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# SCENARIOECO

SG Economic and Sector Studies

# Choppy sequence to a weak recovery

- The end of 2020 is marked by the worsening of the health crisis leading to renewed lockdowns with their related economic impacts. News of vaccine developments, however, offers the prospect of a solution, although several approvals are still pending and the speed of and efficacy of rollout remains uncertain. The key question for the economy is at which pace social distancing measures will be lifted. In our central scenario we expect the social distancing measures to be fully lifted by 1Q22.

- The role of fiscal policies will be key to continue addressing the immediate impact of the crisis through the various measures to support firm liquidity and solvency and household incomes. Central bank action will remain key to ensure that interest rates remain low and credit markets keep functioning. This policy mix seems to find consensus in all major economies and is likely to last in order to ensure solvency in a global economy with historically high sovereign and corporate debt ratios.

- Significant output losses will cause permanent damage to the economy and weigh on trend growth potential; firm indebtedness will weigh on corporate investment and higher structural unemployment will erode room for households to consume. The risk, moreover, is a vicious circle of secular stagnation with higher debt, more non-performing loans, less jobs and lower growth. Again, the role of economic policies to support aggregate demand will remain at the centre of the medium/long term crisis resolution. Contrary to past crises, there seems to be some consensus in public debate on the fact that governments should take advantage from low funding costs to push up fiscal support, and not least to support green and digital transitions. However, the political consensus in the euro area on this matter could be put at question in the medium term.



***Document completed on 14/12/2020***

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# EXECUTIVE SUMMARY

## WORLD ECONOMY HAS LARGE LOSSES TO RECOVER

After the global economic rebound in 3Q20, a new surge in Covd19 is weighing on several major economies, as reflected in both hard data and surveys, particularly in the euro area. Global manufacturing is still benefitting from a catch-up after the trough in April-May as international trade dynamics support container transport volumes already beating 2019 levels in September. In conjunction with the deteriorating health crisis, news of vaccine developments offers the prospect of a solution, although regulatory approval still needs to be obtained in many countries and rollout will take time and comes with its own uncertainty. Investor optimism has been lifted by news of vaccines and stock markets have surged, with US stocks breaking new records, also boosted by fading US election risk. EM currencies have appreciated against the dollar while credit spreads have narrowed and sovereign yields in the periphery are trading at record lows.

At this stage there are two major uncertainties regarding future growth trajectories. The first is related to the duration of the health crisis and the second to the potential costs of the economic crisis. In both cases, the role of economic policies will be key in the quarters and/or years to come.

Regarding the first uncertainty on the evolution of the health crisis, we maintain a multi-scenario approach with two scenarios. The Central scenario assumes that social distancing measures are fully lifted by 1Q22. The Extended health crisis scenario assumes that measures are lifted only by 1Q23.

Recent weeks have seen a flurry of positive headlines on vaccine programs. However, the near-term outlook remains uncertain and not least due to the considerable logistic and communication challenges linked to the vaccine rollout. Questions also remain on the efficacy and duration of the protection afforded by the vaccines. Presently, Covid19 circulates actively and governments across the major economies have been forced to toughen social distancing measures. Experience from the first wave of the pandemic has generally allowed for less draconian measures than those imposed in the spring albeit at a still high economic cost.

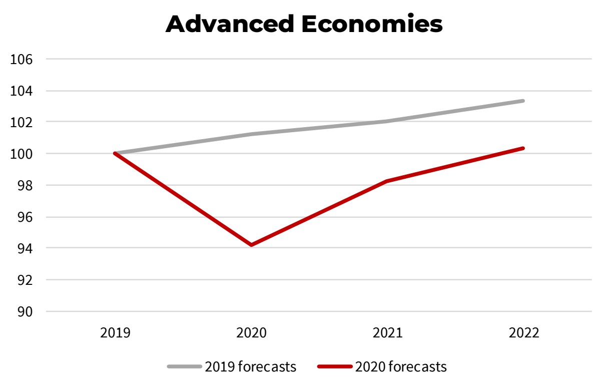
Regarding the second uncertainty on the potential economic costs or post-crisis scars many questions remain outstanding:

- **Households:** How much will structural unemployment increase and how will job demand and skillsets be durably transformed across sectors?
- **Corporates:** How can debt overhang be resolved, what transformations are in store and which sectors will be profitable?
- **Governments:** How can government manage public debt burdens and ensure medium/long-term sustainability?

These questions are the consequence of significant global output losses expected for the forecast horizon as well as the damages caused to growth potential. A further dimension, however, relates to the acceleration of several prevailing pre-crisis trends; climate, biodiversity, digitalisation, etc.

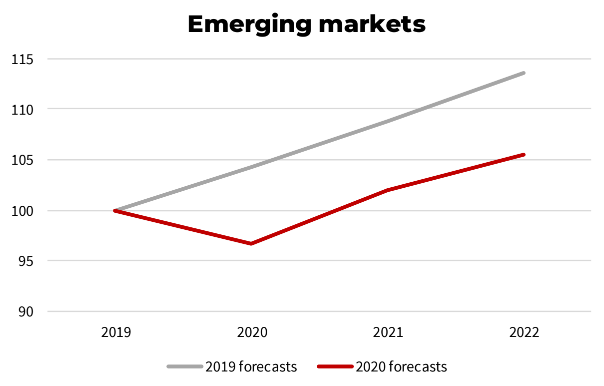
World GDP will contract by historical dimensions in 2020 (-4.3% YoY) and the rebound is expected to be of comparable magnitude in our central scenario in 2021 (+5% YoY). In Advanced Economies (AE), GDP should catch up its 2019 level only by 2022 while Emerging Market Economies (EME) should retrieve their 2019 GDP level sooner in 2021. However, even with such a recovery, income losses will be considerable when compared to pre-crisis expectations in terms of GDP levels. In the case of AE, the cumulated output loss in the 2020-2022 period is expected to be close to 14 percentage points when compared to the pre-crisis expected trajectory. In EME this loss should reach about 22pp. At the World economy level, the output loss is expected to be close to 20pp over the same period. Using 2019 GDP as a benchmark point, the loss in current terms would be USD 12tn in AE and USD 8tn in EME. With these amounts in mind, the forecast horizon will be dominated by the permanent scaring the economy and the associated economic policy reaction. This is vitally important as the vicious circle between high indebtedness, lower growth potential and non-performing loans or defaults could further disturb economic growth mechanisms.

**Output losses are considerable and never observed in recent history**




*Source: SG Economic and Sector Studies*

**Emerging market economies have been the hardest hit**




*Source: SG Economic and Sector Studies*

## FISCAL AND MONETARY POLICIES: THE ONLY GAMES IN TOWN…

Economic scars are likely to durably weigh on aggregated demand. This will be visible on the corporate sector side due to significantly weakened balance sheets and on the household side due to the labour market deterioration. The former will weigh on private investment and the latter on private consumption. Therefore, the question of the public sector demand replacing the private sector's for a certain period of time is taking centre stage.

Beyond economic scars, the crisis should continue to exacerbate already existing social and political tensions. This is likely to accentuate the pressures for lasting supportive policy measures. This will also imply higher public debt ratios, at least for the foreseeable future. On the positive side, market tolerance for higher public debt ratios has significantly increased since the start of the crisis especially thanks to forceful central banks intervention pushing interest rates to record lows. In this context, public debate seems to find some consensus on the fact that governments have to draw the benefits from low funding costs to push up fiscal support. Low interest rates for long should moderate the potential snowball effects even as public debt ratios have reached historical levels especially in AE. For these economies, public debt increased by 20% of GDP in 2020, the highest one-year variation ever observed (at least in peace times). In the case of EME the shock is lower and comparable to past episodes as these economies have experienced much more debt related crises since the last century. All in all, public debt should reach 125% of GDP in AE and more than 60% in EME in 2022.

## Emerging markets hardly hit, but with differences

Contrary to the Global Financial Crisis (GFC) in 2008-2009, EME will not be the growth engine, or at least they will grow at a much lower extent. EME will be limited in terms of policy room contrary to AE, markets tolerance to EME indebtedness is lower (no reserve currency, foreign currency debt…). This is likely to limit the ability of governments to offset post crisis output losses and hence weigh on EME growth potential. These economies have been on a structural growth slowdown after the post GFC rebound and more specially since the collapse in oil prices in 2014. More broadly, global factors which contributed to high growth potential in the past have faded (lower commodity prices, slower international trade, low indebtedness).

Out of this general view, it is worth differentiating between different regions in terms of growth prospects. Central and Eastern European countries (CEEC) benefit from more policy room given the low level of public debt ratios and limited external imbalances. The region is also more integrated to international trade and benefits from the rebound of manufacturing activity. The EU agreement for a EUR 750bn Recovery and Resilience Facility (RRF) should be a significant funding channel for CEEC over the 2021-24 period.

Asia benefits from the rebound of the Chinese economy and the recovery in international trade. These economies also have policy room and low public debt ratios which will help them face new shocks and support growth.

The situation is more complicated in Latin America. The Americas were severely hit by Covid19 registering high death rates (half of the 20 most affected countries in the World are from this region). The impact on growth is severe and the region registered two sovereign defaults and restructurings in 2020 (Argentina, Ecuador).

Contrary to initial fears, Africa has been one of the less affected regions by Covid19. It is, however, the most fragile region given its relatively high levels of debt and its low levels of development. Most of the countries resorting to the G20 Debt Service Suspension Initiative are in Sub-Saharan Africa.

## OUTLOOK MARKED BY SEQUENCING UNCERTAINTY IN ADVANCED ECONOMIES

**Policy measures come with their own sequencing challenges**: Governments have responded to the crisis with large scale policy action. This has helped to reduce the immediate impact of the crisis. Governments presently face numerous challenges on the policy front, and we highlight some of the main ones below.

- **When to lift temporary measures?** Support for furloughed workers, loan guarantees, moratorium and various other forms of income support are intended as temporary only, and a first challenge is to set the correct timing to lift or if needed extend these measures.

- **How to ensure fast-track roll-out recovery support?** Public investment to support digital and green infrastructure figure prominently in many governments' recovery programmes. While attractive on paper, the IMF warns that infrastructure projects typically run 6 to 15 years, with 3 to 8 years of preparation and 3 to 7 years of implementation. As such, governments may do well to focus more on the near-term recovery particularly on upgrading existing infra-structure. However, this is where bottlenecks may emerge, not least as reskilling of labour often comes with significant challenges.

- **Europe agrees to the Next Generation EU Recovery Fund.** Political compromise has been reached during the 10-11 December European Council meeting as Poland and Hungary have lifted their vetoes which were previously blocking the implementation of both the EUR 1.1tr EU Budget and the EUR 750bn Covid19 Recovery Fund. The direct lift to growth from the Recovery Fund in 2021-22 is set to be modest as transfers to member-states will begin to take place well into 2021. However, the indirect impact of agreeing to the Fund has been significant as this, combined with support from the ECB, has boosted market confidence and greatly reduced funding costs for the European periphery.

- **Can the US deliver stimulus?** Hope remains that agreement can be reached on a much-needed short-term relief bill (around USD 900bn) before Christmas. Continuing Resolutions must be passed by 18 December to avoid a government shutdown. The next President is set to take office on 20 January, and while the Democrats will enjoy a narrow majority in the lower house of Congress, the Senate remains uncertain, pending the Georgia runoff election on 5 January.

- **How to ease social tensions?** The sectors hardest hit by Covid19 typically employ a large number of low-skilled workers. As mentioned, the pandemic has increased already existent inequalities. While policies aimed both at income protection and re-skilling are welcome, challenges are significant and not least with the acceleration of the digital transformation. Climate policy must also consider distributional implications. Against this backdrop, the risk of social tensions remains high. Note, that the next national elections are due in autumn 2021 in Germany, spring 2022 in France, and spring 2023 in Italy.

- **How to manage Brexit?** Talks continue, but there is a serious risk to see the UK transition period end on 31 December 2020 with no agreement between the UK and the EU, with risk of serious disruption. Even if a deal is reached, this is set to be narrow and Brexit will come at a high economic cost to the UK, lowering the potential growth trend by around 0.75pp compared to a no Brexit baseline.

# ECONOMIC FORECASTS

## Real GDP Growth, %

| | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Central | Central | Extended | Central | Extended | Central | Extended |
| **Developed Markets** | **1.7** | **-5.8** | **4.3** | **1.3** | **2.1** | **2.9** | **1.9** | **2.1** |
| United States | 2.3 | -3.6 | 3.7 | 0.4 | 2.8 | 3.3 | 2.4 | 2.4 |
| Japan | 0.7 | -5.6 | 2.2 | -0.7 | 1.5 | 1.9 | 0.5 | 0.8 |
| United Kingdom | 1.3 | -11.0 | 5.0 | 2.0 | 3.0 | 3.5 | 2.0 | 2.0 |
| Euro area | 1.3 | -7.5 | 5.8 | 2.0 | 1.2 | 2.6 | 1.4 | 1.9 |
| Germany | 0.6 | -6.0 | 4.0 | 1.5 | 1.1 | 2.0 | 1.3 | 1.5 |
| France | 1.5 | -9.5 | 6.5 | 2.0 | 1.0 | 3.0 | 1.5 | 2.5 |
| Italy | 0.3 | -9.0 | 6.8 | 2.0 | 1.3 | 2.7 | 1.0 | 1.7 |
| Spain | 2.0 | -12.0 | 8.2 | 3.0 | 2.7 | 4.6 | 1.8 | 2.5 |
| **Emerging Markets** | **3.5** | **-3.3** | **5.4** | **2.7** | **3.5** | **4.6** | **3.8** | **4.1** |
| Asia | 5.0 | -1.6 | 6.7 | 3.6 | 4.5 | 5.4 | 4.5 | 4.9 |
| China | 6.1 | 2.2 | 7.2 | 3.8 | 4.8 | 5.2 | 4.6 | 4.8 |
| India | 4.2 | -9.1 | 8.5 | 4.0 | 5.3 | 6.8 | 4.5 | 5.2 |
| CEE | 2.1 | -4.8 | 3.8 | 1.4 | 2.1 | 3.2 | 2.5 | 2.6 |
| Czech Republic | 2.5 | -7.0 | 5.8 | 2.0 | 1.5 | 0.3 | 2.0 | 1.3 |
| Romania | 4.2 | -6.0 | 5.7 | 2.0 | 1.6 | 1.8 | 2.0 | 2.0 |
| Russian Federation | 1.3 | -4.0 | 2.0 | -0.5 | 1.5 | 2.5 | 1.5 | 1.5 |
| Latin America | 0.0 | -8.0 | 3.7 | 1.6 | 1.6 | 2.9 | 2.4 | 2.6 |
| Brazil | 1.1 | -4.8 | 3.5 | 1.0 | 2.3 | 3.2 | 2.0 | 2.1 |
| Middle East & C. Asia | 0.3 | -6.2 | 2.8 | 0.8 | 1.7 | 3.2 | 2.8 | 3.0 |
| Africa | 3.3 | -3.4 | 4.1 | 2.1 | 3.1 | 4.6 | 3.9 | 4.2 |
| **World (PPP weighted)** | **2.8** | **-4.3** | **5.0** | **2.1** | **2.9** | **3.9** | **3.1** | **3.3** |

