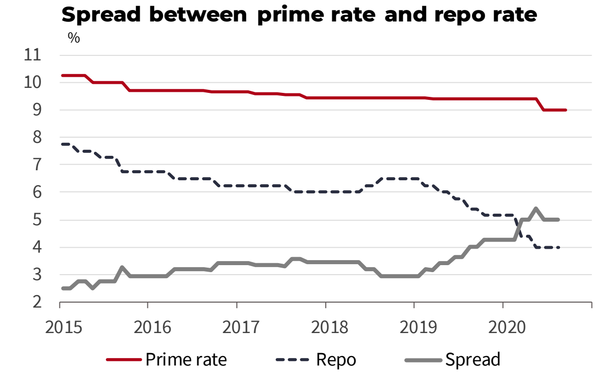
On the monetary side, the effectiveness of the easing is compromised by a very partial transmission of monetary policy. Indeed, the central bank lowered its key interest rate by 115 basis points from March to May, but the banks' prime lending rate for their best customers remained unchanged from its March level. The spread between the policy rate and the bank rate widened to an unprecedented degree.

Even though the repo rate is already at its historically low level of 4%, there is still a fine margin for a decrease. Among economic policy tools, the repo rate is still manoeuvrable, while a fiscal stimulus could further weaken public finances, with the debt-to-GDP ratio expected to rise by about 10 percentage points in fiscal year 2020/2021 without supplementary budget.

A third factor impeding recovery is the vulnerability of the financial system. The country has already experienced a series of defaults of financial institutions, starting with those of non-bank institutions in 2018, which was subsequently expanded with the takeover of Yes Bank, the country's fourth largest private bank, by the central bank in March 2020. Public banks have a higher rate of non-performing loans (more than 10 percent) than private banks, but they must support weak or failing institutions.

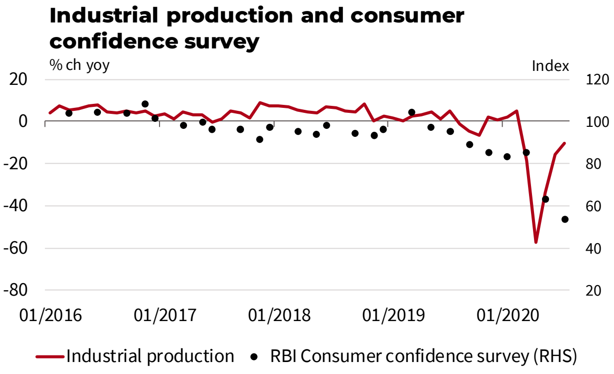
Under the loan repayment moratorium in effect between March and August, the deterioration in asset quality has not yet materialized. Since the moratorium ended on August 31, micro, small, and medium-size enterprises that were most affected by the health crisis could find themselves in a stressful situation if the economic recovery is not sufficiently on track. The vulnerability of the financial system would be aggravated, and its capacity to support growth would be further reduced.

Monetary transmission almost absent



Source: RBI, SG Economic and Sector Studies

Normalisation of activity slow



Source: RBI, Central Statistics Office, SG Economic and Sector Studies

India	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	4.2	-7.2	-10.6	8.4	7.6	5.3	6.6	4.5	5.1
Inflation, %	3.7	6.0	6.5	5.0	5.3	5.0	5.2	5.0	5.0
CA balance, % GDP	-1.1	0.5	0.8	-1.0	-0.5	-2.0	-1.8	-2.0	-1.9
Fiscal balance, % GDP	-7.4	-9.4	-10.9	-7.3	-8.0	-7.0	-7.0	-7.0	-7.0
Public debt, % GDP	69	79	83	77	81	77	80	77	80

Central = Central scenario
Ext. = Extended scenario

BRAZIL

- **The economy is set to significantly contract as a result of the Covid19 crisis and the political gridlock**
- **The BCB is expected to maintain ease financial conditions amidst a favourable inflation outlook**
- **The main risk for the outlook are an extension of the health crisis, a disorderly fiscal adjustment and an prolonged political gridlock**

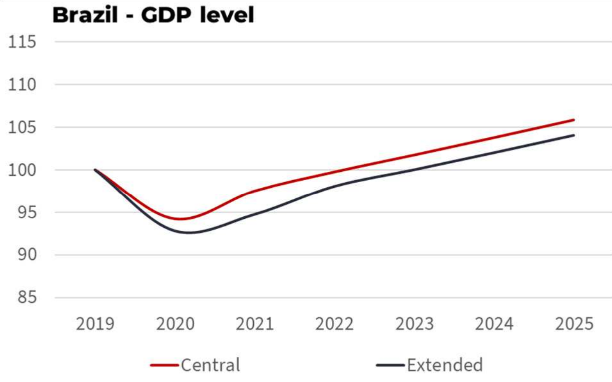
Economic activity fell sharply in the second quarter amidst the Covid19 crisis. Real GDP fell 9.7% QoQ (-11% YoY) as the partial lockdown measures implemented and the overall health crisis environment plummeted private consumption (-12% QoQ) and fixed capital expenditures (-15% QoQ). On the contrary, real exports have remained sustained during the crisis, growing by 2% QoQ as primary goods demand from China remains strong. Higher frequency indicators point however that the economy is starting to recover. Retail sales have returned to their pre-crisis levels mainly supported by the significant government transfers to households included in the recovery package (the equivalent of around USD 120 per month), while industrial production is also recovering supported by ease financial conditions. All in all, the economy is expected to recover very progressively in the coming years, returning to its 2019 level only by the end of 2022, as the fiscal stimulus is set to fade in the coming quarters, overcapacity in several sectors of the economy remain important and political gridlock is likely to remain persistent, blocking major reforms.

