Investec
Investec Bank plc (UK)

23 September 2020

Economics

Global Economic Overview

Wake me up when 2020 ends?

Global

The pandemic has taken a turn for the worse this month, with daily new cases exceeding 300k for the first time. More countries are tightening restrictions in an effort to avoid re-entering lockdown, with Israel making headlines as one of the first to do so. Re-tightening of restrictions in numerous major economies looks set to further weigh on the global recovery, which is now beginning to lose pace, as anticipated. But while we have had to make a number of idiosyncratic downgrades for this year, we now assume a firmer rebound next year amidst positive progress on the vaccine front. We look for a modestly more marked global contraction of 4.0% in 2020 (prev. -3.9%) followed by a slightly firmer rebound of 5.7% (prev. +5.6%) in 2021. But risks remain skewed towards a more protracted economic recovery.

United States

Daily reported US coronavirus cases, though still elevated, have come down following tighter restrictions in many states. These have squeezed growth momentum, but Q3 still appears to be on track for a 25% annualised GDP rise. After that, growth will slow notably, especially in the absence of a further fiscal package. Our current forecasts envisage a 4.2% drop in GDP over 2020 and a 4.5% rise in 2021. We now see the Fed on hold right through until mid-2025, following an updated policy strategy and forward guidance. With the Fed 'on-hold', USD investors have applied greater focus to election uncertainty. Mr Biden is still favourite to take the Presidency, with a less aggressive US-China stance, but there remains a prospect that the 2021 President, whoever that is, faces a divided Congress. There are even questions over the scope for the election result being contested.

Eurozone

Euro area economic activity has rebounded strongly from the trough in April, but the recent spike in coronavirus infections is raising questions over the outlook for the recovery. Despite governments reintroducing social restrictions, they have been less stringent than in March and April. Such measures present a further downside risk to economic growth, but absent of full lockdowns being reintroduced, we expect the recovery to continue and forecast GDP growth of -7.1% 2020 and 5.6% 2021. However given the risks and persistently low inflation, further easing from the ECB remains a distinct possibility. Indeed we expect the ECB to step up the pace of monthly purchases under the Asset Purchase Scheme once the Pandemic Emergency Purchase Programme comes to an end in 2021.

United Kingdom

After a benign summer, COVID-19 infections are climbing again. A number of regions have been subjected to strict measures, whilst new national restrictions include a 10pm pub curfew. We have trimmed our GDP forecasts to -9.0% for this year and +6.4% next (from -8.4% and +6.8%), but a more material downgrade is a risk if more draconian measures are imposed. It will also depend on what path the Chancellor takes in the Budget, although this looks set to be expansionary in net terms. Also, the risk of 'no deal' with the EU has risen but our central expectation is that a workable agreement will be struck (just) in time for an orderly departure from the transition period. Meanwhile, a negative Bank rate is not our baseline view, but we still expect the BoE to sanction a further £75bn of QE in November.

Please click here for a summary of our economic and market forecasts

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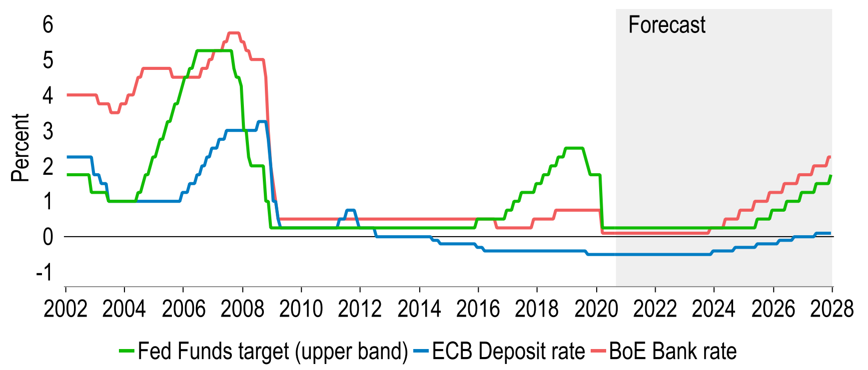
Global

While many have been on holiday, central bankers have been busy at work. The Fed has announced it will pursue an inflation 'make-up' strategy, which should see policy remain more accommodative than under its previous framework. This could serve as a blueprint for the ECB's policy review due in mid-2021. But also for BoE Governor Bailey, who has suggested a shift in policy approach (i.e. unwinding QE before raising Bank rate). We have further pushed out our expectations for Fed tightening, to the extent we now believe it will be among the last to raise rates in mid-2025. Instead, the BoE and ECB are set to lead the charge in late-2023. We also now look for the RBA to cut the cash rate to 0.10% in Q4 owing to recent hints.

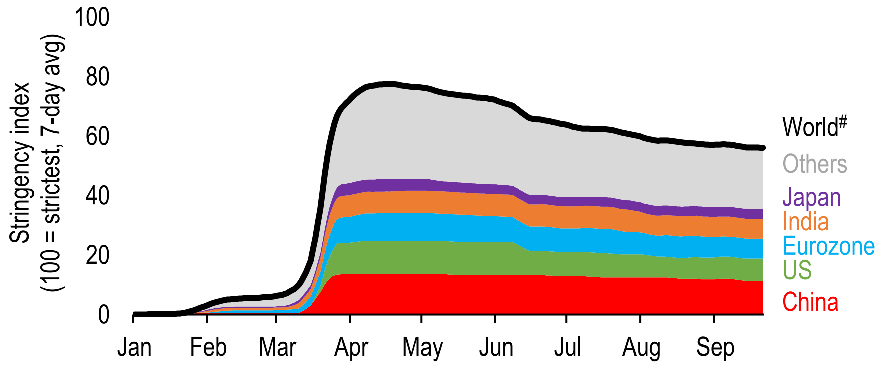
Chart 1: Even after the pandemic subsides, central banks will be in no hurry to raise rates



Source: Macrobond, Investec forecasts

However, this continues to hinge on how the pandemic evolves. It has taken a turn for the worse this month, with daily cases exceeding 300k for the first time. This is being driven by India which, despite a low testing per capita rate, is reporting nearly 100k new cases a day. Moreover, some developed countries are now seeing a resurgence; France, Spain and the Netherlands have all chalked up record case numbers in recent weeks. Countries are putting curbs in place to try and avoid Israel's fate, which has become the first major economy to re-enter lockdown. Our assumption is still that this 'nuclear option' will be avoided by most, but the tighter restrictions will nevertheless be...