## Market variables

| | Last value | Central | | | Extended | | |
|---|---|---|---|---|---|---|---|
| *end of period, %* | ***11.12.20*** | **2021f** | **2022f** | **2023f** | **2021f** | **2022f** | **2023f** |
| ***United States*** | | | | | | | |
| Fed Funds target (high) | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 10y government bonds | 0.91 | 0.90 | 1.00 | 1.50 | 0.50 | 0.50 | 0.50 |
| ***Euro area*** | | | | | | | |
| Refinancing rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Deposit facility rate | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |
| 10y government bond | | | | | | | |
| Germany | -0.60 | -0.40 | -0.30 | 0.00 | -0.60 | -0.60 | -0.50 |
| France | -0.36 | -0.10 | 0.20 | 0.40 | -0.20 | 0.10 | 0.10 |
| Italy | 0.53 | 1.10 | 1.70 | 2.00 | 1.15 | 1.90 | 1.75 |
| Spain | 0.03 | 0.40 | 0.80 | 1.00 | 0.35 | 0.80 | 0.75 |
| ***United Kingdom*** | | | | | | | |
| Bank rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 10y government bond | 0.20 | 0.60 | 0.70 | 1.00 | 0.40 | 0.60 | 0.60 |
| ***Japan*** | | | | | | | |
| BoJ rate | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 |
| 10y government bond | 0.02 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

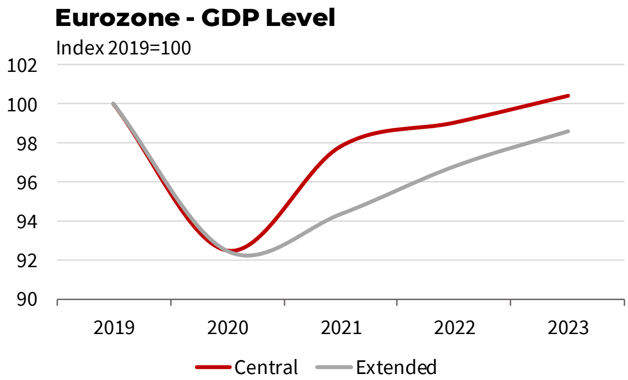
| | Last value | Central | | | Extended | | |
|---|---|---|---|---|---|---|---|
| *end of period* | ***11.12.20*** | **2021f** | **2022f** | **2023f** | **2021f** | **2022f** | **2023f** |
| EUR / USD | 1.21 | 1.15 | 1.15 | 1.20 | 1.10 | 1.10 | 1.10 |
| EUR / GBP | 0.91 | 0.95 | 0.95 | 0.95 | 1.00 | 1.00 | 1.00 |
| GBP / USD | 1.33 | 1.21 | 1.21 | 1.26 | 1.10 | 1.10 | 1.10 |
| EUR / JPY | 127 | 127 | 127 | 126 | 116 | 116 | 116 |
| USD / JPY | 104 | 110 | 110 | 105 | 105 | 105 | 105 |
| USD / CNY | 6.55 | 7.05 | 7.10 | 7.05 | 7.20 | 7.20 | 7.25 |
| Brent ($/b), Year avg | 50 | 45 | 55 | 55 | 38 | 50 | 50 |

# EURO AREA

- **The convergence of GDP to its pre-crisis level will be slow and growth paths will diverge from one economy to another**
- **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**

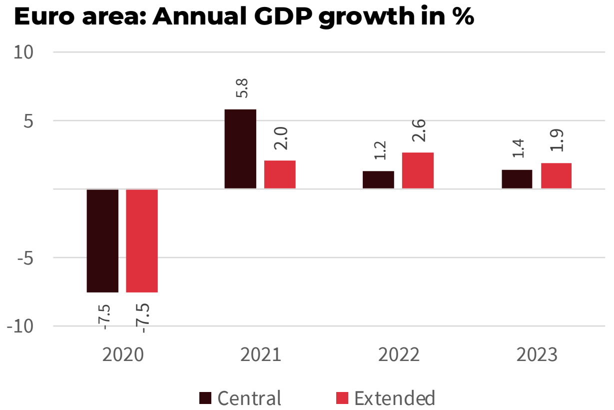
The intensification of health measures in winter 2020-21 will have deepened the recession in 2020. In 2021, vaccination campaigns and the gradual unwinding of measures restricting activity will support a more sustained rebound than initially anticipated. But in the medium term, growth will remain modest. Rising unemployment will slow down the absorption of accumulated savings by households, while the weakening of corporate balance sheets will weigh on the investment cycle. Against this backdrop, GDP is not expected to return to its pre-crisis level before 2023. In a scenario where the pandemic risk persists, delaying the withdrawal of health measures for one year (to early 2023 instead of early 2022), GDP convergence would also be delayed by one year.

**Recovery is set to be very progressive**




*Source: SG Economic and Sector Studies*

**Growth will be very moderate in 2022-2023**




*Source: SG Economic and Sector Studies*

The European Recovery Plan (calibrated according to income losses of each country) will help to rule out the scenario of too strong a divergence in the growth trajectories of the different economies. However, some divergence seems inevitable as some economies are more exposed than others to the pandemic through the sector channel[1].

In 2021, world trade will rebound a little more strongly than initially expected, in the wake of stronger than expected growth in China and the United States. But in the

[1] For example, the sectors most affected by health measures, such as the arts, entertainment and recreation, wholesale and retail trade, accommodation and food services and air transport represent 21.4% of the GDP in Spain compared to only 13.0% in Germany (Eurostat data from 2019).

longer term, the recovery will nonetheless remain very gradual, reflecting a different pace of the pandemic's ebb on a global scale. In addition, certain factors that drove the recovery after the great financial crisis will not be present this time. For instance, the absence of a major fiscal stimulus in China and the weakening of many emerging economies by the pandemic rule out the scenario of a marked and lasting rebound in external demand. Euro area exports will therefore show moderate growth on average over the forecast horizon.

In the wake of the shock recorded in 2020, the rebound in domestic demand will be modest in the medium term. With the support of various national public guarantee mechanisms, companies will have increased their debt to compensate for the losses linked to the forced shutdowns of the economy. In this context, the deterioration in debt ratios, already high in some countries before the crisis, will weigh on investment recovery. In addition, the increase in defaults will certainly lead to a tightening of the lending conditions by banks, which will however be much less marked than during the crises of 2008-2013.

On the household side, the rise in unemployment and wage moderation 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 lending conditions 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).

The ECB enhanced its monetary stimulus at the end of the year, increasing the duration and envelope dedicated to its exceptional asset purchases and announcing a new round of TLTROs[2]. 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 70% of GDP in 2020-2021, an increase of 30pp of GDP compared to the start of 2020. In the longer term, any normalisation of monetary policy appears difficult and the risk will remain tilted towards additional easing measures. Inflation will be low on the forecast horizon. Moderate labour costs and weak demand will deter companies from raising prices, while at the same time oil price growth will remain moderate. Thus, TLTROs and asset purchases (thanks to an extension and an increase in the size the envelope) will remain at the heart of the ECB's strategy.

[2] TLTROs are refinancing operations offered to banks by the ECB, the rate of which is lower than the refinancing rate on condition that the banks meet credit production targets.

The risk of further trade tensions ebbing with political alternation in the United States offers a slight improvement in the balance of risks surrounding our scenario. However, the list of downside risks remains long. A deterioration in the quality of bank balance sheets, particularly in relation to the rise in corporate debt ratios, will be particularly important to watch. Likewise, the downgrade of the sovereign rating of the most fragile countries would fuel new tensions in the sovereign debt market. Politically, the issue of Brexit remains pressing as the EU and UK continue to negotiate the nature of their future relationship. Finally, a new surge in Euroscepticism and political risk cannot be ruled out.

| **Euro Area** | **2019** | **2020f** | **2021f** | | **2022f** | | **2023f** | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 1.3 | -7.5 | 5.8 | 2.0 | 1.2 | 2.6 | 1.4 | 1.9 |
| Inflation, % | 1.2 | 0.3 | 0.7 | 0.4 | 1.3 | 1.6 | 1.3 | 1.3 |
| Unemployment, % | 7.6 | 8.0 | 10.1 | 10.5 | 10.4 | 11.3 | 10.1 | 11.0 |
| Fiscal balance, % GDP | -0.9 | -8.9 | -6.1 | -8.0 | -5.8 | -7.1 | -5.5 | -6.6 |
| Public debt, % GDP | 89 | 107 | 108 | 114 | 111 | 117 | 114 | 120 |

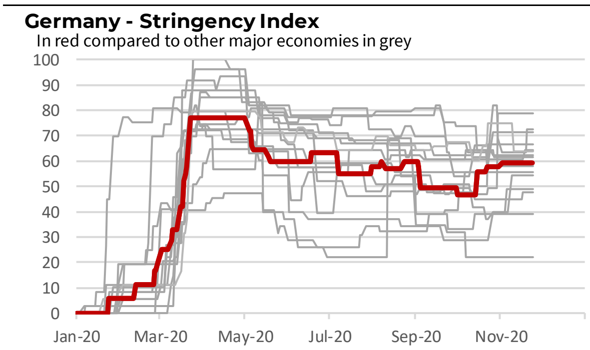
*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# GERMANY

- **Convergence of the economy towards its pre-crisis level will be faster than elsewhere in the euro area but will remain gradual**
- **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**

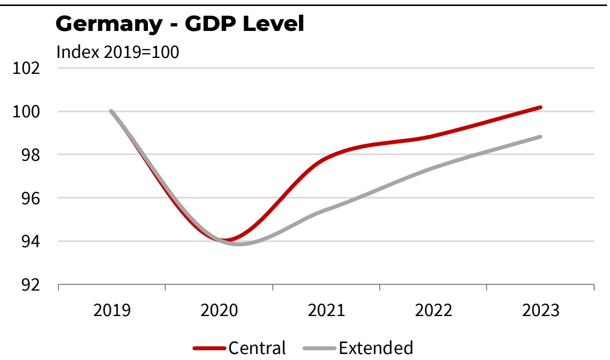
The tightening of health measures in the winter of 2020-21 will have deepened the recession in 2020, which is close to that of 2009. In 2021, the vaccination campaign and the gradual unwinding of health measures (until the beginning of the year 2022) will contribute to a somewhat stronger recovery in activity than initially anticipated[3]. But longer term, the delayed effects of the crisis on jobs, investment and external demand (from the rest of the euro area in particular) will weigh on growth, which will only evolve slightly above its potential in 2022-23. The German economy is forecast, however, to converge more quickly to its pre-crisis level than its main counterparts in the euro area, from the turn of 2023 (a year later if the unwinding of health measures were postponed).

**Lockdown was less stringent in Germany…**




*Source: University of Oxford*

**… but the recovery is set to be slow**




*Source: SG Economics & Sector Studies*

The rebound in exports will be more moderate than what was observed in the wake of the great financial crisis. On the positive side, German industry specializes in branches with low exposure to the uncertainty surrounding the course of the pandemic. In addition, the stronger-than-expected rebound in activity in the United States and China, particularly in 2021, should support foreign trade. However, German companies will benefit less from genuine dynamism in emerging markets to offset weak demand in the euro area and the United Kingdom. Indeed, the scale of the fiscal stimulus is much more modest in China, while the emerging economies are generally emerging from the health crisis weakened.

[3] The stronger sequential growth momentum anticipated in 2021 is reflected by the stability of our annual growth forecast in 2021 while it is revised downward in 2020.

The subsidies granted and the equity provided by the public authorities will have ruled out the scenario of an excessive deterioration in the balance sheet of companies. Debt ratios will, however, have increased with the interruption of activity in 2020. This factor, together with the relative weakness of expected demand, will weigh on the rebound in investment in the medium term. 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 to a likely tightening of lending 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 recovery plan will continue to have positive effects on activity. Thus, in the current situation, the budgetary measures taken in response to the health crisis and the stimulus plan represent around 10% of GDP. Public debt is expected to increase by around 20pp of GDP over the forecast horizon, to around 80% of GDP in 2023.

With aggregate demand slowing and unit labour costs moderating, core inflation will slow over our forecast horizon. With the price of oil also remaining low, total inflation will be low.

Despite the deterioration in public and private debt ratios, the risks to financial stability appear to be limited. The political alternation in the United States and the easing of trade tensions which should result from it reduce the downside risk on the dynamics of foreign trade. But at the same time, the downside risks remain numerous. On top of the list would be a failure of negotiations between the UK and the EU over their future relationship.

| Germany | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 0.6 | -6.0 | 4.0 | 1.5 | 1.1 | 2.0 | 1.3 | 1.5 |
| Inflation, % | 1.4 | 0.4 | 0.5 | 0.4 | 1.3 | 1.1 | 1.4 | 1.4 |
| Unemployment, % | 5.0 | 6.1 | 7.1 | 7.5 | 7.2 | 7.9 | 7.0 | 7.7 |
| Fiscal balance, % GDP | 1.5 | -6.3 | -4.8 | -6.1 | -4.7 | -5.5 | -4.5 | -5.2 |
| Public debt, % GDP | 60 | 74 | 76 | 80 | 80 | 83 | 83 | 87 |

*Base = Central scenario*
*Ext. = Extended health crisis scenario*

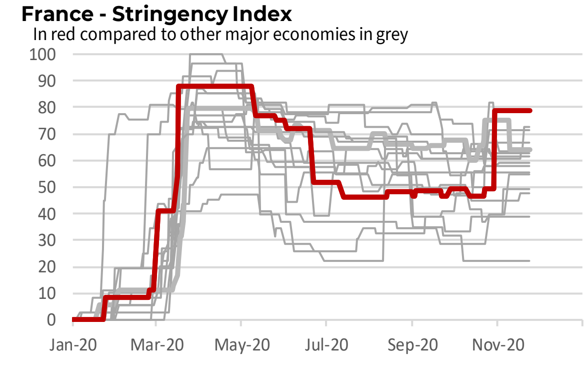
# FRANCE

- **The health crisis legacy on employment and corporate debt will weigh on growth in the medium term**
- **Inflation will be low and financing conditions very favourable over the forecast horizon**
- **Public debt would increase by 30 points of GDP over the forecast horizon, exceeding 130% of GDP in 2023**

The lockdown of winter 2020-21 will have deepened an already historic recession in 2020. In 2021, the vaccination campaign will support a dynamic rebound in activity that will be more sustained than initially anticipated[4]. But in the longer term, growth will be moderate despite the total unwinding of health measures expected in early 2022. Indeed, the legacy of the crisis in terms of job destruction and surge of corporate debt will weigh on growth. Fiscal stimulus will boost activity in 2021-22, of course, but will not fully offset the loss of income recorded in 2020.

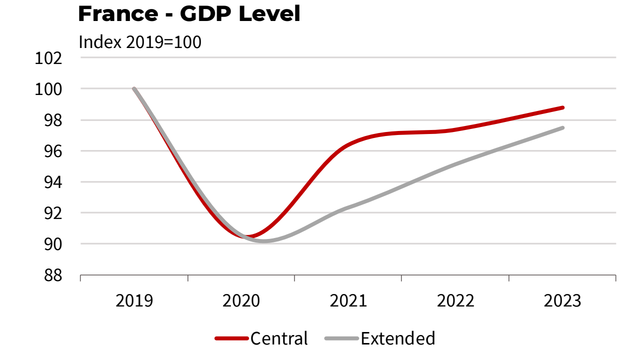
In the absence of more decisive government action in strengthening corporate equity, the convergence of GDP to its pre-crisis level will take a long time. It would not materialise until 2024, with unemployment reaching 11% at its peak. In the scenario of a prolonged health crisis where health measures would not be unbuckled until the beginning of 2023, the convergence of GDP would also be postponed for one year, to 2025.

