



ECONOMIC OVERVIEW MONTHLY

December 2020

- Developments in the COVID-19 pandemic continue to dominate the economic scenario.
- The BioNTech and Pfizer's announcement pushed upward investors' risk appetite.
- The OECD published its report on the outlook for the world economy in December. Global growth has been revised upward, and global GDP is expected to return to pre-pandemic levels by the end of 2021.

ECONOMIC OVERVIEW MONTHLY

- ◆ Developments in the COVID-19 pandemic continue to dominate the economic scenario.
- ◆ The BioNTech and Pfizer's announcement pushed upward investors' risk appetite.
- ◆ The OECD published its report on the outlook for the world economy in December. Global growth has been revised upward, and global GDP is expected to return to pre-pandemic levels by the end of 2021.

Fig. 1
OECD Leading Economic Indicators

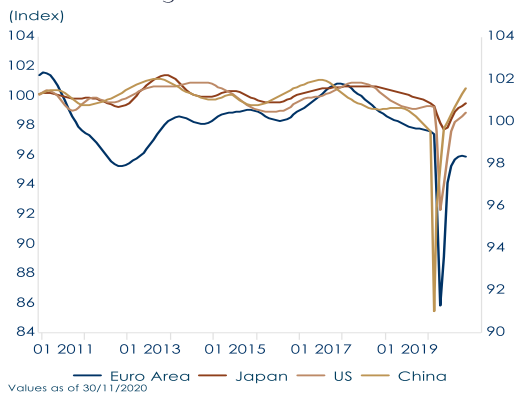


Fig. 2
Composite PMI

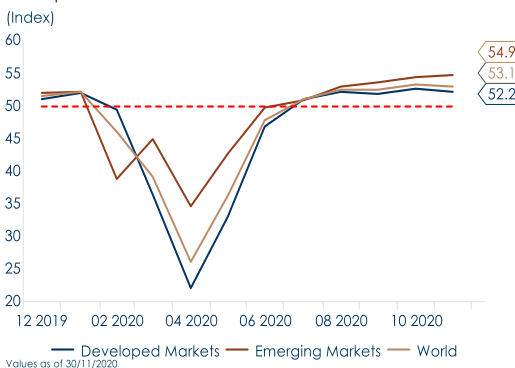
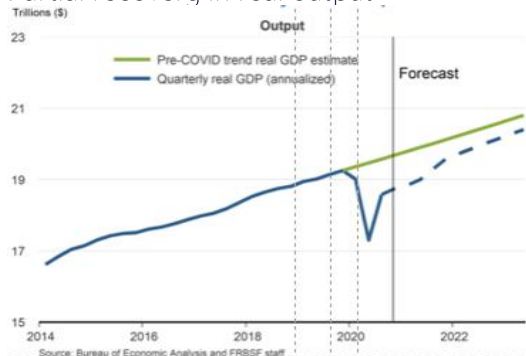


Fig. 3
Partial recovery in real output



MACROECONOMIC BACKGROUND

Global growth: Developments in the COVID-19 pandemic continue to dominate the economic scenario as the virus has not been contained fully (nor everywhere). **The recovery will be driven by China and the United States**, where many economic indicators have returned to pre-COVID levels, while a slowdown is expected in Q4 in the Euro Area.

November can be conceptually divided into two phases. The first phase preceded the presidential election in the United States and was characterized by the risk aversion due to both electoral uncertainty and the increase in the number of COVID-19 infections. The second, post-election phase saw investors' risk appetite pushed upward by BioNTech and Pfizer's announcement that their vaccine was 90% effective in a phase III interim analysis.

The OECD published its report on the outlook for the world economy in December. **Global growth has been revised upward**, and global GDP is expected to return to pre-pandemic levels by the end of 2021, thanks to growth slightly above 4% in 2021 and 3³/₄% in 2022.

Global demand: The recovery will be uneven across countries and lead to long-lasting changes in the global economic order. **It will benefit from the exceptional levels of savings accumulated by households and businesses.** Workers and businesses will pay the highest price, given their indebtedness as in 2009. Global economic performance remains highly dependent on how the pandemic will evolve.

The global composite PMI for November fell marginally due to the weakness of developed countries as a result of the virus. The composite PMI of emerging countries has remained unchanged and high, driven by China. In fact, Chinese PMIs are higher than the global PMIs excluding China.