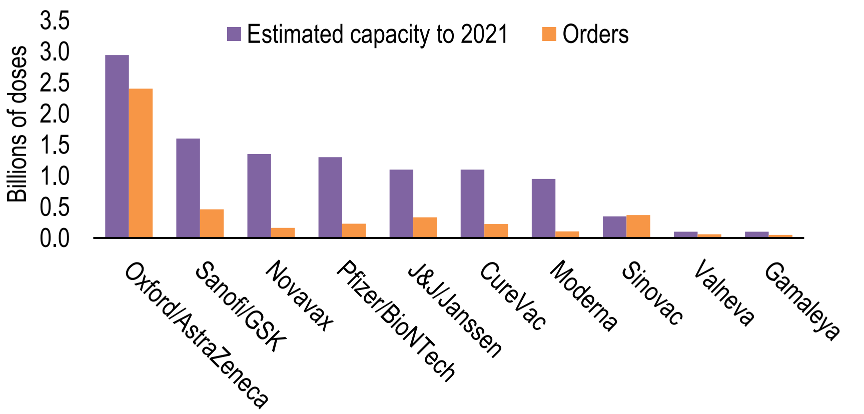
Chart 1: Restrictions remain stringent and risk becoming more so as winter approaches



#We apply the IMF's PPP weights to the University of Oxford stringency indices for 171 countries in order to calculate a world index. Source: University of Oxford, International Monetary Fund, Investec calculations

...another hindrance to the recovery. As expected, this is now losing pace as the sweet spot of re-opening and pent-up demand begins to fade. Another issue is that activity is beginning to run up against social distancing limits, such as on factory production lines and construction sites. Overcoming these will require widespread inoculation, with experts estimating 60% of the 7.8bn global population will need to be vaccinated. With 7 of the 9 vaccines in their final-stage trials requiring two doses, this means nearly 10bn doses will need to be made. This is roughly equivalent to the combined manufacturing capacity of the frontrunner candidates. Among the most promising is one being developed by AstraZeneca. But this had to be briefly...

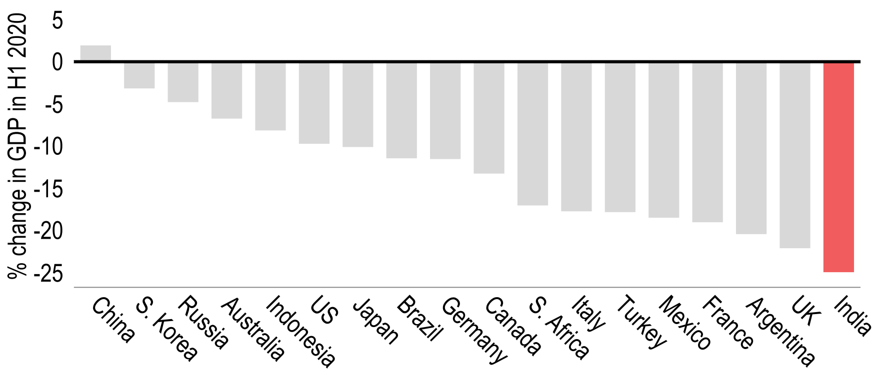
Chart 2: It is estimated that over 10bn vaccine doses can be manufactured by the end of 2021



Source: Nature, Airfinity

...halted after a trial participant became ill, serving as a reminder that the path to a vaccine is unlikely to be problem-free. However, it is widely expected that one or more will be available in H1 2021, which has led us to pencil in a firmer global recovery in H2 2021. However, we have had to make a number of adjustments to our 2020 forecasts. Chief amongst these is that we have cut our projections for Indian GDP owing to the severity of the Q2 decline, which at 23.9% (yoy) was among the worst in the world. We now look for a more marked global contraction of 4.0% in 2020 (prev. -3.9%) followed by a firmer rebound of 5.7% (prev. +5.6%) in 2021. But risks remain skewed towards a more protracted economic recovery.

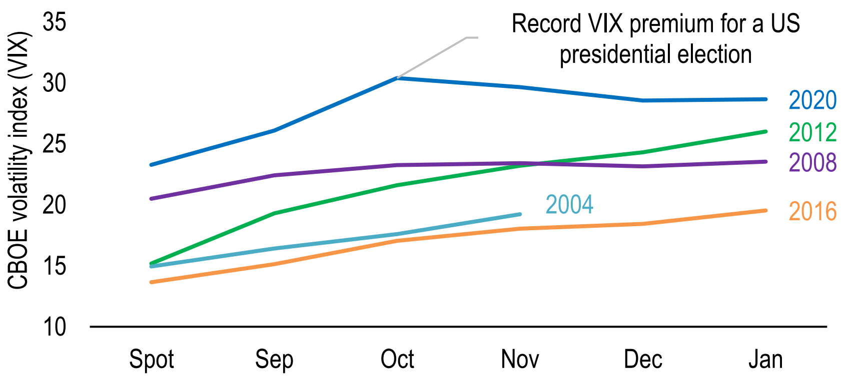
Chart 4: India's economy has suffered more than any other G20 nation during the pandemic#



#Saudi Arabia is yet to publish national accounts data for Q2. Source: Macrobond

The S&P 500 has fallen for three weeks in a row, driven by declines in tech stocks. It is now roughly 9% below its peak, putting it on the verge of 'correction' territory. Also, the VIX has climbed above 30 as the US presidential election comes into view, with futures pointing to it remaining elevated until January. This is in mirror contrast to four years ago, when markets weren't pricing in a *rise* in volatility until January 2017. In fact, contracts expiring at the end of October and November this year carry the biggest election premium on record. But of course this is partly due to other risks coming into relief around the turn of the year, including the possibility of a severe second wave and a breakdown in the UK-EU trading relationship.

