

## Quarterly Macro Report

3rd Quarter 2020

The global economic outlook is opaque right now, clouded by the hunt for a COVID-19 vaccine, structural changes as more people work remotely, rising investments in IT and Healthcare, revised supply chains, soaring public debt and the broad shift to a less-globalised world.

The forward-looking indicators in the chart below suggest that the global economy's performance will worsen over the next six months.

The shape of any eventual rebound is uncertain at this point. A V-shaped recovery appears unlikely given the economic damage done and the uneven prospects of different countries. When the 2008 financial crisis erupted, banks in Brazil and China had no sub-prime loans on their books. Today every country on the planet is pumping debt-derived liquidity into their stalled economies. Our current view calls for a swoosh-shaped recovery—slow to develop and taking long to regain past heights.

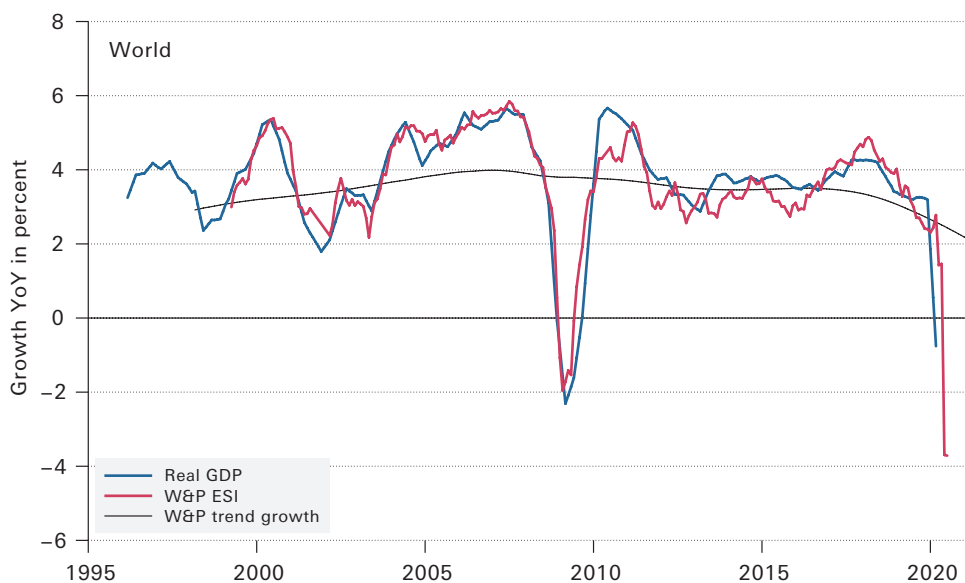
But the possibility of a volatile recovery can also not be excluded, which might result in a W- or a Z-

shaped recovery. The former would be a double-dip recession, while the latter suggests a bit of an overshoot once a “new normal” emerges and consumption surges to satisfy pent-up demand.

We also have to consider the scenario of an L-shaped recovery, where the economy fails to regain pre-pandemic average growth rates. Two factors favour this L-shaped recovery, in our view. First, declining demographic growth rates were already pushing down trend growth in China and Europe before the pandemic hit and a recession is not going to reverse this structural development. In fact, it may accelerate it.

The second argument for a flat L-shaped recovery is that deep, prolonged recessions cause enormous

**Fig. 1: Economy set to deteriorate further**



The forward-looking sentiment indicators in this chart point to a deeper contraction for the global economy than was seen following the 2008 financial crisis. There is no sign yet suggesting what a rebound may look like.

Source: Refinitiv, Wellershoff & Partners

economic damage. Indeed, it may be time to dust off the terms “lost decade” and “lost generation” before we emerge from this latest economic seizure.

### Whatever it takes

In previous recessions some observers argued that fiscal measures were “too little and too late”, but this time the fiscal response got underway even before the official data was in. It is worth noting that we entered this crisis already burdened with mountains of debt and now those mountains have grown even bigger.

There is talk today of levying new taxes, for example, on the sector that some governments were scrutinising before the crisis hit, the online economy. As attitudes sour on globalisation and outsourced supply chains, we should expect more focus on identifying companies that are perceived as “belonging” to a given nation. We have already seen this with airlines, as some were rescued and others were left to go into administration. The nation state is back, and elected officials know their base.