The inflation outlook is still favourable. Even though the BRL has significantly depreciated since the beginning of the year (25% against the greenback), inflation declined in July to 2.3% under the 3% target of the Central bank. Overall this low inflation environment reflects lower commodity prices but also weak demand pressures (services inflation stands at only 1.5%) as the unemployment rate is very high while real wages growth has stagnated over the last 5 years. Given the favourable inflation outlook, the BCB continued its monetary easing cycle, bringing the SELIC rate to 2% in August, its lowest level since the implementation of the inflation targeting regime in 1999, and is likely to remain at this level in the coming quarters. Regarding the asset purchase program that Congress authorized, the BCB has not yet made meaningful purchases BRL government securities and said it will only intervene until “traditional tools have been exhausted”.

"Above the line" fiscal measures	Size R$/bn
Health expenditures	2
Transfers to unemployed or informal workers of BRL 600 per month until July	45
13th salary for retiress	46
Salary bonus allowance	12.8
Withdrwalas from mandatry saving (FGTS)	41.5
Increase of Bolsa Familia	2
Temporary increase of unemployment insurance	10
Continuous cash benefits	5
Tax deferals for companies	36
Transfers to states	80
Credit guarantees	319
Total	599.3
%GDP	8.3%

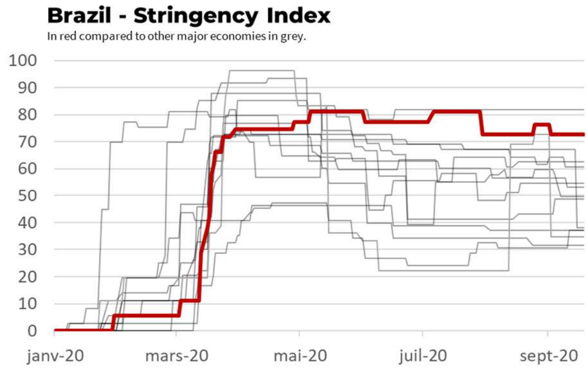
The main risks for the outlook are a worsening of the health crisis, a disorderly fiscal adjustment and persistent political noise. Brazil remains one of the countries most touched by the Covid19 crisis in terms on cases and casualties. Although the implementation of lockdown measures is unlikely even if the number of cases surge, an increasing number of casualties linked to the Covid19 will likely delay the return to the "normal" of consumers, delaying hence consumption. The second risk is a disorderly fiscal environment. Given the depth of the recession and the fiscal stimulus implemented, public debt is likely to reach 100% of GDP by the end of 2020. For the moment, BRL rates have remained anchored and the currency depreciation has little effect on public debt dynamics as most of the debt is issued in BRL. However, a slippage of the fiscal deficit in 2021 and beyond or a return of inflation could spark an increase in local currency rates, tightening hence credit conditions and forcing the government to rapidly adjust. Finally, a prolonged gridlock between the executive branch and the legislative branch could also further damage investment prospects.

The economy is set to register another lost decade following the Covid19 crisis



Source: SG Economic and Sector Research

The number of infections and casualties from the Covid19 remain high



Source: University of Oxford

Brazil	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	1.1	-5.8	-7.2	3.5	2.1	2.3	3.5	2.0	2.0
Inflation, %	3.7	2.5	2.5	3.3	3.3	3.0	3.0	3.0	3.0
CA balance,% GDP	-2.6	-1.0	-1.0	-1.8	-1.8	-2.3	-2.3	-2.3	-2.3
Fiscal balance, % GDP	-6.0	-16.0	-18.0	-8.6	-10.0	-7.2	-8.0	-6.0	-6.0
Public debt, % GDP	77	102	106	107	112	108	116	110	118

Central = Central scenario
Ext. = Extended scenario

RUSSIA

- **The economy will contract less than other large emerging market economies in 2020. However, the ability to rebound remains limited by structural weaknesses**
- **Fiscal stimulus will remain limited while monetary policy is set to be even more dovish**
- **Russia's flexible exchange rate regime, low debt, large FX reserves and fiscal buffers put it at a distinct advantage compared to other commodity exporters and to earlier crisis episodes (2008, 2014)**

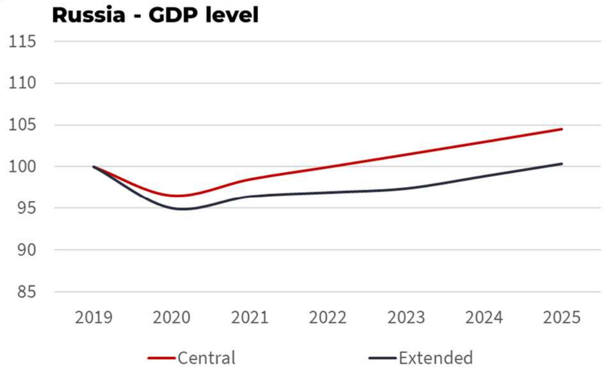
GDP will contract by less than 4% YoY in 2020. Contrary to other economies (developed and emerging markets) this will not be "the largest post war choc" for the Russian economy. However, there are still many underlying weaknesses which will weigh on the ability of the economy to rebound and to grow in the medium term.

The country has been one of the slowest growing emerging market economies over the last five years. This is driven by the gradual contraction of households real disposable income since 2014 (-1% per year on average) weighing on the ability to consume. The high level of indebtedness of the corporate sector at 80% of GDP (against 50% in 2012) and a regime positive real interest rates since 2016 which weighs on enterprises ability to invest. As a result, we expect only a slight rebound in 2021 and growth below 2% a year beyond.

The industry continues to suffer from the reduction in oil production (-14% yoy in June after- 13.5% in May). The mining sector is expected to contract further in the coming months as the 20% cuts in oil output agreed with OPEC partners will be implemented. We expect oil prices to remain below 50 dollars in 2020 despite the OPEC+ deal. For the entire year, crude production in Russia will decrease by 12%, the highest fall in oil output since 1994.