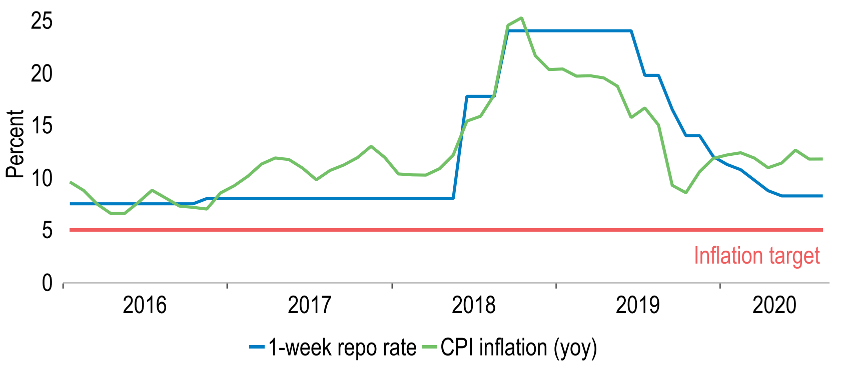
Chart 5: Say do you remember, trading the VIX in September?



Source: Bloomberg

Another notable market mover has been the Turkish lira, which has fallen over 20% this year to a record low of 7.6 versus the USD. A key factor behind this has been TCMB, which pursued aggressive easing even in the face of persistent above-target inflation. Attempts to defend the lira have depleted the country's FX reserves by over 40% this year. However, Moody's estimates these are "close to zero" once banks' required reserves for domestic and foreign liabilities are netted out. These rising external vulnerabilities could lead to a balance of payments crisis, which could have wide-reaching consequences for the global economy due to the high exposure of European banks to Turkey.

Chart 6: TRYing times for the Turkish lira with real rates firmly in negative territory

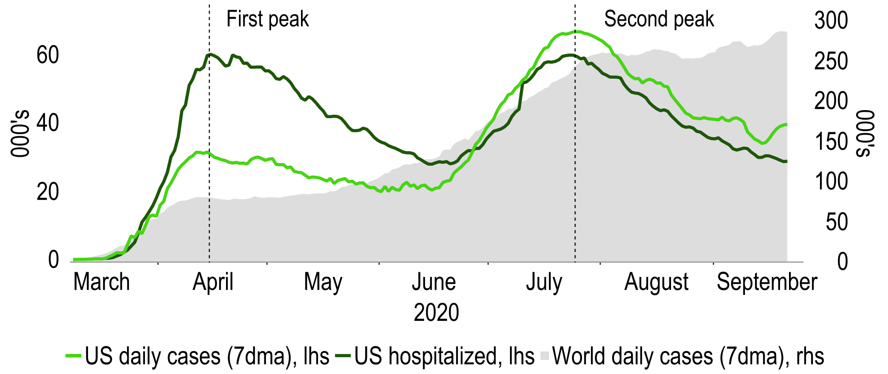


Source: Macrobond

United States

US coronavirus cases dropped to around 40k in mid-September from a high of more than 66k in late-July. However daily infections remain elevated and the national picture continues to mask a divergent trend at state level. Currently the bulk of cases being added come from North Dakota, South Dakota, Missouri and Iowa. The rise in the latter is particularly significant so close to the election. The state's junior senator, Republican Joni Ernst has come under fire for downplaying the severity of the pandemic with the Democrats fighting hard to take the seat this November. As such the handling of COVID in states such as these is not only critical in shaping…

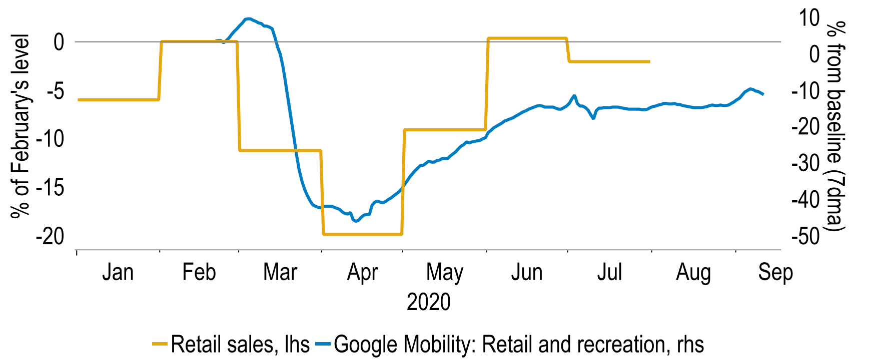
Chart 7: Daily national reported cases have come down, but remain high, and vary state by state



Source: WHO, The COVID Tracking Project, Macrobond

…the near term economic outlook, via the impact on local restrictions which follow, but the policies we can expect from next year. As the national daily case count rose sharply through the summer, restrictions were tightened in key states. Google trends data is useful in assessing how activity responded to such moves; Chart 8 is one example showing retail activity levelled off after June. Nevertheless after the collapse in Q2 GDP, Q3 GDP looks on track for a chunky 25% (saar) rise, before slower growth over Q4. The extent of ongoing fiscal support remains an open question for our forecasts. One issue is that people claiming for loss of pay have received much less financial support since…

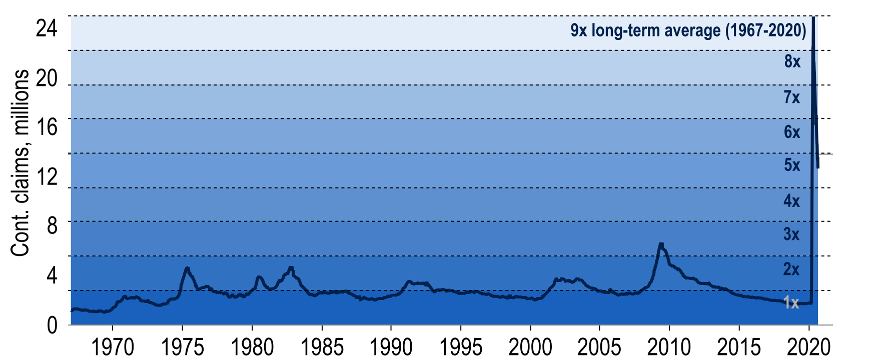
Chart 8: Google mobility data suggests a levelling off in retail sales growth



Source: Google, Macrobond

…31 July. Without a fiscal deal soon, this could drag materially on Q4 consumption; Chart 9 shows continued claims at more than 13m and there are ≈30m claimants across all programs. But for now we envisage a 4.2% drop in GDP over 2020 and a 4.5% rise in 2021. The Fed has updated its Statement on Longer-Run Goals and Monetary Policy Strategy. It has followed this with new guidance which sets out three conditions for a move away from accommodative policy. Firstly, for the labour market to be consistent with maximum employment. Secondly, for inflation to reach 2%. Thirdly, for it to see that inflation is on track to "moderately exceed" 2% for "some time". The new guidance is set in the context of a…

