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SG Economics & Sector Studies

A long and winding road to sustainable recovery

- Government and central bank policy responses have been critical in dampening the immediate economic fallout of the Covid-19 pandemic, such as avoiding a cascade of business failures and ensuring income support to those households unable to work. These efforts, however, do not suffice to avoid global recession and most countries will experience a very sharp contraction in GDP in 2020.
- Even if the pandemic subsides quickly, a rapid economic recovery in 2021 will require massive fiscal support as well as capital injections into companies in sectors ravaged by the crisis.
- Markets welcomed the use of available policy space, particularly in countries where the aggressive expansion of central bank balance sheets does not pose an immediate threat to monetary stability. Yet, uncertainty remains very high, and, in terms of fiscal support, more is needed to enable a fast rebound.
- In many emerging countries, there is less policy room, and the health crisis and the fallout from the global slowdown could precipitate deeper and longer recessions. A further concern is on-going protectionism and political focus on the repatriation of critical supply chains.
- Structural weaknesses in the economies concerned are likely to worsen with the pandemic. As a large part of present losses are transformed into future debt, this will weigh on trend potential growth and require low interest rates for longer. The near-term aggregate economic effect of Covid-19 is set to prove deflationary although some relative price shifts are likely. Long term, however, there is no guarantee that inflation cannot resurge and not least if economic nationalism wins out.

THE FUTURE IS YOU SOCIETE GENERALE

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EXECUTIVE SUMMARY

WORLD ECONOMY

The Covid-19 has triggered a deep global recession as countries have imposed, with varying degrees of stringency, policies of social distancing -including economy-wide lockdowns and travel restrictions- to flatten the epidemiological curb.

Gauging the economic costs of Covid-19 remains an uncertain exercise given the many unknowns as to how long social distancing policies might remain in place and how consumers and business will adapt to the post-pandemic environment. Our forecasts draw both on bottom-up sector expertise and top-down analysis, taking account of the policy response.

Our interim forecast update in April presented a forecast range with a base and prolonged scenario. Given the still heightened uncertainty, both with respect to the near-term developments on the health crisis, consumer behaviours and the policy response, we have opted to maintain this range, offering a detailed country review with our June Economic Scenario.

The base scenario assumes a quick reduction of the remaining non-pharmaceutical interventions (NPI), such as limits on travel and social gatherings, and a more robust policy response, which is key for the shape of recovery in 2021. The prolonged scenario assumes a slow lifting only of NPI with potential pockets of tightening and continued cautious consumer behaviours, along with a weaker policy response.

It is worth emphasising that risks to our outlook remain biased to the downside, not least as neither the base not the prolonged scenario discount a renewed severe outbreak. Further downside risks, moreover, stem from the risk of a sharp correction on financial markets and various political risks.

PHASE I OF THE POLICY RESPONSE SAVED THE SUPPLY SIDE

Policymakers have put in place crisis management measures to offset the economic impact, providing income support to businesses and households, credit guarantees, and monetary easing to ensure market liquidity and promote cheap credit. These efforts have eased the economic impact of the pandemic and notably kept much of the supply side capacities intact. With the demand side collapsing, however, the global economy has nonetheless fallen into recession, with most countries experiencing a sharp contraction in GDP in 2020.

We forecast that World GDP will clock in at -2.3% to -7.8% in 2020, in our two alternative scenarios with contractions across most advanced and emerging economies.

PHASE II NEEDS TO DO THE SAME FOR THE DEMAND SIDE…

The shape of recovery in 2021 and beyond depends much on how governments and societies around the world respond to what by then will hopefully be a post-Covid-19 World. Governments must now do more to stimulate aggregate demand and dispel uncertainty, otherwise GDP in most advance economies will not return to pre-crisis levels for many years. The European Recovery Plan and additional budgetary support in the US will be decisive in improving the outlook. Furthermore, it is important to secure capital injections into companies in sectors ravaged by the crisis.

Support for the demand side must target both consumption and investment; ideally the focus on the investment side will help also to alleviate some of the longer-term issues, such as the green and digital transitions.

…WHILE PHASE III MUST FOCUS ON STRUCTURAL ISSUES

The medium-term challenges are undoubtedly complex. Markets welcomed the use of the available policy space especially in countries where large-scale central bank balance sheet expansion does not pose an immediate threat to monetary stability. However, some structural weaknesses in the economies are likely to worsen with the pandemic. Already before the current crisis, debt levels in most economies were high. As much of the current losses are being transformed into future debt, this suggests a weakening of potential growth and the need for low interest rates for a long period of time, which can translate in financial repression. In emerging markets, where policy room for dealing with the economic effects of the pandemic is much more limited, the health crisis and the fallout from the global slowdown could precipitate deeper and longer recessions.

The post-pandemic world is likely to see increased geopolitical rivalries, and not least between the United States and China. In many countries, depressed growth could fuel social tensions and prove a breeding ground for populist policies. There is also a risk that the global coordination and cooperation needed to achieve the necessary decarbonisation and combat global warming will fade away, but hope remains that the pandemic can be the catalyst for a breakthrough in environmental thinking.

ADVANCED ECONOMIES

The governments have put in place massive monetary and fiscal support, the latter focused on crisis management. We expect GDP growth in the advanced economies between -6% and -11.8% in 2020, with Japan outperforming, but still contracting. As policy support gains traction amid weak oil prices and an assumed recovery in consumer and investor confidence, activity is expected to rebound in 2021.

The **United States** is expected to contract between -6.6% and -11.5% in 2020, depending on whether the environment is the one or the central or the prolonged crisis scenario. Above the line fiscal support, at around 10% of GDP, includes direct transfers to households, temporary increase in unemployment benefits, and financial support for corporates. Risks are tilted to the downside, the recession hit highly leveraged corporate balance sheets, not least in the oil and gas sector damaging down medium-term growth prospects.

In the **euro area**, members have rolled out fiscal support packages and extended credit guarantees for corporate loans that allowed a strong rebound of business sentiment from record lows in April. In contrast to the United States, the rise in headline unemployment has been less pronounced so far as the result of different social models, but we still expect a sharp contraction in economic activity ranging from -6.8% to -12.8% in 2020. A European Recovery Fund is in the pipeline, but it will still take several years for euro area GDP to return to its pre-crisis trend, with the risk of further divergence in the growth patterns of euro area members.

In the **UK**, bold fiscal and monetary policy actions will only partially cushion the blow and both public and private debt will sharply increase. The EU27 and the UK still have very divergent positions regarding the post-Brexit arrangement, adding significant uncertainty to the outlook, with an increasing possibility of leaving without a trade deal. Negotiations entered their third and final session on June 1. Fishing rights and EU demands for common standards on state aid, workers' rights and the environment are still under discussion, with the two sides having taken very different positions. We expect GDP contraction in the UK to range between -6.8% and -12.5% in 2020.

In **Japan**, the postponement of the Tokyo Olympics to 2021 exacerbated the negative economic effects of the pandemic. Despite massive fiscal and monetary support, output is projected to shrink by -2.3% in the baseline and by -9.3% in the prolonged scenario.

EMERGING MARKETS

After hitting a historical low level in 1Q20, the **Chinese** economy is gradually recovering. While normalization has gone rather well on the supply side, there is still a high level of uncertainty on the demand side. Government support has been moderate for the time being at least when compared to the support package of late 2008, when China had to face the spill overs of the global financial crisis. In our prolonged scenario, the Chinese economy could see recession in 2020.

Faced with the Covid-19 crisis, most emerging countries are suffering a perfect storm. Several register large domestic outbreaks and their health systems are often less well prepared to deal with the pandemic. Apart from the health crisis, emerging markets also have to cope with the negative impact of the recession in advanced

countries and the sharp slowdown in China, with a slump in commodity prices and tourism, and a significant decline in remittances. Financial market turbulence was very significant in March and April, and central banks saw their foreign exchange reserves decline, but the situation has improved significantly since May. Countries with good fundamentals have reopened market access and do benefit from the low interest rates. But countries with high public debt levels or with large external financing needs do not have policy room to face the headwinds. This has led to debt moratorium discussions at the G-20 level for poor countries in March. The IMF put in place emergency financing tools and approved about USD 25bn programs for 69 countries.

Central banks

Central banks have moved quickly to cut rates and ramped up their use of balance sheet instruments since the beginning of the pandemic. The Fed cut rates to 0-0.25% on 15 March 2020 and launched an open-ended QE that include unlimited purchases of government debt and mortgage backed securities, as well as large-scale purchases of corporate bonds and of securities issued by states and municipalities. The ECB boosted asset purchases, lifting also geographical restrictions on its bond-buying program. The Bank of Japan increased its securities and corporate bond purchases. We expect central banks to keep rates low in both the base and prolonged scenario and to further expand balance sheets.

Massive monetary support in the advanced economies contributed to the June rally for both stocks and bonds, but it is hard to ignore the fact that fundamentals have weakened for both governments and corporates.

ECONOMIC FORECASTS

Real GDP growth (annual, %)

	2019	2020p		2021p		2022p		2023p	
		Baseline	Prolonged	Baseline	Prolonged	Baseline	Prolonged	Baseline	Prolonged
Developed Markets	**1.7**	**-6.0**	**-11.8**	**5.6**	**9.9**	**1.0**	**0.2**	**1.4**	**0.7**
United States	2.3	-6.6	-11.5	6.1	10.0	0.9	0.5	1.7	1.5
Japan	0.7	-2.3	-9.3	1.6	7.5	0.5	0.0	0.5	0.3
United Kingdom	1.4	-6.8	-12.5	6.3	10.1	0.8	0.2	1.0	0.8
Euro area	1.2	-6.8	-12.8	6.6	10.5	0.7	0.3	1.2	0.6
Germany	0.6	-7.3	-13.1	7.5	11.6	0.5	0.2	1.3	0.5
France	1.3	-5.8	-11.1	6.0	9.6	0.7	0.4	1.1	0.6
Italy	0.3	-7.7	-13.2	6.5	11.3	0.4	-0.2	0.7	0.1
Spain	2.0	-7.5	-13.5	8.1	10.0	1.0	0.6	1.3	1.3
Emerging Markets	**3.7**	**0.7**	**-4.5**	**5.6**	**4.8**	**3.8**	**3.3**	**3.8**	**3.7**
Asia	**5.1**	**2.0**	**-3.9**	**6.6**	**3.7**	**4.7**	**3.2**	**4.6**	**3.0**
China	6.1	2.9	-3.0	7.3	3.0	4.8	3.0	4.6	4.0
India	4.5	1.5	-4.9	5.6	4.6	4.5	3.7	4.5	3.8
Central and Eastern Europe	1.9	-4.0	-7.5	4.0	6.1	2.2	1.4	2.3	2.0
Russian Federation	1.4	-3.0	-8.5	2.0	5.0	1.5	0.5	1.5	0.5
Turkey	0.9	-4.0	-6.5	8.5	7.0	3.5	3.0	3.5	3.0
Latin America	1.0	-1.8	-4.0	4.2	4.5	2.6	2.5	2.8	2.5
Brazil	1.1	-3.5	-5.6	3.4	5.1	2.1	3.4	2.4	2.4
Middle East & Central Asia	-0.5	-1.0	-4.5	3.0	3.5	2.0	1.5	1.8	1.0
Africa	3.2	0.2	-1.8	4.5	5.5	3.0	2.5	3.5	3.0
World	**2.9**	**-2.3**	**-7.8**	**5.6**	**7.1**	**2.8**	**1.9**	**3.0**	**2.4**

Market variables

end of period	19/06/20	2020f		2021f		2022f		2023f	
%		Baseline	Prolonged	Baseline	Prolonged	Baseline	Prolonged	Baseline	Prolonged
United States									
Fed Funds target rate (high range)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10y government bonds	0.70	0.80	-0.50	1.00	-0.25	1.50	0.25	2.35	0.50
Euro area									
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit facility rate	-0.50	-0.60	-0.60	-0.60	-0.70	-0.60	-0.70	-0.60	-0.70
10y government bonds									
Germany	-0.42	-0.60	-1.20	-0.40	-1.00	0.20	-0.50	0.65	-0.40
France	-0.09	-0.20	-0.70	-0.10	-0.60	0.50	-0.10	0.95	0.00
Italy	1.35	1.80	1.50	1.90	1.40	2.50	1.90	2.95	2.00
Spain	0.48	0.40	0.10	0.50	0.00	1.10	0.50	1.45	0.60
United Kingdom									
Bank rate	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.50	0.50
10y government rate	0.23	0.40	0.20	0.60	0.20	1.20	0.70	1.75	0.80
Japan									
Complementary Deposit Facility rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
10y government bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
end of period	19/06/20	2020f		2021f		2022f		2023f	
EUR / USD	1.12	1.10	1.20	1.10	1.20	1.15	1.10	1.20	1.10
EUR / GBP	0.91	0.90	0.90	0.90	0.95	0.90	0.95	0.90	0.95
GBP/USD	1.23	1.22	1.33	1.22	1.26	1.28	1.16	1.33	1.16
EUR/JPY	120	121	132	121	132	127	121	138	121
USD / JPY	107	110	110	110	110	110	110	115	110
USD / CNY	7.07	7.00	7.20	7.05	7.20	7.10	7.15	7.05	7.10
yearly average	19/06/20	2020f		2021f		2022f		2023f	
Oil price									
Brent, $/bbl (Yearly average)	42	32	28	45	38	55	50	55	50

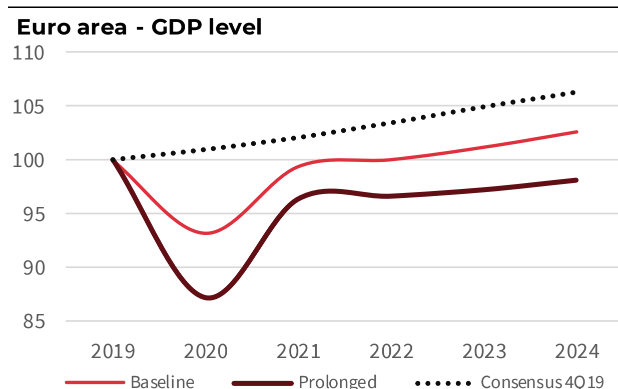
SOCIETE GENERALE

EURO AREA

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

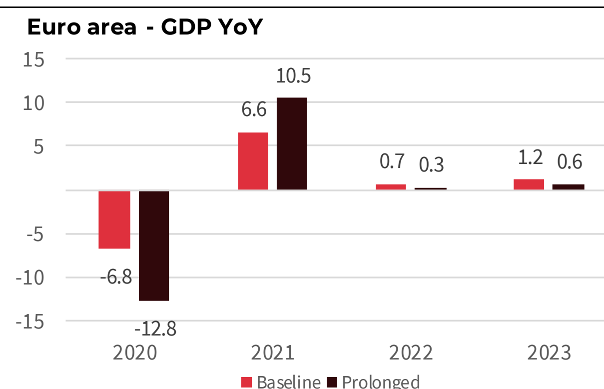
After experiencing the deepest recession in its history in 2020, the euro area economy will post moderate growth in 2021-2022. Indeed, the action of governments in response to the health crisis has postponed the real effects of the crisis on the economy over time. A fiscal stimulus at the European level would be a potential growth driver, but the final form that the Commission's ambitious proposal will take on this plan is still uncertain. In the absence of a significant stimulus, it will take several years for GDP to return to its pre-crisis level, with the risk of further divergence in the growth trajectories of different countries. In our prolonged scenario, GDP would not return to its pre-crisis level over the forecast horizon.