**The second lockdown is less strict**




*Source: University of Oxford*

**Towards a very progressive recovery**




*Source: SG Economic and Sector Research*

Pending the total unwinding of sanitary measures, foreign trade dynamics will remain sluggish. Indeed, French exports strongly depend on prospects in aeronautics and tourism, two sectors particularly dependent on the evolution of the pandemic. In addition, foreign demand risks suffering from the spread over time of the real effects of the crisis (in terms of employment and investment) among the

[4] This more sustained quarterly dynamic is reflected by the stability of the annual growth forecast in 2021 compared to the previous Eco Scenario, while the forecast for 2020 is revised downward.

main trading partners of the French economy. As a result, exports would not really recover until 2023.

| Budgetary measures adopted in response to the health crisis | Size EUR bn |
|---|---|
| ▪ **First emergency plan (PLFR I, II and III) - 2020** | **64.5** |
| Including: | |
| ▪ Enhancement of short time working schemes | 30.8 |
| ▪ Solidarity Fund (subsidies for the smallest companies) | 8.5 |
| ▪ Exceptional funds for health administrations | 9.8 |
| ▪ Offset of social security contribution exemption | 5.2 |
| ▪ Extension of income replacement and postponement of the reform of unemployment insurance | 1.6 |
| ▪ **2020-2025 recovery plan (including EUR 37bn of Maastricht criteria measures[5] included in the 2021 PLF)** | **100** |
| Demand-driven measures: | **41** |
| ▪ Public investment (including energy renovation of buildings, green infrastructure and mobility) | 23 |
| ▪ Support for households (including support to the purchase of clean vehicles and increase in the back-to-school allowance) | 10 |
| ▪ Other public expenditure (including digitalisation of public services and companies) | 8 |
| Supply-driven measures: | **44** |
| ▪ Tax cuts on production | 20 |
| ▪ Innovation (including Future Investment Programs) | 16 |
| ▪ Employment and training (including youth plan, short time working and investment in skills) | 8 |
| Other measures | **15** |
| ▪ **First emergency plan (PLFR IV) - 2020** | **20** |
| Including: | |
| ▪ Enhancement of the Solidarity Fund | 10.9 |
| ▪ Extension of the most favourable short time working scheme until December 2020 | 3.2 |
| ▪ Exceptional poverty allowance | 2.1 |
| ▪ Other measures (including advancement to 2020 of the second Ségur health pact component) | 4.3 |
| **Total** | **184.5** |
| % of GDP 2019 | 7.8 |

*Source: DG Trésor, PLFR I, II, III & IV, PLF 2021, SG Economic and Sector Research*

Companies have been weakened by the forced shutdowns of entire sections of the economy. Successive government emergency measures have supported their liquidity, but the operational losses having been largely offset by massive recourse to borrowing (partly guaranteed by the government) and debt ratios have deteriorated sharply. Despite favourable financing conditions, stabilising debt ratios

[5] Part of the stimulus plan spending will not be accounted in the budget balance. Indeed, some of them will not be executed by entities identified as public administrations within the meaning of Maastrichtian accounting. In addition, others are financial transactions and will be recorded directly in the public debt ratio and not in the budget balance.

will force companies to partially postpone their investment spending in order to increase their financing capacity.

On the household side, job destructions and wage moderation will weigh on spending in the medium term. The absorption of "forced" savings accumulated during the lockdowns will drive consumption in 2021 as the pandemic recedes. But with rising unemployment, households will retain precautionary savings, ruling out the scenario of consumption rapidly converging to its pre-crisis level.

Persistently low oil prices, moderation in labour costs and weak expected demand will help maintain a very low inflation environment in 2021-2022.

The contraction of activity and the government's emergency measures in response to the health crisis will have seriously deteriorated the fiscal position in 2020. The unwinding of certain exceptional measures and the subsidies earmarked to France as part of the European recovery plan will contribute to improving the public balance in 2021. But with the execution of the recovery plan and the slow convergence of the economy towards its pre-crisis level, public debt ratios will deteriorate over the forecast horizon, the public debt reaching 130% of GDP in 2023.

The balance of risks surrounding our scenario has improved with political change in the United States and the risk of trade tensions ebbing accordingly. On the upside risks, a more active government policy on strengthening corporate equity would help accelerate the investment cycle and bring the economy to its pre-crisis level at a faster pace. But the list of downside risks remains long, from a delay in the vaccination campaign to uncertainties in the wake of Brexit and new social movements.

| France | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 1.5 | -9.5 | 6.5 | 2.0 | 1.0 | 3.0 | 1.5 | 2.5 |
| Inflation, % | 1.4 | 0.5 | 1.0 | 1.0 | 1.2 | 1.1 | 1.2 | 1.2 |
| Unemployment, % | 8.1 | 8.3 | 10.2 | 10.9 | 10.9 | 11.8 | 10.6 | 11.5 |
| Fiscal balance, % GDP | -3.0 | -10.8 | -6.9 | -9.2 | -6.6 | -7.9 | -5.9 | -6.8 |
| Public debt, % GDP | 98 | 118 | 124 | 131.4 | 129 | 135 | 132 | 138 |

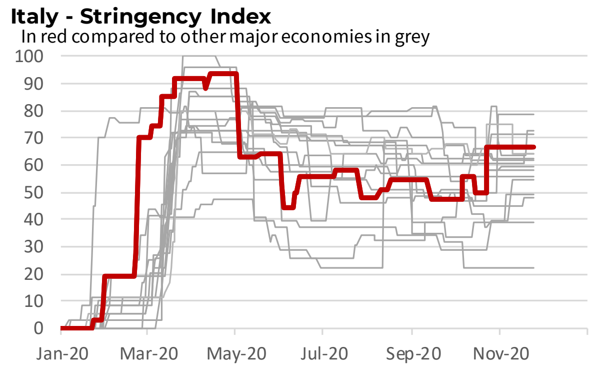
*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# ITALY

- **Heterogenous recovery to pre-crisis levels, slow in aggregate**
- **Narrow window of opportunity for economic transformation**
- **Debt vulnerable to both domestic and European policy errors**

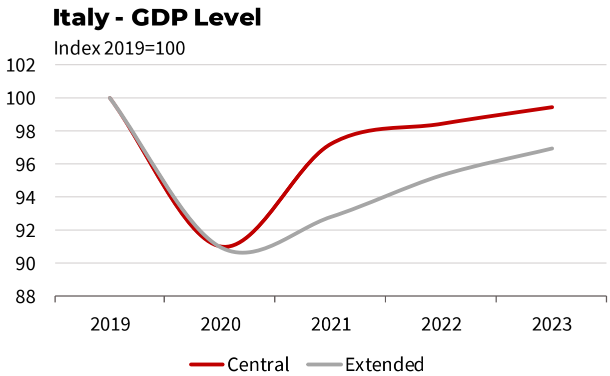
The Italian economy enjoyed better-than-expected performance in 3Q, but a resurgence in Covid19 cases and new social distancing measures point to contraction in 4Q20, albeit milder than in 2Q20. Heading into 2021, we forecast a choppy start to the year, but the arrival of warmer weather and a smooth rollout of vaccine programs, should allow for a gradual recovery taking root in 2H21. The exit from the health crisis remains uncertain, however, and we maintain an extended scenario in which social distancing measures remain in place for an additional year until 1Q23 compared to our central scenario.

**Italy faced one of the toughest lockdowns**




*Source: University of Oxford*

**A slow recovery with structural headwinds**




*Source: SG Economic and Sector Research*

A flurry of temporary policy measures has helped support both households and corporates faced with renewed pressure from the Covid19 crisis. Broadly speaking, these relief measures can be grouped under three broad headings; liquidity, revenue and job protection. Welcome and necessary as these measures are, each comes with a flip side that is set to dampen the subsequent recovery. Liquidity support, such as tax deferrals, debt moratorium and loans benefitting from various guarantees, ease cash crunches but ultimately must be paid back and add to the private debt burden. Revenue support in the form of various government transfers to households and firms, on the other hand, add to the public debt burden. As seen from the table below, measures in 2020 are set to have a budgetary impact of around €100bn. Finally, on job protection, limitations on dismissals, can lead to pent up terminations.

The timing of lifting these various temporary support measures will be a first challenge that policymakers need to address. Lifting before recovery has gained sufficient momentum risks a wave of firm defaults and job losses. This, in turn, would risk a sharp increase of non-performing loans (NPLs) and a resulting credit crunch.

The fact that the Italian banking system entered the present crisis with much stronger balance sheets was the case back at the time of the euro area debt crisis offers a buffer.

| 2020 "Above the line" fiscal measures | EUR/bn |
|---|---|
| *Autumn packages* | **5.4** |
| *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** |
| % of GDP | 6.4% |

In 2Q20, the NPL ratio stood at 6.08% for Italy; slightly less that the level that prevailed when the Covid19 crisis struck and well below the peak of around 19% seen in the wake of the euro area debt crisis. Note that disposals have benefitted from the provisions in the Decree Law 18/2020 that allowed banks to convert a share of deferred tax assets into tax credits against NPL sales.

Turning to public balance sheets, supportive measures from the ECB and the confidence lift afforded by the various European support measures, have allowed Italian bond yields to fall to historic lows, with the 10-year benchmark trading at below 0.6% as we head to press. This positive development is clearly helpful in terms of the very high level of public debt, set to clock in at over 150% in 2021.

The critical factor now is to set Italy on a path of stronger trend potential growth, so that market confidence is maintained once the ECB's pandemic support is lifted. At the December meeting, the ECB committed to keeping the pandemic emergency purchase programme in place at least to the end of March 2022 and increase the envelope of the PEPP by EUR 500bn to EUR 1,850bn. Moreover, maturing PEPP purchases will be rolled at least until the end of 2023. This further added to Italy's window of opportunity.

Looking ahead to 2021, the budget includes measures to support recovery with an estimated budgetary impact of 1.4% of GDP. Importantly, Italy is set to be a major beneficiary to the EU Recovery Funds, which if coupled with appropriate structural reforms, can not only help spur green and digital transitions, but also set the economy on a path to higher trend growth with a reduction of economic divergence across regions, further aggravated by the crisis. The fact that the pandemic has in particular hit those sectors than employ large number of low skilled workers has only added to the challenges.

Numerous hurdles must be overcome, however, to steer the Italian economy in the direction of a more favourable structural path. Effective rollout of public investment is a first prerequisite; history suggests significant risk that funds are delayed by bureaucracy and directed by political motivation to less efficient projects. Continued structural reform is equally critical and not least due to the ongoing demographic headwinds faced by Italy. The list of need reforms is well known, ranging from education and life long-learning, judiciary and bankruptcy, more efficient (and digitalised) public administration, streamlining of the tax code and competition.

In the current context of the fragile coalition government between the centre-left Democratic Party and the traditionally anti-establishment Five Star Movement, the risk of political infighting slowing both the rollout of policy support and much needed structural reform must be considered non-negligible.

Elections are due by 1 June 2023 at the latest and as the election date approaches, the current exceptional window of opportunity for reform could well start to close. Should Italy fail to deliver on boosting trend growth, then the burgeoning public debt is set once again to turn to a source of stress episodes.

| **Italy** | **2019** | **2020f** | **2021f** | | **2022f** | | **2023f** | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 0.3 | -9.0 | 6.8 | 2.0 | 1.3 | 2.7 | 1.0 | 1.7 |
| Inflation, % | 0.6 | -0.1 | 0.6 | 0.3 | 1.0 | 1.0 | 1.0 | 0.9 |
| Unemployment, % | 9.9 | 9.5 | 11.8 | 12.8 | 11.3 | 12.1 | 10.7 | 11.4 |
| Fiscal balance, % GDP | -1.6 | -10.5 | -7.7 | -10.1 | -7.3 | -9.2 | -7.1 | -8.6 |
| Public debt, % GDP | 135 | 158 | 156 | 165 | 159 | 168 | 163 | 172 |

*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# SPAIN

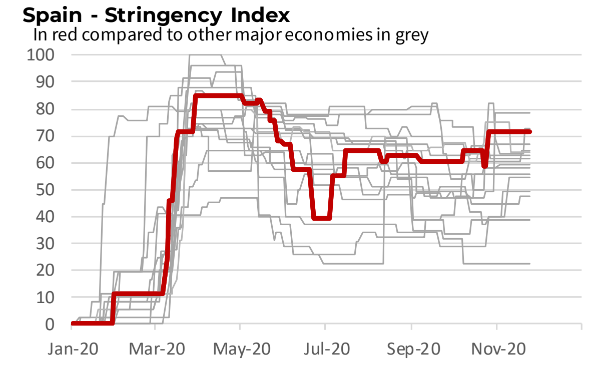
- **Activity rebounded sharply in 3Q20 but already started to lose momentum in September**
- **The reintroduction of restrictions will lead to a decline in activity in 4Q20. We forecast a 12% GDP contraction in 2020**
- **Stimulus will be mainly financed by the European recovery plan**

Activity rebounded by 17.3% in 3Q20, above expectations, but it started to lose momentum in September, when retail sales contracted by 0.3% and the purchasing indicators for services were down. With the re-imposition of restrictions since October, in the form of regional curfews and travel bans, activity is expected to contract again in the last quarter.

The labour market continued to gradually improve in October, having recovered about two-thirds of the jobs lost earlier in the year. However, around 600,000 workers are still registered under partial unemployment schemes and are currently not officially classified as unemployed.

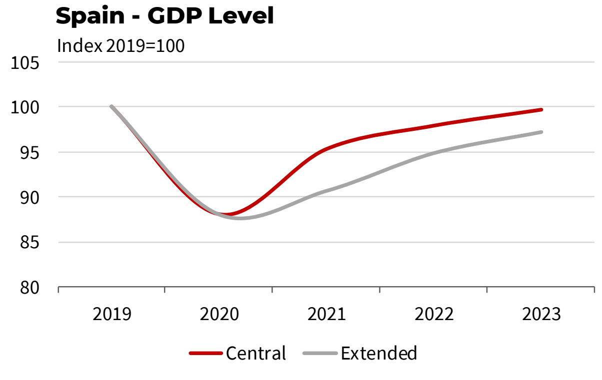
A second wave of job destruction is expected at the end of 2020 and early 2021, due to company bankruptcies or the readjustment of business plans to new market conditions. The unemployment rate would thus peak close to 20% at the end of 2021 in our central scenario. It would remain permanently elevated in a context of still high uncertainty, weakened corporate balance sheets, with an amplified impact of the crisis on labour-intensive sectors, such as retail trade and hotels / restaurants .

**Some lockdown measures are still in place**




*Source: University of Oxford*

**GDP will take time to recover pre-crisis levels**




*Source: SG Economic and Sector Research*

The predominance in the industrial fabric of small companies with little capital, leads to financial weaknesses and a higher risk of insolvency. Total direct support measures adopted so far by the Spanish government remain close to 3% of GDP, which is in the low range of national aid plans. In this context, the European recovery plan "Next Generation EU" is crucial.

| “Above the line” fiscal measures | EUR/bn |
| --- | --- |
| **Labour market measures**<br>- increase protections of vulnerable workers and self-employed<br>- exemptions of social security contributions<br>- temporary employment schemes (ERTEs) … | 26.2 |
| **Strengthening the financing of health and research sectors**<br>-increase allocation to health ministry<br>-transfer of money to regions<br>-implementation of a 0% VAT rate for medical supplies | 5.3 |
| **Introduction of a universal basic income**<br>- 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**<br>- possibility to adapt corporate and income tax payments | 1.1 |
| **Total** | **36.1** |
| % of GDP | 3.2% |

A “Recovery, Transformation and Resilience Plan” was announced in October by the government. It forecasts public spending of EUR 140bn over the period 2021-2026 and should, according to the government, increase the potential growth of the Spanish economy above 2%. In response to the crisis triggered by the coronavirus and the structural challenges of the Spanish economy, this plan provides for public investments in infrastructure associated with digitization and innovation. Another component plans to increase energy efficiency, improve education and continuing training and strengthen inclusion policies. The government plans to create 800,000 jobs. This recovery plan should be fully funded by the European “Next Generation EU” plan. The latter should enable Spain to obtain financing to the tune of EUR 140bn, of which about half will be disbursed in the form of grants and the rest in the form of loans.

Spain will request the share of funds that take the form of grants for the period 2021-2023, but has declared that it is not interested, at this stage, by the nearly EUR 70bn in loans. The European Commission allows members to apply for these loans until July 2023. There is indeed less incentive to apply for loans from the EU, however cheap they may be, as market access is currently facilitated by the asset purchase policy of the European Central Bank which has compressed spreads.