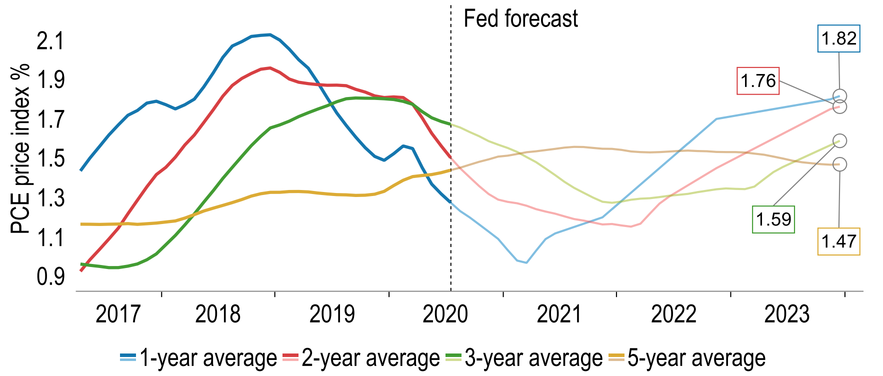
Chart 9: Continued jobless claims remain very elevated, despite much progress



Source: Macrobond

…strategy which requires the Fed to "make-up" for periods of inflation undershoots. Looking at the Fed's latest median inflation projections and recent history of PCE inflation outturns (Chart 10) shows us just how much catch-up there is still to be done, even by 2023, the end of the forecast horizon. As such its new 'dot plot' projections include a 'median' view for no rate rises to take place over this period. In light of this shift in strategy and the updated guidance, we now see the funds target on hold right through until mid-2025. In the meantime, the Fed may even opt to top up its level of policy support through a step-up in the pace/quantity of QE, currently running at around $120bn a month. We judge…

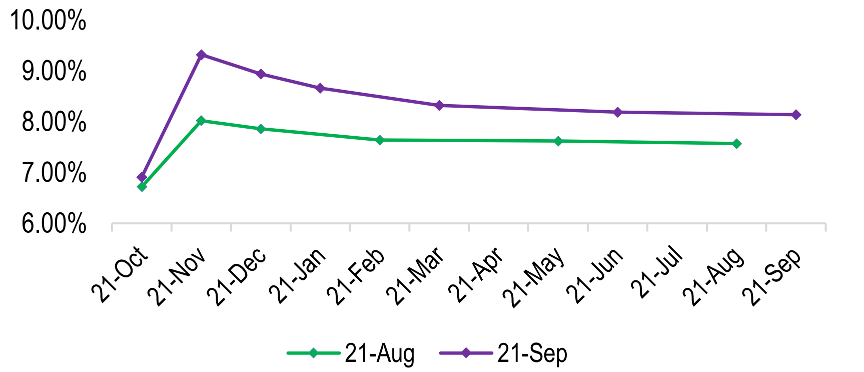
Chart 10: Inflation has a lot of catch-up to do still, even by the end of 2023



The averages include the Fed's median September 2020 projections for end-2020 and beyond.
Source: FOMC , Macrobond

…that the Fed would favour taking any first tightening step by starting to shrink the balance sheet first, albeit not for a good few years yet. With the Fed having set out a plan that sees no movement on interest rates for several years, investors have become more absorbed by what the 3 November election will bring. Chart 11 looks at implied dollar volatility ($:yen in this case). This peaks in November (i.e. election time) and has risen between August and September as election nerves have come into sharper relief. Uncertainty relates partly to who will win the Presidential race. Bet data currently sits 54-44 in Mr Biden's favour, with support in swing states showing the Democratic…

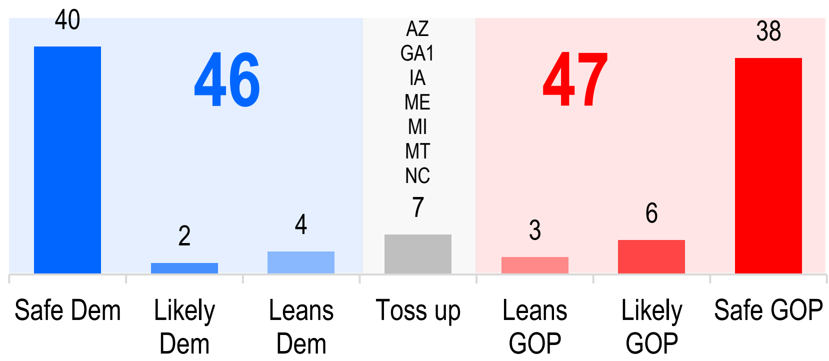
Chart 11: USD:JPY implied volatility spikes at the time of the November Presidential election



Source: Bloomberg

…nominee with a solid lead. However the uncertainty relates to a more complex set of questions. Firstly, USD investors view the Senate race as extremely tight; Chart 12 shows the seats which leave the race fully in play. Depending on the outcome of this contest, Congress could be extremely chaotic in responding to post pandemic challenges. However if the Democrats win the Senate and Biden takes the Presidency (the House looks set to stay under Democratic control), investors will need to weigh up Biden's less aggressive US-China stance against his less market friendly tax platform. Further questions also stem from the scope for the election result to be challenged altogether. For the record, our projections see the USD at $1.17 vs € by end-2020 but with the dollar ceding ground (€:$ at $1.25) by end-2021.

Chart 12: The race for the Senate depends critically on the seven 'toss up' states

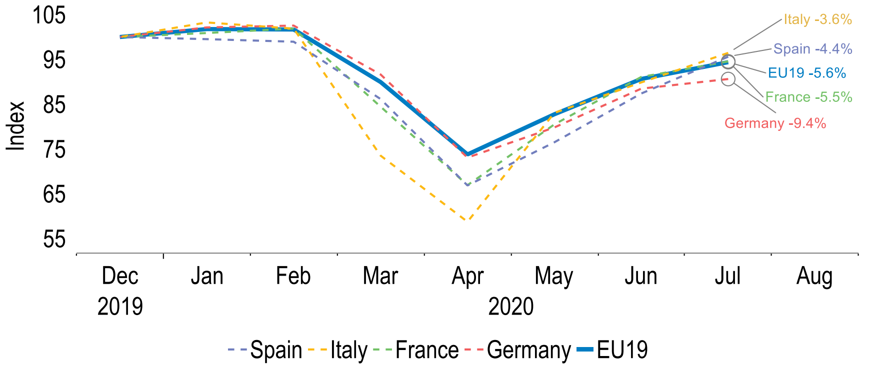


AZ (Arizona), GA1 (Georgia, Senior Senator), IA (Iowa), ME (Maine), MI (Michigan), MT (Montana), NC (North Carolina).
Source: Real Clear Politics. Data extracted 21 September.

