ECONOMIC OVERVIEW MONTHLY

November 2020

- Uncertainty about the pandemic's future development will continue to influence global economic outlook.
- Biden has won more than the 270 Electoral College votes needed to become president.
- Recovery Fund negotiations will be crucial in Europe.
- Euro Area markets are waiting for the new monetary easing measures promised by the ECB.

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MACROECONOMIC BACKGROUND

Global growth: **Uncertainty about how the pandemic will evolve will continue to influence global economic outlook.** Pfizer and BioNTech announced that their mRNA vaccine candidate, BNT162b2, was found to be more than 90% effective in preventing COVID-19 in the Phase 3 clinical trial involving 43,538 participants. The announcement of the vaccine's effectiveness provides a positive boost and is helping to ease financial conditions. The economic situation could result in higher consumer spending as savings rates fall.

Recovery Fund negotiations will be crucial in Europe. The July agreement on the Recovery Fund was a political deal and now the investment plans and fund request procedures need to be drawn up. This month the European Parliament and Council reached an agreement on the budget and Next Generation EU. The EC will announce the procedures for the formulation of requests and the plans that are presented must fit into a coherent framework.

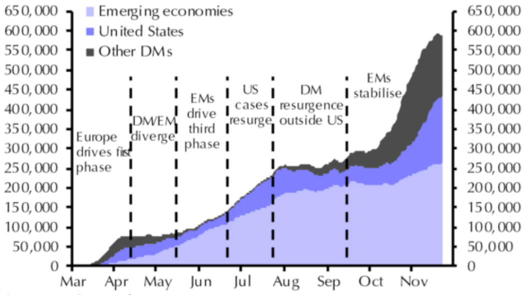
Global demand: The recovery of economic growth has been rapid with a big surprise in Q3. However, production is still far below pre-virus levels in most major economies. Global composite PMIs have shown steady improvement after bottoming out in April. Growth will resume at different rates around the world. It will be faster in the United States, China and Europe. Germany will enjoy a more rapid return to growth than the other Euro economies. Global economic performance remains highly dependent on how the pandemic will evolve. The second wave of outbreaks in Europe will have a smaller impact, both because the containment measures are designed to wreak less havoc on economic activity and because international demand from Asia and international trade are more vibrant.

United States: **The recovery is expected to suffer a slight loss of momentum after the strong expansion seen in the third quarter.** Retail sales have recovered to pre-COVID levels, but industrial production is not there yet. Industrial production decreased in September after a marked slowdown in August, while retail sales showed a slight recovery (in real terms) after two series of weak results in previous months. This is in line with the trends in personal income, which recovered slightly in September, while the household savings rate remained at historically high levels. **Consumer confidence remains modest, but business confidence continues to improve.**

The US job market continues to recover. According to research by the Federal Reserve, the peak in unemployment in the United States in March and April was dominated by an unprecedented increase in temporary layoffs. In general, unemployment due to temporary layoffs

Fig. 1

Global Daily New Infections (7D MA)



Source: Capital Economics

Fig. 2

Composite PMI

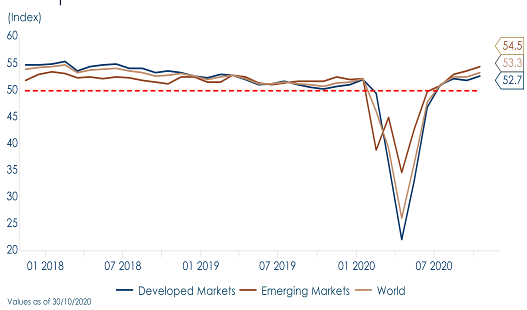
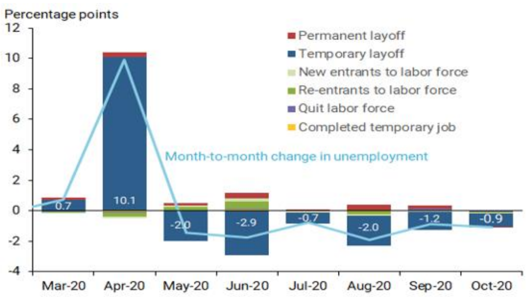


Fig. 3

Monthly unemployment changes by reason, 2020



ECONOMIC OVERVIEW MONTHLY

Fig.4
Timeline of Events that affect End-of-Year Agenda

December 2020	
8	Deadline for states to resolve election disputes.
11	Continuing resolution that funds the government expires.
14	Electoral College meets.
January 2021	
3	New Congress convenes.
5	Georgia holds Senate runoffs.
6	Joint Session of Congress counts Electoral College votes.
20	Presidential inauguration.