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

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

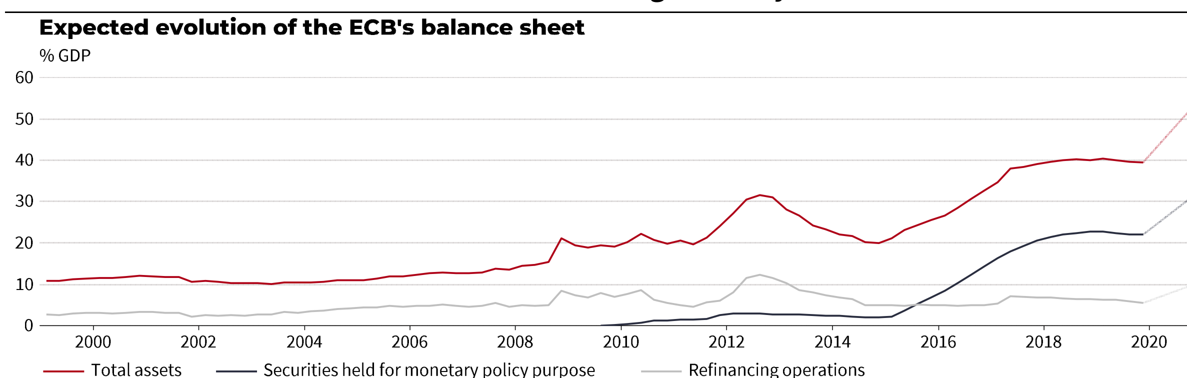
In the wake of the shock recorded in 2020, the rebound in domestic demand will be modest. With the support of various national public guarantee mechanisms, companies will have greatly increased their debt to compensate for the losses linked to the forced shutdown of the economy. In this context, the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

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

Public demand will be stronger. However, despite the low financing costs of governments, the public debt ratios already high before the crisis in some countries limit the room for budgetary manoeuvre. It thus increases the risk of widening divergences in growth trajectories. The Commission's proposal for a European-wide stimulus is a positive development in this regard. However, the amounts mentioned (EUR 750bn i.e. 5.4% of EU-27 GDP) could turn out to be insufficient in view of needs (75% of the funds would not be disbursed before 2023), especially since the scepticism of some member states (some Northern countries oppose that EUR 500bn would be grants and not loans) could call into question the ambition of the project.

Against this backdrop, monetary policy would remain the main lever of economic policy at the euro area level. In 2020, the ECB's strategy will continue to be dictated by managing the direct repercussions of the crisis (ample supply of liquidity to banks and massive asset purchases). Its balance sheet is set to swell to 55% of GDP in 2020-2021, an increase of 15pp of GDP compared to the start of the year. In the longer term, any normalization of monetary policy appears difficult. Inflation will be low in 2021-2022. Moderate labour costs and weak demand will deter companies from raising prices, while at the same time oil price growth will remain moderate over the forecast horizon. Thus, even if a further drop in the deposit rate seems to have been ruled out for the time being, TLTROs and asset purchases will remain at the heart of the ECB's strategy (despite the recent decision of the German Constitutional Court).

The size of the ECB's balance sheet will increase significantly over the forecast horizon



Source: Refinitiv, SG Economic and Sector Studies

The Member States adopting the Commission's stimulus proposal would offer some potential for upside risk to our medium-term outlook. But as explained above, amounts may be disbursed to late and prove insufficient compared to the needs. On

the other hand, the list of downside hazards is long. First, a major new health crisis cannot be excluded. Next, a deterioration in the quality of bank balance sheets, linked in particular to the rise in corporate debt ratios, will be watched. Similarly, lowering the sovereign rating of the most fragile states would rekindle tensions in sovereign debt markets. Finally, a new surge in Euroscepticism and political risk cannot be excluded, particularly in Italy.

Euro Area	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	1.2	-6.8	-12.8	6.6	10.5	0.7	0.3	1.2	0.6
Inflation, %	1.2	0.5	0.2	2.2	1.9	1.5	1.6	1.2	1.0
Unemployment, %	7.6	8.2	9.0	9.4	11.0	9.7	10.9	9.5	10.8
Fiscal balance, % GDP	-0.8	-7.0	-10.1	-3.5	-5.1	-3.8	-5.0	-4.1	-5.1
Public debt, % GDP	89	102	112	98	105	101	109	103	113

Base. = Baseline
Prol. = Prolonged

GERMANY

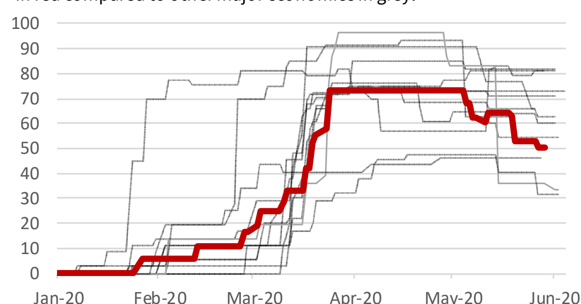
- **Freshly announced stimulus package could accelerate convergence of GDP to pre-crisis level.**
- **With aggregate demand depressed, core inflation will settle over the forecast horizon.**
- **Despite the deterioration of public and private debt ratios, the risks to financial stability are limited.**

The recovery will be gradual in the wake of the 2020 recession. Growth will rebound strongly in 2021 mainly due to favourable base effects at the start of the year. But in 2022, the delayed effects of the crisis on jobs, investment and external demand will weigh on activity, which will grow below its potential. GDP will not return to its pre-crisis level before 2022 (2023 in the prolonged scenario). The stimulus plan of EUR 130 bn EUR (3.8% of GDP) announced by the Grand Coalition in early June, if adopted as it stands, could accelerate the catching up of the economy.

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

Lockdown was less stringent in Germany…

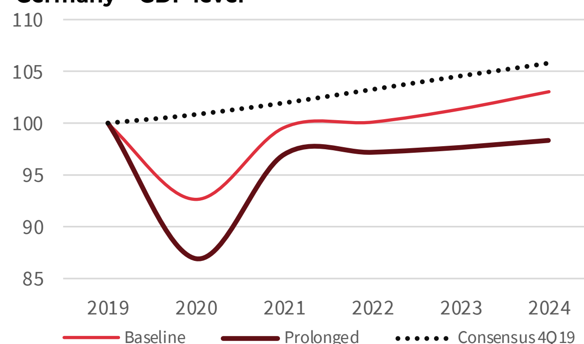
Germany - Stringency index
In red compared to other major economies in grey.



Source: SG Economics & Sector Studies

… but the recovery is set to be slow

Germany - GDP level



Source: Oxford Economics

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

"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%

"Above the line" fiscal measures yet to be adopted	
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
Total	130.0
% GDP	3.8%

The increase in public demand recorded in 2020 as part of the emergency measures will continue to have positive effects on activity. Fiscal measures adopted so far account for 6% of GDP. The newly announced stimulus package would add almost 4% of GDP. With slowing aggregate demand and moderating unit labour costs, core inflation will slow over our forecast horizon. With oil prices remaining low over the forecast horizon, inflation will be low.

Despite the deterioration in public and private debt ratios, the risks to financial stability seem limited. The main downside hazard to our scenario would be a resurgence of the pandemic requiring the reintroduction of lockdown measures. In addition, the risks that structured 2019 are still present. One of them would be the failure of negotiations between the UK and EU27 regarding their future relationship. Similarly, a resumption of trade tensions with, for example, the increase by the United States of customs tariffs on their imports of vehicles would weigh heavily on the German automobile industry, already in difficulty since 2018.

Germany	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	0.6	-7.3	-13.1	7.5	11.6	0.5	0.2	1.3	0.5
Inflation, %	1.4	0.6	0.6	1.8	1.7	1.3	1.4	1.3	1.1
Unemployment, %	5.0	5.3	7.4	6.1	7.8	6.5	7.9	6.3	7.7
Fiscal balance, % GDP	1.5	-6.3	-9.4	-2.4	-5.0	-3.3	-4.4	-3.9	-4.2
Public debt, % GDP	59	69	76	66	73	69	77	71	80

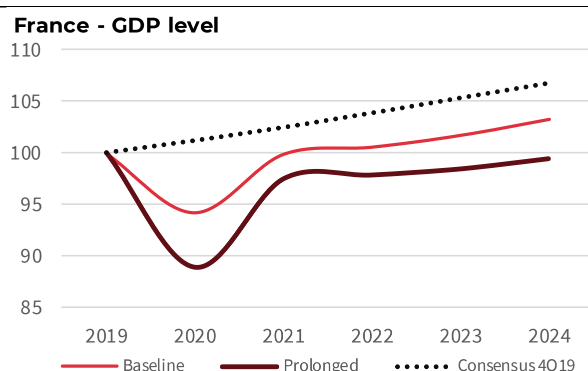
Base. = Baseline
Prol. = Prolonged

FRANCE

- **GDP levels will remain moderate in 2021-2022 and unemployment is projected to exceed 10% over the forecast horizon.**
- **Moderate labour costs and lower oil prices will maintain a very low inflation environment.**
- **The European recovery proposed by the Commission is a bullish risk, but the final form it will take is still uncertain.**

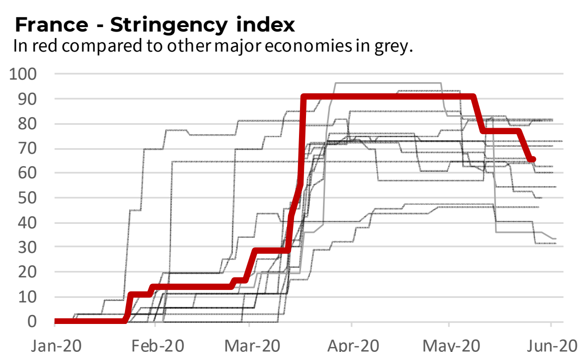
After recording a recession in 2020 of a magnitude not seen since WWII, the French economy is expected to post very moderate sequential growth in 2021-2022. Indeed, the emergency measures taken by the government have postponed in time some of the real effects of the crisis on employment and investment. Thus, in the absence of a more significant fiscal stimulus, GDP would return to its 2019 level in 2022 only and the unemployment rate would stand above 10% in 2022. In the scenario of a health crisis that takes longer to resolve with a slower normalisation of activity, GDP would not return to pre-crisis levels over our forecast horizon.

A very slow recovery ahead



Source. SG Economic and Sector Research

Stringent lockdown has hurt the economy



Source: Oxford Economics

Companies will emerge financially fragile from the forced shutdown of the economy. Government emergency measures (partial unemployment and State Guaranteed Loans in particular) have supported corporate liquidity, but their debt ratios are nevertheless very degraded. Consequently, the need to free up financing capacities to stabilise debt ratios will strongly constrain capital spending in the medium term.

On the household side, job destruction and income moderation will weigh on spending. In the absence of new public support measures, housing investment will remain sluggish in 2021-2022. The absorption of accumulated forced savings (in the first quarter of 2020 alone, the saving rate increased by 4.5 points) during the lockdown will pull private consumption in the second half of this year. But with rising unemployment and persistent uncertainty surrounding the evolution of the pandemic, households will certainly build up precautionary savings, ruling out the scenario of a marked rebound in consumption in 2021-2022.

"Above the line" fiscal measures	EUR/bn
Temporary unemployment benefits (*chômage partiel*)	24.0
Solidarity Fund for small companies	7.0
Exceptional credits for health administrations	8.0
Temporary enhancement of some social benefits	2.5
Delay in the implementation of the unemployment insurance reform	0.5
Emergency plan for the tourism sector	3.0
Emergency plan for the automotive sector	0.6
Emergency plan for the aeronautics sector	0.4
Total	55.0
% GDP	2.3%

The sectoral support plans currently being adopted (in tourism, the automobile industry and the automobile industry) favour supply and do not constitute a real stimulus by demand. In total, the impact of the various measures adopted since March would remain very limited, below 1 point of GDP in 2020-2021. More fiscal stimulus would be needed to help demand recover faster.

Falling oil prices, moderating wage costs and weak anticipated demand will help maintain a very low inflation environment in 2021-2022. Supply chain disruptions would only aggregate a limited (bullish) impact on inflation. The contraction in activity, the increase in public demand and the emergency measures taken by the government to address the health crisis will see greatly degraded public finances in 2020. The unwinding of certain exceptional measures (partial unemployment, for example) will help improve the public balance in 2021. But with the very moderate recovery in activity and the sectoral support measures to come, public debt ratios will remain high over the forecast horizon. The very expansionary monetary policy of the ECB will on the other hand continue to guarantee very favourable financing conditions for the government.

The main upside risk to our forecast medium-term lies in the European Recovery Plan proposed by the Commission. The final form of this initiative, however, remains highly uncertain given the scepticism of some member states. At the same time, the list of downside risks remains long, with a renewed health risk in mind. In addition, the risks that structured 2019 (trade tensions with the US, negotiations in the wake of Brexit, social movements, etc.) are still present.