Eurozone

Since April's lockdown induced nadir in economic activity there has been a clear rebound as restrictions have eased. In the industrial sector EU19 output fell 26% between December and April, but it has since to leave July output just 5.6% lower. Most notable has been the recovery in Italy which had suffered the biggest fall of the 'core 4', but has seen the fastest rebound. Meanwhile the EU19's powerhouse Germany has lagged behind. One question is whether this pace of recovery hit a bump in August. High frequency mobility data from Google points to individuals in the workplace falling back in August, as some tightening in restrictions took place.

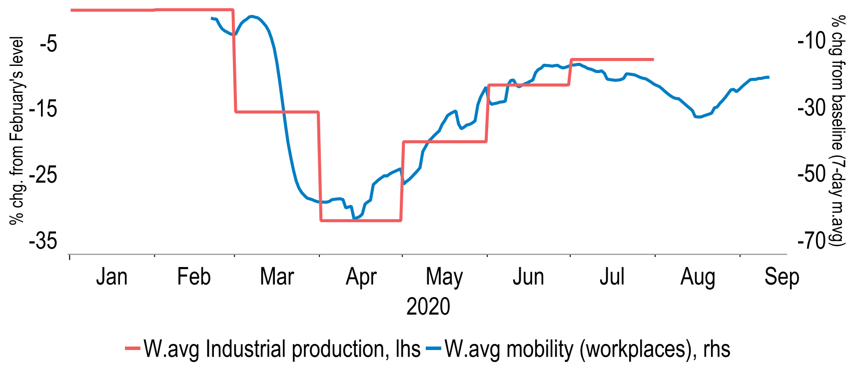
Chart 13: Industrial output (Dec 2019 = 100)



Source: Macrobond

This looks set to dampen industrial output. However Google data for retail and recreation has not suffered to the same extent, remaining steady and even rising in some cases (Germany) over August and September, offering some offset to any industrial sector weakness. The path of coronavirus restrictions still represents the key risk to economic activity. The latest data are worrying in this context; daily cases have surpassed April's peaks in certain countries (e.g. Spain, France and the Netherlands). However unlike April, governments are opting to avoid wholescale lockdowns partly due to deaths not rising to the same extent, yet. Less punitive restrictions are evident in Oxford's stringency indices…

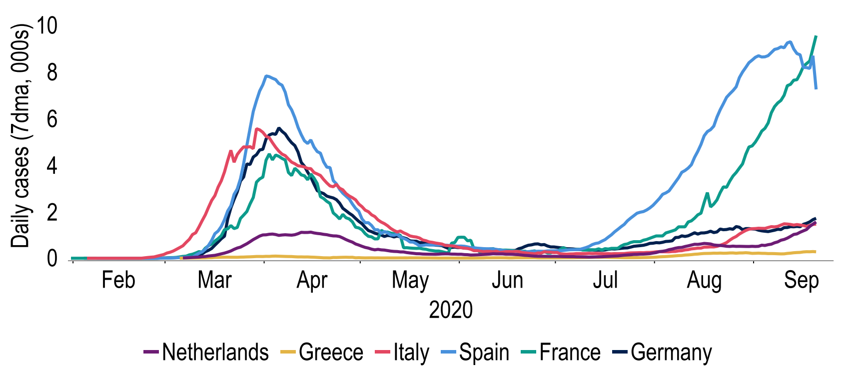
Chart 14: Google mobility versus industrial production



Source: Macrobond

...which have not materially changed over August and September. Even in France, which has seen infections rise sharply, stringency# stands at 49, only marginally higher than the 41 seen in July and way below the 88 seen in April. The point here is that unless absolutely necessary, governments will avoid the harshest measures such as those used earlier in the year in order to protect the economy. So whilst COVID remains a risk to the outlook we do not see another sharp downturn in growth in response to the latest virus numbers. Our own GDP forecasts stand at -7.1% 2020 and 5.6% 2021. Notably the ECB's adverse scenario, even under a resurgence of infections, did not envisage a second sharp drop in GDP; instead growth is expected to flat line across 2020-21.

Chart 15: European daily reported infections rise

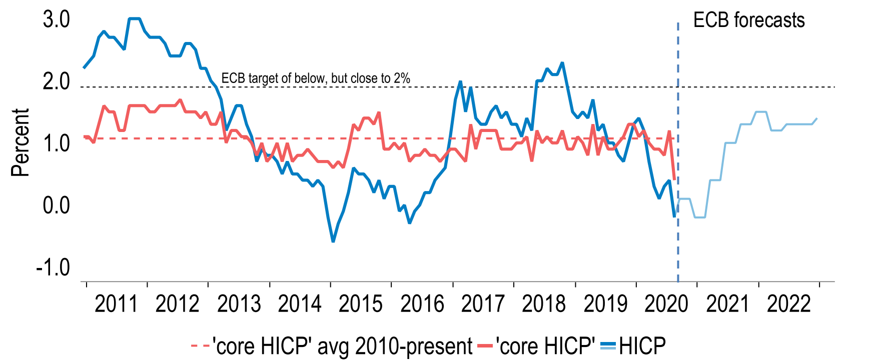


Stringency Index – Composite measure based on 9 indicators including school and workplace closures, travel restrictions, 100= strictest

Source: Macrobond

With risks to the economic outlook tilted to the downside and inflation below target, further ECB easing is a distinct possibility. This was underlined by the ECB's latest set of projections which saw headline HICP inflation in Q4 2022 at 1.4%, a figure short of the 'close to, but below 2%' target. Additionally Governing Council (GC) members have expressed concerns over low inflation becoming entrenched in expectations with core HICP having averaged just 1.1% over the last ten years. The question is what policy tool the ECB might turn to in any further easing. At present QE is the policy of choice with €1.47trn# sanctioned since March. But with €800bn remaining under PEPP...