The political landscape remains very fragmented in Spain, where there is no majority in Parliament and decision-making remains difficult. This will continue to prevent the government from taking action that is quick or that would require broad consensus. Meanwhile, Spain's Supreme Court confirmed in October the dismissal of the President of the Catalan region, Quim Torra, for violating the country's electoral law. As a result, new regional elections will be held in Catalonia on February 7, 2021. Polls suggest that separatist parties could strengthen their parliamentary majority. Most likely, however, is the continuation of the relatively pragmatic approach that has been observed for the last eighteen months.

| **Spain** | **2019** | **2020f** | **2021f** | | **2022f** | | **2023f** | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 2.0 | -12.0 | 8.2 | 3.0 | 2.7 | 4.6 | 1.8 | 2.5 |
| Inflation, % | 0.8 | -0.4 | 0.9 | 0.4 | 1.5 | 1.8 | 1.3 | 1.2 |
| Unemployment, % | 14.1 | 15.9 | 18.7 | 19.8 | 18.3 | 20.2 | 17.7 | 19.5 |
| Fiscal balance, % GDP | -2.9 | -12.5 | -8.7 | -11.8 | -7.6 | -10.0 | -7.2 | -9.2 |
| Public debt, % GDP | 96 | 120 | 118 | 127 | 121 | 129 | 125 | 134 |

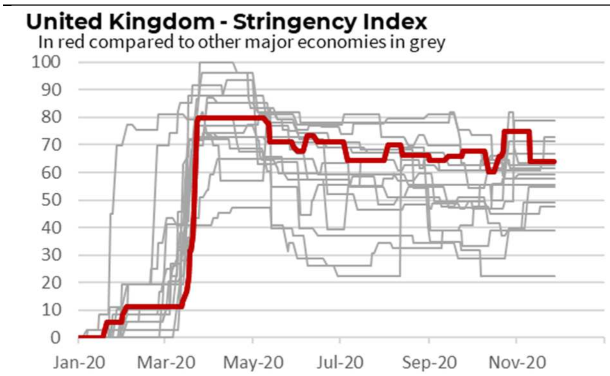
*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# UNITED KINGDOM

- **With one of the highest death tolls in Europe and of the longest lockdown, the UK is severely hit by Covid19**
- **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 uncertainties**

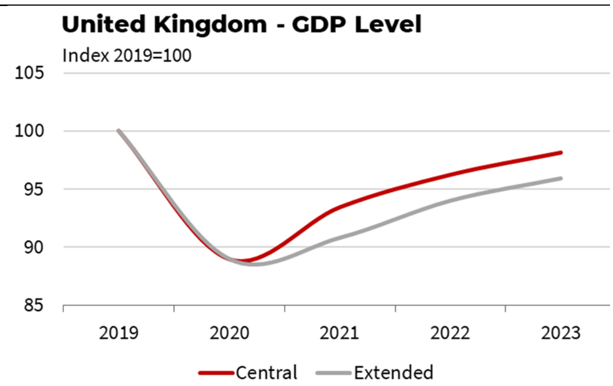
UK economic rebound in 3Q20 (+15.5 %) leaves output far below pre-pandemic levels (-9.6 % as compared to 3Q19). This larger gap with pre-pandemic levels as compared to similar countries reflects a lockdown that has been longer in the UK, and also reflects the Brexit uncertainty effect. In the short run, the recovery speed is threatened by the latest lockdown restrictions and people are expected to stay at home and most businesses and venues are closed.

**A high average stringency index in 2020**




*Source: University of Oxford*

**The new lockdown delays recovery**




*Source: SG Economic and Sector Research*

To mitigate the effect of this second outbreak on the economy, the UK authorities have updated their support package for households, business and public services.

On the fiscal side (see table below), the response encompasses: i/ new additional funding for the NHS, public services, charities and culture (GBP 127bn); ii/ the strengthening of the social safety net, notably by increasing payments under the Universal Credit scheme as well as expanding other benefits (GBP 8bn); iii/ measures to directly support businesses, like property tax holidays, grants for small firms and firms in the most-affected sectors – notably cash grants of up to £3,000 per month for businesses which are closed - and compensation for sick pay leave (GBP 66bn). With the second lockdown, the government has fully reactivated the Self-Employment Income Support Scheme (SEISS) and the Coronavirus Job Retention Scheme (CJRS), that pays 80% of the earnings (to a maximum of GBP 2,500 per employee per month) of self-employed workers and furloughed employees. The combined cost of the measures is now expected to be c. GBP 73bn. However, the Job Retention Bonus (a one-off payment of GBP 1,000 to UK employers for every furloughed employee who remains employed) was part of a package of measures aiming at preserving jobs announced in July that will be redeployed later as the reference date of January 2021 is postponed.

| **"Above the line" fiscal measures** | **GBP bn** |
|---|---|
| **Public services spending:**<br>- Health services, local authorities, measures to support vulnerable individuals, supporting rail services and funding for the devolved administrations | 127 |
| **Employment support:**<br>- Coronavirus job retention scheme<br>- Self-employed income support scheme<br>- Job retention bonus ( we will redeploy at the appropriate time) | 73 |
| **Welfare package:**<br>- Universal credit - minimum income floor<br>- Increase weekly universal credit by £20<br>- Employment and support allowance: removing 7 day wait<br>- Local Housing Allowance measures | 8 |
| **Business support:**<br>- Small business grant schemes<br>- Business rates package | 66 |
| **Total** | 274 |
| % GDP | 12.9% |

The government has also launched schemes aiming at easing firms' access to liquidity. Three separate loan schemes are still currently available: i/ the *Coronavirus Business Interruption Loan Scheme* to support SMEs; ii/ the *Coronavirus Large Business Interruption Loan Scheme* to support bigger firms, which carry an 80 % guarantee for loans up to GBP 5 m for the former and up to GBP 200mn for the latter; iii/ the *Bounce Bank loan scheme* for SMEs which grants a 100 % guarantee for loan amounts up to GBP 50,000 to further ease access to credit for smaller firms facing difficulties. .

| “Below the line” fiscal measures | GBP bn |
|---|---|
| **VAT payments deferral scheme**<br>Value of Facilities Approved as of 7 June | 28 |
| **Coronavirus Business Interruption Loan Scheme (CBILS)**<br>Value of Facilities Approved as of 15 Nov. | 19 |
| **Coronavirus Large Business Interruption Loan Scheme (CLBILS)**<br>Value of Facilities Approved as of 15 Nov. | 5 |
| **Bounce Back Loan Scheme (BBLS)**<br>Value of Facilities Approved as of 15 Nov. | 42 |
| **Future Fund**<br>Value of Facilities Approved as of 15 Nov. | 1 |
| **Covid Corporate Financing Facility**<br>Value of Facilities Approved as of 25 Nov. | 15 |
| **Total** | 110 |
| % GDP | 5.2% |

All these mitigating measures have a cost. In its latest report in November, the Office for Budget Responsibility, the UK public finance watchdog, estimated that the receipts this year are set to be GBP 57bn lower, and spending GBP 281bn higher, than last year. The combined impact of the virus on the economy and the Government’s fiscal policy response pushes the deficit this year to GBP 394bn, its highest level since the Second World War.

Despite the unprecedented size of public support, it is worth noting 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 could turn out to be insufficient to avoid economic scarring, notably because of the effect of the crisis on the job market. 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. In our central scenario we expect the unemployment rate to peak at 8.5% in 2Q21.

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 central bank also expanded its holding of UK government bonds and non-financial corporate bonds by GBP 300bn in March and June. An additional increase of the target stock of government bonds by GBP 150 bn was announced in November to take the total stock to GBP 875bn, this is a cumulated increase of 100% since 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 BoE 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 effectively supported corporates' access to liquidity. The latest figures indicate that UK private sector businesses raised a total of GBP 74bn from banks and financial markets from March to September in debt instruments, causing the amount of outstanding debt to grow by 8.3% over the past 12 months at the end of September. Notably, equity financing has also been dynamic since March, with GBP 15.9bn raised at the end of September. This equity funding alleviates the financial stability concerns resulting from the crisis.

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 reach a deal before transition arrangements expire in December.

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 freights 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.

The short-term impact of an eventual "no deal" Brexit, moreover, is dampened by the fact that companies have had more time to prepare for such an outcome. Moreover, the UK has recently announced that full border controls on goods entering the UK will not come into effect before July 2021. In the 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 | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 1.3 | -11.0 | 5.0 | 2.0 | 3.0 | 3.5 | 2.0 | 2.0 |
| Inflation, % | 1.8 | 0.9 | 1.3 | 1.0 | 1.9 | 1.6 | 2.0 | 1.9 |
| Unemployment, % | 3.8 | 4.9 | 7.8 | 9.2 | 6.2 | 7.6 | 5.1 | 6.5 |
| Fiscal balance, % GDP | -2.3 | -14.6 | -10.4 | -14.4 | -6.2 | -7.5 | -4.9 | -6.3 |
| Public debt, % GDP | 85 | 106 | 108 | 115 | 109 | 117 | 109 | 118 |

*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# UNITED STATES

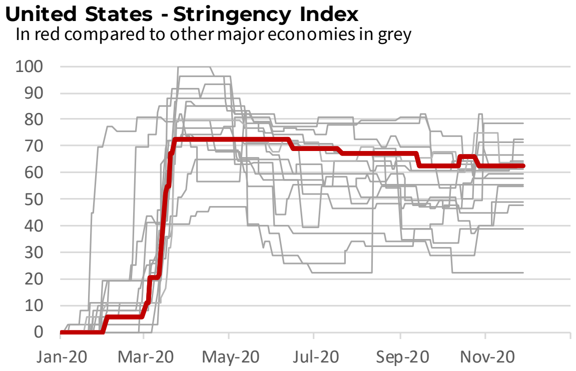
- **The economy is recovering supported by household consumption. The labour market however is still suffering from the health crisis**
- **Financial conditions are set to be accommodative in the coming years as long-term inflation remains within the Fed's target**
- **The main risks are a worsening of the health crisis forcing broad lockdowns and continuing political gridlock which hinders the ability of the new government to implement fiscal stimulus**

The US economy continues on its mixed recovery path in the context of a persistent health crisis. Real GDP expanded in 3Q20 by 33% QoQ AR, bringing the level of output to 97% of its pre-crisis levels, as most sectors of the economy re-open following the lockdowns. Household consumption is the main driver of the recovery and is set to remain sustained in the coming quarters absent of any strong upsurge of the pandemic. Strong consumer spending (less so in the service sector) is supported by improving balance sheets of households at the beginning and throughout the crisis. Household debt was on the decline before the crisis while disposable income sharply increased during the crisis (6% YoY in September) thanks to the fiscal package. Strong asset prices have also kept household wealth buoyant. Corporate investment also rebounded in 3Q20, although the pace of recovery is expected to face challenges as bank financial conditions remain stringent.

The labour market is also recovering but at a more modest pace and with larger discrepancies. The unemployment rate fell to 6.9% in October, from the 14.7% April peak, as temporarily laid off employees returned to their jobs. Nevertheless, the pandemic is still weighing strongly on the economy: labour force participation rate remains at 61%, below the 63% pre-pandemic level while total employment level is at 90% of its pre-crisis level and long term unemployment (defined as people who have been unemployment for more than 27 weeks) is still rising.

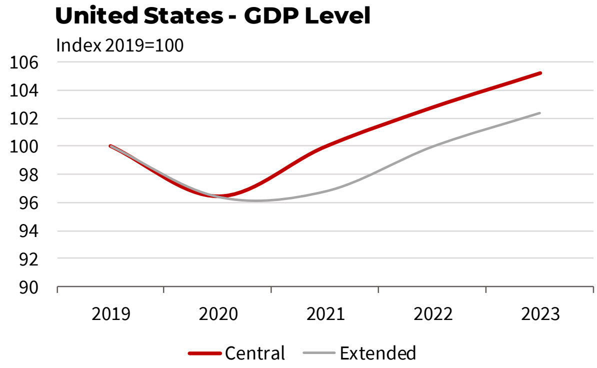
In our central scenario, the economy is set to expand 3.7% in 2021 and 2.8% in 2022 supported by the progressive re-opening of the economy, resilient household consumption, and a renew fiscal support in 2021. This forecast assumes that the health crisis does not force new lockdown measures, and on the assumption that the Biden administration will have congressional support to implement a fiscal stimulus. In our extended scenario in which the health crisis last one additional year, we expect growth to reach 0.4% in 2021 and 3.2% in 2022.

**High average stringency throughout 1H20**




*Source: University of Oxford*

**GDP is set to recover its 2019 level by 2022**




*Source: SG Economic and Sector Research*

Inflation is set to be low. Core CPE in October was clocked at 1.6%, still under the 2% long term average target of the Fed, as services prices (66% of the index) continue to trend downward while non-durable goods prices are contracting. Overall, as the recovery of employment is set to be slow, core inflation is likely to remain under the 2% target in the coming quarters. Against this backdrop, the Fed will likely keep financial conditions very accommodative in the coming years, with policy rates expected at 0% until 2024.

In the case of worsening financial conditions, the Fed will likely continue to use its balance sheet, currently at USD 7tn (33% of GDP), as a stabilisation tool. Recently, and in the context of the April 2020 fiscal package, the Treasury asked the Fed to return USD 454bn of equity to finance lending programs to the private sector and local governments. These programs were largely unused (USD 20bn of USD 2 300bn available), but they have reassured markets concerning access to liquidity. An extension of these programs may now require political support from both the Republican and Democratic parties.

Regarding the fiscal situation, agreeing new stimulus in the lame duck season is proving a challenge. Joe Biden favours continuous fiscal support, based on transfers to both households and local governments, as well as a USD 2tn infrastructure program over 10 years with a focus on energy transition. However, given that the next President will likely face a divided Congress, the fiscal stimulus may be lower than presidential expectations.

The main risk for the outlook remains on the health and political fronts. The number of coronavirus cases has significantly spiked in recent weeks and has forced some states to re-implement late night curfews or close some non-essential businesses. In the case of an aggravation of the epidemiological situation, consumption will remain supressed until the arrival of a vaccine, even as a strict lockdown remains unlikely. The second risk is of political gridlock. The November election yielded a divided Congress, with Republicans expected to keep control of the Senate and Democrats keeping control of the House of Representatives. Runoff senatorial elections will take place in January in the State of Georgia. If republicans manage to keep one seat, they will keep majority in the Senate. Hence, the next President will have to negotiate with the Congress if he wants to implement a direct fiscal stimulus or allow the Fed to implement private sector credit programs. Republicans have already announced their commitment to fiscal conservatism which could block major increases in government spending. Short-term, Congress will need to pass a resolution before December 18 to avoid a Federal shutdown.

| **"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 10mn 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% |

| **United States** | **2019** | **2020f** | **2021f** | | **2022f** | | **2023f** | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 2.3 | -3.6 | 3.7 | 0.4 | 2.8 | 3.3 | 2.4 | 2.4 |
| Inflation, % | 1.8 | 1.3 | 2.0 | 1.4 | 2.3 | 2.6 | 2.5 | 2.1 |
| Unemployment, % | 3.5 | 6.1 | 5.2 | 10.5 | 4.7 | 9.0 | 4.3 | 8.0 |
| Fiscal balance, % GDP | -6.7 | -18.7 | -14.0 | -17.0 | -10.5 | -13.0 | -9.0 | -10.0 |
| Public debt, % GDP | 80 | 99 | 105 | 112 | 109 | 116 | 112 | 120 |

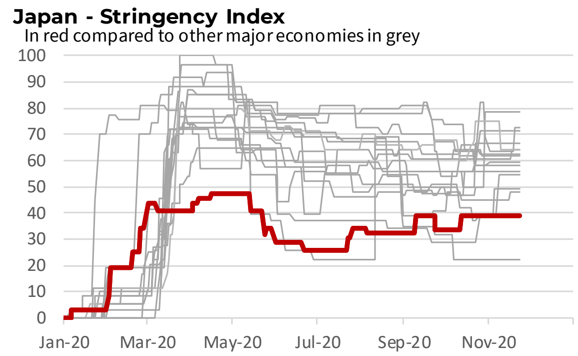
*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# JAPAN

- **A moderate recovery is expected in 2021**
- **The risk of a deflationary spiral should not be ignored**
- **Considerable fiscal stimulus entails a rapid increase in public debt**

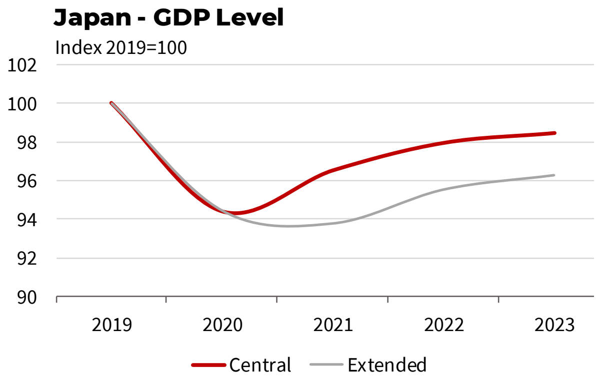
The growth recovery is expected to continue, but at a much more moderate pace than in 3Q20. Health uncertainties weigh on the psychology of economic agents, and therefore the rebound in 2021 is set to be moderate. The economy is set to return to its pre- Covid19 level only about three years after the crisis.