France	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	1.3	-5.8	-11.1	6.0	9.6	0.7	0.4	1.1	0.6
Inflation, %	1.3	1.1	1.0	1.5	1.4	1.3	1.1	1.3	0.9
Unemployment, %	8.2	9.1	10.5	9.8	10.7	10.2	11.0	10.3	11.5
Fiscal balance, % GDP	-3.0	-8.1	-11.8	-4.5	-5.3	-4.1	-5.2	-4.1	-5.5
Public debt, % GDP	99	112	121	110	116	113	121	114	125

Base. = Baseline,
Prol. = Prolonged

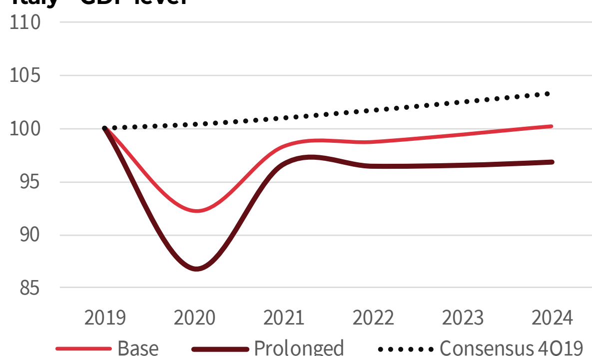
ITALY

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

Italy was struck particularly forcefully by the coronavirus pandemic. Nationwide lockdown measures, including production shutdowns, will result in a 20% drop in GDP in the first half of 2020. Economic activity has started to resume in May and will gradually normalise, allowing output growth to bounce back, helped by sizeable policy support (both Italian and European). Real GDP fall is set to be in the 8% to 13% range in 2020 and would most probably not fully recover before 2024.

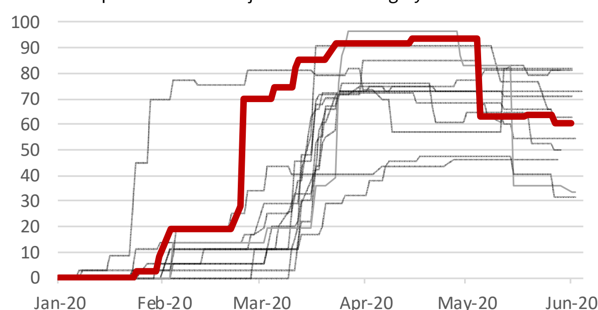
The consumer catch-up effect expected in 2H20, a large stimulus package and the sharp fall of oil prices will only partially offset the drop in activity caused by the pandemic. Growth is set to rebound slightly in 2021-2022 but unemployment is set to head north. The surprising drop in the unemployment rate in April (down to 6.3% from 9.4% in January) is linked to an unprecedented fall in the activity rate, as people do not declare being actively looking for a job during the lockdown. We assume this pattern to be temporary and the unemployment rate to rise to 11.5% next year. Close to 400 000 jobs have been lost during the lockdown period (March-April), mostly temporary contracts. With the current ban on permanent workers layoffs, the employment response is likely to be protracted and job destructions are set to continue in 2021. We estimate at 800 000 jobs the total loss of the crisis.

A slow recovery with structural headwinds



Source: SG Economic and Sector Research

Italy faced one of the toughest lockdowns



Source: Oxford Economics

Companies will be hard hit by the fall of consumption and industries shutdowns. Profit margins are expected to shrink and productive investment to contract. Despite

liquidity assistance for SMEs, it will become difficult for some firms to avoid bankruptcies, and non-performing loans are set to increase.

“Above the line” fiscal measures	EUR/bn
Relaunch Decree (15 May), of which:	**55.0**
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	**80.0**
%GDP	4.8%

The Italian government approved three rescue packages to cushion the impact of the crisis for households and firms: the “Cura Italia” Decree on 8 March, the Liquidity Decree on 4 April and the latest “Rilancio” Decree on 14 May. In total, the three packages are expected to have an impact of 4.5% of GDP on general government net borrowing in 2020.

This government support will provide a liquidity cushion for households and small enterprises most impacted by the crisis but will not be enough to boost the economic recovery. More support for investment projects and structural reforms would help to foster potential growth. On this front, the European Recovery and Resilience facility would be very welcome. Italy would be entitled to EUR 70bn of grants (or a mixture of grants and loans) over the next seven years (4% of GDP).

On top of this investment support starting next year, the country is eligible in 2020 to EUR 36bn of ECCL (ESM credit lines) with light conditionality, EUR 9bn of EIB credit guaranties and EUR 8bn from the SURE mechanism for unemployment benefits.

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

Support to households and the labour market reaches EUR 25bn. It includes: EUR 15bn for the wage supplementation schemes (*Cassa integrazione in deroga*); EUR 5bn subsidies up to EUR 600 a month for self-employed workers (the good news

is that funds will now arrive automatically to those who already got them with the first decree); EUR 1.5bn for so-called 'Emergency Income', i.e. a monthly subsidy for those not covered by other schemes up to EUR 400/800 per person; EUR 1.4bn extra spending for education, university and research (with new hiring); EUR 0.6bn for babysitting vouchers and parental leaves.

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

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

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

Italy	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	0.3	-7.7	-13.2	6.5	11.3	0.4	-0.2	0.7	0.1
Inflation, %	0.6	-0.3	-0.4	1.3	1.2	1.1	1.1	1.0	0.8
Unemployment, %	9.9	11.7	11.8	13.5	13.9	12.7	13.1	12.0	12.4
Fiscal balance, % GDP	-1.6	-10.0	-12.6	-4.9	-5.4	-5.0	-5.5	-5.2	-5.7
Public debt, % GDP	135	156	169	149	155	152	159	155	163

Base. = Baseline
Prol. = Prolonged

SPAIN

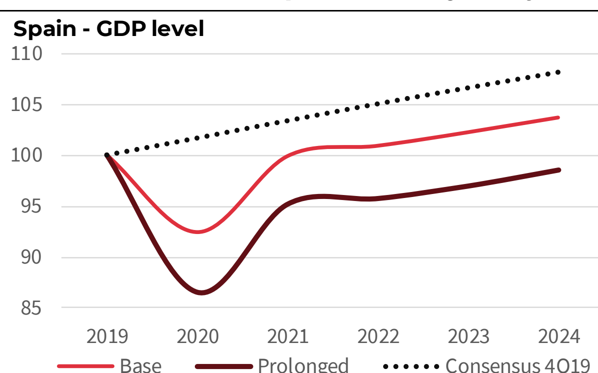
- **The long-lasting lockdown is expected to take an unprecedented toll on economic activity, with a severe impact on the services sector.**
- **Measures to limit job losses and support the corporate sector will cushion some of the impact but will be insufficient to support growth.**
- **The fragmentation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

The Covid-19 pandemic is set to trigger a slump in 2020. GDP contracted by 5% QoQ in 1Q20 and is expected to contract further in 2Q20, before undergoing a strong 'mechanical' rebound in the second half of 2020 as activity gradually resumes.

The health crisis is causing an unprecedented collapse in consumption. Spending on durable goods could lose in three months what it has regained in seven years. The decline in new vehicle purchases reached close to 90% year-on-year in April. Inflation would be close to zero in 2020 boosting households purchasing power, which also benefited from a new rise of the minimum wage in January. This will result in a sharp increase in the saving rate after years of steady decrease.

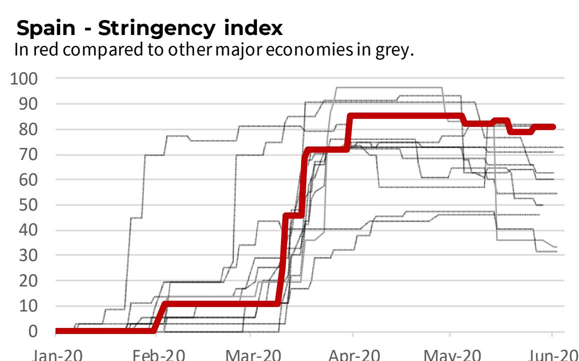
Short-time work schemes (so called "ERTEs") are being used in large numbers and should limit job losses and support household incomes during the downturn. Still, the widespread use of these schemes has not prevented a rapid fall in employment, which has particularly hit temporary workers. The unemployment rate is expected to rise rapidly, amplifying the shock to the economy, although job losses should be partly reabsorbed as activity picks up again. However, the recovery in the labour market is expected to be slower amid high uncertainty, weak corporate balance-sheet positions, and the disproportionate impact of the crisis on labour intensive sectors, such as retail and hospitality.

GDP will not return to pre-crisis trajectory



Source: SG Economic and Sector Research

Stringent lockdown measures still in place



Source: Oxford Economics

Measures aimed at supporting the corporate sector may reduce the number of bankruptcies, but weak demand, high uncertainty, liquidity shortages, and impaired profitability are set to result in a sharp contraction in investment. Although capital expenditure should gain traction from 3Q 2020 onwards, investment in 2021 is expected to remain well below its 2019 level. Exports are also forecast to contract strongly this year due to sharp declines in export markets, production restrictions, and the severe impact of the crisis on the tourism sector. Revenue related to foreign visitors was around 6% of GDP in 2019, 63% of which was recorded between April and September.

“Above the line” fiscal measures	EUR/bn
Labour market measures: increase protections of vulnerable workers and self-employed, exemptions of social security contributions, temporary employment schemes (ERTEs) …	26.2
Strengthening the financing of health and research sectors: increase allocation to health ministry, transfer of money to regions, implementation of a 0% VAT rate for medical supplies	5.3
Ensure corporate viability: possibility to adapt corporate and income tax payments	1.1
Total	**34.2**
%GDP	3.0%

The Spanish Government has adopted four main packages of economic and social measures to fight the pandemic, on 12, 17, 31 March and 21 April. All together, they are expected to increase the public deficit by 2.5% of GDP in 2020 (according to the Spanish government estimates).

The overall package of measures is smaller than in other European countries while Spain has been one of the most hit country in terms of death toll and length of the lockdown. More support in term of investment to boost the recovery will be needed. European support from the Recovery and Resilience facility would be very welcome. Spain would be entitled to EUR 70bn of grants (or a mixture of grants and loans) over the next seven years (5.5% of GDP).

Overall fiscal measures amount to EUR 138.2bn, of which EUR 104.4bn is liquidity measures. Measures related to the health system (EUR 4.3bn) include advance payments to the regions. EUR 19.2bn is dedicated to labour market policies for the self-employed and extension of ERTEs (temporary employment adjustment schemes). There is also a ban on Covid-related dismissals and temporary contracts interrupted during the crisis but must be resumed after the end of the lockdown. EUR 4.2bn is dedicated to selected tax policies: reduction of VAT on medical goods, deferrals/moratorium of Social Security Contributions for the self-employed and firms.

In 2020, the downturn is expected to have a deeply negative impact on government finances. The contraction of tax bases is expected to lead to a significant drop in revenues, while the increase in unemployment and the extensive use of short-time

work schemes ('ERTEs') should result in large increases in social transfers. In addition, health care expenditure is increasing significantly. These factors, together with the already-enacted increases in pensions and public sector pay, should push the deficit up in 2020. The deficit should then narrow in 2021 on a no-policy-change basis, as economic activity resumes and most of the measures put in place to respond to the COVID-19 crisis have a temporary effect.

The political landscape remains very fragmented in Spain with no majority in parliament and difficult decision making. This will continue to prevent the government from taking quick and effective action, and limit the size of public support to the economy. Spreads have been contained thanks to massive monetary policy support and the country would benefit from the European recovery package as of 2021.

Spain	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	2.0	-7.5	-13.5	8.1	10.0	1.0	0.6	1.3	1.3
Inflation, %	0.8	-0.4	-0.6	2.7	2.5	1.8	2.0	1.3	1.1
Unemployment, %	14.1	15.9	19.3	17.7	21.7	17.9	22.0	17.2	21.5
Fiscal balance, % GDP	-2.8	-9.3	-12.3	-5.7	-7.9	-5.6	-7.9	-5.6	-7.8
Public debt, % GDP	96	112	124	107	117	109	122	112	127

Base. = Baseline
Prol. = Prolonged

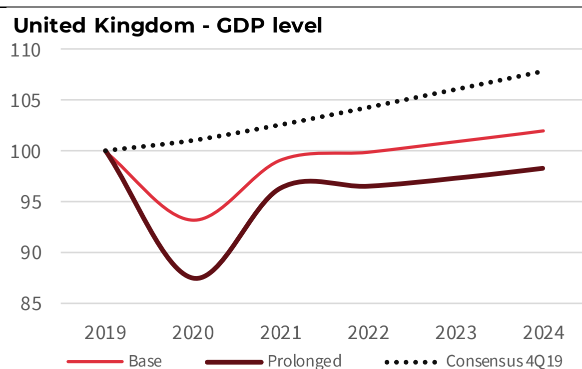
UNITED KINGDOM

- **With one of the highest death tolls in Europe and of the longest lockdown, the UK has been severely hit by the Covid-19 outbreak.**
- **Bold fiscal and monetary policy actions will only partially cushion the blow and both public and private debt will sharply increase.**
- **The EU and the UK still have very divergent positions regarding the post-Brexit arrangement, adding significant uncertainties.**

In response to the Covid-19 outbreak, the UK government announced a strict lockdown across the country on 23 March. It had an immediate impact of business activities. In 1Q20, the economy contracted by -2% relative to the previous quarter, with a -5.8 % mom contraction in March.

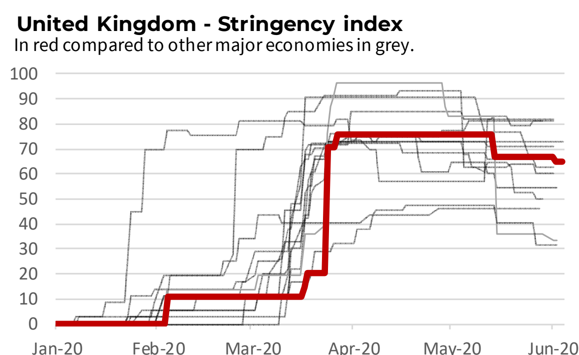
On 10 May, the government set out a roadmap to ease the lockdown and reopen the economy. Since 13 May, people working in the manufacturing and construction sectors have been encouraged to go back to work. Since 1 June, schools as well as outdoor markets and car showrooms are allowed to reopen, while all other non-essential retail reopened on 15 June. Part of the hospitality and personal care industries is expected to reopen on 4 July, while enforcing social distancing.