United States: Economic data suggest a return to steady growth despite the high number of new COVID-19 infections.

The main drivers are in the sectors most affected by monetary policy, particularly residential real estate. **The United States is experiencing an unprecedented boom in housing sentiment**, one of the only positive side effects of the crisis, as suburban housing is in demand and mortgage rates are low.

Although they remain largely in the expansion phase, the ISM indices in November show a modest slowdown, especially in surveys relating to services, which is consistent with the rise in infections. **The deterioration of the public health situation leads to forecasts of a more marked slowdown in growth between December and the**

ECONOMIC OVERVIEW MONTHLY

beginning of January, but not to the extent that it would cause GDP to contract.

Another boost will come when households and businesses "deflate" their precautionary savings once a vaccine is widely available.

Retail sales have recovered to pre-COVID levels, but industrial production is not there yet. Consumer confidence remains modest, but business confidence continues to improve.

Euro Area: The second wave of COVID-19 infections led authorities to impose another round of heavy containment measures in many economies. GDP is likely to contract again in Q4 2020, but not by the magnitude experienced in the spring. A recovery is then expected.

BoFa ML's heat map on Google Mobility continues to indicate that the impact on mobility remains much milder than in the spring. The recent flattening of the virus curve seems to be short-lived. EU governments are re-thinking Christmas plans: restrictions easing was the plan, lockdown tightening might be the action.

Germany will respond to the COVID crisis better than its European peers, thanks to its relatively rapid action when faced with the second wave of infections, its reduced exposure to sectors that are vulnerable to the lockdown and greater participation in global trade.

Fiscal policy will continue to have a bolstering effect, with governments committed to supporting their economies as they emerge from the pandemic. A deal has been reached on the European Economic Recovery Fund, with Poland and Hungary withdrawing their objections. Over time, the European Economic Recovery Fund will provide further support by encouraging investments to make the EU economy greener.

China: China will be the only major economy to expand in 2020. China's economic recovery in 2020 was divided into two phases, with the first supported by government stimulus and the second arriving when the first phase extended to demand. The November PMI showed a surprising uptick to 52,1 from 51,4, driven by better readings of new orders and production. China's economic recovery will help stabilise global growth, while the advanced economies grapple with the second wave of COVID-19. Investments will remain strong, together with a full recovery in consumption, especially in services. Potential risks include headwinds in exports and tightening policies.

The Regional Comprehensive Economic Partnership, the largest free trade agreement ever signed, will facilitate China's increasingly prominent role in international trade.

Japan: The Japanese recovery underway since Q3 will be affected by the new wave of infections.

The government will soon present its third supplementary fiscal package, after the first two packages of 57 trillion yen. This third package should total at least 20 trillion yen and provide for the extension of the "GoTo" programmes and subsidies to businesses for employees at least until March 2021, new funding for healthcare and

Fig. 4
Euro Area PMI Indices, the manufacturing sector continues to recover

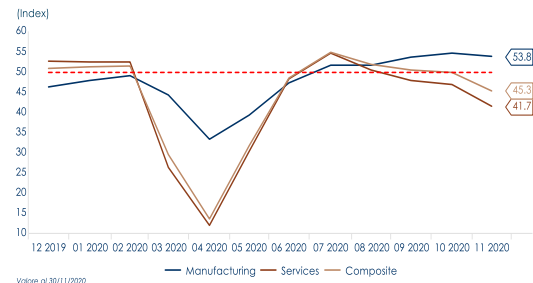
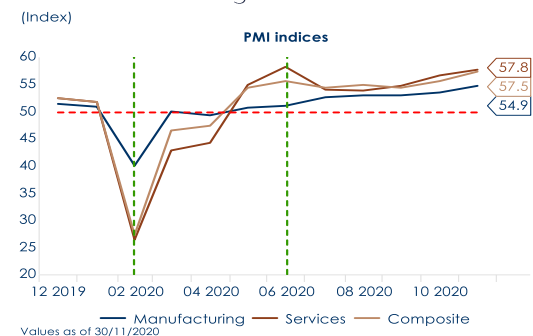
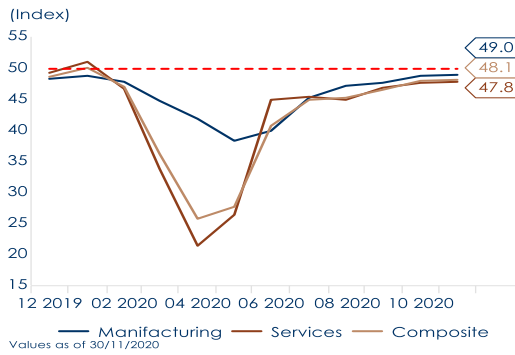