Central banks also know who their ultimate masters are—the people, and they want employment and a stable currency. Central bankers are still ap-

plying the lessons learned from the Wall Street Crash of 1929. When in doubt, extend liquidity generously (since you can always take it back again later anyway). As long as inflation expectations don’t cross the threshold of a central bank’s mandate, the monetary authorities will do what they can to pump up their economies. But once the inflation outlook suggests the need for tighter policy – that is, when the currency strengthens – that’s when the liquidity issue will become more partisan. We are not there yet. On the contrary, sagging commodity prices indicate further downward pressure on inflation in the months ahead.

### Waiting for the consumer

Shops of all sorts, hotels, restaurants and airlines are anxiously awaiting the return of their clients. Even though corporate sales are reviving as restrictions are eased, most businesses are unlikely to repeat 2019’s earnings this year. Thus, without profits, any upswing will rely almost exclusively on revived consumption. But even when the consumers reawaken, we do not expect a return to pre-crisis levels of spending any time soon, at least not until a vaccine is widely available. We think a cautious

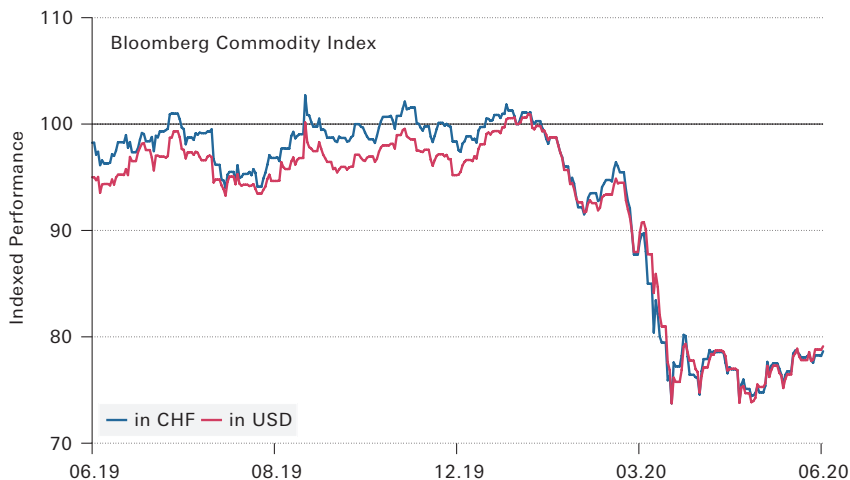
**Table 1: Macroeconomic estimates**

	Real GDP growth in %						Inflation in %					
	2018	2019	2020P	2021P	2020Δ	2021Δ	2017	2018	2020P	2021P	2020Δ	2021Δ
USA	2.9	2.3	-7.5	2.3	-2.1	-2.0	2.4	1.8	0.5	2.1	-0.2	0.3
Eurozone	1.9	1.2	-8.7	2.6	-0.8	-3.6	1.8	1.2	0.2	1.5	-0.1	0.4
Germany	1.5	0.6	-7.2	2.1	-0.9	-3.1	1.7	1.4	0.4	1.6	-0.2	0.2
France	1.7	1.3	-10.4	2.6	-2.2	-4.1	1.9	1.1	0.2	1.7	-0.1	0.5
Italy	0.7	0.3	-11.4	1.8	-1.5	-4.5	1.1	0.6	0.0	1.1	0.2	0.5
Spain	2.4	2.0	-9.3	2.8	-0.2	-3.9	1.7	0.7	-0.3	1.4	0.1	0.4
United Kingdom	1.3	1.4	-10.3	5.5	-2.4	-0.6	2.5	1.8	0.2	1.2	-0.8	-0.2
Switzerland	2.7	0.9	-6.6	2.6	-1.1	-1.7	0.9	0.4	-0.9	0.4	-0.2	0.1
Japan	0.3	0.7	-5.7	3.0	-2.4	0.9	1.0	0.5	-0.4	0.6	0.0	0.5
Brazil	1.3	1.1	-6.7	2.6	-1.4	-0.3	0.6	0.8	3.3	3.2	-0.3	-0.1
China	6.7	6.1	-3.2	8.5	-4.4	-0.7	3.7	3.7	3.0	3.1	0.0	0.5
India	6.1	4.2	-1.4	4.7	-3.3	-2.7	3.9	3.7	3.8	4.6	0.5	1.0
Russia	2.5	1.3	-5.4	2.5	0.1	-1.0	2.9	4.5	2.7	3.6	-0.4	0.6
World (PPP)	3.6	2.9	2.5	2.9	5.5	-2.9	3.6	3.6	2.7	3.2	-0.3	-0.1