Significant long-term damages on the UK economy



Source: SG Economic and Sector Research

A long-lasting lockdown has necessary to curb the spread of the virus in the UK



Source: Oxford Economics

To mitigate the effect of these measures on the economic activity, the UK authorities have set up a package of support for households, business and public services of a unprecedented scale in the UK.

On the fiscal side (see table below), the response encompasses additional funding for the NHS, public services and charities (GBP 16bn), the strengthening of the social safety net, notably by increasing payments under the Universal Credit scheme as well as expanding other benefits (GBP 7bn) and measures to directly support businesses, like property tax holidays, grants for small firms and firms in the most-affected sectors, and compensation for sick pay leave (GBP 27bn). The Government

is also deferring VAT payments and income tax payments of the self-employed by six months (GBP 3 bn). Through the Self-Employment Income Support Scheme (SEISS) and the Coronavirus Job Retention Scheme (CJRS), the government pays 80 % of the earnings - to a maximum of GBP 2,500 per employee per month - of self-employed workers (GBP 15bn) and furloughed employees (GBP 54bn). For furloughed employees, the scheme has been extended until end-October and for self-employed until the end of August, although replacement rates will gradually decrease for both schemes.

"Above the line" fiscal measures	GBP bn
Public services spending: - Health services, local authorities, measures to support vulnerable individuals, supporting rail services and funding for the devolved administrations	16
Coronavirus job retention scheme	54
Self-employed income support scheme	15
Welfare package: - Universal credit - minimum income floor - Increase weekly universal credit by £20 - Employment and support allowance: removing 7 day wait - Local Housing Allowance measures	8
Small business grant schemes	15
Business rates package	13
VAT deferral / Self-assessed income tax deferral	3
Total	124
% GDP	5.6%

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

The Office for Budget Responsibility, the UK public finance watchdog, estimates that the direct impact of these new policy measures on cash borrowing on the fiscal year 2020-21 will be GBP 132 bn, or close to 6 % of GDP. Because of the concomitant drop in government receipts, borrowing of around GBP 300 bn over on the fiscal year 2020-21, or 15 % of GDP, seems now plausible, a level which has not been reached since the Second World War.

Despite the unprecedented size of the UK's intervention, it is worth noticing that the announced packages interact with the pre-existing benefit system. In this respect, the UK tends to stand out by offering a relatively low level of income support to employees who become unemployed, notably when compared to other European countries whose insurance-based systems already provided a much greater level of insurance. The announced fiscal responses are thus unlikely to prove sufficient to effectively support and kickstart the economy.

The UK economic is also supported by extremely accommodative monetary policies aiming at preserving firms' and households' access to financing and insuring market liquidity. The Bank of England (BoE) reduced their main rate by 65 bps to 0.1 % in March. The BoE expanded the central bank's holding of UK government bonds and non-financial corporate bonds by GBP 200 bn (that is a 45 % increase as compared to amount held in March). The BoE also introduced a new Term Funding Scheme for the commercial banks to reinforce the transmission of the rate cut, with additional incentives for lending to the real economy, and especially SMEs. The Treasury and the Bank of England launched the Covid Corporate Financing Facility which, together with the above-mentioned Coronavirus Business Interruption schemes, makes GBP 330 bn of loans and guarantees available to businesses. The Treasury and the BoE also agreed to extend temporarily the use of the government's overdraft account at the BoE to provide a short-term source of additional liquidity to the government if needed.

These policies have efficiently supported corporates' access to debt. The latest figures indicate that UK private sector businesses raised a total of GBP 46bn from banks and financial markets in March and April in debt instruments (+ GBP 45bn as compared to January and February), causing the amount of outstanding debt to grow by 11 % over the past 12 months at the end of April.

The UK has formally left the EU but the terms of its new trading arrangements with the bloc have yet to be fixed, and time is running short to agree a deal before transition arrangements expire in December.

The UK and the EU resumed negotiations on March 20 after a six-week interruption caused by the coronavirus. 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. Meanwhile, the UK continues to rule out an extension to the current standstill transition period. In the recently held "high-level" political meeting both parties underlined "their intention to work hard to deliver a relationship" but a no-deal Brexit remains a very serious possibility, but so is a patchy goods-only deal or the extension of the transition period.

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 will see a third country equivalence being granted to the UK. This

will nonetheless leave the City at risk of revocation. Concerning other services, we expect these to become subject to various restrictions. For example, while UK hauliers should be able to transport goods freely between the UK and EU27, we do not expect them to be allowed to operate freely within the EU27.

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. 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	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	1.4	-6.8	-12.5	6.3	10.1	0.8	0.2	1.0	0.8
Inflation, %	1.8	0.8	0.7	1.9	1.8	2.1	2.1	1.9	1.9
Unemployment, %	3.9	7.5	7.9	8.2	8,5	7.7	8.6	7.5	8.4
Fiscal balance, % GDP	-2.0	-7.1	-8.6	-3.7	-4.5	-3.4	-3.5	-3.3	-3.4
Public debt, % GDP	85	96	103	92	96	92	97	92	97

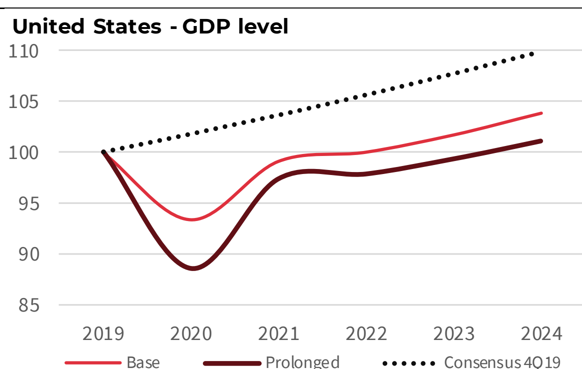
Base. = Baseline
Prol. = Prolonged

UNITED STATES

- **The Covid-19 health and economic crisis has severely hit the country.**
- **The Fed implemented an aggressive monetary easing comprising of unlimited QE and financing of the corporate sector.**
- **The main risks are a renew infection wave, an increase of social tensions or an escalation of trade tensions with China.**

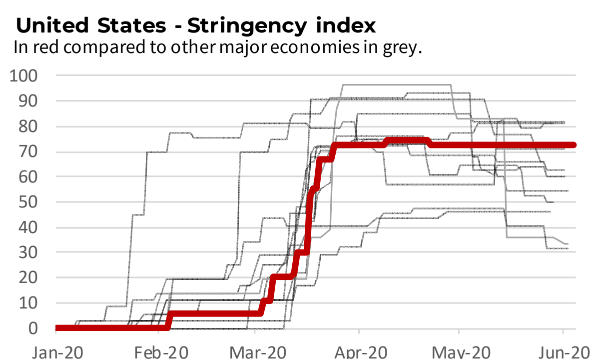
The Covid-19 health and economic crisis have severely impacted the country. Real GDP contracted by 5% QoQ AR during 1Q20, even as non-pharmaceutical interventions (NPI) were implemented only end of March, with private consumption declining by 7% QoQ AR. The depth of the recession is illustrated by the labour market, which has lost 20 million jobs since April, bringing the unemployment rate to 14%. Overall, the economy is set to contract 6.6% in 2020 with a 6% rebound in 2021 and to reach its 2019 level only by 2023.

No near-term catch-up



Source: SG Economic and Sector Research

No marked easing yet of NPI



Source: Oxford Economics

The Fed responded quickly and in a significant way to the crisis. The Fed reduced its interest target range to 0%-0.25% and stated that they will keep the range until the economy reaches full employment again. Furthermore, the Fed launched an open-ended QE program, with no restrictions on the central bank's purchases of US Treasuries, commercial and residential mortgage-backed securities. Finally, the Fed also launched a program (amounting to USD 1 350bn) to purchases corporate bonds or loans to the non-financial sector originated by the commercial banks (which in turn finance the private non-financial sector and local governments.

These different measures have translated into a sharp increase of the Fed's balance sheet, from USD 4tn before March to USD 7tn end of May. It should reach USD 10tn by the end of the year. Overall, these measures have been successful to stabilise financial markets, as corporate credit spreads have decline and the stock market has also recovered. In case of a sharper drop of economic activity or a renew episode of financial volatility, the Fed could still expand it's lending to the private non-financial sector and local governments or even implement a sovereign yield curve control.

"Above the line" fiscal measures	USD bn
Cash headcounts to US residents USD 1,200 (USD 2,400 for couples) + USD 500 per child	293
Paycheck protection program (Loans up to USD 10 mn 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 31July)	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%

On the fiscal side, the authorities announced a USD 2.7tn package (11% of GDP) comprising of direct cash handouts, increasing unemployment benefits and guaranteed loans. More specifically, the government handed a one-off USD 1 200 check per individual, increased the unemployment benefit period and the weekly amount that a person can receive and gave USD 700bn of forgivable loans to firms that kept they payroll in the two months after the loan origination.

Overall, these measures have been so far effective, as household disposable revenue increased in April/May in contrast to previous episodes of increasing unemployment. Nevertheless, this package is likely to be limited as the enhanced unemployment benefits expire in July, a period in which unemployment will remain at double digits. Additionally, the crisis has weakened the balance sheets of States and other local governments (which usually pay the unemployment benefits), forcing them to cut expenditures. The US Congress is debating on expanding the fiscal stimulus package by another USD 3tn, but it is unlikely that it will be approved, as Republicans and the Executive are against further stimulus.

There are several risks to an already weak the outlook. First, a renewed major health crisis. Second, a further increase in social tensions would also depress consumption and investment. Indeed, the current mobilisations sparked by systemic racial inequities lead to the implementation of curfews in large cities that were starting to ease social distancing restrictions. Finally, a sharp increase of commercial and political tensions with China could also lead to further capital expenditures cuts.

United States	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	2.3	-6.6	-11.5	6.1	10.0	0.9	0.5	1.7	1.5
Inflation, %	1.9	0.0	-0.9	2.0	2.0	2.5	2.5	2.1	2.1
Unemployment, %	3.5	18.0	22.0	10.0	15.0	8.0	11.0	7.0	9.0
Fiscal balance, % GDP	-7.2	-16.6	-18.7	-14.2	-15.5	-12.9	-12.5	-10.0	-11.2
Public debt, % GDP	80	99	104	106	110	112	115	118	122

Base. = Baseline
Prol. = Prolonged

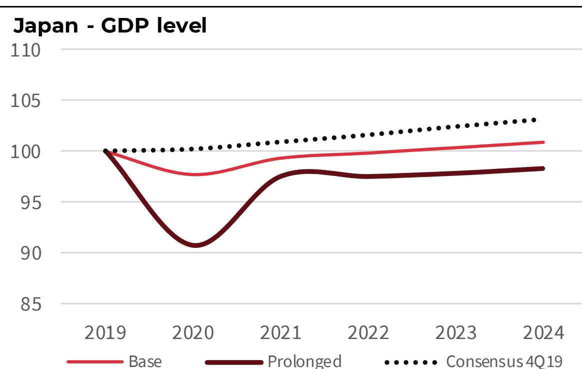
JAPAN

- **A marked contraction in GDP is expected…**
- **… despite a considerable fiscal stimulus effort.**
- **As a result, a rapid increase in public debt.**

Already in a technical recession with a contraction of GDP in 4Q20 and 1Q21, the Japanese economy is expected to decline sharply in 2Q20 before gradually recovering. A sharp drop in GDP is expected in 2020 followed by a rebound in 2021. On the other hand, the economy will not return to its level in 2019.

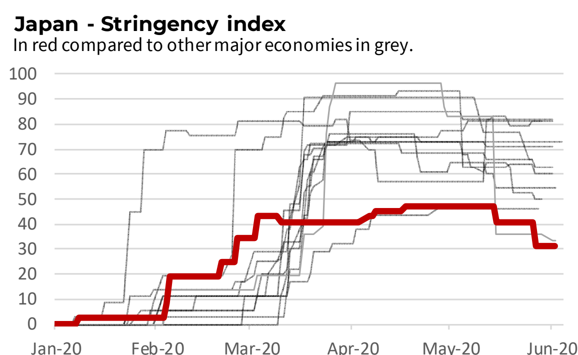
Even though no strict containment has been put in place, a state of emergency with social distance practices was lifted on May 24. It then lasted between 4 and 7 weeks depending on the prefectures of the archipelago. The improvement in the health situation was accompanied by a slight recovery in consumer confidence, albeit its very low level.

Inexorable GDP loss



Source: SG Economic and Sector Research

No strict lockdown



Source: Oxford Economics

The fiscal effort to revive activity is considerable. Three stimulus plans were announced after the onset of the health crisis. They include direct government spending known as "mamizu", at JPY 66tn, or 11.8% of GDP, in addition to the broader support program that also includes spending under the fiscal loan and investment program (FLIP). There is also additional spending by local governments, and deferred tax payments. Compared to the government expenditure mobilized during the Lehman crisis which was 15.4 trillion yen, 3% of the GDP of the time, these fiscal efforts aiming to compensate for the fall in activity linked to the state of emergency and the decline in external demand are far greater.

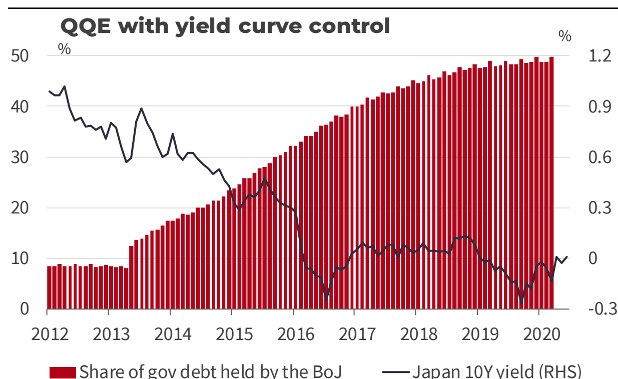
Government spending has two main components. A third of it consist of direct cash payment to households and subsidies to companies whose sales are severely affected by Covid-19. Part of this transferred income will be transformed into consumption and investment. About another third is made up of direct government purchases or investments aimed at fighting the virus on the one hand and structurally improving the economy on the other. The insufficient demand is then

partially compensated. In sum, given the scale of spending, it will have a significant supporting impact on the economy of up to several points of GDP, but a marked contraction in growth seems difficult to avoid.