Fig. 5
Euro Area PMI Indices, the manufacturing sector continues to recover

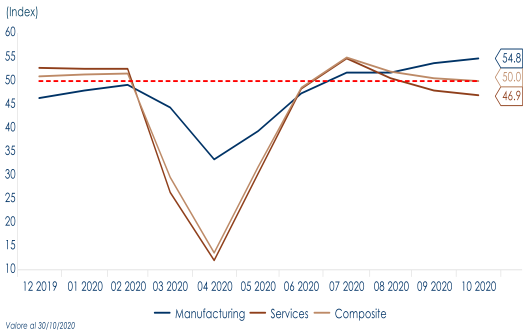
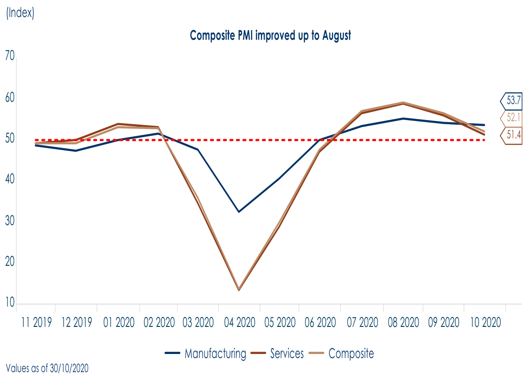


Fig. 6
UK PMI Indices



decreases rapidly once economic conditions improve, as the relationships between companies and workers remain intact, allowing individuals to quickly return to work when demand for work improves. So far, although the unemployment rate has fallen since the peak in April, it is still well above pre-pandemic levels. One encouraging development is that temporary layoffs are currently not becoming permanent at a higher rate than in the past. However, the risk remains that if the current health and economic crisis continues, an increasing share of job losses will be suffered by people in persistent unemployment categories, thus slowing the recovery.
On the political side, **Biden has won more than the 270 Electoral College votes needed to become president**. However, his ability to implement a clean energy bill worth two trillion dollars or raise corporate taxes is likely to be limited by a Republican-controlled Senate. A divided Congress reduces the risk of tax increases and non-business-friendly regulation. In any case, it is still a positive outcome for markets.

Euro Area: The European economy's forward-looking scenario is still uncertain and heavily conditioned by the development of the pandemic, which is exacerbating the asymmetries between the different countries and economic sectors. After the unprecedented decline in GDP in Q2 2020, economic growth rebounded in the third quarter and is expected to slow again in the fourth. The recovery in the Euro Area will be uneven across sectors, with the service sector bearing the brunt of the pandemic, partly due to its vulnerability to social distancing measures. This is also the case for countries whose recovery depends on infection rates and efforts to contain the pandemic. **It will be fundamental to assemble the mosaic of the Recovery Fund before the end of Germany's six-month term of EC presidency.** Monetary policy will continue to be very accommodating. Deflation risk is real and constitutes a concern for the ECB.

United Kingdom: The recovery in activity shows signs of slowing at the end of the third quarter. In the first half of 2020, GDP contracted by about 22% compared to the level observed at the end of 2019. Monthly GDP data available up to August show that economic activity is steadily recovering from its April low, despite recent signs of a loss of momentum. The PMIs also indicate a slowdown since August, even before the roll-out of further containment measures, which have increased considerably since the second half of September. In addition to the rise in the COVID-19 infection rate and hospital admissions, the recovery is also being weighed down by the sharp jump in unemployment and the increased uncertainty surrounding the outcome of the ongoing Brexit negotiations. The announcements in the first week of November by the chancellor and the BoE were key steps in protecting the economy in Q4. The extension of the government sponsored lay-off scheme until the end of March will help provide a necessary bridge for households and businesses until the economy can restart. The BoE has announced that it will expand its asset purchases by an additional £925 billion.