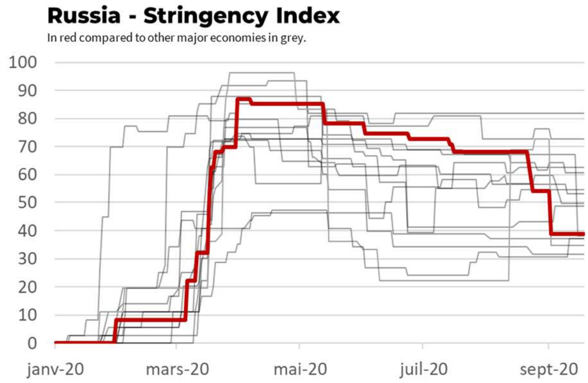
The size of the fiscal rescue package remains quite small (around 5% of GDP) as it is spread over two years. Half of the plan is for spending on the national projects (infrastructure, promotion of import substitution) that would have been implemented anyways. The rest is focused on social support, provisions for SMEs (decline in the payroll tax for SMEs) and the capitalisation of the state bank VEB.

Growth has suffered less than in other economies



Source: SG Economic and Sector Research

...lockdown measures have started to ease during the summer

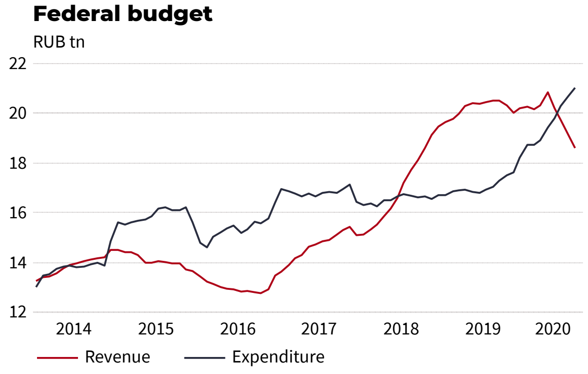


Source: University of Oxford

"Above the line" fiscal measures	RUB/bn
Crisis-related direct spending: social support	750
Crisis-related direct spending: provisions for SMEs	850
Spending on "national projects": infrastructure construction	1 370
Spending on "national projects": promotion of import substitution	1 050
Recapitalisation of VEB (public bank)	209
Other measures	771
Total	5 000
% of GDP (2019)	4.5%

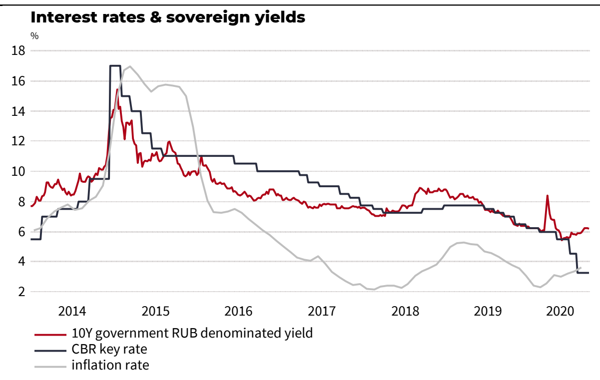
On the prudential side, several measures are helping banks weather the crisis. The national countercyclical capital buffer has been lowered to 0%. Adoption of Basel III has been postponed and a reduction of risk requirements on mortgage products has been allowed. CBR has entitled credit institutions not to recognize certain loans as restructured for the purpose of creating reserves and not to apply macroprudential add-ons to such loans until 30 September 2020. Banks have been allowed not to worsen the credit classification of SMEs, thus avoiding additional loan loss provisions, and to value securities at their price from March 1. FX operations can also be valued at the exchange rate of March 1, except for those on open forex positions.

The fiscal expenditures have grown since end 2019 from a low base…



Source: SG Economics & Sector Studies

…while real interest rates remain high and weigh on the ability to grow



Source: SG Economics & Sector Studies

Contrary to past chocs, Russia hasn't faced major financial tensions. The flexible exchange rate regime, large international reserves substantial fiscal buffers, and low public and external debt put the country at a distinct advantage—not only compared to other commodity exporters but also to the own country experience in earlier crisis episodes (1998, 2008, 2014). During previous crises tighter financial conditions led to credit crunches. The current situation is more manageable as the system is running liquidity surpluses and is less exposed to external financial conditions.

The CBR has cut by 175 bps its policy rate since April and is set to cut further should inflation falls again below the low range of the CBR target (3.5-4%). However, in August inflation printed 3.6% YoY breaching the low range for the first time since November 2019 allowing potentially for a pause if the trend is confirmed which is our central scenario.

A nationwide vote has ratified constitutional reforms proposed by President Vladimir Putin in July 2020. With a 68% turnout, 78% of the those taking part voted in favor of the changes according to Russia's Central Electoral Commission. The package of constitutional changes includes an amendment allowing President Putin to run again for the presidency in 2024 – and stay in power until 2036.