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

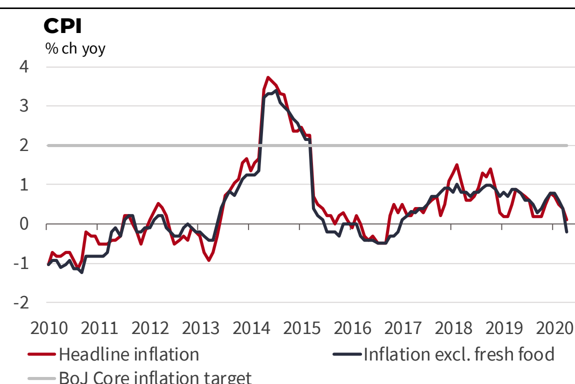
On the monetary side, the Bank of Japan (BoJ) has actively modified its purchase program, with the yield curve control remaining unchanged - the short rate at -0.1% and the 10-year rate around 0%. Thus the annual purchase ceiling of JGBs (treasury bills) at 80 trillion yen was removed; that of ETFs (index trackers) and REITs (listed real estate investment companies) was doubled, reaching 12 trillion yen and 180 billion yen respectively; the upper limit on the outstanding amount of commercial paper and corporate bonds the BoJ can hold was lifted to 20 trillion yen. As a result, the BoJ's balance sheet, which represented 105% of GDP in March 2020, would likely reach 130% of GDP by the end of the year.

10Y yield kept around 0% by the BoJ



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

Relapse into low inflation



Source: BoJ, SG Economic and Sector Studies

Consequence of considerable fiscal efforts: the widening of the deficit and the rise in the public debt ratio. The latter already reached 238% of GDP in 2019, it goes straight to 250% of GDP in 2020. This raises the question of debt sustainability, especially

since the policy of reflation is struggling to succeed (inflation was only halfway to reach the 2% target) and recently inflation has fallen again to 0.1% in April. Even if the cost of financing public debt is kept extremely low with most of the debt held by domestic investors including the BoJ, a calendar of fiscal consolidation staggered many times could nevertheless affect the perception of risk for investors.

Japan	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	0.7	-2.3	-9.3	1.6	7.5	0.5	0.0	0.5	0.3
Inflation, %	0.5	0.4	-0.3	0.3	-0.2	0.5	0.3	0.5	0.2
Unemployment, %	2.3	3.1	5.0	3.1	5.7	2.9	5.3	2.8	5.1
Fiscal balance, % GDP	-3.0	-4.5	-8.0	-3.5	-5.0	-3.3	-4.0	-3.0	-3.5
Public debt, % GDP	238	243	253	241	249	242	245	242	244

Base. = Baseline
Prol. = Prolonged

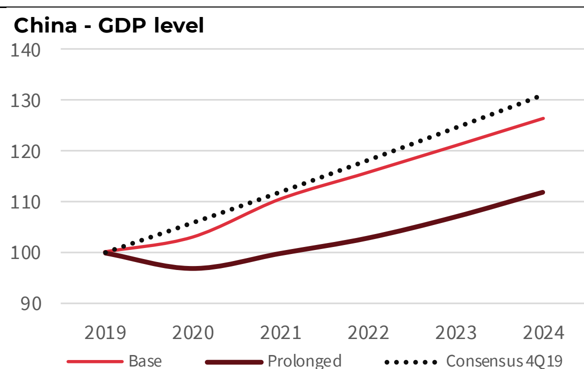
CHINA

- **The recovery will continue but that of household demand will be slower.**
- **The policy mix exerts reasonably significant support with a cautious tone.**
- **In relative respite, credit events will resume once liquidity conditions tighten.**

GDP growth is expected to resume in the second quarter after hitting a historic low in the first three months of the year at -6.8% YoY. The end of strict confinement in Hubei province in early April is accompanied by a visible resumption of activity. This dynamic will continue until the first half of 2021, thanks to fiscal and monetary support measures.

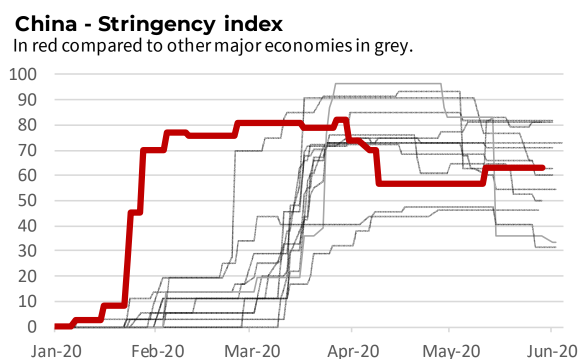
The recovery of production and that of consumption are happening at two speeds. On the one hand, coal consumption in power plants has exceeded the comparable level in 2019 since the beginning of May. Industrial production has already reached the level at the end of 2019 in April. On the other hand, retail sales have barely increased since the start of containment in January and remain 7.5% lower than the year before.

Severe loss in GDP if crisis prolonged



Source: SG Economic and Sector Research

Caution prevails despite low number of cases



Source: Oxford Economics

Economic policy has responded to the risk of prolonged recession, especially since the risk of contracting external demand comes at a time when domestic demand is just beginning to recover. Note also that trade and technology tensions between China and the United States are rising again, representing additional uncertainty.

From the first measures to exempt social security charges and taxes to the increase in the quota for issuing government bonds, announced at the session of the National People's Congress (NPC, the legislative body) on May 22, all measures represent 7% of GDP. Central and local government special bond issues play a predominant role, both in their amount - 1,000 billion (1% of GDP) and 3,750 billion (3.75% of GDP)

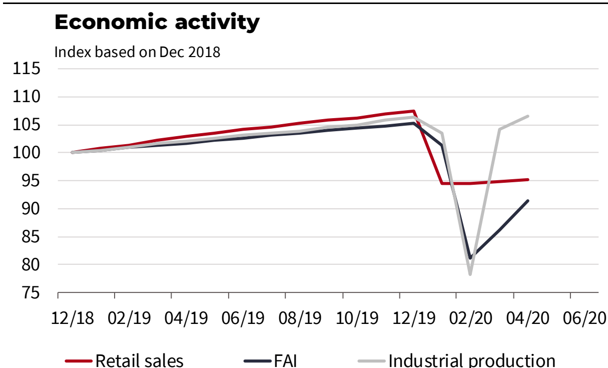
respectively - as in their leverage effect. In fact, these bonds intended to finance investment projects (notably infrastructure) can be partly used as capital of a financing vehicle. Thus, we estimate that the support measures could have an equivalent economic impact of 7.6% of GDP in 2020 and 3% of GDP in 2021, a significant contribution to growth.

"Above the line" fiscal measures	**CNY/bn**
Special local government bonds	3750
Special central government bonds	1000
General government bonds (local + central)*	267
Drawdown of government savings*	880
Reduction in social security charges and tax	1100
Total	6997
%GDP	7%

(*) Estimated by SG Economic and Sector Research. Amount net of automatic stabilizers, i.e. taking into account the reduction in tax revenues and the increase in fiscal expenditures resulting from an economic slowdown.

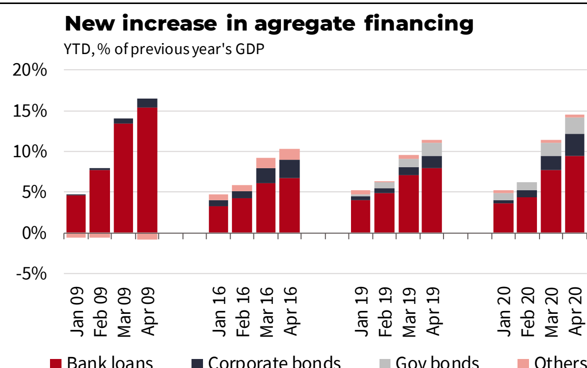
Monetary policy is also becoming more flexible. We note the absence of recommendations such as "keep the debt ratio stable" or "avoid the stimulus" in the Government Work Report published on the occasion of the CNP. With the drop in the interbank interest rate started in late January, from 2.5% to 1.5% in late May, the PBoC has already made liquidity conditions very favourable in order to support the increase in bond issues (by companies and governments) and to a lesser extent bank loans. The loan policy includes a section specifically dedicated to SMEs and micro enterprises, which the PBoC monitors via “window guidance”. For example, large commercial banks must see their loans to SMEs and micro enterprises increase by 40%. Thus, financing of the economy consisting mainly of bank credit and bond issues should continue with the decline of non-bank credit (shadow banking).

Recovery of activity at two speeds



Source: NBS, SG Economic and Sector Studies

Key role of banks and bond market



Source: PBoC, NBS, SG Economic and Sector Studies

These stimulus measures are certainly more cautious in their design. This is explained by a relatively limited room for manoeuvre given the debt ratio of the economy at 250% of GDP (including 155% due to businesses, 55% to households and 40% to the government). More cautious stimulus nevertheless generates new debts, private and public. Hence the reappearance of credit risk in the years to come despite the current respite due to favourable liquidity conditions. On the other hand, compared to previous stimulus cycles, the current one comes after the deleveraging campaign resulted in the suppression of shadow banking from 2017. Credit risk will then increase in the visible and regulated segments of the financial system, which will allow a better appreciation of the risk.

China	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	6.1	2.9	-3.0	7.3	3.0	4.8	3.0	4.6	4.0
Inflation, %	2.9	3.1	0.3	1.6	0.5	2.4	2.1	2.3	1.8
Fiscal balance, % GDP	-2.8	-3.5	-3.5	-2.8	-3.2	-2.8	-3.0	-2.8	-3.0
Public debt, % GDP	37.9	42	46	42	44	42	44	42	44

Base. = Baseline
Prol. = Prolonged

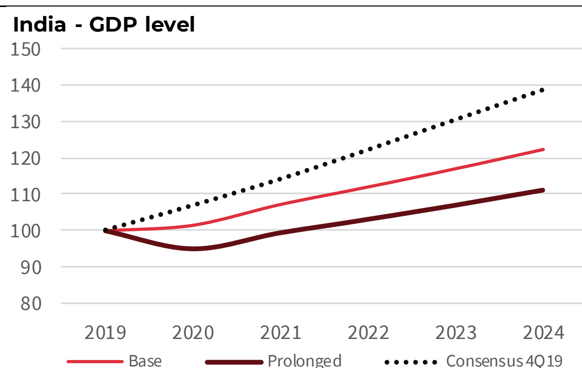
INDIA

- **Risk of severe growth contraction due to many extensions of lockdown.**
- **Stimulus marked by budget constraint, large by program, small by actual expenditure.**
- **Vulnerability of the financial system aggravated by the sharp drop in growth.**

Growth in India will continue to fall, a consequence of the repetitive extensions of lockdown. Activity will recover only starting 3Q 2020, in a very gradual manner. Moreover, the economy is in danger of entering a period of much weaker growth than during the last decade.

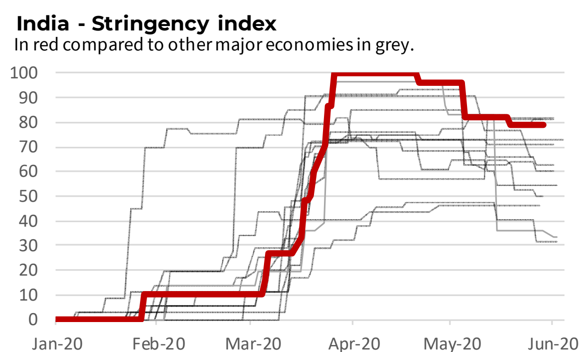
Indeed, the national lockdown was ordered on March 25, it ended on June 8 with gradual opening of shops, religious places etc., but zone of containment will remain in place until June 30. The activity is then severely affected.

Prolonged scenario is getting close…



Source: SG Economic and Sector Research

… with extension of lockdown



Source: Oxford Economics

Faced with the fall in activity, the government announced two stimuli, one dating back to March and the other in May 2020. The plans total 20.9 trillion rupees, or more than 11% of GDP. However, the stimulus impact will be less significant: on the one hand, certain measures are not newly introduced since they are already planned in the budget or support programs; on the other hand, a sizeable chunk of measures concern credit facilities such as credit guarantee and payment term extensions.

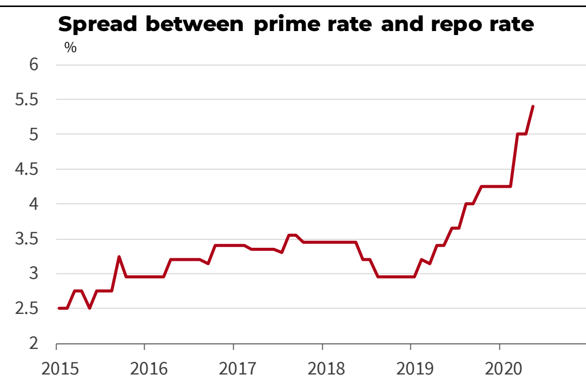
Ultimately, measures involving a reduction in government revenue or an increase in spending should only represent 1.2% of GDP. The economic impact would be even less given certain transfers of income which do not subsequently give rise to expenditure. Public finance efforts were therefore insufficient given the collapse of activity. Indeed, the fiscal space is very limited with public debt nearing 70% of GDP.

On the monetary policy side, the central bank lowered its key interest rate by 115 basis points. But the transmission of monetary easing is totally absent since the lending rate of banks applied to their best customers has remained unchanged, thus widening the gap between the two in an unprecedented way.

