Monthly Letter

October 2020

Economic environment

Marc-Antoine COLLARD
Chief Economist, Director of Economic Research

Although Q3 2020 GDP releases are not yet available, growth is expected to rebound strongly as lockdowns were relaxed and substantial pent-up demand was released. Yet, the outlook remains exceptionally murky, with the pandemic continuing to exert a toll on economies while geopolitical risks remain a wild card.

Recent signs from high-frequency indicators and business surveys suggest the pace of the global recovery has lost momentum. Indeed, the localised lockdowns and new restrictions being imposed to tackle a new wave of outbreaks are likely to have contributed to the recent moderation of the recovery. However, thanks to improved treatment and medication, hospitalization and fatality rates have decreased, which is anticipated to prevent renewed economy-wide lockdowns.

The Covid-19 shock is being felt particularly hard in some service industries – including travel and tourism, accommodation and hospitality, and entertainment – and they are likely to face persistent headwinds as the normalization of activity and cross-border mobility takes time. As there is limited data to track developments in services – nothing analogous to the monthly industrial production data on the goods side of the economy – the assessment of the differential performance across sectors is complex. Market participants have relied on the Markit services business confidence index to track economic activity in the sector and the latest data showed a fall in confidence in September, from 52 to 51.6. While the slip could be a one-off and the index remains above the 50-threshold, it is a reminder that, despite an improving industrial sector, the continued headwinds on the much-larger services side of the global economy could limit the recovery in the coming quarters.

Meanwhile, recent developments have reinforced concerns that fiscal policies may not be managed effectively. In the US, failure to extend fiscal stimulus drove real disposable income down -3.5% m/m in August and households had to draw on earlier stimulus, pushing down the savings rate. While consumer spending recovery continues, the trend has cooled noticeably after a period of strong growth in the early part of the recovery and incomes are affected by declining unemployment insurance benefits. The Democratic-controlled US House of Representatives has approved a new fiscal stimulus package worth $2.2tn, but without the backing of Republicans in the Senate and the Trump administration. Yet, the Fed has repeatedly warned that the withdrawal of fiscal support could stunt the US recovery. In fact, it is highly unusual for the Fed to take part of the public debate on the fiscal front, especially only few weeks before an election, which somewhat foreshadow the fragility of the economy.

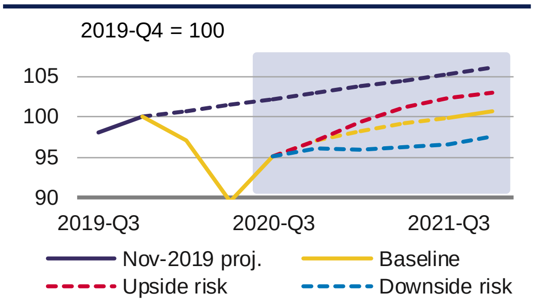
In the UK, the finance minister announced a new jobs support program to succeed the furlough policy that is ending on Oct. 31 and in which the government paid people who were unable to return to their workplaces because of Covid restrictions as much as 80% of their wages. In the new program, workers will be guaranteed at least 77% of their normal wages, although employers could end up paying

Performances in local currency

	Price as of 09/30/20	1 month % change	2020 % change
Equity markets			
CAC 40	4 803	-2.9 %	-19.6%
Eurostoxx 50	3 194	-2.4%	-14.7%
S&P 500	3 363	-3.9%	4.1%
Nikkei 225	23 185	0.2%	-2.0%
Currencies			
1 € = ...USD	1.17	-1.8%	4.5%
1 € = …JPY	123.65	-2.2%	1.5%

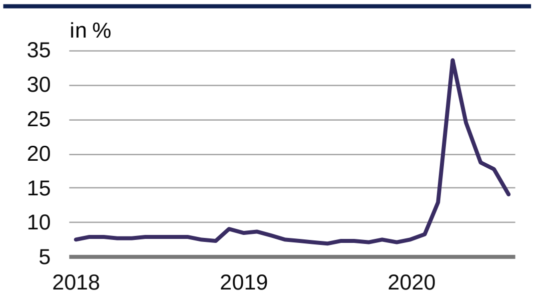
		Price as of 09/30/20	1 month bp	2020 bp
	Government bonds			
3 M	Eurozone	-0.64%	-9	-1
3 M	United States	0.09%	0	-145
10 Y	Eurozone	-0.52%	-13	-34
10 Y	United States	0.68%	-2	-123