Russia	2019	2020f		2021f		2022f		2023f	
		Central	Ext.	Central	Ext.	Central	Ext.	Central	Ext.
Real GDP, % YoY	1.4	-3.5	-5.0	2.0	1.5	1.5	0.5	1.5	0.5
Inflation, %	4.5	3.9	3.9	4.5	6.0	4.0	4.0	4.0	4.0
CA balance,% GDP	3.8	2.0	2.0	2.0	1.5	2.5	2.0	2.5	2.0
Fiscal balance, % GDP	1.9	-4.5	-5.5	-2.5	-3.5	-2.0	-3.0	-1.5	-2.5
Public debt, % GDP	16	19.0	22.0	18.0	22.0	19.0	23.0	19.0	23.0

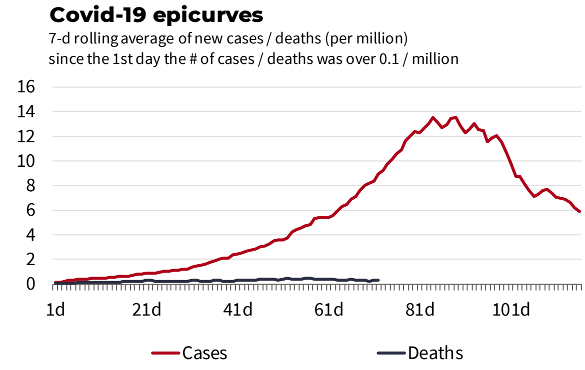
Central = Central scenario
Ext. = Extended scenario

AFRICA

- **The Covid19 pandemic remains under control for the moment**
- **Africa's GDP is expected to contract by nearly 3% in 2020, which would be the first recession in the region's history**
- **Despite strong international financial support and an expected rebound in growth for 2021, the consequences in terms of employment, development or political stability will be significant**

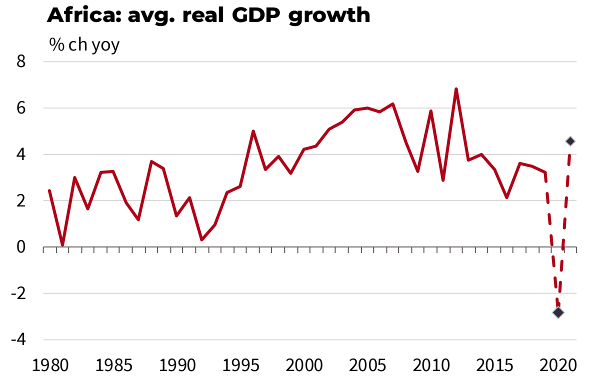
So far, the Covid19 pandemic continues to appear under control in Africa, with the number of cases and deaths (relative to population) significantly lower than in Asia, Europe and the Americas (on a cumulative basis: around 1000 cases and 25 deaths per million population to date). The progression of the virus also appears to be slowing already, since a peak of new infections was reached at the end of July, including in the hardest-hit countries such as South Africa. However, due to the underdevelopment of health systems on the continent, current trends should be taken with caution (the number of cases/deaths may be underestimated) and the risks of an acceleration of the deep health crisis remain present.

Slowdown in new Covid19 cases



Source: SG Economics & Sector Studies

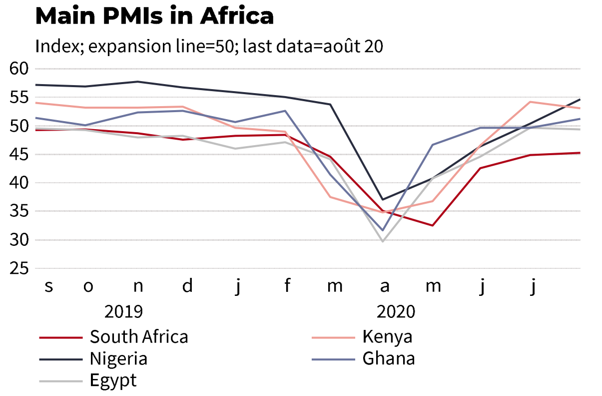
Historical drop in GDP growth



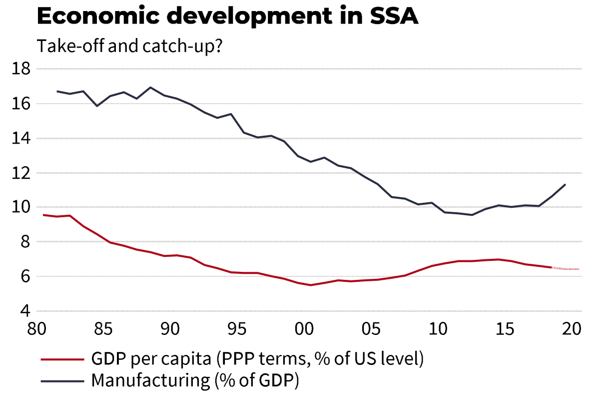
Source: SG Economics & Sector Studies

However, the economic consequences of the Covid19 crisis will be significant. In our "central" scenario, African GDP would contract by nearly 3% in 2020 – constituting the 1st economic recession recorded by the region – before rebounding mechanically (i.e. mainly due to base effects) in 2021 (growth expected at 4.5%). The heterogeneity of growth performance within the region, already highlighted before the crisis, would be confirmed. On the one hand, diversified economies that are not (**Côte d'Ivoire**, **Ethiopia**, **Rwanda**) or only moderately (**Senegal**, **Kenya**) dependent on tourism would record growth rates that are significantly lower than in 2019 (often between 0% and 2% YoY), but "only" comparable to their worst historical performance and *a priori* "sustainable" because they would be limited to a single year. On the other hand, economies exporting industrial raw materials (**Nigeria**, **South Africa**, **Algeria**, **Angola**, **Central Africa**) and/or dependent on tourism revenues (**Morocco**, **Tunisia**) would experience much more severe recessions, often expected to be between -5% and -10%. In our "extended health crisis" scenario, the contraction of GDP would be slightly more pronounced between 2020 (-3.2%), with the 2nd wave of Covid19 breaking the slight recovery of economic activity recorded since June in most countries (with activity remaining far from its pre-crisis level, however). More fundamentally, the rebound in 2021 would be very weak (+3%, below the average annual growth rate between 2010 and 2019).