"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%

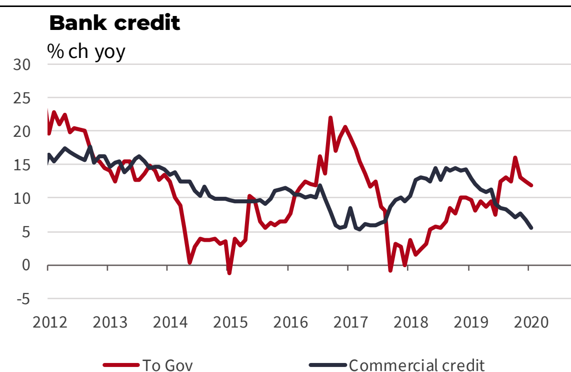
The vulnerability of the financial system could be an explanation for this phenomenon. Recall that the country is going through a crisis of defaults among financial institutions, starting with that of non-banking institutions in 2018, and then subsequently widened with the takeover of Yes Bank, the country's fourth private bank, by the central bank in March 2020. Concerning public banks with higher non-performing loan rate (more than 10%) than private banks, they must nevertheless support other institutions in default. The growth crisis would exacerbate this vulnerability as well as the system's insufficient capacity to support growth.

Absence of monetary transmission



Source: RBI, SG Economic and Sector Studies

Marked slowdown in credit growth



Source: RBI, SG Economic and Sector Studies

India	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	4.5	1.5	-4.9	5.6	4.6	4.5	3.7	4.5	3.8
Inflation, %	3,4	3.6	2.6	4.1	3.1	4.0	3.5	4.0	3.5
Fiscal balance, % GDP	-7,5	-7.7	-9.2	-7.0	-8.5	-6.9	-7.9	-6.9	-7.4
Public debt, % GDP	69	70	74	68	71	67	69	66	68

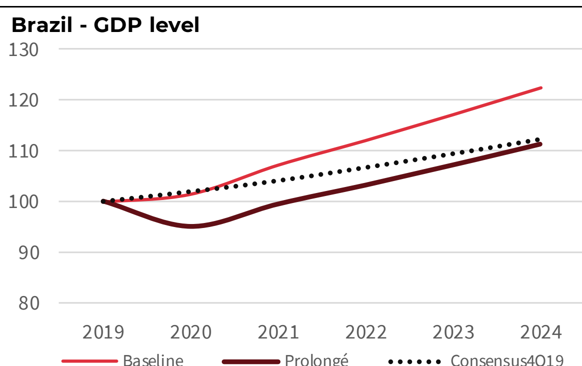
Base. = Baseline
Prol. = Prolonged

BRAZIL

- **The economy is set to significantly contract as a result of the Covid-19 crisis and the political gridlock.**
- **The BCB has cut rates and implemented liquidity facilities.**
- **The main risks relate to a renew infection wave, a further increase of political tensions or a deterioration of the external environment.**

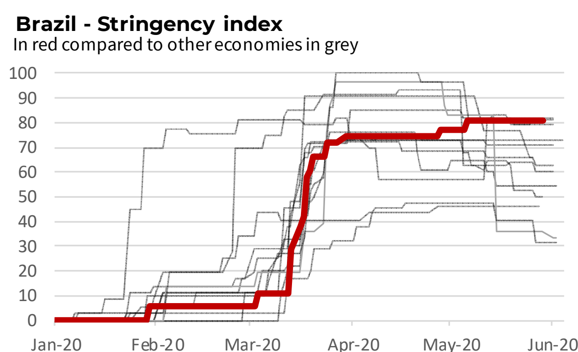
Economic activity has been severely impacted by the Covid-19 crisis and the continuous political turmoil Over the last months, several ministers have resigned, the government has lost its majority in Congress and has several conflicts with the Supreme Court. Real GDP contracted by 1.5% QoQ in 1Q20. Despite a soft lockdown since April, activity is set to severely contract in 2Q-20 and to rebound only modestly. Economic growth has remained sluggish, growing on average only 1% since 2014. The impact of the Covid-19 crisis and the political uncertainties are likely to further damage capital expenditures and growth prospects, further extending the low growth period.

Economic activity plummeted…



Source: SG Economic and Sector Research

Late implementation of NPIs



Source: Oxford Economics

On the monetary side, the Central Bank reduced its policy rate to 3%, its lowest level since the implementation of the inflation targeting regime in 2003. The BCB also made available different liquidity lines for banks, amounting to the equivalent of USD 240bn (15% of GDP), and reduce capital requirements. Finally, the Congress also authorized the Central bank to temporally buy public and private debt securities in the secondary market. Nevertheless, the BCB said that this program will be used only under exceptional circumstances. As inflation (at 2% in April) remains on a downward trend and below the BCB 4% target, the BCB is likely to cut rates by 75bp in the June monetary meeting.

On the fiscal side, the government announced a fiscal stimulus plan of 10% of GDP consisting of credit guarantees (6% of GDP) and temporary increases of benefits and tax cuts (4% of GDP). Among the benefits that the government put forward they include the equivalent USD 120 three-month transfers to informal sector workers

(total cost estimated at 1% of GDP), 1.5% of GDP of transfers to local governments and 2% of GDP of temporary tax cut for companies. An additional stimulus plan seems unlikely for the moment. Contrary to the Lehman crisis where the country had large primary fiscal surplus and could launch a significant fiscal response, Brazil entered the Covid-19 crisis with a large fiscal deficit and a public debt approaching 80% of GDP.

"Above the line" fiscal measures	**R$/bn**
Health expenditures	2
Transfers to unemployed or informal workers of BRL 600 per month until July	45
13th salary for retires	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
%GDP	8.3%

There are several risks to the scenario. The number of infections and deaths from the Covid-19 continues to sharply rise. This has led to some industries and States to extend NPIs. Other countries have implemented travel restrictions to Brazil. Another risk to the outlook is a worsening political gridlock. The health crisis turned into a political crisis, with the Executive losing a large support within Congress and facing an open conflict with the judiciary branch on corruption allegations against the Government.

Brazil	**2019**	**2020f**		**2021f**		**2022f**		**2023f**	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	1.1	-3.5	-5.6	3.4	5.1	2.1	3.4	2.4	2.4
Inflation, %	3.6	3.7	3.7	3.8	3.8	3.5	3.5	3.5	3.5
Fiscal balance, % GDP	-6.0	-8.0	-10.5	-7.0	-8.2	-6.0	-6.0	-5.0	-5.0
Public debt, % GDP	77	84	95	85	96	86	96	85	95

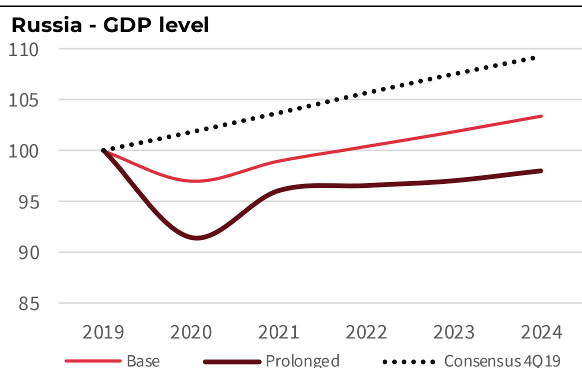
Base. = Baseline
Prol. = Prolonged

RUSSIA

- **The economy will contract in 2020 following the combined shock: large drop in oil prices and the impact of the domestic lockdown to respond to the Covid-19 outbreak.**
- **Fiscal stimulus will remain limited while monetary policy is set to be even more dovish.**
- **Russia's flexible exchange rate regime, low debt, large FX reserves and fiscal buffers put it at a distinct advantage compared to other commodity exporters and to earlier crisis episodes (2008, 2014).**

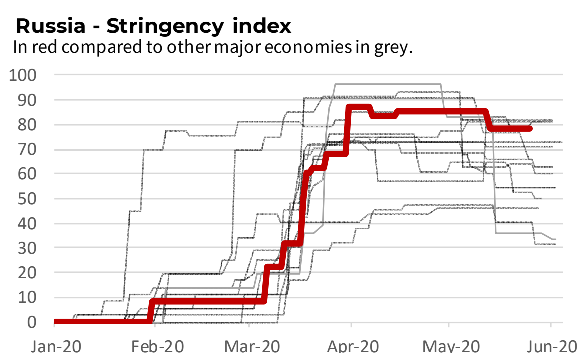
The drop in oil prices coupled with the lockdown implemented end-March will trigger a recession in 2020 in Russia. The seven week-long public holidays, aimed at enforcing social distancing measures, was lifted on 12 May, but wide-ranging restrictions still remain in place, with Moscow still in full lockdown mode. According to the ministry of economy's estimates of monthly activity, GDP contracted by 12% in April,

Slow recovery ahead due to persistent structural bottlenecks



Source: SG Economic and Sector Research

Despite the recent easing, lots of restrictions still in place and Moscow in full lockdown mode



Source: Oxford Economics

The contraction of industrial production by almost 7% YoY stemmed mainly from the 10% decline in manufacturing, while mining output was down by only 3% YoY. But the latter will contract further in May as the 20% cuts in oil output agreed with OPEC partners are implemented. Residential construction data showed a huge 37% YoY drop in April, while retail sales also suffered a heavy blow, falling by over 23% YoY in April. Meanwhile, car sales fell by a record 72%, surpassing the slump seen in the global financial crisis. Weekly data from the CBR on financial flows point to activity still being about 10% below 'normal levels' in May.

We expect oil prices to remain low despite the OPEC+ deal reached on April 12. For the entire year, crude production in Russia will decrease by 12%, the highest fall in oil output since 1994.

In this context of a double crisis, the fiscal stimulus announced has remained timid while monetary policy has been so far more aggressive.

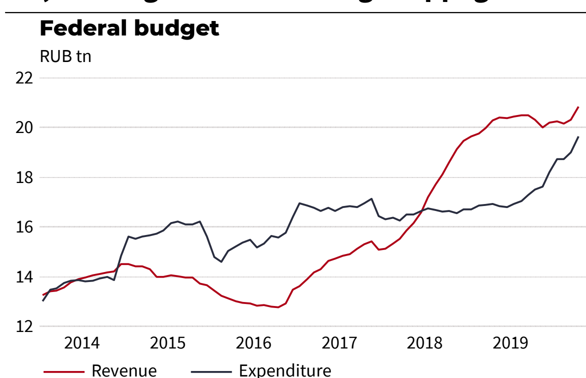
"Above the line" fiscal measures	**RUB/bn**
Crisis-related direct spending: social support	750
Crisis-related direct spending: provisions for SMEs	850
Spending on "national projects": infrastructure construction	1 370
Spending on "national projects": promotion of import substitution	1 050
Recapitalisation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

The details of the fiscal package announced in June suggest that the cabinet continues to outweigh budget stability over other concerns amid fears of a prolonged period of low oil prices. Indeed, PM Mishustin presented a RUB 5tn rescue plan for 2020-2021 (around 5% of GDP). The size of the package remains quite small as it is spread over two years. Half of the plan is for spending on the national projects (infrastructure, promotion of import substitution) that would have been implemented anyways. The rest is focused on social support, provisions for SMEs (decline in the payroll tax for SMEs) and the capitalisation of the state bank VEB.

The CBR has so far reacted efficiently, thanks to the special amendments to the budget rule at oil below $25/bbl and to intervention on the FX market. The CBR also cut the key rate by 50bp end- April. Meanwhile, April and May CPI showed that FX pass-through has so far been limited, with inflation rising only to 3% YoY from 2.3% in February. As a result, the guidance is rather dovish, and more easing is to come.

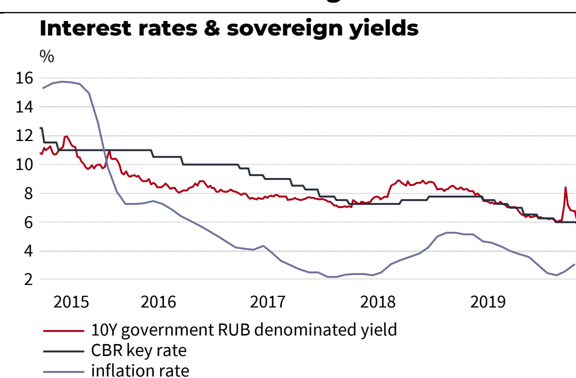
On the prudential side, several measures should help banks weather the crisis. The national countercyclical capital buffer has been lowered to 0%. Adoption of Basel III has been postponed, a reduction of risk requirements with respect to mortgage products has been allowed. CBR entitled credit institutions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

The fiscal stimulus announced remains timid so far, limiting the risk of a large slippage



Source: SG Economics & Sector Studies

The limited passthrough of RUB depreciation to inflation allows a dovish guidance of the CBR



Source: SG Economics & Sector Studies

In this context, we expect a smooth recovery in 2021 with GDP expanding at 2% thanks to slightly higher oil prices. However, income losses and uncertainty among consumers are set to continue hampering consumption. Investments are expected to be held back as major oil companies have announced significant cuts in their investment plans. By contrast, a steady recovery in external demand is likely to boost trade.

Despite the subdued GDP growth forecasted, we do not expect a financial crisis. Russia's flexible exchange rate regime, large FX reserves (USD 563 bn), substantial fiscal buffers, and low debt put it at a distinct advantage—not only compared to other commodity exporters but also to the own country experience in earlier crisis episodes (1998, 2008, 2014).

During the two previous crises encountered by Russia in 2008 and 2014, we observed credit crunches fuelled by tight financial conditions: in 2008, Russian banks experienced significant liquidity shortages which forced them to tighten lending conditions (corporate credit rates rose from 12% to 17% on average in 2009 and from 9% to 18% in 2015). In 2014, the credit shock came via the sharp spike in interest rates. The current situation seems more manageable with the CBR been able to support banks with plenty of liquidity and the banking system still running a liquidity surplus. Besides, the CBR has already cut by 50 bp its policy rate in April and is set to cut further rates in the coming months.