E Estimates Wellershoff & Partners    Δ Deviation from consensus economic forecasts

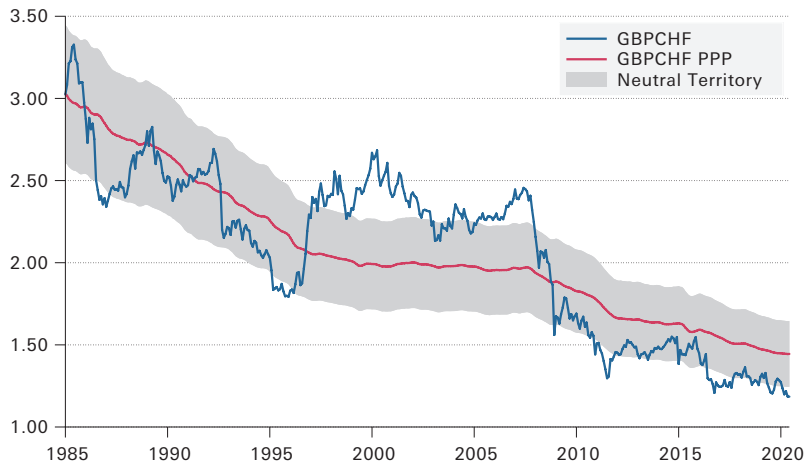
Source: Consensus Economics, Refinitiv, Wellershoff & Partners

**Fig. 2: Commodity prices reflect the collapse in demand, dragging down related currencies and asset prices**



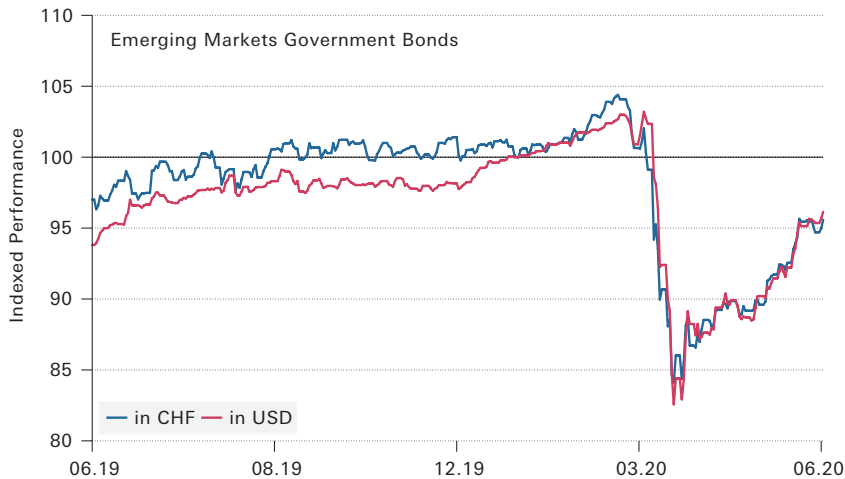
This chart shows the performance of a diversified commodities index, measured in both US dollars and in Swiss francs. Commodity importers can expect to see cheaper raw materials, suppressing inflation generally. Commodity exporters whose currencies have weakened (Australia, Norway, Russia, South Africa, for example) will benefit from their exchange rates acting as a partial shock absorber.

**Fig. 3: Sterling continues to be cheap**



Sterling hit a 170-year low against the Swiss franc as the lockdown started. But the concern remains that there may be no defined deal with the EU, or an inadequate one, after the Brexit transition period ends in December of this year.

**Fig. 4: A new phase of sovereign defaults**



The chart shows the indexed price performance of emerging market sovereign bonds, in US dollars. A stronger US dollar relative to the currencies of emerging market sovereign borrowers, together with a global recession, increases the likelihood of a new wave of sovereign defaults. Investors should carefully review the bond issuers they have in their portfolio.

Source: Refinitiv, Wellershoff & Partners

recovery seems more likely. After all, even the younger generation has now seen the value of savings.

### An FX stress test

How did the world’s currencies respond to the global lockdown? In brief, they reacted as expected, suggesting how they are likely to respond later on.