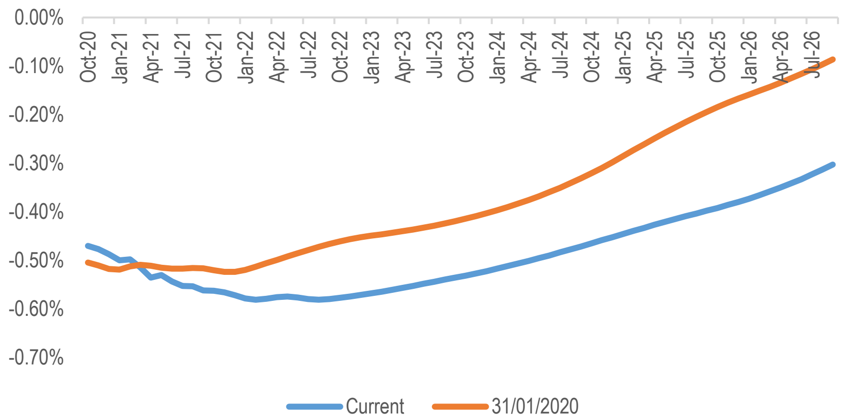
Chart 16: Euro area inflation - a persistent undershoot, which is expected to continue



PEPP (€1.35trn), €120bn additional envelope under APP until the end of 2020. Source: Macrobond

...purchases can continue until mid-2021. TLTRO-III could also be adjusted to provide even more attractive funding. However the big question is whether the ECB is prepared to cut the Deposit rate again. Certainly there appears to be a reticence to use it given it has remained at -0.50% since September 2019, despite the extraordinary stimulus since March. The broad view of the GC is that it remains an option, with the 'reversal rate' yet to be reached, but that is not a uniform view, with German opposition to negative rates well known. Markets see it as a risk with EONIA fully pricing in a 10bp cut in 2021. However we suspect that the ECB will instead opt for a step up in the monthly pace of purchases under the APP* to €30bn (currently €20bn) when the PEPP** ends in 2021.

Chart 17: EONIA forward curves: markets are pricing in another 10bp cut in the Deposit rate

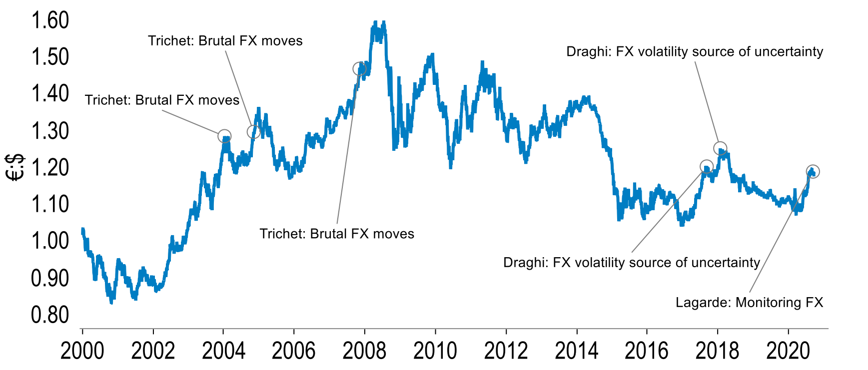


* APP- Asset Purchase Programme, ** PEPP- Pandemic Emergency Purchase Programme

Source: Macrobond

Ultimately policy is set to remain accommodative for a prolonged period of time. How long may depend on the ECB's strategy review, which may not be finalised until mid-2021. But in terms of staging we would suggest that the ECB will raise rates (Q4 '23) before unwinding QE, given concerns over the side effects of prolonged negative rates. Meanwhile in the short term the euro has become an unwanted headache for the GC given the 10% rise in €:$ since May, prompting President Lagarde to make her first verbal intervention. The tone was softer than that of her predecessors and reportedly toned down, given some GC concerns over stoking a currency war with the US. We see the euro ending the year at $1.17, easing the pressure for tougher rhetoric, and rising to $1.25 in Q4 2021.

Chart 18: €:$: historic performance and ECB verbal interventions

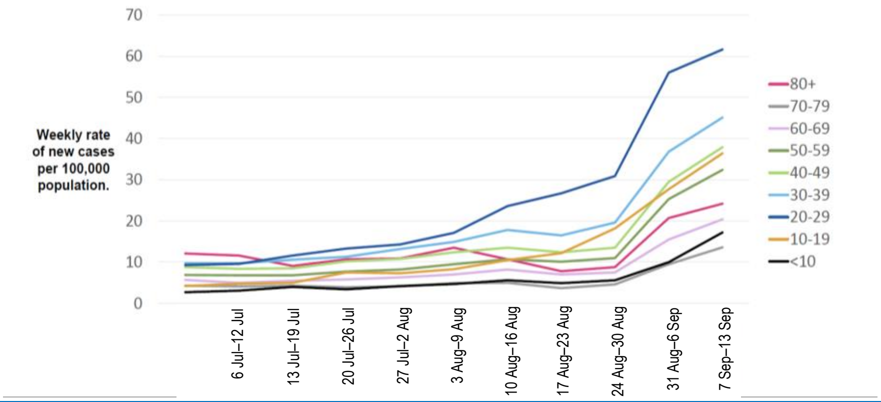


Source: Macrobond

United Kingdom

After a benign summer, UK Covid-19 infections are climbing again - the 7-day average of reported cases now stands above 4000, levels last seen in mid-May. One reason is more widespread testing, particularly as this is picking up milder and asymptomatic cases which would have remained undetected earlier in the year. Also evidence shows the virus spreading most rapidly among younger people, who tend to suffer milder symptoms. However infections are also rising among older people (Chart 19). For now daily death rates remain low (circa 20), but hospitalisations are increasing and the experiences of France and Spain offer worrying lead indicators. In addition to regional measures, the govt has now…