**Low stringency despite a rise in cases**




*Source: University of Oxford*

**Inexorable GDP loss**




*Source: SG Economic and Sector Research*

The number of daily Covid19 cases has resurfaced and is at higher levels than in April and August. With this third wave of the pandemic, which began in November, domestic demand may lack the strength to sustain growth.

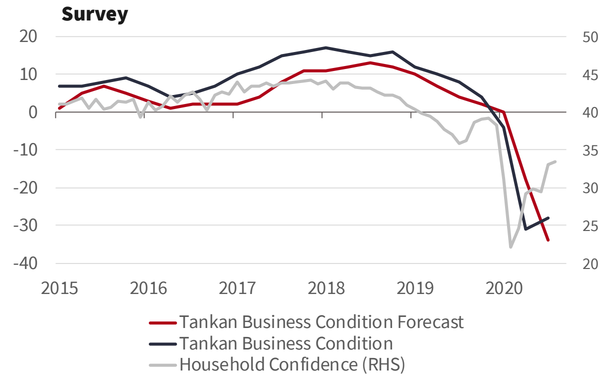
Household confidence was initially heavily affected by the arrival of Covid19 even though incidence and mortality rates remain low. Its recovery is likely to be compromised by a more extended spread of the pandemic.

On the business side, the Tankan surveys reveal that pessimism is predominant as indicated by indices well below zero.

The low level of confidence of economic agents could be the beginning of a vicious circle that weighs on the dynamics of activity for a long time. Indeed, Japan's aging society has already experienced a deflationary past. If household perceptions do not improve because of the health crisis, this implies a very slow return to normal of their consumption level, which impacts investment, and the reflationary objective becomes even more difficult to achieve.

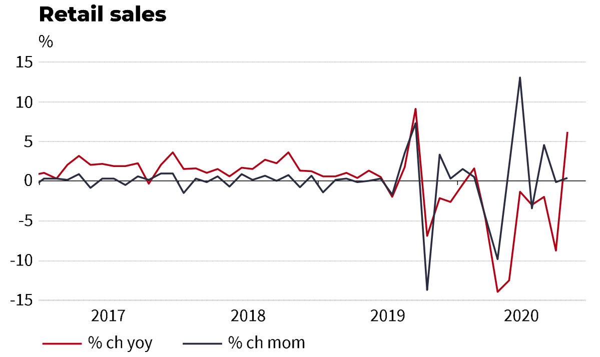
Indeed, inflation is sinking into the negative zone whereas the BoJ's target stands at 2%. In October, inflation excluding fresh products was -0.7%, after having already recorded negative inflation in two consecutive months. The risk of a deflationary spiral then tends to increase.

**Low confidence of economic actors**




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

**Hesitating recovery in retail sales**



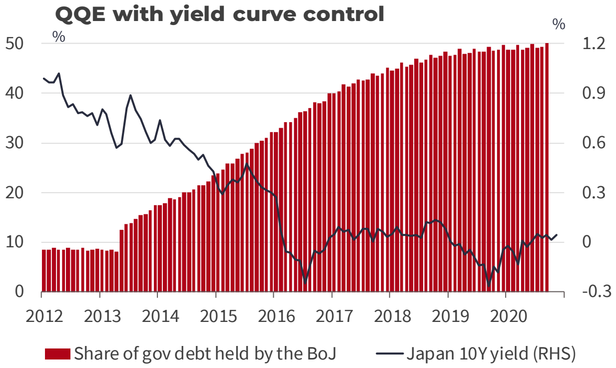

*Source : BoJ, SG Economic and Sector Studies*

| "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% |

Faced with such a risk, the fiscal stimulus effort is considerable despite a public debt/GDP ratio already close to 240%. The total of the three stimulus plans amounts to 40% of GDP. And even if we consider only the direct spending of the government known as "mamizu", it amounts to JPY 65,200bn , or 11.7% of GDP. This makes Japan one of the countries that have supported their economies the most. These budgetary efforts, combined with a containment that was not as strict as in other developed countries, help to explain a less sharp contraction in growth expected in Japan than the last in 2020.

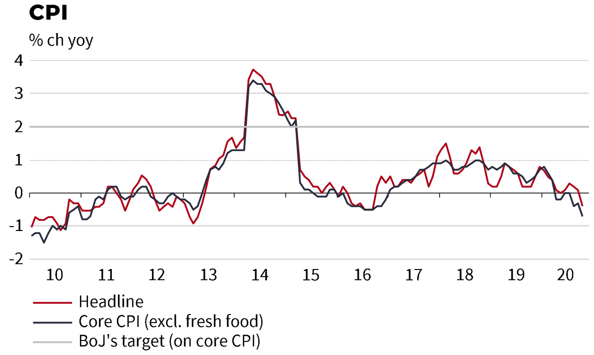
On the monetary side, the Bank of Japan (BoJ) has kept the same targeting of short (-0.1%) and long (0%) rates by actively modifying the ceiling of its purchase programme. As a result, the BoJ's balance sheet rose from 109% of GDP in April to 124% of GDP in October. Although the pace of government securities purchases seems to have slowed down recently, the BoJ balance sheet is likely to exceed 125% of GDP by the end of the year.

**Long-term yield kept around 0% by the BoJ**




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

**Inflation turned negative**




*Source : BoJ, SG Economic and Sector Studies*

As a result of the economic contraction and unprecedented fiscal efforts, the deficit is widening, and the public debt ratio is rising. The latter is expected to reach 250% of GDP in 2020. This raises the question of debt sustainability, even more so as the reflationary policy is struggling to succeed. Even if the cost of financing public debt is kept extremely low with the vast majority (90%) of debt held by domestic investors including the BoJ, the repeated postponement of the fiscal consolidation could end up affecting investors' perception of risk.

| Japan | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 0.7 | -5.6 | 2.2 | -0.7 | 1.5 | 1.9 | 0.5 | 0.8 |
| Inflation, % | 0.5 | 0.1 | 0.3 | -0.5 | 0.6 | 0.4 | 0.5 | 0.6 |
| Unemployment, % | 2.3 | 2.8 | 2.7 | 3.2 | 2.6 | 3.0 | 2.6 | 2.8 |
| Fiscal balance, % GDP | -3.3 | -13.8 | -6.5 | -11.0 | -3.3 | -5.0 | -3.0 | -3.0 |
| Public debt, % GDP | 238 | 251 | 257 | 264 | 259 | 268 | 261 | 269 |

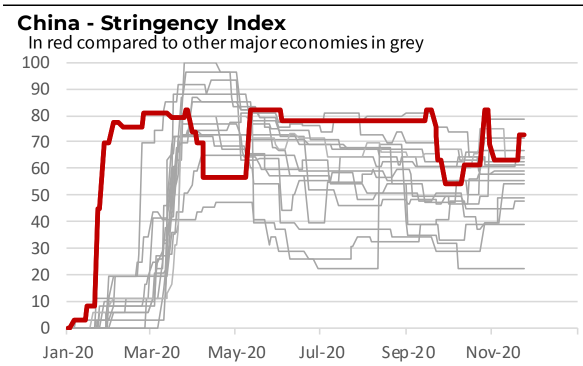
*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# CHINA

- **The recovery steadily continues, driven by both domestic and external demand**
- **The policy-mix, already less accommodating, is part of the measures aimed at limiting the side effects of stimuli**
- **In relative respite, credit events will resume once liquidity conditions tighten**

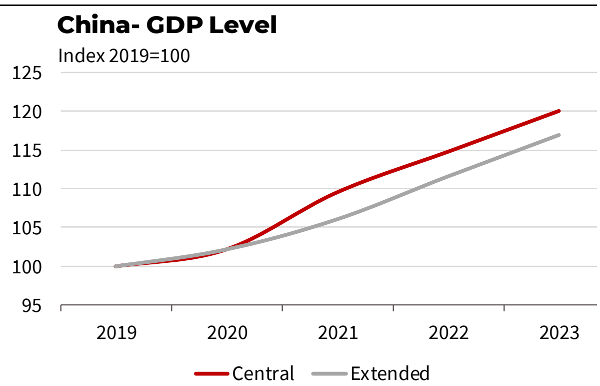
The economic outlook remains positive. Growth has been in a stable recovery; it is set to make a strong rebound in 2021 and then return to its long-term trend in the following years. The recovery is expected to continue, almost without respite, due to a delayed stimulus effect, the return of consumer confidence and the momentum in the services sector.

**Life remains almost normal despite high stringency index**




*Source: University of Oxford*

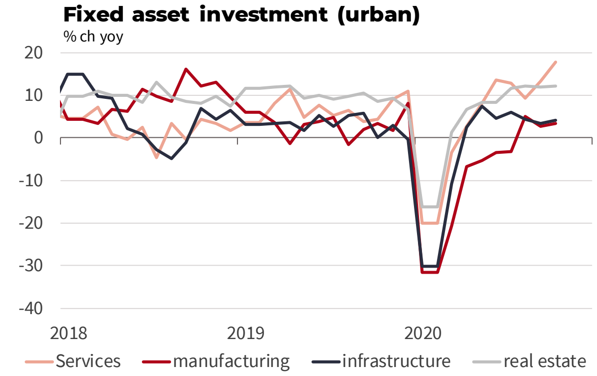
**Deeper loss in GDP in extended crisis would require more stimulus**




*Source: SG Economic and Sector Research*

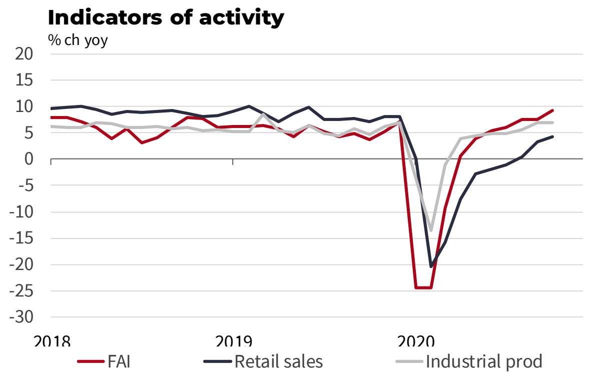
Part of the stimulus plan will be delayed until 4Q20 and 2021. A pillar of the Covid stimulus is the investment (especially in infrastructure) financed by the special bonds of local governments. While bond issues have almost been completed as planned (the CNY 3750bn to be issued by October at the latest), it appears that local government spending has fallen behind, and the Ministry of Finance has called for an acceleration. The slowdown in the growth of urban infrastructure investment since August corroborates this delay. Unspent funds will therefore be carried forward to the end of 2020 and 2021.

### Infrastructure spending stalled




*Source: NBS, SG Economic and Sector Studies*

### Retail sales are catching up



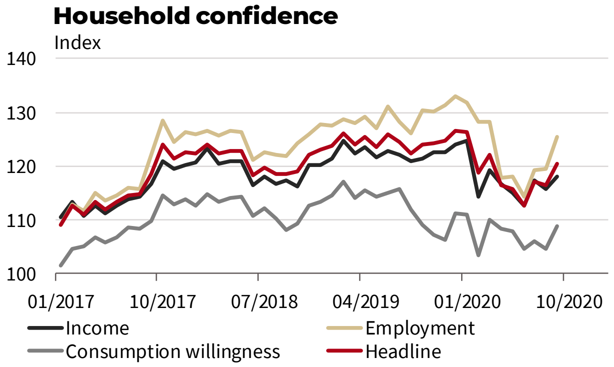

*Source: PBoC, NBS, SG Economic and Sector Studies*

| **Fiscal measures** | **Size**<br>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 |
| % of GDP | 8% |

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

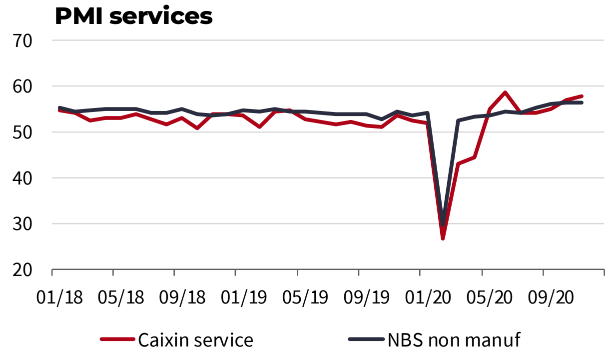
The return of consumer confidence, albeit with some delay, will mark its full contribution to growth in 2021. Indeed, household consumption has been slow to recover, in comparison with investment, which in June returned to its pre-crisis growth momentum. While consumer confidence is recovering almost uninterruptedly, the latest retail sales indicators also continue to improve steadily as Covid19 spread has been under control. Given the rigour of the crisis management approach, it seems less likely that the virus will spread in such a way as to require lockdown or to massively restrict the movement of individuals. This helps to contain the increased likelihood of a relapse in household confidence. Thus, it is reasonable to expect rapid growth in consumption in 2021 compared to 2020, even if confidence is not fully restored.

**Consumer confidence is recovering**




*Source: NBS, SG Economic and Sector Studies*

**PMI services are expanding**




*Source: NBS, SG Economic and Sector Studies*

Finally, the dynamics of the services sector – in strong recovery - is no longer entirely due to the stimulus. Urban investment in services has started to accelerate very quickly and is becoming the main driver of investment growth, ahead of real estate and infrastructure. Services PMIs are moving in the same direction, well above the 50 mark today, they have returned to the expansion zone as early as March for the NBS and May for the Caixin (whose survey sample has a greater presence of SMEs). This rising in services improves the quality of the recovery, which initially showed signs of worsening structural imbalance. In fact, support measures through infrastructure investment have often had the impact of hypertrophying construction activity in the economy and making debts difficult to sustain. In addition, the dynamics of services make growth little dependent on stimulus.