Russia	2019	2020f		2021f		2022f		2023f	
		Base.	Prol.	Base.	Prol.	Base.	Prol.	Base.	Prol.
Real GDP, % YoY	1.4	-3.0	-8.5	2.0	5.0	1.5	0.5	1.5	0.5
Inflation, %	4.5	5.0	11.0	4.5	6.0	4.0	4.0	4.0	4.0
Fiscal balance, % GDP	1.0	-3.5	-4.5	-1.5	-2.5	-1.0	-2.0	-0.7	-1.0
Public debt, % GDP	16	21	28	22	30	22	30	21	29

Base. = Baseline
Prol. = Prolonged

AFRICA

- **Covid-19 appears to be progressing more slowly than elsewhere, but weak health systems call for caution**
- **The main economies of the region will be in recession in 2020**
- **The expected rebound for 2021 will depend, among other things, on strong support from international donors**

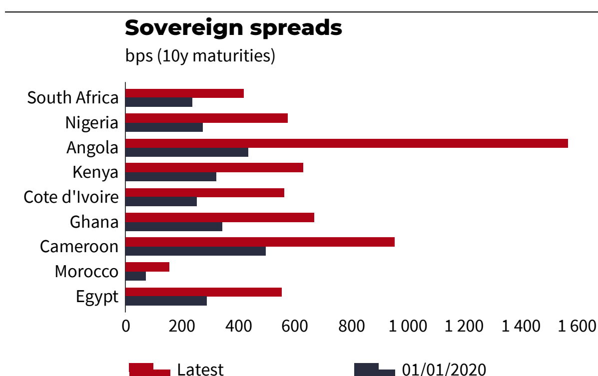
On the health front, the Covid-19 crisis seems, for the moment, less serious than expected in Africa, as the increase in cases and deaths remains slower than in Europe or in the Americas. Certain factors may explain this better-than-expected performance: weather conditions that are less favourable to the spread of the virus, less advanced urbanization and less developed connections between cities and countryside, a young population (the median age in Africa is 20 years) reducing the proportion of people at risk, etc.

In addition, if the health measures taken by the various governments in the region have generally been less drastic than elsewhere (for example, only the most advanced / formal economies – South Africa, Morocco, Tunisia – have been able to implement compulsory, nationwide lockdowns), they were often taken quickly (sometimes even before the first cases). However, the underdevelopment (or even the inexistence) of health systems on the continent means i) that current trends must be taken with caution (the number of cases / deaths may be underestimated) and ii) that the possibility of an acceleration of the pandemic and a deep health crisis can't be discarded.

Contrary to 2008-09, when Africa was hit by the financial crisis with limited indebtedness and reliance on international capital flows (for the continent as a whole: public debt and current account surplus stood at 29% of GDP and USD 61 bn respectively at end-2008), the region entered the Covid-19 crisis with degraded macroeconomic fundamentals, both in terms of public finances (at end-2019: average public deficit at 5% of GDP and public debt at 58% of GDP) and external accounts (with total financing needs exceeding USD 170 billion last year). As a result, macroeconomic responses to the Covid-19 crisis remain mainly monetary for the time being: cuts in key interest rates, measures to support liquidity and bank financing, etc. Some budget support plans have been recently announced as well but remain either of a limited scale (less than 1% of GDP), or more significant but conditional to "new money financing" from international donors. All in all, the continent will record a drastic drop in growth in 2020. The heterogeneity of growth performances within the region, already highlighted before the crisis, will be confirmed. On the one hand, the diversified economies that do not (**Cote d'Ivoire**, **Ethiopia**, **Rwanda**) or little (**Senegal**, **Kenya**) depend on tourism will record growth rates that are indeed significantly lower than in 2019 (often around 2% YoY) but still

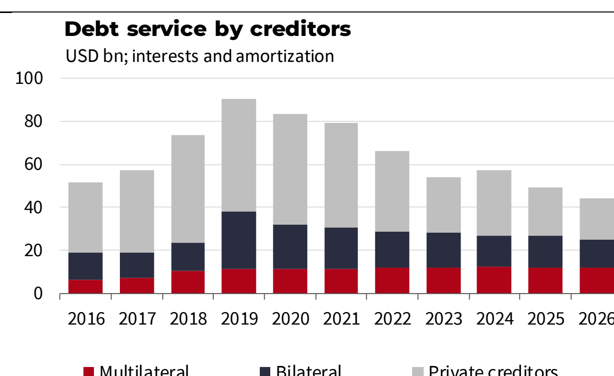
"only" comparable to their worst historical performances and seemingly "sustainable". On the other, the economies that export industrial raw materials (**Nigeria**, **South Africa**, **Algeria**, **Angola**, **Central Africa**) and / or depend on tourism revenues (**Morocco**, **Tunisia**), will experience much more severe recessions.

International capital markets remain closed



Source: Refinitiv Datastream, SG Economics & Sector Studies

Bilateral creditors account for only a small share of Africa's debt service



Source: World Bank, SG Economics & Sector Studies

Assuming that the pandemic is indeed contained on the continent, the depth of the recession in 2020 and the materialization of a growth rebound in 2021 would particularly depend on the extent of international donor support for the region. In fact, faced with the need to increase public spending (at least towards health sectors at first, then to boost activities in the 2nd step), governments will have to find new financial resources, even if i) tax collection (already structurally limited) will be further reduced, and ii) that international financial markets (a growing source of funding since 2017) should remain closed for most countries. In this sense, since the beginning of the crisis, the IMF has increased emergency financial assistance to Africa (already 30 beneficiary countries, for a total amount of USD 13.3 bn), while bilateral creditors (via an initiative of the Paris Club and the G20) have agreed to a moratorium on debt service payments owed to them in 2020 (with discussions therefore focused on public debt denominated in foreign currency).

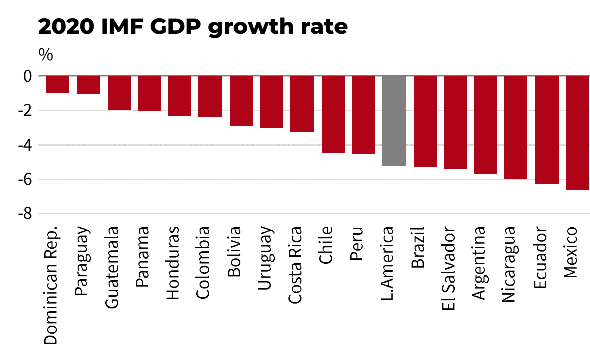
This last initiative could however prove long / complex to implement (to date, around 10 countries have benefited from it). It could also prove insufficient, freeing up a theoretical total amount of USD 20 bn for the region as a whole (to be compared with total debt service of more than USD 80 bn, and to a regional GDP of around USD 2,400 bn), raising the question of a possible extension of this initiative to private creditors, or more generally the potential need for "proper" debt restructurings (ie. cancellation of part of the debt stock) in the most fragile countries (even before the Covid-19 crisis, more than 35% of countries in Africa were in high risk of or already in debt distress according to the IMF/World Bank).

LATIN AMERICA

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

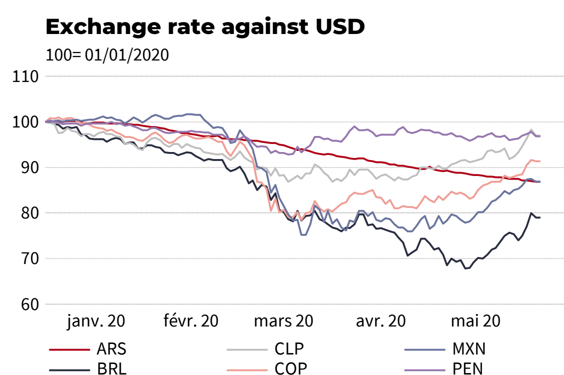
The region is severely affected by the Covid-19 crisis and the economic recession will likely be the largest among emerging markets. The number of infections and deaths keeps increasing. Economically, the region is set to register the deepest recession since the 1930 as, in addition from the economic impact of NPIs, the decline of commodity prices and the loss of revenues from tourist or remittances flows will also hit activity. The depth of the crisis translated into a significant increase of local financial market volatility in March and April, as the currencies of the region experienced large swings. Overall, this crisis should extend the already long period of sluggish growth, increasing hence the likelihood of social tensions in the coming years.

The downturn is deeper in large countries



Source: SG Economics & Sector Studies

Currencies depreciated against the greenback

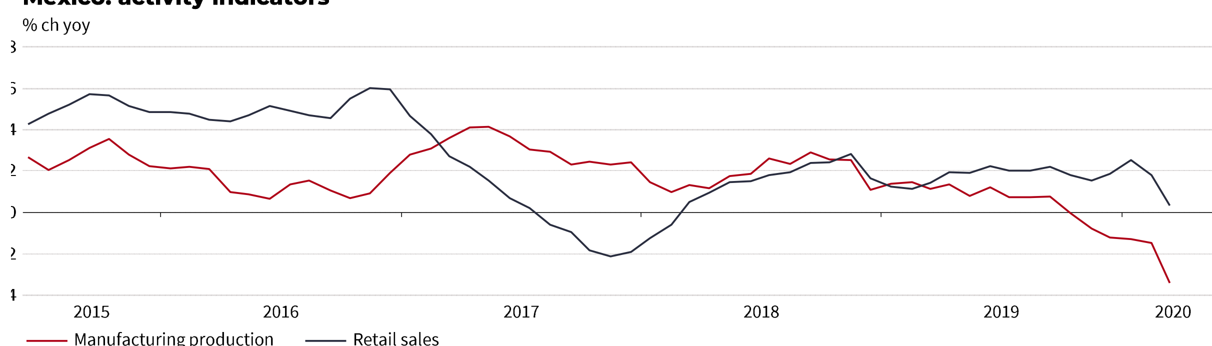


Source: SG Economics & Sector Studies

In **Brazil,** the health crisis is particularly acute, with the number of infections and deaths from the Covid-19 still significantly rising. A sharp recession is expected. To counter the economic impact, the Central bank lowered its policy rate to 3%, its lowest level since the inflation targeting regime started in 2003. The Congress also authorised the Central bank to engage in QE operations with public debt securities and some corporate securities. The government announced a fiscal stimulus package of 4% of GDP and added a program of public guaranteed loans of 6% of GDP. Overall, the Covid-19 crisis is set to prolong the period of anaemic growth of the country (1% on average since 2015).

In **Mexico**, the number of infections and deaths continues to also trend up. As in Brazil, the Mexican authorities did not implement a strict lockdown. On the monetary side, the Central bank has progressively cut it interest rates from 7% to 5% since the beginning of the crisis but real interest rates remain high as inflation has declined to 2%. Mexico has not put forward any fiscal stimulus package. Overall, and not least given the strong dependency of the country to the US economic activity, to workers remittances and to tourism flows and the absence of fiscal support, Mexico is expected to register the sharpest recession of the region.

The Mexican economy is expected to register a sharp recession. Mexico is the only major EM that has not put forward a fiscal stimulus plan



Source: SG Economics & Sector Studies

Smaller economies have seen smaller economic impact of the Covid-19 crisis. In **Peru and Chile**, the number of cases continues to trend up, although at a slower pace, but have implemented aggressive fiscal and monetary policy, reflecting their stronger macroeconomic fundamentals entering the crisis. In Peru, the government announced a fiscal stimulus of 7% of GDP, the largest of the region, while the Central Bank reduced its policy rate to 0.25% amidst a contained inflation and stable currency exchange. In Chile, the government announced a 5% of GDP stimulus package, while the Central bank cut its main rate to 0.25% and announced that it will start a QE program. In Colombia, the government announced a 3% of GDP stimulus package, while the Central bank also started expanding its balance sheet.

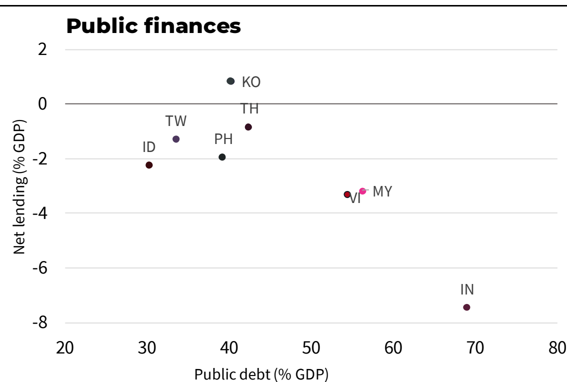
EMERGING ASIA

- **The growth outlook rapidly deteriorates with Covid-19**
- **Policy space likely to support growth to some extent**
- **The US-China relation forms the biggest uncertainty**

Growth in the emerging Asia region is being severely hit by the global spread of Covid-19. GDP (excluding China) is expected to contract in 2020 before recovering in 2021.

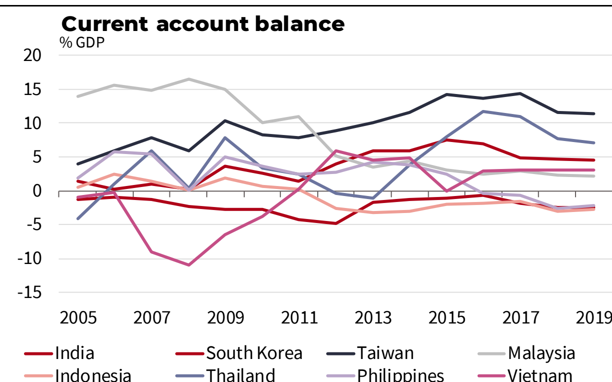
Against a background of global growth uncertainty, the region as a whole, compared to the rest of the world, has the ability to remain relatively resilient thanks to its significant policy space. More precisely, those economies that have strong public finances and weak dependence on external funding will have more flexibility to implement fiscal stimulus and monetary easing (the case of South Korea, Taiwan, Thailand and to a lesser extent Philippines). They either enjoy positive fiscal balance or reasonably low public debt levels. Meanwhile, their external position is strong with positive (very positive) current account surpluses, i.e. capacity to finance the rest of the world (the current balance of the Philippines just turned negative in 2019). Therefore, raising public debt will not imply high cost in the absence of external pressures, nor any currency depreciation risk.