Fig. 7
China PMI Indices, economic activity continues to strenghten

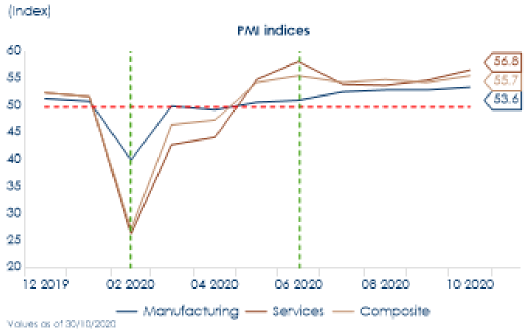
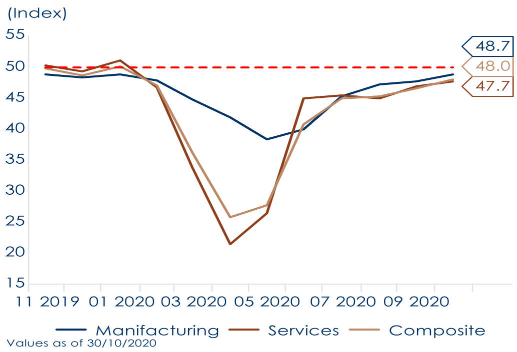


Fig. 8
Japan PMI Indices, confidence remains weak



China

China: **China's economic recovery will stabilize the global growth, while advanced economies are facing a Coronavirus second wave.** While the world is still in the depths of the Great Lockdown Recession, **China has recovered sharply since Q2 2020 and grown steadily in Q3** (4,9% y/y) despite being massively hit by Covid in Q1. The composite PMI index highlights that the recovery has been underway since March and has consolidated since May, when the index settled close to 55. After the two extraordinary above and below 50 fluctuations in the first two quarters of the year, the Chinese quarterly GDP growth is about to return to its long-term average, not far from 1,5% t/t (and 6% y/y). In 2020, **China's expansion has occurred in two phases, the first supported by the state stimulus, the second extending to domestic demand side.** Most noteworthy has been **the growth in export sales** throughout 2020, **the fastest since the US-China trade war started in mid-2018.** Despite weak growth in the rest of the world, China's net exports have increased, accounting for 15% of its growth in the first three quarters. As global trade volume is expected to fall 10% in 2020, China's share in global trade will almost surely rise substantially. The strong rebound in exports stems from the rapid industrial recovery supported by successful domestic containment measures. Moreover, continued discrepancies between supply and demand in many overseas markets have largely contributed to the Chinese recovery. Production in countries still under lockdown is actually being affected by reduced demand. Chinese exporters are actively filling this vacuum. China will most probably continue to go from strength to strength in global trade at least up to the end of the year. **The Regional Comprehensive Economic Partnership recently signed will consolidate China's growing role in the international trade.**

Japan

Japan: Japan has seen a gradual economic recovery as the summer resurgence of COVID-19 infections appears to be contained. After hitting lows, economic activity began moving towards gradual recovery at the end of the partial lockdown in May. Industrial production and real exports of goods have shown an upward trend since then, while imports fell in August for the fourth consecutive month.

Fig. 9
Global COVID-19 Policy Response
Monetary and Fiscal Stimulus % GDP

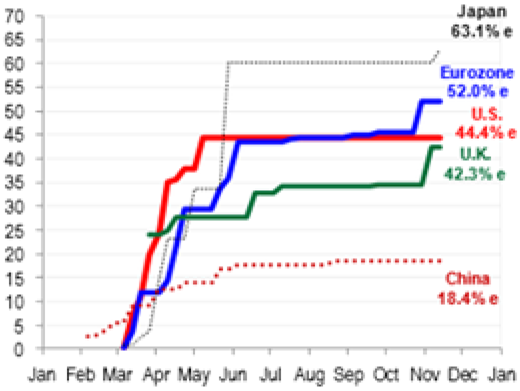
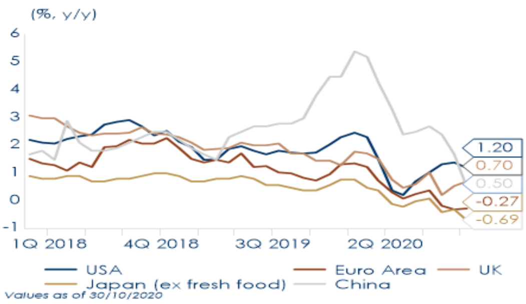


Fig. 10
Consumer Inflation



DISCUSSION POINTS

How to make the return to growth sustainable

The coronavirus pandemic will continue to be the main obstacle to economic recovery in the winter. The sustainability of the recovery in 2021/22 should strengthen if economic policy continues to include stimulus and if one or more anti-COVID vaccines are approved soon, with a further boost as households and businesses stop accumulating precautionary savings. Financial markets rallied when Pfizer/BioNTech announced that their vaccine exceeded expectations in the crucial Phase 3 trial, proving to be 90% effective.