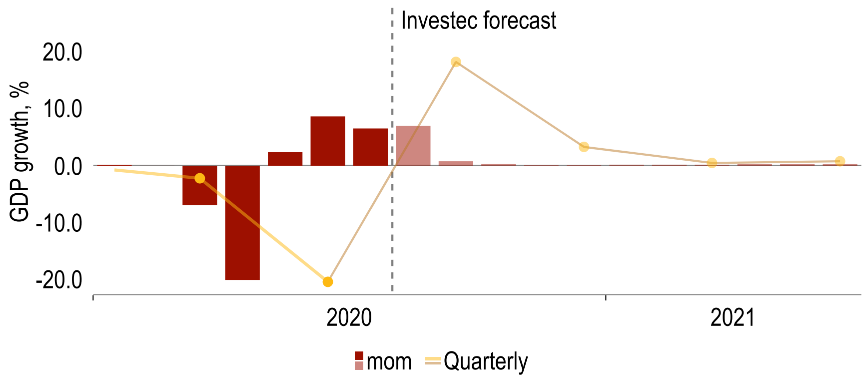
Chart 19: The 20-29 age group is seeing by far the highest infection rate, but…



Pillar 1 and 2 data, based on testing. Source: Public Health England, gov.uk

…also imposed national restrictions such as a 10pm pub curfew. Official economic data, for now remain buoyant, reflecting the previous easing of the lockdown and the release of pent up retail demand. GDP rose by 6.6% on the month in July, after June's 8.7%, while surveys point towards another punchy increase in August. Subsequently growth is set to slow sharply as the direction of the measures swings the other way and as the furlough scheme (CJRS) ceases at the end of October. We have trimmed our GDP forecasts to -9.0% for this year and +6.4% next (from -8.4% and +6.8%) but a more material downgrade is clearly a risk if the government judges more draconian measures are required. We have not …

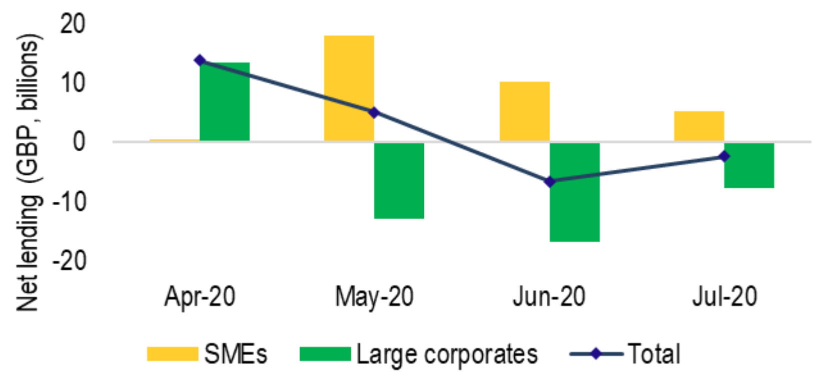
Chart 20: The UK's recovery is likely to slow over the autumn…



Month-on-month forecasts for 2021 are interpolated from quarterly forecasts
Source: Macrobond, Investec forecasts

…changed our view of the course of monetary policy and still expect the BoE to sanction a further £75bn of asset purchases (QE) in November. The Bank also confirmed it would begin 'structured engagement' with the PRA to discuss operational considerations to deploy a negative Bank rate if deemed necessary. Such an outturn is not our baseline view. But it is gaining ground in UK markets with the curve now pricing in a 50% chance of a 25bp cut to -0.10%. Interestingly bank lending to corporates fell back in July (by £2.4bn). There was though a clear split between large companies which have begun to repay loans and SMEs, which are still hungry for cash. Reports suggest an extension of the various government…

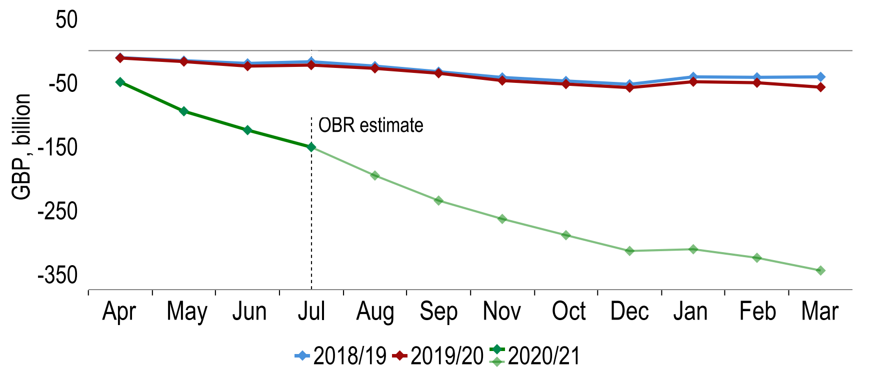
Chart 21: SMEs are still having to borrow, while large corporations are now able to re-pay loans



Source: Bank of England

…lending schemes, such as CBILS, to support firms. On wider fiscal matters, Chancellor Rishi Sunak hinted that he would also take 'creative' steps to prevent a post-CJRS economic 'cliff-edge'. But rumours abound over tax rises at the Budget, expected in November, including a Corporation Tax hike; higher Capital Gains Taxes; and more restrictions on tax relief on pension contributions. Looking at the fiscal metrics shows why. The deficit looks set to exceed £300bn (16% of GDP) this year and net debt has already reached £2trn. But while Mr Sunak may want to announce some tax clawbacks to reinforce the UK's fiscal credibility, economic uncertainty still…

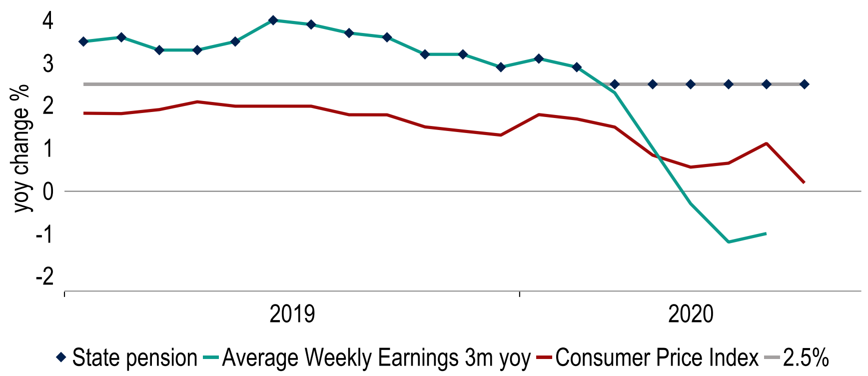
Chart 22: Cumulative fiscal position each year (based on PSNBx): a clear worsening in 2020/21…



Source: OBR, Macrobond

…points to an expansionary Budget in net terms. Indeed work by the IMF suggests that growth is more sensitive to fiscal policy changes when rates are low. Mr Sunak would prefer to ditch the 'triple lock' on State Pension increases (max of 2.5%, CPI inflation and earnings growth) on cost grounds. But this would break a manifesto pledge. An idea is to suspend it for a year. Why? The answer concerns the quirks of the triple lock system. This year inflation is low, pay growth has slumped due to the CJRS (Chart 23), but pensions will be protected by the 2.5% guarantee. In 2021, pay growth will rebound sharply due to the CJRS 'base effect', with pensions uprated by as much as 6%, an additional cost close to £6bn.