Limited fiscal space for some



Source: IMF, SG Economic and Sector Studies

External financing need for some



Source: IMF, SG Economic and Sector Studies

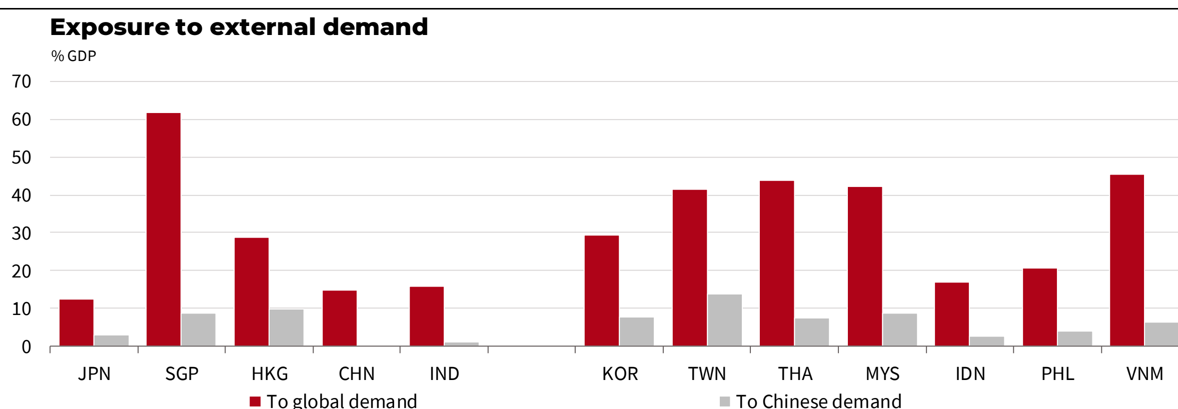
In contrast to the first group, countries such as India, Indonesia have their hands more tied. India has very limited policy space (for more detail, c.f. page 36). Concerning Indonesia, despite its small amount of public debt (30% of GDP), the government relies much on external debt (30% of its liability). In addition, the country has external funding needs with negative current account balance. Since the outbreak, the central bank has only cut once the interest rate by 25 bp to 4.5%, given the underlying high risk of currency depreciation.

Other countries are in-between. They have relatively high public debt but run current account surpluses, which allow them to raise debt at low costs for the moment. However, if higher debt does not come along with higher productivity, debt

problems will only be a matter of time. In this group, we refer to Vietnam and Malaysia.

The dependence on external demand reveals a vulnerability as the region must deal with a collapse in global demand. Indeed, not only have most economies an export-oriented growth model, they are also closely linked by their participation in GVCs. Fortunately, those with a high degree of economic openness also have large policy space. And the two countries that have the least policy space -India and Indonesia- are not as exposed to external demand as the rest.

Many are dependent on global demand



Source: OECD, SG Economic and Sector Studies

Moreover, the region can still benefit from the recovery in China, the largest export market. Even though this time China is not offering the same demand as last resort, China is a couple of months ahead in the global pandemic trends, is already bringing reasonable stimulus.

Finally, the biggest uncertainty lies in the US China trade and technology tensions. The outcome of the dispute would reshape the region's trade and financial relationship, hence the overall economic dynamics.

GULF STATES

- **The Gulf is facing a recession in the non-oil sector and the effects of lower oil prices**
- **Fiscal deficits are expected to widen and external surpluses to evaporate as oil revenues decline**
- **Saudi Arabia accelerates reforms with VAT hike and subsidy cuts**

Struck by the economic fallout from the Covid-19 pandemic and falling oil prices, the Gulf countries will experience in 2020 the worst recession in their history. The magnitude of the contraction for 2020 and the speed of recovery expected in 2021 are subject to a high degree of uncertainty. Lockdowns and distancing measures have weakened consumer demand, and the rebound in service sector activity will depend in part on household confidence. External demand is severely affected by the decline in international trade. In particular, the UAE is facing the impact of the crisis on air traffic and trade, which are weighing on the transport and logistics sectors. Under the assumption of a gradual recovery of the World economy in the 2H20, activity is expected to fall by only 3-4%, but this figure would of course be more pronounced in the case of an extended health crisis.

The biggest factor in uncertainty relates to the decline in oil revenues. The oil price has recently recovered ($36/b in mid-June versus $24/b at the beginning of April), but the average price for 1H20 remains 35% lower than in 1H19. Oil prices could remain depressed in the scenario of an extended health crisis, but also if producers try to counteract low prices by increasing sales. The outcome of the negotiations and agreements within OPEC will, of course, be an important factor to watch out.

The decrease in the oil rent is weighing on the ability to self-finance infrastructure projects and, as a result, has a negative impact on public investment and the expansion of non-oil activities. The decline in the oil rent also put stress on fiscal variables, and budgetary deficits are becoming a structural feature.

Breakeven oil prices generally fallen since 2014 amid austerity policies, like the successful introduction of VAT in Saudi Arabia, the United Arab Emirates and Bahrain and the reduction of subsidies and social transfers in most countries. Countries in the region have resumed fiscal adjustments despite the recession. In Oman, salaries for government employees have been reduced, while Bahrain has announced a 30% reduction in operating expenses and could approve a regulation allowing unpaid leave for public sector employees. Saudi Arabia will triple VAT to 15% from 1 July 2020 and has suspended the monthly allowance of 1,000 SAR (US$267) paid to civil service employees. However, breakeven oil prices remain too high compared to actual oil prices and national budgets are likely to remain out of balance over the medium term.

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

The region has long been preparing for medium-term challenges, which this crisis makes even more relevant. The national economic development plans envisaged by the Gulf monarchies focus on economic modernization, renewable energy development and reforms to isolate public income from oil price volatility. However, this transition is not a barrier-free path, with considerable challenges in the labour market and market regulation, often seen as an obstacle to private sector involvement.

The geopolitical landscape also remains a source of uncertainty. The drone strikes on Saudi Arabia's oil installations in September 2019 have increased uncertainty about the possibility of a military confrontation, in a context of geopolitical rivalry between Iran and the Saudi kingdom. However, tensions have dissipated, and balance and diplomacy seem to prevail at present. However, tensions have dissipated, and balance and diplomacy seem to prevail at present. The blockade imposed on Qatar since 2017 by its neighbours, while not threatening political stability, reduces the business prospects for companies operating in the region.

On a positive note, Saudi Arabia is chairing and hosting the G20 in 2020, confirming the country's intention to assume an open position on the international stage. The World Expo in Dubai has been postponed to 2021, but this should still attract the attention of the business community.

Macro-financial metrics deteriorating

	"breakeven" oil price, $/b	Budget deficit, % GDP		Public debt, % GDP		Current account, % GDP		Foreign exchange reserves, $ bn	
	2019	2019	2020f	2019	2020f	2019	2020f	Dec-19	Apr-20
Bahrain	95	..	..	..	..	-2.9	-9.6	3.7	..
Kuwait	54	4.8	-11.3	11.6	18.9	8.9	-10.2	39.9	..
Oman	87	-7	-16.9	62.6	78.3	-5.2	-14.2	17	16.3
Qatar	49	4.1	5.2	52.3	57.4	2.4	-1.9	54	55.7
Saudi Arabia	86	-4.5	-12.6	22.8	34	6.3	-3.1	502	448
United Arab Emirates	70	-0.8	-11.1	26.6	33.6	7.4	1.5	106	99

Source: IMF Fiscal Monitor April 2020, IMF World Economic Outlook April 2020, IMF Regional Outlook 2019.

CENTRAL AND EASTERN EUROPE

- **Amid the Covid-19-outbreak and lockdowns, GDP growth is set to contract in CEE in 2020 in line with the large drop in the Euro Area.**
- **Central banks have implemented emergency measures (rate cuts, QE, prudential measures) while fiscal packages have been steadily increasing since March.**
- **The main risk is a renewed health crisis with a premature withdrawal of policy support and systemic financial risk.**

Growth in 1Q20 held up better in Central and Eastern Europe than in developed markets, except for Slovakia and Czech Republic, two highly integrated countries in global value chains. The slowdown observed in 1Q20 is largely a result of the region's exposure to global trade, while domestic demand was not yet affected by lockdowns starting in late March.

Most governments in the region have stepped up their efforts to contain the Covid-19 outbreak and have imposed full lockdowns since end-March. As social distancing measures tightened across the region, activity began to fall sharply from April onwards, and thus 2Q20 will reflect the brunt of the impact as suggested by recent PMI releases showing a collapse as well as by the drop of traffic congestion metrics in major cities. The exit of lockdowns has so far been very gradual since end-April or May. We expect only a moderate recovery in 2H20, and activity will therefore remain below the potential for several years.

The countries most exposed to the economic impact of the virus are those that either have large retail and tourism sectors (Croatia and Romania) or are highly exposed to the collapse in external demand due to their integration in global value chains, not least the Czech Republic and Slovakia, where a number of car plants across the region halted operations for several weeks.

The unprecedented measures taken to tackle the Covid-19 pandemic as well as the drop in oil prices have completely changed the inflation outlook by reversing the reflation trend from 2019.

The sharp fall in activity across the region prompted authorities to introduce a set of stimulus measures. Fiscal support includes stepped-up social spending, tax cuts, and the provision of loans and loan guarantees to sectors and enterprises most affected by the COVID-19 shock. Fiscal stimulus measures, together with cyclical revenue weakness, will lead to substantial budget deficits across the region and to increases in debt-to-GDP ratios. Some countries are thus facing mounting issues like Romania, which should post a budget deficit as high as 9% of GDP in 2020, while others -like Poland- where the fiscal deficit will only reach 4% of GDP. Besides, the

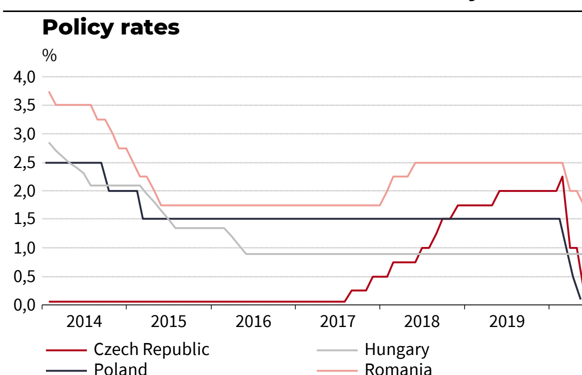
increase in debt-to GDP ratio could be hard to unwind in countries with already-high debt burdens like Hungary for instance.

The Covid-19-induced global recession, as well as border closures and lockdown measures, will also have a significant effect on external accounts through exports and tourism revenues. However, sharply lower oil prices and weakening activity should reduce external pressure through lower energy imports and overall import contraction.

On the monetary policy side, central banks in CEE - with the exception of Hungary - cut interest rates, most aggressively in Turkey and Czech Republic. Some central banks (including those in Poland, Turkey, Hungary and Romania) also began to purchase government securities to ensure smooth functioning of the bond markets and sufficient liquidity for banks to support private sector credit. Such QE could even ramp up further in Hungary and Poland, where the key policy interest rate is near zero. The National Bank of Romania has also intervened to limit the depreciation pressures on the RON.

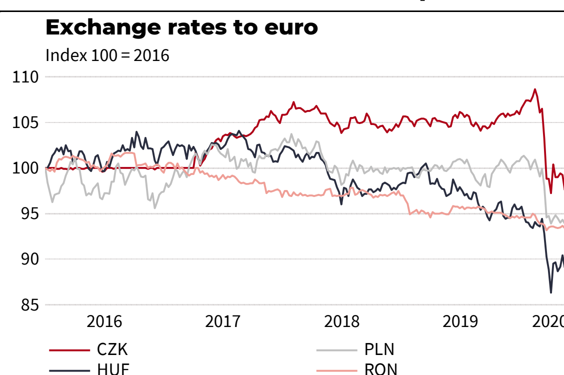
The monetary easing coupled with the challenging environment for emerging market FX and risks assets should keep CEE currencies under pressure in coming months. The RON should continue to be tightly managed, while CZK volatility will remain elevated given the positioning-related moves in the currency and the risk of CNB FX interventions. We also look for more HUF and PLN weakness in coming weeks and months.

Almost all central banks have cut key rates



Source: SG Economics & Sector Studies

CEE currencies to remain under pressure



Source: SG Economics & Sector Studies

Romania remains the weak link in the region as the country have been posting for 3 years now weaker macro fundamentals than CEE peers. Besides to large twin deficits, the Romanian growth model has been unbalanced with the predominance of private consumption and a structural underinvestment. With fiscal measures amounting 2% of GDP, the budget deficit could reach up to 9% of GDP in 2020 and 7% of GDP in 2021. In this context, the financing of the fiscal deficit will be a question in the next years. Financial repression is an option even though banks already post an historically high level of sovereign exposure in their balance sheets.

CONTACTS

Michala MARCUSSEN
Group Chief Economist
+33 1 42 13 00 34
michala.marcussen@socgen.com

Clément GILLET
Africa
+33 1 42 14 31 43
clement.gillet@socgen.com

Olivier de BOYSSON
Emerging Markets Chief Economist
+33 1 42 14 41 46
olivier.de-boysson@socgen.com

Erwan JAIN
Macro-sector analysis
+33 1 58 98 05 35
erwan.jain@socgen.com

Marie-Hélène DUPRAT
Senior Advisor to the Chief Economist
+33 1 42 14 16 04
marie-helene.duprat@socgen.com

Alan LEMANGNEN
Euro area, France, Germany
+33 1 42 14 72 88
alan.lemangnen@socgen.com

Ariel EMIRIAN
Macroeconomic analysis
+33 1 42 13 08 49
ariel.emirian@socgen.com

Simon RAY
Macro-finance analysis, UK
+33 1 4213 70 80
simon.ray@socgen.com

François LETONDU
Macro-sector and macro-finance analysis
+33 1 57 29 18 43
francois.letondu@socgen.com

Valérie RIZK
Macro-sector analysis
+33 1 58 98 82 85
valerie.rizk@socgen.com

Constance BOUBLIL-GROH
Central & Eastern Europe, Russia
+33 1 58 98 98 69
constance.boublil-groh@socgen.com

Danielle SCHWEISGUTH
Western Europe
+33 1 57 29 63 99
danielle.schweisguth@socgen.com

Olivier DENAGISCARDE
Macro-sector analysis
+33 1 58 98 74 22
olivier.denagiscarde@socgen.com

Edgardo TORIJA ZANE
Global economic forecasting
Middle East, Turkey and Central Asia
+33 1 42 14 92 87
edgardo.torija-zane@socgen.com

Juan Carlos DIAZ MENDOZA
Americas
+33 1 57 29 61 77
juan-carlos.diaz-mendoza@socgen.com

Bei XU
Asia
+33 1 58 98 23 14
bei.xu@socgen.com

Yolande NARJOU
Assistant
+33 1 42 14 83 29
yolande.narjou@socgen.com

Société Générale | SG Economics and Sector Studies | 75886 PARIS CEDEX 18

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