Monetary policy will continue to be accommodating for a long time

During the ECB's annual forum, the world's top central banks expressed their willingness to overcome uncertainty by providing continued support for recovery, albeit with a view to building a different kind of economy.
Powell said he might revise the QE program in December. Clarida (Vice Chairman of the Fed) reiterated that the Fed will use all available instruments to support the recovery, maintaining that further fiscal and monetary stimulus will be needed. Also considering the stalemate in Congress over a new stimulus package and the rapid rise in the rate of new infections, the FOMC is likely to announce intervention at its next meeting in mid-December.
The ECB expressed readiness to implement easing in December with the revision of the full set of monetary instruments at its meeting on 10 December.

Inflation

Inflation will remain modest and subject to contrasting forces, partly due to the extremely expansionary economic policies in place.
The expected trend is 2% in the main developed economies, slowed by the output gap, which should more than offset the rises due to higher costs and production bottlenecks.

Other topics

Outcome of the US elections. Joe Biden won, but he will probably have to grapple with a divided Congress. Major fiscal stimulus and substantial tax hikes seem to be off the table in the stalemate that is expected over the next two years.
Now that the US elections are over, the next market catalyst is at the door: Brexit.

FOCUS OF THE MONTH

Economic outlook in the Euro Area: the second wave

Governments in some countries are planning to extend fiscal stimulus to cushion the negative impact on household income. The necessary steps for the ratification of the Recovery Fund are progressing at a snail's pace. The European Parliament and Council have reached an agreement on the budget

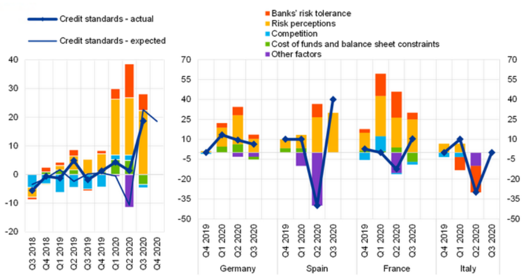
The rise in COVID-19 infections and the tightening of containment measures pose a new challenge to the growth of the Euro Area, deteriorating its short-term prospects. However, the containment measures are expected to have less of an impact than they did during the first wave, as the restrictions are less extensive (manufacturing and construction will continue to operate) and companies are better prepared for social distancing. Transport carrying people to the workplace seems to be less affected than in the spring lockdown, as offices, factories and schools remain mostly open.

Credit market conditions are at risk: the ECB's latest lending survey shows a significant tightening of credit standards for corporate and household loans in Q3 2020, driven by greater perceived risk.

Euro Area markets are waiting for the new monetary easing measures promised by the ECB for the December meeting. At the annual Sintra Forum (held online this year), President Lagarde said that **monetary policy will need to continue to provide support as "It is clear that downside risks to the economy have increased. The impact of the pandemic is now likely to continue to weigh on economic activity well into 2021".**

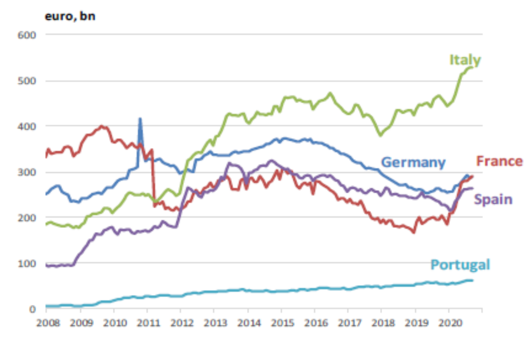
Monetary policy should focus on "supporting demand and preventing second-round effects" on wages and prices, ensuring favourable financing conditions for the whole economy. In addition to avoiding the disorientation effects of fiscal policy on households and businesses, monetary policy will need to "support the banking sector to ensure the transmission of monetary policy". Christine Lagarde reiterated that this is why it is necessary to ensure that the favourable credit conditions remain so for a long time. **Lagarde concluded that "While all options are on the table, the PEPP and TLTROs have proven their effectiveness in the current environment and can be dynamically adjusted to how the pandemic evolves.** They are therefore likely to remain the main tools for adjusting our monetary policy". European banks have used TLTRO to purchase European public debt. The President also explained that fiscal programmes, the prospects of vaccine distribution and the effectiveness of the existing containment measures will also be considered in the December decision.