Limited rebound in activity, far below pre-crisis level



No real economic catch-up in Sub-Saharan Africa



Source: SG Economics & Sector Studies, Refinitiv Datastream

The region is currently receiving financial support from donors, as illustrated by (i) the increase in IMF financing lines to the region (totalling USD 24.3bn, or 1% of African GDP) or (ii) the Debt Service Suspension Initiative (suspending debt service on foreign currency sovereign debt owed to bilateral creditors in 2020), requested by (and in most cases already granted to) 29 countries to date – for a total of USD 5.3bn. However, this significant support remains insufficient when measured against regional GDP and the scale of social challenges, given the continent's population growth (+2.5% per year by 2025) and the fact that past growth rates were already too low to allow for real development in the region. The African Development Bank thus predicts that the Covid19 crisis could destroy about 30 million jobs (4% of jobs at the end-2019) and push nearly 50 million Africans into poverty (living on less than USD 1.90 per day). As a result, social and political tensions, already high in several regions (**Sahel**, **Central Africa**, **North Africa**, etc.) could increase on the continent and degenerate into violent events (such as the recent coup d'état in **Mali**), when several important elections are on the horizon (**Côte d'Ivoire**, **Guinea**, **Burkina Faso**, **Ghana**).

EMERGING ASIA

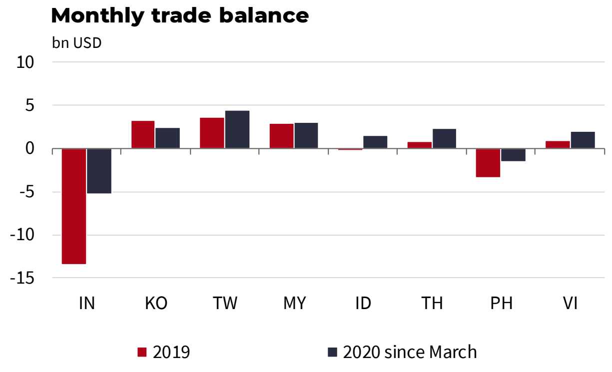
- **The economies are gradually recovering**
- **The accumulation of current surplus helps to strengthen the external safety cushion**
- **The US-China relation forms the biggest uncertainty**

Growth in the region is expected to recover gradually after being severely affected by the Covid19 pandemic. Although in contraction, the region maintains its relative performance compared to the rest of the world.

While the region as a whole has relatively strong fundamentals, their capacity to rebound is nonetheless distinct.

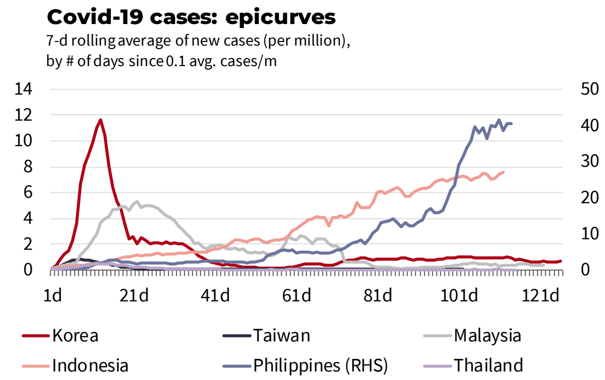
Indeed, public finances are fairly robust, as is the case in South Korea, Taiwan, and Thailand. And when some countries have a higher public debt-to-GDP ratio, their dependence on external financing is fairly low, with a positive or balanced current account balance. In addition, the health crisis was an opportunity for the region to strengthen its external balance. Despite the global recession, Asia maintained its relative export performance. As imports contracted more sharply than exports, the trade surplus grew and the trade deficit in some countries narrowed. Many central banks took advantage of this to build up foreign exchange reserves. Indonesia has replenished about ten billion dollars since March, an increase of 13% in foreign exchange reserves. Thailand and the Philippines have seen their foreign exchange reserves increase by more than 10%. This strengthens the external safety cushion and protects against future external shocks.

Quasi-generalised improvement of trade balances



Source: Datastream Refinitiv, SG Economic and Sector Studies

Covid19 under control, except for the Philippines and Indonesia

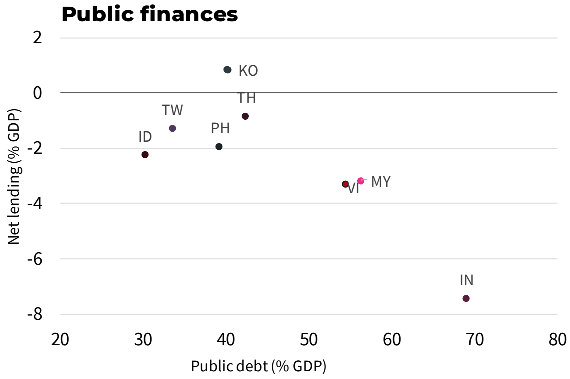


Source: IMF, SG Economic and Sector Studies

Some economies are expected to experience a less pronounced shock and emerge from the health crisis more quickly. The spread of the virus is more limited or controlled. Among the major emerging Asian economies, South Korea, Taiwan, Thailand, Vietnam, and Malaysia appear to have demonstrated a controlled epidemic. While Indonesia and especially the Philippines do not appear to have reached the peak of infections. This difference is generally reflected in the dynamism of economic activity. Vietnam, Taiwan and South Korea are the three countries that have suffered the least from Covid19 in terms of growth in 2Q20, with positive growth at 1.8% in Vietnam and a less marked contraction at 0.6% in Taiwan and -2.7% in South Korea respectively. As regards the recovery in exports, those of Taiwan and Malaysia have already reached the year-on-year level since June, while those of the Philippines, Indonesia and Thailand are still in a double-digit contraction zone lately.