As for economic policy, which has already become less accommodating in a context of stable recovery, it should continue to focus on risk control, i.e. the sustainability of growth. Thus, while monetary policy is expected to be stable in 2021, less fiscal effort will certainly be required. But this will have only a limited impact on growth in 2021. Because, on the one hand, postponing spending from 2020 to 2021 would partially offset this decline and, on the other hand, as discussed above, the current recovery became more independent of stimulus.

| China | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 6.1 | 2.2 | 7.2 | 3.8 | 4.8 | 5.2 | 4.6 | 4.8 |
| Inflation, % | 2.9 | 2.6 | 1.6 | 1.3 | 2.2 | 2.3 | 2.3 | 2.3 |
| Current account, % GDP | 1.0 | 2.4 | 2.1 | 1.9 | 2.1 | 1.9 | 1.9 | 1.8 |
| Fiscal balance, % GDP | -3.1 | -3.6 | -2.8 | -3.0 | -2.8 | -2.9 | -2.8 | -2.8 |
| Public debt, % GDP | 38.5 | 46 | 45 | 47 | 45 | 47 | 45 | 46 |

*Base = Central scenario*
*Ext. = Extended health crisis scenario*

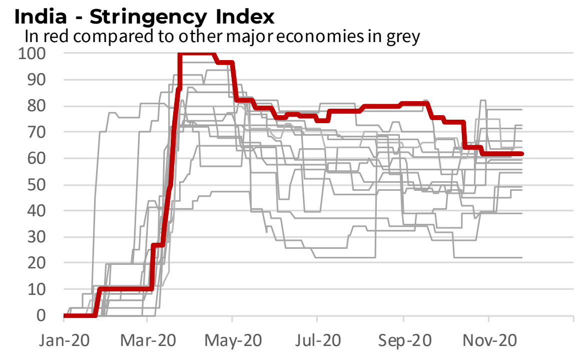
# INDIA

- **There are several obstacles on the road to recovery**
- **Fiscal space is limited by high level of public debt and monetary room is constrained by inflation**
- **The vulnerability of the financial system is increasing with the sharp decline in growth due to Covid19**

The economic recovery is underway, but it risks losing momentum due to several obstacles. Only a gradual recovery is expected over the next few quarters. The risk that growth enters a much weaker growth regime than in the last decade tends to increase.

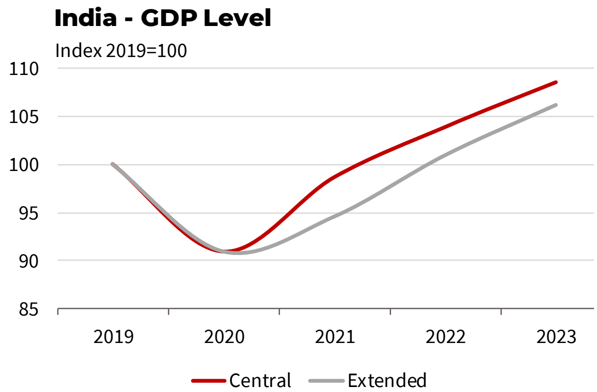
Improving indicators show that economic recovery is underway. While industrial production went from -57% in YoY in April to 0% in YoY in September, sales of refined petroleum products (mainly diesel and petrol) in volume have already exceeded their level of a year ago (despite the -4% fall in value terms due to the fall in oil prices). However, there are several obstacles on the road to recovery. First of all, there is the pandemic itself.

**Fewer daily cases, beware of a second wave**




*Source: University of Oxford*

**Entering a weaker growth regime**




*Source: SG Economic and Sector Research*

Even if the curve of daily cases fell sharply between September and the end of October, the pandemic seems to be on the rise again in mid-November - a date that coincides with the Diwali festival. In some states such as Delhi, Madhya Pradesh, and even industrially important Gujarat, the impression of a second wave of the epidemic is clearly visible. Moreover, difficulties in deploying the vaccine (notably of logistics) mean that one should not count on it for a rapid exit of the crisis. These uncertainties inherent in the epidemic call for precautions in assessing the economic outlook.

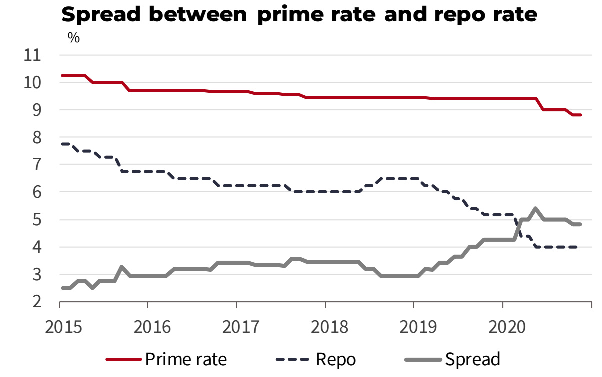
The second obstacle to recovery stems from the limited policy space, both fiscal and monetary. On the fiscal side, the stimulus plan is marked by budgetary constraints, with the public debt to GDP ratio expected to reach 80%. Firstly, some measures are only existing measures included in the plan; secondly, a large majority of measures concern credit facilities, guarantees or extensions of payment deadlines, those measures do not imply additional fiscal expenditure; finally, the "real" measures involving a reduction in fiscal revenue or an increase in expenditure should only represent 1.2% of GDP whereas the plan as announced amounts to 11% of GDP. Fiscal support is therefore not sufficient in the face of the scale of the economic collapse, nor to help the recovery of the economic apparatus.

| **"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 little room for manoeuvre to lower the key rate (which is 4%) is constrained by high inflation. It is above the target band (2%-6%) throughout 2020 except in March. Moreover, the transmission of monetary policy is only very partial. Even if the RBI is likely to lower the key rate once the inflationary risk is mitigated, this easing is conditioned by the banks' willingness to lower their prime rate which, during past episodes of rate cuts, has proved to be inert.

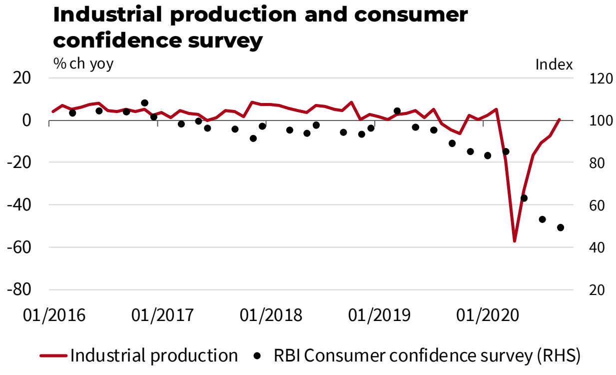
The third factor impeding recovery is the vulnerability of the financial system. The country has already experienced a series of failures of financial institutions, starting with those of non-bank institutions in 2018, which was subsequently expanded with the takeover of Yes Bank, the country's fourth largest private bank, by the central bank in March 2020. Public banks have a higher rate of non-performing loans (more than 10%) than private banks, but they must support weak or failing institutions. Recall that Indian banks are among the least profitable in emerging countries (ROA at -0.1% and ROE at -1.85% in 2019 according to the RBI).

**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*

Under the loan repayment moratorium in force between March and August, the deterioration in credit quality has not yet materialised. Micro, small and medium enterprises have been the most affected by the health crisis, they could find themselves in a situation of stress if the economic recovery is not sufficiently on track. The vulnerability of the financial system would be aggravated, and its capacity to support growth further reduced.

| India | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 4.2 | -9.1 | 8.5 | 4.0 | 5.3 | 6.8 | 4.5 | 5.2 |
| Inflation, % | 4.5 | 7.0 | 5.0 | 6.0 | 5.0 | 5.5 | 5.0 | 5.0 |
| Current account, % GDP | -1.1 | 0.6 | -1.0 | 0.0 | -1.5 | -1.0 | -1.5 | -1.0 |
| Fiscal balance, % GDP | -7.4 | -10.0 | -7.3 | -8.5 | -7.0 | -7.3 | -7.0 | -7.0 |
| Public debt, % GDP | 69 | 81 | 78 | 82 | 78 | 80 | 78 | 80 |

*Base = Central scenario*
*Ext. = Extended health crisis scenario*

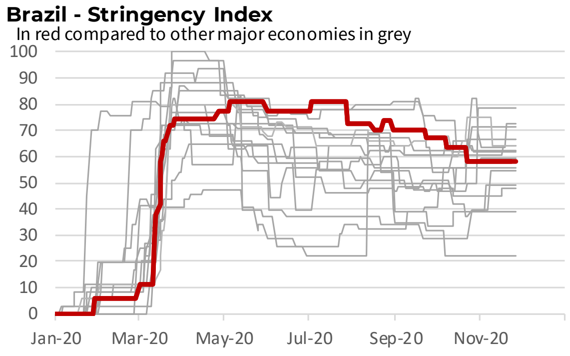
# BRAZIL

- **Activity has recovered rapidly supported by large fiscal transfers and sustained external demand**
- **The BCB is set to maintain eased financial conditions amid modest inflationary pressures**
- **The main risk is a disorderly fiscal adjustment as debt parameters have markedly deteriorated**

The economy is rebounding firmly from the spring shock on the back of important fiscal support and resilient external demand. Real GDP expanded by 7.7% in 3Q20 QoQ and is currently at 95% of its 2019 level. This rebound was mainly driven by private consumption (7.6% QoQ, 94% of its 2019 level), as households have benefited from the strong fiscal transfers and also from eased financial conditions. October retail sales reached their highest level since 2015. The external sector also continued to support growth as exports expanded by 4% QoQ in 3Q20. Brazil will continue benefitting from strong demand for primary goods from Asia and a competitive exchange rate. Investment also rebounded in 3Q20 to reach 95% of 2019 level. Overall, capital expenditures are set to expand modestly as some sectors operate with high overcapacity levels, financial conditions from public banks remain tight, and given political uncertainties.

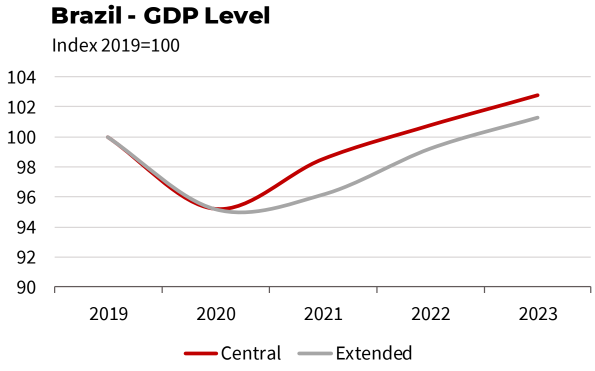
The economy is set to expand 3.5% in 2021 and 2.3% in 2022. Private consumption is set to progressively converge throughout 2021 to its pre-crisis level as fiscal transfers fade while external demand is likely to continue to support growth. In case of a prolonged health crisis, it is likely that the government will not adopt additional lockdown measures. In this respect, the worsening of the health crisis is likely to impact the Brazilian economy by the external and financial channels. In the case of an extended health crisis, GDP growth would only reach 1% in 2021 and 3.2% in 2022.

**Distancing measures eased**




*Source: University of Oxford*

**Recovery to pre-pandemic levels in 2021**




*Source: SG Economic and Sector Research*

The inflation outlook has mildly deteriorated over the last 3 months, yet inflation is set to remain around the BCB's 4% target. Inflation has accelerated to 3.9% in October from 2.3% in July as food prices have increased by 14% YoY. Nevertheless, less volatile components of the consumption basket and services continue to show stability. Demand pressures are likely to remain moderate in the coming months (unemployment rate is very high while real wages growth has stagnated over the last 5 years) and the exchange rate pass-through to prices is now low, supporting the low inflation environment.

The BCB kept 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. The Congress approved an asset purchase program, yet the BCB has not yet made meaningful purchases of BRL government securities and said it will only intervene when traditional tools are exhausted.

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

The main risk for the outlook is a disorderly fiscal adjustment. Given the depth of the recession and the size of fiscal stimulus implemented, public debt is likely to jump to 100% of GDP by the end of 2020 from 77% of GDP in 2019. Interest rates have remained contained and the currency depreciation has had little effect on public debt as most of the debt is issued in local currency. Moreover, the measures that have been taken are set to expire in the beginning of 2021 and the "fiscal golden rule" is set to be binding again in 2021. However, authorities have issued debt with shorter maturities to finance the fiscal stimulus.

A return of inflation could spark an increase in local currency rates, thus tightening credit conditions and forcing the government to adjust rapidly. Furthermore, the expansionary fiscal policy allowed the government to increase its level of approval this year despite the recession and the health crisis. Hence, there remains a risk that President Bolsonaro will not abide to the fiscal rule in 2021 as the 2022 general election approaches, implying a more marked deterioration of fiscal accounts. Finally, persistent political noise that has prompted the departure of "pro-market" members of the federal cabinet could also lead to higher uncertainties in the markets

| Brazil | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 1.1 | -4.8 | 3.5 | 1.0 | 2.3 | 3.2 | 2.0 | 2.1 |
| Inflation, % | 3.6 | 2.8 | 3.3 | 3.3 | 3.0 | 3.0 | 3.0 | 3.0 |
| Current account, % GDP | -2.6 | -1.0 | -1.8 | -0.8 | -2.3 | -1.5 | -2.3 | -2.3 |
| Fiscal balance, % GDP | -6.0 | -16.0 | -8.6 | -10.0 | -7.2 | -8.0 | -6.0 | -6.0 |
| Public debt, % GDP | 77 | 102 | 107 | 112 | 108 | 116 | 110 | 118 |

*Base = Central scenario*
*Ext. = Extended health crisis scenario*

# RUSSIA

- **The continued slowdown in activity in 4Q20 following the worsening of the pandemic will add to the structural weaknesses that already weigh on the economy's rebounding capacity**
- **Inflationary pressures are expected to persist in 2021, limiting the central bank's ability to pursue an expansionary monetary policy**
- **Fiscal support remains limited by the authorities' willingness to avoid any drift in public debt despite having one of the lowest ratios in the world (below 20% of GDP)**

After a contraction of 4% YoY in 2020, GDP is expected to rebound slightly in 2021 to show growth of around 2% YoY. Notably, the shock of 2020, which is historic in nature for most major economies, is just one more in the bumpy history of Russian growth. The economy had already experienced contractions of more than 5% YoY during the Lehman crisis in 2009 and the debt crisis of 1998. What has changed now is the country's increasingly limited rebound capacity. In 1999, GDP grew by 6.4% while in 2010 the rebound following the crisis clocked in at 4.5%. Our scenario for 2021 therefore looks very modest. Structural weaknesses associated with the resurgence of the virus since September have weighed on the short-term rebound capacity pointing to a slowdown in 4Q20.

The reasons for the weak strength of the Russian economy are well known. The economy faces continued dependence on oil rents and an investment dynamic that has been hampered in recent years notably by the relative weakness of crude oil prices (at least when compared to the pre-2014 period). The economy also faces the hit to investment from the policy of external deleveraging by Russian companies, which currently are subject to US sanctions on dollar financing. External debt accounts for one third of total corporate debt, which reached 80% of GDP by 2020. This level of debt is a drag on growth as the economy has faced high real interest rates for the past five years. This is due to changes in monetary policy that have focused on controlling inflation in the context of a loosening of the ruble's exchange rate regime. This transition has been successful and explains the slightest sensitivity of the ruble to the movements in oil prices. On the other hand, this is done at the cost of financing the economy at a structurally higher cost.

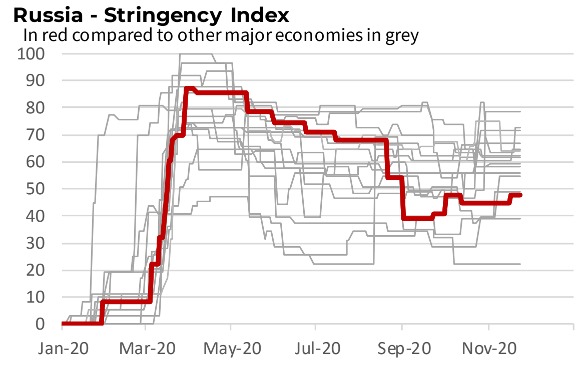
Inflation has accelerated in recent months, and in October has reached the 4% target of the Central Bank of Russia (BCR). This acceleration can be explained by a low inflation comparative base in 2H19 and due to pressures on food inflation, which have suffered from supply constraints related to the management of the pandemic as well as demand pressures from China. These pressures could continue in the coming quarters given the expected recovery in consumption. Real wages are still rising, and household credit continues to grow, which indicates increased household demand in the coming months.