World – GDP level



Source OECD, Rothschild & Co Asset Management Europe

United States – Savings rate



Source Macrobond, Rothschild & Co Asset Management Europe

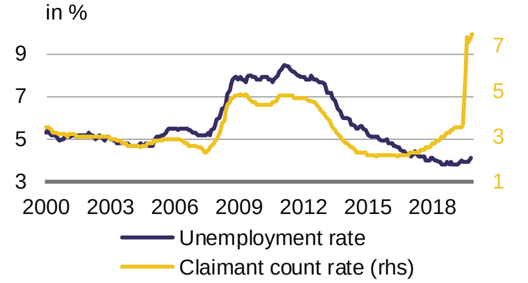
55% of wages for an employee working just a third of their normal time. Hence employers could shun this new wage subsidy scheme rather than paying up for employees on reduced hours, which could result in higher unemployment rate.

Overall, growth prospects depend on many factors, including the duration of new outbreaks and the degree to which containment measures are maintained or reinforced, and the extent to which significant fiscal and monetary policy actions support demand. Furthermore, two geopolitical risks will evolve quickly in the next few weeks: Brexit and the US elections.

UK PM Johnson and the EC President von der Leyen are now personally engaged in trying to unblock talks, notably on state aid, fisheries and dispute resolution mechanisms. On the latter, Brussels is determined to ensure a robust mechanism and the issue has gained urgency since Mr Johnson has introduced the Internal Market Bill that would break the UK's Withdrawal Agreement signed earlier this year. The EC has in fact formally launched a procedure on the grounds that the legislation undermines the duty of cooperation in good faith contained in the agreement. The question now is whether both sides can resolve differences that lie at the heart of the sovereignty arguments that fuelled Brexit. EU leaders will take stock of Brexit talks' progress at a summit on October 15-16 and a realistic deadline for reaching agreement is the end of October, giving the European Parliament, national parliaments and the House of Commons sufficient time to ratify any agreement.

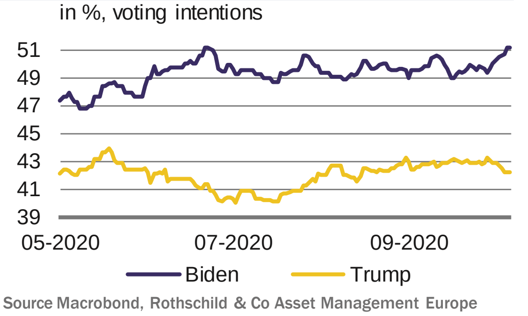
The second geopolitical risk lies in the US elections. While polls suggest Democratic candidate Joe Biden is the favourite to win, President Donald Trump indicated he might not concede if he were defeated on November 3 as he again cast doubt on postal voting, although without tangible evidence the process is ripe for fraud. Were Mr Trump to refuse to accept the result, it would take the country into uncharted territory and it is not clear how it would play out. In previous elections, losing presidential candidates have conceded even when the electoral results were very tight, including in 1960 when John F. Kennedy narrowly beat Richard Nixon and in 2000 when George W. Bush beat Al Gore in Florida. That said, following an appalling presidential debate, Biden's lead has started to edge higher, not only decreasing the likelihood of a contested election, but also increasing the chance of a Democratic clean sweep which would make Q1 2021 fiscal stimulus more likely. Since the pandemic began, the rapid and extensive fiscal support has proved very effective, helping to prevent an even larger economic contraction. With confidence still fragile, continued fiscal support remains necessary to ensure a durable recovery. It is clear that the health of the public finances will have to be restored eventually, although undertaking fiscal consolidation measures now would be far too premature.

United Kingdom – Labor market



Source Macrobond, Rothschild & Co Asset Management Europe

United States – Polls Presidential election



Source Macrobond, Rothschild & Co Asset Management Europe