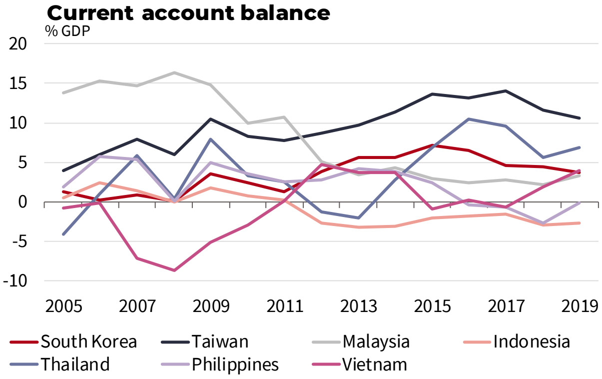
Then, in the face of the risk of a prolonged global recession, the ability to sustain growth is differentiated within the region, even though the region generally has a higher resilience compared to other emerging regions. There are mainly India (not developed in this section) and Indonesia, whose hands are tied. Regarding Indonesia, despite its low public debt (30% of GDP), the government is heavily dependent on external debt (30% of its debt), and the country also has a negative current account balance. The central bank has lowered interest rates while taking into account the high risk of currency depreciation. In fact, the last two rate cuts came late, in a context of a weak US dollar and risk-on from international investors.

Limited fiscal room for some economies



Source: IMF, SG Economic and Sector Studies

Need of external financing



Source: IMF, SG Economic and Sector Studies

Finally, the region's recovery will also be conditioned by the evolution of Sino-American tension. This will evolve according to the results of the U.S. presidential elections in November, but the rivalry between the world's two largest economies will in any case be a major factor in the commercial and geopolitical environment of the region's economies. This is an area of uncertainty that would have a significant impact on the growth profile in the coming years.

GULF STATES

- **As oil revenues decline, external surpluses evaporate, and fiscal deficits become the new normal**
- **Countries can no longer afford all the infrastructure projects envisioned to diversify activities and non-oil investments will slow**
- **The UAE and Bahrain agreed to the full normalisation of relations with Israel**

Struck by the economic fallout from the Covid19 pandemic and falling oil prices, the Gulf countries will experience in 2020 the worst recession in their history, with GDP falling by 5%. The speed of recovery in 2021 is subject to a high degree of uncertainty. External demand is severely affected by the decline in international trade, whilst business and travel hubs such as the UAE, are feeling the impacts to the aviation and hospitality sectors. All over the region, employment could fall sharply, leading to the exodus of migrant workers. Aside from the reduction in total consumption, the fall in population will hurt the retail sector, bank deposits, and real estate occupation.

The biggest factor in uncertainty relates to the decline in oil rents. The oil price has recently recovered ($43/b in mid-September versus $24/b at the beginning of April), but the average price in 2020 remains 35% lower than in 2019. Oil prices could remain low due to a weak global recovery, but also if producers try to counteract low prices by increasing sales. Joint efforts by Opec and non-Opec producers helped cut inventories in July, but the pace of market recovery remains slow and non-compliance remains a risk.

The decline in oil revenues also puts stress on fiscal variables as budgetary deficits are becoming a structural feature. Breakeven oil prices have generally fallen since 2014 amid austerity policies, like the successful introduction of VAT in Saudi Arabia, the United Arab Emirates, and Bahrain as well as the reduction of subsidies and social transfers in most countries. Despite the recession, fiscal austerity remains the norm. Saudi Arabia for instance has tripled VAT to 15% in July 2020, has restrained benefits paid to civil service employees, and is attempting to move on with further privatisation plans. Breakeven oil prices remain higher than actual oil prices and national budgets are likely to remain out of balance over the medium term.

Falling oil revenues are also weighing on the balance of payments, as evidenced by the decline in foreign exchange reserves, not least in Saudi Arabia. Except in the UAE, the current account balance is expected to turn into a deficit in 2020. For countries with a relatively small endowment of external assets under public control (Bahrain, Oman), the reduction in oil rents could ultimately lead to a loss of central bank leeway to maintain the fixed exchange rate regime and require external financial assistance.

The region has long been preparing for medium-term challenges, which this crisis renders even more relevant. The national economic development plans envisaged by the Gulf monarchies focus on economic modernization, renewable energy development, and reforms to isolate public income from oil price volatility. However, this transition is not a barrier-free path, with considerable challenges in the labour market and market regulation, often seen as an obstacle to private sector involvement. The decrease in the oil rent is however weighing on the ability to self-finance infrastructure projects and, as a result, the expansion of non-oil activities might be delayed.

The geopolitical landscape also remains a source of uncertainty. Tensions between Saudi Arabia and Iran persist. The blockade imposed on Qatar since 2017 by its neighbours, while not threatening political stability, reduces the business prospects for companies operating in the region.

On a positive note, Saudi Arabia is chairing and hosting the G20 in 2020, confirming the country's intention to assume a more committed role on the international stage. The World Expo in Dubai has been postponed to 2021, however this should still attract the attention of the business community. Finally, the UAE and Bahrain have agreed to the full normalisation of relations with Israel. Previously, only Israel's immediate neighbours among the Arab states, Egypt and Jordan, established diplomatic relations. Normalisation of relations with Israel offers UAE and Bahrain the chance to boost their economies in key sectors, including defence and security, healthcare, and tourism and transportation.