Fig. 5
China PMI Indices, economic activity continues to strengthen



ECONOMIC OVERVIEW MONTHLY

Fig. 6
Japan PMI Indices, confidence remains weak



vaccines, incentives for digitization and financial relief. The arrival of new stimulus measures and the spread of vaccines in the second half of 2021 point to a recovery in the next two years, driven mainly by consumption and exports. High government support for disposable income should drive consumption in both goods and services (through programmes to support tourism and food service) while investments should be driven by trade flows to the rest of Asia and the US.

ECONOMIC OVERVIEW MONTHLY

DISCUSSION POINTS

How to make the return to growth sustainable

This year, characterized by unprecedented lockdowns and the shuttering of economic activity, the union of monetary and fiscal policy and the change of administration in the United States, has seen the start of a new economic cycle.

In 2021, we will slowly return to a new normal. At present, questions surround how quickly we will return to sustainable economic growth.

However, the recovery will be uneven across countries, potentially leading to long-lasting changes in the global economic order.

Asian countries are expected to experience a more robust rebound, as they were able to control the spread of the virus before others.

Monetary policy will continue to be accommodating for a long time

Central Banks have maintained their accommodating stance with the arrival of the second wave of COVID-19. In the main geographical areas, while they have not changed their monetary policy measures, they have emphasized their resolve to take action in response to the economic crisis.

Monetary policy interest rates in most advanced economies are close to the lower zero bound, so we do not expect significant changes in the cost of money. However, monetary policy could become increasingly expansionary in other ways (e.g., increasing the amount of purchase programmes).

Inflation

COVID-19 is having disinflationary effects in the short term, but the significant expansion of the supply of money resulting from the monetary policies implemented is shaping up to be the main driver of inflationary risk in the years ahead.

Main Risks

The repercussions of COVID-19 remain the largest short-term threat to global growth (the downside being a third wave and the upside being the success of vaccines). The economic scenario is driven by the virus. Markets are driven by the vaccine.

In this context, the news about vaccines has been very encouraging and should reduce uncertainty about recovery from mid-2021 onward, helping to support forecasts for 2022.

Fig. 7
World GDP (Index 2019Q4 = 100)

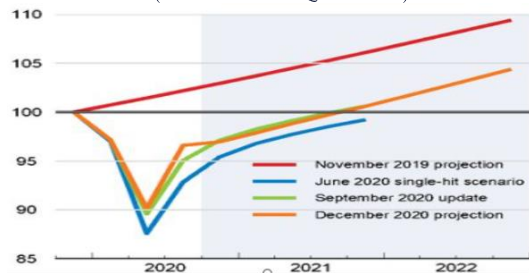
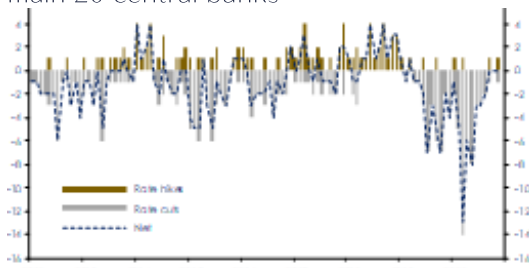


Fig. 8
No. of rate of changes per month by the main 20 central banks



Source: Capital Economics

ECONOMIC OVERVIEW MONTHLY

FOCUS OF THE MONTH

Monetary Policies: Monetary policy interest rates in most advanced economies are close to the lower zero bound, so we do not expect significant changes in the cost of money. However, monetary policy could become increasingly expansionary in other ways (e.g., increasing the amount of purchase programmes).