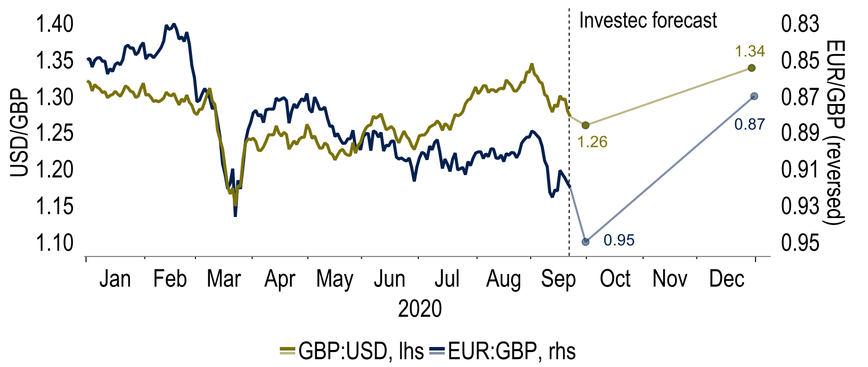
Chart 23: 2021 earnings trend would imply big pension uprating under triple lock system…



Source: ONS, Macrobond

Sterling has slumped from recent highs close to $1.35 to lows of $1.27. The catalyst was the UK Internal Market Bill. Ministers admitted that this contradicted parts of the Northern Ireland Protocol in the EU Withdrawal Agreement, thus breaking international law, risking a mass Tory rebellion in Parliament. Although a compromise was reached in Westminster, progress on a trade agreement with the EU remains slow and uncertain. Our base case is still that the pound will remain unloved until a workable agreement is struck (just) in time for an orderly departure from the transition period at end-year. Clearly though the risks of 'no deal' and of a further sell-off in sterling have clearly risen.

Chart 24: UK Internal Market Bill triggers slide in sterling…



Source: Macrobond

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Global Forecasts

GDP growth (%)

	Global	US	Japan	China	UK	EU19	Germany	France	Italy
2015	3.5	3.1	1.3	7.2	2.4	1.9	1.2	1.0	0.7
2016	3.4	1.7	0.5	6.8	1.9	1.8	2.1	1.0	1.4
2017	3.9	2.3	2.2	6.9	1.9	2.8	2.9	2.4	1.7
2018	3.6	3.0	0.3	6.6	1.3	1.8	1.3	1.8	0.7
2019	2.9	2.2	0.7	6.4	1.5	1.3	0.6	1.5	0.3
2020	-4.0	-4.2	-5.6	1.5	-9.0	-7.1	-4.6	-10.0	-9.4
2021	5.7	-4.5	1.5	9.2	6.4	5.6	4.3	6.7	5.7

Source: IMF, Macrobond, Investec forecasts

Key official interest rates (%, end quarter):

	US Fed funds	Eurozone refi rate	Eurozone Deposit rate	UK Bank rate	Australia cash rate
Current	0.00-0.25	0.00	-0.50	0.10	0.25
2020					
Q1	0.00-0.25	0.00	-0.50	0.10	0.25
Q2	0.00-0.25	0.00	-0.50	0.10	0.25
Q3	0.00-0.25	0.00	-0.50	0.10	0.25
Q4	0.00-0.25	0.00	-0.50	0.10	0.10
2021					
Q1	0.00-0.25	0.00	-0.50	0.10	0.10
Q2	0.00-0.25	0.00	-0.50	0.10	0.10
Q3	0.00-0.25	0.00	-0.50	0.10	0.10
Q4	0.00-0.25	0.00	-0.50	0.10	0.10

Source: Macrobond, Investec

10-year government bond yields (%, end quarter):

	US	Germany	UK
Current	0.67	-0.51	0.20
2020			
Q2	0.66	-0.50	0.21
Q4	0.75	-0.30	0.50
2021			
Q2	1.00	-0.30	0.75
Q4	1.25	-0.10	1.00

Source: Refinitiv, Investec

FX rates (end quarter/annual averages)

		Current	2020				2021				2019	2020	2021
		23-Sep	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	average	average	average
Euro	€:$	1.171	1.10	1.12	1.17	1.17	1.17	1.20	1.22	1.25	1.16	1.13	1.20
Sterling	€:£	0.920	0.88	0.91	0.92	0.87	0.87	0.88	0.88	0.89	0.88	0.89	0.88
	(£:€)	1.087	1.13	1.10	1.09	1.15	1.15	1.13	1.13	1.12	1.13	1.12	1.14
	£:$	1.273	1.24	1.24	1.27	1.34	1.34	1.36	1.38	1.40	1.31	1.27	1.36
Yen	$	105.0	108	108	105	106	108	107	105	104	111	107	106
	€	122.9	118	121	123	124	126	128	128	130	128	121	127
	£	133.6	134	133	133	142	145	146	145	146	146	136	145
Aussie Dollar	$	0.713	0.61	0.69	0.70	0.68	0.69	0.69	0.70	0.70	0.73	0.67	0.69
	€:AUD	1.643	1.79	1.63	1.67	1.72	1.70	1.74	1.74	1.79	1.59	1.68	1.73
	¥	74.81	66.1	74.3	73.5	72.1	74.5	73.8	73.5	72.8	80.8	72.2	73.6
	£:AUD	1.785	2.03	1.79	1.81	1.97	1.94	1.97	1.97	2.00	1.80	1.88	1.97
Swiss Franc	€	1.077	1.06	1.07	1.07	1.08	1.09	1.10	1.11	1.12	1.15	1.07	1.10
	$	0.919	0.96	0.95	0.91	0.92	0.93	0.92	0.91	0.90	0.99	0.95	0.92
	£	1.170	1.20	1.17	1.16	1.24	1.25	1.25	1.26	1.25	1.30	1.20	1.25

Source: Refinitiv, Investec