Macro-financial metrics deteriorating

	"break-even" oil price, $/b	Budget deficit, % GDP		Public debt, % GDP		Current account, % GDP		Foreign exchange reserves, $ bn	
	2019	2019	2020f	2019	2020f	2019	2020f	Dec-19	Jul-20
Bahrain	95	-10.6	-15.7	101	111	-2.9	-7.3	3.7	1.8
Kuwait	54	4.8	-11.3	15.2	17.4	8.9	-7.8	39.9	44.3
Oman	87	-7	-16.9	59.9	63.9	-5.2	-11	17	16.3
Qatar	49	4.1	5.2	53.1	47.9	2.4	-1.8	54	55.9
Saudi Arabia	86	-4.5	-12.6	23.1	28.3	6.3	-3.4	502	448
United Arab Emirates	70	-0.8	-11.1	20.1	20.3	7.4	1.5	106	94

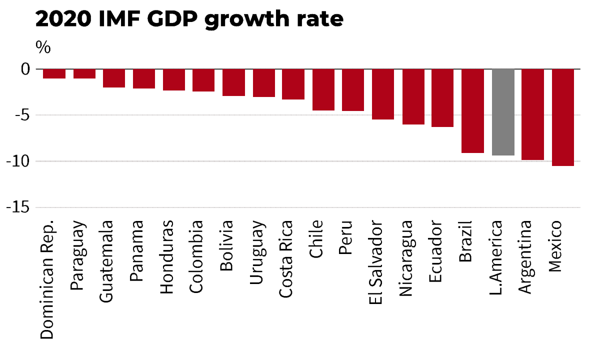
Source: IMF World Economic Outlook June 2020.

LATIN AMERICA

- **Regional growth is set to register its worst performance since the 1930s**
- **Several central banks have cut interest rates and launched modest QE programs. Fiscal response has been moderate in large economies**
- **Risks are on the upside as the number of cases is still on the upside and the region enters this crisis after a period of weak growth**

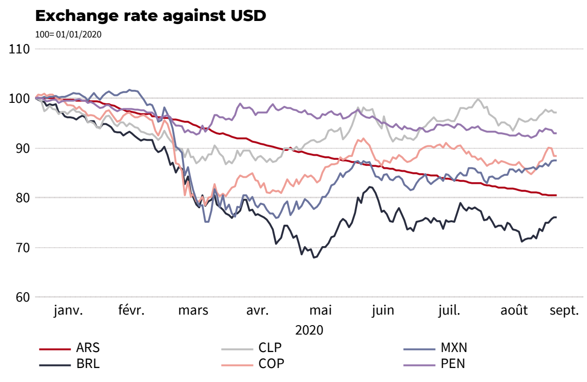
The region is severely affected by the Covid19 crisis. The economic recession will likely be the largest among emerging markets. The number of infections and casualties has started to decline although from high levels. Economically, the region is set to register the deepest recession since the 1930 as, in addition from the economic impact of NPIs, the decline of commodity prices and the loss of revenues from tourist or remittances flows will also hit activity. Financial tensions have moderated since the peak of the crisis, with the currencies of several countries stabilizing and several countries returning to international debt markets. Overall, this crisis should extend the already long period of sluggish growth, increasing hence the likelihood of social tensions in the coming years.

The economy is set to register its deepest recession since the 1930's



Source: SG Economics & Sector Studies

Financial variables have stabilized following the March shock.

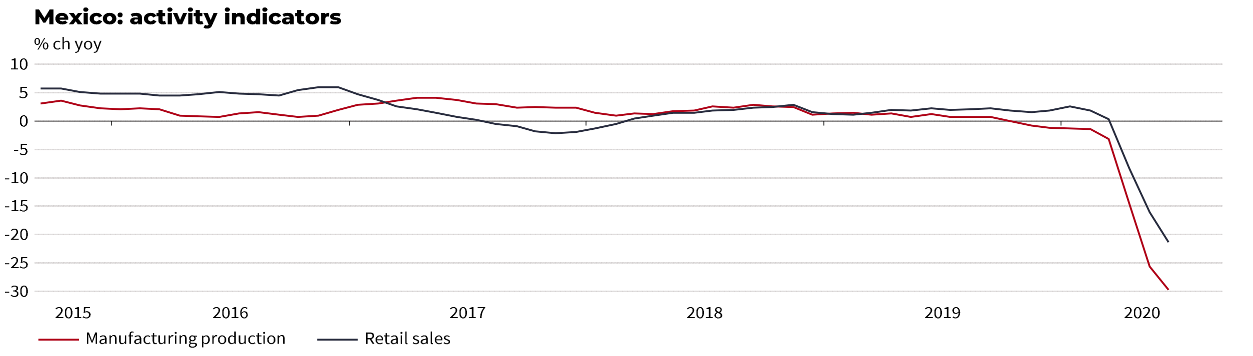


Source: SG Economics & Sector Studies

In Brazil, the health crisis is particularly acute, with the number of infections and deaths from the Covid19 still significantly high. A sharp recession is expected. To counter the economic impact, the Central bank lowered its policy rate to 2%, its lowest level since the inflation targeting regime started in 1999. The Congress also authorised the Central bank to engage in QE operations with public debt securities and some corporate securities. The government announced a fiscal stimulus package of 4% of GDP and added a program of public guaranteed loans of 6% of GDP. Overall, the Covid19 crisis is set to prolong the period of anaemic growth of the country (1% on average since 2015).

In Mexico, the number of infections and deaths continues to also be particularly high. As in Brazil, the Mexican authorities did not implement a strict lockdown. On the monetary side, the Central bank has progressively cut interest rates from 7% to 4.5% since the beginning of the crisis. Mexico has not put forward any fiscal stimulus package. Overall, and not least given the strong dependency of the country to the US economic activity, to workers remittances and to tourism flows and the absence of fiscal support, Mexico is expected to register the sharpest recession of the region.

The economy is set to sharply contract in the context of lack of fiscal support.