In this context, the BCR's room for policy manoeuvring is shrinking. The institution has cut its key interest rate by 175 basis points since April to 4.25%. In the absence of signs of a slowdown in inflation, it is likely that the next Monetary Policy Committee (18 December) will decide to extend the current rate level.

Long-term interest rates, as measured by the government's 10-year financing cost, remain relatively high due to a policy of financing the budget deficit almost exclusively through domestic borrowing. This has resulted in a tightening of the liquidity conditions of banks, which have been heavily solicited by this issuance policy. This dynamic is expected to continue in 2021 as the government will not rely on its sovereign wealth fund (worth of USD 170bn).

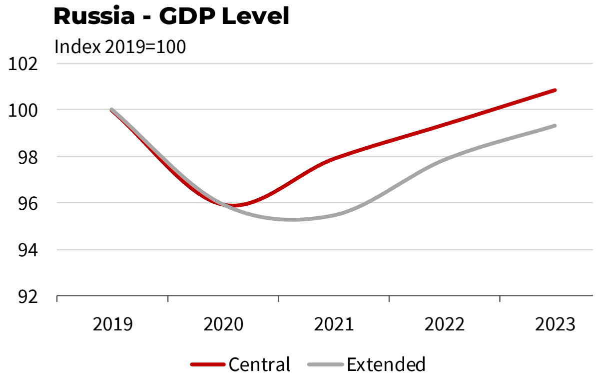
The size of the budgetary support remains quite small (approximately 5% of GDP spread over two years). Half of the plan relates to spending on national projects (infrastructure, promotion of import substitution) that would have been implemented regardless of the pandemic. The remaining amount is focused on social and SME support (lower wage tax for SMEs) and the re-capitalization of the state-owned VEB bank.

**Lockdown measures have eased considerably**




*Source: University of Oxford*

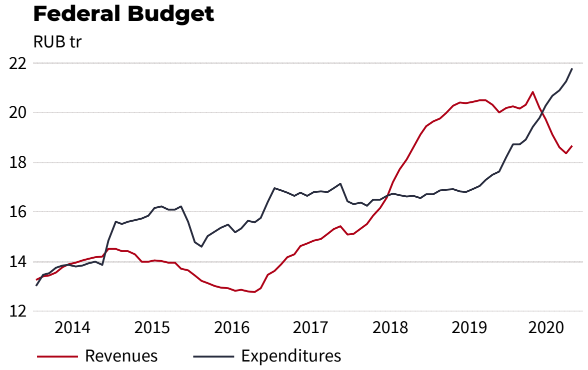
**Growth less affected than in other major emerging economies**




*Source: SG Economic and Sector Studies*

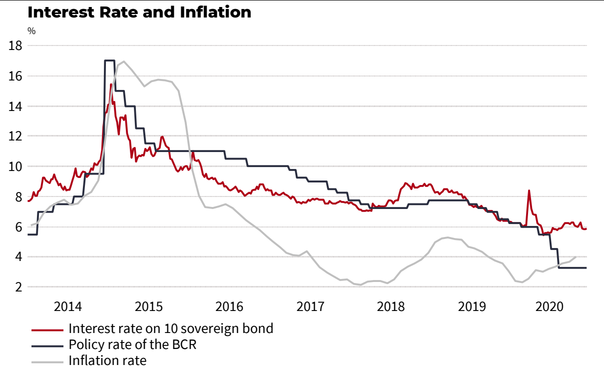
| Measures adopted | RUB/bn |
|---|---|
| Spending directly related to the Covid crisis: support for households | 750 |
| Expenditures directly related to the Covid crisis: support for SMEs | 850 |
| Spending on "national projects": infrastructure | 1 370 |
| Spending on 'national projects': promoting the import substitution strategy | 1 050 |
| Recapitalisation of the state-of-the-bank VEB | 209 |
| Other measures | 771 |
| Total | 5 000 |
| % of GDP (2019) | 4.5% |

**Budgetary spending on the upsurge since the end of 2019...**




*Source: SG Economic and Sector Studies, Refinitiv*

**... real interest rates remain high and weigh on the ability to invest.**




*Source: SG Economic and Sector Studies, Refinitiv*

At the international level, it is important to keep an eye on the evolution of relations between the new US administration and Russia. Biden's statements suggest a potentially slightly more complicated relationship in the future. In this context, the risks of new sanctions cannot be ruled out.

| Russia | 2019 | 2020f | 2021f | | 2022f | | 2023f | |
|---|---|---|---|---|---|---|---|---|
| | Actual | Base | Base | Ext. | Base | Ext. | Base | Ext. |
| Real GDP, % YoY | 1.3 | -4.0 | 2.0 | -0.5 | 1.5 | 2.5 | 1.5 | 1.5 |
| Inflation, % | 4.5 | 3.5 | 4.5 | 6.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| Current account, % GDP | 3.8 | 2.0 | 2.0 | 1.5 | 2.5 | 2.0 | 2.5 | 2.0 |
| Fiscal balance, % GDP | 1.9 | -4.5 | -2.5 | -3.5 | -2.0 | -3.0 | -1.5 | -2.5 |
| Public debt, % GDP | 14 | 19 | 19 | 22.0 | 19 | 23.0 | 18 | 23.0 |

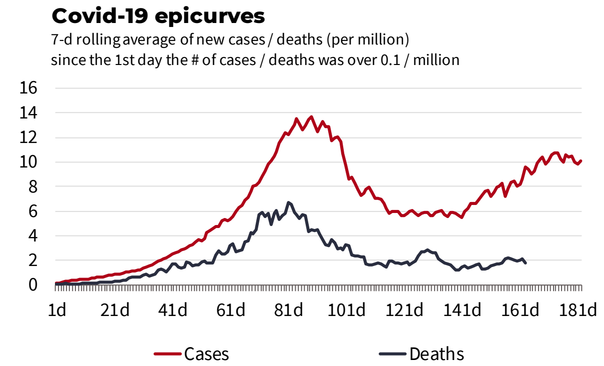
*Base = Central scenario*
*Ext. = Extended health crisis scenario*

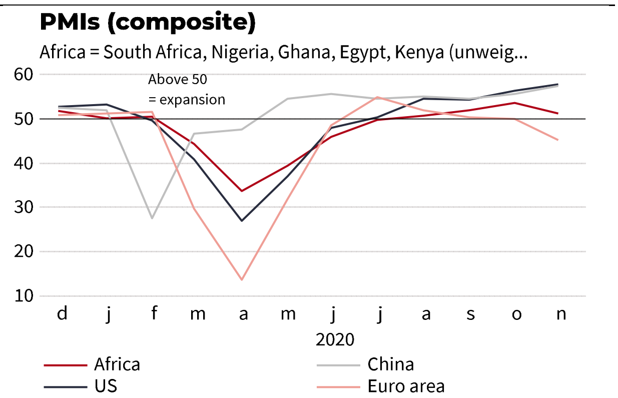
# AFRICA

- **Africa is facing a 2nd wave of Covid19, albeit not as intense as in other continents**
- **The rebound expected for 2021 would remain insufficient to offset the recession of 2020**
- **The region has significant FX financing needs. If not fulfilled, further slowdowns in activity or debt restructuring could not be ruled out**

Since the beginning of October, Africa is facing a 2nd wave of Covid19, as illustrated by a steady increase in the number of contaminations detected. Nevertheless, this wave remains limited for the moment, both geographically (to the Maghreb countries in particular; to a lesser extent, South Africa, Kenya, Ethiopia and Angola) and "quantitatively", with the number of new deaths globally decreasing in the region since a peak reached in early August. Overall, the number of cases and deaths (relative to population) remains low compared to other regions, and initial fears of massive underestimation of the pandemic are receding as no African country appears to have experienced unexplained excess mortality since March. This 2nd wave has prompted some countries (Tunisia and Algeria in particular) to reintroduce restrictive measures (curfews, localized confinement, closure of public places, etc.), which could multiply on the continent.

**The (limited) 2nd wave experienced since October could derail the rebound started this summer**



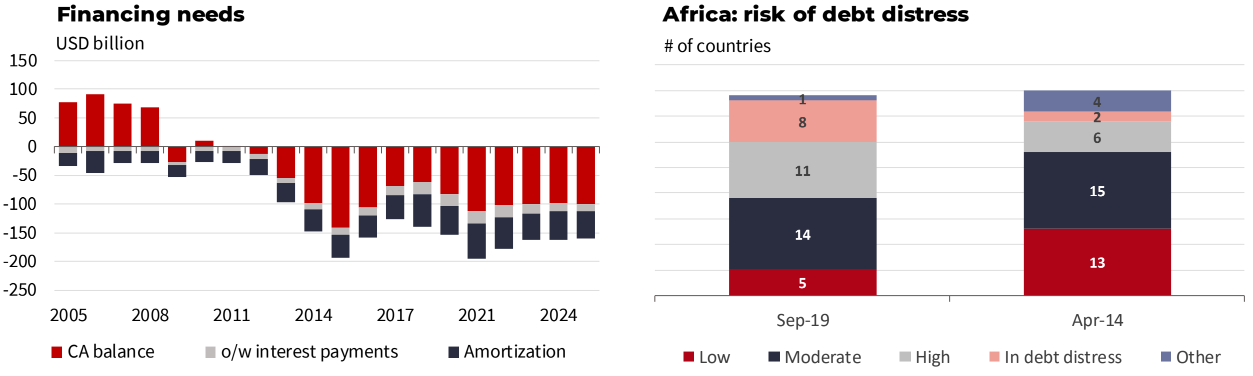




*Source: SG Economics & Sector Studies, WHO, Refinitiv Datastream*

This 2nd wave (if it were to spread to Africa, persist in Europe and the Americas, or appear in Asia) could slow the slight economic rebound recorded this summer, as illustrated by the indices of purchasing managers (composite) returning to expansion territory since July/August in most countries. This represents a downside risk on 2020 growth now forecast at -3.4% (i.e. the first recession in the continent's history), while the expected heterogeneity of economic performance within the region has been confirmed by the 2Q20 and 3Q20 figures.

Broadly speaking: diversified economies with little or no dependence on tourism experienced limited recessions (between 0% and -5% in 2Q20); oil economies experienced deeper recessions (between -5% and -10% in 2Q20); and economies dependent on tourism and/or most connected to the global economy experienced historical recessions (between -15% and 20% in 2Q20). In our central scenario, regional growth would rebound to 4% in 2021, which, given the theoretically very positive base effects, would be a disappointing and insufficient performance: by the end of 2021, regional GDP would barely recover (at best) to its end-2019 level, even though Africa's population will have grown by nearly 5% at the same time.

**Large FX financing needs are raising the issue of public debt sustainability in the region**




*Source: SG Economics & Sector Studies, IMF, World Bank*

Longer term, according to the IMF's latest estimates, Africa continues to have significant FX financing needs, currently around USD 150bn to 200bn per year from 2021. In the past, these needs were mainly covered by a mix of Foreign Direct Investments (FDI), portfolio investments (subscribing to multiples of eurobonds issued by regional sovereigns since 2012), and remittances (the region's leading source of financing). However, these three main sources dried up in 2020: (i) FDI flows to Africa declined by 28% YoY in 1H20; (ii) international capital markets remain closed for the time being for most African signatures (only Morocco, Egypt and Côte d'Ivoire have issued since April, even though investor appetite for the rest of the emerging countries is at historic highs), and (iii) the World Bank forecasts a decline of nearly 10% in remittances for 2020. If these sources were to remain – at least partially – closed, Africa would have no choice but to reduce its financing needs. This would require either (i) reducing the region's structural current account deficit, mainly through a sharp contraction of imports and thus, ultimately, of activity, or (ii) reducing FX debt servicing (interest and amortization). In the latter case, further debt restructuring (i.e. Zambia's recent default) could not be ruled out, as public debt sustainability has deteriorated significantly in recent years.

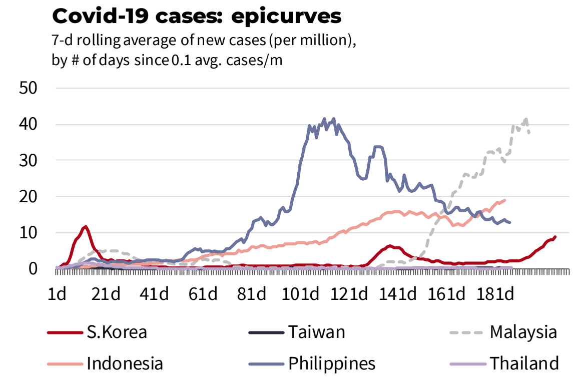
# EMERGING ASIA

- **The disparity in intra-regional growth mainly reflects the disparity in the management of the epidemic**
- **The accumulation of current surplus helps to strengthen the external safety cushion**
- **The risk of a second wave of Covid19, both in the region and worldwide, could delay the return to the normal**

Growth in the region resumed in 3Q20, but with an intra-regional disparity, reflecting the heterogeneity of the health situation. Although in contraction, the region maintains its relative performance compared to the rest of the world.

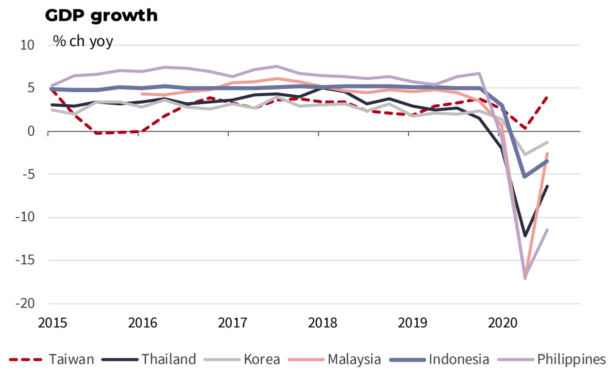
First, some economies have experienced a less pronounced shock and are emerging from the health crisis more quickly. The spread of the virus is more limited or controlled. Among the major emerging Asian economies, South Korea, Taiwan, Thailand and Vietnam seem to have shown a controlled epidemic. While Indonesia, the Philippines and Malaysia still have a significantly higher number of cases per day than the previous group. This difference is generally reflected in the dynamism of economic activity. Vietnam, Taiwan and South Korea are the three countries that stand out for their economic performance, with positive YoY growth of 3.9% in Taiwan, 2.2% in Vietnam and a moderate contraction of 1.3% in South Korea in 3Q 2020. Thailand is an exception of the group whose epidemic is under control, with a contraction of GDP still at -6.4% in the same period due to the internal political crisis. As for growth in the countries most heavily hit by Covid19, the Philippines recorded the largest GDP contraction in 3Q, at -11.5% YoY and Malaysia and Indonesia -2.7% and -3.5% respectively.

**Covid19 under control in some economies…**




*Source: Datastream Refinitiv, SG Economic and Sector Studies*

**… where the growth shock is lessened**

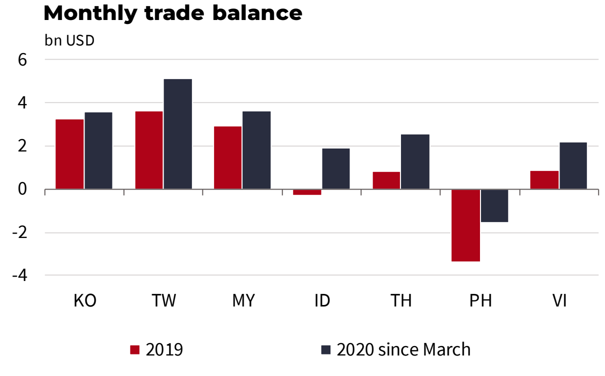



*Source: IMF, SG Economic and Sector Studies*

The region as a whole has relatively strong fundamentals. This allows it to recover more quickly than other emerging economies at this time of health crisis, and to be more resilient in the event of a more protracted crisis, which is currently looming.