Fed: The Fed has announced a **structurally accommodating shift in monetary policy**, adopting a new strategy defining the inflation target as one that **“averages 2% over time”** and eliminating the bias towards preventing inflation for hikes in rates if unemployment is low. **In 2021, the Fed will keep rates unchanged and continue its purchase programme.** The Fed confirmed a broad discussion on the size, duration, composition and lifecycle of its asset purchase programmes and their role in supporting economic recovery.

ECB: This month the ECB recalibrated its monetary instruments as a response to the second wave of coronavirus.

The most significant additional operations include an €500 billion increase in the Pandemic Emergency Purchase Programme (PEPP) by to reach a total of €1,85 trillion, a nine-month extension of the horizon of such purchases until at least March 2022, a one-year extension of the reinvestment of the PEPP portfolio until at least the end of 2023, and three further rounds of Targeted Longer-term Refinancing Operations (TLTROs) subject to more generous conditions, provided that banks can hit a new lending target. Consequently, the reinvestment of principal payments from maturing securities has also been extended, so as not to abruptly reduce its balance sheet when the securities purchase programmes are concluded.

No changes have been made either to the tiering multiplier for bank reserves or to the main interest rates.

Monetary policy will remain accommodating and continue to “support demand and prevent 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”.

PBoC: Monetary policy has successfully supported the resumption of growth. The PBoC will focus increasingly on controlling financial risks. Although we do not expect it to increase the monetary policy rate, we think it will increase the LPR (its new loan prime rate) in 2021.

BoJ: The BoJ’s role is still to absorb JGB and increase its share of securities in order to free up fiscal space and keep the cost of debt as low as possible. The BoJ will continue to control the yield curve by containing the upward pressure on interest rates resulting from the fiscal expansion and will extend the special support programme for business financing, currently set to expire in March, by six months.

Fig. 9
Central Banks Reference Rates

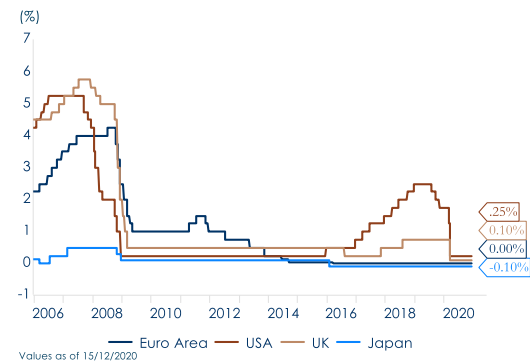
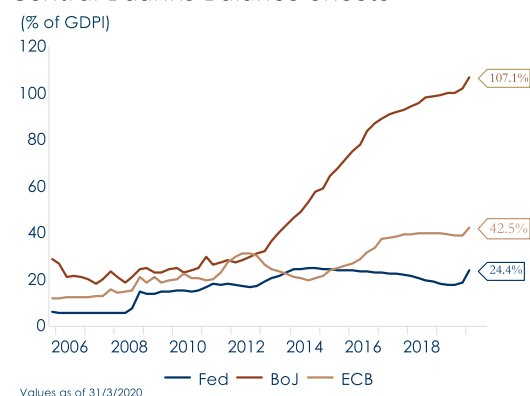