Source: SG Economics & Sector Studies

Smaller economies have a late rising number of cases and casualties linked to the Covid19. In Peru and Chile, the number of cases continues to trend up, but have implemented aggressive fiscal and monetary policy, reflecting their stronger macroeconomic fundamentals entering the crisis. In Peru, the government announced a fiscal stimulus of 7% of GDP, the largest of the region, while the Central Bank reduced its policy rate to 0.25% amidst a contained inflation and stable currency exchange. In Chile, the government announced a 5% of GDP stimulus package, while the Central bank cut its main rate to 0.25% and announced that it will start a QE program. In Colombia, the government announced a 3% of GDP stimulus package, while the Central bank also started expanding its balance sheet.

CENTRAL AND EASTERN EUROPE

- **The effective rebound of the region will be highly dependent on international trade dynamics in 2021. For the time being domestic demand is helping the recovery**
- **Central banks have implemented emergency measures fiscal packages have been steadily increasing since March**
- **The European Commission's Recovery and Resilience Facility should be an important funding channel for CEE over the 2021-24 period**

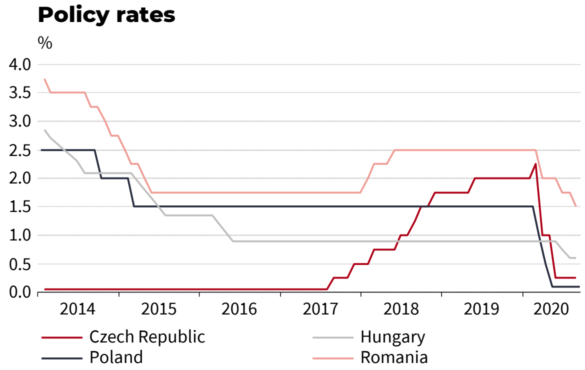
Growth in 2Q20 held up better in Central and Eastern Europe than in the euro area. The slowdown is largely a result of the region's exposure to global trade, while domestic demand was less affected than elsewhere. This can be partly explained by the significant improvement in the situation of households over the last years as real wages grew rapidly in a context of structural labour market tensions.

The countries most exposed to the economic impact of the virus are those that either have large retail and tourism sectors (Croatia and Romania) or are highly exposed to the collapse in external demand due to their integration in global value chains, not least the Czech Republic and Slovakia, where a number of car plants across the region halted operations for several weeks. However, international trade seems to have been slightly more resilient CEE countries than in the euro area as last exports figures register "only" 5% decline on average against a decline of more than 10% YoY for the monetary union

Central and Eastern Europe was an outlier in terms of inflation as it was the only region in the world registering prices pressures. As mentioned, this was driven by labour market tensions have naturally eased since the start of the crisis. This should also give further room to central banks to run more durable expansionary monetary policies.

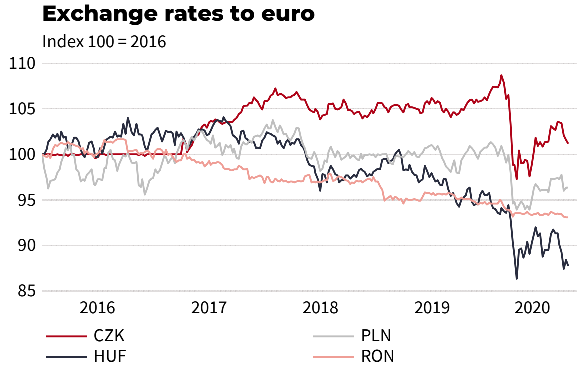
The Fed's actions and ECB's Pandemic Emergency Purchase Program allowed CEE central banks to lower interest rates and start bond-buying programs (except in Czech Republic), without much pressure on their respective currencies. In the case of further appreciation, monetary authorities could be prompted to continue the easing of liquidity conditions, especially since they would likely attempt to avoid losing competitiveness. Further rate cuts, however, would push key policy interest rates into negative territory in Poland and the Czech Republic.

All central banks in the region have cut key rates



Source: SG Economics & Sector Studies

CEE currencies have stabilized following depreciation in March-April



Source: SG Economics & Sector Studies

Some external factors should also support CEE countries in 2H20 and 2021, among them the ECB's augmented pandemic asset purchase program, Germany's large fiscal stimulus package, and the proposed EU recovery fund. The large fiscal packages announced by Germany should support the recovery in CEE. Poland will benefit the most as its exports show the strongest correlation with German domestic demand. The Czech Republic and Hungary should benefit most from a recovery in German exports as they are more integrated into the manufacturing sector's value chains. Germany was relatively successful in bringing its Covid19 outbreak under control and has been able to ease restrictions more quickly than other countries. High-frequency data suggest a pickup in business climate indicators and automobile exports as well. These developments bode well for CEE but effects will differ across countries based on their specific ties to the German economy.

The European Commission agreement for a EUR750 bn "Recovery and Resilience Facility (RRF) should be a significant funding channel for CEE over the 2021-24 period. This will compensate the reduction of EU structural funds, which were one of the drivers of investment growth in the past. The CEE-4 (Czech Rep., Hungary, Poland, Romania) would receive a cumulative EUR124 bn, which should make a noticeable impact on investment and growth in the region over the medium term. However, CEE may not be able to fully utilize the RFF allocation, as funds are required to be used for investment geared towards "green and digital transformation."

Romania remains the weak link in the region as the country have been posting for 3 years now weaker macro fundamentals than CEE peers. Besides to large twin deficits, the Romanian growth model has been unbalanced with the predominance of private consumption and a structural underinvestment. With fiscal measures amounting 3% of GDP as well as with the pension hike of 40% expected in September, the budget deficit could reach up to 9% of GDP in 2020 and 11% of GDP in 2021 according to the European Commission. In this context, the financing of the fiscal deficit will be a question in the next years. Financial repression is an option even though banks already post an historically high level of sovereign exposure in their balance sheets

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