Fig. 11
Changes in credit standards applied to the approval of loans or credit lines to enterprises and contributing factors
(net percentages of banks reporting a tightening of credit standards and contributing factors)



Source: ECB, bank lending survey

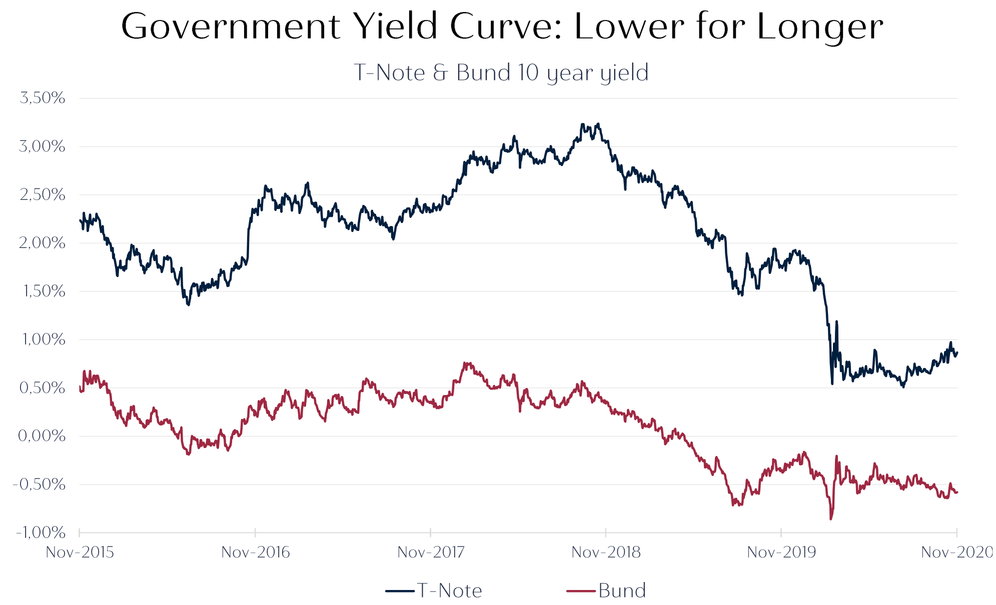
Fig. 12
Public Debt held by banks

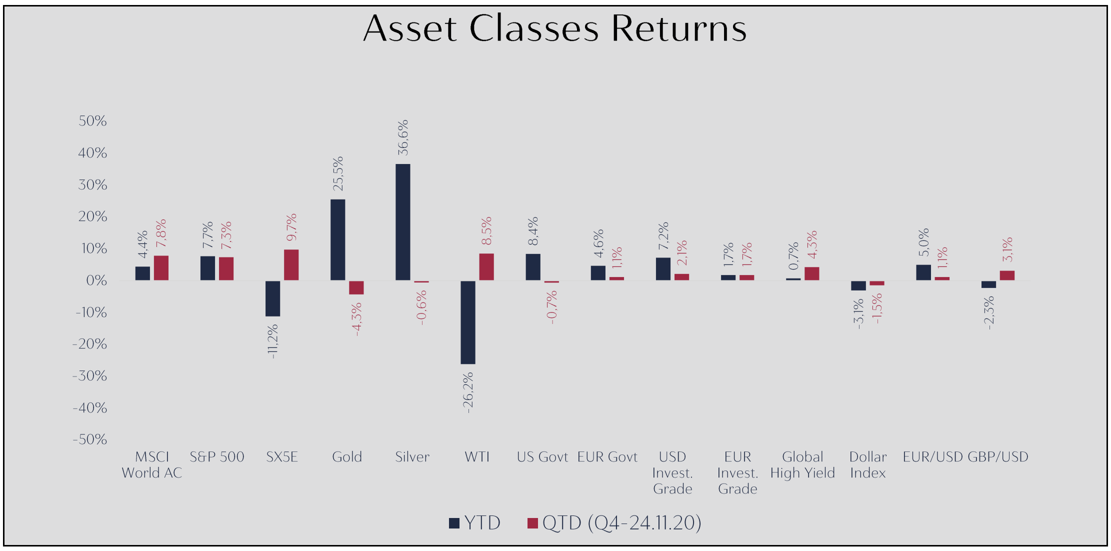


Source: ECB and Jefferies

MARKET UPDATE

The last month can be conceptually divided into two phases. A first phase before the US presidential election, dominated by the risk aversion, and a second phase after the election, where investors' risk appetite was driven upwards by the BioNTech and Pfizer's announcement that their vaccine proved to be 90% effective in an interim phase 3 analysis. At the same time, the outcome of the US elections appears particularly favourable to the market. Joe Biden won, but will probably face a divided Congress. Uncertainty as to how the Senate majority will be composed will probably only be dispelled in January, but in any case, a narrow majority can be expected that will require a bipartisan agreement on many of the economic measures being passed. Huge fiscal stimuli and significant tax increases seem out of the question in the scenario of a stalemate over the next 2 years.