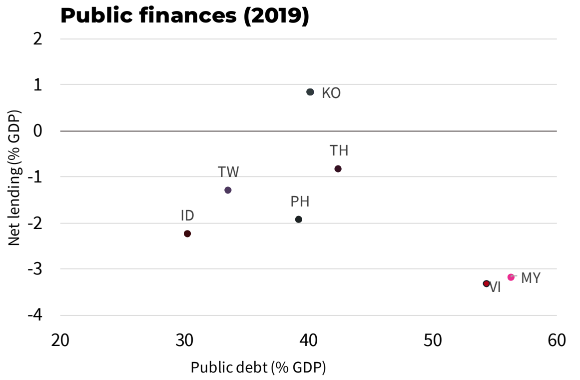
In terms of public finances, only Malaysia has a high public debt-to-GDP ratio, but its very low dependence on external financing allows it to retain some room for manoeuvre. Indonesia, on the other hand, has a low ratio, and it is its dependence on foreign currency debt to the tune of 30% that forces it to lower interest rates when international liquidity conditions are unfavourable.

**Even higher external safety cushion**




*Source : Datastream Refinitiv, SG Economic and Sector Studies*

**Available fiscal space**




*Source : IMF, SG Economic and Sector Studies*

Moreover, despite the global recession, Asia has maintained its relative export performance. Export performance first recovered rapidly and then reached levels quite similar to those of a year ago. Two exceptions are Taiwan, which exported 11.7% more compared to a year ago and Thailand 6.7% less. With imports recording a higher negative shock, the trade surplus has increased and the trade deficit for some has narrowed. Many central banks took advantage of it to accumulate foreign exchange reserves. Indonesia has replenished about ten billion dollars since March, an increase of 10%. Thailand and the Philippines (also thanks to the resilient transfer of remittances) have seen theirs increase by more than 10%. This strengthens the external safety cushion to better protect against future external shocks.

The region has chosen to integrate further by signing the RCEP - Regional Comprehensive Economic Partnership - in November 2020. ASEAN, China, South Korea, Japan, Australia and New Zealand are signatory countries. Although initially the reductions in customs duties for emerging Asia are not significant as they are already covered by the bilateral free trade agreements between ASEAN and the other signatory countries, in the longer term it will promote the integration of the value chain in the region with a harmonisation of standards, particularly with regard to the rule of origin.

# GULF STATES

- **The region is experiencing a sharp contraction as countries grapple with the loss in activity from social distancing measures and the impact of lower oil prices**
- **Countries are presently bridging the shortfall in government revenues through debt issuances, and debt ratios are on the rise**
- **Countries can no longer afford all the infrastructure projects envisioned to diversify activities and non-oil investments will slow**

Struck by the economic fallout from the Covid19 related restrictions and falling oil prices, the Gulf countries will experience the worst recession in their history in 2020, with GDP falling by around 6% on average. The speed of recovery in 2021 is subject to a high degree of uncertainty, as the coronavirus continues to circulate. External demand will start recovering, albeit sluggishly as we do not expect a bounce back in international trade in the near-term. Business and travel hubs such as the UAE, are feeling the impacts to the hit in the aviation and hospitality sectors whilst all over the region, employment will continue falling sharply, leading to the exodus of migrant workers. This decline in population will particularly hurt the retail sector, bank deposits, and real estate occupation.

The biggest factor in uncertainty relates to the decline in oil rents and its impact on public finance and the balance of payments. The oil price has recently recovered ($47/b in mid-November versus $24/b at the beginning of April), but the average price in 2020 remains 25% lower than in 2019. Oil prices could remain low for a while due to a weak global recovery. Joint efforts by Opec and non-Opec producers helped cut inventories since July, but the pace of market recovery remains slow and non-compliance remains a risk.

The decline in oil revenues continues to place stress on fiscal variables. 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 in 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 (from a previous 5% level), has restrained benefits paid to civil servants, and is attempting to move on with further privatisation plans. Oman announces the introduction of the VAT in 2022 among other measures to consolidate the budget. All in all, breakeven oil prices remain higher than actual oil prices and national budgets are likely to remain out of balance over the medium term.

Against this backdrop, the region has turned to debt markets to finance large government shortfalls. 2020 will mark a new record of international sovereign bond issuances for the region clocking in at an estimated $40 bn (Jan-Oct). This figure nearly doubles with the addition of domestic currency issuance.

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 for the UAE, current account balances in the region are 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, if they prove long lasting, will require external international or bilateral financial assistance.

The region has long been preparing for medium-term challenges, which this crisis renders even more relevant. The various 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 as considerable challenges in the labour market and market regulation are often seen as an obstacle to private sector involvement. Furthermore, the decreases in the oil rent is weighing on the ability to self-finance infrastructure projects. Consequently, the expansion of non-oil activities may 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. Yet, parties are currently in talks to find a way out of the blockade (with Kuwait and White House counsellors as mediators).

Saudi Arabia chaired and hosted the (virtual) G20 forum in 2020 as part of wider effort 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. The UAE and Bahrain have agreed to the full normalisation of relations with Israel which will offer both countries 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 | | International reserves, USD bn | |
|---|---|---|---|---|---|---|---|---|---|
| | 2020 | 2020 | 2021f | 2020 | 2021f | 2020 | 2021f | Dec-19 | most recent |
| Bahrain | 93.2 | -13.1 | -9.2 | 128.3 | 130.6 | -8.0 | -5.7 | 3.7 | 1.9 |
| Kuwait | 64.5 | -8.5 | -10.7 | 19.3 | 36.6 | -6.8 | -2.8 | 39.9 | 44.4 |
| Oman | 104.5 | -18.3 | -16.8 | 81.5 | 88.7 | -14.6 | -12.9 | 17 | 17 |
| Qatar | 42.0 | 3.0 | 3.3 | 68.1 | 60.6 | -0.6 | 2.6 | 54 | 37 |
| Saudi Arabia | 78.2 | -10.6 | -6.0 | 33.4 | 34.3 | -2.5 | -1.6 | 502 | 441.5 |
| United Arab Emirates | 75.9 | -9.9 | -5.1 | 36.9 | 38.2 | 3.6 | 7.5 | 106 | 94.6 |

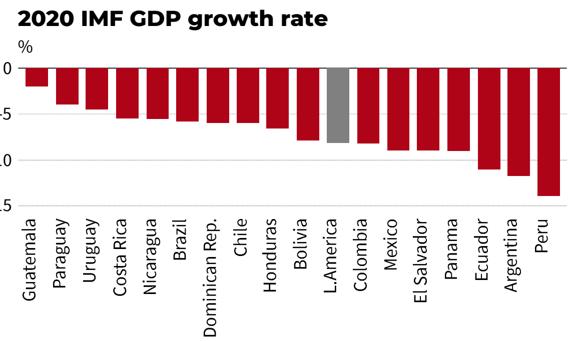
*Source: IMF World Economic Outlook October 2020 and Thomson Reuters*

# LATIN AMERICA

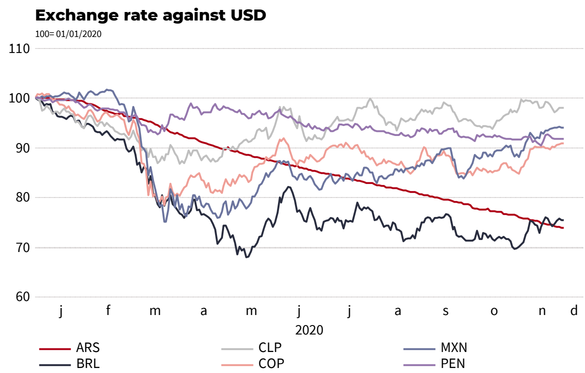
- **Regional growth is set to register its worst performance since the 1930s**
- **Several central banks have cut interest rates and launched modest QE programs. Fiscal responses have been moderate in large economies**
- **Risk remains elevated as the pandemic continues and the region entered this crisis after a period of weak growth**

The region has been severely affected by the Covid19 crisis. The economic recession will likely be the largest among emerging markets. The number of Covid19 infections and casualties has started to decline although levels remain high. The region is set to register the deepest recession since the 1930 as, in addition to the economic impact of social distancing measures, there has been a decline in commodity prices and a loss of revenues from tourist and remittance flows. Fiscal tensions have eased since the peak of the crisis, as the currencies of a number of countries have stabilised, and several have returned to borrowing on international debt markets. Overall, this crisis should extend the recent period of sluggish growth, thus increasing the likelihood of social tensions in the coming years.

**Latin America: GDP growth and FX rates**



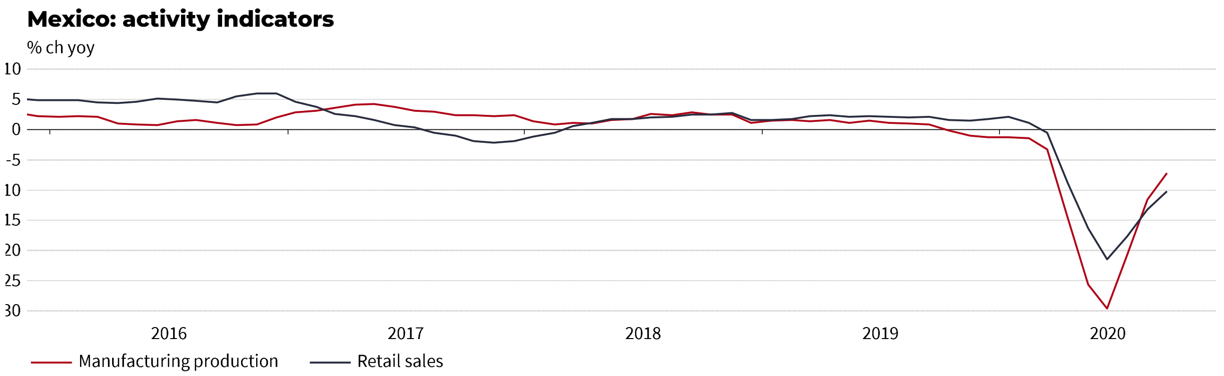

Source: SG Economic and Sector Studies




Source: SG Economic and Sector Studies

In Brazil, where the health crisis is particularly acute, the economy is set to contract but less than the regional average as fiscal and monetary responses have proved effective. The central bank lowered its policy rate to 2%, its lowest level since the inflation targeting regime started in 1999, helping also to bring government yields to historical lows. 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 8% of GDP and implemented a program of public guaranteed loans worth 6% of GDP. Overall, the health crisis is set to prolong the period of anaemic growth of the country (1% on average since 2015).

In Mexico, the virus continues to circulate actively. As in Brazil, the Mexican government did not implement a strict lockdown. The central bank has progressively cut interest rates from 7% to 4.25% since the beginning of the crisis. Given pick-up in inflation, with October core CPI at 3.9% (nearing the 4% higher tolerance band) the central bank l has announced a pause in its easing cycle. Mexico has not put forward any fiscal stimulus package and has managed to keep a primary fiscal surplus (0.6% in 3Q20). Activity is recovering owing to growing manufactured exports. Mexico is expected to register the sharpest recession in the region given the lack of fiscal support and the strong dependency of the country to workers remittance flows from the US and tourism receipts.




*Source: SG Economics & Sector Studies*

Smaller economies have experienced a late rise in the number of cases and casualties caused by Covid19. In Peru and Chile, the number of cases continues to trend up, but the countries 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% in the context of low inflationary pressures. In Chile, the government announced a stimulus package of 5% of GDP, 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 stimulus package worth 3% of GDP, while the central bank also started expanding its balance sheet.

# CENTRAL AND EASTERN EUROPE

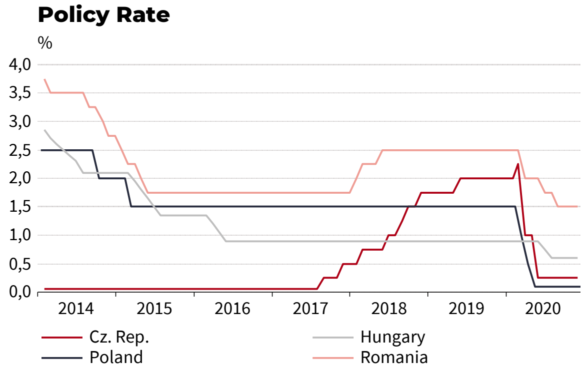
- **The region has been relatively untouched by the first wave of the pandemic in Europe and has faced a second, larger wave, which has stalled the recovery**
- **Central banks are yet to react, but action is likely to follow the ECB's lead after December**
- **A block in the European recovery plan is a risk for growth in 2021**

Activity has been slowing since October. The region has had to deal with an intensification of the virus circulation while the was not significantly hit by the first wave compared to the rest of the EU countries. Containment measures and uncertainty have led to a deterioration in the outlook since October, with figures deteriorating even more in the November activity surveys. The magnitude of the deterioration should be contextualized as it followed a rebound in activity in the 3Q20 thanks to the upward momentum of world trade and strong domestic demand. Since the summer, retail trade has recovered and even surpassed its 2019 level in the major countries of the region (Czech Republic, Poland, Romania, Hungary).

Inflation across countries remains resilient despite the economic contraction. Tensions in the labour market are structural and resulting in wage pressures. Poland has the highest inflation rate in the region. Contrastingly, Romania, which led the way in 2019, experienced a marked deflation in the first quarter and has the lowest rate of the four major countries in the region. With the expected rebound in 2021, inflationary pressures are projected to persist and will lead the Romanian central bank to adjust rates before other central banks in the region.

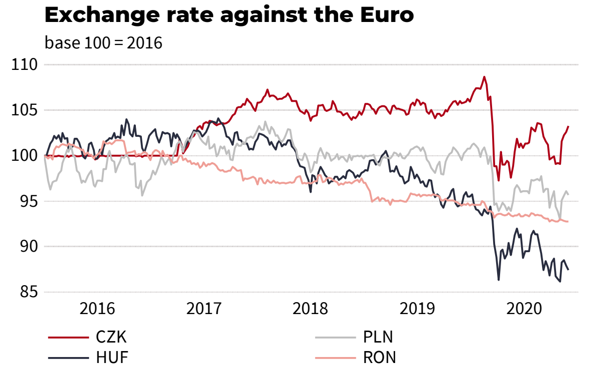
However, given the weakening of activity, central banks will remain overall accommodative. The expansionary measures expected by the ECB in December are likely to support the low policy rate environment in the region. This is not expected to generate depreciative pressures on local currencies. If on the contrary currencies were to face appreciative pressures, monetary authorities may be even encouraged to further ease liquidity to avoid losing price competitiveness. However, further rate cuts would move key rates into negative territory in Poland and the Czech Republic.

## Widespread rate cuts in the region




*Source: SG Economic and Sector Studies, Refinitiv*

## Stabilising Currencies




*Source: SG Economic and Sector Studies, Refinitiv*

At the European level, the ratification of the EU budget remains and the EUR 750bn stimulus package over five years, that aims to distribute the majority of these funds in first two years, is good news for the region.

The stimulus package is expected to be an important funding channel for the CEEC over 2021-26. This will compensate for the reduction in the EU's structural funds, which have been one of the drivers of investment growth in the past. The region's four major economies (Czech Republic, Hungary, Poland, and Romania) will receive a total of EUR 124bn, which is expected to have a significant impact on investment and growth in the region in the medium term. However, the question of the absorption capacity of these funds will arise because they will have to be linked to concrete projects, particularly related to the field of "green and digital transformation".

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