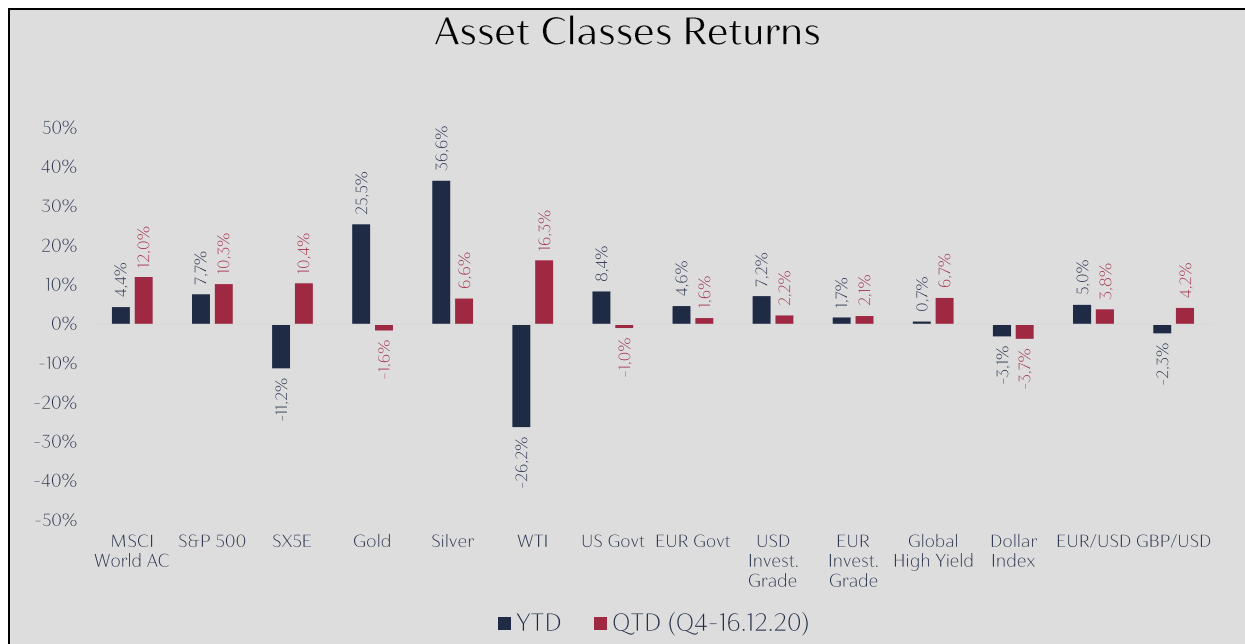
Fig. 10
Central Banks Balance Sheets



ECONOMIC OVERVIEW MONTHLY

MARKET UPDATE

The long-awaited news from the markets arrived in early November. BioNTech and its partner Pfizer – soon followed by Moderna – announced that they have developed an effective vaccine against COVID-19. On 23 November, the University of Oxford/AstraZeneca partnership also announced successful clinical trials. The data on the efficacy of vaccines have triggered a new phase of increased risk appetite. The forward-looking components of the main leading indicators have accelerated and share prices have responded with a reduction in risk premiums, a sharp rise in prices and sector rotation. At the same time, corporate bond spreads narrowed further, approaching pre-pandemic levels. By contrast, government bond yields in the major advanced economies, benefiting from continued central bank support, have remained at modest levels. Only US Treasury yields showed a modest rise in the wake of the increase in US Treasury issuance, which began as early as September, the reshaping of economic growth expectations, following the publication of data on exceptional economic growth during the summer months, and the announcement of effective and available vaccines by the first half of 2021. European government bonds, on the other hand, decoupled from US government bonds, showing a downward trend in the wake of expectations of further monetary easing, as promised by President Lagarde at the ECB's October monetary policy meeting and justified by negative inflation and a weak economic outlook. All this has intensified the search for yield, which has led to a narrowing of peripheral sovereign spreads. The forward inflation implicit in market prices has risen marginally. At the same time, sentiment towards emerging countries improved, benefiting from a significant depreciation of the dollar.



ECONOMIC OVERVIEW MONTHLY

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	HIGH	=
	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 Next Generation EU approval process.	HIGH	MEDIUM	↓
	Eurozone: Eurozone countries economic asymmetry is increasing. 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: The UK's Brexit transition period is set to end on Jan 1. A skinny deal is still possible, but PM Johnson warned of a potential no-deal Brexit. Both a skinny deal and no deal would weigh on the UK's growth prospects, imposing great long-run costs.	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	=

ECONOMIC OVERVIEW MONTHLY

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** is not cheap, 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.

	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

Disclaimer: CMB Monaco prepared this document using information that it considers to be reliable. However, this information comes from third-party, professional sources that have not been independently verified and our institution offers no guarantee, express or implied, as to its accuracy or completeness.

CMB Monaco draws your attention to the fact that the analysis provided in this document may not be suitable for certain investor profiles given their nationality, country of residence or their risk aversion. This document does not take into account your financial situation or investment objectives. You alone can judge the appropriateness of any transactions that you may enter into, based on your personal financial situation, your objectives in terms of duration and your risk exposure.

The price, value and income of any financial instrument mentioned in this document may decrease or increase significantly depending on market fluctuations. CMB Monaco therefore urges you to ensure that you fully understand this information before considering any transaction on the markets.