RISKS OF SCENARIO

	Main Risks	Risk Evaluation		
		Impact	Probability	Development
ECONOMIC	**World:** A second wave of infections and new containment measures would result in a new stop for the economic activity.	HIGH	LOW	⬆
	World: US-China relations are likely to remain tense, although the Biden election could lead to a multilateralism return.	HIGH	MEDIUM	=
	World: Labour market weakness remains high In the US, the recovery of the labour market may prove more difficult than expected. In Europe, the risk is that temporary measures will only postpone the moment when unemployment rises.	MEDIUM	MEDIUM	=
	United States: Covid-19 has deeply affected the U.S. labor market and consequently the consumption component, which could remain depressed for a long time if faced with an increase in precautionary savings in the presence of persistent uncertainty about the evolution of the epidemic.	HIGH	MEDIUM	=
	Eurozone: Euro Area Inflation remained negative. The area risks slipping into deflation.	HIGH	MEDIUM	⬆
	Eurozone: There is a delay in the f Next Generation EU approval process.	HIGH	MEDIUM	=
	Eurozone: The economic asymmetry between Eurozone countries is accentuated. The COVID_19 has asymmetrically affected the Eurozone countries, which have been able to implement different fiscal measures and, above all, will have to face different financing conditions on the markets.	HIGH	MEDIUM	⬆
	Europe: Trade negotiations between the UK and the EU remain at stake. The UK is once again playing hardball with the EU. The proposed Internal Market Bill would violate the terms of the post-Brexit deal already agreed with the EU. the UK seriously risks being treated as a trading partner of the EU without a free-trade agreement, which would cause a massive handicap for the UK's business sector.	HIGH	LOW	⬆
	Emerging countries: The main scenario risk is that of a sudden slowdown in capital flows to emerging economies, which amplifies their degree of vulnerability and brakes their growth.	HIGH	MEDIUM	⬇
POLICY	**United States:** Election risk in the United States. Joe Biden is the new USA President, but he will probably face a divided Congress. Huge fiscal stimuli and significant tax increases seem out of the question in the stalled scenario foreseen for the next 2 years.	MEDIUM	LOW	⬇
	United States: "Fiscal cliff. Failure to provide a new stimulus package is holding back recovery in the country.	HIGH	MEDIUM	⬆
POLITICAL	**World:** There is a progressive loosening of global cooperation.	HIGH	HIGH	⬇
	World: Geopolitical issues (e.g. Hong Kong, Latin America...) continue to present many unresolved elements. The results could spark a new screwiness in the world economy and weigh on the recovery.	MEDIUM	MEDIUM	=

POSITIONING

In this scenario:

- we are taking a **negative view** of **core European government bonds**. We prefer peripheral bonds to core European countries. We remain **neutral on US government bonds**;
- the **corporate bond market** still does **not offer attractive valuations**, however, the support provided by the purchases of central banks, **mainly to the IG component**, remains significant;
- our **view of equities remains positive**. Even after the recent recovery, we see forecast 12-month returns on equities as more attractive than those for fixed income, in line with **an economic cycle that**, according to our base scenario, **will rebound with the support of policy makers**. Emerging countries are more sensitive to the recovery of the economic cycle while the Euro Area should benefit of the change in direction of fiscal policy;
- we believe that the **rise in volatility** due to the economic consequences of the pandemic and growing geopolitical risks will be a key element in the months ahead.

	NEGATIVE		NEUTRAL		POSITIVE
FIXED INCOME			●		
Sovereign EUR	●				
Sovereign USD			●		
Corporate IG				●	
High Yield			●		
Emerging Market Sovereign			●		
EQUITY				●	
USA			●		
EMU				●	
JAPAN		●			
Emerging Market				●	

Source: CMB Monaco, Mediobanca SGR