Even though the US dollar was already expensive in purchasing power parity terms against a broad range of currencies, it gained further as demand rose for USD cash and liquidity. Before the crisis, standing (“permanent”) currency swap arrangements were in place between the Fed and the central banks of Canada, Japan, the UK, the Eurozone and Switzerland. As the pandemic spread, these swap arrangements were extended to Australia, Brazil, Denmark, Korea, Mexico, New Zealand, Norway, Singapore and Sweden for a six-month period. Central banks then tapped the facility for USD 162 billion by mid-March, having started the month at zero.

As we completed this report, some six weeks later, the amount outstanding was just below USD 450 billion. Thus, it could be said, the Fed intervened in the FX markets via these central banks by providing

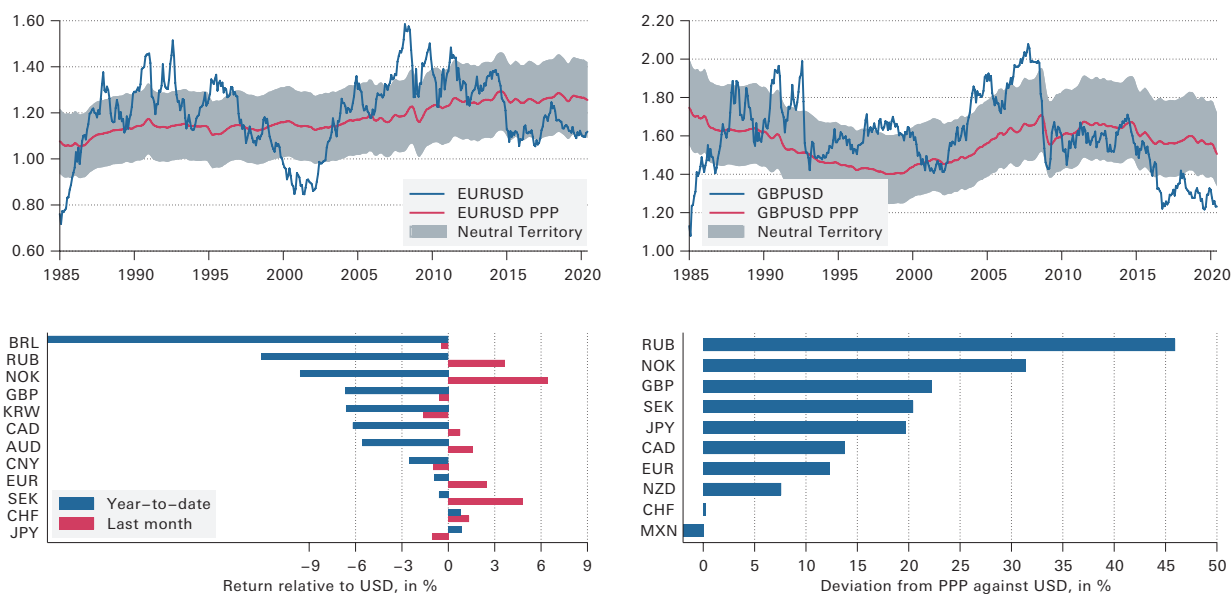
them almost half a trillion dollars in short-term (one-day to three-month) swaps. Had these swaps not been in place, the value of the dollar would probably have spiked and been more volatile.

Thus, even among the major floating currencies, spot prices are not always determined purely by market forces. This would explain the dampened volatility around the USDJPY and USDCHF exchange rates during the days when risk aversion was particularly high.

While there can be disparities between currency fundamentals and spot prices on any given day, our view is that central banks cannot change the underlying economic fundamentals that matter over the medium to longer term. We estimate that the Japanese yen is currently undervalued by around 20 percent against the US dollar, and economic history suggests that this gap is not sustainable over time.

The initial phase of this crisis has opened up large valuation gaps between the Swiss franc, the US dollar and the Japanese yen, on the one hand, and some of the commodities-based and emerging market currencies. In some cases, the gaps are the largest we have seen in the past twenty years (see Fig. 2).

**Fig. 5: FX performance and valuations**



PPP estimates based on producer price indices  
Positive deviations from PPP indicate an undervaluation against the respective currency and vice versa.

Source: Refinitiv, Wellershoff & Partners

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